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# Financing Small- and Medium-Sized Enterprises: Satisfaction, Access, Knowledge and Needs

**Prepared for Industry Canada by**

**The Research Institute for SMEs,  
Université du Québec à Trois-Rivières**

February 2002

**Research Paper prepared for the Small Business Policy Branch as part of the  
Small and Medium-sized Enterprise (SME) Financing Data Initiative.**

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## EXECUTIVE SUMMARY

Further to the 1998 findings of the Task Force on the Future of the Canadian Financial Services Sector (the MacKay Task Force), the Government of Canada asked Industry Canada, Statistics Canada and the Department of Finance to establish a comprehensive program designed to improve understanding of the issue of SME financing. The Research Institute for SMEs therefore received a mandate from Industry Canada to carry out a survey to provide better knowledge of SME owners' perceptions of various financing-related aspects, including loan and credit requests, problems encountered in seeking financing, and satisfaction with the services provided. The survey was to cover all available sources of financing.

The purpose of this survey was to measure:

- ✓ SMEs' access to various financing sources in a variety of contexts (start-up, growth, exporting, etc.), while highlighting the major obstacles encountered;
- ✓ entrepreneurs' motivations in seeking financing;
- ✓ entrepreneurs' knowledge of the various financing sources available;
- ✓ entrepreneurs' satisfaction with the financing obtained, with an emphasis on the major determinants of satisfaction;
- ✓ entrepreneurs' willingness to finance future projects with the same lenders; and
- ✓ variations in financing conditions experienced by firms in the previous six months.

This summary presents the major findings and conclusions of the survey.

- **Profile of the respondents**

The survey revealed that one quarter of the SMEs are owned by women. The female entrepreneurs are, on average, younger than their male counterparts and less experienced in their sector of activity. Their educational level is the same, their objectives for growth are higher and their firms smaller, newer and in a less advanced phase of development.

During the previous three years, Canadian financial markets received more requests from younger entrepreneurs (less than 40 years of age) who are more educated, expect higher growth rates, are more involved in research and development (R&D) and exporting, and are more inclined to share control of their firm.

The more educated entrepreneurs expect higher growth rates for the next two years and are more open to an external partner to finance the firm's expansion or growth. They carry out more R&D and exporting activities and their firms have more employees.

A higher proportion of university graduates own firms that have been in existence for less than five years. These firms expect higher growth rates than older firms do, are more open to financial partners and are more often involved in R&D and exporting.

Most of the firms are more than 20 years old, while 18 were created less than three years before.

The majority (52%) of the SMEs are in the slow growth phase, 21% are in the mature phase and 13% in the fast growth phase. Firms in the initial (seed/start-up) phase represent only 5% of the sample.

The exporting firms represent 20% of the sample, and have highly variable levels of exporting.

A majority of the firms carry out no R&D activities, although 34% do to various degrees, ranging from 0.01% to more than 15% of their sales.

- **Financing applications and approval rates**

- **Line of credit**

Withing the sample, 45.1% of the SMEs requested a business line of credit; 81.5% were approved.

More than 54% did not request a line of credit during the previous three years; in 77% of the cases, this was because they did not need this type of financing.

The probability of a firm's requesting a line of credit is affected by its size, its indebtedness ratio, its specific sector of activity, its degree of investment in R&D, the owner's age, and the number of account managers it has had to deal with during the previous three years.

The number of line of credit requests rises significantly with the number of account managers; however, there is no significant difference in the approval rate.

The larger the firm, the higher the percentage of line of credit requests; however, viewed as a continuum, there is no significant difference in the approval rate.

The more firms export, the lower their line of credit approval rate.

The youngest entrepreneurs (30 years of age or less) request line of credit financing more often than those 60 years of age or over, but their approval rate is lower (8-10% compared to 9-10%).

Approval rates for line of credit requests are lower in the cultural, natural resources and manufacturing industries.

The firms located in central Canada (Manitoba and Saskatchewan) requested the highest percentage of line of credit financing during the previous three years.

The firms in Alberta, British Columbia and the Territories experienced the lowest approval rates.

The probability of approval of a line of credit request is affected by the firm's having a financial officer other than the entrepreneur, by being in the cultural or construction sector, by the firm's size, by the owner's experience in the specific industry and by the fact that the firm is owned by a woman.

- **Medium-/long-term loan**

Approximately 28% of the sampled SMEs requested a medium- or long-term loan during the previous three years. In 86% of these cases, the applications were approved.

- **Line of credit and medium-/long-term loan**

The percentage of requests for lines of credit and medium- and long-term loans rises with R&D activity, but the approval rate falls.

The firms in the seed/start-up phase experience the lowest approval rates for lines of credit and medium- and long-term loans, followed by the firms in the fast growth phase.

The higher the expected growth rate, the lower the approval rate, regardless of whether the request is for a line of credit or a medium- or long-term loan.

Female entrepreneurs made requests to fewer different external financing sources than did their male counterparts, regardless of the type of financing. This lower request rate is unrelated to overall satisfaction or to the approval rate. The approval rate for women's short-term financing requests is identical to that for males, and their requests for medium- and long-term financing are, on average, approved more often.

A higher proportion of requests by Francophones are approved than by Anglophones or Allophones for lines of credit and medium- and long-term loans.

- **Other findings**

Only 11.7% of the SMEs requested financing from government services/programs during the previous three years. The approval rate (64%) is significantly lower than for more traditional financing sources.

The firms most active in R&D turn mostly to internal and external equity financing, and a higher percentage of them state that obtaining additional financing represents a hindrance to their development or growth.

The smaller firms make more use of the services of credit unions, while the larger firms deal mainly with banks and other types of institutions.

A higher proportion of Francophones do business with caisses populaires for their ongoing operations, unlike Anglophones, who make more use of banking institutions.

- **Satisfaction regarding the various financing sources**

- **Line of credit**

The overall satisfaction index of the entrepreneurs regarding their line of credit is 3.66-5. Their major dissatisfactions with their line of credit are the institutions' service fees and the guarantees (personal and corporate) required in order to obtain financing.

The overall satisfaction level falls as the firms' R&D budgets rise.

The owners of firms expecting the highest growth rates report the lowest satisfaction indexes.

The satisfaction index declines significantly with account manager turnover.

The firms in the natural resources and cultural, recreation and tourism industries are generally the least satisfied, while those in the agricultural sector are the most satisfied.

The Quebec firms report the lowest satisfaction rate for the line of credit used.

If one considers the overall satisfaction of the sampled SMEs with their line of credit, 20% of that satisfaction is attributable to the amount granted, 15.6% to the possibility of the SME being able to negotiate the terms of the contract, and 14% to the institution's support of the business.

- **Medium- and long-term debt financing**

Younger entrepreneurs, firms in the seed/start-up phase and entrepreneurs who have dealt with more than one account manager state more often that obtaining additional financing represents a hindrance to their development.

The overall satisfaction index for medium- and long-term loans is similar to the line of credit index at 3.67-5. Also, the service fees and the guarantees required by the institution continue to generate the lowest satisfaction levels.

The lowest satisfaction rates obtained for medium- and long-term loans are observed for firms in the seed or start-up phases, and firms in the administrative and support and natural resources sectors.

Regarding the overall satisfaction of the sampled SMEs with their medium- or long-term loan, 22% of that satisfaction is attributable to the account manager's interest in the business's needs, 21% to the SMEs' ability to provide the guarantees required, 18% to the amount of time to process the request, 14% to service fees, 13% to the amount granted, and 11% to the interest rate.

No specific entrepreneur profile was observed based on degrees of overall satisfaction with line of credit and medium- and long-term loan financing.

- **Changes to financing conditions and entrepreneurs' intentions**

Of the respondents, 13% stated that their financing conditions changed during the previous six months. The major negative change was a rise in service fees.

Of the entrepreneurs questioned, 20% planned to request loans again during the coming year. Of these, 72% stated that they planned to make a request to the institution they currently dealt with for their line of credit, while 69% planned to make a similar request to their current medium-and long-term lender.

More firms in the seed/start-up phase planned to seek financing during the next twelve months than did other groups.

The percentage of firms planning to request financing in the coming year rises according to the extent of their R&D activities.

## *Chapter I:*

### **Introduction and methodology**

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#### **1.0 BACKGROUND**

In 1996, at the time of the most recent amendments to the legislation governing financial institutions, the Government of Canada mandated the Task Force on the Future of the Canadian Financial Services Sector (the MacKay Task Force) to prepare a comprehensive picture of this sector and propose improvements and initiatives that would ensure a reliable and competitive financial sector in the future. Following release of the Task Force report in 1998, the major players appeared to unanimously conclude that the existing information relating to financing of SMEs was inadequate and of questionable quality. The Task Force pointed to the harmful impact of this situation on policy formulation designed to improve the development of SMEs in Canada, and cited a number of possible avenues of improvement.

Reacting to the findings in this report, the federal Department of Finance tabled Bill C-38 and announced a reform of the sector. This reform promoted greater freedom for the various financial institutions, but also a better understanding of customers' needs, especially those of SMEs. To achieve this, the federal government mandated Industry Canada, Statistics Canada and the Department of Finance to establish a comprehensive program designed to improve understanding of the issue of SME financing. As a result of the joint efforts of these three organizations, a large volume of information was compiled regarding financing of SMEs, relating to both supply of and demand for financial services. This information was subsequently to be used in publications facilitating creation of government policies and to ensure better familiarity with the actual situation existing between the many lenders and Canadian SMEs.

Thus two national rounds of discussion were launched, with the goal of enabling the various parties to state their points of view concerning the approach to adopt in implementing this program. It was therefore agreed that the three major partners — Industry Canada, Statistics Canada and the Department of Finance — should conduct two basic surveys, one focussing on financing supply (financial institutions, informal investors, etc.), and the other on financing demand (SMEs). The results of these two surveys would then be studied to highlight issues such as



financing of knowledge-based firms, financing of start-ups, satisfaction of SMEs with the various financing services received, and venture capital financing.

Industry Canada therefore mandated the Research Institute for SMEs to carry out a survey covering all available sources of financing to provide better knowledge of SME owners' perceptions of various financing-related aspects, including access, problems encountered when seeking financing, and satisfaction with the services provided. The study was also to measure the knowledge of SME owners of the many financing sources available on the Canadian market. The survey was to cover the previous three years and focus especially on the previous six months and the financing intentions of the owners for the year ahead.

## 1.2 PRINCIPAL FINDINGS OF PAST SURVEYS REGARDING RELATIONS BETWEEN SMEs AND THEIR FINANCIAL INSTITUTIONS

A number of studies concerning satisfaction of SMEs with the various external financing sources have been published in the past, notably those by Thompson Lightstone & Co. Ltd. (1996-1998)<sup>1</sup> commissioned by the Canadian Bankers Association, and the survey by Wynant and Hatch (1991)<sup>2</sup> sponsored by the same organization, as well as the regular member surveys by the Canadian Federation of Independent Business (CFIB)<sup>3</sup>.

In addition to these surveys, there has been, for example, the work of the Standing Committee on Industry and the Task Force on the Future of the Canadian Financial Services Sector. This work, as well as the many studies

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<sup>1</sup>Thompson Lightstone & Co. Ltd., *Small and Medium-Sized Businesses in Canada: An Ongoing Perspective of Their Needs, Expectations and Satisfaction with Financial Institutions*, prepared for the Canadian Bankers Association, 1996, 1997 and 1998.

<sup>2</sup>L. Wynant and J. Hatch, *Banks and Small Business Borrowers*, Western Business School, 1991.

<sup>3</sup>Canadian Federation of Independent Business, *Banking on Entrepreneurship*, various years, <http://www.cfib.ca>

conducted around the globe on the problem of SME financing,<sup>4</sup> served as background material for the survey reported on here.

The major findings of the Canadian surveys cited above are summarized below. No reference is made to the findings of previous surveys within the chapters reporting the results of the present survey because — as can be noted from the brief descriptions of the methodologies used in the previous surveys — there are substantial differences that prevent adequate comparisons (e.g. characteristics of samples used, formulation of questions and type of survey).

The survey by Wynant and Hatch (1991) was based on the information contained in 1500 credit requests made to banks across Canada, 371 questionnaires completed by executives who submitted those credit applications, 58 direct interviews with SME executives, 12 interviews with accountants of firms that audited certain SMEs included in the survey, and 88 interviews with bankers. The findings of this study are referred to less frequently, since being 10 years old they are less relevant.

The studies by Thompson Lightstone in 1996, 1997 and 1998 were conducted on the basis of telephone interviews of 2600 to 3200 SME owners and on data on financing requests collected from 750 to 1150 account managers of the major Canadian banks. The findings used are mainly from the 1998 study, which followed up on the previous studies and highlighted major changes.

The CFIB conducts member surveys every three years. The most recent survey, released in 2001, included 10 000 respondents, and like all the previous surveys ignored the impact of their affiliation with the various industrial sectors. The present survey used only the findings of the March 2001 survey.



#### **Access to financing**

According to the three surveys conducted by Thompson Lightstone, having access to financing is not a hindrance to the development of SMEs in general. Most of them do not approach a financial institution with the goal of obtaining financing, simply because they do not believe that they need it (80% in 1997 and 70% in 1998). Just over one third of SMEs requested financing in each year (36% in 1996, 32% in 1997 and 38% in 1998).

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<sup>4</sup>J. St-Pierre, *Gestion financière des PME: théories et pratiques*, Presses de l'Université du Québec, 1999.

Firms that had been in business for 20 years or longer requested financing more often (46%); this was true of large and medium-sized businesses with sales of \$500K to \$1M and \$1M to \$5M (54%), and \$5M to \$50M (63%); and in the case of firms located in Manitoba and Saskatchewan (47%), firms in the transportation and communications sectors (46%) and firms in the manufacturing sector (53%). In 1998, financing requests were more frequent for firms expanding quickly (49%) and exporting firms (45%).

Quebec SMEs were significantly more likely than in the past to request financing (26% in 1997 and 45% in 1998).

Fewer financing applications were made by firms owned by women (41%) than by men. Thompson Lightstone attributes this to the fact that women more often own smaller firms (revenue below \$200 000), and these are less likely to apply for financing (27%).

On the basis of data concerning the percentage of firms that requested a short-term loan, a new line of credit or a higher line of credit during the previous three years, the CFIB (2001) found that fewer and fewer SMEs are applying for financing: 60.4%, compared with 73% in 1987, 71% in 1990, 66% in 1994 and 62% in 1997. It was also apparent that the smallest firms (with between 0 and 4 employees) make the fewest requests (53.8% compared with 77.4% for firms with more than 100 employees).

#### **Financing methods**

In 1998, Thompson Lightstone found that 50% of SMEs had a loan from a financial institution, 48% used supplier credit, 46% credit cards and 28% leasing. The reasons cited for using credit cards were: convenience (46%), for travel (14%), or to pay a supplier (16%). Only 4% of firms indicated that a credit card was the only way for the business to obtain credit.

The number of SMEs using financing sources other than banks and other financial institutions rose from year to year: 25% in 1996, 30% in 1997 and 38% in 1998.

In its member survey, the CFIB reported that lines of credit and corporate loans were the two main sources of loan financing for small businesses: 71.2% of small businesses had a line of credit<sup>5</sup> and 41% had a short-term loan. The least common financing sources were loans from government agencies and factoring. The youngest and the smallest businesses made more use of credit cards than the oldest and largest businesses.

#### **Approval rates**

In 1998, Thompson Lightstone found that 93% of loans requested from one of the seven major Canadian banks by SMEs with sales of less than half a million dollars were approved. This rate has increased year over year, with 84% in 1996, 87% in 1997 and 93% in 1998. The approval rate for loan requests from SMEs with sales of less than \$250 000 was 90%.

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<sup>5</sup>The high rate of line of credit use differs from the statistics obtained in other studies. However, it is not known whether this refers only to corporate lines of credit, or whether personal lines of credit are also included.

The 1998 survey revealed that approval rates were 93% for exporting firms, 94% for home-based businesses, 97% for businesses owned by Aboriginal people and visible minorities, 72% for businesses that had existed for less than one year, and 75% for businesses that considered themselves to be in the start-up phase.

The CFIB report indicated that 10.5% of respondents had their financing request refused by financial institutions. It was also found that the more account managers the firm had over the three-year period, the greater the refusal rate. For example, the refusal rate was 7.1% for firms that had one account manager, 8.5% for firms that had two, 16.3% for those that had three, and 22.8% for those that had four.

There was also a link between refusal rate and firm size. The smallest firms had the highest refusal rate: 13.6% for firms with 0 to 4 employees, and 2.5% for firms with more than 100 employees. However, this result contradicts the findings of the 1998 Thompson Lightstone study.

- ✓ Factors explaining refusals: According to the CFIB, if a firm is less than 10 years old, is owned by a woman or is associated with the personal services sector, its rate of refusal increased.

According to Thompson Lightstone (1998), it is very hard to identify a strong relation between certain variables and the refusal rate, given the high loan approval rate for the firms included in their sample. They concluded, however, that, gender, membership in a visible minority, region, type of activity and business size have no significant influence.

In their 1991 study, Wynant and Hatch reported that, based on information provided by account managers, only 6.5% of well-documented loan requests were refused, and these refusals occurred during initial discussions between the entrepreneur and the account manager. Firms representing a higher risk level, i.e. those in the start-up phase, those owned by inexperienced entrepreneurs, and those unable to provide enough guarantees, had a high rate of refusal. Very small firms did not have a higher refusal rate. Furthermore, no discrimination was noted against female entrepreneurs, whether in terms of approval rate, amount, type of guarantee required or borrowing costs.

- ✓ Reasons given by financial institutions to explain refusals: The CFIB survey indicated that the major reasons given for refusing loans were: too much outstanding debt (26.6%), lack of equity (26.6%) and insufficient cash flow (24.8%).

The reasons indicated in the Thompson Lightstone (1998) survey for refusing loan requests are the firm's indebtedness ratio (47%), guarantees (45%), ability to repay (43%), credit history (37%), management skills (31%) and risk associated with the business (24%). These results are similar to those observed in 1997, with the exception of the indebtedness ratio, which was 57%.

### Satisfaction level

According to Thompson Lightstone (1998), 69% of SMEs were satisfied overall (rating of 7 or more out of 10) with their relations with their main financial institution (this result is comparable with the 1997 result, when 70% of SMEs were satisfied). However, the percentage of dissatisfied customers rose over the three most recent years (15% in 1998, compared with 13% in 1997 and 8% in 1996). The lowest ratings were observed in the Toronto metropolitan region (56%); in the sectors of finance (58%), accommodation, food and beverages (58%), agriculture and fishing (77%) and lumber and mining (74%); among firms winding down (54%); in exporting firms (54%); in knowledge-based firms (55%); and in firms that had changed account managers. Firms owned by women and those established during the previous year or more than 20 years before seemed more satisfied.

According to the same study, the factors making the greatest contribution to entrepreneur satisfaction were, in declining order: flexible and appropriate response to changes in operating needs, availability of convenient business services, genuine commitment on the part of the bank to supporting the firm in hard times, and a flexible loan structure. Basically, these results are similar to those obtained in 1996 and 1997, although the ranking differs.

The CFIB found a high satisfaction level overall among its members with regard to the services provided by financial institutions: 84% indicated that they were very satisfied or satisfied. In previous surveys, this percentage was around 77%. The CFIB survey also focussed on SME satisfaction with service fees, where it was found that only 40.1% stated that they were very satisfied (10%) or satisfied (30.1%) with these fees. Firms in the Atlantic provinces, Quebec and Ontario were the least satisfied, while those in Manitoba and Saskatchewan were the most satisfied. Also, as in previous surveys, it would seem that the smaller the firm and the greater the turnover of account managers, the lower the satisfaction level.

According to the Wynant and Hatch study, 68% of small businesses were satisfied with the services that banks provided. Firms that were dissatisfied were unhappy with almost every aspect of their relationship with the bank (amount obtained, cost, level of guarantees, etc.). These firms had a higher risk level, i.e. they were younger, less experienced, had a higher indebtedness ratio and were located in urban areas. There was no difference between the satisfaction levels of female and male entrepreneurs.

### Changes in credit conditions

In 1998 the Thompson Lightstone report indicated that a small percentage of customers of the seven big banks reported a deterioration in their credit conditions over the previous 12 months: 96% experienced no change in the loan amount granted, and 89% experienced no change in the terms of their loan.

Fees applicable to loans remained unchanged since 1997 in the case of 72% of firms, while fees increased for 19% (17% in 1997). Level of guarantees remained unchanged for 85% of the SMEs, while they increased for 7% (5% in 1997) and decreased for 6% (5% in 1997).

### Other findings

Loyalty to the main financial institution remained high: 72% of customers said that they would recommend their bank to another firm (75% in 1997). However, the potential for transfers rose: 38% of respondents stated that they were considering or had considered changing their main financial institution (29% in 1997).

In the Wynant and Hatch survey, SME owners complained about the high turnover rate of their account managers: 60% of firms reported at least one change during the previous three years and 22% more than three changes. According to Thompson Lightstone (1998), the turnover rate of account managers had stabilized. In fact, about one respondent in every two (44%) said that they did business with the same account manager for three years, representing a higher percentage than in 1997 (41%), but lower than in 1996 (47%).

### 1.3 OBJECTIVES OF THIS STUDY

This study reports on the perceptions of Canadian SME owners regarding various aspects of the financing of their firms. In order to give as accurate a picture as possible of the position of Canadian entrepreneurs, the survey considered all financing sources, i.e. the chartered banks, caisses populaires, credit unions, factoring companies, leasing companies, trusts, venture capital companies, government institutions and all other financing sources, including employees, family members and informal investors. The survey measures:

- ▶ Requests made by SMEs to various financing sources in a variety of contexts (start-up, growth, exporting, etc.), while highlighting the major obstacles encountered;
- ▶ entrepreneurs' motivations in seeking financing;
- ▶ entrepreneurs' knowledge of the various financing sources available;
- ▶ entrepreneurs' satisfaction with the financing obtained, with an emphasis on the major determinants of satisfaction;
- ▶ entrepreneurs' willingness to finance future projects with current lenders; and
- ▶ variations in financing conditions experienced by firms in the previous six months.

Although a section of this report looks at certain specific characteristics of the respondents, it will also attempt to note distinctions between the various groups of entrepreneurs (gender, education, age, etc.) and firms (size, age, phase of development, etc.) when discussing other elements, including satisfaction, approval or diversity of the financing sources used.

## 1.4 TOOL DEVELOPMENT AND DATA COLLECTION

To fulfil the the mandate, it is essential to have quality information regarding the financing situation of Canadian SMEs. Given the complexity associated with analysis of information from SMEs and the heterogenous nature of this group of firms, the data collection tool had to be capable of distinguishing between the various groups of SMEs on the basis of the recognized contingency factors that play a role in their development. Ignoring these factors makes it impossible to undertake a comprehensive analysis of the survey results for the purpose of formulating appropriate economic policies.

Several factors influence the organization and development of SMEs, such as activity sector and the age and size of firms. Other contingency factors include a firm's current phase of development: each phase has its own stress factors. A firm in the start-up phase is more concerned with looking for a stable customer base than is a firm experiencing rapid growth, which has an urgent need to acquire tools and practices for planning, management and control. These various situations will impact differently on the SMEs' financial needs on the one hand and on optimal financing choices on the other hand. The same applies to exporting or innovative firms, whose financing needs will differ from those of commercial firms selling low-value-added products on local markets.

An initial mail-out questionnaire was developed by the financial experts of the Research Institute for SMEs. Its purpose was to collect the largest possible volume of data on profiles of financing applicants, in order to gain a better understanding of the extent of their use of, satisfaction with and access to Canadian markets. For reasons of length, a number of variables allowing measurement of the firms' investment risk were dropped.

