

Access to Capital

DISCUSSION PAPER



**NATIONAL INDIGENOUS
FISHERIES INSTITUTE**

Indigenous Program Review

**INSTITUT NATIONAL DES
PÊCHES AUTOCHTONES**

Examen des programmes autochtones

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Program Overview

Indigenous fisheries in Canada employ more than 5,000 people and generate over \$260 million in annual revenues. For many communities, fisheries are the main contributor of “own source” revenue and job creation. They are also an important driver of Indigenous economic development throughout the country. First Nations in British Columbia, for example, have a long history and reliance on fisheries, and many Indigenous communities are supported by fish harvesting in northern Manitoba and Saskatchewan lakes. Over the past 25 years, commercial fisheries have also emerged as a mainstay of business and jobs in Atlantic Canada, Quebec and Nunavut.

To continue and expand the economic development opportunities of Indigenous fisheries, communities need effective asset management and sustained access to capital. In particular, capital is needed to replace and maintain vessels and other fisheries assets, to gain access to new fisheries and licences, and to diversify into value-added businesses. Over the next decade, these investments have been conservatively estimated to be about \$330 million.

Access to capital has long been an issue in the fisheries sector, especially for small- and medium-scale participants (Indigenous and non-Indigenous) in Canada and around the world. This is due to the volatility of fish stocks and competitive world seafood markets – and the response of governments to this volatility. Chartered banks have come to view the fishing industry as high risk and, thus, have limited their exposure to the sector.

The issue is even more acute for Indigenous fisheries. Not only do Indigenous fisheries face the same volatility in fish stocks and competitive world seafood markets, their obligations often include a broader set of community-oriented objectives than a traditional shareholder-oriented business. For example, a community may choose to use fisheries profits to address urgent social pressures, such as health, education and housing, rather than replacing vessels or equipment, or buying new licences or branching into other fisheries business areas. Additionally, federal licensing policy, both in the Atlantic and Pacific, can greatly influence business decisions. For Indigenous communities the nature of and terms and conditions

of the communal commercial fishing licence is also significant and has, in some cases, limited the use of these assets to access provincial lending programs and the private capital market.

The access to capital issue has been discussed in each of the three National Indigenous Fisheries and Aquaculture Forums (formerly, National Aboriginal Fisheries Forum). The lack of access to capital is seen as a limiting factor in the efforts of communities to build increasingly viable commercial fishing enterprises over the long term.

Steps have already been taken to create the right conditions for investment and long-term growth in Indigenous fisheries. The Atlantic and Pacific Integrated Commercial Fisheries Initiatives, and the long-term business development approach, in particular, have been instrumental in creating these conditions by focussing Indigenous commercial fishing enterprises on effective business planning, solid financial management, and governance, as well as training. The influence of governance and financial controls on investment capital and wealth management have been well documented.

The opportunities for profits, employment and increased activity in Canada’s fisheries are real and achievable for Indigenous communities. Despite stock volatility for certain fish species in recent years, Canada has still benefitted from strong world markets in the post-financial crisis. In 2016, the landed value of fish and seafood increased to \$4.22 billion from \$2.7 billion in 2009. At the same time, the total value of fish and seafood exports increased to \$6.55 billion from \$3.88 billion. New markets in Asia, particularly in China, have helped this recovery.

This discussion paper seeks to explore the access to capital issue and long-term growth solutions for Indigenous fisheries through a pilot project proposed for Atlantic Canada and, potentially, the rest of Canada. It is intended to incite the ideas and thoughts of Indigenous communities and commercial fishing enterprises in order to inform this particular pilot project and the future development of other pilots. This discussion paper focuses on the pilot program for Atlantic Canada, but, clearly, additional work will be needed to examine the issue of capital within the Pacific Integrated Commercial Fisheries Initiative and the recently announced Northern Integrated Commercial Fisheries Initiative.

Capital Issues for the Fisheries Sector in General

Fisheries have always been subject to fluctuations; whether short term because of storms or ice coverage, medium term due to market changes or biomass cycles, or long term as a result of changing climate and oceanographic conditions, overfishing or predator-prey relationships. Regardless of the kind, fluctuations influence business decision-making and, as a consequence, influence the risk profile and access to capital of the entire fisheries sector.

Canada is a major fish exporter and market demand changes regularly contribute to boom and bust cycles. The federal government has long tried to bring stability to the industry. In 1944, it established the Fisheries Prices Support Board, which brought in a number of support programs over the years. However, crises in groundfish and lobster stocks in the 1960's, and a financial collapse of several large companies in the 1970's, led to industry re-structuring. The combined issues of stock changes and market volatilities have also led to many task forces and Royal Commissions in both the Atlantic and Pacific fisheries. The collapse of some Atlantic cod stocks in the early 1990's only added to the view of the industry by financial markets.

