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Community Dividend

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The L^{3}C: A new business model for socially responsible investing

By Sue Woodrow and Steve Davis

Peggy Grimes loves food. Specifically, she is passionate about food security and hunger alleviation. Grimes is the executive director of the Montana Food Bank Network (MFBN), a nonprofit organization that solicits donated food and transports it to charitable programs throughout Montana. The MFBN is the largest distributor of emergency food in the state.

Under an agreement with the Montana Department of Corrections, the MFBN operates a food cannery in Deer Lodge, Mont., that is staffed by inmates of the nearby state prison. The Montana Department of Corrections owns the cannery facility, and the department's Montana Correctional Enterprises program provides operating funds. The inmates provide labor as part of a job training and reentry program, while the MFBN provides donated produce from Montana food growers, cannery equipment and supplies, and day-to-day management of the operation. Cannery products are then distributed through the MFBN's network to families in need.

Grimes envisions expanding the cannery operation in order to increase the supply of emergency food and develop a retail line of Montana-grown canned goods. If realized, her vision would further MFBN's hunger alleviation mission, broaden the retail market for Montana food producers, and expand the inmate rehabilitation program. But acquiring funding to realize the vision is a significant barrier. For more than five years, Grimes has pursued—with limited success—grants and government funds to pay for capital investments, such as replacing the aging cannery facility, and operating expenses, such as supporting the day-to-day management of the cannery. Recently, Grimes learned about a new form of taxable business entity called a low-profit limited liability company, or L^{3}C, designed specifically to integrate business savvy and social passion. She believes the L^{3}C model holds real promise for bringing much-needed investment and operating funds "to the table."

The L^{3}C is one of several hybrid business organization models that have been developed in recent years, both in the U.S. and abroad, to help address the funding-related challenges experienced by a growing sector of charitable-purpose entities known as *social enterprises.*[1] A social enterprise is an organization that combines or supports a charitable mission with market-oriented methods. In other words, a social enterprise has a "double bottom line," or double purpose of social benefit and financial gain. Dubbed the "Fourth Sector," social enterprises are increasingly seen as filling a void left unaddressed by the traditional public, private, and nonprofit sectors. In particular, social enterpris-

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Overcoming start-up barriers: Native-owned food business serves up lessons learned

By Sandy Gerber

The main article in this issue of Community Dividend *touches on the topic of* social enterprises*, or businesses that have a "double bottom line" of making money and making the world a better place. The following article discusses a promising social enterprise in South Dakota that aims to generate both healthy profits and healthy lifestyles.*

Native American Natural Foods LLC (NANF) is an Indian-owned, private-sector business headquartered on the Pine Ridge Indian Reservation in South Dakota. The young company creates healthy food products based on the buffalo, an animal intrinsic to Great Plains American Indian heritage and culture.

In 2007, NANF debuted its first food item: the Tanka Bar, a low-fat energy bar made of locally or regionally sourced ingredients, including smoked buffalo meat, cranberries, garlic, onion, and spices. Subsequent products include Tanka Bites, Tanka Bar Hot, and the Tanka Dog, an all-buffalo hot dog.

NANF hopes to tap into consumer demand for portable, nutritious foods that fit today's get-up-and-go lifestyle. However, bringing the Tanka brand to market was no easy task for the company's founders, who encountered financial roadblocks and other obsta-

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Annamaria Lusardi

Gender and financial literacy: A conversation with Annamaria Lusardi of Dartmouth College

By Ericca Richter-Maas

Financial literacy is important. This statement, while never controversial, is being taken more seriously now, in the midst of a financial crisis, than it ever was in the past. While it is unclear exactly what factors and in what combination caused the economic meltdown, it is likely that a lack of personal financial literacy on the part of consumers played some role.

As the economy starts showing signs of recovery, financial education practitioners are looking to seize the moment by focusing more resources and public attention on financial education. For these practitioners, research that offers insights for sizing up the problem and devising effective financial education programs is a valuable tool.

Recent research completed by Dr. Annamaria Lusardi, the Joel Z. and Susan Hyatt Professor of Economics at

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Overcoming start-up barriers: Native-owned food business serves up lessons learned

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cles as they tried to get NANF off the ground. In sharing how they overcame the obstacles, NANF's founders provide lessons that may be useful for other business start ups, in Indian Country and elsewhere.

A larger-than-life vision

In the Lakota language, *tanka* means "larger than life," which reflects the vision of NANF's founders. The company is the brainchild of Mark Tilsen Sr., a longtime Pine Ridge activist, community leader, and entrepreneur; and Karlene Hunter, a member of the Oglala Sioux Tribe and the cofounder and CEO of Lakota Express (LEX), a full-service direct marketing company located on the reservation.

Hunter and Tilsen Sr. are not only accomplished business people. They are also committed members of their community who are seeking to advance the economic condition of reservation residents. In 2004, Hunter and Tilsen Sr. began discussing ways to promote greater well-being on the reservation and agreed that a food business could strike at three major issues affecting the community. First, there are widespread health problems such as diabetes and obesity that are tied to poor nutrition. According to the South Dakota Department of Health, 11 percent of Indian residents in South Dakota counties having a significant Indian population, including the county encompassing Pine Ridge, suffer from diabetes, compared with 6.7 percent of whites in primarily white regions of the state.[1] Second, there is a high level of joblessness. As of 2000, the unemployment rate on Pine Ridge stood at almost 17 percent.[2] Third, there has been a loss of cultural connectedness to traditions and food sources that once sustained a flourishing way of life.

Hunter and Tilsen Sr. established NANF in October 2006, with a focus on launching a company that would not only make money, but also encourage better nutritional choices, create job opportunities for local residents, and promote culturally important food ingredients.

Karlene Hunter

Mark Tilsen Sr.

Hunter and Tilsen Sr. established Native American Natural Foods (NANF) in October 2006, with a focus on launching a company that would not only make money, but also encourage better nutritional choices, create job opportunities for local residents, and promote culturally important food ingredients.

