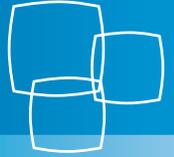




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# COMPREHENSIVE REVIEW REPORT

2009–2014

*Canada Small Business Financing Act*



This publication provides a review of the operations of the Canada Small Business Financing Program from April 1, 2009, to March 31, 2014.

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# 1. PREFACE



The Canada Small Business Financing Program (CSBFP) is a statutory loan loss-sharing program that is governed by the *Canada Small Business Financing Act* (CSBFA) and administered by Industry Canada. As legislated by the CSBFA, the Program operates on a statutory five-year review cycle. This report covers the third such review period, from April 1, 2009, to March 31, 2014.

The overall purpose of the current review is to examine how successful the CSBFP has been during the past five years of operation in facilitating small businesses' access to financing. Specifically, the review considers the degree to which the program has achieved its objectives of:

- helping new businesses get started and established firms make improvements and expand;
- improving access to loans that would not otherwise be available to small businesses; and
- stimulating economic growth and creating jobs for Canadians.

A significant number of background studies were prepared in support of the review including an independent program evaluation conducted by Industry Canada's Audit and Evaluation Branch. All sources used in this report are listed in the bibliography.

## 2. EXECUTIVE SUMMARY

### Program Rationale

- The CSBFP remains an important, efficient and effective program in helping small businesses access financing, in particular, smaller, younger and higher risk businesses, which might otherwise be denied.
- The CSBFP is unique in that it is the only national financing program that is accessible through a wide network of financial institutions to almost all small businesses across Canada.

### Program Activity and Benefits

- During the review period, the CSBFP registered nearly 34,000 loans with a value of \$4.7 billion. However, usage has declined from over 48,000 loans worth more than \$5 billion during the previous five-year review period.
- Loans made under the CSBFP are highly incremental with approximately 58 percent of loans (by value) going to start-up firms less than one year old. In addition, about 75 percent of all CSBFP loans would not have been made at all or would only have been made with less favourable conditions.
- The CSBFP also helped create jobs with borrowers estimated to have hired 9,700 employees for each year of lending from 2009–14. In addition, because of spillover effects, an estimated 6,600 indirect jobs are also created each year as a result of CSBFP loans.<sup>1</sup>
- A cost-benefit analysis of the program found that net benefits far outweigh net costs. From 2003–04 to 2011–12, net benefits exceeded net costs by \$4.5 billion. As such, the benefit-cost ratio is 5:1, so for every dollar the program costs, five dollars in benefits are generated in the Canadian economy.<sup>2</sup>

### Revenues and Expenses

- During the 2009–14 period, 6,535 claims for loss, worth \$361 million, were paid<sup>3</sup> while \$258 million in fees were collected on all new and outstanding CSBFP loans.
- As of March 31, 2014, the net cost to government of CSBFP loans made from 2009–14 is estimated to be \$55.3 million on a net present value basis over the maximum ten-year life of the loans. As a percentage of total lending, this represents a decrease in net costs from 2.8 percent to 1.2 percent, when compared to the previous review period.

1 Industry Canada. *Cost-Benefit Analysis of the Canada Small Business Financing Program*, 2014.

2 Industry Canada. *Cost-Benefit Analysis of the Canada Small Business Financing Program*, 2014.

3 These claim payments reflect losses that were incurred during the review period on defaulted loans made since 1999.



## Program Design

- The CSBFP's legislative and regulatory framework provides a stable foundation for delivery; however, certain aspects of its structure create administrative burden, which diminishes the program's use by lenders.<sup>4</sup>
- In April 2014, Industry Canada implemented regulatory changes geared toward improving uptake of the program by private sector lenders that offer the program to small businesses. It is too soon to assess the impact of these regulatory changes.
- While stakeholders are generally satisfied with program parameters, lower levels of satisfaction were expressed towards certain parameters of the program, such as the \$500,000 cap on lending for real property and the \$5 million revenue cap for eligibility to receive a loan through the program.
- Small businesses have an unmet need for flexible cash flow financing, which is not addressed by the asset-based term loan design of the CSBFP.

## Program Administration

- CSBFP awareness remains low among small businesses. However, there is evidence that suggests relationship-building efforts with small business support organizations are having an impact and that there may be additional opportunities to improve small businesses' knowledge and awareness of the program.<sup>5</sup>
- Loan officers in financial institutions are aware of the CSBFP (98 percent). Since 2009, 71 percent of small business loan officers have made at least one CSBFP loan.<sup>6</sup>
- A new online loan registration system was launched during the review period and has been successful in reducing administrative burden for lenders. In the last year of the review period, 2013–14, 65 percent of CSBFP loans were registered online.

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4 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.

5 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.

6 R.A. Malatest & Associates Ltd. *Canada Small Business Financing Program (CSBFP) Lender Awareness and Satisfaction Study*, 2014.

### 3. OVERVIEW OF THE CSBFP AND FINANCING CHALLENGES FOR SMALL BUSINESSES

The CSBFP aims “to increase the availability of financing for the establishment, expansion, modernization and improvement of small businesses.”<sup>7</sup> It replaces the former Small Business Loans Program (1961) and came into effect for loans made after March 31, 1999.

The CSBFP is a loan loss-sharing program that helps Canadian small businesses obtain access to financing. Under the CSBFP, Industry Canada and commercial lenders share the risk of providing small businesses with term loans for real property, equipment or leasehold improvements. In the event that a registered loan defaults, the federal government pays 85 percent of the net eligible loss. The extent of this liability to each lender is capped by a ceiling (maximum liability) based on a percentage of the total value of all loans registered by each lender within each five-year lending period. By sharing the burden of risk on loans, Industry Canada is able to increase the amount of financing extended to small businesses. The CSBFP is a national program that operates in all provinces and territories. To be eligible, borrowers must be for-profit businesses with revenues under \$5 million per year. The basic parameters of the program are detailed in Appendix A.

The role of Industry Canada is to register loans, collect fees and pay lenders eligible losses on defaulted loans. It does not approve the individual loan applications and is not involved in the administration of the loans.

The role of lenders (chartered banks, credit unions and caisses populaires) is to provide CSBFP financing to small businesses in all provinces and territories. They are responsible for all credit decisions, approving the loans, disbursing the loan proceeds, submitting loans for registration with the CSBFP, administering the loans and, in the event of default, realizing on the security and the guarantees. Each lender has its own lending criteria subject to the requirements of the CSBFP. Once the loan is approved, the borrower receives funds from the lender, not the government.

#### 3.1 Small Business and the Financial Marketplace

Small businesses account for the majority of enterprises in Canada and drive job creation, productivity and growth in the economy. As of July 2014, there were over 1.2 million employer establishments<sup>8</sup> in Canada, 98.1 percent of which were small (had fewer than 100 employees). These small businesses employed more than 10.5 million people, or roughly 68 percent of the private sector labour force.<sup>9</sup> Small businesses are also key drivers of job creation, accounting for 77.7 percent of all private jobs created from 2002 to 2012. In total, small businesses created a little over 100,000 jobs each year on average over that period.<sup>10</sup>

Small businesses must have adequate access to capital to start up and grow. Figure 1 reveals that in 2011, start-ups generally used personal savings and investment by friends and family, with 41 percent seeking debt financing from financial institutions.<sup>11</sup>

