

SME Financing Indicators

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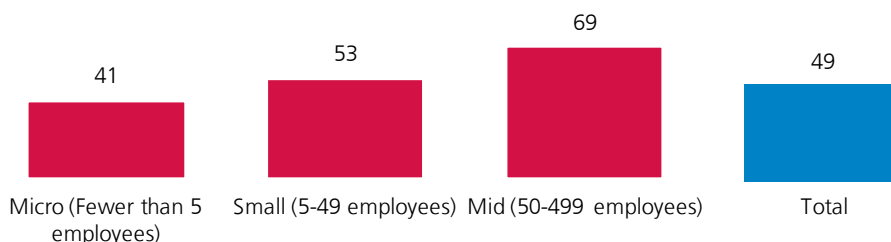
SME Financing Trends in 2012-2015¹

Overall, half of small- and mid-sized enterprises (SME) applied for financing at their main bank during the past three years (see Figure 1). Applications for financing include term loans, new lines of credit, or increases in an existing credit line. Demand for financing increases with business size. While 41 per cent of micro businesses applied for bank financing, a higher proportion of small- and mid-sized business owners applied for financing (53 per cent and 69 per cent respectively). By bank, the percentage of SMEs applying for financing also varies significantly, with six out of ten businesses using Desjardins and ATB applying for financing while only four out of ten businesses applied for financing at TD Canada Trust and CIBC.

Figure 1:

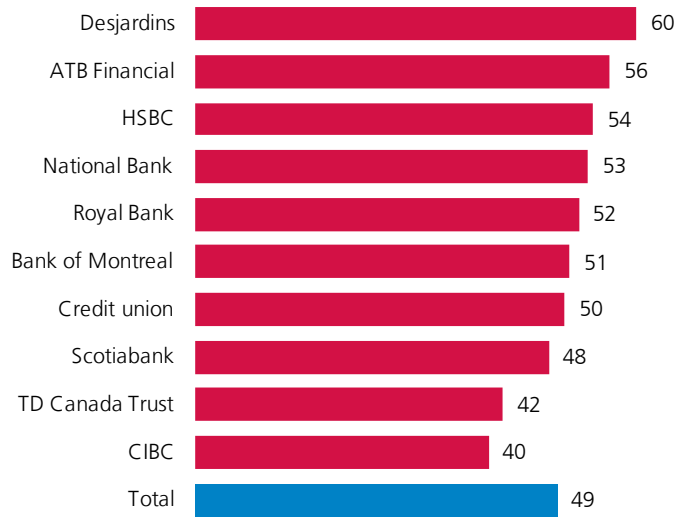
Demand for Bank Financing: Share of SMEs that applied for financing in past 3 years (% response)

By Size of Business:



¹ Financing trends are based on the CFIB business financing survey conducted from September to November 2015.

By Bank:



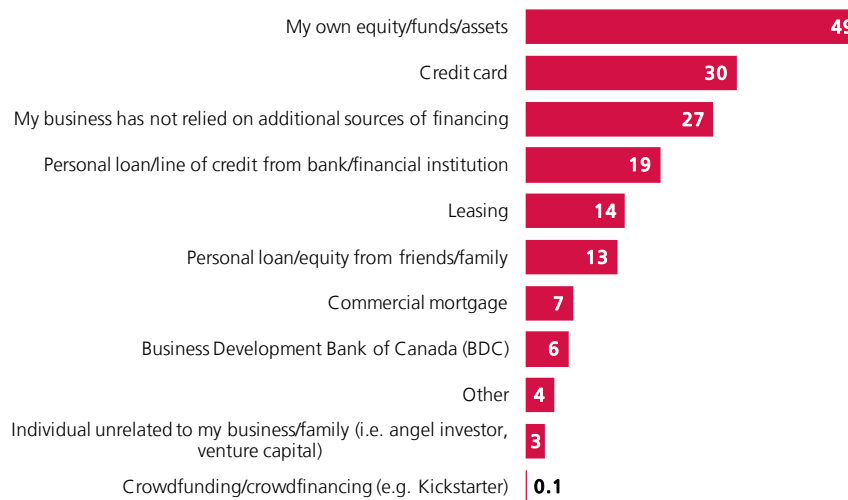
Typical Financing Sources for SMEs

In addition to business loans and lines of credit, many businesses rely on alternative sources of financing. Among the most common sources of financing are personal funds, equity and other assets, at 49 per cent (see Figure 2). More concerning is the percentage (30 per cent) of small business owners that have resorted to credit cards as a source of financing. Although some of the credit card financing used could be related to day-to-day purchases by the business, the use of credit cards may suggest that financing needs are not being met by traditional sources of financing through banks especially among the smallest businesses. Some small business owners may be left with no other choices but to opt for higher cost borrowing options to maintain a steady cash flow. In other cases, banks may encourage financing through credit cards as the banks' rate of return is much higher with credit cards.

Less risky financing options are still being relied on by business owners. Personal financing (e.g. personal loan, line of credit) through a bank is used by one in five business owners. Other alternative sources used by small business owners include leasing (14 per cent), personal loans from friends and family (13 per cent), commercial mortgages (7 per cent), Business Development Bank of Canada (6 per cent), and venture capital (3 per cent).

Figure 2:

During the past 3 years, what additional sources of financing did your business rely on? (% response)

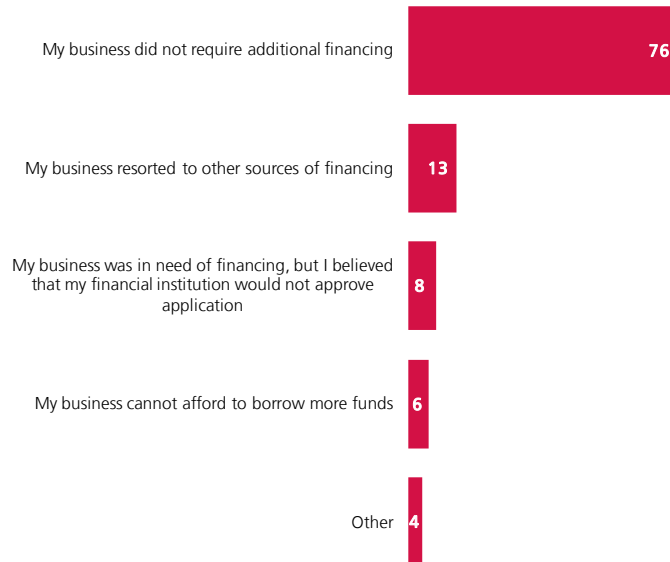


Reasons for Not Applying for Financing in 2012-2015

Out of the business owners who did not apply for financing, one quarter still required additional financing while three quarters expressed that they did not require additional funding during the 2012-2015 period (see Figure 3). Still, 13 per cent of business owners resorted to other sources of financing which could indicate that banks were not meeting the demand from SME owners. In addition, eight per cent of business owners believed that their main bank would not approve their application for financing. It is possible that because businesses have been rejected for financing in the past, they may have stopped trying altogether. Any existing low confidence in the financing approval process is not favourable for the economy as it dampens business growth. Some businesses stated that they could not afford to borrow more during this period (six per cent).

Figure 3:

Why did your business not apply for financing at your business' main financial institution (% response)



SMEs Rejected for Financing

The overall loan rejection rate for 2015 stood at 15.4 per cent (see Table 1) which is substantially lower than the last few years. Loan rejection rates change by the size of business. Similar to findings in past surveys, the smallest businesses experience the highest loan rejection rates. Businesses with fewer than five employees have a loan rejection rate of 22.3 per cent while businesses with 50 to 499 employees have a loan rejection rate of just 3.7 per cent.

Table 1:

Loan Rejection Rates (% response)

2000	2003	2006	2009	2012	2015
10.5	16.6	13.7	19.3	18.4	15.4

Loan rejections can also vary by financial institution. Clients of TD Canada Trust and Scotiabank are rejected for loans at a higher rate compared to clients at other banks (see Figure 4). These banks have rejection rates of 25.7 per cent and 18.8 per cent respectively. Higher loan rejection rates may suggest extra efforts by certain banks to serve the smallest businesses. The smallest businesses can be viewed as the riskiest so it may partially explain why higher than average loan rejection rates are observed among these businesses.

