MARCH 2023

Scaling Lending to Entrepreneurs of Color: Part II

Strategies and Operational Tactics for High-Volume Originations

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INTRODUCTION

Historically, business ownership has been one of the important ways Americans have generated income and wealth. But the opportunity to start *and* grow a business has never been equally available to all. Communities of color have been starved of the capital needed to start and, for those who were able to surmount this barrier, of the credit necessary to grow profitable businesses. This inequality compounds over decades as minority-owned businesses are much more likely to operate in areas and sectors where competition is more difficult, profits are lower, and opportunities for investment are constrained. These ongoing inequities have been thrust into the spotlight over the past few years because of both the COVID-19 pandemic, when businesses owned by people of color were more likely to lose substantial or all revenue and were least likely to get access to small business relief programs they qualified for, and the increased attention to racial inequality catalyzed by the murders of George Floyd, Breonna Taylor, and many others.

Community development financial institutions (CDFIs) have long been a source of support for business owners of color who have lacked access to traditional sources of capital and small business support. CDFIs stepped up to support these firms during the pandemic, fueled by unprecedented levels of government, corporate, and philanthropic resources. In light of the challenge to CDFIs to scale the deployment of capital to meet existing needs and new expectations, the Aspen Institute's Business Ownership Initiative (BOI) has been taking stock of its learnings from decades of studying and partnering with CDFIs that have sought to serve just these small businesses. Much of our work has been focused on the challenges that Black and Latinx entrepreneurs face in accessing capital. Although successfully reaching any group of excluded entrepreneurs (e.g., Indigenous, Asian American and Pacific Islander, and female entrepreneurs, as well as individuals with disabilities) will require practices and competencies that meet their specific contexts and cultures, many of the lessons we have learned and practices that have proven successful will apply to all entrepreneurs who face barriers in accessing credit. These barriers include low levels of wealth, thin or nonexistent credit files, differences in languages, experiences of discrimination, and the amount of credit they are seeking.

This paper follows a prior one that described the critical role that microloans—loans less than $50,000—play in meeting the needs of Black and Latinx borrowers and the challenges that CDFIs face in scaling microlending. Although a clearly unmet demand exists for loans of this size, reaching those customers requires much more than "offer it and they will come." CDFIs that have tried that approach quickly learn that achieving significant growth is hard and requires both an unrelenting focus on growth and specific strategies and approaches to acquiring, underwriting, and servicing these borrowers. In this paper, we describe specific practices of CDFIs that are currently originating many

hundreds or thousands of microloans annually. The findings are drawn from the members of BOI's Microfinance Impact Collaborative (MIC), which has been convening and collaborating since 2015. The MIC comprises six of the nation's largest CDFI microlenders: Accion Opportunity Fund, Allies for Community Business, Ascendus, Dreamspring, Justine PETERSEN, and LiftFund. Collectively, these six CDFIs originated a total of 11,978 loans totaling just under $310 million in 2022. Most of these are microloans, and each of these lenders has an average loan size well below $50,000. In recent years, about 75% of the loans originated by these CDFIs have been to business owners of color.[1]

After a brief review of why microloans are key in meeting the needs of BIPOC (Black, indigenous, and people of color) business owners, this paper shares lessons in six key areas related to microloan origination. The BOI team would like to thank and acknowledge team members from the six MIC members for their engagement in this effort.[2]

Perspectives on the Importance and Meaning of "Scale"

We use the term "scaling" in the title of this series of papers. We recognize that there are disagreements among those within the industry about whether scale should be a goal. This debate may result in part from differences in how this term is defined and interpreted. We think it is useful to be clear why and how we are using this term in this paper and why we believe it important that some CDFIs seek to pursue greater scale in their microlending.

First, we have deliberately focused on the process of scaling rather than on achieving scale. Most CDFIs that make microloans originate fewer than 100 loans per year. The goal here is to describe the practices that microlenders have used to achieve much higher volumes of originations (e.g., reaching many hundreds and even thousands of loans annually) than most CDFIs. Thus, we are not defining an ideal end state or size as "scale." Rather, we are talking about the practices and processes by which growth has been achieved. It is worth noting that the practices identified in this paper may not be the practices that enable CDFIs to reach even higher levels of volume—tens of thousands or more loans per year. We hope to see those emerge.

