LESSONS AND TRENDS OF MICROCREDIT IN THE UNITED STATES

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I. History and Context of the Microcredit Field in the United States

In the United States, the microenterprise development field and its trade association, The Association of Enterprise Opportunity (AEO), have defined a microenterprise as a business with five or fewer employees. Many of these businesses have no employees other than the self-employed owners. Additionally, such microenterprises generally need less than $35,000 in loan capital and do not have access to the conventional commercial banking sector. Most organizations in the field also focus their services on those microentrepreneurs who are defined by the federal government as low-to-moderate income and who struggle to make ends meet. By definition, most of these entrepreneurs are minorities, recent immigrants, women, disabled or for other reasons have special challenges that reduce their ability to access traditional credit and other services.

The microenterprise field has a twenty-year history in the United States. While the term "microenterprise" was in common use internationally by the late 1970s, it came into domestic use about a decade later. Traditionally, the business sector had been categorized into three groups: large, medium, and small. The U.S. Small Business Administration (SBA) defines a small business as having up to 500 employees. In 1991, the SBA recognized microenterprise as a separate category of business and established the Microloan Demonstration Project.

By the late 1980s, the microenterprise development field began to gather steam. Three socioeconomic trends converged in the early 1990s to give impetus to the field. The first trend related to the political debate emerging over the effectiveness of government entitlement programs to help the poor and disadvantaged population escape poverty. The need for welfare reform became evident, both to reduce its burgeoning costs as well as to lesson the dependency of individuals on the state. The debate peaked during the presidential campaign of 1992 and the subsequent passage of a landmark welfare reform bill during the first Clinton Administration. An important tenet of the bill was the idea that individuals should be encouraged, if not required, to support themselves through employment including self-employment.

The second trend stimulating the field was the growing disparity of income distribution and the loss of blue-collar jobs. The gap between those individuals at the top of the income scale and those at the bottom increased during the decade of the 1980s. People with lower levels of education employed in traditional blue-collar jobs and/or single-parent heads of households were most negatively affected by this trend. The shift of jobs from the relatively high-paying manufacturing sector to the minimum-wage service sector has made it more difficult for many families to stay above the poverty line.

Corporate downsizing and the related trend of outsourcing jobs outside the United States have also meant that many middle-class families faced a more uncertain economic future. In light of this trend, policy makers became even more aware of the importance of small business and self-employment as a strategy for creating income and employment for those who lost their jobs or were unable to secure these traditional jobs. In 1993, the SBA reported that small firms created a disproportionate share of jobs in virtually every industry in the late 1980s and early 1990s. During this period those firms with less than 20 employees created almost 4.1 million new jobs against a loss of jobs in medium and large firms of 850,000 and 500,000 respectively.

The third trend involved certain demographic changes that encouraged self-employment as an option. These changes included: 1) the increasing percentage of women in the workforce and the option of self-employment as a way to balance the demands of work and family; 2) the growth in immigration, both legal and illegal, in which many recent immigrants, faced with language barriers and other challenges, turned to self-employment; 3) the aging of the population in which workers over 50 increasingly turned to self-employment as a way to generate income well into their 60s; and 4) the decline of many rural economies in which some individuals and families, bound by their rural roots, chose self-employment as a way to remain in their communities. [1]

These trends created an environment for self-employment to thrive in the United States. At the same time, there was growing awareness of the much more developed microenterprise field in developing countries. The increased recognition of the importance of the informal economy in developing countries, and the success of numerous programs that were lending to microentrepreneurs, gave a direction and a methodological framework for emergence of the microenterprise field in the U.S. Many of the early programs in the U.S. such as ACCION New York, The Lakota Fund in South Dakota, the Good Faith Fund in Arkansas and others were directly inspired by and based on international experience.

These trends and the awareness of the international models combined to increase the visibility of self-employment as an economic and poverty alleviation strategy and gave birth to the microenterprise field in the United States.

