Industry Canada Industrie Canada

SMALL BUSINESS QUARTERLY

SmallBusiness
CREATING JOBS AND GROWTH

Spring 1998

Industry Canada Industrie Canada
Ottawa, Canada
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A MESSAGE TO OUR READERS

As a result of your suggestions, we have begun to change the Quarterly. In addition to a regularly featured core set of trends and statistics, you will now find a *Supplement* that features a variety of information; subjects might include updates on exports, science and technology, special reports, studies, and other items of interest.

In this edition, we have added a section on economic indicators, and in the *Supplement*, you will find a report on a survey of small business leaders in the new economy, and information on small business corporate tax rates in Canada.

Our objective in publishing the *Small Business Quarterly* remains to provide readers with a quick overview of key small business statistics, trends, and recent developments. Your advice for improving our publication is welcomed, and comments may be forwarded by E-mail to:

abdullahi.rizak@ic.gc.ca

Thank you for your continued interest. Good reading!

Peter Sagar
Director General
Entrepreneurship and Small Business Office
Industry Canada
sagar.peter@ic.gc.ca

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Performance TRENDS

- Between the third quarter of 1996 and the third quarter of 1997, over 430,000 net new jobs were added to company payrolls. This represents a more rapid rate of job creation than that of the same period in 1995-96 when 146,000 net new jobs were added. Small and medium-sized enterprises (SMEs) accounted for almost 70% of this increase.
- In 1996-97, the number of employer businesses increased by a total of 16,008. In comparison, a small increase was registered in 1995-96. The largest increases continued to be registered in Western Canada.
- Large firm profit margins have been relatively stable over the past 18 months (fluctuating between 6.8% and 7.7%), while medium-sized firm profit margins have been fluctuating between 5.8% and 7.6%.
- Approximately 18% of medium-sized and large manufacturers intended to increase employment in the fourth quarter of 1997, compared to 7% of small manufacturers.
- Chartered bank loans to SMEs reached a record $54 billion in the third quarter of 1997.
- The percentage of self-employed workers in Canada as a proportion of the total work force has increased steadily in the 90s. In the 80s, annual growth in self-employment averaged 2.4%, but in the 90s, annual increases have averaged 3.3%.
- There were 2,810 bankruptcies reported in the third quarter of 1997 compared with 3,228 in the second quarter of 1997 and 3,941 in the first quarter of 1996.

Job CREATION

Chart 1: Change in Payroll Employment in Canada by Firm Size, All Industries

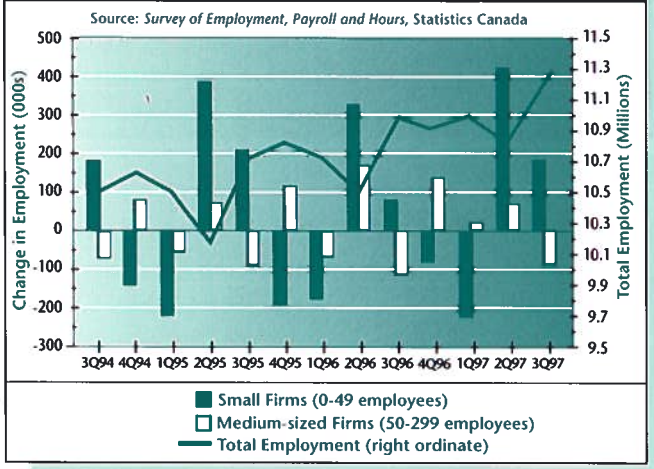
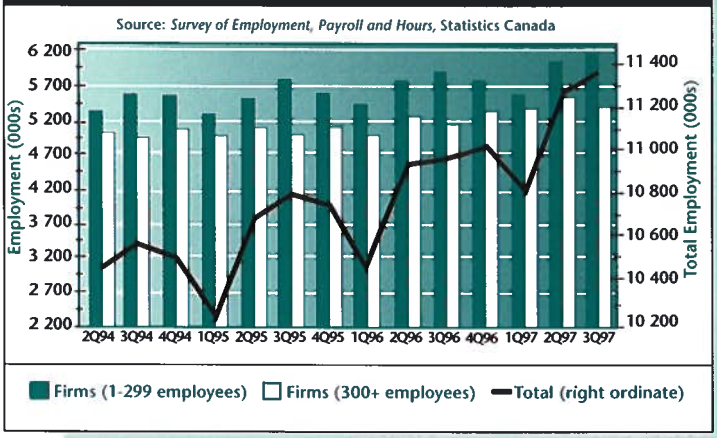


