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Evaluation of the Canada Small Business Financing Program

FINAL

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LIST OF ACRONYMS USED IN REPORT

Acronym	Meaning
AAFC	Agriculture and Agri-Food Canada
AEB	Audit and Evaluation Branch
BDC	Business Development Bank of Canada
CALA	Canadian Agricultural Loans Act
CFP	Community Futures Program
CRF	Consolidated Revenue Fund
CSBFP	Canada Small Business Financing Program
CSBFA	<i>Canada Small Business Financing Act</i>
IC	Industry Canada
PAA	Program Alignment Alignment
PM	Performance Measurement
RDA	Regional Development Agency
R&D	Research and Development
SME	Small and medium-sized enterprises

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EXECUTIVE SUMMARY

Program Overview

The Canada Small Business Financing Program (CSBFP) is a statutory loan loss-sharing program that is governed by the *Canada Small Business Financing Act* and administered by Industry Canada. Under the CSBFP, the Government and private sector lenders share the risk of providing loans to small businesses. The program facilitates access to affordable financing to small businesses for the establishment, expansion, modernization and improvement of their businesses. The increase in the amount of financing extended to small businesses is expected to ultimately stimulate economic growth and create jobs for Canadians.

Evaluation Purpose and Methodology

The objectives of this evaluation are to address the core issues of relevance and performance in accordance with the *Directive on the Evaluation Function*, and support the upcoming comprehensive review, as required under the *Canada Small Business Financing Act*.

Both qualitative and quantitative data were collected to provide multiple lines of evidence to support the conclusions and recommendations in this evaluation. The data collection methods were set out in the CSBFP Performance Measurement Strategy and included a document review, literature review, interviews, administrative data analysis and financial analysis.

Findings

Relevance

There is a continued need for the CSBFP. Smaller, younger and higher-risk businesses have difficulty obtaining financing in Canada as they may face obstacles that others do not with respect to collateral, credit history, expertise and the lender having insufficient information regarding the borrower's operation and potential profitability. The CSBFP is intended to facilitate the availability of debt financing from business lenders under such circumstances. The program aligns with the government's support to Canadian small businesses as well as Industry Canada's strategic outcome of developing competitive Canadian businesses and communities.

The program is also consistent with the federal government's roles and responsibilities, and it is the only program of its nature offered across Canada and to all sectors. That said, there are a number of regional or sector-specific programs that also share the risks of lending to small business with financial institutions and this program is one of many at the federal and provincial levels of government that seeks to bolster financing availability for businesses in Canada.

Performance

The program's regulatory and legislative framework provides the CSBFP with a concrete foundation from which to deliver its objectives. However, the demands of the program, coupled with the slow process by which the framework changes occur, can place stress on its relationships

with its private sector stakeholders and has diminished the program's appeal for lenders. New regulations may address some of these irritants, but it is too soon to assess their impact.

The presence of these irritants, combined with a number of factors beyond the program's control, such as individual financial institution's policies toward lending to small business, have led to a decline in program use. Yet, this decline appears to stabilize somewhat during economic events, such as the "dot com bubble burst" and the recent economic downturn and related recession. This trend results from changes typically made to the program's regulatory framework at these times to make it more accessible.

Awareness of the program is high among lenders overall, but low among borrowers and non-borrowers alike. Outreach efforts have had an impact; however there may be untapped opportunities to promote the program. Since many borrowers indicated that they first learn about the program through their lender, further outreach with front line staff at lending institutions may help foster better knowledge of how the CSBFP works, and increase awareness among borrowers.

All this said, the program has been successful in facilitating incremental debt financing for the small business community over time. In fact, subsequent incrementality studies conducted by the program point to an increase in the program's application when other financing options are either not available or less desirable.

Further, evidence suggests that the CSBFP has a positive impact on the growth of SMEs. Specifically, program participation is shown to increase revenues, salaries and profits when compared to non-participation.

With respect to the CSBFP's economy and efficiency, a cost-benefit analysis of the program found it to be returning a value of five dollars for every dollar spent by IC and lending institutions. The program recovers a proportion of its claim payments through fees and runs at a relatively low cost considering the magnitude of funds it makes available to small businesses. The program's new on-line loan registration system was recently adopted by the Canadian Agriculture Loans Act (CALA) Program—a similar program at Agriculture and Agri-Food Canada, creating efficiencies between the two departments, and for lending institutions.

Recommendations

1. The program recently implemented a package of regulatory amendments mostly focused on increased incentives for lenders to offer financing through the program. Time will be required to assess the impact of these changes. While these changes were primarily targeted at lenders, steps should now be taken to re-engage existing and potential borrowers to determine whether the CSBFP is sufficiently meeting their needs in the current environment. The CSBFP may consider implementing pilot projects as a step toward addressing the needs of borrowers identified through these engagements.
2. The program should continue to develop closer outreach ties with lenders and professional associations willing to collaborate in order to raise awareness of the program and to improve lenders' knowledge of the program and how it works.

1.0 INTRODUCTION

This report presents the results of an evaluation of the Canada Small Business Financing Program (CSBFP). The purpose of the evaluation was to assess the relevance and performance of the program. The report is organized into four sections:

- Section 1 provides the profile of the CSBFP;
- Section 2 presents the evaluation methodology, along with a discussion of data limitations;
- Section 3 presents the findings pertaining to the evaluation issues of relevance and performance; and
- Section 4 summarizes the evaluation's conclusions and provides recommendations for future action.

1.1 Program Description

The Government of Canada recognizes the need for small and medium-sized enterprises (SMEs) to have access to financing. The CSBFP is designed to help businesses with their financing needs by helping to fill gaps in the lending market for certain types of SMEs and, in particular, higher-risk SMEs. The program was launched in 1961 under the *Small Business Loans Act*. In 1999, the *Canada Small Business Financing Act* (CSBFA) was created as its successor. The CSBFP increases the availability of loans for establishing, expanding, modernizing and improving small businesses. Loans may fall under three different categories: the purchase of equipment, leasehold improvements or real property.

Overall, the program has become a key tool for providing financing to SMEs in Canada. In 2012–13, lending institutions across the country, registered over 6,200 loans worth more than \$910 million to small businesses through the CSBFP. Since its inception in 1999 through to March 31, 2013, the program has registered 142,130 loans worth \$14.3 billion.¹

1.2 Objectives of the Program

The main objectives of the CSBFP are:

- to help new businesses get started and established firms make improvements and expand;
- to improve access to loans that would not otherwise be available to small businesses; and
- to stimulate economic growth and create jobs for Canadians.

The program achieves these objectives by sharing the financial risk of lending to small businesses among the borrowers, lenders and the government.

¹Industry Canada, *Canada Small Business Financing Act Annual Report, 2012-13*.

1.3 Delivery and Governance of the Program

The CSBFP is delivered by private-sector lenders, which includes chartered banks, credit unions and caisses populaires. Lenders provide service to Canadians in all provinces and territories and are responsible for all credit decisions, loan approvals, and in the event of default, realizing on security and guarantees. Each lender establishes its own lending criteria subject to the requirements of the CSBFP. Once the loan is approved, the funds that are advanced to the borrower are those of the lender and not the Government.

Industry Canada (IC) administers the CSBFP by registering loans, collecting fees and paying lenders the eligible portions of losses on defaulted loans. The CSBFP does not approve the borrower loan applications and is not involved in the administration of the loans. By registering loans with IC, lenders are entitled to submit claims to Industry Canada in the event of default. The interest rate charged to borrowers is determined by lenders and may be fixed or variable, within the parameters of the regulations:

- Variable rate: The maximum chargeable is the lender's prime lending rate plus 3% (including a 1.25% annual administrative fee)
- Fixed rate: The maximum chargeable is the lender's single family residential mortgage rate for the term of the loan plus 3% (including a 1.25% annual administrative fee).

A registration fee of 2% of the total loan amount is payable by the lender to IC, but may be financed by the borrower as part of the loan.

The target audience of the CSBFP are for-profit small businesses or start-ups operating in Canada with up to \$5 million in annual gross revenues. Not-for profit, charitable or religious organizations and farming businesses are excluded from the program.

In 2012-13, the profile of CSBFP loans included the following characteristics:

- small businesses less than one year old received \$530 million or 58% of the value of all loans made;
- the majority of loans were made to small businesses with annual revenues of less than \$1 million;
- the average loan size was \$146,778; and
- the majority of loans went to small businesses in accommodation and food services (33%), retail trade (15.4%), transportation and warehousing (7.4%), and manufacturing (4.7%).

1.4 Context

In response to the 2008 economic recession, and in an effort to increase the program's use, changes to the CSBFP were enacted on April 1, 2009 through Economic Action Plan 2009. These changes included an increase to eligible loan amounts, an increase to individual lenders' cap on claims, and minor regulatory amendments to streamline the administration of the program. Furthermore, an additional suite of regulatory amendments were enacted on April 1,

2014 in an effort to increase lending under the program by further reducing the administrative burden on lenders, better aligning the program with conventional lending practices and streamlining procedural requirements.

In addition to these regulatory changes, Industry Canada launched an Information Technology system in 2012 to enable electronic registration and fee payments with financial institutions. The system is expected to speed up the registration process and reduce the paperwork associated with loan registrations and fee payments. The CSBFP is continuing to work with participating financial institutions to roll out the initiative.

