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SMALL BUSINESS

Financing Profiles

SME Financing Data Initiative

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Small and Medium-Sized Enterprises in Quebec

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In Quebec, small and medium-sized enterprises (SMEs) account for 96 percent of all businesses.¹ Not only have SMEs been important drivers of job creation and economic growth, but they have also been strong contributors to productivity, having led larger firms in productivity growth over the last 10 years.² Access to financing is critical if SMEs are to develop and expand. Using data from the SME Financing Data Initiative, this article provides an overview of the characteristics of SMEs in Quebec and compares financing activity between the average Quebec firm and the average Canadian firm.

Summary of Key Findings: *SMEs in both Quebec and Canada are small, typically with fewer than five employees. Like many Canadian SMEs, most SMEs in Quebec rely on informal sources of financing, such as personal savings and personal credit. Yet the financing patterns of Quebec SMEs also differ in several respects from those of other Canadian firms. Caisses populaires are important suppliers of debt financing to SMEs and appear to place relatively more documentation requirements on Quebec SMEs. Overall, Quebec firms also tend to be slightly less growth oriented, but account for a significant amount of research and development (R&D) activity in Canada and are more likely to seek and receive venture capital. Risk capital is an important source of financing among high-growth and technology-focused SMEs. Firms in Quebec obtained venture capital at a rate that was disproportionately greater than its share of knowledge-based industries.*

Definitions

This analysis defines small and medium-sized enterprises (SMEs) as commercial (for-profit) businesses with fewer than 500 employees and less than \$50 million in annual revenues.

Excluded are non-profit and government organizations, schools, hospitals, subsidiaries, co-operatives, and finance and leasing companies.

This analysis compares the profile and financing activity of SMEs in Quebec with national averages.

GENERAL CHARACTERISTICS

QUEBEC SETTING FOR SMEs

According to Statistics Canada's 2004 *Survey on Financing of Small and Medium Enterprises*, there are approximately 1.4 million commercial (for-profit) small and medium-sized firms in Canada. Of these, approximately 22 percent operate in Quebec, a proportion that is consistent with Quebec's 24 percent share (7.4 million) of the 2004 Canadian population. Table 1 shows the regional distribution of population, SMEs and share of Canadian gross domestic product (GDP).

The incidence of business formation in Quebec is less than the national average, with 62.5 establishments per 1000 population of the province (compares with the national average of 71.5 establishments per 1000 population of Canada).

¹ Statistics Canada, Business Register, December 2004.

² RBC Financial Group, "Small and Medium-Sized Businesses are Driving Productivity Gains," October 2006.
www.rbc.com/newsroom/20061030smallbiz.html

Distribution of SMEs, Gross Domestic Product and Population across Canada, 2004

Region	SME Share	GDP Share	Population
	(% Canada)		
Atlantic Provinces	6	6	7
Quebec	22	20	24
Ontario	36	40	39
Prairie Provinces	22	21	17
British Columbia	15	12	13
Territories	<1	<1	<1
Canada Total	100	100	100

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Statistics Canada, CANSIM, Table 051-0001, Estimates of Population, by Age Group and Sex, Canada, Provinces and Territories.

Statistics Canada, CANSIM, Table 384-0002, Gross Domestic Product, Expenditure-Based, by Province and Territory.

The age distribution of SMEs in Quebec is consistent with the national average. Approximately 11.5 percent of firms in Quebec first started selling goods or services between 2002 and 2004. This compares with 11.2 percent of all Canadian firms.

PREDOMINANTLY SMALLER FIRMS IN QUEBEC

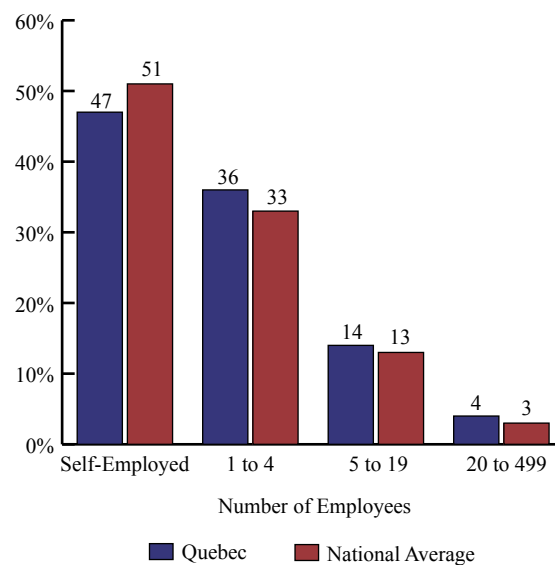
The financing needs of SMEs depend largely on the size of the firm. Medium-sized and large firms are more likely to seek external financing than smaller businesses. It is also widely believed that small firms are less able to obtain financing than large firms and small firms are more likely to turn to informal sources of capital, including personal finances. Figure 1 compares the size distribution of Quebec SMEs with the national average, illustrating that SMEs in Quebec are predominantly small businesses, with 97 percent of firms employing fewer than 20 people. Furthermore, although almost half of Quebec businesses are categorized as self-employed, self-employment is relatively less prevalent in Quebec than the Canadian

average, with 10.3 percent of all workers in Quebec being self-employed compared with the national average of 11.9 percent of all workers.³

