SMALL BUSINESS FINANCE: AN ANALYSIS OF CAPITAL AVAILABILITY IN THE YUKON TERRITORY MAY 1996

by

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ABSTRACT

This paper provides an overview of the capital market in Canada and available capital financing options for small and medium sized businesses. This analysis also looks at emerging trends and shifts such as the decreasing role of the federal government in direct financing in favor of indirect support to small business.

The paper goes on to review the capital supply in the Yukon noting emerging trends in small business finance.

From this review the paper compares Canadian and Yukon supply and demand for capital noting key differences and gaps which exist and possible causal factors..

This is followed by analysis of implications and recommendations for government policy review.

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SMALL BUSINESS FINANCE
AN ANALYSIS OF CAPITAL AVAILABILITY
IN THE YUKON
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BACKGROUND

In 1986, the Government of Yukon Commissioned a study on Access to Capital *(IMC, Ordish, 1986)* which identified a number of problems faced by Yukon businesses of which limited access to capital was a significant barrier to business growth and stabilization, particularly rural businesses. The limited access to financing was both in actual success in obtaining financing, and for rural businesses, problems of physical access to financial institutions concentrated in Whitehorse. Other factors contributing to the inability of Yukon businesses to access capital were limited markets, seasonal operations, lack of experienced entrepreneurs, and limited equity to invest into business ventures *(IMC, Ordish, 1986 p4.2)*.

In 1987 further studies on access to capital *(Heartwell, 1987, p 8)* found that while there was ample supply of capital financing available in the Yukon, there were significant systemic barriers to new businesses, rural businesses, and aboriginal businesses obtaining conventional financing. Believed due to limited competition amongst banks, Heartwell recommended a government owned and operated bank similar to Alberta's Treasury Branches.

The findings of these studies were incorporated into the Yukon government's "Yukon 2000 Strategy" which led to the creation of the Business Loans Assistance Program (BLAP) 1988 to 1990; the Business Development Fund (BDF) 1990 to 1996; and the Canada Yukon Economic Development Agreement (EDA) 1986 to 1991, and renewed 1991 to 1996.

During a ten year period between 1988 and 1996, the government provided $15 million in direct financial assistance to Yukon businesses through the BLAP and BDF programs, and in the last five years a further $21 million in funding through the Economic Development Agreement EDA. These programs included direct loans, guarantees, and contributions (grants) with an estimated leverage of 1.56 in other financing raised for every government dollar spent *(McDavid & Associates, 1995 p.56-58, & 77)*.

The current EDA expired in March of 1996, and the governments of Canada and Yukon have not negotiated for any future economic development programming. Similarly the Yukon Government's Business Development Fund (BDF), which offered low interest loans, grants, and guarantees for the past six years, was terminated in March of 1996 due to the prevailing view that government should have no role to play in providing financing to businesses when the banks and other financial institutions were providing similar competitive services *(Department of Economic Development Three Year Business Plan, Dec. 1995, p.9).* While the Yukon Government has been anxious to get out of providing financial assistance programs to small business, it recognizes some continued responsibilities in this area and has directed the Department of Economic Development to work cooperatively with financial institutions to ensure the provision of capital financing to Yukon businesses who need help. The department is currently developing a loan guarantee program to be offered through local financial institutions which will encourage banks to provide additional financing at higher levels of risk to small businesses in the Yukon.

In general the present mood of both the federal and territorial governments does not support continued direct government intervention into business financing markets, preferring instead to have the market supply key goods and services *(John Manley, Minister of Industry, 1995 Western Economic Diversification Program speech; Yukon Government, Department of Economic Development Business Plan 1995/1997).*

Recent trends in federal programming have been to reduce and concentrate financial programs offered to small and medium sized businesses through Business Development Bank of Canada (former FBDB); enhancing the Small Business Loan Act SBLA; providing key information services through Industry Canada's "Strategis" internet accessible data-base; and community based business service centres *(Small Business, A Progress Report, 1995 p. 2-11).* Through persuasion and invitations to appear before the House of Commons Standing Committee on Industry, government hopes to push the chartered banks toward assuming more responsibility for providing financing to the small business sector *(Ibid., p. 6).*

The Yukon Government believed that government financial programs were duplicating financing options currently available through the private sector, and further that government delivery was not as efficient in providing financial services as the private sector. A key concern for government was both the perceived and potential market disruption associated with "easy" government loans in small and sensitive rural markets. Government however recognizes that there still exist some barriers to financing and has started development of a loan guarantee program to assist existing small businesses and new business start-ups access capital financing through local financial institutions.

The Yukon Territory, like many jurisdictions in Canada, faces unique conditions in which some market failures exist or are perceived to exist. As well, both the supply and demand for capital are not static. The sources of supply of small business financial products and services have responded variously to increased competition, public criticism, and the positive effects of government programs like the enhanced Small Business Loans Act (SBLA). Increased demand, and more significantly, changing perceptions and conditions of risk and return have encouraged banks to begin venturing into new and creative lending situations *(No Assets, No Problem, Canadian Business, Vol. 68(3) March 1995, p. 62-68)*

In turn government programs have also been reevaluated to determine whether they are still meeting their objectives and the needs of the business community, and many have been eliminated, as governments try to operate within increasing financial constraints.

The problems facing policy analysts and program managers are determining whether the market is meeting all of the needs of small business, and whether government should intervene, and if so how, where, and when.

The federal government has undertaken extensive parliamentary hearings and consultations with stakeholders, and has taken steps to identify national capital market conditions, identify gaps, and adjust federal programs accordingly *(Growing Small Businesses, Manley, Martin, February 1994, p.49).*

In order to develop sound policies with respect to regional financial markets, the Yukon Government requires up to date information on the existing and emerging structure of capital markets in both Canada, and the Yukon. Where market failures or gaps exist, government needs to identify the possible causes, and whether these gaps can be corrected through government policy.

Through preliminary consultations between government and stakeholders, key financial institutions and business associations supported the idea of less direct government support in financial markets *(Business Plan, 1995, p. 9).* Other sources, including some of these same stakeholders however believe that small business owners and new business operators continue to experience barriers to accessing conventional capital, adding significantly to risk of business failure *(Yukon Chamber of Commerce "Fax Poll", 1995).* While there were strong calls for less government intervention, there were equally strong concerns about a complete withdrawal.

The Yukon Government's Executive Council (cabinet) favors some form of loan guarantees to help supply venture capital through existing financial institutions. After reviewing similar programs being offered in Nova Scotia, and Manitoba, the Department of Economic Development drafted a loan guarantee program to support small business loans which will be administered through the seven existing commercial lending organizations currently operating in the Yukon *(appendix one lists current financial institutions operating in the Yukon).*

Under the new guarantee program, the financial institutions will be responsible for all aspects of loan administration, while government will agree to underwrite a portion of the risk thereby encouraging the banks to accept higher credit risks than under normal lending circumstances. This new program initiative is designed to create a "risk sharing" between the borrower, lender and government.

Parallel to this program being developed, the department needs to conduct more detailed research on capital financing markets in Canada and the Yukon to identify other policy and program options should the need arise.

This paper will summarize the Canadian capital market for small business finance, and recent changes in the structure of capital markets. The paper will also review the Yukon's supply of small business capital. The analysis will include an identification and analysis of financing gaps and recommendations to government on appropriate actions to consider.

INTRODUCTION

THE IMPORTANCE OF SMALL AND MEDIUM SIZED BUSINESS TO THE ECONOMY

This introduction will look briefly at the importance of SMEs to growth in the economy, and job creation, for both Canada and the Yukon. This section also looks at the importance of capital to SMEs and the varying capital needs as SMEs mature in their life cycles

In 1993 there were 922,182 businesses with one or employees in Canada, and another 1.1 million people who were self employed small businesses with no employees for a total of about 2 million business operations in Canada. By definition, small businesses have less than 100 employees (manufacturing), and less than 50 employees (services), while medium sized businesses have less than 500 employees and $5 to $7 million in revenues *(Growing Small Businesses,, Feb. 1994, p.3; Strategis, Small Business in Canada, A Statistical Overview).* In 1993, small and medium sized enterprises (hereafter referred to as SMEs) accounted for 99% of all business organizations in Canada, and accounted for 57% of private sector gross domestic product GDP *(Growing Small Businesses, 1994 p.3)*.

Fifty three percent of all private sector jobs in Canada are in firms with less than 100 employees (1991 data) and SMEs also accounted for 2.3 million new jobs or 87% of all the new jobs created in Canada in the ten years between 1979 and 1989 *(Growing Small Business 1994 p.3-4).* Not surprisingly, the federal government has identified the SMEs as an essential element in their job creation strategy *(Small Business, A Progress Report, 1995, p.1-4).*

In 1993, there were 1,537 businesses with one or more employees, and another 1,316 self-employed operators with no employees for a total of 2,853 business operations in the Yukon *(Statistics Canada, Comparative Business Statistics 1994, EDA Evaluation 1995, p.49,50)*. Eighty-five percent of Yukon's private sector employees work for SMEs, and Yukon small businesses experienced net growth of 34% from 1983 through 1993, for an average annual growth rate of 4.1%, double the national average *(Yukon Bureau of Statistics, 1994).* Roughly 56% of all working Yukoners are employed by SMEs. Similar to Canada as a whole, SMEs represent a key element in new employment creation and diversification in the Yukon.

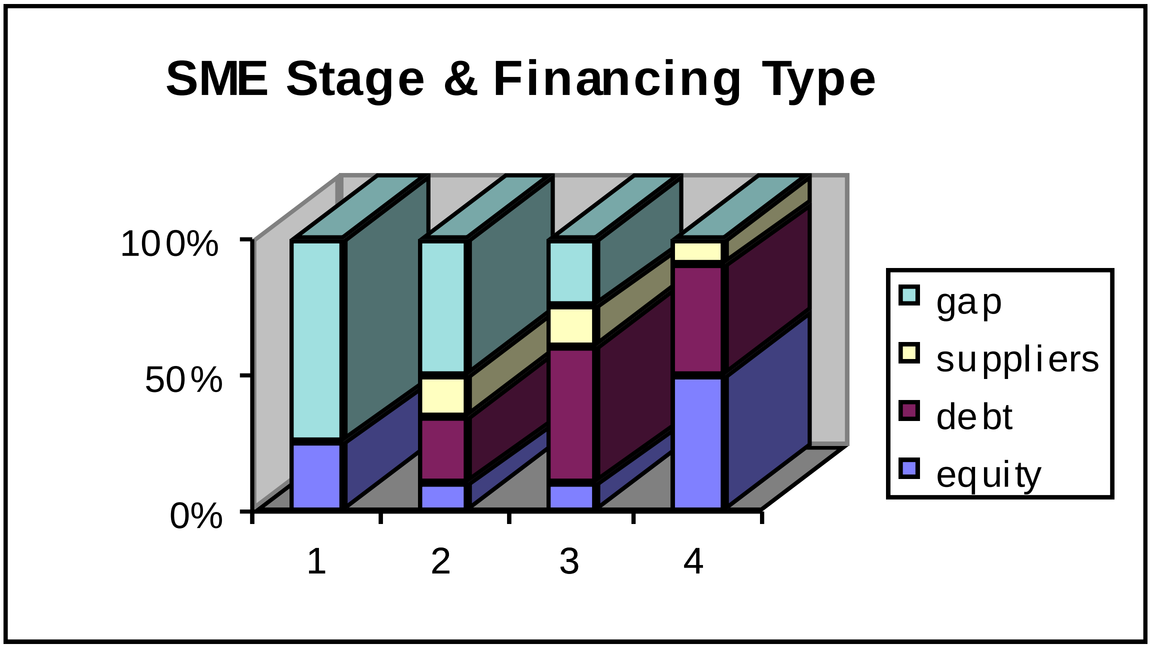
What does it take to create an SME?

