



SMALL Business

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Q U A R T E R L Y

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PERFORMANCE

Trends

Small businesses in Canada generated 9626 jobs, or 2.2 percent of the 439 429 net new jobs created between the fourth quarter of 1999 and the fourth quarter of 2000. This marks a significant decline from the previous year, when 42 847 net small business jobs were created. The relative contribution of small business to job creation has varied widely over the years.

Self-employed workers in Canada numbered 2.32 million in the first quarter of 2001, a drop of 7.5 percent from the peak of 2.51 million reached in the first quarter of 2000.

Venture capital investments reached a record of 1441 rounds of financing (2566 investments) in 2000, up by 46 percent from 989 in 1999.

Total chartered bank loans outstanding reached \$100.3 billion in the fourth quarter of 2000, of which 21.9 percent or \$22 billion were small loans (less than \$500 000).

There were 2477 bankruptcies reported in Canada in the fourth quarter of 2000, marking a slight increase of 0.3 percent from the fourth quarter of 1999.

VENTURE CAPITAL ACTIVITY IN CANADA

With small and medium-sized businesses turning more and more to equity financing, particularly as a source of growth capital, the *Small Business Quarterly* is launching a new Equity Financing section. This new section will cover issues such as trends in venture capital, characteristics of informal investors ("angels"), the role of "love money" for start-ups, and the strengths and weaknesses of the Canadian market for initial public offerings. This issue's feature story presents an overview of venture capital activity in Canada from 1996 to 2000. The new equity financing section on page 6 provides a breakdown of venture capital activity by industry.

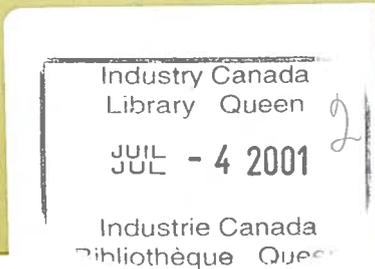
Over the past five years, Canada's venture capital industry has expanded to record levels of activity. The year 2000 saw 1441 rounds of financing, which is 46 percent above the level in 1999 and 128 percent more than in 1996 (see Chart 1). Each transaction with an investee company represents one round of financing, in which multiple investors may have participated. The 1441 rounds in 2000 came about as a result of 2566 investments. Other key results from 2000 include:

- The amount of capital disbursed grew to a record level of \$6.3 billion, reflecting increases of 133 percent and 472 percent over the \$2.7 billion and \$1.1 billion of 1999 and 1996 respectively.

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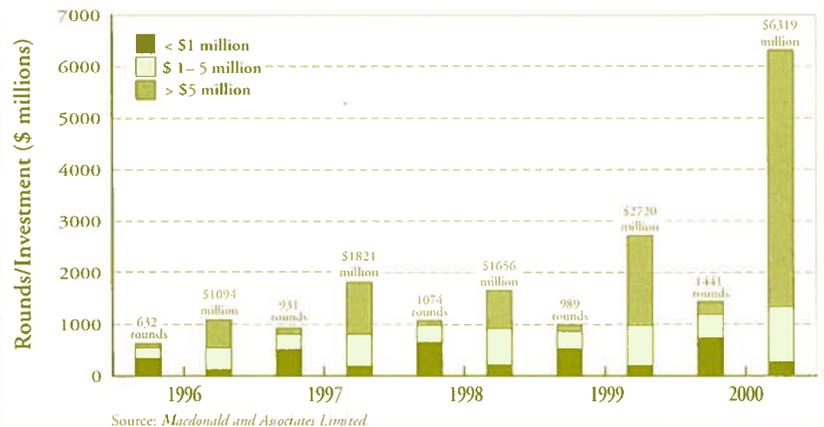
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- The average amount of financing was \$4.4 million, up from \$2.7 million in 1999.
- The high rate of growth in the venture capital industry is powered by large transactions (\$5 million and above), which represent 79 percent of the total dollars invested, compared with 64 percent in 1999 and 50 percent in 1996.
- Small transactions (less than \$1 million) and mid-sized transactions (\$1–5 million) continue to represent a small proportion of the total value of industry investment, accounting for only 4 percent and 17 percent respectively, down from 7 percent and 28 percent in 1999 and from 11 percent and 40 percent in 1996. However, small transactions also continued to make up about half of the total number of rounds.
- The dollar value of small transactions more than doubled from 1996 to 2000. In that same period, the value of large transactions increased almost tenfold.

