



# History of the Business Development Bank of Canada

The FBDB period (1975-1995)

Donald Layne



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For the men and women  
who worked and work  
at Canada's business  
development bank,  
FBDB and BDC

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Cover picture: Stock Exchange Tower, Montreal. BDC's Head Office was located here from 1969 to 1997.

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## Preface

This book provides a history of the Business Development Bank of Canada during the period 1975 to 1995. It is about difficult decisions, hard work, innovation and team work that together took a crown corporation from the brink of annihilation to being a prosperous and important partner in building successful small and medium-sized businesses in Canada.

The writing of this history was initiated in 2011 by the President of the Business Development Bank of Canada, Jean-René Halde. The task was assigned to the author, a retired employee of the Business Development Bank of Canada who had witnessed the period covered in this history.

The Business Development Bank of Canada succeeded the Federal Business Development Bank in 1995, which itself had succeeded the Industrial Development Bank in 1975. The latter was founded in 1944. E. Ritchie Clark, a former Chief General Manager of the Industrial Development Bank, wrote *A History of Canada's Industrial Development Bank* after he retired from the Bank. Clark's history covers the period from 1944 to 1975. The present account extends the history to cover the twenty years following 1975. It refers back to Clark's history to trace the origins of essential elements of the Bank as well as fundamental mandate issues returning to the fore over the decades.

It is the author's intention to present a history that is more interesting than a dry rehashing of facts and figures. As such, there may be certain views, conclusions and inferences that are solely those of the author and may not be shared by the Bank or its directors, officers or employees, past or present.

This history is written principally from the corporate perspective. It recounts events as they unfolded "behind the scenes," events many employees on the frontline were not privy to. It lays out the major challenges the Bank faced during 1975 to 1995 and how they were overcome, and illustrates a key characteristic of the Bank's genetic make-up; when faced with seemingly insurmountable challenges, the Bank finds ways to overcome them and consequently become a better institution. As Guy Lavigueur, the former President of the Federal Business Development Bank, used to say, the employees of this Bank can do the almost impossible; point them in the right direction and with their perseverance and expertise, they will deliver the goods.

Former Bank presidents Guy Lavigueur and François Beaudoin figure prominently in this history as chief decision-makers. Along with their Boards of Directors, they provided the directions for the rest of the Bank to implement. If they had given different directions or taken different decisions, the Bank would not have achieved what it did. Indeed, the Bank's evolution might have taken a different path and BDC would not be what it is today.

This book would not have been possible without the contributions of many former and current Bank employees (identified in Appendix 2). The author is very grateful that they took time from their busy schedules to be interviewed and that they mined their memories for the details needed to fill out this history. It would not have been practical to interview every former and present employee of the Bank, although each could have probably provided an interesting story about challenges they faced and how they were overcome. As seen with those interviewed, many employees, past and present, take pride in their achievements at the Bank, especially in growing Canada's small and medium-sized businesses. It is particularly rewarding when a Bank employee can walk down a street and point to a business he or she helped years ago, a business that is still flourishing. This is one of the most gratifying experiences one can have.

Special thanks go to Jane MacGregor of BDC's Public Affairs department. She arranged research facilities and access to the Bank's archives that provided the bulk of the material for this book. A special thank you also goes to a trusted colleague who worked with the author for many years, Cora Siré. She assisted by drafting the Information Technology chapter and by editing and making changes to the first drafts of this book. Finally, the author thanks all his former colleagues for making his time at the Bank a fulfilling experience, one that allowed him to produce this book. As a crown corporation, the Bank has and will continue to be faced with challenges emanating from paradoxes implicit in its changing mandates. It is said that history teaches valuable lessons. Perhaps this history can contribute in some small way to how the Bank faces and overcomes its challenges in the future.



1944

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# The genesis

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The Bank's genetic make-up is conceived. Founders of IDB grapple with familiar preoccupations: the 'non-competing' mandate, making higher risk, higher cost loans and achieving modest profitability.

The Federal Business Development Bank (FBDB) came into being on October 2, 1975. Created by an Act of Parliament, FBDB was established as a crown corporation wholly owned by the Government of Canada. It took over the operations of the Industrial Development Bank (IDB) which itself was created by Canada's Parliament in 1944. Crown corporations are expected to operate on normal commercial terms but their operating objectives are determined by the government of the day.

A government regulation stipulated FBDB's headquarters be located in Montreal. It joined two other important federal crown corporations also headquartered there – Air Canada and Canadian National Railways. The placement in Montreal was not unexpected as IDB's operational management was already located there, operating out of what was then the Bank of Canada building on Victoria Square.

As an independent crown corporation, FBDB had its own President and Chief Executive Officer and its own Board of Directors. These officers were all appointed by the government of the day. IDB, on the other hand, had been established as a wholly owned subsidiary of the Bank of Canada, another crown corporation. Its President had been the Governor of the Bank of Canada, its Board of Directors was the same as the Bank of Canada's, but its operations were run by a Chief General Manager. In 1975, the Governor of the Bank of Canada was Gerald Bouey and the Chief General Manager of IDB was E. Ritchie Clark.

IDB was created to finance small manufacturers. Many of these businesses had to convert from wartime to peacetime production following World War II. Over the years, IDB had its mandate expanded periodically to finance more sectors of the economy. IDB also added equity financing and advisory services to its offerings in later years. But financing Canada's small business manufacturing sector with term loans remained the main focus, and market, for IDB.

Ritchie Clark joined the Bank as a credit officer in 1947, not long after its founding, and so was witness to almost the whole life story of the Industrial Development Bank. After IDB was taken over by the newly created FBDB in 1975, Clark stayed on briefly as Vice President and Chief General Manager to assist the new President, Richard Murray, in the Bank's transition from IDB to FBDB. After retiring from the Bank, Clark authored an excellent, informative history of IDB<sup>1</sup>. This book, referred to herein as Clark's History and quoted in the paragraphs below, follows IDB from the discussions and debates in the federal government that gave rise to the Bank in the early 1940s to the takeover by FBDB in 1975. Some key events documented by Clark are worth recounting because they illustrate the genetic make-up of the Bank. They also give credence to the maxim *plus ça change, plus c'est pareil* – the more things change, the more they stay the same – one of history's fundamental lessons. The hearings on Parliament Hill when IDB was being created and the manoeuvres by government departments to remove IDB from the Bank of Canada are worth recollecting.

The Bill, or legislation, to set up IDB was introduced in Canada's House of Commons on February 28, 1944. The Governor of the Bank of Canada and the Deputy Minister of Finance, the government's top two economic mandarins, were principal witnesses shepherding the Bill through Parliament. It was passed by the

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<sup>1</sup> E. Ritchie Clark, *The IDB: A History of Canada's Industrial Development Bank*, University of Toronto Press, 1985. Quotes cited in this chapter are taken from pages 19 to 39 of Clark's book.

House on August 11, 1944, passed by the Senate of Canada the same day and received Royal Assent on August 14, 1944.

Clark writes in his History that when Parliament considered the IDB Bill, the name of the new institution “provoked about as much debate as any other part of the proposal.” In its early drafts, the new legislation used the name Industrial Credit Bank. However, after “eight or nine” drafts of the Bill, the name Industrial Development Bank was adopted.

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The other section of the 1944 IDB legislation receiving much attention dealt with the Bank’s supplementary role. To quote Clark’s History: “According to the act, the Bank was not to displace other lending organizations but rather ‘to supplement’ their activities; this was said in the preamble to the act. It was provided in section 15 that financing was to be extended only ‘if in the opinion of the Board, credit or other financial resources would not otherwise be available on reasonable terms and conditions.’” Clark goes on to state: “The problem of determining beyond doubt whether the funds applied for were available elsewhere was never completely solved to the satisfaction of the Bank’s critics, and other financial institutions were often sceptical as to the respect paid by the Bank to this particular requirement.” According to Clark, during the debates creating IDB, one Member of Parliament, representing the affluent bastion of Rosedale in Toronto, said, “I think this bank should never be set up. I think there is no need for it whatsoever.”

The amount of losses the Bank would incur was another issue attracting much discussion during parliamentary hearings on IDB’s legislation. The *raison d’être* for IDB was to make loans that would not attract private interests because the chances of profit were small and the risk of loss, high. Thus, it was natural to conclude large loan losses would result. But IDB’s proponents, while conceding losses on individual loans would occur, expected the new bank to earn a modest profit. Clark writes that the then Deputy Minister of Finance (Dr. W.C. Clark) stated during the 1944 parliamentary hearings: “It seems to me appropriate that the type of institution you set up to perform this function should be essentially a non-profit-making institution which goes out to render a service that is needed

rather than to make profits primarily ... If we get a reasonably efficient management, what I would expect is that there would be a modest or relatively moderate profit rather than large profits.” He conjectured, in 1944, IDB might write off loans to the extent of 1.5% of loans per annum, approximately double the rate then experienced by chartered banks.

Another cause for concern among Members of Parliament was the new bank’s susceptibility to political interference. As Clark’s History recounts, there was a lot of trust placed on the then Governor of the Bank of Canada (Graham Towers) to not only set up the Bank on a sound footing, but also to protect it against political pressures. This trust was not misplaced as the Bank of Canada has been and is, arguably, the most independent of government institutions. But this did not deter some Members of Parliament from believing IDB would be unable to withstand political pressures and with that also bring political involvement into the Bank of Canada “from which it should be aloof.” As one Member saw it, with 245 constituencies in the Dominion of Canada, there would be political pressures from all regions “because you are a public institution for the assistance over a long period of certain industries, the giving of capital assistance from this government bank.” Clark’s History states some Members of Parliament thought it might have been better to set up the new bank as a private institution owned by the chartered banks and other private financial institutions. But IDB’s proponents did not think a private enterprise would do what was not done in the past, which was to take on higher risk loans at the expense of making an acceptable profit.

These views were offered during the process of moving the Industrial Development Bank legislation through Canada’s Parliament in 1944.

Throughout its 31 years of existence, the Industrial Development Bank stayed true to the tenets envisaged by its founders. While many individual loans were written off and overall risk, as measured by loan loss rates, was higher than that of chartered banks, IDB still managed to post a modest profit each year. The Bank also conducted its operations without political interference and indeed, generally sought to distance itself from government influence. To illustrate, Clark writes that IDB was so jealous of its independence, it came to regard “with wariness any involvement, not only with politicians, but with federal government departments as well.” When the Department of Fisheries asked IDB to participate in a special study of the fishing industry in 1951, the Bank declined as it did when approached with proposals to administer any government programs offering financial assistance to industry. Clark reports that this staunch independent stance once evoked a wry remark from one of Canada’s iconic Finance Ministers, the Honourable Walter Gordon. Referring to IDB, he said it was “as independent as a hog on ice.” This prompted Clark to remark: “Just what the metaphor meant to Mr. Gordon is not known, but those in the IDB regarded it as a compliment.”

Placing IDB as a subsidiary of the Bank of Canada went a long way in creating and guarding its independent nature. Another key factor was the location of its operational management. IDB’s legislation fixed the site of its head office in Ottawa, consistent with the location of the Bank of Canada’s head office. However IDB made its operational headquarters in Montreal. This was not considered ultra vires of the IDB Act, likely since the President of IDB, the Governor of the Bank



Construction of  
the Bank of Canada  
building, Montreal

of Canada, was located in Ottawa. Why Montreal? As Clark states in his History: “There developed a tradition in the IDB that it arose from the fact that S.R. Noble, the first general manager of the Bank, had a home there and had no intention of living anywhere else.” A sound tradition as office location theory at one time cited the main factors in deciding where to locate a head office as personal rather than economic. It was where the chief decision-maker of the company wanted to live or more likely, where the spouse of the chief decision-maker wanted to live. Factors such as livability and the arts – symphony, opera, galleries – became more important than economic ones. Furthermore, in 1944, Montreal was Canada’s financial centre and though IDB would not be part of the big boys’ (chartered banks) club, it was located in the same neighbourhood. As Clark states, the decision to locate the management of IDB in Montreal “proved to be one of those small acorns from which great oaks grow.”

The IDB had its supporters and detractors although the latter group, as is common, were more vocal and received more attention. But the cover provided by the Bank of Canada kept detractors at bay. To get to the IDB, one would first have to penetrate the Bank of Canada shield. And so it became clear to anyone wanting to change the way IDB operated, it could best be or, more realistically, only be accomplished by removing IDB from the Bank of Canada.

Clark’s History states that as early as 1959, a new member of the Bank’s Board of Directors suggested IDB be removed from the Bank of Canada. The suggestion was discussed at the Board of Directors but nothing came of it. By the early 1960s, the question was raised again in political discussions involving the Bank. And again the Bank or, more likely the Governor of the Bank of Canada, managed to ward off detractors. But he could not resist the tide of change forever.

1970 to 1975

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# Creating FBDB

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Shaping the new FBDB begins. Despite opposition, the decision is made to remove the new crown corporation from the Bank of Canada. Once again, the debates centre on the name of the new institution and its mandate.

**A**s early as 1970, IDB learned that the Department of Industry, Trade and Commerce had been asked by the government to conduct a study of all forms of government assistance to industrial development in Canada, including the Industrial Development Bank. A few months later, it was learned that the Department of Finance was also looking at IDB as part of its study on foreign investment. Not long after, the government directed the Minister of Finance to bring forward a review of IDB indicating possible changes in its operations. These manoeuvres were taking place behind IDB's back.

Generally, when it is said the government has directed a Minister to do something, it is in all likelihood based on a recommendation contained in a Memorandum to Cabinet from that Minister. And the Memorandum itself would be the handiwork of the Deputy Minister of that department. Thus when the request was made of the Minister of Finance to bring forward a review of IDB, it likely had the fingerprints of the Deputy Minister of Finance all over it. The subsequent placement of the Bank under the wing of the Minister of Industry, Trade and Commerce would also suggest that this recommendation was made in consultation with the Deputy Minister of Industry, Trade and Commerce.

In the early 1970s, the Deputy Minister of Finance was Simon Reisman, a powerful figure (and in many quarters feared) in Ottawa. He had a reputation for toughness and intellectual brilliance, in addition to being abrasive. Before being appointed Deputy Minister of Finance, he had negotiated the 1967 Auto Pact with the United States, been Deputy Minister of Industry, Trade and Commerce, and Secretary (Deputy Minister) of the Treasury Board of Canada. (Later in his career, he would also successfully negotiate Canada's Free Trade Agreement with the U.S., and in the process earn the wrath, it is claimed, of the U.S. Secretary of the Treasury.)

It was known Simon Reisman did not like the idea of IDB being outside the purview of his department. Perhaps too, he did not look kindly on IDB's refusal to assist the Adjustment Assistance Board. This board had been created to help Canadian manufacturers in the automotive industry adjust to the new Auto Pact he had negotiated with the U.S. Holding the purse strings of government, the Department of Finance together with the Treasury Board of Canada had their fingers in the financial and policy affairs of every government department, agency and corporation, save the Bank of Canada, where IDB resided. All indications therefore led to the conclusion that the Department of Finance was likely the driving force behind the removal of IDB from the Bank of Canada. Unbeknownst to IDB's management in Montreal, it was a *fait accompli* – only a matter of time.

The intention of the Department of Industry, Trade and Commerce (IT&C) was made clear in a report prepared at the time by a working group of officials for their Minister, the Honourable Herb Gray. One proposal in the report envisaged removing the financing of manufacturers from IDB entirely and combining it with the General Adjustment Assistance Program, the heavily subsidized flagship business financing program in IT&C. Removing the financing of manufacturing enterprises from IDB would have collapsed the backbone of the Bank, and most certainly sent it into oblivion. Fortunately, this was too big an undertaking to engineer, even for IT&C officials.



All the studies on IDB were taking place in Ottawa with little or no involvement by Bank personnel. They were kept in the dark. Clark's History<sup>2</sup> states: "It was surprising for senior operational management [at IDB] that such studies did not necessarily involve discussions with them on the part of the departmental officials making the studies." This is, of course, the flip-side to insisting on strict independence from government – 'you run your show while we run ours.' Even when it became known that the Department of Finance, under Simon Reisman, was given the directive to conduct a review of IDB, the Bank arranged to have its own response to the government's directive, "apart from anything the Department of Finance itself might say." And while IDB did have its day before the government's Cabinet Committee (of Ministers) on economic policy, the meeting turned into a cross examination on the Bank's policies and practices. Towards the end of 1972, another interdepartmental committee on small business programs was struck. This time, the Bank was represented on the committee by IDB's Secretary to the Board of Directors.

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### **Shaping a new Bank**

Officials in Ottawa began shaping a new Bank to serve what they considered small business priorities and needs. To Bank people, it seemed more like their whims and fancies. As Clark states: "The Bank, and particularly the operational management at Montreal, did not think that advice from outside as to what the IDB should or could do was needed." The key to shaping a new Bank still hinged on separating IDB from the Bank of Canada, a move that was opposed strongly by IDB's Board of Directors and by its President, Louis Rasminsky, the Governor of the Bank of Canada. Rasminsky was perhaps the only senior mandarin in Ottawa who could stand toe-to-toe with the Deputy Minister of Finance in those days. (Rasminsky, another formidable intellect, played a key role at the 1944 Bretton Woods Conference and was credited by John Maynard Keynes for shaping the international consensus that led to the creation of the International Monetary Fund and the post-war system of international finance and trade.)

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2 E. Ritchie Clark, *The IDB: A History of Canada's Industrial Development Bank*, University of Toronto Press, 1985. Quotes cited in this chapter are taken from pages 352 to 361 of Clark's book.

Although Rasminsky's term as Governor of the Bank of Canada extended into 1975, he tendered his resignation in February 1973 to take care of his ailing wife. He was succeeded by Gerald Bouey. In July 1973, this new President was informed by the Honourable Alastair Gillespie, Minister of Industry, Trade and Commerce, that the government was proceeding to set up a new corporation to absorb IDB. The new crown corporation was to be named the Industrial Bank and Development Agency. Apart from taking over IDB and severing the link to the Bank of Canada, new management services (counselling and training) would be added to its mandate. It would have its own Board of Directors and a full-time president as chief executive officer.

In 1972, the writing was on the wall; in 1973, the deal was done. IDB was going to be removed from the Bank of Canada and become the nucleus of a new crown corporation. Gone would be the days when, as was said by a former employee, if we needed money we would just go downstairs to the vault and get some – an apt metaphor. Or, as put more directly by the Deputy Minister of Finance, you won't be able to get your money from Big Daddy anymore. By implication, the Bank would have to go through the Department of Finance to finance its activities.

Once this realization set in, the Bank's management moved conscientiously and wholeheartedly into planning the transition to the new corporation, not without some agony. And agony it was in trying to rationalize between what the Bank was doing, and what seemed like the whims and fancies of Ottawa officials. As Clark's History describes: "Senior officers with long experience in the Bank were surprised to hear proposals about the smallest and most delicate aspect of policy or practice put forward by someone who had had no previous direct contact with the Bank. As a result, the Bank's representatives had to discuss patiently and at length matters that they believed the Bank's experience had settled long ago. Unfortunately, the situation occasionally got the better of patience, and one of the Bank's representatives once gave vent to this exasperation by demanding of a startled departmental official: 'When did you last loan five bucks?'"

Under its new operations, the Bank was to greatly expand its advisory services and equity financing to small business. Advisory services were to grow into a wide offering of management services including business information services, training and counselling. The latter would absorb the Counselling Assistance for Small Enterprises program which was being run by the Department of Industry, Trade and Commerce. CASE, as it was known, was a small business counselling service utilizing the talents of retired businesspeople. These people, more or less volunteers, provided their expertise at a very low cost to the program to make its services affordable for small business owners. The Bank was envisaged as the one-stop shop for small business. If it couldn't help directly with its own financial and management services, it could at least direct an enterprise to the right source of assistance through its business information service.

That the Department of Industry, Trade and Commerce was willing to give up voluntarily its CASE program to the new Bank was an obvious sign the program was not operating well within the Department. This was given credence when, in its first year of operation at the new Bank, small business enquiries for CASE services tripled in number.

### **A new name and new services**

As expected, and as in 1944, much debate arose in various committees regarding the name of the new Bank. The name proposed early in the process, the Industrial Bank and Development Agency, looked more like a consensus agreement. It was a non-starter from IDB's point of view. Another name, Enterprise Canada, had strong support from the Department of Finance. In the end, IDB's views prevailed and the name Federal Business Development Bank (FBDB) was accepted. Keeping the word 'Bank' in its name was very important. It meant the corporation belonged to a very select group of companies. Apart from chartered banks, only the Bank of Canada and IDB could call themselves 'banks.'

The Bank would be classified a Schedule D crown corporation, meaning that it was required to operate normally without parliamentary appropriations. The only financing from government would be payments to increase its capital (equity) base. And since the Bank was expected to operate on a full cost recovery basis, its capital payments would be classified as non-budgetary on the government's books; that is, they would not be part of the government's budget and would not contribute to the deficit. At the same time, it was recognized the new Bank's Management Services would have to be a subsidized activity and an allowance for such payments was made in a way that did not compromise the Bank's Schedule D crown corporation classification. Annual appropriations to subsidize these activities were part of the appropriations the Department of Industry, Trade and Commerce received each year from Parliament. This allowed parliamentarians to call FBDB management to Ottawa to defend the appropriations. As expected, most questions wound up being about the Bank's lending activities and policies.

The second area of expansion was equity financing. Although IDB had done equity financing in the past, principally on a piece-meal basis, a full blown equity financing service was envisaged for the new Bank.

And so, despite IDB's apprehensiveness to all the task forces, working groups, committees and the like swirling around it, the end result was that the Bank was actually going to expand its operations and become a bigger institution.

### **Passing new legislation**

Draft legislation to create the new crown corporation was completed at the end of 1973 and introduced in Canada's Parliament in April 1974. It was expected the legislative process would be completed before Parliament took its traditional summer break. But Parliament dissolved in May 1974 and federal elections were called for July 8, 1974. This meant the whole legislative process would have to start from scratch when a new Parliament was called to session after the election.

The delay placed extra strain on IDB as it was approaching legislated limits on its lending activity. With no way of telling when new legislation would be passed by Parliament – which could be delayed for a long time if a new party were elected to form the government following the elections – the Bank had to prepare procedures to implement the dreaded act of credit rationing. Fortunately, there was no change of government and when Parliament reconvened right after the summer, the Federal Business Development Bank's legislation was fast-tracked.

It passed the House of Commons on December 4, 1974, passed the Senate on December 19 and was given Royal Assent on December 20. The main opposition to the FBDB legislation came from sales finance companies. Since the early 1960s, sales finance companies were publicly complaining to anyone who would listen in Ottawa about IDB taking away their clients and potential clients.

Although the Bill to create FBDB received Royal Assent in December 1974, only those sections pertaining to increasing the Bank's total lending authority were immediately proclaimed, thus removing the spectre of credit rationing. Proclamation of the remaining sections was delayed, ostensibly to allow IDB to complete its fiscal year and to allow for implementation of administrative processes needed to transition smoothly from the IDB, a subsidiary of the Bank of Canada, to a new stand-alone crown corporation, the Federal Business Development Bank. But adding to the delay was a major deterioration in the country's economy and government finances.

In the mid-1970s, Canada was reeling under the twin setbacks of rising unemployment and high inflation, a non-textbook situation. Thus was coined the term 'stagflation.' In 1975, unemployment had jumped to 6.9% from 5.3% the previous year, while inflation was hovering around 11%. During the 1974 federal election, the leader of the Conservative Party of Canada, Robert Stanfield, called for a 90-day wage and price freeze to break the momentum of rapidly rising inflation. This position quickly became a major campaign issue and was ridiculed by the Liberal Party of Canada which went on to win the election. Once elected, however, the Liberal government, under Prime Minister Pierre Trudeau, did a complete reversal and instituted a system of wage and price controls in Canada. It tightened monetary and fiscal policies and imposed severe limits on federal expenditures. This led to major program cuts and delays and brought into question the outlays needed to start up the Federal Business Development Bank. It was reported in the media that FBDB would require some \$150 million to commence operations. This figure, as often happened with media reporting, seemed to be taken out of the blue since its composition and source were unknown.

In fact, IDB had \$44 million worth of debentures falling due on October 1, 1975 along with \$21 million of accrued debenture interest for a total funding requirement of \$65 million. If, as was expected, FBDB was proclaimed to be in business on October 1, 1975, one day after IDB's fiscal year-end, the federal government would have had to fund this \$65 million. If the proclamation was made effective October 2, 1975, it would remain the Bank of Canada's responsibility to fund the \$65 million. And so, FBDB was proclaimed into being on October 2, 1975, contributing in small part to the health of the government's finances – a bit of smoke and mirrors. A one-day financial year, October 1, 1975, occurred between IDB's fiscal year-end of September 30, 1975 and the beginning of FBDB.

### **Expectations and policy environment**

During the process of drafting plans for FBDB, it was often repeated in Ottawa that the Bank could be doing more to help small businesses. In particular, it was thought the new Bank should be taking more risks in its lending as compared to the IDB. Politicians of all stripes felt this way. The same sentiment was heard

outside of Ottawa. In 1973, soon after the Minister of Industry, Trade and Commerce announced to IDB the government's plans to create a new crown corporation, the famed Western Economic Opportunities Conference took place. This conference of First Ministers was pivotal in the history of federal-provincial relations as it brought to the fore, in an emphatic way, the reality of western alienation from central Canada, and in particular from the central government in Ottawa. At the conference, IDB, albeit a small cog in the vast wheel of federal economic programs, came in for criticism from western First Ministers for its alleged failure to assist small businesses in western Canada. They saw IDB as too conservative and wanted it to make riskier loans in addition to providing more equity financing and management services to small business. These views mirrored sentiments felt by most federal politicians. Thus, the political class not only supported the need for a government bank to provide financing to small business but also saw it as one that would take more risk than the IDB had done.

This position was contrary to what some private lenders as well as some bureaucrats were saying. In the Departments of Finance and Industry, Trade and Commerce, there were officials who held the view a financing gap did not exist in the market, other than for equity financing. So, there was no need for a government small business financing institution that provided term loans. This is understandable coming from the Department of Finance given its responsibility for creating the rules and regulations governing Canada's national financial institutions, principally chartered banks. To say these institutions were not providing adequate financing to small business could lead to the conclusion that the Department of Finance's own rules and regulations were lacking. Department of Finance officials did, however, see a need to improve small business management skills so that such firms could qualify for conventional bank loans.

The views coming out of Industry, Trade and Commerce were perplexing considering the Department itself had set up a number of business financing programs including the Small Business Loans Act (SBLA) which guaranteed small business loans made by chartered banks. Nonetheless, politicians had their way and created FBDB to absorb IDB and to take on more risk, make equity investments and provide an array of management services. This was the policy environment when FBDB started out in business.

### **Selecting a President and Board of Directors**

Richard Murray from the Foreign Investment Review Agency in Ottawa was appointed FBDB's first President and Chief Executive Officer in August 1975. To assist in the transition, Clark stayed on at the Bank in the position of Chief General Manager until February 1977. After his appointment, Richard Murray asked Sol Kanee, who was on the Bank of Canada's Board of Directors, to join FBDB's Board. He did, and was elected by the FBDB Board as its Chairman. Under the FBDB Act, the Chairman of the Board was elected from among the Directors by the Directors.



Richard Murray was appointed FBDB's first President and Chief Executive Officer in August 1975.

Murray knew Kanee from his Winnipeg days when he, Murray, was managing director of the Hudson's Bay Company. Kanee's knowledge of IDB was critical but even more important was his political influence in the Liberal Party establishment and his capacity to get things done in Ottawa. Kanee was one of very few who had access to the Prime Minister. The Bank had lost its Bank of Canada shield so it was important to have friends in high places to provide protective cover when needed. Murray was also well connected to the higher-ups in Ottawa's political circles. How else would he have been appointed President of FBDB, a crown corporation, and as such, a coveted position among senior officials in Ottawa? He was also on a first name basis with the powerful Michael Pitfield, Clerk of the Privy Council, a position known as deputy minister of deputy ministers.

In addition to private sector members, the FBDB Board of Directors included deputy ministers from Ottawa and, to provide continuity, the Governor of the Bank of Canada, Gerald Bouey. It was expected the Department of Industry, Trade and Commerce would be represented on the Board by its Deputy Minister, Gerry Stoner, but with all his other duties, he was not interested in the affairs of the Bank and therefore elected to have a senior departmental official take his place on FBDB's Board.

In 1975, that senior official was the department's Senior Assistant Deputy Minister, Policies, Programs and Finance, Guy Lavigueur, who was also the Department's appointee on the board of the government-owned Canada Development Corporation. Lavigueur's appointment to the Board would prove to be a fateful development. As will be seen, he would preside over some tumultuous years at the Bank as the longest sitting President in FBDB's history.

1975 to 1978

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# Early days at FBDB

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Management moves quickly to implement the newly formed FBDB. Decentralization, new branches and increased staff are accompanied by a changing of the guard. Guy Lavigueur takes over as President in March 1978.

On October 2, 1975, FBDB hit the road running. The Bank's Board of Directors had already met the previous month to sign the delegations of authority and by-laws needed for Bank personnel to continue operations seamlessly. The FBDB Act gave all the powers of the corporation to the Board of Directors with the facility that the Board could delegate whatever powers it saw fit to employees of the Bank. Without a specific delegation of authority from the Board, a credit officer or a manager could not authorize loans.

'Streamline the loan authorization process' and 'increase lending' were the mantras of the day when FBDB started out. But streamlining and expanding the lending operation had already begun in the early 1970s at the IDB. These facts did not make an impression on the politicians in Ottawa who kept insisting the Bank needed to increase its lending to small business.

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As part of its legislated mandate, the Bank had to set up brand new operations to deliver management services – counselling, training and business information for small businesses.

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Indeed, from the outset, it was clear the Bank's primary mandate was to increase the amount of loans it was extending to small business while implementing the new functions of management services and venture capital. At the time, one of its Directors, Jack Poole (the man later credited with bringing the 2010 Winter Olympics to Vancouver), reported on a meeting he had with the Honourable Ron Basford, a senior Liberal cabinet minister from Vancouver. The Minister told him the entire cabinet felt FBDB should be more daring and more risk-taking in its endeavour to help small business. He also said the Bank was not widely known among constituents and that Members of Parliament and provincial Members of the Legislative Assembly were ignorant of the Bank's role.

The Bank was seen, even by many of its new Board members, as being too bureaucratic with too many levels of approvals needed before a loan could be authorized. In-house engineers represented a popular target considered to be slowing down the loan authorization process. Each region had a corps of professional engineers who had a say on loans before they made their way up the line for authorization. In essence, the engineers were the repository of the Bank's



industrial intelligence. A separate review of loan proposals by the engineers was part of the modus operandi at IDB, established early on in the Bank's history for analyzing loans to manufacturers. Where a chartered bank would concentrate its analysis of a business on financial measures such as debt-to-equity, liquidity ratios and the like, IDB was looking at operational and industrial measures, such as board-feet output in its analysis of sawmills, for example, in addition to financial measures. This was the nature of IDB's business. To take on extra risk, it had to fully comprehend the operational side of a business, not just the financial aspects.

But while engineering reviews were good for the backbone of the Bank's business, the manufacturing sector, they did not serve much usefulness when it came to clients in the service sectors. And as the economy and the Bank's clientele shifted from manufacturing to service industries, the need for Bank engineers was brought into question. The engineering units survived into the FBDB era and, while they were eventually phased out, they were replaced with regional Project Analysis Groups concentrating on large credits.

### **Decentralization of loan authorizations**

IDB had started its decentralization process in 1967 by formalizing the regional office structure to which branch offices would report. Throughout the early 1970s, delegations of authority allowed regional and branch offices to progressively increase the size of loans they could authorize by amounts ranging from 20% to 65%. The result was that in the 1971-1975 period, the number of loans approved in the field (regional and branch offices) was never below 97% of all loan approvals. It reached 99% in 1975, with branch offices approving 68% and regional offices approving 31% of all new loans. There were even some branches where branch managers and assistant managers approved 75% or more of all loans in their branch territory.

Decentralization of loan authority was accompanied by a push to make the loan-making process more efficient and faster. Paperwork was reduced with the introduction of a short form credit report and more loans were processed without the input of 'second look' investigations by officers or engineers. These moves led to a dramatic decline in the time taken to process a loan, from an average 46 days in 1967 to 27 days in 1970 and to 14 days in 1975.

### **Expansion**

In the early 1970s, IDB made further moves to expand its lending and opened new branch offices at a rapid pace. From 30 branch offices in 1970, there were 75 by 1975. Publicity expenditures increased as radio and television advertising spots were taken out by the Bank. The TV ads caught the attention of finance companies who pointed to the ads as further evidence the Bank was aggressively marketing its loans. As Clark<sup>3</sup> points out: "Energetic publicity efforts by the Bank always ran the risk of arousing the criticism that it was breaking away from its statutory role of complementing" commercial sources of financing. Around the same time, the Bank wanted to update a film about itself which showed a series of short episodes on the various kinds of businesses it assisted. Scripts were submitted for the new film.

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3 E. Ritchie Clark, *The IDB: A History of Canada's Industrial Development Bank*, University of Toronto Press, 1985. Quotes cited in this chapter are taken from pages 301 to 303 of Clark's book.

One of the first scripts, proposed by an employee, was for the film to open with a bevy of 'go-go' dancers tossing dollar bills out of their costumes. The proposal was rejected but someone at the time obviously thought this was an attractive sector for IDB financing.

The end result of these moves was a huge expansion in IDB lending just before it became FBDB. Between 1970 and 1974, there was an almost three-fold increase in loan authorizations. In 1970, 3,584 loans were authorized for \$165 million, followed by annual increases topping 20% each year and hitting a 33% growth rate in 1973. By 1974, fully 9,712 loans were authorized for \$470 million. This kind of growth in lending was unheard of, even in boom times. There was a slowdown in 1975 reflecting zero growth in the economy and loan authorizations dropped to 9,461 loans for \$401 million that year.

Staff levels kept pace with the rapid expansion of the early 1970s, growing from 811 in 1971 to 1,546 in 1975. Staff increases were taking place at all levels in the Bank. Head office staff more than doubled, from 110 in 1971 to 244 by 1975. The same was true for regional offices where staff levels grew from 136 in 1971 to 286 by 1975. In branch offices, staff almost doubled as well, from 565 in 1971 to 1,016 in 1975.

Three observations stand out with respect to the dramatic growth in IDB lending during the early 1970s. First, as alluded to earlier, it seemed the politicians in Ottawa pushing for drastic change to the IDB may have been oblivious to this expansion. In 1973, when the decision was made to move IDB from the Bank of Canada, they were still calling for the Bank to be less conservative in its practices and to lend more to small business. Secondly, the expansion took place without any significant change in the Bank's lending policies. Some emphasis on security coverage was relaxed over the years but the basic credit criteria remained the same. Thirdly, the level of risk taken was very manageable and may even be considered low risk by later standards. For example, the ultimate loss rate (the proportion of net loan authorizations ultimately written off) on loans made between 1968 and 1975 averaged 2.12%, much lower than what was to come.

With rapid expansion, the experience level of the Bank's credit officers dropped so that by 1974, 40% had less than one year's service. Also, as the Bank grew, budgeting procedures had to be implemented. Budgets, however, were restricted to operating costs and were based on numbers of loans made. There were no budgets for net interest income, sundry income or provisions for loan losses. The only statistical report received by branch offices reported on the number of loans made. Within a branch, the important report became the one showing the number of loans made by each credit officer. When the Chief General Manager, attending a regional branch managers' conference, stressed his office was not using 'numbers' to assess a credit officer's work, he was met with the remark: That is all very well, but you are only out here for one day!

After Murray took over the reins of FBDB in 1975, the Bank continued on the same lending path. FBDB's first fiscal year of operation would only be six months as the Bank changed its fiscal year-end from September 30 to March 31 in order to coincide with the government's fiscal year. (Throughout this history, a fiscal year is the 12-month period ending March 31<sup>st</sup> of that year, except for fiscal 1976

which was a six-month fiscal year.) In the six months ending March 31, 1976, the new FBDB authorized 4,776 loans for \$217 million, a 33% increase over the same six months of the previous year. The Bank also authorized 13 equity financing deals worth \$2.5 million in the six-month period.

### **Management services begin**

As part of its legislated mandate, the Bank had to set up brand new operations to deliver management services – counselling, training and business information for small businesses. The CASE program was transferred from the Department of Industry, Trade and Commerce and owner-manager courses from the Department of Manpower and Immigration in late 1975. Eric Scott, formerly Chief Engineer in IDB, was appointed to the position of Director, Management Services and tasked with implementing these services.

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## When Richard Murray was appointed President and Chief Executive Officer of FBDB, he was the first chief executive who did not come from within the ranks of the Bank.

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George Kirkwood was Manager at the Bank's Prince George, British Columbia (B.C.) branch when he received the call to deliver one of the first small business seminars put on by the Bank. With no specialized management services on staff as yet, branch managers were initially asked to deliver the new seminars. In the absence of screening as to who should deliver the seminars, some events were sterling performances while others were not, given that public speaking is not everyone's forte. Kirkwood, however, had the gift of the gab. The first seminar he was asked to deliver, basic bookkeeping for small service and retail businesses, had been prepared by a firm of accountants and tested in the Lower Mainland of B.C. Kirkwood arranged to hold the seminar in Terrace, B.C. at a popular local hotel since it was the only one with a room suitable for holding a seminar. With some advance advertising, the seminar was fully booked, with 35 entrepreneurs scheduled to attend. But by the time the seminar started, 45 business people had shown up. They were all allowed to stay but more kept turning up. Kirkwood was obliged to remain in Terrace for an extra day to deliver the seminar to 40 additional participants. Such was the need for learning business principles among small business owners and operators at the time. Popularity was

probably helped by the open bar following each of the early seminars. A \$10 fee covered the seminar and post seminar activities. In its first (six-month) fiscal year, over 200 FBDB small business training seminars were delivered, mostly in smaller centres.

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It did not take long for the Bank's new management services to reach full speed. In its first full year, fiscal 1977, the Bank completed 2,840 CASE counselling assignments. Business training also blossomed as 628 business seminars were held in fiscal 1977, attended by 12,000 entrepreneurs.

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Later on, as manager of the FBDB Victoria, B.C. branch office, Kirkwood had to start up the CASE counselling program in his area. He had a good friend, Jack Baynes, who was just about to retire as a bank manager at the Main Office of the Bank of Montreal. The bank manager's knowledge of small businesses and their competencies made him an ideal candidate for CASE Coordinator, the program manager for the area. Although it took a lot of persuasion, he agreed to become the local CASE Coordinator. This was a stroke of luck on FBDB's part, as he quickly rounded up a highly competent CASE counselling roster from among his professional contacts. He knew the key players in all the big firms and it took only a month to complete the full roster of counsellors. This essentially was how the CASE program was implemented across the country. CASE counselling became so successful in Victoria that Kirkwood was drafted to become the Assistant Regional Director for Management Services in the B.C. and Yukon regional office where he helped manage both the seminar and CASE counselling programs for the entire region. He would later play another key role as Assistant Vice President, Loans, when he assisted Ken Neilson in improving the quality of FBDB's loans portfolio in the late 1980s, before being appointed District General Manager in Toronto.

From the very beginning, the CASE counselling program was popular among small business owners and small business advocates, especially politicians. Even

critics of the Bank's lending practices would always add that CASE was a very good program. The program had not received much market exposure when it was domiciled in the few IT&C offices across Canada, offices usually located on some anonymous floor in a large office building. Also, IDB officers had not been the most cooperative when IT&C program managers would stop by and ask for referrals for the CASE program. With the program managed by FBDB, however, it was actively marketed, clearly filled a need (lack of management skills) and was cheap. For \$200, a small business owner could call in a CASE counsellor who would diagnose the business problem or opportunity, and provide advice on how to proceed. Diagnostics and recommendations were presented in a full report given to the client. At the start of the CASE program, an equivalent service at a major consulting company would, at a minimum, cost upwards of \$2,000. In its first year of operation, the CASE counselling program had integrated 1,300 retired business persons into its roster and undertaken 502 assignments.

It did not take long for the Bank's new management services to reach full speed. In its first full year, fiscal 1977, the Bank completed 2,840 CASE counselling assignments. Business training also blossomed as 628 business seminars were held in fiscal 1977, attended by 12,000 entrepreneurs. The owner-manager courses taken over from the Department of Manpower were upgraded and distributed to provincial ministries of education for use in colleges. The Bank updated its *Minding Your Own Business* series of mini-books and distributed them through the branch network. FBDB also responded to some 13,000 enquiries for information through its Small Business Information Service. These enquiries principally involved requests for information on government programs.

It soon became clear that management services were not just an add-on to the Bank's financial services but a full blown business in their own right. Scott was rewarded for the quick success of management services and promoted to General Manager (Vice President), Management Services. The design and implementation of the new management services were very sound and they continued to be delivered by the Bank in their original structure well into the 1990s, with only minor modifications and increases in prices to be consistent with the subsidy received from government.

The FBDB Act also called for the creation of Regional Advisory Councils. There was no action on this front until 1976 when the Bank was told Ministers wanted to fill out all five Regional Advisory Councils. The regional council was a forum where local views about FBDB's operations could be expressed for the benefit of the regional Board member and Bank management. Members were appointed by the government of the day. Lesser in stature than a Board of Director appointment, it was still a form of recognition given to prominent businesspeople in different regions of Canada for their political efforts. Though a non-paying position, an appointment to a Regional Advisory Council did include reimbursements for expenses to attend meetings which took place at least once per year. It can be said that unlike Board of Directors deliberations, meetings of the Regional Advisory Councils brought little to the table and served more for getting information about the Bank out to regional interests.

In 1975, the Government of Canada decreed that the nation would convert its measures to the metric system. The government realized there would be substantial costs for small businesses to adopt the metric system and requested FBDB to administer a financial assistance program in this regard. As with previous requests to deliver a government financial assistance program, the Bank declined, arguing that since the metric conversion program would provide financing to those who could not get financing from private sources and FBDB, administering the program would be *ultra vires* to the FBDB Act. A rather convenient interpretation of the Act as, later in its evolution, the Bank with the same governing FBDB Act, did deliver such programs. The Bank suggested the Adjustment Assistance Board, created to assist the automotive sector, would be a better vehicle for the metric conversion program. Gratuitously, the Bank offered to lend resources to the program and to advertise it through its Small Business Information Service. The Bank was still IDB at heart, jealously guarding its independence and not in the mode of building bridges to government departments in Ottawa.

In its first six months, the new FBDB continued to expand its branch network with five new branch office openings. However, for the first time, branch openings were challenged. Board members asked whether there had been any cost benefit analyses done on the new branch openings. None had been done but it was emphasized by management that the openings would expand the Bank's presence across Canada, an implicit part of its new mandate. Just as important, it was posited that to stop opening new branch offices would be detrimental to staff morale.

With all the changes occurring at the Bank, the President, Murray, felt it was necessary to introduce a policy to stop loans from being extended to certain sectors. Specifically, it was decreed that approaches for financing from nightclubs, cabarets and similar businesses should not be encouraged. While the intent of the policy was clear, it was difficult to interpret in practice. For example, should a restaurant with ethnic dance performances be classified as a cabaret or simply a restaurant? The policy was toned down to allow the regional office to rule on the interpretation of the policy in individual circumstances. Despite the spirit of this policy, loans were extended to strip clubs and this led to one of the darker sagas in FBDB's history as will be recounted later on.

### **Borrowing requirements**

At the close of 1975, financial and economic burdens were weighing heavily on the federal government. As a result, FBDB and other crown corporations were asked to limit their borrowings from the Consolidated Revenue Fund (CRF). The CRF is the federal government's bank account so to speak. All government revenues are deposited into the CRF and all payments by the government are paid from the fund. FBDB was asked to limit its drawings from the CRF to \$330 million annually. This was soon reduced to \$245 million. The government suggested that if the Bank could not stay within its limit, it should consider using loan guarantees as a means of financing its small business clients.

At the time, FBDB's loans portfolio was growing on a net basis (new lending less repayments) at around \$125 - \$150 million a year, debt rollovers were around \$175 million and capital requirements were around \$20 million to support a

growing portfolio. Thus, it appeared the \$330 million limit could accommodate the first year's needs. But the Bank's loans portfolio was expanding and so FBDB would soon have to tap financial markets to meet its borrowing requirements. This meant borrowing costs would increase since the Bank would not be able to borrow at the same rate as the Government of Canada (even though its debt obligations carried the Government of Canada guarantee). Compared to the cost of borrowing from the CRF in Ottawa, it was thought that borrowing directly in financial markets would cost a quarter percentage point more. This extra cost would have to be passed on to clients or the marginal profit the Bank was making could become a marginal loss. In any event, FBDB had to make preparations to tap financial markets in Canada and abroad. The Bank commissioned investment houses (as they were then called) Wood Gundy and Burns Fry to do its debt structuring and bidding in financial markets.

### **A new leader is recruited**

When Richard Murray was appointed President and Chief Executive Officer of FBDB, he was the first chief executive who did not come from within the ranks of the Bank. There may have been an understanding within the Board of Directors that his appointment was not for the long-term as, in 1976, they engaged themselves in the process of looking for his successor. A special committee of the Board was created for this task. As tradition would dictate, obvious candidates were the senior general managers (vice presidents) with vast experience in the Bank. In addition to the senior officers from head office who periodically made presentations to the Board, all regional general managers were requested to attend at least one Board and Executive Committee meeting a year. Through their presentations and individual discussions, prospective candidates were given the opportunity to strut their stuff for the top job. But the special committee of the Board was unable to come up with an heir apparent for the top job from within the Bank and started looking elsewhere. Thus began the process of recruiting a new leader for FBDB, one who would wind up modernizing the Bank while steering the organization through the turbulent years ahead.

Guy Lavigne, a chartered accountant with an MBA from Columbia University, had been working in Ottawa since 1972. His education, private sector experience and knowledge of the inside workings of the federal government made him a highly attractive candidate for the Bank's top job.

After senior positions with the Unemployment Insurance Commission and Transport Canada, Lavigne went over to Industry, Trade and Commerce as Senior Assistant Deputy Minister, and was nominated to FBDB's Board of Directors. His position on the Board and his contacts within the federal government exposed him to opposing points of view. Some senior bureaucrats at the time did not support the Bank's role and some bluntly stated they did not see the organization as a priority on the government's agenda.



Guy Lavigueur was hired to be Executive Vice President at FBDB in 1977, with the understanding that he would be appointed President and CEO when Murray left in 1978.

On first arriving in Ottawa, Lavigueur had planned to stay in the government for a maximum of five years. Just as he was preparing to pursue opportunities in the private sector, Sol Kanee and others on the FBDB Board put pressure on Lavigueur to consider leading the FBDB, recognizing that his stellar credentials and reputation as an astute strategist would be assets to the Bank. As it turned out, Lavigueur's experience and lessons learned in the federal government would be applied to good use at FBDB.

An offer was made and accepted, and in December 1976, Lavigueur was hired to be Executive Vice President at FBDB, effective March 1977, with the understanding that he would be appointed President and CEO when Murray left in 1978. Clark, appointed Executive Vice President and Chief General Manager for the interim period December 1976 to March 1977, elected to retire in February 1977. One chapter in the Bank's history was closing and another was about to begin.

### **Mandate challenges**

In 1977, the Bank also grappled with various issues that touched on its legal mandate. FBDB's principal legislated mandate was to provide financing 'not otherwise available on reasonable terms and conditions.' This led to the Bank being constantly referred to in the media and business circles as *lender of last resort*, a phrase abhorred by Bank personnel who considered organized crime the true lender of last resort. They preferred the term *supplementary lender* to describe FBDB's role in the market. The mandate was carried over from IDB that had instituted procedures requiring letters of refusal to ensure the Bank's financing met this statutory condition. Before any loan could be authorized, FBDB



required a letter of refusal from the borrower's usual financial institution. Since this procedure proved impractical in many cases (private bankers were too busy to write these letters), the Bank would instead send a letter to the borrower's financial institution notifying them of the approach to FBDB. For loans over \$250,000, potential borrowers were required to have a second letter of refusal from another financial institution before FBDB could authorize the loan. In the opinion of IDB's Board, this was how the legal mandate of 'not otherwise available on reasonable terms and conditions' could be put into practice. The same practice continued with FBDB. For Bank personnel, getting the necessary letters on file was, at the very least, a hindrance if not a pain. But the law was written as it was, and procedures had to be followed.

In 1977, the Bank also dealt with other issues. The first was its interest rate structure. IDB policy had been to charge higher interest rates on large-sized loans and lower rates on smaller loans. This was the inverse of what arithmetic would dictate since, on a per dollar earnings basis, it was much more expensive to book a small-sized loan than a large one. In 1977, management questioned this inverse relationship, a holdover from IDB days.

At the time, the average loan size outstanding (earning power) was decreasing in real terms and larger sized loans were being prepaid at a higher than average pace. In fiscal year 1977, three of every four new loans were for amounts under \$50,000. More importantly, operating expenses, formerly 2.3% of the average amount of loans outstanding in fiscal 1971, rose to 2.9% in fiscal 1977. In absolute terms, with the Bank's expansion, operating expenses had increased from \$11.8 million in 1971 to \$39.6 million in 1977. Clearly, the expansion of branch offices, regional offices and staff overall was outstripping growth in the portfolio. Given that branch managers and credit officers were being evaluated on the number of loans made rather than the productive portfolio (earnings base), this evolution should not have been unexpected. Nevertheless, the Bank had to get more large-sized loans on its books for the resources it was employing. Reducing interest rates was seen as the enabling factor.

A proposal was put forward by management to the Board of Directors to charge similar interest rates on all loans regardless of size. It ran into opposition from Bouey, the Governor of the Bank of Canada. While acknowledging the interest rate structure favoured small loans, he thought charging higher rates on large loans was consistent with the Bank's legislated mandate. In a letter to the Board, he responded that the principle, as he understood it, had been that the rate on large loans should be high enough to ensure that large borrowers, who are sensitive to interest rates and have more alternative sources of finance than small businesses, would not borrow from FBDB if funds were available elsewhere on reasonable terms and conditions. Bouey further posited that large loans with higher interest rates were not subsidizing smaller size loans – they were just paying their way. In his view, smaller size loans were being subsidized by the Bank's lower cost of borrowing and the use of 'free' capital paid-in by the government. (At the time, no dividends were expected from the equity capital invested in the Bank by the government.) Quantitative data and analysis to prove or disprove Bouey's position were not available back then. But his reasoning provided the rationale for government

intervening in small business lending, that is, to offset higher administrative costs associated with making small loans. As will be seen later, this line of reasoning turned out to be crucial in describing the financing gap in Canada. It was decided to maintain a higher interest rate (one half of a percentage point) on loans over \$250,000 but with the caveat that lower rates could be charged at the discretion of head office, the Executive Committee or the Board of Directors.

When word got out that FBDB had changed its interest rate policy and that this could lead to lower rates for large loans, a private sector lender immediately voiced opposition. They thought that the new interest rate structure at FBDB would make it impossible for them to compete with FBDB. This issue would continue to arise from time to time over the years.

The other issue that brought the 'supplemental lender' role into consideration was the view of some Directors that FBDB remained the 'best kept secret in the land.' (This was typical of the role of Directors. They would raise issues that concerned them and then ask management to respond.) In the population at large, and even within the small business population, the Bank was an unknown entity and, when perceived as another government institution, would naturally attract negative, albeit uninformed, views. Was more advertising the answer? Senior management believed the Bank was already doing sufficient publicity. There were advertised visits to rural communities outside the areas where FBDB branch offices were situated and there was a fair amount of advertising of the Bank's management services, especially upcoming seminars, in local newspapers. While acknowledging there was a relatively low level of advertising for the Bank's financial services, this was justified principally on the grounds of the Bank's supplemental role. If it advertised its financing services too much, management felt financial institutions would complain about FBDB competing with them. Furthermore, at the time the 'best kept secret' comment was made, the Bank was barely in a breakeven position and could not afford, even if it wanted, to put more money into advertising. It could also have been that if the Bank advertised its financial services too heavily, there would have been a greater demand for higher risk loans, many of which would have been rejected, thus leading to more negative views from the business community and politicians. As a result, the Bank continued on the path IDB had taken over the years and restricted advertising of its financial services except when it came to announcing visits to rural communities.

### **Independence of regional offices**

During the first years of FBDB, a schism between the regions and head office was becoming evident and growing. This development had its roots in the early 1970s when regional offices were expanded and given more authority in making loans and in general administration. Clark's History<sup>4</sup> states that regional offices were setting up their own support functions in the 1970s as they expanded: "The staff under a regional general manager already included one or more supervisors and assistant supervisors who assisted in both credit and administrative matters. Administration officers were now appointed to look after preparation of reports, planning for new branches, and general administration. Whereas all personnel work had previously been done at GMO [head office], personnel assistants

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4 E. Ritchie Clark, *The IDB: A History of Canada's Industrial Development Bank*, University of Toronto Press, 1985. Quotes cited in this chapter are taken from pages 312 and 313 of Clark's book.

were now attached to the regional offices.” In addition, Clark writes: “Regions also developed their own books of ‘circular’ directives outlining routines and procedures to be followed within a particular region... The instructions for the Ontario region were famous all over the Bank, not only because they reflected the inimitable personality of the regional general manager, W.C. Stuart, but also because of their attractive acronym CROONS (Central Region Office Organization Notes).”

That a region would have its own version of operating directives was tantamount to having an independent operation. As Clark states: “Growth in the size of regional offices as a result of regionalization ... was a visible reflection of the growing importance of these offices.” He also notes that as a result of this regionalization and rapid growth, by 1975 the Ontario region had reached the size the whole Bank had been in 1966. British Columbia region was the size the Bank had been in 1967.

When Murray arrived as President of FBDB, he was supportive of the regions’ efforts to expand lending to small business. This was what the government wanted; this was why they’d created FBDB. He was also swayed by the regional general managers’ enthusiasm and arguments that more could be done except head office was getting in the way especially when it came to policy and authorizing large-sized loans which required head office involvement. It was described as ‘painful’ to go to head office to get a loan authorized. As a result, it was not uncommon to split a large-sized loan so that a portion could be approved by the regional general manager and the other portion would be shopped with a private lender. Regional managers much preferred to process five \$60,000 loans instead of one at \$300,000 which required head office approval. So enthused was Murray with the regional managers, he wanted to bring one of them, John Millard, to work in head office. Millard, however, would soon take retirement. The message to head office managers was clear: do not alienate the regional general managers. They were bringing home the bacon or bringing the logs to the factory in the words of Rupert Williams, former senior vice president at the Bank. Regional general managers had to be accommodated in every way possible. In Kirkwood’s view, the regional general managers were told, in effect, to go run the Bank. And they did, putting record numbers of new loans on the books each year. This trend, which had started in the early 1970s, continued on throughout the decade. Accompanying this growth was the rapid expansion of the new management services. At the end of the 1970s, the FBDB was running full out on all cylinders.

Regional general managers had higher job grades than those of many head office general managers who, on paper, were in charge of overall services and policies at the Bank. And some were not shy to pull rank on their head office counterparts when it suited them. They would openly remind head office managers that they (the regions) were paying the salaries of head office personnel. Such was the schism that head office personnel wishing to meet with someone in the regions had to have prior permission from the regional general manager, explaining in detail the purpose of their trip. Without prior permission, the visitor stood the chance of being thrown out of the regional office. In actual fact, such an eviction occurred at least once.

The independent nature of regional operations continued to deepen during the early FBDB years. The five regions, Atlantic, Quebec, Ontario, Prairies and Northern, and British Columbia and Yukon, were moving in the direction of creating five mini-banks within the overall Bank structure. By the end of the 1970s, some regional general managers were taking on the stature of princelings, each with his principedom to rule (no women were as yet in these positions). Respectively, the regional general managers were: Doug Kerley in Atlantic, Yves Milette in Quebec, Ken Powers in Ontario, Ray Wheeler in Prairies and Northern, and Harry Baker in B.C. and Yukon.

In FBDB's first year, authorizing limits of regional managers were increased and new branch offices were opened, continuing the trend that started in the early 1970s. By the end of the decade, 16 more branch offices were opened bringing the total number of branch offices to 96. These new offices had to be staffed and more resources were needed to manage them. Between 1976 and 1980, branch office staff increased from 996 people to 1,448, a 45% increase over four years. Regional office staff increased from 289 to 336, a 16% increase over the same period. With regional staff and activity increasing at such a pace, a new position of Deputy General Manager was created in each regional office to assist the general manager. FBDB's rapid staff increases prompted one Board Director to ask, in early 1978, for a report on why staff was growing so quickly. Management gave its justification. The regions had the authorities and the resources to do their job.

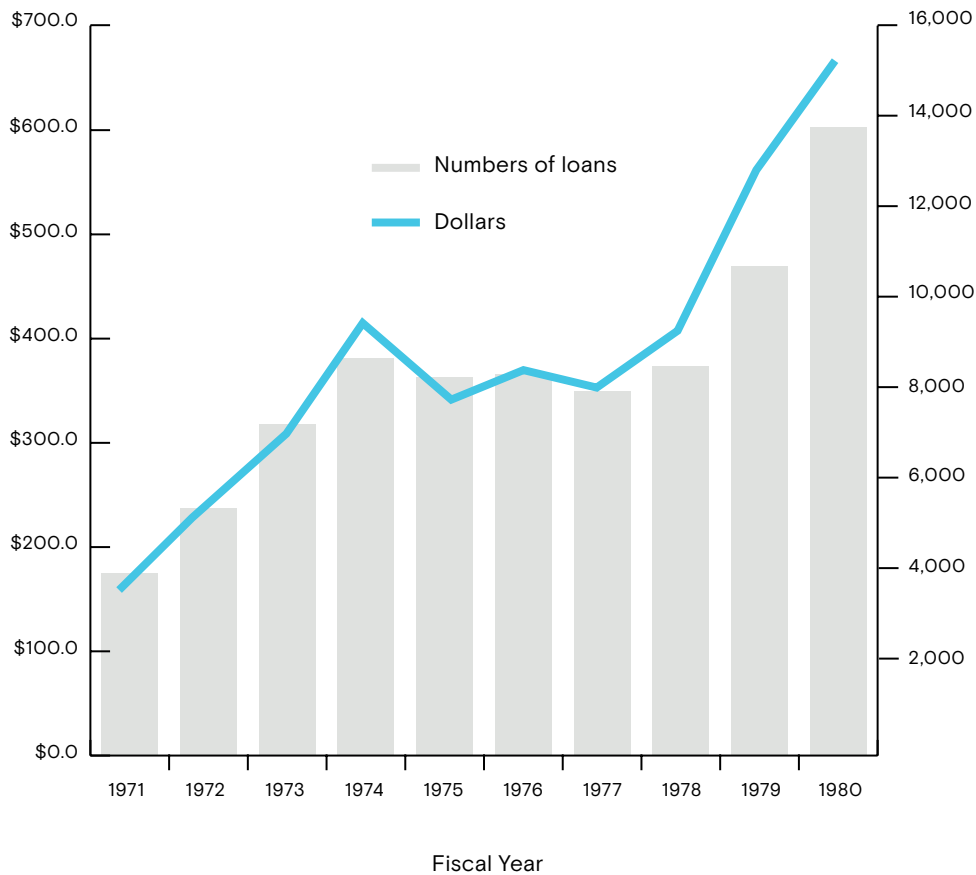
The rise of a vibrant small business economy in Canada was a major contributor to the Bank's rapid growth in the 1970s. The government could not ignore this trend and, in 1976, created a new Cabinet position, Minister of State for Small Business, with Len Marchand, a status Indian from Kamloops, B.C. as Minister. Chartered banks were also seeing their loans to small business increase rapidly, more so than FBDB's, as well as loans made under the Small Business Loans Act (SBLA), the government loan guarantee program for small business loans under \$100,000. It was shown by an economic consultant to the Bank, Charles Schwartz, that loan enquiries to FBDB, rising in the latter part of the 1970s, were a leading economic indicator for the Canadian economy. The economy was growing, small business was growing and so was FBDB lending.

This period of growth was helped by an easing in the Bank's credit requirements. As an example, the Bank became more accommodating when it came to financing leasehold improvements. Although there was no real estate security behind these transactions, they were done if the business was thought to have sufficient earnings to service its loan. It was argued that financing leasehold improvements was no different from financing a sawmill in the middle of nowhere since the latter also had little property value. Another analogy was the financing of specialized equipment. It too might have little or no value in liquidation yet the Bank was perfectly at ease in financing such projects. So why not leasehold improvements? As many small businesses were operating in leased premises, the ability to do these types of loans opened a large market including countless restaurants and small retail stores.

There was another, and perhaps more important, internal factor at work that drove the record number of new loans at FBDB. With the message that the government wanted more lending done by FBDB being delivered directly by the President,

Murray, to regional managers, the pressure intensified. It was not uncommon in the early years of FBDB for a regional general manager to phone another regional office to find out how many loans were done the month before and how many were done so far during the current month. The same for branch managers who would be calling each other regularly to find out how well, or badly, another was doing. It was even rumored that when one branch manager complained of a blockage at the regional office that was holding up authorization of his loans, the regional manager pre-signed a blank loan authorization form. This, of course, was just a rumor but it aptly symbolized the order of the day. Except for a slight pause in 1976-1977 fiscal year, net loan authorizations increased throughout the latter part of the 1970s from 8,059 loans for \$355 million in fiscal 1977 to reach 13,803 loans for \$664 million in fiscal 1980.

