

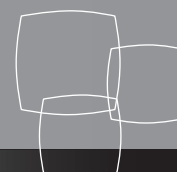


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SMALL BUSINESS QUARTERLY

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PERFORMANCE

Trends

- A recent survey of small businesses¹ conducted for Industry Canada indicates that from 2009 to 2010 the request rate for debt financing increased from 14 percent to 18 percent and the approval rate for debt financing increased from 79 percent to 88 percent.
- Employment levels increased by 1.3 percent in the second quarter of 2011 compared with the same quarter in 2010. The greatest job increases occurred in mining and oil and gas extraction (12.3 percent).
- Since 1987, self-employment has boasted an annual average growth rate of 2.0 percent, outpacing the 1.3 percent annual average growth rate in total employment. Of the 4.7 million jobs gained since 1987, approximately 1 million (21 percent) were self-employed positions.
- The number of business insolvencies has been steadily decreasing since 2007. In the second quarter of 2011, there were 1257 business insolvencies in Canada (10 percent decline from the same quarter in 2010).
- Only 4 percent of small and medium-sized enterprises (SMEs) were R&D intensive (RDI)² in 2007. In 2004 and 2007, RDI firms were more likely than non-RDI firms to request external financing, but were also more likely to be denied financing.

¹ Small businesses are defined as having fewer than 100 employees, medium-sized businesses having 100 to 499 employees and large businesses having 500 or more employees.

² R&D intensive SMEs are defined as SMEs that allocate more than 20 percent of total investment expenditure toward R&D. SMEs that invest 20 percent or less toward R&D are identified as non-RDI SMEs.

ENCOURAGING SIGNS FROM THE CREDIT MARKET:

Results of the 2010 Credit Conditions Survey

The importance of the credit market was arguably never more evident than during the recent financial crisis, when tightened credit conditions threatened national economies around the world. Canada was not immune to the financial crisis as Canadian small businesses encountered greater difficulties in accessing financing between August 2008 and September 2009. Without adequate access to financing, many firms faced the possibility of not having enough resources to operate or expand their businesses, thereby stifling economic growth and risking business failure. However, a recent survey of Canadian small businesses provides encouraging signs that a recovery in the lending market is under way.

Survey Background

Conducted in May and June 2011 by Leger Marketing on behalf of Industry Canada, the 2010 *Credit Conditions Survey* was completed by 3573 employer small businesses (1 to 99 employees), representing firms across major industries and regions. This survey was intended to complement the 2009 *Credit Conditions Survey*, which was also administered by Industry Canada, as well as Statistics Canada's *Survey on Financing of Small and Medium Enterprises*.

Contents

Job Creation	3
Self-Employment	4
Business Insolvencies	5
Business Financing	6
Recent Development / Upcoming Events	8

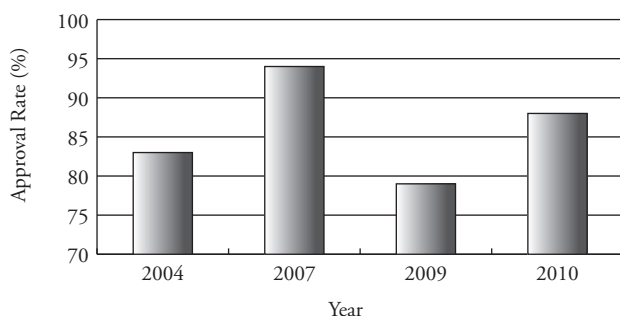
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(continued from page 1)

Access to Financing

Survey results reveal that the debt financing market was noticeably more active in 2010 compared with the year before. In 2010, 18 percent of small businesses in Canada sought debt financing, increasing from 14 percent in 2009. Importantly, growth in debt financing requests was accompanied by an increase in approval rates. Jumping from 79 percent in 2009, the percentage of debt financing requests fully or partly approved was 88 percent in 2010, which is comparable with pre-financial crisis approval rates in 2004 and 2007 (83 percent and 94 percent respectively) (Figure 1). Furthermore, the estimated average amount of approved debt financing increased from \$238 000 in 2009 to \$360 000 in 2010, providing further evidence of enhanced access to debt financing.

Figure 1: Debt Financing Approval Rates



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004 and 2007. Industry Canada, *Credit Conditions Survey*, 2009 and 2010.

