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Unbankable: Microfinance in the U.S.

Recommendations for Kiva Zip

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Abstract

Kiva Zip aims to bring financial networks and local communities together by rewarding good financial reputations and committed entrepreneurial work ethic. Through Kiva Zip, small business owners, often called microentrepreneurs, are able to take out crowdfunded microloans starting at $5,000 from various financial supporters lending money within the Kiva Zip network.

Many entrepreneurs struggle to access the credit that is required to take out even a small loan to help their business in its early years. Where large banking institutions fall short, Kiva Zip allows for microloans that have a major impact on a population that was previously deemed “unbankable” (Sloan, 2013). This paper examines microfinance, primarily in the U.S., and applies lessons learned to help Kiva Zip improve strategies to capture the attention of prospective borrowers, lenders, and a myriad of internal and external stakeholders. Also included are recommendations which consist of a multidimensional approach to help Kiva Zip reach their mission.

Keywords: microfinance, microloans, entrepreneurs, small business

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Introduction

Microfinance in the U.S. can be a powerful tool to empower hopeful microentrepreneurs, to build struggling economies, and provide an opportunity for income equality. Paradoxically, there are still barriers within the U.S. economy and banking systems that prevent a simple replication of the microlending that is commonly seen as wildly successful in many developing countries, and also seen in Kiva's original model. In order for Kiva Zip to be an effective microfinance institution in the U.S., there must be specific criteria followed in order to see long-term success come to fruition. Such criteria is not yet seen across the board in the United States, because we have much more stringent rules and regulations that must be obeyed by financial institutions, individuals seeking credit, as well as business owners themselves (Pierce, 2013).

Kiva Zip

Kiva Zip draws from the core concepts of a thriving community: collaboration, innovation, and trust. The main components of this paper will provide a rudimentary background and history of small business loans, explaining the core benefits of Kiva Zip, as well as present recommendations for improvements of Kiva Zip's progress towards improving their overall microfinance strategies. Through research of previous case studies and various academic articles, it has been identified that microfinance in the U.S. can prove to be effective because it allows for microentrepreneurs to gain financial and social capital, thereby improving local economies and encouraging racial inclusion and income equality. While there are many improvements to be made within the microfinance sector in the U.S., this paper aims to highlight those improvements in hopes that those recommendations can be utilized by microfinance institutions, such as Kiva Zip.

U.S. Microfinance

The history of microfinance began in the 1970's, in an effort to show that the poor were worthy of receiving credit, even when they lack the financial history typically required to receive such credit (Borgman, 2005). In order to obtain the credit required to start a small business, one must procure the financial collateral necessary to establish their entrepreneurial endeavors. It is a maze of finances and paperwork that often leaves those with the drive and the talent to start a business in a situation with diminishing prospects. In the event that they are able to qualify for a loan from a commercial bank, those loans typically come with overwhelming interest rates. Even when a business is profitable, those profits may not be sufficient to keep up with the usual cost of running a business, alongside exorbitant loan repayments.

Along with Kiva Zip, there are a few other leading microfinance institutions in the United States. Institutions such as ACCION, Grameen America, and the Opportunity Fund all exist to help Americans build credit when they are not offered any from traditional banking institutions. Grameen America is product of the Grameen Bank of Bangledesh, considered the founding microfinance institution in the world (Borgman, 2005). Started by Nobel Peace Prize winner Dr. Muhammad Yunus, Grameen Bank provides credit with the understanding that borrowers will repay the loan after their small entrepreneurial endeavors make a profit (Haque & Harbin, 2009). Loan repayment is frequently successful with banks like Grameen, thanks in part to peer pressure an accountability experienced by borrowers in peer lending groups (Borgeman, 2005).

Many of these institutions started as internationally used lending offices, and then started a branch in the United States. However, it was important for all of these organizations to understand that the financial climate in these developing countries that they previously served will be immensely different than that of their new clientele in the United States. Banks such as ACCION International and Grameen Bank have a noteworthy history of providing microloans to people in developing countries with repayment rates around 97%, indicating that these organizations have reached a level of self-sufficiency (Richardson, 2009).

This level of self-sufficiency among microfinance institutions in developing countries is seen for a multitude of reasons. Lending systems and bank regulations in developing countries are often much more informal, innovative, and flexible than that of their U.S. counterparts (Rubach, Bradley III, & Brown, 2010). The businesses themselves also differ in regulatory structure and accreditation standards (Richardson, 2009). A small restaurant in Bangladesh does not a have the same regulatory standards and health codes that a café in Mississippi would have. Along with initial start-up costs of a small business, the U.S. also requires extensive and ongoing fees associated with entrepreneurialism. There is also much more risk of owning your own business in the United States (Kennickell, Kwast, & Pogach, 2015).

