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Growing Small Businesses

The Honourable John Manley, P.C., M.P.
Minister of Industry

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

February 1994

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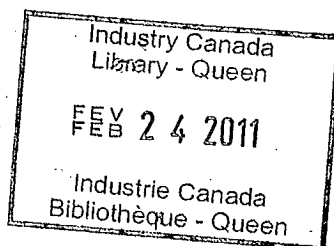
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MESSAGE FROM THE MINISTERS

The growth of small businesses is essential to job creation in Canada. In its electoral commitments and again in the Speech from the Throne, this government expressed its intention to develop, grow, and create better employment opportunities for all Canadians.

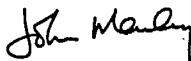
This paper sets out the approach that we will take. Working closely with other economic players, we are determined to improve the environment for small business, and reshape policies and programs in support of small businesses. In meeting the challenges of the new global economy, this government believes that there are opportunities to make wiser use of government support, to rationalize support programs and services, and to make them better focused.

Action is already under way on several fronts consistent with our electoral commitments, and we will proceed with other initiatives in the coming months and beyond. Later this year, the government will report on its progress to Parliament and the public.

The building of an innovative economy requires the small and medium-sized business sector to be a thriving one. We can succeed in turning our agenda into action with the participation of small businesses themselves and other key partners in the private and public sectors. As such, you will find that collaboration is a key theme of this discussion paper. We look forward to working with all those who will be involved.



The Honourable Paul Martin, PC, MP
Minister of Finance



The Honourable John Manley, PC, MP
Minister of Industry

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CHAPTER 1

FOCUS ON SMALL BUSINESSES

Commitment to Action

The federal government recognizes the vital role that small business plays in the Canadian economy. Small businesses create jobs, they generate wealth, and they provide satisfying careers for a growing number of entrepreneurs. To realize their full potential as an engine for growth, however, they need a favourable environment that allows them to prosper and expand. They also need forms of support that are tailored to helping them meet the challenges of a changing and competitive economy. While extensive assistance is already provided to Canada's small businesses (see Figure 1.1), the government has heard their concerns and it is moving energetically to respond. This paper sets out an agenda that reflects the government's determination to work closely with the small business community and with other players to ensure that this crucial sector continues to thrive and grow.

In priority areas where business has spoken clearly with a unified voice – taxation, financing, regulatory and paper burden, overlap in program and service delivery – the government will proceed at once to improve the environment in which small businesses operate. Chapter 2 of this paper outlines these approaches.

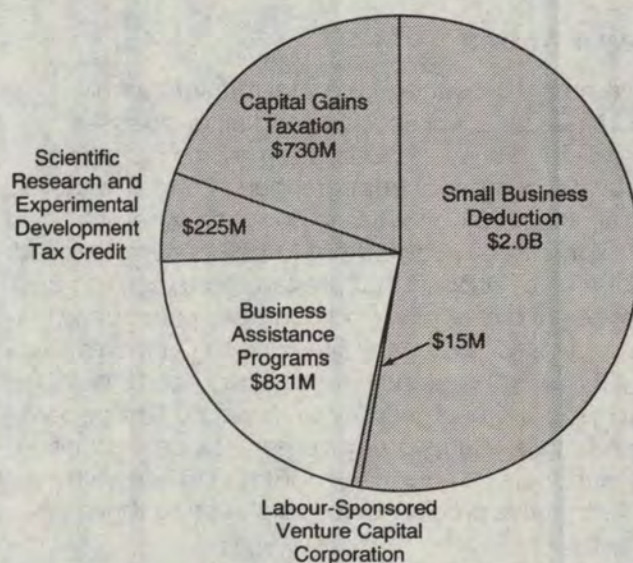
Priority areas

In areas where global economic changes present different and more complex challenges, the government will collaborate closely with others in a comprehensive review of current approaches to supporting small businesses. Chapter 3 points to features of the economic transformation – globalization, technological progress, and accelerating rates of change – that present small businesses with special challenges. It offers a framework for re-engineering the support that government provides to small businesses in management training, labour skills development, technology, trade, and the financing of growth-oriented businesses. And it sets out initiatives that will be the foundation for modernizing the government's approach.

The ability to respond effectively to small business needs is crucial to the country's well-being. Governments, the private sector, and other institutions must act together in a decisive way to realize common objectives. Chapter 4 sets out mechanisms that will lead to co-operative action on small business policy.

Figure 1.1

*Federal Assistance to Small and Medium-sized Enterprises**



*Data on tax measures is for 1990.

Budget Expenditures for Business Programs and Activities That Focus on Small Business – Contributions, Transfers, Loan Guarantees (\$ millions) (1993–94 estimates)

Industrial and Science and Technology Programs	142
Regional Development Programs	598
Small Business, Export Market Development, Management Assistance and Guarantee Programs	91
Total	831

Source: Department of Finance Canada.

What Are Small Businesses?

Although there is no standard definition, small businesses are often described as firms having fewer than 100 employees in the manufacturing sector and fewer than 50 in the service sector. Medium-sized businesses are often described as having 100 to 500 employees. Distinctions become blurred, however, owing to dynamic changes in the economy and innovations in business organization.

***Midsized
businesses
included***

Canada's small business sector is highly diversified by ownership, type of industry, and stage of development. Small businesses cover all sectors from resource-based industries to manufacturing and services. They may be start-ups, stable and established business veterans, or rapidly growing enterprises. They include self-employed people operating their businesses from their homes. In addition, strong regional characteristics add to the diversity of Canada's small businesses.

The small business sector has been tapping new sources of acumen, vigour, and entrepreneurship. Canadian women entrepreneurs have achieved an impressive success rate in small business start-ups and have become a powerful creative force in the small business community. Aboriginal people are establishing and operating businesses in increasing numbers, a key to asserting their economic self-reliance. The disabled are finding new opportunities in small business careers.

The Importance of Small Businesses

Including the self-employed, more than 99 percent of all businesses in this country are small businesses. Table 1.1 shows that, if the self-employed are included, Canada in 1991 had more than two million small businesses with fewer than 100 employees, an increase of 50 percent since 1981.

***Most businesses
are small
businesses***

Fifty-three percent of all Canadians working in the private sector were either self-employed or working in businesses with fewer than 100 employees in 1991.

Job creation is one of the most important economic contributions made by small businesses, as illustrated in Figure 1.2. Since the late 1970s, smaller firms have been the key contributors to net job creation: between 1979 and 1989, businesses with fewer than 100 employees created over 2.3 million of the net new jobs,

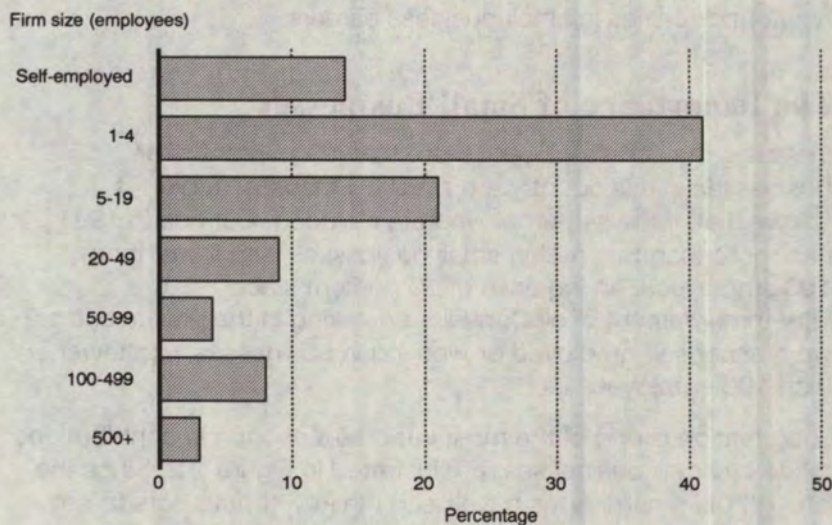
Job creation

Table 1.1
Number of Businesses in Canada

	1981		1991		Change
	Number	%	Number	%	%
Self-employed	678,000	49.3	1,146,000	55.4	69.0
Employer businesses					
< 5 (employees)	522,358	38.0	678,447	32.8	29.9
5-19	125,928	9.2	174,966	8.5	38.9
20-49	30,024	2.2	43,588	2.1	45.2
50-99	10,049	0.7	13,897	0.7	38.3
100-499	7,753	0.6	9,334	0.4	20.4
500+	2,030	0.1	2,020	0.1	-0.5
Subtotal	698,142	50.7	922,252	44.6	32.1
All businesses*	1,376,142	100.0	2,068,253	100.0	50.3

*Individual items may not sum to totals because of rounding.
Source: Industry Canada/Statistics Canada.

Figure 1.2
Employment Creation by Firm Size, 1991



Source: Industry Canada/Statistics Canada.

or 87 percent of all growth in employment during the period. The self-employed added a further 400,000 to the total. About 30,000 fast-growing small businesses made a particularly notable contribution, accounting for 70 percent of the total net increase in employment.

Small businesses have been expanding their economic role in other significant areas. For example, the share contributed by small businesses to gross domestic product (GDP), the total of all goods and services produced in Canada, increased from 33 percent in 1981 to 38 percent in 1991. The small business share of corporate profits rose from 25 percent in 1986 to 32 percent in 1990.

***Other
contributions***

Global Opportunities, Global Challenges

The dramatic growth of the small business sector coincides with Canada's transition to a knowledge-intensive economy, driven by innovation and technological change. At the same time, the revolution in telecommunications and transportation, accompanied by a reduction in barriers to international trade and investment, has given birth to a global economy in which traditional distinctions between domestic and foreign markets are being eroded.