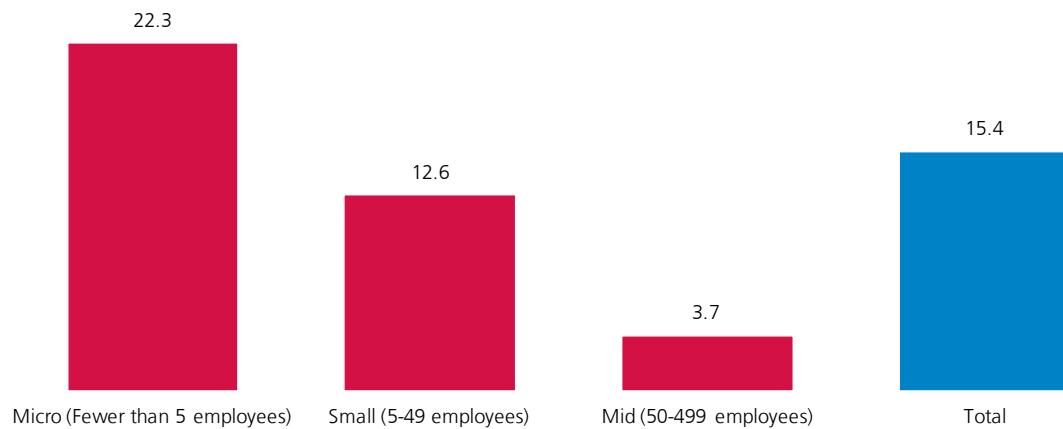
Loan rejections are significantly lower for other financial institutions where loan rejection rates range from 8 per cent to 15 per cent. HSBC, ATB Financial, and Desjardins have the lowest rejection rates at 7.8 per cent, 9.4 per cent and 9.6 per cent respectively.

HSBC has focused more on larger businesses that are in stronger financial positions and seek higher amounts of borrowing in recent years. This can explain the often lower loan rejection rates for HSBC clients compared to other financial institutions. Similar to HSBC, ATB Financial also tends to deal with clients that are better positioned to apply and be approved for larger loan amounts due to the fact that many of ATB's clients are in the agriculture and natural resources sectors. As in previous years, Desjardins continues to charge higher interest rates compared to other financial institutions which partially explains why loan rejection rates are quite low. Clearly, Desjardins is pricing for risk where smaller businesses may pay more for financing but are more likely to be approved.

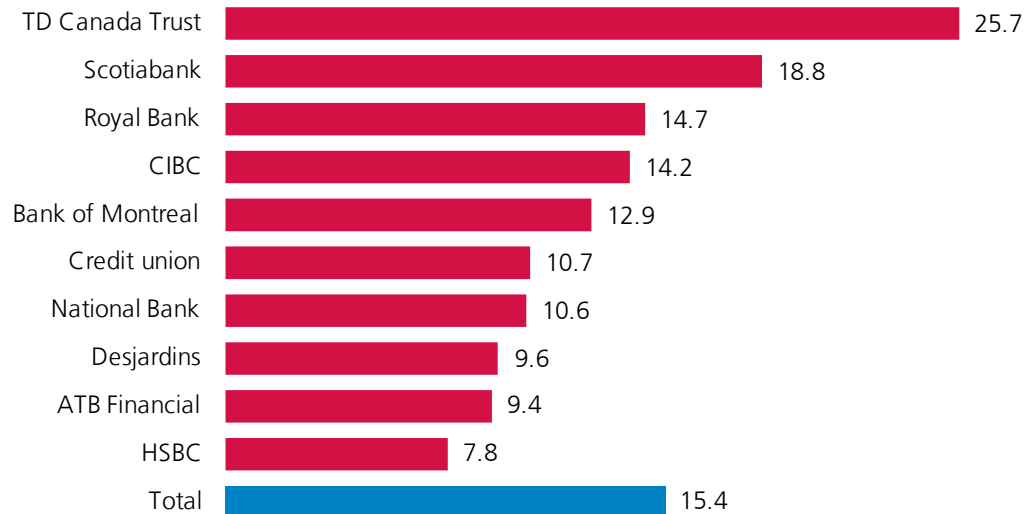
Figure 4:

Loan Rejection Rates (% response)

By Size of Business:



By Bank:



“It's hard to secure financing in Alberta now with the drop in activity, many businesses won't survive if the low activity continues.”

