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SMALL BUSINESS

Financing Profiles

SME Financing Data Initiative September 2007

Small and Medium-Sized Enterprises in the Atlantic Provinces

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In Atlantic Canada, small and medium-sized enterprises (SMEs) account for 95 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 Atlantic provinces and compares financing activity between the average firm in Atlantic Canada and the average Canadian firm.*

Summary of Key Findings: *SMEs in both the Atlantic region and Canada are small, typically with four or fewer employees; however, self-employment appears to be relatively less prevalent in Atlantic Canada than in most regions. Like many Canadian SMEs, those in Atlantic Canada rely on informal sources of financing, such as personal savings and personal credit. Commercial banks are important suppliers of debt financing for Atlantic Canada SMEs. Atlantic region firms tend to be slightly less growth oriented and less likely to be research and development (R&D) intensive. Risk capital is an important source of financing among high-growth and technology-focused SMEs; however, firms in the Atlantic region obtained venture capital at a rate that was lower than its share of knowledge-based industries (KBIs). This is likely attributable to the relatively lower incidence of innovative and knowledge-based enterprises in the region.*

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 Atlantic provinces of New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador with national averages.

GENERAL CHARACTERISTICS

Atlantic Setting for SMEs

With a population of 2.3 million, commercial activity in the Atlantic provinces is concentrated in the energy sector, technologies, specialized manufacturing, professional services, tourism, telecommunications, forestry and seafood processing. 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 firms in Canada. Of these, approximately 6 percent operated in the Atlantic region, a proportion consistent with Atlantic Canada's 7 percent share of the 2004 Canadian population and 6 percent share

[1] Statistics Canada, Business Register, December 2004.

[2] RBC Financial Group, "Small and Medium-Sized Businesses are Driving Productivity Gains," October 2006. **www.rbc.com/newsroom/20061030smallbiz.html**

of Canada's gross domestic product (GDP). 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
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.

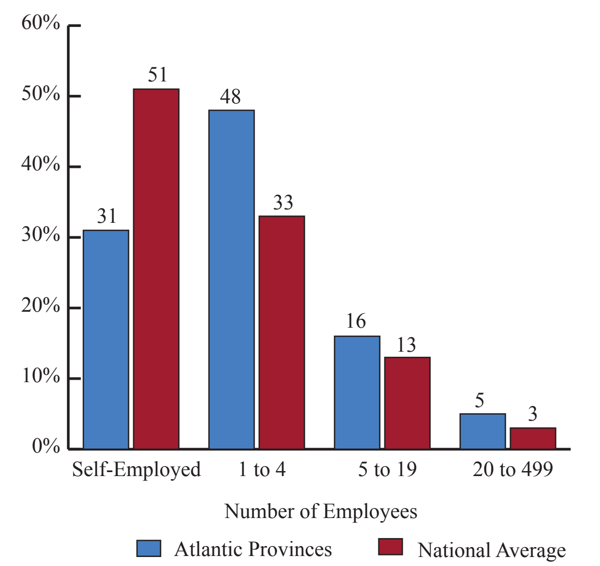
The incidence of business formation in Atlantic Canada was lower than the national average of 71.5 establishments per 1000 population of Canada. The rates for Newfoundland and Labrador, Nova Scotia and New Brunswick were, 51, 58 and 57 establishments per 1000 population of the respective provinces. The incidence of business formation in Prince Edward Island, at 75.7 establishments per 1000 population of the province, exceeded the national average.

The age distribution of SMEs in Atlantic Canada was consistent with the national average. Approximately 11.9 percent of firms in the Atlantic region first started selling goods or services between 2002 and 2004 compared with the national average of 11.2 percent.

Fewer Self-Employed in Atlantic Canada

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 small firms are more likely to turn to informal sources of capital, including personal finances. Figure 1 compares the size distribution of Atlantic region SMEs with the national average, showing that SMEs in the Atlantic area were predominantly small businesses, with 95 percent of firms employing fewer than 20 people.

