Assessing the Value of Small Business Loan Programs and Loan Sales: Tools to Guide CDFI Decision-Making

June 2024

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Introduction

Before the pandemic, most small business lenders that are community development financial institutions (CDFIs)[1] relied entirely on their own balance sheets to fund loans. Net assets gained through philanthropy and CDFI Fund awards enabled balance-sheet borrowing and lending. Only those CDFIs with much larger average loan sizes covered their expenses through earned income; most CDFI small business lenders and 100% of CDFI microlenders require subsidy in the form of philanthropic or government support. The approach to growth was simple and focused on a mix of increasing lending and fundraising for additional net assets to leverage. This model is referred to as "originate-to-hold," and banks, foundations, and the public sector largely encouraged and supported it.

Very few CDFI small business lenders used asset sales to raise liquidity and diversify risk by shifting loans off their balance sheets. In relation to total lending by the industry, loan sales were small and typically driven by specific, unique circumstances at a particular lender or by the availability of guarantees and a ready-made market (e.g., Small Business Administration 7[a] loans). Most CDFIs lacked the scale to originate and sell large portions of their small and microbusiness portfolios, and when they did, it was difficult to do cost-effectively. Furthermore, investors who might purchase loans lacked the information typically available in more established secondary markets that would enable these individuals to understand the risk.

During the pandemic, the approaches available to CDFIs expanded significantly. CDFIs were asked to grow their lending—but in different ways. The Paycheck Protection Program asked lenders to originate loans for fees, growing a portfolio that would be largely forgiven. Cities, counties, and state governments asked lenders to originate loans to specific credit boxes or to provide grants to small businesses in exchange for processing fees. Funders asked lenders to grow but to do so with loans at highly subsidized rates through "buydowns." Even more complex loan participation programs sprouted—so-called originate-to-sell models, such as the New York Forward Funds, California Rebuilding Fund, and Southern Opportunity and Resilience Fund. The brand-new Scale Link (at the time, the Entrepreneur Backed Assets (EBA) Fund) asked CDFIs to consider even those loans they intended to hold as potential sources of capital and, crucially, revenue through CRA-motivated sale premiums. All these tools enabled CDFIs to grow, helped them deal with their own liquidity and risk constraints, and, in some cases, increased revenue and margins on these difficult-to-originate loans (i.e., Scale Link).

As funders and policymakers ask CDFI lenders to embrace parts of these new tools, the era of lending prior to the pandemic becomes unlikely to return. The reauthorization of the State Small Business Credit Initiative (SSBCI) added even more complexity, with many states now offering guarantee, capital access, loan participation, and other programs—all providing tools aimed to increase lending and enhance mission impact. With these expanded options, CDFIs face a new set of strategic choices about whether to hold or sell loans they originate, whether to partner to deliver loans and grants, and how to address the novel programs proposed. To the extent that these programs are built around a

[1] We use the initialism CDFI without the designation of "small business focused" for simplicity throughout the remainder of this paper. We recognize that the approaches described are unique to small business lenders.

new product or different qualification criteria, the CDFIs also confront implications about whom they serve and how changes to their client profiles affect their target market requirements for CDFI certification and their ability to raise philanthropic dollars.

Participation in these new capital tools has both mission and financial implications for the CDFI, and decisions about whether and how to engage are complex to navigate. To assist CDFIs in making these choices, Scale Link and the Business Ownership Initiative have created this decision guide and financial modeling tool. It can be useful in making an initial decision on whether (or how much) to participate in a particular program or fund—or in assessing how to negotiate with a private or public funder about the parameters and economics of the program. This resource can also help CDFIs reassess the extent of their participation as they learn more over time about the financial and mission implications of a particular program.

Why and how to use this tool

The purpose of this tool is to guide CDFIs—and also potential funders—through the process of analyzing new lending programs. These programs can take a variety of forms: guarantee, capital access, or participation programs offered through the State or Tribal Small Business Credit Initiative or the Small Business Administration; privately sponsored "originate-to-sell" programs in which CDFIs can make loans to be sold to a special purpose vehicle or a fund owned by another entity; or programs focused on a specific target population or purpose (such as a disaster relief program), in which the funder sets some or all of the product parameters.

This resource focuses on the four basic factors to be considered in assessing a program's strategic and financial impact on the CDFI. With some initial assumptions about those factors, this tool helps a CDFI to assess the pros and cons of a program relative to these four key factors. By looking at how these pros and cons come together, this guide then points the user to the next set of questions or level of financial analysis needed for making a decision. This document is accompanied by a financial model to help a CDFI go deeper into a program's implications. Click here to download it.