Chart 1: Venture Investment Activity in Canada, Number of Rounds and Amount Invested by Size of Transaction, 1996–2000



Source: Macdonald and Associates Limited

JOB Creation

Payroll data indicate that small businesses (firms employing fewer than 50 employees) created 9626 net new jobs, or 2.2 percent of the 439 429 net new jobs between the fourth quarter of 1999 and the fourth quarter of 2000 (see Table 1). The rate of growth in job creation in small businesses since the last quarter of 1999 has been only 0.2 percent. This is much lower than the rates for medium-sized and large firms, which were 5.3 percent and 5.5 percent, respectively, over the same period.

Chart 2 shows the net year-over-year variation in employment by quarter and size of firm between 1996 and 2000. Since 1998, large businesses (with 300 or more employees) have created the majority of net new jobs. Between the fourth quarter of 1999 and the fourth quarter of 2000, large firms created 311 223 net new jobs, the highest gain in years.

The most recent year-over-year results show that most new small business jobs were created in the construction and services sectors, with gains of 7949 and 21 374 respectively. However, even in these sectors, the job growth in small firms was widely outpaced by growth in larger businesses. In fact, when compared with large firms, the rates of growth in job creation for smaller firms were lower in every sector.

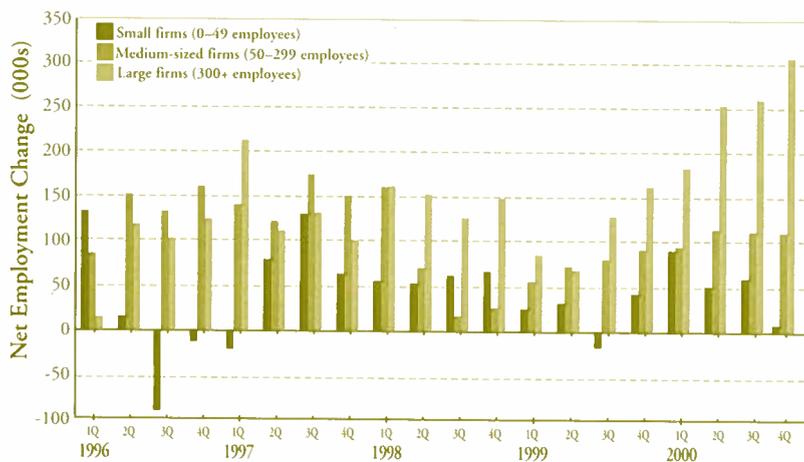
The manufacturing sector incurred the largest job losses in small firms. Here, employment in small firms declined by 3.6 percent, involving more than 16 000 jobs.

Table 1: Net Change in Number of Employees between the Fourth Quarter of 1999 and the Fourth Quarter of 2000, by Size and Industry, and Rate of Growth

	All Industries	Logging	Mining	Manufacturing	Construction	Transportation and Communication	Trade	Finance and Real Estate	Services	Public Administration
Size of Firm by Number of Employees										
0-49	9 626	-1 825	413	-16 305	7 949	3 423	-1 902	-784	21 374	-2 719
Rate of growth (%)	0.2	-4.9	1.5	-3.6	2.0	1.9	-0.2	-0.4	1.4	-5.7
50-299	118 580	783	-1 007	16 454	11 907	1 108	30 778	6 109	51 933	516
Rate of growth (%)	5.3	9.5	-4.3	3.2	12.7	1.0	6.9	6.4	6.0	0.7
300+	311 223	997	2 174	71 481	6 725	18 904	63 879	25 367	114 363	7 333
Rate of growth (%)	5.5	4.3	2.5	7.3	11.2	3.1	8.1	6.2	5.3	1.3
Total	439 429	-45	1 582	71 628	26 582	23 435	92 755	30 692	187 672	5 129
Rate of growth (%)	3.7	-0.1	1.2	3.7	4.9	2.6	4.1	4.3	4.1	0.8

Source: Statistics Canada, Survey of Employment, Payroll and Hours.