Asset management in the fisheries sector also presents unique challenges that influence access to capital. Capital invested in plants and vessels are often not as liquid as other capital investments elsewhere in the economy. Plants located in rural coastal areas where fishing is often the only economic activity have particularly limited alternative use. Capital invested in fishing vessels generally is not easily converted into other activities that generate economic returns. During down cycles in the industry, this results in a higher level of capacity than required. It also explains, in part, why access to capital for fishing vessels and plants has historically been supported by government subsidies or provincial government lending institutions.

The role of provincial lending agencies has, in fact, been key for the non-Indigenous fisheries sector to access capital for vessel replacement. Each of the Atlantic provinces and Quebec provide some capital support; either directly through loans or indirectly through guarantees. Some, like Nova Scotia, adjusted its programming to allow for support to acquire quotas, while others, like Prince Edward Island, have simply invested directly in the acquisition of licences. Many harvesters have also turned to buyers, processors or other harvesters for capital support.

Capital Issues for Indigenous Communities

For Indigenous fishing enterprises, access to capital and provincial lending agency support have been extremely limited. For many, support to Indigenous communities is seen as a federal responsibility.

There have been many studies on the Indigenous access to capital issue. In 2014, for example, the Canadian Council for Aboriginal Business noted that in mainstream industry over 95 per cent of investment is private, while in Indigenous business less than 40 per cent of investment is private. The Council also reported that the terms of loans were different: only five-year terms for Indigenous business as opposed to 15- to 20-year terms for mainstream businesses.

In 2014, the Canadian Public Policy Forum published a discussion paper¹ in which it noted:

“The bottom line is that financial markets still see a significant degree of risk and uncertainty in First Nations ventures, especially those in remote areas. Investors either refuse to participate at all, or demand a higher-than-normal return in the form of high interest rates, special guarantees and unusually stringent conditions.”

The paper also reported that the main drivers of the extra risk and cost associated with First Nations investments were due to the *Indian Act* restrictions on the seizure of on-reserve property and the dependency of many First Nations businesses on volatile and unpredictable resource sectors. Other reports have also pointed to the *Indian Act* as an inhibitor to Indigenous economic development because it limits the ability to convert assets into capital and wealth.

¹ *Getting Together: First Nations and Capital Markets.*

Improving Conditions for Access to Capital Solutions

One thing a business can do to enhance its ability to attract capital investment is to ensure that proper business planning and governance systems are in place.

These include:

- training and human resource development
- effective financial management and control
- effective business planning and asset management
- consistent decision-making and governance

These elements are already part of the Atlantic and Pacific Integrated Commercial Fisheries Initiatives and they are helping to create the conditions necessary to attract sufficient capital investment and long-term financing in Indigenous fisheries. For example, the business development team in these programs has worked to build models that encourage the management of fisheries assets as unique businesses within a community.

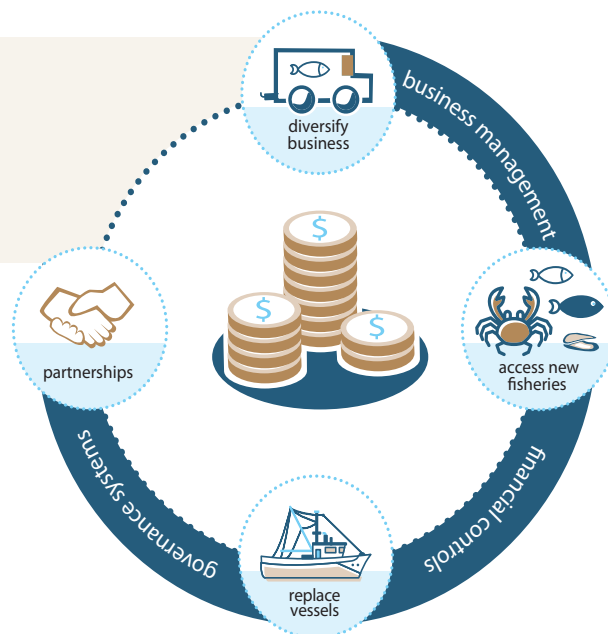
Effective financial management, including financial management information systems and operational control, is key to ensuring effective use of assets. It is also essential for effective business planning both in the short and long terms. Short-term business planning includes accessing loans for asset acquisition and

working capital, while long-term business planning includes debt retirement and capital refreshment or replacement. The issue of working capital is particularly critical for aquaculture development where, depending on the species, revenue streams can be anywhere from two to five or six years out. Aquaculture requires a very understanding banker.

The financial management and business planning elements of a business model can be negated, however, if the decision-making and governance model is lacking. And, the influence of governance on investment capital and wealth management has been well documented.² It is therefore critical that Indigenous communities incorporate all of the elements of the business model: strong business planning, effective financial management, and consistent governance systems.

The approach of the Atlantic and Pacific Integrated Commercial Fisheries Initiatives and the business development team is seen as a best practice and has been lauded by government and academics. It can greatly increase the likelihood of attracting future investment and long-term financing for fisheries development.

Communities need access to sustained capital to continue and expand economic opportunities



² Dr. Tim Raybould, *The Economics of First Nation Governance*, 2006.

