Generating Growth:

Improving Access to Capital by Small and Medium-Sized Enterprises

December 1995

Canadian Labour Market and
Productivity Centre

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The Canadian Labour Market and Productivity Centre (CLMPC) is an independent national bipartite organization working to build business-labour consensus and joint approaches to major social and economic issues. Through the CLMPC, the two parties develop policy recommendations to government aimed at improving the labour market and overall economic performance of Canada. The CLMPC also seeks to influence the policies and practices of business and labour.

The research staff associated with this report included Kirk Falconer, Costa Kapsalis, Shawn O'Connor, and Andrew Sharpe.

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Executive Summary

This report of the Task Force on Access to Capital of the Canadian Labour Market and Productivity Centre discusses and makes recommendations concerning financing barriers relevant to small and medium-sized enterprises in Canada. The work of the Task Force builds on recommendations made by the CLMPC's Economic Restructuring Committee in their 1993 report, *Canada: Meeting the Challenge of Change.*

Over the past decade, small and medium-sized firms have made major contributions to net job creation. Despite this fact, it is these companies, and especially the youngest among them, that encounter significant difficulties seeking external capital. The Task Force feels, further, that issues related to debt capital have tended to overshadow discussion of equity sources.

A central message of the Task Force is that equity capital should be given heightened emphasis in Canadian investment and financing, especially for small and medium-sized enterprises (SME's). Within the equity capital framework, there is a further need to explore in more detail the role and contributions of the relatively new labour-sponsored investment funds.

Both debt and equity capital are essential to the long-term financial health of a business, and the optimum balance of debt and equity is always a crucial question. While not a panacea, equity capital, however, plays an important strategic role in supporting the growth and development of small firms. Equity brings "patient" capital, as well as the knowledge, advice and networks of investors. Equity also provides a firm an ability to leverage debt.

Although it was not possible within the scope of the project to deal with all financing issues, the Task Force has developed recommendations of practical significance in those areas of debt and equity financing which it did address.

The Task Force believes that it is essential to promote the use of equity capital among SME's, and that private decision-makers and public policymakers have a key role to play in this regard. Of central importance in this regard is the need to foster and enhance the management expertise of small business, as well as to increase the amount of information available to small business concerning financing options and opportunities.

For their part, financial institutions must continue to place more emphasis on understanding the industrial context of small businesses, and its implications for their capital needs. This is particularly the case in high-technology sectors characterized by intangible assets. For firms such as these, financial institutions must continue to develop more sophisticated valuation and risk assessment techniques.

The Task Force believes there is significant innovation taking place in Canada in a variety of financing areas, including new approaches to directing capital to small-dollar projects, and new hybrid debt-equity instruments for small business financing. In both areas, however, there is room for continued growth and development. Innovations are also occurring in the area of small business networks which allow small businesses to pool resources for

financing and other purposes, and these need to be promoted and extended.

In the view of the Task Force, there is also room for improvements to a number of aspects of provincial securities regulations. Efforts are needed to harmonize these across jurisdictions, as well as to ensure that their application within jurisdictions respects the limited financial resources, and consequent cost sensitivity, of small businesses. Regulations should also not unnecessarily obstruct the development of regional dealers and brokers. In this connection, the Task Force recognizes that the diverse network of financial means and structures developed in Quebec has had positive impacts on access to capital, and deserves study to identify transferable approaches.

With regard to the labour-sponsored investment funds, since these are a new financing vehicle and each fund has its own objectives, the Task Force identifies certain key characteristics which the funds should possess, and on which their performance should be assessed. The Task Force also recommends that these funds be recognized as a tool for localized venture financing.

Based on Task Force discussions, there is a need for the federal government to review, evaluate, and compare all tax incentives and other mechanisms (grants, loans, etc.) which affect risk capital supply, in terms of their impact on capital supply.

The Task Force recognized that lending institutions have made progress in addressing a number of small business difficulties, including the disruptive effects of high staff turnover and related aspects of customer service. Codes of conduct, alternative dispute resolution mechanisms, and similar initiatives are clearly positive developments. There is a need, in the view of the Task Force, for the institutions to better promote and communicate these initiatives to their clients, and explore ways of enhancing some of the practices themselves.

Improving financing for women entrepreneurs was also researched and addressed by the Task Force. While a small business survey conducted for the Task Force did not isolate bias against women on the part of financing sources, other surveys have presented evidence of such bias. In the view of the Task Force, financial institutions should continue to be vigilant regarding their policies and practices to ensure the equal treatment of women in small business. Initiatives, such as mentoring programs, which support the needs of women businesspersons, also require continuing support.

In summary, the Task Force believes that the increased use of equity capital sources, combined with the Task Force's recommendations on both debt and equity matters, will contribute to improved terms and conditions for financing small entrepreneurs and enterprises overall. It concludes that by guaranteeing increased capital supply through new means and structures, developed and supported in both the private sector and government, a crucial step will have been taken in moving Canada towards a new economy.

List of Recommendations

Recommendation 1

We recommend that Canadian private sector decision-makers and public policy-makers give increased priority to the role of equity financing in assisting new and developing small business.

Recommendation 2

We recommend that small business, assisted by its representatives in national organizations, give more attention to equity in financing demand needs in a new Canadian economy.

For example, business associations, on their own initiative or supported by Industry Canada, should develop information packages or seminars to encourage small businesses to actively consider equity financing.

Recommendation 3

We recommend that all private and public sector participants in Canadian financing relationships act to foster the knowledge and skills needed by small business to access external sources of capital.

Such actions could include:

* *direct assistance in the preparation of business plans;*
* *seminars or literature on how to prepare to approach a funding source;*
* *education programs on budget preparation.*

Recommendation 4

We recommend that financial institutions, governments, and professionals active in small business financing give increased priority to communicating to small business information about capital supply options and programs to lower barriers more widely.

Actions could include:

* *more active promotion or distribution of literature already developed;*
* *enhancing the knowledge of financial institution staff concerning capital supply options, so they can pass this on to clients;*
* *seminars conducted by accountants for their clients, providing information on capital supply sources.*

Recommendation 5

We recommend that financial institutions devote more resources to developing specialized expertise about the equity needs of knowledge-intensive and technology-intensive firms.

Actions by institutions in this regard could include:

* *appointing senior managers responsible for ensuring that staff receive training in the needs of knowledge-intensive firms;*
* *recruiting individuals with knowledge of the needs of high-technology firms;*
* *accessing, as needed, specialized external advice on the needs of high-technology firms.*

Recommendation 6

We recommend that venture capitalists, other financial institutions, and government work in partnership to develop new mechanisms for directing capital to small dollar projects.

*Such a partnership might begin through collaboration between the Business Development Bank of Canada, venture capital firms, and financial institutions to organize a conference on ways to support small **dollar projects.***

Recommendation 7

We recommend that business, finance and government collaborate on new efforts to promote information-sharing and networking between "angels" (wealthy individuals or families who will make direct investments) and small entrepreneurs.

Actions in this regard may include:

* *a new attempt at a centralized matchmaking service;*
* *greater use of electronic communications systems such as the Internet;*
* *an increased role for lending institutions as clearinghouses of information;*
* *a greater information role for professionals in this field, such as accountants or lawyers.*

Recommendation 8

We recommend that traditional debt lenders develop and implement hybrid debt-equity instruments for small business financing using existing private sector and government models for reference.

Recommendation 9

We recommend that financial institutions develop more sophisticated techniques for risk assessment, especially for soft asset lending, that can lead to revised security criteria.

Recommendation 10

We recommend that the Small Business Loans Act be reviewed to assess the feasibility of expanding the range of capital needs beyond the purchase of fixed assets to include financing needs such as working capital and research and development.

Recommendation 11

We recommend that the Quebec financial model be assessed by business, labour and government to identify approaches which may be transferable to other Canadian provinces and regions.

As a specific example, Industry Canada might establish a review, with other business, labour and government participants, of aspects of the Quebec model including:

* *the Caisse de dépôts et de placements;*
* *the Quebec Stock Savings Plan; and*
* *specialized and localized equity pools formed by co-investors.*

Recommendation 12

We recommend that securities regulators act to ensure that standards are not unnecessarily obstructing regional dealers and brokers.

Recommendation 13

We recommend that the federal government review, evaluate and compare all government programs and initiatives which affect risk equity supply in terms of their impact on capital supply.

These would include, but would not be restricted to, tax incentives, grants, loan guarantees, interest-free loans, etc.

Recommendation 14

We recommend that provincial securities commissions review and amend regulations for cost sensitivity to small business financing and initial public offerings.

Specific regulations which might be reviewed include those relating to information disclosure and prospectus requirements, and related application fees.

Recommendation 15

We recommend that the Canadian Securities Administrators review Canada's system of securities regulation and enforcement to encourage simplification and harmonization.

Recommendation 16

We recommend that government reviews of labour-sponsored funds take into account the specific objectives of individual funds and gather evidence as to whether these are being met.

Recommendation 17

We recommend that control and direction by a legitimate labour body, which is stipulated in the legislation governing the funds, be recognized as a requirement for ongoing tax support of labour-sponsored funds.

Recommendation 18

We recommend that general national criteria be established regarding labour-sponsored funds, in addition to basic concerns regarding return on investment and accountability to investors. These could include:

* *job creation and protection;*
* *a full role for unions and workers in directing investment decisions;*
* *a commitment to increased participation in investment by working people;*
* *promotion of business-labour co-operation;*
* *assistance to small and medium-sized firms;*
* *support for regional/community economic development;*
* *encouragement of high performance workplaces;*
* *effective support of national venture financing;*
* *delivery of economic and financial training.*

Recommendation 19

We recommend that labour-sponsored funds be recognized as a tool for advancing localized venture financing, where this is appropriate.

