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SMALL BUSINESS

A PROGRESS REPORT



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SMALL BUSINESS

A PROGRESS REPORT

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Cat. No. C2-268/1995E

ISBN 0-662-23150-3

PU 105105

Aussi disponible en français sous le titre
La petite et moyenne entreprise : rapport d'étape.



PREFACE

Small businesses play a fundamental and increasingly important role in our economy. Since 1992, they have created almost all net new jobs in Canada. Canadians will continue to look to small business for new jobs and economic growth. The role of government is to create an environment of opportunity — an environment where small businesses can thrive and prosper, and continue to drive the economic growth Canada needs.

In *Growing Small Businesses*, a companion paper to the February 1994 budget, we invited the small business community and others to help us shape that environment. Since then, the Small Business Working Committee, a private-sector advisory group, has examined issues facing small businesses. Numerous task forces within government have also examined specific subjects of concern to small business. Groups outside government, such as the Canadian Chamber of Commerce, have conducted their own consultations and shared their findings with us.

Several parliamentary groups also provided input to the review. For example, the House of Commons Standing Committee on Industry conducted extensive hearings on small business financing and related issues and released their report, *Taking Care of Small Business*, in October 1994. The Federal Ontario Liberal Caucus created a task force to look at the availability of capital for small business.

Together, these committees, task forces and working groups have completed a comprehensive review of small business issues.

This paper responds to the Standing Committee's report, and looks at the concerns that small business and others have identified. It highlights recent federal government initiatives, including those outlined in *Building a More Innovative Economy* and the other Jobs and Growth Agenda papers last fall. It also acknowledges actions taken by stakeholders outside government to address those concerns and sets out directions for further cooperation in the future. Reflecting the current fiscal situation and small business recommendations to address priorities within current resources, the federal initiatives outlined here are all being funded through existing budgets or through reallocation of resources.

This progress report recognizes that building an environment which encourages entrepreneurs to start businesses, create jobs and prosper cannot be a task for the federal government alone. This is a task in which all Canadians have an interest, so the government will be looking to many partners in both the public and private sectors to help us build this environment. For example, as indicated in the budget, the government feels the banks have a special obligation to provide financing to small businesses, and will be working with the banks to establish benchmarks against which their performance in small business lending will be measured.

As we work with our partners, the federal government will necessarily be re-ordering its priorities. We will reduce our emphasis on direct financial assistance. By working more through partnerships with other governments and the private sector, we will

P R E F A C E

identify and help fill gaps in the marketplace. The federal government will increasingly focus on getting critical information into the hands of entrepreneurs who can use it to turn business opportunities in Canada and abroad into sustainable jobs and growth for Canadians.

Since the small business community in Canada is so diverse and dynamic, meeting its needs will require ever-evolving strategies. This paper is not the final word on small business policy. This is a report on a journey still in progress. Creating an environment where small businesses can achieve their full potential is not a short-term task.

It requires the efforts of both government and the private sector to abandon old assumptions, explore new approaches, rethink and redefine their own roles in an innovative, fast-changing economy.

The initiatives described here are part of that collective effort — an ongoing effort that is gathering momentum, on course for a new age of innovation and entrepreneurship in Canada.



John Manley
Minister of Industry



Paul Martin
Minister of Finance

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INTRODUCTION

SMALL BUSINESS AND THE NEW ECONOMY

Canada, like all industrial countries, is moving towards a new kind of economy — an economy characterized by rapid technological change, intense global competition and innovation. What many people do not realize, however, is the dynamic role of *small business*¹ in this new economy.

Canada now has about 2 million small businesses — an increase of one-third since 1982. Today, 99 percent of all registered businesses have fewer than 100 employees. In recent years, small business has been responsible for almost all net job creation. Small businesses — including the self-employed — now account for almost two-thirds of private-sector employment and 60 percent of our economic output (see Figure 1).

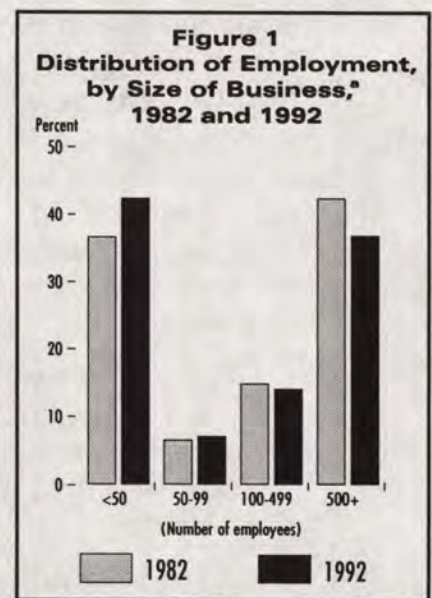
Dramatic growth in the number of small businesses is indicative of the strengths of smaller firms. Successful companies today

The smallness of these firms is a clear advantage, as it makes it easier to sustain innovation and an entrepreneurial spirit. Indeed, several of the most prosperous and competitive economies in the world today are based on small firms.

Taking Care of Small Business,
Report of the Standing
Committee on Industry

are those that keep up with change and innovate aggressively — two areas where small firms and entrepreneurs are often most proficient. New technology puts more power into the hands of small business — often reversing the competitive advantage larger firms once enjoyed through size alone. Many large firms are discovering that size can be a liability. Small businesses can change and adapt quickly, whereas larger firms find rapid change difficult.

At the same time, small businesses must deal with unprecedented challenges. Faced with intense competition, small firms must often overcome restricted access to capital, inadequate management skills and a lack of skilled employees. Many are unable to afford sophisticated technologies and lack well-developed marketing skills, especially when operating in foreign markets.



^a Includes self-employed; excludes public administration.

Source: Based on estimates prepared by Entrepreneurship and Small Business Office, Industry Canada, Ottawa.

HELPING SMALL BUSINESSES GROW

The government is committed to helping small businesses deal with these challenges. More than ever before, small business growth means more jobs for Canadians and a healthier economy. Barriers that prevent small businesses from realizing their potential must be removed.

In February 1994, the government proposed a new framework for small business policy, aimed at two basic goals:

- ensuring that the business environment is conducive to small business growth

¹ The term "small business" is generally understood to include businesses with fewer than 100 employees in manufacturing and fewer than 50 employees in other sectors, while "medium-sized" businesses are those with 100 to 500 employees. Unless otherwise indicated, the term "small business" used in this report refers to both small and medium-sized businesses.

- targeting limited government resources more effectively to enhance competitiveness and growth in the new economy.

Over the past year, the government has received valuable input on small business issues from parliamentary groups and others within government and the private sector:

- *Taking Care of Small Business*, a report by the Standing Committee on Industry. The report deals with a wide range of issues related to small business financing and taxation.
- *Breaking through Barriers: Forging Our Future*, a report by the Small Business Working Committee — an advisory group established to review small business policy and programs following the February 1994 budget.
- *The Federal Ontario Liberal Caucus Task Force Report on Small Business Financing*.
- *International Business Development Review Report*, a private-sector committee report on the government's international business development efforts, and public/private sector programs and services.
- *Financing the New Economy*, an Industry Canada-led task force report.

2 Many other groups, such as the Canadian Chamber of Commerce (through their *Aim for a Million* project) and the Canadian Labour Market and Productivity Centre, have provided insight and advice on small business issues. In addition, several broader policy reviews and studies, such as the social policy review and the comprehensive review of government programs and services, have important implications for small business.

All of those involved have helped to generate a better understanding of the challenges facing small business today. They have provided valuable suggestions about how these challenges can be addressed most effectively. The government appreciates the considerable time and effort spent by so many individuals and organizations to help small businesses grow and prosper.

COMMON THEMES

A wide range of small business concerns has been identified. These will be reviewed in detail in the following chapters. It is important, however, to place the various issues raised in a broader context. Four main messages have emerged.

- **Small business has a vast, untapped potential for creating more jobs and wealth.**

Many individuals and organizations spoke with enthusiasm about the capacity of Canada's small business community to create jobs and long-term, sustainable economic growth. They also expressed concern about the impediments to small businesses' ability to exploit this potential.

The government launched the small business policy review to find ways to facilitate small business growth. The developments outlined in this report are part of a long-term commitment to promote small-business success.

- **Reducing the deficit is one of the most important steps toward unleashing this potential.**

There is a clear consensus that the rapid growth of government debt is a major — perhaps *the* major — impediment to small business growth. Continuing, large deficits lead to high taxes and high real interest

rates. Both of these can be crippling to small business.

Businesses of all sizes and in all regions identified government debt/deficit reduction as the most important issue to help them build a sustainable business and hire additional employees.

Breaking Down the Barriers,
Canadian Chamber of Commerce

In the February 1995 budget, the Minister of Finance recognized that Canadians want full fiscal health. The budget demonstrates the government's commitment to meeting its short-term deficit

reduction targets. To help meet these targets, spending reductions include cuts to financial assistance and business subsidies. The government has always said that its interim target of 3 percent of Canada's gross domestic product was a station on the way, not our ultimate destination. The government will continue to set firm short-term deficit goals — rolling two-year targets, until the deficit is erased.

- **Government programs must become more efficient, effective and relevant to the needs of small business.**

There is no need for the government to spend more funds on new programs. Government must learn to work smarter and manage its affairs better — reducing costs, targeting limited resources more effectively and providing better service to small business, especially at the local level.

This paper outlines a number of ways in which existing programs are being refocused to be more relevant to small business. While the government is undertaking major reductions in program funding, we have placed the interests of small business at the heart of our micro-economic agenda. To this end, we will

continue to seek ways of leveraging our limited resources to meet the changing needs of small businesses.

- **The government alone cannot create the vibrant small business sector Canada needs.**

Small businesses and those who provide them with services — all orders of government, business associations, financial and educational institutions, and other intermediaries — must work together to address the needs of small business. The government's primary role should be to facilitate the efforts of those outside government to build an innovative, entrepreneurial economy.

This report highlights how the government is moving to change its role to bring it more in line with these suggestions.

These themes cut across many of the issues discussed in this report. The following chapters discuss small business concerns — and initiatives under way to address those concerns — in seven specific areas.

Chapter 1: Small Business Financing discusses the cooperative efforts of the government, banks and other providers of capital to make financing more accessible to small businesses. These efforts will result in a significantly improved, more responsive relationship between providers of capital and the small business community. In addition to measures to ease access to debt financing, this chapter also looks at steps to stimulate equity investment in small businesses.

INTRODUCTION

Chapter 2: Taxation and Small Business looks at a number of recommendations regarding the tax system and outlines the government's response to these recommendations.

Chapter 3: Regulation and Paper Burden outlines a wide range of initiatives under way to reduce the "burden of government" on small business, such as cutting red tape, harmonizing regulations and regulating "smarter."

Chapter 4: Program and Service Delivery reviews progress in rationalizing and streamlining the existing maze of government programs of interest to small business, and efforts to make programs and services more accessible.

Chapter 5: Skills Development addresses the need for small business to have access to a well-trained work force and well-developed management skills — and government efforts to facilitate stronger training partnerships between small businesses and providers of skills training.

