



## The Economic Benefits of Encouraging Small Businesses to Grow

### Highlights

- Small businesses, including self-employed owner-operators with no paid employees, account for 98% of all businesses in BC. Of the 385,900 small businesses in the province in 2012, 216,800 were owner-operators with no paid personnel, while 169,100 had between 1 and 49 employees on the payroll.
- BC has only 6,900 “large” businesses – defined as those that employ more than 50 people. The Business Council estimates that 600-700 firms in BC have more than 500 employees.
- Most small businesses don’t grow, and many disappear over time. Research confirms that the very small proportion of businesses which expand rapidly account for a surprisingly large share of net job creation at the economy-wide level. In the US, the fastest growing 1% of businesses are responsible for two-fifths of overall job creation, while the fastest growing 5% account for two-thirds of all net new jobs.
- On average, larger enterprises are more productive than smaller firms, as measured by value added and productivity per worker. They also pay their employees more and are more likely to export beyond local markets.
- Developing a more prosperous BC economy depends on creating an environment in which more small businesses evolve to become medium-sized and large enterprises. Government taxation, regulatory and industrial policies should put a higher priority on establishing conditions that encourage and reward highly innovative and growth-oriented businesses.

The role of small businesses necessarily features prominently in any discussion of the British Columbia economy. Indeed, it is no exaggeration to say that an orientation toward small businesses is a defining characteristic of the province’s private sector. In some respects the same can be said of Canada as a whole: as a jurisdiction, Canada is known as a good place for business start-ups and early stage entrepreneurial activity, a point emphasized in numerous international surveys and analytical reports.<sup>1</sup>

<sup>1</sup> World Bank, Doing Business 2010: Reforming Through Difficult Times (2010). Available at

This issue of Policy Perspectives is concerned with small businesses in British Columbia – and more specifically, with the importance of fostering growth among more of these enterprises as an explicit goal of public policy. The focus on growth reflects the reality that the expansion of business production and payrolls is far from being the norm for firms operating in our economy. In fact, the vast majority of small businesses don’t grow, and relatively few

[www.doingbusiness.org](http://www.doingbusiness.org); Alexandra Bibbee, “Unleashing Business Innovation in Canada,” OECD Economics Department Working Papers No. 997, October 2012.

ever graduate to the point where they become medium-sized or “big” companies. There is also a high mortality rate among start-up businesses: in Canada, around half disappear within five years of being established.<sup>2</sup>

Overall, the small enterprise sector in BC – as in the country as a whole – is dynamic, highly competitive, and populated by many hard-working owner-operators. The sector is also characterized by widespread churn, as many firms enter and exit the marketplace every year. In Canada, approximately 100,000 new businesses were created every year between 2002 and 2010, while “exits” averaged about 90,000 per year.<sup>3</sup> In each case, British Columbia supplied 12-13% of the national totals. With so many entries and exits, the small business sector creates a lot of jobs – but this is accompanied by a significant amount of job destruction.

### **A Snapshot of Small Businesses in BC**

The 2013 Small Business Profile, an annual publication produced by the BC government, provides information on the number and distribution of businesses in the province.<sup>4</sup> The government defines “small businesses” as enterprises with fewer than 50 paid employees, as well as the self-employed – both unincorporated and incorporated – who operate their businesses with no paid help. Firms with 50 or more paid workers are classified as

“large” enterprises in the BC Small Business Profile report.

Parenthetically, it should be noted that the Canadian government and many non-governmental researchers use different cut-off points for determining firm size. Federal government reports typically define small businesses as those having fewer than 100 paid employees, while medium-sized firms have 100-499 employees and large ones have 500 or more.<sup>5</sup> Treatment of the self-employed – including the extent to which they are even counted as small businesses –

**Table 1**  
**Breakdown of Businesses**  
**in British Columbia, 2012**

	Number of <u>Businesses</u>	Per cent <u>of Total</u>
Total small businesses	385,900	98%
Self-employed		
without paid help*	216,800	55%
Businesses with less		
than 50 employees	169,100	43%
Total large businesses	6,900	2%
Total all businesses	392,800	100%

\* Incorporated self-employed are not included in this figure in order to avoid double-counting, since they are already included in the count of businesses with fewer than 50 employees.

Source: BC Stats using data supplied by Statistics Canada.

