

# FIELDforum

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*This is the second in a series of three FIELD forums exploring promising practices being used by microenterprise organizations to increase the sustainability of their services.*

*Each issue profiles an organization and discusses its sustainability strategy, progress to date, critical decisions and successes.*

*Credit-led and training and technical assistance-led programs are profiled.*

## CAPITAL STRUCTURE - GETTING IT RIGHT TO INCREASE SUSTAINABILITY

### Introduction

In 2005, when FIELD published *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States*, which broadly examined the microenterprise industry, practitioners rated its call to focus on new strategies for sustainability as the most important recommendation in the document. This is not surprising. As MicroTest data<sup>1</sup> has demonstrated, the road to self-sufficiency – covering total program costs with earned revenues – has proved arduous. At the end of 2006, credit-led programs, on average, covered 30 percent of their total costs, while those programs that are training- or technical assistance-led covered only seven percent. While self-sufficiency has improved for many over the years – with leaders in the field reaching 41 percent or higher – most practitioners have acknowledged that they must focus on a broader vision of sustainability that implies combining earned revenues and subsidies with the goal of meeting current needs without jeopardizing the ability to provide future services. Securing an institution's future sustainability will depend on applying an entrepreneurial spirit to the task, and devising innovative approaches blending earned income strategies, social enterprise opportunities and creative fund-raising or capitalization techniques. This series aims to capture some of that entrepreneurial spirit and what's being learned by those trying new strategies.

### Focus of This Case Study

This *FIELD forum* focuses on the pursuit of equity capital, and its critical role in supporting an institution's scale-up and sustainability strategy. As the Nonprofit Finance Fund has noted, an institution's sustainability is a balancing act, and depends on keeping mission, organizational capacity and capitalization in line.<sup>2</sup> Too often, organizations are hampered by funding that constrains their operations. When the limitations become insupportable, the institution needs to break through these constraints to develop new sources of capital that keep it moving forward.

This is precisely the situation that confronted Justine Petersen in St. Louis, Mo. Formerly called Justine Petersen Housing and Reinvestment Corporation, it is a nonprofit loan fund with a subsidiary for-profit CDFI. Founded in 1997, the organization's original mission as a housing institution has expanded into a broad-based, asset-building agenda focused on low- to moderate-income families and individuals. The organization focuses on:

- Increasing home ownership opportunities,
- Developing enterprise opportunities,
- Building credit and improving credit scores, and
- Strengthening financial literacy and financial skills.

<sup>1</sup> MicroTest is a national data collection system managed by FIELD. This data is based on submission by 56 microenterprise programs documenting their program performance activities in Fiscal Year 2006.

<sup>2</sup> Clara Miller, "Linking Money and Mission: An Introduction to Nonprofit Capitalization" (New York: Nonprofit Finance Fund, 2001), 5; available from [www.nonprofitfinancefund.org/docs/Linking\\_MissionWebVersion.pdf](http://www.nonprofitfinancefund.org/docs/Linking_MissionWebVersion.pdf); Internet.

## Justine Petersen: Key Accomplishments

Since its inception in 1997, Justine Petersen has:

- Provided one-on-one credit-building services to 15,000 families;
- Assisted 3,500 to purchase homes, accessing \$340 million in safe and affordable mortgage loans;
- Originated \$3.9 million in microloans to 700 microenterprises; and
- Opened 1,200 Individual Development Accounts and facilitated 600 matched withdrawals to purchase assets.

Its clients are 80 percent inner city residents, 81 percent African American, 80 percent low to moderate income, and 68 percent female-headed households. It targets low-income and transitional neighborhoods in St. Louis, as well as across the river in East St. Louis, Ill.

## Context, Motivation and Goals

Over the last several years, the organization has grown its lending and other services. It has embarked on a scale-up strategy for its microlending. It also has purchased and is renovating its own building, centrally located between the upscale arts district and the distressed northern neighborhoods of the city. Besides providing a new and commodious home for staff, the building's location close to neighborhoods in need creates a more public face for the organization and increases its general accessibility. The building also will provide rental space for several businesses and include incubator space for emerging microenterprises. The building represents the optimism and drive of the organization to expand services and increase its impact in communities across the region.

