

# economic LETTER

FEBRUARY 2013



## WHAT IS HAPPENING TO MEDIUM-SIZED CANADIAN BUSINESSES?

In Canada, the majority of businesses are small: 98% of them have fewer than 100 employees. Large companies, with 500 employees or more, and medium-sized businesses with staffs between 100 and 499 employees, make up the remaining 2%. Large companies get talked about quite a bit, as they employ a large share of the labour force and frequently make the headlines. Meanwhile, medium-sized businesses often go unnoticed, since the studies that examine issues specific to small and medium-sized enterprises (SMEs) focus more on the perspective of small businesses, which account for nearly all of this segment.

But the contribution made by medium-sized businesses to Canada's economy is much greater than their proportion of the business population. While that proportion is less than 1%, they generate 12% of the gross domestic product and 17% of the value of exports, and employ 16% of the labour force. Given their contribution to the Canadian economy, BDC wanted to find out more about them. Thanks to Statistics Canada's Longitudinal Employment Analysis Program, it was possible to analyze trends in the numbers of medium-sized businesses during the first decade of the 2000s, by region and by field of activity. In addition, in collaboration with the Harris/Decima market research firm, BDC carried out a survey of medium-sized businesses in order to determine what internal and external issues they face, to pinpoint the factors that prevent them from becoming large businesses, and to identify their competitive advantages and handicaps.<sup>1</sup>

Between 2006 and 2010, the number of medium-sized businesses in Canada tumbled by 17%. The manufacturing sector was hard hit: medium-sized businesses were reduced by half in this sector during that period (-50.8%). Competition from emerging countries, the appreciation of the Canadian dollar, the financial crisis of 2008 and the recession that followed in 2009 all contributed to this decline. The number of medium-sized businesses fell in all parts of Canada, but the decline was more marked in Ontario due to the difficulties faced by the automobile sector. From 2001 to 2010, on average and in each year, 14% of medium-sized businesses became small businesses once again or closed their doors ▼

<sup>1</sup> The survey was conducted among 301 key decision-makers at the helm of medium-sized companies in various regions of Canada and in various fields of activity, from July 12 to August 10, 2012. The margin of error is +/- 5.6 percent, 19 times out of 20.

### Canada

- > Real GDP growth accelerates
- > Employment backtracks slightly
- > The trade deficit narrows
- > Housing starts continue their downwards trend

### United States

- > Real GDP contracts slightly
- > Employment continues to rally
- > The housing market picks up steam

### Interest rates

The key interest rate will remain stable longer than anticipated

### Oil and dollar

### SME confidence

### Credit conditions

### Key indicators

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to February 9. Reliance on and use of this information is the reader's responsibility.

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altogether, while only 1.4% of them evolved into large companies. These statistics show that medium-sized businesses confronted serious issues during the first decade of the 2000s.

But the picture of medium-sized businesses is not all gloom and doom. According to the results of the survey conducted in collaboration with Harris/Decima, the recent performance by medium-sized businesses is generally good. In fact, only 14% of the respondents reported a slump in sales during the past three years, and one third of them indicated that their sales had remained stable, on average, during that period. The other businesses, i.e. half of the sample, recorded sales growth that took place, overall, at an average annual rate of 3.8%. Meanwhile, 64% of the survey respondents expect their sales to increase in the next three years: 53% anticipate average annual sales growth between 1% and 10%, and 11% of them expect even stronger growth.

At present, the respondents consider that fierce competition is the main external issue facing their business. That factor is also one of the obstacles to growth and to the transition from a medium-sized to a large business. However, the greatest obstacle in this regard is access to financing, which was mentioned by 40% of the respondents (Graph). Internally, issues relating to human resources (the ability to recruit, retain and develop key staff) dominate the concerns of medium-sized business leaders. The size of the business, whether too small or too large, is considered by respondents as the main competitive handicap of a medium-sized business, while customer service is, in their eyes, its main competitive advantage.