<sup>5</sup> See for example Industry Canada, Key Small Business Statistics, July 2012; [www.ic.gc.ca/sbstatistics](http://www.ic.gc.ca/sbstatistics). Some federal government reports and analytical papers exclude self-employed businesses with no paid employees from the category of small businesses. That is not the approach taken by the BC government. British Columbia generally counts the self-employed as small businesses, regardless of whether they have any paid workers, perhaps because the self-employed are so numerous in the province.

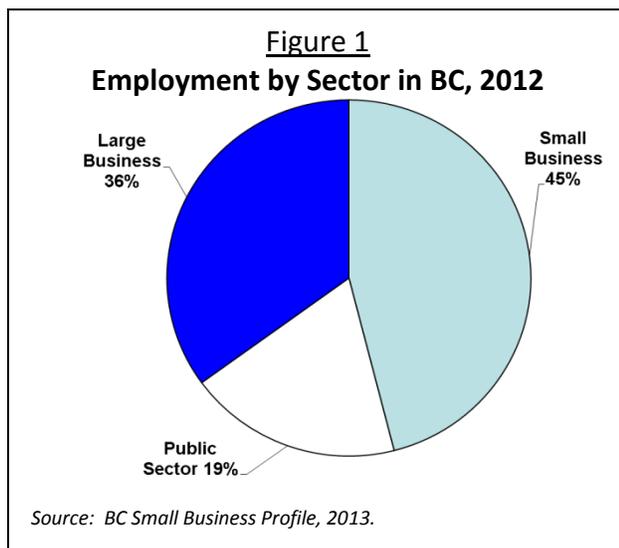
<sup>2</sup> Industry Canada, Key Small Business Statistics, July 2012, p. 14; [www.ic.gc.ca/sbstatistics](http://www.ic.gc.ca/sbstatistics).

<sup>3</sup> *Ibid.*, p. 12.

<sup>4</sup> BC Stats and Ministry of Jobs, Tourism and Skills Training, Small Business Profile, 2013. Available at [www.resourcecentre.gov.bc.ca/pdf/SB\\_Profile\\_2013.pdf](http://www.resourcecentre.gov.bc.ca/pdf/SB_Profile_2013.pdf).

also varies in the studies produced by government agencies and academic researchers. Some Industry Canada and Business Development Bank of Canada reports calibrate firm size on the basis of annual revenues, exports, or even balance sheet indicators, rather than the number of employees. Other developed countries and international economic agencies have adopted their own frameworks for categorizing business enterprises by size. All of this can make cross-jurisdictional comparisons somewhat challenging.

Table 1 summarizes a few top-line findings of the latest BC Small Business Profile report. In 2012, there were 392,800 businesses in British Columbia, of which 98% had fewer than 50 employees and thus were classified as “small”. A substantial majority of these are self-employed individual operators/proprietors with no paid staff. Fully 82% of small businesses in BC have fewer than five employees – these are often referred to as “micro” businesses. About 13,200 BC firms (3% of all businesses) employ between 20 and 49 workers.



In 2012, only 6,900 enterprises in British Columbia directly employed 50 or more people; this is up slightly from the year before. Firms with 50 or more employees can be further divided into “medium-sized” and what can be described as truly “large” enterprises. More than 80% of the businesses falling into these two categories combined have between 50 and 250 workers. The Business Council of BC estimates that 600-700 private sector enterprises in the province have more than 500 employees on their direct payrolls.

Figure 1 shows the distribution of employment in the province as of 2012. Enterprises with 50 or more employees (“large businesses,” as defined by the Small Business Profile report) were responsible for 36% of all jobs, small businesses (including the self-employed) for 45%, and the public sector for about one-fifth of the total. Some 1.87 million British Columbians earn their livelihood in the broadly defined private sector. “Large” enterprises (50 or more paid workers as defined by the BC government) directly support 45% of these private sector jobs, while small businesses with paid employees are responsible for one-third. Some 22% of private sector jobs in BC are supplied by self-employed individuals without any paid help. Some of these are “professionals” – e.g., lawyers, accountants, physicians, dentists, veterinarians, financial planners – while others run tiny (often home-based) businesses in areas like home cleaning, home renovation, appliance and electronic repair, consulting, export/import, landscaping, hairdressing, etc. Many artists, writers, researchers, and child care providers are also found among the burgeoning ranks of BC’s self-employed.