Chapter 6: Science and Technology looks at how commercialization of research and development can benefit small business competitiveness, and examines key partnership initiatives to enhance the technological capacity of small businesses.

Chapter 7: International Business discusses the increasingly important international dimension of doing business and initiatives under way to help small businesses compete in global markets.

CHAPTER 1

SMALL BUSINESS FINANCING

Reliable access to financing is critical to small businesses, especially during their early years or periods of rapid growth. Small business said, loud and clear, that banks — the largest source of debt financing for small businesses — and some other suppliers are simply not responsive to their needs. Stakeholders said that the problem was not so much a lack of capital as it was access to capital by small businesses. In particular, financing for smaller projects, new economy activities and ventures outside metropolitan centres are of crucial concern (see Figure 2).

- stimulating access to equity capital for small businesses.

The problems stem, not from any one group, but from all sectors, small business, financial institutions and government ... Small and medium-sized businesses must realize that through individual and collective effort they themselves can solve many of their own problems ... Financial institutions, especially the banks ... must recognize the importance of small and medium-sized businesses to the national economy. Government must design policy and program regulations that will encourage our financial institutions to respond constructively....

Taking Care of Small Business,
Report of the Standing Committee on Industry

The Standing Committee on Industry, the Small Business Working Committee and the Federal Ontario Liberal Caucus Task Force on Small Business Financing all addressed this dilemma at length. Their recommendations were aimed at:

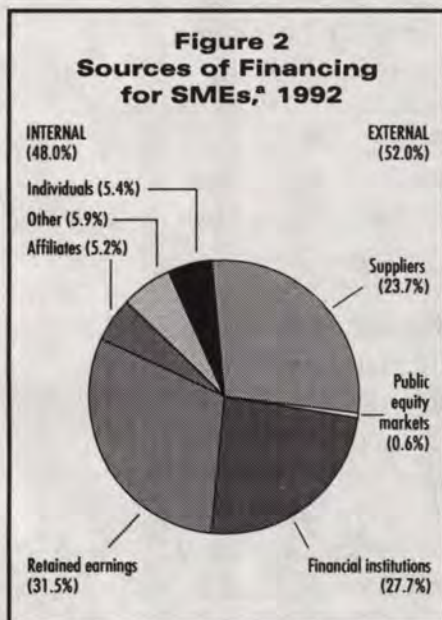
- increasing the participation of banks in small business lending
- improving relations between banks and their small business customers
- strengthening competition in small business lending markets
- refocusing and rationalizing government assistance programs for small business lending

INCREASING BANK PARTICIPATION

The Small Business Working Committee, the Standing Committee on Industry and the Federal Ontario Liberal Caucus wanted to see increased bank participation in small business lending. They called for the banks to develop more innovative lending programs and improve service to small-business borrowers.

They made a number of specific recommendations about how banks could become more responsive to small businesses:

- Establish special units within banks which are closely linked with small businesses and have the technical expertise to better understand the needs of important growth sectors in the small business community. Many feel that such units would be particularly helpful for knowledge-based businesses that lack the "hard assets" banks normally seek as collateral for loans.
- Develop more efficient ways for banks to evaluate and administer small business loan applications, with more flexible risk-rating procedures and pricing techniques.



^a SMEs are defined here as having less than \$25 million in annual revenues in 1992.

Source: John R. Baldwin, *Strategies for Success: A Profile of Growing Small and Medium-sized Enterprises (GSMs) in Canada* (Ottawa: Statistics Canada Catalogue No. 61-523R, 1994).

- Negotiate term working capital loans and provide reasonable advance notice of reductions in lines of credit or requirements to pay down loans.
- Reduce the turnover of their account managers, while ensuring that these managers have better training and more credit decision-making authority.

Some banks have taken initial steps to improve their services. These will be helpful but the government and the small business community view them as insufficient. The government considers it important that the banks work harder to respond to the financing needs of small business.

The government intends to monitor closely bank efforts to improve their service and product mix. The proposed regular bank appearance before the Standing Committee on Industry should provide a useful forum to review developments in this regard.

In addition, the Minister of Finance announced in the February 1995 budget that the government would be working with the banks to establish performance benchmarks for small business lending; these will be used to monitor progress.

Both the Standing Committee on Industry and the Small Business Working Committee called for improvements in statistics on bank lending to small business. They want to see better data on the size and types of loans, as well as the characteristics of borrowers. They recommended that such statistics be published by the government on a regular basis.

The government has been working with the banks to develop new small business lending statistics that can be gathered from

the sources and systems currently used by the banks. While not all the data requested are available, the new data will include the various forms of bank credit provided to the small business sector. They will be published by the Bank of Canada on a quarterly basis, with an initial reference point of December 1994.

IMPROVING BANK RELATIONS WITH SMALL BUSINESS

It is widely recognized that the banks need to improve relations with the small business community. Following extensive consultations with the Industry/Finance Task Force, the major banks have announced a small business code of conduct setting out minimum service standards to be incorporated in individual bank codes; these will be operational by March 31, 1995. By that date, the banks will also have introduced an Alternative Dispute Resolution (ADR) system that small business customers can use when they are dissatisfied with the outcome of credit-related complaints considered by a bank's internal complaint review mechanisms.

The intention of the codes is to provide small business entrepreneurs with a clear set of guidelines for the bank credit process. In circumstances where credit is declined, the banks must disclose the main reasons for refusal and make available, where practical, information on alternative financing sources. An important feature of the bank codes will be a requirement for the banks, under normal circumstances, to provide 15 days' notice of actions such as the reduction or termination of credit lines.

The Alternative Dispute Resolution system at each bank will conform to agreed industry standards. The resulting complaint

A New Relationship between Banks and Small Business

For small businesses, the new code of conduct and Alternative Dispute Resolution procedures will help to ensure:

- **Accountability** — a senior bank officer will ensure compliance with the code.
- **Understandable contracts** — all bank documentation will be in clear and understandable language.
- **More efficient credit processing** — loan applicants will receive clear directions for credit applications, an estimate of when a decision will be made, details of bank information requirements and reasons for collateral requirements.
- **Clarification of credit refusals** — customers will be notified of the reasons for a refusal, the steps required to meet approval and, where appropriate, the availability of alternative financing sources.
- **Notification of reduced credit** — under normal circumstances, a minimum of 15 calendar days' notice will be provided before a credit line is reduced or terminated.
- **More efficient complaint handling** — when complaints cannot be resolved at a branch, a senior bank officer will review the case and provide a timely explanation of the bank's decision.
- **Access to ADR** — where credit-related complaints cannot be resolved through internal procedures, the complainant will have access to a timely, cost-efficient Alternative Dispute Resolution system moderated by a neutral party.

review procedure is designed to be accessible, timely, confidential, cost-efficient and moderated by a neutral party. Senior management in each of the major banks is responsible for ensuring that its staff is fully trained in all aspects of the code and ADR commitments, and for making these important commitments highly visible to its small business customers.

If the banks adhere to their codes and ADR system commitments, their small business clients should see an improvement in their relationships with their bankers. The government intends to monitor the effectiveness of these two initiatives. This process will be supported by the proposed bank

appearances before the Standing Committee on Industry. In addition, the banks will report annually to the Superintendent of Financial Institutions on ADR cases and the operation of the system.

There have been suggestions to have a small business ombudsman who would attempt to expedite and monitor bank non-credit complaint handling. The government's view, at this time, is that it would prefer to monitor the ability of existing and prospective procedures to deal with small business complaints before proceeding with further actions. Should these measures prove ineffective, an ombudsman will be considered.

STRENGTHENING COMPETITION

The Standing Committee on Industry expressed the view that there is insufficient competition in the small business lending market. To address this concern, it recommended that the government ease capital requirements restricting the commercial lending capacity of trust companies, create a new Schedule III category of banks and allow direct branching of foreign banks into Canada.

The federal government has taken steps to enhance both domestic and foreign competition among financial institutions. Recent legislative reforms increased the commercial lending powers given to insurance and trust companies. In addition, some provinces have recently enhanced the commercial lending powers of credit unions. To promote international competition, the 12 percent ceiling on the size of foreign bank assets has been removed as part of legislation to implement the new General Agreement of Tariffs and Trade (GATT) Agreement.

At the same time, the government recognizes concerns expressed by financial regulators and the financial community that relaxation of rules governing trust companies, foreign banks and closely-held domestic banks could raise serious prudential considerations without stimulating any meaningful increase in small business lending.

REFOCUSING GOVERNMENT ASSISTANCE

The Small Business Working Committee recommended that financial assistance from government should generally be targeted to areas not covered by the private sector. It advocated elimination of all direct government subsidies to business. Through the recent comprehensive review of federal programs, steps have been taken to better target activities. For example, the federal government's regional agencies² have focused their programs almost entirely on small businesses and have targeted their funding both to clearly identified gaps in commercial financial markets and key growth industries. In particular, the regional agencies, in accordance with their respective regional strategies, provide support for business start-ups and expansions requiring more patient capital and take a greater degree of risk than the commercial banks will.

The government has moved to dramatically reduce subsidies to business — by 60 percent in three years (see Table).

² The Atlantic Canada Opportunities Agency (ACOA), the Federal Office of Regional Development — Quebec (FORD-Q), the Federal Office of Economic Development for Northern Ontario (FedNor), and Western Economic Diversification (WED).

Major business subsidies (grants and contributions)†*

	1994-95	1997-98
(millions of dollars)		
Agriculture	1 322	893
Transportation	696	19
Regional development	700	234
Industry, innovation and market development	525	264
Energy and resource sectors	410	8
Cultural industries	104	68
Total grants and contributions	3 757	1 486
Percent reduction (grants and contributions)		60.4

* Most subsidies to business, irrespective of their size, are included in this table.

† Source: Department of Finance, 1995.

In this regard, the number of Industry Canada's funded programs will drop by nearly four-fifths during the next three years and the department will see its budget cut by over 40 percent in the same period. Industry Canada's largest remaining program, Aboriginal Business Canada, will continue to help build successful Aboriginal businesses and will seek partnerships with the Federal Business Development Bank (FBDB) and other financial institutions to extend the reach of its initiatives. Likewise, the regional agencies have moved to reduce subsidies in direct business assistance. The Atlantic Canada Opportunities Agency (ACOA) and FORD-Q, to some extent, have recently eliminated all grants and non-repayable contributions and instituted repayability for direct assistance to small business. FedNor is moving towards a policy that would require repayment of all direct assistance to business. Western Economic Diversification (WED) has used repayable contributions since its inception. For the future, WED will work with financial institutions to create joint loans funds, which will provide financing on commercial terms and be administered by the banks for individual small businesses.

Both the Small Business Working Committee and the Standing Committee on Industry made recommendations regarding federal lending programs. They suggested a review of recent revisions to the *Small Business Loans Act* (SBLA) to ensure that the program is meeting small business needs in a cost-effective manner. They also expressed concerns that financial institutions may be using the SBLA for loans that could be provided under conventional lending criteria.

