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Reflections On Operating Microenterprise Services From Within CDFIs

Introduction

This forum examines characteristics of microenterprise programs in multi-service Community Development Financial Institutions, or CDFIs.[1] CDFIs are private-sector financial intermediaries that focus on community development. They make loans and investments in low- and moderate-income communities that are typically considered unbankable by conventional industry standards. CDFIs have diverse structures and strategies, including loan funds, credit unions, banks and venture funds. This *forum* focuses on Community Development Credit Unions (CDCUs) and enterprise-oriented loan funds, both of which focus primarily on retail financial services for individuals and/or small businesses. This analysis also distinguishes between multi-service CDFIs offering microenterprise services as one component of their varied activities, and CDFIs that focus entirely on microenterprises by operating loan funds with a typical maximum loan size of $25,000.

The research for this *forum* relied primarily on the experience and observations of senior staff at four FIELD Institutional Model grantees. Three of the grantees are CDCUs, federally insured, non-profit financial cooperatives that, as regulated institutions, can take investor deposits. CDCUs offer a wide range of financial services including savings and checking accounts, Individual Retirement Accounts, Certificates of Deposit, mortgages, consumer loans and business loans. The fourth grantee in this group is a non-profit loan fund that offers business loans of up to $100,000 in addition to microenterprise loans. All four are retail-oriented CDFIs dedicating most, if not all, of their resources to providing credit and other services to individuals or small businesses, as distinct from wholesale CDFIs with a larger scale focus on real estate or community facilities.

This *forum* also draws on 1999 and 2000 data from MicroTest, FIELD's microenterprise performance measurement. The data presented are average annual measures for 1999 and 2000. Thirty-eight MicroTest participants that had reported 2000 data by September 2001 are included in this analysis. Six of these 38 institutions could be categorized as multi-service CDFIs. In addition to the grantees, one of these MicroTest participants was an enterprise-focused loan fund, and another was an enterprise-focused loan fund within a holding company that also hosts a credit union and several other community development financial services. Their program statistics can be compared to those of all the microenterprise programs reporting data to MicroTest, as well as those from microenterprise loans funds.

This *forum* presents both the advantages and challenges of providing microenterprise support services through multi-service CDFIs, in particular those with a retail, rather than a wholesale, focus on lending and investing. It concludes with recommendations for enhancing the strengths and overcoming the challenges of this institutional setting.

[1] See *FIELD Forum* Issue 8 and *FIELD Forum* Issue 9 for discussions of microenterprise in human service organizations and CDC networks, respectively. See also *FIELD Forum* Issue 6, August 2000, or our Web site (www.fieldus.org/li/institutional.html) for a description of the Institutional Models grant cluster.

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Multi-Service CDFI Grantees

Alternatives Federal Credit Union – Community Enterprise Opportunities (CEO) Program

Alternatives Federal Credit Union is a CDCU serving Ithaca, New York, and surrounding counties. In addition to providing a wide range of financial services, the credit union houses a non-profit venture fund and the Community Enterprise Opportunities (CEO) program. The CEO program offers 4-6 hour training courses on business readiness and a core 33-hour business management course; one-on-one counseling; periodic seminars; an Individual Development Account (IDA) program; start-up loans, Small Business Administration (SBA) microloans and low-interest CEO loans up to $5,000. In addition, CEO participants have access to credit union small business financing, including low-interest loans to women and minorities, SBA participation loans and equity investments.

Burlington Ecumenical Action Ministry (BEAM)/Vermont Development Credit Union (VDCU)

BEAM is a non-profit organization that has started numerous programs, projects and organizations to address community problems throughout Vermont. BEAM founded VDCU, fund-raises for and subsidizes new credit union programs before they can be fully self-sustaining, and is responsible for VDCU program evaluation and development planning. VDCU offers a full range of banking services. The VDCU small business department offers microenterprise loans from $50 to $25,000 and larger enterprise loans, as well as one-on-one counseling designed to develop action plans for customers who do not yet qualify for loans. As part of its small business support activities, VDCU also jointly administers several IDA programs and a peer-lending program.

