

Market study on competition in financing for Canada's SMEs

Submission



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Introduction

We are pleased that the Competition Bureau is undertaking a market study to improve its understanding of the competitive dynamics within Canada's small- and medium-sized enterprise (SME) financing sector.

In our work, we've seen that SMEs face significant barriers to accessing capital and we believe that the lack of competition in the banking sector is one of several important contributing factors. We believe that unlocking capital for SMEs and entrepreneurs will strengthen the Canadian economy, bolster our sovereignty and provide more Canadians with pathways to building wealth. We look forward to seeing how the evidence collected can help inform policymakers interested in tackling this issue.

Context

Enterprise financing in Canada is dominated by a small number of big commercial banks. And while these banks are important institutions, they are structurally limited in who they can serve. Their capital allocation decisions are based on legislated mandates, guidelines from regulators, duties to shareholders and the culture of their institutions, collectively limiting capital deployment to a relatively narrow risk-return profile.

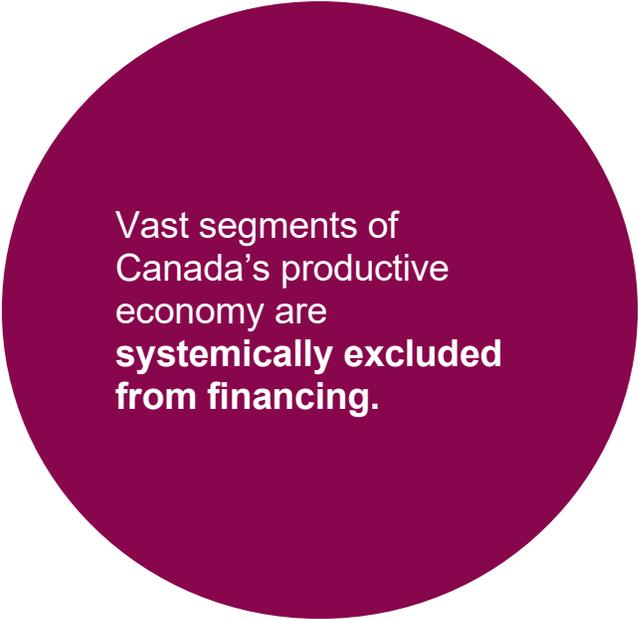
In a diverse financing ecosystem, different institutional types would serve different enterprise profiles. Some would be optimized for scale and efficiency, others for relationship lending, social impact or patient capital. But when six banks control the market, one institutional model's blind spots become the entire system's blind spots. The structural limitations of deposit-funded banking, amplified by oligopoly dynamics and shareholder expectations, define the boundaries of who can access credit in Canada. As a result, vast segments of Canada's productive economy are systemically excluded from financing.

Barriers to accessing financing have negative repercussions for our economy. They weaken productivity and innovation, create barriers to entrepreneurship and concentrate economic power in the hands of those who already have wealth and can leverage their assets to get the financing they need.

In recent years, the federal government has been acknowledging problems with SME financing and has taken steps to address them.

These steps include:

- Making better use of public banks, like the Business Development Bank of Canada (BDC), to better support under-served entrepreneurs



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- Exploring new guidelines and risk-weightings that would encourage big banks to lend more ambitiously to SMEs and entrepreneurs
- New open banking regulations that will make it easier for new entrants to compete with big banks
- Support for public-purpose and social-purpose enterprises by capitalizing the Social Finance Fund

Our system must get more capital into the hands of Canadian enterprises who can deploy it in ways that boost growth, resilience, sovereignty and well-being.

But, taken together, we believe these responses do not get to the systemic challenges inherent in Canada's financing ecosystem.

The Competition Bureau's market study represents an opportunity to address some of the structural weaknesses in Canada's SME financing system. As Canada confronts profound disruptions in the geopolitical and economic environments, it is essential that we build a system to get more capital into the hands of Canadian enterprises who can deploy it in ways that boost growth, resilience, sovereignty and well-being.

