



## SMALL BUSINESS

# Financing Profiles

SME Financing Data Initiative

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## Small and Medium-Sized Enterprises in Ontario

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*Small and medium-sized enterprises (SMEs) account for 97 percent of all Ontario businesses.<sup>1</sup> Not only have SMEs been important drivers of job creation and economic growth, but they have also been strong contributors to productivity, having led larger firms in productivity growth over the last 10 years.<sup>2</sup> Access to financing is critical if SMEs are to develop and expand. Using data from the SME Financing Data Initiative, this article provides an overview of the characteristics of SMEs in Ontario and compares financing activity between the average Ontario firm and the average Canadian firm.*

**Summary of Key Findings:** *In general, the financing patterns of Ontario SMEs are similar to those of other Canadian firms. SMEs in Ontario and Canada are small, typically with four or fewer employees. In Ontario, chartered banks are the most important suppliers of debt financing to SMEs. Compared with other regions, Ontario firms tend to be slightly more growth oriented, more likely to be research and development (R&D) intensive, and relatively more represented within knowledge-based industries (KBIs). Like many Canadian SMEs, those in Ontario rely on informal sources of financing, such as personal savings and personal credit. Although less commonly accessed, risk capital appears to be an important source of financing among high-growth and technology-focused SMEs. Firms in Ontario obtained venture capital at a rate commensurate with its share of knowledge-based industries.*

### Definitions

This analysis defines small and medium-sized enterprises (SMEs) as commercial (for-profit) businesses with fewer than 500 employees and less than \$50 million in annual revenues.

Non-profit and government organizations, schools, hospitals, subsidiaries, co-operatives, and finance and leasing companies are excluded.

This analysis compares the profile and financing activity of SMEs in Ontario with national averages.

## GENERAL CHARACTERISTICS

### ONTARIO SETTING FOR SMEs

Ontario is the primary regional economy within Canada, accounting for 40 percent of Canada's gross domestic product (GDP) in 2004. A high proportion of commercial activity in Ontario is focused on automotive and machinery manufacturing and Ontario accounts for 60 percent of all Canadian manufactured exports. According to Statistics Canada's 2004 *Survey on Financing of Small and Medium Enterprises*, there were approximately 1.4 million commercial

<sup>1</sup> Statistics Canada, Business Register, December 2004.

<sup>2</sup> RBC Financial Group, "Small and Medium-Sized Businesses are Driving Productivity Gains," October 2006.

[www.rbc.com/newsroom/20061030smallbiz.html](http://www.rbc.com/newsroom/20061030smallbiz.html)

(for-profit) small and medium-sized firms in Canada during 2004. Of these, approximately 36 percent operated in Ontario, a proportion consistent with Ontario's 39 percent share of the 2004 Canadian population. Table 1 shows the regional distribution of population, SMEs and Canadian GDP.

**Table 1**  
**Distribution of SMEs, Gross Domestic Product and Population across Canada, 2004**

Region	SME Share	GDP Share	Population
	(% Canada)		
Atlantic Provinces	6	6	7
Quebec	22	20	24
Ontario	36	40	39
Prairie Provinces	22	21	17
British Columbia	15	12	13
Territories	<1	<1	<1
<b>Canada Total</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Statistics Canada, CANSIM, Table 051-0001, Estimates of Population, by Age Group and Sex, Canada, Provinces and Territories.

Statistics Canada, CANSIM, Table 384-0002, Gross Domestic Product, Expenditure-Based, by Province and Territory.

The incidence of all business formation in Ontario was slightly less than the national average, with 68.6 establishments per 1000 population of the province (compared with the national average of 71.5 establishments per 1000 population of Canada).

The age distribution of SMEs in Ontario was consistent with the national average. Approximately 10.0 percent of firms in Ontario first started selling goods or services between 2002 and 2004.

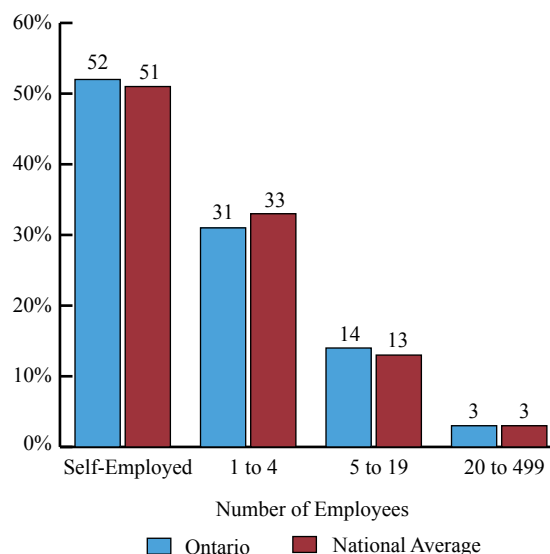
The national average was 11.2 percent.

