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Strategic Risks and Opportunities for First Nations Financial Institutions: Findings from a Market Demand Study

Tom Cooper and Ulnooweg Development Group

Introduction

Capital, and access to it, is a key ingredient in any economic activity. As First Nations groups look to future economic development, it is imperative that they have ownership and control over capital as an essential lever of the economy. The financial services industry, which provides capital to First Nations communities, is therefore an essential element for future growth and development. The question then arises: What are the risks for First Nation and Indigenous communities in pursuing financial services organizations that are owned and controlled by Aboriginals as an economic development strategy?

The purpose of this paper is to review the risks and opportunities for financial services organizations that are initiated and controlled by First Nations and Indigenous peoples. Data for this review is taken from a comprehensive 2007 market demand study (MDS) on Aboriginal financial services commissioned by the Atlantic Canadian First Nations through Ulnooweg Development Group (UDG). Although the study was primarily focused on the needs and opportunities of the Atlantic Canadian First Nations, particular interest in the MDS was addressed to what was occurring in the rest of North America, as well as internationally, in Aboriginal-owned and Aboriginal-controlled financial institutions. Thus, the MDS provides an excellent data set for an assessment of the need—ensuring opportunities as well as risks—for Aboriginal-controlled financial services organizations not only in Atlantic Canada, but internationally as well.

The MDS addressed the development of unregulated and regulated financial institution options in response to the identified and anticipated demand of Atlantic Canadian First Nations. Before the study, it was generally acknowledged that mainstream financial institutions providing the bulk of the First Nation debt-financing fell within the risk tolerance of federally regulated financial institutions. Each community knew its respective borrowing levels and which institutions held that debt, but the information had never been compiled or analyzed on a collective basis.

Ulnooweg's board of directors—comprised of Atlantic Chiefs—gave UDG the responsibility of undertaking a study to document, analyze, and quantify the

demand for capital. In addition to the demand for capital, the MDS provides a rich data set to analyze the issues facing Aboriginal financial institutions. A variety of methodologies were used to create this data set including surveys, a compilation of financial statements from First Nations, as well as key informant interviews. In this paper, the MDS data set is applied to a risk taxonomy developed by Chapman (2006) as well as Slywotzky and Drzik (2005) to analyze specific risks and opportunities present in First Nations financial institutions. The purpose of the application of this taxonomy and ensuing analysis is to provide a basis for the development of policies, as well as avenues for future research on financial services set within a First Nations context.

Background

In 2004, the idea of establishing an Aboriginal financial services holding company was discussed by the Ulnooweg executive as a means to explore potential Aboriginal involvement in the financial services sector. Ulnooweg has been providing loans and business services to Aboriginal entrepreneurs in Atlantic Canada since 1986. With representatives in New Brunswick, Newfoundland and Labrador, and Nova Scotia, its stated mission is to offer convenient, personalized service to clients to help them succeed (UDG).

In 2006, UDG prepared the proposal for a market demand study to examine the feasibility of an Aboriginal financial services institution in Atlantic Canada. In December 2006, the Minister of Indian and Northern Affairs Canada announced funding for the study. As outlined in the MDS document, the study's objectives were as follows:

- Conduct an assessment of the financial services needs of the Aboriginal community in Atlantic Canada
- Examine the experience of other Aboriginal groups and institutions that have been involved in similar undertakings
- Analyze the requirements of capital markets and regulatory institutions
- Conduct an assessment of potential ownership and operational models of various financial institutions

The result was a comprehensive analysis of Aboriginal financial services along with the data to analyze the market demand. It was noted in the MDS that prior to undertaking any action in response to a perceived gap in the market or needs of the community, it was important to clearly identify and quantify that need.

The undertaking of any strategy poses specific risks and opportunities for an organization and the MDS was upfront about these risks and opportunities. In this case, risk may be defined as anything that may enhance or impede an organization's ability to achieve its current or future objectives. Moreover, the identification and quantification of market potential is an essential part of any risk analysis (UDG 2008). The data collected as part of the MDS provides the foundation to

analyze the risks facing First Nations financial institutions in order to more fully understand the market potential of the strategy.

Research Design

The basis of data underlying this paper is the research and findings gathered as part of the MDS. In addition, a number of key informant interviews were conducted with Aboriginal economic development officers and leaders throughout Atlantic Canada.