**Chart 1** Net Loan Authorizations



Note: Dollars are in millions; fiscal 1976 annualized based on 6 months (conversion to fiscal year ending March 31).

In January 1978, Murray tendered his resignation as President of FBDB. The FBDB Act, in such situations, allowed the Board of Directors to appoint an Acting President for a maximum 90 days until a new President could be appointed by the government. Lavigueur, the Executive Vice President, was named Acting President.

### **A new president is appointed**

Since the post of President and CEO of a crown corporation was both prestigious and sought after by senior bureaucrats in Ottawa as well as those with influence in the uppermost reaches of government, the Prime Minister's Office, it was to be expected another external candidate for the President's position would pop up. The FBDB Board of Directors, however, remained adamant about their choice for President. Kanee, Chairman of the Board, took the Board's message to Ottawa and insisted that Lavigueur be appointed President of FBDB, which he was effective March 1978.

When Lavigueur became President, the Board of Directors appointed Eric Scott as Executive Vice President. At the time, the Board appointed senior officers of the Bank at the Vice President level and above. Delegation of authority from the Board to the President to appoint all officers below the rank of President did not come until later. Such was the involvement of the Board of Directors in managing the affairs of the Bank. Scott, in his role as Director, Management Services, had done an outstanding job implementing the new programs across the country and this impressed the Board. But the appointment must have caused consternation among other candidates from the regions as well as head office.

Two other senior Bank officers resigned around the same time as Richard Murray: John Millard as regional general manager for British Columbia and the Yukon, and H.J. Russell, who was general manager Loans at head office. With the new appointments, the nomenclature of general manager changed to vice president, except for the regional general managers who wanted to keep the term 'general manager' in their titles. This maintained their distinctiveness from the head office crowd. (When Ritchie Clark was appointed Executive Vice President, his title also included the term "and Chief General Manager.") So the regional general manager became known as Vice President and Regional General Manager. Eric Bell was appointed Vice President, Financial Services, replacing Russell, while Harry Baker replaced Millard. The Board also appointed Jack Nordin as Vice President, Finance. Previously general manager of corporate development in charge of the transition from IDB to FBDB and before that, general manager of the Quebec region, Nordin was widely respected for his brilliance as 'the smartest guy in the Bank,' but it might have been that Scott had less negatives about him so was appointed to the number two position (Executive Vice President) instead of Nordin.

### **A new Chairman of the Board**

Soon after Lavigueur assumed his position as President of FBDB, Kanee resigned from the Board and went back to being a member of the Board of Directors at the Bank of Canada. He felt he had completed his job in managing the transition from IDB to FBDB. The FBDB Board of Directors was obliged to select a new Chairman and two members stood for election. Unfortunately, neither of the two would stand down so a secret ballot had to be held, a rather uncomfortable situation for the Directors. At the end of the process, Ralph Fiske from Nova Scotia was elected Chairman.

### **Relocating head office**

By the end of the 1970s, growth in head office staff was outstripping the space available at the Bank of Canada building and some departments had to occupy premises elsewhere in Montreal. With projections of over 1,000 head office staff by the 1990s, the Bank started to look at alternatives for a new head office location. A property development consulting group was hired. It recommended the Bank build its own new headquarters in Montreal to accommodate the Quebec regional office and the Montreal branch in the same premises as head office. The Bank therefore purchased a piece of land in downtown Montreal on Dorchester, since re-named Boulevard René-Lévesque. The plan was to build an office tower that would accommodate the Bank as well as another major company based in Montreal. Via Rail was mentioned as a potential co-locator in this regard. However, as will be seen, tough times lay ahead and the FBDB building was never built. Instead, the Bank eventually moved its headquarters to Place Victoria and the piece of land was subsequently sold at a nominal profit.

Head office occupied four contiguous floors at Place Victoria. The Quebec regional office was already located on the lofty 46<sup>th</sup> floor with the Montreal branch office on the main floor. Head office staff sorely missed the Bank of Canada premises mainly because they used to have access to the Bank of Canada cafeteria where a 75 cent coupon purchased a three-course meal at lunch. Staff could also cash their pay cheques at the teller wicket at the Bank of Canada on the main floor. But leaving the Bank of Canada's premises was part of the evolutionary process and a final stage in the transition from IDB to FBDB.

1979

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# On the eve of the great recession

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During the short-lived Joe Clark government, FBDB approaches its legislated ceiling on assets and must consider rationing credit. Management realizes the Bank is about to record its first operating loss in history.



A few years into FBDB's existence, some ominous trends started to appear in the Bank's operations. As alluded to earlier, there was a decline of 7% in new lending in the 1976-77 fiscal year, reflecting, according to President Murray, sluggish economic conditions. Loan write-offs were \$3.9 million in the year, up from \$1.6 million the preceding year. A charge of \$19.9 million was made against income for loan and investment losses, up from \$5.8 million the previous fiscal year, 1976, albeit only a six-month year.

In an interview with the Financial Post newspaper to discuss FBDB's 1977 Annual Report, the President remarked that the Bank had struck the proper balance between risk and caution and did not intend to change its lending policies. Murray expressed the hope that those who favoured higher risks (meaning the politicians) wouldn't increase the pressure after the current flurry of bad debts ended. Unfortunately the flurry did not end. The following fiscal year, the charge against income for provisions for loan and investment losses, remained at the same level, \$19 million.

In mid-1978, it became clear FBDB's profitability was at risk. The average loan size relative to inflation continued to decrease, loan and investment losses were increasing, debt rollover was costing millions of dollars as interest rates were on the rise, the Bank's equity investment activity was being financed by borrowings at an annual cost of \$6 million, and Management Services' appropriations from government did not cover the full cost of services shared with the financial services operations.

The effect of the average loan size not keeping up with inflation was cited earlier when FBDB's interest rate policy was changed to reduce the bias against large-sized loans. It was reported that if the average loan size had kept pace with inflation since 1973, there would have been a positive impact of some \$19 million on net income. The practical question in hindsight is if the Bank had had proper financial modelling tools, would it have been able to quantify the consequence of lower real loan sizes and done something much earlier to mitigate the situation? And would it have even been possible to forecast that the flurry of loan and investment losses was not temporary? Although the Canadian economy was considered soft at the time, it turned out to be in much worse shape, as will be documented later. This was the one big storm no one could have foreseen.

From the perspective of FBDB's head office, there was an increasing generosity in applying credit criteria, a changing customer mix toward riskier types of businesses and a continuing emphasis on small loans where the loan loss experience was higher. Clearly a jab across the schism towards the regional operations where activities were working at cross purposes to financial and economic conditions. Debt rollover costs too were significant in 1978 and became even greater as interest rates increased through to the early 1980s. These costs will be dealt with later in the chapter on the Bank's Treasury Operations (Chapter 11).

Another challenge related to rising operating expenses. These were increasing naturally with staff and branch office expansion. At the same time, inflation was running in double digit territory for much of the 1970s. By fiscal 1978, operating expenses had jumped to 3.4% of outstanding loans, up from the 2.8% level of the

early 1970s. But this level of expenses was thought to be justified on the grounds that certain functions such as information systems, personnel management, inspection and internal audit, for the most part done by the Bank of Canada in the IDB days, had to be expanded within an independent FBDB in order to provide proper controls, especially in context of the Bank's rapid expansion. In its first three years of existence, FBDB had achieved remarkable growth and completed a smooth transition as an autonomous crown corporation. But pressures on profitability and a new regime in Ottawa were about to test the organization as never before.

For FBDB, 1979 was a turning point in many respects. Both external and internal pressures were mounting. Reviews were the order of the day to figure out how to deal with the challenges to profitability. In the meantime, under optimistic assumptions about future economic conditions over the medium term, 4% to 5% real annual economic growth, declining unemployment and inflation rates, the Bank projected that it would break-even on the bottom line for the next few years.

FBDB did declare a small profit of \$0.5 million in fiscal 1979 (compared to \$1.1 million the previous year). This profit was made possible by reducing the general reserve for losses by \$2 million, that is, a reversal of provisions for future loan losses. In effect, \$2 million were added to net income by an accounting move allowed at the time because there was no consensus or fixed guideline on what the general reserve should represent. Should it be to cover all possible losses on loans that were already in the portfolio but that were yet to be identified? Should it cover only new loan losses that were expected to be identified in the next year? Or maybe those to be identified in the first six months of the next year? And so on. Answers on what the general reserve should represent thus kept changing to accommodate current financial realities.

While the Bank was grappling with internal factors affecting its profitability, it had to deal with other issues with potential negative effects. First was the legal limit imposed by Section 20 of the FBDB Act on the total amount of liabilities the Bank could have, which in turn limited the total amount of loans and investments it could have on its books. In 1979, this limit was \$2.2 billion – the maximum amount of equity (\$200 million) allowed plus 10 times that amount. The factor of 10, referred to as the leverage factor, was the amount by which the Bank could lever its capital.

In the first nine months of 1979, the Canadian economy grew at a brisk pace – 4% real growth – and prime interest rates increased only marginally from 11.5% to 12%. For most of 1979, FBDB's lending activity continued its upward climb and by mid-year, it seemed that loan authorizations could surpass the \$1 billion mark for the 1979-1980 fiscal year. At this pace the Bank could reach its legislated \$2.2 billion assets limit as early as October 1979. It was calculated that new loan authorizations would have to be lower than \$847 million to remain within the \$2.2 billion limit until March 31, 1980.

To complicate matters further, federal elections were called in June 1979 and a minority Progressive Conservative government under the Right Honourable Joe Clark was elected. With a new, minority government, the likelihood of swift

passage of a bill in Parliament to change FBDB's lending limit was improbable. So the Bank was forced to begin contingency planning to ration credit.

Any formula for rationing credit is fraught with problems. Should credit be rationed by size of loan, by region or by purpose of loan (working capital, equipment financing, land and building)? Just as the Bank was coming to grips with these issues, interest rates started another upward rise to 15% in the last quarter of 1979. As a result, demand for FBDB loans slackened and the need for credit rationing diminished.

The new government, acknowledging the grave impact credit rationing could have on small business, started drafting new legislation to increase FBDB's lending limit. The Bank preferred to have the \$200 million limit on capital increased, allowing more capital to flow into the Bank and with it, more lending room. But in the draft legislation, the government decided instead to change the leverage factor from 10 to 12 and, if needed, to 15 by regulation, to allow for a \$3.2 billion limit on loans and investments in the portfolio. The Progressive Conservative government clearly had no appetite for putting more equity capital into the Bank. The draft legislation, Bill C-4, was never passed by Parliament, as the minority government was defeated in December 1979. The President of the Treasury Board, the Honourable Sinclair Stevens, wrote FBDB saying that, until the FBDB Act was amended, the Bank could commit to loans beyond its \$2.2 billion limit but not disburse funds in order to remain within the legal limit.

When the Progressive Conservatives were elected in June 1979, it represented the first time since 1963 the party had held the reins of government in Ottawa. The Prime Minister, the Right Honourable Joe Clark, said his government would govern as if it were a majority government. His conviction was the electorate would be supportive of new Conservative policies and management of government, and he would soon be able to go back to the electorate and gain a majority in Parliament. (This had been done by the previous Conservative Prime Minister, the Right Honourable John Diefenbaker, who led a minority government, a majority government and then a minority government in the 1957-1963 period.) The new Joe Clark government, as it was called, was intent on reducing the size of the federal government and privatizing crown corporations.

The government had asked that a report on privatizing FBDB or encouraging the private sector to play a larger role, in at least some of its activities, be prepared and brought forward for consideration. A report was prepared on the various issues and alternatives but privatizing the Bank did not proceed. It would have been doubtful such a measure would have had the support of opposition parties holding the majority of seats in the House of Commons. In any event, the government did not have sufficient time to pass any significant legislation as it was defeated in a non-confidence motion on its first budget in December 1979. The then Minister of Finance, the Honourable John Crosbie, described his budget as short term pain for long term gain, a phrase that quickly became a standard in Canadian lexicon. His budget was controversial, having included an 18 cent gas tax on top of rising gas prices, and was used as fodder in the February 1980 general election won handily by the Liberal Party of Canada. When the new Liberal government came in to office, the Bank was instructed to sell part of its

loan portfolio, if necessary, to stay within its \$2.2 billion legislated limit until the FBDB Act could be amended, which was done in 1980. That amendment basically followed the same formula proposed by the previous government. The total amount of loans and investments the Bank could have on its books, previously limited to 10 times its capital base, was increased to 12 times the capital base and could increase further to 15 times by government regulation. A \$3.2 billion ceiling was effectively placed on the Bank's total assets.

In 1979, the Small Business Financing Review was initiated in Ottawa, under the auspices of the Department of Industry, Trade and Commerce. (This Review, as will be later detailed, would place the Bank in a defensive mode in terms of its government relations.) It was also the year of the second oil price shock. The first took place in 1973 when the price of a barrel of oil jumped from \$3 to \$12 almost overnight. This game changer was seen as the root cause of the recession and hyper inflation that plagued the 1970s – the era of stagflation. (A Saudi Oil Minister at the time famously wondered why the fuss over the price increase since a barrel of oil, at \$3, was cheaper than a bottle of Scotch whisky.) This time, in 1979, the price increase was fuelled by the combined effects of the deregulation of oil prices in the U.S., the Iranian revolution resulting in a sharp cutback in oil production, and the taking of U.S. hostages in Iran followed by the U.S. embargo on Iranian oil. The price for a barrel of oil jumped from \$15.85 to \$39.50, a 150% increase between April 1979 and April 1980. The 1979 oil crisis was at the core of the loss of confidence in all markets and led to an historic rise in interest rates.

With the economy spiralling downwards, the Bank realized its first operating loss would be recorded for the fiscal year 1980. The first estimate of loss, made in October 1979, was for \$1.4 million. By December 1979, the actual loss accumulated to date was \$13.8 million. The final figure for fiscal year 1980 was a loss of \$29.3 million. This was just the beginning of a series of losses over the next four years as the economy plunged into what would later be described as the Great Recession. (This was the original Great Recession, later superseded by the Great Recession of 2008.)

1980 to 1983

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# Cost recovery Part I

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With mounting losses, FBDB is obliged to address the two areas it can control – the level of risk on new loans and operating expenses. So begins the painful process of reducing staff.

**F**iscal year 1980 marked a major reversal in fortunes that started the Federal Business Development Bank on a slippery slope towards oblivion. If it was not a perfect storm that hit the Bank, it was near perfect. The confluence of rapid expansion, taking on greater risk, absence of management information systems, the mismatch of assets and liabilities, and the worst recession since the Great Depression of the 1930s, led to the Bank recording its first ever operating loss.

The increase in interest rates and economic slowdown in early 1980 were widely seen within and outside the Bank as a temporary setback. There was general consensus the Bank would soon rebound, resume its growth path and return to profitability. In fact, even as operating losses were evident, the operating budget prepared for the following fiscal year, 1981, projected new loan authorizations increasing by \$150 million with a commensurate increase in staff of about 150 people. Curiously, it also projected another loss, similar in amount to fiscal 1980.

By mid-1980, optimism started to wane. A revised mid-year budget projected new loan authorizations for fiscal 1981 at half of what was first budgeted and an operating loss of \$37 million. The actual operating loss turned out to be \$44.8 million. The temporary setback had extended for another year as the economy continued to slide. In terms of small business financing activity, the Bank had reached its apex in 1980 when the customer base stood at 40,000 clients and the portfolio was close to \$2.1 billion. It was all downhill from there.

In the midst of this new experience of operating losses, two views as to their cause emerged. One was that economic conditions were the cause. And since the economic situation was temporary, so too were the losses. Hence, the first loss in fiscal year 1980 was considered a fluke and not to be repeated. Even after another loss the following year, 1981, there remained optimism that a turnaround was imminent.

Another view held the economic recession had little to do with the loss and the only contributing factor was the greater risk the Bank had taken on when it became FBDB. This argument reasoned that IDB had operated through many recessions since its creation in 1944 and emerged from all previous downturns without posting an operating loss. Though not expressed publicly, there was still a strong attachment among some IDBers to the IDB way of operations and resentment of the criticism that IDB had been too conservative in its lending practices. What was not known at the time, however, was that the looming recession would be the worst since the Great Depression of the 1930s. The prime lending rate at chartered banks was on the rise, hitting 18.25% by the end of 1980 before peaking at 22.75% in August 1981. This was not a loss of confidence in the economy – it was a crash of confidence.

While the first loss in fiscal 1980 was a shock to the system, it was not totally unexpected. As noted earlier, storm clouds began forming in 1979. When asked by fellow members on the Board of Directors what he thought of the Bank's portfolio, the President, Guy Lavigueur, one year into his new job, gave an assessment based on gut feel as he had no quantitative or analytical data. He expressed the view the Bank would soon be in a loss position – how much and for how long, he could not predict. One Board member thought if the Bank had taken on too

much risk in its expansion, it would take at least five years to get out of a loss position. This was based on his own experience at a chartered bank where he had encountered a similar situation in one of the districts he was managing. Another Board member stated he did not want to be associated with a Bank that was losing money and soon resigned from the Board. The five-year prediction, as it turned out, was right on the mark.

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## In 1980, the Bank faced two uncertainties: where were the economy and interest rates headed and how much risk was in the loan portfolio?

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In 1980, the Bank faced two uncertainties: where were the economy and interest rates headed and how much risk was in the loan portfolio? Numerous prognosticators of the day (economists) took turns addressing the first uncertainty and the vast majority turned out to be wrong in their predictions. With the Governor of the Bank of Canada on its Board, it could have been assumed the Bank had better knowledge of how the economy and interest rates would unfold but the Governor knew better than to enter the forecasting game at a time of such uncertainty, even in private. The second uncertainty, however, was something the Bank could address. While it couldn't change what was already in the portfolio, it could change what was going into the portfolio. Losses already embedded in the portfolio would have to be digested but there was no need to add to the indigestion. The risk on new loans had to be controlled. The only problem here was that the Bank needed better tools to quantify the risk of its loans. Thus started what was perhaps the first real quantitative analysis of the Bank's portfolio.

### **'Outsiders' bring quantitative skills to bear**

An internal Credit Review and Assessment Committee was formed to come up with ways to manage loan risk. Eric Bell, Vice President of Financial Services, and Guy Bourbonnière, Vice President Inspection, spearheaded this effort. The Planning and Economics departments were also represented. Their inclusion is cited since their representatives, Gundars Valdmanis and Don Allen were 'outsiders.' They had recently joined FBDB, were not IDBers, and had never worked as credit officers. What they brought to the table, however, was strong analytical acumen. Allen in particular, who had worked with Lavigueur in Ottawa and was enlisted by him to join the Bank, was well regarded for his quantitative analytics. If a proposal was being put forward, Allen would be the person to put

hard numbers around it. For him, theory was not sufficient without numbers to back it up. Valdmanis had the fortitude to drill down and get to the bottom of the numbers with lengthy algebraic calculations.

The Credit Review and Assessment Committee, or the CRAC committee as it became known, provided the setting where the credit knowledge of the IDBers could be meshed with the quantitative methods of the outsiders to produce a rudimentary but workable risk management system. Getting the two groups to work harmoniously was not an easy task. IDBers were generally wary of outsiders who had no knowledge of the Bank's inner workings. For their part, the outsiders were aghast at the lack of relevant operating data and the difficulty in trying to get hard data out of the loan accounting computer system.

### **Loan grading system**

The CRAC committee relied heavily on work done a year earlier by the Inspection department in which samples of loans from fiscal years 1973 and 1978 were assigned risk grades. Allen, who had just joined FBDB, investigated credit scoring models which existed in the United States. His research, combined with the seasoned knowledge of the Inspection department, led to a grading system with three categories: management, earnings and security. Each loan in the 1973 and 1978 samples was graded in each category as an A or a B. Although the loans were being graded on a retrospective basis – hindsight is 20/20 after all – an effort was made to use only the information available in the loan file at the time of authorization. An A grade in management reflected experienced and capable management running the business. An A grade in earnings reflected a proven earnings track record, and an A grade was assigned to security if collateral backing the loan was 90% or greater than the loan amount. Thus, the MES (Management, Earnings, Security) grading system was created, the first tool with which the Bank could consistently measure loan risk.

The ensuing analysis showed that for both the 1973 and 1978 loans, the percentage of loans that ended up as write-offs or with a provision for loss varied significantly by MES risk grade. Almost all loans had an A grading for management – it would have been difficult to get a loan authorized by superiors if it was known management was lacking. After all, weak management skills were often cited as the reason small (or for that matter, big) businesses fail. Thus, for measuring loan risk, three risk levels were delineated according to grades for earnings and security. Low risk loans were those with AA grades (A earnings and A security); medium risk loans comprised loans with AB and BA grades; and high risk loans were those graded BB. The medium risk category was later refined to two sub-categories for analytical purposes: low medium risk comprising those with A earnings grade, and high medium comprising those with B earnings grade.

In addition to variance by risk category, it was found loss rates were significantly higher among loans made for working capital purposes. There also were indications of slightly higher loss rates among loans for refinancing and change of ownership purposes, and for smaller-sized loans. The graded sample of fiscal year 1978 loans was eventually expanded to include all loans made in fiscal 1978 and correlations done between loss rates and MES grades. The CRAC committee's



work on loss rates provided a major input to the Bank's 1980 Cost Recovery Study. Completed in October 1980, the study recommended actions needed to move the Bank back to full cost recovery, that is, profitability.

### **Cost Recovery Study**

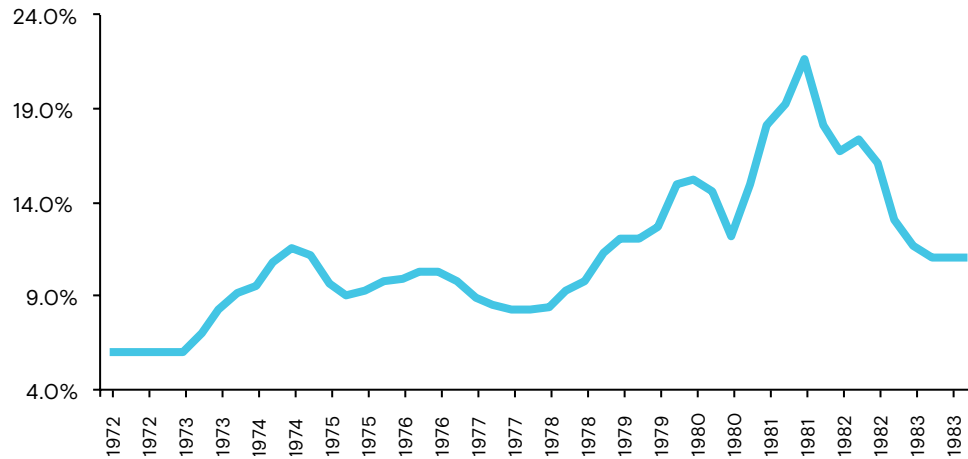
The 1980 Cost Recovery Study laid out the principal components of the near-perfect storm engulfing the Bank. In addition to citing increasing acceptance of risk as well as unstable capital market and economic conditions, the study re-hashed other factors. The Bank's debt-to-equity ratio had increased from 8:1 in 1978 to 10:1 in 1980. This meant more borrowing, and therefore higher costs, to finance the Bank's portfolio. When IDB was created, it had operated with about a 1:1 debt-equity ratio. This ratio increased slowly over the years to about 6:1 in the early 1970s.

Rampant inflation through the 1970s was also eroding the Bank's ability to fully offset costs. Operating costs, mainly salaries and premises, rose with inflation but the earning power of individual loans did not. Between 1971 and 1980, Canada's Consumer Price Index (the basis for measuring inflation) more than doubled. During the same period, the size of the average Bank loan outstanding rose by only a quarter. In other words, while the earning power of the average loan increased by about 25% during the 1970s, the cost of administering these loans doubled.

Inflation had an even greater impact through its effect on interest rates. Chartered banks' prime lending rate, which hovered around 6% in the early 1970s, started rising to the 11.5% level in 1974. The rate then dropped back to around 8.25% in 1977 only to start rising again to 16.75% in April 1980. After a brief period of abatement, interest rates took off again and the prime rate reached its peak in August 1981 at 22.75% triggering a crash of confidence in financial markets.

These astronomical rates battered the business community, especially small businesses. Not surprising was the accompanying increase in delinquent FBDB loans. Yet another devastating by-product of high interest rates was the impact on the mismatch between FBDB's assets and liabilities (as will be reviewed in a later chapter).

The Cost Recovery Study thus concluded: There is little that can be done to improve cost recovery on the Existing portfolio. The gross margin and average loan size cannot be changed, and there is relatively little that can be done to improve potential loan losses. Thus the study will concentrate on measures to achieve cost recovery on New loans. If this is accomplished, these operating losses will gradually reduce as the existing portfolio is replaced by new loans made on a cost recovery basis. The Study also stated that the principal ways to improve cost recovery were to increase income, principally through higher fees, decrease expenses and change loan quality. There was little room to increase revenue by increasing FBDB interest rates as its rates were already higher than what small businesses were being charged by chartered banks.

**Chart 2** Prime Interest Rate

Source: Bank of Canada

The 1980 Cost Recovery Study made an interesting observation that fortunately was not later seen by officials in Ottawa who thought there was no longer a role for FBDB in the market. The Study observed: There has been an increasing involvement of the private sector in term lending to small business in the past five years. The private sector has naturally attempted to select the most attractive risks. This has left the more marginal proposals for the Bank. It has also decreased the Bank's relative position in the market. These developments are not necessarily contrary to the objective of the Bank as a supplemental lender, but there is a negative impact on cost recovery.

As a Schedule D crown corporation, FBDB was ordinarily required to conduct its operations without appropriations. In the absence of full cost recovery, the Bank would have to rely on appropriations to offset its losses. Had this reliance continued, the schedule for the Bank would have been changed to that of a government departmental corporation. This would have meant a loss of independence and more departmental management of FBDB operations. A real possibility, given rumours at the height of FBDB's operating losses in the 1980-84 period that the Department of Industry, Trade and Commerce was looking seriously at the option of moving FBDB to become an agency of the Department and renaming it Enterprise Canada – in effect, closure of the Bank.

The outlook for FBDB was bleak. Lavigueur knew he had to move swiftly to start reducing losses. The Bank could do nothing about the economic environment. Some fees were increased but the effect on income was minimal. This meant the focus had to be on the two areas the Bank could control: the level of risk on new loans and operating expenses.

One strategy to reduce risk and improve the bottom line would have been to eliminate all small loans. It was calculated that to breakeven on loans under \$25,000, even if categorized as low risk, the Bank would have required a margin

(the difference between interest income and interest expenses) of over 12.5%. In 1980, it would have meant charging these small businesses interest rates beyond 30%. The actual margin the Bank received on small loans was about 4.5% so it was automatically losing at least 8% on all loans authorized under \$25,000. While this would have been a quick fix, it was also the Bank's mandate to serve this market. Almost half of the number of loans authorized by the Bank in this period were for amounts under \$25,000.

The focus therefore turned to discouraging loans with the least chance of recovery, minimal economic impact and the greatest negative impact on the Bank's earnings. More specifically, loans for working capital and refinancing purposes that were under-secured (less than 90%) were targeted, as were loans for changes of ownership (except those with proven or A earnings). Exceptions were allowed if approved by the next authorizing level.

The mandate to ensure new loans were of the quality that would eventually return the Bank to full cost recovery fell on Yves Milette who was brought to head office as Vice President, Financial Services. He was formerly the Vice President and General Manager for Quebec region which had the best quality portfolio in the Bank. This was primarily due to its favourable position in the market since chartered banks were relatively less active in the province. It also helped that the region was able to attract more finance and commerce university graduates onto its staff.

As Vice President, Financial Services, Milette was in charge of authorizations of large-sized loans approved at head office, including those to be approved by the Board of Directors. Just as important were the new credit policies and directives he had to develop and enforce to get FBDB back to cost recovery. Plus, he had to implement the new credit standards through the regional vice presidents. Milette was assisted by Rupert Williams, brought to head office as Assistant Vice President, Financial Services. He was formerly Deputy General Manager for the Ontario region.

An analysis showed the credit standards being introduced in 1980 would reduce the number of new loans by about 30% and loan amounts by 15% Bank-wide. The regions expected to be most affected were Ontario and the Prairie region (over 40%) and the least affected would be Quebec (under 10%). The combination of a deteriorating economic situation and tighter FBDB credit policies led to a precipitous decline in new loan authorizations for the next four years.

As alluded to earlier, operating costs were outstripping growth in the portfolio. In 1970, operating expenses were 2.3% of the loan and investment portfolio. By 1975, they had grown to 2.8% of the portfolio. For fiscal 1980, operating expenses totalled \$64 million or 3.4% of a portfolio that was, in addition, becoming more unproductive in revenue generation. The Board Director who had asked earlier for an accounting of why Bank staff was increasing at a rapid pace had sniffed out an underlying problem. The Bank had no choice now but to start reducing the size of its staff.

The Bank's operating expenses were mainly staff and premises costs. Little could be done to reduce the cost for premises as the Bank was committed to

long-term leases. Reducing staff expenses (the number of staff) represented the only meaningful action the Bank could take. At the same time, Lavigueur also wanted to professionalize the staff in head office support functions. Apart from some computer system analysts and managers, support services were staffed principally by officers who came through the credit stream, and did not have the training or background to provide the professional support services the Bank needed. One of the first hires he insisted on was John Langlais who worked with Price Waterhouse, FBDB's external auditor. Langlais was brought in to address improvements needed in the Bank's financial reporting and budgeting systems. As mentioned earlier, Don Allen was hired to head the Economics department. And, with the Bank having to start borrowing funds in capital and money markets, Lavigueur set up a new team of Treasury experts from outside FBDB. The Bank's planning system also needed to be ramped up and a number of MBA professionals were recruited for the Planning department.



Ken Neilson was given the job of hiring professionals to manage the Bank's support functions while reducing overall staff.

### **Staff reductions begin**

The job of hiring professionals to manage the Bank's support functions while reducing overall staff was bestowed on Ken Neilson. He was formerly the Assistant Vice President, Financial Services at head office and, before that, a supervisor in the British Columbia and Yukon region. But nothing in his career at the Bank had prepared him for the task at hand. Then again, no one was prepared since the Bank had never had to cut staff as it would have to in 1980. Strong management and credibility were needed to effect change, and those were the main reasons Lavigueur chose Neilson to manage this difficult task. He was not an outsider. Having worked his way up the credit stream, he had the respect of the regional vice presidents who came to accept his authority over personnel matters.

Neilson understood both the magnitude and consequences of his task. Major staff cuts had to be made. Either this or the Bank would go on losing money and become a target for closure by the powers in Ottawa.

How much to cut, and where, were the crucial questions. As part of the Cost Recovery Study, Valdmanis, under the tutelage of Hugh Carmichael, head of the Planning department to whom he reported, had done an analysis of loan making and loan administration costs. By polling Bank officers with extensive credit experience, he looked at each activity involved in the loan making and loan administration processes, and assigned the amount of hours needed for each activity. Loan making activities involved client enquiries, declined applications and loans authorized at branch, region and head office levels. Loan administration activities were delineated according to whether a loan was in category 1 (performing), category 2 (temporary problems to be resolved), category 3 (downgraded with prospects of being written off) and category 4 (in liquidation stage). Person-hours required for each of these activities were assigned. For example, it was estimated that on average, category 1 loans required 6 hours of credit officer administration per year while loans in categories 3 and 4 required 68 hours of administration per year. Dealing with a loan enquiry involved 1.5 hours of credit officer time, a loan authorized at the branch would require 21 hours and a loan authorized at head office, 64 hours of credit officer time. These figures became known as staffing norms. By multiplying the volume of activities by the person-hours required per activity, it was possible to project the number of credit officers needed in branch offices.

The level of detail analysed to arrive at staffing norms was impressive for that era. Even more impressive was that these intricate calculations were done with just a simple calculator. The days of spreadsheets and personal computers were still a few years away. When just one parameter was changed, all calculations had to be redone, one calculation at a time. They also had to be re-typed as there was no word processing.

With no other tool with which to manage staff reductions, Neilson used the staffing norms to determine how much staff was needed where. The norms were not readily embraced by the regions but it was the only method available to ensure equitable staff cuts. Not by accident, the staffing norms proved they worked – when applied to actual total loan activities for fiscal 1980, the norms produced a staff requirement that virtually matched the actual staff level that year. To make the match, some ‘fat’ (10%) was built into the norms. (Later on, when applying the staffing norms the inevitable question would be: ‘Is that with or without the fat?’)

With loan authorizations down by about 50% in fiscal 1981, considerable cuts had to be made to branch staff. Lavigueur insisted that cuts had to be made at all levels in the Bank. While respecting the need to maintain proportional representations of francophone employees, especially in Quebec, regional offices and head office had to produce at least the same proportion of staff reductions as that occurring in branch offices. Regional vice presidents were given the responsibility to implement the necessary staff cuts in their respective regions. This included both branch office staff and regional office staff. Head office cuts were overseen by Neilson.

While the number of staff reductions at the branch level was determined by applying the staffing norms, at the regional office the vice presidents and their personnel managers had a more difficult task. To effect staff reductions, work methods had to be changed. Regional office support functions with relatively large staff counts were targeted. A case in point was the legal services function in the Ontario regional office. Its head, Jim Hercus, was appointed Regional Counsel in 1979. He had joined IDB in 1971 as branch solicitor in Saskatoon and moved to the Regina and Prince Albert branches before becoming Assistant Regional Solicitor for the Prairie and Northern region. When he arrived at the Ontario regional office, there were about 40 people working in the legal section, including staff in some branch offices. When the call came for staff reductions, Hercus set about changing the way legal services did its work. It was not an overnight job but by the time he left the regional office in 1984 to become General Counsel for the Bank at head office, the regional legal services staff had been pared down to about 10 people and shortly thereafter to about five people. Hercus changed his department's work methods in ways that were soon duplicated by other regions.

Bringing in new professionals to upgrade the Bank's support functions while reducing overall staff counts in line with the regions and branches meant proportionately more staff had to be reduced at head office. Most departments were asked to reduce staff although the loans and venture capital departments were not much affected nor were new functions such as treasury operations. The Bank's Management Services staff too, by and large, was less affected by major layoffs as these services were in a break-even position each year (by design), with the shortfall in revenues made up by a subsidy from the government.

It did not take much deliberation to terminate some head office functions completely. On this list was the Bank's in-house health clinic, staffed by a nurse and an assistant. Included too were the services of a medical doctor who would visit the Bank each Thursday for appointments with Bank employees. Similarly, the Bank's in-house travel agency, whose staff arranged transportation and lodging for staff business trips, was closed down. The Bank's fully-equipped movie studio that produced videos for management services' training programs was also closed. Two departments with relatively large staffs, Records and Insurance, were targeted for major reductions pending a review of work methods. The Records department essentially provided a centralized filing service for all head office departments and had about 20 staff in 1980. By the time it was downsized and merged into the Premises and Supply department (a.k.a. promises and surprise), it consisted of one person, Maureen Pidgeon. Similarly, the Insurance department was merged into Legal Services and later manned by one person, Brian Hammond.

As to be expected, there was much back and forth between Neilson and department heads. Questions were asked along the lines of: 'How can you expect me to do my job if you cut my staff?' or 'why does my department have to reduce by so much when such and such department has so many staff?' Some departments readily accepted reductions as they knew they had some 'fat' in their ranks. One such case was the Economics department, headed by Allen who left the Bank for personal reasons in 1980. He was replaced by the author, Donald Layne, who had also worked with Lavigueur in Ottawa. When Allen left, there were

about five employees, out of 15, who were part-timers. When asked what these part-timers did and what their schedules were, no one could give a reasonable answer and their contracts were terminated. Other staff cuts to Economics followed later.

Cutting staff is arguably the most difficult task for a manager. The difficulty lies not in the number of people to layoff but in dealing with the consequences, reactions and emotions that surface when someone is told he or she no longer has a job. As the one doing the telling, the manager takes on some responsibility for the loss of one's job. Some managers, unable to carry out the task of laying someone off, would call on the Human Resources department for assistance.

This was the environment Yvonne Zacios walked into when she joined the Bank as part of the professionalization of the human resources department at head office in 1980. She was hired to work on improving employee relations. An attitudinal survey of FBDB staff done a year earlier had shown this to be a pressing need. Zacios had relevant experience from having worked at large companies, General Electric and Hygrade Foods, which had large unions to deal with. But her work priority quickly made a U-turn – from improving employee relations to managing layoffs.

To assist managers, Zacios developed a roadmap for the layoff process at the Bank. This included a protocol for handling a layoff situation as well as the elements of a layoff package. She also assisted Neilson in monitoring and providing advice to regional offices regarding their staff reductions.

Neilson told Zacios he wanted the layoff process to be handled in a professional and elegant manner, with as much humanity as the task allowed. The Bank already had enough problems to deal with and he did not want to add to them by mishandling layoffs. Court cases attracting media coverage were to be avoided. Since cutting staff was a new experience for the Bank, there was no process in place to ensure individual layoffs were handled effectively. The task was doubly complicated by the fact that the Bank did not have an effective performance review system. Though employees' performances were reviewed each year, they were not assessed against quantifiable objectives established at the outset. When not much achievement could be documented, subjective assessments such as 'he is a good family man' would turn up in performance reports. In other words, the Bank could not reference documented requirements not being met as a reason for terminating employees for cause, even though some were thought to be underperformers. (The fact one was a good family man may seem trivial and irrelevant but, traditionally, in banking it was required that staff be of solid character with impeccable moral standards to ensure people held them in high regard as protectors of their deposits.)

Even though Neilson may have wanted it to be, laying someone off is never elegant. The protocol developed by Zacios was intended to avoid confrontation by telling the affected employee his/her position was being eliminated as the Bank had no choice but to downsize. She would then quickly acknowledge the person's contributions to the Bank and move on to the details of the severance package the Bank was prepared to provide. If the subject returned to the

inevitable question, 'why me,' Zacios would try to lift the burden of self-doubt by de-personalizing the need for the layoff and emphasizing the Bank's requirement to reduce staff. Most discussions focussed on the financial aspects of the severance package being offered.

While each situation was unique, there was sufficient guidance in the market as to what severance packages were acceptable. FBDB was not the only company faced with the need to reduce staff. The recession was hitting everyone and many large corporations in the private sector had already started their layoffs. As many cases had gone before the courts, there was a lot of jurisprudence on severance packages. Based on salary, years of service and level in the organization, one could consult external experts and jurisprudence to arrive at a fair package. The objective was to offer the best severance package within market norms for the affected employee. Sometimes the Bank's package was even slightly better than market.



Richard Dupuis, the in-house expert on pension rules and calculations, and Maria Koukoutsis.

Another concern arose when the person being laid off was close to being eligible for pension benefits. This was critical not only for the pension itself but also for post-retirement health benefits which pensioners received if they moved directly from the employ of the Bank to the Bank's pension benefits. Alphonse Thibodeau, a recent professional hired in Human Resources for Benefits and Compensation, had to be innovative in constructing severance packages that would bridge the gap, when feasible, to pension benefits. He was assisted by Richard Dupuis, the in-house expert on pension rules and calculations. If anyone needed to know anything about the Bank's pension plan, or for that matter about government pension plans, and more specifically about their own potential pension benefits, they would go to Dupuis. He was consulted by most in the Bank, whether leaving or not. Having started his career at a clerical level in the Bank of Canada, he was the model of the self-taught, self-made professional.



In a layoff situation, details of the severance package would be discussed to ensure the affected employee fully understood its contents. When senior managers were involved, a consultant from a relocation firm would also be on hand to go through the services the firm would be providing to assist the employee in finding another job. Zacios felt there was no need to have security guards on standby to escort the person from the building as this would be quite demeaning. She would usually have her meetings with affected employees on Monday or Tuesday and give them until the end of the week to return with any questions, organize their personal effects at the office and go around to say their goodbyes. As she put it, these were decent people and they deserved to be treated decently. (In later rounds of layoffs, security guards were called on in some cases – usually involving senior officers – to escort laid off employees after they were given notice of their termination.)

Many times, the difficult task of laying off staff was handed over to Zacios. As the bearer of bad news so often, she became known as the Axe Lady. During this period, when an FBDB employee was asked to meet with Zacios, that person knew what was in store. Several times, on the day of such an appointment, the person would call in sick. When Zacios turned up on a floor, a groan could be heard as employees discerned another co-worker would soon be leaving the Bank. In addition to her head office assignments, Zacios provided assistance and counsel to regional personnel managers, from Atlantic Canada to British Columbia, and 60 or 70 hour weeks were the norm for her. In such an environment, the day the Bank achieved full cost recovery status could not arrive too early.

Between March 1980 and March 1981, the Bank's term lending staff was reduced by about 200, from 2,136 employees to 1,941 employees, with all reductions occurring in branch offices. It took some months to work out the staffing reductions for regional and head offices. By March 1983, total term lending staff was reduced by another 468. Of these, 151 were reductions in regional and head offices. Significantly, staff reductions over this period affected all levels as vice presidents also left the Bank involuntarily.

By early 1983, there were signs the economy was recovering. Prime interest rates had dropped to below 12% from the 22.75% peak of August 1981. There was hope in many quarters that the layoffs were finally over. But losses persisted during the early eighties. On top of this challenge, the Bank's very existence was being questioned in the government's review of small business financing in Canada.

1979 to 1983

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# SBFR & a new mandate for FBDB

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Much energy is expended proving to stakeholders that a financing gap exists for small business. Prolonged (and sometimes heated) deliberations culminate with a new FBDB mandate accompanied by capital injections.

**W**henever small business financing issues arose in Ottawa, FBDB inevitably came under scrutiny. This was particularly evident during the 1979 to 1983 period, when a series of studies touched on the Bank's rationale and mandate. The first and perhaps most important was the Small Business Financing Review (SBFR) initiated by the Privy Council Office of the federal government in 1979. This action was taken in response to the request from FBDB to increase its legislated capital base. The Review was given to the Department of Industry, Trade and Commerce (IT&C) to conduct.

The terms of reference for the Review were quite broad and general in nature. The object, as stated, was to determine the extent of, and how effectively, financing was being made available and delivered to small business by non-federal government sources and by the panoply of federal programs. The Review was to deal with most forms of financing while paying special attention to long-term debt and venture capital. The Review was to provide conclusions and recommendations with respect to the usual efficiency and effectiveness of policies and programs. It was also supposed to comment on the need for federal program additions, amendments, integrations or eliminations, in order to deal with both wasteful duplication and significant gaps for which government intervention may be warranted.

The panoply of programs to be studied included FBDB, the Small Business Loans Act (SBLA), Enterprise Development Program, Credit Insurance, Farm Credit Corporation and business financing programs in the departments of Indian and Northern Affairs and Regional Economic Expansion. But it quickly became clear only two programs would be studied, SBLA and FBDB. The Enterprise Development Program, a relatively new program in IT&C, was the department's flagship business subsidy program – in other words, untouchable. And it would have been futile for IT&C to review another department's program, like the Farm Credit Corporation under the purview of the Department of Agriculture. Only a central agency, the Department of Finance or the Treasury Board Secretariat, could consider studying another department's programs.

A study team was assembled within IT&C and headed by Jim Howe who was a Director General in the department. He was given a significant budget and was able to hire external consultants to assist, including Don McFetridge, a professor of Economics at Carleton University, and Joe D'Cruz, a professor at the University of Toronto's business school.

IT&C's Small Business Financing Review was not the only study of small business financing going on at the time. The Canadian Bankers Association (CBA) had also commissioned a study of small business financing in Canada in response to the perennial criticism chartered banks were not providing sufficient financing to Canada's small businesses. The CBA study was contracted to two business school professors at the University of Western Ontario to conduct, Larry Wynant and Jim Hatch. And yet another study, dealing with the federal government's business financing programs, was being initiated at the Economic Council of Canada (now defunct). Entitled *Intervention and Efficiency*, this study, headed by Dr. André Ryba, reviewed all direct government interventions in the marketplace, including the Federal Business Development Bank.

From 1980 to 1983, the Bank would have to deal with the consequences of all these studies over which it had no control. In each case, FBDB was asked to cooperate by providing Bank data and responding to questions. When the studies were completed, the Bank could only react to their conclusions and recommendations. Strategically, FBDB's President commissioned his own study. This way the Bank would be in a position to counter any controversial conclusions and hypotheses that might arise from the other studies. It was the season for small business financing studies in Canada.

Lavigueur hired the firm of Peat Marwick Associates (since merged into KPMG) to conduct the Bank's study of small business financing and FBDB's role. The partner at Peat Marwick overseeing the FBDB study was Guy Cousineau. He knew the ropes in Ottawa and 'how Ottawa thinks.' Before retiring from the federal government, he had been Chairman of the Unemployment Insurance Commission when Lavigueur arrived in Ottawa and had served at the Assistant Deputy Minister level in Treasury Board.

The University of Western Ontario's study done for the Canadian Bankers Association was the first to be completed, in early 1981. From FBDB's point of view, it described fairly how the small business financing market was functioning. The key piece of analysis was a comparison of commercial lending risk for chartered bank non-SBLA loans, SBLA loans and FBDB loans. Various characteristics were used as components of loan risk as shown in Table 1.

**Table 1** Comparison of Riskiness of Chartered Bank Regular Term Loans, SBLA Guaranteed Loans and FBDB Loans

<b>Risk Measure</b>	<b>Non-SBLA Loans</b>	<b>SBLA Loans</b>	<b>FBDB Loans</b>
Years of Relevant Management Experience	9.9	6.0	5.2
Business Age	5.0	3.1	3.2
Debt/Equity Ratio	1.6	1.9	1.4
Collateral/Loan Amount	2.8	2.5	1.5

*Source: A Study of Chartered Bank Financing of Small Business in Canada, by L. Wynant & J. Hatch of the University of Western Ontario for the Canadian Bankers Association, 1981.*

The study also compared the size of firms receiving financing from chartered banks and from FBDB. Its analysis showed FBDB made proportionately more loans to new firms and to firms with annual sales under \$250,000.

With respect to FBDB, the University of Western Ontario study stated: We can conclude that the FBDB provides higher risk loans than do chartered banks. The FBDB also undertakes a more in-depth analysis of loan requests, partly because of the higher risk of their loan applications. FBDB lending officers also spend more time evaluating each loan request. Our interviews suggest that the FBDB has a customer relationship that is similar to that of chartered banks. The FBDB is essentially a passive lender and does not take an active role in altering the

business operations or activities. However, the FBDB is now beginning to link its lending and management advisory (the CASE program) services. These findings would be referred to frequently by the Bank in its dealings with Ottawa during the early 1980s.

Next up was the Peat Marwick study. It found FBDB was producing significant, measurable economic impacts. Personal and corporate income generated by the Bank's clients represented 2% of Gross National Product, and the Bank's clients were creating 3% of all new jobs in Canada. Further, the study found the federal government received \$91.5 million in direct tax revenues annually from incremental projects financed by FBDB, more than enough to cover the \$29 million of losses the Bank recorded in fiscal year 1980. Peat Marwick found that while the marketplace for small business financing was changing, it still was not meeting all the needs of small businesses. The study identified the following areas where private sector sources were lacking: loan financing for higher risk projects, financing with flexible terms catering to the cash flow of a business, fixed rate financing, loan financing for social and economic development, equity and venture capital, information on financing alternatives and packaging and finally, management skills development. (The first two observations would, fifteen years later, be referred to as the risk gap and flexibility gap.)

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From 1980 to 1983, the Bank would have to deal with the consequences of all these studies over which it had no control.

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Peat Marwick recommended FBDB become a dual approach development bank. The Bank should continue its reactive or passive role with respect to its traditional business but should add a proactive economic development role. By proactive, Peat Marwick meant FBDB should aggressively create demand in a manner that would foster government economic objectives in areas beyond the normal scope of the private sector. In its proactive role, they also saw the Bank as packager of financings, taking a lead role in assembling interested parties to provide funds towards a business opportunity. The packager could also have a part of the financing package to obtain a return. Alternatively, a fee could be charged for the packaging service.

This dual role essentially mirrored the perspective espoused a year earlier by Gordon Sharwood, a member of FBDB's Board of Directors. In his view, a business development bank had two separate markets and corresponding roles. The first

was to sustain the general level of business in the country and the second was to back innovation, be responsive to industrial policy and respond to changing economic forces. The first role, as much social policy as economic policy, was associated with loans made to 'mom and pop' businesses such as the retail, hotel, motel and restaurant sectors. These types of businesses were not expected to show rapid growth and would therefore have limited economic contribution. They were providing jobs for their owners and a few others and thus the reference to social policy – that is, job creation.

The second market role comprised corporations whose sales were expected to grow rapidly and, if successful (the key words), would make substantial contributions to the growth of the economy through increased employment and exports. Sharwood thought that while FBDB was doing both types of loans, it was doing many more of the 'mom and pop' variety, implying the Bank should be doing more financing to the second group of potential 'high flyers.' He thought financing proposals from the latter group should be dealt with differently from the Bank's regular procedures.

The Peat Marwick study, as to be expected, reflected the direction in which Lavigne wanted to move the Bank. (He who pays the piper calls the tunes. In matter of fact, much of the analysis and recommendations in the Peat Marwick study were inspired by the Bank's President and officers.) Lavigne saw the reactive role as basically a continuation of the Bank's supplementary term loan financing service but wanted it to return to a fully cost-recoverable position at a 10:1 debt-to-equity ratio. Subsidization of smaller and higher risk proposals would continue in this scenario. In the proactive role, there were opportunities for the Bank to promote Canadian enterprises that could be internationally competitive. Identifying such opportunities and bringing them to fruition would constitute a new challenge, and market, for FBDB. While still conceptual at this stage, the proactive role, in Ottawa parlance, would concretize itself a couple years later, when the Bank received a new operating mandate from the government.

The Bank tabled the Peat Marwick results and conclusions with the Small Business Financing Review (SBFR) team in Ottawa. The latter, however, completely ignored the study's research and findings. The SBFR team was travelling on a different track; the Peat Marwick study was like another train passing in the night – in the opposite direction. Even the results of the Canadian Bankers Association/ University of Western Ontario study were largely ignored by the SBFR. (The Economic Council of Canada study, completed months after the SBFR was done, provided no input to the SBFR team.)

Jim Howe managed the SBFR the way he saw fit. He commissioned what the Bank considered to be theoretical papers from Professor Don McFetridge of Carleton University. The Bank thought McFetridge was of the free market school of economics, emanating from the Chicago School of Economics that was gaining much attention and support in the early 1980s. Ronald Reagan had just been elected President in the U.S. and he espoused free market economics, wanting especially to remove government from the affairs of business. This was the new wave in public policy. McFetridge concluded the market was the best judge of which small businesses should get financing and which should not. Furthermore,

he opined that financial markets in Canada were functioning efficiently and there was no need for government intervention. This led the SBFR to conclude there was no financing gap in Canada for small business and therefore questioned the need for FBDB and IT&C's own Small Business Loans Act (SBLA).

Paradoxically, the U.S. Small Business Administration, which ran a widely-used loan guarantee program for small businesses in the United States, received support from the champion of free markets, Ronald Reagan, and even saw its budget increase while he was President. It seemed a financing gap for small business existed in the world's largest free market but not in Canada. The countries with the next two largest economies, Japan and Germany, also had government-sponsored small business financing programs, Shoko Chukin Bank and KfW respectively. The Bank showed officials in Ottawa that among all these small business financing programs, FBDB was the most cost effective. (Great Britain also had a Loan Guarantee System for small business but it was costly and eventually terminated. Later, following the 2008 financial crisis, The Economist magazine, a standard bearer for conservative economic principles, called on the British government to create a development bank for small business.)

The existence or absence of a financing gap for small business in Canada became the focal point for discussion between the SBFR team and FBDB representatives. Hugh Carmichael, head of the Planning department, led the Bank's team dealing with the SBFR. It included the head of the Economics department and the head of the Bank's Government Relations office in Ottawa, Michel Azam. This was not the first time Carmichael had to deal with Howe. He recalled that when he worked at the Bank's Saskatoon branch, a younger Howe had approached the Industrial Development Bank for a business loan to finance his automobile sales business. That loan was made. But Howe later decided to leave the business and return to university. He gained a PhD. degree in Economics and joined the Government of Canada. Now, as head of the SBFR, he was espousing there was no financing gap in the marketplace and questioning the need for FBDB.

There were endless meetings with the SBFR team in Ottawa as the Bank's argument that a financing gap existed continually fell on deaf ears. The Bank's position was that chartered banks were willing to accept risks only up to a point which was notionally equivalent to the maximum interest rate they were willing to charge small business clients, prime plus 2%. FBDB's interest rates, on the other hand, started at around prime plus 2% to reflect the higher level of risk it was accepting. This was confirmed by the University of Western Ontario study when it produced hard data showing FBDB did take on higher risk in the market. The Bank's line of argument made no impact on the SBFR team. The elephant in the room was the Bank's operating losses. Can a gap be justified if filling it led to operating losses? The fact the losses were the result of very extraordinary economic circumstances and the Bank had already taken steps to return to full cost recovery did not matter. To the SBFR team, the market was perfect so there was no need for government intervention, FBDB and SBLA both. The presence of operating losses in FBDB and SBLA only supported their conviction. Lavigne knew he had to return the Bank to a profitable status but also knew it could not be done overnight and certainly not before the SBFR was completed.

Howe had asked Professor D’Cruz of the University of Toronto to assist in the quantitative side of the Review. D’Cruz was asked to scrutinize the financial forecasts FBDB was submitting to the review team. To understand more fully the assumptions being used, he asked to meet with the person making the forecasts. He met with FBDB’s representative, Valdmanis, in Toronto to go over the assumptions. The next thing the Bank knew D’Cruz had the Bank’s financial model up and running at a computer services company in Toronto and was producing his own forecasting scenarios. This was totally unacceptable and the Bank’s team demanded that the computer program running the financial model be handed over to the Bank. The program was reviewed by the Economics department and deemed to be flawed. This was communicated to D’Cruz and he was told to discard any scenarios he had run with the model as they contained multiple errors. Dac Nguyen, computer analyst, and Dominique Davies, econometrician, both of the Economics department, fixed the computer program running the model and returned it to the Toronto computer services company to run the Bank’s own forecasting scenarios. If the SBFR team wanted any financial forecasts, they would have to ask the Bank to run their assumptions and provide them with the results. There was one useful result of this episode; the Bank now had its financial model on a computer system and was able to run different scenarios very quickly. No more need for calculators and typists.

It was clear where the SBFR team was headed when they requested forecasts of the Bank’s operating income/loss under the assumption of no new lending. Concerned about the high cost ensuing from an immediate closure of the Bank, they wanted to see what the numbers would be if the Bank only administered its existing loan portfolio until all obligations were fulfilled. They were provided with the scenarios they requested but by then, Lavigueur had seen enough of where the Small Business Financing Review was headed. He spoke with the Minister of IT&C and with Bill Teschke, the Associate Deputy Minister of IT&C who was also a member of FBDB’s Board of Directors. Neither the Minister nor Teschke was aware of the direction the SBFR was headed and both were convinced there needed to be a re-direction.

Frank Podruski was one of a small team of policy specialists (wonks) reporting directly to R. Johnston, the Deputy Minister of IT&C. In April 1981, he was called to meet with the Deputy Minister and Teschke and given his marching orders: go to work with the SBFR team and recast its report so there would be a review of the SBLA program and a restructuring of FBDB rather than scrapping them. It was a tall order knowing the theoretical bent and stubbornness of the SBFR team. But the job had to be done to avoid a confrontation between Jim Howe and his two deputy ministers.

When Podruski arrived to work at the Small Business Financing Review, everyone on the team knew why he was there, even though he nominally reported to Howe. On the other hand, while Howe was not one to compromise his beliefs, he also realized he had to work cooperatively with Podruski to produce an acceptable report as he did not want to end up on the wrong side of his two deputy ministers. Podruski’s arrival at the SBFR was a breath of fresh air for FBDB. It signalled an objective look at the issues. Moreover, it had the



extra benefit of working with someone who had been a colleague of the head of the Bank's Economics department when they had worked together in the policy branch at IT&C.

Podruski was briefed by the Bank's team on FBDB operations and on the root causes for its current losses – the economy, the mismatch problem (discussed in Chapter 11 on the Bank's treasury operations) and the mandate to make small loans. Podruski quickly understood the Bank's position. His challenge was to get Howe to move off his convictions, that is, to be flexible, even if only slightly. So he too spent a lot of time in endless meetings with him. Howe held a doctorate degree in Economics but Podruski was the practical policy wonk, undoubtedly the reason he was chosen to be on an exclusive policy team reporting directly to the deputy minister.

Podruski had to convince Howe the market-driven solution was not the only solution. In Podruski's view, there was nothing magical or sacrosanct about the market solution, nor was it a matter of it being right or wrong. In his reasoning, if the social economic costs of the market solution were too great, there would be a role for government intervention, directly or by regulatory means. That's what democratic governments were all about. For Podruski, the financing gap in Canada was associated with the relatively high costs of transacting and administering small-sized loans, especially when commercial lenders placed an upper limit on how much they were willing to charge their small business customers. He pointed out to Howe that there were some 40,000 businesses out there borrowing money, creating jobs, paying taxes and repaying their loans (a reference to the number of FBDB clients at the time). Why should they be penalized because commercial lenders wouldn't charge interest rates to cover their costs? In Podruski's view, government subsidies were justifiable if the government found the social costs of the market solution were too high. One needed only to look at the Enterprise Development Program in IT&C and the Department of Regional Economic Expansion financing programs as examples. With respect to FBDB, he felt that providing an adequate (free use) capital base coupled with the preferential rate at which the Bank, as an agent of the Government of Canada, borrowed its funds were justifiable for offsetting the relatively high administration costs associated with making small-sized loans.

This was the same line of thinking put forward a few years earlier by the Governor of the Bank of Canada, Gerald Bouey, when the Bank's management wanted to increase interest rates for small-sized loans and decrease them for large-sized loans. But one key issue still remained – whether FBDB could return to full cost recovery status or whether it would be floundering in a sea of losses forever. The SBFR team had thought the Bank would not be able to return to full cost recovery but the FBDB team was able to persuade Podruski it could. Whether deep down he accepted the premise or not, he was not a skeptic and was willing to give the Bank a chance to do so with proper capitalization.

At the end of the day, the spirit of Canadian compromise overcame the impasse. Howe and Podruski came around to a position, or wording, they both could live with. In the first iteration of the SBFR report, before Podruski arrived on the scene, the conclusion was that there was no small business financing gap in Canada,

calling into question the existence of both the SBLA and FBDB lending programs. In the second iteration of the report, the conclusion called for a review of the SBLA and a restructuring of FBDB lending. The Deputy Minister and Associate Deputy at IT&C could now accept the report.

In September 1981, the Small Business Financing Review's conclusions were presented to FBDB's Board of Directors. Bill Teschke prefaced the presentation by saying they, IT&C, needed the Bank's input to complete their work on FBDB's mandate. Howe was on hand to respond to any questions.

With respect to FBDB and SBLA lending, the following were the main SBFR conclusions, with some parenthetical commentary in italics:

- Significant changes in the term lending market in the last 10 to 15 years have reduced the relative financing gap filled by government programs (*the SBFR had changed its position of no gap to a reduced gap*);
- FBDB is a major participant in the term lending market but its share of the market has been shrinking and loans are becoming riskier (*the retort "it's the economy..." had not yet entered the lexicon*);
- SBLA loans are not incremental but SBLA does encourage more favourable terms (*interest rates on SBLA loans were limited to prime plus 1% at the time*);
- Financing gaps may exist for self-employment firms as well as in rural areas and for start-ups (*the 'may' was typical compromise wording*);
- Present and public sources of financing leave no major financing gaps (*in other words, do not create any new financing programs*);
- There is no apparent shortage of equity financing except possibly for start-ups (*this conclusion aroused strong reaction from many Board members with FBDB's President emphasizing there was a shortage and another Board member saying that SBFR's analytical tool was wrong*);
- A subsidy provided by government small business financing measures may be justified on several grounds but not solely to fill a gap;
- Given the industry sectors in which small businesses are concentrated, little economic impact can be expected from non-targeted subsidies;
- Since most small businesses operate in local markets, government financial and other assistance programs must be structured around and delivered through mechanisms that understand and operate in local markets. In this context, the SBFR noted FBDB was the most relevant government institution serving Canada's small businesses; and
- The task of being a supplemental lender at reasonable interest rates and being cost recoverable at the same time was heroic if not impossible.

At the end of the day, the Review accepted the fact that FBDB was going to stay in business and thus concluded small businesses would be better served by the Bank taking on more roles. Thus, the Review envisaged FBDB providing financing to fill gaps, providing targeted development financing, delivering other government

programs, developing small business management, providing client services and becoming a focal point for local small businesses, business professionals and advisors – a mandate not unlike that recommended by Peat Marwick. Lavigueur and his team, who had worked hard to convince the SBFR the Bank had a valid and important role, could now move on to other pressing matters.

