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Innovation, Sciences et Développement économique Canada

CANADA SMALL BUSINESS FINANCING PROGRAM
EVALUATION REPORT

AUDIT AND EVALUATION BRANCH
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Canada

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LIST OF ABBREVIATIONS AND ACRONYMS

CSBFP	Canada Small Business Financing Program
ISED	Innovation, Science and Economic Development Canada
OECD	Organization for Economic Co-operation and Development
SME	Small- and Medium-Sized Enterprise

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EXECUTIVE SUMMARY

This report presents the results of an evaluation of the Canada Small Business Financing Program (CSBFP). The CSBFP was launched in 1999 to build upon its predecessor, the *Small Business Loans Act*, which was launched in 1961. The CSBFP increases the availability of loans for establishing, expanding, modernizing and improving small businesses.

PROGRAM OVERVIEW

The CSBFP is a government loan loss sharing program designed to help businesses with their financing needs by helping to fill gaps in the lending market for certain types of small- and medium-sized enterprises (SMEs) and, in particular, higher-risk SMEs.[1] To be eligible, CSBFP borrowers must have annual revenues of $10 million or less.

The objectives of the CSBFP are: to help new businesses get started and assist established firms make improvements and expand; improve access to loans that would not otherwise be available to small businesses; and stimulate economic growth and create jobs for Canadians. The loans made available under the CSBFP through qualified lenders (chartered banks, credit unions and caisses populaires) can finance the purchase or improvement of land or buildings used for commercial purposes and new or used equipment, and the purchase of new or existing leasehold improvements.

Overall, the program has become a key tool for providing financing to SMEs in Canada. Since its inception in 1999 through October 31, 2018, the program has registered 172,820 loans worth $19.7 billion.

EVALUATION PURPOSE AND METHODOLOGY

The objective of this evaluation was to address the issues of relevance, performance and efficiency in accordance with the *Policy on Results* and support the CSBFP Comprehensive Review Report, as required under the *Canada Small Business Financing Act*. The evaluation covered the period from April 1, 2014 to October 31, 2018 and was calibrated to build on the findings of the 2014 evaluation in order to assess the progress towards intermediate and long-term outcomes. The evaluation employed multiple data collection methods: a document review, literature review, interviews, administrative data analysis and review, and financial data analysis.

[1] ISED defines a small business as one with fewer than 100 paid employees and a medium-sized business as one with at least 100 and fewer than 500 employees.

FINDINGS

Relevance

The CSBFP continues to address a demonstrable need to facilitate SME access to financing. There is a need for a program that shares the risk of lending to higher risk SMEs, as they contribute significantly to the economy but have greater difficulty accessing sufficient and appropriate financing. While the CSBFP is the only national loan loss-sharing program open to SMEs regardless of geographic location, the program may not be addressing the evolving needs of SMEs in the current environment. These evolving needs include maximum loan amounts which reflect the present cost of products, lines of credit, expansion of loan classes (including intangible assets and working capital), and further reduction of the administrative burden of the program.

Performance

The CSBFP enables financial institutions to provide loans to SMEs that would not otherwise be made available or would be available only under less favourable terms. Although some SMEs would still be able to access financing, it is estimated that about two-thirds of all CSBFP loans may not have been made in the absence of the program and that, overall, over 80% of CSBFP borrowers likely benefitted from the existence of the program. As well, CSBFP participation has a positive impact on SME revenues and employment levels. Some interviewees also suggested that access to loans could improve if more types of lenders were eligible to become registered lenders (e.g., Indigenous financial institutions).

Awareness of the CSBFP remains low among borrowers and non-borrowers (29% and 10%, respectively), but high for lenders (98%). Although lenders' knowledge of the CSBFP has increased, their knowledge of the program's eligibility criteria (over 60% for all criteria) exceeded their knowledge of the program's terms and conditions (only 31% correctly recalled that the government's loan guarantee covered 85% of the loan amount). Imprecise knowledge of the programs' terms and conditions could impact the provision of loans by financial institutions and misinform potential borrowers.

The vast majority (96%) of CSBFP loan defaults occur within five years of loan issuance. There are a number of factors which influence the probability of defaulting on a loan, with some of the more prominent factors being the age and size of the business, as well as the loan type and amount. Repeat borrowers, which represent approximately 10-16% of all CSBFP borrowers, are less likely to default than one-time borrowers (9% versus 15%).

Efficiency

Net social benefits generated by the CSBFP were estimated to have been positive in every year since 2003, totalling almost $4 billion over the 2008 to 2017 period. Program estimates indicate that the CSBFP is expected to be almost fully cost recoverable for the 2014-15 to 2018-19 period.

RECOMMENDATIONS

The evaluation findings led to the recommendations noted below.

Recommendation 1: Expanding Program Parameters and Reducing Administrative Burden
ISED should consider further program modifications to better meet the evolving needs of SMEs, such as increasing the maximum loan amount for leasehold and equipment expenses, introducing operating lines of credit, expanding loan classes (including intangible assets and working capital), and continuing to lessen the administrative burden for both borrowers and lenders.

Recommendation 2: Increasing Awareness of the CSBFP
ISED should focus on increasing awareness and knowledge of the CSBFP among both borrowers and lenders.

Recommendation 3: Expanding List of Registered CSBFP Lenders
ISED should consider expanding the list of registered CSBFP lenders to help increase access to the program.

1.0 INTRODUCTION

1.1 REPORT OVERVIEW

This report presents the results of an evaluation of the Canada Small Business Financing Program (CSBFP). The program is administered by Innovation, Science and Economic Development Canada (ISED) and was launched in 1999 to build upon its predecessor, the *Small Business Loans Act*, which was established in 1961. The CSBFP increases the availability of loans for establishing, expanding, modernizing and improving small businesses.

The purpose of this evaluation is to assess the relevance, performance, and efficiency of the CSBFP. The report is organized into four sections:

- Section 1 provides the context and profile of the CSBFP;
- Section 2 presents the evaluation methodology and the challenges for the evaluation;
- Section 3 presents the findings; and
- Section 4 summarizes the conclusions and provides recommendations.

AT A GLANCE:

- The CSBFP was launched in 1999 to help new businesses get started and established firms make improvements and expand; improve access to loans that would not otherwise be available to small businesses; and stimulate economic growth and create jobs for Canadians.
- In 2017-18, Canadian lending institutions registered 5,767 CSBFP loans to small businesses valued at almost $1.2 billion.

1.2 CONTEXT

Small and medium-sized enterprises (SMEs) play an important role in the Canadian economy and are key drivers of job creation, productivity, innovation and growth.[2] SMEs account for over 99 percent of the almost 1.2 million businesses operating in Canada and employ almost 90 percent of Canada's private sector workforce.[3] Access to sufficient and appropriate financing is a critical element for SMEs to succeed in the marketplace, particularly for start-ups, young businesses and certain industry sectors (e.g., accommodation and food services). However, lenders are typically averse to extending financing to some SMEs due to the higher degree of risk of default. Lenders respond to this higher degree of risk in a variety of ways (e.g., higher interest rates, higher requested collateral amounts, etc.) that have the effect of limiting the availability of financing for small businesses, particularly during periods of economic difficulties.

1.3 OBJECTIVES AND DESCRIPTION

The CSBFP is designed to help businesses with their financing needs by helping to fill gaps in the

[2] ISED defines a small business as one with fewer than 100 paid employees and a medium-sized business as one with at least 100 and fewer than 500 employees.
[3] https://www.ic.gc.ca/eic/site/061.nsf/vwapj/KSBS-PSRPE_Jan_2019_eng.pdf/$file/KSBS-PSRPE_Jan_2019_eng.pdf

lending market for certain types of SMEs and, in particular, higher-risk SMEs. The main objectives of the CSBFP are to: (1) help new businesses get started and established firms make improvements and expand; (2) improve access to loans that would not otherwise be available to small businesses; and (3) stimulate economic growth and create jobs for Canadians.

The loans made available under the CSBFP can only be used to finance:

- The purchase or improvement of land or buildings used for commercial purposes;
- The purchase or improvement of new or used equipment; and
- The purchase of new or existing leasehold improvements (e.g., renovations to a leased property by a tenant).[4]

The purchase of eligible assets of an existing business[5] may also qualify for financing under the CSBFP (the lesser of the cost of purchase and the appraised value of the eligible assets may be financed). However, it is not possible to use a CSBFP loan to finance items such as goodwill[6], working capital, inventories, franchise fees, or assets that a holding company acquires.[7]

Overall, the program has become a key tool for providing financing to SMEs in Canada, representing about 5% of new loans to SMEs in Canada in 2017.[8] Since its inception in 1999 through October 31, 2018 (the end of the evaluation period), the program has registered 172,820 loans worth $19.7 billion. It is worth noting that the number of loans made had been trending downward since 1999-00 (e.g., 17,741 loans in 1999-00 versus 5,767 loans in 2017-18), but has started to trend upward again over the last few years. In contrast, the average loan size has increased steadily (e.g., $76,226 in 1999-00 versus $203,165 in 2017-18). See Appendix A for a full summary for the 1999-00 to 2017-18 lending period.

