IBC
INDIAN BUSINESS CORPORATION

Alberta's economy is the mother of invention:

What Indian Business Corporation knows about social finance that many of us are missing

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terrapin
SOCIAL FINANCE

ABOUT INDIAN BUSINESS CORPORATION

Established in 1987, the Indian Business Corporation (IBC) provides financing for First Nations peoples in Western Canada. IBC creates economic development through developmental lending and financial services, on the basis that access to capital for First Nation's individuals and businesses provides opportunities for success and development.

ABOUT TERRAPIN SOCIAL FINANCE

Terrapin Social Finance makes developmental lending work better for the good of entrepreneurs, communities, businesses and investors: where entrepreneurs have difficulty with financing, where a social license to operate is essential, where supply chains need local content, and where measurable social change matters.

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Executive Summary

The worst thing about the Alberta economy is the uncertainty of the situation. No one knows when the oil sector will recover and what it will look like when it does. Housing prices are dropping and families are burning through their cash reserves. 2016 will be harder than 2015.

But it's in adversity that opportunity is often found. Tough economic conditions in Alberta are shaping a successful model for social finance and impact investment while opening new and innovative possibilities for First Nations entrepreneurs to flourish. As Wanda Wilson, a First Nations finance specialist puts it: "First Nations entrepreneurs always have their backs against the wall when it comes to accessing capital. Moving past these challenges builds exceptionally resilient companies. In 2008 we saw how First Nations contractors were nimble enough to take work from bigger, more costly operators. We expect to see this again as we emerge from the current crisis."

This is where *developmental lending* begins to resonate. With over 25 years of experience, Aboriginal Financial Institutions (AFIs) have demonstrated in good times and bad how developmental lending can yield social and financial returns through an uncomplicated approach: making loans to First Nations people who can't get one at a bank or credit union. By closing the 'access to capital gap' faced by Aboriginal businesses, Canada's AFI network can offer steady deal flow to an impact investment community seeking more opportunities to make social impact.

Calgary's Indian Business Corporation (IBC) is a good example of the system at work. By focusing on small business lending to First Nations entrepreneurs, IBC takes risks unthinkable for a bank or credit union. In 95% of cases, IBC's loans are repaid in full and they are able to churn and contribute more capital to a long line of First Nations entrepreneurs waiting for financing. Getting loans paid back involves providing extensive pre and aftercare: everything from business planning to helping with receivables to tax filing. Federal and provincial programs help absorb the extra-ordinary costs of developmental lending, which in turn allows IBC to offer impact investors a chance to achieve their goals.

Since 1987 IBC has invested more than $80 Million in loans for First Nation entrepreneurs and they've innovated evaluation and reporting the social and economic outcomes their capital has catalyzed. Their biggest challenge today—they need more loan capital. "We are all loaned out," says Rob Rollingson, IBC's general manager. "I've got $1 Million in approved loans sitting on my desk and no capital to finance them. We know the loans we make change people's lives for the better and amount to collective impact on communities." Rollingson says IBC's current team could lend an additional $5 Million to First Nations customers without compromise to quality or increased risk.

IBC views the communities where they work as unique, complex and nuanced. This is reflected in their approach to lending. "Credit history and lack of collateral are big obstacles for most of our clients," says Patrick Gladue, an IBC loans manager and a member of Bigstone Cree Nation. Our intake process starts with exploring an individual's character and where we can show goodwill. We visit their home or place of business. We take a patient look at their opportunity and their experience. We meet their kids. The risks may be high, but we've shown the social and economic returns are definitely in line. It feels good to help someone turn their life around."

Impact investors and governments have an opportunity to move the needle on social finance by investing in developmental lending. For impact investors struggling to find meaningful investments, Indian Business Corporation has a sound model to secure their investment and deliver the blended (social and financial) return they seek. For governments seeking ways to encourage social finance and social outcomes in First Nations communities, IBC's model delivers measurable social change. This intersection of private sector and government interests creates exciting possibilities for developmental lending and social finance. With a growing number of motivated impact investors on the one-hand and government programs helping to cover risk and cost on the other, the scale and impact of the model is poised for significant growth.