While the SBFR was being completed, the Ministry of State for Economic Development (MSED) in Ottawa was conducting a review of program overlap and consolidation. It too had recommendations affecting FBDB. It proposed to merge IT&C's Business Information Centres (BICs) with FBDB's small business information service into a Canadian government information centre operated by FBDB.

The Small Business Financing Review was not just another study being done in Ottawa. Having been initiated by the Privy Council Office, the Prime Minister's department, it was given prominence and attention in several quarters including Finance and Treasury Board, the two departments controlling the purse strings in Ottawa. Lavigueur knew the importance and impact of the SBFR's findings and recommendations. They would have a large influence on the government's decision to provide the Bank with new capital to offset operating losses, capital that was needed for the Bank to continue its operations. In effect, the SBFR findings could greatly affect the Bank's viability and indeed, its existence. The phone calls he had made to the Minister of IT&C and to Bill Teschke were two of the most important calls he made at the Bank since they led to the redirection of the SBFR. They not only kept the Bank in business, but opened the door for an expanded mandate.

The SBFR final report was never widely circulated and was quietly filed away in IT&C for future reference. It is likely that a first draft of the report had also been filed as subsequent events would indicate. In any case, the Bank still had to deal with the study of business financing underway at the Economic Council of Canada. Policy makers in Ottawa were also looking to this study before deciding on what measures should be taken vis-à-vis FBDB. Several meetings took place with Dr. André Ryba, the study director, to brief him on FBDB's activities and role in the market. However, his study was not completed until 1983 and had no influence on deliberations concerning FBDB's new mandate. For the record, there were no specific recommendations in the Economic Council's study about FBDB but three touched on the Bank indirectly (with author's commentary in italics):

- We recommend that federal and provincial governments modify their policies to facilitate the strengthening of the equity base of Canadian firms, particularly small and medium-sized businesses (*contradicting the SBFR finding*);
- We recommend that public loans be extended only in cases where there is a strong presumption of the existence of a lending gap. We further recommend that in such cases, the loans do not incorporate a subsidy (*the notion of a gap revisited although it allows that a gap can exist*); and
- We recommend that when a subsidy is deemed necessary, the business financing agencies of government explore ways other than loans and loan guarantees to convey this subsidy.

That study, *Intervention and Efficiency*, was one of the last done by the Economic Council of Canada before it was closed. Its recommendations had little or no impact on government policy. In fact, government was moving away from outright grants to business and moving toward recoverable loans.

Soon after the Small Business Financing Review was completed, the Minister of State for Small Business, the Honourable Charles Lapointe, launched FBDB's annual Small Business Week event in Montreal in the fall of 1981. He told reporters covering the event he expected FBDB to become a bigger institution, with hints the Bank could be the one-stop centre for the government's business finance and advisory programs. He expected a new federal policy on small business, resulting from the Small Business Financing Review, to be ready by February 1982.

It was standard humor in those days that when a government report was promised as imminent, one would say: give me the month it will be issued and I will give you the year. So it was with the new FBDB mandate. Expected in February 1982, it was not announced until April 1983.

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## Throughout 1982, the Bank's team worked with IT&C to craft the specifics of a new FBDB mandate.

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### **Crafting a new FBDB mandate**

Throughout 1982, the Bank's team worked with IT&C to craft the specifics of a new FBDB mandate. Within the Bank, Carmichael assembled a small team of seasoned veterans, David Goodman, Jim Evans and Richard Bradbury among them, to work with his newly hired MBAs in the Planning department. They were called on to provide the operating blueprints for various components of a new FBDB. One was a merchant banking division as had been recommended by Peat Marwick. The Senior Vice President of Finance, Jack Nordin, also got involved in this particular activity as he had played a major role in creating the Bank's venture capital operation. The term 'merchant banking' morphed into investment banking, and plans were made to transform the Bank's venture capital operation to one of investment banking. The Planning group also developed specific products around the concept of client services, the packager role recommended by Peat Marwick. Client services later morphed into the Financial Planning Program.

In 1982, the federal Departments of Industry, Trade and Commerce and Regional Economic Expansion merged to become DRIE, Department of Regional Industrial Expansion. Robert Montreuil, the former deputy minister of Regional Economic Expansion took over as deputy minister of the merged department. He

assigned the task of drafting the Memorandum to Cabinet that would lay out a new mandate for FBDB to Frank Podruski and his colleague Robin Butler. These two worked with the FBDB team to craft the new mandate. On a late wintry Friday afternoon in Ottawa, Podruski and Butler were called in to the Deputy Minister's management committee to discuss their draft Memorandum to Cabinet on FBDB. The Deputy Minister was not totally impressed, saying the document did not leave him with a warm and fuzzy feeling. Podruski and Butler were told to have a new draft Memorandum ready for review by the following Monday morning. They worked all Saturday, 'cutting and pasting,' called in their secretary Diane Sinclair to retype the document on Sunday and presented the revised version to their Deputy Minister, Robert Montreuil, on Monday morning. He declared the document fabulous.

Montreuil had been involved with FBDB since its creation. He served as alternate FBDB Board member and full Board member over the years. More importantly, for many years Montreuil was on the Board's Executive Committee which reviewed large-sized loans before recommending them for full Board approval. He knew how FBDB conducted its business and the role it played in the market. His support for the Bank was evident when, as Deputy Minister in charge of the file, he shepherded the Memorandum to Cabinet on FBDB's new mandate and funding through the Ottawa process.

The 1983 mandate for FBDB comprised various components. The first priority for the Bank was to continue its term lending operation on a supplementary basis but with emphasis on providing service to businesses in non-metropolitan and rural areas. This was an affirmation of the Bank's main line of business. The second component was to improve services to small businesses with regards to: i) providing business, industry and program information, ii) preparation and presentation of business plans and iii) management training and counselling. The final component was to develop a new investment banking capability, incorporating the current venture capital activity, which would be targeted in accordance with government economic development priorities.

### **Funding framework**

Critically, the 1983 mandate included a funding framework for the Bank. FBDB would be responsible for covering all of its operating expenses for term lending from its interest and other income while government contributions would be applied to cover loan losses. The Bank's management services would continue to be funded with annual appropriations (subsidies) but the government expected the proportion of costs recovered for these services to increase. The investment banking function would be funded by government equity but had to be structured to meet the Comptroller General's return on investment (ROI) targets at the end of five years.

The monies the Bank would receive as part of this new mandate included a capital infusion of \$30 million to restore the term lending operation to a 10:1 debt-to-equity ratio. Budgetary allocations of up to \$50 million a year were added to offset loan losses. For Management Services, an additional \$5 million were made available to expand services including the new client services function to

be started in each province. For Investment Banking, \$29 million were provided to capitalize the existing venture capital portfolio and a further \$60 million were earmarked for new investments over three years.

Lavigueur knew dependence on annual contributions from government to cover loan losses was not a long-term solution for the Bank, as it would bring into question its Schedule D crown corporation status (giving the Bank autonomy to conduct its business). So the new mandate also directed FBDB to modify its lending operations and make its best efforts to implement its historical mandate as lender of last resort and cover all of its costs, including loan losses, in spite of difficult economic circumstances.

In total, FBDB received a capital injection of \$125 million in fiscal 1983 to finance its new mandate. These funds provided the breathing space the Bank needed as it continued on the road to full cost recovery. FBDB had survived the Small Business Financing Review and emerged with a new mandate. Now the pressure was on to deliver the goods.

1983 to 1986

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# Cost recovery Part II

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As the recession shifts to Western Canada, FBDB losses continue to mount and lending declines. To achieve its cost recovery goal, management implements several painful rounds of staff cuts.

**W**hen the first operating loss of \$29 million hit FBDB in 1980, Lavigueur was told by many senior managers it was a fluke and would be a one-time occurrence. When an operating loss of \$44 million was recorded for fiscal 1981, it was felt again the worst had passed and full cost recovery was just around the corner. The Bank had implemented measures to reduce risk in the loans portfolio and had cut operating expenses through a series of staff reductions. When the financial statements for fiscal 1981 were presented to the Board of Directors, Chairman Harold MacKay asked whether the Bank had tried to bite the bullet quickly enough. In other words, were all potential loan losses inherent in the portfolio being recognized and taken into account? The Assistant Vice President and Controller responded that while one should resist the attempt to take more provisions for losses just for its own sake, the balance sheet had been cleaned up. Which meant there were no hidden loan losses in the portfolio and the Bank's assets (primarily the loans portfolio) were indeed written down to their proper value. He could, of course, not say otherwise.

In fiscal 1982, a report to the Board of Directors on the Cost Recovery Plan showed the budget for the year was holding its own. The Bank's Cost Recovery Monitoring System (CRMS) was tracking the risk grades of new loans as well as staff levels against established norms and objectives and nothing untoward was raising its head. The mid-year budget review called for \$26 million in operating losses for the term lending operation in fiscal 1982, a small \$2 million loss in fiscal year 1983, and profits thereafter. Taking no chances, the President called in the firm of Price Waterhouse to review the Bank's five-year financial forecast. They provided a range of forecasts, the mid-point of which matched the Bank's internal forecast. This was not surprising as they were working with figures provided by the Bank's forecasters. On a cumulative basis, over the five year forecast period, Price Waterhouse found the Bank's forecast could be understated by \$19 million or overstated by \$20 million, depending on their range of assumptions.

### **New analytic tools in projecting provisions for losses**

Lavigueur made it clear to operational management that any and all potential loan losses in the loans and investments portfolios should be recognized and reported. It was time to examine the existing portfolios loan by loan, investment by investment, identify and book any potential loss and take the hit in fiscal 1982. He was prepared for whatever amount the losses may have turned out to be, even if they were to surpass \$100 million. For fiscal 1982, FBDB reported an operating loss of \$75 million, of which \$63 million were in the lending operation and \$12 million in venture capital. Just under half of the lending operations' losses were attributed to the Ontario region, the region hardest hit by the recession. Having cleaned up the portfolio, in the sense of recognizing all potential loan losses, it was again felt by many senior managers, especially within the operations, the Bank was now back to, or at least close to, full cost recovery. But the bad news continued, this time from within the Bank.

While responding to the Small Business Financing Review requests for financial forecasts, the Economics department was gathering and analyzing as much internal data as available on loan losses. Guided by Hugh Carmichael, the



department first collected copies of liability reports and created a computerized liability and liquidation data base for conducting various analyses. This data base was the forerunner of the Provision Sub System in the Loan Accounting and Processing computer system. By analysing loan losses by MES grade as well as historical patterns of loan loss experiences, the department was able to make continuous refinements to the loss provision module of the Bank's financial forecasting model. The bad news was that while most in the Bank thought the loans portfolio had been cleaned up and loan losses would be reduced substantially in fiscal 1983, the analysis showed otherwise.

Soon after the end of fiscal 1982, the Economics department made a presentation on loan losses to the Bank's management committee. In attendance were head office managers as well as regional vice presidents. The presentation projected provisions for new loan losses in fiscal 1983 of \$75.4 million. Furthermore, in spite of lower staff levels, operating expenses as a percentage of loan amounts outstanding was increasing, not decreasing, as the portfolio was shrinking more rapidly due to lower levels of new loan authorizations and mounting write-offs. This key measure of costs was up to 3.5% in fiscal 1982 and was projected to keep on increasing if left unchecked. The presentation concluded the Bank had not yet turned the corner, and losses for fiscal year 1983 would be about the same as for 1982.

This presentation was met not with skepticism, but with resentment. The schism between head office prognosticators and regional vice presidents deepened. Lavigueur asked the presenter to leave the meeting and moved on to the next topic on the agenda. Later in the year, the Vice President and Controller, Yves Milette, presented a revised budget to the Board of Directors that forecast an operating loss of \$82 million for fiscal 1983, slightly more than the previous year's.

When provisions for loan losses were tallied at the end of fiscal 1983, the total was \$76.1 million, \$0.7 million higher than the Economics department's \$75.4 million forecast rejected early in the year at management committee. FBDB recorded an operating loss of \$81 million of which \$62 million was attributed to the lending operation. The Bank had not yet turned the corner on losses, despite controlling risk levels on new loans, cutting new loan authorizations by over 50% and reducing lending staff by 31% between 1980 and 1983.

During the next year, fiscal 1984, the economy started to show signs of recovery. Prime lending rates at chartered banks had declined to the 11% level and there was 2.6% real growth in gross domestic product. But employment lagged and the unemployment rate in Canada climbed to 12% that year. As a consequence, FBDB lending volume was still on a downward slope. Further, the recession that had gripped Eastern Canada between 1980 and 1982 was now moving westwards as the Prairie and British Columbia regions continued to experience fallout from the National Energy Program of 1980, which curtailed oil and gas exploration in the western provinces, and a general weakness in resource industries.

The 1983 mandate required the Bank to cover its operating expenses with net interest income and to contain provisions for loan losses within the \$50 million

level that the government had agreed to fund. From the government's point of view, it was putting a lot of money into FBDB and wanted assurances the new mandate would be respected. It certainly did not want to see its money going down the drain.

To monitor the Bank's progress, or lack thereof, in pursuing its new mandate, the Treasury Board of Canada directed the Bank to report on actions it had taken to contain losses on term loans within the approved level of \$50 million a year. They also wanted reports detailing how the new investment banking and financial planning programs would be designed and implemented. And they wanted quarterly financial reports. So with the new mandate came new reporting to the government, which in itself could be a mini-industry, especially when government officials started asking for explanations of explanations of various issues. An explanation would often lead to having to submit a new ongoing report. It was once calculated that being a crown corporation could add as much as 20% to overhead costs due to the additional paperwork and procedures necessary to comply with rules and regulations for conducting government business.

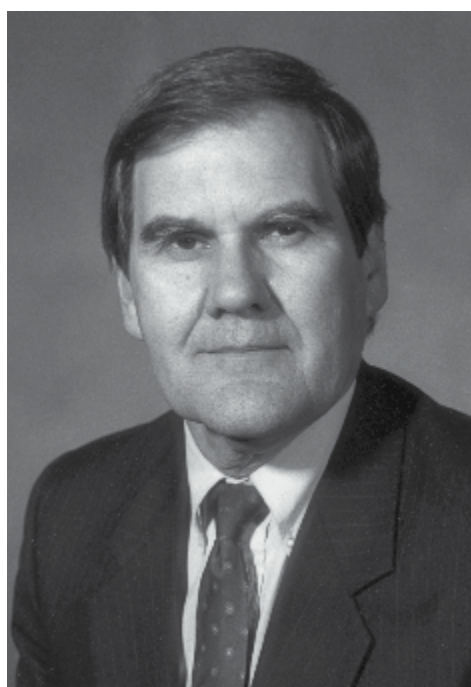
Perhaps even more significantly, the Treasury Board determined that the new infusion of capital to FBDB would be budgetary in the accounts of Canada. This change meant it would be more difficult for the Bank to get equity capital from the government. Previously, capital payments to the Bank were classed as "non-budgetary," meaning they were not part of the government's annual budgets and therefore did not affect government deficits. As non-budgetary payments, they were seen as investments which had value and this was the case with FBDB until 1980 when the Bank started to post operating losses. Being in the budgetary system now meant the Bank had to compete with all government departments for funds. This occurred during a time of growing government deficits and expenditure cuts.

For the first year of its new mandate, fiscal year 1984, it was clear the Bank's lending operation would not be able to contain its loan losses within the \$50 million level and would barely be able to cover its operating expenses with net interest income due to a rapidly declining portfolio. If trends continued, it would not be able to cover its operating expenses the following year. Not wanting to spring any surprises on the government at the last minute, the Bank put forward a number of alternatives to deal with a potential scenario wherein it would not be able to respect its new mandate. The first alternative was to relax the financial conditions of its less than one-year-old mandate. The second called for a major expansion of the Bank's management services, including the new Financial Planning Program scheduled to be implemented in only a few test branches. This proposal would have involved a transfer of about 200 staff from term lending to the Bank's Management Services Division as well as the division taking over some branch offices. Another alternative was to relax the supplemental constraint placed on the Bank's term lending operation to allow access to more profitable loans. This alternative would have required a change in the FBDB Act which, though not feasible at the time, highlighted the difficult mission the Bank was pursuing – heroic if

not impossible in the words of the SBFR. The Bank's various proposals fell on deaf ears. The only offer coming from Ottawa was that FBDB could lend the Department of Regional Industrial Expansion some officers to help clear up a large backlog of applications in its programs. The Bank had to figure out itself how to meet the financial conditions of its new mandate.

### **Bringing down operating costs**

In 1983, Rupert Williams was in Winnipeg as Vice President and Regional General Manager for the Prairies and Northern region, having succeeded Ray Wheeler who previously held that position. One afternoon, he received a call from Ken Neilson, Vice President of Human Resources, who told him the President would like to see him the next morning in Montreal.



Rupert Williams became the Bank's Vice President, Human Resources in 1983.

Williams flew in on the red-eye flight and was at the Bank's head office in time for his 8 a.m. meeting. On the way up to the 6<sup>th</sup> floor at the Bank of Canada building to see Lavigne, he ran into his superior, Eric Scott, who asked him what he was doing in Montreal. Williams admitted that he did not know the purpose of his meeting. A deep fear in Williams' mind was that he was being called in to get his termination papers. At their meeting, Lavigne told him Ken Neilson was moving to become Senior Vice President Loans and he wanted Williams to replace Neilson as Vice President, Human Resources. Lavigne apprised him of the challenges he faced as the Bank had no choice but to return to full cost recovery very soon and that meant bringing operating costs down to 3% or less of loans outstanding, as allowed by the Cost Recovery Equation which set out the following targets for the loans operations:

**Table 2** FBDB Cost Recovery Equation

	% of Average Outstanding Portfolio
Interest Spread	3.5%
Sundry fees	0.5%
Free Equity (10:1 D/E)	1.0%
Net Interest Income	5.0%
Operating Expenses	3.0%
Provision for loan losses	1.5%
Net Income	0.5%

These were the minimum objectives to achieve cost recovery. The interest spread comprised 3.0% built into the Bank's base rate, that is, the spread over the cost of funds as established by the Bank's treasury operation. Loan operations were expected to add a minimum 0.5% on average as a risk premium to arrive at an interest spread of 3.5%. Sundry fees included standby and prepayment fees. The 10:1 debt/equity (D/E) ratio and free use of capital in effect added about 1.0% to interest income. Operating expenses were set at 3.0% because for most of its history, the Bank had operated at less than this ratio and only surpassed it in the late 1970s and early 1980s. This left 1.5% of outstanding amounts for loan losses. (This 1.5% of outstanding amounts on an annual basis is equivalent to a 6.5% ultimate loss rate. That is, for every \$100 lent, the maximum loss that could be accommodated would be \$6.50.) By coincidence, the 1.5% per annum rate was the same rate that was foreseen in 1944 for FBDB's forerunner, the Industrial Development Bank. Remember that when IDB was being created, the Deputy Minister of Finance thought IDB would take more risk than private sector banks and he proffered a loss rate of 1.5% per annum, or about double that of chartered banks. At this rate, he projected IDB would still be able to post a modest profit. It was time for FBDB to get back to basics.

In fiscal 1983, net interest income from the loans operation represented 4.4% of average amount outstanding. The mismatching problem, as will be described later, was still having a negative impact on net interest income. Operating expenses however, represented 3.8% of average amount outstanding while provisions for loan losses accounted for 4.0%.

The monies the government had set aside to cover loan losses, up to \$50 million a year, was considered by the Bank to be a temporary measure that could not be depended on indefinitely. It was Neilson's job in his new role to bring the loans portfolio back in line with the cost recovery objective of having loan losses within 1.5% of outstanding amounts. And it was Williams' job, as Vice President of Human Resources, to reduce operating expenses to less than 3% of outstanding amounts. Concurrently, the Bank had to implement its new mandate

calling for a new Investment Banking operation and expansion of management services offerings to include the Financial Planning Program and the federal government's small business information centre.

When Williams assumed his position, the first thing he did was to solicit ideas from the regions on how the Bank could go about reducing its costs. The regions had just completed a round of staff reductions and were not prepared to do more. Suggestions such as cutting travel and long distance telephone calls were readily offered. The Bank had already reduced its term lending staff by 31% between fiscal years 1980 and 1983 by 'cutting the fat' in the organization. Now there was no fat left to cut, only muscle tissue. With few viable options coming from field operations, Williams gathered his three directors in the Human Resources department to start working on a plan of action. The three musketeers, as they were called, were part of the professionalization of the department and had been hired by Neilson. Alphonse Thibodeau was Director, Compensation and Benefits, André Millette was Director, Corporate Personnel Services and Guy Corbeil was Director, Organizational Planning and Development. Together, they came up with a plan to flatten the organization, change work methods and consolidate branch offices. They figured that with a new organizational structure, about 890 people would be needed for the Bank's term lending operation, including regional and head office functions. On paper, this was not a complicated task. Getting it done would be quite another challenge.

A head office reorganization led to the removal of the Executive Vice President's position. In its place, positions for a Senior Vice President, Loans and a Senior Vice President, Management Services were created. Ken Neilson and Gerry Ross were appointed to the respective positions. The Senior Vice President, Finance was also replaced. In a matter of days, both senior positions below that of the President had been vacated. The writing was clearly on the wall. No one in the Bank was immune to being laid off.

Lists of potential layoffs were prepared by both regional offices and Human Resources in head office. Human Resources was working solely with the results of a performance evaluation system that left much to be desired. Neilson, now in charge of the lending operations throughout the Bank, sent John McNulty to work with Human Resources staff to vet the lists of potential layoffs. When McNulty compared the lists provided by the regions with the list compiled by Human Resources, there was little overlap. The buddy system was still prevalent in field operations. Many managers had a group of colleagues with whom they had worked over the years and befriended. A manager would not offer up one of his friends (or buddies) to be laid off, regardless of that person's performance on the job. McNulty had worked in many different areas of the country throughout his career and he knew the individuals on the lists or at least had a contact in field offices he could consult – his own buddy system. Eventually a common list was agreed on and the second painful round of layoffs began. Yvonne Zacios had more assignments coming her way. In the Timmins branch, where Simone Desjardins started her career at FBDB, everyone wondered whether the coming Friday would be another Black Friday. It was always on a Friday that the regional personnel manager would come up from Toronto to visit the branch office. It meant someone in the branch was being laid off.

As in 1980, FBDB was not alone in downsizing its staff and there was much intelligence and jurisprudence on compensation packages for laid off employees. And as he had said to Neilson earlier, the President told Williams he wanted the cuts to be made at all levels of the organization, which meant head office and regional offices would have to bear their proportionate shares. He did not want 'the head to be bigger than the body.' Lavigueur also said he did not want to see any adverse media publicity about FBDB layoffs and branch closures. To this end, Williams undertook media training which proved its worth when he was called by the Canadian Broadcasting Corporation (CBC) to explain why the Bank was closing branch offices in the Edmonton area. It was obvious employees were contacting the media to look into the Bank's actions.

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## The arrival of new information technologies in the workplace helped flatten the organization and facilitated the introduction of new work methods.

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This time around, the task of reducing staff was complicated by obligations to meet federal targets under the Official Languages Act and the Employment Equity Act being implemented in all government departments and agencies, FBDB included. The federal government had designated areas of the country where its departments and agencies had to provide bilingual service. FBDB had a good inventory of bilingual employees but they were located mostly in the Quebec region. So while laying off workers in some areas, the Bank had to concurrently backfill positions with bilingual employees. What made this process more difficult was persuading staff to change locations, especially to 'high rent' areas such as Toronto and Vancouver. The Bank tapped into the Runzheimer system which provided information to businesses on the amount of incentives required to compensate for increases in costs-of-living due to a change in job location. But differences in costs became so high in some cases (e.g. Vancouver), even the Runzheimer system became meaningless. Getting employees to move to head office in Montreal also proved problematic in some cases, partly due to provincial laws governing the language of education for children.

The arrival of new information technologies in the workplace helped flatten the organization and facilitated the introduction of new work methods. Word processing and a primitive, early form of email meant productivity gains could be

made in office processes. This evolution kicked off a whole new support service in the Bank, in-house training, as everyone had to be trained in the new work methods and desktop computer technology (no laptops yet). New work methods also meant the Policy and Procedures (Red Book) had to be continually changed, in itself a complicated procedure due to the numerous sign offs required.

Moving from a total term lending staff of 1,473 in March 1983 to the objective of 890 could not be done overnight. It took many tranches of layoffs over a three year period to reach this target. During this time, it was often hoped the layoffs were at an end. Then, soon after, another round would begin. (Recall that the Bank had already gone through several rounds of staff reductions during the three previous years, from the March 1980 level of 2,136 employees in term lending.) As the workplace environment was being transformed, the Bank's senior managers kept an eye on who was adapting well to change and who wasn't. They would try to assist those having problems adapting but in many cases such employees wound up on a subsequent list of layoffs.

Again, the toughest aspect in laying someone off was the human one. As the vice president in charge of the downsizing, Williams had to live through several disheartening phone calls. One was from a spouse of a laid-off employee who spoke of kids in university. He would also receive calls late at night only to find no one on the line when he answered. One morning he arrived to find a notice on his office door: Out the Door in '84.

In the three fiscal years – 1984, 1985, and 1986 – branch office staff declined from 924 to 595, a reduction of 36%. Over the same period, regional office staff decreased from 227 to 97, a 58% decrease, and head office staff went from 322 to 199, a 39% decrease. At head office, many professionals hired in the post-1980 period were de-hired. The Planning and Economics departments, who had worked together to get a new mandate for the Bank and provide the blueprints for the new services that came with the new mandate, at one time counted over 20 people on staff. By the end of fiscal 1986, there were 7. In the Controllers department, there were about 75 people on staff at one time. By progressively changing work methods and reducing layers of management, the department's staff was reduced by over 50%. Among all support functions, these questions were part of the daily mindset: is there a way of doing things more efficiently? Why are we doing these tasks, for whom and for what purpose? What if they were not done?

As illustrated above, regional offices endured the greatest reductions. This was due to a major reorganization in 1985 which removed the assistant general manager position. In its stead, a district office was created, headed by a District General Manager (DGM) to bring decision-making closer to the client. The DGM was in charge of the district office, which doubled as a branch office, as well as other smaller branches within the district. The DGM was assisted by a District Manager, Loans and given higher loan authorization limits. A position of District Manager, Management Services was also instituted in the district office.

In total, FBDB term lending staff declined from 1,473 in fiscal 1983 to 891 in fiscal 1986, a 40% cut. This was in addition to the 31% cut between 1980 and 1983. At the height of the layoffs, job security became a foreign concept for everyone

in the Bank, regardless of level in the organization. Like in other corporations going through the same fallout from the recession, company loyalty waned along with trust in co-workers, team spirit and socializing. Christmas parties were no longer fun events and the head office party was cancelled. On entering the office each morning, FBDB employees would look around and wonder who would be next. Many felt that with so many layoffs, the Bank might as well be closed. But in Williams' mind, the downsizing had to be done to make the Bank a viable institution, saving 900 jobs in term lending plus another 340 in management services and venture capital. The whole process took a toll on Williams but he was commended by the Board of Directors and promoted to Senior Vice President, Management Services. He was succeeded as Vice President, Human Resources by André Millette who soon after left the Bank. Another professional hired from outside the Bank had left the building.

### **New performance management system introduced**

At the start of the second round of layoffs in 1983, glaring weaknesses in the Bank's employee performance evaluation system had to be fixed. The system was woefully inadequate in measuring job performance. To this end, a Performance Management Process (PMP) was introduced. This evaluation system called for quantifiable, measurable objectives to be set for operational staff, including branch managers. It was difficult to have quantifiable objectives for support staff, but work objectives still had to be established for each employee against which performance could be measured. The former Male Officers Performance Evaluation and the Administrative Staff Performance sheets of the 1970s gave way to a more effective, standardized performance evaluation system. Assessments such as the aforementioned 'he is a good family man' and comments on neatness and punctuality were relegated to history.

The PMP was a major cultural change for the whole organization. Sitting across from a subordinate staff member and telling him or her "here is what you did well and here is what you did not do well" was not an easy task for managers. In the good old days, many managers would merely inform their subordinates of their salary increases without any discussion about job performance. The regional vice presidents also resisted being included in the PMP evaluation process. "After all, we all know what we're supposed to do so we don't need this process for us." If these were not the exact words offered by a regional vice president, they were pretty close. This is not a knock against FBDB's previous approach to evaluating employees since it was standard practice in private sector companies at the time. This was the era of three-hour martini lunches and expense accounts for the managerial class.

Pierrette Blanchette of Human Resources worked on the implementation and improvement of the PMP evaluation system throughout FBDB. Since the system was new to the Bank, FBDB managers, being innovative, applied PMP in ways that suited them best. Blanchette dealt with situations where a manager would write the objectives and evaluations for subordinate staff members but not show them their PMP report. In the early stages of PMP implementation, it was not written anywhere that employees had to sign off on their objectives. Thus a manager, in



keeping with the traditional way of doing things, would only deliver the news of a subordinate's salary increase without discussion of their performance evaluation. Then there would be the more common occurrence where the manager would tell a staff member to write the evaluation, promising to read and sign it.

In the PMP system, each Bank employee was rated on a scale of 1 to 7; the lowest rating of 1 meant you were next out the door while 7 was reserved for only the very best of the best. There was a direct relation between performance rating and salary as the salary range for each position was split into seven rates. If an employee was rated a 1, that person's salary would be at the bottom of the salary range. If rated a 2, the salary would be one-sixth up the salary range, a 3 rating would be two-sixth up the range, a 4 rating would be at the middle of the range and so on. With salary levels tied directly to performance, there was a natural tendency to rate everyone as high as possible. Furthermore, if an employee's rating dropped from one year to the next, that person's salary would remain at the same level and would not be reduced. Game theorists could have a great time playing the system.

For frontline staff with measurable, quantifiable objectives, it was difficult to over-rate their achievement. But for those with non-quantifiable objectives, there was a natural tendency towards higher ratings. This, however, was dampened by the amount of money available for salary increases. In effect, the amount available for salary increases largely determined the distribution of performance ratings within a staff group. Perhaps not unexpectedly, administrative assistants to vice presidents seemed to have the highest average performance ratings year in, year out.

In the end, despite the challenges and difficult circumstances, the Bank succeeded in modernizing its human resources' management tools while effecting organizational changes and significant staff reductions. Further challenges lay ahead as the Bank's existence would again be called into question.

1984

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# Rock bottom

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FBDB narrowly escapes near death during a review of federal programs undertaken by the newly elected government.

**F**BDB loan authorizations bottomed out in fiscal 1984. During the year, only 1,663 loans were authorized for \$237 million on a net basis (gross loan authorizations less cancellations and reductions). This was an abyss compared to the heydays of fiscal 1980 (only four years earlier) when 13,803 loans were authorized on a net basis for \$663 million. The Bank's Ontario region experienced the largest decline, 92% in the number of loans and 76% in amounts authorized between fiscal 1980 and 1984. Not only did the Ontario region authorize only 8% of the number of loans it had authorized four years earlier, but with more than a third of Canadian economic activity, it authorized fewer loans than both the Quebec and British Columbia and Yukon regions in fiscal 1984. It was not surprising then that FBDB's relevance was often publicly questioned by Members of Parliament (MPs) from Ontario, the most vocal of whom was Don Blenkarn, Conservative MP for Mississauga.

Operating losses continued as the Bank recorded a loss of \$64 million for fiscal 1984, a reduction of \$17 million from the previous year, but still a huge loss. Almost all of this loss, \$63 million, was in the term lending operation with provisions for loan losses at \$72 million. FBDB operations in Alberta and British Columbia accounted for three-quarters of these losses as the recession shifted westwards. In fiscal 1984, the Government of Canada lived up to the commitment it made in the Bank's new mandate of 1983 and paid-in \$50 million to offset loan losses and another \$6.6 million to fund new investments by the Investment Banking Division.

With its crown corporations requiring increasing amounts of funding, the Government of Canada passed a new bill to exert further control over their activities. Amendments to the Financial Administration Act introduced a regime of annual corporate plans to be submitted for approval by the government. It also stipulated special examinations of crown corporations had to be conducted every five years and the Auditor General of Canada would be the auditor for almost all crown corporations, including FBDB.

FBDB's first corporate plan was sent to the government for approval in the spring of 1984. At the time, there were no indications of a major turnaround in the Bank's fortunes. The plan therefore showed an operating loss not only for fiscal 1984, but for all five years in its forecast, albeit on a declining basis. It also showed the Bank adhering to the financial strictures of its 1983 mandate which was to cover its operating expenses with net interest income and to contain provisions for loan losses to under \$50 million each year. The forecast of continuing losses was made even though the Bank's objective was to return to full cost recovery as quickly as possible. Being conservative in its forecasts ensured funds put aside for FBDB in accordance with the 1983 mandate would still be there if the Bank needed them. Otherwise, these funds could easily be snapped up, 'faster than the blink of an eye' by another government program.

FBDB reported to Parliament through the Minister of Regional Industrial Expansion (DRIE). The Minister of DRIE was assisted by Ministers of State, including the Minister of State for Small Business. In May 1984, Ministers were concerned about services to small business provided by both DRIE and FBDB. The Department did not have a small business focus while FBDB, though

strategically located, was not helping small business with its high interest rate loans. Furthermore, FBDB's large decline in financings and its requirement for continued government funding were of concern. Ministers wanted to see much more cooperation between DRIE and FBDB in serving small business, an important constituency and plank in any political platform. DRIE had programs and funding but not the human resources and locations to service small business. FBDB had locations and excess human resources in 1984 but no funds.

DRIE officials started working on two major initiatives involving FBDB. The first was to consider FBDB as the delivery agent for the department's flagship program, the Industrial and Regional Development Program (IRDP). Under this initiative, FBDB officers would process applications for IRDP funds, do any necessary investigation and provide a report to senior DRIE officials who would make the final decision on the application for funding. This initiative, however, would have involved major organizational changes as well as dealing with opposition by DRIE employees whose jobs would be affected. The initiative got nowhere.

The other major initiative was to co-locate FBDB and DRIE offices and officers. Officials in the department reported that the Minister, the Honourable Edward Lumley, wanted co-location of offices or at least that offices be located in the same building. Co-location of offices and officers was opposed by the Bank, although not openly. Lavigne did not want FBDB officers working shoulder to shoulder with departmental officials who had a different culture, work habits and, most of all, higher salaries. But this was the Minister's wish, so planning started down this path with departmental officials looking at potential moves when current office leases expired. The last phrase (when current office leases expire) was a condition FBDB insisted on as it could ill afford to break lease agreements and pay associated penalties. The proposal to co-locate DRIE and FBDB offices and officers was the subject of many discussions but was not implemented. It would, however, come to the fore again in the late 1980s. The old IDB would never have cooperated with such manoeuvres but then again, that is why it was pulled out from the Bank of Canada.

In mid-1984, encouraging signs of the long sought turnaround in FBDB's financial health suddenly appeared. The economy continued on the growth path started a year earlier. As a result, business capital expenditures were on the increase and so was the demand for commercial loans. Chartered banks reported increases in business loans under \$5 million. The same occurred at FBDB, as new loan authorizations were running ahead of budget. Jim Scopick, the newly appointed Senior Vice President, Finance and Planning, reported to the Board of Directors that operating losses for the first four months of the fiscal 1985 were \$4 million versus a budgeted \$16 million. Most importantly, loan losses were on a steep decline. Only 8 accounts were downgraded to categories 3 and 4 within 12 months of authorization compared to 67 accounts a year earlier. Previous analyses had shown downgradings within 12 months of authorization were a key indicator of loan quality and performance. This was cause for optimism. However, the first FBDB corporate plan, the official record in Ottawa, was more cautionary, showing continued operating losses for the next few years.

In September 1984, a federal election was held and the Progressive Conservative Party of Canada, under the leadership of Brian Mulroney, recorded a resounding victory, electing its candidates in 211 out of a total 282 electoral ridings across Canada. The party won 54 of 75 ridings in Quebec, Mulroney's home province. In the previous federal election, Conservatives had won only one riding in the province.

Based on past statements by Conservative MPs as well as FBDB's experience with the previous minority Conservative government in 1979, the Bank knew it was not in a good position, especially given its record of continuous operating losses. Remember that in 1979, the previous Conservative government had wanted to examine the option of privatizing FBDB. Also, while in opposition during the 1980-1984 period, several MPs were outspoken in their opposition to FBDB. Chief among them was Don Blenkarn who had been finance critic for the Conservatives while in opposition. After the September 1984 election, it was expected in some quarters that Blenkarn would be appointed Minister of Finance, a position that would give him a major say in FBDB's fortunes. He was not. Michael Wilson of Toronto was appointed Minister of Finance and Blenkarn was appointed Chairman of the House of Commons Finance Committee. Nonetheless, as Chairman of this powerful committee, he had a major influence on economic matters.

The Honourable Sinclair Stevens was appointed Minister of Regional Industrial Expansion and André Bissonnette, Minister of State for Small Business. Bissonnette was elected in the St. Jean riding of Quebec. He was an entrepreneur and the first thing the Bank did was to search its loan files to determine whether he had ever been a client of the Bank. He had not.

Immediately after taking over the reins of government in Ottawa, many Conservative MPs called for the closure of FBDB. In his several meetings with Lavigueur, the Honourable André Bissonnette leaned towards supporting FBDB but the tide of opposition within the Conservative caucus was too strong to withstand. He told Lavigueur that opposition to the Bank was intense but did commit to organizing a meeting between the Bank and Conservative caucus members. This would be the forum for the Bank to put its case directly to the MPs calling for its closure.

The meeting was quickly arranged. It started after 9:00 pm one October 1984 evening at the top floor of the Metropolitan Life building in Ottawa. Lavigueur arrived with his Ottawa team and a presentation on the past and current situation of the Bank was made. It emphasized the number of small businesses supported by the Bank each year – over 100,000 – mainly through its business information and other management services, and the numbers of jobs its loan clients were creating and maintaining throughout the economy, especially in non-metropolitan areas. The Conservative Members of Parliament in attendance – Blenkarn was not there nor were any Cabinet Ministers except for Bissonnette – were polite and seemed somewhat impressed with what the Bank was doing. This was probably the first realistic briefing they had ever received about the Bank. But at the end of the night, most still maintained their view that less government was better government. In their minds, the new Conservative government was elected to reduce the size of government in Ottawa and that was what they were going to do.

Later on, Lavigueur would meet with Don Blenkarn in the latter's role as Chairman of the House of Commons Finance Committee. Michel Azam, the Bank's Vice President of Government Relations was also present. Blenkarn repeated his view that the Bank should be closed and intimated the President should not fear for his own job as another would be found for him in the government. Of course, Blenkarn did not know that the last thing Lavigueur wanted was another job in government. He firmly believed in the work FBDB was doing for small business and that the Bank could return to a profitable status as economic conditions improved.

### **The Nielsen Task Force**

On the first day after taking office, Prime Minister Mulroney had announced that the Deputy Prime Minister, the Honourable Erik Nielsen, would be heading up a Ministerial Task Force on Program Review. The Task Force was to review all government programs and regulations and come up with a list of program closures and expenditure cuts. Unlike many conservative MPs who entered Parliament for the first time in 1984, the Honourable Erik Nielsen was a long serving MP from the Yukon. He had been an irritant for the previous Liberal government each day Parliament was sitting and his stinging questions and remarks during Question Period had made him a household name across Canada. The Nielsen name was already famous. His brother, Leslie Nielsen had made his fame (and fortune) on Hollywood screens, notably as the star of the Naked Gun series. Erik Nielsen made his fame on Parliament Hill.

Cutting government expenditures was not new to Ottawa. Each successive new government since the 1970s would announce expenditure cuts and salary freezes at the start of its mandate. And after those cuts were announced and implemented, somehow the government's deficit and debt still grew. With the arrival of a majority Conservative government however, officials in Ottawa knew cuts were going to be deep and permanent. Many feared for their jobs.

The Nielsen Task Force, as the Ministerial Task Force on Program Review quickly became known, was a committee of Cabinet Ministers of major government departments. They were charged with overseeing a number of study groups that would evaluate and make recommendations on almost all government programs and regulations. They would vet the study groups' recommendations and take them to the full Cabinet for approval. Conservative MPs opposed to FBDB saw the Nielsen Task Force as the vehicle for closing down FBDB.

### **The FBDB Study Group**

The study group reviewing FBDB was called Services and Subsidies to Business. The group comprised a leader, an associate leader, and two-person teams that evaluated the full range of federal business programs. Each team typically comprised one person from the private sector and one person from the public sector. The Prime Minister had asked the business community to volunteer senior managers from industry to work on these study groups and to pay their salaries and expenses while they were working in Ottawa. The business community graciously complied with the request.



Donald Layne, head of Lavigueur's Economics department and author of this book.

The Services and Subsidies to Business study group was led by Harry Swain. Jack Walsh, a vice president at DuPont Canada representing the private sector, was associate leader of the group. Just prior to this assignment, Swain had been Assistant Deputy Minister, Plans, in DRIE. He knew the ins and outs of all business programs in his department as well as those in other departments with which DRIE competed for financial resources each year. He called Lavigueur and requested the Bank to volunteer someone to work in his study group. Of course that person could not be assigned to the FBDB file. Knowing it would be beneficial to get information from the inside on how FBDB's file would be handled, Lavigueur sent Donald Layne, the head of his Economics department, to work with the study group in Ottawa.

In the fall of 1984, there were 57 different subsidies and 155 programs providing services to business in Canada. The 57 subsidy programs cost a total of \$4.5 billion in grants and contributions, \$7.7 billion in federal revenues, and directly involved 11,440 person-years of staff. The 155 service programs cost \$713 million in grants and contributions and directly involved 56,860 person-years of staff. Their salary bill alone was \$1.9 billion a year and another \$1.5 billion was spent in other operating costs. FBDB's term lending operation was costing the government a maximum of \$50 million a year at the time.

The mandate for the study group on Services and Subsidies to Business – hereafter referred to as the Study Group – was clear. It was to review a chosen list of programs and provide advice to the Ministerial Task Force regarding programs that might be eliminated, programs that could be reduced in scope, groups of programs that could be consolidated, and programs whose basic objective was sound but whose form should be changed.

All FBDB services to business were to be reviewed. The cost to the federal government for FBDB, even with its losses in 1984, was miniscule compared to the vast array of programs whose costs are cited above. Yet, it received perhaps the most attention among all the programs reviewed by the Study Group. The reason for this attention was clear. FBDB had a relatively high profile and was a favourite target for many Conservative Members of Parliament, even before they were elected in the September 1984 federal election. Further, there were still lingering doubts in DRIE about the need for FBDB, especially given the \$50 million of budgetary appropriations set aside each year for FBDB at a time when there was fierce competition for funds among and within departments of government.

Doubts about FBDB's role had re-emerged in a review of small business policy and programs conducted by DRIE just before the Study Group started its work in 1984. When DRIE did its review, the Bank was not consulted and was unaware another review was being done by the Department. The DRIE small business review returned to the table the issue of whether there was still a financing gap faced by small business in Canada. It seemed the first version of the Small Business Financing Review (SBFR) findings from 1981 was still alive and well in the Department. The DRIE review noted the SBFR failed to detect any major financing problem. Furthermore, the SBFR had suggested that other federal and provincial measures plus the increasing attention by private sector institutions to small business financing needs meant small businesses were reasonably well served. The DRIE review concluded that the rationale for FBDB's financial services had diminished considerably.

From a policy point of view, the DRIE review suggested a shift in emphasis from measures designed to make term loans easier to obtain or to improve cash flow by lowering tax rates, to measures directed towards improving the environment for small business; for example, aiding small business to participate in large projects, reducing red tape and regulation, encouraging innovation and export promotion, etc. Would DRIE's own Small Business Loans Act program be affected by this change of emphasis? The review saw the \$23 million annual cost of the SBLA program as a marketing subsidy to the banks using the program and that its macro effect was small. But it concluded the SBLA program ought to be renewed (extended) the following year if changes were made to FBDB.

DRIE's small business review provided options for the future of FBDB's financing portfolio and the small business counselling service. Citing again an SBFR conclusion that there was no evidence of unsatisfactory financing service to the small business sector, the first option put forward was to sell FBDB's \$1.6 billion loan portfolio, at a discount if need be. A major benefit of this option was that the substantial capital employed by the Bank could be put to higher priority use. This option also meant separating the counselling services of FBDB and finding a new home for them. The DRIE review went further and considered the process for implementing such a move. It recommended the government make a statement of intent in a Throne Speech or early budget, to be followed shortly after by the Minister of DRIE announcing evaluation criteria and the bidding process for the sale of FBDB's loans and venture capital portfolios. Further, under this scenario, the government would arrange House of Commons business so that the power to



sell part of FBDB and wind up the rest of the Bank, and the power to bring FBDB employees into the Public Service of Canada through a priority but competitive process, could be done early in the new session of Parliament.

Selling FBDB's financing portfolio was one option. The other was to let FBDB continue its financing activities but under more stringent guidelines to reduce losses. The rationale for this option was based on the notion that selling the portfolio would put FBDB's clients at a disadvantage. But the DRIE review went on to say this argument, while plausible in terms of optics, was not totally valid as small businesses would continue to be well served by the SBLA program, provincial programs and chartered banks as well as by the financial institution that purchased the FBDB portfolio.

With respect to the Bank's counselling service, the DRIE review favoured increased emphasis on counselling and delivery of relevant commercial intelligence and information on government programs. The issue would be where to place these services. If FBDB were to continue its financing services, they would remain with the Bank except, to signal a change, the Bank would be renamed Enterprise Canada (that name again). If FBDB financing activities were to be terminated, then the counselling service could be set up as a distinct crown corporation or be given to DRIE to administer through its regional offices. The former option was considered more attractive as it could then be structured to become a one-stop centre for many federal business services, including those of Revenue Taxation and the Canada Employment and Immigration Commission. It would also mark a clear delineation between advice to business (Enterprise Canada) and financial assistance to business, thereby eliminating potential conflict of interest. FBDB was seen as having a mild conflict of interest in acting as both advisor and lender to businesses.

The DRIE review concluded the preferred option was to sell the FBDB financing portfolio and establish a new, independent small business advisory agency. Under this scenario, the government would receive \$200 million from the sale of the portfolio and cancel annual payments of \$50 million for loan losses, the amount set aside for FBDB as part of its 1983 mandate. For such a major initiative to have been proposed, there must have been some indication that the Minister of DRIE would be on board.

When the Nielsen Task Force's Study Group on Services and Subsidies to Business did its work on FBDB, it had the DRIE small business review in hand. The Study Group did not have the time or resources to do any in-depth research of its own. It had to rely on external sources for data and analyses. The DRIE small business review had a major influence on its findings.

The two-person team in the Study Group handling the FBDB file split its review along the Bank's principal product lines: term loans, investment banking, financial planning, CASE counselling, management training, and business information services. The main focus, as could be expected, was on the Bank's term lending operation. The other Bank services were reviewed but options for their future evolution were dependent on the outcome for the term lending operation.

With respect to FBDB's Financial Planning program, the Study Group recommended that pending the outcome of a program evaluation currently being done, the government should consider restricting the planning service to 20 branch offices and increasing the price for these services to reflect the costs of providing them, that is, increase their cost recovery rate. If the government moved to implement a one-stop shopping service for small business, the Study Team saw this program as an integral part of the services provided. An alternative was to allow the program to lapse after its two-year trial period.

With respect to the Bank's CASE counselling program, the Study Group noted wide acceptance amongst users and quoted from an evaluation carried out for the Bank by Cousineau Professional Services. This is the same (Guy) Cousineau, formerly of Peat Marwick Associates, who produced the Peat Marwick report for FBDB at the time of the 1981 Small Business Financing Review. The Cousineau evaluation found the CASE program was generally judged to be of excellent quality, although it needed to be refined to delineate its activities to avoid supplying counselling to those who could afford to pay professional fees. The Study Group extended this thought to question whether the government should be providing a service to small business available from the private sector, albeit at a higher cost. After analysing different alternatives, it concluded that the CASE program was the least-cost alternative available to government. When the study team interviewed the Canadian Federation of Independent Business (CFIB) and the Canadian Organization for Small Business (COSB), both private sector lobby groups were very positive in their attitude towards the CASE program. The Study Group recommended that the program increase its cost recovery and that repeat users, able to pay, cover the full cost of the service. The Study Group did not offer suggestions on how to determine ability to pay.

With respect to the Bank's Management Training program, the Study Group again saw the need for these workshops and seminars and called for regular consultations with provinces and industry associations to ensure no overlap with the services offered by these groups. It also called for increased cost recovery for the program and cited it as one that would fit well in a one-stop shopping concept.

In terms of the Bank's Business Information service, the Study Group saw dissemination of information on government assistance programs for small business as a necessary service. But FBDB was not alone in delivering such information as many federal and provincial agencies provided this service in one form or another, though on a specialized basis. The Study Group noted that the Bank's Automated Information for Management (AIM) system was still in its developmental stage but was potentially a very powerful tool that could be of great benefit to business and government alike. It recognized a considerable amount of work remained to be done refining the software. Little did anyone know the Bank was way ahead of its time in trying to build a search engine in 1985. The Study Group recommended FBDB be made the primary stop for businesses seeking information (and advice) on federal business programs.

The foregoing recommendations and options for the Bank's various management services and the future of the investment banking service depended on what the government decided to do with the Bank's term lending operation. In reviewing the term lending operation, the Study Group's report aptly reflected the mandate and activities of the Bank. For example, it recognized the Bank was relatively more active in less-developed regions of the country; its 22,000 clients were employing between 250,000 and 300,000 persons with almost a third of these being young people under the age of 25; in comparison to chartered banks, FBDB's term lending was more concentrated in the service industry and offered more loans for working capital, equipment and leasehold improvements; and FBDB offered longer repayment terms, etc. It also noted there were three principles governing the loans operation that obliged the Bank to operate on a knife's edge. These principles were to provide financing not otherwise available on reasonable terms and conditions, to recover its operating costs, and to not compete with private financial institutions. The report then quoted from the Small Business Financing Review that found it was difficult to avoid the conclusion that either the Bank's mission must be changed or constraints released or both. Like DRIE's small business review, the Study Group questioned the necessity of the Bank's term lending mission and observed that the evidence was not conclusive. The SBFR had found that with the measures the federal government had in place and with increasing attention paid to the financing needs of small business by private sector financial institutions, most small businesses were reasonably well served. Another reference taken from the SBFR was that the weight of available evidence suggested the market niche available to FBDB had shrunk and would likely continue to shrink.

As part of the Nielsen Task Force process, the teams reviewing the various programs would meet with senior officials in charge of the programs as well as interested parties in the private sector. The team and its leaders met with Lavigueur in Montreal to get his views on the Bank's situation and to verify the data they had on FBDB. (Lavigueur had been briefed beforehand by his member on the Study Group, who, when he had tried many times to intercede in the discussions surrounding FBDB, was reminded of his conflict of interest.) The team came away impressed with Lavigueur's presentation of the issues. The team also sought input from the CFIB and COSB, the presumed spokespeople for small business. While both were supportive of the Bank's management services, they were critical of the term lending operation. CFIB, COSB and individual business people contacted by the study team all questioned the need for FBDB's loans operation.

The Study Group considered (it did not conclude) there was no longer a general need for the federal government to provide direct financial services to small business through the loans operation of FBDB. However, it noted that if FBDB were to continue its loans operations, consideration should be given to utilizing FBDB to deliver other federal lending programs. Mentioned as candidates were lending programs in two departments, Fisheries and Oceans and Indian and Northern Affairs. Also mentioned was the Farm Credit Corporation. And if it were decided to close FBDB's lending operation, the Study Group thought the operation of the Farm Credit Corporation should also be questioned, even though this corporation was not included in its area of review.

### **Study Group conclusions**

In the final report to the Nielsen Task Force, the Study Group reported the team was of two minds about FBDB's future. On one hand, there were the conclusions of analyses that said FBDB lending had outlived its usefulness. Further, the incompatibility of its operating objectives was eroding the Bank's credibility. Then there was the SBLA that guaranteed small business loans, recently extended for five years. These factors led to one potential option: that FBDB's lending operation should be terminated, thereby undermining its continuation as an institution.

On the other hand, the Study Group concluded a good case could also be made for keeping, even strengthening, FBDB as its bundle of services were worth more together than separately and the Bank came closer to a one-stop shop for small business than most federal institutions. This was seen as a role that could be enhanced. Further, the Bank was recognized as having reservoirs of high-mindedness and competence that should not lightly be dissipated. (This was a novel observation and of a character that could typically be attributed to Harry Swain, who wrote the summary report sent to the Task Force Ministers.) In this option, the Study Group saw an enhanced FBDB delivering other federal financing programs as mentioned earlier as well as substituting partial loan guarantees for direct loans. Being a loan guarantor would place the Bank in a position of being a partner of both the customer and chartered bank, as opposed to a competitor.

The 'of two minds' conclusion – lose it or use it, in that order – made it into the final report of the Study Group on Services and Subsidies to Business published by the Government of Canada. No recommendation was published. That came behind closed doors.

It was reported Jack Walsh, the private sector representative who was associate leader of the Study Group, decided the option to terminate FBDB lending was the option that should be recommended to the Nielsen Task Force Ministers. Jack Walsh and his private sector team had come to Ottawa to cut the size of government and this option was consistent with that objective. It was quite likely he would have discussed the options for FBDB with senior politicians in the government before coming to his decision, a decision that was supported by other private sector members in the Study Group.

### **Doomsday narrowly averted**

When it became clear where the Study Group was headed with the FBDB file, the Bank's member in the group called Lavigueur to deliver the news. Soon after, Lavigueur also received a call from Peter Meyboom who was deputy minister to the Honourable Erik Nielsen, Deputy Prime Minister at the time. Meyboom told Lavigueur that a decision to terminate FBDB term lending was going forward and he wanted to apprise Lavigueur of the decision that would in all likelihood be taken by the Ministerial Task Force. It was common courtesy for deputy ministers to inform each other of pending decisions that could affect their departments or agencies.

Given that the decision was already going forward to Cabinet, immediate action was necessary. Meeting the Minister of DRIE would have been time wasted. Instead, Lavigueur contacted the chief of staff in the Prime Minister's Office,

Bernard Roy, and apprised him of the situation. Roy quickly arranged a meeting with the Prime Minister to argue the case for the Bank. Lavigueur went to Ottawa and the Prime Minister was briefed on the impacts of closing the Bank on small businesses, the Montreal economy where the Bank was headquartered as well as all the other communities where FBDB was present. A phone call was made to the Honourable Erik Nielsen who confirmed a recommendation to close down FBDB's term lending operation was indeed on the table and going forward. Nielsen was asked not to proceed further. Following the intervention facilitated by Roy, Lavigueur returned to Montreal.

Soon afterwards, Lavigueur received a call from Peter Meyboom who, by then, had learned of the reversal of the move to terminate FBDB's term lending operation. Meyboom did not want to know how and why the decision was made. He simply offered Lavigueur his congratulations on a job well done and the call ended.

The Bank had narrowly escaped doomsday. In a postscript, Harry Swain thought the Bank was kept in business because it was seen as a Quebec institution. And though Ritchie Clark could not have foreseen this event, the words in his History of IDB were prophetic: "the decision [to locate the management of IDB in Montreal] proved to be one of those small acorns from which great oaks grow."<sup>5</sup> The oak tree was still standing and the bulldozer was back in the yard. It was speculated that had FBDB been headquartered in Ottawa, terminating its activities would have been a *fait accompli*. It would have been seen as just another government program in Ottawa being cut, with its employees placed on priority lists for job openings in other government departments – a common occurrence then and through the years of successive program reviews carried out by the federal government. At the end of the day, it was understood that the impacts and reach of FBDB were too important to the Canadian economy.

FBDB had experienced near death, an event known to very few employees at the Bank. Lavigueur had decided to keep the Nielsen Task Force deliberations under wraps. Many times after the new Conservative government was elected, he was asked by regional officers how things were going in Ottawa. Everyone knew the Bank was not held in high regard by the new government, especially when senior politicians were publicly making disparaging remarks about the Bank. And most knew of the government's desire to cut back its programs. At these encounters with staff, Lavigueur would only say that nothing important had occurred but that the Bank's staff should focus on their tasks at hand – keep their eyes on the ball. The Bank was close to its cost recovery goal and it was not the time to be distracted.

With its 'still in business' sign up, the Bank now had to build itself back to respectability and, most importantly, ensure it would never again be put in the same potentially disastrous situation.

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5 E. Ritchie Clark, *The IDB: A History of Canada's Industrial Development Bank*, University of Toronto Press, 1985; page 35.

1985 to 1990

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# Rebuilding

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The Bank turns the corner on operating losses and returns unneeded monies to the Government of Canada. FBDB develops new services (financial planning and investment banking) and decentralizes decision-making.

**B**y the end of fiscal 1985, the agony of layoffs and reorganizations, the struggles to get a new mandate and new capital, and the implementation of new credit policies began to payoff. In his annual report, Lavigueur stated: “Fiscal 1985 was a year in which FBDB returned to financial health. A sharp decline in losses, a significant increase in the volume of loans authorized and a rapid expansion of one of its more innovative services, the Financial Planning Program, made it a turnaround year for the Bank.” For fiscal 1985, the Bank declared a profit of \$932,000 before an extraordinary item of \$5.6 million related to staff cuts and administrative reorganization. Technically, the Bank had a financial loss that year but financial analysts normally discount extraordinary items, positive or negative, when looking at the fundamentals of a company’s performance. So too did the Bank in promoting its results to the public. The red ink was gone from the Bank’s books and fittingly, the colour of the cover on that year’s annual report was black.

A big drop in provisions for loan losses was the principal factor in reversing the Bank’s operating losses from \$64 million in fiscal 1984 to a modest \$0.9 million profit in fiscal 1985. Provisions for loan losses, \$72 million in fiscal 1984, declined to \$17 million in fiscal 1985. This led to a small net operating loss of \$2.2 million for the Loans Division, before the extraordinary item, that was offset by the Investment Banking Division’s first profit of \$3.1 million. (With the introduction of Investment Banking, the nomenclature Division was introduced to demarcate the Bank’s three groups of services: Loans, Investment Banking and Management Services.) The large reduction in loan losses was evidence the Bank’s tighter credit policies were taking hold but, more importantly, the Bank was aided by the Canadian economy that grew at a 5% annual rate in real terms during fiscal 1985. Economic growth remained uneven across the country and the western provinces were still in a recession as reflected by regional operating results. The Loans Division’s loss of \$2.2 million in fiscal 1985 comprised a \$0.3 million profit in the Atlantic region, a \$4.8 million profit in the Quebec region, a \$6.5 million profit in the Ontario region, a \$3.2 million loss in the Prairie and Northern region and a \$10.6 million loss in the B.C. and Yukon region.

The staff count in the Loans Division at the end of fiscal 1985 was 925, a quarter less than the previous year and 57% less from the high of 2,159 at the end of fiscal 1980. This led to a reduction in operating expenses which totalled \$55 million in fiscal 1985, or \$13 million less than the previous year. For the year, however, the key operating ratio (expenses as a percentage of loan amount outstanding) stood at 3.4%, still above the 3% cost recovery target. But there was a positive sign on this front as the annualized ratio was 3% in the last quarter of the year and projected to continue improving. The Bank had reached an important milestone. Further, with growth in the loans portfolio and reduction in costs related to the mismatch problem, net interest income comfortably covered operating expenses, thereby satisfying one of the strictures of the 1983 mandate.

The turnaround in the Bank’s financial results was the result of tough decisions and difficult choices at all levels in the Bank, in addition to hard work and sweat. While the President set the direction and goals for the Bank, it was staff at all levels who delivered the goods. As Lavigueur emphasized in his Annual Report: “the positive results of fiscal 1985 didn’t just happen. The perseverance and

expertise of the Bank's staff which has been under severe stress are responsible for the turnaround. Through a period of poor economic conditions, rapid change and large staff reductions, the professionalism of FBDB personnel allowed the Bank to come to grips with its problems and to solve them." Facing seemingly impossible situations and overcoming them has been a longstanding trait in the Bank's genetic make-up.

It was common practice in corporate annual reports for chief executives to thank all staff for their contributions to company results, usually towards the end of their reports. But in FBDB's 1985 annual report, the thank you had special meaning – it was sincere.

That the Bank had turned the corner on its operating losses was already evident in early 1985, when it was dealing with the Nielsen Task Force program review. While the Bank would point to this turnaround, it was not taken seriously. Not that it would have mattered much as ideological push and bias were working against the Bank. But to emphasize it meant what it said, the Bank returned \$15 million to the Government of Canada in March 1985. Under the terms of the 1983 mandate, wherein the government would cover loan losses up to \$50 million a year, the Bank had received \$22 million during the course of the year. With the turnaround in loan losses and growing net interest income, it was deemed only \$7 million was needed by the Bank to offset a forecasted loss of \$7 million. A cheque for \$15 million was written to the order of the Receiver General of Canada and delivered by hand to the Assistant Deputy Minister in charge of small business at DRIE in Ottawa. The accompanying letter stated that due to cost cutting measures and the improved status of the portfolio, \$15 million of the \$22 million received during the year to fund losses in the term lending operation were not needed and were being returned to the government. The cheque was gladly accepted – it likely immediately went to pay for overruns in some other programs – but there was no official or even verbal recognition of the Bank's achievement. In Ottawa, there were still lingering doubts about the Bank's turnaround. There were doubts too inside the Bank.

