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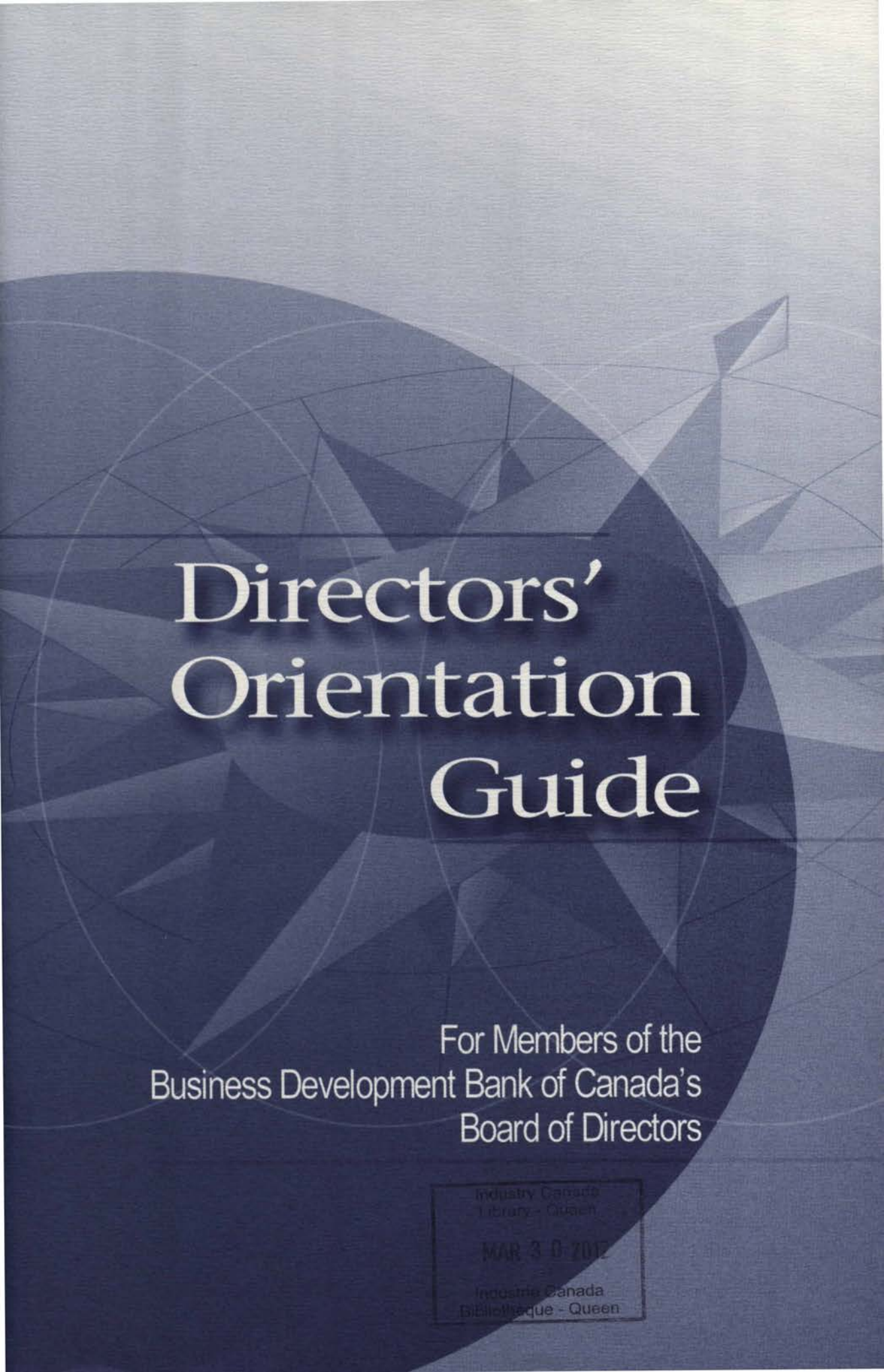
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Directors' Orientation Guide

For Members of the
Business Development Bank of Canada's
Board of Directors

Canada



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Welcome to the BDC Board of Directors

The mandate of the Business Development Bank of Canada is to "support Canadian entrepreneurship by providing financial and management services [to small and medium-sized businesses]."

