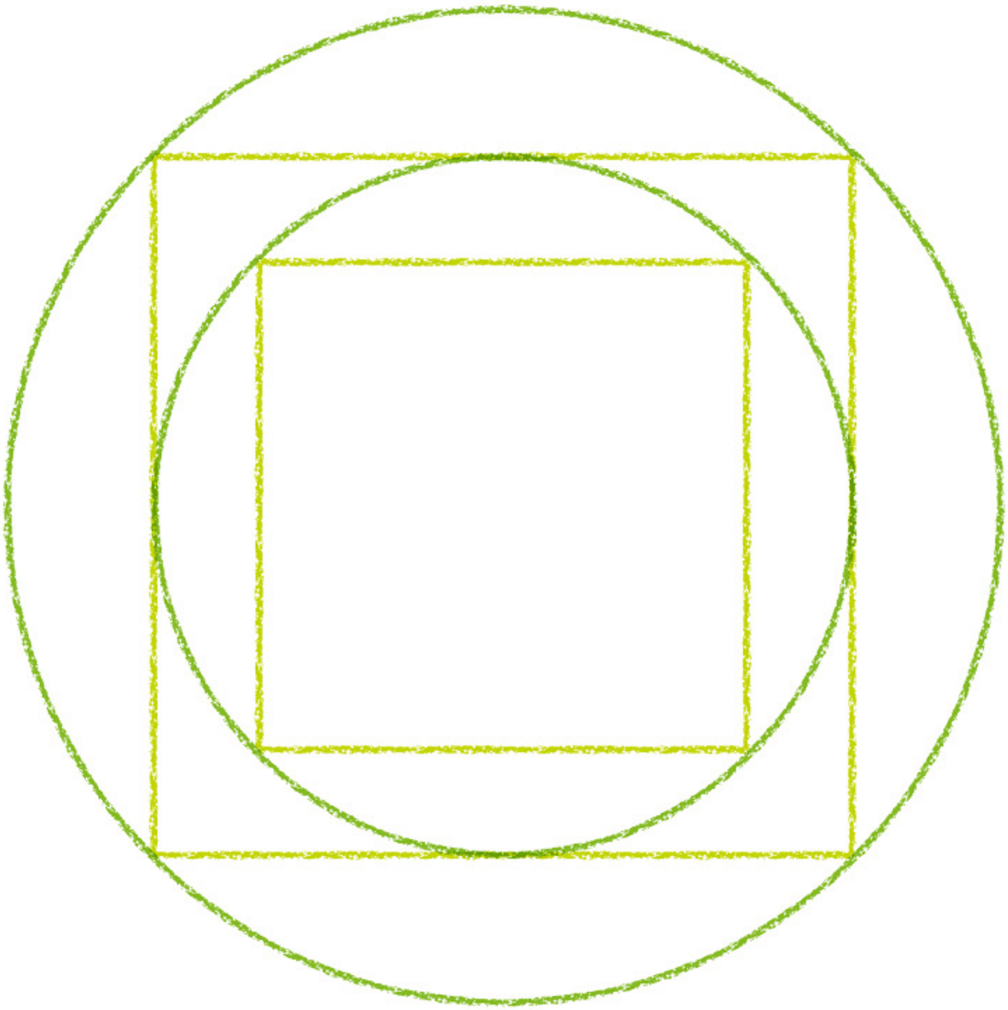

Five research priorities for community development financial institutions:

Advancing financial inclusion through evidence-based practice

CDFI clients, from left: Keynan Ammons, Ammons Design and Home Decor • Tina Travis, Errand Girl • SAY Sí arts education afterschool program participants

Regardless of *how* they do it, CDFIs share a common understanding about *what* they do: **empower individuals and communities by meeting them where they are**, when the needs are significant, and resources are low.

