

# Building Blocks for Strong Communities

A Profile of Small- and  
Medium-Sized Enterprises  
in Canada

**Mark Goldenberg**

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## A Profile of Small- and Medium-Sized Enterprises in Canada

Mark Goldenberg

A research report prepared for Human Resources and Social Development Canada.

March 2006



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Imagine Canada  
425 University Avenue, Suite 900  
Toronto, Ontario M5G 1T6  
Tel.: (416) 597-2293  
Fax: (416) 597-2294  
[www.imaginecanada.ca](http://www.imaginecanada.ca)

Canadian Policy Research Networks  
600-250 Albert Street  
Ottawa, Ontario K1P 6M1  
Tel.: (613) 567-7500  
Fax: (613) 567-7640  
[www.cprn.org](http://www.cprn.org)

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**Canada** 

## **Preface**

This report is one of four produced by Imagine Canada and the Canadian Policy Research Networks (CPRN) as part of a study of small- and medium-sized enterprises (SMEs) and small- and medium-sized community organizations (SMOs) in Canada.

The study compared the structure, development and supports for SMEs and SMOs in Canada and also examined supports available to SMEs and SMOs in other countries. Drawing on learnings from Canadian and international experience, the study made recommendations on how public supports for SMOs in Canada could be improved.

The other three reports produced as part of this study are:

*Building Blocks for Strong Communities: Key Findings and Recommendations;*

*Building Blocks for Strong Communities: A Profile of Small- and Medium-sized Organizations in Canada; and*

*Building Blocks for Strong Communities: Results of Key Informant Interviews.*

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## Introduction

This working paper has been prepared as part of a research project that is being undertaken by Imagine Canada and Canadian Policy Research Networks (CPRN), with the financial support of Human Resources and Social Development Canada, that examines small- and medium-sized enterprises (SMEs) and small- and medium-sized community organizations (SMOs) in Canada.

This paper describes the Canadian SME “universe” – the nature, size and key characteristics of SMEs in Canada and their contributions to society and the economy. It discusses success factors for SMEs, financing structures and use, and challenges and barriers to success.

The paper also describes the current public policies and supports for SMEs in Canada. Information is provided as well on SMEs in the international context, including institutional policies and supports and the experience of other countries.

The paper concludes by identifying a number of policy considerations relative to public policy support for SMEs and SMOs, and offering some reflections on the applicability of policies and supports for SMEs to SMOs.

## Methodology

The paper has been prepared following a review of current literature and research on SMEs in Canada and internationally. It also draws on interviews with key persons knowledgeable about small- and medium-size enterprises and small- and medium-size organizations in the nonprofit sector.

## Definition of SMEs

A variety of criteria are used to define and categorize SMEs, both in Canada and around the world, usually according to the number of employees and annual revenues or sales.

This paper uses a definition frequently used by the Government of Canada: businesses with fewer than 500 employees and with annual revenues of less than \$50 million.<sup>1</sup> This definition is reasonably comparable to that used by other countries and international organizations.<sup>2</sup> It is also comparable to the definition used for small- and medium-size organizations (SMOs).

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<sup>1</sup> *Small and Medium-sized Enterprise Financing in Canada 2003*. Industry Canada, Statistics Canada and Finance Canada. See also *Key Small Business Financing Statistics-August 2005*. Industry Canada, Statistics Canada, Department of Finance. See Industry Canada, *Key Small Business Statistics*. July 2005 for examples of other frequently used definitions in Canada.

<sup>2</sup> For example, the United States also uses 500 employees as the cut-off point; the European Union (EU) uses 250 employees. *Ibid.* See also Ayyagari, M., Beck, T., & Demircuc-Kunt, A. (2003). *Small and Medium Enterprises across the Globe: A New Database*. World Bank: World Bank Policy Research Working Paper Series #3127.

## **SMEs in Canada**

### **Size and Key Characteristics**

Using the above definition, there are more than 1.5 million SMEs in Canada.<sup>3</sup>

A number of sub-categorizations of SMEs, by size, can be used

- self-employed (0 employees)
- micro-enterprises (1-4 employees)
- very small (5-19 employees)
- small (20-99 employees)
- medium (100-500 employees)<sup>4</sup>

The vast majority of SMEs in Canada are small businesses, with fewer than 100 employees:

- More than 80% of SMEs are either self-employed individuals (44%) or micro-businesses (37%)
- Only 14% of SMEs have 5-19 employees and only 4% have 20-99 employees
- Less than 1% (6100 firms out of 1.5 million) have between 100-499 employees
- Only about 0.3% of employer businesses in Canada have more than 500 employees<sup>5</sup>

SMEs are active in all sectors of the Canadian economy. Almost two-thirds of SMEs (64%) are in the services sector, with the goods-producing sector (21%) and the resource-based sector (15%) having the next largest concentrations.<sup>6</sup>

Small businesses make up 97% of goods-producing employer businesses in Canada and 98% of service-producing employer businesses.<sup>7</sup>

The size of SMEs varies across sectors. Agricultural firms and those in the service sector, including wholesale/retail and knowledge-based industries as well as professional services, have a higher proportion of self-employed and micro-businesses, while manufacturing and primary industries have more larger businesses.

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<sup>3</sup> *Small and Medium-sized Enterprise Financing in Canada 2003* and *Key Small Business Financing Statistics- August 2005*.

<sup>4</sup> These are definitions used by the Organization for Economic Co-operation and Development (OECD). Cited in Ayyagari, Beck and Demircuc-Kunt.

<sup>5</sup> *Small and Medium-sized Enterprise Financing in Canada 2003*.

See also Diane Guillemette, *Small and Medium-sized Enterprise Outlook. August 2004*. National Research Council of Canada (NRC) publication no. 47566, and *Key Small Business Statistics*.

<sup>6</sup> *Key Small Business Financing Statistics*.

<sup>7</sup> *Key Small Business Statistics*.

Fifty-eight percent of SMEs are home-based. Eighty-six percent of enterprises are owned by the individual owner/operator. Sixty-five percent of SME owners are English-speaking, 22% French-speaking, and 13% speak another language.<sup>8</sup>

Approximately 47% of SMEs have some degree of ownership by women. While the degree of female ownership varies considerably by industry – for example, nearly one-quarter of SMEs in professional services industries are majority female-owned, but only 3% of SMEs in primary industries are majority female-owned – the percentage of women-owned businesses lags behind that of male-owned in every industry. Female-owned SMEs tend to be smaller (less likely than other SMEs to employ more than 20 people) and more recent start-ups.<sup>9</sup>

The distribution of SMEs across the country is proportional to the distribution of population by region, generally reflecting population density, as well as factors such as industry sector concentration. 58% of SMEs are located in Ontario and Quebec.<sup>10</sup>

Approximately 75% of SMEs in Canada have been in business for five years or more.<sup>11</sup> Failure rates are relatively high in the first few years after start-up, however. There is considerable “churning” in SMEs, with thousands of businesses entering and exiting the marketplace each year. From 1991 to 2002, new entries averaged approximately 8800 annually, on a net basis.<sup>12</sup>

## **Contribution to the Canadian Economy**

SMEs have been described as “the lifeblood of the Canadian economy,” generating almost one-half (43%) of Canada’s private sector gross domestic product (GDP) and employing 62% of Canadians working in the private sector<sup>13</sup>. Small businesses (under 100 employees) alone account for almost one-half (49%) of the total private labour force.<sup>14</sup>

It is estimated that, in the late 1990s SMEs were responsible for up to 81% of net employment creation.<sup>15</sup>

Another study estimates that small businesses (under 100 employees) created 661,000 jobs between 1985 and 1999 and medium-sized enterprises (100-499 employees) 184,000, while large firms shed 348,000 jobs. It concludes that small businesses were “the principal engine of growth among continuing firms” during this period.<sup>16</sup>

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<sup>8</sup> *Small and Medium-sized Enterprise Financing in Canada 2003*.

<sup>9</sup> *Key Small Business Statistics*.

<sup>10</sup> *Key Small Business Financing Statistics*.

<sup>11</sup> *Key Small Business Financing Statistics*.

<sup>12</sup> *Key Small Business Statistics*.

<sup>13</sup> RBC Financial Group, Canadian Manufacturers and Exporters, and Queen’s School of Business, *Managing for Growth: Enabling sustainable success in Canadian SMEs*. 2003. The OECD 2000 Canada profile estimated SMEs’ contribution to private GDP at 43%.

<sup>14</sup> *Key Small Business Statistics*.

<sup>15</sup> *Managing for Growth: Enabling sustainable success in Canadian SMEs*.

<sup>16</sup> Chris Parsley and Erwin Dreessen, *Growth Firms Project: Key Findings*. Small Business Policy Branch, Industry Canada. Revised August 2004.

## **SMEs Internationally**

A review of international literature reveals that the SME sector is as important in other countries as it is in Canada. Public policy attention on SMEs became focussed in the 1980s as the size and contribution of the SME sector was documented and demonstrated.

The size of SMEs is measured with a number of different yardsticks internationally, including number of employees (with some countries defining an SME as an enterprise with less than 500 while many others define the cut-off at 250 employees), assets, sales or investment levels.

Whatever the measurement used, in all the comparator countries, SMEs constituted a large majority of the firms:

- In the USA with 21 million firms, 15.5 million had no employees (largely self-employed or unincorporated firms). Of those with employees, a large majority had fewer than 20 on the payroll. (US Census).
- In the UK, 72.8% of firms had no employees. At the start of 2004, there were 4.3 million enterprises in the UK, of which 99.3% were small – or even very small (fewer than 50 employees). (UK National Statistics, August 2005).
- In France, 63% of the workforce was employed in firms of under 250, encompassing both PMEs and TPEs (*Confédération générale des petites et moyennes entreprises*).

Looking at Canada's immediate neighbour and largest trading partner, the United States, SMEs in both countries "have remarkably similar characteristics," in terms of size, length of time in business, ownership structures and sectoral participation (retail, services, etc.).<sup>17</sup>

However, Canada is more concentrated in terms of small businesses. While both countries have similar proportions of total business establishments that are medium-sized enterprises (e.g. 16.8% of businesses in Canada and 16.3% in the U.S. have 15-9 employees; 11.3% and 10.7% businesses respectively have 20-99 employees), Canada has many more micro-businesses, proportionately, than the United States, and a much lower proportion of large businesses (>500 employees).<sup>18</sup>

Notes one report: "What this clearly suggests is that Canada's public and private policy environment stimulates small business creation, but needs to address the conditions that create growth in firms. Canada faces a challenge to grow its micro-businesses into medium-sized enterprises and to grow its medium-sized employers into larger firms that are at the leading edge of their industries."<sup>19</sup>

The importance of SMEs to the Canadian economy is consistent with findings regarding the economic impact and contribution of such enterprises internationally. According to OECD data,

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<sup>17</sup> RBC Financial Group, Canadian Federation of Independent Business (CFIB) and Canadian Manufacturers and Exporters, *The Path to Prosperity: Canada's small- and medium-sized enterprises*. October 2002.

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

for example, SMEs in OECD countries account for between 60%-70% of employment, and provide the source for most new jobs.<sup>20</sup>

A recent OECD Ministerial declaration notes that “SMEs are the dominant form of business organization in all countries, typically accounting for over 95% of the of the business population in all countries; they constitute an important dynamic element in all economies as they drive innovation, especially in knowledge-based industries, and play a key role in driving sustainable economic growth and job creation while contributing to the social, cultural and environmental capital of nations.”<sup>21</sup>

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<sup>20</sup> Organization for Economic Co-operation and Development (OECD), *Small and Medium-sized Enterprises: Local Strength, Global Reach*. 2000.

See also Ayyagari, Beck and Demircuc-Kunt for data and analysis of the importance of SMEs in the economies of a large number of countries, using comparative data and a variety of definitions of SMEs.

<sup>21</sup> Organization for Economic Co-operation and Development (OECD), *Ministerial Declaration on Fostering the Growth of Innovative and International Competitive SMEs*, Istanbul, 2004.

## **Success Factors for SMEs**

Research on SMEs in Canada and internationally has identified a number of important factors and determinants for their growth and development.

For business enterprises, “success” is usually defined as growth – in sales, profits, firm size, and market share.

It should be noted however that not all SMEs consider growth to be their key or only objective. Stability of income and employment are other important objectives. For many SME owners, lifestyle or product/service and quality are also important. Many small and micro-businesses may be content with an adequate income and not focussed on growth and expansion, particularly if the owner has launched the enterprises for reasons such as quality-of-life, independence or other personal motivating factors. A major recent study notes that “few SMEs define future success in terms of profitability. Most SMEs owners signal that lifestyle choices and company control were reasons for foregoing growth opportunities.”<sup>22</sup>

Success factors for SMEs can be viewed from several different perspectives or “lenses” – for example:

- the “external” and “internal” factors that influence the survival, growth and development of enterprises
- the “lifecycle” or stages of development of SMEs
- SMEs characteristics, including owner/management style, skills and capabilities; business practices and operations; and firm characteristics

## **External and Internal Factors**

*External* factors influencing SMEs’ development include: the overall economic context, both locally and nationally and internationally; markets and demand for the business’ products and services; government policies such as taxation and regulatory frameworks; labour supply and quality; and technology change and development.

A 2002 survey by the Canadian Federation of Independent Businesses (CFIB), the Canadian Manufacturers & Exporters, and the RBS Financial Group found that businesses identified the general economic climate as their number one concern.

Taxation policies, notably capital gains tax and payroll taxes (e.g. employment insurance), and levels of taxation were also rated highly as important concerns, with businesses feeling that they acted as a deterrent or “brake” on entrepreneurship and investment. . Labour shortages were also identified as a significant barrier to growth.<sup>23</sup>

Regulatory policies were a further major concern. While only one in five respondents felt that the overall regulatory burden was too tough, more than seven in ten said the regulatory environment is too complex, onerous, and costly.

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<sup>22</sup> *Managing for Growth: Enabling sustainable success in Canadian SMEs.*

<sup>23</sup> *The Path to Prosperity.*

Regulatory issues are seen as especially problematic for smaller businesses. “When dealing with government regulations, small businesses often face proportionately higher costs than larger businesses due to economies of scale, resulting in a disadvantage for the sector as a whole.”<sup>24</sup>

In key informant interviews, regulations were described as “handcuffs” and the resultant paper burden as “perpetual and ever-growing.” SMEs are also critical of the “multiplicity and “layering” of regulations by different orders of government. Growing government administrative red tape and reporting requirements have sparked demands for “smarter” regulations, not “more.”

*Internal* factors affecting SMEs’ success include: knowledge; human resources and skills; managerial and technical capabilities; networks; and material facilities and capital.<sup>25</sup>

There is some evidence in the literatures and research on SMEs to suggest that internal factors, notably management skills and expertise, are as or even more important than external ones in determining the growth and development of firms.

