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Mobilizing Capital for Regional Development

by

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RÉSUMÉ

Il est essentiel au développement des entreprises - lequel constitue un important élément du développement régional - qu'elles aient accès aux capitaux nécessaires et qu'elles les obtiennent à des conditions avantageuses. Étant donné l'importance croissante attachée par les décideurs à l'entrepreneuriat et, à un moindre degré, au développement économique local, tant au Canada qu'à l'étranger, la mobilisation des capitaux en faveur du développement régional a retenu, ces dernières années, l'attention des spécialistes de la question. Dans les régions moins développées, les limites que semblent connaître les bailleurs de fonds traditionnels - banques, amis et parents, sociétés de capital-risque et gouvernements - ont suscité un regain d'intérêt pour les nouvelles stratégies de mobilisation des capitaux.

Le présent document fait le point sur les diverses stratégies employées pour mettre des capitaux au service du développement régional. La question de la mobilisation des capitaux y est tout d'abord située dans le contexte plus vaste de la politique de développement régional. Les auteurs procèdent ensuite à un examen de plusieurs stratégies de financement par emprunt et par prise de participation auxquelles peuvent avoir recours les différents paliers de gouvernement, les entreprises, les syndicats et les collectivités, notamment les régimes provinciaux et coopératifs d'épargne-actions, l'actionnariat des salariés, les fonds d'investissement mis sur pied par les salariés, les sociétés de capital-risque parrainées par les syndicats, les programmes de microcrédit et les fonds d'emprunt communautaires. En conclusion, ils décrivent brièvement les limites (et les possibilités) de ces approches nouvelles, ainsi que certaines des conséquences dont aurait à tenir compte la politique canadienne de développement régional.

ABSTRACT

Access to adequate and appropriate capital is essential for successful business development, which itself is an important prerequisite for regional development. In recent years, the issue of capital mobilization for regional development has attracted considerable attention in the regional development literature as a result of the increasing emphasis placed on entrepreneurship and, to a lesser degree, community economic development, by policy-makers both in Canada and in other countries. In less developed regions, the perceived limitations of conventional suppliers of capital -- banks, friends and relatives, venture capitalists, and governments -- have prompted increased interest in alternative capital mobilization strategies.

The purpose of this paper is to review experience to date with a range of strategies for mobilizing capital for regional development. The paper begins by situating the issue of capital mobilization within the broader context of regional development policy. A number of debt and equity capital mobilization strategies available to governments, business, labour, and local communities are then discussed, including provincial stock savings plans, cooperative share savings plans, employee share ownership plans, employee investment funds, labour-sponsored venture capital corporations, micro-credit programs, and community loan funds. The paper concludes with a brief discussion of the limitations (as well as possibilities) of these alternative approaches, and some of their possible implications for future Canadian regional development policy.

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FOREWORD

The purpose of the Economic Council's project on Directions for Regional Development was to look at situations in which local communities had assumed more responsibility for their own development, and to see what lessons could be learned from these experiences. Fourteen case studies were undertaken, while a number of Issue Papers examined subjects of general concern to communities and development practitioners. The research was deliberately designed to be different from work typically undertaken by the Council in the past. The primary task was to collect instructive evidence, and to verify it where possible by drawing upon existing evaluation studies. The authors were not expected, for example, to undertake the extensive data collection needed to do cost-benefit studies. Rather, they were asked to capture the diversity of the local development experience in Canada.

The results of the research are being reported in a special collection of Local Development Papers. An overview of the findings from these papers is being presented in a paper entitled Developing Communities: The Local Development Experience in Canada, which is being released concurrently with this paper. A subsequent phase of the project will analyze the context within which local development initiatives take place and evaluate their actual and potential impact on reducing regional disparities.

This paper presents one of the Issue Papers produced by the Directions for Regional Development project under the direction of Dal Brodhead.

Like the case studies, these Issue Papers arose out of the project team's research and consultations with community development workers, government officials, women's groups, business people, non-profit organizations, and many others across Canada. A unique feature of the project was its regional orientation through the use of three regional consultants who played a major role in the development of the case studies and the issue papers and in the consultation process. Equally important were the numerous joint research ventures undertaken with a wide range of regionally-based partners.

Our work in the first part of the project suggests that programs sensitive to the needs of individual communities, and based on some type of partnership between government and local groups, may make a contribution to economic development in Canada's diverse regions. In particular, our research suggests that communities have an important role to play in identifying development priorities and the particular skills requirements of individuals and local businesses. They also indicate that such "bottom-up" strategies can be assisted by a Local Development Organization (LDO), whose mandate is sufficiently broad and constituency base sufficiently large to enable it to take a long-term development perspective. An important feature of "bottom-up" community development strategies is their focus on community capacity-building aimed at increasing local self-reliance and innovation.

The issues on which we have chosen to focus illustrate a number of the ways in which Canada's communities have mobilized their available human, financial, and material resources to help assure a future for themselves. We believe that the resulting papers will be of value both to community and regional development practitioners and to regional policy-makers at all levels of government.

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1 INTRODUCTION

There is increasing agreement that small and medium-sized enterprises (SMEs) represent the greatest potential for job creation and economic development in most modern, industrialized economies. Indeed, research from the United States (Birch, 1979) and the United Kingdom (Storey, 1982), as well as Canada (Department of Regional Industrial Expansion, 1986) indicates that such firms generate between 40 and 90 per cent of all new jobs in industrialized economies.

Sustained and diversified SME development is of particular importance in Canada's less-developed communities and regions, which are less apt than more centrally located communities and regions to play host to large enterprises. The pivotal relationship between small business development and effective regional development has increasingly been recognized by Canadian policy makers at all levels of government (C.D. Howe Institute, 1983). Since access to adequate and appropriate capital is a prerequisite for successful business development, it is not surprising that Canadian policy makers have, over the past decade, paid an increasing amount of attention to the question of how entrepreneurs and small businesspersons generally can best mobilize the capital they need to start, sustain, and expand their enterprises. But despite a growing literature on the subject, (see the Bibliography of this paper for a representative selection), the problem of capital mobilization for regional development has remained a complex and ill-understood one.

Whether or not the less-developed regions of Canada are suffering from an actual shortage of capital as such is a matter of vigorous debate. Some would argue that there is indeed such a shortage; in contrast, others maintain that the principal shortage is that of good business ideas, not money. Still others suggest that while there may be no overall shortage of capital, there does appear to be more or less serious mismatching between the suppliers of equity capital and those seeking it. Yet another school of thought would lay considerable stress on the lack of depth of supply and on the lack of competition between suppliers of equity capital, (Economic Council of Newfoundland and Labrador, 1989). At present, the almost total absence of hard evidence precludes any sort of definitive answer to the question.

Whatever position one takes on the capital shortage issue, few would dispute the fact that Canada's outlying and less-developed regions have, for a variety of reasons, long found it more difficult than other parts of the country to mobilize the capital they require for development. Moreover, recent tendencies in both Canadian and international financial markets point toward increased centralization in the provision of financial services, a trend which certainly does not augur well for less-developed communities and regions or those seeking to invest in them.

In this connection, a problem pointed out by the Canadian Federation of Independent Business (CFIB) in a recent report (CFIB, 1988), bears brief mention. According to the CFIB report, the chartered banks appear to apply more stringent credit terms in an "across-the-board" fashion when any element of risk is perceived in a loan application. That is to say, those businesses (generally smaller and newer enterprises) faced with the highest requirements for collateral also pay the highest interest rates and have a relatively greater likelihood of having their loan applications rejected or of receiving less money than requested. While such practices may make sense from the perspective of the banks' head offices, they do little but make life even more difficult for the already hard-pressed owners of smaller and newer businesses and businesses attempting to operate in the less-developed communities and regions of the country, where risks tend to be higher to begin with. Worse still, a not inconsiderable number of small Canadian communities lack any kind of financial services whatever. Many others are served by a single credit union, caisse populaire, or branch of a chartered bank -- a fact which, however unavoidable, serves to reduce real competition among providers of financial services (CFIB 1988), and possibly to increase costs to businesses in rural areas, as well. Certainly it is more difficult for small businesses to deal with problems regarding such matters as service charges -- a major irritant throughout Canada's small business community -- when the bank in question is "the only game in town" and the businessperson in question may have no viable alternatives.

Other factors may well have had the *effect* of contributing to increased centralization, in fact if not in name, and whether intentionally or not on the part of the banks.* Of these factors, none looms larger than that of account manager turnover. Even in situations in which there is no actual centralization of lending authority, overly frequent turnover of account managers has much the same effect, since, a manager who doesn't "know the territory" -- and his or her customers -- will likely have no choice other than to rely on head office lending criteria, which make little allowance for local conditions. By the same token, as at least one recent case study has demonstrated (Wickham et al, 1989), a bank manager's personal knowledge of his or her customers allows for a much more flexible credit policy, one more closely attuned to local economic needs and realities.

Info

By a ratio of about 5:1, CFIB survey respondents felt that their situation had worsened over the past three years with respect to continuity of account managers (CFIB, 1988, p. 11). This ratio was virtually identical to the proportion who felt that their

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* Here, it should be noted that while the CFIB study did not offer quantitative data as to the extent of centralization that has taken place in recent years, it did identify such centralization as a problem and in its recommendations called for increased decision-making at the local level.

situation had worsened with respect to lending criteria -- a fact which may or may not be coincidental.

In the CFIB survey, general dissatisfaction with banking services appeared to be quite directly related to the number of account managers with whom the business owner had had to deal. Only 20 per cent of respondents who had dealt with a single account manager over the past three years reported feeling such general dissatisfaction. Among those who had dealt with three account managers, the figure was 35 per cent; with five or more, 37 per cent (CFIB, 1988, p. 7). Overall, 27 per cent of survey respondents had had to deal with three or more account managers during the study period; the proportion ranged from 16 per cent of those banking with the Bank of Nova Scotia and 21 per cent of those doing business with the National Bank of Canada to almost 40 per cent of those banking with the Bank of Montreal. Other data showed the Bank of Montreal's small business loan rejection rate to be notably higher than that of any of the other chartered banks, (Ibid, p. 5) and that in "high turnover" situations even those businesses which did receive assistance were forced to put up more collateral and pay higher interest rates than other businesses. A more recent survey showed dissatisfaction with the service charges to be highest in rural areas and in small businesses with five to nine employees. Of this latter group, a full 65 per cent felt that current service charges did not represent good value for money.

While none of the above findings should, by itself, be regarded as definitive, taken together they do appear to point in the direction of a "generalized lack of financing for small firms,"(CFIB, 1988, pp. 4-5) particularly the smallest and newest and those located in rural areas. This is not to accuse the chartered banks of unfairness or discriminatory treatment; as the CFIB (1988, p. 5) itself notes, the banks are "not in the risk capital or equity financing business". It *is* to point out the need for *imaginative alternatives* to financing provided by the banks, particularly in the area of equity financing, where not just the CFIB but such organizations as the Atlantic Provinces Chamber of Commerce have noted numerous problems, the most serious being a high debt to equity ratio, which restricts firms' ability to invest. Such a weak equity base is a particularly serious problem at a time when, because of the Free Trade Agreement, many firms will need to be making additional investments in research and development and new technology of various kinds.

Another partial source of difficulty, one noted by the Economic Council of Canada in a recent research report entitled *Globalization and Canada's Financial Markets*, is the tendency of portfolio managers to restrict their portfolios to stock of those firms comprising major indices such as the Standard & Poor 500 index or the New York Stock Exchange index. Most, if not all, of these stocks are of larger firms; smaller firms seldom find their way into such indices. In 1987, the Council notes, the index of small firms traded over the counter declined much more rapidly than did the Standard & Poor or NYSE ones; this suggests that portfolio managers generally prefer to hold the stock of firms for which well developed futures and option markets exist. While in principle such a result would not necessarily mean further problems for outlying and less developed regions, in practice it does, since larger firms whose stocks are likely to be included in the major indices are more likely to have their head offices in central regions.

