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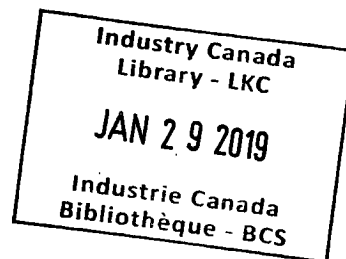
Determining the Future of Small Business Financing Data

Consultations with Stakeholders: Round Two

Summary of Consultation Meetings
held
June 28 - July 20, 2000

October, 2000

Prepared by
Clareydale Services
5 Belgrave Road, Ottawa, Ontario
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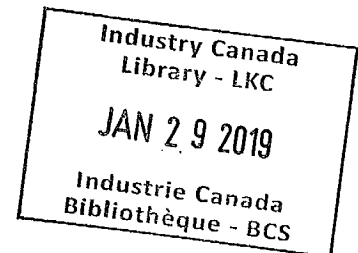
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Contents

	<i>Page</i>
Introduction	2
The First Round of Consultations	3
The Second Round of Consultations	4
• Purpose	
• Information Provided to Participants	
Responses from Private Sector Stakeholders	5
Responses from Public Sector Stakeholders	10
Annex A: List of Participants	13
Annex B Government Presentation to Stakeholders:	16

Introduction

In 1996 the federal government appointed the Task Force on the Future of the Canadian Financial Services Sector (the Mackay Task Force) which reported in late 1998. One of its conclusions was that the poor quality and the lack of coverage of financial data about Small and Medium Enterprises (SMEs) was a major impediment to effective public policy making in Canada. This conclusion 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. 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 develop a consistent, comprehensive, and unbiased information base that can contribute to serving the needs of public policy, firms supplying small business financing, and small businesses requiring financing.

As an initial step, a consultation process was established to assess the scope of the financial information requirements and to establish stakeholder support for implementing a data gathering process. Two rounds of consultations with suppliers of financing, representatives from the SME business community, and government agencies serving SMEs have been undertaken.

The purpose of this report is to present the results of the second round of consultations which were undertaken in June and July 2000.

October, 2000

The First Round of Consultations

The first round of consultations were undertaken in February and March of 2000. Over 28 stakeholder organizations participated in the fifteen meetings that were held across the country- in Montreal, Ottawa, Quebec City, Toronto and Vancouver.

Generally the participants agreed there is a need for better information- whether it is used for policy development or for creating new financing products for increasing awareness of the supply of financing options available to SMEs. However, concern was expressed by many regarding the amount of data that may be requested and the resultant burden on those who provide the information.

Key issues raised during these consultations included:

- availability of data currently
- justification of the need for the additional data
- the burden of providing the information requested
- the number of financing products and services that need to be considered
- definitions of specific data elements
- the need to focus test and to continue the consultation process.

The detailed results of this round were presented in a report published by the Small Business Policy Branch of Industry and Science Policy at Industry Canada in March, 2000. These results were reviewed and the proposed implementation plan was modified. This modified plan formed the basis for the second round of consultations

Following the first round of consultations, a demand side survey was prepared to test the availability of data and the structuring of the questionnaire. This demand survey was being field tested at the time the second round of consultations were undertaken.

The Second Round of Consultations

Purpose

The goal for this round was to seek a commitment from the stakeholders to the revised five-year plan for a program of information collection and analysis.

The revised plan:

- Reduces the requirement to provide qualitative data on SMEs by finance suppliers. (This information will be obtained from the SMEs themselves.)
- Provides a five year phasing in period for data provision.
- Adds a regional segmentation requirement (using postal codes).
- Makes the annual supply side survey mandatory.

The focus of this round was on the revised data acquisition plan for the supply side survey to determine the time frame necessary for information providers to be able to supply the required data.

The consultations were undertaken during June and July of 2000. Over forty-seven consultation meetings were held. There was significant participation from individual firms, particularly as some of the larger associations included key member firms in the sessions. A complete list of participants is presented in Annex A.

Information Provided to the Participants

A consultation document had been provided to the stakeholders prior to the sessions. This was supplemented with a presentation that provided the talking points to assist in focussing the discussion. As well, the proposed supply side questionnaire framework was provided at the meetings.