The organization's 2007 (unaudited) financials indicated total net assets of

\$693,454.38 out of total assets of \$4,447,159.82. Its unrestricted net assets have jumped from \$129,632 in 2006 to \$677,641 in 2007, with the change largely attributed to the acquisition of its new home. Most importantly, the organization has achieved an overall self-sufficiency ratio of 79 percent. Its microlending program achieved an operational self-sufficiency rate of 52 percent by the end of 2007.<sup>3</sup> While this performance places it among the top performers in the industry for this measure, it is still far from where the organization wants to be, which is 100 percent self-sufficient across all its lending products. (It expects that subsidy will always be required for its value-added services – the Individual Development Accounts and the counseling assistance and other technical assistance services that complement its lending.) To get there, the organization needs more capital and more flexible capital, and getting them requires a sophisticated sustainability strategy.

Justine Petersen prides itself on its ability to grow (and increase sustainability) through its capacity to generate fee-for-service revenue and to excel on performance-based grants and contracts. It charges interest, and origination and loan processing fees, on its loan products. It generates brokerage fees from its work connecting clients to mortgages; its real estate license allows it to broker homes. It also generates income from rental properties it has developed. It has grown its microlending under the SBA Microloan program and has been rewarded with larger technical assistance awards because of its overall performance. Other recent grants and contracts with performance criteria also have been executed well.

While the organization has advanced in both size and sustainability using these strategies, its current position also demonstrates certain limitations implicit in this path. The situation in St. Louis presents both a growing need and a growing market for the type of services Justine Petersen offers. The collapse of the subprime market increases the opportunity and need to provide credit education and home

<sup>3</sup> Operational self-sufficiency indicates the percentage of operating costs covered by interest and fee income generated by the microloans and any interest earned on unused loan funds. The cost of capital reduces the self-sufficiency rate. At the end of 2006, the financial self-sufficiency rate, which includes cost of capital, was 35 percent.



ownership preparation to families that previously would have turned to the subprime market. Rising foreclosures indicates the need for more default/delinquency counseling to help people maintain their homes if at all possible, and if not, to preserve equity and avoid the negative effects of foreclosure. In addition to its traditional African American market for microloans, the growing Latino population (which has increased 92.2 percent since 1990), and refugee populations, with limited access to mainstream financial markets present another opportunity for microlending and other asset-building services. And there are few competitors providing these services. The organization has set a number of goals by 2010, among them, increasing the number of microloans from 205 in 2007 to 570 – a 200 percent jump.

One of the greatest challenges facing Justine Petersen revolves around its microlending program, which operates as an SBA Microloan Intermediary. The majority of its loan funds are borrowed from the SBA Microloan program, and the organization is close to the maximum allowable amount of \$2.5 million. (Currently \$2.1 million has been borrowed from that source). Overall, the institution has access to \$3.8 million in borrowed loan capital at interest rates ranging from 1 percent to 8 percent. Its own loan capital is a modest \$300,000.

Obviously that limited capital constrains the organization from growing its microlending. But the terms of the capital are also a constraint. If the institution is to achieve self-sufficiency on its lending, it needs to earn more revenue on each loan. To do so, it only has two choices – decrease costs or increase revenues. Although the organization's lending follows a classic, high-touch model, it already has demonstrated a high level of efficiency. Its operating cost rate of 0.21 puts Justine Petersen among the leaders in terms of microlending efficiency.<sup>4</sup> On the revenue side, the SBA Microloan program caps its intermediaries to a spread of 7.75 percent on loans. While the

institution can charge a higher spread on other funds it has under its for-profit subsidiary, the Great Rivers CDFI, currently only \$700,000 is available in that fund. With an average loan size of \$6,500, and working with a highly disadvantaged population, the spread doesn't go far enough. The organization estimates that a 12.5 percent spread could go a long way toward covering its costs. Although striving for such a spread sounds like a hardship for its already challenged market, the institution's research has found that competitors in St. Louis – largely payday lenders – charge an average interest rate of 422.26 percent.<sup>5</sup>

A second challenge for most organizations is raising capital for a new building. Again, the NonProfit Finance Fund warns about the difficulties bricks and mortar projects bring. Besides project management, high funding requirements can sidetrack an organization from its other goals, and incorporating rental components means taking on the job of property management as well. For most organizations this could be daunting, but Justine Petersen has experience in this area through its work in real estate development. Nevertheless, the organization still needs to raise \$720,000 of the \$1.2 million cost of the building.