The questionnaire (Annex A) was validated in English and French with 10 entrepreneurs in order to confirm understanding of the questions and the response time. It was then mailed to 10 000 Canadian firms<sup>6</sup> based on lists

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<sup>6</sup>SMEs eligible for this study needed to have the following characteristics: fewer than 500 employees, total sales of more than \$30 000 or at least one employee, and not be a franchise, holding company or non-profit organization.

supplied by Dun & Bradstreet. Valid responses were received from 1014 of these firms.<sup>7</sup> In view of the inadequate number of respondents, the data base was supplemented through information obtained from a telephone survey. The mail-out questionnaire was therefore reworked in order to approach Canadian entrepreneurs by phone (see Annex A). Telephone pretesting was conducted with 32 entrepreneurs in order to validate the response time, which was estimated at 20 minutes; 1134 responses were thus added to the data base.

A preliminary analysis of the responses collected through the two survey formats brought to light certain differences, including the size of respondent firms and lower financing application rates. Combining the two survey formats therefore assures better representativity of the Canadian population.

## 1.5 DATA BASE VALIDATION

Because 32 of the firms surveyed did not qualify for the study, they had to be dropped from the sample. In 21 cases, total sales were below \$30 000, there were no employees and the entrepreneur was not the firm's principal manager. In 11 cases the firms in question were not SMEs (based on sales and employee numbers provided) or the respondents were non-profit organizations. Dropping these respondents did not significantly impact on the analysis of results.

In addition, it is well known that entrepreneurs are disinclined to discuss their financing with other parties. It was evident at the outset that any collection of quantitative data could involve certain problems. It should be borne in mind that the financial management skills of entrepreneurs vary greatly, and this was confirmed by a perusal of the financial data collected in the mail-out questionnaire. Initial statistical testing on the collected data indicated a high rate of "anomalous" values for several variables, including: ratio of employees to total sales, indebtedness ratio, and financial risk measurements. Although a number of these errors were caused by faulty data capture, others were simply due to misunderstanding on the part of respondents.

The data base therefore included a large number of firms with an indebtedness ratio equal to or greater than unity (115 respondents). To confirm the validity of these results, the questionnaires were checked to identify the

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<sup>7</sup>The questionnaire was sent to the entrepreneurs in June 2001; this had a significant impact on the response rate. The questionnaire was administered by a specialized polling firm.



following cases: total liabilities had been confused with total liabilities plus equity; total liabilities included the owners' personal liabilities; or liabilities were equal to the total of the two items stated on the two lines above in the table, i.e. total assets and current assets. In cases where it was clear that the values resulted from the respondents' misunderstanding, the figures were converted to missing values.

## **1.6 REPRESENTATIVITY OF POPULATION**

A database of 1014 respondents was formed from the mail-out survey, and this was increased to a total of 2148 through the telephone survey. Taking into account the 32 cases dropped for data validity reasons, the actual valid sample was therefore 2116 firms.

Representation of firms by sector of activity and by size were, however, not in accordance with the nationwide representation suggested by Statistics Canada. To correct this situation, all statistics presented and reflecting the financing situation for Canadian SMEs as a whole were based on an adjusted weighting reflecting the size and activity sector factors of Canadian SMEs. The weighted sample will therefore consist of 2027 observations instead of 2116. Table 1.1 sets out the sectoral allocation before and after weighting adjustment.

**TABLE 1.1: PRESENTATION OF SAMPLE BY ACTIVITY SECTOR**

	N	%	N <sub>weighted</sub>	% <sub>weighted</sub>
Retail trade	90	4.3%	42	2.1%
Wholesale trade	432	20.8%	244	12.0%
Wholesale and retail trade	110	5.3%	57	2.8%
Transportation, warehousing and couriers	101	4.9%	122	5.5%
Information and cultural industries	38	1.8%	29	1.4%
Real estate and renting and leasing	47	2.3%	173	8.5%
Professional, scientific and technical services	301	14.5%	288	14.2%
Administrative and support, waste management and remediation services	24	1.2%	105	5.2%
Educational services	12	0.6%	12	0.6%
Health care and social assistance	16	0.8%	16	0.8%
Arts, entertainment and recreation	48	2.3%	41	2.0%
Accommodation and food services	99	4.8%	120	5.9%
Other services (except public administration)	184	8.9%	178	8.8%
Agriculture	101	4.9%	204	10.1%
Forestry, fishing and hunting	17	0.8%	17	0.9%
Mining and oil and gas extraction	24	1.2%	15	0.8%
Construction	169	8.2%	263	13.0%
Manufacturing				
- non-durable goods: textiles, food, etc.	72	3.5%	26	1.3%
- durable goods: raw material transformation	90	4.3%	35	1.7%
- durable goods: machinery, equipment, furniture	94	4.5%	50	2.5%
<b>Total</b>	<b>2069</b>	<b>100%</b>	<b>2027</b>	<b>100%</b>

Through the adjustment of the sample based on the Statistics Canada weightings,<sup>8</sup> it was possible to achieve a comparable distribution of Canadian SMEs by activity sector and size. As shown in Table 1.2, this also affects distribution of firms by phase of development.

<sup>8</sup> Note that three sectors were not weighted because of the low number of firms they contained: educational services; health care and social assistance; and forestry, fishing and hunting.

**TABLE 1.2: DISTRIBUTION OF SAMPLE BY CERTAIN CHARACTERISTICS OF FIRMS**

Phase of development: (Missing = 33)	Seed/start-up	Slow growth	Fast growth	Maturity	Winding down
Weighted	5.1%	51.6%	12.5%	21.5%	9.2%
Unweighted	5.3%	49.7%	21.8%	16.7%	6.5%
Age of firms: (Missing = 36)	3 years or less	37350	37416	37579	Over 20
Weighted	18.0%	10.0%	15.6%	25.1%	31.2%
Unweighted	21.9%	11.8%	18.1%	21.8%	26.4%
Number of employees:	5 or fewer	37416	37579	21-50	Over 50
Weighted	82.2%	8.3%	4.4%	3.2%	2.1%
Unweighted	45.2%	15.8%	12.5%	15.3%	11.3%
Total sales (\$000): (Missing = 649)	100 or less	100-750	751-1500	1501-3500	3501 or more
Weighted	28.9%	48.6%	10.2%	6.6%	5.7%
Unweighted	15.8%	35.1%	13.9%	15.1%	20.0%

The discussion of the statistics on financing requests, satisfaction and entrepreneurs' intentions will reflect the weighted sample.

Lastly, since certain industry sectors include only a few observations, certain sectors were regrouped according to firms' activities in order to be able to conduct statistical testing. These groupings are similar to those used by Thompson Lightstone, and they cut the number of sectors from 20 to 12. These sector regroupings are shown in in Table 1.3.

**TABLE 1.3: PRESENTATION OF REGROUPED ACTIVITY SECTORS**

	N	%	N <sub>weighted</sub>	% <sub>weighted</sub>
Wholesale and retail trade	632	30.5%	344	16.9%
Transportation, warehousing and couriers	101	4.9%	112	5.5%
Cultural, tourism and recreation industries	185	8.9%	189	9.3%
Real estate and renting and leasing	47	2.3%	173	8.5%
Professional, scientific and technical services	301	14.5%	288	14.2%
Administrative and support, waste management and remediation services	24	1.2%	105	5.2%
Educational services, health care and social assistance	28	1.4%	28	1.4%
Other services (except public administration)	184	8.9%	178	8.8%
Agriculture	101	4.9%	204	10.1%
Forestry, fishing and hunting, mining and oil and gas extraction	41	2.0%	33	1.6%
Construction	169	8.2%	253	13.0%
Manufacturing	256	12.4%	112	5.5%
<b>Total</b>	<b>2069</b>	<b>100%</b>	<b>2027</b>	<b>100%</b>

## ***Chapter II:***

### **Description of the Sample**

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This chapter will provide a description of the sample of entrepreneurs who agreed to participate in the present study,<sup>9</sup> and will profile their firms. This information is essential for a proper understanding of the data to be presented in later chapters regarding financing of Canadian SMEs.

#### **2.1 PROFILE OF ENTREPRENEURS**

The characteristics of the entrepreneurs who seek external financing play a significant role in the supply of financing and in the conditions that may be available to those entrepreneurs. It is therefore important to describe the sample, in order to be in a position to interpret more accurately the information presented later in this study. To enhance the statistical presentation and enable the reader to become more familiar with the sample, various aspects of the entrepreneur profile will be presented, then the characteristics of their firms will be added.

##### **2.1.1 Gender of owners**

One quarter of the firms that responded to the questionnaire are owned by women. As shown in Table 2.1, however, the profile of female entrepreneurs differs in some aspects from that of male entrepreneurs.

It will be noted from the table that the female entrepreneurs are younger on average than their male counterparts (43 compared with 49 years of age), which explains why they are less experienced (17 compared with 22 years of age). On average, their educational level is the same but the distribution is different (greater concentration in high school and college education). In addition, their expectations for growth within two years are higher (43% for women compared with 30% for men).

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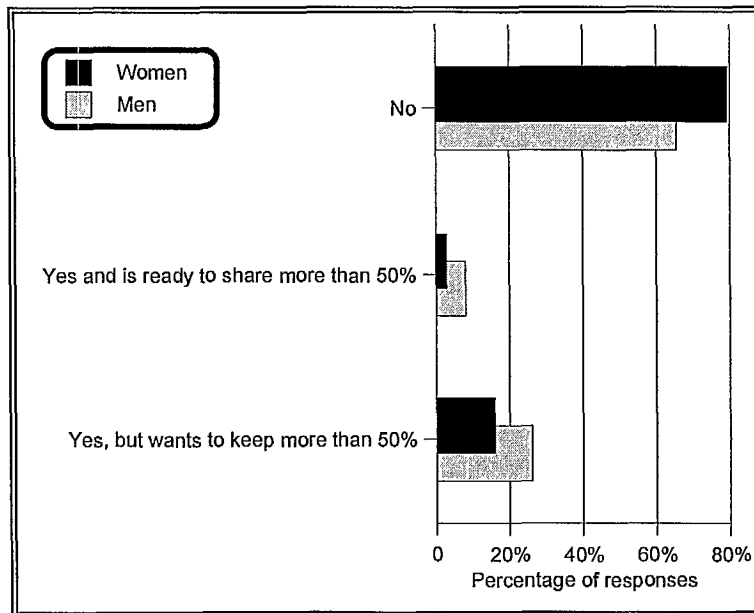
<sup>9</sup> Readers will find in Annexes B and C a detailed presentation of the various aspects briefly addressed in this chapter, as well as the results of the statistical tests performed to measure the "significance" of the differences observed. The data presented in the tables are median values, or percentages in the case of distributions.

**TABLE 2.1: DISTRIBUTION OF ENTREPRENEUR'S PROFILE BY GENDER**

		Entrepreneur's gender:	
		Male (N = 510)	Female (N = 505)
Age of entrepreneur		49 years	43 years
Experience in this activity sector (N = 2006)		22 years	17 years
Education	Elementary	8.9%	2.4%
	High school	36.4%	44.0%
	College	21.5%	28.9%
	University	33.2%	24.8%
Growth expected for next two years (N = 1487)		30.00%	42.85%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 1253)	Already shares 50% of control	39.8%	44.7%
	Yes, but wants to keep more than 50%	15.8%	9.0%
	Yes, and is prepared to share more than 50%	4.9%	1.7%
	No	39.5%	44.7%

When asked whether they are prepared to share control of their business, women answer differently from men. A larger number of female entrepreneurs are already co-owners of their business: 44.7% compared with 39.8% of men. Among women who are sole proprietors, a strong majority want to retain their status (see Figure 2.1). This wish to keep control may impact on potential for financing at a later time, as well as the growth capacity of firms that must turn to external financing at a given point in their development.

**FIGURE 2.1: ENTREPRENEURS' WILLINGNESS TO SHARE CONTROL OF THEIR BUSINESS, BY GENDER**

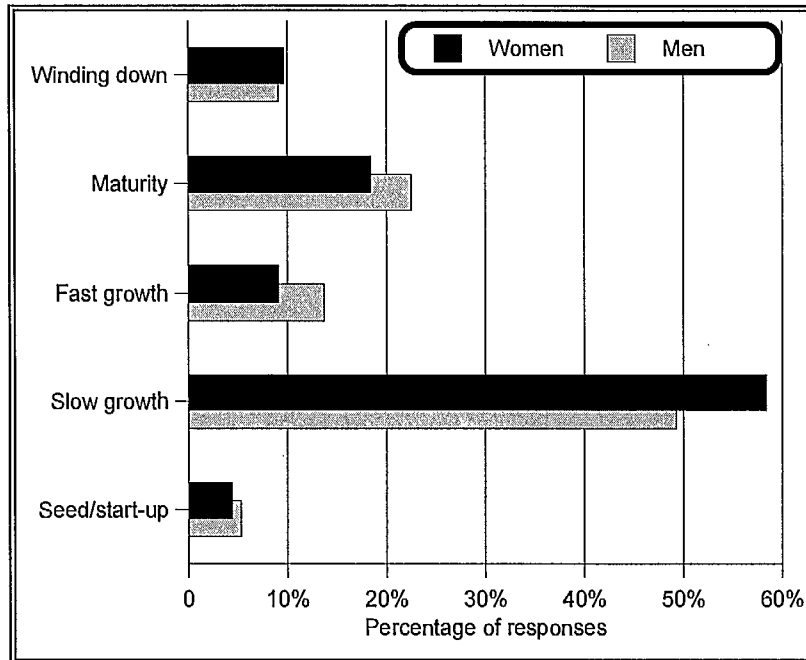


On average, female entrepreneurs own firms that are smaller (see Table 2.2), younger and in a less advanced phase of their development (see Figure 2.2). With regard to areas of activity, significant differences are also noted, in that women own firms mainly in the wholesale and retail trade, cultural industries, tourism, recreation and service sectors (see Figure 2.3).

**TABLE 2.2: DISTRIBUTION OF FIRM'S PROFILE BY ENTREPRENEUR'S GENDER**

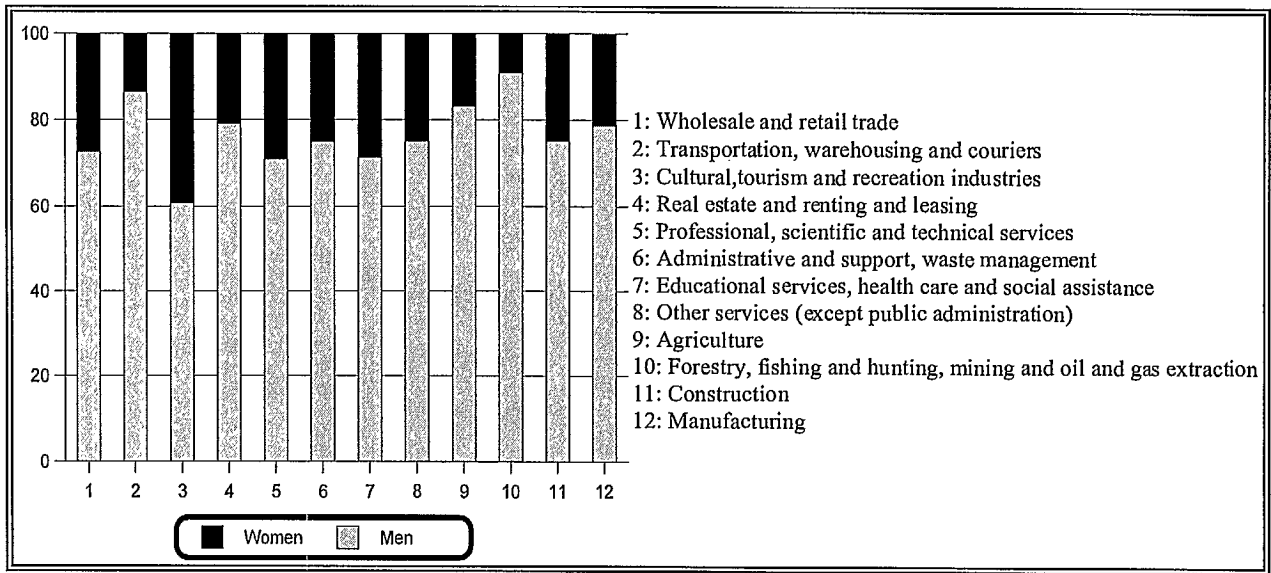
<i>Entrepreneur's gender:</i>		Male (N = 1510)	Female (N = 505)
Number of employees (N = 2015)		2.33	2.19
Age of firm (N = 1979)		14 years	10 years
<i>Phase of development (N = 1982)</i>	Seed/start-up	5.3%	4.4%
	Slow growth	49.3%	58.4%
	Fast growth	13.7%	9.1%
	Maturity	22.5%	18.4%
	Winding down	9.1%	9.7%

**FIGURE 2.2: DISTRIBUTION OF FIRMS BY DEVELOPMENT AND GENDER OF OWNER**





**FIGURE 2.3: DISTRIBUTION OF FIRMS BY ACTIVITY SECTOR AND GENDER OF OWNER**



### 2.1.2 Age of owners

Age is another characteristic of owners that may impact on the financing of their businesses. Young entrepreneurs are less experienced and often have fewer guarantees to offer for debt financing. Table 2.3 shows that, on average, the younger entrepreneurs are better educated than the older ones. Concentrating mainly on the outermost groups of the distribution (youngest and oldest), one can note significant and interesting differences for the financial markets. In addition to being more educated, the younger entrepreneurs have higher expectations of growth rates and are more inclined to share control of their business.

**TABLE 2.3: ENTREPRENEUR'S PROFILE BY AGE**

		Entrepreneur's age group:				
		30 or less (N = 107)	31-40 (N = 385)	41-50 (N = 716)	51-60 (N = 540)	Over 60 (N = 267)
Education (N = 2005)	Elementary	2.8%	2.6%	4.9%	10.1%	15.8%
	High school	36.4%	36.4%	39.2%	41.3%	34.6%
	College	27.1%	28.6%	22.4%	19.5%	24.1%
	University	33.6%	32.5%	33.5%	29.1%	25.6%
Experience in this sector (N = 2005)		7 years	14 years	20 years	27 years	40 years
Growth expected for next two years (N = 1489)	Negative growth	1.4%	2.5%	1.5%	3.7%	11.4%
	0-19%	18.6%	16.8%	19.1%	24.7%	17.0%
	20-49%	24.3%	27.7%	39.2%	32.5%	34.7%
	50-99%	27.1%	15.1%	17.7%	16.9%	12.5%
	100% or over	28.6%	37.9%	22.6%	22.2%	24.4%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 1248)	Already shares 50% of control	37.9%	55.2%	39.5%	36.9%	32.2%
	Yes, but wants to keep more than 50%	27.3%	13.2%	10.8%	17.7%	11.9%
	Yes, and is prepared to share more than 50%	6.1%	4.8%	2.4%	5.5%	4.2%
	No	28.8%	26.8%	47.3%	39.9%	51.7%

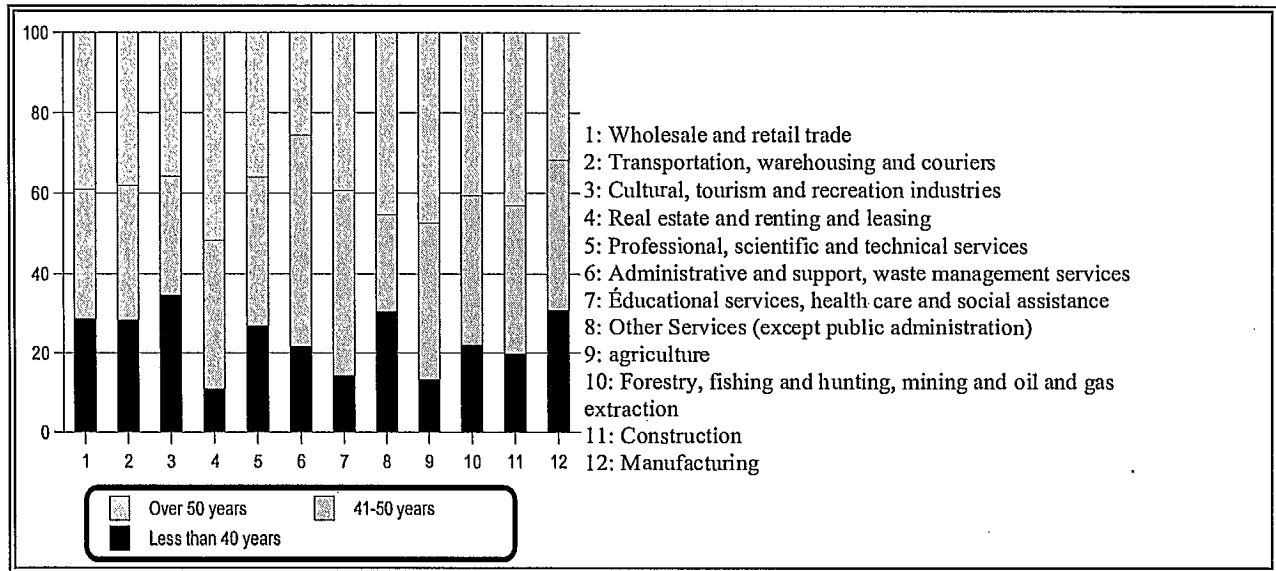
The profile of firms with younger owners is revealing (see Table 2.4). Although they are obviously less mature, these businesses are less often located in the owner's residence, more of them have boards of directors and a financial officer, and a higher proportion are involved in R&D and exporting.

**TABLE 2.4: FIRM'S PROFILE BY ENTREPRENEUR'S AGE**

Entrepreneur's age group:		30 or less (N = 107)	31-40 (N = 385)	41-50 (N = 716)	51-60 (N = 540)	Over 60 (N = 267)
Median number of employees (N = 2014)		2.7	2.6	2.3	2.0	1.9
<i>Phases of development</i> (N = 1984)	Seed/start-up	15.2%	5.8%	5.0%	4.4%	1.9%
	Slow growth	70.5%	55.8%	53.3%	50.6%	35.6%
	Fast growth	9.5%	20.4%	14.8%	8.5%	4.2%
	Maturity	3.8%	14.9%	19.9%	24.4%	37.5%
	Winding down	1.0%	3.1%	7.1%	12.1%	20.8%
Firms located in an owner's residence (N = 826)		34.9%	36.0%	42.7%	41.3%	46.2%
Firms with a board of directors (N = 386)		34.0%	19.5%	21.1%	15.0%	16.6%
Firms with an accounting/financial officer other than the owner (N = 885)		56.6%	45.2%	45.0%	42.9%	37.1%
Firms carrying out R&D (N = 666)		51.0%	45.9%	35.1%	31.9%	26.7%
Firms earning a proportion of their total sales abroad (N = 383)		24.8%	22.3%	21.4%	16.9%	15.7%

Figure 2.5 shows the impact of the entrepreneur's age on selecting an industrial sector in which to establish their business. Older entrepreneurs are found more in relatively traditional sectors like agriculture and real estate and rental and leasing, whereas the median group (41 to 50 years) dominates the administrative and social services sectors (however, the latter sector contains only 28 firms). The younger entrepreneurs prefer the cultural, tourism and recreation industry, other services and the manufacturing sector; they are less represented in certain sectors like agriculture and real estate.

**FIGURE 2.5: SECTOR DISTRIBUTION OF FIRMS BY ENTREPRENEUR'S AGE**



**2.1.3 Educational level of owners**

Another factor that may impact on financing relates to entrepreneurs' general management knowledge and their capacity to negotiate with lenders by clearly presenting their business plan. This variable may also be linked to other equally significant variables, such as activity sector, growth rate acceptable to the entrepreneur, and willingness to accept business partners.

The entrepreneurs have thus been divided into four major educational levels: elementary, high school, college and university. As already shown, whereas the males have less education overall, the females are less represented among university graduates (see Table 2.5). Education is associated with entrepreneurs' experience, with the less experienced being on average more educated than the others. Lastly, those entrepreneurs with more education expect higher growth rates over the next two years than the others. It is interesting to note that this higher expected growth, particularly on the part of university graduates, is also associated with greater openness to an external partner for the purpose of financing the firm's expansion.