Although this document is written as a paper, we, its authors, don't expect you to read straight through it; instead, think of it as a tool with written instructions. We've set up this tool so that after you complete Step 2, you can use the index at the beginning of Step 3 to jump to the section of the instructions that raises the relevant questions and next steps based on your initial assessment of the program.

At its core, this resource focuses on the trade-offs CDFIs face between scale, impact and fairness, and sustainability. In all cases we have seen to date, CDFI lending under $100,000 requires some subsidy and support, and this tool helps CDFIs navigate these tensions.

Critical Decision Factors

This analysis tool brings together the four factors critical for determining whether a proposed program aligns with an organization's strategic and financial needs: cost, revenue, mission and strategic impact, and implications for subsidy. Although cost data can be complicated to derive, it is possible to start using this tool without having exhaustive information and simply employing a rough outline of the proposed program or approach. Having a rough sense of the program outline enables users to begin the iterative process outlined here.

The process starts with filling out trade-off tables, which give a rough sense of a program's financial viability and impact. Once these tables are complete, the conclusions drawn from them can be used to complete an initial review of the financial modeling tool that accompanies this guide. After completing those steps, users might conclude that they need to negotiate differently on the program economics, recommend changes to program eligibility, or make other adjustments with the funder (private or public). Counteroffers and proposed amendments can then be run back through the process in an iterative fashion.

To complete the initial analysis of the trade-off tables, you will need the answers to the following five questions:

1. What is the product structure (loan or grant), and what are the terms and conditions?
2. What are the eligibility (borrower based and geographic) and underwriting guidelines?
3. Based on question 2, what customers are you likely to serve?
4. Who are the funders (even if not direct to you but of the overall program), and what costs are they covering for you? Are there additional fees and grants you can earn?
5. What is the administrative and compliance burden? (Look at the data they require and the amount of servicing you may need to complete, for example.)

Based on these answers, your team can roughly estimate the costs; break them into the direct costs (underwriting and servicing) and indirect costs (administration, loan loss reserve [LLR], client acquisition costs).

If this presents too much complexity for "back of the envelope" assumptions, the attached financial model can be filled out with assumed numbers. Estimating these numbers uses big jumps of logic, but the process can still help put a confidence interval around outcomes. Starting from the financial model will require assumptions that can then be honed as you work through the following considerations.

Analysis

Once you have collected information on the five items listed previously, using the data to complete the following two matrices will allow you to weigh critical outcomes of the program against one another. Typically, any new program will affect the ability of a CDFI to achieve its mission and raise philanthropic subsidy over the long term; new programs will also present tough choices related to organizational capacity and focus. Navigating trade-offs requires a systematic framework such as the one presented here, which will help highlight where additional context is important. No financial model alone will answer critical strategic questions, but a systematic process will highlight the choices necessary.

Each of the following matrices presents nine scenarios based on the intersection of the key variables identified previously. The first matrix juxtaposes costs and revenues of a new program. The second compares target market impact and subsidy requirements. The third brings these two matrices together to complete the analysis. The first versions of these tables do not include any color-coding of the matrices. This is important: The best outcomes and analysis require clear thinking and that you ignore biases (even color-coding) that may influence how you approach each step.

After you have completed the black-and-white versions of the table (using an X to indicate the box into which the program falls), place those marks into the color-coded version of the matrices. The resulting colors will signal whether the CDFI should likely participate (green/vertical stripes), likely not participate (red/horizontal stripes), or dig deep on additional analysis before deciding (yellow/solid color). In each case, narratives after the matrices provide commentary to help aid and guide analysis, but additional insights will undoubtedly arise that this guide cannot exhaustively treat.

Finally, the two matrices must be viewed in combination. The narrative in Step 3 contains additional guidance, with suggestions on how to proceed for any one of the combinations that might result.

Please also note: To cover as many possible scenarios as possible, the narrative for interpreting the results of this analysis is written from the perspective of a CDFI with no outside factors weighing the decision. In other words, the model starts from the perspective of a typical CDFI lender with some capital, some balance sheet space, and the annual need to raise some amount of philanthropy to cover costs. A change in any one of these variables—which is highly likely—will mean some variables receive more weight in the final decision about a program. For example, a CDFI at the limits of its leverage (as seen in its net asset ratio) may be unable to raise liquidity through debt and therefore may look less negatively at a program that provides more liquidity but less revenue. Although this guide cannot fully identify the nuances that might emerge across all CDFIs, it raises as many as possible in the explanations.

Step 1: Assessing Cost and Revenue Implications

The analysis starts by considering a program's economic impact. To make an initial assessment, you should start from your current costs and the cost categories that are affected most dramatically by growth.