So Justine Petersen has a two-fold need for equity. It seeks \$5 million for an Emerging Markets Fund to provide needed capital to grow its microloan program, and it needs a minimum of \$720,000 to pay down the mortgage on its new building, as well as to perform some further enhancements. It also must apply new equity wisely to increase the earned revenue it generates while expanding the impact of its work.

## How to Get From Here to There

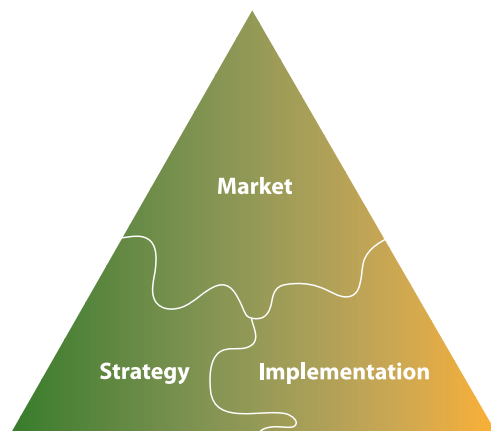
**T**here is not one strategy – but rather, many – for reaching sustainability. And for every organization pursuing sustainability, those strategies are like a puzzle that must fit together

<sup>4</sup> Operational cost rate is measured by dividing credit program operational expenses by the average outstanding loan portfolio for the year. The resulting number reports the cost the organization incurs in managing each dollar in its loan portfolio.

<sup>5</sup> Eric McClure, Report to General Assembly pursuant to section 408.506 RSMO, 17 January 2007. Accessed 24 February 2008; available from [http://www.missouri-finance.org/upload/2007\\_payday\\_lender\\_survey.001.pdf](http://www.missouri-finance.org/upload/2007_payday_lender_survey.001.pdf); Internet. Cited in Justine Petersen Emerging Markets Loan Fund: Business Plan, 2008-2010.

well to work. That puzzle has three major components, and within each component there are choices that need to be decided upon:

- *The market:* It shapes what is possible for a microenterprise program; it includes both the market of potential customers and the “civic market,” the philanthropic and public communities that set or support the community development agenda anywhere. Effectively understanding and responding to both markets is critical for success.
- *The strategy:* This is the business model that the organization chooses; it incorporates the “value proposition” the organization makes to both its markets, and it defines how revenue will be earned and how subsidy will be used to enhance or support mission.
- *The tactic or implementation:* This includes all the factors that represent day-to-day execution. It involves management, decisions regarding how to address risk, approaches to efficiency, how the organization uses its connections and social capital, how flexible it is in adapting to change, and how readily it can innovate.



Graphic by Langdon Morris, InnovationLabs

Justine Petersen already had many of the pieces of the puzzle in place, but there are key gaps that it is trying to fill. It understands and serves its current market well, but needs to make that same connection to its intended Hispanic market. And it needs to substantially enlarge its connections to St. Louis' civic market. As described above, it has many earned

revenue pieces in place and it has garnered subsidy mostly through performance-based grants. Now it needs to get some smarter subsidy in the form of equity that can help it grow its loan portfolio, and further increase the earned revenue piece of the puzzle. And it needs to effectively use its assets (its efficiency, its new building, its proven asset-building strategies) to dramatically grow the program and build new constituencies of support.

To complete the puzzle, Justine Petersen has mapped out three key steps:

- It is increasing visibility in the community through a branding and repositioning campaign.
- It is growing and developing its board to take on a greater role in fund-raising.
- It is developing a systematic development campaign focused on local philanthropy.