II. Size and Characteristics of the Microenterprise Market

Perhaps the most interesting fact about the microenterprise market is that it is very difficult to accurately estimate its size. There is no one data source that provides a definitive answer to the question: How many microentrepreneurs are there in the United States?

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[1] Elaine Edgcomb and Joyce Klein, *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States* (The Aspen Institute, book to be published in May, 2005) Data cited was taken by the authors from various sources.

To better understand the potential market, in 1999 ACCION USA commissioned a study by Roslow Research Group (RRG) to estimate the number of micro-businesses (defined in the study as five or fewer employees) in the country. Based on an enumeration survey, RRG estimated that there were 13.1 million microentrepreneurs in the U.S. Most were self-employed with no employees (71.4%) with the rest having an average of 3 employees.

ACCION USA was also interested in knowing the approximate number of Hispanic and African American microentrepreneurs as they represented a large portion of ACCION's target market. RRG reported that there were 1.3 million Hispanic and 1.2 million African Americans who were self-employed with fewer that five employees.

Perhaps of more interest is the data collected in the same survey relating to their experience with the formal banking sector. Of the 13.1 million total, 10.8 million had not previously received a bank loan for their business. The specific reasons given by those interviewed for not being able to access a bank business loan are interesting:

- 45.7% never considered a bank loan for their business
- 41.5% had considered a bank loan but thought they would be rejected or that the process would be difficult or require too much information
- 12.9% had applied for a bank loan but had been rejected

The overwhelming majority of the Hispanic and African American microentreprenuers had not been able to access bank credit for their businesses. For those who had applied the rejection rate was slightly higher than for their white counterparts.

RRG suggested that these overall study estimates were probably conservative given the informal nature of many microenterprises.

ACCION regularly collects data on the microentrepreneurs to whom it provides services. While it is difficult to characterize their businesses given the extremely diverse nature of the activities they undertake, we can make some general statements to describe them. While the businesses assisted by ACCION may not be representative of all microenterprises, their characteristics are interesting:

- Between 35–40% of ACCION's clients are home-based; 30–35% have a store front or office; the remainder sell in the street or do not have a fixed place of business.
- 50–60% are in the service industries including food preparation and sale, beauty salons, contractors (carpenters, plumbers etc.); 30–35% are in retail including restaurants and clothing shops; and the remainder are artisans or those who produce something.
- 69% have no employees and on average work over 50 hours a week in their businesses.
- The median microenterprise has assets worth $4,200 though 19% have assets worth less than $1,000.

- The typical ACCION microentreprenuer has a household income of $24,000 for a family of three with 55% of the household income coming from the business.
- 13% live in poverty while 56% qualify as low-income households according to federal government standards.
- 55–60% have a business license with the rest operating more informally.
- Most have no more than a high school education and their average age is 40. [2]

III. Current Status of the Microenterprise Field

During the 1990s the microenterprise field grew rapidly in the United States. Starting with a small number of non-profit organizations testing developing-country models, the field now has service providers in every state, a national trade association (AEO), a growing number of state-level associations and financing intermediaries, and several research and policy organizations.

The Aspen Institute and FIELD (Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination) has collected data on the organizations in the field since 1992. The first directory, in 1992, listed 108 organizations that identified themselves as working in the field. By 2002 this number had grown to 650 organizations. Of these, 554 are organizations that provide direct services and 96 are support organizations that offer funding, training and technical assistance to these practitioner organizations.[3]

Clearly, the field has developed in a very organic, grassroots way. There are a very large number of diverse and often small organizations providing services to microentrepreneurs in their local communities. Almost all are not-for-profit entities. These organizations range from those that focus exclusively on the microenterprise sector such as ACCION, to credit unions, community development corporations, universities, immigration and refugee organizations and others.

The microenterprise field is broken down into two general groups of service providers: those who primarily offer credit and financial services (credit led) and those who primarily offer training and technical assistance (training led). Of the 554 organizations that provided services in 2002, the majority identify themselves in the latter category.

