The
Purdy Crawford Chair
In Aboriginal Business Studies

Case Studies in Aboriginal Business

Developmental Financing for Aboriginal Businesses

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The Purdy Crawford Chair in Aboriginal Business Studies was established at Cape Breton University in 2010 in response to Aboriginal community leaders' expression of the need for entrepreneurship, business investment, and corporate skills training for the purpose of creating a model of self-reliance.

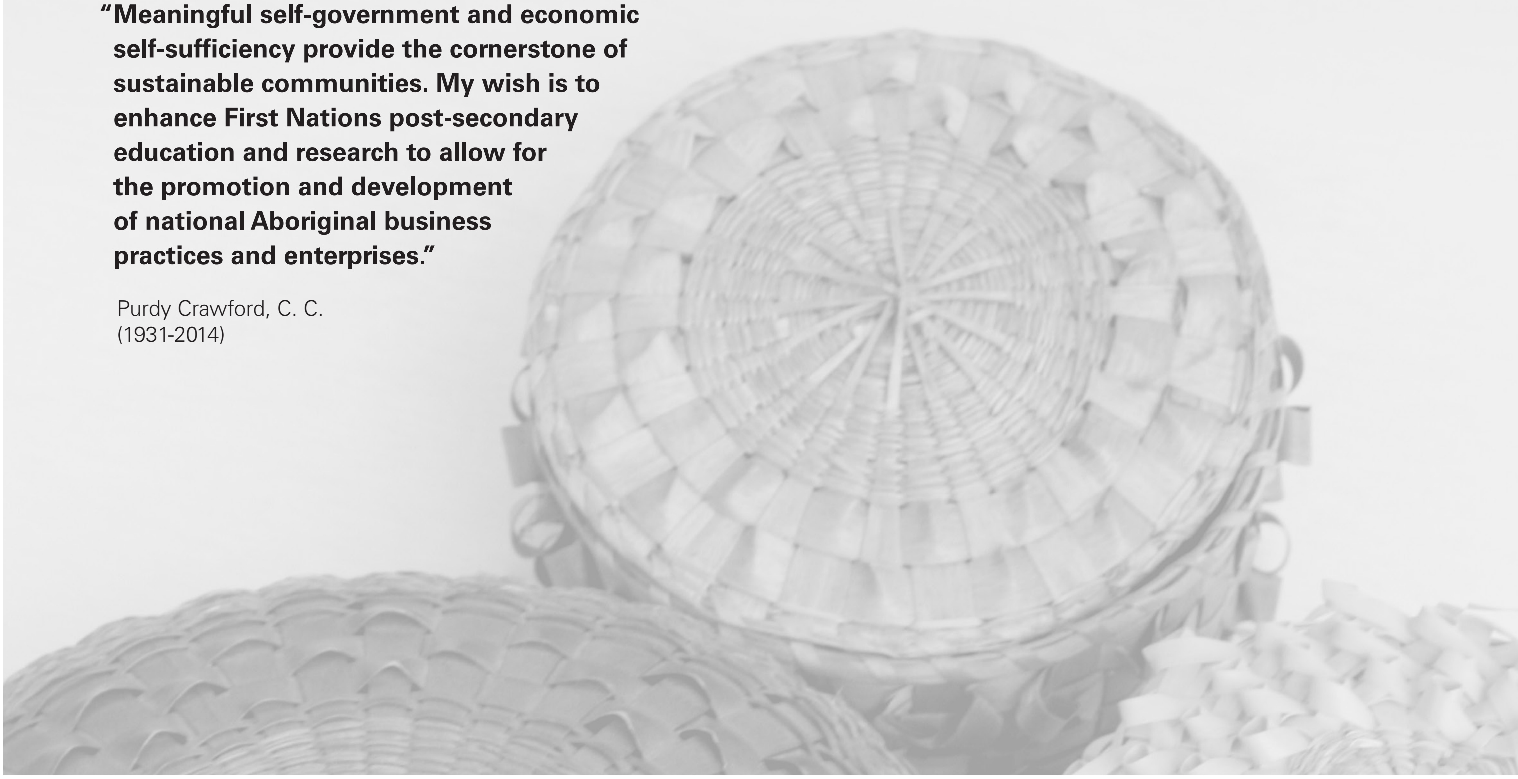
Named in honour of Canadian lawyer and corporate boardroom leader, the late Mr. Purdy Crawford, the Chair aims to promote interest among Canada's Aboriginal people in the study of business at the post-secondary level.

The Purdy Crawford Chair in Aboriginal Business Studies focuses its work in four areas:

- Research on what "drives" success in Aboriginal Business
- National student recruitment in the area of post-secondary Aboriginal business education
- Enhancement of the post-secondary Aboriginal business curriculum
- Mentorship at high school and post-secondary levels

"Meaningful self-government and economic self-sufficiency provide the cornerstone of sustainable communities. My wish is to enhance First Nations post-secondary education and research to allow for the promotion and development of national Aboriginal business practices and enterprises."

