South Shore Bank: Is it the Model of Success for Community Development Banks?

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ABSTRACT

South Shore Bank, the country's first community development bank, began in 1973 with the dual objectives of making a profit and improving conditions in the community of South Shore, Chicago. Although the bank has been hailed as a success, there has been little work on defining or measuring its performance against either objective. This article compares the bank's financial performance against comparable banks (holding companies) and the demographic changes in the South Shore community against changes in the contiguous communities. The results suggest that both the bank and the community exhibit worse relative performance. Additional research is needed to verify these results and to determine how to improve the effectiveness and efficiency of community development banks. © 1995 John Wiley & Sons, Inc.

The decline of the American inner city is among our most serious social problems. Inner-city neighborhoods are plagued by high and rising crime, poverty, and unemployment rates as well as decaying infrastructure. Although the causes are numerous and complex, people are now beginning to believe that financial institutions play a role in urban decline by restricting capital flows into these communities. Specifically, banks are being criticized for discriminating against

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ton recently signed a bill which provides $382 million for "investment in and assistance to community development financial institutions.[3]

The bill presupposes that development banks are both profitable and effective despite little evidence that either assertion is true. This article attempts to fill that void by analyzing Shorebank's financial and development track record. The first part of the article compares South Shore Bank's financial performance against a control group of banks (and bank holding companies). The results suggest that although the bank has been profitable, it has underperformed relative to comparable financial institutions. The second part of the article examines Shorebank's development impact by comparing demographic changes in South Shore against changes in contiguous communities. Over the past 20 years, South Shore has not improved relative to these other communities. This absence of relative improvement is both puzzling and troubling, and merits further research.

The apparent contradiction between these findings and Shorebank's perceived success can be explained in two ways. First, Shorebank has been extremely successful in marketing its name, products, and services—few banks can claim to have an equivalent national reputation or to have been as innovative in opening new markets. In terms of investors, Shorebank has raised millions of dollars from depositors, debt holders, and stockholders who are more interested in the bank's social mission than financial returns; in terms of customers, Shorebank has found a large, and previously unserved, group of inner-city borrowers and has shown the world that there are solid credit risks in low-income areas. The other reason for the Shorebank's perceived success is that performance has been evaluated using output measures (i.e., the number or amount of loans) instead of impact. Without measuring impact, it is extremely difficult to claim that Shorebank has been a success. This study shows not only how difficult it is to measure development impact, but also why it is so important to do so. The only way to improve development banks' ability to revitalize disinvested communities is to define objectives, measure performance, and adjust strategy in response to the results.

Although Shorebank may not be the exact model of success, at least according to this analysis, its history provides valuable lessons regarding development lending. Given the magnitude of the problems in our inner cities and the recent Congressional appropriation of funds, there will be opportunities for others to start and run community development banks. These opportunities make it even more important to understand what makes development banks both profitable and effective.

[3]U.S. House of Representatives (1994). At the signing, Treasury Secretary Lloyd Bentsen said, "These community development financial institutions are some of the most efficient and effective deals going" (Skidmore, 1994, p. 63).

Esty, Benjamin C., ***South Shore Bank: Is it the Model of Success for Community Development Banks?*** , Psychology and Marketing, 12:8 (1995:Dec.) p.789

SHOREBANK CORPORATION

Shorebank's history begins in 1973 when the owners of South Shore National Bank—the last remaining commercial bank in South Shore—decided to sell the bank.[4] The regulators rejected the first offer because it was conditional on being able to move the bank out of South Shore. The reason the investors wanted to move the bank was that the community was rapidly changing both racially and economically: In 1960, South Shore was 100% white and predominantly middle class; yet by 1970, it was 70% African American and working class. As other banks closed or left, capital stopped flowing into the community, residents stopped investing in their homes, and businesses shut down.

Subsequently, four individuals, formerly employed at Hyde Park Bank & Trust Company, made an offer to buy the bank with additional financial support from outside investors. They saw an opportunity to use their banking experience, along with their interest in community development, to address the decline of South Shore. What was unique about their vision was their dual objectives:

> Dual goals have been paramount with this organization from day one: achieving a profit for the company and generating tangible measurable economic development results. We absolutely believe these dual goals are compatible. . .[5]

After buying the bank, the founders realized that community development required more functions than a bank could legally perform and so they created a holding company structure (see Figure 1).[6] Today, the holding company owns (a) South Shore Bank—a full-service commercial bank; (b) City Lands Corporation—a real estate development company; (c) The Neighborhood Fund—a specialized small-business investment corporation; (d) The Neighborhood Institute—a nonprofit institute whose goal is the development of human capital (its nonprofit status means it can accept foundation gifts and federal grants that the for-profit subsidiaries cannot); and (e) Shorebank Advisory Services—a consulting firm that specializes in economic development outside of South Shore. According to the founders, this structure is critical to the bank's development mission: "The structure allows Shorebank Corporation to be both a lender and an initiator of development. The two activities tend to reinforce one another and prime the

[4]The information in this paragraph comes from Grzywinski (1991, pp. 88–89).

[5]University of Illinois (1993, p. 18).

[6]The importance of the holding company structure makes the term *community development bank* somewhat of a misnomer.

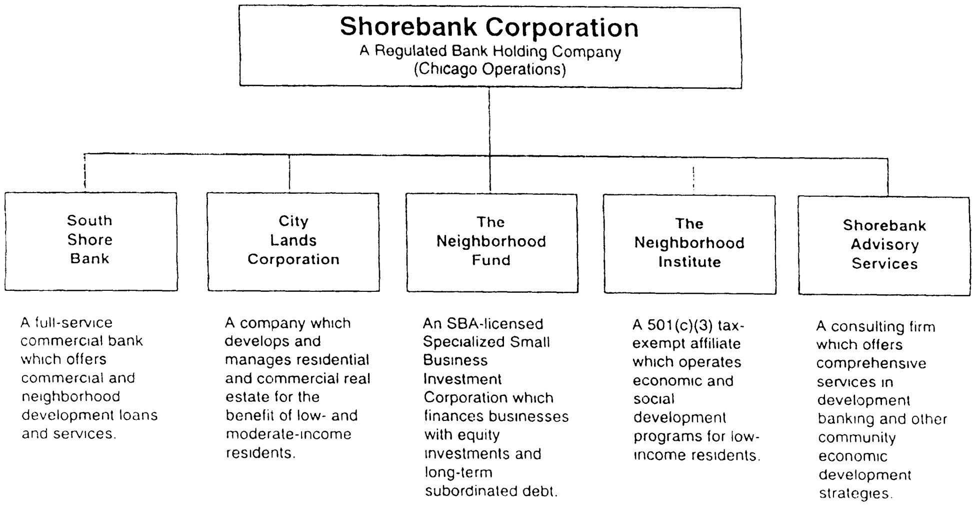


Figure 1

pump for more development.[7]" By targeting their lending to a specific geographic area and by drawing capital into the community, they hope to reverse the process of decline.

Over the past 20 years, Shorebank has grown from $44 million to $272 million in assets, and has done so by opening new markets and finding new customers. For example, Shorebank's Development Deposits program is an innovative approach to attracting funds because many of the depositors live outside of South Shore (in fact, they live in all 50 states and over 17 countries[8]). People choose to open accounts because they know their money is being used for community development. The practice of raising funds from outside the community (known as *greenlining* in contrast to *redlining*) was an outgrowth of the bank's inability to raise funds from within the community.[9] This novel approach to gathering funds has become an enormous success: The bank now has $135 million of Development Deposits (over 60% of total deposits and 50% of assets), an amount that has been growing at a compound annual rate of 13%. Shorebank has also been able to raise debt and equity by tapping into an investor base that is interested in the corporation's social mission. In fact, Shorebank recently raised $11.2 million of nonvoting common stock and $4.5 million of debt.