Introduction and stakeholder overview

Community development financial institutions (CDFIs) foster lasting, transformational development by providing inclusive, fair, and equitable financial services to people, organizations, and places underserved by mainstream banking institutions.[1] The array of products and services offered by the country's certified 1,470+ CDFIs are as diverse as the communities they serve.[2]

This brief outlines a proposed research agenda mainly from the perspective of CDFI loan funds.[3] These CDFIs specialize in offering affordable loans that increase economic mobility and build wealth. Ultimately, this type of lending empowers individuals to own homes and small businesses, supports jobs with livable wages, and offers a pathway to revitalize community infrastructure. In addition to offering credit products, CDFI services may include a range of courses and one-on-one mentoring sessions that build personal and/or business financial literacy. Figure 1 outlines the industry's major stakeholders.[4]

CDFIs have long been an integral part of the financial system. That importance is illustrated by their role in responding to economic recessions and downturns.[5] In 2008, when traditional financial institutions slowed or halted lending operations, CDFIs worked to expand affordable capital access in high-need communities.[6] More recently, the industry saw a surge in media attention and increased funding due to its role as a "financial first responder" during the COVID-19 crisis.[7] Throughout the pandemic, CDFIs provided loans, grants, and other community resources to consumers, small businesses, and nonprofits. The ability of CDFIs to quickly provide this kind of aid has helped cement their importance in the financial inclusion ecosystem.[8]

Regardless of *how* they do it, CDFIs share a common understanding about *what* they do: empower individuals and communities by meeting them where they are, when needs are significant, and resources are low.[9] Yet despite this shared vision of a more inclusive financial system, CDFIs and their stakeholders may differ on how to best track progress. To foster more alignment across these perspectives, we propose five research areas to help CDFIs highlight progress, identify challenges, and ultimately achieve their goals. While not intended to be exhaustive, we offer the following as a starting point for financial inclusion research on, with, and for CDFIs:[10]

1. Outline the theoretical foundations that underpin CDFI activities.
2. Conduct analyses that highlight historical lessons and emerging trends.
3. Work toward improving evaluation and impact measurement/management.
4. Identify funding strategies that improve capacity and sustainability.
5. Demonstrate the value of CDFIs via improving data quality and accessibility.

Figure 1. Key stakeholders in CDFI research

Those who receive or benefit from CDFI services

- Individuals and organizations that obtain a CDFI financial product or service.
- Individuals, organizations, and places that experience an increase in socioeconomic well-being as an indirect benefit of CDFI products and services.

Universities and institutions that engage in applied research

- Applied researchers at think tanks and allied private-sector entities.
- University faculty and students studying inclusive finance and allied topics.

Governments and quasi-public entities

- Federal agencies as well as state, local, and tribal governments that support and/or regulate CDFIs.
- The Federal Reserve system Board and its regional member banks.

Institutional and individual impact investors

- Financial service institutions, allied service providers, and philanthropic foundations that provide debt capital and grant funding.
- Institutional and individual social impact investors that provide capital as part of their purpose-driven investment philosophy.

1 Theoretical foundations of CDFI activities

In our observation, there has been limited theory building that considers the value of CDFIs.[11] What does exist conceptualizes CDFIs as entities that utilize a strategic mix of "interventions" that foster community and economic development.[12] CDFI interventions typically comprise affordable and accessible financing products paired with intensive technical services. However, there may be a growing disconnect between the goals of CDFI interventions and the industry's incentives for activities.[13] Table 1 describes several hypothesized existing and emerging tensions hinted at by other research.

Table 1. Possible tensions between CDFI activities and systems-level forces

Benefit of CDFI activities	Potential structural tension
Offering inclusive financing products and services that respond to community needs[14]	Maintaining deep ties and connections with communities while growing and scaling[15]
Acting as a catalyst for neighborhood renewal by providing services that reverse patterns of racism and institutionalized disinvestment[16]	Use of funding and investment from stakeholders whose policies and products may contribute to systemic inequities[17]
Providing reasonable and accessible financial products/services to individuals, businesses, and organizations that are otherwise unable to access credit[18]	Support system with limited low-cost, long-term, flexible debt capital and unrestricted grant funding due to unfounded perceptions of borrower riskiness[19]

One way to improve the effectiveness of CDFI programs and services is exploring the assumptions behind their preferred strategies and tools. Questions for consideration might include:[20]

Foundational theory of CDFIs

What are the underlying theoretical bases for the CDFI organizational form? How do CDFIs compare to similar community-based organizations?

Selection of strategies and tools

What institutional and social forces have made lending the primary CDFI tool? What are the advantages of lending compared to other strategies like technical assistance and grantmaking?[21]

Assessing structural tensions

What is the extent and nature of the hypothesized structural tensions between CDFIs and their support systems? How do these tensions influence CDFI activities and outcomes?

Operating as intermediaries

Some CDFIs are intermediaries that do not directly interact with community members.[22] How can this intermediary role be built into theory building, impact measurement, and research?

