

**LEGISLATIVE ASSEMBLY OF THE  
NORTHWEST TERRITORIES  
10<sup>TH</sup> ASSEMBLY, 5<sup>TH</sup> SESSION**

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Northwest Territories  
**Venture Capital Program**

## I. INTRODUCTION

A major and growing problem in the N.W.T. is the level of unemployment outside the major centers. Part of the reason for this has been a shortage of cash and equity capital needed for starting or expanding businesses.

Banks and developers have traditionally viewed the north as a marginal place to invest, so that loans are harder to obtain and interest rates on loans which are approved are generally higher, reflecting the lender's higher risk. Thus northern small businesses generally have much higher debt to equity ratios than those in the south. This is particularly true of our smaller communities, and as a result their businesses are unable to fill their role in providing long-term employment opportunities.

None of the existing government assistance programs is able to respond to this sort of business problem because none of them can be used to reduce debt burdens.

To fill the gap, the Minister of Economic Development and Tourism has proposed an N.W.T. Venture Capital Program.

The first purpose of the program is to redistribute surplus capital from areas of excess to those in which money shortage is a barrier to development by providing incentive contributions to anyone willing to invest in eligible businesses in communities with above-average unemployment rates.

A second and equally important objective of the program is to encourage successful businessmen to take an active part in the management of NWT small businesses requiring managerial assistance.

### HIGHLIGHTS

The GNWT will pay 30 cents on the dollar under certain conditions to any individual or company willing to invest a minimum of \$50,000 in at least two eligible businesses for up to three years. The investors need not be residents of the Northwest Territories.

Eligible businesses are those located in the 41 communities with above-average unemployment listed in Schedule A, with the exception of businesses engaged in a few ineligible business activities.

To qualify for contributions, applicants must register as Venture Capital Companies with the Department of Economic Development and Tourism, establish a joint trust account with the GNWT, and negotiate formal agreements with the business in which they will invest.

Once registered, Venture Capital Company shareholders will be eligible for contributions of 30% on their investments. The maximum total investment for which contributions apply is \$1 million (i.e. the maximum contribution for a Company is \$300,000).

Within a year of registration, Venture Capital Companies must apply 100% of their investment funds to the purchase of new voting shares in at least two separately-owned Eligible Businesses, with no more than 75% of the total in any one business.

A Venture Capital Company cannot purchase more than 49% of an Eligible Business's voting shares, although the Business may elect to give the Company a future option to take control of the Business under certain circumstances.

Investments must be maintained for at least three years unless the original Business exercises an option to buy out the Venture Capital Company prematurely or either the Business or the Company is forced into bankruptcy or is dissolved as a result of the death of any shareholder.

## II. PROGRAM OUTLINE

### OBJECTIVE OF THE PROGRAM

The objective of the program is to create long-term employment opportunities in communities with chronically high unemployment by providing individual and corporate investors with an incentive to:

- increase the amount of equity capital available to small businesses in these communities, and
- increase management assistance to small businesses through Venture Capitalists having a stake in the success of recipient businesses and taking an active part in their operation and management.

### DEFINITIONS

Communities with above-average unemployment are those reported in the Government of the N.W.T.'s 1985 Labour Force Survey to have unemployment rates greater than the 17% average for all communities. (See Schedule A for a list of communities.)

For this program, an N.W.T. small business is defined as a sole proprietorship, partnership, co-operative or limited company in which the majority of equity or share capital is held by N.W.T. residents.

Eligible recipient businesses are those northern businesses, as defined in the Business Loans and Guarantees Ordinance, which are located in communities with above-average unemployment, except those that receive more than 50% of their revenues from:

- \* the lending of money;
- \* mortgages or other debt instruments;
- \* the selling of insurance or real estate;
- \* the purchase and sale of shares or commodities traded on a stock exchange;
- \* or any combination of the above.

Businesses engaged in oil and gas exploration, drilling and production are not eligible, although northern businesses engaged in providing services to oil and gas exploration companies will be eligible, subject to the definition of a northern business.