1.5 Resources

The program's operating costs are not cost recoverable and are funded by IC's operating budget. These costs are approximately \$3.1 million annually for a staff of 35 and include costs related to research, IT, and outreach activities.

As the CSBFP is a statutory program, the cost of claims for loan losses are sourced directly from the Consolidated Revenue Fund (CRF). The program collects revenues from a 2% registration fee and a 1.25% administration fee paid on all loans. These fees are submitted to Industry Canada by lenders and used to offset a portion of the program's expenses related to claim payments. Please see Table 1 below for a summary of the program's revenues and claim expenses over the past five years.

Table 1: High-level summary of financial activities by fiscal year

	Revenues (\$000)	Expenses (\$000)	Net Revenues Less Expenses
2007-08	55,066.8	96,341.1	(41,274.3)
2008-09	52,895.4	101,509.4	(48,614.2)
2009-10	52,393.3	109,458.9	(57,065.6)
2010-11	51,732.2	76,318.3	(24,586.1)
2011-12	53,117.1	66,152.5	(13,035.4)
2012-13	50,487.2	51,103.9	(616.7)
Total	315,692	500,884.1	(185 192.1)

Source: Canada Small Business Financing Act Annual Report 2012-13

There are also a number of control mechanisms under the CSBFA which limit the Government of Canada's exposure to liability. For example, the CSBFA establishes a \$1.5 billion liability ceiling for each five-year lending period. This liability is calculated as the sum of the maximum potential liability to each lender under the program, for each lending period. The CSBFP has never come close to reaching its maximum liability limit.

Claim payments on defaulted loans are capped for each lender. For each five-year period commencing April 1, 1999, the Government of Canada's obligation to an individual lender is to pay 85% of eligible claims on defaulted loans up to a maximum of the aggregate of:

- 90 percent of the first \$250,000 in loans registered; plus
- 50 percent of the next \$250,000; plus

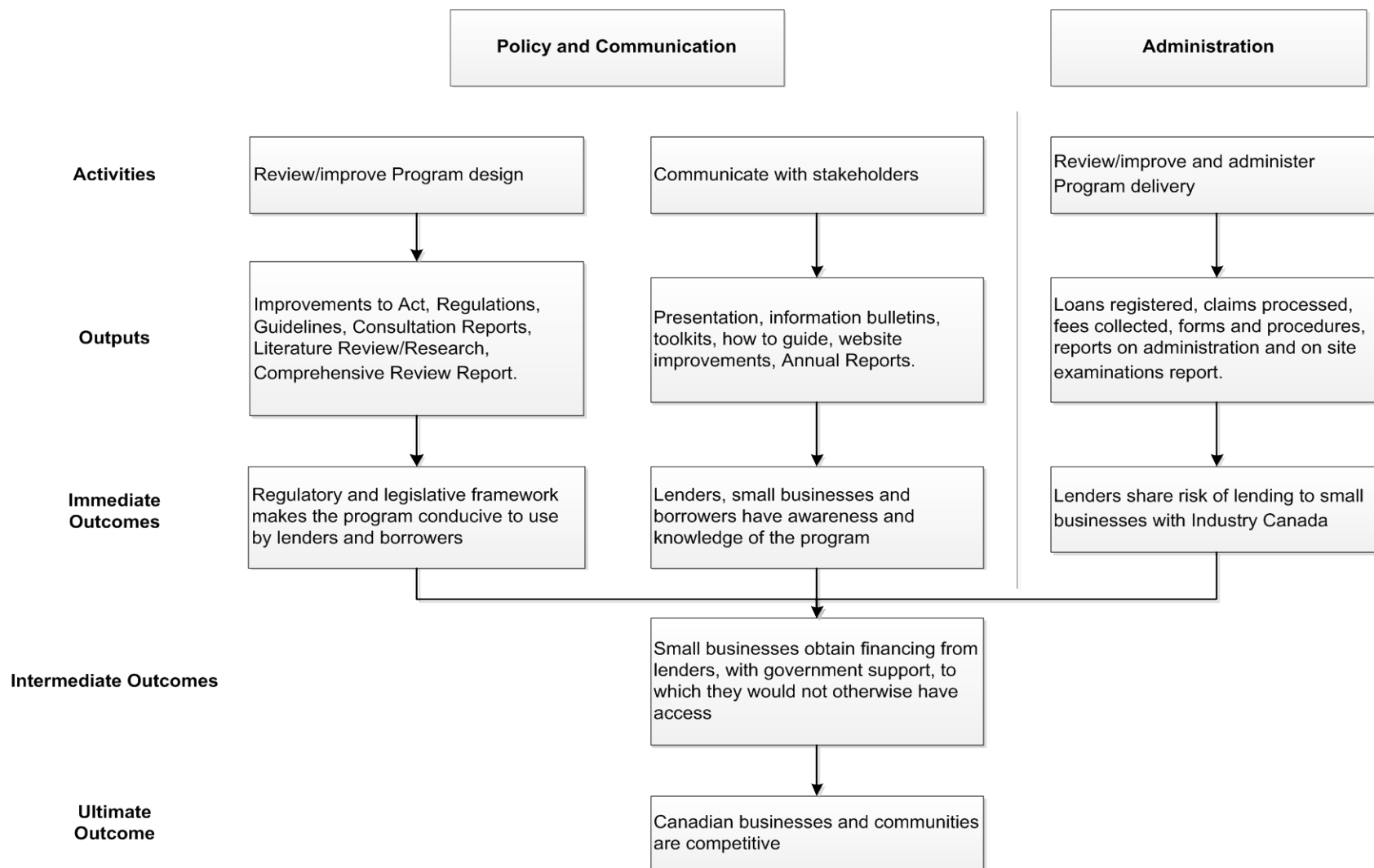
- 12 percent of all loans in excess of \$500,000 for loans made on or after April 1, 2009 (10 percent for loans made before April 1, 2009).

Effectively, for larger lenders, this equates to 12% of their total loan portfolio under the program.

1.6 Logic Model

A logic model is a visual representation that links a program's activities, outputs and outcomes; provides a systematic and visual method of illustrating the program theory; and shows the logic of how a program, policy or initiative is expected to achieve its objectives. It also provides the basis for developing the performance measurement and evaluation strategies, including the evaluation matrix. The logic model for the CSBFP is represented in Figure 1.

Figure 1: Logic Model of the Canada Small Business Financing Program



2.0 METHODOLOGY

This section provides information on the evaluation strategy, approach, objectives and scope, as well as specific evaluation issues and questions that were addressed, the data collection methods, and data limitations for the evaluation.

2.1 Evaluation Strategy

A Performance Measurement (PM) Strategy was developed for the CSBFP in June 2012, which included the logic model contained in this document (Figure 1) and an evaluation strategy. The CSBFP's evaluation strategy was based largely on lessons learned from the previous CSBFP evaluation (June 2009), which evaluated the program's operation from April 1, 2004 to March 31, 2009.

In line with the previous evaluation and in consultation with the policy unit of the Small Business Financing directorate, the evaluation strategy focused on similar issues as the 2009 evaluation in order to provide continuity and have points of relevance for assessing program evolution. Specific attention was also given to the recommendations of the 2009 evaluation.

2.2 Evaluation Scope and Objectives

The objectives of the evaluation were to address the core issues of relevance and performance in accordance with the *Directive on the Evaluation Function*. The evaluation covers the five year period from April 1, 2009 to March 31, 2014.

2.3 Evaluation Questions

The evaluation addressed the following questions on relevance and performance:

Relevance

1. Is there a continued need for the CSBFP?
2. To what extent do the objectives of the CSBFP align with the priorities of the federal government and the strategic outcomes of Industry Canada?
3. To what extent does the CSBFP align with the roles and responsibilities of the federal government?

Performance

4. To what extent is the program's regulatory and legislative framework conducive to use by lenders and borrowers?
5. To what extent do lenders share the risk of lending to small businesses with Industry Canada?

6. To what extent are lenders, small businesses and borrowers aware and knowledgeable of the program?
7. To what extent are small businesses obtaining financing from lenders, with government support, to which they would not otherwise have access?
8. How do firms in receipt of loans by the CSBFP perform?
9. To what extent does the program demonstrate efficiency and economy?

2.4 Evaluation Approach

This evaluation was based on the expected outcomes of the program as stated in the program's foundational documents and logic model. The evaluation was managed by IC's Audit and Evaluation Branch (AEB).

2.5 Data Collection Methods

Both qualitative and quantitative data were collected to provide multiple lines of evidence to support the conclusions and recommendations in this evaluation.

The data collection methods were set out in the CSBFP Performance Measurement Strategy and included:

- Document Review
- Literature Review
- Interviews
- Administrative Data Analysis
- Financial Analysis

These methods collected the necessary lines of evidence to answer each evaluation question.

Document Review

The document review was conducted to gain an understanding of the CSBFP, its alignment with government priorities and its achievement of expected outcomes. Key documents reviewed included:

- Program reporting documents (e.g., Annual Reports)
- Other key program documents (e.g., Research Papers and Publications, Mid-Term Reviews and Survey Reports); and
- Government priority setting documents (e.g., Budgets, Speeches from the Throne)

The Small Business Branch within Industry Canada also commissioned a number of reports as

part of their ongoing performance measurement in consultation with AEB prior to the evaluation. These reports were used extensively to inform this assessment:

- Cost-Benefit Analysis of the Canada Small Business Financing Program, 2014 (Industry Canada)
- Canada Small Business Financing Program Awareness and Satisfaction Study, July 2013 (R.A. Maltest and Associates Ltd.)
- Economic Impact of the Canada Small Business Financing Program, June 2010 (Industry Canada)
- Lender Awareness & Satisfaction Survey², May 2014 (R.A Maltest and Associates Ltd.)

