Comprehensive Finance Institution

Description

This is the most ambitious undertaking that could be considered among all the approaches to capital: the creation of a multi-functional financial institution able to carry out the full range of capital and financial services that may be required in the community and its region. This strategy is clearly a multi-million-dollar affair. So it is not hard to understand that it is rare that any such project has been contemplated and then brought all the way to fruition. There are only two in the U.S. and none so far in Canada. (However, the First Nations Bank of Canada operates nationally to serve aboriginal communities, and a group of credit unions have considered founding a CED-oriented bank to serve all of Canada.) The models in each case are quite different, but it is convenient to lump them all together and abbreviate the category here as CFIs.

The first CFI focussed on community revitalization (Shorebank in Chicago's deteriorated South Shore district), despite years of painfully slow progress, has made an outstanding impact upon its target area, the housing, the businesses, and the people. Its record, in fact, led to the founding of the second US model, targeted to the rural delta region of Arkansas/Mississippi.

Rather than beginning with the goal of starting a CFI from scratch like these models, most communities are perhaps more likely to consider how and whether an existing community-based financial institution might be expanded and re-designed to more or less fill this comprehensive role. For example, a local credit union could be the focus of such attention, with the aim of establishing related entities or subsidiaries to fulfill the necessary functions that ordinary credit unions shun, or are legally restricted from serving.

The VanCity Savings Credit Union has in fact been evolving toward more and more varied community financial services for its service area. It has been successful so far because of the very large and active market area it is focussed on. Clearly, such a comprehensive program cannot survive in the limited market offered by a small town or even by a region of two or three small towns. It is precisely that problem of scale that handicaps smaller towns and less-populated regions in the realm of capital and financial services. And thus the scenario of creating a multi-functional development finance institution will be attractive, if it seems possible to design it for a large enough market that can include many small centres not adequately served.

Some CEDOs in the U.S. have bought or organized a bank (commercial or savings and loan) as a part of their over-all development programs. In some instances, other development finance mechanisms such as a Community Revolving Loan Fund (CRLF) might concurrently be a part of the CEDO's activity. Thus, the CEDO itself might be conceived of as a CFI - organizing and managing a variety of development finance subsidiaries. This might be considered as an alternate approach or format for establishing a CFI.

Benefits

The major benefit is that the CFI (in any format) can offer a full range of investment services, and so communities can contemplate and plan a full range of projects, including quite major development projects. They will know that it is a reasonable possibility that all the pieces of a financial package can be constructed with the aid of the CFI, especially if the CFI has developed effective partnerships with traditional finance institutions. Thus, a very ambitious and far-reaching CED program, entailing the collaboration of many community-based partners throughout a region, can be practical in these circumstances. Further, as a more powerful and evolved institution, the CFI has a better chance of constructing new partnerships with other, more conventional organizations, such as the commercial banks, thus increasing its reach on behalf of the communities.

Also, the effect of the interlocking and mutually supportive functions of a CFI makes it a stronger institution. When a community financial organization is focussed only on a single function, as is the case with a Community Revolving Loan Fund, it stands more or less on its own, and thus vulnerable in part because it does not operate in an environment of supportive partner institutions. This is why it should at least be linked to a CEDO, for best performance. Of course, precisely the same struggle is faced by any co-operative that tries to operate on its own, without the support of other co-operative institutions that share its values and aims. The CFI does not face that problem because it is, by definition, a complex of many mutually supportive finance services. It is probably true, however, that even the powerful CFI is made more effective by alliances with one or more CEDOs.

Major challenges

There are two sets of major challenges. The first is focussed in the organizing stage. It is much easier to find capital for limited development finance programs like a CRLF than for a comprehensive development finance institution - partly because the amount of capital required for a CFI is, of course, so much larger and partly because the idea is so ambitious. A CFI implies such a very substantial capitalization that it becomes meaningful to start thinking about starting such an institution only if, for some unusual reason, the organizers already have a good idea of where a critical portion of the money will be coming from. That is the history of the existing U.S. models.

In addition, the scale and complexity of operations is such that CFIs need to attract the best and most sophisticated development finance talent, but because the field is so small and new the pool of such talent is extremely limited. CFI staff must also be prepared to stay the course for many years in order to stabilize such an institution.

The second set of challenges have to do with the major managerial task, that is, managing the tension between sheer survival and the unavoidable risks of development finance. There are six outstanding questions to be handled:

- How to target investments for the greatest impact, that is, using available capital for the greatest socio-economic effect - e.g., by carefully constructing the strategic plan, by efficiently targeting a specified market (type of investment), etc.
- How to reduce the risk in an investment - e.g., by carefully structuring it so that the project can handle the price of the investment, by careful monitoring, by providing or arranging for technical assistance, by sharing the investment with other financiers, etc.
- How to increase the return from an investment - e.g., by making sure that it is not under-priced, by taking the role of project developer when appropriate, etc.
- How to decrease the burden of transaction costs for making investments - e.g., by accessing subsidies, by passing on transaction costs to the client projects whenever possible, etc.
- How to actually decrease transaction or operational costs - by holding on to competent staff, by on-going staff training, by specializing in particular investment types, etc.
- How to access additional capital - e.g., by increasing the return to investors, by increasing capital recruitment efforts and the necessary expenditures, etc.

Some practical steps

As implied earlier, the potential organizers of a CFI will have to begin with a pretty firm idea of where the initial millions in capital will come from. This suggests that it is more practical to consider a long-term process of re-designing or expanding the reach of an existing well-capitalized institution, like a substantial credit union, rather than creating a totally new one. Re-orienting the horizons of a conventional credit union means that the current members must be prepared for this new view of their banking institution; therefore, organizing the members to elect a board intent on this goal is an essential preliminary. The basis of such an organizing effort will be a reasonable vision of a powerful development finance strategy; and a reasonable approach to such a vision will rely upon consultation with those who have pioneered the model.

Resource organizations & contacts

- Shorebank Corporation, 7054 S Jeffery Boulevard, Chicago IL 60649, (312-753-4702).
- Southern Development Bancorporation, 605 Main Street, Arkadelphia AR 71923, (870-246-3945).

Publications

- *Case Study: "Moving The Mountain." The role which banks must perform in the life and health of small towns is key, not ancillary. For the past ten years Southern Development Bancorporation has been acquiring and repurposing banks and other assets in order to turn them into the "sharp end" of a major initiative to revitalize rural Arkansas and parts of Mississippi.
- Brian Kelley, "Rebuilding Rural America: The Southern Development Bancorporation," *Annals of American Academy of Political and Social Science* (September, 1993, vol. 529, pp. 113-127). This is an earlier, but more analytical treatment of this organization's approach.
- Richard P. Taub, *Community Capitalism: Banking Strategies and Economic Development* (Boston, MA: Harvard Business School Press, 1988). A case study of the Chicago's Shorebank.
- *Community Development Finance: Tools and Techniques for National Banks* (Washington, DC: US Controller of the Currency, 1989). This is an overview of what conventional banks have done to help facilitate community revitalization, and thus it offers some conservative suggestions for CFI design.