

# Microenterprise Development in the United States

## Closing the Gap<sup>1</sup>

by William Burrus

Abstract: To better understand the dynamics of the market and to improve ACCION's own capacity for delivering credit, the ACCION USA Network (ACCION) hired a research firm to conduct a study estimating the number of microentrepreneurs in the United States, the number that had never received a bank loan for their business, and qualitative information. The firm conducted twenty focus groups of 108 potential and current ACCION customers in New York, Chicago, Houston, San Diego, Atlanta, and Miami. This paper reports the key findings of these focus groups and describes some of the changes ACCION has made in its programs to address the findings.

### Introduction

In the mid-1980s, the first microenterprise development programs were established in the United States. Today, more than a decade later, nearly 500 programs offer a range of services to self-employed individuals including credit, training, technical assistance, and networking opportunities.

During the "start-up" phase of the field, microenterprise programs focused primarily on developing methodologies for delivering services. Over time, different approaches emerged, with some organizations specializing in credit and others concentrating on training and technical assistance. Through experience, practitioners learned that their target group was not monolithic: program participants ranged from welfare-to-work mothers to owners of well-established family businesses. Prior

business experience, income and asset levels, educational background, ethnicity, and other characteristics varied greatly. The one characteristic shared by all groups was a simple lack of access to the conventional financial and educational resources needed to start or grow a business.

Today, the field is increasingly committed to reaching greater numbers of low- and moderate-income self-employed individuals who lack access to the resources they need. However, achieving scale is not easy. After more than a decade of work, the approximately 500 microenterprise programs are presently now providing services to, at best, several hundred thousand businesses.

How much of a demand gap is there between the number of microentrepreneurs being assisted and the overall number who might need assistance? To help answer this question as it relates to credit demand, the ACCION USA Network (ACCION)<sup>2</sup> hired a research firm in 1999 to conduct a study estimating the number of microentrepreneurs in the United States and the number had never received a bank loan for their business.<sup>3</sup> This research complemented and added to earlier research that was conducted by ACCION New Mexico in 1997. The firm estimated that there were 13.1 million microentrepreneurs in the United States. Of these, 10.8 million had never received a bank loan. Among this group, almost half (45.7 percent) had never considered applying for a business loan from a bank. Another 25 percent had thought about it but considered themselves unlikely candidates for approval because they were self-employed or because of the small size of their business. About 13 percent had applied for a bank loan and had been rejected. While the study did not inquire about the subjects' needs for business training and technical assistance, one can surmise that a large portion would express the need for support in addition to credit.

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Given this significant market size, why is there such a huge gap between the potential demand and the number of customers currently being served? To better understand the dynamics of the market and to improve ACCION's own capacity for delivering credit, the firm also gathered qualitative information. Over a two-and-a-half-year span, the research firm conducted a total of 20 focus groups composed of 108 potential and current ACCION customers in New York, Chicago, Houston, San Diego, Atlanta, and Miami.

This paper reports the key findings of these focus groups and describes some of the changes ACCION has made in its programs to address the findings. The paper concludes with some yet-to-be-met challenges for ACCION and the microenterprise field in general.

#### Organization and Composition of the Focus Groups

The research firm secured participants for the groups using standard recruiting techniques, including paying the individuals a sum (usually around \$100) at the conclusion of each session. The participants were recruited by telephone and were eligible to participate if they

- Were over 21 years of age.
- Were self-employed and had fewer than five employees.
- Had never received a bank loan for their business.

While the individuals were recruited "at random," the firm made specific efforts to recruit participants representing a good mix of business types and both genders. Specific ethnic groups were also recruited because ACCION was particularly interested in hearing from minorities that it was trying to reach. Of the 108 individuals who participated, 86 represented a minority group. Approximately half the participants were women. In each case the groups were led through a series of questions by a professional facilitator, based on a discussion guide developed by the research firm and ACCION.

## Key Findings

ACCION staff and a professional from the research firm observed each session. The sessions were also videotaped for subsequent later viewing and reference. The discussion guides used were designed to capture the information on a number of topics, including the following:

- Sources of capital for start-up and funding of ongoing financing needs.
- Advantages and disadvantages of these sources of capital.
- Building credibility in the community as a microlender.
- Suggestions for an "ideal" lending organization.
- Awareness of ACCION and other lending or business support organizations among potential customers.