These are challenging times

In Alberta, more than 70,000 jobs have been lost to the downturn in the oil sector. For IBC, the problem is keeping up with each of their ~300 clients and providing personalized supports to ensure their continued success despite economic turmoil.

What happens to social finance in a tough economy? This important question was raised with developmental lenders, impact investors, governments, and other experts[1]. For a real-time perspective this paper takes a close look at Indian Business Corporation, to analyze the ways in which the economy is forcing adaptation and innovation in their lending practices.

Since the chaos of 2008, governments, investors, and organizations have been pursuing social finance with new vigor, and much attention is being paid to complex vehicles such as social impact bonds. Meanwhile, certain Aboriginal Finance Institutions across Canada have been quietly demonstrating how developmental lending can deliver social and financial returns in the midst of today's economic challenges. It's hard to spot social and financial innovation amid the bluster surrounding unproven complex financial instruments and banks obsessed with eliminating financial risk at all costs.[2]

What's the risk of eliminating all risk?

For IBC, eliminating all risk would put them out of business. First Nations entrepreneurs they consider credit worthy would not start or expand the very businesses that build stronger, healthier communities. A willingness to accommodate a clear margin of risk is the fundamental difference between developmental and mainstream lenders. "All our loans are risky, but write-offs in IBC's case account for only 3%-5% of our portfolio," says Rollingson, an early adopter of outcomes evaluation in developmental lending. "When we look at the social value created across our whole portfolio, our directors think it's a sound return on investment. We look at this this way: the losses represent the cost of social change."

In 2012, IBC began tracking the social outcomes arising from the loans they make and the businesses they support. According to Rollingson, the current economic downturn has turned up the pressure on IBC in terms of the supports they deliver to keep clients in good standing so that positive social outcomes can continue. "Social finance needs to work in good times and bad," says Rollingson. "So we'll do whatever it takes."

Glossary

Social Finance an approach to managing money, which delivers both a social dividend and an economic return.

Impact Investing Investments made into companies, organizations, and funds with the intention to generate measurable, social or environmental impact alongside a financial return.

Developmental Lending (DL) Loans for people and organizations who otherwise can't get a bank loan. DL is characterized by a focus on social outcomes.

Aboriginal Finance Institutions (AFI) A national network of 50+ developmental lenders, many with 25+ years making and retiring loans for Aboriginal entrepreneurs.

Social Enterprise A business designed to generate income and create specific social, cultural and/or environmental value.

The problem with social finance

For IBC the big problem isn't lending opportunities with social impact, it is access to capital. Typically, 100% of their $13 Million capital pool is invested in loans, helping First Nations entrepreneurs start or expand businesses, creating employment and economic participation. As of today, IBC has $1,000,000 in approved loans they can't fund. All their capital has been lent. This represents lost opportunities for employment and a high level of frustration for individual entrepreneurs who mostly live on reserve and cannot qualify for a loan with a bank or credit union.

Meanwhile, some impact investors such as private & community foundations can't find the deal flow to put committed capital to work. According to Beth Coates, CFO at the Canadian Alternative Investment Cooperative, "we find ourselves in this weird place where there's too much capital chasing very few deals that are truly able to deliver financial and social returns." While there is the intention to invest more capital at the grass roots, weak deal flow means much of the well-intended capital ends up in socially responsible investments (SRI) in the equity markets. The problem with social

[1] **We spoke to** Rob Rollingson, Patrick Gladue, Margy W itbeck, loan managers at Indian Business Corporation, Narinder Singh, accounting and business planning at Indian Business Corporation, Francine Whiteduck, CEO at National Aboriginal Capital Corporations Association, Joanna Reynolds, Director of Social Enterprise at Centre for Social Innovation, Beth Coates, CFO at Canadian Alternative Investment Cooperative, Martin Garber-Conrad, CEO at Edmonton Community Foundation, Paul Wyminga and Wanda Wilson at Government of Alberta, Department of Indian Affairs, Robert Fortin & Brock Dumville at Indigenous and Northern Affairs Canada, JJ McMurtry, Associate Professor, Business and Society Program, York University.

[2] JJ McMurtry, Associate Professor, Business and Society Program, York University

finance for the investor: not enough places to make these investments, and not enough mechanisms through which risk can be reasonably managed and invested capital will deliver social and financial returns.

