EDC ECONOMICS

TRACKING CANADA'S PRIVATE SECTOR PATTERNS THROUGH 2024

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Summary

- **Head count figures for private enterprises show the distribution of Canada's private sector by company size has been largely unchanged over the past 20 years.**
    - Almost 99% of firms are small or micro, with less than 100 employees. Large-scale firms (500 or more employees) account for only 0.2% of all companies every year since 2001, and medium-sized businesses account for the balance, at 1% or slightly less. [see Figure 1]
    - Canada can expect a small number of large-scale companies to continue to play an outsized role in the economy, while a large number of small companies may serve as potential vendors or partners in supply chains.
    - These trends have implications for future growth and priority sectors for Canada (e.g., agri-food, clean technologies, advanced manufacturing, digital industries) and the services on which they depend for efficiency and competitiveness (e.g., advanced technologies, infrastructure and engineering services).

- **The predominance of micro and small businesses with an average head count of only six employees presents challenges in terms of productivity, scale and global competitiveness.**
    - The future strength in the Canadian economy partly depends on the degree to which more small-scale companies can grow into medium-sized companies active in growth sectors and markets of the future.
    - The Canadian private sector only had 1,895 more medium-sized businesses in 2019 than in 2001, equivalent to 105 net private companies on average each year growing from small to medium size. As these companies often have enough scale to achieve efficient production levels—while also being less complex to manage than large-scale businesses—medium-sized companies are critical to domestic output, global competitiveness, and supply chain strength.

- **While average firm size distributions have been stable for two decades, there have been sector-based reallocations of companies.**
    - Four sectors (professional services, construction, transport/warehousing, real estate) and a mix of “unclassified” companies increased by net 253,022 from 2001-2019. Six other sectors (agriculture, manufacturing, management, wholesale trade, retail trade, other services) declined by 47,793 businesses. [see Figure 2 and Table 1]
    - Such patterns don’t necessarily correlate directly with changes in competitiveness. In some sectors, there are fewer, larger companies due to industry consolidation (e.g., wholesale trade), while in others, a larger number have emerged where barriers to entry are low and companies tend to be small and owner-operated (e.g., construction, professional services, real estate).

- **More recently, there have been “winners” and “losers” in the COVID-19 economy emblematic of a “K-shaped” recovery, some of which reflects a continuation of pre-pandemic trends.**
    - The hardest hit sectors (arts, entertainment and recreation, food and accommodation, transportation and warehousing, mining and oil & gas, other services) are where business failures are most at risk, while agriculture, wholesale trade, retail trade, finance and insurance, and real estate were operating above pre-pandemic levels by late 2020.
    - Even within subsectors, there are winners and losers such as in real estate, with housing markets up while commercial properties face interim pressure on leasing conditions and rising vacancy rates.
    - In some cases, COVID-19 intensified trends that were underway for several years such as in oil and gas (O&G). Likewise, insolvency statistics show highly indebted companies across a broad range of sectors and provinces have experienced accelerated deterioration and failure.

The private sector outlook beyond 2021

- **Considerable uncertainty exists as the world awaits the "new normal" after the pandemic.**
    - This will influence future inward foreign direct investment and Canada's ability to generate services exports. By extension, these influences could affect Canadian trade competitiveness in priority sectors, like cleantech, advanced manufacturing and digital industries.

- **In the post-pandemic Canadian (and global) economy, trends point to a major reallocation of capital and labour across sectors as new technologies are adopted.**
    - Greater automation and digitization in the coming decade will likely shift employment and spending away from lower value-added activities into new applications across all sectors that raise productivity by those employed.
    - Productivity gains will be partly offset by those who are unemployed or under-employed as a result of automation. These trends will entail significant "adjustment costs" to mitigate the risk of workers with less formal education or technical skills being left out of the jobs of the future.
    - In terms of the domestic economy, uncertainty may slow investment and add to disruption. Small businesses in highly competitive, low-margin activities are at risk of closing. One estimate from late 2020 puts more than 180,000 small businesses at risk of failure, threatening 2.4 million jobs. Even a failure rate of half this estimate would be twice the net decline of businesses in the six sectors that lost nearly 50,000 firms from 2001-2019.
    - These at-risk businesses may not be "strategic" in terms of value creation, but they 're important in terms of the sheer number of households affected by potential business failures and consequent contagion risk. In this scenario, higher unemployment could:
        - increase public expenditure;
        - dampen consumer spending;
        - worsen the quality of financial institutions' loan and credit card portfolios; and
        - undermine general market confidence.

