

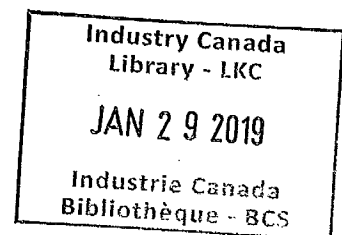
**Determining the Future of
Small Business Financing Data**

A Consultation Document

**Entrepreneurship and Small Business Office
Industry Canada**

Statistics Canada

February 2000



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1. Introduction

1.1 Purpose

This paper has two main goals. The first is to propose a plan to address gaps which have become apparent in recent years in data related to the financing of small and medium-sized enterprises (SMEs) in Canada. This plan is meant to launch a permanent change in the approach to gathering and reporting on the availability of and demand for all kinds of financing for SMEs. The second goal is to provide the framework for discussions with a wide range of stakeholders on the plan, the goals it seeks to accomplish and the means proposed for achieving these. Our goal is to obtain the considered judgement of interested parties as to whether this plan will satisfy the need for SME financing data. In other words, the plan described below is an outline which will be finalized in consultation with both the providers of financial services to small businesses and small businesses through the national associations that represent them.

1.2 Context

Small and medium sized enterprises (SMEs) are an economic powerhouse in the Canadian economy. Over the past decade they have created more than 85% of net new jobs. They make a larger relative contribution to our economy than most other countries with a similar economic structure. By one definition of SMEs, in 1999, there were 1.8 million firms employing fewer than 500 people. These firms account for 99.9 percent of all businesses in Canada. Also, the 2.5 million self employed (18 percent of the workforce) represent a larger share of employment than the whole manufacturing sector. Many small firms are used to thinking of financing being available only from "the bank", yet most research done to date indicates that banks account for only about 50 percent of the financing being used by SMEs. The Canadian Bankers Association and the Crown Financial Institutions have reported their business credit statistics since 1995, but this clearly gives only a very partial picture of the challenges facing these firms in accessing financing.

1.3 Need for Improved Data

The health and development of the small business community is a crucial concern for public policy makers, but also for providers of commercial goods and services who see SMEs as a major part of their market. Yet it has been widely acknowledged that neither public policy nor the firms supplying small businesses are well served by the quality or quantity of the information available about this sector. If decision-makers in the public or

private sectors do not have consistent, comprehensive and unbiased data, they lack a key ingredient for effective action.

In 1996 the federal government appointed the Task Force on the Future of the Canadian Financial Services Sector (the MacKay Task Force) to look into public policies affecting the financial services sector and make recommendation on the full range of public policy issues that affect the environment within which financial service providers operate. When the Task Force reported in late 1998, one of its conclusions was that the poor quality and lack of coverage of financial data about SMEs was a major impediment to effective public policy making in Canada. This confirmed the earlier findings of the House of Commons Standing Committee on Industry and the Senate Committee on Banking, Trade and Commerce. To address this problem the Task Force recommended a concerted effort to improve the quality and coverage of SME financial statistics.

1.4 The Federal Government's Commitment

The Government has accepted this recommendation and Industry Canada, Statistics Canada and the Department of Finance have been mandated to work together to:

“...undertake a comprehensive program of information collection and analysis to ensure that there is adequate information relating to the financing needs of SMEs for effective public policy development. Statistics Canada will be given the mandate to collect and publish data on the supply of debt and equity financing to SMEs. ...To expand the government's analytical capabilities, Industry Canada will be given the mandate to establish a dedicated SME Finance Group that would be responsible for analyzing the Statistics Canada data, conducting other surveys and undertaking continuing research on SME financing issues. Industry Canada will also report annually to the House Standing Committee on Industry regarding the state of SME financing in Canada.”
(Reforming Canada's Financial Sector: A Framework for the future, June, 1999).

