

# MICROLENDING FEASIBILITY STUDY REPORT



Barrio Alegria

2021

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## Executive Summary

Barrio Alegría conducted an exploratory study to outline entrepreneurial challenges for micro-entrepreneurs and assess the feasibility of launching a lending circle program in Reading. Over a 16-week period in the first half of 2021, Barrio engaged 35 Reading-based business owners through a combination of community focus groups and individual interviews to better understand the challenges and lending needs of micro-entrepreneurs in the city. Barrio also researched existing local community development financial institution (CDFI) products and assessed general willingness and interest in a targeted loan product for Reading micropreneurs. This study finds that there is interest in alternative microlending products by local micropreneurs, that recent changes in the CDFI landscape present additional opportunities for partnership, and that Barrio could play a critical role in this over the next few years. This report outlines strategic recommendations for Phase II, including the a) incorporation of an evaluation consultant to measure program efficacy, b) launch of an initial lending cohort guided by industry best practices and incorporating the Most Significant Change Technique (MSC) evaluation protocol, c) strategic relationship with local CDFI to expand their local affinity group model, and d) integration of a creative place-making component to assist with local marketing.

## Methodology: What did we do?

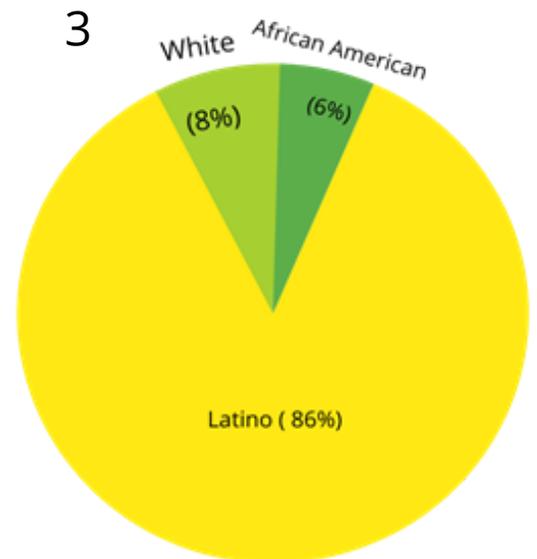
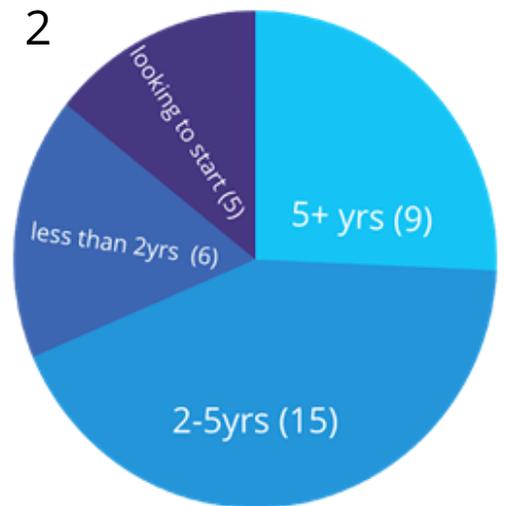
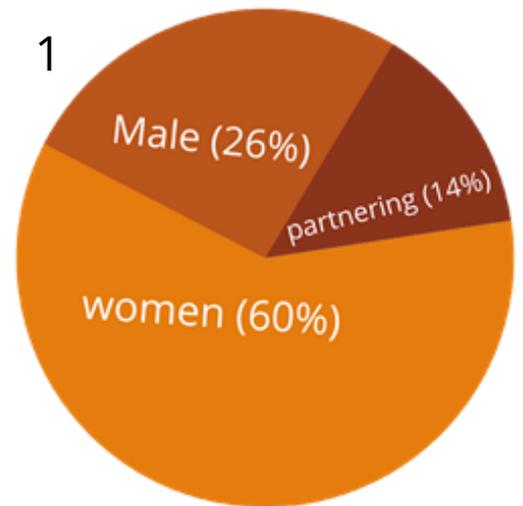
Over a 16-week period, from late January to late May 2021, Barrio Alegría conducted a Phase I feasibility study to assess its participation in launching a microloan program in Reading. To that end, Barrio (a) reviewed best practices for microlending models; (b) outreached to area merchants, engaging them in a combination of focus groups and individual qualitative surveys related to their needs; (c) reviewed the current capacity of existing CDFIs to participate in the launch of a lending circle program in Reading; and (d) explored Barrio's potential role in Phases II and III.

