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Community Dividend

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TURNING EQUITY INTO OPPORTUNITY:

Montana fund helps Native entrepreneurs enter the financial mainstream

By Philip Belangie and Sue Woodrow

For the last several decades, efforts to develop the economies of Indian Country communities have focused heavily on businesses owned by tribal governments.[1] The range of tribal enterprises is diverse and includes gaming operations, natural resource development, tourism, and retail establishments. Some tribes have experienced significant economic gains from these enterprises, as measured by the steady improvement over the last 30 years in inflation-adjusted per capita income for Native Americans residing on Indian reservations. While this growth has been significant, it is unequally distributed. Data show that in 2000, per capita income for Native Americans residing on Indian reservations was less than half the national average, and Indian Country as a whole remains in poverty.[2]

More recently, there has been increased attention paid to entrepreneurship and private business as important contributors to sustainable economic development in Indian Country. Some tribes and Indian organizations are recognizing the need to support small business growth in their communities and have developed revolving loan funds, technical assistance, training, or other programs to support business owners and entrepreneurs.[3] Similarly, Indian Business Alliances have been established in Montana, South Dakota, and Wisconsin as a grassroots approach to support private sector growth in Indian communities. (For more on the Indian Business Alliances, see the sidebar on page 5.)

A commonly cited barrier to the development of private markets in Indian communities is the lack of access to affordable credit and capital. Efforts to address these financing issues are varied. For many years, they focused on lending sources, such as federal loan guarantee programs, community development financial institutions, and micro- and revolving loan funds. Recently, efforts have broadened to include asset development programs, such as earned income tax credits and individual development accounts (IDA). However, asset development programs have not generated enough funds to overcome one important barrier to business development in Indian Country: a severe shortage of *equity*—that is, the entrepreneur's ownership interest in a business venture, provided in the form of cash or other assets.

According to Tanya Fiddler, executive director of Four Bands Community Fund on the Cheyenne River Sioux Reservation in South Dakota, "While efforts such as IDA programs are an important and positive piece of the equity puzzle, they don't have the capac-

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A "Six Forces" view of microenterprise development

By Michou Kokodoko

Entrepreneurs who own *microenterprises*, or businesses with five or fewer employees, often have limited access to mainstream financing. They may find it beneficial to work with nonprofit entities called microenterprise development organizations (MDOs) that specialize in helping build the capacity of very small businesses. MDOs provide one or more of the following services: training and technical assistance, credit and access to credit, access to market services for microentrepreneurs, and financial education and asset development.

The MDO field in the U.S emerged in the mid-1980s, starting with a handful of entities.[1] Today, there are about 500 MDOs in operation in the U.S. In recent years, MDOs have faced increasing competition as more and more public agencies and for-profit organizations begin providing loans and services to microenterprises. To sustain themselves as a field, MDOs must understand the economic and political market in which they operate. They must also implement strategic management methods that recognize the multiple pressures affecting their industry.[2]

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Native CDFIs work toward a new economic reality in South Dakota

By Sandy Gerber

A community development financial institution (CDFI) is an organization that provides loans and financial services to underserved communities. CDFIs were created to bridge the lending gap between low- and moderate-income neighborhoods and mainstream financial institutions.

Some CDFIs are organized as community development banks, while others come in the form of community development credit unions, loan funds, or venture capital funds. CDFIs get their money from banks, corporations, foundations, individuals, governments, and faith-based institutions. The single largest funding source for CDFIs is the CDFI Fund, a program of the U.S. Department of the Treasury. The CDFI Fund certifies CDFIs and awards them resources through a competitive application process. (For more on the CDFI Fund, see the sidebar on page 7.)

CDFIs have a successful track record, as indicated by fully deployed capital and the production of jobs and affordable housing, and they tend to be financially sound. For example, at the end of fiscal year 2005, the loan loss ratio for all certified CDFIs was only 0.3 percent, or \$6,799,247 out of \$2,711,161,088 in total outstanding loans.[1]

According to Mark Pinsky, president of a CDFI membership organization called Opportunity Finance Network, CDFIs have helped banks reassess their perception of risk in underserved markets. As Pinsky noted in a 2005 interview, "CDFIs show that if you lend or

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A "Six Forces" view of microenterprise development

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A rich field of research on management methods for nonprofits has developed in the last several decades. Many of the methods are adapted from principles used in the private sector. One prominent example is the "Six Forces" framework, which author Sharon Oster proposed in her 1995 book *Strategic Management for Nonprofit Organizations: Theory and Cases*. Oster's approach is adapted from a framework for private sector industry analysis and business strategy that Michael Porter of Harvard University developed in 1979. Porter's framework, known as "Five Forces," uses concepts developed in industrial organization economics to derive five forces that determine the competitive intensity and, therefore, the attractiveness of a market.[3]

Porter's original Five Forces framework and Oster's Six Forces adaptation are illustrated in Figures 1 and 2, respectively. What happens when we apply one of these frameworks to MDOs? As described below, when we view the MDO market using the appropriate framework—in this case, Oster's Six Forces framework for nonprofits—a clearer picture of the market emerges. The results can provide decision makers in the field with techniques for improving their operations and achieving sustainability.

Six Forces for MDOs

FORCE 1:

Relations among existing organizations

Assessing the number, capacity, and interactions of existing MDOs

For the 500 or so MDOs currently serving the U.S. market, the level of competition is growing. Many MDOs have limited capacity and provide similar products and services, resulting in duplicated efforts across the field and an inability to take advantage of economies of scale.[4] For example, most MDOs have developed their own training curricula and systems for data tracking and loan documentation. In the city of Minneapolis alone, there are more than a dozen different programs providing some type of assistance to potential entrepreneurs,[5] perhaps vying for the same funding dollars and the same clientele. In this case, one MDO's gain is often another's loss, because it drives down other MDOs' ability to recover program-related expenses.

The rivalry is intensified by the fact that most MDOs, if not all, have goals that go beyond their individual economic performance. As previously noted, MDO programs are formed to provide and promote access to capital for low-income populations and underserved communities. For this reason, MDOs often display a strong commitment to continue running certain programs, despite the poor economic performances of those programs.

FORCE 2:

Threat of new entrants

Assessing the ability of new organizations to enter and compete effectively in the field

In general, upstart nonprofit entities are not a major threat to established MDOs, due to the industry's substantial entry barriers. Oster defines *entry barriers* in the nonprofit sector as any phenomenon that prevents new organizations from entering and serving the market while remaining economically viable. To be economically viable, a nonprofit organization should be able to generate fees from revenues, grants, or donations while accomplishing its goals and objectives.

