PROJECT SUMMARY

Opportunities to improve the financial ecosystem for Aboriginal entrepreneurs and SMEs in Canada.

Report prepared for:
The National Aboriginal Capital Corporations Association (NACCA) and Business Development Bank of Canada (BDC)

Report prepared by:
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Introduction

The Conference Board of Canada (CBoC) is pleased to present the following series of research modules commissioned by the National Aboriginal Capital Corporations Association (NACCA) and the Business Development Bank of Canada (BDC). The purpose of this series, developed by the CBoC’s Northern and Aboriginal Policy group, is to help readers better appreciate the financial ecosystem that supports, and sometimes hinders, Aboriginal entrepreneurship in Canada.

As financial institutions, BDC and NACCA both have mandates to support research on Aboriginal entrepreneurship. BDC’s Aboriginal Banking Unit was created in 1996. As part of the financial ecosystem serving Aboriginal entrepreneurs, it offers advisory services and a variety of customized, long-term and flexible financing solutions. For their part, NACCA and its member Aboriginal Financial Institutions (AFIs) provide business financing and support to a growing and diverse population of Aboriginal entrepreneurs. Since the 1980s, AFIs have grown from 22 members to over 50. Their network includes a variety of institutions including Aboriginal Capital Corporations, Aboriginal Developmental Lenders, and Aboriginal Community Futures Development Corporations.

The economic landscape that AFIs, NACCA, and BDC seek to support has also changed significantly since the turn of the millennium. In terms of size, TD Economics has estimated that the combined income of Aboriginal household, business and government sectors was in between $30 and $31 billion in 2016, up from an estimated $24.3 billion in 2011, $18.9 billion in 2006, and $11.68 billion in 2001.¹

In addition to the growth in privately owned Aboriginal businesses, more Aboriginal community corporations and associations are now actively involved in managing trusts, creating own source revenues, and forging business partnerships across a variety of industry sectors. The stakeholder environment for Aboriginal businesses has also become more complex, as non-Aboriginal governments, mainstream financial institutions, and others have increased their interest and involvement in Aboriginal entrepreneurship to benefit from the expanding role that Aboriginal businesses have come to play in the Canadian economy.

Yet, despite growing Aboriginal business demand for financial services, and the increased interest in meeting that demand, there remain significant barriers in the financial ecosystem that get in the way of Aboriginal entrepreneurs, communities, and their goals. NACCA and BDC both recognize an insufficiency in the current penetration rate of services to finance Aboriginal entrepreneurs. NACCA’s member AFIs, for example, are generally constrained by issues of size and scope, which limits their ability to expand beyond micro-level project financing.

In this regard, how could ecosystem barriers be reduced to improve the flow of financing and expand the range of services that AFIs, NACCA, BDC, and other relevant financial institutions provide to Aboriginal businesses?

To begin to address this guiding research question, The Conference Board of Canada developed three intersecting research modules. These modules are best read in sequence. The series proceeds as follows:

**Research Module 1: Aboriginal entrepreneurship in Canada**

As the first of this three-part research series, Module 1 profiles the landscape of Aboriginal entrepreneurship, and summarizes the more prominent Canadian financial services that focus especially on Aboriginal small and medium-sized enterprises (SMEs). For readers who have only a limited understanding of the current Aboriginal business landscape, this first module provides a necessary foundation for the deeper investigations and policy recommendations that follow in the second and third modules.

Entrepreneurs and SMEs have an important role to play in the Canadian economy, and particularly among Canada’s diverse and growing Aboriginal communities. Beyond providing necessary local goods and services, they create opportunities for Aboriginal employment and wealth creation. A recent study suggests that nearly four-in-ten Aboriginal SMEs in Canada employ at least one individual.² Yet, the size and scope of their economic impact continues to be obscured by a lack of basic information.

In order to better understand the landscape of Aboriginal entrepreneurship in Canada, Module 1 presents a countrywide analysis of Aboriginal business characteristics by size, geography, and industry sector. Whenever possible, the profile we develop in this module distinguishes Aboriginal entrepreneurs and SMEs by several different locational characteristics, such as whether the business is on or off-reserve, urban/rural/remote, and so forth.

Module 1 then seeks to understand the current availability of financial services to Aboriginal entrepreneurs and SMEs in Canada. Our research findings draw from an environmental scan of publicly available data, as well as from custom data made available through NACCA, AFIs, BDC, Indigenous and Northern Affairs Canada (INAC), and other research partners such as the Canadian Council for Aboriginal Business (CCAB).

In summary, Research Module 1 addresses three main questions:

- What is the profile of Aboriginal entrepreneurs and SMEs in Canada, in terms of business size, geographic clusters, and industry sector classification?

- How does the distribution of Aboriginal entrepreneurs and SMEs vary across the Canadian provinces and territories, by size, geography, and industry sector classification?

• What is the size and scope of key financial services currently targeting Aboriginal entrepreneurs and SMEs in Canada?

Research Module 2: The impact of developmental finance on Aboriginal entrepreneurship and economic development in Canada: Insights from NACCA and BDC

As we investigate in this second module, Aboriginal entrepreneurs and community-owned SMEs alike work with many of the same financial institutions that specialize in Aboriginal developmental finance. Some of the key service providers in this diverse field include BDC, NACCA, and a range of AFIs, from Aboriginal Capital Corporations to Community Futures Development Corporations. Increasingly, private sector banks have taken a greater interest in Aboriginal business development; but the field is still largely the purview of specialized developmental lenders associated with NACCA and the broader network of AFIs.

Developmental finance is a general term for financing approaches that specialize in serving entrepreneurs and SMEs who would typically be passed over by conventional banks. The number one impediment that developmental finance seeks to work around is limited client equity. Developmental finance often involves specialized risk assessment, business support, capacity building, and (though not exclusively) government-assisted financing.

In Research Module 2 we take a close look at three important Aboriginal developmental finance services in Canada. Two of these services are associated with NACCA and participating AFIs. The third is associated with BDC’s Aboriginal portfolio. Based on historic data from these services, and available secondary sources, Research Module 2 addresses the following set of guiding research questions:

• What are the direct, indirect, and induced impacts of our focal Aboriginal developmental finance services on the Canadian economy?

• What does a study of these services reveal about the relevant equity participation parameters that affect the small and medium sized enterprise sector at the Aboriginal entrepreneur and community level?