It might have been expected that with the development of new computer technology, location would become a less important factor in the provision of equity capital. In practice, however, this has not been the case at all. Indeed, with the globalization of financial markets, large national and international financial centres have come to take on increasing importance. Such centres (at both the national and international levels) facilitate face-to-face contact and allow would-be buyers to acquire a wide range of specialized information more quickly and easily than they otherwise could. As the Economic Council notes, this in turn "makes the judgement of risk more accurate and enables customers and financial institutions to obtain the financing they need at the appropriate price" (*Globalization*, p. 66). On the world scale, the tendency toward financial centres has caused an increasingly large proportion of activity to be concentrated in such cities as New York, London, and Tokyo. Within Canada, it has led to a concentration of activities in the "Big Three" cities of

Toronto, Montreal, and Vancouver -- again to the likely detriment of individuals and firms located outside these major centres.

As well, globalization has brought about a radical change in financial markets themselves. While it has provided financial institutions with many additional opportunities, it has also increased competition (see Organisation for Economic Cooperation and Development, 1985, 1989); for instance, foreign institutions are now in a relatively better position than in the past to compete with Canadian institutions for domestic Canadian business. But with globalization and free trade, Canadian financial institutions may well have to devote increasing attention to servicing markets in the U.S. or other countries. In some cases, as the Economic Council notes, this may mean directing resources away from established domestic markets. Indeed, increased competition may mean that Canadian institutions decide to withdraw from certain domestic markets where they do not feel they enjoy a comparative advantage. Here again, globalization could work against Canada's less developed and outlying regions, whose smaller markets are likely to afford fewer opportunities for large profit than markets in the centre of the country or the U.S. In this connection, it is worth noting, as the Economic Council has observed, that the benefits of the internationalization of financial services have so far mainly been realized by large corporations and governments, rather than smaller businesses or individuals.

Even prior to the recent wave of globalization in financial markets, Canada's less-developed regions have long suffered from a *lack of depth of supply* of equity capital. In Newfoundland and Labrador, for instance, there were as of 1988 effectively but five suppliers of equity capital: two public and three private. With so few suppliers, there can obviously be little competition among them. Moreover, given the relatively limited demand for equity capital, even those few suppliers which are active in the field are unable to handle very many or very large investments. One result is that investments in excess of $500,000, which could potentially be the most profitable to the suppliers, are extremely rare in Newfoundland. But so, too, are investments of less than $100,000, for which there is the greatest demand because of the extremely small size of most Newfoundland businesses. And because there are so few suppliers, many proposals (including some very worthy ones) are bound to be rejected simply because they fall outside the capital suppliers' areas of interest and expertise (ECNL, 1989).

Equally serious are a number of demand-side problems related to the mobilization of equity capital. Among the major demand-side problems identified in research on entrepreneurship and regional development are lack of information about financing alternatives (Polese, 1985), lack of the specific skills need to prepare financial proposals (Knight, 1985), lack of knowledge of how venture capital firms operate and of the role of equity capital in business (ECNL, 1989), unwillingness to share control with

Pensions

partners or venture capitalists (Martin, 1985), and lack of both general and specific management skills (ECNL, 1989). This last point is of particular importance in severely underdeveloped areas such as Newfoundland and Labrador. Not only does the lack of general management skills make it more difficult for prospective entrepreneurs to obtain the financing they need; lack of specific training in areas such as pension-fund management means that, *faute de mieux*, pension funds must be handled by managers from outside the province (typically located in major centres such as Toronto or Montreal). Such managers know less about potentially promising local investment opportunities than would managers resident in the province. Thus, the lack of training in-province pension-fund managers may well be contributing to the outflow of pension funds from Newfoundland (see ECNL, 1989).

Given the available data, it would be virtually impossible to provide a definitive answer to the question of *whether* these regions are in fact suffering from a shortage of capital as such. But in the final analysis, this question may well prove less interesting, and perhaps even less important, than that of *how* the less-developed parts of the country and manage to mobilize the capital they need to help reverse the vicious cycle of dependency and underdevelopment in which so many of them find themselves. Few serious students of regional development could dispute. For such communities to start developing and implementing alternatives to current mainstream capital mobilization mechanisms. Accordingly, the present paper focuses on alternative mechanisms, including those initiated by business, governments, and labour unions as well as those initiated by local communities. The heart of the paper is devoted to an examination of the recent Canadian experience and, to a lesser extent, the recent American and European experience with these mechanisms. This examination, in turn, leads to a consideration of which of these alternative mechanisms (if any) appears to be of greatest interest to community and regional development practitioners and policy-makers over the medium to long term.

Our purpose in writing this paper has been primarily educational. By *introducing* students and practitioners of regional and community development to a number of capital mobilization strategies and mechanisms which appear to offer some promise for future regional policy directions, we seek to stimulate debate on this important issue, debate which, we hope, will in turn lead to the formulation of new and more effective alternatives. While we have not hesitated to point out instances of success (or failure) in cases where there was a sufficient track record to be thus definite, our major aim has not been evaluation. Nor have we presumed to offer firm policy recommendations; the nature of the evidence available does not allow us to speak with such authority. Indeed, many of the mechanisms described in these pages are sufficiently new that it will be several more years before they can fairly and fully be evaluated. What we have tried to do is to point out that a wide range of strategies for mobilizing capital exist, that some of them do in fact have a significant track record (though rarely a sufficiently lengthy or well-documented one to allow for any kind of formal evaluation), and that certain of them may be of potential value in planning the directions of Canada's future regional policy. To the extent that we manage to achieve these admittedly rather modest aims, we shall count this paper as a success.

2 MOBILIZING EQUITY CAPITAL

The previous chapter raised the issue of mobilizing capital for purposes of regional development, noting the importance of that issue as well as the problems which Canada's less-developed communities and regions are experiencing in mobilizing the capital needed for their long-term development. Now it is time to consider specific capital mobilization mechanisms in more detail.

Therefore, in this chapter, we review the Canadian experience with tools for mobilizing equity capital. Such tools include stock savings plans, cooperative share savings plans, employee share ownership plans, employee investment funds, venture capital corporations, labour-sponsored venture capital corporations, and mechanisms for pension fund investments.

STOCK SAVINGS PLANS

Stock savings plans (SSPs) are designed to mobilize investment in equity capital through the provision of tax incentives to individuals. To date SSPs have been introduced by five provincial governments: Québec, Alberta, Saskatchewan, Nova Scotia, and Newfoundland and Labrador. Governments in Manitoba and British Columbia are studying the concept. The federal government does not operate a national stock savings plan, although this possibility has been discussed at federal-provincial conferences and at least two concrete proposals for such a plan were tabled: by the Progressive Conservative government of 1979 and by the Liberal government of the early 1980s.

The existing SSPs have several features in common. In all plans, individual investors purchase treasury shares from new stock issued by eligible, publicly traded companies. To be eligible, companies must operate a permanent office in the province in question. In return for investing in such companies, investors receive a credit against provincial tax or a deduction from taxable income. Credits or deductions are most generous in the case of shares of small or medium enterprises. Stock purchased under the plans must be held for two to three years.

Table 1 summarizes the main features of four of the five existing plans. Of these four SSPs, the Québec Stock Savings Plan offers the most generous incentives to taxpayers. The Saskatchewan Stock Savings Credit Program provides a flat 30 per cent tax credit for all categories of companies, while the other plans provide a sliding scale of incentive rates, with the largest incentives being linked to investments in small or emerging firms. The Nova Scotia Stock Savings Plan, for its part, permits eligible investments in private companies as well as publicly traded ones. Table 2 presents, by way of comparison, the eligibility criteria by category of business employed by three of the plans.

Table 1

Provincial Stock Savings Plans

Province	Start-up Year	Tax credit or deduction	Maximum credit/deduction on purchase price (as of May 1988)	Obligatory duration of stock holding	Equity generated to January 1988 ($ millions)	Number of new issues generated	Number of investors
Québec	1979	Emerging companies, 100%	10 per cent of personal income	2 years	4,000	200	14% of all Quebec (double from 1983)
		Medium companies, 75%	10 per cent of personal income				- more than 70% of taxpayers earning >$100K
		Major companies, 50%	10 per cent of personal income				- more than 40% earning $50 - 100K
Alberta	1986	Emerging companies, 30%	$3,000	2 years	100	39	n/a
		Expanding companies, 15%	$3,000				
		Mature companies, 10%	$3,000				
Saskatchewan	1986	All companies, 30%	$3,000	2 years	67	12	2,000
Nova Scotia	1987	Small companies, 30%	$3,000	3 years	n/a	n/a	n/a
		Medium companies, 20%	$3,000				
		(private and publicly traded)					

Source Gibbens, 1988; 1988; Mitchell and Medicoff, 1987; Saumier, 1987).

Table 2

SSP Eligibility Criteria for Businesses by Category

Province	Category	Asset Range	Revenue Range
		(Millions of $)	
Québec	"Emerging"	2 - 50	-
	"Medium"	50 - 250	-
	"Major"	> 250	-
Alberta	"Emerging"	< 5	< 6
	"Expanding	5 - 50	6 - 20
	"Mature"	50 - 500	-
Nova Scotia	"Emerging"	< 5	< 5
	"Medium"	5 - 25	5 - 25

Source Gibbens, 1988; Levesque, 1988).

Except for the case of Québec, it is too early to assess the impact of these plans. The introduction of both the Alberta and Saskatchewan plans coincided with a downturn in their respective provincial economies. As a result, initial participation in these plans by both companies and investors was sluggish. The stock market crash of October, 1987 led to further caution and, indeed, fear on the part of small investors. Nevertheless, the Alberta and Saskatchewan plans have generated, since their inception, nearly $170 million in new equity capital for firms based in those provinces. They have also increased the participation of taxpayers in the ownership of their regional economies.

The Québec Stock Savings Plan (QSSP) has been in operation for a decade and thus its impact can be examined in somewhat more detail than that of the more recent funds. The QSSP was introduced in 1979 by the Government of Québec largely as a means of providing relief from high tax rates to high income earners in the province. Yet Québeckers were slow to participate in the plan. Share ownership was not traditionally widespread in Québec, the province lacked a fully developed infrastructure of investment dealers and brokers and indigenous (francophone) firms tended to rely on debt, as opposed to equity, financing (Saumier, 1987).

A convergence of several factors resulted in the QSSP is playing a major role in the "entrepreneurial revolution" of the 1980s that followed the cultural revolution of the 1960s and 1970s. One of these factors was the buoyancy of stock markets in the world economy generally in the early and mid 1980s.

The QSSP's achievements were impressive. A study commissioned in 1986 by the Montreal Stock Exchange found that the QSSP had:

- reduced the tax burden on high salaries and reduced the income tax differential between Québeckers and their Ontario counterparts by about 15 per cent as of 1985;

- enhanced interest in the stock market on the part of Québeckers, with the proportion of Québeckers who were holders of common shares increasing by 125 per cent between 1977 and 1984;

- facilitated the revitalization of the investment industry in Québec, as measured by the number of new share issues, volume of trading, numbers of investment dealers, and employment of stockbrokers;

- contributed to a lowering of debt to asset ratios of manufacturing companies in Québec as opposed to those in Ontario;

- generated, through 1986, $3.5 billion, of which $700 million was directed to companies with total assets of less than $25 million;

- between 1979 and 1986 outperformed, as measured by a composite index of QSSP issues, other indexes such as the TSE 300 and the MSE Portfolio Index (Saumier, 1987).

The total cost of the program to 1986 was approximately $800 million in provincial tax revenues foregone. A subsequent study in 1988 by the Montreal Stock Exchange confirmed the findings of the previous study.

Data published in 1987 indicated that since its inception the QSSP had generated nearly $4 billion in equity investments at a cost of just under $1 billion in tax deductions. Although QSSP issues suffered considerable losses in the crash, they "did not do much worse than junior industrials and small capitalization stocks anywhere in the world in 1987" (Gibbens, 1987:5).

