Community Financing Options

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The global economy has undergone a profound socio-economic shift brought on by the changing structure of the global marketplace and the free flow of capital. In essence, investment capital is now free to move internationally seeking out the highest levels of return with little or no restrictions or social conscience. Without delving too far into globalization and the causes and impacts of economic restructuring, the free movement of capital in global markets can be attributed to the significant shift in investing away from traditional industries located in rural areas and towards the global financial sector and foreign markets. The increasing cost of raising capital through public offerings also prevents many communities from accessing the available pool of investment capital in the world markets. As a result, this global economic restructuring has created a "financing gap" in many smaller Canadian communities. With the strong competition of higher returns, it is difficult for rural communities to attract investment capital for local industry, or for cultural, social or municipal infrastructure improvements. Mainstream financial institutions such as banks and credit unions are unable to fill the void.

With the increasing difficulty of accessing traditional forms of financing and investment, communities have begun to look to innovative ideas and initiatives to help in raising local capital. To a greater extent, communities are looking inward to create a climate of investment and cooperation within the population. As more community members participate, they share both the risk and rewards in creating stronger local economies. There is also a greater emphasis on local empowerment because the control of the funds, schedule and outcomes stays within the community and is not ceded to outside control.

A circuit of local capital is different than that of the global investment market. It is based on raising pools of capital from a self-designated community to invest in a local business or infrastructure. Residents can invest by purchasing local securities in the form of <u>shares</u> (equity; essentially owning a part of the firm) or <u>bonds</u> (debt; loaning the firm a fixed amount over an agreed upon duration of time and interest rate).

Bonds involve a fixed term and rate of return, are typically connected to capital assets and are secured, usually by those assets. If the business does not succeed, the machinery can be sold to repay the debt.

With shares/equity the shareholder *owns* part of the business and their investment is *not* guaranteed. The risk is higher. The return on investment will depend on the success of the firm. As such, investors will most likely provide patronage to the business, and seek to connect with other local businesses and suppliers. The motivation to see a return on investment also encourages the transfer of investor business acumen and connections. More importantly, selling equity ensures that local businesses stay in their home communities. Even if the firm expands, local investment ensures the head office stays in the community.

But where is this local capital found? One primary source of local capital is the wealth that people in the community have invested in their bank accounts, investments and RRSPs. Much of this capital currently leaves the community to be invested globally. Attracting and redirecting this money back to the community can compound the advantages for the community and its investors.

Strengthening the Local Economy

By linking the broader community to local business through community investment, other resources are also mobilized. This not only increases the effectiveness of existing capital, but also helps local businesses obtain a highly effective mix of inputs to optimize productivity. Alongside efficiencies, community ownership encourages an increase in local patronage, as well as partnerships between local suppliers and services. This networking creates a multiplier effect whereby more money is *spent* locally and *stays* in the local economy. The Institute for Local Self-Reliance (2003) found that, for $100 spent locally $45 stayed in the local economy, whereas for every hundred dollars spent at a chain store, only $14 dollars stayed in the local economy[xviii].

> "in exchange for one new part-time job in a mega-discount store, about 1½ full time jobs are eliminated in smaller stores." ...most jobs are minimum wage with little opportunity for improvement or promotion and most are non-union with all the ramifications implicit in such situations (i.e. absence of provision of benefits to large numbers of employees). In some situations, they report, the mega-retailers have closed down operations after several years. Having forced the closure of much of the local retail trade, the closures leave a retail vacuum and an exacerbated unemployment problem.
>
> (Dalal, Al-Khatib, DaCosta and Decker, 1994)

In contrast, locally owned businesses strengthen the economy by clustering. In many communities, marketing of their products and produce externally is done under a regional banner.

Apart from bolstering local capital, other community resources can also be mobilized; in particular *human* and *social capital*. In terms of *human capital*, a group of local investors can bring a wide variety of expertise to bear as they scrutinize local business development opportunities and create well thought out business plans. This arrangement also allows for experienced investors and successful business managers to pass their expertise on to the next generation of novice local entrepreneurs.

