Canada's Economic Rocket Fuel:

How a Switch in Canada's Financing Paradigm Could Help Solve its Productivity Problem

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Executive Summary

This report explores the critical role that independent financing and leasing companies play in addressing Canada's productivity challenges and economic underperformance compared to peer countries in the OECD. The paper argues that a paradigm shift within Canada's financial community, especially through promoting indirect lending and supporting independent finance firms, can help unlock Canada's economic potential.

The aim is to foster public debate and generate key stakeholder interest in the vital role independent financing and leasing companies play in helping Canada build a more competitive and innovative economy. It explores not only their contributions but also the challenges they face and the potential solutions that could be implemented to enhance the Canadian financial sector. The insights presented are based on interviews with experts, industry members and partners, and a review of existing research.

Key Findings Include:

- Canadian SMEs, which employ over 64% of the workforce, face significant barriers in accessing scale-up capital. This impedes their ability to invest in productivity-enhancing equipment, technology, and infrastructure.
- The 2008 financial crisis led to the consolidation of Canada's financial sector, reducing competition and leaving SMEs underserved.
- Independent finance and leasing companies can address these gaps by leveraging their specialized expertise and existing relationships with smaller businesses.

Drawing from international best practices, particularly the British Business Bank's ENABLE program, the report identifies actionable solutions for Canada. These include introducing securitization programs, expanding the Business Development Bank of Canada's (BDC) indirect lending portfolio, and fostering a more vibrant and enhanced financial ecosystem through open banking.

To achieve this, the report recommends policymakers and industry leaders prioritize innovation, competition, and accessibility in Canada's financial market. This will empower SMEs, stimulate private investment, and address Canada's productivity problem sustainably.

Recommendations

1. Competition: increase Canadian small-business growth and productivity by fostering a more competitive financial sector

- Foster a financial environment where new entrants and smaller players can enter, compete and thrive, thus reducing costs and increasing service offers for needy SMEs.
- Introduce policies and leverage existing relationships to reduce barriers to entry for smaller financial actors, such as easing capital requirements for intermediaries with essential sectorial expertise or with a targeted focus on SMEs.
- Encourage regional financial ecosystems by supporting local lending institutions and cooperatives, driving localized competition and innovation.
- Promote competition by creating incentives for financial institutions to develop tailored, sector -specific lending solutions, encouraging innovation and reducing borrowing costs for SMEs.
- Ensure transparent reporting on financial market performance to identify and address anti-competitive behaviors that stifle innovation and raise borrowing costs.

2. Mindset: shift governmental and institutional mentality towards small business growth

- Publicly recognize the pivotal role of SMEs in driving Canada's economic productivity and growth.
- Promote cross-sector dialogues between policymakers, major financial institutions, independent financing companies and small businesses to better align existing programs and future policies with current challenges.
- Create institutional awareness emphasizing how improved financing access enhances productivity and national competitiveness.

3. Access: improve access to capital by leveraging the capacities of smaller and larger financial actors

- Scale up the Business Development Bank of Canada's (BDC) indirect lending portfolio to better support SMEs through intermediaries such as independent finance and leasing companies.
- Simplify the regulatory requirements for smaller financial intermediaries, reducing administrative burdens and enhancing their ability to secure funding.
- Introduce scalable securitization programs that aggregate SME loans, reduce risk, and attract private sector investment, modelled after efficient programs deployed by other G20 partners.

4. Partners: elevate the importance of independent financing and leasing companies

- Recognize the critical role these companies play in bridging the financing gap for SMEs, their ability to enhance Canada's productivity and to provide unique sectorial finance expertise.
- Develop regulatory incentives for major financial institutions to collaborate with independent finance and leasing companies – and to diversify their indirect lending portfolio - to better serve underserved SME markets.
- Strengthen partnerships between independent financing and leasing companies and the BDC, focusing on capacity building and access to affordable capital.

5. Best Practices: learn from international models and promote institutional forward-thinking

- Adapt successful elements of the British Business Bank's programs, focusing on risk-sharing, loan guarantees, and innovation.
- Leverage these insights to design flexible and scalable solutions for Canada's unique economic context.
- Enhance financial ecosystem transparency by implementing an open banking framework to improve access to financial data, reducing transaction costs and enabling better credit assessments for SMEs.
- Eventually establish an online finance hub, modeled after the BBB's Finance Hub, to connect SMEs with tailored financing options and intermediaries.
- Support ongoing research and development in financial systems to identify gaps and implement innovative solutions that enhance SME access to capital.

6. Strategy: create a long-term productivity strategy rooted in SME growth and increased access to capital

- Align SME financing strategies with broader national goals, such as addressing climate change, reducing income inequality, and fostering innovation.
- Leverage the unique sectorial and technical expertise of independent financing and leasing companies to accomplish these targeted national goals.
- Establish an advisory council comprising technical experts, SMEs, and policymakers to continuously evaluate the state of the financial sector and refine – or build – better capital access paths for SMEs.
- Continue and improve upon long-term investments in infrastructure, emerging technology, and human capital, ensuring productive SMEs evolve in an environment that fosters productive behaviours.

In Other Words:

This report argues, and demonstrates with industry insights, that the productivity problem in Canada is partially rooted in the inability for small businesses to access the adequate financing required to grow and scale-up their operations. Whether it is the acquisition of necessary farming equipment or the purchase of much-needed computer screens, a more accessible, vibrant and enhanced financial sector is the path towards a more productive and innovative Canadian small business ecosystem.

- **More competition in the financial sector**
- **Better access to adequate, timely and SME size-adapted financing and leasing programs**
- **Different and innovative mindset regarding SME growth**

- **The sectoral expertise, flexibility and customer proximity of partners such as independent financing and leasing companies**
- **The knowledge, insights and best practices from other international models**
- **The clarity from having a long-term Canadian productivity strategy rooted in SME growth**

Introduction

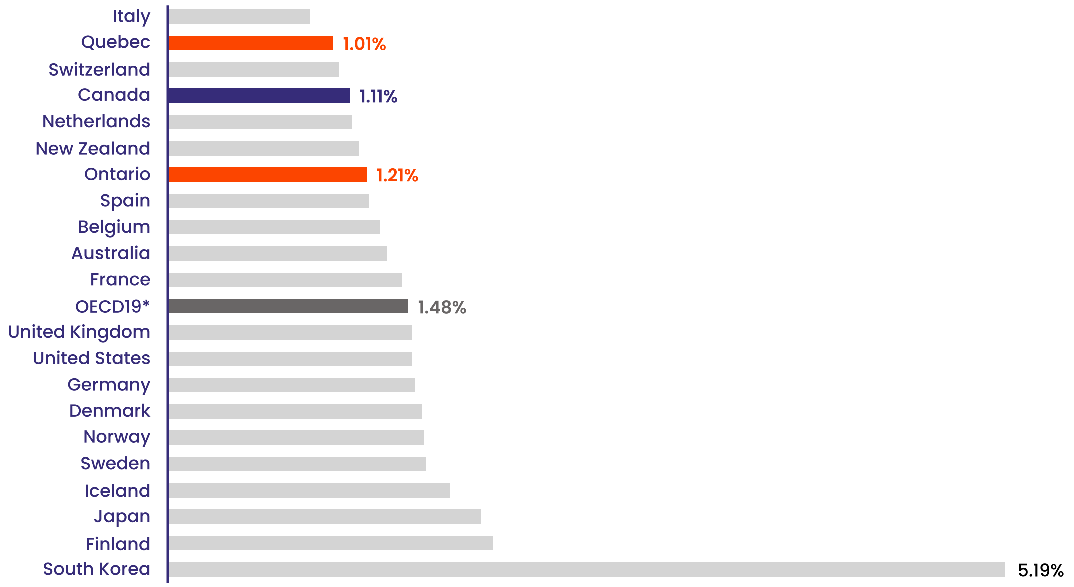
In recent years, the Canadian political environment has been marked by partisanship, with few political actors willing to compromise on key issues. This focus has hindered public discourse and our ability to address critical challenges, including the housing crisis, labour shortages, and climate change. Even the debate on Canada's high interest rates, which holds an unanimously negative public opinion, has been fueled by the heated partisan discussion regarding the potential influence of political decisions on the Bank of Canada and its monetary policy.