Given the importance of SMEs for both Canada and the Yukon, it is important to understand what leads to the creation of a small business. Besides a stable and supportive regulatory regime, adequate labor, and access to markets, all new businesses have three basic requirements: a product or service meeting a market opportunity, entrepreneurial talent, and capital. Not surprisingly, these three elements are the greatest weaknesses of small businesses in Canada *(Canadian Business vol. 68 (8) August 1995, p.68-70, Small Pleasures, Terry Matthews Moonlights as a Venture Capitalist).* While all three elements are critical to small business success, this paper will focus primarily on access and availability of capital.

What is capital and its importance to small business development and stability?

All businesses require capital for the creation of products and services. Broadly defined, capital is the means of production, "the accumulation of goods devoted to the production of other goods, accumulated possessions calculated to bring in an income"(*Webster's 9th New Collegiate Dictionary*) In practical terms, capital are the "things" a company needs to produce the goods or services it offers in the market for sale. These include: physical plant, equipment, patents and licenses, inventories, and working capital. during a small business's life cycle these capital needs change considerably with each phase of business:

Figure One: SME Life Cycle & Financing Type:



SME Stage	(1) start-up	(2) develop.	(3) expansion	(4) maturity
personal	primary	secondary	-	-
Banks	secondary	primary	primary	primary
Government	primary	primary	secondary	-
Investors	primary	primary	-	-
Venture K	secondary	primary	primary	-
Institutions	-	-	secondary	primary
Stock Market	-	secondary	primary	primary
Indust. Investors	-	secondary	primary	primary

(adapted from WED, Financing for Small & Medium Sized Businesses in Western Canada)

Start-up: Includes initial business planning and research activities, business financing strategies. Here equity is the key financing source with a significant "gap" in financing, which is usually filled by private investors, public sector programmes or venture capital pools.

Development: Acquisition of licenses, premises, equipment; initial working capital to cover fixed costs, business start-up costs including staff development and training, and working capital for initial operations. This stage attracts more private venture capital, including new venture capital funds set up by conventional banks, and possibly initial public offering through the stock exchanges.

Expansion: additional capital for replacements, additional working capital to cover increases in inventory, more staff training & development, new management systems development, and marketing and other costs associated with entering new markets. Financing in this stage comes from banks, venture capital and stock exchanges, with supplier credit becoming an increasingly important source for financing growth.

Maturity: Additional capital financing for worn out equipment, technological obsolescence, R&D for extensions or diversification of products or services, and succession through transfer of ownership. Added to the conventional financing sources in this stage are the institutional investors but more and more financing is coming through retained earnings and supplier credit.

With the increase in new small businesses, and the emerging importance of knowledge based industries, traditional capital needs are shifting from fixed assets to the more intangible "people and processes". These types of assets are not included in traditional financial accounting methods, yet require large cash outlays with less for which debt financing is difficult to attract. These new and emerging sectors therefor require heavier emphasis on equity for capital formation.

CHAPTER ONE

SOURCES OF EQUITY CAPITAL FINANCING IN CANADA

This chapter identifies the types and sources of capital used by businesses in Canada (equity & retained earnings, term debt, trade credit, asset lending, and venture capital), relying on 1994 data collected from government sources

Equity:

Broadly speaking there are two main forms of capital financing for small business: equity and debt. All businesses require start-up equity supplied by the business owners which is used to "lever out" additional financing as the business grows. Equity levels therefor vary significantly with stages of the business life-cycle, industry and sector.

Sources of equity also range on a continuum of ownership control, business and legal organization and structure, and ease of access and cost of capital.

Owner's Equity:

The simplest form of equity is owner's equity, made up of contributed capital. This includes "sweat equity, personal cash savings, personal assets, and finally personal borrowings (borrowed funds using personal assets and outside income to obtain the loan).

An extension of personal equity is family resources such as cash savings, family assets, and labor of the extended family contributed into the business operation.

Sole Proprietorship:

Sole proprietorships are unincorporated businesses and owned solely by one person *(Davis & Pinches, 1991 p.22).* Ownership of this type of equity is usually classified as self-employed and registered proprietorships and family businesses (some family businesses may be partnerships or incorporated for liability or other legal reasons).

Partnerships:

Another form of equity can be provided by two or more individuals who form partnerships to establish businesses. In most cases each individual contributes personal equity in equal amounts and shares in the ownership responsibilities, as well as risks and rewards from the business. Also called general partnerships, most provinces and territories have legislation governing partnerships *(Ibid. p. 23).* (Special cases of limited partnerships exist which legally limit the responsibilities and liability of partners). An important contribution of partnerships besides equity is managerial and technical expertise provided by additional business partners.

Additional types of partnering arrangements include Joint Ventures, and R&D Limited Partnerships.

Joint Ventures:

Joint ventures are usually specific short-term projects undertaken by two or more firms which each contribute equity to the project. Normally short term and developmental in practice, joint ventures can be either incorporated or unincorporated, or in the form of registered or limited partnerships. Current applications are seeing suppliers, customers, and even competitors teaming up with other firms to complete projects of size or risk that couldn't otherwise be undertaken *(Costello, 1985,p.160)*.

R&D Limited Partnerships:

Research and development limited partnerships are mainly used in early development projects, product oriented and of normally high risk nature. Tax benefits for investors usually offer encouragement where conventional projects would not be considered. Three benefits of R&D Limited Partnerships are:

- doesn't affect the investor's credit standing
- reduces overall exposure to R&D risk
- doesn't compromise technical or managerial control of the project

Under these agreements, the general partner retains control of actual project while the investor provides the cash in exchange for immediate tax benefits, specified repayment, and other conditions such as the general partner being able to buy-out the investor through royalties based upon gross sales. This differs from an equity investment in that the investor is paid a royalty from sales regardless of the profitability of the company *(Costello, 1985, p.161).*

Corporations:

Corporations are a special form of business organization created to raise additional capital from many individuals by offering portions of ownership in exchange for contributed equity. An important feature of this type of business is the limited risk of owners and owners do not necessarily have to be involved in operating the business. Small businesses generally incorporate to reduce personal liability, acquire additional capital equity, or as part of their financing and tax strategies. Corporate shares can be sold publicly on a stock exchange (regulated secondary market), or be closely held and privately traded.

Retained Earnings:

Once businesses are established, an important form of equity financing is retained earnings. Retained earnings are derived from internally generated profits, usually held in the form of shareholder equity. In Canada today, about 30% of all business financing comes from retained earnings *(WED, 1994 p. 10).*

Other Forms of Equity:

Stock Markets:

In association with larger and more complex business ventures, other forms of equity have emerged. These include the public equity markets such as the Toronto Stock Exchange, and Vancouver Stock Exchange, and venture capital corporations. While the stock exchanges are a highly visible form of equity financing, only .6% of business financing comes from equity markets in Canada today, and only .6% come from the

Canadian venture capital industry *(WED, 1994, p.12, 14).* Initial Public Offerings (IPO) however can raise large amounts of public equity, for example the average IPO on the TSE was $39 million compared to $500,000 and $830,000 on the ASE and VSE respectively *(Ibid., p.12 - 14).* For smaller amounts of equity capital, Alberta offers a special Junior Capital Program for initial amounts of as little as $100,000 at significantly lower listing prices than traditional IPOs *(Alberta Government, Website, 1996)*

Besides common voting shares, corporations can also issue preferred shares in exchange for equity investments. Preferred shares are an intermediate form of financing between equity and debt. Preferred shares provide for specific repayment being made regardless of profitability, and rank ahead of common shares in repayment. While preferred shares normally do not have voting rights, many new offerings now carry voting rights. The advantages of preferred shares are: management doesn't have to surrender control of the company, inability to pay fixed payments on preferred shares doesn't automatically mean the company is in default, fixed payments are predictable, providing increased financial leverage if the company is profitable *(Davis & Pinches, 1991 p. 418,419).* Preferred shares appear in both public and private equity offerings.

Equity markets in general tend to attract investors looking for short term capital appreciation, with investments being held an average of 18 months. Listing requirements and brokerage costs make this source of financing expensive, and often cause management to focus on short term valuation to satisfy shareholders *(Porter, Capital Disadvantage, 1992).*

Public equity tends to be limited to very large projects, often in well established markets, or with proven growth potential. Closely held, privately traded common shares however represent the majority of corporate ownership in Canada amongst SMEs.

Venture Capital:

Other forms of equity capital are venture capital companies and corporations. These are syndicates of individual and institutional investors who pool their funds into companies which provide portfolio management, investing in promising business start-ups, with strong earnings potential. In contrast to the public equity market, venture capitalists are looking for investments with a long term capital appreciation and typically leave funding in a business for up to five or seven years *(MacDonald, 1991 p.7-9).*

The typical investment is for $1,000,000 or more, and selection is rigorous *(Industry Canada, Strategis).* According to Western Diversification's 1994 report, venture capitalists only select one out of seventy proposals for investment. From these venture capitalists expect only 20% of their investments to meet their required return on investment, 20% will fail, and 60% will be marginally profitable *(Canadian Business vol. 68(8) August 1995,p. 68-70 "Small Pleasures...").*

Not surprisingly, venture capitalists are seeking high returns on investments, anywhere from a 35% to 45% return. Venture capitalists usually take both an ownership and managerial role in their investee companies *(WED, 1994 p. 12)*. Venture capital tends to be highly valued for the managerial and financial expertise that usually comes with it, and this has earned it the name "intelligent Capital" (Ibid., 1994). However, one American author cautions that venture capital represents high risk financing for investee companies in view of the significant ownership and managerial control venture capitalists demand. Entrepreneurs could run the risk of losing control of their creations if too much control has to be surrendered to obtain financing (*Costello, 1985, p.162).* This source recommends exhausting all internal sources of equity financing before seeking outside venture capital.

According to the Canadian Venture Capital Association, the venture capital industry in Canada continued to grow in 1995 with 77 venture capital companies investing $669 million in over 610 investments in 364 Canadian companies. Up from 64 venture capital companies on 1994, most of these companies and investments are concentrated in Ontario, Quebec and BC., typically in high-technology, computer, bio-technology, and communications industries *(MacDonald & Associates, 4/96).*

A significant entry into this market has been the new Labor Sponsored Venture Capital Corporations LSVCC *(MacDonald, 1991).* Both the federal government and participating provincial governments provide an average combined 40% tax credit of up to $1,000 on the first $5,000 invested in a given year. Over $1 billion is currently available in these funds, which are intended for direct investments into SMEs. The main concern is that most of these funds are still being held in short term money markets and this may actually be diverting traditional informal venture capital away from SMEs *(Small Business Working Committee, Report to Ministers, 1994).*

Venture capital financing has tended to concentrate in expansion and growth stage companies rather than development and start-up stages *(MacDonald, 1991).* While venture capital represents a significant source of financing for the new economy, venture capital still represents less than .6% of small business financing activities in Canada *(WED, 1994).* Venture capital financing is also heavily concentrated in the more highly industrialized provinces of Ontario, Quebec, and more recently British Columbia. and Saskatchewan.