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



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

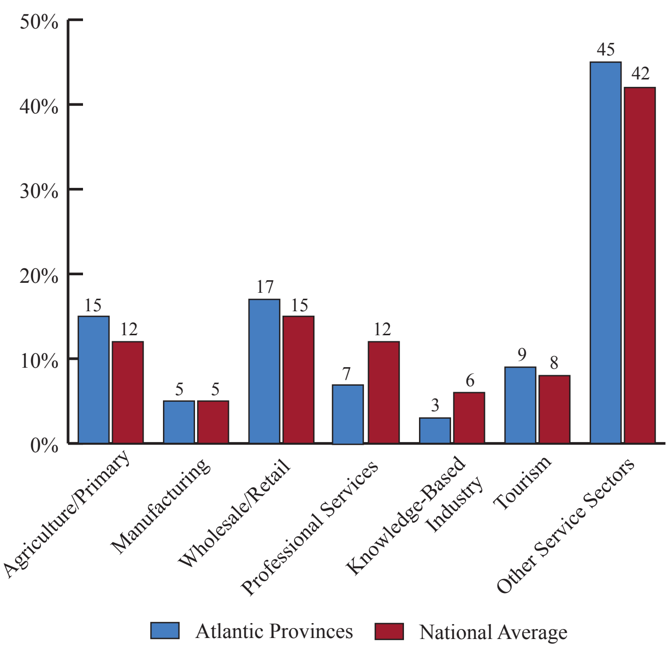
The Atlantic region is unique in that fewer firms were accounted for by self-employed individuals than in any other Canadian region: self-employed individuals comprised 31 percent of firms in the Atlantic region compared with approximately half of all firms nationwide. Of all workers in Atlantic Canada, 9 percent were self-employed compared with 11.9 percent nationally.[3]

[3] Statistics Canada, *Labour Force Survey*. **www40.statcan.ca/l01/cst01/labr66a.htm**

Industrial Composition of Atlantic 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 Atlantic region SMEs with the national average distribution. It shows that the distribution of SMEs in Atlantic Canada was similar to the national distribution, with a slightly higher incidence of firms in the primary sectors and in the wholesale/retail, tourism and other service sectors. Compared with other regions, the incidence of knowledge-based firms in the Atlantic region (3 percent) was lower than in other regions.[4] For example, 7 percent of firms in Ontario were in knowledge-based sectors as were 6 percent of firms in British Columbia and 5 percent of firms in Quebec.

Figure 2
Distribution of Atlantic Region 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 the Atlantic Provinces

Table 2 compares the profiles of primary owners of Atlantic region SMEs with national averages. The data show that the profile of Atlantic Canada SME owners was largely consistent with the national average. As would be expected, owners of SMEs in the Atlantic provinces were predominantly English-speaking; however, the proportion of owners who spoke a language other than English or French (1 percent of Atlantic region business owners) was substantially lower than the national average of 14 percent.

Atlantic Region Business Growth and Innovation

Approximately 38 percent of Atlantic Canada 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 9 percent of Atlantic Canada business owners exported products or services outside Canada in 2004, marginally higher than 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 Atlantic region funded in excess of $826 million in research and development (R&D), accounting for 21 percent of R&D expenditures in the Atlantic provinces (see Figure 3).

According to the 2004 *Survey on Financing of Small and Medium Enterprises*, 23 percent of Atlantic Canada's SMEs reported some investment in R&D during 2004 compared with the national average of 29 percent. Only 2 percent of Atlantic region SMEs

[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 Atlantic Region and Canada, 2004