In response to these concerns, the government is continuing the program and is introducing changes to the SBLA. These revisions meet the goals expressed during the consultations by moving the program to full cost-recovery and providing an incentive to use conventional financing whenever possible. With these changes in place, the program will continue to play a key role in enhancing small business access to financing.

The Standing Committee on Industry also recommended renewal of the mandate of

the FBDB. The Small Business Working Committee said the government must ensure that the bank fills real gaps in small business financing. Many small business representatives also feel the FBDB's activities should be pursued on a full cost-recovery basis.

The government is still reviewing changes to the FBDB's mandate. The FBDB will continue to fill gaps by supplementing private sector financing and complementing the work of the federal regional agencies and public financial institutions, and operating its financial services on a full cost-recovery basis. The FBDB will also establish a Charter of Client Rights that defines standards of client service and information disclosure. An internal ombudsman will be established by the FBDB to monitor compliance with this Charter.

MOBILIZING EQUITY CAPITAL FOR SMALL BUSINESS

Tax Incentives

To make more equity capital available to small businesses, the Small Business Working Committee, the Standing Committee on Industry, and the group on Financing the New Economy, all called for changes to tax provisions. These include:

- maintaining the \$500 000 lifetime capital gains exemption and reducing the capital gains tax rate on long-term investments in small business
- relaxing current restrictions on eligible RRSP investments that prevent RRSP funds from being invested in the holder's own business
- introducing a mechanism to limit fund raising or tax credits until Labour-Sponsored Venture Capital Corporations (LSVCCs) meet targets for small business investment.

Recent Changes to the Small Business Loans Act

The 1993 revisions to the *Small Business Loans Act* (SBLA) dramatically increased lending under the act, and also increased the costs of the program. To move the program to full cost-recovery, the government is imposing a 1¼ percent annual fee on lenders' average outstanding balance on SBLA loans made after March 31, 1995.

The new maximum rate of interest will be prime rate plus 3 percent for floating-rate loans and the residential mortgage rate plus 3 percent for fixed-rate loans. Such measures will encourage borrowers and lenders to seek lower-cost conventional lending options while maintaining access to SBLA loans for those who have difficulty qualifying for conventional lending. Lenders will also be permitted to release personal guarantees given by borrowers when the loan is in good standing and is 50 percent paid down.

The government shares many of the concerns expressed by small business regarding access to equity financing. On the taxation of capital gains, consultations with the small business sector revealed that the \$500 000 lifetime capital gains exemption is needed at this time to help ensure that small businesses have adequate access to equity financing. The exemption will, therefore, be maintained in its current form. Further reducing capital gains taxes on investments in small businesses would be difficult to justify at a time when the government is closing tax loopholes and asking all Canadians to contribute to deficit reduction.

Allowing individuals to invest their RRSP funds in a non-arm's-length business would entail significant revenue costs and compromise the primary purpose of tax assistance for retirement saving. Revenue costs would increase since individuals would invest in their business using tax-deductible RRSP contributions, instead of investing directly. The change would also enable individuals to defer the payment of taxes on the income of their business by having their business pay high rates of return on the amounts raised from their RRSP.

With regard to LSVCCs, the federal government agrees that they have been slow at investing in small business, especially in light of the very generous tax assistance being provided. However, there are already requirements for LSVCCs to invest in small and medium-sized enterprises which take effect five years after a LSVCC starts to raise funds. Failure to comply results in penalties. The government will continue to monitor closely the progress of LSVCCs at investing in small business.

Private-Sector Initiatives

The Small Business Working Committee also argued that major financial institutions should increase their equity investment activity in small businesses. The banks are making some progress in expanding their role as suppliers of venture capital. They have made commitments to the Ontario Lead Investment Fund, a provincial venture capital fund, and are involved in small private-venture capital funds targeted at knowledge-based and export-oriented firms. In addition, some banks have established or expressed interest in establishing Specialized Financing Corporations (SFCs) that would allow them to increase their participation in the venture capital market.

Other Government Incentives

Access to equity capital appears to be particularly difficult for businesses outside major financial centres and can be extremely limited for businesses in rural and remote areas. There is widespread support for programs that seek better links between investors and small businesses at the community level. The Small Business Working Committee argued that the government could act as a facilitator by providing a supportive environment along with subsidies for transaction and/or due diligence costs, but should not provide investment funding or operate programs.

In response, the government announced in *Building a More Innovative Economy* that it will establish the Canada Community Investment Plan. The program will be aimed at stimulating access to equity capital for small and medium-sized enterprises, including those in small and remote communities. Under this plan, several demonstration projects will be launched to help community-based investment groups

SMALL BUSINESS FINANCING

match investors and local sources of venture capital with local firms looking for small amounts of equity. Program details will be announced shortly.

To help address the financing needs of firms in small communities, the small business community expressed support for the Community Futures Program. To improve the effectiveness of this program, the government is currently in the process of merging Community Futures Committees with Business Development Centres to form Community Futures Development Corporations. It also plans to transfer responsibility for the newly combined

entities from Human Resources Development Canada to the regional development agencies. This transfer is expected to result in greater focus on the economic development objectives of the program.

Atlantic Canada is the only region without a private-sector venture capital fund. Accordingly, ACOA is pursuing the establishment of an Atlantic Investment Fund (AIF) with the Atlantic provinces and chartered banks. Each partner would contribute one-third to the \$20-million to \$30-million fund. The AIF would be operated by the private sector on a full commercial basis.

CHAPTER 2

TAXATION AND SMALL BUSINESS

Taxation is perhaps the most direct and visible way in which governments affect the small business environment. At present, the federal income tax system for small business is among the most generous in the industrialized world and compares especially well to that of the United States.

Nevertheless, a number of task forces and committees recommend adjustments to the tax system to ensure that it further encourages small business growth and development in the most effective way possible. Specifically, these recommendations address the areas of:

- taxes and payroll levies which are insensitive to profits, such as Unemployment Insurance premiums
- the impact of taxes on a business' ability to retain earnings for investment
- the need to simplify the tax system as a whole, particularly in the sales-tax field.

Small business is also concerned about further tax assistance to encourage technological innovation and exports. These issues are addressed in the chapters on Science and Technology, and International Business, respectively.

PROFIT-INSENSITIVE TAXES

Small businesses are concerned not only about the general level of taxes, but also about the level of taxes that are not related to business profits. Profit-insensitive taxes include payroll levies such as Unemployment Insurance and health insurance premiums, workers' compensation premiums and municipal property taxes. Since these levies are not based on profits, they impose the same burden whether a business is doing well or going through difficult times. Almost two-thirds of all profit-insensitive taxes are imposed at the provincial and

For small businesses facing increased pressures on profit margins, relatively high increases in profit-insensitive taxes imply lower retention of profits, higher vulnerability to recessionary times and increased reliance on external financing.

Breaking through Barriers,
Small Business Working Committee

municipal level (e.g., Workers' compensation, general payroll levies, business and property taxes).

The Small Business Working Committee urged the federal government to reduce the burden of profit-insensitive taxes by lowering Unemployment Insurance (UI) and Canada Pension Plan (CPP) premiums. It suggested this could be done by:

- eliminating the funding of social, regional and economic objectives from the UI program
- making employer's UI premiums, currently 1.4 times the share paid by employees, equal to employee premiums within four years
- reducing the benefit and administration costs of UI by reforming the overall structure of benefits and improving the efficiency and effectiveness of delivery
- reviewing the CPP/QPP benefits and program administration to determine cost savings
- ensuring that all profit-insensitive taxes remain deductible for income tax purposes.

The committee also urged the government to encourage similar action at the provincial and municipal levels. It would like provincial governments to review the costs of and benefits provided by workers' compensation programs and the way these programs are financed. The committee felt that administrative costs and premiums under various provincial plans could be reduced.

It would like payroll taxes for programs/ services such as health care to be replaced by direct premiums or consumption taxes. Similar action should be taken at the municipal level to reduce business and property taxes, as well as licensing fees.

The government recognizes that payroll taxes create a disincentive for firms to create jobs. As a result, the federal government is committed to ensuring lower and more stable UI premiums, the most significant payroll levy for which it is responsible. The UI premium rate has been rolled back to the 1993 level of \$3.00 per \$100 of wages for 1995 and 1996 from the 1994 level of \$3.07. Over the longer term, the government's objective, as reaffirmed in *Building a More Innovative Economy*, is that UI premiums will be reduced through progressive cuts once the UI account is healthy again.

The social security review, launched by the Minister of Human Resources Development, Mr. Axworthy, established the foundation to act upon many of the Small Business Working Committee's recommendations. It is anticipated that one result of the social security review will be a UI program that does a much better job of investing in people and that permits lower UI premiums. In considering how to adjust the burden of UI financing, the government will be exploring a number of models, including user pay or experience-rating, so that those whose employment patterns place fewer demands on UI would pay less.

In addition, during 1995, the federal government and the provinces will review the financing of the Canada Pension Plan as required by the *Canada Pension Plan Act*.

ENCOURAGING RETAINED EARNINGS

Many small businesses rely on accumulated earnings to provide the capital for investment and growth. Tax incentives, such as the Small Business Deduction (SBD), help small businesses accumulate more after-tax earnings for reinvestment and expansion. This also helps them to build their equity base, making them more attractive to external investors.

At present, the SBD reduces the basic federal corporate tax by 16 percentage points on the first \$200 000 of active business income earned by Canadian-controlled private corporations. Above that income level, the marginal tax rate increases to the general corporate tax rate of 28 percent (or 21 percent in the case of manufacturing and processing profits). This deduction delivers over \$2 billion of assistance annually and, in conjunction with other special tax measures for small business, provides Canadian small businesses with a more favourable income tax regime than in most other countries.

Both the Small Business Working Committee and the group on Financing the New Economy recommended creating an intermediate stage before small businesses are required to pay the full corporate rate. For example, the Small Business Working Committee suggested that a reduced rate also apply to income between \$200 000 and \$400 000. In addition, the Federal Ontario Liberal Caucus Task Force on Small Business Financing recommended that small business profits should be only taxed when they are distributed as dividends, rather than when they are earned. The argument is that this would provide a strong incentive for small firms to retain earnings for reinvestment.

The government has examined the various recommendations to enhance the SBD. Although such additional tax relief might encourage the retention of earnings for some companies, it would significantly reduce government revenues. Therefore, considering current fiscal constraints and the fact that the SBD already provides considerable support to small business, the government has decided not to enhance the SBD. However, the federal government will continue examining the tax system to identify areas where it may be impeding or frustrating business in its efforts to grow and create jobs.

THE GOODS AND SERVICES TAX

Many small businesses are concerned about the compliance burden of the goods and services tax (GST). Although there is substantial coordination between the federal government and the provinces in the area of income taxation, coordination in the sales tax field has been limited. Most businesses must deal with two sets of rules and comply with two separate systems of administration. This lack of coordination is especially onerous on small businesses, most of which have only limited in-house resources to deal with complex tax issues.