### Sources of Capital for Business Start-Up and for Ongoing Needs

The research confirmed what is well known to practitioners: most microentrepreneurs do not see a bank as a viable option to finance their business—neither in the start-up phase, nor as their business matures. In fact, the researcher concluded that this population often has negative feelings about banks. This fact was true regardless of group composition. Of the entire sample, about 16 percent had attempted to get a bank loan and had been turned down. For most, banks were not considered a potential source of capital. Why? Some had pre-conceived notions that banks just wouldn't lend to people or businesses like theirs. For some it was a function of having no credit or bad credit. Others were fearful of rejection, and a significant number directly or indirectly cited prejudice against minorities or the young age of the applicant. Finally, some felt that the application process would be too complicated or intrusive. Whatever the reason, the bottom line was almost always the same. Bank loans are not an option:

- "Bank loans are for big, established businesses."
- "We go to a bank? It would be useless."
- "They want so much information, it's intimidating."

While the issue of prejudice or perceived prejudice against minorities was more strongly expressed in some markets than others—and more directly expressed by African-Americans than Hispanics—it was a concern in the majority of markets. Participants expressed their concerns in several ways:

- "There is discrimination against the belief that a black small business will succeed. If you're African-American and nicely dressed, you must be a drug dealer. If you are poorly dressed you must be a bum."
- "It's also because we're Hispanics."

If banks aren't a real option for microentrepreneurs, where did they get the capital to start up their businesses and to continue to operate? The participants cited four general sources and discussed their advantages and disadvantages.

Many started up or operated with "savings." This money source should not be taken literally but referred rather to a combination of cash savings, "day-job" income, cash-flow from the business or reinvestment, or spouse's income:

- "I started with a small camera and did a little bit at a time."
- "We started little-by-little, in our backyard."
- "My husband provided the money . . . from his salary. We used the rent money and paid our rent late."

Family and friends was the second common source of capital. This source was particularly popular among Hispanics. While it appeared to be socially acceptable and common for Hispanics, it was unacceptable for many of the African-American and general-market participants:

- "You may ruin a friendship."
- "Its awful. . .because of the guilt."

Hispanics cited this source as a lifesaver:

- "My family would be insulted if I didn't go to them for the loan."
- "I needed money for promotion. I didn't get it from the bank, so I borrowed from friends. My church-people who are members-loaned me the money, interest-free and on a payment schedule."

The use of credit cards varied greatly in the different markets and among the various groups. In some cases it was hard to determine if and when credit cards were used for the business as opposed to personal needs. Using a credit card for personal needs also frees up cash for use in the business. In general, the use of credit cards seemed more prevalent among non-Hispanic participants, although not as popular as the "friends and family category." Hispanics were in general more "debt-averse," and as it related to credit cards, there seemed to be a fear of the insidious nature of such borrowing.

The fourth source of capital for financing a business was "other sources," which generally referred to finance companies and loan sharks. Neither was a prevalent source of capital but was considered the source of last resort.

- "I used one once, and it broke my back."
- "Yes, I've used [a loan shark], but it's ten percent a week. I was afraid of going to the bank: there is a lot of red tape, and they make it so difficult."
- "I got a loan from a finance company. The interest rate was higher, but it was easier. They didn't ask for any collateral."

#### Sense of Business Insecurity among Microentrepreneurs

One clear theme that ran throughout the focus groups was the insecurity participants expressed about their knowledge of how to start-up or run their business. While the level of sophistication varied dramatically across the groups, almost everyone felt that they needed help. Many expressed it in terms of wanting access to business courses, training, and general business expertise:

- "You just don't need money. You also want information. Have experts in different fields and people who give information about their own businesses and how they're doing. Sometimes that's more important than the money itself."
- "[At start-up] I could have used help, advice with marketing and promotion."
- "You can see in the long run your business is going to work . . . but you've got to know how to write a proposal [business plan]. I didn't know how to do it."