Chart 2: Payroll Employment in Canada by Firm Size, All Industries



Between the third quarter of 1996 and the third quarter of 1997, over 430,000 net new jobs were added to company payrolls. This represents a more rapid rate of job creation than during the same period in 1995-96 when 146,000 net new jobs were added. SMEs accounted for almost 70% of this increase.

Chart 1 illustrates the quarter-by-quarter variation in payroll employment by size of firm.

Small employers (those with establishments of fewer than 50 employees) created over 130,000 of the net new jobs, while medium-sized firms increased their payroll employment by over 174,000. Larger employers (with establishments of over 300 employees) added 132,000 employees. Job creation figures by firm size are illustrated in Chart 2.

The largest number of new jobs in the third quarter of 1997 were added in the services sector (39%), followed by trade (26%) and manufacturing (15%). In the services sector, SMEs accounted for the largest increase in job growth (69.5%), with large firms accounting for the balance. In the trade sector, SMEs have rebounded and now account for the majority of employment growth in this sector.

Net Employer BUSINESSES

Chart 3: Business Growth Trends Canada, 1991-97

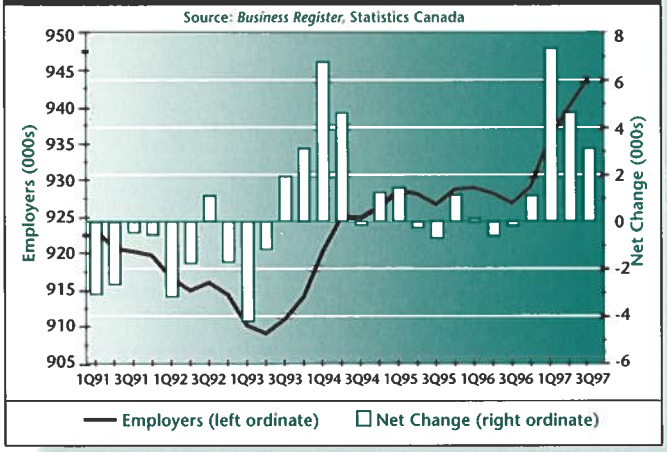
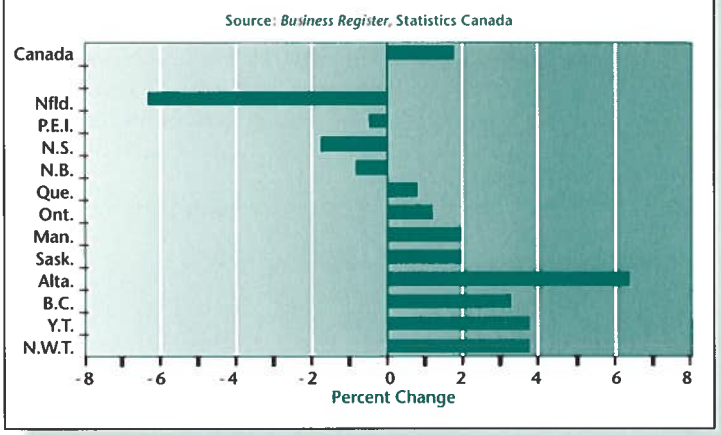


Chart 4: Employer Business Growth by Region, 1995-97



Growth in the number of employer businesses in Canada has continued its strong upward trend. The number of businesses is up by 16,008 from the third quarter of 1996 to the third quarter of 1997 (see Chart 3). This compares to the very marginal growth in registered businesses over the same period from 1995-96.