Chart 2: Net Change in Number of Employees, by Firm Size, Year Over Year by Quarter, 1996-2000



Source: Statistics Canada, Survey of Employment, Payroll and Hours.

SELF-Employment

According to Statistics Canada's *Labour Force Survey*, self-employed workers numbered 2.32 million in the first quarter of 2001 (calculated from seasonally adjusted monthly data). This is a 1.9-percent decline from the previous quarter. Since the first quarter of 2000, the number of self-employed workers has decreased by 189 000 or 7.5 percent (see Chart 3).

Table 2 shows that the largest category of self-employed workers is unincorporated without paid help. In 2000, this category represented 51.3 percent of all self-employed workers. Next largest are those incorporated with paid help, representing 22.1 percent.

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Between 1999 and 2000, only the number of self-employed workers who were incorporated without paid help and unincorporated with paid help increased. The largest drop occurred for those unincorporated without paid help, with a loss of 56 900 jobs. In fact, 85 percent of employment reductions are in this category.

For further information on the different definitions of self-employed workers, refer to Statistics Canada's *Guide to Labour Force Survey* at <http://www.statcan.ca/english/freepub/71-543-GIE/0000071-543-GIE.pdf>

Chart 3: Number of Self-employed Workers, Seasonally Adjusted, 1990–2001, Based on Monthly Averages

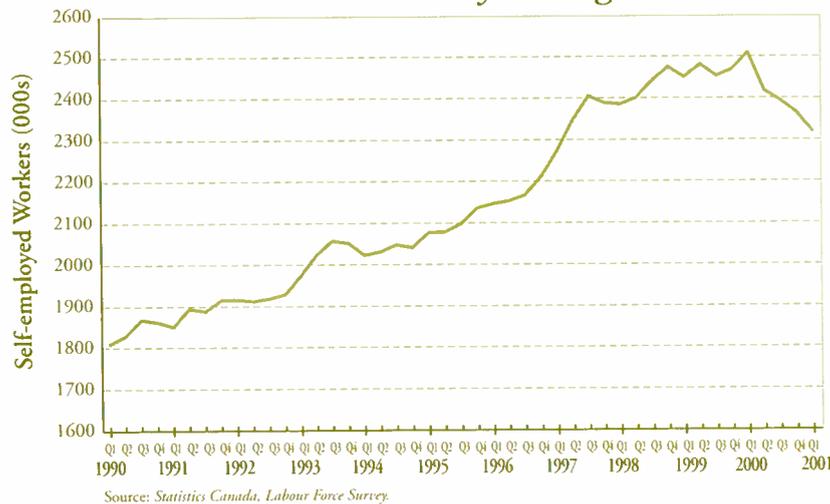


Table 2: Self-employment by Category of Worker, 1990–2000 (000s)

Year	Total	Incorporated, with paid help	Incorporated, no paid help	Unincorporated, with paid help	Unincorporated, no paid help	Family business, no pay
1990	1842.7	477.7	120.5	323.5	852.5	68.5
1991	1887.4	497.5	132.6	331.1	861.1	65.0
1992	1919.3	493.6	140.1	320.2	899.1	66.3
1993	2027.1	508.4	144.0	324.5	975.1	75.0
1994	2036.3	469.2	157.4	335.9	1015.6	58.0
1995	2097.8	510.5	170.5	319.3	1039.6	57.9
1996	2169.4	493.0	189.8	320.9	1109.4	56.3
1997	2353.7	530.9	253.6	288.4	1215.6	65.2
1998	2425.2	515.4	250.4	299.4	1299.4	60.6
1999	2462.9	541.9	279.6	296.8	1298.0	46.5
2000	2421.4	534.9	297.0	305.1	1241.1	43.3

Source: Statistics Canada, Labour Force Survey.