Purdy Crawford, C. C.
(1931-2014)



DEVELOPMENTAL FINANCING FOR ABORIGINAL BUSINESSES

SYNOPSIS

Court decisions over resource and revenue sharing continue to benefit Aboriginal communities across Canada and, as opportunities emerge, Aboriginal businesses are growing much more quickly than in mainstream Canada. Consequently there is an increasing demand for access to capital and innovative financing to enable the start-up and growth of such businesses. Most Aboriginal businesses are small and medium-sized enterprises (SMEs) and are often the primary engines of economic growth for many Aboriginal communities. They represent a significant opportunity to address many of the existing socio-economic challenges by reducing unemployment and creating wealth.

However, many Aboriginal SMEs face significant challenges in accessing commercial loan capital for a number of reasons. For example, in the eyes of mainstream financial institutions, most SMEs represent relatively higher transaction costs and are perceived as higher risk due to their smaller size and limited management capacities. These factors are often accentuated by a relative lack of equity capital, over-reliance on debt financing, less familiarity with commercially-oriented debt management practices, and a greater proportion of early stage businesses. In the First Nations context, on-reserve businesses present further challenges related to both Section 89 of the *Indian Act (*such as differing commercial cultures and fewer incorporated businesses due to tax-free status), and their often remote locations which limit market opportunities.

ABORIGINAL FINANCIAL INSTITUTIONS & NACCA

A network of Aboriginal Financial Institutions (AFIs) is the primary source of “developmental” financing and management support services across Canada for those Aboriginal businesses that cannot secure such financing from mainstream financing institutions. Whereas debt financing made by mainstream institutions are often dependent on available security, AFIs focus more on the character of the entrepreneur to enable both social and financial returns.

The National Aboriginal Capital Corporation Association (NACCA) is the membership organization for almost all of these AFIs and plays a central coordinating role by providing a common voice, facilitating partnerships, providing capacity building and operating support systems, and delivering a suite of programs to its members. Currently there is a network of 59 AFIs comprised of a diversity of groups:

- Twenty-one (21) Aboriginal Capital Corporations (ACCs);
- Twenty-four (24) Aboriginal Community Futures Development Corporations (ACFDCs);
- Six (6) dual designated organizations (ACCs and ACFDCs); and
- Seven (7) other lending organizations capitalized privately or by other levels of government.

Each AFI is unique with respect to its structure, funding sources, capacities, performance, client focus, services, and territories it serves. All AFIs are independent, accountable to their own community, and operate at arms-length from community politics, giving them a unique ability to place more reliance on community-based credit worthiness assessment to supplement deficiencies in their clients' financial situations. Through ownership of their AFIs, Aboriginal communities have been able to exercise control over the financial support and related services provided to many of their local entrepreneurs, thereby having a significant influence on the economic development of their communities.

As of March 31, 2014 an estimated 3,700 Aboriginal businesses were supported by 4,468 AFI loans valued at $311 million. Since they began to be established in the late 1980's, AFIs have provided over 38,000 loans totalling more than $2 billion; and approximately $100 million in loans is disbursed annually to over 1,000 Aboriginal businesses.

The Aboriginal economy is changing dramatically with larger projects and resource deals becoming more common in tandem with changes in government and industry approaches to resource development. Land claim settlements have also augmented the financial expertise and experience of community leaders, and are now leading to enhanced opportunities both on reserve and in major centres. In addition to more traditional term financing, there is increasing demand for seed capital and youth entrepreneur loans, larger term loans, operating loans, loan insurance, surety services, quasi-equity/subordinated debt and equity financing. Notwithstanding the increase in client sophistication, there is continuing need for a comprehensive business support network providing both financial and management support services.

In response to these challenges, NACCA is progressively building its "AFI-Central" capacity by developing a range of targeted and often customized support services designed to enhance the institutional and operational capacity of member AFIs. NACCA's 2012-2014 NACCA Strategic Plan identified the following four priorities:

- broadening access to sustainable lending;
- diversifying the AFIs' capital base by putting Aboriginal and commercial capital to work for AFIs and utilizing bonds, debentures or other innovative approaches;
- growing capacity through professionalism and self-regulation; and
- expanding AFI financial services to respond to emerging capital needs.