Growth in the number of employer businesses continues at an uneven rate across Canada (see Chart 4). Alberta, for example, enjoyed the largest increase of 6.3%, or 6,461 businesses, from the third quarter of 1995 to the third quarter of 1997, while Newfoundland had a decrease of 6.4%, or 1,275 businesses, over the same period. Ontario and Quebec have shown no significant change, while Atlantic Canada continued to experience decreases in the number of businesses over the past two years. Table 1 lists the number of employer businesses, by province and territory, from the first quarter of 1992.

Table 1 : Number of Employer Businesses by Quarter, 1992-97

Source: *Business Register*, Statistics Canada

	Canada	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	Y.T.	N.W.T.
1992 — Q1	916,672	21,093	6,566	28,480	24,778	226,999	307,980	32,353	37,315	95,655	131,059	1,298	1,633
Q2	914,962	21,130	6,534	28,556	24,831	226,392	306,002	32,298	37,266	95,744	131,733	1,309	1,627
Q3	916,037	21,191	6,548	28,710	24,980	226,317	305,041	32,311	37,297	96,169	132,272	1,322	1,621
Q4	914,395	21,085	6,510	28,706	24,965	225,575	303,945	32,265	37,099	96,268	132,873	1,337	1,611
1993 — Q1	910,231	20,848	6,410	28,599	24,805	224,327	302,117	32,148	36,839	96,048	133,261	1,350	1,611
Q2	909,158	20,859	6,394	28,730	24,761	223,801	300,716	32,065	36,733	96,135	133,822	1,352	1,607
Q3	911,052	21,167	6,443	28,992	24,857	224,126	300,044	32,110	36,743	96,630	134,600	1,342	1,609
Q4	914,123	21,224	6,509	29,132	25,028	224,784	300,037	32,290	36,819	97,406	135,679	1,333	1,629
1994 — Q1	920,869	20,948	6,618	29,254	25,326	226,084	301,371	32,577	36,990	98,756	137,531	1,333	1,652
Q2	925,416	20,701	6,655	29,411	25,521	226,887	302,326	32,696	36,850	99,737	138,949	1,345	1,674
Q3	925,338	20,509	6,614	29,499	25,570	226,815	302,140	32,671	36,503	100,207	139,681	1,358	1,690
Q4	926,712	20,428	6,584	29,571	25,629	227,130	301,915	32,685	36,289	100,783	140,251	1,364	1,705
1995 — Q1	928,667	20,546	6,536	29,627	25,668	227,745	301,670	32,703	36,066	101,403	140,661	1,362	1,732
Q2	928,422	20,397	6,472	29,519	25,640	227,945	301,188	32,683	35,857	101,902	141,088	1,363	1,758
Q3	927,601	20,039	6,437	29,351	25,593	228,100	300,744	32,638	35,750	102,189	141,482	1,366	1,773
Q4	928,726	19,911	6,456	29,280	25,578	228,614	300,564	32,682	35,803	102,470	141,738	1,371	1,779
1996 — Q1	928,837	19,745	6,484	29,124	25,512	228,689	300,036	32,690	35,726	102,741	141,908	1,385	1,772
Q2	928,067	19,441	6,476	28,889	25,385	228,268	299,497	32,716	35,739	103,285	142,323	1,392	1,773
Q3	927,769	19,146	6,432	28,717	25,290	227,837	299,160	32,766	35,747	103,961	142,789	1,391	1,782
Q4	928,807	18,935	6,412	28,614	25,251	227,725	299,274	32,861	35,841	104,710	143,229	1,393	1,785
1997 — Q1	936,057	18,976	6,418	28,698	25,250	229,111	302,433	33,053	36,210	106,112	144,519	1,411	1,802
Q2	940,595	18,856	6,399	28,675	25,235	229,568	303,810	33,165	36,406	107,314	145,477	1,424	1,826
Q3	943,777	18,764	6,402	28,821	25,379	229,729	304,275	33,280	36,469	108,650	146,193	1,418	1,840