The Small Business Working Committee recommended that the government pursue sales tax harmonization with the provinces, provided that:

- there would be no overall tax increase
- the process does not increase compliance costs for small business
- administrative improvements related to harmonization are consistent with small business practices and realities.

The committee also expressed concerns about the complexity and confusion caused by the broad range of exempt and zero-rated goods under the current GST.

The federal government is committed to replacing the GST with a sales tax system that, among other objectives, improves federal-provincial harmonization and coordination, and minimizes the transitional impact on taxpayers. The House of Commons Standing Committee on Finance report titled *Replacing the GST: Options for Canada*, which was released in June 1994, recommended that the existing GST be replaced with an integrated, national, value-added tax. Discussions are continuing with the provinces on the design and implementation of a sales tax system consistent with this recommendation.

The federal government appreciates the Small Business Working Committee's support in its pursuit of a harmonized sales tax. The concerns of the small business community about the GST, primarily relating to compliance burden, will certainly be taken into consideration when finalizing the reform of the GST.

SIMPLIFYING THE TAX SYSTEM

Small businesses do not have the in-house resources to deal with complex tax issues, record-keeping, or remittance and audit requirements. The burden of compliance is exacerbated by the lack of coordination among various types of taxes and levels of government. The large number of different taxes at various levels of government imposes compliance costs which are particularly onerous for small businesses.

... The direct costs of taxes are compounded by the costs of time and human resources devoted to complying with Canada's complex and overlapping regulatory regime.

Taking Care of Small Business,
Report of the Standing Committee on Industry

To address these concerns, the Small Business Working Committee recommended that a significant effort be made to simplify and harmonize the tax system as a whole. In addition, they urged that the goal of Revenue Canada should be to ensure efficiency, consistency, cooperation and fairness in dealing with small businesses.

The government recognizes the time and effort which small business must invest in order to comply with all government rules and regulations. With respect to the tax system, the federal government is committed to ensuring that it does not impose an undue compliance burden. A considerable amount of progress has already been made to address the tax-related complexity and compliance concerns of small business. Revenue Canada is continuing to reduce the compliance requirements for small business and to improve their access to information. These initiatives are outlined in more detail in Efficient Administration of the Tax System, found in Chapter 3. In addition, the federal government is constantly working with the provinces to reduce the compliance cost by increasing the harmonization and coordination of taxes, specifically in the area of sales taxes.

CHAPTER 3

REGULATION AND PAPER BURDEN

Small businesses are increasingly frustrated by the time and expense required to deal with government paperwork and regulation. The government's involvement in business, either as a regulator or a collector of information, costs both sides time and money.

The lighter these burdens are for small business, the easier it is for them to remain competitive in global markets. At the same time, the government itself can no longer afford its current levels of intervention in the marketplace. The government is committed to maintaining current standards in health, safety and environmental protection, but recognizes that it must find less expensive, more efficient ways to achieve these goals.

A January 1993 all-party report by the House of Commons Sub-Committee on Regulations and Competitiveness identified a number of challenges related to regulatory reform. The Small Business Working Committee took up this theme, but looked beyond government regulations to consider paper burden — requests for information from government. Their report was followed by a Canadian Federation of Independent Business survey that identified additional concerns related to paper burden.

These reports provide a wide range of recommendations which identify four main areas for action:

- **reducing red tape** — cutting the amount of time small businesses spend on official requests for information
- **harmonizing standards and regulations** — reducing overlap, duplication and inconsistencies at the provincial, national and international levels
- **providing a more efficient and responsive regulatory process** — with clearer

rules, better communication and better consultation

- **increasing flexibility** — giving business greater flexibility in the way it meets the public policy objectives set by government.

REDUCING RED TAPE

Small business argues that government fails to recognize how demands for information or compliance impose a burden on small business in terms of complexity, frequency and time. Some of the more notable irritants mentioned include:

- different departments asking for the same information
- departments and governments imposing duplicate or contradictory regulatory requirements
- departments demanding information or compliance without any apparent sensitivity to the inherent costs
- information requested in ways which do not match a firm's information holdings
- compliance required for outdated government regulations which conflict

Streamlining Paper Burden: Two Examples

- **Statistics Canada:** As part of its continuing commitment to reduce response burden, in collaboration with Revenue Canada, Statistics Canada has significantly reduced the demand on small firms to provide monthly data for its *Employment Earnings and Hours* publication. By adding questions about employment and total payroll to Revenue Canada payroll deduction remittance forms, the number of small business contacts the agency makes every year has been reduced by over 300 000.
- **Human Resources Development Canada** has completed a major review of the way employers provide data used to determine an employee's UI benefits. This review identified options which are under consideration to increase employers' flexibility in keeping pay data, simplifying premium calculations and reducing the number of data elements reported.

with good business practices and international norms.

The Small Business Working Committee recommended that the federal government address these irritants and target a 10 percent annual reduction of the total information burden over the next five years.

In *Building a More Innovative Economy*, released in November 1994, the government made a commitment to a major reduction in the amount of time small business must spend on official requests for information. A key to achieving this objective is better information-sharing among departments, notably Human Resources Development Canada, Revenue Canada and Statistics Canada.

A joint private- and public-sector Forum on Paper Burden has been established to reduce the information demands on business. Brien Gray, Senior Vice President of the Canadian Federation of Independent Business, and a senior official with the Treasury Board Secretariat will serve as the Forum's co-chairs. Within six months of its creation, this forum will produce a plan of action that includes targets, timetables and strategies for reducing paper burden for small business over the next four years.

HARMONIZING STANDARDS AND REGULATIONS

Both the House of Commons Subcommittee on Regulations and Competitiveness and the Small Business Working Committee have urged the gov-

ernment to work toward increased international and interprovincial harmonization of standards. In *Building a More Innovative Economy*, the government said it would work with provincial and foreign governments to reduce duplication, overlap and differences in regulations. Cooperation among governments, both within Canada and abroad, benefits all.

Promoting Harmonization: Some Examples

Agriculture and Agri-food Canada, and related departments are working with provincial governments to redesign government inspection in the agri-food sector. The goal is to reduce the burden and expense caused by overlap and duplication of programs.

Environment Canada is negotiating administrative agreements with provincial governments for implementing pollution prevention agreements, and is working with the Canadian Council of Ministers of the Environment to establish one consistent framework for environmental management across Canada.

Fisheries and Oceans Canada has proposed a consolidation and rationalization of ocean programs into a *Canada Oceans Act* which, along with amendments to the *Fisheries Act*, would allow cooperative arrangements with industry or provincial, territorial and municipal governments.

The Standards Council of Canada will receive a broader mandate under legislation to be introduced in 1995. This will allow the Standards Council to focus more attention on, among other things, the harmonization of standards within Canada and internationally.

Prior to the Agreement on Internal Trade coming into force on July 1, 1995, the government will seek to work with the provinces to reduce obstacles to trade caused by differences, duplications or overlaps of regulations. In addition, the President of the Treasury Board will publish a document on smarter ways for government to cooperate on regulatory programs.

The government is making progress in harmonizing international standards. For example, it will sign a joint declaration

The government must act to harmonize standards across departmental and jurisdictional boundaries.

Breaking through Barriers,
Small Business Working Committee

with Japan in 1995 that will lead to mutual recognition of building product standards. In addition, Health Canada is moving to harmonize more of its regulations with international standards.

A MORE EFFICIENT, RESPONSIVE PROCESS

The Small Business Working Committee noted that the regulatory process itself does not reflect the needs or realities of small businesses. For example, they were concerned about the way consultations on proposed regulations take place — particularly when consultations take place only after key decisions have already been made. Furthermore, the small business community is concerned that, when regulations have been introduced, there is no effective mechanism for small business to express concerns about the way they are implemented.

*In December 1994, the President of the Treasury Board issued *The Regulatory Review Report* which outlines the findings of long-term regulatory reviews conducted in each federal department. It will result in revocation of over 250 regulations and revision of a further 370 by the end of 1996.*

- **Doing a better job in developing regulations:** The Treasury Board Secretariat will work with the private sector and the seven major regulatory departments³ to set clear and auditable standards for developing and implementing regulations.
- **Resolving complaints:** Federal regulatory departments will be required to resolve complaints about the administration of regulatory programs according to generally accepted management prin-

ciples, developed in consultation with the public. Once approved, the principles will become part of the regulating departments' management standards.

- **Business Impact Test:** The Business Impact Test, an interactive computer software tool developed by the Canadian Manufacturers' Association and the federal government, is designed to help determine the impact regulations will have on business and identify alternatives that might be more cost-effective. By the fall of 1995, the seven largest federal regulatory departments — and by 1996, all federal regulatory departments — will use the test or an equivalent for all major regulatory changes.
- **Putting the law into plain language:** Many jurisdictions are using plain language in regulations to make them more understandable. The federal government has pilot projects under way to improve the understandability of its regulations in two areas: explosives and the transportation of dangerous goods. Given the success of these pilots to date, the government will encourage the use of plain language in the writing of all regulations, starting in 1995.
- **Accessing information more easily:** The government has launched a pilot project at the Canada-Saskatchewan Business Service Centre to make it easier for individuals to access regulatory information on federal agriculture programs. If the project is successful, it will be extended to other areas of regulation and other parts of the country.
- **Training and communications:** Small businesses have complained that reforms are often not implemented efficiently and consistently within a department. Experience in regulatory reform shows that officials at all levels need education

³ The Departments of Agriculture and Agri-Food, Environment, Fisheries and Oceans, Health, Industry, National Revenue, and Transport.

and training to make sure that new approaches are accepted throughout the organization and result in real change. By mid-1995, the Treasury Board Secretariat will develop courses to help regulators formulate cost-effective regulations, particularly as they apply to small business; to enable field staff to be more effective; and to ensure a common vision of the new regulatory approach among all officials.

- **Legislative framework changes:** The government will soon introduce legislation to reform the *Statutory Instruments Act*, the legislative framework and authority for making regulations. The reform will aim to simplify and speed up the regulatory process, giving departments greater capacity to respond quickly and effectively to rapidly changing circumstances.

INCREASED FLEXIBILITY AND RESPONSIBILITY

Both the Small Business Working Committee and the Sub-Committee on Regulation and Competitiveness expressed interest in proposals that would give greater flexibility and responsibility to the private sector in meeting regulatory objectives. They suggested that, in some cases, federal departments could vary the details of how a regulation is implemented by entering into compliance agreements with individual businesses. In some cases, it may make sense for the government to facilitate the development of performance standards

by the private sector as an alternative to government regulation.

At the same time, many small businesses have expressed concern over the lengthy process of testing and approval required to meet some standards. If competitiveness is to be enhanced through process and product innovations, bureaucratic red tape cannot stand in its way. Because time is often critical, small business has called for measures to accelerate testing, approvals and certification, especially for Canada's fast-moving high-tech businesses.

The Committee ... supports the concept of both decreasing the need for government inspection and monitoring, and increasing the competitiveness of Canadian business internationally by encouraging, although not requiring, the adoption by companies of quality assurance standards and quality management practices.