Among the 198 organizations that offered credit and financial services, 182 offered individual loans while only 36 offered some type of peer group loan, demonstrating that the peer lending model imported from abroad has found only limited success. While microloans remain the primary financial product offered to microentrepreneurs, some organizations offer small seed grants, microequity investments, and Individual Development Accounts (special savings that can be used for education, the purchase of a house or for starting a business).[4]

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[2] Cristina Himes with Lisa Servon, *Measuring Client Success: An Evaluation of ACCION's Impact on Microenterprises in the United States,* U.S. Issues Series No.2, p 2.
[3] Edgcomb and Klein, forthcoming
[4] Edgcomb and Klein, forthcoming

For those organizations that were training led, the core product was preparing a business plan. Organizations usually sponsor a business plan development course that helps microentrepreneurs organize their ideas, test the feasibility of a business and perhaps prepare them for receiving a loan. These entities may also offer courses and direct one-on-one technical assistance in tax preparation, marketing, use of technology, business finances and other topics.

Finally, there have emerged more organizations with more specialized purposes and training services dealing with specific populations. For example, those that work with refugees, the physically disabled, women transitioning from welfare, etc.

While the growth of the field in the United States is impressive, it is important to note that it is relatively young. 43% of the 554 organizations reporting in the 2002 Aspen Institute Directory were established between 1995 and 1999. 10% were established after 2000. Thus, more than half the field has been in existence for fewer than 10 years. The average operating budget reported by these organizations in 2002 was $378,781 and the majority of the programs had five or fewer full-time staff. The field is still growing and evolving and this fluid state has important implications for the future. These implications are discussed in the last section of this paper.

What is the current collective outreach and impact of the field? FIELD estimates that in the year 2000, microenterprise organizations collectively reached between 150,000 and 170,000 individuals. This estimate considers 114,000 individuals who received direct services in the form of loans, training and technical assistance. The remaining individuals received less intensive services. FIELD also estimates that approximately $98.5 million in 13,758 loans was outstanding at the end of 2002. In addition to these loans made directly by microenterprise organizations, an unspecified amount of financing was also provided directly by banks with assistance from these organizations. [5]

What has been the performance of the field? Performance should be measured in several ways: First, how effective and efficient are the organizations? Second, what has been the impact of services provided on the target population?

Level of Effectiveness and Efficiency

Regarding the questions related to the effectiveness and efficiency of the organizations in the field, several preliminary conclusions can be drawn from the information collected and analyzed by FIELD.

The data supports the fact that the field has been generally true to its mandate and collective mission. For example, in 2000, of all clients served:

- 65% were women
- 55% were from minority groups

[5] Edgcomb and Klein, forthcoming

- 59% had incomes at or below the level set as low-income by the U.S. government

While the cumulative number of businesses helped since the early 1990s is large, the current reach of the field, particularly in comparison to the potential need is still very modest. For example, if one compares the potential need in the market of those microentrepreneurs who have not received bank credit (10.8 million) to the current number of outstanding loans (13,728), the percentage of the market reached is far below 1%. Even if one assumes that only half of those who have not received a bank loan would even qualify for a microloan the disparity is still striking.

Most of the organizations in the field are very small in their outreach. The average and median client numbers that were reported to FIELD in 2003 were 332 and 195 respectively. While most organizations appear to be growing, the fact remains that most are serving very small numbers of clients.

With regard to outreach, there is a concentration of effort in the field. For example, of the 230 existing lenders, 16 account for 45% of all the microloans made in 2002. The largest organizations are serving over 1,000 clients a year, both among the credit organizations as well as those that primarily provide training. At the end of 2004, ACCION New York, for example, had an outstanding loan portfolio of $10.6 million and 1,432 active borrowers.

While many organizations were challenged in the early years of the 1990s with effectively managing their loan portfolios, more recent experience points to the fact that most are demonstrating strong performance. For example, of 58 of the largest and most visible lending organizations surveyed by FIELD in 2003, the average total portfolio at risk > than 30 days was 13% while the median was 9%. The loan loss rate average for the same period was 8% while the median was 5%.