7 *Canada Small Business Financing Act.*

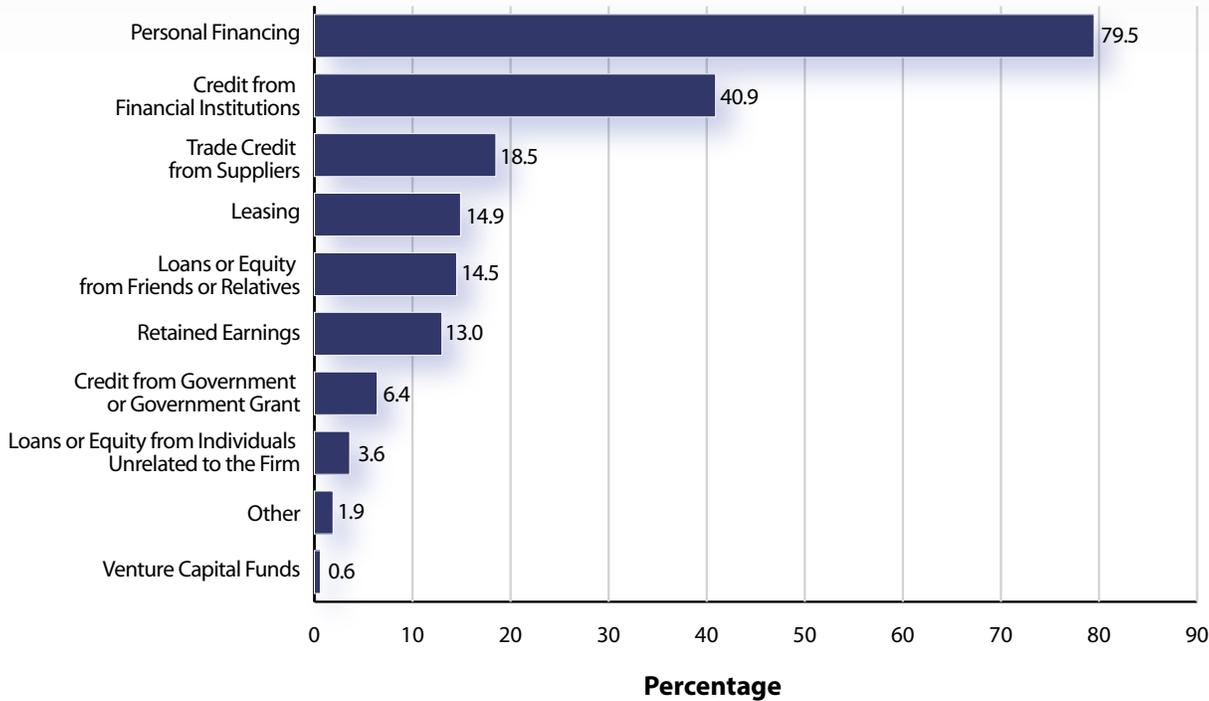
8 Employer establishments are those businesses that maintain a payroll of at least one person.

9 Statistics Canada. *CANSIM Table 282-00753. Labour force survey estimates (LFS)*, 2014.

10 Industry Canada. *Key Small Business Statistics*, 2013.

11 Statistics Canada. *Survey on Financing and Growth of Small and Medium Enterprises*, 2011.

**FIGURE 1**                      **Types of Financial Instruments Used by Start-ups (2011)**



In 2011, 36 percent of all small and medium-sized enterprises (SMEs) reported seeking some type of external financing, with debt being the most common form sought. Table 1 shows that the vast majority of SMEs meet their financing needs through market transactions without any government involvement and that debt financing is the most common form of external financing sought.

**Table 1: SME Financing Request and Approval Rates, 2011<sup>12</sup>**

Type of Financing Requested	Request Rate (percent)	Approval Rate (percent)
Debt Financing	25.5	89.9
Equity Financing	2.3	75.5
Lease Financing	6.9	97.4
Trade Credit	8.1	98.5
Government Financing	3.7	83.8

<sup>12</sup> Industry Canada. *Summary of the Survey on Financing and Growth of Small and Medium Enterprises, 2011, 2013.*



SMEs intended to use debt financing primarily for working capital (51.3 percent), for machinery or equipment (25.8 percent) and for vehicles (19.1 percent). Other intended uses included purchasing land/buildings (17.4 percent) and computer hardware/software (10.9 percent). To a lesser degree, SMEs intended to use debt financing to fund debt consolidation (7.6 percent) and research and development (4.9 percent).

## 3.2 Current Environment and Financing Challenges

In the fourth quarter of 2008, Canada entered a recession, which was characterized by the loss of over 400,000 jobs and negative growth in gross domestic product.<sup>13</sup> During this period, small businesses' demand for and access to debt financing plummeted. In 2009, small businesses' request rate for financing dropped to 14 percent with an approval rate of 79 percent.<sup>14</sup>

Since the economic downturn, financial markets have stabilized and financial institutions have disbursed more financing to small businesses, with term loan disbursements to small businesses<sup>15</sup> increasing from \$20.2 billion in 2011 to \$22.8 billion in 2013.<sup>16</sup> Request rates for financing have also increased, and access to financing seems to have stabilized at pre-recession levels.

Nevertheless, some types of small businesses face difficulties accessing financing, even in times of economic growth. In particular, start-ups, smaller businesses, majority female-owned firms and businesses in the accommodation and food services, knowledge-based and professional, scientific and technical services sectors have more difficulty in obtaining debt financing.<sup>17</sup>

Feedback from small businesses indicated that they experience particularly acute challenges accessing financing during start-up and growth phases and that their need is primarily for flexible working capital financing.

Possible reasons why some firms face greater challenges accessing financing could include more volatile sales and earnings, higher loan default rates, fewer assets to pledge as collateral and shorter credit histories. In addition, an imbalance of information and lack of understanding about a small business' operations can make it more difficult for lenders to assess the financial and operational risk of the businesses and monitor their activities once funds have been supplied.<sup>18</sup>

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13 Statistics Canada. *Canada's Employment Downturn, Perspectives on Labour and Income*, Vol. 10, No. 12, 2009.

14 Industry Canada. *Credit Conditions Survey*, 2009.

15 Small business loans are defined as those with loan authorization levels below \$1 million.

16 Statistics Canada. *CANSIM Table 190-0001*, 2014.

17 Industry Canada. *Financing Statistics—Special Edition: Key Small Business Statistics*, November 2013.

18 Industry Canada. *Small Business Access to Financing: Request and Approval Rates, Interest Rates and Collateral Requirements (2000–10)*, 2013.

## 4. CHANGES TO THE CANADA SMALL BUSINESS FINANCING ACT

### 4.1 April 2009 Amendments

In the context of *Budget 2009: Canada's Economic Action Plan*, the following changes were made to the CSBFP and coincided with the beginning of the review period:

- The eligible loan amount was increased from \$250,000 to \$500,000 (of which no more than \$350,000 can be used for purposes other than the purchase of real property);
- Financial institutions are allowed to claim reimbursement on losses of up to 12 percent of the value of their portfolio above \$500,000, up from 10 percent; and
- Minor technical amendments aimed at easing the administrative burden of the program were implemented (e.g., clarifying the definition of “related borrower”).

### 4.2 April 2014 Amendments

In response to stakeholder concerns raised in the *CSBFA Comprehensive Review Report: 2004–2009*, a package of regulatory amendments was developed in collaboration with program stakeholders during the review period and implemented on April 1, 2014.

These changes sought to help reduce red tape, deter fraud and increase the amount of financing available to small businesses.

Key changes included:

- allowing lenders to charge conventional lending fees;
- reducing the amount of proof of purchase documentation required to be submitted during claims procedures;
- deregulating the maximum financing percentage;
- allowing an unsecured personal guarantee to be taken for the full amount of the loan; and
- enabling lenders to have claims paid in situations where the lender has conducted a site visit of the borrower's premises, but security is not valid and enforceable.

Program officials will monitor the impact of these changes as time progresses.