How does Canada's SME financing system stack up compared to our peers?

Canada's financing ecosystem is unusually concentrated, with the six Canadian chartered big banks accounting for more than 93% of the Canadian banking system.

Unsurprisingly, these big banks provide nearly 70% of all debt financing to SMEs (including nonprofits, social enterprises and cooperatives) across Canada. Excluding Quebec, where credit unions have a stronger foothold, banks provide nearly 80% of SME lending.

Canadian big banks do a poor job of serving SMEs when compared to our peers. In 2021, only 11.3% of outstanding commercial lending was directed to SMEs, which is significantly below the OECD median of 44%.

Figure 1

Percentage of outstanding loans held by SMEs (2021)

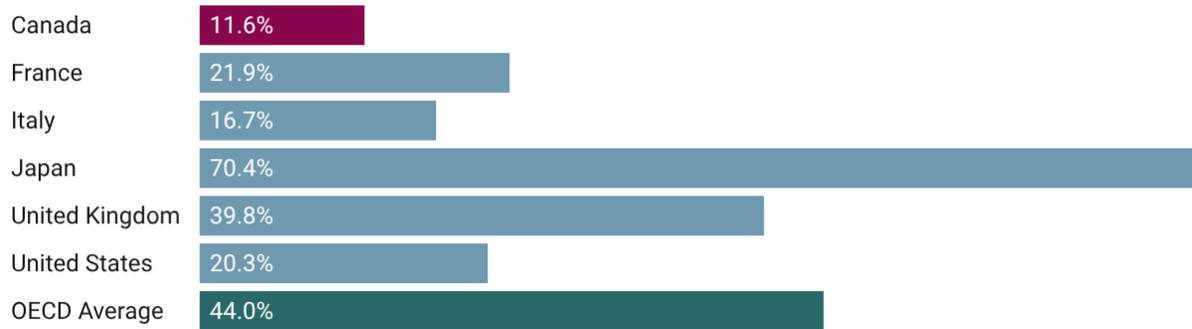


Chart: Social Capital Partners • Source: OECD • Created with Datawrapper

Relatedly, between 2016 and 2022, the percentage of outstanding new loans held by SMEs dropped by 1.51 percentage points in Canada, whereas, on average across OECD countries, it increased by 1.26 percentage points.

These are not trivial numbers. At a time when entrepreneurship rates in Canada are plummeting despite a growing population, getting capital into the hands of Canadian entrepreneurs is widely recognized as an important national priority.

When SMEs can get financing, they face higher interest rates than their counterparts in peer economies, paying 6.21%, compared to the OECD median of 4.37%.

Figure 2

Average SME interest rate (2022)



Source: OECD • Created with Datawrapper

Despite the importance that access to capital plays in economic strength and resiliency, Canadian banks are notably risk averse compared to our peers. For example, Canadian banks have very low loan-loss rates (the percentage of a lender’s total loans that are not expected to be repaid) compared to our peers. Only Japan reports a lower rate.

Figure 3

Realized loan loss (impairment) rate (2024)