One study, for example, found that businesses fail in Canada in large part because of internal management and organizational problems. “Almost half the firms in Canada that go bankrupt do so primarily because of their own deficiencies rather than externally generated problems. They do not develop a basic internal strength to survive. Overall weaknesses in management, combined with a lack of market for their product, cause these firms to fail. The main reason for failure is inexperienced management.”<sup>26</sup>

Some research suggests that the development of “core functional competencies” within a firm, such as management, marketing, production, financing and human resources, is a key success factor.

The development of these core competencies is seen as a basic prerequisite for small-firm survival. At the same time, investments in knowledge creation, notably in research and development and technology acquisition, are found to be predictors of high performance.<sup>27</sup>

Most Canadian firms, however, would appear to believe that external factors (state of the economy, competition) are the primary barriers to growth. In terms of factors under the firm’s control, they attach importance to sales/marketing, advertising, better staff and improved customer service. Despite the importance of management skills and competencies suggested by research and the SME literature, most firms rank management as low in factors to promote growth.<sup>28</sup>

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<sup>24</sup> Industry Canada, *Small Business and Regulatory Burden*, Small Business Policy Branch. October 2003.

<sup>25</sup> See for example Evangelia Papadaki and Bassima Chami, *Growth Determinants of Micro-Businesses in Canada*, Small Business Policy Branch, Industry Canada, July 17, 2002.

<sup>26</sup> J. R. Baldwin, E. Gray, J. Johnson, J. Proctor, M. Raliqzaman, and D. Sabourin, *Failing Concerns: Business Bankruptcy in Canada*. Ottawa. Statistics Canada Catalogue No. 61-525-WPE. 1997. Cited in *Managing for Growth: Enabling sustainable success in Canadian SMEs*.

<sup>27</sup> John R. Baldwin, Guy Gellatly, and Valérie Gaudreault, *Financing Innovation in New Small Firms: New Evidence from Canada*. Statistics Canada Catalogue No. 11F0019MIE – No. 190. May 2002.

<sup>28</sup> Guillemette.

In a survey of Canada's 50 "best-managed companies," however, it is worth noting that these companies rated management and human resources issues, business planning and strategies, and leadership skills most highly in their top 10 challenges, ahead of economic conditions, competitiveness and taxation.<sup>29</sup>

Similarly, a survey of higher-growth SMEs found that these enterprises place high value on management capabilities and entrepreneurial values as key for growth. These firms also identified marketing ability, employees' skills, access to capital, ability to adopt technology, R&D and innovation capability as important success factors.<sup>30</sup>

## **Lifecycle of SMEs**

Success factors for SMEs can also be examined as they vary across the different stages of the "lifecycle" of an enterprise.

A typical lifecycle definition used in SME literature identifies the following stages for SMEs:<sup>31</sup>

- Nascent/Pre-start-up
- Start-up
- First stage of growth
- Expansion/Transition
- Maturity

Similar phases were identified in a recent study by Canadian financial and business organizations. The study proposes a "SME Growth Framework" to assess the needs of enterprises across the lifecycle.<sup>32</sup>

In the nascent/pre-start-up phase, a "guiding vision" and effective business plan are essential. Financing needs focus on seed funding.

The start-up phase sees informal organizational structures – "managed chaos" – and a premium on entrepreneurship, intuition and management skills that focus on marketing and communications to secure financing and build clients.

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<sup>29</sup> 2002 survey by Queen's Centre for Economic Development. Cited in *Managing for Growth: Enabling sustainable success in Canadian SMEs*.

<sup>30</sup> John R. Baldwin, *Innovation: The Key to Success in Small Firms*. Statistics Canada catalogue no. 76. February 1995.

<sup>31</sup> See Guillemette. Other researchers use different definitions. For example, Churchill and Lewis use existence; survival; success; take-off; and maturity. See C. N. Churchill and V.L. Lewis, *Growing Concerns: The Five Stages of Small Business Growth*. *Harvard Business Review*, 3: 30-50. 1983. Cited in Evangelia Papadaki and Bassima Chami, *Growth determinants of Micro-Businesses in Canada*, Small Business Policy Branch, Industry Canada. July 2002.

<sup>32</sup> RBC Financial Group, Canadian Manufacturers and Exporters Association and Queen's School of Business, *Managing for Growth: Enabling Sustainable Success in Canadian SMEs*, 2003. The phases in the lifecycle are described as: Start-up; fast-growth; sustainability; and global enterprise.

The early-growth stage sees a financial plan become a major management tool as management/owner skills and efforts are directed towards raising capital, securing sources of supply, acquiring equipment, recruiting and training personnel, starting production and developing markets.

The expansion/transition phase sees more formal organizational structures built around products or markets – what is needed is to “professionalize” the business.” Management is focussed on exploiting strategic opportunities, showing leadership, working with stakeholders, and greater delegation. Financing becomes more diversified. Alliances, networking and partnerships assume greater importance. Ability to see opportunities and the need for change is critical. Some SMEs speak of a “founder syndrome,” where the original owner of a firm has difficulty delegating or moving on to the next phase of management and operations.

In the maturity or sustainability phase, owners spend more time on strategic decision-making and less on day-to-day operations. Organizational stability is balanced with the need for monitoring and re-engineering as necessary. New sources of funding are exploited and new alliances and mergers.<sup>33</sup>

A number of categories are used to define levels of growth in SMEs. “High growth” firms are firms that double the number of employees within five years, and have at least 20 employees at the end of that period. “Growers” increase the number of employees by at least 20%, while “stable” firms remain within their original 20% range. “Decliners” decrease their employment by more than 20% from the start of the reference period, while “deaths” are firms that have ceased to exist at the end of the five years.<sup>34</sup>

Only 1.4% (16,005) of Canadian businesses are high-growth firms – such firms are also known as “gazelles” or Growth SMEs (GSEMs) – and the majority of these (11,464) have fewer than 20 employees.<sup>35</sup>

## **SME Characteristics**

Literature on SMEs points to the attributes and skills of the owner-manager, business practices, and certain characteristics of the enterprise as key success factors.<sup>36</sup>

### **Management skills**

A recent study on success factors for Canadian SMEs notes “the vital importance of management skills in moving entrepreneurial start-ups to profitable businesses with the scale and scope for ongoing success.” The study identified “leadership, vision and corporate direction” as major internal challenges facing SMEs.<sup>37</sup>

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<sup>33</sup> See Guillemette and *Managing for Growth: Enabling Sustainable Success in Canadian SMEs*, 2003.

<sup>34</sup> Guillemette.

<sup>35</sup> *Ibid.*

<sup>36</sup> See for example Evangelia Papadaki and Bassima Chami

<sup>37</sup> *Managing for Growth: Enabling Sustainable Success in Canadian SMEs*.

As discussed above in the context of SMEs' lifecycle, the management skills and competencies needed by firms vary considerably depending on the stage of development of the enterprise:

*Skilled management of the day-to-day challenges of running a business is clearly key to success. But management's ability to focus on less tangible issues – business, management and organizational development – determines the company's ability to grow into a larger, more stable company.*

*Management must learn to change and adapt as the business changes. What is appropriate at one growth stage can be a negative influence at another.*

*The management skills and capabilities required by a firm change dramatically as the company moves through different stages of growth and success.*

## **Entrepreneurship**

The entrepreneurial nature of the organization, and particularly of the owner-manager, is critical for success. "Entrepreneurial intensity" – active risk-taking, usually measured by the willingness of an individual to take personal financial risk – tends to be higher among higher-growth firms.<sup>38</sup>

"Entrepreneurs," notes an OECD report, "are people who sense opportunities, innovate, take risks, and develop new goods and services. They drive business dynamics – the birth, expansion, contraction and death of firms – and fuel overall economic growth."<sup>39</sup>

"The entrepreneurial process, however," notes the report, "remains mysterious. Social, cultural and political factors in countries influence the availability of entrepreneurial opportunities as well as the degree of risk-taking and the mobility of resources."<sup>40</sup> Education and training, as well as regulatory framework and institutional infrastructure, are identified as factors that can encourage or impede entrepreneurship.

A 2004 Canadian survey of business leaders on entrepreneurial styles found that no single characteristic or set of characteristics can be seen as defining the entrepreneur.<sup>41</sup> "There is no single personality type or style that is strongly associated with business ownership or entrepreneurial success." Business owners surveyed self-identified according to the following entrepreneurial types: "goal-oriented achievers" (38%); "idea-generators" (26%); "expert people managers" (21%); and "super salespersons" (14%).

Different models and theories have been used to help explain entrepreneurship, how it is created and developed, and how it works.

A recent Western Canadian study that reviewed conceptual theories of entrepreneurship notes that earlier theories explained entrepreneurship as primarily driven by the characteristics of the entrepreneur, including: need for achievement; propensity to take risks; energy level; and desire for personal control. However, more recent thinking suggests that entrepreneurship is "both

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<sup>38</sup>Evangelia Papadaki and Bassima Chami.

<sup>39</sup> Organization for Economic Co-operation and Development (OECD), *Small and Medium-sized Enterprises: Local Strength, Global Reach*. PECD Policy Brief. 2000.

<sup>40</sup> *Ibid.*

<sup>41</sup> Canadian Federation of Independent Business (CFIB), *Do you have what it takes? Results of CFIB survey on entrepreneurial styles*. CFIB Research. November 2004.

multi-layered and multi-dimensional” and places “approximately equal emphasis on human capital, financial capital and social capital in the entrepreneurial process.”<sup>42</sup>

The study notes several factors that both underlie and support entrepreneurship. “Knowing when and how to act in the face of opportunity” means relying on intuitive methods as well as rational thinking. While ideas are the “spark” for entrepreneurship, “process” is also important as the “engine” that drives to action and success. Networking is “at the heart of process” if ideas are to be turned into “an actionable plan.”<sup>43</sup>

*If one thing stands out in contemporary thinking it is the non-linearity of entrepreneurial actions. The path from here (the idea) to there (the realization) is full of information assembly, segmentation and evaluation, of future reference points, of intuition, feedback loops and reassessment, of sustaining existing contacts and finding and incorporating new ones into an expanding network, of searching out and acquiring an appropriate resource bundle, of improvisation, of timing and of the ability to act.*<sup>44</sup>

Current thinking on entrepreneurship emphasizes the interplay between entrepreneurs and the local/regional environment and context.

There is seen to be “an interdependent relationship among entrepreneurs, government policy and the local environment (i.e. social and commercial institutions, physical and human capital resources). . . In a well-functioning entrepreneurial system, each component reinforces the other to promote firm, industry and cluster development.”<sup>45</sup> In this context, some studies suggest that entrepreneurs are people who “have a greater ability to perceive opportunity, accept challenges, and organize resources.”<sup>46</sup>

## **Innovation**

Capacity for innovation has merged as one of the key factors that encourages growth in firms, and some studies identify it as the most important factor in growth.

*Innovative activities are the most important determinant of success; that is, for a wide range of industries, they serve to discriminate between the more- and less-successful firms better than any other variable.*

*It is innovation that is found everywhere to discriminate between the more- and less-successful groups of firms.*

*In the new world economy, innovation is the crucial determinant of success*<sup>47</sup>

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<sup>42</sup> Edward J. Chambers and Stuart E. Shaw, *A Primer on Western Canadian Entrepreneurship*. Western Centre for Economic Research, University of Alberta. Information Bulletin No. 76. April 2004.

<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*

<sup>45</sup> Maryann P. Feldman, Johanna Francis and Janet Bercovitz, *Creating a Cluster while Building a Firm: Entrepreneurs and the Formation of Industrial Clusters*. Regional Studies, Vol. 39.1. February 2005.

<sup>46</sup> *Ibid.*

<sup>47</sup> Innovation: The Key to Success in Small Firms.

A Government of Canada White Paper (January 2001) on *Canada's Innovation Strategy* defined innovation as “the creative process of applying knowledge and the outcome of that process.”<sup>48</sup>

Increasingly, innovation is being understood and defined in very broad terms as encompassing not only new ideas and products but also different and improved products and processes and ways of working. “Innovation,” notes one study, “means not just new products, technologies and production processes. Innovation also includes finding cheaper ways to produce existing products, better marketing techniques, and more efficient organization of activities ranging from design, sourcing, manufacturing, and marketing, to the management of inventory, finance, human resources, and information processing.”<sup>49</sup>

Various measures are used to assess the innovation behaviour of firms, including R&D expenditures, the number of new or significantly improved products, goods or services introduced over a period of time, and other characteristics.<sup>50</sup>

Research on innovative SMEs suggests several key factors that are positively related to the innovation capacity of an enterprise.

These include: expenditures on research and development (R&D); technological capability; the role of the entrepreneur-owner; and networking and partnerships, including innovative “clusters.” Management skills and competencies, organizational factors, and government policies are also considered important. Moreover, it is the interplay among these various factors, rather than any single factor, that makes some firms more innovative than others.

R&D is seen as perhaps the most important factor influencing innovation in enterprises, and measures such as whether a firm has an R&D unit, R&D expenditures relative to total investment, and R&D-to-sales ratio are often used as proxies for innovation by firms.

SMEs in Canada spend much less on R&D than large firms in absolute terms, but spending on R&D by SMES as a percentage of revenue (R&D intensity) is much greater.<sup>51</sup>

There is evidence, for example, that high-growth firms with 20-49 employees are significantly different from other firms in the same size category in that they are more innovative, more involved in innovative collaborations, apply more for patents, and make more use of R&D tax credit programs. Generally, industries with high R&D spending are more likely to have a higher proportion of high-growth firms.<sup>52</sup>

A recent American study, looking at successful innovation examples such as Silicon Valley in California, emphasizes the importance of the entrepreneur in the innovation process, and “how entrepreneurs actively interact with and shape their local environment”<sup>53</sup>. It describes entrepreneurs as “economic-change agents, able to create or attract the necessary resources and

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<sup>48</sup> Government of Canada, *Achieving Excellence: Investing in People, Knowledge and Opportunity*. January 2001.

<sup>49</sup> Zoltan Acs, Randall K. Morck, and Bernard Yeung, *Small Firms, Globalization, and Canadian Public Policy*. Joint Series of Competitiveness No. 20. January 2000.

<sup>50</sup> See for example *Key Small Business Statistics*.

<sup>51</sup> Evangelia Papadaki and Bassima Chami.

<sup>52</sup> *Ibid.*

<sup>53</sup> *Creating a Cluster while Building a Firm: Entrepreneurs and the Formation of Industrial Clusters*.

institutions to support their ventures, and able to draw on the rich historical and regional context in which they operate.”<sup>54</sup>

One study of Growth SMEs (GSMEs) undertook an in-depth analysis of the different characteristics of such firms and surveyed owners about key success factors. It concludes that growth factors for successful firms include: management skills, marketing ability, employee skills, access to capital, ability to adopt new technology, and R&D capability. A key finding of the study is that while many SMEs may demonstrate these characteristics, it is when they are related to innovation capability and activities that growth best occurs. “The common thread for all industries . . . is that the ability of a firm to grow relative to its immediate competitors and to increase its profitability relative to the industry mean reflects policy choices primarily, but not exclusively, in areas that involve innovation.”<sup>55</sup>

The study found that the three policies that were seen as contributing most to growth were R&D, access to markets, and technological ability.