Along with these steps, and as it achieves financial success, it will grow its loan portfolio, and apply the earned revenue strategy to help make its lending function more self-sufficient.

While the notion of a nonprofit embarking on a development campaign is not new, Justine Petersen's work on this exemplifies the systematic approach that an organization must take to be successful. The organization has hired three consultant organizations to help with planning and implementing the strategy, each of which has an important part to play in both increasing the institution's profile in the St. Louis metro area and increasing its long-term capabilities. A public relations firm is helping increase visibility and connections. A media firm has helped develop a new look for its Web site and other materials. And a strategic management firm helped the organization assess its development potential, and is now helping craft and implement a development plan. Justine Petersen has found that investing in these consultancies has added expertise quickly, and at lower cost than doing this in-house initially. Ultimately, the organization will need to increase its internal development capacity, but for now, this arrangement allows it to plan, launch and test a coordinated set of initiatives.



## Branding, Repositioning and Connecting to the Local Community

While Justine Petersen had a strong track record, like most microenterprise programs and other CDFIs, it had largely labored under the radar in St. Louis. Its Web site was minimal, and even though it was named for a leading housing advocate, the organization was not widely known. To address that, the organization developed a multipronged approach:

- *Creating a strong and clear image:* Justine Petersen officially shortened its name and adopted a new tagline to capture its mission, “Building Assets, Changing Lives.” The tagline appears on all materials and is prominently displayed throughout the new building. (To see the new look, visit: [www.justinepetersen.org](http://www.justinepetersen.org).)
- *Increasing public visibility:* It has begun making media contacts to position staff as experts on such issues as asset development, credit building, the mortgage crisis and subprime lending. That work already has resulted in a feature article in the area’s major newspaper, the *St. Louis Post-Dispatch* (circulation, 200,000 weekdays; 350,000 weekends), and there are plans for additional placements in other key business print, radio and television media. The organization also participates in the SBA Small Business Week, and Cinco de Mayo and other Hispanic events.
- *Making connections:* With the help of its public relations firm, Justine Petersen staff members are introducing or reintroducing themselves to principals in government, banking and the Hispanic community. The aim is to both generate financial support and create a favorable profile in the Hispanic community, the target of its Emerging Markets Fund. One immediate result of this outreach is the willingness of one CRA officer to host a meeting with others from the banking community to take a close look at the fund.
- *Leveraging the new building:* To garner attention for its mission and services, Justine

Petersen provided tours to key contacts and held a “grand opening.” Having retail storefronts and an incubator in the building shine a spotlight on the role of microenterprise development in the community.

- *Increasing communications:* As a complement to its new Web site, the organization plans a blog, and later a newsletter for clients.

## Growing and Developing the Board to Support Ambitious Goals

Justine Petersen has always had a small, but highly committed, board made up of individuals with strong community connections, expertise in the community development finance field, and law. The value of the board was that it served as a dependable “brain trust” for its executive director, who felt that this model mirrored that of many companies, enabling the organization to move with some agility. Under the new growth and sustainability strategy, the board must transform itself as well. Greater diversity is needed to reach into newly targeted communities, as are board members who are willing and able to open doors for staff, and contribute financially.

Because the organization has great trust in its current board, the goal is to enhance its strength, and to help long-term members participate in the board’s evolution. Key steps include: board development and education to generate a common vision of board roles and responsibilities; an assessment of current skills and qualities, and the identification of gaps; and the creation of a nominating committee and the search for strong additions to the board. The aim is to grow from six to 12 members over an 18 to 24 month period, and strengthen the board in such areas as banking and finance, and in connections to both the grassroots and leadership sectors in the region.