Their experiences in founding NANF illustrate that the goal of starting up a well-positioned business on an Indian reservation is attainable, provided certain elements are in place.

Start-up barriers

Hunter and Tilsen's start-up company quickly encountered some hurdles. According to Hunter, financing issues topped the list. Indian residents of Pine Ridge have long faced obstacles in getting loans from area banks. There are numerous reasons for this, including the difficulty of using land held in trust by the U.S. government (a large portion of reservation land) as mortgage collateral, the lack of a commercial code to ensure recourse to financial institutions in the event of a loan default, high debt levels and low credit scores associated with high unemployment and poverty rates, and some residents' perceptions of racial discrimination.

There are remedies available for some of these obstacles. For example, Hunter points out that it's very doable for a bank, together with the Bureau of Indian Affairs (BIA), to enact a lease transfer, which would enable the bank to take possession of property in the event of default. However, most banks are unfamiliar with such alternatives. "If the banks could learn how financing works in Indian Country, it could be better for everyone," she says.

Brand-building and market penetration presented additional hurdles. According to Hunter, obtaining bank financing for brand-building and other needs that are outside the bricks-and-mortar arena was a challenge. She notes that marketing and brand-building are major expenses for companies trying to create a national market, but brand-building, by and large, "hasn't happened with businesses operating on Indian land." Breaking into the whole foods arena was another challenge. "To get into the whole foods market, you have to have a track record, and to do that you have to have a recognized product," Hunter says. For instance, when NANF's founders approached purchasing agents from the military, the agents asked which national stores were already buying the Tanka Bar.

Partnerships and creative financing are the keys

To overcome the obstacles facing their start-up business, Hunter and Tilsen Sr. realized they had to bring in partners with

TANKA BAR
TANKA BAR
Net WT 1 oz (28.4g)

NORBERG PICTURES

resources and skills that could support and complement their efforts. For example, NANF partnered with the Patton Boggs Law Firm for legal assistance, Nakota Designs for advertising and design work, and the American Indian College Fund for written material for the Tanka Bar web site. All are Indian-owned and -operated organizations, or have a significant Indian client base, and were willing to participate in a venture that could help the Indian community on multiple fronts.

In order to build their brand, “We had to get creative and get a lot of alternative funding,” Hunter recalls. Initial funding came in the form of an equity investment facilitated by the Lakota Fund, which is the longest-standing Native community development financial institution (CDFI) in the country and is located within the Pine Ridge reservation. Founders of NANF had been involved in the effort to establish the Lakota Fund, which was then able to assist years later when the need arose.

To obtain funding to help NANF, the founders approached the Northwest Area Foundation (NWAF) about making an equity investment in NANF via the Lakota Fund. Dividends from the investment would go to the Lakota Fund’s revolving loan fund. NWAF, which has a long-standing commitment to the dual issues of poverty reduction and Indian Country development, agreed to make the investment. Using the Lakota Fund as a conduit for the equity funding enabled NWAF to support NANF without investing directly in the company. The arrangement simplified matters for the foundation, since making a direct investment in NANF would have meant seeking prior approval from the Internal Revenue Service. [For more on foundations making investments in private entities, see the main article, “The L^{3}C: A new business model for socially responsible investing,” which begins on page 1.] The deal among NWAF, the Lakota Fund, and NANF may have been one of the first times a foundation and a CDFI delivered equity funding to a private, Native-owned company in such a way. According to Hunter, demonstrating this new way to make equity investments was a major stride forward for Indian Country.

Hunter and Tilsen Sr. themselves contributed additional equity financing, as did their family members and friends. Also on the financing front, NANF received a grant from the U.S. Department of Agriculture, which has funded other housing and business development ventures in South Dakota’s Indian Country. The only bank financing NANF received was a BIA-guaranteed loan from First National Bank in Nebraska. The bank had a long-term involvement with Hunter and Tilsen Sr. through lending to LEX, which created a sense of trust.

According to Hunter and Tilsen Sr., additional funding came in the form of an investment by a nonprofit organization called the Indian Land Tenure Foundation (ILTF), whose mission is to buy back lands located within the original boundaries of Indian reservations. It was the first investment made through the ILTF’s newly created Buffalo Reinvestment Fund, an entity that will provide capital to Indian agricultural producers who raise buffalo.

Much of NANF’s financial resources have been dedicated to building the Tanka brand. Tanka products are heavily marketed to Native communities via pow-wows, conferences, print media, and the Internet. Mark Tilsen Jr., who is Mark Tilsen Sr.’s son and serves as assistant director of marketing at NANF, is proud that the company has the savvy to market its products through social networking sites such as Facebook, Bebo, and Twitter. He emphasizes the importance of building an online community of customers who discuss everything from culture to health to politics. Tanka products have also made inroads nationally. Currently, they are sold at more than 3,000 locations, including major retailers such as REI, and about 20 new locations are added each day.

Lessons learned

When extracting lessons from the NANF experience that could apply to other small business start ups, it’s important to distinguish among elements that are particular to the place and people (Indian people residing at Pine Ridge), elements that may apply to Indian people in other places, and elements that may apply more broadly to non-Indian communities. Pine Ridge- and Indian-specific elements that have contributed to the successful establishment of NANF include:

- The existence of a defined cultural base from which the business could initially draw a market.
- Products that are oriented toward members of that culture, but also have broader appeal. For example, there is capacity to broaden the Tanka Bar’s appeal beyond the Indian community, to health food aficionados, young people, outdoor enthusiasts, etc.
- Connections to a network of businesses and organizations that is also oriented toward that culture.
- A long-standing relationship of trust between the founding partners, forged through years of work on community issues and on building a previous Native-owned enterprise—in NANF’s case, LEX.
- A long history with some major funders—particularly those that finance projects in Indian Country—that “greased the wheels” for financing a new enterprise.