The 1999-2004 Comprehensive Review Report[9] suggested that the decline in loans during the initial years of the CSBFP, and perhaps in the years which followed, was impacted by program design and administrative burden. Lenders felt that some program requirements, such as those to gather and keep invoices for each loan, or rules that prohibit service fees, were inconsistent with their evolving and increasingly automated lending practices and the competitive environment in which they operate.

Further, a study of CSBFP borrowers noted that the declining loan volume from 2011-2012 to 2014-2015 may have been driven by structural changes in the financing needs of entrepreneurs and more diversity in private sector financing products.[10] These trends, as well as the increase in

[4] http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h_la02296.html#q2
[5] http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h_la03133.html#s4
[6] Goodwill is a special type of intangible asset that represents that portion of the entire business value that cannot be attributed to other income-producing business assets, tangible or intangible.
[7] http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h_la02296.html#q3
[8] 2017 Biannual Survey of Suppliers of Business Financing.
[9] As legislated by the *Canada Small Business Financing Act*, the Program operates on a statutory five-year review cycle. https://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/vwapj/Comprehensive-review-1999-2004-eng.pdf/$file/Comprehensive-review-1999-2004-eng.pdf
[10] *SME Profile: CSBFP Borrowers March 2016*, Innovation, Science and Economic Development Canada.

average loan size, are reflective of borrowers requesting greater loan amounts to meet their business needs, the rising costs of fixed assets, and recent program changes including the increase in maximum real property loan amounts from $500,000 to $1 million.[11]

1.4 RESOURCES

The program's operating expenditures are not cost recoverable and are funded by ISED's operating budget. These costs are approximately $2.6 million annually for a staff of 22 and include costs related to operations, research, Information Technology, and outreach activities.

As the CSBFP is a statutory program, the cost of claims for loan losses is sourced directly from the fiscal framework (i.e., the Consolidated Revenue Fund). The program collects revenues from the registration fee and the annual administration fee (based on the lender's outstanding loan balances). These fees are submitted to ISED by lenders and used to offset a portion of the program's expenses related to claim payments.

There are also a number of control mechanisms under the CSBFP which limit the Government of Canada's exposure to liability. For example, the CSBFP establishes a $1.5 billion liability ceiling for each five-year lending period.[12] The CSBFP has never come close to reaching its maximum liability limit, peaking at $700.7 million during the April 1, 2014 to March 31, 2019 lending period.

In addition, to control costs and mitigate risks, each lender has a cap on claims under the CSBFP. The cap on claims is calculated based upon the total amount of loans that a lender registers with the program during each five-year period. Specifically, the program's obligation to an individual lender is to partially pay eligible claims (i.e., 85 percent of the eligible loss) on defaulted loans up to a maximum of the aggregate of:

- 90% of the first $250,000 in loans registered; plus
- 50% of the next $250,000; plus
- 12% of all loans in excess of $500,000.

For example, if a lender registers $100 million in loans under the program during a five-year period, the lender's cap would be equal to roughly $12 million. Therefore, 85% of the value of each defaulted loan would be paid to that lender, until cumulative payments have reached $12 million. Once the $12 million cap is hit, the CSBFP would cease paying claims to that lender until the next five-year loan period begins.

This calculation is meant to encourage low volume lenders to participate in the program and limits the government's potential liability to high volume lenders, effectively, to 12% of the value

[11] *Mid-Term Review Report 2014-2019*, Innovation, Science and Economic Development Canada.
[12] ISED is not liable to make any payment to a lender in respect of a loss sustained as a result of a loan once ISED's aggregate contingent liability in respect of the aggregate principal amount of the loans made by all lenders (and registered by ISED during each consecutive five-year period, starting with the period beginning on April 1, 1999) exceeds $1.5 billion or any other amount that is provided by an appropriation Act or another Act of Parliament.

of the loans registered under the program. This ensures that high volume lenders bare their share of risk.

1.5 DELIVERY AND GOVERNANCE

The CSBFP is delivered by private sector lenders, and is limited to chartered banks, credit unions and caisses populaires. Lenders provide service to Canadians in all provinces and territories and are responsible for all credit decisions, loan approvals, and in the event of default, realizing on security and guarantees prior to making a claim with the CSBFP. Each lender establishes its own lending criteria subject to the requirements of the CSBFP. Once the loan is approved, the funds advanced to the borrower are from the lender and not the Government. However, the Government maintains control of some of the key parameters that include fees, maximum interest rates, maximum loan sizes, and asset classes of the loan (i.e., real property, leasehold improvements, and equipment).

ISED administers the CSBFP by registering loans, collecting fees and paying lenders the eligible portions of losses on defaulted loans. The CSBFP does not approve the borrower loan applications and is not involved in the administration of the loans. By registering loans with ISED, lenders are entitled to submit claims to ISED in the event of default. The interest rate charged to borrowers is determined by lenders and may be fixed or variable, within the parameters of the regulations:

- Variable rate: the maximum chargeable is the lender's prime lending rate plus 3% (including a 1.25% annual administrative fee).
- Fixed rate: the maximum chargeable is the lender's single family residential mortgage rate for the term of the loan plus 3% (including a 1.25% annual administrative fee).

A one-time registration fee of 2% of the total loan amount is payable by the lender to ISED at the time of loan registration, but may be financed by the borrower as part of the loan (a decision which is at the discretion of the lender).

The target audience of the CSBFP is for-profit small businesses in Canada with gross revenues of $10 million or less. Eligible businesses can be corporations, sole proprietors, partnerships or cooperatives. Not-for-profit, charitable or religious organizations, and farming businesses are excluded from the program.

In 2017-18, the profile of CSBFP loans included the following characteristics:

- The average loan size was approximately $203,165;
- By province/territory, 36% of loans were distributed in Ontario, 24% in Québec, 18% in Alberta, 8% in British Columbia, and the remaining 14% in the other provinces and territories;
- Small businesses less than one year old received $765.5 million, or 65.0% of the value of all loans issued by financial institutions;

- Those with estimated annual revenues of less than $2 million accounted for the vast majority (92.3%) of the value of loans made;
- The majority of loans (in terms of the dollar amount disbursed) went to small businesses in three specific sectors: accommodation and food services (40.6%), retail trade (12.3%), and other services (11.8%); and
- The distribution of CSBFP loans by asset type was 44.8% for leasehold improvement and equipment, 27.4% for equipment only, 15.3% for real estate only and 11.3% for leasehold improvements only.[13]