Despite the tense atmosphere in Canadian politics, one topic has risen above the partisan vitriol: productivity. This economic concept is quickly being adopted by politicians, media and the public as a way to underline Canada's economic underperformance compared to other Organisation for Economic Co-operation and Development (OECD) countries[1].

Despite its widespread use in public discourse, its exclusion from parliamentary debate is a product of Canada's falling productivity being much closer to an empirical fact than a public perspective, partisan argument or industry insight. Comparing Canada's data with OECD countries displays the gravity of the productivity issue, leading to a broad consensus that is a major concern.

As **Figure 1** indicates, Canada's productivity problem has persisted across governments and decades, rooted in its unique approach to economic growth and innovation. Canada's distinct way of doing business leads to lower productivity than its peer economies. Solving this will require a nuanced strategy, which political parties focused on electoral gain are poorly positioned to provide.

Figure 1: Average annual growth labour productivity (1981 to 2022)



Source: Deslauriers, J. & *al.* (2024). *Productivité et prospérité au Québec* : *Bilan 2023*. Centre sur la productivité et la prospérité – Fondation Walter J. Somers, HEC Montréal. [French only].

This begs the question: if productivity isn't politically polarizing and is seen as priority, why don't Canada's politicians make it one?

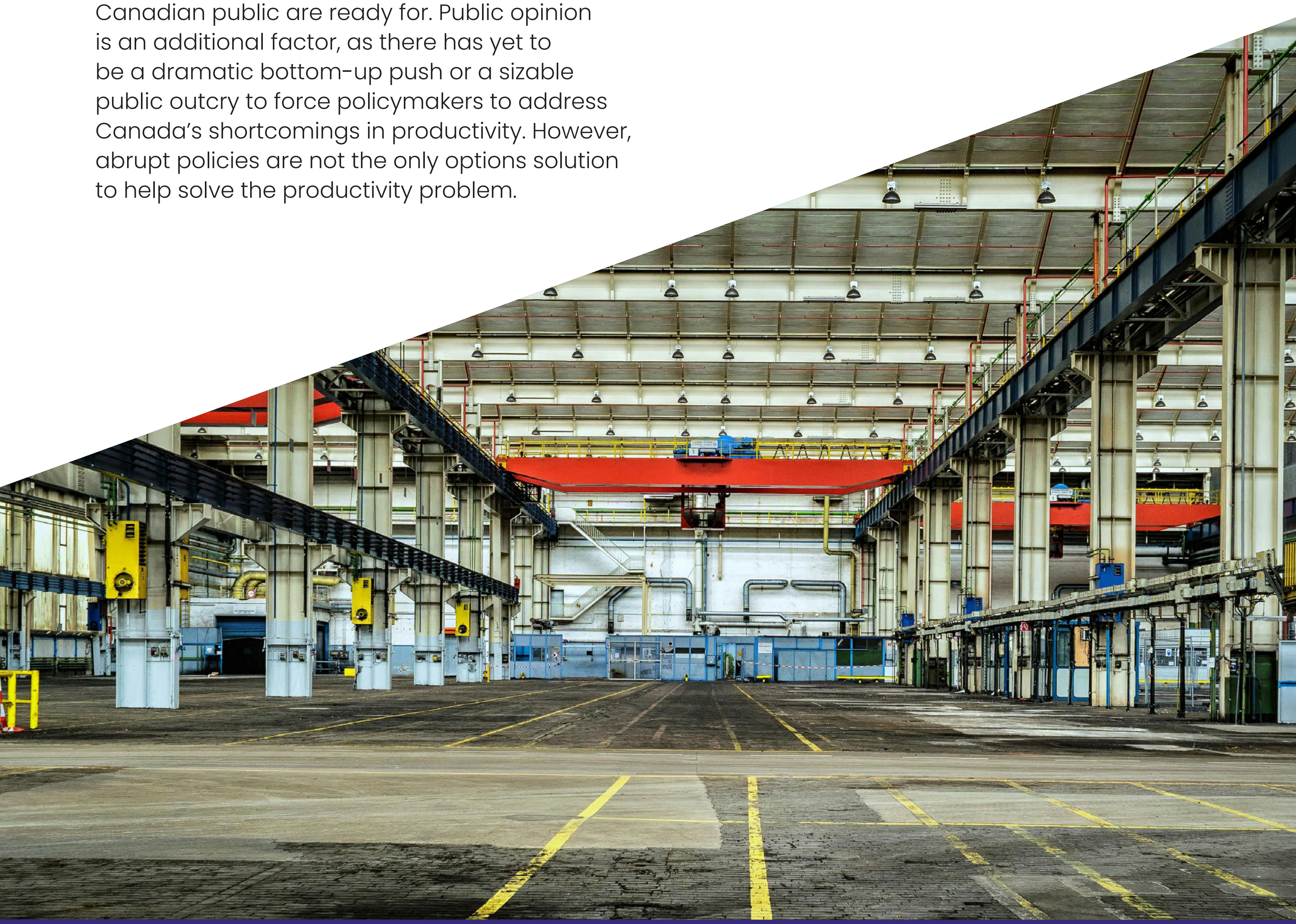
In 1994, the famed economist Paul Krugman quipped that "Productivity isn't everything, but in the long run, it is almost everything."[2] Increased productivity allows a country to generate more economic growth - or output – while keeping the amount and price of inputs consistent. A popular example of an input cost is leisure time for employees, which leads to the more traditional understanding of what a productive society is: it allows its workers to generate the same economic output in less work hours, thus reducing the cost in time for leisure or extra productive activities.[3] For the Canadian economy, being more productive is about being more efficient with the current inputs and, naturally, having the ability to capitalize on any additional inputs being generated by economic actors, whether it's the hiring of qualified talent or significant investments in research in development.

[1]OECD (2023). *OECD Compendium of Productivity Indicators 2023.*
[2]Paul Krugman (1994). *The Age of Diminishing Expectations: U.S. Economic Policy in the 1990s.*
[3]U.S Bureau of Labor Statistics (2020). *Why is Productivity Important?*

However, it is obvious to all: that greater productivity leads to outright economic growth and higher GDP. If discussing productivity isn't moving the political needle, there are few words that elected officials love more than Gross Domestic Product. Emphasizing the importance of productivity for Canada's GDP growth, and overall economic health is essential in potentially generating more political proactivity.

Given the importance of productivity to a healthy, growing economy and how central a theme the poor state of our economy is to our politicians' speeches, it is peculiar that they rarely reference Canada's poor productivity; the reason is likely the sheer size of the challenge. As hinted at earlier, addressing a structural issue will require changes that will have some displacing effects, which neither Ottawa nor the Canadian public are ready for. Public opinion is an additional factor, as there has yet to be a dramatic bottom-up push or a sizable public outcry to force policymakers to address Canada's shortcomings in productivity. However, abrupt policies are not the only options solution to help solve the productivity problem.

One thing that can be done progressively by our federal and provincial governments is acting with intent as a leading force behind a paradigmatic change in how Canada supports and amplifies the drivers of productivity growth in our economy. In simpler terms, be it a specific industry or an unexploited economic lever, Canada already possesses some of the necessary ingredients for productivity growth, but their current organization and calibration have not produced the results capable of addressing its core issue. This transformation can be done incrementally - no need for rash decisions - but will require a lot of introspection from large, historically static institutions and governmental apparatuses.



Carolyn Rogers, the Bank of Canada's senior deputy governor, captured this idea in a speech given in 2023:

> **Improving productivity doesn't mean shutting down whole sections of the economy and telling workers they have to go learn new sets of skills. It means paying attention to where the future high-value industries are coming from (…) We need to ensure that the right incentives are in place to allow companies in these industries to grow and thrive. And they need the right supports, such as access to markets and financing.[4]**

By readjusting the environment our businesses evolve in, whether by nurturing competition or reducing government involvement, Canada could see long-term benefits for its economic growth and underlying productivity.