Business Development Bank of Canada Act

Known as Canada's "bank for small business," the Business Development Bank of Canada (BDC) serves a vital sector of the Canadian economy. Canada's small businesses are responsible for more than 50 percent of all private sector employment and economic output. Many of these businesses are dynamic and aggressive; they couple high growth with innovative processes, products and services — often in non-traditional ways.

In becoming a member of the Board of Directors of the BDC, you have agreed to help fulfil an exciting and important responsibility: to help ensure the growth and prosperity of small businesses across Canada. You have also agreed to play a critical role in ensuring the proper delivery of public policy on behalf of the Government of Canada. By providing informed advice and guidance, by analysing and questioning the Bank's strategic direction, and by stimulating healthy debate and discussion within the confines of the Board of Directors, you will help the government and the Bank foster economic growth and job creation. In particular, you will be there to ensure the appropriate accountability of Bank management. During deliberations, you must keep the Bank's mandate and role as a public policy instrument foremost in your mind, and balance this with the Bank's commercial mandate. Your role is also to make decisions taking full account of the interests of the shareholder, the Government of Canada. This orientation guide will help you prepare to take on this important role, and will complement the briefings you will receive in the near future from the Bank.

As a Crown corporation, the Bank operates within a framework of federal departments and agencies that governs its mandate and activities.

→ This guide will help to explain the government and public policy parameters within this framework. It will give you an overview of the relationships that govern the actions of the Bank, and of its responsibilities to the shareholder. This guide was developed in response to questions raised by former and current Board members who wanted to understand how their actions fit into the context of the government's decision-making structure, which involves several organizations. It should be stressed here that the Bank's management and Board have considerable autonomy for implementing the BDC's mandate. Most issues brought before the Board do not require the involvement or approval of government agencies. Some decisions, however, require

broader government involvement. As a general rule, this happens when management and/or the Board recommend changes to the BDC's strategic direction or mandate. While the BDC's primary relationship is with the shareholder — represented by the Minister of Industry — Parliament, Cabinet and a number of other ministers are involved in decisions concerning the Bank. The BDC's relationships with these bodies are conducted formally through the Minister of Industry and Industry Canada. While Board members are rarely, if ever, directly involved in communication between the BDC and other government bodies, it is useful to have an understanding of the decision-making process beyond the Board level.

X This guide provides:

- a brief overview of the history, mandate and priorities of the BDC;
- a description of the BDC's role as a member of the Industry Portfolio;
- an explanation of how the BDC interacts with six government bodies; and
- flowcharts detailing the development and approval processes of the annual corporate plan and of policy documents/proposals such as the mandate review report.

BDC: Overview

The BDC is a Crown corporation that has a mandate to operate in a commercial fashion while meeting important federal government public policy goals. Its mission is twofold: to help entrepreneurs create and develop Canadian small and medium-sized enterprises (SMEs) and, through this, to help deliver the government's objectives of economic growth and job creation. The Bank offers its financial services at rates equivalent to commercial rates (it also operates in market niches where no comparable commercial rates are available), so its customers are not subsidized by the taxpayers.

The Bank fulfils its mission by providing a range of specialized financing products that fill critical financing gaps for SMEs — gaps related to insufficient support for smaller, riskier loans, gaps in the provision of loans to knowledge-based industries (KBIs), and gaps in flexibility in loan terms and conditions. Through its BDC Consulting Group, the Bank also provides a wide range of business counselling, training and mentoring services. The BDC is the only national financial institution to offer one-stop shopping to help Canadian entrepreneurs succeed and grow.

A Short History

The BDC has been serving Canadian SMEs for more than 50 years. First created as the Industrial Development Bank in 1947, it became the Federal Business Development Bank in 1975. In 1995, the Bank underwent a fundamental review of its mandate to align its operations more closely with the needs of its SME clientele, and its strategies more with the policy objectives of the federal government.