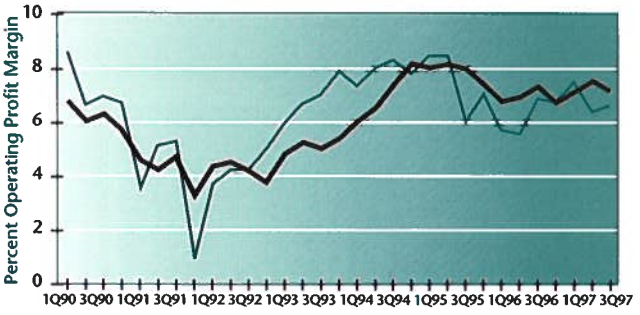
Business PERFORMANCE

Large firm profit margins have been relatively stable over the past 18 months, fluctuating between 6.8% and 7.7%, and up significantly from the 1991-93 recession period. Profit margins for medium-sized firms have been fluctuating between 5.8% and 7.6% (see Chart 5).

Chart 5: Business Performance Trends

(Total non-financial industries)

Source: Statistics Canada



Medium-sized Firms ($5 million to $25 million in revenue)
Large Firms (over $25 million in revenue)

Business CONDITIONS

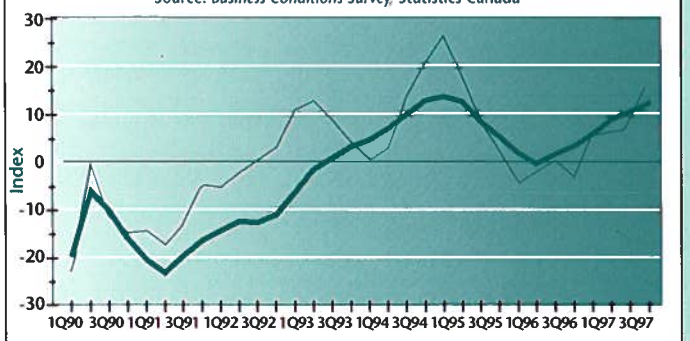
Manufacturers have shown increasing optimism over the last two years, according to Statistics Canada's October 1997 *Business Conditions Survey*. On a four-quarter moving average basis, both large and small manufacturers expected to increase production in the next three months. Overall, medium-sized and large manufacturers tended to be more optimistic about their production capacities than small manufacturers (see Chart 6).

Approximately 18% of medium-sized and large manufacturers intended to increase employment in the fourth quarter of 1997, compared to 7% of small manufacturers. The October 1997 survey also reported that working capital concerns continued to be a low priority for small, medium-sized and large firms, i.e., only 9% of small manufacturers and 1% of medium-sized and large firms, reported problems with working capital (see Chart 7).

Chart 6: Manufacturer Confidence

Balance of Opinion on Production

Source: *Business Conditions Survey*, Statistics Canada

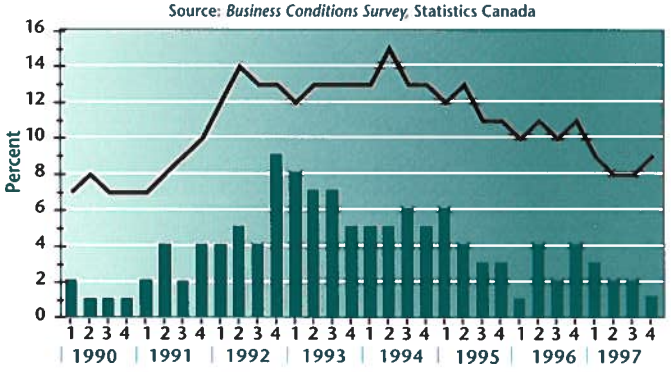


Medium-sized and Large Firms (over $10 million) — moving average
Small Firms (under $10 million) — moving average