Elements that may apply more broadly to other entrepreneurs seeking to start a business include:

- A passionate commitment to the mission on the part of the founders.
- A mission that includes, but goes beyond, the desire to make a profit. NANF’s dual mission strengthened the founders’ dedication to succeed and increased the responsiveness of the products’ target customers.
- An emphasis on making use of complementary skills. In NANF’s case, Hunter brought strong business skills, which complemented Tilsen Sr.’s marketing and organizational development skills. Tilsen Jr. was able to apply his knowledge of technology to expand the reach of the business.
- Connections to an external network of partners—businesses, community organizations, colleges—that can supply the skills and resources necessary for a start-up business’s success.
- Founders with some degree of business savvy or experience to make the case for financing and win trust and commitment from funders.
- An understanding of the importance of incorporating technology and social networking sites into marketing and other business components.

Hunter and Tilsen Sr.’s experiences in founding NANF illustrate that the goal of starting up a well-positioned business on an Indian reservation is attainable, provided certain elements are in place. It has been a struggle for NANF’s founders to secure all the necessary components and move forward. However, a strong sense of social mission, combined with business know-how and the support of committed partners, have carried NANF a long way already and may help open the door to a national breakthrough.

For more on NANF and its products, visit www.tankabar.com.

[1] From the report *The Health Behaviors of South Dakotans 2007*, available at http://doh.sd.gov/statistics.

[2] U.S. Census Bureau, Census 2000.

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es are seen as straddling the for-profit business sector, which is generally constrained by the duty to generate profits, and the nonprofit sector, which is generally constrained by tax laws and the duty to fulfill social objectives.

At the heart of the social enterprise movement is the ongoing challenge of accessing investment capital for socially responsible purposes.[2] Acquiring start-up capital is a common issue for many nonprofits. It's exacerbated by federal tax laws that restrict nonprofits from accessing traditional forms of equity, such as venture capital and, sometimes, commercial debt. For the most part, nonprofits must rely on private foundation grants, government support, and, for some, earned income such as fees for services. To subsidize their earned income, some nonprofits have set up separate social enterprise business sidelines.[3] For example, an animal shelter in Minneapolis recently opened a full-service day care, grooming, and boarding facility for pets.

The for-profit sector faces its own challenges in funding charitable activities because federal tax laws generally restrict private business entities from accessing foundation grants and government assistance. In addition, for-profit investors expect market-rate returns and maximized profits. Their expectations don't align well with social mission-focused entities, which need "patient capital" and typically have slower, more modest growth.

There is a growing body of thought that new business models and possibly new tax incentives or structures are needed to effectively bridge the "sector" gap. These new models would eliminate the need for social entrepreneurs to either choose between the for-profit and nonprofit business models or create and manage both. One such model, the L^{3}C, is a newly developed form of business that blends attributes of nonprofit and for-profit organizations in order to promote investment in socially responsible objectives.

The idea behind the L^{3}C model grew out of a 2006 meeting convened by the Aspen Institute's Nonprofit Sector and Philanthropy Program and titled "Exploring New Legal Forms and Tax Structures for Social Enterprise Organizations." Legal, financial, and other experts gathered to discuss the myriad issues that the growing Fourth Sector faces. The key question that emerged was whether traditional business structures and nonprofit tax laws are hindering the growth of hybrid social enterprise models.[4]

It was at this meeting that Robert Lang, president of the Mary Elizabeth & Gordon B. Mannweiler Foundation; Marcus Owens, a partner with the Washington, D.C., law firm Caplin & Drysdale and former director of the Exempt Organizations Division of the Internal Revenue Service; and Arthur Wood, director of Social Financial Services for Ashoka, an international organization that promotes social entrepreneurship and socially responsible investing; met and began collaborating to create a business model that would address, among other things, two key challenges for social enterprise development: federal tax law and "patient capital." According to Lang, "There was a whole portion of the for-profit sector which, while self-sustaining, produced too low a profit to induce normal for-profit investors to engage on their own. Yet this area is where a lot of socially beneficial enterprises fit."

A hybrid of a hybrid

The trio of Lang, Owens, and Wood developed the L^{3}C as a self-sustaining means to achieve a social mission at the lowest possible cost and with the greatest efficiency. An L^{3}C can make a low profit of 1 to 10 percent, but this is secondary to its social purpose. Unlike a traditional charity, however, an L^{3}C may distribute its low profits to its investors.

As its name suggests, the L^{3}C is a hybrid form of a for-profit limited liability company, or LLC. The LLC is an established form of business entity in most states and U.S. territories and on several Native American reservations. Basing the L^{3}C on the LLC model was a strategic decision that ensured the L^{3}C would have the LLC's flexible profit, loss, and taxation features. LLCs themselves are hybrids of corporations and partnerships. Like the liability of shareholders of a corporation, the liability of LLC owners, or *members*, is limited. The LLC is like a partnership, however, in that the organization can be structured to bear no direct tax consequences. For federal income tax purposes, the profit and loss tax liabilities may be passed through to the LLC's members unless the operating agreement specifies otherwise.

The L^{3}C modifies the standard LLC in a couple of important respects. First, an L^{3}C's organizing document, called articles of organization, must set forth as its primary business objective "one or more charitable or educational purposes," as defined by the Internal Revenue Code. In addition, the term "low profit" is embedded in the title of the business form to put investors and philanthropic funders on notice that the entity is motivated first and foremost by its expressed social mission, but not necessarily to the exclusion of making money.

Second, the L^{3}C's articles of organization must state that the operating agreement among its members contain specific language that mirrors IRS regulations regarding *program-related investments,* or PRIs. Facilitating the use of PRIs is at the heart of the L^{3}C structural concept. Authorized by Congress in the Tax Reform Act of 1969,[5] a PRI is an investment that a foundation makes in a nonprofit or for-profit venture to support a charitable project or activity, with the potential of a return on the foundation's capital over a period of time. A PRI can be any type of investment vehicle, such as a loan or loan guarantee, line of credit, asset purchase, recoverable grant, or equity investment. Notably, foundations can use PRIs to meet their federally mandated 5 percent minimum payout obligation.[6] To deter investments in speculative deals, an investment must meet three tests to qualify as a PRI: 1) its primary purpose must be to further the tax-exempt objectives of the foundation, 2) the production of income or the appreciation of property cannot be a significant purpose, and 3) it cannot be used for political lobbying or campaigning.[7] By nature, PRIs are intended to be high-risk and/or low-return.