“All of these factors are related to the capacity to innovate. R&D is closely associated with the development of new products and processes. New markets often have to be penetrated in order to sell new products; thus, the attention paid to accessing new markets differentiates firms by their innovative marketing ability. Finally, technological capability must be relied on to master the new production processes.”<sup>56</sup>

Interestingly, the same study found that while government assistance was ranked last in the survey, the *choice* of government assistance can be considered as significant for innovation and as a strategy for growth. While procurement and training were ranked low in terms of government programs, broad framework policies and programs that provide support for R&D and for export development were ranked high.

*These are the policies which complement private sector success strategies. Firms that give greater stress to innovation are more likely to make use of these programs. They are also more likely to be winners. In these cases, private sector winners pick government programs rather than the reverse, which considerably reduces the onus on governments when they try to pick the winners themselves. .*

*Governments still must devise the nature of their offerings so that they are broadly supportive of innovation and maximize the likelihood that they will indeed be chosen by winners rather than losers.*<sup>57</sup>

SMEs possess many advantages in terms of innovation capacity, by their very nature and the context in which they work. Their small size may itself be a positive factor for innovation. Having fewer resources than larger firms, they rely more on local networks for inputs to innovation, and tend to search for innovations in “less crowded” areas of research. “Small firms are often better at creating innovations, especially truly radical ones” notes one research study.”<sup>58</sup>

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<sup>54</sup> *Ibid.*

<sup>55</sup> *Innovation: The Key to Success in Small Firms.*

<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.*

<sup>58</sup> *Small Firms, Globalization, and Canadian Public Policy.*

Key informant interviews also agreed that “break-through” innovations may be more likely to happen in small businesses where there is often “no choice but to innovate, to find a new or better way to build a product or provide a service,” while in larger firms, who may have resources already invested in particular technologies or approaches, change may be more incremental.

## **Networking and Partnerships**

Research also points to the importance of networking and partnerships for the success of SMEs, and in particular for fostering innovation. .

A recent OECD report notes that:

*Even more than larger firms, SMEs need to access external sources of information, knowledge, know-how and technology in order to build their own innovative capability and to reach their markets.*

*They must participate in networks, particularly those that nurture the tacit knowledge and other non-tradable competences that are critical for pursuing innovation-based competitive strategies.*

*All must be connected to the most prolific sources of new knowledge and expertise, either directly or through multi-layered innovation networks that link the most research-intensive and/or innovative firms to others at regional, national and global levels.<sup>59</sup>*

This suggests that owners-entrepreneurs will need appropriate skills to foster such networking and partnerships. A Canadian study notes that “SME business leaders are often portrayed as John Wayne characters: isolated, fiercely independent, competing ferociously against all contenders. However, in the contemporary business landscape, firms must learn that isolation is a liability and that networking and connectedness are survival skills. Business leaders need to develop an interest in areas that run quite contrary to the lone-gun image – networking, alliances and social capital.”<sup>60</sup>

It has been suggested that there may be a role for public policy measures to raise awareness of networking opportunities and the search for partners, helping organize networks, and interfacing scientific and innovation networks.<sup>61</sup> The OECD notes that public-private partnerships for innovation are an especially promising means.

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<sup>59</sup> Organization for Economic Co-operation and Development (OECD), *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*. 2<sup>nd</sup> OECD Conference of Ministers responsible for Small and Medium-sized Enterprises (SMEs). Istanbul. June.

<sup>60</sup> *Managing for Growth: Enabling Sustainable Success in Canadian SMEs*.

<sup>61</sup> Organization for Economic Co-operation and Development (OECD), *Networks, Partnerships, Clusters and Intellectual Property Rights: Opportunities and Challenges for Innovative SMEs in a Global Economy*, Background information for the 2<sup>nd</sup> OECD Conference of Ministers responsible for Small and Medium Enterprises, Istanbul, Turkey. 2004.

## Clusters

“Clusters” – local concentrations of related, specialized firms – is also seen as an effective way to stimulate innovation and encourage growth, and provide competitive advantage.

The OECD defines clusters as:

*localised innovation systems where increasing private and social returns on public and private investment result from physical or cultural proximity that encourages human networks and facilitates flows of tacit knowledge. They also result from close co-operation between firms and government in building tangible and intangible infrastructures for innovation and in coping with market failures.*<sup>62</sup>

The advantages of geographically concentrated clusters of firms can be manifold. “In tightly linked clusters, firms can share costs for increased efficiency, local pools of highly specialized talent can emerge, and knowledge and technologies can spill over between firms. This environment encourages innovation, R&D intensity, inter-firm collaboration, and new venture start-ups.”<sup>63</sup>

Many factors contribute to the development of clusters. The OECD notes the importance of networks and partnerships, the role of universities and knowledge-intensive services, and linkage to regional development strategies as key factors encouraging the growth of clusters.

A study of highly successful American industrial clusters points, again, to the role of the entrepreneur and the interrelationship between him or her and the local environment in cluster development. It is the interplay of the entrepreneur, technological and market opportunities, and the local context and institutions and resources that lead to the creation of clusters:

*Entrepreneurship is a local event: individuals start companies in the location where they have formed business networks and have access to resources.*

*Entrepreneurs draw on existing resources in the local environment and, in turn, add new resources to the environment that others can draw upon. Entrepreneurial activity shapes the local environment through active learning and experimentation, the reinvestment of profits and expertise, the extension of relationships with universities and government laboratories, the building of institutions such as industry networking associations, and the subsequent pull of a new group of actors to the region. Over time, a cluster may succeed and become entrenched, but building a cluster takes time and there are no guarantees about its final configuration or ability to sustain itself.*<sup>64</sup>

The study suggests that clusters, like enterprises, see different phases in their development.

In the first or “emergent” phase, entrepreneurial innovation “is ignited by a confluence of exogenous events.” The entrepreneur responds to opportunity and begins to seek resources and build networks and linkages with other firms.

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<sup>62</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy.*

<sup>63</sup> *Managing for Growth: Enabling Sustainable Success in Canadian SMEs.*

<sup>64</sup> *Creating a Cluster while Building a Firm: Entrepreneurs and the Formation of Industrial Clusters.*

A second phase sees the cluster “self-organize” as individuals, businesses, resources and institutions come together to exploit and develop the opportunity. The entrepreneur stimulates the local environment to further innovation and also draws on local learning.

In a third stage, a “fully functioning entrepreneurial environment within an innovative and adaptable industrial cluster emerges.” The various components and factors form a “dynamic system that may be self-sustaining and reinforcing.”<sup>65</sup>

## **Demographic Factors**

Finally, a number of demographic factors can be seen as growth drivers that are expected to increase the number of SMEs over the rest of the current decade.<sup>66</sup>

The baby boomer population will continue to fuel SME growth for the next several years, with the bulk of SME owners falling into the 40-64 age bracket. Subsequently, this trend will reverse as older people tend to shy away starting or owning their own companies. This also suggests the importance of succession planning over the next few years.

The growth in the number of younger new entrepreneurs, and the generally higher levels of education that they bring with them is also expected to foster SME growth.

The significant increase in female labour force participation since the 1960s and 1970s has already been translated into greater female ownership of businesses, with the growth in female-owned establishments outpacing overall growth in new businesses, and can be expected to continue.

A further SME growth driver is the increase in visible minority communities, reflecting shifting immigration patterns. Visible minorities are at least as likely to become business owners as other Canadians, and proportionately more so among younger population cohorts.

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<sup>65</sup> *Ibid.*

<sup>66</sup> RBC Financial Group, *Canada needs more growth-oriented small businesses*. October 2004.

## The Financing of SMEs in Canada

Financing can have a significant impact on SMEs' survival and development. As one study notes, "Financial inputs are unlike other inputs; they are ubiquitous, shaping all aspects of a firm's investment behaviour – its purchase of new machinery and equipment, its expenditure on workplace training, its advertising and marketing campaigns, and its research and development expenditures."<sup>67</sup>

Financing needs and patterns for SMEs in Canada vary significantly depending on the stage of development of the enterprise, firm size, and other factors such as the industrial sector and the nature of the business.

### SME Financing "Typology"

The two main types of financing instruments used by SMEs are "equity" financing and "debt" financing. Equity financing includes retained earnings from sales and services and share capital. Debt financing includes short- and long-term debt, both secured and unsecured. Other types of financing instruments for SMEs include trade credit, contract financing, investment tax credits, and grants and subsidies.<sup>68</sup>

Sources for these financing instruments can be categorized as "formal" or "informal."

The term "formal sources" refers to financing that is obtained from external sources/suppliers who are in the business of providing financing such as:

- domestic and foreign banks, credit unions and *caisses populaires*
- finance and insurance companies

Formal financing includes:

- commercial loans and lines of credit
- lease financing
- risk and venture capital
- government/public subsidies, grants and loans

The term "informal sources" refers to financing obtained from sources/suppliers who are not in the business of providing financing. Informal financing includes:

- funds acquired as a result of the business' activities (sales, retained earnings, etc.)
- financing from the owners (e.g. personal savings)
- "love money" or investments from family and friends, usually invested for long periods and with lower expectations of returns

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<sup>67</sup> *Financing Innovation in New Small Firms: New Evidence from Canada.*

<sup>68</sup> See "Taxonomy of Financial Structure – Instruments and Sources" in *Ibid.*

- financing from private investors, known as “angel investors” (i.e. individuals who decide to invest in an enterprise). Angel investors invest their personal funds (while venture capitalists invest someone else’s), and often their time and know-how as well, and usually take an equity share in the firm. Some angel investors operate in informal networks, led by “archangels.”<sup>69</sup>

## **SME Financing Patterns**

The primary source of financing for SMEs in Canada is debt financing – in 2000, debt accounted for 75% of SMEs’ long-term financing structure.<sup>70</sup>

Overall, SMEs use commercial financing more than other forms of financing – some 49% of SMEs had recourse to commercial financing (loans, line of credit) in 2000, and 39% used trade credit from suppliers more than any other form of financing.

In 2001, nearly one-fifth (18%) of SMEs made a request for new or additional commercial debt (down from 23% in 2000), of which 80% were approved.<sup>71</sup>

However, SMEs also make substantial use of informal financing: nearly 40% of SMEs’ outstanding debt in 2000 was owed to informal types of financing<sup>72</sup>. Some 35% of SMEs financed their operations through personal savings, followed closely by the use of the business’ retained earnings (31%).<sup>73</sup>

Differences in the use of financial instruments by SMEs are significant, varying according to factors such as age, size, sector and nature of the enterprise:

- Informal investment plays a relatively greater role in the initial stages of SMEs’ development, as start-up SMEs often lack a credit history and adequate collateral to secure a commercial loan
- 66% of start-up SMEs in 2000 used personal savings of the owner(s) compared with 35% of all SMEs
- Only 29% of start-up SMEs used commercial loans, compared with 49% of all SMEs
- Smaller businesses, self-employed SMEs, service sector firms, and knowledge-based firms tend to use more informal types of financing
- Knowledge-based firms, for example, have the highest use of retained earnings (37%) of all sectors).

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<sup>69</sup> Industry Canada, *Angel’s Touch!!! An Entrepreneur’s Guide to Informal Investment*. Bridging the Investment Gap Conference, June 13-14, 2001.

<sup>70</sup> *Key Small Business Financing Statistics-August 2005*.

<sup>71</sup> *Small and Medium-sized Enterprise Financing in Canada 2003* and *Key Small Business Financing Statistics-August 2005*.

<sup>72</sup> *Ibid.*

<sup>73</sup> *Small and Medium-sized Enterprise Financing in Canada 2003*.

- Knowledge-based firms also use less commercial loans and lines of credit (21%, the lowest of all sectors)<sup>74</sup>
- Self-employed SMES have the highest use of informal types of financing (37% use personal credit cards; 36% personal savings of the owner; only 34% use commercial financing, compared with 49% of all SMEs)<sup>75</sup>
- Medium-sized firms and resource-based and goods-producing firms use more formal types of financing
- For example, 86% of medium-sized firms used commercial loans and lines of credit, compared with 49% of all SMEs. 75% of medium-sized firms used trade credit from suppliers<sup>76</sup>
- 71% of agricultural firms used commercial loans and lines of credit. 58% of manufacturing firms used trade credit from suppliers<sup>77</sup>
- Risk capital is more frequently used by firms with high-growth potential, international/export orientation, high rates of return on equity, and high spending on research and development to create new products
- Equity capital is not used as a major financing instrument by SMEs, in part because of the attitudes of SME owners; 41% of SME owners say they would refuse to share ownership in their firms in return for equity capital<sup>78</sup> This has been referred to as the “Pecking Order Hypothesis” – entrepreneurs prefer financing in an order that minimises external control and ownership dilution, and rely first on internal resources and then debt before equity financing.<sup>79</sup>

## **SMEs and Government Financing**

Overall, use of government/public financing is less important for SMEs in Canada than other forms of financing.

For example, chartered banks are the main suppliers of debt financing to SMEs in Canada (67% of requests made by SMEs in 2001) while Crown corporations such as the Business Development Bank of Canada provided only 7% of debt financing to SMEs.

In key informant interviews, the view was expressed by some that government grants are “more trouble than they are worth,” and that they create “grantpreneurs” with expertise in proposal-writing rather than in running a business.

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<sup>74</sup> *Ibid.*

<sup>75</sup> *Small and Medium-sized Enterprise Financing in Canada 2003 and Key Small Business Financing Statistics-August 2005.*

<sup>76</sup> *Ibid.*

<sup>77</sup> *Key Small Business Financing Statistics-August 2005.*

<sup>78</sup> *Ibid.*

<sup>79</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy.*

Government/public financing is significant, however, and is also important because it enables SMEs to access financing that would not normally be available to them.

Use of government/public financing varies according to size, region and sector:

- 4.1% of SMEs requested grants or subsidies from government or community programs in 2001
- Larger SMEs make more use of such financing (15.8% of firms with 100-499 employees made requests)
- Some regions seek government/public financing more than others: Alberta and the Northwest Territories (7.6% of firms requested grants or subsidies); Atlantic (7.3%); Manitoba, Saskatchewan and Nunavut (5.6%); Quebec (4.9%); Ontario (1.9%)<sup>80</sup>
- Agricultural firms (28%) use more government loans or grants than all other sectors<sup>81</sup>

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<sup>80</sup> *Small and Medium-sized Enterprise Financing in Canada 2003.*

<sup>81</sup> *Ibid.*

## **Challenges and Barriers to Growth**

### **Management Skills and Competencies**

Many firms with the capacity for greater profits and growth lack the necessary management skills to achieve success.

