

Labour-Sponsored Venture Capital Corporations and Community Economic Development

by François Lamontagne and Ted Jackson

One of the common priorities identified by both private and public sector leaders is the importance of finding effective ways and means of supplying capital to small and medium-sized companies.¹ Parallel to that, the lack of capital accessible to underdeveloped regions and marginalized communities remains an important preoccupation for both CED practitioners and policy makers.² On the policy front, this preoccupation has translated into a number of government financing vehicles such as Saskatchewan's Community Bonds, Jobs Ontario's Community Investment Funds, and the Business Development Centres funded by the Community Futures Program. Several nonprofit and community-based organizations also provide innovative solutions to community financing problems.³

In spite of the existence of financial mechanisms specifically targeted at communities and small businesses, anecdotal evidence⁴ and a recent report of the Standing Committee on Industry (1994) suggest that access to capital remains an important obstacle to community and small business development. It is in this context that labour-sponsored venture capital corporations (LSVCCs) deserve closer scrutiny.

These funds represent a unique investment concept and they were primarily conceived as a vehicle for collective capital formation. However, some of the characteristics of several labour funds—especially with respect to the promotion of workplace education, worker ownership, rescue operations, and CED groups—suggest that they should be assessed more thoroughly from a CED perspective.

SALIENT FEATURES OF LSVCCs

At the end of this year's RRSP season, Canada's 16 LSVCCs reported nearly \$2 billion in assets under management. While aggregate assets of the mutual funds industry are still 100 times larger than those of the labour funds, LSVCCs have mobilized by far the largest pool of new venture capital available to small and medium-sized enterprises (SMEs) across the country.

Some recent initiatives and trends indicate that LSVCCs could become significant allies of Canada's community economic development movement.

The rapid expansion in the number and size of LSVCCs—in 1984, there were only six such funds with \$1.3 billion in assets—is explained primarily by the generous tax treatment they receive from federal and provincial governments. Each level of government provides a 20% tax credit on shares of the funds purchased by individual Canadians. LSVCCs units are also eligible for RRSP deductions. These tax breaks have caused controversy in certain investment circles, particularly amongst some venture capitalists who do not receive similar tax treatment. However, some of Canada's largest brokerage houses, such as Midland Walwyn and Wood Gundy, are aggressively selling LSVCC shares to their customers, while major financial institutions like Royal Trust provide custodial and other serv-

ices to the funds. LSVCCs have gone big time.

In return for the tax breaks they receive, the labour funds must create jobs and invest most of their assets in SMEs in regions or sectors designated as priorities by their sponsors. The Solidarity Fund of Québec, the oldest and largest labour fund (and one sponsored by the Québec Federation of Labour), focuses on Québec-based resource and manufacturing businesses that require restructuring or have the potential to expand. Funds established by the Manitoba Federation of Labour and the United Steelworkers of America seek to promote worker-owned conversions and buyouts. The B.C. Federation of Labour, the Canadian Federation of Labour, and the Professional Association of Foreign Service Officers have set up LSVCCs that target technology-intensive SMEs.

ASSESSING LSVCCs FOR CED

Can LSVCCs become allies of Canada's community economic development movement? Some recent LSVCC initiatives and trends suggest they might. In 1992, for example, the Solidarity Fund of Québec created a network of regional and local funds. By October 1993, these funds had invested a total of \$7.7 million in businesses located in four non-metropolitan areas of Québec. While this amount is not very large, it is growing and may represent a significant trend.

In addition, research has shown that these regional and local funds are potent levers of investments into these areas. On average, every one dollar supplied by the Solidarity Fund has leveraged approximately \$4.50 in additional investment.⁵ The creation of these funds

represents an attempt to decentralize investment decision-making and to channel capital into non-metropolitan areas.

In the west, the proponents of both the British Columbia and Manitoba LSVCCs have played important roles in promoting locally-owned and socially progressive co-operatives and credit unions in those provinces. The CEO of B.C.'s Working Opportunity Fund, David Levi, helped to expand and diversify the services of VanCity Credit Union, the nation's largest credit union. Among Vancity's offerings are the Ethical Growth Fund (an ethically-screened mutual fund) and lending programs for small business and social housing. In addition, the emphasis of Manitoba's Crocus Fund on employee-ownership led it recently to make its first investment in a local technology-intensive worker-owned firm.

In Ontario, the LSVCC with the greatest community orientation seems to be the new First Ontario Fund. Two of its sponsors—the United Steelworkers and the Ontario Worker Co-operative Federation—are well-known advocates of worker ownership. The Steelworkers are notable for their employee buyout of Algoma Steel in Sault St. Marie, an intervention that saved thousands of jobs and created a viable company. In the east, the recently established Worker Investment Fund of the New Brunswick Federation of Labour is also likely to take a more community-oriented approach to its work.

Of more direct relevance is the experience of the Solidarity Fund of Québec which, in the late 1980s, injected \$337,000 into the Montréal Employment Development Fund, a \$1.3 million small business development fund sponsored by three prominent Montréal CED groups. A major financial institution is also involved in the venture. This initiative is remarkable because it represents a direct form of LSVCC support to CED, as well as a partnership involving government, a private-sector financial institution, CED organizations, and a labour fund.