### **PREDOMINANTLY SMALLER FIRMS IN ONTARIO**

Size of firm is an important aspect of SME financing. Medium-sized and large firms are more likely to

seek external financing than small businesses. It is also widely believed that small firms are less able to obtain financing than large firms and that small firms are more likely to turn to informal sources of capital, including personal finances. Figure 1 compares the size distribution of Ontario SMEs with the national average and shows that SMEs in Ontario were mostly small enterprises, with 97 percent employing fewer than 20 people. This distribution was consistent with the national average. Prominent among SMEs are self-employed individuals. In Ontario, self-employed persons comprised more than half of all SMEs and self-employed individuals accounted for 11.4 percent of all workers in Ontario, compared with the national average of 11.9 percent.<sup>3</sup>

**Figure 1**  
**Distribution of Ontario SMEs by Business Size, 2004**



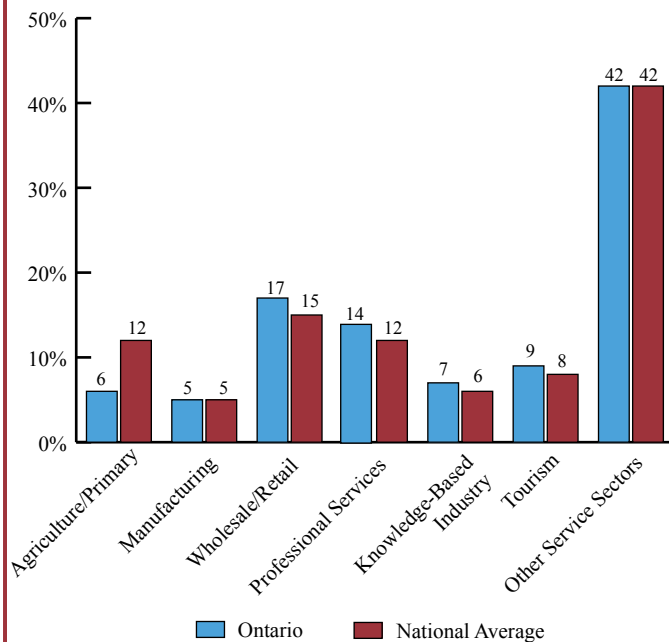
Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

<sup>3</sup> Statistics Canada, *Labour Force Survey*. [www40.statcan.ca/101/cst01/labr66a.htm](http://www40.statcan.ca/101/cst01/labr66a.htm)

## INDUSTRIAL COMPOSITION OF ONTARIO SMEs

The industry sector is also an important determinant of SMEs' needs for, and access to, financial capital. Figure 2 compares the sectoral distribution of Ontario SMEs with the national average distribution. Ontario SMEs operated in all major industry sectors and Ontario laid claim to relatively more firms in the wholesale/retail, professional services, tourism and knowledge-based sectors.<sup>4</sup> With 7 percent of Ontario firms in knowledge-based sectors, Ontario ranked first in Canada in this respect, followed by British Columbia (with 6 percent) and the Prairies and Quebec (each with 5 percent). In keeping with its high share of urban population, Ontario encompassed relatively fewer firms in agriculture-related and primary industries.

**Figure 2**  
**Distribution of Ontario SMEs by Industry Sector, 2004**



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

## CHARACTERISTICS OF SME OWNERS IN ONTARIO

Table 2 compares the profiles of primary owners of Ontario SMEs with national averages. The data show that the profile of Ontario SME owners was largely consistent with the national average. As would be expected, Ontario owners were predominantly English-speaking (78 percent); however, the proportion of owners who spoke a language other than English or French (19 percent) was substantially higher than the national average of 14 percent and second only to British Columbia.

## ONTARIO BUSINESS GROWTH AND INNOVATION

Approximately 42 percent of Ontario SME owners intended to expand their businesses within the next two years compared with 39 percent nationally. Developing a growth strategy is contingent on identifying drivers of, and obstacles to, growth. Firms across Canada reported productivity, commercialization, succession planning and access to financing as the top drivers for business success. One growth strategy is exporting and 8 percent of both Ontario and all Canadian SMEs exported products or services outside Canada in 2004.

Another means of achieving business growth is through innovation. In keeping with the relatively higher proportion of knowledge-based firms, it is not surprising that Ontario firms were relatively more likely to invest in research and development (R&D). From 2000 to 2004, small, medium-sized and large firms in Ontario funded in excess of \$29 billion in R&D, accounting for over half of the R&D expenditures in the province (see Figure 3).

According to the 2004 *Survey on Financing of Small and Medium Enterprises*, 34 percent of Ontario's SMEs reported some investment in R&D during 2004 compared with the national average of 29 percent.