- "Small business owners need a bank tailor-made for us. We're not so sophisticated all of the time. We need help, for example, doing business proposals."

#### Establishing Credibility with Microentrepreneurs

Participants were asked questions about how an organization established to provide loans and other services to microentrepreneurs could establish credibility with them. There does appear to be a fair amount of general skepticism that must be overcome by any lender who is interested in serving this population. Several concepts were discussed in the focus group sessions related to the idea of credibility.

An important way to develop credibility is centered on the concept and use of the word community. Participants expressed a strong desire for an entity that would serve their community. In this context, community sometimes referred to a geographic area of a city but most often meant an ethnic group such as the "Hispanic community." It was clear from the minority groups interviewed that they would more readily respond to an organization offering services if they thought it was established to serve their particular needs.

The groups were also asked to respond to the concept of a "nonprofit" lending organization. The groups' responses were surprising and very mixed. A significant portion of respondents were unclear what the concept of "nonprofit" even meant. In many cases the focus group facilitator had to explain the purpose and concept of a "nonprofit" organization. Perhaps even more interesting, once the concept was explained, many quickly came to the conclusion that the organization did not need to "make money," and therefore the interest rate on loans should be at, or close to, zero. Only after more explanation from the facilitator about the organization "reinvesting the interest money earned back into the community" did the respondents begin to react positively to the idea. Our assumption that being a nonprofit lender was a positive aspect that should be emphasized proved incorrect. While the concept is not negative, it is often not immediately understood

and requires more explanation, particularly in the context of lending and interest charged.

Perhaps the most obvious-but also the most important-key to gaining credibility with microentrepreneurs is simply creating a welcoming environment. We may underestimate the level of insecurity, self-doubt, and defeatism that exists among many of our potential customers, particularly when it relates to applying for a business loan. Past negative experiences contribute to this attitude. If they were given the "runaround," were overwhelmed with the paperwork and requirements involved, or have no credit history or a less than stellar history, they assume they will be unsuccessful in applying. In other cases they may have never applied for a loan before, but because of perceived prejudices or other factors, they assume they will be turned down if they do apply. Thus many microentrepreneurs approach the loan application process with much trepidation. Most simply want someone to believe in them.

#### Qualities Microentrepreneurs Would Look for in an Organization Providing Loans

As part of the focus group interviews, the facilitator asked participants what they would look for in an "ideal loan company." While a number of ideas were presented, three seemed particularly valuable. First, it was clear that there is a wide range of opinions about interest rates and a general lack of knowledge about the subject. Almost instinctively, many automatically want a "low interest rate." Regardless of the organizational form of the lender, some stated that acceptable rates should be five percent or less:

- "A bank is good because they give you enough time to pay. But the interest rate is high for a small business; they charge five percent."
- "The interest rate should be what the banks give for savings . . . maybe two or four percent."
- "If the interest rate is too high-like 12 percent-I might as well just use a credit card."



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Second, regarding the application process, most participants want the application to be simple and noninvasive with "not too many requirements." Most accept the idea that a loan requires collateral or some form of assurance that the borrower will repay the money. However, most assume that they have no form of acceptable collateral. Most found the idea of finding a cosigner problematic and, for a few, it was even distasteful. While most understood the term collateral, they usually interpreted it based on their knowledge or experience of what a bank defines as acceptable collateral.

The discussion of loan amounts, products, and terms was also revealing. Respondents asked for a wide range of loan amounts, from as little as \$500 to \$100,000 and more. It appeared that an upper range of \$25,000 was reasonable for most of the participants. However, it was also clear that there is a market for loans ranging up to \$50,000 for individuals who did not qualify with a bank. Participants also asked for diverse loan products including a line of credit and flexible terms, including grace periods, graduated payment plans, and variable interest rates, etc.

Finally, it is interesting to note that there was openness to applying for a loan over the phone or via the Internet. This willingness to consider remote applications was higher among the general and the African-American participants. It was less so among Hispanics, though this seemed to be changing over the course of the two-year period when the focus groups were conducted. In any case, while participants were open to applying via the phone and Internet, they quickly pointed out that this approach should not replace the personal contact that for them was essential.