***The global
economy***

The revolution in information and telecommunications technology puts more power into the hands of small businesses that choose to take advantage of it. Technology, combined with flat management structures and flexibility, can give small businesses the capacity to respond quickly to changing consumer needs – a decisive advantage in today's highly competitive marketplace. It can also open new markets and new opportunities at home and abroad.

The promise of the new economy will be best realized by those companies that keep up with change, hone their skills, and innovate aggressively. But small businesses can face serious impediments – restricted access to capital, inadequate management skills, a lack of skilled employees, limited technological sophistication, and underdeveloped marketing abilities, especially abroad. Small businesses may be proliferating in Canada, but individually they remain vulnerable to these problems.

Since both job and wealth creation increasingly depend on this sector, the impediments faced by small businesses in realizing their full potential are a cause for public concern. Their economic strength is all the more relevant since Canada's small businesses now compete against the best in the world, even if they choose to stay at home. If they are to become more resilient, small businesses will need a business environment that favours their efforts. To compete successfully at home and abroad, small businesses need the support of public policies attuned to the demands of the new economy.

Other areas of the world have already grappled with these challenges. Regional governments in Europe – in Emilia-Romagna, Baden-Württemberg, Catalonia, and Rhône-Alpes – have adopted policies and assistance that enhance small businesses' competitiveness and promote economic dynamism. The success of these four motors of Europe arose from encouraging partnerships and building co-operative industrial systems adapted to contemporary markets and technologies. Canada can learn much from their experiences.

A New Policy Approach

To encourage growth and competitiveness

The government's electoral commitments recognize the importance of small business to the Canadian economy and include concrete measures to support this sector. This agenda, emphasized in the Speech from the Throne, has been developed in close collaboration with the private sector, especially small businesses themselves. It aims to encourage growth and competitiveness, and has two basic thrusts.

- I. ***To make sure that the business environment is conducive to small business growth.*** This means ensuring that the tax system does not inhibit growth and job creation, improving the availability of financing for small businesses, cutting back the regulatory and paper burden, and making the delivery of services effective and efficient. Chapter 2 deals with these objectives.
- II. ***To ensure that limited government resources are effectively targeted to enhance competitiveness and encourage growth in the new global economy.*** This means redefining the role of government to emphasize the provision of strategic information, and expertise. Further, it

means critically reviewing and re-engineering small business support policies in the areas of management, labour skills development, trade and marketing, technology, and capital for growth. Chapter 3 deals with these concerns.

Future Directions

The business community must be directly involved in the design and implementation of the government's proposed policy agenda for small businesses. The plan of action, summarized in Table 4.1 of Chapter 4, seeks to involve all interested parties in the policy-making process, to inform the broader public of the issues, and to sketch out a framework for intergovernmental co-operation. The use of parliamentary committees to ensure that small business views are fully reflected will be an important part of this process.

***Broad
involvement
foreseen***

In today's complex global economy, no single player acting alone can create a vibrant small business sector. Small businesses and those who provide them with services – all orders of government, business associations, private sector intermediaries, and educational institutions – will play an important part in ensuring that small businesses are an engine for job creation and growth in Canada.

CHAPTER 2

IMPROVING THE BUSINESS ENVIRONMENT

Framework for Action

The domestic business environment influences how small businesses are created and how they survive. It can determine whether they grow and prosper or fail and disappear. The pressures of operating a small business can be overwhelming. The creative capacity of business owners needs to be focused completely on the demands of their enterprise: producing, marketing, selling, and distributing. And in a global economy, firms must meet and beat the competition from abroad just as much as from across the street.

***Conditions
that make
a difference***

At all stages of a firm's life cycle, a positive business environment can make the difference between success and failure. The business environment refers to the general conditions under which businesses operate, including the national fiscal balance, the tax system, the extent of freedom to do business anywhere in the country, the structure of regulations, the practices and expectations of lenders and borrowers, and the efficacy of government programs.

When external constraints become overly burdensome, the energies of business owners are needlessly diverted. Governments, which exert the single largest influence on the business environment, therefore have a key role to play in ensuring that the national climate nurtures the entrepreneurial spirit and is conducive to the start-up and growth of small enterprises.

This chapter reviews government actions as they affect the business environment. The focus is on the national marketplace and the kind of national policy framework that is needed to improve the environment for small businesses in all parts of the country. The major concerns expressed by Canada's small businesses can be dealt with effectively only through the federal government acting in concert with other orders of government, the small business sector itself, and other interested parties.

Canada is a country with significant regional differences. That is why one of the ways that the government implements national policies is through regional agencies – the Atlantic Canada Opportunities Agency (ACOA), the Federal Office of Regional

Development – Quebec (FORDQ), Federal Economic Development Initiative in Northern Ontario (FEDNOR), and Western Economic Diversification (WED). These agencies work closely with provincial and local governments and the private sector to strengthen businesses in those areas.

Small Business Opinion

Small businesses repeatedly voice the same concerns about the business environment: high taxes, difficulty in obtaining financing, regulatory and paper burden, and the inefficiencies and ineffectiveness of government programs and services. They have long called for improvements in all four areas.

Taxation

In addition to sharing the concern of all Canadians with the general level of taxes, small businesses decry the growing burden of payroll taxes in particular as a tax on employment – a kind of tax they say this country can ill afford with present levels of unemployment. They also state that the paperwork associated with the goods and services tax (GST) and payroll taxes is drawing energy away from productive activities that create wealth.

Financing

Small businesses continue to express strong concern about their treatment by financial institutions. Business owners complain of seemingly arbitrary reductions of credit lines, increases in required loan collateral, difficulties in obtaining export financing, and unsympathetic attitudes among lending institutions.

Regulatory and paper burden

In a recent survey by the Canadian Federation of Independent Business (CFIB), 71 percent of respondents in 1992 expressed concern about the burden of regulations and paperwork from all orders of government, up from 43 percent in 1983. Almost three-quarters of respondents to a 1991 Chamber of Commerce and Gallup survey indicated that they were not satisfied with the federal government's approach to regulation. Another recent survey by the CFIB found that 25 percent of those surveyed spent about one day a week dealing with government regulatory and paper burden; a further 37 percent spent about half a day. Regulatory burden falls disproportionately on small businesses because they have limited resources to deal with paperwork.

***Delivery of
government
programs
and services***

Small businesses believe there is an urgent need for governments to eliminate waste and duplication, especially when fiscal restraint is needed to reduce operating deficits. Where similar programs are offered by different federal departments or by different orders of government, good business practice demands co-ordination and rationalization. Elimination of overlap and duplication through the rationalization of government programs and services and their delivery can realize significant savings for both government and businesses. Some government programs and services are also criticized as poorly designed and irrelevant to current business needs. Small businesses will benefit from a program structure that is easier to understand and use.

Preliminary results from the Canadian Chamber of Commerce "Aim for a Million" project, which were issued on 14 February 1994, reinforce many of these concerns. Final recommendations from this project will be presented to the Prime Minister in April 1994.

Taxation

The challenge

Taxes affect businesses in a number of ways. In particular, they increase the cost of doing business, both in terms of burden and compliance. They come in various forms – payroll, income, property and capital taxes – and from all orders of government. Small businesses have raised the following concerns about the tax system:

- The general burden of all government levies is too high.
- Much of the burden comes from levies such as payroll and property taxes that are not directly related to profits.
- The tax system is too complex, largely because there is not enough co-ordination between the different orders of government, particularly in sales taxes.

The federal income tax system contains several special provisions that encourage investment in small businesses, make their tax burden lower than that of larger businesses, and simplify compliance. Both governments and the small businesses themselves have an interest in making these provisions as effective as possible.

Current initiatives

Table 2.1 describes the most important federal provisions for small businesses.

The Small Business Deduction (SBD) provides by far the most assistance to small businesses. The federal SBD reduces the basic federal corporate income tax rate for small Canadian-controlled private corporations by 16 percentage points – from 28 percent to 12 percent. Provincial tax rates on small businesses range from 5 percent to 10 percent. These lower tax rates allow small businesses to retain more of their earnings in the business for reinvestment.

The small business deduction

Although referred to as small business measures, these measures also benefit medium-sized businesses. Indeed, in 1990, more than \$781 million of the federal small business deduction (about 38 percent of the total amount) was claimed by businesses with assets exceeding \$1 million.

The small business tax rate, in combination with the dividend tax credit, is designed to integrate the corporate and personal income tax systems; that is, to ensure that salary income and dividend income from a small corporation are taxed at about the same rate. Changes in tax rates in recent years have caused a slight over-integration – dividends from small Canadian-controlled private corporations are currently taxed at a lower rate than salary income and income from unincorporated businesses.

As Table 2.1 indicates, the total federal tax assistance in 1990 was about \$3 billion. This translates into a significantly lower federal income tax burden on small (and to some extent midsize) businesses than on large businesses (Figure 2.1).