Recommendation 20

We recommend that business, finance and government support new and continuing initiatives to promote the use of small business networks in Canada.

Specifically, Industry Canada should work with business associations to expand the number and scope of these networks.

Recommendation 21

We recommend that lending institutions continue to develop means for preventing high staff turnover where it affects quality working relationships with small proprietors.

For example, independent surveys of customer satisfaction levels could be a useful tool for lending institutions in monitoring the effects of changing staff turnover levels on relationships with clients.

Recommendation 22

We recommend that lending institutions:

* *better communicate policies and practices to their small business customers through newly developed codes of conduct and complaint handling initiatives, and*
* *increase the effectiveness of small business ombudsmen by ensuring that they are directed independent of the institutions themselves.*

Recommendation 23

We recommend that all financial institutions continue to be vigilant regarding their policies and practices to ensure the equal treatment of women in small business.

Recommendation 24

We recommend that business, finance, labour and government lend support to financing value-added programs for women, such as mentoring programs.

I Introduction to this Report

1. Background

In November, 1993, the Task Force on Access to Capital of the Canadian Labour Market and Productivity Centre (CLMPC) was established with a membership of senior business and labour representatives and with a mandate to study, discuss and make recommendations concerning financing barriers relevant to small and medium-sized enterprises in Canada. As such, the Task Force is heir to a landmark process completed in early 1993 when the CLMPC's Economic Restructuring Committee greatly expanded the scope of themes and issues for business and labour consultation and consensus-building at the national level. This includes the issue of the amount and quality of productive investment in a high value-added economy and its support by adequate financing.

Canada's system of capital markets, banks and other financial institutions has been recognized internationally for its soundness, efficiency, and comprehensive provision of products and services. Nevertheless, as far-reaching economic change and restructuring takes place, so too are overall conditions of financing demand and supply evolving at a rapid pace.

Hence, the work of the Task Force on Access to Capital builds on recommendations made by members of the CLMPC's Economic Restructuring Committee in their 1993 report *Canada: Meeting the Challenge of Change.*

In approaching its mandate, Task Force members recognized that this subject is not a new one. Savings, investment and capital formation have always been integral to national economic performance. By having access to capital resources at a reasonable cost, Canadian individuals, companies and governments can continuously make the types of investments that yield jobs, wealth and income. In particular, private industry is able to finance production maintenance and expansion which is so very essential to economic growth and better living standards.

At the same time, Task Force members point out that capital availability concerns have risen significantly on the national agenda in recent years. This suggests that matters of investment and financing may be even more critical today as the economies of Canada — and indeed, all other advanced industrialized countries — are beset by fundamental and on-going changes. Increasingly, private and public sector decision-makers have argued for improvements to productivity and higher value-added employment as a response to the circumstances of a new, global economy. This effort, plus the costs of adjustment, entail large and diverse investments which, in turn, depend on a sizeable and timely delivery of capital.

Canada's system of capital markets, banks and other financial institutions has been recognized internationally for its soundness, efficiency, and comprehensive provision of products and services. Nevertheless, as far-reaching economic change and restructuring takes place, so too are overall conditions of financing demand and supply evolving at a rapid pace. For this reason, the Task Force believes it is appropriate for decision-makers and policy-makers to more regularly review and assess the state of Canadian capital allocation to ensure it is keeping abreast of new economic challenges and needs in the future.

2. The Focus of the Report

The following report of the Task Force addresses the small business sector's current financing experience. This, it will be widely acknowledged, is absolutely central to broader Canadian investment and capital allocation trends given the clear contribution small and medium-sized firms, both new and established, have made to net job growth over the past decade or more. Despite this fact, research suggests, it is these companies, and especially the youngest among them, that encounter substantial — and in some cases, apparently intractable — difficulties seeking external sources of capital.

Task Force members believe a preoccupation with borrower-lender concerns may have overshadowed the vitally important role equity financing can and should play in industry, today, and in the new economy.

In dealing with this issue, the Task Force has chosen to concentrate on access to equity capital. This is because of its conclusion that, while considerable public attention has been devoted to capital availability to small business as of late, most of this attention has been geared to problems of debt. Of course, this is understandable in light of widespread use of commercial loans and credit. However, as a consequence, Task Force members believe a preoccupation with borrower-lender concerns may have overshadowed the vitally important role equity financing can and should play in industry, today, and in the new economy.

Hence, while this report will touch on selected questions involved with access to debt and equity capital, the Task Force wishes to give greater emphasis to the latter.

Historically, research has revealed that it is size, not surprisingly, that is the pervasive characteristic of all underfinanced commercial concerns (i.e., as defined by total employment, assets, sales, or level of financial demand). However, research literature has found that barriers may be in place due to other variables as well, such as the innovative or technical nature of production or products, location in a disadvantaged region or community, or the gender of company owners and managers.

For this reason, Task Force members also chose to concentrate on the particular experiences of very small business (such as micro-enterprises), high technology firms, firms located in specific Canadian regions, and firms owned and operated by women. The Task Force believes strongly that the capital availability problems of these groups merit special consideration.

Finally, in the context of discussing equity financing, the Task Force determined to devote some attention to the growing prominence of labour-sponsored investment funds in the Canadian economy. It was felt that the funds represent a very significant development in the activity of unions and workers in many capital markets and should be better understood given the relative absence of accurate and comprehensive data about them.

3. *The Nature of Supporting Research*

To assist the deliberations of members, the Task Force authorized several research projects utilizing a range of methodologies. These projects were conducted over the period 1993 to 1995 by CLMPC research staff in partnership or co-operation with other interested organizations and individuals. This included the Canadian Chamber of Commerce (CCC) which worked with the CLMPC to produce a survey of close to 1,500 small and medium-sized companies on on-going financing requirements and constraints. The survey was complemented by focus group interviews with firm owners and managers and with representatives of financial institutions across the country.

Another organization working with the CLMPC on the topic of the costs, effects, and benefits of labour-sponsored funds was Carleton University's Centre for the Study of Training, Investment and Economic Restructuring (CSTIER).

CLMPC research projects also benefited from the advice and help of several well-known Canadian experts in this field, including Mary Macdonald of Macdonald and Associates, Professor Allan Riding of Carleton University, and Professor Barbara Orser of Ryerson Polytechnical Institute.

The final versions of all research papers are complete and are available upon request from the CLMPC. The following are a list of published papers (as of November, 1995), along with additional CLMPC documents of value to the Task Force, that should be referred to as investigative supplements to this report.

- *Access to Capital Resources in Canada*, CLMPC, 1993;
- Canadian Business Speaks Out on Access to Capital, CLMPC/CCC, 1995
- *The Role and Performance of Labour-sponsored Investment Funds in the Canadian Economy: An Institutional Profile,* CLMPC, 1995
- *Adding Value: The Economic and Social Impacts of Labour-sponsored Venture Capital Corporations on Their Investee Firms,* (written by CSTIER), CLMPC, 1995

4. *Access to Capital: An Overview*

Research into Canadian capital supply and demand, though extensive, does not fully describe the true incidence, character and dimensions of problems. Over the years, however, some degree of understanding has been developed based on both anecdotal and empirical evidence. For instance, while broad Canadian commercial demand is generally satisfied in the marketplace, a discernible pattern has been shown to exist whereby firms in specific industries, sectors and regions encounter barriers to obtaining adequate, affordable financing.

Most researchers do not attribute this situation to any past or current shortages in the national capital stock (though some economists have given warnings about future trends in this regard).

Rather, supply deficiencies, when they occur, tend to be linked to specific capital markets, such as the venture capital market (which has suffered from low investor participation in the past).

Many barriers to access may well be more institutional or structural in nature. That is, they pertain to legal or regulatory regimes, institutional relationships and market practices, costs of transactions, limited infrastructure, or systems for disseminating knowledge and information, for example. It is these, recent data and analysis indicate, that can cause so-called "gaps" in mainstream capital markets or bring about a poor matching of supply with specialized demand. A compelling examination of some of the structural impediments associated with capital allocation is presented in University of Toronto Professor Jeffrey Macintosh's 1994 paper *Legal and Institutional Barriers to Financing Innovative Enterprises in Canada*.

In an attempt to explain long-standing financing barriers, many researchers have drawn attention to the policies and practices of lending institutions, borrower-lender relationships, and the quality of decision-making of firm proprietors.

It is not the intention of this paper to replicate, or simply report, the research already carried out on the gamut of questions posed around access to capital. However, in the interest of providing context, some overview of small business financing is necessary. The following, therefore, is a very brief look at current conditions of debt and equity capital provision in Canada and some details about its availability for small and medium-sized enterprises (for more detailed evidence and discussion, please see CLMPC reference documents previously listed).

(a) Access to Debt Financing

For Canadian small business owners and operators looking for external sources of capital, debt is, overwhelmingly, the instrument of choice. The CLMPC/CCC survey found that more than 80 percent of companies use debt financing (and/or personal and internal capital).

The national commercial lending market is valued at approximately $300 billion. Most of this activity consists of conventional loan and credit instruments supplied by banks and near-banks — trusts, credit unions and *caisse populaires* (and including government-run institutions). Alternative forms of credit include non-residential mortgage financing and bonds and commercial paper which are provided by various institutions. Some financial institutions, such as the biggest banks and trusts, attempt to supply all market segments while others, such as small trusts and credit unions, may focus on specific classes of borrowers.

In an attempt to explain long-standing financing barriers, many researchers have drawn attention to the policies and practices of lending institutions, borrower-lender relationships, and the quality of decision-making of firm proprietors. Study after study, including the CLMPC/CCC survey, have discovered a large measure of customer dissatisfaction with their banking options.