[7]James Fletcher, President of South Shore Bank (Linnen, 1989, p. 63).

[8]1991 Annual Report, p. 13.

[9]Several other banks have since started similar programs. The Bank of Newport, in Oregon, offers Progressive Banking accounts and Vermont National Bank offers the Socially Responsible Banking Fund, which is targeted to environmentally sound loans (O'Hara, 1994, p. 6).

In a similar fashion, Shorebank has discovered a new, and largely untapped, customer base for the asset side of its balance sheet. Shorebank's lending focus has been on residential real estate rehabilitation and development. Whereas many banks have begun to lend in low-income areas out of fear of retribution from the regulators for violating the Community Reinvestment Act, Shorebank did so for sound business reasons:

> It's not that we have some magic in what we do, but we take very seriously that premise that there are good loan opportunities with minority borrowers . . . Bankers haven't yet caught on that lending to minorities is a good and profitable business.[10]

Shorebank's relatively low charge-off rate on residential loans supports this claim, as does a recent study by the Federal Reserve (Federal Reserve System, 1993).

Today, based on the firm's survival and growth, the founders believe they have been successful in South Shore and view expansion of operations as the major challenge in the future.[11] Already Shorebank has operations in Chicago, northern Michigan, Ohio, and Oregon, and is consulting on development banking in such places as Kansas City and Arkansas. Although it appears that the expansion strategy is well underway, it is not clear that Shorebank has actually achieved its original objectives of profit and economic development in its first community. The next two sections examine Shorebank's financial performance and development impact to see if, indeed, it has met its original objectives.

FINANCIAL PERFORMANCE

Shorebank's first objective, separating it from a charity or other nonprofit organization, is to be profitable. In order to judge whether it has met this objective, one has to define an appropriate standard of comparison. One alternative is to compare Shorebank's performance against a group of nonprofit development organizations. Yet given its objective of earning a profit, it seems more appropriate to compare Shorebank against a group of for-profit institutions such as banks or bank holding companies. Although banks may be the right base of comparison, it is important to remember that Shorebank differs because of its development mission. As a result, Shorebank's objective is not profit maximization, for that would likely hinder development efforts, even

[10]Cox (1993, p. 21).

[11]1990 Annual Report, pp. 1, 5; 1991 Annual Report, p. 4.

though profitability is an objective. Thus one should not expect Shorebank to exhibit superior relative performance vis-a-vis a control group of banks. Instead, the key questions are how well has Shorebank performed and has it generated competitive returns for its investors.

This first set of analysis examines Shorebank's financial performance at both the bank and the holding company levels. The reason for looking at the bank is that it is the cornerstone of the organization: Over the past 5 years the bank has contributed an average of 95% of total corporate assets (though this is falling), and 127% of net income. The reason for looking at the holding company is that the other subsidiaries play a critical role in the company's mission and may affect overall performance.

The initial screen of banks for the control group was based on asset size and location. Potential candidates had assets as of 12/31/89 ranging from $50 million to $1 billion and had their main office in the city of Chicago.[12] The banks were then divided into two groups based on the racial composition[13] and median household income of the zip codes where the banks have their headquarters (see Table 1). The first group, called the Closest Comparable Banks, consists of Chicago Bank & Trust Company, Seaway National Bank, Independence Bank, Marquette National Bank, and Heritage/Pullman Bank & Trust Company. These banks are in neighborhoods that are predominantly non-White (98.5% on average compared to 97.7% for South Shore) and have household income levels just under $23,000 (compared to $20,479 for South Shore). The second group of banks, called the Other Comparable Banks, consist of Hyde Park Bank & Trust Company, South Chicago Savings Bank, Steel City Bank, Chicago National Bank, and Drexel National Bank. The banks in this second group are in neighborhoods with a lower percentage of minorities than South Shore 71.8% vs. 97.7%), but with similar levels of household income ($22,747 vs. $20,479). Collectively, the set of 10 banks is called the Full Set of Comparable Banks.

One problem with this methodology is that bank activity is assumed to occur in the zip code where the bank has its head office. To the extent that these banks have many branches or lend in areas away from their head office, they will not be comparable to South Shore Bank, whose service area is close to the head office. No attempt was made to verify the banks' actual service areas.

[12]Of the banks in existence at 12/31/89 in the Chicago area in this asset range, none failed by 12/31/93, although there were several mergers. Thus the sample is not biased in favor of survivors.

[13]The reason for examining racial composition is that if discrimination is a function of race, then discrimination is likely to be more severe in neighborhoods with a greater proportion of minorities.

Table 1. Comparable Banks and Bank Holding Companies.

Bank Name	Zip Code of Head Office	Bank Assets ($millions) 12/31/93	Bank Holding Company	Holding Company Location	Holding Co. Assets ($millions) 12/31/93	Demographic Data for Zip Code As of 1990: Total Population	Percent Non-White	Median Household Income
South Shore Bank of Chicago	60649	$259.9	Shorebank Corporation	Chicago	$281.3	54,795	97.7%	$20,479
Five Closest Comparable Banks								
Chicago City Bank & Trust Co.	60621	$201.4	Chicago City Bancorporation	Chicago	$201.6	56,458	99.5%	$13,087
Seaway National Bank	60619	$213.7	Seaway Bancshares, Inc.	Chicago	$214.2	74,469	99.2%	$24,651
Independence Bank of Chicago	60619	$135.3	Indecorp, Inc.	Chicago	$274.3	74,469	99.2%	$24,651
Marquette National Bank	60636	$738.1	Marquette National Corporation	Chicago	$765.3	58,048	97.8%	$22,653
Heritage/Pullman Bank & Trust Co.	60628	$240.0	HP Holding Co.	Oak Park	$367.7	94,317	96.7%	$29,531
Mean		$305.7			$364.6	71,552	98.5%	$22,915
Median		$213.7			$274.3	74,469	99.2%	$24,651
Other Comparable Banks								
Hyde Park Bank & Trust Co.	60615	$190.1	HPK Financial Corp	Chicago	$193.7	44,137	74.9%	$22,161
South Chicago Bank	60617	$241.9	Advance Bancorp, Inc.	Homewood	$605.9	98,612	70.6%	$28,131
Steel City Bank of Chicago	60617	$103.2	Steel Bay Bancorporation, Inc.	Lansing	$215.3	98,612	70.6%	$28,131
Chicago National Bank	60609	$109.8	Alpha Financial Corp	Chicago	$206.1	89,762	70.3%	$15,725
Drexel National Bank	60616	$134.6	Indecorp, Inc.	Chicago	$274.3	45,750	72.5%	$19,587
Mean		$155.9			$299.1	75,375	71.8%	$22,747
Median		$134.6			$215.3	89,762	70.6%	$22,161
Full Set of Comparable Banks								
Mean		$230.8			$331.8	73,463	85.1%	$22,831
Median		$195.8			$244.8	74,469	85.8%	$23,652

Sources: Federal Reserve Bank of Chicago and Sourcebook of Zip Code Demographics, 9th Ed (1994), CACI Marketing Systems.