House of Commons Sub-Committee on Regulations and Competitiveness

The government is implementing a number of initiatives to address these concerns:

- The proposed *Regulatory Efficiency Act* tabled on December 6, 1994, would reduce unnecessary barriers to business while ensuring that the intent of regulations is still met and that the health, safety and environmental standards which Canadians have come to expect are maintained. Under the proposed act, businesses or individuals will be allowed to adopt innovative ways of meeting regulatory obligations, provided they can demonstrate that their alternatives are better. If such proposals fully respect the public interest, the government would have the authority to enter into agreements to permit their use. The Canadian Manufacturers' Association estimated

... Individual businesses, not governments, are in the best position to determine how to meet regulatory objectives in the most effective and efficient manner, taking into consideration the particular circumstances of their businesses.

Breaking through Barriers,
Small Business Working Committee

that this part of the legislative reform could lead to potential savings for Canadians of over \$3 billion a year.

- The government will encourage small business to adopt more performance standards as a means of lessening the regulatory burden. In *Building a More Innovative Economy*, the Minister of Industry announced that he would introduce legislation to give the Standards Council of Canada a broader mandate. This would include, for instance, allowing it to focus on helping small businesses better influence the development of standards.

EFFICIENT ADMINISTRATION OF THE TAX SYSTEM

As mentioned in the previous chapter, the Small Business Working Committee recommended that a significant effort be made to simplify and harmonize the tax system as a whole. Small businesses have also complained about such issues as the number and frequency of remittances, penalties for late or deficient remittances, the complexity of payroll deductions, and the timeliness of advance rulings. In addition, they urged that the goal of Revenue Canada be to ensure efficiency, consistency, cooperation and fairness in dealing with small businesses.

Revenue Canada is focused on providing quality service to small business and reducing its paper burden. Revenue Canada's recent administrative changes are aimed at reducing delays and duplication, and improving the quality and efficiency of departmental services for many small businesses.

Revenue Canada's new Business Number system allows businesses to use a single number, eliminating multiple registrations for the GST, income tax and payroll taxes. This should streamline and simplify the department's relations with its business clients. Revenue Canada's Business Windows provide business clients with one-stop service, either over the counter or by telephone.

Since the beginning of 1995, businesses have been able to use a diskette-based version of the *Payroll Deduction Tables* which amalgamates the Canada Pension Plan, Unemployment Insurance and income tax tables. Imaging technology has recently been approved for business books and records for tax purposes, which could save some small businesses 10 to 20 percent in operating costs.

Eligible small businesses can file their annual GST return with their individual income tax return. This allows businesses to offset a debit from one return with a credit from the other. Businesses can also combine debits from the two returns and send Revenue Canada one remittance. For a business in extraordinary circumstances, the department can waive or cancel all or any part of a penalty or interest charged to the business.

Revenue Canada is also improving the customs commercial process. As part of this exercise, a small business project will examine ways to streamline the importing process, reduce costs and ease the paper burden. The new National Customs Rulings Program gives businesses nationally binding rulings on their customs liabilities within specified times.

CHAPTER 4

PROGRAM AND SERVICE DELIVERY

The diversity and complexity of existing programs creates two major problems for the small business community. First, it is very difficult for many small businesses to get information about the kinds of service or support that is available. It is simply too time-consuming for business clients to penetrate the complex maze of separate delivery structures and bureaucracies that has grown up around the programs.

Business has had to redefine and re-engineer itself in the marketplace in order to survive. Government must do the same. And it must do so using the same tools: client-oriented service improvements, a focus on the bottom line, strict accountability, measuring results and emphasizing effectiveness.

Breaking through Barriers,
Small Business Working Committee.

Second, the proliferation of programs leads to overlap and duplication, without any clear focus on identifying real needs or measuring results. For example, the small business community feels that many government subsidies to business have been poorly designed, were introduced without consultation and do not achieve the results intended. They argue that many subsidies should be cut.

The Small Business Working Committee recommends a major re-evaluation of government small business programs. Overlap and duplication — within the federal government and between levels of government — must be eliminated. Programs must be made more relevant to the needs of small business. The committee feels the federal government should focus more clearly on its role as a facilitator and a source of strategic information and on making that information easily accessible to those who need it.

As mentioned earlier, the federal government is placing increasing emphasis on providing strategic information and much less on funded programs. Despite these changes in focus, the government will continue to work with partners in the public and private sectors to identify and find ways of filling critical gaps in marketplace provision of services essential to the growth and competitiveness of the small business community.

RATIONALIZING THE SYSTEM

By working closely with provincial governments and the private sector to eliminate overlap and duplication, the federal government will substantially reduce the number of programs it operates by 1998. This close collaboration among stakeholders will also help to identify gaps and build agreements as to who should fill them and how. The net result of this effort will be fewer programs that provide more relevant support in a more cost-effective manner. At the same time, various levels of government are working to coordinate and improve delivery in regions and economic zones. For example, when different public sector organizations offer related programs or services, it may make sense to co-locate field offices to simplify client access.

IMPROVING ACCESS TO INFORMATION AND GOVERNMENT SERVICES

Small business has repeatedly asked the government to make vital information available and accessible to the businesses that need it in areas such as financing, exporting, skills, training and procurement. The government is taking a number of steps to improve access to information by improving the linkages and flow of information among organizations.

Single Window Links Federal and Provincial Programs

Business Service Centres have now been established across Canada to provide small business with a single access point for information on almost all federal and provincial programs, services and regulations. Clients get the information they need quickly or are referred to the right place the first time. The private sector has played a significant role in establishing these centres. In Quebec, for example, the Centre Info-entrepreneur, funded one-third by the local Chamber of Commerce, also provides information about municipal business programs and regulations. Through fax-on-demand services, clients can receive descriptions of services and programs using a touch-tone phone and a fax machine — seven days a week, 24 hours a day. The centres are also exploring other ways to make technology better serve clients.

To provide business (including small business) with single-window access, the government has established 10 Canada Business Service Centres (CBSCs) across Canada — one in every province. To meet the growing demand for information provided by these centres, investment is to be raised by \$15 million annually and the federal government is exploring expanded access through partnerships with organizations like the local Chambers of Commerce, local economic development corporations, educational institutions and existing federal/provincial government offices. The government is also working with provincial governments toward establishing integrated “one-stop shops” for all federal and provincial trade information and, where possible, with appropriate linkages to the national network of CBSCs.

In the February 1995 budget, the government established a new role for Canada's regional agencies. They will focus on small and medium-sized enterprises, but they will rely on loans and repayable contributions rather than direct subsidies. The regional agencies' field offices, and Industry Canada

in Ontario, will provide a single point of contact to federal government programming for the small business sector.

In providing their services, the regional agencies will continue to take a cooperative/partnership approach to simplifying the delivery of programs and information to the small business community. For example, ACOA has implemented a “Team Atlantic” approach built on region-wide coordination/harmonization across the federal government with provincial and private-sector partners, and bottom-up partnerships with the private sector. WED is emphasizing multi-stakeholder initiatives to address industry-wide competitiveness challenges and opportunities in Western Canada. Working with the provincial governments and representative groups in key growth industries, WED is investing in cooperative approaches to structural or business-climate problems. FORD-Q is undertaking a complete re-engineering of client service built on cooperative arrangements with other federal government departments serving business clients.

Community Access

In February 1995, the government launched the Community Access program which will provide non-profit educational and community organizations of rural communities with access to the Internet. The objectives of this program are to raise awareness of the job creation potential of the Internet, to provide these communities with access to new learning and training tools, and to provide electronic delivery of government services, all of which are important to small business. The program will be delivered on a cost-shared basis in partnership with provincial and territorial governments, and private-sector participants.

IMPROVING ACCESS TO GOVERNMENT PROCUREMENT

Many business groups recognize that the strategic use of government procurement can improve the climate for small business growth while promoting innovation. The Small Business Working Committee, for example, recommended that the government improve small business access to procurement contracts, especially for knowledge-based and technology-intensive firms. It further suggested that the government consider measures such as set asides and a more active unsolicited proposal program to support the development of innovative products and services.

In *Building a More Innovative Economy*, the federal government announced a number of initiatives in the area of procurement:

- A set aside program for Canadian small businesses and Aboriginal businesses will provide exclusive access to purchases below \$125 000 when qualified, cost-effective suppliers are available. For purchases between \$25 000 and \$125 000, the set aside will be available to all Canadian small firms through the open and transparent Open Bidding Service. This will be accompanied by complementary measures to facilitate Aboriginal business awareness and participation in federal procurement markets.
- Another program will set aside selected procurement in excess of \$125 000 for preferential bidding by Canadian small businesses and Aboriginal businesses where the potential exists to support or develop innovative firms and where cost-effectiveness can be ensured. Increased emphasis will be placed on requiring prime contractors to provide subcontracting plans to Canadian small businesses and Aboriginal businesses. In addition, procurement destined primarily for Aboriginal populations will be reserved for Aboriginal businesses. The preference will require procurement to be advertised on the electronic Open Bidding Service with the criteria for participation clearly stated.
- The government will also initiate a pilot program called *First Market Opportunities*, which will provide bridge or supplementary funding in addition to the current brokerage function of the Unsolicited Proposal Brokerage Service. The main objective of this program is to use procurement to enhance the technological capabilities of small businesses and provide a test bed, or first market opportunity, for processes or products that have international market potential. This project is expected to run for three years starting in 1995.

CHAPTER 5

SKILLS DEVELOPMENT

Growing companies need good employees — the right people, at the right time, with the right skills for the job. This represents a major challenge in an increasingly knowledge-intensive economy, where frequent retraining and skill-upgrading is required. Many small businesses find it difficult to fund formal training.

Small businesses face an equally difficult challenge in developing the management skills required to develop and maintain a competitive business. A number of studies have shown that small businesses often have poorly developed skills in marketing, finance, human resource planning, technology and strategic planning — all areas that are critical to business success.

The main responsibility for employee and management skills development lies with individuals themselves and the businesses that employ them. As the Small Business Working Committee pointed out, the primary role of government should be to facilitate those efforts. Federal initiatives should not attempt to duplicate or replace private-sector efforts to build a strong, flexible base of skilled workers and managers.

Key recommendations were that government efforts should focus on:

- **encouraging partnerships** among business, labour, educators and training institutions to address skill-development needs
- **rationalizing and increasing the relevance of federal labour market programs**, so they support workplace skills needed by employers in the most cost-effective way
- **new approaches to apprenticeships and cooperative education**, especially towards improving skills required for the

knowledge-based economy and training Canada's young people

- **addressing gaps in management skills**, primarily by helping small businesses work with educators and training institutions to identify those gaps, and by making information on available resources easily accessible.

ENCOURAGING PARTNERSHIPS

Individual small businesses seldom have the time or the resources to conduct extensive research into current and future skill needs, or to develop appropriate training programs based on that research. Businesses within a sector or industry, however, have found that they can overcome this limitation by working together — to identify and address their common needs and establish closer ties to educational and training institutions. The federal government can play a valuable role in facilitating these partnerships.