Smaller borrowers have argued that lending institution policies in such areas as collateral security, borrowing costs, and account management are key determinants of access. For instance, security standards may tend to favour financing fixed or hard assets rather than soft assets and intangibles in enterprises of all kinds. While banks and near-banks have, in many cases, moved to correct policy shortcomings, problems remain. Some believe that change is also necessary in attitudes and behaviours on the demand side and regarding the role government assumes in the allocation of loans and credit.

Widely-held public equity offers unprecedented growth and development potential to the small or medium-sized company. Research indicates, however, that there are distinct barriers to smaller entities obtaining it.

(b) Access to Public Equity Financing

For those small entrepreneurs wishing to stay private, a long-term financing goal may be to supplant external sources with retained earnings. For others, a related goal is frequently to expand and develop to the stage where an initial public offering of equity becomes feasible. Once an enterprise is listed with an organized securities exchange, all subsequent capital requirements can be managed, in the main, through sophisticated public market channels.

Canada's public capital markets consist of roughly $450 billion in pools bringing together pension assets, surpluses of financial institutions, and investment funds of all types. Collectively, these pools purchase government and private debt and equity instruments, mortgages and real estate. Successful corporate issues generally must secure the commitment of sizeable institutional investors. In one fashion or another, virtually all financial institutions participate in organized exchanges in Toronto, Montreal, Vancouver and other Canadian centres.

Widely-held public equity offers unprecedented growth and development potential to the small or medium-sized company. Research indicates, however, that there are distinct barriers to smaller entities obtaining it. Initial public offerings, for instance, involve considerable costs, in large part due to provincial regulatory strictures concerning the public disclosure of information. This and other factors weigh against small public issues (e.g., under $1 million). Thus, the initial public offering alternative is relevant to only a minority of small businesses.

The over-the-counter market is a secondary equity capital source for firms unable to qualify for an organized exchange listing or that have elected to remain unlisted. This market is made up of brokers and dealers who purchase securities and resell them publicly.

(c) Access to Private Equity Financing

There are many Canadian enterprises that are young or developing that cannot obtain debt, and at the same time, are not ready for public offering. For them, the only viable external financial alternative may be private equity capital. Such capital is often ideal for high risk industrial activity, such as seedings, start-ups, early stage developments, and deals featuring acquisitions, turnarounds and restructurings.

With higher risks, markets for private equity also promise higher returns. This is what attracts a wide array of participants, including banks and near-banks that join, through subsidiaries, other risk capitalists, such as venture capital institutions (including labour-sponsored funds), informal venture investors (also known as "angels"), merchant banks, mezzanine lenders, corporate and institutional investors making private placements, etc. The size of active private markets, though not completely known, is relatively modest — the institutional venture capital market was $5 billion in 1994 while the angel market may be only twice this amount.

Total dollar commitments to private equity financing indicate little of its great strategic importance to the Canadian economy through its specific application to the growth of individual firms. Much of the supply of this capital carries attributes essential to multi-faceted business development, such as "patience" in the investment process. Such qualities (which are detailed at length in Section II) are vital to knowledge-intensive and technology-intensive industries, for instance, the success of which will determine this country's future prosperity.

Total dollar commitments to private equity financing indicate little of its great strategic importance to the Canadian economy through its specific application to the growth of individual firms. Much of the supply of this capital carries attributes essential to multi-faceted business development, such as "patience" in the investment process.

Barriers here are said to be unique to particular markets. To illustrate, Mary Macdonald has argued the need to improve infrastructure and supply conditions in the institutional venture capital market, and to inject more expertise into certain investment projects. In another example, information about angels, and means for gaining proximity to them, have been historical difficulties.

II The Case for Equity Financing

1. *Introduction*

A central message of the CLMPC's Task Force on Access to Capital is that equity capital should be given heightened emphasis in Canadian investment and financing. CLMPC research and other studies have consistently shown that capital of this variety is apparently underutilized in the small business sector, perhaps because its strategic merits are unknown or underappreciated. The following is a brief discussion of the Task Force's case for more emphasis on equity financing.

2. *Underutilization of Equity Capital*

Is the value of equity capital going unrecognized because of too strong a continuing focus on collateralized debt? The evidence is that this may be true. For instance, it has long been acknowledged that there are, proportionately, far fewer initial public offerings in Canada as compared with the United States. In addition, some private markets for higher risk equity capital in Canada have, up until quite recently, been underdeveloped or have lacked sufficient profile, especially in the small business sector. More recent data are found in the CLMPC/CCC survey of 1994-95.

That financing barriers adversely impact the majority in Canadian small business was confirmed in the CLMPC/CCC survey. Over one-half of respondents said their financing circumstances were only somewhat adequate or were not adequate. For one-quarter of respondents, problems were most serious in specific areas, such as working capital, capital for buildings, machinery and equipment, and research and development. Indeed, the latter category proved the most troublesome — fully 34.9 percent reported difficulty obtaining capital for research and development purposes.

An alternative solution is for the owners and operators of new and developing small firms to give thought to equity capital (in its different forms) or a more diverse mix of financial instruments that includes equity.

Perceived impediments were more pronounced for the smallest and youngest of these firms. Furthermore, high technology enterprises seemed to encounter twice as many financing roadblocks as their low technology counterparts. This may be due to several factors, such as the presence of intangible assets and more stress placed on research and development spending.

The same survey found that equity capital use was generally low. Less than 10 percent of small and medium-sized company representatives said they utilized external sources of equity. Interestingly, a higher proportion tried and failed to secure such financing. Fully 28.4 percent of those who pursued this option were unsuccessful.

Moreover, the experience of seeking equity capital proved to be more complicated than the experience of seeking debt. The survey found that one-in-five enterprises had difficulty accessing external supply. Of this number, 42.1 percent seeking equity capital sources reported problems, in contrast with 20.9 percent seeking debt sources.

Such statistics need to be put into context. For a great many small establishments, financing arrangements reflect fairly straightforward commercial aims and operations. Indeed, being profitable or financially sustainable while staying private, independent (e.g., family-owned) and moderately-sized may be the overriding *raison d'être* (this was clearly reflected in CLMPC focus group interviews with small businesspeople). For these, debt may be the most sensible external supply option.

However, for those entrepreneurs and enterprises elsewhere on the development spectrum, and particularly those that are new or are following a path of exceptionally rapid growth, exclusive reliance on lending institutions may be inappropriate.

In fact, the intransigency of financing barriers may, to some extent, pertain to demand side actions on this score. The strategic aim of most banks and near-banks is to maintain low risk loan portfolios that generate steady returns to depositors. Substantial collateral and personal guarantees are key to this low risk strategy. However, it is quite clear that commercial loan applicants become frustrated when consequently securing too little financing, enduring

The Task Force believes that increased attention must be paid to the potential offered by equity financing, from both external public and private sources, by small business decision-makers and by those government policy-makers with an interest in this sector's success at the forefront of Canadian economic change.

unfavourable terms, or exposing themselves to vast personal risk. This frustration has rightly challenged lenders — and continues to challenge them — to reconsider policies and implement changes.

An alternative solution is for the owners and operators of new and developing small firms to give thought to equity capital (in its different forms) or a more diverse mix of financial instruments that includes equity. The next section of this report looks briefly at the strategic advantages of taking this route.

3. The Strategic Role of Equity Capital

The Task Force believes that increased attention must be paid to the potential offered by equity financing, from both external public and private sources, by small business decision-makers and by those government policy-makers with an interest in this sector's success at the forefront of Canadian economic change. Of course, this must be understood in light of those characteristics specific to different forms of equity.

The organizational goal of a young enterprise, for example, is frequently to expand to a point where it can "go public" and assume the advantages of that strategic position. However, the supply of capital for development leading to this moment must often be high risk equity capital (especially once owners/operators exhaust internal capital or borrowing limits). Hence, equity financing use involves distinct capital markets with distinct functions, however systematically connected they may be.

Everything depends on what source best suits the commercial entity according to its strategic plan and where it is on the growth and development path.

Both debt and equity capital are essential to the long-term financial health of a business. The optimum balance of debt and equity is, in fact, always a crucial decision. However, as discussed above, the small or medium-sized company that does not access external equity may, in some circumstances, be placing constraints on its ability to leverage debt. This may adversely affect not only the bottom line, but also its capacity to respond flexibly and strategically to swift-moving market conditions.

Hence, one of the primary qualities of equity capital is as a complement to debt. Indeed, in the case of risk (equity) capital, such as institutional and informal venture capital, there is often a leveraging role that necessarily precedes other kinds of financing, including debt. In the case of risky initiatives, such as seedings, start-ups, early stage developments, acquisitions, turnarounds, and restructurings, venture capitalists sometimes act as first-in suppliers. In so doing, they can establish a clear equity commitment that leverages further co-investment.

Another key aspect of some equity capital sources, mentioned previously, is its potential long-term duration in an investment. Considerable supply is often available on a quasi-permanent basis, as there is no maturity date for re-imbursement, as is the case for debt instruments. Institutional venture capital is invested in projects for between three to ten years, on average.

> ***In short, much equity capital is patient capital which gives enterprises the opportunity to expand and develop at a reasonable pace. This is critical to knowledge-intensive and technology-intensive firms where long-term product gestation is common.***

In short, much equity capital is patient capital which gives enterprises the opportunity to expand and develop at a reasonable pace (public equity, of course, is not illiquid, but has other features described below). This is critical to knowledge-intensive and technology-intensive firms where long-term product gestation is common. Getting a new or revolutionary product to market, in this instance, may be an arduous journey, without prospect of short-term returns, and only realized with the aid of committed financial backers.