During weeks 4 through 9, we surveyed 35 local entrepreneurs and held 4 focus group sessions. The surveys and focus groups were designed to gauge business needs and determine appetite for lending products or business services. It is important to note that the merchants were selected for participation based on Barrio's network of business owners and program participants. In keeping with best practices in qualitative research, participants were selected based on relevant experience, relationships, and expertise. The survey results broadly paint a picture of the experience of Latin@ micro-entrepreneurs in Reading. Results reported here combine the focus group data with the individual interview data



60% of surveyed entrepreneurs identified as women, 26% identified as male, and 14% were joint owners of a business with a spouse/partner (represented in figure '1'). Of the entrepreneurs surveyed, 9 had established businesses existing for over 5 years, 15 had growing businesses with 2-5 years in existence, six (6) had been running their business for less than 2 years, and 5 were entrepreneurs looking to start a business in Reading (represented in figure '2'). A majority of participants identified as Hispanic/Latin@ business owners (86%), while only 8% identified as white and 6% identified as African-American business-owners ( represented in figure '3'). 57% of those that were already in business had a physical location or storefront, while 43% were operating out of their home.

This Phase I feasibility study was conducted by a cross-section of the Barrio community, which included Board, staff and community representation. Brian Kelly - Board member and community economic development professional with over 20 years of experience in the field - provided strategic guidance during the conceptual development and exploratory research components of the project. Daniel Egusquiza - Executive Director and community transformation practitioner with over 10 years in the field - provided project management oversight and partnership development. Fabiola Flores - Barrio Alegría staff person currently pursuing Business Management certification through RACC - conducted the community outreach and project coordination for the project. All three collaborated on the study and the generation of this report.



While the Microlending pilot program is aligned with Barrio’s mission, its Board of Directors has maintained a cautious approach to determining the fitness of a microloan project housed at Barrio. Prior to and throughout Phase I, the Barrio Board of Directors vetted the project to determine (a) alignment with mission, (b) determination of community need, and (c) organizational capacity.

During March and April 2021 Barrio reviewed the capacity of existing community development agencies that provide business support services to merchants. The selection criteria heavily weighted (a) organizations who had a strong background in community lending, especially with immigrant populations, (b) had experience with alternative community lending models, specifically lending circles, (c) had experience in Reading, PA, and (d) whose mission and values were complementary to Barrio’s. We identified two potential partners for the project and conducted exploratory conversations with both. ASSETS and Community First Fund are both Community Development Financial Institutions with established reputations in the region who provide lending and business support services and meet all of our selection criteria. We held exploratory conversations with staff at each organization to gauge interest in collaboration.

## What did we find?

### A. Local Entrepreneur Engagement

Several themes emerged while investigating the experience of micropreneurs in Reading.

#### Theme 1: Business Support Service usage and understanding.

37% of surveyed business owners (13) had received publicly available small business support services in the past (ie. business plan creation, marketing, cash flow forecasting, etc. ), while 63% indicated that they had never received such business support services. This supports the initial hypothesis that despite the extensive business support services available, many entrepreneurs are not taking advantage of these services.

When we explored the reasons why, many indicated that they did not know such programs were available. Others indicated that although they heard that programs were available, they didn’t know anyone who had been there so did not pursue it. A small number of participants indicated that the organizations were difficult to get in touch with.



Another theme that emerged was a general distrust of “free business support services,” with 2 primary reasons cited. Over half of those that expressed this distrust cited a general distrust of governmental institutions alongside a belief that most business support programs have links to governmental agencies.

This distrust was particularly pervasive amongst those who felt vulnerable based on their personal or familial immigration status.



The gap between the availability of business support services and the utilization of those services by local business owners has roots in a lack of information and historic distrust.

Approximately 30% of those citing distrust demonstrated a clear lack of understanding about what publicly available technical assistance services were available. To them, “free business support services” sounded like the opening line to get you in the door, so that they could try to sell you a package or some service. “Who gives away consulting services for free?” was a recurring theme with this group. Several people indicated that they already knew they wouldn’t be able to afford whatever “recommendations” came from the consultation, so why bother exploring further.