• What does a study of these services reveal about the relationship between equity participation, business development, and community economic development (including job creation)?

Using custom datasets provided by NACCA and its partners, we take a close look at two national scale developmental services they provide, to understand their impacts and equity participation parameters. These are:

• The Aboriginal Business Financing Program (ABFP) delivered by participating AFIs with support from NACCA, and Indigenous and Northern Affairs Canada (INAC), focused primarily on capital investment, marketing, business plan development, and business advisory services; and
The Aboriginal Developmental Lending Assistance (ADLA) program delivered by NACCA, and supported by INAC, which supports eligible AFIs in recovering some of the costs associated with the provision, management, and repayment of developmental loans.

These two particular programs are used as inputs to our analysis for several reasons. First, they represent the most well-documented national scale programs delivered by participating AFIs and NACCA; and were selected based on discussions with NACCA managers and staff, as well as NACCA’s Board, and INAC.

The importance of these programs outweighs their limitations as subjects of research. For example, while ABFP constitutes approximately one third of the AFI network’s total lending activities, the data collected by participating AFIs and NACCA to fulfill ABFP program requirements allow us to associate specific dollar amounts of developmental financing with information about the industry sectors and business activities invested in. The links to industries, based on the North American Industry Classification System (NAICS), and business activities (such as capital investment versus marketing), are what allow us to investigate ABFP’s economic impacts. For its part, ADLA provides a similar level of detail to support our analysis and captures unique insights into the links between developmental finance and local job creation; although it too is only a slice of the actual AFI network’s financing activities (which are discussed in greater breadth in Modules 1 and 3). In both cases, the impacts of these programs are also tied to government-assisted financing in the form of non-repayable contributions (from INAC and Regional Development Agencies).

The findings from our analysis of these two important programs should therefore not be construed as a definitive account of the general impacts the AFI network may have on the Canadian and global economies. Reliable economic data about the industries and business activities supported by the entire AFI network are simply not available for us to draw more general conclusions at this time. Unfortunately, to date, Canada’s AFIs and the broader Aboriginal developmental finance sector have yet to be given the attention they deserve from economic researchers; and our hope is that Module 2, despite its limited scope, will encourage AFIs and their partners to more actively participate in future economic research and data collection.

As a point of comparison and contrast with the two NACCA associated developmental finance services, ABFP and ADLA, we also examine the national profile of BDC’s Aboriginal portfolio, which includes loans for capital investment, working capital, and Information Communications Technology (ICT) services. Although BDC is a federal Crown corporation, in its case, the loans it provides to Aboriginal businesses are independent of non-repayable contributions; and this dataset provides an additional layer of context to our investigation of Aboriginal developmental finance services and their impacts.
Research Module 3: Barriers to Aboriginal entrepreneurship and options to overcome them

Like their non-Aboriginal counterparts, Aboriginal entrepreneurs and SMEs need access to appropriate financing at various stages of their business development, from help starting up, to support with operations, acquisitions, and business expansion³. Yet, despite these evident needs, a variety of experts in the field of Aboriginal business development continue to observe significant financial hurdles for Aboriginal communities and individuals.⁴ Their general conclusion is that mainstream private sector finance has largely failed to meet, or sufficiently understand, the needs of Canada’s Aboriginal entrepreneurs and SMEs. This third and final research module focuses on the financial service preferences and needs of Aboriginal businesses in light of the overarching financial barriers they face.

In Research Module 3 we investigate the financial service preferences of Aboriginal entrepreneurs and SMEs in Canada. From this starting point we then investigate their unmet service needs and summarize key barriers that restrict their financial capabilities and access to capital. Of special interest are associated opportunities to address unmet service needs and reduce financial barriers. This research module therefore addresses three main questions:

- What are the financial service preferences of Aboriginal entrepreneurs and SMEs?

- What kinds of financial barriers and unmet service needs affect Aboriginal entrepreneurs and SMEs?

- What opportunities and options are available to reduce barriers and expand/enhance financial services for Aboriginal entrepreneurs and SMEs?

In responding to these questions, Research Module 3 pursues five lines of inquiry. The first line of inquiry examines the context of Aboriginal entrepreneurship in Canada, and seeks to clarify the basic terminology used to describe Aboriginal entrepreneurs and SMEs in the relevant research and financial industry literature. Here we also draw upon available data and background research to examine what is known about the financial preferences of various groups of Aboriginal entrepreneurs and SMEs.

Our second line of inquiry in Module 3 shifts from preferences to examine the barriers and unmet service needs that are prevalent for different groups of Aboriginal entrepreneurs and SMEs. The third line of inquiry then examines some of the dominant location-specific challenges that Aboriginal entrepreneurs and SMEs face in Canada, depending on whether they are located on or off-reserve or in rural, remote (Northern), or urban areas.

Lastly, the fourth and fifth lines of inquiry in Module 3 focus on opportunities and solutions. Here we examine the adequacy of current financing solutions, as well as considerations that need to be assessed beyond traditional credit risk measures, to improve the flow of appropriate financing. We then conclude the module and this series, with a discussion of smart practices and recommendations to improve the

⁴ Source: Standing Senate Committee on Aboriginal Peoples. Sharing Canada’s Prosperity - A Hand up, Not a Handout. P. 6
financial ecosystem for Aboriginal business development. These smart practices are drawn from the experiences of public and private sector entities, from NACCA and the AFI network, from BDC, and from the relevant research literature.

Summary of Findings

The following sections provide a summary of findings under each of the specific research questions that belong to each module.

Aboriginal entrepreneurship in Canada

Our understanding of Aboriginal entrepreneurship in Canada continues to be limited. Most of the broadly comparative literature and research around the circumstances and impacts of Aboriginal entrepreneurs and SMEs relies on dated or incomplete information. However, by combining the findings of relevant national surveys, and specific national and regional research initiatives, it is possible to compile a more reliable profile of the landscape of Aboriginal entrepreneurship in Canada. Module 1 presents the results of this data synthesis.

What is the profile of Aboriginal entrepreneurs and SMEs in Canada, in terms of business size, geographic clusters, and industry sector classification?

