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Financing Profiles

SME Financing Data Initiative

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Small and Medium-Sized Enterprises in the Prairie Provinces

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In the Prairie provinces, small and medium-sized enterprises (SMEs) account for 97 percent of all businesses.¹ 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.² 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 the Prairie provinces and compares financing activity between the average firm in the Prairie provinces and the average Canadian firm.

Summary of Key Findings: *SMEs in the Prairie provinces are small, typically with four or fewer employees. Like many Canadian SMEs, those in the Prairie provinces rely on informal sources of financing, such as personal savings and personal credit. Yet the financing patterns of Prairie region SMEs also differ in several respects from those of other Canadian firms. Although chartered banks are the primary suppliers of debt financing for SMEs, financing co-operatives are also important suppliers of debt financing for Prairie region SMEs. Prairie region firms tend to be slightly less likely to be research and development (R&D) intensive. Risk-capital investment, an important source of financing among high-growth and technology-focused SMEs, appears to be disproportionately low in the Prairie provinces as firms in the region obtained venture capital at a rate that was disproportionately less than its share of knowledge-based industries (KBIs).*

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 throughout the Prairie provinces of Manitoba, Saskatchewan and Alberta with national averages.

GENERAL CHARACTERISTICS

SMEs in the Prairie Provinces

With a population of more than 5.5 million people, the Prairie region economy is based mainly on oil and gas (especially Alberta, which has the fastest growing economy in Canada), agriculture, minerals and forestry, and Saskatchewan has an emerging biotechnology sector. According to Statistics Canada's 2004 *Survey on Financing of Small and Medium Enterprises*, there were approximately 1.4 million commercial (for-profit) small and medium-sized

¹ Statistics Canada, Business Register, December 2004.

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

firms in Canada. Of these, approximately 22 percent operated in the Prairie provinces, a proportion somewhat higher than the Prairie region's 17 percent share of the 2004 Canadian population. Table 1 shows the regional distribution of population, SMEs and Canadian gross domestic product (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
Canada Total	100	100	100

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.

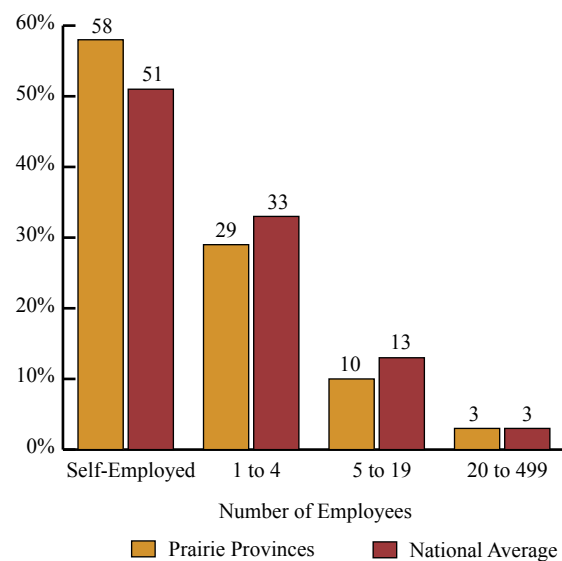
The incidence of business formation in the Prairie provinces ranged from 64 establishments per 1000 population of the province in Manitoba to 94 establishments in Alberta and 96 establishments in Saskatchewan per 1000 population of the provinces. These rates compare with the national average of 71.5 establishments per 1000 population of Canada.

The age distribution of SMEs in the Prairie provinces was lower than the national average. Approximately 10.2 percent of firms in the Prairie region first started selling goods or services between 2002 and 2004 compared with the national average of 11.2 percent.