A recent study of two labour funds—the Solidarity Fund of Québec and B.C.'s Working Opportunity Fund—provides important insights on the impact of LSVCCs.⁶ The study found that LSVCCs demonstrated significant downstream effects at the firm

level in terms of employment retention, spin-offs for economic development in the area, improved labour relations and employee involvement, and reported gains in productivity.

Nevertheless, LSVCCs are not specifically designed to function as community investment vehicles. Their main focus remains the promotion of capital formation and investment by organized labour.

In addition, LSVCCs can provide SMEs with significant non-financial benefits. In particular, the Solidarity Fund experience shows that LSVCC-sponsored economic education in the workplace can help to increase transparency in management practices, improve labour-management relations and communication, enhance the collective bargaining process, and promote greater worker involvement in work scheduling and personnel decisions. These findings suggest that LSVCCs can encourage a certain democratization of the workplace, which is compatible with CED's local control and human resource development focus.

It would seem, then, that there are several ways in which LSVCCs can support community development. While not all labour funds value the initiatives discussed above highly, a few LSVCCs, including some of the country's largest, are already engaged in these areas of work.

LIMITATIONS OF LSVCCs

In spite of this relatively positive assessment, LSVCCs are limited in how effectively they can meet the capital requirements of impoverished areas and remote communities. One of the reasons for this is that the labour funds themselves are markedly different in their own policies and approaches. Some funds, such as the Solidarity Fund of Québec, the Crocus Fund, and Working Opportunity Fund, are somewhat sensitive to the needs of SMEs, small regions and workers. They often use a combina-

tion of social, economic, and financial criteria to assess business proposals. Others operate as very conventional venture capital firms with only their sponsors distinguishing them from the mainstream. For the latter, the criteria by which to judge business ventures do not differ markedly from that of "mainstream" venture capitalists.

Another limitation is that LSVCCs are not specifically designed to function as community investment vehicles. While several LSVCCs meet some of the requirements of CED financing, their main focus remains the promotion of capital formation and investment by organized labour. (Even this focus does not find universal acceptance. Some labour groups, such as the CAW-Canada and many large public-sector unions, do not support LSVCCs.) Furthermore, even the LSVCCs that are committed to community and regional development are necessarily pre-occupied with the formal, often technologically-advanced segment of SMEs, particularly those with export potential. For their part, most CED strategies focus on labour-intensive businesses in the service sectors or manufacturers serving local markets.

A more fundamental issue is whether the investment decision-making process of LSVCCs sits well with local priorities and needs. Most of the labour funds—a notable exception being the regional and local funds set up by the Solidarity Fund of Québec—possess relatively centralized decision-making structures. In this context, the control and ownership of the decision-making process, as well as the setting of priorities regarding the funds' investment strategy, are out of the control of communities. An immediate consequence of this situation is the bureaucratization of some of the larger funds and the creation of delays in the processing and acceptance of investment proposals. For the many communities and entrepreneurs faced with a dearth of investment capital alternatives, it also means little local control over an essential development lever.

CONCLUSION

Overall, there are many areas of compatibility between what LSVCCs can offer and what communities and SMEs need for their long-term development. How-

ever, the review also suggests that labour funds are not the universal answer to the financial problems of remote or underdeveloped regions.

Before one can be more enthusiastic about the value and significance of LSVCCs for CED, more research must be carried out. One obvious research area is the assessment of the impact on local and regional employment, income, and quality of life when LSVCCs have decentralized some of their investment activity. In this context, a simplified set of development indicators might be used as benchmark data.⁷ Another area to investigate would be the examination of the effects of decentralization on risk and cost reduction, leveraging effect, and generation and use of local savings.

In the final analysis, Canada's economic renewal demands positive action on several fronts. Perhaps CED groups and labour-sponsored venture capital corporations can benefit from closer and deeper links while they each pursue their own objectives. CED practitioners and policy-makers would benefit from a clearer understanding of both the limits and the possibilities proffered by LSVCCs.✍

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Notes

¹ Standing Committee on Industry, *Taking Care of Small Business: Report of the Standing Committee on Industry* (Ottawa), October 1994.

² See for example *Building on Strengths: Community Economic Development in the Atlantic Provinces—Summary of Conference Proceedings* (Wolfville, N.S.: Atlantic Provinces Economic Council and New Economy Development Group Inc., March 1994), p. 35.

New Economy Development Group, *Defining a Mid-Term Plan of Action and Research Agenda on Community Economic Development*, prepared for National Welfare Grants (Ottawa, March 1992), pp. 37-40.

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³ See for example *Making Waves*, Vol. 4, No. 2 (May 1993), an issue devoted to community investment. See also, François Lamontagne, *Les expériences de soutien technique et financier à l'échelle locale*, prepared for the Prescott-Russell Business Development Centre (Ottawa, June 1994).

⁴ *Ibid.*, pp. 1-2.

⁵ Canadian Labour Market and Productivity Centre, *The Role and Performance of Labour-sponsored Investment Funds in Canada: Some Preliminary Findings* (Ottawa, March 1995), p. 30.

⁶ Edward T. Jackson and François Lamontagne, *Adding Value: The Economic and Social Performance of Labour-Sponsored Venture Capital Corporations* (Ottawa: Canadian Labour Market and Productivity Centre, forthcoming 1995).

⁷ See for example: François Lamontagne and Christyne Tremblay, *Development Indices: A Quebec Regional Comparison*, Local Development Paper No. 14, (Ottawa: Economic Council of Canada, December 1989).