In a general sense, Aboriginal businesses are those that are majority owned by First Nations, Métis and/or Inuit individuals. For the purpose of this research, we follow the definition promoted by Statistics Canada that characterizes small businesses as having 1 to 99 employees; medium-sized businesses as having 100 to 499 employees, and large businesses as having 500 or more employees.\(^5\)

A useful starting point for a basic profile of Aboriginal entrepreneurs and SMEs is the 2011 National Household Survey (NHS) – now replaced by the 2016 census (which was unavailable at the time our research was completed). Using self-employment as a measure of business ownership, the 2011 NHS data suggest there are at least 38,000 Aboriginal entrepreneurs across Canada. However, this number appears to underestimate the number of entrepreneurs and SMEs located on-reserve, especially since it does not account for community and collectively-owned businesses.

Demographically speaking, Canada’s Aboriginal entrepreneurs are young compared to the rest of the population. They have also grown at significant rates over the past two decades. From 2003 to 2011, based on past census and NHS data, for example, the estimated number of Aboriginal entrepreneurs grew by nearly 10,000 individuals. These entrepreneurs are also creating businesses across a broad range of industry sectors. In this case, geographic and locational differences play an important role in distinguishing trends. Smaller, more remote areas have high rates of business in construction, utilities, and agriculture, forestry, fishing and hunting. By comparison, urban locations have high rates of

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construction businesses, as well as high rates of businesses in other sectors such as professional, scientific, and technical services. In addition, urban locations tend to have a greater diversity of business types than rural and remote locations.

How does the distribution of Aboriginal entrepreneurs and SMEs vary across the Canadian provinces and territories, by size, geography, and industry sector classification?

The 2011 NHS, 2003 Statistics Canada Survey of Aboriginal Entrepreneurs, and data from BDC suggest that the vast majority of Aboriginal entrepreneurs are located off-reserve. The 2016 Canadian Council for Aboriginal Business (CCAB) data and more recent NACCA ABFP program data both reflect this trend, but they also appear to pick up on some of the business activities that are not included in the other perspectives. In the 2016 CCAB data, over half of First Nations businesses were located on-reserve, and the NACCA ABFP datasets found over a third of Aboriginal businesses are located on-reserve. The CCAB data also suggest that on-reserve First Nations businesses are more likely than off-reserve businesses to access loans from Aboriginal Financial Institutions. Moreover, the 2015 Canadian Business Patterns (CBP) data from the Statistics Canada Business Register indicate that there are close to 10,000 businesses located on-reserve (versus the less than 3,000 captured by the 2011 NHS). The CBP perspective also suggests that business activities on-reserve may be highly concentrated to a small number of key regions and more highly industrialized communities. Module 1 goes into further detail on the distribution of Aboriginal entrepreneurs and SMEs across the provinces and territories.

Although Aboriginal entrepreneurs can be found across all industry sectors, there are some significant concentrations in construction, professional services, other services, and agricultural based industries. These concentrations are reflected, more or less, in all of the datasets we have investigated (see Modules 1 and 2).

Nevertheless, geography matters, and there are important differences in industrial composition based on location — whether urban, rural, on-reserve, etc. The 2011 NHS, 2015 CBP, and NACCA ABFP program data support the idea that on-reserve businesses are concentrated in construction and primary sector industries. The findings are less unanimous for the types of businesses that are located off-reserve. While data from the NHS, CBP, and NACCA ABFP all reflect high concentrations of construction based industries off-reserve; there is less agreement around the other leading industry categories.

Finally, in terms of business structure, there continues to be evidence to support the inference that Aboriginal business owners prefer simpler SME structures. The majority of Aboriginal businesses are small in nature, acting as either sole proprietorships or partnerships. Yet despite their small nature, Aboriginal business owners are optimistic about their futures. Recent surveys indicate that nearly three-quarters of business owners felt that it was very likely they would still be running their business in five years.6 Moreover, Aboriginal communities are finding ways to generate and invest their own source revenues through various kinds of collective business enterprise. Alongside the sole proprietors, these

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community-owned SMEs are seeking financing opportunities to grow their businesses and amplify their economic impact.

**What is the size and scope of key financial services currently targeting Aboriginal entrepreneurs and SMEs in Canada?**

There are several available streams of financing options for Aboriginal entrepreneurs in Canada. Notably, the four major access points touched upon in our research include:

- Indigenous and Northern Affairs Canada (INAC), which supports Aboriginal entrepreneurs through the Aboriginal Business Financing Program (ABFP) delivered through NACCA and partner AFIs (explored in detail in Module 2). The program matches non-repayable federal contributions against client equity and loans, providing up to $99,999 for individual entrepreneurs, and up to $250,000 for community-owned Aboriginal businesses. These non-repayable federal contributions help to strengthen the client’s ability to access loans from AFIs and commercial lenders.

- NACCA and the network of Aboriginal Financial Institutions (AFIs) in Canada support Aboriginal entrepreneurs through a variety of developmental financing and more conventional lending services. As shown in Module 1, NACCA’s AFI members have provided over 1,300 loans, amounting to over $110 million in disbursements per year to Aboriginal entrepreneurs in recent years.

- BDC supports Aboriginal entrepreneurs through two specialized initiatives, the “Aboriginal Business Development Fund” and “Growth Capital for Aboriginal Business”. These services are provided in addition to BDC’s mainstream financial service offering. It has provided close to 400 loans amounting to nearly $100 million in commitments to Aboriginal businesses in the past three years.

- Several major mainstream banks in Canada have Aboriginal banking units which are dedicated to supporting Aboriginal individuals; though not all mainstream banks necessarily have specific programs for Aboriginal entrepreneurs.

Despite these and other available services, there is general agreement across the relevant research literature that Aboriginal individuals face significant barriers to accessing capital. The majority of Aboriginal entrepreneurs rely to some degree on personal savings to start their businesses. And despite the financial services that are available, a minority of Aboriginal individuals appears to access loans or credit from banks or government supported programs.

Beyond regulatory and legislative restrictions, in many cases the resources required to support and inform Aboriginal entrepreneurs are simply not present. This helps to explain why only a minority of Aboriginal start-ups appears to access loans or credit from Aboriginal business lending institutions,
government programs, or mainstream financial institutions. Moreover, beyond their initial start-up, Aboriginal business owners continue to cite access to financing, equity and capital as barriers to growing their businesses.

One of the pressing issues highlighted in the relevant research is the noticeable absence of financial institutions for Aboriginal entrepreneurs located in small rural and remote locations. The major Canadian banks\(^7\) have a limited presence in Aboriginal communities, with less than 50 Aboriginal branches across the country. This is particularly true for Northern locations which face challenges in accessing basic financial services such as having a bank account.