Credit Where Credit is Due/Neighborhood Trust Federal Credit Union (NTFCU)

Credit Where Credit is Due is a non-profit organization originally founded to design, fund-raise and start the Neighborhood Trust Federal Credit Union, serving Washington Heights and West Harlem in upper Manhattan. CWCID currently fund-raises for new initiatives undertaken by the credit union, runs a financial literacy education program and a Trickle-up seed grant program, and coordinates volunteer technical assistance provided to microentrepreneurs. CWCID offers entrepreneurship workshops, involving 17.5 hours of business development instruction, on a quarterly basis. NTFCU is a community development credit union, offering loans up to $10,000 and other banking services to members.

Northeast Entrepreneur Fund (NEEF)

NEEF is a non-profit organization that originally offered training and loans up to $25,000 only to microenterprises. In 1997, the organization added the Enterprise Loan Fund, providing loans up to $100,000 to existing businesses and experienced entrepreneurs. NEEF's training courses include an introductory workshop, a workshop to help individuals identify the kind of business they want to start, a business planning course, and a record keeping class. NEEF business consultants provide one-on-one business counseling and originate loans. In 2000, the organization divided its resources almost equally between training and credit services.

Table 1: Characteristics of Grantees (1999/2000 annual averages)

	Alternatives/ CEO	VDCU/ Sm. Bus. Dpt.	CWCID/ NTFCU	NEEF
Date established	**1979/1998**	**1989/1997**	**1994/1997**	**1989**
Total number of staff (2000)	**32.5**	**16.5**	**30**	**10**
Number of microenterprise staff (2000)	**4**	**1.2**	**3**	**10**
Number of microenterprise participants (receiving any service from program)	**181**	**100**	**N/A**	**490**
Number of microenterprise clients (receiving at least 10 hours of service or a loan)	**141**	**66**	**72**	**331**
Percent clients with start-up businesses	**44%**	**7%**	**40%**	**23%**
Percent clients with on-going businesses	**23%**	**83%**	**44%**	**28%**

Advantages of Multi-Service CDFIs

Management staff of the four grantee programs housed within multi-service CDFIs identified many advantages of their institutional structure. The following points emerged as the most common themes:

Providing multiple strategies for building wealth in disenfranchised communities

Multi-service CDFIs offer multiple strategies for low-wealth individuals to accumulate assets. Loan funds can offer affordable sources of credit for building businesses, and occasionally for purchasing homes. In addition to credit, regulated institutions like CDCUs and banks provide no-cost savings and checking accounts, and market-yield CDs and IRAs. Most CDFIs also provide some education services to help people manage their finances. Multi-service CDFIs can meet the needs of customers who have varying levels of readiness for asset accumulation. For the industry, offering multiple services can result in greater impact in terms of investment in individuals and whole communities. For customers, accessing multiple financial products provides both the potential for a long-term relationship with a financial institution and one-stop convenience.

Alternatives has developed a model strategy that identifies those credit union products and services that can meet customers' needs as they progress through four financial stages as transactors, savers, borrowers and owners. The three CDCU grantees in this group cited numerous examples of individuals who used various services at the credit union, depending on their various financial "stages" or demands. In fact, when a FIELD consultant visited six of the VDCU small business department customers, all had gone to the credit union for a business loan because they had opened their personal checking and savings accounts there years earlier. They saw the credit union as the bank that served and cared about their community. In the predominantly immigrant community served by Neighborhood Trust, the credit union often is the first place their microenterprise clients have ever opened a savings account. While obviously more limited, even a business-oriented loan fund like NEEF, offering loans up to $100,000, cites the advantage of being able to retain customers who outgrow the capacity of a microloan fund.

