PROCEEDINGS

THE WOODSTOCK INSTITUTE SYMPOSIUM ON INCREASING ACCESS TO FINANCING FOR RURAL SMALL BUSINESSES

Edited By

Jane Rosser

October 25-27, 1988

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The Woodstock Institute

The Woodstock Institute is a not-for-profit organization based in Chicago. For the past sixteen years, the Institute has carried out applied research and developed and implemented programs which increase private sector investment in modest-income and minority communities for the benefit of those who live there. It designs programs which bridge the gap between the needs of communities and the resources of banks, savings and loan associations, foundations and others.

The Institute provides a variety of services to community-based organizations, financial institutions, foundations and government agencies, including applied research, policy analysis, program design and evaluation.

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INTRODUCTION

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For the past fifteen years, the Woodstock Institute has worked to promote reinvestment in distressed urban and rural communities to support the goals of affordable housing and job retention and creation. As part of this work, the Institute was funded by the Ford Foundation to hold a symposium in October, 1988, to examine strategies and policies that address the financing needs of rural small businesses. The symposium was designed to bring together a small but diverse group of participants. The majority of participants represented alternative capital and credit providers or institutions which focus on policy or program initiatives that increase access to financing in rural areas. Other participants represented institutions which concentrate on technical assistance, academic research, advocacy/organizing or linkages with traditional financial institutions.

The agenda was structured to encourage open and active discussion. Formal presentations were limited so that participants could examine, through a series of discussions, strategies, tools and mechanisms that address the unmet capital and credit needs of rural small businesses. From the discussion, major issues became apparent and common themes began to emerge. These included:

* **Sustainability, Scale and Wide-Spread Impact**

  Many participants are facing issues of sustainability, scale and wide-spread impact. Attempts are being made to achieve these while still providing critical and innovative services to their constituents.

* **Profitable Loans Versus Riskier Loans**

  Participants realize there will always be tension between the need to make profitable loans to achieve sustainability and the need to make riskier loans to achieve social goals.

* **Need for Capital and Credit**

  Most participants agreed that there will be a permanent need for alternative capital and credit providers. These intermediaries will evolve, however, and those that are not effective will drop off.

* **Isolation and Need for Information**

  Despite the similarity of issues, most alternative capital and credit providers remain isolated from each

other. There is a lack of documentation on alternative capital and credit providers, community financing needs, and the impact of policies or programs on financing of rural small businesses.

* **Undeveloped Capacity of Rural Banks**

  Small rural banks often lack the capacity to understand commercial lending to small businesses. Since this lack of understanding results in profitable loans not being made, many alternative capital and credit providers both broker loans and educate bankers.

* **Emerging New Strategies**

  There are a range of strategies for assisting small businesses to gain greater access to capital. They include: establishing linked deposit programs for state funds as a reward for risk taking or development lending; creating a secondary market for small business or development loans; expanding risk pooling funds; enhancing the risk taking authority of banks and other institutions; endowing rural CDCs or venture funds; promoting policies which allow federal deposit insurance on amounts over $100,000 for development banks and credit unions.

Details of the discussion concerning these issues are contained in the proceedings. The proceedings have been prepared based on notes taken of the discussions. The intent is to present the major discussions and the various viewpoints expressed by the participants. Since the proceedings are based on notes and not on tapes, we hope that the participants will forgive any inaccuracies.

TUESDAY, OCTOBER 25

I. INTRODUCTORY REMARKS

PROCEEDINGS

TUESDAY, OCTOBER 25

I. INTRODUCTORY REMARKS

Presenter: Jean Pogge
Woodstock Institute

The idea for this symposium first surfaced several years ago as the Institute began to work on the development of a working proposal for commercial loan disclosure. The experience with lending disclosure as a tool for leveraging better access to credit and particularly housing credit has been very good. The Home Mortgage Disclosure Act has provided urban communities with the data they need to sit down with lenders with a shared understanding of lending patterns. However, this data base is incomplete for two reasons: it does not provide information on commercial lending, and it does not provide detailed data for nonmetropolitan areas. As the Institute worked to develop a working proposal for possible commercial loan disclosure it became increasingly clear that rural practitioners had much to add to the discussion of the usefulness of loan disclosure in their work and to the details of what should be included in a proposal. The idea of a symposium to facilitate that discussion emerged.

Over the past year in discussion with you and others working on rural issues, it became clear that there are problems with access to credit for small business financing in rural areas. From these discussions we concluded that while a discussion of commercial loan disclosure data would be helpful, there is a need to think collectively about a broad range of policy options that could support ongoing work as well as new initiatives to remove barriers to credit for small business in rural areas. In response, a range of strategies, many of which are represented by the work of people here tonight, have emerged to open access to financing for rural small businesses. Although many of these strategies are new, there are now organizations with multi-year track records.

What we hope to do in the next day and a half is look at the role of traditional and alternative credit providers within the context of the importance of developing financing strategies that emphasize and meet the needs of specific communities and srengthen community institutions. There is something special about rural life that is important not only to those that live in

rural areas but also to those of us that live in urban areas. The interdependence of these worlds compels us to share experiences and successes while addressing similar problems.

For many reasons, this symposium is very timely. Much good work is being done across the country but in many cases people feel isolated from the work of others. As we approach the election, it is clear no matter who wins, we will continue to find federal resources very scarce. The time has never been better to learn from the work of others and to develop and maintain communication between ourselves.

WEDNESDAY, OCTOBER 26

I. ADDRESSING THE BARRIERS

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I. ADDRESSING THE BARRIERS

A. An Overview

Presenter: **Jean Pogge**
Woodstock Institute

In the last decade we have witnessed changes in the American economy that are more fundamental than any other period since the Great Depression. There has been a major restructuring in basic manufacturing causing tremendous shifts in the location and type of jobs available to workers; the agricultural sector has suffered from poorly designed federal interference, drought and a serious credit crisis; and the banking business, once composed almost exclusively of staid intermediaries between savers and borrowers has experienced changes in technology and in banking law and its interpretation that have had a major impact on the way that banking is done and on who provides banking services.

The impact of these changes in rural areas has been profound. Thousands of family farmers have lost their land due to foreclosure and those that still farm often must supplement farm income with one or more jobs. The migration from rural areas to cities and towns that followed previous downturns in rural conditions continues but the new arrivals find cities with high unemployment rates and few jobs to offer those without professional skills. Finally, those willing to take the risk to start new businesses in rural areas find historically conservative bankers still smarting from agricultural loan losses. These bankers not only are extremely risk averse but also have little or no understanding of how to lend to businesses or entrepreneurs.

Several years ago, Woodstock Institute began to look at rural credit issues with a basic misconception. That is, that there were vast differences between urban and rural credit needs and in the response of lenders to those needs. In fact, as we have gained an understanding of rural credit needs, we have found that there are many more similarities than differences.

Like their urban counterparts, rural residents find it impossible to maintain a healthy local economy without private sector investment. Access to capital and credit is critical for the development of new businesses that offer the kind of jobs that pay enough to support a family. The specifics of those

business opportunities vary from community to community and region to region but access to credit is a critical ingredient to success.