Literature Review

The review of academic literature covered evaluation issues related to continued need, and federal roles and responsibilities. Specifically, the literature review examined the continued need to support small businesses in attaining debt financing, the role of the federal government to provide loan guarantees in Canada as well as an examination of comparable programs in other jurisdictions - domestically and internationally. The review was informed by literature provided by the program and independent research conducted by AEB.

Interviews

The objective of the interviews was to gather in-depth information, including views, perceptions and factual information that address the evaluation questions. The interviews were designed to obtain qualitative feedback from a range of respondents. A total of 29 interviews were conducted, including the following types of respondents:

- Industry Canada, CSBFP officials (8)
- Financial Institutions (9)
- Professional associations (8)
- Academic experts (4)

Administrative Data Analysis

Data analysis was conducted to inform the program's performance, efficiency and economy. The profile of borrowers, including their key characteristics as well as detailed information on trends among lenders and borrowers were obtained from the program. Shifts in the economy as well as changes to the regulations of the program were also considered in the analysis.

Financial Analysis

A high level financial analysis of the CSBFP was conducted to address the evaluation issues of efficiency and economy. There were three areas that were specifically reviewed, namely

² Note that the lenders' survey population was comprised of small business loan officers at various financial institutions across the country.

revenues, the administrative expenses of the program relative to the value of the loans, and a comparison between the costs of the program relative to the economic benefits achieved. The analysis was largely sourced from the Cost Benefit Analysis report conducted by the Small Business Branch in 2013 and made use of some survey data that relates to the incrementality of the program.

2.6 Limitations

The following were limitations on the methodology:

Response Burden and Program Operating Environment

Program stakeholders had recently been consulted regarding a series of program amendments that went into effect on April 1, 2014. In addition, many stakeholders had been surveyed in the past year as the program prepared for this evaluation and a second survey was in the field during the evaluation's conduct phase. As such, interviewees for this assessment had been subject to response burden in the period leading up to the evaluation and were further being surveyed by the program during the evaluation's conduct phase. Interviews were adjusted to assure minimal overlap with work previously (or currently) being undertaken by the program with an aim to avoid confusion and reduce response burden.

Data Availability and Lag Time of Research Reports

Statistical research requires time and cannot always be completed as soon as data becomes available. For that reason, studies such as the economic impact study the program completed in 2014 use program data from 2009. This is an organic limitation of some quantitative research. Further, expertise required to complete the next iteration of the program's incrementality study, planned for in the program's PM Strategy, was not available when anticipated and so the production of the report was delayed, leaving the evaluation without this piece of evidence. However, some data relating to incrementality, including survey data that identifies the magnitude of incrementality (e.g., full versus partial) was available for the assessment, and supplemented with additional qualitative data from interviews conducted in support of the Lender Awareness & Satisfaction Survey.

3.0 EVALUATION FINDINGS

3.1 Relevance

3.1.1 Is there a continued need for the Canada Small Business Financing Program?

Finding: There is a continued need for the program. Smaller, younger and higher-risk businesses have difficulty obtaining financing in Canada as they may face obstacles that others do not with respect to collateral, credit history, expertise and the lender having insufficient information regarding the borrower's operation and potential profitability. The CSBFP is intended to facilitate the availability of debt financing from commercial lenders in such circumstances.

An important part of the Canadian economy, small businesses require financing to survive and grow.³ Financing needs range from start-up or expansion funds to shorter-term cash-flow needs or the purchase of physical capital such as equipment or inventory.⁴ Debt financing tends to be the most common form of financing sought out by small businesses;⁵ however, smaller enterprises typically have a more difficult time accessing credit because of a lack of collateral, limited credit history, little professional experience and the lender having insufficient information regarding the borrower's operation and potential profitability (called "information asymmetry").⁶

In 2011, chartered banks were the main suppliers of financing to SMEs, providing 55% of financing requests, followed by credit unions or Caisses populaires at 16 %.⁷ While 90% of financing requests were approved that year, an IC study notes that "both requests and approval rates for debt financing increase with business size," suggesting a potential gap in smaller businesses having the access to traditional financing methods they require.⁸

Another IC study revealed that while small businesses have been successful at raising necessary funds overall, certain categories of small businesses in Canada continue to face relatively greater difficulties accessing financing.⁹ Specifically, the study found that "partial gaps in financing exist for the smallest businesses, youngest businesses and most R&D intensive businesses".¹⁰

³ Bruce, Doug and Queenie Wong. Battle of the Banks: How SMEs Relate to Their Banks, Canadian Federation of Independent Business, May 2013.

⁴ Bruce, Doug and Queenie Wong. Battle of the Banks: How SMEs Relate to Their Banks, Canadian Federation of Independent Business, May 2013.

⁵ Seens, Daniel. Small Business Access to Financing: Request and Approval Rates, Interest Rates and Collateral Requirements (2000-10), Industry Canada, Small Business Branch Research and Analysis Directorate, July 2013.

⁶ OECD. Financing SMEs and Entrepreneurs 2013: An OECD Scorecard, February 2013.

⁷ Industry Canada. Summary of the Survey on Financing and Growth of Small and Medium Enterprises, 2011, February 2011.

⁸ Industry Canada. Summary of the Survey on Financing and Growth of Small and Medium Enterprises, 2011, February 2011

⁹ Seens, Daniel. Small Business Access to Financing: Request and Approval Rates, Interest Rates and Collateral Requirements (2000-10), Industry Canada, Small Business Branch Research and Analysis Directorate, July 2013.

¹⁰ Seens, Daniel. Small Business Access to Financing: Request and Approval Rates, Interest Rates and Collateral Requirements (2000-10), Industry Canada, Small Business Branch Research and Analysis Directorate, July 2013.

These types of businesses bare higher financing costs while larger and older businesses are subject to greater collateral requirements.

The CSBFP is intended to equip Canada's financial institutions with a safety net when providing loans to small businesses that present a heightened risk of default. This is a common approach to addressing credit availability for SMEs. Credit guarantees similar to the CSBFP are used around the world to ease the financial constraints for SME's and start-ups.¹¹ These programs function as risk transfer, or risk sharing mechanisms that reimburse a pre-defined share of an outstanding loan in the event of default.¹²

Interviewees spoke highly of the CSBFP's mandate and underscored its importance in engaging start-ups, newer businesses or those in high-risk activities and industries such as R&D, food services and non-franchised retail. Financial institutions and associations in particular underscored the difficulty some types of businesses have in obtaining debt-financing compared with others. Interviewees from all groups indicated that although credit continued to be available in Canada throughout the financial crisis, there remain some businesses struggling to find adequate financing.

The program's *Awareness and Satisfaction Survey* of borrowers and non-borrowers revealed that 82% of borrowers felt there was a high or very high need for a loan program like the CSBFP while 56% of non-borrowers held the same view.¹³ A further 15% of borrowers and 30% of non-borrowers said the need for the program was "medium" while less than 4% of borrowers and 6% of non-borrowers suggested the need was low.

A minority of interviewees suggested that the program does not occupy the same market share as it once did. Credit cards and lines of credit were not the norm for small businesses at the time the program was created more than 50 years ago, and these now may be more attractive options to both lenders and borrowers in some situations. In fact, the lenders' survey indicated that 19.6% of small business loans officers who had never used the CSBFP stated they had not done so because they felt they could provide other financing options to borrowers. That said, it is noteworthy that while interviewees suggested that the need for the program is less than what it was at one point in time, those same interviewees stressed that the need for the CSBFP specifically is still present.

All financial institutions interviewed indicated that they both use the program and that there are businesses receiving financing through the program that would not otherwise have access. Considering this, as well as the difficulty a subset of Canadian entrepreneurs encounter when seeking debt financing for their small businesses, there is a continued need for the program.

¹¹ OECD. *Financing SMEs and Entrepreneurs 2013: An OECD Scorecard*, February 2013.

¹² OECD. *Financing SMEs and Entrepreneurs 2013: An OECD Scorecard*, February 2013.

¹³ Industry Canada, *Canada Small Business Financing Program Awareness and Satisfaction Study*, 2013.

3.1.2 To what extent do the objectives of the CSBFP align with the priorities of the federal government and the strategic outcomes of Industry Canada?

Finding: The CSBFP aligns with Government priorities through its support to Canadian small businesses. The program is also aligned with Industry Canada's strategic outcome of developing competitive Canadian businesses and communities.

The objective of the CSBFP is to facilitate access to asset-based debt financing for the establishment, expansion, modernization and improvement of small businesses. The program achieves this objective by sharing the financial risk of lending to small businesses with lenders (i.e., financial institutions). Overall the CSBFP aims to provide small businesses with access to financing that would not otherwise be available or would only be available under less favourable terms. It is this incremental access to financing that is expected to increase business-related activities and ultimately benefit the Canadian economy. These program objectives are directly aligned with the Government's priorities related to support for small businesses and measures to increase economic growth in Canada.