A layered investment approach

At the core of the L^{3}C concept is the use of PRIs as part of a multiple-tiered, or *layered*, investment strategy that, theoretically, will help attract a wide range of both socially motivated and profit-oriented investments. Following this strategy, a foundation makes a PRI in an L^{3}C and accepts a lower-than-market rate of return as well as a disproportionately higher risk—or "first risk"—position, which in turn attracts other for-profit investors by lowering their risk and increasing their potential rate of return. The diagram on page 5 illustrates the mechanics of a sample L^{3}C layered investment strategy and shows how different types of investors can formulate a plan that best suits the risk-to-reward ratios each is willing to accept.

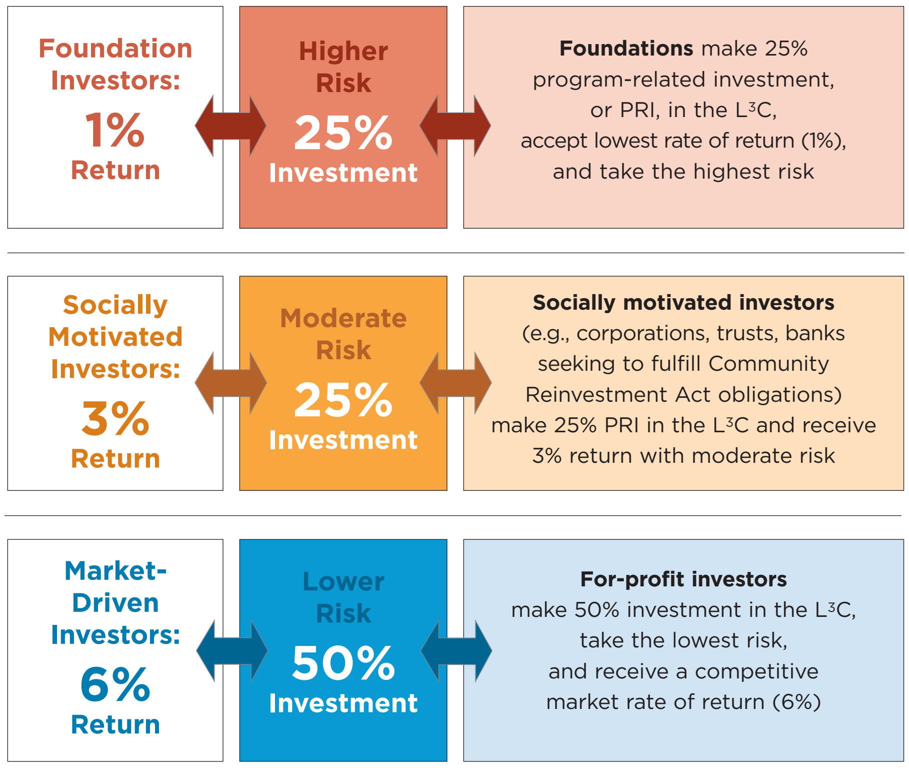
A for-profit entity does not need to organize as an L^{3}C to utilize PRIs for charitable purposes. But Lang and Owens contend that PRIs are significantly underutilized. Of the nearly 80,000 private foundations operating in the U.S. today, only 5 percent make PRIs, and these are primarily loans to charities.[8] According to Lang and Owens, foundations typically don't engage in PRIs because of the perceived need to seek prior approval from the IRS to ensure compliance with PRI requirements. Upon request and for a fee, the IRS will issue a private letter ruling that states whether a proposed investment will qualify as a PRI. A private letter ruling is not required by law, but the risks of a post-investment determination by the IRS that a foundation's investment does *not* qualify as a PRI may include financial penalties. In addition, when the investment is subsequently subtracted from the foundation's calculation of tax-exempt purpose expenditures, the foundation may face more penalties or even lose its nonprofit status if the subtraction results in falling short of the 5 percent payout requirement. However, obtaining a private letter ruling can be very costly and time-consuming. The costs and perceived risks of seeking or failing to seek private letter rulings deter some foundations from making PRIs. The L^{3}C is structured to help address these barriers and thus facilitate PRIs by requiring the operating agreement among an L^{3}C's members to include language that sets forth the federal legal requirements for PRIs. This is intended to provide assurance to foundations that their investments in L^{3}Cs comply with federal tax requirements and thus qualify as PRIs without the added expense and time needed to obtain private letter rulings.

To further address the deterrents that keep foundations from making PRIs, Lang and Owens are lobbying for legislation that would amend the federal tax code so that a foundation's investment in an L^{3}C is presumed to qualify as a PRI unless proven otherwise. This rebuttable presumption is not intended to do away with a foundation's need to exercise due diligence in its decision-making process, but it would arguably offer the added assurance foundations seek when considering investments in for-profit entities. In addition, Lang and Owens are advocating for L^{3}C legislation at the state level through an informational organization called Americans for Community Development, L^{3}C.