First, determine if the new product or offering would result in similar revenue to the organization without consideration of any additional grants or support (yet). For example, how do the interest rate and fees compare with those of your current products?

Second, consider the primary (potential) cost benefits in two categories: provision expense and client acquisition. One of the primary costs for CDFIs seeking to scale their lending is client acquisition. In addition, loss provision expense grows significantly as a CDFI scales its small business lending. One of the main benefits of several new pandemic-related programs has been their ability to drive customers to CDFIs while also controlling for loan losses. In the case of publicly funded or supported programs, federal, state, and local governments have helped drive awareness and traffic to application portals, helping to reduce the cost of customer acquisition to CDFIs. This can be a significant benefit of a program. Many new programs also provide some protection to the CDFI against loan losses, which is particularly valuable in a time of economic uncertainty. Both features can help to reduce key cost elements for CDFIs. In the following table, the "cost" focus is meant to be on the potential benefits to CDFI client acquisition and LLRs.

Other more operational cost categories are important to consider, but they are better suited for exploration in the final version of the financial model. For example, a program may also come with a large administrative burden. If the program has marginal benefit according to this guide, then the process of factoring in a high administrative expense may cause the program to be a net negative. Alternatively, a program that has marginal benefit in the initial analysis but boasts a quick and easy administrative process might end up being a great fit. That final analysis should happen with the financial tool.

To start, rate the program for its revenue implications using the following simple categories. In some instances, the loan products associated with new programs carry appealingly low interest rates that are below those typically charged by the CDFIs. Lower rates will obviously yield lower revenues. Additionally, in instances in which loans originated under a program are sold, CDFIs will forgo interest earnings, although they may receive origination and servicing fees. Revenue is always important to assess for organizational sustainability but especially during periods of economic uncertainty or recession and over the longer term (e.g., a two- to three-year horizon).

Put an X in the box that best describes the program and its product.

Less revenue than existing products	Same revenue as existing products	More revenue than existing products

After looking at the revenue implications, turn to the cost categories. If a new program supports client acquisition, think of that as cost avoidance. When assessing the total cost implications, consider them on a total rather than on a marginal or unit-cost basis. This point is important because new programs may reduce your cost per client acquired but also increase your total number of clients—which will increase your total costs even while your marginal or average costs decline. In assessing the impact on your LLR, consider whether the program is offering any loan loss protection, either through direct support or through a nonrecourse purchase (i.e., the buyer takes all risk of loan loss) of the asset. If the program results in a benefit to one category but not the other—for example, if it lowers client acquisition costs but does not provide any benefit in terms of the LLR—then it is likely best to treat this benefit as marginal.

Again, put an X in the box that best represents the impact on your key cost factors.

Similar acquisition and LLR expenses	
Generates *marginal* acquisition and LLR reduction	
Generates *significant* acquisition and LLR reduction	

In this part of the analysis, there is an additional factor to consider: the (potential) unintentional substitution effect of a new fund or program. For example, a new program that involves a product with a lower interest rate than that of the CDFI's existing products can lead existing clients to refinance to the cheaper loan option. Or, if the new loan product is easier to apply for and quicker to receive, existing clients who are ready for a new loan might opt for the new product over the CDFI's core product. The phenomenon of unintentionally offering a product that gets taken up by existing customers is called cannibalization, and it has two major financial implications. First, if existing customers switch to a product with lower revenue, then this shift can compound the effect of a new product reducing overall revenue for the organization. In these cases, revenue lost as clients switch must be accounted for in addition to the lower revenue from simply originating the new loan. Second, new products and programs often have an upfront cost to consider, and this cost is spread over a thinner margin when cannibalization occurs. Thus, "switching costs" may be significant.

The next step is to put the outcomes of the first two analyses together into a matrix (Table 1) that identifies the outcome among one of nine possible scenarios. This is where the color-coded approach is introduced and starts to indicate whether or under what conditions a CDFI might choose to participate (or if it should do further analysis). Programs that fall in the green box likely merit participation and may require that the CDFI spend less time and energy on in-depth financial analysis. Alternatively, if the result lies in one of the three red cells, the program will undermine the financial performance of the CDFI over the long term. In these situations, a CDFI may use the financial analysis tool to highlight the financial gap leading to the red designation and seek compensation from the program sponsor in the form of grants or fees to improve the revenue.

Table 1: Cost and Revenue Implications

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Outcomes in the cells highlighted in yellow require the most careful consideration. A CDFI may choose to participate in a program because it offers stronger benefits to its clients, but CDFIs must understand the financial implications of that choice. In the matrix in Table 1, the yellow scenario in the center cell indicates the program involves a product that will generate revenue similar to that of the existing products, along with a marginal cost reduction. In this case, if there is no benefit to client acquisition and LLR expenses, then it is likely not worth the time to participate. Alternatively, using the financial model to illustrate the minimal cost benefits to the program sponsor, or funder, might help make the case for additional grant support. If there are benefits in the cost categories and the revenue generated through the program or product is the same, then the net financial outcomes will, of course, still be positive but likely insignificant.