Second, we think it is important that some CDFI microlenders work to significantly scale their originations for the reasons cited directly here. However, we also believe that not all CDFI microlenders can and should seek to scale significantly. As in any industry, important roles are to be filled by players who can reach large numbers of customers and also by those who make tailored offerings to more specialized and niche markets who may not be well served by those who have implemented the practices needed to reach high volumes. Thus, the practices described here may not be a fit for all CDFI microlenders, although we believe that some of them may be beneficial no matter the scale of an organization's lending. And we hope that some CDFIs will choose to pursue these practices to ensure that more business owners of color secure access to responsible financing.

1 This figure represents data from the MIC members for all non-white borrowers. This includes Black, Latino, Asian American and Pacific Islander, Native American, and individuals of mixed race.

2 We would especially like to thank Janie Barrera and Nelly Rojas-Moreno from LiftFund; Michael Rapaport from Accion Opportunity Fund; Anne Haines, Francisco Lopez, and Marisa Barrera from Dreamspring; Brad McConnell and Mary Fran Riley from Allies for Community Business; Paul Quintero and Ana Hammock from Ascendus; and Sheri Flanigan-Vazquez and Galen Gondolfi from Justine PETERSEN.

WHY MICROLOANS? AND WHAT SIZE MICROLOANS?

The first paper in this series made the case that microloans are a critical product for reaching many BIPOC businesses. Structural and systemic factors have precluded BIPOC individuals from building wealth, accessing financial products and markets, and accessing other markets and information. A consequence of this exclusion is that the firms started by BIPOC entrepreneurs are smaller (in terms of employment, capitalization, revenue, and profitability), with obvious consequences for the amount of debt they can successfully service. Offering smaller loans that are underwritten and serviced in ways that match the financial capacities of these businesses is critical to meeting their capital needs.

Smaller loans also enable lenders to do three important things critical to reaching more entrepreneurs of color:

- **Create customer-centric products:** Customer-centricity is not just about the size and terms of the loan itself but includes the lending process and lending criteria. Products must meet entrepreneurs of color where they are in terms of their capacity to provide collateral, meet credit score requirements, and produce documents or information such as financial statements.
- **Minimize aggregate risk:** Reducing the exposure to any single loan through diversification (making small loans to many borrowers rather than fewer larger loans) allows for making loans that are individually riskier.
- **Create a faster underwriting process:** Fewer documents and requirements can lead to a faster process that is also more efficient for lenders. This allows them to compete more effectively against lenders with fast processes but higher-cost or less supportive products. The MIC members' experiences show that speed of loan approval is important (often more important than price) to business owners seeking smaller loans.

PRACTICES FOR INCREASING MICROLENDING VOLUME

The CDFIs that are MIC members have identified a set of practices that have played a central role in enabling them to originate microloans at a high volume. Although the manner and degree to which they use these practices vary, the MIC members are generally in agreement about the importance of these practices in driving volume.

Microloan Products and Underwriting Criteria

High-volume microlenders offer unsecured smaller-dollar term and credit-building products underwritten largely based on cash flow, global debt service coverage, and the borrower's experience in managing their financial obligations. High-volume microlenders are actively seeking to serve operating businesses that need credit to support liquidity and make small investments in inventory and equipment. These loans are underwritten based almost entirely on current cash flow, eschewing requirements for collateral and formal financial statements and projections.

The MIC lenders have elected not to look at collateral and projections for several reasons. First, collateral requirements present a significant barrier to BIPOC individuals (and others) who, because of historic inequities, have lower levels of wealth. Furthermore, MIC members have found that the value of collateral that many microbusinesses can provide is limited, and the cost of liquidating collateral is often higher than the amount of the recovery. Thus, they have looked at other approaches to managing risk.