- **It remains uncertain how sector profiles will realign.**
    - Global trade frictions may culminate in more closely integrated regional supply chains in goods manufacturing, as well as in the provision of critical supplies needed for services (e.g., advanced technologies for logistics and distribution, project and process management, "smart" physical and social infrastructure).
    - While such tensions may add to costs on a global basis, such movement may also increase opportunities for Canadian businesses with North American markets. Food, water management, pharmaceuticals, clean energy, and any business with national security and/or broader strategic importance (e.g., rare earths mining) would be expected to benefit, as would cleantech, fintech, life sciences and health care, quantum computing, artificial intelligence, linked sensors, drone technology, robotics and space exploration.
    - With a high level of uncertainty, a simple approach to projecting the future is to build on earlier patterns of enterprise formation from 2001-2019 by sector and estimate reasonable upper and lower bounds reflecting optimistic and pessimistic scenarios, with the base case in the middle. The simple modelling approach shows Canada's private sector could either grow from an estimated 1.15 million companies in 2019 to nearly 1.29 million by 2024, or decline to less than 1.15 million. [see Figure 3]
    - Medium-sized firms would range from 9,452 to 15,095, but most likely around 12,273. This is a net increase of 999 from 2019 levels, which is higher than the average annual growth in medium-sized companies in 2001-2019. [see Figure 4]
    - Large-scale businesses would range from 1,997 to 2,172, with a base line of about 2,084 for a net increase of 82 from 2019 levels. This is lower than the average annual growth in large-scale companies in 2001-2019. [see Figure 5]
    - The negative scenario implies stagnation, which is symptomatic of a static economy lacking the needed drive for innovation, productivity and competitiveness. But there's also at least partial replacement of failed companies by more productive or value-adding companies that ultimately contribute more to gross domestic product (GDP) per business unit.

- In basic terms, this may mean fewer restaurants, bars, hotels, salons and gyms, but more businesses and individuals working in professional, scientific and technical fields (e.g., data analysis, machine learning, automation, cybersecurity, robotics, fintech, risk management), health care, construction and specialized trades (e.g., systems management, machinery repair and maintenance).
- Labour market requirements for the future will include additional education and skills development for ongoing competitiveness. [see Box 1]

Figure 1

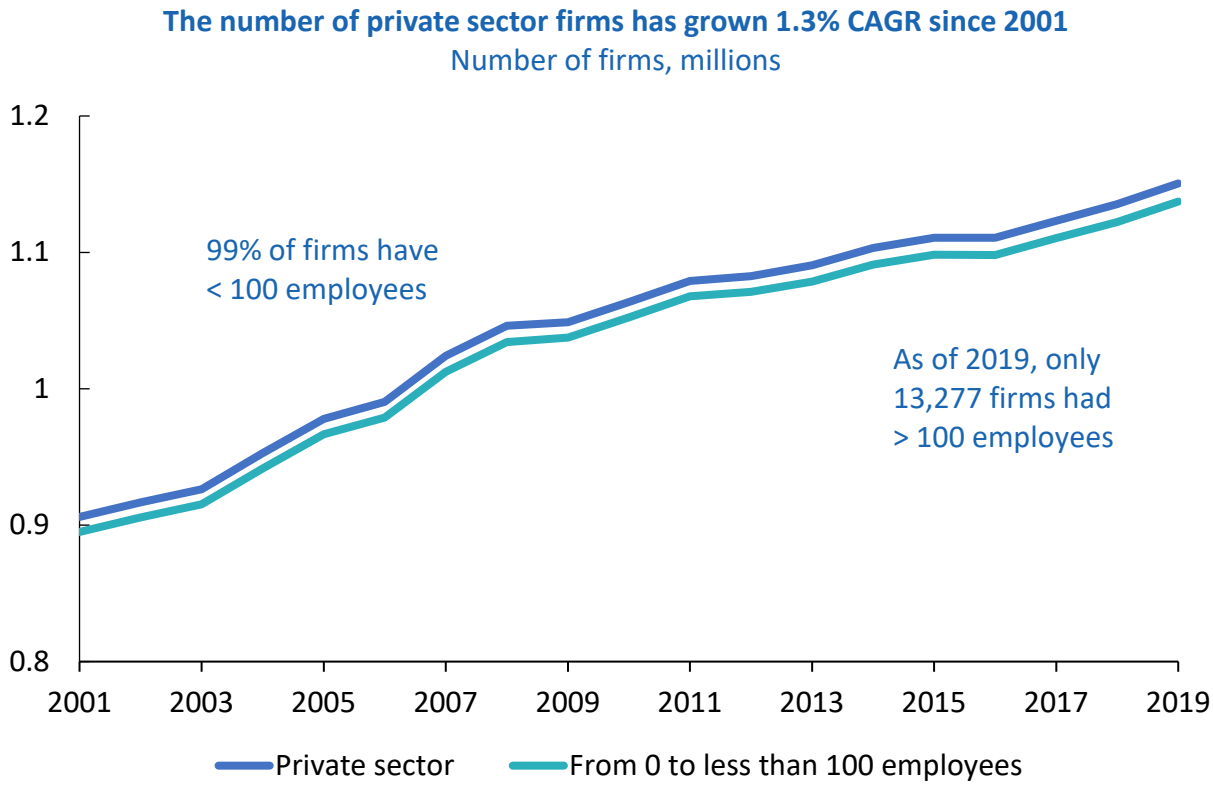
The number of private sector firms has grown 1.3% CAGR since 2001
Number of firms, millions
1.2
1.1
1
0.9
0.8
99% of firms have
< 100 employees
As of 2019, only
13,277 firms had
> 100 employees
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019
Private sector
From 0 to less than 100 employees