[4]Carolyn Rogers (2024). *Time to break the glass: Fixing Canada's productivity problem.*

Kickstarting the Growth of Canadian Small Businesses

The Canadian government would have to embark on many different decision-making paths, most of them simultaneously, to dramatically improve our current situation. Multiple factors are at play, and Canadian productivity can only be increased if solutions are integrated, sometimes simultaneously, at different levels of our economy.

However, there is one potential - and actionable - change often linked to productivity issues, which is to generate more Canadian investments by transforming how companies and small businesses access financing.

In fact, a significant amount of literature correlates increased private-sector investments with productivity and subsequent economic growth.[5] For small businesses, investing usually means obtaining the necessary equipment, technology and infrastructure they need to compete and stay afloat within the market. On one side of the equation, private-sector investment drives demand for certain products and new employees in this industry.

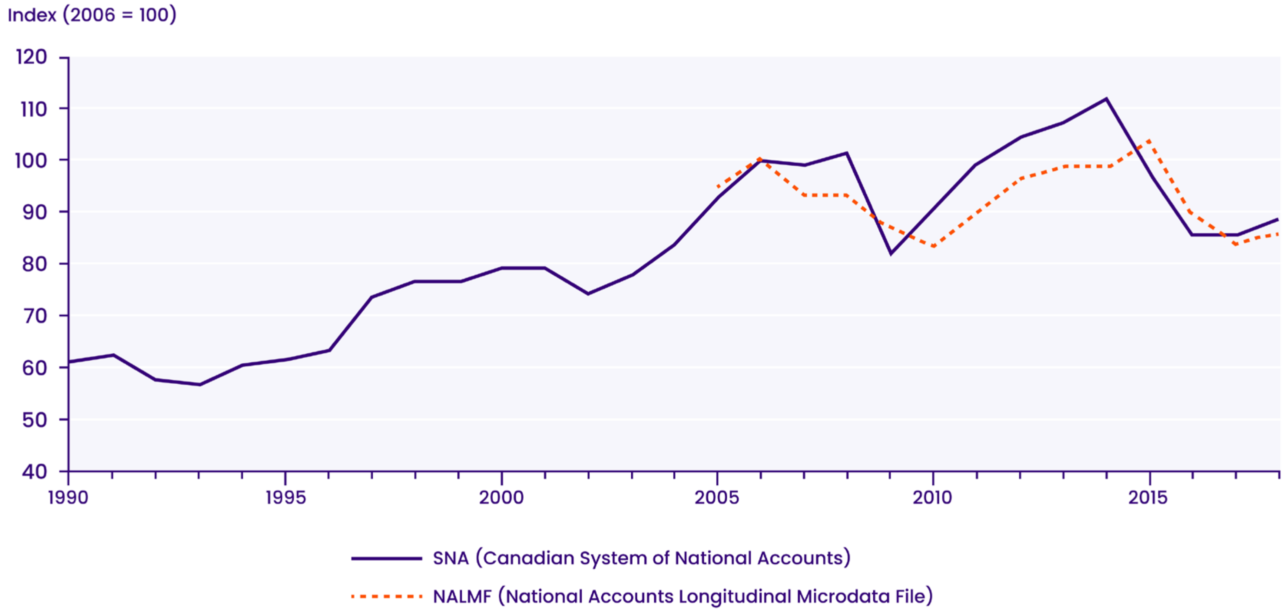
On the other hand, having access to better inputs such as equipment and services should generate a better output in fewer hours worked, which is at the heart of the problem Canada's trying to fix. Carolyn Rogers also hinted at this in her aforementioned speech.

Put simply, private-sector investment is a prerequisite for economic growth. Thus, maintaining a steady flow of readily available and reliable financing is essential for businesses to upscale their capacity, productivity, and contribution to GDP. Capital investment on a firm-to-firm basis means the development of better inputs, such as equipment or infrastructure, which ensures a better level of per-unit output or production. This places the flow of capital and business investment at the center of Canada's productivity problem.

For small businesses, this dependence on capital flow becomes even more essential for obtaining the equipment, technology, infrastructure, and labour necessary to maintain and grow their often razor-thin profit margins. In the context of the Canadian economy, with

[5]Tegan Hill (2024). Business investment key to addressing Canada's productivity crisis.

Figure 2: Investment per unit of labour in the business sector (1990 to 2022)

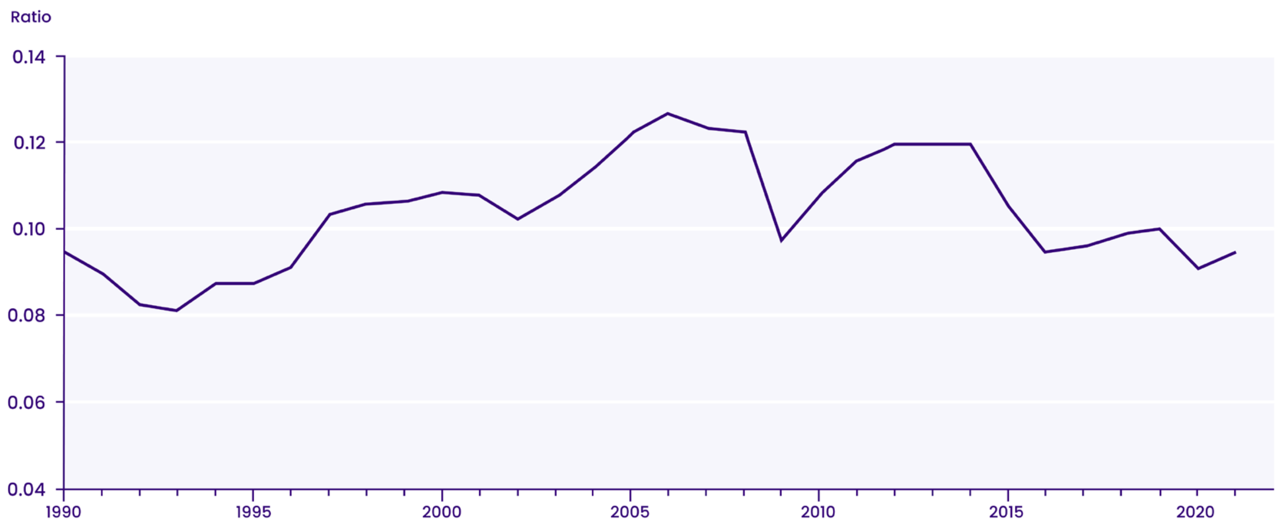


Source: Gu, W. (2024). *Investment Slowdown in Canada After the Mid-2000s: The Role of Competition and Intangibles*. Statistics Canada.

over 64% of the workforce employed in SMEs, the ability, or inability, of these companies to access capital becomes a make-or-break feature of the Canadian economy as a whole[6]. Unfortunately for Canadians, starting in the mid-2000s, SMEs were unable to access the capital they needed to grow their businesses, their market share, and the Canadian economy.

[6]Government of Canada (2024). *Key Small Business Statistics 2023.*

Figure 3: Investment to capital stock ratio in the business sector (1990 to 2021)



Source: Gu, W. (2024). *Investment Slowdown in Canada After the Mid-2000s: The Role of Competition and Intangibles*. Statistics Canada.

As these figures demonstrate, starting in 2008, Canada has struggled to manage a reliable flow of capital to domestic businesses. From 2014 – 2022, inflation-adjusted total business investment in Canada declined by $34 billion, a decline of 2.3% annually[7]. What is important to understand about this decline is that it cannot be accounted for by a harsh global economic climate or a change in the global economic system. Canada's peer economies in the OECD experienced a general increase in business investment during this same time frame, resulting in a discrepancy developing within key markers of economic growth and productivity[8].

As of 2024, Canada's GDP per hour worked—a key measurement of the per-unit productivity of labour—is among the lowest in the developed economies of the OECD. Canada has the lowest projected rate of per-person GDP growth among the 32 most advanced global economies for the next 40 years[9]. The separation between Canadian economic performance and its peers is made clear when compared against the United States, Canada's largest economic partner[10].