Second, MIC members have found that many of the potential borrowers who come to them do not have formal financial statements or projections. Many CDFIs address this issue by requiring applicants to create these items (offering technical assistance to support them in the process of doing so). Although this can sometimes be helpful to the business owner, this requirement involves time that business owners may not have (if, for example, they have a pressing need for funds to repair an essential piece of equipment or to pay vendors or employees). It can also be a daunting process that borrowers simply cannot or do not complete. High-volume microlenders have also found that projections (whether created by the business owner or by the CDFI's lending team) are typically not sufficiently accurate to provide a sound basis for sizing or approving a microloan. Given these issues, MIC members have instead focused on information-gathering practices (which can be broader than a required document list) that allow them to create a sufficient picture of a business's revenues, expenses, and cash flow. This allows them to structure loans that fit with the business's current scale and debt service capacity. In some cases, microlenders are also able to tailor their products and underwriting criteria based on industry. For example, microlenders that want to serve a significant number of family day care providers, food vendors, or food truck businesses may be able to build a customized lending process that leverages their own team's knowledge of the industry in a way that makes for a simpler and more customer-centric product and process for the borrower.

Although these practices form the core of how high-volume microlenders approach their products and underwriting criteria, a few related items are important to understand:

- Although high-volume microlenders may not base their loan decisions on the availability or the value of collateral, they often take collateral if it is available. Many file a Universal Commercial Code (UCC) blanket lien as part of the lending process even if they do not take specific collateral (some MIC members take blanket liens for all loans, whereas others take blanket liens for loans above a certain amount).[3] Filing a UCC is helpful to lenders even if the value of any collateral is limited because it gives other responsible lenders visibility into the debt provided by the CDFI. MIC members who make loans to purchase vehicles also require that the vehicles serve as collateral.

- Although CDFIs that engage in high-volume microlending are thoughtful about how they take on and manage risk, they are willing to take on higher levels of risk than is typical in most other forms of CDFI lending. Lending to people who face real and systemic economic disadvantages involves risk because of history, not because of character. Unsecured lending also involves more risk than secured lending. The MIC members have varying levels of risk tolerance, and these inform their specific underwriting criteria. However, in general, their losses run about 8% on a vintage basis (e.g., over the full term of a loan, not in a single year), which is typically higher than that experienced by CDFIs offering other loan products. Microlenders that originate higher numbers of loans also manage risk in part through diversification (spreading risk across a larger number of small loans), carefully managing concentration (or, in other words, their exposure) to specific industries and geographies.

3 Universal Commercial Code (UCC) filings allow creditors to notify other potential creditors that a debtor's assets have been used as collateral in a secured transaction. A "blanket" UCC filing means a lien on all of the debtor's assets. Liens under the UCC are filed with the Secretary of State, and the information is publicly available.

Microloan Underwriting Process

High-volume microlenders focus on giving borrowers a quick sense of whether they will qualify, and for what amount, subject to verification. Their application and underwriting processes vary by loan product and size.

Speeding up the lending process is one of the most important changes a CDFI microlender can make to acquire more customers and to serve them better. MIC members have found that the capital needs of business owners seeking small amounts of financing are often highly time sensitive. This may be because they have a pressing need for the funding; it may also be because they do not want to invest too much time in applying for a loan given past experiences with rejection. If a CDFI tells an entrepreneur seeking $10,000 that she needs to put together multiple financial statements and projections to apply and then must wait until next month's loan committee meeting for a decision, that entrepreneur will likely turn to a merchant cash advance or to a subprime loan from a truck dealership or other vendor.[4]

High-cost nonbank small business lenders in today's market can get money into a borrower's bank account in as fast as a day or two. In many cases, their underwriting is so streamlined that it is insufficient to truly assess ability to pay; this is of course risky, but these lenders offset the risk by charging exorbitant rates, coupled with murky disclosures about pricing. A CDFI's mandate is to offer clients responsible credit that builds wealth rather than extracts it; of course, they also cannot fulfill their mission if they take on too much risk or burden too many entrepreneurs with unsustainable debt. Importantly, what high-volume CDFI lenders have learned is that often *delivering* the loan proceeds as quickly as predatory lenders do is not the most important part of the process. What is important is being able to quickly tell the loan applicant that they can qualify for a loan and for how much.