## PROGRAM PROVISIONS

1. Every N.W.T. Venture Capital Company must be a new entity and cannot have carried on business prior to registration with the Department of Economic Development and Tourism. Upon registration the Venture Capital Company will be obliged to file an Annual Return showing the status of its investments in Eligible Businesses in the N.W.T.
2. Shareholders of a Venture Capital Company may apply to the Minister of Economic Development and Tourism for a contribution of 30% of their individual paid-in capital. After registration with the Program Manager the Venture Capital Company must place at least 30% of its paid-in capital in a jointly held trust account with the Government of the N.W.T. As investments are placed in Eligible Businesses,  $\frac{3}{7}$  or 42.8% of the amount invested in the Businesses will be released from the trust fund. (42.8% is calculated from the ratio of 30% Government contribution divided by 70% Venture Capitalist paid-in capital. It represents the proportionate risk taken by both parties.) Accordingly the fund's balance will reach zero when 70% of the paid-in capital is placed in Eligible Businesses.
3. Individual investors receiving contributions are not obliged to reinvest the money in their Venture Capital Companies, but if they choose to do so the reinvested contributions will be eligible for additional 30% contributions.
4. To register, a Venture Capital Company must have a minimum of \$50,000 in paid-in capital. It must then place 100% of its capital in at least two Eligible Businesses within a year of registration and, under normal circumstances, maintain its investments for the succeeding four years.
5. Contributions will be paid on a maximum of \$1-million in paid-in capital. Venture Capital Companies may have in excess of \$1 million in paid-in capital but the excess will not be eligible for contributions.
6. There are no restrictions on the origin or nationality of investors in N.W.T. Venture Capital Companies.
7. Investments must be made through the purchase of new equity (voting) shares in Eligible Businesses. Venture Capital Companies cannot own more than 49% of an individual business. However, to protect their interest in the event of default, Venture Capital Companies may also take convertible-preferred shares in consideration of an equity position.

8. Venture Capitalists must have "arm's-length" relationships with Eligible Businesses and must operate within the spirit and intent of the Program Objectives.

9. Businesses receiving Venture Capital funds must not lend those funds or reinvest them outside the N.W.T.

10. If an Eligible Business ceases to be a northern business as herein defined, the Venture Capital Company will have a year to divest itself of its interest in the Business.

11. If an Eligible Business becomes engaged in any of the ineligible businesses activities listed above, the Venture Capital Company will have three years to divest itself of interest its in the Business.

12. The Minister of Economic Development and Tourism may deregister any Venture Capital Company failing to comply with the provisions or the spirit and intent of the Venture Capital Policy and take actions to recover the total contributions paid to shareholders, plus a penalty equal to the prime bank rate plus 1% calculated annually from the date each contribution was paid to the date of deregistration.

### **III. EXAMPLE OF A VENTURE CAPITAL INVESTMENT**

This example shows how government funds are matched by Venture Capitalist funds, and their ultimate effect on Eligible Businesses in high-unemployment communities.

#### **STEP #1. FORMATION OF THE VENTURE CAPITAL COMPANY**

For investors to take advantage of the program they must be incorporated to purchase new shares in Eligible Businesses. For this example assume five individuals, each with \$20,000 cash, have incorporated a Venture Capital Company under the laws of the N.W.T..

#### **STEP #2. REGISTRATION OF THE VENTURE CAPITAL COMPANY**

Next, the Venture Capital Company must register with the Venture Capital Program Manager in the Department of Economic Development and Tourism.

#### **STEP #3. ESTABLISH A JOINTLY HELD TRUST FUND**

Upon registration, the Venture Capitalist must establish a joint trust fund with the Government of the N.W.T., in which 30% of it's paid-in capital will be deposited. The amount released from the trust to the Venture Capital Company would depend on the value of investments placed in eligible businesses.