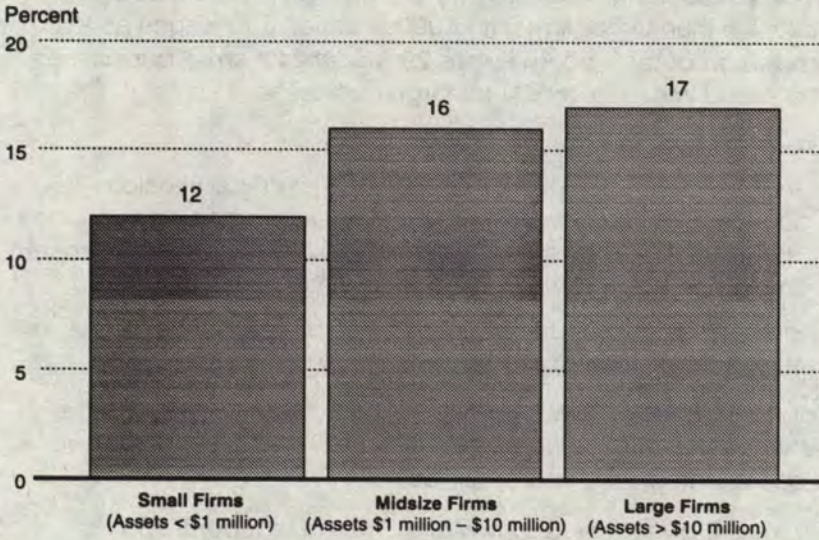
Table 2.1

Key Small Business Federal Tax Measures, 1990

Measure	Description
Small Business Deduction (SBD)	<p>Tax rate on the first \$200,000 of income of Canadian-controlled private corporations reduced from 28 percent to 12 percent.</p> <p><i>Value of assistance:</i> \$2.1 billion <i>Claimants:</i> 270,000</p>
Capital Gains Taxation	<p>The first \$500,000 of capital gains on the disposition of qualified small business shares by individuals are exempt from income tax. In addition, capital losses arising from the disposition by an investor of shares and debts of qualified small business corporations may be used to reduce any income of the investor. (Other capital losses may only offset capital gains.)</p> <p><i>Value of assistance:</i> \$731 million <i>Claimants:</i> 65,000</p>
Labour-Sponsored Venture Capital Corporation (LSVCC)	<p>Investors in LSVCCs receive a 20-percent federal tax credit as well as a matching provincial credit in many cases. LSVCCs pool funds of individuals to invest in a portfolio of small businesses.</p> <p><i>Value of assistance:</i> \$14 million <i>Claimants:</i> 50,000</p>
Scientific Research and Experimental Development Tax Credit	<p>Canadian-controlled private corporations can claim a scientific research and experimental development tax credit: the rate is 35 percent rather than 20 percent for large businesses; the credit can be refundable.</p> <p><i>Value of assistance:</i> \$225 million <i>Claimants:</i> 3,500</p>

Source: Department of Finance Canada.

Figure 2.1
Effective Federal Corporate Income Tax Rates* (1990)



* The ratio of income and capital taxes to business income.
 Source: Department of Finance Canada.

Despite their benefits to small businesses, the tax measures give rise to the following questions:

- Are existing tax incentives to encourage the financing and growth of small businesses as effective as possible?
- Do some tax measures impede the ability of small businesses to raise capital and grow?

***Taxes not
 related
 to profits***

Apart from income taxes, corporations pay a number of direct levies based on payroll, capital, and property that are not related to profits. Businesses must pay them in both good economic times and bad.

Levies not related to profits can be especially burdensome for small businesses. Payroll taxes, for example, hit small firms disproportionately because they are generally more labour-intensive than larger firms. (In 1990, salaries and wages as a proportion of total income were 29 percent for small businesses, compared with 14 percent for large businesses.)

There are two basic types of payroll levies:

- levies that are deferred compensation (Canada Pension Plan/Quebec Pension Plan (CPP/QPP)) or are earmarked to finance specific programs for employees (for example, unemployment insurance (UI) and workers' compensation programs); and
- general levies that do not finance specific programs (for example, general provincial payroll levies).

For the purpose of this section, no distinction has been made between these two types; both have been included to present as broad an information base as possible.

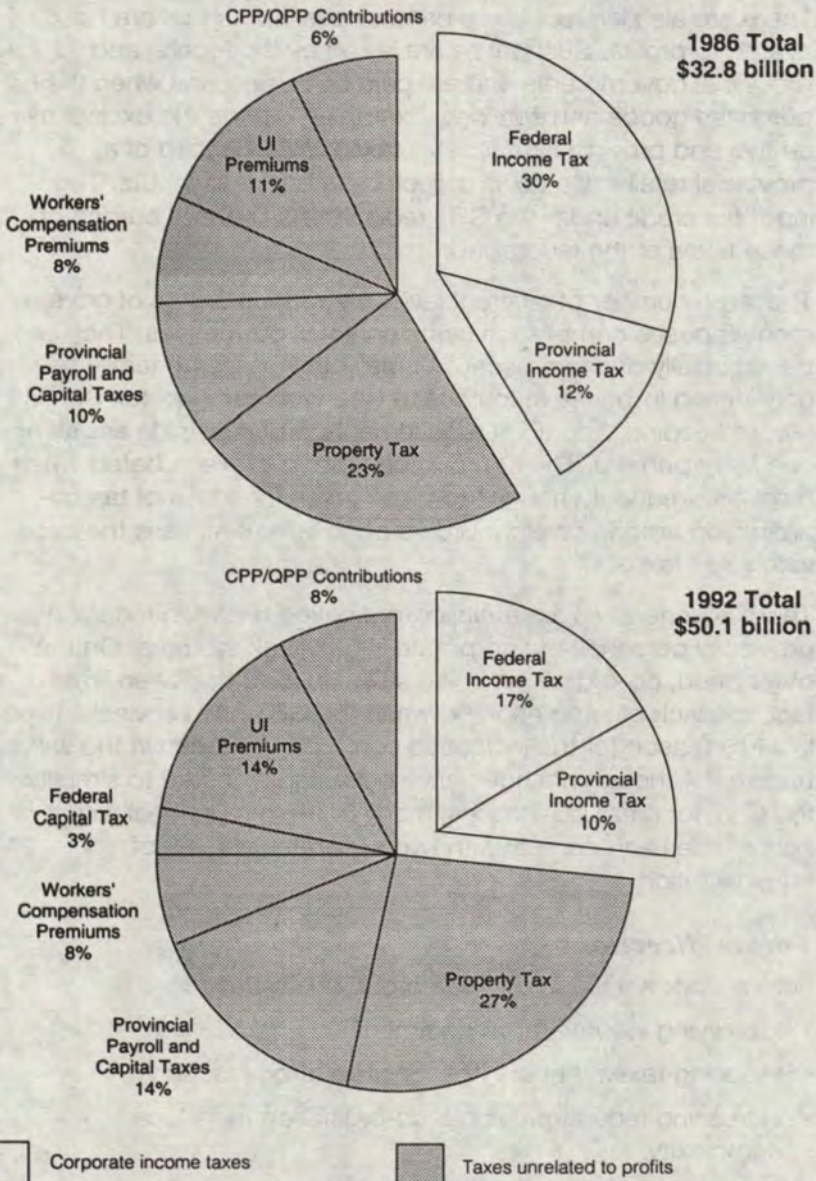
Figure 2.2 gives a breakdown of the range of federal and provincial direct levies. Several key points can be made from this presentation.

First, levies not related to profits account for a significant portion of the overall tax burden: about \$36.5 billion in 1992, representing about 73 percent of the \$50 billion of direct corporate taxes paid that year.

Second, the burden of direct taxes not related to profits is an issue for all levels of government. About two-thirds of the payroll and property taxes on business are levied by provinces and municipalities.

Finally, the importance of taxes unrelated to profits has been growing in recent years: they increased from 58 percent of direct taxes in 1986 to 73 percent in 1992. During that time:

- Employers' UI contributions as a percentage of direct corporate taxes increased from 11 percent to 14 percent.
- Employers' CPP/QPP contributions as a percentage of direct corporate taxes increased from 6 percent to 8 percent.
- Property, provincial payroll and capital taxes, and workers' compensation premiums as a percentage of direct corporate taxes increased from 41 percent to 49 percent.

Figure 2.2*Composition of Direct Corporate Taxes – 1986 and 1992*

Notes: Detail may not add to 100 percent because of rounding. Federal capital taxes are linked with the federal income tax system: the 3 percent corporate surtax is creditable against the large corporations tax, and the income tax is creditable against the capital tax on financial institutions.

Source: Department of Finance Canada.

This shift from income taxes to taxes unrelated to profits results partly from the decline in corporate profits during the past few years.

There are also indirect taxes on business inputs that are not related to profits. Such taxes are levied by the federal and provincial governments and are paid by businesses when they purchase goods and services. Examples include the excise taxes on fuel and provincial retail sales taxes; about a third of all provincial retail sales tax is collected on business inputs. The input tax credit under the GST reduces the financial burden of these taxes at the federal level.

***Complexity of
the tax system***

The large number of different levies by various orders of government imposes compliance costs on small businesses. They can be especially onerous because small businesses generally have only limited in-house resources to deal with complex tax issues, record keeping, and audit requirements; using outside assistance can be expensive. The compliance burden is exacerbated when there are frequent changes to these taxes, or a lack of tax co-ordination among different orders of government, as is the case with sales taxes.

There is generally substantial co-ordination between federal and provincial personal and corporate income tax systems. On the other hand, co-ordination in the sales tax field has been limited. In fact, the lack of integration between the GST and provincial taxes is a key reason for the increased compliance burden in the sales tax area. Although changes have been implemented to simplify the GST for small businesses, many of them must deal with two sets of rules and comply with two separate systems of administration.

Future directions

Future work will focus on three broad tax issues:

- identifying income tax impediments;
- reducing taxes that are not sensitive to profits; and
- increasing federal-provincial co-ordination to reduce complexity.

***Income tax
impediments***

Fiscal constraints and the considerable amount of tax assistance already provided to small businesses make additional tax assistance inappropriate. The tax system will be kept under examination, however, to identify areas where it may be impeding

or frustrating small businesses in their efforts to grow and create jobs. Further, the government will examine the existing tax incentives designed to encourage the financing of small businesses to ensure that the amount of assistance currently provided is being delivered as effectively as possible.

