INSIGHTS ON...
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Financing small business

– *results of the 1994 National Survey on the Financing of Small Business*

*Greg Peterson**

Small businesses represent a dynamic engine of growth, but there has been concern that the expansion of this key sector has been hindered by inadequate access to financing. This article reports on the 1994 National Survey on Small Business Financing.

Small businesses represent a substantial source of employment for the Canadian economy. In 1993 over 97% of the 927,000 businesses operating in Canada had less than fifty employees.[1] Between 1978 and 1992, moreover, they accounted for a disproportionate share of net job gains.[2] But there has been a growing concern that the expansion of this key sector is being hindered by inadequate access to financing, particularly through financial institutions.[3]

The National Survey on the Financing of Small Business was undertaken to obtain factual information on the experience of small businesses in raising funds. For reasons of timeliness and in order not to overburden respondents with lengthy forms, the scope of the survey was limited to specific key questions: what kinds of financing do small businesses seek? From whom do small businesses seek funds? How successful are small firms in obtaining financing? What types of small businesses are most likely to seek financing? What is the frequency of loan refusals?

What kinds of financing do small businesses seek?

Small businesses overwhelmingly seek debt as opposed to equity financing. In the twelve month period ended October 31, 1994, more than one third of small businesses tried to obtain debt financing. In contrast, less than one in fifty tried to obtain equity financing. Of those businesses seeking debt financing, over 80% were successful. Conversely, some 20% were refused financing at least once during the year.

Who do small businesses seek financing from?

Chartered banks are by far the largest source of debt financing for small businesses. They receive loan applications from 68% of small businesses. Other financial institutions receive them from 27%. These sources rank ahead of government

[1] Statistics Canada, *Employment Dynamics,* 1995.

[2] See Picot, G. and R. Dupuy, *Job Creation by Company Size Class: Concentration and Persistence of Job Gains and Losses in Canadian Companies,* Analytical Studies Branch Research Paper No. 93, Statistics Canada, Ottawa, April 1996

[3] See Ted Mallett, *Small Business: Banking on Job Creation,* Toronto: Canadian Federation of Independent Business, 1994; and House of Commons, *Taking Care of Small Business,* Report of the Standing Committee on Industry, Ottawa, 1994.

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guaranteed loan programs such as the Small Business Loans Act (SBLA), which received loan applications from 11% of small businesses, and provincial small business loan programs.

In every sector, banks were the most important funding source. Other types of financial institutions were the second choice for all sectors except manufacturing, where borrowers turned more frequently to the public sector.

Sources other than financial institutions and governments were also significant, their percentage share of loan applications reaching double digits. The importance of banks and other financial institutions is not surprising: not only do they have an appropriate pool of funds to invest, but small businesses typically have long-standing relationships with them for banking services.

How successful are small firms in obtaining financing?

Over 80% of small businesses seeking financing from banks and financial institutions were successful – slightly less than the 88% success rate for small businesses obtaining loans from friends and relatives (Table 1). However, only 7% of small businesses attempted to borrow money from their friends and relatives while 68% of the businesses surveyed turned to the chartered banks. The survey suggested that small businesses are less successful in obtaining loans from public sector sources than from chartered banks.

There are a number of reasons for the lower incidence of loan approvals by the public sector. Public sector financing is often conditional, and may require small businesses to have been refused financing from other sources. Loans guaranteed under the SBLA, for instance, are targeted at businesses otherwise unable to obtain financing, and are typically for new or improved fixed assets, such as buildings or machinery and equipment. Similarly, the Business Development Bank of Canada only provides term loans to businesses refused financing by conventional means or facing financial difficulties. Provincial loan programs are often a top-up, making funds conditional on financing being obtained from private sector sources. The banks and other financial institutions thus appear to be in a position to give loans to the cream of the crop, leaving a disproportionate number of less successful or higher risk firms to approach public sector financing sources.

Table 1

Small business loan requests and approvals, by source of funds

Source	Loan requests*	Loan approvals*	Success rate %
Government	17	11	66
Banks	68	55	81
Other financial institutions	27	22	84
Other	16	13	84

* *Expressed as % of the number of small businesses seeking financing. Does not add to 100% as businesses may have attempted to obtain debt financing from more than one source.*

What types of small businesses are most likely to seek financing?