The research design for the MDS was a mixed methods approach. At the proposal stage of the study, UDG recognized the need to engage the First Nations in the process on a fully informed and consensual basis. This principle was carried throughout the study. In the design process, every attempt was made to ensure that conclusions on the demand for financial services were triangulated; that is, at least three sources of information were used to document demand.

According to the MDS document, it became apparent to the study team that it was necessary to build the collective level of support for the project by actively seeking and securing the endorsement of the Atlantic Chiefs prior to sending out the community information packages. To that end, the following documents were prepared and distributed to the Atlantic Chiefs at an All Chiefs' Meeting on February 14, 2007:

- Study briefing note
- Study questions and answers
- Study fact sheet for media inquiries
- Briefing note on Ulnooweg for media inquiries

Chief Terrance Paul of UDG delivered a PowerPoint presentation explaining the need for and merits of the study to the Atlantic Policy Congress of First Nations Chiefs. This resulted in a resolution of support from the Atlantic Policy Congress to collaborate with UDG to gather the required information (UDG 2008).

Considerable time and effort were invested in the development of the community information package and data collection tools that would be sent to the individual First Nations to solicit their direct participation in the project. The First Nation representatives on the advisory committee pointed out that having a resolution from the Atlantic Chiefs was an important endorsement of the project. Moreover, it was emphasized that the individual First Nations would need to consent to providing the information (UDG 2008). The following data collection tools were used as part of the MDS:

- Structured interview guide for First Nation chiefs
- Structured interview guide for First Nation CEOs or general managers
- Survey for economic development officers
- Semi-structured interview guide for Aboriginal financial institutions

The tools were field tested with a representative of the sample group. The results of the field test were then discussed within the study team and appropriate changes and modifications were incorporated.

A considerable amount of primary and secondary data was collected as part of the market demand study. The data sources included:

- First Nation financial statements
- Key informant interviews with chiefs
- Key informant interviews with general managers
- Key informant interviews with collateral agencies
- Economic development officer survey

The consolidated financial statements of the bands were specifically analyzed to develop a detailed picture of how debt is constructed and used, the rates of interest being offered to First Nations, as well as the amount of interest being paid to lenders.

Finally, after the completion of the MDS a number of key informant interviews were arranged with Aboriginal economic development officers, as well as community leaders in Atlantic Canada. Questions were asked about the risks and opportunities in Aboriginal business and economic development.

Aboriginal Financial Institutions

It is important to first outline the existence of Aboriginal financial institutions in order to analyze the risks they may be facing. According to the report *Equity Capital and First Nation Business Development* (National Aboriginal Risk Capital Association 2004), the current Aboriginal financial institutions (AFI) network in Canada had its beginnings in the mid-1980s with the creation of the Aboriginal Capital Corporations (ACCs). In 1996, the National Aboriginal Capital Corporations Association (NACCA) was formed as an association of eighteen ACCs to co-develop and deliver business products and services to Aboriginal entrepreneurs. By 1998, all thirty-one of the ACCs were NACCA members.

In 1998, NACCA opened its membership to the Aboriginal Community Futures Development Centres (ACFDCs). Since then, the ACCs and ACFDCs have been collectively referred to as AFIs. The NACCA membership now includes fifty-eight AFIs—thirty-three Aboriginal Capital Corporations, twenty Aboriginal Community Futures Development Centres, and five other financial institutions.

The MDS outlined the experiences of other Aboriginal groups and organizations that have taken similar paths in other jurisdictions (see Ulnooweg Development Group 2008). In Canada, these groups include:

- Anishinabek Nation Credit Union, established in 2000
- Mohawk community of Khanawake, which established a Caisse Populaire in 1982

Figure 8.1: Common Risks Seen in Organizations

Hazard Risk ▶	Natural and man-made catastrophes, employee safety and health
Financial Risk ▶	Credit, pricing, reserving, valuation, liquidity
Operational Risk ▶	Internal controls, distribution channel conflict, legal, regulatory, data quality, fraud, technology, human resources, communication skills, employment practices, class action lawsuits, market conduct and claim practices, business continuity
Strategic Risk ▶	Strategy and planning execution, reputation, infrastructure/process/controls to support growth, competition

Source: Cooper (2008)

- First Nations Bank of Canada, established in 1996
- Peace Hills Trust of Hobema, Alberta, established in 1980

The history and existence of financial services organizations that are owned and controlled by Aboriginals allow for a better understanding of the risks and opportunities for a new entity. Specifically, failures or successes in strategy can be identified and used as a method of planning for improvement. Yet history is just one element that needs to be considered in evaluating the risks and opportunities of establishing a First Nations financial services organization. The most salient element to consider is whether establishing an Aboriginal-owned and Aboriginal-controlled financial institution is an appropriate strategy.

