

***Let’s get the job done!***

Policy paper number 4:

**Three steps to promote jobs**

**and access to capital**

January 13, 2012

Dear friend,

There is much to say about jobs and the economy in these times of rising inequality, recession, unemployment, child poverty, and global financial crisis. I will continue to address these issues in the coming weeks, and our party had much to say about these issues in the recent federal election.

I believe that:

1. *Canada should aim for greater economic equality as a first priority.*

In my paper *What the NDP is all about: Social democracy, and a more equal Canada,* I argue that the fundamental difference between Liberals and New Democrats is that Liberals seek equality of opportunity in the economy, while New Democrats seek substantive equality -- equal access to fundamentals like employment, health care, education, shelter, public transportation, a clean environment, and a much smaller gap in incomes between the richest Canadians and the rest of us.

I argue that on many important measures (poverty, crime rates, social mobility, longevity, etc.) more economically equal societies are better societies for everyone – including the wealthiest among us. Taking practical steps towards greater equality is our fundamental purpose as a party, and will be the measure of our success in office.

1. *To that end, distortions in our tax system should be addressed.*

In my paper *Bringing Fairness and Balance to Canada’s Tax system*, I propose that regressive and ineffective Liberal and Conservative tax expenditures be re-allocated to more productive priorities.

1. *Canada will build a better economy in part by addressing climate change.*

In a recent speech to the Economic Club of Canada and in my forthcoming paper *Green Canada, Prosperous Canada*, I set out some of the ways I believe the federal government can contribute to building build a more prosperous and sustainable economy.

1. *The NDP’s 2011 platform proposed a detailed plan to promote jobs and income security.*

Finally, in our May 2011 election platform, our party set out a detailed economic and jobs plan – including short- and long-term proposals to reduce unemployment and to promote income security. I think these proposals hold up well. They include:

1. Support for job creation in the small business sector:
* A pay-for-performance, $4,500 credit for the creation of a new full-time job;
* Extension of other targeted measures , including extending the accelerated capital cost allowance for investments in manufacturing and processing and clean energy sector, and the mineral exploration tax credit; and
* A reduction in the small business tax rate from 11% to 9%.
1. Modernization of Canada’s infrastructure;
* A sustained federal infrastructure program to modernize our transportation, energy, sewer and water systems – basic building blocks of our economy.
1. Investment in post-secondary education and job training;
* Funding to promote excellence and accessibility in our post-secondary education system.
1. Reinforcement of Canada’s income security system;
* A major initiative to address the crisis of private pensions, through the phasing in of a stronger Canada Pension Plan and enhanced old age security system sufficient to bring all seniors out of poverty; and
* Steps to improve Canada’s employment insurance system.
1. Steps to help families and to reduce child poverty
* An enhanced child benefit program; and
* Federal investment in child care.

To support our recovery and a dynamic economy, the federal government should promote access to investment capital in the real economy, by taking further concrete steps to help finance small and medium-sized businesses.

In this paper I propose:

* **Enhancing the new federal framework for credit unions;**
* **An enhanced, reformed, tightly-regulated federal labour-sponsored venture capital program, that builds on success and learns from mistakes; and**
* **A stronger federal commitment to work with small and medium-sized businesses to build export markets.**

This is the fourth of a series of policy papers I've released during this leadership campaign. You can find all of them at [www.briantopp.ca](http://www.briantopp.ca). If you liked this one, please forward it to others you think might be interested, and I also would value your comments or suggestions. If I have persuaded you to support my campaign, please get in touch with me through my website to volunteer or donate.

All the best,

Brian Topp

**Why target small and medium-sized companies?**

Small and medium-sized businesses (SMEs) are critical to the Canadian economy. They act as engines of job creation, economic growth and innovation. An “SME” is usually defined as a business with less than 500 employees and less than $50 million in sales. The economic and social importance of this sector is well recognized in academic and policy literature. Canadian SMEs deliver 60% of Canada's economic output, generate 80% of national employment and 85% of new jobs**.[[1]](#footnote-1)**

It has been frequently acknowledged that small and medium-sized businesses face challenges in access to capital. If we want a healthier small and medium sized business sector in Canada, financing needs to be available across the entire balance sheet, including senior financing such as accounts receivable or inventory financing, as well as higher risk forms of investing including mezzanine or cash flow lending, and equity capital.