The federal government is committed to ensuring that UI premiums are as low as possible. As part of the review of the social policy framework in Canada, launched by the Minister of Human Resources Development, it is anticipated that UI will be fundamentally reformed by 1996-97. That reform will lead to significant reductions in UI expenditures and hence premium rates. All orders of government should examine the heavy and increasing reliance on taxes not related to profits.

***Taxes not
sensitive
to profits***

The federal government is already working with the provinces to reduce the compliance burden for businesses by increasing the harmonization and co-ordination of taxes. The key priority for the federal government is to replace the GST with a system that improves federal-provincial sales tax harmonization and co-ordination, minimizes the transitional impact on taxpayers, provides a reliable and stable source of revenue, encourages economic efficiency and competitiveness of Canadian industry, and generates equivalent revenues.

***Federal-
provincial
co-operation***

A parliamentary committee will review options to replace the GST. The views of small businesses will be an important contribution. Small businesses will also play an important part in the government's review of social policy, where the issue of UI premiums will be thoroughly examined.

Next steps

Financing

The challenge

Access to financing can be a critical issue for small businesses, particularly during their early years. The vast majority of Canadian businesses, large or small, meet their financing needs through private capital market transactions with no public sector assistance. Equity and debt are the primary kinds of financing for small businesses, but non-traditional forms such as leasing are increasingly being used.

***Critical in
early years***

Typically, the initial capital for a new small business comes from the owner or from family and friends, sources that are soon exhausted. Most small businesses meet additional equity needs from retained earnings. Some attract the attention of local investors who can bring the business both capital and expertise. Not many small businesses obtain equity financing from institutional investors such as venture capitalists or pension and mutual funds, since administrative costs can be high relative to profit potential for investments below about \$500,000. Few firms raise capital through the public stock markets. The challenges faced by growing, innovative firms in obtaining financing are discussed further in Chapter 3.

Most small businesses turn to debt financing at an early stage. Banks are the main lenders, dealing with more than 80 percent of independent businesses in Canada. Trust companies, credit unions, caisses populaires, and other institutions play a smaller but significant role. Some critics contend that small business lending by the banks is lagging behind the needs of a recovering economy.

According to Bank of Canada statistics, total small business loan portfolios, excluding commercial mortgages and agricultural loans, stood at \$20.9 billion at December 1989, decreased to \$17.4 billion at the end of 1992, and increased to \$18.3 billion at 30 September 1993.

Financing problems tend to increase when general economic activity slows and cash flows weaken. Lenders become more risk-conscious; raising or even maintaining financing becomes more difficult, even for businesses with a proven track record. From the business person's perspective, uncertainty about financing increases the difficulty of planning for the medium and long terms.

Credit crunch at issue

Much has been said and written about small businesses facing a "credit crunch." Individual business people and their associations have spoken of what they feel is unfair treatment by banks. They argue that the banks view their businesses as being riskier than is really the case. Long-established, successful business people complain of arbitrary reductions in credit lines and requests for additional loan collateral, sometimes from unfamiliar account managers. Borrowers often perceive banks as being unsympathetic and driven by short-term considerations, using formula-based, inflexible risk assessment models. They are also

viewed as driven by strategies that can periodically tighten credit to businesses in specific industries or regions. In short, many business people have expressed the feeling that banks are not willing to work with them in a co-operative and helpful way.

Not surprisingly, bankers view the situation differently. They contend that much of the criticism results from a misunderstanding of their role in financial markets. As low-risk lenders, with responsibility to depositors and shareholders, they assess the risks involved in a business to ensure that loans can be serviced and ultimately repaid. If a bank sees the situation of a business deteriorating, it will adjust its lending to what the bank feels is a serviceable level.

Current initiatives

Both the public and private sectors have taken measures recently to improve the availability of small business financing.

***Public and
private
responses***

The federal government has improved a long-standing program – the *Small Business Loans Act* (SBLA) – to increase the flow of capital to small businesses. Recent amendments to the SBLA broadened the criteria for eligibility, increased the amount of financing available to individual businesses, and reduced personal guarantee requirements. The annual rate of lending under this program has increased from \$500 million in fiscal 1992–93 to about \$2 billion in 1993–94.

A number of banks recently have taken some innovative steps to provide better service to small business clients:

- In a more competitive environment, banks are increasingly seeking to differentiate themselves and their products, and small businesses are becoming beneficiaries through better terms for financing or reduced banking costs.
- All banks are re-examining their practices, from how they assess credit to how they train, educate, and assign their staff.
- One bank has instituted unsecured term loans with deferred repayments for businesses meeting certain qualifications.
- Pilot programs are testing the workability of new approaches, including an expansion of the traditional banker's role into one of financial facilitator collaborating with the customer.
- Banks are improving their in-house expertise in innovative technologies and risk-assessment techniques.

Future directions

There are several areas in which co-operative action can improve access to financing.

Most banks are beginning to recognize the specialized needs of knowledge-based businesses. A few are considering the particular needs of Aboriginal businesses. Banks are also developing new approaches to traditional business financing, such as providing contract financing on firm purchase orders, or developing new financing mechanisms for trade and offshore projects. These are positive developments, but much remains to be done.

New code of conduct

Encouraged by government, the banking community is developing a code of conduct to clarify its role in small business lending so that borrowers will know what to expect. Such a code should help to establish a more constructive relationship between small businesses and financial institutions and facilitate the financing process.

The issue of personal guarantees for loans under the SBLA requires resolution. Under the 1993 amendments to the SBLA, personal guarantees were limited to 25 percent of the original loan amount. Many small businesses, however, favour eliminating them. The banking community disagrees, although one bank has indicated that it will ask for guarantees only in exceptional circumstances. The government will resolve this issue with the financial institutions.

The government is also reviewing the mandate of the Federal Business Development Bank (FBDB) to ensure that its programs and services still meet the needs of small businesses. This will include a review of the bank's role in providing financing supplemental to that of the commercial banks, its venture capital operations, its ability to develop and deliver innovative financing instruments to growing small businesses, and opportunities to improve customer service.

Next steps

The working committee on business environment issues proposed in Chapter 4 will examine initiatives to improve the availability of conventional financing. It will also explore ways of tapping into less traditional sources of capital, particularly at the local and community level.

Regulatory and Paper Burden

The challenge

Regulations set out the rules of the marketplace in such areas as public health, product quality, safety standards, environmental protection, business practices, and competition in order to ensure fair treatment for both businesses and consumers. In most instances, businesses appreciate the need for regulation and often welcome the stability it lends to their activities. In fact, many regulations are initiated by industry.

*A necessity
and a burden*

Nevertheless, the scope, complexity, and rigidity of regulatory processes causes concern. Many businesses feel that the proliferation of regulations by different orders of government has led to regulatory overkill. Restrictions on business activities are often seen as interference that prevents companies from getting on with the job. Small businesses also find that regulations are complicated and confusing, and that complying with them takes too much time, effort, and money. Figure 2.3 illustrates this concern with the regulatory and paper burden imposed by all levels of government in Canada.

Advocates of regulatory reform make these points:

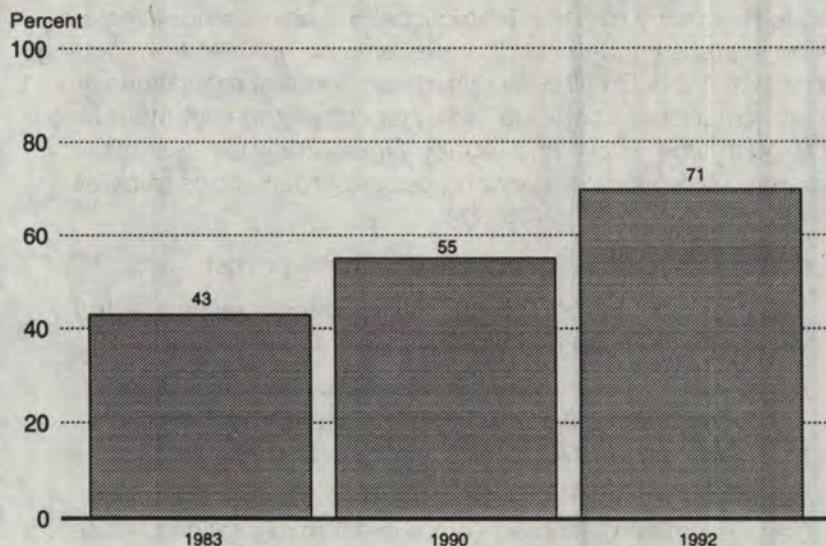
*Costs in time
and money*

- The growing cost of fees, permits, and licences connected with regulation can be hard for smaller firms to bear.
- Regulatory complexities often mean that businesses must devote significant in-house resources to ensure compliance or must seek expensive professional help to make sure they are doing things correctly.
- Because most businesses are subject to regulation by different departments of different orders of government, entrepreneurs must acquaint themselves with the policies and procedures of several bureaucracies.
- The burden of regulation is heightened when, in some areas, responsibilities of governments overlap, leading to conflicting regulations and differing information requirements that cause additional uncertainty, confusion, and paperwork.

- Companies wishing to do business outside their home province often bear an additional regulatory burden. Standards differ for certain products and services across provinces. To comply with these various standards, businesses face additional costs and paperwork. They must often adapt their production processes and products, and register or even operate an office in each province where they wish to do business.

Figure 2.3

Percentage of Small and Medium-sized Business Owners Who Find Regulatory and Paper Burden to Be a Significant Problem, All Levels of Government



Source: Canadian Federation of Independent Business.