Yet the kind of capital and credit needed is that which is most difficult to secure. New businesses are risky, and there is some question whether it is prudent for commercial banks to provide startup financing. Small loans do provide a smaller return for the time invested by the lender. Regulators have become tougher on loan portfolio evaluations. Many bankers do not have the skills it takes to properly underwrite a commercial loan, and we all know bankers are the last people to ask for help.

At the same time as it has become more important to increase access to financing for rural small businesses, the fundamental changes in the banking business have begun to impact rural communities. When we visited southwestern Minnesota this summer, we found that the R.D Jones Investment Firm was going town by town soliciting deposits. Flyers were being left on the front door knob of every house which advertised higher interest rates than local banks for FDIC insured deposits. The local bankers we talked with were worried about the effect of this competition on their cost of funds and even the amount of deposits that might leave and never come back.

Yet, big banks are not interested in the loan business in rural areas. The bankers we talked to in Texas also voiced concern about the cost of deposits. But when we asked bankers in the Rio Grande Valley if the Dallas banks were competing for local commercial loans, one banker put it very clearly when he said, "There are maybe three or four businesses in the Valley with annual sales over $5 million--so Dallas banks don't bother."

The new players in the banking business are also having an impact. The Land Stewardship Project reports that in 1987, 12 major insurance companies owned 5.2 million acres of farmland, up from 4.1 million acres in 1986. This is more than the Farm Credit system and the Farmers Home Administration combined, and the land was, for the most part, acquired through foreclosures.

It is true that the new banking business offers new products and services and has the potential to move capital across state and regional boundaries to respond to credit needs. But in fact, what good is a $100,000 line of credit to a business that needs only $25,000? What good are credit products that are available only when the borrower must pledge personal collateral that far exceeds the degree of risk in the deal? What good does it do for a borrower to deal with a banker that does not understand his business or his credit needs? Over and over again we have heard from small business owners both in cities and in rural areas that the banker does not understand his business. A recent article in

the American Banker illustrated just how damaging this miscommunication can be for both the lender and the borrower.

A dairy farmer borrowed $100,000 and pledged his herd of dairy cattle as collateral. He fell behind on his payments, the bank foreclosed. Being an honest man, he found a buyer for the herd who offered $89,000. The bank refused to let him sell the herd. So after a frustrating attempt to convince the banker that this was a good deal, he herded the cows into town and turned them over to the banker. The banker did not like it and punched him in the nose. Well, the bank sold the dairy cows for $42,000. The borrower sued and the court awarded him $200,000 for interference in his business, lost equity in the herd and aggravated battery.

Over the last five or six years, a range of strategies that address barriers to capital and credit in rural communities has been developing. Communities have organized to fight foreclosures and in some cases to use the Community Reinvestment Act to challenge bank mergers and acquisitions. Alternative capital and credit providers have been developed that either substitute for or supplement traditional lending sources. New ways to change the lending practices of rural banks have been adopted. Research on capital and credit needs in rural areas has been done. While there are yet no definitive answers, the questions have become clearer and the need for more information is evident.

When community financial institutions disappear, either through bank acquisitions or bankruptcies, the community fabric is torn. One of the strategies that has emerged as a response to the need for access to affordable capital and credit are alternative capital and credit providers. These include credit unions, venture capital pools, revolving loan funds and other creative financing intermediaries.

In addition to these strategies, the numerous CRA challenges filed in the last five years have made bankers more aware than ever before of the need to at least pay lip service to community reinvestment. The Senate Banking Committee hearings in April on the effectiveness of the regulators in enforcing CRA has produced a renewed enforcement effort. Bankers from all over the country have begun asking: How do we find poor people? What is our CRA responsibility?

It is now appropriate to ask ourselves the tough questions about alternative financial institutions:

* What is the role of alternative financial intermediaries and strategies in financing rural small businesses?

* How can and do they effect institutional change?

* What is the role of banks in financing rural small businesses?

* How can both traditional lenders and alternative financial intermediaries strengthen and build communities while remaining accountable to the diversity and uniqueness of communities?

* Is it time to begin to move towards a dual public policy that not only requires financial institutions to be accountable for meeting the credit needs of their local communities but also supports a new generation of community development financial institutions?

* If so, what are the support mechanisms needed to enable those institutions to survive in today's competitive environment?

* Is it naive to determine that just as we needed to create the S&L industry in the 1930s to ensure that long-term mortgage money would be available for home ownership, we now need to create community development financial institutions to ensure that affordable, accessible credit is available to local communities?

B. An Overview

Presenter: **Deborah Markley**
University of Massachusetts

What do we Know About Barriers to Financing Rural Small Businesses?

We know that small businesses are critical for rural economic development; that they are important sources of jobs and economic growth in rural areas. We know that equity capital for these small rural enterprises is generally limited. We don't really know yet whether changing financial markets in rural areas (more large banks, less local control, expanded thrift role, increased competition,) that result from deregulation bring net benefits or costs for small rural businesses or whether there is even a definitive, general answer to that query. We do know that rural capital markets, particularly in terms of capital for small businesses, are composed of more than banks. We have primarily looked at regulated institutions because we have the greatest leverage with them. We need to, however, also look at public, private and combination programs.

Where Does This Leave Us?

We still need to identify rural capital gaps, particularly for other than equity capital. We need to evaluate which public, private or nonprofit programs are addressing these important capital gaps. We need to identify the most effective programs--those that increase availability rather than simply lower the price of capital. We need to evaluate the options for getting capital into the hands of small businesses. We need to identify what more banks and other regulated financial institutions can and should be doing. What are their limits? How far can we stretch those limits? We need to examine the regulatory role. Can we make banks do more within their existing powers (CRA)? Should we increase their powers to permit them to take on moderately risky portfolios? Stretching the limits of banks will help clarify gaps. Regulatory change, however, affects only those institutions that are regulated, not other capital providers.

What Recommendations Can be Made?

From the academic perspective, there are still many unanswered questions in terms of what are the rural credit gaps and what are the most effective ways to intervene in the market to increase capital supply to rural small businesses. This means that we must continue research to try to evaluate the situation, particularly regulatory change. It requires more research effort across more states and more information about rural capital markets.

From the activist perspective, we should assume there's a gap of some sort and proceed with programs to assist businesses to gain greater access to capital. These would include:

* public programs; states should do more to leverage funds from the private sector (financial institutions and non profits); examples are:
  - establishing programs for linked deposit state funds as a reward for risk taking or development lending (not just cheaper capital);
  - endowing rural CDCs or venture funds;
  - creating a secondary market for small business or development loans (is this feasible?);
  - expanding risk pooling funds such as the Michigan Strategic Fund;
* regulatory change; examples are:

- enhancing the risk taking authority of banks and other institutions;

- linking reform with information to help achieve monitoring;

* technical assistance; we need more than capital--we need to get out to rural entrepreneurs and help turn entrepreneurial ideas into bankable deals; the banking community won't take good ideas and package them; we need intermediaries; we also need to clarify how we can increase the capacity of rural bankers to do more business lending; maybe this is as much of an issue as assistance to businesses.