### Low Awareness of ACCION and other CDFIs

In all the markets studied, perhaps the most surprising finding was that focus group participants were almost completely unaware of community-based lenders in their area. In the cities that did not yet have an ACCION program, participants were given lists of other organizations identified beforehand as

microlenders. Without exception, none of the participants had received a loan from these organizations; and, perhaps even more surprising, very few of the participants had even heard of them. At best, a few had vague recollections of some of the organizations.

In those communities where ACCION was operating (in some cases for six or more years), participants were asked if they had ever heard of ACCION. Again, few had ever heard of us, even among certain groups such as Hispanics, on whom ACCION had concentrated its outreach efforts.

ACCION had particular interest in gauging the reaction of participants to its name, given that it is a Spanish word. Hispanics were, not surprisingly, very comfortable with the name, although the name itself does not describe what the organization does. Non-Hispanics clearly struggled with the name, beginning with how to pronounce it. A number of respondents assumed that it would be an organization established to serve only Hispanics; others thought that it might be an acronym.

### ACCION's Marketing Strategy to Address the Findings

During the past two years, ACCION has been in the process of reengineering its microenterprise assistance model towards reaching greater scale, efficiency, and self-sufficiency. Some of the changes being made are a direct result of the marketing research and are briefly described below.

#### Establishing Trust and a Welcoming Environment

The research prompted ACCION to view microentrepreneurs more deliberately as potential customers and gave us a greater understanding of how better to serve their financial needs. Given their insecurity and frequently held perception that they will be unsuccessful in applying for a loan, ACCION instituted several changes in the way we deal with microentrepreneurs. First, we have strengthened the customer-loan

officer relationship to encourage trust and confidence in the institution. Key to this process has been relieving the loan officers of many of the "back office" functions they traditionally performed, such as loan document preparation, reference checks, etc. This change gives the loan officers more time to develop new business and to build an ongoing relationship of trust with their current customers.

Second, to help bridge the gap between the banks and microentrepreneurs, we have forged very rich relationships with many banks across the country. Since almost universally, the banks are eager to reach out to the community, partnering with ACCION has been mutually beneficial.

Third, at some locations ACCION has shortened the loan application or created a very short pre-application form, intended to make the application process easier, to speed it along, and to minimize the time spent by the microentrepreneur. This change also enables us to communicate a decision to those who will not qualify for a loan early in the process, lessening their expectations and minimizing disappointment.

Fourth, ACCION has developed a greater appreciation for the overall personal and business needs of microentrepreneurs. While we continue to specialize in providing financial products, we are developing links and partnerships in the community that will serve to meet the other needs of our customers. Paramount, of course, are their business training and technical assistance needs. In all cities where ACCION operates, we have developed formal partnerships with a select group of organizations and institutions that can provide appropriate business training and assistance to our customers. These institutions include community colleges, other nonprofits, banks, small business development centers (SBDCs), and others. Some of the ACCION programs also have links with and make referrals to other community resources that may assist customers, resources including chambers of commerce, mental health and employee assistance programs, daycare provider associations, trade associations, insurance providers, and others.

Finally, we have increased our efforts to make our services as accessible as possible, starting with the loan application process. As part of our partnership arrangements, our loan officers often work out of the offices of other community organizations and banks. We hold initial orientation meetings for potential customers in various remote locations and at different times throughout our cities of operation. The purpose of this decentralization is to reach out as much as possible to potential borrowers, to be as accessible as possible, and to eliminate any physical, psychological, or time barriers they may face in getting a loan.

### Making Operational Changes

The research revealed that several aspects of ACCION's operations could be improved to meet the financial needs of microentrepreneurs more effectively. The most important issue was interest rates. Our traditional model included one interest rate for all of our term loans, regardless of size and whether the loan was a new loan or a repeat loan. We have now revamped the interest rate structure to account for the loan size, perceived risk, and whether the loan is new or not. Several ACCION programs offer a discounted rate to reward customers who have demonstrated an excellent payback record.