FBDB had endured five years of operating losses, from fiscal 1980 to fiscal 1984, before returning to profitability. By coincidence, five years of losses was what had been predicted at the outset by the Board member who had experienced first-hand a similar banking experience. Had the Bank not received capital infusions from the government during the 1980 to 1984 period, it would have been essentially bankrupt on paper. The cumulative losses suffered between fiscal years 1980 to 1984 amounted to \$295 million. At the start of fiscal 1980, the Bank had \$181 million of equity.

Although a profit was declared for fiscal 1985, there was an overhanging cloud at FBDB's Board of Directors. Many directors had been on the Board in the early 1980s and could still remember being assured by management that losses would soon end, which they did not. Now they were being assured of profits. Though not broached directly, the concern was whether loan losses would rise again. Board members recognized a rebuilding job had already started. The question was whether the foundation was laid on sand or bedrock. The cloud became darker when the Canadian Commercial Bank and the Northland Bank, both based in Alberta, declared bankruptcy in 1985. The Canadian Commercial failure was the largest bankruptcy by



a chartered bank in Canada and the first in over 60 years. These bankruptcies had a psychological impact on FBDB's Board of Directors. If the economic recession in the western provinces was having such an effect that Canadian chartered banks had to declare bankruptcy, were there more losses to surface in FBDB, a lender of last resort? FBDB's senior management was often challenged by the Board to justify that the turnaround had indeed taken hold. When Ken Neilson was asked by Yves Milette, who had moved back to the position of Vice President, Loans, to get increased authorizing limits for field and head office officers, he was told it was not the time to broach such a subject with the Board of Directors. They needed more convincing that profits were here to stay before giving out more lending authority.

Also creating angst on the Board were the losses they were seeing on large-sized loans, loans they themselves had approved on recommendation by management. They asked for a presentation on the performance of large loans. There were 25 clients in the portfolio whose loan authorizations exceeded \$5 million. Of these, 8 were in category 4, that is, in liquidation stage, and another 3 were in category 3, that is, impaired. If one looked at loans authorized for \$2 million or more, there were 78 clients in the portfolio. Of these, 10 were in category 3 and 11 in category 4. Large-sized loans were prized as they boosted the earning power of the portfolio and were considered lower risk. These numbers showed otherwise. It was estimated the ultimate loss rate for these large-sized loans would exceed 10%, well above the cost recovery objective of 6.5% established for the whole portfolio. Little wonder the Board of Directors did not want to give out higher authorizing limits to the staff.

While on the topic of large-sized loans, it should be noted that reversals of earlier provisions for losses on large loans contributed to declining loss provisions in fiscal years 1985 and beyond. Two are noteworthy. The first, a large loan authorized to a food packing company in Southern Ontario, was performing well up until the company suddenly closed down. This was surprising to the Bank as the company's audited financial statements showed it was performing very well. It turned out the audited financial statements were misleading and that the auditors, when inspecting inventory levels, would open the door of a large freezing facility and count the boxes overflowing to the freezer entrance. They assumed the freezer was completely full. They did not take the time to check what was behind the front row of boxes. A lot of space. FBDB had to take a provision for loss on the account in the early 1980s but eventually recouped a major portion of its losses from the auditors' insurance company. This allowed the Bank to reverse a portion of its earlier provision for loss on the account.

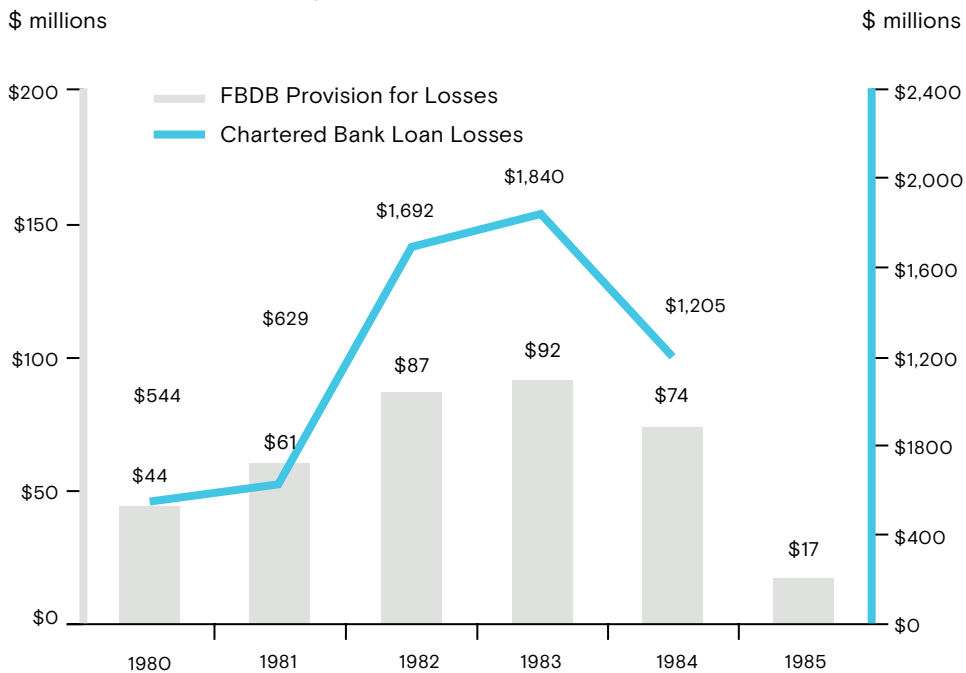
The second case involved a large-sized loan guarantee authorized to a transport company. Before the loan guarantee could be recommended, Yves Milette insisted on having the personal guarantee of the company's principal owner. This was not possible he was told, as the owner never gave his personal guarantee on company loans, to which Milette replied, there would be no FBDB loan guarantee. He stood firm and obtained the owner's personal guarantee. Not long after, the company suffered difficulties and the Bank recorded a provision for loss on its books. Later, in the company's reorganization process, the Bank's guaranteed loan was one of the first obligations to be repaid and the provision on this large account was reversed. It most likely would not have been without the

personal guarantee. Reversal of provisions for losses such as these helped the Bank return to profitability coming out of the recession.

Taking personal guarantees on its loans was important for the Bank even though, to distinguish itself from private sector lenders, FBDB would promote itself in Ottawa as the bank that would not realize on personal guarantees in the event of loan default, along the lines of ‘We don’t throw people out of their homes to collect our money.’ The official line was that these guarantees were used primarily as leverage to ensure business owners repaid the amounts owing to the Bank as much as possible. Otherwise, business owners would place FBDB, a federal government agency, at the bottom of the list to be repaid in the event of liquidation. Bank officers would refer to a case, real or imagined, wherein a bailiff threatened to seize an owner’s Harley Davidson motorcycles if his FBDB loan wasn’t repaid. The loan was quickly repaid. Though FBDB may have been less inclined than chartered banks to realize on personal guarantees, they were called on more than once to help reduce the Bank’s record levels of loan losses.

With the economic recovery underway in the mid 1980s and FBDB’s loan losses dropping sharply, it became evident the recession of the early 1980s had been the principal driving force behind FBDB’s record losses. Further, the Bank was not alone in racking up record levels of loan losses. The following chart (Chart 3) was included in FBDB’s fiscal 1985 Annual Report. It showed chartered banks also suffered heavy loan losses during the early 1980s. (They did not have a Small Business Financing Review to tell them that their losses were indicative of a shrinking market for their lending operation and all they were left with were high risk borrowers.)

**Chart 3** FBDB Provision for Losses Compared to Domestic Loan Loss Experience of Five Canadian Chartered Banks\*



\*RBC, BMO, CIBC, BNS, TD

Table 3 below shows ultimate loss rates experienced by the FBDB and its regions on loans authorized before, during and after the 1980-1982 Great Recession. Recall the ultimate loss rate for a group of loans is the amount of loss recognized for that group expressed as a percentage of the amounts authorized to that group. A 6.5% ultimate loss rate would be consistent with a break-even income position, as per the Cost Recovery Equation cited in Chapter 7.

Table 3 shows that even after FBDB had imposed stricter credit criteria with its 1980 cost recovery plan and loan authorizations had declined precipitously, loans authorized in fiscal years 1981 through 1983 still had record loss rates. This clearly was the impact of the recession. The table also shows the impact in western Canada of a lingering recession attributed to the National Energy Program.

**Table 3** Ultimate Loss Rates by Year of Authorization and Region

<b>Vintage</b>	<b>Atlantic</b>	<b>Quebec</b>	<b>Ontario</b>	<b>Prairies</b>	<b>B.C. &amp; Y</b>	<b>Bank</b>
1978	5.5%	6.5%	8.7%	4.3%	4.0%	5.9%
1979	10.3%	6.1%	12.6%	5.2%	6.8%	8.4%
1980	11.6%	9.8%	17.8%	11.2%	15.4%	13.9%
1981	11.0%	13.8%	19.9%	16.6%	14.7%	15.9%
1982	11.9%	7.7%	13.0%	19.5%	24.4%	14.9%
1983	6.0%	7.1%	5.4%	13.7%	13.0%	8.9%
1984	8.2%	2.5%	1.5%	7.1%	2.2%	3.7%
<b>1985</b>	<b>1.9%</b>	<b>3.1%</b>	<b>3.6%</b>	<b>17.3%</b>	<b>4.7%</b>	<b>5.1%</b>

The profit declared in fiscal year 1985 marked the start of rebuilding FBDB. Solidifying FBDB's financial viability was of prime importance. But there were other developments to be dealt with including the introduction of services emanating from the 1983 mandate (the Financial Planning Program and Investment Banking), and continuing 'dialogue' with the government. Before delving into the Bank's new services, another development is worthy of mention.

The mid-1980s saw more women opening their own businesses. Sensing the trend, FBDB's Board of Directors wanted to ensure the Bank was addressing the needs of women entrepreneurs. Richard Kroft, a Director, asked for information on how many loans were being authorized to women entrepreneurs. It was common at the time throughout the banking industry that few loans would fall into this category. It was more common that when a woman entrepreneur wanted a business loan, the spouse was required to co-sign loan documents. In response to the question at the Board, Ken Neilson said the Bank was not collecting such data but committed to having the loan accounting system programmed to record loans going to women entrepreneurs. The Bank started giving special attention to women entrepreneurs. Seminars and workshops were set up specifically for women entrepreneurs which, in turn, provided

opportunities to market all the Bank's products, including term loans. The Board also wanted data on women in management at FBDB. Moving more women into management ranks proved a greater challenge for the Bank, an institution that only a few years before had a Male Officers Performance Evaluation form.

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## The 1983 mandate provided for a new FBDB service, the Financial Planning Program. (See Exhibit 1)

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### **The Financial Planning Program (FPP) is created**

The 1983 mandate provided for a new FBDB service, the Financial Planning Program. The Bank had made a case for this program during its dealings with the 1981 Small Business Financing Review and the FBDB-sponsored Peat Marwick Study on small business financing. Initially referred to as Client Services, both these studies confirmed an intermediary role FBDB could play in assisting entrepreneurs obtain financing from private sector lenders, with partial FBDB financing if needed. It was felt there were cases where feasible projects were not going forward because the entrepreneur lacked the skills to put together a proper financial plan and proposal. On the other hand, lenders, including FBDB, did not have the free time to sit with these entrepreneurs and draw up proper financing proposals. These proposals by their nature were more complex and demanding than the average small business financing request a bank would receive. This was the rationale for the new program.

The first product introduced under the Financial Planning Program (FPP) was Packaging and Intermediation. As the program brochure described it: "if your business requires funding, FBDB will complete a full assessment of the project and prepare a report that will greatly facilitate the analysis of your needs by selected financial institutions or government agencies. FBDB is also prepared to act as your intermediary in presenting your request for funding."

Exhibit 1 shows that the report prepared by the Bank would be quite comprehensive.

# Exhibit 1 – Financial Planning Program Packaging Report Contents

## **EXECUTIVE SUMMARY**

A brief overview of the business including its history, management, objectives of the program and plan of financing, current financial position, established and projected earnings record, and estimated security values.

## **HISTORY**

A record of the significant events in business history in chronological order.

## **OWNERSHIP AND MANAGEMENT**

Details of the ownership including a share structure, shares issued and held, an in-depth assessment and review of the Management Team highlighting backgrounds of key management figures including age, work experience, education, specialized skills and personal net worth.

## **PROGRAM & FINANCING**

Objectives of the proposed program and plan of financing.

## **OPERATIONS**

A description of the applicant's products and/or services with an assessment of the quality. A description of the principal materials and/or services purchased, including sources and adequacy of supply, prices and terms, etc. Number of employees, special skills, wage rates and availability. A description of the production methods.

## **MARKETING**

A complete review of the markets served, potential markets, and the company's marketing strategy and competition. A description of the pricing policy, credit policy and advertising methods. A list of major customers with orders on hand, if applicable.

## **BALANCE SHEET ANALYSIS**

## **OPERATING RESULTS/FORECAST EARNINGS**

## **WORKING CAPITAL ANALYSIS**

## **FACILITIES/SECURITY VALUES (Land, Building, Equipment, Vehicles)**

## Conclusion

As such, the cost of doing in-depth analyses of various aspects of the company, preparing reports and acting as intermediary would be high. The Packaging and Intermediation service therefore targeted, as its market, medium-sized and growth businesses. For the very small “mom and pop” type small businesses that could not afford the service, the Bank already had its training seminars, workshops and CASE counselling program to service their needs, and it added a series of Do-It-Yourself Kits.

Five Do-It-Yourself Kits were published and sold by the Bank through its branch offices. The first title followed directly from the packaging concept. It was called Arranging Financing. The other four titles were: Forecasting and Cash Flow Budgeting; Analyzing Financial Statements; Evaluating the Purchase of a Small Business; and Credit and Collection Tips. Each kit was sold for \$10 and a bound set of the five kits was available for \$45.



Do-it-yourself kits

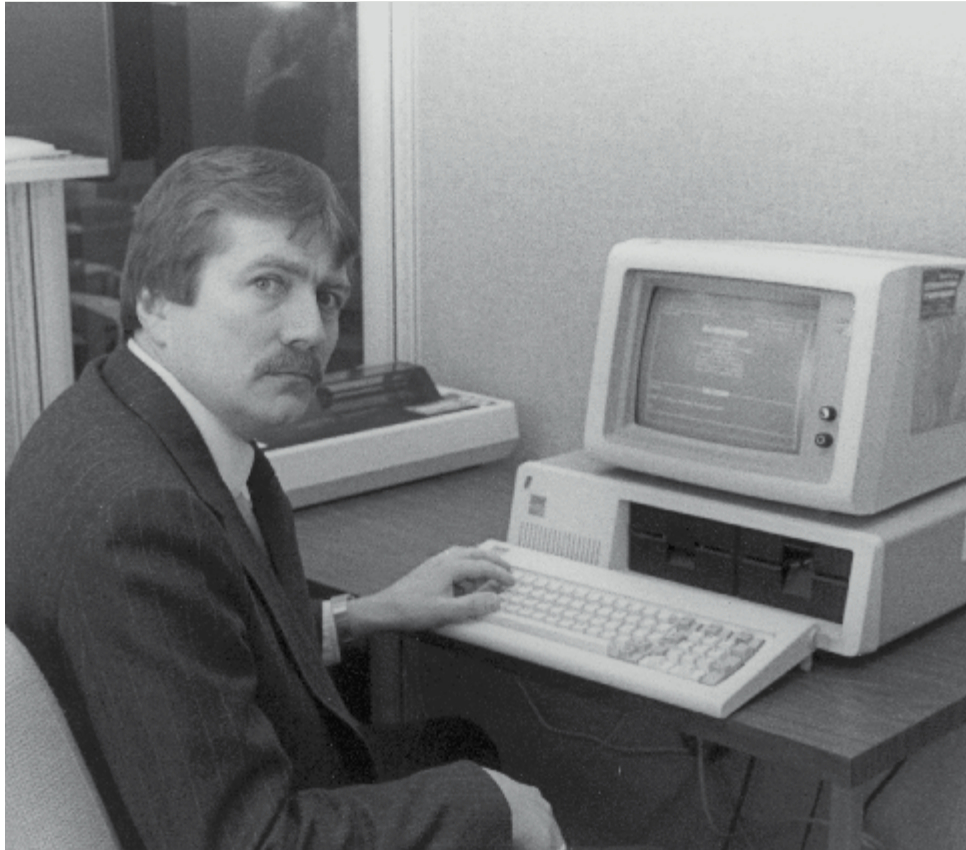
Another observation made in the small business financing studies of the early 1980s was the lack of equity capital for small business. It was noted that, on one hand, private investors were saying there was no shortage of investment capital in Canada, only a shortage of good projects in which to invest. On the demand side, small businesses were saying they couldn't find equity capital. This led to FBDB creating a second product under the FPP umbrella – Financial Matchmaking, an intermediary service matching individual investors with small business owners seeking equity capital. Its principal tool was a computerized data base listing, firstly, potential investors in small business and what they were looking for, and secondly, small business owners looking for equity capital. Although it was a national data base, its application was mainly at the local level, trying to match local investors with local businesses. Most potential investors were looking not only for attractive investment opportunities but also for situations where they could contribute their particular expertise to the management of the investee business. They knew they had to be an active participant in the management of an investee company in order to have a chance of getting a return on their investment.

The final product added to FPP was Strategic Planning. The firm ADM Pragma had done some corporate consulting work for the Bank and, through this assignment, saw what the Bank was achieving with its Financial Planning Program. They had done consulting assignments in strategic planning for large-sized firms and they proposed to the Bank that their methodology could be adapted and applied to smaller firms. ADM Pragma was hired by the Bank to produce the structure of a strategic plan for medium-sized firms. They also trained a few FBDB employees on how to work with businesses to produce their strategic plans. These trained employees, in turn, trained others in the Bank. As the FPP brochure stated: “the Strategic Planning service will help you see how your business stacks up against the competition, where your weak points are, and how well-poised you are to take advantage of opportunities now existing or soon to come up in your marketplace.” The Strategic Planning product was so well structured it was often used internally by Bank management to improve market presence and for planning purposes.

The 1983 mandate for FPP envisaged the program being implemented initially as a pilot project since no one knew exactly what the market was for the service. It was understood that full implementation across the country and related funding would be approved at a later date if an evaluation of the pilot project showed positive results. FPP was introduced first in one branch per region, then later extended to 10 branches and eventually to 20 branch offices. John Ryan was given the job to implement the program in the selected branches.

Ryan had joined the Industrial Development Bank in 1972. He first applied to the Bank's Halifax branch for a job as credit officer. Although he was turned down by the branch manager, he was soon hired by Ken Powers, the regional general manager, as a financial analyst in the regional office. Not long after, he was sent to the Halifax branch office as a credit officer – to work with the same manager who had turned him down earlier. He produced outstanding results and was appointed branch manager in various Atlantic region branch offices before moving to

Montreal as special assistant to the Executive Vice President, Eric Scott, in 1983. Ryan rose through the ranks of the Bank over the years and was Chief Operating Officer by the time he left the Bank in 1997 to take on the position of President of the Farm Credit Corporation.



John Ryan had joined the Industrial Development Bank in 1972 and rose through the ranks of the Bank over the years. He was Chief Operating Officer when he left the Bank in 1997.

Ryan encountered resistance from senior officers in regional offices as he tried to get some of their better people to work in the FPP pilot project. Furthermore, many throughout the Bank thought the FPP was a curious role for FBDB. If an entrepreneur could not obtain financing from the private sector, then FBDB was there to take a second look. And if FBDB turned down the request, then the project was not worth financing. So why was this program needed? It was Ryan's job to explain that, with its new mandate, the role of the Bank had been broadened and the FPP project was a pilot to test the market for the service.

If many FBDB officers thought the packaging and intermediation role was a curious one for the Bank, they were not alone. After financial packages were completed by FBDB Financial Planning officers, they would be 'shopped' with chartered banks. The private sector banks saw this to be very unusual – why would FBDB be bringing loan proposals that looked bankable to them? What was being hidden? After careful analysis and due diligence they found the packages put together by FBDB were indeed bankable. They went ahead and financed them. In



many cases, projects were financed jointly with FBDB. But something even more curious occurred. In some cases, the FPP-prepared financial package would be shown to FBDB loan officers and they would refuse to finance the proposed project. The same package would then be shopped with a chartered bank where it received financing. There was no plausible explanation for such occurrences except that the Bank had become too risk averse, in some quarters, after experiencing large losses and layoffs. Another explanation was that some FBDB officers could not handle complex proposals.

In this regard, the Financial Planning Program had a long-term positive effect on the Bank. It introduced the Bank to a new market that was more upscale in terms of growth potential. To be sure, the proposals coming from these companies were more complex than average but they enabled the Bank to learn how to deal with complex financing proposals and the management style of high-growth companies. In a way, the financial packaging service was another “acorn from which great oaks grow” to quote Ritchie Clark.

In fiscal 1985, the first full year the FPP was operational, the Bank sold 12,313 Do-It-Yourself Kits and completed 125 Packaging assignments, 30 equity matchmaking deals and 15 strategic plans. The equity matchmaking data base contained a listing of 435 potential small business investors and 620 business opportunities seeking equity capital.

In 1985, the level of FPP activity was sufficient for the Bank to commission evaluations of its new products. The government had indicated the FPP could be expanded following a favourable evaluation of the pilot. Government funding for the FPP pilot was about \$2 million annually and the Bank wanted this amount increased in order to provide the service more widely across the country.

The FPP evaluation was undertaken according to guidelines originating in the Office of the Comptroller General of Canada. It was overseen by an interdepartmental steering committee with representatives from the Program Evaluation Directorate of DRIE, the Crown Corporations Division of DRIE, the Crown Corporations Division of Treasury Board, The Office of the Comptroller General of Canada and FBDB. All bases were covered. The evaluation was done by an Ottawa based company, CPER Management Consulting, and the results were positive.

The FPP evaluation concluded the Packaging and Intermediation service had done well in terms of objectives achievements; the incrementality ratings on these products were high compared to comparable government assistance programs to industry; the research confirmed there was a need for the packaging and intermediation service; and the equity matchmaking service was addressing a real need in the small business sector. The evaluation determined the Strategic Planning service was too new to be evaluated. However, one client company from each of the five regions was surveyed. In all five cases, companies were supportive of the service they received and had instituted changes they considered would increase sales and profitability. The Do-It-Yourself Kits were not evaluated but the CPER report stated the sales of the Kits spoke for themselves. By Canadian publishing standards, the Kits were bestsellers.

With a positive evaluation in hand, the Bank requested the government to provide funding to expand the FPP to more branch offices. The response came that while the evaluation results were good, any decision on expanding the FPP would be made in the context of an overall review of FBDB's mandate. As will be seen in the next chapter, inaction on FBDB requests due to an ongoing review of the Bank's mandate was a repetitive theme for the rest of the 1980s and early 1990s.

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Another major element of the 1983 mandate was the creation of FBDB's Investment Banking Division. It was intended to provide a new focus for a proactive equity investment operation.

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By the end of the 1980s, the Financial Planning Program was still operating in a pilot project mode. On an annual basis, about 300 financial packages and 100 strategic plans were being completed and 26,000 copies of the Do-It-Yourself Kits were being sold. The cost recovery rate for the program, or proportion of costs recovered, was about 44%, higher than the rest of the Bank's management services which had an overall cost recovery rate in the 20% range for much of the 1980s.

### **Creating the Investment Banking Division**

Another major element of the 1983 mandate was the creation of FBDB's Investment Banking Division. The creation of this separate division in the Bank was in line with the 1981 Peat Marwick recommendation that the Bank enter into merchant banking. Its purpose was to take a proactive role in the market, targeting companies with high-growth potential that would return significant economic benefits to the country. It was an organizational move to provide a new focus for a proactive equity investment operation.

Prior to the creation of the Investment Banking Division, the Bank made equity investments in an eclectic mix of companies. About two in three of these companies were in the manufacturing sector, the sector where growth companies for the most part resided. Up until the 1980s, manufacturing was considered the engine for economic growth. High technology had not yet entered the economic development landscape. In fact, top mandarins in Ottawa spent much intellectual and financial capital trying to find ways to grow the manufacturing sector. They

wanted Canada to move away from being a resource-based economy or, in their words, 'hewers of wood and drawers of water.' This was and continued to be the main focus of Canada's industrial policy. As the costs of manufacturing in Canada became internationally uncompetitive during the 1980s, the policy focus shifted in the 1990s to promoting knowledge-based, high technology companies. (All the while, natural resources continued to be the sector generating much of the country's investments and foreign exchange.)

In its peak year of activity, fiscal year 1980, FBDB authorized 83 new equity investments for a total \$14.3 million. Many of the investments the Bank made prior to 1983 proved successful and some investees went on to become public companies. An example is Winpak, a packaging company that grew and became listed on the Toronto Stock Exchange. Others did not.

There were cases where the Bank would have a term loan with a company experiencing major difficulties and the FBDB loan was converted into an equity position in the hope that, with the passage of time, the company would rebound. The Bank prided itself in being more patient than its private sector counterparts. One example was a paperboard manufacturer in Ontario. It received several rounds of FBDB financing that were converted to equity participation before it eventually closed. But in one noteworthy case, the patience shown by the Bank paid huge dividends to the economy. This was the case of Blackcomb ski resort in British Columbia.

In 1976, FBDB had in its possession the assets of Snowridge Ski Development following foreclosure proceedings. The Bank joined Aspen Skiing Corporation, operator of the famed American resort and interested in investing in skiing in Canada, to evaluate what could be done to resurrect the Snowridge operation. The ski mountain was located in the Kananaskis region of Alberta, arguably the most scenic area in Canada. Aspen saw potential in the site and agreed to form a 50-50 partnership with FBDB. The Bank would put up the assets it possessed and Aspen Corporation would invest \$1 million to upgrade the mountain's facilities. A new company, Fortress Mountain Resorts Limited, was created to reflect the new Aspen-FBDB partnership.

In 1978, following a call from the Government of British Columbia for proposals to develop a new ski area at Blackcomb mountain in British Columbia, Aspen Corporation had been looking and was aware of Blackcomb's potential. Conversely, the Government of British Columbia saw in Aspen the right mix of operating experience, management skills and financial resources to carry through with the development. But while Aspen was keen to take on the Blackcomb project, it needed a Canadian partner and FBDB agreed to be a 50-50 partner with them. The Bank's Board of Directors agreed to co-invest with Aspen Corporation to develop Blackcomb mountain and the crown lands attached to the development plan. Hugh Smythe, who was the general manager of the Fortress operation in Alberta and originally from the Whistler area, was brought in to manage the Blackcomb ski development. He would later be credited with having a very large role in building what is arguably the best ski facility in North America, Whistler-Blackcomb.

In 1986, Aspen Corporation, by then part of Twentieth Century Fox, the movie behemoth, decided not to invest further in the Blackcomb development and its share was bought out by FBDB. After looking for a new partner, the Bank sold the Aspen share to Intrawest Properties Limited. Intrawest was founded by Joe Houssian, a native of Manitoba who became one of Canada's more successful entrepreneurs. He knew little about the ski business but his company brought to the table expertise and experience to develop the lands at the base of the mountain that were part of the package Aspen and FBDB had procured from the provincial government. Soon after, Intrawest bought out FBDB's share in Blackcomb. With Intrawest in the picture, development of Blackcomb mountain ski facilities and the whole of Whistler village took off. In 1996, Intrawest merged with the Whistler Mountain ski operation and propelled the combined Whistler Blackcomb resort to the top ski resort in North America. (It was host to the 2010 Winter Olympics.) And to complete the circle, Intrawest, then a public company, was bought out in 2006 by the U.S. hedge fund, Fortress Investment Group.

Blackcomb is one of many enterprises financed by the Bank over the years that eventually expanded into a large Canadian corporation. Perhaps the one that grew the most was Rogers Communications. Its founder, Ted Rogers, is considered one of Canada's greatest entrepreneurs. And he got his start with an IDB loan to finance an FM radio station in Toronto, at the time when these stations were coming on line. Rogers had a great idea but insufficient money. The Bank's credit officer handling the file was Mike Rudkin who later rose through the ranks to become Regional Vice President, Atlantic Region before retiring. Although there was little collateral to support the loan, Rudkin worked to get the loan approved by his superior. (A personal guarantee and a second mortgage on a property were essentially the collateral on the loan.) Later, while on a stint at head office, Rudkin would open the Rogers loan file to see what had become of the loan. In the file was a remark inserted by the General Manager that suggested the loan should probably never have been made. The rest is history. Rogers parlayed his radio station and IDB loan to create Rogers Communications.

The new Investment Banking Division was not going to simply take over the existing venture capital operation and continue its operations. It had to be a different kind of outfit to fulfill its proactive development role focussing on companies with high-growth potential. In planning the operations for the new Investment Banking Division, Hugh Carmichael and Dick Bradbury, under the watchful eye of Jack Nordin, looked at what others were doing in the U.S. to provide equity capital to companies with very high growth potential. They focussed on the operations of Hambrecht & Quist as the model for the new Investment Banking Division.

Hambrecht & Quist operated in California's Silicon Valley and promoted itself as a provider of the full range of investment banking services to both emerging and threshold-level companies. The firm provided the same services to smaller growth companies that Wall Street investment banks were providing to large public companies. Reproducing a Hambrecht & Quist operation in Canada would have meant providing an all-encompassing set of financial services to Canada's growth companies. Included would be packaging and intermediation, underwriting, joint ventures, syndications, equity financing, venture capital, mergers and

acquisitions, and management buyouts. It was also envisaged that equity financing from the Investment Banking Division would be supplemented by other FBDB financing such as term loans, loan guarantees and venture loans when needed.

The Bank knew this vision could not be accomplished overnight. It would start with the basics, providing equity capital, and grow from there. But a crucial objective had to be accomplished first, and that was to establish the Bank's credentials in Canada's financial and business communities. This could not be done with the market reputation as a money-losing lender of last resort. So, the Investment Banking Division was created and promoted as a separate entity from the rest of the Bank. Roger Lafond, who had been head of the Investments group before the new 1983 mandate, was selected to head the new Investment Banking Division.

The division started with a clean slate. The equity portfolio transferred from financial services included only potential winners. The rest was left with the Loans Division to administer. Before the Investment Banking Division was created there were 116 customers in the Bank's investment portfolio. Only about 50 were transferred to the new division. In addition, the transferred portfolio was fully capitalized with \$29 million received from the Government of Canada as part of the 1983 mandate. This mandate included a commitment to inject further capital amounting to \$60 million over the next three years to fund new investments.

Starting out with a mature portfolio fully capitalized by the government, the Investment Banking Division was able to declare profits in its second year of operation, fiscal 1985, profits that allowed the Bank to declare an overall profit and signal its long sought turnaround. Also, with its early profits, the division had more capital than it could invest and the \$60 million earmarked for new investments were continuously re-profiled to later years.

A separate committee of the Board of Directors was created to oversee the creation and operations of this new division. Richard Kroft, chair of the committee, and his fellow members were very involved in establishing investment and operating policies for the division as well as in the authorization of new investments. It was what could be termed active direction. In its first three years, the division made 69 investments for a total of \$32 million. Importantly, each dollar invested by FBDB was levered by another \$2.70 from other investors. Leverage was an important FBDB objective as it showed the Bank establishing itself as a respected member of the investing community in Canada. Its credibility in the industry was helped early on by the \$3.1 million profit it declared in fiscal 1985. In the following year, fiscal 1986, the division again recorded a profit, this time of \$3.4 million. Selecting only potential winners to seed the Investment Banking portfolio was key to establishing the division's reputation in the business investing community.

### **From Investment Banking to Venture Capital**

In 1986, the Board's Investment Banking Committee recommended hiring a senior vice president to head the Investment Banking Division. Marc Vaillancourt quickly made his mark. First, he said FBDB was not in the investment banking business, it was providing venture capital to Canada's growth businesses. So he changed the name of the division to Venture Capital Division. Then he solidified and established

new partnerships with Canada's venture capital industry. This he did with personal visits, backed by an operation that was profitable, and by promoting the Association of Canadian Venture Capital Companies, of which he was elected president. Vaillancourt also hosted an annual event that would assemble venture capital fund managers from across the country. The event would coincide with a FBDB Board meeting. Invitees would attend seminars during the day followed by a dinner with the Board of Directors and some noted speaker in attendance. Change at the division had arrived, change that was punctuated by an FBDB advertisement in Venture magazine with Vaillancourt's name featured prominently. Bankers from the staid IDB did not place their names in corporate advertising. But Vaillancourt achieved the goal of positioning FBDB as a respected member in Canada's venture capital community.

### **Decentralizing decision-making**

The first profit following the Great Recession of the early 1980s, declared for fiscal 1985, was the starting point for rebuilding the loans portfolio. With a yoke over their shoulders – loans could only be made if they were not otherwise available elsewhere on reasonable terms and conditions – Ken Neilson and his team of regional and head office vice presidents set about building a profitable loans portfolio as well as an efficient delivery system. With Neilson in charge of Loans, the princedoms dismantled themselves. To achieve the goals Lavigueur had set, everyone had to be singing from the same song sheet, working as one team. To be sure, regional vice presidents still carried much weight in major Bank decisions but they could no longer be perceived as autonomous princelings.

There were some snags along the way to sustained profitability. One was the lack of new capital to keep the term lending operation at a 10:1 debt-to-equity basis, the ratio used for planning the financial objectives for the Loans Division. On the operational side, one temporary setback was the implementation of the PDM concept. A PDM was a Project Development Manager and conceived as the first person a client would meet at an FBDB office. The PDM would respond to the client's needs, be they for financial or management services. The PDM was seen as the 'Renaissance Man' who would carry the Bank into its new age. (In the mid-1980s the Bank, like society in general, was slow to add the word 'person' to its lexicon.) The PDM concept did not improve productivity at the branch level. It was quickly recognized as a step backwards and was scrapped. There would be separate loan officers and management services officers in branch offices.

To grow the portfolio, the Bank had to be more responsive to clients' demands and decision-making was decentralized. As cited earlier, District offices, headed by a District General Manager, were created to bring decision-making authority closer to the client. The District General Manager was assisted by a District Manager, Loans and a District Manager, Management Services. Seventeen district offices (designated 'A' branches) were created across the country, each having 'B' and 'C' branches reporting to them. The five regional offices were kept in place but with far fewer staff to handle financial, human resource, administrative and legal matters. The Bank renamed its credit officers Senior Account Managers and Account Managers, following the practice in chartered banks. PDMs were gone, SAMs were in. Almost every FBDB staff member a client would deal with was now

a manager. When asked to speak to the manager, the FBDB officer could say, “you ARE speaking with the manager.” In later years, in dealings with chartered banks, small business owners upped the ante by asking to speak with the vice president in charge. Chartered banks responded by appointing scores of vice presidents in their branch offices. The Bank eventually followed suit.

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## The first profit following the Great Recession of the early 1980s, declared for fiscal 1985, was the starting point for rebuilding the loans portfolio.

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The benefits of the decentralized structure and new directions were quickly realized. In fiscal year 1986, FBDB authorized term loans totalling \$545 million on a net basis, that is, the amount authorized after cancellations and reductions by clients. This was about double the amount authorized on a net basis two years earlier. The following year, fiscal 1987, net loan authorizations reached a peak of \$732 million and they stayed around the \$700 million level for the three subsequent years before the next recession altered the economic landscape.

### **Returning to profitability**

Although FBDB had declared an operating profit for fiscal 1985 before extraordinary items, the Loans Division had recorded a loss of \$2.2 million offset by a profit from the Investment Banking Division of \$3.1 million. The next year, fiscal 1986, the Loans Division recorded a small profit of \$1.4 million, to which was added another \$3.4 million from the Investment Banking Division. The Loans Division's profit, the first in seven years, was made possible by a decrease in operating expenses in the amount of \$4.4 million, the third consecutive year of decline in expenses. In subsequent years, profits for the Loans Division were as follows: \$1.4 million in fiscal 1987; \$2.9 million in fiscal 1988; \$2.6 million in fiscal 1989; and \$7.2 million in fiscal 1990. These levels were similar to profits FBDB and its predecessor IDB had recorded before the 1980–1982 recession and were seen to be reasonable since the Bank had to walk a tightrope when it came to its profit/loss position. If it had recorded exorbitant profits, it would have been criticized for not doing enough to help small business – not taking enough risk. If it had recorded losses, as in the 1980 to 1984 period, it would have been criticized as another money-losing crown corporation. Profits in the \$5 million range seemed just right for FBDB, in the sense of political correctness. But they masked another of Lavigueur's objectives, which was to prepare the Bank for another, inevitable economic recession.

As indicated earlier, the Bank had formulated a cost recovery equation on what its net interest income, operating expenses and provisions for losses had to be as a percentage of amounts outstanding. While the percentages for net interest income and operating expenses would remain fairly stable from year to year, provisions for loan losses could fluctuate widely according to economic conditions. So the 1.5% of outstanding amounts targeted for provisions for losses was, in effect, a long run average.

In the years prior to fiscal 1986, the provisions for loan losses charged against income would be similar to the actual amount of new loan losses recognized during the year, referred to as the actual loan loss experience. This changed in fiscal 1986 when the Bank charged a greater amount for provisions for loan losses against income than the actual loan loss experience (LLE). And this practice continued until fiscal 1990. In effect, the Bank changed its accounting for provisions for losses to reflect an averaging type of methodology that would dampen fluctuations through economic cycles.

Under the new accounting practice, provisions for loan losses charged against income were added to a general provision account. As actual loan losses became recognized, they were deducted from the general provision account. To justify this method of accounting, the Bank pointed to a decision of the Treasury Board that directed the Bank to earn an annual surplus and to continue to place priority on establishing an adequate provision for loan losses. Sometimes, directives from the government conveniently reflected what the Bank wanted to do administratively. More was happening backstage than met the eye.

Had the Bank recorded only the actual loan loss experience as a charge against income, the declared profits would have been higher and perhaps not politically correct. Table 4 illustrates the hypothetical case if actual loan losses were charged against income for the Loans Division.

**Table 4** Loans Division – Restated Profits Fiscal 1986–1990 (\$ in millions)

Fiscal Year	Actual LLE	Provision for Loan Losses	Declared Profit	Restated Profit
1986	\$11.8	\$21.5	\$1.4	\$11.1
1987	\$9.2	\$29.6	\$1.4	\$21.8
1988	\$8.1	\$34.3	\$2.9	\$29.1
1989	\$10.5	\$49.9	\$2.6	\$42.0
1990	\$11.6	\$55.2	\$7.2	\$50.8
Total	\$51.2	\$190.5	\$15.5	\$154.8

\*LLE-Loan Loss Experience

From fiscal 1986 to 1990, the cumulative difference between the actual loan loss experience (LLE) and the provisions for loan losses charged against income amounted to \$139.3 million (or \$190.5 million less \$51.2 million). This amount was, in effect, put away for rainy days which were sure to come.



On April 1, 1989, the beginning of fiscal 1990, the Auditor General of Canada became FBDB's auditor. According to the Financial Administration Act, the Auditor General of Canada was to be the auditor or joint auditor for crown corporations on or after January 1989. The Bank elected to have joint auditors and the firm of Raymond, Chabot, Martin, Paré (RCMP) was selected. When RCMP arrived on the scene, the first thing they wanted to audit was the provision for loan losses. Though never stated openly, there may have been concerns about whether the Bank, in declaring profits as a supplemental lender, was recognizing sufficient provisions for losses in its income statements. After a short review, they quickly realized the opposite – the Bank was providing for more than its actual loan losses in its income statements. The Bank's management then pointed to the aforementioned Treasury Board decision to justify its method of providing for loan losses. The next task was to convince the Auditor General of Canada that the Bank was not hiding losses and the accounting method was appropriate. This task was handed to RCMP as joint auditor.

A special study on provisions for losses was done by the two joint auditors. They found that the accumulated provisions for losses on loans, guarantees and venture capital investments, as determined by management, were acceptable. The size of the provision for losses soon became a non-issue as the 1990 recession kicked in. The experience of the next few years showed that the Bank had been prudent in its method of accounting for loan losses. In the mid-1990s, the methodology was changed again as the Bank was obliged to implement an impaired loans methodology prescribed by the Canadian Institute of Chartered Accountants for all banks in Canada.

The RCMP auditors were not the only ones skeptical about the profits FBDB was declaring in the post-1985 period. Many times, when officers of the Bank would point to its profits in discussion with persons outside the Bank, there would be expressions of doubt. With the Auditor General of Canada in place, the Bank's officers could now ask the skeptics if they would like to trade external auditors. All would decline.

The Bank had rebuilt its loans portfolio and created a strong foundation on which to build its next phase. This was achieved by the whole team at the Bank, all staff at all levels working together to deliver the goods. Building this foundation became even more important as the Bank was soon hit with major crises and another economic recession.

1985 to 1990

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# Working with government

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FBDB establishes a track record in delivering new programs on behalf of government departments and is a conduit for a large government investment. Several attempts are made to obtain a new mandate.

**A**s part of its rebuilding effort, the Bank found opportunities to cooperate with federal government departments for mutual good. In its first set of corporate plans submitted to the government for approval, the Bank had a specific corporate objective to “work with government.” Just over ten years earlier, at the Industrial Development Bank, this objective would have been considered heresy. Times had changed and indeed, not working cooperatively with the government could have led to disastrous outcomes, considering the experiences of dealing with the Small Business Financing Review, negotiating the 1983 mandate and the deliberations of the Nielsen Task Force.

There were challenges in working more closely with the government but there were opportunities as well. The latter stemmed from the desire of government to make the elusive one-stop shop for small business a reality. As the Small Business Financing Review and the Nielsen Task Force emphasized, FBDB was ideally suited to deliver other government small business programs. It had an efficient delivery network, systems, procedures and business expertise already in place. Plus, surveys showed FBDB had a better reputation among business owners than any other small business program run by government departments. In the second half of the 1980s, delivering business programs on behalf of government could help fill excess capacity in the Bank and contribute to overhead costs. This was part of the mindset of FBDB’s President when Lavigueur first met with the Honourable Sinclair Stevens, the Minister of DRIE and Minister responsible for FBDB.

Although Lavigueur had met several times with the Small Business Minister, the Honourable André Bissonnette, early in the Conservative government’s mandate, it took a while before a meeting could be arranged with Stevens, the senior Minister. When the meeting was finally scheduled, it was relayed to the Bank that the Minister wanted to see Lavigueur privately. The Ministerial briefing book, maintained by the Bank, was updated and customized for this meeting. The briefing book had statistics galore on the Bank’s various activities, including the number of small businesses assisted and jobs created each year. The second section had proposals for what the Bank could be adding to its repertoire, each justified and costed.

When Lavigueur arrived at the top floor of the C.D. Howe building located at 235 Queen Street in Ottawa, the DRIE headquarters, he was ushered into the waiting area and greeted with the perfunctory, ‘The Minister is running a little late today but will see you shortly; would you like to have a coffee?’ Usually when FBDB issues would be discussed with Ministers, there would be senior departmental officials in the room taking part in the discussion. Others would be there to take notes and answer any questions from the Minister. But there were no departmental officials in the waiting area. It was going to be a private meeting with the Minister after all. Lavigueur sensed something unusual was afoot.

Minister Stevens came through the back door to his office to greet Lavigueur and led him directly into his office. He was in a pleasant mood, smiling as they entered his office. Before Lavigueur could take out the FBDB briefing book, the Minister went over to his desk, picked up a sheet of paper and handed it to Lavigueur. There lay the purpose of the meeting. It was not to receive a briefing on FBDB activities. It was to inform FBDB that the government had agreed to

invest \$79 million in Cominco Ltd. and FBDB was to be the conduit for the investment. The Department, DRIE, did not have the powers to make investments in companies. However, Section 99 of the Financial Administration Act allowed the federal government to give directives to crown corporations. (Directives were needed when an activity would fall outside the corporation's mandate and normal activities.) And, of course, the government would bear any cost arising from the directive. Lavigueur was taken aback, as Cominco, a giant Canadian mining corporation, was not your typical small or medium-sized business. This was not what the Bank had in mind when it set "working with government" as a corporate objective.

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## As part of its rebuilding effort, the Bank found opportunities to cooperate with federal government departments for mutual good.

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The Cominco investment was part of a \$260 million modernization project for the company's smelting operations in Trail, British Columbia. A twenty-year agreement between the Government of Canada and Cominco provided for a sharing of the risk in the project. There were three tranches to the FBDB investment, two for \$28 million each in fiscal years 1987 and 1988 and a third for \$23 million in fiscal 1989. The redemption of FBDB's preferred shares investment in Cominco and related dividends were tied to the success of the project, and the prices of lead and silver over the life of the agreement. However, the rate of return index was insufficient to trigger any dividend or redemption and Cominco discontinued use of the technology that was part of the original modernization project. Cominco did subsequently successfully complete the modernization project using a more suitable technology, which has now been in continuous operation since 1997. This was largely accomplished with the FBDB assistance and ultimately allowed Trail Operations to continue operation with enhanced environmental performance. Nevertheless, it became clear that redemption of FBDB shares was unlikely and the Bank took a full write-down of the investment in 1992. A \$79 million loss for FBDB, reported as an extraordinary item in the financial statements.

Around the same time the directive was given to invest in Cominco, DRIE officials sent a proposal to the Bank that would have FBDB invest in a new company called TIEM Canada. The company, in conjunction with Control Data, a U.S. information technology firm, had proposed to the Government of Canada that it privatize its job creation efforts. Control Data had set up job creation projects in

the U.S. and saw an opportunity to export its know-how to Canada. The proposal found favour with Minister Stevens, a proponent of privatization. In the previous Conservative government of 1979, he had been Minister in charge of privatizing government services.

The deal was envisaged as follows. TIEM would create a national network of small business development centres, incubating small businesses so to speak. These businesses, with the help of TIEM's services, would then grow and create permanent jobs for which TIEM would be compensated by the Government of Canada. TIEM also expected to receive royalties from the companies it helped build. To establish the TIEM centres, DRIE would provide \$12 million to TIEM over a two-year period as a repayable loan and some \$28 million would be paid by the Canada Employment and Immigration Commission (CEIC) for the new jobs it was estimated TIEM's clients would create. TIEM had raised \$400,000 in capital to start-up its business and DRIE officials communicated to FBDB that it should consider an investment of \$200,000 in TIEM for a 5% ownership position. It was said Minister Stevens supported the project. This was not a directive. The Bank would have to decide for itself, without external influence, whether or not to make the investment under its own powers. After some discussion at the Bank, it was decided to make the investment. It was an action consistent with the Bank's mandate and its corporate objective to work with government, but would also provide knowledge about the relatively new concept of incubating businesses. Unfortunately, the investment was later fully written-down.

### **Student Business Loans program**

Not all collaborative ventures with government departments ended in failure. FBDB delivered a number of business programs on behalf of other government departments which were successes for both the Bank and sponsoring department. These programs provided funds for the Bank to extend its reach among small businesses, albeit in targeted ways, and made more efficient use of the Bank's delivery network. The Student Business Loans program was sponsored, and paid for, by CEIC. The program provided interest-free loans of up to \$3,000 to students starting up businesses during the summer months. Business training and counselling were also made available under the program.

The program started in 1985 and became an annual rite of summer at FBDB. The Bank used loan guarantees to deliver the program. Typically, each summer FBDB would authorize about \$3.5 million in loan guarantees to about 1,200 students who would go on to create around 2,400 summer jobs. There was an incentive of a \$100 cash rebate if loans were repaid in full before fixed dates each year and about one in three students would take advantage of this option. Default rates for the program were under 20%. For CEIC (which later morphed into Human Resources Development Canada), this program was a cost-effective way to create summer jobs. For FBDB and chartered banks, it was a way of encouraging the next generation of Canadian entrepreneurs and coaching them in best business practices. A study found students receiving loan guarantees under the program were nine times more likely to become full-time business owners than others.

### **Mollusc Growers Loan program**

Another business program delivered by the Bank was the Mollusc Growers Loan program. In 1988, a crisis hit the mussel farming industry in parts of Atlantic Canada. The Department of Fisheries and Oceans (DFO) requested FBDB to provide working capital loans to mollusc growers to tide them over the crisis. After negotiating the costs for providing the required financing with Ron Crowley, a director general at DFO, the Bank agreed to provide financing to mollusc growers on behalf of the department.

Under the program, 36 loans for working capital purposes amounting to over \$800,000 were authorized by the Bank. This was a small amount of loans but it showed the efficacy of using FBDB to deliver business programs and generated much support for the Bank at Treasury Board, the overseer of government efficiency and effectiveness. The contact with Ron Crowley was an added benefit to the Bank. After he retired from DFO, he became a valued member, as consultant, of the FBDB team working on the Bank's 1995 legislation.

### **Cultural Industries Development Fund**

In 1990, the Department of Communications announced the creation of the Cultural Industries Development Fund (CIDF). The department was moving away from providing non-repayable grants to repayable loans and FBDB was called on to deliver the program. The Bank understood well the financings would be of a high risk nature, with little or no collateral, and it would be responding to the financial needs of companies accustomed to receiving grants from government. The Bank also knew the cultural industries could command much media attention whenever it suited their needs. These two factors, cost and potential negative publicity, had to be well covered before the President and the Board of Directors would agree to take on the program. An agreement satisfactory to both the department and FBDB was negotiated with Susan Katz of the Department of Communications.

CIDF was set up as a departmental program delivered by FBDB. In its submission to the Treasury Board of Canada to receive permission to go ahead with the CIDF, the Department of Communications stated that the CIDF was a completely original initiative without precedent in Canada. The department provided all the funds to be loaned under the program so there would be no loan loss exposure for FBDB. Funding for the program was set at \$33 million for 5 years, including \$26 million earmarked for actual lending and the rest for administration. A joint committee comprising departmental officials and FBDB officers was also established. This committee was struck principally to oversee and provide direction to the program, but part of its purpose was to handle complaints. In effect, it would become the department's responsibility to handle any complaints from applicants to the program. As it turned out, there were very few over the life of the program and they were quickly resolved.

The Bank began accepting loan applications under the CIDF in 1991. CIDF provided unsecured loans for amounts between \$20,000 and \$500,000 although there was a provision that the joint committee could consider requests up to \$1 million. At first, financing was made available to book and magazine publishers only. It was soon followed by financings to the sound recording, film, and video sectors.

There were some within the Bank who were skittish about providing financing to these high risk sectors represented by potentially vocal advocates. Bank officers already had their hands full dealing with FBDB's own clientele. Establishing the program's credibility both in the industry and FBDB was an important first step. In announcing the program, the Bank's representatives across the country, assisted by departmental officials, carefully explained FBDB's loan criteria. Bank officers also took the opportunity to spend extra time at these meetings with the more viable members of the industry. The CIDF had one principal attraction for these companies – the lending rate was set at prime rate plus 1%, an attractive borrowing rate for many. As the first wave of CIDF loans were being authorized, word quickly spread inside the Bank that companies being financed by CIDF were not what had been expected. There were, in fact, a number of viable companies in the industry FBDB would lend to under normal circumstances. Thus the program's credibility within the Bank was quickly established. Clients also liked the way FBDB was delivering the program. There was quick turnaround, much less red tape, and dealings with the Bank were done in a businesslike fashion. Thus, FBDB's credibility within the industry was also quickly established.

The CIDF program ran throughout the 1990s. It was deemed a success both in the Department of Communications and FBDB. Annual activity in the fund was in the range of 60 loan authorizations for about \$8 million. In addition, each year between 150 and 200 businesses would take advantage of business counselling offered under the program and delivered by the Bank's Management Services Division. While \$26 million of the fund's \$33 million were originally earmarked for financing, by fiscal 1997, loan repayments had allowed the fund to lend a total of \$52 million. In fiscal year 2000, the department, now called Heritage Canada, transferred the whole CIDF portfolio to the Bank.

Student Business Loans, Mollusc Growers and CIDF were full-fledged programs sponsored by a government department and delivered by FBDB. There were other business programs where the Bank was requested to provide assistance though was not responsible for their complete delivery. In the 1980s, the government overhauled its regional development strategy and established a number of new regional-based programs. There were delays in starting these new programs and FBDB was asked to provide resources to get them underway. The Atlantic Enterprise Program, the precursor to the Atlantic Canada Opportunities Agency, the Western Diversification Office and the Northern Ontario Economic Development Program were all assisted in their early stages by FBDB personnel in project investigations and analysis, for which the Bank was compensated.

### **Export Receivables Guarantee program**

Then there was a partnership with the Export Development Corporation that produced a new FBDB product for smaller exporters facing working capital shortfalls. These shortfalls were the result of chartered banks severely discounting the foreign receivables of smaller firms. John Taggart from the Bank's British Columbia region was seconded to head office to develop a product to address this need. The outcome was the Export Receivables Guarantee product wherein FBDB would provide loan guarantees to chartered banks so that they could

increase small exporters' lines of credit. The loan guarantees were secured by export receivables insured by EDC. Program take-up was limited. By 1992, only 80 loan guarantees for \$16 million were issued by the FBDB. The activity level may have been less than expected but it did bring to the fore an ingrained trait in the Bank. For much of the Bank's history, when an opportunity appeared, the Bank would analyze it and if warranted, find a way to take advantage of the opportunity to the benefit of the small and medium-sized businesses it served. And it would do so in a way that did not compromise the bottom line.

There were other government programs with the potential for FBDB delivery but ultimately, they were not taken on. At one time, the Bank considered delivering the Small Business Loans Act on behalf of DRIE but this ran into much opposition within DRIE.

Another proposal, from the Department of Transport, involved FBDB financing Canadian independent truckers who were experiencing working capital shortfalls. The deal would have been for FBDB to provide loan guarantees of up to \$50,000 to chartered banks in order to reschedule and increase loan amounts to independent truckers. There was particular urgency for this program on the part of the department as truckers had blockaded highways and border crossings in order to pressure the government to do something to assist them. Lavigueur and his recruit from Ottawa (the author) had flashbacks of the angry protests in front of Unemployment Insurance Commission offices by unemployed persons whose UIC cheques were delayed because of computer glitches in the early 1970s. They did not want similar protests by truckers (and their rigs) in front of FBDB offices. This program had to be structured to avoid such protests. The Bank agreed to deliver the program but its administration fee was not accepted by the department. Officials there thought FBDB's administrative costs would be \$250 per loan. The Bank's figure, which was non-negotiable, was many times that. The Department of Transport decided to provide tax rebates to truckers instead of loan guarantees through FBDB. A file, inches thick with paperwork on this proposal that went nowhere, was the result.

### **Community Business Initiatives**

Although the Bank had earned a national and international reputation for providing practical services to help small businesses grow and prosper, it was constantly on the lookout for innovative practices. In the mid 1980s, one such idea came to the Bank's attention. At Confederation College in Thunder Bay, Ontario, Jim Rapino had introduced a concept referred to as an 'incubator without walls.' It had the same business development goals as the TIEM Canada model except there would be no centres – offices and walls – and no restrictions to start-up stage businesses. The Rapino model called for assembling a group of about 25 to 30 local, non-competing small businesses that would receive business training in groups followed by visits at their places of business by counsellors who would assist in implementing business practices learned in class. The counsellors included the leader of the initiative and members of a local Advisory Board created to support the group. The participants would receive training and counselling over a 12-month period during which they would typically attend 10 four-hour seminars on topics of their choosing.



Jim Rapino did not have a national network to implement his incubator model and DRIE officials asked the Bank to look at this method of training. Rupert Williams, who was Senior Vice President, Management Services at the time, met with Rapino and negotiated an arrangement whereby the Bank would have the rights to implement his business incubator model in other centres across Canada. The Bank then negotiated with local CEIC offices to get funding from their Jobs Strategy to support the formation of training groups. This was likely more cost-effective for CEIC than the TIEM projects. FBDB named this service its Community Business Initiative (CBI).

The CBI combination of training and counselling a group of businesses quickly became popular and was widely applied. When Atomic Energy of Canada Limited announced that its Port Hawkesbury and Glace Bay plants in Nova Scotia were to be closed, they contracted with FBDB to coach laid off workers who wanted to start a business. FBDB applied the CBI model of training to these workers. The same was done following a major CN Rail layoff in Atlantic Canada.

CBIs were highly regarded by users and had very positive impacts. They were also cost effective. About 30 CBIs would be started each year, mostly with CEIC funding.

FBDB's Management Services Division also received funding from Multiculturalism and Citizenship Canada for activities with ethnocultural business communities. Eight advisory committees were formed to assist in organizing training and information events in local communities for ethnocultural entrepreneurs. These initiatives were similar to the ones previously created to promote women entrepreneurship.

### **Seeking a new mandate**

While the Bank was building partnerships with government departments for mutual benefit, it was also working with its sponsoring department, DRIE, to get a new mandate from the government. The Financial Planning Program had proven its worth in its pilot project phase and the Bank wanted it expanded. Community Business Initiatives too were shown to be highly effective in growing businesses and the Bank wanted its own funding to expand the reach of this product without having to rely on decisions made at local CEIC offices. The Bank had also developed a new financing instrument, venture loans (later renamed participating debentures, then patient capital, then subordinated debt) and wanted new capital to support the introduction of this product to the market.

More importantly, the amount of equity capital the Bank could receive from the government was close to its legislated limit. The capital received for the Cominco investment had all but used up the total amount the government could pay into the Bank under Section 28 of the FBDB Act. With financings growing in the second half of the 1980s, FBDB needed new capital to keep up with portfolio growth. In essence, a new mandate was needed to confirm continuation of existing financial and management services, provide funding for expanded services and get authority to introduce new legislation to, inter alia, provide room for the Bank to receive new capital in support of its expanding financial services.

In the latter half of the 1980s, a recurring process took place as the Bank sought a new mandate. The process would start with the annual corporate plan wherein the Bank would seek new funding for its various services and emphasize the need for new legislation to increase its capital limit. The corporate plan would be sent to the Minister of DRIE who would then send it on to Treasury Board with his recommendations. Invariably, no new funding would be recommended under the premise that such a request would be addressed in an upcoming Memorandum to Cabinet dealing with a new mandate for FBDB. There would be discussions about the new mandate throughout the following year with officials from DRIE but nothing concrete would be accomplished. In its annual corporate plan a year later, the Bank would again include proposals for new funding to expand its services. Once again, the response would be that the proposals would be dealt with in an upcoming Memorandum to Cabinet on FBDB's new mandate.

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## In the latter half of the 1980s, a recurring process took place as the Bank sought a new mandate.

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In the ongoing back and forth on a new mandate, new wrinkles were introduced each year. One year, the Bank was requested to consider substituting loan guarantees for its term loans. The Bank did its analysis and showed the cost of loan guarantees would be much greater than supporting term loans with equity on a 10:1 debt-to-equity basis. The Bank suggested a slightly cheaper alternative that would have a two-tier guarantee system, with the first tier essentially subsuming the SBLA program and a second tier providing guarantees for larger loan sizes. But even this two-tier system of loan guarantees would have led to much higher funding levels than what the Bank was requesting to support its term lending operation. The problem with loan guarantees was that the financial institutions being guaranteed benefited from the full interest spread to cover operating expenses and produce profit margins, while the guarantor, or the government, was left with loan losses far greater than guarantee fees.

In 1987, DRIE departmental officials consulted with the Bank on a new mandate. They had also consulted with the Canadian Bankers Association (CBA) which produced a scathing submission to DRIE on the role of FBDB from the bankers' perspective. FBDB's somewhat vitriolic response to the CBA submission summarized the difference of views, suggesting that the CBA submission was a self-serving analysis of FBDB's term lending operations and the state of the smaller term loans market in Canada. FBDB's response further suggested that the

authors did not understand the Bank's business, were unaware that FBDB's interest rates exceeded those of the chartered banks, failed to recognize that FBDB's term lending program was cost recoverable, and that it had not received a cent from the federal government since 1985. While repeatedly highlighting FBDB losses, the Bank's response indicated, the CBA submission did not mention that during the early 1980s, all lenders had been burned with losses as the economy did a nose-dive. Moreover, FBDB's response pointed out that the submission avoided noting that FBDB loan loss provisions were back to their pre-recession levels while the banks' loan losses continued to escalate.

Throughout its history, FBDB had an uneasy relationship with the Canadian Bankers Association, even though there were several meetings over the years with the changing presidents of the CBA in which the President of FBDB would try to explain the differences between chartered bank lending to small business and FBDB's.

It was particularly distressing when the CBA supported a move to have the Canadian Chamber of Commerce declare FBDB redundant at one of its annual general meetings, which usually garnered much publicity in the media. The Small Business Committee of the Canadian Chamber of Commerce had been lobbied by one of its members to pass a resolution condemning FBDB and calling for its closure. The resolution was supported by the CBA and slated to be presented to the annual general meeting of the Canadian Chamber of Commerce. Lavigueur intervened with the President of the Chamber, Roger Hamel, and the issue was dropped from the agenda. This potentially embarrassing experience prompted the move by FBDB to have more representation at local Chambers of Commerce across the country.