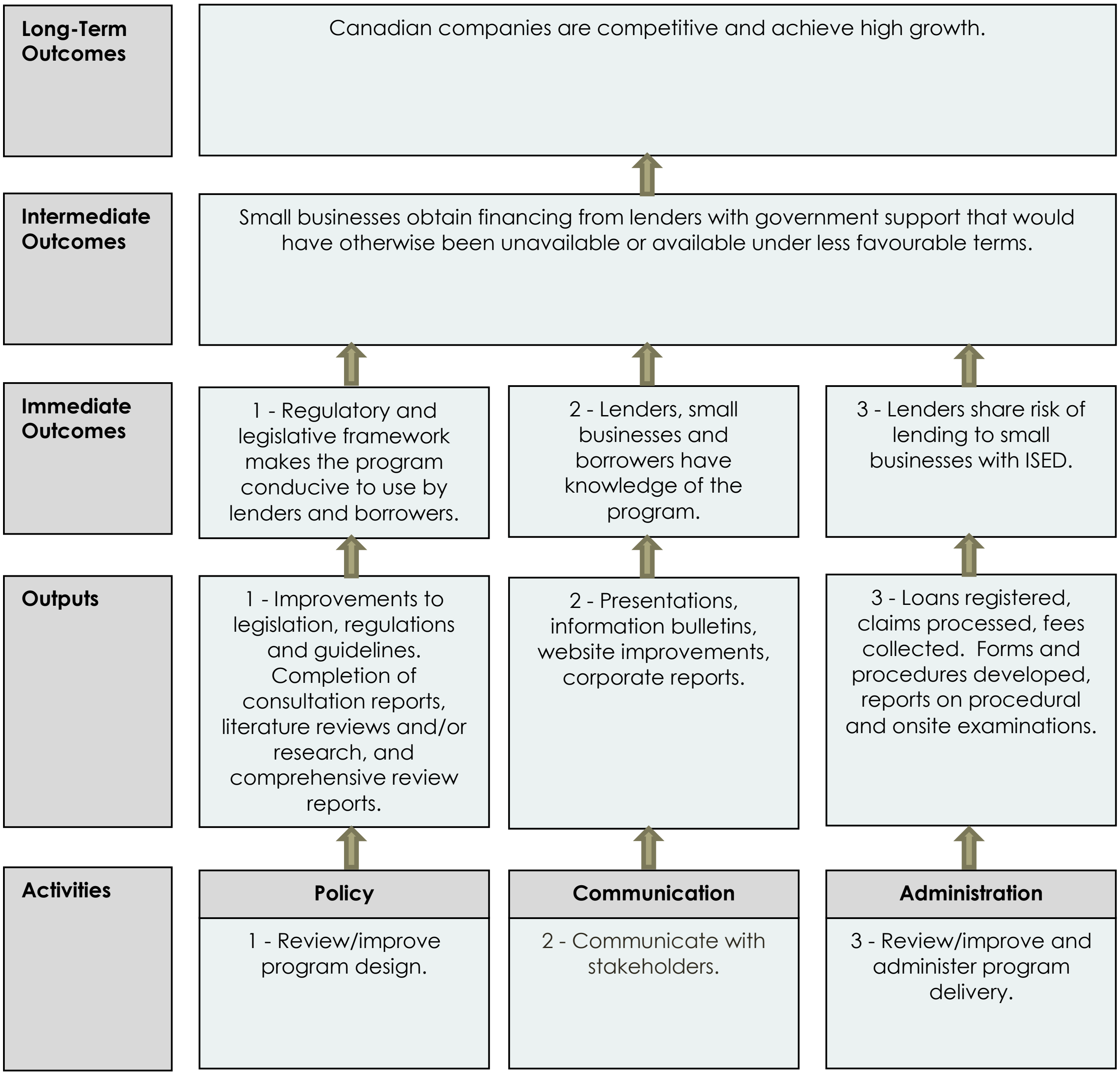
1.6 LOGIC MODEL

The logic model for the CSBFP is presented in Figure 1.[14] It is a visual representation that links a program's activities, outputs and outcomes; provides a systematic and visual method of illustrating the program theory; and shows the logic of how a program, policy or initiative is expected to achieve its objectives. It also provides the basis for developing the performance measurement and evaluation strategies.

In terms of its link to Canada's Innovation and Skills Plan, the CSBFP helps to support Canadian innovators by putting more money in the hands of all types of SMEs – from everyday businesses to high growth/high performing businesses – to grow their businesses and create jobs.[15]

[13] The remaining distribution was 1.1% for real estate and equipment; 0.1% for real estate and leasehold improvement; and 0% for loans which included real estate, leasehold improvement, and equipment.
[14] The logic model is derived from the December 5, 2017 Performance Information Profile for the Support and Financing for Small Business program.
[15] https://www.budget.gc.ca/2017/docs/themes/Innovation_en.pdf

Figure 1: CSBFP Logic Model



2.0 METHODOLOGY

This section provides information on the evaluation context, objectives, scope and approach, issues and questions, data collection methods, and limitations.

2.1 EVALUATION CONTEXT

The CSBFP was evaluated in 2014 and covered the period from April 2009 to March 2014. The evaluation suggested a continued need for the program as smaller, younger and higher-risk businesses have difficulty obtaining financing in Canada given their limited collateral credit history, expertise, and the lender having insufficient information regarding the borrower's operation and potential profitability.

As well, regarding the effectiveness and efficiency of the program, the evaluation determined that:

- The program's regulatory and legislative framework provides the CSBFP with a concrete foundation from which to deliver its objectives. However, the demands of the program coupled with the slow process to make the legislative framework changes can place stress on its relationships with its private sector stakeholders and has diminished the program's appeal for lenders.
- Awareness of the program tends to be high among lenders overall, but low among borrowers and non-borrowers alike.
- The program has been successful in facilitating incremental debt financing for the small business community over time.
- The CSBFP has a positive impact on the growth of SMEs.
- The CSBFP demonstrates value for the investment made in that it returns approximately five dollars to the economy for every dollar spent of the program.

The evaluation recommended that: (i) program officials re-engage existing and potential borrowers to determine if the CSBFP is sufficiently meeting their needs in the current environment; and (ii) closer outreach ties be developed with lenders and professional associations willing to collaborate to help raise awareness and knowledge of the program.

The 2014 evaluation faced significant data analysis limitations. As the 2014 Incrementality Study was not finished in time, the report findings were not included. In addition, the Economic Impact Analysis findings were based on data from 2009.

2.2 OBJECTIVES

An evaluation of the CSBFP is required to support the Comprehensive Review Report, as required under the *Canada Small Business Financing Act*.[16] The objectives of this evaluation were to examine the CSBFP in accordance with the Treasury Board *Policy on Results* and address issues identified by Small Business Branch management.

2.3 SCOPE AND APPROACH

The evaluation was conducted in-house and covered the period from April 1, 2014 to October 31, 2018. It examined the continued relevance, performance, and efficiency of the CSBFP. In the assessment of performance, the evaluation focused on the progress toward the intermediate and long-term outcomes identified in the logic model in Section 1.6, as the 2014 evaluation already examined the immediate outcomes. The current evaluation also followed up on the recommendations made in the 2014 evaluation.

2.4 EVALUATION ISSUES AND QUESTIONS

The evaluation addressed the following questions:

Relevance

1. To what extent does the CSBFP continue to address a demonstrable need?[17]

Performance

2. To what extent has awareness and knowledge of the program increased since 2014?
3. To what extent are small businesses obtaining financing from lenders with government support that would have otherwise been unavailable or available under less favourable terms?
4. To what extent do some firms receive multiple loans via the CSBFP?
5. To what extent do loan default rates vary by firm, sector, market or other factors?
6. To what extent are CSBFP loan recipients competitive, innovative, and achieving high growth?

Efficiency

7. To what extent does the program demonstrate efficiency?

[16] The most recent Comprehensive Review Report covered the third such review period, from April 1, 2009, to March 31, 2014.

[17] In addressing this question, the following issues were explored: where else SMEs can go to for loans; the role of different levels of government in this space; complementarity with financial institutions; funding gaps which persist in the marketplace and how they can be filled; and considerations for funding real property, leasehold or equipment.

2.5 DATA COLLECTION METHODS

Multiple lines of evidence were used to address the evaluation questions. The data collection methods included a document review, literature review, interviews, administrative data analysis and review, and financial data analysis.

Document Review

A document review was conducted to gain a thorough understanding of the program and to provide insights into relevance and performance. The review included:

- Program reporting documents (e.g., annual reports and overviews);
- Other key program documents (e.g., research papers and publications, mid-term and comprehensive reviews, survey reports, etc.);
- Previous evaluations and audits; and
- Government priority-setting documents (e.g., Budgets, Speeches from the Throne, Mandate letters etc.).

Literature Review

The review of academic literature covered issues related to the continued need for the program, specifically the need to support small businesses in attaining debt financing, the role of the federal government to provide loan guarantees in Canada, as well as an examination of comparable programs in other jurisdictions – domestically and internationally. It also assessed the influence of firm-specific, sector, market and other factors on the loan default rates of SMEs. The review was informed by literature provided by the program and independent research.

Interviews

The objective of the interviews was to gather in-depth information related to the relevance, performance, and efficiency questions. The interviews were semi-structured in nature to help collect qualitative information from a range of key stakeholders. Interviews were conducted either in-person or by telephone.

The identification of key stakeholders was confirmed with program management. In total, 29 interviews were conducted as part of the evaluation with the following four groups:

- CSBFP representatives at ISED (9 interviews);
- Financial institutions such as banks and credit unions (10 interviews);
- Professional associations such as Chambers of Commerce and Boards of Trade (6 interviews); and
- Experts on SME financing (4 interviews).

Administrative Data Analysis and Review

Data analysis was conducted to inform the program's performance and efficiency. The database included all borrowers, including their key characteristics, as well as detailed information on trends among lenders and borrowers. Shifts in the economy, as well as changes to the regulations of the program, were considered in the analyses.