[7]Wulong Gu (2024). *Business Investment Slowdown in Canada After the Mid-2000s: The Role of Competition and Intangibles.*

[8]David Williams (2022). *Canada's Productivity Performance over the Past 20 Years.*

[9]Tegan Hill (2024). *Idem.*

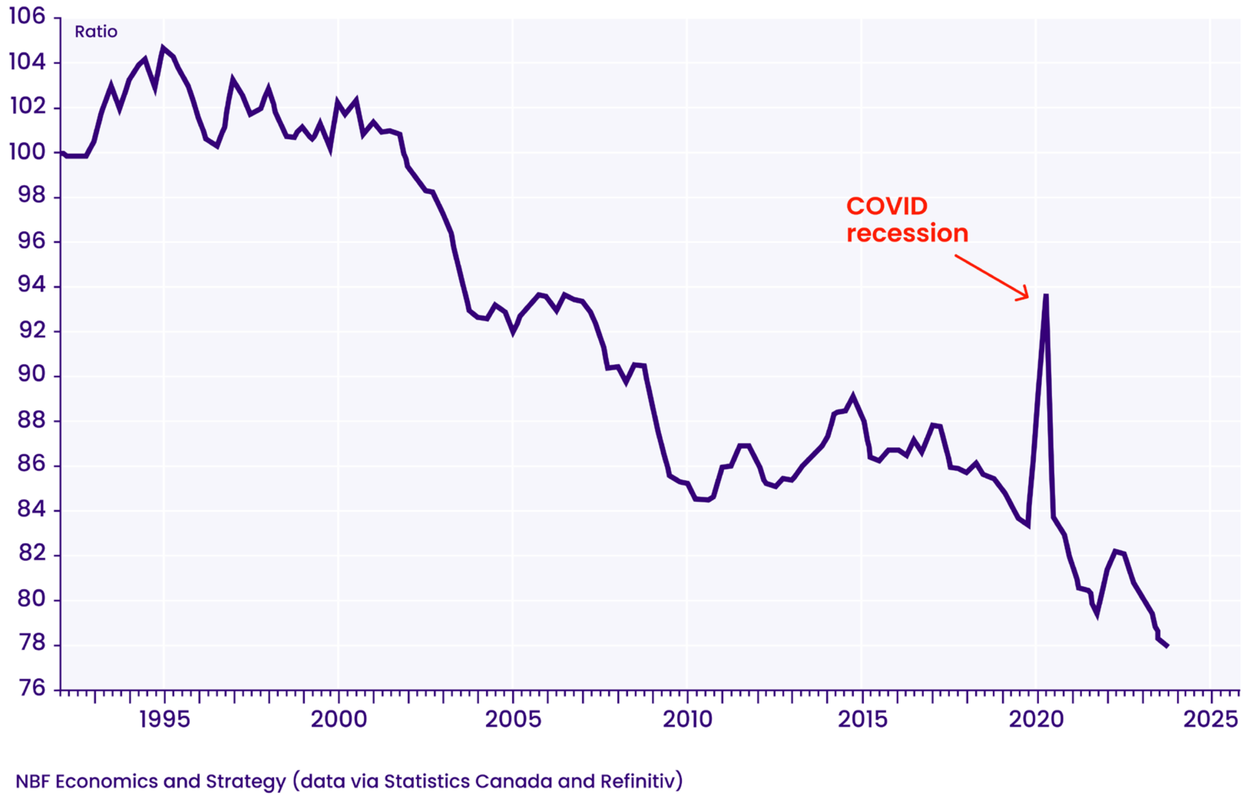
[10]World Bank Group (2024). *GDP Per Capita (Current US$) – Canada, United States.*

As of 2024, Canada's GDP per hour worked—a key measurement of the per-unit productivity of labor—is among the lowest in the developed economies of the OECD.

The widening discrepancy between Canadian and American economic performance in the last decade is a complex issue, but what is undeniable is that Canada's financial system has failed to provide sufficient access to the capital necessary for emerging enterprises to enter the market.

Due to our financial market structure, Canada's direct and indirect costs associated with firm innovation are substantially higher than those of the United States. The inability to access reliable and affordable financing is estimated to be 60% of the reason why Canadian firms, on average, are 1/3 the size, produce 1/3 the output and have a 4% decrease in TFP (total factor productivity) compared to American firms[11].

Figure 4: Productivity Gap with the U.S. Continues to Widen - Ratio of Canada to U.S. Business Sector



Source: Marion, S. (2024). *Attract private investment: Canada's only way out*. Special Report: Economics and Strategy, National Bank of Canada.

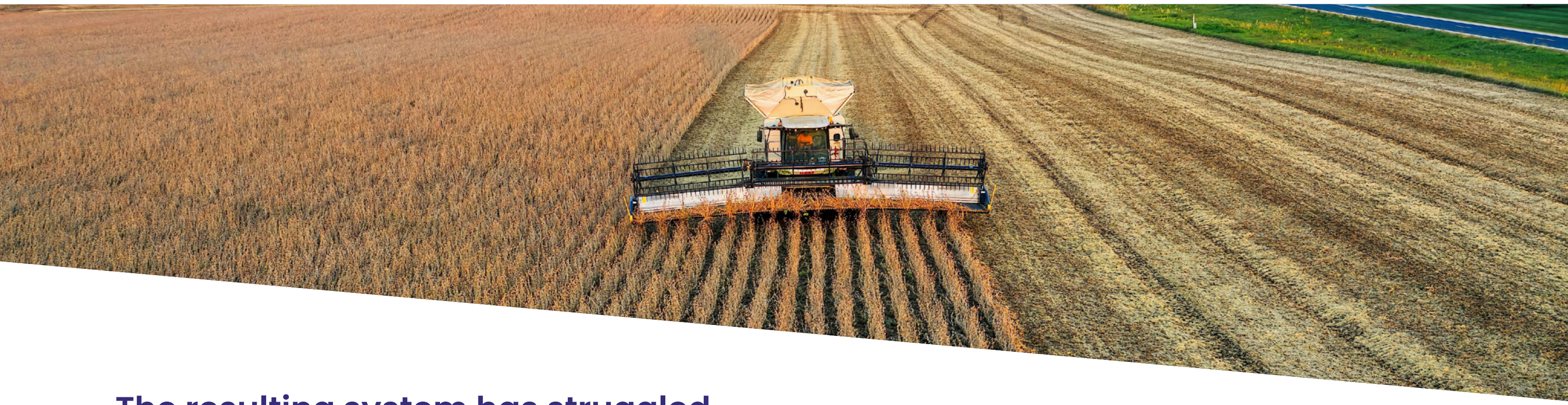
[11]Ashantha Ranasinghe (2017). *Innovation, Firm Size and the Canada-U.S. productivity Gap.*

The core of Canada's struggles with providing scale-up capital is the gap that emerged in the Canadian financial market following the 2008 recession. The higher rates associated with lending during this time period pushed many 'middle of the market' financial firms to close operations or consolidate in Canada's established banking system.

These 'middle of the market' firms made their margins, providing reliable capital to small, emerging enterprises who often carried too much risk to access the prime rates of Canada's larger financial institutions. Following the exit of these independent financial companies, SMEs in Canada were unable to access the support and finance they needed to scale their operations to increase their productivity and output.