Chart 7: Working Capital Difficulties

Small, Medium-sized and Large Manufacturers

Source: *Business Conditions Survey*, Statistics Canada

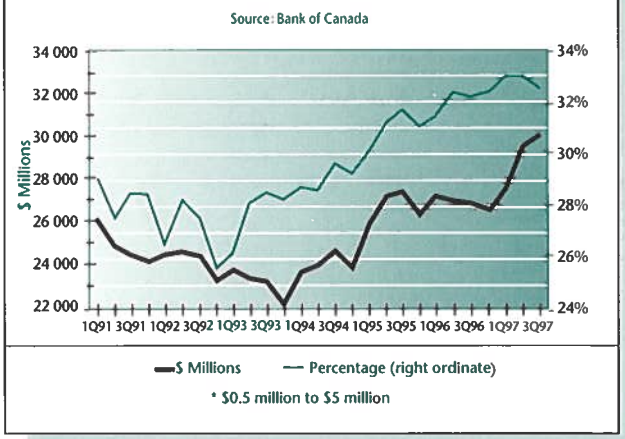


Small (under $10 million)
Medium-sized and Large (over $10 million)

Business LOANS

The Bank of Canada reported that chartered bank loans to SMEs reached a record $54 billion in the third quarter of 1997; this represents an increase of approximately 9% from levels of a year ago. The largest increase was in the medium-sized loan category (see Chart 8), which increased by about $3 billion over a one-year period (i.e., from about $27 billion in the third quarter of 1996 to nearly $30 billion in the third quarter of 1997). The increase in small-sized loans to business over the same period totalled $2.423 billion (see Chart 9).

Chart 8: Chartered Bank Medium-sized Loans to Business*
Size of Authorized Loan (current $)



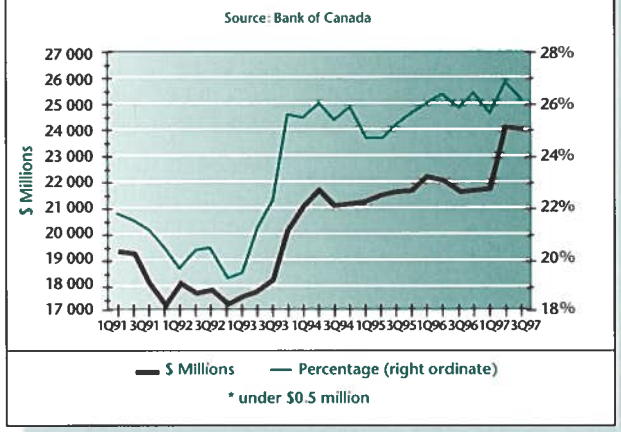
Self-EMPLOYMENT

The number of self-employed workers (defined by Statistics Canada's seasonally adjusted *Labour Force Information* — Catalogue # 71-001) reached 2,527,500 by the end of the third quarter of 1997.

The percentage of self-employed workers in Canada as a proportion of the total work force has increased steadily in the 90s. In the 80s, annual growth in self-employment averaged 2.4%, but has since picked up in the 90s, with annual increases averaging 3.3%; currently, 17% of all Canadian workers are self-employed, up from 14% in 1989. (Growth in paid employment, on the other hand, averaged 1.9% in the 80s and 0.2% in the 90s.)

Despite the fact that self-employed workers have a longer work week than employees (41.8 hours vs. 36.1 hours per week) and have slightly lower-than-average earnings, self-employment still represents the preferred form of work for these individuals. In 1995, only 12% of self-employed workers indicated that this option was chosen due to a lack of other forms of work.

Chart 9: Chartered Bank Small-sized Loans to Business*
Size of Authorized Loan (current $)

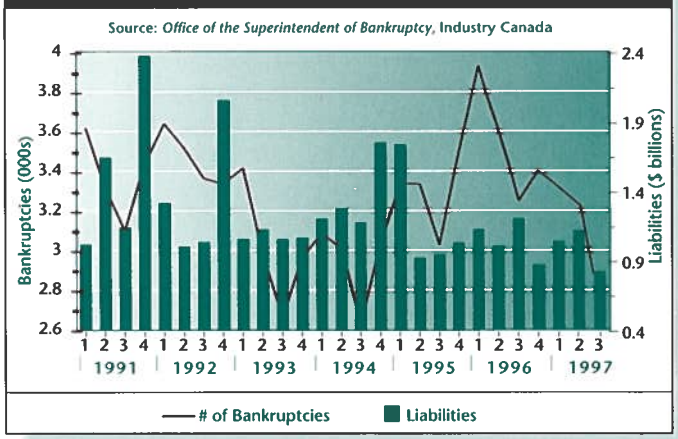


Business BANKRUPTCIES

There were 2,810 bankruptcies reported in the third quarter of 1997 compared to 3,228 bankruptcies in the second quarter of 1997 and down significantly from the 3,941 business bankruptcies in the first quarter of 1996, when they were at their highest level in six years (see Chart 10).