To identify the effectiveness of microfinance in the U.S., we must examine all stakeholders involved and pinpoint areas that need to be improved upon. Learning from the past experiences of borrowers and lenders, we can make a case for the effectiveness of Kiva Zip in the Bay Area, and in the U.S. in general.

Borrowers

Those that need credit from microfinance institutions are those that require credit to obtain credit, but do not have the collateral necessary to get the loan that they need. There is no shortage of borrowers looking for a microloan. Microfinance institutions could be doing a better job of vetting for borrowers that will improve or maintain their organization's high repayment rates and long-term success stories.

The most popular story of those seeking microcredit loans is that of a well-intentioned person with a noble business idea and the right entrepreneurial spirit who just needs a financial boost to help them get on their feet. This is the single mom who wants to start her own daycare but needs $5,000 to help with operating expenses and liability insurance. This is the farmer who needs $10,000 to purchase a piece of farming equipment critical to the success of his next crop. By examining trends within these entrepreneurial stories, microlenders might be able to identify borrowers that will help them reach new levels of self-sufficiency.

A possible weakness of Kiva Zip is the slippery slope that might be seen if their mission appears to move away from alleviating third world poverty and promoting income equality, and towards funding the hobbies or side projects of American entrepreneurs. Possible income criteria could be enforced, ensuring that only those truly underserves are qualified for this microlending process.

Lenders

Lender involvement plays a critical role in a successful microfinance situation, particularly in the case of Kiva Zip. In some of the more common microfinance institutions, crowdfunding is not factored into the procurement of finances. There is a social element of peer lending used in institutions such as Grameen America, where you need to gather a group of like-minded microentrepreneurs who would also take out the same loan amount and hold equal responsibilities, should one member of the group default on their loan (Foroohar & Ramirez, 2010). Within Kiva Zip, there is some level of pressure placed on borrowers to keep lenders up-to-date on their successes as well as their struggles. But because the majority of these relationships are facilitated online, there is not a physical presence that is often seen in the joint-liability lending in developing countries (Borgman, 2005). With over 13 million microentrepreneurs in the U.S., the demand for microfinance lenders is high (Allison, Davis, Short, & Webb, 2015). With borrowers spread out all over America, many microfinancers lose out on the benefit, often experienced by their international counterparts, of social collateral networking because they do not participate in this peer lending that provides a more intimate experience with group interaction that encourage borrowers to repay their loans (Rubach, Bradley III, & Brown, 2010). The social element of Kiva Zip is almost entirely online, which leaves much to be desired in terms of feeling a sense of interpersonal comradery and accountability amongst your fellow borrowers. However, this utilization of social collateral in group lending is only a tool for encouraging loan repayment, not fund procurement. But with significant repayment statistics, banks or organizations like Kiva Zip are better able to entice lenders to participate.

Targeting Investors

Because the world of microlending, specifically when utilizing crowdfunding, is relatively new, the data to support or refute the effectiveness of microfinance is limited. It is identified that this is a relatively untapped market, with a potential to be seen as big business for some financial institutions, namely credit unions. Even though there are millions of America microentrepreneurs, the majority have never received microloans (Richardson, 2009). With commercial banking providing the majority of the credit to borrowers in the U.S., this could be an area of opportunity for credit unions to cater to the needs of micro entrepreneurs. Access to capital is the biggest barrier to growth for small businesses; more so than talent, government regulations, strategic planning, financial management, or technology (Samaad, 2013). Because credit unions have long been associated with first and foremost being connected to their community, it is a natural fit that they could benefit microfinance and vice versa.

Targeting lenders in the Bay Area is a unique situation, as so many cities like San Francisco, Oakland, etc. face gentrification and a wider gap of income inequality. This angle could be used as a tactic to be more strategic in launching Kiva Zip, city by city. In only offering these crowdfunded loans to cities that meet specific demographic data requirements, you could reap more of the benefits seen in the group lending of developing countries (Richardson, 2009). If future studies could capture data that suggests that microlending can lessen reliance on government assistance, then Kiva Zip could also partner with other nonprofits that encouraged financial literacy and professional development for underserved populations. There needs to be a greater reason than neighborly altruism to bring new and devoted lenders to the Kiva Zip website.