Sector Councils

There has been considerable progress in mobilizing private-sector training initiatives through Sector Councils. These councils represent employers and workers within a sector or industry. With initial start-up funding from the government, they identify current and future training needs within the sector, establish occupational standards and develop an industry-led training program. Each of these training programs is intended to be financed by the industry once it is up and running. Sector Councils already exist in the electronic, tourism, horticulture and auto repair industries, and other industries where small businesses play a key role.

Among the key roles of these councils is the establishment of up-to-date, industry-

wide skills standards for occupations within their sector. This includes undertaking long-term human resource planning to identify future job requirements. Such planning helps the councils work with colleges and universities to ensure an adequate supply of graduates with the right skills. In some cases — with the Canadian automobile repair sector, for example — Sector Councils are working closely with the educational sector to first develop new training courses, then help train college teachers, and finally, launch cooperative education programs for students.

Sectoral Partnerships: An Example

The Electrical and Electronic Manufacturers' Association Sectoral Council — representing both workers and employers in the industry — has shown how partnerships can improve skills, boost productivity and create jobs.

Unions and management set up a training fund with contributions from participating firms matched by a joint federal-provincial contribution. The fund is used to support training based on three key principles:

- Decisions about the kind of training offered are made at the local plant level.
- The shop floor is the best training ground.
- Training decisions are made by consensus — recognizing that effective training must benefit both workers and employers.

Productivity gains sparked by the training fund have already created new jobs as companies become more competitive in the marketplace.

These councils have shown how partnerships in developing internships and career development assignments can benefit industries and individual small businesses. The Sector Councils' approach is particularly attractive, since a small government seed investment can lever considerable investment in training by the industry.

RATIONALIZING AND INCREASING THE RELEVANCE OF LABOUR MARKET PROGRAMS

One of the main recommendations of the Small Business Working Committee is to rationalize federal labour market programs to make them more relevant to local labour market needs and the needs of small business.

The 1995 federal budget announced that as part of the Program Review, HRDC will streamline, restructure and combine its programs and services into a unified Human Resources Investment Fund. The fund will focus on actively helping unemployed people find and keep jobs, combating child poverty and providing assistance to those who need help most. In establishing this new fund, HRDC will pursue its effort to improve labour market programs and make them more relevant to labour market needs. Consultations following the release of the discussion paper *Improving Social Security in Canada* in October 1994, have highlighted the need to redesign labour market programs with a view to making them more flexible, more market-driven and better focused on measurable results. Key to achieving these objectives will be greater emphasis on local-level decision making and working in partnership with provinces and the private sector. As part of the Social Security Reform, details of the new Human Resources Investment Fund will be announced later this year.

New Approaches to Apprenticeships and Cooperative Education

Small business supports closer cooperation between the federal and provincial governments in specific skills development initiatives. For example, the Small Business Working Committee has argued that the

federal government should work closely with provincial and territorial governments, educational authorities, business and labour to extend the apprenticeship model into new occupations — especially those in the burgeoning service sectors of the knowledge-based economy. It should seek to increase the proportion of the labour force that takes advantage of provincial apprenticeship programs, attract younger people into apprenticeship programs, and work with the provinces and territories for greater harmonization in apprenticeable trades.

The Small Business Working Committee also argued that cooperative education can give young people a perspective on the skills needed to succeed in the workplace. It suggested that the government promote and facilitate expansion of cooperative education by all key stakeholders, particularly secondary and post-secondary educational institutions, and small and medium-sized businesses. While education is wholly within provincial jurisdiction, the federal government encourages and supports the development of cooperative education.

The federal government agrees that apprenticeship models of training have proven effective, both in Canada and in other countries. Through the Youth Internship Program, the demonstration phase of which was launched in 1994, the government is working with the provinces, territories, education and training institutions, industry Sector Councils and communities to develop up to 20 000 internships a year for young people in new and emerging sectors of the economy. It is also supporting initiatives by the Canadian Labour Force Development Board and the Canadian Council of Directors of Apprenticeship designed to

improve the effectiveness of the apprenticeship system including the applicability of common occupational standards.

Training under the Unemployment Insurance Program

At present, the program funds for Unemployment Insurance (UI) recipients in need of training or other employment assistance are provided by the UI account. The Small Business Working Committee, business representatives active in the Canadian Labour Market and Productivity Centre and associations such as the Canadian Federation of Independent Business have all strongly argued against the use of UI funds for such training programs. They also insist that funds from the UI account should only go to UI beneficiaries and should not be used to fund other labour market and social programs.

The government intends to reform the UI Program to make it a more effective instrument in support of employment. Legislative reforms will be tabled in the fall of 1995. Funds will be channelled from those aspects of the benefit structure that create dependence and stifle the economic energy of the country, to investments in people to make them more employable. Increasing the active assistance provided to the unemployed is an objective of labour market policy which is strongly recommended by the OECD. In this regard, consideration will be given to more flexible use of unemployment insurance funds to provide more effective employment assistance to Canadians.

MANAGEMENT SKILLS

Improvements in the skills of employees must be matched by the development of appropriate skills among business managers.

Management skill deficiencies can have far-reaching consequences. For example, a task force commissioned by the Canadian Labour Market Productivity Centre to study the problem of small business access to capital has pointed out that, from a lender's point of view, poor management skills constitute one of the major reasons why firms fail to obtain financing.

Human Resources Development Canada has undertaken a number of initiatives which focus specifically on small business management skills development. The department is working with Industry Canada, the FBDB and other organizations to identify gaps not filled by private sector providers of management skills development training. It is looking at use of the Sector Councils as an intermediary to provide such services which would allow small business owners/operators to enhance their management skills.

Industry Canada is working with sectoral and non-sectoral associations, universities and research organizations to develop management workshops, seminars and training for small business. Areas of focus include total quality management, strategic alliances, expanding into new markets and managing innovation. In February and March 1995, the Atlantic Council for Organizational Excellence, in partnership with Industry Canada, ACOA, the FBDB and the provinces, is holding 15 total quality management seminars in the Atlantic region.

A variety of private-sector practitioners have developed diagnostic tools for accurate identification of management skills deficiencies. Industry Canada has participated in assessing some of these products

to determine their impact on the economic performance of companies and to explore the possibilities of further testing development and more widespread application in Canada. The diagnostics currently under review include *Readiness for Change* and *Total Company Assessment* of the Saskatchewan Research Council, and the *Manufacturers Assessment Methodology* and *Market Scout* tools of the Alberta Research Council. Diagnostic tools will also be applied to a group of businesses in the Manitoba aerospace industry this spring.

In addition, the federal government will support the creation of a Management Information Network to facilitate efficient interaction among business clients, intermediaries and suppliers of management development products and services. Intended primarily to serve small business, the network will be an electronic partnership involving government, non-profit and private suppliers. Suppliers will be responsible for maintaining the integrity of their product service, including quality control. Industry Canada will manage this partnership and will provide the electronic integration and brokerage system. Current plans call for development of a prototype and piloting the concept in 1995-96.

Entrepreneurship Development

As noted by the Small Business Working Committee, the emergence of the new economy will require a high degree of entrepreneurship development as well as more conventional management skills. A strategic priority for ACOA is entrepreneurship development, including promoting entrepreneurship as a valid career option for youth. With its partners, the agency is looking at the training requirements of small business owners, including

work-to-school transitions, apprenticeships, distance learning and cooperative learning programs. As well, entrepreneurship development is a priority in FORD-Q's new programming. FORD-Q is working with the FBDB to develop international entrepreneurship among small business owners through the NEXPRO initiative (see Chapter 7, International Business, for more details). FedNor is providing funding to partners such as community colleges, the FBDB and Business Development Centres to provide pre-business start-up training to individuals wanting to start a business.

Business Networks

The Standing Committee on Industry pointed out that countries such as Italy, Japan and Denmark have achieved remarkable success through networking — establishing cooperative linkages that help maintain the viability of small businesses in a highly competitive environment.

Business networks help small businesses to:

- *acquire world-class business skills*
- *gain access to new financial instruments and capital*
- *use competitive advantages based on knowledge, innovation, new technologies, quality and productivity*
- *develop and diversify global export markets.*

The government is working with the Canadian Chamber of Commerce, representing the Canadian Business Networks Coalition, to undertake a National Business Networks Demonstration program. This program will consist of wide information dissemination on networks, regional round tables to promote the concept, and network broker training. It will support 30 sectorally and regionally balanced networks identified on the basis of commercial viability and potential to compete internationally. As well, a key component of FORD-Q's new mandate is a service to help establish a small business network, with emphasis on export readiness and new technologies.

CHAPTER 6

SCIENCE AND TECHNOLOGY

In *Building a More Innovative Economy*, the government recognized the importance of science and technology in supporting a spirit of entrepreneurship and a more competitive economy. The government also recognizes that, as the primary engine of economic growth, small business should be a key target for efforts to enhance Canada's performance in technology.

The Small Business Working Committee noted that Canada's performance in science and technology needs improvement. Canadian firms take longer than their foreign competitors to commercialize new technology, and the percentage of Canadian firms carrying out R&D is lower than in other countries. In addition, the committee pointed to the lack of technology management skills among entrepreneurs and a general lack of technical skills in the Canadian work force (see Figure 3).

The committee concluded that support for innovation must be clearly focused on the *commercialization* of science and technology, closely linked to the marketplace. It also emphasized that government initiatives should adopt a more holistic approach to help innovative firms succeed — an approach that builds stronger links between the various stages of inno-

vation, from basic research to commercial application, marketing and development.

The government agrees. A holistic approach is critical to building a national system of innovation that facilitates the rapid transfer of ideas, technology and new production processes throughout the economy. To this end, the government is concentrating its efforts in four key areas:

- **building partnerships** — encouraging closer collaboration between all players, from scientists through to businesses
- **improving strategic access to information** — ensuring that small businesses and entrepreneurs benefit from the increasing flow of technological information
- **tax incentives for innovation** — improving the effectiveness of the R&D tax incentives
- **science and technology review** — optimizing federal investment in S&T.

BUILDING PARTNERSHIPS FOR INNOVATION

The Canadian Technology Network
The government launched the Canadian Technology Network in August 1994. A key building block for a national system of innovation, this network will help small and medium-sized Canadian businesses acquire, adapt, commercialize and manage new and complex technologies, in partnership with the Canadian research community. It provides businesses with rapid access to information on domestic technology and will subsequently be extended to include international technology. The network was developed jointly by Industry Canada and the National Research Council's Industrial Research Assistance Program (IRAP). IRAP, with a national field force of over 250 Industrial Technology Advisors,



* Difference in Mean Score for a given strategy between the more-successful and less-successful firms. Success is defined by the level of a firm's increase/decrease in the market share.

will implement and manage the network. Other partners include the regional agencies, the Association of Federal/Provincial Research Organizations, Technology Outreach Centres, the university community and the private sector.