Major management and leadership deficiencies identified in SME literature include: weak strategic planning; inability to communicate the potential of their firm to investors and financial institutions, using “the language of finance”; short-comings in terms of networking and partnership skills; inability to adapt to changing management skills requirements across the course of the lifecycle of firms; and inability to foresee and undertake organizational change necessary in growth stages.<sup>82</sup>

Key informant interviews also suggest that, while they may possess strong entrepreneurial skills, many SME owners may lack formal management training and knowledge – many SME owners tend to “learn by doing.”

### **Access to Financing**

Access to financing is a significant challenge frequently identified by SMEs.

A recent OECD report notes that “limited market power, the lack of management skills, high share of intangible assets, the absence of adequate accounting track records and insufficient assets, all tend to increase the risk profile of SMEs. Consequently, traditional commercial banks and investors have been reluctant to provide financing services to SMEs.”<sup>83</sup>

Start-up SMEs – which also tend to be smaller in size – experience difficulties accessing commercial financing because they may lack the assets or collateral, as well as credit history, to secure loan financing. The relatively high failure rate among new enterprises – 2 out of 5 firms do not survive beyond their second year of operation – also contributes to their difficulty in securing financing.<sup>84</sup> These financing difficulties have been described as “early stage gaps” by the Business Development Bank of Canada.<sup>85</sup>

Small-size SMEs may have similar difficulties accessing formal types of funding such as commercial loans and credit, as they typically have smaller profits, fewer assets and larger debt/equity ratios than mid-size firms.<sup>86</sup>

High-growth firms and SMEs in knowledge-based industries may have difficulty securing commercial loans and other forms of debt financing, since they may lack tangible assets or

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<sup>82</sup> *Managing for Growth.*

<sup>83</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy.*

<sup>84</sup> John Baldwin, Lin Brian, Richard Dupuy, *Failure Rates for New Canadian Firms: New Perspectives on Entry and Exit.* Statistics Canada. 2000. Cited in *Ibid.*

<sup>85</sup> Cited in Equinox Management Consultants Ltd., *Gaps in SME Financing: An Analytical Framework.* Industry Canada. February 2002.

<sup>86</sup> *Small and Medium-sized Enterprise Financing in Canada 2003.*

require an “incubation period. For such firms, “risk capital” may be a more appropriate form of financing.<sup>87</sup>

Access to risk and venture capital has been identified as an issue for SMEs in Canada. There is a perception that there is a shortage of such financing in Canada that is hindering the development of high-potential enterprises.

There may also be some “demand-side” issues that contribute to the financing difficulties experienced by some SMEs. A recent report prepared for Industry Canada notes that there is some evidence that potential investors perceive a shortage of “investment-ready opportunities” with respect to SMEs in Canada, a lack of qualified “investable” or “bankable” SMEs.<sup>88</sup>

The same study identifies four potential and perceived gaps in the debt market.

There may be a “size gap” in that business owners seeking financing may think that their needs are too small to interest institutional lenders.

A “risk gap” may exist if lenders do not price loans to reflect risk, but rather reject loan applications if the risk is too high or collateral insufficient.

There may be a “flexibility gap” if financial institutions do not provide flexible terms and conditions for their loans to address SMEs’ needs.

A “knowledge gap” may exist if lending institutions do not adequately understand small- and medium-size enterprises, especially those in knowledge-based industries.<sup>89</sup>

The literature on SMEs notes that perceived gaps in financing for enterprises must be demonstrated to actually exist, i.e. that there are problems in securing financing for firms due to market imperfections or failures, rather than resulting from inadequacies in the enterprise itself that mean it does not “merit” financing. Otherwise, public interventions and supports could themselves lead to distortions and unfair competition. “It is essential to determine the extent to which, if any, categories of firms are *systematically* disadvantaged, rationed, with respect to access to capital.<sup>90</sup>

## **Access to Information Technologies.**

Access to and use of information and communication technologies (ICT) can be important for the development and growth of enterprises.

Small enterprises, however, tend to adopt basic information technologies because they are relatively inexpensive and easy to acquire and implement. Small firms lag behind larger firms in the use of more complex technologies such as websites, intranets, and e-commerce.

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<sup>87</sup> *Key Small Business Financing Statistics-August 2005.*

<sup>88</sup> *Gaps in SME Financing: An Analytical Framework.*

<sup>89</sup> *Ibid.*

<sup>90</sup> *Ibid.*

Common barriers for SMEs to adopt more advanced technologies include acquisition and maintenance costs, availability of skills and qualified personnel, transaction security and trust factors, and concerns about intellectual property rights.<sup>91</sup>

## **Access to and Capacity for Innovation**

SMEs also experience difficulties in accessing financing for innovation and in maximizing their capability to use innovation to develop new products and services.

The difficulties experienced by SMEs in innovation can be seen as arising, at least in part, from “size-related” characteristics, as they have very limited internal resources, particularly with respect to finance, management and knowledge-base.

These limited resources, notes a recent study of innovative SMEs, “make it harder for smaller firms to reap the benefits of innovative activity particularly in terms of R&D and the marketing of new product inventions. As well, the “distinctive organizational culture of SMES, stemming from the combination of ownership and management that typifies the majority of SMEs” can impact on firm behaviour, e.g. willingness to take risk or even to seek external expertise and assistance. Moreover, “limited human resources can influence a firm’s propensity and ability to be aware of, and respond to, opportunities presented by the external environment.”<sup>92</sup>

In terms of financing innovation, funds for investments in R&D and new technology are difficult to obtain because such investments are seen as too risky and offer less collateral for needed guarantees for loan financing.

A recent OECD policy paper notes that “Access to risk capital is a major obstacle to SME expansion,” particularly for innovative SMEs seeking to expand. “First, the returns to innovative activities are highly uncertain and often skewed. Second, entrepreneurs may possess more information about the nature and characteristics of their products and processes than potential investors. Third, innovative activities are usually intangible so that it is difficult to assess their monetary value before they become commercially successful.”<sup>93</sup>

There is some evidence that the financial structure and sources of financing of SMEs may also hinder innovation. SMEs that rely more heavily on debt financing – which may mean more conditionality and stringent re-payment schedules – have been found to invest less in R&D. Firms that rely more on equity financing (notably, retained earnings) have been found to invest more in R&D.<sup>94</sup> In general, small, firms in high-knowledge sectors tend make less use of debt and greater use of reinvested profits than those in low-knowledge sectors.<sup>95</sup>

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<sup>91</sup> Guillemette. See also *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

<sup>92</sup> David North, David Smallbone and Ian Vickers, *Public Sector Support for Innovating SMEs*. Small Business Economics 16. 2001.

<sup>93</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

<sup>94</sup> Financing Innovation in New Small Firms: New Evidence from Canada.

<sup>95</sup> Guy Gellatly, Alan Riding and Stewart Thornhill, *Growth History, Knowledge Intensity and Capital Structure in Small Firms*. Statistic Canada no. 11F0027 No. 006. August 2003.

## **Public Policy and Supports for SMEs in Canada**

SMEs in Canada have access to a wide variety of supports and assistance from the Government of Canada, as well as from provincial/territorial governments.

It should also be noted that the SME sector has itself, over the years, developed supports and services for firms, through organizations such as Chambers of Commerce, business umbrella and spokesperson organizations, and industrial/sectoral associations. These organizations provide services and information, develop tools and various supports, constitute a forum for discussion and collaboration, and offer a “voice” for firms/members.

Such organizations are financed in most instances by membership fees, although in some cases they may also receive government funding for specific projects and activities.

### **Government of Canada**

Government of Canada support for SMEs is available in a number of key areas: information, support and advisory services; financing assistance; support for innovation, technology and R&D; skills and human resources development; tax measures; government procurement; and export development. These supports and services are provided through a number of government institutions and organizations, many of these offering several different types of assistance.

Some of the key Government of Canada programs and supports for SMEs are summarized in the following paragraphs.

The Government of Canada Regional economic development agencies – the Atlantic Canada Opportunities Agency (ACOA), Canada Economic Development for Quebec Regions, and Western Economic Diversification Canada (WD), as well as the Federal Economic Development Initiative in Northern Ontario (FedNor) – support SMEs with access to capital, markets, information and skills development.

These agencies also offer a variety of financial assistance programs, often tailored to the regional context, frequently in collaboration with other federal departments, provincial governments, municipalities and the private sector.

Some of the programs offered by these agencies include: the Community Futures; the Atlantic Investment Partnership program; the Atlantic Innovation Fund; the Strategic Community Investment Fund; Innovative Communities Fund; Business Development program; and the WD Loan Investment Fund program.

The Canada Small Business Financing Act assists SMEs in obtaining loans from commercial banks and other authorized lending institutions to finance the purchase or improvement of fixed assets including real property, new or used equipment and leaseholds or lease property.

Canada Business Service Centres provide information and financial and technical advice to businesses.

The Business Development Bank of Canada (BDC) supports local economic development and offers information, advisory and consulting services as well as financing assistance.

Industry Canada through its small business information website *Strategis* provides information for SMEs and a variety of business-information products, as well as links to other sources of information and assistance for SMEs.

Government of Canada support for innovation and technology development is provided under a number of programs and initiatives including: the Industrial Research Assistance program (IRAP) under the National Research Council; Technology Partnerships Canada; the Connecting Canadians Initiative; the Smart Communities program; and the Community Access program.

Human Resources and Skills Development Canada (HRSDC) offers a variety of programs to assist employers with their human resources needs, help businesses deal with labour adjustments, and assist unemployed individuals acquire skills, find work or start their own businesses. Programs include: Sectoral Partnerships; employment benefits and measures such as targeted wage subsidies and job creation partnerships under the Employment Insurance program and Labour Market Development Agreements with the provincial/territorial governments; and Youth Employment programs.

A variety of taxation measures provide support and assistance for SMEs in Canada. These include: R&D tax credits; tax credits for Labour-Sponsored Venture Capital Corporations (LSVCCs); the Small Business Deduction; tax rate reductions for small businesses; and different capital gains exemptions, roll-overs and other measures.

A number of other Government of Canada agencies provide information and other forms of assistance for SMEs.

For example, the Canada Revenue Agency (CRA) offers small business information seminars and a “new employer visit” program. Statistics Canada provides information for enterprises by province and industry sector. The Standards Council of Canada oversees the National Standards System. Public Works and Government Services Canada (PWGSC) operates the Office of Small and Medium Enterprises (OSME) to assist SMEs in accessing the government procurement system and competing for government business.

Further information on these and other Government of Canada supports for SMEs can be found in Appendix I.

## **Provincial/Territorial Governments**

Many provinces/territories also provide support to SMEs in Canada.

Ontario, for example, has 50 Small Business Enterprise Centres across the province, Business Advisory Services Offices, the Small Business Agency of Ontario, and the Ontario Investment Service, as well as programs such as the Community Small Business Investment Fund Program and the Labour Sponsored Investment Fund.

Quebec provides an extensive array of programs and services, including financial assistance programs; consultative services; support for partnerships and industrial clusters; research assistance; and a variety of tax measures and incentives.

Alberta also offers a wide variety of supports, including the Young Entrepreneur’s Financing Program, the Mainstreet Improvement Financing program, small business tax deductions and other measures, and the Innovations Assistance Program. The Alberta First web portal

([www.albertafirst.com](http://www.albertafirst.com)) for business information is a partnership between government and industry and is administered by a nonprofit company.

Further information on provincial/territorial supports for SMEs can be found in Appendix I.

## **International Policies and Supports for SMEs**

Research and literature on SMEs, both in Canada and internationally, suggest a three-fold rationale for public supports, financial and other:

- SMEs' contribution to the economy overall
- SMEs' importance to the economy of particular (disadvantaged) regions or populations (e.g., youth, women, minorities)
- the need to compensate for market failures and “imperfections” that mean that SMEs are systemically disadvantaged and denied or limited in access to some sources of private-sector financing

Internationally there is a wide range of policies, interventions and instruments that have been put in place to support or facilitate the operation of SMEs.

Recognizing “the increasing importance of small- and medium-size enterprises (SMEs) in economic growth, job creation, regional and local development, and social cohesion,” the OECD adopted the *Bologna Charter on SME Policies* in June 2000 and has established an on-going process to identify and share best practices in member countries to promote the growth and development of SMEs.<sup>96</sup>

The OECD notes that “Governments often need to go beyond provision of the framework conditions that influence the business environment to address policy and market failures that dampen entrepreneurial activity and limit the scope for innovative small firms to grow.”<sup>97</sup>

The following approaches have nearly all been adopted at some point in time by some governments in various combinations, varying according to the historic, economic and political variables.

Most countries have a department or agency responsible for SME policies and programs. In addition some have senior political mechanism to signal the importance of this sector and serve as a bridge with government. For example:

- The United Kingdom: Small Business Service within the Department of Industry and Trade
- The UK's All-Party Parliamentary Small Business Group (APPSBG)
- The UK's Ministers' Business Forum
- The UK's “Small Business and Government: The Way Forward” initiative to bridge whole-of-government to whole-of-sector
- USA Small Business Administration

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<sup>96</sup> Organization for Economic Co-operation and Development (OECD), *The Bologna Charter on SME Policies*, June 15, 2000.

<sup>97</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

Governments provide information, tools and services. These are in both physical and electronic forms and provide a wide array ranging from business planning, information on legal and regulatory frameworks, brokering services and advisory and consulting services. Some examples are:

- The UK Small Business Services (SBS) delivers government supports, including programs of financial support; encourages ethnic entrepreneurship, especially in disadvantaged regions and with underrepresented groups; and pursues better regulations and policies regarding small business
- The UK Small Business Portal delivers a range of tools from start-up materials, sources of financing including grants, loans, fundraising, sales and marketing, and advice on legal matters, technology and facilities/premises
- The USA Small Business Administration operates offices across the country with tools and advice and “protecting the interests of small business
- The USA Centres for Entrepreneurship focus on help to minority entrepreneurs

Governments provide a wide variety of financial supports and facilitate access to financing by SMEs.

Government financing programs and supports that can be accessed directly by SMEs include loans, subsidies, development funds, and tax treatment to encourage specific activity such as R&D or innovation. Countries tend to lean towards the use of certain of these sets of these instruments.