Figure 2

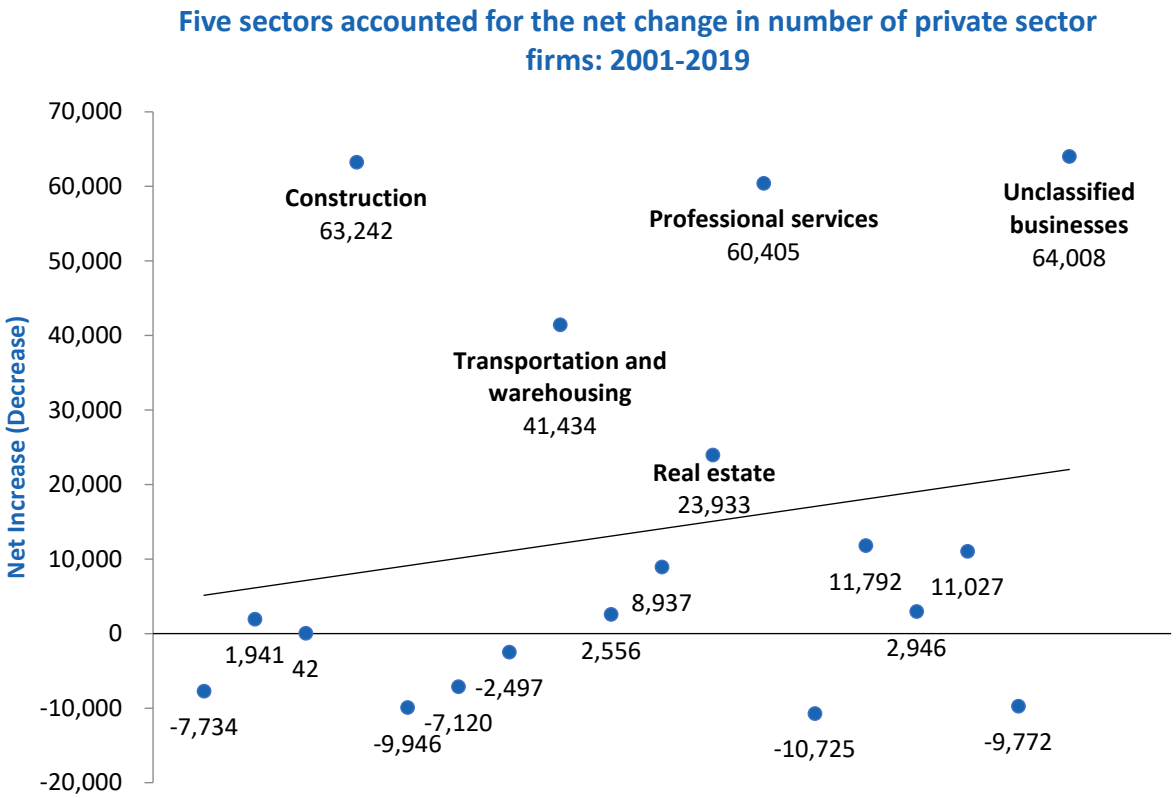
Five sectors accounted for the net change in number of private sector firms: 2001-2019
Net Increase (Decrease)
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
-10,000
-20,000
Construction
63,242
Professional services
60,405
Unclassified businesses
64,008
Transportation and warehousing
41,434
Real estate
23,933
1,941
42
-7,734
-9,946
-7,120
-2,497
2,556
8,937
-10,725
11,792
2,946
11,027
-9,772

