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INDUSTRY CANADA

A Briefing on the Concerns of Small Business

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A Briefing on the Concerns of Small Business

November 2, 1995

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1.0 Introduction

1.1 The big picture

Few analysts would disagree that the Canadian economy has changed profoundly as a result of the global economy in the last decade. In fact, that point has become somewhat of a mantra in any dialogue about Canada's evolving economy.

Although small business[1] does not participate in international trade to the extent that larger businesses do,[2] their economic impact can not be ignored. Small business, including the self-employed, account for almost two-thirds of private sector employment and 60% of economic output. From the middle of 1993 to the end of 1994, small business accounted for 16,000 new businesses (this does not include the self-employed).

In 1994 there were more than 925,000 small businesses in Canada. This does not include the 1,185,000 individuals considered to self-employed. Ninety-nine percent of all businesses in Canada had less than 100 employees. Just over 1.5 million households in 1994 included a member who operated a business from home.[3]

1.2 Does size count?

When it comes to understanding the issues facing small business, the name itself underscores their concerns. Size, or lack of it, is critical when it comes to interacting with government and financial institutions. Having fewer employees and resources than larger companies means that the president, account executive, sales representative, bookkeeper, receptionist and front-line employee are shared responsibilities among few or even one person.

To underscore the importance of small business to the Canadian economy, Exhibit 1 details the penetration of home-based businesses as a percentage of all households in Canada. As shown, 14.7% of all households in Canada have a home-based business.

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1 For the purposes of this report, "small business" is defined as having between 10 and 49 employees. "Micro-business" is defined as having less than 10 employees.

2 Small and medium-sized enterprises accounted for less than 1% of manufacturing exports though their share of all revenue is 12%.

3 Market Facts of Canada Limited as taken from the *Globe and Mail*, April 10.

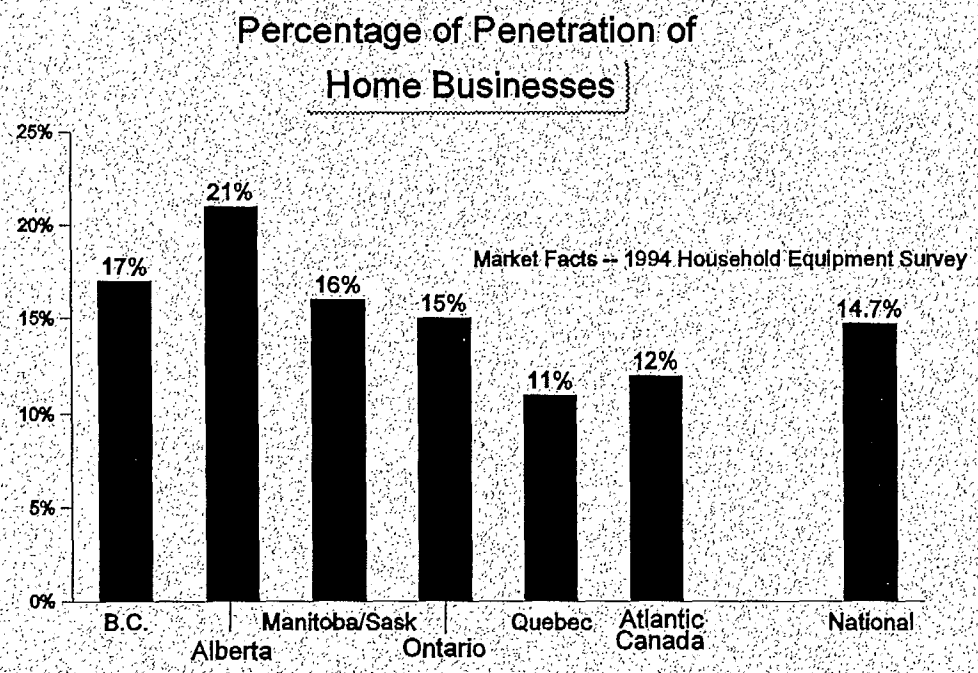

Exhibit 1

Issues such as taxes, reporting mechanisms or financing have an amplified affect on small business. This is because often they do not have the skill, the time or the means to be able to address, challenge or ameliorate changes in their operating environment.