What Is Strategic Risk?

The first step in analyzing the threats and opportunities facing a First Nations financial institution is to identify the risks it would face, specifically around strategy. The practitioner management literature points to strategic risk emphasizing the importance of strategy, decision making, and implementation management in addressing risk within any organization. The academic literature has also been robust in the study of financial risk management. The literature suggests that strategic risk may be particularly high for organizations with significant long-term programs of innovation or where high levels of uncertainty exist about key issues in the environment (Cooper and Hsiao 2008). **Figure 8.1** outlines the levels of risks usually seen within an organization.

The purpose of this paper is to focus on financial, operational, and strategic risks, as these were seen as the most salient for an Aboriginal financial institution. Strategic risk is particularly important in the context of planning and policy development. Moreover, the need for strategic risk analysis would be consistent with

the objective of the MDS to provide an innovative way to address First Nations capital needs. There is also evidence that there has been a progressive move to incorporate formal risk assessment in regular business plans, as well as in the investment appraisal of major projects (Slywotzky 2007). The basis and motivation for the MDS manifests the need for an appraisal and assessment of the risks facing First Nations financial services organizations.

Risk is an incredibly important concept in the management fields. The writings of Knight (1921) started the management literature but risk, as a subject, is extremely old. The modern conception of risk is rooted in the Hindu-Arabic numbering system, which emerged over eight hundred years ago, but the serious study of risk began in 1654 during the Renaissance with the work of Pascal (Bernstein 1999). The concept of risk within society has also been increasingly analyzed, reflecting a rising societal concern about risk and its management. Moreover, elements such as reputational risk reflect the increasing concern that organizations ensure ongoing trust and address licence-to-operate issues—this is especially important in a First Nations context.

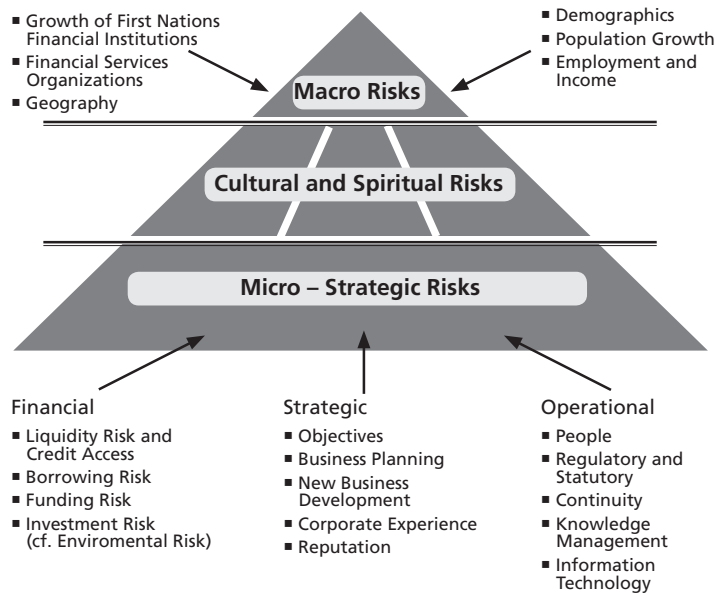
The increasing societal concern about risk is manifest in the findings of the MDS, as well as the subsequent follow-up interviews. There was, first of all, recognition within the MDS that there were risks around developing a First Nations financial institution. However, while there has been little in the First Nations literature about business risk or how it has been managed, considerable academic literature is available on business strategy and its impact on First Nations communities.

The Concept of Strategic Risk

It is relatively rare for an organization, either Native or non-Native, to focus on its strategic risks. Even among more advanced practitioners, the focus of risk management rarely includes more than financial, hazard, and operational risks. The result is that organizations may be focusing on the wrong risks, instead of the strategic risks that can cause much more serious value destruction (Slywotzky and Drzik 2005).

In the case of a First Nations financial institution, the main question to address is: What is the strategic risk for First Nations communities and other stakeholders in developing their own financial institution? Investigating the risk of pursuing a particular strategy may be seen as another method of examining its acceptability (Cooper and Hsiao 2008). To really understand the viability of any strategy, traditional quantification of financial or market risk, while important, has to be subsumed within a higher level analysis of the strategic risks inherent in establishing a financial institution.

