

# **Economics**

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# **Start-ups** — Present and Future

by Benjamin Tal

As of June of this year, more than half a million Canadians were in the process of starting their own business. And almost half of those entrepreneurs will stay in business for more than five years. Regionally, British Columbia has the greatest start-up<sup>1</sup> activity in the nation followed closely by Alberta and Saskatchewan. Looking at the types of businesses that were created, those in the educational, science, health-related and trades have been the most popular sectors for new entrepreneurs.

And this might be just the beginning. Irreversible structural forces suggest that the next decade might see the strongest start-up activity in the Canadian economy on record. The gradual shift to a strong culture of individualism and self-betterment, the role of technology in driving the transition from boardrooms to basements, the more global and interconnected markets that require greater specialization, flexibility and speed, as well as small business friendly demographic trends are among those forces that are likely to support a net creation of 150,000 new businesses in Canada in the coming ten years.

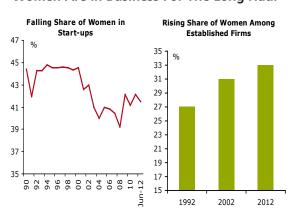
## Choice vs. Necessity

The recent improvement in start-up activity despite a relatively healthy labour market indicates that a significant number of new entrepreneurs chose self-employment as a career rather than being forced to open a business due to a lack of other employment opportunities. We estimate that only 20% of those who started their own business in the past two years can be considered "forced" self-employed. This is notably a lower proportion than observed among those who started their business during the jobless recovery of the mid-1990s and in the early 2000s. With more business owners starting operations by choice, their likelihood of success may increase.

## Women: More Selective

Start-up activity is still dominated by men, who now account for almost 70% of total start-ups. In fact, the share of start-ups run by women fell from 45% in the 1990s and the early 2000s to nearly 40% currently. However, there is more to the story. Among established businesses (non start-ups), the percentage of female entrepreneurs rose from 27% in the early 1990s to the current 33% (Chart 1). This suggests that when

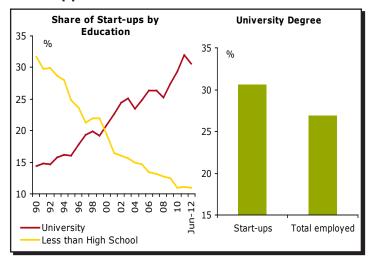
Women Are In Business For The Long Haul



Source: Statistics Canada, CIBC

Chart 2

Start-uppers More Educated



Source: Statistics Canada, CIBC

women decide to start a business, they stay in business longer. In other words, on average, their survival rates are higher.

# **Rising Education Level Among New Entrepreneurs**

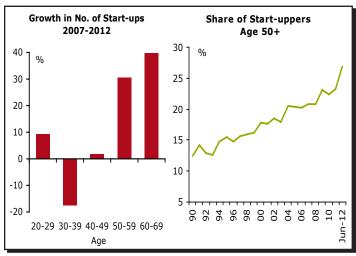
The newly self-employed tend to be more educated. Almost one in three of those who opened up shop in the past two years have a university degree. That is double the rate seen in 1990 and a full five points above the rate seen for the working population as a whole. At the same time, the share of start-ups with less than high school education fell from 33% in 1990 to close to 10% currently (Chart 2).

#### **Boomers Create Their Own Jobs**

By far, the fastest growing segment of the start-up market is the 50 and over age group. This group now accounts for close to 30% of the total start-ups, more than double the rate seen in the 1990s (Chart 3). This trend represents not only an aging Canadian society, but also increased propensity to start a business among baby boomers. The affordability and availability of technology enables older Canadians to provide services from home. They are also able to use their well-developed skills and take advantage of their wide business networks and connections more effectively.

Chart 3

Start-uppers Getting Older

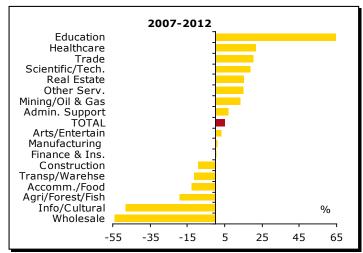


Source: Statistics Canada, CIBC

# Education, Science and Health-related Fields are Growing Quickly

The fastest growing segment of the newly self-employed are those in educational services (up by an annual average of almost 15% since 2007). The recent focus on health care is generating both regular employment (total employment in the sector rose five times faster than the average of all industries since 2007) and the creation of start-ups in the industry, which are up almost 20% over the same period. Start-up activity in scientific/technical sectors also rose notably (Chart 4).

Chart 4 **Growth in Start-ups by Industry** 



Source: Statistics Canada CIBC

# **The Regional Picture**

By province, British Columbia is the hub for start-ups with a nation-leading 3.7% of the working population being part of a start-up. Alberta is second, largely due to the positive spinoffs from the energy sector and the business service sector, followed closely by Saskatchewan. The propensity to open a business in Ontario is in line with the national average while Manitoba, with a 2.0% propensity, has the lowest relative level of start-up activity in the nation (Chart 5).

## The Future

Rapid change will define the future of start-ups in Canada. Some of these changes will be external to the firm, beyond the control of any single small business owner. The following discusses some of the major forces that are likely to shape the nature of the small business sector in the coming decade.