Possibilities vs. concerns

The range of socially responsible purposes potentially suited to the L^{3}C structure is broad, from affordable housing initiatives and mortgage assistance to historic building preservation and biotech development. For example, a recently chartered L^{3}C in Vermont produces innovations in medical imaging technology. It has high research and development costs, but relatively low rates of return for its investors. An interesting L^{3}C possibility in North Carolina involves plans to revive the flagging furniture industry. Many of the furniture manufacturing conglomerates in the state have

The L^{3}C's Layered Investment Strategy*



Foundation Investors: 1% Return ⟷ Higher Risk 25% Investment ⟷ **Foundations** make 25% program-related investment, or PRI, in the L^{3}C, accept lowest rate of return (1%), and take the highest risk

Socially Motivated Investors: 3% Return ⟷ Moderate Risk 25% Investment ⟷ **Socially motivated investors** (e.g., corporations, trusts, banks seeking to fulfill Community Reinvestment Act obligations) make 25% PRI in the L^{3}C and receive 3% return with moderate risk

Market-Driven Investors: 6% Return ⟷ Lower Risk 50% Investment ⟷ **For-profit investors** make 50% investment in the L^{3}C, take the lowest risk, and receive a competitive market rate of return (6%)

*The percentages listed here are provided for illustration purposes and represent just one of many possible risk-return arrangements for L^{3}Cs.

moved production overseas, leaving behind struggling communities. Lang is working with parties in North Carolina to explore developing an L^{3}C capitalized by foundations and for-profit investors that would buy the closed manufacturing plants, rehabilitate and re-equip them, and then rent them at low rates to local, start-up furniture manufacturers. Lang notes, "These would-be entrepreneurs are long on talent but short on cash." The proposed L^{3}C would provide up-and-coming furniture companies in North Carolina with affordable access to manufacturing capacity. Efforts to pass L^{3}C legislation in that state are under way.

Despite the possibilities, the L^{3}C has its critics and skeptics. Some argue that existing business forms are sufficient for the purposes discussed above, and adding yet another legal entity as an option will "muddy the waters." Others express concern that the proposed legislation to amend federal tax law pertaining to PRIs in L^{3}Cs entails a loosening of the tax laws for for-profit entities, and that it's too early to consider amendments because L^{3}Cs are still a relative unknown. Some concern has also been expressed that without the supporting federal tax legislation, the L^{3}C movement will die out.

Proponents of the L^{3}C stand by the new model as a potentially powerful tool for social entrepreneurs and an evolutionary step in social enterprise development. Many believe that as more jurisdictions enact L^{3}C laws, the L^{3}C brand will increasingly attract foundation and for-profit investment. Their belief could soon be tested, because L^{3}Cs are gaining traction across the country. To date, five states and two Native American tribes have enacted some form of L^{3}C legislation. Vermont took the lead, signing L^{3}C legislation into law in April 2008. Michigan, Wyoming, Utah, Illinois, the Crow Tribe in Montana, and the Oglala Sioux Tribe on the Pine Ridge reservation in South Dakota followed suit in 2009. According to L^{3}C Advisors, L^{3}C, the first L^{3}C chartered for the purpose of advocating for and supporting the development of L^{3}Cs, some form of L^{3}C legislation is pending or under review in 20 other states. As a matter of comity, an L^{3}C chartered in one U.S. jurisdiction will be recognized as a lawful business in all other U.S. jurisdictions, whether or not they have enacted L^{3}C legislation.

Realizing the vision

So how would the L^{3}C model enable Peggy Grimes to realize her cannery vision? Grimes would charter the cannery as an L^{3}C, removing it from day-to-day management of the MFBN and reliance on Montana Department of Corrections funding. She would continue to staff it with inmates from the Deer Lodge state prison, resulting in further growth of the inmate training and reentry program at no additional cost to the state. Her hope is that opportunities to invest in the L^{3}C would open up and attract PRIs from foundations. The PRIs, in turn, would provide incentives for additional for-profit investors. The L^{3}C would use the PRIs and additional investments to replace the current, aging cannery with a new facility. Then the L^{3}C would buy food from Montana producers, thus expanding the market for local farmers, and use the food to produce a high-end line of retail canned goods. The proceeds of the retail goods would sustain the operating costs of the cannery, which would continue to supply the MFBN.

"The L^{3}C model provides MFBN an opportunity to realize a vision that's been in the making for more than ten years," Grimes notes. "It offers a practical vehicle for raising the necessary capital to enable Montanans to have access to products that are grown and processed in Montana, to provide consistent access to healthy food for the emergency food system, and to offer an excellent means for inmates to acquire skills to help them succeed outside the prison system."

The Montana Department of Corrections has given its initial approval for the initiative. Grimes sees the possibilities that an L^{3}C, and the capital it could attract, can offer: a sustainable public-private partnership that would provide new markets for Montana food producers, enhanced rehabilitation training for prison inmates, and—most important—a significant tool to help alleviate hunger in Montana. cd

At the time of this writing, Steve Davis served as an AmeriCorps VISTA volunteer with Rural Dynamics, Inc., a community development organization in Great Falls, Mont.

For more information about the L^{3}C, visit www.americansforcommunitydevelopment.org. To learn more about the MFBN and its cannery project, call 800-809-4752 or e-mail info@mfbn.org.

[1] Examples of hybrid business models in the U.S. include the Socially Responsible Corporation, introduced in Minnesota Senate Bill 3786 in 1986 (the bill failed), and the B-Corporation concept being developed by Jay Coen Gilbert and B-Lab. Examples from abroad include the "community interest company," which was enacted into law in Great Britain in 2005.

[2] A "socially responsible investment," or SRI, is an investment made principally for a charitable, educational, environmental, community development, or ethical purpose and not primarily to maximize a return on the investment.

[3] For more about nonprofits creating social enterprises, see "Earning income, serving the community: An introduction to social enterprises" in *Community Dividend* Issue 1, 2009. Available at www.minneapolisfed.org.

[4] Thomas J. Billitteri, *Mixing Mission and Business: Does Social Enterprise Need a New Legal Approach? Highlights from an Aspen Institute Roundtable*, The Aspen Institute, January 2007.

[5] See USC § 4944(c) for the statutory provision regarding PRIs.

[6] Private foundations are required by federal law to distribute each year at least 5 percent of their endowments—specifically, their net investment assets. This is known as the *minimum payout obligation*, or *payout rule*.

[7] To read the full regulatory definition of PRIs, see 26 CFR § 53.4944-3(a).

[8] IRS Business Master File system, January 2007.

Inmates at work at the Montana Food Bank Network (MFBN) cannery in Deer Lodge, Mont. (top three photos); an MFBN office/distribution center in Missoula, Mont. (second photo from bottom); a semi from MFBN's delivery fleet (bottom photo).