Figure 3

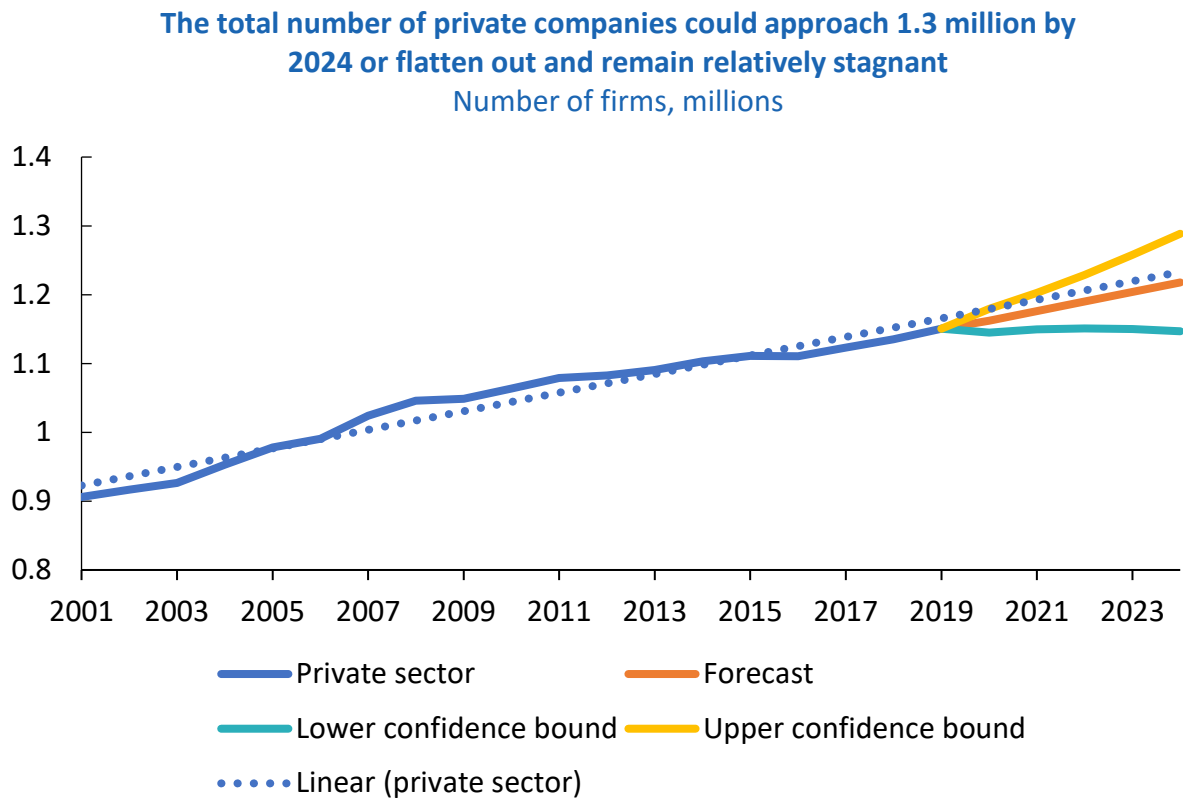
The total number of private companies could approach 1.3 million by 2024 or flatten out and remain relatively stagnant
Number of firms, millions
1.4
1.3
1.2
1.1
1
0.9
0.8
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019
2021
2023
Private sector
Forecast
Lower confidence bound
Upper confidence bound
Linear (private sector)