— TD Canada Trust client, Manufacturer, Edmonton, Alberta

“I'm very discouraged with the banks and small business. They are very restrictive, require excessive collateral and as a result we're planning an expansion and looking into alternative sources of money. We'll likely continue to use bank money for lines of credit but will in all likelihood use a leasing company to finance the expansion. The financing terms are comparable with fewer restrictions and entanglements with commercial banking”

— TD Canada Trust client, Crop Production Services Provider, Seaforth, Ontario

“We have never been rejected for a loan in 15 yrs of business but this was the first time. Also we have had 13 bank account managers in 15 yrs. Very hard to do business with a stranger. If I were to start this business today, I couldn't get financing for sure and I don't think we would have continued.”

— RBC client, Manufacturer, Chase, British Columbia

Approved Financing Amounts

Small business owners were surveyed regarding their financing amounts either through a new line of credit, an increase in an existing line of credit, or a term loan (see Table 2). The median financing amount was \$50,000 for the smallest firms with fewer than five employees increasing to \$1 million for mid-sized businesses with 50 to 499 employees.

Table 2:

2006-2015 Median Amount of Financing Approved*, by Size of Business

Business size (# employees)	2006	2009	2012	2015
Micro (Fewer than 5 employees)	\$ 50,000	\$ 50,000	\$ 60,000	\$ 50,000
Small (5-49 employees)	150,000	172,500	250,000	200,000
Mid (50-499 employees)	950,000	1,000,000	1,200,000	1,000,000
Overall	100,000	125,000	161,000	150,000

* Includes the term loan amount and/or credit line limit approved by a bank.

Median loan amounts have decreased from 2012 for most banks which could be an indication of a weaker economy and slowing demand for financing (see Table 3). As mentioned in the previous section, higher loan amounts are common for ATB Financial and HSBC clients (\$450,000 and \$750,000 respectively). Scotiabank, Desjardins, and credit union clients typically have median loan amounts up to \$100,000, indicating that they serving more micro businesses.

Table 3:

2006-2015 Median Amount of Financing Approved*, by Banking Institution

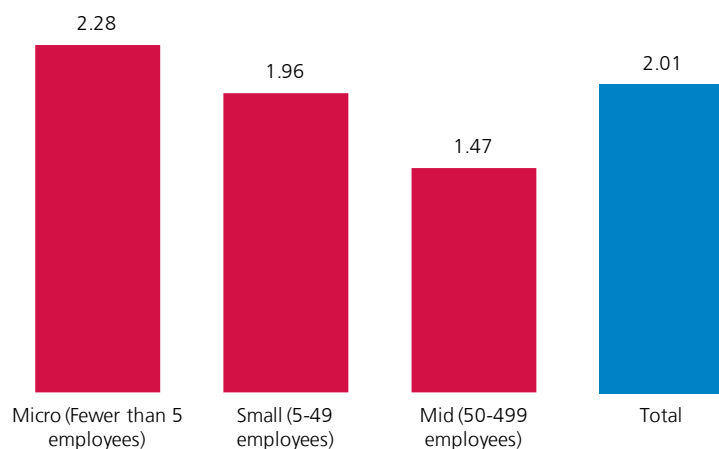
	2006	2009	2012	2015
	\$	\$	\$	
Royal Bank	100,000	150,000	200,000	150,000
CIBC	100,000	200,000	250,000	200,000
Bank of Montreal	200,000	240,000	286,000	300,000
Scotiabank	80,000	70,000	90,000	75,000
TD Canada Trust	100,000	100,000	142,500	140,000
National Bank	150,000	187,500	200,000	190,000
HSBC	500,000	400,000	600,000	750,000
Desjardins	75,000	75,000	125,000	100,000
Credit union	71,000	91,500	100,000	100,000
ATB Financial	155,000	250,000	400,000	450,000
Overall	100,000	125,000	161,000	150,000

* Includes the term loan amount and/or credit line limit approved by a bank.