In addition, recent reports commissioned or prepared by the Small Business Branch as part of their ongoing performance measurement were reviewed. The reports listed below were used as evidence for the evaluation to the extent that the data was relevant to the period under examination:

- *Incrementality Study of the Canada Small Business Financing Program*, March 2018 (ISED);
- *Cost-Benefit Analysis of the Canada Small Business Financing Program*, December 2018 (ISED);
- *Canada Small Business Financing Program (CSBFP) Borrower Awareness and Satisfaction Study*, August 2018 (R.A. Malatest and Associates Ltd.);
- *Canada Small Business Financing Program: Economic Impact Analysis*, December 2018 (ISED);
- *Canada Small Business Financing Program (CSBFP) Lender Awareness and Satisfaction Study*, March 2018 (EKOS Research Associates Inc.); and
- *Survey on Financing and Growth of Small and Medium Enterprises*, 2018 (ISED).

Financial Data Analysis

Financial analysis of the impact of the CSBFP was conducted to address the efficiency of the program. Specific areas reviewed included revenues, the administrative expenses of the program relative to the value of the loans, and a comparison between the costs of the program relative to the economic benefits achieved.

2.6 LIMITATIONS

Maturity of Data for Defaulted Loans

The findings for the CSBFP loan default analyses completed for this evaluation only cover the period from 1999-00 to 2012-13. The reason for this is that an adequate amount of time is needed to observe loan default, as many loans do not go into default until three or more years after being issued. As a result, any findings generated for the 2013-14 to 2017-18 evaluation period would be inconclusive and subject to significant change. For example, the default rates for 2016-17 and 2017-18 were calculated to be 2.0% and 0.3%, respectively, compared to default rates ranging from 11.1% to 15.8% during the 1999-00 to 2012-13 period.

Potential for Stakeholder Bias

Many stakeholders interviewed for this evaluation have a vested interest in the group that they represent (e.g., banks, Chambers of Commerce, credit unions, etc.). As such, the findings may have been biased towards more favourable outcomes for the group interviewed. The evaluation mitigated this by interviewing participants across four different stakeholder categories and by incorporating other lines of evidence (e.g., surveys, document review, literature review) into the analysis.

3.0 FINDINGS

3.1 RELEVANCE

3.1.1. To what extent does the CSBFP continue to address a demonstrable need?

<u>Key Finding</u>: The CSBFP continues to address a demonstrable need to facilitate SME access to financing. There is a need for a program that shares the risk of lending to higher risk SMEs. While the CSBFP is the only national loan loss-sharing program open to SMEs regardless of geographic location, the program may not be addressing the evolving needs of SMEs in the current environment.

SMEs are the backbone of the Canadian economy and make significant contributions to economic growth. As of December 2017, SMEs accounted for 99.8% of businesses, employed 89.6% of the total private labour force, and were responsible for 41.9% of Canada's total value of exported goods. Additionally, SMEs contribute over 50% to Canada's Gross Domestic Product, with the contribution being almost 75% for the service-producing sector. As well, between 2013 and 2017, SMEs were responsible for 85.3% of net employment growth.[18]

Although they make significant contributions to the Canadian economy, SMEs, especially smaller, younger, higher risk SMEs (e.g., firms in the accommodation and food services sector), have greater difficulty accessing sufficient and appropriate financing than their larger and more established counterparts. The document and literature review showed that one of the most significant determinants of an SME's commercial success is having access to sufficient and appropriate financing. SMEs have greater difficulty accessing financing because of their higher loan default risk, shorter credit histories and track records, inadequate collateral, and greater year-to-year fluctuations in sales and earnings. As such, financial institutions are less willing to extend financing, which may lead many potentially profitable SMEs to be inadequately funded. Access to financing is especially important for the survival of smaller businesses, start-ups, and those operating in riskier sectors. For example, a 2018 report profiling Canadian SMEs found that start-ups had higher demands for external and debt financing than non-start-ups, but were less likely to be approved.[19] This is noteworthy, as CSBFP borrowers are predominantly smaller, newer start-ups (from 2014-15 onwards, about 77% of CSBFP borrowers have fewer than five employees and 57% have been in business for less than one year).

The CSBFP facilitates access to financing by sharing the risk of lending to SMEs with financial institutions. Administrative data showed that over the evaluation period, CSBFP loans were disbursed to borrowers with the most difficulty accessing financing (i.e., firms in the

[18] *Key Small Business Statistics January 2019*, Innovation, Science and Economic Development Canada.
[19] May Song and Richard Archambault, SME Profile: Canadian Start-Ups — a perspective based upon the 2014 *Survey on Financing and Growth of Small and Medium Enterprises*, September 2018.

accommodation and food services sector, firms with 1-4 employees, and businesses less than one-year old). In stakeholder interviews, there was a consensus that there is a strong need for a program that shares the risk of lending to higher risk SMEs. Some interviewees explained that the need exists due to a trend among SMEs requiring more financing options available and that some potential borrowers, particularly start-ups, would be shut out from receiving financing. According to an SME financing expert[20], the continued need for the CSBFP is also linked to the increase in regulatory constraints on banks following the 2008-09 financial crisis, which required banks to hold more reserve capital than before. In interviews, some financial institutions also suggested that in the absence of the CSBFP, while higher risk SMEs might still be able to secure alternate sources of financing, it would likely be at an unreasonable cost (i.e., greater than prime + 3% as under the CSBFP).

An additional ISED study, the 2018 Borrower Awareness and Satisfaction Study, showed that former program borrowers and the broader SME community agree that there is a need for the program. A majority of CSBFP borrowers (87%) and non-borrowers (75%) indicated a high or very high need for a loan program like the CSBFP.

A review of comparable, domestic loan guarantee programs showed that the CSBFP is the only national, loan loss-sharing program accessible to Canadian small businesses regardless of geographic location and open to the majority of sectors. While other public credit guarantee programs exist, they tend to be open only to SMEs operating in specific regions (e.g., Nova Scotia's Small Business Loan Guarantee Program[21] or the Yukon Venture Loan Guarantee Program[22]) or sectors (e.g., Canadian Agricultural Loans Act Program[23]). A 2017 Organization for Economic Co-operation and Development (OECD) report entitled *SME and Entrepreneurship Policy in Canada* notes that the federal government offers a range of programs that provide loan guarantees to banks for small business lending through organizations such as the Business Development Bank of Canada (BDC), the Regional Development Agencies, and Export Development Canada. The BDC, for example, differs from the CSBFP in that it is a commercially-oriented financial institution that is wholly-owned by the Government of Canada, providing direct loans for business activities, including working capital, and offers advisory services. Furthermore, the BDC is mandated to be complementary to financial institutions, doing so through a flexible lending approach while often assuming the portion of risk that is beyond the tolerance of private banks in order to fill market gaps. The BDC supports high-growth or riskier businesses like high-technology firms, who may not have a track record or the collateral required

[20] Interviews were conducted with SME financing experts with expertise in international business and trade, public credit guarantee schemes, industrial relations, and SME financing.
[21] Under Nova Scotia's Small Business Loan Guarantee Program, credit unions provide financing of up to $500,000 in the form of term loans, working capital and lines of credit. Loans may be granted for a term of up to of 10 years. The maximum guarantee supplied by the Province of Nova Scotia is 90% of the value of all term loans. The guarantee is 75% on lines of credit but a 90% guarantee may be available to those that qualify under certain special financing streams.
[22] The Yukon Venture Loan Guarantee Program is a partnership between the Government of Yukon and participating financial institutions. This program encourages commercial lenders to invest in new local start-ups by guaranteeing a portion of the loan. A new start-up can borrow up to $100,000 and the Government of Yukon guarantees 65% of the venture loan. There is a one-time fee of 1.5% of the guarantee amount. The repayment term is a maximum of 6 years.
[23] Under the Canadian Agricultural Loans Act Program, the federal government guarantees, to the lender, repayment of 95% of a net loss on an eligible loan issued. Loans are limited to a maximum of $500,000 for the purchase of land and the construction or improvement of buildings and $350,000 for all other loan purposes, including consolidation/refinancing.

by other lenders. The BDC also supports Canada's venture capital ecosystem, and incubators and accelerators (and graduate firms) across the country. Although the BDC only supports for-profit enterprises and does not support not-for-profits, it does provide a portfolio loan guarantee to Futurpreneur Canada (which is a not-for-profit) to allow Futurpreneur to increase its lending to young entrepreneurs. In fiscal year 2017-18, the BDC had lending activity of over $6.8 billion and the CSBFP facilitated approximately $1.2 billion through financial institutions. However, the CSBFP is the most prominent, national loan guarantee program for small businesses in Canada.[24]

Furthermore, the prevalence of loan guarantee programs internationally demonstrates that the need for a loan loss-sharing program to support SME financing is not exclusive to Canada. According to a 2018 OECD study of 43 countries' SME financing policies, most advanced and developing states have a credit guarantee program and they are the most widespread policy instrument of choice to address SMEs' financing constraints.[25] The evaluation's review of comparable programs in the U.S., U.K., and Germany showed a common rationale among these programs to expand small businesses' access to capital that would not otherwise be available. Generally, studies assessing the programs' impact found that they all had a positive impact on reducing SME financing constraints. For example, the 2017 evaluation of the U.K.'s Enterprise Finance Guarantee concluded that the program continues to create significant economic benefits for society.[26]

Evolving Needs of SMEs

While the CSBFP addresses the need to facilitate SME access to financing, evidence suggests that there are still some areas where the program may not be addressing the evolving needs of SMEs in the current environment. For instance, many interviewees in the 2014 evaluation noted that the $500,000 maximum loan amount for real property was no longer sufficient (this maximum was raised to $1 million in Budget 2015). Although no similar issues were raised in the 2014 evaluation regarding the $350,000 maximum loan amount for leasehold and equipment, a recommended re-engagement of existing and potential borrowers for the 2018-19 evaluation indicated a change in sentiment, with a large number of interviewees feeling that the maximum loan amount no longer reflects the present cost of products.