What are the expectations of small business with respect to government's role? Although there are specific demands, two factors stand out: stability and improving the infrastructure for business to operate more efficiently.

1.3 Climate of stability

Small businesses ask governments to create a climate of stability, although changes to ease the burdens of small business are always welcome. This is because business plans and reporting mechanisms have been established to address current, but not unforseen, obligations. Governments inability to deal with the tax burden, fiscal policy, debt and

internal trade barriers contributes to continuation of an uncertain and high risk environment.

Creating stability in their operating environment explains why the Canadian Federation of Independent Business (CFIB), a traditional advocate of small business, now lobbies for simplification and harmonization of the GST when once it lobbied hard against it. The reason -- small and micro-business crave stability, systems are now in place to address the GST, changing it now would create instability.

The CFIB also contends that governments must recognize that stability in both taxation and government policies generally is a fundamental requirement if smaller firms are to plan and commit to a course of action.

1.4 Infrastructure of business

Second, government is asked to be in the business of improving the infrastructure of business. This includes improving transportation links, reforming regulation, providing greater fiscal freedom and reducing taxes. Improving the infrastructure becomes more apparent later in this report.

1.5 Media review

A review of the media over the last several months finds a tone of rising cynicism regarding government vis à vis small business. They are portrayed as being quick to talk about the concerns of small business but slow to act and implement reform. It is felt that the federal government, as well as provincial and municipal governments, must do more than publicly express their support for small business.

The advocate of small business is the CFIB. This organization appears to be an effective voice for them. The media regularly obtains their perspective on issues of concern to small business.

The CFIB has endorsed both the federal government plans (as outlined in Jobs and Growth) and the Ontario government's election agenda for business (see page 9). How long their support continues depends on the extent to which planned initiatives become reality.

The balance of this report examines each of the concerns of small business in more detail: small business climate, taxes, paperburden & regulation, financing, and grants & subsidies. The report ends with small business expectations of the federal government and conclusion & recommendations.

Notes ...

2.0
Small Business Climate

An Insight Canada Research Report[4] asked respondents, in their own words, what was the most serious issue facing small business. As shown in Exhibit 2, high taxes, financing, government regulations/intervention and the state of economy were the four most important issues for small business. Together, they accounted for almost one-half (44%) of all small business concerns.

High taxes, government regulations/interventions, state of the economy and interest rates ranked first, third, fourth and seventh on the list of most important issues facing small business. These represent direct government interventions in the affairs of small business and account for 37% of all of the issues. A further 11% (financing) may directly or indirectly be influenced by governments. Taxes, government regulations/intervention and financing are issues discussed in chapters 3, 4, and 5 respectively in this report.

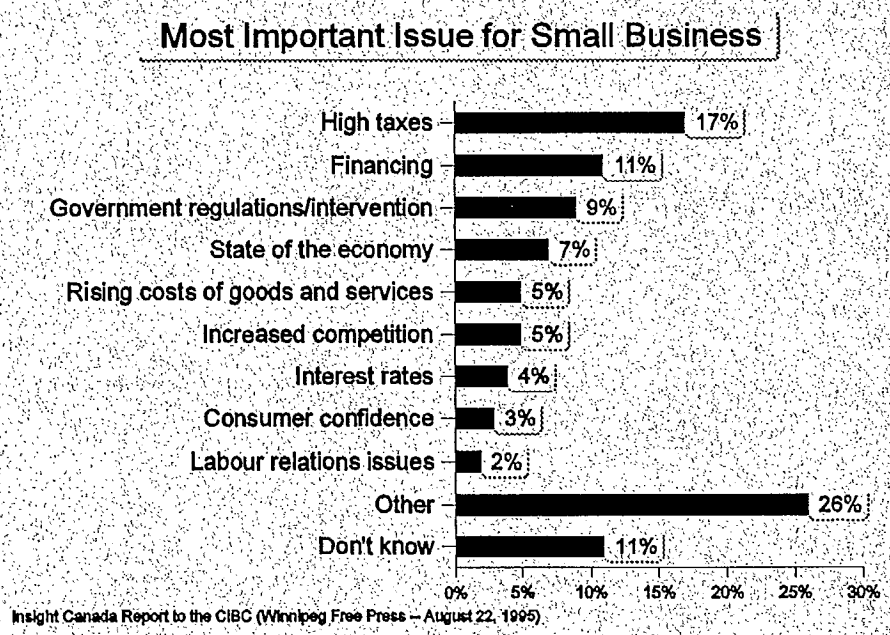

Exhibit 2

[4] An Insight Canada Research Report for the CIBC (1995)

Although the aforementioned issues are important, the ultimate objective of small business is to enhance its ability to sustain itself and grow. In the report Aim for a Million,[5] the priorities that business feel are required to be sustainable and encourage growth are detailed in Exhibit 3.