KEY CHALLENGES

AFIs have operated under an unsustainable business model wherein AFI lending costs comprise 10% for administration and 6% for losses, versus loan portfolio revenue of 9% negatively impacting financial viability and reducing available loan capital and lending capacity. The launch of Aboriginal Developmental Lending Assistance (ADLA) programming in 2014 enables the full deployment of AFI loan capital by compensating AFIs for developmental loan losses and the high cost of developmental loan administration. Qualified AFIs are able to apply for ADLA support to absorb the cost of capital shortfall tied to developmental lending as well as the pre and post loan care costs, thereby enhancing AFI financial self-sustainability. ADLA programming is a proactive approach to maintaining AFI network health rather than a reactionary response occurring as a result of loan capital erosion. The performance based framework for ADLA demonstrates the requirement for both government and the AFIs to look at programming support as a function of performance.

A total of twenty-three AFIs qualified to use ADLA programming for the year ending March 31, 2015. Loans supported by ADLA created or maintained 1,910 jobs leveraging an overall investment of $47,450,119 from Aboriginal entrepreneurs, commercial and government sources. Three of the twenty-three AFIs that qualified for ADLA have provided 2015 audited financial statements as at the date of this writing. The financial impact of ADLA programming reflected in the three financial statements confirms the yield on the three AFIs loan portfolios was boosted by an average of 3.9% from 2014 to 2015 as a direct result of ADLA programming. As Aboriginal SME demand and AFI portfolios grow, AFIs will need to secure up to $78 million in loan capital over the next five years.

The federal government has provided assistance to AFIs in support of Aboriginal business development since the mid 1980s. Funding has been fragmented because federal agency roles differ by region and support differing types of AFIs with differing funding structures. For example, at the federal level ACCs are funded by AANDC, the Regional Development Agencies (such as Western Economic Diversification) fund the ACFDCs, and some AFIs are designated and funded as both ACCs and ACFDCs. In addition, provincial or territorial governments, Métis Associations, and other organizations fund other AFIs. The AFI role, as well as the type and level of funding support, differs greatly between the respective funding agencies. NACCA is funded exclusively by AANDC.

Federal fiscal constraint is also beginning to impact the level of assistance available to AFIs and their clients, with increasing focus being placed by funding sources on the efficiency, effectiveness and viability of AFIs with respect to their developmental lending activities and related financial services.

In this changing environment the primary challenge for AFIs is to become more efficient, effective, and financially viable as developmental lenders and providers of related financial services to Aboriginal entrepreneurs. NACCA's primary challenge is to enhance its support services for AFIs. Responding to these challenges will require major adjustments by the AFIs themselves, by NACCA, and by federal government stakeholders.

REPOSITIONING AFIs AND EXPANDING THEIR ROLE

NACCA and the Government of Canada are in ongoing discussions around program restructuring. The Aboriginal Entrepreneurship Program (AEP) suite includes the following components:

1. Sustainability – Addressing AFI financial viability through Aboriginal Developmental Lending Assistance (ADLA) programming rolled out by NACCA in April 2014 which will defray the cost capital shortfall incurred by 23 AFIs that qualify for ADLA programming;
2. Capital – Enhancing loan capital availability through the exploration of a Capital Attraction Tool (CAT) initiative intending to facilitate access to private sector and Aboriginal capital sources for developmental lending;
3. Client services – Enhancing the range of critical financial services available qualified AFIs and their Aboriginal business clients through NACCA delivery of the Aboriginal Business Financing Program (ABFP); and
4. Capacity – Enhancing the skills and operational capacity of AFIs through continuation and refinement of the Support and Training component of the Aboriginal Capacity Development Program (ACDP).

PROGRAM DEVOLUTION AND GOVERNANCE

The AFI network is maturing and managing more programs. AANDC continues to be accountable to the public and Parliament, monitoring NACCA and AFI outcomes. Private sector capital sources must also be assured of the program manager's stability and ability to manage risk. In recognition of these challenges, NACCA's governance structure establishes the program oversight, such as:

- ensuring that programs are managed efficiently and effectively;
- developing AEP policies and procedures framework and ensuring that program activities are consistent with AEP goals;
- establishing a new NACCA Board Committee to review policy amendments to widen program access and to serve as a dispute resolution mechanism;

- monitoring AEP activities and resolving problems by initiating a nation-wide quality assurance review of policies and processes that is solution, not deficit, driven sharing best practices within the network;
- streamlining reporting;
- reallocating resources across program components; and
- advocating options for enhanced program design.

Related considerations include the concern that the government may be devolving programming to evade its responsibilities and that the existing discretionary funds will diminish over time. NACCA must also ensure that its members remain comfortable with the network's strategic objective of building NACCA's capacity as "AFI-central."

QUESTIONS FOR DISCUSSION

1. What is an appropriate role for federal and provincial governments in the development of Aboriginal business and economies?
2. Given the changing circumstances and economic environment, how can AFIs better position themselves to serve Aboriginal businesses?
3. How can NACCA assist AFIs to improve access to capital?

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