A higher proportion of small businesses in the primary and manufacturing industries sought debt financing than businesses in other industries. Almost one half of small businesses in these two industries attempted to obtain debt financing during the survey period, possibly reflecting the higher capital requirements in these industries for investment in plant and equipment. Small businesses in the personal and business services industries were least likely to seek debt financing, with one in three applying (Table 2). Small

About the survey

The National Survey on the Financing of Small Business was a telephone survey of 2,200 small businesses conducted in October 1994. The survey covered active businesses with less than fifty employees, and asked if they had sought financing in the twelve month period ending in October 1994, in what form, and from whom.

Businesses were asked whether they had approached any of eight specific funding sources in the private and public sectors. Private sector sources included chartered banks, other financial institutions, friends and relatives, individuals other than friends and relatives, and a miscellaneous category comprising leasing and factoring companies and other sources. Public sector sources included the Federal Business Development Bank, loans guaranteed under the Small Business Loans Act, and loans guaranteed by a province. The sample was stratified into nine industry groupings, but for reasons of statistical reliability the responses were aggregated into five industrial categories.

In the interests of timeliness and minimizing respondent burden, the survey was highly focussed on a specific number of key questions. It did not ask for financial information, nor were financial institutions asked about their lending practices. Conclusions cannot be drawn about the creditworthiness of firms, therefore, nor about businesses that may have closed or not started because of difficulties in securing financing.

For more information on the Survey or on small business statistics, please contact Paul Johanis at (613) 951-0662 or Ed Hamilton at (613) 951-0822.

Table 2

Percentage of small businesses seeking financing, by source of funds

Industry	Govern-ment	Chartered Banks	Other Financial	Other Sources Institutions	All Sources
Primary	12	74	31	16	46
Manufacturing	38	64	23	15	46
Wholesale and retail trade	21	71	28	..	35
Personal and business services	12	64	25	23	33
Other services	16	69	27	17	29

Table 3

Success rates* of small businesses in obtaining debt financing, by source of funds

Industry	Govern-ment	Banks	Other Financial Institutions	Other Sources
Primary	83	85	87	..
Manufacturing	55	73	65	87
Wholesale and retail trade	81	77	89	..
Personal and business services	..	80	84	83
Other services	56	83	78	94

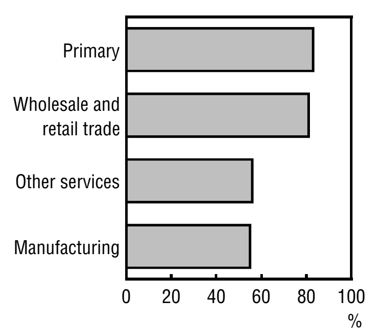
** Approvals as % of requests*

Figure 2

Loan refusals

Figure 1

Success rates from public sector sources, by industry



businesses in the primary industries are more likely to seek funds from their banks than firms in other industries (Table 2). Moreover, they are more likely to be successful (Table 3).

One reason why manufacturers are more likely than other industries to seek financing from public sources is because a number of public sector programs support capital expenditures, which are not as significant in the service industries as in manufacturing. Although manufacturers are more likely to seek public sector financing, their success rate in obtaining financial assistance from governments appears to be lower than that of firms in other industries, particularly the primary and wholesale and retail trade industries.

Loan Refusals

Refusal rates[4] in the twelve months through October 1994 were highest in the wholesale and retail trade and manufacturing industries (Figure 2). Small businesses in the primary industries, which were more likely than firms in other industries to seek funds from chartered banks or other types of financial institution, faced the lowest rate of loan turndown.

The reasons for financing being refused are varied. Almost one in five businesses cited a lack of collateral, while others cited poor market conditions (6%), the age of the business (6%), a poor credit record (5%) and the size of the business (5%).

Summary

The National Survey on the Financing of Small Business paints an initial picture of the types and sources of funds for small business operators. In order to produce results quickly and not to burden respondents unduly, the survey focussed on a limited number of key questions on the types of financing sought and obtained.