Technology Partnerships Program

The government launched the Technology Partnerships Program in January 1995. The program promotes collaboration between Canadian universities, federal laboratories and small businesses to commercialize technology developed in the university sector. This initiative provides strategic support to stimulate the commercialization of Canadian innovation through a mechanism to share the costs of product development between the private sector and the university community. This is the result of a partnership between Industry Canada, the Natural Sciences and Engineering Research Council, the Medical Research Council, and the Social Sciences and Humanities Research Council.

Canadian Environmental Industry Strategy

In September 1994, the government undertook to deliver support to the environmental industry — one of Canada's most innovative — in a direct, easily accessible, cost-effective manner. A partnership, including all levels of government, regional agencies, the environmental industry association and the National Environmental Technology Advancement Centres, is implementing this strategy.

Support for International Linkages

The competitiveness of Canadian small businesses depends in part on their ability to develop and commercialize innovative technologies, as well as on accessing tech-

nologies from abroad. The government assists Canadian firms, particularly small businesses, to access international technology opportunities in a number of ways, for example, by directing funds to promising R&D initiatives through mechanisms like the Canadian Environmental Industry Strategy. The government also facilitates the participation of small businesses in international R&D alliances and helps them to acquire best-practice technologies from abroad. The government also promotes international rules and agreements to make international technology opportunities accessible to Canadian companies.

Raising Awareness

The federal regional agencies play an important role in assisting the commercialization of R&D, and have recently taken steps to focus efforts on this critical component of economic growth. For example, ACOA provides small business access to information about emerging technology and, with Nova Scotia, is sponsoring the Nova Scotia Technical People in Industry program to help small businesses hire recent graduates skilled in the application of technology.

STRATEGIC ACCESS TO INFORMATION

The Information Highway

Canada has a world-class telecommunications industry and infrastructure. This gives Canada a distinct advantage in developing the information highway. The information highway will allow wider communications over a broader range of media to ever-larger numbers of individuals and organizations than previously possible. Small businesses will benefit from easy access to information and services previously unavailable to them. The federal government will increasingly use this medium to provide strategic

information. For example, Industry Canada is currently developing a menu of information products that will help Canadian businesses find and exploit business opportunities at home and abroad.

The recently renewed *Telecommunications Act* is designed to increase competition, encourage investment and expand markets in this burgeoning sector. The Canadian Radio-television and Telecommunications Commission this past year unveiled a new regulatory framework which also supports a more competitive market. These new directions mean the small business sector can look forward to a wider range of products and services from which to choose and, more importantly, greater access to technical information services.

Science and Technology Canada

Science and Technology Canada is a technology information service currently being developed by Industry Canada. It is a user-friendly computerized system which provides information on the location and nature of science and technology activities performed throughout Canada. It is aimed at the small business sector, university researchers and government laboratory scientists who are seeking technology partners, new technology products or services and potential clients for their own technologies.

TAX INCENTIVES FOR INNOVATION

One way the federal government supports innovation is through an investment tax credit (ITC) for scientific research and experimental development (SR&ED). Qualifying small Canadian-controlled private corporations receive an enhanced tax credit. The small business community feels that R&D tax incentives are an impor-

tant measure to help small firms finance the inherently risky process of R&D.

The Small Business Working Committee recommended that the enhanced tax credit for small corporations not only be maintained, but expanded to include a broader scope of innovation activities. In addition, the committee recommended that:

- qualifying companies should remain eligible for the enhanced credit for three years after an initial public offering
- the government should adopt procedures to ensure consistency of interpretation, including a pre-approval and/or a summary approval procedure
- the government should simplify audit procedures related to the tax credit
- the government should establish a clear, fast and independent appeal process.

The Canadian SR&ED tax incentive system is the most generous in the industrialized world and is generally recognized to be working well. A number of changes have been made in recent years to simplify the system and make it fairer. These changes introduced an optional proxy method to simplify the determination of eligible SR&ED overheads and broadened the eligibility for enriched benefits to include Canadian-controlled private corporations with taxable income between \$200 000 and \$400 000.

The government acknowledges that expanding the SR&ED tax credit could encourage a broader scope of innovation activities. However, no immediate action can be expected due to the current fiscal constraints, the considerable amount of assistance already provided, and the difficulties associated with defining and administering this broader concept.

The proposal to maintain eligibility for the enhanced benefits for three years after the initial public offering has been carefully examined by the government. The government is of the view that the difficulties which smaller companies face when raising financing are reduced when they go public. Although an argument could be advanced in support of some form of shorter term transitional relief, the government is concerned that the provision of such relief would be complex and difficult to administer. Therefore, the government will not change the current rules on the eligibility for the credit after an initial public offering.

As indicated in the Auditor General's 1994 report and in the February 27, 1995, budget, the Department of Finance and Revenue Canada are undertaking a thorough evaluation of the tax incentives. In addition, the budget announced an accelerated review of the component of the evaluation dealing with information technology R&D. These actions are part of the government's ongoing efforts to monitor, review and refine the system of SR&ED tax incentives to ensure that they are effective.

Revenue Canada is committed to ensuring consistent application of the program; audits that are effective and efficient; and an appeals process that is clear, fast and unbiased. Administrative procedures are constantly being reviewed and further options may be considered to ensure effective administration of the program. With regard to the pre-approval procedure, recommendations made by the Small Business Working Committee have been reviewed by Revenue Canada in consultation with its SR&ED Advisory Committee. On the basis of this review, Revenue Canada considers that the suggested administrative changes would not be feasible at this time.

SCIENCE AND TECHNOLOGY REVIEW

The federal government is the largest investor in science and technology in Canada. The effectiveness of its investment, therefore, is a major determinant of the quality of the country's science and technology performance. The Small Business Working Committee urged the government to review all government programs to ensure they are working as intended and are sensitive to the needs of small business. In June 1994, a national policy review was launched to ensure federal science and technology investments promote economic growth and job creation, enhance the quality of life and advance the leading edge of scientific knowledge. It will outline new directions for federal science and technology expenditures. The initial phase of this review is expected to be completed in the coming months.

The review of the science and technology strategy will pay particular attention to the development of regional/local partnerships that support regional strengths and priorities. For example, together with Industry Canada and the National Research Council, WED is working with the four western provincial governments to articulate a Western S&T Strategy, building on the directions established in the federal S&T review. This cooperative, integrated approach to public sector efforts in support of science and technology for small business will ensure effective targeting of limited resources. In particular, the strategy will focus on the commercialization of R&D and the development of dynamic "clusters" of regional, industrial, scientific expertise within private and public facilities. The "cluster" approach will build on local strengths in both science and business.

CHAPTER 7

INTERNATIONAL BUSINESS

Traditionally, small business has been reluctant to participate directly in international business. It has lacked the information, contacts, skills and resources to compete effectively in an international marketplace dominated by large corporations. In today's global economy, however, small business no longer has a choice — it is a part of the international marketplace.

The primary responsibility for increasing trade lies with business; it is up to business to make itself ready to take up the challenge.

Breaking through Barriers,
Small Business Working Committee

Enhanced international business is a keystone of the government's economic policy, as outlined in the policy paper *Building an Innovative Economy*. That paper discussed a wide range of new and ongoing initiatives to help Canadian businesses compete in foreign markets. For example, to ensure that Canadians can compete on a level playing field in international markets, the government is working to reduce both tariff and non-tariff barriers.

However, the government also recognizes that small businesses face unique challenges when attempting to develop export markets or international business linkages. To help address these challenges, the Minister for International Trade asked 13 members of the business community, representing businesses of many sizes, to review the government's support for international business development. In addition, the Ministers of International Trade, Industry and Finance met with 13 banks and financial institutions to develop an *SME Exporter Action Plan* which identifies priorities for improving financial support and access to information for small business exporters. Through these reviews, as well as those by

the Small Business Working Committee and the Standing Committee on Industry, the small business community identified several areas to be addressed:

- accessing clear, comprehensive information and intelligence on international businesses
- improving support services to small businesses
- strengthening partnerships to set priorities and make better use of existing infrastructure
- obtaining appropriate financing.

INFORMATION ON INTERNATIONAL BUSINESS

The Small Business Working Committee, among other committees, acknowledged that a great deal of trade-related support for small business is already available in Canada from both the private and public sectors. Nevertheless, surveys such as the Canadian Chamber of Commerce's *Aim for a Million* initiative suggest that smaller firms lack access to market information, and that this is an important barrier to increased exporting. Access to this information is made all the more difficult because of fragmentation of sources. The small business community has consistently argued that there is no single, easily accessible source of information on market opportunities and market intelligence. As well, the various government and private-sector providers of information may not be as sensitive as they could be to the needs of small and medium-sized enterprises.

To address the first problem, the Department of Foreign Affairs and International Trade (DFAIT) has introduced a number of initiatives to help small businesses — which make up over 90 percent of the department's clients — gain access to timely, strategic information. For example,

international business documents are now available 24 hours a day by fax through the department's *FaxLink* service and through an electronic bulletin board connected to Internet.

Canadian firms, particularly those new to exporting, are frequently frustrated by the fragmented access to information on trade finance, export finance, and export business development available from public and private sources...The task of searching for information on a needed export service or program from the currently available array can be overwhelming.

Servicing SME Exporters — Government and Banks
Working towards Better Support

Recognizing, however, that before companies can access this information they must learn how, a *Step-by-Step Kit for Accessing Information on Federal Government Programs and Services for Exporters and Potential Exporters* was developed to introduce smaller firms to DFAIT's main information channels. In addition, *The Road Map to Exporting and Export Finance*, a user-friendly guide to information sources, was developed by DFAIT, banks and other financial institutions.

To increase the sensitivity of trade officers to the needs of small business, the government is stressing training, with a focus on SMEs, in the areas of market intelligence and information, helping services exporters, and investment and strategic alliances. As well, to enhance the ability of trade officers around the world to pass on market intelligence directly to small businesses, DFAIT is improving its internal information systems. For example, the Trade Enquiries Sourcing Team (TEST), a "quick response" unit, was established as a pilot project to speed the flow of trade leads received from Trade Commissioners abroad to Canadian industry, particularly small businesses.

The *SME Exporter Action Plan* recognized the important role played by financial institution specialists providing business information about exporting and export finance. As a result, beginning in the spring of 1995, the Canadian Bankers Association is coordinating a training initiative to raise the industry's awareness in these areas, including the roles of government programs and services.

IMPROVING SUPPORT SERVICES

Focusing Support

The International Business Development Review Committee recommended that the government focus support for international business development on key foreign markets and promising industrial sectors. The government is targeting the high-growth markets of Asia-Pacific and Latin America, and is allocating resources to these markets to meet client demands. Trade offices will be opened or strengthened in key growth markets, such as Vietnam, Korea, China and Chile. As well, in the United States and Western Europe, the government is shifting the focus of its support to investment and strategic alliances.

The International Business Development Review Committee also recommended that the government focus international business development financial support on small businesses and encourage them to become active exporters. In response, resources assigned to the Program for Export Market Development (PEMD) will be focused on firms with annual sales of less than \$10 million, or fewer than 100 employees in the case of manufacturers, 50 in the case of services firms. The Market Development Strategies portion of PEMD will also be changed so that assistance can be provided for the implementation of a

company's two-year marketing plan. In Quebec, small business access to PEMD will be increased through FORD-Q's 13 regional offices.