Several recent studies have argued that Canadian private industry needs access to a good deal more patient capital. For example, a 1992 report of the American Council of Competitiveness found that, in Canada and the United States, there was too close a market concentration on quarterly and annual profits at the expense of patient risk-taking (a trait that is perceived to be more deeply ingrained in Japanese and some European corporate and financial cultures). The result may be deterence of long-term productivity and economic performance.

Some forms of equity financing also introduce stores of “knowledge” to the investment process. Venture capitalists, for instance, often bring resources of knowledge, experience, infrastructure, and networks to investee companies. They are pro-active, if temporary, shareholders, providing expert guidance on matters of business strategy and financial management. In other words, these equity suppliers also yield up significant value-added through investment monitoring and mentoring.

In actuality, pro-active, knowledgeable financing is precisely what some venture professionals, institutional and informal, are sought out for. This is particularly relevant to the growth process in certain industries and sectors. Canadian angels, for instance, are credited with combining financial and industrial expertise in the evolution of the Ottawa Valley’s high technology sector. This quality is also present elsewhere in markets for high risk private equity capital.

As compared with debt, equity capital suggests several other, related advantages. Since there are no obligatory interest payments that have to be met, small business cash flow may be improved. Dividends are discretionary and this renders the firm better able to withstand cyclical downturns. In addition, equity investment does not tend to tie up corporate assets as collateral dictates with debt investment. Also, because the claims of lenders on cash flow and assets rank ahead of shareholders, the creditworthiness of a firm is further enhanced with equity.

It is the view of the Task Force that the Canadian entrepreneurs and enterprises that gain most from turning to equity capital are the so-called "gazelles" or those small and medium-sized firms in growth-oriented industries. It is these that are most closely identified with possible new generation of job and income opportunities in the Canadian economy.

Finally, increased equity stakes always augment the net worth of a commercial entity. Once a developing enterprise becomes able to rely on an organized securities exchange (and/or retained earnings), it benefits from this new situation. Widely-held share capital also offers, for instance, a very sizeable and diverse pool for future financing needs (along with the same leveraging capability noted above), flexibility through liquidity, and the chance to raise a company's profile (as well as that of its goods and services).

Jeffrey MacIntosh and other researchers have also suggested that the sale of securities to the public can increase organizational transparency. This, in turn, should produce gains to efficiency and cost-effectiveness.

4. Conclusion

The Task Force recognizes and stresses that equity financing is not a panacea. Indeed, as was previously stated, such supply is completely inappropriate for some commercial purposes. Mary Macdonald has made this point repeatedly concerning venture capital.

Also, some of the evident qualities of equity capital, such as greater risk-taking, patience, and the injection of knowledge and mentoring, are qualities that should be extended to more comprehensive and higher value-added financing vehicles in an effort to improve access to capital. Indeed, heightened utilization of private and public equity sources is one means of achieving this overall result.

Naturally, many in small business are shy of taking this step. One of the chief obstacles in this regard is the perception among small proprietors that they are relinquishing control. However, the Task Force believes that sharing decisions, temporarily in some circumstances, is not the same thing as giving up decision-making. Risk equity investors often only assume a minority position in firms. Also, small owners must be mindful of the strategic value-added, outlined above, that they often receive in return. In other words, they may be well-advised to share control in the short-term when the trade-off is help to realize immediate opportunities and long-term potential.

It is the view of the Task Force that the Canadian entrepreneurs and enterprises that gain most from turning to equity capital are the so-called "gazelles" or those small and medium-sized firms in growth-oriented industries. It is these that are most closely identified with possible new generation of job and income opportunities in the Canadian economy. This is most apparent in some industries, such as high technology, which may deserve preferential treatment because of its irreplaceable contribution to innovation and exports, for instance. A strategic role for equity financing can ensure the fueling and fostering of their development.

III Increasing Equity Capital Use and Overcoming Barriers to Financing: Recommendations

1. Introduction

Along with its general message about the utilization of equity financing, the Task Force has considered various issues linked with access to capital for small and medium-sized Canadian firms. Most of these issues emerged out of CLMPC investigative studies, and particularly from the CLMPC/Canadian Chamber of Commerce survey (including focus groups and interviews with business and finance representatives) and CLMPC/CSTIER research into labour-sponsored funds.

The Task Force has not attempted to address all of the major aspects of financing questions. Rather, it has isolated several key themes that it has concluded — based on CLMPC studies as reinforced elsewhere in research literature in recent years — are among the most significant to removing or reducing barriers to the supply of both debt and equity capital in this country.

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In so doing, the Task Force has discussed and crafted recommendations relevant to most parts of the Canadian financial system, and reflecting what it believes it has heard from small business, financial institutions, labour representatives, and other stakeholders, alike. The following identifies issues deemed to be of utmost significance to the Task Force and which, in most cases, apply fully or partially to the delivery of both debt and equity financing. Recommendations are directed to all individual and institutional partners within national financing relationships, from both the demand and supply sides, and including government.

(a) Increasing the Use of Equity Capital

The preceding has outlined most of the substantial argumentation around the need to ensure a strong supply of equity, risk and share capital for the financing for small entrepreneurs and enterprises in Canada, and especially those that are new and developing. This, the Task Force believes, must be a top priority in meeting the twin objectives of eliminating barriers to capital availability for particular companies, sectors and regions, and establishing firmer ground for Canadian economic growth that realizes the highest productivity potential.

As a consequence, the CLMPC's Task Force on Access to Capital begins its recommendations with the following:

Recommendation 1

We recommend that Canadian private sector decision-makers and public policy-makers give increased priority to the role of equity financing in assisting new and developing small business.

(b) Encouraging Equity Financing Among Small Firms

Also as was previously stated, the Task Force believes that the lack of experience small and medium-sized owners and managers have utilizing a great variety of equity options to meet different financing requirements is due for a change. The Task Force has observed a certain reticence on the part of this sector to venturing outside the bounds of its traditional debt reliance. The Task Force believes this reservation is, to a very large extent, determined by an absence of adequate knowledge and data available to small business about its non-debt alternatives. This topic is dealt with separately below as part of a more general recommendation concerning the development of more knowledgeable Canadian financing arrangements and relationships.

The Task Force believes that the lack of experience small and medium-sized owners and managers have utilizing a great variety of equity options to meet different financing requirements is due for a change.

Another cause of small proprietor reluctance to approach equity as a supply source has also been mentioned. This has to do with the subject of control. As the Task Force has previously indicated, the Canadian "menu" of equity capital choices is a large and growing one that is currently more capable of accommodating small and medium-sized firms demands and stipulations than may be popularly understood. Heightened market use of this source will also increase sophistication and sensitivity over time.

Inviting an equity stake is often a short-term phenomenon, but sufficiently long-term to stimulate patient resourcing of economic development. As minority investors, many equity providers only share in decision-making. In other words, a high value-added financial-industrial partnership is attained that eventually yields final authority back to owners (when retained earnings, et al, can replace some or all external shareholding). This partnership cannot be underestimated as it implies numerous benefits of syndication and pooled resources. Indeed, this attribute is increasingly being acknowledged as central to all new economy strategies.

For this reason, the Task Force concludes that Canadian small business may be well advised to consider new and diverse financial instruments that highlight equity or combine debt and equity within capital structures. All major Canadian financial institutions remain relevant in this supply and its evolution in future — banks and near-banks (those that sponsor risk capital or hybrid financial instruments), venture capitalists, angels, institutional investors, securities brokers and dealers, etc.

The Task Force believes that national business organizations that have a small business constituency have a role to play in broadening popular discussion of this issue and advancing positive equity financing models. The Task Force believes such action may go some distance towards relieving several access to capital problems.

Recommendation 2

We recommend that small business, assisted by its representatives in

national organizations, give more attention to equity in financing demand needs in a new Canadian economy.

For example, business associations, on their own initiative or supported by Industry Canada, should develop information packages or seminars to encourage small businesses to actively consider equity financing.

(c) Improving Business Knowledge for Financing

It was discussed earlier that insufficient knowledge on either the demand or supply sides can impede relations and prevent positive financing outcomes. For instance, lending institutions have identified a lack of proper business and financial management skills in potential clients. This can lead to loan rejections since such skills are critical to a bank's assessment of risk and credit worthiness.

CLMPC focus group interviews with key supplier informants revealed that this problem is universally reflected in the world of finance. Lenders, venture capitalists, angels, securities dealers — in fact, all financial sources — cite the barrier created when a commercial applicant is unable to demonstrate managerial and financial expertise.

The broad concern about knowledge on the demand side is exemplified in the importance debt and equity providers accord to business plans submitted as part of financing proposals. For both lenders and investors, high quality plans are a meaningful indicator of risk and the capacity of small and medium-sized customers to utilize capital effectively. Advance preparation of a business plan is thus central to a firm's success.

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Another touchstone is the quality of management personnel in a small or medium-sized company. CLMPC supplier interviewees agreed that small business applicants must themselves demonstrate strong management skills or show that they can recruit such talent, since this will be used to evaluate risk and draw conclusions. This is particularly the case for firms with soft assets, whose management strength will be especially important in their valuation and their ability to raise capital.

Of course, ongoing access to high quality management expertise or advice, whether internal or through external mentors, is essential not just to its ability to raise capital, but to its eventual overall success.

Owners and managers of small enterprises often do not give credence to alleged deficiencies in their expertise (as discovered in CLMPC focus groups). On the other hand, many actively seek skills development. Some, for instance, enter training courses geared to enhancing business and financial management skills that are sponsored by financial institutions and others. The Ottawa-Carleton Economic Development Corporation, for instance, has a program for assisting small proprietors to access regional financing through sounder business plan preparation. This initiative provides an excellent example for other municipalities' economic development agencies to follow.

