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Canada

# AN EVALUATION ASSESSMENT OF THE SMALL BUSINESSES LOANS ACT PROGRAM

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# SMALL BUSINESSES LOANS ACT PROGRAM

**Prepared for:**

THE EVALUATION DIRECTORATE
Department of Regional
Industrial Expansion

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## EXECUTIVE SUMMARY

### PURPOSE OF REPORT

The objective of this report, and the evaluation assessment upon which it is based, is to provide background and outline the objectives of the Small Businesses Loans Act (SBLA) Program; identify the main questions and issues surrounding the program and its delivery; the methodologies which might be used in its evaluation, and to provide a set of evaluation options.

### PROGRAM DESCRIPTION

The Small Businesses Loans Act (the Act) was brought into effect in January 1961 for the purpose of encouraging lenders in the private sector to make term loans to small business enterprises.

Under the Act, the Minister is liable to pay to an approved lender 85 percent of the amount of any loss sustained by the lender as a result of a business improvement loan made, provided requirements specified in the legislation are met. The principal requirements relate to the maximum amount which may be outstanding to an individual borrower at any one time, the minimum security to be taken, the maximum rate of interest which may be charged to a borrower, the maximum repayment term, the eligible purposes for which a loan may be made and the eligibility of the borrower as a defined small business enterprise.

The Small Businesses Loans Act has a single stated objective "to make loans to small business for improvement and modernization of equipment and premises". As a result of discussions within the Department and a review of the program documentation, it became clear that the following were both the direct and more informal objectives for the program:

- to make loans to small businesses for the purposes of purchase of fixed or moveable equipment, improvement or modernization of plant, equipment or premises; purchase or construction of premises, and purchase of land;

- to increase the availability of medium term credit to small business;

- creation of additional employment;

- increase efficiency and the competitive strength of small business; and,

- provision of term financing at lower rates than small business could otherwise obtain.

The program currently limits the size of loans outstanding under the Act to $100,000 per firm. Loans may be made only to firms who have less than $2.0 million in annual sales.

The process and operation of SBLA is characterized by its private sector delivery system and a minimal degree of departmental involvement. The promotion of the program, and credit decisions which govern its use, are in the hands of lending officers at chartered banks and other designated lenders. If they make a loan under the SBLA, the Small Businesses Loans Act administration in the Department is informed after the fact of the size and use of the loan, the class of business, name of borrowing firm and the province in which the borrower's operation is located. Unless the loan defaults and results in a claim, this initial notification represents the sum total of Departmental involvement. Should a default occur and a claim by the lender on the loan insurance result, the Small Businesses Loans Act administration determines whether or not the regulations were followed and adequate security was taken by the lender. A decision is then made by Program personnel, and the claim for payment on loan default is either accepted or rejected.

**EVALUATION OPTIONS**

From discussions with departmental officials and the Evaluation Steering Committee, a set of five themes emerged as most important for purposes of undertaking an evaluation of the Program. These were:

- pricing of the program in terms of how appropriate is the current: interest rate, up-front 1% usage fee for borrowers, and the 85/15 split in claim liability between the banks and government;
- the incrementality or benefits of the Program in terms of availability of credit, and impacts on business, government, and the economy;
- the regional distribution of the Program's benefits;
- the claim activities and resultant impacts; and,
- the lending practices used under the Program.

From an examination of the important issues and approaches associated with each of the five themes, three different evaluation options were developed. These are:

a) analyses of changes in pricing and employment impacts;
b) incrementality analysis; and,
c) cost benefit analysis.

The first option addresses the impacts of changes in the pricing of SBLA loans. This would include the impact on program usage of the changes to the Program made in 1985 and, some inferences as to what the future impacts might be if the current pricing of SBLA loans was changed. Included as well would be an analysis of one of the more important impact areas, that of the employment in the businesses receiving SBLA loans.

would be more relevant in cases of new businesses

The second option expands Option 1 considerably through the use of surveys of SBLA lenders and borrowers. This would enable an analysis of many of the Program's impacts including those of availability of credit as well as other business impacts such as profitability and growth.

The third option then examines the most comprehensive level of impacts, that of the net economic benefit of the Program to the economy. This requires a comprehensive approach using cost benefit analysis.

Table 1 provides a summary of each evaluation option, the information required, outputs expected and preliminary cost estimates.

**RECOMMENDED OPTION**

After a careful review of each of the three options presented for a potential evaluation of the Small Businesses Loans Act Program, the Evaluation Steering Committee recommended that Option 1 be implemented. This option would focus upon impacts of the changes in the pricing of SBLA loans and provide an estimate of the employment impacts which have resulted from the Program.

Was option 1 or 2 decided upon ?

**TABLE 1: SUMMARY OF EVALUATION OPTIONS**

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| OPTION | INFORMATION REQUIRED | EXPECTED OUTPUTS | ESTIMATED COSTS |
|---|---|---|---|
| 1. Analyses of changes in pricing and employment impacts | • profile of Program users and of SBLA loans; Statistics Canada's corporate financial data | • an indication of how pricing changes will impact upon Program users<br>• estimates of employment impacts resulting from the Program (weak information on Program incrementality) | $39,000 |
| | • indications of banks' normal loan loss rates versus SBLA loss rates | • an indication of how pricing changes will impact upon lenders | $ 21,000<br>$ 60,000 |
| 2. Incrementality analysis | • information required for Option 1<br>• detailed information obtained from a survey of borrowers and lenders | • outputs described in Option 1<br>• estimates of incrementality of SBLA lending & employment impacts<br>• estimates of the complimentarity of SBLA loans to other types of loans | $ 60,000<br>$ 40,000<br>$100,000 |
| 3. Cost benefit analyses | • a detailed profile of lenders and borrowers; detailed profile of total lending activity within specific communities; identification of incremental benefits resulting from SBLA lending within specific communities | • cost/benefit analysis for SBLA lending within 10 representative communities across Canada | $250,000 |

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# 1.0 INTRODUCTION

The Department of Regional Industrial Expansion requested that an evaluation assessment be undertaken of the Small Businesses Loans Act (SBLA) Program. The purpose of this report is to present the findings obtained from the conduct of this assessment. Specifically, this report provides:

- a program profile which describes the legal mandate for the Program, its delivery systems and significant operational activities;

- a description of the issues relevant to the Program and its delivery, which could form the basis for a subsequent evaluation;

- a description of indicators and approaches to be used in evaluating each of the issues assessed (by the Evaluation Steering Committee) as being of significant interest; and,

- a description of three possible evaluation options, including preliminary cost estimates, which will be presented for consideration to senior management within the Department.

The purpose of the evaluation assessment is to present a design (in the form of three options) for the conduct of an actual evaluation. As such, the assessment does not attempt to resolve any of the issues identified at this phase of the evaluation cycle.

## 1.1 BACKGROUND TO THE SBLA ASSESSMENT

This current SBLA evaluation activity is the second such assessment of the Program. The first assessment and subsequent evaluation took place in 1981. The 1981 evaluation was conducted in association with the Small Business Financing Review (SBRF). The SBRF examined the Canadian capital market as it pertains to small businesses. As one of its objectives, this study looked for "gaps" in the small business financial market which were not being fulfilled by existing (1981) institutions and debt/equity instruments. This initiative required a substantial expenditure by the Department. As a result and in consideration of the complexities involved in such a study, the issues associated with the SBLA and Canadian capital markets in general, were not considered for purposes of this assessment.