**TABLE 2.5: ENTREPRENEUR'S PROFILE BY EDUCATIONAL LEVEL**

Entrepreneur's educational level:		Elementary (N = 145)	High school (N = 772)	College (N = 469)	University (N = 624)
Gender (N = 2007)	Male	91.7%	71.1%	68.9%	80.0%
	Female	8.3%	28.9%	31.1%	20.0%
Experience in this activity sector (N = 2003)		30 years	22 years	20 years	20 years
Expected growth over next two years (N = 1484)		25.0%	30.0%	35.9%	42.4%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 1256)	Already shares 50% of control	32.0%	40.6%	44.9%	40.1%
	Yes, but wants to keep more than 50%	17.3%	13.8%	12.6%	15.1%
	Yes, and is prepared to share more than 50%	2.7%	2.5%	3.1%	6.9%
	No	48.0%	43.1%	39.5%	37.9%

**TABLE 2.6: FIRM'S PROFILE BY ENTREPRENEUR'S EDUCATIONAL LEVEL**

Entrepreneur's educational level:	Elementary (N = 145)	High school (N = 772)	College (N = 469)	University (N = 624)
Median number of employees (N = 2007)	1.9	2.0	2.3	2.7
Age of firm (N = 1975)	23 years	15 years	12 years	9 years
Firms located in owner's residence (N = 823)	58.0%	49.3%	38.6%	28.8%
Firms with a board of directors (N = 386)	9.0%	14.7%	15.1%	30.5%
Firms carrying out R&D (N = 667)	32.8%	31.5%	39.0%	40.2%
Firms earning a proportion of their total sales abroad (N = 383)	3.5%	14.1%	16.7%	33.3%

On average, the most educated entrepreneurs own larger firms that are more often located outside the owners' residences (see Table 2.6). Their firms also carry out more R&D and exporting.

### 2.1.4 Mother tongue of owners

The representation of owners' mother tongues reflects the Canadian population, with English dominating, followed by French and other languages (since no language is really dominant among the "others," they have been grouped together for statistical purposes).

**TABLE 2.7: ENTREPRENEUR'S PROFILE BY MOTHER TONGUE**

		Entrepreneur's mother tongue:	French (N = 549)	English (N = 1188)	Other (N = 279)
Gender (N = 1505)	Male		65.9%	77.3%	81.7%
	Female		34.1%	22.7%	18.3%
Age of owner (N= 2011)			46 years	48 years	49 years
Education (N = 2007)	Elementary		9.9%	6.3%	6.1%
	High school		43.7%	38.0%	30.6%
	College		22.2%	23.2%	25.9%
	University		24.2%	32.4%	37.4%
Experience in this activity sector (N = 2007)			21 years	20 years	20 years
Average growth targeted over next two years (N = 1490)			25%	37%	49%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 1251)	Already shares 50% of control		33.4%	42.2%	48.9%
	Yes, but wants to keep more than 50%		13.3%	15.4%	11.3%
	Yes, and is prepared to share more than 50%		3.6%	4.3%	4.8%
	No		49.7%	38.1%	34.9%

Table 2.7 shows that the profiles of entrepreneurs differ according to their mother tongue: 27% are Francophones, 59% are Anglophones and 14% are Allophones. In general Francophone entrepreneurs are younger and have a lower educational level but significantly more years of experience than the other entrepreneurs. On the other hand they expect more modest growth and are less often willing to share control of their business. A higher proportion of female entrepreneurs are Francophones.

Allophone entrepreneurs contrast with the Francophones: they are older and more educated but have less experience. On the other hand, they expect higher growth and they are prepared to accept a co-owner if they have not already done so. In addition, these entrepreneurs own firms that are less mature (see Table 2.8) and are more involved than

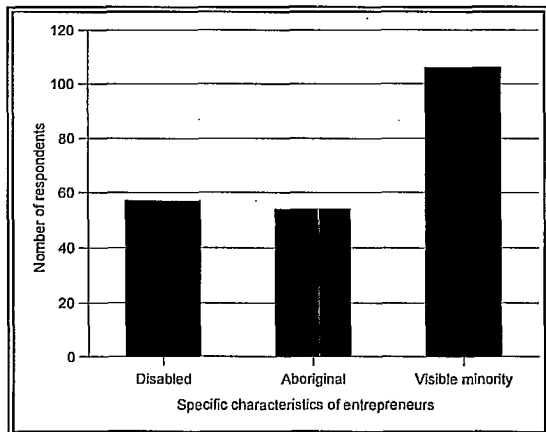
the others in exporting, but less in R&D.

**TABLE 2.8: FIRM'S PROFILE BY ENTREPRENEUR'S MOTHER TONGUE**

Entrepreneur's mother tongue:		French (N = 549)	English (N = 1188)	Other (N=279)
Number of employees (N = 2016)		2.3	2.3	2.0
Age of firm (N = 1982)		14 years	13 years	8 years
Phase of development (N = 1984)	Seed/start-up	1.1%	5.0%	13.6%
	Slow growth	54.2%	50.8%	49.8%
	Fast growth	11.6%	13.0%	12.5%
	Maturity	21.4%	22.2%	19.0%
	Winding down	11.6%	9.1%	5.1%
Firms carrying out R&D (N = 662)		34.8%	37.3%	31.0%
Firms earning a proportion of their total sales abroad (N = 381)		13.0%	21.4%	25.6%

**2.1.5 Other specific characteristics of entrepreneurs**

**FIGURE 2.6: REPRESENTATION OF FIRMS BY CERTAIN SPECIFIC OWNER CHARACTERISTICS**



When asked to indicate whether they had a disability, were Aboriginals or belonged to a visible minority, 217 entrepreneurs responded yes to one of these questions and 16 responded yes to more than one. For the profile presentation, those who belonged to one of the categories have been included.

Table 2.9 shows the significant differences in a set of variables, highlighting the specific profile of each group.

- ▶ The entrepreneurs with a disability are older than the general sample of entrepreneurs, are less educated, are relatively more experienced in their area of activity and have little interest in accepting another owner

to finance the growth or expansion of the business (see Table 2.9). These entrepreneurs own relatively small and long-established businesses (see Table 2.10).

- ▶ The Aboriginal entrepreneurs are relatively less educated, but in more than 98% of cases participated in creating their business. They have already taken an outside partner in approximately 57% of cases. Their firms have no distinguishing features.
- ▶ The visible minority entrepreneurs are younger and more educated, have less experience and expect higher growth rates. They are already co-owners or, in the case of those who are sole proprietors, are relatively open to partners. Their business are younger (see Table 2.10) and are more involved in R&D and exporting

**TABLE 2.9: ENTREPRENEUR'S PROFILE BY CERTAIN SPECIFIC CHARACTERISTICS**

The entrepreneur has the following specific characteristic:		Disabled (N = 57)	Canadian Aboriginal (N = 54)	Visible minority (N = 106)	Other (N = 1795)
Gender (N = 2000)	Male	75.4%	81.5%	80.2%	74.3%
	Female	24.6%	18.5%	19.8%	25.7%
Age of owner (N = 2000)		53 years	46 years	44 years	48 years
Education (N = 1995)		H.S.	H.S.	Univ.	Coll.
Experience in this activity sector (N = 1996)		30 years	22 years	12 years	20 years
Average growth expected over next two years (N = 1487)		42.6%	28.3%	50.0%	33.0%
Entrepreneurs who participated in creating the business (N = 1750)		87.7%	98.1%	83.0%	87.3%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 1251)	Already shares 50% of control	29.4%	56.8%	55.2%	39.7%
	Yes, but wants to keep more than 50%	38.2%	18.9%	11.9%	13.5%
	Yes, and is prepared to share more than 50%	0.0%	0.0%	11.9%	4.0%
	No	32.4%	24.3%	20.9%	42.9%



**TABLE 2.10: FIRM'S PROFILE BY CERTAIN SPECIFIC CHARACTERISTICS OF THE ENTREPRENEUR**

The entrepreneur has the following specific characteristic:	Disabled (N = 57)	Canadian Aboriginal (N = 54)	Visible minority (N = 106)	Other (N = 1795)
Number of employees (N = 2010)	2.0	3.0	2.0	2.3
Age of firm (N = 1978)	19 years	14 years	4 years	13 years
Firms located in owner's residence (N = 815)	59.6%	47.2%	33.3%	40.3%
Firms carrying out R&D (N = 665)	38.9%	31.1%	41.5%	35.7%
Firms earning a proportion of their total sales abroad (N=383)	22.4%	9.6%	26.5%	19.8%

## 2.2 PROFILE OF FIRMS

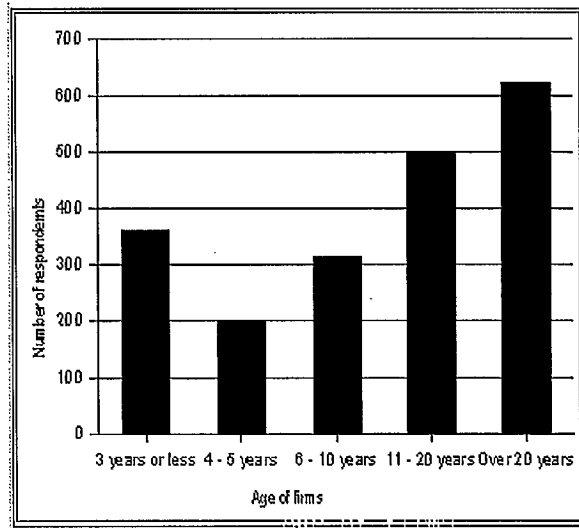
The main elements in the profile of firms highlighted here are, on the one hand, those that could be associated with higher levels of risk for lenders and, on the other hand, those that may better illustrate a degree of diversity in Canadian financial markets, such as the respondent's location or home province<sup>10</sup> These variables will be analysed while also taking into account certain specific characteristics of the profile of the entrepreneurs.

### 2.2.1 Age of firms

Figure 2.7 shows that a higher proportion of firms have existed for over 20 years (31% of the sample), while 18% were created less than three years ago.

<sup>10</sup> Readers can find all the statistical results in Annexes B and C. The results presented here merit special attention.

**FIGURE 2.7: DISTRIBUTION OF FIRMS BY AGE**



Female entrepreneurs (see Table 2.11) more often own younger firms (less than five years), while older entrepreneurs own older firms. Also noteworthy is the impact of the entrepreneur's education, since a higher proportion of university graduates own firms that have existed for less than five years. As anticipated, growth rates expected by the entrepreneurs vary inversely with the age of their firm, that is, the owners of the youngest firms expect growth rates to be significantly higher than those of the older firms.

**TABLE 2.11: ENTREPRENEUR'S PROFILE BY FIRM'S AGE**

		Age of firm	3 or less (N = 359)	4-5 (N = 199)	6 -10 (N =311)	11-20 (N = 500)	Over 20 (N = 622)
Gender (N = 1979)	Male		69.6%	67.8%	72.6%	76.1%	82.0%
	Female		30.4%	32.2%	27.4%	23.9%	18.0%
Median age of entrepreneurs			41 years	44 years	44 years	49 years	55 years
Education (N = 1975)	Elementary		1.1%	6.1%	3.2%	8.9%	12.1%
	High school		31.5%	32.0%	37.5%	39.6%	42.7%
	College		24.5%	23.9%	27.8%	20.9%	23.4%
	University		43.3%	38.1%	31.4%	30.6%	21.8%
Growth expected over next two years (N = 1469)			100%	41%	35%	30%	25%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 1241)	Already shares 50% of control		49.1%	41.4%	38.6%	42.8%	35.5%
	Yes, but wants to keep more than 50%		16.7%	12.9%	14.0%	12.9%	14.4%
	Yes, and is prepared to share more than 50%		7.3%	7.1%	6.5%	1.9%	1.5%
	No		26.9%	38.6%	40.9%	42.4%	48.7%

Lastly, willingness to share control of the firm with a partner in order to ensure its expansion or growth is negatively related to the firm's maturity, with the oldest firms more often having owners who are less open to financial partners.

Specifically, it is noteworthy that the younger firms hire more personnel than the older firms (see Table 2.12), and that fewer of them are located in the owner's residence. They are also more likely to have a board of directors, and more of them are involved in R&D and exporting .

**TABLE 2.12: FIRM'S PROFILE BY FIRM'S AGE**

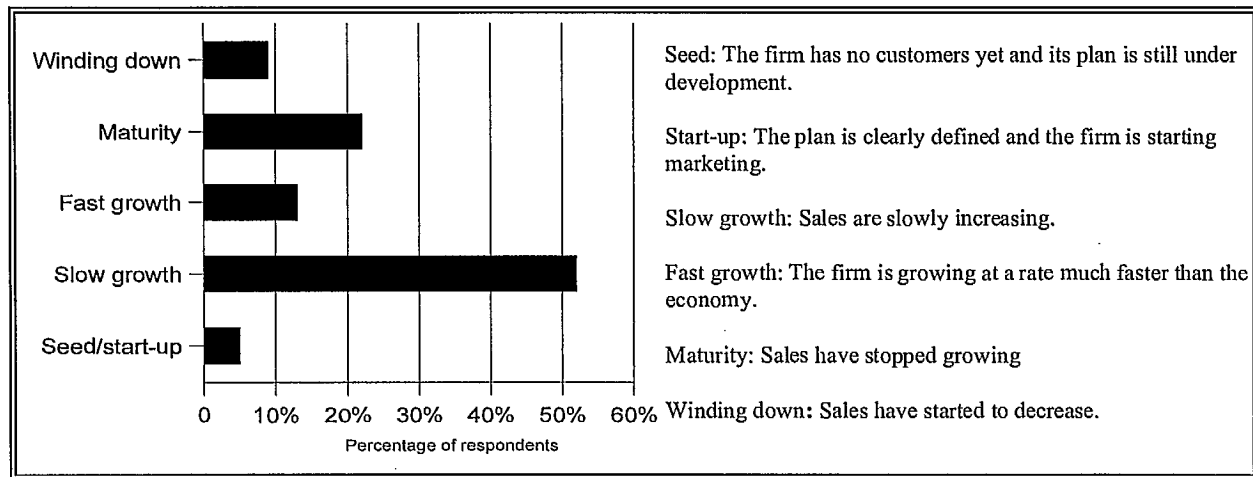
Age of firm:		3 or less (N=359)	4-5 (N=199)	6 -10 (N=311)	11-20 (N=500)	Over 20 (N=622)
Number of employees (N =1988 )		2.3	2.6	2.3	2.3	2.0
<i>Phase of development</i> (N = 1960)	Seed/start-up	17.6%	7.6%	3.6%	1.4%	0.7%
	Slow growth	51.0%	55.6%	57.9%	46.8%	50.9%
	Fast growth	22.4%	20.2%	14.2%	11.9%	4.1%
	Maturity	7.8%	12.1%	17.2%	29.4%	29.2%
	Winding down	1.1%	4.5%	7.1%	10.5%	15.1%
Firms located in an owner's residence (N = 816)		32.8%	33.0%	35.2%	48.6%	45.3%
Firms with a board of directors (N = 380)		31.3%	19.6%	22.2%	15.7%	13.4%
Firms carrying out R&D (N = 655)		43.5%	31.7%	45.9%	33.3%	29.4%
Firms earning a proportion of their total sales abroad (N = 382)		34.3%	24.3%	20.3%	16.0%	13.4%

### 2.2.2 Phases of development

Not all firms experience the same phases of development. Some quickly enter a period of growth following start-up, while others disappear before maturity. As the statistics below indicate, it is not possible to link a firm's age with its phase of development.

For statistical reasons, the seed and start-up phases, which represent only 5% of the sample, have been merged. Figure 2.8 shows the domination of firms in the slow growth phase (52%), which in most cases accords with the owners' plans for development.

**FIGURE 2.8 DISTRIBUTION OF FIRMS BY PHASE OF DEVELOPMENT**



Briefly the following points distinguish firms in each phase of development:

Seed and start-up firms represent 5% of the sample:

- ▶ In more than 50% of cases, the entrepreneur is a university graduate and expects a growth rate of more than 100% within two years.
- ▶ The entrepreneur is already sharing control with at least one other owner in 62% of cases.
- ▶ The average age of the firms is 2 years.
- ▶ Firms have 2 employees and median total sales of \$120 287.
- ▶ 46% of firms carry out R&D, and 40% export their products/services.

Slow growth firms represent 52% of the sample:

- ▶ The entrepreneur has relatively little education and over 20 years experience on average.
- ▶ The entrepreneur expects modest growth within two years, and he or she is reluctant to share control of the business.
- ▶ The firms are relatively long established and have an average of 2.3 employees.
- ▶ The firms are less involved in R&D and exporting.

Fast growth firms represent 13% of the sample. They are normally highly dynamic, create jobs and are demanding with respect to markets. They share some characteristics with start-up firms:

- ▶ In most cases these firms are owned by a university graduate.
- ▶ Approximately 40% of the entrepreneurs expect their firm's size to double.
- ▶ In 48% of cases, the entrepreneurs share control of their business.

Mature firms represent 21% of the sample. They and their owners have the following profile:

- ▶ The entrepreneur is reluctant to share control.
- ▶ He or she has less education.
- ▶ He or she has extensive experience in the activity sector.
- ▶ The entrepreneur's growth expectations are relatively modest.
- ▶ The firms are relatively small and long-established.
- ▶ The firms are less involved in R&D and exporting.

Firms in the winding down stage represent 9% of the sample. They and their owners have a profile similar to that of the mature firms:

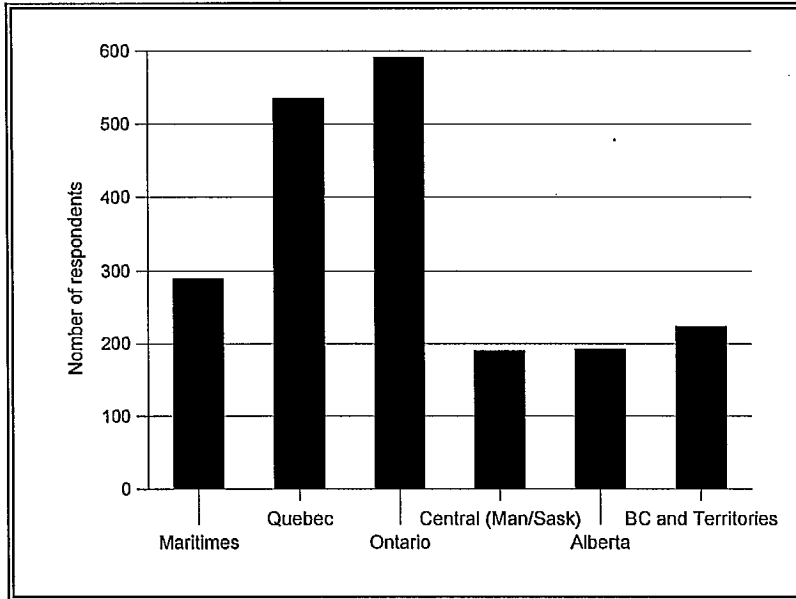
- ▶ The entrepreneur is relatively older than the average.
- ▶ He or she has less education and has extensive experience in the activity sector.
- ▶ The entrepreneur's growth expectations are modest and he or she does not want to share control.
- ▶ The firms are relatively small and have been in existence for an average of 21 years.
- ▶ They generally belong to the real estate, agriculture and construction sectors.

As will be seen later, the most dynamic firms, i.e. those in the seed/start-up and rapid growth phases, behave differently with respect to financing.

### 2.2.3 Geographic and sectoral distributions of firms

In order to ensure adequate representativity of all Canadians, firms in every part of Canada were approached to participate in this survey. This representation is relatively similar to that used in other studies of the same type.

**FIGURE 2.9: GEOGRAPHIC DISTRIBUTION OF FIRMS IN CANADIAN REGIONS**

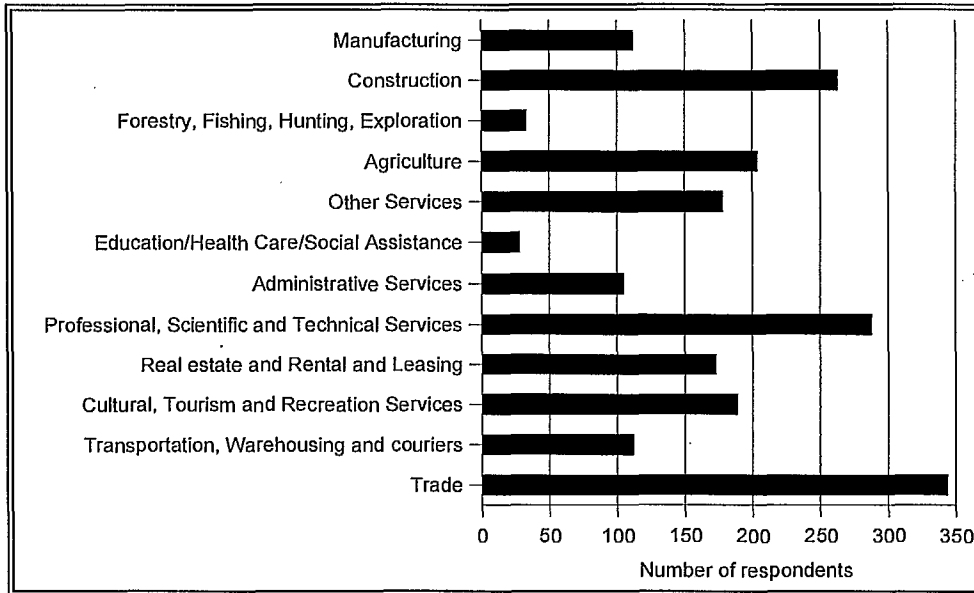


Not all regions have the same sectoral distribution. For example, 40.5% of the agricultural sector is located in the Central Canada region; 35% of the transportation and warehousing sector is concentrated in Quebec; 42.3% of the manufacturing industry is in Ontario; and 37.1% of the administrative and support and waste management service sectors are located in Atlantic Canada. Lastly, in view of the weighting of the sample based on Statistics Canada data to ensure representativity of Canadian industries, there is a preponderance of

firms in the service sectors (38%), in wholesale and retail trade (17%), and construction (13%) (see Figure 2.10).

There is no special characteristic of the sectoral and regional distributions that deserves mention here, except that some sectors are more likely than others to include firms that are growing strongly, are carrying out R&D and exporting, and are likely to have special financing issues. These aspects will be addressed again later.

**FIGURE 2.10: SECTORAL REPRESENTATION OF FIRMS IN THE SAMPLE**



Finally, based on the firms’ postal codes, 28% located in rural areas, 56% in urban areas and, 16% in metropolitan areas (the Toronto, Vancouver and Montreal regions). Approximately 50% of the firms located in the metropolitan areas are owned by university graduates, are involved in R&D and exporting, and have relatively high growth expectations.

**2.2.4 Research and development and exporting<sup>11</sup>**

R&D and exporting are important for firms’ sustainable development and competitiveness, but they are also characterized by uncertainty and therefore by risk. Under these conditions, certain projects may not necessarily find lenders interested in financing them. Which firms are involved in R&D or exporting?

A majority of the firms in the sample carry out no R&D, while 34% do so to various degrees. They may earmark from less than 1% to more than 15% of their sales for the R&D budget. The extent of innovation is linked to the entrepreneurs’ education, to very high expected growth rates, and to greater willingness to share control of the firm

<sup>11</sup>All statistics can be found in Annexes B and C. Only the most important findings are presented here.

if this is not already the case. In addition, more and more firms in the start-up phase are strongly involved in R&D, which obviously increases the risk factors and thus makes them more vulnerable to the financing supply situation. Lastly, the extent of R&D is also associated with a stronger probability of exporting.

Exporting firms represent 20% of the sample; for firms involved with R&D, the extent of exporting is highly variable from one firm to the next. The entrepreneur profiles for these two groups are similar, i.e. a university graduate who is expecting a high growth rate and is prepared to share control of the firm in order to finance its expansion or growth.