As well, many interviewees indicated that there has been an increased demand for operating lines of credit and suggested that the CSBFP should consider including this as part of the program. This was corroborated in the Borrower Survey, where about half of all respondents indicated that their business would have use for a business line of credit.

Further, the CSBFP could be expanded to include intangible assets, such as intellectual property (e.g., patents, copyrights, trademarks), and start-up costs (e.g., marketing, inventory, franchise fees). This approach has been recommended by the OECD and would likely receive strong stakeholder support from both financial institutions and Canadian SMEs. Through roundtable

[24] SME and Entrepreneurship Policy in Canada, OECD (2017).
[25] Financing SMEs and Entrepreneurs 2018: An OECD Scoreboard, OECD (2018).
[26] London Economics (Nov 2017), Economic Impact Evaluation of the Enterprise Finance Guarantee (EFG) Scheme.

discussions with Canadian SMEs in 2014, ISED heard that Canadian businesses face restricted access to financing, especially for intangible assets such as intellectual property, and operating expenses such as wages and marketing. The CSBFP also conducted consultations with major financial institutions on this subject in 2017. Many lenders indicated that the ability to offer more flexible financing for business assets, such as intangibles, and start-up costs, would be a welcome change to the program. Through the 2018 Lender Awareness and Satisfaction Study, one of the top recommendations to improve the CSBFP was to expand eligible assets/expenses to include intangible assets and working capital. In terms of risks, intangible assets and start-up costs are not expected to perform as well as the current loan classes since they are more difficult to recover in the event of default than real property and equipment.

Finally, many interviewees suggested that efforts need to continue to reduce the administrative burden for both borrowers and lenders, as the level of documentation required is leading some lenders to avoid using the program, echoing findings from the 2014 evaluation. Some suggestions included eliminating the requirement for on-site visits by financial institutions to SMEs in remote locations (as defined in the Canada Revenue Agency's list of prescribed zones for each province and territory) and permitting the use of bar codes, photographs, videos and e-mails; and extending the verification timeline following the final disbursement of funds from 90 days to 180 days for SMEs in remote locations to allow for sufficient time for the shipping /transportation of equipment/materials and their installation.

3.2 PERFORMANCE

3.2.1 To what extent has awareness and knowledge of the program increased since 2014?

<u>Key Finding</u>: Awareness of the CSBFP remains low among borrowers and non-borrowers, but high for lenders. Although lenders' knowledge of the CSBFP has increased, their knowledge of the program's eligibility criteria exceeded their knowledge of the program's terms and conditions.

Awareness of the CSBFP remains low among borrowers and non-borrowers, but high for lenders. The 2018 Borrower Awareness and Satisfaction Study reported that 29% of CSBFP borrowers and 10% of non-borrowers were aware of the CSBFP compared to 41% and 12%, respectively, in 2013. Recognition of the federal government as the guarantor of their loan was roughly the same for borrowers in 2018 (67%) as it was in 2013 (66%). Among these borrowers, more were likely to identify the CSBFP as the program that covered their loan in 2018 (51%) than in 2013 (30%). In addition, 64% of CSBFP borrowers first heard of the program from a financial institution official (45% in 2013), while non-borrowers learned about the CSBFP from a wide variety of sources, with financial institution officials being the most prominent at 19% (13% in 2013). With respect to lenders, the 2018 Lender Awareness and Satisfaction Study found that awareness continues to be high, with 98% recognizing the program by its name (97% in 2014).

Borrower awareness of the CSBFP differed by region, sector, and age of firm. About 35% of borrowers from Western Canada were aware of the program compared to only 24% of borrowers from Québec, while awareness of borrowers from the Atlantic (29%) and Ontario (26%) were more comparable to the national average (29%). In terms of business sector, 34% of accommodation and food services businesses were aware of the program, which was above the overall awareness rate of 29%, and much higher than that among businesses in the transportation and warehousing sector (22%). Finally, younger firms tended to have a greater awareness of the CSBFP. For example, 32% of firms less than one year old were aware of the CSBFP, in comparison to 25% of firms more than three years old and 21% of firms between one and three years old.

Concerning knowledge of the CSBFP, the 2018 Lender Awareness and Satisfaction Study revealed that while lender comprehension of the CSBFP has increased, knowledge of the program's terms and conditions relative to their knowledge of the program's eligibility criteria is lower. Most operational partners could correctly identify the eligible and ineligible expenditures under the CSBFP. For example, nearly all respondents correctly classified equipment and leasehold improvements as eligible (98% and 95%, respectively). However, there appeared to be some confusion related to inventory and registration fees – just 68% knew that inventory is ineligible, and only 62% were aware that CSBFP registration fees are eligible. Relative to their knowledge of eligibility criteria, lenders scored lower in terms of their knowledge of some of the program's terms and conditions. For example, only 31% recalled that the maximum percentage of losses on a loan for which the government will reimburse the lender in the event of default is 85% (down from 42% who recalled this in 2014 and 52% in 2004). Assuming a lower reimbursement rate than 85% could impact the provision of loans by financial institutions, as a lower assumed rate may result in some loans incorrectly not meeting a financial institution's internal risk scoring model. There was also a substantial decline in awareness of the maximum loan size (47% provided a correct response compared to 79% in 2014, with the vast majority of those unaware believing the maximum loan size was less than $1 million). This could lead to potential borrowers being misinformed about how much they are eligible to borrow under the program. Further, just over half of lenders were aware of changes made to the CSBFP in 2015 and 2016, while four in ten were not.[27]

Stakeholder interviews indicated that although there are opportunities to improve awareness and knowledge of the CSBFP, resources for doing so are limited. Professional associations and ISED officials suggested using existing organizations (e.g., regional Chambers of Commerce) to convey CSBFP information to their members and provide outreach and training to financial institutions and other relevant stakeholders via in-person conferences or Internet webinars. Others suggested increasing use of social media advertising/marketing (e.g., via Twitter, Facebook, etc.) and conducting a public awareness campaign. Out of nine ISED officials interviewed, all but one stated that more could be done in terms of improving awareness and knowledge of the program for borrowers and lenders. However, it was noted that program

[27] Changes included an increase in the maximum loan amount for the purchase or improvement of real property from $500,000 to $1 million and an amendment of the definition for small business eligibility from those with $5 million in gross annual revenues, to those with $10 million in gross annual revenues.

resources dedicated towards outreach activities had been reduced.
The stakeholder interviews also explored awareness of programs that overlap with the CSBFP and suggested that interviewees were generally unaware of other overlapping programs. Among the programs mentioned by interviewees were the Community Futures program in Alberta which offers loan solutions and business development services for rural Alberta; small business loans of up to $100,000 via Business Development Canada; and loans and grants via Entrepreneurship Manitoba. In addition, some professional associations noted that programs in Québec run by Caisse de dépôt et placement and Fonds de solidarité FTQ are similar to the CSBFP.

3.2.2 To what extent are small businesses obtaining financing from lenders with government support that would have otherwise been unavailable or available under less favourable terms?

Key Finding: The CSBFP enables financial institutions to provide loans to SMEs that would not otherwise be made available or would be available only under less favourable terms. Although some SMEs would still be able to access financing, it is estimated that about two-thirds of all CSBFP loans may not have been made in the absence of the program and that, overall, over 80% of CSBFP borrowers likely benefitted from the existence of the program.

As noted in Section 1.3, the CSBFP is designed to help businesses with their financing needs by helping to fill gaps in the lending market for certain types of SMEs and, in particular, higher-risk SMEs. This is accomplished by incentivizing financial institutions to provide financing to SMEs that would otherwise be unavailable, or would be available only under less favourable terms, via the provision of the federal government's 85% loan guarantee. The extent to which this financing was provided was analyzed by reviewing existing ISED studies and by conducting CSBFP stakeholder interviews.