The MIC members use a range of techniques to speed up the application and loan approval process. One technique is to use prequalified offers. Loan applicants are asked to authorize a "soft" credit pull (which will not affect their credit score) or to answer a set of questions about their credit status and history. They are also asked a series of questions about length of time in business, monthly revenues and expenses, and so on. Based on the soft credit report and the answers to the questions, the CDFI can determine whether or where the applicant fits into its "credit box" or its risk tiers, and if so, issue a prequalified offer. The offer states the loan amount, the term, the interest rate, and the monthly payment. The offer also includes language stating that the client must now provide documentation to verify the information provided in the preapplication and authorize a "hard" credit check. With this method, clients who have submitted accurate information can be certain they will get a loan before they go through the trouble of assembling documentation.

Another way that high-volume lenders have increased the speed of their lending process is by minimizing or eliminating the use of loan committees, especially external loan committees. Assembling loan committee members is often a time-consuming process and increases the loan applicant's wait time for a decision. MIC members allow experienced staff to approve smaller loans (and, in some cases, loans exceeding $100,000) or use a small in-house credit committee for approvals. This requires hiring (or training) staff members who have the requisite credit expertise, which relates to another practice used by high-volume microlenders—that of separating the underwriting role from that of the loan officer, which we address in greater detail.

Although MIC members have eliminated or minimized the role of loan committees, they have credit committees that play an

4 A merchant cash advance (MCA) is a form of business financing in which a business receives funding based on its future sales. The lender receives repayment daily or weekly via a percentage of the business's debit and credit card sales or a fixed withdrawal directly from its bank account. Most MCA lenders offer financing at annual percentage rates (APRs) higher than 36%, with many charging interest rates in the triple digits.

essential role in setting and managing to the organization's risk policies. What this means is that rather than reviewing and deciding on individual loan applications, the credit committee is charged with reviewing data and information on the organization's loan portfolio and with recommending needed steps or changes to ensure that its lending performance is aligned with its desired risk tolerance and targets. Of course, the credit committee must be aligned with underwriting staff on the revised criteria and processes for underwriting and assessing risk for making these loans (as described previously).

Many CDFI microlenders have loan officers who are responsible for all tasks from lead generation through completion of the underwriting process. Separating loan and business development officer roles from underwriting is important for streamlining loan originations; it also is an important step in managing risk.

MIC members have improved the speed, efficiency, and effectiveness of their process by creating greater differentiation in the roles of staff involved in the functions required to get to a loan decision. They have identified three sets of tasks involved in these functions: tasks related to generating leads (e.g., marketing to and making contact with potential applicants), tasks related to application completion and applicant support, and tasks related to underwriting. Staff who support lead generation (sometimes called business development or loan officers) may focus on reaching out to businesses in specific geographic territories, building partnerships with bank loan officers or with community organizations who can provide referrals, or building relationships and channels in particular industries. They may help borrowers complete loan applications (including accessing the required documents and support information) and may address other requests from underwriters—or there may be staff who focus solely on this task and are not responsible for generating leads. These staff may also make site visits, if needed. Underwriters, meanwhile, are responsible for analyzing the data on the applicant, comparing it to the CDFI's credit box, and making a recommendation on whether to fund the loan. Underwriters may have approval authority (sometimes in tandem with other staff members).

The MIC members have organized their teams and processes in different ways to fulfill these three functions. In some cases, loan officers engage in both lead generation and application and applicant support. One MIC member that is now relying largely on referrals from corporate partners and industry channels that lead businesses to its online application has largely done away with staff who are dedicated to generating individual leads; they have built a call center that provides 24-hour, multilingual support to business owners who apply online. It is likely that MIC members will continue to reorganize and redistribute these roles as they continue to grow their microloan originations.