In formulating a new mandate for FBDB in 1987, DRIE officials seemed to be acquiescing to the CBA. They proposed that FBDB raise its interest rates by up to 2%, even though FBDB's interest rates were already higher than typical chartered bank rates. They also proposed that FBDB move its branch offices from urban to rural areas and that more lending be done in non-metropolitan and low growth areas. They did not want annual increases in FBDB loan authorizations to exceed 20% without approval of the DRIE Minister. This was referred to as a 'modified bank option.' In effect, DRIE officials wanted FBDB to move further into high risk areas and be cost recoverable at the same time. In a way, the Bank was a victim of its own successes. FBDB countered with its own proposals for financial and management services, basically mirroring what had been proposed in successive corporate plans. The 1987 attempt to procure a new role and mandate for FBDB got nowhere.

In the spring of 1988, the Bank's annual corporate plan was forwarded to the Treasury Board of Canada for approval subject to certain modifications. This time, there was Ministerial support for additional capital to return the term lending operation to a 10:1 debt-to-equity ratio. Pending a decision, the Bank was asked not to reduce its lending based on a scenario of no additional capital. With respect to increased funding for management services, it was indicated it would be dealt with in an upcoming Memorandum to Cabinet.

Treasury Board endorsed the recommendation that the Bank's term lending operation return to a 10:1 debt-to-equity ratio but did not provide the capital to do so. To follow the letter of this decision, the Bank, in absence of new capital, would have been obliged to reduce the size of its lending portfolio. The spectre of credit rationing raised its head once again. Lavigueur, the Chairman of the Board of Directors, William McAleer, and other Board Members worked with their Ottawa contacts and eventually, in June 1988, the Bank was informed it would receive \$35 million of new capital to support its term lending operation. This was the first tranche of new capital the Bank had received in five years to support its expanding term lending operation. An innovative interpretation of the FBDB Act allowed the Bank to receive this capital by way of an appropriation as the amount of capital that could be paid-in to the Bank under Section 28 of the FBDB Act, the normal channel for paying in capital, had reached its limit.

The 1988 attempt to procure a new mandate for FBDB was different from previous approaches in that it was principally about instituting a National Entrepreneurship Policy, of which the FBDB mandate would be a part. The Entrepreneurship Policy, as proposed, was to harness entrepreneurship for the economic, social and cultural development of all parts of Canada in partnership with the private sector, provincial and territorial governments, and the academic community. The objective of this policy was to create wealth and jobs. It was also meant to promote and nurture entrepreneurship and remove obstacles to entrepreneurship. It was a high water mark for penmanship and all-inclusiveness.

The principal elements of the proposed policy were to establish a National Institute for Entrepreneurship, use FBDB as an instrument to achieve objectives and introduce a National Incubator Policy. Specific actions related to FBDB mirrored proposals the Bank had put forward in successive corporate plans. They included: continue term lending on a full cost-recoverable basis, structured at a 10:1 debt-to-equity ratio; expand Export Receivables Guarantees; pilot a new Export Performance Bond program; continue with the existing mandate for Venture Capital; introduce a new Participating Debentures program; continue Management Services and expand the AIM information system and network, the Financial Planning Program and the Community Business Initiatives program; increase the cost recovery rate for Management Services from 20% to 30%; and be authorized to act as agent for other government departments in the provision of bankable services on a full cost-recoverable basis. Importantly, the FBDB Act would be amended to enable the Bank to carry out its mandate and the name of the Bank would be changed to Canadian Development Bank.

The National Entrepreneurship Policy went nowhere and neither did a new FBDB mandate. Following several failed attempts with DRIE to get a new mandate, the Bank decided at one time to draft its own Memorandum to Cabinet in the hope of circumventing the bureaucracy. But this attempt too did not pan out. Mandate-wise, the Bank was in a state of suspended animation that carried on into the first half of the 1990s.

A contributing factor to the several failed attempts to get a new mandate for the Bank over the 1985 to 1990 period was the revolving door of Cabinet Ministers in charge of DRIE and FBDB. The Honourable Sinclair Stevens was

appointed Minister of DRIE in 1984 but was forced to resign from Cabinet following code of conduct allegations in 1986. He was succeeded by the Honourable Don Mazankowski in 1986, the Honourable Michel Côté in 1987, the Honourable Robert R. DeCôtret in 1988, the Honourable Harvie André in 1989 and the Honourable Benoit Bouchard in 1990. Such discontinuity no doubt contributed to the recurring and failed attempts to procure a new mandate for FBDB.

An even greater hurdle was the negative view held of the Bank by its stakeholders. With each attempt to procure a new FBDB mandate, DRIE would undertake consultations with various stakeholders including the Canadian Bankers Association as mentioned earlier. Consultations also took place with the two major organizations representing small business in Canada, the Canadian Federation of Independent Business (CFIB) and the Canadian Organization for Small Business (COSB). Neither supported FBDB's term lending operation. COSB stated the Bank should drop out of the lending business and concentrate on management services. Industry associations were also not supportive. FBDB was seen to resemble chartered banks in its lending practices. The industry associations consulted wanted the Bank to take more risk and in particular, provide more term loans for working capital purposes, the greatest need by small businesses. The SBLA program, with its legislated maximum prime plus one interest rate, was more popular among industry associations who called for an expansion of the program. Similar support was voiced for other government subsidy programs such as the Industrial Research and Development Program (IRDP). The irony was that industry groups wanted subsidy programs expanded but at the same time were calling for government to cut or reduce its handouts, an approximation of the 'not in my backyard' philosophy. Officials were getting one story from the Bank and quite another from the business community. They told the Bank it was not getting its message across to industry.

As described later, the Bank would not receive a new mandate until 1995 when it became the Business Development Bank of Canada. In the meantime, FBDB would endure further shocks and another economic recession. But before proceeding to these developments, one specialized area of the Bank, its Treasury Operations, warrants particular attention because of its role in solving the mismatch problem and undertaking the Bank's borrowings on capital markets.

1979 to 1995

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# Treasury ops

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A new treasury function is created after the Bank can no longer access the government's Consolidated Revenue Fund. The first challenge is to deal with the costly mismatch problem. The second is to tap new sources of funds with innovative borrowing instruments.

In the five fiscal years 1980 to 1984, FBDB's net operating losses totaled \$295 million. Of this, about \$50 million was due to a mismatch of maturities between the Bank's assets (loans to small businesses) and liabilities (borrowings to fund these loans). Practically, it would be almost impossible for a bank such as FBDB to have no mismatch between assets and liabilities as loan repayments to the bank could never mirror exactly repayments by the bank to its lenders. The objective therefore is to reduce the mismatch as close as possible to zero.

Between fiscal years 1976 and 1979, it was estimated that mismatch costs totaled \$18 million. In the post-1984 period, mismatch costs totaled another \$50 million. In each of these two periods, pre-fiscal 1980 and post-fiscal 1984, FBDB reported small profits despite its mismatch costs. Taken all together, the mismatch between assets and liabilities would cost the FBDB a total of \$118 million before the problem was resolved.

In the days of the Industrial Development Bank (IDB), all of the Bank's borrowings were done by and from the Bank of Canada, reflecting the allegory "if we needed money we would just go down to the vault and get some." These borrowings were generally for five-year terms. IDB loans, on the other hand, were fixed rate loans for varying terms which averaged out at around eight years. Many loans involved terms of over 12 years, for example when IDB financed a building. If \$100 million were borrowed by IDB from the Bank of Canada and loaned out to clients, \$20 million in principal would be repaid to the Bank of Canada in each of the five subsequent years. But in each of those years, on average of only \$12 million would be scheduled to be repaid to IDB by its clients. This meant each year, to repay the principal on the \$100 million borrowing, IDB would have to borrow an extra \$8 million at prevailing interest rates. This scenario assumes all clients were repaying their loans according to schedule (almost never the case) and therefore the amount of rollover, the \$8 million, would be even greater. This was the nature of the mismatch inherent in each borrowing done by IDB to finance new loans. On a cumulative basis, it meant that after five years, the original borrowing by IDB had been repaid but, at best, only 60% had been repaid by its clients, leaving 40% that had to be rolled over through new borrowings at prevailing interest rates.

After FBDB was created, it borrowed its funds from the Consolidated Revenue Fund (Government of Canada) on eight-year terms. Though the term of these borrowings matched the average term of the Bank's loans, a mismatch was still prevalent as the practice of extending fixed rate loans for varying terms, with many over 12 years, continued. Even with eight-year term borrowings, at least 20% of the amount originally borrowed had to be rolled over through new borrowings.

In the IDB era, as interest rates were fairly stable, the financial impact of the mismatch was small and went unnoticed. In the latter half of 1978, however, when interest rates started their upward climb, debt rollover costs were no longer small and they impacted FBDB's bottom line in a significant way. For instance, IDB debt, contracted in fiscal 1974 at an average rate of 7.47%, was re-loaned to Bank clients at 10.23% for a spread of 2.76%. But by 1978, 40% of that debt, which was now FBDB debt, had to be rolled over at an average interest rate of 8.5%, reducing the spread on the 1974 loans by one percentage point. As another example, FBDB

debt maturing in 1980 had interest rates of 8% but this debt was replaced by new debt at 10.2%, a loss of over 2% on the spread from related loans. And matters got worse well into 1981 when the prime interest rate peaked at 22.75%. This was the nature of the mismatch problem that, as indicated, cost the Bank \$118 million before it was resolved.

In 1978, FBDB was told by the government it could access the Consolidated Revenue Fund for a maximum of \$245 million. This limit was imposed due to ever increasing borrowings by the Government of Canada to fund its deficits. For all additional funds required above this \$245 million limit, the Bank was instructed to do its own borrowings in capital markets. And since public markets in Canada were already saturated with government debt issues, FBDB was restricted to private placements with each borrowing having to be approved in advance by the Minister of Finance. This meant in Canada, the Bank would have to deal with individual institutions, primarily life insurance companies and large pension funds, who added a premium of 20 to 30 basis points to their lending rates for the illiquidity of FBDB debt obligations. When extra costs for commissions and legal fees were included, at least another quarter percent was added to the cost of FBDB borrowings as compared to borrowing from the Consolidated Revenue Fund, a premium the Bank could ill afford at the time.

In 1979, the Canadian firm Wood Gundy was selected to manage FBDB's first borrowing in capital markets, a \$15 million issue. Another Canadian firm, Burns Fry, managed the second debt issue for \$25 million. A total of \$105 million was borrowed in capital markets in 1979 in addition to borrowing all of the allowance from the Consolidated Revenue Fund. Furthermore, pending development of its own Treasury operation, FBDB used chartered bank (prime rate based) loans to fund a large portion of its fixed rate term loans. This occurred at a time of an inverted yield curve; short-term interest rates were higher than long-term rates. In October 1979, the Bank was further advised by the government that starting April 1980, it would no longer have access to the Consolidated Revenue Fund for any borrowings. The only funds coming from the government would be annual appropriations to subsidize its Management Services and equity capital for its financial services.

### **Eliminating the mismatch problem**

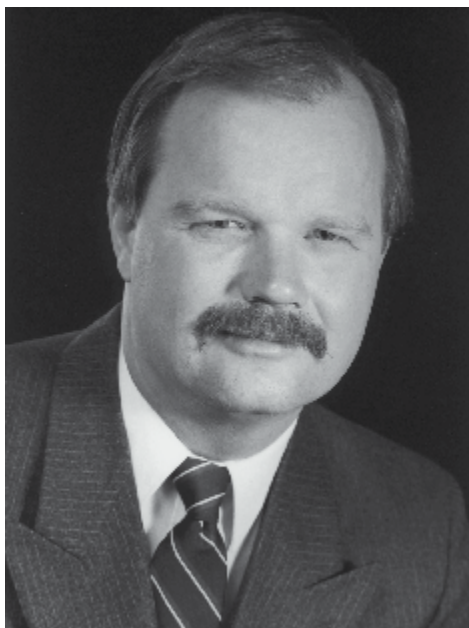
Pierre Charbonneau was hired by FBDB to be its Treasurer in November 1979. His mission was to start up and run a borrowing operation to fund FBDB loans. He came from the Toronto Dominion Bank where he'd worked in its money market operations. His first challenge was to find funds to replace the large amount of borrowings done with chartered banks on a current basis to fund the term loans portfolio. These current debts had to be replaced quickly with longer term debt: first, to match the portfolio; and second, to reduce borrowing rates as the chartered bank prime rate continued its upward climb.

Looking at the profile of debt the Bank had contracted and debt rollovers done over the previous years, it did not take long for Charbonneau to realize there was another, more challenging job that had to be tackled, one that was not even mentioned when he was interviewed for the job as the Bank's Treasurer. A serious



mismatch problem existed at the Bank which, if not resolved, would lead to a continuing erosion of the Bank's interest spread.

In early 1980, Charbonneau met with Guy Lavigueur and told him the Bank was in deep trouble. Lavigueur initially thought there was a problem in finding sources of funds to finance the Bank's term loans. Instead he was told the deep trouble stemmed from the mismatch between the terms of the Bank's term loans to clients and its borrowings. When asked by Lavigueur how serious the problem was, Charbonneau said he could not give an answer as the data and analyses needed to quantify the problem did not exist. He just knew a large problem existed and if it continued, the Bank's interest spread would continue to erode. He had asked the head of the (Information) Systems Department to get the relevant data from the Bank's Loan Accounting and Processing System (LAPS) but was told it would take months to obtain.



Pierre Charbonneau was hired by FBDB to be its Treasurer in November 1979.

Charbonneau explained the root of the problem lay in the structuring of the Bank's term loans. He told Lavigueur the Bank's lending policies had to change. This struck a nerve and Lavigueur immediately called a meeting of his management committee. He asked Charbonneau to explain the problem to the Bank's senior management. Simply put, the Bank could not borrow funds for terms of five years and relend that same money for terms of 15 years. It had to change its lending terms and conditions. As could be expected, the operations side of the Bank questioned his proposition. First, they thought their new Treasurer could not find money to fund the Bank's operations – wasn't that why he was hired? Charbonneau was told the Bank never had problems finding money (just go down to the vault) and further, never had to worry about cost of funds. But as he explained the problem, it became clear changes had to be made or mismatch costs would continue to mount and erode the Bank's interest spread.

In April 1980, the Bank's lending policy was changed. All new FBDB term loans were to be made for a maximum fixed interest rate term of five years, regardless of the term to maturity of a loan. This interest rate term matched the term the Bank was able to get in capital markets on its own debt. The Bank could then adjust interest rates every five years to reflect its current borrowing costs and maintain its interest rate spread. (Almost, since not all loans are repaid according to schedule.)

As interest rates continued to climb in 1980, FBDB clients did not want to be stuck with high interest rates for five years and the demand for floating interest rates grew. In October 1980, the Bank began offering floating rate term loans.

In early 1981, to accommodate the matching process, Charbonneau further proposed that interest rates be set at the time loans were disbursed and not at the time of authorization as had been the practice. This proposal, however, met stiff opposition from branch officers who couldn't understand the reason for the change and further, could not defend it to their clients. So rates continued to be set at the time of loan authorization but a standby fee on undrawn amounts after one month was imposed. Charbonneau did succeed in changing the loan prepayment policy to compensate the Bank better for costs incurred. With this change, clients were allowed to switch their interest rate plans from fixed to floating rates and vice-versa. These actions helped offset the costs of mismatching.

By 1981, the Treasury department had three sub-operations: borrowing long-term funds in capital markets to fund fixed rate loans; borrowing in short-term markets to fund floating rate loans; and fixing the yet-to-be-figured out mismatch problem. Clément Albert was hired from National Bank in 1981 to run the capital markets operation. He joined Sol Bayer who was executing short-term borrowing transactions. Gundars Valdmanis, who wanted to transfer from the Planning department to Treasury to expand his horizons, was brought in to help quantify the mismatch problem.

The Treasury department now had the twin objectives of sourcing funds for the Bank at the lowest possible cost and eliminating the mismatch problem. With respect to the latter, Lavigueur would constantly ask Charbonneau, "where are we on the critical path (to resolving the mismatch problem)?" And for over a year he would receive the same answer: "we don't know – we don't have the data." That's how long it took to figure out the composition of the mismatch problem. Profiles of the Bank's debts were known. What was unknown was the profile of how the Bank's term loans would be repaid. Recognizing the Bank's information system was lacking, Lavigueur told Charbonneau to do the analysis loan-by-loan if that was the only way to get the answers he was looking for. At the beginning of 1981, the Bank had over 42,000 term loans in its portfolio.

An early version of the Bank's financial forecasting model built by Valdmanis included a module that simulated how the loans portfolio would behave. From the LAPS computer system, he was able to get some data on contracted positions for loans already in the portfolio. To this, he added assumptions on the amounts of new loan authorizations and profiles of how they would behave. He brought these data over to the Treasury department and there he continued to refine his

methodology to help figure out the mismatch problem. By 1982, the gaps between the profiles of the Bank's debts and its term loans to clients were quantified. The next step was to structure new borrowings to fund new loans and to correct the existing mismatch. But just as this next step was initiated, new complications arose.

The Bank was still experiencing high loan losses and interest rates had started to decline from their August 1981 peak. These events led to movements in the loans portfolio that exacerbated the mismatch between the Bank's assets and liabilities. The first was the increase in delinquency rates for loans made in the 1980 to 1982 period. Losses amounted to about 15% of amounts authorized in dollar terms (the ultimate loss rate). But in terms of numbers of loans becoming delinquent and going off the books prematurely, the percentage was about double, 30%, the difference being that when a loan went bad, the Bank was still able to collect, on average, half of what was owed through liquidation of pledged collateral. The second contributors to further mismatching were switches from fixed to floating rate plans. In the 1979 to 1981 run-up in interest rates, the yield curve was inverted; long-term rates were lower than short-term rates. Not uncommonly, many FBDB clients opted for the lower fixed rate on their new loans. But when short-term rates dropped lower than fixed rates later on, many opted to switch to floating rates, even with penalty. And as the economy started to improve, those who could find alternative sources of funds elsewhere simply prepaid the full amount of their loans outstanding. Between March 1977 and March 1981, FBDB's loan portfolio had grown by close to \$550 million or 47%; between March 1981 and March 1985 it had shrunk by about \$500 million, 23%. Loans were going off the books faster than FBDB was repaying the debt used to finance those same loans.

This changed the character of the mismatch. In the late 1970s, new debt at relatively higher interest rates had to be contracted to fund loans already on the books, the original mismatch problem. During the first half of the 1980s, the Bank had too much debt contracted at relatively high rates for loans on its books. Put another way, with the original mismatch problem the Bank had insufficient low rate debt; now it had too much high rate debt. A "double whammy" in that the Bank got hit coming and going through the interest rate cycle. The good news was that even though the problem was made more complicated by the economic environment, data and analyses were now in hand to know what had to be done. It took over four years to bring down the mismatch problem to an acceptable level – not zero but almost there.

John Langlais, one of the first professionals Lavigueur brought into the Bank as part of his professionalization program, approached Clément Albert and told him he had just read about a new financial strategy, defeasance, being deployed in the U.S. and asked if there were applications being done in Canada. Albert had not heard of any but immediately saw its use as a way to help remove excess debt FBDB had on its books. With defeasance, a company can sell a specific debt to a third party, and that debt can then be removed from its balance sheet, with an appropriate footnote to its financial statements. With this strategy, the Treasury department was able to rid the Bank of some of its excess debt and even at a small profit. Three such deals were done: with Continental Bank (which later

became part of National Bank of Canada); and with two Alberta-based chartered banks, Canadian Commercial Bank and Northlands Bank. The latter two became insolvent in 1985 but (luckily) FBDB did not lose any money on the defeasance deals. The Northland deal matured one month before they declared insolvency and Canadian Commercial Bank went insolvent a few months later, after the FBDB deal had matured. Only three defeasance deals were done by the Bank as rules for using this strategy were soon tightened to require that counterparties be AAA graded. These transactions are mentioned to exemplify the pioneering spirit of the Bank's Treasury operation in its early days.

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## As borrowing markets tightened, availability of funds became an issue and FBDB was faced with having to take what was available on the market.

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In the 1980 to 1982 period, financial markets were in turmoil to say the least. It seemed each day brought new challenges to funding the Bank's financial requirements. As borrowing markets tightened, availability of funds became an issue and FBDB was faced with having to take what was available on the market. For instance, a borrowing in this period was made for a three-year term even though the funds were to be used to lend at five-year terms. It meant a mismatch was built in to this borrowing. But the economy was in bad shape and large portions of loans were going off the books prematurely. This tempered the impact of the mismatch. Or maybe the mismatched borrowing helped, as the nature and extent of the total mismatch was still unknown. The Bank also entered into extendible debt contracts, where at the end of the term, the lenders had the right to exercise the option of extending the term of the debt if interest rates were in their favour. The market was such that even the Government of Canada had to issue similar options to attract investors (buyers of its bonds). When interest rates declined in subsequent years, investors in three of these FBDB contracts, totaling \$175 million, exercised their options. With the use of new market instruments, the Bank's Treasury operation was able to offset related costs.

### **Innovative borrowing instruments**

The turmoil in financial markets caused by high and unpredictable interest rates led to many innovations and the early 1980s marked the start of financial engineering. And as just illustrated with the defeasance strategy, FBDB was a pioneer in Canada in using new instruments coming onto the market.

Following the introduction of a financial futures market in Chicago, the Toronto Stock Exchange (TSE) created a futures market in Treasury Bills and Government of Canada Bonds in 1982. FBDB, to cover the risk of interest rate declines, was one of the first institutions to tap this market for interest rate hedges with the firm Burns Fry as advisor. At one time, 95% of all outstanding contracts in the TSE futures market had FBDB's name on them. In a way, FBDB was the market creator. The hedges allowed FBDB to offset losses arising from the decline in interest rates after September 1981. With this hedging, FBDB could also rollover its excess debt to finance new loans without incurring major costs arising from interest rate differences.

It was not always a smooth ride in the futures market as interest rates fluctuated wildly. One Friday, the Bank's position in the market would show a (paper) loss of \$2 million but by the next Friday, it would be turned around to a \$5 million (paper) profit. When the mismatching problem was resolved, the Bank pulled out of its hedged positions. Gundars Valdmanis, who was tracking the market, advocated for the Bank to stay in the market a few more weeks to reap additional profits. But the objective of fixing the matching problem had been achieved and true to its objective of sourcing funds at the lowest cost to the Bank, the Treasury department unloaded its hedged positions.

It was estimated, ex-post, that hedging interest rates offset about 50% of potential mismatch costs at FBDB in the first half of the 1980s. Had Valdmanis' recommendation to keep the hedges for a few more weeks been followed, significant profits could have been realized. Then again, if markets had moved the other way, well, hindsight is always 20/20. FBDB was not in the market to make money, it was there to save money, a working philosophy that likely saved millions in the long run. The Bank already had sufficient problems with the government in trying to fund its operating losses and it certainly could not add the risk of further losses arising from Treasury operations. Once the mismatch problem was resolved, the Bank was able to set its interest rates in stable relation to those offered by chartered banks. This removed one element of uncertainty when dealing with clients on the frontline.

As financial engineering took hold in capital markets, FBDB and its advisors tapped new sources of funds and concocted innovative structures – all towards achieving the objective of sourcing funds at the lowest possible cost. Further, it enabled the Bank to offer a wider range of terms to clients: floating rates, one-year fixed rates, two-year fixed rates, etc., up to seven-year fixed rates. The evolution of individual borrowings illustrates the progressive nature of the Bank's Treasury operations.

Locked out of the public domestic market for its long-term borrowings starting in April 1980, FBDB looked overseas to source its funds. Wood Gundy, a principal advisor to the Bank, had a prominent operation in London, England, that gave the Bank access to "pockets of money" in Europe. The first borrowing was referred to as a "plain vanilla Euro-Can" borrowing, that is, a borrowing in Europe in Canadian dollars at a fixed rate for a fixed term. The Bank then tested the market in the U.S. with a \$100 million debt issue, lead-managed by Solomon Brothers, a major Wall Street firm. As U.S. investors had no knowledge of the FBDB, cross-country

briefings were arranged for potential buyers of the FBDB debt issue. Jack Nordin and Pierre Charbonneau did the briefings – in one day. They started with a 7:30 a.m. breakfast meeting with potential investors in Boston, followed by a luncheon meeting in New York, followed by a mid-afternoon meeting in Chicago and a dinner meeting in San Francisco. They could hardly speak at the end of the day but the debt issue was successful. One weakness with respect to U.S. debt issues pertained to legal costs (New York lawyers). Commissions were also very high in the U.S. so the Bank looked to the European capital market to sell most of its new debt issues.

FBDB was operating in a niche market so to speak. Its debt issues were generally in the range of \$50-\$100 million. More importantly, as an agent of the Government of Canada, it had an AAA rating that was very attractive to investors looking for safe places to put their money. The Bank and its advisors also found that with a little financial engineering and innovation, the cost of funds could be reduced, even if only marginally.

A notable piece of engineering was the “Euro-Kiwi” debt issue done with European investors. The Bank borrowed in Kiwi (New Zealand) dollars, not Canadian dollars. The amount borrowed was the equivalent to \$50 million Canadian dollars at prevailing exchange rates. The borrowing rate was 17.75%. In Canada comparable borrowing rates would be in the 10% range. Why borrow Kiwi dollars at 17.75% to fund Canadian dollar loans? This was the territory for financial engineers. Through a series of swaps and hedges, FBDB ended up in a position where its original Kiwi dollar obligation to European investors at a 17.75% interest rate was transformed into a Canadian dollar obligation at a 9.5% interest rate. How? First of all, the Kiwi dollar was under severe pressure in international markets and the market demanded a high premium to offset a likely decline in the value of the Kiwi dollar. In the early 1980s, New Zealand was on the verge of bankruptcy, close to running out of foreign exchange reserves. The situation became so dire that at one time, New Zealand’s embassies and high commissions around the world were told to stop spending.

The 17.75% interest rate was in fact a “good rate” when taking the market’s view of the Kiwi dollar into account. FBDB simultaneously swapped this Kiwi debt with the Royal Bank of Canada for a \$50 million Canadian dollar borrowing at 9.5%. Under the swap, FBDB loaned the Kiwi dollars to the Royal Bank at 17.75% and borrowed \$50 million Canadian dollars at 9.5%. The Royal Bank repayments on the Kiwi debt to FBDB would be passed on to the Bank’s European lenders, thereby fulfilling FBDB’s obligations. The Royal Bank, for its part, did a further swap with the Australia and New Zealand (ANZ) Bank under which ANZ would assume the Kiwi dollar debt in exchange for U.S. dollar funds. In effect, ANZ Bank, flush with Kiwi dollars, would repay the Royal Bank in Kiwi dollars (which were passed on to FBDB and passed on again to the European investors), and Royal Bank would pay ANZ in U.S. dollars in return. Royal Bank assumed the hedge between the U.S. and Canadian exchange rates. Complicated for the era, but doable with all parts of the deal taking effect simultaneously. The end result yielded an FBDB borrowing of \$50 million Canadian dollars at 9.5%, better than an equivalent Government of Canada borrowing rate of around 10% at the time.

This deal raised a few eyebrows and a Canadian Member of Parliament questioned why FBDB was borrowing money at 17.75% – not quite misinformed, but yet another question in the House of Commons to be dealt with by the Bank's Government Relations office in Ottawa.

In terms of innovation, the Bank's Treasury operations did not stop with the Euro-Kiwi debt issue. It later issued debt where returns to investors were linked to different products. One such issue was a straightforward fixed rate debt with a warrant attached that allowed the investor to buy gold at \$462 an ounce. That is, if conditions were advantageous, the buyers of the debt could require FBDB to sell them gold at \$462 an ounce. The warrant was never exercised but the Bank had nonetheless hedged against such an outcome. Even with hedging costs, the cost of this borrowing to FBDB was lower than prevailing market rates. This particular debt issue did not go unnoticed in industry circles. In September 1987, the International Financing Review published an article entitled "Canada goes for gold." It said: "Federal Business Development Bank should have won a medal for the first ever C-dollar issue with gold warrants."

Another FBDB debt issue had returns linked to a stock market index. Again, after fully hedging its exposure, the Bank ended up with a favourable interest rate. One innovative debt issue that led to a remarkably low cost of funds involved tax breaks for the lender in the United Kingdom. To ensure conformity with international tax agreements, Revenue Canada had to be consulted before striking the deal.

The Treasury department had developed a sophisticated money market operation principally to fund its floating rate portfolio. But occasionally it would swap fixed rate borrowings into floating rate borrowings to lower its costs of funds. The Bank would, for example, borrow \$100 million at a fixed rate, say 6.0%. It would then enter into a swap transaction with a financial institution which would pay FBDB a fixed rate of say 6.2% in return for FBDB paying the bankers acceptance (BA) rates on a floating basis. The difference between the 6.0% FBDB paid on its fixed rate debt and the 6.2% it received from the financial institution reflected specific market conditions at the time as well as FBDB's AAA rating. The net result was that FBDB obtained funds on a floating rate basis at 20 basis points (0.2%) below its benchmark BA rate. Swaps from floating rate to fixed rate obligations were also done to keep the portfolio matched and lower the costs of funds. Generally, interest rate swaps allowed the Bank to save at least 10 basis points on its borrowings.

In 1987, the Bank entered the Yen market in Japan. Working through the Canadian Embassy in Tokyo, meetings were arranged with top Japanese investment houses to brief them on the unknown Canadian entity, the FBDB. Included were Daiwa, Yomura Securities, and Yamaichi, all top firms in the Japanese financial services industry already lending to Canadian companies with appetites for large sums of money – EDC (then known as Export Development Corporation) and provincial Hydro companies. To brief potential buyers of FBDB debt, Charbonneau arrived in Tokyo in October 1987 on the very day the stock market had crashed. Japanese are renowned for their punctuality. He knew the crash was having serious repercussions as all his appointments were running late. Soon after, the Bank was tapping the Yen market for funding with

all the appropriate Yen–Canadian dollar hedges in place. The Bank later went to Singapore to tap the Asian–Canadian market, seeking out savings wherever they could be found. Each 20 basis points (0.2%) on a \$2 billion dollar portfolio produced \$4 million in extra revenue a year, significant when compared to annual profits of around \$5 million in the second half of the 1980s.

In the annals of FBDB’s Treasury operations, the 1980 to 1984 period was one of dealing with challenges. The Treasury function had to be built from scratch, the Bank had to go abroad for its funds and a serious mismatch problem had to be fixed. These challenges then led to profitable opportunities in the 1985 to 1990 period as the Bank became a pioneer in debt structuring. The Bank was innovative, not only in its capital markets operation but also in its money market operation. Charbonneau would remark that being thrown out of the Consolidated Revenue Fund was, in the end, a good thing for the FBDB, since it was able to fund its operations at a lower cost than if it had continued borrowing from the Government of Canada.

Clément Albert eventually took over the reins of Treasury and essentially continued the department’s activities on the same path, entering into even more complex debt structures. But the market was telling borrowers and lenders alike that more attention needed to be paid to risk factors, especially counterparty risk.



Clément Albert,  
Treasurer of FBDB.

The Bank had an internal Assets and Liabilities Committee (ALCO) comprising senior members of management. Established as a result of a comprehensive audit of the Treasury operations, ALCO’s mandate was to oversee the operation, paying special attention to risk factors. One factor that received constant attention was



interest rate risk. Given the Bank's experience with mismatching, Treasury regularly measured and reported on the impact of a sudden and permanent shift of 2% in interest rates, both plus and minus 2%. Some presentations to ALCO were complex, reflecting the structure of transactions Treasury was undertaking and, no doubt, some members did not fully comprehend all presentations. It was up to the Treasury department to identify problems and present them and their solutions to ALCO.

One such problem occurred in 1994. FBDB had initiated swap transactions with a subsidiary of Confederation Life Insurance Company, Confederation Treasury Services Limited (CTSL), which, in 1992, was rated AAA. By early 1994, following several downgrades of Confederation Life, CTSL was rated A+, which meant, according to Treasury policy, all transactions with maturities over three years had to be unwound immediately. By then, FBDB had five swap contracts with CTSL totaling \$156 million. As a group, FBDB was owed \$5.8 million by CTSL under these contracts. Two of the five contracts, totaling \$75 million, had to be unwound (sold to another counterparty). This did not pose much of a problem as the market value of these contracts was \$7.5 million; that was the amount owing to FBDB by CTSL. In August 1994, however, CTSL filed for bankruptcy and, by court order, stopped payments to all counterparties. When payments were halted, FBDB owed CTSL \$120,000 but was also owed \$220,000 by CTSL, a shortfall of \$100,000. In effect, sound Treasury guidelines and strict application of policy had reduced a potential loss of \$5.8 million to \$100,000. By the time CTSL went out of business in 1995, the Bank was able to receive \$140,000 from the remaining CTSL swaps. The market had moved in a favourable direction.

CTSL was the only FBDB counterparty to go bankrupt. Following the CTSL event, ALCO was regularly presented with a status report on transactions with counterparties. Concern was raised about the amount of swaps the Bank had entered with the firm AIG Reinsurance. ALCO was given the assurance AIG had a top rating and besides was the largest financial institution in the U.S. – in effect too big to fail. Much later, in the 2008 financial market crash, AIG did fail but was bailed out by the U.S. Government. By then, the Bank was out of the market.

As a postscript, it is worth adding that things changed again in the Treasury operations, well after the creation of BDC. In 2004, the Bank was notified of the government's intention to study the feasibility of crown corporation borrowings in capital markets. The Government of Canada, flush with budget surpluses, had much less need to go to the market for new money. Three years later, after the study was completed, crown corporations, including BDC but excluding Export Development Canada, were directed to source all of their long-term funds from the Consolidated Revenue Fund. With no more capital market borrowings to be done, Clément Albert retired from the Bank in 2008. A scaled-down Treasury operation continued with responsibility for matching BDC assets and liabilities as well as money market (short-term) financing. The Bank had come full circle. It was told to leave the CRF in 1980 and told to return in 2007.

1989

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# Shocks to the system

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FBDB is shaken to its core by unexpected events. First, the government cuts the subsidy for management services and then the strip club scandal erupts. FBDB is subject to intense media scrutiny.

In 1989, major shocks rocked the world's political systems. The fall of the Berlin wall that had separated Germany into East and West, the toppling of regimes in former Communist countries of Eastern Europe, and the occupation of Tiananmen Square in the world's most populous country all took place in 1989, a year that changed the world. That year was also memorable for FBDB as it experienced two major shocks to its operations. The first occurred early in the year – a drastic cut in its Management Services operations followed by the second, later in the year – the strip club scandal.

In the spring of 1989, the federal government, in its annual Budget, announced cuts to a series of government programs. FBDB was not spared. The Budget stated that the government contribution to the Bank's Management Services would be reduced by \$13 million per year. The reduction would be phased in over the course of the year to allow the Bank to adjust its programs and increase cost recovery. The cut represented half the amount received from the government each year to support FBDB management services (counselling, training and information).

The Vice President of Management Services, Claude LeBon, had only recently joined FBDB from Simon Fraser University where he was a professor in its highly regarded business school. On joining FBDB, LeBon's priority task was to conduct a strategic review and lay out a new plan for the Management Services Division. He had just completed his review when the federal cuts were announced. He had to throw out the plans he had crafted and figure out how to operate with half the amount of subsidy the division received from the government.

The unexpected cut in the Management Services budget was a major blow to the Bank, coming at a time when there was optimism for a new expanded mandate. One-third of the Management Services staff, comprised of about 330 persons, had to be laid off as a result of the budget cut. Reminders of earlier staff reductions in the Loans operations surfaced. Lavigueur wrote to the Minister of DRIE to the effect that the severity of the cut-back had a negative impact on the morale of the entire staff of FBDB and raised questions about possible future cut-backs in other areas. Lavigueur also expressed the hope that the activities discontinued by the Bank would not resurface elsewhere in a government department under a different guise.

The Bank had to adapt to these cuts and adjust its operations quickly. It was decided to concentrate the resources of the Division on in-depth management assistance in the form of training, counselling and planning, and eliminate services with the least amount of cost recovery. This led to the termination of the Bank's Information Services, including the promising AIM program. (More on AIM will follow in Chapter 14 on Information Technology.) The Financial Matchmaking service was also discontinued as it had not resulted in the number of matches the Bank had planned. Increasing the cost recovery rate for other management services led to the Bank terminating the availability of management services through the Bank's smallest (C) branches. The Bank's library in head office was also part of Management Services' information services and was slated for elimination. However, the President agreed to keep a pared down version of the library and amalgamated it with the Economics

department. The library was, and continued to be, an essential corporate resource. Cora Siré assumed responsibility for it as she was seen throughout the Bank as the go-to resource person when anyone wanted any business information, internal or external. She was later assisted by Jane Patterson, a librarian (and Canadian judo champion) who moved the library's research service into the internet age.

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The 1989 Budget cut affected Management Services Division directly but there was also an indirect financial impact on the Bank's Loans Division. Reduced management services activity meant less contribution to overhead expenses recorded in the Loans Division's books. But by 1989, the Loans Division was in a sound financial position and managed to absorb the fallout from the Budget cut with some adjustment.

Later in 1989, another shock hit the Bank that would have far-reaching and lingering consequences. It began one Friday afternoon in November. It was after 5 p.m. when Ken Cavanaugh, Director of Public Affairs at head office, received a phone call from a newspaper reporter in Ottawa. The reporter wanted to obtain some information about an FBDB loan to a strip club located in Gatineau, Quebec, just across the river from Ottawa. Taken aback, Cavanaugh called the Loans Department to get the requested information but on a cold Friday evening, no one was around to answer the call. He then called Cora Siré to see whether she could help. All she could do was repeat what was written in the Bank's policy circulars, the Red Book. Normally she could provide statistics on Bank lending to any industry sector but could not in this case as there was no specific industry classification for strip clubs. With no information to give to the reporter, Cavanaugh tried to buy time. If the reporter could wait until Monday morning, he would try to get the requested information.

Next morning, Saturday, it was front page headline news in the Ottawa newspaper: FBDB was financing strip clubs. Prime Minister Mulroney was on a highly publicized trip to Moscow and it was expected the front page headline would be about his meeting with Mikhail Gorbachev, President of the Soviet Union. Instead, news about his trip lay buried in the inside pages of the paper.

The Ottawa headline had a huge, instant snowball effect as newspapers across the country dispatched their reporters to find local strip clubs financed by FBDB. Although the Mulroney Government had been elected to another majority just recently, its approval rating was running low and the media was ready to pounce on any news that would add to the woes of the government. All week, headlines kept turning up about FBDB-financed strip clubs along with relentless comical cartoons.

On the following Monday morning, Cavanaugh tried to get more information about the Bank's lending to strip clubs from the Loans Division but no straight answers were forthcoming. The officers didn't know how many such enterprises were financed by the Bank but at the same time were not denying the loans had been made. Calls kept coming in from reporters across the country as they combed local registries to find out who held mortgages on buildings known to house strip clubs. But Cavanaugh did not have much to give them. With the lack of forthcoming information, it seemed the Bank was trying to buy time. This was a classic case of obfuscation in the face of overwhelming evidence and so the story would not go away. No press conferences were called by the Bank to explain its policies and the circumstances under which the loans were made. It was known throughout the Bank such loans had been authorized over the years but it was not talked about. Guy Lavigueur, though, had to talk about these loans when he was called before the House of Commons Standing Committee on Industry, Science and Technology to explain the Bank's actions.

Fortunately, the meeting called by the House of Commons Standing Committee was not an emergency meeting so the Bank had a couple of weeks to gather its information. Lavigueur assigned Jacques Lagacé, Vice President of Internal Audit and Inspection, to gather all information and files that related, even remotely, to strip clubs. Lavigueur wanted complete information and data on what was in the portfolio. When he appeared before the House of Commons Committee on December 12<sup>th</sup>, 1989, Lavigueur had to have a good picture of what the Bank had financed in the sector.

The December 12<sup>th</sup> meeting attracted an unusually large audience, including a significant media contingent. The room on Parliament Hill where the Standing Committee would normally meet could not accommodate the public attendees so the room was switched to the famed Railway Room, the only one large enough to accommodate the public and the media. Even there, it was standing room only. Presiding over the meeting was the Committee Chairperson, Barbara Sparrow, who was put in the unsavoury position of having to defend the government in the strip club scandal.

Calling the Committee meeting to order, Sparrow asked the media to remove all electronic equipment from the room. It was overflowing with cameras and other recording devices. She then asked Lavigueur to introduce his colleagues at the witness table and make his opening statement, noting that afterwards "we do have some questions."<sup>6</sup>

The President began by saying: "In recent weeks the FBDB has been the subject of numerous reports in the media deploring loans the Bank has made to businesses providing exotic entertainment. Speaking on behalf of the Bank,

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<sup>6</sup> House of Commons, *Minutes of Proceedings and Evidence of the Standing Committee on Industry, Science and Technology, Regional and Northern Development*, Issue N<sup>o</sup>. 20, December 13, 1989. Quotes cited here and in subsequent paragraphs are taken from pages 20:4 to 20:32.

I would like to state for the record that I deplore the situation in which we find ourselves today. It has never been the intent of the Federal Business Development Bank to extend loans or any of its business services to an establishment that, while legal, may be considered to be conducting inappropriate activities and therefore may be considered inappropriate for a crown corporation.” From that moment onwards the Bank would not refer to “strip clubs.” Instead they were termed “establishments that provided exotic entertainment” and loans to strip clubs were referred to as “inappropriate loans.”

Lavigueur went on to debunk several misconceptions being reported in the media. He stated that FBDB borrowed all the money it lent and these monies did not come from the government, that businesses were not being turned down for FBDB financing because their monies were being lent to inappropriate businesses, there was no political influence in the granting of Bank loans, and the Bank was not another money-losing crown corporation. He then provided all the facts available to that date on the Bank’s inappropriate loans. (These are provided later, along with ensuing changes to lending policy.)

The session before the Standing Committee was supposed to be about how and why inappropriate loans were made by the Bank. But some Opposition members, bent on embarrassing the government even further, questioned Lavigueur about the use of external lawyers, particularly the firm of Lapointe Rosenstein that was engaged by FBDB to provide an interpretation of the FBDB Act in respect of its capital ceiling, section 28 of the Act. Different interpretations had led to different conclusions on how much more capital the Bank could receive from the government. (Hence, the innovative interpretation of the FBDB Act that allowed the Bank to receive new capital in 1989 by way of appropriations.) The Lapointe Rosenstein assignment was intended to clarify the issue. This line of questioning, however, was ruled out of order by the Committee Chair.

The Bank’s December 1989 appearance at the Standing Committee was theatre of the highest order with a mass media presence and the questioning on how and why loans were made to strip clubs. Some references from the session give a flavour of the proceedings. One committee member stated, “in the (FBDB) brief the word exotic is used every now and then. That is not a misprint for “erotic”, is it?” At another point in the proceedings, the following exchange took place:

**MacDonald:** So we have \$17 million inappropriate loans?

**Lavigueur:** That is right. That represents 0.002% of the entire portfolio.

**MacDonald:** It does not make it right. I do not care what the percentage is.

**Lavigueur:** One would have been too many. I said that at the very beginning and I still say it.

**MacDonald:** Now we have 38.

**Lavigueur:** One is too many.

**MacDonald:** By saying it was 0.002% you are minimizing the fact that what was wrong is still wrong, and I find that a little offensive.

**Lavigne:** I hope the honourable member does not take it that way, because the purpose of telling you is to be able to detect it for the department of inspection. I have a letter from our external auditor that I would like to quote from.”

The President explained he had asked the Bank’s external auditor why loans contrary to policy were not detected during inspections and audits. The auditor’s response had been that with so small a proportion, it was unlikely they would have been selected by inspectors and auditors for review. That was the context of his reference to 0.002%.

The President continued: “For the record Madam Chair, one would have been too many... I am not saying we are perfect. There is always a place for improvement.” He would also say, as a crown corporation, “not only do we have to be pure, we have to appear to be pure.”

As the Standing Committee proceeding continued towards its second hour, some members were seeing their allotted time for questions shortened to which one Opposition Member remarked: “on point of order, the witness should refrain from lengthy answers. It reduces the length of our questions. Madam Chair, could you please reduce the length of the witness’ answers?”

Towards the end of the session the Bank did come in for some praise in its handling of this very public scum. A government member remarked: “I wish to thank Mr. Lavigne and his team for appearing before this committee. I have been observing you for almost two hours. I have noticed that you are very well organized and that the people with you are providing you with answers very quickly. The Bank must be very well administered if one can go by the way you are answering our questions.”

That was not an uncommon comment on the management of FBDB. The Nielsen Task Force team that reviewed FBDB had doubts about its continuation but after interviewing the President in his Montreal office, the team said they thought the Bank was very well managed. Perhaps this impression contributed to the Study Group’s remark about the Bank having reservoirs of high-mindedness and competence that should not lightly be dissipated. In another instance shortly after, a deputy minister from Ottawa, on leaving FBDB’s Board of Directors, remarked that while there were doubts about the Bank’s relevance, in his view it was the best managed crown corporation.

When Lavigne left the Committee meeting room after responding to members’ questions, he was mobbed by the media, this time with cameras and recorders, all pushing their equipment to his face. Trying to deflect their questions, he received a quick kick to his knee. Perhaps one reporter thought this might be the only way to stop him from walking away. The pain from this blow would linger for days.

After the Standing Committee meeting, the media moved on to other matters. There was a subsequent mention of the scandal in Parliament two months later, in February 1990, but it was in context of the shutdown of Cominco’s Sullivan mine in Kimberley, British Columbia. Sid Parker, the MP for Kootenay East, stated: “We recently learned that some disciplinary action may be forthcoming

within FBDB as a result of loans given to strip clubs. I would like to suggest to the minister that handing over \$79 million to a hugely profitable company with no strings attached may constitute a more serious problem than strip club loans.”<sup>7</sup> The disciplinary action referred to by the Member was one of the internal repercussions of the scandal.

It took another month after the Standing Committee meeting for Jacques Lagacé to collect and scrutinize all files related to inappropriate loans. It was found there were 70 loan clients with businesses providing exotic entertainment. Loan amounts authorized to these clients totaled \$33 million, of which \$28 million were outstanding in December 1989. They represented 0.45% of the loans portfolio. More files were discovered after Lavigueur appeared before the House of Commons Standing Committee. Almost three of every four businesses identified as inappropriate were “mixed” businesses, where exotic entertainment was only a part of an otherwise appropriate business endeavour such as the provision of accommodation and food services. Of the 70 businesses identified, 31 were known at the time of loan authorization to be providing exotic entertainment. The remaining 39 establishments were in other lines of business but converted to providing exotic entertainment some time after they had received their FBDB loan. In one case in Ontario, the FBDB loan was made to finance a restaurant operation. The business fell on rough times and the owners sought help from the Bank. A CASE counsellor was sent in to help turn around the business. It was the CASE counsellor who advised the owners to introduce exotic entertainment to keep the business alive.

The Bank’s position was that it could not have done anything about the 39 cases that had converted their businesses after they had obtained their FBDB loan. But it accepted culpability for the 31 cases known to be providing exotic entertainment at the time of loan authorization.

When the news broke in the Ottawa newspaper about the strip club scandal, it referred to an establishment in Gatineau, Quebec. As the number of cases emerged, there was a misconception that most were located in the province of Quebec. It turned out that the case cited in Gatineau was the only one in Quebec. The majority of the establishments – 18 of the 31 known cases – were located in Ontario. There were two others in the Prairie and Northern Region and 10 in British Columbia and Yukon.

Another misconception was that these loans were profitable for the Bank. In fact, they were more often in arrears than average. Businesses converting operations to provide exotic entertainment had usually not been successful and their financial health rarely changed after conversion. While 9% of all FBDB accounts as at November 1989 were in arrears, 16% of the 70 customers identified as providing exotic entertainment were in arrears.

FBDB’s Board of Directors received a complete briefing on all loans made to these establishments including three large loans authorized at the Board level upon recommendation by management. There was no way any Board member could have known these loans were going to businesses providing exotic entertainment even if they had asked the perfunctory “is there anything else in

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<sup>7</sup> *House of Commons Debates*, Second Session of the Thirty-fourth Parliament, February 5<sup>th</sup>, 1990; Vol. 6, page 631; Library of Parliament.



this file we should know of?" It was even doubtful cases authorized by the credit committee at head office would have detailed documentation about the activities of the business being financed.

The strip club scandal was a huge setback for the Bank, coming at a time when it had worked very hard to build a solid financial foundation on which to expand and received \$35 million in new capital from the government to support its term lending operation. Its image was now tarnished. One fallout from the scandal was no new capital for the Loans Division would be forthcoming for the next six years in spite of significant growth in its portfolio.

There were other major internal repercussions. First of all, the Bank's lending policy had to be changed immediately. Policy issues surrounding the granting of loans to night clubs and cabarets had a long history in the Bank. When the mandate of the Industrial Development Bank (IDB) was expanded in 1961 to include the service sectors, night clubs and cabarets were designated as inappropriate businesses for IDB loans. This policy changed in 1968 when the internal prohibition against these businesses was lifted, the rationale being that the subtleties of morality were becoming progressively more difficult to rule on, especially considering these businesses were receiving local and provincial licences to operate. Then, in 1976, when the FBDB's first President, Richard Murray, expressed concerns about the Bank's involvement in night clubs, cabarets and similar businesses, the lending policy was changed again. Regarding these businesses, the policy stipulated that because of the difficulty in determining whether or not certain applicants may be dealt with, branches should not decline an enquiry or application without first consulting the regional office.

To remove any ambiguity or room for misinterpretation, the lending policy was revised in December 1989. It covered not only exotic entertainment but other types of businesses the Bank could potentially be criticized for financing. The new FBDB lending policy expressly excluded financing businesses or suppliers of premises to businesses: a) that are perceived to be sexually exploitive, including enterprises that feature sexually explicit entertainment, products or services. Enterprises likely to fall into this category would include escort agencies, sex boutiques and certain types of massage parlours, bars, nightclubs or video stores, newsstands and cinemas specializing in x-rated material; b) businesses that fail to conform to health and environmental standards; c) businesses that trade with countries that are proscribed by the federal government; and d) businesses that may be associated with or perceived to be associated with illegal activities.

The Bank also added a standard clause to all its new financings to the effect that any unauthorized change to the nature of operations would constitute default and the Bank's loan would become immediately due and payable. This condition for financing would ensure loan clients could not convert their businesses to inappropriate activities. Unfortunately, it could only be applied to new loans made after December 1989, as another news story, about biker gangs, illustrated a few years later.

One of the objectives of Jacques Lagacé's review of all 70 loan files with exotic entertainment was to find out who in the Bank knew what, and when these loans

were authorized, insofar as the documentation showed. Bending somewhat to public political calls for the dismissal of senior Bank officers, the Bank penalized those who knowingly approved these loans. Fourteen senior officers had their salaries frozen for periods ranging from three months to 18 months. The biggest repercussion, however, was the departure of Ken Neilson from the Bank. Shortly after the scandal broke and politicians were calling for heads to roll, Neilson offered his resignation but it was refused by the President. He ultimately did retire, marking the end of an era at the Bank. He had been largely responsible for bringing the FBDB back to a solid footing by the end of the 1980s, first as Vice President, Human Resources in charge of paring staff in the early 1980s and then in the capacity of chief operating officer responsible for the expansion and profitability of the late 1980s. Neilson had the respect of senior managers in the Bank for being a no-nonsense, down-to-earth kind of a guy. When he retired, he was asked what he wanted as a retirement gift. Neilson replied: “a Husquvarna chain saw.” No high end watches or gold pens for him. He was retiring to the Kootenay region in British Columbia where a chain saw would serve him more than a flashy pen.

Back to the scandal, there were other reactions emanating from the media coverage. An elderly lady called John McNulty, Vice President, Prairie and Northern Region at the time, to tell him: you are all going straight to hell! Also, Don Blenkarn, MP and Chairman of the House of Commons Finance Committee, told the press his committee tried to get the Bank abolished in 1985 but the government was persuaded to keep it by André Bissonnette, the Minister of Small Business. This was the only public reference to the near closure of the Bank. Blenkarn then told the media he was considering another run at the Bank through his Parliamentary committee. Fortunately, this did not materialize.

In his 2002 book, John Crow, former Governor of the Bank of Canada and member of FBDB’s Board of Directors at the time, writes he thought the Bank overreacted to the strip club scandal. To quote: “BDC management overreacted and proposed a new set of financing codes more suited to the stricter sort of religious foundation than to the Canadian business environment. My view, supported by Georgina Wyman, on the board as deputy minister of Supply and Services and also familiar with how such things went in Ottawa, was that all the attention was a nine-day wonder. We were able to persuade management to calm down and consider necessary changes in a more measured and realistic way.”<sup>8</sup>

In the *post mortem*, many wondered why the Bank did not go to the media and affirm the Bank did indeed extend loans to bars and nightclubs, including strip clubs. This argument would have been that these were legitimate businesses, licensed by local and provincial authorities. Like the chartered banks, with whom all the businesses in question dealt, FBDB was not in the business of regulating morality. But if the government wanted the Bank to stop making such loans, the Bank would immediately comply. This strategy may have calmed down the media but could not be carried out as the information on how many inappropriate loans were made was not readily forthcoming. Lack of information led to the perception of obfuscating which, in turn, led to the perception of a cover-up. Furthermore, if the Bank had been placed in a situation by the media where it would admit it did not know how many strip club loans were made, the uproar could have worsened.

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<sup>8</sup> John Crow, *Making Money: An Insider’s Perspective on Finance, Politics, and Canada’s Central Bank*, Wiley, 2002; page 58.

### **A new crisis management strategy**

The Bank was caught flat-footed by the scandal partly because it did not have a strategy in place for dealing with such news stories. Shortly afterwards, a crisis management strategy was devised and put in place. It called for the immediate gathering of all facts in a case, crafting of the Bank's position and drafting potential questions and answers. The crisis management team, or "SWAT" team as it would be called, was to be headed by the relevant vice president who would then keep the President fully informed. Government Relations would also be kept in the loop as they would keep the Minister's office fully informed and provide potential questions and answers for use in Parliament.

A key to success was quick response. To this end, a system was put in place whereby any senior officer in head office or in regional offices could be contacted at any time, 24/7. These officers in turn would have their own means of contacting any of their subordinates at any time. The system was implemented in an era when Bank officers did not have mobile phones (the forerunner to cell phones).

The crisis management system was put to the test in the early 1990s when the Montreal media reported that FBDB had loaned money to the Rockers motorcycle gang, reputed to be a criminal gang. The news came into head office around 3 p.m. A crisis management team was assembled by the Vice President, Corporate Development and included the Vice President for Quebec region, André Bourdeau. By 5 p.m. all the facts in the file were gathered and a position crafted. The Bank had made a loan to a machine shop. The owner had passed away and his widow had sold the shop to the biker club. The FBDB loan was transferred with the sale. The Bank's position was that it never lent money to the biker club and it had no involvement in the sale of the business premises. As far as the Bank was concerned, it had lent money to a machine shop. The Bank issued a press release to this effect and sent it over the media wires. By 6 p.m. interviews with the Vice President, Corporate Development and the Vice President, Quebec region were broadcast on local radio stations. There was limited mention of the story the following day in some print media but there was no mention of it in political circles. The story lasted for two days and proved the crisis management system worked. Apart from limited media stories, there was one small fallout. In the Bank's press release picked up across the country, the Bank made a statement to the effect it did not lend to biker clubs, a phrase that could be interpreted in a pejorative way. That led a social club of motorcyclists to stage a ride-in in front of the Bank's Halifax office. They were coerced into dispersing by Doug Artz, the district manager, just minutes before a local television crew arrived.

Preparedness and a clear Bank position also helped later as the Fifth Estate investigative program on the Canadian Broadcasting Corporation (CBC) television network decided to do a story critical of FBDB. The Bank's regional office in Vancouver had been contacted beforehand by the CBC saying they were planning a segment involving a business the Bank had foreclosed on. The CBC felt it had a newsworthy item about an entrepreneur who had his business foreclosed and livelihood taken away from him by a bank, a government bank to boot. It would be part of the well known weekly Fifth Estate program.

A “SWAT” team was assembled within the Bank to deal with the issue. The entrepreneur had received multiple loans from FBDB to refurbish a cruise boat. From the Bank’s point of view, he kept overspending and after several missed repayments, the Bank decided to call the loan. At the time the loan was called, the cruise boat operator had failed to obtain the necessary Department of Transport licences to operate a passenger cruise boat.

John McNulty, Vice President of the region was designated the spokesperson for the Bank. He was assisted locally by Lois Campbell who was Manager, Counselling and Training at the Vancouver Branch office but prior, had been Manager, Public Affairs for the region (until that position was abolished as part of what seemed to be annual cost cutting exercises at the Bank). Public Affairs at head office played a supporting role.

McNulty and Campbell tried to persuade the producer of the CBC program there was no story there. Someone failed to make his loan payments and after several postponements the loan had to be called. The CBC was not persuaded. Linden McIntyre, the on-camera reporter, was on his way out to Vancouver and the story was not going to be cancelled. The Bank then hired a local media specialist to prepare John McNulty for the TV interview. He went through a series of potential questions and answers with the specialist and was totally prepared for the interview with Linden McIntyre.

When the program aired, it mainly featured the reporter speaking with the cruise boat owner in a public park as well as some clips of the interview with John McNulty. After the program, the cruise boat, which by that time had been repossessed by the Bank (after the owner had opened a fire hose on the bailiff), sank at its moorage in the Vancouver area.

FBDB had emerged from the fallout of media scrutiny both wiser and better prepared. But the strip club scandal cost the Bank dearly and was hard on employee morale. Working for an organization being vilified in the press led to assorted questions and comments by business contacts, friends and family. One lingering effect of the scandal was that subsequent newspaper articles on FBDB would often refer back to the incident, a tarnish that would only be removed, once and for all, by changing the Bank’s name. That five year journey to new legislation still lay ahead. In the meantime, the Canadian economy was about to contract just as FBDB emerged from shocks of 1989.

1990 to 1991

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# Another recession

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FBDB braces for a downturn with proactive measures that enable it to sail through the storm. The government proposes various policy initiatives as the Bank continues to push for new legislation.

In 1989, Guy Lavigueur was in his third five-year mandate as FBDB's President and had intimated to the Board of Directors it would be his last mandate at the Bank. The Board established a Special Committee to find his successor even though the decision on who is appointed President of the Bank is made by Governor in Council (Cabinet). As in 1976, the Board of Directors likely felt it could influence the choice of the next FBDB President. And, as in 1976, after looking in-house for potential candidates, the Board committee decided to conduct an external search.

In March 1990, François Beaudoin was hired as Executive Vice President and Chief Operating Officer. He would have a good three years to prove his mettle to the Board. Beaudoin would eventually become President and lead the Bank through a substantial transformation and modernization. He had an MBA from Columbia University and was formerly a Vice President at the Bank of Montreal where he had held several executive positions in Quebec and Ontario, including the position of Vice-President, Eastern Canada Region.



François Beaudoin was hired as Executive Vice President and Chief Operating Officer of FBDB in March 1990.

Beaudoin's first challenge could not have arrived sooner. In the second quarter of 1990, the Canadian economy entered another recessionary cycle.

The onset of the recession was not unexpected. In fact, Lavigueur had been discerning early warning signs of an impending recession many months before it actually (statistically) started. These were communicated to the Board of Directors as well as to management in field offices and may have contributed to the slow growth in lending in 1989. The experience of 1980 was still fresh in his mind when FBDB had continued going full steam ahead with record loan authorizations just as a deep recession was starting. By early 1990, the signs of an impending recession were clearly visible to all. Prime lending rates at chartered banks had increased during 1989 to 13.5% and were now at over 14%.

Heeding these signs, in January 1990 the Bank instituted a loan monitoring system wherein head office reviewed every third loan authorized below the regional limit. These reviews focussed on the quality of credit decisions, credit assessments and presentations. There was feedback to the regions and districts and, where applicable, credit training was provided. In the first two months of 1990, the loan monitoring system found about a quarter of loans reviewed were marginal or weak credits and there were deficiencies in credit assessments and presentations in about half the cases. Through feedback to the regions and training, this situation was quickly turned around. By June 1990, marginal or weak credits would drop to about the 3% level and deficiencies to about 20%.

Although Directors on the Board had not been at the Bank in 1980, they knew full well the experience the Bank had lived in the 1980 to 1984 period and the fallout of the losses during that period, the most critical being the near closure of the Bank. They were quite concerned about a repeat of operating losses, especially coming on the heels of the worst scandal in the Bank's history. They turned to management, and particularly François Beaudoin, to assure them the Bank was well prepared to handle the recession and there would be no repeat of the 1980 to 1984 experience. For most of 1990, this was the focus of management and the Board of Directors.

The first action taken was to reduce objectives for fiscal 1991. The corporate plan, approved by the Board of Directors and tabled with the government, called for new loan authorizations of \$785 million on a net basis for fiscal 1991. After reviewing regional economic trends with the regional vice presidents, Beaudoin, as chief operating officer, came up with revised objectives for new loan authorizations. This led to a reduction in the Bank's overall objective to \$585 million in net loans for the fiscal year. The reduction ensured that managers throughout the Bank did not pursue marginal credits for the sake of attaining their assigned volume objectives.