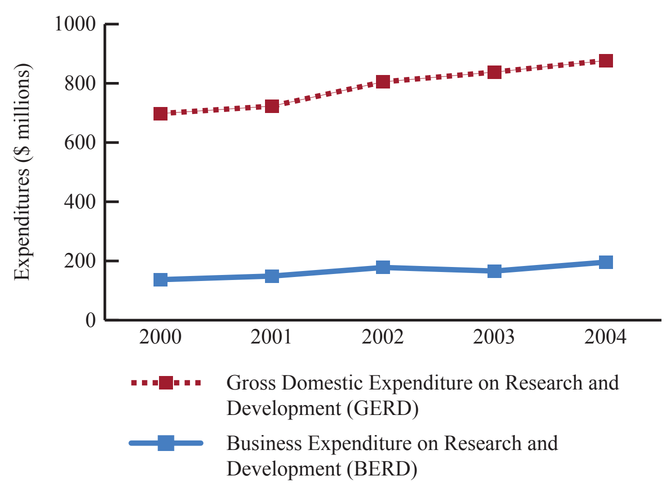
Atlantic Region Entrepreneurs	Characteristics	National Average
11 percent owned by women, 69 percent owned by men and 20 percent are equal partnerships	**Gender**	16 percent owned by women, 64 percent owned by men and 20 percent are equal partnerships
1 percent visible minority, 3 percent Aboriginal, 2 percent disabled and 2 percent are recent immigrants	**Minority Status**	7 percent visible minority, 2 percent Aboriginal, 4 percent disabled and 1 percent are recent immigrants
2 percent are under 30, 89 percent are between 30 and 64, and 9 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
88 percent speak English, 11 percent speak French and 1 percent speak a non-official language	**First Language**	67 percent speak English, 19 percent speak French and 14 percent speak a non-official language
11 percent have fewer than 5 years, 17 percent have 5 to 10 years and 72 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
49 percent urban-based and 51 percent rural-based	**Location**	72 percent urban-based and 28 percent rural-based
9 percent export outside Canada	**Export Activity**	8 percent export outside Canada

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

devoted more than 20 percent of their investments to R&D (compared with 4 percent nationally), the lowest proportion of research-intensive firms relative to other regions of Canada. This is consistent with the proportion of knowledge-based firms in Atlantic Canada, at 3 percent, which is the lowest of all Canadian regions. 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] Hence, the relative scarcity of innovative firms in the Atlantic region may be linked to access to venture capital.

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). Table 3 shows the relative importance of various obstacles to growth as perceived by SME owners. Owners in the Atlantic region were particularly concerned about levels of taxation and insurance rates. Access to financing was cited less frequently as a barrier to growth than most other factors (but was cited as a barrier more often than the national average), mentioned as an obstacle by 26 percent of Atlantic region SME owners.

Figure 3
Expenditures on Research and Development in the Atlantic Provinces, 2000–2004



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

[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

		Atlantic Region SMEs	SME National Average
		%	
External to the Firm	Levels of Taxation	54	47
	Finding Qualified Labour	36	37
	Instability of Consumer Demand	42	36
	Government Regulations	37	33
Internal to the Firm	Insurance Rates	46	36
	Low Profitability	47	38
	Obtaining Financing	26	20
	Management Capacity	10	13

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

FINANCING ACTIVITY

During 2004, 26 percent of Atlantic Canada 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. It summarizes, by region, rates at which SMEs applied for various forms of financing and corresponding rates of approval.

Table 4 shows that 20 percent of Atlantic Canada SMEs applied for commercial loan financing. The majority (65 percent) of loan applications were made to chartered banks and 18 percent were made to credit unions or Caisses populaires (see Figure 4). The most frequent types of loan applications were from owners seeking to finance working capital (54 percent of loan applications) or to finance fixed assets (50 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 13 percent of loan applications from Atlantic Canada SMEs were turned down, a rate that is slightly higher than the 12 percent national average. At the same time, 68 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 3 percent of Atlantic Canada business owners sought lease financing and approval rates for leases were high (94 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