Priorities for Business to Be Sustainable and Grow

Reason	"Micro" < 10 employees	"Small" 10 to 49 employees
Debt/deficit reduction	57%	64%
Lower payroll taxes	47%	52%
Reduced regulatory burden	41%	44%
Better training and education of workforce	39%	43%
Lower corporate tax rate	31%	45%
Improved political climate (provincially)[6]	40%	34%
Increased government incentives to small business	39%	29%
Reduced government borrowing in capital markets	27%	29%
Better access to private sector financing	34%	27%
Improved political climate federally	25%	19%

Exhibit 3

In the CFIB publication entitled Small Business Outlook for 1995 (December 1994), the CFIB asked what conditions would be required before a business would consider hiring more employees. As shown in Exhibit 4, 80% of respondents mentioned an increase in demand for their products or service. The CFIB notes that this condition is always the top-ranking prerequisite for taking on more people.

Looking again at Exhibit 4, the second, third, fourth and fifth reasons are all government-related initiatives. These included a freeze or reduction in payroll taxes, stable government taxes and policies, deficit elimination and stable interest rates.

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5 Aim for a Million published by the Canadian Chamber of Commerce (August 1994)

6 Survey taken before the last provincial election in Ontario.

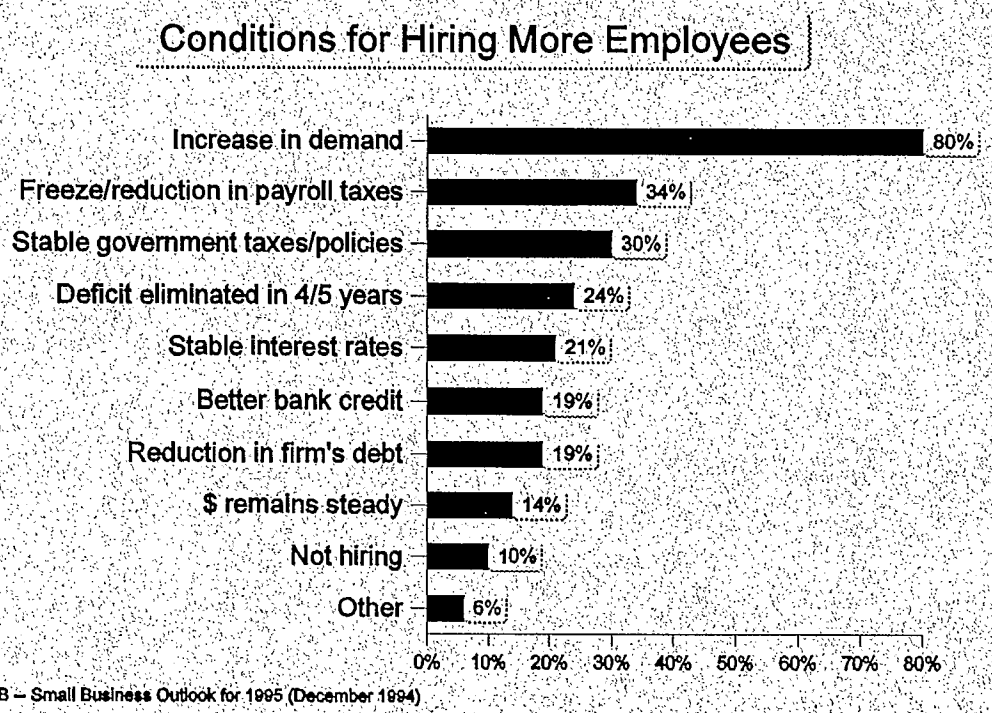

Exhibit 4

The CFIB believes that there is a golden opportunity for much stronger employment growth across the country and particularly in Ontario. However, they contend that this potential is being thwarted by governments that are not addressing the fundamental needs of business.