There are two major barriers to entry in the microenterprise development field. The first is reputation. The vast majority of MDOs depend heavily on subsidies from government and philanthropic institutions. These donors are more likely to trust and fund existing organizations with proven track records than new, unproven organizations. The importance of reputation is growing, because public funding for MDOs is on the decline. For example, funding for the U.S. Small Business Administration's Program for Investment in Microentrepreneurs dropped from $15 million in 2001 to $3 million in 2008. In addition, a growing number of philanthropic institutions that historically funded MDOs are now questioning the MDO industry's ability to measure the impact of its work. These trends in public and philanthropic funding make it more challenging for newcomers to attract resources away from established, reputable MDOs.

The second major entry barrier in the MDO industry is *cost recovery*, or the capacity of an organization to pay its expenses with revenues generated by its own programs. Cost recovery rates for MDOs vary. For example, some MDOs that specialize in lending had an average recovery rate of 47 percent in 2003, whereas in the same fiscal year, training-led programs documented an average rate of 6 percent. The highest cost recovery rates were 60 percent and 89.5 percent, respectively, for credit-led and training-led programs.[6] Generally speaking, MDOs with established, revenue-generating programs have higher cost recovery rates than newer organizations. Start-up MDOs must invest heavily in building their programs. These early costs are difficult to recover, and they create a competitive disadvantage for new organizations.

FORCE 3:

Threat of new substitutes

Assessing the ability of MDO clients to find a different product that can meet their needs

When the competitive threat posed by substitute products or services is high, it becomes more challenging for organizations to charge fees for their products or services and secure enough funding to cover their costs. What are some substitute products in the case of an MDO? Clearly, microloans, credit cards, and other products and services offered by for-profit entities compete with the products MDOs offer. Banks and other for-profit financial service providers use credit scoring to serve riskier borrowers—a market segment traditionally served by nonprofit lenders. Credit cards appear to be an effective product for banks and other lenders in serving "marginal" small business borrowers. The application process for credit cards is faster and less exhaustive than the process for small business loans. For these and other reasons, increasing numbers of small business borrowers are choosing credit cards as a financing avenue. According to a Federal Reserve study, the share of small businesses that used business credit cards as a source of credit jumped from 34 percent in 1998 to 48 percent in 2003.[7]

Banks, finance companies, and other for-profit organizations are also beginning to offer training and technical assistance to entrepreneurs. For instance, eBay, Verizon, and American Express provide online business education to their customers.[8] Indeed, as people continue to show a preference for convenience or simplicity over price, MDOs will find it more challenging to attract and efficiently serve them.

Identifying the specific competitive forces that affect MDOs can help the leaders of these organizations perform SWOT (strengths, weaknesses, opportunities, and threats) analyses, develop better strategies, exploit changes in the industry, and gain a competitive edge.

FORCES 4 AND 5:

The power of users and donors

Assessing a) the ability of users to drive up costs and b) the challenges fundraising presents

MDOs typically focus on entrepreneurs who are underserved by mainstream commercial lenders. So for MDOs, users include a high proportion of low-income individuals, ethnic and racial minorities, women, individuals with disabilities, and new immigrants. Since substitutes for the services offered by MDOs are available, MDO users have significant market power. MDO clients continue to demand more and better services and, consequently, drive up the costs of creating and delivering those services. That means it is essential for MDOs to understand their users and examine the individual needs of each segment of this market. Services traditionally offered by MDOs (e.g., business development, technical assistance, and access to small business loans) may no longer respond effectively to customers' needs.

Donors constitute a second group with significant market power. MDOs have little power relative to their major donors, who can change their priorities and funding guidelines as they wish. MDO advocacy groups, such as the Association for Enterprise Opportunity, recommend the development of performance-based grantmaking systems that would standardize funding criteria across the industry. However, MDOs and donors have shown little or no inclination to accept and adopt any industry-standard measures.

FORCE 6:

Bargaining power of suppliers

Assessing how the labor supply affects the capacity of MDOs

Dedicated, knowledgeable employees are a nonprofit organization's greatest resource. Therefore, fluctuations in the labor supply are a concern for most nonprofits. To stay competitive, MDOs must attract high-quality employees. However, it is difficult for MDOs to find the resources necessary to hire and retain skilled staff, so turnover and staff development are a common challenge. The *2007 Minnesota Nonprofit Economy Report* released by the Minnesota Council of Nonprofits shows that Minnesota nonprofits paid $10.8 billion in wages in 2006, about 42 percent of total expenditures. On average, a typical charitable organization spends one-half of its operating expenses on labor. The picture is no different for MDOs.

A tool for leaders in the industry

In applying Oster's Six Forces framework to the MDO industry, we begin to see a fuller picture of the challenges MDOs face and how those challenges might affect the industry's long-term sustainability. Identifying the specific competitive forces that affect MDOs can help the leaders of these organizations perform SWOT (strengths, weaknesses, opportunities, and threats) analyses, develop better strategies, exploit changes in the industry, and gain a competitive edge. If all of the leaders of MDOs examined the market using the Six Forces framework or a comparable management method, the industry might be better equipped to confront its various challenges, avoid duplication of services, and benefit from economies of scale.

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[1] For more information on the current state of the microenterprise field in the U.S., see the article "Microenterprise development in the U.S.: Past, present, and future" in *Community Dividend,* Issue 2, 2007, at www.minneapolisfed.org.

[2] This point is reinforced in *Pump Up the Volume: Strategies for Reaching Scale in the U.S.,* which is published by the Association for Enterprise Opportunity, a trade association of microenterprise programs.

[3] "The Five Competitive Forces that Shape Strategy," *Harvard Business Review,* January 2008.

[4] In general, the term "economies of scale" refers to changes in average unit costs that are related to changes in scale or size of an organization. Due to economies of scale, large organizations have greater access to markets and can operate with broader geographic reach than small organizations.