The questionnaire grouped the data requirements into four modules to reflect the type of instruments and type of financing provider involved. These are:

- debt financing (credit) module;
- equity financing (investments) module;
- factoring module
- operating lease module.

Within each module, the key data elements were:

- Amounts outstanding as of December 31st (stocks)
- New amounts provided during the calendar year being surveyed (flows)

- Loss provisions/write-offs during the calendar year.

It was proposed that the information be provided on the basis of SME size (employees).

The participants were reassured that the information to be collected under this initiative would be aggregated to ensure confidentiality for the individual supply and demand side information providers.

The presentations made at the consultation sessions by Industry Canada and Statistics Canada is presented in Annex B.

As an information item, copies of the demand side survey were distributed. The participants were invited to review the survey and to provide comments in writing.

Responses from Private Sector Stakeholders

The Survey Process

As in the first round, process issues were raised in most of the sessions. The comments centered on the burden of providing information in the detail requested and how often information would need to be provided (reporting cycle).

- ***Identification of Suppliers***

The main suppliers of financing were readily identified by the organizations consulted (ie. Banks, credit unions, major leasing firms, institutional, venture capital investors and discounters; government programs). Existing data banks in Statistics Canada will be used to identify specific firms not members of the groups consulted. However, sources such as angel financing, supplier financing, specialized discounters and venture capital firms may be more difficult to identify.

Clarification was requested on whether financing provided by Canadian suppliers to SME firms/locations outside of Canada should be included.

It was generally agreed that the firms identified provided a good representative sample of suppliers.

- ***Phase in Period***

Comments were made on the fact that not all data points requested are currently being collected by the firms. Significant changes would need to be made to the data systems and the forms used to capture information. The burden of collecting and reporting SME

employee size, postal code, and industrial classification (NAICS/SIC) information was considered by some as considerable. The larger firms with more complex data capture systems reported that the costs to adapt their systems would be significant.

However, several providers indicated that their systems were being updated and the added changes could be easily incorporated. Also, with the growing use of credit scoring models, some suppliers of financing are already starting to update information on clients annually.

The majority of those consulted, believed the required data could be on line before the end of the five year implementation period. Specific phase in schedules for specific supplier groups need to be developed.

- **Reporting Schedule/Timing**

Year End- As many information providers do not have a year end at December 31st, adjustments will need to be made to their systems. As many firms would like to have the figures audited, there was general consensus that the reporting of calendar year end results could not occur before the end of February of the following year. *Many firms favoured the March-April time frame for transferring year end data*

Quarterly Updates- It was suggested that by reporting certain information elements (e.g. amounts outstanding) on a quarterly or semi-annual basis, a measure of new financing and seasonality could be captured. *The feasibility of quarterly reporting would be examined.*

Most participants favoured the transmission of data electronically.

Publishing findings- There was general consensus that the delay in publishing of the results should be as short as possible, as the relevance of data in a volatile economic environment diminishes rapidly. *Publishing of results within 6 to 10 months from year end was encouraged.*

Specific Comments- Where RRSP's provide a significant source of funding (venture capital, institutional investors, etc.), significant capital is raised in the first two months of the following year. The suggestion was made that capital raised in the first two months should be considered in the year end figures. *The possibility of such adjustments to year end would need to be assessed.*

Some suppliers such as co-operatives, leasing companies also report to provincial authorities. It was suggested provincial agencies should be consulted as they may be a useful source for the information.

- ***Survey Frequency for Smaller Suppliers of Financing***

Smaller financing providers may find the burden of providing information on an annual basis significant. The feasibility of stratifying the sample to permit longer cycles for small firms would be investigated. *The issue of a minimum eligible firm size that would be surveyed will be reviewed.*

Data Issues

Significant discussion centered on the specifics of the data points to be provided. Comments were made on a wide range of issues including reliability, accounting practices, definitions etc. A data requirements handbook with definitions was suggested as a useful tool for supply side data providers.

The issues raised have been grouped to assist in the analysis of the results.