The paper burden resulting from regulations, including filling out forms and filing them, is a key business concern. Paperwork and reporting requirements take the small business person away from more productive activities and frequently result in the additional cost of contracting expert assistance. A compounding irritant to small businesses is the array of apparently arbitrary and costly penalties imposed for even such minor violations as late payments.

Small businesses are particularly vulnerable to the effects of government regulation. Large firms can more easily absorb the costs of permits, staff to do paperwork, and the professional services of accountants and lawyers. With their limited resources, small businesses face a disproportionate burden of compliance.

***Special
difficulties***

Current initiatives

An attack on these problems has been under way following the report of a 1992-93 House of Commons all-party committee on regulatory reform. At the time the committee began its work, federal departments and agencies also began a comprehensive review of their regulations and regulatory processes. Thousands of small businesses have contributed to the work of both the committee and federal departments.

***Cutting
the excess***

More than 1,700 federal regulations are being eliminated or changed. The 1994 Regulatory Plan just presented to Parliament contains a number of simplified regulations and proposals for further improvements. Table 2.2 gives examples of some current initiatives.

Table 2.2
Results of Current Regulatory Initiatives

Issue	Example of Result
Co-ordination between different orders of government	Federal departments and the provinces are developing food safety standards allowing for a common inspection approach and plant rating system for all orders of government and mutual recognition of inspections by all departments and orders of government. A six-month trial of common inspection approaches to bakeries has recently been completed.
Involvement of those affected by regulation	The Business Impact Test, developed co-operatively by government and business, will give businesses a more effective and influential way of participating in the design of regulations. Businesses can complete the test and forward their responses to government departments to feed into the development of regulations.
Removal of unnecessary regulations	Some of the retail package size requirements have been removed, making it easier to sell fresh produce from large bins.
Impact on competitiveness	The 1994 Federal Regulatory Plan contains cost-benefit analysis of the impact of proposed regulations or amendments compared with previous years.
Making regulations easier to understand	Transport Canada is reviewing the language of regulations on the transportation of dangerous goods to make them simpler to understand. Saskatchewan provides a toll-free number for information on provincial regulations and programs.
Simplification of procedures	Changes to the <i>Canada Business Corporations Act</i> will improve service to businesses incorporated under the act. Filing requirements will be reduced, and businesses will be able to make greater use of electronic filing procedures.

... continued

Table 2.2 (continued)

Issue	Example of Result
Dissemination of information	The federal government has developed an on-line library of all federal regulations and is working with business associations and others on ways to make it available. Canada Business Service Centres will have on-line information in plain language on about 300 federal regulations.
Alternatives to regulation	A guide for federal regulators has been developed that offers alternatives to regulation such as consensus standards and economic incentives.
New approaches to regulation	The Government of Newfoundland is applying sunset provisions to all regulations; they will expire unless they can be justified in the future.

Future directions

The paper burden imposed on businesses is unacceptable. The government in 1994 will launch a formal and public process to reduce it substantially within the next year.

The working committee on business environment issues will examine proposed regulatory changes and will collaborate in the process of reducing regulatory burden. This will include examination of the regulatory best practices of other countries and governments in areas such as sunset legislation and the elimination of unnecessary or inappropriate licences, certification costs, and other charges. Ways to clarify terms, criteria, and reasons for regulatory decisions will be examined. The use of phase-in periods, differential standards, and thresholds to alleviate the burden on smaller companies will also be studied. In addition, the examination will consider how to reduce the complexity of the federal regulatory approval process, develop more effective mechanisms to appeal regulatory decisions, and simplify or reduce the number of forms, reports, and records required by regulation.

Next steps

Negotiations are under way between the federal, provincial, and territorial governments to eliminate barriers to the free flow of goods, services, people, and capital within Canada. They are to be concluded by 1 July 1994, with an agreement taking effect next year. The proposed Internal Trade Agreement will be broad in scope, addressing 11 major sector and issue areas.

Delivery of Government Programs and Services

The challenge

A recent inventory found over 700 federal and provincial government support measures for small businesses.

Business has told government that accessing the right programs and services is far too complex and unfriendly, and that they are being hobbled by extensive overlap and duplication in the delivery structure. Different orders of government have too many delivery agents. Some of these may be competing with private sector suppliers of services to businesses.

Current initiatives

Single- window access

The federal government is working with the provincial governments and the private sector to create single windows through which small businesses can easily access the programs, services, and other forms of assistance available to them.

This approach is being used to develop Canada Business Service Centres (CBSCs) in at least one major city in every province. The centres provide small businesses with information about relevant programs and services, referrals to sources of assistance, and some diagnostic assistance. A leading example is the government's CBSC pilot in Winnipeg, led by Industry Canada, which links 17 public and private sector organizations in serving small business clients.

Canada's key international competitors are pursuing similar initiatives. For example, the United Kingdom will develop 200 private sector-operated "one-stop shops" over the next few years under the name of "Business Links." Business support organizations and services will be linked through each centre using a common approach and standards along the lines of a master franchise agreement. The centres will provide basic information and specialized services. They will be staffed by account managers who understand business problems and who can assemble help to meet the needs of each customer.

The federal government is putting greater emphasis on providing small businesses with strategic information on economic performance, market trends, emerging opportunities, new technologies, and business best practices that can help firms improve their competitiveness.

*New emphasis
on information*

Future directions

A global, knowledge-based economy demands comprehensive and current information on markets, technologies, and best practices. Effective dissemination of more relevant and useful information is central to the government's policy agenda for small businesses. A CBSC in each province will serve as the key access point through which this information will be delivered to small businesses across the country. Centres are already operational in three provinces, and further centres will be opened in the remaining provinces by the summer of 1994.

The government will also capitalize on developments in technology to reduce the cost and improve the effectiveness of delivering both programs and information. The emerging information highway will give two million small businesses efficient access to an immense store of information on regulations, standards, programs, services, export markets, business practices, technology opportunities, and sources of assistance. Though useful to the entire small business community, such technology can be particularly important in putting businesses in smaller cities and in rural Canada on an equal footing with their counterparts in the major centres.

Next steps

The government will accelerate its examination of the delivery of small business programs and services. In many cases, delivery should be handled at the regional or community level where needs are better identified and services can be tailored to meet them. Consideration will also be given to private sector delivery options. This review will be undertaken in conjunction with the provinces.

CHAPTER 3

ENCOURAGING GROWTH IN CHALLENGING TIMES

Components of Success

Growing businesses are important to Canada because they are the source of new ideas, new forms of competitive advantage, and new jobs. Some 70 percent of the new jobs created in the 1980s originated with 30,000 rapidly growing small businesses. The future economic health of Canada depends on the country's ability to achieve greater success through the growth of these small businesses.

Strong small business role

The government seeks to create a supportive business environment that will help all small businesses, whether they grow or not. Additionally, it seeks to develop appropriate forms of specialized assistance that will help growth-oriented firms realize their full potential in both domestic and international markets.

The Economy Transformed

Small businesses today face a new and daunting set of challenges. Rapid technological progress, including a revolution in communications and information technology, has been joined by new liberalized international trading arrangements, new forms of business organization, and a host of other changes. These have combined to open up new markets and create new opportunities. While the new, knowledge-based economy will continue to change, Table 3.1 sets out many of its key characteristics and their implications for small businesses.

Small business affected

Table 3.1
Characteristics of the Emerging Economy

Feature	Impact on Small Businesses
Globalization	<ul style="list-style-type: none"> • Technological change and the removal of trade barriers have created a global marketplace. • The distinction between domestic and international markets is disappearing. • Key factors of production can move to wherever the business environment is most attractive.
The prominence of services	<ul style="list-style-type: none"> • Services now account for almost two-thirds of GDP in advanced industrial societies. • It is no longer possible to draw an absolute distinction between goods and services. • A large part of the value-added in the goods-producing sector is attributable to service-based activities.
Knowledge intensity	<ul style="list-style-type: none"> • Knowledge is central to the new economy. • The knowledge component of many products is increasingly more valuable than the materials, physical labour, or capital that went into them. • Companies use knowledge to develop marketable new technologies, improve their products and services, or enhance their internal operations.
Competitive advantage independent of size	<ul style="list-style-type: none"> • The technological revolution has reduced the relative importance of size as a determinant of competitive advantage. • Automated manufacturing systems and process controls mean that short production runs can be just as cost-effective as long ones.
Niche marketing	<ul style="list-style-type: none"> • Markets are fragmenting as customers and consumers become more demanding and particular about what they want. • Technology is making it possible to customize goods and services to meet highly specific requirements.
Continuous and rapid change	<ul style="list-style-type: none"> • Changes that used to take centuries are now compressed into decades and, in some cases, into a few years. • A growing number of new technologies are coming on-stream while product life cycles are shortening.

These characteristics of the new economy present small businesses with significant opportunities and challenges:

- **Globalization:** The erosion in the distinction between domestic and international markets means that even smaller companies are finding it increasingly easy to source, produce, and deliver anywhere in the world. This offers small businesses access to new markets and new opportunities. At the same time, domestic markets are almost completely exposed to the full force of international competition. Even if they stay at home, small Canadian companies will have to act like exporters, competing against the best in the world in our domestic markets.
- **Prominence of services:** The emergence of a service-based economy presents opportunities to small businesses, many of which are service providers. In addition, many service-oriented businesses can be built on the knowledge and cleverness of the entrepreneur; they do not require large capital investments. However, as more companies move into and compete in the service sector, securing a decisive competitive advantage will prove more challenging.
- **Knowledge intensity:** In a knowledge-based economy, technology can confer significant competitive advantages on companies that know how to use it. For example, small businesses can use information technologies to create value, extend reach, and compete with large organizations on a more even playing field. At the same time, however, technological change can threaten a small company if it does not keep up with or stay ahead of competitors.
- **Size:** In the age of computerization, automation, and rising productivity, fewer workers are required for any one task, so small businesses can be just as cost-effective as larger firms. Large organizations often lack the flexibility required to keep up with a rapidly changing environment. Any advantage that size still confers can be achieved by small businesses through new forms of economic association, such as strategic alliances, interfirm networks, joint ventures, and other forms of partnership that can be used to tackle larger projects. However, such partnerships present small businesses with the challenge of managing new and complex external relationships.

