

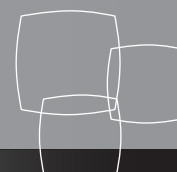


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# SMALL BUSINESS QUARTERLY

VOLUME 11, No. 3, NOVEMBER 2009

## PERFORMANCE

### *Trends*

- The number of payroll employees decreased by 341 239 in the second quarter of 2009, which corresponds to a year-over-year job loss of 2.3 percent. The contribution to job losses was 53.4 percent from small businesses,<sup>1</sup> 25.6 percent from medium-sized businesses and 21.0 percent from large businesses in the second quarter of 2009.
- Among small businesses, industries that experienced the greatest increases in employment were health care and social assistance (5138 jobs) and educational services (1609 jobs).
- The manufacturing sector experienced the greatest number of jobs lost at 205 732, of which 22.6 percent (46 605 jobs) were lost among small businesses and 53.5 percent (110 190 jobs) were lost among large businesses.
- From 2000 to 2008, the number of employed workers increased by 17 percent and the number of self-employed individuals increased by 10.8 percent.
- The economic downturn in 2008 took its toll on businesses in Canada as the value of insolvency liabilities peaked at approximately \$3.9 billion during the fourth quarter in 2008. The value of insolvencies for the first half of 2009 fell to levels similar to pre-recession levels.

<sup>1</sup> Small businesses are defined as having fewer than 100 employees, medium-sized businesses having 100 to 499 employees and large businesses having 500 or more employees.

## UNDERSTANDING

### *Discouraged Borrowers*

It is generally recognized that small and medium-sized enterprises (SMEs) have more difficulty accessing financing than large businesses. In examining the accessibility of financing for SMEs, policy-makers have traditionally considered approval and rejection rates. This focus, however, fails to acknowledge potential borrowers who fear rejection and, therefore, do not apply for financing. Such “discouraged borrowers,” just like denied borrowers, will not receive financing that could be important for their business. To examine this issue, Industry Canada (IC) has undertaken an analysis to determine whether discouraged borrowers may in fact have good chances of being approved or whether their decision not to apply for financing is justified because they would be denied financing even if they applied for it.

Previous research offers mixed evidence on the issue of discouragement. Cavalluzzo et al. (2002)<sup>1</sup> argue that minorities tend to be more discouraged, which would suggest that the fear is irrational because no bias against minorities has been found. Han et al. (2009)<sup>2</sup> show that discouraged borrowers are riskier than applicants and that discouragement, therefore, is an efficient self-rationing mechanism.

This IC analysis posits that discouraged borrowers are riskier than applicants, but they are better informed than denied borrowers regarding their situation (see Figure 1). In other words,

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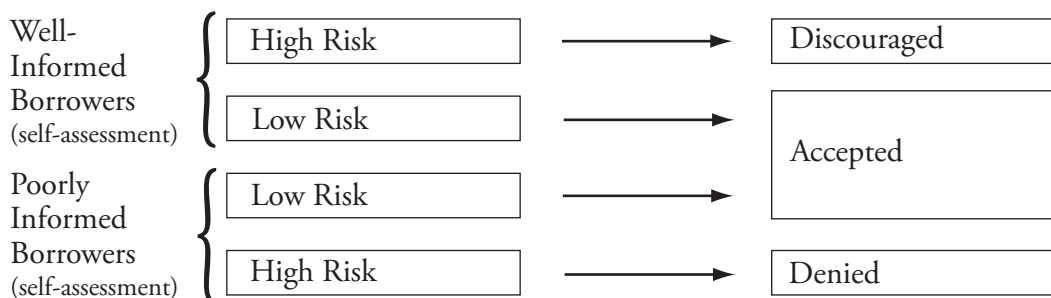
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discouraged borrowers know that their credit rating is too low to be accepted by any financial institution, so they do not apply in the first place. As other studies show that banks tend

to finance SMEs with which they have a good relationship, because they know and trust them, SMEs can learn about themselves through their relationship with banks.