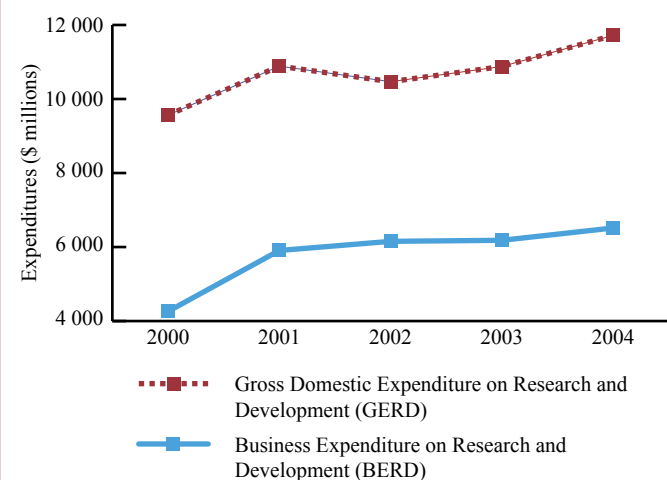
<sup>4</sup> Knowledge-based firms are defined using Industry Canada's categorization of industries in the science and technology field and those considered "high knowledge" based on measures of research and development activity.

**Table 2**  
**Profile of Entrepreneurs, Comparison between Ontario and Canada, 2004**

Ontario Entrepreneurs	Characteristics	National Average
16 percent owned by women, 64 percent owned by men and 20 percent are equal partnerships	<b>Gender</b>	16 percent owned by women, 64 percent owned by men and 20 percent are equal partnerships
10 percent visible minority, 4 percent disabled and 1 percent are recent immigrants	<b>Minority Status</b>	7 percent visible minority, 4 percent disabled and 1 percent are recent immigrants
2 percent are under 30, 86 percent are between 30 and 64, and 11 percent are over 65 years	<b>Age</b>	3 percent are under 30, 87 percent are between 30 and 64, and 10 percent are over 65 years
78 percent speak English, 3 percent speak French and 19 percent speak a non-official language	<b>First Language</b>	67 percent speak English, 19 percent speak French and 14 percent speak a non-official language
13 percent have fewer than 5 years, 21 percent have 5 to 10 years and 66 percent have more than 10 years	<b>Managerial Experience</b>	12 percent have fewer than 5 years, 19 percent have 5 to 10 years and 69 percent have more than 10 years
83 percent urban-based and 17 percent rural-based	<b>Location</b>	72 percent urban-based and 28 percent rural-based
8 percent export outside Canada	<b>Export Activity</b>	8 percent export outside Canada

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

**Figure 3**  
**Expenditures on Research and Development in Ontario, 2000–2004**



Source: Statistics Canada, CANSIM, Table 358-0001 and Catalogue No. 88F0006XIE, Estimates of Canadian Research and Development Expenditures.

Moreover, business R&D expenditures in Ontario accounted for 52 percent of the national total, followed by Quebec (30 percent) and British Columbia (less than 10 percent). More than 5 percent of Ontario SMEs were especially research-intensive, devoting

more than 20 percent of their investments to R&D. Past research suggests that SMEs that accessed equity financing were more likely to conduct R&D activities than firms that sought debt financing.<sup>5</sup>

Nationally, business owners were more likely to identify as obstacles to growth external factors (such as current tax levels and finding qualified labour) than internal causes (such as low profitability and insurance rates) (see Table 3). Ontario firms cited taxation (48 percent) and insurance rates (42 percent) among the top concerns. Access to financing was cited less frequently as a barrier to growth than most other factors, mentioned as an obstacle by 20 percent of Ontario SME owners.

## FINANCING ACTIVITY

During 2004, 20 percent of Ontario SMEs applied for some form of external financing. Table 4 presents an overview of the financing activity of SMEs in the major regions of Canada during 2004. Ontario entrepreneurs made fewer requests for debt and

<sup>5</sup> Baldwin, J., G. Gellatly and V. Gaudreault. "Financing Innovation in New Small Firms: New Evidence from Canada," Statistics Canada, May 2002.

**Table 3**  
**Perceived Obstacles to Business Growth and Development, 2004**

		Ontario SMEs	SME National Average
		%	
External to the Firm	Levels of Taxation	48	47
	Finding Qualified Labour	36	37
	Instability of Consumer Demand	37	36
	Government Regulations	37	33
Internal to the Firm	Insurance Rates	42	36
	Low Profitability	38	38
	Obtaining Financing	20	20
	Management Capacity	12	13

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

leasing than SMEs nationally. The most frequent request was to chartered banks (84 percent) as seen in Figure 4. The most frequent types of loan applications were for fixed assets (44 percent) and working capital (63 percent).

