

Comments on International and Cultural Dimensions Panel

Martin Levine¹

I'd like to begin by congratulating the Federal Reserve System's Division of Consumer and Community Affairs for what you've accomplished during the past two days. As with the previous Community Affairs Research Conferences, this event has brought together an extraordinary assemblage of researchers and practitioners to explore the latest findings on how best to foster sustainable community development. You've convened a first-rate group of professionals in community and economic development, and you've focused discussions on identifying practical strategies for success.

I'm flattered to be included in such a gathering, and I'm pleased to be representing ShoreBank. I'm also keenly aware that as the last speaker on the last day of the conference, my remarks are all that stand between this audience and both lunch and the thoughts of Chairman Greenspan. While I can't promise to be as provoking as I'm sure Mr. Greenspan will be, I will try to contribute to the dialogue of the last two days. And I promise to be brief.

It is appropriate that this last session broaden our focus to look at approaches to serving ethnically diverse communities in the U.S. and to explore experiences outside our country as well. In crafting strategies to bring the benefits of financial services to all of our fellow citizens, it is important to be cognizant of the constantly changing ethnic variety of the United States. Also, in the spirit of the conference's theme of seeking to identify "What Works, What Doesn't and Why," it's important to be open to lessons from other countries – particularly as immigrants from those countries are increasingly the source of population and economic growth in our own country.

In my comments this morning I will attempt to identify common themes from the three papers presented as part of this panel and to draw broader inferences as to successful approaches to promoting investment in underserved communities. In reading these papers and in listening to the remarks of their authors, I've been struck by the extent to which their research findings are consistent with ShoreBank's experiences as a community lender in the U.S. and as an advisor to financial institutions in other countries.

As many of you know, ShoreBank is our nation's first and largest community development bank holding company. Founded in 1973 to arrest the flight of lenders from a Chicago community that was undergoing rapid racial and economic change, ShoreBank has grown to an institution with more than \$1.4 billion in assets. We serve disinvested communities in five states through subsidiary banks as well as for-profit and nonprofit affiliates. ShoreBank's lending activities are concentrated in small-business lending and in home loans, including lending to finance the rehabilitation of older multi-family

¹ Martin Levine is senior advisor to ShoreBank Advisory Services, the research and consulting arm of ShoreBank Corporation. The views expressed here are Dr. Levine's. They do not necessarily reflect the opinions of ShoreBank.

properties. We supplement these lending products with formal and informal business development services that we offer to our borrower base of first-time entrepreneurs.

Perhaps less well known, through our consulting arm, ShoreBank Advisory Services, we assist other financial institutions, nonprofit organizations, and governments to design and implement community development strategies. Outside the U.S., during the past 20 years, SAS has partnered with more than 60 banks and microfinance institutions, including some of the sort described by Anna Paulson in her paper. We've assisted these institutions in providing more than \$200 million in loans to 7,200 small enterprises and homebuyers. We've learned much from these experiences – and from our own false starts – regarding the conditions that need to be in place in order for a financial institution to successfully reach new, diverse markets. I will draw on those experiences in my comments this morning.

Three recurring themes struck me as I reviewed the papers prepared for this panel. First, in reaching out to underserved populations, the expectations of potential borrowers themselves can play an important role in a program's success. Where those borrowers expect to fail to qualify for credit, we see them selecting themselves out of the process. The study of efforts to serve Hmong small-business owners in Minneapolis/St. Paul found that 23 percent of such owners did not even apply for loans because they expected to be turned down. This points to the need for targeted and persistent outreach to new markets – and to the potential value of using prior customers to spread the word to others within a community who might be hesitant to take advantage of services that a financial institution is offering.

Another common thread running through these papers is the observation that potential borrowers who have not had prior experiences with lending institutions may lack the knowledge to readily avail themselves of the opportunities being offered. For example, Ms. Giusti's study of microenterprise programs in the Colonias region along the Texas-Mexico border found that many first-time entrepreneurs did not know that lenders would require a business plan as part of the loan application process. Such gaps in the knowledge of people who are opening businesses for the first time suggest the value of, and need for, systematic business development services to supplement the loan products that banks offer.