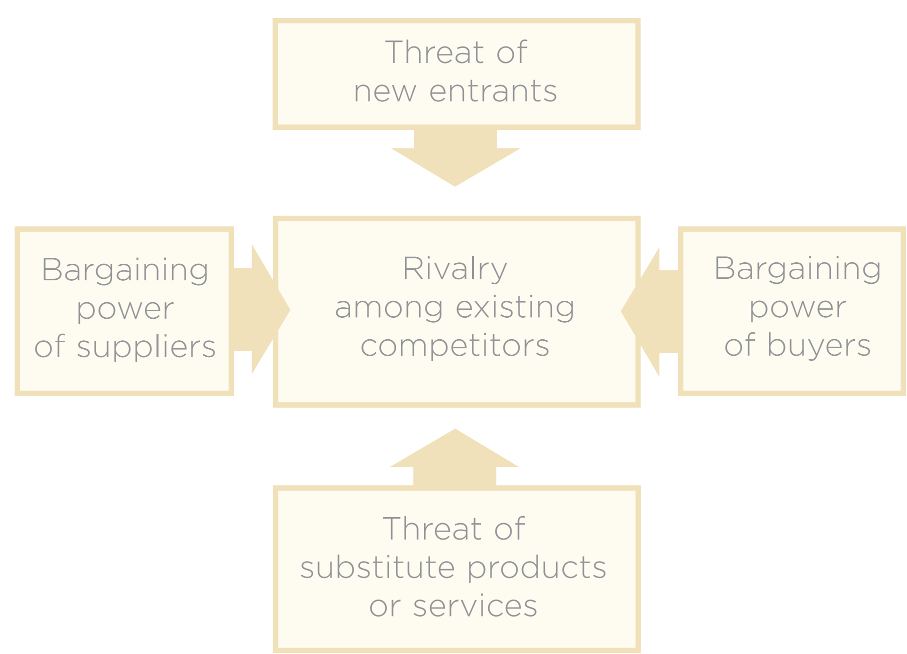
[5] *Starting a Business in Minneapolis: A Practical Guide,* City of Minneapolis Community Planning and Economic Development Department, 2007.

[6] Elaine Edgcomb and Joyce Klein, *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States,* The Aspen Institute, 2005.

[7] The 1998 and 2003 *Survey of Small Business Finances,* Board of Governors of the Federal Reserve System.

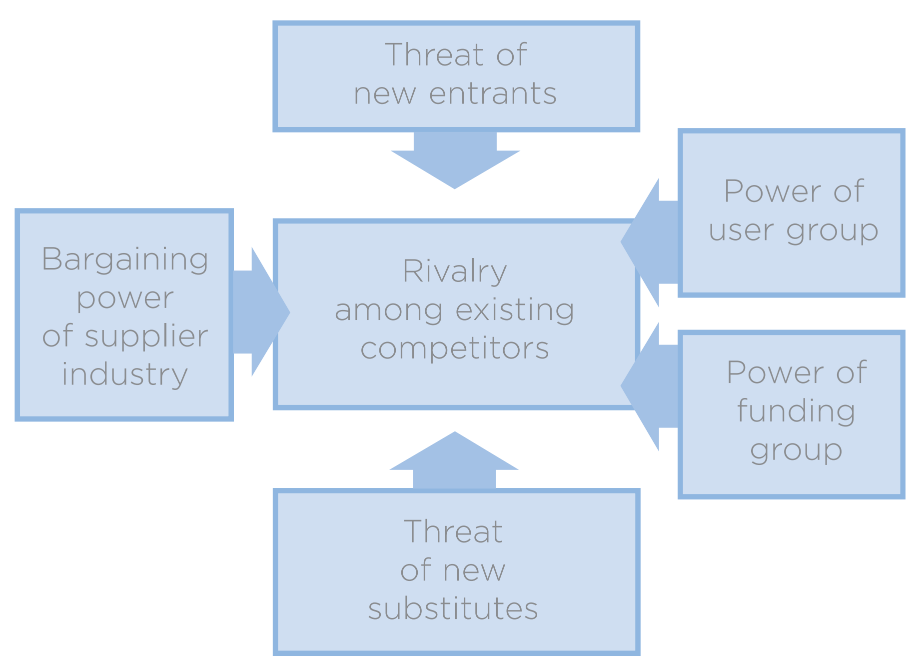
[8] *Supply-Side Scan of Microenterprise Financing,* The Aspen Institute Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination, October 2005.

Figure 1. Michael Porter's "Five Forces" Framework for For-Profit Organizations



Source: *Harvard Business Review*, January 2008.

Figure 2. Sharon Oster's "Six Forces" Framework for Nonprofit Organizations



Source: *Strategic Management for Nonprofit Organizations: Theory and Cases,* 1995.
(Chart labels have been modified slightly for consistency with Porter's framework.)

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ity to meet the need for bigger deals."

Fortunately for some Indian Country communities, there is a new funding program designed to address the equity shortage. The Montana Indian Equity Fund (Equity Fund) was implemented in 2007 by the Montana Department of Commerce, with support from the Montana State Tribal Economic Development Commission and the Montana Governor's Office of Economic Development. The Equity Fund is a pilot initiative to determine whether and how small contributions of equity might assist American Indian entrepreneurs in accessing commercial loans or other financial resources. In its first year of operation, the Equity Fund's ten clients collectively leveraged $63,000 of equity into more than $550,000 in loans and collateral. Those results demand a close look at the Equity Fund's origins and design. They also suggest that the program could provide a model for business development policy in Indian Country.

Three questions

Outside of Indian Country, sources of equity commonly used for starting and expanding small businesses include home equity, inheritance, and funding from friends and relatives. Within Indian Country, these sources are scarce. According to Pamela Standing, executive director of the Minnesota American Indian Chamber of Commerce, "The lack of equity is the single biggest barrier to the creation of Indian businesses."

Statements like that prompted the entrepreneur development program manager for the Montana Department of Commerce Small Business Development Center to work with the Montana Governor's Office, the Montana State Tribal Economic Development Commission, First Interstate BancSystem, and other members of the Montana Indian Business Alliance in considering whether providing grants of equity to Indian entrepreneurs could stimulate private development on Montana's Indian reservations.

The program manager considered three key questions at the outset.

FIRST,

Why is the private business sector underdeveloped in Indian Country?

The program manager concluded that the answer lies in 150 years of history. Prior to the mid-1800s, the Indians of the American West were highly engaged in trade through vast intertribal networks that often included European and American traders. In the latter half of the nineteenth century, as a result of the westward expansion of white settlement and the development of federal policies that removed Indians to reservations, these networks ceased to exist. Reservation communities were virtually isolated from external commercial activity, with the exception of minimal business dealings in the reservation border towns. In the absence of trading networks and traditional means of livelihood, an alternative economic model developed. Reservation communities became dependent on the federal government for their survival. While the economies of adjacent non-Native communities continued to develop through trade and other commercial activity, the entrepreneurial culture that once defined many tribes largely faded away.

An informal model of government dependency persists, affecting development efforts in much of Indian Country. Today, most Indian Country economic development strategies focus on businesses owned and managed by tribal governments. Even in communities where successful, tribally owned enterprises are found, there is often little business diversity because private sectors are typically underdeveloped. And, for the most part, the limited private sector activity that does exist within Indian reservations remains outside mainstream financial markets.

SECOND,

How do business owners outside Indian Country access sources of financing?

In non-Native communities, the commercial banking system is the predominant source of business development finance. The equity of the entrepreneur or business owner enables access to this source of financing. It is the borrower's "skin in the game" that commercial lenders require to mitigate risk. Through the use of equity and the commercial loan capital it generates, a business owner can be truly entrepreneurial and actively move his or her business forward. This commercial financing activity is what drives business development in market economies.