The decline of medium-sized businesses in Canada in the past decade is a subject of concern, given their substantial contribution to the economy. More research is needed to understand the financing and management requirements that need to be met, in order for them to grow and prosper in the current economic climate. ■

### In your opinion, what factors prevent medium-sized businesses from becoming large businesses?



Source: Harris/Décima, Survey on Business Challenges of Mid-Sized Firms, September 2012



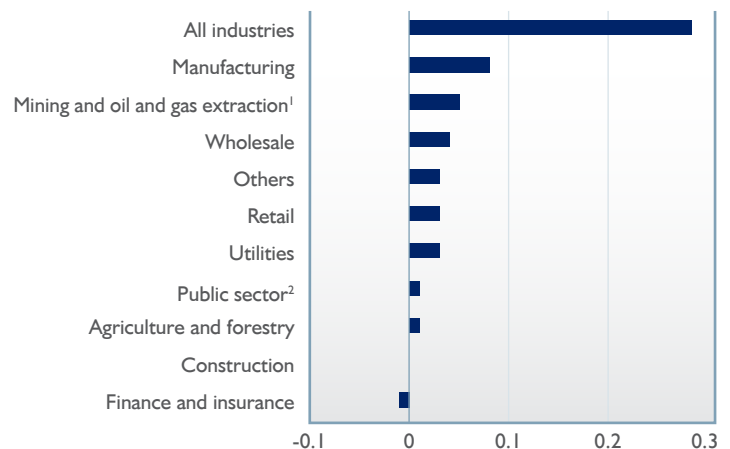
[Back](#)

The foreign trade data lead us to believe that exports made another negative contribution to real GDP growth in the last quarter of 2012. On the other hand, job growth remained solid until the end of the year, which no doubt supported consumption. After several months of gains, January's contraction in employment is not surprising, but the drop in housing starts suggests that investment in residential construction might be even lower than expected in 2013.

### Real GDP growth accelerates

Real GDP by industry grew by 0.3% in November compared with the previous month. This is the best result recorded since April 2012. Production rose in the bulk of the major sectors. For example, after three straight months of decline, manufacturing production gained ground in November. Wholesale and retail trade, mining and oil and gas extraction and utilities also posted healthy advances. On the other hand, the finance and insurance sector reported a downturn. Lastly, the level ▼

### Main industrial sector's contribution to the percent change in GDP (Percentage points, November 2012)



<sup>1</sup> Includes quarrying

<sup>2</sup> Education, health and public administration

Source: Statistics Canada

of production in the construction sector remained flat (Graph). The Bank of Canada has revised its forecast of real GDP growth for the fourth quarter downwards, from 2.5% to 1.0%. The November data are compatible with the central bank's expectations.

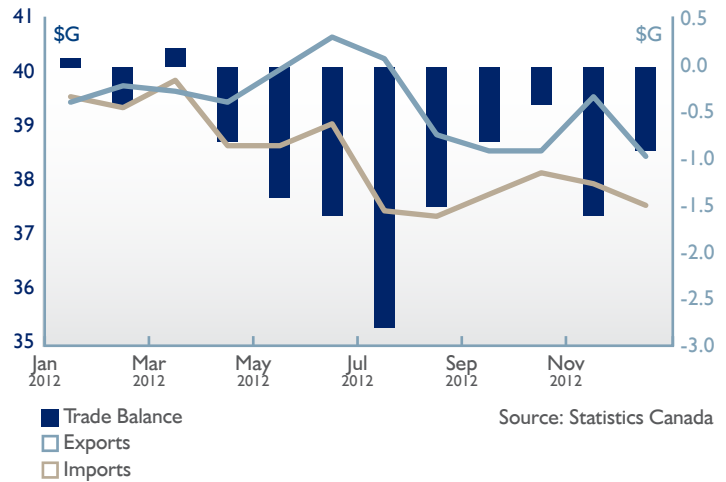
### Employment backtracks slightly

After five months of solid growth, employment contracted slightly in January. The majority of the job losses (21,900) were concentrated in full-time work (20,600). The public sector was the hardest hit, especially education, where 30,900 jobs were lost. In the private sector, pullbacks in manufacturing and in finance, insurance and real estate were offset by gains in construction and in professional, scientific and technical services. Looking at the regions, the largest losses were sustained by Ontario (-31,200) and British Columbia (-15,900). Despite the contraction in employment, Canada's unemployment rate dipped slightly in January, from 7.1% to 7.0%, due to a decline in the labour force.