TOP THREE PHOTOS COURTESY OF MONTANA CORRECTIONAL ENTERPRISES; BOTTOM TWO PHOTOS COURTESY OF THE MONTANA FOOD BANK NETWORK

Gender and financial literacy:

A conversation with Annamaria Lusardi of Dartmouth College

Continued from page 1

Dartmouth College, and her coauthors offers a host of information on the extent to which individual consumers lack the knowledge necessary to make prudent financial decisions. In particular, Dr. Lusardi's research has found that while low levels of financial literacy are a widespread problem for both genders, women tend to be less financially knowledgeable, on average, than men.

Community Dividend spoke with Dr. Lusardi to learn more about the gender gap in financial literacy and discuss how financial education practitioners can use her research to reach women more effectively.

Community Dividend: Let's start with the general findings of your research. Broadly speaking, what have you found out about the current state of financial literacy?

Annamaria Lusardi: What my coauthors and I have found by examining data from modules on financial literacy we've designed for national surveys in the U.S. and abroad is that there is a very low level of financial knowledge among the population, especially among women. However, one point I'd like to make is that we have *not* become more ignorant than before. What's happened is that the world around us has changed, but our knowledge is lagging behind. We're transitioning to a world of enhanced personal financial responsibility, where the pension landscape is shifting from defined benefit plans to defined contribution plans, where we have to make decisions about saving for our children's education, where we confront complex financial instruments, and so on. This is happening especially quickly in the U.S., where the formal and informal safety nets are not as wide as they are in many other developed countries.

CD: Could you provide some context for the gender gap you've observed in your research? Specifically, are men more knowledgeable about financial matters than women, but still not knowledgeable enough, or would achieving parity mean that women would have adequate levels of financial literacy?

AL: We've found that both men and women have too low a level of financial knowledge to be well-equipped to make decisions in our current, complex financial markets. For example, in a survey designed to assess debt literacy, or financial knowledge related to debt, we found that only a third of all respondents knew that they can't eliminate credit card debt by paying a minimum amount equivalent to the interest payment. [For more on the surveying Dr. Lusardi and her colleagues conducted, see the sidebar at the top of page 7.]

In that instance and others, when we break the data into gender groups, we find that women fare worse than men. While it's troubling that there's a gap, it's especially worrisome that women are sitting at the bottom of the scale at a time when they often have to fend for themselves in a financial world that is increasingly complex. The divorce rate is much higher than in the past, single motherhood is very high in certain demographic groups, and the greater longevity of women calls for more retirement savings for women than for men. On top of that, women are often concerned about saving for their children's education and helping their aging parents.

Defining our terms

Financial literacy:
The ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being.

Financial education:
The process by which people improve their understanding of financial products, services and concepts, so they are empowered to make informed choices, avoid pitfalls, know where to go for help, and take other actions to improve their present and long-term financial well-being.

Source: *2008 Annual Report to the President,* President's Advisory Council on Financial Literacy, U.S. Department of the Treasury, January 2009.

CD: Has your research shown that there are particular subgroups of women that fare better or worse than others?

AL: Our samples aren't so big that we can cut the data in such a granular way. What I can say is that when we cut the data not within gender, but by larger groups like age, race, level of education, and socioeconomic status, we find lower levels of financial literacy among the young and the old, racial minorities, individuals with low levels of education, and individuals with low incomes.

What this means is that if you're a woman and you're young, or if you're a woman and you're African American or Hispanic and maybe also low-income, you're more likely to display very low levels of financial knowledge. Women in the subgroups I mentioned are already vulnerable for a variety of reasons, and these low levels of financial literacy put them in an even tougher position.

CD: Your research looks at financial literacy levels around the world. Have you observed a similar financial literacy gap between men and women in other countries?

AL: Yes, and I think that looking at the cross-countries comparison is very informative and important. In almost every country that we've looked at, including Italy, Germany, the Netherlands, and Ireland, we've found a gender difference. So, irrespective of the education system of the country, the retirement system, or the labor force participation rate, the gender effect persists.

I'm just back from New Zealand, where yet again—in a survey very similar to the ones we have done here in the U.S.—a gap in financial literacy between men and women has been found. The fact that a gender difference is such a robust feature of the research and that it persists across countries indicates to me that there's something there, and that the topic of women and financial literacy deserves more thought and attention.

CD: What are the implications of the low levels of financial knowledge among women? In your opinion, do they hold women back?

AL: I do think they're holding women back. One of the questions in our research is, "Does financial literacy matter?" Our empirical work shows that financial knowledge does, in fact, affect behavior. People with higher levels of financial knowledge are less likely to borrow at high costs and more likely to participate in financial markets, accumulate wealth, and plan for retirement. Knowledge does translate into behavior that is associated with potentially higher financial well-being.

CD: In your experience interacting with policymakers and financial education practitioners, have you found that there's broad awareness of the gender gap in financial literacy?

AL: I'm not sure that the groups you mentioned are fully aware of the gender gap, and when I look at programs that have been implemented, I don't see particular attention paid to gender. Certainly, there are institutions with gender-specific missions that are pushing this idea, but on the whole, I feel one of the problems with existing financial education programs is that they're too one-size-fits-all. In order to be effective with financial education programs, we need to think a lot more about the audiences those programs are targeting. In particular, we need to think more about targeting and reaching women.

I've mentioned that my research shows

> *The current financial crisis has made clear how dire the consequences of financial mistakes are and has highlighted the need for increased financial education. I believe the present circumstances have great potential as a teachable moment.*
> *—Annamaria Lusardi*

women have low levels of financial knowledge, but what I've also found is that when we ask women to assess their own financial knowledge, they're aware that it's low. While other groups think they know more about personal finance than they actually do, women tend to acknowledge what they don't know. This is very important, because it indicates women are sensitive to their lack of knowledge and are therefore potentially more interested in addressing it.