Certain categories of small businesses saw notable gains in access to debt financing. Small businesses in the retail and wholesale trade sector posted an 18 percentage point increase in approval rate, rising from 70 percent to 88 percent, in 2010 (Table 1). Firms with 20 to 100 employees also saw a significant increase in approval rate, jumping from 79 percent in 2009 to 97 percent in 2010. However, access to financing did not improve significantly for some sectors, such as accommodation and food, and transportation/warehousing. Among the regions, small businesses in Quebec were the most active in requesting debt financing in 2010 (25 percent request rate). In addition, Alberta posted a large improvement in approval rate, increasing from 71 percent in 2009 to 90 percent in 2010.

Table 1: Debt Financing Approval Rates by Enterprise Characteristics

	Approval Rate (%)*	
	2009	2010
Number of Employees		
1–4	70	84
5–9	89	88
10–19	85	93
20–100	79	97
Region		
Atlantic	99	97
Quebec	79	87
Ontario	77	86
Manitoba–Saskatchewan	87	100
Alberta	71	90
British Columbia and Territories	81	83
Industry		
Accommodation and Food	81	84
Agriculture and Fishing, Forestry, and Oil and Mining	86	100
Construction	99	95
Manufacturing	87	88
Professional Services	76	86
Retail and Wholesale	70	88
Transportation/Warehousing	79	81
Exporting Activities		
Exporter	84	86
Non-Exporter	78	88

Source: Industry Canada, *Credit Conditions Survey*, 2009 and 2010.

* A request that received either full approval or partial approval was considered "approved."

Cost of Financing and Non-Pricing Conditions

The survey results also show that the average interest rate charged for non-residential mortgage and term loans decreased from 5.5 percent in 2009 to 5.4 percent in 2010. On the other hand, the average Bank of Canada prime business rate fell from 3.1 percent to 2.6 percent over the same period, meaning that the risk premium (the difference between the interest rate charged to businesses and the Bank of Canada rate) imposed on small businesses actually increased. Moreover, the percentage of small businesses being asked for collateral to secure term debt financing increased from 57 percent in 2009 to 62 percent in 2010, meaning that non-pricing debt lending conditions have actually tightened further since the financial crisis. So while the higher approval rate and the higher average amount of approved debt financing represent a significant easing of credit conditions in 2010, there remains some evidence of more stringent credit conditions compared with conditions prior to the financial crisis.

(continued on page 3)

(continued from page 2)

Recovery in the Leasing Market

Encouraging signs also extend to the capital leasing market. The leasing request rate increased slightly from 1 percent in 2009 to 2 percent in 2010; however, the leasing approval rate jumped from 76 percent to 97 percent over the same period, demonstrating a strong recovery in the leasing market.

JOB *Creation*

Businesses of all sizes saw an increase in their year-over-year quarterly employment levels in the second quarter of 2011. Employment levels increased by 1.3 percent in the second quarter of 2011 compared with the same quarter in 2010.

Figure 2 shows trends in year-over-year quarterly employment by business size from the second quarter of 2009 to the second quarter of 2011. As shown, while the recession ended in the second quarter of 2009, firms of all sizes continued to experience a negative year-over-year change in employment for a number of quarters. In the second quarter of 2010, small businesses were the first to enter into positive employment growth, but medium-sized and large businesses quickly caught up and have since surpassed small business employment growth.

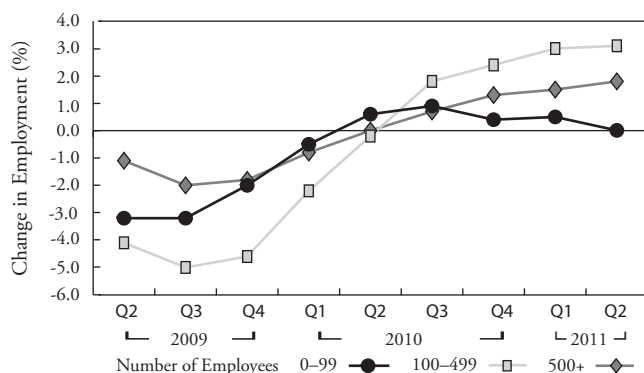
Although not growing as quickly as medium-sized and large business employment, small business employment has continued to show positive year-over-year quarterly gains. Most recently, small firms gained approximately 500 jobs (0.01 percent increase) in the second quarter of 2011 compared with the same quarter in 2010. In contrast, medium-sized and large businesses gained almost 66 000 jobs (3.1 percent) and 118 000 jobs (1.8 percent) respectively.