2

CDFI history, operations, and trends

CDFIs arose from a mix of grassroots advocacy and institutional regulatory pressures.[23] Through the 1960s, many banks were less likely to provide financial services to low- and moderate-income communities. This exacerbated disparities in access to capital, economic development, and wealth across the country.[24]

Change in this area started in earnest with the Economic Opportunity Act of 1964, which provided funding for community development corporations (CDCs). CDCs are grassroots local service providers, and their mode of operation laid the groundwork for the modern CDFI industry. Later, the Community Reinvestment Act (CRA) in 1977 created a regulatory framework that required certain large financial institutions to provide banking services in low- and moderate-income neighborhoods.

Though the CDFI certification is only a few decades old, organizations with CDFI-like activities have existed for some time.[25] Chicago's South Shore Bank, founded in 1973, is often considered to be the nation's first CDFI due to its mode of operations. The products and services provided by the bank were mimicked by other community entities, including those gathered at the first large "CDFI" meeting in Waltham, Massachusetts, in 1985.[26] In 1994, the Department of the Treasury's CDFI Fund was established and subsequently created the CDFI certification. Today, entities certified by the CDFI Fund offer services across many American neighborhoods.

Understanding this institutional history is critical because it suggests CDFIs are subject to strong path-dependent forces shaped by governments (local, state, and federal), mainstream financial institutions, and other similarly vested stakeholders.[27] The sector's development and evolution appear to be somewhat different from allied financial inclusion initiatives with similar goals.[28] To that end, in order to better identify opportunities for cross-sector growth and inter-industry collaboration, we propose a line of inquiry focusing on:

Structural efficiencies

What are the respective roles and competitive advantages of different CDFI organization types (loan funds, credit unions, banks, venture capital funds) and forms (nonprofits, for-profits, social enterprises)? How can the industry leverage this variation to improve operational efficiencies and enhance social impact?

Models of collaboration

What types of collaborations between different organization structures can address shared operational challenges and enhance social impact? What examples of successful collaborations—both within the industry and across allied sectors—can CDFIs emulate?

Contributions to social change

What role can or do CDFIs play in addressing the social inequities that prevent marginalized communities from achieving prosperity? How have endogenous (organizational capacity, cultural competence, etc.) and exogenous (path dependency, isomorphic pressures, etc.) forces influenced CDFI effectiveness in social change issues?

Analysis of industry trends

How have CDFIs changed and evolved over time? What programmatic, operational, and financial trends have emerged, and how have they shaped operations and performance? How do these trends vary by organizational type, sectoral focus, asset level, beneficiary demographic, geography, and similar characteristics?

CDFIs act as a catalyst for **neighborhood renewal** by providing services that reverse patterns of racism and institutionalized disinvestment.

CDFI clients: Marygrove Early Education Center

3 Impact measurement/management and program evaluation

CDFIs know the effectiveness of their programs is critical to amplifying their social impact.[29] In a recent survey of Opportunity Finance Network members, impact measurement/management (34%) and program evaluation (22%) were flagged as high areas of need.[30] Despite the acknowledged importance of these items, the industry often interchangeably uses terms like "impact measurement," "impact management," and "program evaluation."[31] For instance, the "impact measurement and management (IMM)"[32] term is sometimes used to encompass both performance measurement and program evaluation activities.[33] In contrast, program evaluators typically use it to describe causal claims about outcomes—that is, the net effect of what may have happened "but for" the program or activity in question.[34] There may be value in adopting a consistent definition set in this area, either by borrowing from another discipline or crafting something de novo.

For purposes of this brief, *impact measurement (and management)* refers to a continual process involving methods and leading practices to collect quantitative and qualitative data.[35] The reason for these data collection efforts is to track progress against targeted outputs and outcomes.[36] *Evaluations* are episodic analyses that use impact measurement data. The scope of evaluations varies widely, but at a high level, they are intended to assess whether a product, program, or activity performs as intended and is consistent with the organization's mission.[37] In support of developing research in this area, Table 2 proposes several guideposts for consideration.[38]