Technology can also play a role in speeding up the loan process by supporting document and information collection. Products are on the market now that enable instant uploading of bank statements and tax returns, along with sophisticated fraud detection and identity verification tools that can replace or reduce the need for site visits. In addition, some MIC members have sufficient data from their past lending to create their own risk models; others are working to embed data sources and risk tools and assessments built by others into their lending process. For example, MIC members are using tools offered by LexisNexis, RiskView, and PayNet in their loan analysis process. They agree, however, that scoring and risk models should be paired with the involvement of human underwriters in the lending process.

Microlenders that want to grow should consider partnering with another CDFI, or even a fintech, that already has developed the capability to offer loans online with fast approvals and closings. Partnerships between lenders and lending platforms are common among for-profit lenders and are an option for CDFIs as well (we describe some of the experiences and challenges with such partnerships in the section on customer acquisition). A partnership of this sort could be a first step toward the CDFI developing the capacity to offer rapid-decision loans on its own.

ROLE OF TECHNICAL ASSISTANCE IN HIGH-VOLUME UNDERWRITING

High-volume microlenders do not require potential borrowers to receive technical assistance (TA) before or after receiving a loan. Rather, the role of preloan TA is to support borrowers in completing the application and underwriting process. Although high-volume microlenders may offer postloan TA, it is not required, and it is not viewed as a tool to manage risk.

Many microenterprise development organizations offer TA as a key part of their services. In fact, in the early years of the microenterprise development movement in the United States, programs were typically more focused on TA than on lending. These services support the management capacity and knowledge of microbusiness owners, who may bring industry knowledge and skills to their business but often do not have deep experience in financial management, marketing, and other important aspects of running a business.

Over time, two beliefs gained widespread acceptance among microenterprise organizations:

- The belief that all businesses can benefit from technical assistance
- The belief that the provision of technical assistance is a critical means of managing microlending risk

Together, these beliefs led many microlenders to require mandatory technical assistance, sometimes before receiving a loan and sometimes after. High-volume microlenders do not require mandatory TA and in fact have found that requiring it limited their ability to scale their lending. If TA is a required part of the loan application process, these entrepreneurs will turn to lenders that offer a faster but often higher-cost product. MIC members have found ways to underwrite effectively and much more quickly without requiring TA, thus enabling them to serve more clients while managing their risk.

High-volume microlenders offer technical assistance in the lending process, but this assistance is typically provided by members of the lending team (not by dedicated TA staff) and is focused on helping potential borrowers provide information and address questions necessary for underwriting. Because, as noted earlier, these lenders are also focusing largely on cash flow and credit, the information and materials required from an applicant do not include financial statements and projections—items that are often the focus of mandatory preloan TA. They may, however, include conversations focused on helping borrowers document revenues and expenses and visits to the business that help verify location, inventory, and other factors. During these interactions, loan officers may provide advice to the business owners that can support their business operations.

Although high-volume microlenders have moved away from mandatory TA, they believe in its value and use and support it as follows:

- Some of the MIC members offer more robust business coaching services because they have found business coaching is a valuable and in-demand service—*but only among the population of entrepreneurs who truly want that assistance*. They have little evidence that coaching helps entrepreneurs who do not want it and participate only because they think they need to in order to get the loan.
- Although the MIC members rely on their underwriting process (and, in particular, on examining past use of credit, cash flow, and sizing loans to debt service coverage) to assess and manage risk, if borrowers struggle with loan repayment, they may be referred to or provided technical assistance to help them address their business challenges.

- Many MIC members place a strong focus on helping potential borrowers understand and build their credit. This support connects directly to the loan application process because an individual's history with credit is a key element of the lending decision. This support can take the form of credit coaching and/or credit builder loans and may be provided internally or via a partnership with another organization.

CUSTOMER ACQUISITION

Customer acquisition is the biggest challenge facing microlenders as they work to grow. There is no easy answer to the question "What's the best strategy for acquiring more microloan borrowers?" There are, however, some general lessons.