THIRD,

Given the scarcity of equity sources for Indian entrepreneurs, would an injection of equity help make a deal happen in Indian Country, as it does for business owners elsewhere?

To answer this question, the Montana Department of Commerce was willing to create a pilot program to see what effect small grants of equity might have.

Mirroring the commercial loan process

The Equity Fund's developers based the program on a straightforward premise: The scarcity of equity available to Native American business owners is a significant barrier to business development in Indian Country; therefore, providing equity should assist in opening up financial markets to the Indian entrepreneur. Accordingly, the Equity Fund's developers took a straightforward approach in designing the program's features.

The Equity Fund was developed to closely parallel a commercial loan process, as opposed to a grant program or other special funding program. For example, the Equity Fund application was based on a typical commercial bank's loan application. This proved to be an important component of the Equity Fund's success, as it aligned the thinking of both the equity applicants and the Equity Fund's review committee members with commercial financing practices. And, as in commercial lending, the equity applications were not competitive; instead, they were reviewed on a first-come, first-served basis. There was only one requirement attached to the awarding of an equity grant. Each recipient had to provide a dollar-for-dollar match for the grant, in the form of collateral or loans. Recipients could leverage their equity grants to acquire loans from lenders of their choice.

The equity application review was developed as a two-part, two-committee process. The first, or local, committee consisted of a commercial bank loan officer,[4] a person of good standing from the applicant's community, and a representative from a local development corporation. The local committee provided a recommendation to the second review group, which included staff from the Montana Department of Commerce and the Montana Governor's Office of Economic Development. Final approval was reserved for the director of the Montana Department of Commerce.

To manage an applicant's risk, the Equity Fund's developers applied the same criteria and quality assurance measures as in a typical commercial loan. For example, in order to keep the application process in line with commercial financing practices, they chose not to attach special prerequisites to the grants. As a means of managing risk, lending programs offered by nonprofit organizations often make applicants complete special requirements, such as training or technical assistance, before they provide loans. Since special prerequisites are not usually required for a commercial loan, the Equity Fund's developers omitted them from the application process.

The Equity Fund veered away from a commercial lending model in one important respect. In a typical commercial bank's loan application risk assessment, credit history is a major factor. However, because having a poor credit history or no credit history at all is common among the American Indian population, often due to limited or no banking experience, the credit review is frequently a deal-killer for business loans in Indian Country. Recognizing this, the Equity Fund criteria allowed credit reviews, but for informational purposes only. Instead of using the credit review as the basis for approving or denying an application, the local review committee evaluated each applicant in the way a traditional, small town banker might evaluate a potential borrower, by asking "Is he or she good for it?" The committee relied on the character endorsement from the member of the applicant's community in this component of the review.

Success stories

The ten recipients of the Equity Fund's first-year allocations included several Indian artists, a small engineering consulting firm, a home care assistance provider, a beauty salon, an educational consultant, a silkscreening business, and a home remodeling and renovation company. They represented six of Montana's seven reservations, as well as the Little Shell Tribe of Chippewa Indians of Montana—a landless tribe headquartered in Great Falls. The equity grants the entrepreneurs received ranged from $3,375 to $7,875. To illustrate how the recipients used their grants, three of their stories are highlighted below.

April Custer owns **Care and Comfort Home**, a home care service for medical patients. Her business is located in the

Meet the entrepreneurs.
To view photos of the Montana Indian Equity Fund clients profiled in our article, visit *Community Dividend* on the Publications tab at www.minneapolisfed.org.

Photos by R.W. Warren

town of Havre, which is adjacent to the Rocky Boys Reservation in north central Montana. Custer received an equity grant of $7,875 to hire a part-time bookkeeper so she could expand her services. Upon further discussion with the local review committee, Custer decided instead to purchase and renovate a building. She leveraged her equity with $150,000 in loans from a local commercial bank and $49,918 in community development block grant funds, for a total match of $199,918. Custer moved the business into her new facility in February 2008. She is now planning to further expand the business to serve additional clients, "as soon as I can find more money."

Curtis and Jenny Trinder own **Trinder Enterprises**, a remodeling business on the Fort Peck Reservation in northeastern Montana. The Trinders received an equity grant of $4,375 to purchase appliances and a cabinet display. The immediate growth in sales they realized as a result of the expansion encouraged them to seek a $225,000 loan from a local development corporation for the purchase of a building and inventory, including cabinets, appliances, flooring, paint, wall coverings, and window treatments. The business is now a full-service home renovation center.

"The equity grant really helped us see that expanding our business in this direction was a good move," says Curtis Trinder.

Rae Ann Cline owns **The Mane Event**, a beauty salon in the town of Browning on the Blackfeet Reservation in northern Montana. Cline received $7,875 for equipment, inventory, and cash flow. As the deal moved forward, however, Cline expanded her business plans to include a space for a coffee and gift shop. Using her equity grant, she established a relationship with a commercial bank and received a loan for $21,000 to fund the expansion. According to Cline, the business expansion has made her salon "a place where my customers can truly relax."

Moving into the mainstream

These three Equity Fund recipients turned their aggregate $20,125 in equity grants into $445,018 in loans. Collectively, the ten Equity Fund recipients matched $63,000 with $550,603 in loans and collateral. An impressive result, but the Equity Fund's success at attracting resources and empowering entrepreneurs can be measured even more broadly. Grants from the Equity Fund enabled these Indian business owners to move into the mainstream of business finance, build relationships of trust with commercial lenders, and enter what the Peruvian economist Hernando de Soto calls the "bell jar," or mainstream, of commercial activity.[5]

Significantly, the positive developments have not all been business-related. Several of the Equity Fund recipients have become much more involved in their communities. Cline has become active in the Browning Chamber of Commerce as a business mentor, Curtis Trinder is now mentoring youth entrepreneurs, and Custer is serving on community health boards.

Dr. Johnel Barcus, executive director of the Browning Community Development Corporation on the Blackfeet Reservation in Montana, is encouraged by the Equity Fund's impact in her community.

"Until recently, the possibility of owning a business has been a mere pipe dream for our tribal members. With the creation of the Equity Fund and seeing what it enabled Rae Ann to do with her salon here in Browning, other potential business owners in my community now know that they, too, can achieve their dreams. This fund is very significant for us."

Shannon Augare, a Native American Montana legislator who serves as director of public policy and community relations at Rural Dynamics Incorporated, is encouraged as well.

"The Equity Fund offers an invaluable service by providing equity to entrepreneurs from Indian Country who would otherwise not have access to such funds," says Augare. "This program proves that by giving these entrepreneurs a chance, they will not only succeed, but will also bring a sense of pride and accomplishment back to their communities."