It is critical that you consider product cannibalization in all the yellow scenarios. Ask yourself these questions:

1. Does the program's path to market (i.e., its so-called market channel) end up primarily marketing to similar customers already in your portfolio?
2. Does the program's product eligibility result in a different client base?

Even with significant cannibalization, a lender may decide that the benefit to customers (perhaps a lower interest rate) warrants participation. However, the long-term implications for the lenders profit and loss statement should be studied. CDFIs may consider asking funders to cover the "cost hangover," as the portfolio generates less income in the next several fiscal years due to cannibalization.

Finally, in the yellow scenario in the lower left-hand cell—one in which both expenses and revenues are lower—you should consider whether the significant cost benefit to client acquisition and LLR warrant participation. In this case, it might be helpful to create a new product and packaging process (such as a product that is easier to underwrite and disburse) to ensure that cannibalization is limited and complementary outcomes result. This streamlined product might be score driven or oriented toward a

specific industry where underwriting can be tailored to the business model, such as trucking or child care. It is important to remember that efficiencies can be achieved on any product through operational reviews and packaging improvements, but efficiencies can also be achieved with a different credit box and changes to required documentation. With a streamlined product, even with lower revenue than old products, the high volume of the new product may still generate positive financial outcomes. It is also important to note that if CDFIs are eliminating underwriting steps, then these institutions should generally assume that loan losses will go up—regardless of who will be holding the loan loss risk.

CDFIs that choose to implement a streamlined product must also weigh its impact on its target market. Scored loans have a history of serving a more limited set of primarily white and higher net-worth entrepreneurs. This is particularly the case if the program offers cheaper interest rates than those of traditional loans (as businesses that might otherwise turn to banks are attracted by the lower rates).

It may still be worth considering participating in a new program even if a CDFI's target market clients are less likely to qualify for it. If the program drives a significant number of applications—and the CDFI can still serve its target customers with its core loan product (rather than the new one)—then the CDFI can still benefit from the client acquisition benefits. Experience has shown that it's important that such a process (1) not involve an initial decline from the first program but instead provide an offer for a different loan and (2) not require the applicant to reapply or resubmit information collected in the first application. These steps will create a positive customer experience and help to minimize the CDFI's own costs. It's also wise to consider whether the CDFI's core product is less attractive (e.g., comes at a higher cost) than the one offered in the new program, as this difference could undermine trust among the CDFI's target clients.

Step 2: Weighing Mission and Subsidy Implications

For most CDFI small business lenders, especially those that specialize in loans under $100,000, lending costs are not covered by the income from new originations and their portfolio. To cover the gap between their earned revenues and their costs, these CDFIs raise subsidy in the form of both direct grants for operating support and discounted debt capital from government, philanthropic, and community development sources. These subsidies are typically driven by the mission impacts that the funders and investors want to achieve. Step 1 should have established the likely subsidy (i.e., the size of the loss or gain) outcome of a program for the CDFI lender. If the new cost and revenue outcomes of a CDFI create a lower margin on its lending, then additional subsidy will likely be needed. And as most CDFIs know, if there is doubt about the program's ability to serve the existing target market mission, or to expand it, then raising subsidy will be much more difficult.

Because mission outcomes and subsidy provided are so intertwined, we weigh how a program influences both in Step 2. Assessing mission impact requires evaluating the way outreach is conducted, eligibility is determined, and the loan product is structured. These combined factors will strengthen or weaken the extent to which a product will align with the CDFI's target market.

In the first of the following tables, indicate the impact of the program on the CDFI's lending to its target market.

Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market

The next part of the analysis brings in subsidy considerations. The source of the subsidy can be direct or indirect. For example, in some cases subsidy in the form of loss protection flows directly to the CDFI (e.g., in the form of a guarantee). In other cases, it might flow to a program administrator or intermediary (e.g., if a funder is providing LLRs to an entity that is purchasing loans in a participation program). Alternatively, it may be the case that a subsidy is being used by the program administrator to market the loan program or to provide an advantageous origination fee or pricing to the participating lenders. In the analysis, think through only the subsidy of the program, regardless of whether the funds flow to the CDFI or to the program administrator. In these cases, the economics of the lending haven't changed; additional subsidy was used to provide the benefits to the lender indirectly in the cost and revenue consideration and may actually be increasing the unit costs of the lending.