#### **STEP #4. PAYMENT OF THE CONTRIBUTION**

With the trust account in place the Venture Capitalists may apply to the Minister of Economic Development and Tourism for a 30% contribution payable to the individual shareholders or back to the company, at their discretion. The amount of the contribution will be equal to 30% of the value of each investor's equity in the Company. There will be no restrictions on how the individual investors spend their contributions. However they may reinvest the contributions in the Company and become eligible for an additional 30% contribution.

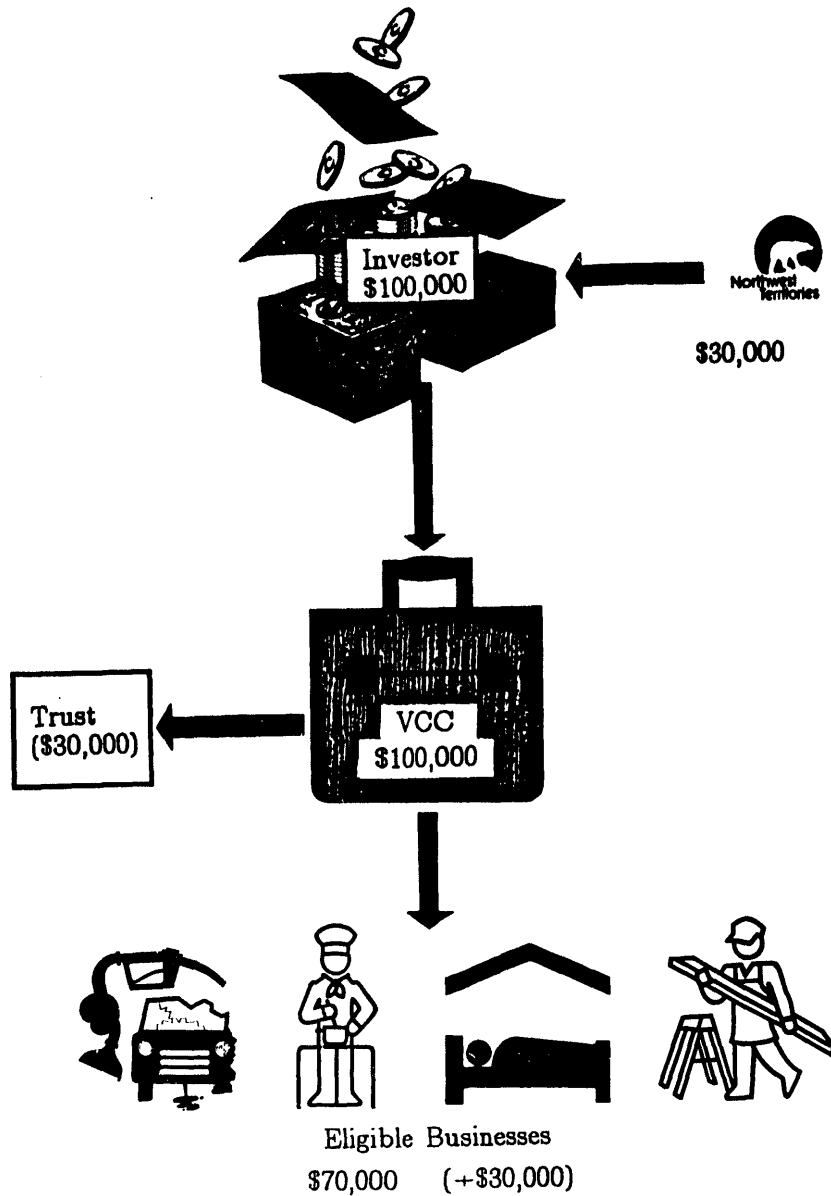
#### **STEP #5. PURCHASING EQUITY IN ELIGIBLE BUSINESSES**

The Venture Capital Company will now be required to purchase shares in at least two Eligible Businesses within a year of registration on the basis of an agreement which details the terms of their relationship, including operating budgets, management salaries and buy-out terms and conditions, etc.



