

F. INCREASE ACCESS TO FINANCING, PARTICULARLY PATIENT CAPITAL

1. The Opportunity

Access to capital is critical to the development of new products, the development of new markets, and making changes in how organizations operate. For example, it often takes five to seven years or even longer to bring a new product to market. As such, the availability of knowledgeable and patient capital to finance and nurture the development of new markets and commercialization of new products can be the single most important factor determining the success of businesses. As one writer put it, “The reality of the current industry in Canada, and in other countries, is that it is not always the company with the best product that succeeds; often times, it is the company that has the best access to capital or the company that is most creative in finding these sources of capital that will ultimately succeed.”

The following table summarizes the most common sources of capital at various stage of business development.

COMMON TYPES OF FINANCING BY SIZE OF FIRMS

Sources By Stage of Development (\$ Revenues)	Start-up	Very Small (Under \$200,000)	Small (\$200,000 to \$5 Million)	Medium (\$5 Million-\$25Million)	Large (Over \$25 Million)
Personal assets and resources/ friends and relatives	■	■	■		
Household mortgages, personal credit, and micro-loans	■				
Business loans		■	■	■	■
Retained earnings			■	■	■
Partner(s)			■	■	
Angel Investors			■	■	
Venture Capital				■	■
Non guaranteed institutional loans				■	■
Sale of equity shares					■

Some of the major sources of external capital for business development in BC include:

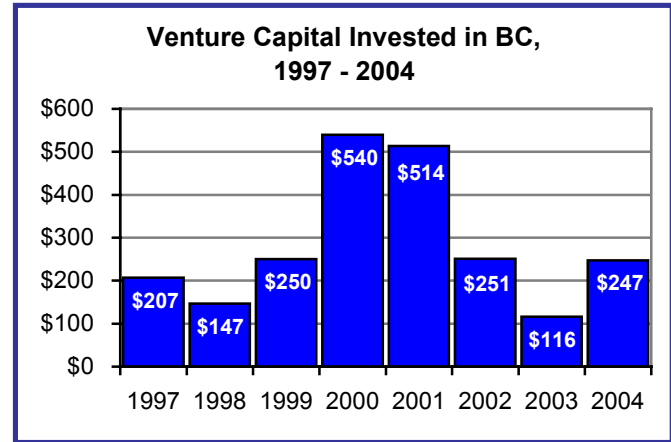
- *Angel investors*

The term “angel investor” is often used to describe an informal private investor. The network of angel investors in Western Canada is very informally structured which can make it difficult to link potential investors and businesses. Angels invest their personal funds, expertise and experience in a business in exchange for an equity stake (usually minority) in the company. They differ from venture capitalists in that they are using their own money. Venture capitalists also tend to focus on high technology while angels tend to have more diverse interests.

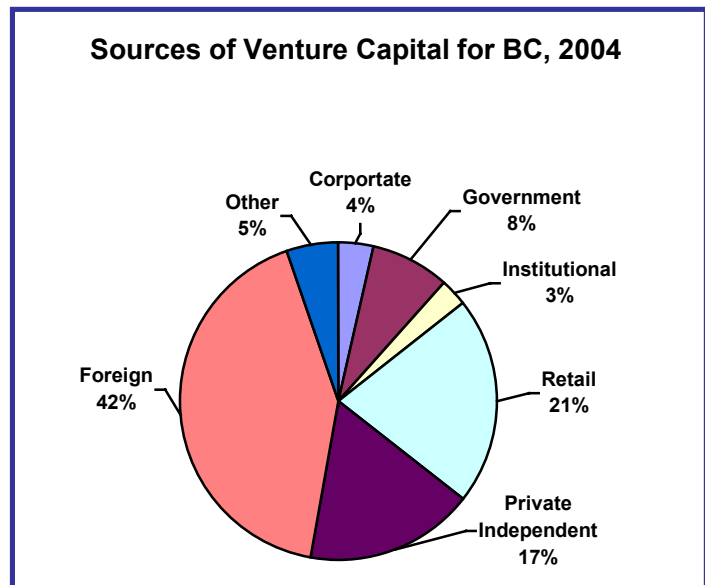
According to the Canadian Angel Investment Network, angel investors are currently investing over \$3 billion in Canadian small business each year (in comparison, the value of venture capital invested in Canada each year is under \$1.8 billion) and this number would be substantially higher if these angels were better able to find and review investment opportunities. A recent study estimates that about 60% to 80% of arm's length, early stage, private equity is angel investment. The size of angel investments varies widely, but most commonly ranges between \$30,000 and \$250,000.