HIGH PERCENTAGE OF SELF-EMPLOYED THROUGHOUT THE PRAIRIE PROVINCES

Size of firm is an important aspect of SME financing. Medium-sized and large firms are more likely to seek external financing than small firms. 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 Prairie region SMEs with the national average. It shows that SMEs in the Prairie provinces were predominantly small businesses, with 97 percent of firms employing fewer than 20 people. Self-employed individuals accounted for a relatively large fraction (58 percent) of SMEs in the Prairie provinces compared with approximately half of all firms nationwide. Likewise, self-employed individuals were considerably more prevalent in the Prairie provinces, comprising 14.6 percent of all workers compared with the national average of 11.9 percent.³

Figure 1
Distribution of Prairie Region SMEs by Business Size, 2004

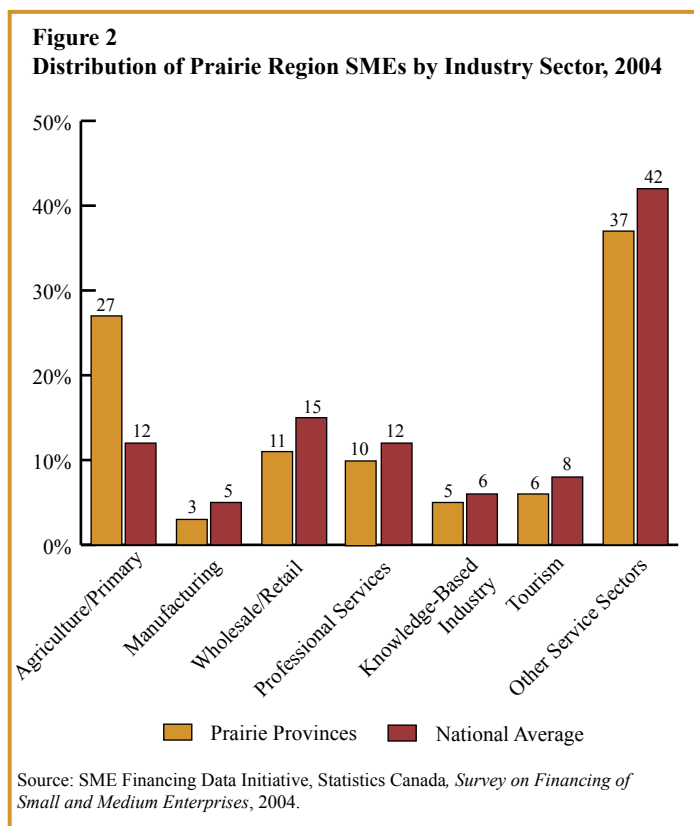


Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

³ Statistics Canada, *Labour Force Survey*. www40.statcan.ca/101/cst01/labr66a.htm

INDUSTRIAL COMPOSITION OF PRAIRIE REGION 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 firms in the Prairie region with the national average distribution of SMEs by sector. It shows that firms in the primary and agricultural services sectors were relatively heavily represented in the Prairie provinces, with correspondingly lower concentrations of firms in other sectors. The incidence of knowledge-based firms in the Prairie region was 5 percent, which compares with 7 percent of firms in Ontario, 6 percent of firms in British Columbia and 5 percent of firms in Quebec.⁴



CHARACTERISTICS OF SME OWNERS IN THE PRAIRIE REGION

Table 2 compares the profiles of primary owners of Prairie region SMEs with national averages. The data show that the profile of SME owners in the Prairie provinces was generally consistent with the national average.

PRAIRIE REGION BUSINESS GROWTH AND INNOVATION

Approximately 35 percent of SME owners in the Prairie provinces 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 7 percent of Prairie region business owners exported products or services outside Canada in 2004, a proportion not statistically different from the national average of 8 percent of SMEs.

Another means of achieving business growth is through innovation. From 2000 to 2004, small, medium-sized and large firms throughout the Prairie provinces funded nearly \$5 billion in research and development (R&D), accounting for 39 percent of R&D expenditures in the region (see Figure 3).