The analysis of financial performance is based on the rating system used by the federal banking regulators (referred to by its acronym CAMEL) which assesses performance in five categories: capital, assets, management, earnings, and liquidity. This article examines financial ratios in seven categories:

1. Asset mix.
2. Capital adequacy.
3. Asset quality.
4. Earnings/profitability.
5. Liquidity.
6. Funding.
7. Sheshunoff rating (a composite bank rating).[14]

The analysis, because of year-to-year variation, is based on 5-year averages (1989–1993) for each bank for each variable using data obtained from Sheshunoff Information Services. South Shore Bank (SSB) is compared against the median value for the Five Closest Comparable Banks and for the Full Set of Comparable Banks (the results using the average and weighted average are similar). The results appear in Table 2.

Asset Mix. SSB has a greater percentage of assets in real estate loans and commercial and industrial loans (C&I). The former is expected given SSB's real estate focus, yet the latter is somewhat surprising. The most noticeable difference between SSB and the other banks is the loan/asset ratio—typical of a development bank, SSB loans out a much greater fraction of its assets. The comparable banks are similar in size, although SSB has grown faster.

Capital Adequacy. SSB holds significantly less capital than the comparable banks: core capital (essentially Tier 1 capital) as a percentage of assets is 5.95% compared to 7.96% for the full set of comparable banks. SSB also has lower loan loss reserves by almost a full percentage point. If SSB held equivalent loan loss reserves, then its accounting profit would have been lower due to greater loan loss provisions.

Asset Quality. Interestingly, SSB has fewer nonperforming loans than the comparable banks even though SSB holds a greater percentage of bad loans on their books (other real estate owned) and charges off a greater percentage of their loans: 0.48% versus 0.29% (for the

[14]Sheshunoff Information Services collects, assesses, and provides financial data on all banks and bank holding companies.

Table 2. South Shore Bank vs. Comparable Banks. Average Financial Performance: 1989–1993.

		Medians for Comparable Banks		Difference between South Shore Bank and the Medians for Comparable Banks	
Performance Measure	South Shore Bank	Five Closest Comparable Banks	Full Set of Comparable Banks	Five Closest Comparable Banks	Full Set of Comparable Banks
Asset mix					
Real estate loans/total assets	38.11	15.99	16.47	22.11	21.64
Commercial and Industrial loans/total assets	25.89	13.31	13.50	12.58	12.39
Total assets ($ millions)	$211.9	$195.3	$178.7	$16.5	$33.1
Compound annual growth rate of assets	8.86	6.56	5.67	2.31	3.19
Capital adequacy					
Core capital/adjusted total assets[a]	5.95	7.70	7.96	−1.76	−2.02
Loan loss reserve/total loans	1.12	2.11	2.02	−0.99	−0.89
Asset quality					
Other real estate owned/total assets	0.24	0.07	0.08	0.16	0.16
Nonperforming loans/gross loans	2.05	2.73	2.20	−0.68	−0.15
Net charge-offs/average loans	0.48	0.39	0.29	0.09	0.19

Earnings/profitability					
Return on average assets	0.87	1.35	1.31	−0.48	−0.44
Return on average equity	14.57	16.95	16.35	−2.38	−1.79
Net interest margin/average assets	4.69	4.58	4.37	0.11	0.32
Interest income/average assets	9.47	8.14	8.12	1.33	1.34
Interest expense/average assets	4.77	4.00	3.85	0.78	0.92
Net noninterest margin/average assets	−2.90	−2.22	−2.32	−0.69	−0.59
Total noninterest income/avg. assets	0.97	1.41	1.00	−0.44	−0.03
Total overhead expense/avg. assets	3.87	3.51	3.45	0.37	0.42
Liquidity					
Liquid assets−Large liab./total assets[a]	−13.74	7.77	6.98	−21.51	−20.73
Funding					
Cost of deposits[b]	5.12	4.49	4.42	0.63	0.69
Sheshunoff rating[a]	7.5	52.0	58.9	−44.5	−51.4

All numbers are percentages except total assets.

Five Closest Comparable Banks include Chicago City B&TC, Seaway NB, Independence Bank, Marquette NB, and Heritage/Pullman B&TC.

Full Set of Comparable Banks includes the Five Closest Comparable Banks plus Hyde Park B&TC, South Chicago Savings Bank, Steel City National Bank, Chicago National Bank, and Drexel National Bank.

The Sheshunoff rating is a composite percentile ranking of banks from 0 to 99 (high) based on asset size.

Source of Data: Bank call reports from Sheshunoff Information Services.

[a]Data available for only four years 1990−1993.

[b]Data available for only three years 1991−1993.

full set of comparable banks).[15] Whereas a 10–20 basis point difference may not seem like much, it is a big difference for firms whose net income is only 1% of average assets. Although higher than the comparables, SSB's level of charge offs and real estate owned are well within reasonable limits, especially given the type of lending it does.

Earnings/Profitability. SSB lags the comparable banks in terms of net profitability. Its return on average assets is 40–50 basis points below the comparable banks (0.87% vs. 1.31% for the full set of comparable banks) and its return on average equity is lower as well (even given its greater leverage). The difference in profitability is not due to a difference in net interest income, but rather differences in loan losses (see above) and net *non*interest margin (−2.90% vs. −2.32% for the full set of comparables). SSB's noninterest income is lower than the comparables and its noninterest expense (overhead expense) is much higher. The difference in noninterest expense can be explained by SSB's expenditures on credit analysis, R&D (experimenting with new development programs), and marketing (they are trying to sell banking products as well as a concept).

One other point to notice is that although SSB's net interest margin is approximately equal to the comparables, both its interest income and interest expense are significantly higher: SSB's interest income is 134 basis points higher than the comparables (9.47% vs. 8.12%) and its interest expense is 92 basis points more (4.77% vs. 3.85%). In both cases, portfolio differences may explain this result. A second explanation is that SSB is charging more for similar loans and simultaneously paying higher rates on similar deposits (see below).

Liquidity. This ratio measures the extent to which a bank is threatened by the withdrawal of its most liquid liabilities (the large liabilities). Whereas SSB has a negative ratio, which implies that it has fewer liquid assets than liquid liabilities, the median for the comparables is positive. The reason is that SSB has a greater percentage of assets in loans than other banks and correspondingly less in liquid assets such as cash.

Funding. SSB pays more for its deposits than the comparable banks: Its cost of deposits (the interest paid divided by the average balance in deposit accounts) is 60–70 basis points higher on average over the past 5 years. Differences in rates and mix (in terms of maturities and insured/uninsured status) can explain some of SSB's higher funding cost (see below).

[15]According to Shorebank's management, a large part of this loss was due to a single bad loan.

Sheshunoff Rating. This is a composite, percentile rating from a low of 0 to a high of 99 based on overall financial condition and performance for all banks in similar asset size categories. SSB is in the bottom 10% of banks in the country based on its size, whereas the median for the comparable bank is in the 50–60th percentile.

From this analysis, one can conclude that South Shore Bank's relative financial performance has been worse than comparable banks in South Chicago. Yet, as mentioned before, SSB's objective is not to be the most profitable bank, but rather to achieve accounting profitability. Measured against this standard, South Shore Bank has been successful; measured against the financial track record of nonprofit development organizations, South Shore Bank would appear even more successful.