- *Venture Capital*

The amount of venture capital invested in BC companies tends to vary widely from year to year. In 2004, while the value of venture capital placed in Canada increased from \$1.66 billion to \$1.76 billion, the value placed in BC increased from \$116 million to \$247 million. Sixty-two BC companies received investments in 2004. At \$79.8 million, Victoria's Aspreva Pharmaceuticals Corp. was the recipient of the largest venture capital placement in Canada in 2004.



In 2004, the primary sources of venture capital in BC were foreign investment, retail funds, and private independent funds.



The Government of BC's Equity Capital Program encourages investment in BC businesses by providing BC investors with a 30 percent refundable tax credit. The investment can be made directly or through a holding company, called a Venture Capital Corporation (VCC). Two related tax-credit programs, the Community Venture Capital Program (CVCP) and the New Media Program (NMVCP), operate very much like the ECP. The allowable maximum tax credit budget is currently \$20 million per year for these three program which would allow up to \$66.7 million to be raised and tax-credited. An example of a venture capital corporation that was established under the Equity Capital Program is WUTIF Capital (VCC) Inc., which is a \$30 million seed investment fund established for the purpose of investing in promising technologies such as those being developed at BC's universities and institutions.

Investors can also receive tax credits of 30% for investments in labour-sponsored funds. The Working Opportunity Fund, which is BC's largest venture capital fund, invests equity capital in small to medium sized businesses in BC's emerging industries such as information technology, life sciences, advanced manufacturing, film & entertainment, and environment sectors. During its thirteen-year history, WOF has invested over \$370 million in 95 BC companies.

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- *Business Development Bank*

The Business Development Bank of Canada (BDC) is a leading source of venture capital and debt financing for businesses in BC. The BDC authorized loans of \$178 million in BC in fiscal 2005 (increasing the portfolio to \$702 million). Across Canada, BDC authorized 78 venture capital investments of \$118 million in 2005, increasing the investments outstanding to \$348 million.

- *Community Futures*

Community Futures is also an important source of debt financing for small and medium sized businesses, particularly in rural BC. The program is delivered through a series of 34 Community Futures Development Corporations (CFDCs) located throughout BC. The primary objective of a CFDC is to enhance the overall well-being of the community by increasing economic activity and, often more importantly, by empowering community members to take an active role in the development of their community and thus building community capacity to deal with economic change and labour force adjustments. CFDCs annually provide about \$20 million in loans to businesses in their regions across BC.

2. Sectors Specifically Highlighting the Issue

Some of the sectors that specifically highlighted financing as an issue in their SWOT analyses and or development strategies include:

- | | |
|---|--|
| <input type="checkbox"/> Health products and functional foods | <input type="checkbox"/> Mushrooms |
| <input type="checkbox"/> Organics | <input type="checkbox"/> Small scale food processors |
| <input type="checkbox"/> Food and Beverage processing | <input type="checkbox"/> Value added food and beverage |
| <input type="checkbox"/> Horticulture | <input type="checkbox"/> Floriculture |

3. Situational Analysis

- **The need for capital is increasing in the agri-food industry.**

The need for change in the agri-food industry sector has increased the demand for patient capital. This funding is essential to finance the required innovations necessary to maintain competitiveness. These innovations take time to develop and implement and patient capital is essential to the cycle. In addition, operations are becoming larger, more complex and increasingly cash intensive due to automation and growth. This is particularly true in technology intensive sectors such as greenhouse vegetables. The food processing sector has seen major increases in capital inputs and a reduction in labour inputs since the 1960's.

- **In particular, capital is needed to exploit emerging opportunities in value-added products.**

It is difficult to raise capital for new product development or to modernize plants. The food-processing sector needs capital for technology and for the growing number of producers that see the advantages of transforming into processors.

- **Given the importance of the agri-food industry to the economy, the level of new investment remains low.**

While the amount invested annually is significant in real dollar terms (e.g. over \$400 million last year), the total investment for the agriculture and food & beverage sectors represents only about 1.5% to 1.8% of the total private sector investment made in British Columbia even though the sector accounts for about 2.4% of GDP.

BC INVESTMENT EXPENDITURES 1993-2002
 (\$ Millions-Current)

	2000	2001	2002	2003	2004
Agriculture	158.9	157.6	202.2	178.2	201.7
Food & Beverage Manufacturing	116.6	125.0	133.4	127.8	199.6
Total, Agriculture, Food & Beverage	275.5	282.6	335.6	306.0	401.3
Total Investment in BC	16,407.8	18,391	18,513.7	19,699.5	23,802.9
Percent of Invested in Food System	1.7%	1.5%	1.8%	1.6%	1.7%

- **The agri-food industry receives a small proportion of venture capital invested in Canada.**

In the period 1996 to 2003, venture capital investment in Canada totaled \$20.8 billion. Venture capital investment in traditional agriculture in that same period totaled \$57 million while primary food processing totaled \$102.6 million, representing only 0.3% and 0.5% respectively of the amount invested.