The industry showing the biggest improvement (from third-quarter 1996 to third-quarter 1997) was the fishing and trapping industry (49% drop in number of bankruptcies). The real estate operations, finance and insurance, and business service industries were next, showing decreases of 42%, 27% and 22%, respectively. Several industries reported an increased number of bankruptcies, i.e., logging and forestry (53%), and transportation and storage (19%).

Chart 10: Business Bankruptcies & Liabilities 1st Quarter 1991 - 3rd Quarter 1997



Economic SNAPSHOT

Macroeconomic Indicators

Surging domestic demand . . . A sharp increase in domestic demand boosted real GDP by 4.1% (annual rate) in the third quarter of 1997, marking the economy's fifth consecutive quarter of strong growth. Despite this sustained period of solid growth, inflation remains subdued. Final domestic demand rose 5.9% in the third quarter, supported by a large increase in consumer spending and sharply higher investment in plants and equipment.

The unemployment rate . . . declined to 8.6% in December, the lowest rate since September 1990.

Inflation . . . remains firmly under control. Year-over-year consumer price index inflation was 0.9% in November, the lowest rate in almost three years.

Consumer confidence . . . rose to its highest level in nine years in the third quarter. The Conference Board of Canada reported that improving employment prospects and low interest rates are fuelling the surge in confidence.

Business confidence . . . remained near its record high in the third quarter, according to a survey by the Conference Board of Canada. More than two-thirds of firms believe their financial situations will improve over the next six months.

The Canadian dollar . . . has weakened considerably over the past few months, trading at record lows. The dollar's weakness stems in part from volatility in global stock markets, which has prompted a flight to safe-haven currencies such as the U.S. dollar.

Short-term rates . . . The Bank of Canada has raised its bank rate by a total of 125 basis points since June 26, triggering similar increases in the prime rates.

Capacity utilization . . . rose 0.7 percentage points in the third quarter, propelled by high foreign demand and strong spending by businesses and consumers.

Housing affordability . . . is at all-time high, making ownership an option for more renters.

The outlook for housing . . . remains very good for 1998. According to the Canada Mortgage and Housing Corporation, housing starts are expected to increase a robust 9.3% over the coming year, as a result of strong job creation and low mortgage rates.

Economic Outlook

The economy . . . is expected to grow briskly this year. The consensus of private-sector forecasts calls for growth of 3.4% in 1998 and 3.0% in 1999.

International organizations . . . also predict strong growth. The International Monetary Fund predicts that Canada will lead the G7 countries with growth of 3.2% in 1998, while the Organisation for Economic Co-operation and Development (OECD) forecasts growth for Canada of 3.5% this year. The OECD economies are expected to grow at an average of 2.9% in 1998.

Text provided by the Micro-Economic Policy Analysis Branch, Industry Canada. For more detailed information on the economy, visit the *Strategis* website at:

http://strategis.ic.gc.ca/sc_ecnmy/engdoc/homepage.html (English)

http://strategis.ic.gc.ca/sc_ecnmy/frndoc/homepage.html (French)

SUPPLEMENT

Relative to the United States, the federal corporate tax system in Canada is quite attractive for small business. The small business deduction reduces the income tax rate from 29.12% to 13.12% on the first $200,000 of taxable income. The United States provides reduced tax rates for small business over a much smaller range; full rates apply to incomes over about $107,000 in Canadian dollars. While provinces also provide reduced rates of tax for small business, provincial taxes in Canada are, on average, somewhat higher than rates in American states, about 7% for provinces versus about 5% for states. Overall, there is a significant tax rate advantage for Canadian small businesses at most income levels.