In the non-Aboriginal management literature, the focus has been on quantitative research on financial risk management issues that may have a strategic impact upon the organization. There has been little consideration of the non-financial strategic risks facing an organization. However, financial risk is primarily quan-

Figure 8.2: Levels of Risk Facing a First Nations Financial Institution

titative, with emphasis on the risk-return relationship. When placed in a First Nations context—with the importance of the community, spiritual, and cultural risks that emerged from both the MDS and interview analysis—it is difficult to quantify a number of the strategic risks facing any First Nations financial services organization.

Operating in a First Nations context makes it apparent that while financial risks are important, they are not the only risks. The research from the MDS, as well as the key informant interviews show that cultural communities and spiritual risks must be considered by the management of any First Nations community or institution.

The next section of this paper outlines the specific strategic risks associated with the development of a First Nations financial institution, using risk taxonomies developed by Chapman (2006) and Slywotzky and Drzik (2005). The strategic risks can be seen in levels, as contextual risks, macro risks, and micro risks that face any proposed First Nations financial services organization. **Figure 8.2** outlines the strategic risks facing First Nations financial institutions.

Examining the Macro Risks

In the MDS, the First Nations of Atlantic Canada identified the opportunity for a financial institution controlled and owned by Aboriginals to respond to its needs for access to capital. At a strategic level, UDG in the MDS study asked the following questions: Why does the need for a financial institution exist and why is it important that this need be addressed? How is this need currently

Figure 8.3: Macro Risks Facing First Nations Financial Institutions

being addressed? What is happening in the financial services sector that First Nations must understand in order to formulate a response? What options do First Nations consider? All of these strategic decisions create macro risks that need to be analyzed and addressed. **Figure 8.3** outlines these macro risks and each is discussed below.

(Financial) Growth in Aboriginal Communities

Canadian financial institutions are paying more attention to the over one million people in Canada who identify as First Nation, Métis, and Inuit. With help from billions of dollars in land claim settlements and joint ventures with established corporations, these groups are starting more businesses. Further, Aboriginal people own and control 20% of the Canadian land mass and this is expected to rise to 30% in the next fifteen years (Mason 2008). The Aboriginal population is also growing at a pace of 4.1% on average per year—more than five times the national average. At the present time, Aboriginal people make up approximately 4% of Canada's population.

The rapid growth of the Aboriginal population, increased access to resources, and the emergence of a strong Aboriginal business community all require increased access to capital.

According to Charles Coffey, executive vice-president, government and community affairs with RBC Financial Group, the business benefits of providing financial services in the Aboriginal community are clear:

We see a major and expanding market opportunity. The rapid increases in the Aboriginal population represent new customers. Land claims represent increased economic and financial clout. The Aboriginal business sector, which has grown at a dramatic rate in recent years and is steadily moving the Aboriginal population towards economic self-sufficiency, is generating wealth and creating jobs. (Coffey 2002)

As a result of the financial growth in Aboriginal business, the first contextual strategic risk that is to be addressed is the failure to take advantage of the market opportunity around the growth of First Nations communities.

Financial Services Sector

The financial services sector is going through a period of fundamental change. Advances in information and communication technology have made access to capital a truly global market. Mergers, consolidation, outsourcing, cost reductions, efficiencies, and regulatory renewal are hallmarks of this change. In many ways, these changes combine to make niche institutions with a clear mandate, such as an Aboriginal financial services institutions, viable. In the past, the supportive technological infrastructure required to support a financial institution (to process and clear transactions, maintain customer databases, and provide data security, etc.) was only available to those large institutions with the resources to invest in its development.

According to the study *Equity Capital and First Nation Business Development*, First Nations in Canada “confront poverty, geographic and cultural isolation, infrastructure deficiencies, poor links to markets, low capacity for business development and growth and the flight of skilled human resources to urban centers” (NARCA 2004, 4). Many First Nation leaders see the solution to these conditions in having greater access to capital to stimulate economic growth.

In the past few years, there has been a surge of interest in the market potential for financial services companies to serve un-banked and marginally banked consumers. This is evidenced by the increasing number of financial institutions entering the Aboriginal marketplace. These financial institutions take a number of forms including banks, trust companies, and credit unions.