- **Niche marketing:** Small companies can compete successfully against large organizations by identifying and occupying small, tightly defined segments of the marketplace that they can serve better than anyone else.
- **Change:** A highly fluid environment continuously presents small businesses with new technologies, new markets, and new opportunities. At the same time, it challenges them to keep up with the latest developments. The business that stands still risks being swept aside by the onrush of change.

Challenges for Small Businesses

Few, if any, small businesses can hide from the realities of the new global economy. But they will be affected to different degrees, depending on the sector they are in, the market they are trying to exploit, and the objectives they are pursuing.

Implications of growth

Rapidly growing companies have special challenges because growth implies taking on new responsibilities, learning how to manage an ever larger organization, and solving ever more complex problems. It means finding the right people to fill expanding roles in a company. It implies abandoning routine and pursuing innovation; that, in turn, requires at least some familiarity with technology. Moreover, rapid growth may not be possible if a company restricts itself to only a local or domestic market; it may have to go abroad to find markets large enough to sustain growth. Growth also means getting supportive financing when it is needed.

All small businesses face a common set of challenges in responding to the new global economy. These are outlined in the following pages.

Management

To keep up with change, more Canadian small businesses will have to adopt new management practices. In a technology-intensive economy, it is vital to manage innovation and the application of new technologies.

Strong evidence presented in the box on the next page suggests that management skills remain a difficult challenge for many Canadian small firms. There is also little evidence that small business owners and managers are looking to formal management training programs and courses to upgrade their skills. Possible reasons include:

- **Relevance:** Many courses and training programs are not focused on the immediate needs of small businesses.
- **Accessibility:** Courses in management are generally offered in the classroom and not in the workplace.
- **Selection:** It is difficult to select relevant courses from the many available.
- **Time:** Small business owners and managers cannot spare time away from their businesses to participate in conventional training programs.
- **Cost:** Formal courses may seem expensive to small businesses, which are also unlikely to be able to afford management consultants.

Impediments to skill building

Labour skills development

Many companies are responding to the challenges of the new global economy by decentralizing decision making and giving their employees greater responsibility. Consequently, the jobs being created in the 1990s require higher levels of training and education than was the case in the 1980s, as indicated in Figure 3.1.

Jobs upgraded

Companies seeking skilled employees in Canada will have to contend with numerous human resource problems. The country's labour force is aging. Educational shortcomings are suggested by the high level of high school dropouts and the weak performance by high school students on international science tests. Yet the need for highly educated and skilled people in the labour force is greater than ever.

MANAGEMENT IN CANADA: ROOM FOR IMPROVEMENT

The 1993 World Competitiveness Report, an opinion survey of business leaders in advanced industrialized nations, ranks Canada fourteenth in managerial performance among 22 industrialized countries. The criteria included entrepreneurship, long-term orientation, business efficiency and productivity, employee satisfaction, and corporate financial performance.

Technology advisers of the National Research Council's Industrial Research Assistance Program have found that management attitudes and capabilities are often an impediment to the introduction of new technologies and processes.

According to a 1990 Canadian Labour Market and Productivity Centre survey of 187 professional management trainers, the capabilities of their small business clients were rated as "low" in marketing, finance, human resource planning, personnel management, management of technology, strategic planning, and leadership.

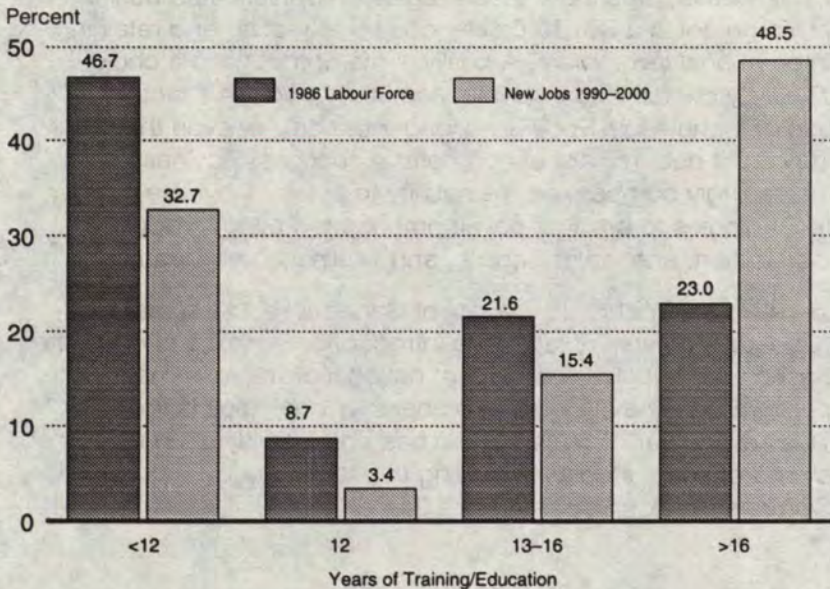
Bankers, venture capitalists, and individual investors consistently state that inadequate management and business planning skills are a main reason why small businesses encounter difficulty in obtaining financing.

A 1993 federal government survey¹ on the use of quality management practices by Canadian manufacturing firms reveals that only one firm in five regularly uses 80 percent or more of the practices studied, even though suppliers meeting quality standards have a competitive edge in world markets.

¹ See *Striving for Quality: A Survey of Quality Management Practices in Canadian Manufacturing* (Ottawa: Industry Canada, October 1993), p. 3.

Small businesses have special difficulties because they generally cannot afford the formal training their employees need to maintain and develop the skills the new economy requires. Yet a Canadian Federation of Independent Business survey in June 1991 showed that small firms are committed to on-the-job training and are aware of the importance of ensuring that the skills of their employees are up-to-date.

Figure 3.1
Changing Occupational Skill Requirements



Source: Human Resources Development Canada, 1992.

Innovation

Many small businesses are slow to innovate or apply technology to improve competitiveness. They may lack the time or resources to become well informed about technological change or its implications for their businesses. They may not even recognize that solving a problem or realizing an opportunity could depend on technology.

The impact of technology

Some see technology as a double-edged sword. On the one hand, its introduction can lead to job losses as increased productivity makes it possible to do more with fewer people. On the other, creating a technologically sophisticated business environment is a way to create jobs by attracting and retaining international investment. Actually, firms do not have a choice. The only choice is to innovate, especially through effective use of technology. Price is no longer the only or even the most important determinant of competitive success. Businesses increasingly compete on their ability to apply innovative technologies to product development, marketing, production, distribution, after-sales service, and internal administration.

In 1987, the Economic Council of Canada² reported that "Canada's persistent lag in the introduction and use of computer-based technologies is an urgent national problem of major proportions. The diffusion of process technologies is too slow." This seven-year-old observation has consistently been reinforced by more recent studies, including the 1993 World Competitiveness Report (Figure 3.2).

² Economic Council of Canada, *Making Technology Work: Innovation and Jobs in Canada* (Ottawa: Supply and Services Canada, 1987), p. 6.

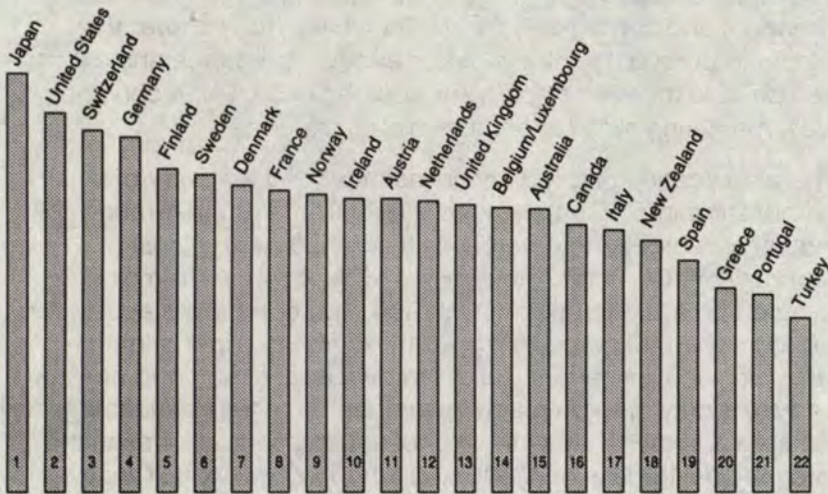
A review of Canada's performance in innovation as well as research and development (R&D) suggests the following:

***Weakness
in innovation***

- Aggregate measures of R&D activity indicate a real weakness in private sector, non-defence R&D spending relative to the other members of the Group of Seven (G-7) large industrialized economies.
- Less than half of one percent of Canadian firms perform R&D.
- Canadian companies, especially smaller firms, are behind their U.S. counterparts across a wide range of industries in adopting a number of advanced manufacturing technologies.
- Canada's share of international patents is lower than its share of population in the advanced industrial countries of the Organisation for Economic Co-operation and Development (OECD).

Figure 3.2

*Development and Implementation of Science and Technology**



* Scientific and technological capacity together with success of basic and applied research.

Source: World Economic Forum, 1993.