Surveys of Canadian and U.S. business owners suggest that access to financing in Canada is more difficult than in the United States. Using the 2003 Survey of Small Business Financing in the United States and the 2004 Survey on Financing of Small and Medium Enterprises in Canada, compared to U.S. SMEs, Canadian SMEs rely more heavily on loans from individuals (family, friends and others) and less on loans from financial institutions.[[2]](#footnote-2)

A key hurdle for a SME to receive financing is that the company may not have the security required for conventional collateral-based bank lending, nor high enough returns to attract formal venture capitalists and other risk investors who provide mezzanine and equity capital. The most frequently-cited reason for an SME seeking financing is to finance working capital (45%).[[3]](#footnote-3) Financing working capital is of particular importance to growing firms, exporters, and newer firms.

The need for mezzanine and equity financing is becoming more important as baby boomers look to retire and facilitate succession planning or sell their businesses and retire. It is estimated that 29 % of Canadian entrepreneurs will be retiring between 2010 and 2020.[[4]](#footnote-4) Without proper succession, the health of the sector, and the greater Canadian economy, will suffer. Only one-third of family-owned businesses survive the transition to the second generation. And of these businesses, again only one-third will survive to the third generation.[[5]](#footnote-5) This suggests a need for financing the purchase of family-owned businesses.

Access to capital is also a major issue for new and young entrepreneurs. In 2007, young entrepreneurs were more likely to indicate “obtaining financing” as an obstacle (26%) than the average entrepreneur (17%). Younger firms typically lack the operating history and collateral to fit the risk profile that financial institutions are prepared to take.[[6]](#footnote-6) The lack of operating history, management experience, and the size of the firm make it more challenging for financial institutions to lend to them. This in turn forces the owners of start-ups to rely on informal credit sources such as personal savings and family money to support their operations. Programs designed to encourage investment in young entrepreneurs will help them succeed, as the Baby Boomer group begins to retire.

So what is to be done?

Here are three proposals to promote access to capital for small and medium-sized business:

1. *Enhance Federal credit union legislation*

Credit unions play an important part in the Canadian financial sector. Credit unions are community-based and community-focused. They play an integral role in local development by reinvesting their deposits and profits in the community as personal and business loans, mortgages and dividends paid on member shares. Over the years, credit unions have taken the lead in developing and introducing financial service products. Credit unions are often smarter, more flexible and more determined to succeed in lending to small and medium-sized businesses in the communities in which they operate. There is potential to broaden the credit union system, and to promote credit unions to lend more to small and medium-sized business.

**I propose that new federal credit union legislation be enhanced to promote the establishment of new credit unions while respecting the integrity of the credit union governance structure. Enhancements would allow them to reach a larger client base while respecting the credit union difference.***Enhance the Federal Labour-sponsored venture capital program*

Labour-sponsored venture capital funds have a history of success in Canada. Quebec’s Solidarity Fund is the shining example. The Quebec Federation of Labour’s Solidarity Fund has become a major element in the economic development of Quebec. A voluntary pension scheme with over 583,000 shareholders and assets of approximately $8.1 billion Canadian dollars, the Fund holds equity in some 2,100 small and medium-sized enterprises that have created and/or saved over 160,000 jobs. The success of the Fund is founded upon twin objectives. Its main goal is profit, yet the Fund promotes workers’ rights and training and development for employees. The Solidarity Fund is an example of how retail investor and public sector tax credits can combine to provide a healthy and successful way to deploy risk capital to SMEs.

Some tough lessons can be learned from Ontario’s less-successful “LSIF” program. A number of unsuccessful labour-sponsored funds were launched in Ontario in the mid to late 1990s. Too many funds were launched; excessive fees suppressed returns; and a singular focus on risky high technology investments resulted in steep losses, which in turn led the Ontario government to phase out its program – at a high price.