Because the bank is only one part, albeit the most important part, of Shorebank Corporation, it is also important to analyze financial performance at the holding company level. The approach is the same as the analysis on banks except that the control groups are composed of the holding companies rather than banks (see Table 1). The only complication is that one of the Closest Comparable Banks (Independence Bank) has the same holding company as one of the Other Comparable Banks (Drexel National Bank). Rather than counting this holding company twice, it is included in the Closest Comparable Holding Companies set. As a result, there are only nine holding companies in the Full Set of Comparable Holding Companies. The results appear in Table 3.

In general, the results at the holding company level are similar, although some new variables do provide additional insight. Under asset quality, three new variables have been added that look at the ratio of net charge offs by loan type. This analysis shows that Shorebank's losses on real estate loans have been comparable to the other holding companies, yet its losses on commercial and industrial loans and on consumer loans have been worse (0.99% compared to 0.30% for commercial and industrial loans and 0.99% compared to 0.23% for consumer loans). In terms of overall performance, Shorebank has a higher Sheshunoff rating at the holding company level than at the bank level, even though it still ranks in the 21st percentile—well below the 54th percentile for the comparable group.

Investor Returns

The second aspect of Shorebank's financial performance is the returns earned by its investors, including depositors, debt holders, and equity holders. Although most of the data needed to make concrete statements about financial returns are unavailable, one can piece together bits and pieces of information from the financial statements and annual reports to make some judgments about the returns.

Esty, Benjamin C., ***South Shore Bank: Is it the Model of Success for Community Development Banks?*** , Psychology and Marketing, 12:8 (1995:Dec.) p.789

Table 3. Shorebank Corporation versus Comparable Bank Holding Companies. Average Financial Performance: 1989–1993.

Performance Measure	Shorebank Corporation	Medians for Comparable Bank Holding Companies		Difference Between Shorebank Corp. and the Medians for Comparable Bank Holding Companies	
		Five Closest Comparable Holding Cos.	Full Set of Comparable Holding Cos.	Five Closest Comparable Holding Cos.	Full Set of Comparable Holding Cos.
Asset mix					
Real estate loans/total assets	36.40	16.22	16.26	20.17	20.13
Commercial and Industrial loans/total assets	25.13	13.28	12.94	11.86	12.19
Total assets ($millions)	$222.4	$270.8	$219.3	($48.46)	$3.0
Compound annual growth rate of assets	10.09	6.53	6.34	3.56	3.75
Capital adequacy					
Core capital/adjusted total assets	6.78	6.37	9.05	0.41	−2.27
Loan loss reserve/total loans	1.17	2.11	2.07	−0.94	−0.90
Asset quality					
Nonperforming loans/gross loans	2.24	2.29	2.29	−0.05	−0.05
Net charge offs/average loans	0.59	0.30	0.19	0.28	0.39
Real estate charge-offs/avg. RE loans	0.21	0.26	0.17	−0.05	0.04

Esty, Benjamin C., ***South Shore Bank: Is it the Model of Success for Community Development Banks?*** , Psychology and Marketing, 12:8 (1995:Dec.) p.789

Commercial and industrial charge-offs/avg. C&I loans	0.99	0.30	0.20	0.69	0.79
Consumer charge-offs/avg. consumer loans	0.99	0.23	0.28	0.76	0.71
Earnings/profitability					
Return on average assets	0.68	1.20	1.10	−0.52	−0.43
Return on average equity	11.41	13.21	12.19	−1.80	−0.78
Net interest margin/average assets	4.51	4.39	4.01	0.11	0.50
Net noninterest margin/average assets	−3.09	−2.30	−2.30	−0.79	−0.79
Liquidity					
Liquid Assets − Large Liab./Total Assets	−17.04	1.15	3.04	−18.19	−20.09
Sheshunoff ratings[a]	21.0	48.6	54.8	−27.6	−33.8

All numbers are percentages except total assets.

Five Closest Comparable Holding Companies includes: Chicago City Bancorp, Seaway Bancshares, Indecorp, Marquette National Corp., and HP Holding Company.

Full Set of Comparable Companies includes: the Five Closest Comparable Holding Companies plus HPK Financial (3 years of data only), Advance Bancorp, Steel City Bancorporation, Alpha Financial Corporation.

[a]The Sheshunoff rating is a composite percentile rating of bank holding companies from 0 to 99 (high) based on asset size.

Source of data: Sheshunoff Information Services.

Shorebank's best known product, and its primary source of funds, is the Development Deposit. Although many people believe that these deposits are subsidized, CEO Ronald Grzywinski claims that only 4.1% of deposits (it is not clear whether that is by number or by amount) are subsidized.[16] The fact that South Shore Bank's cost of deposits is 60 basis points more than the comparables (see Table 2) seems to refute the claim that South Shore Bank is paying below-market rates on its deposits. One can test this hypothesis by comparing South Shore Bank's rates on certificates of deposit (CDs) as of 9/27/94 versus the Chicago BRM Deposit Rate Index.[17] On average, South Shore Bank pays 14 basis points less on 6-month, 1-year, and 2-year CDs and pays 41 basis points more across a range of jumbo CDs (above $100,000). According to South Shore Bank, it has to pay more because its depositors, particularly the Development Depositors, view higher-yielding money market instruments as the alternative for their money rather than bank deposits. Shorebank's funding cost could also be higher because of differences in mix (percent uninsured deposits) and maturity. In terms of mix, Shorebank's ratio of uninsured deposits to total assets is twice as large as the comparable holding companies. Because it is a riskier institution—it has a lower Sheshunoff rating—one would expect the market to demand a higher return. In conclusion, it appears that depositors earn competitive returns.

The second set of investors, debt holders, hold $7.76 million of notes payable equal to 3% of assets as of 12/31/93. Of this amount, $1.5 million appears to be at a subsidized rate (the 3% note from the Ford Foundation). Assuming the rate is five percentage points below market, the subsidy works out to $75,000 per year or about 4% of total income.

The final set of investors is equity holders. Shorebank has five classes of preferred stock (with a book value of $6.8 million) outstanding and two classes of common stock (with a book value of $11.6 million) as of 12/31/93. The yield on the preferred stock ranges from 3.5% to 7%, although the proportion of 7% preferred stock has fallen from 60% to 24% in the past few years. Most of the preferred stock is held by foundations that classify their investments as program-related investments (PRIs). In order to receive special tax treatment from the Internal Revenue Service, PRIs must be at subsidized rates. A rough estimate is that the preferred stock is being subsidized on the order of 3–7% per year, which translates into approximately $200–$450,000 per year. Because preferred dividends are after-tax cash payments, net income is not affected by this subsidy. However, it does mean that

[16]Grzywinski (1991, p. 92).

[17]The Chicago BRM Deposit Rate Index is a survey of deposit rates offered by local banks and was kindly made available by the Bank Rate Monitor of North Palm Beach, Florida.

retained earnings, or capital, is higher than it would be if the bank were paying market rates of return.

Common stockholders also provide subsidies to Shorebank in the form of forgone returns. Because the stock is not publicly traded, it is only possible to make back-of-the-envelop calculations of the returns.[18] For example, in 1989, Shorebank repurchased common stock at $1,050 per share (the market/book ratio using prior year-end book value is 52%). In 1993, Shorebank sold 2,175 common stock (nonvoting) at approximately $3,985 per share (market/book ratio of 105%). In comparison, over the last 5 years, banks in the 20th percentile (Shorebank's Sheshunoff ranking) have traded at market/book ratios of 80%.[19] Thus it appears that the price was low in the first transaction and high in the second.