*Figure 1: Type of Borrowers\**



\* In this simplified framework, borrowers differ according to information level and risk. Well-informed borrowers only apply for financing when they are low risk. Poorly informed borrowers always apply because they cannot determine their level of risk, so they simply take a chance. Accepted borrowers were accepted by a financial institution, but not necessarily by the first one they approached.

The analysis uses data from Statistics Canada's *Survey on Financing of Small and Medium Enterprises* (2004), which targets Canadian SMEs and investigates their financing behaviour. Specifically, it determines what kind of SMEs request financing in the form of debt, leasing, equity and trade credit, and which are approved. The survey also contains information on variables that account for the satisfaction of the borrower, the kind of bank approached and the number of years the SME has had a relationship with the financial institution in order to capture the strength of the relationship. SMEs that indicated they do not seek financing because they fear rejection were considered discouraged.

A multinomial regression analysis was used to derive the following three results:

- Discouraged borrowers are much smaller than applicants in terms of numbers of employees;
- Discouraged borrowers identify financing as a major obstacle to growth, just like denied borrowers; and
- SMEs satisfied with their relationship with their account manager are more often discouraged.

These findings support the idea that discouraged borrowers have a good relationship with their financial institution, through which they can learn more about themselves and take better decisions. Consequently, discouraged borrowers are actually realistic borrowers. They know that they are risky and decide rationally not to apply for financing.

This paper will be available in early 2010 at [www.sme-fdi.gc.ca](http://www.sme-fdi.gc.ca), under "Research Reports" in the "SME Financing" section.

<sup>1</sup> Cavalluzzo, K., L. Cavalluzzo and J. Wolken, 2002. Competition, Small Business Financing, and Discrimination: Evidence from a New Survey. *Journal of Business* 75(4), 641–679.

<sup>2</sup> Han, L., S. Fraser and D.J. Storey, 2009. Are Good or Bad Borrowers Discouraged from Applying for Loans? Evidence from U.S. Small Business Credit Markets. *Journal of Banking and Finance* 33, 415–424.

