

## 2009 SME Check-up – Surviving the Crisis

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It has been an extraordinary year. The reality of the economic crisis has been staggering. The financial position of more than half of SMEs has experienced a downturn in terms of revenue and profitability (AMEX, April 2009). Many were taken completely by surprise. In June 2008, 41% expected stronger performance in the coming year. Yet looking back only 20% could actually claim to have achieved these expectations (CFIB).

Cash flow and sales revenue were identified as being hardest hit. (Scotiabank, June 2009) And it is not over. Even now many businesses continue to experience worsening conditions. Nearly half (47%) indicate that they are performing worse than they were just three months earlier. (CFIB, June 2009)

The economic crisis is pervasive, not only affecting businesses but investors as well. Business performance has been especially limited by the current climate for investment. This is in marked contrast to the top business barrier cited by entrepreneurs in 2008: energy costs.

### Top Barriers Identified to Business Growth

Q1 2008	Q1 2009
1. Energy Costs (71%)	Climate for Investment (55%)
2. Product Input Prices (47%)	Product Input Prices (47%)
3. Wage Costs (41%)	Customer Demand (41%)

CFIB (March 2009, March 2008)

Without investment or clients it is no surprise that SME employment growth has stalled. Typically, Canadian small and medium sized businesses account for half of the net new jobs created in Canada. By the end of 2008 the sector barely accounted for 1 in 5 jobs created. Particularly hard hit were businesses in the 50 to 99 and 100 to 499 employee-size ranges.

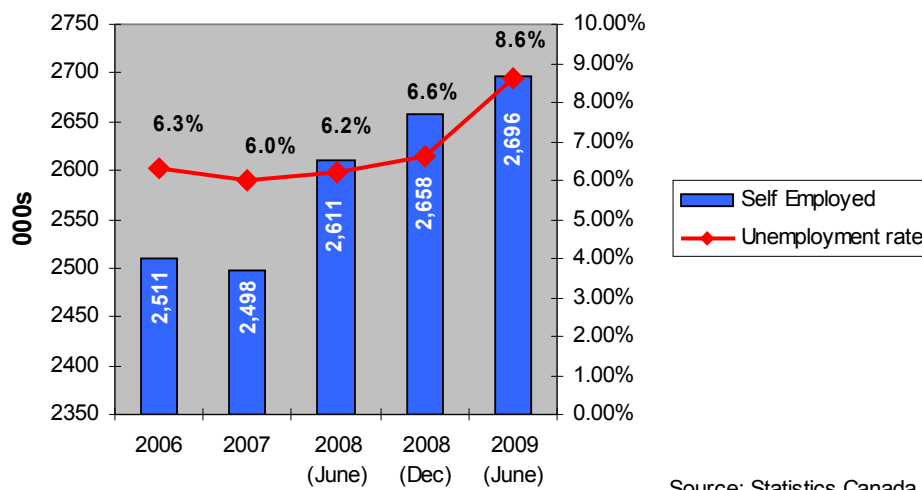
**% Contribution to Total Net Change (Number of Employees)**

	Jobs	0–4	5–19	20–49	50–99	100–499	500+
Q4 2007	366 758	-1.2	16.9	11.1	7.1	14.0	52.1
Q1 2008	298 728	4.4	14.3	11.2	10.2	9.7	50.2
Q2 2008	301 763	6.9	9.7	11.6	9.7	12.7	49.4
Q3 2008	232 081	2.8	1.9	11	11.4	13.6	59.4
Q4 2008	142 488	-1.1	7.5	6.2	3.7	5.4	78.3

Source: Statistics Canada, Survey of Employment, Payrolls and Hours, March 2009

Without the employment engine of the SME sector, unemployment rates in Canada have risen rapidly over the last year. As is often the case however, higher unemployment rates have actually spurred entrepreneurial activity. Self-employment has reached new heights with nearly 2.7 million Canadians now identifying themselves as being their own boss. It is true that many of these new business owners were forced into entrepreneurship but this should not be considered a flood of weak ventures. According to a CIBC study “forced” entrepreneurs are just as likely to succeed and grow as those who voluntarily launched their own business. This rise in self-employment is a much-needed surge of new energy and innovation.