One clue as to why the investors in the 1993 offering were willing to pay such a high price and to accept nonvoting stock is in who the investors were. Initially, the shareholders included foundations, individuals, and church groups (Taub, 1988, p. 78). However, the newest investors are Chicago banks and insurance companies. This dramatic shift toward financial institutions is related to the increased regulatory pressure on banks to conform to the Community Reinvestment Act (CRA). Before investing, the investors consulted with the regulators to make sure that they would get CRA credit for the investment (Remey & Dees, 1993, p. 13).

To measure returns over this period, one can use the 80% market/book ratio to calculate a per-share market price in 1989 of $2,095 and a price in 1993 of $3,051 (voting shares should be worth even more). With a holding period of 4 years (assuming mid-1989 as the date of the buy back and mid-1993 as the date of sale), this is an increase of 46% on a stock that does not pay dividends. Over the same period, the S&P 500 Index rose 38%, the S&P Financials rose 48%, and the SNL Securities Small Bank Stock Index (for banks under $500 million in assets) rose 52%. Compared to these indices, the returns on Shorebank's common stock have been reasonable over the past few years.

In contrast, the returns prior to this period have been less attractive. The book value of the common stock in 1989 was $1,000 per share, which was the price of the stock whenever it was sold.[20] As

[18]These figures are calculations based on the 1990 and 1993 Annual Reports.

[19]I would like to thank SNL Securities of Charlottesville, VA, for providing data on bank market/book ratios and on bank returns over time. This number is for banks under $500 million in assets.

[20]According to the 1990 Annual Report, Shorebank shows another repurchase of 60 shares at a cost of $60,000 for a per-share cost of $1000.00. This transaction, or transactions, provides evidence that Shorebank's common stock was worth approximately $1000.00 per share prior to 1989.

discussed above, there was a buy back in 1989 for $1,050 per share. If one assumes that the original stock was sold 10 years earlier (Taub, 1988, p. 77, says that much of the common stock was sold prior to 1978), then return from 1979 to 1989 was only 5%, well below the 147% return for the S&P Financials over the same period. A Shorebank officer admits:

> The one are of real subsidy, and it's been valuable—we couldn't do this work without it—has been . . . in the form of the common equity capital that we've had since 1973. Common shareholders have yet to receive dividends. . ."[21]

Thus it appears that the early shareholders have made the biggest financial sacrifice. One admitted, "the motivation for investing was not to make a lot of money, but not to lose money either.[22]"

The fact that certain capital providers, primarily the common and preferred stockholders, have not or are not receiving competitive returns implies that investors are subsiding Shorebank to some degree. Subsidies, *per se*, are not good or bad as long as the investors are getting something in return. In fact, Shorebank prides itself on being a delivery mechanism for subsidies. The relevant question is not whether the bank is subsidized, for it is, but rather are the investors getting social returns instead of financial returns? In other words, has Shorebank been effective in fostering economic development?

DEVELOPMENT IMPACT

Shorebank's management describes their second objective in a variety of ways: "to foster economic development in a targeted communities," to contribute to "social progress," or to increase "opportunity in disinvested communities.[23]" These are broad and somewhat amorphous concepts that need to be defined before they can be measured and judged. This section presents one definition of community development and tries to measure the changes in South Shore as a way to evaluate Shorebank's development impact.

In order to understand what community development is, it is helpful to understand what it is not (Taub, 1988). For instance, successful community development does not mean driving out poorer citizens and replacing them with more affluent citizens. Nor does it mean

[21]University of Illinois (1993, pp. 21–22).

[22]Leech (1992, p. 34).

[23]1990 Annual Report, p. 5.; 1991 Annual Report, p. 2; and 1992 Annual Report, p. 1; respectively.

solely improving the physical structures (the houses, apartments, and shops). True community development means improving the physical surroundings while at the same time improving the lives of the current residents. Both elements are important and are examined in the evaluation of Shorebank's effectiveness.[24]

To date, most of the analysis on Shorebank's development impact has not quantified impact. For example, Taub (1988, pp. 109–110) presents the qualitative results from a survey of neighborhood residents. Shorebank, itself, measures development in terms of output (i.e., number of loans, dollars of loans, etc.). In the 1990 Annual Report (p. 2), management states that Shorebank companies have rehabilitated nearly 30% of the neighborhood's multifamily housing units; in the 1993 Annual Report (p. 6), they state that the bank generated $37.5 million in new development loans. The rationale for using output measures is that they illustrate a willingness by residents to invest in the community. However, the problem with output measures (alternatively, loans can be viewed as an inputs to development) is that there is no clear connection between output and impact.

This article takes a different approach by measuring the changes in South Shore relative to a group of contiguous communities over the period from 1970 (the bank began in 1973) to 1990. The assumption is that changes in demographic data on population, housing, education, employment, income, and banking accurately reflect community development. This range of variables covers both the condition of the citizens' lives (i.e., median income and education levels) as well as infrastructure development (i.e., median rent and median housing values). All of the data come from the Chicago Community Area Profile, which is an abstract of the decennial U.S. Census. The Community Area Profile reports data for each community according to boundaries dating back to 1920.

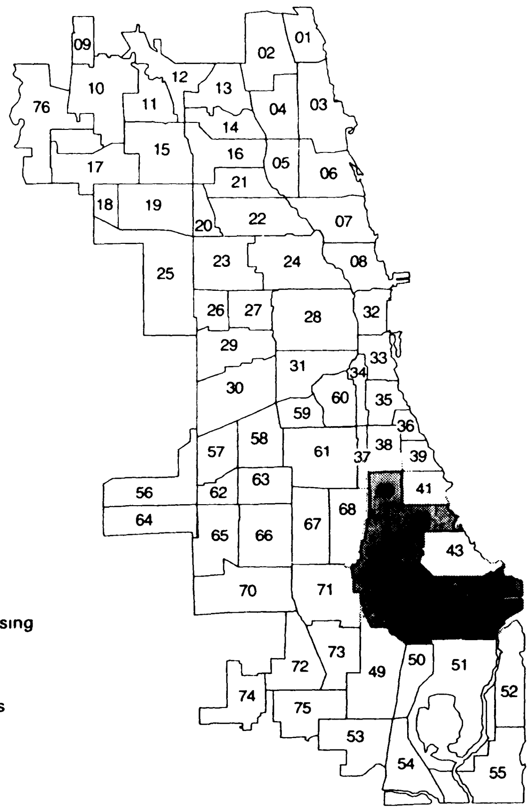
The control group contains the eight communities that circumscribe South Shore: Washington Park, Woodlawn, Chatham, Avalon Park, South Chicago, Burnside, Calumet Heights, and Greater Grand Crossing (see Figure 2).[25] By selecting all of the contiguous communities, one minimizes selection bias. This methodology assumes that the changes in the contiguous communities are indicative of the path that South Shore might have taken in the absence of having a community development bank. One can see from Table 4, which presents

[24]Shorebank defines development as "creating a community where people want to live, play, and work."

[25]One neighborhood, Hyde Park, is not included in the analysis even thought it is contiguous to South Shore. The reason is that, as of 1970, Hyde Park had a population that was 36% non-White and a median house value of $112,255; compared to 70% and $68,227 for South Shore; and 90% and $44,131 for the other contiguous neighborhoods.