In Canada, a bank is a financial institution that operates under federal legislation—the *Bank Act*. A bank can accept deposits from, and make loans to, individuals, corporations, and other organizations. Recent legislative changes also allow banks to provide customers with other financial products and services, such as investment products and financial management services. Of all the approaches to capital, a bank is the most ambitious possibility. The building of a multi-functional financial institution that would meet the needs of Aboriginal people and that carries out the full range of capital and financial services is a significant undertaking.

A trust company is a financial institution that operates under either provincial or federal legislation and conducts activities similar to those of a bank. However, a trust company can administer estates, trusts, pension plans, and agency contracts, which banks are not permitted to administer. These institutions are regulated under the federal *Trust and Loan Companies Act* and are authorized to accept deposits from individuals, corporations, and other organizations. Trusts and trust services will be particularly important to First Nations communities that receive land claims or residential schools settlements.

A credit union (“caisse populaire”) is a cooperative non-profit association that is owned and operated by its members. Ownership and corporate governance are based on cooperative principles. A credit union’s primary commitment is to serve its members’ financial needs. Affiliations with trust companies, insurance companies, and investment dealers (through the cooperative movement) allow most credit unions to offer a full range of financial services to their members. Credit unions are not-for-profit businesses. After expenses are paid and reserves set aside, surplus earnings are returned to members in the forms of higher dividends, lower loan rates, and free or low-cost services. In addition, having “shareholder members” enables credit unions to relate products and services to member requirements.

Considering the different approaches—banks, trusts, or credit unions—the second major contextual strategic risk for First Nations financial institutions is not having the appropriate organization form (i.e., a credit union, bank, or trust company). The two major strategic risks—not recognizing the opportunity for First Nations financial services growth, as well as the appropriate structure for the organization to take—were fundamental in examining the macro- and micro-strategic risks behind a First Nations financial services organization.

The demand for financial services is one result of the demographic, political, and economic changes within First Nations communities. In spite of general recognition of the unmet demand among Indigenous communities, organizations, and consumers, the MDS noted that there are important gaps in information about these market segments. These gaps pose an obstacle to those institutions interested in providing financial services to this market. This information gap poses a specific strategic risk to any First Nations financial institution.

The MDS also found that the financial needs of First Nations communities are increasing. Specifically, the study was able to relate current and anticipated future need to demographic composition, geographical diversity, political structure, and projected population growth. All of these posed specific strategic risks to any First Nations financial institution.

Geographical Analysis

A study of the Atlantic Canada Opportunities Agency and the Canadian Institute for Research on Regional Development, *Aboriginal Economic Development in Atlantic Canada: Lessons Learned and Best Practices*, conducted in 2003 presents

a concise overview of the distribution of Aboriginal people in Atlantic Canada. Atlantic Canada is home to several Aboriginal peoples—Mi'kmaq, Maliseet, Passamaquoddy, Innu, Inuit, and Métis. The Atlantic Canada Aboriginal population remains relatively small, with a total of between 38,000 to 51,000 people, depending on the definition used. This represents about 4.7% of the national Aboriginal population and slightly more than 1.5% of Atlantic Canada's population (ACOA and CIRRD 2003). There are thirty-three First Nation communities in Atlantic Canada distributed throughout four provinces. Each First Nation is autonomous and governed by an elected chief and council. Although the elected chiefs and band councils of individual First Nation bands are the basis of the political structure in Atlantic Canada, there are a number of entities which arise from different configurations of these bands. This distribution poses specific strategic risks around ensuring community acceptance of any First Nations-owned financial institution, as well as governance-related issues.

In respect to governance, Aboriginal governments, businesses, and consumers are not a homogeneous group. In Atlantic Canada, there are communities that have self-government agreements, land claim settlements, tribal councils, landless bands, etc. Business enterprises range from those owned by governments with millions of dollars in assets to small entrepreneurial operations with one employee. Communities exist within urban boundaries, in proximity to large urban centres and in remote coastal and inland communities. Consumers belong to many different Aboriginal groups and have widely varying forms of employment, education, and housing. Not recognizing the heterogeneity of the First Nations population is a strategic risk for any financial services institution, specifically in terms of governance and community acceptance.

However, all of Atlantic Canada's First Nation communities belong to the Atlantic Policy Congress of First Nations Chiefs. The APC Secretariat is a policy research and advocacy secretariat for thirty-three Mi'kmaq, Maliseet, and Passamaquoddy chiefs, nations, and communities in Eastern Canada. As a result, the variety of First Nation stakeholders with a potential interest in an Aboriginal-owned and Aboriginal-controlled financial institution represents an important political force and also a significant strategic risk around governance.

