

Freund Building Supplies Ltd.

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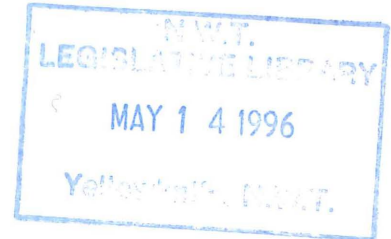


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May 10, 1996

Minister Stephen Kafkwi
Public Works & Services
Government of the Northwest Territories
P.O. Box 1320
Yellowknife, N.W.T.
X1A 2L9



Dear Minister;

Re: Business Incentive Policy Changes

We understand our government intends to change the current Business Incentive Policy. We appreciate the direction received from our legislature dictating that community consultations must be undertaken. Consultation, we trust, means more than simply coming into a community and offering a presentation. On this basis and having taken the time to study the document provided; we wish to provide our comments. We hope you will study our letter and accept our views as an integral part of the consultation process.

Freund Building Supplies Ltd. is a retail building supply organization in Fort Smith operating since 1987. This company is 100% northern owned, does all of the administrative tasks in Fort Smith, has an inventory valued at \$1,000,000.00 and employs and trains 12-15 northerners while providing a valued service to the community of Fort Smith. We feel the proposed changes in BIP will put our firm at risk.

General Comments

Your document says that BIP is a procurement policy. As this policy is a government policy, we are surprised with the choice not to acknowledge issues such as taxes, grants and economic strategies. Increased business volume in the Northwest Territories is an assured way of increasing the future revenue of our government through taxation. Simultaneously, increased northern spending decreases our cost of living and government social programs. We believe that the restructuring of this policy should address the future of the Northwest Territories and be a corner stone to their economic development strategy.

We object to your use of the word "subsidy" in relation to an amount paid by the government purchaser. BIP originally allowed the government to close their own warehouses and start to purchase from local suppliers while also making these products available to the private sector. The only rationale is that the accomplishment of this policy was a Government of the Northwest Territories economic strategy. The many benefits accrued to the government by reducing their own operating while also allowing the private sector to enjoy reduced costs of materials for home building and

maintenance. This decision generated jobs, training and slowed the leakage of dollars to the south. It now seems the government of the Northwest Territories wishes to change a policy that has generated far more benefits than it has costs. Please allow us the opportunity to offer our comments, topic by topic, on what we foresee as the impact of your proposed policy changes. We trust you will review our letter and respond accordingly.

Does the Current BIP Work?

The Chart offered shows the government paying a BIP premium of \$15,000,000.00. This is not entirely accurate when the costs of Social programs are brought into the complete picture. Jobs that go south could mean an increase in welfare and reduced spending for those forced to go on UIC. Our government must also address the impacts or costs of losing jobs because of their proposed modifications to BIP. Our northern economy requires, first, protection from the south and second, territorial economic development. Economic development must protect existing businesses, who have already made significant investment in the NWT, from being placed in jeopardy. At this time, we understand the money from ED&T for business development is not always spent with BIP guidelines. Future spending by communities under the Block Funding arrangement may bypass BIP.

The market sector numbers for the Airline Charter group and the Road Builders group is offering a higher factor to encourage more northern investors in these industries. We feel changing the building material sector to 5.8% from 15% is too drastic a change. This change in the material supplier sector is virtually eliminating any protection afforded existing businesses. This change is particularly of concern when the opportunity for non northern owned firms can probably register in the new BIP and then will only face a 2.50% disadvantage. Do not put the existing businesses at risk. You may be guilty of hamstringing your homegrown investors for the sake of short term cheaper prices.

We are of the opinion the Graph or Chart on page three shows northern suppliers have become more competitive. The existing BIP in our community has seen northern competitors working more diligently and keeping the money at home. Examine the cost of materials, examine the cost of labour in your "As and When" contracts and you will see the costs have been reducing yearly. Our government, through the current BIP, set up an economic strategy that worked. It has increased competition because it addressed the costs of doing business in the north. Reduction of the per centages will harm northern Material Suppliers but not reduce the cost to the GNWT. Every purchase made in the south hurts our economy. Should our business volume decrease significantly, we face only two options. One option is to raise our prices; the second choice is to close our doors.