Community Area Names

01	Rogers Park	**40**	Washington Park
02	West Ridge	**41**	Hyde Park
03	Uptown/Edgewater	**42**	Woodlawn
04	Lincoln Square	**43**	South Shore
05	North Center	**44**	Chatham
06	Lakeview	**45**	Avalon Park
07	Lincoln Park	**46**	South Chicago
08	Near North Side	**47**	Burnside
09	Edison Park	**48**	Calumet Heights
10	Norwood Park	**49**	Roseland
11	Jefferson Park	**50**	Pullman
12	Forest Glen	**51**	South Deering
13	North Park	**52**	East Side
14	Albany Park	**53**	West Pullman
15	Portage Park	**54**	Riverdale
16	Irving Park	**55**	Hegewisch
17	Dunning	**56**	Garfield Ridge
18	Montclare	**57**	Archer Heights
19	Belmont Cragin	**58**	Brighton Park
20	Hermosa	**59**	McKinley Park
21	Avondale	**60**	Bridgeport
22	Logan Square	**61**	New City
23	Humboldt Park	**62**	West Elston
24	West Town	**63**	Gage Park
25	Austin	**64**	Clearing
26	West Garfield Park	**65**	West Lawn
27	East Garfield Park	**66**	Chicago Lawn
28	Near West Side	**67**	West Englewood
29	North Lawndale	**68**	Englewood
30	South Lawndale	**69**	Greater Grand Crossing
31	Lower West Side	**70**	Ashburn
32	Loop	**71**	Auburn Gresham
33	Near South Side	**72**	Beverly
34	Armour Square	**73**	Washington Heights
35	Douglas	**74**	Mount Greenwood
36	Oakland	**75**	Morgan Park
37	Fuller Park	**76**	O'Hare
38	Grand Boulevard		
39	Kenwood		



Notes: South Shore is area number 43.
Contiguous communities are shaded and include Washington Park (40), Woodlawn (42), Chatham (44), Avalon Park (45), South Chicago (46), Burnside (47), Calumet Heights (48), and Greater Grand Crossing (69).

Source: Federal Reserve Bank of Chicago.

Figure 2 Chicago community areas.

demographic data for the communities as of 1970, that there is significant heterogeneity among the communities in the control group. Despite the within-group variance, the medians for the control group are quite similar to South Shore except for the percentage of non-White citizens (70.1% in South Shore vs. 90.0% for the comparables), the median house value ($68,227 vs. $44,131), and the education levels (more college-educated people in South Shore). Whether the control group is, in fact, comparable is discussed below.

Table 5 reports the level of each variable in South Shore and the median (the median is used because of the small sample size) for the contiguous communities for the years 1970, 1980, and 1990. In addition, Table 5 reports the change in each variable from 1970–1990 and

Table 4. Contiguous Chicago Communities.

Community	1970 U.S. Census Data						
	Total Population	Percent Non-White	Median House Value ($1989)	Housing Unit Vacancy Rate	Percent with 4 years of College	Unemployment Rate	Median Family Income ($1989)
Washington Park	46,024	99.5%	$28,719	7.6%	1.7%	8.0%	$22,131
Woodlawn	53,814	96.4%	$41,178	14.7%	4.7%	7.1%	$22,334
Chatham	47,267	98.0%	$55,256	2.9%	9.3%	3.5%	$36,423
Avalon Park	14,412	83.7%	$50,441	2.0%	13.0%	4.0%	$41,964
South Chicago	45,655	23.9%	$44,765	6.5%	5.5%	4.2%	$33,686
Burnside	3,181	4.2%	$36,115	1.8%	3.5%	2.7%	$32,909
Calumet Heights	20,123	46.5%	$59,642	2.0%	13.3%	2.8%	$45,005
Greater Grand Crossing	54,414	98.5%	$43,498	4.5%	5.1%	5.9%	$29,294
Mean for Comparables	35,611	68.8%	$44,952	5.3%	7.0%	4.8%	$32,968
Median for Comparables	45,840	90.1%	$44,131	3.7%	5.3%	4.1%	$33,298
South Shore	80,660	70.1%	$68,227	3.7%	13.5%	4.2%	$35,342
City of Chicago	3,369,359	34.5%	$54,791	5.8%	8.1%	4.4%	$34,605

Source: 1970 Chicago Statistical Abstract—Community Area Profiles, Department of Planning and Development, City of Chicago.

Table 5. Comparison of Demographic Data: 1970 to 1990. South Shore vs. Contiguous Communities.

	South Shore							Contiguous Communities [a]						
	Census Data			Change from 1970 to 1990		Change from 1980 to 1990		Census Data (median)			Median Change from 1970 to 1990[b]		Median Change from 1980 to 1990[b]	
Census Variable	1970	1980	1990	Absolute Change	Percent Change	Absolute Change	Percent Change	1970	1980	1990	Absolute Change	Percent Change	Absolute Change	Percent Change
Population														
Total population	80,660	77,743	61,517		(23.7%)		(20 9%)	45,840	34,129	23,449		(20.5%)		(14 7%)
Percent non-White	70 1%	96.4%	97.9%	27 8%		1 5%		90.0%	97 0%	98.7%	8.3%		1.1%	
Housing														
Housing unit vacancy rate	3 7%	8.2%	14.4%	10.7%		6 2%		3.7%	5 5%	12.0%	7.3%		6.0%	
Condo vacancy rate	n/a	17.4%	13.0%	n/a		(4 4%)		n/a	0 6%	10.5%	n/a		0.0%	
Median house value ($1989)[c]	$68,227	$67,295	$66,600		(2 4%)		(1.0%)	$44,131	$54,314	$58,500		30 9%		6.9%
Median rent (1989)[c]	$453	$381	$451		(0 4%)		18 4%	$323	$315	$423		25 7%		27.8%
Education														
Percent of pop w/4 years of high school	57 5%	68.1%	72 2%	14 7%		4.1%		41.7%	55 4%	65 6%	19 3%		8.2%	
Percent of pop. w/4 years of college	13.5%	15.0%	16 0%	2 5%		1 0%		5 3%	7 9%	10 1%	5.0%		2.5%	
Employment														
Unemployment rate	4.2%	13.1%	15 6%	11 4%		2 5%		4 1%	12 8%	17 4%	12.4%		3 8%	
Percent not in labor force	32.4%	33.1%	36.3%	3.9%		3.2%		40.1%	39 3%	37 4%	3 1%		(0 9%)	
Percent traveling < 20 mins to work	n/a	14.6%	16 0%	n/a		1.4%		n/a	16 7%	18 4%	n/a		2.2%	
Income														
Median family income ($1989)	$35,342	$27,275	$23,690		(33.0%)		(13.1%)	$33,298	$33,231	$27,737		(20.2%)		(7 6%)
Percent of pop. below poverty line	10.8%	23.1%	27.0%	16.2%		3 9%		8.6%	17.7%	23 1%	10 9%		2.7%	
Banking														
Number of financial institution offices	4.0	2.0	1 0	(3 0)		(1.0)		3 0	2 5	4.5	0.5		0.5	

Sources: 1970–1990 Chicago Statistical Abstract—Community Area Profiles; number of financial institution offices from Kaufman and Mote (1994)
[a]Contiguous communities include Washington Park, Woodlawn, Chatham, Avalon Park, South Chicago, Burnside, Calumet Heights, and Greater Grand Crossing.
[b]The change in the median may not equal the median change.
[c]The 1970 median house value and median rent are calculated by interpolation from the given distribution
n/a = not available
Dollar amounts are expressed in $1989 using the Consumer Price Index, U S Dept of Labor

1980–1990 and compares the change in South Shore against median percentage change for the contiguous communities. One can also do this analysis using averages or weighted averages.[26] Although South Shore's relative performance improves when using the averages (see Table 6), the results remain decidedly mixed at best.