Demographic Analysis

The 2001 census showed that the North American Indian population is quite young. Its median age in 2001 was 23.5 years compared with 37.7 years in the non-Aboriginal population. This means that 50% of the North American Indian population in 2001 was less than 23.5 years old. More than one-third of this group is aged fourteen and under.

The MDS research demonstrated that there are far more young people approaching working age than there are older people preparing to leave the workforce over the next ten years. Specifically, the group aged five to fourteen years was more than four times larger than the pre-retirement group aged fifty-five to sixty-four

in 2001 (UDG 2008). This difference foreshadows a potential shortfall between the number of young people entering the workforce and the availability of jobs, posing a specific strategic risk around market potential.

Strategic risks therefore emerge around the rate of job growth in the Aboriginal community in contrast to the non-Aboriginal community. If there is no vehicle for providing the capital (both working and infrastructure) that will be needed to meet the future economic development and job creation needs of First Nations communities, then there may be a failure of these communities from a socio-economic standpoint. If capital to ensure economic development is not available, then that poses a significant strategic risk to those communities. A First Nations-owned financial institution would have to recognize the strategic risks related to not being able to provide that capital, or allocate the provision of capital to a non-Native institution.

Projected Population Growth

Statistics Canada (2005) has prepared a projection of Aboriginal population growth in Canada up to the year 2017. This projection was based on the Aboriginal population in 2001 and assumes the continuation of fertility trends in place at that time. According to Statistics Canada projections, the Aboriginal population in Atlantic Canada is expected to increase from 57,200 in 2001 to 78,900 in 2017—an increase of approximately 72%. The growth of the young adult Aboriginal population (twenty to twenty-nine years) was projected to be 41.9% from 2001 to 2017, compared to a growth of 8.7% for the young adult population in Canada for the same period.

Strategic risks for a First Nations community around this growth rate relate to the increased demand for personal financial services (vehicle loans, mortgages, credit cards, consumer purchases) from individuals aged twenty to twenty-nine as they enter the workforce. It will also place demands on Aboriginal governments to increase the rate of economic and business growth, which in turn will require access to larger amounts of capital. The strategic risks for a First Nations financial institution then are more specifically related to deciding whether to offer services to communities—such as personal financial institutions—or to focus on meeting the needs of Aboriginal governments.

Employment and Income Analysis

Classical economic theory shows that employment and earnings are the key variables affecting purchasing power. These variables affect choice of housing, transportation, recreation, food and beverages, and use of technology. They are also key determinants of an individual's ability to access capital for personal or commercial purchases. Employment income data for the year 2000, as reported in the 2001 census report, reveals that the majority (70%–75%) of Aboriginal people fifteen years and over in Atlantic Canada earn under \$24,999 per year. The group that earns between \$25,000 and \$49,999 shows remarkable consistency

across all four provinces, ranging from 20%–22% of the total employment group (Statistics Canada 2001). In all comparisons, the average employment income of Aboriginal people in Atlantic Canada falls below that of non-Aboriginal people in the Atlantic Provinces and in Canada. The average income gap between Aboriginal and non-Aboriginal people in Atlantic Canada ranges from a low of \$6,074 in Prince Edward Island to a high of \$7,836 in Nova Scotia (UDG 2008).

The low-income statistics of Aboriginal communities demonstrate that there are significant strategic risks for any First Nations financial institution. The employment and income statistics demonstrate that a First Nations member's ability to access capital for personal or commercial purchases is significantly lessened by poor employment prospects, as well as low income. Strategically, a First Nations financial institution will have to plan for the fact that a large portion of its market may not be "creditworthy" when compared to traditional credit-risk metrics. Understanding the context of Aboriginal business practices specifically around low-income and employment prospects, as well as the socio-economic challenges the communities face will be important in establishing the processes and controls within a First Nation's financial institution.

According to the report *The Changing Banking Environment in Atlantic Canada* (Folkins 2002), chartered banks reduced their branch network in Atlantic Canada by more than 16% from 1992 to 2002. They also rationalized business banking services and lending decision making to regional or larger centres. The report, prepared for the Atlantic Canada Opportunities Agency, concludes that this has created serious gaps in access to capital and banking services for rural communities in the Atlantic region. All of these changes pose significant strategic risks, as well as opportunities, for First Nation financial institutions.