(Figure Two): Venture Capital Investment by Location (1994)

Location	**#**	**%**	**$(mm)**	**%**
British Columbia	50	12	45	10
Alberta	9	2	10	2
Saskatchewan	42	10	45	10
Manitoba	18	4	21	5
Ontario	100	24	125	27
Quebec	157	38	172	37
Atlantic Provinces	1	-	2	-
Foreign Countries	32	8	39	9
Total	409	100	460	100

(From Venture Capital in Canada Annual Statistical Review & Directory June 1995)

Informal Venture Capital:

This form of equity is usually provided by wealthy individuals with substantial net worth, personal income, and business start-up experience. In 1994, 5.4% of business financing in Canada was raised through this source, and about 6% of businesses reported this as a significant source of equity for financing their business *(WED, 1994, p15; Industry Canada Strategis).* Informal venture capital investors normally restrict investments to their local communities, or a finite geographic area (ten to fifty mile radius of investors home) (WED, 1994 p.17). Known as "angels" because of their altruistic behavior, informal venture capital investors frequently provide mentoring along with their cash resources, and are generally patient investors who are interested in community development as much as for economic returns. Informal investors however are normally hard to track down, with the most frequent method of matching through networking, chambers of commerce or other social or business encounters. Several reports estimate that this source represents a significant untapped potential for small business finance lacking only a more organized method of matching projects to investors *(WED, Strategis)*.

According to a recent survey of small businesses (Canadian Labor Market & Productivity Centre and the Canadian Chamber of Commerce, 1995), 28% of companies surveyed indicated that they had sought some form of equity financing but were unsuccessful in obtaining it. Only 9% of companies indicated that they used any form of equity financing *(Financial Post Daily, v.8 (50), May 2, 1995, p.13 Small Business Capital Hard to Find).*

The informal venture capital market is normally tapped through private networking with business associates, customers, suppliers, accountants, lawyers, and local chambers of commerce (the Canadian Opportunities Investment Program C.O.I.N. which matched investors to investees was recently wound done due to low uptake).

According to Western Economic Diversification, this type of investment could play a significant role in SME financing *(WED, 1994 p.15 - 17).* The major difficulty for small business is how to find it.

Government Sponsored Equity Programs:

Besides private equity sources, governments in Canada play a significant role in providing equity or "near" equity capital to small businesses *(see Appendix Two, table two for western provincial sources).*

Industry Canada has responded to stakeholder concerns about limited access to investment equity by announcing the creation of the Canada Community Investment Plan, CCIP pilot program for 1996 *(Industry Canada News Release, March 22, 1996).* The CCIP program will be aimed at improving local access to equity capital for small and medium sized enterprises, particularly small and remote communities. The program works by funding the establishment of a community based investment "clearing house" which will match local informal investors and local sources of venture or equity capital with firms and entrepreneurs looking for smaller amounts of equity capital. The program details released on March 22, 1996 call for communities to submit imaginative proposals outlining how they will match local entrepreneurs with local sources of investment. Each organization in the initial pilot will receive a $600,000 contribution spread over five years covering two thirds of the operating and administrative costs of the local program. The $120,000 for annual administration has to be matched by the community organization by at least $60,000 each year plus the required venture funding for investments. Only twenty proposals will be funded in the next two years, and will act as pilots for possible national roll-out of the most successful models developed.

Besides the Canadian Community Investment Program, Industry Canada has also mandated Business Development Bank of Canada (Formerly FBDB) to offer a variety of venture loans aimed at the equity needs of high growth small businesses in the new economy. The venture loan programs include a "patient capital" program which while in the form of debt, actually operates like equity capital; export assistance; and a cultural industries loan fund (funded by Heritage Canada).

All provinces are offering a wide variety of equity enhancing programs targeted at specific industries, sectors or regions *(see Appendix Two, table two for Western Canada).* These programs typically involve tax credits of 20% to 30% to stimulate private investment, but also include incentives, loans, and grants for research and development in high technology industries. As an example, in British Columbia, there are seven venture capital programs offered through the provincial government which target specific sectors.

These programs provide assistance through incentives to investors ranging from 20 to 30% individual tax credits, equity and debt investments, and a program to facilitate permanent residence for immigrant investors *(WED, 1994, see table two, appendix six).*

Alberta, Manitoba, and Saskatchewan also offer a variety of venture capital programs: five in Alberta; two in Saskatchewan; and three in Manitoba, all of which include some tax credits, equity, debt, contributions or grants.

CHAPTER TWO

SOURCES OF DEBT CAPITAL FINANCING IN CANADA

This chapter looks at types and sources of debt financing available to SMEs in Canada today, as well as recent federal government trends reducing direct involvement in debt financing

Debt:

The other major component of business capital is debt. Debt typically takes the form of funds which are invested in a business with a specified cost of borrowing, repayment, and often secured by assets held by the company. Debt, also called credit, is provided through demand and term loans, debentures, bonds, commercial paper, and other similar types of financial instruments with specific terms of repayment, interest costs, and security. Debt is provided to SMEs primarily by chartered, commercial, and merchant banks, and to some extent by credit unions and trust companies. Other providers of debt are insurance companies, pension funds, investment companies, suppliers, leasing companies and factoring companies *(Davis & Pinches, 1991 p.803, 648,407 -408; WED 1994, p.19-20)*

Other providers of debt are from the government sector and include Business Development Bank of Canada, a federal crown corporation, and a large number of provincial government programs, agencies, and crown corporations providing loans, guarantees and other forms of credit *(Davis & Pinches, 1991 p.804-805)*

In this analysis debt will categorized under: Financial Institutions (banks, credit unions, trust companies), government (including provincial, municipal, and crown corporations), and suppliers (including trade credit, leasing, and factoring companies).

In order to obtain credit, SMEs are normally required to provide a formal a business plan and professionally prepared financial statements to lenders to assess their company's ability to repay the requested loan. Depending upon the stage in the business's life-cycle, complete information may not be available, and these business have to provide sound market analyses and projections to support the proposed credit request. The key ingredients for SMEs to obtain debt financing and credit through any financial institution are:

- establishing a satisfactory credit rating and sound business management (Character).
- profitable operations and adequate cash flow (Capacity)
- adequate equity and sufficient assets to provide security (Capital)
- a willingness to pledge sufficient assets to secure the debt (Collateral)
- developed share of a stable or growing market (Conditions).

Also known as the five "C"s of credit: Character, Capacity, Capital, Collateral, and Conditions, businesses need to develop all five of these elements of credit to meet a financial institution's risk selection criteria.

Financial Institutions

Banks:

With over 8,000 branches and agencies in Canada, the shear number of branches and general availability throughout Canada, make banks a highly visible and approachable source of financing for small businesses *(See Appendix Two, table three for number of bank branches by institution and location).* The "big six" Canadian banks (Royal, CIBC, Montreal, BNS, TD, National, & Hong Kong Banks) had $152 billion in small business loans under $500,000 in 1994, which represented about 4% of all bank assets *(WED, 1994 p.11; Taking Care of Business, Oct. 1994 p.10)*.

In a 1994 survey, approximately 68% of businesses reported seeking debt financing from chartered banks, and 27% sought funding from other financial institutions. At least 80% of small businesses in Canada who sought financing through banks and financial institutions were successful *(Peterson, 1995)*. While the majority of small businesses report that they were successful in obtaining financing, this data comes from surveys of existing small businesses, and does not include any data from discouraged entrepreneurs who were unable to obtain financing or whose businesses were never established. There is no reliable data on the number of discouraged entrepreneurs who never started their businesses (one lender advised the author that for all loan inquiries received, only 15% actually processed through formal the application process, of which 80% to 90% were successful). This could mean that as many as 88% of inquiries to banks about business loans never receive funding. Given the high rates of business failures (often quoted as 75% in the first three years), there is strong anecdotal evidence that there is a high degree of "pre-screening" occurring, given the high rates of reported success in obtaining bank financing. What this data suggest is that while banks represent an important source of financing for SMEs, SMEs represent a very small part of bank business and banks can therefor afford to be very selective in granting credit.

While generally accused of being overly conservative by industry, bankers freely admit that they are low risk lenders *(Taking Care of Small Business, Oct., 1994, p. 11).* Canadian Chartered banks indicate that they aim for loan losses of between .5% and 1% of loan capital. The reasons they give for their caution are that with 95% of loan funds originating from their depositors, and they have a strong fiduciary responsibility to be correct in their lending decisions 99% of the time *(Ibid.).*

Banks generally take three times the value of collateral security to the value of the loan *(WED, 1994, p. 11).* This penchant for taking all available security was a criticism leveled at banks by the Canadian Federation of Independent Business in the report to the Commons Standing Committee on Industry (1994). Because bank loans are generally of very low risk, banks usually only charge interest rates on loans at prime plus two to three percent. Prime rate is considered the rate banks would charge to their best credit risks, usually 1% to 1.5% over the bank of Canada's weekly trend setting rate. Currently the Bank of Canada's trend setting rate is 5% and prime is at 6.5%, so a business loan of normal risk would be priced at 8.5% comparable to the five year residential mortgage rate of 8.5% (as at May 7, 1996).

While banks and financial institutions provide 80% of businesses with debt financing, this represents only 16% of all bank assets of which only 4% of all bank assets are loans provided to SMEs. By and large banks receive over half of their loan revenues from personal or consumer loans and mortgages, government borrowing, and loans to large corporate borrowers *(see Appendix Seven - Figure Three, taken from WED, 1994).* This suggests that bank lenders have to concentrate their efforts where the greatest return is, and that generally is retail lending, and larger corporate accounts.

Analysis of the historic data on SME financing in Canada shows that loan volumes to SMEs in the western provinces have been declining over time, while loans to other parts of Canada have been growing steadily. This trend indicates a general contraction of SME lending with banks tending to focus on retail or consumer based lending *(WED, 1994, p. 12).* It is therefor not surprising when SMEs feel banks are indifferent to their concerns *(Taking Care of Small Business, Oct. 1994 p.12-13).*

One of the problems with SME financing seems to be that banks don't want to make more risky loans even if they could charge more interest to offset potential losses on more risky loans. According to James Hatch, a professor of finance at Western University, "there is a notion that if you are a big bank, you should be able to provide money at low cost, and if you provide it *(loans)* at higher cost, the government will jump all over you. As a result banks are very reluctant to charge any more" *(Canadian Business v.68(3) March 1995 pg. 62-68: No Assets, No Problem*). Hatch and Wyant's 1990 report indicates while 30% of SMEs are dissatisfied with the process of obtaining bank loans, most are successful in the end in getting financing from one source or another (*Banks & Small Business Borrowers, J. Hatch, L. Wyant Western University 1990*).