Since the phasing out of Ontario’s program, risk capital has had an astonishing drop compared to Quebec. In Ontario the number of companies that received VC financing decreased 16% from the second quarter of 2010 compared to the second quarter of 2011, while the number of companies that received VC financing in Quebec increased by 35% in the same period.[[7]](#footnote-7)

What remains of the venture capital industry in Ontario is drifting away from small business. In the second quarter of 2011, the average venture capital investment was $3.74 million in Ontario (a total $116 million in only 31 investments) whereas in Quebec it was $1.47 Million ($113 million in 77 investments). In other words, Quebec is doing a much better job of getting its venture capital into the hands of a greater number of smaller businesses.

**I propose an enhanced and renewed federal labour-sponsored venture capital program, that learns from the success of the Quebec system and from the lessons of the Ontario experience. I propose that permitted placements in federally-chartered labour-sponsored funds be increased to $15,000 from then current $5,000; that eligible investors be limited to sophisticated parties, who are investing on the advice of investment professionals; and that management fees and charges, diversification of investments, and eligible managers be much more carefully regulated and limited than was the case in Ontario.**

1. *Expand the Export Development Corporation Contribution to small and medium-sized business*

Finally, the federal government should do a better job working with small and medium-sized businesses to encourage them to build export markets.

One of the most impressive characteristics of the German economy is its “Mittelstand”, its tier of small and medium-sized businesses who have built global export markets by pursuing excellent, high-quality, innovative products and marketing them around the world (as just a small example of the reach of this sector, I recently visited an increasingly-successful British Columbian distillery on Vancouver Island, which is building a Canada-wide market for several artisanal spirits products. At the heart of the operation was polished, sophisticated and high-quality distillery equipment – imported from a small German firm, with a well-earned reputation for manufacturing the best such equipment in the world. Even small organic farm and distillery operations on the west coast of B.C. are creating jobs in Germany in that country’s small and medium-sized business sector – a lesson for us).

We can do better. Once we have begun to address how to better capitalize small and medium-sized businesses, we need to work with them to take their place in the global market – a key element of any plan to move Canada away from dependence on the bulk export of raw materials, and into value-added economic development at the community level.

Export Development Canada currently provides services in support of Canadian trade businesses including, but not limited to guarantees to banks in order to increase operating lines, accounts receivable insurance, and/or alternatively provides their bonding services to free up working capital when dealing with foreign trade partners who require letters of credit to establish a trade relationship.

**I propose that Export Development Canada explicitly allocate at least 5% of its programming to small and medium sized business – and actively engage with small companies to encourage them to build their overseas sales.**

Mandating a volume and/or dollar amount to the SME financing segment would create a new focus on the SMEs; which in turn, would help to free up working capital and encourage export growth.

**Conclusion:**

A new mandate to banks; a stronger national credit union system; a renewed, tightly-regulated venture capital incentive; and enhanced export assistance can be building blocks for our real economy -- steps that will encourage job creation, diversification and value-added enterprise across Canada.

1. Industry Canada 2002 (<http://www.ic.gc.ca/eic/site/ecic-ceac.nsf/eng/gv00454.html>). [↑](#footnote-ref-1)
2. Bank of Canada 2008 Are there Canada US Differences in SME Financing http://www.bankofcanada.ca/2008/10/publications/research/working-paper-2008-41/ [↑](#footnote-ref-2)
3. Government of Canada, Key Small Business Financing Statistics, December 2009 [↑](#footnote-ref-3)
4. CIBC World Markets, Are Canadian Entrepreneurs Ready for Retirement, 2005 [↑](#footnote-ref-4)
5. BDO Canada, Succession Planning for Family Business, [↑](#footnote-ref-5)
6. Government of Canada, Key Small Business Financing Statistics, December 2009, [↑](#footnote-ref-6)
7. Industry Canada, Q2 Venture Capital Monitor, 2011 [↑](#footnote-ref-7)