### The trade deficit narrows

A larger drop in imports than in exports (-2.8% versus 0.9%) caused the trade deficit to tumble, from \$1.7 billion in November to \$901 million in December. Exports to the United States fell by 4.0% after a 4.4% increase in the previous month, while those to other countries surged by 8.5%. It was energy products that led the decline in exports in December, followed by motor vehicles and parts. Exports followed a downwards trend throughout 2012, and the balance of trade has been in a deficit position since the month of April (Graph).

**International Trade**  
(January 2012 to December 2012)



### Housing starts continue their downwards trend

The number of housing starts was down for the fifth month in a row: from a peak of 228,284 units in September 2012, it fell to 160,577 in January 2013. In urban centres, starts of single-family homes plunged by 11.2% in January compared with the previous month, while starts of multiple-unit buildings plummeted by 28.9%. Both Ontario and Quebec recorded substantial declines in housing starts, while the Atlantic provinces saw considerable gains. The Canada Mortgage and Housing Corporation was anticipating a slowdown in housing starts to the tune of 193,600 units in 2013. If the current trend continues, the results could be weaker than expected. ■

## ★ UNITED STATES

[Back](#)

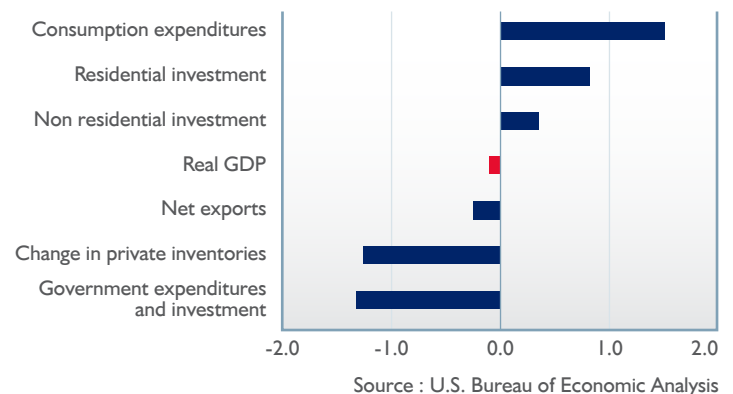
The economy is gradually getting back on track: the housing market is continuing its recovery, and employment keeps expanding. We should not worry too much about the contraction in real GDP in the fourth quarter, as it is mainly due to a temporary disruption caused by Hurricane Sandy and by an exceptional cut in military spending that is unlikely to be repeated. The national accounts data show acceleration in consumption and in private investment, which bodes very well.

### Real GDP contracts slightly

In the fourth quarter of 2012, real GDP dipped by 0.1% compared with the previous quarter. This downturn is mainly due to a decline in investment in business inventories, which no doubt stems from disruptions to the production chain caused by Hurricane Sandy. Changes in inventory had the effect of subtracting 1.3% from real GDP growth in the fourth quarter. A substantial cut in government spending—defence spending in particular—pushed real GDP growth down proportionally (Graph). Lastly, net exports also made

a negative contribution to growth. On the other hand, consumer spending and private investment, both residential and non-residential, advanced more strongly than in the previous quarter. Despite the fourth quarter decline, real GDP grew by 2.2% in 2012, as forecast by the Consensus. ▼

**Contribution to percent change in real GDP**  
(Percentage points)



## Employment continues to rally

Employment continued to make headway in January, recording an increase of 157,000 jobs. The data for 2012, particularly those for November and December, were revised upwards significantly based on additional information provided by businesses since the latest release, the updating of seasonal factors and the annual revision of the process used to estimate data. As a result, the average monthly increase in employment in 2012 comes in at 181,000, instead of 153,000 as previously estimated. In January, employment rose in most sectors, but to a greater degree in retail trade, construction and healthcare. It was relatively stable in the manufacturing sector. The unemployment rate came in at 7.9%, compared with 7.8% in December.