Data as of May 4, 2001

BUSINESS Bankruptcies

There were 2477 bankruptcies reported in Canada in the fourth quarter of 2000, a slight increase of 0.3 percent from the same quarter in 1999 (see Chart 4). For all of the year 2000, 10 040 business bankruptcies occurred in Canada, which was similar to the 1999 level of 10 023 bankruptcies.

Despite the small increase in the number of bankruptcies, business liabilities increased 22.1 percent compared with the same quarter in 1999, reaching \$834 million during the fourth quarter of 2000.

The comparison by quarter between 1999 and 2000 shows that the number of bankruptcies has remained relatively stable while the amount of business liabilities has increased. This trend suggests that the average size of firms going bankrupt is increasing.

The Canadian economy... rose at an annualized rate of 2.6 percent in the fourth quarter of 2000, slowing significantly from the recent pace of growth. Domestic demand was virtually unchanged on the quarter as declines in machinery and equipment investment and residential construction were offset by increases in consumer spending and non-residential construction. Net exports also contributed to output growth. Growth for 2000 as a whole was 4.7 percent, up slightly from the 4.5 percent growth posted in 1999. Available data suggest that growth slowed in the first quarter, dragged down by weakness in the manufacturing sector, particularly the production of automobiles and telecommunications equipment.

The economic outlook... calls for growth to slow from the strong pace of the previous two years. The April 2001 consensus of private-sector forecasts calls for growth of 2.4 percent in 2001, followed by 3.3 percent in 2002.

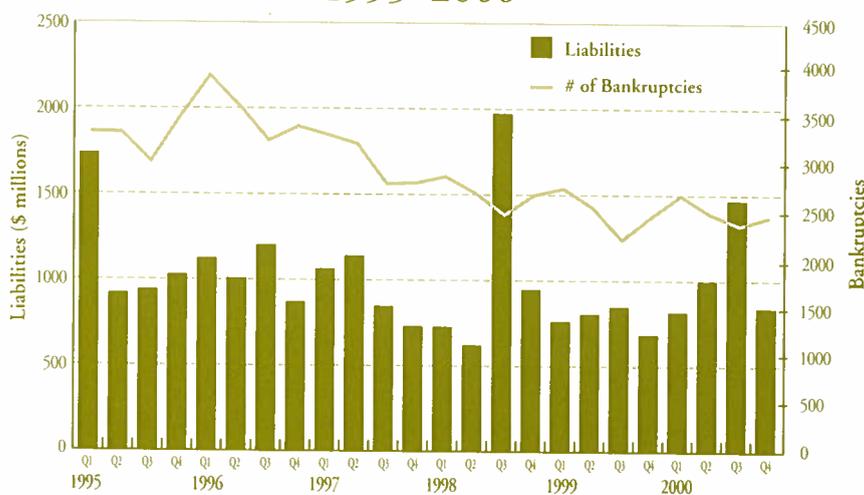
The April Business Conditions Survey... reveals that manufacturers are more optimistic about production prospects in the coming quarter. The percentage of manufacturers stating an intention to maintain or increase production in the coming quarter jumped to 73 percent from 59 percent in the previous quarter. Manufacturers in the transportation equipment industry did not expect to cut production further in the second quarter, but manufacturers in the paper and fabricated metal products industries did. Manufacturers were less concerned about current levels of orders and inventories, but more pessimistic about employment prospects.

The national unemployment rate... edged up 0.1 percentage points to 7 percent in March, after averaging 6.8 percent in 2000 and 7.6 percent in 1999. Employment increased by 30 000 in March, following two months of little movement.