Acquiring new customers for financial products and services can be costly and difficult—especially for nondepository lenders. Banks and credit unions have the advantage of offering services—such as checking and savings accounts—that almost everyone needs and uses. Having acquired checking account customers, they can market their loans to an audience that already does business with them and generally trusts them. Most CDFIs are not depository institutions and do not have this built-in customer base. In fact, for most nonbank small business lenders, customer acquisition is one of their largest variable expenses—if not the largest.

Larger banks and fintech lenders also have significant advertising budgets and the ability to build familiar brand names, which most CDFIs certainly do not have. Although the Paycheck Protection Program and other relief programs increased awareness of CDFIs—awareness that many CDFIs are now working to capitalize on in their nonrelief lending programs—before the pandemic, few potential customers had any idea that CDFIs existed.

The MIC members have used various strategies to find effective and efficient ways of scaling customer acquisition. Strategies vary because demand differs across geographic markets, changing technology and economic conditions affect the feasibility and efficacy of different strategies, and optimal strategies change as organizations grow.

In the early stages of their growth, most MIC members relied substantially on "boots on the ground" to acquire customers. This involved deploying loan or "business development" officers into the community, where they conducted extensive in-person outreach to business owners (such as going door to door or even stall to stall or food truck to food truck).

It is not enough, of course, to charge certain staff with customer acquisition and put them on the street. These staff need to be trusted among the communities they are attempting to reach or be able to build trust where it is in short supply. They need to speak the language, literally and figuratively, of target customers.

Often, these loan or business development officers are hired for their sales skills as well as a basic knowledge of the lending process and the ability to read bank statements and do a simple cash flow analysis. They are managed and compensated as a sales team, with clear goals and financial incentives tied to loan volume. Although using incentive compensation may be a new and somewhat controversial approach within CDFI circles, evidence from MIC members shows that it can be effective at increasing volume. It is important, however, that performance targets also include portfolio quality.[5] As noted previously,

5 This should include not just loan performance—after all, the point is to increase lending to customers who face more barriers and challenges. Compensation schemes that put too heavy an emphasis on long-term loan performance will undermine the intended outreach and acquisition. Alternatively, effective controls can include the rate at which follow-up confirms details of prequalification (via separate audit and compliance teams), shorter-term loan performance, borrower satisfaction, and business outcomes.

it is important that, as these staff roles evolve to focus more on sales, controls be put in place to ensure that customer acquisition staff do not have a role in loan approval or servicing (this is yet another reason to separate the underwriting function from the loan officer role).

As they have grown, MIC members have added additional sales strategies beyond "boots on the ground," such as building target industry-specific channels and products (usually with the explicit input of the customer acquisition staff who see the potential customer objections and acquisition challenges firsthand). These have included trucking, day care, and food vending. In these efforts, the CDFIs build relationships with vendors or with organizations that provide services or support to businesses in these industries; this becomes a more effective means of generating leads. In addition, by building deep knowledge of the typical financial profile and performance of businesses in an industry, the CDFI can develop targeted underwriting practices and knowledge that enable it to originate loans more quickly (which further boosts customer acquisition).

Among CDFIs and funders, there has long been a belief that the most efficient path to scaling microlending is via referrals from banks—the belief is that banks can provide a steady and sizable pipeline of customers who may just be barely outside commercial lenders' credit boxes. However, in practice, referrals from banks have had limited value in driving scale for the most successful microlenders. It is not that referrals never work. MIC members have found that "warm" referrals from loan officers at banks who know a CDFI and its lending criteria will have relatively high conversion rates. However, it is difficult to scale this strategy because it requires developing and maintaining ongoing relationships with individual bank loan officers. This can involve much staff time on the part of the CDFI, particularly because high turnover exists among loan officers at commercial banks.