Beaudoin then introduced the concept of a "watch list." There were two objectives to this list. The first was to identify accounts having a probability of being downgraded within six months. These would be the accounts on the watch list. The second was to work with clients on the list to reduce the likelihood of downgrading occurring. Watch list clients would have any of the following characteristics: loan payments being returned for reason of Not Sufficient Funds (NSF); requests for postponement of principal repayments; requests for working capital loans; negative financial statement reviews or chartered bank feedback; and, in general, any adverse trends in a client's business.

Administration of accounts on the watch list was quite intensive. It included a client visit to ascertain problems and inspect business assets. Identified problems as well as potential solutions had to be reviewed with clients. There were to be third party verifications – chartered banks, auditors, property tax updates, etc. – where warranted. Monthly visits, full documentation, monthly reporting and ongoing assessments were all part of this intensive effort. Branch watch lists, together with problem resolution and liquidation reports, were to be prepared and received at the district office no later than the fifth of the month following. Then they were to be sent to the regional office no later than the 10<sup>th</sup> of the month and

to head office no later than the 15<sup>th</sup> of the month. Of the Bank's 15,000 customers, close to 1,000 were placed on watch lists during fiscal 1991. Working with clients to resolve their problems paid off as some 79 accounts were upgraded in the latter half of the year.

Accountability measures were also implemented. All loan submissions above the regional limit now had to carry the formal recommendation of the regional vice president. And a new component was added to the performance evaluation process. For each field level (regional vice president, district general manager, branch manager and account officer) loan portfolio management was added as a component of their performance evaluation.

Success in managing the watch list as well as performance against key measurements such as risk mix, arrears and non-productive accounts became part of the performance evaluation criteria. To stress the importance and give emphasis to portfolio management, the Loans Department in head office was reorganized. Two new assistant vice president (AVP) positions were created: an AVP, Loan Portfolio Management and an AVP, Credit Policy and Portfolio Risk Management. Denis Casavant and Les Elliott were appointed to the respective positions, reporting to John Ryan, Vice President, Loans Operations. At the same time, Frank Watters was given a long awaited and deserved promotion to Vice President, Credit, also reporting to Ryan.

Another administrative action introduced by Beaudoin was third party appraisal. Prior to this, the Bank's officers would themselves do appraisals of assets in liquidation. It was thought independent appraisals would lead to more realistic estimates of potential loan losses. One of the problems encountered during the 1980 to 1984 period was the constant, upward revisions of loan losses on delinquent accounts as time progressed. This was due to downward revisions of appraised values of assets pledged as collateral on Bank loans. Deterioration of asset values was a natural outcome of a deepening recession but appraisals by FBDB staff were perceived as unrealistic in some cases. In any event, it was felt third party appraisals would give better estimates of loan losses and fewer revisions during the liquidation process.

By October 1990, the Canadian economy was in recession and new loan activity at the Bank was following suit. Although the fiscal 1991 objective for net loan authorizations had been revised downwards from \$785 million to \$585 million, it appeared that volume would be even less, around \$360 million (half of what it was the preceding year). Non-performing loans were also on the rise, increasing rapidly from about \$50 million in April 1990 to about \$90 million by the month of October. FBDB was not the only bank seeing a rise in non-performing loans. Domestic non-performing loans at two chartered banks (for which data were available) were more than double the levels of the previous year.

By the end of fiscal 1991, FBDB saw its net loan authorizations drop to \$426 million from \$722 million the previous year. The staffing norms, which had been refined and were still in use, suggested the Bank had a surplus of staff of roughly 10%. In normal times, that surplus would lead to staff cuts. At the time, there were about 900 employees in the Loans Division and it was calculated there

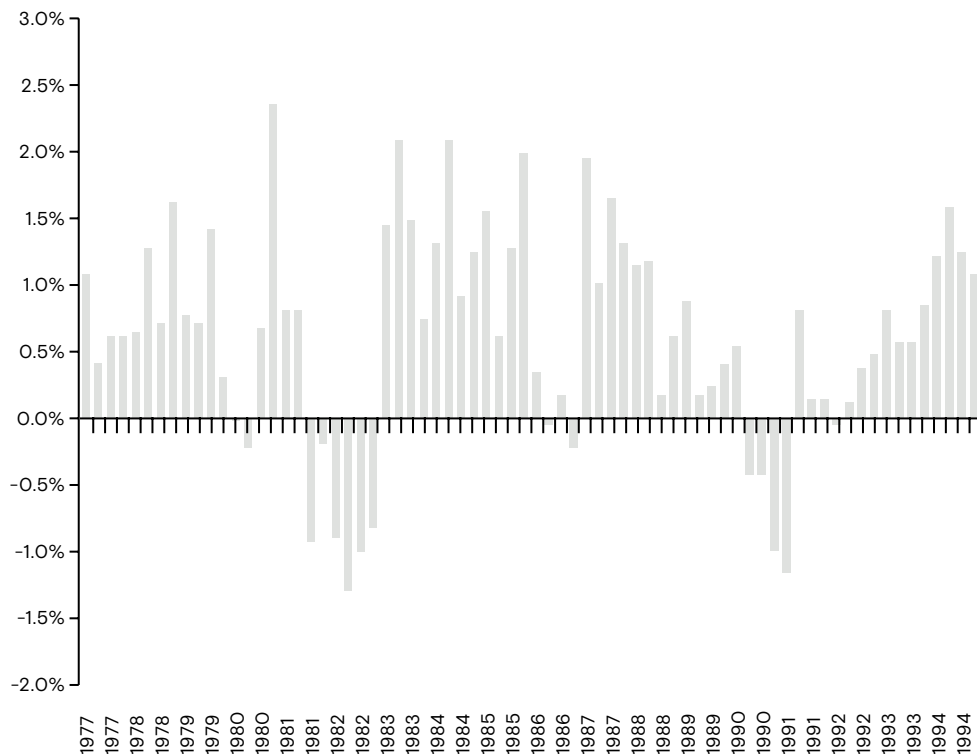


was an excess of 83 positions in the Bank when assessed against loan activity. However, the Bank's management convinced the Board of Directors it would be beneficial to keep the excess staff as they would be needed when the economic recovery arrived. It was predicted the recession would not be as severe as the 1980 to 1982 recession and the costs of laying-off and rehiring staff did not pass the cost-benefit test. It was agreed to allow normal staff turnover to reduce staff counts and to redeploy staff from low to high volume locations. The bottom line was that the Bank could afford to carry excess staff through the recession.

The following charts show the comparison between the economic recessions starting in 1980 and 1990 from the standpoint of growth in real domestic product and interest rates.

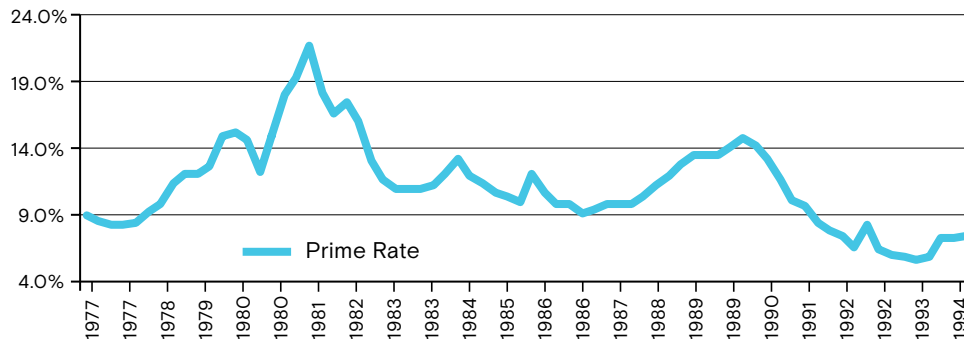
As it turned out, loan authorizations did not return to their pre-recession levels until fiscal 1995 as economic growth was modest coming out of the 1990 recession. The new loan monitoring system also likely led to a slightly more cautious approach in the market. Another more important factor was that actual loan losses, that is, losses associated with loans becoming impaired, remained relatively high through the whole fiscal 1991 to 1994 period, in spite of lower levels of new loan authorizations. This was a clear result of the impact of economic recession on FBDB's portfolio.

**Chart 4** Real Gross Domestic Product Growth (Quarterly)



Source: Statistics Canada.

**Chart 5** Prime Interest Rate



Source: Bank of Canada.

Table 5 below shows the Loans Division was still able to post a profit in spite of relatively high actual loan losses in the fiscal 1991 to 1994 period. This was due to foresight in the late 1980s to build up general loan loss reserves. As discussed in an earlier chapter, over the fiscal 1986 to 1990 period, the cumulative difference between provisions for loan losses charged against income and actual loan loss experience had amounted to \$139.3 million. This \$139.3 million was now available to tide the Bank over the 1991 to 1994 period. Table 5 also shows the differences between the provisions for losses charged against income and actual loan losses during this time. The differences between these two amounts came from the general loan loss reserves built up in the late 1980s. The objective to be profitable through all economic cycles was put to the test, and the Bank clearly achieved its objective.

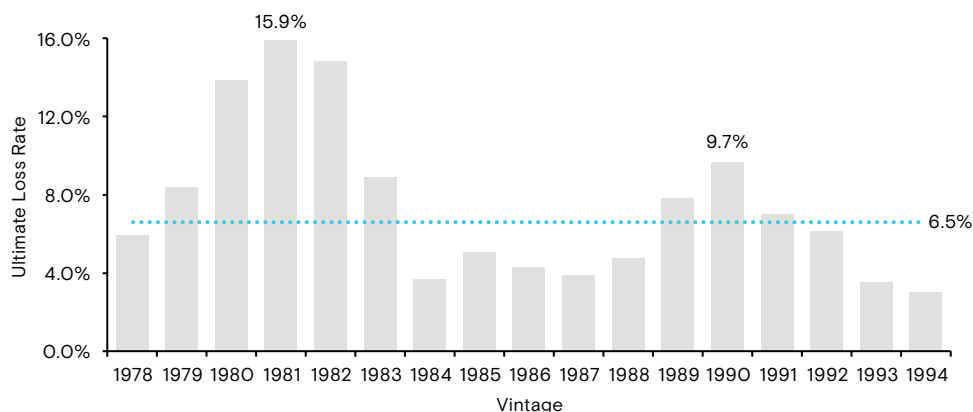
**Table 5** Loans Division – Use of General Loan Loss Reserves Fiscal 1991-1994 (\$ in millions)

Fiscal Year	Actual LLE	Provision for Loan Losses	Difference	Declared Profit
1991	\$53.3	\$48.4	\$4.9	\$4.3
1992	\$50.8	\$37.5	\$13.3	\$0.6
1993	\$48.9	\$38.9	\$10.0	\$1.0
1994	\$55.4	\$45.6	\$9.8	\$4.6
Total	\$208.4	\$170.4	\$38.0	\$10.5

\*LLE-Loan Loss Experience

The foregoing table shows \$38 million of the \$139 million in general loan loss reserves built up in the late 1980s were required for the Bank to post its small profits, leaving \$100 million of reserves with which to build the next phase of the Bank.

Loss rates on loans authorized in the 1989 to 1992 period were not as high as those experienced in the early 1980s. But they were still above the cost recovery objective of 6.5%, as the following chart shows.

**Chart 6** Ultimate Loss Rate – FBDB Loans Year of Authorization 1978 – 1994

*Ultimate loss rate is the total amount lost as a proportion of amount authorized in a fiscal year.*

As in the early 1980s, Ontario bore the brunt of the recession. Between fiscal years 1990 and 1994, FBDB's non-performing loans increased by a factor of 2.6. Over the same period, the factor was 8.2 in Ontario followed by 3.8 in the Atlantic region, 1.8 in Quebec and 1.1 in the Prairie and Northern region. In the B.C. and Yukon region, non-performing loans increased slightly in 1991 and 1992, then declined to about two-thirds of the 1990 level thereafter.

In the early 1990s, as FBDB was 'sailing through the storm,' the first priority was to ensure proper management of the loans portfolio. But there were other issues to be dealt with by the Bank and, as usual, with Ottawa.

### Responding to government proposals

With the fortunes of the ruling Progressive Conservative government on a downward slope, Prime Minister Mulroney changed the composition of his Cabinet in 1991. After serving for seven years as the Minister of Finance, the Honourable Michael Wilson was appointed Minister for Industry, Science and Technology (ISTC) and Minister for International Trade. As Minister of Finance, he had been responsible for implementing the Goods and Services tax, a sales tax widely acknowledged to have saved Canada from going further into debt and possibly following the path New Zealand was on in the 1980s. As Minister for International Trade, he was responsible for negotiating the North American Free Trade Agreement (NAFTA) with the U.S. and Mexico. Those were two huge feathers in his cap. As Minister of ISTC, he was responsible for FBDB, possibly not a feather by his standards, but an important responsibility nonetheless.

Following a meeting Minister Wilson convened with the heads of all departments and agencies reporting to him, a Prosperity Agenda was released by his office. It called for, inter alia, new measures aimed at small business, an important constituency. All the new measures were to be administered by the department, ISTC. But it was in FBDB's interests to be involved and, given the Bank's delivery network of offices, it was called on to contribute to various new ventures, many of which never saw the light of day.

First, FBDB was required to participate in “Community Talks” which were the part of the Prosperity Initiative, the Agenda having morphed into an Initiative. The Talks were aimed at soliciting feedback from the business community on ways to get the economy moving again and out of the recession. They also served to promote services provided by the federal government. The Bank did not mind being part of these Talks as local FBDB officers would bring into the room many of the Bank’s supporters, including clients. Such involvement would show grassroots support for FBDB and stem any criticisms of the type officials were receiving from industry when they were crafting and re-crafting the elusive new FBDB mandate in the latter half of the 1980s.

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In the early 1990s, as FBDB was ‘sailing through the storm,’ the first priority was to ensure proper management of the loans portfolio.

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Other initiatives in which the Bank was asked by ISTC to participate financially included a study by Price Waterhouse consultants to look into the feasibility of establishing a national business information network. Once the study was completed, it spawned a proposal to establish the Canada Opportunities Investment Network (COIN). This initiative resembled FBDB’s former Matchmaking service that was terminated when Management Services funding from Ottawa was cut in half in 1989, two years earlier. At the time of the cut, FBDB’s President had written to the Minister of DRIE saying he hoped the programs cut by FBDB would not turn up in a different guise in a government department in Ottawa. COIN was left on the drawing table.

Another proposal coming from ISTC requiring a response from the Bank was the establishment of Community Venture Pools (CVPs). These pools of money were to be targeted to start-up situations. It was thought “angel” investors (wealthy individuals) would participate in CVPs. FBDB was asked to deliver the CVP program. For the Bank’s part, its participation hinged on being compensated for its administrative costs plus any liabilities that could arise from administering the pools of money. CVPs, like COIN, were never implemented.

Then came the proposal for a Business Networks Initiative. The vagueness of this proposal, which the Bank was asked to respond to, can be characterized by a letter sent to the Bank by an ISTC official, along the lines of: Further to our telephone conversation this a.m. on this subject, I am pleased to enclose a notional concept of the concept, scope and funding of such a strategic initiative.

In its February 1992 Budget, the government called on all departments and agencies to take all reasonable steps to provide government services in “clusters” through common points of service delivery. This led to the creation of Canada Business Service Centres and FBDB was expected to co-locate with government departments providing services to business. This initiative, recall, was tried earlier in 1983 when the Minister of DRIE mandated FBDB and DRIE to co-locate offices where feasible. Calls for one-stop small business centres seemed to be a leading indicator of upcoming general elections.

The Bank had been quietly reticent to the initiative in 1983 and was so again in 1992. As in 1983, the Bank agreed to a co-location (same street address/office tower) strategy but not co-habitation. At the time, the Bank was in the process of moving its Bathurst branch office, coincidentally, to the same office complex where other federal agencies were already located. For FBDB, the Bathurst office became its poster office for cooperation in co-locating federal business services. The Bank agreed to share the cost of a common receptionist but drew the line at sharing other facilities. It was made known to other federal departments in the building that the Bank’s meeting rooms, copiers and the like were already being used to full capacity.

The Bank worked actively on some proposals coming from Ottawa. In early 1992, the U.S. Department of Commerce imposed a 14.5% countervailing duty on imports of Canadian softwood lumber. The duty was challenged by the Canadian government but it would take years to resolve. In the meantime, softwood lumber exporters to the U.S. had to post bonds or cash deposits with U.S. customs for the countervailing duty. FBDB was asked by the Department of External Affairs and International Trade to assist those exporters unable to obtain bonds or make the cash deposits. The Bank quickly developed a program to guarantee the bonds when needed. The Bank’s only condition was that it be compensated for its costs. Like others, this program was not implemented but it did show a strong willingness on the Bank’s part to assist in special government initiatives.

### **Proposed expansion of Farm Credit Corporation**

The most important challenge the Bank faced in Ottawa in the early 1990s was the proposal by Farm Credit Corporation (FCC) to expand into FBDB’s sphere of lending: specifically, to provide loans to small businesses in rural Canada. FCC’s loan portfolio had decreased by \$1.5 billion in the previous five years while their administration expenses had risen from \$33 million to \$53 million. An expensive recovery plan for FCC was in place but the corporation was looking for future growth markets.

FCC’s expansion proposal was strongly opposed by FBDB, which had the majority of its clients in non-metropolitan areas. When FCC claimed FBDB was not active in rural areas, the Bank sent them a cross-Canada listing of over 400 rural towns where it had loan clients. The potential problem for FBDB was that FCC, which was not a supplementary lender and could compete for loans with chartered banks, could easily make significant inroads to FBDB’s market since FCC offered lower interest rates. The Bank was concerned FCC could lure its clients away with lower interest rates even if it led to operating losses for FCC. History

had shown FCC's operating losses were readily financed by the government. FCC had strong political and industry support, support FBDB did not have. (It was often joked if FCC was faced with closure, as FBDB had been, there would be crowds of livestock demonstrating on Parliament Hill.)

FBDB's position was that if the government wanted more small business lending done in rural communities, FBDB was the best vehicle to get the job done. FBDB was not alone in opposing FCC's expansionary proposals as the Canadian Bankers Association also registered opposition.

There was an added urgency to getting a new Farm Credit Corporation Act passed in Parliament. The Minister of Agriculture wanted to move FCC's head office to Regina, Saskatchewan. Such a move would provide a major boost to the local economy, not to mention the popularity of the politician who made it happen. The government had agreed to the move but FBDB's opposition to the expansion of FCC's lending mandate was a major stumbling block. Meetings at all levels of government took place to resolve the FCC/FBDB issue. When senior officials were meeting, Beaudoin attended on the Bank's behalf.

Senior officials had high regards for Beaudoin as he gave them the view from the private sector. In the meantime, the head of FBDB's Corporate Development group was keeping a key advisor to Minister Wilson abreast of events in the file. The advisor was Rob Dunlop, a ministerial staff member. At the first meeting of department and agency heads Minister Wilson had called, soon after he was appointed to ISTC, Lavigne noticed the Minister consulting with Dunlop quite frequently. On returning to Montreal from this meeting, he told his head of Corporate Development to contact Dunlop and brief him on FBDB matters. Periodic meetings between the two took place, all without any agenda or particular purpose in mind, just sharing of information. Through this contact, the Bank ensured a key advisor to the Minister of ISTC was kept abreast of general matters concerning the Bank.

FBDB's position received much support in Ottawa from officials who did not look favourably on: i) overlap that would be created between FCC and FBDB; ii) more competition between FCC and private sector lenders; and iii) the potential for federal-provincial conflicts. These were important policy conflicts the officials would rather have avoided. FCC had strong support, however, from its Minister of Agriculture.

Senior officials from the Privy Council office intervened. The Privy Council, as noted earlier, is the Prime Minister's department. The fact they had to intervene in the file meant there was a serious problem, even by Ottawa standards. Eventually, FCC pulled back from their position to expand into small business lending and FBDB agreed to a slight expansion of FCC's mandate to include lending for "on-farm" diversification projects and to "off-farm" value-added agricultural operations. The Farm Credit Corporation legislation was subsequently passed before the 1993 general elections and its head office moved to Regina.

The debates over FCC would have been non-existent if the government had followed the conclusions of the Nielsen Task Force in 1985. The Study Group reviewing FBDB concluded that if the Bank were to be kept in place – recall they

were of two minds, to keep or not to keep – consideration should be given to having FBDB deliver a wider range of business financing programs, including those of the Farm Credit Corporation.

The idea of merging federal crown corporations providing financing to businesses was raised during the latter part of the 1980s. The hypothetical merger would have included the Export Development Corporation (EDC), FBDB, FCC and the Canadian Commercial Corporation (CCC). The Honourable Robert DeCotret, as President of the Treasury Board of Canada, was intrigued with the idea. After all, chartered banks provided the same types of financing all under one roof. A major stumbling block to such a merger was determining which crown corporations would be merged into which. Each corporation had its own Board of Directors, head office, unique culture and operating system. One proposal put forward was to create a holding company initially, with four operating divisions. Over time, common services such as human resources, treasury and information systems could be moved to the holding company. It was an exercise that got nowhere. However, the concept of merging the financial crowns, as they became known, would return to the table in the mid 1990s.

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## While FBDB was responding to new ideas and initiatives for small businesses, the Bank was still pushing for its own new legislation.

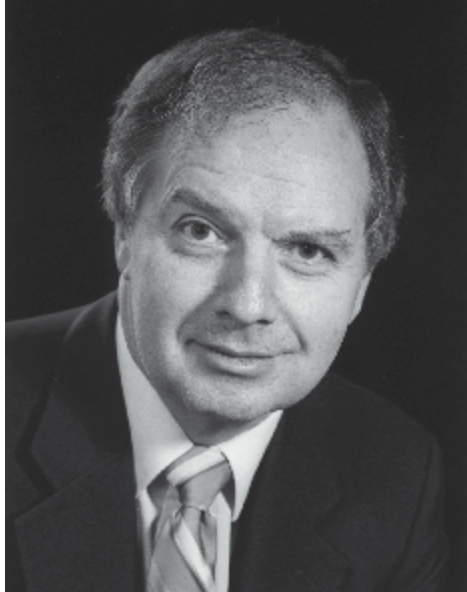
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While FBDB was responding to new ideas and initiatives for small businesses, the Bank was still pushing for its own new legislation. But as in the 1980s, discussions with Ottawa officials kept running into dead ends and action on new legislation was continually postponed. By 1993, the Bank received somewhat definitive word when it was told Parliament had a heavy workload and could not consider any new Bank legislation.

### **Reorganizing head office**

On the internal front, Lavigne continued to hand over responsibilities to François Beaudoin. In the early 1990s, head office functions were reorganized, including the merger of the Planning and Economics departments. The new department was merged soon after with the Government Relations and Public Affairs departments to become Corporate Development, which later became Corporate Affairs when the Legal Affairs and Information Systems departments were added. The head of the Economics department (the author) was appointed

to lead these successive groups. As a result of these mergers, two stalwarts took early retirement: Hugh Carmichael who was head of the Planning department; and Michel Azam, the head of Government Relations. Both had played major roles in the transformation of the FBDB and in keeping it alive through the perilous years of the 1980s.



Hugh Carmichael,  
head of the Planning  
department.

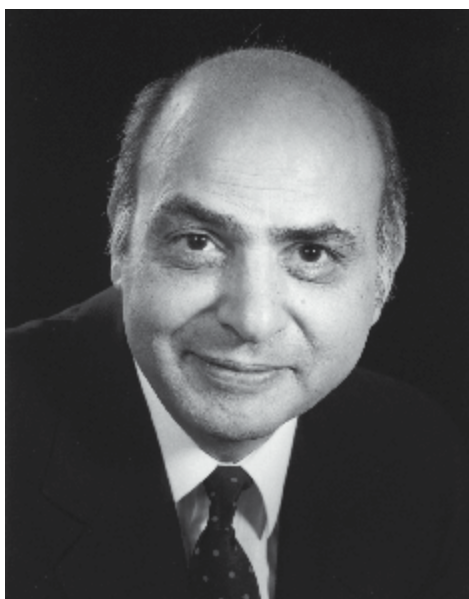
Hugh Carmichael's exposure to the ways of Ottawa reached back to the 1970s when negotiations were being conducted to transform the Industrial Development Bank to FBDB. His enlightenments of government officials to the practical aspects of small business financing were mini-lectures to behold. Ritchie Clark in his *History* does not attribute the quote, "when was the last time you ever lent five dollars?" but it certainly rings "Carmichaelian."

As head of the Planning department, Carmichael was constantly pushing for change as all good planners do. His speciality was management systems. When the latest ideas were published by gurus such as Peter Drucker of Harvard University, Carmichael would push to have them implemented in the Bank. This was the case when the best-selling book *In Search of Excellence* by Tom Peters and Robert H. Waterman, Jr. hit the shelves in 1982, providing insights on management techniques used by leading companies with records of profitability and continuing innovation. Carmichael was also responsible for providing the blueprints for the Bank's new services following the 1983 mandate, the first set of corporate plans, the integration of planning and budgeting systems, and the innovative venture loan financing instrument. He worked closely with Michel Azam to get all necessary government approvals for the Bank to continue its work.

Michel Azam had been recruited by Lavigne in 1980 from the Department of Industry, Trade and Commerce to head up the Bank's Government Relations office in Ottawa. Handling day-to-day enquiries from Members of Parliament, mostly



concerning loan refusals and foreclosures, as well as enquiries from officials were standard parts of his job. His more important responsibilities required diplomacy and subtlety. When critical issues arose, Azam bridged gaps between the Bank and the government. Even more important was his unofficial role as confidant to the President. In this role, he not only provided advice but was also a channel of communication with senior officers.



Michel Azam, head of Government Relations.

### Forging international relations

By the start of 1992, most executive responsibilities had been handed over to François Beaudoin in his position as Executive Vice President. One of the last tasks for Lavigueur was to chair a conference of the Organization for Economic Cooperation and Development (OECD), the Paris-based organization. Azam had negotiated with Florence Estimé of OECD to bring its small business conference to Montreal under the co-sponsorship of FBDB and other Canadian corporations. The theme of the May 1992 Montreal conference was “Small Business in the Global Economy: New Structures for Development.” It attracted hundreds of participants and publicity for FBDB. It was at this conference that Lavigueur posed the question: do we want to be a nation of hamburger flippers? As will be presented, the implications of this question were the focus of the first special examination of the Bank conducted by the Auditor General of Canada and shaped the Bank’s next mandate.

The OECD conference was not the first international conference hosted by FBDB. In 1989, it had hosted the annual meetings of the Association of Development Financial Institutions of Asia and the Pacific (ADFIAP), and the World Federation of Development Finance Institutions (WFDI). FBDB was seen as a leader among the world’s institutions providing development financing. The Bank was often tapped by the World Bank to provide training to bank officers from

developing countries. For example, the World Bank sponsored a training visit to FBDB by a team of officers from the China Construction Bank. Close to two dozen officers from that bank came to FBDB to look at its systems and lending practices. (China Construction Bank is now one of the largest banks in the world.)

In 1992, the Canadian economy was coming out of its recession and the attention turned to growth, improving the efficiency of FBDB operations and implementing new approaches in response to environmental and other issues. Prior to the recession, FBDB had increased the size of its loans portfolio from a low of \$1.5 billion in 1985 to \$2.7 billion in 1990. Coming out of the 1990 to 1991 recession, it was now up to Beaudoin and his team to get the Bank back on track to increasing the loans portfolio, without incurring operating losses. He also had to address the grave impacts environmental liability could have on the Bank.



A team of officers from the China Construction Bank visiting FBDB.

### **New environmental policies**

New laws had placed potential liabilities on lenders to businesses causing environmental damage. Furthermore, the Bank, as reflected in its new Inappropriate Loans policy, did not want to be associated with businesses that failed to conform to health and environmental standards. Since most businesses have the potential to affect the environment, a new set of policies and procedures relating to the environment had to be developed and implemented.

The Bank had already identified 89 clients' businesses that posed a potential threat to the environment. There was one particular case causing much concern. The Bank had taken possession of a gas station in Ontario as part of a liquidation process. The gas station was found to be the source of groundwater contamination in the area. Residents depended on the groundwater for domestic use. Under the "deep pockets" provisions of the law, any owner of a business causing damage to the environment, regardless of when that damage was done, was responsible for liabilities arising from the damage. In the Ontario case, FBDB

did not cause the damage, its client had. But since it took ownership of the property at one time, it became liable for the damage. The Bank supplied the Ontario community with bottled water for a number of years.

Lavalin Environment Inc. was hired to develop FBDB's environmental policy and related operating procedures. The firm had a large customer base of federal and provincial environment departments and knew well how various laws and regulations on the environment would be applied.

When FBDB implemented its Environmental policy and procedures, it was one of the first (if not the first) among lending institutions in Canada to do so and it served as a model for those who followed. There were clear objectives to the new policy: i) establish an environmentally minded staff; ii) minimize the Bank's environmental liability; and iii) establish efficient and workable review procedures to implement the policy for existing and new clients. An Environmental Risk Management Manual (ERMM) was produced to assist the Bank's officers, most of whom were non-scientific professionals, in administering the policy. The manual identified and described various forms and sources of pollution such as waste generation, waste water, atmospheric emissions, hazardous materials, and soil and groundwater contamination. Special training was given to officers across the Bank on how to apply the new policy and use the manual.

The Bank's environmental policy called for three levels of environmental assessments to be part of its loan investigations. A Phase 1 assessment required completion of an environmental questionnaire for businesses with a low risk of environmental contamination. A Phase 2 assessment involved a more detailed questionnaire for businesses where there was confirmed environmental risk such as auto body repair shops and scrap yards, and for businesses using contaminants and having a high potential for polluting the environment. A more rigorous Phase 3 assessment was required for all businesses producing contaminants, such as a chemical manufacturing plant.

The Environmental policy and procedures were implemented smoothly across the Bank and undoubtedly helped prevent liabilities for the Bank. The development and delivery of staff training for administering the policy served as a model for future changes to Bank operations.

### **Operational review to improve efficiency**

François Beaudoin had the unique advantage of seeing how both the private sector and FBDB were organized to carry out their lending activities. It did not take long for him to start making changes to the structure of the Bank's operations. He initiated the first operational review. There was a second one done later as continuous improvement in operations and productivity was a recurring theme in the 1990s. The purpose was to streamline workflow processes and develop standards to measure efficiency and effectiveness throughout the Bank.

The operational review focussed on the amount of time spent on various job tasks at all levels, the number of levels involved in approval processes, delegations of authority, the amount of paperwork generated and training requirements. Management Services was also conducting a review of its activities and its

delivery mechanisms were included in the operational review. These efforts were expected to result in a number of organizational changes as advances in information technology were spawning drastic improvements in how information could be processed and shared in companies.

The first result of the operational review was the creation of an independent credit function in field offices. Eight assistant vice president (AVP) positions were deployed across the Bank, reporting not to regional vice presidents, but directly to the Loans Department in head office. The objectives for these positions were related solely to creditworthiness and credit quality. Viewed another way, it was a decentralization of the head office credit function with credit decisions being brought closer to clients. The independent credit function allowed for the removal of the district office layer of management and, with the AVP Credit position in place, regional vice presidents would be less involved in routine day-to-day transactions – or so the theory went. In this line of thinking, the Bank's 17 district offices could be removed from the organizational hierarchy and replaced with a structure that saw 43 branch offices reporting directly to regional vice presidents, and the remaining 35 smaller branch offices reporting to the 43 branch offices. This structure was not implemented as it ran into stiff opposition. Instead, district offices became area offices headed by an assistant vice president and area general manager. With the AVP Credit position in place, however, 17 District Managers, Loans were removed from the organizational structure. The operational review did not achieve the goal of removing a layer of management but it would try again in a later round.

The greatest impact of the operational review was in the area of information processing. For decades, the Bank (both FBDB and IDB) had come to rely totally on its Form 4073. This was the form containing all information needed to decide whether a loan was authorized or not. It was painstakingly typed on a typewriter by typists, stenographers, secretaries and administrative assistants over the years. If changes had to be made to a typed Form 73, as it was called, the form had to be re-typed in full or, if feasible, pieces were cut and taped together. This was standard procedure as changes were always being made to Form 73 information. The only productivity improvements to this process over the decades were the introduction of electric typewriters, notably the IBM Selectric, the introduction of whiteout liquid over which revisions could be typed, and typewriter eraser tape.

The operational review changed the way the critical Form 73 could be prepared with the introduction of an application known as The Manager. The development of this software, which produced one of the largest productivity gains at the Bank, is described in Chapter 14 in the context of the evolution of information systems at the Bank.

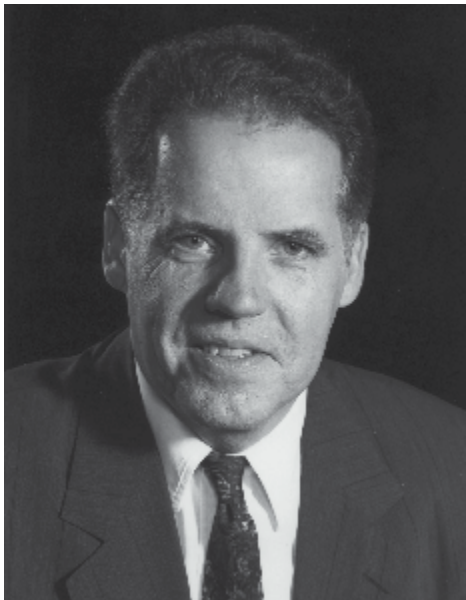
The Manager allowed account managers to enter all relevant client data directly to a computer data base (although many still relied on administrative assistants to enter the data onto computers). It allowed for quick and efficient revisions to Form 73s as well as electronic communication with other Bank officers. This led to a reduced need for administrative staff whose main function, in many cases, was the typing and re-typing of Form 73s and Form 4046s (the latter form used to amend loan conditions). With the onset of The Manager, FBDB was able to convert administrative staff to client service representatives (CSRs) with responsibilities for

administering loan accounts. CSRs also provided the benefit of being a continuing contact person at the Bank for clients since account managers were frequently on the move.

Another impact of the operational review was the introduction of a Lender Qualification program. It formalized skills and experiences required for various loan authorizing levels. The loan review program was also expanded to provide ongoing feedback to credit officers with the aim of improving credit skills and clarity of the Bank's credit criteria. To meet the goals of the operational review, the Bank's staff training program was greatly expanded. At one point, there were so many employees on training that a special trainee category had to be created in the staff counts. These staff were not available for productive work so the staff productivity model had to be adjusted to account for staff in training – the staffing norms had morphed into a productivity model.

The Management Services Division had to conduct its own operational review. But this review was broader in scope, in that it was combined with a review of products and services. Change was needed to increase cost recovery for the division. The 1989 federal Budget with its unexpected cuts had shown the Bank could not depend on government to provide annual appropriations (subsidies) at consistent and predictable levels to support the division's activities. Apart from the Financial Planning Program added in 1983 and termination of business information services in 1989 (when appropriations were cut in half), the Management Services Division had seen little significant change in its operations since FBDB was created in 1976. The flagship programs were still training seminars and CASE counselling, with both being delivered in essentially the same fashion as in the 1970s.

When John McNulty was appointed Vice President, Management Services in 1991, he was tasked with providing the long term strategy for the division.



John McNulty was appointed Vice President, Management Services in 1991.

To develop a strategic plan for the division, McNulty used the same methodology the Bank used to develop strategic plans for its clients. He had an external advisory group consisting of independent practitioners who provided management training and consulting to small business and were knowledgeable about market needs. The group was a sounding board for new ideas and provided perceptions on how well the Bank's services were being delivered and received in the market. For example, they pointed out the need to train CASE counsellors and to better match their skills with client needs. While hiring a retired business person and sending him on an assignment may have worked in the 1970s, it was not sufficient for the 1990s. Assignments were more complex and there needed to be some specialization on the roster. As one of the advisory group members said: you cannot bring old skills to the new marketplace. The advisory group thought the Bank's Community Business Initiative (CBI) was its best product. It also offered the opinion that the Bank's long-running publication, Profit\$, was dull and old-fashioned.

The strategic and operational reviews shifted the division's emphasis from being a retailer in the market, providing management services directly to clients, to a wholesaler, selling its services through third parties. Instead of FBDB staff members providing financial and strategic planning services, for example, they would now be delivered by external professionals on the FBDB roster. The division was moving to increase its leverage effect and revenues. 'Training the trainers' became the division's mantra.



Profit\$, the Bank's long-running publication.

Management Services also became more client driven, rather than product driven. The priority was to package products to fit client needs. In this vein, more emphasis was placed on developing innovative products to meet emerging needs. For example, the Bank developed a new product to assist businesses in obtaining ISO certification. Then it developed a succession planning product for family-owned businesses. Both products were seen as innovations in the market. Like the Loans Division, productivity measures were introduced for Management Services.

Revenue per operational staff was a key measure. Norms were established such as (revenue producing) person days of training and person days of counselling per operational staff.

The Venture Capital Division was also subject to an operational review. The Bank contracted the firm Price Waterhouse to conduct the review. After the Venture Capital Division had been created in 1983, the most deals done in a year was in fiscal 1988 when 32 new investments were authorized for \$22.5 million. After 1988, new investments declined to around 12 per year, one a month, for an average of just under \$1 million per investment. There were about 20 employees in the division. Price Waterhouse concluded such productivity was at the low end compared to firms used for benchmarking purposes. They recommended targets should be set for account management as well as for new authorizations per investment manager. Venture capital, however, is unlike the term lending business, and the best practical advice Price Waterhouse could offer was to allow some smaller investments to be authorized by a committee of vice presidents and fewer by the Board of Directors. New investment authorizations continued at the same level, about 12 per year, until fiscal 1996.

### **Improving the Bank's image**

As the Bank was conducting its operational review, it received a “wake-up call” from the Minister of State for Small Business when he visited FBDB's Board of Directors at the end of 1992. He delivered stinging criticisms of the Bank. First, he told the Directors not to expect any new capital infusions from the government. Then he raised complaints he and fellow Members of Parliament (MPs) were receiving from constituents – the Bank was taking too long to process loans; was not taking enough risk; was asking for too much collateral; and was raising expectations of clients, then letting them down. He said FBDB was not publicizing the government's initiatives sufficiently and added that FBDB's reputation, unlike that of Farm Credit Corporation, was poor among MPs. The Board of Directors asked management to respond to the Minister's concerns.

The Bank had already moved to improve relations with Members of Parliament. An MPs visit program had been launched in the fall of 1992, wherein FBDB branch managers were required to visit their local MPs, brief them on the Bank's activities in the local community and establish a direct line of communication with the MP. If there was a complaint about FBDB, the MP was encouraged to call the local branch manager directly to try and resolve the issue. Cabinet ministers were to be visited by regional vice presidents. As part of the program, community activity sheets were prepared and the Bank distributed press releases to local news media. Business planning kits were left in MPs' offices which they could hand out to small business owners and managers. The MPs visit program, managed and coordinated by Mary Grover-Leblanc in the Government Relations department, generated positive feedback on the Bank.

In response to the Minister's criticisms, management pointed to the ongoing operational review and a customer service initiative that was soon to be launched. With respect to publicizing the government's small business measures, several were included in the next issue of the Bank publication Profit\$.

The Bank was also asked to hold more meetings of Regional Advisory Councils and it agreed to hold two each year plus a meeting with each individual council member. For most of the Bank's regional vice presidents, who were responsible for organizing and attending these meetings, holding more regional council meetings was unproductive and time-consuming.

With federal elections approaching in 1993, a televised debate was held for aspirants to the leadership of the Progressive Conservative Party of Canada. (Prime Minister Mulroney had stepped down as party leader.) Among them was Garth Turner, an MP from Ontario. Before his leadership campaign he was known for his public denunciations of FBDB. During the televised leadership debate he repeated his opinion FBDB should be dissolved. His remarks did not go unnoticed as several of the Bank's customers wrote to chastise him for the position he had taken. Their letters made the following points:

- We were able to survive the eighties thanks only to F.B.D.B. There are many similar businesses operating successfully at present, that would be long gone if not for F.B.D.B. For these reasons we take strong exception to the remarks you made;
- There was one statement you made that disturbed me very much. That was your intention, if elected, to abolish the F.B.D.B. Well sir, I cannot speak for the rest of Canada, but in Newfoundland, I feel that the F.B.D.B. has been responsible for the success of many, many businesses, my own included. I wish you well in pursuit of your goal and I feel confident a man of your intelligence will not make any rash decisions without asking the opinion of those who have been involved on the battle field;
- After hearing your very disputable debate on T.V. I realized you certainly are not the person that could have any real understanding of the many small businesses in Canada that the Federal Business Development Bank has helped with financial packages. I would be interested in facts, not just fast political yap.

This was the kind of support the Bank knew it had among its clients but such testimonials were rarely put in writing, much less sent to politicians. FBDB's President also wrote to Garth Turner describing the Bank's achievements and seeking a meeting on FBDB that would demonstrate the Bank's role as a solution to many of the economic problems facing Canada. Turner did not win the leadership of his party. Kim Campbell won and was appointed the first female prime minister of Canada after the Right Honourable Brian Mulroney resigned from the post. Turner later crossed the floor in the House of Commons to join the Liberal Party of Canada after it had formed the next government.

FBDB had endured the 1990/91 recession without operating losses and fended off a potential market overlap with another crown corporation. Efficiency gains were paving the way towards solid growth and these gains were largely related to new information technologies. Before proceeding to the Bank's rebirth as the Business Development Bank of Canada, the next chapter describes the Bank's technology transformation.



1975 to 1995

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# Information technology @ FBDB/BDC

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The Bank seizes opportunities arising from new technologies with innovations such as the Automated Information Management (AIM) system and The Manager. As the new millennium approaches, work begins on replacing legacy systems and critical business applications.

“If you give bright people computers, some amazing things are going to happen.”<sup>9</sup> So said Ed Roberts, father of the personal computer, in a statement that aptly characterizes the Bank’s technology revolution.

In the mid-1970s, on entering a typical FBDB office, one would see a few closed offices and rows of desks equipped with calculators the size of a boot box, telephones without buttons (rotary contraptions used to spin-dial numbers), ashtrays (often overflowing) which doubled as pie chart stencils for those required to produce graphic presentations, and electric typewriters operated by full-time typists. The ringing phones, calculators churning out columns of numbers on looping spools of white tape, and the electric tapping of typewriter keys created quite a racket. Noise pollution was not yet in the lexicon, not to mention the harm associated with second hand smoke.



Adding machine.

Employees analysed and reported on branch, regional and Bank-wide activities and performance based on data generated from one of three computerized systems inherited from the Bank of Canada. These were LAPS (the loan accounting and processing system), GL (the general ledger) and Payroll.

These systems were programmed in the era of keypunched cards, usually in Cobol or Fortran languages, to produce printouts from which employees recalculated data and produced hand-written tables which were then typed onto long sheets – an especially onerous task if a specific report was presented by region and/or branch. Much of the raw data produced by the three computer systems wound up being reprinted by typewriter.

<sup>9</sup> Steve Lohr, *Digital Revolutionaries – The Men and Women Who Brought Computing to Life*, Roaring Book Press, New York, 2009; page 112.

In the pre-PowerPoint and Excel age, when a department head or manager wanted to deliver a presentation, the numbers had to be retyped again. Special orator balls had to be inserted into typewriters to change the font for any line. Graphics such as pie charts or bar graphs were drawn by hand and then numbers entered beside them with the typewriter. Paper versions were photocopied onto transparencies designed for overhead projectors.

Communications were restricted to telex for senior management urgencies, land-line telephones, snail mail and courier, including what was called the 'diplomatic pouch' between Montreal and Ottawa for government business. It could easily take more than a week for mail from a remote branch to reach head office as the envelope would pass through the regional office before being sent on to Montreal.

No wonder the Board of Directors' top concerns about FBDB operations in the 1970s were: slow turn-around times – for example, the average processing time from application to loan approval in 1975 was 14 working days or, three weeks elapsed time; bureaucracy – too much paperwork and too many signatures required for loan authorizations; and steering the ship through fog – the lack of ongoing indicators of performance and results (for example, provisions for loan losses were available only close to year-end).

Looking back, it's easy to see the potential emerging technologies offered in overcoming these problems and vastly increasing staff productivity. It was not so clear at the time. Microsoft had just introduced its first software in 1975 and Apple Computer was about to launch its first product. But these developments, centred in Silicon Valley, California, had yet to impact businesses. Moreover, FBDB, like all Canadian banks at the time, was a stodgy place, used to doing things a certain way and resistant to change.

It was the dawning of an age of massive technological change. The Bank was about to be revolutionized by various, occasionally overlapping, groups of employees: the pioneers, firefighters and innovators with the ingenuity and imagination to transform the way the Bank did its work. These were the bright people who introduced and implemented new business applications and hardware in the decades leading up to the year 2000 (Y2K).

Advancements in hardware generally drove new software acquisitions at the Bank. But by 1980, the growing stain of red ink was the mitigating factor. It created an urgent need for better, faster analyses of the Bank's portfolio and inherent risk, but it also meant operating expenses had to be tightly controlled. It was not the time to spend big on computers and information systems. Any investment the Bank made had to be strategic and justifiable with an immediate, positive return.

As mentioned earlier, outsiders brought into the Bank by Guy Lavigueur were appalled at the lack of information systems that could produce relevant data for analysis. Remember that when Pierre Charbonneau could not quantify the magnitude of the mismatching problem because of the lack of data from the LAPS system, Lavigueur told him to do the analysis manually, loan by loan. When Don Allen wanted to measure the Bank's economic impacts to offset negative reaction to the Bank's operating losses, he had to carry out his work on an external

computer system, and he had to hire his own computer analyst, Dac Nguyen, to write the necessary computer programs. One of his innovations was the acquisition of a Dun & Bradstreet computer tape listing all businesses in Canada. The tape and its programs were housed on a mainframe computer at a service bureau, IST. For the first time, the Bank could quantify its penetration rates by region and industries, and its importance in financing, for example, businesses in Quebec or in manufacturing industries across the country. When Allen tried to build an in-house economic sub-system within the LAPS environment, it created many internal conflicts and the project was eventually scrapped.

In the early 1980s, measuring risk in the loans portfolio and predicting loan losses were the greatest management information needs. The earliest pioneers propelled the development of applications like the provision sub-system, created off LAPS to provide ongoing data for analysing loan losses and for new financial modelling techniques. In order to rein in mounting loan losses and turn the Bank around, key questions had to be answered: what was the ultimate loss rate on loans going to be; how quickly were losses on loans recognized; and what were the best predictors of risk? Without the spreadsheet applications that came later, every estimate had to be calculated by hand based on assumptions and, when the assumptions changed, the whole manual process had to be redone (and retyped by typists).

LAPS resided on a Digital Equipment Corp. minicomputer located in the Information Technology (IT) department then known as the Systems Department. The introduction of risk grading under the Cost Recovery Plan and the need to provide more data for monitoring and analysing the loans portfolio put more pressure on the LAPS system, already victim to recurring computer shutdowns. Such was the reliability of computers of the era. Multiple computer glitches and shutdowns led to the decision to migrate LAPS to a mainframe environment. But instead of buying its own computer, the Bank leased a mainframe computer located in a service bureau. Dumb terminals (green screens) in branches and departments allowed access to LAPS using a wide area network consisting of Bell Canada data circuits.

To improve its analysis of the loans portfolio, in 1981 the Bank acquired a license to use the database software and Focus programming language from Information Builders Inc. Amazingly, this software package was still in use at the Bank at the time of writing. When the Bank acquired the software, Gilles Guillemette of Systems was the initial in-house database and Focus language expert. A monthly extract from LAPS, known as Infobase, was produced and Focus programs were run on this extract to provide much needed data on the loans portfolio. Over time, others in the Bank became adept at using the Focus programming language. Sandy Mendelsohn used it and the Infobase extract to “slice and dice” the portfolio and monitor loan quality for the Financial Services department tasked with bringing the portfolio back to a cost recovery status. For financial forecasting, Dac Nguyen in the 1980s, and Tomasz Koch in the 1990s, used Focus and the extract file to analyse various factors such as loss recognition patterns and security coverage ratios that would assist in predicting loan losses for the Bank. The database was also used to measure the Bank’s economic impacts and provide any special analyses the Bank needed in its dealings with Ottawa.

Other Focus-based specialized databases were constructed, one example being an application allowing for the entry and processing of every loan enquiry received by the Bank. This enabled surveys of businesses who may not have obtained FBDB financing, contributing to customer service strategies, an improved understanding of the Bank's market, and the outcomes for businesses who did not obtain FBDB loans (an issue frequently raised by Ottawa officials). Allowing non-Systems users to produce their own reports was an important advancement and helped ease frictions between departments clamouring for data and reports that everyone needed yesterday.

Some departments had very specialized needs. Treasury, for example, contracted with external suppliers (such as Reuters) to obtain access to real-time data relating to money and capital markets. As the Bank's borrowing activities became more sophisticated and the availability of data services grew, specialized hardware was purchased. With its numerous monitors and extensive wiring, Treasury's trading room came to resemble a command and control centre worthy of a micro-NASA.

Managing a decentralized, coast-to-coast branch and regional office network without any connectivity would be unimaginable today. But that was the corporate reality before the possibilities of remote access and multi-user applications drove a wave of acquisitions in new infrastructure in the early 1980's. For FBDB, the wave began with Wang technologies.

Wang machines – to the era's uninitiated, a computer was considered just another machine – provided a solution with its word processing and limited data processing capabilities. They were purchased and installed in regional offices, some branches and head office. Wang was chosen since it was the system the Government of Canada had purchased. If it had passed the Government of Canada tests then it should be sufficient for FBDB's needs. Further, it allowed for electronic communication of documents between the Bank and Ottawa.

The acquisition of Wang machines led to the first wave of technology training delivered to a large number of Bank employees, overriding a lingering chunk of Luddite thinking at FBDB. An early application of Wang capabilities was done by the Planning Department. Working in conjunction with the Controller's department, the Wang system was used to introduce an integrated budgeting/planning process that dove-tailed into the first corporate plans produced by Hugh Carmichael.

Fax technology soon arrived on the scene. No longer could one tell a Minister's office the briefing or letter or submission "is on its way" by courier (buying a few hours time until the 4 o'clock pick-up of the diplomatic pouch). No longer could a regional office or branch take its time submitting a report or form to head office and vice-versa. With fax, turn-around times accelerated from weeks to days, from days to hours. Transmission of the early faxes, however, was costly and slow. Special paper was required and feeding a longer document into the fax required more patience than the most saintly FBDB employee possessed. Pages stuck together, the document had to be re-transmitted and at the other end, the output could be blurry. But the fax had the additional benefit of producing a receipt stating the time and date of transmission. This was a pre-email first and helpful in maintaining a paper trail.

### The first personal computers

The greatest technological leap of that period was the introduction of the personal computer. Micro processing technologies had been developing since the 1960s culminating with Intel's 4004 chip, considered the world's first microprocessor. Xerox introduced the Alto, its prototype PC, in 1973 and three years later, Apple launched its first product, the Apple I. The first spreadsheet program for personal computers, VisiCalc, was produced in 1979. The great leap forward came in 1981, when the fledgling PC industry was brought into the mainstream with the introduction of the IBM PC. The business world sat up and took notice. IBM was the poster company for corporate size and stability. More importantly, it personified technological innovation and advancement. Its products were reliable and if IBM sold personal computers, it signalled to the corporate world that the time had come to purchase these machines. Many bought PC's although they didn't always know what to do with them.

In 1982, the PC made the cover of Time Magazine as "Machine of the Year." (Even the venerable Time Magazine called computers "machines.") That same year, FBDB purchased one of the first IBM PC's in Montreal which, fully loaded and including disk drives and printer, cost a whopping (1982) \$10,000. FBDB was in the midst of its record operating losses so, as previously mentioned, each new purchase had to be justified on the grounds of immediate paybacks, paybacks that were to be measured only by real dollar savings. The justification for purchasing the PC was the cost savings associated with the financial modelling done on a Burroughs minicomputer that cost about \$14,000 per year in outside computer services. Recall this was the result of the Bank repatriating the computerized model from the Small Business Financing Review team. The Bank's first personal computer would pay for itself within a year.

Purchasing the Bank's first PC required management committee approval. Dac Nguyen, the person who would be the main user of this new computer, put together a presentation for the committee. It was not an easy management decision to make as this was unknown territory for most. Some questioned the need for a personal computer while others asked, why not buy an Apple instead? But given the Bank's needs, especially in the areas of financial modelling and portfolio analyses, Microsoft's operating system (MS-DOS) was deemed superior for its openness, compatibility and efficiency. The question was also raised, why should the Bank's first PC be housed outside of Systems Department? But the machine was being bought for specific uses by the financial modellers and they justified its costs and productivity gains. Whereas it had taken three to four hours to run a financial forecasting scenario on the minicomputer (the wait time was principally waiting in queue for the job to run), the same task on a PC was almost instantaneous. On the downside, the first PC's were not user-friendly, had limited memory, required floppy disks and were finicky. Static emanating from synthetic carpeting was blamed for a number of interruptions and lost time until plastic sheets were installed under the desks where the PC's were stationed.

Personal computers soon made their way onto the desks of secretaries, mainly for word processing. No more whiteout, cutting and pasting before a document was finalized. But it did require training in computer technologies to a wider group



Vintage personal computer.

of staff. As word processing software changed from MultiMate to WordPerfect to Word, training demands continued. Software that caused much headache for its users was Ventura. It was supposed to be cutting-edge software to produce presentations. Users like Maureen Morganstein and Lauren Nesbitt spent hours trying to figure out how to use the software to produce presentations for meetings of the Board of Directors and with officials in Ottawa. Even in-house experts in the software had problems. Ventura just seemed to be unwieldy. Luckily for all, Word with its various fonts and characters soon came on the scene, followed not long after by PowerPoint.

For all the PC's usefulness in terms of spreadsheet and word processing software, data were still being pulled off LAPS and the GL and re-entered onto the PC. This re-entry of data continued until the PC's memory and power were expanded and PC versions of software such as Focus were purchased to allow for automatic data transfers from mainframe systems.

The battle between the pro-Apple and pro-PC camps flared up in 1984 when Apple introduced the Macintosh, the first affordable machine with point-and-click, a mouse and on-screen graphic icons. Management Services, with its requirements for graphics and desktop publishing related to training documents and brochures, purchased a Mac and the two camps settled along divisional lines for years to come.

All this time, the Systems Department was managed by Bank insiders who had progressed to higher ranks in the Bank through the term lending operation. They were supported by a few IT professionals. This changed with the arrival of Frank Urbanski as Senior Vice President, Management Systems and Finance. He joined the Bank from Teleglobe, another crown corporation headquartered in Montreal. In late 1986, he brought in systems professionals Terry Gilbert and Guy Hanchet, former colleagues in Teleglobe, to work in the Systems Department. (He also brought in Maurice Rossin who took over the financial forecasting model and, for much of his career at the Bank, continued to make refinements to the model to produce more accurate and detailed forecasts.)

One of the first decisions Urbanski made was to cancel the mainframe service bureau contract the Bank had with the firm CSG. Costs under this contract were running at \$3 million per year. In its stead, IBM mainframe equipment was purchased for a \$1 million onetime cost and hosted at a CGI data centre for about \$300,000 per year. The Systems Department was also re-organized into two divisions with a director for each: Operations & Technical Support under Terry Gilbert and Systems Development under Guy Hanchet.

For most of the 1980s, the information technology and systems environment at FBDB was still the "wild west," with battles among department heads clamouring for new technologies, no filters for prioritizing demand and budget challenges. Within the Systems Department, it was often easier, and more efficient, for professional IT staff to do what they thought had to be done and ask for permission later. Some may call it a "cowboy" spirit, others a "pioneering" spirit and still others an "innovative" spirit. In any case, it moved the Bank forward by providing tools to improve staff productivity, eventually leading to better customer service and profitability.



With new tools and computers coming on stream at head office, there was a longstanding perception in the field that head office had better “stuff.” Ironically, the mentality of head office employees, drilled into them by rotating vice presidents from the regions, was that the priority, first and foremost, was always the branch offices where the deals were being sealed, where the income was coming from and the greatest efficiency gains could be realized.

### **Creating the AIM system**

In terms of micro-computer facilities around the mid-1980s, there was nothing in field offices until the creation of the Automated Information Management (AIM) system – developed and implemented by FBDB’s Management Services. AIM was born out of FBDB’s new mandate in 1983 and the directive to become a one-stop shop for Canadian entrepreneurs seeking information on government programs. Every provincial government, in addition to many federal government departments and agencies, offered some form of financial or non-financial assistance to entrepreneurs. The trend to introduce programs for small business accelerated as unemployment rates soared and a landmark study in the U.S., *The Job Generation Process* by David L. Birch, showed that the lion’s share of new jobs was created by smaller firms. Today this has become almost a cliché but at the time it was revolutionary and heavily used by Reaganomists for its grass roots appeal.

In Canada, hundreds of acronymic government initiatives led to an “alphabet soup” of programs of overwhelming complexity. These programs delivered one or more financial instruments (grants, guarantees, tax credits, low interest loans, etc.) and/or counselling or training assistance, each with their own eligibility criteria. Some were only available for specific industries (such as agriculture, manufacturing or tourism) and/or in defined locations (single industry towns, rural areas or provinces). Others had complex rules relating to purpose of assistance, age or size of business. Canadian entrepreneurs complained vociferously about the confusing search for assistance. While FBDB had been producing the ABC Handbook, a telephone book-sized directory listing government programs, it was often out of date by the time it was printed, in addition to being expensive to maintain and print.

FBDB had never created a system for branch users before but AIM was a golden opportunity to prove the Bank as an innovator and get PC’s into every branch, an investment the Bank, without government appropriations, could not have made at the time. After a sputtering start, John Ryan was brought in to lead the AIM development project, and he selected Rich Goulet, another long-time FBDBer, to assist in 1985.

The challenge was immense, especially given the tools available at the time. The team had one year to develop the AIM computer logic, write the software, and configure and wire the hardware. Alain Carrière was hired as an IT professional to help build the AIM system. During his FBDB job interview in 1985, he drew a sketch of his proposed solutions and was hired on the spot under a one-year contract. (In 2013, he was still employed at the Bank.)

A large team was assembled in head office to enter and proofread the bilingual texts for the description of all government programs aimed at small business. The

firm DMR built the software in C language (third generation) with Btrieve, a software developed for fast retrieval of data and used for index files. The logic required numerous levels of indexing such as industry and geographic area. The target retrieval time was one second, once users had looked up the key words in an index.

AIM's innovation was its capacity to search the database of government programs based on key words entered by the user. At the time, the Bank did not know it was years ahead of its time in trying to build a search engine, a game-changing technology that would be introduced years later by the likes of Google, Yahoo and Microsoft.

The end of March 1986 was approaching and the team was still developing the AIM software. Funds provided by the government for the project were going to be unspent in the fiscal year. So the Bank decided to purchase the computers the system would require when it was completed, rather than let the funds lapse and be lost forever. Such moves were typical of government departments and agencies. About 80 computers were purchased, configured and stacked in conference rooms until AIM was officially launched. That the Bank was able to procure this amount of computers in one order before the March 31<sup>st</sup> spending deadline was not a feat. Suppliers generally expected large government purchases as the fiscal year end approached and usually increased inventory for such purchases. The computers the Bank procured for AIM were IBM PC's (not XT) with 64k RAM and 30 megabytes of memory – exceptional features at the time. The cost was about \$5,000 per PC (a figure that would now elicit raised eyebrows).

The AIM system was delivered to all branches in 1986 including the Business Information Centres taken over by FBDB with its new mandate. The system was formally launched in Vancouver at Expo'86. Rod Stillwell and Rich Goulet were sent to train branch users across Canada. In Ottawa, a special demo was held to show officials what the Bank had achieved. It was a first: the consolidation of all programs for business into one database. AIM was a rudimentary search engine and while some users complained about having to search the key words, which they said took longer than flipping through the old ABC directory, the system worked. The Bank had fulfilled its directive and AIM became a useful, user-friendly source for Canadian businesses and public sector employees at all levels of government.

Updates to program information in AIM were to be done by managers of the programs included in the AIM database. Some did their jobs while others didn't, which meant some of the information in AIM became dated. Database updates were sent regularly to FBDB branch offices and other users on floppy disks, copied manually (one by one, i.e. over 80 times) until a firm in California was found to produce multiple copies faster.

The axe fell on AIM in 1989 when the government cut its appropriations in support of FBDB's Management Services. As mentioned earlier, the Bank eliminated its information services and that included AIM. It was hoped provincial governments and chambers of commerce would take over AIM on a nationwide basis but only Quebec and B.C. governments kept it going, without updates, and the system eventually disappeared.

As the first custom-made application oriented to users in the Bank's branch offices, AIM left a crucial legacy. It led to the installation of PC's in every branch and became a catalyst for future field-driven innovations. It broke in FBDB employees, helping them to become microcomputer-literate and accelerated the learning curve for effective computer training approaches in branch and regional offices. Having PC's in the field allowed for the migration from dumb terminals to access the mainframe.