While the QSSP enjoyed considerable success in the early and mid 1980s, it also attracted critics. Some analysts argued that companies, encouraged by the plan, were being brought to market too early and that the quality of new issues was uneven. Others pointed out that the plan was subsidizing the issues of many large companies that did not require outside support to raise equity capital. In some quarters, the QSSP was viewed as a problem by venture capitalists. One reason may have been that, at the beginning, "blue chip" stocks enjoyed the same tax breaks as emerging, high-risk issues. The QSSP, wrote one observer:

> is a perfect example of how market conditions can be a blessing and a blight to venture investors. The QSSP allowed investors to exit readily and profitably from Québec-based investments. At the same time, the QSSP has effectively been competition to the venture capital community.

As a result, successive provincial governments moved to limit the incentives offered by the plan and to focus on support for emerging and medium-sized firms.

Particularly, in the immediate wake of the October crash, the QSSP appeared to be in peril. Between April and November, 1987, the QSSP composite index tracked by Lévesque Beaubien Inc. fell 39 per cent, compared to a decline of 20 per cent for the TSE 300 in the same period. In response, some 40 new issues were put on hold in the aftermath of October 19. The provincial government allowed companies extra time to buy back their own shares and encouraged the Caisse de dépôt et placement, Québec's provincial pension fund investment company, to support certain firms through private placements (Horsman, 1987; Wallace, 1987, Gibbens, 1988).

Assessing the fallout from the crash, *The Financial Post* (1987), while recognizing the role of the plan as a powerful stimulus to stock market investment in the province, argued in an editorial that the plan should be phased out. "Far better to reduce basic income tax rates for potential investors and then let them decide how and where to invest based on the merits of the investment, not the attractiveness of a tax break", concluded the *Post*. However, the Investment Dealers Association of Canada, the Montreal Stock Exchange and the Montreal Chamber of Commerce all called for a strengthening of the QSSP and increased tax deductions under the plan.

In its May 1988 budget, the Québec Government once more strengthened the QSSP as a policy instrument. In particular, the maximum allowable deduction on the purchase price of eligible shares was changed from $5,500 to 10 per cent of personal income.

In addition, emerging firms were redefined upwards in terms of maximum size of assets, from $25 million to $50 million. Measures were also taken to enable trading of QSSP shares on the secondary market (Levesque, 1988). In general, the provincial government demonstrated again how the QSSP, as a flexible policy instrument, could be modified and fine-tuned in response to changes in the economic environment.

By late 1989, however, the QSSP had begun to lose its appeal to investors for a different reason. A spate of takeovers in the post-crash era confirmed that many stocks eligible under the plan had been grossly overpriced by underwriters. A pre-recession shakeout in a number of sectors resulted in numerous sell-offs and mergers by Quebec firms, at bargain share prices. Small investors suffered most during this adjustment period (*Globe & Mail*, 1989).

As the 1980s came to a close, many observers claimed that the Québec entrepreneurial revolution had run its course. Many of the province's firms were scaling back, downsizing, and focusing on what they do best. Conglomerates were out; lean and highly specialized companies were in. To be sure, the QSSP had, by 1989, generated over $6 billion during Quebec's period of growth. But, the sense was that that period was over and that Québec entrepreneurs had begun to look to a new era in which the plan would play a less prominent role (McKenna, 1989).

Two important factors must be noted with respect to the QSSP's decade-long success. First, the province's high tax rates -- up to 70 per cent for high income earners in the late 1970s -- meant that tax incentives became an attractive policy instrument to both government and taxpayers. However, as André Saumier (1987:28), former President of the Montreal Stock Exchange, has observed: "This is a paradox. They provide higher taxes and then they provide tax breaks. These simply cancel each other out."

Second, the QSSP was instituted within the framework of a broad range of policy instruments and other initiatives intended to stimulate investment in the regional economy. These instruments included:

- Société de placement dans l'entreprise Québécoise (SPEQ), which provides taxpayers with a 125 (formerly 100) per cent deduction on the purchase of shares of private firms based in Québec;

- Employee Share Purchase Plan, which provides employees with tax deductions on investments in the companies in which they work with special incentives in the case of QSSP - eligible firms;

- Québec Cooperative Share Purchase Plan, which provides tax deductions for equity investments in registered cooperatives based in Québec;

- Solidarity Fund, a venture capital company controlled by the Québec Federation of Labour, which offers provincial and federal tax credits to investors (both individual and institutional), and which in turn invests venture capital in small and medium companies based in Québec.

- Société de développement industriel, which provides guarantees for equity issues and loans of firms based in Québec; and

- Caisse de dépôt et placement, the government-controlled manager of public sector pension funds, which engages in venture capitalism with emerging and expanding companies in Québec as well as investing in blue chip companies (see Table 3).

In 1988, investments in SPEQs, the QSSP, the QCIP and other tax incentive programs were grouped together in a single "strategic investment account" which received further tax benefits.

In times of crisis, the individual components of this policy framework can be mutually supportive. In particular, the Caisse du dépôt et placement and the Solidarity Fund played major (and often collaborative) roles in stabilizing the QSSP market in the wake of the October 1987 stock market crash (Gibbens, 1988). In contrast, in other provinces the crash's negative effects were not similarly mitigated because such additional instruments did not exist. In those provinces, SSPs operate in relative isolation and are not part of a broader policy framework.

Table 3

System of Instruments in Québec

Instrument	Sources of capital	Incentives	Investment target
QSSP	Individual investors	Tax deduction	Public companies based in Québec
SPEQ	Individual investors	Tax deduction	Private companies based in Québec
ESPP	Employees	Tax deduction	Public and private companies based in Québec
Solidarity fund	Individual investors/ Pension funds	Tax credit	Public and private companies based in Québec
QCSP	Individual investors/ Members of co-operatives	Tax deduction	Registered co-operative enterprises in Québec
Caisse de dépôt	Public pension funds	Yield	Public and private companies based in Québec
Société de développement industriel	Government funds	n/a	- Companies and co-operatives based in Québec (- guarantee initial capital offering?)

Source Levesque, 1988.

Experience to date with the stock savings plan in Québec suggests that the impact of such plans on regional economies can be significant. The many problems faced by SSPs include international stock market volatility, lack of listed companies in poor regions, unevenness of quality of issuing companies, lack of understanding of the market on the part of taxpayers and complexity of regulations governing the plans.

The Canadian experience to date suggests that successful SSPs must be located within a broader framework of policy instruments, must be tailored to meet the precise needs of taxpayers in a particular jurisdiction, should focus on small and medium-sized enterprises (both publicly traded and private) and must enjoy the support of the regional business and investment community. Sufficient infrastructure, such as brokerage services, must be available in the investment community if SSPs are to be used at maximum effectiveness. Perhaps most important of all, taxpayers must be made aware of the normal cycles of the stock market and of the consequent risk to which they subject themselves when they invest in an SSP.

In this connection, the question of a national stock savings plan, though admittedly complex technically, warrants further study. Research is warranted on whether the economies of scale to be realized through such a plan would outweigh its disadvantages, such as the costs of hiring federal civil servants to administer the plan and of foregone tax revenues. Another approach which also bears further examination is that of federal support for existing provincial plans. For instance, the federal government could provide "matching" tax incentives to those investors in those provinces already providing such incentives. Here again, cost-benefit analysis is in order to determine the likely effects of such an approach.

COOPERATIVE SHARE SAVINGS PLANS

Cooperative share savings plans provide tax deductions or tax credits for investments in preferred (non-voting) shares of registered cooperatives by employees and members of these cooperatives. The Québec Cooperative Investment Plan was the first cooperative share savings plan in operation in Canada. The Government of Prince Edward Island introduced a similar plan in the late 1980s. Although members of the cooperative sector have called for a nation-wide plan, concrete proposals have not emerged from any federal government.

Announced in 1985, the Québec Cooperative Investment Plan (QCIP) was designed to assist Québec cooperatives to increase their equity base, an area in which cooperatives have traditionally been weak. Under the plan, eligible investors -- members and employees of registered agricultural, forestry and worker cooperatives -- received a deduction on their taxable income of 150 per cent of the share purchase price (to a maximum of $20,000) in 1985 and 100 per cent in subsequent years. The maximum deduction was lowered to $12,000 in 1986 but is being increased by $2,000 annually, back to a maximum of $20,000 in 1990. The plan also offers an additional 20 per cent deduction of QCIP funds invested in registered retirement savings plans. In 1988, the provincial government announced that the maximum deduction for an investment in the QCIP would be 10 per cent of total income, regardless of amounts deducted for purposes of investing in the QSSP or the Solidarity Fund (see below) (Levesque, 1988).

Table 4 shows the growth of participation in the plan during its first three years of operation. Between 1985 and 1987, the number of cooperatives receiving investments under the plan nearly doubled, the number of participants increased by 50 per cent and the amount invested by participants rose by $1.5 million. In 1988, over 6,000 Québeckers invested $6.7 million through the QCIP in 91 cooperatives across the province.

Although it is too early to judge the impact of the QCIP, it would appear that the plan holds promise as an instrument to mobilize the savings of employees and members for the equity financing of cooperatives in the region. Whether the costs of the government in foregone taxes and the risks borne by individual investors will be outweighed by the performance of the cooperatives in business and job creation is a question awaiting further analysis.

Guérard (1987) has pointed out that, in the case of worker cooperatives at least, the impact of the QCIP is minimized by other features of the tax system which, in his view, discriminate against members of these organizations. Members are treated

Table 4

Investments in Québec Co-operative Investment Plan, 1985-1987

	1985	1986	1987
Number of co-operatives	51	84	91
Number of participants	4,049	5,295	6,007
Amount invested	$5,286,119	$5,591,616	$6,761,192

Source Gouvernement du Québec, 1988. solely as salaried employees and do not enjoy the same tax benefits of other owners of businesses who receive favourable tax treatment on salary advances and dividends. These are both treated as salary income for worker-owners. Furthermore, Guérard argues that members cannot take advantage of the employee stock savings plan to obtain a further deduction. He concluded that an overhaul of tax policy relating to worker cooperatives must be carried out through legislative change.

With respect to the federal government's role in relation to cooperative investment, a national task force in 1984 found that: "Unfortunately, cooperative capital renewal efforts have been hampered by the absence of an equitable tax environment for co-op investment. Federal government tax policy initiatives designed to encourage individual investment in Canadian business have failed to address the special nature of co-op investments" (National Task Force on Cooperative Development, 1984:46). The task force pointed out that while members of cooperatives already utilize cooperative equity in their long-term financial planning, cooperative equity investments are not normally as marketable as required by RRSP regulations. As well, regular stock investment plans "cannot accommodate the non capital-gain return characteristics of co-op shares" (*Ibid.*, p. 46) and thus tax incentives related to capital gains are not available to members of cooperatives. Cooperative patronage refunds -- a prime source of income for members -- are excluded from capital gains tax deductions and dividend tax credits conferred on investors in other private sector enterprises.

In light of the above considerations, the task force recommend that: "The federal government should develop a Co-op Registered Savings Plan that would encourage long-term tax deferred investment in cooperatives. Provisions of the plan would include: tax deferral provisions similar to existing RRSPs, group administration to minimize cost per member, and the opportunity for members to automatically contribute patronage refunds to such plans" (*Ibid.*:47). To date the Government of Canada has not acted on this recommendation.

EMPLOYEE SHARE OWNERSHIP PLANS

Employee share ownership plans (ESOPs) are mechanisms whereby companies provide incentives to their employees to purchase the shares of the firms in which they work. A wide variety of ESOPs have been sponsored by the Canadian private sector. Two provinces, Ontario and Québec, offer tax incentives to employees participating in ESOPs. In the United States, federal legislation provides generous tax incentives to ESOP sponsors and participants.

An early study of ESOPs in Canada found that the most effective plans are rooted in a number of important principles, including the following: participation in ownership should be significant; employee-held shares should be broadly distributed; direct ownership is more effective than indirect (i.e., through a trust) an ESOP should not be considered a substitute for good pay and fringe benefits; and employees should be able to increase their involvement in decision-making within the firm as well as in ownership if the ESOP is to achieve maximum effectiveness (Nightingale & Long, 1982, pp. 33-34).