The Task Force believes that more knowledgeable financing arrangements, as they pertain to the demand side, are possible only if private sector and government facilitators develop a better system of conveying data about capital supply options and access-related programs.

This brings us to the matter of related information and its dissemination. The Task Force believes that more knowledgeable financing arrangements, as they pertain to the demand side, are possible only if private sector and government facilitators develop a better system of conveying data about capital supply options and access-related programs. Small business is not always aware of the whole financing spectrum or about the rules and criteria lenders and investors use to approve requests.

Along these lines, the Canadian Chamber of Commerce has supported the need for more informed financing decisions, in part through greater information distribution about the alternative offered in risk and share capital.

There are several models in existence, or in development, to support this objective. Several of the top six chartered banks, for instance, produce excellent resource materials on drafting business plans and locating equity alternatives to loans and credit, though such information does not always reach all those that need it. British Columbia venture capital institutions similarly interact with local business associations (e.g., the Vancouver Enterprise Forum) to communicate their high risk alternative and facilitate deal flows. The same can be found in systems that match angels with potential customers.

The Task Force concludes that the provision of knowledge, skills, and information for demand purposes must be comprehensive in its scope to have a profound impact on Canadian small business's access to capital. Consequently, this task must be increasingly taken up by industry associations, financial institutions (and their associations, such as the Canadian Bankers Association), community organizations, government, post-secondary institutions, and others (such as accountants, consultants and other professionals), independently and in partnership.

Recommendation 3

We recommend that all private and public sector participants in Canadian financing relationships act to foster the knowledge and skills needed by small business to access external sources of capital.

Such actions could include:

* ***direct assistance in the preparation of business plans;***
* ***seminars or literature on how to prepare to approach a funding source;***
* ***education programs on budget preparation.***

Recommendation 4

We recommend that financial institutions, governments, and professionals active in small business financing give increased priority to communicating to small business information about capital supply options and programs to lower barriers more widely.

Actions could include:

* ***more active promotion or distribution of literature already developed;***
* ***enhancing the knowledge of financial institution staff concerning capital supply options, so they can pass this on to clients;***
* ***seminars conducted by accountants for their clients, providing information on capital supply sources.***

(d) Improving Financial Knowledge of Industry

Of course, there is another side to achieving more knowledgeable and informed financing decisions. Small entrepreneurs and proprietors have strong concerns about the lack of expertise in financial institutions — again, of all kinds — in relation to their specific industry sector, market conditions, and possibilities and constraints that may be individual to some firms.

An obvious illustration is the difficulty some banks appear to have with non-traditional lending. Understandably, many bankers have little background in evaluating intangible or soft assets (e.g., research and development, human resources) or the innovative product ideas of some potential clients. The result may be risk averse behaviour and fewer loans being made available to new and developing firms, especially in industries that are knowledge-intensive or technology-intensive.

Small business people also observe that financial institutions, and particularly lending institutions, do not always function with full comprehension of their industrial context. Loans may not be extended, for instance, because bank officials do not appreciate the market flux involved with technology products, such as computer software, which may have short lifecycles.

The Task Force views such trends as disconcerting since it indicates some lenders and investors may not be yet fully equipped to deal with the kind of fundamental changes currently happening in the Canadian economy. Rather, all financial institutions should be pro-active in trying to respond to the specialized or “niche” requirements of leading edge industries and sectors.

The National Advisory Board on Science and Technology noted a similar inadequacy in the provision of equity to small and high technology companies. The *Report of the Committee on the Financing of Industrial Innovation* of 1991, discovered that the venture capital market in Canada was hampered by "vicious circles" whereby both demand and supply side actors operated with meagre knowledge and understanding of one another. However, Jeffrey MacIntosh concludes that, on balance, equity investors top lenders in addressing such circumstances.

There are signs that capital suppliers are starting to recognize systemic shortfalls in knowledge and experience that can cause financing barriers. CLMPC focus group interviews with representatives of these indentified strong supplier interest in augmenting skills respecting unique sectors, such as high technology. In addition, lenders are acknowledging the need to re-examine traditional risk assessment standards and techniques.

Small entrepreneurs and proprietors have strong concerns about the lack of expertise in financial institutions of all kinds in relation to their specific industry sector, market conditions, and possibilities and constraints that may be individual to some firms.

Many financial institutions are also taking corrective actions. The top six chartered banks, for instance, are developing new means and structures to facilitate specialized financing. This includes a model network of independent units established across the country to house staff expertise and resources used for evaluating applications from technology-intensive enterprises. Expert branches are also being set up by the banks in certain localities, such as Ottawa, Markham, and Kitchener-Waterloo, where high technology development is transpiring. Some of these are still in an "incubation phase."

The new Ontario Lead Investment Fund has accomplished something comparable in the venture capital market. This fund operates with a second tier of expert investment bodies responsible for assisting knowledge-intensive and technology-intensive companies. British Columbia has a similar structure — BC Focus — a multi-investor institution (that includes government), which manages not just capital flows, but technical support.

Western Economic Diversification Canada (WED), in partnership with two major banks and the Farm Credit Corporation, has established two separate loan funds, in the Biotechnology and Agriculture Value-Added sectors, aimed at assisting small firms unable to access loans from other sources. The loan funds have, respectively, $30 million and $100 million available over a five-year period, with WED providing a loan loss reserve.

Despite these promising models, there is a pressing need for more to serve innovative enterprises in growth-oriented fields. In particular, deep and stable equity pools, linked to assorted expertise through infrastructure, should be formed for specialized purposes.

Specialized, or "expert" pools may be riskier for the investor but, once in operation, can offer better strategic direction to investees because of their inherently more detailed understanding of investee firms and markets. They improve financing arrangements because they understand how to value investee companies and they are capable of initiating strategic partnerships among investee firms. Ideally, such pools should be directed towards certain sectors, such as computer-related industries, biotechnology and medical-related industries, communications, other electronics industries, genetic engineering and industrial automation.

The Task Force believes that, despite the higher risks, there are clear benefits for both demand side and supply side participants in increased knowledgeable — and, by extension, higher value-added — financing inherent in specialized strategies.

It is the belief of the Task Force that such innovative models for small deal-making should be emulated and that broad-based financial participation (including lenders) should be encouraged to ensure capital depth and diversity.

Recommendation 5

We recommend that financial institutions devote more resources to developing specialized expertise about the equity needs of knowledge-intensive and technology-intensive firms.

Actions by institutions in this regard could include:

* ***appointing senior managers responsible for ensuring that staff receive training in the needs of knowledge-intensive firms;***
* ***recruiting individuals with knowledge of the needs of high-technology firms;***
* ***accessing, as needed, specialized external advice on the needs of high-technology firms.***

(e) Increasing the Number of Small Dollar Deals

CLMPC focus group research discovered considerable concern about the propensity of venture capital institutions, and others, to invest in small dollar projects (e.g., less than $1 million). Venture capitalists have answered that it is difficult to manage such transactions due to the high fixed costs of performing the due diligence, rendering them unprofitable (generally speaking, this is also the rationale provided by lenders with regard to conducting small loans).

Recently, the venture capital market has been the scene of some change here. The creation of government-owned institutions, such as Innovations Ontario (which is mandated to invest in deals under $500,000) has led to greater attention to the low end of the financing spectrum.

In Atlantic Canada, the Atlantic Canada Opportunities Agency (ACOA) is about to launch a $30 million venture capital fund with a focus on small dollar projects. The fund, which will be private sector operated, will be aimed directly at financing deals in the $150,000 - $1 million range in the four Atlantic Provinces. Funding will be provided by ACOA, the four Atlantic Provinces, and seven chartered banks.

The British Columbia Government has set up Seed Management, Inc., under the BC Focus program, which is designed to invest smaller amounts of money in early stage companies. The management of the $10 million fund has been contracted out to three private sector partners with extensive experience in investing in startup companies. Seed will invest between $50,000 and $500,000 in a new venture.

Several Stock Exchanges also list underwriters who do small financing deals.

Another important contributor to this effort has been labour-sponsored funds. The *Fonds de solidarité des travailleurs du Québec (FTQ)*, for instance, has established a network of specialized, regional and local funds across Quebec. These are small, independent equity pools with mandates for assisting certain sectoral or regional development. These pools operate with investment minimums beginning at anywhere between $5,000 to $50,000. Recently, the national Working Ventures Canadian Fund also implemented its own small dollar investment program, beginning with the Ottawa-based MOTIVE fund.

The equity pools of these two labour-sponsored funds also intend to combine financial and industrial expertise. Moreover, they involve co-investment with other debt and equity capital suppliers (depending on the pool under discussion).

It is the belief of the Task Force that such innovative models for small deal-making should be emulated and that broad-based financial participation (including lenders) should be encouraged to ensure capital depth and diversity. Where necessary, government should also be partner to these measures.

Recommendation 6

We recommend that venture capitalists, other financial institutions, and government work in partnership to develop new mechanisms for directing capital to small dollar projects.

Such a partnership might begin through collaboration between the Business Development Bank of Canada, venture capital firms, and financial institutions to organize a conference on ways to support small dollar projects.

Another method for generating more small dollar projects is to encourage, where appropriate, small business consideration of the angels market. Angels — wealthy individual operatives, families and networks of individuals frequently with strong backgrounds in both industry and finance — have traditionally been one of the few external sources of small investments for struggling new and expanding enterprises. These informal venture capitalists are important potential commercial mentors in the quest for more knowledgeable financing.