According to the 2004 *Survey on Financing of Small and Medium Enterprises*, 24 percent of SMEs in the Prairie provinces reported some investment in R&D during 2004. This rate is among the lowest of all regions in Canada, but is comparable to the national average of 29 percent. Only 3 percent of Prairie region SMEs devoted more than 20 percent of their

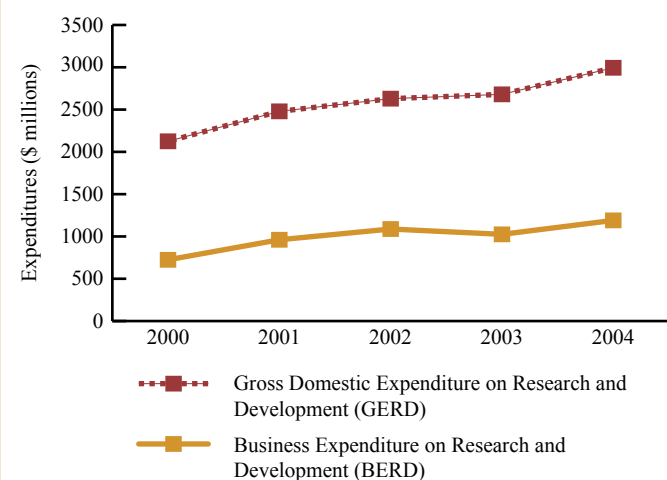
⁴ Knowledge-based firms are defined using Industry Canada's categorization of industries in the science and technology field and those considered "high knowledge" based on measures of research and development activity.

Table 2
Profile of Entrepreneurs, Comparison between the Prairie Provinces and Canada, 2004

Prairie Region Entrepreneurs	Characteristics	National Average
14 percent owned by women, 57 percent owned by men and 29 percent are equal partnerships	Gender	16 percent owned by women, 64 percent owned by men and 20 percent are equal partnerships
5 percent visible minority, 5 percent disabled and 1 percent are recent immigrants	Minority Status	7 percent visible minority, 4 percent disabled and 1 percent are recent immigrants
4 percent are under 30, 88 percent are between 30 and 64, and 8 percent are over 65 years	Age	3 percent are under 30, 87 percent are between 30 and 64, and 10 percent are over 65 years
92 percent speak English, 1 percent speak French and 7 percent speak a non-official language	First Language	67 percent speak English, 19 percent speak French and 14 percent speak a non-official language
10 percent have fewer than 5 years, 15 percent have 5 to 10 years and 75 percent have more than 10 years	Managerial Experience	12 percent have fewer than 5 years, 19 percent have 5 to 10 years and 69 percent have more than 10 years
53 percent urban-based and 47 percent rural-based	Location	72 percent urban-based and 28 percent rural-based
7 percent export outside Canada	Export Activity	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 the Prairie Provinces, 2000–2004



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

investments to R&D (not statistically different from 4 percent of firms nationally). Past research suggests that SMEs that accessed equity financing were, in general, more likely to conduct R&D activities than firms that sought debt financing.⁵

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). Table 3 shows the relative importance of various obstacles to growth as perceived by SME owners. Generally, Prairie region perspectives on obstacles to growth were in line with national views; however, Prairie region respondents were relatively more likely to mention low profitability as an obstacle.

FINANCING ACTIVITY

During 2004, 30 percent of Prairie region SMEs applied for some form of external financing compared with 24 percent of firms nationally. Table 4 presents an overview of the financing activity of SMEs in the major regions of Canada during 2004. It summarizes, by region, rates at which SMEs applied for various forms of financing and corresponding rates of approval.

⁵ 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

		Prairie Region SMEs	SME National Average
		%	
External to the Firm	Levels of Taxation	50	47
	Finding Qualified Labour	39	37
	Instability of Consumer Demand	35	36
	Government Regulations	34	33
Internal to the Firm	Insurance Rates	35	36
	Low Profitability	46	38
	Obtaining Financing	20	20
	Management Capacity	17	13

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

Table 4 shows that 23 percent of Prairie region SMEs applied for commercial loan financing. Approximately 49 percent of these loan applications were made to chartered banks and 34 percent were made to co-operative lenders such as credit unions (see Figure 4). The most frequent types of loan applications were from owners seeking to finance fixed assets

(51 percent of loan applications) or to finance working capital (49 percent of loan applications).