There are basically two types of ESOPs sponsored by the private sector in Canada: share purchase plans and stock option plans. Share purchase plans enable workers to buy company stock that is available to the general public. In this case, employers will, typically, assist employees by providing market or commission discounts, loans, or payroll deductions. In return for such assistance, employees must agree to certain conditions which may include a restriction on the number of shares purchased, either as a proportion of salary or a reflection of rank, or a stipulation of the period in which shares become vested (i.e., become the distinct and portable property of the worker). Conditions often differ for managerial and non-managerial employees. Shares bought through ESOPs may also be held directly by the employee or indirectly by a trust, and "voted" by plan trustees -- usually management appointees (Toronto Stock Exchange, 1987).

Stock option plans, for their part, grant the worker the right to purchase a specified quantity of company stock at a stipulated price within a certain period of time. Typically, stock option plans are offered to managerial staff and contract employees or consultants. Different types of stock option plans may be offered to different ranks of employees (Toronto Stock Exchange, 1987).

A recent survey of the 1,100 companies listed on the Toronto Stock Exchange (TSE) found that nearly two-thirds of all listed companies offer some form of ESOP. Almost one quarter of TSE-listed firms offer share purchase plans. More than half of the listed companies offer stock option plans. In general, large companies offer a wise range of plans to all employees while small firms offer stock option plans to management and directors (Toronto Stock Exchange, 1987).

The Toronto Stock Exchange survey found that: "Canadian employers are highly positive on the impact of their employee share ownership plans on employee job attitudes and satisfaction, on employees' interest in the financial success of their companies and on employees' sense of ownership and participation within the company" (Toronto Stock Exchange, 1987:6). While employees were found to be less likely to attribute the impact of ESOPs to changes in their daily work experience or participation in corporate affairs, quantitative data indicated that companies with ESOPs are more than 25 per cent productive than their non-ESOP counterparts, and dramatically outperform their competitors in terms of profitability, return on equity and return on capital. Companies with ESOPs also were found to demonstrate lower debt-equity levels than their non-ESOP competitors.

The Toronto Stock Exchange study concluded that share purchase plans are the plans "most likely to generate widespread corporate change and economic growth", but only 31 per cent of plans at TSE-listed companies are of this type. For this reason, it urged government to provide incentives to encourage share purchase plans in order to ensure broad exposure to employee share ownership across the country. Such plans would, the study argued, lead to greater productivity and profitability at a significant number of firms, which would in turn stimulate further economic development (Toronto Stock Exchange, 1987, P. 59)

Where government has provided incentives for ESOP sponsorship and participation, employee ownership has grown rapidly. Research undertaken by the Government Auditor's Office of the United States (1986a,b) found that, between 1981 and 1986, the number of workers in that country participating in ESOPs increased from 4.25 million to 7.5 million. Observers attribute this growth to the incentive package provided by the federal government combined with favourable stock market conditions.

In Canada the federal tax framework currently provides immediate tax deductions for the employer in the case of various types of profit-sharing plans (i.e., cash-based profit-sharing plans, employee profit-sharing plans, profit-sharing pension plans and deferred profit sharing plans). The employee receives tax deferrals in most cases and a tax deduction only in the case of profit-sharing pension plans. However, special tax incentives are not available through the federal tax framework to ESOP sponsors or participants. At the provincial level, only the Ontario and Québec Governments offer tax incentives to employers and employees involved in ESOPs.

ESOPs have been criticized on a number of counts. One major concern is that employees bear all the risks of volatile international and domestic markets when they invest through ESOPs. For this reason, trade unionists argue strongly against replacing existing workers' pension plans with ESOPs. Other trade unionists are suspicious of ESOPs because, they argue, the plans undermine worker solidarity, by tending to promote workers' loyalty to their enterprise rather than to fellow workers in an industry or region. Still others note that ESOPs have seldom resulted in employees' gaining a substantial voice, through voting shares, in the management decisions of the company, such as mergers, sales, or dissolutions negotiated by management.

A different although not unrelated concern is that ESOPs restrict the mobility of employee capital to one enterprise. International market fluctuations and technological change may dictate the decline of some enterprises and the ascendance of new ones. These critics argue that employee capital should be mobile, free to invest in winners and to develop an investment portfolio that spreads and minimizes risk.

The models of the worker cooperative and the "democratic ESOP" offer responses to the criticism of lack of control. By legal definition, all workers in a worker cooperative own equal voting shares and elect a board of directors which, in turn, appoint and directs management. In Canada the worker cooperative form has been applied most frequently to small private firms that are not listed on stock exchanges. It is worth noting that Ontario's ESOP incentives do not apply to worker cooperatives. A democratic ESOP is one in which all workers, through a share ownership plan, own and exercise equal voting rights (one worker/one vote), control a block of votes (often through a holding company associated with their union), and exert a dominant influence over the affairs of the enterprise vis-à-vis other investors. This approach has been used in the United States.

With regard to the questions of worker solidarity and the mobility of employee capital, two other instruments for mobilizing equity capital may have stronger appeal to the labour movement than ESOPs. One of these instruments is the labour-sponsored venture capital corporation. The other is the employee investment fund, applied either on a national or regional scale. Both of these instruments emphasize collective, as opposed to individual, ownership of shares by employees.

Of the employee investment fund, a great deal need not be said, given the comparative lack of Canadian experience with this mechanism. Quite simply, employee investment funds (EIFs) are funds, collectively owned and controlled by employees, which are used for investment in private companies. EIFs are typically financed by a percentage of both company profits and wages. The funds are managed by trade unions, which hire experts to analyze and monitor investments. While EIFs have been studied and debated in several Western European countries -- for example, Denmark, Sweden and the Netherlands -- they have been widely applied in practice only in Sweden (see Heclo and Madsen, 1988; Matthews, 1989). The Swedish EIFs, now five years old, are managed by locally-based fund managers. Together the five funds, plus the government-controlled, national pension fund, may not control more than 49 per cent of the voting shares of any Swedish company. Fund guidelines provide that a local union may request that up to one half of the voting power of any shares in its company held by the funds be transferred to the local union.

No systematic assessment of the impact of the Swedish EIFs has been published to date. It can be expected that the funds, each possessing a particular regional base and loyalty, would emphasize investments -- and thus business and employment development -- in their home region to a greater extent than would a more centralized investment mechanism. It can also be reasonably expected that worker commitment and productivity would be somewhat higher in investee firms of the EIFs, since, to some extent at least, workers identify the EIFs as *their* investment instruments. These and other expectations should be tested against reality through empirical study. As well, the possibilities and limitations of EIFs as regional development mechanism for Canada also deserve study.

To be sure, the political and economic context within which EIF's must operate is quite different in Canada than it is in Sweden. In particular, Canada lacks Sweden's social democratic tradition; nor had this country's labour movement generally played a major role in economic policy formulation. These characteristics have, however, been more common during the recent past in Québec than elsewhere in Canada. Thus that province may be the most logical one in which to test an EIF approach.

VENTURE CAPITAL CORPORATIONS

Although many definitions of venture capital exist, practitioners, at least, would generally agree that venture capital is an investment in an enterprise that is not secured by assets. The investments can take the form of equity (common or preferred shares of the enterprise) or of non-secured debt (debentures) accompanied by common shares or by rights or warrants to purchase common shares at a later date (Shorewest Capital Corporation Limited, 1987:1).

The 1980s saw remarkable growth in Canada's venture capital industry. In 1974, the Association of Canadian Venture Capital Companies was formed by twelve founding members. In 1988, the Association's membership included fifty full and sixty associate members. In 1987, assets under management by venture capital organizations in Canada reached a record $2.3 billion, a 50 per cent increase from the previous year and a 77 per cent increase from 1985. While such startling annual growth is unlikely to be sustained indefinitely, the above figures indicate the emergent and dynamic nature of the industry.

Moreover, the structure of the venture capital industry is changing. The percentage of venture capital managed by independent, private firms is growing, reaching 50 per cent of all industry capital in 1987. Corporate subsidiaries manage 30 per cent. Government-related venture capital organizations manage 20 per cent, down form 28 per cent in 1985. In addition to being more numerous than before, private venture capital organizations are generally much larger today as well (*Canadian Venture Capital*, 1988). Furthermore, the sources of capital to finance industry activities have broadened considerably in the 1980s. In 1987, $800 million in new venture capital was committed by pension funds (37 per cent), foreign sources (19 per cent), individuals (17 per cent), corporations (15 per cent), and insurance companies (11 per cent).

Certain characteristics of the structure of Canada's venture capital industry are of relevance in connection with the problem of capital mobilization in the country's less developed communities and regions. First, most venture capital firms are concentrated in central Canada, with firms in Ontario and Quebec managing almost 80 per cent of the industry's funds. Firms in Atlantic Canada, in contrast, are virtually invisible in industry studies (see *Canadian Venture Capital*, 1988; 1987, b,c). Indeed, regardless of their head office location, capital firms tend to concentrate their investments in Central Canada (Association of Canadian Venture Capital Companies, 1987; Shorewest Capital Corporation, 1987). In addition, there is in the industry a strong tendency toward "later stage" investment in larger, more mature businesses, which are preferred by institutional investors. One report suggests that the entire industry spent only $500,000 on new start-ups in 1987 (Harrison, 1988). Moreover, the average size of venture capital investments is increasing; very few venture capitalists make investments of less than $100,000 (Shorewest Capital Corporation, 1987). All of these trends suggest that less-developed regions have comparatively less access to venture capital than do more developed parts of Canada.

Why are such concentration and centralization the case? Many observers would argue that there are fewer high quality projects in poorer and more remote regions than elsewhere. Others suggest that in such regions there is a lack of information flow and communication between potential investors and prospective investees. Still others note that the high overhead costs attached to operating in outlying, less populous areas strongly discourage venture capitalists from setting up shop there. It has also been pointed out that poor regions do not have the capacity to train indigenous venture capitalists; thus individuals from such regions interested in becoming venture capitalists must relocate to major centres in order to pursue their careers. While none of these explanations suffices by itself, each clearly has some merit.

That there is a least a broad perception of inadequate venture capital availability is suggested by the fact that almost all Canadian provincial governments have felt compelled to intervene in the venture capital market place by stimulating private investment in small business -- in particular, by offering either tax credits or tax-free grants (usually amounting to about 30 per cent of the investment in question) to individuals or companies that invest in registered venture capital corporations (VCCs). These mechanisms are also known as small business equity corporations (SBECs) or small business development corporations (SBDCs). Table 5 summarizes the venture capital programs offered by provincial and territorial governments across Canada. In 1986, these programs attracted, in all, about $310 million in equity investment.

Knight (1985b) has proposed additional tax incentives for investment in small firms generally and those in rural areas in particular. He has also proposed that these investments be designated by the federal government as eligible for inclusion in the portfolios of self-directed registered retirement savings plans (RRSPs). In a similar vein, the Keewatin Chamber of Commerce (1988) in the eastern Arctic has proposed the establishment of a northern-based RRSP.

Investing in VCCs is risky, whatever the extent of the benefits. The failure rate for small businesses is high. In addition, there is rarely a secondary market for VCC shares and thus this type of investment is not very liquid. Moreover, VCC investments generally take five to ten years to yield maximum returns (Gates, 1988). Canadians appear to want their governments to reward them for participating in such high-risk, slow return ventures through a system of tax benefits. But it remains to be seen whether Canadian governments, faced with increasingly severe fiscal constraints, will continue to increase such benefits in the years ahead.