Chart 1: DPWS Tools to meet GNWT Objectives

The majority (66%) of the check marks on this chart fall under business development and employment. This was the original fundamental reason for BIP. Should these tools be reduced or eliminated by drastically changing the degree of northern or local preference, the fall out could be severe. Do the government expect private sector to absorb what the government cannot? Remember Government employee layoffs have already reduced local spending.

GNWT's Concerns with Current BIP

Why should an Air Charter business receive a different level of BIP? Each company, whether an aircraft company or a supplier or a contractor, face many same costs associated with doing business in the north. The proposed changes will impact negatively on a material supplier while effecting positively on an Aircraft Charter firm or a Road Builder. The examples clearly show this trend.

Ownership is important but when we consider the previous comparison of a supplier or contractor with

an Air Charter company the question must be asked - " Who owns the airplanes?" A supplier, to meet the ownership requirements, must own the inventory and not have on consignment from a southern supplier. Or is the word " Ownership" simply a means of defining who owns the company? An example may be that an individual owns the company 100% and is a resident of NWT but the inventory his business has is on consignment versus owned by the registered owner. A storefront by definition is simply a false front for ownership and for accessing BIP qualifications. To qualify as a supplier of goods the inventory must be owned by the supplier. If the goods are not owned by the supplier and a firm misrepresents this fact then the supplier must be removed from the BIP registry for a long term. Long term should be measured in years as opposed to days or weeks or months. A contractor is often transient and seldom has permanent community roots when compared to a material supplier.

A southern business who does business in the NWT is still guilty of taking their profits south and paying their taxes in the south.

Problems with BIP identified by Public

All your comments are noted. However, changing the market factor for businesses sectors should be fair and address each market sector's contribution. Dropping a material supplier 5.8 % is drastic and raises some serious questions.

How do you justify why an Air Charter company is eligible for 20.7 % while a Material Supplier is only eligible for 5.8 %?

Is it your belief that it is easier to do business in the north as a Material Supplier as opposed to an Air Charter? Perhaps a Material Supplier can fly his inventory or assets south to Jamaica in the winter time and sell product there. Perhaps the Material Supplier can benefit by bringing in somebody elses material in the summer to increase sales during a busy fire fighting season? A Material Supplier must offer his customers service year round, employ people year round and take risks on his investment daily. A local Material Supplier offers materials for emergencies. A local Material Supplier provides storage for materials within the community the year round.

Where did these numbers come from and why is a Material Supplier so negatively rated? A Material Supplier's presence in the community enhances the quality of life. Which came first - the trading post or the community? We suspect you have used "southern numbers". These numbers reflect that Material Suppliers are on nearly every corner. In Fort Smith there was not a serious supplier until after the introduction of the original BIP. Let's not be guilty of trying to lump our northern economy with that in southern Canada. Northern businesses need a commitment from the GNWT to buy northern from northern owned and northern run companies that are competitive. The formula certainly seems to open the door to anyone to be BIP registered. The fact that it is northern run and northern operated must be worth more than the 5% you are proposing.

Why is a Material Supplier rated at the same level as a General Contractor? General Contractor status can be achieved by anybody that holds a business license and is registered with BIP. Does a General Contractor need to maintain an inventory, or provide a retail outlet or be required to be in operations for twelve (12) months? Grouping a qualified Material Supplier into the same group as a General Contractor is patently unfair to the Material Supplier.

Efforts are made to ensure that the BIP creates jobs in the North and goes as far as to outline the rewards or the penalties. Yet BIP groups the Material Supplier with a General Contractor. Has there been any consideration given the cost of being a Northern Material Supplier? The southern supplier leaves off loading costs to the customer. Northern suppliers are expected to

off load with a fork lift and replace even minor defects at no charge or paperwork.