Our experience at Dartmouth has shown this to be the case. When we did focus groups to devise a program to help Dartmouth employees save for retirement, I was struck by how articulate women were in describing their needs and objectives. What we also found is that women were looking forward to getting advice and help.

In all of the financial programs and initiatives I've been involved with, I've seen that women are an eager-to-learn audience and are expressing a demand for being better informed and more knowledgeable. If you go to a financial education program, you'll likely see that a large majority of the audience is women. If you look at the market for financial advice, the more successful books and writers are those that target women.

CD: During your research, what have you learned about how practitioners can tailor their programs to have a greater effect on women?

AL: What I've learned is that the first step in making a program effective is to listen. One has to listen to the concerns and problems of the group one is trying to address. To really improve financial knowledge, you need to go and talk to people and design programs with the participants you are trying to affect in mind.

One organization that has used this approach effectively is Doorways to Dreams. I heard about their initiatives from the founder and president, Peter Tufano, when I visited Harvard Business School last year. The objective of one of their projects was to improve the financial knowledge of mostly young, low-income women. They knew that using a classroom approach with this audience was probably not going to work. What they discovered from talking with and learning about this audience is that they play video games. In response, they designed a video game that puts the player in the role of managing a celebrity figure's finances. The game teaches players the workings of credit cards, annual percentage rates, and so on. It was an effective initiative because it gave women—most of them low-income—what they wanted. Financial literacy should start from the needs and wants of the target audience, not from our view of what people need to know. [To play the video game Dr. Lusardi describes, visit www.celebritycalamity.com.]

CD: Looking ahead, what do you think the future holds for financial education?

AL: I started working on these issues many years ago, when financial education was mostly considered a sideshow. The current financial crisis has made clear how dire the consequences of financial mistakes are and has highlighted the need for increased financial education. I believe the present circumstances have great potential as a teachable moment. More than ever before, we've become aware of how important it is to know the ABCs of finance.

My hope is that the current momentum doesn't go away—that the moment doesn't pass us by, but instead is viewed as an opportunity to get serious about implementing financial education programs. I'm optimistic that more attention will be paid to financial education. In most countries in the world—from developed countries and, more and more, to developing ones—there are people and institutions thinking hard about how to improve financial literacy and how to be effective in providing financial education. One question for practitioners and policymakers in the U.S. is whether they want to be leaders in this field or lag behind. cd

To learn more about Dr. Lusardi's work, including her recent book Overcoming the Saving Slump: How to Increase the Effectiveness of Financial Education and Saving Programs, *visit www.dartmouth.edu/~alusardi and http://annalusardi.blogspot.com.*

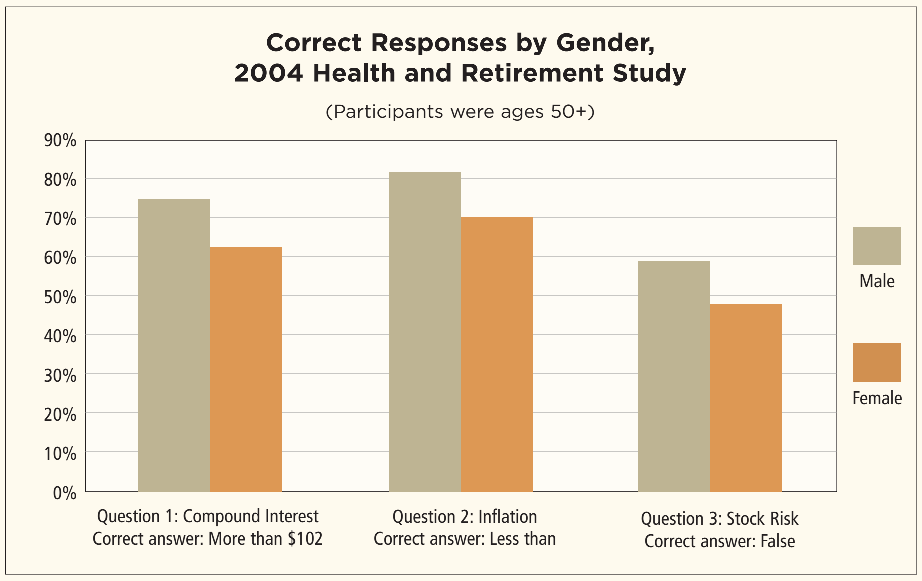
Determining how much people know about personal finance

To uncover how much individuals know about personal finance, Dr. Annamaria Lusardi and her coauthors have inserted finance-related questions into a variety of existing surveys, both in the U.S. and abroad. For example, Dr. Lusardi and her collaborator Dr. Olivia Mitchell created the following three-question module that was inserted into the 2004 Health and Retirement Study (HRS). The HRS surveys a sample of Americans over the age of 50 every two years and is supported by the National Institute on Aging and the Social Security Administration. The three personal finance questions are designed to cover the basic concepts of compound interest, inflation, and stock risk. A graph indicating correct responses by gender appears below.

Question 1: Suppose you had $100 in a savings account and the interest rate was 2 percent per year. After five years, how much do you think you would have in the account if you left the money to grow: more than $102, exactly $102, or less than $102?

Question 2: Imagine that the interest rate on your savings account was 1 percent per year and inflation was 2 percent per year. After one year, would you be able to buy more than, exactly the same as, or less than today with the money in this account?

Question 3: Do you think the following statement is true or false? Buying a single company stock usually provides a safer return than a stock mutual fund.



Fed site features financial education resources

The Federal Reserve System is committed to helping individuals of all ages build their personal financial skills and knowledge. To access the Fed's financial education resources, including consumer guidebooks, teachers' guides, and online learning tools, visit www.federalreserveeducation.org.