Gaining financial sustainability

MicroTest data in Table 2 show that the multi-service CDFIs have very cost-efficient lending operations, compared to the MicroTest group as a whole and to microenterprise loan funds in MicroTest. The multi-service CDFIs reporting to MicroTest – most of which focus on retail lending – spent almost one-fourth of what all MicroTest participants averaged in maintaining their microenterprise portfolios, and less than half the average amount spent by microloan funds. The multi-service CDFIs are more cost-efficient in part because of larger average loan sizes, which allow them to accumulate larger portfolios at less cost than the microloan funds. Between their cost-efficient operations and larger portfolios, the microloan programs within multi-service CDFIs also cover more of their operational costs than other programs (48 percent, compared to 27 percent for all programs and 31 percent for microloan funds). With rates of return on their microfinance portfolio averaging almost one percentage point less than the rate of return for microloan funds, multi-service CDFIs cover more of their microfinance costs, despite charging lower interest and fees to their customers. Both because the microlending operations in multi-service CDFIs are more self-sufficient, and because they can cross-subsidize their microenterprise programs from more profitable programs, microenterprise programs within these institutions rely 17 to 21 percent less on external funding than other types of microenterprise programs represented in MicroTest.

The CDCUs in this group surmise that their cost-efficient lending approach comes from years of experience managing sustainable retail lending operations in low- and moderate-income communities. VDCU, for example, looks to its fully self-sustaining home- and indi-

Table 2: 1999/2000 MicroTest Data on Sustainability

Average annual measure	Multi-Service CDFIs	All Programs	Microloan Funds
Operational cost rate*	**.80 n=6**	**2.95 n=28**	**1.77 n=9**
Operational self-sufficiency**	**48% n=6**	**27% n=33**	**31% n=9**
Average loan size	**$8,837 n=6**	**$6,336 n=28**	**$4,222 n=9**
2000 Microloan rate of return (microloan interest and fees/avg. loans outstanding)	**14.4% n=5**	**13% n=24**	**15.2% n=9**
Percent of microenterprise program's net income from non-program funding	**68% n=6**	**86% n=38**	**82% n=9**

*Microcredit program's operational costs divided by the average loan portfolio for the year. The cost of managing $1 in a microloan portfolio.
**Income from the microloan fund divided by the microcredit program's operational costs.

vidual consumer-lending operations to plan the trajectory of its nascent small-business lending. The small business department has adopted the institution's counseling-based lending methodology, whereby a loan officer assesses the credit-readiness of each customer and develops an individualized work plan identifying the steps needed to qualify for a loan. The business loan officer refers anyone with personal credit problems to VDCU's counselors/lenders in the individual development loan department. Individuals with intensive business technical assistance or training needs are referred to other service providers. The business loan officer stays in touch with all potential credit applicants referred for additional counseling services. VDCU has determined that, given its cost structure, an $800,000 portfolio with a 5 percent spread can support the cost of one loan officer and the necessary ancillary services.[2] VDCU also has found that both the scale and cost-efficiency of distinct loan departments typically accelerate dramatically after a slow one- to two-year start-up stage.

Microenterprise programs within multi-service CDFIs also can tap into the resources of their larger institutions to help promote their financial sustainability. These larger institutions, for example, share their overhead or administrative costs with several programs or departments. They also can rely on subsidizing microenterprise programs from more profitable operations or departments. NEEF added the Enterprise Loan Fund with the specific intent of subsidizing microlending operations, in addition to capturing a larger portion of the small business market. While most CDCUs expect each lending department eventually to be financially self-sufficient, these institutions can help cover temporary shortfalls by shifting funds generated by larger-scale and more established departments.

While many CDFIs rely on partnerships to avoid the cost of offering training and intensive technical assistance, some have begun to experiment with developing more sustainable training operations. The president of NEEF, for example, believes its highly respected training curriculum could be a source of earned income if sold to other service providers in the state and nation. To generate additional demand for its training within Minnesota and Wisconsin,

[2] A spread is the difference between the rate earned on money lent by the credit union/loan fund/bank and its costs of funds (the interest rate they paid for the money).