Economic Action Plan 2009 included the CSBFP, along with several other initiatives, as part of its action plan to improve access to financing for small businesses during the worldwide recession. Specifically, Economic Action Plan 2009 increased the CSBFP's maximum loan amount from \$250,000 to \$350,000 and to \$500,000 for real property. In addition, the limit of allowable losses that an individual financial institution could claim for reimbursement under the program went from 10% to 12% of the value of their loan issuances. These measures were intended to provide incentives for lenders to continue offering CSBFP loans to small businesses and result "in more small businesses having access to the financing they need, for an amount that is more in line with current prices."¹⁴

More recently, the Economic Action Plan 2014 reconfirmed the Government's commitment to support small businesses and outlined their impact on the Canadian economy by stating that "Small businesses are crucial to Canada's long-term prosperity. Canadians depend on the jobs they create and the services they provide." These statements demonstrate the Government's current priority to support the business community and the direct relationship they have on the overall economic growth in this country; directly corresponding with the objectives of the CSBFP.

The CSBFP is also aligned with Industry Canada's 2014-15 Program Alignment Architecture (PAA) and in particular Industry Canada's Strategic Outcome 3: Canadian businesses and communities are competitive; and the priorities listed under the Small Business Research, Financing and Services Program Activity. The aim of this Program Activity is to enhance the growth and competitiveness of small business and encourage entrepreneurship. The Sub-Activity – Small Business, Financing and Growth helps Canadian small and medium-sized enterprises access financing that would not otherwise be available without government support, which is consistent with the objectives of the CSBFP.

¹⁴ Canada's Economic Action Plan: A First Report to Canadians, March 2009, p.120.

3.1.3 To what extent does the CSBFP align with the roles and responsibilities of the federal government?

Finding: The CSBFP is consistent with the roles and responsibilities of the federal government. The CSBFP is unique in that it is the only national loan loss sharing program that is accessible to all Canadian businesses regardless of owner, business sector, and includes financing for a wide array of business activities. That said, this program is one of many that seeks to bolster financing availability for businesses in Canada.

The objectives of the CSBFP are to facilitate access to asset-based debt financing for the establishment, expansion, modernization and improvement of small businesses, which is consistent with Industry Canada's mandate. The program's objectives directly align with the *Department of Industry Act* of 1995, which provides the powers, duties and functions of the Minister of Industry to extend to matters relating to "small businesses."¹⁵ In addition, the CSBFP is governed by its own legislation, the *Canada Small Business Financing Act*, which sets out the program parameters, including loan conditions, eligibility criteria and Minister liability.

Programs similar to the CSBFP exist internationally as SMEs are "recognized by governments worldwide as powerful economic forces and major engines of job creation."¹⁶ As such, governments seek opportunities to address constraints that small businesses face. Loans and loan guarantees are two such measures introduced by governments to support small businesses in accessing capital. These programs are virtually ubiquitous and according to the literature, it is estimated that more than 2,000 loan guarantee-type programs exist in over 100 countries worldwide with only a few country exceptions in Asia, Northern and Eastern Europe and Central America.¹⁷

The Canadian federal and provincial governments offer a wide variety of programs to assist small businesses in obtaining the financing they require, such as grants, contributions, loans, loan guarantees and tax credits. The CSBFP is the only loan guarantee program in the country that is available in all jurisdictions and for all small businesses seeking debt financing for equipment, leasehold improvements or real property. The Canadian Agriculture Loans Act (CALA) provides similar services for agricultural producers, who are not eligible under the CSBFP. When asked about similar programs to the CSBFP, interviewees identified the Business Development Bank of Canada (BDC) and several provincial programs as overlapping with the CSBFP's mandate.

The provincial governments of Nova Scotia and New Brunswick partner with credit unions in their respective provinces to deliver a very similar program to the CSBFP. The Quebec Government provides loans, loan guarantees or quasi-equity financing through its UNIQ Financing Program that offers entrepreneurs up to 100% of project costs for the purchase of

¹⁵ Section 4(1)(a) of the *Department of Industry Act* of 1995

¹⁶ O'Bryan, William E. "An Analysis of Small Business Loan Guarantee Funds" University of Nebraska, 2010.

¹⁷ Organisation for Economic Co-operation and Development: "SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises" January 2013.

buildings, equipment, and leasehold improvements. Interviewees also pointed to a program in Manitoba that reflected similar objectives. The main differences between the types of loan guarantee programs offered by the provinces and the CSBFP are that the maximum loan amounts in the provinces are generally less than those offered under the CSBFP (except for Quebec that has a \$50,000 minimum) and in many cases the provinces include restrictions on the types of business activities or business sectors that can be financed.

BDC differs significantly in its design, as it is a commercially-oriented financial institution wholly-owned by the Government of Canada with a mandate to support SMEs and entrepreneurs. The majority of its activities are related to term lending. BDC does not offer the CSBFP, but provides direct loans for business activities, including expanding facilities, obtaining equipment lines, starting, buying and expanding a business, working capital and, ICT adoption. Further, BDC supports high-growth or riskier businesses like high-technology firms, who may not have a track record or the collateral required by other lenders. BDC prices its loans to risk, meaning its rates reflect the risk associated with individual clients. Typically, this results in lending rates that are higher than those offered by private sector financial institutions.

SMEs in Canada can also receive access to capital, namely loans, through a variety of other federal programs, such as the Community Futures Program (CFP). To be eligible for a CFP loan, applicants are generally required to first be denied a loan from a financial institution. As these financial institutions would have been eligible to offer CSBFP loans, it would seem to indicate that most CFP loan clients were not able to access a CSBF loan. As such, the CFP and the CSBFP cater to slightly different SME clients. In addition, the CFP targets rural communities, while the CSBFP does not differentiate based on location. It should also be noted that SMEs may also be eligible to receive business loans through Regional Development Agency (RDA) flagship programs, such as the Atlantic Canada Opportunities Agency's Business Development Program that provides unsecured, interest-free loans toward the eligible costs of a new establishment, expansion, modernization or a project which improves business competitiveness.

In conclusion, the majority of loan guarantee programs are designed to assist specific types of businesses or sectors (e.g., agricultural businesses, high tech, or those owned by recent immigrants, or women), particular regions (e.g., northern Ontario or a specific province) or those involving certain business activities (e.g., research and development or export-related activities). The CSBFP is unique in that it is the only loan loss sharing program that is accessible to all Canadians regardless of business owner, sector, and includes a wide array of business activities.

3.2 Performance

3.2.1 To what extent is the program's regulatory and legislative framework conducive to use by lenders and borrowers?

Finding: The regulatory and legislative framework provide the CSBFP with a concrete foundation from which to deliver on its objectives. However, the demands of the program, coupled with the slow process by which the framework changes, can place stress on its relationships with private sector stakeholders and has diminished the program's utility for lenders. New regulations may have addressed some of these irritants, but it is too soon to assess their impact.

The operating environment around the CSBFP is extremely complex, requiring its regulations to walk a fine line with respect to ensuring the program is both palatable to banks and helpful to the small business community. The program must also be prepared to respond to economic shifts and changes within the banking industry. While the CSBFP is over fifty years old, it has modified its legislative and regulatory framework in order to keep pace with the evolution of its operating environment. This framework predominantly involves the *Canada Small Business Financing Act* and its associated regulations, but also implicates the *Financial Administration Act*. Program documentation points to very thorough investigative and analytic work undertaken when considering the possibility and likely impact of any change to its legislative and regulatory framework.

Interviews indicated that the presence of legislation and regulations for a financing program demonstrates its importance to both staff and stakeholders. However, interviews also pointed to the amount of work and time required to change this framework in any way, as well as the very rigorous audit and evaluation schedule the program is subject to. Lenders went as far as asking if it is necessary to audit them independently as well as have an on-site examination by the program every year, while staff spoke to the heavy reporting burden locally for their own audits and evaluations. Some interviewees from both groups acknowledged an understanding that certain checks and balances should be present when the public trust is involved.

Previous assessments identified a number of regulatory requirements that were not in sync with the operating environment of lenders. Reflecting the findings of the program's last evaluation, this assessment found that the program's lack of profitability and heavy administrative burden coupled with claims issues are irritants for lenders that dissuade program uptake and therefore limit its availability to small businesses. These results were echoed in interviews, with lenders most commonly citing the need to collect receipts for 100% of the loan amount and the back and forth on claims that sometimes results in non-reimbursement as examples of irritants. The document review revealed that the program is well-aware of these issues and has been studying how best to resolve them for some time.

The results of the lenders survey of small business loans officers point to the amount of documentation required as the most often-cited facet of the program that could be improved

(selected by 32.4% of respondents), underscoring comments of more senior staff in interviews and results of previous work with respect to the program's heavy administrative burden.

It is noteworthy that just over 15% of small business loans officers in financial institutions view the interest rate as a potential area for improvement. Approximately 4.9% held the same view with respect to the 1.25% quarterly administration fee charged to the lender. Interviews with more senior staff at major financial institutions pointed to the need for the program to be profitable if uptake is to increase. This is echoed in the literature review, which suggests that profitability is a critical component of a program of this nature.¹⁸

In interviews, lenders also indicated that the amount of lead time they were given to implement regulatory changes was too short, citing the need for larger institutions to modify internal processes and communicate with small business loans officers as things evolve, and the difficulty created when time lines are relatively short. This is in part attributable to the amount of time required to make regulatory changes, and is a facet of such a program being legislative in nature.