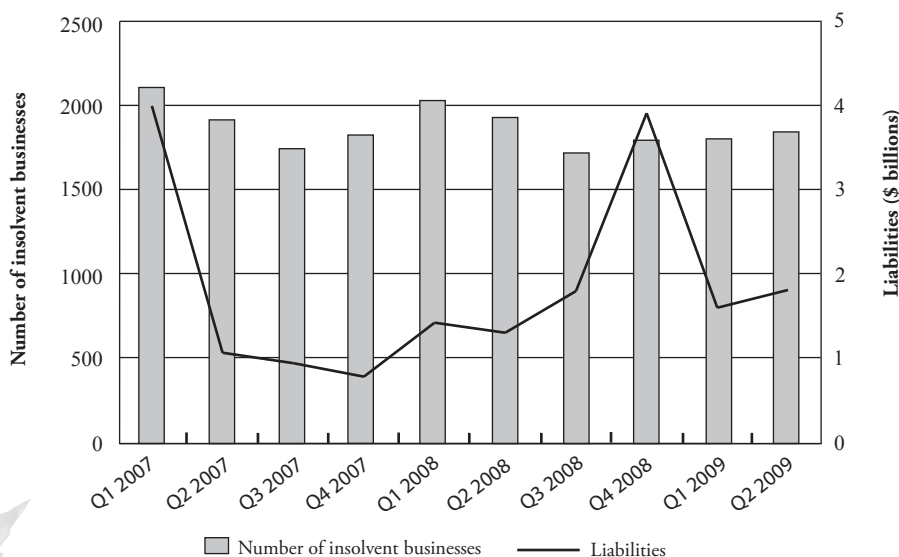
# BUSINESS *Insolvencies*<sup>1</sup>

Statistics on business insolvencies represent one measure that economists and policy-makers use to assess the underlying health of the Canadian economy. Figure 2 compares the number of insolvencies in Canada between 2007 and 2009. Business insolvencies in Q2 2009 were less than in Q2 2008, with 1837 insolvent businesses in Q2 2009 compared with 1922 in Q2 2008. This represents a decline of 4.4 percent, mainly attributable to improved credit conditions for businesses compared with one year earlier. Although not shown, businesses in the construction industry and the arts, entertainment and recreation industry displayed the largest decreases in insolvencies (-28 percent and -29 percent respectively). Businesses in the utilities industry and the finance and insurance industry, on the other hand, experienced the largest increases in insolvencies (1000 percent and 85 percent respectively).

A second dimension of business insolvencies, “value of insolvency liabilities,” is also illustrated in Figure 2. From the figure, it is clear that the economic downturn in 2008 took its toll on businesses in Canada as the value of insolvency liabilities peaked at approximately \$3.9 billion during the fourth quarter in 2008. The upward trend in the average “value” of insolvencies could suggest that more large firms were filing for bankruptcy during this period compared with small firms. Since Q4 2008, the upward trend in the value of insolvencies has reversed, falling to nearly \$1.6 billion in Q1 2009 and settling at \$1.8 billion in Q2 2009. This is close to pre-recession levels and could be indicative of an economic recovery.

<sup>1</sup> Insolvencies include both proposals (i.e. propositions to creditor to restructure) and bankruptcies. Bankruptcies account for 82 percent of insolvency cases.

*Figure 2: Business Insolvencies 1<sup>st</sup> Quarter 2007 to 2<sup>nd</sup> Quarter 2009*



Source: Office of the Superintendent of Bankruptcy Canada ([www.osb.ic.gc.ca](http://www.osb.ic.gc.ca)).

# JOB *Creation*

According to the latest release of Statistics Canada's *Survey of Employment, Payrolls and Hours*, the number of payroll employees decreased in the second quarter of 2009 by 341 239 compared with the second quarter of 2008. This represents an annual change of -2.3 percent (Table 1). Small firms contributed the most to this loss. The year-over-year contribution to job losses from small businesses was

53.4 percent, 25.6 percent from medium-sized businesses and 21 percent from large businesses.

Between the second quarter of 2009 and the second quarter of 2008, the highest job declines were reported in forestry (-21.7 percent), manufacturing (-12.1 percent), and mining and oil and gas extraction (-9.6 percent). The manufacturing sector

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*Table 1: Year-Over-Year Net Change<sup>1</sup> in Payroll Employment<sup>2</sup> by Industry, 2<sup>nd</sup> Quarter 2009*