As Exhibits 2 and 4 show, the perceived high levels of payroll and other taxes faced by labour intensive small firms are a major factor in keeping new hirings to a minimum.

All of these exhibits taken from various sources point to three main areas of concern for small business. These are taxes, paperburden and regulation and financing.

Notes ...

3.0 Taxes

3.1 Introduction

As shown in Exhibit 2 on page 5, the burden caused by the range of federal, provincial and municipal taxes is by far the small business owner's greatest concern. A business owner's tax load would typically include income tax, UI premiums, CPP premiums, WCB premiums, provincial payroll taxes, employer health tax, municipal business and property taxes, sales taxes and gas taxes. The CFIB concludes that this is a major factor contributing to decreased consumer spending, the underground economy, business closures, start-ups and expansions.

The most recent tax-related issue picked up by the media was coverage of the release of a CFIB survey on the impact of property taxes on business. The study noted that Ontario homeowners pay $1,460 in taxes on $100,000 worth of property while business owners pay $3,190 on $100,000 worth of property. Ontario has the fourth highest business to residential gap.

CFIB's senior economist Ted Mallett was quoted extensively on the report and noted: "the potential fall-out of a $3,000 to $7,000 per $100,000 tax load on homeowners acts as a sufficient deterrent ... yet governments think little of imposing these absurd levels of taxation on business owners" (*Financial Post*, October 5).

He further noted that "one of the long-time, but inaccurate, justifications for imposing higher property taxes on business has been that they are better able to afford them. The steep tax load is particularly hard on smaller companies. The media family income for entrepreneurs was $40,000 in 1993 compared with $55,000 for families whose main breadwinner is a salaried employee." (*Globe and Mail*, October 5)

In order to address business concerns, the Ontario Conservative Party pledged, in the 1995 election campaign, to reduce the tax and regulatory burden on business including to:

- repeal Bill 40, the NDP labor legislation business says is pro-union;

- reform the Workers Compensation Board by cutting premiums and eliminating the $11.4 billion unfunded liability;
- eliminate the Employer Health Tax on payrolls under $400,000;
- freeze Ontario Hydro rates for five years;
- review all regulations affecting business;
- disband the Workplace Health and Safety Agency;
- freeze the minimum wage, apparently the highest in Canada; and,
- eliminate the deficit by fiscal 2001.

The CFIB has generally endorsed the Ontario initiatives. As Catherine Swift, CFIB president, noted "they are planning some pretty progressive moves." Regarding the Industry Canada Building a More Innovative Economy: Agenda Jobs and Growth, Ms. Swift noted that "(the contents of the report) is moving in the right direction."

3.2 The CFIB demands

The CFIB looks to government to simplify the sales tax regime. They contend that the existing sales tax regime should be replaced with a simpler system to reduce the onerous compliance burden on small and medium-sized businesses while remaining revenue neutral relative to the present system. A political consensus for change must be built among the federal and provincial governments.

In addition, governments must work to reach agreement on how to collectively reduce the tax burden, the regulatory burden and escalating expenditures caused by the duplication and overlap of government programs. They hinder business competitiveness.

The CFIB has published in various forums what they believe to be appropriate government initiatives regarding small business. They ask the federal government to:

- not increase existing taxes or introduce new taxes;

- jointly pursue reductions in payroll taxes through the reform of the workers' compensation systems and the replacement of payroll taxes to fund health care with individual premiums or consumption taxes;

- freeze UI premiums and move quickly with UI/social reform agenda;

- stop the erosion of tax breaks such as the capital gains tax exemption, RRSP limits, carry forward provisions and meals and entertainment deductions. Reducing these so-called "tax give-aways" works as a hidden tax increase; and,

- consider increasing the lower corporate tax rate threshold from the current $200,000 level -- this will help increase small business retained earnings and thus allow the firm to grow.

Where should the cuts come from? CFIB members gave a high priority to cuts to public sector wages, social assistance and grants and subsidies.

Notes ...