Eligible Businesses which are not incorporated will have to do so in order to issue shares to the Venture Capital Company.

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#### IV. CASH FLOW OF THE VENTURE CAPITAL FUND

The following diagram illustrates the flow of capital and contribution funds in our example.

##### CASH FLOW DIAGRAM FOR THE VENTURE CAPITAL FUND

	<u>VENTURE CAPITAL FUND</u>		<u>TRUST FUND</u>	
	TRANSACTION /	BALANCE	TRANSACTION /	BALANCE
-----				
1. Form Co.	100,000	100,000	0	0
2. 30%-Trust	(30,000)	70,000		\$30,000
3. Invest.1	(30,000)	40,000	(12,857)	17,143
4. Trust Ref.	12,857	52,857		17,143
5. Invest.2	(70,000)	(52,857)	(17,143)	0
-----				

**note:**

Transactions assume no return on equity investments during the first two years. Therefore the Venture Capital Fund does not reflect dividend payments. Earned interest from the trust account is assumed to revert to the Government of the N.W.T..

In situations where a Venture Capitalist wishes to place a second investment that would exceed its outstanding paid-in capital balance, the G.N.W.T will release funds from the trust account in order to make up the total investment required. This will eliminate the need for interim financing. Item #5 in the above table highlights such a transaction.

The above table illustrates the flow of contribution and capital monies resulting from establishment of a Venture Capital Company. As shown, two investments, valued at \$100,000 were placed in Eligible Businesses, \$30,000 was released from the trust fund and \$30,000 in contributions was paid to the individual investors. The Venture Capital fund was also reduced to a zero balance.

The Venture Capital Company will now need to maintain its two investments for a minimum of five years or until the Eligible Businesses' owners buy back the shares issued.

## V. EFFECT OF A VENTURE CAPITAL INVESTMENT ON A SMALL BUSINESS

The following discussion shows the effects of a \$30,000 Venture Capital investment on a business in a small community:

### PRESENT OPERATIONS

- \* A small motel located on the Dempster Highway employs three people full time and two people on a part time basis;
- \* the business has been poorly managed and is considered a marginal but potentially viable operation;
- \* since the business started in 1981, annual gross profits have steadily declined to \$11,250 and interest charges on long term debt have eroded cash;
- \* outstanding long term debt is \$100,000 and interest is calculated at 10% per annum;
- \* because of poor management, business travellers and tourists are reluctant to use the facility. Instead of stopping for fuel or meals and accommodation tourist and truckers continue on to Inuvik. Fly-in business travellers restrict visits to one day and leave in the evening;
- \* the motel would not be eligible for financial assistance under existing government programs because there is a history of poor management and a revitalized business in this case would not be expected to create any new jobs.

### MARKET CONSIDERATIONS

- \* because the Dempster Highway is now fully maintained year round and Beaufort exploration activity has accelerated, traffic on the Dempster is expected to increase by 10% annually over the next five years;
- \* the opportunity to provide meals, accommodation and fuel exists but it is lost to motel's shabby condition, poor management and lack of cash;

## ROLE OF THE VENTURE CAPITALIST

- \* Through a match-up service provided by the Department, the motel owners meet with an interested Venture Capital Company from Yellowknife. Investors in the Company have extensive experience in the hotel and hospitality trade. The motel owners explain their situation to the potential investors and convince them of the potential return on their investment;
- \* the Venture Capitalists agree to invest \$30,000 for 45% of the business' voting shares and negotiate an annual rate of return of 15% on their investment to be taken from the business commencing in Year 3. A buy-out provision is given to the owners. This can be exercised at any date beyond Year 3. A plan to revitalize the business is agreed upon; the plan becomes the control instrument for the Venture Capitalist. It contains the following:
  - the Venture Capitalist takes a 45% voting position on the company's board of directors.
  - a general manager is appointed, financed by C.E.I.C. funding (premised on a training objective).
  - a marketing program that includes new services, and an operating budget designed to free up an additional \$8,500 in cash over the year.
  - financial reports are produced by management and reviewed at quarterly board meetings.
  - buy-out agreement provisions.
  - convertible-preferred shares sufficient for Venture Capitalist to take ownership of the business in the event of non-performance by its owners and management.