The operational efficiency of credit led organizations has also been improving over time. For example, with 8 organizations reporting their numbers to MicroTest[6] in 1998, the median operational cost was $2.33 (it was costing $2.33 to loan $1). By 2003, with 45 organizations reporting the cost to loan a dollar had dropped to $.44. However, it is also clear that there is a significant discrepancy in operational efficiency between those organizations that are large and those that are small. For those with more than 50 loans outstanding, the median cost per dollar lent was $.40. For those with fewer than 50 loans outstanding the median cost rose to $.90.

Cost recovery for organizations that primarily provide credit averaged 49% and for the top performers the average rate was 59%.

For the training led organizations the measures used for effectiveness and efficiency tend to focus on the percentage of clients completing their training courses or

[6] A project initiated by FIELD to standardize the reporting results for microenterprise assistance organizations.

completing a business plan. In 2003, among 58 organizations reporting, 79% of clients receiving training completed their courses. 65% of clients finished a business plan. [7]

Level of Impact on Clients

There is a growing body of evidence to support the belief that the impact of credit and other services on those individuals and families who participate in programs is positive. While most of the research studies undertaken in the United States in the last ten years to detect possible impact have limitations in their design, they have revealed generally consistent findings. Some of the key findings are as follows:

Microbusinesses that receive credit and other assistance from organizations do grow over time. For example, in a study commissioned by ACCION in 1998, clients who had received three loans increased their average monthly profits by 47%, their business equity by 42% and their take-home income by 38% over an average of 17 months.

The survival rates of businesses owned by low-income individuals compare favorably with the rates of other small businesses. The SBA reports that " two-thirds of new employer firms survive at least two years and about half survive four years." Other studies have shown similar results. Studies show that low-income microenterprises generally create 1.5 jobs for individuals other than the owners. While some of these jobs are full-time, most are part time or seasonal jobs. [8]

Microenterprise is one important way of creating additional income for families and can often make the difference to move them out of poverty. Studies have shown that, generally, income levels of microentrepreneurs increase over time, in part at least, as a result of receiving credit and other businesses services. Increases in income seem to be particularly significant among the lowest income participants. For example, the ACCION study cited previously shows that while the incomes of all participants grew on average, low-income microentrepreneurs experienced the greatest growth in income both in percentage and absolute terms.

Self-employment is often used as a supplement to other family income. In this sense it becomes one strategy that a family may use to make ends meet. Often one member of the family is employed part or full-time in a job while the other pursues self-employment. Often, the same person may begin a self-employment activity while holding a part or full-time job. If the endeavor is successful, the business contributes an increasingly higher percentage of total family income over time to the point where the person may quit the salaried job.

Self-employment is proving to be an effective strategy for building assets and equity, particularly among low-income individuals. Studies demonstrate that over time asset accumulation does occur and business equity increases. For example, in the ACCION

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[7] The data in this section was taken from Edgcomb and Klein, forthcoming

[8] See, for example, The Self-Employment Learning Project (SELP) study *Microenterprise and the Poor: Findings from the Self-employment Learning Project Five-Year Survey of Microentrepreneurs* and the *Self-Employment Investment Demonstration Final Evaluation Report* (SEID) by Margaret Sherrard Sherraden, Cynthia K. Sanders and Michael Sherranden, 2004.

study, for 312 clients that had received three loans from ACCION over a 17-month period, a total of over $1 million in additional equity had been accumulated.

Finally, it is clear that there are important and often very meaningful non-economic effects of the services of a microenterprise organization on those who are self-employed. Often these effects are at least as important as the financial and economic factors and may be the primary reason for choosing self-employment over wage employment.