The survey revealed that debt financing is sought more often than equity financing, and that in obtaining loans, small businesses most often turn to private sector sources. Banks and other financial institutions were a favoured source of financing. Small businesses experienced success rates of greater than 80% in obtaining funds from these sources, exceeded only by funding by friends and relatives, which had a success rate of 88%. However, some 20% of small businesses were refused bank financing over the survey period.

[4] A business is said to have been “refused financing” if it had been refused financing at least once in the previous 12 months. It should be noted that a business may be both refused and successful in its quest for financing. It is possible, for example, for a business to have been refused financing by three different banks before being accepted by a fourth bank. Thus the same business may be included in the success rate and the refusal rate. The survey did not measure the relationship between refusals and approvals of financing.

Emerging trends in Canada's food processing industry

*Michael Trant**

The food industry has always been one of the staples of the Canadian economy. But faced with slowing population growth, demographic shifts and more openness to international trade, the industry has had to respond to a changing social and economic environment.

The Canadian food processing industry is large by any measure. In 1995 it employed 184,000 people, accounting for 10% of total manufacturing employment and 11% of manufacturing shipments and value added. It is Canada's third largest manufacturing industry.

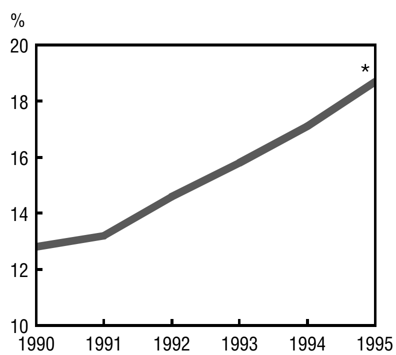
The Canadian food processing industry represented 1.9% of Canadian gross domestic product (GDP) in 1993, similar to the share of the food sector in other major industrialized countries. In the United States for instance, the food industry constituted 1.3% of GDP, compared to 1.5% in Germany, 1.6% in the United Kingdom, 1.8% in Italy, 2.3% in France, and 2.4% in Japan.

The food processing industry does not include economic activity associated with the production of primary agricultural products such as wheat, barley, oats and oilseeds shipped in bulk, live animals, fresh eggs and unprocessed fresh fruits and vegetables. Added together, the agriculture and food processing sectors represent almost 5% of total Canadian employment and about 4% of GDP valued at factor cost.

The Canadian food processing industry is mature and developed, and has registered slow but steady growth in recent years. Given the modest expansion of domestic markets and the liberalization of export opportunities under the North American Free Trade Agreement (NAFTA) and General Agreement on Tariffs and Trade (GATT), many Canadian food processors see new export opportunities in foreign markets. The value of the Canadian dollar in relation to other major currencies has given Canadian producers an additional cost advantage in export markets. In recent years the export-orientation of the Canadian food industry has increased, exports rising to more than 18% of industry shipments in 1995 from about 14% in 1990 (Figure 1).

This article is extracted from a new series of **Industry Profiles,** *to be launched in September.* **Profiles** *on Information Technology. Machinery, and other industries will follow at a later date. For more information on* **Industry Profiles,** *please contact Fred Wong at (613) 951-2994 or frewong@statcan.ca.*

Figure 1
Exports as % of industry shipments – Food Processing industry, 1990-95



* Estimate

Demographic change – aging population, ethnic diversity, smaller families

Population growth, demographic shifts and household composition have a major impact on food consumption and spending. Canada's population has been growing at about 1.3% a year since 1980, marginally higher than in the United States, where the population is expected to grow 1% annually for the remainder of the 1990s.

Immigration has averaged about 250,000 per year over the past 4 years, making a greater contribution to the growth of the Canadian population than the natural increase. The expanding immigrant population, mainly from Asia (Hong Kong, India, the Philippines and China), Europe, and South and Central America, is having a noticeable effect on the food processing industry, which must now meet a wider variety of tastes and preferences.

Demographic shifts affect the demand for food products. The Canadian population is aging, with demographic projections for the next decade indicating the greatest expansion – nearly 28% – in the 40-54 age group (Figure 2). By the year 2006 the 40-54 year-old age group will number almost 8 million people, or 23% of the total population. Seniors – those 65 years and over – are expected to increase by 20% to 4.4 million people by 2006, representing over 13% of the total population. The food processing industry will therefore have to cater increasingly to the needs of the older shopper.

