Industry Canada | Industrie Canada

Canada

Credit Condition Trends 2009–2012

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Introduction

Industry Canada maintains close contact with the small business community as part of its monitoring and data collection activities. Since 2009, Industry Canada has conducted annual surveys on the borrowing activities of small businesses. The *Credit Conditions Survey* (CCS)[1] is implemented in years when the *Survey on Financing of Growth of Small and Medium Enterprises* (SFGSME)[2] is not conducted. These surveys aim to monitor small and medium-sized enterprises (SMEs) access to financing and to provide key information on small businesses lending condition to the business community, lenders, policy makers and academics.

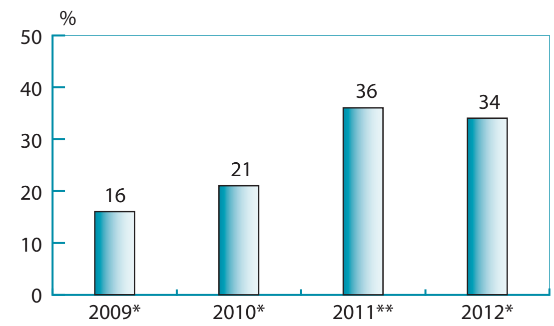
External Financing Need

Small business financing requests have gone up significantly since the recession, as 34 percent of small businesses reported requesting financing (debt, lease, equity, trade credit, and/or government) in 2012 compared with 16 percent in 2009 (Figure 1).

Twenty-six percent of small businesses requested debt financing (e.g. mortgages, term loans, lines of credit, and/or credit cards) in 2011 and 2012 (Figure 2). This represents a 12 percentage point increase from the height of the financial crisis and economic recession in 2009.

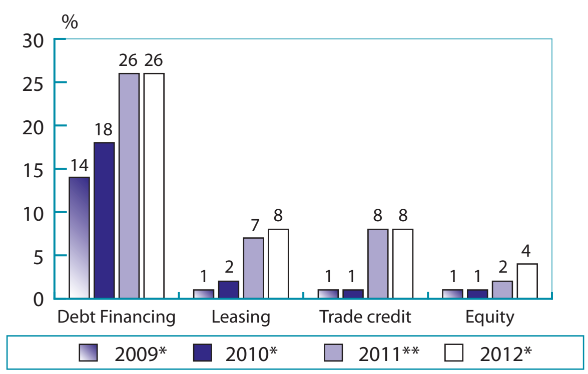
The percentage of small businesses requesting other types of financing also grew sharply, signalling their improving confidence in business earning expectations and investment plans.

Figure 1: Request rates for external financing are up



Sources: *Industry Canada, CCS, 2009, 2010 and 2012; **Statistics Canada, SFGSME, 2011.

Figure 2: Requests for all types of financing increased between 2009 and 2012



Sources: *Industry Canada, CCS, 2009, 2010 and 2012; **Statistics Canada, SFGSME, 2011.

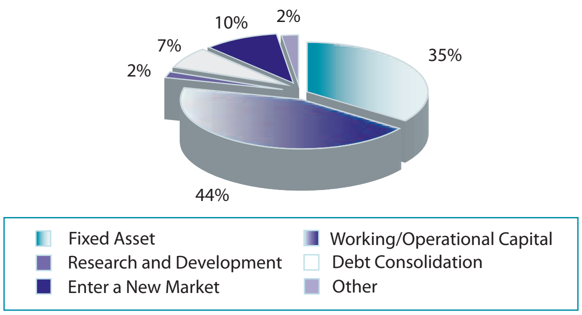
Reasons for Seeking/Not Seeking Financing

Roughly 44 percent of small businesses that requested financing in 2012 reported doing so to support day-to-day working and operational capital expenditures. Thirty-five percent requested financing to fund fixed asset purchases (Figure3). Another 10 percent intended to use the financing to enter a new market, 7 percent to consolidate debts, and 2 percent to invest in research and development activities. These 2012 findings are generally consistent with those of previous years.

[1] In 2009, 2010, and 2012, CCS data were collected from over 2,500 small employer businesses across the country. For more information concerning the CCS, consult the SME Research and Statistics website (www.ic.gc.ca/eic/site/061.nsf/eng/h_02192.html).