There are a number of significant challenges to overcome in undertaking this task. Both the SME sector and the financial services sectors are large, diverse and dynamic. The difficulty of achieving broad coverage and in-depth information about all financing providers and significant samples of users, within a limited budget, should not be underestimated. Moreover, the detailed picture we are hoping to obtain demands that, wherever possible, we need to be able to associate qualitative data (e.g. the purpose of the request for financing, the reasons for a financing proposal being turned down) with quantitative data (e.g. size of financing, authorization levels) to be able to develop a

statistically sound and informative picture of the scope and nature of any gaps in the financing market. Related to this we will need to capture as many aspects for current and emerging forms of financing as possible, to ensure we reflect the dynamic nature of the market. The cooperation, indeed, collaboration of a wide range of financial services providers and users will be critical to the successful implementation of this mandate. This is why the consultations are an integral component of the development of the plan.

Some might ask why we do not simply follow the example of other countries in implementing such a plan. The difficulty is that there are not many models to follow. Other countries, such as the U.S. and the U.K., have recognized the need to monitor SME financing on a regular basis. The Bank of England now reports annually on small business financing and discusses current developments and other specific topics that are of concern to SMEs. In the U.S., the Federal Reserve reports to Congress, every five years, on the availability of small business debt financing. What Canada is proposing is somewhat more comprehensive than either of these examples and the structure of Canada's industries and financial markets are substantially different than those in the United States or the United Kingdom.

To meet these challenges, the government has committed resources to put in place a new regime for collecting data on SMEs financing – this is a permanent, on-going responsibility which Statistics Canada and Industry Canada will be seeking to implement with data-providers over a period of time. While Statistics Canada and Industry Canada will lead the implementation of the project, Department of Finance will share the management of this project with Statistics Canada and Industry Canada.

While Statistics Canada and Industry Canada are responsible for implementing the project, this does not preclude the use of data and information provided by other bodies. Wherever possible we will seek to avoid duplicating effort. Where relevant sources of data and information are being gathered by non-government bodies, we will seriously consider using this information, rather than developing our own sources.

1.5 Expected Benefits from the Project

Recognizing that there are costs to taxpayers and data providers (including financial services companies and SMEs) for this project, we see important benefits to both the public and private sectors. The project is aimed at providing, for the first time in Canada, a comprehensive picture of the supply and demand for financing among SMEs. The goal is to cover the entire gamut of supply of financing products and services which are used by SMEs, including debt and equity, as well as the "mezzanine" financing between. We also hope to have a much clearer picture of who is seeking financing, the sector in which they operate, the stage of development of their businesses, and the purposes for which they are

seeking outside financing. Eventually, this should help stakeholders in the public and private sectors to better understand the challenge of providing capital to one of the most important engines of growth in our economy.

These data will not only form the basis of a more informed debate, they will also provide financial institutions with information they need to gain a better understanding of their clientele, to permit them to design their products to more precisely meet market needs. The small business community will benefit from a better awareness of financing providers, options and instruments. Policy makers will be able to use this information so that they can assess whether SMEs' needs are being addressed by the market and also to assess the effectiveness of policies and programs.

1.6 Scope and Nature of Consultations

We recognize that, to be successful, this project will require a long-term commitment from data-providers. Our work to date makes us very much aware that this project will imply some additional costs for the providers of the data. While the approach laid out in this plan is one model for collecting data, there may be other, equally viable models, which we are prepared to explore during consultations.

Our goal is to deliver on the mandate we have been given in the most cost-effective manner possible, not only for the public sector, but also for those we will be calling upon to provide data. During the first round of consultations, we expect to discuss the range of information that we propose to collect. Our goal for this first round of consultations is to inform stakeholders of our project plan and get their general impressions on the direction we are proposing. Having received input on the scope of the project in the first round we expect to revise the project proposal and the implementation plan accordingly. We hope to deal with the technical details and the means of ensuring cost-effective implementation of the plan during the second round of consultations.

Each section of this paper outlines a number of questions on which we are seeking the views of stakeholders. We are offering over 40 groups, associations, or individual firms the opportunity to participate in the first round of discussions. The second round may include a wider group.

