



Overview of Financial Services for Mid-Tier Food Chain Enterprises

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Introduction

Like all businesses, Mid-Tier Food Chain Enterprises need an accurate, transparent, convenient method of understanding and controlling their finances. Financial services are primarily transactional, focused on the daily movement of capital required to operate the business.

This chapter outlines the primary financial products and services most commonly used by value-added food businesses, using financial products to structure a loan deal, developing relationships between depository and non-depository institutions, and innovations related to financial products.

Although many Community Development Financial Institutions (CDFIs) do not directly provide financial services, including access to depository products, financial services are an important need of small businesses, including food-related businesses. Access to financial services represents an area of potential partnership with other financial institutions interested in serving the emerging food-related market.

Financial Products and Services

Financial products and services are generally organized into the following three categories: loan products (addressed in the Mid-Tier Food Chain Enterprises chapter), depository products, and additional business banking products and services.

It is important to note that many small credit unions, community banks, and revolving loan funds may not offer some or all of the following financial products and services. In addition, some small value-added food businesses may not want or need a full array of products and services at their particular stage of development. Nevertheless, many small businesses can increase their financial safety, efficiency, and earnings by establishing a relationship with a full-service, insured depository. CDFIs that do not offer depository or additional banking products are encouraged to consider establishing a relationship with a larger financial institution, and also to encourage their clients to take advantage of an appropriate array of services that can support the growth and success of their value-added food businesses. By understanding the financial services needs of their borrowers and developing complementary partnerships, CDFIs are not only providing valued service referrals to their customers, but also providing a degree of protection against predatory financial service providers that target low- and moderate-income communities.

Depository Products

Depository products range from simple savings and checking accounts to more sophisticated investment services.

- **Business Savings and Checking**
Business savings and checking accounts give business owners a safe, accessible place to deposit and withdraw funds as needed in the daily operation of their businesses. Business accounts often require the customer to maintain a minimum balance or average daily balance to offset monthly service fees.



Business savings and checking accounts may offer a wide range of conveniences to businesses, including unlimited access to accounts through secure internet connection, automated telephone access to accounts, Bill Pay options to pay bills electronically, a business debit card to be used while making purchases, online account statements with images of cleared checks, automatic alerts regarding low balances, and automatic transfers between accounts. Other deposit account services include text banking, remote deposit capture, and a courier service for larger business customers.

Using some or all of these options can be of great convenience to busy small business owners, including low-income customers of Community Development Financial Institutions.

- **Night Deposit Services**

Many small business owners find it difficult to visit their financial institution during normal banking hours, particularly if they are patching together income from multiple sources or jobs. Night deposit services can be a convenient way to deposit funds in a timely manner. Night deposit services also provide increased security compared to holding funds in a cash register overnight and allow the business owner to earn interest immediately upon deposit in an interest-bearing account.

- **Cash Management and Investment Services**

Cash management services may be set up to automatically move funds from a no-interest or low-interest bearing account to a higher interest-bearing account when a cash threshold established by the customer has been reached. These kinds of "sweep" accounts allow the business owner to maintain a comfortable level of funds available for daily operations, without losing an opportunity to generate a higher level of deposit interest income with periodic surplus funds.

Although not typically in strong demand by CDFI customers, investment services are generally attractive to larger business with greater amounts of capital available for investment. Investment services place a specified amount of funds into higher yield investment instruments to maximize the potential gain for the customer.

- **Additional Financial Products and Services**

Two additional financial services with value for many small value-added food businesses are payroll services and payment services. For CDFIs, it may be advantageous to offer these products through a third-party vendor rather than keep the associated back office operations in-house for a smaller financial institution.

- § ***Payroll Services***

- Processing payroll every week or two can be a time consuming task for small business owners, particularly if a company has more than ten employees. Given the importance of ensuring that all deductions are taken and reported accurately to multiple stakeholders, having access to payroll services is useful for many small value-added food businesses.

- § ***Payment Services***

- The ability to accept debit and credit card payments from customers, both in-person and online, represents a potential increase in business competitiveness and profitability. Debit and credit cards are also a convenience for business owners when making purchases of supplies and other necessities for running their businesses.



Using Financial Products Together to Structure a Deal

Owners of start-up and expanding Mid-Tier Food Chain Enterprises often know more about their value-added food products than about how to get access to the financial products most appropriate for their businesses. By working collaboratively with value-added food business owners, Community Development Financial Institutions can help them understand their credit needs, transactional needs, and how to leverage available resources.

Understanding the credit needs of the borrower

Most value-added food enterprises need access to a line of credit for working capital (inventory, supplies) and a term loan (purchase of equipment or real estate) at some point in their development. It is important to match the loan term with the type of credit so that short-term assets are used to pay current expenses. If the repayment schedule does not match the cash flow from the normal cash conversion cycle, there will be insufficient cash available to pay down the loan when it comes due.

Similarly, long-term loans are made to acquire fixed assets and these loans are repaid from net income over time. Structuring this type of loan as a short-term note makes it very difficult for the borrower to repay the note as agreed. Conversely, if the loan is structured to be repaid over a too-long maturity that exceeds the economic life of the asset financed, the lender will eventually be in a weak collateral position with the borrower making payments on an asset with little liquidation value.

A strong lender will listen to the borrower in order to really understand the business and its credit needs, now and in the future. The lender will also help the borrower understand why a loan is structured as either short-term or long-term and its potential impact on the company's profitability and capacity for growth.

Understanding the transactional needs of the borrower

Every business has transactional needs. Value-added food producers are often cash-intensive businesses, with a need for an array of depository and other financial products and services. Loan products and depository products may be bundled together to give the customer a full-service package of financial products and services.