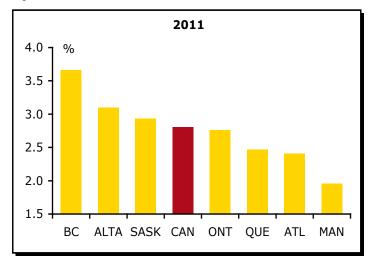
Increased Export Orientation: The growing impetus to think and act on a global scale is quickly modifying the environment for new and existing businesses as small businesses (including many start-ups), are increasingly identifying foreign markets and foreign sources of supply as an important part of their strategy for growth and success. A glance at Chart 6 tells the tale. Younger businesses are much more export-oriented than more established firms. No less than half the revenues derived from businesses aged 2-5 years are coming from outside Canada. That is not only a record high, but also double the

share seen among businesses that have been in operation for more than twenty years. Small firms in Ontario have the highest propensity to export followed by British Columbia and Alberta.

Contributing to this trend is immigration. Currently, close to 20% of the self-employed are immigrants. This is almost double the rate observed in the 1980s. This trend is widely expected to accelerate. Given that more than two-thirds of these immigrants arrived in Canada as adults, this suggests that they still have some potential business connection with their country of origin.

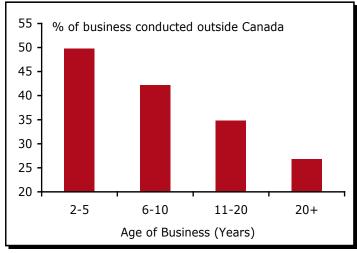
These same forces, however, will also work to increase foreign competition in the products and services these small firms both provide and purchase. This type of competition will put increasing pressure on small business in terms of price, quality, cost control, efficiency, marketing expertise, customer satisfaction and innovation. Moreover, the globalization of the economy means that more and more new firms must export from their inception in order to be competitive. The implication is that in order to profit from globalization, these small firms will have to be able to penetrate new markets. This, in turn, is achievable only if these firms succeed in identifying niche markets. Increased export and import orientation also suggests increased complexity of doing business. Small businesses will have to be increasingly more aware of trade, tax and other regulations in the countries with which they trade. Foreign exchange risk is another important factor to consider. It is not clear that small businesses in Canada are prepared to fully deal with the impact of globalization.

Chart 5
Start-ups as a Share of Employed Population—
by Province



Source: Statistics Canada, CIBC

Chart 6
Younger Firms Export More



Source: Leger, CIBC

**Technology and Increased Connectivity:** The ever changing technological landscape is leading increasingly to a higher level of cooperation between small business, self-employed and larger firms. The theme here is that each participant provides a specific expertise as it relates to a specific project. This kind of cluster of competencies and strategic alliances will be temporary in nature, and at the end of a particular project will dissolve and may or may not cooperate again.

The same forces are already leading to the evolution of a new type of operation —the virtual enterprise— in which clusters can be created quickly, work intensely on a given project, and upon completion can be dissolved and cease to exist. As long as the project is alive, the self-employed and small organizations included in these strategic alliances can, for a time, perform almost like a traditional business. This means that in the future, it will be even more difficult to identify exactly what a small business is. It is also likely that domestic home-based firms will increase their partnership with non home-based firms to collaborate on individual projects. More small businesses in Canada will become virtual corporations, stopping and starting on a project-by-project basis.

Increased connectivity will both allow and require small businesses to be more responsive to their customers' particular needs. The development and design of new customized products will give small firms an advantage and, at the same time, put pressure on them to produce customized products with greater speed than ever before. Small businesses must diversify to a greater extent to maximize their ability to respond rapidly to new demands for products and services.

A side effect of these technological advances is that in order to compete effectively in the rapidly changing economic environment, big businesses are now having to subdivide their internal functions into what are essentially self-contained units that function in many ways like small business.

Outsourcing: While many view small firms and large organizations as separate and at times competing entities, this could not be further from the truth. Canadian small businesses are in a co-evolutionary relationship with corporate business in the economic landscape. Small businesses are needed by large corporations to create the necessary reach and depth into local markets as distributors and agents for products and services. Small businesses are important customers of the corporate providers of basic technology and infrastructure and they create a diversity of uses and the rapid exploitation of technologies and niche markets. Similarly, small businesses provide many of the inputs to production, management and distribution systems of corporate business. Small business and large business not only work together but are also dependent upon each other. Small businesses exist to simultaneously service large business and to fulfill the gaps left by them. In fact, outsourcing activity is playing a significant role in small business success with one in two Canadian businesses beginning operation after receiving their first outsourcing contract. Furthermore, two-thirds of Canadian small businesses could not have begun operations or survived without outsourcing. And with governments downscaling and large corporations looking to save costs in an increasingly competitive environment, outsourcing activity will continue to play a major role influencing the pace of small business formation in Canada.

### Increased Demand for Personalized Products:

The changing age profile of the population also means growing sophistication and a rapid pace of change in consumer tastes. This is positive for self-employment. By their nature, small scale operations are flexible enough to support the increased demand for personalized services given their ability to focus on niche markets.

*Immigration:* The pace of growth in self-employment among immigrants has risen dramatically over the past two decades. Currently close to 20% of self-employed are immigrants, more than double the rate observed in the 1980s. Given that immigration will become an even more significant source of labour market growth, this trend is likely to support small business formation.

### Note

1. For the purpose of this study, a start-up is defined as a company that has been in operation for less than two years.

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