- The USA for example relies more heavily on the adjustments delivered through the tax system to assist small business and foster certain activity, as for example the recently announced tax reductions for new capital investments

Governments have also established mechanisms to facilitate or broker financial assistance i.e. bringing funders and entrepreneurs together; for example:

- UK Small Business Investment Task Force which helps SMEs’ with growth potential access investment funding, and equity funding
- Many countries’ small business web sites or portals feature directories of available grants, investors, and funders

Governments put in place and pursue framework policies to promote innovation and entrepreneurship. These can include:

- Institutional frameworks to ensure transparent and competitive environments within which small business can flourish and compete fairly; enabling regulatory frameworks and laws; and policies to support the development and diffusion of new technologies
- Economic frameworks including policies to enhance productivity and growth as well as economic development in particular populations and regions

Governments pursue policies to promote an environment conducive to the development of SMEs. These can include:

- Recognition of role of intermediaries and infrastructure organizations, such as self-help groups, business associations, technology assistance centres etc., in fostering international cooperation and partnership among SMEs and providing improved access to information, financial and technological resources and new markets; in some cases government assists the creation and operation of such organizations
- Promoting a culture of entrepreneurship, e.g. through marketing campaigns which profile and convey the “value” of small business; and measures on the human resources front such as introducing entrepreneurialism into school curriculum

Most governments focus their attention, at least cyclically, on both the content and the operations of regulations which impact small business. For example:

- Many jurisdictions undertake reviews and improvements in their regulations to “better regulations” (UK Action Plan, coming on the heels of a Regulatory Reform Action Plan)
- These initiatives are often accompanied or associated with paperwork reduction and regular efforts to avoid duplication, synchronize and harmonize rules and requirements in order to reduce the cost of compliance
- A related issue is that of liability, an issue that is often a challenge or impediment to small business; the USA, for example, recently announced possible legislation to limit frivolous law suits

Governments have adopted a wide variety of measures to foster and support innovation. Some examples include:

- Programs to extend small business access to R&D, for example the US Small Business Innovation Research Program
- The UK Government’s Smart Scheme that supports the development of new technology-based products that are “new” within a sectoral or national context
- France has measures to encourage innovation in the context particularly of local development and local economies
- The EU operates 140 Business Innovation Centres across Europe with a view to stimulating the creation and expansion of innovative SMEs in Less Favoured Regions of the EU
- The EU also operates Structural Funds which support, among others, selected colleges and training centres to assist SMEs with innovation, design and technology transfer

Governments adopt measures to provide fair access to government business (procurement policies). Examples include:

- US Small Business Contracts Council to oversee access to government contracts, with recently announced increased efforts to make further improvements
- The UK has committed to develop a small business Procurement Concordat to be signed by public sector bodies aimed at improving opportunities for small businesses to tender for contracts

- A number of the service offices and portals feature information on government contracts and how to access them

## **What Works – Lessons Learned from Canadian and International Experience**

Governments have put in place a wide variety of policies, programs and supports for SMEs. The effectiveness of different instruments will depend in large measure on the particular economic, social and governmental context.

A number of general observations can be made in terms of lessons learned from Canadian and international experience, drawing on relevant research and studies, program evaluations, and international reports and cross-country comparisons.

### **Blanket, one-size fits all policies are generally less successful**

Overall framework, taxation and regulatory policies aimed at economic development and increasing productivity and competitiveness are essential in order to create the environment in which SMEs can flourish and develop.

However, policy initiatives and supports for SMEs are more effective if they are directed towards specific issues, needs and situations.

As discussed earlier, firms' financing needs vary considerably across the lifecycle of SMEs and government policies and supports need to be designed to address clearly identified barriers and gaps at different stages of development.

In the area of risk capital, for example, the OECD suggests that “modest public support” may be appropriate where private financial markets do not provide adequate risk capital to some categories of SMEs. It suggests that such support should be targeted to the early stages of SMEs' development, where difficulties accessing financing are most acute, managed by the private sector and structured to leverage private investment.<sup>98</sup>

A Canadian study on micro businesses similarly notes that “Blanket policy approaches to small business growth, and micro-businesses in particular, may not be effective. Policies targeted at micro-businesses that want to grow are preferable.”<sup>99</sup>

The OECD suggests that, generally speaking, focussing public support on early stages and leveraging private financing can be more effective than broad-based programs in promoting entrepreneurship and innovation in SMEs.<sup>100</sup>

Programs also need to be evaluated and re-assessed on an-ongoing basis. The OECD notes that “there are already a large number of government programs to deal with SME financing constraints. These programs are often characterised by overlap, fragmentation, and competition among managing agencies.”<sup>101</sup>

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<sup>98</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy.*

<sup>99</sup> Evangelia Papadaki and Bassima Chami.

<sup>100</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy.*

<sup>101</sup> *Ibid.*

### **Money isn't the only answer, or necessarily the best answer**

International studies and research repeatedly note that direct government funding, in the form of grants and subsidies or loan and loan guarantee programs may not always be the most effective solution.

Moreover, direct government funding can distort the market, displace private financing, and discourage private investment. This theme comes up repeatedly in international literature and research on SMEs.

An OECD report notes for example that Canada's Labour-Sponsored Venture Capital Corporations (LSVCCs) had "tended to crowd out private investment" until program changes were made.<sup>102</sup> It notes that Canada's Business Development Bank (BDC) focuses on leveraging private financing but cautions that effects of such programs need to be evaluated regularly.<sup>103</sup>

"Direct funding by the government to improve financing access by SMEs does not appear to be very effective in meeting its objectives," concludes the OECD. Among other things, government programs typically do not provide an appropriate incentive structure, and lack the technological and management expertise to provide advice to the portfolio company and monitor its performance.<sup>104</sup>

### **Government supports for SMEs should be linked to broader economic and regional development strategies**

International experience indicates that SME support policies are most effective when situated within the broader economic, regional and community context.

"The aim should be to focus those public resources that are available on the needs of the economy at the regional (or national) level rather than simply on the expressed needs of individual firms themselves," notes one international study.<sup>105</sup>

### **Direct government loan programs and loan guarantee programs must be appropriately designed**

The OECD notes that there is a perceived "debt-financing gap" or "credit rationing" for some SMEs because they "are perceived to be riskier than other types of enterprises." Loan guarantee programs that "transfer part or some of the risk to the public sector" may therefore be appropriate.<sup>106</sup>

However, the OECD finds that "most direct loan programmes do not appear to be suitable" for financing SMEs and its "general assessment on loan guarantee schemes is not particularly encouraging." Such programs may displace private financing. Direct government programs, moreover, do not share potential upside return, but assume a significant portion of downside risks. They also tend to have low volumes of operations and high operating costs.

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<sup>102</sup> *Ibid.*

<sup>103</sup> *Ibid.*

<sup>104</sup> *Ibid.*

<sup>105</sup> *Public Sector Support for Innovating SMEs.*

<sup>106</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy.*

For example, the OECD notes that Canada's Small Business Loans Act (SBLA) had only limited success. In some cases, the OECD reports, assistance was given to firms that already had access to conventional forms of loans, and banks may have used the programme to reduce risk on loans they would normally have made. The Canadian evaluation of the program found that approximately 50% of loans would have been granted without the program, and another 25% of loans under the program would also have been given but as smaller loans.<sup>107</sup>

The program was replaced by the Canada Small Business Finance (CSBF) program in order to strengthen and streamline administration and improve its financial self-sufficiency. Fees are now charged to offset the costs of the claims, moving the program towards cost-recovery.

In terms of lessons learned from loan programs, the OECD notes that there must be "a genuine market imperfection in providing credit to SMEs." The design of the program "has to be related to the source of credit and market imperfections so as to avoid duplicating private sector financing." The OECD suggests that lending banks should be required to assume part of the risk. Finally, it points out that evaluations need to consider entire costs of the program including set-up costs, subsidies and transaction costs.

However, the OECD does conclude that government loans and loan guarantee schemes "may be an appropriate instrument to deal with the specific problem of lack of collateral for an otherwise commercially fundable project of an equivalent risk."<sup>108</sup>

**Government supports for SMEs that seek to provide, or improve access to, information and knowledge and expertise, and that encourage and support networking and partnership, can be effective**

Supporting SMEs' development through the provision of access to information, knowledge and technical assistance, and by supporting networking and the exchange of knowledge, expertise and information among SMEs, is increasingly seen as a legitimate and valuable role for governments.

Government can assist in bringing enterprises and financing/investing parties together, and in providing tools and technical assistance to SMEs (e.g. financial accounting and reporting, presenting a business case, measuring and reporting returns, and "talking the language of finance").

Canadian experience has indicated that such measures can have an impact. The *Canada Community Investment Plan* supported demonstration projects in 22 communities designed to assist entrepreneurs and bring investors and entrepreneurs together, along with community institutions, to improve access to risk capital. The program evaluation showed that these kinds of interventions were effective in assisting entrepreneurs to improve their investment readiness and learn how to work with investors. The evaluation results suggested that no single model of

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<sup>107</sup> Industry Canada, *Evaluation of the Canada Small Business Financing Program. Final Report*. Audit and Evaluation Branch. November 2004.

<sup>108</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

investment facilitation could be applied and that community-based approaches were successful.<sup>109</sup>

Research attributes at least some of the financing difficulties experienced by SMEs to “information asymmetries” between firms and financial institutions and potential investors, and lack of skills on the part of entrepreneurs in terms of relating to potential investors. “Addressing these problems,” notes the OCED, “requires finding ways to fuse entrepreneurship and finance. This involves ensuring the availability of entrepreneurial, technical and managerial expertise to the providers of finance and engaging investors actively in the development of the firm.” Initiatives to promote close contacts and good communications between suppliers of funds and those requiring finance and to support business networks and “incubators” can be valuable.<sup>110</sup>

The OECD notes that supporting “angel networks” is one effective means of doing this. “Business Angel Networks (BANs) have the potential to bring together private investors seeking good investment opportunities and entrepreneurs searching to raise finance by providing a channel of communications.” The OECD cites Canadian experience in this area as suggesting that locally-oriented angel networks designed in the context of industrial structure and the local community may be more effective than national efforts.<sup>111</sup>

Measures to assist SMEs to pool risk may be also appropriate and helpful – e.g. several countries (Japan, Italy, France) have measures to help local SMEs and SME associations to assist each other through mutual guarantee funds or loans among members.<sup>112</sup>

### **Supporting innovation bears results**

Many governments have put in place policies and programs to support innovation in and by SMEs. These often include support for R&D investments and technology acquisition.

The OECD suggests three areas where government supports can be effective.

The first is to ensure the operation of efficient financial markets. This can include assistance to develop effective financial information and reporting systems, and to help investors to evaluate the nature and quality of SMEs’ assets and credit worthiness (e.g. information and statistical tools).

A second area is to reduce uncertainty and risks associated with financing innovative SMEs. This can include public sector loan guarantee programs, especially if designed as a supplement to private sector capital and with private sector management of pooled funds or loans. Privately-led insurance schemes for innovative SME loans can be another effective means. Governments can also encourage the formation of small business associations that can provide insurance (or guarantee) on bank loans to their members, thereby spreading out and sharing risk.

The third area is government action to reduce information asymmetries between innovative SMEs and potential investors. This includes the development of an “expert intermediary sector,”

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<sup>109</sup> Industry Canada, *Evaluation of the Canada Community Investment Plan. Final Report*. Audit and Evaluation branch. September 2001.

<sup>110</sup> *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*.

<sup>111</sup> *Ibid.*

<sup>112</sup> *Ibid.*

supporting the formation of angel and other networks, providing information on raising funds, and helping enterprises prepare business plans and financial projections.<sup>113</sup>

### **Access to technology is important**

As noted earlier, research underlines the importance of technology as a key factor supporting innovation and the growth and development of SMEs.

Government programs to assist firms in acquiring and adapting new technology can be effective. In particular, notes the OECD, “the issues for governments are to move beyond policies that encourage basic connectivity and to foster business environments that facilitate e-business and the use of more complex applications of information technology.”<sup>114</sup>

A Canadian study on micro-businesses notes that government initiatives to “demonstrate the benefits of innovation, new technologies, and electronic commerce and target programs that facilitate the adoption of such technologies” can be effective in supporting these businesses.<sup>115</sup>

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<sup>113</sup> *Ibid.*

<sup>114</sup> *Ibid.*

<sup>115</sup> Evangelia Papadaki and Bassima Chami.

## **Summary and Conclusion**

This working paper has reviewed the nature and key characteristics of SMEs in Canada, critical success factors, financing issues, other challenges and barriers, and Canadian and international experience and practice in terms of public policies and supports.

This work is part of a larger research project undertaken by Imagine Canada and Canadian Policy Research Networks (CPRN) comparing the situation and public policy supports for SMEs and SMOs (small- and medium-size not-for-profit organizations).

### **SMEs in Canada**

There are 1.5 million SMEs in Canada, the very great majority of them being small in size (under 100 employees). They dominate, in numbers, every industrial sector and are significant in every region of Canada. They account for a large portion of employment and private sector GDP, and have been the engines of job creation and economic growth over the last two decades.

Critical success factors for SMES include external factors, such as the overall economic climate and situation as well as taxation and the regulatory framework, and internal factors such as management competencies, business practices and firm characteristics. Factors vary in nature and importance across the different phases of the lifecycle of SMEs. Management skills, entrepreneurship, innovation capacity, technological capabilities, and networking and partnerships are some of the most critical success factors.

SMEs depend on both internal and external sources of financing, and their use of financial instruments varies considerably depending on their size and stage of development.

Key challenges and barriers to SMEs' growth and development include: management capabilities; access to financing; capacity for innovation; and access to information technologies.

Governments in Canada and internationally have adopted a wide variety of policies and supports for SMEs, including framework policies, financing, information and other supports, skills and human resources development, and support for innovation and technology.

Research and evaluation studies suggest a number of lessons from Canadian and international experience with different policies and instruments. One-size-fits-all policies are generally less successful and policy initiatives and supports should be targeted to specific needs, situations and stages of the lifecycle. Money is not the only answer, or the best answer, and may distort the market if funding programs are not properly designed and managed. Support for SMEs must be linked to broader economic and regional development strategies. The provision of information and other support services and access to knowledge and expertise, as well as support for networking and partnerships, can be effective. Support for technology development and innovation capacity can bear results.

### **SMEs and SMOs**

Consideration needs to be given to the differences and similarities in situation, needs, success factors and public supports for SMEs and for small- and medium-size organizations (SMOs).

## **A Possible Framework for Public Policies and Supports**

The review of public policies, programs and other measures and initiatives relative to SMEs in Canada and in other countries suggests that public sector support for SMEs can be conceptualized under a broad framework of policies, programs and supports:

**1. Framework policies that support a favourable environment and economic and social context for SMEs' development and growth**

This includes sound public finances and fiscal policies and policies to support economic growth, competitiveness, productivity, innovation, and labour quality and mobility.

**2. Taxation and regulatory policies**

In addition to the general taxation structure and rates, this includes measures such as tax credits, tax deductions and reductions and other measures specifically directed towards SMEs.