2. Current SME Financing Data Collection

The current system for collecting data on private sector SME financing is based largely on the data voluntarily collected and released under the auspices of the Canadian Bankers Association (CBA) and hence deals primarily with major chartered banks. According to Thompson and Lightstone's surveys for the CBA, currently reported bank data accounts

for barely one half of the total sources of financing used by small business and focuses primarily on data related to institutional lenders. The following are the principal data publications of the CBA:

- Quarterly statistics on the SME lending activities of the major chartered banks;
- Annual data on loan loss provisions taken by the major banks against business lending, including SME lending; and
- Annual survey of SMEs concerning their needs, expectations and satisfaction with financial institutions (conducted by Thompson Lightstone & Company Limited and published in 1997 and 1998). Also included in this survey is a survey of bank loan officers concerning credit applications and approvals.

In addition to the CBA, industry groups, such as the Canadian Venture Capital Association and the Canadian Finance and Leasing Association, provide regular reports on the activities of their members in financing SMEs. The Canadian Federation of Independent Business also regularly surveys its members to determine their perceptions and experience with respect to the availability of credit. The Conference Board of Canada has undertaken two surveys (1996 and 1998) of SME debt financing. Crown Financial Institutions (Business Development Bank of Canada, Canadian Commercial Corporation, Export Development Corporation, Farm Credit Corporation) report their SME-related activities in an annual publication. Statistics Canada collects some data from banks and insurance companies about commercial loans and some data from small leasing companies about the value of leases to businesses. However, none of this information is collected by size of business or other relevant business characteristics.

Unfortunately, despite all these data-gathering efforts, gaps and inconsistencies in the data have meant that neither the industry nor policy-makers has a comprehensive picture of SME financing.

3. Needed Improvements to Existing SME Data

Although some improvement has been made in the past few years with respect to data on small business financing, further improvements are still required to address policy needs. Ideally, these would include:

- Coverage of additional suppliers of financing beyond major banks and venture capitalists, including, but not exclusively, non-bank financial institutions such

as credit unions, insurance companies, factoring companies, pension funds, providers of love money, and informal investors;

- Enhanced coverage of crown financial institutions and more comprehensive coverage of government programs;
- Coverage of all main types of SME financing, including loans, leases, credit cards and equity financing;
- Coverage of the particular needs of knowledge-based industries (KBIs).
- Greater detail on the characteristics of SMEs, including size and sector of business, regional location, rural-urban location and gender;
- Collection of data from the SME perspective to determine the significance of different sources of financing;
- Collection and analysis of data by independent sources to reduce concerns about bias in collection and interpretation.

In general, what is needed is comprehensive data collection that will provide a solid base for analysis of SME financing issues. To achieve this objective, the Government has decided to proceed with a model that is presented in more detail below.

4. The Proposal

The proposed model for implementing a comprehensive system for data collection and analysis regarding the financing of SMEs, is as follows:

- Statistics Canada will undertake an annual program of collection and publication of information on the supply of SMEs debt and equity financing. The program will cover all significant public sector and regulated and unregulated private sector providers of financing. (This program will now be referred as the supply-side survey in this document)
- In consultation with Industry Canada, Statistics Canada will conduct a periodic survey of SMEs to provide comprehensive benchmark information on financing needs and sources. An initial survey should be done as soon as possible, with follow-up surveys to be conducted every three to five years. (This program will now be referred as the demand-side survey in this document)

- Industry Canada will coordinate a regular survey of SME attitudes about the availability of financing. This survey could be similar to the Thompson Lightstone studies funded by the Canadian Bankers Association, but would cover all significant providers of financing.

While Statistics Canada and Industry Canada are responsible for implementing the project, this does not preclude the use of data and information provided by other bodies. Wherever possible we will seek to avoid duplicating effort. Where relevant sources of data and information are being gathered by non-government bodies, we will seriously consider using this information, rather than developing our own sources.

4.1 Questions to be addressed

The initial goal of the data collection program is to answer several basic questions concerning the financing of SMEs (see table 1 in the Annex for additional details) .

- How much financing have SMEs received (in the reference period)? How is the amount of financing they receive changing over time?
- How significant are the different types of suppliers of finance and the various financing instruments? How is the significance of the suppliers and instruments changing over time?
- Is there a gap between the demand for financing and the supply of financing and, if so, how big is it?
- If there is a gap between demand and supply, what factors contribute to it?
- What are the risks associated with financing SMEs?
- What is the purpose of the financing requested by SMEs?