Social capital is best described as the frequency and value of transactions that occur as a result of relationships between groups and people (Putnam 2001). Community owned businesses bring people together, and do so more frequently. This can help in finding good employees, suppliers and consumers while reducing advertising costs (word-of-mouth). Social capital also helps identify investment opportunities, connecting investors and entrepreneurs.

One example of the benefits of exploiting local capital is the Green Bay Packers of the National Football League, which is owned entirely by local shareholders. In order to finance the team to enter the league in the 1930s, the team sold shares to the community. Whenever they have needed to raise capital, it has come through additional public offerings. These shares (which cost $250 USD) are non-tradable and cannot be sold back to the team. They do not come with any free tickets or other memorabilia. The success of the team (Green Bay has continuously fielded a competitive team and most recently won the 2011 Super Bowl) provides an effective community based business, marketing and community service mechanism. It is these social factors, rather than just capital, that strengthen local economies.

> "Established communities, whether urban or rural, central or peripheral are known to be sources of social capital and the well spring of democratic action" (Johnstone, 2011)[xix].

As we plan for more sustainable communities, community ownership is integral in addressing local underdevelopment. It empowers communities to decide what they produce and consume rather than adhere to the objectives of large outside firms beholden to their shareholders. Profits are returned to community owners and are spent and/or reinvested locally.

The adoption of innovative ownership models also plays a part of any local sustainability initiative. Co-op Power, an American (Massachusetts based) clean energy Co-op, finances green energy projects while also addressing issues of social inequality based on class and race (www.cooppower.coop). To do so, they engage different communities around environmental issues, while providing opportunities for lower income individuals to participate through a multi-stakeholder share structure. Co-op members can loan the co-op money through purchasing a bond, or own part of the co-operative as a shareholder. Moreover, there are opportunities for members to earn shares through sweat-equity as well as buy-in to the co-operative over two years. This gives workers and members, many of whom have fewer assets, the opportunity to become owners and then benefit from any earnings.

Getting the different groups together to invest their savings as well as future earnings in ventures that might create only small tangible returns and intangible returns that might only be accrued by future generations is challenging. The group might be made up of people with different backgrounds, but they usually share common values, and a common vision towards their community. While this might seem strange to global investors, it is not uncommon local investor behavior. Farrell (2001) found that local or industry peer investors often invest as a group and, as such, they are less risk averse and are willing to wait longer to see a return on their investment[xx].

Comparing the ideals of the flow of global capital to the need for strengthening local economies, Michael Schuman (2011) explains:

> If you can produce the goods and services you consume in your own backyard, it doesn't make sense to import them. Every time you import something unnecessarily you give away a piece of your economy. A key to economic vitality is diversifying your economy with as much self-reliance as possible[xxi].

Given that Canadians invest a great deal more outside of the country (Holden 2008), it is apparent that there is a great deal of potential to increase the scope and scale of community investment funds and local capital.

Local Financing and Investment Mechanisms

This section examines the various methods rural communities can utilise to raise local capital. It summarizes different strategies and provides some additional examples from other communities. These mechanisms are intended to link investors and local entrepreneurs. Underlying these financing mechanisms is a commitment to strengthening the local economy, supporting local businesses, keeping local jobs and fostering ethical and increasingly sustainable business practices.

Credit Unions

Credit Unions are local member owned financial institutions. Many credit unions provide business loans, as well as business banking and often other advisory services. Credit Unions are intended to be active in their community and tend to have a better understanding of local needs. The resurgence of community owned businesses in Nova Scotia, as well as in the UK, is attributed to promoting the role of Credit Unions in financing local business development (Perry, 2009[xxii]; Nakagawa and Larratta, 2010[xxiii]). A business loan from a Credit Union is the most basic and straightforward form of local capitalization, however it does not facilitate a great deal of community ownership.

Crowd Sourcing

This is a new technique based on leveraging support, often from the online community, through websites such as Kickstarter.com. Basically, an entrepreneur raises funds by posting their business idea online along with a request for start-up funding and interested people donate accordingly. While this doesn`t have an ownership component, many entrepreneurs use this mechanism as a way to guarantee initial sales by offering an exchange of goods or services based on the amount donated. This crowd-sourcing method is gaining popularity and could easily be adapted on a community level.