Angela Armstrong, President of Prime Capital, an independent finance company that went through the 2008 financial crisis, said this about the situation:

> **"Good quality organizations delivering essential solutions to entrepreneurial businesses across the country, who have the rug literally pulled out from under them overnight, is not contributory to any version of a working Canadian economy."**



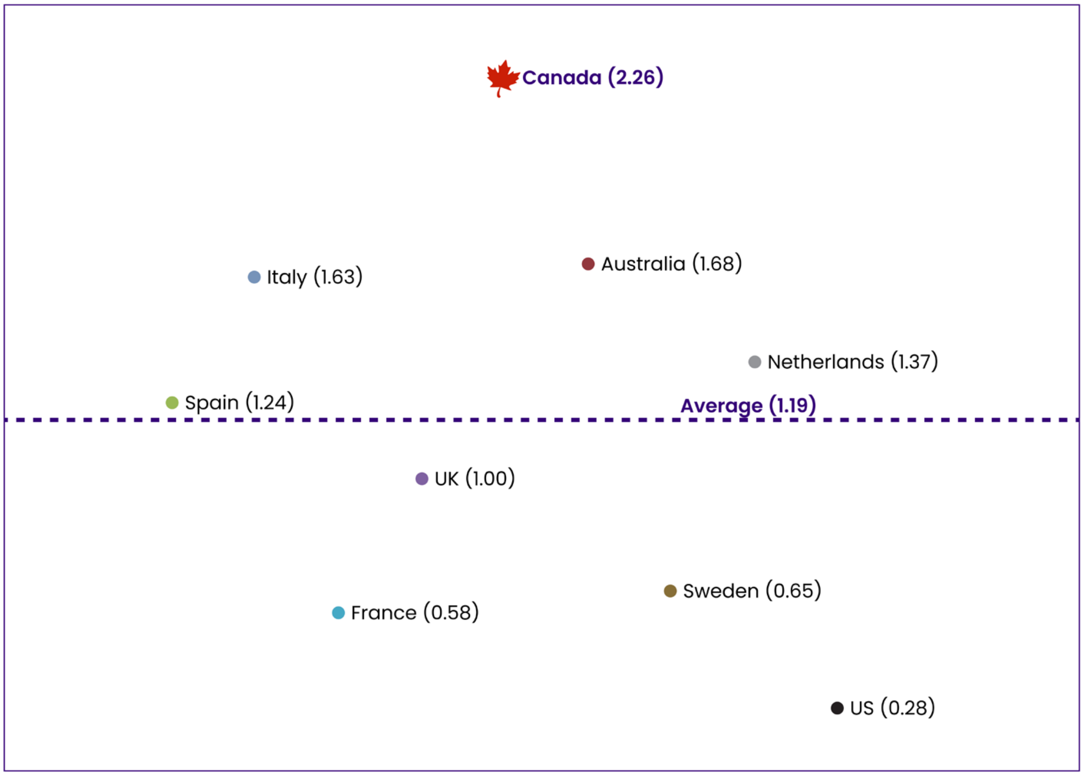
The resulting system has struggled to provide for Canadian SMEs.

The major banks, who have control over 94% of all banking assets in Canada, are often limited by regulators from the riskier lending portfolios needed to scale up small enterprises successfully. The gap that emerged in the market removed any independent financial firms that could serve the needs of these underdeveloped, capital-starved entrepreneurs.

This has led to the decline in business investment and labour productivity that has characterized the Canadian economy over the last decade. The evidence of this comes from looking at the current small business landscape facing Canadians. Canada's interest rate spread—measuring the difference between interest rates available for large and small businesses—is by far the largest in the OECD[12].

[12]Jeremy M. Kronick & Mawakina Bafale (2022). *Deepening Canadian Capital Markets.*

Figure 5: Interest Rate Spread, Large vs Small Businesses, Canada and Peer Countries (2011-2019)[2]



Source: Kronick, J. M. & Bafale, M. (2022). *Deepening Canadian Capital Markets*. Intelligence Memos, C.D. Howe Institute.

This reflects the centralized, risk-averse nature of the Canadian financial market and its regulators. These conditions have starved Canadian entrepreneurs of the capital they need to expand their operations. This year, in a survey that attempts to measure attitudes of Canadian small businesses, 51% of small business owners are currently facing difficulties due to borrowing costs, with 47% of small business owners citing borrowing costs as a major input cost constraint[13].

51% of small business owners are currently facing difficulties due to borrowing costs.

[13]Canadian Federation of Independent Business (2024). *Monthly Business Barometer.*

Hugh Swandel, President of Meridian Onecap, a financing and leasing company specializing in commercial equipment, explained the nature of Canada's productivity challenge;

> **There's a lot of reasons why Canadian productivity is not great, but if you just stick to efficient lending as one of them, Small and Medium Sized businesses are underserved. The larger financial institutions in Canada say publicly that they love small business, however in practice the average transaction size of the banks, shows a preference for large ticket finance.**

Canada's economy does a great job mobilizing capital for start-up companies through grants and incubators. However, medium to small businesses looking to scale up their enterprises by accessing the equipment they require struggle to find a partner that can fit their specific needs. Canada's major banks' risk-averse and centralized nature by design favours larger, more established firms, while the middle-of-the-market firms capable of matching these needs struggle in the current financial market.

Swandel added to his original statement:

> **Large Financial Institutions are effective at handling financings in excess of $1 billion but they struggle to efficiently handle small business financing requests for amounts under $100,000. Improving productivity, creating innovation, and driving the economic activity requires that Canada has to get out of the bottom half of the OECD in terms of lending.**

Opportunities and Limitations for the Finance and Leasing Sector

After observing the data on Canada's economy and capital investments, it becomes pretty obvious that this relationship is at the heart of Canada's productivity problem. As mentioned earlier, there are many pieces of the puzzle to this critical challenge, and some are sometimes either hard to identify or extremely difficult to fix.

In this instance, there's general agreement on the issue at hand, but multiple actors have different opinions on which levers should be pulled to generate more capital investments by Canadian SMEs.

An actionable solution is to promote, support and improve the indirect lending and financing environment in which Canadian entrepreneurs are involved.

This might feel like a complicated finance-heavy word salad, but the basics of it and, most importantly, the intent, is quite simple and powerful.

It refers to a process where larger financial institutions leverage the distribution of independent financial intermediaries, which often come in the form of specialized financing and leasing companies, by providing them with access to affordable capital. This allows financial institutions to make margins indirectly, as opposed to directly, investing in businesses that require more hands-on management than their large corporate structures and risk-adverse nature would typically allow for.

In other words, indirect lending allows Canada's financial institutions to safely invest in SMEs without damaging their market role or increasing their exposure to risk. Simultaneously, it increases the number of actors involved in these financing negotiations, thus incentivizing competitive behaviour and often reducing the 'cost of money' for entrepreneurs.

The loans that these independent firms obtain are often asset-backed, meaning the agreement between the financial institution and its customer is secured by collateral, which is the equipment, vehicle, or tool for which the loan was approved.

Financing and leasing companies, who have the ability to specialize in specific industries and in providing small-scale loans, are able to manage these clients responsibly and help them gain access to equipment – whether it is computer monitors or a brand-new backhoe – they need to grow and support their entrepreneurial dream. Over time, these financing and leasing companies acting as third parties have built their own technical and service expertise, leading to a diverse, competitive ecosystem of firms that can properly assess the type of financial structure and support the client company needs before taking on the asset for which the loan was required.

Therefore, instead of leaving these mid-market and emerging companies to deal with the larger major financial institutions – which have little incentive to entertain these smaller deals – the indirect lending process allows an added layer of knowledge, risk distribution and service capabilities.

However, many of these financing and leasing companies need cash flow and capital, which is why they get involved with a bigger financial institution. When this relationship works well, and affordable capital is indeed accessible, their involvement is able to promote more forward-looking investment by Canadian SMEs, into the economy. Adapting indirect lending in the Canadian financial market can give SMEs the strong and reliable access to capital they need to scale up their capacity and improve their productivity.

The basic structure of indirect lending works through a loan or line of credit being provided as a 'backstop' to the short-term losses that independent financing and leasing companies often experience with lending to small businesses. Without access to this 'backstop', effectively lending to small businesses becomes nearly impossible due to the incredibly small gains experienced within the first years of investment. Hugh Swandel explains the importance of 'backstopping' in the context of SME lending:

> **"When an SME-heavy sector is in trouble, you can't unilaterally reduce the amount of money available to them; with a 'backstop,' we will show that with the right lending policy, we can continue to fund SMEs and keep these companies afloat."**

The addition of a 'backstop' by larger financial institutions would allow independent financial firms to provide the steady, long-term capital needed for small businesses to scale up their capacity and productivity. In the context of the Canadian economy, this access to reliable scale-up capital is what the Canadian financial market has failed to provide, which has led to the dramatic slowdown in firm size, investment, and productivity since 2014.