The changing composition of Canadian households is a further influence on consumer food expenditure patterns, with the trend towards increasing numbers of single-person and single-parent households expected to continue. The average Canadian household

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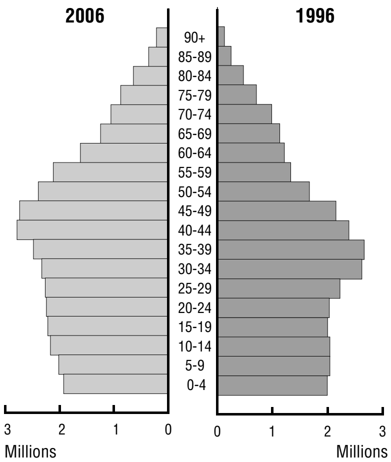
Figure 2
Population projections by age – 1996 and 2006

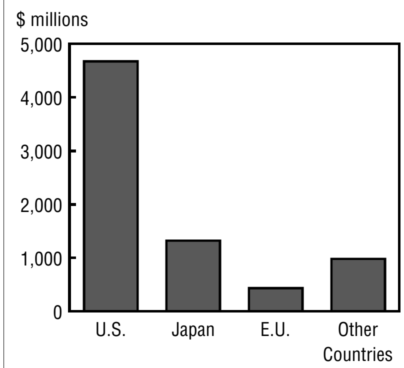


is also becoming smaller: in 1996, the average household is estimated at 2.74 persons, almost 8% smaller than a decade earlier.

Increasing participation in the labour force by women – 58% in 1993 compared to 50% in 1980 – is resulting in increased demand for prepared foods. Canadians spent an estimated $29.47 weekly per person on food from stores and an additional $12.72 for restaurant food (for a total of $42.19) in 1993. That was 12.5% of after tax income in 1992, the most recent year for which such estimates are available. Expenditures on food and non-alcoholic beverages were over $45 billion in 1993, an increase of 3.5% over 1992.

The combination of an aging and more culturally diverse population characterized by decreasing household size and greater numbers of single-person and one-parent households suggests that growth in food expenditures is likely to continue to be slow but steady. More women in the workforce and more single-person and single-parent households also imply increased demand for prepared foods and foods

Figure 3
Canadian food product exports – geographic distribution, 1995



prepared outside the home. The Canadian food processing industry will be catering to older, smaller and more culturally diverse households. With modest growth in domestic demand, the industry is expected to intensify efforts to expand exports, which have increased dramatically in recent years.

Exports – new directions, new markets

On balance Canada exports about the same value of food products as it imports. In 1995 Canada exported about $7.4 billion worth of food products and imported about $7.5 billion.

The patterns of trade in food products between Canada and its major trading partners range from many years of near-balanced trade with the United States, which purchased 63% of Canada's total processed food exports in 1995, to a widening imbalance in favour of the European Union (EU). The latter was associated with a decline in the total value of food product imports by the EU but modest increases in the import of EU products by Canada. Canada is experiencing growth in food product exports to Asia, with significant success in penetrating new markets. Canada recorded a significant and growing surplus in its trade with Japan, which stood at $1.3 billion in 1995.

A rapidly growing middle class in developing countries is contributing to the growth in demand for higher value-added Canadian food products, such as meat, bakery goods and dairy products. The higher value-added industries offer the greatest investment and employment opportunities in Canada and manufacture consumer-ready, highly processed packaged products such as breakfast cereals, cake mixes, biscuits, frozen dinners, pizzas and soups.

The 1990 Canada-United States Trade Agreement included tariff cuts for agriculture and food products. Market access for food products was subsequently improved by the provisions of NAFTA, signed in 1992, and was followed by a marked pickup in trade in processed food products with the United States and Mexico.

Global trends

International trade in food products has tended to lag that of other sectors, particularly manufacturing. Agriculture and food exports now account for less than 10% of global merchandise exports, compared to about 25% in the early 1960s.