As a result of long-standing industry wide complaints about access to financing tabled by the Commons Standing Committee on Industry, in 1994 the federal government proposed four initiatives to improve access to financing for SMEs. These included:

- identifying measures to facilitate the flow of high risk capital to small businesses

- reviewing the proposed code of conduct developed by banks to clarify their relationship in lending to small business
- examining the issue of personal guarantees under the SBLA
- reviewing the mandate of BDBC (former FBDB) to improve its ability to meet small business needs.

The four actions have been largely fulfilled with the recent announcement of the Canada Community Investment Program CCIP March 21, 1996 (see section on Informal Venture capital) which should address the problem of access to high risk capital by small businesses in small and remote Canadian communities. The Canadian Banker's Association has developed a code of conduct for bank relations with SMEs which has been adopted by each chartered bank. An alternative dispute resolution model has also been established for small businesses who are dissatisfied after going through the bank's normal complaint handling procedure. *(Canadian Bankers Association, Industry Canada, Strategis, 1996).*

Business Improvement Loans, Small Business Loans Act (SBLA)

The federal government's Small Business Loans Act (SBLA) was revised in 1993 to increase loan amounts from \$100,000 to \$250,000, the amount guaranteed was increased from 85% to 90% of loan funds, and eligibility extended to businesses earning revenues of up to \$5 million annually. These improvements increased the number of loans granted by banks under the SBLA to the \$4 billion ceiling in 1994 (in the 1994/95 federal budget this ceiling was increased to \$12 billion).

In 1995 the program was again amended so that banks could release personal guarantees given by borrowers when the insured loan is in good standing, and the balance has been paid down by 50% *(Small Business, A Progress Report, Industry Canada, 1995).* Amendments to the SBLA to limit personal guarantees have resulted in a number of chartered banks changing their policies on the use of personal guarantees, including

Scotia Bank which has stopped routinely taking “unlimited” personal guarantees, and other banks which now make personal guarantees an optional security requirement *(Canadian Bankers Association, Industry Canada, Strategis, 1996).*

There is an up front two percent loan premium paid by the client for the guarantee, and banks can charge interest rates to a maximum of prime plus three percent, and also provide fixed rates loans. Banks are free to charge rates lower that the prime plus three ceiling, and some have adopted fairly competitive programs within these new regulations *(CBA, Strategis, 1996).* The SBLA has also moved towards full cost recovery with a 1.25% annual premium charged to bank’s average outstanding loan balances on loans made after March 31, 1995. This annual fee was designed to cover loan write-offs, and to discourage banks from needlessly using the SBLA to secure otherwise low risk loans *(Taking Care of Small Business, 1994 p. 25-26).*

Approximately 11% of SMEs searching for financing reported seeking SBLA financing *(Peterson, 1995, p.2),* while banks are reported to be using the guarantee to secure up to 30% or 40% of the least risky loans in the bank’s portfolio *(Taking Care of Small Business, 1994 p.25).* It is estimated that bank term loans under $200,000 grew by more than $2 billion in 1994 indicating heavy reliance on the SBLA insurance for small business lending (Ibid. p.16). Today, most qualifying businesses can readily access SBLA insured capital financing pretty well anywhere in Canada.

Business Development Bank of Canada BDBC:

Federal Business Development Bank FBDB, recently renamed Business Development Bank of Canada BDBC, has had its mandate extended to aggressively supply capital to SMEs with a variety of new programs. BDBC has just announced a program designed to provide “micro-loans” of up to $50,000 (micro-loans are defined as loans less than $100,000) to small businesses. Qualifying businesses will have to pay for business planning and training through Business Development Bank’s management services as a condition of obtaining the loan. Lending officers are presently receiving training in the administration of the new program which should be available across Canada in the summer of 1996 *(see Appendix Three - Globe & Mail, 1995).*

In western Canada, all federal loan programs have been canceled or rolled into the Business Development Bank to provide a one window approach to SME loan assistance. Business Development Bank concentrates on term loans for heavy capital items, and specializes in higher risk loans compared to the bank's and their commercial lending centres. The Business Development Bank also provides management training services to SMEs, and provides counseling, business planning, and individual and group training. While the Business Development Bank used to be considered a lender of last resort (businesses would have to first be formally turned down by a chartered bank) BDBC now competes directly with banks for commercial loans. BDBC however charges higher interest costs than chartered banks, and cannot offer other banking services like deposit and chequing accounts, or revolving credits which make chartered banks more attractive to SMEs.

Credit Unions & Trust Companies:

Surprisingly little information was available on the extent to which trust companies and credit unions are providing capital to small business. There are an estimated 1,000 credit unions operating outside of Quebec and one recent national survey indicated that about 27% of businesses seek debt financing from "other" financial institutions which include credit unions and trust companies *(Peterson, Aug. 1995, p.4)* Credit unions and trusts barely made mention of in the Commons Standing Committee Report on Access to Capital and appear to be included with data summarized on banking.

According to an unpublished report prepared by 1990 KPMG, Peat Marwick Stevenson & Kellogg for the Yukon Development Corporation, there were approximately 90 active deposit taking trust and loan companies operating in Canada, either federally or provincially chartered, twelve of which were mortgage subsidiaries of chartered banks. While trust companies can and do lend to SMEs, the regulations governing them severely limit the amount and type of corporate debt they can hold, and most trust companies are more focused towards mortgages, securities, and estates, trusts, and agency activities. Trust companies however act as agents for the sale of commercial paper, a form of bonds issued by larger companies for large amounts of short term financing *(Yukon Trust Company Feasibility Study, September 1990, KPMG, Peat Marwick Stevenson & Kellogg).*

While credit unions can lend under the SBLA, because of their small size and dispersion, they are not a significant player in small business finance outside of Quebec *(Small Business Working Committee, Report to Ministers, 1994).* It can be inferred that trust companies and credit unions are either a very small players in small business financing, or businesses do not differentiate between banks, trusts, and credit unions in various industry surveys undertaken on this subject.

Suppliers:

Another significant source of financing for business is suppliers who currently provide up to 24% of business financing needs (WED, 1994) Suppliers typically provide "trade credit" offering their business customers short term financing to pay for goods and services which they provide to these businesses. Interest costs can range from no added charge, to as high as 24% per year. Businesses with good supplier relations can often stretch their accounts payable out to an average of 45 days depending on industry (Note: collection periods ranged from 7 days in Accommodation/Food/Beverage sector to 150 days in financial/insurance sector)*(Statistics Canada, key business ratios, 1994,).*

Supplier trade credit represents a critical part of working capital for all businesses, but it is most important small businesses, and new business start ups. Similarly for suppliers, offering trade credit is an important method of increasing sales and market share but at normally higher risk as trade credit is usually unsecured, and requires sound credit evaluation skills, and collection systems.

Other forms of supplier credit include equipment leasing and other forms of asset based financing. The main difference between leasing and normal debt financing, is the ownership of the assets involved in the lease normally remains in the name of the financier, with the borrower paying "rental" payments, often with the option of purchasing or returning the asset at the end of the contract term. New businesses and small businesses who lack the ability to obtain conventional credit are the key beneficiaries of leasing.

The main reasons for SME leasing are: lack of equity for a down payment, and lack of established credit history *(WED, 1994, P20)*. Leasing now accounts for 11% of equipment financing in Canada with about 100 companies active in the market *(Taking Care of Small Business, Oct., 1994 p.22).*

Supplier trade credit appears to provide SMEs with significantly more leverage, and a valuable source of short term working capital. Suppliers bear higher administrative costs for cost of capital, credit approval, collection, and write-offs, which are covered through financing charges, or included in the pricing of goods and services provided, and also justified by increased sales revenues.

Government Loan Programs:

Government loan programs at all levels of government have played a key role in small business financing in Canada with about 1.2% of all business financing coming from government source, about double that of the venture capital market *(WED, 1994, p 18).* Another recent survey (Canadian Labor Market and Productivity Centre and the Canadian Chamber of Commerce) found that 12% of the companies surveyed reported benefiting from government grants, loans, or loan guarantees *(Financial Post Daily, Small Business Capital Hard to Find, vol.(50), May 2, 1995,p.13).*

At various times the federal government has had over 200 programs to assist small business offered by many of the federal departments, including regional development programs targeting areas with stubborn structural problems *(WED, 1994, Figure 16).* While government sources are a small portion of the overall financial market, government financing is significant because it is concentrated in early development, R&D, and higher risk business start-ups.

Provincial government programs account for about 8% of SME financing and are often set up as "top-off" funds, conditional on the business receiving other private sector financing *(Peterson, 1995, p.3).* According to the ARA report in 1995 on government loan programs, most programming is based upon an economic development focus, while some are based upon filling gaps in access to financing, often based upon the philosophy of the government of the day *(ARA, 1995).*

The Western Diversification Program developed a comprehensive list of government programs available in western Canadian provinces in 1994. This list demonstrates regional specialization to deal with local capital financing issues (see Appendix Six).

In 1995, the federal government announced it was getting out of direct financial loan programs for SMEs. Industry Canada's program budget is being reduced by 40% over the next three years, and funding programs to small business will be reduced by 80% *(Small Business, A Progress Report, Industry Canada, 1995.*

Instead federal intervention in small business financing will be offered through BDBC, and the SBLA program. Other initiatives include increased information and training for small business owners through the Strategis Internet Site, the single window access to government programs through Canada Business Service Centres, set up in cooperation with municipal and provincial authorities in at least one major centre in each province *(Growing Small Businesses, 1994, p.26).*

CHAPTER THREE

GAPS IN CAPITAL MARKETS IN CANADA

This chapter reviews the current literature on access to financing to identify real and perceived gaps, barriers, or market failures in Canada today both for equity and debt supplied to SMEs

The Equity Gap:

Equity capital represents a significant gap in financing in Canada today for small and medium sized enterprises *("Business Capital Hard to Find", Financial Post Daily vol.(50), May 2, 1995p.13).* SMEs often require equity capital in amounts greater than the entrepreneur can raise from personal sources, but too small to attract formal venture capital. There is a critical absence of any visible market mechanism to match small informal investors with small business entrepreneurs. The gap in equity capital financing for small business in Canada is concentrated in new business starts, and businesses in higher risk sectors and regions of the country.