To respond to these questions, the proposed model implies the collection of the following statistical information from the suppliers of SME financing (the supply-side) and from the SMEs themselves (the demand-side) by surveying them. Table 1 in the attached Annex describes the detailed survey approach outlined here:

- Total value of financing outstanding at the end of the reference period by type of supplier and financing instrument. (Obtained from the supply-side and the demand-side)

- Total value of new financing obtained by SMEs during the past 12 months by type of supplier and financing instrument. (Obtained from the supply-side and the demand-side)
- The proportion of financing approved as a percentage of the amount requested. (Obtained from the supply-side and the demand-side)
- The reasons why requests for financing were not approved or the amount approved was less than the amount requested. (Obtained from the supply-side and the demand-side)
- Loss provisions and/or ratios, and write-offs. (Obtained from the supply-side only)
- The purpose of the requests for financing. (Obtained from the supply-side and the demand-side)

Does the proposed methodology create unintended barriers to compliance? If so, what alternatives do you suggest to accomplish these goals?

Does the information proposed to be collected (also described in more detail in the Annex) address the full range of data required? If not, what else should be included?

4.2 “Demand Side” Survey: Approach to collection of information

To meet the objectives of this project it is very important that information should be collected both from the suppliers of financing – the “supply side” – and the recipients of financing – the “demand side.” Information must be collected from both “sides” of the market in order to present a complete picture of the state of SME financing.

Surveying only the “supply side” would have significant drawbacks because not all suppliers (private persons, private individual investors -- “business angels”-- shareholders and foreign suppliers, for example) may be readily identified and surveyed. Financial institutions may not know the extent to which the financing provided to persons may be used for business purposes. Suppliers may not have full knowledge of the current characteristics of their clients’ businesses.

Surveying the “demand side” can offset these limitations. It should be possible to collect from SMEs important information about the types and sources of financing used and the main characteristics of the businesses and their owners. However, the length of the questionnaire must be limited to ensure that the response burden on small businesses is reasonable. Statistics Canada will collect information from both the supply and demand sides to provide integrated information that is as comprehensive as possible. It is estimated that the demand side survey will be administered to about 15,000 SMEs.

These surveys will be conducted according to all the standard policies and practices implied by a Statistics Canada survey under the Statistics Act. This includes protection of the confidentiality of respondent data. Only Statistics Canada employees would have access to company data obtained from the survey. Only aggregate data (totals, averages, percentages) that do not identify information pertaining to an individual business would be released by Statistics Canada, and respondents would be informed as such at the time of the survey.

The first demand-side survey is planned to be conducted between January to March 2001, with its findings being released in October 2001. This survey will be repeated every three to five years and will report financing information for the years ending December 31 as with the supply-side survey. A pilot version of the SME survey will be administered to a small sample of businesses in spring, 2000. This will serve as a test run and allow for a first glimpse of the kinds of findings that will be explored in greater detail in the benchmark demand-side survey. We expect to release the results of the pilot survey in October 2000.

Selected businesses will be mailed a questionnaire, and will subsequently be contacted by Statistics Canada interviewers to assist in filling out the form, if needed. The SME survey will be representative of all for-profit businesses with less than 500 employees, excluding only unincorporated firms with no employees and less than \$30,000 in annual revenues. The sample will be drawn from Statistics Canada's business register and will be adequate to produce reliable information for broadly-defined industry sectors and size categories, with a particular attention to firms in the knowledge-based industries¹.

The information that we propose to be collected from the demand-side survey is listed in table 1 of the Annex. In addition, the way we propose to have the data segmented for analysis and reporting is described in tables 2 to 5 of the Annex.

4.3 "Supply-side" Survey: Approach to collection of information.

The first annual survey of SME financing suppliers, the supply-side survey, is expected to take place between January and March 2001, with its findings released in October 2001. The periodicity of this survey provides for reporting of financial information on an annual basis for years ending December 31. For the first survey, its focus will be to collect the types of information proposed in table 1 of the Annex from as many suppliers of SME financing as possible and to expand the data collected from the financial service providers that have not previously provided detailed data with respect to their small business lending or investing activities.