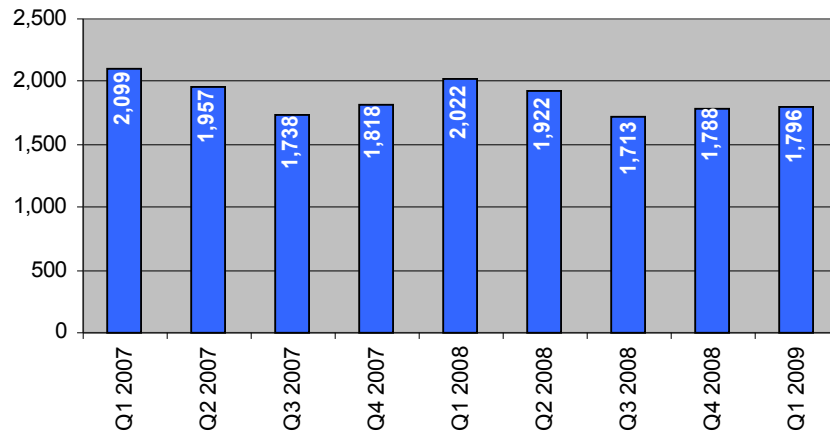
**Forced Self-Employment in Canada**



Source: Statistics Canada

While the SME sector has been battered, it is definitely not beaten. Canadian SMEs are determined to survive the current economic crisis. Insolvency statistics for the Q4 2008 and Q1 2009 are lower than they were at the beginning of 2008 and 2007. For most, regardless of the severity of the economy, bankruptcy is not an option they want to consider.

**Total Business Insolvencies in Canada  
(Proposals & Bankruptcies)**

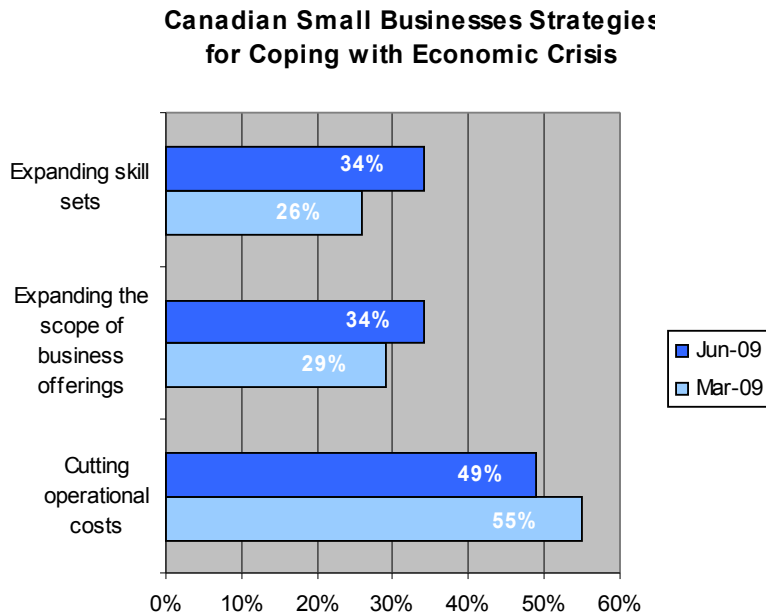


Source: Office of the Superintendent of Bankruptcy Canada

## COPING WITH THE CRISIS

Canadian small businesses are doing everything they can to stay open. The resilience of SMEs in exceptional economic conditions is in part due to the agility of the sector to adjust strategies based on changing opportunities. According to the STAPLES Canada Small Business National Quarterly Confidence Index, 55% of businesses in March 2009 were cutting operational costs to cope with economic conditions, yet three months later there is evidence of a change in strategy. In June 2009 there was a 6-point drop in businesses citing this approach. Instead they are now

beginning to turn their attention to business building activities such as expanding their skill sets and the scope of their business offerings.