### **2.2.5 Indebtedness ratio**

An important consideration for lenders is the degree of financial risk they represent, which is associated with their capacity to repay creditors or compensate investors. While there are several ways to measure a firm's degree of financial risk, the most common is the indebtedness ratio. Therefore the entrepreneurs were asked to state approximately their firm's indebtedness ratio, i.e. the percentage of financing provided by debt. This was then used to assign one of three levels of indebtedness: low, average or high.<sup>12</sup>

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<sup>12</sup>In the mail-out questionnaire, the entrepreneurs were asked to provide sufficient information to calculate the indebtedness ratio. For reasons associated with response time, this question was changed in the telephone questionnaire, where the entrepreneurs were asked instead to indicate the range into which their firm's debt bearing interest fell. The responses to the two questionnaires did not indicate the same extent of debt, since the firms that responded to the telephone survey had lower levels than the others. The main difference between total debt and debt bearing interest relates to credit provided by suppliers, which should be at the same level for firms based on specific features of their sector, whether they responded to the mail-out survey or the telephone survey. Since liabilities to suppliers are not really relevant for the purposes of the present study, it was decided to ignore them and to divide the firms into three groups based on low, average and high levels of debt. Firms that participated in the mail-out survey and indicated a low level of debt were combined with those that responded to the telephone survey and also had a low level of debt, and so forth. Statistical tests performed on these groupings did not indicate problems regarding interpretation of the results from the combined samples and did not affect the findings.



***FIGURE 2.11: DISTRIBUTION OF FIRMS BY RATIO OF DEBT BEARING INTEREST***

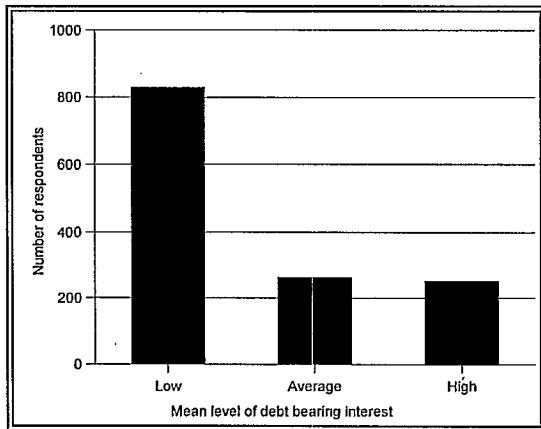


Figure 2.11 shows that a majority of the SMEs have a low level of debt (when this is defined as debt bearing interest, rather than all items included in the firms' liabilities).

Table 2.13 shows that the firms with the highest debt levels are owned by younger entrepreneurs who are on average more educated than the others, have less experience in their activity sector and are expecting higher growth than the others. However, this quest for growth is complemented by openness to sharing ownership to assist in financing their firm's expansion and development.

Furthermore, apart from the fact that they have more employees than the others, the firms with the highest debt levels presented no other significant difference relevant to the present discussion (see Annexes B and C).

**TABLE 2.13: ENTREPRENEUR'S PROFILE BY FIRM'S DEBT**

		Level of debt bearing interest		
		Low (N=828)	Average (N=263)	High (N=251)
Gender (N = 1335)	Male	73.2%	77.4%	77.6%
	Female	26.8%	22.6%	22.4%
Age of owner (N= 1336)		49 years	47 years	46 years
Education (N = 1335)	Elementary	7.2%	6.5%	5.2%
	High school	34.5%	45.2%	32.4%
	College	24.6%	23.8%	29.6%
	University	33.7%	24.5%	32.8%
Experience in activity sector (N = 1337)		21 years	20 years	20 years
Growth expected over next two years (N = 1073)		39.9%	30.0%	42.1%
Entrepreneurs who participated in creating the business (N = 1150)		85.6%	83.1%	90.8%
Is the entrepreneur prepared to share control in order to finance the firm's expansion or growth? (N = 878)	Already shares 50% of control	47.3%	43.6%	46.6%
	Yes, but wants to keep more than 50%	14.6%	21.8%	35.6%
	Yes, and is prepared to share more than 50%	11.8%	4.6%	5.8%
	No	73.6%	73.6%	58.6%

## ***Chapter III:***

### **Financing Sources of Canadian SMEs**

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As Table 3.1 confirms, the Canadian banks are still the principal external lenders for SMEs' ongoing operations.

***TABLE 3.1: DISTRIBUTION OF FIRMS BY THEIR MAIN FINANCIAL INSTITUTION FOR ONGOING OPERATIONS***

Institution:	N	Dist.	Total sales	Age of firms	Firms headed by men	Number of account managers
Canadian bank	1473	73%	\$240 000	12	74.3%	1.58
Credit union	221	11%	\$130 000	17	84.4%	1.33
Caisses populaires Desjardins	262	13%	\$201 685	14	65.6%	1.38
Other institutions*	71	4%	\$202 419	11	91.9%	1.64

\*Distribution of firms mainly financed by institutions other than the first three in the table: foreign banks = 13; trust companies = 16; Alberta Treasury Branch = 27; other institutions = 4

In addition, it is noteworthy that the number of account managers the entrepreneurs dealt with during the previous three years differs from one institution to the next and ranges from 1.33 to 1.64. Overall, 62% of the firms had one account manager during the previous three years; 26% had two; 8% had three; and 3% had four or more (this data will be addressed in greater detail in Chapter 6).

### 3.1 DEBT FINANCING SOURCES APPROACHED OR NOT APPROACHED

Table 3.2 presents a summary of the financing situation of Canadian SMEs over the previous three years. To give a relatively accurate idea of the identity of those requesting financing, a number of variables are used to describe the firms. This information will be looked at in more detail in the following sections.

**TABLE 3.2: SUMMARY REGARDING STATUS OF "DEBT" FINANCING REQUESTS SUBMITTED BY THE SMEs DURING THE PREVIOUS THREE YEARS**

Financing source:	Business line of credit	Factoring	Medium-/long-term loan	Leasing	Government programs
Firms that requested financing	45.1% (N = 910)	2.1% (N = 42)	27.7% (N = 559)	18.8% (N = 380)	11.7% (N = 236)
Number of employees	26	41	29	36	30
Total sales (\$000)	250	515	250	500	250
Age of firms	12 years	5 years	12 years	11 years	7 years
Female (25%)	21.9%	31.0%	18.8%	21.9%	16.9%
Male (75%)	78.1%	69.0%	81.2%	78.1%	83.1%
<i>The principal owner is:</i>					
Disabled (3.4%)	1.9%	0.0%	1.3%	2.3%	2.7%
Aboriginal (3.6%)	3.0%	2.7%	4.9%	2.5%	5.7%
Visible minority (5.6%)	5.4%	11.4%	4.6%	4.5%	3.2%
Approval rate	81.5%	---	85.6%	---	64.2%
Firms that did not submit applications because they had no need	77.0%	34.7%	83.8%	---	55.4%

SMEs often make requests from a number of financing sources simultaneously: 3% of the firms that requested line of credit financing also made a request from a factoring company, 41% requested medium-or long-term financing, 24% turned to leasing, 17% made requests from government agencies and 11% sought equity financing.

### 3.1.1 Short-term financing

In the questionnaire short-term financing is broken down into line of credit (personal and business), credit card and factoring.

#### A) Business line of credit

In most developed countries, a business line of credit is the most important financing source for SMEs, after suppliers. It is also the financing source that generates the greatest dissatisfaction among entrepreneurs,<sup>13</sup> who are not always comfortable with the related approval rules.

For the sample as a whole, the overall request rate for a line of credit was 451%, and the approval rate was 81.5% (see Table 3.2). Table 3.3 shows that certain entrepreneur groups requested lines of credit less often than others. For example, this is true of women, who seek significantly less of this type of financing than men, although their success rate is identical. The lower request rate for women cannot be associated with a lower approval rate, which would deter female entrepreneurs.

The older and more experienced entrepreneurs requested lines of credit at a lower rate during the previous three years (possibly because they already had one); however, their approval rate was better.

The approval rate for requests from Francophones was clearly higher than the average, unlike Allophones, whose approval rate was lower. As will be seen later, there is an institutional, locational and activity sector effect that may explain these results.

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<sup>13</sup>This phenomenon, which is well documented in the financial literature, has been observed in several developed countries, including the United Kingdom, France, Switzerland and the United States.

**TABLE 3.3: CHARACTERISTICS OF ENTREPRENEURS WHO REQUESTED A LINE OF CREDIT DURING THE PREVIOUS THREE YEARS**

		Requests	Approvals
Gender	Male (1510)	46.8%	81.7%
	Female (505)	39.1%	80.3%
Specific entrepreneur groups	Disabled (66)	23.9%	81.2%
	Canadian Aboriginal (69)	37.7%	88.0%
	Visible minority (113)	40.7%	57.8%
Age group of owner of firm	30 years or less (107)	44.2%	80.4%
	31-40 years (385)	55.6%	77.8%
	41-50 years (716)	46.9%	84.4%
	51-60 years (540)	45.6%	78.4%
	Over 60 years (267)	24.4%	92.2%
Experience in this activity sector	3 years or less (350)	52.0%	80.3%
	4-9 years (483)	49.0%	78.0%
	10-15 years (377)	38.0%	76.9%
	16-20 years (309)	49.2%	78.8%
	Over 20 years (496)	39.8%	93.4%
Mother tongue	French (549)	46.8%	90.7%
	English (1188)	44.2%	80.2%
	Other (279)	44.8%	68.9%

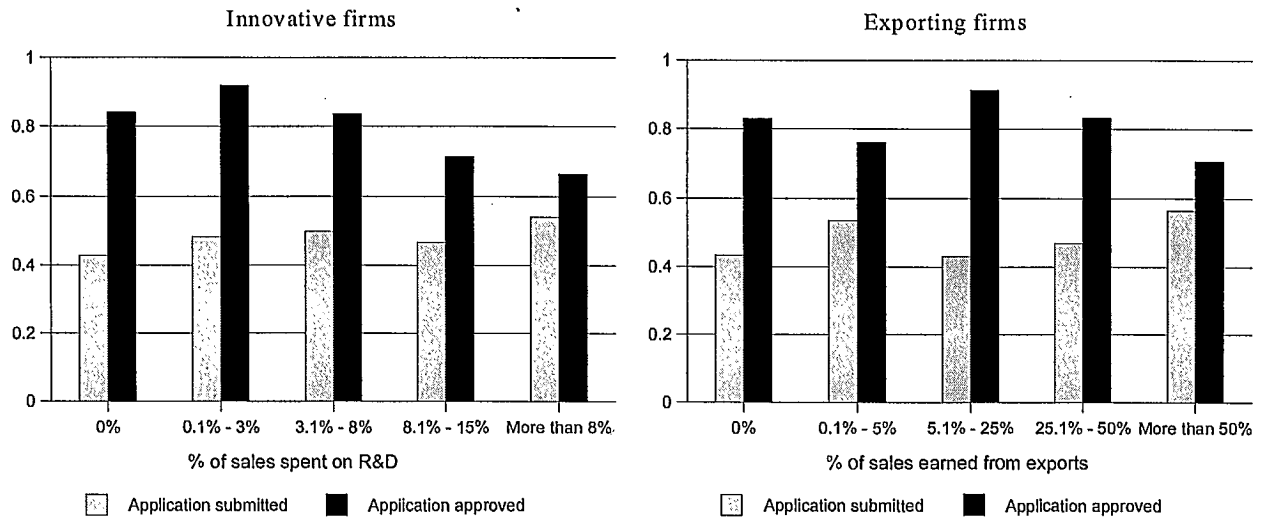
Financing request and approval rates rise with the size of firms. On the other hand, it is noteworthy that firms' phases of development result in different approval rates. It is surprising that firms in the start-up phase experience a higher refusal rate than firms in the winding down phase. These two phases of development share a relatively high risk level but differ in the components of this risk. When firms are in the seed/start-up phase, the business risk is high because of the inexperience of the owners and because everything concerning their business needs to be developed, but the larger cash flows lie in the future. Whereas although firms in the winding down phase have been developed and organized, their market is contracting and the largest cash flows lie in the past. The return potential is therefore substantially below that of start-up firms and even of firms in the strong growth phase. In the latter case, a below-average approval rate is also noted. The highest approval rates are reserved for firms in the most stable phrases.

**TABLE 3.4: VARIABLES RELATING TO DEVELOPMENT OF FIRMS THAT REQUESTED A LINE OF CREDIT DURING THE PREVIOUS THREE YEARS**

		Requests	Approvals
Number of employees	5 or fewer (1666)	41.9%	80.2%
	6-10 (165)	53.3%	85.4%
	11-20 (89)	60.7%	86.8%
	21-50 (65)	62.1%	80.5%
	Over 50 (42)	78.0%	90.6%
Phase of development	Seed/start-up (102)	44.4%	59.1%
	Slow growth (1029)	46.9%	84.6%
	Fast growth (250)	62.6%	77.5%
	Maturity (429)	36.1%	83.9%
	Winding down (184)	34.8%	79.7%

The firms that make the greatest contribution to a country's economic growth are those that innovate and export. However, these firms must be supported by a flexible financial system that responds to their sometimes urgent and extensive needs. In short, these firms present different challenges for lenders. Figure 3.1 shows that the more that firms innovate or export, the lower their line of credit approval rate.

**FIGURE 3.1: LINES OF CREDIT REQUESTED BY INNOVATIVE AND EXPORTING SMEs, AND APPROVED**



Furthermore, Table 3.5 shows that there is a very strong indication of a sector and geographical location effect influencing line of credit requests and approvals. It can be seen that approval rates are lower in certain sectors, including the cultural industry (3), natural resources (10) and manufacturing (12). Looking at the Canadian regions, the significant variances may be due to the differences between the institutions operating in each province, the profile of their respective customer bases and the economic fabric of individual provinces.



**TABLE 3.5: LINE OF CREDIT REQUESTS BY SME SECTOR AND LOCATION**

		Requests	Approvals
Sector	1. Wholesale and retail trade (344)	47.5%	84.7%
	2. Transportation, warehousing and couriers (112)	45.9%	84.0%
	3. Cultural, tourism and recreation industries (189)	38.6%	61.1%
	4. Real estate and renting and leasing (173)	31.8%	85.5%
	5. Professional, scientific and technical services (288)	31.2%	82.8%
	6. Administrative and support, waste management and remediation services (105)	43.3%	80.0%
	7. Educational services, health care and social assistance (28)	50.0%	85.7%
	8. Other services (except public administration) (178)	36.7%	86.2%
	9. Agriculture (204)	57.4%	90.5%
	10. Forestry, fishing and hunting, mining and oil and gas extraction (33)	39.4%	66.7%
	11. Construction (263)	63.5%	80.2%
	12. Manufacturing (112)	53.6%	74.6%
Location	Atlantic Canada (290)	47.2%	88.9%
	Quebec (535)	44.3%	86.0%
	Ontario (591)	44.5%	76.9%
	Manitoba/Saskatchewan (190)	54.7%	89.4%
	Alberta (192)	47.4%	72.5%
	British Columbia and the Territories (223)	36.0%	70.4%

More than 54% of the SMEs did not request a line of credit during the previous three years for the following reasons:

- ▶ they did not need this type of financing 77%
- ▶ they already had a line of credit 9%
- ▶ the procedure was too complicated 7%
- ▶ this type of financing was too expensive 6%
- ▶ they were turned down before 4%

It can be concluded from the foregoing tables that the firms that do not to apply for a line of credit do not present a uniform profile; however, some characteristics occur frequently:

- ▶ they are often owned by young entrepreneurs, women in most cases; and
- ▶ the firms are fairly new and smaller than the others.

## B) Factoring<sup>14</sup>

Factoring is a less well known and less common financing source than a line of credit, and one that targets a more limited market. This is confirmed by the low number of firms that sought this type of financing over the previous three years: only 42, or 2.1% of the sample. These firms sought this type of financing for the following reasons:

- |   |     |
|---|-----|
| ▶ to improve the conditions of other financing      | 57% |
| ▶ to assure a good follow-up on accounts receivable | 14% |
| ▶ to benefit from the factor's expertise            | 10% |

Furthermore, the following observations can be made based on the analysis of these 42 firms:

- ▶ the larger firms are more likely to use factoring
- ▶ the innovative firms and the exporting firms are more likely to use factoring
- ▶ the firms in the transportation, education, health care and social services and natural resources sectors are more likely to use factoring

On the other hand, 98% of Canadian SMEs did not use this type of financing because:<sup>15</sup>

- |  |     |
|--|-----|
| ▶ they did not need this type of financing                   | 77% |
| ▶ they were not aware of this type of financing              | 20% |
| ▶ this financing was too expensive                           | 7%  |
| ▶ the procedure to obtain this financing was too complicated | 6%  |

---

<sup>14</sup> For reasons of questionnaire length and response time, the same information was not the subject of questions for the various types of financing. The results presented in this report will therefore vary from one financing source to the next.

<sup>15</sup> This question was asked only in the mail-out questionnaire; this reduces the number of respondents by half.

### 3.1.2 Medium-/long-term debt financing

#### A) Medium-/long-term loans

Approximately 28% of Canadian SMEs requested medium- or long-term loans during the previous three years. These applications were approved in 86% of cases. The reasons for requesting this type of financing are as follows:

- ▶ to reduce pressure on cash flows 54%
- ▶ to diversify sources of financing 18%
- ▶ because the financing conditions were attractive 13%

The characteristics of the entrepreneurs and firms that requested medium- and long-term loans are set out in Tables 3.6 and 3.7.

**TABLE 3.6: CHARACTERISTICS OF ENTREPRENEURS WHO REQUESTED MEDIUM-/LONG-TERM LOAN FINANCING DURING THE PREVIOUS THREE YEARS**

		Requests	Approvals
Gender	Male (1510)	29.7%	83.4%
	Female (505)	21.0%	93.2%
Specific entrepreneur groups	Disabled (66)	10.6%	85.7%
	Canadian Aboriginal (69)	37.7%	96.2%
	Visible minority (113)	21.4%	87.5%
Age group (N = 2015)	30 years or less (107)	24.5%	92.0%
	31-40 years (385)	34.0%	76.9%
	41-50 years (716)	30.9%	89.1%
	51-60 years (540)	25.9%	83.9%
	Over 60 years (267)	15.8%	95.2%
Experience in this activity sector	3 years or less (350)	30.9%	82.1%
	4-9 years (483)	30.1%	76.6%
	10-15 years (377)	21.9%	85.2%
	16-20 years (309)	32.4%	89.0%
	Over 20 years (496)	25.1%	96.7%

Table 3.6 shows that women are less likely to apply for this type of loan, although on average their requests are approved more often. The impact of the other entrepreneur characteristics on the request and approval rate is similar to the findings relating to lines of credit.

Turning to the characteristics of firms, it can be seen that approval rates are not related to the size of firms. However, the impact of their phase of development is still felt, as in the case of lines of credit, but to a lesser extent. Firms in their initial stage still experience the highest refusal rates. The same applies to innovative or exporting firms. The more they innovate, or the more they export, the higher the rate of refusal in response to their requests for financing. Lastly, a sector effect is still evident (see Table 3.7), but it differs from the effect on lines of credit. Refusal rates remain high in the more “intangible” sectors. Looking at firms’ locations, the results are comparable to those relating to lines of credit.

**TABLE 3.7: ACTIVITY SECTORS OF FIRMS THAT APPLIED FOR A MEDIUM-/LONG-TERM LOAN DURING THE PREVIOUS THREE YEARS**

	Requests	Approvals
Wholesale and retail trade (344)	26.8%	86.5%
Transportation, warehousing and couriers (112)	25.0%	82.1%
Cultural, tourism and recreation industries (189)	28.0%	71.7%
Real estate and renting and leasing (173)	18.0%	100.0%
Professional, scientific and technical services (288)	20.1%	91.4%
Administrative and support, waste management and remediation services (105)	31.7%	66.7%
Educational services, health care and social assistance (28)	32.1%	77.8%
Other services (except public administration) (178)	16.3%	93.1%
Agriculture (204)	50.7%	95.0%
Forestry, fishing and hunting, mining and oil and gas extraction (33)	60.6%	95.0%
Construction (263)	25.9%	79.1%
Manufacturing (112)	33.9%	78.9%

Lastly, 1455 entrepreneurs stated that they did not apply for a medium- or long-term loan for the following reasons:

- ▶ they did not need this type of financing 84%
- ▶ the procedure to obtain this financing was too complicated 8%
- ▶ they were not aware of this type of financing 4%
- ▶ they were turned down before 4%
- ▶ this financing was too expensive 4%

## B) Leasing

Of the Canadian SMEs polled, 18.8% turned to leasing. These entrepreneurs gave the following reasons for their choice of financing:

- ▶ the financing conditions were attractive 59%
- ▶ they wished to borrow up to 100% of the business's asset value 29%
- ▶ a financial institution had turned them down for a loan 7%

**TABLE 3.8: CHARACTERISTICS OF ENTREPRENEURS WHO REQUESTED LEASING FINANCING DURING THE PREVIOUS THREE YEARS**

		Requests
Gender	Male (1510)	19.6%
	Female (505)	16.6%
Age group	30 years or less (107)	17.9%
	31-40 years (385)	22.0%
	41-50 years (716)	19.7%
	51-60 years (540)	19.7%
	Over 60 years (267)	10.5%
Experience in this activity sector	3 years or less (350)	26.2%
	4-9 years (483)	18.8%
	10-15 years (377)	17.2%
	16-20 years (309)	15.7%
	Over 20 years (496)	16.2%

**TABLE 3.9: VARIABLES RELATING TO DEVELOPMENT OF FIRMS THAT REQUESTED LEASING FINANCING DURING THE PREVIOUS THREE YEARS**

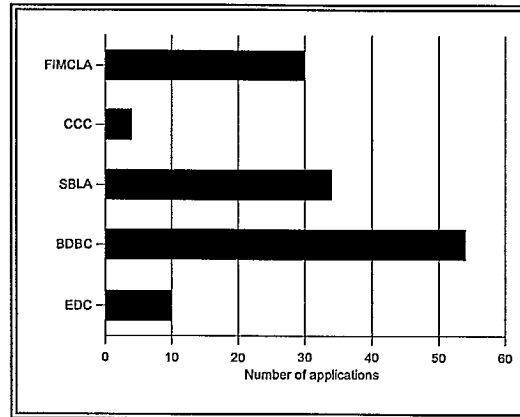
		Requests
Number of employees	5 or fewer (1666)	14.5%
	6-10 (165)	29.8%
	11-20 (89)	42.7%
	21-50 (65)	47.7%
	Over 50 (42)	52.4%
Phase of development	Seed/start-up (102)	16.7%
	Slow growth (1029)	17.8%
	Fast growth (250)	29.8%
	Maturity (429)	15.4%
	Winding down (184)	13.6%

Table 3.8 shows that the least experienced and youngest entrepreneurs (less than 40 years of age) apply most often for leasing; this rate consistently declines with experience and age. No other entrepreneur characteristic apparently plays a significant role in leasing financing applications.

Furthermore, firm size (see Table 3.9) plays a significant role in relation to use of this type of financing, since size is related to the degree of need for specific assets for the firms's operations. The impact of the phase of development shows that the firms with the greatest needs, due to their rate of development (fast growth), most often request this type of financing. Firms in the following activity sectors request lease financing the most often: transportation (30.4%), education (32.1%), natural resources (27.3%), and manufacturing (23.4%). Looking at another aspect, firms in Ontario (21.9%) and British Columbia and the Territories (24.7%) request lease financing the most often.

C) Government services or programs

**FIGURE 3.2: PRINCIPAL GOVERNMENT PROGRAMS/SERVICES RECEIVING REQUESTS FROM SMEs**



Government services/programs<sup>16</sup> were approached by 11.7% of the SMEs (236 firms) during the previous three years. The organization approached most frequently was the BDBC, followed by the SBLA administration. The profile of firms requesting government programs/services is presented in the following tables.