### RESULTS:

Assuming this plan was successful in restoring business volume by capturing an increased share of the Dempster traffic, cash flow would have improved, and the business would have been saved along with its employees' jobs.

**CASH FLOW OF THE DEMPSTER MOTEL LTD.**

	Before	After
Gross Profits	\$11,250	\$19,750
Interest Charges	(10,000)	(7,000)
Net Profits	\$1,250	\$12,750
Income Taxes (25%)	\$312	\$3,187
Net Cash Flow	\$937	\$9,563

As a result of the new management plan and additional cash provided by the Venture Capitalist, the business's cash flow would have increased from \$11,250 to \$19,750, an increase of about 75%. Further, a reduced debt load, would have reduced interest from \$10,000 to \$7,000, providing an additional \$3000 for operations, and an after-tax cash flow increase from \$937 to \$9,563.

SCHEDULE "A"

VENTURE CAPITAL PROGRAM TARGET COMMUNITIES

**BAFFIN REGION**

**TARGET COMMUNITIES**

Arctic Bay  
Broughton Island  
Cape Dorset  
Hall Beach  
Igloolik  
Lake Harbour  
Pangnirtung  
Pond Inlet  
Resolute  
Saniquiluk

**EXCLUSIONS**

Clyde River  
Frobisher Bay  
Grise Fjord

**KEEWATIN REGION**

Baker Lake  
Chesterfield Inlet  
Coral Harbour  
Eskimo Point  
Repulse Bay  
Whale Cove

**EXCLUSIONS**

Rankin Inlet

**KITIKMEOT REGION**

Gjoa Haven  
Holman Island  
Pelly Bay

**EXCLUSIONS**

Bathurst  
Coppermine  
Spence Bay  
Cambridge Bay

**INUVIK REGION**

Aklavik  
Colville Lake  
Ft. Franklin  
Ft. Good Hope  
Ft. Mc Pherson  
Paulatuk  
Tuktoyaktuk

**EXCLUSIONS**

Fort Norman  
Arctic Red  
Inuvik  
Norman Wells  
Sachs Harbour

**FORT SMITH REGION**

Detah  
Enterprise  
Ft. Providence  
Ft. Simpson  
Ft. Resolution  
Hay River  
Jean Marie River  
Kakisa  
Lac La Martre  
Nahanni Butte  
Paradise Gardens  
Rae Lakes  
Rae-Edzo  
Snowdrift  
Trout Lake

**EXCLUSIONS**

Ft. Liard  
Ft. Smith  
Pine Point  
Snare Lake  
Tungsten  
Wrigley  
Yellowknife

# DRAFT FOR DISCUSSION PURPOSES ONLY

## Annual Return

An Annual Return must be filed within 90 days after each anniversary of the date of registration. ▶

Registration Number	
Corporation Tax Number	
Date of Registration	Anniversary Date

Name			
Head Office Location - Street Number and Name			
City, Town, Village		Postal Code	Person to Contact  Telephone Number ( )
Mailing Address (if different from above)			
City, Town, Village		Postal Code	

- complete:
- (1) the attached Schedule A which asks for details of all investments made by this development corporation; and
  - (2) the following Questionnaire (and for each question answered "Yes" a Schedule, List or Copy must be provided).