NEEF has explored strategies for certifying its curriculum both for community college accreditation and for state continuing education requirements for licensing businesses, such as building contractors. While still far from paying for itself, in 2000 NEEF's training generated income to cover seven percent of training costs, more than double the MicroTest group's average training cost recovery of three percent.

Managing microlending risk

MicroTest data also suggest that multi-service CDFIs are skilled managers of risk in microlending. Table 3 shows that, while the multi-service CDFIs reporting to MicroTest have comparable, if not better, end-of-year portfolio at risk and restructured loan rates, their loan loss rates have been lower than both those in microloan funds and those in the MicroTest group as a whole. The lower loan loss rates among these multi-service CDFIs suggest that they ultimately control the risk in their microloan portfolios more effectively than other organizations. Interestingly, they show lower loss rates, despite having a significantly higher proportion of their microloan portfolios invested in start-up businesses, compared to microloan funds. Since the microloan operations in many of these multi-service CDFIs are relatively young, continued monitoring of these institutions will be necessary to determine whether they can maintain lower than average loss rates.

The experience of the three CDCUs in this grantee group indicates that providing multiple financial services to customers can help with risk management. Many of VDCU's business customers, for example, have held bank accounts at the credit union for several years, and some have previously borrowed money from either the home- or consumer-loan departments. Small business department staff can draw on the business loan applicant's history with the institution to help inform lending decisions. VDCU also has developed a product to help establish the financial responsibility of individuals with no history at the credit union and/or bad credit histories elsewhere. This "tracker loan" is a small loan deposited into an account at the credit union. The customer pays the loan back in regular increments and can withdraw the amount of the loan from the account when it is fully repaid. The "tracker loan," which is essentially a service to help customers set aside a consistent amount of savings, allows the credit union both to keep potential business loan customers in the credit pipeline and to gauge their capacity to use credit responsibly.

All of the grantees in this group see quality training and/or technical assistance as a means for managing risk in their portfolios, as well.

Table 3: 1999/2000 MicroTest Data on Risk Management

Average annual measure	Multi-Service CDFIs n=6	All Programs n=26	Microloan Funds n=9
Loan loss rate	**4.6%**	**5.0%**	**6.6%**
Portfolio at risk	**14%**	**17%**	**10%**
Restructured loan rate	**6%**	**11%**	**8%**
Percentage of portfolio lent to start-up businesses	**37%**	**37%**	**26%**

The technical assistance provided in-house by VDCU focuses specifically on credit repair and responsible credit management. At the other three organizations, credit management is a component of the training programs offered. CWCID offers business training partly because it feels a business owner educated about the importance of establishing good credit will prove to be a more responsible credit union borrower. The education coordinator at CWCID also believes training can serve to mitigate lending risk by allowing the institution to get to know potential borrowers who have been through the training. He notes that business owners who stay committed to their training courses often prove to be responsible borrowers, as well. The director of Alternative's CEO microenterprise training program also emphasizes that convincing some clients they are not yet ready for credit is as much a successful outcome of their training as helping others qualify for credit union loans.

Providing high-quality training and technical assistance

Grantees felt that, as financial institutions, they were offering high-quality business training and technical assistance to clients because their counseling and education could have direct financial implications. Business counselors and trainers are motivated to prepare clients to manage sound businesses that could make them long-term financial services clients. Those financial institutions offering larger-scale business financing, in addition to microcredit, may be especially motivated to provide quality business management services. The president of NEEF, which in its early years focused more on training than finance, claims the quality of its training improved as it increased its lending focus and began to prepare customers to handle greater amounts of credit.

