Community Loan Funds for Business Development

by Jack McCall

On the frontier, the barn raising was a part of the economic and social structure of the community. It was quite simple: when a farmer needed a new barn, all of the farm families in the area gathered, worked together, socialized, and in a couple of days completed the structure. It is a picture of the past, of neighbors helping neighbors to increase the others ability to earn a living, and to increase the economic activity of the settlement.

One of the modern equivalents of the barn raising is the community loan fund gathered by people in a community to assist others in starting businesses.

A small town in Missouri which had been very successful in recruiting and maintaining some large manufacturers found itself in the position of having more jobs than people living in town. Workers and executives were forced to commute from as far away as fifty miles. Most of these people were well paid but were spending most of their income in other places. As a result, a great deal of the economic benefit of the businesses was being lost.

Community members gathered and decided they would try to recruit housing developers in the same way they had recruited their present industries. This proved to be more difficult than imagined, despite survey results which indicated that more than one million dollars of housing could be sold immediately. No outside developers were interested.

However, there were some young entrepreneurs willing to take the project on if they could acquire the necessary capital. Led by the local bank, a group of local people pooled their money, forming a revolving loan fund. Money from the fund was made available to assist the local entrepreneurs create a corporation and successfully complete the first round of construction. As the houses were sold, the loan fund was replenished — allowing those who contributed to the fund to make good on their investment, while also maintaining a funding source to assist future projects. And, of course, the town benefited by enabling more of its workforce to live in town.

Community revolving loan funds are increasingly being used to supplement other credit sources. They can provide critical financial support to local businesses which have a somewhat higher level of risk or not enough equity to qualify for a conventional loan. The loan funds are usually sponsored either by the local government or by a non-profit, and administered by a volunteer board of directors. As the loans are repaid, the fund is replenished for others to borrow from.

Look Before You Leap

While revolving loan funds have worked in many communities, it's important to think through what you want to accomplish, and what you will need to do.

1. You will need to carefully consider the purposes and goals of the fund. Will you try to provide all the funding for a business or part of the equity needed for the entrepreneur to acquire commercial bank funding? Most communities have found that revolving loan funds work best as a lever to other funds. It is also invaluable to involve people with experience in the kinds of businesses the loan fund will be trying to encourage. Similarly, it makes sense to draw on the talent of members of your local banking community.

2. Learn from what other communities have done. Your state's economic development agency is likely a good place to get information about the steps in setting up a revolving loan fund, and will probably be able to point you to successful examples within your region. Then arm yourself with questions and go out and visit some communities that have already made use of loan funds.

3. Revolving loan funds need to include clearly spelled-out policies on items such as:

a. eligibility criteria for loans;
b. the development of a business plan by loan recipients;
c. penalties for failure to repay;
d. reports required to be filed by the loan recipients;
e. counseling and other assistance available (support during the first few years of a loan is especially important); and
f. equities, cash requirements, or alternatives to these requirements.

The key to success is careful planning and ongoing communication with the loan recipients. It is also critical that the goals and purposes of the loan fund be clearly articulated to avoid misunderstandings and any impression that the loan fund is a "give away" program.

Whatever your purposes, loan funds can be an important method of increasing economic activity and making sure that your community's economic development efforts will have maximum impact. ◆

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