# 5. PERFORMANCE REVIEW

## 5.1 Approach

A number of research studies and ongoing internal analyses were carried out to inform the review of the CSBFP. They can be grouped into the following categories:

- *Program evaluation:* An independent program evaluation was conducted by Industry Canada's Audit and Evaluation Branch, based on a performance measurement strategy that the Treasury Board of Canada Secretariat recommends be used for assessing major policies, programs and initiatives.
- *Economic impact and benefit:* Studies were undertaken on the program's incrementality, longitudinal economic impact and cost-benefit.
- *Default risk and cost recovery forecasts:* Borrowing, defaults and claims experiences of CSBFP borrowers were examined. Cost recovery forecasts based on various statistical models were carried out and subsequently updated with the latest information. A risk and revenue analysis of the portfolio's changing characteristics was also conducted.
- *Stakeholder discussions and surveys:* Awareness and satisfaction surveys of lenders, small businesses and CSBFP borrowers were conducted. Interviews with Industry Canada officials, financial institutions, small business associations and academic experts were conducted as part of the program's evaluation. In addition, Industry Canada held roundtable discussions with small businesses across Canada on financing in the fall of 2014.

## 5.2 Program Activity

The CSBFP has successfully helped many new businesses get started and established firms make improvements and expand. Between 2009–14, the CSBFP registered about 33,950 loans to small businesses worth nearly \$4.7 billion. The average loan size during this period was \$138,400.

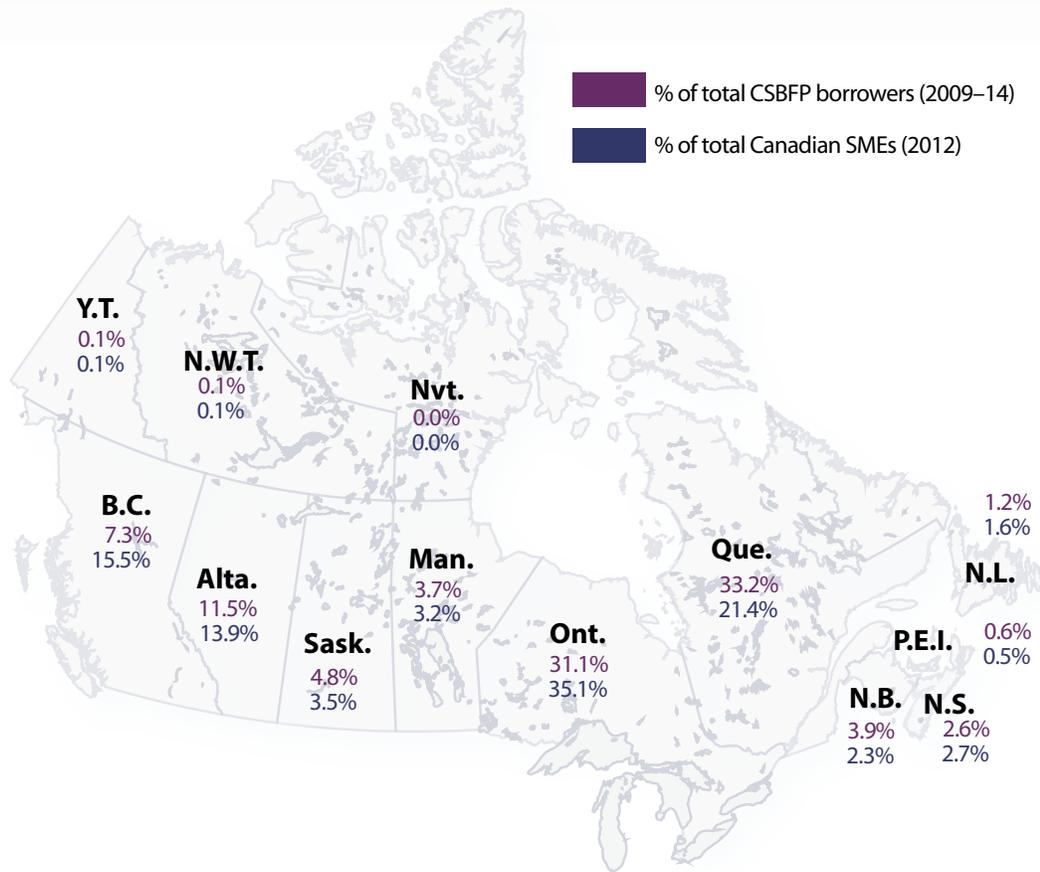
Start-up firms less than one year old accounted for 52 percent of the five-year total number of CSBFP loans and 58 percent of their value.

From 2009–14, 58 percent of the total value of CSBFP loans were made to small businesses in four sectors: accommodation and food services (31 percent), retail trade (15 percent), transportation and warehousing (7 percent) and manufacturing (5 percent).

The program facilitated financing of small businesses in all provinces and territories. Figure 2 compares the population of CSBFP borrowers (2009–14) to the overall population of SMEs (in 2012). It shows that in most regions the share of borrowers roughly equalled the share of SMEs located in that region. However in some provinces (e.g., Quebec, Saskatchewan and New Brunswick), the share of CSBFP borrowers exceeded the region's share of SMEs and vice versa (e.g., British Columbia, Alberta and Ontario).



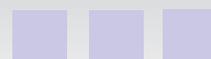
**FIGURE 2** Percentage Distribution of CSBFP Borrowers (2009–14) vs. Canadian SME Population by Region (2012)



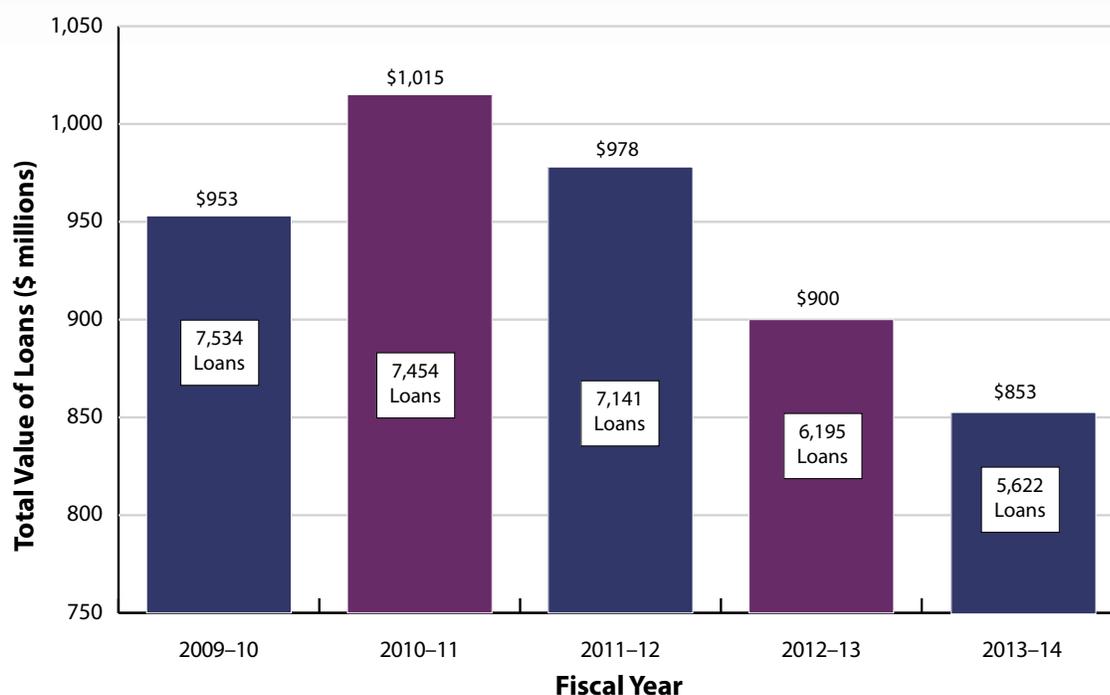
The CSBFP is demand-driven and does not target any particular region or sector. As such, these regional variations in program uptake reflect the choices made by lenders and borrowers.