Leveraging resources

It is common in microenterprise programs to link access to credit with access to training, technical assistance, and mentoring opportunities. Many micro-entrepreneurs and small business owners cite access to non-financial benefits, such as technical assistance, as being at least as important to the success of their business as the financial benefits, such as access to savings vehicles or affordable credit.

Developing Relationships Between Depository and Non-Depository Institutions

Effective models of affiliation between small and large financial institutions, between nonprofits and financial institutions, and between government agencies and nonprofits and financial institutions are emerging around the country. For many institutions, these partnerships produce significant benefits for their clients in terms of efficiency and scale, local knowledge and community investment, and product



diversification. For Community Development Financial Institutions operating without the ability to directly offer deposit products to their customers, developing relationships with depository institutions is of particular interest.

- **Improved efficiencies**

It is hard for a financial institution to be simultaneously small and community-based and also have the capacity to offer a full array of financial products and services to its customers. By developing a relationship with a group of lenders or a larger financial institution, a small lender may be able to take advantage of economies of scale and provide better services and pricing to its customers.

For example, a small financial institution may be in a position to fund all or part of a particular loan, but not to provide access to the depository needs of the customer. In this event, the customer, the small financial institution or lending agency, and a larger financial institution may all benefit from a referral or affiliate arrangement between the financing entities.

- **Enhanced lending**

Managing credit risk while simultaneously investing in viable value-added food businesses can be a challenge for the lender. Credit support through loan guarantees or mission-related investments can make the difference in whether or not a loan request is funded. Loan participation between multiple financial institutions may be a solid option that benefits all lending parties.

Small lending institutions and revolving loan funds may at times have liquidity issues and face difficulty in securing sufficient loan capital to meet the credit needs of their customers. Similarly, small lenders may not be set up to service their loans, including accepting and tracking all of the individual and aggregate loan payments.

Partnerships with groups of lenders or larger financial institutions or third party vendors may enhance a small lender's ability to make and service loan requests from value-added food businesses.

Many financial institutions are also motivated to support CDFI lending, through program related investments or equity equivalent investments, to support their Community Reinvestment Act (CRA) goals. This can significantly increase the capital available to CDFIs to lend to their communities.

- **Access to new markets**

Small, community-based lenders generally excel at knowing their local communities, which may be challenging for larger national and international financial institutions. By affiliating with local nonprofits and smaller lenders, large financial institutions may gain access to new markets previously inaccessible to them. This may be particularly true with immigrant communities and emerging markets with limited prior experience with the formal financial sector.

Additionally, by supporting microenterprises and fledgling businesses during the start-up and early growth phases, the larger financial institution will likely see a future benefit with the businesses that grow and prosper.



Public benefit

The multiple public benefits of supporting Mid-Tier Food Chain Enterprises are well established. In addition to increasing access to healthy food in communities across the country, value-added food producers assist with job creation at various skill levels as well as income generation for individual and communities.

Innovations and New Models

While progress has been made over the last several years in improving access to affordable credit and financial service for food-related businesses, there is ample room for innovation and implementation of new models.

- **Integrated back office services for lenders and financial intermediaries**
Pressures of scale and efficiency will likely lead to continued aggregation of small and community-based financial institutions. One alternative to continued consolidation is to retain the identity of smaller financial institutions and intermediaries while simultaneously taking advantage of more deeply integrated back office operations related to loan servicing, information technology, and other functions of financial institutions that are less directly related to human contact and community relationships.
- **Further exploration of innovative debt/equity structures**
Small food-related businesses often need capital to start or expand but cannot afford to take on significant debt. Although some value-added food businesses can get access to equity capital, many cannot. Financial institutions traditionally are able to extend debt financing but not equity capital, and at times take on risk more appropriate for equity deals due to a desire to support the new business.

A different model is to combine a financial intermediary's ability to extend both debt financing and equity capital, possibly using a for-profit/non-profit structure, with an exit strategy that makes sense for all parties.

Additionally, associations of healthy food-related enterprises could be structured to create opportunities for expanded networks of community financing models, as well as mission-related investment opportunities for individuals, foundations, and others.
- **New product development**
The Center for Financial Services Innovation (CFSI), a national authority on financial services for under-banked customers, has identified the following priorities for innovative solutions to providing financial services to low-income customers.¹
- **Diversification of credit offerings**
 - § Incorporating flexible repayment terms, extended repayment options, alternative credit data solutions, and employer-based lending.

¹ Center for Financial Services Innovation website (June 2011)



- **Expand financial transaction products**
 - § Develop prepaid solutions, mobile and electronic payments, money transfers.
 - § Deepen financial capability of low-income customers.
 - § Increase financial coaching and literacy training, include online budgeting tools.
- **Combine financial product offerings**
 - § Link loan repayments with a savings component, open micro-branches, develop transaction accounts that build credit history.

Summary

In the Financial Services for Small Healthy Food Businesses chapter, the following topics have been addressed, with focus on Community Development Financial Institutions:

- Primary financial products and services most commonly used by value-added food businesses.
- Using financial products to structure a loan deal.
- Developing relationships between depository and non-depository institutions.
- Innovations related to financial products.

The underlying theme in this chapter is the importance for Community Development Financial Institutions to recognize that small food-related businesses have a need for financial services, including depository services. Because many CDFIs in the country do not directly provide access to non-credit financial services, it is important for CDFIs to consider forming a relationship with a depository institution in order to better serve its customers. Additionally, the development of new financial products geared toward serving the financial needs of under-banked customers is an exciting area of innovation for CDFIs and their low-income customers.