Because of the relatively hidden and unorganized nature of much of the angels market, it has been difficult to connect small and medium-sized firms with this unique brand of risk capital. Imperfect information about the latter represents an effective barrier to access.

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To remedy this situation, several programs have been launched geared to information dissemination and matchmaking, including those sponsored by the Canadian Opportunities Investment Network (COIN), the Business Development Bank of Canada

(BDBC), provinces such as British Columbia and Alberta, and some municipal partnership measures.

Past and current efforts, such as COIN, have not been as effective as intended, partly because of the modest numbers of demand and supply side participants and the fact that informal venture capital typically functions on a local and personal level. Because the participation of individual investors in financing activities may often be irregular, maintaining an up-to-date network faces further difficulties. The Task Force nevertheless concludes that more must be done. This may include greater utilization of electronic systems for matching potential investors and investees, an increased role for lending institutions as a clearing house of data, and a similar occupation for legal and accounting professions.

Recommendation 7

We recommend that business, finance and government collaborate on new efforts to promote information-sharing and networking between "angels" (wealthy individuals or families who will make direct investments) and small entrepreneurs.

Actions in this regard may include:

* ***a new attempt at a centralized matchmaking service;***
* ***greater use of electronic communications systems such as the Internet;***
* ***an increased role for lending institutions as clearinghouses of information;***
* ***a greater information role for professionals in this field, such as accountants or lawyers.***

It seems clear that, in the foreseeable future, most small and medium-sized companies will continue to perceive the banks and other lending institutions as the primary source of external capital, regardless of long-standing complaints and alleged barriers. The Task Force has already proposed an alternative to this circumstance in utilization of a more diverse mix of financial instruments that includes equity stakes.

Another option is for traditional debt lenders to revise some conventional commercial lending to combine with certain equity features. This is consistent with a call from some observers for lending institutions to consider devoting a larger, fixed percentage of their aggregate capital to equity financing of some variety.

This approach was taken by the BDBC in its creation of a "venture loan" instrument which is seen as a good way of addressing the soft asset financing requirements of small business with a specific knowledge or technology intensity. The BC Trade Development Corporation's Export Development Fund provides equity, loans, and venture loans to companies that are export ready.

Bridging the gap between debt and equity financing to arrive at instruments with a quasi-debt, quasi-equity character has been in practice among private mezzanine lenders, venture capital institutions and merchant bankers for some time. It is usual for such "loans" to have high interest rates along with an "equity kicker." Illustrations of debt accompanied by an equity kicker include a bond with warrant attached, and convertible debt that depends less on collateral and personal guarantees to secure investments.

In the interest of increased provision of risk capital in Canada, the Task Force believes this form of financial innovation should be encouraged and expanded. Existing models, such as that of the BDBC venture loan, will prove instructive. Incidence of more hybrid debt-equity instruments may be especially helpful to new and developing high technology industries. The Task Force further believes that such innovation must actively include top lending institutions to ensure widespread success.

Another option is for traditional debt lenders to revise some conventional commercial lending to combine with certain equity features.

Recommendation 8

We recommend that traditional debt lenders develop and implement hybrid debt-equity instruments for small business financing using existing private sector and government models for reference.

(f) Dealing with Security and Credit Limits

Generally speaking, the Task Force discovered that Canadian small business has persisting concerns about the extent to which lending institutions understand them and are attempting to accommodate them through policy reform. On this question, there appears to remain very different outlooks between borrowers and lenders about the nature and significance of issues and where to find the appropriate remedies. In part, the problem is a lack of awareness about some of the initiatives that have already been undertaken.

One of the most common financing difficulties reported by small business respondents to the CLMPC/CCC survey was the perceived high collateral requirements of banks and near-banks. These requirements, said firm owners and managers, frequently imposed harsh terms and conditions on loans and, more generally, limited access.

The issue of lender security requirements is an old one. It has been estimated that, on average, a company must pledge almost three dollars in collateral for every one dollar borrowed, often in the form of personal assets. Some studies have demonstrated that this ratio is even higher for micro-enterprises and diminishes as an entity ages and grows in size. Lending institutions counter that security is a crucial secondary source of repayment in case of default. Naturally, they say, specifications for guarantees may be weightier where the firm is very small, start-up, or otherwise high risk.

Researchers have found that some borrowers encounter a cumulation of restrictive practices in a single financial transaction. Studies have shown that those paying the highest interest rates also provide the highest collateral coverage ratios. Small proprietors argue such heavy restrictions are not always clearly indicative of high risk. Micro-firms, for instance, face compounded restrictions despite credit records which may in fact be superior.

Numerous CLMPC focus group interviewees said that debt supplier criteria often undervalued assets for security purposes. As was previously discussed, this is certainly true in relation to soft assets and intangibles in all enterprises, particularly those that are knowledge-intensive and technology-intensive.

The Task Force acknowledges that some difference in opinion between lenders and borrowers on the question of security and credit limits is probably inevitable. However, it remains an important concern and the Task Force is encouraged that some banks and near-banks are taking positive steps on this front.

The Task Force acknowledges that some difference in opinion between lenders and borrowers on this question is probably inevitable. However, it remains an important concern and the Task Force is encouraged that some banks and near-banks are taking positive steps on this front. Such efforts should be continued and expanded.

Recommendation 9

We recommend that financial institutions develop more sophisticated techniques for risk assessment, especially for soft asset lending, that can lead to revised security criteria.

Given the preponderant use of collateralized debt by small business, and its preponderant application to working capital, the Task Force believes attention to this area may produce exponential effects.

The Task Forces points to the federal Small Business Loans Act (SBLA) as one possible source of solutions here. The goal of this program is to assist small and medium-sized companies in obtaining loans and credit for fixed assets that might otherwise be inaccessible because they lack the required collateral. To achieve this, the SBLA guarantees up to 90 percent of a loan and restricts personal guarantees to a maximum of 25 percent. These beneficial characteristics of the SBLA could be significantly broadened by coverage of other types of financing needs, such as working capital and expenditure on research and development.

Recommendation 10

We recommend that the Small Business Loans Act be reviewed to assess the feasibility of expanding the range of capital needs beyond the purchase of fixed assets to include financing needs such as working capital and research and development.

(g) Redressing Regional Imbalances in Equity Financing

The Task Force recognizes that historical disparities exist between Canadian provinces, regions and communities with respect to the supply and delivery of debt and equity capital. These disparities are, in effect, barriers for those small and medium-sized firms in economically disadvantaged regions or communities that are rural and remote. In parts of Atlantic, western and northern Canada, structural difficulties associated with engendering local demand and supply conditions are not easy to rectify.

There may be fewer problems in the regional allocation of loans and credit (though local small businesspersons will frequently feel that debt barriers are steeper for them), due to national banking and the existence of community-oriented institutions, such as credit unions and *caisse populaires*. Ensuring regional access to public and private equity capital, on the other hand, poses very distinct challenges.

The Task Force concludes that Quebec has provided several very timely models for improving capital availability in specific localities.

For instance, both institutional and angel venture capitalists have traditionally been highly centralized because of the propensity of both to invest close to home. In recent years, only two in ten venture capital institutions were located outside of central Canada. Capital supply and investment has frequently eluded the Prairies, the northern territories and Atlantic Canada, as well as individual communities within provinces. This situation is offset somewhat by the establishment of government-owned institutions, and other forms of public tax and direct spending, and labour-sponsored funds (see below).

One of the findings of CLMPC research and other recent studies is that access to capital in Quebec appears to be somewhat more adequate than elsewhere. The Task Force suggests that a possible explanation for this is Quebec's long-term development of a diverse and integrated network of financial means and structures, many of which are also quite innovative.

Large, non-conventional private and public sector participants, such as the *Confédération des caisses populaires Desjardins*, the *Caisse de dépôts et de placements*, the Quebec Stock Savings Plan, the *Fonds de solidarité*, Innovatech, and others have perhaps given the province creative and closer institutional arrangements supportive of knowledgeable and patient investment and financing that is well distributed.

In co-operation with other Quebec-based financial institutions, the *Fonds de solidarité* has, as was mentioned earlier, set up small, independent equity pools for the purposes of regional and community economic development. There are currently over twenty-five local and regional funds valued at approximately $155 million, with many more to be situated in all Quebec urban and rural communities, in the years ahead.

The Task Force concludes that Quebec has provided several very timely models for improving capital availability in specific localities. Some of these are already being emulated in other provinces. The Task Force believes this should continue.

Recommendation 11

We recommend that the Quebec financial model be assessed by business, labour and government to identify approaches which may be transferable to other Canadian provinces and regions.

As a specific example, Industry Canada might establish a review, with other business, labour and government participants, of aspects of the Quebec model including:

* ***the Caisse de dépôts et de placements;***
* ***the Quebec Stock Savings Plan; and***
* ***specialized and localized equity pools formed by co-investors.***

In the realm of public equity financing, some discussion has also occurred about availability in regions. Unlike the United States, Canada has had very little development of its network of regional securities dealers and brokers. This situation may dampen access to capital as the American experience is that regional dealers tend to give emphasis to smaller and riskier firms, including small initial public offerings.

If anything, says Jeffrey MacIntosh, Canada's network of regional dealers has probably been squeezed by larger national entities in recent years along with much of their positive brokering activity (there may be a similar dearth of "boutique" dealers specializing in market niches). One of the reasons given for this trend is the cost of operating at the local level in our large, but comparatively less populated, country.

Another impediment to regional dealers in public equity may be some technicalities of securities regulation that appear to misunderstand the nature and cost of their functioning. The Task Force believes a Canadian regional dealer/broker network must be allowed to grow and evolve naturally — if that is to happen, since the real dilemma here may be the small size of the country — and that provincial securities commissions must ensure standards do not act as an unnecessary disincentive.