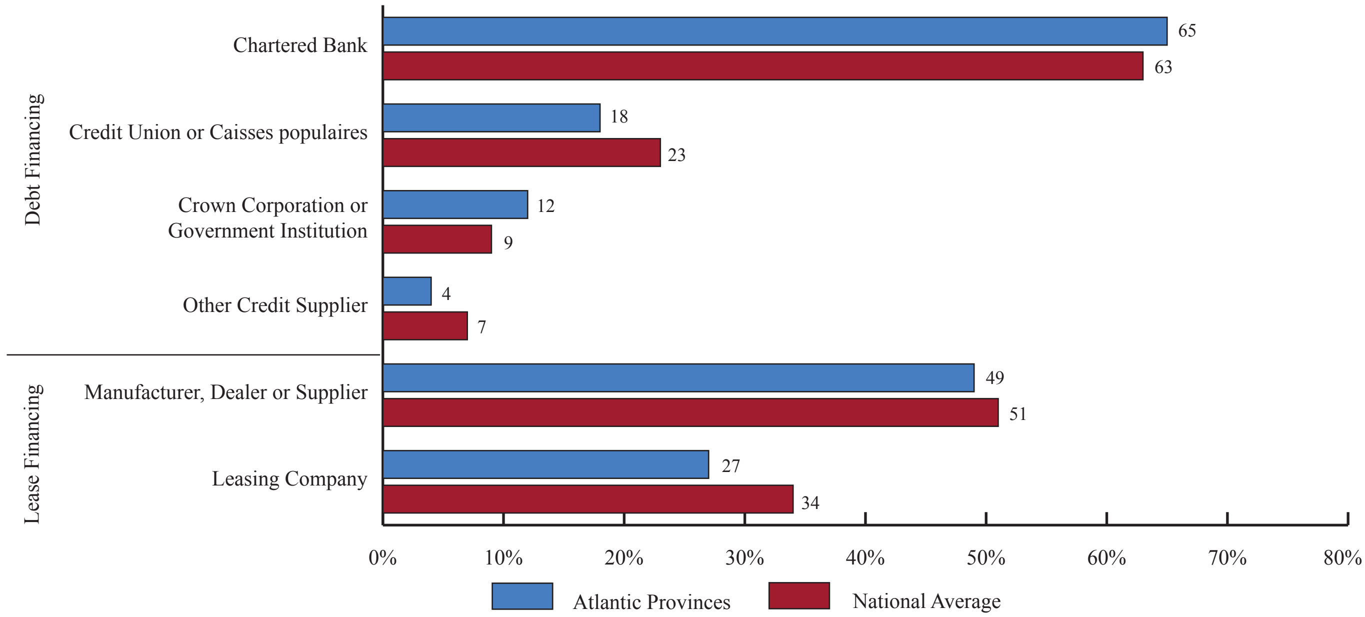
Table 4
Financing Request and Approval Rates, 2004

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.

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.

equity financing during 2004. Differences across regions were not statistically significant.

Atlantic Canada's Financing Environment

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 Atlantic region, lenders authorized a total of $32 billion in debt financing in almost 122 000 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 Atlantic Canada appear to have faced similar application requirements as firms elsewhere in Canada (Figure 5). Atlantic region lenders were only somewhat less likely to require formal applications or appraisals of the assets being financed, but slightly more likely to require business plans.