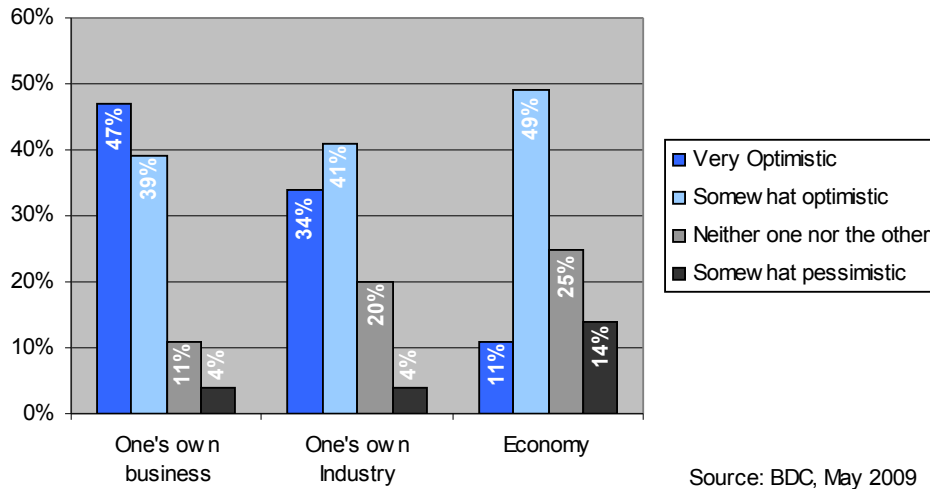


Source: STAPLES/ Angus Reid Strategies

The strength of Canadian entrepreneurs lies in their confidence in their own abilities. Little heed is paid to media hyperbole. In an October 2008 AMEX Ipsos Reid survey, 64% felt 'wary and cautious' about current economic conditions, yet more than three quarters (77%) still said they planned to "stay the course" during these uncertain times. Few planned dramatic changes in how they ran their business. In fact only 16% worried about short-term viability.

Canadian entrepreneurs are very optimistic about the future performance of their own business (BDC May 2009). Nearly half are very optimistic. They know their strengths and options and what needs to be done. They are less confident however about what is beyond their direct control. Optimism is not as robust for their own industry sector and even less so for the economy as a whole.

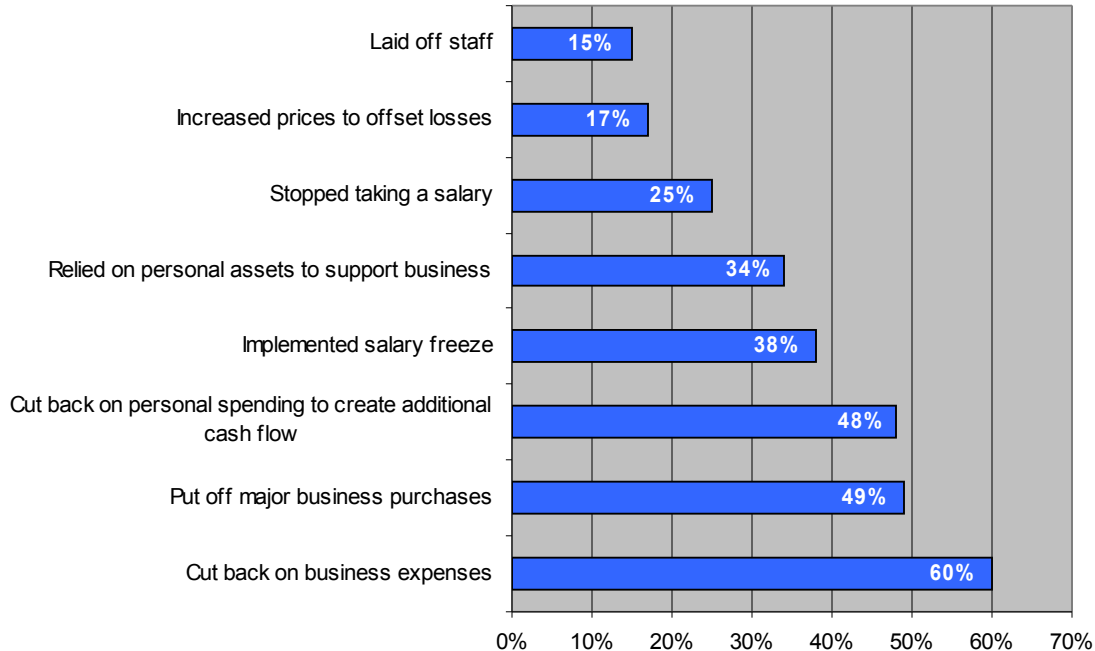
**Canadian SME Optimism for Future Performance**