The overall downward trend in the program's use, highlighted in the *CSBFA Comprehensive Review Report: 2004–2009*, continued throughout the 2009–14 period. The number of loans declined from 7,534 in 2009–10 to 5,622 loans in 2013–14. As a result of the increase in the maximum loan amount introduced in 2009, the average annual loan size increased, from \$126,500 in 2009–10 to \$151,700 in 2013–14. Given the trend of fewer but larger loans being made, the total value of loans made over the period increased slightly before decreasing to \$853 million in 2013–14, as shown in Figure 3.

During the 2004–09 review, lenders identified that administrative burden and a number of irritants were limiting their use of the program. As discussed in section 4, changes intended to address these issues were developed over the review period and were implemented on April 1, 2014. Time will be needed to determine if these changes will help reverse the declining usage of the program.



**FIGURE 3**                      **Number and Value of CSBFP Loans, 2009–14**



During the current review period, interviews with lenders identified additional possible reasons for the continued decline in lending volumes. For instance, lenders may have reined in the extent that they use the CSBFP to lend to higher-risk small businesses. This could be due to the fact that following the financial crisis, a number of lenders reached the maximum liability limit under the CSBFP for which Industry Canada could pay claims for loss. To prevent this situation from occurring again, Industry Canada increased the maximum liability limit for all loans made since 2009. Nevertheless, it appears that some lenders have since modified their use of the program when lending to higher-risk small businesses.

It is also important to note that this analysis is for program use overall. At the institutional level, a number of lenders have held steady in their use of the program over time, while others have dropped substantially. Interviews indicated that this is linked in part to the issues already mentioned as well as general banking policies. Some institutions view the program as an opportunity to invest in a longer-term relationship with a client, while others do not use the program because of the lack of profitability and the high risks associated with lending to certain types of businesses.<sup>19</sup>

Appendix B provides more information on program activity.

19 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.



## 5.3 Incrementality

The CSBFP strives to increase the availability of financing for small businesses by extending financing that would not otherwise be available to them (full incrementality) or would only be available under less favourable terms such as additional collateral requirements, lower amounts, more borrower equity, higher interest rates and shorter loan terms (partial incrementality).

In general, the level of incrementality is tied to the risk level of loans made under the CSBFP. The riskier the loans, the higher the level of incrementality (it is more likely that they would not be made in the absence of the program).

During the review period, the fact that CSBFP loans are highly incremental was reflected in interviews with both small business associations and lenders, who stressed that a subset of their small business clients would not be able to obtain any degree of financing without the program. This notion was also reiterated by small businesses that had used the CSBFP during roundtable discussions.

The heavy use of the program by start-ups is another indicator that CSBFP loans are highly incremental, given their high risk and the greater difficulties they experience accessing financing discussed in section 3.

In 2004, it was estimated that 75 percent of CSBFP loans were incremental in some way. In 2009, it was estimated that between 80 percent and 85 percent of CSBFP loans were fully or partially incremental.<sup>20</sup> During the current review period, about 67 percent of CSBFP loans are estimated to be fully incremental<sup>21</sup> and 75 percent of CSBFP loans are estimated to be financially incremental in some way (partially and fully incremental).<sup>22</sup>

The decrease in the incrementality level of CSBFP loans from the previous review period can be attributed to a decrease in the risk level of CSBFP loans made during the current review period.

## 5.4 Economic Benefits

Throughout the review period, the CSBFP has helped create jobs for Canadians and stimulated economic growth both for small business participants and throughout the Canadian economy.

The CSBFP continues to have a positive impact on the growth of program participants. In fact, the program was responsible for increasing revenues of CSBFP participants by 12 percent, salaries by 6 percent, profit by 14 percent and value-added by 15 percent. Despite the 2008–09 economic downturn, CSBFP participants were found to be consistently better off than those financed by other sources or not financed at all.<sup>23</sup>

The positive impact of the CSBFP on the growth and performance of small businesses that obtained loans through the program is confirmed in a 2012 survey of CSBFP borrowers. The vast majority of CSBFP borrowers indicated that the CSBFP loan they received had a positive impact on their ability to grow (81 percent), their ability to stay in business (71 percent), their profits/sales (69 percent), their employment levels (69 percent) and their productivity/efficiency (67 percent).<sup>24</sup>

20 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.

21 Industry Canada. *Requantifying the Rate of Incrementality for the Canada Small Business Financing Program*, 2015.

22 R.A. Malatest & Associates Ltd. *Canada Small Business Financing Program (CSBFP) Lender Awareness and Satisfaction Study*, 2014.

23 Industry Canada. *Canada Small Business Financing Program: Updated and Extended Economic Impact Analysis*, 2014.

24 R.A. Malatest & Associates Ltd. *Canada Small Business Financing Program (CSBFP) Awareness and Satisfaction Study*, 2013.



The CSBFP also helped borrowers create jobs. As part of the loan registration process, CSBFP borrowers are asked to report the number of employees they expect to hire as a direct result of the loan. Previous research has shown that actual job creation is about half of borrowers' estimates.<sup>25</sup> Given this, it is estimated that for each year of lending during the review period, CSBFP borrowers hired an average of 9,700 employees as a result of obtaining a CSBFP loan.

In addition to the benefits of the CSBFP on participant firms, job creation and other economic benefits were felt throughout the economy due to the spillover effects of the additional demand created by CSBFP borrowers.

CSBFP borrowers place additional requests for goods from their suppliers and, in turn, their suppliers increase employment to support the higher production and sales. As such, an estimated 6,600 jobs per year were indirectly created in the economy due to CSBFP borrower demand during the review period.<sup>26</sup>

In addition, the direct gross domestic product (GDP) impact of expenditures by CSBFP borrowers on machinery and equipment, real property and leasehold improvements averages about \$320 million per year.

Expenditures made by suppliers also generate indirect GDP impacts for the Canadian economy through salaries, wages, benefits and company profits. Indirect GDP impacts resulting from CSBFP-backed loan expenditures averaged about \$215 million per year.

The overall benefits generated to the Canadian economy by the program far outweigh its costs. A cost-benefit analysis shows that from 2003–04 to 2011–12, the total net present value of costs of the program was \$1.1 billion, whereas the total net present value of benefits of the program was \$5.6 billion, resulting in total net benefits of \$4.5 billion. This translates into a benefit-cost ratio of 5:1. For every dollar the program costs, five dollars in benefits are generated in the Canadian economy.<sup>27</sup>

## 5.5 Revenues and Expenses

Under the CSBFP, Industry Canada pays claims for eligible losses on defaulted loans. Industry Canada also collects revenues from a 2-percent registration fee and a 1.25-percent administration fee paid on all loans. These fees are submitted to Industry Canada by lenders and used to offset a portion of the program's expenses related to claim payments. As the CSBFP is a statutory program, all fee revenues and claims for loss flow directly in and out of the Consolidated Revenue Fund.

### Claim Expenses

From 2009–14, 6,535 claims (valued at \$361 million) were paid to lenders, averaging \$55,256 per claim (see Figure 4). These claim payments reflect losses that were incurred during the review period on defaulted CSBFP loans made since 1999.

As discussed in section 5.2, claim payments decreased throughout the review period primarily because the economic crisis caused a number of lenders to reach their maximum liability limit for claim payments under the CSBFP for loans made during the 2004–09 period. As a result, once total claim payments to a lender reached this cap, Industry Canada could no longer pay any further claims for losses incurred on those loans.