What Are the General Perceptions Based On My Recent Limited Field Research?

The research consists of looking at banking in four rural New England states. In order to clarify small business credit needs, we're asking small businesses their impression of changes in the financial markets. We're also doing a survey of lenders to identify their commercial lending policies. We're doing the survey with the small rural banks and not at headquarters. The results, which are still very preliminary, indicate that:

* there are credit gaps; CDCs, new banks and independent banks are all trying to address specific credit needs; these needs are mainly for small business loans in the range of $10,000 to $50,000;

* changing markets have created room for new players;

* competition, even in remote rural areas, is much greater for commercial loans; the question is whether this translates into economic development via new loans or whether the pie is just being cut differently; it is still unclear what the real impact is or will be;

* an awful lot depends on the skill and initiative of individual bankers; they should be competent and aggressive not passive and inexperienced; these characteristics don't change based on the structure of the bank above them; in addition, even with bank mergers, personnel seem to remain;

* the role of CDCs is increasing because loan officers don't have the capacity to go out and make the deals; traditionally most have been consumer lenders and even though they are now commercial lenders, they act the same; in general, commercial lending officers at small rural banks don't have a good idea of what they are

doing; it's important for CDCs to continue to intervene between borrowers and lenders perhaps even increasingly so in future;

* much of what we need to know can be obtained only by talking to bankers; this is the only way to really get a handle on identifying gaps; we must also extend our investigation to other credit providers as well for a complete picture.

C. Participant's Comments

The survey tool doesn't identify people who tried to go into business but couldn't get off the ground because of lack of credit. It would be difficult to identify them. CDCs and other intermediaries could possibly do this. What we need to understand is whether there is a viable credit need that's not being met. By viable credit need we mean that the business is capable of repaying the loan and that the bank can make money off the loan. We also need to understand the role of scale, collateral and risk. For instance, is there evidence of pricing for risk?

A lot of small banks make relatively small loans which don't pay for themselves but are to existing customers. In very rural areas there may be many $10,000 loans.

A major problem is that small rural banks may not have the capacity to understand each particular business or commercial lending to the extent that they can realize that it may be a profitable loan. This may result in capital gaps. We should understand that some of these bankers are not trained to be bankers. Bankers are very scared of not knowing the answers and having that become known.

The commercial loan to deposit ratio will probably be higher for a bank that has someone who specifically focuses on commercial lending. Some of the small rural branches have other commercial lending officers to whom they can refer but these are often not that helpful. It might be helpful to have access to commercial lending officers who specialize in a specific commercial sector. Businesses, however, don't recognize the lack of capacity of banks.

CDCs and other intermediaries can reduce the transaction costs for bankers. One participant reported success in working with a commercial loan officer by bringing in independent expertise outside of the bank. As a counter balance, "circuit riders" are brought in to get applicants to the needed level of sophistication.

How can we measure whether this commercial lending which we are "brokering" is having any economic development impact? One approach would be to identify secondary data (employment and income data) and see if there is any relationship with the loans. There need to be clear indicators of the link between the two. It would directly influence commercial lending patterns.

In rural Texas, loan to deposit ratios have plummeted when local banks have been taken over by the big Houston/Dallas banks. Some loan to deposit ratios are as low as 38%. However, it's also an opportunity for the remaining small banks to get into really small loans and for the intermediary to go in there and assist. The threat of lender-liability suits also makes bankers want to come to an intermediary for technical assistance so that they can increase their expertise about a specific sectoral area.

Perhaps a consortium for high risk lending could be a vehicle for offering technical assistance to banks.

One participant reported that their experience has been that bankers don't want assistance in or outside the industry. An intermediary operates outside the bank. Capital is the bait that legitimatizes the bank working with an intermediary and getting increased knowledge about the deal. By bringing money to the deal, the intermediary works on a one to one with the banker. There is a learning curve and some bankers are learning.

The question seems to be whether intermediaries need capital as bait to complement their technical assistance?

Another participant thought this perspective was somewhat askew. The cost of funds to rural banks is low enough. The banks don't need to do commercial lending. They don't see themselves as community institutions. They're content to take the best of the lot. It's not just lack of capacity. It's that they can succeed well enough without risk. All of this, though, is changing now given consolidation. There's even competition for car loans.

We should challenge the idea that banks are interested in economic development. Banking is a profit making but not profit maximizing business. Economic development risks are high. Banks are designed to take deposits and really don't have the flexibility to make commercial loans. They don't want to take risks. It's harder to take risks...you need to work harder.

D. Major Discussion Points

* Small rural banks often don't have the capacity to understand commercial lending to each particular small

* Alternative financial intermediaries serve both an education function by helping familiarize the bank with specific commercial sectors and a brokering function by bringing the loan applicant up to the necessary level of sophistication required by the bank.

* A consortium for high risk lending might be a vehicle for offering technical assistance to banks.

* Alternative financial intermediaries probably need capital as bait to complement their technical assistance. It legitimatizes their role with the bank.

* Banks are not necessarily interested in economic development which can be a high risk endeavor. Banks are profit-making not profit-maximizing.

II. ALTERNATIVE CAPITAL AND CREDIT PROVIDERS

II. ALTERNATIVE CAPITAL AND CREDIT PROVIDERS

Discussion Leaders: **Kate McKee and Martin Eakes**
Center for Community Self-Help

Peggy Clark
The Ford Foundation

Four questions should be posed.

* What are these alternative capital institutions? What defines them? Why have we created them?
* Should they be permanent? Which features should be permanent?
* What are the different strategies for long-term impact?
* How can they survive over time if we feel that some of them should be permanent?

A. Participant's Comments

Question One

What are these institutions? Some of the types of alternative capital institutions are credit unions, development venture capital firms, revolving loan funds, development banks. Credit unions take deposits, often have a movement ideology, are member owned and service oriented. Development banks often provide both technical assistance and credit, have vehicles for both equity and debt financing, and have a target population.

Alternative capital institutions attempt to serve a public purpose as opposed to just a profit making purpose. This effects their goals and how they measure success. They try to fill capital gaps by taking higher risks, offering equity, serving businesses that might only be marginally profitable for a bank, being a catalyst to move people into the main stream. They may also focus on geographic areas and racial groups who have been subject to discrimination. Some alternative financing institutions try to increase productivity for a specific geographic area; others try to increase equity in the distributional sense. The nature of the targeting may effect where an institution comes out on the growth-equity spectrum.

It's important that development finance institutions demonstrate that they can do things in a profitable way in order to break down perceptions.

Question Two

Given the roles and functions of alternative capital institutions, should they be permanent or can some of them wither away? Hopefully, there won't be a permanent relationship with a borrower, but there will always be borrowers. Can we really expect the attitude of bankers to change? There will be a perennial need for some of these alternative institutions. They will, however, evolve, and those that are not as effective will drop off.