News and Notes

Fed offers tips for HELOC lenders and borrowers

A new publication from the Board of Governors of the Federal Reserve System offers guidance for lenders and borrowers of home equity lines of credit, or HELOCs. The guide, titled *5 Tips for Dealing with a Home Equity Line Freeze or Reduction,* explains the rights and responsibilities of lenders and borrowers when a HELOC is reduced or frozen. By law, a lender may reduce or freeze a HELOC, regardless of whether the borrower has made timely payments, but must promptly notify the borrower of the cause of the action. Common causes include a drop in the value of the home or a change in the borrower's financial situation. The *5 Tips* guide encourages borrowers to contact their lenders in the event of a reduction or freeze and ask what steps can be taken to have the HELOC reinstated. The new guide complements a previous Fed publication titled *What You Should Know about Home Equity Lines of Credit.* Both publications are available at www.federalreserve.gov/pubs.

New federal law protects tenants of foreclosed properties

A federal law enacted May 20, 2009, protects tenants from immediate eviction in cases where the ownership of residential rental properties changes hands due to foreclosure. The Protecting Tenants at Foreclosure Act of 2009 is designed to ensure that tenants facing eviction from a foreclosed property have adequate time to find alternative housing. The law requires the persons or entities that take ownership of foreclosed rental properties to provide 90 days' notice to tenants prior to eviction. It also requires the new owners to allow tenants with leases to occupy the property until the end of the lease term, unless the unit is sold to a purchaser who will occupy the property, in which case the 90-days'-notice requirement applies.

Community development corporations, housing counseling agencies, and other organizations that may be concerned with the foreclosure crisis and tenants' rights may wish to share information about the new law with the populations they serve. The Board of Governors of the Federal Reserve System (Board) encourages financial institutions, which are usually the immediate successors in ownership when a foreclosure is completed, to discuss any questions related to the new law with their legal counsel, as appropriate. The Board has issued examination procedures to ensure financial institutions are aware of and in compliance with the new law. To read the procedures, visit the Consumer Affairs Letters page at www.federalreserve.gov/boarddocs/caletters and view the attachment to letter CA 09-5.

Report sums up research on social effects of foreclosures

A recent report from the Urban Institute provides a summary of existing research on the social effects of home mortgage foreclosures. *The Impacts of Foreclosures on Families and Communities,* which was prepared on behalf of the Open Society Institute, collects and condenses the findings of surveys and studies that examine how foreclosures affect the stability and well-being of families, neighborhoods, and municipalities. The report identifies various categories of effects, such as Displacement and Housing Instability; Personal and Family Stress, Disrupted Relationships, and Ill Health; Declining Property Values and Physical Deterioration; and Crime, Social Disorder, and Population Turnover. Under each category, the authors list relevant research findings or, where applicable, explain why credible findings are not yet available. In the closing sections of the report, the authors offer a strategic framework for responding to foreclosures and identify a list of foreclosure effects that merit further research. To read the report, visit www.urban.org/publications/411910.html.

CRF to launch green loan program for small businesses

Community Reinvestment Fund, USA (CRF), a Minneapolis-based nonprofit organization that provides a secondary market for community development loans, has announced it is developing a "green" building loan program for businesses. The proposed program, called the CRF Capital Solutions–NMTC Green Building Loan for Businesses, is designed to spur investment in low- and moderate-income communities by helping small commercial and manufacturing businesses make energy-saving improvements to their buildings. According to CRF, the program will cover improvements from weather stripping to full-scale green renovations that will help business owners cut energy costs and increase the long-term value of their properties. Loans will be funded by NMTCs (New Markets Tax Credits) and issued to eligible businesses operating in NMTC-designated census tracts. The City of Minneapolis Department of Community Planning and Economic Development and the St. Paul Port Authority will serve as primary lending partners for a regional pilot of the program. CRF is currently identifying investors and additional partners for the pilot, which it plans to launch in 2010.

2008 was a mixed year for CDCUs, report says

The financial turmoil of 2008 yielded mixed results for community development credit unions, or CDCUs, according to a recent report from the CDCU industry's national membership organization.

CDCUs are federally insured credit unions that primarily serve low- and moderate-income people and communities. In *Financial Trends in Community Development Credit Unions: 2008,* the National Federation of Community Development Credit Unions (NFCDCU) shares findings from an analysis of year-end 2008 data from all 209 of its member CDCUs. The analysis reveals modest growth in some aspects of CDCUs' performance, coupled with modest setbacks in other areas. For example, on the positive side, total assets of CDCUs grew by 5.3 percent in 2008, or $224 million on a base of $4.3 billion, and total membership in CDCUs grew 2 percent, from 1,016,129 at year-end 2007 to 1,036,779 at year-end 2008. However, the return on average assets declined from 1.01 percent to 0.06 percent during the same period, while delinquent loans as a share of total loans increased from 2.25 percent to 2.88 percent.

Comparisons between the performance of CDCUs and the performance of all federally insured credit unions, or FICUs, suggest that CDCUs have been disproportionately affected by the economic crisis. For example, 35 percent of CDCUs had a negative return on assets in 2008, compared to 26 percent of all FICUs. In 2007, prior to the crisis, the percentages of CDCUs and FICUs with negative returns on assets were more similar, at 17 percent and 13 percent, respectively. According to the NFCDCU, the disproportionate nature of such effects stems from the fact that CDCU customers are largely low-income and are severely affected by trends like high unemployment, business failures, and mortgage foreclosures. To access the report, visit www.cdcu.coop.

Calendar

Transforming Our Work: From Challenging Times to Hopeful Futures. The 2009 Joint Annual Conference of the Minnesota Council of Nonprofits and the Minnesota Council on Foundations. November 5–6, St. Paul, Minn. An opportunity for representatives of nonprofits and foundations to assemble practical tools for transforming their organizations during turbulent times. Additional information: visit www.transformingourwork.org.

Community Development Forum

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December 1, 2009

Community Development Forum. December 1, Minneapolis. Topic: Neighborhood stabilization initiatives in the wake of the foreclosure crisis. Sponsored by Metropolitan Consortium of Community Developers, Twin Cities Local Initiatives Support Corporation, and the Federal Reserve Bank of Minneapolis. Additional information: visit the News and Events tab at www.minneapolisfed.org.