One could also argue that there could eventually be an argument for a scenario where thousands of dollars via online crowdfunding helps to fund a small business that eventually grows so large that the business reach an initial public offering, leaving the early supporters feeling like they had missed an opportunity to secure any shares available to them (Knight, Leo, & Ohmer, 2012). This is a far-fetched scenario, and one that can easily be mended by the appropriate documentation, but one that must nonetheless be taken into consideration if Kiva Zip wishes to grown significantly in the United States.

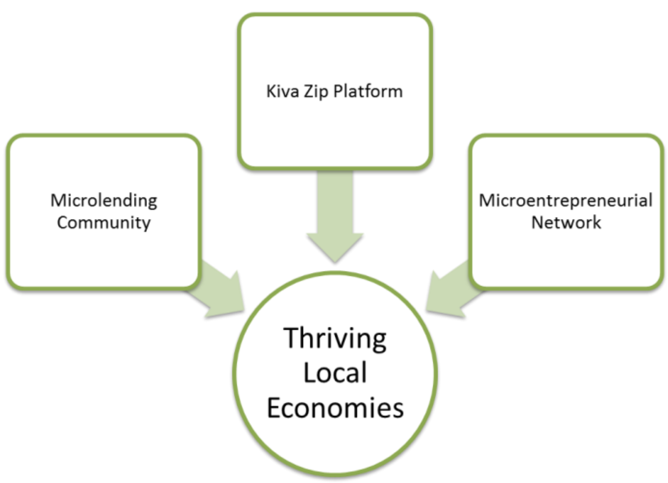
Local Economies

As previously mentioned, the economies seen in developing countries that have historically used international microfinance models are vastly different than the local economies seen in even the poorest parts of the United States. There is simplicity to successful microentrepreneurship in developing countries that is not present in the United States due to a myriad of reporting requirements, financial statements, and other legalities involved when operating an America business (Knight, Leo, & Ohmer, 2012). The idea of investing in a small business in the U.S. is a very attractive concept – contributing to the American Dream and helping others reach their goals and achieve prosperity. This success because of microloans has been seen in Black communities that had benefitted from access to credit from local credit unions (Gordon Nembhard, 2013). Many low income communities are susceptible to predatory lenders who offer payday advances or other loans requiring astronomical interest rates.

Microloans are also a benefit to society during economic recessions, when many have been laid off from their jobs and need to look and entrepreneurial endeavors (Rubach, Bradley III, & Brown, 2010). Especially after a natural disaster, when people have lost their jobs and must get creative in how to make a livelihood from scratch, microentrepreneurialism is a feasible option. This was seen after Hurricane Sandy, when thousands of small business owners were in need of “disaster microloans” to help their businesses recover from the damages cause by the hurricane (Tucker, 2014).

Recommendations

It became apparent that Kiva Zip would need a shift in their approach, moving away from relying on the feel-good investment in the American Dream, and towards the data and research that will support the growth and efficiencies of microlending in the United States. There is abundant evidence that microfinance in developing countries can hugely benefit individuals and communities (Richardson, 2009). However, when the same techniques and concepts are applied to a U.S. microfinance environment, you are met with a square peg trying to fit in a round hole. Social collateral, a useful tool in third world microfinance, will only accomplish so much when introduced to microlending in the United States. It is my recommendation that Kiva Zip take a step back to better integrate their organization into the existing climate of U.S. microfinance, and also to serve as pioneers in offering solutions to this innovative field.



In order for Kiva Zip to grow into the premiere microfinance institution in the U.S., the following high-level recommendations should be taken into consideration. These are meant to guide future program development and business strategies for Kiva Zip.

Education

It takes a thorough knowledge of small business strategies to thrive in an entrepreneurial setting. Many times, there is an entrepreneurial spirit, but is misguided during the critical beginning years of a new business.

It would be of great benefit for Kiva Zip to integrate a more comprehensive educational element into their model. Alternatively, they could partner with an existing organization that specializes in educating small business owners on financial matters. Getting funds to an entrepreneur is only the first step in implementing real change in the lives of the entrepreneur as well as the entrepreneur's local economy. While there are many heartfelt stories of Kiva Zip loans providing promise of a better tomorrow, the true success in a Kiva Zip story should be measured in longevity of the success of the microentrepreneurs that they support (O'dea, 2015).

Kiva Zip does include very basic resources to those wishing to use their service to obtain the credit they need to start or improve upon their small business endeavors. However, a deeper level of commitment would help ensure long-term success for these microentrepreneurs. Serving as educational resource to help borrowers better understand the high risk involved in U.S. microenterprise allows for more credibility of the Kiva Zip program, but also promotes healthier economies at a local level. Businesses in their infancy are required to report on their operations and financial statements, reports that require a minimal level of literacy (Knight, Leo, & Ohmer, 2012). Such levels are likely not found in low income neighborhoods, making the holistic approach to financial education a necessary one.