This part of the analysis examines whether subsidy is involved in the program and where that subsidy is derived. The source is considered because the reality is that the pools of subsidy available to CDFIs are limited. The CDFI may have a more advantageous economic outcome from program participation—but only because the program itself has subsidy. Nevertheless, it is important to consider that if the subsidy for a new program is coming from a CDFI's existing funder, that arrangement may limit the CDFI's ability to secure additional support directly from that funder in the future.

The following analysis puts a significant premium on programs that bring in *new* subsidy or do not need ongoing subsidy. If a new source of subsidy is being cultivated and added to the overall industry pool of support as a result of the program, then it is likely a net positive. Experience shows that, rather than focusing on one lender, some new funders prefer programs that reach across the industry or develop industry-needed tools. Nevertheless, if the program is not bringing in new subsidy but instead relies on the same sources of subsidy that most lenders already use, then CDFIs must consider the impact on their fundraising in the near and long term.

Indicate where the subsidy for the program comes from:

Uses subsidy from same base of funders	
Uses new source(s) of subsidy	
Does not need subsidy	

Once selections are made in the columns addressing subsidy and target market impact, the two can be put together. As in Step 1, the color-coding approach in the matrix in Table 2 indicates whether the

target market and subsidy outcomes are positive (green), problematic (red), or in need of further analysis (yellow).

Starting with the first row: If a program requires subsidy and it comes from one of the CDFI's existing funders, we believe it is high risk to participate unless the new program is expanding the CDFI's mission outcome. For that reason, the first two scenarios are shaded red. Feedback to the program designers would need to highlight that the program is unlikely to expand mission outcomes, and thus the funder should consider program changes or look for other ways to deploy philanthropic subsidy. When mission impact does expand, the CDFI and program can show complementary outcomes that require the additional subsidy from the common investor. In this case, because the common philanthropic support to both the new program and the CDFI lender is likely more than the philanthropist granted in prior years to similar causes, it is important that CDFIs calculate whether the elevated amounts are sustainable beyond the immediate term and whether that elevated support in the near term will jeopardize any future support.

Table 2: Target Market and Subsidy Implications

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

In the second row, we look at whether the new program's subsidy needs are covered through sources that are new to the CDFI small business lending space or from a new government program such as SSBCI. In this case, if the target market outcome is better, then participation is likely a great idea (pending review of other factors). If the source is new and the target market impact neutral, lenders should consider whether the new source of subsidy is short or long term. For example, consider a 12-month lending program with new subsidy available only for that period versus one with sufficient

capital for 36 months. Depending on the economics of participation for the CDFI and the administrative burden, it may not make sense to go through the operational investment necessary to join the program for a short period. If the target market outcome is negative but the program is bringing new subsidy, it may still be advantageous to participate even with the mission drift. The question in this case is whether the CDFI has sufficient bandwidth to support the new program without impairing efforts more attuned to its target market. For example, even with lower target market impact, a program that allows the CDFI to gain net assets over time can help it build toward future growth and mission impact. But it will be important for CDFIs to understand whether there might be opportunity costs in terms of target market impact in the near term.

If the new program does not need subsidy, the scenarios are much easier to consider. In this case, neutral or better outcomes to the target market would likely be sufficient to warrant participation; however, this situation is likely uncommon for CDFI small business lenders, particularly those that originate smaller loans. If a program requires no new subsidy, then it is more likely that private actors like banks and fintechs may already be competing in the market. In those cases, if the CDFI can enter and increase target market outcomes more than other market participants can, then entering can have a big impact, but we have rarely seen such a scenario. If there is no new subsidy and the target market impact is weak , then the program may be capable of subsidizing other lending at the CDFI. Small Business Administration 7(a) loans often fit this program type. The loans don’t require subsidy at the CDFI level, and CDFIs improve target market outcomes against other market participants. As a result, the product’s earned revenue can cross-subsidize other efforts that better serve the target market.

Step 3: Bringing Together All Four Factors

The next step is to look at the two matrices together to identify how to move forward. At this stage in the process you will have two matrices, and an X will appear in one of the nine boxes in each matrix. The X will be in a box (or cell) that is shaded green, yellow, or red. You should look at the tables in tandem while reviewing the narrative, which presents the next steps in deciding whether to participate based on the combination of red, green, and yellow across the two tables. Many possible groupings of outcomes exist; rather than read through the entire document, you should complete the previous analysis and then identify which of the following six possible outcomes fits your findings. This document is set up so that if you click on the highlighted color combination that relates to your program analysis, you will be directed to the relevant section of the paper that outlines next steps for your CDFI.