### **New branch-based applications**

In Management Services and the Controller's department, a new system was under development that would become known as MS-BOS. Designed to process costs and activities at the branch level, MS-BOS allowed revenues to be tracked as they were received rather than when the activity was booked and inevitably led to some significant drops in activities and cost recovery rates. Written in Zim, a fourth generation language like Focus, a driving force for implementing the system was the introduction of the Goods and Services Tax (GST) in 1991 and its impact on fees charged by consultants and trainers.

Throughout the late eighties and early nineties, continuous improvements were made to technical infrastructure and business applications at the Bank. With the availability of lower cost clones, the number of PC's deployed in the Bank rose from about one per branch to 800 Bank-wide. The availability of micro-computers across the Bank opened the door for new technologies to be introduced. An example was a primitive form of email based on an early version of Microsoft Mail. These innovations were supported by a head office help desk originally consisting of a three person team – Hélène Febrile, Collette Hamilton and Jeanette Mende – and managed by Elwin Jopling. The desk later evolved into a call centre supporting all computer hardware and software used in the Bank.

In the Loans Department, an early breakthrough came in 1986 when Jean Pierre Hébert and Gilles Guillemette used Focus software to create the Local Loan Administration System, a branch-based loan accounting application that evolved into The Administrator. The Loan Support Analysis Module, LSAM, was developed in Lotus 123 (later transposed to Excel) for entering and analysing a client's financial statements. These applications were considered major breakthroughs at the time.

Around 1990, branch offices began using a package called Form Easy, which quickly became known as 'form hard' and 'form crazy' for obvious reasons. For the first time, the loan authorization form, F4073, was completed on a computer rather than a typewriter. As its nicknames suggest, this application was the cause of extreme frustration. Form Easy was branch-based without a linkage to LAPS. But in branch offices, the system had a habit of freezing and losing information and caused major headaches for users and even more for call centre operators. Users were often told not to hit buttons on the keyboard if the system was not responding. But by then it was too late. Computerizing the Form 73 was needed but Form Easy couldn't do the job. Thus began another innovation in the early 1990s that revved up FBDB productivity in a big way. Known as The Manager, it would become the second longest lasting application (after LAPS) at the Bank and was still in use in the 2<sup>nd</sup> decade of the 21<sup>st</sup> century.



Rod Stillwell,  
training branch users  
across Canada.



Jean Pierre Hébert  
and Gilles Guillemette  
(Loans Department)  
with Guy Lavigueur  
(President and CEO).

### Creating The Manager

In 1992, Denis Poirier, with many years of field experience, received a mandate from Dave Mowat, in Winnipeg at the time, and John Ryan, who was in charge of Loans Operations, to develop an application to replace Form Easy. The project was to last three months. A key requirement: no change in formats to the forms involved – the loan authorization form and the forms for loan amendments and disbursements.

The Manager was developed by FBDB employees, chief among them, Denis Poirier and Alain Carrière (of AIM fame). They exemplified the cowboy spirit in systems development. Importantly, the development was user-led and resulted in an application oriented towards branch office needs. The working environment was all about attitude (hard work) and a sense of humour rather than altitude (or rank).

The platform selected for The Manager was Microsoft's Access database management system and Visual Basic (first introduced in 1991) which came in cheap at \$99 a copy. Other options were rejected because they did not allow for the construction of a database. Microsoft provided consulting advice. During the project's early days it was known as 'clux' (the word used by a consultant) but

eventually became known as “The Manager” of your client’s data. The decision, a wise one in hindsight, was made to allow for linkage to LAPS and possibilities for communications, once local area networks could be installed throughout the Bank.

The clock, again, was ticking. Three months went by and scope creep set in. More consultants were contracted to work on the application. After two years, the Vice President of Systems impatiently declared The Manager would never work. Soon after, a test version was sent to branch offices. It included the command: “Do not click on this button.” When the user clicked on the button, the message “why did you click on this button, you weasel?” had inadvertently been left in. (Or had it?)

In the summer of 1994, the first version of The Manager was rolled out. It had to be installed in every branch by its developers and staff had to be trained accordingly. One developer logged 21 flights in 19 days. The system was slow but easy to use and, unlike the crazy system it replaced, no data were lost. In the beginning, it was decentralized with one database per branch. This meant over 100 databases had to be backed-up onto servers every night. Paper copies of the loan authorization Form 73 were still being sent to the Controller’s department at head office for data entry and, in the early years, the application was never used to actually authorize loans. A diskette was sent to and from the branches when information on the Form 73 was modified. In a later edition, a loan authorization button was added to the screen. It depicted a cartoon character with red hair and a green jacket bearing an uncanny resemblance to one of the Bank’s regional vice presidents.

The Manager was a work in progress with continuous improvements made along the way. Communications were facilitated when local area networks were installed in the branch offices in 1995. A project expected to take three months to complete went on for four years. Its success was tied to the patience of its senior backers and their acceptance of hiccups along the way, as well as the determination of its developers.

The Manager became the catalyst for office automation and email and helped overcome, once and for all, lingering suspicions of computers. At one time, when IT employees went to upgrade PC’s in the branch offices, they found a few that had never been touched, still in their boxes. Others were loaded with all sorts of software purchased on an ad hoc basis. The Manager improved productivity and, despite initial resistance, field employees began entering their own credit reports into computers instead of asking an assistant to type them up. It set the Bank ahead of its time. It allowed for improved branch connectivity and increased overall Bank productivity. New recruits from other financial institutions heaped praise on The Manager.

As new information systems and training became recognized for their important roles in increasing staff productivity, a new IT position was created in each region – Regional Information Systems Representatives (RISR’s). Each RISR supported the installation of hardware and software in the branch offices located in their region and provided upgrades or repairs as well as training and coaching to facilitate the adaptation to new applications in the field.

Throughout the 1990s, the Bank continued to upgrade and replace PC operating systems and office automation software. MS-DOS was replaced by

successive versions of Windows. Novell-based local area networks were installed from 1993 to 1995 in all branches and much later, in 1999, the LAN operating system was moved to Windows NT.

Meanwhile, the impending doom of Year 2000 (Y2K) loomed in the not too distant future. LAPS, the GL and Payroll, the Bank of Canada legacy systems, were not Y2K compliant. Information Systems had been planning for these major upgrades throughout the nineties as illustrated in a 1993 presentation to the Board:

### **Projects underway**

#### **Develop**

- “The Manager” for our lending staff
- MS-BOS for our management services staff

#### **Re-develop**

- Our Loans Administration System (LAPS)

#### **Replace**

- General ledger application
- Human Resources / payroll application
- Treasury application

Source: IT presentation to the Board of Directors, December 1<sup>st</sup>, 1993.

### **Replacing legacy systems**

Work accelerated in the Systems Department on replacing the patchwork quilt LAPS had become during the previous two decades. Similarly, there was an urgent need to replace the general ledger (GL), Payroll and Treasury applications to ensure Y2K compliance. These legacy systems did not ‘talk to each other’ and, after at least 25 years, were completely obsolete. While the actual conversions of the legacy systems occurred after 1995 (and the scope of this history), much of the work and key decisions originated earlier. The following paragraphs summarize what was done to replace the Bank’s legacy systems including their outcomes, for the record, even though they took place in the post-1995 period.

Abacus was the name chosen for the new system that would replace LAPS. After many inconclusive studies on how to proceed, Price Waterhouse was called in. The firm recommended the Bank migrate its system to one being developed by a software company in San Diego, California. Created for U.S. financial institutions, Advanced Commercial Banking System (ACBS) consisted of modules written in Lansa. BDC was the first Canadian user of this new software followed by National Bank; other chartered banks kept their own LAPS-like systems.

After consultation with the San Diego company, an AS/400 computer was purchased to run Abacus. This decision later resulted in challenges running the

GL and human resources and finance applications of PeopleSoft as they were primarily designed to run on IBM360 platforms. The primary difficulty was the scarcity of experienced and knowledgeable people familiar with supporting PeopleSoft on an AS/400 platform.

The project would have gone relatively smoothly if BDC processes could have been adapted to fit the ACBS package. But BDC was, as its annual report advertised, A Different Kind of Bank, and migrating LAPS to a pre-tailored application proved difficult. As the patchwork LAPS was compartmentalized into the ACBS modules, it quickly became evident that the Bank's needs for flexibility (for example, the allowance of seasonal repayments by clients) could not be easily accommodated by the system's structure. BDC processes differed substantially from those for which ACBS had been designed (regional banks in the U.S.).

Gaps between the new system and LAPS had to be bridged by modifying the new system rather than modifying BDC procedures. The tail could not be allowed to wag the dog. Complicating the transformation was the paucity of systems analysts who could work with the Lansa language. The Bank had to find and compete for this scarce resource in Montreal. The "fit gap" processes took many months to complete.

Meanwhile, the clock was ticking ... and loudly. Mireille Rondeau and her team, including Anne Boutin, Guy Turcotte and Louis Dallaire, had to find ways to solve the problems presented by "fit gap" obstacles. In addition they had to adapt existing applications, such as The Manager, to 'talk to' Abacus.

After a few technical glitches involving the AS/400, Abacus went live on March 31, 1999. Amazingly, for such a critical system, there was no parallel testing of LAPS and Abacus. All eggs went to the market in one basket. There really was no alternative. The Abacus project cost \$5 million including the purchase of the ACBS system at \$500,000. One lesson learned was that the payments for purchasing the system should have been staggered. On buying the software package, it was agreed the vendor would provide consultant services to BDC as the Bank built Abacus. But these consultants were hardly made available once the vendor received full payment. Mireille Rondeau and her team had to figure out solutions to complex problems. But it is in situations such as these that the Bank has shown it can rise to practical challenges and emerge successful. This uncanny ability was in the Bank's genetic make-up.

Meanwhile, work was proceeding on replacing the general ledger (GL), Payroll and Finance applications to ensure Y2K compliance. The GL was recognized as "broken" and vulnerable to compliance issues. The scope of the upgrades was huge and affected virtually all employees in all locations.

The Bank's payroll system was made Y2K compliant through the purchase of human resources software from PeopleSoft. Such products, known as enterprise resource planning systems, were developed for businesses and partly fuelled by the need to plan for a Y2K response and, in Europe, for the Euro conversion. Some systems were wide ranging in scope. They encompassed integrated systems operating in real time with a common database to support finance, accounting, human resources, customer relations, etc. PeopleSoft, used by manufacturers



and financial institutions, had its roots in human resource systems as the name suggests. Unlike other software options needing a busload of consultants to implement, PeopleSoft required just a carload. It was a product used mostly by very large corporations as BDC representatives found out when they attended training sessions with other users, many from larger companies with 50,000 to 100,000 employees. Once the Bank made the decision to purchase PeopleSoft software, work proceeded to complete another mammoth task with the clock ticking, again, very loudly.

Ross Hamilton and Claude Mailhot were two of the bright people tasked with implementing the system. One big challenge for the team related to the AS/400 computer purchased for Abacus. This piece of hardware was not a recommended platform for PeopleSoft and caused some grief in the conversion process.

On the Finance side, it took 25 consultants and a team of in-house IT staff to effect the GL conversion. On April 1<sup>st</sup>, 1998, in time for the new fiscal year, PeopleSoft Financials 7.01 was in production on the AS/400. In its early days, it took much time to produce reports, in one instance over 24 hours, but turnaround eventually improved.

For Human Resources (HR), the conversion of the payroll system was completed with Price Waterhouse assisting the in-house IT team. In the fall of 1998, unsuccessful attempts were made to run the payroll on the new system. It finally worked in December and for January 1<sup>st</sup>, 1998 the payroll was produced off PeopleSoft (Version 7.01). One change required the President's approval. Twice-monthly salaries in PeopleSoft were calculated by dividing annual salaries by 26. In contrast, the legacy payroll system (Genesys) inherited in 1975, used a divisor of 26.088 for bi-weekly payments, like the federal government. This change increased paycheques issued to each employee and even though it was so small as to be negligible, a pay increase is always welcome. The overall impact on the Bank was in the thousands of dollars.

In addition to payroll, HR relied on separate systems to manage employee data, performance and succession planning. In 1988, it had purchased a package from Compshare used for entering basic information on each Bank employee that also generated required reports on employment equity and official languages. Employee performance reports were first developed as typewritten forms known as PMP's (performance management process) which were succeeded by PACT in Word software. All these separate systems as well as benefits and pension administration (since outsourced) were later integrated into PeopleSoft and eliminated the need for re-entry of data.

Over time, upgrades to PeopleSoft were released and migrations to more efficient hardware platforms implemented. One of the system's strengths, its flexibility, turned into a serious challenge. As noted with Abacus, employees at the Bank were accustomed to doing things a certain way and this rigidity necessitated a large number of customizations. When PeopleSoft upgrades were implemented, IT people had to deal with as many as 3,000 customizations.

Ex-post, the hype surrounding the arrival of Y2K seemed to have been fabricated by doomsday prophets but, in fact, it had been promoted by knowledgeable systems

professionals. Throughout the 1990s, major management and systems consulting companies were telling their clients of impending doom related to Y2K. Computer systems that were built without regard for the turn of the century would crash and all activities dependent on these systems would cease. Many of the data fields in business applications were two digits (e.g. 95 for 1995) so that time-related calculations (salaries, schedules, maturities, etc.) would, if unmodified, go haywire at 12:00 a.m. on January 1<sup>st</sup>, 2000. The more creative prophets were predicting catastrophes such as planes falling out of the sky at midnight and nuclear power stations melting down leading to havoc among the population. Many people stockpiled rations for the impending disaster. In reality, Y2K arrived hour by hour around the world without calamity. However, the Bank's legacy systems would have been severely affected by the change of dates into Y2K. It is a measure of the Bank's success that it managed to avert any serious problems with needed changes implemented on time before the start of the new millennium.

### **Further advances in communications and portability**

François Beaudoin, by then president, saw the value of procuring and implementing new information processing systems in order to improve staff productivity and customer service. His support was crucial for moving the Bank forward technologically. In 1995, the Bank's new name and mandate, with its emphasis on knowledge-based industries, meant the organization itself had to adapt to a rapidly changing technological landscape and prepare for the predicted explosion in e-commerce.

The development of Abacus and PeopleSoft coincided with two new waves of technological innovations: connectivity and portability. The Internet came into being in the 1990s, forcing the Bank to grapple with security and access issues. At first, the policy of having separate, stand-alone PC's for Internet browsing in selected offices was seen as the solution. But this quickly changed into a broader-based approach using software (rather than hardware) to maximize security. Google became a market leader in search technology and eventually all BDC employees had access to the Web at their desk. The Bank's wide area network was changed to Bell Canada Frame Relay circuits, and data transmission speeds increased substantially during the 1994 to 1999 period. The Web boom of the 1990s also led to the development of BDC's online presence and the creation in 1998 of Connex as a one-stop BDC portal for businesses.

Advancements in portability drove the development of secure remote access infrastructure such as virtual private network technology. One of the first portable PC's at the Bank was a Compaq that weighed a good 20 pounds. Lugging it around was not a pleasure, especially if a briefcase was involved as well. But it was the precursor to the evolution of truly portable laptops and tablets.

On the communications front, the first portable phone was the size of a shoe box with calls scrambled for security purposes. It was used by selected (read very senior) managers, as were pagers. During the mid-1990s, one vice president sported a pen-sized pager in his shirt pocket, given to him by the President. Technologically advanced at the time but on call 24/7. As mobile phone technology improved, cell phones were introduced culminating with the eventual deployment of Blackberries years later.



Luc Provencher, the artisan of the Executive Information System.

Meanwhile, tools for analysing and monitoring the Bank's portfolio improved dramatically with ongoing upgrades to the Executive Information System (the brainchild of Luc Provencher), improved portfolio risk management practices and recalibrations to financial modelling.

BDC eventually excelled at the depth and quality of reporting including longitudinal analyses that had been but a dream for certain FBDB employees in the 1980s when the request to have a 'push button system' for accessing and analysing Bank data was met with stares to the ceiling. The questions first posed in 1980 with respect to ultimate loss rates on cohorts of loans, loss recognition and predictors of risk could now be answered in a flash – with the push of a button. Just before the end of the 1990s, when consultants were hired to develop a credit scoring model for small loans, they presented their wish list of requirements, data which other clients were unable to furnish in the detail required. BDC, however, was able to provide 90% of these data.

During the 1990s, outsourcing of corporate functions was often considered a cost saving business strategy and a way to reduce head count. In this context, the Bank's IT department had been the subject of intense discussions, even the occasional shouting match, during at least three outsourcing exercises. This was back when IT was staffed by about 40 people. One of the lessons learned was that the Bank had a bargain on its hands: the IT department operated on a budget of about \$15 million per year while outsourcing this service would have cost in the order of \$35 million annually.

### **Head office move**

Another major challenge faced by Information Systems began as the new Business Development Bank came into being – the head office move planned for 1996.

Again, while this was completed in the period beyond the scope of this history, it is worth recounting here, since preparations for the move began much earlier.

Relocating head office presented a high-stakes, visible challenge for the Information Systems department that required meticulous planning and fast footwork, not to mention sweat. Over 200 employees had to be moved lock, stock and barrel, from Place Victoria to new quarters at 5 Place Ville Marie in Montreal. The move had to be completed over a weekend so that the Bank could carry on its operations seamlessly. Each of the 200 plus employees had to have all their belongings packed up by 5 p.m. one Friday afternoon. On the following Monday morning, they would report to their new digs at Place Ville Marie and continue their work as if nothing happened, except that upgraded coffee machines were available in new lunch rooms.

To most staff, getting ready for the move was not overwhelming. One benefit would be discarding all the useless junk acquired and kept over the years. For the Information Systems department, it was quite another story. They were responsible for ensuring each person's telephone and networked computer system would work on the Monday morning, as if the move had never happened.

Over the weekend, a six-person team from the Operations and Technical Support group worked non-stop to install the hardware and ensure all systems and communications would function as they should. At one point, they realized a data switch in the LAN had been damaged in the move and they scrambled to contact a firm in California for a solution. The team checked every single phone and computer in every work station on every floor occupied by BDC. Monday morning, when BDC staff arrived at their new digs, all systems and phones were fully functioning. The department had proven its mettle and its image within the Bank took another step in the right direction.

By way of postscript, two years later, a rescue operation was required to respond to a disaster that was completely unforeseen. In January 1998, an ice storm devastated the Montreal region and resulted in sustained power outages in many communities. While Place Ville Marie had some electricity, the heating system was turned off to conserve power. Most head office employees were allowed to stay at home. Not so for Terry Gilbert and his technical support team who had to work around the clock to ensure the Bank's critical systems kept functioning in the cold. The Bank's entire email system, coast to coast, operated out of head office and they had to make sure it was business as usual at the Bank's offices outside Montreal. Luckily for the Bank's mainframe-based systems, CGI had contingency plans for such emergencies. On their premises were back-up generators and a tank of diesel. In the end, there was little impact on BDC operations. But like all businesses hit by the ice storm, new disaster procedures had to be developed and implemented throughout the Bank. The Treasury department, for example, although not significantly affected by the ice storm, developed a procedure wherein all its operations would be backed-up and, if needed, the department could relocate and operate from an office in Ottawa in the event of a local disaster.

### Looking back on the changes

In hindsight, the massive changes implemented from 1975 to 1995 were driven by some combination of new hardware/software, the availability of financial resources and management's willingness to take risks and be patient. Despite its limited spending power, the Bank was ahead of the curve with user-led applications such as AIM and The Manager. Change came in waves and a weakness, looking back, was the lack of continuous development after major expenditures were made to introduce new systems. The Bank was a relatively small company in the financial services industry but it operated and had the same management and information systems requirements as large companies. It had to opt for big software intended for big companies but being A Different Kind of Bank, it wound up having to customize the applications to suit its processes and needs. An IBM executive is credited as saying, there is no worse mess than a computer mess. While the Bank had its share of technological glitches and delays, it never experienced an utter systems boondoggle.

Twenty years of bright people doing amazing things completely changed the face of the Bank. Now, when entering a typical Bank office, one would see offices and work areas equipped with desktop personal computers and/or laptops with access to integrated corporate systems and instantaneous communications technologies. It could seem eerily silent for one who worked at the Bank before the "Machine" arrived on the scene. Analytic tools developed over the years would also leave the early 1980s employee astounded by the amount of data available on the portfolio and how fast the numbers could be obtained.

Still to come in the years following 1995 (and reserved for the next history of the Bank) are the many developments we know of such as data warehousing, improved wireless technologies, cloud computing and the tablet, as well as all the unforeseeable breakthroughs that will once again revolutionize BDC.

1992 to 1995

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# Start of a new era

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Customer service initiatives and a more visible public profile are followed by preparations for a new mandate and legislation. The Business Development Bank of Canada is created in July 1995 with the passage of Bill C-91.

In early 1993, when François Beaudoin was named President, FBDB was in a healthy financial position with a solid foundation on which to prepare for the new BDC. Guy Lavigueur, who went on to pursue opportunities in international banking, had steered the organization through the storms of fifteen tumultuous years. With the support of the Board of Directors, particularly those who understood the importance of FBDB's role and the challenges small businesses encountered from their own private sector experience, Lavigueur had succeeded in proving a strong case for the Bank's continued viability in financing and supporting Canadian SMEs. Under his leadership, the Bank had developed into a modernized and valued organization poised to meet future challenges in the evolving economic landscape. Beaudoin's appointment as President and Chief Executive Officer of FBDB was supported by the Board of Directors. John Crow, then Governor of the Bank of Canada and an FBDB Board Member, reflected the sentiment of the Board in his previously referenced book in which he underscored his role in the nomination of François Beaudoin as President of the Bank.

It was not a major transition to the office of President as Beaudoin had already been managing most aspects of the Bank as Chief Operating Officer. He continued with the changes he had already started to move the Bank to the next level.

The operational review of all the Bank's divisions was intended to improve productivity by streamlining operations. The higher goal was to improve customer service and achieve growth in new business. Customer service, though, was an ongoing challenge for FBDB, and reflective of the paradoxical mandate to be a supplementary lender, that is, to require letters of refusal from other financial institutions, take higher risk and be profitable, all at the same time. Surveys throughout the 1980s had shown FBDB clients, for both financing and management services, were quite satisfied with the service they received at the Bank. The questionnaires handed out at the end of seminars or counselling assignments all showed well over 90% satisfaction with FBDB's service. The only complaint the Bank received from its loan clients was that FBDB's interest rates were too high. (In an environment where interest rates were steadily above 10%, even chartered banks were subject to the same complaint.)

To get a current reading on service quality at the Bank, an independent in-depth survey by Goss Gilroy, a management consulting group from Ottawa, was done in 1992. It measured satisfaction levels of FBDB loan customers, looking at several components of service including: courtesy and knowledge of staff; explanation of terms and conditions; responsiveness to customer needs; and time to process applications. The Bank scored well over 90% satisfaction levels (satisfied or very satisfied) on almost all counts. Only 'time to process application' fell below the 80% satisfaction level. Comparing service levels to other lenders, 72% of respondents agreed FBDB provided better service. Yes, better service. Only 6% rated FBDB worse than other lenders. Over 95% stated they would return for another loan and recommend FBDB to others. Apart from loan processing time, respondents showed some discontent with the Bank's interest rates and fees.

That those receiving financing from FBDB were quite satisfied with the service they received was beyond doubt. On the other hand, Members of Parliament (MPs) were frustrated with FBDB's handling of referrals they had sent to the Bank.

Constituents who were refused financing often complained about the treatment they received at the Bank. Some MPs even said they would stop referring constituents to FBDB because they always returned complaining about how they had been treated. This view of FBDB's customer service was emphasized in the Minister of Small Business' remarks to the Board of Directors at the end of 1992 (mentioned in Chapter 13). MPs were not the only group with complaints about FBDB's customer service. When the Department of Regional and Industrial Expansion conducted its surveys of FBDB stakeholders in the late 1980s, they received many critical comments about FBDB's service from industry associations.

While the Bank had little to improve on when it came to customers who received financing and management services, it had to do a better job with businesses who did not receive the financing sought. The MPs visit program, mentioned earlier, helped improve their understanding of the Bank's actions and the limitations on what FBDB could deliver. Beaudoin, however, made customer satisfaction a priority for the Bank with an important caveat. To him, the customer was anyone approaching the Bank for any of its services. It was a standard maxim in marketing circles that one satisfied customer would tell of a good service experience to only one other person, while one unsatisfied customer would tell ten others of a bad service experience. Coming from a retail operation in a chartered bank where customer satisfaction was paramount, Beaudoin instituted a series of actions to ensure customer satisfaction was a priority for all Bank staff.

A brochure entitled *If you're not happy, we're not happy* was produced. The brochure was placed in a prominent location in all branch and regional offices. Directed at customers who were unhappy with the service they received from the Bank, the brochure stated: "we want you, our client, to know that we will seriously look at any concern ... if we can't give you a positive response, we'll explain why." Three levels of contact to resolve a problem were made available to any client walking in and out of any FBDB branch office. The first level was the local branch manager. If the problem could not be resolved to the satisfaction of the client at this level, the client was invited to contact the regional vice president whose address and fax number were provided in the brochure. If still not satisfied, the client could write to the President and Chief Executive Officer of the Bank. His address and fax number were also provided in the brochure.

Statistics were not officially kept on how many clients availed themselves of the redress mechanism but one could be sure almost all would have been resolved at the branch level. Branch managers would not want their regional vice presidents resolving complaints coming from their branches and regional vice presidents would not want the President resolving complaints coming from their regions. Later on, the President's office was removed from the complaint hierarchy when an Ombudsman position was created. In 1995, the Bank instituted its Charter of Client Rights, monitored by the Ombudsman. It also introduced a cost-shared independent mediation service for situations where a loan had been called and issues could not be resolved by the complaint handling system. A toll-free hotline was also made available for all customers.

The *If you're not happy, we're not happy* brochure was accompanied by an internal one for staff, *If they're not happy, we're not happy*. It explained the Bank's



service objectives and strategies as well as ways to handle customer concerns. A staff training program aimed at providing extraordinary customer service was developed and implemented. Continuous surveys of clients were also put in place. The results of these surveys were used in staff performance evaluations. Beaudoin went one step further and instituted internal customer satisfaction as a performance measure. Field staff were asked to rate the level of service they received from departments in head office. These ratings affected departments' overall performance ratings which in turn affected individual ratings. With their ratings affecting personal performance evaluations, customer satisfaction became a priority for all staff at the Bank. The old adage was at work again: people do what you inspect, not what you expect.

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*A brochure entitled **If you're not happy, we're not happy** was produced. The brochure was placed in a prominent location in all branch and regional offices.*

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### **The Bank's mission comes into question**

While introducing operational improvements, Beaudoin also had to deal with unexpected results emanating from the special examination carried out by the Auditor General of Canada. Under the Financial Administration Act, each crown corporation had to have a special examination done every five years. A special examination is akin to a comprehensive audit, except it is done by the government and in particular, by the Auditor General of Canada. It required the auditor to determine whether systems and practices were maintained in a manner to provide reasonable assurance that: i) the Bank's assets were safeguarded and controlled; ii) the financial, human and physical resources of the Bank were managed economically and efficiently; and iii) the operations of the Bank were carried out effectively. In 1989, the firm of Price Waterhouse was engaged to carry out the first such examination of the Bank. It did not find any significant deficiencies in systems and practices at the Bank. There were lower level deficiencies that management, under the watchful eye of the Board of Directors, was mandated to resolve.

The second special examination by the Auditor General of Canada, however, done in the 1992 to 1993 period, resulted in the identification of not one, but two significant deficiencies at the Bank. The Auditor General reported that in their opinion: i) the mission of the Bank, based on its legislated mandate, required

further definition to allow for setting objectives and reporting results; and ii) the Bank lacked comprehensive plans for marketing its services and addressing objectives, including coordination of activities throughout the Bank. To the layperson these may be considered important albeit non-earth shattering remarks. In reality, these issues went to the heart of the Bank and how it carried out its mandate as legislated by Parliament.

The two significant deficiencies identified by the special examination led to several animated discussions between the Bank and the office of the Auditor General of Canada. The Board of Directors and management were convinced the Bank was carrying out its legislated and policy mandates according to the letter of these mandates. The principal in the Auditor General's office who conducted the 1993 examination, Beant Barewall, was convinced otherwise and he had the full support of the Auditor General of Canada. Barewall also had support from his private sector advisory committee that included former senior bankers. In Barewall's view, the Bank should have been playing a developmental role targeting specific sectors of the economy that produced significant economic benefits. The Bank pointed out that its legislation did not refer to targeting specific sectors. The FBDB Act stated that the object of the corporation was "to promote and assist in the establishment and development of enterprises in Canada by providing financial assistance, management counselling, management training, information and advice and such other services as are ancillary or incidental to any of the foregoing." According to the FBDB Act, the corporation was to give particular consideration to the needs of small business enterprises. This was the only targeting the Bank was legislated to undertake.

The ensuing debate harked back to discussions within the Bank, including the Board of Directors, about the market role for FBDB. Should the Bank be reacting to the requests and needs of all small businesses or only to a small select group that generated significant value-added to the economy, principally the manufacturing sector? Gordon Sharwood, a Board Director, had initiated this discussion back in 1980. As noted earlier, he thought the Bank should be focussing its financing more on growth sectors and less on "mom and pop" establishments. The same topic was broached in 1981 when Peat Marwick proposed that the Bank play a reactive role to serve the "mom and pops" and a proactive role for growth companies. The Investment Banking Division was created in part to serve in this proactive role, but the number of investments the Bank made each year hardly qualified it as playing a significant developmental role in the economy. In reference to the level of venture capital activity at the Bank, one senior Ottawa official once remarked it was like a fart in a windstorm—but a good fart.

FBDB's legislation and policy mandates stated it was to serve all small businesses at large. The Bank argued that to provide services to only specific sectors of the economy would be ultra vires of the FBDB Act. The Board Director representing the Department of Industry, Science and Technology Canada (ISTC) noted it was government policy for FBDB to be providing its services in a non-discriminatory manner. The government's developmental activities were concentrated in its regional development agencies and in ISTC, where subsidy programs resided.

The second deficiency identified by the special examination related to marketing the Bank's services. The main tool for marketing is advertising and this deficiency resurrected a recurring issue at the Bank. Just after FBDB was created in 1975, Jack Poole, a Board member, had reported the Honourable Ron Basford, a cabinet minister from Vancouver, thought the Bank was not known by the public. This lack of visibility later led to the remark at the Board of Directors that the Bank was the best kept secret and discussion of how much advertising the Bank should be doing. As recounted earlier, there was the view an aggressive advertising campaign would draw the ire of chartered banks and FBDB would be seen to be competing for business as opposed to being a supplemental lender providing financing "not otherwise available ...". Over the years, the Bank did advertise its services in various media but not in a manner that could be seen as aggressive. Further, the amount spent on advertising was limited to a large extent by how much the Bank could afford among competing demands. While marketing might have been a deficiency, it was not considered by the Bank to be a significant deficiency taking into consideration its legislated supplementary role.

Marketing FBDB's services was a source of much discussion throughout the 1980s. As the Bank embarked on growing its loan portfolio after 1985, many field officers thought the Bank would benefit from having a marketing department. The proposal was not acted on instantly but eventually, after repeated demands, a marketing group was created at head office and the following scenario played out. The head of marketing would be on the job for a few months but with no tangible results to show for the position, the person would be reassigned to other tasks. The marketing position would remain vacant for a short while and subsequently disappear from organization charts. Then the need for a marketing group would be raised again and someone else would be appointed to head the group. And again with no tangible results to show, the person would be reassigned elsewhere and the group dismantled and eventually disappeared. To make an impact, one head of the marketing group proposed that responsibility and budgets for the Bank's advertising program be transferred out of Public Affairs to the group. The proposal was rejected and the cycle continued. At the time of the special examination, the Bank knew that marketing its services posed a special challenge.

Depending on the severity of a deficiency, the Auditor General of Canada had the option of reporting it to the corporation's Board of Directors, to the Minister responsible for the crown corporation or to Parliament. Lower level deficiencies, those usually related to operating deficiencies, are reported to the Board of Directors that would then oversee corrective action by management. But in this special examination, the positions of the Bank and the Auditor General were so opposed, there was the possibility the Auditor General's report would be sent to Parliament. This action would have triggered another round of Parliamentary hearings on a negative issue for the Bank. Fortunately the special examination report with its two significant deficiencies was sent to the Minister of Industry and it was up to him to take corrective action. By that time, there was a new government in place and a new Minister of Industry to receive the report.

In October 1993, federal elections were held and the Liberal Party of Canada won a large majority of seats in Parliament. The ruling Progressive Conservative

Party lost all but two seats it had held prior to the elections. The Bloc Québécois, under the leadership of the Honourable Lucien Bouchard, a cabinet minister in the former Progressive Conservative government, won the second largest number of seats, 54, and formed the Official Opposition in Parliament. The Reform Party, with support principally in Western Canada and from former Progressive Conservative voters, won 52 seats, not quite enough to become the Official Opposition.

During the 1993 electoral campaign, the Liberal Party had released its manifesto, the Red Book as it became known. It outlined actions the party would pursue if it formed the government. There was a strong emphasis on small business development in the Red Book. When the new Minister of Industry, the Honourable John Manley, received the special examination report from the Auditor General of Canada, he stated the deficiencies would be resolved through a change to FBDB's mandate and legislation.

### **Increasing the Bank's public profile**

With the real prospect of having a new mandate and legislation, Beaudoin embarked on another of his priorities. He wanted to raise the Bank's public profile and at the same time change it. One of the first actions he had taken as President was to tweak the Bank's logo. It had been a stylized circle with the subsumed letters b and d. The logo was kept but placed in a square box. The next step was to revitalize the ads the Bank was placing in news media. The new ads gave the Bank a fresh look and attracted the attention of small business. It helped that ads in the print media were much larger than previous ones, some taking up a quarter of a page in newspapers and half a page in magazines. This was a big change from the Bank's previous ads, most so small they went unnoticed. They were called business card ads because they were almost the size of business cards.

The positive impact of the new ads did not happen by chance. The process of preparing new ads started with focus groups and surveys of small business owners/managers across the country. Focus groups were held first in Toronto, Montreal and Vancouver. The object was to gauge the attributes small business owners were looking for from providers of financing and management services, their knowledge and impressions of FBDB, the news media they read and listened to, and which phrases, clichés, etc. caught their attention. Findings from the focus groups were then used to design larger surveys to obtain representative views of small businesses at large. The survey information was analysed and given to the Bank's advertising agency that then designed new ads. Groupe BCP of Montreal was selected as the Bank's advertising agency after a call for concepts was put out and submissions received. The job of the agency was to design and place ads with the news media on behalf of the Bank. But, their designs had first to be approved by the management team, including the President.

Almost all participants in focus groups and surveys had never dealt with the Bank. When they were asked to name financial institutions that provided financing, few would mention FBDB "off the top of their mind." However, when prompted (have you ever heard of the Federal Business Development Bank?), almost all interviewees would respond in the affirmative. Moreover, they knew what services the Bank provided, both financial and management, but their impressions of the

Bank were on the whole neither negative nor positive. If, by chance, one of the participants had received financing or a management service from the Bank, the impression would be positive.

Christiane Beaulieu joined FBDB in 1994 to head the Public Affairs department. She was given responsibility for developing and managing a strategy to increase public visibility and awareness of the Bank. From the recently completed business surveys, the Bank had a baseline measure of its awareness among small business owners and managers. One objective of the advertising strategy, therefore, was to raise the level of “FBDB” responses when small business owners and managers were asked to name financial institutions that provided financing. The Bank also sought to raise small business owners’ impressions of FBDB to more positive levels.



Christiane Beaulieu, head of the Public Affairs department, and André Bourdeau, Vice President for the Quebec region.

Groupe BCP placed FBDB ads in newspapers, magazines and on television. It had been a very long time since the Bank had placed ads on TV. The first set of ads did not go unnoticed and they received positive feedback, especially from field operations. So positive, it was decided to increase the amount of advertising beyond what was budgeted for. The Bank was now going to spend around \$1 million in advertising. For FBDB, a million dollar advertising budget was considered enormous, but given that a single placement of a full page ad in a Toronto newspaper could cost upwards of \$100,000, spending lesser amounts would not have had a significant impact. Restricted budgets and the requirement to advertise over a wide base were the reasons the Bank could only previously afford miniscule-type ads.

With positive feedback coming from the ads, Beaulieu was allowed to go over budget, so to speak, on her advertising expenditures. The Bank was posting a

small profit of just under \$5 million a year in the 1993 to 1994 period so some monies were available for this priority. Not everyone needing increased budgets got them. In fact the Bank was in the mode where spending over budget was not tolerated unless it had been pre-approved by the highest authorities. After all, each \$50,000 saved meant an extra job could be saved at the Bank. In 1993 and 1994, the Loans Division was still in a downsizing mode, though mostly from voluntary departures.

As President, Beaudoin had made increased visibility and awareness of the Bank another corporate priority. (Notably, this came shortly on the heels of the Bank's opposition to the significant deficiency in marketing identified by the Auditor General of Canada – an example of turning a threat into an opportunity.) New ads and larger advertising space were the principal vehicles. But there were others. Budgets were created for field staff to join local business associations, especially local chambers of commerce. A budget was also created to sponsor local business events where the Bank (and its new signs and brochures) could be prominently displayed. Wherever possible, the Bank would lever its sponsorship contribution to have one of its officers deliver a speech at a business event. Such involvements in local business affairs had occurred prior to 1994 but on an ad hoc basis, few and far between. Now there was a concerted and funded effort for such involvement.

With more spending on larger ads in newspapers, Groupe BCP was able to arrange editorial board meetings for the Bank. At these meetings, the Bank's officers would be interviewed by the newspaper's business editor and reporters. The Bank wanted to get its story out to the public through the news media, in advance of anticipated changes in its mandate and legislation. Editorial board meetings were held in major centres across Canada, with Vancouver being the exception. Both major dailies in Vancouver declined to have the meetings. The head of Corporate Affairs and a local FBDB manager met with editorial boards in western Canada and in the Atlantic region. The President did the Quebec boards and both did the editorial board at the Globe and Mail in Toronto. Following these meetings, the newspapers all published positive articles on the Bank, including the prospect of a new and expanded mandate for FBDB.

The editorial board at the Globe and Mail was important given the national distribution and readership of its daily Report on Business. However, it was where the Bank's representatives ran into tough questioning from an unexpected source. Andrew Coyne was a well known columnist for the Report on Business section of the paper. His viewpoints were reflective of a champion of free markets. At the editorial board meeting, he questioned the need for the Bank and the existence of a financing gap. It was the Small Business Financing Review revisited. While it had been expected that his questions for the Bank would be difficult, the Bank's representatives had not anticipated he would question the need for the Bank. After all, his father, James Coyne, had once been Governor of the Bank of Canada and President of the Industrial Development Bank, the predecessor to FBDB. The elder Coyne, known for his staunch independent stand at the Bank of Canada, actually resigned from the post in the early 1960s rather than implement the Diefenbaker government's monetary expansion policies. In any event, there was much relief when the Globe and Mail published a positive article on the Bank a few days later.

The President was also interviewed by senior columnist Neville Nankivell with the Financial Post, another newspaper with national distribution and business readership. Following the interview, a positive article appeared in the Financial Post. It was noteworthy for its reflections on what a new mandate for the Bank could entail, including the possibility of having private sector involvement in the ownership of the Bank through the issuance of preferred shares, foreshadowing an area of debate that would come up in crafting the Bank's new legislation. The article also indicated that although there was a time when many questioned the need for an institution such as FBDB, the banking community seemed to have accepted its [FBDB's] place in the market and worked closely with it. The Bank had recently formed a strategic alliance with TD Bank in which its CASE counselling program would be used by TD small business customers.

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## In 1994, there was mounting internal and external pressure to change the Bank's legislation quickly.

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### **Increasing pressure for a new mandate**

In 1994, there was mounting internal and external pressure to change the Bank's legislation quickly. In addition to the need to respond to the Auditor General's special examination deficiencies, the Bank was close to its legislated limit on liabilities of \$3.2 billion. In June 1994, management reported to the Board of Directors that the ceiling may have been exceeded for one day. It was not definitive as there were many estimates underlying the production of monthly unaudited financial statements. But it reflected the urgency to get new legislation. The Board of Directors instructed management to ensure the legislated limit was not exceeded.

Members of Parliament too were calling for a change in FBDB's mandate and legislation. Following-up on the emphasis placed on small business as the engine for economic growth in the Liberal Party's platform for the 1993 federal election, contained in the Red Book, members of the Ontario Liberal caucus held small business "town hall" meetings across the province. These meetings kept focussing on the credit crunch faced by small businesses.

A key member of the Liberal caucus was Dennis Mills. He had a part in making small business a focal point of the Red Book and was critical of chartered banks' treatment of small businesses. Mills was appointed Parliamentary Secretary to the Minister of Industry. He was a champion for small business and also an advocate for changing FBDB's legislation. His colleagues on the House of Commons

Standing Committee on Industry produced a report, *Taking Care of Small Business*, that recommended the Federal Business Development Bank be refocused as a complementary lender to small and medium size businesses, and that it be authorized to use new financial instruments to fulfill its mandate. Mills told the head of the Bank's Corporate Affairs group, at one of their early morning meetings, that the government would quadruple the size of FBDB. The Industry Committee also proposed the Bank be renamed Small Business Bank of Canada.

That chartered banks were seen to be more stringent in their small business lending was not surprising. In the early 1990s, the Canadian Bankers Association (CBA) commissioned a study with the University of Western Ontario to look at chartered banks' lending practices. The same Business School professors, Wynant and Hatch, who had done a similar study for the CBA in the early 1980s, conducted the study. The purpose of this update was to examine the relationship between chartered banks and their small business customers, identify problems and recommend solutions.

Instead, this edition of the CBA small business study attempted to justify why chartered banks were becoming more demanding with their small business customers. The study concluded that: i) chartered banks were in the business of providing low risk financing to small businesses; ii) to ensure safety of deposits, banks had set limits on loan losses; and iii) to achieve a 99.5% recovery rate for loans, bankers felt that they must be assured of a secondary source of repayment should a business not succeed. It was the first time chartered banks revealed their objective of having a 99.5% recovery rate on small business loans, or a 0.5% loss rate. It was also the first time banks had used 'safety of deposits' to justify taking minimal risk on small business loans, the implication being that if they were to take more risk, Canadians at large stood to lose their bank deposits.

There were other factors, not mentioned in the study, that affected chartered banks' willingness to take on risks and expend the administrative effort associated with small business loans. During the 1980s, Canadian chartered banks had experienced very high loan losses on loans made to developing countries and, with the 1990 recession, large loan losses had accrued from the commercial real estate sector. These events led to a general tightening of credit standards in the banking industry, analogous to what FBDB did in its cost recovery efforts of the early 1980s. Then there were new capital requirements imposed on banks emanating from the first Basel Accord. Higher capital requirements meant capital had to be rationed among competing activities and higher returns generated from all assets, small business loans included. In such an environment, capital would flow first to those activities providing the highest returns.

With MPs voicing their displeasure with the state of small business financing in Canada, the Minister of Industry, the Honourable John Manley, and his Deputy Minister, Harry Swain, sat down to plan the future direction for FBDB. The Minister, by his own admission, was not a vocal supporter of the Bank. As a member of the Opposition in earlier Parliamentary Committee hearings, he had shown by his questioning of Bank officers that he was not enamoured with some Bank actions. However, he agreed with his Deputy that the Bank could play a key role in the government's Jobs and Growth Strategy. This required changing the vision and



role for the Bank. In the views of both the Minister and his Deputy, the Bank had to change its focus or be sold. To support the overall Jobs and Growth Strategy, the Bank would have to be repositioned to address the needs of a technology, export-based economy. According to the Minister, the Bank should gradually decrease its real estate-backed loans and increase loans to knowledge-based companies. He was prepared to take this new direction and the required changes to FBDB's legislation to his cabinet colleagues for approval. The Memorandum to Cabinet process thus started in earnest.

Minister Manley supported changes to the Bank's role and mandate. The Bank had proposed that the clause in its Act to provide financing not otherwise available on reasonable terms and conditions be removed to allow greater access to the market like the Farm Credit and Export Development Corporations. On the other hand, senior officials in the Department of Industry wanted to keep the last resort role of the Bank intact. Beaudoin took the matter up with Minister Manley and it was decided the Bank would play a "complementary" role in the market. This role still envisaged filling financing gaps.

In early 1995, the Memorandum to Cabinet (MC) was written by the new Associate Deputy Minister of Industry, Kevin Lynch. Referred to by many as having one of the brightest minds in government, he quickly placed the mandate issues into a fresh perspective. Soon after, when he was appointed Deputy Minister of Industry, Lynch became a member of the Bank's Board of Directors and oversaw the implementation of his handiwork. (Later he progressed to become Deputy Minister of Finance and then Clerk of the Privy Council, the highest ranking public service position in the federal government.)

Lynch broke down the financing gap into four components. First there was a risk gap in the market. The risk gap resulted from the unwillingness of many lenders to lend in higher risk situations, even at high interest rates. Then there was the size gap. This resulted from the relative high costs of assessing small loans, costs that negated potential returns to lenders. This was the same gap the former Governor of the Bank of Canada, Gerald Bouey, and Frank Podruski had cited in earlier times in relation to FBDB's market role and the small business financing gap. Lynch also identified a knowledge gap as financial institutions generally did not have the methods and knowledge base to evaluate lending and investment risks for businesses in the new economy. Finally there was the flexibility gap, the unwillingness of lenders to finance promising businesses on flexible terms. These were situations the Bank had financed throughout its history. Most importantly for the Bank, Lynch – a top economist in the government – accepted that gaps existed in the small business financing market. The Minister of Industry would refer to these gaps frequently in his subsequent presentations in Parliament.

### **Drafting new legislation**

In normal circumstances, a Memorandum to Cabinet was prepared to seek approval for specific actions. If a major change of legislation was required, the cabinet decision would include a directive to the Department of Justice to prepare the relevant legislation. The draft legislation would then be brought back to Cabinet for approval before being presented to Parliament. This process would

normally take many months to complete. In FBDB's circumstances, however, with the \$3.2 billion ceiling fast approaching, there was insufficient time to go through this two-step procedure. To fast track the process, the Bank had to convince officials from the Department of Justice to allow the Bank itself to draft the legislation to change the FBDB Act. They agreed, on condition the draft legislation would be thoroughly vetted by an interdepartmental group including lawyers from the Department of Justice, the Department of Industry and the Treasury Board of Canada. This way, they had veto power over the content of the legislation without incurring the cost of production.

Securing Department of Justice approval for this procedure was crucial from a timing perspective. It was further agreed the draft legislation would accompany the Memorandum to Cabinet so that approval of the MC would include approval of the draft legislation to change the FBDB Act and its presentation to Parliament. It was an unusual procedure but all concerned parties realized that to meet the deadline of having new legislation in effect by mid-1995, there was no other alternative.

Beaudoin called on the law firm Martineau Walker in Montreal, to prepare the new legislation under the direction of the Bank's legislative task force. The legislation had to be prepared in less than a month. The Bank's task force was led by the head of Corporate Affairs and included Jim Hercus, Vice President, Legislation, and Mary Grover-Leblanc from the Government Relations department. Other departments participated in the drafting sessions as needed, including Treasury which needed explicit powers, for greater certainty, to carry on its innovative borrowings.

Daniel Picotte from Martineau Walker was assigned the task of writing the new legislation. It was decided very early in the process that the existing FBDB Act would not be amended piecemeal but instead would be replaced completely by a newly written Act. Normally, businesses would be incorporated under the Canada Business Corporations Act (CBCA) that would govern their activities. Crown corporations, however, are governed by their own Acts of Parliament. A crown corporation cannot do anything that is not included in its enabling Act. This meant anything the Bank did, or would do in the future, had to be included in its Act. Thus, the draft legislation had to foresee future needs, reflect precise wording and avoid anything that could impractically stifle or inconvenience the Bank in the future.

Drafting the legislation literally started with a pencil and a blank sheet of paper. The existing FBDB Act was a guide but the Bank wanted many of its major clauses changed. Over the decades – the FBDB Act was over twenty years old – many legal issues had arisen with respect to the Bank's activities, especially Treasury's borrowing activities and FBDB partnerships with other organizations. These issues entailed major expenditures on legal interpretations. One objective therefore was to remove the need for such interpretations by making explicit the powers to carry out such activities. Jim Hercus as General Counsel had kept a file on all issues that had to be resolved when the Act was revised.

Daniel Picotte, with his expertise in the CBCA and the Bank Act governing chartered bank activities, had the task of drafting the Bank's legislation so that it contained powers normal corporations would have while respecting the Bank's

policy constraints, such as that of being a complementary lender, as well as constraints imposed by the government's Financial Administration Act. Each section drafted and re-drafted by Picotte was thoroughly vetted by the legislative task force, word by word. It was assumed the new legislation would have to last for at least twenty years. Its wording had to be interpreted not only against the current environment but against all plausible 'what if' scenarios. Placement of commas became very important. Diane Reid, Assistant Corporate Secretary, kept track of the clause-by-clause analyses done by the legislative task force, highlighting changes to the FBDB Act and reasons for the changes. This would prove useful in dealing with questions from lawyers on the interdepartmental group and questions in Parliament.

The legislative task force met its deadline and proceeded to negotiations with lawyers from the aforementioned government departments. There was a lot of give and take at these sessions, especially as the new Act had to conform to limitations imposed by the Financial Administration Act. And lawyers, being lawyers (with the added presence of economists in the room), had much to argue about potential interpretations of individual words, phrases and placement of commas. Eventually a draft of the new Act was agreed on within the tight deadline.

Concurrently, a draft Memorandum to Cabinet (MC) on the Bank's new mandate was presented and discussed with all related and interested federal government departments and agencies. Unexpectedly, there were reservations expressed by the Minister responsible for Atlantic Canada Opportunities Agency (ACOA), the Honourable David Dingwall (although at interdepartmental meetings, his officials had raised no specific objections to the new mandate detailed in the MC.) But without Minister Dingwall's support, the MC would not go forward as there had to be solidarity at the Cabinet table for changes to the Bank's mandate and legislation – just as when legislation for Farm Credit Corporation was being changed.

Time was running out for FBDB as it was fast approaching its liabilities ceiling of \$3.2 billion. An alternative was proposed to split the new Bank legislation into two parts. One part would deal only with raising the \$3.2 billion ceiling and the second would deal with all the other changes at a later date. The Bank's Board of Directors agreed that splitting the legislation was neither advantageous nor recommended. Minister Manley also did not want to split the new legislation. A contingency plan for credit rationing was again discussed by the Board and was to be implemented to ensure the Bank stayed within its \$3.2 billion ceiling. At the time, new loan authorizations were increasing at a 17% annual rate.

The Chairman of the Board, Patrick Lavelle, and FBDB's President met with Minister Dingwall to discuss passage of the Bank's Memorandum to Cabinet. Lavelle had joined the Bank's Board of Directors as Chairman in October 1994. He was a former Deputy Minister of Industry in the Ontario provincial government. Initially, he wanted to be appointed Chairman of the Export Development Corporation but this posting was not available. Patrick Lavelle was persuaded to take on the FBDB position after he saw elements of what its new mandate would be. The Honourable David Dingwall held the unofficial title of Minister for the Atlantic region. By coincidence, Patrick Lavelle also had ties to the Liberal political establishment from the region. (At one time he had served as an assistant to the

Honourable Allan J. MacEachen, a former Finance Minister and unofficial Minister responsible for the Atlantic region in the Trudeau era.)

At the meeting with the Bank's Chairman and President, Minister Dingwall requested that the Bank play a bigger role in Atlantic Canada. He wanted a Memorandum of Understanding (MOU) between ACOA and the Bank regarding support for small businesses in Atlantic Canada. An MOU between the Bank and ACOA was subsequently signed in mid-1995. The Bank committed to participating in the capitalization of an Atlantic Investment Fund, to establish a venture capital office/capacity in the region and, on a best-effort basis, increase lending in the region over the following three years with emphasis on the new economy. The meeting with Minister Dingwall led to another major hurdle being cleared and a new Bank was on its way.

### **Passage of new legislation**

On May 15, 1995, the Honourable John Manley tabled legislation in the House of Commons. Bill C-91 was an Act to continue the Federal Business Development Bank under the name Business Development Bank of Canada. In an uncommon move, he asked that Bill C-91 be referred to the House of Commons Standing Committee for Industry after its first reading in the House. A bill is usually referred to a Standing Committee for study after its second reading in the House.

At the Standing Committee stage, witnesses are called to present their views on the bill at hand and be questioned by committee members. Interested parties can make representations to the committee and request to appear in person. In the Bank's case, it was expected the Canadian Bankers Association (CBA) would appear before the Industry Committee. They declined to do so, saying they were too busy, but sent a written position to the committee. The CBA in its submission opposed changing the Bank's last resort role. Other industry associations, notably the Canadian Federation of Independent Business, also did not participate in the discussion of Bill C-91. The Minister of Industry (the Honourable John Manley), his Parliamentary Secretary (Dennis Mills), and Bank officers appeared as witnesses before the Industry Committee in respect of Bill C-91.

On May 31, 1995, the Honourable John Manley and the President of FBDB appeared at the start of the committee's hearings. Beaudoin returned the next week to respond to questions concerning contents of the bill. The following week, on June 13, the Industry Committee did its clause-by-clause review of Bill C-91, with Dennis Mills as the principal witness representing the government, assisted by the Bank's legislative task force.

Time was of the essence. June 13, 1995 was absolutely the last day the Industry Committee could conduct its clause-by-clause review and send its report and recommendations back to the full House of Commons, where they would be debated and voted on. According to the established timetable, a full week was needed to get the necessary paperwork and translations done before a Committee report could be tabled in the House of Commons. It had been announced Parliament would be recessed on June 22 and would not reconvene until the fall. More critically, it was widely expected the fall session would open with

a Speech from the Throne signalling the start of a new session of Parliament. This meant all legislation that had not passed in the previous Parliamentary session would have to be reintroduced and the whole process started from scratch.

Only one day, with breaks to attend to matters in the House of Commons such as the daily Question Period, allowed little time for the Industry Committee to conduct a clause-by-clause review of the Bank's legislation, especially given the new powers being introduced in Bill C-91. The Chairman of the committee, Paul Zed of New Brunswick, valued highly the consensus building spirit his committee had forged among its members. This spirit had been evident a year earlier when committee MPs from both sides of the House of Commons reached a consensus agreement on the contents of its report Taking Care of Small Business. He thus allowed in-depth debate when the clause-by-clause session began. However, the first two clauses studied by the committee were controversial for members of the Opposition parties – the Bank's new name and the switch to become a complementary lender. (Further commentaries from this discussion are referenced in the next chapter dealing with the substance of the new Act.)

By the end of the morning session, only four of the 50 or so clauses in Bill C-91 were debated and voted on by the Standing Committee. If the clause-by-clause review was not completed by the close of day, there would be no new Bank legislation for a long time.

While it was never divulged what discussions had occurred over the lunch break, the pace picked up when the committee meeting resumed in the afternoon. The Chairman allowed debate and discussion of the issues but he moved the meeting along at a sufficient pace to have the clause-by-clause review and amendments completed by the end of the day. And there were no complaints from Opposition Members on the committee about the quick pace. It helped that FBDB officers, Jim Hercus and Mary Grover-Leblanc, had spent time with Opposition Members the previous day, briefing them on the key aspects of the legislation and responding to any questions they had. The Members appreciated this gesture by the Bank.

The Industry Committee report on Bill C-91 was sent to the House of Commons for second reading with 33 amendments. On June 21, 1995, the amendments were debated and voted on in the House of Commons. As one MP proffered, the job of the Opposition in Parliament is to oppose. That they did. Bloc Québécois MPs said there was no need for the new legislation as the Bank was doing just fine in the province of Quebec. They considered expanded powers being given to the Bank as a federal government tactic to become more involved in the region's economic affairs, which they held were the domain of the provincial government. Reform Party MPs said their Party did not support the creation of new crown corporations which, technically, Bill C-91 did. In their view, federal crown corporations should be closed or be privatized. They pointed to the privatization of Air Canada and CN Rail as exemplary actions by the government. However, they recognized Bill C-91 would be passed by the government majority in the House of Commons, so they supported the amendments sent by the Industry Committee. If the Bank was going to exist, it should be structured properly.

The next day, Bill C-91 was supposed to receive third reading and be passed by the House of Commons. But Murphy's Law was at work again and an unexpected roadblock arose at the last minute. Jacques Hudon, the Bank's Vice President of Government Affairs, learned the Official Opposition, the Bloc Québécois, planned to use parliamentary procedures to block Bill C-91 from being passed. It seemed the move was not specifically aimed at the Bank but was the result of overall disagreement with the government. The air in Parliament was heavy with the upcoming referendum in Quebec. Jacques Hudon immediately apprised Beaudoin of the situation. He then arranged for Beaudoin to speak with the Leader of the Opposition, the Honourable Lucien Bouchard. Beaudoin convinced Bouchard to allow Bill C-91 to proceed through Parliament. If the Bank's legislation had been delayed, the Bank would have had no choice but to institute credit rationing the following month. Quebec, having the largest volume of lending at the time, would have been most affected.

In the House of Commons, Dennis Mills thanked the Leader of the Opposition for his cooperation in allowing passage of Bill C-91. He noted a commitment on the government's part not to accelerate Bank lending or aggressively promote its presence in Quebec before the upcoming referendum.

Bill C-91 was passed by the House of Commons on June 22, 1995, the last day of sitting for that session of Parliament. It was passed in the Senate on July 13, 1995 and received Royal Assent the same day. The Senate Banking Committee would normally hold its own hearings on any legislation coming before it for approval. There were no Senate hearings in respect of Bill C-91. Minister Manley later revealed the concession he had made to the Senate Committee so that Bill C-91 could be passed quickly in the Senate. The concession was to support the Senate Banking Committee holding hearings on all federal government financial crown corporations.

On July 14, 1995, the Bank's Board of Directors took formal notice of the coming into force of the new Business Development Bank of Canada Act. It passed all the resolutions the Corporate Secretary, Andrée Leblanc Daviault, had prepared so that Bank operations could be carried on seamlessly. Just as in 1975 with the creation of FBDB, the powers of the new Bank lay in the hands of the Board of Directors to delegate to officers of the Bank as they saw fit.

At the Bank, there was excitement and jubilation on the day Beaudoin announced to all employees that the legislation had been passed and that their employer was now officially the Business Development Bank of Canada.

1995

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# The BDC act

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Important sections in the BDC Act represent the outcome of much debate and negotiation. These include the Bank's name, complementary role, share structure, purpose and specific powers as well as the provision for future legislative reviews.

**T**his chapter presents the background to principal changes incorporated in the Business Development Bank of Canada Act, proclaimed in 1995, and referred to herein as the BDC Act.

### **Name of the Bank**

The Bank's new name was embedded in the first clause of the BDC Act: "This Act may be cited as the Business Development Bank of Canada Act." As in the previous IDB and FBDB Acts, the name of the Bank attracted much debate among Members of Parliament. The House of Commons Standing Committee on Industry, both Opposition and government members, did not like the name. Nor did they appreciate the government changing one of their cherished consensus decisions.

In their report, *Taking Care of Small Business*, the Industry Committee had agreed FBDB should be transformed and re-named Small Business Bank of Canada. Members of the committee all showed an attachment to this name, especially the Parliamentary Secretary to the Minister of Industry, Dennis Mills. It was their baby, as the saying goes. This name for the new Bank was cited so often following publication of the committee's report it was being used in management presentations at the Bank, almost as a *fait accompli*. But the name had to be tested: what does it mean to small businesses? When the Bank held focus groups of small business owners and managers, it posed this question. The focus groups were also asked to give their reactions to other potential names. There was consensus among the focus groups; they preferred the name Business Development Bank of Canada. So this was the name Minister Manley adopted for the Bank. The tough task of notifying the Industry Committee that the government proposed to change the name of the Bank to Business Development Bank of Canada was given to Dennis Mills.

Some Industry Committee members showed a preference for retaining the old name Federal Business Development Bank if the name Small Business Bank of Canada was to be rejected. The expense of changing the Bank's name was cited as a reason to keep the old name. One Opposition member even said the old name was well respected in the province of Quebec. For the Bank, however, a name change was one of the two most important priorities for the new legislation. Rebranding is a common practice in industry when too much baggage becomes attached to a product or company name. FBDB was still, in media articles, being associated with financing strip clubs. And, more substantially, FBDB wanted to shed its image as lender of last resort. In addition, too many people referred to the Bank as "fub-dub" and as cited earlier, FBDB was many times mispronounced and miswritten as FDBD. In the 1980s, even a member of the Bank's Board once sent a note to fellow directors referencing FDBD.

In its clause-by-clause analysis of Bill C-91, the BDC Act, the Industry Committee voted to send an amendment to the full House of Commons to change the name back to Small Business Bank of Canada. Minister Manley persevered and government members in the House voted for the name Business Development Bank of Canada.