Quarter	Change		% Contribution to Total Net Change (Number of Employees)								
	%	Jobs	0-4	5-19	20-49	50-99	0-99	100-299	300-499	100-499	500+
Q2 2008	2.1	301 763	6.9	9.7	11.6	9.7	37.9	2.2	10.6	12.7	49.4
Q3 2008	1.6	232 081	2.8	1.9	11.0	11.4	27.0	-0.4	13.9	13.6	59.4
Q4 2008	1.0	142 488	-1.1	7.5	6.2	3.7	16.3	0.0	5.4	5.4	78.3
Q1 2009	-0.8	-109 650	16.0	30.1	10.6	27.6	84.2	36.4	6.0	42.4	-26.7
Q2 2009	-2.3	-341 239	14.9	9.1	11.6	17.8	53.4	13.3	12.3	25.6	21.0
Industry			Change (Jobs)								
Forestry	-21.7	-9 725	-1 261	-1 248	-1 628	-952	-5 089	-913	-117	-1 030	-3 606
Mining and Oil and Gas Extraction	-9.6	-18 875	-449	-1 365	-2 868	-2 013	-6 695	-567	-2 534	-3 101	-9 081
Utilities	0.5	645	42	16	-56	65	67	-539	356	-183	762
Construction	-6.0	-50 064	-8 883	-8 805	-6 452	-9 468	-33 608	-7 454	-4 417	-11 871	-4 584
Manufacturing	-12.1	-205 732	-393	-7 306	-16 923	-21 983	-46 605	-35 545	-13 391	-48 936	-110 190
Wholesale Trade	-3.8	-29 024	-827	-3 866	-5 292	-6 131	-16 116	-457	-2 803	-3 260	-9 646
Retail Trade	-2.0	-38 715	-7 592	-6 622	-3 325	-7 018	-24 557	-3 095	-1 973	-5 068	-9 091
Transportation and Warehousing	-2.6	-18 007	-1 256	-3 294	-4 070	-2 385	-11 005	-3 888	-1 761	-5 649	-1 355
Information and Cultural Industries	-0.4	-1 299	-592	-455	-212	-1 131	-2 390	1 463	-4 833	-3 370	4 461
Finance and Insurance	2.0	13 271	-1 925	-1 443	-1 474	-1 488	-6 330	652	-1 632	-980	20 581
Real Estate and Rental and Leasing	-5.0	-12 852	-1 387	-2 651	-1 327	-1 377	-6 742	-2 608	-490	-3 098	-3 011
Professional, Scientific and Technical Services	-0.1	-817	-7 447	1 404	-278	-5 003	-11 324	-2 551	1 083	-1 468	11 976
Management of Companies and Enterprises	-3.6	-4 400	81	-409	-927	155	-1 100	1 160	51	1 211	-4 511
Administrative and Support, Waste Management and Remediation Services	-7.6	-59 395	-5 725	1 267	-2 033	455	-6 036	-8 038	-9 932	-17 970	-35 390
Educational Services	1.0	11 831	-1 162	341	1 183	1 247	1 609	-1 560	593	-967	11 189
Health Care and Social Assistance	3.6	54 481	-3 409	6 048	4 257	-1 758	5 138	16 817	2 868	19 685	29 658
Arts, Entertainment and Recreation	4.4	10 933	-690	-1 335	1 439	214	-372	1 970	-391	1 579	9 727
Accommodation and Food Services	-1.0	-11 191	-4 024	-407	1 311	-3 135	-6 255	-3 587	-2 146	-5 733	796
Other Services (excluding Public Administration)	-0.9	-4 363	-3 324	-1 772	-1 085	1 119	-5 062	-137	642	505	193
Public Administration	3.2	32 061	-476	722	161	-302	105	3 559	-1 073	2 486	29 470
<b>Canada Total</b>	<b>-2.3</b>	<b>-341 239</b>	<b>-50 698</b>	<b>-31 181</b>	<b>-39 598</b>	<b>-60 888</b>	<b>-182 365</b>	<b>-45 320</b>	<b>-41 902</b>	<b>-87 222</b>	<b>-71 651</b>

Source: Statistics Canada, *Survey of Employment, Payrolls and Hours*, October 2009.

<sup>1</sup> Year-over-year net change in payroll employment is calculated as the variation between the level of employment in a given quarter and the level in the same quarter a year before.

<sup>2</sup> *Survey of Employment, Payrolls and Hours* data exclude self-employed workers who are not on a payroll and employees in the following industries: agriculture, fishing and trapping, private household services, religious organizations and military personnel of defence services. The data breaking down employment by size of firm also exclude unclassified industries.



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experienced the greatest number of jobs lost at 205 732, of which 22.6 percent (46 605 jobs) were lost among small businesses and 53.5 percent (110 190 jobs) were lost among large businesses. Other industries where small businesses produced significant decreases in employment were construction (33 608 jobs) and retail trade (24 557 jobs).

Job losses in small firms spread across most industries, while they were concentrated in the manufacturing sector for large firms (-110 190 jobs). These significant job losses in manufacturing were somewhat offset by jobs created by large firms in health care and social assistance (29 658 jobs), public administration (29 470 jobs), and finance and insurance (20 581 jobs). Among small businesses, the industries that experienced the greatest increase in employment were health care and social assistance (5138 jobs) and educational services (1609 jobs).