Table 4 also reports the rate at which loan applications were approved; however, among those that were not approved were instances where loan applications

**Table 4**  
**Financing Request and Approval Rates, 2004**

Type of Financing		British Columbia	Prairie Provinces	Ontario	Quebec	Atlantic Provinces	Canada
		%					
Debt Financing	Request Rate	20	23	15	18	20	19
	Approval Rate	82	82	77	88	82	81
Lease Financing	Request Rate	4	5	2	3.2	3	3
	Approval Rate	88	99	98	97	94	96
Equity Financing	Request Rate	1.1	0.9	1.3	1.4	1.7	1.2
	Approval Rate*	78	—	—	—	80	—
Government Grant or Subsidy	Request Rate	1.8	6	1.5	3.1	3.9	3
	Approval Rate	—	72	72	68	80	70

\* Data not available due to low quality or confidentiality concerns.

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

were pending at the time of data collection as well as instances where the application had been withdrawn. After allowing for these events, a total of 15 percent of adjudicated applications for commercial loans from Ontario firms were turned down. This is higher than the 12 percent national average. At the same time, 63 percent of the SMEs in Ontario that sought financing were satisfied with the overall level of service provided by their credit supplier (compared with a national average of 62 percent).

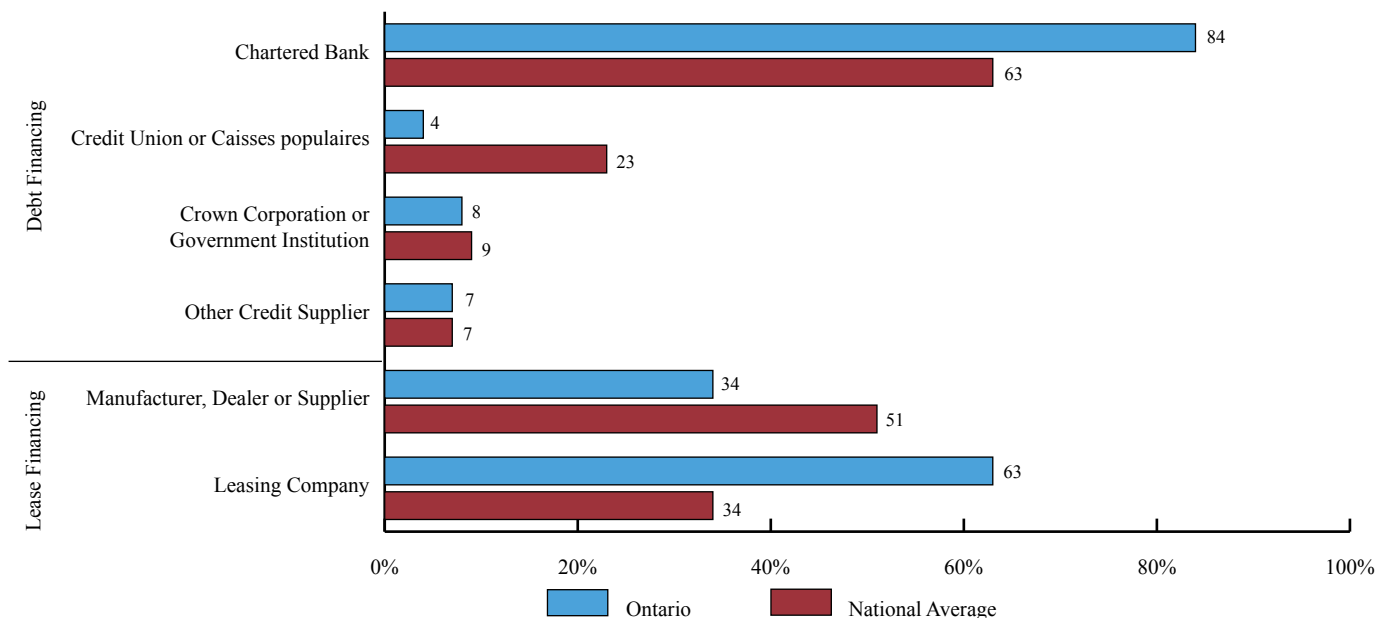
Only 2 percent of Ontario business owners sought lease financing and approval rates were commensurate with those reported in other regions.

Rates of application for equity financing were low in all regions, with fewer than 2 percent of firms seeking equity financing during 2004. Differences across regions were not statistically significant.

### ONTARIO'S FINANCING ENVIRONMENT

According to the 2005 SME Financing Data Initiative *Survey of Suppliers of Business Financing*, approximately \$868 billion in debt financing was authorized in almost 2 million transactions nationwide. In Ontario, lenders authorized a total of \$434 billion in commercial debt financing in more than 652 000 transactions.

**Figure 4**  
**Financial Supplier Approached by SMEs by Type of Financing, 2004**



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Nationally, loan authorizations of less than \$250 000 (arguably, most of these were loans to smaller enterprises) comprised more than \$70 billion and were made available in the course of approximately 1.6 million loan transactions. Of the latter, \$42 billion was outstanding at the end of 2005.<sup>6</sup>

To a greater extent than any other region, Ontario SMEs drew on chartered banks as their main source for debt financing with chartered banks being the credit supplier of choice for 84 percent of loan applicants, substantially greater than the 63 percent national average (see Figure 4). This proportion is consistent with the composition of the financial services sector in Ontario. Compared with other regions, credit unions and Caisses populaires have not been as important in Ontario, receiving 4 percent of loan requests.