- ***Contextual Issues***

Loss Provisions- Tax rules and accounting practices can lead to variations in reporting this data. For example, general provisions for losses can vary, depending on instruments and accounting practices used. There was a general concensus that actual losses tend to be more specific and may be a better measure for some types of suppliers. The reporting of loss provisions, write offs, debt losses is under discussion with the Department of Finance and the outcome of those discussions may have a bearing on what is provided for the survey.

Alternative Financing Options- There are many sources of SME financing that may be difficult to capture. For example, there are firms that are increasingly active in providing advances to permit acquisition of equipment and materials.(Fertilizer companies and equipment suppliers providing crop advances to finance equipment purchases is an example.) Such advances are frequently recorded as outstanding liabilities. Some firms may invest in research and take equity positions (phased equity financing). Trading in environmental credits were indicated to be a form of financing.

Calculation of Fees- Cost of financing includes many components that need to be captured to ensure comparability among the wide variety of instruments available. It was suggested that interest rates should be measured relative to prime rates. Reported interest rates may or may not include fees which, in some cases can be significant part of the cost (e.g. application and processing fees). The Size of collateral required can vary and is a hidden fee. It was suggested that hold backs, where used, should be considered as a type of fee.

- ***SME Definition***

Employment as a Measure of Size- Discussion centered on the availability and relevance of employee based information. Many suppliers do not capture employee information in a systematic way. Often it is only captured only at the time of application or refinancing and this will not capture the seasonality of many SME business cycles.

Suggested proxies for employment measures include authorization levels, revenues, and asset size. Most financing institutions have this data. (One organization offered to provide correlations relating these measures to the number of employees in support of using proxies.) A proxy measure suggested is 3 employees per \$1 million in sales.

With "new economy" firms, employee numbers are considered less relevant as many employ contract employees and/or outsource work. There is a growing number of firms that have no (or very few) employees such as consulting firms and this phenomenon needs to be captured.

- ***Geographic Information (Postal Codes)***

Not all suppliers collect client postal code information in a systematic way and adjustments would be required. Most firms felt that the limitation to a two digit postal code system would protect the confidentiality of most clients. *The location of the establishment is preferred but, if not available, then the business address would be acceptable. An urban-rural and regional split of information was felt to be useful.*

- ***Industrial Classification (NAICS)***

Not all the organizations collect information on the basis of NAICS. Where an industrial classification is used, SIC or the firm's own system is used. Client firms are frequently asked to self identify. Practically all organizations would have to modify their information base.

Suggestions were made that knowledge based industries (KBI) should be segmented into software, internet and equipment firms as financing demands differ greatly. Reference was made to a US technology-based classification system which is frequently used for these types of industries.

- ***Financing Instrument Definitions***

The definitions used to describe specific instruments vary depending on how they are packaged and marketed. For example, there is a trend with the banks to provide a total credit limit or authorization for a customer account and the instruments used within that

authorization may vary widely depending on client needs and products offered. There is a risk of double counting clients if instruments rather than clients are used as a base.

- ***Debt or Equity Financing***

Whether the financing instrument is to be considered as debt or equity will vary depending on how the total financing deal is structured. The rule of thumb is that if the package is predominantly equity financing, then it would be recorded as equity. It was noted that equity and/or other securities are often used as a collateral for a debt instrument. How letters of credit, supplier guarantees, foreign exchange guarantees, syndicated loans, convertible and blended debt are to be reported was raised as an issue requiring clarification.

- ***Double Counting***

A risk of double counting financing was identified where (re)financing/investment is made to firms that, in turn, lend to others. Institutional financing of firms who provide financing for equipment/vehicle purchases/leases was cited as an example. Also, the same SME may obtain financing from a variety of institutions.

- ***Measuring Amounts Provided (Flows)***

As financing provided can vary during the course of the year, and if only increases are measured, reductions will be masked. Reporting of amounts outstanding (Stocks) at different points in the year would give a more accurate picture and would be easier to provide. "Starting balance" would be better to use instead of "authorizations" as credit authorized does not mean that the amount is disbursed.

- ***Loss provisions***

A suggestion was made to define actual losses as losses plus 'write-offs' less recoveries. This would be a better measure as firms tend to record loss provisions differently depending on the stage of the portfolio (i.e. general provisions, loan specific provisions, and write-offs when uncollectible). In measuring write-offs, a consensus should be developed to determine if market value, book value or residual value of an asset should be used. This is an issue particularly in leasing.