Recommendation 12

We recommend that securities regulators act to ensure that standards are not unnecessarily obstructing regional dealers and brokers.

(h) Enhancing Risk Capital's Tax Environment

Government's system of taxation (of both individuals and business) has a significant impact on the supply of equity capital ear-marked for high risk activity. In particular, the treatment of capital gains income has great influence. In 1994, the federal government abolished the $100,000 capital gains exemption for individuals, leading to a charge made by some market experts, such as venture capitalist Denzil Doyle, that the risk capital stock was unduly and negatively affected.

Because failure may be just as possible as success in the venture capital market, institutional and angel investors aim for superior returns that are equal to their assumed risk and costs. Earnings do not normally come in the form of dividends or interest, but through strong, long-term equity appreciation and capital gains once shares are disposed.

Denzil Doyle, the Canadian Chamber of Commerce, and others have argued that recent federal legislative changes have made the capital gains tax rate higher than the dividend tax rate. This, in turn, may be precipitating investors to place their money in established, dividend-paying enterprises, rather than new and developing enterprises which are critical to positive economic change in Canada. Many business observers argue that such changes have negative effects on

Canada's overall investment climate, relative to others.

The increase in capital gains taxation may have had its biggest impact on angel investors and their ability to conduct expensive small dollar transactions.

In its 1994 report, *Aim for a Million*, the Canadian Chamber of Commerce proposed that government explore the feasibility of a new tax incentive for equity financing. This, it was thought, would spur capital pools to assume more long-term equity stakes in small and medium-sized companies. A preference in this case would involve a maximum at-arm's-length investment in enterprises and a 30 percent refundable tax credit. The Chamber also proposed that share purchasing in these pools be eligible for tax support.

The Task Force notes that the precise effect of specific tax expenditure programs facilitating high risk equity provision have not been properly studied.

The Task Force is very concerned about maintaining and building Canadian stocks of patient risk capital. It also acknowledges the crucial role of the tax system in this objective. For instance, the introduction of tax-assisted labour-sponsored funds has certainly added substantially to supply of the institutional venture capital market, however, this is only one source.

This said, the Task Force notes that the precise effect of specific tax expenditure programs facilitating high risk equity provision have not been properly studied. As a consequence, the Task Force believes that the federal government should test various incentives, both past, current and prospective, to determine how they might improve supply conditions in those corners of private equity financing that require it most. In so doing, government officials should conduct a comprehensive examination of 1994 tax changes as they were felt by capital markets in which angels are active.

The Task Force further concludes that this federal initiative is most relevant to Canadian regions and communities where equity capital markets are weaker, and hence, may have the most to gain from direct and indirect government incentives.

Recommendation 13

We recommend that the federal government review, evaluate and compare all government programs and initiatives which affect risk equity supply in terms of their impact on capital supply.

These would include, but would not be restricted to, tax incentives, grants, loan guarantees, interest-free loans, etc.

(i) Reducing Regulation-induced Obstacles

Rules and regulations governing securities in Canada are appropriately aimed at protecting members of the general public. Such standards, monitored and enforced by provincial securities commissions, also contribute to the efficient functioning of capital markets, including high risk equity markets. From the perspective of many in small business and finance, however, securities regulations sometimes go too far in the direction of investor protection.

This, in turn, may unnecessarily undermine capital supply.

The Canadian Chamber of Commerce has raised this issue in the past, focusing on the impact that stringent regulatory standards appear to have on angel financing and private placements. For instance, information disclosure requirements may impede sophisticated investors in these markets from pooling their resources for the benefit of seedings, start-ups, and early development projects.

In addition, the extent of disclosure specifications may be inhibiting initial public offerings for small and medium-sized enterprises ready for this step. Some overly complex stipulations result in high legal and accounting costs for small firms, and, very importantly, tie up the time of management personnel attempting to comply with them. This diversion of management attention from the business itself may impact on the health of the business. Moreover, restrictions on initial public offerings may obstruct preliminary access to risk capital as institutional and angel venture capitalists need to know they have this as a long-term exit mechanism.

The Task Force does not endorse the removal or radical overhaul of important prudential restrictions on investment. However, with the above two illustrations in mind, it does suggest, as many economists have, that regulatory standards must be rendered more cost conscious so as not to negatively affect the availability of public and private equity financing.

In general, when it comes to very small public issues and transactions, the weight of requirements should also, where prudent, diminish. Jeffrey MacIntosh, for instance, has proposed a complete exemption from prospectus requirements for public offerings under $2 million (as is the case in the United States). Other observers have suggested that application fees associated with IPOs be tied to the size of the offering.

The Task Force also notes that problems imposed by regulation on small business financing may have as much to do with monitoring and enforcement procedures. The Task Force sees merit in the idea of having market participants invited to assist in the process where consumer protection is of less concern.

Recommendation 14

We recommend that provincial securities commissions review and amend regulations for cost sensitivity to small business financing and initial public offerings.

Specific regulations which might be reviewed include those relating to information disclosure and prospectus requirements, and related application fees.

A related matter is the alleged "balkanization" of securities regulations in Canada.

> ***The Task Force does not endorse the removal or radical overhaul of important prudential restrictions on investment. However, it does suggest, as many economists have, that regulatory standards must be rendered more cost conscious so as not to negatively affect the availability of public and private equity financing.***

> ***The Task Force believes simplification and harmonization should also be a renewed goal of federal and provincial government regimes that share the regulation and supervision of financial institutions, markets, and products.***

As one of the very few industrialized countries in the world without a national securities commission or set of investment standards, Canada reflects a "patchwork" of diverse provincial rules and regulations established and enforced by officials in different provincial jurisdictions. This, it has been argued by members of the financial system, results in costs and inefficiencies in the operation of capital markets and institutions.

By extension, this circumstance leads to high and potentially prohibitive costs for small and medium-sized companies. For instance, firms making public offerings in a number of provinces are forced to meet the distinct strictures of each.

The 1992 report of the federal Steering Group on Prosperity stressed the importance of easier, more flexible access to domestic and international pools of debt and equity capital. Indeed, they recommended that all securities laws, registration procedures, and reporting requirements, be harmonized to facilitate interprovincial cross-border access, broaden the sources of capital supply, reduce administrative expenses, and permit further diversification of risk profiles, among other things.

The Task Force believes that provincial authorities should co-operate in an overall review, in consultation with the federal government. The goal of this effort should be increased simplification and harmonization of regulations to eliminate duplication and overlap between jurisdictions and lower compliance costs. Indeed, the Task Force believes simplification and harmonization should also be a renewed goal of federal and provincial government regimes that share the regulation and supervision of financial institutions, markets, and products.

Recommendation 15

We recommend that the Canadian Securities Administrators review Canada's system of securities regulation and enforcement to encourage simplification and harmonization.

(j) Assessing Labour-sponsored Funds

Of central interest to the Task Force was looking at the current role and performance of labour-sponsored investment funds in Canadian capital markets. Indeed, up until the research project commissioned by the Task Force, a true and complete picture of this new and increasingly influential financial institution did not exist, at least outside of Quebec.

Labour-sponsored investment funds have unique characteristics. On the one hand, such funds operate as venture capital institutions with a tax-subsidized mandate to finance, on a long-term basis, a diverse array of transactions involving small business. On the other hand, many — though not all — funds bring a particular value-added to the investment process through an emphasis on employment outcomes, social and environmental responsibility, worker participation, training, etc. Research suggests that these complementary goals can be productivity-enhancing.

Despite certain common qualities evident in legislation everywhere, it is clear that the specific mandates of labour-sponsored funds can differ substantially. The *Fonds de solidarité*, for example, acts as a general engine of Quebec economic development, while Working Opportunity acts more as a financial agent of economic and job diversification in British Columbia. Each of these are valid approaches that need to be better understood by all parties.

It is therefore imperative that all funds reflect the priorities set out for them in their private mandates and federal/provincial statutes. The Task Force believes that all funds should be held to observe certain benchmark criteria in investment matters and related programs.

Recommendation 16

We recommend that government reviews of labour-sponsored funds take into account the specific objectives of individual funds and gather evidence as to whether these are being met.

In engaging in performance reviews and evaluations, governments should recognize some differentiation in priorities and emphasis that will continue to exist between funds. Moreover, the federal government should heed additional objectives initiated by their provincial counterparts in co-operation with labour. At this point, any changes to statutory frameworks should be co-ordinated between both levels of government.

It is therefore imperative that all funds reflect the priorities set out for them in their private mandates and federal/provincial statutes. The Task Force believes that all funds should be held to observe certain benchmark criteria in investment matters and related programs.

To assist legislators in their review exercises, the Task Force notes that the funds should not be assessed strictly in traditional ways, and suggests the development of general assessment criteria. In addition to basic concerns regarding return on investment and accountability to investors, these could include job creation and protection; a full role for unions and workers in directing investment decisions; a commitment to increased participation in investment by working people; promotion of business-labour co-operation; assistance to small and medium-sized firms; support for regional/community economic development; encouragement of high performance workplaces; effective support of national venture financing; and delivery of economic and financial training.

Recommendation 17

We recommend that control and direction by a legitimate labour body, which is stipulated in the legislation governing the funds, be recognized as a requirement for ongoing tax support of labour-sponsored funds.