**3. Financial supports and access to financing**

This includes direct government subsidies and grants, loan programs and loan guarantees, measures to facilitate access to capital and financing, and targeted financial assistance for key areas such as R&D, innovation, and technology.

**4. Infrastructure, information, tools, and support and advisory services**

This can include government institutions that serve as focal points for SME assistance; information and referral services; access to technical and expert advice; consulting services; tools; assistance for associations and for networking and partnerships.

**5. Access to government business**

This includes measures and initiatives to ensure fair access for SMEs to government procurement and to assist SMEs in competing for government business.

The proposed framework for SMES may have some applicability to SMOs, and current supports for SMOs could be assessed against this framework.

## **Some Possible Directions**

Some areas where current public policy interventions and supports for SMEs may be applicable for SMOs could be the following:

- Financial instruments and measures to improve access to private-sector financing and leverage private financing
- Financial and other supports for innovation and technology development and acquisition
- Initiatives and measures to provide information and other advisory and support services' facilitate access to technical and expert assistance; support infrastructure development; and encourage networking and partnerships
- Taxation measures and assistance
- Reduction of administrative red tape and paper burden and improvement of regulatory framework

## **Appendix I – Government of Canada Programs, Policies and Supports for SMEs**

This Appendix provides information about public policies and supports for SMEs offered by the Government of Canada and also by some provincial/territorial governments. It is not intended to be a complete or comprehensive listing and description, but rather illustrates the range and type of supports available.

### **Industry Canada**

The *Strategis website* <http://strategis.ic.gc.ca> is an information website hosted by Industry Canada since 1996. The website provides business and consumer information, including a range of tools applicable to SMEs.

The Strategis *ebiz.enable* site <http://strategis.ic.gc.ca/epic/internet/inee-ef.nsf/en/Home> is a SME resource for e-business issues and aims to encourage success in the global online environment.

Through the *Canada Small Business Financing Act*, *Small Business Loans Act* and the Capital Leasing Pilot Project, the *Canada Small Business Financing Program* facilitates loans to SMEs for equipment, real property and leasehold improvements. The federal government facilitates financing for SMEs that would not otherwise be available by offering loan loss-sharing partnerships with private sector lenders (government pays 85% of lenders' losses on defaulted loans and lender pays 15%). The program operates on a cost-recovery basis and has been running since 1961; it underwent substantial extension of coverage in 1993, which was reduced again in 1995.

The maximum loan amount is \$250,000 and up to 90% of eligible assets can be financed. In 2003-04 11,150 loans were given.

November 2004 assessments indicate that 50-55% of loans would not have been granted to the borrower in the absence of the CSBF program, and an additional 25% of CSBF loans would have been granted only as smaller loans in the absence of the program.

The net cost to government of the CSBF loans that have been made over the period 1999/00-2003/04 is estimated at \$330 million. Also, at participating firms, 2.7 jobs (FTE) were created per loan.

### ***Innovation and Innovation Commercialization Initiative of the Industrial Research and Development Institute***

In 2000, Industry Canada agreed to invest \$3 million over a 3 year period in the Industrial Research and Development Institute, an independent research and development facility. The investment went towards the Innovation and Innovation Commercialization Initiative allowing IRDI to expand its contract research and development services to SMEs. The agreement was later extended by one year.

The *Canadian Apparel and Textile Industries Program* (CATIP) was set up to encourage innovation in this industry. The program supported textile companies to increase productivity, lower costs, improve efficiency, and find new markets. The program has distributed all its

financial contributions. Assistance was provided to 339 projects worth \$22.5 million as of October 2004.

The ***Canadian Textiles Program*** (CANtex) was launched in 2004 with \$26.7 million of funding over three years. The objective of the program is to help make Canadian textile manufacturers more competitive. In December 2004 an additional \$50 million was announced for the program and the program date was extended to March 2010. The additional financial support for the program will be used for repayable contributions to textile companies engaged in lower value-added textile manufacturing operations who wish to increase or expand to higher value-added textiles. Eligible costs include those outlined already under the first initiative as well as equipment costs.

### **Business Development Bank of Canada ([www.bdc.ca](http://www.bdc.ca))**

The Business Development Bank of Canada provides financial, investment and consulting services to small businesses in Canada. BDC focuses particularly on the technology and export sectors.

The BDC offers support in the areas of start-up financing and venture capital. Start-Up financing includes up to \$150,000 available for the manufacturing, distribution, services and tourism sectors to be repaid over 6 years. Venture Capital assistance focuses on the following sectors: advanced technologies, information technology, life sciences, and telecommunications. Venture capital investments focus specifically on an industrial sector, developmental stage of business or geographic area.

In 2003-04, BDC provided financing products to 22,796 clients, venture capital to 170 clients and consulting services on 2,153 projects.

The BDC ***Co-Vision Start-Up Financing Solution*** targets start-ups or SMEs in their first stage. The program offers up to \$100,000 for new businesses that demonstrate long-term viability. Eligible costs include working capital, acquisitions, fixed assets, marketing and start-up costs.

### **Regional Economic Development Agencies: Atlantic Canada Opportunities Agency, Western Economic Diversification Canada, Canada Economic Development (for Quebec regions), Federal Economic Development Initiative in Northern Ontario and others**

There are several regional initiatives across Canada to promote economic development, jobs, investments and infrastructure. These include Atlantic Canada Opportunities Agency, Canada Economic Development for Quebec Regions, Federal Economic Development Initiative for Northern and rural Ontario, Western Economic Diversification Canada, Enterprise Cape Breton Corporation, Community Futures and the Canada-Ontario Infrastructure Program.

The ***Community Futures Program*** is managed by each of the regional economic development agencies (listed above). See the web-site of the Pan-Canadian Community Futures Group at [www.communityfutures.ca/home/index-eng.html](http://www.communityfutures.ca/home/index-eng.html). The program supports over 268 Community Economic Development offices across the country. The objective of the program is to make sure Canadians have access to resources and opportunities in rural areas through community and economic development.

In 2004 the Community Futures Program gave a total of 5471 loans worth \$212 million and created 27,200 jobs.

### **Atlantic Canada Opportunities Agency ([www.acoa.ca](http://www.acoa.ca))**

ACOA administers programs supporting economic development in Atlantic Canada particularly focused on innovation, technology, infrastructure, and industry.

In 2000, the *Atlantic Investment Partnership* invested \$700 million in the economy over 5 years focused on innovation, technological capability, infrastructure and competitive ability. The initiative was renewed in 2005 and focuses on innovation, communities, people, and the business climate. The investments included nearly \$300 million in approximately 100 research and development projects, \$178 million in 486 community initiatives, \$60 million in building human capital, and \$175 million to nonprofit business, sector and industry associations.

The *Atlantic Innovation Fund* focuses specifically on developing knowledge-based industries. The fund supports innovation, research and development, and commercialization through capacity-building, partnerships and alliances between the private sector, research institutions and organizations, and improving access to national funding. Funding is directed towards the development of technology-based products, processes, services or their commercialization. Universities, research organizations, and businesses are eligible to have project costs covered such as wages/salaries, testing, project operating expenses, and building and renovation expenses. Up to 80% of eligible costs for non-commercial projects are covered by the fund and non-repayable. Up to 75% of eligible costs for commercial projects are covered and repayable based on project success.

The *Business Development Program* provides loans for business development, expansion, modernization and competition. The program provides 50% financing for buildings, machinery/equipment, site improvements, infrastructure, start-up costs and working capital, as well as patents, trademarks and licenses. The program provides 75% financing for marketing, training, productivity and quality improvement, innovations, consultant advice, contract bidding, business proposal development, and business support provided by nonprofits. Financing is repayable based on a custom schedule.

The *Canada/Atlantic Provinces Cooperation Agreement on International Business Development* is aimed at increasing the exporting ability of Atlantic Canada. The agreement provides financial support to improve the competitiveness of SMEs in international markets. Federal, provincial, and municipal governments, not-for profit organizations, business networks, associations, and universities are eligible for funding. Individual companies are not eligible for funding.

The *Seed Capital Program* administered by ACOA is aimed at starting, improving or expanding small businesses. The program offers a maximum \$20,000 loan for starting, improving or expanding business and a maximum \$2,000 loan for business training and counselling.

ACOA also offers a web-portal of information on *Venture Capital*. The purpose of the program is to provide access to information on 'angel' investment in Atlantic Canada.

### **Canada Economic Development for Quebec regions ([www.dec-ced.gc.ca](http://www.dec-ced.gc.ca))**

Canada Economic Development facilitates and improves the financial development of SMEs in Quebec. The *IDEA-SME Program* offers resources and services regarding innovation, testing/experimentation to enhance natural resources, productivity, e-business, export market development, entrepreneurship and business climate.

Eligible SMEs and regional economic development associations can receive repayable and non-repayable financial contributions. Contributions cover up to 50% of costs; for acquisition of new equipment contributions cannot exceed \$200,000. Between 1999 and 2000 the program helped 954 clients. Between 1995/96 and 1999/00 a total of approximately \$244,000,000 in contributions were approved; 54% were repayable contributions and the rest were non-repayable. During the first 5 years of the program an average 3,385 jobs/year were created.

The program focuses on the development of entrepreneurship, improvement of the business climate, supporting business start-ups through university assistance centres, information distribution, competitions, and technology and development assistance.

The ***Info Entrepreneurs*** website is designed to provide SMEs with access to information regarding government programs and supports. Information on the following topics is provided: eBusiness, Employment/training, Financing, Innovation/R&D, International Trade, Multimedia, Self-Employment, Social Economy, Start-Up/Expansion, Women Entrepreneurs, and Young Entrepreneurs.

In addition Canada Economic Development offers many regional programs in Quebec.

[www.dec-ced.gc.ca/asp/ProgrammesServices/strategie.asp?LANG=EN&HEADER=PROG\\_SERV&SEL\\_MENU=CHOIX\\_REGION](http://www.dec-ced.gc.ca/asp/ProgrammesServices/strategie.asp?LANG=EN&HEADER=PROG_SERV&SEL_MENU=CHOIX_REGION)

#### **Western Economic Diversification Canada** ([www.wd.gc.ca](http://www.wd.gc.ca))

Western Economic Diversification supports innovation, competitiveness and sustainable community development in Western Canada.

The latest ***Western Economic Partnership Agreements*** were signed in 2003 to administer multi-year funding for economic development in the four western provinces. Previous agreements included \$160 million in economic support over 5 years. The 2003 agreements allocate \$200 million over 4 years. The investment is equally cost-shared between the provinces and focuses on innovation, entrepreneurship and sustainable communities.

Western Economic Diversification Canada offers several targeted programs that support SMEs. The ***Loan Investment Fund Program*** works directly with financial institutions to provide capital to SMEs through a series of loan programs. The program is particularly focused on the industry sectors and their need for business planning, technology reviews and preparation of funding documents. Examples of sector-oriented loan programs include ***Growth Capital Program***, ***Conservation Finance Program***, and ***Knowledge and Growth***.

The ***Growth Capital Program*** targets SMEs in manufacturing, service technology, entertainment, green economy, and communications with the potential to grow and less than \$12 million in annual sales. Through Van City, the program provides up to \$2 million for expansion, marketing, and management buyouts.

The focus of the ***Conservation Finance Program*** is to promote environmentally-responsible business growth in the province of British Columbia. SMEs engaged in environmental initiatives and/or wishing to improve environmental performance that have less than \$12 million in annual sales are eligible for loans and technical assistance to expand their business and/or decrease their environmental impact. In 2002 the program was used by 6 organizations.

The ***Knowledge and Growth Loan Fund*** is designed for SMEs in Western Canada in the knowledge sector including aerospace, advanced manufacturing, biotechnology, environment, health, information technology and communication, multi-media, film, tourism, and ocean industries. To be eligible businesses must have less than \$12 million in annual sales. Specifically the fund aims at providing capital for projects not normally financed by traditional financial institutions such as ongoing commercial research and development, commercial product development, marketing, acquisition of special assets, pre-shipping costs, and working capital. Available loans range from \$50,000 to \$500,000 per project as well as a maximum of \$1,000,000 per borrower with a maximum 7 year repayment schedule.

Western Economic Diversification also includes an ***Urban Micro-Loans*** program for small businesses. The loans are offered by local financial institutions in 6 western cities.

The Community Futures Development Corporations administer the ***Entrepreneurs with Disabilities Program***. The program provides business loans up to a maximum of \$125,000 for Canadians with disabilities who are starting/expanding a business, purchasing new technology, upgrading facilities and equipment, developing marketing and promotion materials, or establishing working capital for anticipated sales increases. The program also provides access to business training and development and mentoring and counselling.

The ***Women's Enterprise Initiative*** provides loans and business information and advisory services to women entrepreneurs in western Canada.

#### **Federal Economic Development Initiative for Northern Ontario (FedNor)**

(<http://strategis.ic.gc.ca/epic/internet/infednor-fednor.nsf/Intro>)

FedNor works with several partners to facilitate and catalyze economic development in communities across Ontario. The organization has initiatives focusing specifically on economic growth in Northern Ontario and Eastern Ontario. As well, the Social Economy Program for Ontario fosters the development of the social economy and volunteer-based sector.

#### **Department of Finance, Canada Revenue Agency ([www.fin.gc.ca](http://www.fin.gc.ca), [www.cra-arc.gc.ca](http://www.cra-arc.gc.ca))**

The Department of Finance legislates and the Canada Revenue Agency administers tax laws and programs applicable to small- and medium-size enterprises in Canada.

In 1990 the ***Small Business Deduction*** administered by the Canada Revenue Agency to Canadian SMEs reduced the federal corporate income tax rate from 28% to 12%. In 1990 the value of this assistance was \$2.1 billion and there were 270,000 claimants. The deduction is slowly phased out as a company's taxable capital increases and when it reaches \$15 million the deduction is eliminated.

***Capital Gains Taxation*** allows for the first \$500,000 of capital gains on the disposition of small business shares to be exempt from income tax. In 1990 the value of this assistance was \$731 million and there were 65,000 claimants.

The ***Labour-Sponsored Venture Capital Corporations*** encourage individuals to pool their funds and invest in small businesses. In return, investors receive a 20% federal tax credit and often a matching provincial tax credit. In 1990 the value of assistant was \$14 million with 50,000 claimants.

The Federal Government implemented a ***Five-Year Tax Reduction Plan*** in 2000 and strengthened it again in 2003 to promote investment and entrepreneurship in Canada. In 2003 the amount of income eligible for the 12% small business tax rate was increased from \$200,000 to \$300,000 to be phased in over four years. As well, between 2001 and 2004 the corporate tax rate was reduced from 28% to 21%. In 2000 the government reduced the portion of a capital gain subject to income tax from  $\frac{3}{4}$  to  $\frac{1}{2}$ .

In 2000 the government also made provisions for individuals to defer tax on capital gains sold from a small business if it was reinvested in another small business. In 2003 the government eliminated the \$2 million cap on the amount eligible for deferral.