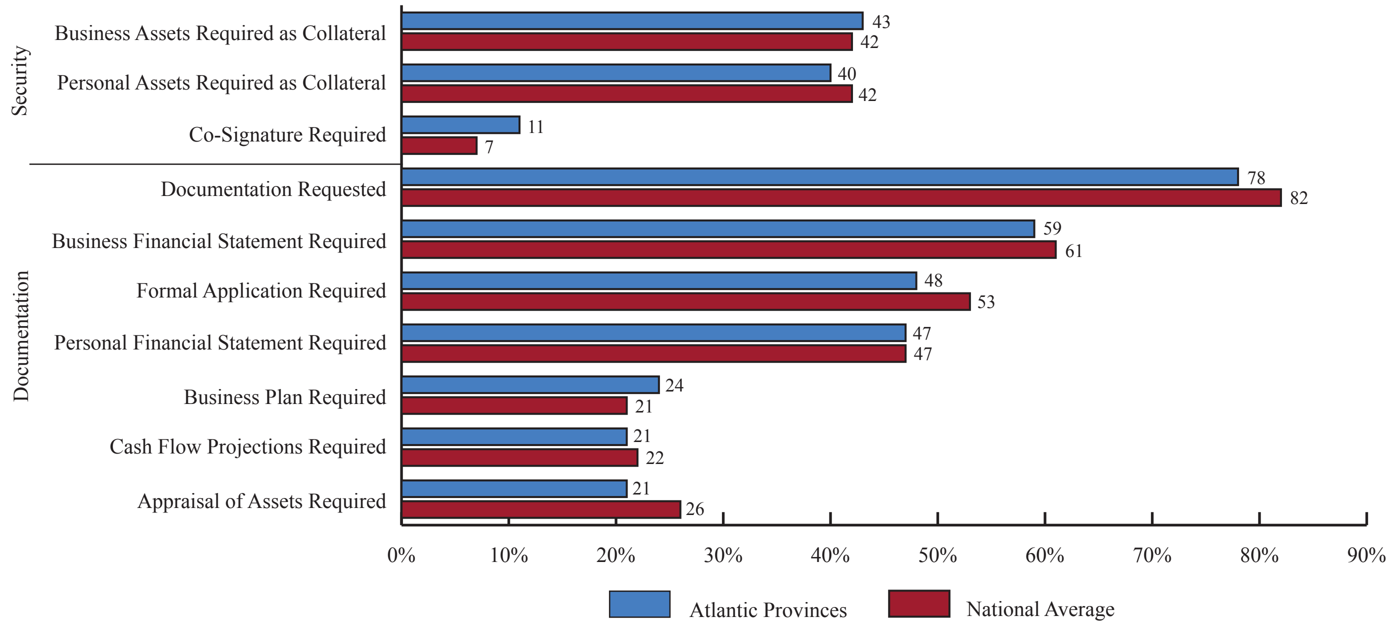
Capital Structure

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 Atlantic Canada SME 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 for SMEs in the Atlantic region were personal savings and personal credit instruments. This pattern

[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.

was repeated for SMEs in all regions. Among established firms, Atlantic region companies were as likely as companies in other regions to have used informal sources, such as retained earnings, personal savings and personal credit cards, but more likely to resort to formal instruments (such as commercial credit cards, commercial lines of credit and commercial loans).

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.

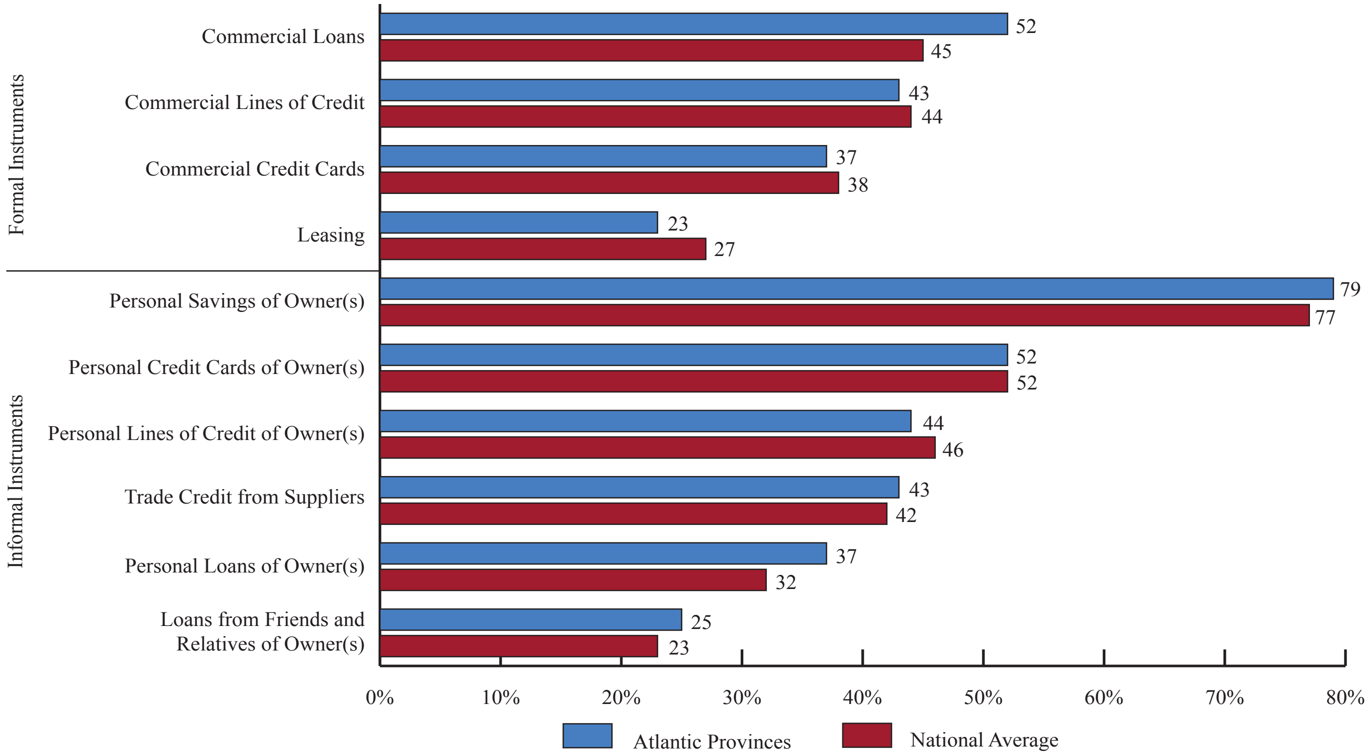
Approximately 14 percent of businesses in Atlantic Canada have received angel financing over their history and 23 percent have received financing from friends and family.[9]

[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."