By industry, from the second quarter of 2010 to the second quarter of 2011, the greatest job increases occurred in mining and oil and gas extraction (12.3 percent), followed by utilities (4.9 percent) (Table 2). In contrast, the greatest job losses were reported in management of companies and enterprises (3.5 percent) and forestry (3 percent).

For more information on the 2010 *Credit Conditions Survey*, visit www.sme-fdi.gc.ca/surveys.

The largest number of jobs created by small businesses occurred in health care and social assistance (6055), representing over 18 percent of job growth in that industry from Q2 2010 to Q2 2011. In contrast, the retail trade sector posted the largest job losses among small businesses, with 6244 jobs lost. Among medium-sized firms, a significant increase in the number of jobs occurred in construction (15 232), whereas large firms gained the most jobs in health care and social assistance (25 959).

Figure 2: Year-Over-Year Quarterly Change in Employment by Business Size, 2nd Quarter 2009 to 2nd Quarter 2011



Source: Statistics Canada, *Survey of Employment, Payrolls and Hours*, September 2011.

(continued on page 4)

(continued from page 3)

Table 2: Year-Over-Year Net Change¹ in Payroll Employment² by Industry and by Firm Size, 2nd Quarter 2011

Industry	Change (%)	Change (Number of Jobs)			
		All Sizes	Small (0-99)	Medium (100-499)	Large (500+)
Forestry	-3.0	-1 124	-202	-41	-882
Mining and Oil and Gas Extraction	12.3	22 266	407	267	21 592
Utilities	4.9	5 785	-7	-306	6 097
Construction	2.3	19 008	1 031	15 232	2 745
Manufacturing	1.6	22 855	-3 703	13 257	13 300
Wholesale Trade	1.7	12 754	-1 016	6 993	6 776
Retail Trade	-0.3	-6 255	-6 244	9 133	-9 145
Transportation and Warehousing	1.6	10 854	3 592	621	6 642
Information and Cultural Industries	-0.1	-477	-2 865	-2 255	4 642
Finance and Insurance	0.0	-162	148	-402	92
Real Estate and Rental and Leasing	1.3	3 129	3 957	-3 299	2 469
Professional, Scientific and Technical Services	2.5	18 966	1 246	-823	18 541
Management of Companies and Enterprises	-3.5	-3 686	-1 091	-1 309	-1 285
Administrative and Support, Waste Management and Remediation Services	1.3	9 562	-859	10 627	-206
Educational Services	-0.3	-3 774	-1 095	4 002	-6 682
Health Care and Social Assistance	2.0	32 512	6 055	496	25 959
Arts, Entertainment and Recreation	-0.2	-383	-5 254	2 120	2 751
Accommodation and Food Services	1.6	16 702	2 216	4 686	9 800
Other Services (excluding Public Administration)	1.2	5 972	4 094	3 767	-1 889
Public Administration	1.8	19 508	96	3 125	16 287
Canada Total	1.3	184 014	507	65 900	117 607

Source: Statistics Canada, *Survey of Employment, Payrolls and Hours*, September 2011.

¹ Year-over-year net change in payroll employment is calculated as the variation between the level of employment in a given quarter and the level in the same quarter a year before.

² *Survey of Employment, Payrolls and Hours* data exclude self-employed workers who are not on a payroll and employees in the following industries: agriculture, fishing and trapping, private household services, religious organizations and military personnel of defence services. The data breaking down employment by size of firm also exclude unclassified industries.

SELF-Employment

In Canada, self-employment¹ has become increasingly important to job growth over the last few decades. From 1987 to 2010, self-employment boasted an annual average growth rate of 2.0 percent, outpacing the 1.3 percent annual average growth rate in total employment. Of the 4.7 million jobs gained over this period, approximately 1 million (21 percent) were self-employed positions. Moreover, the self-employment rate (proportion of self-employed in total employment) over this

period increased 2 percentage points, from 13.7 percent to 15.7 percent.