It's still a question whether competition will make banks change. Perhaps we should consider the actions of banks more as cultural transactions rather than just financial transactions. We should think whether it's possible to change the culture (values) of banks or any large institution. Since banks have a very protected market perhaps we should determine what is the catastrophe in the banking industry that will force banks to change. Perhaps this is the only way that banks will change.

If you can discover truly profitable markets in neglected areas you can have the appearance of cultural change.

You need to effect the ownership of banks. However, there will still be a tradeoff between development and the business of running a bank. Senior management is committed to development... junior management is committed to order. The sense of desperation of the local economy is a pressure to change. Banks are glad, though, that alternatives exist so that they don't have to do these loans.

Perhaps the banks should be taxed to underwrite the costs of some of these alternatives.

Question Three

Since we agree that there will always be a need for alternative financing institutions, what are the different strategies that can help them achieve long-term impact such as changing poverty levels and increasing empowerment for poorer communities?

Approach one may be to reach a scale of operation which is large and effective enough to achieve economic growth and diversify the local economy. You also need to operate on a larger scale if you're going to take a sectoral approach. Sectoral concentration requires large infusions of capital.

Approach two may be financial advocacy and demonstration. The purpose would be to reform the mainstream, to demonstrate lending and public policy alternatives. The influence of regulatory mechanisms and individual pressure points are included in this approach.

Approach three would be to raise an endowment as a strategy to achieve earnings which could underwrite organizational costs. This buys you a seat at the table.

We also need to plug in the universities as potential allies to increase our chances for achieving long-term impact.

Question Four

Since we feel that some of these alternative institutions should be permanent, how can they survive over time?

The question really is, what type of support system do we need for alternative capital and credit providers?

We need to develop a business strategy. For instance, do we need to create secondary markets? Now that banks are looking for reinvestment opportunities, do we have the experience to bring deals to the banks? In developing a business strategy there will always be a tension between needing to do profitable loans to help achieve sustainability and needing to do riskier loans to achieve our social goals.

We need to reach a scale (size) where we can survive and do advocacy. This probably means some sort of endowment. Some have suggested that the level of scale that the this implies is reaching a net worth of at least $10 million.

It is possible to achieve sustainability with a net worth of about $8.5 million. You can do this if you don't have all the costs associated with traditional institutions and if you can leverage money externally.

We need extra income or resources to support "research and development" work else in order to survive the alternative institutions won't be able to take risks. We also need public sector funds provided to alternative institutions to provide a wedge to get traditional institutions to lend. Public policies should be established to provide low cost capital, tax traditional institutions to subsidize the loans of alternative providers, and provide public deposit subsidies.

B. Major Discussion Points

* Alternative capital providers serve a public purpose as opposed to just a profit making purpose. They take higher risks, offer equity and serve businesses that might only be marginally profitable for a bank. It's important, however, that they operate profitably in order to break down perceptions.

* There will be a permanent need for alternative capital and credit providers. They will evolve, however, and those that are not effective will drop off.

* Long-term impact such as improving poverty levels may be achieved through: attaining a scale of operation which is large and effective enough to achieve economic growth and diversify the economy; financial advocacy and demonstration; and creating sustainable operations by raising an endowment or earnings which underwrite organizational costs.

* Sustainability of alternative capital and credit institutions may necessitate:

  - creating secondary markets for community development loans;

  - providing resources to support riskier loans which should be viewed as "research and development" work;

  - providing public funds to be used as low-cost capital;

  - taxing traditional financial institutions to subsidize the community development loans of alternative providers;

  - providing public deposit subsidies.

* There will always be a tension between the need to make profitable loans to help achieve sustainability and the need to make riskier loans to achieve social goals.

III. COMBINING TRADITIONAL FINANCIAL INSTITUTIONS WITH ALTERNATIVE CAPITAL AND CREDIT PROVIDERS: PROBLEMS AND OPTIONS

III. COMBINING TRADITIONAL FINANCIAL INSTITUTIONS WITH ALTERNATIVE CAPITAL AND CREDIT PROVIDERS: PROBLEMS AND OPTIONS

Presenters/Discussion Leaders: **Ron Grzywinski and Mary Houghton**
Shorebank Corporation

The Southern Development Bancorporation is a for-profit bank holding company established to create jobs and to deliver capital and information services. The following tools have been or will be put in place: a $55 million bank in Arkadelphia, Arkansas; the Opportunity Lands Corporation, a for profit real estate development company; the Arkansas Enterprise Group, a 501(c)(3) nonprofit organization. The Arkansas Enterprise Group will consist of: Southern Ventures, a for-profit small business investment corporation; the Seed Capital Fund which gives small loans in the range of $5,000 to $10,000 to businesses for specific activities such as planning or marketing; the Good Faith Fund which provides short-term loans in the range of $500 to $5,000; and, a management assistance component.

The Good Faith Fund seems to hold the most promise of meeting the needs of ordinary people. It provides an appropriate scale of credit and gives loans for self-employment and for such items as equipment purchases to increase productivity.

The holding company structure adds to the credibility and authority of the Good Faith Fund even though the Fund could have been established separately.

The Good Faith Fund is based on the Grameen Bank model from Bangladesh. People organize themselves into groups of five which is the number that seems to force people to think of themselves as a group.

The groups make decisions concerning the loan presentations but we prefer to keep separate our community work and our management decision-making. We place a high value, though, on being accountable and responsive to the groups.

The reaction of the banking industry to the bank holding company and its subsidiaries is varied. A number of the banks, four to five, won't invest but are very courteous. Other bankers will participate in some of the deals. In terms of long-term impact, this is important. The banking commissioner, probably in response to the Governor's encouragement and enthusiasm, has been very supportive. The reputation of the bank is fine and many of the former staff remain at the bank. Basically, people are curious. The bankers believe it won't work, but we have brought in outside money that wouldn't have been there otherwise.

It's important to have the bank as part of the structure. It raises deposits which can be converted into development credit. It is the engine for development credit.

There are 22 shareholders in the holding company, 50% are from Arkansas and 50% are from outside the state. We asked for equity rather than charitable contributions because we believe in ownership and the responsibility that creates to shareholders. The stock, however, is illiquid. It's been difficult to raise money from private corporations. The funds, perhaps, need to come from public capital, individuals, and foundations. The question seems to be, "How can we capitalize programs of vision and innovation?" Raising capital from corporations is easier if you're located in the same geographic area as the corporation. The solution to raising capital probably has to do with the liquidity of the equity investment. The investor can get out in an orderly way. The exit is more important than the return on the investment.

One of our challenges will be to find out whether the holding company model is working. Someone has been hired to develop an evaluation framework. However, it is not yet clear what is going to be evaluated. Some of the indicators might be number of direct jobs created, dollars of development loans made, number of delinquencies, economic indicators of impact from baseline data. Other indicators could substantiate that people feel that it's a good place to start and expand businesses, that Southern Bancorp's input has normalized market forces, that it has helped with the process of racial change.

A. Major Discussion Points

* The bank holding company model is capital intensive and depends on scale of operation for sustained and widespread impact.

* The model should be studied as to the effect it has on creating institutional change among banks and other local institutions.