Also, relative to interest rates, we have developed and disseminated to our customers a brochure on financial literacy that defines common terms and helps customers better understand the credit transaction. Our orientation sessions describe the prevailing interest rates of banks, credit cards, and even loan sharks and finance companies, putting our interest rate and fees into perspective.

Third, we have diversified our loan products to more appropriately fit the needs of the customer. The traditional model involved a "stepped approach" with relatively fixed loan amounts starting small (\$1,000-\$3,000) and then progressing upward as the customer demonstrates capacity. Today, ACCION takes a much more tailored approach to each loan,

adjusting the amount to the real specific needs of the microentrepreneur. In some cities, we offer a line of credit as well as balloon payment loans. These are most appropriate to contractors, who often do not get paid until the work is completed.

In addition, the research clearly demonstrated that we were at risk of losing some customers because our initial loan amounts and maximum loan amounts were too small. In response to the market, we now offer initial loan amounts as high as \$15,000 and offer loans to reliable customers of as much as \$50,000. Of course, loan terms and rates are also adjusted accordingly.

Finally, the research indicated that some microentrepreneurs were comfortable with applying for a loan over the telephone or on the Internet. ACCION recognizes that this "low touch" method of working with potential clients is inconsistent with the field's preference for personal assistance. However, if the microenterprise field is to expand significantly, additional, less "high touch" methods for processing loans must also be developed. Ultimately, potential customers should have a variety of venues through which they can apply for a loan. To test this hypothesis, ACCION New Mexico has begun to take applications by telephone, including for new customers. To date, this experiment is proving very positive. Of course, customers still meet personally with an ACCION representative to close the loan and sign all the necessary documents.

### Strengthening Our Image in the Community

The research that was specific to ACCION revealed that we have a long way to go in terms of strengthening our image in the community and among microentrepreneurs. We have made several changes to address this challenge.

The research made clear that our name was a liability, at least among non-Spanish speakers. While those Latinos participating in the focus groups reacted positively to the name, they often suggested more descriptive language to identify what ACCION does. We ultimately determined that the most

practical course of action was not to change our name but to add a tag-line that would capture and describe what we do. The tag-line, "Lending, Supporting, Inspiring" captures not only what we actually do—lend—but also the spirit we want to convey—supporting and inspiring. The feedback that we have received from customers about the tagline has been quite positive.

The second action we have taken nationally is to consolidate and make more uniform our "brand." Simple details like using the same colors and formats consistently for the logo, stationery, brochures, annual reports, and other public documents contribute significantly to creating "brand" awareness. We developed a new descriptive brochure, designed specifically to appeal to our customers, and chose a new stationery letterhead that is brighter and more colorful than the traditional one.

Third, in response to the research, we have tried to become more cognizant of how we describe ourselves to our prospective customers. As an alternative to the use of nonprofit organization as the way to identify ourselves, we now describe ACCION as a "local, community organization." The word "community" evoked many positive responses from the focus groups, and we have integrated it into our literature.

#### Creating Greater Awareness in Our Target Market

Perhaps the most obvious lesson from the focus groups is that most potential customers are simply unaware that ACCION and other microenterprise organizations are there to serve them. While we have certainly been aware of the need to publicize our work, we have not fully appreciated the challenges in reaching this market. Changing our approach has required a shift at two levels: The first requires a change in orientation and attitude. While continuing to value and adhere to our mission, we must learn to become customer-driven. This shift poses a significant challenge because it requires making fundamental changes in organizational culture. It means thinking of microentrepreneurs as "customers." We must be prepared to actively seek them out in ways that are appropriate to them.

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This shift in attitude, which is still occurring at ACCION, must be translated to the second level of practical marketing plans and budgets. Historically, ACCION has spent relatively little on marketing and outreach. Since conducting the research, we have significantly increased our marketing and outreach budget. We have developed marketing plans and strategies for each market and are in the process of developing the tools that will enable us to better evaluate the results.

The research also demonstrated that effective outreach efforts must be carried out at two levels: Media exposure and advertising, whether free or paid for, is essential: newspaper articles, radio talk shows, TV spots, bus and subway ads—all can be important vehicles for spreading the word. In addition, there is no substitute for grassroots outreach. While this type of outreach is labor intensive, it is critical to developing local credibility among the customer base. Connecting with local organizations that will speak well of the organization and ultimately refer customers from their constituency is key.