However, the reader should have a context from which to view SBLA as part of small business lending. Small business **term loans** are estimated* to have a total value of some $5 billion per year. However, this is but one instrument for small business financing. For example, this figure does not include the value of "lines of credit" used to finance receivables. This same source also reported that SBLA lending represents 11% of the total value of loans for less than $200,000 made by the chartered banks. However, not all loans having a value of less than $200,000 are made to small businesses. As a final piece of contextual information, there were some 743,400 small businesses in Canada in 1984 having annual sales between $10,000 and $2,000,000. In that same period, SBLA loans totalled 34,714 with a total value of about $1 billion.

From the background information presented above, it can be seen that although SBLA lending is significant from the viewpoint of beneficiaries, these loans play a relatively small role in the Canadian capital market. This fact has important implications which create severe limitations on the measurement of economic benefits of SBLA at a national level.

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* Source: Statistics Canada/Globe and Mail, May 29, 1987.

# 2.0 PROGRAM COMPONENT PROFILE

## 2.1 PROGRAM MANDATE

The Small Businesses Loans Act (the Act) was brought into effect in January 1961 for the purpose of encouraging lenders in the private sector to make term loans to small business enterprises.

Under the Act, the Minister is liable to pay to an approved lender 85 percent of the amount of any loss sustained by the lender as a result of a business improvement loan made, provided requirements specified in the legislation are met. The principal requirements relate to the maximum amount which may be outstanding to an individual borrower at any one time, the minimum security to be taken, the maximum rate of interest which may be charged to a borrower, the maximum repayment term, the eligible purposes for which a loan may be made and the eligibility of the borrower as a defined small business enterprise.

Since 1961 there have been a number of changes to the legislation of which the following are most significant:

1. In 1971, the maximum loan amount outstanding to any one borrower at any one time was increased from $25,000 to $50,000 and a small business enterprise was redefined as one with estimated annual gross revenue not exceeding $1,000,000.

2. In 1977, the total amount permitted to be oustanding to any one borrower at any one time was increased to $75,000 and a small business enterprise was redefined as one with estimated annual gross revenue not exceeding $1,500,000.

3. In February 1978, the formula establishing the maximum interest rate permitted to a lender was changed from a fixed rate established semi-annually to the prime rate of the chartered banks plus 1 percent, floating with the prime rate for the term of the loan.

4. In July 1980, the maximum total loan amount outstanding to any one borrower at any one time was increased from $75,000 to $100,000.

5. In April 1985, a small business enterprise was redefined as one with estimated annual gross revenue not exceeding $2,000,000. A requirement was introduced for the payment, at the time a loan is made, by lenders, to the government, of a one percent fee. Also introduced was a loss-sharing arrangement whereby, instead of effectively paying a lender's total loss, the government shares losses on individual loans in a ratio of 85 percent government/15 percent lender[1].

There are as well a set of regulations governing the use of the program which are distributed to all eligible lenders.

## 2.2 COMPONENT OBJECTIVES

not new establishment ?

The Small Businesses Loans Act has a single stated objective "to make loans to small business for improvement and modernization of equipment and premises". As a result of discussions within the Department and a review of the program documentation, it became clear that the following were both the direct and more informal objectives for the program:

[1] SBLA Annual Report, March 1986.

- to make loans to small businesses for the purposes of purchase of fixed or moveable equipment, improvement or modernization of plant, equipment or premises; purchase or construction of premises, and purchase of land;

- to increase the availability of medium term credit to small business;

- creation of additional employment;

- increase efficiency and the competitive strength of small business; and,

- provision of term financing at lower rates than small business could otherwise obtain.

The program currently limits the size of loans outstanding under the Act to $100,000 per firm. Loans may be made only to firms who have less than $2.0 million in sales annually.[2]

In the 1980/81 Evaluation of the program and a subsequent OAG audit, it was pointed out that the formal "legislated" objectives from 1961 were not sufficiently precise or clear to give direction to the program. A change to this is now being drafted by the Department. This objective will more accurately reflect the direction identified in the above objectives.

## 2.3 COMPONENT DESCRIPTION

The process and operation of SBLA is characterized by its private sector delivery system and a minimal degree of departmental involvement. The promotion of the program, and credit decisions which govern its use, are in the hands of lending officers at chartered banks and other designated

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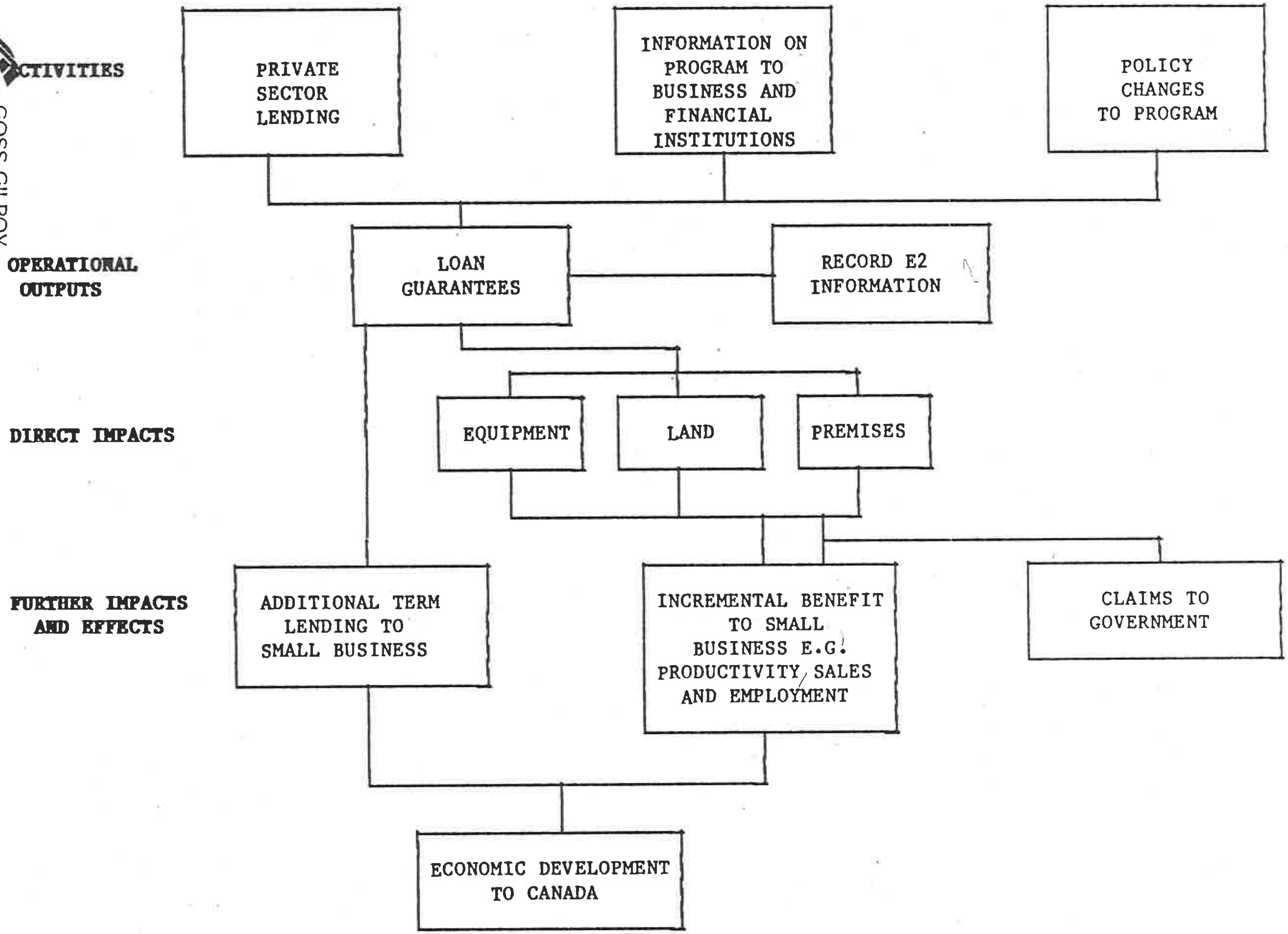
[2] 1980/81 SBLA Evaluation.

lenders. If they make a loan under the SBLA, the Small Businesses Loans Act administration in the Department is informed after the fact of the size and use of the loan, the class of business, name of borrowing firm and the province in which the borrower's operation is located. Unless the loan defaults and results in a claim, this initial notification represents the sum total of Departmental involvement. Should a default occur and a claim by the lender on the loan insurance result, the Small Businesses Loans Act administration determines whether or not the regulations were followed and adequate security was taken by the lender.