INDUSTRIAL COMPOSITION OF QUEBEC SMEs

Quebec boasts an economy that is primarily based on natural resources and energy, but includes 25 percent of Canadian information technology firms, 55 percent of Canada's aerospace production, 30 percent of the pharmaceutical industry and 40 percent of biotechnology companies. Quebec also accounts for 44 percent of all Canadian high-tech exports.

Figure 1
Distribution of Quebec SMEs by Business Size, 2004



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

³ Statistics Canada, *Labour Force Survey*. www40.statcan.ca/l01/cst01/labr66a.htm

Figure 2 compares the sectoral distribution of Quebec SMEs with the national average distribution. Although Quebec SMEs operate in all major sectors, Quebec possesses a relatively higher proportion of SMEs in the manufacturing and wholesale/retail sectors than the national average. Within Quebec, 5 percent of firms are in the knowledge-based sector.⁴ In this regard, Quebec ranks third behind Ontario (with 7 percent of firms in the knowledge-based sector) and British Columbia, which ranks second (with 6 percent of firms in the knowledge-based sector).

CHARACTERISTICS OF SME OWNERS IN QUEBEC

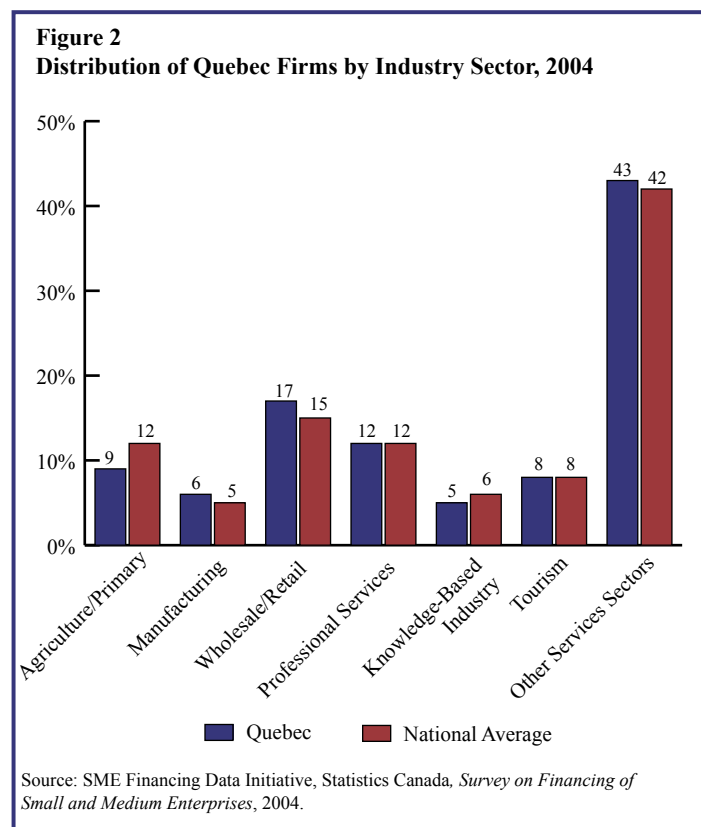
Table 2 compares the profiles of majority owners of Quebec SMEs with national averages. The data show that the profile of Quebec SME owners is largely

consistent with the national average. As would be expected, Quebec owners are predominantly French-speaking; however, the proportion of owners who speak a language other than English or French (6 percent of Quebec business owners) is substantially lower than the national average of 14 percent. Only the Atlantic provinces were lower in this measure.

QUEBEC BUSINESS GROWTH AND INNOVATION

Approximately 34 percent of Quebec SME owners intended to expand their businesses within the next two years compared with 39 percent nationally. Developing a growth strategy is contingent on identifying drivers of, and obstacles to, growth. Firms across Canada reported productivity, commercialization, succession planning and access to financing as the top drivers for business success. One growth strategy is exporting and 8 percent of both Quebec and all Canadian SMEs exported products or services outside Canada in 2004.

Another means of achieving business growth is through innovation. From 2000 to 2004, small, medium-sized and large firms in Quebec funded in excess of \$18 billion in R&D, accounting for over half of the R&D expenditures in the province (see Figure 3). Business R&D expenditures in Quebec accounted for 30 percent of the national total, significantly lower than Ontario at 52 percent. It should also be recalled that Quebec accounts for a high proportion of Canadian information technology, aerospace, pharmaceutical and biotechnology companies. Although many of these are larger firms, it suggests that considerable R&D is occurring within the province.