Reborn as the Business Development Bank of Canada through a 1995 Act of Parliament, the BDC has moved from being known as a lender of last resort to becoming a complementary lender and trailblazer in developing new financing products for SMEs. Many of these products are created and delivered through strong partnerships with the private sector and federal government departments.

Today the BDC plays an important role as a lender that serves a traditional clientele, as well as the emerging needs of high-risk businesses and industries that do not have a traditional borrower profile: KBIs, exporters, growth-oriented businesses, and small firms. The BDC's venture capital products are key to meeting the needs of this segment of the economy. In recent years the BDC has become a significant player in venture capital, particularly for smaller deals, with a portfolio that grew from \$32 million in 1996 to \$145 million in 2000.

Thus, the BDC complements the financial services available from private sector lenders by offering priced-to-risk services that are critical to these growing businesses but that are not offered by commercial financial service providers. Its services are tailored to clients' needs, but are usually priced significantly above those of the commercial lending market, so that the Bank can make a return commensurate with the level of risk. These financial services do not provide subsidies to Canadian small businesses; on the contrary, BDC loans are usually more expensive than commercial loans. However, the Bank's financial services are often made available to businesses that would not qualify for the same sort of financing from commercial lenders. Research among SMEs indicates that for the majority of these businesses the critical financing issue is not so much price as access.

Mandate: Support Canadian Entrepreneurship

Canadian businesses operate today in a world where knowledge-intensive industries dominate output and employment growth. Globalization and the information revolution have combined to radically restructure the nature of competitive advantage, trade, and business growth prospects.

The BDC's mandate is to support Canadian entrepreneurship within this changed — and rapidly changing — business environment. The Bank does so by:

- providing specialized financing products that support the growth of SMEs, products such as venture capital, subordinated debt financing, and special support for micro-businesses; and
- supporting this financing with business counselling and mentoring services designed to give SMEs access to information that large corporations take for granted, services such as market analysis, business feasibility studies, strategic planning services, and sales and distribution planning.

With 2.5 million SMEs active in Canada, the potential market for BDC products is very broad. However, a wide range of players serves a number of niches within that market. A critical aspect of the Bank's mandate is to serve unserved and underserved demand, while avoiding overlap or duplication with other institutions' mandates and activities. To do this effectively, the Bank depends on partnerships with institutions in both the public and private sectors.

In carrying out its mandate, the Bank is expected to manage its portfolio to achieve a return at least equal to the government's cost of capital. As a complementary lender, it is also expected to take on higher-risk clients and to price its financial products in consequence of that risk. Ultimately though, the Bank is expected to exercise normal commercial prudence in making its credit decisions.

Priorities

Focus on KBIs and Exporters

Canadian KBIs and exporters are at the forefront of small business growth in Canada. KBIs produce information, advanced technology or scientific research. Exporting allows SMEs to take advantage of larger markets and to be exposed to emerging technologies. Although KBIs account for only 2.3 percent of all businesses in Canada, they form a rapidly growing segment of the economy. From 1995 to 1998, KBI employment growth was an estimated 28.6 percent, while total employment grew only 5.9 percent. During the same period, the Canadian gross domestic product (GDP) grew 8.4 percent, while KBIs' contribution to GDP grew approximately 27.9 percent.

Often, however, KBIs do not fit the profile of a "traditional" borrower, with hard assets to pledge as security. Frequently, KBIs have more development potential than real assets. They need financing that recognizes the value of their intellectual assets, and that takes into account the special needs and risks inherent in new economy enterprises. More often than not, they have difficulty accessing this financing from traditional sources.

To fill this gap, the government asked the Bank in 1995 to target KBIs and exporters. The Bank's focus was further sharpened in 1998, when the government instructed the BDC to build on its previous record and become much more aggressive in developing financing products and programs that support the particular needs of these companies. Currently, the Bank's target is to have KBIs and exporters represent 47 percent of its loan authorizations. To date, 97 percent of the Bank's venture capital portfolio is investments made to KBIs.