The quality of a financial institution's training and technical assistance may be further enhanced by its concern about the financial sustainability of its services. All three of the multi-service CDFIs offering business training courses charge fees for classes based on a sliding income scale. While none draw enough income from these fees to cover a significant portion of the training costs, they see the fees as a means of ensuring a degree of accountability from both trainers and clients. When customers pay for the class, trainers must provide a service customers believe is worth the tuition. They are also more likely to be committed to attending and completing the course. NEEF's strategy to generate income by selling its training curriculum to other service providers also demands high-quality training curriculum and service that others will pay for. While MicroTest data is very limited in terms of measuring the quality of training services, the data in Table 4 show that the training and business plan completion rates for the three multi-service CDFIs with training programs (only two include the completion of a business plan in their curriculum) are higher than the MicroTest group as a whole.

Potentially reaching low-income clients

At first glance, MicroTest data, shown in Table 5, suggest that multi-service CDFIs do

TABLE 4: 1999/2000 MICROTEST DATA ON TRAINING

Average annual measure	Multi-Service CDFIs	All Programs	Microloan Funds
Training completion rate	**84% n=3**	**78% n=25**	**81% n=4**
Business plan completion rate	**82% n=2**	**66% n=21**	**88% n=2**

not have a comparative advantage in reaching low-income clients within the microenterprise field. On average, multi-service CDFIs reporting to MicroTest serve a smaller proportion of low-income clients than other MicroTest participants, no matter which measure of low-income is used. A closer look at the three grantees in this group with in-house training programs, however, indicates that some multi-service CDFIs are reaching low-income and very low-income populations in proportions comparable to, if not higher than, the averages for all the microenterprise programs in MicroTest.

Interestingly, none of the three grantees with in-house training programs felt their training clients had different income profiles than their financing clients. It does not appear, therefore, that the income levels of customers are necessarily related to the CDFI's strategy or services offered. Instead, CDFIs with training programs may have different marketing strategies than those that do not. Alternatives' CEO program, for example, was originally housed within the Ithaca Urban Renewal Agency with Community Development Block Grant funding that required the program to serve only clients with incomes at or below 80 percent of median area income. Once Alternatives took over the program in 1998, CEO began to serve a wider market, but its marketing channels targeting low-income clients were already well established. If marketing rather than program strategy is the more important factor in determining whether an organization serves a higher proportion of low-income clients, then multi-service CDFIs without training programs potentially could provide their services to a much greater proportion of low-income microentrepreneurs.

Accessing sophisticated information systems

Multi-service CDFIs, particularly regulated depository institutions such as CDCUs, tend to have sophisticated Management Information Systems (MIS) for their financing operations. These institutions invest significantly more money than microloan funds in MIS, both because they have more complicated needs and because they have the resources. VDCU, for example, with 2001 budgeted operating expenses of $1.5 million, is preparing to make a $250,000 capital investment in MIS. A typical microloan fund is more likely to spend between $5,000 and $20,000 on MIS. As one component of their total portfolio, the microlending operations of credit unions can rely on the institution's sophisticated systems for tracking portfolio data. Unfortunately, MIS capacity within credit unions is primarily designed to meet regulatory requirements and does not often include systems for tracking baseline or longitudinal data on the socio-economic characteristics of customers. Staff in these microlending programs also finds it difficult to dedicate enough time to learning how to use their information systems most effectively.

Table 5: 1999/2000 Average Annual MicroTest Data on Client Incomes

Percentage of clients at or below:	All Programs n=36	Microloan Funds n=9	Multi-Service CDFIs n=6	CDFI Grantees with Training Programs n=3
100% HHS poverty guidelines	**28%**	**24%**	**19%**	**27%**
150% HHS poverty guidelines	**40%**	**37%**	**33%**	**43%**
80% Median area income	**60%**	**64%**	**55%**	**63%**

Challenges of Multi-Service CDFIs

The following challenges emerged:

Balancing training and financial sustainability

The four grantees felt that the quality and scale of their microloan portfolios depended on the availability of strong training and technical assistance resources for their microentrepreneur customers or potential customers. Intensive training and technical assistance, however, can be a major expense typically requiring external funding. Despite efforts by such CDFIs as NEEF to gain some income from its training and technical assistance programs, on average multi-service CDFIs in the MicroTest group are not any more efficient at covering non-lending related costs than other organizations in the field. Training, which for regulated institutions is often located fiscally outside of the regulated institutional structure, remains a highly subsidized activity. While on average microenterprise programs in multi-service CDFIs still cover more of their costs than the average microloan fund, as shown in Table 6, the cost of training programs compromises the significant advantage they have in covering the costs of their microfinance operations, shown earlier in Table 2.