Recommendation 18

We recommend that general national criteria be established regarding labour-sponsored funds, in addition to basic concerns regarding return on investment and accountability to investors. These could include:

- ***job creation and protection;***
- ***a full role for unions and workers in***

directing investment decisions;

* ***a commitment to increased participation in investment by working people;***
* ***promotion of business-labour co-operation;***
* ***assistance to small and medium-sized firms;***
* ***support for regional/community economic development;***
* ***encouragement of high performance workplaces;***
* ***effective support of national venture financing;***
* ***delivery of economic and financial training.***

CLMPC research indicates that labour-sponsored funds active in 1994-95 contributed positively to the national venture capital market and are pursuing many of the goals outlined above. For instance, the funds have added enormously to the national stock of equity capital. They have also facilitated non-traditional investment (i.e., household savings) as the chief new source of venture capital. The *Fonds de solidarité* has established a clear employment record.

One area where the funds have had a distinctly positive impact is in investing in Canadian regions and communities. The creation of new equity pools and investment activity by labour-sponsored funds in British Columbia, the Prairies, and the Maritimes, are important milestones. As well, models of specialized financing of the *Fonds de solidarité* and Working Ventures, suggest new possibilities in ensuring capital availability tied to regional and community economic development.

Recommendation 19

We recommend that labour-sponsored funds be recognized as a tool for advancing localized venture financing, where this is appropriate.

(k) Strengthening the Resources of Small Firms

Small and medium-sized enterprises often confront a market disadvantage linked to size. Historically, potential large contractors, including government, have been known to select a larger competitor despite whatever obvious merits the smaller entity may possess. There are other problems associated with a firm's size, such as limits to staff numbers, skill bases, and other operational resources that can affect flexibility in production and commercialization.

One method for overcoming size-based obstacles, is for small businesspersons to establish formal networks whereby resources may be effectively pooled and shared and similar competitive goals pursued. Unlike joint ventures, companies function independently within networks, launching co-ordinated bids and complementing one another with respect to skill requirements, et al. Such networks have enjoyed considerable success in such countries as Denmark.

The collective benefits of small business networks can also give participants greater access to capital.

The Canadian Business Networks Coalition is a group of industry associations seeking to assist small entrepreneurs and enterprises through the promotion of networks. With federal government aid, the Coalition is managing a demonstration project. The Task Force strongly supports this initiative as a way of advancing the use of this model across the country in future. In particular, the Task Force believes high technology firms can benefit from this approach.

One method for overcoming size-based obstacles, is for small businesspersons to establish formal networks whereby resources may be effectively pooled and shared and similar competitive goals pursued.

Recommendation 20

We recommend that business, finance and government support new and continuing initiatives to promote the use of small business networks in Canada.

Specifically, Industry Canada should work with business associations to expand the number and scope of these networks.

(l) Addressing Other Important Debt-specific Matters

CLMPC/CCC survey and focus group activity uncovered other concerns related to the allocation of loans and credit to Canadian small and medium-sized firms. For instance, another barrier to knowledgeable financing, it was found, is the on-going problem of frequently rotating or changing lending institution personnel. This situation, small borrowers insist, undermines long-term financing relationships built on a high level of knowledge, experience, understanding and trust.

Banks and other financial institutions are apparently aware of difficulties that can be precipitated by high and constant staff turnover, especially at the local level. From their perspective, the challenge is to advance reward structures within institutions that encourage officials, and mainly account managers, to stay longer in one place.

While the Task Force concludes that continuity in lending institution managers and employees has probably improved somewhat in recent years (based on the actions of some banks, credit unions, etc.), members also believe there is still room for improvement. Should such occur, the Task Force believes that banks and near-banks must be more assiduous about publicizing them.

Recommendation 21

We recommend that lending institutions continue to develop means for preventing high staff turnover where it affects quality working relationships with small proprietors.

For example, independent surveys of customer satisfaction levels could be a useful tool for lending institutions in monitoring the effects of changing staff turnover levels on relationships with clients.

Another issue relevant to small borrowers is perceived arbitrary changes to lines of credit. Several CLMPC focus group respondents on the demand side spoke of banks that had abruptly pulled or reduced lines of credit, creating serious circumstances for them since this mechanism is integral to managing operating expenses and cash flow.

In key informant interviews, lending institutions denied that line of credit changes would be undertaken without good cause. When this happens — and bank representatives believe it does happen only periodically — it is due to a severe drop in creditworthiness, perhaps because the borrower has violated the terms and conditions of an agreement.

Still another issue pertains to the views of commercial customers regarding paperwork burdens imposed by banks and near-banks, such as complex loan applications and excessively detailed monthly statements. Above all, it is costly to small and medium-sized enterprises. Of course, the outlook on the supply side is that paperwork compliance is necessary to ascertaining the long-term financial viability of potential and current clients.

It could be that there are more cost-effective methods for determining financial health in loan applicants and monitoring loan portfolio projects. With new technologies, an increasing amount of reporting can now be done swiftly and efficiently with electronic support. Lenders may well welcome any suggestions small borrowers have along these lines.

It is the belief of the Task Force that matters like changes in the disposition of credit, paperwork burdens, and other policy questions, can be dealt with, to some extent, through the effective application of the codes of conduct and alternative dispute resolution models which have been developed within the lending institution sector. Some banks have also appointed a small business ombudsman to address complaints that cannot be resolved through regular channels, and the Canadian Bankers' Association has announced plans to set up an industry-wide ombudsman in April, 1996.

Lending institutions should take the opportunity to broadly articulate such codes and related initiatives, to clarify the rules and criteria employed in handling the concerns of small borrowers, as well as the rationale behind these. In time, codes may be accompanied by benchmark standards for the allocation of loans and credit to small and medium-sized companies, as proposed by the federal Minister of Finance (February, 1995). Institutions may also wish to consider whether the effectiveness of ombudsmen would be increased if they were directed independently from the institutions themselves.

It is the belief of the Task Force that matters like changes in the disposition of credit, paperwork burdens, and other policy questions, can be dealt with, to some extent, through the effective application of the codes of conduct and alternative dispute resolution models which have been developed within the lending institution sector.

Recommendation 22

We recommend that lending institutions:

* ***better communicate policies and practices to their small business customers through newly developed codes of conduct and complaint handling initiatives, and***
* ***increase the effectiveness of small business ombudsmen by ensuring that they***

are directed independent of the institutions themselves.

(m) Improving Financing for Women Entrepreneurs

Members of social groups that own or operate firms have been known to encounter unique barriers to capital availability. For instance, despite the growing stature of women in the new Canadian economy (e.g., in self-employed enterprises), there remain indications of their marginalization in the financing process. Indeed, women in small business themselves often point to gender bias in the institutional allocation of capital.

The CLMPC/CCC survey did not isolate this bias, although other surveys have presented evidence of such bias. Some CLMPC small business focus group participants reported instances where they perceived such bias.

Focus group interviewees from the supply side were very troubled with charges that they may treat women applicants for financing differently than men. Bankers argued that the nature of entities women are running or joining, such as micro-firms or companies located in retail and service industries, probably offers a better explanation of why they are viewed as being above average risks. This suggests that turn-down rates for women may have more of a commercial, and less a gender, basis.

However, to deal with perceptions of discrimination, initiatives have been undertaken, such as the Canadian Bankers Association's code of conduct and dispute resolution mechanism, and individual banks' approaches based on these models, whereby complaints can be lodged and given a thorough response. On this issue, such efforts are intended to close the gap in outlooks between lenders and women borrowers.

Despite a research focus on the top banks, the Task Force points out that all institutional sources of capital — lenders, venture capitalists, and other providers of equity capital — have a responsibility in this area. All financial institutions must be conscious to review policies and practices, especially those related to processing applicants, to ensure gender bias is not a factor.

Also, again in support of more knowledgeable financing, the Task Force believes that female entrepreneurs and proprietors must be guaranteed equal access to the same business and financing education and training as their male counterparts. The Task Force sees the mentoring programs being set up in both the private and public sectors as an excellent model to this end. The BDBC "Step Up" program, for instance, permits comprehensive training for women aiming to expand their firms through the use of mentors. Such measures must be encouraged, not only for reasons of fairness, but to stimulate the strategic role being assumed by women in an era of economic change.

Recommendation 23

We recommend that all financial institutions continue to be vigilant regarding their policies and practices to ensure the equal treatment of women in small business.

Recommendation 24

We recommend that business, finance, labour and government lend support to

financing value-added programs for women, such as mentoring programs.

2. Conclusion

The essential conclusion of this report of the CLMPC's Task Force on Access to Capital is that although equity capital is not widely utilized by small and medium-sized enterprises, at present, the strategic advantages it offers to new and developing small owners and operators is such that it should see greater use. Indeed, the Task Force believes that Canadian small business encountering financing barriers should avail itself of a much broader range and combination of financial instruments that includes equity — again, for strategic reasons.

By guaranteeing increased capital supply through new means and structures, developed and supported in both the private sector and government, a crucial step will have been taken in moving Canada towards a new economy.

Increased use of equity capital sources, combined with the Task Force's recommendations concerning both debt and equity matters, would, it believes, result in a situation of improved terms and conditions for financing small entrepreneurs and enterprises overall. It would lead to more patient, more knowledgeable, and more informed financing arrangements and relationships, which, in turn, would lead to more productive and high value-added investment.

In this report, the Task Force has given considerable emphasis to financing relationships and the need to involve all Canadian stakeholders, and especially business, finance, labour and government, in decision-making. This would ensure some drawing on expertise from all sources, as well as ensuring that investment and financing trends are always responding to the on-going requirements of the national economy and society. Improved communications and partnerships between small business and financial institutions, combined with the influence of other productive actors, will help to eliminate access to capital roadblocks.

By guaranteeing increased capital supply through new means and structures, developed and supported in both the private sector and government, a crucial step will have been taken in moving Canada towards a new economy. As was stated earlier, the Task Force believes that future job and income opportunities depend on it. It is hoped that this report has made a positive contribution to this final outcome.

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