Under the leadership of the Board of Directors, the BDC developed a series of innovative financing products — such as small-deals subordinated debt, Productivity Plus Loans, Innovation Financing and venture capital investment products — and established ambitious growth targets for them. In 1999, the government embraced this more ambitious growth path and agreed, in principle, to a regular injection of required capital to support this growth. In 1999 and 2000, \$80 million was invested in preferred shares of the Bank. Further investments will be subject to demonstration of capital requirements as the growth strategy is implemented.

Other Mandated Priorities

In addition to KBIs and exporters, the Minister of Industry has established a number of other priorities for the BDC.

- Provide specific financing options for businesses run by women, youth and Aboriginal people.

- Pursue strategic alliances with other Crown financial institutions (the Export Development Corporation, the Farm Credit Corporation, and the Canadian Commercial Corporation), and with the private sector to leverage government activities.
- Increase the visibility of the Bank and its services.
- Strengthen the Bank's national presence.
- Focus on being a world leader in the provision of electronic banking services.

A Pathbreaker in Financing

The Bank has responded by developing a wide variety of product lines and initiatives, some of which are listed here.

- BDC Connex, a pioneer of on-line banking in Canada, provides access to the Bank's entire range of products.
- The Student Business Loans Program is administered in collaboration with Human Resources Development Canada. In 2000, the BDC authorized 744 student business loans, totalling more than \$2.3 million.
- The BDC has adopted a more aggressive approach to developing strategic alliances. It now has alliances with each of the large Canadian chartered banks and with credit unions. In 2000, the BDC was involved in lending projects totalling \$2.6 billion, a 9 percent increase over the previous year, and twice the value of the Bank's own authorizations.
- A national advertising campaign, 17 Entrepreneurship Centres across Canada, and the gradual relocation of branches to street-level operations continue to encourage growth in the number of clients the Bank serves, particularly among micro-businesses.
- Venture capital commitment at year-end 2000 reached \$195 million, a 24 percent increase over fiscal year 1999. Through partnerships with co-investors, BDC has been able to raise the level of investment in companies by a factor of 4.8, which means that for every dollar that BDC invests, nearly five additional dollars of equity are injected into the company from other sources.

Through these and similar initiatives, the BDC helps to deliver the public policy mandate and goals of the federal government. As a member of the Board of Directors, your responsibility is to ensure that the Bank's strategic direction, products and services respond to this public policy mandate. The main tool for this activity is the five-year corporate plan that the Board submits annually to the shareholder.

BDC: A Strong Partner Within the Industry Portfolio

The BDC is one of 15 federal departments and agencies that make up the Industry Portfolio, the group of organizations that report to the Minister of Industry.¹ The Minister interacts differently with each of the organizations. For example, the regional development agencies report to their respective Secretary of State as well as to the Minister, whereas other partners often have a president and/or chair who would report directly to the Minister in his/her capacity as shareholder. All the partners are uniquely positioned to further some aspect of the government's goal of building a knowledge-based economy in all regions of Canada, and to advance the government's agenda for jobs and economic growth. The Deputy Minister, Industry Canada, and one of the deputy ministers representing the regional development agencies (on a rotating basis) are members of the BDC Board of Directors.

As a key member of the Industry Portfolio, and as well as exercising its financing responsibilities, the BDC is:

- the lead federal agency for Small Business Week in Canada (the third week in October);
- core sponsor of the federal government's SME Info-Fair team, which brings valuable financing and management information to SMEs across Canada;
- partner with FedNor and Western Economic Diversification Canada in delivering management consulting services and financial products to clients in Northern Ontario and the Western provinces;
- provider of seed capital to finance new technology developed by scientists at the National Research Council Canada; and
- partner with the Canadian Tourism Commission in the Tourism Investment Fund, which helps entrepreneurs to acquire, expand or improve facilities that serve the tourism industry.