Inflation... remains in check, registering 2.5 percent in March, the lowest rate since August 2000. Inflation averaged 2.7 percent for the year 2000 as a whole, despite sharply higher energy prices. The year-over-year "core" rate of CPI inflation stood at 1.7 percent in March, in the bottom half of the Bank of Canada's official target range of 1–3 percent. The core rate excludes the volatile food and energy components.

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Chart 4: Business Bankruptcies and Liabilities, 1995–2000



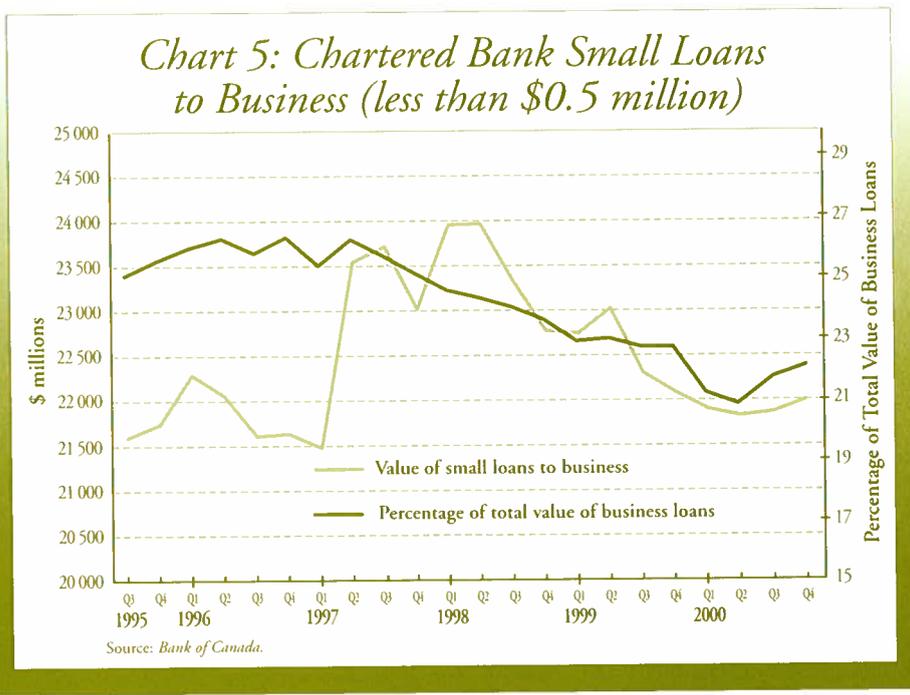
Source: Industry Canada, Office of the Superintendent of Bankruptcy.



BUSINESS *Loans*

Total chartered bank loans outstanding to business reached \$100.3 billion in the fourth quarter of 2000. Of this amount, 21.9 percent, or \$22 billion, was for loans of less than \$500 000.