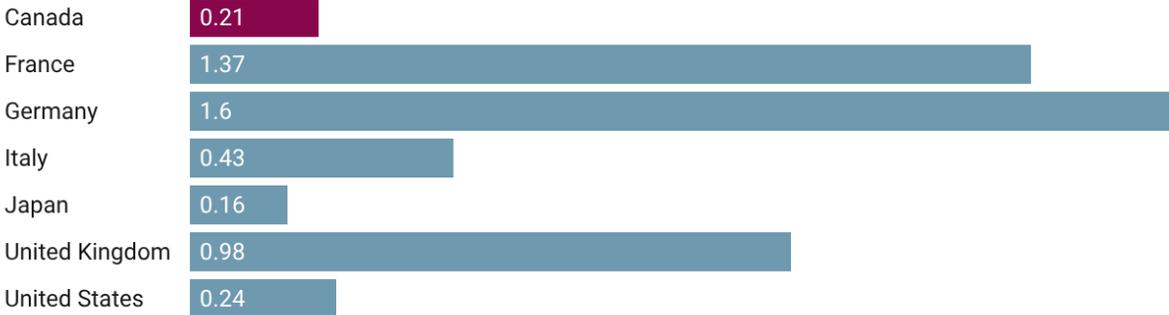


Chart: Social Capital Partners • Source: AMRO • Created with Datawrapper

Canadian banks are among the most profitable in the G7 across multiple measures. For example, their return on equity (a gauge of how much profit a company earns for every dollar of shareholder investment) is the highest in the G7.

Figure 4

Bank return on equity (2021)

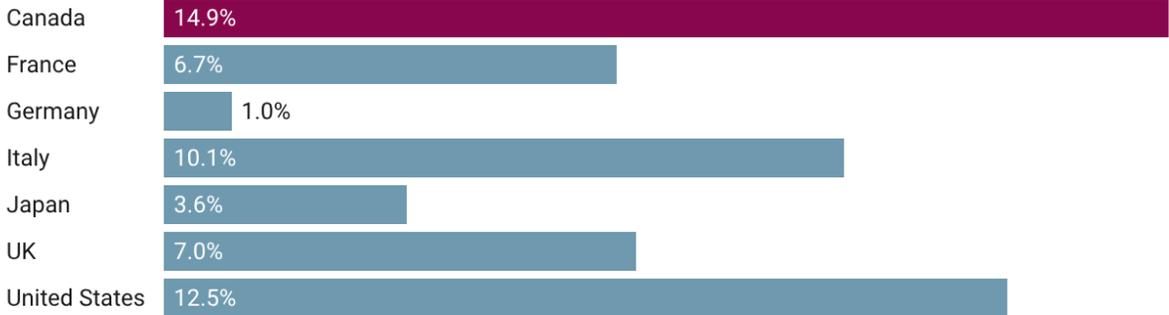


Chart: Social Capital Partners • Source: OECD • Created with Datawrapper

In sum, Canada’s big banks do very well compared to those of our peers, while at the same time failing to serve the full range of SMEs very well. Canada’s banks are more profitable, while Canadian SMEs get fewer loans and pay higher interest rates than those of our peers. Many different kinds of SMEs are particularly poorly served:

- those seeking small amounts of financing
- those needing flexible terms

- those seeking social returns or public-purpose returns as well as financial returns
- rural and remote business
- those without collateral or asset-backing, including those with intangible assets
- those seeking financing for modernization and productivity-enhancing investments that will pay out over a longer time period
- SME acquisition by management, employees or co-ops
- those with non-traditional ownership structures, such as community ownership

Although it is likely beyond the mandate of the Competition Bureau's present study, we note that while the lack of financing options creates challenges for many kinds of SMEs, these challenges are even more acute for not-for-profit enterprises.

Conclusion

An enterprise financing system dominated by big banks cannot and will not serve the full range of viable SMEs, which is a problem for the Canadian economy. Insufficient access to financing contributes to weak growth, low productivity, rising inequality and concentrated ownership of assets.

We are glad that the Competition Bureau is directing more attention to this issue. A robust and effective enterprise financing system is one with significant institutional diversity, not just in terms of size of the institution, but also in terms of mandate and governance model. While competition policy is not the only tool that is required to build this diversity, it is an important one.

As Canada confronts profound disruptions in the geopolitical and economic environments, it is essential that Canada enjoys a competitive and diverse enterprise financing system that gets capital into the hands of Canadian enterprises that can deploy it in ways that promote economic growth, resilience, sovereignty and well-being.

We commend the Competition Bureau for launching this study. We look forward to the research that will help clarify the nature and extent of the problem in Canada and highlight plausible pathways to cultivate the kind of institutional diversity that will unlock more capital and more financing options for Canadian SMEs.