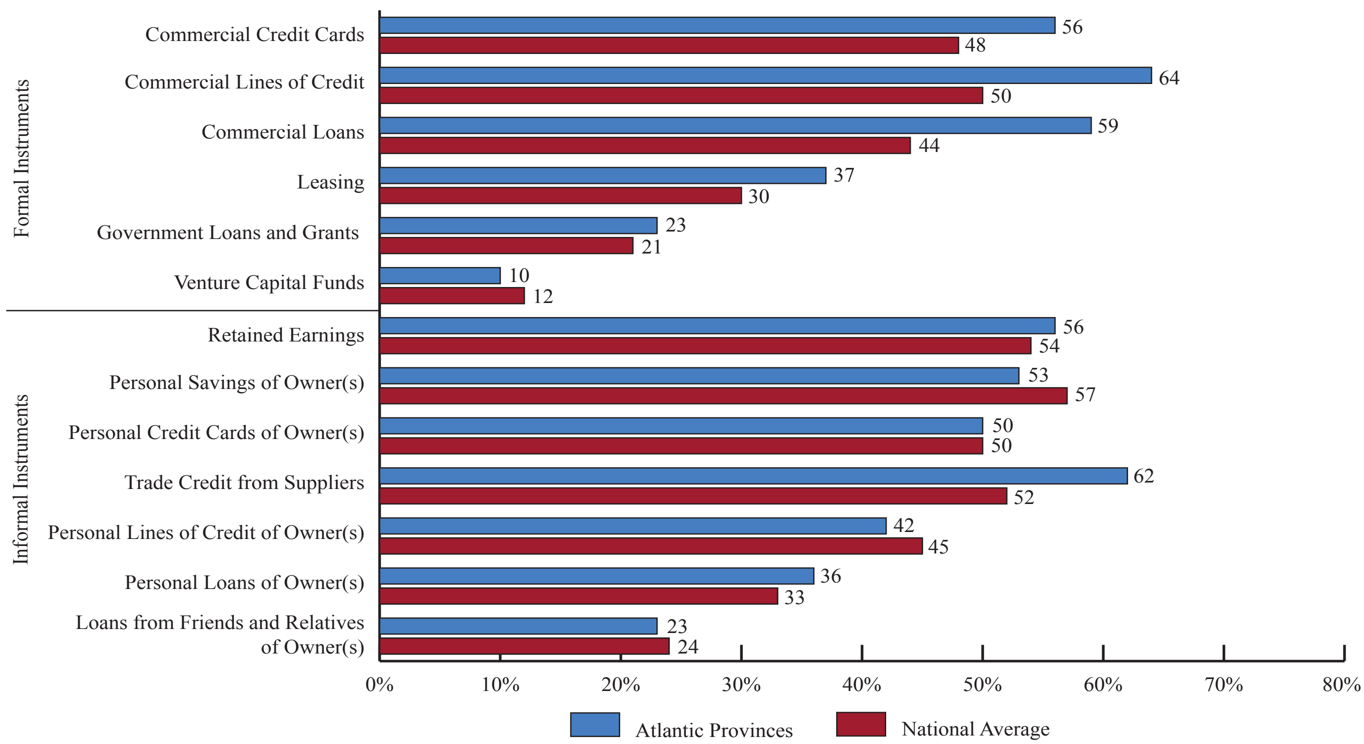
[9] Riding, A. and Belanger, B. "Small Business Financing Profiles: Informally Financed SMEs," SME Financing Data Initiative, Industry Canada, September 2006.

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.

Although more than 38 percent of SME owners in Atlantic Canada intend to expand in the next two years, 55 percent of these stated they were willing to share equity in their business to achieve their growth objectives. 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.