25 Industry Canada. *Cost-Benefit Analysis of the Canada Small Business Financing Program*, 2014.

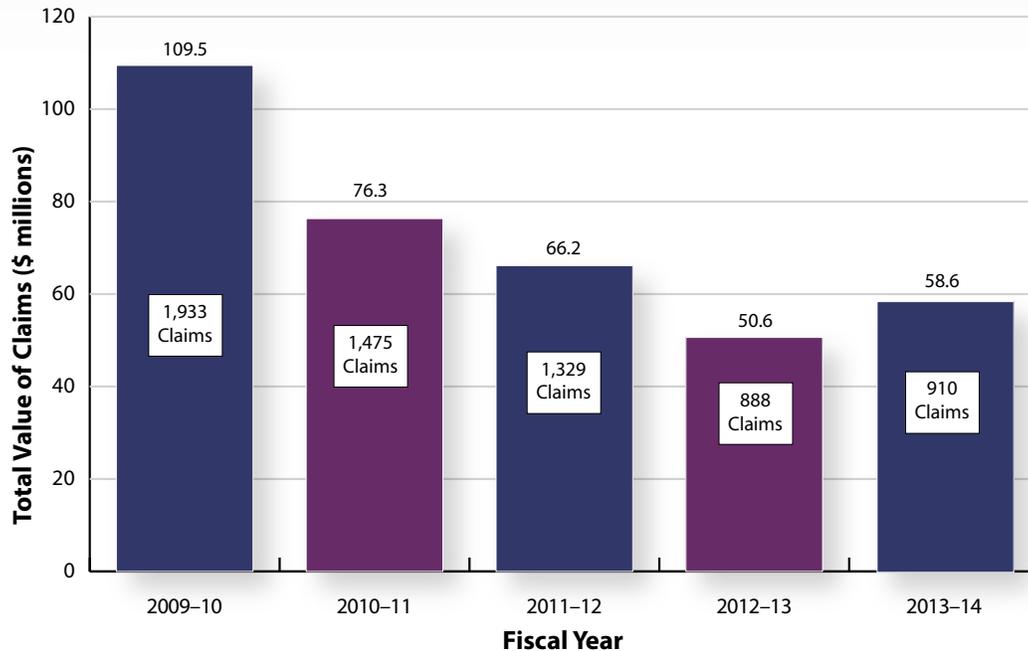
26 Industry Canada. *Cost-Benefit Analysis of the Canada Small Business Financing Program*, 2014.

27 Industry Canada. *Cost-Benefit Analysis of the Canada Small Business Financing Program*, 2014.



**FIGURE 4**

**Number and Value of CSBFP Claims, 2009–14**



## Operating Costs

In addition to paying claims for loss, the program’s operating costs are approximately \$3.2 million annually for a staff of 34. Operating costs include expenses related to research, information technology and stakeholder outreach activities. This is a relatively small sum considering that the program facilitated access to over \$900 million annually in financing for small business over the five-year period.

## Fee Revenues

Over the 2009–14 period, \$258 million in program fees were collected. These fees include registration fees collected on loans made during the review period and annual administration fees collected on all outstanding CSBFP loans made since 1999.

## Cost Recovery

Cost recovery forecasts are regularly updated to predict the extent to which fee revenues will offset the cost of claims for loss under the CSBFP. These forecasts estimate the value of future claims from loan losses over ten years following the year in which loans are made, net of revenues from registration and administration fees paid to the Crown. It was recognized early on by the Auditor General that fees could not fully offset the cost of claims for loss without unduly compromising the objective of the program to facilitate access to financing that would otherwise be unavailable.



As of March 31, 2014, fee revenues are expected to offset 82.0 percent of the cost of claims for loss for CSBFP loans made from 2009–14. On a net present value (NPV) basis, the net cost to the Government of Canada for CSBFP loans made from 2009–14 is estimated to be \$55.3 million. On lending of \$4.7 billion, the expected net cost to the federal government will be 1.2 percent (as a percentage of total lending).

Relative to loans made during the 2004–09 period, for which fees are expected to offset 63.1 percent of the cost of claims for loss, the level of cost recovery has improved. For loans made between 2004–09, it is forecast that NPV costs will total \$141.5 million on lending of \$5.0 billion, for a net cost to the federal government of 2.8 percent (as a percentage of total lending).

While the program is not fully cost-recoverable when looking strictly at revenues from administration and registration fees charged by the program, it is nearly cost-recoverable (97 percent) when additional federal tax remittances from CSBFP borrowers are considered.<sup>28</sup>

A more detailed overview of cost recovery for each lending period of the CSBFP is provided in Appendix C.

## 5.6 Program Design and Administration

### Program Design

In terms of program design, the recent evaluation of the CSBFP found that the program's legislative and regulatory framework provides a stable foundation for delivery; however, its heavy structure creates administrative burden, which limits the extent to which lenders offer the program to small businesses.<sup>29</sup>

Despite the program's structure, most loan officers are satisfied with its policies and procedures (67 percent) and the service provided by Industry Canada (72 percent).<sup>30</sup> As mentioned in section 4.2, in April 2014, Industry Canada implemented regulatory changes geared toward improving uptake of the program by alleviating administrative burden and other irritants that limit lender usage. It is too soon to assess the impact of these regulatory changes.

Generally speaking, borrowers are satisfied with the program and the majority of small businesses (54 percent) and CSBFP borrowers (66 percent) perceive the overall terms and conditions of the program as appropriate.<sup>31</sup> A number of small business roundtable participants who had used the CSBFP indicated that it is a good program to help improve access to asset-based financing.

That said, interviews with lenders and small business associations, as well as roundtable discussions with small businesses, identified that certain parameters of the program, such as the \$500,000 cap on lending for real property and the \$5-million revenue cap for eligibility to receive a loan through the program, may no longer reflect current market conditions and that consideration should be given to modifying these parameters.

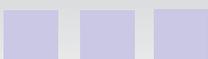
As the economy becomes more service-oriented, although the need for asset-based financing still exists, on the whole the need to purchase and finance hard assets is diminishing. Small businesses in all industries have expressed an unmet need for flexible cash flow financing, which is not addressed by the current asset-based term loan design of the CSBFP.

28 Industry Canada. *Cost-Benefit Analysis of the Canada Small Business Financing Program*, 2014.

29 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.

30 R.A. Malatest & Associates Ltd. *Canada Small Business Financing Program (CSBFP) Lender Awareness and Satisfaction Study*, 2014.

31 R.A. Malatest & Associates Ltd. *Canada Small Business Financing Program (CSBFP) Awareness and Satisfaction Study*, pp. 18–23, 2013.



## Outreach Efforts

Since 2009, Industry Canada has made significant strides to step up outreach efforts with both small business support organizations and lenders. In order to strengthen relationship building, a wide range of outreach activities were conducted throughout Canada to increase knowledge and awareness of the program among small businesses, lenders and business support organizations. In addition, the program's website was also enhanced to provide easier access to the most sought-after information. With over 250,000 visits annually, it is now one of Industry Canada's most visited sites.

Although most loan officers (98 percent) have heard of the CSBFP, loan officer usage of the program varies. Since 2009, 71 percent of small business loan officers have made at least one CSBFP loan. Loan officers at large financial institutions (79 percent) were more likely to have made at least one CSBFP loan than those at small banks (59 percent) and credit unions / caisses populaires (54 percent).<sup>32</sup> As such, outreach efforts have focused on increasing loan officer knowledge and familiarity with offering the program.

CSBFP awareness continues to be very low among small businesses in general (12 percent) and among those small businesses that have obtained CSBFP loans (41 percent). However, there is evidence that suggests the program's outreach efforts are having an impact and that there may be additional opportunities to educate small businesses about the program.<sup>33</sup>

## Information Technology System Improvements

The *1999–2004 Comprehensive Review Report* specifically indicated that Industry Canada should make better use of information technology in the administration of the CSBFP. In 2011–12, a new online loan registration system was launched. At the end of the review period, 65 percent of CSBFP loans were registered online.