⁴ Knowledge-based firms are defined using Industry Canada’s categorization of industries in the science and technology field and those considered “high knowledge” based on measures of research and development activity.

Table 2
Profile of Entrepreneurs, Comparison between Quebec and Canada, 2004

Quebec Entrepreneurs	Characteristics	National Average
19 percent owned by women, 71 percent owned by men and 11 percent are equal partnerships	Gender	16 percent owned by women, 64 percent owned by men and 20 percent are equal partnerships
3 percent visible minority, 1 percent Aboriginal, 2 percent disabled and 1 percent are recent immigrants	Minority Status	7 percent visible minority, 2 percent Aboriginal, 4 percent disabled and 1 percent are recent immigrants
3 percent are under 30, 90 percent are between 30 and 64, and 7 percent are over 65 years	Age	3 percent are under 30, 87 percent are between 30 and 64, and 10 percent are over 65 years
9 percent speak English, 85 percent speak French and 6 percent speak a non-official language	First Language	67 percent speak English, 19 percent speak French and 14 percent speak a non-official language
12 percent have fewer than 5 years, 17 percent have 5 to 10 years and 71 percent have more than 10 years	Managerial Experience	12 percent have fewer than 5 years, 19 percent have 5 to 10 years and 69 percent have more than 10 years
68 percent urban-based and 32 percent rural-based	Location	72 percent urban-based and 28 percent rural-based
8 percent export outside Canada	Export Activity	8 percent export outside Canada

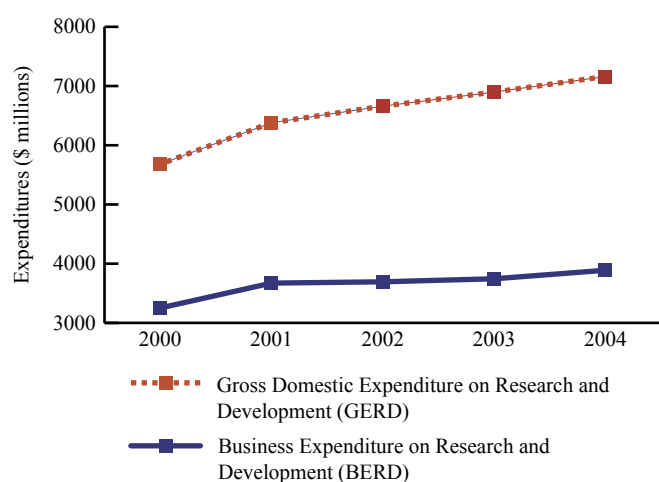
Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

According to the 2004 *Survey on Financing of Small and Medium Enterprises*, 25 percent of Quebec's SMEs reported some investment in R&D during 2004 compared with the national average of 29 percent. Approximately 5 percent of Quebec SMEs were especially research-intensive, devoting more than

20 percent of investments to R&D (compared with 4 percent nationally). Past research suggests that SMEs that accessed equity financing were, in general, more likely to conduct R&D activities than firms that sought debt financing.⁵

Nationally, business owners were more likely to identify as obstacles to growth external factors (such as current tax levels and government regulations) than internal causes (such as management capacity and low profitability) (see Table 3). This was true for both Quebec business owners and for those in all other regions. However, Quebec owners were particularly concerned about levels of taxation and insurance rates, with 39 percent of firms having identified levels of taxation as a barrier to growth and 35 percent citing insurance rates. Access to financing was cited less frequently as a barrier to growth than most other factors, mentioned as an obstacle by 21 percent of Quebec SME owners.

Figure 3
Expenditures on Research and Development in Quebec,* 2000–2004



* Excluding the National Capital Region.

Source: Statistics Canada, CANSIM, Table 358-0001 and Catalogue No. 88F0006XIE, Estimates of Canadian Research and Development Expenditures.

⁵ Baldwin, J., G. Gellatly and V. Gaudreault. "Financing Innovation in New Small Firms: New Evidence from Canada," Statistics Canada, May 2002.

Table 3
Perceived Obstacles to Business Growth and Development, 2004

		Quebec SMEs	SME National Average
		%	
External to the Firm	Levels of Taxation	39	47
	Finding Qualified Labour	33	37
	Instability of Consumer Demand	33	36
	Government Regulations	28	33
Internal to the Firm	Insurance Rates	35	36
	Low Profitability	31	38
	Obtaining Financing	21	20
	Management Capacity	14	13

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

FINANCING ACTIVITY

During 2004, 22 percent of Quebec SMEs applied for some form of external financing. Table 4 presents an overview of the financing activity of SMEs in various major regions of Canada during 2004. It summarizes, by region, the rates at which SMEs applied for various forms of financing and the rates of approval.