1. Outcomes are green in both tables.
2. Outcomes are red in both tables.
3. Red outcome in one table, green outcome in the other.
4. Yellow outcome in one table, green outcome in the other.
5. Yellow outcomes in both tables.
6. Yellow outcome in one table and red outcome in the other.

Green Outcomes in Both Tables

This is a rare but highly desirable outcome. Go for it! The financial analysis tool may be helpful in capturing in detail the financial benefits to your CDFI.

Red Outcomes in Both Tables

Programs with red outcomes in both scenarios should be avoided in almost all circumstances, as the mission and financial outcome simply do not warrant participation. Nonetheless, the financial analysis tool included here can still be applied to those "double red" programs to show program designers the gap to success and offer feedback on how the product may need to change to improve the target market impact. This feedback can be important if the funder is a longtime partner of your CDFI and you need to respond to and engage with the offer. In these cases, the tables you have created along with the financial analysis tool can start the conversation about how to improve the program.

Red in One Table and Green in the Other

If the red outcome for your CDFI is in the cost and revenue table, the financial outcomes are problematic. In this case, the fact that the program is green on the subsidy and mission impact table means that not enough of the subsidy is being directed to the CDFI. Use the financial tool to analyze your outcomes and propose changes to program designers to increase your financial benefit. In this case, you likely have negotiating strength, as you can provide positive target market results if you do participate—but you need better support to achieve those outcomes.

If the red outcome for your CDFI is in the mission outcomes table, it means that the program is using or would use an existing source of subsidy to produce worse target market outcomes. However, if the program is green in the cost and revenue situations, the outcome is that a common funder is creating a program that benefits your CDFI financially but results in worse target market outcomes. This program is designed poorly in terms of its outreach to your target market. The common funder should be approached to help change the program design, or the funder should simply fund the CDFI directly to expand its core work—where it is already achieving good target market outcomes.

Yellow in One Table and Green in the Other

In cases where the yellow outcomes are in the mission and subsidy table, we can group together neutral and better target market outcomes (Table 3, highlighted cells). On the cost and revenue table, the outcomes are green (Table 4). These situations are considered yellow for mission and subsidy because although the target market outcome is neutral or positive, the source of subsidy is new, unpredictable, or from an existing funder. In both cases, the issue for the CDFI is really about the long term. If the economics work and the target market outcomes are positive or neutral, then the challenge is whether the sources of subsidy might create long-term funding issues. In the case of a new source of subsidy, consider whether those funds may be exhausted quickly—in which case, it may not be worth the operational challenge to do the program for neutral mission outcomes. If the subsidy is coming from an existing funder, ask direct questions about whether the new funding will jeopardize other support in future years. If the scenarios are extremely positive financially (e.g., the program offers significant reductions in client acquisition and LLR costs), then it may still be worth participating even if the subsidy is temporary or may have long-term impacts on future subsidy from the existing funder.

Table 3

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

Table 4

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

If your analysis shows that the target market outcome is negative but that the program uses a new source of subsidy or does not need a subsidy (Table 5, highlighted cells), then these outcomes are coded as yellow, meaning the program is worth further consideration. Such further review is particularly warranted if the cost and revenue analysis shows a positive financial impact for the CDFI.

Table 5

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

If the program is creating new subsidy, the matters to investigate are (a) whether the subsidy is long term and (b) whether the organization has the bandwidth to do the program (such that there isn't a significant opportunity cost to participate). If the answer to both questions is yes, then it may be worth participating to supplement the financial performance of the organization and help support other more mission-focused outcomes. In cases where subsidy is not needed to operate the program, the next point to examine is whether the new program provides enough income to subsidize other mission-related work. In both cases, a thorough review of the financial tool will help you analyze how to move forward.

In cases where the yellow outcomes fall on the revenue and cost table and the outcomes on the missions and subsidy table are green (meaning they are positive), the main challenge is determining whether the substantial pressure on the CDFI's financial margins and outcomes is warranted to generate the good mission outcomes—or whether the program can be modified to reduce the problematic financial outcomes.

In cases where a new product would generate revenue equal to the CDFI's current revenue and there are also opportunities to reduce costs (the cells highlighted in Table 6), you might conclude that participation will improve the organization's financial performance. However, the key issue to check here is whether the new product will take existing customers from the portfolio rather than bring new customers to the organization. The financial model can be helpful here, and it will be important not to assume that the existing portfolio will maintain at its current size or income as customers trade over to the new program. Although this loss of revenue needs to be considered, it would (hopefully) be offset due to the cost benefits to customer acquisition and LLR expenses. In the cases where the mission impact is higher than what the organization normally achieves, participation is likely the best option—even with cannibalization.