Table 4 also reports the rate at which loan applications were approved; however, among those that were not approved were instances where loan applications were pending at the time of data collection as well as instances where the application had been withdrawn. After allowing for these events, approximately 11 percent of loan applications from Prairie region SMEs were turned down, a rate that is slightly lower than the 12 percent national average. At the same time, 59 percent of SMEs in the region that sought financing were satisfied with the overall level of service provided by their credit supplier (compared with a national average of 62 percent).

Approximately 5 percent of Prairie region business owners sought lease financing and approval rates were high (99 percent), 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.

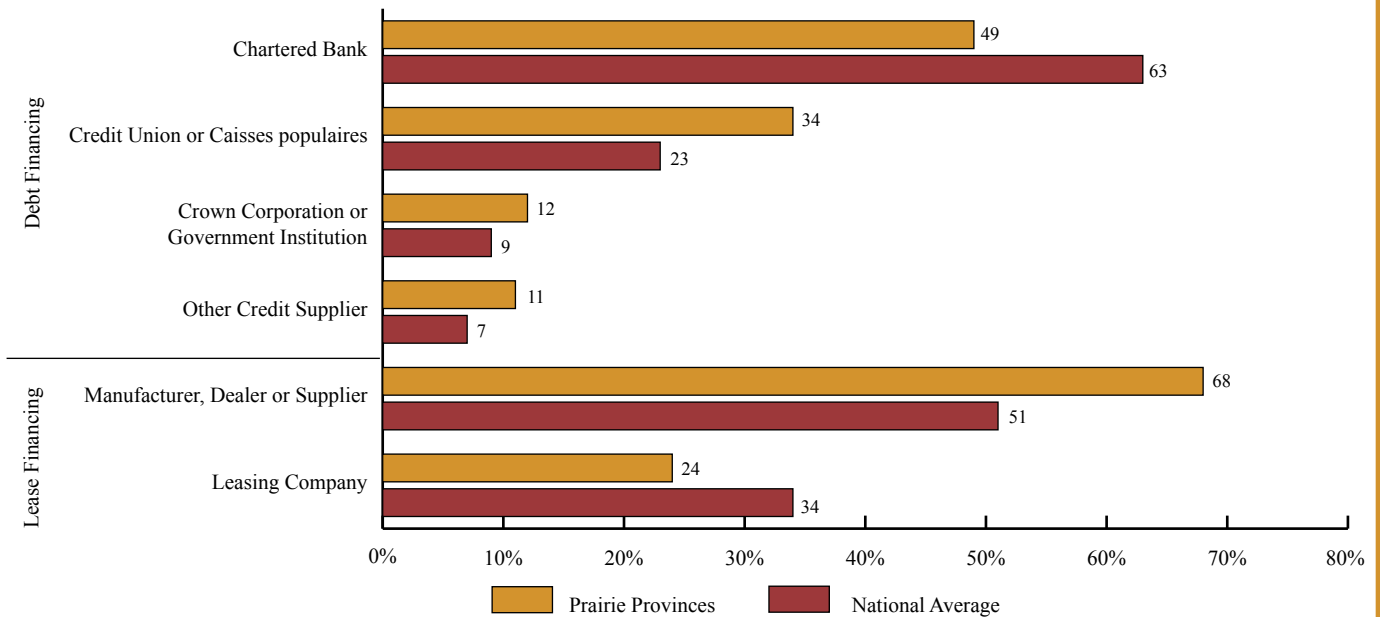
Table 4
Financing Request and Approval Rates, 2004

		British Columbia	Prairie Provinces	Ontario	Quebec	Atlantic Provinces	Canada
Type of Financing		%					
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.

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.

FINANCING ENVIRONMENT IN THE PRAIRIE PROVINCES

According to the 2005 SME Financing Data Initiative *Survey of Suppliers of Business Financing*, approximately \$868 billion in commercial lending was authorized in almost 2 million transactions nationwide. In the Prairie provinces, lenders authorized a total of \$164 billion in debt financing in almost 594 000 transactions.