When interviewed, many microentrepreneurs express their increased sense of self-esteem as a result of their involvement with an organization. The fact that someone believed in them and their business is an extremely important boost to their morale and self-confidence. As a small machinist in Chicago, Illinois described it:

> *They [ACCION staff members] have been very helpful. If you surround yourself with negative people you will end up being a very negative person. But if you get hooked up with positive-thinking people that believe in you, it just makes you feel good about yourself.*

Women often report the sense of independence that they gain by running their own business and receiving a business loan from a microlender.

> *I probably could have asked my husband to give me a loan but I wanted to do it on my own. That's all I wanted.* (Florist in El Paso, Texas)

When interviewed, clients also often cite the increased opportunity they perceived. For those who do not have access to credit due to insufficient credit history or past credit problems including bankruptcy, the fact that an organization is willing to lend to them is truly significant.

> *I had to file bankruptcy five years ago… So there were no doors that were open and no one would even hear me…it was a great experience [getting credit from ACCION] because now I could finally try to establish my credit and hopefully one day I will be able to keep going and borrowing more money from the banks.* (Hair stylist in San Antonio, Texas)

Finally, microentrepreneurs often relate that being self-employed and having an organization help them be successful is important to their sense of family.

> *What ACCION has done is give my family choices. When my husband got out of the military, the reason that he got out was that they were going to send him overseas on a company tour for a year by himself. He would have missed the birth and the first year of our daughter's life. At that time we made the choice for me to proceed in my business* (Mary Kay distributor, San Antonio, Texas) [9]

[9] Himes with Servon, p59-64.

IV. Summary of the ACCION Experience in the United States

ACCION International began working in the United States in 1991 with the creation of ACCION New York. Building on the success of that early experiment, in 1994 ACCION established additional organizations in four other locations: Chicago Illinois, San Antonio Texas, Albuquerque New Mexico, and San Diego California. In 1999 it established new lending offices in Atlanta Georgia, Miami Florida, and Boston Massachusetts, the headquarters location.

During the fourteen years of its work in the U.S. ACCION has loaned out approximately $100 million to over 10,000 micro-entrepreneurs. The historical average loan size is $4,500. Cumulative loss rates have been 5%. Over this time the ACCION model has evolved significantly. While the early model was based on ACCION's experience in Latin America, the model was very quickly modified based on actual experience in the various locations.

Today the salient characteristics of the ACCION model can be summarized as follows:

1. ACCION International created ACCION USA as a not-for-profit subsidiary to oversee and implement all its lending activities in the United States. ACCION USA has two forms of operating:

- As a "franchiser" in which it licenses the name and trademarks to independent, non-profit organizations that have their own legal status, board of directors, and staff. These include the ACCION programs in New York, Chicago, Texas, New Mexico and San Diego.
- ACCION USA also has "company-owned" offices that are run directly. These include Boston, Miami and Atlanta. Each has a local Advisory Board and a staff whose members are employees of ACCION USA.

Collectively these entities form the ACCION U.S. Network.

2. ACCION USA and its " franchisees" are "credit-led" organizations. That is, they focus almost exclusively on providing loans to microentrepreneurs. ACCION partners with other organizations in the community such as universities, non-profits, government agencies, small business development centers and others to provide clients with needed business training.

3. ACCION traditionally provided one product to its clients: a term loan for working capital or the purchase of small equipment. Today we offer additional products that include a line of credit, a "credit builder" loan (for those who have no credit history) and variations on the term loan to meet the cash flow needs of borrowers.

4. ACCION defines its target market as those with the following general characteristics:

- Microentrepreneurs who do not have access to conventional credit with a special focus on low to moderate-income borrowers.
- Women and minority groups, particularly Hispanic and African American
- Individuals who are already in business or who have recently started a business. We do not finance pure start-ups if the person has not made any real financial or psychological commitment to making the business successful

5. The functions of marketing and business development have been separated from the functions of loan underwriting and servicing. Loan officers in the field generate new business and initial client intake. A centralized back office does loan underwriting, loan closings, loan servicing and collections. This division of duties creates more specialization of functions and more efficiencies.