For government departments such as Indigenous and Northern Affairs Canada, (INAC) and The Government of Alberta's Department of Indigenous Affairs (GOA) the problem is finding effective ways to encourage more lending and investment, while simultaneously promoting reliable outcomes through measurement and reporting in order for the model to grow. Social finance is a natural fit where indigenous communities are concerned given the challenges of persistent poverty on one hand and the anticipated wealth from resource sector development (much of which is on First Nations territory) on the other. Government departments are starting to recognize the AFIs' value. Particularly when it comes to small business financing that supports community economic development while fostering local contractors, suppliers, and services—many of which end up working directly or indirectly in the resource sector.

Social finance grows outside the centre of power

JJ McMurtry, associate professor of business and society at York University notes that Canada has been a centre of social finance innovation at different points throughout history. He points out that in 1900 the rural Quebec economy was divorced from the centres of power. In response, Alphonse Desjardin cultivated a model that built local capital and resilience in the midst of a bad economy. The federation of Desjardin's credit unions took off and continues to thrive at the centre of Quebec's economy today.

McMurtry draws a direct parallel between the Desjardin model and Aboriginal Finance Institutions today. "Across Canada some of the AFIs are demonstrating how developmental lending can deliver social and financial returns in the midst of economic challenges for communities too often outside of the centres of power," he says. But, like Desjardins in 1900, they tend to fly below the radar. It can be difficult to track the results of developmental lending amid increasing obsession with complex financial instruments and banks focused on large-scale investments and risk elimination. "These noisier obsessions mean we stand to miss truly exciting innovations happening right in front of our eyes," McMurtry says.

'Downloading' by federal and provincial governments has resulted in a stark reality: all municipalities must become self-sufficient. In this sense, Aboriginal communities are harbingers of the future. Given the level of poverty on reserve and within urban Aboriginal communities, social finance has emerged as both a necessity and a desirable policy alternative. Finding simple ways of doing social finance is a crucial priority at this particular moment in Canada. We have to learn from our history and from each other to create clear pathways for investment capital to flow to entrepreneurs in urban centres, rural areas and on reserve.

A Lean Machine

IBC manages approximately 300 loans worth approximately $15 M with a team of 5: General Manager, two loan officers, an accountant, office manager. Rollingson feels they could manage 400 customers worth $20 M without having to re-tool their shop.

"We've proven we can deliver social and financial returns, we just need to find the investors who share our commitment to First Nations economic development."

Mad cow and other market forces

We've seen how a tough economy creates fertile ground for social innovation because people are forced to respond to challenges, look for new solutions, and seize opportunities quickly. It also tends to drive a tightening of access to capital from the mainstream lenders. This is another factor in how innovation in social finance is often the response to a tough economy.[3]

Joanna Reynolds is director of social enterprise at Toronto's Centre for Social Innovation and was involved in the national dialogue on social finance in 2008 as a founding director of MaRS Centre for Impact Investing. "After the crash in 2008 we saw how social loan portfolios appeared to move against declines witnessed in other parts of banking," Reynolds notes. "Social loan funds experienced steady repayment and fewer write-downs than expected." Reynolds and colleagues at MaRS based these observations largely on the experience of credit unions where higher rates of repayment were attributed to the small scale of the lending and the importance of individual relationships between lenders and their customers. These factors seem to result in a lower level of default than one might expect in the face of economic adversity, especially from less affluent clients.

[3] Joanna Reynolds, Director of Social Enterprise at Centre for Social Innovation

For IBC, 2008 was one thing. Mad cow disease (BSC) on the other hand, proved a bigger disruption, but one from which they learned a great deal about their own sustainability. At the height of mad cow, IBC was heavily invested in First Nations ranchers and their response to the BSC was to waive payments. Cash flow suffered and loan delinquency rose. The result for IBC was a loss of $2 M, which they wrote off their books in 2007. IBC emerged from that experience better equipped to meet similar challenges. "We learned that this kind of cyclical risk can be managed first by seeing it on the horizon and then by creating an appropriate provision. Such a move would have allowed us to avoid the write off," says Rollingson. In the current context and based on hard-earned experience, IBC will make the necessary provisions to manage anticipated losses in this exceptional year. "This is the kind of thing that comes along every 10 years or so," Rollingson says. "You have to plan your business around this too so you don't take a $2M loss in one year. I suppose you could call that innovation in a time of uncertainty. We call it learning from experience."