Some recent efforts have sought to enable high-volume referrals between banks and CDFIs using a more automated approach. In theory, such automation would solve many of the problems that have prevented traditional referral programs from successfully generating scale, but many technical and regulatory issues have (at least to our knowledge) prevented these programs from reaching the hoped-for levels of volume. Those include:

- Commercial banks need guarantees that CDFI partners will meet all the bank's (regulation-mandated high) standards for privacy, security, and fair lending, as well as for customer service levels, which many CDFIs have a hard time doing.
- Many commercial banks shy away from perceptions of bias toward one or a few selected CDFIs, preferring to invest in programs for all CDFIs in communities they serve.
- Automating referrals would require commercial banks to make what they perceive to be significant IT investments to alter critical systems—and given the lack of financial return for referrals, such IT projects fall to the bottom of the list of priorities.
- CDFIs in turn have mission-related objectives and are not willing to simply take all the referrals that a commercial bank might send their way, whereas banks are concerned about blowback from customers who are referred but are not approved by a CDFI.

Unless these (big) issues can be resolved, it is unlikely that automated referrals from banks will become a reality. Some CDFI microlenders have focused on partnerships with large nonbank corporate and nonprofit referral providers. For example, Accion Opportunity Fund has shown that a prequalified "second-look" program can work with a large fintech lender—in this case, Lending Club—and has also pursued partnerships with corporations and associations. Although these partners may not have all the same regulatory or technology considerations as banks, it is still the case that these partnerships require significant investment by both parties. Corporate partners will still want to be sure that customers have a good experience, and effective partnerships require investment to integrate technology. As a result, many corporate partners are reluctant to build relationships with multiple CDFIs.

Many MIC members have also worked to acquire customers directly online, and as described later, most have invested in online applications and lending systems that enable them to do so. The challenge lies in gaining visibility and traffic in a context in which nonbank and traditional bank lenders have much more significant advertising and marketing budgets and staff. MIC members have found that they do not have the money to compete in direct online advertising. Instead, they have relied on partnerships with organizations and programs that can afford to or have relationships that drive traffic to their online applications, including lender matching platforms such as Connect2Capital operated by the Community Reinvestment Fund.

MIC members share the view that repeat customers are an important source of volume, particularly once their portfolios have started to scale. Much of the early rationale for CDFI small business lending was to prepare and enable small businesses to "graduate" to traditional (bank) credit. However, given that banks have increasingly elected not to make loans of less than $250,000, and that many small firms will remain too small to take on loans of that size but still need sources of capital and liquidity, CDFIs are well positioned to retain them as long-term and repeat customers. Many MIC members have explicit strategies to build long-term relationships with borrowers. This can involve including past borrowers as key targets for marketing and product development, using small loans as an entry point for customers who may not qualify for larger loans but may be able to grow into them over time, and offering better pricing to repeat borrowers.

Finally, reaching scale requires sustained growth, not just a short-term uptick in applications or loans. Sustained growth comes not from following a list of best practices but from the ability to scale and evolve customer acquisition practices over time. The effectiveness of any customer acquisition strategy will vary, and new strategies may become feasible as a CDFI develops its microlending products and processes. Therefore, the ability to track (and manage based on) the effectiveness of acquisition strategies and channels is a key part of scaling. Tracking customer acquisition costs is a standard practice in many firms but is not standard practice among many CDFIs.

INVESTING IN LOAN ORIGINATION TECHNOLOGY

High-volume microlenders have invested in technology to support loan originations. But simply buying and deploying technology will not lead to higher volume.

Each of the MIC members has invested significantly in loan origination technology. Some have custom built their own software and systems, whereas others have worked with established vendors to customize commercial platforms or systems to their own products and processes. Although technology has been and will continue to be essential to scaling lending volume, MIC members have learned that technology can only amplify the outcomes of products, processes, and policies. Wise technology investment can be rocket fuel for scaling the right products, processes, and policies, but no matter how much is spent, technology cannot fix poorly designed products, processes, and policies.

The MIC members have built, selected, or customized their loan origination IT systems to support the products and processes they have found to be successful. They recognize that technology should follow and support an organization's identity, products, and processes. So, they have built systems that enable them to quickly access credit and cash flow information. These systems can be customized to meet different levels of documentation requirements

(often much more limited than for larger small business loans, particularly those that carry Small Business Administration guarantees), incorporate alternative risk models and verification tools and processes, and originate loans virtually.