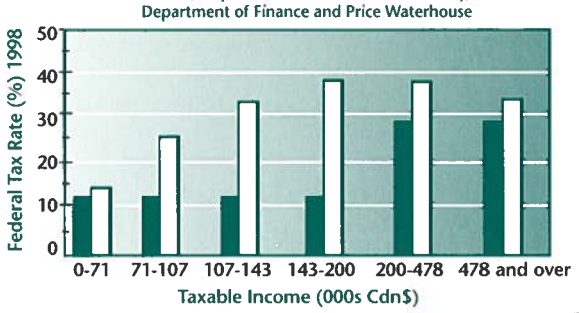
Small businesses in Canada also benefit from other federal tax measures, including the following items.

Capital Gains Taxation: Only 75% of capital gains are subject to tax and the first $500,000 of capital gains on the disposition of qualified small business shares by individuals are exempt from income tax. In addition, capital losses arising from the disposition by an investor of shares and debts of qualified small business corporations may be used to reduce any income of the investor. (Other capital losses may only offset capital gains.)

Scientific Research and Experimental Development Tax Credits: Canadian-controlled private corporations (small businesses) with less than $200,000 of taxable income can receive a refundable tax credit on their qualifying expenditures on scientific research and experimental development (SR&ED).

Small Business Federal Corporate Tax Rates

Source: *Corporate Taxes a Worldwide Summary*, Department of Finance and Price Waterhouse



Canada ☐ United States

Provincial and state taxes also apply. On average, provincial corporate tax rates are about 7% for small business and state rates are effectively about 5%.
Assumes an exchange rate of $1 Cdn = $0.70 U.S.
Canadian rate of 29.12 reduces to 22.12 for manufacturing and processing activities.

The tax credit rate for eligible expenditures incurred by these corporations is 35%. Other Canadian corporations (large businesses) earn non-refundable tax credits on eligible SR&ED expenditures at the rate of 20%.

Labour-Sponsored Venture Capital Corporations **(LSVCCs):** Investors in LSVCCs receive a 15% federal tax credit, as well as a matching provincial credit in many cases. LSVCCs pool funds of individuals to invest in a portfolio of small businesses.

Text provided by the Micro-Economic Policy Analysis Branch, Industry Canada.

Business Development Bank of Canada Survey of Small Business Leaders in the New Economy: Business as a Lifestyle

(Text provided by the Business Development Bank of Canada)

The "New Economy" is a term that has become synonymous with small, entrepreneurial companies with high growth rates. But what do we know about these companies? To what do they attribute their success? What obstacles, if any, do they see to their growth in the future?

In December 1997, the Business Development Bank of Canada (BDC) released a survey entitled *Beyond their Small Businesses: Insight into Canada's New Economy Leaders.* The entrepreneurs interviewed for the survey all manage innovative, knowledge-based or high-growth companies, many of which are exporting. They all have less than 150 employees.

The survey, which partly focussed on the performance of the companies, found that most of them have existed for less than 10 years, typically have four executives and about 40 employees and, on average, generate annual sales of $1 million to $5 million. Other interesting facts from the survey include the following:

- The small New Economy businesses surveyed have an average of eight more full-time employees than they had a year ago. When asked about the success of their company, the factor mentioned most often (28%) was the quality and competence of their employees. Other factors were customer service (21%), the quality of products and services (20%) and the leaders' passion for their work (19%).
- More than half (54%) of the respondents indicated that their company had some exports, which accounted for nearly a quarter of their sales on average. The value of exports relative to total sales varies according to the size of the company, with higher percentages of exports being reported by companies with a greater number of employees and with higher sales and profits.
- Seventeen percent of respondents said they do not expect any major obstacles to develop in their company in the near future. For 18% of respondents, the main foreseen constraint related to financing, while 15% saw potential problems related to the availability and quality of human resources. Only 12% said they saw competition as a threat.
- Nearly 64% of the companies surveyed use the Internet. Of those leaders whose companies have Internet access, 74% use it themselves. Over one third have a portable computer and nearly half

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have a fax machine at home. Many use an electronic agenda, and cellular phones are standard equipment for 79% of these leaders.