Implications of Macro-Strategic Risks

According to the MDS, the Atlantic Aboriginal community is one that exhibits high population growth, increasing levels of entrepreneurship, and a richness of diversity and strengths. All of these elements pose strategic risks for any First Nations financial services organization. As noted in a 2001 report titled *Strategies for Building the Atlantic Aboriginal Economy*, the diversity and strengths of the First Nations are "a source of advantage in an increasingly competitive, interdependent world" (Implementation Committee 2001, 4). Not recognizing these strengths as opportunities poses a strategic risk to any First Nations financial institution. These strengths include:

- Aboriginal rights to traditional lands and resources
- Treaties to hunt, fish, trap, and trade in order to secure an economic livelihood
- Strategic location of many communities in or near large urban areas, on major highways, or on the oceans, lakes, and rivers of the region
- Close proximity of many communities to the major markets of the

eastern seaboard of the United States

- Ability to sell or purchase goods and services on-reserve without paying taxes
- Opportunity to establish gaming enterprises or share in the revenues from those established off-reserve
- Young and rapidly growing population (Implementation Committee 2001)

While income growth is below regional and national levels, as the Aboriginal economy continues to grow and expand these inequities should decrease. All indications are that the earning power, consumer demand, and levels of entrepreneurship in First Nations communities are increasing. These are all significant factors in examining the macro-strategic risks facing any Aboriginal financial institution.

Micro-Strategic Risks

There are also a number of micro-strategic risks facing First Nations financial institutions. By micro risks, we mean risks that are internal to the organization and need to be managed. Some of these micro risks are outlined below.

Liquidity and Credit Risk

While most financial institutions are now experiencing a liquidity risk, the liquidity risk for Aboriginal financial institutions would be low. This is due to funding from the federal government, the homogeneous population, and the niche market that an Aboriginal financial institution would target.

Some of the attributes that constitute credit risk include default, exposure, recovery, and counterparty risk. This risk would be quite high given the experience of financial institutions such as Ulnooweg and the review of the financial statements of the First Nations communities as outlined in the MDS. Credit risk will be particularly important to any First Nations financial institution and should be specifically managed as a strategic risk. The ability to address credit-related issues and place them in the forefront of strategic planning will be critical to the establishment of any First Nations financial institution.

Borrowing Risk

Borrowing risk refers to the ability of an institution to borrow. While we did not see this as a major risk in the data analysis, in our analysis of financial statements we did see specific issues related to the level of the interest rate. If interest rates being charged were not sustainable from a business-model perspective, this would create specific strategic risks to the First Nations financial institution. To develop a sustainable business model, interest rates would have to be borrowed at market or below-market rates. From a strategy planning side, having appropriate sources of funding to access borrowing will be critical; these funds may come from governmental or philanthropic sources. However, the main risk around borrowing stems from not charging market competitive rates. Without market competitive

rates, there would be no reason for First Nation stakeholders to switch financial institutions.

Funding Risk

Funding risk (i.e., the ability to fund specific projects) was seen as a major financial risk for First Nations communities that could be addressed through a dedicated Aboriginal financial institution. For the First Nations financial services organization, the funding risk would be specifically related to ensuring that the funding was done in a transparent manner consistent with the strategy and objectives of the organization.

Environmental Risk

In reviewing the data, environmental risk is the most salient investment risk for First Nations communities and is particularly important for Aboriginal business and financial institutions. This is due to First Nations' communities' close proximity and historical attachment to the environment. Environmental risk would be one of the primary concerns when investments are made in either First Nations communities or Aboriginal businesses.

Strategic Risks

There are a number of specific strategic risks that emerge from a review of the MDS and the key informant interviews. The first strategic risk is around business objectives. There is a risk that objectives are not clear from a policy or planning side for an Aboriginal financial institution. Ensuring that these objectives are clear will require a published strategy and mandate that is accepted by all identified stakeholders.

Business planning also creates another strategic risk. The risk is that there is an insufficient business plan to ensure that the strategy for any First Nations financial institution would be implemented. This can be mitigated through an extensive business planning exercise along with rigorous implementation processes.

The MDS also demonstrated a concern that when an Aboriginal financial institution undertakes new business development it may have insufficient experience in specific areas of the new business. Secondly, the First Nations financial institution may lack the resources necessary to implement any new business development. Risks around new business development tie into a lack of corporate experience, which may lead to reputational risk emerging for the First Nations financial institution. All of these risks need to be considered as part of the strategy development process.