Perhaps the design features with the greatest impact on the nature and use of the program are its interest rate structure and guarantee provisions. From the inception of the Small Businesses Loans Act in 1961 until February 8, 1978, lenders were compelled to charge an interest rate derived from the weekly sale of Government of Canada bonds. This rate was almost always below the banks' prime rate and was fixed for the term of the loan. Faced with an apparently unattractive return on lending made under the program, chartered banks and other designated lenders appeared reluctant to undertake a high level of SBLA lending. The change in 1978 to a floating interest rate set at prime plus 1% has coincided with a surge in the amount of lending under the Small Businesses Loans Act.

As depicted in Figure 2.1 (SBLA Program Elements in Causal Linkage Form) direct impacts of incremental lending under SBLA on the businesses participating, operate through the firm's purchase or improvement of equipment or facilities. If the firms involved are able to realize improvements in productivity, sales or increased levels of employment, there may ultimately be some net increase in national economic output as a result of the Program unless such improvements come about in conjunction with losses suffered by competing firms. The intended program effect on the capital markets in the causal linkage diagram is portrayed as additional term lending to small business.

**FIGURE 2.1: SBLA PROGRAM ELEMENTS IN CAUSAL LINKAGE FORM**



The volume of lending undertaken annually under the Small Businesses Loans Act has grown from $25.5 million in 1961, to $268.7 million in 1979[3] and to 23,593 business improvement loans amounting to $737,823,578 during the fiscal year ended March 31, 1986. The average size of business improvement loans made during the fiscal year ended March 31, 1986, was $31,273 compared to $28,960 during the previous 12-month period.

From inception of the program in 1961 to March 31, 1986, a total of 210,533 business improvement loans amounting to $5,109,686,610 have been made. During the same period, payments were made to lenders under the loss reimbursement provisions of the legislation in respect of 6,683 — 3.18% of loans claims amounting to $134,662,719. The distribution of loans and claims is shown in Table 2.1.[4] 2.64% of total loans.

## 2.4 RELATION TO ESTIMATES PROGRAM

Included under Vote 3C of the Regional Industrial Expansion Estimates:

> "Pursuant to subsection 6(j) of the Small Businesses Loans Act to increase from $1,000,000,000 to $2,500,000,000 the aggregate lending ceiling for the period April 1, 1985 to March 31, 1990."

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3 1980/81 SBLA Evaluation.

4 SBLA Annual Report, March 1986.

## TABLE 2.1: SUMMARY OF OPERATIONS

| PERIOD | BUSINESS IMPROVEMENT LOANS (B.I.L.s) MADE | | AVERAGE SIZE OF B.I.L. | CLAIMS PAID | | |
|---|---|---|---|---|---|---|
| | Number | Amount $ | $ | % | Number | % Amount $ |
| 12 months ended Dec. 31 | | | | | | |
| 1961 - 1969 | 20 865 | 195 424 436 | 9 366 | 0.7 | 142 | 873 289 |
| 1970 | 1 367 | 13 772 340 | 10 075 | 2.0 | 27 | 148 649 |
| 1971 | 2 138 | 22 361 763 | 10 459 | 0.9 | 20 | 71 329 |
| 1972 | 2 860 | 28 453 509 | 9 949 | 0.7 | 21 | 125 955 |
| 1973 | 3 149 | 32 068 566 | 10 184 | 0.5 | 17 | 112 178 |
| 1974 | 2 947 | 37 241 269 | 12 637 | 1.3 | 37 | 239 175 |
| 1975 | 4 835 | 82 003 157 | 16 960 | 0.7 | 35 | 237 093 |
| 1976 | 5 106 | 91 893 663 | 17 997 | 0.8 | 42 | 231 896 |
| 1977 | 5 000 | 99 586 016 | 19 917 | 1.4 | 72 | 632 794 |
| 1978 | 7 319 | 176 711 904 | 24 144 | 1.7 | 122 | 1 380 584 |
| 1979 | 10 817 | 268 675 323 | 24 838 | 1.4 | 152 | 1 788 619 |
| 1980 | 16 829 | 421 421 123 | 25 041 | 1.4 | 242 | 3 825 688 |
| 1981 | 17 541 | 522 401 338 | 29 782 | 2.2 | 390 | 6 761 102 |
| 1982 | 17 376 | 450 685 148 | 25 937 | 3.2 | 561 | 11 705 508 |
| 1983 | 26 488 | 713 013 826 | 26 918 | 3.8 | 998 | 22 283 733 |
| 3 months ended March 31 | | | | | | |
| 1984 | 7 589 | 210 846 980 | 27 783 | 4.9 | 368 | 10 746 504 |
| 12 months ended March 31 | | | | | | |
| 1985 | 34 714 | 1 005 302 671 | 28 960 | 4.4 | 1 533 | 29 079 005 |
| 1986 | 23 593 | 737 823 578 | 31 273 | 8.0 | 1 884 | 44 419 618 |
| TOTAL | 210 533 | 5 109 686 610 | 24 270 | | 6 663 | 134 662 719 |

Note: (1) Statistics shown above under "B.I.L.s MADE" and "AVERAGE SIZE OF B.I.L." for 12 months ended March 31, 1985, and prior periods may differ from those presented in previous Annual Reports because of late registration of B.I.L.s by lenders.

(2) Subsequent to the December 31, 1983, calendar year, the reporting period was changed to coincide with the Government's fiscal year-end of March 31.

## 2.5 COMPONENT RESOURCES[5]

| | | |
|---|---|---|
| Number of Subordinate Staff Years | | 31 |
| **Operating Budget** | | |
| Non-Salary | | $ 339,600 |
| Salary | | 1,710,000 |
| | | $2,049,600 |
| **SBLA - Scope** | # | $ Billions |
| Authorized Lending Limit | | 2.5 |
| Average Loans Made (per annum) | 25,000 | 0.8 |
| Outstanding Loans Portfolio | | 1.7 |
| **SBLA - Activity** | # | $ Millions |
| Claims Paid - 1985/86 | 1,900 | 44.4 |
| Cost Reductions (est.) | | |
| Fees Collected (1%) | - | 8.0 |
| Claims Declined | 900 | 18.0 |
| Recoveries | - | .8 |
| | | 26.8 |

11.9% of

Total claims paid 6663
declined 900
7563

5 Job Description, Director, Special Programs, Crown Investments and Guarantees.

## 2.6 ELEMENTS AND STRUCTURE

1. Component Elements

   i) Activities

      Private Sector Lending

      Record E2 information

      Process and Review Claims

   ii) Outputs

      Loan Guarantees

      Record of Loan with Government

   iii) Impacts and Effects

      New Equipment, Land or Premises

      Additional Term Lending

      Claims to Government

# 3.0 EVALUATION ISSUES AND QUESTIONS

## 3.1 INTRODUCTION

In determining the issues to be addressed in the evaluation assessment of the Small Businesses Loans Act Program, the evaluation team interviewed individuals from within and outside the Government of Canada. From within the Government, interviews were conducted with personnel from the Small Business Secretariat, the SBLA Program, Members of the Evaluation Steering Committee and senior management at DRIE. As well, interviews were conducted with individuals from the Canadian Chamber of Commerce, the Canadian Federation of Independent Businesses and the Canadian Bankers Association.