Another common theme was the exclusivity of language when it came to potential business service support. For example, there was virtually no demonstrated interest in support around cash flow forecasting, operating capital, and financial projection modeling, when asked about these topics explicitly. However, a majority of those interviewed indicated that they subscribe to the “when we have cash, buy things that we need, when we don’t have cash, make due with what we’ve got,” management method, and would like support in breaking that cycle.

Once those surveyed received a little more information about business services, 31% indicated they are interested in receiving support around marketing, while 17% were interested in support with website development, 17% were interested in receiving networking/coaching support, and 14% expressed an interest in having a single point of contact that they could turn to related to support for their business.



## Theme 2: Loan utilization, appetite & belief systems

34% of surveyed business owners had received at least 1 loan in the past. Of the 66% of business owners who have never received a loan, the majority indicated that they assumed they did not qualify and therefore have never tried to get one. The other common themes amongst those who had not taken out loans in the past included (a) a general fear of taking on debt because they could potentially lose their business, and (b) the belief that they needed a business plan in order to take out a loan, and that they didn't have one.

83% of those surveyed expressed an interest in taking out a small loan, a majority of whom (86%) indicated an interest in receiving a loan of \$501-5,000. 10% of those interested in a loan preferred a loan of less than \$500, while only 1 micropreneur indicated an interest in receiving a loan greater than \$5,000, specifically to increase her inventory of elegant dresses.

## Theme 3: Business plans

26% of the business owners surveyed indicated that they either have an incomplete business plan and/or would like assistance in developing their business plan. When those who didn't have a business plan were asked why they didn't have one, the common themes that emerged were (a) not believing they had enough time/capacity to put it together, and (b) not feeling that they had enough money to pay someone to make their business plan.

## Theme 4: Trust networks

Of those that understood that business support services and loans were available, they did not feel comfortable going to those programs because they didn't know any other entrepreneurs who had also used those services. Barrio has found that trust networks are very important in community work, and misinformation is rampant.

A common theme that surfaced was a willingness to participate in a lending program due to Barrio's involvement. Several owners cited their trust in Barrio as a key factor for their willingness to entertain pursuing financial and business support. While there may be some selection bias based on the survey participants being selected based on previous experience with Barrio, this feedback was unsolicited.

An additional theme that emerged was the micro-clustering of social capital and trust networks, perhaps unsurprisingly along extended familial and/or common origin lines. This confirmed a preference in favor of the initial hypothesis that lending circles should be rooted in existing social capital networks. Mexican entrepreneurs, for example, expressed a





Some business owners with over 30 years of operations have not taken out a bank loan because of a general distrust with the banking system.

willingness to enter a lending circle with other Mexicans with whom they had prior relationship and trust. This may mean that despite a general trust of Barrio as an organization, an interethnic cohort of borrowers may present additional challenges to successful implementation of a lending circle program. Best practices in the field seem to support this hypothesis.

## **B. Lending Circles Model and Existing CDFI Landscape Review**

Exploratory research focused on the lending circle models, a subset of the larger field of microfinance. The model has appeal because of a) its higher success rate, b) its community model, and c) its applicability to people on the economic fringe.

The average annual default rate in Pennsylvania for SBA loan products is 14.2% for the state's largest provider of SBA loans. For specialized microlending programs run by nonprofits, average default rates exceed 15%. An internal Community Development department report indicated the default rate of government-issued microloans exceeded 30% in the City of Reading. In contrast, the industry default rate for peer-to-peer lending models averages 2-4%; admittedly the peer-to-peer models are generally technology-

based and not necessarily low-income community focused.

Lending circles are very common in immigrant communities and areas where the traditional banking services are not widely accessible. The Mexican tanda, Korean kye, and West African susu are all examples of informal loan clubs where participants all contribute at regular intervals, and alternate who receives the 'loan.' The lending circle model adds an interesting community element to the microloan concept, because everyone is involved in loaning funds to each other. A 2-year study of five lending circle initiatives in the Bay area found a default rate of .7%. The models from that study focused on personal loans for the purpose of credit building, as opposed to small business lending.

Barrio's attraction to this program relates to how collective success is built into the model, as opposed to traditional lending programs that focus solely on the individual. Despite its alignment with the Barrio mission, the Board of Directors indicated a hesitancy to move forward with a lending program in-house, citing capacity concerns. The feasibility study therefore included early stage discussions with two (2) local community development financial institutions to evaluate current offerings and determine fitness for a potential partnership.