When possible, finance-oriented institutions partner with local training or technical assistance providers to avoid the expense of operating such programs. VDCU, for example, will provide credit-repair assistance to microcredit applicants, but refers customers with other business management problems to Small Business Development Centers (SBDCs) with which it has forged close working relationships. Alternatives and NTFCU, however, felt their customers did not have access to these services from other local providers, and developed their own educational programs. Both believe their training programs will require grant funding indefinitely. Both also feel that the success of their credit union's microfinance activity depends, at least in part, on the availability of these services. It is unlikely, therefore, that multi-service CDFIs' microfinance operations could continue to serve high-risk groups at the same capacity, should funding for training and technical assistance dwindle. Even NEEF's efforts to help cover the cost of training by selling its curriculum would be compromised if other service providers could not afford to buy NEEF's product. Currently, however, none of the grantees feel they would have any difficulty raising outside funding for their training programs.

Scaling up

Multi-service CDFIs should be positioned to reach greater numbers of microentrepreneurs than stand-alone institutions because they can tap into the resources and established market presence of the larger financial institution. Because of the relatively recent entry of CDCUs into microfinance, however, it is still too early to determine whether their potential for greater

Table 6: 1999/2000 MicroTest Data on Training Cost Recovery

Average annual measure	Multi-Service CDFIs	All Programs	Microloan Funds
Training program cost recovery	**2% n=5**	**2% n=35**	**3% n=7**
Program-related income as percent of total operating costs	**28% n=6**	**15% n=38**	**22% n=9**

scale will be realized. Table 7 shows that for 1999 and 2000 the typical multi-service CDFI reporting to MicroTest, while comparable in reach to the typical MicroTest participant, made fewer loans and served fewer clients on an annual basis than the median microloan fund. The relatively small scale of microenterprise programs in multi-service CDFIs is likely a function of their youth. Table 7 shows that two-thirds of the microenterprise programs in multi-service CDFIs were less than six years old, as compared to one-third of microloan funds. The three CDCU microenterprise programs in this group were less than three years old when they reported 1999 data to MicroTest, and they are pioneering the CDCU industry's involvement in the microenterprise field.[3]

All of the grantees in this group are prepared to face the challenge of increasing the scale of their microenterprise activity. Before hiring a full-time business loan officer in September 2000, VDCU marketed its business lending only passively within its host city of Burlington. The business loan officer has been marketing the program throughout the state for roughly a year, and the department planned to add an additional loan officer in Rutland by September 2001 to concentrate on southern Vermont. Alternatives' CEO program served only Tompkins County, where Ithaca is located, until last year when it expanded to a neighboring county. NTFCU established its second branch in Upper Manhattan only last year and CWCID has not yet begun to market its microenterprise training program in that area. Even as the older institution in this group, NEEF, which served 330 clients in 2000, has plans to step up operations through an expansion in 2001 to northwestern Wisconsin and by marketing and providing services through the Internet.

The grantees felt that only a few obstacles might slow their future growth. The primary challenges they identified were the need for additional office space, and the ability to attract skilled staff. Some felt the high cost of training could preclude significant growth in their training activities. For credit unions, the concerns of regulatory agencies about the risk of small business lending also could slow growth in their microfinance activity.