Figure 3 shows trends in self-employment and employment in Canada from 1987 to 2010 (indexed, 1987 = 100). As shown, growth in self-employment is not always in line with growth in total employment. One possible explanation for this is related to “push” and “pull” factors. If the number of self-employed

(continued on page 5)

(continued from page 4)

is increasing while the number of employees is decreasing, it may suggest that individuals are being “pushed” into self-employment because of a lack of attractive alternatives. On the other hand, if the number of employees is increasing while the number of self-employed is increasing even more, it may indicate that workers are being “pulled” into self-employment.

During the recession in the early 1990s and the most recent 2008–09 recession (both shaded in Figure 3), self-employment increased while total employment decreased, suggesting that workers may have been pushed into self-employment because of poor job opportunities. However, as explained in a previous article (*Small Business Quarterly*, August 2010), in the latest recession, individuals who became self-employed were likely not the same people who lost their jobs. This suggests that other factors (e.g., greater earning potential, access to financing, work–life balance) might have pulled a significant number of workers into self-employment without the impetus of a layoff.²

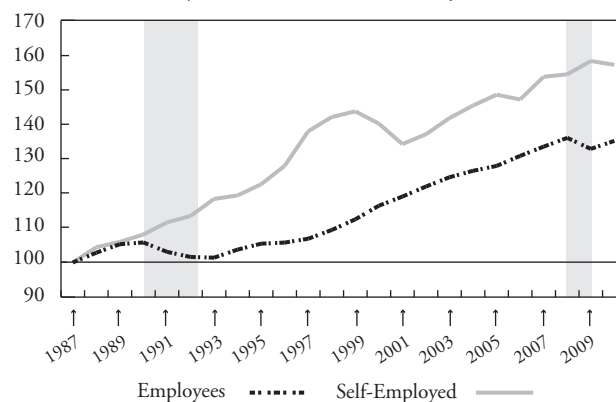
Total employment grew consistently between the recessions, but self-employment experienced a dip from 1999 to 2001, decreasing 6.6 percent. While this cannot necessarily be explained by the “push” and “pull” factors discussed above, it was found that both the goods-producing and services-producing sectors contributed equally to this decrease. Furthermore, when analyzing trends in self-employment by category of worker, it was found that unincorporated

self-employed individuals without paid help represented 84 percent of the total decrease in self-employment.

¹ Self-employment includes incorporated self-employed, unincorporated self-employed and unpaid family workers.

² Source: LaRochelle-Côté, Sébastien, *Self-Employment in the Downturn*, Statistics Canada, March 2010.

*Figure 3: Trends in Self-Employment and Employment in Canada, 1987–2010
(Index, 1987 = 100)*



Source: Statistics Canada, *Labour Force Survey*, 2010; Industry Canada calculations.

BUSINESS *Insolvencies*¹

Many businesses fail because of external shocks and events that are beyond their control. Coming out of the recent financial crisis and the ensuing recession, Canadian businesses have faced many challenges, yet unexpectedly there has been a remarkable decline in the number of business insolvencies.

Figure 4 shows the number of business insolvencies in Canada since the first quarter of 2007. Year-over-year quarterly insolvency levels have been steadily decreasing since 2007, which is different than what has happened in other major economies.

The situation in Canada was somewhat unique as the year-over-year decline in business insolvencies continued during the 2008–2009 recession (between the third quarter of 2008 and the second quarter of 2009). This is due, in part, to Canadian SMEs’ orientation toward the domestic market (only 9 percent of SMEs were exporters in 2007²) and to the fact that domestic demand shrank at a lower rate than export volume during the recession (0.5 percent versus 4.5 percent, on average).

(continued on page 6)

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In the second quarter of 2011, there were 1257 business insolvencies in Canada, a decline of approximately 10 percent from the same quarter in 2010. Given this trend, the Canadian economy is well placed to post the tenth consecutive annual reduction in business insolvencies.