LABOUR-SPONSORED VENTURE CAPITAL CORPORATIONS

Labour-sponsored venture capital corporations made their appearance in Canada in the 1980s. Labour-sponsored VCCs are venture capital funds owned and controlled by labour organizations. They seek to invest in small and medium-sized enterprises in order to create and sustain employment. Such funds often seek to promote job security for their members, contribute

Table 5

Venture Capital Programs by Province and Territory, 1986

Jurisdiction	Extent of government assistance through venture capital programs	Number of registered venture capital companies assisted	Vehicle for venture capital
	(Millions of $)		
Alberta	73.1	461	Small Business Equity Corporation
British Columbia	8.5	32	Small Business Venture Corporation
Manitoba	5.0	67	Venture Capital Corporation
New Brunswick	.9	8	Venture Capital Corporation
Newfoundland and Labrador	1.2	n.a.	Venture Capital Corporation
Northwest Territories	.25[1]	n.a.	Venture Capital Corporation
Nova Scotia	34.5	48	Venture Capital Corporation
Ontario	131.5	899[2]	Small Business Development Corporation
Prince Edward Island	5.7	22	Venture Capital Corporation Small Business Development Corporation
Quebec	14.6	96	Quebec Business Investment Company (SPEQ)
Saskatchewan	34.3	55	Venture Capital Corporation
TOTAL	309.6	1,688	

1 Data supplied by the territorial government.
2 Of which 300 have been de-registered.

Source McQuillan et al, 1987; interviews.

far the largest, labour-sponsored VCC is the Solidarity Fund of the Québec Federation of Labour. In 1988, the Fund reported assets of $180 million and 65,000 investors, most of whom were union members. Between 1984 and 1987, the Fund made 21 investments worth $16 million. The Fund claims to have created or saved 7,000 jobs through these investments. Investments, which range from $150,000 to 42 million, are directed to small and medium private enterprises based in Québec, with an emphasis on communications, distribution, EDP software and service, forest products and industrial manufacturing. The Fund typically purchases 25 per cent to 33 per cent of the equity of an investee firm and requires directorships as well in return for its investment, which may take the form of equity, or debt with equity (*Canadian Venture Capital*, 1987a, Shorewest Capital Corporation Ltd., 1987).

The Solidarity Fund's major source of capital is the long-term investments of individuals, who receive federal and provincial tax credits equal to 40 per cent of their investment. Pension funds may also invest in different categories of shares in the Fund. Governmental support of the fund helped it attract initial investors. In 1983, the Government of Québec provided a $10 million loan on favourable terms to the Fund; a year later, the federal government matched this loan and added a $1 million grant for education activities related to the Fund (see Jackson, 1988).

A second labour-sponsored VCC is that of the Cape Breton Solidarity Fund, sponsored by the Cape Breton District Labour Council. This fund, initiated in 1986, seeks to channel pension funds generated in the area to local development initiatives in order to create jobs in Cape Breton. The Cape Breton Solidarity Fund, currently in the process of starting up, has targeted five per cent of the $300 million in pension funds of which Cape Breton workers are members. The Fund would be professionally managed and would seek to earn a reasonable rate of return (*Workplace Innovation*, 1988).

A third labour-sponsored VCC worthy of mention is Working Ventures, the national venture capital corporation of the Canadian Federation of Labour (CFL), which represents 225,000 workers who are mainly employed in the building trades. Announced in March 1988, Working Ventures offers a federal tax credit of 20 per cent on investments in the shares of the Corporation. This tax was provided in the 1988 federal budget. The CFL is presently negotiating with provincial governments to obtain a matching tax credit along the lines of that enjoyed by the Québec Solidarity Fund. Under certain conditions, an investment in Working Ventures will qualify as part of a self-administered registered retirement savings plan (*Globe and Mail*, 1988).

In 1989, the Ontario Federation of Labour (OFL) approved the establishment of a "social investment fund" designed to invest in "socially useful" projects such as low-cost and cooperative housing, environmental technologies, and businesses run by low-income individuals. The OFL has thus opted for a model significantly different from the Quebec Solidarity Fund. For its part, the British Columbia Federation of Labour plans to launch a venture capital fund in that province later this year. This fund, in contrast to the OFL's, will be structured along the lines of its Quebec counterpart. At the national level the two million member Canadian Labour Congress (CLC) is also studying the feasibility of launching a national venture capital fund. Earlier this year, the federal government published draft legislation to enable individual investors to receive 20 per cent tax credits for investments in the VCCs of both the CLC and CFL.

Another type of venture capital corporation, in addition to privately-owned and labour-sponsored VCCs, is the community-owned venture capital corporation (COVCC). Although Canadian experience with this structure is limited to COVCCs which provide loans to small businesses, Perry (1987) reports on American COVCCs which use equity as their primary investment strategy. Often these COVCCs take the form of joint ventures and partnerships involving community development corporations (CDCs) on the one hand, and outside private investors, on the other.

Perry (1987:165) points out that CDCs can offer valuable advantages to their private sector partners in development projects, including:

> ...the matching capital from the CDCs own funds. Or, for others, it might be control of a valuable piece of property deeded by the city to the CDC for development purposes; or a responsible management team ready to carry out the project; or the ideas and a well-worked-out plan for the venture; or influence with those (for example, government officials or departments, other possible investors, etc.) who can help make the project profitable; or many other possible advantages, such as non-profit, tax-exempt status.

Because of special tax incentives under American law, private investors have most frequently joined with CDCs in partnerships to rehabilitate and construct low-income housing.

The American experience with COVCCs suggests that Canadian governments should examine the advantages and disadvantages of providing community-owned VCCs with the same tax advantages as privately-owned ones. In some jurisdictions, such as the Northwest Territories, this distinction seems not to matter; the benefits to the two types of VCC are the same. However, in other jurisdictions, COVCCs do not receive equal treatment with regard to taxes. As means of mobilizing equity capital which often originates from different sources and motivations than those of private VCCs, COVCCs could be a potentially useful alternative mechanism for mobilizing equity capital to promote regional development in Canada.

MECHANISMS FOR PENSION FUND INVESTMENT

Pension funds have become a major source of venture capital in recent years. "As Canadian pension groups gain more experience in investing in venture funds (and assuming there are no major disappointments), they will continue to be the major source of capital for venture funds" (*Canadian Venture Capital*, 1987b:23).

Pension funds can be channelled to small and medium-sized enterprises through a variety of mechanisms. One such mechanism is a government-owned investment company. In Canada, the best-developed example of this mechanism is Québec's Caisse de dépôt et placement. Created by the provincial government in 1965, the Caisse managed, in 1988, about $32 billion in public pension and insurance plan assets. In 1986 the Caisse reported $225 million in equity and debt investments in medium-sized enterprises based in Québec.** During the same year, the Caisse allocated $435 million to the establishment of three new venture capital companies. The Caisse has thus become a major player in the promotion of ventures in the region (see Caisse de dépôt et placement du Québec, 1986 and 1988). Similar use has been made of public employee retirement systems of the United States. There, state governments, in particular, have made extensive use of public employee retirement systems to support venture capital efforts. (MacDonald and Perry, 1985:36).

** For 1988, this figure was $207 million.

The Government of Canada has also experimented with other mechanisms intended to stimulate pension fund investment in small and medium-sized enterprises. The 1985 federal budget, in particular, created a range of vehicles designed to attract venture capital from pension funds though tax incentives. The primary method employed in the budget was to offer an expansion in foreign property limits to pension funds in return for investment small business.

The 1985 budget created three qualifying vehicles for this purpose: the Small Business Investment Corporation, (SBIC) the Small Business Investment Limited (SBILP) and the Small Business Investment Trust (SBIT). For every one dollar pension funds invest in these vehicles -- which in turn is invested in prescribed Canadian-controlled venture capital corporations (through none are prescribed by the budget for the Atlantic provinces or the territories) or Canadian corporations with assets of less than $35 million -- pension funds receive a three dollar expansion in their foreign property limited (see Figure 1).

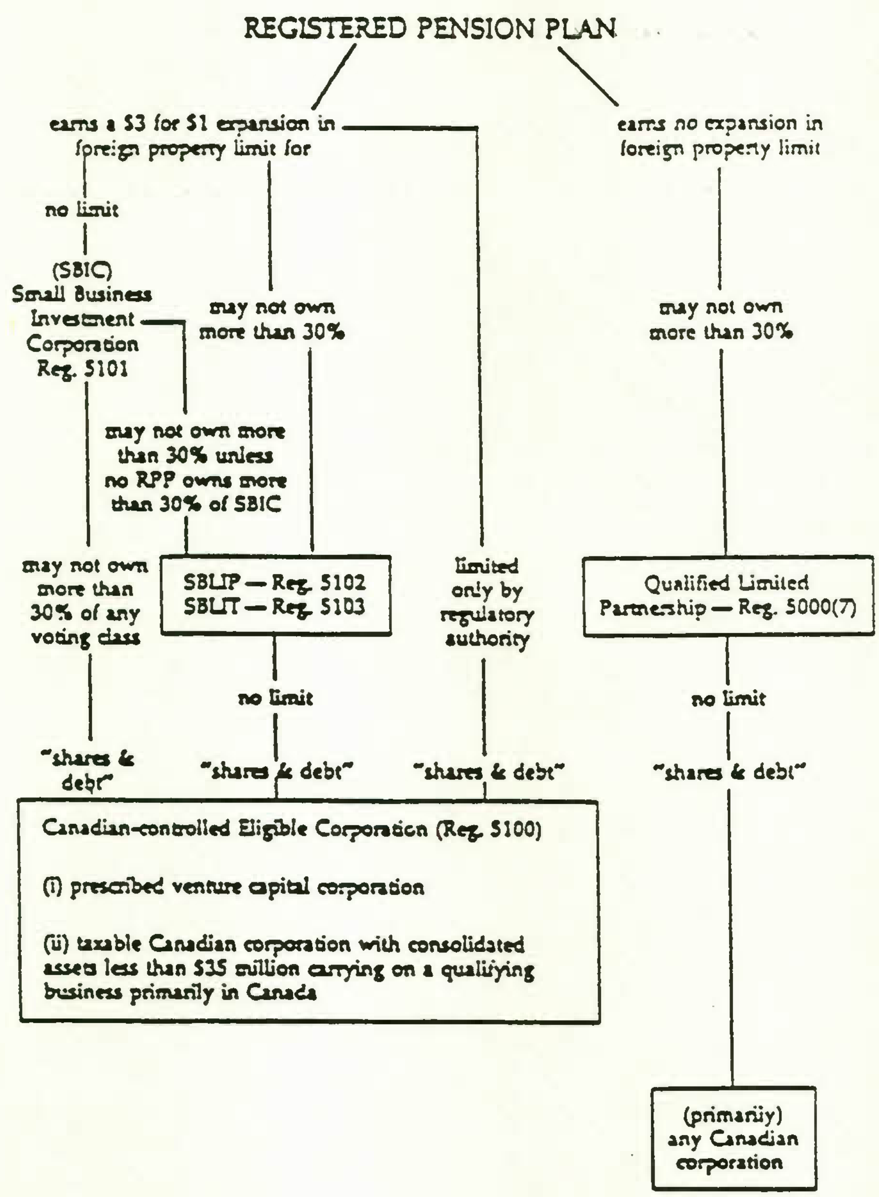
While there is little substantive difference between an SBILP and an SBIT, there are important differences between an SBILP and an SBIC. In particular, the limited partnership is granted up to three years to invest most of its capital; the SBIC has only three months to do so (McQuillan et al, 1987).

One striking feature of the 1985 budget was the total lack of monitoring, on the part of Revenue Canada and the Department of Finance, of the use of these mechanisms by pension funds. No evaluative data are available to assess the impact of these measures -- a lack which makes it difficult to determine whether the provisions have had the desired effect.

By early 1990, institutional investors were lobbying the federal government to expand its foreign property limit yet again. With an eye to the high-growth stock markets in western Europe and southeast Asia, in particular, pension funds sought greater flexibility in investing across national boundaries. The impact of increased pension fund investment abroad on employment and development prospects in Canada's poorer regions is a matter which bears further research.

Figure 1

Venture Capital Opportunities for Registered Pension Plans



Source: McQuillan et al, 1987, p. 158

3 MOBILIZING DEBT CAPITAL

The purpose of this chapter is to review the Canadian and American experience with tools for mobilizing debt capital for small and medium-sized enterprises. These tools include micro-credit programs, community loan funds, community banks, credit unions, loan guarantees, business development crentes, small business development bonds, and program-related investments.