1. The 15 partners are: Atlantic Canada Opportunities Agency, Business Development Bank of Canada, Canada Economic Development for Quebec Regions, Canadian Space Agency, Canadian Tourism Commission, Competition Tribunal, Copyright Board Canada, Enterprise Cape Breton Corporation, Industry Canada, National Research Council Canada, Natural Sciences and Engineering Research Council of Canada, Social Sciences and Humanities Research Council of Canada, Standards Council of Canada, Statistics Canada, and Western Economic Diversification Canada.

BDC: Interactions with the Federal Government

The BDC is owned by “Her Majesty in Right of Canada” (i.e. the federal government, its sole shareholder). As such, the Bank has ongoing obligations with respect to accountability, planning and budgeting, within two distinct layers:

- As an instrument of the federal government, the BDC was created by Parliament, and ultimately must account to Parliament for its mandate and activities. This is done through the intermediary of the “designated minister,” the Minister of Industry, who represents the shareholder. The Minister must approve and recommend any change in mandate, capital structure, corporate strategy, corporate plan, capital budget or borrowing plan. The *Business Development Bank of Canada Act*, the legislation that created the Bank, provides the statutory cornerstone for all that the Bank does.
- As a Crown corporation, the Bank must operate within the constraints of the *Financial Administration Act*, the overall mandate of the federal government, and norms that apply to all federal departments and Crown corporations. In this respect, the BDC maintains key relationships with Industry Canada, as well as the Department of Finance and Treasury Board. Officials from these organizations work closely together to facilitate analysis of all Bank proposals. Each proposal undergoes a distinct approval process, as outlined in the flowcharts at the end of this guide.

There are six key government bodies that play a role in accountability and approval processes.

- Parliament, and Parliamentary committees (usually the House of Commons Standing Committees on Industry and Finance and the Standing Senate Committee on Banking, Trade and Commerce);
- Cabinet, particularly the Cabinet Committee for the Economic Union (the Bank interacts with Cabinet through the Minister of Industry);
- Industry Canada (as advisor to the Minister of Industry);
- the Department of Finance (as advisor to the Minister of Finance, who must recommend any change in the capital structure and must approve the Bank’s borrowing plan);
- Treasury Board and Treasury Board Secretariat (which must approve the corporate plan, capital budget and borrowing plan); and
- the Privy Council Office (as advisor to Cabinet and the Cabinet Committee for the Economic Union.

Parliament of Canada

As a creation of Parliament, the BDC is accountable to Parliament through the designated minister (the Minister of Industry). The most concrete expression of this accountability is the Bank's annual report. This report, which details the Bank's activities and financial status, is a statutory requirement under the terms of the *Financial Administration Act*. It must be tabled in Parliament by the Minister of Industry within three months of the end of the Bank's fiscal year (March 31).

The Bank may also be called upon to appear before any of the House of Commons or Senate committees to provide professional advice and information on a particular issue or piece of legislation. For example, in 1998, the Bank appeared before the House of Commons Standing Committee on Finance, and the Standing Senate Committee on Banking, Trade and Commerce, to provide its perspective on the proposed chartered bank mergers.

Bank officials may also be called before the House of Commons Standing Committee on Finance, or the House of Commons Standing Committee on Industry, to provide information on the nature of, and need for changes to the *Business Development Bank of Canada Act*. Likewise, Bank officials may also be called before these committees to discuss elements of the Bank's mandate or to provide testimony on the state of small business financing in Canada. It is unusual for Board members to be called before a Parliamentary committee.

Cabinet

Recognizing that many of today's complex issues are cross-sectoral, thereby involving several government departments, the Prime Minister has formed a series of Cabinet committees, including the Cabinet Committee on Social Development and the Cabinet Committee for the Economic Union (CCEU).

The CCEU is made up of the ministers, including those of Industry, Finance, and Trade, who deal most with economic issues. The CCEU addresses issues on a macro scale. It must approve major strategic initiatives that the Minister of Industry puts forward concerning the Bank, including any proposed changes to the *Business Development Bank of Canada Act* or to the Bank's mandate. The CCEU will thus be closely involved in the mandate reviews called for in the *Business Development Bank of Canada Act*.