Figure 4

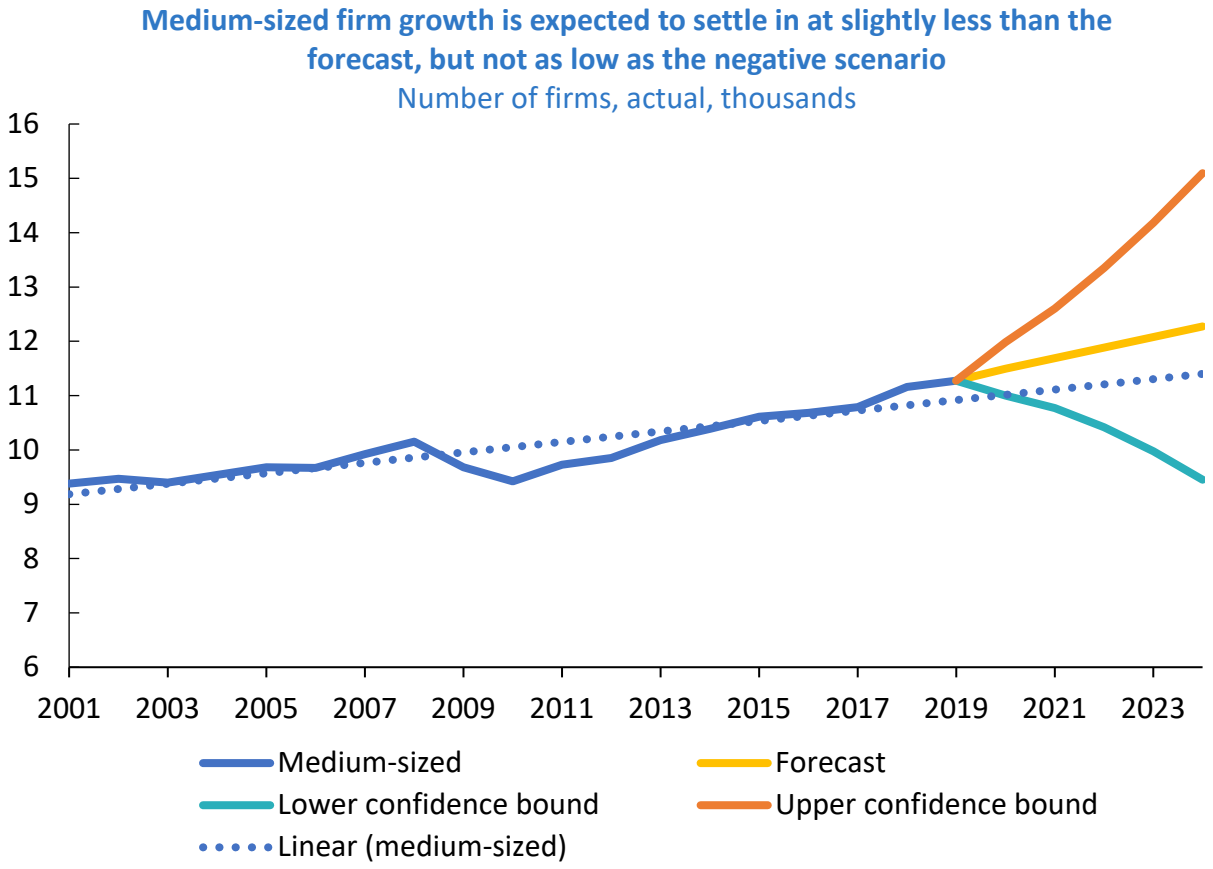
Medium-sized firm growth is expected to settle in at slightly less than the forecast, but not as low as the negative scenario
Number of firms, actual, thousands
16
15
14
13
12
11
10
9
8
7
6
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019
2021
2023
Medium-sized
Forecast
Lower confidence bound
Upper confidence bound
Linear (medium-sized)