### Complementary role

As indicated in the previous chapter, it took a full morning session for the Industry Committee to review the first four clauses of the BDC Act. The first clause related to the name of the Bank and the second clause referred to the Bank's new complementary role, the two main controversial aspects, and priorities, of the new Act. The Industry Committee itself had recommended the Bank play a complementary role in the market, but there were differing views as to what a complementary role meant. In the version of the BDC Act first tabled in Parliament, section 14(4) stated: "the loans, investments and guarantees are to complement those available from commercial financial institutions."

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## The Bank's new name was embedded in the first clause of the BDC Act: "This Act may be cited as the Business Development Bank of Canada Act."

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In its first set of hearings on the BDC Act, members on the Industry Committee asked what the word "complement" meant. A dictionary definition was given, that is, to "fill out or complete." As this question was being asked often, it was decided to define the word "complement" in the interpretations section of the BDC Act, Section 2. As such, it spurred debate about the complementary role early in the clause-by-clause review. Some Industry Committee members wanted the Bank to remain a last resort lender. Their view was that with the new complementary role, the Bank would move away from its traditional supplementary lending and compete with chartered banks for profitable business. It was pointed out to them that if competing with the private sector were the objective, no reference to a complementary role would be in the Act. It would then be similar to the laws governing Farm Credit and Export Development Corporations. The presence of the condition to be complementary meant exactly that – the Bank would be complementing financing available from commercial institutions.

The Industry Committee recommended an amendment to Bill C-91. They removed the definition of the word "complement" from Section 2, the interpretations section, and changed section 14(4) to read: "the loans, investments and guarantees are to fill out or complete services available from commercial financial institutions." This amendment later passed in the House of Commons and was incorporated into the BDC Act. Some months on, a new member at the Industry Committee asked what the phrase "to fill out or complete services" meant. The first reply given was that it meant "to be complementary."

The change in the market role for the Bank meant one thing for certain. A large yoke had been lifted from the Bank. The previous role of having to provide financing not otherwise available on reasonable terms and conditions was terminated and by Parliament. So the Bank was no longer obliged to seek letters of refusals before authorizing loans, a bureaucratic, time-wasting procedure the Minister of Industry, and the Bank, wanted eliminated. While the Bank's last resort role was terminated, the government did not want it to be in full competition with the private sector either. The word "complement" and its dictionary definition were chosen to represent a middle ground between these two alternatives.

Not unexpectedly, the practical meaning of the phrase "to fill out or complete" and more specifically the word "complementary," would be the subject of many discussions after the BDC Act came into force. To clarify things, an example of the complementary role was given by the Bank that reflected a partnership characteristic of a complementary relationship. If a business had an operating line of credit with a chartered bank and a term loan with BDC, then the BDC term loan was considered to be complementing the line of credit (in addition to all the other services the chartered bank would be providing the business). To underscore this role, the Bank informed each client's principal banker of the financing program it was considering. Another characteristic of a complementary role was described in the context of markets and product differentiation. An analogy to the beer market was cited. In the 1990s, the market comprised two major Canadian bottlers, Molson and Labatt's, and U.S. bottlers, Budweiser, etc., all competing with one another in a market also occupied by smaller sized and micro breweries. The latter provided a specialized product for those who found their product attractive and were willing to pay a slightly higher price. They were not in the same competitive market as the major bottlers and were considered to be providing complementary products. In this analogy, BDC was the smaller sized brewery and chartered banks were the major bottlers. In the Minister's view, the Bank, in its complementary role, would be leading the way in small business financing with its unique risk assessment methods and new innovative financing instruments.

### **Share structure**

Early on, it had been decided the Bank should convert its capital structure to a share structure. The previous capital structure, defined by the FBDB Act, included payments to the Bank of Canada and was worded in such a way that many legal interpretations had to be done to determine how much capital the Bank could receive, all at a cost. With multiple interpretations being given by various parties, Jim Hercus noted in his legislative file that when the Bank's legislation would be changed, its capital structure should be converted into a share structure like those of normal companies incorporated under the Canada Business Corporations Act.

Thus, the next major change incorporated in the BDC Act was the switch to a share structure for the Bank's equity. The BDC Act allowed for the issuance of common and preferred shares to the Designated Minister of the government. In addition, a clause was added in the Act to allow for the issuance of hybrid capital to non-government sources. This structure attracted much debate at the Industry Committee and in the House of Commons.

A new Act allowed the Bank to start with a clean slate by converting the Bank's net equity to common shares held by the Government of Canada, each share with a par value of \$100. On July 13, 1995, net equity in FBDB amounted to \$303.4 million. This was converted into 3,034,000 common shares in BDC.

The power to issue preferred shares was included in the BDC Act. It arose from the FBDB having been rejected, on so many occasions, when it requested new capital injections. It was proposed by the Bank that private sector institutions might, at some point, be willing to invest in preferred shares of the BDC thereby reducing the need for the government to place scarce funds in the Bank. A mixed private-public sector ownership was envisaged in this scenario although the private sector would be limited to non-voting preferred shares. Recall in the debates of 1944, it had been suggested that the IDB should be created as an institution owned by chartered banks and other private institutions. In 1995, it was offered by the Bank that chartered banks might be willing to invest in BDC preferred shares to show their commitment to small business and ward off criticisms from politicians for not helping this important sector of the economy.

The Minister of Industry did not reject the proposal to include preferred shares in the BDC share structure. But he wanted the Industry Committee to debate the issue before making a decision. At the drafting stage, however, lawyers from the Treasury Board held a different position. The Financial Administration Act stipulated that only the Government of Canada could own shares in a crown corporation. It was pointed out by the Bank that if Parliament wanted, they could change this stipulation via the BDC Act. The issue could have been a deal breaker. To get agreement to proceed with the legislation to Parliament, the Act had to be drafted so that only the Government of Canada could hold BDC preferred shares. Officials allowed preferred shares to be in the share structure as they thought this vehicle would make it easier for the Bank to get new capital from the government. Preferred shares could be dividend-paying and would be classed as a non-budgetary item in the government's books. That is, they would not affect the budgetary deficit and would thereby face fewer obstacles in the approval process.

In its review of the BDC Act, the Industry Committee did not support the notion of private ownership in the Bank and wanted preferred shares to be issued only to the Government of Canada. This closed the books on what could have been a truly innovative public-private partnership.

A clause was added to the legislation to allow for the issuance of hybrid capital – a defensive move to provide for the event that issuance of preferred shares to private sector interests would not be allowed. Section 28(1) of the BDC Act stated: “with the approval of the Governor in Council, on the recommendation of the Minister of Finance, the Bank may issue to persons other than the Crown, hybrid capital instruments prescribed in whole or in part, as equity of the Bank.” Section 28(2) stated: “the Crown is not in any way liable for the payment of amounts owing under an instrument issued under subsection (1).” Section 28(3) stated: “for greater certainty an instrument issued under subsection (1) is not a share within the meaning of Part X of the Financial Administration Act.”

The insertion of hybrid capital instruments into the BDC Act attracted much debate in Parliament. When asked by the Industry Committee what a hybrid capital instrument was, François Beaudoin responded with a definition taken from the Office of the Superintendent of Financial Institutions, Canada's financial services regulator. Hybrid capital was described as an unsecured, subordinated debt that is fully paid up. Such instruments were not redeemable at the initiative of the holder but would be redeemable by the issuer after an initial term of five years, with the prior consent of the Superintendent. The President noted that hybrid instruments were being used by chartered banks, that they were being referred to as subordinated debt and were considered Tier 2 capital for regulatory purposes. Tier 1 capital was usually common shares.

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## As with the Bank Act governing chartered banks in Canada, a ten year review of the BDC Act was included.

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The hybrid capital section made it through Parliament but, for even greater certainty, another section was added to the BDC Act in this regard. Section 40 stated: "the Governor in Council may, by regulation, define hybrid capital instrument." The hybrid capital facility was one of the 'flexibility' clauses in the Act, belonging to the class of "who knows what will occur in the future."

With respect to BDC's size limit, Section 30(1) of the BDC Act stipulated that the aggregate of borrowings of the Bank and contingent liabilities in the form of guarantees must not exceed twelve times the equity of the Bank. The facility to increase this leverage to fifteen times, as contained in the FBDB Act, was removed in the BDC Act. This ensured the Bank would not be over-levered. The factor of twelve more or less corresponded to capital requirements for private sector banks under the first Basel Accord. Section 30(2) specified the components of Bank's equity: amounts paid for shares, retained earnings which may be positive or negative, amounts paid-in as capital by Parliamentary appropriation and such proceeds of debt instruments, hybrid capital instruments or other arrangements as may be prescribed as equity by the Governor in Council. This clause provided some measure of flexibility for future unknowns.

Section 23 stated that the maximum of paid-in capital in the form of shares, together with any contributed surplus and proceeds from hybrid capital prescribed as equity, must not exceed \$1.5 billion. While the FBDB Act placed a \$3.2 billion absolute limit on the Bank's total liabilities, the BDC Act does not set a

rigid limit as it would depend on the value of each component of the Bank's equity, defined by Section 30(2). The amount of retained earnings, for example, would be a factor in determining the maximum size of the Bank.

### **Purpose of the Bank**

Perhaps the main 'flexibility' clause in the BDC Act related to the purpose of the Bank. The FBDB Act stated: "the objects of the Corporation are to promote and assist in the establishment and development of business enterprises in Canada by providing, in the manner and to the extent authorized by this Act, financial assistance, management counselling, management training, information and advice and such other services as are ancillary or incidental to any of the foregoing." This section was replaced in the BDC Act by Section 4(1): "the purpose of the Bank is to support Canadian entrepreneurship by providing financial and management services and by issuing securities or otherwise raising funds or capital in support of those services." Section 22 of the BDC Act further stated the Bank may do all other things that are incidental or conducive to attaining the purpose of this Act. These changes reflected perceptions that the objects specified in the FBDB Act tended to narrow the focus of the Bank's purpose. The new purpose on the other hand, provided flexibility for future "who knows what" activities.

Other changes in the BDC Act fell into the categories of "housecleaning" and "for greater certainty." Over the years, the Bank had to rely on legal interpretations for many activities, chief among them, the various borrowing strategies employed by its Treasury department. Thus, for greater certainty, a whole part was added in the BDC Act to authorize a full range of Treasury activities. Further, the power to enter into agreements with others, such as government departments, and to provide services on their behalf, was made explicit by Section 20 of the BDC Act. This power was not explicit in the FBDB Act and the Bank again had had to rely on legal interpretations to carry out such activities as delivery of the Cultural Industries Development Fund. Section 21 of the BDC Act added that the Bank could carry out duties assigned to it by the Designated Minister in relation to any program supporting Canadian entrepreneurship, to the extent it is able to recover the costs of carrying out such duties. This section was included to make clear the Bank had to be compensated for any money-losing activity assigned to it by the Designated Minister.

Section 16 clarified the powers to purchase loans and other instruments from financial institutions and others for purposes such as securitization. Formerly, under the FBDB Act, the Bank needed legal interpretations to ascertain such powers. Section 16 of the BDC Act stated that: "the Bank may acquire and deal as its own any loan, investment or guarantee made or given by another person if (a) the loan, investment or guarantee would meet the Bank's eligibility criteria in sub-section 14(3) or (b) it is part of a block of loans, investments or guarantees the majority of which meet those criteria." Sub-section 14(3) essentially stated that the Bank is to provide financing to enterprises that are reasonably expected to prove successful, the commercial viability clause as it was referred to under the FBDB Act.

Requests for Bank information filed under the Access to Information Act were dealt with by Bob Annett, legal counsel for most of his career at the Bank. While

information collected from clients was considered confidential, there were limits as to what the Bank could withhold under Access to Information. Section 37 of the BDC Act made it clear customer information could not be communicated, disclosed or made available except under specific circumstances which were: for the purpose of administering or enforcing the BDC Act; for the purpose of prosecuting an offense under any Act of Parliament; disclosure to the Minister of National Revenue for the purpose of administering or enforcing the Income Tax Act or the Excise Tax Act; or with the written consent of the person to whom the information relates. The BDC Act also triggered an amendment to the Access to Information Act by adding section 37 of the BDC Act as a recognized statutory exemption for the purpose of the Access Act. This meant that customer-related information would be “privileged” and therefore exempt from disclosure under Access to Information. The first test case of this section came a few years later in the case of L’Auberge Grand-Mère when reporters tried to obtain client information from BDC files under provisions of the Access to Information Act. The Information Commissioner in Ottawa agreed Section 37 of the BDC Act took precedence over relevant sections of the Access to Information Act.

The Bank’s income tax status was also addressed for greater certainty. There had been periodic reviews of the income tax status of all crown corporations. Each time the Bank had to make representations as to why it should not be subject to income tax. Section 35 of the BDC Act stated: “the Bank is exempt from taxes imposed by the Income Tax Act.” The intention of Section 35 was to signal to officials that Parliament wanted BDC to be tax exempt, in effect raising another consideration to be dealt with if a change were to be made. A noteworthy deletion from the FBDB Act related to Regional Advisory Councils. With no mention of them in the BDC Act, they were in effect discontinued. Instead, the BDC Act gave the Board of Directors explicit power to establish its own advisory groups.

As with the Bank Act governing chartered banks in Canada, a ten year review of the BDC Act was included. Industry Committee members wanted an earlier review so the Act stipulated that a review of the BDC Act would be done five years after passage of the Act and every ten years thereafter. Within a year after a legislative review, the Designated Minister must submit to Parliament a report on the review. The report in turn must be reviewed by a committee of the Senate or the House of Commons or by a joint committee.

With two heavy yokes off its back, the “fubdub” name and reputation as well as the last resort role, the Bank was now better equipped to move to the next level. Expectations were very high. Many politicians and officials had rallied to reach consensus and meet tight deadlines. Stakeholders, the media, the business community and the Bank’s employees were watching.

1995

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# Mandate change begets culture change

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The new BDC works quickly to implement its mandate with a new image, increased visibility, new products and cooperative initiatives backed by a transformation in corporate culture.

In a short period following passage of the legislation to create BDC, many new strategies were implemented by the Bank's management. As President, François Beaudoin led the Bank through this transformation. With vision, determination and hard work, he championed changes that touched on virtually all aspects of the Bank's operations and activities, and set BDC on a strong course to fulfilling its new role and mandate.

Some of the changes implemented in 1995 had immediate results. Others laid the groundwork for later achievements. Their outcomes, while occurring beyond the scope of this history, are included to illustrate the extent of change at the Bank.

From the outset, new BDC legislation was accompanied by expectations for a new operating approach. The Minister of Industry and his Deputy Minister wanted a change in the Bank's market focus. Thus, a new operating mandate from the government called for a move towards smaller loans and investments, more focus on knowledge-based and exporting firms without abandoning traditional activities, strategic alliances with federal regional development agencies, increased financings to Aboriginal-owned businesses and a revision of the Bank's Management Services. Financial conditions were also set as part of the new mandate. The term lending operation was to operate at least on a break-even basis, the venture capital operation was to earn a return at least equal to the government's cost of funds and the management services operation was to increase its cost recovery levels.

The new mandate seemed to be a hodgepodge of targets but each was selected on the basis of what the Industry department thought were the most pressing needs among small businesses. The mandate to increase the number of smaller loans and investments was a response to the size gap for loans and the venture capital industry's focus on investments of \$1 million or more. The focus on knowledge-based and exporting companies was to align the Bank with the priority of the department, Industry Canada.

Throughout the nineties, advances in applied sciences were spawning new technologies and a new economy. Manufacturing was continuing its move to overseas destinations where labour costs were cheaper. Canada's competitive advantage now lay with knowledge-based firms bringing new technologies to market. Non-traditional firms whose principal assets and inputs were "knowledge" were considered to be the growth engines of the future. However, the lack of financing for these companies was seen to be a major impediment and so the Bank was called on to expand its innovative quasi-equity and working capital instruments and focus on these companies.

The Department of Industry had also increased its focus on (and funding for) Aboriginal-owned businesses and wanted BDC to follow suit. The mandate to work with regional development agencies was intended to encourage synergy between BDC and regional agency financings. The Memorandum of Understanding between the Bank and ACOA, the Atlantic region's development agency, was to be built on with other regional development agencies.

The new mandate was the result of long discussions between Bank representatives and officials from the Department of Industry, including



discussions at the Board of Directors where senior officials from the Department of Industry sat. At the Bank's insistence, the phrase "without abandoning traditional activities" was added to the mandate. The discussions on what BDC's market focus should be were about the dichotomy of the small business population, the low flyers versus the high flyers, their respective financing risks and contributions to economic growth. Such discussions were throwbacks to those of the early 1980s and the Auditor General's Special Examination in 1993, but wrapped now in the context of an evolving new economy.

Two weeks after the BDC Act was passed by Parliament in 1995, the Minister of Industry, the Honourable John Manley, addressed BDC's Board of Directors. He outlined the new mandate, stressing that the government was looking to the Bank to increase its activity in filling financing gaps; in particular, loans to micro-businesses, knowledge-based businesses, financings for groups such as Aboriginal peoples and for certain regions such as Atlantic Canada. He acknowledged the Bank would not abandon its traditional lending sectors, but thought some of these activities, such as tourism and low technology manufacturing would almost have to be scaled back. The Minister wanted the Bank to focus much more on strategic lending among knowledge-based, value added, traded goods firms. He also indicated the Bank should lead private sector institutions into these areas by example, a mandate to demonstrate novel and superior banking skills.

The Minister recognized the Bank needed to tool up to meet the challenges of its new mandate. He cited the need to undertake an effective communications effort to establish the Bank's new name and mandate with the business community. He recognized too that the Bank's compensation policies had to be changed in order to recruit and retain appropriate frontline staff. He was looking forward to receiving a revised Corporate Plan that reflected the Bank's new mandate.

The Minister expected the new Corporate Plan would lead to a gradual decrease in real estate-backed loans. This was an issue raised by Departmental officials at the Board of Directors in the months leading up to the new mandate. At one point the Bank commissioned Price Waterhouse to conduct a study on the commercial real estate financing market. The study found the availability of small business financing for real estate-backed projects had been significantly curtailed. The number of traditional suppliers had diminished with the takeover of trust companies by chartered banks. Banks too were favouring residential projects over commercial real estate projects. This was a reaction to the heavy losses banks suffered earlier in the decade on commercial real estate projects, especially office towers in central urban areas.

In 1995, the Bank's loan portfolio was considered to be principally realty-based, at 71%. However, these loans were spread over all sectors of the economy with real estate comprising the main value of security backing the loans. If the Bank did not take such collateral, it would have long gone out of business. Having adequate collateral that can be monetized is in many ways the essence of commercial banking. But seen through the lens of industrial policy makers, loans with real estate collateral were basically commercial mortgages that did not contribute much to economic growth, especially when the businesses financed were in the hotel/motel or service sectors.

Following Minister Manley's address, the Board of Directors created a Transition Committee of the Board to look at options available to the Bank to carry out its new mandate and to oversee a new Corporate Plan reflecting the new mandate. In September 1995, the Transition Committee reviewed an outline of potential strategies.

Minister Manley had told the Bank not to expect any new funding from the government to carry out its mandate. Thus, a key strategy for the Bank was to significantly expand its loans portfolio and increase profits to fund start-up costs associated with new financing programs required to fulfill the new mandate. Growing the loans portfolio profitably therefore became the prime operating objective for the Bank. The Bank's management, recognizing the need to quickly convert the organization to deliver on its new mandate with respect to knowledge-based and technology companies, suggested that a separate division within the Bank should be created to implement new financings to these companies as they had business characteristics and risk factors significantly different from those of traditional sectors. Accordingly different skill sets were needed to analyse their risks and perhaps a different corporate culture.

A precedent cited at the time was the Saturn car company, created as a distinct company by General Motors in the U.S. to change the culture of car manufacturing. BDC's Saturn Division would concentrate on providing quasi-equity financings to knowledge-based and high technology companies within a different mode of operation. Project Saturn, as it was called, was quickly rejected by the Board as it was felt the whole Bank should undergo a cultural change to meet the demands of its new mandate especially as it related to financing knowledge-based companies.

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Two weeks after the BDC Act was passed by Parliament in 1995, the Minister of Industry, the Honourable John Manley, addressed BDC's Board of Directors.

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While everyone was referring to knowledge-based companies, there was no single definition of what these companies were. In such instances, everyone could have a different understanding of a concept and yet be in agreement with each other. Furthermore, how would one know whether the Bank was achieving its new mandate if there was no standard definition of these companies? The Bank

sought the advice of Nuala Beck. She had written extensively on the emerging new economy and the kinds of companies that made up the new economy. While her writings provided numerous examples of these companies, she had no standard definition that could be measured. The Bank therefore worked with Industry Canada to establish which Statistics Canada industry classifications could be used as a proxy for knowledge-based companies. In the end, a series of industry classifications were chosen to represent knowledge-based industries. These classifications reflected where knowledge-based companies were prevalent and were adopted by the Bank and Industry Canada to measure knowledge-based activities.

In applying the selected industry classifications, it turned out only 4% of all businesses in Canada could be classified as knowledge-based. At BDC, 7% of its clients were classified as knowledge-based. However, to measure the Bank's progress in its new mandate, management pushed to include exporters in the target group. In his address to the Board of Directors, Minister Manley had included firms trading goods among his target sectors for the Bank and this was used as the rationale for including exporters. Among the Bank's clients, another 10% were exporters. So, at the start of its new mandate, 17% of BDC's loan clients were in knowledge-based industries or were exporters. These groups of companies were referred to as KBIs. For the first fiscal year of the Bank's new mandate, the Board of Directors set the objective that 25% of all new BDC loans should be authorized to KBIs.

Since his arrival at the Bank in 1990, Beaudoin had made significant changes to the Bank's operations. The new mandate however called for fundamental, structural change. The Bank did not have the luxury of time and had to move on many fronts simultaneously. First, the Bank had to create a new image of itself. Then this image had to be engrained in the minds of small business owners and recognized by industry and the public at large. Internally, the skills and productivity of the Bank's human resources had to be sharpened to meet the requirements of the new mandate. There were major challenges related to staff turnover, staff competencies and compensation. These had to be resolved quickly. New products had to be developed for the target groups stipulated in the new mandate. Management Services needed an overhaul to mesh with the new mandate and to increase cost recovery. Venture Capital also needed to increase its level of activity. Perhaps most importantly, there had to be a culture change throughout the whole organization. Changing an organization's culture is often the most difficult of tasks. And doing so normally takes years.

When, during the legislative process, it became evident what the Bank's new name would be, a few quick actions were taken. First was selecting the trade name/acronym for the Bank. Would it be like the previous FBDB/BFD, the Bank's initials in English and French? Management wanted only one set of initials, BDC, even though it was not a complete abbreviation of the English name of the Bank. As mentioned earlier, over the years the initials FBDB were often misspelled in the media. The initials also led to the nickname "fub dub." The Bank did not want this small part of its history repeated and its name mangled along the lines of "bud dub."

Another immediate task was to get a new logo for the Bank. Christiane Beaulieu, in charge of Public Affairs, put out a call for proposals to design a new Bank logo. The three top national agencies doing this type of work were asked to tender their designs. The designs that were submitted did not excite the Bank's reviewers, including the President. So Beaulieu decided to call on the talents of a small Montreal-based firm managed by Roland Ménard who produced the stylized intertwined D&C that became the eventual choice for the Bank's logo.

Before finalizing decisions on its acronym and logo, the Bank commissioned Insight Canada to get a reaction from small business owners, like it had done with the Bank's new name previously. All four designs of the logo received by the Bank were tested in four focus groups. The intertwined D&C with the maple leaf garnered by far the most favourable reception. It was seen to represent a cooperative, hand-in-hand service-oriented company. It was more associated with a high technology company than a bank. A few participants thought the logo was too "oriental-looking" for a Canadian organization particularly since it was red in colour. The maple leaf however helped offset this impression while adding a sense of stability. (Later, a Board member had to be assured by the head of Corporate Affairs that the logo was not an expletive in Chinese or any other language.)

The focus groups also preferred the use of BDC as the acronym for the Bank. BDBC was considered difficult to remember and pronounce and the letters BC at the end made some think it was an organization specific to British Columbia. Getting the Bank's logo and trade name right was important since they represented the public's first impression of BDC's image.

When the decision to use BDC as the trade name was final, Tony Singelis of Management Services had the presence of mind to suggest that the Bank immediately reserve its 1-800 toll free phone number and domain name for its website. The first choices were 1-800-BDC-INFO for the toll free number and BDC.com for the website. Singelis tried to get the toll free number and domain name reserved but found they were already taken. The Bank settled for the toll free number 1-888-INFO-BDC and the web domain, BDC.ca.

### **Raising awareness of the Bank**

Beaudoin wanted not only to change the public image of the Bank but also wanted it recognized as widely as possible and especially among the target groups specified in the Bank's new mandate. In his words, it was time to be "coming out of the shell." A multi-pronged communications plan was developed which called for reinvigorated strategies for advertising, media relations, promotion, direct marketing, "infiltrating the business community" by forging alliances with professional and industry associations, closer contacts with professionals providing services to small business and developing the Bank's website.

Groupe BCP was again commissioned to develop new ads for the new BDC including print ads for newspapers and magazines as well as television ads. As before, the ads were tested in focus groups of small business owners who provided their impressions of the messages the ads were conveying. Using a pre-exposure/post-exposure methodology, the impacts of the ads were measured

with respect to various characteristics such as impression of BDC, BDC's level of expertise and likelihood of approaching or recommending BDC. With the ads tested and adjusted accordingly, one small hurdle remained, the advertising budget. The Board of Directors approved a special budget to the tune of \$3 million of which \$1.3 million would be for print ads and \$1.7 million for television ads. This was in addition to about \$0.5 million that was in the base budget for advertising. The first television ads were strategically placed as a run-up to the 1996 Small Business Week events.

Ex-post, the impacts of the ads showed that recall of BDC advertising had jumped by 11 percentage points, from 18% to 29% among small business owners at large. Among BDC clients the recall jumped from 45% to 58%. Recall of ads was important as about half of all small business owners who recalled BDC ads were likely to consider using the Bank's services. The following year, fiscal 1998, the Board of Directors, at the President's urging, approved another special budget of \$4 million to extend the advertising.

Advertising was just one prong in the campaign to raise awareness of the Bank and change its public image, albeit the most expensive. The next strategy was for more effective media relations. The object was to get more articles about the Bank published in newspapers and magazines as well as television exposure. The latter was difficult to achieve but Beaudoin did appear several times on television to promote the Bank and its services. He was even interviewed on the national program Canada AM to promote Small Business Week. (While this meant being in the CTV television studio in Markham, Ontario at 5:30 a.m., it was worth the exposure.)

In its media relations strategy, the Bank would produce articles ready for publication and relay them to business news editors and journalists. Peter Stewart, the master writer in the Public Affairs department, would ask branch offices to provide success stories, clients whose line of business or growth would be newsworthy locally. He would then craft an article around the client's business, all the while making the connection to BDC and its services. The article would then be transmitted to local journalists. Many of these articles were published with little modification. They became so popular with branch offices that a standard article was crafted that could then be used by local branch managers who would fill in the name of the client and description of the business. Placing a BDC ad in some business magazines was accompanied by a Bank article in the magazine, a sort of quid pro quo understanding.

After the Bank received its new legislation and mandate, there was a huge increase in the number of press releases the Bank sent over the news wires. New products created by the Bank provided attractive content for such releases. So too were the results of studies on the economic impact of small businesses sponsored by the Bank, and in particular those done for the Association of Canadian Venture Capital Companies (ACVCC). When Small Business Week arrived, there would be numerous BDC-written articles sent to local and national media to generate interest. The highlight of the media strategy of the day was a 14 page Globe and Mail supplement on Small Business Week. It published BDC's articles but was paid for by advertising dollars from BDC and its partners, including

FedEx, Bank of Montreal, Nortel, Scotiabank, IBM, Microsoft, Royal Bank and Export Development Corporation. Fourteen pages of advertising in the *Globe and Mail* would cost several million dollars. BDC's share was just a fraction but the focus of the supplement was BDC's Small Business Week. When the Bank's media tracking service tallied all BDC related articles published each year in news media, it was estimated that the value of the publicity the Bank received from the articles ran in the millions of dollars, far outstripping the advertising budget.

The Bank worked on other fronts to polish its image. *Profit\$* magazine, delivered to all business addresses in Canada, received a long-needed makeover. It became a brighter looking magazine with a glossy finish and images in bright colours. The makeover was akin to a 'rags to riches' transformation. Success stories were added to the content and the previous practice, where all articles were written by in-house staff, was changed so that most of the articles were now contributed by external professionals. The latter received free publicity in return for their efforts. This was another avenue to building partnerships with small business advocates.

New brochures for the Bank's various products were also produced. These brochures emphasized the Bank's new economy focus by placing Canadian inventions, and their inventors, prominently on their covers. The covers were so attractive and informative, many people visiting a BDC office would instinctively take one or more to carry with them. The Bank also had to construct its website. With no in-house expertise, the job of building the website was contracted out. The first version was quite basic if judged by later standards – websites were still a new phenomenon in the mid-1990s – but it received a favourable rating from small business owners who accessed it.

The next prong in the communications plan was to have BDC managers speak about the Bank's new mandate at business conferences. More funds were made available to regional and branch offices to sponsor small business related events, where BDC promotional material would be displayed and a speech given by a BDC representative. Each local branch manager was expected to deliver one speech each quarter at a local business event. Depending on the nature of the conference, sometimes senior management would be called on to deliver the speech. Beaudoin delivered several to very large business audiences, for example at Board of Trade conferences.

Later on, in 1998, the Bank launched a Community Support Strategy at national and local levels. The strategy, targeted at Canadian youth involved in various sports activities, was intended to enhance the Bank's image in communities where it was present and to show it was a good corporate citizen, giving back something to the community. The ultimate objective was to expose the Bank to Canada's future entrepreneurs. One of the first sponsorships was that of a ski group in Mont Tremblant, north of Montreal. The ski group had the BDC name prominently featured on their clothing. This caused some concern as it recalled the early 1970s when skiers at Banff, Alberta with their "On UIC" bibs created a huge political uproar. Fortunately there was no similar reaction to the BDC-sponsored skiers.

Another strategy to improve BDC visibility involved new branch office openings to extend the reach of the Bank. Storefront locations in high business traffic areas

were chosen for new branch offices. And since the Bank would be a class A tenant, like federal government departments, Beaudoin insisted the Bank be given prominent signage on buildings. When head office and the Montreal area office moved to Place Ville Marie in downtown Montreal in 1996, the Bank procured the rights to have its logo placed at the top of the building, 5 PVM. The building became officially known as The BDC Building/L'édifice de la BDC. Similar signage rights were procured in prime locations such as the Bentall Centre in Vancouver, the Cogswell Tower in Halifax and at the intersection of King and York in Toronto.

The head office move to Place Ville Marie in Montreal was an example of controversy avoidance. Beaudoin was determined to keep the process free of any political influence and so called on an independent consultant to assist the Bank in its review of proposals. The Board of Directors created a special Premises Committee of the Board to oversee the project. The office space market was depressed at the time so the Bank was able to negotiate what was seen by the industry as a very favourable lease for its new premises.

As Vice President, Human Resources and Administration, Simone Desjardins managed the head office relocation project. She was the first female credit officer who had risen through the ranks to become a vice president at the Bank, breaking one glass ceiling so to speak.



Simone Desjardins,  
Vice President,  
Human Resources  
and Administration.

Desjardins estimated that over the life of the new lease at Place Ville Marie, the Bank realized savings of some \$27 million compared to the terms of the expiring lease. To ensure the Bank's process was fair and free of undue influence, Desjardins called in the federal Department of Supply and Services (DSS) to review the procedures used. DSS was the department negotiating all real estate procurements and leases for the whole federal government. DSS officials lauded the Bank for its procedures which they found to be thorough as well as beneficial for the Bank.

### **Restructuring human resources**

When Minister Manley addressed the Board of Directors following passage of the BDC Act in Parliament, he said he would help resolve the compensation issue at the Bank. As alluded to earlier, each new government in Ottawa undertook some form of program reviews, expenditure reductions and salary freezes. The Bank was not immune to these actions as evidenced by the Nielsen Task Force and the 50% reduction in the Management Services' subsidy. However, over the 1980s as well as the 1990s, cumulative freezes in salary levels had deleterious effects. The Bank suffered a high staff turnover rate among its frontline staff. To carry out the new mandate, Beaudoin wanted not just stability among the ranks but also a staff complement with outstanding skill sets. This meant that the Bank's compensation levels, being way below market rates, had to be upgraded.

When Rob Yuzwa arrived at the Bank in the early 1990s, what he found was a frontline staff with a 30% turnover rate per year and salary levels approaching 50% of comparable private sector positions. To deal with the turnover, the Bank introduced a program to hire new employees to replace those leaving. It was called Selecting the Best and the Brightest. Beaudoin had a penchant for flair. When a new Bank program was to be announced, he made sure it caught attention. Much like the official launching of Small Business Week each year, major events noted for their highly professional and theatrical-like productions. In Selecting the Best and Brightest, young post-graduates from business schools were targeted. They would bring their talents to the Bank and the Bank would train them in "The BDC Way." At the start of the program, many came, many were trained, many left. *Veni, vidi, reliqui*. They went away for higher pay at other financial institutions. At human resource conferences, Yuzwa would be thanked by other bankers for the well-trained personnel they had hired away from the Bank.

Yuzwa worked with two Vice Presidents, Human Resources through most of the 1990s, Simone Desjardins and Dave Mowat, to build a human resource (HR) administration structure to support the Bank's overall objectives. They held numerous meetings with Treasury Board officials to try and get some relief from salary constraints imposed on the Bank. But there was little movement in closing the gap with the private sector. It was not until the new mandate was announced that the Board of Directors made the decisions to move the Bank to market compensation levels. Even then, it took until 1998 for the Bank to finally reach parity with private sector counterparts.

Adjusting compensation levels was only one, albeit major, piece of the puzzle to put an effective HR administration structure in place. Others involved job ratings, performance measurements and their relation to compensation amounts. Over the years, the Bank's job rating system had been thoroughly massaged by managers wanting to get the last ounce out of the rating system for their staff (and themselves). The rating system was based on the Hay system but it became so discombobulated by actions to circumvent salary constraints that in the early 1990s, the Hay group threatened to remove the Bank from its salary surveys. The results of the Hay surveys were used by numerous large corporations, including the Bank, to gauge market pay scales for comparable job ratings. The Bank's input was so out of range, they were skewing the Hay benchmarks. To make the HR



administration structure effective, job descriptions and ratings had to be revamped to make them comparable to equivalent private sector jobs if private sector compensation levels were to be applied. A job evaluation committee was created and it assigned job points to each position in the Bank. As could be expected, every manager wanted to be on this committee. The committee was assisted by an expert from Hay and Associates.

The senior account manager (SAM) position at BDC was very similar to its equivalent at chartered banks and so was used as the benchmark against which other positions would be rated. In the BDC system, the SAM position was given a B9 rating. Difficulties were encountered in rating some professional support jobs as the scope of the Bank's operations was smaller than that of a chartered bank. Also tying private sector compensation levels to equivalent job ratings was not possible for senior management as their salaries were compressed to maintain a practical relative relationship to the President's salary. The latter was set by the government and reflected the public service pay scale for deputy ministers, a pay scale that bore no relationship to private sector jobs as no equivalents existed in the private sector (it was thought). At the end of the exercise, all jobs were re-rated and the Bank was kept in the Hay system.

The performance measurement system also had to be re-engineered. Recall the Performance Management Process (PMP) was instituted in the 1980s when the Bank was in the midst of severe downsizing. The PMP performance evaluation system was also massaged to its limit by managers attempting to counteract the effects of relatively low salary levels. One of the first tasks Simone Desjardins took on as Vice President, Human Resources was to canvass managers throughout the Bank to find ways to improve the PMP process. She also assembled focus groups made up of representatives from all employee groups. After putting together all the information she collected, the HR team developed and implemented a new performance evaluation system for the Bank. It became known as PACT, standing for Performance Assessment based on Contribution Targets. It was a fairer, more transparent system that focussed on objectives achievement and accountability. Each staff member was given Key Responsibility Areas (KRAs) that focused on customers, people and results. Their performances would be measured by how well they achieved objectives set for each KRA.

PACT became a two-way communication tool for staff and their supervisors. Managers had no choice but to sit with subordinates and discuss their evaluations. It also provided the opportunity for subordinates to provide their own comments as well as their career aspirations. This feature meshed with a succession planning system also instituted after the new mandate was received.

Performance evaluation was an important component of the Bank's compensation structure so it had to be effective. PACT met this requirement and soon gained notoriety and praise among corporate HR managers. The Bank was invited to describe its PACT system to other corporations and was courted by a company to give it rights to develop a software version. With PACT, market compensation and market equivalent job rates, the Bank was now equipped with a fair and competitive compensation structure.

In the early 1990s, the Bank was losing account managers to chartered banks. Before the decade was out, the Bank had turned around its reputation in the market and chartered banks were losing their account managers to BDC. Chartered bank managers were now complaining BDC was stealing their good employees. With its new training and human resource policies, BDC was attracting, and retaining, *the best and the brightest*.

Getting an effective and competitive compensation structure was one pillar in the overall human resources strategy. The next was staff training to meet the demands of the new mandate. New hires went through a six month training program on “The BDC Way.” It included classroom sessions and on-the-job mentoring. Account managers had a syllabus to choose from depending on their needs and recommendations of supervisors. The training syllabus included courses on due diligence, management skills, venture capital approaches to financing, business development and credit presentations. Training courses proved so popular that at one time there were waiting lists for staff wishing to take some courses and a formal training centre was opened at head office.

Restructuring BDC’s human resource management and administration systems in the second half of the 1990s provided another solid foundation on which to build. The results, presented later, will show the Bank’s success. And for its efforts, during the following decade BDC, gained an outstanding reputation in human resource management circles and was placed on the list of Canada’s top 100 Employers and on Fortune Magazine’s list of Top Companies for Leaders, the only Canadian organization to make this list.

### **New products, services and alliances**

With new, challenging objectives to grow the loans portfolio profitably, while paying for all the added expenses to restructure the Bank and its image, Direct Access was instituted in 1996 to make the Bank more responsive to its clients and more productive. Direct Access involved streamlining the organization. The principal action taken was the elimination of the regional office layer of management. Recall a few years earlier, in the first iteration of the operational review, it was proposed to remove the district office layer from the delivery structure and have more branch offices reporting to regional vice presidents. This met with opposition and was not implemented. Regional vice presidents were now told the regional offices and their positions would be eliminated. There was no leeway for consultation.

Regional office authority was distributed to the Bank’s seventeen area offices, each now headed by a Vice President and Area Manager (VPAM). Support functions formerly in regional offices – for example, controller and human resources – were placed in field service support centres but overall, the number of staff in regional support functions was reduced. Head office support functions too had to be “rationalized.” This term signalled staff had to be reduced. Since the first cost recovery efforts of the early 1980s, it had been Bank doctrine that if field staff was being reduced, proportionate reductions had to be made at head office. There was little room to reduce staff so some services were contracted out to meet head count objectives. As an example, the Bank’s translation service was

contracted to an external supplier. This led to higher costs but the head count objective was achieved. As recounted earlier, the Bank also looked at contracting out its information systems functions but declined to do so as costs would have been too great. As staff counts in support functions were decreasing, the number of staff dealing with customers increased.

The reorganization emanating from Direct Access meant that a number of staff had to be reassigned to new positions. The young hires who stayed with the Bank and had shown promise were given more responsibilities and coaching to grow within the Bank. The reorganization also led to a number of staff leaving the Bank. In total, between 1993 and 1998 there was a 50% staff turnover in the Bank, with an even higher percentage in branch offices. There were 500 new hires over this period while total Bank staff stayed fairly steady at around 1,000, of which just under 900 were in the Loans Division. An early retirement plan was authorized by the Board of Directors as part of the Direct Access program.

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To extend its reach among knowledge-based companies, the Bank signed a series of Memoranda of Understanding with regional development agencies and chartered banks.

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The next task was to introduce products that focused on particular parts of the new mandate. These new products were basically all variations of existing lending and quasi-equity products. In term lending, new products would extend the risk the Bank was prepared to take. But they were given attractive names and limits on the amounts that could be financed. The attractive names pinpointed their target groups and also helped garner attention in the market. The volume limits ensured losses accumulating through the learning period would be contained.

Before the new mandate was announced, working capital was seen as the greatest need by small business. Nothing new here except that it was highlighted by the Industry Committee in its report Taking Care of Small Business. In response, BDC launched the Working Capital for Growth product. Term loans of up to \$100,000 were made available to top-up existing lines of credit customers had with their chartered banks. Next up were Micro business loans. These were loans of up to \$25,000 that could be made by the Bank contingent upon the

successful completion of a training and counselling program, and production of a viable business plan. It was aimed at increasing the number of smaller loans as called for in the new mandate. This was also the rationale for the opening of Entrepreneurship Centres across Canada. Thirteen such centres were opened in BDC offices to focus on start-up and small growing companies, providing financial as well as consulting services.

Then came Patient Capital, essentially the ‘venture loan’ product the Bank had introduced in the early 1990s with a new name (and registered as an official trademark of the Bank). Advocates for small business were saying that the pressing need for financing by new growth companies was capital that was patient; that is, capital that did not have to provide an immediate return. So the Bank’s venture loan product was rebranded as Patient Capital. It targeted knowledge-based businesses with high growth potential that could not attract venture capital. Like its venture loan predecessor, returns were based on a combination of interest and royalties tied to a client company’s sales or profits. Patient capital started out with a maximum loan size of \$250,000 that was soon raised to \$500,000. This product later evolved into subordinate financing.

To extend its reach among knowledge-based companies, the Bank signed a series of Memoranda of Understanding (MOUs) with regional development agencies and chartered banks. With the regional agencies, the Bank could lever their funding to provide its own financing, patient capital and term loans, as well as provide mentoring services partly paid for by the agencies. With Royal Bank of Canada, the Bank would provide support to knowledge-based companies and innovative manufacturers in Southern Ontario’s “Technology Triangle.” The Triangle was centered in the Kitchener/Waterloo area and, in particular, the University of Waterloo, one of the main recruitment grounds for the likes of Microsoft.

### **New partnerships with banks and crown corporations**

The alliance with Royal Bank of Canada reflected a change in attitude towards the Bank by the main chartered banks. By 1998 BDC had partnership agreements with all of the Big Six chartered banks to provide BDC services to their small business clients. The Bank, through its communications strategy and by its actions, was seen as a leader in financing the new economy and chartered banks saw an opportunity to join this politically attractive bandwagon.

An MOU was also struck with Farm Credit Corporation (FCC) to establish a joint Agri-business Development fund. The fund was intended to provide up to \$100 million in financing over a three-year period. There were other areas of cooperation specified in this MOU, including cross-referrals of clients, usage of respective offices when visiting clients and staff secondments.

The MOU with FCC was part of a larger push by the government to have its financial crown corporations work in a more cooperative manner. Recall the concept of merging these corporations arose in the latter half of the 1980s. After passage of the BDC Act in 1995, the Senate Banking Committee in its review of the government’s financial crown corporations, looked at this concept again and recommended the merger of BDC and FCC into one institution. The Export

Development Corporation (EDC) was excluded from the merger proposal, perhaps because it was dealing principally with large corporations. After consideration of the Senate committee's recommendation, the government decided not to merge BDC and FCC. One likely issue in this file was the location of the head office of the new entity and its jobs. The political uproar that followed the assignment of the F-18 jet fighter maintenance contract to Bombardier of Montreal, instead of to Bristol Aerospace of Winnipeg, was probably still fresh in political minds. So instead of merging corporations, a Council of Financial Crowns was created to coordinate operational activities as well as dealings with clients as much as possible among the financial crowns. The Chairman and President of each of the financial crown corporations as well as deputy ministers from sponsoring departments sat on the Council.

In the spirit of cooperation, BDC and EDC renewed their partnership for providing working capital financing to exporters. The Export Receivables Financing product, launched in the late 1980s, was revitalized and renamed Working Capital for Exporters. It was launched as an innovative new product. It provided up to \$250,000 in BDC financing to top-up existing lines of credit to finance higher inventories and receivables, production of goods and export marketing.

With venture capital companies concentrating on investments of over \$1 million and moving away from early-stage companies, BDC moved to establish seed capital funds with partners. The Bank committed \$40 million to three seed funds to be established for Quebec, Ontario and Atlantic Canada, and Western Canada. Pools of capital in the range of \$25 million were created, targeting the commercialization of research discoveries. Then, to encourage young entrepreneurs, a Young Entrepreneurs Financing program was established by the Bank. It was modeled on the micro-business financing program. Partnerships with CIBC and Bank of Montreal were formed to promote this program.

A Year 2000 Ready program was introduced to provide businesses with financing needed to make software and hardware changes to prepare for Year 2000 and its potential computer glitches and shutdowns. A \$500 million Tourism Investment Fund was created in partnership with the Canadian Tourism Commission to encourage development of high-end destination tourism infrastructure. This was a notional fund as the Bank did not put \$500 million into a fund to be managed separately from the rest of the Bank. It was just another lending activity in the Bank targeting a specific sector. The Bank also entered into a partnership with TD Visa to provide a Global Line of Credit product. This product would be the mainstay of the Bank's online offerings through the portal BDC Connex. An Innovation Loan was introduced, as was a techno.net loan. Another product, MBO Partners, addressed a need to finance management buy-outs and management buy-ins (MBO/MBI). It was another notional fund that would have a (notional) BDC contribution of \$100 million with other partners contributing to the fund. Included were Royal Bank Capital Corporation, McKenna Gale Capital, the Solidarity Fund and Export Development Corporation. It was thought that MBO Partners would invest up to \$300 million in MBO/MBI situations requiring financing in the \$3 million to \$15 million range.

The introduction of numerous new products showed the Bank was serious about meeting its new mandate and would not go about the task in its usual, time-honoured way, by providing term loans. “New Times and New Horizons” (the moniker on the fiscal 1996 BDC Annual Report) called for new approaches and while the new products were all variations of three basic financing products from the 1980s – term loans, venture loans and venture capital – they signalled to the business community a new BDC approach to responding to their financing needs, and in particular to those in the Bank’s target sectors, knowledge-based companies and exporters. To be sure, credit risks would be extended with the new products, especially working capital financing and patient capital, but they were contained, as noted earlier, by placing limits on total amounts financed with these new instruments and by the enhanced loan monitoring system that had been put in place in the early 1990s. In effect, the Bank was extending its risk spectrum but in a carefully managed way.

To tackle the challenging objective to rapidly increase financing to knowledge-based and exporting companies, an Emerging Markets Division was created and headed by a senior vice president, David Mowat. The new division took over the venture capital operation and was responsible for the Bank’s new patient capital/venture loan products.

The new BDC significantly ramped up its presence in the Canadian venture capital market to address the gap in private sector financing of high growth firms requiring smaller investments. The objective was to increase activity and maximize leverage by co-investing with other players in the market. In this way, BDC helped develop the venture capital industry while supporting a greater number of emerging, high growth firms. BDC’s portfolio of venture capital investments increased almost four-fold by the fiscal year 2000.

Alliances/partnerships with other institutions formed a major component in the roll out of new products. Alliances with chartered banks, as well as the proactive role the Bank was playing in knowledge-based industries, led to closer cooperation overall with the banking community. In late 1996, the Chairman of the Canadian Bankers Association (CBA) met with Beaudoin to seek out a strategic partnership with BDC. The CBA had recognized BDC’s strategic market role and become a supporter of the Bank.

In the mid 1990s, the federal government moved to increase emphasis and resources to support First Nations’ entrepreneurship. The Department of Industry had created a separate branch responsible for Aboriginal Business development. It would provide support to Aboriginal Capital Corporations that were set up across the country. BDC’s new mandate called for increased financing to Aboriginal-owned businesses. Financing these businesses posed challenges to the Bank throughout its history as it could not take security on First Nations’ lands. Some loans were made but not many. Too few to be counted.

To increase the amount of BDC financing of Aboriginal-owned businesses, an internal structure focussing solely on this objective had to be created. To this end, the Bank hired Jim Richardson to head up its Aboriginal Banking Unit. He became the advocate for the Bank in the Aboriginal business community and the

advocate for Aboriginal businesses within the Bank. Thus, his first tasks were to increase BDC's profile in the Aboriginal business market and develop products and programs to better serve the market.

Richardson had to increase BDC's awareness of the cultural and environmental factors unique to the Aboriginal business market. He then had to increase the Bank's capacity to deliver services to the market. In this vein, he had to find and hire Aboriginal account manager staff. With the full support of the President and the Board of Directors, which formed an Aboriginal Business Development Committee, Richardson embarked on a series of training and communication actions to accomplish his objectives. He struck alliances with Royal Bank of Canada, CIBC and the Apeetogosan Development Inc. to provide financing, counselling and mentoring to Aboriginal businesses. Another BDC fund, the Aboriginal Business Development Loan Fund, was created to provide financing. This was later accompanied by a new initiative, Growth Capital for Aboriginal Business. All these activities produced some tangible results as the amounts of loans authorized to Aboriginal-owned business increased from \$4.7 million in fiscal 1996 to \$12.4 million in fiscal 1998. By fiscal 2000, the Bank had \$37 million in loans committed to Aboriginal-owned businesses.

### **Transforming management services into BDC Consulting Group**

As the Bank was embarking on its new mandate, which focused primarily on financial services, a review of the Management Services Division was initiated. The review led to a restructuring of the division and its services. The consulting company Secor completed a strategic diagnosis of the market for management services. It found that many independent providers of these services, self employed with professional backgrounds, had entered the market. They were offering many of the same services as the Bank and at the same prices. The basic tenet of the Bank's management services, as a subsidized service, was called into question. Thus, one option offered was that the Bank terminate its management services. Another option, the one ultimately chosen, moved the Bank from being product-driven – produce so many seminars, so many counselling assignments and so much revenue – to being client-driven, focusing on growth companies and exporters, similar to the mandate given for the Loans Division.

In September 1996, the Board of Directors approved a plan to transform the division to the BDC Consulting Group to provide, as stated in the fiscal 1997 Annual Report, “made-to-measure solutions matched to client needs in relation to their business evolution.” The Board also decided not to seek any further appropriations from the government to support the division, thereby ending its government subsidization. It was felt that profits generated by the Bank's financial services were sufficient to cover the amount of these appropriations and this move would provide further incentive for the division to achieve its ultimate goal of full cost recovery. About \$14 million a year in appropriations were left on the (government's) table.

To effect the transformation, the Division would have to restructure the way it was organized to accommodate the shift from being product-driven to client-driven; it would have to develop a new marketing strategy to target knowledge-based, growth

companies and exporters; it would have to totally revamp its roster of counsellors and build a network of functional experts; and it would have to have the right skill sets in its human resources which meant another round of hiring and de-hiring.

The new market role for the BDC Consulting Group would lead to a drastic reduction in the number of clients receiving management services from the Bank. In fiscal 1995, before the transformation started, the Bank reported over 5,000 counselling assignments were completed, 35,000 participants attended Bank seminars and workshops, and 43,000 participated in mentoring programs. With the new focus of the BDC Consulting Group, the number of clients for the division would drop to below 10,000 annually. Precise figures are not available as the Bank stopped reporting on the number of clients served. A four-year transformation period was envisaged starting in fiscal 1998. At the end of 1999, the Division was still in the “thick” of the transformation dealing with major challenges in change management and acquiring the right skill sets among its human resources.

### **Communicating change within BDC**

To effect real change in line with the Bank’s new mandate, there had to be a change in culture as well. All of the foregoing actions signalled the Bank was undergoing a culture change but to complete the task, each employee had to have the same understanding of the Bank’s new mission, each had to buy-in and be pulling in the same direction. In large hierarchical organizations, internal communication was an inexact science and, in many cases, an oxymoron. In earlier years, a message could be interpreted and misinterpreted in many ways as it was passed on down the hierarchical chain. And many times the message would simply not be passed on. Beaudoin and his team decided to take his message and vision for the Bank directly to each and every BDC employee.

National and regional conferences attended by scores of BDC employees became the order of the day. The first was a national conference of all staff at the manager level and up. It took place around the time the new mandate was being crafted. The President and others from head office made presentations on where the Bank was headed and how it intended to get there. Soon after the new mandate was announced in 1995, Beaudoin and his senior managers embarked on a series of regional conferences. The first was in Toronto attended by all staff in the Ontario region. The conference would be the first business trip for many and it created a certain amount of excitement among the staff. Regional and branch offices were kept open for business by temporary staff hired to answer telephone calls.

At the regional conferences, staff attended workshops on the revamped Bank operations. The President described the Bank’s new mission and vision and how it would be accomplished. The conferences went smoothly and one consistent message was heard by all. There was only one small snag. In British Columbia, the regional conference was held at the resort town of Whistler at a time when Vancouver television stations were seeking out and reporting on lavish conferences put on for B.C. Government employees. A television station got wind of the news BDC was holding a conference for all staff at Whistler and decided to send a reporter and camera crew up to Whistler to investigate. The Bank’s crisis management system paid off and Lois Campbell, formerly the Public Affairs manager in the region, was able



to convince the news crew there was no story to report. Hotel accommodations at Whistler were cheaper than in Vancouver since it was off-season at Whistler, all staff were attending training seminars, which the reporter saw, and no one was on the golf course. The reporter called his producer to tell him there was no story – and returned to Vancouver with his camera crew to seek out another story.

There was one other national conference of note, this one attended by all account managers from across the country in September 1996. They were the frontline staff who would deliver on the key objective of the new mandate: to increase the proportion of loans going to knowledge-based and exporter companies. The conference was held to update everyone on where the Bank stood, how well it was doing in respect of its new mandate and what objectives lay ahead. The conference ensured every account manager received the same message, undiluted, from the Bank's senior officers. The conference opened with a scene that underscored the task the Bank faced. The hall darkened and then spotlights shone on actors, dressed in black, rappelling down from the 25 foot ceiling to the musical theme from the Mission Impossible movie series. It recalled, for some, the comment made by the Small Business Financing Review in 1981. The SBFR report had stated that achieving the Bank's mandate would be "heroic if not impossible."

In the second half of the 1990s, the whole Bank was being transformed. With its new BDC Act and new mandate, BDC was a different development bank from FBDB. François Beaudoin had put in place all the major pieces needed to get BDC moving in its new direction. The Bank had a new image and much wider visibility. New products (with catchy names) oriented towards meeting the needs of knowledge-based, exporting and high growth firms were being introduced. Direct Access had restructured the delivery of the Bank's services and led to increased productivity. The Bank's human resources had been re-tooled with effective performance measures and compensation policies. The Bank literally presented a new face resulting from de-hirings and the hirings of "young guns." BDC was becoming a preferred employer of choice. There was a sense of purpose among BDC employees.

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By the turn of the century, the oak tree evoked in E. Ritchie Clark's history of the Industrial Development Bank, referred to in earlier chapters, had grown to new heights: the trunk was wider, its branches higher and its roots deeper. It had weathered twenty-five years of recessions and upswings, low points and near death experiences, reviews and transformations. At its essence, the Bank's genetic make-up remained unchanged: reservoirs of high-mindedness and the willingness of many employees to work really hard, overcome seemingly insurmountable obstacles and take pride in helping Canadian SMEs thrive.

The new BDC had emerged stronger and was poised to play a leading role in supporting the vitality of entrepreneurship in Canada in the years ahead, a decade of accelerated competition and globalization, of financial crises and technological revolutions – challenges left for the next sequel in the Bank's history.

The next sequel in the Bank's history – which was filled with both successes and challenges – is still being written 20 years later.

1975 to 1995

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# Members of the boards of directors

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Federal Business Development Bank  
and Business Development Bank of Canada

The following women and men served on the boards of directors of the Federal Business Development Bank and the Business Development Bank of Canada during the period 1975 to 1995. They are listed roughly according to when they joined the Board. An asterisk besides a name indicates the person served as Chairman of the Board. Three names in blue indicate those who served as President of FBDB or BDC during the period, that is, J.R. Murray (1975 to 1978), Guy A. Lavigueur (1978 to 1992) and François Beaudoin (1993 to 1999).

<b>S. Kanee*</b> , Manitoba	<b>D.R. Andrews</b> , British Columbia	<b>G. Wyman</b> , Ontario	<b>N. Hughes</b> <b>Anthony</b> , Quebec
<b>G.K. Bouey</b> , Ontario	<b>G.R. Sharwood</b> , Ontario	<b>H.G. Carter</b> , British Columbia	<b>H.G. Rogers</b> , Ontario
<b>H.B. Cohen</b> , Alberta	<b>W.R. Teschke</b> , Ontario	<b>W.J. McAleer*</b> , Ontario	<b>R.E. Stafford</b> , Nova Scotia
<b>G.J. Desmarais</b> , Quebec	<b>B.D. Stanton</b> , Alberta	<b>H.J.F. Bloomfield</b> , Quebec	<b>F. Beaudoin</b> , Quebec
<b>R.F. Fiske*</b> , Nova Scotia	<b>R.G. Annable</b> , British Columbia	<b>J.W. Crow</b> , Ontario	<b>L. Goulet</b> , Quebec
<b>C.C. Frenette</b> , Quebec	<b>J.S. Cowan</b> , Nova Scotia	<b>H.J. Flemming</b> , New Brunswick	<b>H. Swain</b> , Ontario
<b>G.A. Lavigueur</b> , Quebec	<b>R.H. Kroft</b> , Manitoba	<b>C. Lemelin</b> , Ontario	<b>J. Burns</b> , Alberta
<b>Dr. J.M. LeClair</b> , Ontario	<b>R.C. Montreuil</b> , Ontario	<b>P. Black</b> , Alberta	<b>P. Lavelle*</b> , Ontario
<b>J.D. Love</b> , Ontario	<b>L.P. Nolet</b> , Quebec	<b>L.L. Willis</b> , Ontario	<b>D. Braverman</b> , British Columbia
<b>H.H. MacKay*</b> , Saskatchewan	<b>Y. LeBlanc</b> , New Brunswick	<b>D. McMillan</b> , Saskatchewan	<b>R. Lc de Santis</b> , Quebec
<b>J.R. Murray</b> , Quebec	<b>M. Baril</b> , Quebec	<b>R.C. Atkinson</b> , Manitoba	<b>E.A. Carmichael</b> , Nova Scotia
<b>J.W. Poole</b> , British Columbia	<b>P. George</b> , Ontario	<b>B. Tsakumis</b> , British Columbia	<b>G. Savard</b> , Quebec
<b>R.G. Rankin</b> , Ontario	<b>A. Lutfy</b> , Quebec	<b>A. Celmainis</b> , Alberta	<b>C. Stedman</b> , Ontario
<b>F.D. Rosebrugh</b> , Ontario	<b>G. Ritchie</b> , Ontario	<b>D.H. Freeman</b> , Ontario	<b>F. Lamont</b> , Manitoba
<b>G.F. Osbaldeston</b> , Ontario	<b>G. Veilleux</b> , Ontario	<b>J.C. Lebel</b> , Quebec	<b>R. Caron</b> , Quebec
<b>M. Reid</b> , Newfoundland	<b>J.T. Douglas</b> , Nova Scotia	<b>J. Bourgon</b> , Ontario	<b>K. Lynch</b> , Ontario
<b>S. Cloutier</b> , Ontario	<b>B.J. Lavoie*</b> , Quebec	<b>R.M. Canonico</b> , Ontario	

1975 to 1995

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# Contributors

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Federal Business Development Bank  
and Business Development Bank of Canada

**T**he following persons graciously gave their valued time to meet with the author. They are listed more or less in the order they were interviewed.

<b>Guy Lavigueur</b>	<b>Rob Yuzwa</b>	<b>Luc Provencher</b>
<b>Hugh Carmichael</b>	<b>Rupert Williams</b>	<b>Sandy Mendelsohn</b>
<b>Yves Milette</b>	<b>John McNulty</b>	<b>Michel Ré</b>
<b>Michel Azam</b>	<b>Alain Carrière</b>	<b>Patrick Lavelle</b>
<b>Terry Gilbert</b>	<b>Ross Hamilton</b>	<b>William MacAleer</b>
<b>George Kirkwood</b>	<b>Claude Mailhot</b>	<b>Simone Desjardins</b>
<b>Jim Hercus</b>	<b>Denis Poirier</b>	<b>Christiane Beaulieu</b>
<b>Rich Goulet</b>	<b>Anne Boutin</b>	<b>Harry Swain</b>
<b>John Langlais</b>	<b>Nancy Crisafulli</b>	<b>John Ryan</b>
<b>Richard Morris</b>	<b>Cécile Cournoyer</b>	<b>Dave Mowat</b>
<b>Clément Albert</b>	<b>Frank Podruski</b>	<b>Lois Campbell</b>
<b>Pierre Charbonneau</b>	<b>Jacques Hudon</b>	<b>Mike Rudkin</b>
<b>Yvonne Zacios</b>	<b>Pierrette Blanchette</b>	<b>Bob Annett</b>
<b>Maryse Corbella</b>	<b>André Bourdeau</b>	<b>Jacques Lemoine</b>

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This book provides a history of the Business Development Bank of Canada, more specifically the FBDB era, between 1975 and 1995. It is about difficult decisions, hard work, innovation and team work that together took a crown corporation from the brink of annihilation to being a prosperous and important partner in building successful small and medium-sized businesses in Canada.