Evidence suggests that a significant funding gap would exist in the absence of the CSBFP. The 2018 Incrementality Study[28] estimated that 69% of CSBFP borrowers would likely not have been able to access financing in the absence of the program – up slightly from the 67% estimated in the 2015 Incrementality study.[29] Neither of these Incrementality studies provided estimates of the share of CSBFP borrowers that would likely still have been able to access financing, but under less favourable terms.

The 2018 Lender Awareness and Satisfaction Study estimated that 51% of CSBFP borrowers would likely not have been able to access financing in the absence of the program. Further, an

[28] This study uses data from the 2014 Survey on Financing and Growth of Small and Medium Enterprises linked to other sources such as the General Index of Financial Information and Payroll Account Deductions (PD7) from 2010 to 2014. A two-step approach was used, whereby the probability that a firm's application for a non-guaranteed loan would be approved is estimated, conditionally on explanatory variables related to the firm's performance metrics, characteristics and industry sector. The second stage of the analysis used the resulting model to classify CSBFP loans as to whether or not the applications would have been rejected in the absence of the CSBFP, providing an estimate of incrementality.
[29] Both the 2015 and 2018 studies followed the same methodology.

estimated 30% would likely have been able to access financing, but under less favourable terms (e.g., higher interest rates, shorter repayment period, etc.). These figures were similar to those reported in the 2014 version of the study (46% and 30%, respectively).

Among financial institutions, professional associations, SME financing experts and ISED officials interviewed, there was agreement that there would be a funding gap in the marketplace if the CSBFP did not exist. Interviewees indicated that the main benefit of the CSBFP to borrowers and potential borrowers was access to funding that would otherwise be unavailable.

Overall, the findings suggest that the existence of the CSBFP is critical for providing access to financing to many SMEs who would otherwise not be able to gain access to financing or only under less favourable terms. Based on the evidence analyzed, over 80% of CSBFP borrowers likely benefitted from the existence of the program.

According to some interviewees, there is the potential for more SMEs to benefit from the program. Currently, lenders need to be part of the Canadian Payment Association to be a registered lender. As an example, interviewees noted that indigenous financial institutions are not currently part of this association. By exploring ways to include Indigenous and other types of financial institutions as registered CSBFP lenders, the program could become more inclusive to certain segments of the population.

3.2.3 To what extent do some firms receive multiple loans via the CSBFP?

Key Finding: Repeat borrowers represent approximately 10-16% of all CSBFP borrowers and are less likely to default than one-time borrowers.

Repeat CSBFP borrowers are SMEs which have registered two or more (simultaneous or otherwise) CSBFP loans with financial institutions using the same business number. During the period from 1999 to 2018, CSBFP administrative data indicated that 83.6% of borrowers received only one CSBFP loan during this period and 16.4% received at least two CSBFP loans (i.e., were repeat borrowers). Of these repeat borrowers, 74.0% received two loans, 16.2% received three loans, and 9.8% received four or more loans during this period.

Over the evaluation period (April 1, 2014 to October 31, 2018), 90.4% received only one CSBFP loan (dating back to 1999) and 9.6% were repeat borrowers of varying degree (i.e., had received at least two CSBFP loans since 1999).

The administrative data review also found that repeat borrowers are less likely to default on loans than one-time borrowers. From 1999-00 to 2012-13[30] the proportion of repeat borrowers who defaulted was 9% and the proportion of one-time borrowers who defaulted was 15%. These

[30] This period was chosen to coincide with the loan default analysis that follows. Loan defaults for fiscal year 2013-14 onwards are not included because not enough time has elapsed for a majority of defaults to be observed (the majority of loan defaults occur within five years of loan start).

findings suggest that CSBFP loan recipients receiving additional CSBFP loans might be less risky than one-time borrowers, as their default rates are significantly lower.

Financial institutions interviewed indicated that each loan application is treated with the same level of due diligence, but that an applicant with an established track record with a financial institution may obtain a second CSBFP loan more easily than a potential borrower with no credit history (loan eligibility is dependent upon the potential borrower having less than $1 million in outstanding CSBFP loans). Interviewees also mentioned that upon application for a second loan, previous CSBFP borrowers might qualify for a conventional loan product. Although repeat CSBFP borrowing was noted as being fairly uncommon, some examples were provided under which additional CSBFP loans have been issued:

- Initial purchase of a business followed by a loan for improvements or expansion;
- To finance real estate and equipment purchases simultaneously, financial institutions require separate CSBFP loans due to amortization periods; and
- For operators of franchises who open additional franchises.

3.2.4 To what extent do loan default rates vary by firm, sector, market or other factors?

<u>Key Finding</u>: The vast majority of CSBFP loan defaults occur within five years of loan issuance. There are a number of factors which influence the probability of defaulting on a loan, with some of the more prominent factors being the age and size of the business, as well as the loan type and amount.

The calculation of CSBFP loan default rates excluded the period from 2013-14 to 2017-18, as an adequate amount of time is needed to observe default (about 17% of loan defaults occur in years four or five after loan issuance and a further 4% thereafter).[31]

Administrative data analysis indicated that between 1999-00 and 2012-13, CSBFP loan default rates were as low as 11.1% in 2002-03 and as high as 15.8% in 2006-07, with most defaults (96%) occurring within five years of loan issuance. Nearly 22% of all loan defaults occur within one year of loan issuance and about 35% occur in year two of a loan.

Adverse economic conditions appear to lead to quicker loan defaults. Loans which were issued around the same time as the financial crisis in 2008-09 had different results with respect to the speed of loan default. For example, over 65% of defaulted loans issued in 2007-08 or 2008-09 defaulted within two years of loan issuance. By comparison, less than 48% of defaulted loans issued in 2010-11 or 2011-12 defaulted within two years of loan issuance.

The evaluation also explored the influence of key factors on the probability of borrowers defaulting on a CSBFP loan via statistical estimation analysis. Overall, the age of a business,

[31] As evidence, CSBFP loan default rates dropped sharply in each year following 2012-13 (9.2% for loans issued in 2013-14, 6.2% in 2014-15, 4.2% in 2015-16, 1.9% in 2016-17 and 0.2% in 2017-18).

number of employees, sector, region, type of loan, and CSBFP loan amount were key predictors of loan default for the 1999-00 to 2012-13 period:

- CSBFP borrowers whose business was less than one-year old were more than 50% more likely to default on their loan than those whose business was more than three years old. This is noteworthy given that more than half of all loans issued during the 1999-00 to 2012-13 period went to borrowers whose business was less than one year old.
- With respect to business size, firms with more employees had a lower probability of defaulting. For example, borrowers with 21 or more employees were 26.3% less likely to default than borrowers with no employees (i.e., self-employed).
- In terms of sector, CSBFP borrowers whose business is related to transportation and warehousing or construction were more than 25% less likely to default than borrowers whose business is related to accommodation and food services. In contrast, borrowers whose business is related to manufacturing were about 19% more likely to default.
- On a regional basis, compared to Ontario, borrowers in the other four regions were less likely to default, particularly borrowers in the Prairies (48.6% less likely) and British Columbia (38.3% less likely).
- Concerning the type of loan, the probability of defaulting was far less for loans issued exclusively for real property, while any other types of loans (i.e., leasehold improvements, equipment, or a combination of the three) had at least a 25% higher probability of defaulting.
- Further, loan amount was positively correlated with default rates. For example, loans of under $50,000, of which 35% of all loans were during this period, were 37.2% less likely to go into default than loans of $200,000 or more.

Stakeholder interviews provided insight into the impact of loan default on a borrower's ability to access another CSBFP loan. A majority of financial institutions (6 of 10) indicated that a previous CSBFP loan default would definitely impact a future loan application (CSBFP or not) in terms of the likelihood of receiving another loan. However, although they would be much less receptive, they indicated that if circumstances were out of the control of the borrower or if circumstances had changed for the new application, they would give the loan application consideration. Three out of the remaining four financial institutions indicated that such a borrower would not get another loan at their institution, while one indicated that they had never had a CSBFP loan default.

3.2.5 To what extent are CSBFP loan recipients competitive, innovative and achieving high growth?

<u>Key Finding</u>: CSBFP participation has a positive impact on some economic indicators, particularly on SME revenues and employment levels.

As noted in Section 1.6, the CSBFP is designed to help Canadian companies be competitive and achieve high growth. This is accomplished indirectly via the CSBFP, which incentivizes financial institutions to provide financing to higher risk SMEs, thereby supporting business growth. The extent to which CSBFP participation has had an impact on some of the outcomes of SMEs was analyzed by reviewing existing ISED studies, Statistics Canada's Survey on Financing and Growth of Small and Medium Enterprises, and CSBFP administrative data.