Small businesses are eligible for a ***Scientific Research and Experimental Development Tax Credit*** of 35% up to the first \$2 million of expenditures for business in Canada and 20% on any amount above that. In 1990 the value of assistance was \$225 million with 3,500 claimants. The federal tax credit is meant to encourage Canadian businesses in various sectors to engage in research and development. The SR&ED program is the largest single source of federal government support for industrial research and development. Businesses can apply for tax credits for wages, materials, machinery, equipment, overhead and contracts for work that includes experimental development, basic and applied research.

#### **Human Resources and Skills Development Canada ([www.hrsdc.gc.ca](http://www.hrsdc.gc.ca))**

The ***Targeted Wage Subsidies*** program offers temporary wage subsidies to enable employers to hire individuals who face barriers to employment and would not otherwise be hired by the employer. The program helps unemployed Employment Insurance eligible individuals find an employer willing to enter into an employment agreement. Agreements are approved for a maximum of 78 weeks. Eligible employers include businesses, nonprofits, municipalities, band/tribal councils, public health and educational institutions, and provincial/territorial governments. In some provinces and territories programs similar to the Employment Benefits and Support Measures are delivered by the provincial/territorial government and in other provinces and territories Service Canada delivers the Employment Benefits and Support Measures.

The ***Self-Employment program*** is an HRSDC program administered by the Community Futures Development Corporations. The program enables individuals receiving Employment Insurance to continue receiving financial assistance while starting up a new business or purchasing a new business.

***Sector Councils*** are permanent organizations that work with various stakeholders in an industrial sector to address human resource challenges. Sector councils act as a bridge between firms and encourage collaboration.

In the 1980s three sector councils were formed with HRDC: Canadian Steel Trades Employment Council, Electrical and Electronic Manufacturers Association of Canada, and Canadian Automotive Repair and Service. In 1989 the Labour Force Development Strategy funded the development of sector councils in order to address sector-specific human resource needs. .

The Sectoral Partnerships Initiative was launched in 1992 to expand funding for sectoral activities to include: national occupational standards, skills upgrading, sectoral youth internships, science and technology internships, career information initiatives, essential skills and skills

enabling activities. The 2001 Federal Budget allocated funding to expand the network of sector councils. The HRDC Workplace Skills Strategy provided an additional \$5 million to support project-based sectoral skills activities.

The ***Sector Council Program*** provides funding for sector councils to support growth, innovation, collaboration and increase their capacity to address relevant sector issues. The program supports businesses by providing new services for their workers, a strong voice in developing training, increased industry relationships, nationally and internationally, and a competitive edge in the knowledge-based economy. The program also supports activities in the following areas: occupational/skills standards, core curriculum, skills enabling/upgrading projects, transition projects, national sectoral adjustment service projects, labour mobility projects, youth internship projects, youth information strategy projects, research and innovation projects and career development projects.

Funds are provided for a maximum of 36 months. Eligible costs include wages, overhead costs, and capital expenditures. Eligible partners include sector councils, cross-sectoral organizations, or industry based organizations that address career, occupational, learning, labour market or skills information issues.

The Sector Council Program is working towards increasing the coverage of the labour market (from 25% to 50%), focusing on results, increasing HRDC's engagement with industry and industry colleges, stabilizing sector councils with performance-based support, and having a better connected sectoral delivery mechanism.

The HRSDC ***Skills Development Program*** provides financial assistance to unemployed Employment Insurance eligible individuals who require skills training in order to be employed. Eligible individuals select, arrange and pay for their own training. Program contributions are given for between 52 weeks and 3 years. Funding is provided to cover all or a portion of tuition, living expenses, required books, software and costs due to participation such as dependant care, disability needs, transportation and accommodation.

The HRSDC ***Work-Sharing Program*** helps employers and employees avert temporary layoffs. The program provides income supports to workers eligible for Employment Insurance who are willing to work a temporary reduced work-week due to a reduction in the business that is not in the employer's control. Agreements are approved by the employer, employee and Employment Insurance Commission and range from 6-26 weeks with a maximum extension of 38 weeks. To be eligible employers must demonstrate that a return to normal employment hours is likely within 26 weeks. Employers must also have been in business year-round for a minimum of 2 years. Employers have to demonstrate that the reduction in business is temporary, unavoidable and not-seasonal. Employers must receive voluntary agreement from employees to engage in the program. Employers have to guarantee a reduced work week of not more than 3 days and not less than 1 day. At least 2 employees must be a part of the work-sharing unit.

The HRSDC ***Youth Employment Strategy*** includes three programs: Skills Link, Career Focus, and Summer Work Experience. The Youth Employment Strategy programs are delivered in conjunction with 13 other federal departments/agencies, and several private, public and nonprofit groups. The other federal departments/agencies involved are: Agriculture and Agri-Food Canada, Canada Mortgage and Housing Corporation, Canadian Food Inspection Agency, Canadian Heritage, Canadian International Development Agency, Department of Foreign Affairs Canada,

Environment Canada, Indian and Northern Affairs Canada, Industry Canada, National Research Council Canada, Natural Resources Canada, and Parks Canada.

**Skills Link** provides support to youth facing barriers to obtain employment. Youth facing barriers include single parents, Aboriginal youth, young persons with disabilities, recent immigrants, youth living in rural and remote areas and high school dropouts. Businesses are eligible to be a recipient of a youth employee, as well as, crown corporations, organizations, public health and educational institutions, band/tribal councils and municipal governments.

**Career Focus** provides funding to employers to help youth obtain work experience, develop their skills and become leaders. Sponsor organizations are responsible for recruiting and selecting youth. The program is administered through 4 different structures. National Career Focus provides financial support for national projects employing youth. Regional Career Focus is administered through regional organizations that provide financial support to employers for regional projects. Sectoral Youth Career Focus financially supports sector councils in developing youth work opportunities for post-secondary graduates. International Academic Mobility supports Canadian post-secondary institutions to develop international learning opportunities for students.

The **Summer Work Experience** program provides summer work opportunities for secondary and post-secondary students as well as supports summer employment offices. .

The program provides wage subsidies to create summer work opportunities for students and help students finance school.

### **National Research Council of Canada**

The **Industrial Research Assistance Program** <http://irap-pari.nrc-cnrc.gc.ca> provides SMEs and industrial associations with innovation assistance such as value-added technological and business advice and financial assistance for research and development, networking and partnerships. The program provides advisory services to approximately 12,000 SMEs annually, non-repayable financial contributions to approximately 2,600 firms, and the program engages 235 Industry Technology Advisors. Advisory services and financial assistance cost \$62 million. Assistance to SMEs wishing to hire students cost \$4.8 million; 475 students were placed in 473 firms in 2003-04.

Financial assistance for research and development activities includes support to SMEs for commercialization, mentoring, and technical projects. Financial assistance also goes towards increasing the innovation capacity of SMEs on behalf of Technology Partnerships Canada/Industry Canada. In 2003-04 the program assisted 40 projects and cost \$20 million.

### **Public Works and Government Services Canada**

The **Office of Small and Medium Enterprises** was created to reduce barriers for SMEs wanting to do business with the federal government.

The office helps SMEs navigate the government procurement system and ensures the system treats SMEs fairly and equally. The Office helps SMEs access government business by helping them understand and comply with the process, acting as an ombudsman, providing information, attending business trade shows, organizing events including information sessions for SMEs. The Office works to ensure the procurement system treats SMEs fairly by analyzing SME access to

government business, reviewing SME participation on major procurements, and assisting in the development of effective procurement processes.

The Office strengthens SME access to government business by collaborating with industry associations and businesses on training, information, development of support tools, and participation in procurement policy changes.

### **Canadian Commercial Corporation (a Crown Corporation)**

The *Progress Payment Program* provides working capital to SMEs and others to allow them to take advantage of export contracts. Specifically, the program improves access to pre-shipment financing through partnerships with 19 banks and financial institutions.

### **Export Development Canada**

Export Development Canada supports and develops Canada's export trade and the capacity of Canadian businesses to engage in this trade. They administer programs aimed at reducing the risk of exporting. In 2004 they had 6,345 clients.

### **International Trade Canada**

*Team Canada Inc.* is a partnership of federal, provincial and territorial governments committed to helping Canadian companies succeed in world markets. Team Canada Inc. offers information and tools for businesses wishing to export.

The *Canadian Trade Commissioner Service* works within Team Canada Inc. to increase the number of Canadian exporters, expand and diversify exports, and support the investment initiatives of Canadian SMEs and other businesses and industries. Specifically they assist businesses with the development of export plans and market intelligence, as well as advising on trade fair participation.

### **Environment Canada**

The *Canadian Pollution Prevention Information Clearinghouse* is an on-line database that provides Canadians, including SMEs, with information on pollution prevention. Several programs provide financial support and technical advice to SMEs to encourage the development and application of environmental innovations such as pollution prevention initiatives.

### **Initiatives involving multiple governments/departments**

*Business Access Canada* is an inter-departmental initiative to improve awareness and simplify access to government purchasing information. The program facilitates expertise sharing and networking to help SMEs access government business.

*BizPal* is a web-based service for businesses to generate a customized list of permits and licenses needed from all levels of government. Governments involved in the pilot project include: Kamloops, Halton, Whitehorse, Yukon, British Columbia, Ontario and Industry Canada.

*Canada Business* is a collaborative arrangement of forty-three Government of Canada departments, provincial and territorial governments, and some not-for-profit organizations that assists Canadian entrepreneurs in obtaining the correct and region-appropriate information, advice and support they need to build their businesses. There are 13 centres across Canada.

Canada Business has developed a *Business Start-Up Assistant* site for information on government services, programs and regulations for business.

## **II. Provincial/Territorial programs, policies and supports for SMEs**

### **ONTARIO**

#### **Small Business Agency of Ontario**

The *Small Business Agency of Ontario* is made up of representatives of Ontario's business community and elected representatives of the Ontario government. The Agency promotes regulatory best practices, streamlines paperwork, ensures small business interests are part of government decision-making processes, and conducts outreach between business owners and government.

The activities of the Small Business Agency of Ontario include working with the Ontario Government Task Force, and the Small Business Tax Administration Advisory Committee, as well as maintaining the Regulatory Registry. The *Regulatory Registry* is a one-stop website that makes it easier for businesses to find out about proposed Government of Ontario regulations that affect them. The goal of the Regulatory Registry is to increase participation in the development of regulations in Ontario, and improve understanding of and compliance with these regulations. .

#### **Ministry of Economic Development and Trade ([www.ontariocanada.com](http://www.ontariocanada.com))**

There are approximately 50 *Small Business Enterprise Centres* in Ontario that support start-up and small enterprises during their first 5 years. The Centres offer business consulting and information on management, marketing, technology and financing. The support provided includes guidance on licenses, permits, registrations and regulations, import and export information, information on patents, copyrights and trademarks. There are also mentoring and networking opportunities.

The *Business Advisory Service Offices* support existing SMEs wishing to grow and innovate. The 12 offices in Ontario provide assistance in removing barriers to growth, help firms become export-ready and diversify their exports, encourage partnerships with financial institutions, support new technology, and provide opportunities to develop new business.

The *Ontario Investment Service* provides a single source of customized information, investment marketing materials and services to Ontario businesses considering an expansion, as well as potential investors in Ontario.

#### **Ontario Ministry of Finance ([www.fin.gov.on.ca](http://www.fin.gov.on.ca))**

The *Community Small Business Investment Fund Program* provides small businesses in Ontario with greater access to capital. The program encourages the formation of community sponsored venture capital pools, and provides eligible investors with incentives for purchasing shares of registered Canadian Small Business Investment Funds. The program does not provide grants or loans to businesses. Investors include 'Labour Sponsored Investment Funds,' financial institutions, individuals, pension funds and corporations. The program seeks to encourage investments within the same community as the investor and the small business. The Community Small Business Investment Fund Program is administered by the Business Investment Plans Section of the Ministry of Finance.

The ***Labour Sponsored Investment Fund*** supports the creation of venture capital corporations by trade unions, associations or federations of unions or workers. The venture capital corporations provide alternative sources of capital for SMEs in Ontario. Eligible investors in the Fund receive shares. Eligible investors were able to claim Ontario tax credits for investments up to \$5000 per year; however the Ontario government has announced it will eliminate the 15% tax credit for investors no earlier than the end of the 2005 taxation year. A complementary federal tax credit is also available.

## **QUEBEC**

### **Ministère du Développement économique, de l'Innovation et de l'Exportation Quebec** ([www.mdeie.gouv.qc.ca](http://www.mdeie.gouv.qc.ca))

The Ministry provides programs and services, including financial assistance and tax measures, in support of businesses, regional development, exports, and science and technology.

The Ministry's ***assistance program for partnerships and industrial clusters*** supports sectoral organizations, business associations and cooperatives in Quebec. The program's objective is to encourage sectoral or regional collaboration and market development in areas related to the Ministry's mandate. Funding is available for projects that enhance competitiveness, develop markets or develop businesses or groups of businesses in the private sector, cooperatives or social-economy businesses. Up to 40% of eligible project expenses can be financed through the program through non-refundable contributions.

The ***assistance program for businesses*** provides consultative services to businesses to enable them to establish themselves, to develop and to receive financial assistance. Eligible projects include market development, innovation and adaptation to change, and development of technological and business partnerships. Financial contributions to businesses cover up to 40% of eligible expenses for a project.

The ***Research assistance program*** also provides financial contributions to support research projects, strategic research organizations and groups, research infrastructures, and international research and innovation initiatives.

The objective of the ***Industrial agreement program*** (Programme d'accords industriels) is to foster industrial partnerships between partners in regions in Western Europe and SMEs in Quebec. This program facilitates technology transfer between partners.

The government authorizes ***deferred income tax rebates*** for members of a qualified cooperative or federation of cooperatives. Members that receive a rebate may defer taxation on the rebate until they dispose of the units.

The ***fashion design tax credit*** is designed to promote fashion and textile design research, development and use in order to encourage high value-added businesses in Quebec.

The ***industrial design tax credit*** is designed to promote the use of industrial design to encourage the manufacturing and marketing of distinctive products with high value-added.

## **ALBERTA**

### **Agriculture Financial Services Corporation ([www.afsc.ca](http://www.afsc.ca))**

*Agriculture Financial Services Corporation* (AFSC) is a provincial crown corporation offering financial services to small businesses and farm corporations in Alberta. They provide debt financing, loans guarantees, disaster loans, capital sourcing, alliance lending, export financing, and consulting services.

The *Financing Alberta Student Businesses* program supports post-secondary students to start summer businesses. AFSC provides a maximum \$3,500 Student Loan per project for the purchase of assets or working capital. Loans must be repaid by September 30 of the same year.

The *Young Entrepreneur's Financing Program* of AFSC provides loans up to \$250,000 for new ventures started by young people under 30 years.