## SELF-Employment

The 2008 results of the *Labour Force Survey* provide a breakdown of the education levels attained by employed and self-employed individuals from 2000 to 2008. During this period, the number of self-employed individuals increased by 10.8 percent and the number of employed workers increased by 17 percent (Table 2). More than half (about 58 percent) of the individuals who were employed or self-employed in 2008 have a post-secondary certificate/diploma or university degree.

The share of workers with less than high school education decreased while the number of workers with post-secondary education has increased. Self-employed individuals had a greater decline in the number of individuals with less than a high school education compared with employed individuals. More specifically, unincorporated firms without paid help (one of the categories of self-employment) experienced the greatest decline in the share of individuals with less than a high school education, decreasing from 22 percent to 14.1 percent (Table 2). In other categories of self-employment, unincorporated individuals with paid help and unpaid family workers had an overall decline of 12.9 percent and 39.2 percent, respectively, in the number of individuals across all education levels.

Between 2000 and 2008, the share of employees with a post-secondary certificate/diploma rose from 32.8 percent to 35.1 percent while the

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## SELF-EMPLOYMENT Program

The Self-Employment Program is an employment program of Human Resources and Skills Development Canada that provides financial assistance by region to unemployed individuals to help them create jobs for themselves by starting a business. To be eligible to participate in the Self-Employment Program, one must be an “insured participant,” an unemployed person who was engaged in insurable employment as defined by the *Employment Insurance Act* (Employment Insurance Program).<sup>1</sup>

Since the beginning of the global economic downturn, the number of people in Canada considering self-employment has been steadily increasing. According to the latest figures from Statistics Canada's *Labour Force Survey*, the number of self-employed workers increased by 3.5 percent to 2.7 million from August 2008 to August 2009. This increase can be explained by the fact that when labour market conditions tighten, individuals who cannot find suitable employment tend to start their own businesses and thus become self-employed.

Although requiring extensive thought and planning, self-employment can be a rewarding alternative to generate income. To support individuals considering self-employment or launching their own business, the Canada Business Network provides government information services for businesses and start-up entrepreneurs.

To determine if entrepreneurship is for you and to find out more about the Self-Employment Program, including eligibility requirements, as well as other available programs, contact your local member of the Canada Business Network by visiting [www.Canadabusiness.ca](http://www.Canadabusiness.ca).

<sup>1</sup> For more information on being an “insured participant” as defined by the *Employment Insurance Act*, visit [www.servicecanada.gc.ca/eng/ci/legislation/ei\\_act\\_toiprovis\\_1.shtml](http://www.servicecanada.gc.ca/eng/ci/legislation/ei_act_toiprovis_1.shtml).

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share of employees with a university degree rose from 19.3 percent to 23.4 percent. Meanwhile, the share of self-employed with a post-secondary certificate/diploma rose from 31 percent to 33.4 percent while those with a university degree rose from 22.2 percent to 25.1 percent (Table 2). University degree holders experienced the largest growth in both employed and self-employed individuals (41.8 percent and 33.0 percent respectively), followed by post-secondary certificate/diploma holders (25.1 percent and 22.3 percent respectively) (Table 2). These upward trends are also reflected in the self-employed group of incorporated and unincorporated individuals.

The proportion of unpaid family workers with a post-secondary certificate/diploma or university degree also experienced an increase to 24.5 percent and 8.7 percent respectively (Table 2).

In 2008, the highest proportion of individuals with a post-secondary certificate/diploma and university degree occurred in the incorporated without paid help category at 63.7 percent while the lowest proportion was found in the unpaid family workers category at 33.2 percent.