While the federal government's recently announced Canada Community Investment Program CCIP is designed to address the need for the formation of small amounts of equity in remote and small communities in Canada, the provincial government programs continue to play a key role in providing venture capital as a form of equity for small business (see Appendix Six). As well, a growing number of the chartered banks are experimenting in offering new loan programs aimed at providing venture capital and other forms of higher risk debt for businesses in the high technology, high growth, information based sectors of the economy *("No Assets, No Problem, A new breed of banker is learning to Live with the idea that a little more risk might be a good* *thing for both the banks and the country" Canadian Business vol. 68(3), March 1995 p.62-68).*

For larger amounts of equity, Canadian venture capital corporations have tended to focus only on growth and acquisition proposals rather than start-ups and developmental proposals *(MacDonald 1991 & 1994).* The larger amounts of financing per "round" of venture capital financing also tend to limit its applicability to most Canadian SMEs *(Industry Canada, Strategis 1996.*

The Small Loan/Limited Assets Gap:

Two additional areas of difficulty in accessing financing nationally are: small loans under $25,000, and loans to companies which have few tangible assets. Loans under $25,000 are difficult to obtain because the interest charged by lenders does not cover the costs of funds, administration, and loan losses *(Appendix Three - Federal Bank Tackles Small Loan Gap Globe & Mail, 1995).* Banks are reluctant to make small loans because of the higher administrative costs and low profits associated with these loans. The BDBC program for micro-loans up to $50,000 will help make small loans available to qualifying businesses with businesses paying additional costs for due diligence as a condition of obtaining the loan. This program should be available in all regions of the country in 1996 *(Discussions with local BDBC Office, 1996).*

Businesses with limited assets tend to be concentrated in personal services, information based businesses, and home-based businesses. These businesses have difficulty pledging sufficient security in support of loans, with lack of collateral the most frequently cited reason for bank rejection *(Peterson, 1995, p. 8).* A common complaint of SMEs is that bankers do not take "character and commitment" into consideration when dealing with these types of businesses, while bankers argue that entrepreneurs are unwilling or unable to pledge personal assets as collateral *(Small Business Working Committee, Report to Ministers, 1994 p.18).*

A significant problem appears to be that most small businesses fail to take into consideration that banks are low risk lenders and feel little obligation to lend money to higher risk businesses. Small businesses also do not attempt to obtain equity financing from informal sources until they have been pushed to do so by a bank in the credit granting process *(Hatch/Wyant, 1990).*

For most small businesses however, finding informal equity investors is a lot more difficult and time consuming than approaching their local banker or applying to a government loan program.

The Business Start-up Gap:

Another gap in financing for both equity and debt is found in higher risk, new business start-ups. Often with no proven track record, either market, management, or profitability, new business start-ups have trouble attracting either equity or debt. With most start-ups financed by owner's initial equity contributions, start-ups normally need additional cash to development market share and growth. Banks tend to avoid start-ups unless there is strong and proven management, detailed cash flow projections, lots of security, and finally alternative sources of income. Few start-ups can meet all of these requisite conditions.

While formal venture capital is a potential source of start-up financing, formal venture capital tends to focus on large projects, $1 million or more, and mostly those businesses which have already gotten past the "start-up phase" and are seeking financing for growth *(MacDonald, 1991).* Informal venture capital is an alternative for SMEs but it is extremely difficult for start-up SMEs to locate and successfully match their proposal to such funds *(WED, 1994).*

Suppliers tend to be a readily available source of capital financing for SMEs, but usually in and after the growth phase, once the company has established itself and is able to provide bank references, and initial financial results.

Government loan and equity programs appear to be the one outside source of financing most available to SME start-ups in most jurisdictions in Canada (WED, 1994). Most of the existing programs fall under an economic development philosophy, with specific industries, sectors, or regions targeted for assistance *(ARA, 1995).*

CHAPTER FOUR

SOURCES OF EQUITY CAPITAL AVAILABLE IN THE YUKON

This chapter identifies the types and sources of equity capital currently available in the Yukon, and provides some data on the degree to which each type of financing is currently used by SMEs in the Yukon

Owner's Equity:

With a high rate of new business start-ups in the Yukon (twice the national average), many new businesses are relying upon owner's equity for their start-up financing. While no data could be found which quantified how many businesses make use of owner's equity, discussions with lenders indicate that all bank financing to SMEs requires personal risk on the part of the business owners. As a rule of thumb, bankers state that minimum equity starts at 25% of financing requirements and increases from that point based upon perceived risk and available security.

The Yukon Government's 1994 Access to Financing Survey unfortunately did not ask businesses specific questions about internal sources of financing, which must be indirectly inferred from the data collected.

Retained Earnings:

A major source of equity financing in the Yukon is retained earnings. The 1994 Yukon Business Survey asked small businesses what source of outside financing they had used, and 39% of respondents indicated that they had not sought outside sources of financing for their businesses, inferring that they used retained earnings or personal sources of equity for their financing *(Yukon Statistics Bureau, Access to Capital ,1994).* This data is consistent with national data indicating that about 30% of business financing provided by retained earnings, including personal contributions *(WED, 1994, p.10).*

Formal Venture Capital:

In the 1994 Access to Capital Survey, less than 2% of businesses surveyed indicated that they sought equity financing from venture capital corporations, of which only 54% were successful in obtaining financing *(Yukon Business Survey, Access to Capital, 1994).* Similar to experience elsewhere in Canada, formal equity markets in the Yukon are not a major source of financing for SMEs. However national data indicates about 28% of businesses surveyed sought venture capital, 9% indicated using some form of equity financing,, of which 6% was informal venture capital financing. This data infers that access to formal venture capital by Yukon SMEs is more limited than in Canada, and that success rates in obtaining financing are probably lower as well.

Informal Venture Capital (Friends/Family):

Friends and family were a significant source of informal equity capital in the Yukon. Businesses reported seeking this source in 11% of the Yukon sample and these businesses were successful 43% of the time (family was the toughest capital to obtain at 30% success, while friends as a source was successful in 77% of the cases) *(Ibid.).* The national survey data indicated about 6% to 7% of businesses reported using family sources, and an 88% success rate in obtaining financing *(Peterson, 1995).* These data indicate that Yukon businesses rely as heavily on informal venture financing as southern businesses but may experience less success in obtaining this financing.

Government Equity Programs:

The are no current government equity programs being offered in the Yukon, by any level of government. While grants and contributions have been provided in the past by both the federal and territorial governments for both aboriginal and non-aboriginal clients, both debt and equity financing through government sources appear to have been included with the survey responses to debt as a source of financing.

In the recent past, the Yukon government offered a Venture Capital Program component under their Business Development Fund which provided a maximum $100,000 contribution to community based Venture Capital Corporations. About five contributions were made to First Nation communities between 1990 and 1992 before this program was terminated. Additionally the Venture Capital Program included an employee share purchase component and a component for strategic investments but both of these components had minimal uptake, and were likewise canceled in 1992.

The Economic Development Agreement (EDA) provided grants to small businesses for higher risk research, training, planning and development activities but as of 1996, this financing source is no longer available. Similar to many programs offered by provincial governments in southern Canada to stimulate investment in specific areas, termination of the EDA leaves a gap in a key source of risk financing for SMEs in the Yukon.

Federal programs in the Yukon are similar to nationally available programs like the Industrial Research Assistance Program IRAP for applied research. IRAP is administered out of British Columbia, and with the closure of the local IRAP office as well as the Industry Canada office in Whitehorse, access to federally offered programs may become more difficult for Yukon businesses.

Aboriginal Business Development still provides some forms of grants for financing under $100,000 to qualifying First Nations businesses. This program is available through Dana Naye Ventures, in Whitehorse.

CHAPTER FIVE

SOURCES OF DEBT FINANCING IN THE YUKON:

This chapter summarizes the source of debt financing used by SMEs in the Yukon, as well as a discussion of the importance of each type of debt financing to SMEs in the Yukon

Banks:

Financial institutions were chosen by 54% of businesses in the Yukon in the Yukon, with a success rate of 84% . While the success rate is consistent with data for bank financing in the rest of Canada, the number of businesses reportedly seeking bank financing is lower than the 67% value of businesses in southern Canada *(Access to Capital, 1994; Peterson, 1995).*

Five of the major chartered banks are represented in the Yukon (Royal Bank, Commerce Bank, Scotia Bank, TD Bank, and Bank of Montreal). The Commerce Bank has two branches in Dawson City and Watson Lake, and the Commerce bank also offers agency services in a number of the other rural communities (as part of their service contract with the Yukon Government). Since the TD Bank has won the Yukon Government contract, the provision of rural banking services will likely change.

Regardless of availability of agency arrangements rural businesses typically must come to Whitehorse to negotiate any financing, often involving up to two days of travel per visit and several visits to conclude financing agreements.

Other Financial Institutions:

There are no credit unions or trust companies operating in the Yukon at this time. In Canada, “other financial institutions” (besides banks) accounted for 27% of small business choices for financing with an 84% success rate. The absence of these institutions may represent a gap in Yukon financing. The Yukon however is serviced by Business Development Bank (formerly FBDB) and Dana Naye Ventures, two additional sources of "other" institutional financing. Business Development Bank offers commercial loan services to higher risk businesses, particularly in rural communities in Yukon. Dana Naye Ventures acts as a local commercial financing corporation to provide financing to First Nations, and rural businesses in the Yukon and northern British Columbia. Both of these institutions provide business counseling and training services as well as term loan financing. DNV also provides working capital and revolving credits to small businesses, and has extended guarantees to chartered banks on behalf of some clients for operating loans. BDBC does not offer working capital or revolving credit, except under their special programs such as venture capital and patient capital programs. As both organizations have offices located in Whitehorse, rural businesses must travel to Whitehorse to negotiate and conclude their financing requests.

Supplier Credit/Leasing:

While supplier credit did not show up in the Yukon's 1994 access to capital survey, supplier credit does exist in the Yukon and likely plays as significant a role in SME financing as it does in southern Canada. Local banks were surveyed and all report that they provide operating loans to established businesses secured by good quality accounts receivable, typically under 90 days. Banks margin accounts receivable at a fraction of their value (anywhere between 50% to 75% of good quality accounts receivable).

Statistics for the Yukon indicate that current liabilities account for up 50% of total liabilities of Yukon companies, and accounts receivable have collection periods averaging 190 days *(Small Business Profiles, Yukon, 1994 Edition p. 582-584).*

These data provide indirect support of the importance of supplier financing to Yukon businesses, both as a provider of such financing and a user of supplier financing.

Government Programs:

Similar to the rest of Canada, direct federal provision of capital for small business is now limited to programs offered through BDBC, and SBLA insured loans provided by chartered banks and some credit unions. Business Development Bank's micro-loan program will likely play the most useful role in small business start-ups. The patient capital and venture capital programs however are geared towards high technology, high growth industries which simply do not exist in great numbers in the Yukon at this time. By and large most new small businesses in Yukon are service related, with tourism being the largest market to exploit at this time.

As an asset lender with experience in resource industries, transportation, and lending outside urban areas, BDBC should be willing and able to play a key role in rural financing, particularly in forestry development in south-east Yukon. (note: ten years ago the IMC - Ordish Access to Capital study identified short tenure of forest permits as the biggest obstacle to financing in the forestry sector, a condition which remains unchanged in 1996).

Business Improvement Loans (SBLA):

The SBLA program appears to be heavily used by local chartered banks. In discussions with lenders in the five chartered banks, all were familiar with the program, confirmed they were using it in their credit decisions, with some noting that the SBLA was instrumental in enabling them to lend in what they see as high risk sectors such as tourism and rural communities. As well Yukon Government loan program administrators observed a noticeable decrease in capital financing requests from SMEs once the new SBLA was introduced by chartered banks in the Yukon in 1993.

Yukon Government Loan Programs:

Until recently the Yukon Government was offering a wide range of programs to small business which offered capital, working capital, and funding for training, research and development, and many other activities for which capital is normally hard to find. As of April 1996, the Yukon Government offers only two direct loan programs to businesses interested in resource development: Yukon Industrial Support Policy YISP; and the Energy Infrastructure Loans for Resource Development program EILRDP, and the proposed loan guarantee program called Venture Partnership:.