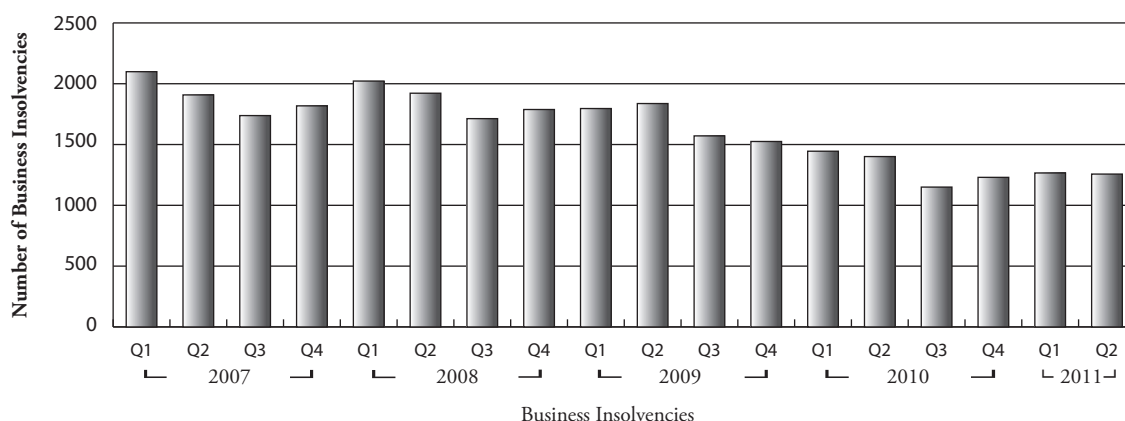
With the exception of the utilities sector, all goods-producing industries experienced a decrease in the number of business insolvencies in the second quarter of 2011 compared with the same quarter in 2010. In services-producing industries, the largest year-over-year quarterly declines took place in management of companies and enterprises, real estate and rental and leasing, and retail trade. At the same time, finance and insurance, and health care and social assistance experienced year-over-year quarterly increases in business insolvencies.

On an encouraging note, industries that typically have the highest insolvency rates are performing well. From the second quarter of 2010 to the same quarter of 2011, the number of insolvencies in construction, manufacturing, retail trade, and accommodation and food services — industries that have historically accounted for over half of all business insolvencies — decreased by 7 percent, 8 percent, 21 percent and 5 percent, respectively, corresponding to an overall decrease of 10 percent.

¹ Insolvencies include both proposals (i.e., propositions to creditor to restructure) and bankruptcies. Bankruptcies account for approximately 65 percent of insolvency cases.

² Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2007.

Figure 4: Number of Business Insolvencies, 1st Quarter 2007 to 2nd Quarter 2011



Source: Office of the Superintendent of Bankruptcy Canada (www.osb.ic.gc.ca).

BUSINESS *Financing*

Financing Challenges Faced by R&D-Intensive SMEs

Investments in research and development (R&D) activities have the potential to substantially improve a firm's chances to survive and thrive in a competitive business environment. On the other hand, R&D investments can be very costly, with no immediate payoffs. In 2004 and 2007, R&D-intensive (RDI)

SMEs, namely those that invest more than 20 percent of total investment expenditure on R&D, were more likely than non-RDI firms to request external financing, but were also more likely to be denied financing, according to Statistics Canada's *Survey on Financing of Small and Medium Enterprises*.

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Notwithstanding the potential benefits of R&D, only 4 percent of SMEs in Canada were R&D intensive in 2007. In fact, 77 percent of SMEs made no investment in R&D in 2007. RDI SMEs were more prominent in the manufacturing industry and in knowledge-based industries¹ in 2007.

RDI SMEs were significantly more likely than non-RDI firms to request debt financing and equity financing and apply for government-sponsored financing programs in 2004 and 2007 (Table 3). However, RDI SMEs were significantly less likely to be approved for debt financing in 2004 and 2007, and had a significantly lower approval rate for government-sponsored financing programs in 2007. In spite of the lower approval rate for government-sponsored financing programs, these programs constituted a sizeable portion (20 percent) of the total amount of external financing approved for RDI firms in 2007, suggesting that these programs helped compensate for the lower availability of debt financing among RDI firms (Figure 5).

A full financing profile of R&D-intensive SMEs will be available in Industry Canada's forthcoming *Canadian Small Business Innovators*, a special edition of *Key Small Business Statistics*. To receive the publication, please subscribe online at www.ic.gc.ca/SMEstatistics/subscription.

¹ Knowledge-based industries (KBIs) include pharmaceutical and medical manufacturing, aerospace product and parts manufacturing, and satellite telecommunications. For a complete listing of KBI sectors, visit www.sme-fdi.gc.ca/eic/site/sme_fdi-prf_pme.nsf/eng/01990.html#appendixB.