Request rates for government programs/services are influenced by certain entrepreneur characteristics, including gender and age. Experience as an SME owner and the entrepreneur's mother tongue play no significant role.

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<sup>16</sup> EDC = Export Development Corporation; BDBC = Business Development Bank of Canada; SBLA = Small Business Loans Act; CCC = Canadian Commercial Corporation; FIMCLA = Farm Improvement and Marketing Co-operatives Loans Act.

**TABLE 3.10: CHARACTERISTICS OF ENTREPRENEURS WHO REQUESTED FINANCING FROM GOVERNMENT SERVICES/PROGRAMS DURING THE PREVIOUS THREE YEARS**

		Requests	Approvals
Gender	Male (1510)	13.0%	63.4%
	Female (505)	8.0%	70.0%
Specific entrepreneur groups	Disabled (66)	9.1%	66.7%
	Canadian Aboriginal (69)	19.1%	28.6%
	Visible minority (113)	6.2%	42.9%
Age group	30 years or less (107)	10.5%	90.0%
	31-40 years (385)	17.2%	54.5%
	41-50 years (716)	12.0%	66.3%
	51-60 years (540)	10.9%	66.1%
	Over 60 years (267)	4.9%	76.9%

On the other hand, a review of the firms' characteristics shows that more of the larger firms made requests to government services/programs, as well as more firms in the start-up or fast growth phases (see Table 3.11). Also, the number of requests rose in proportion to the extent of the firms' R&D and exporting activities. The existence of highly specialized programs and services may explain these use trends. Indeed, this is supported by the data on activity sectors presented in Table 3.12.

It is noteworthy, however, that approval rates are relatively low and significantly less than the rate reported for more traditional financing sources, which is above 80%, compared with 64% in the case of government programs/services.



***TABLE 3.11: VARIABLES RELATING TO DEVELOPMENT OF FIRMS THAT REQUESTED FINANCING FROM GOVERNMENT SERVICES/PROGRAMS DURING THE PREVIOUS THREE YEARS***

		Requests	Approvals
Number of employees	5 or fewer (1666)	9.8%	59.7%
	6-10 (165)	17.8%	67.9%
	11-20 (89)	22.7%	80.0%
	21-50 (65)	20.0%	84.6%
	Over 50 (42)	23.8%	70.0%
Phase of development	Seed/start-up (102)	26.2%	73.1%
	Slow growth (1029)	10.5%	74.5%
	Fast growth (250)	22.0%	40.7%
	Maturity (429)	6.1%	52.2%
	Winding down (184)	10.3%	84.2%
Sales spent on R&D	0 (1209)	8.8%	68.3%
	0.1-3 (153)	7.2%	81.8%
	3.1-8 (134)	12.6%	58.8%
	8.1-15 (171)	15.8%	55.6%
	Over 15 (170)	30.6%	57.7%
Export sales	0 (1555)	8.9%	65.7%
	0.1-5 (95)	13.7%	69.2%
	5.1-24.9 (85)	12.9%	83.3%
	25-49.9 (52)	17.3%	88.9%
	50 or more (153)	29.1%	38.6%

**TABLE 3.12: ACTIVITY SECTORS AND LOCATIONS OF FIRMS THAT REQUESTED FINANCING FROM A GOVERNMENT SERVICE/PROGRAM DURING THE PREVIOUS THREE YEARS**

	Requests	Approvals
Sector		
Wholesale and retail trade (344)	11.1%	73.0%
Transportation, warehousing and couriers (112)	6.3%	50.0%
Cultural, tourism and recreation industries (189)	12.8%	79.2%
Real estate and renting and leasing (173)	8.1%	50.0%
Professional, scientific and technical services (288)	8.4%	66.7%
Administrative and support, waste management and remediation services (105)	13.3%	21.4%
Educational services, health care and social assistance (28)	10.7%	66.7%
Other services (except public administration) (178)	9.0%	68.8%
Agriculture (204)	27.0%	76.9%
Forestry, fishing and hunting, mining and oil and gas extraction (33)	24.2%	71.4%
Construction (263)	3.4%	44.4%
Manufacturing (112)	21.4%	50.0%
Location		
Atlantic Canada (290)	17.9%	61.5%
Quebec (535)	11.4%	62.3%
Ontario (591)	9.0%	53.8%
Manitoba/Saskatchewan (190)	17.9%	74.2%
Alberta (192)	8.9%	82.4%
British Columbia and the Territories (223)	7.6%	70.6%

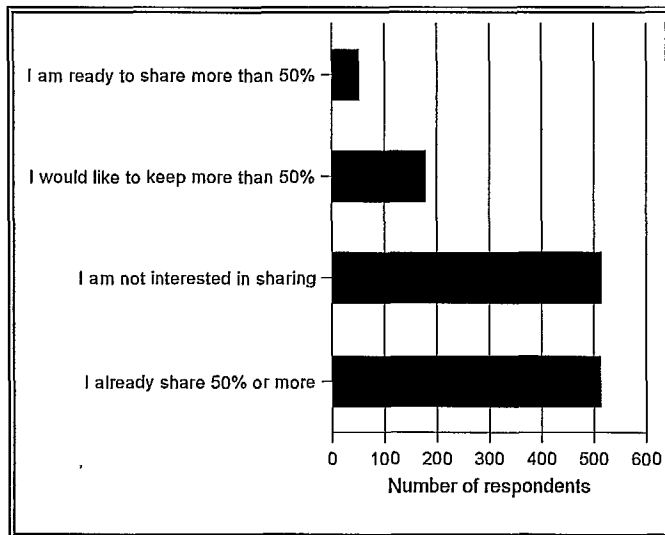
Lastly, 1785 entrepreneurs stated that they had not requested financing from government services/programs for the following reasons:

- ▶ they did not need these programs/services 55%
- ▶ they were not aware of the different programs/services offered 35%
- ▶ the procedure to obtain this financing was too complicated 14%
- ▶ the acceptance process was too long 7%
- ▶ the firm did not meet the acceptance criteria 3%

### 3.2 EQUITY FINANCING SOURCES REQUESTED OR NOT REQUESTED

Statistics on Canadian businesses show that 36% of them are unincorporated, thus reducing the number of equity financing too a maximum of 1291.

**FIGURE 3.3: ENTREPRENEURS' WILLINGNESS TO SHARE CAPITAL**



Among incorporated firms, 41% of the owners already share control with shareholders, while a further 41% refuse to share control, as shown by Figure 3.3.

These data largely explain the very small number of equity financing requests; this behaviour is entirely compatible with that of entrepreneurs in other developed countries.

**TABLE 3.13: SUMMARY OF EQUITY FINANCING REQUESTS MADE BY SMEs<sup>17</sup>**

	Equity request	Internal capital		External capital			
		Friends/family	Employees	Informal invest.	Venture capital	Crown corp.	
Number of applications submitted	110	70	17	40	42	7	
Number of employees	4.8	4.51	3.6	10.2	9.8	22.1	
Total sales (\$000)	669	351	469	423	466	2300	
Age (years)	5	3	7	5	4.3	3.6	
<i>Principal shareholder is:</i>	Female	14.8%	10.3%	43.8%	5.0%	0.0%	0.0%
	Male	85.2%	89.7%	56.3%	95.0%	100%	100%
	Minority group*	21.4%	24.6%	6.3%	16.7%	18.4%	50.0%
Acceptance rate	---	82.8%	47.0%	65.0%	38.0%	57.1%	

\*Minority group: entrepreneur with a disability or who is an Aboriginal Canadian or a member of a visible minority

Table 3.13 shows the distribution of financing requests made during the previous three years; a business size effect is evident. The larger the business, the more the entrepreneur must use external capital and reach beyond his or her own network to finance the firm's needs. Furthermore, this is unrelated to the age of the firms. These data will be presented again in the following tables in order to highlight the profile of firms and entrepreneurs who request equity financing.

Table 3.14 shows that younger entrepreneurs (less than 40 years of age) are more likely than other entrepreneurs to request equity financing. It will be recalled that these entrepreneurs also expect the highest growth rates within the two years to come. Their openness to external partners is essential to meet their growth objectives.

<sup>17</sup>Since the total number of financing requests through an initial public offering is very low, these firms will not be analysed further, as doing so could cause certain statistical problems.

**TABLE 3. 14: CHARACTERISTICS OF ENTREPRENEURS WHO REQUESTED EQUITY FINANCING DURING THE PREVIOUS THREE YEARS**

		Requested equity* (110)	Internal investor		External investor	
			Friends/family (70)	Employees (17)	Informal invest. (40)	Venture capital company (42)
Gender	Male	92	61	9	38	40
	Female	16	7	7	2	0
Age group	30 years or less	18	16	3	4	5
	31-40 years	33	22	1	10	15
	41-50 years	27	11	10	7	8
	51-60 years	25	16	1	15	11
	Over 60 years	6	4	1	5	1
Experience in this activity sector	3 years or less	47	36	6	17	18
	4-9 years	42	23	9	16	16
	10-15 years	9	6	1	4	4
	16-20 years	4	3	0	1	0
	Over 20 years	7	2	1	3	4

\*The total number of requests made to the various types of investors exceeds 110 since certain entrepreneurs made the same request to more than one type of investor.

**TABLE 3.15: VARIABLES RELATING TO DEVELOPMENT OF FIRMS THAT REQUESTED EQUITY FINANCING DURING THE PREVIOUS THREE YEARS**

	Requested equity (110)	Internal investor		External investor		
		Friends/family (70)	Employees (17)	Informal investor (40)	Venture capital company (42)	
Number of employees	5 or fewer (1666)	56	40	10	16	16
	6-10 (165)	15	8	1	5	6
	11-20 (89)	13	9	1	8	8
	21-50 (65)	15	8	3	7	8
	Over 50 (42)	11	4	1	5	4
Phase of development	Seed/start-up (102)	25	22	4	14	17
	Slow growth (1029)	43	29	3	15	10
	Fast growth (250)	28	15	3	10	13
	Maturity (429)	4	3	0	0	0
	Winding down (184)	8	0	7	1	1
Firm's sales spent on R&D	0	59%	39%	10%	19%	15%
	0. 1-3 (153)	9%	5%	1%	3%	2%
	3. 1-8 (134)	4%	1%	0%	1%	2%
	8. 1-15 (171)	9%	6%	1%	4%	3%
	Over 15 (170)	25%	16%	5%	13%	19%
Firm's sales from exports	0	59%	42%	13%	20%	19%
	0. 1-5 (95)	6%	5%	1%	3%	3%
	5. 1-24. 9 (85)	6%	2%	1%	3%	2%
	25-49. 9 (52)	10%	3%	0%	3%	3%
	50 or more (153)	25%	14%	2%	11%	12%

The larger a firm becomes, the more frequently the entrepreneur seeks funds from investors outside the firm or his or her network. Furthermore, a high proportion of firms request financing from external investors right from the start-up stage (25 of 102 firms, or 25% of SMEs in the seed/start-up phase). This could be explained by the existence of specialized funds in certain activity sectors. Looking at another aspect, firms that export a great deal or that carry out extensive R&D make more financing requests to potential investors, who are more likely to be external investors.

Lastly, Table 3.16 indicates a sector effect and a location effect with respect to requesters of equity financing.

**TABLE 3.16: ACTIVITY SECTORS AND LOCATIONS OF FIRMS THAT REQUESTED EQUITY FINANCING DURING THE PREVIOUS THREE YEARS**

Potential investors to whom requests for equity financing were made:		Friends/ family (70)	Employees (17)	Informal investors (40)	Venture capital companies (42)
Sector	Wholesale and retail trade (344)	9	3	4	5
	Transportation, warehousing and couriers (112)	1	0	1	0
	Cultural, tourism and recreation industries (189)	8	1	7	3
	Real estate and renting and leasing (173)	7	7	0	0
	Professional, scientific and technical services (288)	15	3	8	11
	Administrative and support, waste management and remediation services (105)	4	0	2	4
	Educational services, health care and social assistance (28)	3	0	2	3
	Other services (except public administration) (178)	6	0	2	5
	Agriculture (204)	0	0	1	1
	Forestry, fishing and hunting, mining and oil and gas extraction (33)	9	0	5	3
	Construction (263)	0	0	1	0
	Manufacturing (112)	7	1	6	4
Location	Atlantic Canada (290)	9	1	2	5
	Quebec (535)	8	8	5	7
	Ontario (591)	28	5	15	15
	Manitoba and Saskatchewan (190)	1	0	0	1
	Alberta (192)	12	1	9	7
	British Columbia and the Territories (223)	11	2	10	6

An analysis of requesters of equity financing shows that 25% of them approached only one potential investor during the previous three years (see Table 3. 17), 33% approached two and 42% approached more than two, making a total of 204 equity financing requests to potential investors (including the stock market).

**TABLE 3.17: DISTRIBUTION OF EQUITY FINANCING REQUESTS MADE TO POTENTIAL INVESTORS DURING THE PREVIOUS THREE YEARS**

<i>Source approached:</i>	Internal Investor		External Investor			
	Friends/ family	Employees	Informal Invest.	Venture Capital	Govt.	Public
1	27	7	6	6	0	2
2	21	3	14	15	2	3
<i>Number of sources</i> 3	10	2	10	9	3	2
4	10	4	9	10	1	7
5	2	1	2	2	1	1
<i>Total</i>	<i>70</i>	<i>17</i>	<i>41</i>	<i>42</i>	<i>7</i>	<i>15</i>

Entrepreneurs' satisfaction with their various types of financing varies based on a variety of data. In order to avoid unduly criticizing financial markets and accusing them of failing to appropriately meet the needs of SMEs, these data will be analysed individually in the chapters that follow. A more detailed assessment involving cross-referencing of a number of variables will be carried out in Part 3 of this report.



## Chapter IV:

### Canadian Entrepreneurs' Satisfaction with the Various Financing Sources

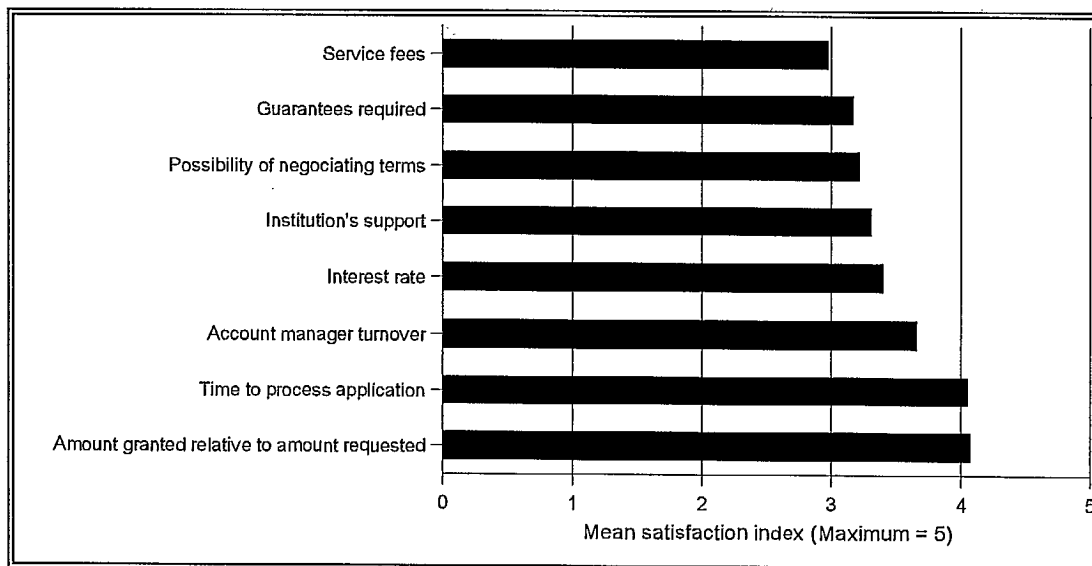
#### 4.1 SATISFACTION WITH LINE OF CREDIT

##### 4.1.1 Satisfaction regarding line of credit held

The overall satisfaction index for entrepreneurs regarding their line of credit is 3.66/5. As shown in previous studies, the main dissatisfaction factors of Canadian entrepreneurs regarding their line of credit remain the institutions' service fees as well as the personal and corporate guarantees required in order to obtain financing.

*FIGURE 4.1: MEAN SATISFACTION INDEX OF ENTREPRENEURS REGARDING THEIR LINE OF CREDIT*

A more detailed analysis of the data revealed that satisfaction could vary with the characteristics of entrepreneurs and firms. The principal results of this analysis are presented in Table 4.1 for each element queried.



**TABLE 4.1: SATISFACTION REGARDING EACH LINE OF CREDIT ELEMENT, BY CHARACTERISTICS OF ENTREPRENEURS AND FIRMS**

Element queried	Evaluation obtained based on various groupings of firms and entrepreneurs
The amount granted by the institution relative to the amount requested	These two elements always yield the highest satisfaction levels. The lowest satisfaction levels are expressed by the least experienced entrepreneurs.
The time to process the application	
The interest rate	The entrepreneurs in Atlantic Canada, British Columbia, the Territories and Alberta consider this element to be the second or the third least satisfactory.
The service fees	Young entrepreneurs report the lowest satisfaction levels with service fees and guarantees required. Quebec firms consider service fees to be the least satisfactory element of all (lowest rating obtained).
The personal and corporate guarantees required by the institution	
The institution's support to the business when business is good as well as when times are harder	The least experienced entrepreneurs indicate this element to be the third least satisfactory of eight alternatives; this also applies to owners of mature firms and firms winding down, who need their lender to demonstrate patience and understanding.
The possibility of negotiating the terms of the contracts (reimbursement conditions, service fees, etc. )	Overall, this element ranks sixth with respect to entrepreneurs' satisfaction level.
Account manager turnover	The satisfaction level with account manager turnover is stable and, regardless of the groupings formed, ranks third after amounts granted and application processing time.
Overall	The overall satisfaction level increases with the age of the entrepreneur. As the desire to grow the business declines, older entrepreneurs submit fewer financing applications. The overall index is lower among entrepreneurs with less experience. The index is also lower in the case of firms winding down.

It would also appear that the overall satisfaction level declines as firms' R&D budgets increase. Firms also indicated lower satisfaction when questioned regarding the amount granted by the institution relative to the amount requested. Exporting firms report different results; firms that export small volumes are less satisfied, unlike non-exporters and heavy exporters, which behave similarly. This is explained by the fact that the initial experience of exporting always leads to a rise in commercial and management risk, since it is uncertain whether the activity will succeed, and furthermore there is less expertise within the firm, which may mean that it is unable to effectively resolve the problems related to this activity.

Lastly, sector has a significant impact on the firms' overall satisfaction level. In general, the firms in the natural resources sector (index = 3.03) and the culture, recreation and tourism sector (index = 3.10) are the least satisfied, while those in the agriculture sector report the highest satisfaction level (index = 4.10).

As just shown, entrepreneurs' satisfaction level varies with the element considered (guarantees required, interest rate, etc. ) and depends on a number of factors specific to the entrepreneur and the firm. Given this, it is interesting to identify and attempt to understand, as Thompson Lightstone did, which elements among those queried influence the overall satisfaction level. The univariate tests suggest that service fees and guarantees are strong elements in reducing entrepreneurs' satisfaction. Do these two specific elements dominate the overall satisfaction index? This theory was tested through regressions in which the dependent variable was the overall satisfaction index.

In general, and disregarding specific contingency factors, the results show that satisfaction with the amount granted explains 20% of the overall satisfaction variation of SMEs regarding their line of credit (see Table 4.2). Ranked next are the possibility of negotiating the terms of the contracts (16%) and the institution's support to the business (15%). Service fees and guarantees required by the institution explain 14% and 10% of overall satisfaction.

**TABLE 4.2: CONTRIBUTIONS OF VARIOUS ELEMENTS QUERIED TO OVERALL SATISFACTION VARIATION REGARDING LINE OF CREDIT**

Elements cited as reasons for refusal:	Contribution to overall satisfaction variation
The amount granted by the institution relative to the amount requested	20.7%
The possibility of negotiating the terms of the contracts	16.3%
The institution's support to the business when business is good as well as when times are harder	15.0%
The service fees	14.5%
The guarantees required by the institution	10.3%
Account manager turnover	8.2%
The time to process the application	7.6%
The interest rate	7.5%

It is thus possible to rank the satisfaction elements on the basis of their relative impact on the overall satisfaction rating. It can be concluded from this that while the entrepreneurs may report less satisfaction with service fees or guarantees required, these two elements have an insignificant impact on their overall satisfaction level.

Furthermore, as has already been stated, certain contingent variables specific to a firm may impact on its financial needs and therefore on the entrepreneur's attitude to markets. These phenomena have been accounted for by dividing the sample on the basis of a number of variables, in order to determine whether these influenced entrepreneurs' satisfaction. The results are presented below.<sup>18</sup>

**A) Influence of entrepreneur's profile on overall satisfaction determinants**

**❖ Age of entrepreneurs:**

The table below shows that the overall satisfaction of the oldest entrepreneurs (51 to 60 years of age) is explained primarily by the possibility of their negotiating the terms of their contracts, followed by the interest rate and the guarantees required by the institutions. It should be borne in mind that these entrepreneurs often own mature firms or firms winding down, which may justify their greater concern regarding more tangible elements of their line of credit financing. It can also be seen that the 31-40 are group is influenced primarily by the service fees and the amount granted by the financial institution.

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<sup>18</sup>We have included only the statistically significant results for discussion purposes, in order to highlight the most relevant elements. Furthermore since the regression coefficients were standardized, the satisfaction elements can be prioritized by reference to their regression coefficient. Lastly, we will present only the three major elements for each grouping of firms. All the results are presented in Annex D.

Age group of entrepreneurs:	31-40	41-50	5-60
The amount granted by the institution relative to the amount requested	0.2538	0.2592	
The interest rate			0.1829
The service charges	0.2629		
The guarantees required by the institution			0.1805
The institution's support to the business when business is good as well as when times are harder		0.1867	
The possibility of negotiating the terms of the contracts	0.1457	0.1840	0.2009

❖ **Entrepreneurs' interest in growth:**

Service fees are with overall satisfaction in the case of the entrepreneurs who expect high growth rates and major financial needs. The amount granted by the financial institution is an important element for three out of four groups of entrepreneurs. Lastly, the guarantees required are a significant component of overall satisfaction for those entrepreneurs who have relatively low growth objectives. It will be recalled that these are also the oldest entrepreneurs and those who have the most experience in their area of activity.

Growth expected over the next two years:	0-19%	20-49%	50-99%	100%+
The amount granted by the institution relative to the amount requested	0,2119	0,2532	0,1887	
The interest rate			0,172	
The service fees	0,1581		0,1841	0,263
The guarantees required by the institution	0,1534			
The institution's support when business is good as well as when times are harder		0,1825		0,2013
The possibility of negotiating the terms of the contracts		0,1687		0,1702

**B) Influence of firm's profile on overall satisfaction determinants**

**❖ Age of firm:**

The table below shows the degree to which the satisfaction elements can vary from one type of business to the next. The oldest firms (like the youngest) are influenced primarily by the possibility of negotiating their loan, by the service fees, and by potential support from their financial institutions. The other age groups are influenced to varying degrees by the various elements queried.

Age of firm:	3 or less	4 to 5	6 to 10	11 to 20	Over 20
The amount granted by the institution relative to the amount requested	0,1667	0,283	0,1931	0,311	
The interest rate				0,1401	
The service fees	0,206				0,1867
The guarantees required by the institution		0,2411		0,2926	
The institution's support to the business			0,2088		0,1782
The possibility of negotiating the terms of the contracts	0,3197				0,193
Account manager turnover		0,252	0,1845		

**❖ R&D activities:**

The entrepreneurs involved in R&D are primarily sensitive to the amount of financing granted by the institution, the possibility of negotiating the terms of their contracts and the potential support from the institution when business is good as well as when times are harder. These findings are hardly surprising, since R&D activities involve a high degree of uncertainty, which can lead to difficulties in obtaining adequate financing from a "patient" lender. Interest rates and service fees are not the primary determinants of overall satisfaction for these entrepreneurs.