SMEs in Ontario appear to have faced similar application requirements as firms elsewhere in Canada (Figure 5). Ontario lenders, primarily banks, were less likely to require business and personal financial statements and somewhat more likely to require formal applications. Ontario lenders were also less likely to require business plans and appraisals of the assets being financed.

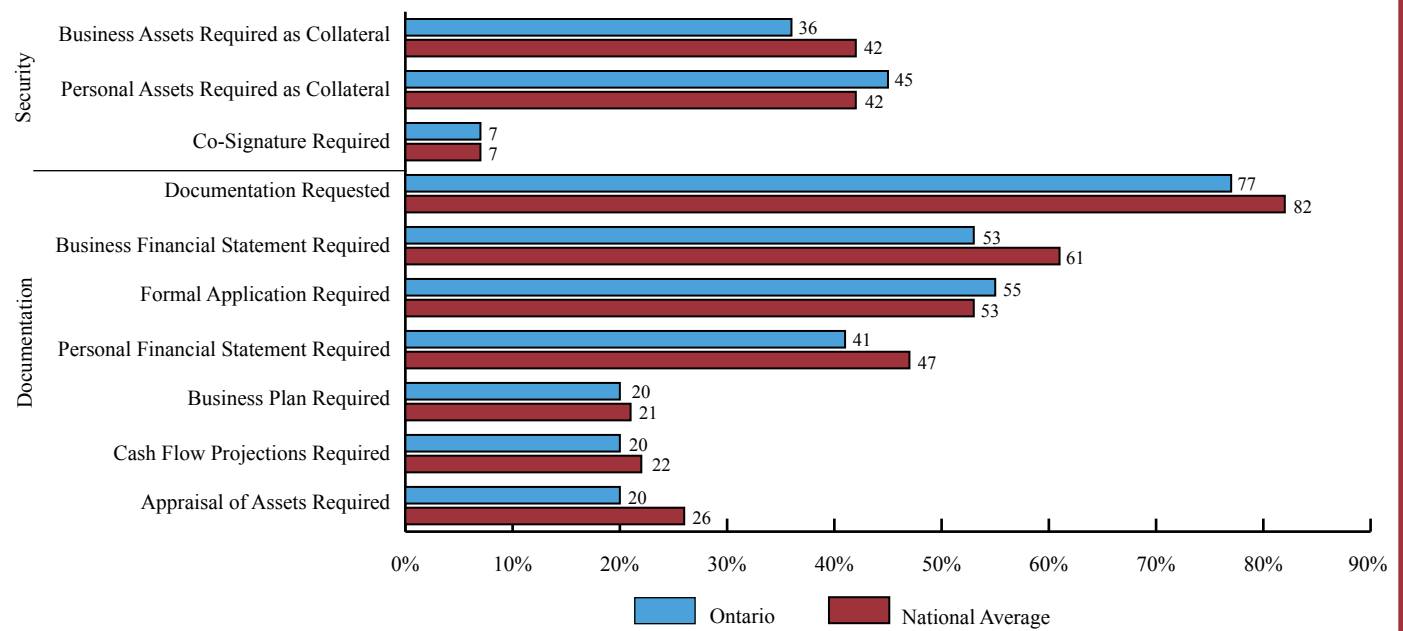
### CAPITAL STRUCTURE

SME owners typically look to informal sources of financing, such as personal loans and personal savings, when starting a business or funding day-to-day operations. Figures 6 and 7 list sources of financing used by average Ontario SMEs compared with average firms in Canada during start-up and for established operations in 2004.

<sup>6</sup> SME Financing Data Initiative, Statistics Canada, *Survey of Suppliers of Business Financing*, 2005. Note that total authorization amounts are defined as the sum of clients' maximum amount of money they are permitted to borrow from a supplier. This may not be the amount the client actually borrows. Outstanding debt is defined as the principal amount of money that a client has actually borrowed but not yet paid back, aggregated over all clients.



**Figure 5**  
**Security and Documentation Required by Financial Providers, 2004**



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

At the start-up stage, the primary sources of financial capital in Ontario were personal savings and personal credit instruments. This pattern was repeated for SMEs in all regions. Among established firms, Ontario companies were as likely as companies in other regions to have used informal sources, such as retained earnings, personal savings and personal credit cards.