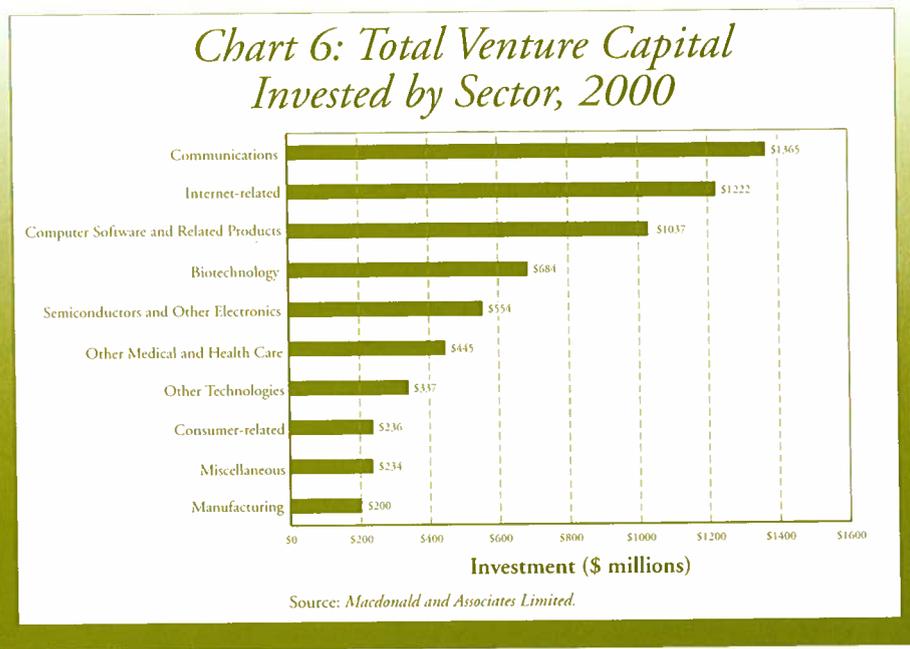
Chart 5 illustrates that small loans, as a percentage of the total dollar value of chartered bank loans to businesses, increased by one percentage point between the second and the fourth quarter of 2000. However, taking the longer view, the value of small loans has lost ground since 1997, with a decline of 4.4 percentage points between the second quarter of 1997 and the fourth quarter of 2000. The total value of small loans also declined during this period, from \$23.5 billion to \$22 billion.



EQUITY *Financing*

As highlighted in the feature story, the level of venture capital investment in 2000 showed extraordinary growth over 1999. Technology was the industry of choice for venture capitalists, specifically the communications, Internet-related, and computer software and related products sectors, comprising 22 percent, 19 percent and 16 percent of total dollar value invested respectively.

Communications companies witnessed 149 rounds of financing in 2000, totalling almost \$1.4 billion (see Chart 6) or an average of \$9.2 million per round. The amount of



investment that flowed into this sector increased almost fourfold from its 1999 level. Within the communications sector, fibre optics and photonics received the largest share, accounting for 27 percent of the total.

Companies with an Internet focus received 203 rounds, totalling \$1.2 billion or an average of \$6 million per round.

The computer software and related products sector registered 257 rounds, capturing \$1 billion, resulting in an average investment of \$3.9 million.

RECENT *Developments*

Results of the Small Business Needs Assessment Survey

In January 2001, the Small Business Policy Branch commissioned COMPAS Research to conduct a survey of owners and managers of small businesses (under 100 employees) in Canada. The survey was undertaken to learn more about the information needs of small business, to explore the challenges and opportunities facing them, and to identify their main sources of information and preferred delivery methods. In total, 1000 interviews were conducted. Here are some highlights from the report:

- *Challenges:* Employee-related issues (hiring, training, retaining), followed by regulations and access to capital.
- *Source of information:* Eighty-eight percent of those surveyed identified informal sources (their clients and colleagues) as the most important source while 50 percent identified banks, associations and the media as important sources.
- *Awareness:* Two thirds of small business owners and managers know where to go to get information to address challenges.
- *Types of information sought:* Information on sectors, innovation, management skills and trends.
- *Internet use:* Almost half of small businesses report they do not use the Internet at all for their business and half of the rest report minimal use.
- *Information preference:* Almost 80 percent of respondents prefer to receive information in printed form rather than electronically.

The full report is available at <http://strategis.ic.gc.ca/SSG/rd00081e.html>

A Business Case Framework for Small Firms Making the Transition to E-Business

Last November, the Small Business Policy Branch commissioned Service-Growth Consultants Inc. to determine how to calculate the costs and benefits to small business of a change-over to e-business.

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ECONOMIC *Snapshot*

Data as of May 4, 2001

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The bank rate... was lowered 25 basis points by the Bank of Canada on April 17, following a 50-basis point cut on March 6, and a 25-basis point cut in January. The moves have followed aggressive cuts in the U.S. federal funds rate in response to a slowing U.S. economy.