Table 4
Financing Request and Approval Rates, 2004

		British Columbia	Prairie Provinces	Ontario	Quebec	Atlantic Provinces	Canada
		%					
Debt Financing	Request Rate	20	23	15	18	20	19
	Approval Rate	82	82	77	88	82	81
Lease Financing	Request Rate	4	5	2	3.2	3	3
	Approval Rate	88	99	98	97	94	96
Equity Financing	Request Rate	1.1	0.9	1.3	1.4	1.7	1.2
	Approval Rate*	78	—	—	—	80	—
Government Grant or Subsidy	Request Rate	1.8	6	1.5	3.1	3.9	3
	Approval Rate	—	72	72	68	80	70

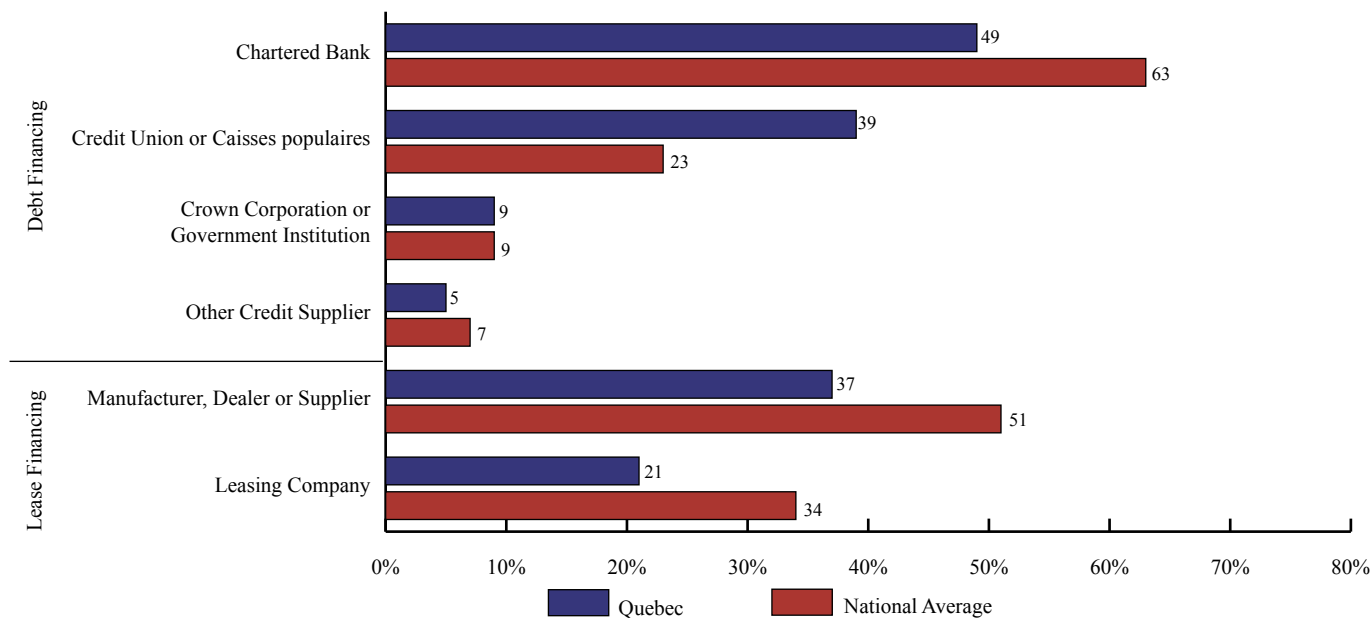
* Data not available due to low quality or confidentiality concerns.

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Table 4 shows that 18 percent of Quebec SMEs applied for commercial loan financing in 2004. With the strong presence of Caisses populaires in the province, only 49 percent of applications for commercial loans were made to chartered banks (compared with 63 percent nationally) and 39 percent of loan applications were made to Caisses populaires (see Figure 4). The most frequent types of loan applications were from owners seeking to finance fixed assets or to finance working capital, with 53 percent of loan applications in each category.

Table 4 also reports the rate at which loan applications were approved; however, among those that were not approved were instances where loan applications were pending at the time of data collection as well as instances where the application had been withdrawn. After allowing for these events, approximately 9.5 percent of loan applications from Quebec SMEs were turned down, the lowest turndown rate among all regions and substantially less than the 12 percent national average.

Figure 4
Financial Supplier Approached by SMEs by Type of Financing, 2004



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Approximately 3 percent of Quebec business owners sought lease financing and approval rates for leases were high (more than 90 percent), commensurate with those reported in other regions.

Applications for equity financing were low in all regions, with fewer than 2 percent of firms seeking equity financing during 2004. Differences across regions were not statistically significant.

QUEBEC'S FINANCING ENVIRONMENT

According to the 2005 SME Financing Data Initiative *Survey of Suppliers of Business Financing*, approximately \$868 billion in commercial lending was authorized in almost 2 million loan transactions nationwide. In Quebec, lenders authorized a total of \$148 billion in debt financing in more than 349 000 transactions.