- ***Authorizations***

Suggestion was made that there be a category of \$0-\$5,000 to measure most overdrafts and small lines of credit.

Questionnaire

Revisions to the questionnaire and clarifications on definitions were suggested. The questionnaires for individual groups should be tailored to the type of financing activity they provide. Further, added tables should be provided in the factoring module to provide a distinction between secured and unsecured instruments and to identify losses. Many of those consulted would like to see definitions provided for all the data elements.

Responses from Federal Public Sector Agencies and Programs

The Survey Process

Process comments from the federal agencies and programs centred primarily on adapting and adjusting their existing systems. Several comments were made regarding resource requirements to make this information available. However, most of the agencies and program offices indicated that they could make the system changes necessary to provide the required appropriate data within the transition time frame.

Even though most agencies/programs have a March 31st year end, their systems could be adapted to report the December 31st year end as well as quarterly information. Electronic data transfer is the preferred method by all participants.

It was noted that several provinces and local agencies also provide programs and financing for SMEs and that these will need to be identified as well. The Quebec Farm Credit Bureau was given as an example.

Data Issues

Much of the discussion on data centred on the nature of the programs and services provided and how the instruments could be fitted into the data definitions that are to be used. The provision of a handbook or mapping tool was considered useful for this purpose.

- ***Contextual Issues***

Agencies- Agencies, such as Export Development Corporation (EDC), Canadian Commercial Corporation (CCC), Business Development Canada (BDC) and the Farm Credit Corporation (FCC), view themselves as enablers as well as suppliers of financing to SMEs. This is achieved by providing such instruments as guarantees, bonding, and insurance. It was suggested that it would be more accurate to have private sector suppliers indicating the amounts financed to SMEs that have government support, by agency or program.

There are exceptions such as where agencies provide financing to SMEs on foreign receivables (accelerated payment plans) when foreign sovereign guarantees are involved.

All agencies report to the government on their financial results and the definitions used in those annual reports may be different than those being proposed for this survey. Reporting for this project, before the financial reports are formally made public, is an issue that the agencies plan to address.

Programs- Government programs for SME's typically provide support through non-repayable and repayable contributions. However, there is some limited grant programming for designated purposes. Typical financing is less than \$60,000 but it can be as high as \$500,000.

- ***SME Definition***

Not everyone collects information on SMEs on the basis of employment size and adjustments would have to be made. The question of including non-profit organizations and sole proprietorship/professionals in the definition of firms to be surveyed was raised as was the treatment of strategic alliances (public-private partnerships).

- ***Geographic Information (Postal Codes)***

Postal codes are not stored systematically by all those consulted and system adjustments would be required. Several felt that in addition to urban-rural stratification, there is a need to separate out major metropolitan areas to capture "hot" regions. Three digit instead of two digit information would permit better targeting of programs. The use of establishment locations was recommended. Corporate addresses should be used only as a fall-back.

- ***Industrial Classification (NAICS)***

Most of those consulted currently use SIC codes and have not yet converted to NAICS but conversion can be undertaken within the time frame. With reference to definitions, it was recommended that fishing, hunting and forestry should be identified separately.

- ***Financing Instrument Definitions***

Debt or Equity Financing- Repayable contributions should be considered as debt and non-repayable contributions should be considered as an equity. The participants sought clarification on how government guarantees would be measured in a total blended financing package for an SME.

- ***Double Counting***

As many of the government finance support products and programs are to facilitate SME financing through commercial suppliers (eg. banks), care needs to be taken that the private sector suppliers report financing that is government supported. The same financing may also be reported by government programs and agencies.

- *Measuring Amounts Provided*

Most of the organizations noted there is a difference between authorizations and the amount actually provided; accounts receivable and amounts outstanding. The definitions need to be clear as to what is to be reported.

- *Loss Provisions*

It was noted that there are general and specific loss provisions. However, it was reported that actual losses on the basis of SME size can be provided. As with commercial lenders, clarification is needed if book value or market value is to be used.