6. ACCION works in close partnership with banks and financial institutions both on a national and local basis. ACCION receives the following services from them:

- Financial support to capitalize the loan fund and to help cover operational costs.
- Participation by bank officials on ACCION boards of directors, loan committees and other groups.
- Referrals to ACCION of customers the banks are unable serve.
- Execution of loan intakes and closings. In New Mexico, for example, ACCION has signed agreements with several banks whereby their branch employees around the state will help clients fill out the ACCION loan application and, if approved, will do the loan closing and disbursal.

The banks are generally very willing to partner with ACCION in these areas for several reasons:

- The national legislation first enacted in 1977 called the Community Reinvestment Act (CRA) mandates that banks will be rated by regulators, in part, based on their participation in channeling resources directly or indirectly (through organizations such as ACCION) into low-income communities.
- In the referral program, when a bank denies a loan application from a small business, it generally prefers to refer that person to ACCION as a possible resource rather than to simply reject the person outright.
- Where the banks proactively participate at the branch level in loan intake and disbursement, they are partly motivated by a desire to be helpful but primarily because this process generates more "foot traffic" in the bank. It offers the opportunity for the banker to sell other bank products, such as checking accounts, to the ACCION borrower.

7. As non-profits, the ACCION licensees and ACCION USA itself need capital for three purposes: First, the loan funds are capitalized through a combination of grants and long-term, concessionary loans that are provided by banks, government agencies, private foundations, church groups and what, in the U.S., is called "socially responsible investors." Second, loan loss reserves are established as a percentage of the amount of

the outstanding portfolio. These reserves are funded through grants. Finally, the operational and administrative costs are covered through a combination of the interest and fees generated from the loans, investment income and grants provided by public and private sources.

8. Two important tenets in ACCION's philosophy grew out of its international experience and still guide our work in the United States. These tenets are reaching scale and financial self-sufficiency. While ACCION is the largest microlender in the United States, we are not content with the number of clients we are reaching. We are continually innovating and experimenting with the goal of reaching many more thousands of clients.

While ACCION has now been operating in the United States for over a decade the goal of creating programs that are financially self-sufficient is still illusory. For us financial self-sufficiency means that an organization will generate enough revenue from its lending activities to cover the costs of its operation. Reaching this goal continues to be a challenge. ACCION New York, the oldest of the ACCION programs, achieved a level of self-sufficiency in 2004 of 63%. The rest of the ACCION programs in 2004 reached levels ranging from 25% to 60%.

V. Future Perspectives and Challenges for the Microenterprise Field

The microenterprise field in the United States faces a crossroads. On the one hand, it has developed into a national movement that consists of many practitioner organizations, a national association and a number of state associations. The White House and the National Congress have recognized it as an industry worthy of recognition and support. It has demonstrated that it can be an effective strategy for reducing poverty, revitalizing distressed communities and assisting budding entrepreneurs to gain entrance to the financial system.

Yet there are some looming dark clouds on the horizon that the field is already beginning to confront. How it weathers this storm will determine the future of the movement in the years ahead. There are seven key challenges faced by the field that are discussed briefly below.[10]

1. There is a huge gap between the potential market and the number of customers currently being reached.

The first section of this paper cited the RRG study that estimated that there are about 10.8 million microentrepreneurs that have not received a bank loan for their businesses. The field is currently reaching 150,000 – 170,000 with services including credit and training. Even if one assumes that of the 10.8 million, only half of these individuals want

[10] Variations of these challenges have been presented and discussed by the author and other participants such as Elaine Edgcomb, Joyce Klein and Lisa Servon in two different seminars held in Washington DC in 2004.Some of these same ideas are expressed by Lisa Servon, Senior Research Fellow, New America Foundation, in a paper that is forthcoming titled "Microenterprise Development in the United States: Current Challenges and New Directions".

credit or would qualify for it, the disparity between the potential demand and current market penetration is still huge. What is required to better understand why this gap exists and to begin to close it? We suggest three areas of endeavor to be pursued:

- Conduct additional market research to better understand the dynamics of the market and what microentrepreneurs need to start and grow their businesses.
- Create more strategic marketing partnerships. Most non-profit organizations simply do not have enough resources to effectively and consistently market their products. Organizations should look to partner with banks and corporations that service the small business community such as office supply stores, building and construction supply stores, etc. to leverage their marketing resources. Self-employment trade associations may be another avenue for collaboration.
- Diversify the product mix offered to microentrepreneurs based on market research. The standard working capital term loan may have limited appeal and other financial products such as lines of credit, stored value cards, and credit builder loans, may find more demand.

2. The marketplace has changed dramatically since the field began in the early 1990s.

Several trends have occurred in the marketplace that pose both a threat and a potential opportunity for the field. First, the conventional banking and financial sectors have moved downstream in their loans and financial products. In the early 1990s, most banks did not make small business loans under $50,000. Today, because of the evolution of technology and credit scoring, banks are able to profitably make much smaller loans to qualified applicants using a very quick, automated process. Other financial institutions such as American Express are aggressively marketing business credit cards and other financial services to small businesses. Additionally, financial institutions have recognized the growing importance of the Latino market and are competing fiercely to offer an array of financial services to them, including remittances that are sent back to their countries of origin.

Another phenomenon that has appeared in the last ten years is what, in the United States, is known as " fringe banking" or alternative financial service providers. These are generally small private retail outlets that target low and moderate-income communities and immigrants. They include check cashing companies, payday lenders, pawnshops, rent-to-own stores, signature loan companies and others. Many are "one-stop" shops offering multiple services including remittance services, payment of utility bills, purchase of money orders, etc.

These outlets offer a real alternative to those who have traditionally been outside the financial mainstream or immigrants who may not trust banks based on their experience in their home countries. While none specifically offer microloans, many do provide instant cash that can used for many purposes including to meet business needs.

While the push downward of the banks and these alternative financial entities narrows the market for microlenders, developing strategic partnerships with some may prove beneficial for the microenterprise field.

3. There are simply too many organizations in the microenterprise field.

As previously noted, in 2002 there were approximately 650 organizations nationally that identified themselves as being active in the field, 554 of which are providing services directly to microentrepreneurs. Of these, 191 made microloans but just over half (98) had fewer than 25 active borrowers in 2000.[11] In spite of so many organizations operating, there is very little real collaboration among them, little specialization and no economies of scale. Each one tends to operate independently, often offering a wide range of services, and duplicating all the financial and operational systems, training materials, loan underwriting and processing, etc. that is required to run an organization. This state of affairs cannot be maintained. The inefficiencies that result drive up the cost of product delivery to an unsustainable level.

There are some hopeful signs that this scenario is beginning to change, in part encouraged by the marketplace and the funders of these organizations. As the field looks to the future it should rapidly evolve by:

- Promoting the merger and consolidation of some of the organizations. ACCION USA and Working Capital, for example, merged their Boston operations in 1991.
- Promoting further specialization so that organizations can become better and more efficient at providing one or two services. This means separating out the lending from the training function so that organizations can focus on one activity.
- Exploring the use of a centralized "back office" to process loans for multiple organizations to carry out other common functions.
- Pooling loan funds so that each organization is not managing its own but has access to a common fund based on its performance.

4. The service delivery methodologies of most organizations, both lending and training, are too expensive and too labor-intensive.

Relatively little innovation has occurred on either the lending side or the training side that has resulted in significant cost reductions. On the international scene, one can point to specific methodological innovations that were introduced by non-profits in the early years of the microfinance industry that made efficiency and scale possible. For example, the introduction of peer group or "solidarity group" lending in which several borrowers ban together to cross guarantee each other's loans effectively lowered the costs of lending. This arrangement was treated by the lending organization as one loan.