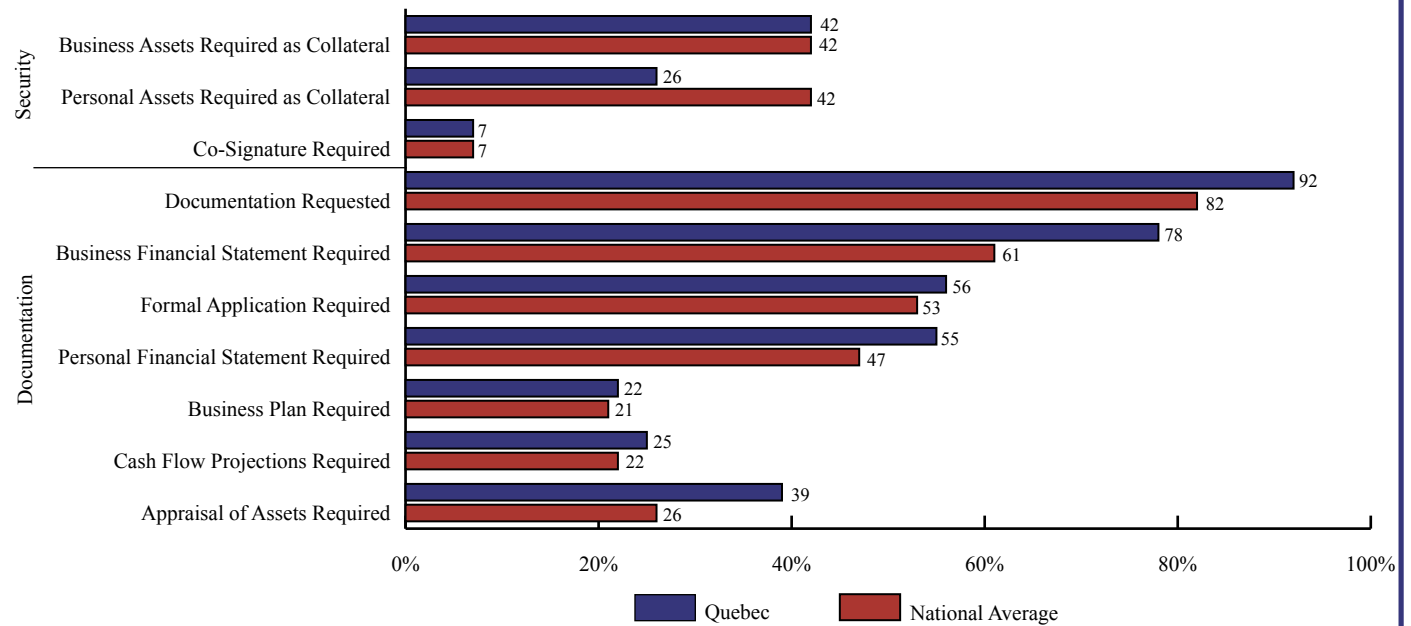
Nationally, loan authorizations of less than \$250 000 (arguably, most were loans to smaller enterprises)

comprised more than \$70 billion and were made available in the course of approximately 1.6 million transactions. Of the latter, \$42 billion was outstanding at the end of 2005.⁶

SMEs in Quebec appear, on average, to have faced different application requirements compared with firms elsewhere in Canada (see Figure 5). Quebec lenders were more likely to require virtually all types of documentation, especially business and personal financial statements and appraisals of the assets being financed. This may reflect the prevalence of Caisses populaires in the province (see Figure 4). During the 2004 reference year, Caisses populaires had not yet adopted credit scoring loan adjudication methods as had large commercial banks. This may explain why additional documentation was sought.

⁶ SME Financing Data Initiative, Statistics Canada, *Survey of Suppliers of Business Financing*, 2005. Note that total authorization amounts are defined as the sum of clients' maximum amount of money they are permitted to borrow from a supplier. This may not be the amount the client actually borrows. Outstanding debt is defined as the principal amount of money that a client has actually borrowed but not yet paid back, aggregated over all clients.

Figure 5
Security and Documentation Required by Financial Providers, 2004



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

CAPITAL STRUCTURE

SME owners typically look to informal sources of financing, such as personal loans and personal savings, when starting a business or funding day-to-day operations. Figures 6 and 7 list sources of financing used by an average Quebec firm compared with the average firm in Canada during start-up and for established operations in 2004.

At the start-up stage, the primary sources of financial capital for both Quebec and other Canadian firms are personal savings and personal credit instruments. Among established firms, Quebec companies were more likely than other regions to have used formal credit instruments, such as commercial loans, lines of credit and government grants or subsidies.