### RISK CAPITAL

Risk capital is a means of financing often used by high-growth, knowledge-based or technology-based firms.<sup>7</sup> Risk capital includes angel investment (venture financing provided by a high net worth individual), loans from friends and family, and formal venture capital, as well as subordinated debt and capital from public share offerings on capital markets. Firms that seek risk capital tend to be early stage or in the process of developing a concept or product and bringing that product to market. Since these firms

are often not yet generating revenues and lack tangible assets, they have problems accessing credit.<sup>8</sup> Risk capital is more suitable for such firms as it offers a means to raise money that does not require an immediate cash flow to support repayments. As such, risk capital may be especially important in the Ontario context given the relatively high proportion of R&D-intensive, knowledge-based firms, and growth firms. Of Canadian firms that had, at some point in their development, sought risk capital,

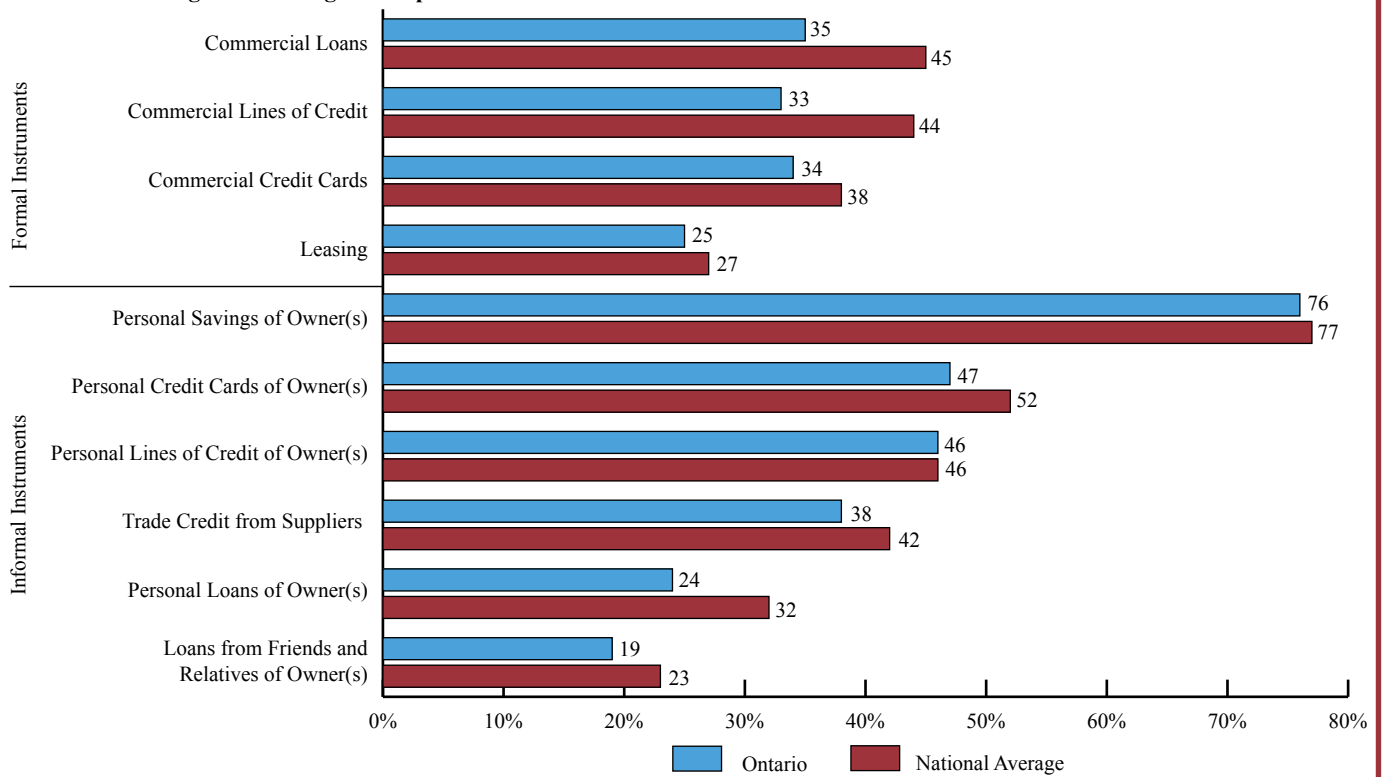
- 23 percent approached friends or family for financing,
- 22 percent sought out business angels,
- 20 percent looked to existing stakeholders, and
- 7 percent contacted a venture capital firm.

Approximately 12 percent of businesses in Ontario have received angel financing over their history, the lowest relative frequency of business angel investment

<sup>7</sup> Industry Canada, “Canadian Venture Capital Activity: An Analysis of Trends and Gaps, 1996–2002.”