Table 2. Impact measurement/management and program evaluation guideposts

Area	Considerations and guideposts
Process[39]	Program evaluation is a non-adversarial process done **with** an organization and its clients (and not a process done **to** them). Evaluators need to consider any inherent privilege and craft processes that equitably reflect the needs of CDFIs, their borrowers, clients, and communities.
Scaling[40]	The need for rigor is balanced against the need for flexible and creative evaluation methods. Evaluators can right size the process to fit a CDFI's available financial resources and staffing capacity.
Metrics[41]	Metrics are ideally crafted to fit with the evaluative processes' timeline, oriented toward longer-term outcomes, and are integrated into the organization's overarching strategic goals.
Limitations[42]	It is unlikely that the socioeconomic changes prompted by CDFI interventions can be disentangled from the complex community systems they work in. The nature of CDFI activities means that significant time may pass between an intervention and an observable outcome.
Goals[43]	To offer the right mix of products and services, it's helpful to know what is working (and what is not). To do that, findings can be structured to inform organizational strategy by offering an objective assessment of program implementation and effectiveness.

Given existing levels of CDFI organizational and resource capacity, engaging in rigorous program evaluation may be difficult. Compounding the issue, CDFIs have multiple constituencies across the array of governments, philanthropic organizations, and private institutions that provide funding. Engaging with these interests often involves conducting multiple types of evaluations, as it is unlikely any single assessment could fit the needs of every stakeholder.[44] After all, it may be difficult to understand *what* to measure and *whose standards* should serve as benchmarks.[45] Nevertheless, the field is under increasing pressure to show organizational legitimacy by adhering to an agreed-upon set of standards and processes.[46]

Researchers have argued that these pressures can be categorized into *coercive, mimetic,* and *normative* forces.[47] *Coercive* forces arise when organizations seek to respond to pressures from political, regulatory, and funder stakeholders.[48] For instance, CDFIs may feel pressure to assess activities to fit funder needs over community needs.[49] *Mimetic* pressure occurs when entities "copy" strategies utilized by other organizations.[50] One example is the tendency of CDFIs to adopt impact metrics used by peer organizations perceived to be more successful. *Normative* pressure is the result of standards and processes within organizations being shaped by the forces of professionalization.[51] This can take the form of CDFIs conflating compliance with impact measurement.[52]

To be sure, impact measurement/management and evaluation issues are common challenges across many types of nonprofits and social enterprises. But for CDFIs and their stakeholders, this area is important because it enables better tracking of progress toward a more inclusive financial system. We propose a research agenda that highlights the value of impact measurement/management and evaluation while also socializing and educating stakeholders about limitations:

Creating industry terminology

Which frameworks, terminologies, and definitions of impact measurement/management and program evaluation are appropriate and useful for CDFIs? Should CDFIs use the terminology of adjacent sectors, or craft their own language to describe these activities?

Assessing the viability of systems-level frameworks

Given the diversity of CDFI activities and their constituencies, is it possible (or desirable) to craft a systems-level evaluation framework?[53] What are the trade-offs of this type of framework? How can any proposed meta-level framework be consistently applied across one CDFI to the next?[54]

Standardizing organizational evaluation processes

Is it possible (or desirable) to offer leading practices for CDFI evaluation and impact measurement/management activities?[55] Are there ways that other social sectors have enhanced evaluation knowledge and uptake that can be applied to CDFIs?

Identifying outcome metrics

How can CDFIs identify the set of outcomes they should focus on while balancing endemic capacity constraints?[56] How can measurement and evaluation activities be fashioned in a manner that allows community, borrower, and client voices to be heard, centered, and valued?[57]

Exploring the utility of rating systems

How do CDFIs and their stakeholders use voluntary rating systems? How do these systems align with the research on the qualities of effective voluntary rating systems in other sectors?[58] How do these systems affect a CDFI's capacity and accountability?[59]

Centering equity in metrics

What strategies should be used to incorporate the voices of CDFIs, their borrowers, clients, and communities when crafting metrics? How can the needs and perspectives of other stakeholders (e.g., funders, investors) be balanced in this area?

Program evaluation is a non-adversarial process done **with** an organization (not a process done **to** them).

CDFI clients: Alabama Aerospace and Aviation High School (AAHS)

4 Funding to enhance capacity, sustainability, and impact

As of 2021, about three-quarters of certified CDFIs were nonprofits.[60] The extent of self-sufficiency within the industry varies greatly, but many CDFIs need funding from government, business, and/or philanthropic institutions to sustain operations.[61] Despite noble intentions, research suggests these institutional funders may sometimes add to capacity constraints. For example, philanthropic organizations may offer grant opportunities that encourage the creation of one-time programs based on funder (rather than community) priorities.