The survey also examined the more personal aspects of the lives of these New Economy small business leaders, and found that, despite the stress and strain of running their own businesses, on average they are happy with their lives. Other interesting facts from the survey include:

- Nearly half of them have a university degree. Sixteen percent have a master's degree or even a doctorate. Only 28% did not attend college or university.
- Although they work 50- to 70-hour weeks, they still manage to get an average of a little less than seven hours of sleep a night.
- Seventy percent of the principals are between 35 and 55 years old, and the average age is 47. Eighty-eight percent are married or living as a couple. Eighty-seven percent have children.
- Four out of 10 respondents took seven days of vacation or less last year. However, of those who managed to take at least a week off, 46% remained in almost permanent contact with their company or clients, and 24% kept in touch occasionally. This suggests that 70% of these leaders continued to run their businesses while on vacation.

"The business becomes the lifestyle. They work it, they holiday it. They golf because it lets them work. And it pays of financially," said Dave Mowat, BDC's Senior Vice-President, Emerging Markets.

The full text of *Beyond their Small Businesses: Insight into Canada's New Economy Leaders* is available on the BDC website at:
http://www.bdc.ca

Businesses can obtain hard copies of the survey by calling **1-888-INFO-BDC** (1-888-463-6232).

SMALL BUSINESS QUARTERLY

ENTREPRENEURSHIP AND SMALL BUSINESS OFFICE

Team Leader: James Kendrick
Editor: Rizak Abdullahi

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 Entrepreneurship and Small Business Office of Industry Canada.

Please send your comments to the editor:

Rizak Abdullahi
Entrepreneurship and Small Business Office
Industry Canada
Room 505A
235 Queen Street
Ottawa, Ontario
K1A 0H5

Tel.: **(613) 954-3601**
Fax: **(613) 954-5492**
E-mail:
abdullahi.rizak@ic.gc.ca

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ISSN 1205-9099
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Recent DEVELOPMENTS

ISBC 1999

Canada will host the International Small Business Congress (ISBC), October 12-15, 1999, in Toronto. Representatives of small business, government, industry associations, academia, and other specialists from more than 60 countries convene at the ISBC on an annual basis. The ISBC is an important forum for debating the complex issues facing SMEs, and for the exchange of information in support of SME policies and practices.

John Bulloch, Chairman and Founder of the Canadian Federation of Independent Business (CFIB) is Chair of the ISBC Steering Committee. The CFIB will play a key role in advising on program development and promoting the event to its 88,000 members. ISBC 1999 is expected to have more than 1,000 participants, including 300 international delegates.

Risk Capital

The Internet-based *Steps to Growth Capital* program is designed to help growth-oriented firms find investors, by opening the doors to potential sources of risk capital and providing advice on improving the quality and scope of investments. The 13-module program covers everything from identifying financial needs to finding and managing a relationship with an investor. *Steps to Growth Capital* can be found on the Internet at:
http://strategis.ic.gc.ca/growth

Small Business Counselling Certification

A new federal-provincial advisory committee has been established to develop and validate national occupational standards for small business counsellors. The development of Canadian standards across sectors will lead to improved service for clients, and will become the cornerstone for a rapidly growing profession. For example, in Atlantic Canada, where certification is offered through the Institute of Small Business Counsellors, Inc., about 270 business advisors have registered. It is hoped that, eventually, small business counselling standards will be extended into the international milieu through groups such as Asia–Pacific Economic Cooperation (APEC).

Business Management Practices

Want to know more about leading business management practices? "Ask the Expert" sessions on Industry Canada's *Contact!* website provide answers from business experts across the country on issues such as intelligence gathering, marketing and financing. In addition, a business library contains more than 550 articles on a wide range of business topics. For more information, visit *Contact!* at:
http://strategis.ic.gc.ca/contact

Small Business Info–Fairs 1998

Are you researching a new business idea? Expanding your company? Exporting around the world? The Government of Canada Small Business Info-Fairs have something for you — dozens of federal programs for small business, and numerous "how-to" seminars. There are two ways that you can access the information, and both are free: either attend one of 25 info-fairs across Canada, or visit the following website:
http://strategis.ic.gc.ca/info-fairs