## Crafting and Implementing a Development Campaign

With the development assessment complete, the organization moved to develop a new strategic plan and a business plan for the

Emerging Markets Fund. These two documents provide an energizing focus for board, management and staff, and demonstrate the feasibility of their proposals to new supporters. Now the organization is moving to create a detailed development plan that will:

- Use the new building to attract greater visibility and new funders, including offering naming opportunities. For example, Justine Petersen agreed to name the recently restored classic, historic entrance to the building after the funder that underwrote the costs.
- Take advantage of current issues related to the subprime mortgage crisis to demonstrate how Justine Petersen is part of the solution.
- Leverage the credibility of other funders. The Danforth Foundation's support for a targeted neighborhoods campaign that has been well implemented is a positive calling card in the city. The aim now is to connect to other funders, including many in the corporate sector, with the expectation that several endorsements from these sources will demonstrate that the institution has been well vetted.
- Once this support is achieved, move to an individual donor campaign.

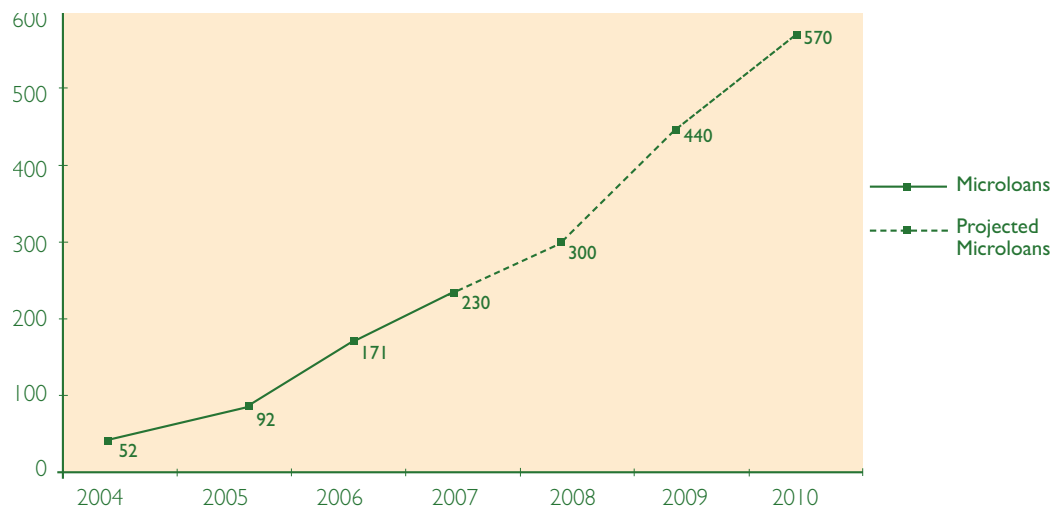
An integral part of this development work will be creating internal capacity for long-term sustainability. While staff is now being supported by consultants, internal development capacity needs to be built to capture needed, ongoing subsidy.

### Executing Well

To ensure the success of the Emerging Markets Fund, Justine Petersen must reach out to more aspiring entrepreneurs among its traditional African American customers, as well as in the Hispanic market. A 30 percent increase in loan production is envisioned for 2008, followed by a 46 percent increase the following year, and 30 percent the next. While staff believes the market is there, the organization will need to work hard to reach these numbers. The organization wants to increase its marketing by adding a billboard campaign, featuring its microloan products, along with radio spots that will target both the micro market and the housing market. Engaging with the Hispanic community, as described above, is also expected to generate strong demand.

The organization also expects to continue operating at the same level of efficiency, which means a caseload of 140 loans a year per counselor, while maintaining its low average

## Microloans





loan size and high-touch approach. (Loans funded through its SBA Microloan fund will average \$8,000, while loans under its Emerging Markets Fund are expected to average \$5,000.) While ultimately the institution may need to consider more technological solutions to managing growth, it believes that its current operations – which stress quick-stepped lending based on client performance – provide the right mix of customer service, risk management and efficiency.

Finally, the organization expects to increase scale with a pricing structure that will lead to full cost recovery of its credit operations by 2010. It will offer loans with variable rates depending on the product and the funding source. The spread, which will range between 7.75 percent and 12.5 percent, along with fees and interest earned on deposits, will get them there, assuming that the organization achieves its projected volume. This represents 75 percent of the total budget. The other 25 percent, which consists of the value-added technical assistance and consulting services, strengthens its developmental impact. While this does not free the organization from needing ongoing subsidy, it does reduce this obligation and ensures that the core loan products can be maintained if adverse circumstances arise.