Raising funding to enhance capacity has been a long-term challenge of the nonprofit sector.[62] But in the aftermath of both the COVID-19 pandemic and increased nationwide attention to racial violence, new innovations have emerged. For example, the CDFI Fund's 2021 Rapid Response Program provided entitlement-based funding awards for lending and technical assistance.[63] During the same timeframe, an array of philanthropic funders reoriented their giving toward community engagement, relationship building, and flexible grant terms. This included a focus on providing community organizations with recurring and unrestricted aid. Such changes reflect the theory that nonprofits, and not funders, have the experience to understand the needs of the populations they serve.[64]

Capacity constraints are often equated with limited budgetary resources, but the constraints CDFIs face are both financial and nonfinancial. The community and economic development literature suggests at least four other types of capacity.[65] First, *organizational capacity* encompasses the business processes CDFIs use for activities, adapting to change, and hiring/retaining human capital.[66] Second, *programmatic capacity* refers to the level of effectiveness of an organization's services. In the case of CDFIs, this includes financing and a large array of free technical assistance initiatives.[67] Third, *political capacity* is the extent to which CDFIs successfully maintain relationships with regulators, policymakers, and major funders.[68] Fourth, *network capacity* is the ability to engage secondary stakeholder groups. For CDFIs this includes ties with other community nonprofits, faith-based organizations, and educational institutions.[69]

To meet the needs of both CDFIs and their array of cross-sector supporters, we propose building an evidence-based funding framework for capacity building:

Funding source effectiveness for CDFIs

What is the relative utility of funding from different sectors (government versus philanthropic versus private) in the CDFI industry? How can CDFIs leverage and pair different funders and sources to improve capacity and impact?

Funding system improvements

How can funders and investors structure loans and grants to improve CDFI capacity and impact? What are the trade-offs of different funding and capitalization sources?

CDFI capacity constraints

How do CDFI capacity constraints compare to those observed in other areas of community and economic development? How should funders and investors build organizational, programmatic, political, and network capacity to bolster long-term CDFI sustainability?

Effects of recent events

How did financial support for CDFIs change due to events like the pandemic and the Black Lives Matter movement? What discrete philanthropic strategies were targeted at CDFIs during this period? Did these strategies build CDFI capacity, and if so, how? Can or should these examples be emulated?

Engagement in the policymaking process

How do CDFIs engage with local, state, and federal policymakers? How do federal, state, and local policies affect CDFIs in terms of their ability to grow, scale, and effect change?

5 Expanding research data infrastructure

Data is a prerequisite for research and needed to evaluate financial inclusion efforts.[70] Table 3 lists the major quantitative datasets that cover at least some portion of the CDFI loan fund industry. Though well-suited to capture CDFI processes and outcomes, qualitative data collection has not garnered much attention in the industry.[71] Many CDFIs collect data via focus groups, interviews, and participant observation. For example, CDFI staff frequently interview clients to gather information for marketing and promotional purposes.[72] But such efforts are rarely standardized enough to make them amenable to formal qualitative analysis. If collected in line with accepted protocols, transcripts from these interactions could serve as rich sources of data and may be well-suited for hybrid thematic analysis frameworks.[73]

Concerted efforts to improve data quality through standardization and enhanced collaboration may be of large benefit to the industry. To understand why, consider analyses of the CDFI Fund's Transaction Level Reports (TLRs), which contain detailed information on the quantity and characteristics of CDFI financial transactions.[74] Analyses of the data have sometimes resulted in unexpected findings. In one case, a quasi-experimental study found that areas with high levels of CDFI investment had worse economic outcomes (mortgage approval rate and median mortgage amount) compared to similar places with no investment.[75] It isn't possible to know for sure, but such findings could be due to low data quality, limited scope of coverage, and/or an inability to triangulate the TLR data with other sources. Regardless of the cause, these issues highlight the need for data quality improvements.