Population. There have been large declines in the contiguous communities and in South Shore, although the median decline has been less in the comparables (20.5% versus 23.7%). One area of difference is that South Shore was still in a state of racial transformation during the 1970s, whereas the contiguous communities had already become over 90% minority by 1970 (note the average across the eight communities is 69%)—little change has occurred since 1980.

Housing. Housing unit vacancies began at the same level in the 1970s and have risen faster in South Shore. Condominium vacancies, on the other hand, have been falling faster in South Shore over the last 10 years due, in large part, to Shorebank's focus on rehabilitating condominiums. More surprising is the median change in housing values and rents. Whereas both have been essentially flat (in real 1989 dollars) in South Shore since 1970, they have risen 30.9% and 25.7%, respectively, in the contiguous communities. This increase also exists in the 1980s at a time when Shorebank was doing most of its rehabbing in South Shore.

The analysis on vacancies can be further broken down to detect whether the increases in housing unit vacancy rates is due to an increase in the supply of housing (the number of available units), a decrease in demand (the number of vacant units), or both. Over the 1970–1990 period, one finds that the number of housing units is down 11% in South Shore while the number of vacant units is up 245% (results not shown). Similar patterns exist for the contiguous neighborhoods although the median increase in the number of vacant units is much less (138% versus 245%). Thus it appears that demand is off more in South Shore, which helps explain why prices have not increased in real terms.

Shorebank's management provides an alternative explanation for why housing unit prices have not increased. They claim the bank intentionally "holds down the market (meaning prices)" to make the units more affordable and to provide additional lending security to the bank. It is ironic that management claims to be controlling market forces while at the same time claiming that one of the Corporation's

[26]With small numbers of observations, the averages are driven by outliers such as the communities of Washington Park and Woodlawn. In 1990, their housing vacancy rates were 27.7% and 23.7%, respectively, compared to a median of 12.0%; their unemployment rates were 31.0% and 24.4%, respectively, compared to a median of 17.4%.

Table 6. **Comparison of Demographic Data: 1970–1990. South Shore versus Contiguous Communities.**

Census Variable	Change from 1970–1990				Change from 1980–1990			
		Contiguous Communities				Contiguous Communities		
	South Shore	Median	Mean	Weighted Average[b]	South Shore	Median	Mean	Weighted Average[b]
Population								
Total population	(23.7%)	(20.5%)	(24.1%)	(31.4%)	(20.9%)	(14.7%)	(17.8%)	(18.1%)
Percent non-White	27.8%	8.3%	27.6%	15.2%	1.5%	1.1%	3.0%	2.6%
Housing								
Housing unit vacancy rate	10.7%	7.3%	8.3%	9.1%	6.2%	6.0%	7.9%	8.7%
Condo vacancy rate	n/a	n/a	n/a	n/a	(4.4%)	0.0%	4.9%	7.3%
Median house value ($1989)[c]	(2.4%)	30.9%	34.9%	33.6%	(1.0%)	6.9%	7.4%	8.5%
Median rent ($1989)[c]	(0.4%)	25.7%	39.3%	32.1%	18.4%	27.8%	31.5%	29.5%
Education								
Percent of pop. w/4 years of high school	14.7%	19.3%	21.2%	19.1%	4.1%	8.2%	8.9%	8.9%
Percent of pop. w/4 years of college	2.5%	5.0%	5.3%	5.0%	1.0%	2.5%	2.4%	2.5%
Employment								
Unemployment rate	11.4%	12.4%	13.3%	13.9%	2.5%	3.8%	4.4%	4.6%
Percent not in labor force	3.9%	3.1%	1.2%	4.1%	3.2%	(0.9%)	(0.9%)	0.2%
Percent traveling <20 minutes to work	n/a	n/a	n/a	n/a	1.4%	2.2%	1.7%	2.3%
Income								
Median family income ($1989)	(33.0%)	(20.2%)	(20.1%)	(24.9%)	(13.1%)	(7.6%)	(12.0%)	(12.6%)
Percent of pop. below poverty line	16.2%	10.9%	13.2%	14.4%	3.9%	2.7%	3.0%	3.3%
Banking								
Number of financial institution offices	(3.0)	0.5	0.5	0.3	(1.0)	0.5	0.3	0.1

Sources: 1970–1990 Chicago Statistical Abstract—Community Area Profiles; number of financial institutions from Kaufman and Mote (1994).
[a]Contiguous communities include Washington Park, Woodlawn, Chatham, Avalon Park, South Chicago, Burnside, Calumet Heights, and Greater Grand Crossing.
[b]The weights are based on the communities' total population at the start of the period.
[c]The 1970 median house value and median rent are calculated by interpolation from the given distribution.
n/a = not available.

mission is ". . . to use business disciplines to restore market forces in disinvested communities" (1991 Annual Report, p. 2). These statements are consistent only to the extent that one believes there is a need to lend a helping hand to nonfunctioning markets before they can begin functioning again.

Education. The citizens in South Shore are, on average, better educated than those in the other communities, although the other communities have been gaining ground: Since 1980, the percentage of residents in the comparable communities with high school degrees has increased at twice the rate of those in South Shore (8.2% versus 4.1%). The same is true for the percentage of the population with 4 years of college (2.5% versus 1.0%).

Employment. The unemployment rate in both South Shore and the contiguous communities rose sharply during the 1970s and remained high through the 1980s. South Shore's lower 1990 unemployment rate (15.6% versus 17.4%) and slower increase is one indication of better economic performance. Interestingly, the percentage of the population that works near where they live (a proxy for the level of job activity in the community) is higher and growing faster in the other communities.

Income. Despite the relatively good employment performance for South Shore, the median family income has fallen more significantly in South Shore over the past 20 years than in the control communities (33.0% vs. 20.2%). In fact, it was higher in 1970 and is lower in 1990 (all numbers are in real 1989 dollars). As the median family income fell, the percentage of the population living below the poverty line rose in all communities, yet at a 50% faster rate in South Shore (16.2% vs. 10.9%).

One explanation for why South Shore's median income has not risen is the community's housing stock. The majority of the housing units are multifamily dwellings, which are more likely to appeal to a lower- and middle-class population. Communities with a higher percentage of single-family houses are more likely to attract a wealthier population. A second explanation may be that residents of South Shore are accumulating wealth in the form of real estate rather than higher current income. And so although their income may be relatively low, their total wealth may be increasing faster than residents of other communities. More research is needed to verify these alternative explanations.

Banking. Whereas the number of financial institutions in South Shore has fallen from four to one, the median number of financial institutions in the contiguous communities has actually increased from three to four and one half. The median increase in the number of financial institutions for the contiguous communities is one half.

Based on these results, it appears that South Shore's relative performance has been worse than the contiguous neighborhoods. With the exception of employment (rates not incomes) and condominium vacancies, South Shore's relative performance lags in every other category and in both time periods.