* The holding company prefers equity investments rather than charitable contributions because they believe in ownership and the responsibility to shareholders it creates. The stock, however, is illiquid making it difficult to raise capital. Liquidity of stock is probably more important than return on investment.

IV. COMMUNITY PARTICIPATION AND ACCOUNTABILITY: RESPONDING TO THE UNIQUE FINANCING NEEDS OF COMMUNITIES

IV. COMMUNITY PARTICIPATION AND ACCOUNTABILITY: RESPONDING TO THE UNIQUE FINANCING NEEDS OF COMMUNITIES

Presenter/Discussion Leader: David Leckey
Southwest Minnesota Initiative Fund

The Southwest Minnesota Initiative Fund was established to mobilize and channel resources for economic development and human services for citizens of the southwest region of Minnesota. It focuses on improving self-reliance through implementing an economic development revolving loan fund.

The Fund has a twenty member Citizen's Advisory Committee and eight Board Members. They do the preliminary review of all grants and loans. The Board of Directors considers the funds a rallying point for diverse communities.

The Citizen's Advisory Committee is more than just an advisory group. They are all volunteers and very committed. They see the funds as having the potential for making a big impact on the region. They are actually neighbors making decisions on how the money should be used.

The Southwest Minnesota Initiative Fund views its purpose not just in economic terms. It considers all of its loans "good" because the Committee has decided that the loans are needed.

In addition to participation by the Advisory Committee, the Fund always makes loans in participation with local banks (the Fund always takes a second position) and/or community groups. There are even some instances such as Clarkfield Enterprises, where the community itself puts in money. It's not because it was low risk but because they were committed to helping their community.

The Fund is trying to get people to step out of the traditional mode. It broadcasts that it has money for small business start-ups and that it usually funds working capital. Nothing will happen if nothing is started. Giving the money gives people confidence.

The Fund's payoff is in terms of jobs, income and sense of community.

Presenter/Discussion Leader: John Ruoff
South Carolina Fair Share

South Carolina Fair Share is a statewide organization with programs in community organizing, training and technical

assistance. It helped organize a drive which brought a commitment of $10 million over five years to minority businesses from South Carolina's largest bank.

Empowerment is something you do to things. Organizations should work with people as they take power. They should be interested in what role people in a community have in defining economic development for the community. Previously, these people have only had an opportunity to work for somebody else.

South Carolina Fair Share through CRA activities, has increased lending to minority (black) groups. This still means, however, that it is dealing with banks about their money. It's critical at this point to create alternative financial institutions. It's important for people to have institutions that do more for them than to them. Part of the power equation is to defend communities against certain types of economic development such as smoke stack chasing which has brought busier roads, higher taxes and not much improvement in income for poor people.

Economic work and political work need to be done at the same time. Both pieces are needed. If communities control the budget making apparatus, they can force the creation of revolving loan funds.

It's also important to know who the accounting agent is for the intermediary. Who is the intermediary accountable to? It's essential to have community committees, local boards of directors, public meetings so that the intermediary is accountable to the community which it represents. Advisory structures, though, are usually impotent because they are not decision making structures.

A. Major Discussion Points

* The Initiative Fund relies extensively on community input for loan review. They view community participation as essential for uniting and strengthening the region. They feel that their goal of economic development can best be achieved through community representatives directly controlling decisions which effect their local economy. This type of extensive community participation and leadership development requires time, staff, and resources.

* Economic work and political work need to be done at the same time. This is necessary to create alternative financial institutions which are supported by public funds.

V. AN INTERNATIONAL PERSPECTIVE

V. AN INTERNATIONAL PERSPECTIVE

Presenter: **Paul Barker**
The Organization for Economic Cooperation and Development (OECD)

The purpose of the OECD's Initiatives for Local Employment (ILE) program is to encourage new ways of employment creation and local economic development through the exchange of information and experience. The program was born at a time when many of the more traditional approaches to combating unemployment were found wanting. Its intention is to look at new ways of stimulating local level job and business creation especially via the often neglected vehicle of new and small enterprises.

The early ILE program had a predominately urban focus. It wasn't until 1986 that a high level conference on strengthening the economy of less populated areas was held in Finland. This conference was followed by a series of study visits to selected rural areas in Austria, Finland, France, Switzerland and the United States. These visits showed, amongst other things, that local initiatives were making a difference in these areas. Since then, a network of practitioners has been built up and several important initiatives documented.

The Commission of the European Community in its recent report entitled "The Future of Rural Society" outlines a useful conceptualization of the problem [of rural areas] by developing the notion of three standard problems.

The first standard problem is conceived by them as pressure of modern development--such as urban encroachment, seasonal influxes of tourists and scattered and/or unplanned settlements. In the European context this problem is manifest in competing land use in the face of competing interests.

The second standard problem is that of rural decline especially manifest in aging populations, emigration of youths and costly public infrastructure to be maintained by fewer people. This problem is centered around issues of development and economic diversification.

The third standard problem concerns the more marginalized areas that suffer from considerable natural and structural disadvantage. Often these areas are relatively inaccessible and remote. The problem here is manifest in severe depopulation and even abandonment of land.

What then are the other issues that have arisen from the ILE program on rural development to date. By way of a summary of key issues, I've listed eight points.

The first concerns the demonstrable need for Local Employment Initiatives. There is a pronounced groundswell amongst local communities who throughout OECD countries are trying to revitalize their economies by creating jobs and enterprises. Pronounced economic restructuring is occurring as OECD governments move away from selective investments in rural areas to what is known euphemistically as free market policies. At the same time people in rural communities have voted with their feet by not walking. They've stayed or moved back to rural areas for all manner of reasons, not the least being economic and cultural. It is in the face of these trends and in light of the redistributive effects of macro-economic change not reaching people in rural communities that local people have mobilized to go it on their own.

Second, human resource development is a vital part of local employment initiatives. Leadership within the community will emerge or become refocused and a process of change will occur involving broad attitudinal changes to community development. New partnerships with interests outside the community may be fostered including private and/or public sector.

Third, an area underpinning all ILEs is access to capital/finance for enterprises. The potential to tap community savings and low income sources for community economic development has been underscored. Also, there is the very important phenomenon of community groups entering the economic mainstream by obtaining direct control of land, property or influencing land use.

Fourth, the identification of new opportunities and partners for development. Rural communities often have untapped resources --particularly human resources such as the active elderly with transferable pensions, expertise and skills. Also there is the very important area of non-traditional entrepreneurs such as ethnic minorities and women. An initiative that interests us is the management shops that exist in France. They have attempted to assists occupational groups such as coal miners who have lost their jobs. The program has been of assistance in helping areas without a history of self-employment by training and assistance. Also of interest is the use of institutional resources in new and innovative ways. One example is the use of some universities as a vehicle for community economic development such as occurs in Finland and Cape Breton, Nova Scotia. A second example are the school based enterprises.