> **"Canada has done a really good job at mobilizing capital for raw start-ups – but we are very poor at enabling scale up activity where real growth and incremental, sustainable employment can thrive."**
>
> *– ANGELA ARMSTRONG, PRESIDENT OF PRIME CAPITAL, AN INDEPENDENT EQUIPMENT LEASING COMPANY*

Indirect lending creates a valid pathway for Canada's financial institutions to invest in emerging enterprises by leveraging their distribution network, market expertise, service offering and the regional proximity of Canada's independent financing and leasing industry. Angela also added:

> **"The banks can't do it alone because their mandate is not to be risk-prone. I don't want the banks to be risk-prone; we rely on them as the backbone of the economy. We (independent firms) can take a little bit more risk, we're a little closer to the ground and a little more 'hands on', we understand that the client is not yet sophisticated, but they have a desire to be there."**

Through the bank's involvement, these independent financing and leasing firms are able to fill the gap in the Canadian financial market, which has largely left scale-up businesses underserved and underfunded. This allows for the rise of a necessary solution partner for Canadian SMEs, who are able to lend to the future of their company. In this sense, capitalized independent financial firms become essential in Canadian SMEs' ability to scale up their capacities to eventually access the de-risked capital of Canadian banks, which is primarily distributed to large, well-established companies.

> **Our clients, who are trying to grow and scale their businesses, don't always have the capital ability to hire good technical, financial or other expertise to help them make good decisions. Good expertise helps them gain analytical input and business data to position properly in the market. They struggle, especially in early stages, to hire quality employees who can help them perfect the delivery of their product or service. What we love, in our business, is our purposeful focus on being one of the resources that those businesses can rely on as they stage their growth intelligently.**
>
> *– ANGELA ARMSTRONG*

As the last decade has demonstrated, Canada's major financial institutions are simply structurally unable to meet the unique needs of Canadian small businesses. Institutionally and publicly promoting the development and growth of a strong independent finance sector through these well-tested and properly established indirect lending practices will allow for these needs to be satisfied.

> **What we do is fill a gap in the market. If you think about a graph (where) at one end is the banking community, where the capital is very difficult to access, the bar is high, but the cost of capital is cheap. Why is the capital cheap? Because it is de-risked, the companies (that are lent to) are mature and have access to sophisticated technology and experienced players within the business that have the ability to de-risk it. The banks come calling to them; they aren't out shopping for financing; they're in a buyers' market, not a seller's market. But down at the other end of the spectrum are start-up companies, and there is a huge start-up ecosystem. The in between – growth-oriented companies rely on the independent market to access capital that accepts a bit more risk and is nimble enough to do higher quality of interaction and one on one coaching with those businesses, so they can reach success.**
>
> *– ANGELA ARMSTRONG*

The BDC and Canada's Role in Bridging the Financing Gap

While every financial institution has the ability to be involved in indirect lending, there is one major player that is unique and has made a point of working with independent financing and leasing companies: the Business Development Bank of Canada (BDC).

Before the 2008 financial crisis, nearly all of Canada's major banks had a dedicated group for indirect lending. Following the crisis, almost all of them moved away from the practice.

However, part of the original mandate of the BDC's program was to fill the gap that had emerged between the capital needs of Canadian small businesses and the focus on big-ticket, large-value financing that characterizes major financial institutions. Most of the BDC's portfolio remains anchored in direct financing, but the bank has made an effort to act as partners to the independent financing and leasing firms who are better positioned to service the needs and requests of the underserved SMEs looking to scale. This was done through targeted lending to good independent companies capable of managing this middle-ground within Canada's financial market.

> **The intent was that the middle area was going to get filled by those independent lenders, the likes of them are going to grow to be a large equipment lease finance company that has the scale and size to be able to get cheaper pricing by going to the bank asset-backed conduit where they would need to do active interest rate hedging.**
>
> *– TED FUJISAWA, PREVIOUS MANAGING DIRECTOR AND GROUP HEAD OF BDC'S INDIRECT FINANCING BRANCH*

During Fujisawa's seven years as Managing Director and Group Head of the BDC's Indirect Financing branch, he saw the group's outstanding commitments rise to more than $2.0 billion.

> **The return on capital we generate can't be beaten by anyone – it (indirect lending) is a very productive and efficient way to lend money, and in my opinion, a secure way of doing it where every stakeholder in the process is aligned so as not to lose money.**
>
> *– TED FUJISAWA*

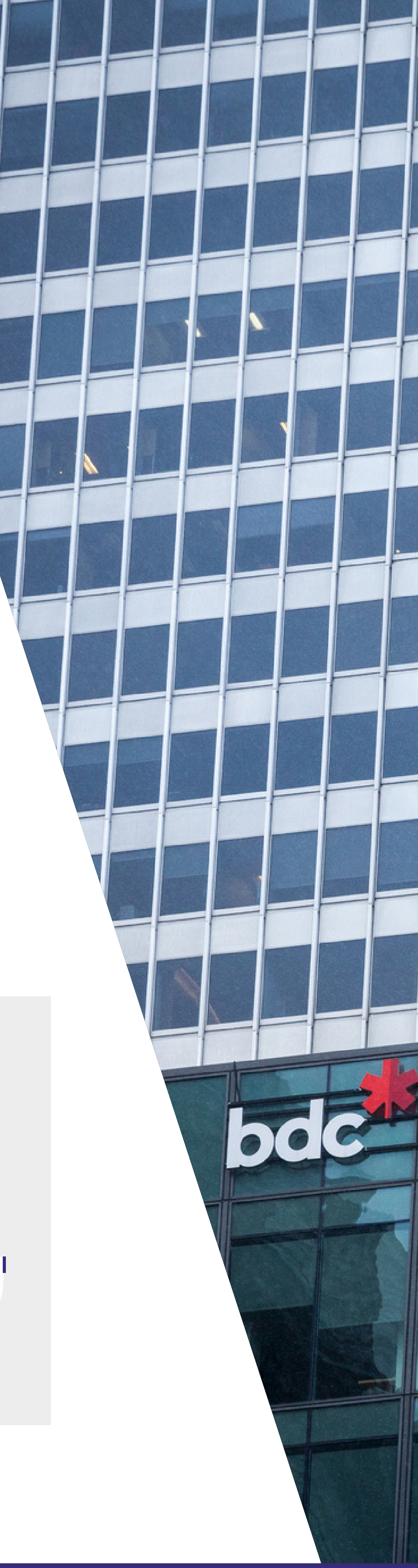
This highly successful program provided backstops to independent financial companies through securitization, which allowed the funder, in this instance, the BDC, to lend to an individual contract made by the independent lender. These securitizations are created so that the first equity loss is taken from the independent financing and leasing firm. This further incentivizes both parties to pursue sound, secure, and profitable investments.

However, before securitization can happen, each firm must be thoroughly audited, and technological and capital benchmarks must be met before negotiations can take place. This process often takes six months to a year before a final settlement is made.

For independent financing and leasing companies, the yields on their contracts take years to accumulate. In addition to operating costs, this process requires a very disciplined company to make smart investments with the support of a lender like the BDC to create an effective lending profile.

This makes the role of the BDC in providing affordable capital essential for developing IFLs (independent finance lender), which can take up the middle market by supporting Canadian SMEs and subsequently increasing their productivity.

> **The BDC plays a critical role in the country as the only lender who can be very deliberate and intentional with the curation process. They are uniquely positioned to be able to say ”okay, you’re not a micro start up anymore, you’re a growing company with prospects, and if capital is one of the things that can fan the embers, let’s do that. We can co-create a good accountability cycle and together help you stay within pre defined guardrails that will ensure success. Creating thoughtful and methodical growth is really important for Canada.**
>
> *– ANGELA ARMSTRONG*



Addressing Limitations: Constraints on Lending

While considering the benefits of the BDC's indirect lending program, it is also important to consider its limitations in accomplishing this objective.

One example comes from the BDC's institutional mandate, which structurally limits the size and scale of its lending ability[14]. This mandate prohibits the BDC from directly competing with Canada's financial community, requiring the institution to reduce the scope of its lending to independent firms. This limitation has largely prevented the program from achieving its primary objective of developing independent financial companies capable of supporting Canadian small businesses.

> **It is clear to me, after my 15 years at BDC and the 7 years running the group, that we have the expertise, the people and capabilities to do much more.**
>
> *– TED FUJISAWA*

One way to address this limitation is to augment the BDCs program to incentivize the entry of Canada's banking community into indirect lending. Recognizing the inherent constraints of the program to accomplish its primary objective requires supplying more capital to unlock the benefits of indirect lending in the Canadian economy. This can be accomplished by demonstrating to the private sector that it is not only a profitable way to invest but also a safe and secure way.