Over the past decade, the number of business operators with paid employees grew only one-third as fast as the number with no paid staff. This suggests that a substantial amount of net private sector job creation is actually occurring in one-person “businesses,” most of which aren’t likely to expand (if they survive). This trend, if it persists, may have wider economic consequences: because the self-employed, on average, earn less than paid workers, sustained growth in the number of self-employed is apt to exert a dampening effect on household income (even though some of the self-employed do enjoy high incomes).

Looking just at firms with paid workers, medium- and large-sized companies (50 or more workers) together employed significantly more British Columbians (838,900 as of 2012) than their smaller counterparts (614,100). Across Canada, the proportion of total employment in the small business sector has fallen since the 2008-09 recession.<sup>6</sup> Thus, the frequently-cited claim that micro and other small businesses are responsible for most private sector jobs, and for almost all net job creation, is incorrect. In a growing economy, all size categories of businesses tend to be adding jobs over time.

### **Small Business, Fast-Growing Firms, and Employment**

In the United States, the pioneering work of Birch and his collaborators in the 1980s and early 1990s cast a spotlight on the central role of the subset of fast-growing firms – “gazelles” was the term he used – in driving job creation within the private sector

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<sup>6</sup> *Ibid.*, p. 9.

economy.<sup>7</sup> More recent research reinforces this finding. A detailed study by the Kauffman Foundation estimates that, in a typical year, the top-performing 5% of all American businesses – measured by their rate of employment growth – generate two-thirds of new jobs in the economy. And the top 1% of firms is responsible for an astonishing 40% of net job creation.<sup>8</sup> Thus, a relative handful of US companies account for a markedly disproportionate share of employment growth at the economy-wide level.

Turning to Canada, a recent Industry Canada paper explored the issue of fast-growing firms in a national context. The authors determined that 4% of all Canadian businesses could be classified as “high growth,” as measured by their increases in employment. Specifically, such firms had to be adding jobs by at least 20% a year over a consecutive three-year period to be defined as high-growth. On this basis, only 0.5%-1.0% of Canadian firms grew fast enough to qualify as “gazelles.”<sup>9</sup>

Rapidly growing businesses are critical to job creation and economic dynamism. This

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<sup>7</sup> D. Birch, “Change, Innovation and Job Generation,” *Journal of Labor Research*, volume 10, number 1 (1989), pp. 33-39; D. Birch and J. Medoff, “Gazelles,” in L.C. Solomon and A. R. Levenson, eds., *Labor Markets, Employment Policy and Job Creation*, Westview Press, 1994.

<sup>8</sup> Dane Stangler, *High Growth Firms and the Future of the American Economy*, Kauffman Foundation Research Series: Firm Formation and Economic Growth (March 2010). Available from: [www.kauffman.org](http://www.kauffman.org).

<sup>9</sup> Industry Canada, *The State of Entrepreneurship in Canada* (February 2010). Report compiled for Industry Canada by Eileen Fisher and Rebecca Reuber. Available from: [www.ic.gc.ca](http://www.ic.gc.ca).

small subset of firms plays an important role in innovation by introducing new products, processes and business models. Fast-growing firms also contribute significantly to industrial change and the re-allocation of resources (labour and capital) across economic sectors.

Industry Canada research, like that produced by the Kauffman Foundation in the US, casts doubt on the notion that small businesses are always and everywhere the predominant source of employment growth. Looking at the period 2001-2011, what Industry Canada defines as large enterprises (500 plus employees) as a group created more jobs than either small or medium-sized firms from 2003 to 2008; small firms led the way in 2001-2002, and again in 2010.<sup>10</sup> Over the entire period, small companies supplied 43% of all new private sector jobs. A majority of Canadian small businesses did not create any new jobs – and a sizable number shed jobs or closed down – during the period.

### **It's Not Just About Jobs**

While media reports and government news releases commenting on small business issues tend to focus on jobs, the economic impact of smaller enterprises extends well beyond the labour market. This section touches briefly on several other measures that help to illuminate the economic contributions of both small enterprises and businesses in general.

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<sup>10</sup> Industry Canada, *Key Small Business Statistics*, July 2012, pp. 21-22. Employment fell across all business size groups in the recession year of 2009.

### ***GDP/Value Added***

In BC, businesses with 0-49 paid workers accounted for 26% of output or real gross domestic product (GDP) in 2012. This is slightly higher than the figure for Canada (25%).<sup>11</sup> Using a different definition of small businesses – firms with 1 to 100 paid employees – Industry Canada estimated that such enterprises collectively were responsible for 31% of the country's GDP in the mid-2000s.