**The impact of developmental finance on Aboriginal entrepreneurship and economic development in Canada: Insights from NACCA and BDC**

BDC and the NACCA-AFI network help to fill the financing gaps that Aboriginal entrepreneurs and SMEs face, by offering specialized developmental finance services.

To help better understand the impacts of such services, NACCA staff created a historic dataset of the loans and government-assisted financing that participating AFIs provided to Aboriginal entrepreneurs and SMEs through the INAC supported Aboriginal Business Financing Program (ABFP) in fiscal years 2013-2014 and 2014-2015. (The ABFP program represents a third of the AFI network’s total lending). In addition to featuring information about the general purpose of loans and equity contributions, the dataset also describes the industry sectors involved, along with details on the client’s equity participation and matching government contributions. BDC staff in turn, provided a comparable dataset representing the bank’s Aboriginal business portfolio for the fiscal years 2013-2014 and 2014-2015.

The ABFP and BDC datasets both represent an economic situation where Aboriginal businesses are focused particularly on growth. To grow, businesses require funds for capital investment. In the ABFP dataset, for example, approximately 63 per cent of the capital investment funds ($189.6 million) included in our analysis involved business start ups. Among the clients represented in the BDC dataset, almost 40 per cent indicated in their pre-selection screening survey, that purchasing equipment was part of their business growth strategy over the next 12 months. Purchasing equipment was the most frequent response clients made to the BDC survey, followed by expanding production, another capital intensive strategy.

**What are the direct, indirect, and induced impacts of our focal Aboriginal developmental finance services on the Canadian economy?**

Because the clear majority of loans and equity contributions associated with ABFP and BDC’s Aboriginal portfolio in 2013-2014 and 2015-2016 address capital investments, their domestic impacts are considerably dampened by economic leakage. As is the case when most Canadian businesses make capital investments, their spending typically involves a series of imports to satisfy their demand for

\(^7\) Including BMO, CIBC, RBC, and Scotiabank.
machinery and equipment. In the case of the ABFP dataset, almost 45 per cent of the total capital investment ($189.6 million) flows out of the country for imports; while in the BDC dataset international imports take almost 36 per cent of total capital investment ($87.65 million)\(^8\).

Despite such similarities on the capital investment side, the two datasets have different mechanisms driving their developmental financing activities. In the case of the ABFP dataset, AFIs are a prospective business client’s point of contact for accessing the ABFP and its related developmental finance services; but, in terms of total investment, AFI lending is not the key driver of economic impacts associated with the ABFP dataset. (Indeed, as mentioned earlier, ABFP related loans only account for approximately 1/3 of the total lending undertaken by NACCA’s AFI members). In the case of BDC’s Aboriginal portfolio, BDC is the prospective client’s point of contact, and its lending also drives the portfolio’s economic impacts. Thus, while BDC’s lending activities comprise around 70 per cent of total capital investment associated with its Aboriginal portfolio, AFI lending comprises 18.9 per cent of total capital investments associated with the ABFP dataset. The differences between the two datasets extend further when we compare the leverage that BDC and ABFP’s participating AFIs get from their respective contributions to capital investment.

Our combined findings from Module 2 suggest that for every dollar AFIs lent to clients for capital investment under ABFP, about $3.6 was added to GDP\(^9\), thanks to matching funds (associated with other lenders, client equity, and non-repayable government contributions including ABFP program contributions from INAC). By comparison, for every dollar BDC lent to clients for capital investment under its Aboriginal portfolio, about $1.15 was added to GDP\(^10\), thanks to a smaller pool of matching funds (associated with other lenders and client equity). The AFIs participating in ABFP have more than three times BDC’s leverage because they are able to attract a considerably higher proportion of matching funds from other commercial lenders and client equity, in addition to their use of non-repayable government contributions.

The AFIs’ capacity to attract substantial matching funds through ABFP is a testament to their abilities as developmental lenders. In particular, it highlights their skill at brokering financing arrangements between other lenders, clients, and government programs. As Module 2 investigates in greater depth, there is substantially more going on in the ABFP financial ecosystem than a simple transfer of non-repayable government funds from INAC to clients. In particular, other commercial lenders provided 34.1 per cent of the total financing directed at capital investments, (while INAC’s non-repayable ABFP contributions amounted to 20.3 per cent). The risk the AFIs face, however, is being potentially over-reliant on external partners; which can lead to capital shortfalls when government programs withdraw contributions, when clients lack equity, or when other commercial lenders decide to pursue other opportunities. Such risks threaten to undermine the economic impact they can make.

\(^8\) Table 14 in Module 2 provides a more detailed breakdown of the capital investment expenditures.
\(^9\) This multiplier is explained in Module 2 on page 25.
\(^10\) This multiplier is explained in Module 2 on page 25.
What does a study of these services reveal about the relevant equity participation parameters that affect the small and medium sized enterprise sector at the Aboriginal entrepreneur and community level?

Research over the past 15 years has repeatedly observed that many Aboriginal businesses in Canada have limited equity to finance their projects or attract private investors. As a complement to this research, the ABFP and BDC datasets provide detailed insights into historic equity participation patterns; and reveal several relevant equity participation parameters for Aboriginal entrepreneurs and community-owned SMEs. Broadly speaking, these parameters can be grouped under the following three categories:

- Aboriginal identity and location;
- Industry selection; and
- Business structure and capacity.

The Aboriginal identity and location of the business client both have an important influence on the size of loans and matching client equity. Specifically, First Nation businesses on reserve and Inuit owned businesses stand in sharp contrast to off reserve First Nation, Métis, and non-status Aboriginal businesses.

Overall, the Inuit and on reserve First Nation client groups contributed over 80 per cent of total client equity in the BDC dataset. Yet they made up just 12 per cent of the total number of businesses, and received just over 31 per cent of total loans (BDC plus other commercial loans). While equity participation appears to be critical for Inuit clients and for First Nation clients on reserve to secure loans, it is not as apparent a condition for clients who are less remote and off reserve. The latter group typically possesses assets which are less constrained by issues such as remoteness or the complicated property rights systems associated with reserves and other Aboriginal landholding arrangements (e.g., as under the Nunavut Land Claims Agreement). The more urban business clients also tend to be larger in size.

