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Flush with capital, CDFIs need to start thinking bigger

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There was a time not long ago that community development financial institutions and minority-owned banks struggled to find the capital needed to increase financial inclusion, catalyze growth and reduce inequality in low- to moderate-income communities across the United States. Today, though, the sector has the opportunity to scale up by increasing total assets by a factor of 10 — and commensurately increase the impact in LMI markets.

Everything changed last year when the Black Lives Matter movement helped local and national leaders recognize the sector as an important agent of change in these communities. Both the public sector (via the Emergency Capital Injection Program and CDFI Fund) and the private sector are investing new capital and committing other support to these institutions — in billions, rather than millions, of dollars.

The industry is now at a pivotal and transformative moment in its history. It has the potential to reimagine and scale up the impact in LMI communities that form the foundation of their work and help solve social and economic justice issues that our society faces. Here is what needs to be done for the sector to achieve scale:

First, CDFIs and minority-owned banks must reimagine themselves and think about growth in a radically different manner — specifically, they need to scale up tenfold. With the inflow of new capital these institutions have an opportunity to do exactly that — adapt their business models radically, invest in human capital and physical infrastructure, as well as enter into partnerships to originate assets and implement programs that meet the impact goals of their work. For example, City First Bank in Washington, D.C., and Broadway Federal Bank in Los Angeles recently merged, creating the largest African American-focused bank in the U.S.

Second, CDFIs and minority-owned banks must focus on becoming investor-friendly, even as they are generating impact. They need to create robust strategies to provide return on and return of capital to investors within a reasonable period of time. Institutions that adopt this approach can access more capital and hence scale. On the other hand, institutions that do not adopt an investor-friendly approach will find it difficult to grow.

Finally, investors and funders need to make long-term commitments, not one-off contributions. This is not about a moment of good public relations for a few CEOs; it is about catalyzing a lifetime of change for hundreds of thousands of Americans. Several large banks, corporations and financial technology companies have committed capital and funding to the sector, and this capital has to have three characteristics:

1. **Long-term capital** — investors and funders need to commit capital that is long-term in nature. It takes years, decades and sometimes longer to create vibrancy in these communities that have suffered from disinvestment. Long-term capital is needed that can be deployed in a patient manner to meet the needs in local communities.

2. **Lower-cost capital** — creating change in communities requires a combination of capital from market rate to lower-cost capital. Lower-cost and philanthropic capital is needed for creating a safety net and/or loan-loss reserves, and long-term capital helps in filling gaps in capital stacks, while market rate capital can be used to generate scale.

3. **Significant amounts of capital —** corporate America and the government must commit capital at scale in order to solve the social and economic justice issues that are so deeply ingrained in society.

We laud the major banks, foundations and philanthropists, as well as the Congress and Treasury for their equity investments into CDFIs and minority-owned banks — a vindication of work done over the last several years. At the same time, it is concerning when corporations believe that by placing fully insured, market rate, short term deposits into banks, they can create change. We need greater engagement as we collectively define success.

The industry needs to do a better job of measuring and communicating the impact of CDFIs and minority-owned banks. The sector needs to step up to measure the impact that they generate in a qualitative and quantitative manner. This will allow benchmarking and also generation of longitudinal analysis to further support the case.

Technology partners need to partner as enablers for the sector to support scaling. The sector generates data on its borrowers and depositors that can be used to make more inclusive decisions on lending. Several technology companies have used this information to take business away from the banks. Can we create a symbiotic relationship for mutual gain?

Here's the good news: The sector now has a real road map showing how best to scale up significantly to create more jobs, support more small businesses, foster sustainability, and promote individual success in minority communities.

The tragedy here is that it took the death of George Floyd and other Black Americans and the Black Lives Matter movement to galvanize the attention of the nation. But now, there is before us a truly once-in-a-lifetime opportunity to bring together enough human, infrastructure and financial capital from the government, philanthropies, the tech sector, individual donors and other sources to create unprecedented hope and opportunity for low- and moderate-income communities across rural and urban America.

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