- Yukon Industrial Support Policy (YISP) is an incentive program designed to provide financial assistance for road construction, energy supply, grid connection, or training programs in association with a resource development project *(YISP Policy Outline, Department of Economic Development, January 1995).* To date, no projects have been approved under this policy, partly because the process for negotiating a loan requires significant time for stakeholder intervention, including legislative debate on a case by case basis. With a minimum project size of $5 million, and lengthy approval process, this program is not targeted at SMEs.
- Energy Infrastructure Loans for Resource Development Program (EILRDP) is a loan program to assist the "resource development sector with the high capital cost of energy infrastructure" *(EILRDP Program Guidelines, Department of Economic Development).* The program application process is more clearly defined than YISP, and doesn't require legislative approval. Loan limits are 50% of capital costs, to a maximum of $3 million. To date one loan has been approved under this program for $2 million for electrical infrastructure for a gold mine near Dawson City (For details, refer to Energy & Mines Department of Economic Development: Brewery Creek Project).

- Venture Partnership Program, still under development at the writing of this paper, will be a government guarantee program providing additional security to participating financial institutions who make loans to qualifying Yukon businesses. The guarantee is designed to complement the federal SBLA program by providing a guarantee for "non-capital" business start-up costs not currently covered under the SBLA.

Similar in operation to the SBLA, the venture partnership guarantee will be limited to 65% of the declining principal balance, and will pay the financial institution a maximum of 65% of any deficiency after realization on any loan security.

With guarantees available between $10,000 and $100,000, the program targets new SMEs, and businesses planning on expanding operations into new products, services or new markets. The seven existing lending institutions (appendix one) have all reviewed a draft of the proposed program, and believe it will help them lend in situations where risk is viewed as too high for conventional financing, notably rural businesses, and possibly the tourism sector *(Stakeholder Interviews, Department of Economic Development, 1996).*

While national data indicate that up to 12% of businesses seek government financing, the Yukon survey indicated 18% of businesses sought financing through government including territorial programs, through federal programs, and through first nation's programs. Businesses seeking government financing report a 61% overall success rate *(Access to Capital, 1994).*

While somewhat similar to national responses, differences emerge when location of business in the Yukon is taken into account. Rural businesses seeking government sources increase to 52% with a success rate of 59%, (37% territorial programs, 10% federal programs, 5% first nation's programs with success rates of 59%, 46%, & 80% respectively. This data suggests that government sources of capital financing were very important to businesses located in rural areas of the Yukon up to 1994.

CHAPTER SIX

GAPS IN CAPITAL FINANCING IN THE YUKON

Through comparison of national and regional data, this chapter analyzes the data collected and identifies market failures in the supply of capital financing in the Yukon

EQUITY

Retained Earnings:

No difference was found between southern Canada and the Yukon in the use of retained earnings as a source of financing for small business, approximately 39% of financing in Yukon compared to 30% in southern Canada. (See page 56 for further discussion).

Venture Capital (Formal and Informal):

Approximately 28% of Yukon businesses reported using informal sources of financing (family, friends and individuals) with an 87% success rate *(Access to Capital, 1994)*.

This compares with 10% in the national survey, with an 80% success rate *(Peterson, 1995).* The Yukon data are slightly higher than the national data, and suggest that informal capital sources are both available and readily used in the Yukon.

There are no known sources of formal equity financing currently offered or available to small businesses in the Yukon. While 2% of businesses reported seeking formal venture capital as a source of financing, these businesses likely approached any of the seventy-seven venture capital providers operating in southern provinces. The thirty-three Yukon businesses which sought venture capital financing reported a 54% success rate, compared to the national survey where 3% sought formal venture capital financing with a 71% success rate. The lower success rates experienced by Yukon businesses are probably a result of geographic restriction on southern venture capital funds due to tax rules or other lending restrictions. The approval rates reported by businesses in both Yukon and southern provinces contradicts other which indicate that venture capitalists review 70 applications for each funding approval *(WED, 1994).* Applications are probably being "pre-screened" so that business do not consider the failure to have their proposal reviewed a formal application or rejection. In any event, Yukon businesses are reporting approximately the same access to formal venture capital as southern businesses though experiencing lower success rates.

Informal investors do exist in the Yukon, and are likely being matched through personal networking and private referrals. The 1994 survey noted 3% of Yukon businesses sought financing from individuals and friends with a 77% success rate. This compares to the national survey which indicated 3% of businesses sought this option with an 67% success rate. The difference is due to the national survey categorizing sources as "friend or relative" and "other individuals" while the Yukon survey categorized "family" and "friend or individuals". Combined, friends, family and relatives made up 28% of Yukon sources, with a success rate of 87%, compared to 10% and 80% respectively for the national survey. This data tends to confirm that Yukon businesses are relying on informal investment capital from individual sources and experiencing success at slightly greater rates than southern businesses.

The Western Economic Diversification Report in 1994 suggested that informal investors provide up to 5.4% of all business financing, and normally approve only one in forty proposals they review. The high rates of reported success for both the Yukon and southern provinces again may be suggesting that there is significant pre-screening occurring in the informal networking and referral process. This source of equity financing however could represent a strong source of local capital in the future.

Government Equity Programs:

At this time no government programs exist which contribute direct equity into Yukon businesses. Programs are offered through BDBC called patient capital, a hybrid loan which acts like venture capital. Repayment is tied to profitability and the debt is subordinated to other debt and is just ahead of shareholders. Based upon eligibility criteria, there are few existing businesses or emerging high growth sectors in the Yukon which would qualify for this funding. Other jurisdictions all report some forms of equity financing programs which involve personal tax credits, to encourage investment into key sectors, regions or industries. Yukon's supply of equity capital from government sources is therefor comparatively much lower than that offered to SMEs in southern Canada.

Other Equity:

There are no existing labor sponsored venture capital corporations operating in the Yukon, and it is uncertain whether any existing funds have the mandate to invest outside of their jurisdictions because of the provincial tax credit implications.

Federal programs still exist for assisting in export marketing finance, research and development through Industry Canada and National research Council, and the Scientific Research & Experimental Development Program's refundable investment tax credits available through Revenue Canada. The export assistance programs available through Industry Canada should have application in the emerging Yukon forest development sector.

DEBT

Banks:

Five chartered banks operate seven branches and six agency offices in the Yukon (Appendix One, and Two), but only providing a full range of commercial banking services in Whitehorse. The Commerce Bank operates two rural branches located in Watson Lake and Dawson City, with commercial loan applications processed by lending staff based in Whitehorse. The ARA Consulting Group Inc. report entitled "Study of the Rationale for the Yukon Business Development Fund, April 1995, determined that Yukon branches of the chartered banks make commercial loan decisions similar to their lending colleagues in southern Canada. The report concluded that there are no regional or systemic differences in lending practices used by the banks in the Yukon.

While no overt discriminatory practices exist in local lending, the bank's perception of location risk may be excluding rural businesses from access to capital financing (IMC, Ordish Access to Capital , 1986). This report found that banks hesitate to lend outside of Whitehorse due to higher costs to service loans, including due diligence, security valuations, and the perceived higher costs of collection for businesses located in rural communities. In recent discussions with bankers, little has changed since 1986 when the key concerns about rural financing were small and seasonal markets, absence of a strong secondary market for commercial property in remote locations, and higher seasonal security costs associated with loan realization.

Stakeholders continue to emphasize access to conventional financing as a key problem challenging SMEs in the Yukon *(Chamber of Commerce Fax Poll, 1995; Stakeholder interviews, Economic Development Business Plan 1995).*

In the 1994 access to capital survey, 54% of Yukon businesses reported using banks or financial institutions for financing with a success rate of 86%. The Yukon source is lower than the national survey data which indicated 68% of businesses seek financing from banks, and a further 27% seek financing from other financial institutions with success rates of 81% to 85% respectively. This difference emerges due to the responses of rural businesses in the 1994 Yukon survey. While 54% of all Yukon businesses reported using banks or financial institutions, only 29% of rural businesses reported seeking financing through this source. Likewise these rural businesses reported only 70% success when obtaining financing from this source.   This data confirms stakeholder comments that it is more difficult for rural businesses to obtain bank financing than businesses located in Whitehorse. Whitehorse businesses sought bank financing in 67% of the sample, the same as southern businesses, except that the Yukon businesses experienced a 97% success rate with the effect of rural responses netted out. This is significantly higher that the national survey data, and may be due to significant pre-screening of Yukon business applicants, as well as a very stable and well established business community in Whitehorse.

In interviews with bankers, most indicated no existing bank policies which discouraged lending in rural Yukon, however several bankers indicated that they were unable or unwilling to lend to tourism commercial operations located outside of Whitehorse without the SBLA guarantee.

This data strongly suggests that rural businesses face more difficulty in accessing bank financing than Whitehorse based businesses, due to real and perceived higher risks for banks in rural lending.

Other Financial Institutions (BDBC & DNV)

With no credit unions or trust companies located in the Yukon, businesses have fewer choices than southern businesses who report seeking financing from this source 27% of the time, and enjoying an 84% success rate.

The Business Development Bank of Canada offers programs to Yukon businesses similar to southern Canada, and BDBC has gained a reputation for lending in rural communities and sectors where banks typically will not lend due to perceived risk. With their expanded mandate, BDBC is a significant source of capital financing in the Yukon.

BDBC however cannot provide working capital and other types of non-asset based lending to small businesses.

Besides chartered banks and Business Development Bank of Canada, Yukon businesses can access capital financing from Dana Naye Ventures, a First Nation's capital corporation operating out of Whitehorse. Dana Naye Ventures now provides small business loans up to $250,000 and provides term loans, operating credits, bonding and other forms or seasonal credit. Funding under Native Economic Development Program is limited to first nations applicants, while the general loan fund is limited to available capital. Dana Naye Ventures also offers funding through the Aboriginal Business Canada initiative funded by Industry Canada. Part of a national program, ABC provides $9 million for loans for First Nation's projects, which must compete for this funding with first nation's businesses in western Canada.

Dana Naye Ventures offers a range of loans to small businesses at higher costs than conventional banks, but is normally willing to take on higher risk projects than the banks. Also Dana Naye Ventures administers the Self Employment Assistance Program funded by Human Resource Development Canada for unemployed workers to start their own small businesses. This program assists unemployment insurance recipients develop a business plan, and where feasible permits them to extend their insurance payments for a further period while they launch their business. Approximately 5% of Yukon businesses indicated accessing first nations funding with an 80% approval rate. No comparable data on national use and success rates were found.

Supplier Credit/Leasing:

While no direct data was found on the availability of supplier credit and leasing in the Yukon, there was inferential data which suggests that Yukon businesses utilize trade credit and other forms of short term liabilities to finance operations *(Small Business Profiles, Yukon, 1994 Edition p. 582-584).*

Government Programs:

The Yukon Government's 1994 Access to Capital Survey indicated that about 28% of businesses obtained financing from all government sources (federal, territorial and first nation's programs), with a 54% success rate. The rural respondents reported heavier reliance on government sources. Businesses outside Whitehorse reported approximately 54% reliance on government sources of financing with a 51% success rate. Only 17% of businesses in Whitehorse reported using government sources with a 55% success rate.