The *Mainstreet Improvement Financing* program provides financing for land, building, renovations, equipment, inventory and supplements to working capital. Loans are also eligible for refinancing debt and purchasing existing businesses. Loans are repayable to a maximum term of 15 years.

### **ATB Financial (Alberta Treasury Branches) ([www.atb.com](http://www.atb.com))**

ATB Financial is a crown corporation that provides financial services including loans, investment products and services to businesses.

### **Alberta Finance [www.finance.gov.ab.ca](http://www.finance.gov.ab.ca) .**

As of 2004 the Alberta *Small Business Tax Rate* is currently 3% (now tied with NB for the lowest among the provinces). The *Small Business Deduction* is 8.5% and the *Small Business Limit* is \$400,000. As well, Alberta businesses pay no provincial capital tax, payroll tax, or sales tax and have the lowest gasoline tax in the country.

The Alberta small business deduction is now patterned on the federal small business deduction. Prior to April 1, 2001, there were no material differences between the two programs other than the deduction rate. In April 2001 Alberta started to increase the small business limit, from \$200,000 to \$400,000 over the past three years. Since the Alberta small business deduction is patterned on the federal small business deduction, Alberta's small business limit is calculated as a percentage of the federal small business limit. For example, if the Alberta small business limit is \$400,000 and the federal small business limit is \$200,000, the Alberta small business limit is calculated as 200% of the federal small business limit.

In April 2003 the *Small Business Deduction* was 8.5%, the *Small Business Tax Rate* was 4% and the *Small Business Limit* was \$400,000.

### **Alberta Energy Research Institute ([www.aeri.ab.ca](http://www.aeri.ab.ca))**

The Alberta Energy Research Institute supports energy research and technology development. The *Innovations Assistance Program* supports small inventors to develop and test their ideas. Grants from \$5,000 to \$50,000 are provided.

### **Programs/resources/supports provided in partnership.**

*Alberta First* [www.albertafirst.com](http://www.albertafirst.com) is a web portal of information promoting business and economic development in Alberta. Alberta First is a partnership between provincial and

municipal government and industry and is administered by the nonprofit company AlbertaFirst.com. It also provides several small business guides.

The **Calgary Business Information Centre** [www.calgary-smallbusiness.com](http://www.calgary-smallbusiness.com) is a nonprofit organization funded by federal, provincial and municipal government and a member of the Canada Business Service Centre network.

**The Business Link** [www.cbsc.org/alberta](http://www.cbsc.org/alberta) is a nonprofit organization supported by Western Economic Diversification and Alberta Economic Development, and a member of the Canada Business Service Centres network.

## **Appendix II – International Literature Review on Small- and Medium-sized Enterprises**

The SME Sector constitutes the vast majority of firms in all the countries reviewed. It is measured with a number of different yardsticks, including number of employees, assets, sales or investments levels. Of these, number of employees is the most widespread. Even using this measure there tends to be variety in comparing the size across countries because of the use of different cut-offs, with some countries defining an SME as an enterprise with less than 500 while many others define the cut-off at 250 employees (Ayyagari, M., Beck, T., and Demircuc-Kunt, A.).

Recognizing this variation in measurement however, in all the comparator countries, SMEs constituted a large majority of the firms:

- In the USA with 21 million firms, 15.5 million had no employees (largely self-employed or unincorporated firms). Of those with employees, a large majority had fewer than 20 on the payroll. (US Census).
- In the UK, 72.8% of firms had no employees. At the start of 2004, there were 4.3 million enterprises in the UK, of which 99.3% were small – or even very small (fewer than 50 employees). (UK National Statistics, August 2005).
- In France, 63% of the workforce was employed in firms of under 250, encompassing both PMEs and TPEs (Confederation generale des petites et moyennes entreprises).

For purposes of this study however, the significant fact is that it is very large and that it is therefore the subject of attention and support. It is vital to the well-being of the economies of all countries. As expressed by the OECD in the Ministerial Declaration on Fostering the Growth of Innovative and International Competitive SMEs (Istanbul 2004), “SMEs are the dominant form of business organization in all countries, typically accounting for over 95% of the of the business population in all countries; they constitute an important dynamic element in all economies as they drive innovation, especially in knowledge-based industries, and play a key role in driving sustainable economic growth and job creation while contributing to the social, cultural and environmental capital of nations”(OECD Ministerial Declaration June 2004).

All countries recognize the importance of the small business sector and its effective and sustainable functioning. The OECD at the first Ministerial Forum on this subject in Bologna 2000 recognized the increasing importance of SMEs to economic growth, job creation, regional and local development, and social cohesion, and went on to recognize the importance of the sector for restructuring economies and for combating poverty, and to state clearly that SME policies need to be tailored to the circumstances and priorities of individual countries and sectors while contributing to sustainable development and social progress (OECD Bologna Charter, 2000).

So what do SMEs need to be successful? Clearly the sector is very diverse across countries as well as within countries and varies greatly by industrial sector as well as by size and stage of maturity. Some research has been done differentiating the sector by industry type and by size (Ayyagari, M., Beck, T., and Demircuc-Kunt,A.on the data of each country); studies of impacts in particular locales (McGuinness,S., and Hart, M in “Mixing the Grant Cocktail” for the Northern Ireland Research Centre) but less analysis exists about the functioning and the needs

within firms, or the policies intended to address these needs, or to address the process of growing and evolving from one type of small firm into another.

The exception is the case of innovative organizations, particularly those in the knowledge economy, and the particular challenges they face. Considerable work has gone to the study of such enterprises and their particular needs and circumstances (as described, for example, in “Financing Innovative SMEs in a Global Economy” for the OECD; “Public Sector Support for Innovating SMEs” in *Small Business Economics* 2001, vol 16, issue 4; or “Innovation dans les petites et tres petites entreprises et dynamique du developpement local” for the European Commission, 1999).

Even at this level of generality it is clear that there are some common success factors and common challenges facing SMEs. Most prevalent factors for success are access to financial resources at key stages in forming and operating a small/medium business. There are a myriad of ways which have been attempted to facilitate financing, and some of these are referenced below. Underneath many lies the challenge of lack of recognition of the assets of small business, particularly new start-ups. If what they are creating or providing is not yet recognized, it has limited collateral value and will make it much more difficult to access private capital. It is in this situation that government policies can sometimes come forward to fill the gap. If this is the major external impediment, then the chief internal impediment is attitude or managerial capacity or style (as evidenced by the large percentage of those who identify lack of financing as a major impediment but have never sought it).

Other common factors for SME success identified across countries include the importance of clusters or networks, particularly for innovation. In settings featuring firms, academic institutions and others engaged in research and new applications, there is clear evidence that individual firms have better chances of doing well. At the other end of the spectrum comes evidence of the difficulty creating the synergies and conducive environment in locations where it has been absent or underdeveloped. These are often the same disadvantaged communities or regions where entrepreneurship is looked to as key part of the economic development strategy.

A further pervasive factor for success is a supportive environment including factors such as an educated work force, well-developed social and institutional infrastructure as well as an economic infrastructure that features low rates of inflation etc.

A clear and simple regulatory and legal system within which to operate is another success factor. Not only does the system need to be transparent and simple, but it also needs to avoid impediments such as costly entrance, exit, transition and compliance procedures.

Rates of taxation are often cited as a critical factor to success, particularly to growth in a global economy. Where the rates of tax on capital are considered higher, successful firms are more likely to link up with others and relocate in other lower-tax jurisdictions.

When examining the factors critical to success – or lack of success – internal factors can be just as important as external factors. As enterprises are created, grow and evolve, there are many critical transition points when the capacity to manage and support the move to a new level of operation is critical to the firms’ “getting over the hump.”

## **Approaches and Mechanisms in place in other countries to assist SME/PME sector**

Internationally there are a range of policies, interventions and instruments that have been put in place to support or facilitate the operation of SMEs. The motivating factors, or policy drivers tend to fall into three categories:

- SMEs' contribution to the economy overall,
- SMEs importance to the economy of particular (disadvantaged) regions or populations (most often youth, minorities, and women), and.
- The importance to create a more level playing field by compensating for market imperfections which favour large business.

Most countries have associations of small or independent business which serve as a powerful and effective voice for the sector as a whole. These are referenced in context of particular measures that have been put in place.

The approaches on this list have nearly all been adopted at some point in time by some governments in various combinations, varying according to the historic, economic and political variables.

### **1. Focal point for attention – Political and administrative**

All countries have a department or agency responsible for SME policies and programs. In addition some have senior political mechanism to signal the importance of this sector and serve as a bridge with government. For example,

- UK: All-Party Parliamentary Small Business Group (APPSBG), a standing committee to focus on issues and concerns of small business and act as a bridge between politicians and small business (created in 1997 largely through the efforts of the Small Business Research Trust, a membership organization focused on promoting the issues and interests of small business as well as Identifying the impacts of government policies on small business)
- UK: mechanisms with particular focus, for example the Minister's Business Forum directed towards promoting entrepreneurship in ethnic communities and others with a regional focus
- UK: recent initiative to bridge whole-of-government to whole-of-sector Dec. 02 "Small Business and Government: the Way Forward" with a concrete action and implementation plan including creation of a conducive environment, start up support, capacity building, financing support, administrative streamlining, regulatory improvements and a focus on disadvantaged communities
- UK: Small Business Service, an agency within Department of Trade and Industry, with the mandate of "making the UK the best place in the world to start and grow a business"
- USA: Small Business Administration focusing on issues and assistance for small business

## **2. Provision of Services and Information**

Provision of information, tools and services is widespread. These are in both physical and electronic forms and provide a wide array ranging from business planning, legal and regulatory frameworks, brokering services and advisory and consulting services. Some examples:

- UK: Small Business Services (SBS) to foster a suitable environment, deliver government supports, including programs of financial support, encourage ethnic entrepreneurship especially in disadvantaged regions and with underrepresented groups, and to pursue better regulations and policies regarding small business
- UK: Small Business Portal – delivering a range of tools from start-up materials, sources of financing including grants, loans, fundraising, sales and marketing, and advice on legal matters, technology and facilities/premises
- USA: Small Business Administration, operates offices across the country with tools and advice and “protecting the interests of small business
- USA: Centres for Entrepreneurship, focusing on help to minority entrepreneurs

## **3. Provision of and Access to Financial Supports**

One category consists of government and public financing instruments which can be accessed directly, often to fill gaps or address shortfalls, from loans to subsidies to development funds to tax treatment to encourage specific activity such as R&D or innovation.

There are many programs in each of these categories, but countries tend to lean towards the use of certain of these sets of these instruments:

- the USA for example relies more heavily on the adjustments delivered through the tax system to assist small business and foster certain activity, as for example the recently announced tax reductions for new capital investments

A second category, more applicable to small business, is mechanisms to facilitate or broker financial assistance i.e. bringing funders and entrepreneurs together; for example:

- UK Small Business Investment Task Force which helps SMEs’ with growth potential access investment funding, equity funding
- many countries’ small business web sites or portals feature directories of available grants, investors, funders

## **4. Infrastructure policies**

Often characterized as the framework for innovation and entrepreneurship, it often becomes the first-line approach when government focus switches from direct supports to indirect support for employment through “framework policies.” These can include:

- Institutional frameworks, with efforts to ensure transparent, competitive environments within which small business can flourish and compete fairly, including stable but focused economic policies, enabling regulatory frameworks and laws and systems of governance that support development and diffusion of new technologies

- Economic frameworks including policies to enhance productivity and growth as well as in some cases a focus on economic development in particular populations and regions; within these the value of partnerships and networks is increasingly recognized and encouraged

## **5. Building a Conducive Environment**

These include policies and approaches at the level of economic development policies and shifting or enhancing public attitudes in areas such as:

- recognition of role of intermediaries, i.e. infrastructure organizations, such as self-help groups, business associations, technology assistance centres etc., in fostering international cooperation and partnership among SMEs and providing improved access to information, financial and technological resources and new markets; in some cases government assists the creation and operation of such organizations
- sometimes includes promoting a culture of entrepreneurship: this culture can be promoted through marketing campaigns which profile and convey the “value” of small business: [see campaign currently underway in Ontario]; it can be furthered also by measures on the human resources front such as introducing entrepreneurialism into school curriculum

## **6. Regulatory Framework**

Most governments focus their attention, at least cyclically, on both the content and the operations of the regulations which impact small business. This attention has several different manifestations:

- many jurisdictions undertake reviews and improvements in their regulations to “better regulations” (UK Action Plan, coming on the heels of a Regulatory Reform Action Plan)
- often accompanied or associated with paperwork reduction, with regular efforts to avoid duplication, synchronize and harmonize rules and requirements in order to reduce the cost of compliance (many jurisdiction undertake such paperwork reduction and simplification exercises on either set cycles or as perceived need requires)
- a related issue is that of liability, an issue that is often a challenge or impediment to small business: US recently announced possible legislation to limit frivolous law suits

## **7. Measures to encourage and support innovation**

There is a wealth of measures developed by all governments to foster and support innovation: some examples include:

- programs to extend small business access to R&D, for example the US Small Business Innovation Research Program which assures small business to federal R&D resources
- the UK Government’s Smart Scheme that supports the development of new technology-based products that are “new” within a sectoral or national context
- France has measures to encourage innovation in the context particularly of local development and local economies

- the EU operates 140 Business Innovation Centres across Europe with a view to stimulating the creation and expansion of innovative SMEs in Less Favoured Regions of the EU
- the EU also operates Structural Funds which support, among other, selected colleges and training centres to assist SMEs with innovation, design and technology transfer

### **8. Fair Access to Government Business (procurement policies)**

These two areas of activity occupy much of Governments' attention to small business (these issues affect large business equally, but tailored efforts are often made to ensure small business is afforded equal access):

- US Small Business Contracts Council to oversee access to government contracts, with recently announced increased efforts to make further improvements
- UK committed to develop a small business Procurement Concordat to be signed by public sector bodies aimed at improving opportunities for small businesses to tender for contracts
- a number of the service offices and portals feature information on government contracts and how to access them

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### **Web-based resources**

Business Development Bank of Canada.

[www.bdc.ca/en/home.htm](http://www.bdc.ca/en/home.htm)

Conference Board of Canada.

[www.conferenceboard.ca/](http://www.conferenceboard.ca/)

Canadian Federation of Independent Business.

[www.cfib.ca](http://www.cfib.ca)

Industry Canada, Small Business Policy Branch

<http://strategis.ic.gc.ca/epic/internet/insbrp-pppe.nsf/en/Home>

National Research Council of Canada.

[www.nrc-cnrc.gc.ca/main\\_e.html](http://www.nrc-cnrc.gc.ca/main_e.html)

Pan Canadian Community Futures Network.

[www.communityfutures.ca/](http://www.communityfutures.ca/)



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