Positive Impact of CSBFP on SME Revenues and Employment Levels

Data from various studies indicated that CSBFP participation has an impact on economic growth via higher SME revenues and employment levels.

The 2018 Economic Impact Analysis study reported that CSBFP participation had a positive impact on SME revenues from 2014 to 2016. Specifically, it was estimated that CSBFP participation led to $52,000 in increased revenues per SME over this period and that CSBFP borrowers had higher average revenue growth (16%) than all SMEs (4%). The Survey on Financing and Growth of Small and Medium Enterprises for 2018 (as well as 2014) indicated that CSBFP borrowers had higher average sales growth rates and lower negative sales growth rates than all SMEs. For example, based on sales data from 2015 to 2017, 17% of CSBFP borrowers had growth rates of 20% or higher versus 8% for all SMEs, while 6% of CSBFP borrowers had negative growth rates versus 13% for all SMEs. Further, 60% of borrowers surveyed in 2018 indicated that CSBFP participation had a positive impact on sales or profits. In addition, the majority of other previous ISED studies suggested a positive impact of CSBFP participation on revenues.[32]

In terms of employment, the 2018 Economic Impact Analysis study indicated that employment rates grew faster for CSBFP borrowers (16%) than for all SMEs (6%). Statistical estimation analysis confirmed an impact, indicating that CSBFP participation was associated with a 3% increase in employment from 2014 to 2016. Additionally, 53% percent of borrowers surveyed said that CSBFP participation had a positive impact on their business employment levels. As well, analysis of administrative data revealed that the average number of current employees employed by SMEs who received a CSBFP loan grew by 11% between 2014-15 and 2017-18. As was the case with revenue, the majority of previous ISED studies found positive impacts of CSBFP participation on employment levels.[33]

Other Economic Indicators

For other economic indicators (profits, salaries, labour productivity and competitiveness) as well as for innovation, analysis suggested no clear evidence of an impact from CSBFP participation. In terms of innovation, inconclusive impacts were found. However, by facilitating access to capital to SMEs (who are drivers of innovation), the CSBFP aligns with one of the objectives of the Innovation and Skills Plan, which is to make Canada a world-leading centre for innovation.

<u>Profits</u>

The 2018 Economic Impact Analysis study found that CSBFP borrower profits increased at a 7%

[32] The 2010 Economic Impact Analysis study (Chandler) found no statistically significant impact on revenues.
[33] The 2014 Economic Impact Analysis study (Song) found no statistically significant impact on employment.

greater rate than for all SMEs, and that CSBFP participation was associated with $22,000 in increased SME profits from 2014 to 2016. The 2014 version of the study reported that between 2007 and 2009, CSBFP participation was associated with roughly $49,000 in increased profits for SMEs. However, the 2018 Cost-Benefit Analysis study and the majority of other previous ISED studies reported no significant impact of CSBFP participation on SME profits.[34]

Salaries

Evidence also suggests an inconclusive impact of the CSBFP on salaries. Although the 2018 Economic Impact Analysis study indicated no statistically significant impact of CSBFP participation on salaries for SMEs between 2014 and 2016, the 2014 version of the study found that CSBFP participation increased salaries by 6% ($23,000) from 2007 to 2009.[35]

Labour Productivity

The 2018, 2014 and 2010 Economic Impact Analysis studies all found no significant impact of CSBFP participation on labour productivity. That being said, the 2018 and 2014 Borrower Awareness and Satisfaction studies found that 64% and 67% of borrowers, respectively, indicated that program participation had a positive impact on productivity.

Competitiveness

Lastly, the Survey on Financing and Growth of Small and Medium Enterprises data suggested that CSBFP participation did not impact SME competitiveness. For example, the proportions of actual CSBFP borrower sales in 2018 by region were almost identical to those in 2014. In other words, CSBFP borrowers captured similar proportions of market share in 2018 as they did in 2014, suggesting no increase in competitiveness.

Innovation

Inconclusive impacts were also found for the impact of the CSBFP on innovation. As reported in the 2018 Survey on Financing and Growth of Small and Medium Enterprises, although CSBFP borrowers are more often classified as innovators[36] compared to all SMEs (42% versus 31%), the share has decreased from 52% in 2014. In contrast, the proportion of CSBFP borrowers intending to use debt financing for R&D doubled from 4% to 8% between 2014 and 2018 (the proportion increased from 6% to 7% for all SMEs). Further, the proportion of CSBFP borrowers holding intellectual property (IP) rose from 17% in 2014 to 29% in 2018 and surpassed all SMEs (27% of which reported IP holdings in 2018 – up from 21% in 2014). There was also an increase in the proportion of CSBFP borrowers with non-disclosure agreements, rising from 7% in 2014 to 20% in 2018 (the proportion increased from 12% to 21% for all SMEs). However, the 2018 Economic

[34] This includes the 2010, 2008 and 2004 Economic Impact Analysis studies, as well as Statistics Canada economic impact studies from 2008 and 2004.
[35] The 2010 Economic Impact Analysis study found no statistically significant impact on salaries.
[36] Defined in the 2018 Survey on Financing and Growth of Small and Medium Enterprises as SMEs reporting “At least one type of innovation between 2015 and 2017.”

Impact Analysis study indicated no statistically significant difference between innovation growth rates for CSBFP borrowers versus all SMEs based on the multivariate analyses completed using an innovation variable. As well, the Survey on Financing and Growth of Small and Medium Enterprises results and previous studies found no causal relationship between CSBFP participation and increased R&D investment or increased IP holdings.

3.3 EFFICIENCY

3.3.1 To what extent does the program demonstrate efficiency?

Key Finding: ISED studies estimate net social benefits generated by the CSBFP to be positive in every year since 2003, with net social benefits estimated to have been $4 billion over the 2008 to 2017 period. Program estimates indicate that the CSBFP is expected to be almost fully cost recoverable for the 2014-15 to 2018-19 period.

In examining the efficiency of the CSBFP, two metrics were considered:

- Net social benefits: estimation of the net social benefits generated by the CSBFP; and
- Cost recovery: comparison of program expenditures and revenues.

Net Social Benefits

ISED's 2018 Cost-Benefit Analysis provided estimates of the net social benefits generated by the CSBFP during the 2008 to 2017 time period. The estimates were generated based on three different scenarios, each of which assumed different discount and incrementality rates, and common employment displacement rates and employment creation figures.[37]
CSBFP costs included the following components:

- Salaries and benefits: CSBFP salary costs, employee benefit costs, and corporate management costs;
- Operating and maintenance expenditures: overhead costs (e.g., staff training) and direct operating costs (e.g., resources, products, contracting, Information Technology, etc.);
- Capital expenditures: Information Technology systems used for electronic registration were purchased in 2008-09, 2012-13 and 2013-14;
- Claims paid on loan defaults; and
- Loan default costs to lenders.

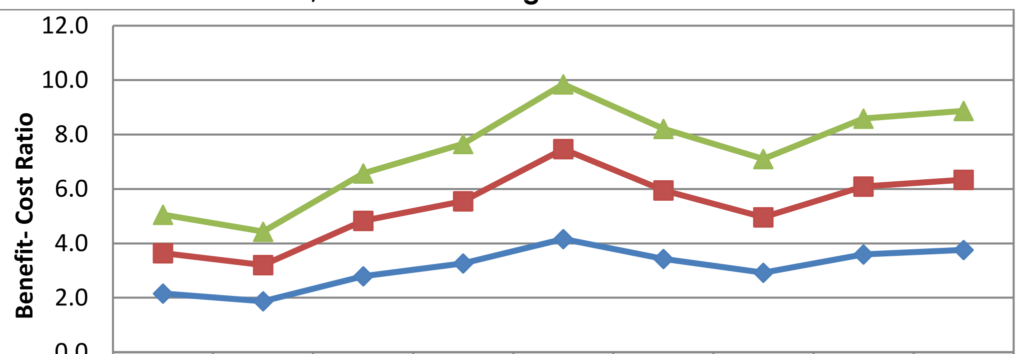
CSBFP-generated benefits were measured by adding together:

[37] The medium scenario (i.e., base case) assumed a discount rate of 5%, a full incrementality rate of 50% and a partial incrementality rate of 25%. The high scenario assumed a discount rate of 8%, a full incrementality rate of 75% and a partial incrementality rate of 0%. The low scenario assumed a discount rate of 2.4%, a full incrementality rate of 25% and a partial incrementality rate of 50%.