The Equity Fund's success may have implications for Indian Country policy development. It demonstrates that policymakers should consider directing funds for Indian business development toward sources that will put equity into the pockets of the wealth creator—the entrepreneur—and enable him or her to access conventional sources of business financing.

Soon, more Indian entrepreneurs in Montana will have an opportunity to benefit from this new, equity-focused approach to business development. The Montana Department of Commerce funded the equity project again for 2008 and is open to receiving additional funding from other sources. Anthony Preite, director of the Department of Commerce, sees promise in the Equity Fund's initial success.

"The hope is that by enabling Indian business owners to enter the mainstream of commercial finance, there will be a ripple effect that will lead to a wave of entrepreneurial development and growth."

Shawn Real Bird, who serves as chair of the Montana State Tribal Economic Development Commission and economic development director for the Crow Nation, concurs, adding, "Without the development of a private sector in Indian Country, our only alternative is to continue in poverty."

Access to affordable financing is essential to the development of private businesses. Maybe the simple provision of equity to Indian business owners can help make it happen. cd

Business alliances promote private sector development in Indian Country

As our main article describes, there is a growing movement to create private sector economies in American Indian communities. One driving force in this movement is a network of Indian Business Alliances (IBAs) that are working to build the tribal legal and governmental infrastructure necessary for private businesses to thrive in Indian Country.

Each IBA is a diverse, statewide coalition of Indian tribes, nonprofit organizations, financial institutions, private businesses, and government entities. IBA members are united in their mission to develop the commercial laws, court systems, support systems, and policies needed to create private business sectors on Indian reservations.

The IBA concept took root following the first Montana Indian Business Conference (MIBC), which was held in Great Falls in February 2006. Prior to the MIBC, most Indian business development efforts in Montana and elsewhere focused on tribally owned enterprises. In contrast, the MIBC emphasized the importance of building a foundation for private Indian business development and entrepreneurship. Following the MIBC, more than 70 participants from 50 different organizations continued to meet and share ideas. In May 2006, they formed the Montana Indian Business Alliance (MIBA) as a means of sustaining their efforts.

Since then, the MIBC/MIBA model has been replicated in other states. The Federal Reserve Bank of Minneapolis, which was a key sponsor of the MIBC and a founding member of MIBA, has cosponsored Indian Business Conferences in South Dakota (February 2007) and Wisconsin (February 2008). At the close of the conferences, participants formed IBAs for their respective states. Efforts to establish IBAs in two other states in the Ninth Federal Reserve District are in progress. The first annual Minnesota Indian Business Conference, scheduled for October 2008, will close with the formation of an IBA, and discussions about forming an IBA in North Dakota are under way.

To further their mission of promoting private business development in Indian Country, IBAs deliver technical assistance and training to Indian business owners, entrepreneurs, and mentors; create networking resources, such as web sites and membership directories; provide tools and workshops for the development of tribal commercial laws and tribal courts; and promote small business lending and development programs. To learn more about the IBA model, contact Sue Woodrow, Community Affairs project director at the Minneapolis Fed's Helena, Mont., branch, at 406-447-3806 or susan.woodrow@mpls.frb.org.

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[1] Kate Spilde Contreras, Ph.D., *Business Development in Indian Country,* prepared for the National Congress of American Indians Policy Research Center (NCAIPRC), May 2007, p. 3.

[2] Stephen Cornell and Miriam Jorgensen, *The Nature and Components of Economic Development in Indian Country,* prepared for the NCAIPRC, May 2007, pp. 7–8.

[3] Examples of these programs include the Entrepreneurial Center at Sitting Bull College on the Standing Rock Sioux Reservation, the Mille Lacs Band of Ojibwe's Small Business Development Program, and the Browning Community Development Corporation's "Indianpreneurship" business training workshops.

[4] Loan officers from First Interstate Bank, Bear Paw Development Corporation, and Great Northern Development Corporation volunteered for this role in the pilot program.

[5] Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else,* 2000, Basic Books, New York City, p. 66.

Native CDFIs work toward a new economic reality in South Dakota

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invest wisely, it's possible to provide a solid return to your investors and manage capital responsibly while connecting nonconforming customers to the economic mainstream."[2]

Many CDFIs have become specialized in serving particular populations or geographic areas. For example, a CDFI might focus on providing affordable housing to recent immigrants or making small business loans within a designated county. A subset of the CDFI field specializes in providing loans and financial services to Native communities. The Ninth Federal Reserve District is home to a large proportion of Native CDFIs, and one Ninth District state in particular—South Dakota—is an important proving ground for the Native CDFI field. In this article, we trace the development of CDFIs and share specific information about several Native CDFIs in South Dakota.

Origins and growth

The origins of CDFIs date back several decades. In the 1960s, the federal government established the Office of Economic Opportunity to support antipoverty initiatives in urban and rural communities. Some of these initiatives, such as Community Action Programs (CAPs), promoted citizen engagement and community control. CAPs gave rise to community development corporations (CDCs) and CDFIs arose out of the necessity to secure financing for the grassroots economic development efforts of CDCs. ShoreBank in Chicago, which was founded in 1973, is often cited as one of the earliest CDFIs.[3]

Throughout the 1970s, the movement to revitalize low-income communities gathered momentum as major institutions stepped forward to provide support. CDCs got a significant boost from the Ford Foundation, and CDFIs expanded their funding sources through contributions from individuals and faith-based organizations. Federal agencies, including the U.S. Department of Housing and Urban Development, the Department of Agriculture, and the Economic Development Administration, launched business development loan funds. Community development banks and credit unions were organized during the decade as well.

The growth of the CDFI field accelerated in the 1990s, spurred by two events. The first was the establishment of the CDFI Fund in 1994. The second event occurred in 1995, when the Community Reinvestment Act (CRA) was revised. The CRA requires depository institutions to meet the credit needs of their entire communities, including low- and moderate-income neighborhoods. Under the revised rules, banks could get CRA credit for lending to and investing in CDFIs. In addition, the rise of national CDFI intermediaries and trade associations such as Opportunity Finance Network provided an advocacy, policy, and technical assistance arm to the burgeoning CDFI movement. There are now approximately 800 certified CDFIs across the U.S., according to the CDFI Fund, plus many additional CDFIs that have not sought or received certification.

Barriers and recommendations

While the 1970s through the 1990s saw rapid growth of CDFIs across the U.S. as a whole, American Indian reservations were experiencing a different reality. As of 1999, there were only two Native-focused CDFIs in the country, despite the fact that most Indian reservations are made up of low- and moderate-income communities—the very market that CDFIs were created to serve.