It is important to consider reputational risk and its elements, including licence-to-operate and trust issues. The interviews conducted with key stakeholders pointed to reputational risk as being particularly important. Reputational risk is critical to any organization and may be more important when examining the

strategic risks facing a First Nations financial institution. Being owned and operated by First Nations may establish a reputation, but the key informant interviews indicated that this may not necessarily translate into trust. Considering how to establish trust would be a critical element in any strategic or implementation plan. Part of addressing this risk may include visiting and consulting with the First Nations communities and other key stakeholders involved in establishing the financial institution.

Operational Risk

An Aboriginal financial institution's ability to pay salaries that are sufficient enough to attract the necessary people to run a First Nations institution is the first major operational risk. Salaries should not be a huge impediment, but the interviews did show that human resource management practices could be seen as a risk if there was a necessity to hire only First Nations community members.

The regulatory and statutory requirements around people and process management for a financial institution that is controlled and owned by First Nations should be no different than for any other financial institution. This holds true in terms of other people-related risks such as health and safety. However, the degree of rigour and the management processes needed to ensure that regulatory and statutory requirements for any financial institution are met are significant, not just for a First Nations financial institution, but for any organization creating a new structure in the financial services market. Issues around the level and type of regulation need to be considered, to ensure that not only are the appropriate operational risks considered, but also that licence-to-operate and trust issues are addressed.

Spiritual and Cultural Risk

Two risks that emerged from the MDS and key informant interviews were spiritual and cultural. These risks are primarily strategic, but could also influence the operations of any financial institution. Spiritual and cultural risks are unique to a First Nations context and should be considered as part of any strategic planning process.

Spiritual risk emerges from not understanding or ignoring the spiritual dimension of any Aboriginal-owned institution or organization. Individuals interviewed believed that this spiritual dimension is what makes First Nations institutions (businesses as well as communities) unique and different. Failing to consider the spiritual element in the development of a First Nations financial institution is a specific risk that cannot be ignored.

Spiritual risk must also be combined with cultural risk. Cultural risk refers to not understanding the culture of First Nations communities and institutions. If there is no community engagement, spiritual and cultural risks are not considered. This will lead to a lack of understanding of the First Nations context and could lead to a lack of support for the institution.

Conclusion

From a strategic risk standpoint, a convergence of issues facing existing banks and other financial institutions has created a window of opportunity for First Nations peoples to undertake the development of their own financial institutions. The period of business planning that is required to establish an institution will coincide with the settling of financial markets. Adopting a rigorous planning and strategy process around risk will allow any new institution to develop in an efficient and comprehensive manner, providing accountability and transparency to investors and stakeholders.

As outlined in the MDS, current opportunities in the financial services sector are a result of the unprecedented convergence of market demand and institutional/fiscal capacity within the collective Aboriginal community. The MDS identified a number of demands for capital including infrastructure, housing, and investment projects. In general, with the growth of natural resources projects on Aboriginal land, settlements from land claims, and other compensation that will emerge to address the historical injustices experienced by Aboriginal people, owning one of the essential levers of the economy—capital—will be vital for their long-term development and prosperity. Addressing risks—both macro and micro—in planning and policy development will increase the ability of Aboriginal peoples to attract mainstream financial capital (such as that from banks, trusts, and other financial institutions) for existing and future projects.

Ultimately, the purpose of this paper is to demonstrate that financial institutions that are owned and controlled by Aboriginals create a number of opportunities and threats. Using the results of the MDS study and taxonomies developed in the risk management literature, strategic risks that First Nations financial services organizations will need to address in order to ensure a better understanding and use of financial capital have been identified.

Aboriginally owned and controlled financial services organizations should address risk in their planning and policy development, particularly in the creation of business-level strategy. Moreover, there should be an essential understanding that any financial institution that is owned and controlled by Aboriginals has to understand the spiritual and cultural risk that makes it unique; this will create a context that makes such a financial institution a viable option for First Nations communities and organizations. Moreover, further research should be conducted on the spiritual and cultural risk facing First Nations governments and organizations. Potential First Nation financial institutions will need to conduct extensive consultation with stakeholders and understand that they need to be more than “just a bank.” Without understanding and managing strategic risks, the promise of Aboriginally owned and controlled financial institutions will be lost to the communities and institutions that they have been developed to assist.

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