- Lender jobs, legal fees or Information Technology system expenditures created as a result of the CSBFP;
- Net interest income to lenders on CSBFP loans;
- Profits for CSBFP borrowers: investment from a CSBFP loan that allows borrowers to generate a profit;
- Borrower-generated economic activity: job creation and the resulting salaries and wages paid, as well as federal income taxes generated on those salaries and wages;
- GDP impacts (direct[38] and indirect[39]); and
- Registration and administration fees collected by ISED.

As shown in Figure 2, under all three scenarios, the 2018 Cost-Benefit Analysis estimated program benefits to largely exceed costs in each year, with annual benefit-cost ratios ranging from 1.9:1 to 9.9:1. Under the medium scenario, during the 2014-15 to 2016-17 evaluation period, the average annual benefit-cost ratio was 5.8:1 and the average net social benefits generated were $375.8 million per year (not shown). Over the entire 2008-09 to 2016-17 period, under the medium scenario net social benefits totaled almost $3.9 billion, with an average annual benefit-cost ratio of 5.3:1.[40]

Figure 2: Benefit-Cost Ratios – Low, Medium and High Scenarios



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Benefit-cost ratio–Low Scenario	2.2	1.9	2.8	3.3	4.2	3.4	2.9	3.6	3.8
Benefit-cost ratio–Medium Scenario	3.6	3.2	4.8	5.5	7.5	6.0	5.0	6.1	6.3
Benefit-cost ratio–High Scenario	5.1	4.4	6.6	7.7	9.9	8.2	7.1	8.6	8.9

Source: 2018 Cost-Benefit Analysis (ISED).

Cost Recovery

The methodology used to determine the level of cost recovery (based on actual and estimated

38 Direct impacts quantify the effect of increased production and imports necessary to meet the demand for investment due to CSBFP loans.
39 Indirect impacts estimate the upstream economic activity of producers of intermediate inputs used by directly impacted industries.
40 Using a similar methodology, ISED's 2015 Cost-Benefit Analysis estimated net CSBFP generated social benefits from 2003-04 to 2011-12 under the medium scenario to be almost $4.5 billion, with an average annual benefit-cost ratio of 5.7:1.

revenues and expenses) was developed by the Program in conjunction with university professors and was approved by the Office of the Auditor General. For the 2014-15 to 2018-19 lending period, it was estimated that total revenues ($318.7 million) divided by total expenses ($319.2 million) will result in 99.8% cost recovery (see Table 1).

Table 1: CSBFP Revenues, Expenses and Cost Recovery

Cohort	Loans ($ millions)	Revenues & Expenses ($ millions)				% Cost Recovery	Net Cost / Loans
		Reg. Fees	Admin. Fees	Claims	Net Cost		
2014-15	798.0	15.8	35.5	-55.8	-4.5	91.9%	-0.6%
2015-16	876.1	17.2	36.7	-62.1	-8.2	86.8%	-0.9%
2016-17	969.8	19.4	40.6	-65.4	-5.4	91.8%	-0.6%
2017-18	1,200.0	23.0	50.1	-66.7	6.5	109.7%	0.5%
2018-19	1,300.0	25.7	54.7	-69.3	11.1	116.0%	0.9%
Total	5,143.8	101.1	217.6	-319.2	-0.5	99.8%	0.0%

Note: Figures in blue are estimates and are attributed to the year in which the loan was issued. For example, the figures for 2015-16 include revenues and expenses only for loans which were issued in 2015-16. The % Cost Recovery is based on revenues (registration & administration fees) divided by expenses (claims).

Note that since the majority of recently-issued loans are still active (and therefore have not yet defaulted), the amount paid to financial institutions for defaulted loans would be significantly understated if only actual figures were reported. For example, using actual figures for loans issued in 2017-18, the CSBFP was 844.9% cost recoverable in 2017-18 (revenues of $41.4 million divided by expenses of $4.9 million).

The estimates of higher-than-expected recent levels of cost recovery have been attributed to a stronger Canadian economy (which generally results in lower default rates among all types of credit products) and a shift in CSBFP lending away from equipment to real property loans, where significantly lower default rates result in much lower claims being paid out (as noted in Section 3.2.4). Analysis of CSBFP administrative data confirms this shift in CSBFP lending. In 2013-14, the total value of loans made for equipment was $195.2 million compared to $156.1 million for real property. By 2017-18, real property lending ($290.0 million) had significantly passed lending for equipment ($180.8 million).

4.0 CONCLUSIONS AND RECOMMENDATIONS

4.1 CONCLUSIONS

Relevance

- The CSBFP continues to address a demonstrable need to facilitate SME access to financing. There is a need for a program that shares the risk of lending to higher risk SMEs, as they contribute greatly to the economy but have greater difficulty accessing sufficient and appropriate financing. While the CSBFP is the only national loan loss-sharing program open to SMEs regardless of geographic location, the program may not be addressing the evolving needs of SMEs in the current environment. These needs include maximum loan amounts which reflect the present cost of products, lines of credit, expansion of loan classes (including intangible assets and working capital), and further reduction of the administrative burden of the program.

Performance

- Awareness of the CSBFP remains low among borrowers and non-borrowers, but high for lenders. Although lenders' knowledge of the CSBFP has increased, their knowledge of the program's eligibility criteria exceeded their knowledge of the program's terms and conditions. Imprecise knowledge of the programs' terms and conditions could impact the provision of loans by financial institutions and misinform potential borrowers.

- The CSBFP enables financial institutions to provide loans to SMEs that would not otherwise be made available or would be available only under less favourable terms. Although some SMEs would still be able to access financing, it is estimated that about two-thirds of all CSBFP loans may not have been made in the absence of the program and that, overall, over 80% of CSBFP borrowers likely benefitted from the existence of the program. Some interviewees also suggested that access to loans could improve if more types of lenders were eligible to become registered lenders (e.g., Indigenous financial institutions).

- Repeat borrowers represent approximately 10-16% of all CSBFP borrowers and are less likely to default than one-time borrowers (9% versus 15%).

- The vast majority of CSBFP loan defaults occur within five years of loan issuance. There are a number of factors which influence the probability of defaulting on a loan, with some of the more prominent factors being the age and size of the business, as well as the loan type and amount.

- CSBFP participation has a positive impact on some economic indicators, particularly on SME revenues and employment levels.

Efficiency

- Net social benefits generated by the CSBFP were estimated to have been positive in every year since 2003, totalling almost $4 billion over the 2008 to 2017 period. Program estimates indicate that the CSBFP is expected to be almost fully cost recoverable for the 2014-15 to 2018-19 period.

4.2 RECOMMENDATIONS

The evaluation findings led to the recommendations noted below.

Recommendation 1: Expanding Program Parameters and Reducing Administrative Burden
ISED should consider further program modifications to better meet the evolving needs of SMEs, such as increasing the maximum loan amount for leasehold and equipment expenses, introducing operating lines of credit, expanding loan classes (including intangible assets and working capital), and continuing to lessen the administrative burden for both borrowers and lenders.

Recommendation 2: Increasing Awareness of the CSBFP
ISED should focus on increasing awareness and knowledge of the CSBFP among both borrowers and lenders.

Recommendation 3: Expanding List of Registered CSBFP Lenders
ISED should consider expanding the list of registered CSBFP lenders to help increase access to the program.

Appendix A

Table A1: Summary of CSBFP Loans Issued from 1999-00 to 2017-18

Fiscal Year	Number of Loans Made	Dollar Value of Loans Made	Average Dollar Value per Loan
1999-2000	17,741	$1,352,320,461	$76,226
2000-2001	14,442	$1,159,048,039	$80,255
2001-2002	11,016	$899,247,596	$81,631
2002-2003	11,263	$951,159,087	$84,450
2003-2004	11,085	$999,868,260	$90,200
2004-2005	11,142	$1,041,063,018	$93,436
2005-2006	10,790	$1,087,702,938	$100,807
2006-2007	9,595	$1,024,535,633	$106,778
2007-2008	8,930	$987,662,612	$110,601
2008-2009	7,796	$901,120,150	$115,588
2009-2010	7,534	$952,865,664	$126,475
2010-2011	7,454	$1,015,070,067	$136,178
2011-2012	7,141	$978,260,586	$136,992
2012-2013	6,195	$899,683,743	$145,227
2013-2014	5,668	$854,002,661	$150,671
2014-2015	5,177	$797,958,966	$154,135
2015-2016	5,075	$876,163,733	$172,643
2016-2017	5,293	$986,488,697	$186,376
2017-2018	5,767	$1,171,654,862	$203,165
Total	169,104	$18,935,876,773	$111,978

Source: CSBFP Administrative Database.