Data assembled by the OECD indicate that in most advanced economies, larger firms – specifically those with 250 or more employees – produce 40-56% of private sector “value-added,” which is the difference between the value of firms' output and their consumption of intermediate inputs. Across the higher-income OECD countries, there is also considerable variation in the proportions of value-added attributable to small businesses (fewer than 50 employees): from 22% in Japan to 31-32% in Germany and the UK, to more than 40% in Spain, France and Belgium.<sup>12</sup>

On a per worker basis, value-added tends to climb in tandem with number of employees in a business establishment, meaning that workers are often more productive when they are attached to larger enterprises. Several factors can help to explain this pattern. One is that bigger firms generally have better educated and more highly skilled workforces. Another is that they

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<sup>11</sup> *Small Business Profile 2013*, p. 20.

<sup>12</sup> OECD, *Entrepreneurship at a Glance 2012*, [http://www.oecd-ilibrary.org/industry-and-services/entrepreneurship-at-a-glance-2012\\_entrepreneur\\_aag-2012-en](http://www.oecd-ilibrary.org/industry-and-services/entrepreneurship-at-a-glance-2012_entrepreneur_aag-2012-en).

typically have a higher ratio of capital per employee, compared to micro- and other smaller firms. Bigger firms also invest more in worker training and skill upgrading. Other factors that may tend to boost value-added per employee as firm size expands include longer production runs (allowing fixed costs to be spread over more output), increased specialization of tasks, a greater propensity to sell outside of local markets, readier access to sources of finance, and better educated and more experienced managers.<sup>13</sup>

### ***Wages/benefits***

Because there is a positive relationship between both value-added per employee and labour productivity, on the one hand, and plant or establishment size, on the other, it should come as no surprise that, on average, a similar relationship exists between firm size and worker compensation.

National data collected by Industry Canada and summarized in Table 2 show that employees of businesses with fewer than 50 and 100 workers had weekly earnings below the economy-wide average of \$852 in 2011; earnings were also below the average for some employees at firms classified as medium-sized. In contrast, employees of larger enterprises receive compensation that is comfortably above the private sector average.<sup>14</sup> Larger firms are also more likely to provide access to retirement, extended health, and other

benefits that may significantly increase overall employee compensation. Most small businesses – understandably – have neither the financial nor the organizational capacity to offer more than quite modest non-wage benefits (beyond what is required by law).<sup>15</sup>

Number of Employees	Earnings
0-4	\$789
5-19	\$727
20-49	\$771
50-99	\$793
All “small” firms (avg)	\$763
100-299	\$865
300-499	\$742
All medium sized	\$832
500 or more	\$941

Source: Industry Canada, *Key Small Business Facts*, July 2012.

Does the broad Canadian compensation picture sketched above apply to British Columbia? Yes: “On average, large businesses [in BC] traditionally have paid their employees more compared to small businesses.”<sup>16</sup> The lower average wages in the small business sector, in turn, produce smaller annual earnings. In 2012, the average full-time equivalent small business worker in BC pulled down an annual salary of \$39,210, compared to \$48,318 for employees of “larger” businesses (50 or

<sup>13</sup> Institute for Competitiveness and Productivity, *Small Business, Entrepreneurship and Innovation*, Working Paper 15, February 2012; [www.competeprosper.ca](http://www.competeprosper.ca).

<sup>14</sup> Industry Canada, *Key Small Business Statistics*, July 2012, pp. 25-6.

<sup>15</sup> That said, some small firms may compensate for lower pay/benefits by providing more flexible work-time arrangements, greater employee learning opportunities, and/or a higher quality work environment.

<sup>16</sup> *Small Business Profile, 2013*, p. 21.

more workers), a gap of some \$9,100 per worker.<sup>17</sup> Unfortunately, the BC data don't permit a more refined breakdown of earnings by firm size (e.g., 1 to 4 employees, 50 to 250 employees, 500 plus employees, etc.). But based on the national data, it seems reasonable to assume that annual earnings and employee benefits will tend to be better at the biggest companies – i.e., those employing 500 or more workers – although this is by no means a hard-and-fast rule.<sup>18</sup>

What about the growth of worker pay over time? According to the BC government's Small Business Profile, between 2007 and 2012 “the difference between wages of employees of small and large businesses widened somewhat, as average earnings of small business employees increased at less than half the rate than those of their large business counterparts.”<sup>19</sup>

### **Exports**

Cross-national research confirms that as businesses expand, they are more likely to engage in international commercial activity, including exporting. In most advanced economies, at least half of total exports come from enterprises with at least 250 employees.<sup>20</sup> Canada follows the general

OECD pattern in terms of the export orientation of businesses of differing sizes. In 2010, about three-quarters of Canada's merchandise exports came from firms with more than 100 employees. Smaller firms (less than 100 employees) were responsible for one-quarter of the value of the country's exports in that year.<sup>21</sup> Of the latter amount, the bulk of the export sales were made by firms with 50-99 employees (i.e., by “large” companies as defined by the BC government).