RISK CAPITAL

Risk capital is a means of financing often used by high-growth, knowledge-based or technology-based firms.⁷ Risk capital includes angel investment (venture

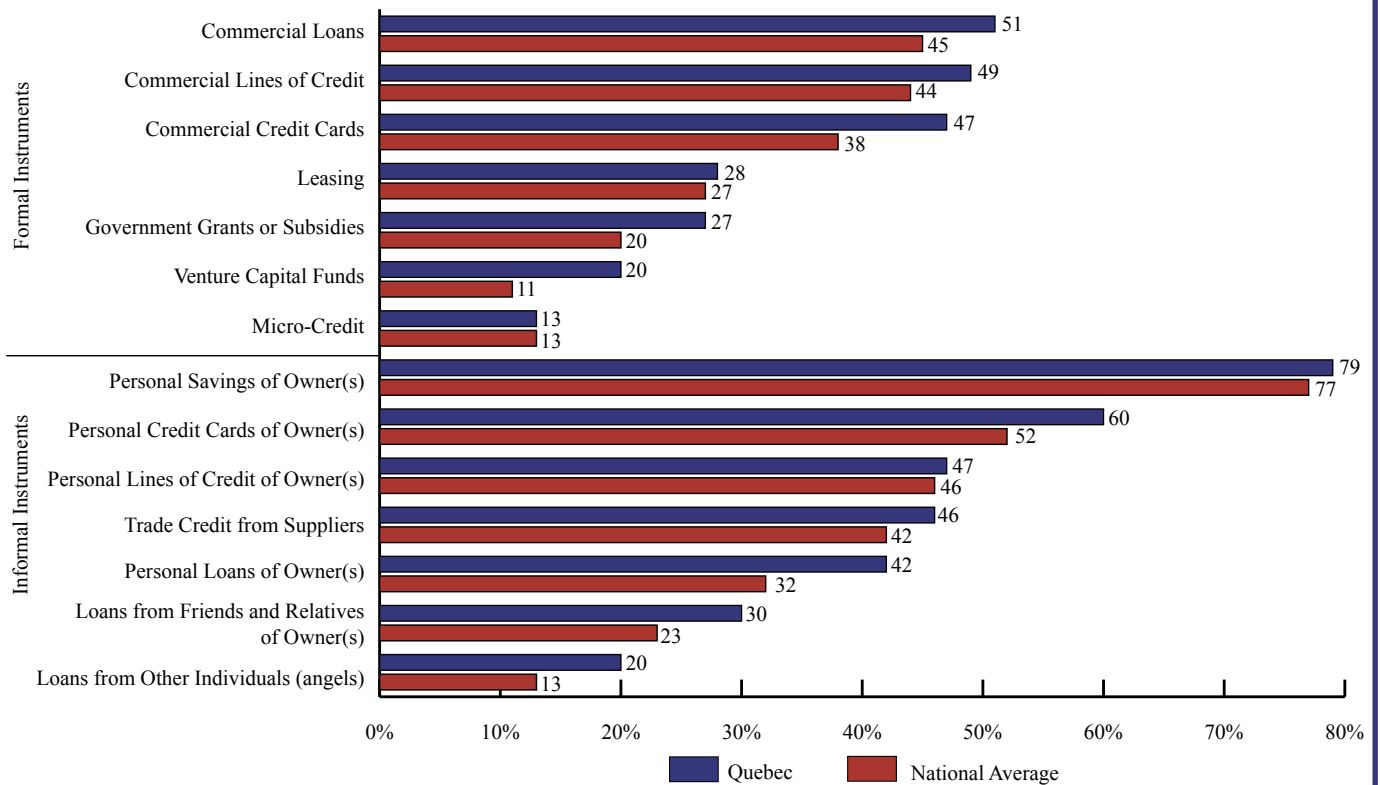
financing by a high net worth individual), loans from friends and family, and formal venture capital, as well as subordinated debt and capital from public share offerings on capital markets. Firms that seek risk capital tend to be early stage or in the process of developing a concept or product and bringing that product to market. Since these firms are often not yet generating revenues and lack tangible assets, they have problems accessing credit.⁸ Risk capital is more suitable for such firms as it offers a means to raise money that does not require an immediate cash flow to support repayments. Of Canadian firms that had, at some point in their development, sought risk capital,

- 23 percent approached friends or family for financing,
- 22 percent sought out business angels,
- 20 percent looked to existing stakeholders, and
- 7 percent contacted a venture capital firm.

⁷ Industry Canada, *Canadian Venture Capital Activity: An Analysis of Trends and Gaps, 1996–2002*.