Canadian entrepreneurs are so confident in their businesses that they willingly make what they consider to be short-term personal sacrifices to survive. According to the American Express Small Business Monitor (April, 2009) nearly half (48%) have cut back on personal spending to create additional cash flow flexibility. One in four have stopped taking a salary and a third (34%) have relied on their personal assets to support the business.

These personal sacrifices have been made to spare hardship for both their employees and their customers. Only 15% have laid off staff and only 17% have increased prices to offset losses. In fact, 30% are continuing the practice of giving out bonus cheques to deserving employees, and 28% are authorizing pay raises to those who deserve it. For Canadian entrepreneurs the well-being of their employees and customers come first. They understand that when the economy turns, these resources will propel future growth.

### Actions taken by Small Businesses to Cope with Economic Crisis



Source: American Express Small Business Monitor (April 2009)

The burden incurred by entrepreneurs is not only financial. In a separate survey, more than half of self-employed Canadians feel their stress level is higher now compared to a year ago. (Desjardin Financial Security, April 2009) Overall, two-thirds (67%) indicate they have been stressed out by the state of the economy in particular. Seven in ten are worried specifically about pension and retirement finances. (AMEX, April 2009)

Time is also a resource Canadian entrepreneurs especially women entrepreneurs are willing to sacrifice to beat the current challenges. Eight out of ten women entrepreneurs said that "committing extra time" in their business is the most important way of coping with difficulties and challenges. (Angus Reid, Dec 2008)

Some entrepreneurs have also sacrificed their retirement or at least postponed it. 37% of Canadian boomers who plan on retiring in the next five years and who have their own business, plan on delaying their retirement due to current economic conditions. Of course entrepreneurship

is not just a job. It is a lifestyle. One-third (32%) of retiring boomer business owners, say they will never fully retire recession or not! (RBC February 18, 2009)

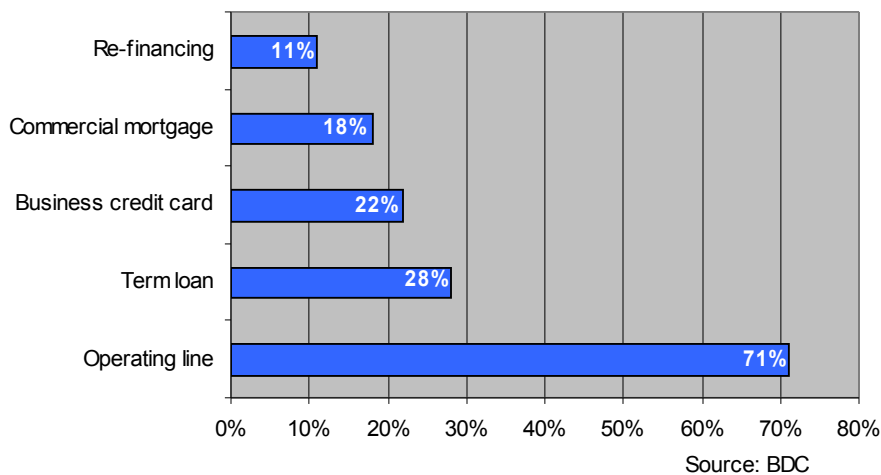
While many might consider these sacrifices severe, and therefore key reasons for not wanting to start one's own business, entrepreneurs consider all these actions to be short-term pain. Nearly all small business owners (91%) still believe the rewards and opportunities of running their own business outweigh the risks and challenges. When asked if they would do it all over again, 93% said YES! (AMEX, April 2009)