While Yukon businesses regardless of location have about the same success rate with government programs, three times as many rural businesses rely on government programs as Whitehorse based businesses. With the withdrawal of Yukon Territorial business loan programs, and the termination of the federal/territorial Economic Development Agreement in 1996, it is highly probable that rural businesses will face a significant gap in capital financing. With conventional lender's reluctance to lend in rural communities where risk is viewed as higher than acceptable for conventional lending, rural businesses will likely face an even greater gap in capital financing in the near future.

CHAPTER SEVEN

ANALYSIS OF THE YUKON CAPITAL MARKET CONDITIONS

This chapter analyzes the Yukon market in terms of systemic barriers to capital formation, looking for conditions which may be unique to the Yukon, or disadvantageous in comparison with southern Canada

Retained Earnings:

Aggregate statistical data indicate that 73% of Yukon Businesses are fairly profitable, and debt to equity ratios indicate businesses range from 1.7:1 in the bottom 25% to .3:1 in the top 50% *(Small business Profiles, Yukon 1994 Edition p.582-585)*. Coupled with the results of the 1994 Access to Capital Survey, Yukon businesses in general appear to have healthy levels of retained earnings to finance operations.

Similar to reports in southern Canada, Yukon small businesses may be "starved" for equity at the critical early stages in their growth and have to rely on greater proportions of debt financing. A 1983 survey found significant differences in debt to equity based upon business size and between businesses in Canada and Yukon. Here one sees Yukon businesses earning between $50,000 and $100,000 in revenues with the Yukon debt to equity ratio at 5.7:1 compared to 1.9:1 in southern Canada. A high total debt to equity value would be 3:1 with most banks prefering a 2:1 ratio.

(Table Two) Debt/Equity Ratio 1983 (by firm size K = 000s):

Revenues	<$50K	$50K-$99K	$100K-$249K	$250-$500K	$500K+
Canada	1.82	1.9	2.75	3.0	2.86
Yukon	.89	5.7	1.61	2.75	4.38

(Financial resources:An Economic Environment Discussion Paper, Yukon 2000, Colin Heartwell, 1987).

This data on debt to equity ratios tends to indicate that very small businesses experience a credit crunch early in the growth phase of their business cycles, where debt exceeds equity (a rule of thumb in small business would be to try and maintain a debt to equity ratio under 3:1). As one source indicated, businesses often plan for enough working capital for one year, and "companies experiencing high growth potential often need to seek outside equity as they quickly run out of internally generated funds and borrowing limits" *(Financial Post Daily vol. 8(50), May 2, 1995 p.13 Small Business Capital hard to Find).* Yukon businesses appear to be financing growth by using a greater proportion of debt than equity when compered to Canada as a whole.

Formal Venture Capital:

Formal venture capital, either through southern based corporations or local sources is not likely to be a significant source of small business finance for the Yukon. Representing only 2% of small business finance, venture capital is possibly the least visible and accessible to small business, and even more so to businesses in the Yukon. Venture capitalists select possibly one in seventy proposals and target proposals which offer returns as high as 40%. Recently Canadian investments have been concentrated in expansions and acquisitions rather than early stage development projects *(Venture Capital in Canada, Annual Statistical Review and Directory, June 1995, table 3).* Given the high number of projects eliminated in the approval process, Yukon proposals would be at a disadvantage competing with the shear volume of southern proposals. Still, Yukon businesses have reported accessing formal venture capital sources with reasonable levels of success *(see 1994 Access to Capital Survey, Yukon Statistics Bureau).*

A local "formal" venture capital company or corporation would be difficult to establish because of the large volume of potential high return projects required to develop a self-sustaining portfolio. As well, with minimum investments of $500,000 to

$1 million, formal venture capital is positioned at the high end of the SME investment market for most Yukon businesses needs.

Informal Venture Capital:

The Western Economic Diversification Report, "Financing for SMEs in Western Canada, 1994", suggest that in Canada "for every active investor, there are at least ten potential investors" in the informal investor pool. The profile for this group are individuals with average annual incomes of $150,000, and net worth's of $1 million or more. Most informal venture capital investments are less than $250,000, and the average personal investment tends to be about $100,000 *(WED, 1994 p.17).* With informal venture capitalists believed to be evenly distributed in the national population *(WED, 1994 p.18)*, the author estimates that there could be between 170 and 280 individuals in the Yukon who would fit this profile. This potential pool of investors could possibly raise $17 to $28 million in investment capital for the Yukon. Dana Naye Ventures recently estimated that it would take a $10 million loan portfolio to be self supporting, therefor, an informal venture capital company could be feasible by capturing about 50% to 70% of available informal investors in the Yukon.

The recently announced Canada Community Investment Program CCIP through Industry Canada is structured to support a locally based program to match informal investors with local projects requiring equity. Based upon other provincial models, such programs normally include a tax credit to encourage private investments. Tax credits range from 20% to 30% on investments in these programs *(see Appendix Six, Table Two).* A similar tax incentive program may be necessary in the Yukon to lever out private venture capital investment.

Yukon Sources of Debt

Banks:

Data from the 1994 ARA Business Development Fund Loan Rational study and the 1994 Access to Capital survey indicate that Yukon businesses have similar access to institutional financing as southern small businesses. Businesses report about the same success in obtaining bank financing as southern businesses (80% - 81%), and by all accounts the local "term debt" market appears adequately served. The exception appears to be rural businesses which report much fewer approaches to banks, and less success in obtaining bank financing.

Rural businesses also reported more reliance on government funding sources which are no longer available. The apparent gap in rural bank financing could therefor be compounded by the cancellation of federal and territorial government financing programs for small businesses. On the other hand, both Business Development Bank of Canada and Dana Naye Ventures have expanded mandates to provide financing to small businesses and both have expertise in rural lending where perceived risk is as higher.

Business Development Bank of Canada:

The Business Development Bank of Canada micro-loan program may meet some of the needs of rural Yukon businesses, particularly with the loss of territorial government programming. The difficulty with the micro-loan program will be the cost of the "up-front" due diligence which the applicants must pay for to qualify for these loans. Training, advisory, and business counseling services are all located in Whitehorse and rural businesses will have to pay higher costs to travel to Whitehorse for the training and counseling sessions. If training is provided in rural Yukon communities, the costs of such training will greatly add to the administrative costs of the program compared to costs of service to Whitehorse based businesses. It remains to be seen how Business Development Bank will deliver this program in rural Yukon.

Dana Naye Ventures:

Dana Naye Ventures has increased its loan limits from $100,000 to $250,000, and is targeting about one half of its loans to rural businesses. Offering counseling and training along with financial services, Dana Naye Venture's loans and services are priced higher than Business Development Bank to reflect both risk and cost of funds. Dana Naye Ventures also provides Aboriginal Business Canada (ABC) funding for first nation's businesses, which are normally concentrated in the fourteen rural communities in Yukon. Dana Naye Ventures should therefor be able and willing to fill some of the gap in rural lending services left by government's withdrawal, but they are severely constrained by their own access to funds for lending.

SBLA:

The local chartered banks report using the SBLA guarantee to extend loans into rural communities, and national studies indicate that about 35% of SBLA funding goes into new high risk business starts *(Taking Care of Small Business, Oct. 1994* This means that at most, perhaps 25% of the SBLA insured loan funds in Yukon may be reaching rural businesses.

Venture Partnership Program:

The Yukon government's planned venture partnership guarantee program may encourage financial institutions to extend more working capital loans to higher risk business start-ups and businesses located in rural Yukon. With the experience of the SBLA program as a guide, the $3 million earmarked for the guarantee program may see about $750,000 reaching its target, levering out a further $214,000 in unsecured bank financing. One key difference is that the SBLA insures 90% of the loan on a declining balance, while the venture partnership guarantee of the Yukon government proposes a 65% guarantee on a declining balance. With the chartered bank's preference for 3:1

security coverage on small business loans, it remains to be seen whether the venture partnership guarantee will encourage banks to lend into more risky areas like rural Yukon.

CHAPTER EIGHT

OPTIONS FOR MARKET CORRECTION:

Does the market require correcting? Four gaps or failures in the Yukon market appear when compared to Canadian capital markets. This chapter briefly examines each gap and possible options to correct or fill these gaps.

Based upon the data collected to date, small business capital market in the Yukon is as well served as southern markets with the following exceptions:

- *the absence of credit unions and trust companies as options for debt financing*
- *the absence government sponsored venture capital programs (with tax credits),*
- *the elimination of government loan programs*
- *less access to financing by rural businesses*

Trust Companies and Credit Unions:

The absence of credit unions and trust companies result in fewer options for small business financing than available in southern Canada. The 1990 report by KPMG suggests that a trust company could prove feasible with significant direct investments from both the Yukon Territorial Government, Yukon First Nations, and a joint venture partnership with an existing trust company which would supply the operational expertise.

No analysis of market was conducted, and any trust company would face stiff competition from existing banks in the territory. Given the regulatory restrictions on trust company commercial lending, it is questionable whether a trust company would provide greater access to capital financing, particularly to higher risk rural businesses.

While no specific investigation was conducted on credit unions, feasibility is believed to be similar to that of credit unions. As credit unions are not a significant player in commercial financing, it is unlikely that this option would provide additional access to SME financing in the territory.

Government Sponsored Venture Capital:

While some informal investors currently exist in the territory, SMEs appear to have great difficulty locating them, and informal investors are not likely to absorb the risk of most new business start-ups without an added tax incentive and the ability to syndicate and share this risk with other investors.

A government sponsored venture capital company is possible with the federal government's new Canadian Community Investment Program. With some form of tax credit coupled with the federal program underwriting of two thirds of administrative costs for up to five years, a local venture capital company could provide a significant source of equity capital for local business financing. A local venture capital company would screen projects, administer a tax credit program, and syndicate risk. Expertise could be contracted from existing southern organizations until local experience could be developed.

If such a program were limited to $12 million paid-in capital, given a 30% tax credit, the program would only cost government on a one time only basis $3,600,000 in foregone tax revenues. This would likely be spread over a number of years rather than hitting in one fiscal period as it would take time to attract sufficient investors for the program to become fully subscribed.

Government Loan Programs and Rural Business Financing

Rural businesses experience greater difficulty in obtaining bank financing, and to rely more heavily upon government funding options. In the absence of direct government funding programs, Yukon's rural businesses will probably experience additional problems in successfully accessing financing. While BDBC and DNV have increased mandates which should reach rural businesses, this sector will have to be monitored closely to determine if any adverse effects begin to materialize.

The Yukon Government's Venture Partnership Program may help to extend credit to rural businesses through the chartered banks. However, with the increased risk banks are being asked to accept under the program (35% compared to the 15% under SBLA guarantees), it is questionable whether venture partnership guaranteed loans will actually reach rural businesses. The program will have to be monitored closely to evaluate whether it is improving access to financing for rural businesses.