¹The sampling methodology will ensure sufficient representation of the KBI sectors for further analysis.

4.4 The Challenges

Even though some financial industry associations have published data on the financing activities of their members, we expect to face some challenges in regards to the collection and reporting of information:

- Achieving the goal of improved depth and breadth of coverage of SME statistics will likely require some changes in the way that statistics are collected and reported, and some compromises by all parties to reflect what is practical and cost effective.
- Integration of all new data with existing data collected from different sources;
- Some institutions, including trust companies, life insurance companies, credit unions and caisses populaires, will need to provide significantly more data than they have in the past;
- As well, data pertaining to government programs, such as the Canada Small Business Financing Act (CSBFA) (formerly known as the SBLA), and data from crown financial institutions (BDC, CCC, EDC, and FCC), which are currently reported individually, will also need to be integrated into the data collection system.

The information that we propose to collect from the financing providers is listed in table 1 of the attached Annex and the way we propose to have the data segmented for analysis and reporting is described in tables 2 to 5 of the Annex. Recognizing that this data collection project will demand a substantial amount of effort from the financing providers, tables 2 to 5 of the Annex suggest a five-year process to “ramp-up” collection of the needed information. The information in non-shaded areas is proposed to be collected earlier in the process and the information in the shaded area is proposed to be phased-in over five years. As indicated earlier, the phase-in period will form the basis of one track of the second round of consultations.

Are the proposed approaches outlined in this document appropriate?

In your view, are the proposed approaches feasible and will they achieve the goal set by the government?

5. Data Analysis

An SME Finance Group is being established within Industry Canada to analyze and report on small business financing issues. Its work will be based on the data gathered and published by Statistics Canada, as well as supplementary surveys and specific research studies. This Group would identify trends in small business financing, assess public policy issues that emerge from analyses and initiate surveys to provide supplemental information as required.

The SME Finance Group will have specific responsibility for the following:

- A regular survey - every two to three years - of SME financing needs and expectations of and experience with various providers of financing (similar to what was previously conducted by Thompson Lightstone for the CBA); and
- Continuing occasional research related to SME financing issues, including, among other topics:
 - ▶ Regional availability of SME financing;
 - ▶ Rural / urban differences in availability of SME financing;
 - ▶ Whether gender is an issue in the provision SME financing;
 - ▶ Special financing requirements of KBIs;
 - ▶ Financing needs of aboriginal businesses;
 - ▶ Availability of financing to youths;
 - ▶ Roles and motivations of angel investors;
 - ▶ Perception and use of angel investments by SME;
 - ▶ Investment patterns of venture capitalists;
 - ▶ Impediments in the Canadian IPO market; and
 - ▶ Provision of SME financing through electronic means.

Based on the above, the Group would prepare regular reports on the state of small business financing. These reports would be tabled with the House of Commons Industry Committee and made available to interested parties.

6. Concluding Remarks

Much concern has been expressed regarding the breadth and the depth of the information available about SME financing in Canada. Some noticeable improvements have been made in recent years, but the government's commitment to undertake a comprehensive data and analysis program in that area provides a unique opportunity to begin a process of long-term improvement toward a solid information base. Better information about the state of financing of the small business community will ultimately benefit all the stakeholders including the small businesses themselves, the financing providers and the policy makers by putting key information in the hands of decision makers to finally improve access to financing to the SMEs.

QUESTIONS FOR DISCUSSION

General questions:

1. Are the proposed approaches outlined in this document appropriate?
2. In your view, are the proposed approaches feasible and will they achieve the goal set by the government?

Information needs:

3. Are there categories of suppliers or financing instruments not covered in the proposal?
4. Do the data proposed to be collected (described in details in the Annex) address the full range of data required? If not, what else should be included?

Data collection issues:

5. With respect to data collection, are there particular problems associated with specific financing providers?
6. Does the proposed methodology create unintended barriers to compliance? If so, what alternatives do you suggest to accomplish these goals?
7. Recognizing this will not be your only opportunity to discuss this issue, with respect to implementation and compliance, do you anticipate any problems? If so, do you have any suggestions relating to mitigating them?