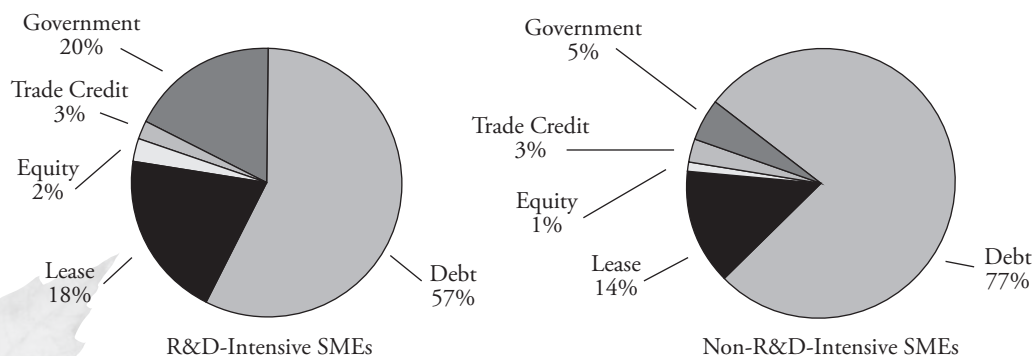
Table 3: Financing Request and Approval Rates

	Rate	2004		2007	
		R&D Intensive (%)	Non-R&D Intensive (%)	R&D Intensive (%)	Non-R&D Intensive (%)
Any External Financing	Request	36	23	26	18
	Approval	70	92	87	97
Debt	Request	32	18	17	13
	Approval	70	88	82	94
Lease	Request	5	3	7	5
	Approval	98	96	87	94
Equity	Request	5	1	5	1
	Approval	49	44	70	71
Trade Credit	Request	13	11	9	9
	Approval	63	91	99	99
Government	Request	6	3	11	3
	Approval	—	—	71	81

Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2004 and 2007.

Bold values denote statistically significant difference at 5 percent.

Figure 5: Distribution of Approved Financing, 2007



Source: SME Financing Data Initiative, Statistics Canada, *Survey on Financing of Small and Medium Enterprises*, 2007.

RECENT *Development*

WORLD ECONOMIC FORUM:

Global Competitiveness Report 2011–2012

In September 2011, the World Economic Forum released the *Global Competitiveness Report 2011–2012*. The report provides an assessment of the competitiveness of national economies using the Global Competitiveness Index. Switzerland tops the list, followed by Singapore, Sweden, Finland and the United States. Canada's ranking fell two positions this year to 12th place. The report notes that "improving the sophistication and innovative potential of the private sector, with greater R&D spending and producing goods and services higher on the value chain, would enhance Canada's competitiveness."

The report also indicates that while competitiveness in advanced countries has remained virtually stagnant for the past seven years, many emerging economies have improved their competitiveness.

Small Business Quarterly Small Business Branch

The *Small Business Quarterly* (SBQ) provides a quick and easy-to-read snapshot of the recent performance of Canada's small business sector. The SBQ is published by the Small Business Branch of Industry Canada.

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UPCOMING *Events*

NATIONAL FRANCHISE & *Business Opportunities Show*

The National Franchise & Business Opportunities show is an opportunity for entrepreneurs to meet representatives from top franchises and learn about opportunities in their region. The show includes an Entrepreneur Expo, which provides entrepreneurs with an opportunity to meet advisors and suppliers and obtain information on resources and other tools needed to start a business. This event will take place in Toronto (January 14–15, 2012), Winnipeg (January 28–29, 2012), Halifax (February 11–12, 2012), London (March 10–11, 2012), Vancouver (March 31 and April 1, 2012) and Montréal (April 14–15, 2012).

For more information on this event, visit www.franchiseshowinfo.com.

CONFERENCE OF ECONOMIC FORUM OF ENTREPRENEURSHIP & *International Business*

The Economics & ECO-Engineering Associate, Inc., Canada, is holding its second annual Conference of Economic Forum of Entrepreneurship & International Business. The conference covers all areas relevant to business, economics and the pursuit of equitable and sustainable economic development. This year's conference will be held at the University of Ottawa in Ottawa, Ontario, February 2–4, 2012.

For more information on the conference, visit www.eco-ena.com/conferences.html.