Questionnaire			If "YES", complete as specified below:
In the twelve month period immediately preceding the anniversary date of registration has there been any change -	No	Yes	
1 in capital structure ?	<input type="checkbox"/>	<input type="checkbox"/>	Schedule B
2 in directors or officers ?	<input type="checkbox"/>	<input type="checkbox"/>	Schedule C
3 in the identity of affiliated corporations ? (if so, provide the name and address of each affiliate.)	<input type="checkbox"/>	<input type="checkbox"/>	List
4 in shareholders ? (if so, provide either a copy of the shareholders' register or a list of shareholders, their addresses and holdings.)	<input type="checkbox"/>	<input type="checkbox"/>	Copy/List
5 in the Articles of Incorporation ? (if so, provide a certified copy of any Amendment to the Articles.)	<input type="checkbox"/>	<input type="checkbox"/>	Copy

The Minister may verify all statements contained in this Annual Return. I understand that it is an offence to make a false or misleading statement in a return.

### CERTIFICATION

In submitting this Annual Return, I certify that  
I am an authorized signing officer of  
All statements made in this Return are true and correct as of the anniversary date of registration

.....  
DATE DIRECTOR OR OFFICER



**Schedule A**

List of all investments held at any time during the previous year

**ELIGIBLE INVESTMENTS**

Eligible Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date of Acquisition	Purchase price	Date of Disposition or Ineligibility	Proceeds of Disposition	Net Gain / Loss	
Eligible Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date of Acquisition	Purchase price	Date of Disposition or Ineligibility	Proceeds of Disposition	Net Gain / Loss	
Eligible Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date of Acquisition	Purchase price	Date of Disposition or Ineligibility	Proceeds of Disposition	Net Gain / Loss	
Eligible Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date of Acquisition	Purchase price	Date of Disposition or Ineligibility	Proceeds of Disposition	Net Gain / Loss	
Eligible Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date of Acquisition	Purchase price	Date of Disposition or Ineligibility	Proceeds of Disposition	Net Gain / Loss	

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**FORMER ELIGIBLE INVESTMENTS**

Small Business or Former Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date Investment became ineligible	Purchase price	Date of Disposition or Date Investment Regained Eligibility			
Small Business or Former Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date Investment became ineligible	Purchase price	Date of Disposition or Date Investment Regained Eligibility			
Small Business or Former Small Business			Class of Shares held	Number of Shares	Number of Votes per Share
Date Investment became ineligible	Purchase price	Date of Disposition or Date Investment Regained Eligibility			

**DEBT OBLIGATIONS**

Small Business			Nature of Debt Obligation	
Terms of Repayment	Date of Acquisition	Total Amount of Obligation	Date of Disposition	
Small Business			Nature of Debt Obligation	
Terms of Repayment	Date of Acquisition	Total Amount of Obligation	Date of Disposition	
Small Business			Nature of Debt Obligation	
Terms of Repayment	Date of Acquisition	Total Amount of Obligation	Date of Disposition	

Schedule B  
Changes in Capital Structure

Class of Shares	Number of Votes per Share	Date of Change	Change (issue redemption, purchase conversion or surrender)	Number of Shares Involved	Consideration Received or Paid

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Percentage of Equity Shares owned,  
controlled or directed by Non-Residents %

**COMMENTS**

**Schedule C**  
Changes in Directors / Officers

Surname		Given Name(s)		Occupation / Profession	
Residence Address - Street Number and Name (Apt. No., R.R. No.)				Telephone Numbers	
City, Town, Village		Province	Postal Code		Home:
Position:		Dates Position Held			
		From:		To:	
Surname		Given Name(s)		Occupation / Profession	
Residence Address - Street Number and Name (Apt. No., R.R. No.)				Telephone Numbers	
City, Town, Village		Province	Postal Code		Home:
Position:		Dates Position Held			
		From:		To:	
Surname		Given Name(s)		Occupation / Profession	
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City, Town, Village		Province	Postal Code		Home:
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City, Town, Village		Province	Postal Code		Home:
Position:		Dates Position Held			
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Residence Address - Street Number and Name (Apt. No., R.R. No.)				Telephone Numbers	
City, Town, Village		Province	Postal Code		Home:
Position:		Dates Position Held			
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		From:		To:	

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