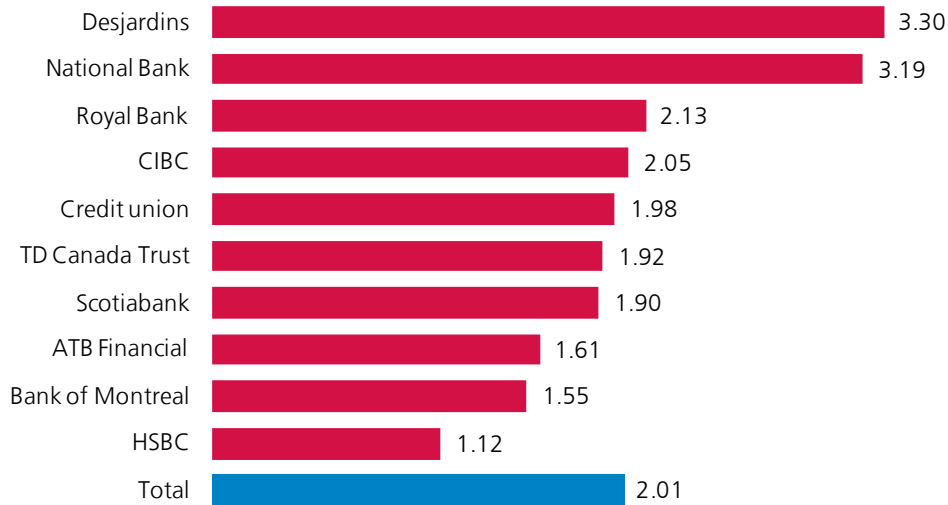
Cost of Financing

SMEs that obtained financing from their bank paid on average 2.01 percentage points above the prime rate (see Figure 5). The prime rate charged by the major chartered banks during the survey period was 2.95 per cent.²

Figure 5:

Interest Rate over Prime (percentage points above the prime rate)**By Size of Business:**

² Bank of Canada. Canadian interest rates and monetary policy variables: 10-year lookup. Web. 18 January 2013. <http://www.bankofcanada.ca/rates/interest-rates/canadian-interest-rates/>

By Bank:

The smaller the business, the higher is the cost of bank financing. On average, businesses with fewer than five employees were charged 2.28 percentage points above prime. The average rate over prime for small and mid-sized businesses was significantly lower at 1.96 per cent for businesses with 5 to 49 employees and 1.47 per cent for those with 50 to 499 employees.

Consistent with the findings that HSBC tends to focus on medium-sized and larger businesses, it follows that the lowest average financing rate was also offered to its clients at an average of 1.12 percentage points above prime. Bank of Montreal and ATB Financial remain competitive by offering lower interest rates than most banks at 1.55 and 1.61 percentage points above prime. Desjardins clients were charged the highest rates above prime, at 3.30 percentage points above prime which is even higher than rates observed in 2012. National Bank is charging interest rates comparable to Desjardins (average of 3.19 percentage points above prime). On average, other financial institutions charge between 1.90 to 2.13 percentage points above the prime rate.

Conclusions and Recommendations

Being able to obtain adequate financing is essential to SMEs' success. Therefore, it is important that financial institutions continue to provide the needed financing for SMEs at a reasonable cost. Ensuring that SMEs have access to the financing they need can help with the creation of jobs and in keeping the Canadian economy stable.

SME owners

- ▶ Use the information in this report to help determine which bank is the most appropriate for your financing or banking needs.
- ▶ Shop around for competitive rates and services.
- ▶ Keep your bank account manager informed about your developments, plans, needs, and concerns. A more informed banker is better able to serve you.
- ▶ Request regular meetings with your bank account manager to review your business banking needs.
- ▶ Ask your bank for alternative sources of financing if declined for bank financing.
- ▶ Stay aware of bank fee changes.

Banks, credit unions & caisses populaires

- ▶ Focus on reducing account manager turnover to better serve SME clients in their financing needs.
- ▶ Ensure new online lending operations (e.g. Kabbage, Thinking Capital, etc.) only supplement, not replace, traditional bank lending.
- ▶ Focus on "relationship" lending by ensuring small business bankers get to know their SME clients.
- ▶ Concentrate on providing low cost financing and increasing access for SMEs in need of financing.
- ▶ Do not promote credit cards as a main alternative source of long-term financing for SMEs.
- ▶ Offer more flexibility in lending and provide more information on banking solutions to your SME clients (e.g. offer information on Canada Small Business Financing Program if bank financing is declined by bank).
- ▶ Adhere to the *Small Business Banking Code of Conduct*³ with regards to financing.
- ▶ Do not restrict financing during economic downturns for SME clients with a good history.