Some of the most far-reaching changes to patterns of world trade in agriculture and food products may come from the recent economic reforms in the People's Republic of China. As it industrializes and shifts away from its agrarian roots, China's appetite for food imports from countries such as Canada is expected to result in sharply higher demand and world prices for cereals and other food products. China's share of world agricultural imports has remained stable over the past decade, at around 2.3%, but that proportion is expected to increase as China's economic reforms proceed.

Increasingly diversified markets and more intensive regional trade have dominated agricultural trade flows during the past few decades. The impact has been far from uniform but has not resulted in large shifts in overall patterns of agricultural trade.

The closely integrated agricultural markets of Eastern and Central Europe and the former USSR became much more open to imports, particularly from North America and the EU, even before the reforms of the 1990s and the breakdown of the traditional regional trading systems. In addition, developing countries still depend to a very large extent on developed country markets as both suppliers of imports and outlets for exports.

Sources

Data from the following Statistics Canada and OECD sources were used for this article:

- OECD, *Main Economic Indicators*
- OECD, *Structural Analysis (STAN) Data Base*
- Statistics Canada, *Food Industries* (Catalogue no. 32-250)
- Statistics Canada, *Industrial Monitor* (on CD-ROM) (Catalogue no. 15-F0015-XCB)
- Statistics Canada, *Canadian International Merchandise Trade* (Catalogue no. 65-001-XPB)
- Statistics Canada, *Apparent Per Capita Food Consumption* (Catalogue no. 32-229-XPB)
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Canada's maturing wine industry

*by Rick Burroughs**

Since the early 1980s, the Canadian wine industry has faced some daunting challenges. But after making some big changes, the industry is now holding its own.

Since the early 1980s, the Canadian wine industry has been seriously threatened by wide swings in consumer tastes and intense competitive pressures. The industry has responded with sweeping changes in crops, products and marketing. It is still adapting, but the collapse predicted by some observers has not happened. After slipping in the late-1980s, the market share of Canadian wines has been holding its own, and today Canada's wine industry employs 1,400 workers and generates annual revenues of $250 million. This article looks at how Canada's domestic wine industry has responded to changing consumer tastes and heightened competition in an era of deregulation and more open markets.

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Changing consumer tastes – from Concord to Cabernet

From modest beginnings, the Canadian wine industry has developed in a fairly short space of time to a sophisticated niche player in the domestic wine market. Canada's first commercial vineyard was planted on Pelee Island in Lake Erie in the 1860s, but grape cultivation did not begin in earnest until after the turn of the century. It bloomed during prohibition in the United States when wine, unlike other alcoholic beverages, was socially acceptable. By 1927, 60 wineries operated in southern Ontario producing sweet, high alcohol (20% minimum) wine.

Although the Pelee Island winery is still in production, many of the earlier wineries have disappeared. Other wineries have been established in their place, however, and there are still about 60 wineries operating in Canada.

A feature of the Canadian wine industry since the mid-1970s has been the creation of a number of cottage and estate wineries. Faced with the twin challenges of changing consumer tastes and increasingly competitive market conditions, the evolution of the Canadian wine industry has been marked by a move to higher quality, particularly by the estate wineries. Nevertheless, the longer-established firms still predominate, with the four largest wineries accounting for fully 70% of production.

Originally, Canadian wine was fermented from a native North American grape, Vitis labrusca, known not only for its winter hardiness and high yields but also for its distinctive flavour. But with the growth in Canada's immigrant population, consumer tastes began to change. Domestic wines produced from the native labrusca grape declined in popularity, while a growing preference for dry table wines imported

Grapevine Culture in Canada

Today there are nine designated viticultural areas in three provinces: the Annapolis Valley and Northumberland Strait areas of Nova Scotia; the Niagara Peninsula, Pelee Island and Lake Erie North Shore areas of Ontario; and the Okanagan Valley, Similkameen Valley, Fraser Valley and Vancouver Island areas of British Columbia. Almost all of the grapes grown in Nova Scotia and British Columbia are used in winemaking. A little over half of Ontario's production is sold to wineries, while the remainder reaches the consumer in the form of juices, fresh grapes and jelly.