*Table 2: Share of Self-Employed Workers and Employees by Category of Worker and Education Level, in Canada, 2000 to 2008*

Education Level	Employed			Self-Employed			Incorporated				Unincorporated				Unpaid Family Workers	
	Share (%)		Percent Change <sup>1</sup>	Share (%)		Percent Change <sup>2</sup>	With Paid Help		Without Paid Help		With Paid Help		Without Paid Help		Share (%)	
	2000	2008		2000	2008		2000	2008	2000	2008	2000	2008	2000	2008	2000	2008
0-8 years	3.2	2.2	-22.2	6.2	4.5	-36.1	4.5	2.7	4.4	2.7	6.7	4.0	6.8	3.9	15.4	17.8
Some high school	13.1	10.4	-7.6	13.3	10.5	-18.8	10.2	10.1	10.1	8.9	11.9	9.5	15.2	10.2	27.9	20.6
High school graduate	21.3	20.0	9.9	19.6	19.7	8.6	19.8	18.7	18.7	18.1	18.8	18.5	19.8	19.4	21.6	24.1
Some post-secondary	10.2	9.0	3.0	7.8	6.7	-5.7	7.9	7.7	7.7	6.5	6.1	6.6	8.1	6.9	8.9	—
Post-secondary certificate/diploma	32.8	35.1	25.1	31.0	33.4	22.3	31.4	32.5	32.5	34.7	27.6	30.4	31.7	35.2	19.2	24.5
University degree	19.3	23.4	41.8	22.2	25.1	33.0	26.2	26.5	26.5	29.0	29.0	31.1	18.3	24.4	7.2	8.7
All levels	100.0	100.0	17.0	100.0	100.0	10.8	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistics Canada, *Labour Force Survey*.

<sup>1</sup> Percent change in employed workers from 2000 to 2008.

<sup>2</sup> Percent change in self-employed workers from 2000 to 2008.

Note: Dash indicates estimates are suppressed to meet the confidentiality requirements of the *Statistics Act*.

# BUSINESS *Financing*

The percentage of SMEs seeking debt financing was about 20 percent in any given year but has decreased from 19 percent in 2004 to 13 percent in 2007 according to Statistics Canada's *Survey on Financing of Small and Medium Enterprises*. A number of factors can explain this decline, such as lower demand for financing due to an economic slowdown, sufficient means to self-finance or improvement in liquidity. An analysis of these factors suggests that a general improvement in profitability and liquidity is the main reason. The use of retained earnings, a type of self-financing, explains the lower request rate for external financing in 2007.

The lower request rate does not suggest that businesses undertook fewer projects but rather they self-financed projects using their equity instead of approaching banks for financing. According to Statistics Canada's *Quarterly Financial Statistics*, the total equity of non-financial firms increased from \$900 billion to \$1.1 trillion between 2004 and 2007. This 22-percent increase could be responsible for some of the decrease in the percentage of SMEs seeking credit, which would be a positive sign that SMEs have sufficient liquidity to finance their own projects.

Changes in intended use of debt financing also indicate an improvement in liquidity. Instead of borrowing to cover short-term needs, SMEs were financing long-term projects. In 2004, 9 percent of SMEs sought financing for debt consolidation compared with 8 percent in 2007. Furthermore, the percentage of businesses seeking debt for working capital dropped from 56 percent in 2004 to 45 percent in 2007. Long term needs, such as research and development, accounted for a higher proportion of debt financing, rising from 4 percent in 2004 to 5 percent in 2007.

At first glance, a decrease in the percentage of businesses seeking debt financing might seem negative because of the usual association of business investment as an indicator of future economic growth. However, the lower request rate in 2007 is positive since it reflected strong balance sheets — instead of turning to the banking system for financing, firms reinvested their equity into their business.

## KEY SMALL BUSINESS *Financing Statistics Report*

*Key Small Business Financing Statistics* is a reference document that highlights key findings on the state of small and medium-sized enterprise (SME) financing in Canada for all three types of financing (debt, leasing and equity) by region, sector, size of business and stage of business development. The report has four parts:

**SME Marketplace** describes the distribution of SMEs by region, sector and size.

**Financing Activity of SMEs** describes the demand for financing, requests made and approvals granted, as well as the amount of financing received.