MICRO-CREDIT PROGRAMS

One type of program which deserves further attention and study is the micro-credit program. Typically, a micro-credit program will provide very small amounts of debt capital to persons wishing to start or expand their own micro-enterprise. Micro-enterprises are generally:

> Extremely small, often labour-intensive, economic activities which require a minimal capital investment, and which may operate on a full-time, part-time, or seasonal basis. They are usually community or home-based and can be found in both urban and rural areas. Micro-enterprises are often described as the "informal" or "invisible" sector. They operate in the trades, service or small-manufacturing sector.
>
> (Calmeadow Foundation, 1987:2)

Advocates of micro-enterprise as a means of providing employment and income opportunities to socially and economically disadvantaged citizens recognize that self-employment through micro-enterprise will not, by itself, solve the problems of low-income people, but it can provide a significant boost to people who lack the education, skills, contracts or experience to break into the economy at a higher level (Calmeadow Foundation, 1987:2).

One important Canadian micro-credit initiative is the Native Self-Employment Loan Program of the Toronto-based Calmeadow Foundation, a non-governmental organization. Under a pilot program launched in 1987, the Foundation provided credit to Native people for micro-enterprise development on three Ontario Indian reserves. Short-term loans up to a maximum of $3,000 (with an average size of $2,000) were provided through an intermediary, usually a private bank, with Calmeadow assisting with guarantees and subsidizing the transaction costs of the loans. Calmeadow also provided training for the responsible officers of the intermediary. The total budget for the three-year program was (in addition to salaries for field staff, who undertake extensive travel on behalf of the program), $300,000, including a $100,000 loan fund.

why not a credit union

The Native Self-Employment Loan Program was designed as a demonstration effort. The program's original objectives included testing the credit worthiness of Native micro-entrepreneurs; measuring the impact of credit provision on beneficiaries in terms of income levels, job creation, and local economic activity;

determining the market for micro-credit at the local level; and developing a low-cost, effective credit delivery mechanism.

Other features of the program are worthy of note, as well. Borrowers were obliged to form small groups of four or five persons. These "borrowers' circles" assessed individual applications, collected payments, and negotiated loan guarantees. Each borrower received his or her loan in succession, after the previous member of the group had successfully met repayment requirements.

In early 1990, after an extensive evaluation, Calmeadow decided to take its Native Self-Employment Loan Program national. It will soon be sponsoring borrower's circles in Native communities across Canada. To this end, it has raised a significant capital pool from both public and private sources.

Thanks to Calmeadow's work, the Business Development and Loan Center for Inverness County of Cape Breton has established a $40,000 fund to be used for micro-loans or guarantees for new groups in the county. The Sydney-based centre for Community Economic Development facilitated the connection between Calmeadow and the Inverness County Organization.

Although Calmeadow initiatives are very new, similar methods have been applied for larger periods and to other Canadians in other contexts for longer periods and with great success. For example, ACCION International, a non-profit organization, provides assistance to nearly 20 local foundations operating micro-credit schemes for poor traders in urban areas of ten countries in Latin America. Short-term loans, averaging $300 each, are provided to "solidarity groups", whose members collectively guarantee the loans made to each individual business. Between 1983 and 1986 these schemes assisted more than 17,000 businesses. The aggregate loan repayment rate for all the schemes was 98 per cent. The loans served to create between .5 and 1.5 jobs per business at a cost of less than $1,000 in credit extended per job. "This is one-tenth to one-twentieth the cost of creating a job in the formal sector", notes the Calmeadow Foundation (1987:18). In 1988, ACCION International and Calmeadow Foundation (1988) published a manual of operating micro-credit programs.

A second impressive overall example is that of the Grameen Bank of Bangladesh, established in 1976 with start-up funds from the Government of Bangladesh and the International Fund for Agricultural Development (IFAD). The Grameen Bank lends very small amounts, averaging about $75 each, to landless and illiterate borrowers in rural areas of Bangladesh to assist them in establishing micro-enterprises. Over the past fourteen years the bank has lent more than $50 million to 500,000 Bangladeshis. The loan repayment rate during this period has been 98 per cent.

In 1988, the bank operated 400 branches in 7,000 villages across the country. Loan officers travel to villages by bicycles to collect payments from borrowers' clubs, which approve all loans, and deliver lectures to villagers on potable water, health and hygiene and other aspects of development (Johnson, 1988). Over the next five years, the Grameen Bank plans to double the number of its branches, officers, and customers across Bangladesh, with assistance from the Ford Foundation, IFAD, and a number of bilateral donor agencies, including the Canadian International Development Agency (see also Tendler, 1989).

COMMUNITY LOAN FUNDS

Community loan funds (CLFs) are non-profit organizations which lend short-term debt capital to community enterprises and local projects. A community loan fund administers a revolving fund financed by individual and institutional investors, such as religious organizations, foundations, and businesses and other organizations. A board of directors representing various investor groups and local community interests oversees the operations of the community loan fund.

CLFs are best developed in the United States, where many enjoy tax-exempt status. The National Association of Community Development Loan Funds groups together 35 CLFs from across the U.S. with combined assets of $55 million U.S. in 1989. In 1988, the NACDLF launched a $1.5 million U.S. "seed fund" to assist in the establishment of new loan funds across the country. A leading player in the National Association -- and one of the most active

CLFs in the country -- is the Institute of Community Economics, based in Greenfield, Massachussetts. The Institute operates its own revolving loan fund established in 1979, which had lent nearly $12 millions U.S. by late 1989. In 1987 alone, the fund received $1.4 million U.S. from lenders and placed $2.5 million U.S. in loans to community development projects (Matthei, 1987; to Institute for Community Economics, 1988; Franklin Research and Development Corporation, 1989).

In 1987, 86 per cent of the fund's lenders were individuals; the remainder were institutions -- mainly religious organizations and foundations. Lenders originated in 32 states but were concentrated in the Northeast. Loans from lenders ranged in size from $1,000 U.S. to $1,000,000 U.S., in accordance with the pattern shown in Table 6.

Table 6

Percentage of Loans by Size of Loan from Lenders
Revolving Loan Fund, Institute for Community Economics

Size (U.S. $)	Percentage of loans
1 - 10,000	65
10,001 - 25,000	17
25,001 - 50,000	11
50,001 - 100,000	6
60,000 and over	1

Source Institute for Community Economics, 1988.

Nearly two thirds of the loans to the fund were for terms of three years or less but almost half of these were extended. "Most lenders choose to receive below-market interest returns, as part of their commitment to those in greatest need", notes the Institute (*Community Economics*, 1987:3). Nearly half of all lenders paid an interest rate of between 3 and 6 per cent, and nearly one-fifth of lenders received no interest at all.

The Revolving Loan Fund of the Institute for Community Economics, like other CLFs, has sought to match community oriented investors with investment opportunities in the community. Loans made by the Institute's fund to community initiatives break down as shown in Table 7. While the funds has concentrated its lending in community land trusts and cooperative and non-profit housing, it has channelled over U.S. $700,000 to worker-owned businesses, consumer cooperatives, and non-profit enterprises.

Table 7

Percentage of Loans by Borrower, Revolving Loan Fund, Institute for Community Economics

Borrower	Percentage of loans
Small cooperative businesses	9
Land and housing groups	83
Community service organizations	8

Source Institute for Community Economics, 1988.

Loans for real estate ventures are secured by collateral on land and existing buildings. Equipment, inventory, and receivables are employed as collateral in business lending. In other cases, guarantors are used. The interest on loans paid by investee organizations varies. Approximately two thirds of all loans carried interest rates between 6 and 9 per cent, with very short loans carrying the highest interest rates.

As of 1988, the Revolving Loan Fund of the Institute for Community Economics had written off a total of U.S. $2,583, or .03 per cent of the $9 million U.S. loaned over the past decade. Moreover, no lender had lost any funds during this period (Institute for Community Economics, 1988). Part of the reason for the fund's success appears to be that the Institute for Community Economics provides investee organizations with a comprehensive support package, including financing, technical assistance and organizational development. The Institute is thus itself an active and demanding investor.

Most funds which are members of the NACDLF, like the Institute for Community Economics, invest heavily in low income, cooperative and non-profit housing and in land trusts to hold land for such projects. One exception is the revolving loan fund of the Boston-based Industrial Cooperative Association, which focusses exclusively on loans to worker cooperatives. CLFs work with borrowers to strengthen their proposals and, having provided financing, assist borrowers to subsequently obtain "mainstream" financing. CLF dollars thus lever additional capital from conventional sources (Bronstein, 1985).

In Canada, there are relatively few CLFs. For the past seven years, the Ottawa-based Communityworks Inc., a non-profit agency, has made three-year loans of up to $30,000 to cooperatives in eastern Ontario and has played an active role in financing non-profit housing in the area. In Toronto, the Canadian Alternative Investment Cooperative, financed by 40 religious orders and charitable organizations, lends a portion of its $2 million in assets to cooperative enterprises and social housing projects.

In recent years, revolving loan funds focussing on community enterprises have been established on a national basis by the United Church of Canada and locally by such agencies as Womenskills of Vancouver, the Local Enterprise Trust Society of Lethbridge and the Ontario Social Development Council, which operates funds supporting women's self-employment in three centres in Ontario. The Cooperative Resources Pool, started by cooperative activists, has established a loan fund for cooperatives in Ontario. In Nova Scotia, the Extension Department of St. Francis Xavier University has set up the Community Development Cooperative, which operates a loan fund for cooperatives in the area. In 1989, a new affiliate of the international organization Women's World Banking was established in Cape Breton by Sydney-based Venture Concepts. The new group will provide loans and loan guarantees, as well as training, to women starting up new businesses on Cape Breton Island.

The loan fund of the United Church of Canada, started in 1987 by the church's Economic Animation Project, provides loans to cooperatives and enterprises owned by non-profit organizations in order to promote community economic development, particularly in economically depressed areas of the country. Loans are made on a short-term basis up to a maximum of $50,000, carry an interest rate of 8 per cent and are secured by mortgages on property or chattel mortgages on equipment. Applicants must carry out a feasibility study to demonstrate the viability of their venture and produce a detailed financial plan. Applications are screened first by the appropriate regional bodies of the church and then forwarded for assessment by a national steering committee (United Church of Canada, 1987).

Although Canadian CLFs are active, creative instruments, they remain small-scale and thus limited in their impact. For example, the Cooperative Resources Pool manages $50,000 in its fund; the Community Development Cooperative, $65,000. Even the more active funds rarely exceed $.5 million in assets. Governments could facilitate the growth of these funds by providing loans to be used as security to attract larger investments from individuals, religious organizations, foundations, corporations, and pension funds. When the funds have achieved a viable, self-sustaining "critical mass" of capital, they can repay these government loans in full.

Two practical handbooks on community loan funds have appeared recently. One such manual is entitled *A Guide to Community Revolving Loan Funds*, published by the Voluntary Fund for the United Nations Decade for Women (also known as UNIFEM). In 1987, the Institute for Community Economics published *The Community Loan Fund Manual*. A handbook on operating CLFs in the Canadian context has not yet been produced. Such a handbook would certainly be a useful resource for community development practitioners.

OTHER MECHANISMS

A number of other mechanisms have been used to provide debt capital to small businesses and local development projects. One such mechanism is the community bank. The community bank had been most extensively developed in the United States, where banks may be chartered on a local basis.

The South Shore Bank of Chicago, with assets of more than $130 million, is the most developed community bank in the U.S. Now more than fifteen years old, this bank was formed by community activists to reverse the capital outflow from the South Shore of Chicago and to rebuild local neighbourhoods. An important tool used by South Shore has been "Development Deposits", which are insured, market-rate deposits by investors from outside the South

Shore locality. These deposits, in turn, are used to rehabilitate housing, pay college tuition and finance small businesses and non-profit organizations. Over $85 U.S. million has been provided in credit to neighbourhood residents under this program. Current assets in Development Deposits now total nearly $60 U.S. million.