In November 2001, the CDFI Fund released a comprehensive report on lending in Native communities titled *The Report of the Native American Lending Study* (NALS) that described 17 major barriers to accessing capital for business development, homeownership, facilities construction, and other major projects on Indian reservations. Specific barriers included a lack of financial institutions on or near Indian lands, a lack of networking among Native-owned businesses and equity investors, uncertainty regarding tribal commercial laws and regulations, and a lack of technical assistance resources. The report proposed a range of remedies, including improving tribal legal infrastructure and planning processes; creating mechanisms for delivering capital on Indian lands; increasing the level of equity investment and the number of financial institutions on or near Indian lands; developing financial products and services that meet the needs of Native customers; and expanding financial literacy efforts, technical assistance, and training.[4]

Following the release of the NALS, the CDFI Fund sought to increase the amount of support, financing, and technical assistance for establishing or expanding Native CDFIs (NCDFIs). As defined by the CDFI Fund, an NCDFI is a certified CDFI that primarily serves Native American, Alaska Native, or Native Hawaiian people or communities.[5]

As of May 2008, the CDFI Fund recognized 49 NCDFIs in the U.S. In addition, there were approximately 100 Native-focused financing institutions in varying stages of development. The largest numbers of NCDFIs are found in Arizona, Oklahoma, South Dakota, Minnesota, and Montana. The latter three states are located in the Ninth Federal Reserve District, and one of them—South Dakota—is where the NCDFI story officially began.

As the home of several NCDFIs, South Dakota provides a window on the origins and accomplishments of the NCDFI field. The state is home to a total of eight CDFIs that focus on Native communities. Three of them are relatively new and not yet certified as NCDFIs: Cheyenne River Community Federal Credit Union, Sicangu Fund, and Teton Financial, Inc. The remaining five have received NCDFI certification: Lakota Funds; Four Bands Community Fund; Mazaska Owecaso Otipi Financial; Sisseton-Wahpeton Federal Credit Union; and First Nations Oweesta Corporation, the only NCDFI intermediary in the country. We now turn to a discussion of the history and activities of South Dakota's NCDFIs.

NCDFIs in South Dakota

Where it all began: Lakota Funds

In 1986, Oglala Lakota Tribal College and First Nations Development Institute, a national advocacy organization for Native communities, collaborated to establish Lakota Funds (LF). LF was created as a revolving loan fund to finance small businesses on the Pine Ridge Indian Reservation in southwestern South Dakota. The CDFI Fund certified LF in 2002 and later designated it the first NCDFI in the nation.

The founders of LF cite two inspirations, one indigenous and one global. The first was *wawokiye*, the Lakota value of "generosity, helping without expecting rewards or payment."[6] The second inspiration was the Grameen Bank in Bangladesh, a microlending program that has become a model for antipoverty initiatives on several continents.

Around the time of its founding, LF was the only commercial lender located on the 7,000-square-mile Pine Ridge Reservation, where the per capita annual income was just over $3,500 and the unemployment rate was nearly 30 percent.[7] According to Elsie Meeks, a founder and former executive director of LF, rather than "build an economy on donations of used clothes" and other charity, the founders would focus on key roadblocks to economic development, many of them cited years later in the NALS: access to capital, technical assistance, business networks, and infrastructure.[8]

LF began as a microlender. Initially, it financed artists and craftspeople and had a maximum loan size of $500. LF now offers five categories of loans, with limits ranging from $500 to $200,000, and its portfolio includes resorts, contractors, and retail shops.

LF places a heavy emphasis on entrepreneur development. The organization offers a six-week seminar on the fundamentals of business planning called the *Core Four Business Planning Course.* The Wawokiye Business Institute, a technical assistance affiliate that was recently established at LF, begins where the *Core Four* training ends. The institute's Success Coaches provide intensive, one-on-one coaching to fledgling entrepreneurs to give them the best possible chance to succeed.

To promote the financial well-being of the broader reservation community, LF conducts a six-week training course focused on personal finance, budgeting and saving, repairing credit, and reading a credit report. LF builds on the training by operating an individual development account (IDA) program through which people can open savings accounts that provide a two-to-one match for every dollar saved. The savings can only be withdrawn for asset-building purposes: a down payment on a house, funds for starting a business, or money for additional education.

Two recent LF initiatives include the 10,000 Arrows campaign, which seeks donations, grants, investments, and leveraged capital as a means of increasing LF's lending capacity, and the Oyote Woableza Otipi Project, which involves developing two new loan products, improving LF's lending and investment policies, creating partnerships in lending and technical assistance, and promoting business expansion.

Over its 23-year history, LF has made notable progress in developing a private sector on Pine Ridge. According to LF Executive Director Dowell Casselli Smith, the organization has helped establish 325 businesses on the reservation, made a total of $4,118,054 in loans, created 937 jobs, and trained more than 3,600 active or aspiring entrepreneurs.

The place to grow: Four Bands Community Fund

Four Bands Community Fund (Four Bands) is an NCDFI located on the Cheyenne River Indian Reservation in northwestern South Dakota. Since the fund

The growth of the CDFI field accelerated in the 1990s, spurred by two events. The first was the establishment of the CDFI Fund in 1994. The second event occurred in 1995, when the Community Reinvestment Act was revised.

was founded in 2000, it has experienced tremendous growth and is now a guiding force behind small business lending, entrepreneur development, financial education, and state-tribal business development collaborations on the reservation.

According to Executive Director Tanya Fiddler, traditional Lakota values such as generosity, courage, respect, and wisdom underlie the fund's work. Four Bands is based on the concept of *Icahya Woecun,* or "the place to grow." The major goal of Four Bands is to expedite business development and asset building in reservation communities. Loans from the fund can be used for working capital; purchase of land, equipment, or vehicles; or construction.

Four Bands offers extensive business development training that includes an orientation class called *Planting the Seeds of Entrepreneurship* and a comprehensive business development class called *CREATE (Cheyenne River Entrepreneurial Assistance Training and Education)*. In addition, Four Bands offers a financial literacy class and an IDA program and makes a special effort to reach out to youth by offering money management and entrepreneurship education in the local schools, plus a supplementary youth entrepreneur internship program.

Fiddler acknowledges the challenges her organization faces. In a statement on Four Bands' web site, she notes that from a pessimist's perspective, or "a glass half empty," the Cheyenne River Indian Reservation is made up of "very rural towns located large distances from each other and [facing] some of the highest unemployment and poverty rates in the country." However, from an "'asset-based' approach—a glass half full," the reservation is made up of "people with a rich and unique culture, art, leadership, and history."[9]

To make the most of those assets, Four Bands is supporting Native Discovery, a culturally based tourism project that promotes opportunities on the Cheyenne River, Rosebud, and Pine Ridge reservations. Four Bands has worked closely with the State of South Dakota Department of Tourism to advance Native Discovery. The project's web site at www.nativediscovery.org directs prospective visitors to artists, businesses, cultural performances, maps, and group and self-guided tours. The site is offered in multiple languages in order to appeal to international tourists, who have been particularly interested in the history and culture of American Indian tribes in the United States.