Table 6

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

In the event a new program reduces revenues and generates significant cost savings (Table 7, highlighted cell) and has strong target market and subsidy outcomes (Table 8), the CDFI faces a challenging financial situation. Revenue will likely go down, but costs are likely to drop significantly too. Additional financial analysis will be very important and will likely drive the decision. Additionally, because the subsidy is new or not needed, the borderline financial case likely means that the CDFI should look to negotiate better terms. It may be possible to negotiate additional servicing or origination fee revenue—and thereby improve the program's returns. Alternatively, if the CDFI can identify other areas where it can improve its costs to deliver the product or program (perhaps a more streamlined underwriting process), it may be possible to marginally improve the economics of the program.

Table 7

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Table 8

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

Yellow Outcomes in Both Tables

The following tables show the analysis for programs that are neutral in terms of revenues, reduce costs (Table 9), and have a neutral to positive impact on the CDFI's target market (Table 10). In these cases, the program can help the lender serve more or similar customers in the target market, with similar financial outcomes. However, the program undoubtedly requires subsidy and draws that subsidy from an existing donor or a new donor to the lender. While adjustments could be made to move where the subsidy is needed, at the program level or directly paid to the lender, this movement just shifts where the subsidy is coming from and will not fundamentally solve the subsidy need. If the program brings new subsidy that would not be available without the program, and it is long enough to warrant the operating cost to start up, this program may be a viable option. Perhaps less intuitively, if the program's subsidy comes from an existing donor, you may consider not running this as a third-party managed program on its own but instead integrating it directly into your CDFI. The funder subsidizing the third-party program manager and the lender via the program may simply add unnecessary cost to loan delivery. If integrating the program at one CDFI is not possible, then the outcome in this scenario depends in large part on the willingness of the donor to cover the cost of the new effort for a sufficient period to warrant the CDFI investment to prepare fore the program. In these cases, any large amount of cannibalization would make any outcome difficult. Robust financial analysis with conservative assumptions should drive your final decision.

Table 9

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Table 10

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

Another set of yellow/yellow scenarios emerges when programs have neutral impacts on a CDFI's costs (Table 11), reduce impact the impact of a CDFI on its target market, but, on the positive side, bring new sources of subsidy (Table 12). Programs with these outcomes do not move the needle on mission impact or financial outcomes. However, they may provide some benefits; it could be that the program provides capital more easily to the CDFI or supports the lender in entering a new region. If the new subsidy—or lack of need for subsidy—is reliable, then it may be worth it for the CDFI to negotiate for additional benefit to make this program worth doing. For example, if the CDFI can negotiate better economics of the program, then the new subsidy could help cross-subsidize more impactful products. In essence, the need is to improve the potential outcomes away from yellow and yellow. If that can't be achieved, the program should be viewed as a low priority for participation.

Table 11

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Table 12

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

Another set of yellow/yellow outcomes are those in which the CDFI's revenues are lower, the program is reducing expenses (Table 13), and the CDFI is experiencing a significant growth in clients. At the same time, target market outcomes for the program are neutral or worse, but it provides new subsidy or does not require subsidy (Table 14). Several yellow categories are lumped together in this scenario, but the approach to dealing with them is similar, because in each case if the CDFI has the capacity to dedicate some creativity and effort, it might be able to generate significant benefit. The positives of these outcomes are that the program can drive significant client acquisition and LLR benefits—and that those benefits are not being funded by existing donors. If the reason that the target market is projected to be worse is that many of the CDFI's target customers will be turned down for the program, an opportunity exists to channel those leads into a product and process that *do* work for them. In essence, the CDFI would be using a new program and source of subsidy to create many new leads and able to capture mission impact by creating an effective "turndown" product and process for those customers who do not meet the criteria of the new program. It's worth noting that the turndown product would need to be tested rigorously so that it does not result in a significant expenditure of energy that yields little from a mission perspective. If a CDFI does this testing for a turn down product, it may want to seek additional funding to create and manage the product.

Table 13

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Table 14

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

The final scenario of yellow combinations occurs when a new program increases target market outcomes using support from an existing funder (Table 15), but revenue is falling alongside a significant increase in customers and in LLR expense reductions (Table 16). If the results of the financial analysis tool indicate that revenue loss is fully offset by increased volume and cost reductions, then this program is a great way for the funder to support your organization while also boosting impact. However, you should pay special attention to whether the increased client acquisitions trigger additional underwriting or administrative costs.

If the financial analysis indicates that the economics are marginal, but the target market impact is large, the CDFI may want to bring another new funder to the table to increase the subsidy. Securing that funding may be possible given the large mission outcomes. This program should also lead to an interesting dialogue with the existing funder, as a program with similar or better economics than those of your existing loans and that enhances your mission impact is a strong improvement. If the economics can indeed be realized, your organizational business model might simply need to shift toward the new program to capture the target market benefits over the long term. This effort would entail adopting some of the program's design features as core products for your CDFI after the program ends.