Community banking has also been conducted in New Zealand, within the general framework of British law. An approach used by at least one financial intermediary in that country is to require community-based agencies, as borrowers, to solicit deposits on behalf of the lender. These deposits, made by individuals and organizations, are used, in turn, to secure a portion of the loan made to the borrower. At the same time, the lender agrees to pay the borrower a commission on these deposits at a relatively high rate. The borrower remains free to negotiate actual rates of interest on deposits that are lower, although the commission on low-rate deposits is proportionately reduced (McKinlay, 1985).

A somewhat better known mechanism is the credit union, or caisse populaire. These are financial cooperatives which are owned and controlled by their members. Members of the credit union or caisse populaire must also be members of a "bond of association" group -- which may be defined by geographic area, place of work, type of work, ethnic group, or gender -- in whose interest the credit union is founded. Members each receive one vote to elect the board of directors of the credit union. The board, in turn, appoints senior management.

Local credit unions are members of provincial federations of credit unions, known as centrals. Provincial centrals are federated at the national level. National federations may belong to the World Council of Credit Unions, which represents nearly 83,000 credit unions worldwide managing over $500 billion U.S. in assets (Co-operative Union of Canada, 1987; World Council of Credit Unions, 1985).

In 1986, credit unions and caisses populaires in Canada managed nearly $50 billion in assets, fully half of which originated in Quebec. Total assets of the credit union movement represent nine per cent of assets of all financial institutions in Canada. Credit unions and caisses populaires lent over $37 million to members for personal and business purposes in 1986. Nearly nine million Canadians are members of credit unions and caisses populaires (Co-operatives Secretariat, 1988, Cooperative Union of Canada, 1987).

Many credit unions offer a full range of banking services. Credit unions and caisses populaires have been noted for their innovation in the areas of member services, automated teller machines, daily interest savings and flexible loans and mortgages. The Desjardins movement of caisses populaires in Quebec has promoted the concept of social auditing, a process of measuring the impact of credit unions on local community development (see Ellmen, 1987).

Although the chartered banks continue to be, by far, the major providers of credit to small businesses in Canada, credit unions and caisses populaires are slowly gaining ground in the field of business lending. In Nova Scotia, for example, there are indications that centralized lending procedures and high service charges on the part of the banks are causing an increasing number of small businesses to seek credit at local credit unions. Entrepreneurs report that they appreciate the personal service, knowledge of local businesses, and the ability to make rapid decisions which characterize credit unions (Butters, 1988).

LOAN FUNDS

In fact, some credit unions have made special efforts to assist small businesses and community enterprises. In Quebec, caisses populaires in the Desjardins movement have sponsored or financed worker cooperatives, housing cooperatives, seniors' housing, youth training projects, housing for disabled adults, community libraries and special no-interest loan funds for unemployed workers (Credit Union Central of Ontario, 1987a). In Ontario, Bread and Roses credit Union has loaned over $800,000 for community development projects initiated by worker cooperatives, housing cooperatives, and non-profit organizations. Over the past ten years this credit union has financed over 300 initiatives and organizations. In Vancouver, the CCEC (Community Congress for Economic Change) Credit Union has, since 1974, provided low-interest loans to cooperatives and community enterprises. In the same city, the Vancouver City Savings Credit Union, Canada's largest credit union, operates a seed capital program to support new private businesses which are not eligible for conventional financing (Ellmen, 1987).

The Credit Union Central of Ontario has produced materials for its membership on ways in which local credit unions can promote community economic development (CED). Among the activities which credit unions can undertake in this area are self-education, public education, provision of general advice and assistance to local initiatives and establishment of special programs to provide secured lending to local businesses. With respect to lending to CED ventures, credit unions can, among other things:

-IDEAS

- set up a marketing program to attract deposits of community organizations, charities, and non-profits;

- establish a community lending advisory committee to help pinpoint community needs and provide advice on specific loan applications;

- set up a special lending fund with below-market rates, supported by below-market rates for deposits;

- establish a working relationship with other community agencies that can provide loan guarantees or risk capital for worthy community projects;

- become the primary financial institution for all private non-profit and non-profit co-op housing projects providing financial services and mortgages, whenever possible;

- establish a special no-interest loan program, supported by no-interest deposits, for families in distress situations;

- reduce or drop all service charges for community groups;

- set up an increased interest rate for term deposits by community groups";

(Credit Union Central of Ontario, 1987a:5)

The Credit Union Central of Ontario has published a discussion paper, entitled *Developing and Launching A Community Development Lending Program*, which provides guidelines for the operation of a model lending program.

The role of credit unions and caisses populaires has been particularly critical to the economic and social cohesion of Acadians in the Maritimes (see Daigle, 1987). One illustrative case is that of Evangeline in Prince Edward Island, where the area's 2,500 residents have promoted cooperatives for several generations. Today, fifteen cooperatives provide 324 jobs and a wide range of services to the community, including fish processing, groceries, hardware, health services, handcrafts, lumber and funeral services. In 1986, these cooperatives paid out nearly $870,000 in wages, about $190,000 in rebates and $430,000 in interest on savings and shares. Arsenault (1987:8) has noted that:

> The backbone of this cooperative system is the Evangeline Credit Union, which provides the banking services for most of the residents. This credit union -- one of the strongest in the province has 2,900 members and $10 million in assets.

It is worth noting that the credit union has played a key role in financing the start up of a new worker cooperative which produces potato chips. Several financing methods were used. Cooperative members borrowed $70,000 from the credit union for the purpose of member's equity; the credit union invested $51,000 in common shares in the cooperative, as a working capital loan secured by a second mortgage, and the venture capital arm of the credit union invested $35,000 in the new enterprise (Iler, 1987). It is also noteworthy that the current provincial Minister of Industry, who has supported the cooperative movement in Prince Edward Island, is a former Manager of the Evangeline Credit Union.

Some observers argue that the cooperative movement has been a major contributor to the survival of the French langauge in the area. "Unlike most other Acadian areas of the province, the Evangeline area has not suffered major assimilation", observes Arsenault (1987: 7-8). It would seem that, in the case of Evangeline, an interaction of economic, social, and cultural factors has been responsible for the strong commitment to self-reliance and co-operation in the area.

In certain cases governments have played a more direct role in local development by providing loan guarantees for community initiatives. For example, in Prince Edward Island the Department of Industry offers such a service. Community organizations wishing to finance an economic development project apply to the Department for assistance. If the application is approved, the Department transfers the required amount for the guarantee (to a maximum of $50,000) to the P.E.I. Development Agency which in turn arranges to guarantee the loan through a private bank or credit union. Upon repayment of the loan by the community group, the government obligation is to guarantee the loan is dissolved and the funds revolve for use by other groups.

One important feature of the Prince Edward Island loan guarantee program is that Departmental staff make frequent visits to meet with community organizations and assess local projects. The small size of the island and its population perhaps permits more regular on-site contact than in more remote regions or those with larger populations elsewhere in the country. Nevertheless, the outreach factor is an important one, and bears examination and perhaps replication in other parts of Canada.

BUSINESS DEVELOPMENT CENTRES

Business development centres (BDCs) are federally-funded, non-profit corporations, directed by community-based boards of directors, which pool capital and, in turn, provide short-term loans and equity capital for small businesses in a locality. At the same time, BDCs also offer technical assistance to emerging enterprises. The BDC is a key instrument of the Community Futures Program of the Canada Employment and Immigration Commission.

Under current CEIC regulations, BDCs may lend up to $75,000 per firm. A ceiling of $1.5 million has been set as the maximum loan fund to be managed by any one.

The *Community Futures* Program is directed both at non-metropolitan areas with exceptionally high unemployment and at those anticipating major layoffs in their main industries. A local Community Futures Committee selects an appropriate mix of activities from five program options: BDCs, incentives for self-employment, relocation assistance, direct purchase of training and a community initiatives fund (Decter, 1989).

The precursor of the BDC was the LEAD (Local Employment Assistance and Development) Corporation, supported by CEIC in the early 1980s. By the mid-1980s these corporations were called LEDAs (Local Employment Development Associations). Under the LEAD program, centres with populations of less than 50,000 received three-year grants to provide venture capital, in the form of short-term loans, to local businesses (MacLeod, 1988; Perry, 1987).

Recent research has pointed to two shortcomings of BDCs as a mechanism for mobilizing capital for regional development. First, because CEIC requires BDCs to become self-sufficient in approximately five years, the may tend to focus their assistance on larger SMEs in their locality and to rely on secured loans rather than unsecured equity participation. In this connection, some commentators have recommended that each BDC should be assign on local conditions and markets rather than on national guidelines, which may or may not be locally appropriate (Baron and Watts, 1989).

Second, applicants seeking assistance from BDCs must have been rejected by other private and public lending institutions. This creates a fundamentally negative image of the role of BDCs as a tool for business and economic development, according to one study (ENCL, 1989). Instead, BDCs should be a proactive and positive force for business development, and "any regulations which hinder this role," such as the one just noted, should be changed. (Ibid., p. 25).

The above caveats notwithstanding, Colville Investments has performed relatively effectively, as have other similar corporations. The BDC model would thus appear to have the potential to complement other mechanisms for mobilizing capital and stimulating business and employment development.

SMALL BUSINESS DEVELOPMENT BONDS

In Newfoundland and Labrador, the provincial government has created a new instrument for supporting small business known as the development savings bond. The provincial government sponsors a public issue of government-guaranteed development savings bonds, which pay market rates of interest. A portion of the proceeds of these bonds then flows to the government-owned Newfoundland-Labrador Development Corporation (NLDC). NLDC, in turn, lends a percentage of these funds to small businesses to support new start-ups and expansion. The first issue of development bonds received enthusiastic response in the province, with sales reaching $9 million in early 1988 (ECNL, 1989).

The Newfoundland-Labrador approach addresses some of the deficiencies of other uses of bonds to support small business. In particular, the use of an intermediary institution -- in this case NLDC -- ensures that the funds will be channelled to their planned targets. Too often governments have directed revenues from bonds into the larger pool of general revenues and have neglected to develop mechanisms which will channel the proceeds efficiently and effectively to the firms in greatest need (Litvak and Daniels, 1979).

To date, there has been no assessment measuring precisely how the proceeds of the Newfoundland bonds have been used. This may be a task worth understanding by the province's Economic Recovery Commission, which has now assumed control over the NLDC.

PROGRAM-RELATED INVESTMENTS

Program-related investments (PRIs) are new instruments in the Canadian experience, but they have been widely used in the United States for nearly two decades. A program-related investment may be defined as:

> an investment made by a foundation or other charitable organization for the primary purpose of directly advancing some program goal of the investing organization -- such as economic development, land conservation, the building of educational facilities, etc. The investment itself, as compared to the income generated by it, is the instrument for achieving organizational goals. The investment can take the form of a loan, loan guarantee, or purchase of shares or other equity interests (Cooperative Assistance Fund, 1983:3).

It is estimated that some 100 foundations make PRIs totalling $50 million every year in the United States (Council on Foundations, 1982).

The oldest and largest PRI mechanism in the United States is the Cooperative Assistance Fund (CAF). Formed in 1968, CAF is a vehicle through which twelve foundations and three religious organizations pool their resources to make PRIs in low-income rural and urban communities. Among the key members of the fund are the Ford and Levi Strauss foundations and the United Methodist Church.

During the period 1969-86, CAF made more than 50 investments worth US $6 million, which in turn levered US $52 million in additional private or public capital. Investments made by the fund, in the form of both debt and equity, were distributed among private and community enterprises initiated by minorities and low-income communities, with the sectoral breakdown presented in Table 8.

Table 8

Percentage of Investments by Sector, Cooperative Assistance Fund

Sector	Per cent
Farming/food processing	28
Investment capital companies	15
Construction/housing	14
Banking	9
Electronic/communications	8
Credit unions	8
Printing and publications	2
Other	17

Source Cooperative Assistance Fund, 1986.

For the same period, 44 per cent of investment was in the form of equity, 39 per cent in loans, 8 per cent in program deposits and 6 per cent in loan guarantees (Cooperative Assistance Fund, 1986).