This can be demonstrated by expanding the lending profile of the BDC's indirect lending program. A larger lending profile will demonstrate the sustainability and reliability of an indirect lending approach to Canada's banking community and, in time, its ability to enhance Canada's approach to financing SMEs.

[14]Government of Canada. *Organization Profile – Business Development Bank of Canada*.

> **When you do that, you open the eyes of all these lenders to say, hey, I can actually create a model with static losses much higher than my core business, and I can make riskier deals and make money out of it. Now you've changed the system, but when you set up shop across the street from the larger financial institutions and say 'I'll focus on the bad stuff, you can do the good stuff', that's not going to create entrepreneurship.**
>
> *– HUGH SWANDEL*

Another possible way to encourage private sector involvement would be to change the direction of the BDC's lending to IFLs. Instead of a securitization approach, where money provided by the BDC is directly leveraged to expand the firm's lending profile, the BDC loans could be targeted to support the development and maturity of these smaller companies. This would give smaller financial companies the capital they require to equip themselves with the staff and resources necessary to expand their operations. This would develop a set of independent firms capable of satisfying the credit constraints of the major banks allowing them to access the affordable capital they need to manage the middle market and satisfy the needs of SMEs.

This 'bottom-up' approach to indirect lending incentivizes the private sector's entry into indirect lending by allowing independent finance and leasing companies to meet the current requirements of Canada's major banks. This strategy is especially important when considering the current challenges facing IFLs.

> **For the first 15 years, our business growth was pretty flat – we had the same problems as our entrepreneurial clients: limited capital and therefore the inability to really get the right people around the table. Accessing the BDC capital was a catalyst for growing our lending business, which in turn permitted us to slowly bring on the talent, which in turn, enabled more good growth.**
>
> *– ANGELA ARMSTRONG*

For independent finance and leasing companies operating without access to affordable capital, lending to small businesses is an incredibly risky and labor-intensive process. Their inability to hire the technical and financial experts they need to find and attract suitable investments to grow and streamline their enterprise remains one of the largest barriers preventing the private sector from engaging in indirect financing.

> **All [IFLs] need to become more sophisticated on the treasury side. Most of them are owner-operators; they do everything; they look for capital, they run their business, and they make credit decisions. But as you get bigger you have to start looking for a CFO, a CEO, a treasurer who's going to manage all of that. You have to grow with that, and that's the biggest hurdle I find with trying to grow those companies – and I think that ties back to productivity.**
>
> *– TED FUJISAWA*

The BDC's program supporting the emergence of independent financial firms is important not only because it supplies the capital independent lenders need to expand their lending profile but also because it provides the resources required to scale their operations. Together, these two facets are critical for developing IFLs capable of serving the middle of the market and encouraging private-sector entry into the indirect financing industry.

The BDC's current program does incorporate lending to grow small lenders; however, like its securitization initiative, it remains limited in size. Expanding the BDC's lending profile in both areas is crucial to achieving its broader goal of unlocking the potential of indirect lending in Canada.

Addressing Limitations: Regulatory Barriers to Indirect Lending

An additional limitation of the current BDC program is the rigidity of its regulatory process. Its strict auditing and negotiation process imposes a significant administrative burden on IFLs seeking funding through the BDC. While a responsible and diligent regulatory process is essential, the burden of this process deters many prospective partners from pursuing and receiving funding. This issue is particularly acute for smaller lenders, who typically face manpower shortages and overstretched managerial capacities, making it difficult to navigate the rigorous requirements imposed by the program.

This was on display during the 2008 financial crisis. When the BDC first offered lending to IFLs, the regulatory process often prevented smaller lenders from accessing the funding they desperately needed to stay afloat.

Angela Armstrong explains the administrative burden associated with lending to smaller clients, which often limits their ability to manage the heavy regulatory process of the BDC's program.

> **This is a high touch kind of business; it's a lot of management, it's a lot of handholding, it's a lot of touchpoints, and it can feel like death by papercut to get simple things done because it's an unsophisticated client moving at 100 miles per hour and trying to do a lot of things.**
>
> *– ANGELA ARMSTRONG*

One solution to this limitation of the BDC's program is introducing of a more flexible regulatory process that adjusts based on the size of the loan and borrowing institution. By reducing the administrative burden in proportion to the loan size, this approach would reduce the barriers preventing the flow of capital to all levels of Canada's financial market. Addressing this limitation ensures that businesses of all sizes can access the capital they need to scale and enhance their productivity.

The potential of a flexible regulatory process can be seen with the example of the British Business Banks (BBB) regulatory process. Much like the BDC, the BBB lends to financial intermediaries to expand SMEs' access to affordable capital. Its lending program utilizes lending requirements that respond to a firm's administrative capacity and size of the loan. This approach has proven to significantly broaden access to affordable capital, including for even the smallest independent lenders in the British system. Adopting a similar model in the Canadian context would greatly enhance the accessibility and effectiveness of the BDC's indirect lending program.

Despite these limitations, the BDC's program remains one of the few attempts by a crown agency at indirect lending. Highlighting the program's success and massaging its limitations can go a long way in encouraging the use of indirect lending as a legitimate way for bigger financial institutions to support independent finance and leasing companies while benefitting from their smaller-scale loans.

The BDC's role in improving Canadian financing and leasing companies is a great start in promoting the use of indirect lending to address the investment shortages hampering the Canadian economy. However, it remains structurally limited by its mandate and, subsequently, in its ability to incentivize the private sector's involvement.

Considering the current priorities of the BDC and some of the public misconceptions about the nature of indirect lending, it is fair to assume that this paradigm shift can only happen if important thought leaders are increasingly supportive of this idea of diversifying SMEs' access to capital. All of these important decision-makers would agree that Canada is facing a productivity issue and would also agree that the lack of private-sector investments is part of the problem. Promoting the development of a more competitive, diverse and integrated financing and leasing ecosystem is a good place to start.

What Can We Learn from the British Experience with Indirect Lending?

Both Canada and the U.K. are advanced, service-oriented economies, each creating a government program to address the gaps that emerged in their financial markets following the 2008 financial crisis. For the U.K., this led to the establishment of the British Business Bank, with a mandate similar to that of Canada's BDC indirect lending program: to stimulate investment in domestic SMEs struggling to scale up or access capital[15]. Like Canada, the British economy faces a productivity crisis exacerbated by these financial market gaps. However, the approaches taken by their respective governments to address these issues differ significantly.

The most notable distinction between the two institutions lies in their operational focus. The BBB primarily operates through wholesale financing, channelling funds through financial intermediaries rather than lending directly to businesses. In contrast, the BDC primarily engages in direct lending to SMEs alongside its smaller wholesale/indirect financing program mentioned earlier.

As of March 31, 2022, the BDC had approximately $47.8 billion (CAD) committed to over 95,000 SMEs across Canada[16]. By comparison, the BBB had around $20.45 billion (CAD) in total commitments[17]. Despite this significant advantage in overall lending, the BDC only has $3.5 billion invested in its wholesale/indirect financing program[18] compared to the BBB's $5.72 billion[19].

> **In Canada, by contrast, only 10% of the market is covered by independent finance and leasing companies.**

The result of this discrepancy has created significantly different outcomes for their financial market.

One key difference is the market share of independent finance and leasing companies (IFLs). In the U.K., independent finance and leasing companies account for a third—37%—of all fixed capital investment[20].

[15]British Business Bank (2022). *British Business Bank Framework Document.*
[16]Business Development Bank of Canada (2022). *2022 Annual Report.*
[17]British Business Bank (2023). *Driving growth across the UK.*
[18]Business Development Bank of Canada (2024). *2024 Annual Report.*
[19]British Business Bank (2024). *Driving growth across the UK.*
[20]The Investment Association (2024). *Investment Management in the UK. 2023 – 2024.*

In Canada, by contrast 17% of the market is covered by independent finance and leasing companies[21]. This divergence has a profound impact on SME financing.