The interviews, as specified above, resulted in the identification of a number of issues which could form the basis for a subsequent evaluation of the SBLA Program. All issues identified by this process are presented in the sub-section to follow. These issues were then reviewed by members of the Steering Committee. This review process resulted in certain issues being selected as relevant for a subsequent evaluation. The remaining issues were excluded from further consideration.

## 3.2 EVALUATION ISSUES AND QUESTIONS

This sub-section of the report will present all evaluation issues which were identified from the personal interviews. For each issue the narratives will provide: a statement of the issue to be addressed; an elaboration of the issue including identification of any associated sub-issues; and, an indication as to whether the issue was targetted for subsequent evaluation.

**Issue 1: Is the Small Business Loans Act benefitting small businesses in terms of improving the access to credit or, improving the terms and conditions under which they can obtain credit?**

The fundamental issue is one of incrementality - does the program offer a better interest rate to businesses that would not have obtained financing under the same terms and conditions without the program and, does the program result in a net economic benefit to Canada.

Issues related to Issue 1 included:

- What types of businesses are benefitting from the program? Are beneficiaries primarily start-ups or firms that are financially at risk? Which industrial sectors benefit from the program?
  ↳ SBLA also open to some service industries

- How appropriate is the SBLA as a regional development tool?

- What are the characteristics of the program's benefits? Do these benefits include access to greater amounts of capital, improved financing terms and/or a reduction in required collateral or security or, elimination of personal guarantees?

- Does the program duplicate assistance from other government programs?

- What are the program's impacts in terms of: employment; sales; profits; and, exports?

- Is the program encouraging the expansion of some firms at the expense of other firms or is business expansion taking place in reaction to expanding markets?

This issue was deemed important and relevant for purposes of evaluation. However, reservations were expressed with respect to the cost of addressing such an issue.

**Issue 2: What is an appropriate pricing policy for loans made under the Small Businesses Loans Act?**

This issue was identified by people both within and outside the Government of Canada. Of particular concern was the issue of the appropriate rate of interest to be charged for loans made under the Act. Several groups suggested that a "market rate" (the CFIB estimates that market rate is 1½% to 2% over "prime") would ensure that lending institutions make only incremental loans under the Act. Loans which were previously given for "promotion" purposes or as "rewards" would no longer be attractive to borrowers if a market rate was used. On the other hand, it was suggested that lending institutions would use the program to cover losses they currently incur for lending made at existing market rates.

However, there is an alternative point of view to be considered when examining possible changes to the interest rate. While it is likely that increasing the interest rate will reduce the number of "good" creditors (low default risk) who borrow under SBLA, one should examine the benefits of including these borrowers as part of the SBLA Program. These low risk borrowers pay a 1% user fee to the government which could subsidize defaults associated with borrowers in a higher risk class. Low risk borrowers, given they do not default, impose little or no incremental costs on the Program. If this rationale is valid, then increasing the interest rate would reduce the number of SBLA borrowers (increase the proportion of incremental SBLA borrowers), increase loan cost to the remaining borrowers, increase the cost of the Program from the Government's point of view and, possibly increase the return to the lending institutions on these loans.

With respect to the current 85/15% sharing of loan losses, it was suggested that other countries have a lower loss coverage by government - in the range of 70%-80% of losses incurred.

Since the volume of lending under the Act did not significantly change when the government reduced its loss coverage from 100% to 85%, there is interest in examining the potential for further reduction of loss coverage. On the other hand, it has been suggested that a further reduction in loss coverage by the government would mean that businesses, who should benefit from the program, will no longer be attractive borrowers from the viewpoint of the lending institutions.

The banks in particular, strongly suggest that the ability to charge fees would enable them to make many loans not currently underwritten because they are not profitable. Imposing a fee is very similar to increasing the rate of interest to the borrower. As such, the discussion presented relative to the appropriate interest rate is relevant. The desirability of such a fee is therefore an issue which could be addressed by an evaluation of the Program.

This issue was identified as a priority issue for purposes of the evaluation.

**Issue 3: What is the impact on the Government of Canada of the SBLA Program?**

The value of claims against the Program has significantly increased during the recent past. The current annual cost to the government is between $40 million and $50 million, not including the cost of program operations or revenue from fees. The question of what future losses will be and whether losses need to be this high, is related to the pricing of SBLA loans and the characteristics of businesses using the Program.

Another area of importance is the relationship between the SBLA Program and other government assistance programs. Are these other progams complementary in nature or do they represent a duplication of efforts.

It was suggested by persons both within and outside the government that some businesses include SBLA as one of many instruments they use for assistance. As such, SBLA does not really represent an incremental benefit.

This issue should be included as part of an evaluation of the SBLA Program.

**Issue 4: Is the current process for claims review appropriate?**

Claims review is now a significant component of the government's administration of the Program (involving some 15-20 person years) and has aroused considerable controversy within the banking community in particular. This is because they feel there is a lack of flexibility in the processing of claims where, although the letter of the law (or regulations) was not enforced, in fact the principle was enforced. For example, in the cases where the loan was slightly over 80% of the value of the asset, their feeling is that some proportion of the claim should be covered by the government. This is related as well, to a suggestion by some persons within the government that the claim's review process should simply be an audit and should not attempt to determine whether probity and prudence were used in the administration of the loan by the bank. In this case a different set of pre-conditions would be laid down, which if followed would deem the claim eligible under the program. This particular change was viewed differently by other persons who suggest that regulations should simply allow flexibility in the interpretation of the claiming activity. The current status is that program personnel, because of legislative requirements, have no provision for flexibility when assessing the validity of claims.

The new changes to be included as part of SBLA will allow more flexibility in interpreting the Program's regulations. As a result, the Steering Committee did not feel that this issue should be a priority for purposes of the evaluation.

**Issue 5: Does the claim's review operation pay for itself?**

Although this issue is related to Issue 4, it has a very different focus. Specifically, is the claim's process cost effective and could the process be privatized? A related issue concerned an examination of rejected claims to ascertain what portion actually met the terms and conditions of the Program.

The Steering Committee did not exclude these issues from the set of issues to be evaluated, however, the issue does not have a high priority.

**Issue 6: Are there alternatives to the SBLA Program?**

These alternatives to some extent depend on what rationale one would see as operative for the program. There is clearly controversy with respect to the objectives for the program. This lack of clarity in the objectives (the contradiction between lenders using "normal lending practice" versus a government program which is to assist those who would not obtain loans under "normal lending practice") remains. This has been raised in the previous evaluation in 1981, in a subsequent Auditor General's report and, by internal audit. While various objectives such as increasing the availability of credit to businesses, or making business more competitive have been suggested, there is no consensus on what would be operative. Moreover, there is agreement that the current objectives do have a certain appeal since they encourage probity and prudence on the part of the lender, while allowing business to take advantage of a government program.