Exemptions for Accredited and Eligible Investors

The federal government, under National Instrument 45-106P *Prospectus and Registration Exemptions* allows individuals of a certain income level and net worth to purchase exempt market shares in a local business without that business having to provide an offering document. The rationale is that these individuals are wealthy enough that they can incur the losses if their investment is lost. These shares are eligible to be included into a self-directed RRSP, or can be purchased by transferring existing RRSPs. As these shares are RRSP eligible it also allows the investor to defer part of their tax payments. This type of informal investing, if structured in a way that provided voting rights for all parties involved, could facilitate broader community ownership.

Community Investment Funds

Community Investment Funds (CIFs) are pools of capital drawn from a self-designated area to be invested locally, by a group of community members. While they do resemble and serve a similar function as venture capitalist firms, traditional lenders and (development) banks, they are structured in a way to not only provide a return on investment but also broader community benefits . CIFs mobilize more than just financial capital, but mobilize human and social capital as well by providing an opportunity for various stakeholders (investors, workers, entrepreneurs and community members) to harmonize their goals to create stronger local economies.

In this structure investors purchase shares in an investment fund which is then invested into a local business. This delineation prevents the CIF from micro-managing the firm they invest in. CIFs can invest in local business by employing two different strategies: providing loans (debt) or purchasing shares (equity). CIFs have been incredibly successful in Nova Scotia with their Community Economic Development Investment Funds (CEDIFs). This program assists eligible communities by providing templates for public offerings, as well as significant tax rebates for individuals who invest locally. Over the past eight years this program has mobilized over 40 million dollars to be invested locally. This has helped to create hundreds of jobs as well as expand their renewable energy sector.

Community Bonds

Community Bonds are a debt instrument that enables communities, as well as not-for-profits and charities, to raise capital. This strategy is typically used to finance the purchase of a large capital asset such as a building. Instead of going to a bank for a loan, the group sells bonds to their extended network of members for the same amount. These bonds are guaranteed, and typically have a fixed rate of return and are paid back over a longer term. An excellent example is Toronto`s Centre for Social Innovation, which provides a program for local investment in community bonds. Currently there is no provincial program for community bonds in Alberta. However, the government is looking into the feasibility of using it to help finance the not-for profit sector. Given certain exemptions under the co-operative act (see below) there are ways in which communities could create their own form of *ad hoc* community bonds.

Co-operatives

The legislation around co-operatives provides a number of opportunities to mobilize local capital. Most co-operatives require membership fees, and often have programs where members can provide loans. In Alberta members of a co-operative with less than 100 members are allowed to invest up to an initial amount of $10,000, plus $5,000 in every following year. As such, co-operatives can mobilize close to one million dollars to build or expand their business. However, given the constraints of the size and ability of the membership to raise capital amongst themselves, there is often a need to look at other local financing options. The following shows two programs that enable co-operatives to raise local capital.

- ***Canadian Worker Co-operative RRSP Program***

Co-operatives (whether producer, consumer, solidarity, multi-stakeholder, or worker) are able to raise capital by selling shares to its members under a federal program administered through the Canadian Worker Co-operative Federation (CWCF) and Concentra Financial. In terms of the former these shares are eligible to be included as part of one's own Self-Directed RRSP, thus providing some tax relief to the shareholder when they are purchased. This process is relatively straightforward and has been successful in financing the growth of several successful co-operatives.

These key steps include:

- The co-operative registers with the CWCF RRSP Program and pays a yearly registration fee of $100.
- The co-operative assembles an information package for its members and potential investor that will include:
  - The co-operative's history, its key financial information, etc.
  - An overview of the offering: size of the offering and what it will be used for, share size, minimum and maximum amount of shares an individual can purchase and other related information

Potential investors are also able to transfer existing RRSPs to purchase shares in a co-op. Dividends are paid directly into this account, or potentially reinvested within the co-op. Most offerings for co-operative shares are intended to be held for at least five years.

❖ *New Generation Co-operatives*

A New Generation Co-operative (NGC) allows members and non-members to purchase market exempt shares in an agricultural co-operative. However, unless they are a member, investors (shareholders) cannot vote on matters related to the co-operative. Voting rights are based on one-member one vote, not one share one vote. These shares are usually a mid to long-term investment (5 years).