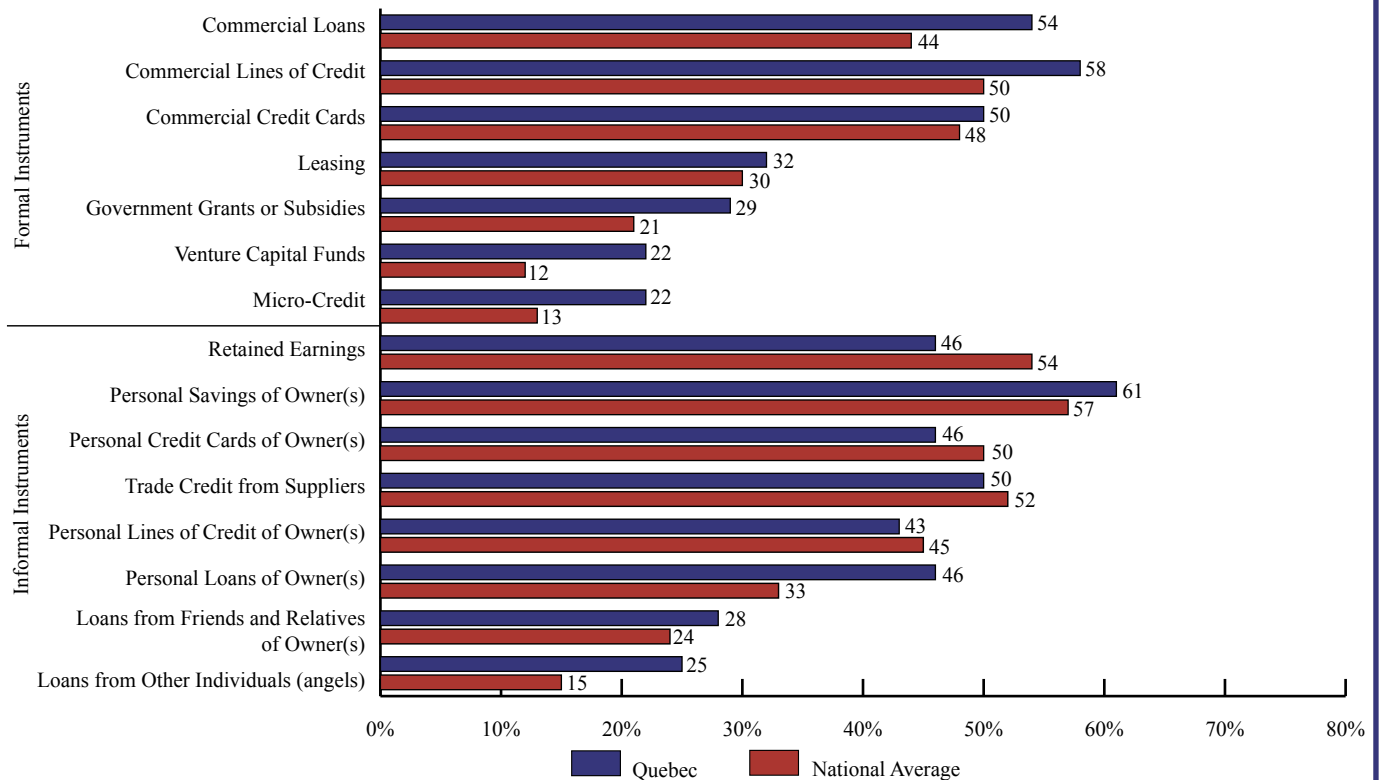
⁸ SME Financing Data Initiative, Industry Canada, *Small and Medium-Sized Enterprise Financing in Canada, 2003*.

Figure 6
Sources of Financing Used During Start-up*



* Start-up is defined as the period prior to the first sale of goods or services. Includes any source used, regardless of whether it was authorized or obtained in a previous year.
Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Figure 7
Sources of Financing for Established Firms, 2004*



* Includes any source used, regardless of whether it was authorized or obtained in a previous year.
Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004.

Approximately 23 percent of businesses in Quebec have received angel financing over their history, the highest relative frequency of business angel investments in any Canadian region. In addition, almost 26 percent of Quebec firms have received financing from friends and family (the highest proportion among Canadian regions except for Ontario at 27 percent).⁹

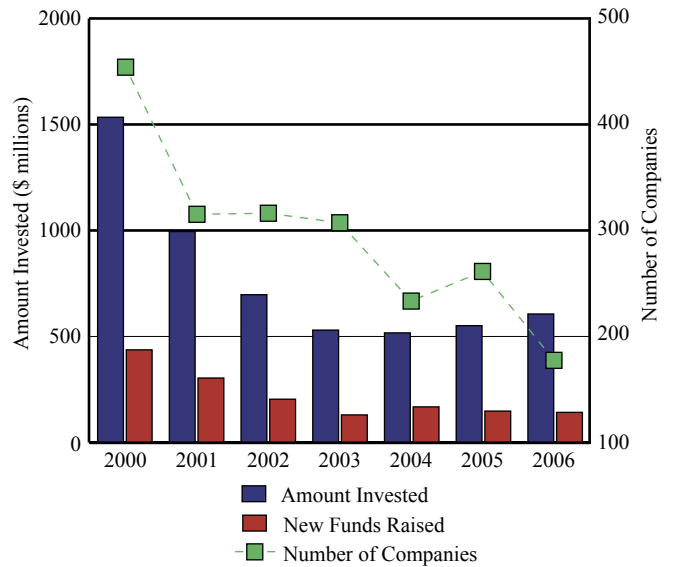
Although more than 34 percent of SME owners in Quebec intend to expand in the next two years, only 42 percent of these stated they were willing to share equity in their business to achieve their growth objectives. By comparison, 39 percent of business owners across Canada expect to grow and 46 percent of Canadian entrepreneurs were willing to share ownership in their business to obtain growth capital.