A third shared finding from these papers is critically important to this conference's goal of identifying successful community investment strategies. In different ways, each of the studies presented today concluded that the practices that lenders follow in attempting to reach underserved populations can significantly affect how successfully they overcome the challenges they face. The study of programs directed to Hmong businesses in Minnesota, for example, demonstrated that persistent, targeted outreach can succeed in reaching even linguistically isolated populations. By contrast, the more limited outreach efforts employed in the Colonias achieved markedly less success. Findings from the study of village banks in Thailand were particularly intriguing. On the one hand, because these institutions grew up among their potential customers, they have a natural advantage in reaching their microentrepreneur clientele. On the other hand, the rigid lending

guidelines that these banks employed and the often complex procedures they imposed on their borrowers undermined their locational advantage.

Building on these findings, I'd like to close with a few thoughts about general principles that might guide lenders as they craft sustainable community investment strategies. A number of these observations flow from the three excellent papers presented on this panel. Others of these principles have been demonstrated in papers presented earlier in this conference and are reinforced by ShoreBank's own experiences in serving disenfranchised communities.

The first general principle I'd offer is that in order to be sustainable, a community lending program must be designed with a mandate to be profitable. Too often in the past, financial institutions have attempted to enter underserved markets in response to outside pressures they might perceive. Under such circumstances they may begin these undertakings with an expectation that the costs they will face and/or the losses they will incur will render their new lines of business ultimately unprofitable. While expecting to succeed in any new venture is no guarantee of doing so, expecting to fail will almost certainly prove to be self-fulfilling.

Related to this is the observation that institutions should be realistic about the front-end investments that are likely to be required to enter any new market – whether in market research, designing tailored outreach strategies, developing new products, adapting technologies, or training staff. Management should budget for these costs and should be prepared to absorb them. At the same time, institutions must be diligent in managing such expenses, to be certain that costs do not run away from them.

It is also critical that lenders tailor the products they design to serve the special circumstances of non-traditional borrowers. The needs of microentrepreneurs or small businesses, for example, are not the same as those of larger, more established enterprises. Similarly, an ethnically diverse community of business people may bring different concerns or sensitivities to a bank's door. In structuring products to meet the financing needs of new markets, an institution may also need to adapt its underwriting guidelines and risk management tools and to craft culturally sensitive marketing plans – in some cases accompanied by business development services.

Education and training within an institution are also important to ensure that the front-line personnel on whose actions the success of new products will depend understand the new tools they are being offered and how they are expected to apply them. Such training should encompass loan originators and credit officers, among others, as well as the managers of the departments who will be responsible for implementing the new products. To the extent that the compensation of such people is currently tied to targets for the production and performance of loans, appropriate financial incentives should be established as well for originating sound community investment loans.

Buy-in among an institution's senior-most management is also essential – to sustain the commitment to serving new markets during the inevitable problems that will arise and to

communicate unambiguously to the rest of the organization the value placed on the initiative. Finally, an undertaking as challenging as successfully serving communities that may have previously been outside the reach of financial services is most likely to succeed when it is viewed as part of an institution's core strategy. For example, a lender might tie its community investment objectives to a broader goal of expanding its geographic footprint. In another instance, a new thrust into underserved markets might be seen as part of developing or enhancing a consumer-oriented institutional culture. By linking community investment in such a way to an institution's broader goals, it is more likely to be seen as critical to an organization's success – rather than being viewed as of secondary importance or at odds with an institution's strategic objectives.

All of us who have spent large parts of our careers in community investment – as researchers, practitioners, or policymakers – recognize the challenges that such activities present. However, we're also aware of the business benefits that an institution can achieve by expanding its reach into previously underserved markets. In addition, we recognize that as business persons, as community representatives, and as government officials, we must continue to find ways to succeed in such ventures – if we are going to continue to build the society of shared opportunity of which we all want to be a part.

Thank you again for inviting me to participate in this conference.