## The housing market picks up steam

Housing starts in December were up by 12.1% from the previous month, reflecting 8.1% monthly growth in the single-family homes segment and 23.1% in the multiple-unit segment. As for sales of existing homes, they slipped by 1.0% in December month-over-month, but surged by 12.8% compared with December 2011. The housing market picked up steam in 2012: housing starts soared by 28.8% compared with 2011, enabling them

to get a bit closer to their long-term average (Graph). Meanwhile, home sales advanced by 9.2% year-over-year, reaching their highest volume in the past five years, i.e. 4.65 million versus 5.03 million in 2007. ■

## Housing Starts (1980 to 2012)



## INTEREST RATES

### The key interest rate will remain stable longer than anticipated

On January 23, the Bank of Canada decided to leave the key interest rate unchanged, as expected. The central bank reiterated that some modest withdrawal of monetary policy stimulus (i.e. a slight increase in the key rate) would likely be required over time, but that it would not happen as soon as previously thought. The facts of the matter are that the Canadian economy slowed more than expected in the second half of 2012, and inflation is not as strong as the central bank had anticipated. The Bank has revised its estimate of real

GDP growth in 2012 downwards (Table), but expects that it will gradually accelerate going forward, with the economy reaching full capacity in the second half of 2014. ■

### Real GDP Growth Forecasts

October 2012	2.2%	2.3%	2.4%
January 2013	1.9%	2.0%	2.7%
	2012	2013	2014

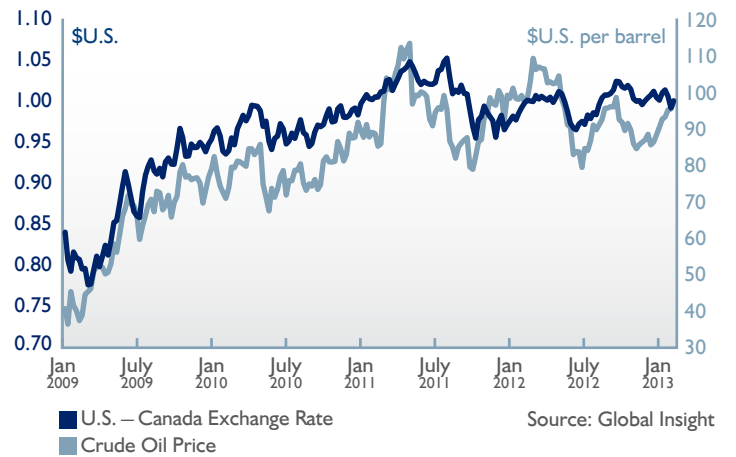
Source: Bank of Canada, Monetary Policy Report, January 2013

[Back](#)

## The price of oil rebounds, the Canadian dollar remains stable

Several factors pushed the price of crude oil up in the past month, in particular renewed optimism about the economies of the United States and China (the two largest consumers of oil on the planet), the worsening of tensions in the Middle East (assassination of a prominent opposition leader in Tunisia, new attacks by rebels in Syria and Iran’s refusal to negotiate directly with the United States on the nuclear issue) and the announcement of a more moderate-than-expected increase in American oil inventories. Meanwhile, the Canadian dollar remained relatively stable during this period (Graph). ■