Business association comments on this were mixed as organizations prefer the best environment possible for their clients, but also understand the need to fund the programs being accessed. Borrowers are split on the matter. The *Awareness and Satisfaction* survey indicated that 53% of borrowers felt the interest rate was just right while 45% said the current rate is too high. Any future changes with respect to addressing this particular irritant will have to be made with care.

Generally speaking, borrowers are satisfied with the program and three quarters of borrowers indicated that they felt the program's terms and conditions are appropriate.¹⁹ This group was most satisfied with the availability of program information, the securities and guarantees required and the administrative reporting requirements.

That said, a majority of those surveyed also considered the administration fee of 1.25% of the outstanding loan balance to be too high. About 73% of borrowers viewed the maximum loan amounts of \$350k or \$500k as being about right, with 17% suggesting they are too low. This may point in part to the commercial real estate market. Interviews with lenders, staff and associations, suggested that in a number of areas of the country, half a million dollars will no longer purchase significant real property for commercial use. Simply raising the limit for real property loans may not address this issue, though, as one lender commented that real property is sometimes purchased by a holding company associated with the small business client in some way, and that these companies are not eligible for financing by the program.

The continued use of the program in spite of these issues speaks to its value, although that use has diminished over time.

¹⁸ Riding, Allan, Judith Madill and George Haines, Jr. Incrementality of SME Loan Guarantees, Small Business Economics, 29. 2007; OECD: Facilitating Access to Finance: Discussion Paper on Credit Guarantee Schemes.

¹⁹ CSBFP Awareness and Satisfaction Study, Industry Canada, 2013. pp 18-25

Recent regulatory changes

In April 2014, the program implemented regulatory changes that are geared toward improving uptake of the program by alleviating some of the main irritants for lenders. There were strong, yet varied opinions from staff and stakeholders as to how effective the new regulations would be as well as clear interest in participating in the evaluation and any potential improvement to the program.

While lenders and program staff indicated that the changes were generally moving in the right direction, many did not think they went far enough with respect to making the program profitable. Others felt that the allowance of conventional lending fees (e.g. set-up and renewal fees) and reduced requirements for providing receipts for claims would serve to improve things. A smaller number of interviewees saw the new site visit requirement to ensure “valid and enforceable” security on equipment purchases as a new irritant. Not all institutions have the capacity to travel to client sites to confirm the presence or absence of security and, where this is not common practice with respect to other lending activities, the resources required to complete such work are not currently available.²⁰ That said, the lenders’ survey of small business loans officers suggested that 68.1% of this population is expecting the changes to increase use of the program in some way (51.5% moderately increase and 16.6% greatly increase).

Further, 68.9% of respondents to the lenders’ survey indicated that they were not yet familiar with the program’s recent changes. Interviews with staff and lenders both pointed to a need to allow time for institutions to absorb the new regulations and adapt their internal policies, as well as for small business loans officers to gain experience working with the new guidelines before the impact of the new regulations can be assessed.

²⁰ Note that site visits are not mandatory under the new regulations and this may require some additional outreach work with lenders to convey. At the time of this assessment, the program had already sent a bulletin out to lenders on the subject.

3.2.2 To what extent do lenders share the risk of lending to small businesses with Industry Canada?

Finding: There has been an overall declining trend in program use since the mid-nineties. This decline can be attributable to a variety of factors, some of which are outside the purview of the program. Other factors include changes to the program and regulatory and non-regulatory irritants for lenders. This said, program uptake stabilizes during recessions and other economic events that increase the risk of lending to small business and continues to secure substantial funds for the small business population. This trend is in step with adaptations typically made to the program's regulatory framework at these times to make it more accessible.

Program use is steady during economic events, such as recessions, but declines in-between these events. While the number of loans does not increase significantly at times of economic stress, the value of loans approved for the program has increased over the course of the past two major economic events, following revisions in program parameters made in response to these events.

The longer-term downward trend in the number of loans registered dates back to a spike in use following significant program changes in 1993 (a time of recession) that were geared toward improving the program's appeal to lenders, borrowers and taxpayers (See figure 2). Lenders were permitted to charge more interest and the government shifted the loan loss ratio, covering up to 90% of losses rather than 85%, to take on more risk. The definition of a small business was increased to include firms with up to \$5 million in revenues a year. In addition, real estate as well as financial and insurance companies were added to the lists of eligible firms.

These changes invited unsustainable interest in the program and, following an increase in the program's then-approved lending limit of \$4 billion to \$12 billion, the program was again restructured as IC reintroduced some of the restrictions that had been removed and prepared to accommodate the new liability. Program documentation points to lessons learned from this time in the program's history and underscores the risk of introducing volatility to the program when too many sudden changes are made to the regulatory and legislative framework²¹.

While loans decreased substantially in response to changes after that time, the trend balanced out over the following two decades and analysis of loans administered reveal that the value of the loans approved has not declined at the same rate, in part resulting from changes to the maximum amount of CSBFP loans.

Program use was relatively stable from 2001-02 to 2004-05, hovering at an average of 11,100 registered loans per year. Uptake then dropped by about 30% between the 2004-05 and 2007-08 fiscal years, and declined at a slower rate for several years, following the economic downturn and subsequent recession.

The value of loans increased during the 2001-02 to 2004-05 period from \$899 million to over \$1 billion. Additionally, the overall value of loans increased from about \$900 million in 2008-09 to

²¹ Industry Canada. *Financing Growth for 37 Years with the SMALL BUSINESS LOANS ACT*.

Audit and Evaluation Branch

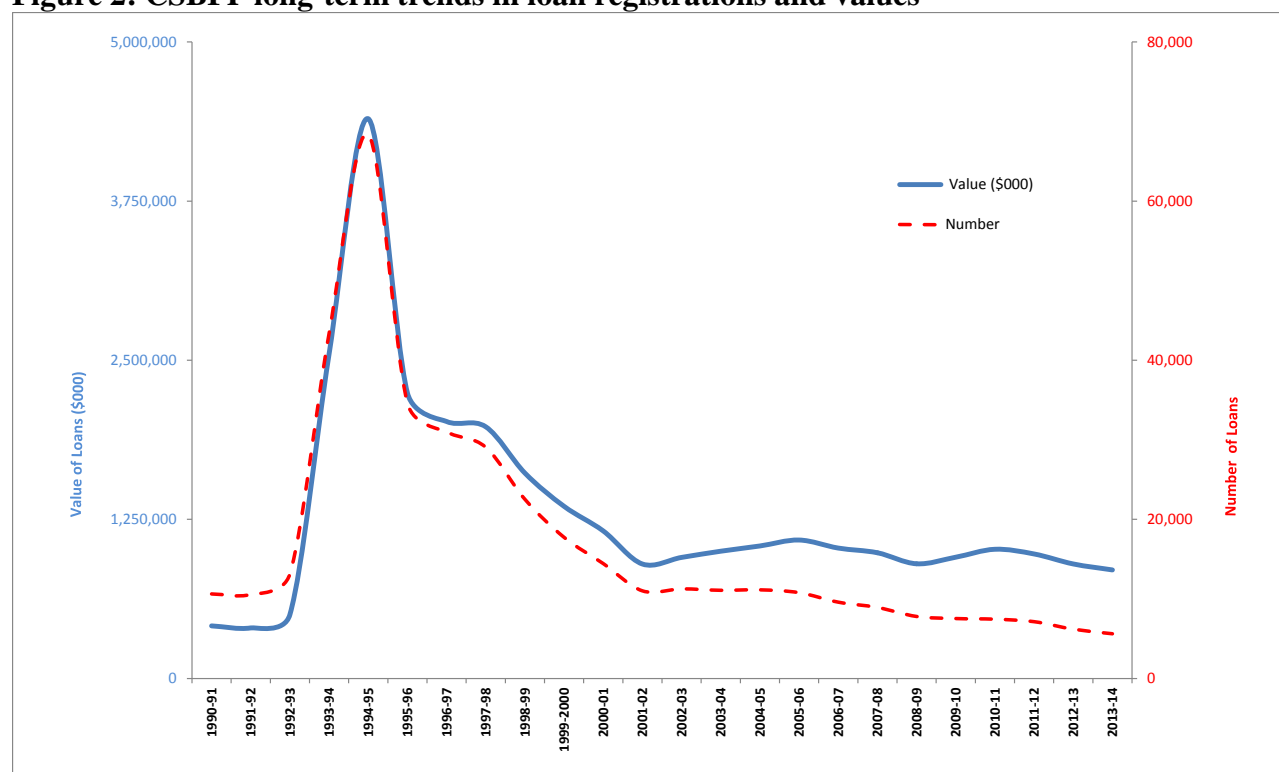
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a high of about \$1 billion in 2010-11. Note that the maximum value of loans was also increased during this period, which may largely explain this increase. The most recent fiscal year, 2013-14 saw loans totalling \$852 million.

Further, losses associated with the recent economic downturn led some financial institutions to back away from lending to small businesses with certain profiles, even with the prospect of sharing losses as the risks associated with lending to these businesses are now perceived to be higher than before. Interviews suggest that a small number of financial institutions have become more cautious with respect to financing businesses with certain profiles since the downturn (e.g. non-franchised restaurants). Echoing this, 10% of respondents to the lender's survey who had never used the program reported that it was because of a corporate decision not to use the program. Also, a number of lenders reached their 10% caps, for loans made between April 2004 and March 2009, in the wake of the economic crisis.