These shortcomings indicate that Canada lags behind its key competitors and must improve its R&D performance and application of technology if it is to respond effectively to the demands of a knowledge-intensive new economy.

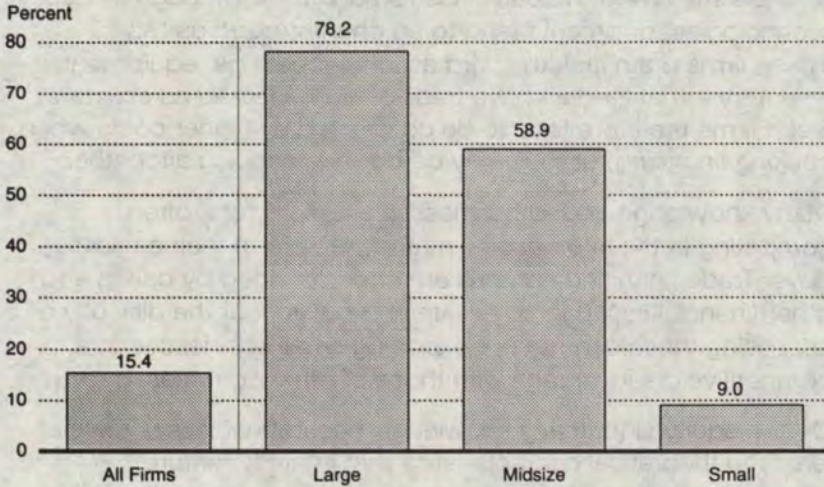
International trade

This country's future economic health will depend on its ability to compete, not only in international markets but also in Canadian markets entered by foreign corporations. Every billion dollars worth of additional exports translates into 9,000 new jobs in this country. Improved performance in foreign marketing is particularly important owing to the new export opportunities offered under the General Agreement on Tariffs and Trade (GATT) and the North American Free Trade Agreement (NAFTA).

Broader trade base needed

According to the 1993 World Competitiveness Report, Canada ranked twentieth among 22 industrialized countries in the extent to which it participated in international trade and investment flows. Canada's small businesses need to diversify their markets, improve awareness of the importance of trade, develop their international management skills, and foster better trade-related networks and strategic alliances. They have been slower than others to pursue the joint ventures and foreign partnerships that can provide them with additional sources of capital, technology, local marketing skills, and trade-related expertise.

The globalization of trade and investment and the entry of new competitors into global markets is exposing a broader range of industrial sectors and enterprises to intense international competition. Canada's international trade, however, remains focused on a few large firms: in 1990, 100 companies accounted for more than 60 percent of the \$141 billion of exports in that year. Only 7.6 percent of Canadian businesses exported at all, and a majority of them made fewer than three transactions a year. Figure 3.3 shows that, in the manufacturing sector, for example, international trade is concentrated among a few firms. Clearly, Canada has failed to build a broadly based trading culture within its private sector, despite large expenditures on trade promotion.

Figure 3.3*Export Participation of Manufacturers, by Firm Size*

Source: Statistics Canada, Survey of Manufacturers, 1989.

Not all small businesses will export, nor will exporting be appropriate for many of them. But all small businesses will have to become internationally competitive, even if only to defend their domestic markets from international competitors. The globalization process is affecting all sectors and firms, even those, such as distribution industries, that have traditionally been insulated from the international economy. To continue to grow and create attractive jobs, Canada's small businesses will have to raise their productivity and secure competitive advantages. They will increasingly have to benchmark themselves against their international as well as their domestic competitors.

Capital for growth

The "soft asset" hurdle

Knowledge-based firms, which are increasingly common in the new economy, are complex and difficult for lenders and investors to understand and evaluate. Assets such as knowledge, process technologies, or patents tend to be characterized as "soft."

These firms often lack the hard assets – buildings, equipment, inventory – that lenders have traditionally accepted as collateral. Such firms therefore tend to be confronted by higher costs when seeking financing, or they may be denied financing altogether.

Many knowledge-based businesses are exporters, often competing in the international marketplace from their earliest days. Trade financing services are often provided by banks and other financial institutions, private and public, but the difficulty of accessing these can put our exporting small businesses at a competitive disadvantage with those of other countries.

On the equity side, many knowledge-based businesses have at least the theoretical characteristics that interest venture capitalists: many of them experience rapid growth and offer high profit potential. A minimum investment threshold of about \$500,000, however, is a significant hurdle for start-up firms and early-stage small businesses seeking to attract venture capital.

Moreover, many innovative growth companies, particularly those in emerging knowledge-based sectors, have difficulty finding venture investors with enough knowledge about their business to add value. Today, only a handful of venture capitalists in Canada have the expertise and experience to be knowledgeable in particular emerging sectors.

At the end of 1992, there was roughly \$3.3 billion in venture capital funds in Canada, including private funds, government-owned funds, and funds that receive a government incentive to attract investment from individuals, such as labour-sponsored venture capital funds. Of this, about \$1.2 billion was available for investment. Early-stage investments accounted for about 30 percent of capital invested in 1992; about 59 percent went to technology companies. Several new venture capital initiatives have been launched in recent years, including provincial funds; they will increase the supply of venture capital available for investment.

Attracting financing will be a challenge to the entrepreneurial skills of small knowledge-based companies themselves. The technological and creative skills of entrepreneurs in knowledge-based businesses are frequently not matched by their management and general business skills. For lenders and investors, these managerial shortcomings increase the risk of deals that are already difficult to understand.

How Successful Businesses Have Responded

Many Canadian small businesses have enjoyed significant growth by responding to the challenges of the new economy. One important study,³ *Strategies for Success*, a survey of some 2,000 small and medium-sized businesses, examines the approaches adopted by businesses experiencing rapid growth between 1984 and 1988. The study reported on several areas in which the practices of these growing firms could be distinguished from those of less successful firms.

Strategies for Success

Management practices

Growing businesses emphasize management skills because they recognize that management is crucial to all other aspects of a business, including innovation and financing. Decision making is flexible and sophisticated. Advanced management practices, such as Total Quality Management, and innovative organizational structures are stressed. Growing businesses also have a smaller percentage of executives and managers, and a higher proportion of sales people than the average business, giving them a lean managerial structure and an emphasis on marketing.

³ John R. Baldwin, *Strategies for Success: A Profile of Growing Small and Medium-sized Enterprises (GSMES) in Canada* (Ottawa: Statistics Canada, 1994).

Labour skills development

The quality of labour skills is a priority for rapidly growing businesses, which rank the skills of their employees as superior to those of their competitors. The human resource strategy of these businesses focuses on hiring the best people available, with more than half of them providing continuous training to their employees. On average, 10 percent of their investment expenditure goes to staff training.

Innovation

A substantial proportion of the investment made by fast-growing firms goes into R&D. Even so, these firms emphasize an ability to innovate even more than conducting in-house R&D. Many firms innovate by introducing external technology into the company. A substantial proportion of rapidly growing firms regard the introduction of new products or entering new markets as crucial and have adopted aggressive strategies in these areas. Many of them focus on developing new products, especially by adopting and adapting new technologies.

Trade

Rapidly growing small businesses conduct a significant amount of business outside their regions, even if they do not trade internationally. The search for new markets and an emphasis on marketing play a central role in the activities of these firms. About 22 percent of their investment spending goes to marketing. A large percentage of their sales comes from outside their home province. While their exports to other countries make up a lower percentage of sales than is the case for large firms, they are active participants in export markets.

Financing

Managers of rapidly growing small businesses regard the cost of capital and access to capital as highly important to the performance of their firms. These companies use relatively more long-term capital than short-term capital. They use more equity than debt. The more successful and more profitable of these businesses make less use of internally generated funds to finance their operations, though it is not clear whether this is an underlying cause or a result of their success.

Business networks

In recent years, particularly since the period covered by *Strategies for Success*, businesses have increasingly been seeking a competitive advantage by learning from and assisting each other through networking. This business networking can involve collaboration between companies of various sizes with common interests in such issues as starting a new venture, market development, procurement, skill building, and technology development. Such networks provide a real opportunity for smaller businesses to help each other with only limited assistance from the government. Networks also allow small businesses to assemble resources comparable with those of large corporations without assuming their costs and organizational inflexibility.

Mutual assistance

The private sector is already pioneering new services to business through networks in Canada. For example, the Business Cooperation Network, offered under the aegis of the Canadian Chamber of Commerce, will help Canadian companies find foreign partners. More than 30 high-tech systems development consultants have formed a network to share resources and explore export markets. Similarly, a group of engineers and agronomists have formed Agratech, a business network focusing on improving grain handling, importation, and storage. The Canadian Chamber of Commerce is also leading a consortium to develop a national program to promote the formation of business networks.

A New Emphasis

Strategies for Success finds that only a small proportion of rapidly growing firms consider government subsidies to be important to their success. On the other hand, the study also reports a strong correlation between success and the use of programs such as export incentives, market information services, and training. The most successful firms tend to value these programs and therefore use them more intensively than the less successful firms. A self-selection process, in effect, makes winning firms choose the government programs that can be most useful to them.

However, *Strategies for Success* and more recent evidence show that business performance depends primarily on the insight and energy of the entrepreneur. There is little that any government can offer to substitute for hard work, creativity, good judgment, and persistence.

Business environment and information

What then is government's role? As set out in Chapter 2, government must first ensure that Canada's business environment is as supportive of entrepreneurship as possible. Government must also ensure that its support for small businesses is appropriate to the new competitive environment. One of the key ways in which government can help is to focus on the timely provision of vitally needed information, knowledge, and expertise.