### SME CREDIT CRISIS

SMEs have consistently identified "tightening credit" as the top factor that might negatively affect business growth in the near future (next 12 months). As the recession has deepened, there is a debate on whether or not financial institutions have squeezed off credit flow to SMEs. Access to credit is vital to the success of the sector. One quarter of respondents (25%) acknowledge that their company will have serious problems in the near future if they don't have access to credit or loans for their day-to-day needs. (Amex, Nov 2008).

The most common type of financing sought is an operating line of credit (71%), followed by a term loan (28%).

**Types of Financing Sought by Canadian SME:**



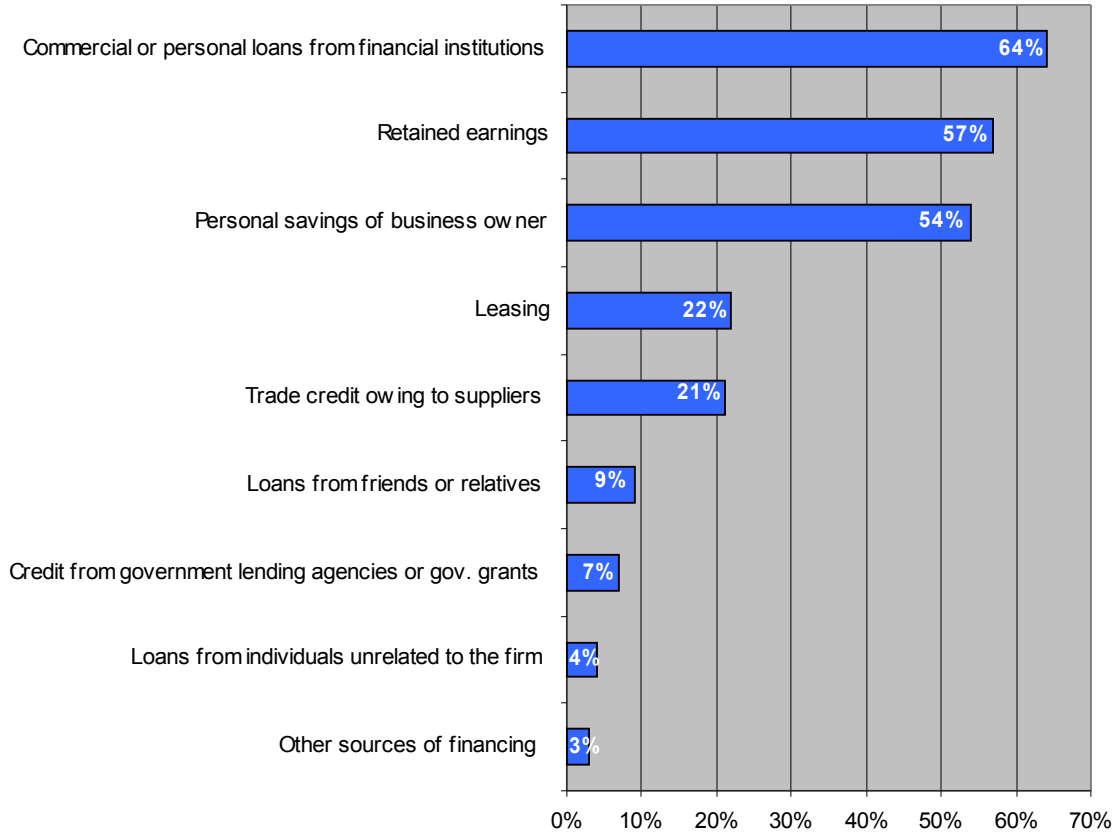
SMEs seek credit primarily for working capital/operating capital such as inventory or paying suppliers (45%). This is followed by credit for funding business growth (36%) and for funding “other machinery and equipment” purchases (32%).