Figure 5

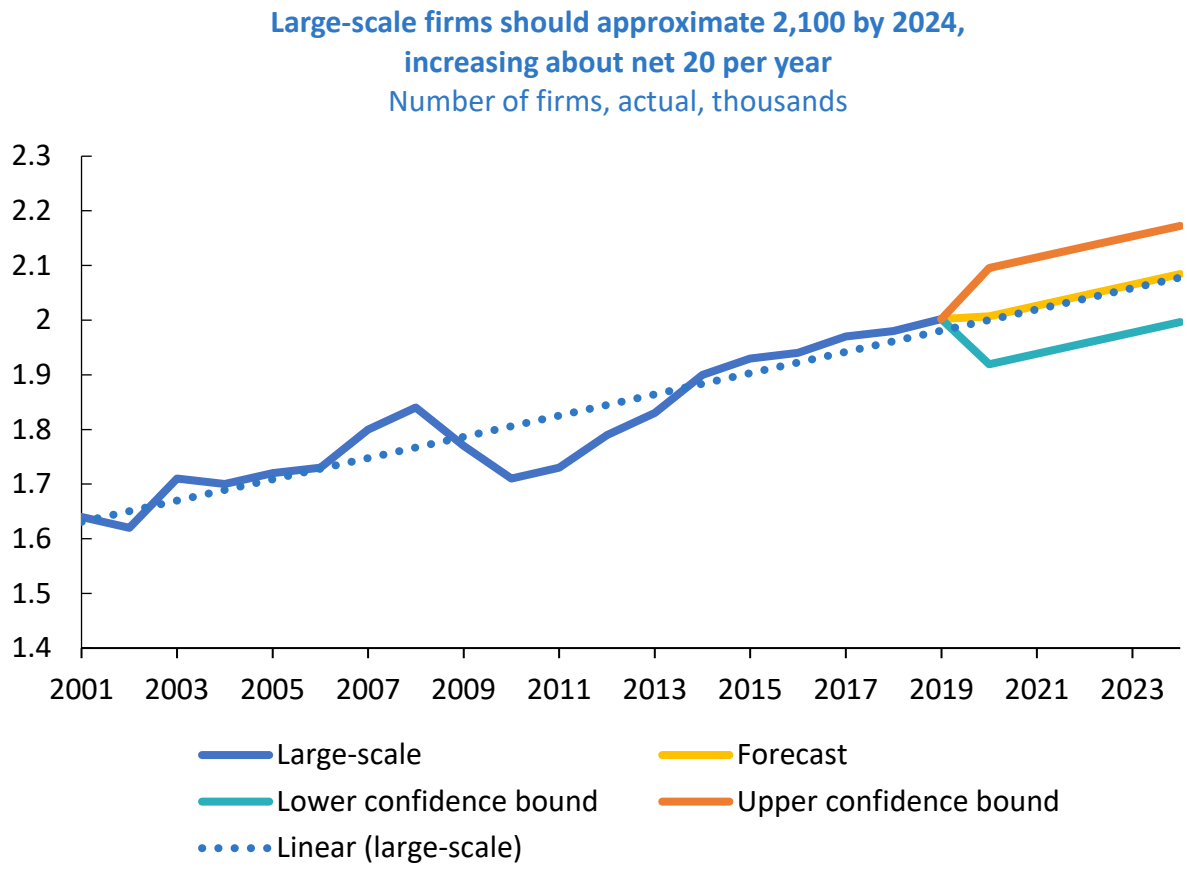
Large-scale firms should approximate 2,100 by 2024, increasing about net 20 per year
Number of firms, actual, thousands
2.3
2.2
2.1
2
1.9
1.8
1.7
1.6
1.5
1.4
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019
2021
2023
Large-scale
Forecast
Lower confidence bound
Upper confidence bound
Linear (large-scale)

Table 1: Net change in private sector enterprises		
Two-digit North America Industry Classifications (NAICS)	**Net 2001-2019**	**Avg. change per year**
Agriculture, forestry, fishing and hunting [11]	-7,734	-430
Mining, quarrying, and oil and gas extraction [21]	1,941	108
Utilities [22]	42	2
Construction [23]	63,242	3,513
Manufacturing [31-33]	-9,946	-553
Wholesale trade [41]	-7,120	-396
Retail trade [44-45]	-2,497	-139
Transportation and warehousing [48-49]	41,434	2,302
Information and cultural industries [51]	2,556	142
Finance and insurance [52]	8,937	496
Real estate and rental and leasing [53]	23,933	1,330
Professional, scientific and technical services [54]	60,405	3,356
Management of companies and enterprises [55]	-10,725	-596
Administrative, waste management and remediation services [56]	11,792	655
Arts, entertainment and recreation [71]	2,946	164
Accommodation and food services [72]	11,027	613
Other services (except public administration) [81]	-9,772	-543
Unclassified businesses	64,008	3,556
Total	244,469	13,582
Note: Unclassified businesses are estimated differently from others due to major inter-year volatility of Statistics Canada estimates that culminate in compound annual growth rate (CAGR), leading to significant deviations from 2019 estimates. As a result, estimates used for 2019 are a residual figure.		