## Lessons Learned

This *forum* focuses on an institution that has made considerable progress since its founding some 11 years ago, and is now embarked on a new stage of growth. While it is too early to see results from the sustainability path it has set, already some lessons have emerged for other microenterprise programs seeking to enhance sustainability. These lessons include:

- The challenge of restrictive funding. While an institution can establish a strong track record – and deliver valuable services – by executing performance-based grants and contracts well, the restrictions they bring create real challenges for an organization seeking long-term sustainability. It is important to develop unrestricted sources of funding as early as possible. And it is

important for funders to understand the need for, and value of, unrestricted funding for institutional development.

- Building a funding base requires a systematic approach. To that end, Justine Petersen developed a strategic vision and achieved clarity among all parties – consultant partners, board and staff – with respect to the goals, strategy and message.
- Consistency across all of an organization's materials and messages, and a high-quality, professional appearance is needed. Having a strong tagline that conveys the essence of the organization is also helpful.
- A clear focal point is needed within the organization for development activities. While Justine Petersen is still wrestling with how to structure and staff those activities, they are considered essential.
- Following up is as important as making contacts. Justine Petersen staff has found that while the new building has created a lot of opportunities for tours and introductions, finding time to maintain those connections also must be carefully planned.
- A development strategy is not a quick fix. The organization has committed to full implementation during the next 18 to 24 months before evaluating its effectiveness. Although tactics will be evaluated along the way, the overall strategy will be tried for a sufficiently long period before results are truly assessed.
- It takes multiple approaches to move an organization to greater sustainability. Justine Petersen has multiple product and service lines, all of which help support its overall institutional stability. Its earned revenue strategy has many elements: money is generated through microloans and other lending products; its mortgage brokerage and real estate management also provide revenue. In addition, the organization recognizes that it needs to generate some new, more flexible capital to fuel its next stage of growth. The strategy to develop these funds also has multiple pieces that complement each other to gain the desired results.

- Scale can get you to sustainability only if the price – and cost – are right. Unless an organization can earn money on its loan products, scaling up only increases the subsidy required. In a recent survey of the CDFI industry, a little over half (51.7 percent) of the practitioner respondents were using subsidy to underwrite the operational expenses of lending. At the same time, more than two-thirds (67.4 percent) indicated that they were looking at scaling up their loan volume as a strategy to increase sustainability.<sup>6</sup> The two are contradictory: Unless the organizations can change the loan terms, or increase the amount of subsidy available for their core lending services, scaling up cannot succeed. In Justine Petersen's case, there is a sense that market conditions favor a pricing strategy that will enable the organization to make scaling up and increased sustainability go hand in hand.
- It is a rare microenterprise program that does not need subsidy. The goal is to find ways to use the subsidy wisely so as to increase the institution's strength, and allow it to develop capacities for greater revenue generation later.

## Looking to the Future

Justine Petersen has charted a course that appears to have many winning elements. How well it succeeds will depend not only on execution, but also on the context in which it operates. As mentioned, the organization expects to target philanthropy and the public for equity investments. In a down market, with lower corporate earnings, and banks tightening the flow of credit, even organizations doing wonderful work may find it hard to raise funds. For Justine Petersen, the challenge will be to stick with the game plan even through a difficult period knowing that this work and its reputation ultimately will produce payoffs when the economy improves. For many microlenders, the picture is the same: developing a workable solution to the puzzle of sustainability will require similar vision and consistent effort in hopes of future rewards.

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<sup>6</sup> This survey was conducted by Aspen's Economic Opportunities Program as part of a research study on sustainability funded by the CDFI Fund. Representatives of 261 organizations responded to the survey. For more information, see the study, *Approaches to Sustainability*, forthcoming, at [www.fieldus.org](http://www.fieldus.org).

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