It seems that by affixing a rate equivalent to that of a General Contractor, the GNWT, is prepared to discount all Material Suppliers from the North. A General Contractor can reduce his levels of employment based on construction activity but a Material Supplier needs to remain operational to continue to service the economy year round.

Road Builders, as a rate group is higher than Material Suppliers by 7.9 % but Road Builders do not keep all their construction equipment used in the north. Does this mean that Road Builders are nearly 2.5 times (13.5% / 5.8%) more significant to our northern economy than Material Suppliers? Road Builders are also seasonal.

Local Preference

The government of the Northwest Territories has a mandate to devolve many things to the community. The proposed change of BIP appears to ignore this mandate by reducing the local preference to 2.5%. This could mean that firms that operate out of a large community such as Yellowknife as compared to Fort Smith must compete almost equally. Yet each services very different market sizes. The new level is too low. Existing local preference is important when you have chosen to assign community factors that see a very, very small spread between Fort Smith and Yellowknife. The community factor is simply 0.12% and when one adds the 2.5% for local preference the spread is only 2.62%. This number is not only low; it is also scary.

Community Preference

If we compare Fort Smith versus Pelly Bay, we see Fort Smith at a factor of 1.0201 while Pelly Bay has a factor of 2.0744. Assume that a Contractor starts a business in Pelly Bay and qualifies for BIP. Using your formula it would allow a variance of 6.11% between Fort Smith and Pelly Bay for the supply of Materials into Fort Resolution as follows:

	Fort Smith Contractor	Pelly Bay Contractor	Variance
Market Sector	5.80%	5.80%	0%
Location Factor	1.0201	2.0744	203%
Equals	5.92%	12.03%	6.11%
Admin in NWT	100%	100%	0%
Equals	5.92%	12.03%	6.11%
Plus 100% NWT Ownership	2.50%	2.50%	0%
Total Preference	8.42%	14.53%	6.11%
Location Adjustment	0%	0%	0%

There is a distinct advantage to run your business from Pelly Bay. Look at the situation should the Pelly Bay entrepreneur wish to compete in Fort Smith. The Pelly Bay entrepreneur would have an advantage over the Fort Smith Supplier by 3.61%. It is apparent the formula does not work fairly. The

Location factor is based on MACA numbers that reflect historical differences. We question the application of MACA or Stats Canada ratings, especially on Building Supplies. These numbers only reflect the past but do not correct historic over charging. Suppliers in isolated communities dictate the price. In communities like Fort Smith our pricing is dictated by Hay River, Fort McMurray and Grimshaw. If BIP does not offer stronger local protection to the Material Suppliers then the dollars will leak south and the Material Suppliers in Fort Smith will be down graded.

Fort Smith is at the end of the road and in comparison to Fort Providence does not benefit by having drive by transportation both ways. Yet Fort Smith is rated at 1.0201 while Fort Providence is rated at 1.2037. Fort Providence has suppliers and customers on both sides. Fort Smith has competition on both sides during the winter and customers on neither. This differential of 0.1836 seems some what unfair.

The labour market would also be impacted seriously by allowing these numbers to be transportable from community to community. Look at the chart we prepared and ask the question of whether the Pelly Bay entrepreneur should receive a 6.11% advantage over Fort Smith.

Our Recommendations:

On reviewing our comments on the proposed new BIP, we have concluded the existing BIP is not a perfect policy. It is one that achieved the economic development objectives of the GNWT; however, it needs fixing to address the loop holes that allows abuse of the policy. Given the success of the existing policy, we favour continuing with the existing policy but fixing it with the following modifications or changes:

- Leave the local preference at 5%. This is consistent with the GNWT mandate to enhance community development. Any reduction would harm those communities that do not enjoy the advantages of market, access or infrastructure. These advantages vary from community to community.
- Introduce a severe penalty for non compliance or abuse. Abusers should face loss of the registration for years. Your proposed new BIP addressed a way to monitor and accordingly penalize or reward labour. There should be a similar penalty or reward system for materials and services.
- Eliminate the "grandfather" registrations. This task should be done firmly . We suggest picking a date.
- Apply the community factor only in the community in which the work is being undertaken. Businesses compete. The community factor will have communities competing with each other based on their community factor.
- Rationalize the Market Sector numbers. Raise the Material Supplier market sector from 5.8% to at least 12%. Material Suppliers, as permanent members of Northern communities need more protection than a transient General Contractor who can move from community to community by buying an airline ticket. Consider maximizing the portion of a true General Contractor preference at 5.8% but ensure that the General Contractor buys northern and uses northern sub trades. Ensure General Contractors hire locally. Ensure General Contractors comply with Labour Standards Act.
- Reconsider the numbers used in establishing the community factors. These numbers may be

based on cost of living figures that simply reflect historic monopoly charges. The use of these numbers will perpetuate the problems as opposed to correcting the problem.

- Consider the inclusion of penalties and damages for labour and also materials.
- Introduce eligibility criteria for BIP registration. Perhaps some of these items would help in defining a northern contractor. We suggest the criteria be based on:

Ownership Residency - the objective is to be 100% northern owned. If it is 100% northern owned then full 15% be afforded. If it is 50% northern owned then reduce 15% to 7.50%. If 66% northern owned then reduce to 10%. Owners must be resident full time in the Northwest Territories. Any abuse would lead to loss of BIP registration for two years.

Inventory Ownership - the objective is to maximize inventory ownership and eliminate store fronting. This should be self-policing for volumes and commodities. The penalty for abuse would be loss of BIP registration for two years.

Length of Time in Business - minimum of six (6) months with representative inventory in place to secure BIP registration. Consider the application of a bonus for length of service to the community.

Value of Inventory - must be representative of the commodities or products listed in BIP registration. Make BIP registration information available to the public for commodities, inventory and ownership items.

Service or Value to Community - the objective of measuring value or service to the community is to ensure the storefronts are differentiated from the retailer. There should be a penalty from the 15% if the supplier of materials does not offer the following:

- no staff available to serve the private sector during scheduled store hours. The penalty is to reduce the 15 % by 7.5% to 7.5%.
- no service provided such as delivery of materials, unloading materials, secure storage of materials until required. Penalty of 7.5%.
- size of inventory and service should be a value to the community not simply one that will allow access to BIP.
- compliance with all GNWT rules and regulations. All licensing and regulations must be met and kept current. All funds flowing from GNWT, such as ED & T and Block Funding for Communities must be directed to follow BIP rules. Loss of BIP status until in compliance.
- be current with all payments to GNWT. 3 months in arrears should eliminate BIP status until current.
- Make local preference available from the first dollars. Why exclude the first \$5,000.00.
- Local and Northern preference Petroleum, Oil and Lubricants. This will encourage competition and stop gouging by Southern Suppliers. This can be verified in Fort Smith since the local northern bulk plant opened in 1994.

Should these qualifiers not be required, the door is open to anybody with a business license and an owner of minimal inventory with poor management skills to conduct operations that are ultimately detrimental to NWT economy.

As a long term northern resident, a serious investor in the Northwest Territories, a significant employer of northerners and ardent supporter of the "BUY NORTH" concept, the direction suggested in your document on the proposed new BIP is unsatisfactory. The changes do not correct the problems; the changes simply put my investment as a Building Material Supplier at serious risk. Protection afforded by the current BIP will be removed and the suppliers from the south will again dictate the market.

We know that we do not have all the answers, but please take more time and reconsider the proposed changes suggested in your documents as the fall out of these changes will harm our fragile economy when our economy needs strengthening.

Yours truly,



Walter Freund
President
Freund Building Supplies Ltd.

cc: MLA J. Michael Miltenberger
Fort Smith Chamber of Commerce
NWT Chamber of Commerce
Ken Lovely - Chair SMPC
Igloo Building Supplies - Hay River
Lakeshore Building Supplies - Hay River