Related to the issue of the objectives for the Program and its rationale, are some alternatives on the way in which it might be defined or structured. These include:

- the pricing of SBLA loans (identified in Issue 2);

- whether personal guarantees should or should not be required by lenders (they may be used only as an incentive for care on the part of the business) - this issue was rejected for purposes of the evaluation;

- whether the program might be administered by the Federal Business Development Bank despite the apparent conflict of interest inherent in such administration;

- whether an equity instrument would be better for business rather than increasing debt - this issue was rejected for purposes of the evaluation;

- whether the personal guarantee is important in making loans; and,

- whether the program should be regionalized, recognizing differences such as the need for example, of 90% coverage of claims in disadvantaged regions and 80% in more economically viable regions.

Except where noted, this issue will be examined as part of the evaluation options.

**Issue 7: Are small businesses sufficiently informed about the SBLA Program?**

The concern expressed by this issue is that a significant number of small businesses are not aware of the Program and therefore do not ask lending institutions for this type of loan. As well, there is a belief that the lending institutions are not doing an adequate job of informing small businesses of the availability of this lending instrument.

The Steering Committee decided that this issue was not a priority for purposes of the evaluation.

**Issue 8: Is the Department serving the lending institutions in a satisfactory manner?**

An implicit context for this issue includes the assumption that the lending institutions are clientele of the Program. A significant number of those interviewed stated that the chartered banks in particular, were the Program's immediate clientele. While it is important to realize that the lending institutions have the infrastructure required to deliver the program, it should also be remembered that the arrangement between the SBLA Program and the lending institutions is a business arrangement. Several of those interviewed stressed that if the "price is right" the lending institutions will do business.

# 4.0 INDICATORS AND APPROACHES

## 4.1 INDICATORS

From the discussion with departmental officials and the Steering Committee, a set of five themes emerged as most important for purposes of undertaking an evaluation of the Program. These were:

- pricing of the program in terms of how appropriate is the current: interest rate, up-front 1% usage fee for borrowers, and the 85/15 split in claim liability between the banks and government;
- the incrementality or benefits of the Program in terms of availability of credit, and impacts on business, government, and the economy;
- the regional distribution of the Program's benefits;
- the claim activities and resultant impacts; and,
- the lending practices used under the Program.

We will briefly review the questions and indicators related to each of these issues.

### 4.1.1 Pricing of SBLA Loans

As identified in the previous sub-section, there are three components to the pricing of this Program:

- its interest rate, currently set at 1% over prime;
- the 1% fee which borrowers pay upon taking out such a loan; and,
- the 85/15 split in claim liability between the government and the lending institutions.

Of particular interest to the department are the impacts of the recent change in this pricing (the introduction of the 1% fee and the 85/15 split in liability) and the potential impact if further changes were made in the pricing of SBLA loans.

The impact of pricing can be felt in two areas. Firstly, in terms of the financial returns to the banks, and whether these returns are affecting bank behaviour (in changing the clientele or even in changing the usage of the Program) and, secondly, the impact of pricing on Program benefits. If SBLA loans are less profitable for the banks they may use them for lower risk businesses, thereby thwarting the original intent of the program.

In terms of indicators for the impact of the product's pricing, the most important one would be the change in borrower characteristics that have occurred since the Program changes introduced in March of 1985. These would include:

- the number of companies who are start-ups;
- the number of companies in a loss position; and,
- the number of different industry sectors using the Program and the purposes for which loans are made.

Of particular interest is the number of SBLA loans made to start-ups that are really associated with other businesses. This is critical since a company may be characterized as a start-up, but if it is simply one of a number of businesses, either owned by the same proprietor or having majority ownership by the same shareholder, then in fact the business is not a start-up (from a credit viewpoint) and should not be characterized as one. It would be important in any analysis, because of implications on Program incrementality, to differentiate between true start-up businesses and those which are associated with a group of companies. Other indicators of incrementality are related to different conditions under which loans are made. These conditions include security taken for the loan, the terms of the loan, use of personal guarantees, etc.

The only comparisons which can be made, however, are for loans made before March of 1985, and since that date. The number of claims which have been made since 1985 are relatively insignificant since it typically takes a year or two after a loan has been made before any claim is apparent to the Department.

In terms of assessing the impacts on financial returns to the lending institutions which result from changes in loan pricing, it would be necessary to identify the net change in bank administrative costs and profitability in lending now, versus the period prior to 1985. As well, and to the extent possible, one should identify other loans outstanding against the business. This would address whether SBLA loans, used in conjunction with other loans, provides a blended rate of return which is satisfactory to the lending institutions.

In order to capture information on these indicators, it would be necessary to produce a profile of the businesses and associated loans made before March 1985 and subsequent to that date. As well, this information would be further enhanced with information obtained from interviews and surveys of lenders, on loan costs and program incrementality. There could also be a survey of borrowers to further identify changes in Program incrementality since March of 1985.

### 4.1.2 Incrementality or Benefits and Impacts of the Program

As suggested in the previous section, there are really four areas into which one can classify program incrementality. We will identify these separately, together with the indicators.

**Impact on the Economy**

In terms of an evaluation of the SBLA Program, the measurement of economic benefits is the single most difficult and expensive issue to address. Addressing this issue would require a measurement of the net impact of the Program on the Canadian economy including the measurement of relevant changes in total profits and rents in the economy as well as any net employment changes, if these were deemed to be incremental to the program. It would be particularly important to separate out any displacement effects where an SBLA company simply has displaced the business of another company already operating in a particular market. This would mean that in order to obtain a measurement of net benefit, any displacements within industry sectors or particular geographic regions would have to be identified and removed from the benefits calculation. This would be a very expensive undertaking.

**Availability of Credit**

This particular impact of the program is currently being contemplated as a new program objective to be included in the legislation (along with the changes required to include the Fisheries Improvements Loan Act as part of SBLA). Indicators to address whether the Program is increasing credit availability would include:

- characteristics of SBLA businesses versus those associated with normal lending; and,

- different lending conditions associated with SBLA loans versus normal loans.

Of particular importance would be to separate out two factors. The first factor is related to other loans associated with a particular business receiving a SBLA loan, and the other factor is related to associated businesses linked to businesses benefitting from the SBLA loan. In both cases these could be critical confounding factors which impact on incrementality.

**Impact on Business**

While several implicit departmental objectives address this issue, there is no explicit program objective to increase the competitiveness or benefits to businesses. However, indicators in terms of the impacts on business would include:

- employment in the business;
- secondary employment associated with the business;
- profitability of the business; and,
- business growth.

Clearly, it would be important to measure changes in these indicators prior to the pricing changes made in March 1985 and subsequent to that date.

**Impact on Government**

The impact on the government occurs in two separate areas. First, there is the administration of the program, which currently involves some 30 person years, a significant portion of which is for review of claims (approximately $10,000,000 worth of claims are rejected each year). The other aspect is related to loan defaults which have increased substantially in the program over the five years since the first program evaluation. This increase in defaults resulted from increases in the volume of lending and the impacts of the recession. In order to address this impact there would need to be a measurement of loan losses with some future prediction of these losses as a function of business and loan characteristics. There could also be a review made of the claim process including both approved and rejected claims.

A profile of users and loans before and after the March 1985 pricing changes would be required to address all four issues. As well, information obtained from interviews with both borrowers and lenders would supplement the profile and provide qualitative information with respect to credit and its impact on business and program incrementality. This approach could also identify potential changes which might be made with respect to the Program's design or delivery.

### 4.1.3 Regional Distribution of Program Benefits

Of particular importance is the need to address the impact of the Program in terms of its benefits, incrementality and, availability of credit across the different geographic regions of Canada. It was suggested that five separate regions might be used in such an analysis including: British Columbia, the Prairies, Ontario, Quebec, and the Atlantic Provinces.