Britain's interest rate spread between large and small businesses is significantly lower than Canada's, at 1.00 compared to 2.26[22]. This narrower spread suggests that gaps in the British financial market are far smaller than those in Canada. A more competitive market structure for SME lending—enabled by the BBB's emphasis on wholesale financing—has been a key factor. The BBB's model fosters competition by limiting its program intervention in the market, allowing IFLs to expand their lending profiles and grow organically.

In contrast, the BDC's focus on direct lending often bypasses independent financiers, limiting the development of competitive, resilient firms capable of addressing market gaps. This approach risks creating a "hothouse" environment, where both SMEs and independent financial rely heavily on BDC support. Effective government intervention in financial markets should ideally be a short-term solution aimed at fostering self-sustaining IFLs that can independently support SME growth. To achieve this, the BDC's market influence must be carefully managed. Expanding its wholesale/indirect lending programs could be a step toward addressing these issues, as evidenced by the BBB's model.

Beyond fostering competition, the BBB's approach also enables the introduction of innovative finance programs designed to expand SME lending. This emphasis on innovation highlights another significant advantage of a more competitive financial market structure, demonstrating how targeted policy choices can drive meaningful improvements in SME access to capital.

[21]Joe Millott (2024). *The Future of Wealth Management in Canada is Independent*.
[22]Jeremy M. Kronick & Mawakina Bafale (2022). *Idem*.

Adapting to the Market Through Industry-Led Innovation: The British Business Bank's ENABLE Product

The BBB has shown a strong ability to create and implement innovative solutions to expand the British economy's ability to lend to SMEs. This success can be attributed to its collaborative approach, working closely with industry stakeholders to design the products it takes to the market. By shaping its services in alignment with the competitive market in which these firms operate, the BBB has developed strategies that have enabled financial firms to expand their lending to SMEs.

One notable example is the ENABLE program, which uses securitization to package smaller microfinance loans into one portfolio. This has allowed private financial companies to profitably invest in small business loans they would deem too small or too risky individually. This approach successfully disperses the risk associated with lending to individual small businesses, making such loans much more attractive to the private sector.

> **Since its launch in 2014, the Enable program has facilitated over $2.6 billion in microfinance portfolios and an additional $1.06 billion in its ENABLE Build initiative.**

Additionally, the BBB provides a guarantee component, enabling small businesses to access capital at affordable, competitive rates. Since its launch in 2014, the ENABLE program has facilitated over $2.6 billion in microfinance portfolios[23] and an additional $1.06 billion in its ENABLE Build initiative, aimed specifically at SME housebuilders[24]. This highlights the immense potential of the program to stimulate private-sector investment in SMEs by effectively managing the risk associated with small-business loans.

In the Canadian context, a program like ENABLE could serve as a valuable tool to encourage private-sector involvement in SME growth. By securitizing SME loans through the involvement of the BDC, Canada's major banks could be incentivized to participate more substantially in funding those independent finance and leasing companies with a particular focus on SME financing. Additionally, using the example of the ENABLE Build program, securitizations could help facilitate targeted investment into industries our economy needs to address not only Canada's productivity issue but also other economic challenges like the ongoing acute housing crisis.

[23]British Business Bank (2025). *Enable Programmes.*
[24]British Business Bank (2025). *How the Enable Build Programme works.*

In general, the BBB's overall approach to lending differs significantly from that of the BDC. Most of the BBB's financing is provided through the Enterprise Finance Guarantee (EFG), which guarantees up to 75% of a loan issued by a financial intermediary in case of default. This effectively reduces risk for lenders while significantly lowering the cost of capital for SMEs. Although the BDC offers a similar product — the Accelerator Loan Guarantee — its scale remains limited as direct lending methods are preferred.

Beyond the EFG, the BBB provides additional programs like the Growth Guarantee Scheme, a match-funding program, and has recently introduced an asset-backed financing option. This diversity stems from the BBB's close collaboration with industry professionals, allowing the institution to quickly adapt to changing market conditions by introducing new financing products that support the industry's needs.

Simon Goldie, Director of Advocacy for the British Finance & Leasing Association (FLA), highlights the value of the BBB's industry relationships:

> **For us, the best thing from the industry's point of view is being able to feed into the development of products; when they [the BBB] are looking at something, they come to us and they ask, can we do this? What do your members think? Will it work? Can we meet with them and talk about it? Is there anything you need and so on. Then the rest flows from there.**
>
> *– SIMON GOLDIE*

A renewed focus by the BDC on strategies like the Accelerator Loan Guarantee or the adaptation of a securitization program, much like the Enable product, could stimulate the private sector's involvement, which is necessary to address the gaps in Canada's financial market over the long term.

Additionally, as shown by the BBB's engagement with industry professionals, fostering stronger relationships with independent finance and leasing companies could significantly support the BDC's efforts to grow the sector and enhance SME financing opportunities.

Thinking Ahead: The Role of Accessible Information in Finance

The primary goal of the BBB is to facilitate risk-sharing while providing cheaper capital to ensure more finance reaches small businesses. This is achieved through the BBB's focus on securitization, loan guarantees, and match-funding. However, a crucial component of increasing SME financing is improving access to information—for both small businesses and lenders alike.

Access to information plays a pivotal role in reducing transaction costs for finance companies, fostering heightened competition for individual loans while creating an overall safer lending environment. For SMEs, having access to accurate and comprehensive information not only enables them to secure funding but also ensures they choose the right type of funding for their specific needs. In this way, access to information is a cornerstone of a competitive and efficient financial market.

One significant advantage of the British financial system is its open banking system. In the aftermath of the 2008 financial crisis, the U.K. quickly adopted an open system, making banking information publicly accessible. Ted Fujisawa emphasizes the impact of this shift, attributing much of the BBB's success in implementing a commercially driven strategy to the availability of banking information:

> **They (the BBB and IFLs) had the benefit of being able to get access to that credit history, banking information, about originators, about the underlying portfolios. We don't really have that in Canada. That would be something that would be good for us.**
>
> *– TED FUJISAWA*

Access to banking information removes one of the biggest hurdles for independent lenders: screening the creditworthiness of potential customers. The ability to access this information easily would significantly lower transaction costs for independent lenders while also ensuring the BDC is capable of making well-informed decisions while selecting small lenders to support. By contrast, Canada's lack of an open banking system presents a significant challenge for independent finance companies to find prospective clients and for the BDC to find capable lenders. This is a significant burden to the Canadian financial system's ability to effectively lend to SMEs.

The accessibility of banking information in the British system allows the BBB to work with a broader range of independent finance and leasing companies Canada's more restrictive regulatory framework tends to exclude. This isn't due to weaker regulations in the U.K. but rather because the open banking system reduces the administrative burden associated with vetting and, ultimately, lending to these smaller firms. This streamlined flow of information enables the BBB to adopt a broader, more inclusive lending approach than the BDC, making a meaningful difference in getting capital into the hands of SMEs.

The BBB has also recognized the importance of ensuring that SMEs themselves have access to critical information about financing. Goldie highlights how vital this is for both small businesses and independent finance and leasing companies:

> **"One of the agreements the BBB decided to have was to ensure that SMEs understood the different finance options that were out there and how they could get it. We (The FLA) think this is critical because if SMEs don't know, then they don't know our members."**
>
> *– SIMON GOLDIE*

To achieve this, the BBB utilizes its Finance Hub platform, a feature of its website. After completing a brief questionnaire, prospective SMEs are presented with financing options tailored to their specific needs while being connected with financial intermediaries who offer a variety of rates based on their assessed risk. By simplifying what is often a complicated process, the Finance Hub ensures that the administrative burden associated with SMEs accessing financing options is reduced. For Goldie and the FLA, this service is essential for the distribution of capital to SMEs:

> **It's not just about providing finance, although that's the heart of what the [BBB] does, it's also about providing that information.**
>
> *– SIMON GOLDIE*

While the BDC offers an online platform for SMEs seeking financing, its tool is limited to showcasing the BDC's own products. This approach falls short of providing SMEs with the full picture of financing options, and it does little to support or expand Canada's IFL sector. By contrast, the BBB's focus on a comprehensive assessment empowers SMEs and strengthens the financial ecosystem. Offering a service like the Finance Hub should be targeted by the BDC to reduce the informational gaps that are preventing SMEs from accessing financing in the Canadian financial market.

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