Government is uniquely positioned between generators and consumers of knowledge. By working closely with business schools, private corporations, management consultants, and the small businesses for which the information is intended, government can assist in developing and disseminating the kind of knowledge small businesses need to improve their competitiveness. This includes information to help with:

- **Skill building:** A career in business increasingly requires a commitment to lifetime learning – ongoing training for both managers and employees. Government can assist by promoting the creation of business networks, by sponsoring exchanges of information, and by strengthening and supporting the role played by educators, trainers, and management consultants.

- **Assessment:** Successful businesses continuously compare their performance with that of others and learn from the difference. Government can help by working with business intermediaries to develop diagnostic tools and assemble benchmarking information that allows for interfirm and transnational comparisons, self-evaluation, and ongoing improvement.
- **Access to help:** Government can give small businesses better access to its programs and services. By making it easier to find out what programs are available and who is eligible, government can save small businesses valuable time. It can also act as a clearing house for information on other sources of assistance, including private sector experts, educational and training institutions, and investors and companies interested in partnering.
- **Research:** In a world of technological intensity and rapid change, small businesses will need to keep up with innovation. Governments can help them find and implement state-of-the-art technologies by supporting the creation of technology databases, research networks, and a system of referrals to technical advisers.

While government has an important role in gathering and packaging information, business networks operated by business for business can best deliver it. The government can encourage creation of the network. It can support networks by providing a comprehensive set of business-related materials – publications, tapes, planning guides, and directories.

Action Items

Pathway to innovation

The government's policy agenda for small businesses is comprehensive and far-reaching. As a first step, it includes a number of key initiatives that represent a new foundation for government support to growing small businesses in a rapidly changing economy. For example:

- **The Canadian Technology Network:** To be added to the highly regarded Industrial Research Assistance Program, the network will ensure that small firms have access to the latest information on new technology and an expanded range of advice and services so that they can fully exploit new market opportunities.
- **The Engineers and Scientists Program:** The program will provide funds to small businesses for the hiring of engineers, technologists, scientists, and industrial designers. It will help smaller firms fully benefit from technology transfer opportunities and be partners in commercializing new products.
- **The Canada Investment Fund:** New ideas and new technologies will never be commercialized if funding for innovation is not available. Important opportunities will be lost. The fund will help ensure an adequate supply of patient capital for the financing of innovation by leading-edge companies.
- **Business networks:** These are the vehicles by which smaller firms are gaining the resource advantages of larger firms, without taking on their burdensome and rigid overheads. Virtually all successful small knowledge-based businesses will be part of many networks over their lives. These networks can work only if they are controlled by the private sector, but the federal government is committed to providing matching grants to make the networks more extensive.
- **Information highway:** The information highway will profoundly alter the global economic geography of where new information products and services have to be produced and where they can be sold. Countries in the forefront will be the producers and the sellers on this information highway; those who lag will be the consumers of other countries' products and will lose out on its job and wealth-creation potential. The government this year will develop, in consultation with the stakeholders, a Canadian strategy for the information highway of the 21st century.

These initiatives reflect a common focus on the provision of knowledge, expertise, information, and enhanced financing for firms that are based on these soft assets. They have been benchmarked against the real needs of rapidly growing small businesses. They are, however, only the first step of a comprehensive small business strategy. There are four other key elements in this strategy:

- creating effective business-government mechanisms through which small businesses can participate directly in the reshaping of the program and policy agenda;
- undertaking a critical and comprehensive review of existing programs; to benchmark them against the real needs of small businesses in the new economy, and to assess them in relation to the government's increasing focus on providing strategic information;
- rationalizing programs where possible and eliminating them where they are of doubtful value; and
- minimizing, in collaboration with the provinces, the overlap and duplication of programs.

To implement this approach, the government proposes to establish a working committee on growth issues, led by the private sector, which will preside over this comprehensive review. The review will address the challenges facing small businesses in the new economy and recommend how the federal government and the private sector should best structure their support. The subjects to be addressed should include the following:

*Joint review
of issues*

- **Management skills:** The committee will study ways to ensure the provision by government of relevant programs, services, and information products, including examination of the role of the Federal Business Development Bank.
- **Labour skills development:** Although education and training will be included in the comprehensive study of the modernization of the social security system, the committee will need to focus on such items as work-based training alternatives for young Canadians, apprenticeship programs, and community-based skills development and training approaches.
- **Technology:** Within the broad science and technology priorities of the government, the committee will examine opportunities for improving technology development and diffusion services for small businesses.

- **International trade:** The committee will review current international business development programs and information and assistance services to ensure that they are clearly targeted to meet the priority needs of Canadian small businesses, and that they maximize opportunities for private sector participation and direction.
- **Capital flows:** The committee will examine ways in which the government can encourage capital flows to growth-oriented small businesses, including such initiatives as the proposed Canada Investment Fund and innovative approaches to financing knowledge-based businesses, including a comprehensive examination of the availability of export financing.

CHAPTER 4

ACTING TOGETHER

Major issues being dealt with

The Government of Canada has already launched specific initiatives in some major areas concerning the GST, unemployment insurance, tax compliance, internal trade barriers, and financing. The following actions are under way.

*Action
under way*

- The House of Commons Standing Committee on Finance has been asked to develop options to replace the GST.
- A comprehensive review of social programs, including unemployment insurance has been launched. It will deal with the issue of payroll taxes for the UI program.
- The small business advisory committee that reports to the Minister of National Revenue is considering the burden of tax compliance.
- All governments have appointed negotiators with the objective of reaching agreement by 30 June 1994 on the removal of internal trade barriers. The federal Minister of Industry and Ministers from each province are pursuing an agreement that will be broad in scope, covering 11 major sector and issue areas.
- The government and the Canadian Bankers' Association are examining a number of issues related to the financing of small business.

New process of collaboration

Translating this small business policy agenda into action will depend on the active participation of the small business community and others interested in its success. The government proposes to establish two business-government working committees to take up key items on the agenda.

Next steps

- A working committee on business environment issues will tackle the critical questions of small business financing as well as regulatory and paper burden. It will include representatives of the federal government, the small business community, and other stakeholders.

- A working committee on small business growth issues, led by the private sector, will examine forms of small business support appropriate to the requirements of the new economy. This committee will include representatives of the small business community, other private sector enterprises, and public and private sector institutions with a stake in issues such as management training, labour force development, technology, international trade, and the financing of innovation.

The government is committed to giving a progress report to Parliament and the public in the fall of 1994. This report will include the results of the two committees' work as well as other activities undertaken by the government in the interim. The Minister of Industry and the Minister of Finance will be responsible for coordinating the small business policy agenda.

A call to action

By adopting this co-operative and collaborative approach, the government's intention is to foster the kind of team spirit the country needs to face the challenges of the next century. All are needed to contribute their ideas and energy to ensure that small businesses remain in the forefront of the Canadian economy.

Table 4.1 summarizes federal government actions in pursuing the policy agenda for small businesses. The two working committees on business environment issues and on small-business growth issues are going to approach these subjects with a focus on the specific needs of small businesses in Canada.

Table 4.1
Policy Agenda for Small Businesses

Current Initiatives	<ul style="list-style-type: none">• The House of Commons Standing Committee on Finance has been asked to develop options to replace the GST.• A comprehensive review of social programs, including unemployment insurance has been launched. It will deal with the issue of payroll taxes for the UI program.• The business advisory committee that reports to the Minister of National Revenue is considering the burden of tax compliance.• All governments have appointed negotiators with the objective of reaching agreement by 30 June 1994 on the removal of internal trade barriers. The proposed Internal Trade Agreement will be broad in scope, covering 11 major sector and issue areas.• The government and the Canadian Bankers' Association are examining a number of issues related to the financing of small businesses.
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Table 4.1 (continued)

Issue	Proposed Actions
Working Committee on Business Environment Issues	
Financing	<ul style="list-style-type: none"> • Identify measures to facilitate the flow of capital to small businesses. • Review proposed code of conduct developed by banks to clarify their relationship in lending to small business. • Examine the issue of personal guarantees under the <i>Small Business Loans Act</i>. • Review the mandate of the FBDB to improve its ability to meet small business needs.
Regulatory and Paper Burden	<ul style="list-style-type: none"> • Establish a forum to allow small businesses to contribute to proposed regulatory changes; reduce the complexity of the federal regulatory approvals process, and develop more effective mechanisms to appeal regulatory decisions. • Examine ways to clarify terms, criteria, and reasons for regulation. • Examine best practices in areas such as sunset regulations and eliminating unnecessary licences and charges. • Study the use of phase-in periods, differential standards, and thresholds in developing new regulations to alleviate the burden on smaller companies. • Reduce the number of forms, reports, and records.

... continued

Table 4.1 (continued)

Issue	Proposed Actions
Working Committee on Growth Issues	
Management Skills	<ul style="list-style-type: none"> • Ensure provision by government of more relevant programs, services, and information products, and examine the role played by the FBDB.
Labour Skills Development	<ul style="list-style-type: none"> • Focus on such items as work-based training alternatives for young Canadians, apprenticeship programs, and community-based skills development and training approaches.
Technology	<ul style="list-style-type: none"> • Examine opportunities for improving technology development and diffusion services for small businesses.
Trade	<ul style="list-style-type: none"> • Review current international business development programs and information and assistance services to ensure that they are clearly targeted to meet the needs of Canadian small businesses, and that they maximize opportunities for private sector participation and direction.
Capital Flows	<ul style="list-style-type: none"> • Examine ways to encourage capital flows to growth-oriented businesses, including such initiatives as the proposed Canada Investment Fund, and new approaches to financing knowledge-based businesses. • Examine innovative approaches to export financing.

Parliamentary Committees

A committee of Parliament will be asked to critically examine the government's progress and to report in the fall 1994.