The data for British Columbia are only partially consistent with the national story. In 2011, about 6,500 BC companies were engaged in export trade – defined as selling goods to non-Canadian buyers.<sup>22</sup> Some 85% of these firms had fewer than 50 workers. The data suggest that these small firms produced more than 40% of the province's international merchandise exports in 2011.<sup>23</sup> Depressed market prices for lumber and natural gas may have temporarily inflated the share of small business exports in the provincial total, since large companies account for the bulk of BC's natural gas and lumber export sales. Even so, the evidence indicates that enterprises with fewer than 50 employees make a bigger contribution to BC's international exports than is the case for Canada as a whole.

Only 1.4% of BC small businesses are involved in exporting goods to foreign

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<sup>17</sup> It is unclear from the Small Business Profile report whether the annual earnings figures are adjusted to reflect possible differences in average hours worked in small compared to large firms.

<sup>18</sup> In particular, many small and medium-sized enterprises in the broad professional, scientific and technical services sector pay their employees well and rank near the top among all industries in average employee compensation.

<sup>19</sup> Small Business Profile, 2013, p. 21.

<sup>20</sup> OECD, “Selling to Foreign Markets: A Portrait of OECD Exporters,” Statistics Brief No. 16, 2011; <http://www.oecd.org/std/47014723.pdf>.

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<sup>21</sup> Industry Canada, Canadian Small Business Exporters, Special Edition: Key Small Business Statistics, June 2011.

<sup>22</sup> Unfortunately, data on international exports of services and on interprovincial exports of both goods and services are not available by size of firm.

<sup>23</sup> Small Business Profile, 2013, p. 23.

markets. This underscores the fact that exporting is a specialized and fairly unusual activity for small firms. About 30% of small exporters are manufacturers, an industry that has a much greater export propensity than other sectors of the economy. But BC small business exporters are also found in agriculture, mining and other sectors.<sup>24</sup> (Many other small BC firms are involved in exporting services, but service exports are difficult to measure and thus are not captured in the information presented here.) The substantial contribution of smaller firms to BC's export mix is a positive sign, one that suggests there is considerable scope to further increase the involvement of locally-based small and medium-sized enterprises (SMEs) in international markets.

### **Conclusion**

The small business world can be divided into two types of firms: a huge number of "main street" businesses that don't grow much if at all, but collectively employ many people and produce/sell a wide array of needed goods and services in local markets; and a much smaller number of entrepreneurial high-growth firms that expand rapidly and are important sources of job creation, productivity, exports, and innovation. "Main street" businesses are found in many sectors of the economy but are particularly ubiquitous in industries like retail, foodservices, car repair, home renovation, and personal and business services. They are a visible and significant part of the business community, but they are far from being the whole story when it comes to business or job growth.

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<sup>24</sup> Note that the export data cited here do not include interprovincial trade or international exports of services.

A large body of research indicates that growth-oriented SMEs follow a different path. The founders of these firms are often crucial to their ongoing development. Importantly, fast-growing businesses are scattered across many industries – not just in high-technology, software, etc. But the reality is that they represent only a tiny slice of the hundreds of thousands of businesses operating in our economy – certainly less than 5% of all firms with paid help in the case of British Columbia.

Federal and provincial government policy should pay greater attention to this subset of striving, growth-oriented firms. Policy-makers need to look for ways to encourage and support entrepreneurs and enterprises that are ambitious to expand production, to export, and to innovate. They should be less concerned with promoting small businesses and self-employment in general, and more concerned with enabling the success of the subset of entrepreneurial, high-growth, high-impact firms. As a federal government expert advisory group concluded in 2008:

"Federal and provincial governments' small and medium-sized enterprise policies should focus on those firms that demonstrate the desire and capacity to grow to become large enterprises."<sup>25</sup>

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<sup>25</sup> Competition Policy Review Panel, Competing to Win, Final Report, June 2008, p. 75.