Fifth, is innovation in social policy. This includes the centrality of education and training to enhance innovation,

entrepreneurship and capacity for keeping abreast of change. Also included are the new ways and mechanisms for delivering social policy. One such example is the self-employment schemes which allow unemployed people to capitalize their unemployment insurance or pay an allowance in lieu of unemployment benefits. These schemes play a significant role in that they change unemployment benefit systems from having an income maintenance objective to something more akin to an active labor market objective. This is particularly so in the case of countries which have their schemes dovetail with provisions for training and small business advice. The schemes are especially significant in France, Britain and Spain. In France, for instance, in 1985, almost 25% of the total number of new businesses created that year were assisted by such a program.

Sixth, the role of the public sector. Increasingly there is a redefinition of the public sector role moving from that of a policy function to a nurturing and facilitative role. The public sector role has also been important in providing technical support and advisory backup to local development initiatives. A particular manifestation of the public sector support and advisory services are the intermediary organizations. These organizations are usually set up with government funding and act as an interface between governments and local communities. One such example is the Scottish Highlands and Islands Development Board created in the early 1960s with a broad mandate for facilitating economic development. The Board is interesting in that it was created by a Labor Government and has survived, in part, by changing its focus over the years from the interventionist smoke-stack chasing mode to the more bottom-up development focus.

The seventh issue is the question of appropriate time frame. The ILE approach is essentially a long term proposition. Changes to school based curriculum towards a more entrepreneurial direction may take a generation or more for the effects to filter through. Turning a single industry, resource-based community around into an economically diversified and thriving community will almost always take longer than political election cycles or government departmental budget cycles. The question of a longer term evaluative stance with which to measure costs and benefits of different approaches to rural economic development is pertinent.

The final observation concerns the future direction of local employment initiatives in the rural context. Most local employment initiatives have arisen in one form or another as the result of externally imposed change. Similarly, many local employment initiatives have arisen in spite of government programs rather than because of them. It is apparent that the whole urban/rural relationship is changing and the rapid pace of change in many, rural areas will doubtless continue. The challenge that lies

ahead for all actors involved in community economic development is to not only keep abreast of this change but to manage it... manage it to ensure that economic development enhances rural society and manage it to mitigate the problems, both present and future.

THURSDAY, OCTOBER 27

I. TOOLS FOR THE FUTURE: INTRODUCTION

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A. Federal Overview

Presenter: **Bob Rapoza**
Rapoza and Associates

STATUS OF RURAL DEVELOPMENT LEGISLATION

Overview

The 100th Congress saw the most activity in rural development legislation since the passage of the Rural Development Act of 1972. However, for a variety of reasons--a hostile administration, disagreement over policy, and an overriding concern about the deficit--action on major legislation was not completed.

While the authorizing committees could not reach agreement concerning new initiatives, the appropriations process took advantage of current authority to revitalize two small programs.

New Legislative Proposals

While several broad-based rural development bills were introduced, the philosophy behind them can be generally divided into two camps: those proposing to continue the direct federal role in prompting rural development, but with increased state participation; and those willing to turn over responsibility for all rural development programs to the states.

Most of the legislation proposed various plans for the reorganization of the main federal development agency, the Farmers Home Administration FMHA). Legislation which did not call for block grants established a separate rural development agency within Agriculture. This new agency would be composed of any newly authorized programs along with the FMHA's economic development programs--Business and Industrial Loan Guarantees.

Another popular item was a rural commission to study federal rural development policy and progress. Equally attractive to many members was the establishment of a new position at the White House--Assistant to the President for Rural Affairs.

While the notion of an omnibus bill, which would address education, job-training and health was attractive to the members, in the end, the major legislative effort was restricted to the jurisdiction of the Agriculture Committee and the rural development program of the Agriculture Department.

Summary of Major Legislation

H.R. 1800 S. 845 The Rural Area Reorganization Act
H.R. 3771 S. 1729 The Rural Economy Act

These bills were principally sponsored by Rep. Ed Jones (D-TN), Chairman of the House Agriculture Subcommittee on Rural Credit and Sen. Patrick Leahy (D-VT), Chairman of the Senate Agriculture Committee.

The Rural Area Reorganization Act authorized $100 million in new rural development funds. The principal aim of this legislation was to build capacity for development activities in rural communities, capitalize revolving funds and address small system water and waste water problems.

The Rural Economy Act included all the elements of H.R. 1800/S. 845 into a major piece of legislation. H.R. 3771/S. 1729 carried a price tag of $500 million and beyond capacity building and revolving loan funds, included $200 million for interest rate reductions for new businesses located in rural areas, $205 million for an infrastructure block grant program aimed at stimulating and supporting business development and a $50 million state incentive matching grant program.

The legislation also established a Rural Development Financing Authority, headed by an Assistant Secretary of Agriculture, who would administer the programs authorized in this legislation along with the FMHA Business & Industrial Loan program.

H.R. 2026/S. 1403 Rural Development Reorganization Act

Representative Tom Coleman (R-MO) and Senator Robert Dole (R-KS) were the principal sponsors of H.R. 2026 and S. 1403, the Rural Development Reorganization Act. The main goal of this bill is to increase the visability of rural development as an agenda item within the Department of Agriculture. It changes the department's name to Agriculture and Rural Development.

The legislation authorizes the establishment of a Rural Development Authority headed by an Assistant Secretary of Agriculture. Staff of the Authority would administer the rural development programs of FMHA, the Economic Research Service and the Cooperative State Research Service.

The legislation authorizes a GAO study of rural development issues and establishes an Office of Rural Advocacy at the White House. Rural technology grants are also authorized.

The bill also authorizes an infrastructure block grant and rural development assistance block grant to the states. The purpose of the latter is to provide rural economic development technical assistance and leadership development.

None of the authorities in the House version of the legislation includes a dollar figure. The Senate version authorizes $1.1 billion to a business loan guarantee program.

Committee Action

The Senate Agriculture Committee spent a number of weeks preparing a bill. In the end, disputes over the role of states prevented the Committee from completing action.

The Senate draft bill authorized approximately $100 million in new rural development funding. Of this amount, $50 million was set aside for capacity building, $25 million for a Star Schools program for rural areas and $25 million for research on agriculture diversification.

The House did not take action on rural development legislation.

Appropriations Action

While the authorizing committees could not reach consensus on rural development legislation, the Appropriations Committee did provide a modicum of new funding for rural development. For each fiscal years '88 & '89 Farmers Home Administration received an additional $20.5 million in rural development funding.

Of the amount provided, $14 million was applied to recapitalize the Rural Development Loan Fund (RDLF). The RDLF, a remnant of the War of Poverty, provided 1% loans to public and private non-profit sponsors which in turn make loans, at low rates, to promote business development in rural communities.

The balance of the funding was used for the Industrial Development Grant program. The program originally was authorized to provide grants to public bodies to finance the preparation of industrial parks. In the 1987 Reconciliation Act, Congress amended the law to permit non-profit participation and authorize the financing of small and emerging businesses.

B. State Overview

Presenter: **Roxanne Ward**
National Center for Policy Alternatives

"Rural Development Finance Needs:
State Public Policy as a Tool for the Future"

Rural Small Business

Rural small businesses take a variety of forms. Not only are they the "Mom & Pop" stores on the Main Streets of rural America, they are the farming cooperatives and "home-spun" entrepreneurs. They are the agri-businesses and the small manufacturers adding value to the products drawn from the fields.