Industry Canada

Formed in 1994 by Act of Parliament (the *Department of Industry Act*), Industry Canada is the principal advisor to the Minister of Industry, the designated representative of the Bank's only shareholder. As one of the lead departments responsible for economic development and job creation, Industry Canada's mission is to foster a growing competitive, knowledge-based Canadian economy. The Department's five strategic objectives (improving Canada's innovation performance; making Canada the most connected country in the world; building a fair, efficient and competitive marketplace; improving Canada's position as a preferred location for domestic and foreign investment; and working with Canadians to increase Canada's share of global trade) assist Canada in improving growth in productivity, employment, and income, all of which supports small business.

Small Business Policy Branch

Within Industry Canada, the Small Business Policy Branch (SBPB) is responsible for advising the Deputy Minister (who is a member of the Board of Directors) and the Minister of Industry on the Bank's plans and activities. As such, SBPB is the primary point of interaction between officials of the BDC and Industry Canada. In particular, SBPB is tasked with a dual role:

- SBPB works with the BDC to help facilitate the Bank's interactions with other government departments. This includes helping to develop the Bank's annual five-year corporate plan, and ensuring that all the necessary analysis and information are provided to ensure a smooth approval process. This work also extends to matters such as the Bank's responsibilities under the *Financial Administration Act*, and preparing the way for the Bank's mandate reviews.
- SBPB advises the Deputy Minister of Industry, and through him/her the Minister of Industry, on dealings with the Bank.

SBPB also maintains a network of contacts both within and outside government to obtain ongoing advice on the effectiveness of government initiatives aimed at helping SMEs. SBPB works closely with the Department of Finance and the Treasury Board Secretariat on all policy issues pertaining to the Bank's mandate. In addition to its BDC-related responsibilities, SBPB also provides policy advice to the Minister of Industry on the *Canada Small Business Financing Act*.

Department of Finance

Formed in 1867 as a creation of the Constitution, the Department of Finance is primarily responsible for providing the government with analysis and advice on the broad economic and financial affairs of Canada. Best known by Canadians as the department responsible for preparing the federal budget (including setting personal and corporate tax rates), the Department of Finance advises on the economic, fiscal, social, and tax implications of the government's key priorities, and recommends measures regarding government borrowing and cash management.

The Department of Finance also maintains a special relationship with the financial sector. As the lead department for the development of regulatory policy for the financial sector, the Department of Finance was responsible for creating the Task Force on the Future of the Canadian Financial Services Sector. The report of that task force (the "Mackay Report") strongly endorsed the BDC's role in developing innovative financing instruments, and recommended that the Bank's activities in filling important niches be encouraged.

The Finance-BDC relationship is based on provisions and duties that are established in both the *Financial Administration Act* and the *Business Development Bank of Canada Act*.

Within the Department of Finance, the Economic Development and Corporate Finance Branch advises the Minister as to the merits of the proposed activities outlined in the Bank's annual corporate plan. These activities must be consistent with the Bank's mandate. Any new activities must be shown to be filling market gaps and client needs, and any budgetary implications must be clearly understood. The Branch also advises the Minister on equity injections: how much is needed and why, and how the amounts have been calculated.

The Financial Sector Policy Branch advises the Minister of Finance regarding the borrowing of the BDC. Specific transactions are considered on the basis of cost, risk, and the Crown's need to manage its asset/liability requirements. Borrowing activities are based on the Bank's capital. Therefore, approval of borrowing requires the approval of capital requirements. The Branch also negotiates the terms and conditions of the subscription of shares on behalf of the Minister of Finance.

The Minister of Industry makes recommendations to the Minister of Finance on any changes to the Bank's capital structure and borrowing plan. The Minister of Finance's approval is required before any such proposal can be implemented.