Pilot Project: Potential Sources of Capital

In May 2017, a pilot project on access to capital was announced by the Minister of Fisheries and Oceans Canada at the National Indigenous Fisheries and Aquaculture Forum. The pilot will begin in Atlantic Canada and, if successful, may be implemented across the country.

The pilot will require participating communities to continue the Atlantic Integrated Commercial Fisheries Initiative's requirements for program access. It will also commit to seek Financial Management System Certification from the First Nations Financial Management Board.

Proposal

The creation of an investment fund by pooling regional fisheries resource access, which is:

1. Focused primarily on increasing access to resources
2. Built for fast growth, high asset and income leverage
3. Seeded with long-term capital through investing member First Nations

The pooled investment fund could either be a limited partnership or a for-profit corporation with two shareholder classes:

- Class A would operate access rights under a service agreement and would be subject to cash calls
- Class B would be for investing Nations and these would be retired over a 15-year repayment schedule

First Nations participation will be on a volunteer and capacity basis. They would need to meet criteria under the Atlantic Integrated Commercial Fisheries Initiative and apply for the First Nations Management Board Certification.

A manager would be appointed to design the operational policies and procedures for the investment fund and, once designed, to manage the operations and offer technical services.

The capital structure of the investment fund would be \$20 million with Class B shareholder access to a limited \$2 million backstop federal contribution by Fisheries and Oceans Canada. The

backstop would be held in trust by a third-party to ensure timely payments to investors if the investment fund ever had insufficient capital to pay their obligations. Income earned from the backstop would be used to support capacity-building advisory services to all First Nations. The backstop contribution could be increased in the future. As more communities indicated interest, there would also be potential to create new investment pools.

Investment Fund Objectives

- Increase fishery access in order to maximize Indigenous community benefits (jobs and wealth creation) and long-term economic benefits
- Increase the sustainability of Indigenous commercial fishing enterprises by strengthening their autonomy, diversification, resilience and synergy within the industry

Risk Mitigation

The proposed investment fund capital and ownership structure is designed to mitigate the risk of failure and to protect Class B investors. For example:

- The investment fund would take a portfolio diversification approach to acquire licences to provide better risk protection for members compared to individual community ownership in a small number of licences
- A five per cent reserve, almost \$1 million, would be established to ensure timely payments to class B investors regardless of small market swings
- No dividends would be paid out to Class A investors until all Class B investors were fully paid out
- A cash call to Class A investors would be in place and failure to meet a cash call would result in dilution of interest, including possible forfeiture
- Class B investors would have priority access to licences if Class A investors failed to redeem their shares on a timely basis
- Class B investors would also have access to the \$2 million federal backstop, which would be protected by the priority of cash flow, the five per cent reserve, and cash calls

Points of Discussion

The issue of capital is applicable to Indigenous communities and commercial fishing enterprises across the country. The pilot described here is under discussion within the Atlantic Integrated Commercial Fisheries Initiative context.

A separate examination of the capital issues and possible options will need to be completed for both the Pacific and Northern programs. The unique circumstances within each area must be examined in order to develop effective options for communities and commercial fishing enterprises.

Within the Atlantic Integrated Commercial Fisheries Initiative, the proposal is to implement a capital fund, based on shared risk, to increase access to the resource for participating communities. Other capital requirements to address vessel replacement, working capital and diversification will continue to be supported by the Business Development Team.

The following questions are designed to stimulate discussion on the issue of capital that will help with the development of the Atlantic pilot and in the examination of capital in the Pacific and Northern programs.

1. Does your community or commercial fishing enterprise have a business plan that includes an asset management plan and defined long term objectives? Does achieving these objectives require capital?
2. Has your community or commercial fishing enterprise made capital investments in recent years? If so, how did you secure capital?
3. Do you regularly review and update your long-term capital plan?
4. Has your community or commercial fishing enterprise tried to obtain capital from the private market? If yes, what was your experience?
5. What are the key internal technical and management factors, if any, that limit your ability to secure long term capital?
6. Is the shared/pooled risk model of interest to your community or commercial fishing enterprise?
7. Are you prepared to work with other communities to develop a long-term capital plan for fisheries development?
8. Has your community or commercial fishing enterprise incurred issues with sufficient working capital in recent years?

Lexicon of Terms

Class A Investors Eligible First Nations investors that will invest 20 per cent of the capital of the investment fund.

Class B Investors Eligible First Nations investors that will invest 80 per cent of the capital of the investment fund on a 15-year term basis. These investors will receive an interest payment and will be redeemed at an agreed-upon schedule.

Five Per Cent Reserve A cash reserve created at the outset and held in a separate account to ensure timely payment to Class B investors. This reserve is to be replenished from time to time from operations and before investment in additional licences can take place.

Cash Calls Funding requests to Class A investors by the fund manager to ensure timely payment to Class B investors.

Share Redemption Class B shares will be retired on a scheduled basis over a 15-year period.

Federal Backstop A \$2-million separate fund held in trust for the benefit of Class B investors.