In addition to business debt, entrepreneurs have personal debt concerns. Compared to the general population, the self-employed tend to carry a heavier burden. The vast majority of Canadians (85%) have a non-mortgage debt load of less than \$25K. Only half of self-employed Canadians fall into this lowest debt category. In fact they are four times more likely than the average Canadian (21% vs. 5%) to report debt loads in the highest (\$50K+) category. (Desjardins Financial Security, 2009) In a credit crisis, entrepreneurs are exposed on both sides: personal and business.

Traditional financial institutions remain the top credit source for SMEs. This is likely due more to convenience than anything else. Most businesses are not very aggressive in searching for credit. Many simply use their current financial institution without consulting other sources. In fact business owners typically only approach one lending source when seeking credit. Only 11% actually shop around comparing three or more lenders.

The top finance tools used to keep businesses in operation are commercial or personal loans from financial institutions, retained savings and personal savings of the business owner.

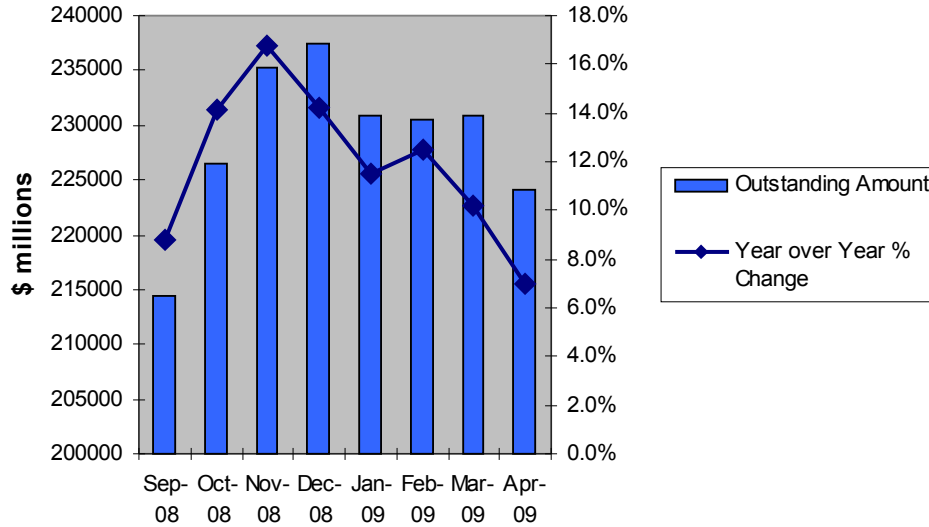
**Sources of Finance Used to Keep Business in Operation**



Source: BDC, May 2009

According to the Bank of Canada credit to Canadian businesses has flowed with a degree of certainty over the first eight months of the crisis. In April however there was a significant drop in year over year growth. The banking sector states that this drop is to be expected as deteriorating business conditions have depressed the demand for investment funding and that it is not an indication of tightening credit.

**Business Loans by Canadian Banks**



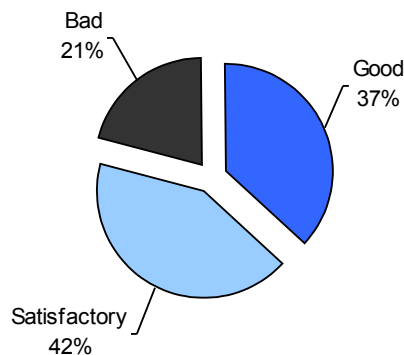
	Outstanding Amount (Millions)	Year over Year % Change
Sep-08	214,416	8.8%
Oct-08	226,561	14.1%
Nov-08	235,267	16.8%
Dec-08	237,523	14.2%
Jan-09	230,895	11.5%
Feb-09	230,488	12.5%
Mar-09	230,921	10.2%
Apr-09	224,175	7.0%

Canadian SMEs have a different point of view. A BDC survey in May 2009 found that 39% of businesses had directly experienced a tightening of credit since the beginning of the current economic crisis and 17% of businesses already identify access to credit as an obstacle to business growth. Of the 46% that recently sought financing for their business, only one third obtained the funding.