Furthermore, during the review period, the CSBFP embarked on a shared system development initiative with the *Canadian Agricultural Loans Act* (CALA) program, a similar program for the farming industry located at Agriculture and Agri-Food Canada. It was recognized that the two programs shared a common business requirement to create an external component that would allow financial institutions to register loans online. Program documentation indicates that "the most cost effective and operationally efficient solution" was to partner. The initiative also aligned with Treasury Board's *Common Service Policy*, which encourages programs to consider developing shared information and support systems solutions when possible.

The new CSBFP/CALA system has resulted in noteworthy development and maintenance cost-savings for both CSBFP and CALA. In interviews, the majority of lenders praised the initiative as both improving their working processes with both departments as well as making efficient use of public funds.<sup>34</sup>

32 R.A. Malatest & Associates Ltd. *Canada Small Business Financing Program (CSBFP) Lender Awareness and Satisfaction Study*, 2014.

33 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.

34 Industry Canada. *Evaluation of the Canada Small Business Financing Program*, 2014.

# CONCLUSIONS AND FUTURE DIRECTIONS

This comprehensive review of the provisions and operations of the CSBFP from 2009–14 has demonstrated that the program continues to be a successful, efficient mechanism for facilitating asset-based debt financing to small businesses, particularly start-ups.

The CSBFP supports billions of dollars in new financing for small businesses, helping them to drive the Canadian economy forward. The economic benefits for Canada generated by the CSBFP, both within small business participants and throughout the Canadian economy, far outweigh the costs associated with it.

## Future Directions

During the course of the review period, both small business and lender stakeholder groups acknowledged that the CSBFP remains an important product to increase the availability of fixed-asset loans to small businesses.

Industry Canada remains committed to maintaining the CSBFP's core strength: the provision of a reliable asset-based financing program on which small businesses have come to rely. Industry Canada recognizes that many small businesses face challenges accessing financing and that there is a need for more flexible cash flow financing. As such, Industry Canada will work with stakeholders to determine the feasibility and whether the CSBFP is the best delivery mechanism to support this type of financing.

As announced by Prime Minister Stephen Harper on January 22, 2015, the Government of Canada will make several improvements to CSBFP parameters, which have been suggested by stakeholders. Namely, the maximum loan amount for real property, the length of government coverage and the revenue eligibility threshold for small businesses will be increased to better reflect current market realities.

Industry Canada officials will pursue its efforts to strengthen relationships with stakeholders; to work with financial institutions in increasing loan officer knowledge of, and familiarity with, the CSBFP; and to raise knowledge and awareness of the program among small business support organizations.

Industry Canada will also continue to assist lenders in taking advantage of the program's online loan registration application to submit loans and registration fees electronically. In addition, program officials will assist lenders in converting all payment processes, including claim payments, to convenient electronic payments, thereby expediting fund transfers and reducing administrative burden and cheque processing fees.

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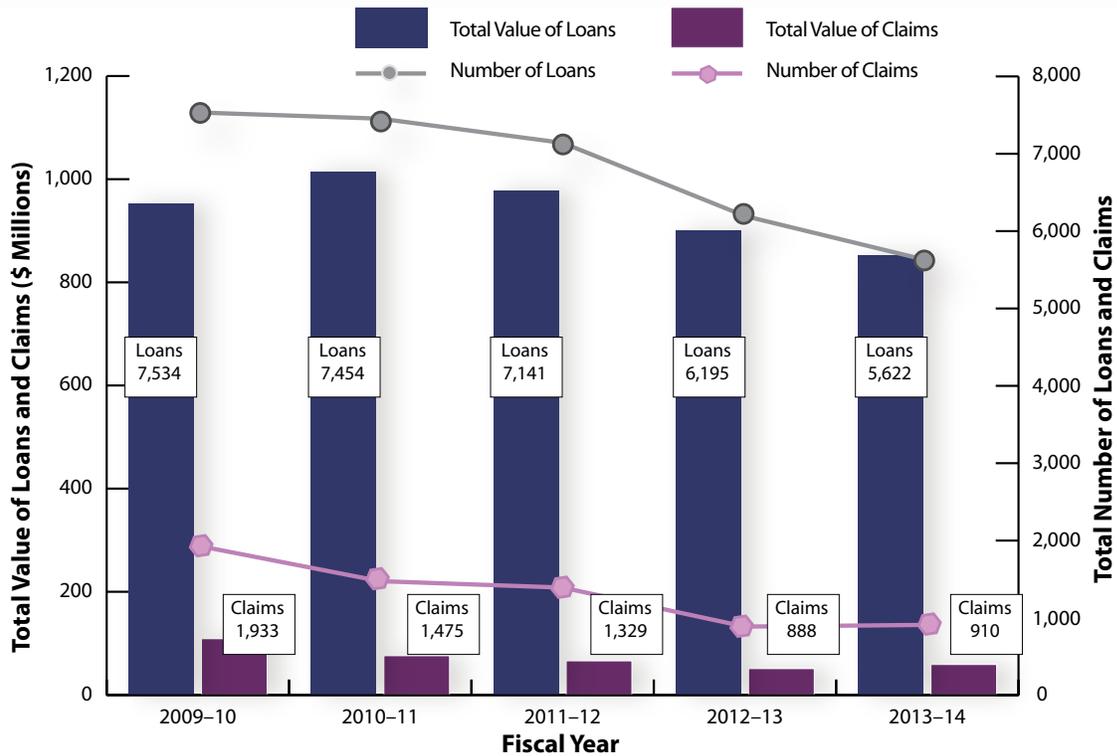
# APPENDIX A: KEY CANADA SMALL BUSINESS FINANCING PROGRAM PARAMETERS

Parameters	Loan requirements
Small business eligibility	<ul style="list-style-type: none"> <li>- Borrowers must have a for-profit business that operates in Canada and has annual gross revenues of \$5 million or less.</li> <li>- Farming businesses and charitable and religious institutions are not eligible.</li> </ul>
Assets financed	<p>Loans are restricted to financing the following:</p> <ul style="list-style-type: none"> <li>• the purchase or improvement of               <ul style="list-style-type: none"> <li>▪ equipment</li> <li>▪ real property or immovables</li> </ul> </li> <li>• leasehold improvements</li> <li>• program registration fees</li> </ul>
Maximum financing amount	A borrower can finance up to \$500,000 (of which a maximum of \$350,000 can be used to finance the purchase or improvement of equipment or make leasehold improvements). These limitations apply to a borrower's total loans outstanding under the CSBFP.
Maximum interest rate	<ul style="list-style-type: none"> <li>- Floating rate: the lender's prime rate plus 3 percent (includes the 1.25-percent administration fee).</li> <li>- Fixed rate: the lender's single-family residential mortgage rate plus 3 percent (includes the 1.25-percent administration fee).</li> </ul>
Length of term	The maximum term for any loan is 10 years from the scheduled date of the first payment of principal and/or interest.
Fees paid by lenders	<ul style="list-style-type: none"> <li>- 2-percent registration fee: This amount is paid at the time of registration and can be included in the CSBFP loan.</li> <li>- 1.25-percent administration fee: An annual fee of 1.25 percent is paid on outstanding loan amounts. This fee can be included as part of the interest rate charged on loans.</li> </ul>
Loss-sharing ratio	Eligible losses on loans are shared as follows: 85 percent government and 15 percent lender.
Cap on claims	<p>For each five-year period (e.g., 2009–14), Industry Canada's obligation to an individual lender is to pay eligible claims (i.e., 85 percent of the eligible losses) on defaulted loans up to a maximum of the aggregate of:</p> <ul style="list-style-type: none"> <li>• 90 percent of the first \$250,000 in loans registered; plus</li> <li>• 50 percent of the next \$250,000; plus</li> <li>• 12 percent of all loans in excess of \$500,000.</li> </ul>

Source: Statistics Canada, *CANSIM Table 551-0006*, 2014; *CANSIM Table 282-00753*, *Labour force survey estimates (LFS)*, 2014.