Simple innovation

For IBC's loan mangers, the Alberta economy has merely added an extra layer to the daily challenges they face in good times and in bad. "We are in the business of helping First Nations people grow their economies by lending them money to start or expand a business," says Gladue. "In many cases entrepreneurs, First Nations and otherwise, are new to things like business plans, financial statements and tax filing. First Nations customers are often dealing with a whole host of factors that add to the challenges of starting or expanding a business. If what we do is seen as innovative, that's nice. For us, it's often a matter of getting up early, getting in the truck, and driving to see a client, helping where it's needed, being there to help make business decisions...we see it as fundamental."

Basic or not, IBC out-performs many developmental lenders in terms of the volume of loans made to so-called high-risk First Nations clients ($80 Million to 2500+ customers since 1987) and the containment of bad loans to a rolling five-year average of less than 5%.

With the oil crash, IBC has seen an increase in the number of customers 'in arrears' from 10% to 18% or from 25 to 40 customers between February 2015 and February 2016. With the experience of Mad Cow disease in their recent memory and individual client assessments, the IBC team feels they have contained the arrears and are working extra hard to keep their portfolio healthy, and their clients moving forward.

"We start by looking at their books," says Margy Witbeck, an IBC loan manager. "It's time consuming, but essential to understanding their operations so we can support difficult decisions that may allow the businesses to survive." She points to an example of a company that needed to switch from short gravel hauling to long haul trucking. "We were there to support the business decision and provide additional financing to make the transition."

"It's better for everyone if we can keep the loans on track," says Rollingson. "We have a few different paths we can take to do this. It really comes down to knowing the needs of the individual customer, which comes down to trust and regular contact."

The instance of a customer in arrears does not mean the loan is doomed to fail. In some cases it makes sense to collect interest only or reduce the interest rate. In every case IBC's loan managers look at the individual customer and make the best decision based on a range of factors and opportunities. According to Gladue, it's a case-by-case decision. "There's no book to tell you what to do. It relies on *knowing the client really well*. Do they have the skills and opportunity to adapt? Have they shown the work ethic to try? What's their past record with IBC?"

The difference between developmental and commercial lending

The cost of developmental lending adds up, and is reflected in IBC's interest rate (12.5% for all loans). Driven by its mission, IBC believes it's better and more efficient to keep the loan in service. The transaction costs on a foreclosure may be higher than keeping people in business...the social costs of foreclosure are definitely higher. IBC's philosophy is simple – "we don't want to throw good money after bad." Every case is going to be different – you can't generalize. The client who goes from gravel to long haul trucking might not be suited to long haul trucking either. But there are solutions. He might have to sell one of his trucks. Sell a truck, reduce your debt and carry on.

IBC's client support (referred to as after care) is delivered with the recognition that calling a loan is a last resort. While they may recover 60 – 70 % of principle (as most loans are secured by a piece of equipment) the bigger loss will be to the individual, they will be hard-pressed to recover economic ground. And, it will cost the community. It's far better if IBC can keep people in business. "Paradoxically though, there's value to be realized through foreclosure for us and our client," says Gladue. "Entrepreneurs generally experience failure before they get it right. It's part of the journey and as their lender we gain a great deal of experience in terms of judging risk. It's always the last resort and usually by the time we are there it's a mutual decision."

What some see as innovation may just be a reflection of IBC's mission and governance: they are 100% owned by Alberta's 42 First Nations who placed their shares in a trust, which operates from IBC at arm's length and without political interference. This, according to Rollingson, is the secret to their success and allows them to stay on mission. "Chances are a commercial bank isn't going to support a small business customer into another line of business. There are switching costs. You miss payments and a commercial lender will shut you down. The questions we ask every time a client hits a major challenge: Do we think they can make it? Are they worth our effort to try and salvage their business? What's the community impact if they shut down? Are we throwing good money after bad? How much good money are we willing to throw after money that's already at risk? Can we get our money back?" Every individual case is unique, and is treated as such.

