
BETA Project: Accion Texas

Helping Borrowers Make Payments on Time



Summary

Small businesses are the linchpin of the US economy, often providing a route out of poverty for people from economically disadvantaged communities. Yet starting a small business is never easy. In order to be successful, entrepreneurs have to overcome a huge number of hurdles, of which managing their finances is just one. This can be particularly challenging for low-income individuals, many of whom are “unbanked” or “underbanked”, and therefore may not be regular users of mainstream financial services. In 2013, nearly 28% of Americans were considered unbanked or underbanked, and this number rises to almost 43% among Americans with annual incomes of \$30,000 or less (FDIC 2014). As a result of these challenges, small business owners can sometimes miss loan repayment deadlines, leading to late fees and poor credit ratings that can hinder the growth of their business.

As part of the Behavioral Economics Technical Assistance (BETA) Project, ideas42 and the Corporation for Enterprise Development (CFED) partnered with Accion Texas to design and test an intervention to reduce the number of late loan repayments using insights from behavioral science. Accion is one of the largest microlenders in the US, providing loans and other support to small business owners in low-income areas. To provide an indication of the scale of the problem, during our four-month intervention period, the group of borrowers who did not experience our behavioral intervention were charged a total of over \$16,000 in late and Non-Sufficient Funds (NSF) Fees, after fee reversals and waivers.

Our behavioral diagnosis highlighted several barriers that could get in the way of clients making on-time payments. First, borrowers often simply forgot to make sure they had enough money in the relevant account before the payment was withdrawn. Second, borrowers tended to stick with the default payment date even when it wasn’t ideal for their own situation. Finally, the small hassles associated with making deposits sometimes led to borrowers procrastinating on this task, and therefore failing to make payments into their accounts in time.

Based on these insights, we redesigned the monthly statement sent to borrowers to include a planning tool and visible reminder to help overcome procrastination. We also created a system of timely email and text reminders that prompted clients to make a deposit or check their account balance before a payment due date. While operational constraints prohibited us from allowing borrowers to actually change their due dates, we designed our reminder messaging and timing to specifically prompt borrowers to notify Accion sufficiently early if they would be unable to make a payment on-time in a given month. This package of interventions was tested in a randomized controlled trial (RCT) so we could measure its impact.

The results showed that these small, low-cost interventions had a significant effect, reducing the number of NSF charges by almost 25%. If this were to be scaled up to all of Accion’s 2000+ borrowers, those that might have had issues with ACH payments may collectively save a total of more than \$8,000 every year.

If the insights from this project are applied more widely, thousands of small business owners could avoid late fees and potentially improve their credit scores. It could also help to make the case for expanding loan provision to the underbanked population, helping them to build assets and grow businesses.

Defining the Problem

Compared to the industry average of 3.6% in 2011 (Federal Reserve), Accion's charge-off rate of 5% in 2012 did not seem problematic, especially when the vast majority of Accion's borrowers are those who would not qualify for a loan through conventional credit channels. However, an Accion staff member reported that the portion of the organization's portfolio that was "at risk" in 2009-2010 (specifically loans that were 30 days or more past due, including loans that have gone through extensions, restructuring or charge-offs) was as high as 30%. This indicated that more borrowers might struggle with on-time loan repayment than the charge-off rate suggests.

The team set out to understand and solve the problem of borrowers who had difficulties making consistent, on-time repayments through their designated accounts, which were linked to the Automatic Clearing House (ACH) electronic withdrawal system utilized by Accion Texas. In 2011, 68% of Accion microloan borrowers were considered low-to-moderate income individuals, with 45% considered low-, very low- or extremely low-income. Because a disproportionate number of low-income individuals are either unbanked or underbanked, this suggests that Accion's client base would be less likely to already be using mainstream financial services to meet their needs.

At Accion, loan officers and the collections team typically start contacting borrowers once they are five days late in making their payment. Not only is there a significant amount of staff resource dedicated to working with these borrowers, but there are consequences for borrowers in the form of late charges and NSF fees, and the risk of damaging their credit scores if Accion ultimately reports their delinquency—a serious consequence for entrepreneurs seeking capital to help their businesses grow.

Problem Diagnosis

During the diagnosis phase, we analyzed relevant data to better understand the repayment system and the client base, conducted interviews and focus groups with Accion staff and clients, observed the daily operations of the organization, and reviewed the materials given to clients. We uncovered a number of behavioral bottlenecks that reduced the likelihood that borrowers would make on-time payments.

First, borrowers may simply forget to put sufficient money into their designated account before the due date. Because Accion requires borrowers to make automatic payments from a designated account, they must remember to deposit sufficient funds into that account before the payment date, as well as make sure the balance remains high enough until the withdrawal date.

Second, borrowers tended to stick with the default payment date each month, even when it was not ideal. Borrowers have the option to change their payment date if it does not match the timing of their cash flow cycles. However, many borrowers did not make the change until they encountered an issue with payment, rather than thinking through the ideal payment date for them before they entered into their loan agreement.

Finally, steps associated with making deposits, including physically going to the bank and locating the necessary documents to make a deposit into the ACH account, created hassles that caused borrowers to procrastinate on completing this task. While they appear small, these hassles may have impeded borrowers from achieving their goals.

Intervention Design and Testing

We created a package of solutions to address the barriers identified in the diagnosis phase. The first component consisted of a redesigned statement with planning tool and a built-in reminder. We saw the monthly statement as an opportunity to prompt borrowers to take the right action at the right time. The redesigned statement highlighted a recommended date to check for sufficient funds, and included a Post-it note to help plan the deposit of funds and provide a salient, visual reminder.

The second part of the package was made up of email and text message reminders. We devised a system of strategically timed email and text reminders which prompted borrowers to check their account balances and make a deposit before their payment date.

To evaluate the effectiveness of the solutions, we worked with Accion staff to conduct a randomized controlled trial (RCT) with clients divided into a control group of 899 borrowers and a treatment group of 909 borrowers. The treatment group received the redesigned statement along with the email and text reminders, while the control group continued to get the original monthly statements with no additional reminders.

The behaviorally designed solutions reduced the average NSF fees charged to borrowers by almost 25%. This shows that more borrowers were either taking the necessary steps to ensure there were sufficient funds in their accounts prior to the payment date, or were contacting Accion preemptively to make alternative arrangements, such as a delayed withdrawal or different means of payment. Borrowers were therefore able to avoid late fees, as well as preemptively avoid a path towards delinquency or default.

Lessons for the Future

In this experiment, we proved that simple plan-making tools and reminders could have a big effect, in this case reducing late fees and increasing on-time payments for small business owners – particularly those from lower-income and more risky groups. Reducing late payments not only helps people avoid costs in the short term, but it can also allow them to build a stronger credit rating and gain greater access to the credit they need to grow their business.

As with many interventions that draw in behavioral insights, the solutions we designed were inexpensive (the intervention cost Accion less than \$5,000 in total to implement) and highly scalable. Accion has continued to use elements of the tested solutions and anticipates rolling out a more comprehensive reminder system in 2015.

These findings highlight the power of behavioral insights to solve problems. If banks, credit unions and asset-building programs made similar small adjustments to their communications with their clients, countless lives could be improved through better financial management.