All in all, the rates of equity participation in the ABFP dataset are considerably higher for most business structures than in the BDC dataset, regardless of whether they are on or off reserve. While this suggests that client equity is more important for securing ABFP financing than for BDC, it also reflects conditions for accessing the ABFP’s non-repayable government contributions, which require matching funds from clients. In particular, First Nation community owned businesses make the greatest use of equity participation to secure loans compared to other business structures on reserve.

Industry selection is another equity participation parameter evident in the BDC and ABFP datasets. Industry selection represents the fact that officers of developmental finance services make loan decisions based – in part – on information they receive about the performance of different industry sectors and the expected risks and returns of associated business opportunities. Similarly, many

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business owners, whether of start ups or established firms, weigh their investment decisions based on how they think relevant industries are doing in the short, medium, and long terms. A simple example would be the difference in expected profit and loan payback performance between an incorporated business looking to expand its logistical services to an established diamond mine, versus a small sole proprietor looking for a loan to expand a local hair salon or outfitting business. The industry selection perspective considers how the perception of value and associated risk in each venture depends on the industry sector as well as on the type of business structure, location, and scale of the enterprise.

In both datasets, we find that, as lenders, AFIs, BDC, and associated commercial lenders have some distinct preferences for industry sectors. These revealed preferences relate to client equity participation and government contributions in complex ways. The perspective we take to understand these patterns in Module 2 is based on each party’s contribution to total industry sector investment (loans plus client equity).

The top four industry sectors, by total loans and client equity, are similar for the BDC and ABFP datasets, except that BDC includes manufacturing while ABFP includes accommodation and food services. The common sectors include: retail trade; construction; and agriculture, forestry fishing and hunting. Within each dataset, different investor groups – lenders, government programs, and clients – have distinct preferences for industry sectors where they play leading roles (i.e., contributing the largest share of the total investment). For example, AFIs, as lenders in the ABFP dataset, play leading roles in mining and oil and gas extraction, and transportation and warehousing, while other commercial lenders play leading roles in manufacturing and arts, entertainment, and recreation. These revealed preferences suggest potentially higher risk tolerances for certain industry sectors where lenders may have a better appreciation of the average returns and capabilities of their client groups. However more in-depth research is required to better understand the patterns.

Closely linked to the revealed preferences of these lenders is the financial institutions’ identification of growth opportunities for developmental finance. This typically requires access to industry knowledge and forward looking data from macroeconomic forecasting models. The Conference Board of Canada, for example, provides such data and related industry sector views in its recurring forecasts of Provincial/Territorial Economic Trends12.

Despite current turmoil in the global economy, the longer term macroeconomic picture is favourable for Aboriginal businesses given their industry sector concentrations. The Conference Board of Canada predicts that Aboriginal communities and businesses are poised to benefit from an expected wave of major project investments over the coming decade, totalling over $342 billion in the natural resources sector alone13. In particular, the Conference Board’s outlook for growth in the metal and non-metal mining industries is favourable; and we use this sector as an example of opportunities for developmental finance in Module 2. For Aboriginal businesses, and their investors, the opportunity that

12 See: [http://www.conferenceboard.ca/products/reports/territorial-reports.aspx](http://www.conferenceboard.ca/products/reports/territorial-reports.aspx)
mining presents extends beyond local employment benefits. Mining companies have significant capital requirements for machinery and equipment. They also have significant needs for a broad range of support services, from accounting and legal services, catering and site management, to equipment repair and maintenance, among others. These opportunities along mining sector supply chains help support business development for a number of small and medium sized enterprises and can produce significant returns for lenders and co-investors.

Lastly, business structure and capacity have a role to play in shaping equity participation and access to financing. Although the ABFP and BDC datasets both feature a variety of business structures, the most frequent are sole proprietorships and incorporated businesses. In the BDC dataset, sole proprietors are associated with 57 per cent of loans, followed by incorporated businesses at 25 per cent. In the ABFP dataset the order is reversed, with 41 per cent of loans associated with incorporated businesses, followed by sole proprietors at 25 per cent. In terms of the general landscape of Aboriginal business, CCAB survey data from 2010 and 2015 suggest that sole proprietors make up around 61 per cent of Aboriginal businesses in Canada. In this context, the developmental financing activities in the ABFP dataset in particular appear to be focusing on more diverse business structures in a landscape that’s still dominated by sole proprietors.

In the BDC dataset, for every dollar BDC loans out, the average incorporated business contributes $0.23. By comparison the average sole proprietor contributes $0.12 for each BDC dollar. Meanwhile, BDC’s average loan to incorporated businesses is 3.6 times larger than its average loan to sole proprietors. A similar pattern holds in the ABFP dataset, but it is less pronounced. For every dollar an AFI loans out under ABFP, the average incorporated business contributes $0.32, while the average sole proprietor contributes $0.29. Furthermore, under ABFP the average AFI loan to incorporated businesses is 2.1 times larger than the average AFI loan to sole proprietors.

The difference between the datasets could be due to a number of factors. One potentially important difference is the greater presence of on reserve small businesses in the ABFP dataset. Here a perception of higher risk may call for a greater commitment of client equity (with additional security provided by the non-repayable government loans). AFIs typically describe themselves as focusing on smaller start up companies, particularly on reserve and in rural and remote areas. In the ABFP dataset 62 per cent of loans and non-repayable government contributions went to small business start ups, of which 55 per cent operated on reserve. More broadly, 53 per cent of total loans and non-repayable government contributions involved businesses on reserve. By comparison, 26 per cent of loans in the BDC dataset went to businesses on reserve (whether for start up or expansion). Another important difference between ABFP and BDC is the role of government programs, and the conditions they place on clients to match non-repayable contributions with equity. This dimension is completely absent from the BDC dataset, which does not include non-repayable government contributions. Without that backstop, BDC

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14 Beyond the ABFP program, 52 per cent of new AFI loans in 2015 were directed at small business start-ups, compared to 66 per cent in 2014. In terms of loan value, small business start up loans totalled $28.9 million (or 26 per cent of all new AFI loans in 2015). See: www.nacca.ca/downloads/nacca_afi-portrait-2015.pdf
regional managers and staff may have to apply different levels of risk tolerance than the AFIs that participate in the ABFP program.