Policy and Advocacy

Rather than overlay a similar framework used with microfinance in the developing world, each approach to microfinance in the U.S. should have a strategy based on the economy it wishes to insert itself in. For Kiva Zip, this likely means some more detailed research into the local city governments, as well as taking the temperature the cultural details within that city. Quite often, the goals of politicians align with goals of microlending when it comes to alleviating poverty (Richardson, 2009). The microfinance needs and long-term business goals of artisan bakers in Oakland, California will look very different than that of rural farmers in Illinois or inner city shop owners in Detroit. On a national scale, convincing Congress to implement microlending reforms could also advance the overall microfinance industry in the United States, prioritizing national policy change. By working with advocacy and policy influencers to promote legislation supporting microfinance, Kiva has a greater chance of catering the Kiva Zip launch to any given city.

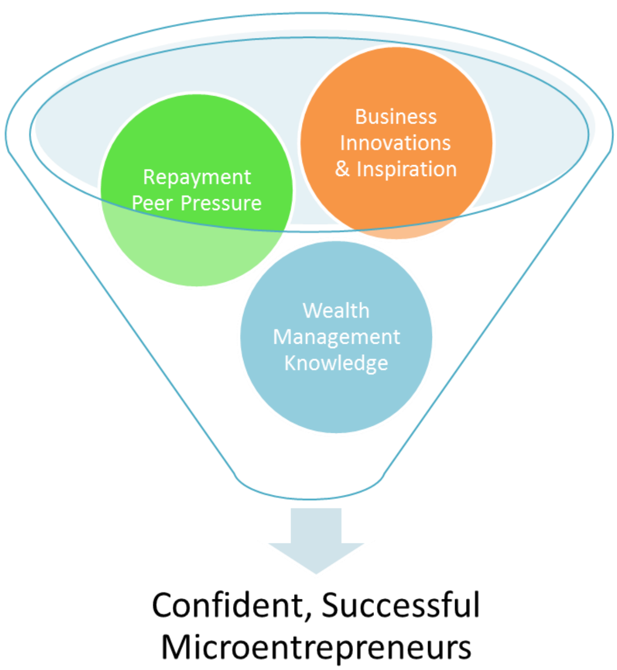
Target Populations

In order to meet the needs of the poorest and the most economically disadvantaged populations in the U.S., Kiva Zip should also aim to cater microfinance products and services to women and minorities in low-income households (Borgman, 2005). If successful, this could also greatly reduce the need for government assistance, offering a way for many out of poverty (Richardson, 2009). However, the importance of education surfaces again with this recommendation. You can give out all the microloans in the world to microentrepreneurs with the very best of intentions, however if they do not know how to sustain that wealth and maintain their success in their local economy, then the initial loan was a wasted resource.

Reframing the Lender Relationship

By changing the way that Kiva Zip reaches out to lenders, there could be a broader lender pool to utilize. With the right data available, Kiva Zip could communicate the idea that their donated amount will not just help an individual to start or improve upon their business, but that their action will help communities at large. Reframe messaging around the relationship between lender and borrower to paint the picture of a bigger ripple effect cause by an individual loan of just $25. Some lenders might wish to see specific small business endeavors thrive, but others might have a greater desire to see neighborhoods and local economies thrive.

Facilitate Peer Lending Experiences



The power of small group accountability to cultivate a sense of borrower comradery and joint liability amongst microentrepreneurs has been seen time and time again in developing countries where fellow borrowers live and work in close proximity (Borgman, 2005). Because Kiva Zip microlending is facilitated online, there is little to no opportunity for fellow borrowers to communicate, share ideas, or support each other. When launching in a city, there should be an established physical place to meet and participate in either a social or educational capacity. Taking these conversations offline can be instrumental in increasing repayment rates and long-term business success.

Conclusion

While there are a number of logistical, as well as theoretical, limitations on microfinance in the U.S., there is a considerable amount of positive change made in the lives of hopeful small business owners and entrepreneurs. Kiva Zip is in a great position, with the international success and notoriety seen from their founding organization, Kiva. The key takeaway for Kiva Zip is to treat Kiva Zip as its own unique endeavor, and not rely on the systems and strategies that worked internationally. It is an exciting time for Kiva Zip to be so deeply rooted in the microfinance field and they have abundant opportunity to fine tune the shape, strategy, and structure of their business.

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