This type of structure allows co-operatives to raise capital within a larger network beyond their membership. It invites and permits community members, patrons, suppliers, and other groups to become involved in owning local economic resources. Westlock Terminals NGC (founded in 2002) was able to initially raise over a million dollars to purchase and expand their local grain terminal, and more importantly to prevent its' closure. A second share offering in 2006 raised another 1.2 million dollars. There are some 270 members. Since purchasing the grain terminal there has been a significant investment in new capital, including new elevators and systems, an increase in profits and payback on investment shares of seven percent (Cabaj, et al. ,2009)[xxiv]. In 2011 Westlock Terminals scaled up its operations, and purchased a stake in the ownership of GNP Grain Source, a major inland storage owned by 7 independent grain terminals with grain handling facilities for over 2.2 million metric tons of annual throughput.

The NGC model is popular in many other parts of the world, including the UK, Australia, New Zealand and the United States. Some of the recent literature (Cook and Chaddad, 2004) has also shown some interesting examples of how NGCs have transformed into what could be described as investment co-operatives. This has occurred most recently in the ownership structure of irrigation and dairy co-operatives in Australia (Plunkett, Chaddad, and Cook, 2010[xxv]), and New Zealand (Trechtor, McGregor, and Murray-Prior, 2003)[xxvi] respectively.

❖ *Investment Co-operatives*

This is a relatively new type of co-operative and has shown some proven successes in Alberta. The Sangudo Opportunity Development Co-operative (SODC) has raised over a quarter of a million dollars locally in member loans to finance local business development (Evans, 2011)[xxvii]. An investment co-operative is similar to a local institutional investor, or a community investment fund, but is structured like a co-operative. Like a CIF it facilitates the process of finding an opportunity that requires a capital investment and then sells shares in that opportunity to its members. This structure often has a development component to it as well, with a small portion of the profits being re-invested into a local development fund. Like an NGC it follows the OMOV principal. This creates a set of checks and balances that prevent one group from controlling (and profiting from the sale of) a local business.

❖ *Other Co-operative Strategies*

Many co-operatives in Europe and North America also help in financing the development of new co-operative businesses, by pooling and reinvesting a small percentage of their profits. One example is the Arizmendi Association Model. In this case one co-operatively owned business (a bakery and cheese shop) helped another co-op get started. They assisted in the business planning and technical aspects of the business, but also helped them finance the initial start-up costs. Over the past 14 years they have done this six times (Marrafino, 2011)[xxviii]. This has grown the size of their development fund, and by increasing the amount of members, they added to the amount of skills available. The Evergreen Economic Development Co-operative in Cleveland Ohio has followed a similar strategy on a slightly larger scale. They have started a worker-co-operative industrial laundry service for a large teaching hospital. Portions of the profits are kept to help start a renewable energy company that installs solar panels, as well as a large-scale urban green house agriculture project (Alperovits and Williams, 2010[xxix]).

Labour-Sponsored Venture Capital Corporations

There are a variety of local investment programs incentivized through tax credits at both the federal and provincial level. Labour Sponsored Investment Funds (LSIF) typically partner with local economic development agencies to invest in businesses, and often social-enterprises. Many of these funds are similar to the aforementioned CIFs in that job creation, as well as supporting workers' rights and collective enterprises, is in close proximity to the priority of providing a return on investment. These funds have also been highly effective in addressing the financing gap in disadvantaged regions. For instance the Solidarity Fund QFL, founded in Quebec in 1998, created seventeen decentralized regional funds to invest between $50,000 and $2 million in new businesses start-up capital.

Further:

> On the local level, 87 local funds (SOLIDE) were established in collaboration with the Union des municipalities regionals de comtés (Alliance of Regional Municipal Counties). Half the capital was provided through a $10 million central common fund (SOLIDEQ) created by the Solidarity Fund QFL and the remaining capital came from the municipalities and other sources. The approach of these funds is the same as the regional funds, but they target smaller projects ($5,000 to $50,000) (Hebb, Wortman, et al. 2006 citing Ninacs, 2003)[xxx].

Similarly in British Columbia LSIF Working Opportunities partnered with Community Futures and contributed $750,000 to their community loan fund (Hebb, Wortman et al. 2006).