Figure 2: CSBFP long-term trends in loan registrations and values



Program data indicates that the number of loans allocated to most industries has declined since 2000-01, however there were over 5,500 fewer loans approved to finance the purchase of equipment in 2011-12 compared with the 2000-01 period. Considering that the net drop in loan registration over this time period is 7,200, this is a significant trend, representing just over three quarters of the decline. Interviews with lenders indicated that ensuring valid and enforceable security on equipment loans is challenging and may be contributing to a decline in program use. The bulk of the remaining drop relates to real property loan registrations, which may be tied to

the increasing cost of real property in some regions of the country and the program's limit of \$500,000 for loans of this nature. Loans related to leasehold improvements have held relatively steady over time. It is of note that significantly fewer loans went to businesses that were less than a year old in the same time frame.

During the 2013-14 fiscal year, program uptake was at an all-time low of 5,600 registered loans. That said, the value of loans made available to the small business community totalled \$852.7 million. Further, it is possible that lenders eased off the program in anticipation of regulatory changes, which came into force April 1, 2014.

It is also important to note that this analysis is for program use overall. At the institutional level, a number of lenders have held steady in their use of the program over time while others have dropped substantially. Interviews indicated that this is linked in part to the issues already mentioned, as well as general banking policies toward debt financing small businesses. Some institutions view the program as an opportunity to invest in a longer-term relationship with a client in circumstances where the risk will likely result in more business later, while others do not use the program because of the lack of profitability and the high-risks associated with certain types of businesses.

The overall downward trend for the program's use over time was examined in depth in the program's last evaluation and little had changed at the start of this assessment. As mentioned earlier in the report, however, recent regulatory changes may impact uptake of the program moving forward. The program has also made significant strides with respect to addressing non-regulatory-related issues, such as stepping up outreach efforts and implementing an on-line loan registration system, which has been met with enthusiasm by the lending community.

Further, CSBFP staff who have worked toward changes to the program since its last assessment are viewed with high regard by those who work with them. Without prompting or questions being asked on the matter in interviews, interviewees from all groups expressed appreciation for the professionalism and dedication they have experienced over time, especially with respect to answering questions, consultations and the implementation of the program's new regulations.

3.2.3 To what extent are lenders, small businesses and borrowers aware of and knowledgeable of the program?

Finding: Awareness of the CSBFP continues to be high among lenders overall, and low among borrowers and non-borrowers. Evidence suggests the program's outreach efforts are having an impact; however, there may be untapped promotional opportunities for the program. Since most borrowers learn about the program through their lender, further outreach with front line staff at lending institutions may help foster better knowledge of the CSBFP, and increase awareness among borrowers.

Awareness of the CSBFP has been low historically among borrowers, but the program enjoys a significant degree of recognition amongst lenders. Knowledge of the program amongst financial institutions is critical to the success of the program as they are ultimately the delivery agents to the small business community. That said, knowledge of the program may be of value to potential borrowers when seeking financing.

Awareness of the program amongst lenders is very high, with 97% of respondents to the lenders' survey knowing the program by name and an additional 2% recognizing an alternate name (i.e., the Small business Loans Act Program or Business Improvement Loans Program). Nearly three quarters of these respondents have had some direct experience with the program since 2009, although use varied by institution.

The *Awareness and Satisfaction Study* of borrowers demonstrates that while 41% of borrowers were aware of the program by its proper name, less than half of those respondents were able to provide the name of the program unaided. About four-fifths of all CSBFP borrowers were able to recognize that they had received financing from a government program and either recognized the program's name or provided an alternate name. This is an improvement over survey results in 2007, when only 25% of borrowers were aware of the program by its name with 21% able to recognize the program from a list and only 4% able to identify the program by its name unaided. Non-borrowers surveyed were not very aware of the program, however when alternate names were taken into account (e.g Small Business Loans Program), nearly half of respondents could be said to be aware of the program.

Although 41% of borrowers were aware of the program, only about 30% of all borrowers and 2% of non-borrowers surveyed were knowledgeable of how the program operates. Even among borrowers, over a quarter could not tell interviewers anything about the program. It should be noted, however, that previous studies demonstrated lower levels of knowledge among borrowers, indicating a measure of improvement.

There are a number of factors that can impact program awareness. For example, studies on the service dynamics between government programs and the business community demonstrate that business clients do not normally differentiate between levels of government, nor do they commonly recognize unique program brands when interfacing with the government for any

reason.²² This is compounded by the fact that borrowers receive their loans from a commercial lending institution, which makes the involvement of a specific government program less obvious for CSBFP clients than those who may access services through government service windows.

Nearly half (45%) of borrowers first heard about the program from an official in their financial institution. A significant proportion of borrowers and non-borrowers alike first learned about the program through the internet (21% and 19% respectively), although the web sites differ. Only 13% of non-borrowers heard about the program through a financial institution official, and 18% heard about the program through non-internet media sources. Details of the results can be viewed in Table 2.

Table 2: How respondents first learned of the CSBFP

Source	CSBFP Borrowers %	Non-borrowers %
Financial institution Official	45	13
Friend/Colleague	11	15
Business service provider (e.g. accountant, financial advisor)	11	5
Bank/other private sector web site	11	3
Internet search	8	11
Business associations	2	8
Involved in programs*	2	2
Government contact/other government program	1	3
Federal government web site	1	5
CSBFP website	1	0
Canada Business Network/CBN	1	2
Small Business Funding Centre	1	2
Media sources (non-internet)	1	18
Previously obtained CSBFP Loan	< 1	0
CSBFP brochure/pamphlet	0	7
Other (specify):	< 1	0
Not sure/can't recall	3	8

*Professionally involved with CSBFP, whether by virtue of working in the public or private sector
Source: *Canada Small Business Financing Program Awareness and Satisfaction Study*, July 2013

Interviews were reflective of these findings with many interviewees underscoring the reliance of the program on its intermediary financial institutions in relaying information on the program to borrowers when appropriate. This makes the knowledge of front-line staff in these institutions critical to the success of the program. Only about 4.5% of front-line staff who had never made a loan under the CSBFP indicated it was because they are new to their position or else have insufficient experience. About 30% of those surveyed were already familiar with changes made

²² Institute for Citizen-Centred Services, *Taking Care of Business*, 2004, *Taking Care of Business 2*, 2007, *Taking Care of Business 3*, 2010; and *Taking Care of Business 4*, 2014.

to the program, a significant proportion considering the changes had been announced only weeks prior to the survey. That said, interviews indicated that some lenders may be willing to facilitate program outreach work with front-line staff in order to foster better knowledge of the CSBFP.

Many associations expressed enthusiasm for working more closely with the program and ensuring members are fully informed of their options. Some were already familiar with IC staff and spoke highly of their interactions with them to date.

In recent years, the program has increased its outreach efforts and worked with other government programs and a variety of groups and associations to promote the program to both lenders and the small business community. While marketing and outreach work has largely followed commonly applied practices such as making presentations, circulating pamphlets, assuring a web presence and attending trade shows, the program's aim to make personal contacts in the business community is noteworthy. The program further uses e-mail blitzes and provides ready-to-use articles to the media with some success: the program identified 19 of these articles in print in the 2013-14 fiscal year.

When presented with networking opportunities, program staff attend networking events to collect contact information from those interested in the program and enter that information into a local Access database²³. When an opportunity to reach out to these contacts presents itself, they are e-mailed by their contact within the program. Interviews indicated that program staff have noted an increase in inquiries about the program in geographic areas where outreach efforts have been focused. That said, these efforts are subject to resource limitations. Interviewees from the program pointed out that more could be done to promote the program, but that the funds to fuel additional activities are lacking.

Other interviews indicated that there are financial institutions and associations willing to work with the CSBFP more closely to ensure small businesses are better informed of the program. One interviewee suggested that the program engage social media to a greater degree and seek out directors and board members of chambers of commerce and use targeted demographics to advertise.

That said, opinions on the impact that outreach directly to the small business community was mixed. While a number of financial institutions indicated that a request to use the program by a borrower may influence the lenders decision to offer a CSBFP loan, some associations indicated that they knew of members who had approached banks for these loans who had been turned down. Considering the varying magnitude with which lenders use the CSBFP, it could be that this dynamic is partially dependent on which lender is approached, as well as the risks and palatability associated with a given loan.

In sum, while there is evidence that both borrowers and lenders are aware of the CSBFP, small businesses do not necessarily know the program's proper name. This is a common issue among programs that interface with the small business community in Canada. In mixing common

²³ Note that staff do not simply staff a booth at these events. They additionally spend time networking on the floor of the event, shaking hands and taking a personal interest in potential clients.

approaches to outreach with a concerted effort to gain interpersonal contacts within the community, the program is experiencing some early indications of success. The leveraging of these efforts appears to be having a positive impact on the program's visibility. Resource constraints may be limiting the program's ability to leverage outreach opportunities.

3.2.4 To what extent are small businesses obtaining financing from lenders, with government support, to which they would not otherwise have access?

Finding: Evidence suggests that the program has been successful in facilitating incremental debt financing for the small business community over time. Studies show that the percentage of incremental loans is increasing.