[2] The SFGSME was designed to collect the information of SMEs on their attempts to obtain new financing, growth, engagement in international business activities, innovation and intellectual property, as well as owner characteristics. This survey was conducted by Statistics Canada in 2011. For more detailed information concerning the SFGSME, consult the SME Research and Statistics website (www.ic.gc.ca/eic/site/061.nsf/eng/h_02774.html).

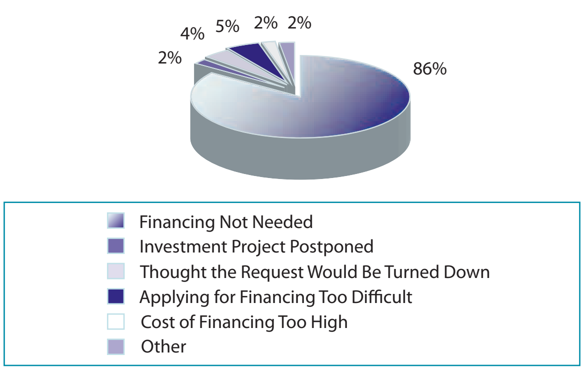
Figure 3: The main reason small businesses requested financing was for working capital in 2012



Source: Industry Canada, CCS, 2012.

Among businesses that did not seek financing, the majority (86 percent) indicated that financing was not needed (Figure 4).

Figure 4: The main reason small businesses did not request financing was that it was not needed in 2012



Source: Industry Canada, CCS, 2012.

Discouraged borrowers, those that did not request financing because they thought the request would be turned down, represent 4 percent of the businesses that did not seek financing. CCS data show that the percentage of discouraged borrowers in the Canadian economy has increased slightly, rising from 3 percent in both 2009 and 2010, yet remains below 5 percent observed at the beginning of the decade.[3]

Five percent of small businesses did not seek financing because they thought the application process would be too difficult. Only two percent did not request financing because they thought the cost of financing was too high. This is consistent with findings from previous years.

Access to Debt Financing

Small business access to debt financing improved in 2012 (Table 1).

Specifically, 89 percent of small businesses that requested debt financing in 2012 were approved for their loans compared with 79 percent in 2009. A few factors contributing to the improved access to financing could include higher business profitability, improved profit expectations, greater economic stability, and an improvement in lender risk perception.

Table 1: Access to debt financing continued to improve in 2012 as measured by approval rates and authorized-to-requested ratios (in percentage)

Year	Request Rate	Approval Rate	Rate of Amount Authorized-to-Requested
2009*	14	79	72
2010*	18	88	88
2011**	26	89	91
2012*	26	89	90

Sources: *Industry Canada, CCS, 2009, 2010 and 2012; **Statistics Canada, SFGSME, 2011.

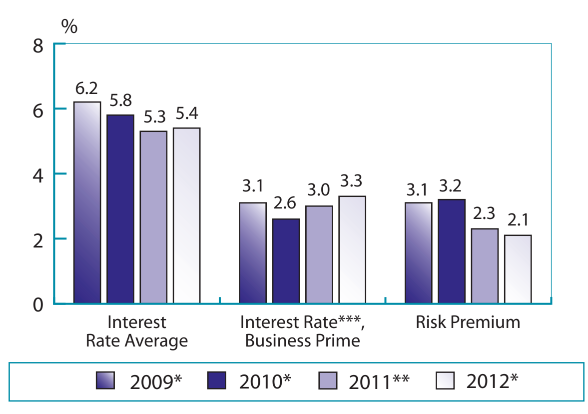
The ratio of funds authorized-to-requested continues to grow, reaching 91 percent in 2011 and 90 percent in 2012, up from 72 percent in 2009. This indicates that, overall, there has been a narrowing of the small business "financing gap."

Interest Rates

Average interest rates on loans and non-residential mortgages show that small businesses experienced a slight loosening in credit conditions in 2012. The average interest rate for small businesses declined by 0.5 percentage points to 5.3 percent in 2011 and increased by 0.1 percentage point in 2012, reaching 5.4 percent (Figure 5).

Another good sign was that the business risk premium decreased from 2.3 percent in 2011 to 2.1 percent in 2012. That is, the difference between the average small business interest rate and the business prime rate (the rate charged to the most credit worthy borrowers) fell even though the business prime rate rose 0.3 percentage points in 2012.