Questionnaire

Given the unique nature of the products provided, it was felt that a separate questionnaire for government programs and agencies would be desirable to ensure the appropriate data is captured.

Annex A: List of Participants in Second Round of Consultations

Acorn Partners

Peter Kemball, President

Alliance of Manufacturers & Exporters Canada

Jayson Myers, Senior Vice-President and Chief Economist

Canadian Advanced Technology Association

David Paterson, Executive Director, Ottawa

Canadian Chamber of Commerce

Paul Lalonde, Policy Analyst

Canadian Bankers Association

Caroline Hubberstey, Advisor, Small Business, CBA
Caroline Donkin, Director, Research and Data Services, CBA
Anne Koski, Royal Bank of Canada
Andy Ott, CIBC
Brian Mulvagh, CIBC
Mark Jordan, Bank of Nova Scotia (?)
Ron Kester, Bank of Nova Scotia
Lori Dicks, Toronto Dominion Bank
Doug Irvine, Toronto Dominion Bank
Karen Sherwood, Toronto Dominion Bank

Canadian Federation of Independent Business

Ted Mallet, Director of Research
Brian Grey
Doug Bruce, Senior Economist Hopkirk, ABF Capital Corporation

Canadian Finance & Leasing Association,

David Powell, President, CFLA
Tom Hopkirk, ABF Capital Corporation
Robert McAllister, CAPMOR Leasing
Laks Swaminathan, Charter Financial
Ross McEachem, Daimler Chrysler Financial
Peter Andrew/Wende Rapson, GMAC
Michael Wong, HP Technology Finance
Dorothy Ward, IBM Global Financing - Canada
Dara Coulter, MTC Leasing

Grace Lam, Volvo Commercial Finance
Maia MacNiven, Thompson, Gow & Associates

Canadian Venture Capital Association

Ron Begg, President
Mary Macdonald, President, Mary Macdonald & Associates Ltd.

Confédération des caisses populaires et d'économie Desjardins du Québec

Jean-François Smith, Conseiller en crédit normatif, Division Gestion du risque de crédit;
Serge Gagné
Mario Couture
Danny Bélanger

Credit Union Central of Canada

Robert Martin, Policy Advisor, Government Affairs,
Howard Bogach, Chief Executive Officer, Metro Credit Union

CS Co-op

Michel Cousineau, Director, Commercial Services
Brian Lawson, Relationship Manager, Commercial Services

Fédération des caisses populaires de l'Ontario

France Naud, Conseillère en Gestion et développement du crédit,

Information Technology Association of Canada

David Betts, Vice President, Programs

Investment Funds Institute of Canada

Hon. Thomas A. Hockin, President & CEO

Montcap Financial Corporation

Matthew Levinson, Vice President
Cynthia Aboud, Regional Vice President

Pension Investment Association of Canada

Keith A. Douglas, General Manager

TCE Capital Corporation

Tom Haw, Business Development Manager

VanCity Capital Corporation

Axel Christiansen, Investment Manager,

Vancouver City Savings Credit Union

Kevin Zakus, Manager, Business Services
Felicity Clark, Risk Manager, Business Services

Government Agencies

Business Development Bank of Canada

Michel Bergeron, Director, Corporate Planning,
Susan Hughes, Planning Officer

Canadian Commercial Corporation

Paul Thoppil, Chief Financial Officer

Export Development Corporation

Jean-Louis Renaud, Policy Officer, Government Relations

Farm Credit Corporation

Jacques Lagacé, National Director, Government Liaison,
Rebecca Clark
Lance Groff

Government Programs

Agriculture and Agri-Food Canada

Dave Culver, Chief, Farm Data Analysis

Aboriginal Business Canada

Katherine Spero, Project Officer, Program Services

Atlantic Canada Opportunities Agency

David Carpenter, Senior Economic Policy Analyst

Canada Economic Development

Raymond Auger, Senior Advisor, Policy and Advocacy, (Quebec Regions)

Small Business Loans Administration

Misa Palacek, Manager, Program Policy

Western Economic Diversification Canada

Shannon Rogalski,

Annex B:
Presentation to Participants List of Participants

[Slide decks to be attached by Industry Canada and Statistics Canada]