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 transactions. Of the latter, \$42 billion was outstanding at the end of 2005.⁶

SMEs in the Prairie provinces appear to have faced somewhat similar application requirements as firms elsewhere in Canada (see Figure 5).

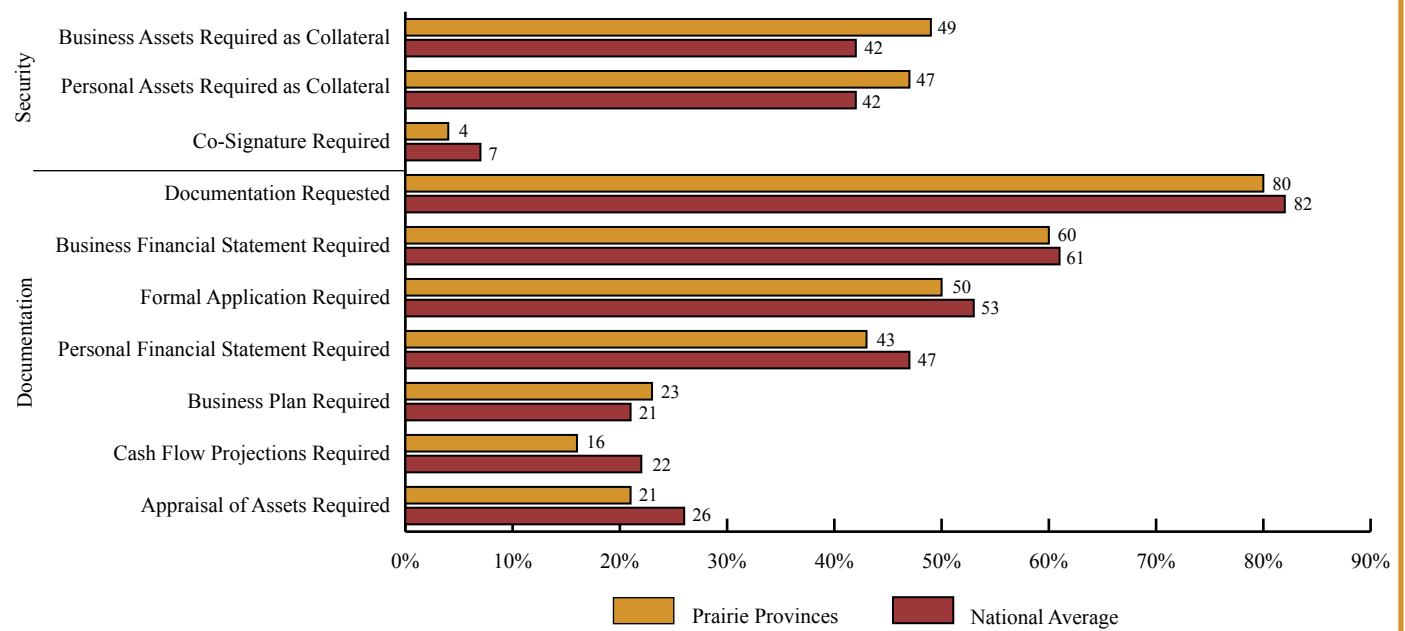
CAPITAL STRUCTURE

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 an average Prairie region firm compared with the average firm in Canada during start-up and for established operations in 2004.

At the start-up stage, the primary sources of financial capital in the Prairie provinces were personal savings and personal credit instruments. This pattern was repeated for SMEs in all regions. Prairie region firms were relatively more likely to draw on formal sources of financial capital at the start-up stage. Among established firms, Prairie region companies were more likely than other regions to have used informal sources, such as retained earnings and personal credit cards.

⁶ 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.