Integrating microenterprise services into the larger institution

The larger of these multi-service institutions find that full integration of the microenterprise program into the larger institution can be challenging. At Alternatives, a CDCU with a $3.5 million budget and 33 staff members, credit union staff without direct links to the CEO program may not know what the program does. Subsequently, while CEO often refers training customers to the credit union's financial services, credit union staff does not always inform cus-

Table 7: 1999/2000 MicroTest Data on Scale

Median annual measure	Multi-Service CDFIs	All Programs	Microloan Funds
Number of clients	236 n=6	237 n=38	343 n=9
Number of loans disbursed	43 n=6	30 n=29	131 n=9
Percent of programs less than 6 years old (2000)	67% n=6	29% n=38	33% n=9

3 The City of Ithaca founded the CEO program in 1995, but the program did not move to Alternatives until 1998

tomers about the availability of microenterprise services through CEO. CWCID had the same difficulty marketing its educational program through Neighborhood Trust. VDCU staff members feel their relatively small group, compressed into extremely tight office space, is aware of the various services offered at the credit union. However, they foresee new integration challenges as they offer more small business services in southern Vermont through an off-site loan officer. Even NEEF, with all staff dedicated to business development, has had to make concerted efforts to ensure that everyone feels s/he is working together to promote both good business management among customers and increased lending volume for the organization.

Retaining and attracting skilled staff

Like most nonprofits, multi-service CDFIs face the challenge of attracting and retaining staff willing to work for less pay than they would in the for-profit sector. The fact that most positions in multi-service CDFIs require relatively sophisticated financial skills compounds the problem as the disparity between salaries in the for-profit and non-profit financial sectors is vast. Located in the competitive labor market of New York City, CWCID and Neighborhood Trust have faced significant staff turnover as their often young, inexperienced staff move on to better paying jobs once they have acquired valuable skills at the credit union or as business trainers. Even in the less competitive markets of Burlington, Vermont and Ithaca, New York, both VDCU and Alternatives have experienced turnover and/or difficulty hiring new staff, both for entry- and senior-level positions. Only NEEF in rural Minnesota reports that it is seen locally as a comparably stable and well-paying employer, with an organizational commitment to paying near-market salaries to attract and retain experienced staff.

Facing regulatory scrutiny

While non-depository loan funds are not regulated, CDCUs and community development banks are examined annually by the same regulatory agencies that examine conventional financial institutions. On the one hand, this regulatory oversight helps ensure that CDCUs and Community Development Banks are responsibly managed and, therefore, helps them attract investments and deposits from individuals and institutions with low-risk tolerance. On the other hand, the regulatory agencies apply traditional financial-industry standards to organizations operating within environments largely abandoned by the traditional financial industry. CDFIs, by definition, work in communities that the for-profit sector has deemed too costly to serve. They are, therefore, largely doomed to appear risky or costly, according to conventional industry standards.

Regulator concerns about the risk and high cost of community development financial operations curtail their capacity to launch innovative strategies to serve low-income communities. The CDCU's very entry into the microenterprise sector has been limited by regulators because loans to microenterprises, which many CDCUs traditionally have made as individual consumer loans, are scrutinized with the tougher standards applied to business loans.

Regulators also raise concerns about the sustainability of any grant-funded activity, such as training or intensive technical assistance. The CEO program director at Alternatives reports that its regulators annually pose questions regarding the need to raise grant funds for the training program. Indeed, multi-service CDFIs often develop complex structures and accounting procedures to satisfy regulatory requirements. Nearly all CDCUs are closely connected to one or several 501(c)3 organizations. These nonprofit organizations take on grant-funded activities, such as providing educational services or piloting new programs, and even house loan funds for lending activity perceived to be too risky for the credit union.