Grapevines flourish in two bands around the globe between thirty and fifty degrees of latitude north and south of the equator. The vineyards of Nova Scotia and Ontario straddle the forty-third parallel which passes through the famous wine producing areas of France, Italy and Spain. The vineyards of British Columbia share the fiftieth parallel with the wine growing region in the lower Rhine Valley of Germany.

Area of Grapes, 1991

	Hectares
Nova Scotia	69
Québec	103
Ontario	5,645
British Columbia	781
Other provinces	7
Total	**6,605**

Source: *Statistics Canada, Census of Agriculture, 1991.*

from Europe saw the development of hardier strains of Vitis vinifera, the classic grapevine of Europe. Canadian wineries responded by ploughing up older grapevines during the 1980s and undertaking extensive replanting with European hybrids.

Changing consumer tastes led to the production of premium quality wines to capture a share of the upscale market. These wines differ according to the type of grape used, their geographic origin, sugar content, the winery producing them, and the vintage. Panels of experts established by the industry in the various wine-making regions ensure that premium wines – identified by a Vintners Quality Alliance (VQA) label – meet established standards.

An important innovation associated with the production of higher quality wines has been the appearance since the mid-1970s of cottage and estate wineries. These are small wineries producing premium quality wines from grapes grown in their own vineyards. Although accounting for less than 5% of wine sales in Canada by volume – but considerably more by value – estate wineries have experienced considerable success in international competitions, winning a number of prestigious awards.

Canadian wineries have also modified their product line to cater to the demand for medium-priced dry wines. Mid-range products consist mainly of blends of domestic and imported wines bottled under brand names owned by the wineries. In addition, lower quality grapes are used to produce a range of low-alcohol wine coolers, consisting of wine blended with fruit juices.

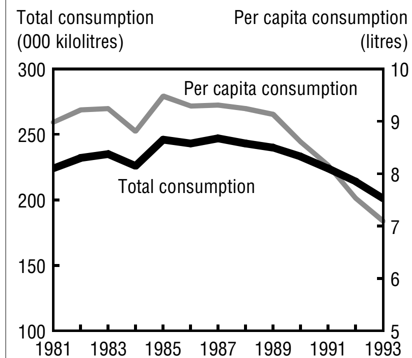
More competitive markets

By the end of the 1980s, trade negotiations signalled an end to a protected domestic market for Canadian wines. Free trade negotiations with the United States and multilateral negotiations under the GATT both had the effect of easing access for imported wines. At the same time, output by traditional and non-traditional wine-producing countries was expanding.

As supply was increasing, moreover, demand fell. In Canada, as in the United States and Europe, there was a gradual shift in consumption away from alcoholic beverages. Wine consumption, both in total and per capita, remained stable until 1985, but then trended downwards (Figure 1).

The net effect of all these factors was an unprecedented choice and supply of wine available to the consumer, and downward pressure on prices.

Figure 1
Canadian wine consumption falling



Source: Statistics Canada – Apparent Per Capita Food Consumption (Cat. No. 32-229)

Deregulation

Until quite recently the wine industry had been accustomed to operating in a highly regulated environment, affording protection not only to wineries but also to grape growers.[1] But deregulation and the dismantling of trade barriers under NAFTA and the GATT have exposed Canadian wine producers to increased competitive pressures.

One way in which provincial governments have protected the wine industry within their own jurisdictions is through assured markets for grape-growers. In the major grape-producing provinces of Ontario and British Columbia, provincial regulations have historically ensured markets for the grape harvest. In Ontario, wineries are required to purchase a minimum of 25,000 tonnes annually – almost half the total. In addition, until 1990 blended wine was limited to no more

[1] It should be noted, however, that domestic wineries and importers receive a relatively small share of the consumer expenditure on their products – $687 million in 1993, little more than one-third of the $1.9 billion in retail wine sales rung up at the cash register. The difference of $1.2 billion goes towards transportation, warehousing, retailing and – the lion's share – various forms of tax.

than 25% of imported materials. This limit has since been raised to 75%. Wineries in British Columbia have been required to purchase almost all of the grape harvest each year, but with the 1995 harvest they were free to source their requirements from anywhere in Canada or abroad. As a result, there is a risk that a portion of the grape crop in British Columbia – particularly of lower quality grapes – might not be purchased by domestic wineries.