The Canadian dollar... has fallen against the U.S. dollar in the early months of the year, reaching a 2 1/2 year low of US\$0.633 on April 2nd before rising to US\$0.651 at the end of April. Movements in the dollar reflect increased concerns and uncertainty surrounding world economic prospects.

Merchandising exports... edged up 1.0 percent in the fourth quarter in real terms, as cooling U.S. demand led to the third consecutive decline in auto exports. As imports fell significantly (-9.8 percent), Canada's *real* trade surplus rose sharply, contributing to Canada's fourth consecutive surplus on the current account (\$5.9 billion) in the fourth quarter. The annual surplus for the year 2000 as a whole reached a record \$18.9 billion, well above the previous annual high of \$4.6 billion posted in 1996. Merchandise exports have fallen in the first two months of 2001.

Housing investment... weakened in the fourth quarter of 2000, largely owing to a drop in new housing construction. However, resale activity picked up in the first quarter of 2001, as sales rose to their highest quarterly level since 1996. Housing starts experienced a pick-up in January, but declined in the two subsequent months. Housing starts are expected to reach 158 600 units this year, up 4.6 percent from their 2000 level, according to Canada Mortgage and Housing Corporation.

Retail sales... fell 0.3 percent in February to \$23.6 billion after advancing rapidly in the previous two months. Consumer spending rose an annualized 2.3 percent in the fourth quarter, down from an average growth of 4.3 percent since the beginning of 1999. Sales have weakened as consumer confidence has been affected by stock market volatility and the weakening U.S. economy.

Corporate profits... continue to rise, advancing 10.4 percent (annual rate) in the fourth quarter. Corporate operating profits surged 21.2 percent in 2000, building on a similar advance in 1999.

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The paper "A Business Case Framework for Small Firms Transitioning to E-Business" is a starting point for policy analysts and for small business owners to help answer questions such as, Under what conditions should small businesses reposition as e-businesses? If a business is already successful, why invest resources in making that transition? What are the implications for small businesses if they continue with "business as usual"?

The paper shows how various functions (such as e-mail, Web presence, on-line order taking) are linked to specific technologies such as a Web site, Intranet and Extranet. Similarly, strategic objectives are associated with the potential gains and cost savings a small firm may achieve. The comparative costs of engaging or not engaging in e-business are also set out. Tools to calculate benefits and costs are provided. The study concludes with an illustration of three hypothetical business cases of making the transition to e-business (assuming 4, 10 and 15 employees) using the tools developed in the paper.

The full report is available at
<http://strategis.ic.gc.ca/SSG/rd00099e.html>

SMEs, Exports and Job Creation: A Firm-level Analysis

Industry Canada recently released Occasional Paper 26, *SMEs, Exports and Job Creation: A Firm-level Analysis* by Élisabeth Lefebvre and Louis A. Lefebvre of CIRANO and École Polytechnique de Montréal.

The paper focuses on the importance of firm-specific factors for the export performance of small and medium-sized enterprises (SMEs), and investigates the role of export activities in job creation by SMEs. Key findings of the research are:

- The most important determinants of export performance in SMEs are R&D, access to distribution channels, the proportion of scientists and engineers in the work force, volume of imports and firm size.
- SMEs experiencing export expansion are more likely to have increased employment. This relationship is stronger in small firms than in medium-sized firms, but weaker for firms in industries with higher levels of R&D and human capital than in industries with lower levels of R&D and human capital.

This paper is part of the Industry Canada Research Publications Program and is now available at <http://strategis.ic.gc.ca/SSG/ra01789e.html>

Small Business Quarterly Small Business Policy 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 Policy Branch of Industry Canada.

Please send your comments to the editor:

Prichya Sethchindapong
E-mail: sethchindapong.prichya@ic.gc.ca

Small Business Policy Branch
Industry Canada
235 Queen Street
Ottawa ON K1A 0H5
Tel.: (613) 954-5494
Fax: (613) 954-5492

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