Grantee Recommendations

Commit to cross-selling services

Retail-oriented multi-service CDFIs have great potential for enhancing the impact and scale of their microenterprise services because both the microenterprise program and its cus-

tomers can access the resources of the larger institution. To reap these benefits, however, staff within these institutions must be sufficiently apprised of the availability and characteristics of the various services offered. To maximize the comparative advantage of these larger institutions, senior staff must commit to a strategic goal of cross-marketing services offered at the CDFI. VDCU, the only credit union in the group that did not report significant challenges in integrating its microenterprise work into the credit union as a whole, has made an institutional commitment to cross-selling the credit union's services. Cross-selling services requires concerted efforts to educate all staff, in particular front-line staff, such as loan officers and tellers, about the programs and products offered at the institution. To that end, VDCU closes its offices one work day a year for a staff retreat, and one afternoon a month for on-going staff training. These required sessions are specifically designed to keep staff apprised of changes in and additions to the services offered at the credit union.

Regularly assess the low-income market

On average, multi-service CDFIs in the MicroTest group are serving significantly smaller proportions of low-income clients among their microenterprise customers than other types of institutions. There are a few institutions, however, that are serving well above the field average of low-income clients, suggesting that higher incomes are not an inherent characteristic of the customer base of larger scale CDFIs. Given the diversity of the markets served, staff of each CDFI should determine whether the needs of low-income microentrepreneurs in their market areas are being served. By making concerted efforts to market to very low-income, self-employed individuals, some institutions may discover an as yet untapped market for their services.

Build partnerships with trainers and TA providers

Because of the high cost typically associated with providing training and intensive technical assistance to microentrepreneurs, most financial institutions would be best served, in terms of financial sustainability, to seek local partners to provide these services. If quality training or technical assistance providers exist locally, microlending staff at the financial institution should have regular contact with staff at these organizations to forge a lasting partnership. Regular contact between loan officers and the other organization's front-line staff about individual prospective credit applicants keeps these individuals in the financial institution's pipeline and allows each partner organization to offer its customers comprehensive service. This strategy is the basis for VDCU's counseling based lending methodology, whereby all prospective customers are tracked as qualified, near qualified or long-term qualified. VDCU's small business loan officer has built strong working relationships with local technical assistance providers to work with near- and long-term qualified applicants.

For CDFIs with in-house training, explore income-generating opportunities

Those institutions that start in-house training programs should carefully assess the cost-benefit of the program for the financial institution. Do both the scale and quality of the microfinance activity within the institution rely on the availability of training to prepare prospective clients to manage credit responsibly? Do graduates of the training program, in fact, use the financial services offered at the institution?

If the institution determines that in-house training is worth the cost, it should then explore opportunities to generate income with these services. While CWCID, Alternatives and NEEF do not expect their training programs to be self-sustaining, each organization charges fees for the training offered on a sliding-income scale. None of the organizations have encountered criticism from customers about the fees. In order to help lower-income customers pay for training, NEEF encourages them to seek tuition reimbursement from workforce centers, Temporary Assistance for Needy Families and a local foundation.

This *FIELD forum* is the third of three that offers an in-depth look at the advantages and disadvantages associated with operating microenterprise programs in various institutional settings.

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Even though many CDCUs have been making microenterprise-like loans within their individual consumer-lending operations for years, only recently have they begun to differentiate these loans as credit used for business purposes. For regulators, therefore, microenterprise lending activity is uncharted and risky territory to be avoided. The regulated community development financial industry and individual institutions must carefully document the performance of their microfinance activities to educate regulators about the true risk involved. Indeed, sound business practice would dictate careful assessment of the risk involved with various types of credit activity in any financial institution, regulated or not. Regulated institutions simply have more to gain, in terms of more liberal access to new markets, if they can show regulators an established track record of responsible risk management of their microenterprise portfolios. By now, enough regulated institutions have negotiated their way into microfinance territory to begin to establish this track record. As part of this evaluation and documentation process, CDFIs involved in microfinance should determine the factors that appear to be associated with risk in their microloan portfolios, and link their reserve levels to the risk factor profile of their portfolio at any given time. Experience with this kind of evaluation will help the entire microfinance field establish responsible risk-management practices.

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