Does the firm carry out R&D activities?	No	Yes
The amount granted by the institution relative to the amount requested	0,1732	0,1821
The guarantees required by the institution	0,1285	
The institution's support to the business		0,148
The possibility of negotiating the terms of the contracts	0,1489	0,1511

❖ **Exporting activities:**

As with the entrepreneurs active in R&D, the overall satisfaction of those who are exporters depends on the possibility of negotiating the terms of their contracts and the amount granted by the financial institution. Like the entrepreneurs who do not export, their overall satisfaction is unrelated to service fees.

	Is the firm an exporter?	
	No	Yes
The amount granted by the institution relative to the amount requested	0.2105	0.2116
The service fees	0,1428	
The institution's support to the business	0,1536	0,1394
The possibility of negotiating the terms of the contracts		0.28

#### 4.1.2 Satisfaction regarding refusals of requests for lines of credit

Of 907 applications submitted, 167, or 18%, were refused. The main reason given for the refusal was the inability of the business to provide guarantees. As shown in Table 4.3, a majority of the entrepreneurs (69%) disagreed with this reason. In view of the small number of respondents to this question, this finding will not be analysed further.

**TABLE 4.3: DEGREE OF AGREEMENT WITH REASONS GIVEN FOR REFUSAL OF LINE OF CREDIT FINANCING**

Main reasons given for refusals:	N	Degree of entrepreneur's agreement with these reasons	
		Yes	No
The business could not provide enough guarantees	69	20%	44%
The request did not meet the criteria (financial and other)	60	8%	38%
The business had a poor credit history	13	2%	11%
The management team was too inexperienced	4	0%	4%
The request was incorrect or incomplete	5	4%	0%
Other	22	0%	19%

## 4.2 EVALUATION OF SATISFACTION REGARDING MEDIUM-/LONG-TERM LOAN FINANCING

### 4.2.1 Satisfaction regarding approved applications

The overall satisfaction index for medium- and long-term loans, 3.67, is similar to the index for lines of credit. Similarly, the elements of service fees and guarantees required by the institution generated the lowest satisfaction levels.

*TABLE 4.4: DEGREE OF SATISFACTION WITH APPROVAL OF REQUESTS FOR MEDIUM-/LONG-TERM LOANS*

	Degree of satisfaction (Maximum = 5)
The amount granted by the institution relative to the amount requested	4,22
The time to process the application	4
The interest rate	3,33
The service fees	3,16
The guarantees required by the institution (personal and corporate)	3,17
The account manager's interest in the business's needs	3,67
<b>Overall</b>	<b>3,67</b>

Unlike the case of line of credit, where the degree of satisfaction was relatively high, the interest rate on medium- and long-term loans generated the third lowest degree of satisfaction on the part of the entrepreneurs. On the other hand, its ranking changes in certain cases. It generates the lowest satisfaction rate among women, heavy exporters, firms winding down, firms in Atlantic Canada, British Columbia and the Territories, and firms operating in the following sectors: cultural, tourism and leisure; administrative and support services; and natural resources.

The lowest satisfaction rates regarding medium-and long-term loans were observed among businesses in the seed or winding down phases, and businesses in the administrative and support services sector and the natural resources sector.

As in the case of the line of credit, analysis of the major determinants of the overall satisfaction index regarding medium- and long-term loans revealed that these indexes varied based on different aspects of the



entrepreneur and the business.

Overall, satisfaction with medium- and long-term loans is not influenced by the same elements as satisfaction with the line of credit. It is noted that the guarantees required by the institution explain more than 21% of overall satisfaction, whereas they accounted for only 10% in the case of the line of credit. The time to process financing applications is also more important for medium-/long-term loans than for the line of credit. The different behaviour of the entrepreneurs is explained by the specific needs met by these two types of financing.

**TABLE 4.5: CONTRIBUTIONS OF VARIOUS ELEMENTS QUERIED TO OVERALL SATISFACTION VARIATION REGARDING MEDIUM-/LONG-TERM LOANS**

Element explaining overall satisfaction:	Contribution to variation in overall satisfaction
The account manager's interest in the business's needs	22.0%
The guarantees required by the institution	21.2%
The time to process the request	18.0%
The service fees	14.3%
The amount granted by the institution relative to the amount requested	13.3%
The interest rate	11.1%

**A) Influence of entrepreneur's profile on overall satisfaction determinants regarding medium-/long-term loans**

**❖ Age of the entrepreneur:**

The table below shows that, as in the case of the line of credit, the age of the entrepreneur impacts on the determinants of their overall satisfaction. The younger entrepreneurs are concerned mainly with the amount granted by the institution relative to the amount they requested, and then with service fees; the older entrepreneurs are influenced primarily by the guarantees required. The latter finding is surprising, insofar as limited companies are supposed to provide a separation between the business as a legal person and the individual who is the owner. It would seem that this separation is not really recognized, to the extent that an entrepreneur, regardless of the legal format of his or her business or its age, will nevertheless be required to provide guarantees for all types of loans sought on behalf of the business.

Age group of the entrepreneurs:	31-40	41-50	51-60
The amount granted by the institution relative to the amount requested	0.4126		
The time to process the request		0.2485	0.2365
The interest rate		0.2088	
The service fees	0.2171		
The guarantees required by the institution			0.3711
The account manager's interest in the business's needs	0.1222	0.2615	0.2005

❖ **Entrepreneur's interest in growth:**

Another aspect influencing the determinants of overall satisfaction is related to the growth rate expected by the entrepreneurs, which is itself an indicator of the extent of financing needs. The table below shows that the overall satisfaction of the entrepreneurs expecting the highest growth rates is determined first by the match between the amount requested and the amount of financing obtained, then by the financing conditions, i.e. guarantees and interest rates. The time required to process requests seems to be a concern for those who expect more modest growth rates.

Growth expected over the next two years:	0-19%	20-49%	50-99%	100%+
The amount granted by the institution relative to the amount requested				0,3711
The time to process the request	0,5679	0,2169		
The interest rate			0,1617	0,2071
The service fees		0,2346		
The guarantees required by the institution		0,2126	0,3281	0,2161
The account manager's interest in the business's needs	0,5385	0,2374	0,3531	

**B) Influence of firm's profile on overall satisfaction determinants regarding medium-/long-term loans**

❖ **Phase of development:**

The table below shows that fast growing firms are the only ones whose overall satisfaction is influenced by service fees. This is explained mainly by the fact that these firms, which have extensive cash requirements, sometimes have problems finding patient partners.

Phase of development:	Slow growth	Fast growth	maturity
The amount granted by the institution relative to the amount requested		0,3771	0,1511
The time to process the request	0,1915		
The service fees		0,1966	
The guarantees required by the institution	0,2406		
The account manager's interest in the business's needs	0,1862	0,1491	0,3666

❖ **Exporting activities:**

The overall degree of satisfaction of exporting firms is determined primarily by service fees and the time taken to process their financing request. Their concern with service fees is very understandable if one bears in mind that these firms' activities require a variety of services that are more specialized than those related to domestic activities.

Is the firm an exporter?	No	Yes
The time to process the request	0,1523	0,2735
The service fees		0,2909
The guarantees required by the institution	0,2672	
The account manager's interest in the business's needs	0,204	0,1453

❖ **Indebtedness ratio:**

The table below shows that the indebtedness ratio also has a significant impact on the determinants of the entrepreneurs' overall satisfaction. Only the owners of the firms with the greatest indebtedness ratio are influenced by the interest rate and guarantees required by the financial institutions, which is easily explained by the fact that the indebtedness ratio is normally used to "set" institutions' requirements in financing agreements.

Firms' debt bearing interest:	Low	Average	High
The amount granted by the institution relative to the amount requested		0,295	
The time to process the request	0,2076	0,2185	
The interest rate			0,2002
The service fees	0,3477		
The guarantees required by the institution			0,2191
The account manager's interest in the business's needs	0,2126	0,2392	0,1907

#### 4.2.2 Medium-/long-term loan requests refused

As in the case of the line of credit, the table below indicates whether the entrepreneurs agreed with the reasons given by the financial institutions to refuse their request for medium- or long-term financing. In view of the small sample size, these findings will not be analysed further.

**TABLE 4.6: DEGREE OF SATISFACTION REGARDING REASONS GIVEN FOR REFUSAL OF REQUESTS FOR MEDIUM-/LONG-TERM LOANS**

Main reasons given for refusals:	N	Degree of entrepreneurs' agreement with reasons	
		Yes	No
The business could not provide enough guarantees	29	8	19
The financial results did not meet the criteria	27	4	18
The business had a poor credit history	2	0	2
The management team was too inexperienced	2	0	2
The request was incorrect or incomplete	0	0	0
Other	21	1	10

## Chapter V:

### Changes in Financing Conditions and Entrepreneurs' Intentions

#### 5.1 ENTREPRENEURS' PERCEPTION OF RECENT EVOLUTION IN THEIR FINANCING CONDITIONS

When questioned regarding their financing conditions, 13% of the respondents stated that these conditions had changed in the last six months. Of those who explained these changes, 42% mentioned a negative change relating to the line of credit, compared with 23% relating to medium- or long-term financing. The major negative change occurring in relation to these two financing sources was an increase in service fees.

*TABLE 5.1: CHANGES IN FINANCING CONDITIONS DURING THE PREVIOUS SIX MONTHS*

<i>The following negative changes occurred:</i>	Line of credit (N = 83)	Medium-/long-term financing (N = 35)
The interest rates have increased	25%	34%
The service fees have increased	60%	69%
The credit limit has been reduced	18%	11%
A request to renew the credit line was declined	25%	14%
The financial provider has withdrawn from the sector of activity	12%	20%

For the two types of financing under consideration, these firms reported the lowest levels of satisfaction for financing obtained during the previous three years. And when questioned regarding major hindrances to their development, these firms referred to problems in obtaining additional financing.

**TABLE 5.2: ENTREPRENEURS' SATISFACTION INDEX REGARDING LINE OF CREDIT AND MEDIUM-/LONG-TERM LOANS, BASED ON WHETHER THEIR FINANCING CONDITIONS REMAINED STABLE OR CHANGED NEGATIVELY DURING THE PREVIOUS SIX MONTHS**

(Totally dissatisfied = 1; totally satisfied = 5)	Line of credit		Medium-/long-term loan	
	Stable conditions (N = 967)	Negative change (N = 79)	Stable conditions (N = 296)	Negative change (N = 14)
The amount granted relative to the amount requested	4,19	3,28	4,09	3,96
The time to process the request	4,14	3,81	3,66	3,24
The interest rate	3,45	3,03	3,14	2,88
The service fees	3,1	2	2,82	2,44
The guarantees required by the institution	3,3	2,32	2,61	2,02
The institution's support to the business	3,43	2,37	3,44	2,96
The possibility of negotiating the terms of the contracts	3,37	2,33	---	---
Account manager turnover	3,75	2,83	---	---
Overall	3,76	2,65	3,31	2,58

## 5.2 FINANCING INTENTIONS FOR THE YEAR TO COME

Of the entrepreneurs questioned, 29% (570) were planning to seek new financing to meet certain needs during the year to come. To meet these needs, 72% of the entrepreneurs stated that they planned to request a line of credit from the institution with which they currently did business, while 69% said they would request a medium- or long-term loan from their current institution.

**TABLE 5.3: ENTREPRENEURS' INTENTIONS REGARDING THEIR FINANCING FOR THE YEAR TO COME**

Financing request:	None	New	Increase
Line of credit	178	188	146
Medium-/long-term loan	216	194	79
Leasing	316	91	27
Equity financing	290	85	22

The reasons given by the entrepreneurs who stated that they wished to change institutions are presented in Table 5.4.

***TABLE 5.4: REASONS GIVEN FOR CHANGING FINANCIAL INSTITUTIONS IN ORDER TO MEET NEW FINANCIAL NEEDS***

Extent to which the following statements explain the change of institution (Totally disagree = 1; totally agree = 5)	Line of credit (N = 103)	Medium-/ long-term loan (N = 113)
The services offered by the current institution no longer meet my needs	3,14	3,51
We are trying to diversify our financing sources	3,37	3,33
The documentation they request is too complex	2,97	3,01
The current institution's service fees are too high	3,35	3,49
The current institution's interest rates are too high	3,39	---
Our account manager has left the institution	2,23	---

It is interesting to note that the entrepreneurs who planned to request new financing were generally less satisfied with their conditions during the previous three years than those who did not plan to request new financing. Table 5.5 presents the satisfaction indexes for the financing obtained during the previous three years, based on whether the entrepreneur did or did not plan to request new financing in the coming year.

**TABLE 5.5: ENTREPRENEURS' SATISFACTION INDEX REGARDING THEIR FINANCING SOURCES, BASED ON WHETHER OR NOT THEY PLANNED TO REQUEST NEW FINANCING**

(Totally dissatisfied = 1; totally satisfied = 5)	Line of credit		Medium-/long- term loan	
	No of requests (178)	New request or increase (334)	No request (216)	New request or increase (273)
The amount granted relative to the amount requested	4,27	3,32	4,22	3,96
The time required to process the request	3,99	3,67	3,97	3,72
The interest rate	3,05	3,04	3,23	3,18
The service fees	2,71	2,61	3,03	2,9
The personal and corporate guarantees required by the institution	2,93	2,48	2,86	2,77
The institution's support to my business	3,04	2,66	3,25	3,5
The possibility of negotiating the terms of the contracts	3,02	2,65	---	---
Account manager turnover	3,91	3,13	---	---
<b>Overall</b>	<b>3,02</b>	<b>2,65</b>	<b>3,54</b>	<b>3,44</b>

In addition, the degree of satisfaction impacts on the decision to request financing from the same lender again, as shown by Table 5.6. It can be seen that the entrepreneurs who were planning to request financing from a new lender were less satisfied overall with their financing conditions than the other entrepreneurs.



**TABLE 5.6: ENTREPRENEURS' SATISFACTION INDEX REGARDING THEIR FINANCING SOURCES, BASED ON WHETHER OR NOT THEY PLANNED TO REQUEST FINANCING FROM THE LENDER WITH WHICH THEY WERE ALREADY DOING BUSINESS**

(Totally dissatisfied = 1; totally satisfied = 5)	Line of credit		M /L-term loan	
	Same lender	Change lender	Same lender	Change lender
The amount granted relative to the amount requested	3,86	3,38	3,96	3,28
The time required to process the request	3,88	3,51	3,79	3,11
The interest rate	3,35	2,88	3,33	2,52
The service fees	3,02	2,46	3,02	2,31
The personal and corporate guarantees required by the institution	2,72	2,39	2,87	2,27
The institution's support to my business	3,01	2,43	3,46	3,28
The possibility of negotiating the terms of the contracts (repayment conditions, service fees, etc.)	3,01	2,32	---	---
Account manager turnover	3,59	2,98	---	---
<b>Overall</b>	<b>3,45</b>	<b>2,67</b>	<b>3,45</b>	<b>2,71</b>

Lastly, it will be noted in Table 5.7 that firms in certain sectors are more likely than others to request financing during the coming year.

***TABLE 5.7: DISTRIBUTION OF FIRMS PLANNING TO REQUEST A LINE OF CREDIT OR MEDIUM-/LONG-TERM LOAN DURING THE YEAR TO COME, BY SECTOR AND LOCATION***

		Line of credit	Medium-/long term loan
Sector	Wholesale and retail trade (87)	65.5%	58.0%
	Transportation, warehousing and couriers (22)	68.2%	50.0%
	Cultural, tourism and recreation industries (54)	70.4%	62.5%
	Real estate and renting and leasing (37)	81.1%	26.7%
	Professional, scientific and technical services (57)	66.7%	52.9%
	Administrative and support, waste management and remediation services (45)	53.3%	35.6%
	Educational services, health care and social assistance (10)	60.0%	70.0%
	Other services (except public administration) (40)	62.5%	57.6%
	Agriculture (58)	46.6%	72.7%
	Forestry, fishing and hunting, mining and oil and gas extraction (16)	56.3%	50.0%
	Construction (53)	73.6%	26.5%
	Manufacturing (34)	79.4%	56.0%
Location	Atlantic Canada (70)	61.4%	33.9%
	Quebec (122)	66.4%	52.3%
	Ontario (137)	72.3%	63.8%
	Manitoba and Saskatchewan (61)	50.8%	57.7%
	Alberta (54)	64.8%	53.7%
	British Columbia and Territories (67)	64.2%	43.3%

In addition, the firms that planned to seek external financing during the year to come are mainly those that requested financing most during the previous three years. In fact, 75% of the firms that requested from four or more sources during the previous three years are planning to seek financing again, as opposed to 12.2% of the firms that requested no financing during the previous three years.

Number of financing sources receiving requests during the previous three years	0	1	2	3	4 or more
Percentage of firms that plan to obtain external financing during the twelve months to come	122	273	472	506	754

## ***Chapter VI:***

### **Analysis of Applications, Satisfaction and Intentions by Respondants' Profile**

In this chapter, some of the data presented previously will be repeated, but this time highlighting aspects of the SMEs and their owners that are associated with their overall financing situation. The variables related to financing will be analysed in the light of the characteristics of the entrepreneurs and the firms in turn. Unlike in Chapter 3, the emphasis will be on the data as a whole, rather than on specific financing sources.<sup>19</sup> This discussion will therefore provide a useful overview.

#### **6.1 ANALYSIS BASED ON ENTREPRENEUR'S CHARACTERISTICS**

##### **6.1.1 Entrepreneur's gender**

Table 6.1A shows more clearly that female entrepreneurs make requests from fewer different external financing sources than their male counterparts, regardless of the type of financing. It is also noteworthy that women make less use of personal lines of credit and credit cards. However, this difference is not statistically significant. The lower rate of requests for and use of a line of credit, for example, is not associated with a different degree of satisfaction, as shown by the average satisfaction index presented.

In addition, it can be seen that medium- and long-term loan requests are approved more often for women (9 times out of 10) than for men (8 times out of 10), and that the satisfaction index is slightly higher for the women.

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<sup>19</sup>Since factoring companies received requests from only 42 firms in the sample during the previous three years, they will not be analysed in this chapter. However, readers can find further information in the Annexes.

**TABLE 6.1A: FINANCING CHOICE AND SATISFACTION BY ENTREPRENEUR'S GENDER**

		Entrepreneur's gender:	Male	Female
	Used (N=1101)		56.5%	50.5%
Line of credit	Requests (N=900)		46.8%	39.1%
	Approvals (N=731)		81.7%	80.3%
	Firms that did not make requests because they had no need (N=851)		74.8%	80.2%
	Satisfaction index (N=1083)		3,65	3,69
Personal line of credit	Used (N=670)		34.8%	28.7%
Credit card	Used (N=1270)		63.7%	62.1%
	Requests (N=552)		29.7%	21.0%
	Approvals (N=469)		83.4%	93.2%
	Satisfaction index (N=462)		3,59	3,87
	Firms that did not make a request because they had no need (N=1216)		84.4%	79.8%
Leasing	Requests (N=379)		19.6%	16.6%
	Requests (N=236)		13.0%	8.0%
<i>Government program/ agency/service</i>	Satisfaction index (N=147)		3,62	3,62
	Firms that did not make a request because they had no need (N=981)		55.3%	54.7%
Internal equity financing	Requests (N=77)		4.2%	2.8%
External equity financing	Requests (N=63)		4.0%	0.4%

Table 6.1B shows that to a greater degree women remain in the traditional financing system, represented by banks and credit unions. Lastly, they will make fewer requests than men during the next twelve months. Those who do apply for financing will, like the men, return to the same lenders 7 times out of 10.

**TABLE 6.1B : OTHER ASPECTS OF FINANCING BY ENTREPRENEUR'S GENDER**

		Entrepreneur's gender:	
		Male	Female
Main financial institution	Canadian bank (N = 1465)	72.1%	74.3%
	Credit union or caisse populaire (N = 480)	23.6%	24.5%
	Other (N = 71)	4.3%	1.2%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 514)		26.5%	22.4%
Firms that will request financing during the coming year (N=568)		32.1%	20.9%
Firms that will request a short-term loan from the same lender in the coming year (N=264)		73.3%	66.1%
Firms that will request a medium- or long-term loan from the same lender (N=262)		69.3%	73.2%

### 6.1.2 Entrepreneur's age

The entrepreneur's age plays a significant role in his or her financial behaviour. In Chapter 2 it was shown that the younger entrepreneurs were also those who most often owned firms in a major development phase (seed/start-up or fast growth), which therefore had substantial financing requirements. It is also known that they seldom have the same financial capacity as their older counterparts, and are less experienced.

These results are evident in Table 6.2A, which shows that a higher proportion of the youngest entrepreneurs (30 years of age or less) requested lines of credit financing than those aged 60 years or over, and that they experienced a lower approval rate (8/10 compared with 9/10). Also, fewer of them have any line of credit, and they make less use of a personal line of credit. Furthermore, they make more use of credit cards, which may therefore represent an alternative to refused financing sources. The other financing sources are approached more often by the entrepreneurs in the lower age groups.

**TABLE 6.2A: FINANCING CHOICE AND SATISFACTION BY ENTREPRENEUR'S AGE**

		<i>Entrepreneur's age:</i>				
		30 or less (N = 107)	31-40 (N = 385)	41-50 (N = 716)	51-60 (N = 540)	Over 60 (N = 267)
Line of credit	Requests (N = 905)	44.2%	55.6%	46.9%	45.6%	24.4%
	Approvals (N = 734)	80.4%	77.8%	84.4%	78.4%	92.1%
	Used (N = 1105)	36.5%	57.2%	58.8%	56.6%	47.0%
	Satisfaction index (N = 1083)	3.77	3.57	3.55	3.75	3.93
Personal line of credit	Used (N = 673)	23.4%	33.2%	34.3%	34.9%	32.7%
Credit card	Used (N = 1273)	65.1%	67.0%	66.3%	59.7%	57.7%
Medium-/ long-term loan	Requests (N = 557)	24.5%	34.0%	30.9%	25.9%	15.8%
	Approvals (N = 474)	92.0%	76.9%	89.1%	83.9%	95.2%
	Average satisfaction index (N = 465)	3.47	3.69	3.60	3.60	4.07
Leasing	Requests	17.9%	22.0%	19.7%	19.7%	10.5%
Government program/ agency/ service	Requests (N = 235)	10.5%	17.2%	12.0%	10.9%	4.9%
	Satisfaction index (N = 146)	3.91	3.92	3.49	3.61	3.09
Internal equity financing	Requests (N = 77)	15.1%	5.7%	2.7%	3.0%	1.5%
External equity financing	Requests (N = 64)	5.6%	4.9%	2.0%	3.7%	1.9%

It should be borne in mind that since the entrepreneur's age is associated with an interest in growth (the older entrepreneurs have lower expectations), it is unsurprising that there are fewer financing requests from the older entrepreneurs. This is confirmed by the fact that a high proportion of entrepreneurs aged 60 years and over state that they did not request financing because they had no need (86% for line of credit; 92% for medium- and long-term loans; 65% for government programs/services). However, their approval rate for was higher than for the other age

groups, as was the average satisfaction index (except in the case of government programs/services).

Canadian financial markets therefore receive more requests from young entrepreneurs (less than 40 years of age). As shown in Chapter 2, these entrepreneurs are more educated, are interested in achieving high growth rates and are more involved in R&D and exporting. The profile of financing requesters is therefore changing, and markets will have to adjust to the new trends, which more closely reflect the new economy.