Before drawing any conclusions from these results, however, it is worth stepping back and examining the process that delivered the results. On one hand, the results may be misleading because of methodological problems. In order to improve the reader's understanding of what the results actually mean and to improve future research, the next subsection describes the potential problems in greater detail. On the other hand, the results may reflect reality. If this is the case, then the analysis raises some important questions about Shorebank and its effectiveness, which are discussed in the conclusion.

Methodological Issues

There are five methodological issues that could affect the interpretability of the results in Tables 5 and 6. First, there is a problem of attribution.[27] In other words, do the census variables measure economic development or, more importantly, do they measure Shorebank's role in developing South Shore? The analysis attempts to solve the former by utilizing variables covering a wide range of community attributes. The latter is more difficult to solve because Shorebank's input is just one variable in an exceedingly complex equation. As it stands, this analysis does not control for investment in education, health care, criminal justice, or public works, all of which affect the speed and magnitude of development. To the extent that better development measures exist or that there are cleaner ways to measure Shorebank's impact, they should be used in future research.

Second, there is a problem with scope in that community-level data may be too broad. Shorebank's influence may have changed 1,000 lives, which in itself would be an accomplishment, yet there are over 60,000 residents in South Shore. As a result, analysis on the entire community does not show much of a change. A related scope problem is that Shorebank does not define the community of South Shore the way the Community Profile does: Shorebank excludes census tracts on the northwest and south sides as being outside its targeted lending area. Nevertheless, it is still somewhat surprising that one cannot see greater evidence of impact given Shorebank's role in the community: It has rehabilitated one third of the housing units and made $216 mil-

[27]I would like to thank Jim Austin for helping me think about how to frame this discussion.

lion of development loans over the period from 1973 to 1990 in South Shore.[28] To improve the analysis, future research can solve the scope problems by using census tract data rather than aggregated community data. Analysis at the census tract level will not only increase the number of available observations, it will also increase the power of the tests by allowing one to control for variance in such factors as housing stock and population.

Third, and in contrast to the argument that Shorebank has affected only a small portion of South Shore, one might argue that Shorebank has had an impact on the contiguous communities. Although it is true that Shorebank has begun to broaden its lending base (in 1989, 54% of new development loans were made in South Shore and 18% were made in the contiguous communities;[29] these percentages changed to 33% and 38%, respectively, in 1993), this has been a relatively recent phenomenon. Because only $14 million was invested in the contiguous communities between 1973 and 1990 compared to $216 million in South Shore,[30] Shorebank's influence on the contiguous communities must be considered weak at best, certainly in comparison to its influence on South Shore.

Fourth, it is possible that the comparable communities do not form a valid control group. As mentioned earlier, there is significant heterogeneity among the comparable communities (see Table 4). If one were to compare South Shore against Woodlawn or Washington Park, then South Shore's relative performance would appear better; yet both of these communities were already further along in their decline than South Shore according to the 1970 census figures. The opposite would be true if one were to compare South Shore against Avalon Park or Calumet Heights—the starting points are more similar yet these two communities show better relative performance than South Shore.

To do this analysis better, one would need to control for not only the starting points, but also the direction of change at the starting point. For example, if one views the changes over the 1970–1980 period as measuring the direction of change and the changes over the period from 1980–1990 as measuring the magnitude of change, then South Shore's relative performance improves, especially if one uses the weighted average of the comparables instead of the median (see Tables 5 and 6). The point is that properly controlling for a community's starting point is not easy with so few observations.

[28] 1990 Annual Report, p. 1.

[29] The other neighborhoods include Chatham, Woodlawn, and Auburn-Gresham according to the 1990–1992 Annual Reports. Both Chatham and Woodlawn are in the sample of contiguous neighborhoods.

[30] 1990 Annual Report, p. 1.

And finally, there may be a problem with the time horizon: The time period may be too short or it may be the wrong 20-year period. For example, given how slowly development occurs (in contrast to the speed with which disinvestment occurs), the analysis might be improved by extending the horizon to 30 years—say 1970–2000. Alternatively, given the fact that Shorebank did not become a major lender in the community until the mid-1980s, the analysis might be improved by examining the changes over the period from 1980–2000 instead of 1970–1990.

Collectively, these problems cast some doubt on the meaningfulness of the results. Without further analysis, one cannot tell whether the results are accurate reflections of reality or not. Additional research along the lines described above should help answer many of these questions.

CONCLUSION

The concept of market-based institutions attacking social problems is new and potentially very exciting. Shorebank is an example of such an institution, and its 20-year history has shown that the concept can work. But viability is not the issue. The issue is economic development and understanding how to do it effectively and efficiently. The reason effectiveness and efficiency are so important is that competition will be increasing in the coming years. As banks feel the pressure to comply with the Community Reinvestment Act, they will expand into low-income areas such as South Shore. At the same time, congressional funding of community development institutions will increase the number of competitors.

As competition in lending and borrowing markets increases, cost control, or efficiency, will become more important. The analysis on Shorebank's financial performance has specific implications for managing community development banks in the face of growing competition. For example, Shorebank's higher funding costs, operating costs, and charge-off rates all need to be reduced. Shorebank has shown the world that there are sound credits in low-income neighborhoods and the key to future success lies in being able to attract the best of those borrowers.[31] As costs come down, Shorebank will be in a better position to compete for those borrowers based on rates rather than on its monopoly position.

An equally serious competitive threat is going to emerge over funding. Because Shorebank is one of the few development banks in the

[31]A recent study by the Bank Insurance Market Research Group reports that more than half of the surveyed banks view CRA lending as a profitable (Seiberg, 1994).

country, it has been able to attract subsidized debt and equity capital. But as the number of development organizations increases, and the competition for funds intensifies, Shorebank will need to show that it is effective in changing communities.

Unfortunately, the lessons from the analysis on Shorebank's development record are less clear. The results in Section 4 suggest that Shorebank may not be so effective in achieving sustainable revitalization. Porter (1994, p. 6), in his analysis on the competitive advantage of inner cities, claims that Shorebank's real estate model is flawed because, "real estate projects are the outcome, not the driver, of economic development." There are other development models and Shorebank has, and is, trying them. For example, Shorebank is trying a strategy of developing both real estate and commercial opportunities in the Austin neighborhood of Chicago, where they have been active since 1986. It will be crucial to follow this endeavor and compare the results to what happened in South Shore and in other communities where development banks are active.

The key to learning how to do community development more effectively depends on measuring performance. As one can see from the analysis in Section 4, this task is very difficult, especially in organizations with social missions. Just because it is difficult, however, does not mean it should not be done or even attempted. It is not enough to measure success in terms of output, success must be judged in terms of impact (and cost). The real challenge for managers of community development banks and of other social enterprises is to improve goal setting and performance measurement.

This call for improved performance measurement is one of the major objectives of this article. It is time to shift the debate away from examining what Shorebank does and begin examining how well it achieves its stated objectives. This analysis is an initial foray into measuring performance and the results raise a number of intriguing issues. The wrong conclusion from these results is that there is no role for community development banks in reversing community decline, for the problem is too big and too serious to be ignored. The right conclusion is that there is more work to do to figure out how to achieve sustainable development. Shorebank and other development banks provide the medium in which to study these issues further.

Once we have learned more about how to restore disinvested communities, the challenge will be to find enough capital to attack such an enormous social problem on a large scale. Those banks that can show they are effective in reversing economic decline will be the ones that are able to attract capital and grow. The benefit of increasing competition for funds will be an increase in the amount of development and a decrease in the per-unit cost of development. These outcomes will benefit us all.

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