Although diverse, they all share one thing in common. Rural small businesses find it increasingly difficult to survive in this time of vulnerability. Local capital markets rise and fall according to international market forces, state trends in economic development policy and the shape of the banking industry.

Barriers to Rural Small Business Finance

Experts today have gathered to recognize the barriers to rural small business finance. Major cutbacks in federal programs such as Small Business Administration (SBA), Housing and Urban Development (HUD) and Farmer's Home Administration (FMHA) have left a patchwork of financing holes in agricultural based local economies. Federal disinvestment from rural economic development and rapid changes in the banking climate have placed responsibility for revitalizing rural communities on state and local governments.

Small agricultural banks are disappearing from every midwest state; some have failed, others have given in to larger competitors. In the East and West Coast corridors "super regional bank holding companies" have flooded the markets and bought out many local and rural financial institutions. The central plains are also feeling the pinch caused by the concentration of the banking industry.

These nationwide trends have influenced the economic fabric of small rural America. Many rural towns that have banked on local institutions to meet their credit needs are now finding themselves left out in the cold. One rural Minnesota community lost 38 small businesses when the town bank closed.

The banks which remain are faced with fierce competition for local deposits. New York banks and megafinancials such as insurance companies and brokerage firms are successfully soliciting hometown deposits. The results are the drainage of deposits from the local community...disinvestment. Shrinking local economies reduce local purchasing power and produce the negative multiplier effect.

Large Texas holding companies have used rural banks as a resource to draw deposits into the cash starved holding companies. Small bank affiliates provide the resources to recover from LDC and oil loan losses and to fuel bid dollar development in the city. In many instances throughout the state, rural communities are cut off from access to loan dollars for local enterprises.

At the same time, lending is becoming more difficult for the remaining rural bankers. Faced with international, national and regional fluctuations in agricultural products, small rural lenders may find themselves ill equipped to make decisions on farm and small business loans.

Some experts indicate that small banks are not familiar with creative financing needed for small business start up, conversion or for diversification of a farm community. Agricultural loans are still treated as risky and risks, by and large, are avoided not managed by bank administrators.

Other Considerations in Rural Economic Development

Capital gaps in small business financing is only one of four key tenets of a successful state/local economic development program for rural areas. Each of these programs must be in place to ensure proper and strategic use of financing dollars:

1. Leadership Development-building the capacity of human resource development within rural communities is vital to any locally initiated project, urban or rural. State and private programs can nurture a "leadership infrastructure" in rural areas.

   Example: Entrepreneurial Training:
   * Chicago Self-Employment Training Program

   Example: Rural Community Goal-Setting
   * Minnesota's Small Star Cities Program

2. Pre-Bank Development and Support-ensuring the effective use of available financial resources through provision of marketing, product and financial assistance from experts.

Example: Small Business Incubators/Small Business Support Centers
* Maine Women's Business Development Corporation

3. Capital Availability-creating the necessary structures to leverage private financing with public dollars and direction.

Example: (see next section)

4. Long-Term Market Structure-planning and working within financial markets to create a self-perpetuating funding system. Local reinvestment is the key to regional economic self-reliance.

Example: Secondary Market Programs for Rural and Low-Income Community Economic Development
* Maryland Community Investment Fund

Example: International, regional and local market development for agricultural goods
* The Fulda Experiment: Minnesota Trade and Economic Development

Two areas not discussed due to limitation of time are infrastructure financing and conservation/natural resource considerations. Both are vital to any long term sustainable growth in resource rich rural America.

State Strategies for Financing Rural Small Business

States can take on a variety of roles to meet the short and long term financing needs of small businesses. State policy can shape traditional financial institution behavior with both regulation and incentives. Legislators can support the creation and existence of new financial intermediaries. State leaders can also create state and quasi-state financing structures to meet capital needs. In some instances, private initiatives have out performed state public policy and states must stretch their economic development plans to help maintain these programs.

Typically, a public program is deemed effective when a significant private source of funding has matched state dollars. An example of a public/private program is the Iowa Agricultural Linked Deposit Program administered through the State Treasurer's Office. State deposits of up to $500,000 are granted to financial institutions lending for alternative agricultural farming and production. The Treasurer also allows up to a 3% interest rate subsidy on the money deposited. The goal of the program is to stimulate bank lending to worthy farmers and businesses which are adding value to alternative crops in the state.

Other linked deposit programs, like Massachusetts, reward institutions with long term state deposits if they meet corresponding CRA criteria. Nine states and three cities implement some variation of a linked deposit program.

The Capital Access Program of the Michigan Strategic Fund is a popular small business loan guarantee fund where the state shares the risk with lending institutions. The program has been successful in generating bank loans for both rural and urban small businesses.

However, state leverage is not limited to attractive financial incentives for traditional capital markets. Increasingly, states are exercising regulatory powers to boost community reinvestment lending to low-income and rural communities. In particular, Minnesota, Maryland, Vermont, and Iowa (pending) have included language in their interstate banking bill to require lending to disadvantaged communities and to women- and minority-owned small businesses. Additionally, these states gather information vital to assessment of capital gaps for urban and rural areas as well as for specific populations in need.

Massachusetts' Community Reinvestment Act and its Linked Deposit Program promote responsive lending by state chartered institutions. In addition, the Thrift Seed Fund was created to finance non-traditional business ventures. Through an asset-based allocation process, all Thrifts in the state share the risk in lending to small businesses such as the organic farms in Western Massachusetts. The program has proven helpful to rural economic development.

Private financial institutions including development banks (Ameritrust, Shorebank and the Arkansas Development Bank), community development credit unions, and community development loan funds are meeting key needs in the communities in which they operate. States are beginning to recognize the importance of these private efforts as they consider legislation to support such institutions.

A number of states have emerged with policies which support non-traditional financial institutions which meet the debt and equity needs of developing and existing enterprises.

The Michigan Strategic Fund is the model in state equity financing for small business with the BIDCO and Minority BIDCO, Business Development finance Corporations. By leveraging "patient" money from large corporate and institutional investors, BIDCOs invest directly in the moderate risk and moderate return category for promising, growth-oriented small businesses.

This year the Georgia Legislature is considering a similar notion of Small Minority Business Development Corporations which would be capitalized through the support of lending institutions in the state. The Massachusetts Product Development Corporation is also notable in providing innovative financing.

New York has been a leader in providing millions each year for small business working capital, equipment and real property loans through the New York Business Development Corporation. The state pension fund is supporting this effort with $136 million. NYBDC is a private institution supported also through a consortium of New York commercial and savings banks.

Rural areas with high unemployment and low job growth, have turned to entrepreneurial job creation strategies. The Watermark Association of Artisans of northeastern North Carolina, is one such private initiative which has helped to create 280 steady jobs for craft persons. With successful national and international marketing of the cooperative's goods, many of these North Carolina entrepreneurs were lifted from the welfare rolls.