IBC Client Mix

- A third of IBC's clients are in **oil and gas sector**. Work has slowed and rates have been cut 30% - 50%, which means less revenue. Steam trucks, vac-trucks, gravel trucks, oil well maintenance, etc.
- A third are in **ranching and farming**. Mostly they are doing ok although the general state of the economy is affecting all sectors
- A third of IBC's customers are in **everything and anything** you can imagine from tattoo parlors to mobile rodeo scoreboards. These businesses are often contingent on the economic and social climate, adapting to disparate circumstances.

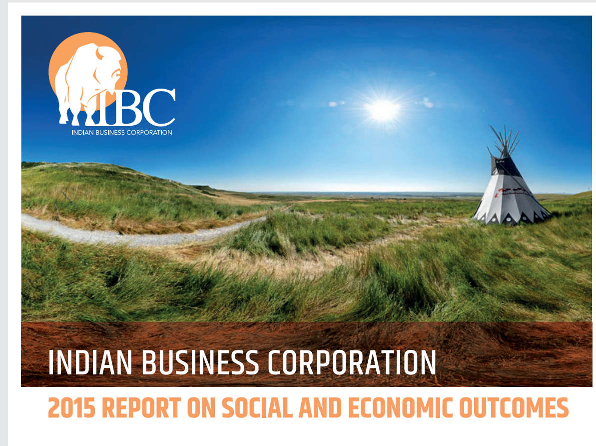
Government enables social finance

Under the new federal Liberal government, Indigenous and Northern Affairs Canada (INAC) is experiencing unprecedented profile and priority. Within the department, social finance is viewed as an important potential source of capital for social enterprises. INAC sees AFIs as longstanding models of social enterprise. "They provide a mechanism to finance Aboriginal small businesses," says Brock Dumville, manager for Indigenous and Northern Affairs. "If AFIs are positioned in the milieu of social enterprises and develop an acceptable set of indicators to measure social and economic outcomes, we think this may help them secure private sector investment. It's good leverage of the capital we can provide from the public sector."

"Both the federal and provincial government are doing quite a bit to help us," says Rollingson. "There are a couple of key federal programs and some direct support from the GOA that help absorb the extra-ordinary costs of developmental lending. Thanks to ADLA or Aboriginal Developmental Lending Assistance, and IRB or Interest Rate Buy-down programs there are dollars to support after care e.g. business planning, accounting, and more face to face visits with clients."

INAC hasn't seen any decline in demand for their programs, which are fully committed for 2016, indicating lending activity is on the rise in spite of the economy. "Both ADLA and IRB were designed to build a stronger voice among the AFIs when they engage with the private sector. Our intention was to help attract more impact investment to the network, says Robert Fortin, a director at INAC. "Moving forward, we'd like to focus on tools to unlock the idle capital within Aboriginal communities such as under-utilized trust monies."

IBC, in partnership with the Siksika Nation has already done something novel in terms of mobilizing under-utilized capital. In May of 2015, Siksika Nation South-East of Calgary established a $2 Million loan fund within IBC to finance entrepreneurs within their own community. The Siksika/IBC partnership demonstrates how useful AFIs can be in obtaining trust monies working in the community while mitigating the associated risks. This is another example of IBC's appetite for innovation in social finance: unlocking idle or hard-to-spend trust monies in a way that's transparent to the community and creates measurable community benefit. The Siksika/IBC partnership will issue their first outcomes report later this year.



Provincially, IBC has received help to develop evaluation and reporting systems. Rollingson explains that the province is a co-investor in the Siksika/IBC loan fund. "Without government support, 'social finance' would just be 'finance'; 'developmental lending' would just be 'lending' as IBC couldn't afford to deliver the necessary level of pre and after care, or to track and report social outcomes," he says. "The portfolio performance would slip, as would the social outcomes e.g. moving people out of poverty."

J.J. McMurtry acknowledges the support from government in helping AFIs make ends meet. "It's the Government's opportunity to help manage the risk and the cost of developmental lending including the cost of evaluation and reporting. These activities are essential to demonstrating their social and economic value, but they are nascent among AFIs. It's a complex and costly challenge to develop performance measures that are truly useful and reflective of the individuals and their communities." McMurtry sees evaluation as essential to supporting better practices, helping the sector grow, and achieving more and better outcomes from social finance.