In the United States, as a result of the Federal Tax Reform Act of 1969, PRIs are regarded as a class of tax-exempt investments which are judged not to violate the "prudent investor" rule governing investments by foundations. PRIs do not yet enjoy similar status in Canada. However, some Canadian foundations are seeking ways to make PRIs within the current legislative framework in Canada. The two foundations playing leadership roles here are the Calmeadow and Laidlaw foundations, both located in Toronto.

Relevant legislation which may require amendment in order to permit PRIs in Canada includes the Income Tax Act, pension legislations, and perhaps federal and provincial trust law and regulations in all jurisdictions. This task is daunting, and made even more so by the fact that the pool of capital managed by private foundations in Canada is much smaller, both in absolute terms and on a per capita basis, than that managed by American foundations. Nevertheless, a favourable legal environment for PRIs could yield a new mechanism for mobilizing capital in Canada's less-developed regions; thus the research is worth undertaking.

4 PRINCIPLES, CONCLUSIONS, AND NEW RESEARCH DIRECTIONS

The purpose of this chapter is to explore some possible implications of the various capital mobilization mechanisms discussed in the preceding chapters for Canadian Regional and community development in the 1990s. Among the principles that appear most important to us are those of partnership, decentralization, critical mass, outreach, coordination, evaluation, and precision.

In addition to discussing possible policy implications, this chapter also seeks to take certain steps toward setting forth a research agenda on capital mobilization. The Canadian and foreign experience described in the previous chapters suggests that we now know more about capital mobilization mechanisms than we did, say, fifteen or twenty years ago. But as we know more about capital mobilization, we also learn more about what we don't know -- hence the appropriateness of a new research agenda arising out of the past decade's experience.

To begin with, the Canadian experience suggests that partnerships are essential to the success of mobilizing capital for regional development. Partnerships involving various combinations of governments, business, labour, and community interests have succeeded in generating capital for employment and business development. Similarly, business development centres are based on collaboration among business, government, and community organizations, while community loan funds often involve a variety of community and business interests, including individuals, churches, foundations and cooperatives. During the next decade, it will be important to continue to establish local-level partnerships. Once the success of these local initiatives has been demonstrated, then partnerships may be explored on broader levels. Ultimately, regional coalitions involving business, labour, community, and government interests, (like The Québec Solidarity Fund) will likely be required to maximize access to capital in less developed regions.

The experience of the 1980s has also pointed toward the effectiveness of *decentralized* mechanisms for mobilizing capital for regional development. Employee share ownership plans, venture capital corporations of various kinds, micro-credit programs, community loan funds, community banks, credit unions, and business development centres are all tools which can be applied on a decentralized basis. In this regard, there appears to be agreement across the political spectrum that there should be a continued movement away from direct delivery of programs to provide capital by governments; rather, arm's length regional development agencies should provide flexible support to locally-based organizations, which can deliver such services according to local conditions and priorities. In the 1990s, a key challenge will be for the stakeholders in the regional development process to multiply the number of decentralized mechanisms to mobilize capital, while coordinating these mechanisms so as to minimize needless duplication and to maximize complementarity.

As well, the experience of the past decade underscores the importance of what might be called critical mass. That is, in order for policy tools to exert maximum and sustainable impact on employment and business development, certain economies of scale and a certain level of complexity must be achieved. At the level of individual mechanisms, this means that the volume of loans or equity investments must be sufficient to stimulate significant employment and business growth. Sufficient volume is also required for such mechanisms to become self-sustaining by generating adequate revenue to cover overhead and profit.

At the regional level, a critical mass of policy tools must be achieved if there is to be a meaningful change in regional employment and business growth. Such a mass -- in terms of scope and complexity -- of all types of regional development policies appears to have been reached in Québec. The large scale investment in education in Québec during the 1960s and 1970s paid dividends in a skilled and confident emerging business and professional class in the 1980s. Other policies, such as the establishment of resource groups to promote worker cooperatives and legislation supportive of cooperative development generally, worked together with other social and economic policies to create a momentum for change.

Although the conditions of other regions in Canada diverge considerably from those in Québec, the need to achieve critical mass is common to all areas of the country. The particular nature and composition of this critical mass may (and should) differ from region to region, but the principle holds in every case.

Yet another important principle is that of *outreach*, or the methods whereby capital mobilization mechanisms deliver their services personally to local residents. The experience of the 1980s indicates that extensive outreach is fundamental to the success of mobilizing capital in poor areas, both rural and urban. But a greater emphasis on outreach is necessary if local residents are to be educated as to the use of existing capital mobilization methods.

The Canadian experience in the 1980s also shows that there is a need for coordination of the various policy tools to mobilize capital. Regional development agencies and planning processes could facilitate the coordination of these instruments in order to ensure maximum impact. Decisions regarding the relative emphasis to be placed on the types and stages of businesses to be assisted in any particular region are especially important. In addition, there is a need to coordinate the efforts of all support services to business development and employment generation, including training programs, business incubators, legal and business advisory services and so on.

One way to facilitate such coordination would be to establish a network of regional development banks. These banks would provide flexible, long-term support -- through loans and equity investment and technical assistance -- to locally based agencies providing capital to local businesses, both private and community-based. They could be created as crown corporations, private foundations, or investment companies. As for the matter of financing, they could be financed by a combination of investments by the private sector, church groups, charitable and other non-profit organizations, and public sector funds reallocated from existing regional development agencies, such as the Atlantic Canada Opportunities Agency and the Western Diversification Office. The banks might also provide local development agencies with contributions to personnel costs, including the salaries of loan officers and other outreach workers.

Not least important, a recent experience suggests that insufficient attention has this far been placed on evaluating the effectiveness and efficiency of various policy tools for mobilizing capital. Here is one area where much more research will be needed. The lack of basic data on key variables such as capital flows in and out of regions renders monitoring of such processes virtually impossible. Too many mechanisms for mobilizing capital are characterized by truncated, biased or unused evaluative research, or no evaluative research at all. Business, labour, governments, and community groups are all guilty of neglecting evaluation. Greater emphasis on evaluation will enable all parties to understand more precisely the limits and possibilities of various tools for mobilizing capital for regional development. Systematic and detailed evaluation can guide the charting of new directions in future policy.

Bosworth et al. (1987) have stressed the need for more comprehensive evaluations of government credit programs. They argue that such evaluations must focus primarily on the costs of the subsidies associated with such programs rather than their dollar volume. Perry (1987, 1989) has pointed to the need to evaluate local development initiatives, particularly those involving capital mobilization, through a number of methods. One of these approaches is known as the ROTI method, which seeks to measure "return on taxpayers' investment." In Canada, Baron and Watson (1989) have explored the concept of net economic benefits to the community derived from local loan funds and other similar initiatives.

The 1980s showed policymakers and practitioners how to use particular strategies to support specific types of businesses. Micro-enterprises require loans of between $1,000 and $3,000 and do *not* require equity capital. Small start-up enterprises -- private or community-owned -- require loans and guarantees between $5,000 and $100,000, and perhaps equity capital in the same range. Expanding small businesses require between $100,000 and $250,000 in debt or equity investments. Medium-sized enterprises need investments of between $250,000 and $1 million. Mature medium-sized businesses seek investments of more than $1 million. Different delivery mechanisms are required for each category of business. And different mechanisms permit the accessing of different *sources* of capital for different purposes (Wickham, et al. 1989, ECNL, 1989; CFIB, quoted in Network, Inc., 1986).

Overall, then, one of the most important lessons of the 1980s is the need for *precision*. Policymakers and practitioners must, and can be increasingly precise about why, for whom, how, and how much capital is to be mobilized for regional development in less-developed regions. To this end, additional research of the type we shall be suggesting presently may well be required.

CONCLUSIONS

In general, there is little doubt that the 1990s will bring even greater challenges to the less-developed regions of Canada than they have faced in the past. The international economy will almost certainly continue to become more competitive. Technological change will trigger rapid and continuous transformation of key economic sectors everywhere in the world. Advanced communication systems and the electronic integration of the world economy mean that even the most remote communities will be affected by change more rapidly than ever before.

In the financial sector, competition resulting from changing regulation and other factors is also likely to continue. Such conditions seem likely to prompt financial institutions to seek even greater efficiency and productivity gains than those achieved in the 1980s. In doing so, they may opt for even larger transactions with even more familiar entities. Such a trend, to the extent that it becomes reality, does not bode well for small and medium businesses in less developed regions.

While a lack of hard data makes it impossible to determine whether the country's less-developed regions are suffering from an insufficient supply of capital, these regions undeniably suffer from a *lack of depth of supply* -- and did even prior to the recent wave of globalization in financial markets. In this connection, we have already spoken of the situation prevailing in Newfoundland in 1988. As well, less-developed regions have a number of equally severe demand-side problems, including lack of information about financing, lack of the specific skills needed to prepare financial proposals, unwillingness to share control with partners or venture capitalists, and lack of both specific and general management skills. Often these demand-side problems are integrally connected to supply-side problems. For instance, the lack of demand for venture capital in Newfoundland is one reason why suppliers of venture capital in that province are very rarely able to make large loans (greater than $500,000).

But the picture is not entirely a negative one. While the problems faced by Canada's less-developed regions may be more severe than ever, more is known now than before about how to mobilize capital for regional development. This is not to say that all the questions have been answered. Far from it. As we shall see presently, there is still a long list of questions requiring empirical answers -- a situation complicated by the chronic lack of evaluation and monitoring in this area. Still, the 1980s saw the introduction of a wide variety of new mechanisms; thus policymakers have at their disposal a wider array of tools for mobilizing capital than was available at any previous point in history. What is needed now, in addition to continuing innovation and development of new tools, is a careful sifting and sorting-out of some of those that have already been created, in order to determine whether and to what extent they represent promising new directions for future Canadian regional development policy.

We have spoken already of the problem of the lack of hard evidence concerning capital outflow from Canada's less-developed regions. Precise responses to regional capital problems are extremely difficult, if not well-nigh impossible to formulate in the absence of such knowledge. In addition to determining whether such outflows exist, it will also be important to determine their nature and extent.

We have spoken, as well, of the need for more thorough measurement and evaluation of capital mobilization measures. At this stage, it is important to determine the precise impact on business growth, employment, family income, tax revenues and other indicators of at least some of the various instruments for capital mobilization described in the preceding chapters. For example, what would be the feasibility of rewriting federal and provincial income tax and pension laws to allow tax-exempt status for program-related investments? What would be the impact of less restrictive regulations governing the operation of the Business Development Centres established under the Community Futures Program, such as an increase in the total amount of loans each such centre is allowed to make? And what would be the likely effect on investment and job creation in less-developed regions of a national stock savings plan structured along the lines of the Quebec SSP? These are but three of literally hundreds of important capital mobilization issues which would benefit immensely from detailed evaluative study.

Nor will quantitative studies, however thorough and detailed, be enough. In addition, it will also be important to prepare detailed, critical case studies of particular capital mobilization instruments and mechanisms, in order to describe and analyze their internal structure and operations and to consider their overall place in the policymaker's box of tools. Such studies will also require attention to institutional factors, such as the training and education of potential entrepreneurs in Atlantic Canada and the generally lower level of management skills found in that region. Only when such institutional factors are considered is it possible to get a sense of the interrelationship of different capital mobilization measures, and their larger impact on communities and regions.

A question of particular interest, given the potential scope of such a mechanism, is that of how -- and how effectively -- a national development bank would work. To this end, research would do the country a useful service by developing a viable model of such a development bank, one linked to a network of development finance institutions at the local and regional levels, which would coordinate and promote complentarity among the wide range of capital mobilization mechanisms now in operation across the country.

All in all, the issue of mobilizing capital is likely to receive sustained attention in the regional development literature throughout the 1990s. Analysts concerned with entrepreneurship and community economic development, in particular, will be interested in deepening their understanding of this issue. Other scholars and practitioners in the field are also likely to be drawn to the issue of mobilizing capital, as the decade progresses. Leaders in business, labour, and local communities are already very aware of the importance of adequate and appropriate capital in meeting the challenge of regional development. We believe that the recent Canadian experiences demonstrating that community-based expertise, in combination with professional expertise, can help chart the way forward.

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