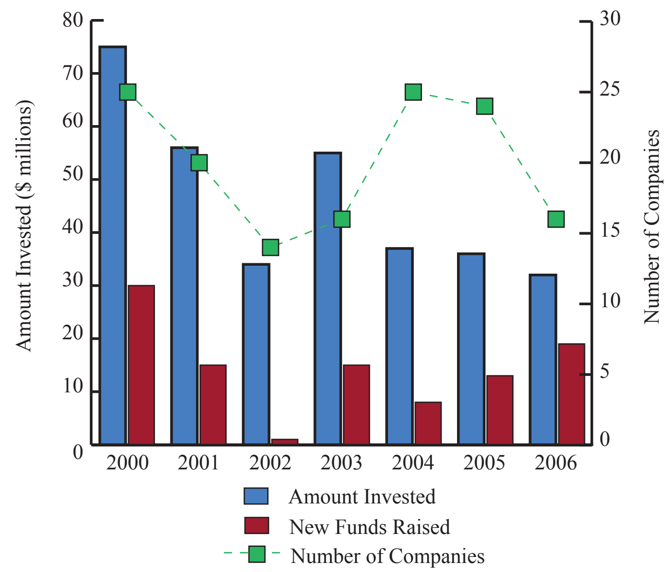
Venture Capital Activity in Atlantic Canada, 2000–2006

Venture capital (VC) is a form of risk capital used to support a small number of high-growth early-stage firms as they expand beyond the seed financing stage. During 2006, institutional venture capital firms invested a total of $32 million in Atlantic Canada enterprises, the least among any of Canada's major economic regions. This represents a disproportionately low share of venture capital, less than 2 percent of the $1.693 billion national total in a region that comprises 7 percent of Canada's population.

Figure 8 presents recent trends in venture capital investment in the Atlantic region. As was true nationally, 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.

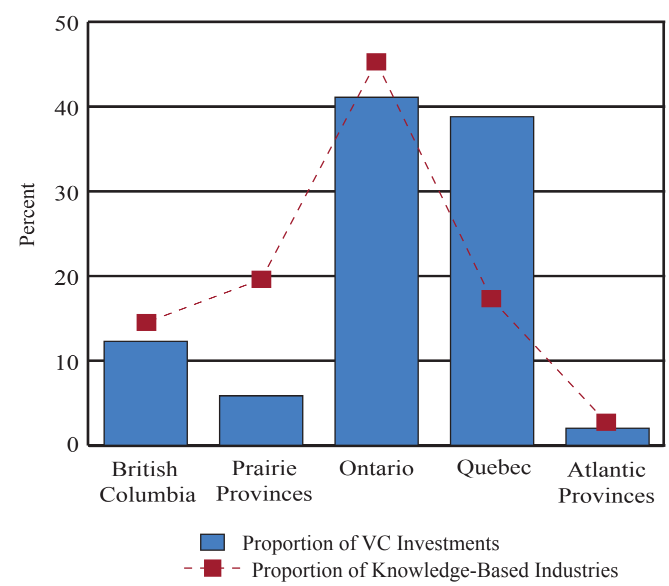
Figure 9 compares the share of venture capital investments in each of Canada's major regions with their share of knowledge-based businesses. The chart shows that Atlantic Canada's share of venture capital activity is less than would be expected based on its share of knowledge-based industries (KBIs).

Figure 8
Venture Capital Activity in Atlantic Provinces, 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.

SUMMARY AND DISCUSSION

SMEs in both the Atlantic region and Canada are small, typically with four or fewer employees; however, self-employment appears to be relatively less prevalent in Atlantic Canada than in most regions. Like many Canadian SMEs, those in Atlantic Canada rely on informal sources of financing, such as personal savings and personal credit. Commercial banks are important suppliers of debt financing for Atlantic Canada SMEs. Atlantic region firms tend to be slightly less growth oriented and less likely to be R&D intensive. Risk capital is an important source of financing among high-growth and technology-focused SMEs; however, firms in the Atlantic region obtained venture capital at a rate that was lower than its share of knowledge-based industries. This is likely attributable to the relatively lower incidence of innovative and knowledge-based enterprises in the region.

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Thomson Financial, VC Analyst II, 2006.

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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