Making homeownership happen: Mazaska Owecaso Otipi Financial, Inc.

Mazaska Owecaso Otipi Financial, Inc. (Mazaska), is an NCDFI created in 2004 by the Oglala Sioux Tribe Partnership for Housing (OSTPH). OSTPH is a Native Housing Development Corporation that was established on the Pine Ridge Reservation in 1999 to provide mortgage loans, homeownership counseling, and support for self-help construction.

The mission of Mazaska is to decrease the cost of housing on the reservation and increase the number of homes owned by tribal members. One approach Mazaska has pursued for decreasing housing costs is to originate home construction loans directly rather than work through third-party lenders, who attach expensive requirements to the loans. For example, third-party lenders required new construction on Pine Ridge to include amenities that cost borrowers up to an additional $5,000. When Mazaska began originating its own loans, it dispensed with the amenities and helped borrowers save money.

During Mazaska's short history as an NCDFI, it has focused on improving the performance of the loan portfolio it inherited from OSTPH, creating a set of comprehensive loan policies, and developing several new loan products. In addition, Mazaska has risk-rated its portfolio and adjusted its loan loss reserve account accordingly. The underlying goal of Mazaska's improvements and enhancements is to position the NCDFI to increase the number of homeowners on Pine Ridge. Mazaska has committed to originating at least 15 mortgages per year in order to promote homeownership on the reservation and expedite the elimination of substandard housing units.

An NCDFI revival: Sisseton-Wahpeton Federal Credit Union

In contrast to well-established organizations like LF and Four Bands, the Sisseton-Wahpeton Federal Credit Union (SWFCU) on the Sisseton-Wahpeton Sioux Reservation in Agency Village, S.D., is just beginning to find its legs as an NCDFI.

SWFCU was established in 1979 to provide financial services to members of the Sisseton-Wahpeton Sioux tribe and employees of the school systems and federal agencies that serve the reservation. For nearly 30 years, the credit union has provided savings accounts, personal and vehicle loans, and other services to its customers. It currently has assets of $3 million and more than 2,100 members.

In the early 2000s, the Sisseton-Wahpeton tribe launched an effort to promote policies that would favor small business development on the reservation. To further the effort, the tribe applied for and received NCDFI certification for SWFCU. However, a change in political leadership in 2002 put the tribe's plans for the newly certified entity on hold for several years. Elections in 2006 installed a new administration and the tribe is now in the process of reviving its NCDFI.

According to Barry Zephier, the tribe's small business development specialist, the aim is to expand SWFCU's lending capacity and then spin the NCDFI component off as one or more stand-alone entities that will provide small business and housing loans, technical assistance, and educational services.

"We want to take it to the point where we can provide education and support for small business owners, to help them get started and be successful," Zephier says. "Eventually, we'd like to get the educational component into our K-12 schools and community college, so tribal members will know about credit building before they decide to become business owners."

To prepare for the revival of the Sisseton-Wahpeton community's NCDFI, Zephier is attending training workshops sponsored by community development organizations and seeking advice from other tribes with CDFI experience. A number of the other South Dakota-based Native organizations profiled here, including Four Bands and First Nations Oweesta, have provided guidance and technical assistance.

A unique role: First Nations Oweesta

First Nations Oweesta (Oweesta) in Rapid City, S.D., is the only NCDFI intermediary in the country. It was incorporated in 1999 as an affiliate of First Nations Development Institute and is funded through foundations, banks, service fees, government programs,

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CDFI Fund provides capital for community building

The CDFI Fund, a program of the U.S. Department of the Treasury, is the largest source of capital for CDFIs. It was established in 1994 with the passage of the Riegle Community Development Banking and Financial Institutions Act. As noted in our main article, the CDFI Fund certifies CDFIs and, through a competitive application process, awards them grants, loans, equity investments, and technical assistance funding to support capacity building and capitalization. CDFIs must provide matching funds from private or nonfederal sources in order to receive some types of CDFI Fund awards. 2006 saw the eleventh round of funding for the CDFI Fund, which has awarded more than $800 million to community organizations and financial institutions.

In addition to providing direct support for CDFIs, the fund conducts two programs designed to promote private sector investment in CDFIs. The first is the Bank Enterprise Awards Program, which encourages bank-CDFI partnerships by providing cash awards to banks that invest in CDFIs. As of 2002, banks had received more than $179 million in awards. The second is the New Markets Tax Credit (NMTC) Program, which provides tax credits to private companies that invest in specialized organizations called community development entities, or CDEs. All certified CDFIs are classified as CDEs and are therefore eligible for NMTC investments.

For more about the CDFI Fund, visit www.cdfifund.gov.

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and individual donors. Oweesta helps Native communities determine whether and how to initiate CDFIs and other asset-building programs. It offers training in all aspects of operating a CDFI, including chartering, governance, capitalization, loan products, loan policies, and market studies; helps NCDFIs establish business revolving loan funds, credit unions, banks, and housing loan funds; and provides one-on-one technical assistance. Oweesta also operates a business development fund that provides loans to NCDFIs ranging from $50,000 to $250,000. Grant programs and additional loan products are in development.

In addition to institution building, asset building, housing, and other development projects, Oweesta has a strong interest in promoting financial literacy in Native communities.

"At the local level, our clients often need to provide a lot of technical assistance and training to potential entrepreneurs—for example, in financial literacy—before they're able to get and effectively utilize loans," says Stewart Sarkozy-Banoczy, vice president and chief operating officer of Oweesta. "We at Oweesta provide whatever assistance is necessary on the national level so our clients have the tools to do that."

Oweesta spearheads the technical assistance and training components of the *Building Native Communities: Financial Skills for Families* curriculum and is a founding member of the Native Financial Education Coalition, a planning and collaboration hub for Native financial education efforts, pilot projects, information exchanges, and policy updates.

Oweesta's unique role as an innovator and information broker enables it to experiment with bold ideas. One example is the Enterprise Development System (EDS), a conceptual model for launching successful entrepreneurs. EDS is based on the premise that "by systematically growing the private sector in Native communities, conditions of long-term poverty can be reduced."[10] The fourfold program includes client-centered, on-site, long-term technical assistance, with access to equity and debt capital; policy change to support entrepreneurship; education; and access to networks.

One major step Oweesta has taken toward implementing entrepreneurship systems for Native communities was to establish the Native Enterprise and Entrepreneurship Development (NEED) Initiative, funded by the CDFI Fund. NEED is a training and technical assistance program that helps Native communities form partnerships and develop supportive social, physical, legal, and business climates for entrepreneurs.