ASSETS is a non-profit organization based in Lancaster, PA "focused on transforming the community through ethical and inclusive business." ASSETS offers entrepreneurial training, community lending, and impact consulting services to local businesses and prioritizes women and POC-owned businesses. Their microloan model is designed for borrowers unable to get traditional bank loans, and includes personalized financial counseling and group entrepreneurial training. Barrio was very interested in their emphasis on community transformation through inclusive entrepreneurship and ethical business.

Assets has a well-developed model that seems to include critical wrap-around services for small business and micropreneurs. In our exploratory conversations, Assets indicated that it was not interested in offering alternative loan products themselves. Their leadership team indicated that although they are willing to serve in an advisory capacity, and could provide loan application review support for a fee, they did not have an appetite to take on the legal and financial responsibility of servicing loans.

Community First Fund (CFF) is a community development financial institution that provides loans, business training, and one-on-one counseling and is "committed to aligning capital with justice for low income communities and low wealth individuals." CFF has underwritten loans as low as \$500 using its vast experience in community finance and technical support. The organization maintains an office in downtown Reading, and has a significant capacity



to lend funds. In 2020, CFF merged with Finanta, another mission-driven CDFI based in Philadelphia with a robust affinity group lending program.

The CFF/Finanta affinity group lending model combines lending and technical assistance. Affinity groups are informal and members share some sort of community, cultural, family, friendship, industry, or neighborhood connections. Loans are guaranteed by the entire group, and each group member receives loans of between \$1,200 to \$3,600 with a 12-24 month payback period. The program “is tailored for entrepreneurial borrowers seeking to increase business and financial capacity.” Currently the affinity group model is only offered in Philadelphia, but CFF indicated that they are planning to expand it to additional markets served by Community First Fund, including Reading. This expansion has not yet happened, but staff indicate it could be as early as late 2021. Staff indicated that Barrio could play a role in potentially identifying a local affinity group to take out a loan.

One important difference between the Affinity Group Lending model offered by CFF/Finanta and the traditional Lending Circle model, is that the latter is structured more as a community savings program. In the Lending Circles model pioneered by Mission Assets Fund, total strangers can participate in a group lending circle. Each participant contributes monthly, usually \$50-\$200 monthly, and loans are distributed from the contributions of each member. In an instance of default, the organization makes up the difference to ensure that those contributing receive their full amount. The focus here is on credit building for participants. The CFF/Finanta model focuses on business loans, whereby participants receive loans of \$1,200-\$3,600 with a repayment period of 12-24 months, in addition to technical assistance and business support services. Pre-existing relationships are very important in this model, because the borrowers all co-guarantee each others’ loans. Staff indicated that the loans were predominantly used by extended family networks where there was a lot of social reinforcement to ensure repayment.

### **C. Role of Barrio Alegría in Microfinance?**

Before exploring how Barrio could be involved, it is important first to explore the existential question of whether Barrio should be involved. After all, as an arts-based, community building organization, neither lending nor community finance are a core competency for Barrio.

Based on the recent merger with Finanta and CFF’s interest in expanding the affinity group lending circle model to Reading, Barrio is hopeful that specialized loan products and technical assistance will now be available to micropreneurs in Reading in a new way. This established CDFI has decades of experience supporting wealth-building in low-income communities. They process, service, and monitor lending products, in addition to providing marketing, management and other technical assistance to businesses.



Preliminary research into the field of microfinance revealed that a lending circle model saw significantly reduced default rates over individualized lending models. This makes sense based on Barrio's theory of change and the importance of community support. In short, microfinance and lending circles are not just about loans; they are about community building. Loans provide crucial operating capital to cash-strapped entrepreneurial efforts, and outcomes are improved when the loans are paired with technical assistance and other community support. Based on Barrio's core competency in community building, it appears that Barrio could play a critical role in setting the foundation for this initiative here in Reading by adding value in three explicit areas:

### **1. Trusted Business Navigation Services**

The web of business support providers is sometimes complicated to navigate, and many of those surveyed expressed interest in there being a single point of contact to understand what resources are needed, and the research found significant misunderstandings in business owners' understanding of the nature and availability of business support services. Furthermore, the technical jargon of the community development field can be intimidating. Due to its local reputation, Barrio could leverage its social capital to make referrals to the appropriate business service providers. This community business navigator role would be a natural fit, and Barrio could act as a bridge to the interconnected web of business service providers, lessening the barriers to entry of micropreneurs focused on their businesses. This would also help in the advertising of these programs to micropreneurs who often fly under the radar screen and don't know about available services.