Figure 5: Annual interest rates on debt financing have decreased since 2009



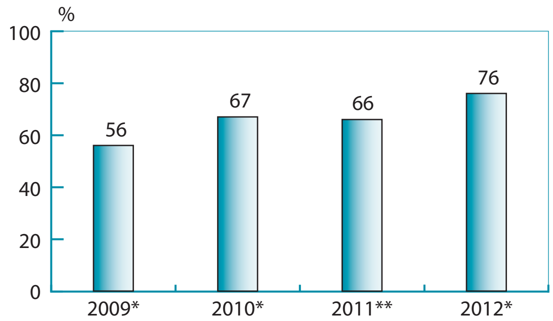
Sources: *Industry Canada, CCS, 2009, 2010 and 2012; **Statistics Canada, SFGSME, 2011; ***Bank of Canada.

[3] Statistics Canada, SFSME, 2004.

Collateral Rates

Lender underwriting standards appear to be getting stricter. While only 56 percent of small businesses were required to pledge collateral to secure their loans in 2009, 67 percent were required in 2010, 66 percent in 2011, and 76 percent were required in 2012 (Figure 6).

Figure 6: Collateral rates for debt financing have increased significantly



Sources: *Industry Canada, CCS, 2009, 2010 and 2012; **Statistics Canada, SFGSME, 2011.

Access to Debt Financing by Type of Business

Financing request rates continue to be positively related with the size of the business (Table 2). Specifically, 20 percent of businesses with 1–4 employees requested debt financing in 2012 compared with 30 percent of businesses with 5–19 employees and 38 percent of businesses with 20–99 employees. A similar positive relationship was recorded in 2009, 2010 and 2011.

Table 2: Smaller and younger businesses faced relatively greater difficulties accessing financing

	Request Rate (%)	Approval Rate (%)
All Small Businesses (1–99 employees)	26	89
Employment Size		
1–4 employees	20	85
5–19 employees	30	91
20–99 employees	38	91
Export		
Exporter	28	85
Non-exporter	25	89
Age of Business		
2010–2011 (2 years old or younger)	36	79
2002–2009 (3–10 years old)	25	89
1992–2001 (11 to 20 more years old)	29	89
Prior to 1992 (more than 20 years old)	23	91
Innovation Activities Developed or Introduced		
Innovator	32	89
Non-Innovator (none of the above)	20	89

Source: Industry Canada, *Credit Conditions Survey*, 2012

Approval rates were also positively related to business size, increasing from 85 percent for businesses with 1–4 employees to 91 percent for businesses with 5–19 employees and 91 percent for businesses with 20–99 employees. Historically, greater year-to-year fluctuations in sales and earnings and higher loan default rates have been identified as possible factors explaining why the smallest businesses have the greatest difficulties accessing financing.[4]

The request rate for start-ups (2 years old or younger) (36 percent) was significantly higher than for older more established businesses (more than 20 years old) (23 percent). However, the approval rate was much lower (79 percent vs. 91 percent respectively). This indicates higher financing needs for start-ups and for younger businesses, which usually lack retained earnings, solid credit histories, and collateral to pledge.

Small business exporters were more likely to request financing than non-exporters (28 percent vs. 25 percent respectively) in 2012. They were also less likely to be approved for financing.

Small business innovators also had significant debt financing needs in 2012, as evidenced by a 32 percent request rate. This compared with 20 percent for non-innovators. While historically small business innovators have had greater difficulties accessing financing, there was easing of credit conditions for this group. In 2012, approval rates for both innovators and non-innovators stood at 89 percent. This suggests that, in 2012, innovators were as capable of accessing debt financing as non-innovators.

Conclusion

This analysis provides information on changes in lending conditions and is useful for better understanding credit-market trends. Overall, business lending conditions continued to ease in 2012, a finding consistent with the *Senior Loan Officer Survey* conducted by Bank of Canada. However, certain sub-categories of businesses continue facing greater difficulties accessing financing such as start-ups and exporters.

[4] Seens, Daniel. *Small Business Access to Financing: Request and Approval Rates, Interest Rates, and Collateral Requirements* (2000–2010). Industry Canada. 2013.

This report was prepared by the Small Business Branch.

If you have questions or comments about the content of this publication, please email smers-rspme@ic.gc.ca.

You can obtain more information on credit conditions into the **Survey and Analysis Data** section (www.ic.gc.ca/surveys) of our SME Research and Statistics Web site (www.ic.gc.ca/SMEresearch).