- **Traditional sources of capital tend to be less available to emerging companies in the agri-food industry.**

Traditionally banks and other capital lenders tend to finance projects that are lower risk, higher return and occupy more established markets. On the other hand, most venture capitalists are not very familiar with the agri-food industry. As a result, innovative agri-food related opportunities have difficulty in accessing capital because they are often considered too new or too risky for bankers and are not on the radar screen of most venture capitalists.

- **There are some government sponsored financing programs.**

Western Economic Diversification Canada (WD) offers the Agricultural Value-Added Loan Program in cooperation with Farm Credit Canada (FCC). This Loan Program is designed to improve access to patient debt capital for small and medium-sized processors in this sector. The food & beverage processing sector is eligible under the provincial government’s Equity Capital Program, although most companies in the agriculture sector are not. Agri-food sector venture capital funds tend to be government sponsored.

- **Despite the concerns of investors, available data suggests that the return on capital earned in the food processing sector compares favourably with the returns of other sectors.**

The return on capital averaged over 10% in each of 1990, 1995 and 1998 as indicated below.

Average Rate of Return to Capital (%)¹

¹ Ibid., A3.2

	Food-Only Processing	Non-Food Processing	Food Retail	Non-Food Retail	Food Service	Economy
1990	13.07	6.3	12.98	10.76	12.29	7.61
1995	11.57	12.7	15.07	5.96	8.18	9.02
1998	10.9	8.4	12.93	9.56	9.07	7.61
Ave.90-98	11.6	7.5	12.1	7.0	9.1	7.3

4. Potential Strategies

The ability to attract both patient and venture capital will be crucial for the development of new products and processes. The inability to attract the required levels of capital will restrict entry into new sectors and new products, create a productivity lag, and ultimately reduce competitiveness. Some of the strategies that have been employed by industry and governments to attract investment to the sector include the following:

- **Establish a financing agency for the agri-food industry.**

Some jurisdictions have created institutions specifically for financing agricultural enterprises. Some are government agencies while others are industry initiatives. Some services these enterprises offer include:

- Term debt financing;
- Export financing;
- Guarantees;
- Operating lines of credit;
- Special contracts for inventory purchase;
- Capital sourcing;
- Leasing services;
- Consulting; and
- Financial restructuring.

These organizations can also play a role in helping agriculture operations to find available grants and other sources of investment. Examples of these types of agencies include the Alberta Agriculture Financial Services Corporation, the Manitoba Agricultural Credit Corporation, the Ontario ACC Farmers’ Financial, and the Cascadia Revolving Fund based in Oregon. Saskatchewan has a livestock loan guarantee program and a hog loan program.

AVAC is a corporation started by the Alberta and Canadian governments to increase access to investment capital for value-added ideas and innovations. Alberta’s AVAC, started with seed capital of \$45 million has committed \$31.3 million to 154 early stage projects. Eleven projects have entered the start-up & revenue stages, 20 other projects will be ready for “start-up capital” once their ‘early stage work is completed and six clients are likely to become ‘investment grade’ in venture capital terms. There are 15 other financed projects touted as success stories.

- **Make direct investments in agriculture enterprises.**

There are jurisdictions that have vehicles for making direct investments in specific operations. These are normally agencies that are arms length from government or the result of an industry co-operative initiative. These organizations pursue investment strategies designed both to keep them self-sufficient and promote specific high potential areas of agriculture. Operations pursuing value-

added export markets and new technological applications are usually targeted. One example of this type of organization is Saskatchewan's Ag-West Bio Inc. This agency provides direct investments as well as assistance in locating other grants and investments for start-ups or expanding companies. The target is early stage technologies that present high risk for private capital sources.

- **Subsidize costs of activities related to attracting investments.**

Funding can be made available to agriculture enterprises to improve their attractiveness to investors. These activities would normally be related to improving the sophistication of the management tools and documentation that investors prefer to have available. They may include business plans, marketing plans, feasibility studies and market development plans.

- **Establish Managed Investment Pools.**

There is potential for the government to take a role in creating financial instruments that are of interest to investors. Managed Investment Pools could present investments that would be more diverse and have lower managed risk than those presented by single enterprises. Clustering and industry coops could be encouraged to facilitate the creation of these types of financial instruments.

- **Include agriculture production in Venture Capital Corporation Programs.**

Currently agriculture production is not a part of the BC Venture Capital Corporation Program. Inclusion of agriculture in this program or the formation of a separate agriculture venture capital program would provide tax incentives for investment in the industry.