Government

- ▶ Ensure that banks adhere to the *Small Business Banking Code of Conduct*⁴ and that the interests of SMEs are served.

³ Canadian Bankers Association. "Canadian Bankers Association's Model Code of Conduct for Bank Relations with Small- and Medium-Sized Businesses". http://www.cba.ca/contents/files/misc/vol_20090403_bankrelationsmes_en.pdf (accessed May 20, 2016).

- ▶ Ensure banks actively promote alternative sources of financing besides bank financing (e.g. angel investing, crowdfunding, venture capital) as per the *Small Business Banking Code of Conduct*⁵. Ensure the policy environment is encouraging of alternatives.
- ▶ Introduce an independent authority to monitor bank fees for SMEs and to provide advice on bank fees (i.e. similar to Financial Consumer Agency of Canada⁶ for consumers) or expand the mandate for Financial Consumer Agency of Canada to include SME bank fees and financing issues (e.g. ensuring banks provide reasons for why a business is declined for financing)
- ▶ Bank of Canada should reinstate the reporting of data on financing provided to small businesses (i.e. authorized business loans less than \$200,000) to learn if the smallest businesses have adequate access to financing and to ensure that banks are accountable for their lending practices (e.g. lending to businesses of all sizes)
- ▶ Monitor use of new online SME lending technology at major banks to ensure that they do not displace traditional lending or shift to usurious rates of interest.

This report is based on the results of a survey conducted over the period from September to November 2015 in which a total of 11,400 responses were received. The responses are accurate within plus/minus 0.9 percentage points, 19 times out of 20.

For further details on recent CFIB research publications on banking issues, please refer to the following:

Bruce, Doug and Queenie Wong. Battle of the Banks. Toronto: CFIB Research. (May 2013).

<http://www.cfib-fcei.ca/english/article/5171-battle-of-the-banks-how-small-businesses-rate-their-banks.html>

Bruce, Doug and Queenie Wong. Banking on Better Service. Toronto: CFIB Research. (April 2010).

<http://www.cfib-fcei.ca/english/article/1812-banking-on-better-service.html>

Bruce, Doug. Banking Matters. Toronto: CFIB Research. (November 2007).

<http://www.cfib-fcei.ca/english/article/152-banking-matters.html>

Bruce, Doug. Banking on Competition. Toronto: CFIB Research. (October 2003).

<http://www.cfib-fcei.ca/english/article/272-banking-on-competition.html>

Bruce, Doug. Banking on Entrepreneurship. Toronto: CFIB Research. (March 2001).

Some business owners may be participating in exclusive discounts offered by Scotiabank through the CFIB Scotiabank Privilege Program.

⁴ *Ibid.*

⁵ *Ibid.*

⁶ The Financial Consumer Agency of Canada (FCAC) provides consumers with a tool to compare bank account fees and services by financial institution (Account Selector Tool).

Financial Consumer Agency of Canada. "Account Selector Tool." <http://itools-ioutils.fcac-acfc.gc.ca/STCV-OSVC/acst-osco-eng.aspx?f1=1&f2=1> (accessed January 27, 2016).

Appendix:

A. Additional Data

Table A1:

Selected SME Debt Financing Indicators, by Industry

	Median Loan Amount Approved (\$)	Interest Rate Over Prime (%)	Loan Rejection Rate (%)
Agriculture	297,000	1.25	9.0
Natural Resources	500,000	1.49	13.8
Construction	180,000	1.72	11.9
Manufacturing	300,000	1.66	13.9
Wholesale	290,000	1.68	11.3
Retail	100,000	2.01	19.2
Transportation	250,000	1.71	14.6
Arts, Recreation, and Information	80,000	1.98	22.8
Finance, Insurance	172,500	1.55	11.1
Professional Services	100,000	1.57	12.9
Enterprises and Admin.	150,000	2.05	18.9
Social Services	60,000	1.47	14.1
Hospitality	125,000	2.35	22.1
Personal, Misc. Services	50,000	2.44	20.5
All industries	150,000	2.01	15.4