RISK CAPITAL

Risk capital is a means of financing often used by high-growth, knowledge-based or technology-based firms.⁷ 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.⁸ 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. 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 15 percent of businesses in the Prairie provinces have received angel financing over their history and 21 percent have received financing from friends and family.⁹

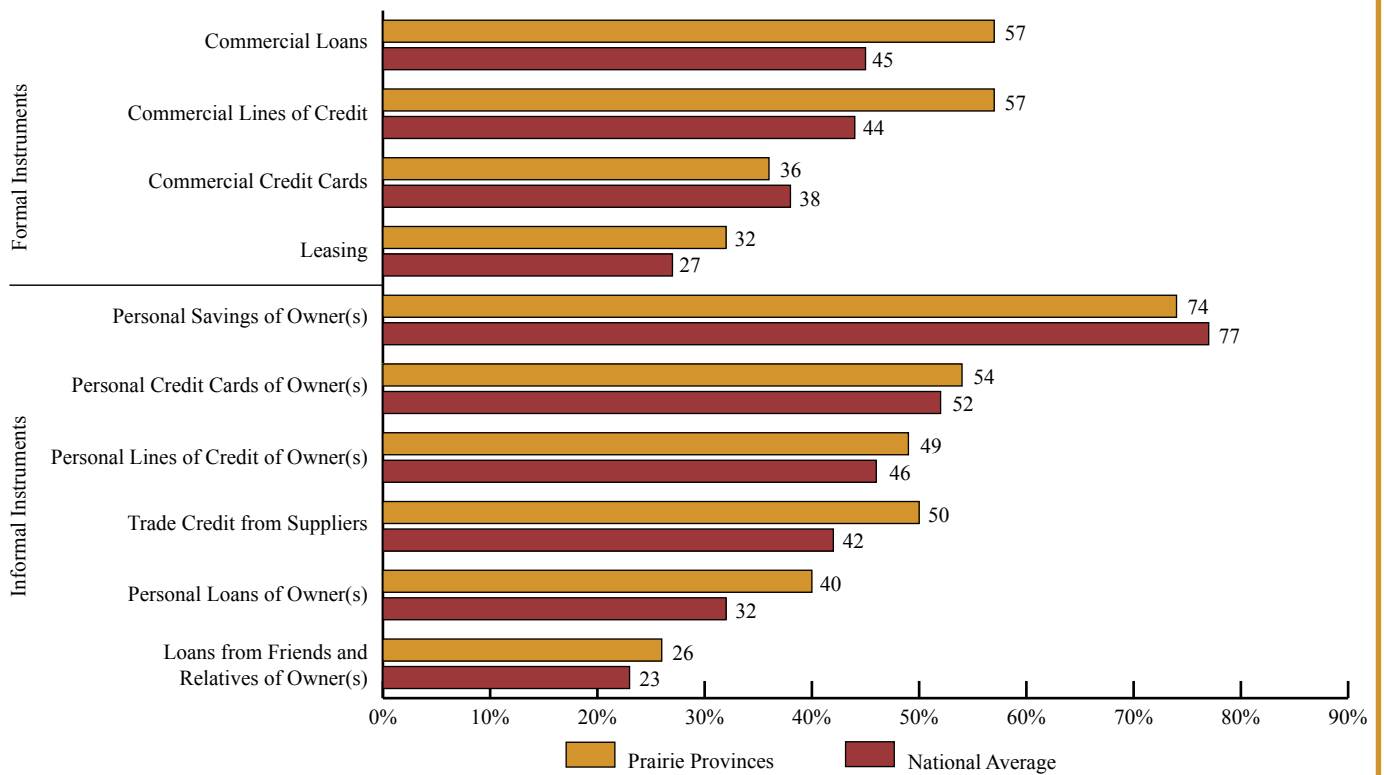
More than 35 percent of SME owners in the Prairie region intend to expand their business in the next two years. These Prairie region SME owners appeared to be more willing to share ownership of their firm in order to attract equity capital, with 56 percent of owners having stated they were willing to share equity in their business to achieve their growth objectives.