Source: Statistics Canada 33-10-0164-01

Box 1: The future of jobs and implications for Canada	
Workforce automation and implications	
The workforce is automating faster than expected, displacing 85 million jobs in the next five years: 43%. **of businesses surveyed indicate they're set to reduce their workforce because of technology integration. Forty-one per cent plan to expand their use of contractors for task-specialized work.; 34%t plan to expand their workforce as a result of technology integration. Five years from now, employers will divide work between humans and machines roughly equally.**	**Automation could create opportunities in relevant sectors (e.g., professional, scientific and technical), and elevate levels of competitiveness for those that reduce fixed costs and strengthen strategic focus and specialization**. But technology and systems integration require capital investment in ICT, data, etc. With the average small-scale firm having only six employees, most businesses in Canada will face challenges with investment.
Robotics and implications	
The robot revolution will create 97 million new jobs. **As the economy and job markets evolve, new roles will emerge in technology fields (e.g., artificial intelligence (AI)) and in content creation careers (e.g. social media management, content writing).** The emerging professions reflect greater demand for green economy jobs, roles at the forefront of the data and AI economy, and new roles in engineering, cloud computing, and product development. The up-and-coming jobs highlight the continuing importance of human interaction in the new economy; in marketing, sales, and content production; and in roles that depend on the ability to work with different types of people from different backgrounds.	**Canada's private sector is positioned to capitalize on emerging growth and demand in AI, cleantech, and related areas of "smart" innovation**. Infrastructure investment can serve as a major inducement to broader transformation in Canada. An open immigration policy also helps to attract talent and foster global ties. But investment in robotics has lagged in some cases due to the small scale of most private companies, as well as the limited availability of after-sales service for complex technologies in many areas where manufacturing exists. There also hasn't been evidence of a spike in trade and investment due to immigration policy.
Analytical thinking and implications	
In 2025, analytical thinking, creativity, and flexibility will be among the most sought-after skills. **Employers see critical thinking, analysis, and problem-solving as growing in importance in the coming years. Emerging this year are skills in self-management such as active learning, resilience, stress tolerance, and flexibility.**	**Active learning opportunities are widely available in Canada** such as through local colleges that have expanded physical presence and online offerings. Trades require more people as older practitioners retire.
Skills development and upgrading and implications	
The most competitive businesses will focus on upgrading their workers' skills. **For workers set to remain in their roles over the next five years, nearly half will need retraining for their core skills. The public sector needs to provide stronger support for reskilling and upskilling of at-risk or displaced workers. Only 21% of businesses report being able to make use of public funds to support their employees through retraining initiatives.**	**Canada's public expenditure addresses much of the public sector role required for skills development and upgrading.** Improvements in education and training are provincial domains. Looking ahead, these will be important challenges that may also be compromised if budget deficits, rising interest expense and a weaker fiscal base culminate in weaker funding and/or less robust social safety nets.
Remote work and implications	
Remote work is here to stay. **Eighty-four per cent of employers are set to rapidly digitalize work processes. Employers say there's potential to move 44% of their workforce to operate remotely. But 78% of business leaders expect some negative impact on worker productivity and many businesses are taking steps to help their employees adapt.**	**Remote work patterns in Canada appear consistent with global patterns.** Recent house price increases are partly due to remote work-related trends and investment. Many banks and other financial institutions have stated they expect part of their staff to continue to work from home. Adverse impact on productivity may be specific to individuals, types of activity and/or limits on household ICT access.

Sources: Derived from World Economic Forum, Future of Jobs Survey, 2020, and IMF newsletter

CONCLUSION

It's too early to predict how trends will play out. On the negative side, there are clear structural issues that threaten long-term competitiveness in Canada that would impact GDP growth and trade. The main challenge is the number of private sector companies and corresponding levels of employment in areas that are considered low in value creation. With less than 14,000 medium- and large-scale businesses (1.2% of the total number of private enterprises in Canada), the pool of companies with sufficient capital for major investment is limited. With a diminished number of manufacturing companies in Canada over the last two decades (from 59,500 in 2001 to an estimated 49,554 in 2019), there's also less of an industrial base within Canada to serve as a buyer of raw materials and consumer of services. Canadian interprovincial trade barriers are an additional feature that add obstacles to scale within the Canadian marketplace.