*What does a study of these services reveal about the relationship between equity participation, business development, and community economic development (including job creation)?*

Both the ABFP and BDC datasets present views of developmental finance services shifting business development away from the national profile presented in CCAB’s 2010 and 2016 survey research – where sole proprietorships dominate the Aboriginal business landscape. In the CCAB research and associated literature, sole proprietors tend to take small loans (< 50k), and make limited use of financial sector services. The associated literature also links sole proprietors to lower rates of government-assisted financing compared to incorporated businesses and, especially to community owned businesses and Aboriginal economic development corporations.

The optimal path for economic planners, however, is not necessarily to replace sole proprietorships with incorporated businesses or community owned businesses. As we investigate in Modules 1 and 3 of this series, the more complex forms of business, and particularly incorporation, can place considerable demands on client capacity/time/energy, and introduce a range of business concerns including taxation issues, and so forth.

Moreover, as the CCAB and associated research indicates, sole proprietors play a vital role in community economic development, as they are frequently the providers of local goods and services in Aboriginal communities. Evidence from CCAB suggests that despite the risks associated with small business failures in Canada, Aboriginal sole proprietors are turning profits and maintaining stability. Evidence from research on reserve and in the North also points to substantial opportunities in the local economic sectors frequented by sole proprietors. These opportunities are tied to the ongoing economic leakage that occurs, as Aboriginal communities continue to purchase goods and services from outside their local and regional market areas. While economic leakage is a persistent problem for rural and remote communities, it also presents an opportunity for Aboriginal entrepreneurs to solve with new business ideas.

Sole proprietorships are an important entry point for entrepreneurs, given their relatively simpler start up requirements compared to the steps required for incorporation or the creation of a joint venture or limited partnership. In that relative simplicity is an opportunity for the developmental finance sector to provide supports and incentives for capacity building and business support.

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15 While the 2010 CCAB survey found that Aboriginal entrepreneurs generally viewed financial institutions positively, loans from Aboriginal business lending institutions accounted for just 15 per cent of financing used by Aboriginal start-ups. More than half of Aboriginal entrepreneurs noted that they relied on personal savings for their business start-ups, while 17 per cent accessed either business loans/credit from a bank, or credit from other government programs.

All community economic development options come with trade-offs. As we saw earlier in our economic footprint analyses of ABFP and BDC’s Aboriginal portfolio, the vast majority of associated expenditures went to capital investments. Looking at total investment divided by jobs in our third available dataset from the NACCA ADLA program (2014-2015), presents some potentially useful exploratory insights about the strategic trade-offs.

Based on the average investment scenario presented in the ADLA dataset, if a financial institution or government’s developmental finance strategy was focused on jobs over capital investment, it might be more conducive to concentrate on sole proprietorships rather than a First Nation community owned business, corporation, or partnership. In this context, sole proprietors require significantly smaller loans and matching funds to create or maintain jobs; although the quality of those jobs (in terms of income and benefits) is another set of factors that would need to be taken in consideration before one executes this kind of developmental financing strategy.

On the other hand, the ADLA data suggest that a developmental financing strategy focused on maximizing matching equity contributions from clients and government investors, would likely prefer a First Nation community owned business, with its substantial matching investments. In this context there could be significant direct and indirect economic benefits from this approach, due to investments in construction and demand for goods and services from regional suppliers – especially in the context of major projects for community infrastructure or in the natural resources sector. However, as we saw in the ABFP and BDC impact models, a substantial portion of capital investment typically leaks out of the region (and country) due to imports for machinery and equipment, and the need for specialized expertise and labour; and this leakage would need to be carefully considered before any real conclusions could be drawn about the local impacts of capital investment.

Every financing decision comes with trade-offs; and the context of the business to be financed, including its location, industry sector, size, structure, and capabilities, all play a role in shaping the risk a financial institution will have to take. That risk, and how it is perceived, in turn determine the commensurate levels of equity participation the financial institution may require from clients in exchange for a loan. The presence of non-repayable government contributions through programs such as ABFP help to strengthen the case for financing a potentially risky business, especially in areas, such as reserves and remote Northern communities, that continue to be portrayed as higher risk by the mainstream banking industry. Our third module takes a closer look at the related challenges and associated barriers that Aboriginal businesses face, both on and off reserve, and in rural, remote, and urban areas. It then concludes with a discussion of potential solutions for overcoming them.

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17 For a regional case study around mining sector investments, see: The Conference Board of Canada’s recent Northwest Territories Labour Market Forecast and Needs Assessment, http://www.conferenceboard.ca/e-library/abstract.aspx?did=7512
Barriers to Aboriginal entrepreneurship and options to overcome them

As with other entrepreneurs in Canada, Aboriginal entrepreneurs conduct their business through a variety of business structures, including sole proprietorships, partnerships, and limited liability corporations. These general structures in turn contain numerous variations. As discussed in Modules 1 and 2, and based on CCAB data, just over 60 per cent of Aboriginal businesses are sole proprietorships, roughly 11 per cent are partnerships, and the remainder are incorporated businesses.

Beyond business structure, contemporary research on Aboriginal or Indigenous entrepreneurs has identified common cultural values that characterize Aboriginal approaches to business development. For instance, case studies of Aboriginal and Indigenous entrepreneurs, in Canada and internationally, have found them to share entrepreneurial values that espouse collective success and community concern over narrower views of economic profit tied to individual achievement.18 Innovative financing services need to respect these values and play to their strengths.

What are the financial service preferences of Aboriginal entrepreneurs and SMEs?

The research indicates that programs to stimulate entrepreneurship on-reserve and in Northern and remote communities need to be community-based and reflective of collective community values. Without this recognition, programs will likely be ill fitted to local realities and preferences, and will not be as effective as they could be.