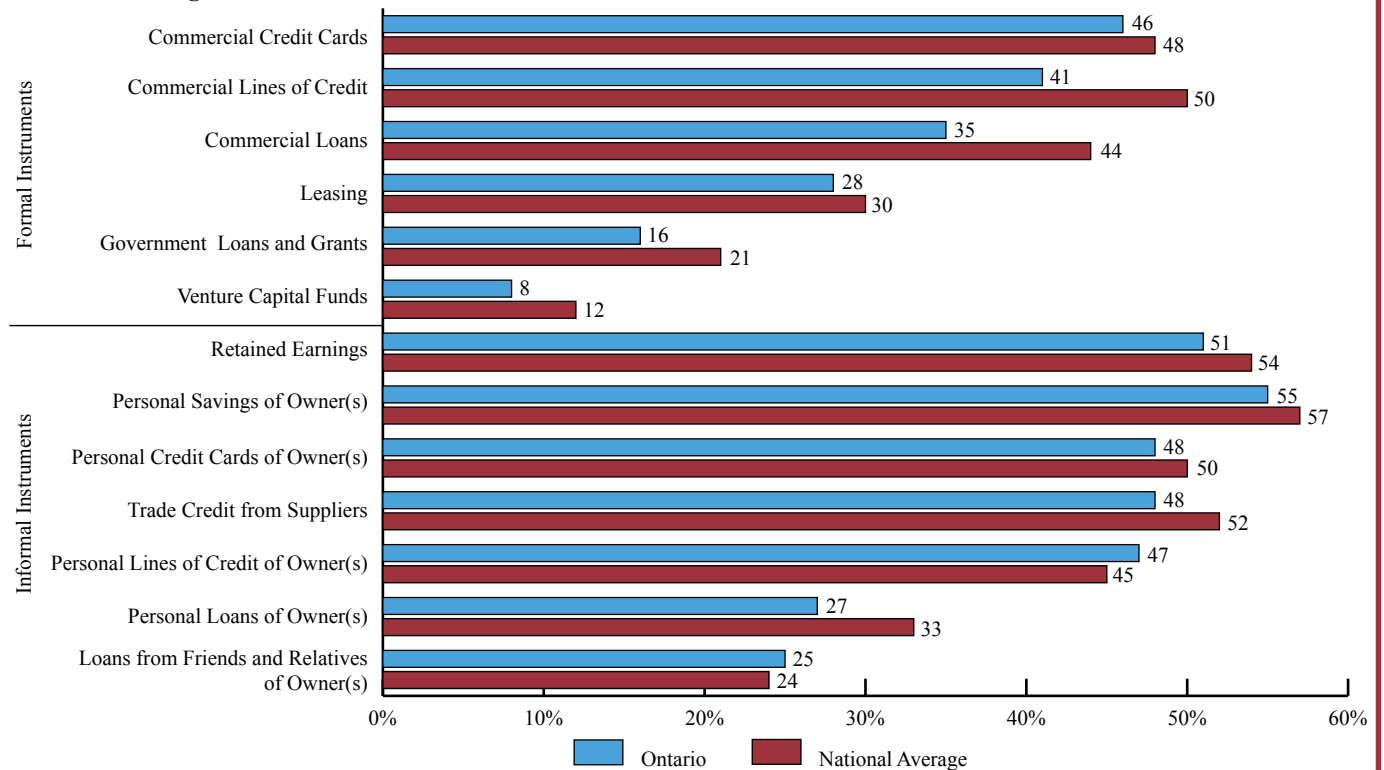
<sup>8</sup> SME Financing Data Initiative, Industry Canada, “Small and Medium-Sized Enterprise Financing in Canada, 2003.”

**Figure 6**  
Sources of Financing Used During Start-up\*



\* Start-up is defined as the period prior to the first sale of goods or services. Includes any source used, regardless of whether it was authorized or obtained in a previous year.  
Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

**Figure 7**  
Sources of Financing for Established Firms, 2004\*



\* Includes any source used, regardless of whether it was authorized or obtained in a previous year.  
Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.



in any Canadian region. Almost 27 percent of Ontario firms have received financing from friends and family (the highest proportion among Canadian regions).<sup>9</sup>

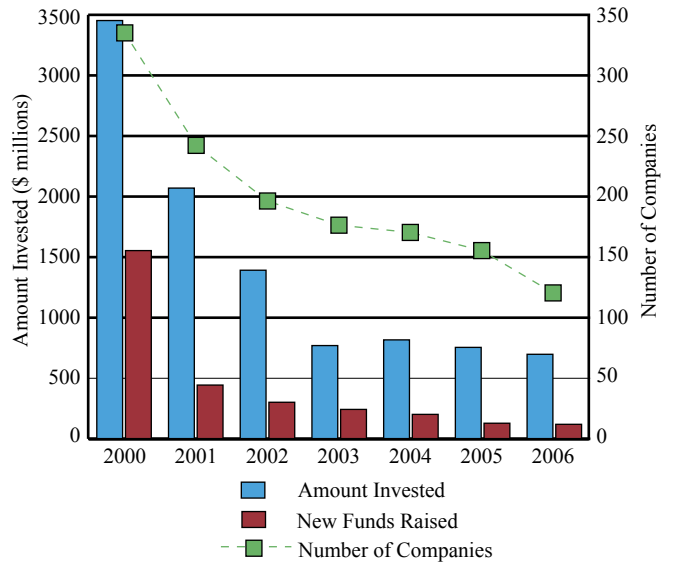
Approximately 1.3 percent of Ontario firms actually sought equity financing (see Table 4) in 2004. Although more than 41 percent of SME owners in Ontario intend to expand in the next two years, only 43 percent of these stated they were willing to share equity in their business to achieve their growth objectives. By comparison, 46 percent of entrepreneurs in Canada were willing to share ownership in their business to obtain growth capital.