The same indicators suggested for the previous issue would be used here and they would be addressed for the various geographic regions. The profile of borrowers and loans as well as interviews would provide the primary source of information.

### 4.1.4 Claims Procedures Review

A minority of persons interviewed suggested that it would be important to examine the current procedures for reviewing claims from SBLA loans in default. This review will be undertaken to identify areas for improvements to these procedures. It was indicated in some quarters that while the rejections are always legally correct, flexibility in interpreting Program terms and conditions would be beneficial. It was also suggested that the review process should perhaps be an audit only, rather than assessing lenders' decisions on detailed "legalistic" criteria. Clearly, a set of indicators for this issue would involve claims rejected and their characteristics, versus claims reviewed and their characteristics.

Related to a review of claims would be a prediction of losses under the program, taking into account existing and proposed pricing changes, as well as the changing population of program users and the characteristics of SBLA loans. One approach for examining this issue would be to review the claim procedures and a sample of rejected and approved claims for SBLA loans in default.

### 4.1.5 Lending Practices

A minority of persons interviewed suggested that it would be important to determine the lending practices used for SBLA loans versus those used in normal lending. While there was agreement that this issue was difficult to address, nevertheless it was felt that this would lend insights as to how the program is being used by lenders. Others suggested, however, that this is really a given for program delivery particularly since lenders are instructed that normal lending practices are to be used. As such, a review of lending practices would not provide significant information, since much of the lending practices are buried in qualitative, judgemental factors, which are difficult to measure or substantiate.

Of the five issues which we have identified, the first three were seen as critical and should be addressed in any evaluation of the Program. The latter two issues were viewed as substantially less important. → Lending practices could be very imp. in ATL where overly cautious bank mgrs can have negative impacts on business

## 4.2 APPROACHES

From the discussion in the previous section there are really six approaches (identified in Table 4.1) which might be used to address the three most important issues. These approaches range from a profile of applicants and loans to an economic analysis of a sample of communities. Table 4.1 outlines briefly the contribution of information which each approach makes to the issues and questions identified above. We will outline briefly what is contained in each approach and identify related costs associated with implementation.

**FIGURE 4.1: INFORMATION FROM APPROACHES TO ADDRESS ISSUES AND QUESTIONS**

GOSS, GILROY & ASSOCIATES LTD.

| ISSUES & QUESTIONS | PROFILE OF APPLICANTS AND LOANS BEFORE 1985 AND AFTER | POLICY ANALYSIS OF BANK COSTS | ANALYSIS OF CLAIM ACTIVITIES | SURVEY BRANCH MANAGERS | SURVEY BORROWERS | ECONOMIC ANALYSIS OF SAMPLE OF COMMUNITIES |
|---|---|---|---|---|---|---|
| 1. Pricing | | | | | | |
| - Incrementality | M | L | L | M | H | H |
| - Bank Costs | - | M | L | H | - | H |
| 2. Incrementality | | | | | | |
| - Economy | L | - | - | L | L | H |
| - Credit | M | M | L | H | H | H |
| - Business | M | - | - | L | H | H |
| - Government | M | - | H | - | - | - |
| 3. Regional Distribution | L | - | L | M | M | H |

Legend: H - High Contribution of Information
M - Medium Contribution of Information
L - Low Contribution of Information

### 4.2.1 Profile of Borrowers and Loans

This profile will be developed for loans made before March 1985 and subsequent to March 1985. The sample of approximately 1500 borrowers would be stratified by period of loan, industry sector, and potentially loan purpose. The computerized database kept by data-line (using the E-2 information) contains six pieces of data on each loan including:

- name of company;
- branch of lending institution;
- size of loan;
- purpose of loan;
- date of loan;
- industry sector (7 sectors); and, since March 1985
- number of years in business.

This approach would make a comparison of the characteristics of the business and the conditions of the loan before and after March 1985. Comparisons would be made of the number of start-ups, number of loans (and associated firms) in a loss position, financial performance of firms, size of businesses, etc. As well, the conditions of the loan, particularly relating to security (both type and amount), term of loan, use of personal guarantee, or other covenants could also be compared. Inferences could be then drawn as to the incrementality of the program before and after Program changes were made. The previous evaluation suggested a 25% incrementality rate for SBLA loans and a subsequent study by Wynant, a 50% incrementality rate with both studies being based on similar types of information. As well, inferences could be drawn on the cost of administering the loans and the potential losses or profitability of the Program to the lending institutions.

This profile, used in conjunction with secondary data obtained from Statistics Canada, would allow estimates of employment impacts (resulting from SBLA loans) to be made. Indicators required for these estimates include:

- loan size;
- loan purpose;
- industry sector in which loan was made; and,
- sector specific financial ratios.

In order to undertake this approach it would require:

| | |
|---|---|
| • Design and select a sample of 1500 firms | |
| 1 week senior consultant | $ 2,500 |
| • Obtain information on lending forms (Schedule 1 in the loan application) from the bankers | |
| 1 week senior consultant | 2,500 |
| • Edit submitted information and keyboard data | |
| 4 weeks, analyst | 10,000 |
| 4 weeks, clerk | 3,000 |
| • Estimate employment impacts | |
| 3 weeks senior consultant | 7,500 |
| 2 weeks junior consultant | 3,000 |
| • Analyze data | |
| 2 weeks senior consultant | 5,000 |
| • Draft and consultation on final report | |
| 2 weeks senior consultant | 5,000 |
| | $38,500 |

### 4.2.2 Policy Analysis of Bank Costs

The focus of this approach would be to determine the profitability to the banks of making SBLA loans, compared to the profitability of similar types of loans not covered by the program. The most difficult task would be to gather substantive information on the administration of such loans and the losses or profitability to the lending institutions of SBLA loans. Information could be gathered from the Canadian Bankers Association and the individual chartered banks on loan costs and losses generally, as well as for those loans covered by SBLA. The Small Business Financing Review in 1981 and the subsequent study by Wynant at the University of Western Ontario offers some information, although not sufficient to make such estimates. As well, information might be obtained from Statistics Canada on loans and lending institutions in aggregate as well as from the Inspector General of Banks on lending practices of the major chartered banks.

The approach would provide an analysis of losses on loans covered by SBLA and of similar loans made by lending institutions and identify the **relative profitability** of the different instruments. As well, it would include an analysis of the impact of a change in the interest rate (if such were made) on program uptake, loan losses and characteristics of borrowers. A necessary part of the analysis would be to include as well any impacts of the pricing changes made in March of 1985.

In order to undertake this approach it would require:

| | |
|---|---|
| • Gathering information on banks' costs and profitability | |
| 2 weeks senior consultant | $ 5,000 |
| 2 weeks junior consultant | 3,000 |
| • Analysis of information | |
| 2 weeks senior consultant | 5,000 |
| 2 weeks junior consultant | 3,000 |
| • Drafting and consultation on final report | |
| 1 week senior consultant | 5,000 |
| | $21,000 |

### 4.2.3 Analysis of Claim Activities

There would be two issues examined in this particular approach. The first issue concerns how the review procedure is working and whether it could be improved. The second issue is related to current loan losses and estimates of future issues, as a function of the program's clientele and volume of loans made under the program. This latter issue would require drawing a sample of claims and analysing them to determine the claim rate as the function of the financial characteristics of borrowers and/or loan characteristics.