## 2. Creative Place-making

31% of those surveyed expressed interest in receiving marketing support, and identified that they didn't have the resources to get the word out about their business to more potential customers. Creative placemaking describes initiatives in which art plays an intentional and integrated role in place-based community planning and development.

Barrio's arsenal of creative placemaking tools could be deployed in support of the micropreneurs selected into the lending program. The microfinance industry has long recognized the importance of pairing financial products with marketing, management and technical assistance. While these services are helpful for the entrepreneur, a key ingredient is aligning the interests of the community with the success of the local businesses. Barrio's activation of local artists helps to spark new life into often overlooked areas of the community, and can stimulate additional market interest.

## 3. Affinity Group Development

The CFF/Finanta Affinity Group Lending Circle model seems very promising and we look forward to its expansion to Reading. Staff indicated that this model often revolves around existing extended family networks who approach the organization. Barrio sees an opportunity to merge the strength of the lending circle model with the existing structure of the Affinity Group model. The lending circle model has significant value because it can bring together individuals who do not know each other to build relationships and trust and support each other to improve their individual credit circumstances. Barrio's bedrock is the development of this community trust through its reweaving of the community fabric. Barrio could therefore be involved in the trust-building component, assisting in the assembly of an affinity group that would apply to the CFF/Finanta for the Affinity Group loan.

## D. Measuring for Impact

Our review of the field of community microfinance solutions revealed the importance of programmatic evaluation. How will we be able to measure the programs' results and determine if it is working? Barrio will be performing community building and creative-placemaking while strategically referring Affinity Groups to a local CDFI capable of providing the technical support that they need. What exactly does the model look like?

Barrio has recently been exploring how to further embed the Most Significant Change Technique (MSC) evaluation model into all of its programming. The MSC technique is a powerful story-based and participatory tool that organization's can use to evaluate the impact of community projects beyond the standard quantitative metrics (ie. # of loans distributed and default rates). While broadly used, MSC has found increasing application to the community development field.



During March and April we held several conversations with a boutique consulting firm that has international experience in microfinance programmatic oversight and evaluation. Collective Justice Consulting has a team with decades of experience working and consulting on organizational development and culture change, leadership coaching, operations and impact evaluation, storytelling and communications for groups, institutions, and governments internationally, nationally, and regionally. Their lead consultant has worked extensively on evaluation and policy projects with the United Nations in New York, Geneva, Mali, and Somalia, and has specific experience in the evaluation of microfinance programs (e.g. FINCA Zambia 2011 Client Assessment Study) and market-based approaches to the prevention of violent extremism (e.g. 2017 evaluation of a UN demining and employment project in Somalia, 2018 evaluation of a UN community development project in central Mali). This lead consultant has been using the MSC technique, and adapting it successfully for different contexts and methods of inquiry, for over ten years in qualitative and mixed-methods evaluations of community development programs.

Collective Justice has offered to work with Barrio staff to design an evaluation and monitoring program to assess the program's efficacy. They have provided critical guidance to help Barrio understand the role of non-CDFI community organizations in supporting microfinance initiatives.

## Recommendations

Barrio Alegría does not have the capacity in the short to medium term to launch a microlending program on its own that includes the evaluation, processing, and servicing of loan products. However, this Phase I feasibility study has identified a number of factors that suggest proceeding with Phase II. The CFF/Finanta merger and expansion of Affinity Group lending circles means that a new lending product will be available in Reading provided by a very reputable CDFI with decades of experience in the region. The feasibility study has revealed an appetite for microlending products and identified several gaps in business support service provision. Barrio's community reputation and nationally-recognized creative placemaking activities positions them to support local entrepreneurs through their community work.

The Barrio Board has reviewed this Phase I report and believes that the recommendations outlined herein to partner with experts in the field in order to guide the financial processing and oversight of any future phases adequately addresses its capacity concerns related to staffing, loan servicing and programmatic evaluation. With those elements in mind, the following recommendations outline the key elements of a Phase II launch with the Barrio+ model.