Taking the first steps

Although NCDFIs got a late start in comparison to the broader CDFI field and faced circumstances that seemed daunting, their progress on multiple fronts should stimulate a greater flow of resources in their direction. Additional funding and support will enable NCDFIs to continue growing in numbers, capacity, and influence. According to individuals involved with South Dakota's NCDFIs, there is strong interest in expanding the field.

"Interest in CDFIs is on the rise in Indian Country," says Zephier of the Sisseton-Wahpeton tribe. "More people are looking at the CDFI model and asking, 'How can we bring this to our community?'"

Sarkozy-Banoczy of Oweesta sees promise in a "giant wave of NCDFIs that have emerged recently," and notes that large amounts of funding that the CDFI Fund has recently awarded to NCDFIs are "a good sign for other funders to take note of."

However, he acknowledges the challenges Native communities face. To promote economic development, they need to build their human capital through training and technical assistance. They also need to address basic legal and physical infrastructure needs before commercial development can take place. In Sarkozy-Banoczy's words, "We have to crawl before we can walk."

In South Dakota, NCDFIs are working to help their communities do both of those things. Their commitment is an indication that the NCDFI field holds promise for enabling Native communities to meet their challenges and take their first steps toward a new economic reality. cd

1 *Three Year Trend Analysis of Community Investment Impact System Institutional Level Report Data, FY 2003–2005,* Community Development Financial Institutions (CDFI) Fund, December 2007.
2 "CDFIs at a crossroads: A conversation with Mark Pinsky of National Community Capital Association," *Community Dividend,* Issue 3, 2005. Available at www.minneapolisfed.org.
3 The label "CDFI" was not created until years later; however, we use it throughout this article for consistency.
4 *The Report of the Native American Lending Study,* CDFI Fund, November 2001, pp. 4–10.
5 In addition, an NCDFI must identify a target market consisting of a Native American population, qualified census tracts located in Indian reservations or Alaska Native villages, and/or a low-income population. To read the full definition of an NCDFI, visit www.cdfifund.gov/docs/certification/CDFI/CDFIcertification/Application.pdf.
6 *Standard College Dictionary,* Harcourt, Brace & World, Funk & Wagnalls, 1966, p. 1,283.
7 U.S. Census Bureau, 1990.
8 The Lakota Fund, "Message," www.lakotafund.org/message.htm.
9 Four Bands Community Fund, "About Us—History, Mission, and Values," www.fourbands.org/hismisval.htm.
10 First Nations Oweesta, "Oweesta Collaborative EDS Initiative Interview," www.oweesta.org/oc/overview.

News and Notes

High schoolers' financial literacy remains low, survey finds

The financial literacy of high school seniors in the U.S. remains low and declined slightly over the last two years, according to a biennial survey conducted by the Jump$tart Coalition for Personal Financial Literacy (Jump$tart) and funded by the Merrill Lynch Foundation.

The survey consisted of 31 multiple-choice questions on topics such as credit cards, savings, investments, insurance, and mortgages, plus a series of 25 additional questions about students' socioeconomic backgrounds, academic interests, and financial habits. Jump$tart surveyed nearly 5,900 twelfth graders in 40 states and also conducted an identical survey among more than 1,000 full-time college students nationwide.

On average, the high school respondents answered just 48.3 percent of the survey questions correctly—a decrease from the 2006 survey's already low average of 52.4 percent. As in previous survey years, the average score for 2008 corresponds to a failing grade of F on a typical academic scale. White students had an average score of 52.5 percent, while Hispanic and African American students scored lower, averaging 45 percent and 41.3 percent, respectively. Students who scored 27 or better on the ACT college entrance examination answered 59 percent of the questions correctly, on average, while students scoring 20 or below on the ACT had an average score of 43 percent.

According to state-specific results of the high school survey, students in four of the six states in the Ninth Federal Reserve District scored better than the national average. Twelfth graders in Wisconsin had an average score of 57 percent. Average scores for South Dakota, Michigan, and Minnesota were 54.9 percent, 54.5 percent, and 53.1 percent, respectively. (Survey results for Montana and North Dakota are not available.)

College-level participants outperformed their high school counterparts by answering 62 percent of the survey questions correctly, on average. Still, their comparatively high score corresponds to a failing grade on an academic scale. When grouped by class year, the results show that the level of financial literacy climbs slightly higher with each successive year in college. The average score for freshmen was 59 percent, while the average scores for sophomores, juniors, and seniors were 61 percent, 62 percent, and 65 percent, respectively. On average, white college students scored 63.3 percent of the questions correctly, Hispanic college students scored 59.8 percent, and African American college students scored 55.3 percent.

To view detailed survey results, visit www.jumpstart.org and click on "Downloads."

OCC releases mortgage metrics report

A new report from the Office of the Comptroller of the Currency (OCC) reveals that more than 90 percent of the mortgage loans serviced by nine of the largest national banks are in good standing. The report, titled *OCC Mortgage Metrics Report: Analysis and Disclosure of National Bank Mortgage Loan Data, October 2007–March 2008,* is based on an analysis of comprehensive, loan-level data from October 1, 2007, through March 31, 2008, on all first residential mortgages serviced by the nine national banks with the largest mortgage servicing portfolios.* Combined, the nine banks service 23 million first mortgage loans, or 40 percent of all mortgages outstanding in the U.S. The OCC notes that the total portfolio is not representative of the overall mortgage market, since the subprime mortgages captured in the data set make up just 25 percent of all subprime mortgages.

The report focuses on loan modifications, delinquencies, loss-mitigation activities, and foreclosures. According to the findings, 94 percent of mortgages in the total portfolio were current and performing as of March 31, 2008. There was a steady rise in foreclosures over the study period, from 0.9 percent to 1.23 percent, resulting in a total of 283,988 foreclosures in progress at the end of March. Subprime mortgages made up less than 9 percent of the total portfolio during the study period, but were tied to 43 percent of all loss-mitigation activities and 47 percent of all loan modifications.

The *Mortgage Metrics Report* is the first of a planned series; additional reports will be published quarterly. To read the report, visit www.occ.gov/ftp/release/2008-65b.pdf.

* The nine banks are Bank of America, Citibank, First Horizon, HSBC, JPMorgan Chase, National City, U.S. Bank, Wachovia, and Wells Fargo.

Calendar

Minnesota Indian Business Conference. October 28–29, hosted by the Prairie Island Indian Community at Treasure Island Resort and Casino in Welch, Minn. Sponsored by the Minnesota American Indian Chamber of Commerce, the Federal Reserve Bank of Minneapolis, and more than a dozen partner organizations. Additional information: call 651-789-6533 or e-mail pjstanding@maicc.org.