4.0
Paperburden & Regulation

According to the CFIB, paperburden is the number two problem facing small business. It appears to be a particularly small business problem as they rarely have the necessary in-house legal, financial or other resources to comply with the constantly changing regulation and legislation they typically face. As a result, business owners often find themselves dealing with the majority of the paper load instead of spending their time more productively.

The alternative finds that many small firms pay excessive fees to outside professionals to merely remain in compliance with the numerous government regulatory demands.

The CFIB contends that firms need a signal that government is not the enemy and a reduction in their paperburden is a low-cost, meaningful way for government to send that message.

An opinion piece by the editor-at-large of the *Financial Post*, Neville Nankivell, (September 16) noted that the small business community is impatient over slow progress on the federal government's commitment to lighten the paperburden and other regulatory burdens it finds so irritating and costly. As he noted: "clearly the pace needs stepping up ... reducing bureaucratic burdens on small business would be a cheap way to boost the economy and create a lot of new jobs." This theme was echoed by Brien Gray, senior vice-president of the CFIB: "it's been a year now, but we haven't seen too much beef yet in terms of solid achievements."

Recommended changes include the record of employment form ("it's time consuming and complex"), prompt payment procedures to suppliers from government ("small firms are more interested in getting their money promptly, rather than the interest") and more flexible deadlines for payroll tax remittances.

Notes ...

5.0
Financing

The importance of financing to small business needs no more evidence than to note that there were no fewer than five major reports which dealt, in whole or in part, with the financing problem faced by small business in 1994.[7] This is reinforced by the findings as shown in Exhibit 2 on page 5 which noted that "financing" is the second-most frequently mentioned issue for small business.

The importance of financing to small business was recognized by the Canadian Bankers Association.[8] They reported that retained earnings are one of the most important factors taken into account when a small business applies for financing. Since taxes reduce the amount of retained earnings, the tax burden can seriously impair the smallest companies' access to financing.

The CFIB agrees. Although they believe work can be done to improve the alleged lending deficiencies of Canada's banking community, the optimum strategy would be to allow firms to retain earnings which can be reinvested for expansion and job creation.

As Exhibit 5 on page 16 shows, micro-business sources of capital differ substantially from larger businesses. The most important sources of equity for micro-businesses, other than retained earnings, are a financial institution loan with a personal guarantee (58%), personal savings (51%) and loans from family or friends (23%).

This differs markedly from larger businesses which rely on financial institution loans without the need for a personal guarantee (63%) and share issues (41%).

These exhibits dramatically highlight how the capital market views small business. Both small and large business rely on financial institutions as their primary source of capital. However, financial institutions apparently view smaller businesses as riskier than larger businesses, hence the need for personal guarantees.

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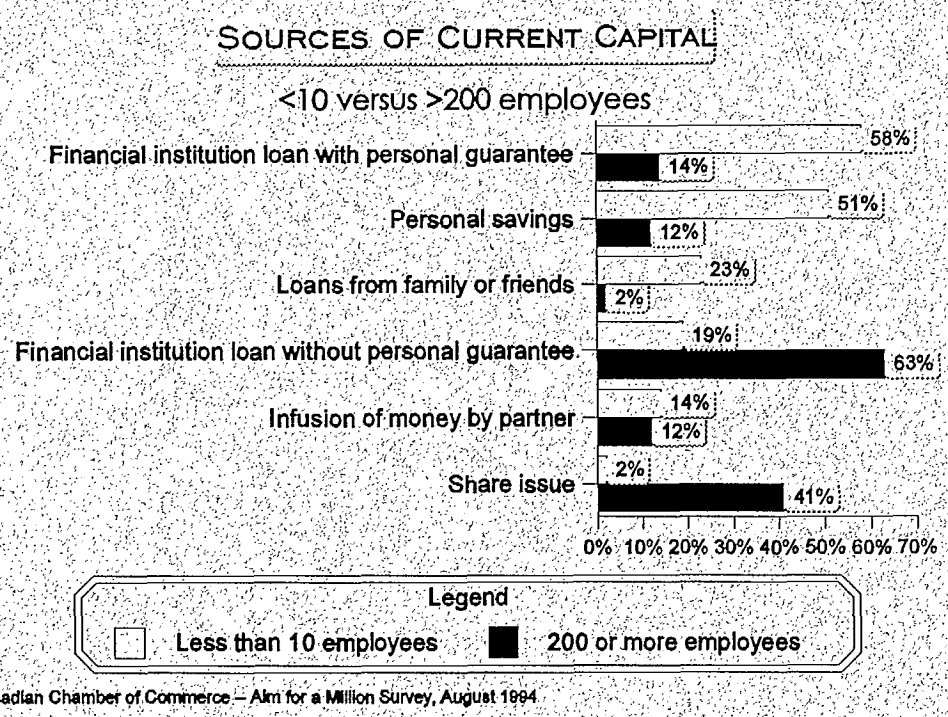
7 CFIB Statement to the Standing Committee on Industry, April 26, 1995.