Seed Capital Funds are sprouting up around the country (Colorado, Michigan, Massachusetts, Iowa, Georgia) to help entrepreneurs with their business start-ups. The effectiveness of the Seed Funds can be determined by the populations targeted, the terms of the lending, the concurrent management assistance provided, and the private dollars leveraged.

Programs for new business owners can also focus on using existing state funds. The Iowa AFDC Self-Employment Project provides a lump sum grant and case management services to a welfare recipient with the interest and capacity for starting a small business. Although this requires a waiver by the federal government, many other state and local programs are approaching "welfare reform" with self-employment foals. Women and Employment of West Virginia has succeeded in providing the training and could use state support in leveraging private funds.

State Policy: Tools for the Future

We have highlighted states with concrete and active programs to meet the capital demands of small business in the state. These states have worked through the challenges of a failing rural economy and have created programs to address the root problems.

With responsibility for rural economic development resting in the 50 states comes the potential for innovative change. We encourage each state to stimulate rural small business lending with three strategies:

1. Support existing financial institutions and investors that meet rural and low-income community needs. Strategic use of economic development, state treasury and pension fund dollars is a powerful tool.

2. Set reinvestment standards to encourage broad-based participation in community development lending by financial institutions. Appropriate small business, farm, and geographic loan disclosure is necessary to ensure proper enforcement.

3. Create new financial institutions when necessary to play an intermediary role in economic development.

II. TOOLS FOR THE FUTURE: A POLICY AND ACTION AGENDA

II. TOOLS FOR THE FUTURE: A POLICY AND ACTION AGENDA

Discussion Leader: **Jean Pogge**
Woodstock Institute

Based on yesterday's discussion, there seems to be agreement on a number of points. Specifically, there is a capital and credit gap, banks should be encouraged to meet this gap, there is a definite need for alternative financing vehicles and alternative vehicles or institutions need to be permanent. Given that conclusion two major questions arise: How can alternative vehicles or institutions survive and how can they be replicated?

A. Participant's Comments

It's difficult to survive over the long term because of high cost, high risk and low return. It's also difficult to attract and keep staff because of the lack of professional growth and appropriate financial compensation. Basically the high cost, high risk, low return factor makes it difficult to fund a corporate growth strategy. In addition, the commitment to supporting a net worth/endowment approach has not been made by funders.

From the funders view there needs to be a checks and balance system in place. As of now, funders don't have a history or track record in evaluating rural small business development programs.

Public sector supports also aren't there. Perhaps we don't yet know enough to attract state level funding commitments. We should work to identify the types of support that would make what we do more profitable. For instance, it's very difficult to use market rate money in what we are doing.

The public sector is loath to put funds into independent bodies. They prefer to have a fragmentation of funding rather than a concentration of funding in one institution in order to sustain that institution.

We need to quantify CRA, to provide better guidelines, to tighten the screws on the CRA. We also need a more inventive look at state and union pension funds such as the Texas Growth Fund which uses 1% of state pension funds. We should take a more innovative look at insurance funds and getting megafinancials to open up some money.

We need to institute a policy which allows retaining FDIC deposit insurance on amounts over $100,000 for development banks and credit unions.

We should seriously explore the possibility of creating a secondary market for develop lending. To do this we need better evaluations of what we are doing. For instance, we shouldn't look at loan losses but, instead, dollars of payroll created and retained. This is your tax base return. Your economic return to the community. It provides a legitimacy to the intermediary organization. We need to develop public support not just public sector support.

When evaluating alternative intermediaries, there seem to be different advantages and levels of performance which need to be examined. Some have good management, some have skillful political ability, some can do what a bank can do but with less capital. We should also examine rural development models in Europe and the lessons learned by the OECD.

B. Major Discussion Points

* Sustainability is difficult because of: a high cost, high risk, low return factor; a lack of support from funders for the endowment approach; a lack of public sector support.

* Funders need to gain experience in evaluating rural small business development programs. They need to see a system of checks and balances in place and how this relates to the effectiveness of a lending program.

* Other sources of funds should be investigated. These include state and union pension funds and insurance and megafinancial corporations' resources. Additional strategies for assisting alternative financial intermediaries include, creating a secondary market for development lending and promoting policies which allow retaining FDIC deposit insurance on amounts over $100,000 for development banks and credit unions.

III. CLOSING REMARKS: WHERE DO WE GO FROM HERE?

III. CLOSING REMARKS: WHERE DO WE GO FROM HERE?

PARTICIPANT'S COMMENTS

Roxanne Ward

- I'll continue to explore state options for supporting financial intermediaries.

Neal Nathanson

- I'm going to look at major recapitalization of funds, pool guarantees from the federal government so that we can break loose some of the pension fund money, and a spin off of state wide clones of NRDFC.

David Leckey

- I'm going to think about developing an endowment base to serve rural development needs.

Ellen Arrick

- I'm going to try to continue to support alternative credit providers including credit unions, and technical assistance for rural bankers.

Roland Arriola

- I'm going to continue to sensitize banks in order to open access to credit and to look at different types of models that could be put in place in the Rio Grande Valley.

Jerry Hansen

- I'm going to concentrate on mobilizing local resources for rural development.

Peggy Clark

- I'm going to try supporting initiatives to determine why there are so few good intermediaries. It will be important to clarify their function, limits to growth, linkages to smaller groups, problems, leadership or lack of it. I'm interested in questions concerning the development of intermediaries.

Mary Mountcastle

- I'm looking at federal rural policy, the concept of financial and other types of intermediaries, ways in which these intermediaries can be "born", and specific models and demonstrations.

Debby Markley

- I plan on finishing and distributing the New England project, looking at new banks in the region, why they are there and the niches they fill. I also want to examine banker capacity and develop an evaluative technique to determine where interventions are actually resulting in rural economic development for low-income people.

Steve McConnell

- I want to explore more federal involvement on a demonstration level and develop more funding sources for the demonstration level. I also want to quantify results to demonstrate positive impact.

Bob Rapoza

- I'll be working on the Rural Development Bill next year, a study on federal policy in rural areas, and looking at intermediaries for getting funds to rural areas.

John Ruoff

- I'm going to move forward on a lot of the financing issues which we have discussed.

Mary Houghton

- I'm interested in European and Asian intermediaries and the relationship between being cost effective/market driven and the issue of scale.

Kate McKee

- I'm interested in expanding our risk capital base. I'm also interested in exploring how to work with locally based loan funds, community development loan funds and credit unions. This will involve questions concerning outreach, intermediation, pooling of services. Finally, I'm interested in developing our financial advocacy role.

Sal Valdez

- I plan on taking the information from this meeting and disbursing it to the grassroots. I'm also going to continue to network.

Paul Barker

- I'm concerned with defining local rural initiatives in the policy context. I also feel a need to disseminate information on European intermediaries.

Jean Pogge

- I'm going to continue our work with alternative financial institutions. This will involve focusing on credit unions which are structurally designed to be community institutions, exploring the range of alternative financial institutions, and investigating sources of funds to provide capital and credit to low-income communities.

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