The success of the CSBFP can be determined by measuring the likelihood of a firm obtaining debt financing from a commercial lender without the program's intervention. Full incrementality refers to loans issued that would not have otherwise been approved.²⁴ Partial incrementality points to loans that offer the borrower more favorable terms than would otherwise be available (e.g., the loan would have carried a higher interest rate or more stringent security arrangements without intervention). Such loans may also open doors for borrowers to access a wider range of financial services. Note that some financial institutions may offer other products to borrowers alongside program loans, such as bank accounts and credit cards.

Both literature and previous evaluations of the program indicate that the degree of incrementality achieved by a program of this nature is challenging to measure. Many similar programs in Canada and around the world are unable to determine whether or not their loans offer a true value-add for borrowers. It is counterfactual to ask what proportion of loans provided under a Program would not have otherwise been issued.²⁵ Further, while the government shares the risk related to the loans in the event of default, it does not have responsibility for assessing loan applications and making credit decisions.²⁶ This means that the degree of incrementality at the time a loan is approved is not directly observed by the government.²⁷ The CSBFP, however, has found means to demonstrate this over time. In the past, the program hired a consultant who developed a credit scoring model in an attempt to mirror that used by lending institutions. These studies found that loans made under the Program are incremental, and that incrementality was increasing over time. In the program's 2004 evaluation, it was estimated that 75% of loans were incremental in some way. Between 2004 and 2007, the trend moved upwards steadily from 75% to around 78%²⁸.

The results of the most recent study, conducted in 2009, show another increase.²⁹ The study revealed that between 80% and 85% of CSBFP loans are either incremental or partially

²⁴ Riding, Allan. *Canada Small Business Financing Program: Updated Analysis of Incrementality*. June 2009.

²⁵ Industry Canada, *Evaluation of the Canada Small Business Financing Program: Final Report*. August 2009.

²⁶ Industry Canada, *Evaluation of the Canada Small Business Financing Program: Final Report*. August 2009.

²⁷ Industry Canada, *Evaluation of the Canada Small Business Financing Program: Final Report*. August 2009.

²⁸ Industry Canada, *Evaluation of the Canada Small Business Financing Program: Final Report*. August 2009.

²⁹ Note that work to replicate this study and update these measures in time for the program's legislative review in 2015 was underway at the time of this assessment, but would not be available for use until some time later. Where both the evaluation and the incrementality study are required inputs for the review, it was not possible for the evaluation to wait out the availability of the study.

incremental. This study also indicated that CSBFP loan recipients reported higher interest rates and fees than non-program borrowers, something the study suggests is to be expected because of the registration fees and annual fees built into the registration rates of the loans. Further, the study found there to be no statistical difference in security requirements between these two groups. That said, CSBFP recipients were able to borrow for a longer term than non-program borrowers, which eases stress on a borrower's cash flow during loan repayment.³⁰

The Lender Awareness and Satisfaction Survey, indicated that small business loans officers estimated that about 50.3% of loans are fully incremental and that 36.1% are partially so³¹. This was reflected in interviews with both associations and lenders, who stressed that a subset of their small business clients would not be able to obtain any degree of financing without the program. While some suggested that credit cards are sometimes an alternative, they are generally offered at a higher interest rate, pointing to partial incrementality³².

Program staff and experts mentioned that the program should be entirely incremental and suggested that the most recent study may have reflected a statistical error. Further, incrementality is difficult to capture from a statistical perspective as it also relates to the overall risk within a given financial institution's small business loan portfolio at the time of application. In these circumstances, the program would be used to offset an internal risk, something not easily captured in a study of this nature. That said, the historically lower levels of incrementality, coupled with decreasing levels of loan registration and claim adjustments mentioned earlier suggests that financial institutions may be climbing a learning curve, or else may have become more specialized with tailored products and expertise that have enabled better risk assessments. This demonstrates an improvement of program knowledge over time and, coupled with increasing incrementality rates, suggests the program is being used more effectively.

³⁰ Riding, Allan. *Canada Small Business Financing Program: Updated Analysis of Incrementality*. June 2009.

³¹ These numbers are averages of estimates provided by respondents and provide some insight into what the program's next incrementality study may demonstrate.

³² Note that the program makes financing of a greater magnitude available than what a credit card would typically offer.

3.2.5 How do firms in receipt of loans by the CSBFP perform?

Finding: Overall, evidence suggests that the CSBFP is having a positive impact on the growth of SMEs. Specifically, CSBFP participation is shown to increase revenues, salaries and profits when compared to non-participation. However, evidence is split on whether the program can be shown to be having an impact on firm viability.

Studies indicate that the program is backing growing businesses. In 2010, Vincent Chandler published the “Economic Impact of the Canada Small Business Financing Program Working Paper,” which examined the growth of four variables: employment, total salary, revenues and profit in relation to small businesses receiving CSBFP loans.³³ According to this research, the participation in the CSBFP was estimated to impact growth by slightly above 10% in the cases of salaries and employment and slightly below 10% in the case of revenues when compared to non-participation. “In the case of absolute differences, CSBFP borrowers would have hired 0.63 employees more than non-borrowers and had revenues \$78,352 superior to non-borrowers between 2004 and 2006.”³⁴

Recently, an Updated and Extended Economic Impact Analysis (2014) was conducted on a more comprehensive dataset than the one used in the 2010 study. In addition to data from the Survey on Financing of Small and Medium Enterprises (2007), the updated economic impact analysis also sourced data from the Business Register, the Longitudinal Employment Analysis Program, the General Index of Financial Information and the Exporter/Importer Register. The 2014 study reaffirmed that the CSBFP may be having a positive impact on the growth of SMEs. Specifically, the study found that recipients of the program saw increased revenues by 12%, salaries by 6% and profit by 14%.³⁵ In addition, the study found that “despite the 2008-09 economic downturn, CSBFP participants are shown to be consistently better off than those financed by other sources or not financed at all.”³⁶ In particular, SMEs that participated in the CSBFP are estimated to have increased revenues by over \$100,000, salaries by \$23,000 and profit by close to \$50,000. However, the study also indicated that “there was no evidence to show that CSBFP participation had an impact on firm viability.”³⁷

The findings of these economic impact studies are further corroborated through evidence from the CSBFP’s Awareness and Satisfaction Study (2013). The study asked borrowers if the CSBFP loan they received had impacted their business positively, negatively, or not at all. Specifically, borrowers were asked to examine the impact the loan had on the business’ ability to grow, increase sales and/or profits, increase productivity or efficiency, increase employment

³³ Chandler, Vincent “The Economic Impact of the Canada Small Business Financing Program: Working Paper” June 2010, Small Business and Tourism Branch, Industry Canada.

³⁴ Chandler, Vincent “The Economic Impact of the Canada Small Business Financing Program: Working Paper” June 2010, Small Business and Tourism Branch, Industry Canada.

³⁵ “Canada Small Business Financing Program: Updated and Extended Economic Analysis”, Small Business Research and Analysis: Industry Canada, January 2014.

³⁶ “Canada Small Business Financing Program: Updated and Extended Economic Analysis”, Small Business Research and Analysis: Industry Canada, January 2014.

³⁷ “Canada Small Business Financing Program: Updated and Extended Economic Analysis”, Small Business Research and Analysis: Industry Canada, January 2014.

levels, and stay in business.³⁸ In each case, the majority of borrower respondents indicated that the loan they received from the CSBFP had a positive impact on their business and most noticeably on the businesses' ability to grow (81%). Please refer to Table 3 below for detailed responses.

Table 3: Impact of CSBFP loan on business performance (n=73)

Potential Impact	Don't know	Negatively	No Impact	Positively
Ability to grow business	4%	4%	11%	81%
Business' ability to stay in business	6%	7%	16%	71%
Ability to increase profits/sales	11%	3%	18%	69%
Business' employment levels	8%	3%	21%	69%
Business' productivity/efficiency	11%	0%	22%	67%

Source: R.A. Malatest & Associates, "Canada Small Business Financing Program: Awareness and Satisfaction Study" Final Report, July 2013, p.25.

Overall, evidence suggests that the CSBFP is having a positive impact on the growth of SMEs, and in particular as it relates to increased salaries, revenues, and profits. While the Economic Impact Analysis (2013) did not find that CSBFP loans were having an impact on a business' viability, 71% of respondents from the Awareness and Satisfaction Survey (2013) indicated that the loan they received from the program did have a positive impact in this regard.³⁹

³⁸ R.A. Malatest & Associates, "Canada Small Business Financing Program: Awareness and Satisfaction Study" Final Report, July 2013.

³⁹ The survey only included respondents that were still in business and had survived. As such, the findings may be elevated due to a survivor bias on the part of the respondents.

3.2.6 To what extent does the program demonstrate efficiency and economy?

Finding: The CSBFP demonstrates value for the investment made in that it returns approximately five dollars to the economy for every dollar spent on the program. The program recovers a proportion of its claims payments through fees and is making efficient use of its administrative resources and runs on a relatively small sum at IC considering the magnitude of funds it makes available to the small business community. The program's new on-line loan registration system has been leveraged by another government program, facilitating efficiency across departments.

The value of the CSBFP can be seen through the loans it leverages for the small business community, relative to the costs of the program, and through the wider economic benefits it generates. It has also generated benefits for the federal government via a recent collaboration on a new IT system.