VENTURE CAPITAL ACTIVITY IN QUEBEC, 2000–2006

Venture capital (VC) is a form of risk capital used to support a small number of high-growth early-stage firms as they expand and move beyond the seed financing stage. During 2006, institutional venture capital firms invested a total of \$603 million in Quebec enterprises, second only to Ontario (\$686 million). This represents a disproportionately high share of venture capital, almost 36 percent of the \$1.693 billion national total. Figure 8 shows recent trends in venture capital investment in Quebec. As was true in all regions of Canada, venture capital activity peaked during the technology boom of the late 1990s and has since moderated, a consequence of the bursting of the technology bubble in 2000.

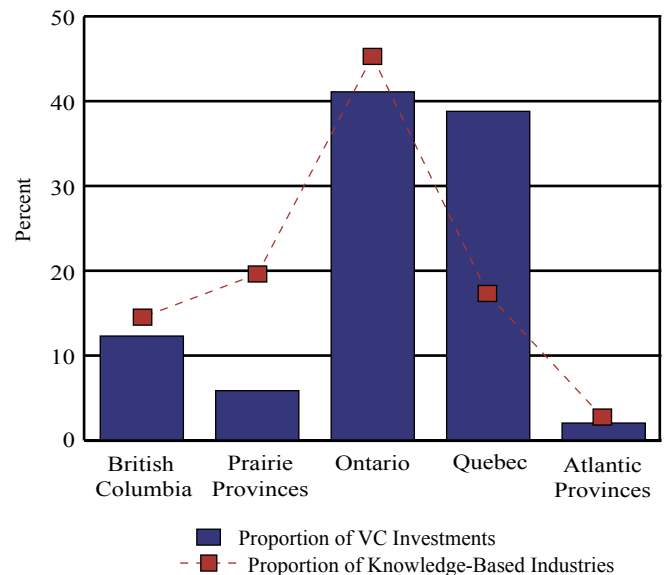
Figure 9 compares the share of venture capital investments in each of Canada's major regions with the corresponding share of knowledge-based enterprises. The chart shows that Quebec's share of venture capital activity is substantially greater than would be expected based on its share of knowledge-based firms. This is most likely a result of the

Figure 8
Venture Capital Activity in Quebec, 2000–2006



Source: Thomson Financial, 2006.

Figure 9
Regional Shares of Venture Capital Investment, 2006



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004; Thomson Financial, 2006.

continued dominance of Quebec in terms of (retail) venture capital fundraising, resulting in a relatively large supply of venture capital.

⁹ Riding, A. and Belanger, B. *Small Business Financing Profiles: Informally Financed SMEs*, SME Financing Data Initiative, Industry Canada, September 2006.

SUMMARY AND DISCUSSION

SMEs in both Quebec and Canada are small, typically with fewer than five employees. Like many Canadian SMEs, most SMEs in Quebec rely on informal sources of financing, such as personal savings and personal credit. Yet the financing patterns of Quebec SMEs also differ in several respects from those of other Canadian firms. Caisses populaires are important suppliers of debt financing to SMEs and appear to place relatively more documentation

requirements on Quebec SMEs. Overall, Quebec firms also tend to be slightly less growth oriented, but account for a significant amount of research and development activity in Canada and are more likely to seek and receive venture capital. Risk capital is an important source of financing among high-growth and technology-focused SMEs. Firms in Quebec obtained venture capital at a rate that was disproportionately greater than its share of knowledge-based industries.

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SME FINANCING DATA INITIATIVE

Small Business Financing Profiles is an ongoing series of articles on specific segments of the marketplace and a component of Industry Canada's reporting efforts on SME financing.

Consistent with recommendations in 1999 from the Task Force on the Future of the Canadian Financial Services Sector, the SME Financing Data Initiative is a comprehensive data collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of, and demand for, small and medium-sized business financing to provide a complete picture of SME financing.

As part of the initiative, Statistics Canada administers a series of national surveys on small and medium-sized enterprises (*Survey on Financing of Small and Medium Enterprises*) and financial providers (*Survey of Suppliers of Business Financing*). Industry Canada supplements these surveys with additional research into niche areas of SME financing.

For further information on the SME Financing Data Initiative and access to statistical findings and reports, visit www.sme-fdi.gc.ca. For information regarding the methodology of the *Survey on Financing of Small and Medium Enterprises*, visit Statistics Canada's website at www.statcan.ca.

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