Offsetting these challenges are the integrated ties in North American markets that allow Canada to leverage opportunities in two markets with combined populations that are more than 12 times Canada's domestic population. This should provide Canadian businesses with greater scale than they otherwise would be able to achieve within Canada. But there are persistent frictions and risks. Neither the United States nor Mexico can be wholly relied on to help Canada escape its challenges of productivity, competitiveness and scale.

Additional free trade agreements have the potential to help Canada diversify its trade and open new markets, although only limited progress has been achieved in the last decade with countries that are signatories to these agreements. Prospects for increased trade with China and India (Canada does not have free trade agreements with them) are also limited as of early 2021[i]. By contrast, and notwithstanding recent political and trade frictions with the U.S., aggregate trade levels have been sustained over time, and geographic proximity offers Canada better prospects for partial re-industrialization with a domestic focus on strategic and critically needed goods for future emergencies and contingency planning. Imperfect as this option may be, the reality is that Canadian businesses and the economy have generated trade surpluses with the U.S. market for decades. This has resulted in greater sales and incomes than they would likely have generated without market integration. There's been no evidence that any other regional markets or countries will open up to Canada enough to meet this level of trade and render comparable benefits[ii].

In terms of the impact of COVID-19 on Canada's export trade, the track record has been favourable in terms of goods exports. Canadian goods exports by the end of 2020 were just about at pre-COVID-19 levels. Services exports, however, remain weak. It's instructive that, among the five Canadian sectors (out of 20 in total) operating at or less than 90% of pre-COVID-19 levels of output (February 2020), the most severely affected have been in services along with O&G. As services exports include tourism, the adverse effects on small businesses in hospitality, arts and recreation, and culture have been deep and aren't likely to reverse in the near term. This will continue to impact services exports.

Looking ahead, near-term challenges for Canada and its private sector include (but aren't restricted to) how to:

- **Foster an environment in which large-scale and medium-sized firms can make the needed investments in technology and systems integration to:**
    - generate domestic, regional and global market power; and
    - strengthen their roles in supply and value chains.
- **Encourage small-scale companies to move up the value chain and unlock economies of scale by:**
    - investing in needed technologies to sustain growth;
    - ensuring they have access to adequately trained staff;
    - ensuring they have sufficiently diverse management teams across a range of specializations and skills;
    - improving their capacity to manage working capital and to ultimately access long-term finance for needed investment in machinery, equipment, data and systems; and
    - protecting them from cyberattacks.
- **Revamp domestic industrial production to:**
    - generate the critical mass needed for essential supplies (food, water, pharmaceuticals, electricity);

- meet national security requirements (with allies, but with strengthened emphasis on immediate physical proximity to national boundaries, water bodies, rail, roads, maritime and air space); and
- manage environmental risks.

- **Efficiently encourage human capital development in critically needed functions of the economy by:**
  - co-ordinating closely with private industry on future economic needs accounting for trends involving automation, robotics, artificial intelligence, linked sensors, quantum computing and related technological advancements;
  - addressing after-sales maintenance and repair requirements—not just production or creation of new technologies—and factoring these requirements into trades curricula, so time isn't lost by producers due to idling of critical assets;
  - actively promoting continuing education (online and otherwise) through colleges and universities to encourage individuals to pursue skills upgrading and career rotation in advance of sector decline or market shocks; and
  - increasing the attractiveness of specializations and trades linked to vocational and polytechnical institutes as a part of provincial education sector planning.

About this report

This report is written by EDC Economics staff. The views expressed in this report are those of the authors and shouldn't be attributed to Export Development Canada or our Board of Directors.

This report was written by Michael Borish, with review and input by Stephen Tapp, copy edits from Karen Turner and research assistance from Jerry Wang.

[i] Recent frictions with China suggest there is a high level of political risk associated with concentrated exposures to this market. Negotiations with India have been ongoing for a decade without an agreement.

[ii] Even with Mexico, which is a part of the Canada-U.S.-Mexico Agreement (CUSMA) framework, Canada has achieved limited trade volumes compared with the U.S. market. This is also the case with the U.K., Europe, and Asian markets.