**Access to Financing** looks at the types of financing instruments used by SMEs and the conditions under which they are accessed.

**SME Business Owner and Financial Characteristics** examines the profile and financing characteristics of women, youth, visible minority, new immigrant and Aboriginal entrepreneurs in Canada and cooperatives.

In 2007, 13 percent of SMEs made a request for new or additional debt from a credit supplier for business purposes, a decrease from 19 percent in 2004. Of those requests, 87 percent were approved (Table 3). The request rate among firms gradually increases with the size of the firm, as does the approval rate.

Table 3: Request and Approval Rates by Size of Business and Sector, 2007

	Request Rate (%)	Approval Rate (%)
CANADA	13	87
Size of business (number of employees)		
0-employees	10	85
1-4 employees	13	86
5-19 employees	20	92
20-99 employees	27	88
100-499 employees	30	97
Sector		
Agriculture/Primary	24	96
Manufacturing	19	88
Wholesale/Retail	12	87
Professional Services	8	92
Knowledge-Based Industries	8	85
Accommodation and Food Services	10	80
Other Sectors	12	83

Source: SME Financing Data Initiative, Statistics Canada, Survey on Financing of Small and Medium Enterprises, 2007.

*Key Small Business Financing Statistics* will be available by the end of 2009 at [www.sme-fdi.gc.ca](http://www.sme-fdi.gc.ca). To receive a copy by email, subscribe at [sbrb-dgpet.publications@ic.gc.ca](mailto:sbrb-dgpet.publications@ic.gc.ca).

# RECENT *Developments*

## KEY SMALL BUSINESS STATISTICS — JANUARY 2010

### *Special Edition on Growth Performance of Canadian Firms*

*Key Small Business Statistics* is a semi-annual publication that provides information on the most frequently asked questions pertaining to small businesses in Canada. Fully 98 percent of businesses in Canada are considered small and they employ 48 percent of the private sector labour force. In addition to the usual updates of statistics on the number of businesses in Canada, the January 2010 special edition will focus on the range of growth performance by Canadian firms.

To receive the publication in January 2010, you can subscribe online at [www.ic.gc.ca/SMEstatistics/subscription](http://www.ic.gc.ca/SMEstatistics/subscription).

### *Small Business Quarterly* Small Business and Tourism Branch

The *Small Business Quarterly* (SBQ) provides a quick and easy-to-read snapshot of the recent performance of Canada's small business sector. The SBQ is published by the Small Business and Tourism Branch of Industry Canada.

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## WORLD BANK REPORT:

### *Doing Business 2010 — Overview*

In September 2009, the World Bank released an overview of its annual report *Doing Business 2010*. The report provides an annual assessment of regulatory reforms and administrative processes related to complying with regulations that impact the ease of doing business across 131 countries. Using results from ten indicators, the report reveals that Canada has maintained its eighth-place ranking over the past two years on the ease of doing business. Singapore, New Zealand and Hong Kong have ranked among the top three for the past two years. The full report, which will be available by the end of the year, will include international assessments and rankings on regulatory areas such as starting a business, protecting investors, trading across borders and closing a business.

For more information or a copy of the World Bank report, visit [www.doingbusiness.org](http://www.doingbusiness.org).

## CANADA BUSINESS *Launches New Website*

Canada Business, a government information service for businesses and start-up entrepreneurs in Canada, has developed a new and improved website to reflect the changing needs of Canadian entrepreneurs and small businesses. By serving as a single point of access for federal and provincial/territorial government services, programs and regulatory requirements for businesses, Canada Business aims to reduce the complexity and burden of dealing with various levels of government.

The website is designed to reduce the time and effort required by small businesses to find information from governments. It will help entrepreneurs and small businesses in all regions of Canada to succeed and grow through streamlined access to reliable, up-to-date and relevant information and services.

Visit [CanadaBusiness.ca](http://CanadaBusiness.ca) — Connecting your clients with the information they need.