In the United States the microenterprise field should consider how to better utilize technology to create greater efficiency and scale. For example, ACCION USA has recently developed an "online" loan application that can be completed and sent directly via the Internet. By mid 2005 ACCION USA will begin its experiment with Internet lending in which potential client applications submitted on-line will be acted on and, if approved, disbursed to the applicant regardless of his physical location.

[11] Edgcomb and Klein, forthcoming

On the training side, a new, web-based effort sponsored by FIELD called MicroMentor connects microentrepreneurs with more experienced business mentors across the country using an on-line matching system. Mentors are drawn from the corporate sector as well as from experienced business owners and provide business advice via the Internet to their microbusiness counterparts.

5. The statistical data on program performance is inadequate and inconsistent.

The field has been slow to create uniformity and consistency across organizations in the collection of data so that it is still difficult to compare performance across programs or to aggregate the information to draw conclusions. Until recently there was no common agreement on even basic definitions of such terms as "percentage of portfolio at risk", "restructured loans", "financial self-sufficiency" and many other basic terms.

Some progress has been made in recent years on this front. In 1997 FIELD initiated MicroTest. The process started with developing standardized definitions of key industry terms and has become an important tool for measuring performance of individual organizations and the collective results of MicroTest members. The number of organizations that belong to MicroTest and report accordingly has steadily grown. However, the current membership is small (less than 100) compared to the size of the overall field.

6. There is a general lack of regulation and accreditation in the field.

Because the field grew organically and involved mostly non-profit organizations, there is no regulatory body that oversees the members. Unlike almost all other financial institutions in the United States, such as credit unions and banks, non-profit microlenders operate in a gray area and are essentially unregulated. They must comply with the general Internal Revenue Service requirements for non-profits and must adhere to any general consumer or small business lending laws that may apply at the state level. Beyond these two general areas, they are not regulated.

Historically, members of the field have also not needed any accreditation to operate, either as a lender or as a trainer. This situation is now changing. To receive federal money an organization must now submit to a certification process and become a recognized Community Development Financial Institution (CDFI).

In addition, AEO, the national trade association, has recently instituted a process that proposes to establish minimal standards relating to lending and/or training performance, governance and management issues and financial soundness. This process is currently underway and is being discussed by the membership.

Finally, National Community Capital, a national association of entities registered as CDFIs, has initiated a national rating system for CDFIs called CARS (CDFI Assessment and Rating System). The first ten CDFIs were examined and rated last year in the test phase of the project by an independent team of consultants.

All of these efforts will be important to the long-term stability and growth of the field. If they are to continue to provide resources to the field, funders, lenders and investors will increasingly demand transparency and consistency of data and performance.

7. Future funding for the field appears to be a serious challenge.

Most organizations in the microenterprise field are still heavily dependent on subsidies in the form of grants and below-market interest rate loans. Yet, several factors have combined to reduce the overall amount of available funding:

- Perhaps the most obvious factor is that with the growth of the field the combined need for resources from so many organizations has grown much faster than the supply.
- Federal funding for microenterprise programs is on the decline, partly because of the current Administration’s relative lack of interest and partly because federal budget deficits are resulting in cost reductions across many federal programs.
- The foundations that originally funded the field such as the Ford Foundation and the John D. and Catherine T. MacArthur Foundation have moved on to other priorities, hoping that their pioneering seed money would attract others to the field. While some new donors have entered the field, the overall level of resources has remained flat.
- Large national and regional banks were traditionally one of the primary sources of capital for the field. However, over the past five years there have been at least five mergers resulting in a fewer number of these large institutions. As a result the overall availability of funding is less.

In short, the microenterprise field must transform into an industry. This change involves standardization and accreditation, increased specialization and professionalism, and consolidation in which smaller and weaker organizations give way to stronger and more efficient ones. To become an industry, it must be willing and able to innovate and to become more sophisticated about the changing needs of its customer base.

Without question there will continue to be a significant segment of the population in the United States that chooses, or is forced into, self-employment and that requires specialized help to succeed. The question is: will the microenterprise field be prepared and able to effectively respond to this need for assistance?