A cost benefit analysis of the program demonstrated that it contributes to the economy through the additional salaries and wages of new employees hired within borrower's businesses, the interest revenues earned by lenders, direct and indirect GDP impacts to the economy, and registration and administration fees collected by the program. While the direct and indirect costs of the program are \$1.1 billion (including costs of administering the program and costs of loan defaults to both lenders and IC), the benefits of the program are \$5.6 billion⁴⁰. This equates to the program generating benefits with a value of about five dollars for every dollar spent, directly or indirectly, on the program⁴¹.

Designed to share losses of high-risk loans with financial institutions, the program recovers a substantial proportion of its claims payments via the registration and annual administration fees it charges. The program felt the effects of the economic downturn most in the 2009-10 fiscal year, when it recovered slightly less than half of its claims payments (47.8%). By 2011-12, the program was able to mitigate 78.2% of its claims payments⁴². Table 4 shows the program's cost recovery over the five years leading up to the evaluation.

Over the course of the period used for the Cost-Benefit study, the CSBFP averaged \$2.1 million a year in salaries and \$0.8 million in Operations and Maintenance (O&M). This is a relatively small sum considering that the program facilitated over \$900 million dollars annually in financing for small business over a five-year period. Interviews indicated that there is very little room in the budget, but that extra funds could be well-used in such capacities as increasing program awareness, IT system development or improving other facets of the program. That said, the program's efficiency and economy is clearly a source of pride among staff, who often quoted

⁴⁰ Industry Canada. *Cost-benefit Analysis of the Canada Small Business Financing program*. Small Business Branch, Research and Analysis Directorate. 2014.

⁴¹ Industry Canada. *Cost-benefit Analysis of the Canada Small Business Financing program*. Small Business Branch, Research and Analysis Directorate. 2014.

⁴² Note that all major lenders hit their individual caps for this lending period, at which point IC stopped sharing in the losses for these loans. This accounts for higher cost-recovery numbers.

the amount it costs to run their program relative to the impact it has on the small business community.

Table 4: Summary of Cost Recovery by Fiscal Year, 2007-08 to 2011-12

(\$ Millions)		Revenues & Expenses				% Cost Recovery ¹	Net Cost /Loans (%)
Cohort	Loans	Reg Fees	Admin Fees	Claims	Net Cost		
1999-2000	1352.3	26.8	48.4	-115.5	-40.3	65.1	-3.0
2000-01	1159.0	22.9	41.8	-100.2	-35.4	64.7	-3.1
2001-02	899.2	17.8	31.5	-65.1	-15.8	75.7	-1.8
2002-03	951.2	18.8	31.6	-64.2	-13.8	78.5	-1.5
2003-04	999.9	19.8	31.0	-77.3	-26.5	65.7	-2.7
C01 (1999-2004) Total	5361.6	106.1	184.3	-422.3	-131.9	68.8	-2.5
2004-05	1041.1	20.6	38.8	-81.7	-22.2	72.8	-2.1
2005-06	1087.7	21.5	38.7	-104.5	-44.3	57.6	-4.1
2006-07	1024.5	20.2	33.6	-99.7	-45.8	54.0	-4.5
2007-08	987.7	19.5	29.7	-98.5	-49.3	49.9	-5.0
2008-09	901.1	17.8	23.7	-65.2	-23.7	63.7	-2.6
C02 (2004-09) Total	5042.1	99.6	164.6	-449.5	-185.3	58.8	-3.7
2009-10	952.9	18.8	38.7	-75.3	-17.8	76.3	-1.9
2010-11	1015.1	20.0	41.8	-77.0	-15.2	80.2	-1.5
2011-12	978.2	19.3	39.1	-72.0	-13.5	81.2	-1.4
2012-13	899.7	17.8	35.0	-75.2	-22.4	70.2	-2.5
2013-14	861.6	16.9	32.6	-74.2	-24.7	66.7	-2.9
C03 (2009-14) Total	4707.4	92.8	187.2	-373.8	-93.8	74.9	-2.0

Notes: Highlighted figures are estimates comprised of actual and forecasted revenues and expenses over the possible 10 year life of loans made in a given fiscal year. Estimates provided by the CSBFP.

¹ % Cost Recovery: revenues (registration & administration fees) divided by expenses (claims).

Efficiency in new IT system implementation

In the 2011-12 fiscal year, CSBFP launched a new on-line loan registration system which has resulted in noteworthy cost savings between both the CSBFP and CALA – a similar program for farms located at Agriculture and Agri-Food Canada (AAFC). Early in the project, it was recognized that the two programs had a common business requirement to create an external component to an existing database that would allow financial institutions to register their loans on-line. Program documentation indicates that the programs had similar databases and as such, “the most cost effective and operationally efficient solution” was to partner.⁴³ The initiative also

⁴³ Industry Canada. *CSBFP/CALA Shared System Overview*.

aligned with Treasury Board's *Common Service Policy*, which encourages programs to consider developing shared information and support systems solutions when possible.

Historically, financial institutions had to register new loans using paper forms and cheques. According to financial institutions interviewed for this assessment, this process was cumbersome and involved a high risk for errors. In interviews, staff and financial institutions unanimously praised the new system and its well-managed implementation while reporting that the error rate of new registrations had dropped to very low levels. Internally, the program has moved away from back-and-forth work with lenders to correct errors and toward a deeper focus on data integrity. At the time of this assessment, more than 70% of incoming loans were being registered by the new system. Some of the institutions that had not yet initiated use of the system were in the process of adopting the new technology while others simply did not process a volume of loans that would justify the implementation of an IT system to facilitate the registration process.

The project is viewed to have facilitated a more efficient use of government resources between the two departments, reduced system development costs and reduced ongoing system and maintenance costs for both IC and AAFC.⁴⁴ Documentation also suggests that the new system has streamlined business processes affecting financial institutions, reduced administrative burden and allowed lenders to register loans faster and more easily.^{45 46} In interviews, most lenders praised the initiative as both improving their working processes with the departments as well as making efficient use of public funds. Note that a minority of lenders will not be using the system as they do not process loans frequently enough to adopt the new technology. These lenders will continue to register their loans via the legacy paper process.

Interviews indicated that the system has removed a prior impediment in using the program, however, most lenders indicated that they continue to find the claims process cumbersome. While this process is clearly more complex and has more sophisticated requirements than registration, it would behove the program to continue to seek out informatics solutions that will further reduce the administrative burden for lenders while improving the efficiency of program operations.

⁴⁴Industry Canada. *CSBFP/CALA Shared System Overview*.

⁴⁵Regulatory Impact Analysis Statement.

⁴⁶Canada Small Business Financing Act: Annual Report 2011-12, Industry Canada.

4.0 CONCLUSIONS AND RECOMMENDATIONS

4.1 Relevance

Regarding relevance of the program, the evaluation determined that:

- There is a continued need for the program. Smaller, younger and higher-risk businesses have difficulty obtaining financing in Canada as they may face obstacles that others do not with respect to collateral credit history, expertise and the lender having insufficient information regarding the borrower's operation and potential profitability.
- The program aligns with the governments' support to Canadian small businesses as well as Industry Canada's strategic outcome of the development of competitive Canadian businesses and communities.
- The program aligns with the roles and responsibilities of the federal government and it is the only program of its nature offered across Canada and to all sectors. There is some overlap perceived with provincial jurisdictions.

4.2 Performance

Regarding the effectiveness of the program, the evaluation determined that:

- The program's regulatory and legislative framework provides the CSBFP with a concrete foundation from which to deliver on its objectives. However, the demands of the program coupled with the slow process to make the framework changes can place stress on its relationships with its private sector stakeholders and has diminished the program's appeal for lenders.
- New regulations may have addressed some of these issues, but it was too soon to assess their impact at the time of this evaluation.
- The presence of these issues, combined with a number of factors beyond the program's control, such as individual institution's policies toward lending to small business, have led to a decline in program use. Program uptake is more stable during times of economic stress.
- Awareness of the program tends to be high among lenders overall, but low among borrowers and non-borrowers alike—a trend that has continued since the program's last assessment. Outreach efforts have had an impact; however there may be untapped opportunities to promote the program. Since many borrowers indicated that they first learn about the program through their lender, further outreach with front line staff at lending institutions may help foster better knowledge of how the CSBFP works, and increase awareness among borrowers.

- The program has been successful in facilitating incremental debt financing for the small business community over time. Studies show that the percentage of incremental loans is increasing.
- The CSBFP has a positive impact on the growth of SMEs. Specifically, program participation is shown to increase revenues, salaries and profits when compared to non-participation. Evidence is split on whether the program can be shown to be having an impact on firm viability.

Regarding the efficiency of the program, the evaluation determined that:

- The CSBFP demonstrates value for the investment made in that it returns approximately five dollars to the economy for every dollar spent on the program. The program recovers a proportion of its claims payments through fees and is making efficient use of its administrative resources and runs on a relatively small sum at IC considering the magnitude of funds it makes available to the small business community. The program's new loan registration IT system has been leveraged by another government program, facilitating efficiency across departments.

Recommendations

The evaluation led to the following recommendations:

1. The program recently implemented a package of regulatory amendments which provided incentives for lenders to offer financing through the program. While time will be required to assess the impact of these changes, program officials should now consider re-engaging existing and potential borrowers to determine if the CSBFP is sufficiently meeting their needs in the current environment. The CSBFP may consider implementing pilot projects as a step toward addressing the needs of borrowers identified through these engagements.
2. The program should continue to develop closer outreach ties with lenders and professional associations willing to collaborate in order to raise awareness of the program and to improve lenders' knowledge of the program and how it works.