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

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

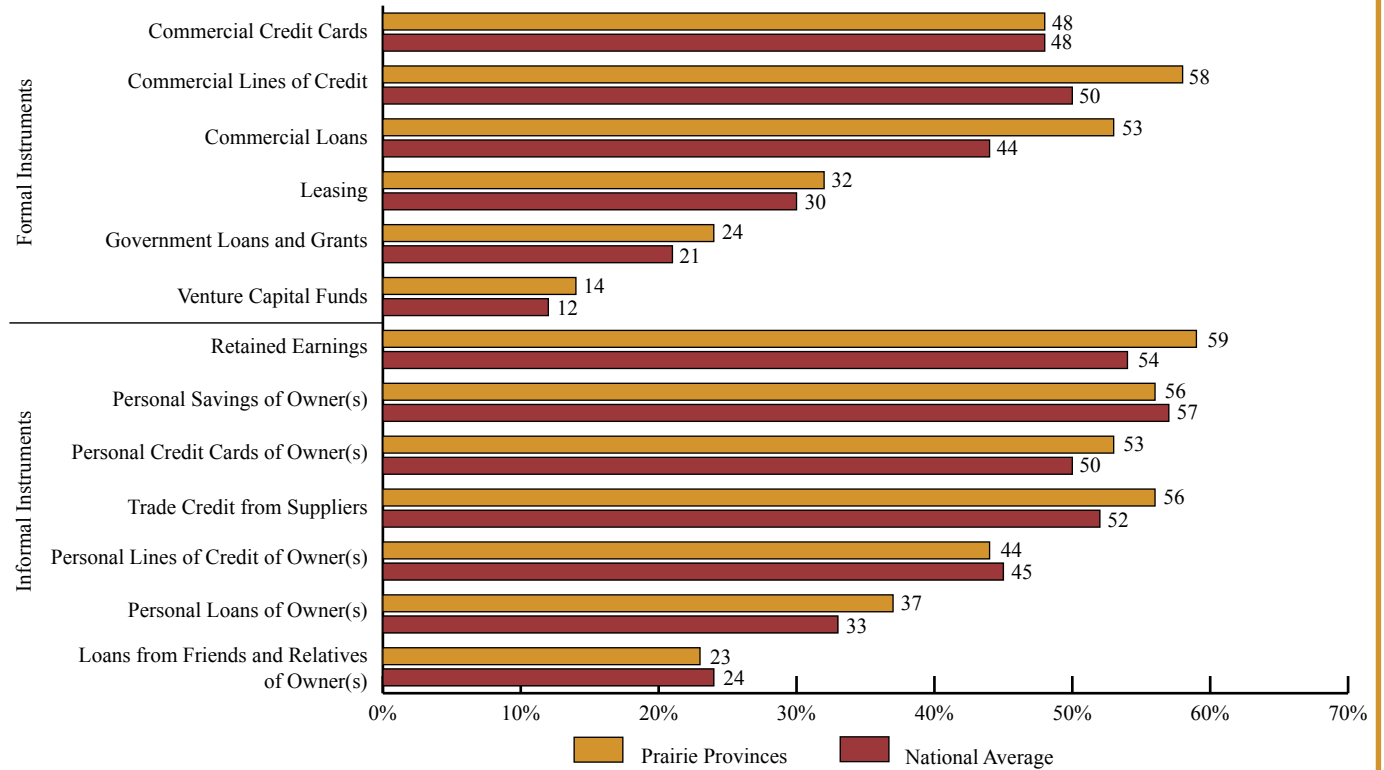
⁹ Riding, A. and Belanger, B. “Small Business Financing Profiles: Informally Financed SMEs,” SME Financing Data Initiative, Industry Canada, September 2006.

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.

By comparison, 39 percent of business owners across Canada expect to grow and 46 percent of Canadian entrepreneurs were willing to share ownership in their business to obtain growth capital.