Of course marketing and advertising are expensive, whether through the media or at the grassroots level. However, one has to ask the question: If the microenterprise field wants to reach significantly greater numbers of people, can we afford not to increase our marketing budgets dramatically? One way to help offset the cost of marketing is to find corporate partners who may be willing to help underwrite some or all of the costs. Examples of this approach include simple ideas, such as asking a bank to underwrite the cost of a brochure or mounting a co-branding campaign with a company in which it underwrites the effort and receives public recognition for doing so within a customer base or community that is important to it.

Ultimately, of course, the best marketing strategy is to build a reservoir of satisfied customers who will naturally refer other microentrepreneurs. Being customer driven means that we must always be willing to really listen to what people want and change to meet that demand. The research that ACCION

has conducted has convinced us that it must be a continual process. Our decision to invest in this type of research has had a profound impact on the entire ACCION USA Network.

### Challenges for the Future

The microenterprise field in the United States is only recently waking up to the fact that reaching much greater numbers of the low and moderate-income self-employed will depend on dramatically increasing marketing and outreach efforts. To scale up through successful marketing efforts, we need to recognize and meet several important challenges.

The first is that the field must be willing to invest substantially greater amounts of human and financial resources in marketing, beginning with research. One reason that practitioners are reluctant to invest resources is that public and private donors historically have been unwilling to provide grants for this activity. Resources for marketing and marketing research are considered by some donors to be "overhead," rather than activities that are directly service or customer oriented. This fact suggests that the practitioners in the field need to make a better case to donors as to why marketing and outreach are so necessary.

The second challenge facing organizations such as ACCION is to convert market research findings into actions. While it may seem obvious that market research should reveal ways to improve our services, actually making those changes is often quite difficult. As staff, management, boards of directors, and stakeholders become invested in a particular approach or methodology, they often resist change, particularly if the change suggested is significant. The successful conversion of market research findings into products and services requires that the culture of the organization support change.

We must also be prepared to embrace the fact that the microenterprise marketplace is not static and is affected by many factors, including at the macro level. For example, in the past five years, banks and other formal lending institutions



have dramatically changed their small-business lending policies and practices. Through credit scoring, they have been able to reach down the economic ladder. Consumer credit cards have also flooded the market, often with very low introductory rates.

Even the characteristics of prospective customers change over time. For example, the welfare-to-work legislation enacted in 1998 meant that many individuals, most of whom were women, began considering self-employment as an option for the first time. Their needs, characteristics, and readiness to be self-employed all greatly affect how programs are designed to assist them. National immigration policies (and the realities of illegal immigration) may mean that ethnicity, language, trust in financial institutions, and past use of and attitudes towards credit of these new customers may be radically different. Will the field be able to rapidly adjust to these changing conditions and needs of the microentrepreneur?

The final challenge we face is to stay true to our mission while meeting customer demand. This subtle-but important-challenge has two aspects. First, as the field attempts to scale up and reach larger numbers of borrowers, will we experience "mission drift"? That is, will the profile of our borrowers change to a more stable, "upscale" individual? Second, will we be able to separate our mission from our methodology? Often organizations often blend the two and become static and out of sync with the very market they seek to serve.

Our ability to overcome these four challenges will determine whether the microenterprise development field's ability to become a truly significant national player will truly have national impact.

### Notes

1. Much of the material for this paper was drawn from various market research reports commissioned by ACCION, and from Abbe, Burrus, and Yatskowitz (2001).

2. The ACCION USA Network is composed of ACCION New York, ACCION Chicago, ACCION Texas, ACCION New Mexico, ACCION San Diego, and ACCION USA.

3. For the purposes of the study, "microbusiness" was defined as having five or fewer employees.

### Reference

Abbe, S., Burrus, W. & Yatskowitz, A. H. (2001). *A Guide to Strategic Marketing Research for Microenterprise Development in the United States*. Boston: ACCION International.