Treasury Board and the Treasury Board Secretariat

The Treasury Board is one of four Cabinet Committees of the Queen's Privy Council. It was established by the Constitution in 1867, and given statutory powers in 1869. A small number of ministers sit on the Board, among them the Minister of Finance. It is headed by the President, and its activities are supported by public servants in the Treasury Board Secretariat (TBS).

The Treasury Board is the general manager, expenditures manager and employer of the Government of Canada. In this capacity, the Treasury Board establishes policies for areas such as government-wide accounting, audit procedures, financial management, information technology, and real property. These policies set the rules by which all government departments and Crown corporations, including the BDC, must operate.

Since the Treasury Board also provides financial management for the federal government, it must approve the spending plans of all government departments and Crown corporations. In this respect, the Treasury Board has the final say in approving the BDC's corporate plan and its capital and operational budgets, as well as in granting or denying the Bank authority to borrow.

The Treasury Board's approval of the corporate plan, based on the recommendations of the Minister of Industry and the Minister of Finance, is required before the annual capital and operating budgets can be implemented by the Bank. BDC Board members and officials are not required to deal directly with Treasury Board ministers. Proposals are submitted through the Minister of Industry.

As the administrative arm of the Treasury Board, TBS recommends and provides advice on its policies, directives, regulations and program expenditure proposals with respect to the management of the government's financial, human, and information and technology resources.

Privy Council Office

The Privy Council Office (PCO) is the central coordinating office for all federal government departments, agencies and Crown corporations. It reports directly to the Prime Minister, and has dual responsibilities, as the department that supports the Prime Minister and as Cabinet secretariat.

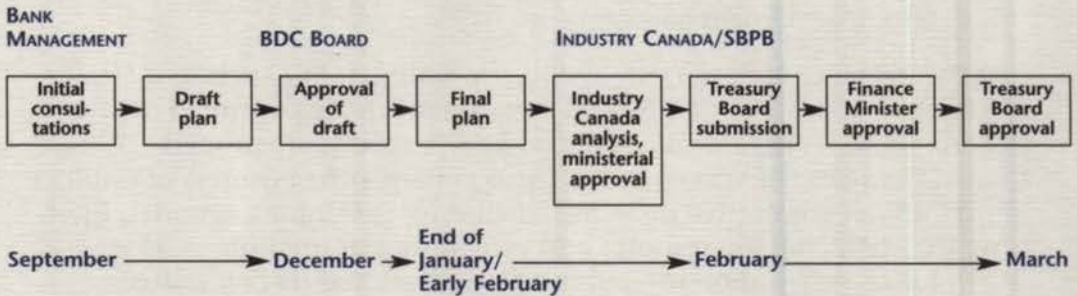
As the department that supports the Prime Minister, PCO establishes the government's policy priorities; develops and coordinates the implementation of those policies; oversees ministerial mandates and the organization of the government; and makes senior appointments within the public service, including appointments to the boards of directors of the BDC and other Crown corporations.

As the provider of Secretariat services to Cabinet, PCO acts as a "traffic manager." It ensures that federal departments have consulted on areas of shared concern, and that policies and programs are properly coordinated between departments. PCO also manages the business of Cabinet and Cabinet committee meetings, including developing agendas, briefing the chairs, taking minutes and providing information. PCO is therefore a very important conduit to Cabinet and its committees. Working closely with the Small Business Policy Branch of Industry Canada, it helps smooth the way for major BDC initiatives such as mandate reviews or changes in strategic direction. For example, PCO ensures that officials of Industry Canada, the Department of Finance and the Treasury Board have addressed possible ministerial concerns before ministers actually meet at the CCEU. PCO also ensures that all members of the CCEU are briefed on the issues ahead of time, and that their questions are dealt with quickly.