## SME OUTLOOK

Of course the trillion-dollar question right now is what does the future hold and how long will this recession last? In June 2009, Canadian SMEs were still hesitant about the future. The sector is nearly split 50-50 on their overall expected performance for the next three months. The balance of opinion on specific indicators though is clearly negative with the net expectations for inventories (-20%), new orders (-27) and staff overtime (-39%) all being pessimistic. Despite these concerns, most entrepreneurs still consider the condition of their business to be satisfactory or good.

### Condition of Own Business

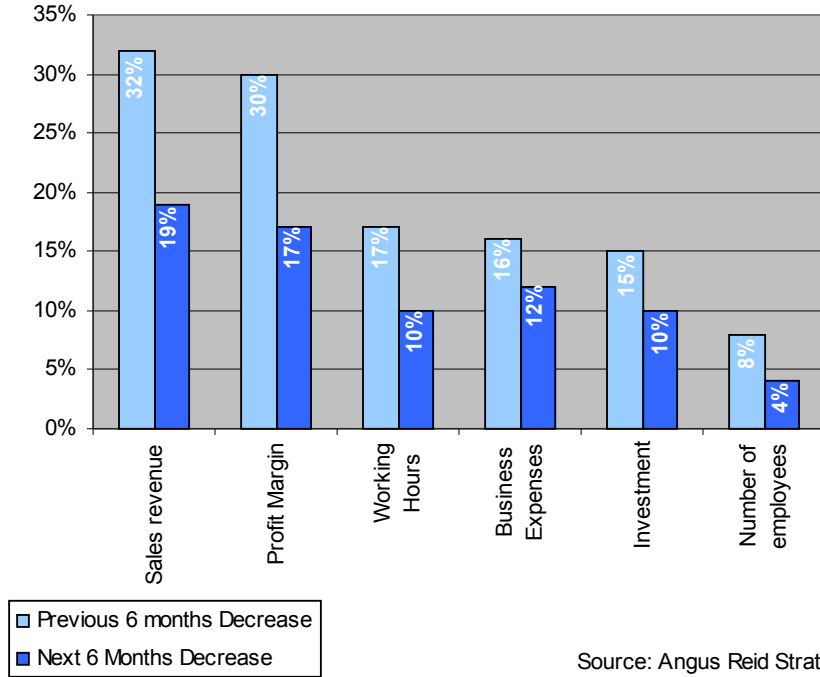


Source: CFIB June 2009

Beyond the next three months, SMEs are starting to show signs of cautious optimism. In a separate survey by Angus Reid Strategies (June 2009) the majority (58%) described themselves as moderately optimistic about the second half of 2009.

The bleeding is expected to stop, especially in the areas of sales revenue and profit margin. In the first half of 2009 nearly a third of SMEs experienced a drop in these areas. Yet less than 20% expect negative performance for the remainder of the year.

**Negative Performance Indicators  
Experience & Expectations of SMEs (June 2009)**



Source: Angus Reid Strategies

The majority of businesses expect performance in all areas to stay the same for the next 6 months. The worst of the storm appears to be over and for now SMEs are content to “hold steady to the course”.

**SME Performance Expectations for Next 6 Months**

	Increase	Stayed the Same	Decrease
Sales revenue	39%	37%	19%
Profit Margin	29%	50%	17%
Working Hours	32%	55%	10%
Business Expenses	21%	63%	12%
Investment	14%	68%	10%
Number of employees	9%	84%	4%

Source: Angus Reid Strategies (June 2009)

The current crisis is testing the mettle of Canadian entrepreneurs. The long-term effect will be debated for years and full recovery to pre-crisis performance levels will be a slow process. For now though SMEs are focused on surviving to the next quarter without compromising their future.