CDFI clients, from left: SueEllen Mancini, Sad Girl Creamery • Cordon family, Phat Daddy's on Da Tracks • Shae Jones, Olivia J

Table 3. Summary of major CDFI data sources

Data source	Coverage and scope	Limitations
Annual Certification Report (ACR)[76] **CDFI Fund**	• Institution-level data about portfolios, development services, and operational characteristics • Population-level coverage of all certified CDFIs	• Time lag in data releases • Some variables are withheld in public releases of dataset • Changes from predecessor format make longitudinal comparisons difficult[77]
Transaction Level Report (TLR)[78] **CDFI Fund**	• Detailed loan-level data across 50 variables[79] • To date, primary data source for bulk of existing CDFI research	• Some variables are withheld in public releases of dataset • Regulatory changes have improved scope of coverage; historical comparisons remain difficult[80]
CDFI Survey[81] **Federal Reserve System**	• Institutional survey of CDFIs containing data on financials, activities, and industry trends • Though extensive efforts are taken to solicit responses, CDFI participation is not mandatory	• Convenience sample and not necessarily representative • Because many survey questions change over time, longitudinal comparisons are difficult
Aeris Cloud Data **Aeris Insights**	• Financial and output data that is used in Aeris financial and impact management ratings[82] • Scope is rated CDFIs and non-rated CDFIs that voluntarily choose to report certain metrics	• Raw data is not publicly available but can be requested; however, approval criteria is not published[83] • Sample is not representative and includes only a subset of loan fund CDFIs
Annual Member Survey[84] **Opportunity Finance Network**	• Data on CDFI staffing, capitalization, lending activities, portfolio performance, financials, and programmatic outputs • Scope is OFN's membership, which is focused on revolving loan funds	• Raw data are not publicly available but can be requested; however, approval criteria is not published • Sample is not representative because it includes only OFN members that respond to the survey

While it can seem a highly technical exercise, good quality data is **essential** to helping CDFIs meet their goals. To enhance and build on existing CDFI data sources, we recommend focusing on the following issues:

Creating data collaborations

How can the industry improve data availability and transparency while balancing the reporting burden on CDFIs? Is it possible or desirable to start a data collaboration platform that builds upon existing reporting?

Enhancing data collection practices

How do CDFIs typically collect and store data? How does this vary by size, targeted clients, borrowers, and communities? How can researchers and CDFI stakeholders improve data collection processes?

Leveraging qualitative data

How can use of qualitative data by and for CDFIs be enhanced? Is there value in a standardized set of semi-structured interview guides, focus group questions, and similar instruments for qualitative data collection?

Improving existing data assets

How can existing CDFI data sources be analyzed for robustness and data quality? How can data collectors be encouraged to transparently release anonymized data for research purposes?

Building new data assets

What are the shortcomings of existing data sources? Can any of them be remedied? What data needs to be collected to address the industry's pressing questions? How can CDFIs and their stakeholders work together to improve data collection resources while balancing capacity constraints?

CDFI clients: Los Angeles Mission

Panelists at Opportunity Finance Network's 2023 Small Business Finance Forum

Concluding thoughts

CDFIs and their stakeholders see value in prioritizing research capacity and infrastructure. And researchers inside and outside the industry can help by cultivating these burgeoning professional norms. We are keenly aware that a requisite level of capacity is needed to engage in research, data collection, and evaluation.[85] Not all CDFIs are able to devote the resources needed for these activities. Yet ultimately, we believe the CDFI community at large may benefit from bolstering the five focus areas proposed here.

The proposed areas are designed to build on existing research initiatives while centering the needs of CDFIs and the communities they serve. In recent years, both the number of CDFIs as well as industry's stature in policy, philanthropic, and business dialogues has increased. That upward trend means communities, businesses, and individuals throughout the country have better access to fair and equitable financial products and services. But to continue this growth and build on these successes, there is a need to better understand how CDFIs contribute to the nation's financial inclusion ecosystem.

CDFI clients: Great Oaks Charter School Bridgeport

CDFI client, Kristy's Early Childhood Development Center

CDFI client: Mike Mwenedata and Rwanda Bean Company team

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Acknowledgments

The authors wish to express their gratitude to the many individuals who provided input for this report. We are deeply grateful for the thoughtful feedback and support received from:

Deloitte

Vee Bell

Ivy Clark-Dominguez

Nora Ellison

Constance Gamache

Carey Oven

Caroline Schoenecker

Opportunity Finance Network

Sacha Adorno

Alba Castillo

Lisa Chensvold

Seth Julyan

Sindhu Lakshmanan

Beth Lipson

Caroline Valvardi

Raza Development Fund

Annie Donovan

Melissa McDonald

Carolina Small Business Development Fund

Lori Diaz

James Onorevole

Federal Reserve Bank of Atlanta

Charlene van Dijk

Federal Reserve Bank of Richmond

Surekha Carpenter

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Mike Eggleston

Urban Institute

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Teshanee Williams

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K0192422