CHAPTER NINE

CONCLUSIONS AND SUMMARY

Over the years access to capital has been a subject of strong debate and government has traditionally taken the role of intervention to alleviate market failure. Through the 1980s government loan programs were available in most jurisdictions in Canada, including the Yukon. Yukon Government loan programs reached perhaps 10% of the small business market with higher penetration in rural communities. After almost ten years of government loan funding, it is early too determine what impacts the government withdrawal from the financial market will have on small business, particularly as local economic conditions are still buoyant. With existing supply of capital financing, and the financing programs being offered, the Yukon business community is likely to experience little immediate decline in supply of credit. The impacts however will be felt by new business starts, and higher risk sectors such as rural businesses which previously relied on higher risk government financing.

The Venture Partnership program should be monitored closely to ensure it is being extended to higher risk businesses, particularly in rural Yukon. If after initial evaluation, it is determined that the program has not mitigated bank risk sufficiently to increase lending for new business starts and in rural areas, the program guidelines could be amended to target rural businesses, possibly through increasing the level of guarantee provided for rural business loans (I.e. increasing guarantee from 65% to 100% if necessary).

The Canada Community Investment Program may provide an excellent vehicle for matching local investors to local entrepreneurs. The Yukon Government could consider playing a key a role in providing tax credits for qualifying investments to help lever out the private capital necessary for this program to work. The Department of Economic

Development should review these measures with the Department of Finance to determine what level of support could be provided to a community based venture capital provider.

While capital availability appears adequate in Yukon at this time, market conditions are changing constantly and could be influenced by a downturn in the business cycle. Government should continue to monitor changes in the capital market, and adjust policies and programming as required to ensure Yukon businesses enjoy similar opportunities to access capital as their southern counterparts.

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Appendices

Appendix One:

List of financial institutions operating in the Yukon

Appendix Two:

Table Three - Bank branches by institution and location in Canada (CBA)

Appendix Three

Globe & Mail Article - Federal Bank Tackles Small Loan Gap

Appendix Four:

Sources of Financing Canada, (Pie Chart)

Appedix Five

Sources of Financing & Success Rates, Yukon

Appendix Six

Table Two - List of Government programs for small business available in western Canada (taken from WED, 1994)

Appendix Seven

Chartered Bank Assets, Western Canada 1993

APPENDIX ONE
Financial Institutions Operating In Yukon

Bank of Montreal
Manager, (over 15 years in the community), Two commercial lenders
Specializing in personal banking and commercial loans

Canadian Imperial Bank of Commerce (CIBC)
Manager (average two years in community), Two commercial lenders
Specializing in personal banking and commercial lending, former holder of government accounts.
Only bank with rural branches in Dawson City and Watson Lake.

Toronto Dominion Bank (TD Bank)
Manager, (new to community, previously posted here in the 70s), Two commercial lenders
Current holder of the government's accounts, specializing in both commercial and personal lending.

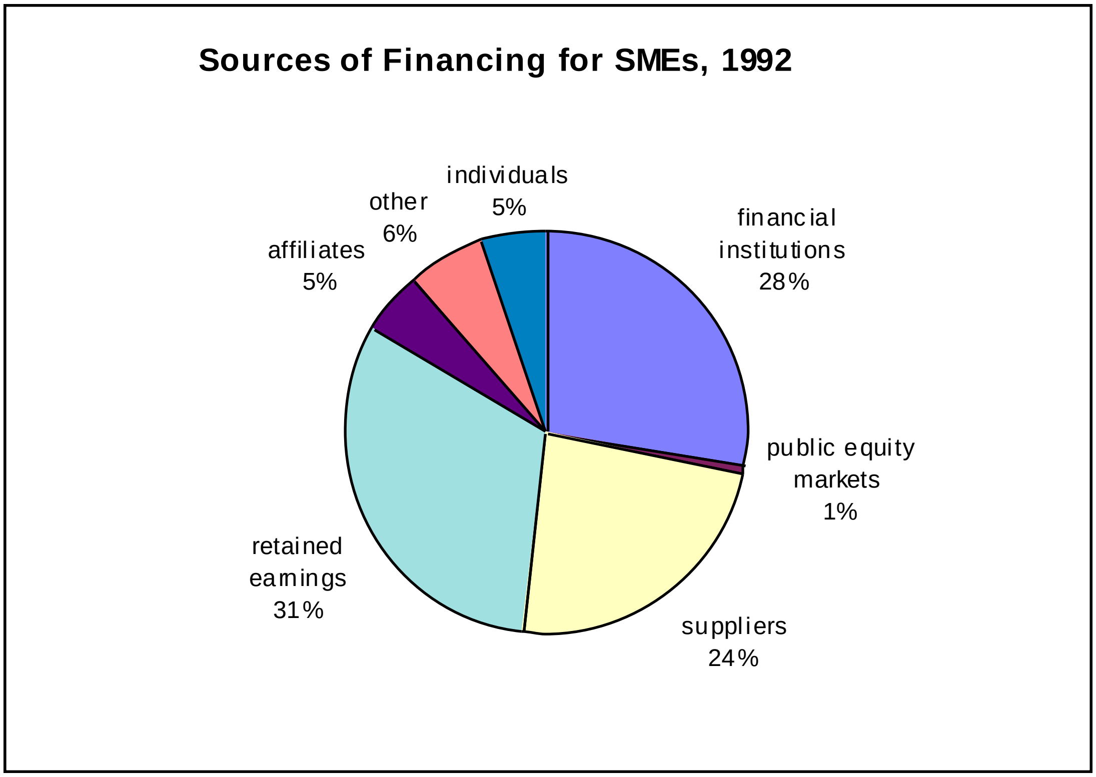
Royal Bank of Canada (Royal Bank)
Manager (average about two years in community), Two commercial lenders
Specializing in commercial lending, and personal mortgages and loans.

Bank of Nova Scotia (BNS)
Manager (average two to five years in community), one commercial lender
emphasis on personal lending, some retail commercial.

Business Development Bank of Canada (BDBC)
Manager (average two to five years in community), Two commercial lenders, one management services officer
focus on asset lending, specialize in rural business loans.

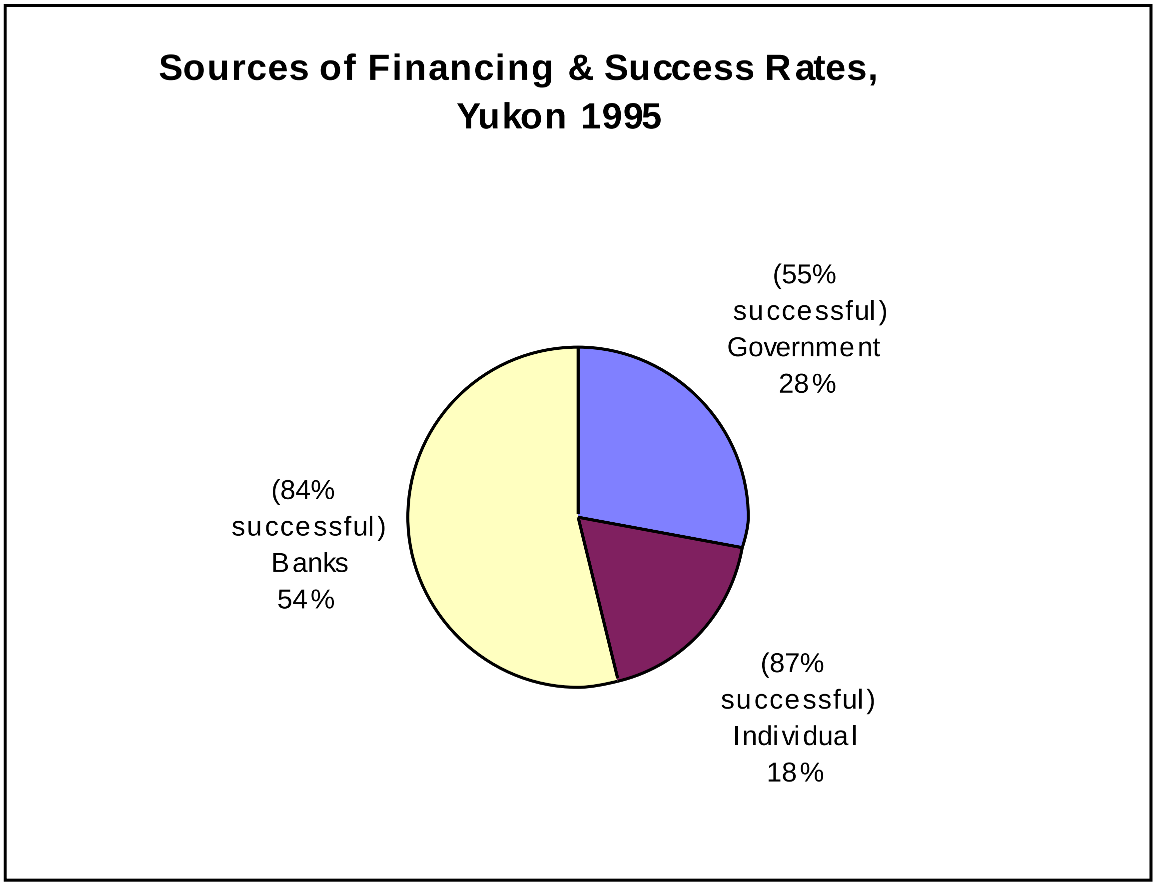
Dana Naye Ventures (DNV)
Loans Board (appointed from local community)
Manager , three commercial lenders, two business training consultants
Focus on aboriginal businesses, and rural businesses

APPENDIX FOUR



Source: John R. Ba;dwin, <u>Strategies for Success: A Profile of Growing Small and Medium Sized Enterpriese (GSMEs) in Canada</u> (Ottawa: Statistics Canada Catelogue No. 61-523R, 1994

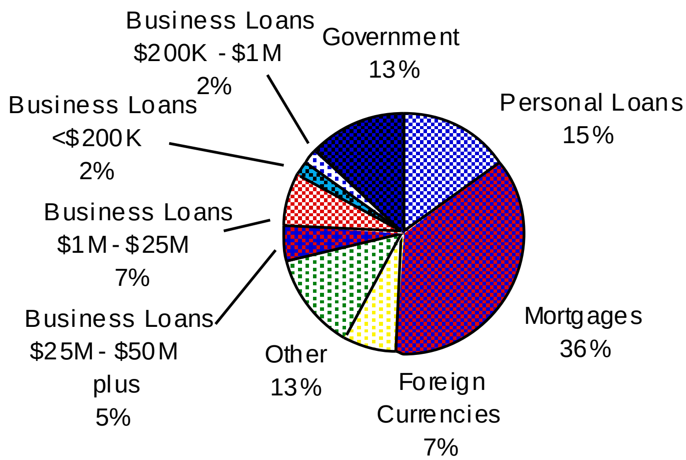
APPENDIX FIVE



Individual sources included both family and other individuals; Banks included banks, trust companies and other venture capital or stock exchanges; and Government included Yukon Government, Government of Canada, and Yukon First Nations.
Source: *Government of Yukon, Yukon Bureau of Statistics:* *1994 Yukon Business Survey, Access to Financing, Queens Printer, 1995*

APPENDIX SEVEN

Chartered Bank Assets, Western Canada 1993



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