In contrast to more limited forms of entrepreneurship, Indigenous entrepreneurship identifies success across a range of economic and non-economic dimensions.19 In this way, Indigenous entrepreneurship is very similar to social entrepreneurship, where the social entrepreneur is one who works to support the community, uses their experience to help other entrepreneurs, acts as a role model for the community, and seeks to promote local employment and economic development as a policy and measure of success.20

Depending on their size and structure, these Aboriginal businesses tend to have different financial service preferences. For instance, sole proprietorships without employees see government loans and grants as being of great importance; whereas larger, more complex businesses (specifically those with over half-a-million dollars in revenues) find business loans and lines of credit from varying financial institutions as being of greater importance.21

Similar to sole proprietorships and small businesses, community owned businesses and Aboriginal economic development corporations operate in a wide range of industries. The CCAB survey of

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20 Source: McBride, J.E. Aboriginal Community Economic Development: Overcoming Barriers to Aboriginal Entrepreneurship. P. 36
Aboriginal economic development corporations in Ontario, for example, found that the most popular industries include energy, construction, and services such as tourism and property management.\(^{22}\)

Moreover, the survey found that these economic development corporations generally utilize a mixture of government assisted and private financing, as well as own source revenues to fund their operations.\(^{23}\) In terms of financial service preferences, less than one-in-five established Aboriginal economic development corporations cited banks and other private institutions as being important sources of operational financing.\(^{24}\) Moreover, when starting up, less than a third of them counted private institutions as their main sources of financing.\(^{25}\) Instead these business entities tend to turn to government financing when starting up.\(^{26}\) This insight resonates with our findings around the ABFP in Module 2.

**What kinds of financial barriers and unmet service needs affect Aboriginal entrepreneurs and SMEs?**

Aboriginal entrepreneurs and business owners face several obstacles in accessing financing for start-up, on-going operations, acquisitions, and expansions. Numerous studies have shown that access to capital for Aboriginal entrepreneurs continues to be a substantial barrier. Despite the numerous challenges, we argue that these concerns generally fall under three categories: structural, financial, and cultural/institutional challenges. In addition, these challenges can vary with business structure and location.

Structural challenges are those that relate directly to the conditions and wellbeing of individuals living in Aboriginal communities; for instance, the generally lower levels of employment, educational attainment, and income; as well as greater distances from population centres where financial institutions and government programs are more likely to have offices. These structural challenges need to be recognized before discussing the more direct challenges to Aboriginal entrepreneurship. They also contribute to the financial institutions’ perceptions of risk, for example associated with an entrepreneur living on or off reserve or in a remote or rural area.

Financial challenges include the limited availability of banking services, a lack of financial literacy and capacity, and the potential threat of fringe financial services and predatory lending. As noted, the major banks in Canada have a limited “on-the-ground” presence in Aboriginal communities, and not all major banks have services that specialize in Aboriginal entrepreneurship. However, even moving beyond the physical presence of banks to options of online-banking can present challenges when individuals have limited opportunity to expand their financial literacy, and have limited access to virtual services because of infrastructural deficits (such as poor internet access). The current research indicates that Aboriginal


entrepreneurs in Canada face severe financial capability constraints that need to be addressed by more collaborative and targeted approaches on the part of multiple governments and financial service providers – both Aboriginal and non-Aboriginal.

Many of these challenges are intensified for entrepreneurs living on-reserve due to regulatory and legislative restrictions associated with the reserve system. But entrepreneurs living in rural, remote, Northern, and urban settings also face obstacles, including their own, and common, structural challenges that need to be addressed.

In many cases, the resources required to support and inform Aboriginal entrepreneurs are simply not available; and insufficient efforts have so far been made to help educate youth about the necessities of financial literacy and financial capability. This current state of play helps to explain why only a minority of Aboriginal start-ups access loans or credit from Aboriginal business lending institutions, government programs, or banks. The majority are not getting the right information and support they need to make better informed decisions about the financial services available to them.

What opportunities and options are available to reduce barriers and expand/enhance financial services for Aboriginal entrepreneurs and SMEs?

Since the majority of Aboriginal businesses in Canada are small sole proprietorships, we have particularly focused our recommendations on ways to target the needs and challenges of these business entities. Our assessment of opportunities and options covers two broad streams of recommendations:

1) to improve Aboriginal entrepreneurs’ financial capabilities and access to financing, and

2) to increase the availability of relevant financing.

Module 3 goes into greater depth on the issues addressed by each recommendation.

Improve Aboriginal entrepreneurs’ financial capabilities and access to financing

In order to improve the conditions that affect how Aboriginal entrepreneurs access lending and financial services, we recommend that federal and provincial/territorial governments, alongside AFIs and other financial institutions, concentrate their efforts on:

- Simplifying access to financing;
- Improving financial literacy and strengthening financial capabilities;
- Exploring options to increase the availability of micro-loans; and
- Supporting efforts to overcome the financial barriers brought on by the Indian Act (and section 89 in particular).

Highlights for each of these opportunity areas are discussed below:

Simplifying access to financing
Simplifying access to financing for Aboriginal entrepreneurs requires improved information products. Having readily accessible plain language tools that provide information on where to find financing, how one can apply for it, and what a business needs to meet the necessary requirements would be instrumental. Where possible, the information available in this toolset should provide specifics for various sub-populations including youth and women, and be tailored to different business types (e.g., sole proprietorships versus Aboriginal economic development corporations). This effort would help fill the information gaps entrepreneurs have noted.

**Improving financial literacy and strengthening financial capabilities**

Several actions should be pursued to improve the financial capabilities of individuals and communities. In the immediate financial services environment, we suggest that financial institutions pursue a more concerted effort to link financial literacy and capability development to loans and credit. Such direct linkages could help increase the capacity of Aboriginal entrepreneurs to succeed (and have proven to be successful among tribes in the United States). Broader efforts should also be undertaken to include components of financial literacy and capability in school curricula and adult education programs. Finally, we recommend that further research on the feasibility of programs aimed at improving the credit ratings of Aboriginal individuals is warranted.

**Exploring options to increase the availability of micro-loans**

Research indicates that particular demographic sectors, such as Aboriginal women who operate sole proprietorships in the services sector, could benefit from having greater access to micro-loans. Based on the relevant research, reviewed in Module 3, we believe that the federal government and financial institutions, including BDC and AFIs – which already deliver micro-loan programs – should make a greater effort to share information on smart practices, and explore options to increase the availability of micro-loans. This collective effort should include initiatives to better understand the benefits, including economic and social benefits, as well as the costs and limitations of micro-loan programs.

**Supporting efforts to overcome the financial barriers brought on by the Indian Act**

The Indian Act, as investigated in Module 3, presents several structural barriers to economic development. Most notably, Section 89 of the Indian Act, which restricts the seizure of assets on-reserve, acts as a significant obstacle for entrepreneurs attempting to access financing.