8 Canadian Bankers Association -- 1995 Small Business Annual Report.



Canadian Chamber of Commerce – Aim for a Million Survey, August 1994

Exhibit 5

The media has picked up on some of the issues including announcements by CIBC, Bank of Nova Scotia and Toronto-Dominion bank to take credit decisions out of their head office and put them into local branches. This was hailed by Brien Gray, senior vice-president of CFIB as a "sea-change of attitude" (*Ottawa Citizen*, September 23).

In a related development, the *Ottawa Citizen*, September 23 noted that the federal government and the banks are working towards establishing an ombudsman's office, financed by the banks, that would step in to resolve disputes between the banks and small business.

When media covers the topic of small business financing and solicits the views of small business, the language can be colourful and negative. Many of the concerns centre around perceived high service charges and lack of financing support. In a *Calgary Herald* article (October 16), a small business owner noted that "the big problem is they want five to six dollars of equity for every dollar they lend you ... most small businesses don't have that, and if they did, they wouldn't need the banks."

6.0
Grants and subsidies

A top priority of business is to cut grants and subsidies to small business. This is a point shared by the Ontario government which plans to cut $200 million per year until subsidies are eliminated (*Ottawa Citizen*, October 25, 1995).

William Saunderson, minister of economic development, trade and tourism for Ontario believes that direct grants to companies are unfair and noted that "we shouldn't be skewing the marketplace by giving some companies an unfair advantage over their competitors and propping up unviable businesses" (*Ottawa Citizen*, October 25, 1995).

As Garth Whyte (CFIB) noted "we have a long history of pushing for this. We have surveyed our members. About two-thirds say cut grants and subsidies to business." Mr. Whyte also noted that grants just encourage "grant-preneurs instead of entrepreneurs."

The cuts appear to have wide endorsement. Graeme Kirby, general manager of the Ottawa-Carleton Economic Development Corporation notes "I happen to agree absolutely with what they are trying to do ... in many cases business does not need the money, its much better to improve the transportation links and improve regulations to ease the job of business."

Notes ...

7.0
Expectations of Government

Not surprisingly, tax reform was the principal change sought by small business of the federal government.[9] As shown in Exhibit 6, approximately one in three micro and small business owners sought tax reform by the federal government.