The Government of Alberta shares Dr. McMurtry's concern for useful and community focused evaluations. "In the past, evaluation has been defined by policy shops that, after some cross-jurisdictional research have been known to declare 'this is the standard by which all must perform,'" says Paul Wyminga, director of Aboriginal Development at GOA. "It's not a very helpful approach. Every region has different circumstances and differing priorities. Outcomes must be defined with the community's participation."

Within the GOA the discussion seems to be less on social finance and more on economic diversification. "Small business development is becoming a bigger focus for Indigenous Affairs," says Wyminga. "Our goals align well with IBC. That's why we helped cover the cost of their 2015 Report of Social and Economic Outcomes. From a policy development point of view, it's helpful that AFIs measure the outcomes of entrepreneurship and improve socio-economic conditions. We'd like to see best practices established and shared across the network."

IBC has also innovated in attracting private sector investment to support First Nations social finance. In 2015 AltaGas, an Alberta-based energy infrastructure company, chose a novel method of investing to expand developmental lending through IBC. As their objective was focused on social rather than financial returns, the company chose to make a $500,000 interest free loan to help expand IBC's loan portfolio. The investment is mutually beneficial. The AltaGas First Nations Developmental Loan Fund helps support long-term relationships and provides enduring benefits to the communities where they operate while simultaneously boosting IBC's capacity to finance First Nations entrepreneurs.

Leadership from AFIs & Community Foundations

Francine Whiteduck is the CEO at the National Aboriginal Capital Corporations Association which provides a national voice for Aboriginal Finance Institutes in Canada. "What sells well," Whiteduck says, "are Aboriginal communities and businesses with the organizational capacity to provide governance and oversight to manage capital." This process is valuable for investors, government, and Aboriginal communities alike; creating viable businesses that can deliver social outcomes. Whiteduck acknowledges the risk. "There will be failures and as long as we are prepared to accept failure as a stage of growth, we are OK," she says. It's a risk she feels the AFIs are well suited to take: "we need to stop talking about it and just try it...if we can eliminate the fear of failure and embrace risk we can expect to see some really valuable innovations take root."

The Edmonton Community Foundation's Social Enterprise Fund (SEF) is another key player in Canada's emerging social finance scene. "With regime change in Ottawa, governments are poised to pump billions into the Canadian economy," says Garber-Conrad. "If a tiny fraction of this investment were to be redirected towards developmental lending it would yield profound results. We know this already, we have the evidence, " he says. "A modest investment in developmental lenders like IBC or SEF could prove as significant as infrastructure investments, which are also terribly important. We'd just like to see a tiny bit of the exposure and investment flow to this area which has proven so positive in terms of dealing with root causes of poverty."

Garber-Conrad goes further to suggest four ways the provincial and federal governments could help expand the scale and impact of developmental lending in Canada:

1. A donation - to proven developmental lenders
2. An investment, such as in interest-free loan - into the operations of proven lenders
3. Loan guarantees - can be made at a minimal cost given the low default rate
4. Co-investment in larger projects - in partnership with developmental lenders

In this respect, developmental lenders are setting a clear path for Governments to follow. Their goal is to help governments move to action by providing good ideas, worthy investments and solid social outcome reporting. As Garber-Conrad notes, there is already a small but growing number of good developmental lenders across Canada to deploy this capital. "Some like Indian Business Corporation are in the AFI network, others are within a community of private foundations, while still others like Canadian Alternative Investment Cooperative are venerable and deeply experienced," he says. "Given governments' focus on First Nations and infrastructure spending, they have the opportunity to move the needle on social finance and poverty elimination at a fairly low cost. Good networks are already in place."

Conclusion

Aboriginal finance institutes have cleared a path for impact investors and governments to support and enhance their model of social finance by investing in developmental lending. Each piece of the puzzle is in place: impact investors and governments have the opportunity to make meaningful investments and support First Nations communities respectively, in the form of IBC's measurably successful loan structure. In connecting these two forces—private sector and government interests—transformational possibilities for developmental lending exist. While Alberta's economy continues to face big challenges, the power of developmental lending as an impetus for social change is clear and unchanging.

IBC's model is set for growth, and with it, the profound depth of its impact—both social and financial.

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