### VENTURE CAPITAL ACTIVITY IN ONTARIO, 2000–2006

Venture capital (VC) is a form of risk capital used to support a small number of high-growth early-stage firms as they expand and move beyond the seed financing stage. During 2006, institutional venture capital firms invested a total of \$686 million in Ontario firms, 41 percent of the \$1.693 billion national total. As a proportion of total venture capital activity, this is down slightly from 45 percent in 2005. Figure 8 shows recent trends in venture capital investment in Ontario. As was true for the rest of Canada, venture capital activity peaked during the technology boom of the late 1990s and has since moderated, a consequence of the bursting of the technology bubble in 2000.

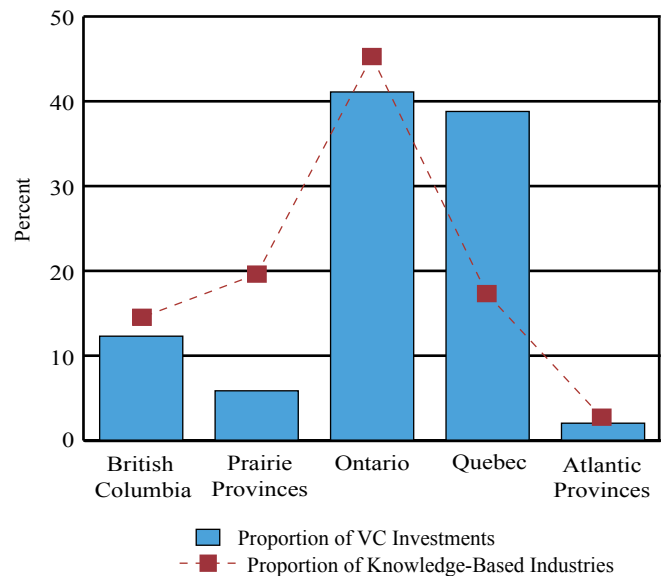
Figure 9 compares the share of venture capital investments in each of Canada’s major regions with their share of knowledge-based industries (KBIs). The chart shows that Ontario’s share of venture capital activity is approximately commensurate with its share of knowledge-based firms. Conversely, the chart suggests that the level of venture capital investment in Quebec is disproportionately large.

**Figure 8**  
Venture Capital Activity in Ontario, 2000–2006



Source: Thomson Financial, 2006.

**Figure 9**  
Regional Shares of Venture Capital Investment, 2006



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004; Thomson Financial, 2006.

<sup>9</sup> Riding, A. and Belanger, B. “Small Business Financing Profiles: Informally Financed SMEs,” SME Financing Data Initiative, Industry Canada, September 2006.

## **SUMMARY AND DISCUSSION**

In general, the financing patterns of Ontario SMEs are similar to those of other Canadian firms. SMEs in Ontario and Canada are small, typically with four or fewer employees. In Ontario, chartered banks are the most important suppliers of debt financing to SMEs. Ontario firms tend to be slightly more growth oriented, more likely to be R&D intensive, and relatively more

represented within knowledge-based industries. Like many Canadian SMEs, those in Ontario rely on informal sources of financing, such as personal savings and personal credit. Although less commonly accessed, risk capital appears to be an important source of financing among high-growth and technology-focused SMEs. Firms in Ontario obtained venture capital at a rate commensurate with its share of knowledge-based industries.

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## **SME FINANCING DATA INITIATIVE**

*Small Business Financing Profiles* is an ongoing series of articles on specific segments of the marketplace and a component of Industry Canada's reporting efforts on SME financing.

Consistent with recommendations in 1999 from the Task Force on the Future of the Canadian Financial Services Sector, the SME Financing Data Initiative is a comprehensive data collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of, and demand for, small and medium-sized business financing to provide a complete picture of SME financing.

As part of the initiative, Statistics Canada administers a series of national surveys on small and medium-sized enterprises (*Survey on Financing of Small and Medium Enterprises*) and financial providers (*Survey of Suppliers of Business Financing*). Industry Canada supplements these surveys with additional research into niche areas of SME financing.

For further information on the SME Financing Data Initiative and access to statistical findings and reports, visit [www.sme-fdi.gc.ca](http://www.sme-fdi.gc.ca). For information regarding the methodology of the *Survey on Financing of Small and Medium Enterprises*, visit Statistics Canada's website at [www.statcan.ca](http://www.statcan.ca).

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