Table 15

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Table 16

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

Yellow in One Table and Red in the Other

The remaining scenarios involve cases where the outcome is yellow in one table and red in the other. In general, programs that are marked red in the impact and subsidy table and yellow in the cost and revenue table will be difficult to make work. You may want to double-check your assumptions to be sure, but because the programs rely on an existing subsidy provider and don't have significant mission outcomes, there are very few potential upsides to make the program viable without significant redesign to move some aspect of the outcomes into green scenarios.

Programs with outcomes that are red on revenue and cost and yellow on mission and subsidy are difficult to make work. This is especially true when the mission and subsidy analysis indicates that the program will have equivalent or worse mission outcomes. In these instances, the organization will be financially worse off and will not have increased its impact.

The final three scenarios are red on the revenue and cost table but would increase impact with subsidy from an existing funder. In this case, the red revenue and cost scenarios would be very difficult to make work. Only in the scenario highlighted in Table 17, in which there is a marginal increase in clients along with a reduction in the LLR expenses, could the value in terms of target market increase be made viable. This is because an existing funder is supporting a program for which its underlying economics are worse than those in your current lending program. Given that the program is being funded or led by an existing funder with which you would likely hope to retain a relationship, you should consider having a frank conversation about the program design before backing out. This tool and the financial model might be helpful in negotiating adjustments that could improve the program economics. Achieving this goal will likely take a larger commitment from the funder, so attention should be paid to the long-term implications for support from that source.

Table 17

	Less revenue than existing products	Same revenue as existing products	More revenue than existing products
Similar acquisition and LLR expenses			
Generates *marginal* acquisition and LLR reduction		Check for cannibalization.	
Generates *significant* acquisition and LLR reduction	Explore streamlined product. Check for cannibalization.	Check for cannibalization.	

Table 18

	Reduces % of loans to target market	Neutral impact on target market %	Increases % of loans to target market
Uses subsidy from same base of funders			Is additional level of required subsidy sustainable over time? Does it hurt future fundraising?
Uses new source(s) of subsidy	Is the new source of subsidy sustainable or additive over time? Is it the best use of organizational bandwidth?	Consider the sustainability of the source and timeline of program.	
Does not need subsidy	Does the program create a surplus that can be used to cross-subsidize lending to the target market?		

Conclusion

The pandemic introduced to CDFIs new tools that enable them to serve more clients and bring on new capital. The structure of these new programs and tools may also expand the loan products CDFIs can originate and the potential to use their balance sheet in a different way, including selling loans they originate.

In determining whether and at what level to take advantage of these new options, CDFIs need to consider both the mission and the financial outcomes these programs present. Analyzing these outcomes is not a simple task. This paper and the related financial model are tools that CDFI leaders can use to analyze programs' strengths and weaknesses, helping these decision-makers work through the trade-offs and choices involved. As new lending programs and tools for CDFIs come online, the stakes can be high. The right decisions should result in greater impact and organizational growth and stability; the wrong ones can lead to long-term financial and mission challenges. We hope these tools are valuable to CDFIs as they evaluate programs and to their funders as they design them. And we welcome feedback from you on ways to improve these resources.

Acknowledgments

Support for this publication was provided in part by the Initiative for Inclusive Entrepreneurship. Announced in October 2022 by Vice President Kamala Harris and launched by Hyphen, the Initiative for Inclusive Entrepreneurship (IIE) is a national effort to expand access to capital for small businesses owned by people of color. IIE harnesses the power of public–private collaboration to ensure that the United States Department of the Treasury's $10 billion State Small Business Credit Initiative (SSBCI) strengthens the small business ecosystem and advances racial equity by coordinating, streamlining, and enhancing communications and driving actionable implementation for the US Treasury, states and Tribal Nations, capital providers, and small businesses.

IIE has provided grant funding through partnerships with JPMorgan Chase, W.K. Kellogg Foundation, John D. and Catherine T. MacArthur Foundation, Mastercard Center for Inclusive Growth, Nathan Cummings Foundation, Skoll Foundation, and Wells Fargo.

About

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Scale Link created and manages an innovative secondary market for microloans from community development financial institutions (CDFIs). By enabling CDFIs to sell loans, Scale Link's secondary market helps CDFIs expand their impact, while also helping commercial banks meet their Community Reinvestment Act lending goals. Scale Link's secondary market provides CDFIs with consistent, unrestricted funding that complements public sector and philanthropic support and helps the CDFI sector scale. Learn more at scalelink.org

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