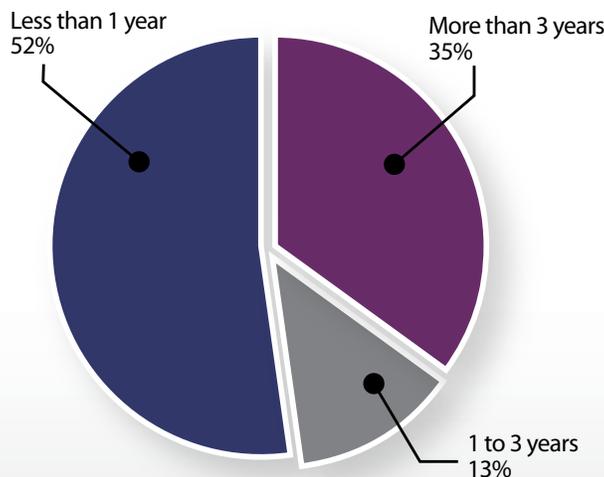
# APPENDIX B: CANADA SMALL BUSINESS FINANCING PROGRAM ACTIVITY REVIEW

**FIGURE B-1** Number and Value of CSBFP Loans and Claims, 2009–14

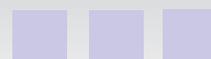


CSBFP lending has decreased from 7,534 loans in 2009–10 to 5,622 in 2013–14. Lending has also declined from \$953 million to \$853 million during the same period. Average loan value has increased from \$126,500 in 2009–10 to \$151,700 in 2013–14.

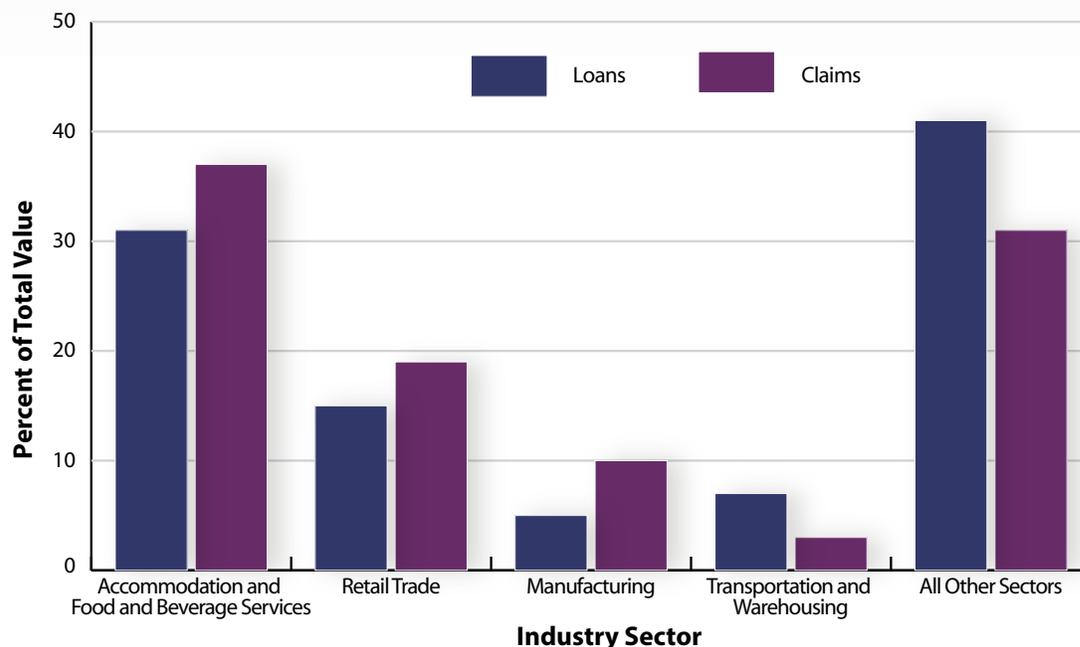
**FIGURE B-2** Percentage of CSBFP Loans by Age of Borrower Firm, 2009–14



Roughly 52 percent of the number of CSBFP loans were to start-ups and businesses that were less than one year old.

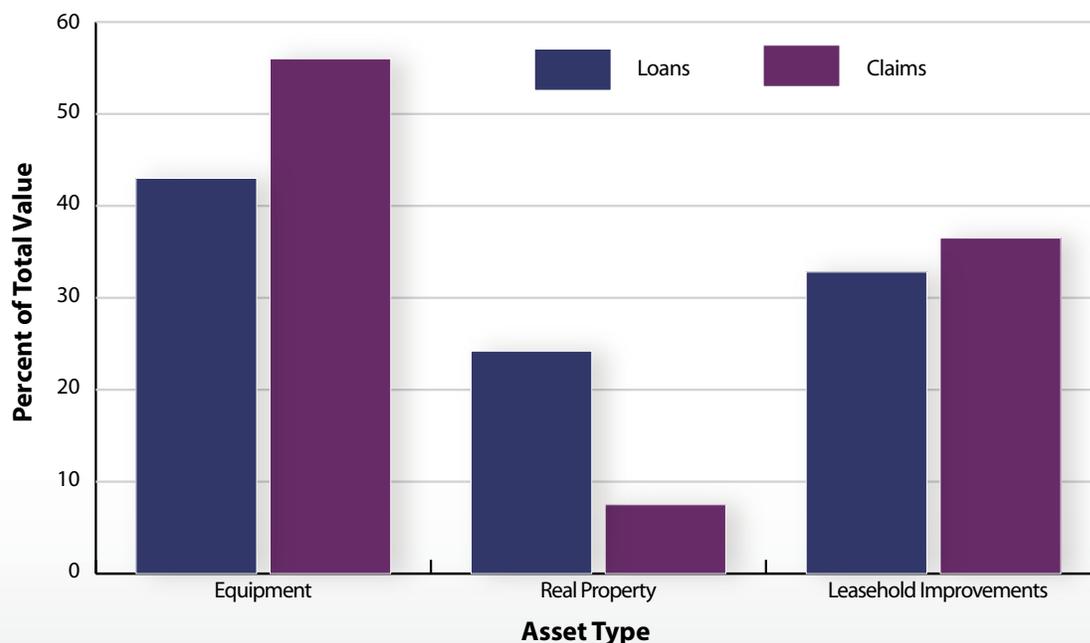


**FIGURE B-3** Percent of Total Value of CSBFP Loans and Claims by Industry Sector, 2009–14



Four industry sectors accounted for 59 percent of the value of loans and 69 percent of the value of claims.

**FIGURE B-4** Percent of Total Value of CSBFP Loans and Claims by Asset Type, 2009–14



Over the review period, equipment loans accounted for 43 percent of loans and 56 percent of claims. Real property accounted for 24 percent of loans but less than 8 percent of claims. Leasehold improvements accounted for 33 percent of loans and 37 percent of claims.

# APPENDIX C: CANADA SMALL BUSINESS FINANCING ACT BACKGROUND ON COST RECOVERY

The importance of carefully monitoring the financial performance of the loans portfolio and regularly updating the program's cost recovery model was reinforced by the Auditor General in 1997 and 2002.

## Methodology

Forecasting program revenues and costs is a complex task. First, sufficient data on loan risk and lender behaviour take nearly four years to accumulate from the time of a parameter change. This is essential to a forecasting model. Second, the cost recovery model must cover the entire life of all loans made in a given year, which can be as much as ten years. Third, lenders are allowed up to three years after default to submit a claim for loss, so the period can be extended to as much as 13 years. Finally, there is a significant lag time between the receipt of revenues and the payment of claims. As a result, revenues and claims need to be forecast long into the future, making estimates of cost recovery difficult and subject to variance according to economic conditions and other factors. For this reason, Industry Canada updates its forecasts and forecasting models on a regular basis to ensure they reflect the most recent experience.