Building Export Readiness

The Small Business Working Committee recognized that it is the responsibility of business people to prepare themselves for the challenges of international business. Small business has also said, however, that business could benefit from help in identifying and evaluating the available export training options. Export-ready firms are also interested in mechanisms to help develop linkages to the trade practitioners, trade associations and experts who can provide valuable advice and ongoing mentoring.

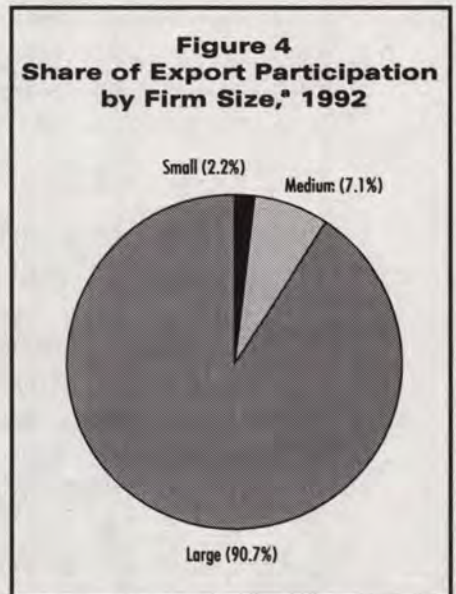
The federal government is cooperating with the private sector and the academic community in funding the initial start-up phases of the Forum for International Trade Training (FITT). In February 1995, Industry Canada, DFAIT, HRDC and FITT reached a funding agreement which should see the forum placed on a self-financing basis in 1996. Since its inception three years ago, the forum has already created a wide range of courses to develop export-readiness skills. FITT will put an increased focus on sector-specific customized training programs. In addition, the FBDB, with Industry Canada and FORD-Q, and the forum are cooperating in developing the NEXPRO program for new exporters. Furthermore, the federal government is developing measures to improve information and access to domestic and global market opportunities for companies through the Canadian Environmental Industry Strategy.

STRENGTHENING PARTNERSHIPS

Small business exporters account for a relatively small proportion of Canada's exporters. Smaller firms face significant challenges in identifying and exploiting export opportunities (see Figure 4).

Federal and provincial governments have in the past provided separate, sometimes overlapping services to assist exporters. We recognize that this duplication is no longer sustainable. The federal government is committed to a Trade Team Canada approach to use existing resources better, including federal-provincial co-management of international trade services where there is provincial interest.

To help focus support on priority areas, the government will strengthen Canada's Export Strategy, known as the International Trade Business Plan. A key focus of the plan is developing and coordinating international strategies, priorities and activities across the federal government in close consultation with the provinces and the private sector.



^a Size is defined by the value of goods/services exported:
Small = less than \$500 000
Medium-sized = \$500 000 to \$5 million
Large = over \$5 million

Source: Estimates prepared by Entrepreneurship and Small Business Office, Industry Canada, based on data provided by Statistics Canada.

Building Tourism through Partnerships

To address the needs of Canadian tourism businesses (more than three-quarters of which are small businesses), a National Tourism Initiative has been developed. A Canadian Tourism Commission will work with public and private-sector partners to coordinate tourism promotion within Canada and abroad. The latter will include a broad range of activities including advertising, public relations and marketplace familiarization tours.

As well, important initiatives in support of tourism development have been undertaken at the regional level. The Atlantic Canada Tourism Partnership is a three-year marketing initiative that brings together major stakeholders in tourism to undertake specific projects such as tourism research, tourism technology and human resources development. Last year, over 70 small and medium-sized tourism operators participated in this partnership.

WED recently developed a five-year Western Tourism Strategy in partnership with the private sector and the four western provincial governments. This strategy will include a package of Aboriginal/heritage tourism initiatives focused on eco-oriented outdoor experiences and broader application of technology throughout the industry.

Building Trade and Investment Partnerships with the Private Sector

Small business has suggested that private-sector-driven business centres in foreign markets would provide Canadian business people with convenient bridgeheads from which to penetrate new and unfamiliar markets. For instance, the government's recent opening of a Canadian Business Centre in Mexico City is a possible model.

Ontario and the federal government have agreed to improve coordination of international business development activities. The government is pursuing similar agreements with other provinces.

In May 1994, the government signed a Pan-Atlantic Cooperation Agreement on International Business Development with the four Atlantic provinces to optimize coordination of trade-related activities and effectiveness of limited resources.

Western Economic Diversification and western provincial counterparts recently agreed to pursue coordinated trade promotion efforts. The focus will be on the development of Asia-Pacific and Latin American markets by Western Canadian entrepreneurs and on specific sectors, such as energy and agriculture.

The Federal Office of Regional Development — Quebec coordinates federal efforts with provincial and private-sector initiatives. As well, FORD-Q is working with DFAIT on international business development strategies of particular concern to Quebec's entrepreneurs.

This is a user-pay, multipurpose trade centre designed to provide Canadian firms, particularly small and medium-sized enterprises, with exhibition space, temporary executive offices, telecommunications services, and fully equipped seminar and conference rooms. The centre is a pilot project that may serve as a model for future business centres abroad.

There is growing recognition by both government and business of the role that international investment plays in creating jobs and competitive firms. The government is working with the private sector to attract foreign capital to support the growth of small businesses. Current efforts to help small businesses find international investment partners and best-practice technologies will be expanded to include more sectors. For example, DFAIT is working with the Canadian Advanced Technology

Association to introduce international venture capitalists to promising Canadian technology firms. Other improvements include the use of multimedia technology to prepare profiles of small Canadian firms that allow their executives to tell potential international investment partners about their companies, their technologies, their objectives in seeking an investment partner and what they have to offer.

Building closer ties with industry associations is another clear way in which the government can take advantage of existing infrastructure to provide more effective international business-related services. In the business service sector, more than 40 industry associations have been contacted about developing export strategies based on member surveys that would identify market priorities and information needs.

FINANCING FOR SMALL BUSINESS EXPORTERS

Small firms often have difficulty securing sufficient operating capital to finance production for export or to maintain cash flow while completing shipments and waiting for payment.

The Standing Committee on Industry has recommended that the federal government establish a limited working capital guarantee for small and medium-sized business exporters. This would encourage the banks to provide financing for the pre-shipment phase of exporting to support the purchase of materials, components, parts and labour to be used in producing goods and services for export contracts. The Small Business Working Committee called for greater availability of export financing, at both the pre- and post-shipment phases, and emphasized that pre-shipment financing assistance must be accessible for foreign

sales in general, and not be restricted to purchases by foreign governments or international financial institutions.

The government, through the Export Development Corporation (EDC) and the Canadian Commercial Corporation (CCC), in cooperation with private-sector financial institutions, has launched three major initiatives which will improve financing for small business exporters.

First, the CCC recently introduced a Progress Payment Program designed to make pre-shipment export financing more accessible to small and medium-sized exporters. This will allow an exporter to draw on a special line of credit established by its principal banker and approved by the CCC for a particular export sale. The CCC will monitor the contract and, as the work progresses, approve progress payments based on the exporter's cost. On contract completion, the CCC will collect from the exporter's customer and reimburse the financial institution from the proceeds. The program is available for transactions with foreign governments as well as private-sector buyers.

Second, the EDC has proposed a program to encourage financial institutions to extend operating lines of credit against the foreign accounts receivable of their small business customers. Under the proposed program, the EDC would guarantee the payment of a portion of an exporter's foreign accounts receivable to the exporter's bank. Discussions are presently under way with two Canadian banks to begin running pilot tests of this new facility in early 1995. In addition, the banks themselves have re-examined their treatment of foreign receivables, with a view to giving greater value to U.S. receivables.

Third, a closer partnership has also been achieved between the EDC and Canadian financial institutions in the provision of medium-term financing for exporters, particularly small businesses. In November 1994, EDC and the banks reached agreement on an SME Risk-Sharing Framework targeted at exporters with annual export sales of less than \$10 million. The framework allows Canadian banks to provide medium-term buyer financing with a partial EDC guarantee for certain types of transactions in a large number of developing country markets.

TAX INCENTIVES FOR EXPORT DEVELOPMENT

The federal government's tax assistance to small business — including the Small Business Deduction, as well as the tax credit for scientific research and experimental development — provides significant indirect support for small firms seeking to develop export markets.

The Small Business Working Committee feels that, in addition, the federal government should provide a refundable Export Market Development Tax Credit. The view of the committee is that it would encourage small firms to target export markets by offering tax relief based on the costs of researching and developing foreign markets.

There are several considerations, in addition to cost, that require closer examination before the government could consider providing an Export Market Development Tax Credit. For example, the introduction of such a program would appear to be inconsistent with our international trade obligations (e.g. GATT 1994). It would also be inefficient in promoting exports — many non-tax factors such as exchange rates and comparative advantage over other competitors are more important determinants of trade. Furthermore, such a credit would provide tax relief even in cases where there is no increase in export activity. Finally, such a program, if implemented through the tax system, would necessitate complicated legislation to prevent abuse. Without very precise and restrictive rules, a variety of both business and personal expenses could be construed as export-promoting.

LOOKING AHEAD

Taken together, the initiatives discussed here represent a significant milestone in the implementation of a new, more responsive approach to small business in Canada. But they do not represent the end of the journey.

Creating a climate that supports and encourages a dynamic, innovative small business sector requires a long-term commitment to action — by the federal government, other levels of government, financial institutions and small businesses themselves. The federal government has made that long-term commitment. We will be implementing the initiatives and program changes discussed here over the next few months.

As mentioned in the introduction, the small business community is looking to government to make major inroads into the deficit. We have done this. Like the rest of the business community, small businesses demanded an end to business subsidies. The budget has made it clear that major reductions have been achieved in this area.

The inevitable result of the reduction in spending is that the federal government must increasingly work through partnerships, leveraging its limited resources into effective support for small business. We will have a smaller, more affordable public sector, which can still provide quality service in partnership with others. That is why we place a focus on federal-provincial cooperation in responding to the call from small business for fewer, more flexible and relevant programs. As a beginning, federal and provincial governments have cooperated

in putting in place an infrastructure to provide access to the programs which remain. Other examples of partnerships include the adoption of common approaches to international business development with interested provinces, and work with industry and the provinces on regulatory and industry standards.

While steps have been taken to improve access to private-sector sources of capital, the government will continue to press the financial services industry to increase the quality and availability of their support for small businesses in the areas of debt and equity financing.

Given the scope of the changes outlined in this report, their implementation will require constant input from the small business community. The government has already established consultative mechanisms with this community which will provide fora to monitor the impact of these changes.

The recent consultations have already done much to generate a new understanding and appreciation of the small business community in Canada. These consultations have formed new and stronger links among all those involved. This is an important accomplishment, and these new links need to be maintained.

The government is grateful to all those who have devoted so much time and energy to this review over the past year. Our collective challenge is to sustain this energy and commitment to achieve solid, lasting economic growth.