### ➤ **Recommendation #1: Pursue relationship with CFF/Finanta**

Barrio's efforts are best served in supporting the expansion of the Affinity Group lending model to Reading by spreading the word and cultivating potential Affinity Groups. The CFF/Finanta Affinity Group lending program is already operational and provides a very strong strategic fit. While focused currently in the greater Philadelphia region, CFF staff has expressed an interest in expanding the affinity group to the Reading market. This allows Barrio to focus on its core strength in community outreach and relationship building, while allowing CFF/Finanta to focus on its area of expertise: financial and business assistance to small and fledgling businesses.

Barrio has already identified a group of entrepreneurs who are interested in pursuing financing for capital purchases for their businesses. However, Barrio Alegría does not have a core competency in the delivery of business support services and/or business technical assistance, which is something for which CFF/Finanta is well known. Barrio's strong reputation as a grassroots community organization positions it to be a consistent point of entry for businesses operating on the fringes of the economy. Barrio should begin to cultivate relationships among these borrowers and support the development of an initial pilot Affinity Group.

### ➤ **Recommendation #2: Mobilize local artists to enhance local marketing efforts**

In 2020, Barrio received a national placemaking award through the Center for Community Progress, and continues to design programs around using arts as a way to further stimulate economic development activity. We recommend that Barrio contract with local artists on a campaign that can integrate with Barrio's larger creative placemaking plans and provide marketing support for affiliated local businesses.

### ➤ **Recommendation #3: Pursue relationship with Collective Justice**

Collective Justice Consultants has a demonstrated capacity with microfinance evaluation projects (as referenced above), and a mission that aligns with that of Barrio. By engaging them, Barrio could establish a cost-effective approach to program design and evaluation. Collective Justice can work with Barrio staff to outline programmatic oversight and to operationalize the implementation of the Most Significant Change Technique (MSC) to ensure that Barrio captures relevant data related to project impact. Collective Justice is able to provide the following specific services:

- Training. Collective Justice can design and deliver tailored training for staff and volunteers on program monitoring, the MSC technique, and evaluation implementation.
- Evaluation design. Collective Justice can design a mixed-methods and participatory evaluation, centered around the MSC technique.



- Technical assistance and support. Collective Justice can supervise and advise Barrio in implementing the evaluation.
- Analysis and reporting. Collective Justice can take a lead role in data analysis and reporting, including reporting back to evaluation participants, generating evidence-based conclusions and recommendations for future programs and supporting the development of case studies and best practices that can be shared with the larger community development microloan field nationally.

#### ➤ **Recommendation #4: Support the development of key Barrio staff**

Fabiola Flores has demonstrated an interest and capacity to continue to coordinate the project moving forward. She coordinated the focus groups, conducted a majority of the interviews with business owners, and actively participated in team discussions about CDFI inclusion and strategic partnership. She is a natural fit for the role of community navigator. It is important to provide her with the appropriate training that she will need to succeed in her position.

The following infrastructure should be in place to support her role:

- Initial Loan Application.
- Involvement with continuing conversations with CFF/Finanta to better understand the Finanta model and thus how to structure the affinity group support work.
- Revolving Loan Pool Program Evaluation oversight by Collective Justice.
- Establishment of an intersectional committee of Barrio Board, staff, and Leadership Development cohort members to support Most Significant Change data collection and evaluation.





**A big thanks to the local entrepreneurs who took time out of their days to join focus groups and take surveys as part of the exploratory research phase.**

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In addition, we would like to thank Jobany Bedoya, Lucy Cortez, and Jim Buerger for their critical insights into the current scope and availability of financial products and business support services for Reading entrepreneurs.

We would like to also thank the Barrio Alegría Board of Directors for their due diligence and oversight during this process.

**We invite you to join Barrio in our efforts to weave additional resiliency into the community fabric, one person and one family at a time.**



**Barrio Alegría**  
140 North Fifth  
Reading, PA 19601  
(610) 743-3313

[www.barrioalegria.com](http://www.barrioalegria.com)   
[microlending@barrioalegria.com](mailto:microlending@barrioalegria.com)   
[@Barrioofhappiness](https://www.facebook.com/Barrioofhappiness) 