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There is clearly a need for a small business banking product aimed at minority and low and moderate income individuals. Recent newspaper articles discussed problems faced by both borrowers and lenders in the inner city. The social fabric is rapidly disintegrating in several urban areas. One study revealed 42% of young black males in Washington, D.C. involved with the criminal justice system.[1] Banks appear to shun borrowers in these areas.[2] Certain pension funds stand ready to provide capital, but face a lack of products designed to let them safely and on a fair-market basis invest funds in these businesses and areas.[3] Pension funds active in this area have designed loan products to suit their needs, at a high loan origination cost. These products are nonstandard, custom securities, usually with certain credit enhancements.

Other organizations designed to funnel capital to low and moderate income and minority individuals and areas have not made many loans. One economic development organization in Washington, D.C., Anacostia's Economic Development Corporation, reportedly "gets only two loans a year approved."[4] These institutions are slow in meeting the needs of the community, and may be giving extravagant salaries and benefits to managers. Minority owned investment banks, brokerage firms, banks and thrifts have yet to design

[1]Young Black Men in Capital: Study Finds 42% in Courts. The New York Times. Page A1. April 18, 1992.

[2]. Credit Where Due? Small Businesses, Key to Urban Recovery, Are Starved for Capital. The Wall Street Journal. Page A1. June 11, 1992.

[3]. Hearing the Wake-Up Call. The New York Times. March 15, 1992. Business Section.

[4]. Credit Where Due? Small Businesses, Key to Urban Recovery, Are Starved for Capital. The Wall Street Journal. Page A2. June 11, 1992.

products that meet these credit needs. Still these institutions are often the beneficiaries of public policy programs designed to encourage minority ownership of financial institutions.

Sheltered market and set aside programs have also come under criticism lately. These programs allocate a few contracts to minority companies. Problems with these programs are many. Several face legal challenges. Established programs have been shown to hinder the development of other minority businesses, typically new firms or firms lacking political connections.[5]

[5]. 4 Dominated D.C. Minority Contracting. The Washington Post. June 1, 1992. Page A1.

Financial institutions, specifically minority-owned financial institutions, may welcome the creation of new products designed to attract deposits and simplify lending. One nonminority bank recently held a "bank fair" to help in distributing credit to these areas. At these events, loan officers from a given bank or banks come into the community, typically at a church, to take applications for mortgages, small business loans, and other credit products. These affairs, at the time perhaps useful, serve as window dressing on occasion. While many loan applications are taken, very few, or no loans may be granted.

This document outlines a bank credit product designed to get past these problems. The product is market-based, self regulating, self financing, and liquid. It may allow institutional investors to provide capital in an ERISA compliant manner. The product could be used in newly formed, recently democratic regimes and countries. It is based on a financial technique used very successfully by one ethnic group, but is structured as a standard, formal bank product. Very generally, the product can be described as a credit enhanced, bank administered, customer driven micro business loan.

Background

Korean entrepreneurs have used micro loan funds and loan pools to provide start up capital for small businesses.[6] A loan pool club, called a "Keh", functions as follows:

1. A club is formed to collect money from members monthly.

2. A member of the club receives money from the pool each month to invest in a start up business.

A single person gathers friends and acquaintances. They agree to meet once a month and to bring a certain amount of money to the meeting. The organizer usually receives the first allotment. A ten member pool, meeting monthly, with each

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[6]. For Koreans, 'Keh' is Key to Success. The Washington Post. November 3, 1991. Page B1.

member bringing five hundred dollars, generates five thousand dollars per meeting and sixty thousand dollars per year. Five thousand dollars are allocated at each meeting to the person with the "best" or most urgent business idea. These loan pools work due to the sense of community and responsibility of Korean organizations. The key question is whether these values can be expanded in other ethnic cultures. The loan product assumes these values can be found everywhere.

New Application

To perform the duty played by these Korean cultural factors, a bank would "run" the pools, performing formal credit reviews on the individuals and businesses applying both for loans and membership. In addition, the bank will be responsible for reviewing assets of the members of the group and attaching these assets, if necessary.

Small/Minority Business Loan Bank Product outline

The product is structured as follows:

1. The Bank acts as organizer, announcing the creation of a loan pool product. A community of individuals is asked to participate. The bank collects and reviews credit information on the participants. Criteria are established jointly to decide what credit profile is needed to become a full, participating member.

2. Several loan pools are structured. Individuals with modest credit needs may be directed to a small pool. Companies and individuals with larger needs could form pools with the ability to make larger loans. In this way, members would self-select groups that met their needs.

For each pool, a meeting is held to choose a member as an unpaid community-based director/chief administrator of the loan pool. Understandings concerning contribution amounts, purpose of the fund, fund governance, and other items are decided. The bank agrees to perform all administrative functions. The bank will maintain records, administer and distribute funds. Acorn or the bank will provide a meeting place. These activities will be viewed favorably by regulators as helping to meet community credit needs, and will be carefully documented for the banks CRA (Community Reinvestment Act) file.

Administrative costs will be considerable. The bank makes the loan. It recovers expenses in several ways. Administrative costs can be deducted from deposit interest. The spread between the high small business loan interest rate and the bank's cost of funds, low due to the self funding nature of these pools, will cover most costs. Members may be asked to pay a processing fee.

3. Regular, monthly meetings are held. Business plans are reviewed. Members bring deposits, perhaps $100 to $1,000 dollars. Deposits are held in individual or pooled CD or money market accounts until distributed. Members not having deposits are requested to arrange to obtain needed funds. As an incentive, funds in the pool may be forfeited unless the member participates fully.

4. Loans are granted by a loan officer at the bank.

5. Private or public market, third party guarantees are sought, either from a municipality, the SBA or from a bank willing to provide a letter of credit to back the loan pool.

6. The credit enhanced pool is sold to an institutional investor. The bank continues to function as the main administrator and loan servicer for the life of the pool, which expires when the last loan is fully repaid.

A pilot program in Los Angeles using a majority-owned bank (preferably a wholesale bank), a Korean-American bank and an African-American bank operating, for purposes of the program, as joint venture partners could be structured.

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FOOTNOTES