Document Development and Approval Processes

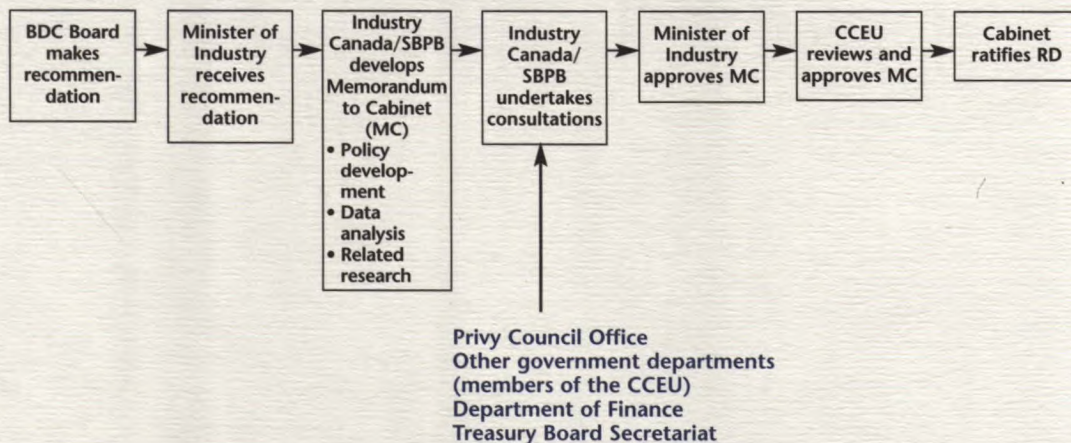
The following flowcharts illustrate the steps in the development and approval process of the annual corporate plan and of policy documents/proposals such as the mandate review report, as well as the interaction with federal departments at critical stages.

BDC Corporate Plan



- BDC Management consults Industry Canada and the Department of Finance and prepares the first draft of the BDC five-year corporate plan for review by the BDC Board.
- BDC Board provides comments and direction on the draft plan.
- BDC Board approves the final version of the five-year corporate plan.
- The corporate plan is submitted to the Minister of Industry. The Minister sends it to the Small Business Policy Branch (SBPB) for analysis.
- SBPB staff analyse the corporate plan and prepare a draft Treasury Board submission based on the plan. At this time, SBPB seeks comment and analysis from the Department of Finance and Treasury Board Secretariat on the Bank's corporate plan and its supporting Treasury Board submission. Based on SBPB's own analysis, and on feedback from the Department of Finance and the Treasury Board Secretariat, SBPB will recommend that the Minister of Industry support the Bank's corporate plan in its entirety, or support a portion of it.
- The final Treasury Board submission is submitted to the Minister of Finance for approval.
- Once approved, the Treasury Board submission is sent to the Treasury Board Secretariat for final approval.
- Final approval from Treasury Board is received. The Bank receives authority to borrow for the new fiscal year.

BDC Mandate Review/Policy Proposals



- The BDC Board makes a policy recommendation to the Minister of Industry.
- The Minister of Industry reviews and forwards the recommendation to the Small Business Policy Branch (SBPB) for analysis.
- SBPB prepares a Memorandum to Cabinet (MC). This includes drafting the appropriate policy framework, collecting and analysing data in support of the policy and researching related policy frameworks.
- SBPB undertakes consultations with related federal departments on the MC. The Privy Council Office (PCO), government departments whose ministers are members of the CCEU, the Department of Finance and Treasury Board Secretariat provide comments and input to the MC.
- The Minister of Industry reviews and approves the final version of the MC, and brings it to the CCEU for consideration.
- The CCEU reviews the MC. At this point, PCO has already ensured that all ministerial questions and concerns have previously been addressed and that all members of the CCEU have been briefed on the contents and implications of the MC. The CCEU issues a Record of Decision (RD) on the proposals contained in the MC.
- The RD goes to Cabinet for ratification.
- If a proposal requires amendments to the *Business Development Bank of Canada Act*, then following ratification by Cabinet the policy goes for legislative drafting, is introduced in the House, then must pass through four approval steps in the House of Commons and four more in the Senate prior to coming into force. An MC usually takes about four to five months to go through all stages, but if legislation is needed to implement a policy, final approval can take another six to eight months, depending on the volume of Parliamentary business.