**TABLE 6.2B: OTHER ASPECTS OF FINANCING BY ENTREPRENEUR'S AGE**

Entrepreneur's age:		30 or less (N = 107)	31-40 (N = 385)	41-50 (N = 716)	51-60 (N = 540)	Over 60 (N = 267)
Main financial institution	Canadian bank (N = 1463)	85.8%	72.2%	67.8%	73.3%	79.1%
	Credit union or caisse populaire (N = 482)	11.3%	22.9%	30.1%	22.4%	16.8%
	Other (N = 71)	2.8%	4.9%	2.1%	4.3%	4.1%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 514)		34.0%	37.1%	21.6%	25.7%	15.4%
Firms that will request financing during the coming year (N = 567)		35.7%	41.6%	28.5%	26.2%	17.2%
Firms that will request short-term financing from the same lender in the year to come (N = 264)		76.9%	73.9%	71.8%	67.0%	82.8%
Firms that will request medium- or long-term financing from the same lender (N = 261)		76.0%	71.8%	70.1%	67.3%	66.7%

Table 6.2B shows that a larger percentage of the younger entrepreneurs (40 years of age or less) state that obtaining additional financing is a hindrance to their development. Furthermore, more of them will request financing in the coming year and, like the older entrepreneurs, will approach the same lenders more than 7 times out of 10.

### 6.1.3 Entrepreneur's interest in growth

The growth objectives of SME owners cannot always be met without the contribution of financial resources, which may or may not be substantial and can be obtained from various internal or external sources. We therefore asked

the entrepreneurs what total sales figure they would like to reach within two years, and we compared this with their current total sales. Based on this comparison, the firms were divided on the basis of their expected growth rates.

**TABLE 6.3A: FINANCING CHOICE AND SATISFACTION BY ENTREPRENEUR'S INTEREST IN GROWTH**

Expected growth over the next two years:		Negative				100% or more (N = 386)
		growth (N = 52)	0-19% (N = 299)	20-49% (N = 505)	50-99% (N = 386)	
Line of credit	Requests (N = 704)	50.0%	43.5%	48.3%	50.4%	46.9%
	Approvals (N = 573)	73.1%	92.3%	85.7%	81.6%	68.7%
Medium-/ long-term loan	Requests (N = 452)	34.6%	25.0%	31.2%	36.7%	28.6%
	Approvals (N = 391)	66.7%	94.6%	93.0%	92.3%	71.6%
	Satisfaction index (N = 385)	2.77	3.81	3.70	3.60	3.26
Government program/ agency/ service	Requests (N = 187)	7.7%	13.3%	7.7%	12.7%	18.8%
	Satisfaction index (N = 117)	3.72	3.80	3.69	4.13	3.29
Internal equity financing	Requests (N = 45)	1.9%	2.3%	2.0%	2.4%	5.4%
External equity financing	Requests (N = 45)	3.8%	1.7%	1.4%	2.0%	6.7%

Table 6.3A shows that the expected growth rate is related to the request rate and the approval rate. The higher the expected growth rate, the lower the approval rate, whether for a line of credit or a medium or long-term loan. Entrepreneurs expecting the highest growth rates have their requests approved less often; and the same applies to those who anticipate a decrease in total sales. It will also be noted that these entrepreneurs have the lowest satisfaction indexes.

Table 6.3B shows that the entrepreneurs identified as interested in negative growth or in a growth rate above 100% are more likely to have a Canadian bank as their main financial institution. They also state more frequently that obtaining additional financing is a hindrance to their development, and will seek additional financing during the



twelve months to come, mainly from the same lenders (except in the case of medium- and long-term financing for firms experiencing fast growth; 4 out of 10 of these will try to take on another partner).

**TABLE 6.3B: OTHER ASPECTS OF FINANCING BY ENTREPRENEUR'S INTEREST IN GROWTH**

Expected growth over the next two years:	Negative growth (N = 52)	0 -19% (N = 299)	20-49% (N = 505)	50-99% (N = 386)	100% or more (N = 386)
Main financial institution					
Canadian bank (N = 1049)	76.9%	59.3%	71.1%	63.6%	80.9%
Credit union or caisse populaire (N = 395)	23.1%	37.0%	26.1%	32.4%	15.2%
Other (N = 50)	0.0%	3.7%	2.8%	4.0%	3.9%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 1494)	42.3%	14.0%	23.2%	28.3%	40.9%
Firms that will request financing during the coming year (N = 294)	32.7%	16.7%	22.3%	40.4%	47.0%
Firms that will request a short-term loan from the same lender in the coming year (N = 294)	84.6%	84.8%	63.0%	63.2%	71.2%
Firms that will request a medium- or long-term loan from the same lender (N = 306)	84.6%	85.3%	69.5%	65.4%	63.2%

#### 6.1.4 Entrepreneur's mother tongue

Table 6.4 presents the distribution of firms by the entrepreneur's mother tongue, with the goal of establishing whether this variable is related to their financing needs, conditions and degree of satisfaction. With respect to line of credit, no difference is noted for request rates. However, Francophones have a higher approval rate than Anglophones or Allophones. Lines of credit are used more by Francophones and Allophones, although these two groups have the lowest satisfaction indexes. With respect to medium- and long-term financing, approval rates for Francophones are clearly higher than for the others. Also, more Francophones do business with a credit union or caisse populaire for their ongoing operations, unlike Anglophones who work more with banking institutions. Are the differences due to the financial institution in question or to the entrepreneur's mother tongue?

**TABLE 6.4: FINANCING CHOICE AND SATISFACTION BY ENTREPRENEUR'S MOTHER TONGUE**

		Entrepreneur's mother tongue:	French (N = 549)	English (N = 1188)	Other (N = 279)
Line of credit	Requests (N = 902)		46.8%	44.2%	44.8%
	Approvals (N = 735)		90.7%	80.2%	68.9%
	Used (N = 1104)		61.3%	55.3%	42.0%
	Satisfaction index (N = 1083)		3.53	3.74	3.56
Medium-/long-term loan	Requests (N = 554)		29.7%	28.2%	21.2%
	Approvals (N = 472)		93.8%	83.4%	74.6%
	Satisfaction index (N = 463)		3.68	3.71	3.22
Leasing	Requests (N = 377)		13.5%	20.7%	20.8%
Government program/ agency/service	Requests (N = 234)		14.4%	11.1%	8.7%
	Satisfaction index (N = 146)		3.69	3.67	3.13
Internal equity financing	Requests (N = 77)		2.4%	4.5%	3.6%
External equity financing	Requests (N = 64)		1.3%	3.8%	4.3%
Main financial institution	Canadian bank (N = 1465)		47.9%	80.2%	89.6%
	Credit union or caisse populaire (N = 481)		50.6%	15.6%	6.5%
	Other (N = 69)		1.5%	4.2%	3.9%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 513)			23.7%	25.3%	29.4%
Firms that will request financing during the coming year (N = 566)			23.4%	30.3%	36.3%

An analysis of the samples by the two main types of institutions (firms financed by banks and firms financed by credit unions) shows results comparable to those presented here. Regardless of the type of institution they deal with, on average Francophones are approved for financing more often than others. Also, Francophones planned less frequently to apply for financing in the coming year. In Chapter 2 it was shown that Francophones anticipated relatively low growth rates and more often owned firms with little involvement in exporting. Since these characteristics are low risk factors, this may explain their higher approval rate.

## 6.2 ANALYSIS BASED ON FIRM'S CHARACTERISTICS

### 6.2.1 Phase of development

As previously stated, firms can develop at very different rates and be at different phases of their development when they are studied or questioned. Each phase of development has its own stress factors that may place the firm in more or less acute situations of vulnerability. This is generally true of the seed/start-up and fast growth phases, where both uncertainty and risk may be relatively high.

Table 6.5A shows that firms in the seed/start-up phase have lower approval rates for their line of credit requests; firms in the fast growth phase rank next in this regard. It is interesting that firms in the winding down phase have a slightly better approval rate than firms experiencing fast growth (79.7% compared with 77.5%). Furthermore, firms winding down have the lowest satisfaction indexes for the line of credit used and for medium-and long-term loans requested.

It will also be noted that firms experiencing rapid growth are those most likely to request financing from different sources, except for equity financing, where firms in the first phase of development post higher numbers (note, however, the low number of observations).

**TABLE 6.5A: FINANCING CHOICE AND SATISFACTION BY FIRM'S PHASE OF DEVELOPMENT**

<i>Firm's phase of development:</i>		Seed / start-up (N = 102)	Slow. growth (N = 1029)	Fast growth (N = 250)	Maturity (N = 429)	Winding down (N = 184)
Line of credit	Requests (N = 898)	44.4%	46.9%	62.6%	36.1%	34.8%
	Approvals (N = 731)	59.1%	84.6%	77.5%	83.9%	79.7%
	Used (N = 1097)	28.2%	58.3%	63.7%	53.5%	46.4%
	Satisfaction index (N = 1077)	3.90	3.63	3.63	3.86	3.35
Medium-/long-term loan	Requests (N = 556)	21.8%	30.9%	34.1%	23.6%	17.8%
	Approvals (N = 475)	72.7%	88.9%	76.2%	86.1%	87.5%
	Satisfaction index (N = 465)	3.47	3.72	3.51	3.76	2.93
Leasing	Requests (N = 365)	16.7%	17.8%	29.8%	15.4%	13.6%
Government program/agency/service	Requests (N = 235)	26.2%	10.5%	22.0%	6.1%	10.3%
	Satisfaction index (N = 147)	3.20	3.74	3.54	4.01	3.35
Internal equity financing	Requests (N = 78)	21.6%	2.9%	6.4%	0.7%	3.8%
External equity Financing	Requests (N = 63)	21.4%	1.9%	7.6%	0.2%	0.5%

Table 6.5B shows that the firms that will make the most requests for financing during the 12 months to come are those whose needs, dictated by their pace of development, require the use of external financial resources: i.e. firms in the seed/start-up and fast growth phases. These are also the firms most likely to state that obtaining additional financing is a hindrance to their development, and those that experience the lowest approval rates for lines of credit and medium- and long-term loans. Despite this, 7 firms out of 10 will approach the same lender with their next request (except in the case of medium- and long-term loans, where 6 out of 10 firms in the growth phase will approach the same lender). Some loyalty to their financial institution can therefore be noted in the case of most of the firms. Lastly, note that 8 out of 10 firms in the seed/start-up phase are financed by a Canadian bank for their ongoing operations; this is the highest rate, since it falls to 7 out of 10 for the other phases of development.

**TABLE 6.5B: OTHER ASPECTS OF FINANCING BY FIRM'S PHASE OF DEVELOPMENT**

Firm's phase of development:		Seed/ start-up (N = 102)	Slow growth (N = 1029)	Fast growth (N = 250)	Maturity (N = 429)	Winding down (N = 184)
Main financial institution	Canadian bank (N = 1447)	83.3%	74.2%	68.8%	68.3%	71.9%
	Credit union or caisse populaire (N = 477)	10.8%	23.0%	27.6%	28.4%	20.5%
	Other (N = 71)	5.9%	2.7%	3.6%	3.3%	7.6%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 508)		47.6%	24.1%	32.8%	16.3%	31.9%
Firms that will request financing during the coming year (N = 567)		48.5%	29.8%	44.4%	19.3%	21.4%
Firms that will request a short-term loan from the same lender in the coming year (N = 265)		71.4%	77.7%	71.1%	65.9%	53.8%
Firms that will request a medium-/long-term loan from the same lender (N = 263)		71.4%	75.7%	60.3%	66.7%	61.5%

### 6.2.2 Firm's size

Size is an element, together with growth rate and specific activities, that significantly impacts on SMEs' external financing needs. Table 6.6A shows that the larger the firm, the greater the percentage of line of credit requests; however, there is no significant difference with respect to approval rates when this element is looked at as a continuum. Nevertheless, it can be seen that 9 out of 10 firms with more than 50 employees had their line of credit request approved, compared with 8 out of 10 in the case of firms with 5 or fewer employees. Table 6.6A also shows that the use rate of personal lines of credit falls significantly with SME size. In the case of credit cards, the rise in their use rate in accordance with their size is based mainly on their easy accessibility and their convenience.

**TABLE 6.6A: FINANCING CHOICE AND SATISFACTION BY FIRM'S SIZE**

		Number of employees:				
		5 or fewer (N=1666)	6-10 (N=165)	11-20 (N=89)	21-50 (N=65)	More than 50 (N=42)
Line of credit	Requests (N = 910)	41.9%	53.3%	60.7%	62.1%	78.0%
	Approvals (N = 740)	80.2%	85.4%	86.8%	80.5%	90.6%
	Used (N=1109 )	52.1%	66.3%	67.4%	67.2%	85.4%
	Satisfaction index (N = 1089)	3.70	3.52	3.49	3.42	3.62
Personal line of credit	Used (N = 672)	34.8%	29.7%	26.1%	24.2%	14.6%
Credit card	Used (N = 1281)	61.2%	72.0%	73.0%	76.9%	81.0%
Reason given for using credit card						
	Its convenience	81.7%	83.2%	87.3%	87.7%	86.7%
	Financing conditions attractive	7.1%	7.2%	8.3%	8.5%	6.5%
	Suggested by the institution	6.5%	6.3%	13.9%	7.9%	10.6%
	Only way for the business to obtain credit	15.0%	10.0%	13.4%	13.7%	7.1%
	Easily accessible	38.1%	38.1%	31.1%	2.3%	29.3%
Medium-/long-term loan (N = 559)	Requests	25.0%	33.5%	42.0%	45.5%	57.1%
Leasing (N = 380)	Requests	14.5%	29.8%	42.7%	47.7%	52.4%
Government program/agency/service (N = 235)	Requests	9.8%	17.8%	22.7%	20.0%	23.8%

Lastly, Table 6.6B shows that it is mainly the smallest firms that use the services of credit unions or caisses populaires, whereas the largest firms rely on the banks and other types of institutions to provide financing for their ongoing needs. In addition, it was mainly the largest firms that said they would request financing in the coming year.

**TABLE 6.6B: OTHER ASPECTS OF FINANCING BY FIRM'S SIZE**

Number of employees:		5 or fewer (N=1666)	6-10 (N=165)	11-20 (N=89)	21-50 (N=65)	More than 50 (N=42)
Main financial institution	Canadian bank (N = 1474)	70.9%	77.1%	84.3%	86.2%	78.6%
	Credit union or caisse populaire (N =483)	25.7%	19.9%	12.4%	9.2%	11.9%
	Other (N = 71)	3.4%	3.0%	3.4%	4.6%	9.5%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 514)		23.8%	27.7%	36.0%	38.5%	33.3%
Firms that will request financing during the coming year (N = 570)		26.5%	38.7%	40.9%	46.9%	50.0%

### 6.2.3 Firm's regional location

Each Canadian province and region has certain specific features related to its economic development and to the agencies that assist the SMEs operating in the province or region. To measure whether this impacted on or was related to the financing of the SMEs, the firms were segregated firms according to their region.

The results presented in Table 6.7 show the significant part played by the regional factor. Relatively speaking, the firms located in central Canada (Manitoba and Saskatchewan) requested lines of credit the most frequently during the previous three years, while the firms in Alberta, British Columbia and the Territories had the lowest approval rates. Furthermore, firms in Quebec posted the lowest satisfaction rate for the line of credit used. Seven out of 10 Ontario firms used credit cards for their operations, whereas the average rate is closer to 6 out of 10. Approval rates for medium- and long-term loan requests were lower in Ontario, although this province had the second lowest rate of requests.

Credit unions and caisses populaires mainly serve in central Canada and Quebec, while in the other regions the institution responsible for financing ongoing operations is, in more than 7 cases out of 10, a member of the Canadian banking system. Lastly, firms in central Canada and the Maritimes request financing from government agencies the most frequently, while firms in central Canada have the lowest overall satisfaction index.

**TABLE 6.7A: FINANCING CHOICE AND SATISFACTION BY REGION**

Location of firms:		Maritimes (N = 290)	Quebec (N = 535)	Ontario (N = 591)	Central (N = 90)	Alberta (N = 92)	BC and Territories (N = 223)
<i>Line of credit</i>	Requests (N = 907)	47.2%	44.3%	44.5%	54.7%	47.4%	36.0%
	Approvals (N = 738)	88.9%	86.0%	76.9%	89.4%	72.5%	70.4%
	Used (N = 1108)	67.2%	55.7%	50.9%	66.0%	49.5%	45.0%
	Satisfaction index (N = 1087)	3.69	3.43	3.78	3.84	3.72	3.62
Personal line of credit	Used (N = 672)	37.1%	24.3%	37.4%	32.6%	32.8%	39.7%
Credit card	Used (N = 1278)	59.8%	54.6%	73.8%	64.0%	63.5%	62.6%
	Applications submitted (N = 554)	32.2%	26.9%	24.3%	36.8%	32.4%	19.7%
Medium-/long- term loan	Applications approved (N = 472)	94.6%	93.7%	75.2%	84.5%	80.3%	79.5%
	Satisfaction index (N = 461)	3.36	3.65	3.73	3.75	3.71	3.71
Leasing	Requests (N = 377)	13.1%	16.2%	21.9%	19.5%	16.8%	24.7%
Government program/agency service	Requests (N = 234)	17.9%	11.4%	9.0%	17.9%	8.9%	7.6%
	Satisfaction index (N = 145)	3.62	3.78	3.65	3.27	3.70	3.59
Internal equity financing	Requests (N = 79)	3.1%	3.0%	4.9%	1.1%	6.3%	4.9%
External equity financing	Requests (N = 64)	1.7%	2.1%	3.9%	0.5%	6.3%	5.4%



**TABLE 6.7B: OTHER ASPECTS OF FINANCING BY CANADIAN REGION**

Location of firms:		Atlantic Canada (N = 290)	Quebec (N = 35)	Ontario (N = 91)	Central (N = 90)	Alberta (N = 92)	BC and Territories (N = 223)
Main financial institution	Canadian bank (N = 1468)	79.7%	54.4%	90.4%	53.4%	73.3%	75.4%
	Credit union or caisse populaire (N = 482)	19.9%	44.5%	6.3%	43.9%	8.9%	21.9%
	Other (N = 72)	0.3%	1.1%	3.4%	2.6%	17.8%	2.7%
Firms that will request financing during the coming year (N = 567)		28.4%	25.7%	26.5%	36.5%	37.2%	33.0%
Firms that will request a short-term loan from the same lender in the coming year (N = 262)		63.9%	63.3%	79.1%	70.0%	87.5%	64.0%
Firms that will request a medium- or long-term loan from the same lender (N = 261)		63.9	59.8	73.9	76.1	74.4	72.3

#### 6.2.4 Firms carrying out research and development

The importance of innovation is increasingly being recognized, particularly for SMEs that want to stand out from the competition and retain their market shares through distinct advantages. This innovation can be achieved through systematic R&D activities. However, these activities may be considered risky, since the potential results or products for firms are somewhat uncertain. It is therefore important for those promoting these activities to avoid adding the uncertainty of intermittent and patchy financing to the uncertainty of the result of R&D activities.

**TABLE 6.8A: FINANCING CHOICE AND SATISFACTION BY PERCENTAGE OF SALES ALLOCATED TO R&D AND IMPROVEMENT ACTIVITIES**

		Portion of total sales allocated to R&D:			
		0.01-3.00% (N = 153)	3.01-8.00% (N = 134)	8.01-15.00% (N = 171)	More than 15 (N = 170)
Line of credit	Requests (N=827)	48.4%	50.0%	46.8%	54.2%
	Approvals (N=673)	91.9%	83.6%	71.3%	66.3%
	Used (N = 999)	69.1%	70.1%	53.2%	49.4%
	Satisfaction index (N = 980)	3.59	3.54	3.48	3.55
Personal line of credit	Used (N=622)	34.9%	34.1%	33.9%	40.0%
Credit card	Used (N = 1174)	71.7%	77.6%	60.2%	71.6%
Medium-/long-term loan	Requests (N=513)	23.7%	30.6%	32.9%	32.4%
	Approvals (N=439)	94.4%	77.5%	76.4%	76.4%
	Satisfaction index (N = 431)	3.60	3.60	4.05	3.48
Leasing	Requests (N = 341)	29.4%	30.8%	22.9%	25.9%
Government program/agency/service	Requests (N = 213)	7.2%	12.6%	15.8%	30.6%
	Satisfaction index (N = 132)	3.70	3.70	3.72	3.63

The firms have been segregated according to the budget they spend on R&D activities. Two thirds of the SMEs queried do not carry out any systematic R&D activities. The others spend between 0.1% and more than 15% of their sales on R&D. Table 6.8A shows that the percentage of line of credit and medium and long-term loan requests increases with the rate of R&D, while the approval rate simultaneously falls.<sup>20</sup> It is also noted that there is more intensive use of personal lines of credit as R&D increases.

Table 6.8B shows that the percentage of firms that will request further financing in the coming year increases with the intensity of their R&D activities. And fewer of these firms will make a request from the same lender. Lastly, more of the firms that carry out R&D activities state that obtaining additional financing is a hindrance to their development.

<sup>20</sup>The same statistical results are observed when the firms are grouped by their export rates. The higher the export rate, the higher the percentage of firms requesting a line of credit or a medium- or long-term loan, and the greater the probability of refusal. All these tables are presented in the Annex.

**TABLE 6.8B: OTHER ASPECTS OF FINANCING BY PERCENTAGE OF SALES ALLOCATED TO R&D AND IMPROVEMENT ACTIVITIES**

Percentage of total sales allocated to R&D:		0.01-3.00% (N = 153)	3.0-8.00% (N = 134)	8.01-15.00% (N = 171)	More than 15.00% (N = 170)
Main financial institution	Canadian bank (N = 1333)	85.0%	70.9%	83.0%	74.1%
	Credit union or Caisse populaire (N = 436)	11.8%	25.4%	11.7%	22.9%
	Other (N = 68)	3.3%	3.7%	5.3%	2.9%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 477)		32.7%	37.8%	26.9%	41.2%
Firms that will request financing during the coming year (N = 512)		34.3%	35.8%	41.0%	47.7%
Firms that will request a short-term loan from the same lender in the coming year (N = 247)		81.0%	60.0%	75.0%	64.6%
Firms that will request a medium- or long-term loan from the same lender (N = 242)		65.4%	66.7%	59.4%	57.4%

## 6.3 ANALYSIS BASED ON FINANCING CHARACTERISTICS

### 6.3.1 Main institution providing financing for ongoing operations

As stated in Chapter 3, the vast majority (75%) of the SMEs use a Canadian bank to finance their ongoing operations. The fact that these institutions have a network of branches covering the entire territory accentuates this situation; this contrasts with the credit unions and caisses populaires, which are seen mainly as provincial or regional institutions.

Table 6.9 shows that the approval rate for line of credit and medium- and long-term loan requests is higher for credit unions and caisses populaires than for banks, which in turn rank ahead of "other" institutions. However, these different approval rates do not generate different satisfaction indexes. On the contrary, the firms financed by credit unions and caisses populaires plan to make requests from as many financial sources as the others in the year to come, but fewer of them plan to request from lenders with which they currently do business. Lastly, the firms that did business with credit unions and caisses populaires had, on average, to deal with fewer account managers during the previous three years than those that did business with banks or with other institutions.

**TABLE 6.9: FINANCING CHOICE AND SATISFACTION BY TYPE OF FINANCIAL INSTITUTION**

Main financial institution of the firms for their ongoing operations:		Canadian banks (N = 1473)	Credit unions and caisses pop. (N = 483)	Other (N = 71)
Line of credit	Requests (N=909)	43.8%	48.2%	50.7%
	Approvals (N=740)	80.4%	85.8%	75.0%
	Used (N= 1109)	52.6%	63.4%	49.3%
Credit card	Used (N = 1280)	65.4%	58.8%	54.9%
Medium-/long-term loan	Requests (N= 559)	25.6%	33.0%	36.6%
	Approvals (N= 477)	83.2%	93.6%	73.1%
Number of account managers dealt with during the 1998- 2000 period	1 (N = 1177)	59.0%	72.8%	54.5%
	2 (N = 493)	27.8%	20.5%	28.8%
	3 (N = 157)	9.0%	5.2%	16.7%
	4 or more (N = 64)	4.2%	1.5%	0.0%
Firms that will request financing during the coming year (N = 571)		29.7%	26.3%	40.8%
Firms that will request a short-term loan from the same lender in the coming year (N = 265)		74.4%	58.7%	93.8%
Firms that will request a medium- and/or long-term loan from the same lender (N = 263)		69.9%	67.1%	87.5%

### 6.3.2 Number of account managers the firm dealt with

Analysis of the information reveals no difference in the profiles of the entrepreneurs or the firms according to whether they dealt with one or four account managers during the previous three years. On the other hand, choices of and satisfaction with financing are different, as shown in Table 6.10.