Price of Oil and the Canada – U.S. Exchange Rate

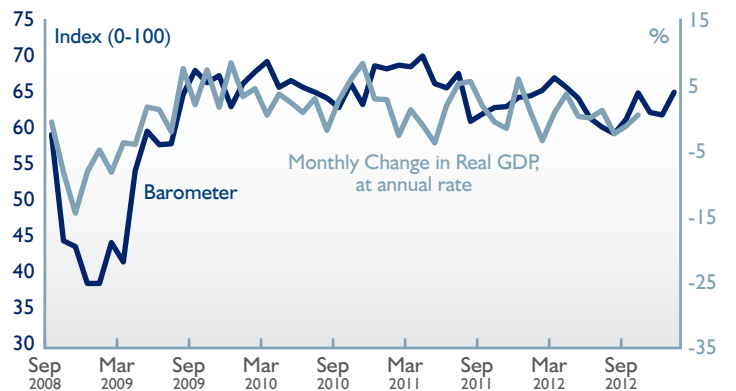


## SME CONFIDENCE

### Business confidence firms up

After deteriorating slightly at the end of 2012, the confidence of small and medium-sized business leaders firmed up in January: the Canadian Federation of Independent Business’s Business Barometer Index climbed back to 65.7, close to where it stood in October (Graph). The situation improved in all provinces except British Columbia. The January results are positive. At 27%, the percentage of business leaders who expect to hire full-time staff in the next three months now stands at its highest point since the recession. Furthermore, 44% of respondents consider that overall business conditions are good; this is the best result seen in four years. ■

Business Barometer







# BUSINESS CREDIT CONDITIONS

Back

## Bank credit expands, and lending conditions remain stable

After decelerating to some degree, growth in credit granted to businesses by the chartered banks resumed a vigorous pace: short-term bank credit escalated by 21.3% in December compared with the previous month, while long-term credit expanded by 18.3%. Meanwhile, according to the Bank of Canada's Senior Loan Officer Survey, the lending conditions faced by businesses have not changed in the past three months (Graph). As for the Business Outlook Survey, it shows that lending conditions have not changed for the vast majority of businesses, but that some of them, particularly large businesses, have benefited from some easing in this regard. ■

Business Credit Conditions (balance of opinions)



Source: Bank of Canada

## KEY INDICATORS — CANADA

Back

Key indicators – Canada	Historical				2012				Latest	Forecasts		
	2008	2009	2010	2011	Q1	Q2	Q3	Q4		2013	2014	
Real GDP (% growth)	1.1	-2.8	3.2	2.6	1.7	1.7	0.6		Nov	0.3	1.8	2.4
Machinery and Equipment Expenditures (% growth)	0.1	-20.4	13.7	10.7	4.1	1.6	0.2				4.7	6.7
Pre-Tax Corporate Profits (% growth)	11.0	-33.1	21.2	15.4	-23.7	-17.2	4.4				3.4	5.2
Industrial Production (% growth)	-3.1	-9.5	4.9	3.5	-1.5	1.0	-2.5		Nov	0.8	1.8	2.8
Industrial Product Prices (% growth)	4.3	-3.5	1.0	4.6	0.9	0.9	-2.5	-0.1	Dec	0.0	1.3	1.9
Non-Residential Construction (% growth)	7.8	-18.6	15.0	10.2	9.0	14.2	-4.4					
Housing Starts (' 000 units)	211	148	191	193	205	231	222	202	Jan	161	186	177
Personal Expenditures (% growth)	2.9	0.1	3.5	2.4	1.1	0.4	3.1				2.1	2.2
Consumer Price (% growth)	2.4	0.3	1.8	2.9	2.1	0.1	0.1	1.4	Dec	-0.6	1.8	2.0
Employment (% growth)	1.7	-1.6	1.4	1.5	0.8	2.6	0.6	2.4	Jan	-0.1		
Unemployment Rate (%)	6.1	8.3	8.0	7.5	7.4	7.3	7.3	7.2	Jan	7.0	7.2	7.0
SMEs Confidence Index (CFIB)	56.1	57.7	66.7	66.4	66.3	64.4	61.0	63.7	Jan	65.7		
Manufacturers Confidence Index (CFIB)	52.7	56.0	68.6	67.2	69.0	67.2	65.3	65.2	Jan	66.7		

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business. Annual growth, quarterly growth at annual rate and month-over-month growth.