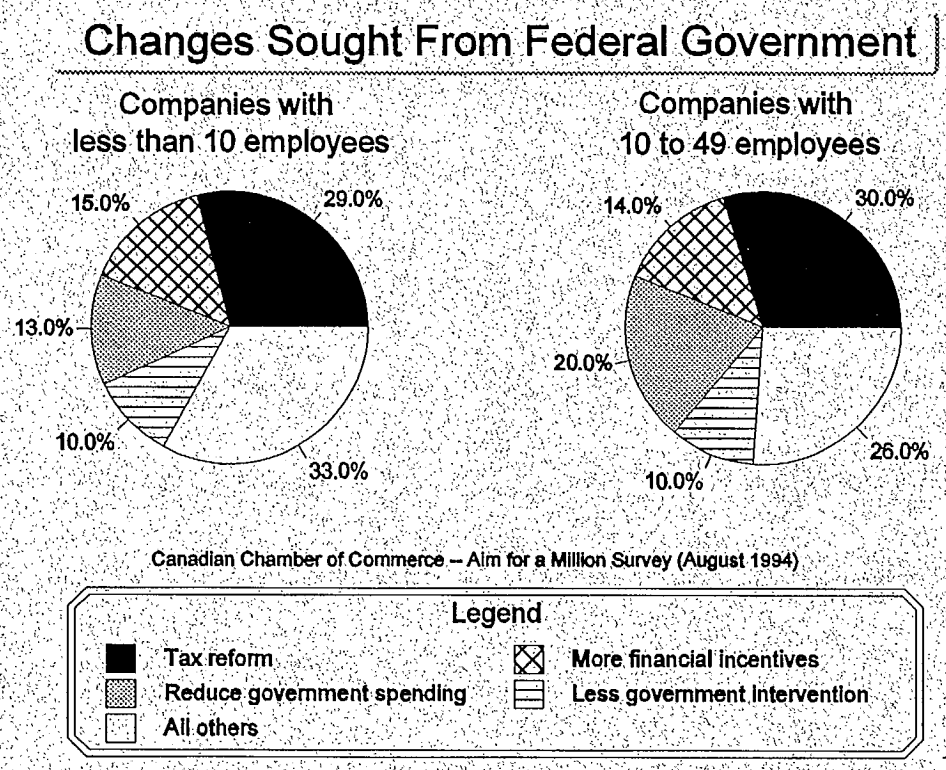


Exhibit 6

[9] Canadian Chamber of Commerce -- Aim for a Million Survey, August 1994.

These findings were reinforced by the COMPAS Business Agenda survey[10] which reported that business leaders gave priority to reducing the tax complexity and compliance costs, reducing regulations/paper burden and improving access to financing.

In addition, the report entitled Rethinking Government[11] noted that there was more support for the federal government to help business develop and use new technologies (80%), to set up networks to better compete in international markets (79%), to assist businesses in providing on the job training rather than classroom training (79%), and to providing businesses with information on marketing techniques and trade opportunities (77%).

There was less support for the federal government to fund national organizations to design and provide training for workers (64%) and to provide businesses with money to help establish new ventures (61%).

Notes ...

10 COMPAS Business Agenda survey of business leaders (Winter, 1995) -- a survey of leaders of small and large-sized businesses.

11 Ekos Research Associates (1994) -- a survey of the Canadian public.

8.0
Conclusion & Recommendations

1. Depending on the perspective of the reports that were used as the basis for this research, the concerns of small business are given a different slant. However, there appears to be a general consensus that the three most important issues facing small business are the perceived tax burden, paper and regulatory burden, and access to financing. The first two are clearly within the realm of government while the latter may be indirectly influenced.

   Although business would ideally prefer a minimum of government involvement, the evidence suggests that many would settle for a climate of certainty if they could be assured that they would not be blind-sided with more taxes and/or regulations.

   The federal and Ontario governments have made commitments to address many of the concerns of business. This has created expectations. While the Ontario government continues to enjoy a honeymoon with the electorate, business and small business advocates, the federal government has had a longer period of time to address some of their issues. Thus, one sees the first stages of grumbling (chiefly among the media) that the federal government has not moved fast enough to address some issues.

2. The Minister may wish to take this opportunity to announce changes, initiatives and other progress that is being made with respect to small business. Be aware that small business is expecting more action and less talk. In addition to the three main issues facing small business, the following will be of interest to small business:

   - deficit/debt initiatives;
   - public sector wage restraint;
   - measures that have increased certainty in the market; and,

- measures that have improved the infrastructure that allows businesses to operate e.g., capital infrastructure program, communications de-regulation.

Small business awareness of changes to the Federal Business Development Bank (now the Business Development Bank of Canada) and to the Small Business Loans Act appears to be low. The Minister may wish to take an opportunity to explain how these changes benefit small and micro-sized businesses.

3. Consideration should be given to reinforcing the perception of the role of Industry Canada as a business advocate organization and outline more of the action plan *Jobs and Growth*. Details on how the ombudsman's office will work to resolve disputes between the banks and small business would be of interest.

4. The Ontario government is perceived as making progress on issues of concern to small business. They are in the beginning of their mandate. The federal government's mandate is almost one-half over.

5. The issues of concern to small business differ substantially from that of larger business. Speeches should address this point specifically.

6. There is no evidence of substantial regional differences of small business issues.

7. The CFIB is the voice of small business. It appears to obtain media attention, either through publishing research results (e.g., the property tax study) or by having the media seek them out knowing that they are the advocates of small business in Canada.

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