**TABLE 6.10: FINANCING CHOICE AND SATISFACTION BY NUMBER OF ACCOUNT MANAGERS DEALT WITH DURING THE PREVIOUS THREE YEARS**

Number of account managers during the previous three years:		1 (N = 1177)	2 (N = 493)	3 (N = 157)	4 or more (N = 65)
Line of credit applied for	Requests (N = 876)	41.8%	50.2%	58.7%	71.9%
	Approvals (N = 707)	82.1%	82.0%	73.6%	78.3%
	Used (N = 1060)	52.1%	61.5%	61.9%	80.0%
	Satisfaction index (N = 1040)	3.90	3.36	3.17	3.21
Personal line of credit	Used (N = 638)	32.3%	35.3%	33.5%	47.7%
Credit card	Used (N = 1196)	58.6%	70.6%	70.7%	78.1%
Medium-/long-term loan	Requests (N = 531)	25.7%	31.3%	36.3%	31.7%
	Approvals (N = 453)	87.7%	88.3%	68.4%	70.0%
	Satisfaction index (N = 443)	3.77	3.55	3.22	3.63
Firms that stated that obtaining additional financing was a hindrance to their development (N = 495)		23.2%	27.9%	37.6%	38.5%
Firms that will request financing during the coming year (N = 549)		26.0%	35.7%	38.0%	45.6%
Firms that will request a short-term loan from the same lender in the coming year (N = 253)		75.7%	68.8%	60.0%	66.7%
Firms that request a medium-or ong-term loan from the same lender (N = 252)		71.2%	73.1%	48.7%	58.8%

It can therefore be seen that the number of line of credit requests rises with the number of account managers, whereas the satisfaction index falls. On the other hand, the approval rate is not statistically different. It can also be seen that the firms that dealt with more than one account manager made more use of the other short-term financing sources such as personal lines of credit and credit cards. When queried regarding the factors that could harm their development, a larger percentage of entrepreneurs who did business with more than one account manager stated that obtaining additional financing was a hindrance.

The number of firms that would seek financing during the coming year increases with the number of account managers they did business with during the previous three years. There is no apparent causal relation between these two variables, but it is noted that a smaller proportion of the firms that dealt with more than one account manager would approach the same lender.

### 6.3.3 Number of financing sources approached

As financing needs increase, firms may be forced to request financing from more lenders. This situation, which may be quite normal for large firms, is not necessarily beneficial for smaller firms that have more problems developing partnership relations with their main lender. Such relations are necessary to promote enhanced knowledge and to improve SMEs financing conditions. It seemed useful to enquire whether a history of requesting financing from more than one source during the previous three years indicated something specific.

The following profiles were established for the entrepreneurs and firms that requested financing from more than two sources:

- ▶ A higher proportion of the entrepreneurs are university graduates.
- ▶ They expect relatively high growth rates and a higher proportion of them want to double their sales within two years.
- ▶ They are more open to an external partner to finance their firm's expansion or growth.
- ▶ The firms are slightly larger and less mature than the others.
- ▶ A larger proportion of them are in the seed/start-up and fast growth phases.
- ▶ A significantly higher proportion of them carry out R&D and exporting activities.

Table 6.11 shows that the line of credit satisfaction index falls significantly as the number of financing sources rises, that the number of line of credit requests rises with the number of financing sources, and that the line of credit approval rate simultaneously falls. The same findings are observed for medium- and long-term loan financing.

**TABLE 6.11: FINANCING CHOICE AND SATISFACTION BY NUMBER OF FINANCING SOURCES SOUGHT DURING THE PREVIOUS THREE YEARS**

Number of financing sources sought during the previous three years:		1 (N = 636)	2 (N = 402)	3 (N = 52)	4 or more (N = 58)
Line of credit	Requests (N = 909)	56.6%	82.3%	89.6%	96.6%
	Approvals (N = 740)	86.5%	81.3%	75.6%	69.6%
	Used (N = 1110)	63.1%	80.6%	74.3%	73.7%
	Satisfaction index (N = 1089)	3.83	3.45	3.51	2.96
Personal line of credit	Used (N = 674)	36.3%	45.0%	43.7%	47.4%
Credit card	Used (N = 1281)	66.0%	73.6%	71.7%	80.7%
Medium-/long-term loan	Requests (N = 559)	19.4%	57.6%	85.2%	86.2%
	Approvals (N = 477)	95.9%	87.0%	79.5%	72.0%
	Satisfaction index (N = 467)	3.84	3.57	3.70	3.32
Leasing	Requests (N = 379)	16.9%	33.0%	49.7%	86.0%
Government program/ agency/service	Requests (N = 237)	4.6%	15.9%	54.9%	75.4%
Firms that stated that obtaining additional financing was a hindrance to their development (N = 513)		21.3%	42.0%	47.5%	64.9%
Internal equity financing	Requests (N = 77)	1.9%	7.2%	9.3%	33.3%
External equity financing	Requests (N = 65)	0.6%	4.7%	9.8%	41.4%
Firms that will request financing during the coming year (N = 570)		27.3	47.2	50.6	75.4
Firms that will request a short-term loan from the same lender in the coming year (N = 265)		80.5	68.8	70.6	64.7
Firms that will request a medium-and or long-term loan from the same lender (N = 262)		84.5	73.3	64.9	64.7

A higher proportion of the firms that requested financing from several sources also indicated that obtaining additional financing was a hindrance to the SME's development.

Lastly, the percentage of firms that stated they planned to request financing during the coming year rose with the number of financing sources sought during the previous three years. On the other hand, a smaller proportion of

the firms planned to make a request to the financial institution with which they currently did business (fewer than 7 out of 10, compared with 8 out of 10 for firms that did not request financing)

In view of the fact that these firms had high financial needs given their phase of development, that the entrepreneur was expecting high growth rates in the two coming years, and that they were relatively innovative and involved in exporting, a question can be raised as to whether Canadian financial markets are capable of adequately meeting the needs of these firms.

#### **6.3.4 Satisfaction rates and profiles of entrepreneurs and firms**

The survey sought to determine whether the least satisfied entrepreneurs had a different profile from the others, or whether their firms stood out in any way. Therefore the SMEs were divided into two groups: those that responded 1, 2 or 3 on the satisfaction scales were considered to be the least satisfied, and those that responded 4 or 5 were considered to be the most satisfied. The following are the main conclusions regarding overall satisfaction with lines of credit:

- ▶ No specific entrepreneur profile seems to readily emerge based on degrees of satisfaction, except that the least satisfied entrepreneurs are more likely to include those expecting very high growth rates or negative growth rates.
- ▶ The number of employees is slightly higher among the least satisfied, who also include a higher proportion of owners whose firms are winding down.
- ▶ The least satisfied entrepreneurs had a higher proportion of financing requests.
- ▶ More of the least satisfied entrepreneurs stated that obtaining additional financing was a hindrance to their development (42.5% vs. 16.0%).
- ▶ Lastly, a lower proportion of the least satisfied entrepreneurs who planned to request financing during the coming year would approach the same lender (6 out of 10 vs. more than 8 out of 10 for the most satisfied).

When the firms are grouped together by the overall satisfaction index obtained for medium- and long-term financing, the results are practically the same as those stated for lines of credit, although a higher proportion of firms in the fast growth phase are among the least satisfied.



## ***Chapter VII:***

### **Analysis of probabilities of request and approval of line of credit and medium-/long-term loans**

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This final chapter will focus on the determinants of the probability of a Canadian SME's requesting financing. The previous chapters provided detailed analysis of the components of satisfaction with, access to and knowledge of Canadian financial markets. Here, a different and complementary viewpoint is adopted in order to determine, in a "multivariate" context, whether profiles emerge, first of firms most likely to request financing, and secondly of firms most likely to have their request approved. Lastly, these statistical results will be compared with the profile of the firms that stated that they would make a further request to financial markets during the year to come.

#### **7.1 LINE OF CREDIT**

##### **7.1.1 Probability of submission of an application<sup>21</sup>**

The probability of a firm's requesting financing is a function of its specific needs, which can depend on its selected rate of growth, of the turbulence of the markets in its activity sector, and of its own self-financing capacity.

A group of factors specific to the firm — factors that may influence its financial needs — was selected in order to create the basic model (M1). The factors are size (measured in terms of assets and number of employees); phase of development (the seed/start-up and growth phases require additional resources, unlike the maturity and winding down phases); indebtedness ratio; extent of the firm's involvement in R&D activities and exporting; and sector of activity.

Building on the previous chapters' results, where it was shown that the entrepreneur's profile could influence the probability of financing being requested, a second model (M2) was created by adding to the basic model variables

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<sup>21</sup>Given the binary form of the dependent variable, logistic regression analysis was used to measure the relations between it and the independent variables.

specific to the entrepreneur, now including the entrepreneur's profile, i.e. gender, age, level of education, experience, interest in growth during the two years to come, and interest in sharing control of the firm to finance its growth or expansion.

Data specific to the operation of financial markets were highlighted in Chapter 6. The data introduced in the third model (M3), include the type of financial institution the entrepreneur does business with for ongoing operations, the number of account managers met during the previous three years with this institution, and the firm's location.

The final model presented (M4) is merely the results of a "stepwise" regression that selects the variables that have the most statistically significant impacts on the probability of financing being requested. No variables are added here.

**TABLE 7.1: DETERMINANTS OF PROBABILITY OF A REQUEST FOR A LINE OF CREDIT**

	M1	M2	M3	M4
Total employees	0.0104**	0.0194**	0.0210**	0.0198**
Total assets	0.2614**	0.2891**	0.2498**	0.2523**
Is the firm in a positive growth phase?	0.3814**	0.1213	0.2477	-
Is the firm in a negative growth phase?	-0.2953	0.1204	0.0425	-
Indebtedness ratio	0.3325**	0.2924**	0.2774**	0.2940**
Wholesale and retail trade sector	1.3496**	1.0000**	1.0551**	-
Transportation	0.7226	0.3607	0.5569	-
Culture	0.8236*	0.7313	0.8437*	-
Real estate, etc., services	0.3249	-0.3255	-0.4193	-1.3992**
Professional, etc., services	0.9625**	0.4909	0.5130	-0.6159**
Administrative, etc., services	1.2630**	1.3697**	1.5249**	-
Other services	1.1699**	0.7790	0.7721	-
Agriculture	1.8162	1.7309**	1.5215**	-
Construction	2.3455	1.8167**	1.8482**	0.7642**
Manufacturing	1.4736	1.1685**	1.2598**	-
Percentage of sales spent on R&D	0.0082	0.0069	0.0117**	0.0130**
Percentage of sales from exports	0.0066	0.0062*	0.0033	-
Owner's age	-	-0.0084	-0.0096	-0.0247**
Owner's education	-	-0.0863	-0.1182	-
Owner's experience in specific industry	-	-0.0210**	-0.0207**	-
Gender	-	0.1947	0.2194	-
Growth expected over next two years	-	0.0001	0.0001	-
Entrepreneur shares 50% or more of control	-	-0.2020	-0.1628	-
Entrepreneur wants to keep more than 50%	-	0.1990	0.1940	-
Entrepreneur is prepared to share more than 50%	-	-0.2600	-0.4202	-
Main financial institution is a bank	-	-	-0.0088	-
Main financial institution is a credit union	-	-	-0.2497	-
Number of account managers	-	-	0.2920**	0.0033**
Firm's location (rural, urban, metropolitan area)	-	-	0.2026	-
Overall (Wald)	138.40**	145.54**	146.39*	132.55**
Probability ratio ( $\chi^2$ )	177.33**	211.34**	219.74*	189.31**

The results from M1 show that it is more probable that a line of credit will be requested when the firm's size is increasing and if it is in a positive growth phase, which is a clear indicator of the firm's financial needs. In addition, the probability also increases with the firm's debt level. This is an indicator of vulnerability and, combined with the growth rate, indicates that the firm is not generating enough resources to fully meet its own expectations for development. The probability is also influenced by certain activity sectors, as previously shown.

Adding variables specific to the entrepreneur (M2) improves on the quality of M1 (see probability ratio) and confirms the “univariate” results, in that it is more likely that younger and less experienced entrepreneurs will seek financing, since more of them own firms in the seed/start-up or growth phases and report the highest expected growth rates.

In M3, a number of contingent variables have been introduced: type of institution, number of account managers and firm’s location (rural, urban or metropolitan area). The only variable that has a significant impact is the number of account managers, thus confirming the previously observed findings that the more account managers the firm had to deal with in the previous three years, the higher the probability of making further requests for financing.

Finally M4, the best statistical model to predict the probability of a line of credit being requested, highlights the roles of size, debt, certain specific sectors, R&D activities, owner’s age and number of account managers the owner dealt with in the previous three years.

The entrepreneurs were asked to indicate their financing intentions for the coming year with respect to lines of credit. The four models were tested on the firms that indicated their intention to request a line of credit, in order to evaluate their predictive value. The results, presented in the table below, show that only just over 50% of the firms that indicated their intention to request financing correspond to the profile of applicants of the previous three years — the profile on which the models were developed. The profile of requesters of financing would thus seem to be in the process of changing, which could impact on approval rates.

M1 (N = 990)	M2 (N = 889)	M3 (N = 856)	M4 (N = 856)
55.86%	55.12%	53.39%	51.64%

### 7.1.2 Probability of approval of a request<sup>22</sup>

It is interesting to see which entrepreneurs will be the most likely to request a line of credit in the years to come, but it is equally interesting to know their chances of success.

M2 seeks to determine the probability that a line of credit request will be approved. In view of the functioning of financial markets and, more specifically, the functioning of financial institutions, it is clear that the probability that a request will be approved depends on the level of risk it represents. Therefore a number of variables were selected that can be used to assess the risk that SMEs represent for creditors. The indebtedness ratio was selected to measure the financial risk; the existence of a board of directors or management committee, as well as of a financial officer, to measure the management risk; the activity sector, exporting, R&D and the phase of development as measures of the commercial risk; and the entrepreneur's profile to measure the entrepreneurial risk.

In M2 the basic model was supplemented by taking into account financing variables, including the number of account managers, the main financial institution, the number of financing sources sought, and the firm's location.

The results presented in Table 7.2 show, first, that the components of commercial risk — particularly sector — impact strongly on the probability of approval of a request. Some sectors are more likely than others to be supported by the financial community. In addition, the probability of approval is lower for firms winding down and for firms involved in R&D. The existence of an officer responsible for the finance/accounting function increases the probability of approval, since it can be an indicator of good communication, support for the data on the firm's needs, or of defending the firm's position with the account manager. Lastly, total assets, the entrepreneur's experience in the sector and being female increase the likelihood of success. In the latter case, the greater chance that female entrepreneurs will succeed could be due to the fact that they head smaller firms and ones less involved in R&D and exporting; such firms represent a lower degree of uncertainty in the eyes of creditors.

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<sup>22</sup>To develop a comprehensive model, variables other than those available from the survey would have been necessary. It is immediately obvious that the models presented here cannot be fully specified. However, the exercise, although imperfect, is still useful for the purpose of raising certain problems and making recommendations.

**TABLE 7.2: DETERMINANTS OF PROBABILITY OF APPROVAL OF A LINE OF CREDIT REQUEST**

	M1	M2	M3
Debt level	-0.1537	0.1845	-
Existence of management committee	0.4700	0.4725	-
Existence of accounting/finance officer	1.0831**	1.3587**	1.2722**
Wholesale and retail trade	2.9537**	2.3676**	-
Transportation	5.3372**	4.7517**	-
Culture	1.1917	0.5270	-1.4470**
Real estate, etc., services	3.4192**	2.9441**	-
Professional, etc., services	3.1775**	2.4282*	-
Administrative, etc., services	.2858**	2.5241**	-
Other services	2.6354**	1.7331*	-
Agriculture	2.1968**	1.3733	-
Construction	1.7668**	1.0416	-0.8230**
Manufacturing	2.4233**	1.8533**	-
Firms in positive growth phase	-0.5208	-0.2878	-
Firms winding down	-1.4172**	-0.9035	-
Research and development	-0.0179**	-0.0094	-
Exporting	-0.0023	-0.0046	-
Number of employees	0.0029	0.0047	-
Assets	0.4922**	0.6969**	0.7042**
Owner's age	-0.0062	0.0014	-
Owner's experience in the industry	0.0518**	0.0629**	0.0480**
Education	-0.0381	0.1300	-
Gender	-0.8077**	-0.5397	-0.7299**
Main financial institution is a bank	-	0.3744	-
Main financial institution is a credit union	-	0.8234	0.6778
Number of account managers	-	-0.4021**	-0.3338
Number of financing sources approached	-	-0.7458**	-0.7632
Firm's location	-	0.4194**	-
Overall (Wald)	88.96**	99.66**	91.27**
Maximum likelihood (probability) ( $\chi^2$ )	134.50**	176.46**	141.52**

Adding other financial variables (M3) makes it possible to enhance the model's predictive power. The probability that the request will be approved declines when the number of account managers rises and when the number of financing sources rises. However, as we have already seen, these two variables are important indicators of the firms' needs.

Finally, M4 is produced on the basis of a “stepwise” regression, which includes only the major determinants of the probability that a line of credit request will be approved. However, its explanatory power is less than the other models, and no new observations are made here, except that the role of the activity sectors is greatly diminished and that only the cultural and construction sectors emerge as sectors where the probability of line of credit approval is relatively low.

To evaluate the predictive power of the models, they were tested on the firms that were used to develop them, and accurately predicted the approval of their line of credit requests in more than 85% of the cases. Thus these models can help to predict success rates for the entrepreneurs included in our survey who indicated their intention to request a line of credit during the coming year. Table 7.3 shows that only 50% of the SMEs who planned to request a line of credit had a better than 90% chance of success. These results could be compatible with the hypothesis that the profile of entrepreneurs requesting financing is changing, and that lenders may not be ready to finance their needs unless they change their methods. To prove this hypothesis, it will clearly be necessary to undertake more detailed studies on requesters of financing.

***TABLE 7.3: PROBABILITY OF APPROVAL OF LINE OF CREDIT REQUESTS FORESEEN IN THE COMING YEAR***

Model used:	M1 (N = 234)	M2 (N = 228)	M3 (N = 228)
Below 50%	3.85%	10.96%	8.77%
50-70%	14.96%	9.21%	12.28%
70-90%	29.06%	30.70%	29.82%
Over 90%	52.14%	49.12%	49.12%

## 7.2 MEDIUM-/LONG-TERM LOANS

As already stated, financing requests are directly related to a firm's financial needs. Therefore the model set used for lines of credit was also used for medium- and long-term loan requests. The results obtained<sup>23</sup> are very similar to those for lines of credit, despite the fact that the two types of financing do not meet the same needs for the firms.

Four of the most determining factors are common to the two types of financing and all have positive impacts. However, there is a major difference in the strength of these impacts. The number of employees seems to triple the likelihood of requesting short-term credit rather than medium- or long-term financing. The existence of debt doubles the likelihood of requesting a long-term loan rather than a short-term loan. If the firm belongs to the construction sector, it is more likely to request a short-term rather than a long-term loan. The role of the other sectors varies with the type of assets SMEs can provide as guarantees for lenders; lines of credit are guaranteed essentially by inventories and accounts receivable, while medium- and long-term loans are guaranteed by fixed assets. The sector to which a firm belongs can therefore play a more important role in one type of financing than in another.

Futhermore, the probability of requesting a medium- or long-term loan falls with the rise in the R&D budget of the firms, while the number of account managers, which increases the probability of requesting a line of credit, plays no significant role here.

With regard to approvals, no major differences are noted by comparison with lines of credit.

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<sup>23</sup>Readers can find the detailed results in Annex E.



## FINDINGS AND RECOMMENDATIONS

As a result of the detailed analysis of the responses of the SMEs sampled, a number of findings have come to light that will be helpful to policy development regarding the financing of Canadian SMEs. In the paragraphs below, these findings will be recapped, highlighting some that may lead to judicious initiatives on financial markets that would promote the development and competitiveness of SMEs. These findings will be followed by a set of recommendations for further work conducive to a better understanding of SME financing.

### FINDINGS

SMEs often request financing from several sources simultaneously. Request rates depend on the firms' needs, which are greater in the case of firms that are:

- ▶ larger;
- ▶ owned by a young university graduate less than 40 years of age;
- ▶ in the seed/start-up or fast growth phase; and
- ▶ active in R&D and/or exporting.

At the same time, the firms that request financing from several sources are less satisfied than other firms. However, a causal relation could not be established between satisfaction and requests made to several financing sources.

If firms do not request financing, it is usually because they do not need it. No problems relating to knowledge of financing sources were identified that might explain why certain sources receive fewer requests than others, except in the case of government services/programs. The degree of knowledge of entrepreneurs of the various financing sources and their advantages and disadvantages therefore cannot be highlighted in this study. To obtain such information, it would be necessary to further explore the extent to which knowledge of various types of financing depends on the entrepreneurs' needs and their inclination to "shop around" among various lenders, which are then effectively in competition to offer the best possible conditions.

Approval rates of financing requests depend on the firms' degree of risk. These rates vary across the different regions of Canada and the different industry sectors, but are higher among firms that are:

- ▶ in a stable phase of development (slow growth and maturity); and
- ▶ owned by an older entrepreneur with extensive experience in the specific activity sector.

Equity financing is not popular among entrepreneurs in Canada (or in most developed countries), because they do not wish to share control of their firms. Entrepreneurs who expect very high growth rates (university graduates involved in R&D and/or exporting) are more open than the others to external partners to finance their growth/expansion. Furthermore, government financing attracts very few Canadian entrepreneurs (which is also true

in other countries).

The entrepreneurs are relatively satisfied with their financing on Canadian markets. As already shown in other studies, the main elements of dissatisfaction remain guarantees and service fees. However, the entrepreneurs' overall satisfaction is little affected by these two elements; and the heterogeneity of the sample is apparent in the elements of dissatisfaction, which depend on the firm's phase of development, the entrepreneur's age, the expected growth rate, and involvement in R&D and/or exporting.

The entrepreneurs are relatively loyal to their financial institutions because they normally request financing infrequently. The least loyal are those with major needs that are dictated either by their growth rates or by the specific characteristics of their needs (i.e involvement in R&D or exporting).

The entrepreneurs who approach the markets most frequently are apparently those who are most likely to make a contribution to the country's economic growth, but are the least satisfied and the worst served. On the basis of their statements, the same entrepreneurs are most likely to request financing in the coming year. Will financial markets be able to meet their needs?

## RECOMMENDATIONS

**Compile a data base of organizational and financial information in order to make the link between satisfaction with financial markets and the degree of firms' risk.** This recommendation emerges from the finding that financing decisions within SMEs are not based on the criteria dictated by economic theory, which emphasizes the rationality of the players. Continued ignorance of the specific characteristics of entrepreneurs and of the fact that their reasoning, unlike that of their lenders, is not based solely on economic and financial criteria, will make it impossible to develop an overall approach to the financing of SMEs.

**Provide better support for the entrepreneurs who are more daring and more capable of meeting the challenges of the new economy.** These entrepreneurs are highly educated, are involved in R&D, are active on international markets, are open to financial partners and are expecting high growth rates. The financial markets must be ready to support them: Canadian international competitiveness depends on this.

**Achieve better identification of innovative and value-generating firms.** The survey results indicate that firms involved in R&D can be found in every activity sector. It would therefore seem that the activity sector is not the only parameter allowing their identification. Concentrating solely on the sector as a selection criterion may impede their recognition, as well as the development of financing solutions suited to their specific characteristics.