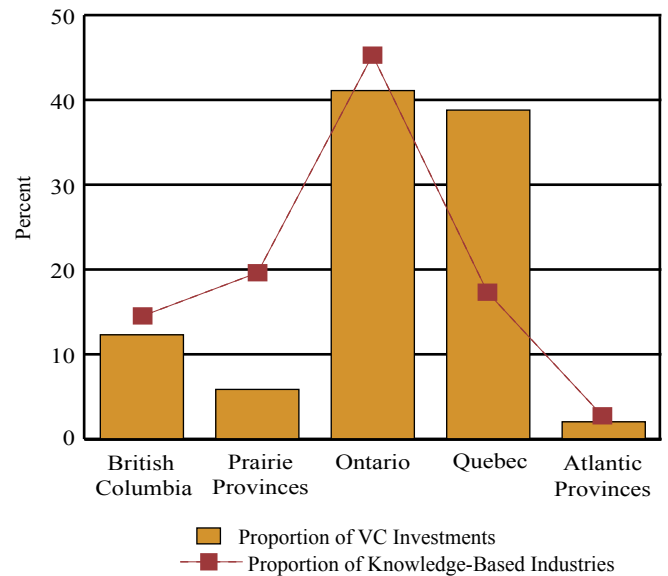
VENTURE CAPITAL ACTIVITY IN THE PRAIRIE REGION, 2000–2006

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 \$76 million in Prairie region enterprises. This represents a disproportionately low share of venture capital, less than 5 percent of the \$1.693 billion national total in a region that comprises 17 percent of Canada’s population and almost 20 percent of knowledge-based firms.

Figure 8 shows recent trends in venture capital investment in the Prairie region. The pattern displayed is not unlike that in other regions or nationally. Venture capital investing spiked during the technology boom of the late 1990s and has since moderated, a consequence of the bursting of the technology bubble in 2000.

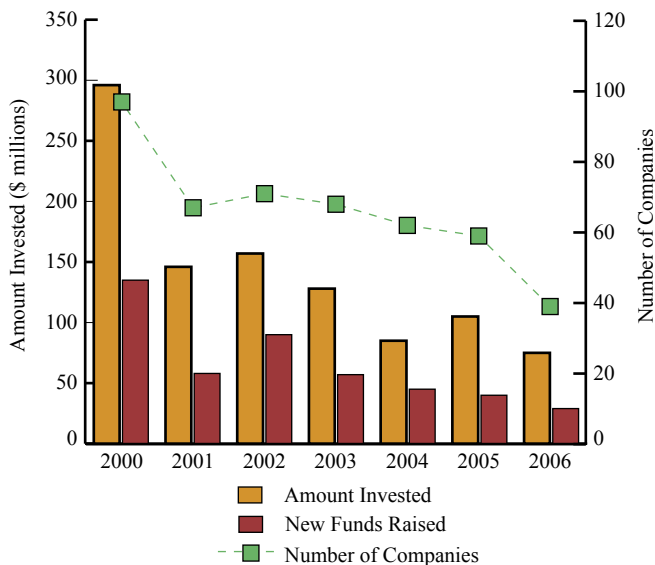
Figure 9 compares the share of venture capital investments in each of Canada’s major regions with their share of knowledge-based industries (KBIs). The chart shows that the Prairie region’s share of venture capital activity is substantially lower than would be expected based on its share of knowledge-based businesses.

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.

Figure 8
Venture Capital Activity in the Prairie Provinces, 2000–2006



Source: Thomson Financial, 2006.

SUMMARY AND DISCUSSION

SMEs in the Prairie provinces and across Canada are small, typically with four or fewer employees. Like many Canadian SMEs, those in the Prairie provinces rely on informal sources of financing, such as personal savings and personal credit. Yet the financing patterns of Prairie region SMEs also differ in several respects from those of other Canadian firms. Although chartered banks are the primary suppliers of debt

financing for SMEs, financing co-operatives play a more important role in financing Prairie region SMEs than in other regions. Prairie region firms tend to be slightly less likely to be R&D intensive. Risk-capital investment, an important source of financing among high-growth and technology-focused SMEs, appears to be disproportionately low in the Prairie provinces compared 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. For information regarding the methodology of the *Survey on Financing of Small and Medium Enterprises*, visit Statistics Canada's website at www.statcan.ca.

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