Using statistical and econometric-based forecasting models, Industry Canada is able to project future claims<sup>35</sup> against the forecast revenues to arrive at the cost recovery forecast for the program for each five-year lending period.

## Findings

Table C-1 below illustrates the current cost recovery forecasts for the three lending periods of the CSBFP (1999–2004, 2004–09, and 2009–14). These tables provide a summary of the revenue and expense streams associated with each of the aforementioned annual cohorts.

In aggregate, for the five years of lending under the current review period (see Table C-1 below):

- Revenues (registration and administration fees) are expected to reach approximately \$280 million.
- Expenses (claims) are expected to be approximately \$374 million for a net cost of \$94 million.
- Revenues are expected to offset expenses by 74.9 percent.
- From an overall loan portfolio perspective, the net cost to government for this five-year lending period is expected to be 2.0 percent of the total loans made, down from 3.7 percent for loans made during the previous C2 (2004–09) period.

35 Riding, Allan. *Forecasting Expenses Related to SBLA and CSBFA Debt Financing Loans*, January 2005.



**Table C-1: Cost Recovery Model Summary for CSBFP Period C1 (1999–2004), C2 (2004–09) and C3 (2009–14)**

Cohort	Revenues and Expenses (\$ Millions)					Percent Cost Recovery <sup>1</sup>	Net Cost/Loans
	Loans	Reg Fees	Admin Fees	Claims	Net Cost		
1999–2000	1,352.3	26.8	48.4	-115.5	-40.3	65.1%	-3.0%
2000–01	1,159.0	22.9	41.8	-100.2	-35.4	64.7%	-3.1%
2001–02	899.2	17.8	31.5	-65.1	-15.8	75.7%	-1.8%
2002–03	951.2	18.8	31.6	-64.2	-13.8	78.5%	-1.5%
2003–04	999.9	19.8	31.0	-77.3	-26.5	65.7%	-2.7%
<b>Total (1999–2004)</b>	<b>5,361.6</b>	<b>106.1</b>	<b>184.3</b>	<b>-422.3</b>	<b>-131.9</b>	<b>68.8%</b>	<b>-2.5%</b>
2004–05	1,041.1	20.6	38.8	-81.7	-22.2	72.8%	-2.1%
2005–06	1,087.7	21.5	38.7	-104.5	-44.3	57.6%	-4.1%
2006–07	1,024.5	20.2	33.6	-99.7	-45.8	54.0%	-4.5%
2007–08	987.7	19.5	29.7	-98.5	-49.3	49.9%	-5.0%
2008–09	901.1	17.8	23.7	-65.2	-23.7	63.7%	-2.6%
<b>Total (2004–09)</b>	<b>5,042.1</b>	<b>99.6</b>	<b>164.6</b>	<b>-449.5</b>	<b>-185.3</b>	<b>58.8%</b>	<b>-3.7%</b>
2009–10	952.9	18.8	38.7	-75.3	-17.8	76.3%	-1.9%
2010–11	1,015.1	20.0	41.8	-77.0	-15.2	80.2%	-1.5%
2011–12	978.2	19.3	39.1	-72.0	-13.5	81.2%	-1.4%
2012–13	899.7	17.8	35.0	-75.2	-22.4	70.2%	-2.5%
2013–14	861.6	16.9	32.6	-74.2	-24.7	66.7%	-2.9%
<b>Total (2009–14)</b>	<b>4,707.4</b>	<b>92.8</b>	<b>187.2</b>	<b>-373.8</b>	<b>-93.8</b>	<b>74.9%</b>	<b>-2.0%</b>

Note: Figures in blue are estimates.

1. Percent Cost Recovery: revenues (registration and administration fees) divided by expenses (claims)

Table C-2 provides the same summary of the revenue and expense streams associated with each of the CSBFP annual cohorts. This table takes into consideration the timing of when the revenues are received and when the expenses are paid (i.e., presented on a net present value [NPV] basis).

In aggregate, for the five years of lending under the current review period, on an NPV basis:

- Revenues (registration and administration fees) are expected to reach approximately \$252 million.
- Expenses (claims) are expected to be approximately \$307 million for a net cost of \$55 million over the life of the loans.
- On a percentage basis, revenues are expected to offset expenses by 82 percent.
- From an overall loan portfolio perspective, the net cost to government for this five-year lending period is expected to be approximately 1.2 percent of loans made, down from 2.8 percent for loans made during the previous C2 (2004–09) period.

**Table C-2: Cost Recovery Model Summary (NPV Basis<sup>1</sup>) for CSBFP Period C1 (1999–2004), C2 (2004–09) and C3 (2009–14)**

Cohort	Revenues and Expenses (\$ Millions)					Percent Cost Recovery <sup>2</sup>	Net Cost/Loans
	Loans	Reg Fees	Admin Fees	Claims	Net Cost		
1999–2000	1,352.3	26.1	41.9	-96.9	-29.0	70.1%	-2.1%
2000–01	1,159.0	22.4	36.4	-83.8	-24.9	70.2%	-2.2%
2001–02	899.2	17.4	27.5	-54.5	-9.6	82.3%	-1.1%
2002–03	951.2	18.3	27.6	-53.8	-7.8	85.4%	-0.8%
2003–04	999.9	19.3	27.1	-64.7	-18.3	71.7%	-1.8%
<b>Total (1999–2004)</b>	<b>5,361.6</b>	<b>103.4</b>	<b>160.5</b>	<b>-353.6</b>	<b>-89.7</b>	<b>74.6%</b>	<b>-1.7%</b>
2004–05	1,041.1	20.1	33.9	-68.8	-14.9	78.4%	-1.4%
2005–06	1,087.7	20.9	33.9	-88.7	-33.8	61.9%	-3.1%
2006–07	1,024.5	19.7	29.7	-85.3	-36.0	57.9%	-3.5%
2007–08	987.7	19.0	26.3	-84.8	-39.5	53.5%	-4.0%
2008–09	901.1	17.4	21.2	-56.0	-17.5	68.8%	-1.9%
<b>Total (2004–09)</b>	<b>5,042.1</b>	<b>97.1</b>	<b>145.0</b>	<b>-383.6</b>	<b>-141.5</b>	<b>63.1%</b>	<b>-2.8%</b>
2009–10	952.9	18.3	33.4	-62.3	-10.6	82.9%	-1.1%
2010–11	1,015.1	19.5	36.0	-63.3	-7.8	87.6%	-0.8%
2011–12	978.2	18.8	33.7	-58.8	-6.2	89.4%	-0.6%
2012–13	899.7	17.3	30.1	-61.7	-14.3	76.9%	-1.6%
2013–14	861.6	16.5	28.0	-60.8	-16.4	73.1%	-1.9%
<b>Total (2009–14)</b>	<b>4,707.4</b>	<b>90.5</b>	<b>161.2</b>	<b>-307.0</b>	<b>-55.3</b>	<b>82.0%</b>	<b>-1.2%</b>

Note: Figures in blue are estimates.

1. Net present value (discount rate = 5 percent)

2. Percent Cost Recovery: revenues (registration and administration fees) divided by NPV expenses (claims)

## Conclusion

A comparison of the results for the first three lending periods of the CSBFP indicates that cost recovery during 2009–14 has increased since 2004–09, and it is expected to be slightly better than the 1999–2004 period. Higher levels of cost recovery during this period can be partially attributed to better economic conditions and lower risk lending among a few of the major financial institutions. Industry Canada will continue to update its forecasts and refine its forecasting models on the basis of the latest available data to ensure appropriate monitoring of the program's cost-recovery performance.