Restricted access to wine markets has been a common feature of many countries, including Canada. Market access and distribution are controlled by the provincial governments through the operations of the provincial liquor stores. Most wine in Canada is sold through these outlets, although in all provinces consumers may purchase wines directly from wineries.[2] The listings and price markups of provincial liquor distribution agencies have, in the past, favoured the sale of provincially produced wine over other domestic and imported products. But in recent years Canada has concluded agreements with its trading partners guaranteeing equal access and distribution rights for both domestic and imported wines. The agreements, entrenched in both the FTA and the GATT, provide for a phase-out of preferential price markups and tariffs, leading to an increasingly open market environment.

Responding to the challenge

Canadian wine producers have embarked on an ambitious set of initiatives to meet the twin challenges of declining consumption and increased competition. In partnership with the federal and provincial governments, the industry has developed an adjustment strategy, known as the Canadian Wine Market Development Program, involving the production of high quality vinifera grapes, the development of modern, efficient wineries, and the dismantling of interprovincial trade barriers. The program compensates growers for ploughing up labrusca vineyards, modernizing wineries and developing new markets.

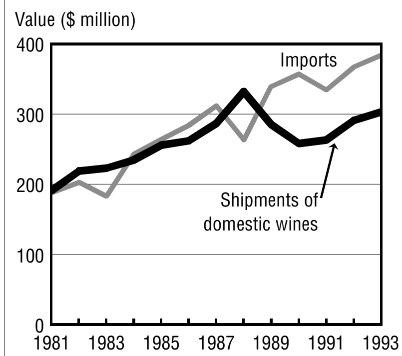
Progress to date has included the success of domestically produced, premium quality wines in both national and international markets, the rise in acceptance of mid-range wines, and aggressive market development of wine coolers – an outlet for lower-quality wines including wines made from fruits other than grapes. In addition, genetic research is being undertaken at the University of Guelph to improve the cold tolerance of vinifera vines.

Over a relatively short period of time, the Canadian wine industry has responded to changing consumer tastes and market conditions. It has transformed its products from predominantly low-priced, labrusca wines to a more balanced range of products extending from low-priced wine coolers to vinifera wines comparable in quality to those from more established wine-producing regions.Canadian wineries now produce a little less than half the wine sold in Canada (Figure 2), the other half consisting of imports dominated by wines from France and, to a lesser extent, Italy and the United States (Figure 3). After slipping from around 50% (in volume terms) in the 1980s, the market share of domestic wineries now appears to be stabilizing at around 44%. Moreover as the quality of Canadian wine improves, the industry has put itself on a sounder footing to face the competitive pressures posed by more open markets, deregulation, and an increasingly discerning clientèle.

[2] Some of the provinces permit additional outlets. In Quebec, wines bottled in the province are also sold in grocery stores. A number of private wine stores in Alberta and British Columbia sell both domestic and imported wines, while Ontario permits wineries to operate retail outlets for the sale of their own wine.

Figure 2

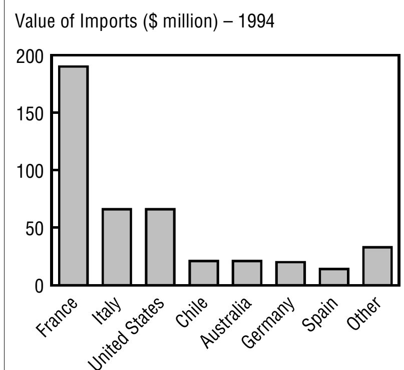
Market share of domestic wine slips below 50%



Sources: *Statistics Canada*
– *Annual Survey of Manufacturers*
– *International Trade Database*

Figure 3

French wines dominate imports



Source: *Statistics Canada*
– *International Trade Database*

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The statistics used in this article were taken from the following Statistics Canada sources:

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- *The Control and Sale of Alcoholic Beverages in Canada* (Catalogue no. 63-202)
- *Apparent per Capita Food Consumption* (32-229-XPB)
- *Canadian Agriculture at a Glance* (Catalogue no. 96-301-XPB)
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- *Imports by Commodity* (Catalogue no. 65-006).

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