To undertake this approach it would require:

| | |
|---|---|
| • Design and select a sample of 300 claims | |
| 1 week senior consultant | $ 2,500 |
| • Data input and editing | |
| 1 week senior consultant | 2,500 |
| 1 week clerical | 750 |
| • Analysis of data | |
| 2 weeks senior consultant | 5,000 |
| • Review of claim procedures | |
| 1 week senior consultant | 2,500 |
| 1 week junior consultant | 1,500 |
| • Draft final report and consultation | |
| 1 week senior consultant | 2,500 |
| | $17,250 |

### 4.2.4 Survey of Branch Managers

This approach would obtain information from branch managers who have made SBLA loans (using those loans for which the sample was drawn in 4.2.1 above). The survey of Branch Managers could cover such topics as:

- the marketing of the program;
- SBLA conditions versus those for normal lending;
- changes in the program and impact on usage;
- problems with the program;
- administration burdens of the program;
- incidence of including SBLA as one instrument in the debt portfolio held by specific businesses; and,
- characteristics of start-ups - are they typically in association with other businesses.

The survey would provide an indication of the banks' costs and provide information on program incrementality.

This approach would require:

| | |
|---|---|
| • Design and pilot test survey instrument | |
| 1 week senior consultant | $ 2,500 |
| • Implement survey instrument through Bankers Association | |
| 1 week senior consultant | 2,500 |
| • Data input | |
| clerical | 750 |
| • Analysis of information | |
| 2 weeks senior consultant | 2,500 |
| 1 week junior consultant | 1,500 |
| • Draft and consultation on final report | |
| 1 week senior consultant | 2,500 |
| | $14,750 |

In addition to the above tasks there would be a verification of survey responses through interviews with approximately 20 lenders. If this were seen as an important additional step there would also be:

| | |
|---|---|
| 2 weeks senior consultant time | 5,000 |
| | $19,750 |

4.2.5 Survey of Borrowers

Using the same sample drawn for 4.2.1, there would be a survey of the firms who have been recipients of SBLA loans. The survey questionnaire could potentially be distributed through the Canadian Bankers Association and actual lenders to ensure a high response rate. Alternatively, survey questionnaires could be mailed directly to businesses since their addresses are on the E-2 form currently kept by the department. Such a questionnaire would address:

- impact on the business using the Program including employment, increased competitiveness and other indicators identified above;
- conditions for SBLA loans versus normal loans;
- problems with the Program;
- monitoring undertaken by the bank; and,
- the process for obtaining an SBLA loan (for example, who suggested this type of loan and why).

It would be important to identify other financing which the business has obtained from the same lending institution and, any other businesses associated with the borrower. This information would help clarify precisely what kind of businesses use SBLA and what lending instruments have been used in relation to specific businesses. Such an approach would provide good information on the impact and incrementality of the Program and some information on costs (to lending institutions) of administering SBLA loans.

The cost for such an approach would be:

| | |
|---|---|
| • Design and pilot test survey instrument | |
| 1 week senior consultant | $ 2,500 |
| • Distribution of survey questionnaire through the banks | |
| 1 week senior consultant | 2,500 |
| • Data input | |
| 1 week clerk | 750 |
| • Analysis of information | |
| 2 weeks senior consultant | 5,000 |
| 1 week junior consultant | 1,500 |
| • Draft and consultation on final report | |
| 1 week senior consultant | 2,500 |
| Total | $14,750 |

Once again, an additional task could be verification of findings and survey information with interviews of 20 borrowers.

| | |
|---|---|
| 2 weeks senior consultant | 5,000 |
| Total | $19,750 |

4.2.6 <u>Economic Analysis</u>

This approach would focus on selecting ten separate communities both rural and urban where one would identify all SBLA loans from branches within those communities. There would be a review undertaken of similar businesses in the selected communities and an analysis made of the relative impact of SBLA versus other lending instruments in the selected communities. The information obtained from implementation of this approach would allow for a cost/benefit analyses of the SBLA Program with particular emphasis on the incrementality of benefits. In order to undertake this approach it would require:

- An identification of communities

| | |
|---|---|
| 2 weeks senior consultant | $ 5,000 |

- Identification of Small Businesses Loans Act loans and other loans

| | |
|---|---|
| 3 weeks senior consultant | 7,500 |

- Visit to community

| | |
|---|---|
| 4 weeks senior consultant<br>4 weeks junior consultant<br>for $16,000 per community | 160,000 |

- Data input and organization

| | |
|---|---|
| 4 weeks senior consultant | 10,000 |
| 12 weeks junior consultant | 18,000 |

- Analysis of information

| | |
|---|---|
| 10 weeks senior consultant | 25,000 |
| 10 weeks junior consultant | 15,000 |

- Drafting and consultant on final report

| | |
|---|---|
| 2 weeks senior consultant | 5,000 |
| 2 weeks junior consultant | 3,000 |
| Total | $248,500 |

# 5.0 EVALUATION OPTIONS

## 5.1 INTRODUCTION

From our examination of the important issues and approaches presented in the previous section, we have developed three different evaluation options. These are:

a) analyses of changes in pricing and employment impacts;
b) incrementality analysis; and,
c) cost benefit analysis.

The first option addresses the impacts of changes in the pricing of SBLA loans. This would include the impact on program usage of the changes made in 1985 and some inferences as to what the future impacts might be if the current pricing of SBLA loans was changed. Included as well would be an analysis of one of the more important impact areas, that of the employment in the businesses receiving SBLA loans.

The second option expands Option 1 considerably through the use of surveys of SBLA lenders and borrowers. This would enable an analysis of many of the Program's impacts including those of availability of credit as well as other business impacts such as profitability and growth.

The third option then examines the most comprehensive level of impacts, that of the net economic benefit of the Program to the economy. This requires a comprehensive approach using cost benefit analysis.

Table 5.1 presented at the end of this Section, provides a summary of each evaluation option, the information required, outputs expected and preliminary cost estimates. We will now examine each of the options in more detail.

## 5.2 OPTIONS

### 5.2.1 Option 1: Analyses of Changes in Pricing and Employment Impacts

The analysis of the impact of changes to the pricing of SBLA loans requires the development of a profile of businesses that have used the Program before March 1985 and since that time. There is a profile of businesses available from the previous evaluation, but this information is somewhat dated since it refers to the period prior to 1980. It would be necessary to draw a new sample, as identified in the previous section, and to profile businesses with respect to such characteristics as the number of years in business and financial characteristics to see if the types of business utilizing the Program have changed over time. As well, it would be possible to compare, using Statistics Canada information, the profile of the SBLA businesses to a profile of all small businesses. The primary use of such a comparison would be to determine the type of businesses using SBLA relative to the small business universe. This would help to predict program usage given pricing changes.

any survey of a control group ie non users of SBLA

The coverage of this option in terms of the generic evaluation questions, relates to the Program's rationale and alternatives. That is, the Program is based on certain assumptions with respect to bank lending such that a 1% over prime interest rate, an insurance fee and, insurance coverage of 85% of loan losses will encourage incremental lending. The analysis provided here should give some estimates of the extent to which changes from the original form of the Program have indeed increased or decreased lending to the types of businesses seen as the Program's target market. As well, and if the degree of incrementality has either increased or decreased as a result of the Program changes, the analysis should provide some inferences concerning alternatives to the Program. If employment has changed as a result of these program changes, this will provide further corroboration as to the additional changes to Program incrementality.

The advantage of this approach is that it uses readily accessible information which could be provided through the Canadian Bankers Association (CBA). Requests (as with the 1980/81 evaluation) for lender application information would be made through the CBA Small Business Loans Committee. As a result of consultation during the evaluation assessment, we expect the full cooperation of the CBA. This would mean a relatively high response rate in terms of obtaining information from the sample of business loan applications. As well, the types of analyses to be undertaken are relatively clear for this particular option since they involve a comparison of the characteristics of the businesses before and after March 1985, using such indicators as:

- number of start-up businesses;
- financial ratios;
- types of security taken; etc.