The federal government has developed a series of legislative tools that help to address financial barriers presented by the Indian Act. These include the Fist Nations Fiscal Management Act, the First Nations Land Management Act, the First Nations Commercial and Industrial Development Act, and the First Nations Oil and Gas and Moneys Management Act. Collectively, these acts present “ways for First Nation governments to leverage on-reserve property taxation, own-source revenues, and a strong land base to
gain access to capital markets and gain control over financial management as well as lands management”.

We believe that the federal government should continue to support the practical implementation of these Acts, and explore additional policy options to reduce structural barriers that have been created by the Indian Act. In addition, the federal government should strive to make information products about the current options and tools as accessible and simple to understand as possible. Other programs that may be worth re-examining and retooling to better serve First Nations needs, include the Loan Loss Reserve Program, developed by Indigenous and Northern Affairs Canada in 2008.

In addition to these federal initiatives, several financial institutions have developed their own innovative strategies to acquire security on loans to businesses on reserve. As noted in Module 3, several AFIs will obtain a band council resolution that enables them to access assets on-reserve in the instance of default. Similarly BDC has also worked with band council resolutions to mitigate the risk of default from businesses on-reserve. Some smaller financial institutions also use similar systems. For instance, the Me-Dian Credit Union has in the past worked with band councils in order to allow them to repossess items in the case of default (although these have typically been used for small loans). We believe that a collective effort should be made to explore the feasibility of adapting these systems to a broader set of more mainstream financial institutions across Canada.

Increase the availability of relevant financing

Beyond improving an individual’s ability to access current financing, the literature strongly emphasizes the need to increase the amount of financing available to Aboriginal entrepreneurs and SMEs. The financial ecosystem needs to have a strong continuum of lenders that are able to provide for Aboriginal businesses at all stages of development. How this continuum develops, and how Aboriginal businesses move from one stage of financing to another will need to be researched and developed in greater detail. However, given the prevalence of Aboriginal businesses in early stages of development, operating mainly as sole proprietorships, our recommendations focus on developmental lending.

In particular, federal and provincial/territorial governments, along with the financial services sector, and other investors should seek to:

- Increase funding for Aboriginal Financial Institutions; and
- Explore opportunities for social financing.

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30 Source: Martin, K. Deepening Relationships: Opportunities and Challenges for Aboriginal Peoples and the Credit Union System. P. 12
Increase funding for Aboriginal Financial Institutions

As shown in Module 3, the financial needs of Aboriginal entrepreneurs and businesses are great. In its efforts to meet these needs the AFI network has limited liquidity; and several AFIs have a need for affordable capital beyond what they have available. NACCA has estimated that the AFI network requires $82 million in additional loan capital to fill its current capital gap plus an additional $54 million to accommodate projected growth in lending from 2015 to 2020.\(^{32}\)

From the government side, relevant federal and provincial/territorial programs should work with AFIs to continue decentralizing the delivery of their financial capacity development services and products for Aboriginal businesses (such as the ABFP, examined in Module 2). As recommended by other authors, these relevant government programs should also include resources to support the capacity development of existing AFIs so they can better manage and deliver the services that entrepreneurs and SMEs need.\(^ {33}\) This will help the AFIs, and help the relevant government programs deliver on their mandates to grow the Aboriginal economy and support Aboriginal entrepreneurs and SMEs.

Relevant government partners also support the sustainability of AFIs by increasing operating subsidies for these institutions, and ensuring that they have the debt and equity capital required to continue operating.\(^ {34}\) It should be noted that steps have already been taken to address this issue. For instance, in 2015 the Government of Canada announced a $62 million contribution to NACCA in order to increase its role in assisting AFIs, and in turn the role of AFIs to support Aboriginal businesses.\(^ {35}\) Given this, we recommend that the federal government, NACCA, and the network of AFIs routinely check in to evaluate the needs gap and assess capital shortfalls in order to better address the challenges that AFIs face. The mainstream financial institutions and major banks should also work more closely with NACCA and the AFI network to develop solutions that could strengthen the Aboriginal developmental finance sector.

Explore opportunities for social financing

Social financing can be thought of as the management of resources to provide both a social and economic return. Within this framework, the Canadian Task Force on Social Finance noted in 2010 that there is a need to “more efficiently connect the best people and the most innovative ideas to the private capital they need to tackle complex societal problems, create jobs and strengthen communities”.\(^ {36}\) They argue that this will help leverage opportunities for investors to participate in opportunities that provide financial, social and environmental impacts.\(^ {37}\) In this context, it is not a large leap to see Aboriginal developmental finance as a form of social financing in Canada, given that it seeks to develop small and

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33 Source: Parker, Z., and V. DeBono. Aboriginal Access to Capital in Western and Northern Canada: Issues, Obstacles, and Directions. P. 27
36 Source: The Task Force on Social Finance. "Mobilizing Private Capital for Public Good." P. 1
37 Source: The Task Force on Social Finance. "Mobilizing Private Capital for Public Good." P. 1
medium sized businesses that will create local benefits and employment in their communities, and create social value beyond what is typically measured in terms of returns on investment.

Given this, we recommend that NACCA should continue to capture the AFIs role in the social economy (with social impact metrics, etc.) and investigate the potential to attract social impact investors (including the major banks and other mainstream financial institutions which have corporate social responsibility mandates that resonate with social impact investing). In doing so, they can position themselves to increase available funding through partnerships as a force for social investment.

NACCA has already begun looking into ways to increase loan capital availability; and in 2015 they explored a Capital Attraction Tool that would “facilitate access to private sector and Aboriginal capital sources for developmental lending”.38 Other work in this space is identifying partnerships with players in key non-financial sector industries of the Canadian economy. For instance, in 2014, a report commissioned by the Indian Business Corporation came out identifying the need for greater access to capital for developmental lenders.39 The report highlighted opportunities for industry sector proponents, such as mining, forestry, and oil and gas developers, to invest in developmental lenders as a way to gain “social license” and move forward with Aboriginal communities and businesses on major project agreements.40

Given the work that has already occurred and the initiatives that are in development, we suggest that there should be a collective effort made to promote the value of developmental finance for both the businesses that this lending supports and for prospective investors (public and private) that have espoused goals for social impact investing.

39 See: Impakt Corporation. Social Finance: Unlocking the Potential of Developmental Lending
40 See: Impakt Corporation. Social Finance: Unlocking the Potential of Developmental Lending