With robust loan origination systems in place, the technology focus of the MIC members is primarily centered on integrating new tools and technologies that can further automate and improve their lending processes. For example, MIC members have invested in integrations with tools that support the collection of cash flow data or identity verification and sources of data that support assessment of credit risk. They use tools that enable them to close loans remotely. And they have incorporated messaging platforms that make it easier and faster to communicate with borrowers and, in some cases, have created borrower portals to enable their customers to access information about their loans online.

Of course, effective implementation and use of technology depend on people. So, MIC members have also invested in and brought on team members and talent that support this. The importance of investing in IT personnel should not be underestimated, and many CDFIs may find that hiring and retaining IT personnel to maintain and evolve systems are a significantly bigger challenge than choosing and deploying technology in the first place. From a management perspective, CDFIs that want to scale microlending need to consider the total cost of ownership of IT, including not just IT acquisition costs but customization, ongoing licensing and maintenance costs, and the staff or consultants required to keep the systems running. They also need to factor in training and customer service budgets to ensure that staff and clients can use the tools.[6] To cope with the total cost of IT systems that can support scale, MIC members have used both internal employees and external service providers.

CONCLUSION

Because of the longstanding challenges that BIPOC business owners have faced in accessing capital, there has been a belief that all CDFIs need to do to tap this unmet demand is to simply show up. However, years of efforts to grow have demonstrated that this is not true. The market for small-dollar small business lending is a competitive one, albeit one in which BIPOC business owners are typically served by high-cost and often predatory lenders. But because this competition exists, scaling lending requires strategic investments. Executing a successful scale strategy also requires active alignment from CDFI funders. Our work with the MIC members has suggested the following path:

- First, get the product and the process right by taking a customer-centric approach. BIPOC (and many white) small business owners face plenty of challenges and barriers to success every day—having to guess whether it's worth the investment of time and effort to apply for a loan should not be one of them. Business owners need to quickly get a sense of whether they will get funding from a lender and how much. They cannot wait months to get funding, much less just to find out if they are approved (with conditions and caveats). They don't have years of financial statements and projections and don't want to create them. If they had collateral that was easy to assess and value, they would already be borrowing elsewhere. Microloans are the product that most BIPOC-owned firms need. Even with the right product, getting the process right is critical for microlenders starting their journey to scale. Changing processes to serve these customers is hard but necessary. Funders who set metrics

6 For more from BOI on the use of technology in CDFI micro- and small business lending, see https://www.aspeninstitute.org/events/integrating-technology-into-cdfi-small-business-lending-the-real-deal/.

for reaching large numbers of BIPOC-owned firms also must recognize that supporting the product and process changes to scale microlending is key to this outcome.

- Technology has much to offer, and the MIC members have invested significantly in it. But technology investments must come second to product and process. There is no question that CDFIs face a technology gap compared to fintechs and even to most traditional financial institutions. But investments in technology won't make a difference if you have the wrong products and policies. CDFIs and (even more importantly) their funders also need to recognize that leveraging the value of technology is not about a one-time or occasional expenditure— ongoing investment in technology systems and teams will be necessary and will often exceed the costs of IT acquisition.

- Once the right product, process, technology, and systems are in place and an organization is making hundreds or thousands of loans, the big challenge for further scale will come down to resources for customer acquisition. Much noise exists in the small business lending marketplace, and despite the progress made during the past few years, knowledge about CDFIs remains relatively limited. Even business owners who are aware of CDFIs may not be able to easily determine which one(s) might have a product and process that meet their needs. Funders would do well to take note that providing substantial marketing and advertising resources to high-volume microlenders will be key to further scale.

This brief was developed as part of the Global Inclusive Growth Partnership, a collaboration between the Aspen Institute and the Mastercard Center for Inclusive Growth

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Inclusive Growth