Thus, a relatively straightforward comparison could be made to determine whether the types of businesses using the Program, and the volumes of business within certain categories, has changed as a result of the pricing.

The disadvantage of this option, however, is that conclusions drawn will be primarily inferential. That is, if there were changes in the types of businesses utilizing the program, the evaluation could only tentatively conclude that this change was solely due to the changes in pricing of SBLA loans. However, if the changes were relatively substantial and occurred simply before and after March 1985, the degree of conclusiveness would be relatively strong. As well, the employment impacts would be derived in light of these conclusions, using relevant Statistics Canada data and extrapolating this to SBLA borrowers.

The information provided to the Department should give some preliminary estimate of whether in fact the portfolio of types of borrowers has changed as a result of the pricing and some preliminary estimates of the employment impact of the program. Depending upon the conclusiveness of these findings, further analysis could be undertaken using the more comprehensive options described below.

While Option 1 focuses on loans made by the Chartered Banks, it should be noted that these institutions currently undertake 80% of total SBLA lending. In Quebec, Caisses Populaires deliver approximately 50% of SBLA loans. However, it is believed that Caisses Populaires' lending practices and borrower profiles are sufficiently similar to Chartered Banks that a separate review should not be undertaken. If SBLA borrowers who use Caisses Populaires are to be profiled, costs for implementing Option 1 will increase. Increased costs will result because the institutions are not coordinated to the same extent as the Chartered Banks.

5.2.2 Option 2: Incrementality Analysis

This analysis would extend Option 1 to include other impact issues, particularly those with respect to the impacts on availability of credit as well as other business impacts such as profitability, competitiveness, and financial viability. This more comprehensive analysis of impacts would be possible by undertaking a survey of lenders and a survey of borrowers (evaluation approaches 4.2.3 and 4.2.4). In addition, the methods of data collection would enable an analysis of whether borrowers were involved in other associated businesses and whether borrowers had other loans outstanding with the same financial institution. This is particularly important given the need to estimate Program incrementality and the complimentarity of SBLA loans with other loans made with the same financial institution. As well, to the degree there are associated businesses, this would have a strong impact on estimates of the number of start-ups (a start-up which is simply another business associated with a number of others is not really a start-up from a credit worthiness point of view).

The primary focus in this option is on the impacts of the Program and its incrementality in providing additional credit or benefits to SBLA borrowers. As such, this option focusses primarily on the program's objectives and its impacts.

The advantage of this evaluation option is that it provides a more comprehensive analysis of the impacts of the program on both businesses and lenders, recognizing the way in which additional or different types of credit are made available to borrowers. As well, and because of the ability of this option to clarify whether there are associated loans or associated businesses, this option will further refine the estimates of Program incrementality and the analysis of impacts which could result from changes to the Program.

An important advantage of this evaluation option is that it not only results in estimates of Program incrementality (from the survey of borrowers and lenders) but it also provides an analysis of the reasons why the program operates in the way it does. That is, lenders and borrowers could identify why they have used the program in the way they have, and the likely way in which usage would change if further program design alterations were made. This option provides further information on alternatives than would be given in Option 1.

A further advantage of this particular option results from distributing to both lenders and borrowers, survey questionnaires through the Canadian Bankers Association. The experience in the previous evaluation suggested there will be some sensitivity on the part of the CBA with respect to the types of questions asked in such surveys. Nevertheless, with adequate planning there should be sufficient time to thoroughly vet questionnaires with the CBA and thereby ensure their delivery to the appropriate lenders and borrowers. This survey approach will result in a higher response rate than could otherwise be expected.

The disadvantage of this Option is that the additional information collected, results from a survey of borrowers and lenders. Necessarily this information is subjective and would represent only the opinions of these two groups with respect to program incrementality and impacts on credit and businesses. Nevertheless, the structuring of the questionnaires should result in consistent responses. As well, a further follow-up with a subset of each group (described as an additional option in the previous section) should provide verification, at least to some degree, of whether the findings from the survey questionnaires are valid. Any further check on the validity of survey responses could be made using profile information.

A further disadvantage of this option is that estimates of Program incrementality would not be net estimates. That is, while the business may obtain benefits from SBLA lending, there would be no analysis of the degree to which other businesses suffered losses as a result of this business benefitting from SBLA. Similarly, while additional credit, or credit under different terms, may be made available to SBLA businesses, there would be no analysis of the degree to which other types of lending to non-SBLA businesses changed as a result of the Program. This problem of estimating net Program incrementality is addressed in Option 3.

### 5.2.3 Option 3: Cost Benefit Analysis

This Option provides a comprehensive analysis of the net economic benefits of the Small Businesses Loans Act Program. The approach used for undertaking this analysis (described in the previous section) would focus on ten separate communities and the total lending made within those communities. The methodology requires a detailed analysis of SBLA lending and other lending within each community. The information provided would be comprehensive and would allow for estimates of the net economic benefit of the Program versus employment impacts as estimated in the previous two options.

This option is perhaps an ultimate one in that it focusses on the net incremental economic benefits of the Program. The difficulty in implementing this particular option is the data collection itself. While some banks might be persuaded to open up their information on lending, it is not likely that all the major chartered banks or other financial institutions would do so for each community. Data access could be a substantial problem in this particular case.

While Options 1 and 2 provide for a progressive refinement of estimates of Program impacts, and other changes resulting from changing SBLA loan pricing, Option 3 is limited to an analysis of the net economic benefits of the Program. Obviously, this option could be combined with either Option 1 or 2. However, this option has unique difficulties associated with it. For this reason it was presented on its own, to better allow the decision makers to comprehend the costs and limitations of undertaking a comprehensive cost/benefit analyses of the SBLA Program.

Table 5.1 which follows, presents a summary of the three options.

### 5.2.4 Recommended Option

After a careful review of each of the three options presented for a potential evaluation of the Small Businesses Loans Act Program, the Evaluation Steering Committee recommended that Option 1 be implemented. This option would focus upon impacts of the changes in the pricing of SBLA loans and provide an estimate of the employment impacts which have resulted from the Program.

**TABLE 5.1: SUMMARY OF EVALUATION OPTIONS**

yes

| OPTION | INFORMATION REQUIRED | EXPECTED OUTPUTS | ESTIMATED COSTS |
|---|---|---|---|
| 1. Analyses of changes in pricing and employment impacts | • profile of Program users and of SBLA loans; Statistics Canada's corporate financial data<br><br>• indications of banks' normal loan loss rates versus SBLA loss rates | • an indication of how pricing changes will impact upon Program users<br><br>• estimates of employment impacts resulting from the Program (weak information on Program incrementality)<br><br>• an indication of how pricing changes will impact upon lenders | $39,000<br><br>$ 21,000<br><br>$ 60,000 |
| 2. Incrementality analysis | • information required for Option 1<br><br>• detailed information obtained from a survey of borrowers and lenders | • outputs described in Option 1<br><br>• estimates of incrementality of SBLA lending & employment impacts<br><br>• estimates of the complimentarity of SBLA loans to other types of loans | $ 60,000<br><br>$ 40,000<br><br>$100,000 |
| 3. Cost benefit analyses | • a detailed profile of lenders and borrowers; detailed profile of total lending activity within specific communities; identification of incremental benefits resulting from SBLA lending within specific communities | • cost/benefit analysis for SBLA lending within 10 representative communities across Canada | $250,000 |