

SPECIAL REPORT

Small Business is Big Business in Ontario

Positioning for Post-Pandemic Prosperity

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Executive Summary

Many of Ontario's small businesses emerged battered and bruised from the pandemic. Client-facing sectors with a lot of small businesses, such as accommodation and food services, were particularly hard hit. Many businesses were forced to close. And those that made it through are more highly leveraged than in the past, resulting from the need to take on debt to pay rent and payroll during public-health lockdowns and subsequent social-distancing requirements.

But these industries were also positioned to benefit from the economic resurgence that came from reopening. Sectors like arts and culture as well as wholesale and retail trade were able to capitalize on Ontarians' desire to get out of the house and return to public spaces. At the same time, industries that tend to be dominated by larger businesses, such as manufacturing and mining, oil and gas extraction, also rebounded strongly and contributed to the general tailwind for small businesses in Ontario.

There was a downside to this rapid reopening, however. Labour shortages became acute, with Ontario experiencing one of the highest job vacancy rates in the country. Global supply chains were also in disarray, adding to the obstacles facing small businesses in meeting customer demands. High input prices were passed on to consumers where possible and ate into margins where it wasn't. Businesses of all sizes were forced to adapt. This included increasing investment in labour-saving technology, exploring moving supply chains more locally, and working with existing business partners to improve processes.

Just as some of these disruptions look to be easing, there are other storm clouds developing on the horizon. With the Bank of Canada having dramatically increased interest rates to beat back inflation, rising borrowing costs have caused Ontario's housing market to correct. The construction sector, also home to many small businesses and a pandemic-era outperformer, is correcting as a result. But we think there are reasons for small businesses to be optimistic in the near term. Services, home to a large share of small businesses, are likely to outperform goods sectors in the coming economic slowdown. Households continue to be sitting on substantial savings, albeit having had their purchasing power eroded somewhat by inflation. Further, the labour market remains red hot, with the pace of employment growth expected to slow to a crawl as opposed to sharply contract. And then there are government transfers, which have demonstrated their ability to respond quickly to a downturn.

The long-term economic prospects for Ontario look bright too. One reason for this is elevated international immigration, which has been shown to be paramount to Ontario's economic success and is a priority area for the provincial government. Also of note is the nascent reshoring or nearshoring of supply chains to North America, which bodes well for Ontario's highly-integrated, trade-oriented economy. A wealth of critical minerals necessary for the energy transition also has the potential to be a major driver of future economic activity, particularly in the province's northern and remote communities. Finally, investment in technological and digital solutions has ramped up as a result of the need to overcome pandemic challenges, and may be poised to accelerate as costs continue to fall.

Just as small businesses catch their breath following the COVID-19 pandemic, rising interest rates to combat inflation are contributing to renewed economic uncertainty. How are small businesses positioned to contend with these new challenges? And what can they expect going forward given their greater prevalence in some sectors than others?

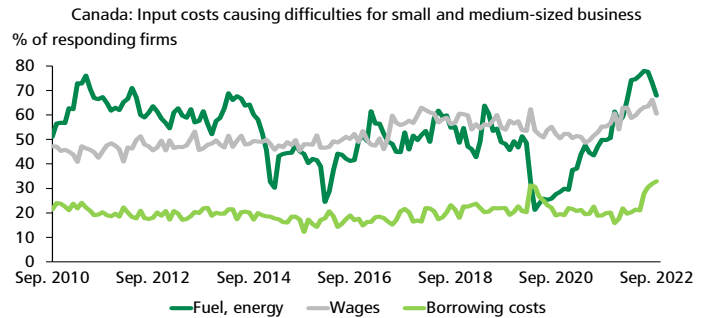
What are Canadian businesses saying?

The pandemic posed substantial challenges for most businesses in Canada. At the onset of public-health-mandated lockdowns, companies scrambled to adjust their business models to unprecedented circumstances in the face of significant uncertainty.

Small businesses were most profoundly impacted by the COVID-19 pandemic.¹ According to the [Canadian Survey of Business Conditions](#), nearly 30% of small businesses in Canada say they are in a worse overall position today than in 2019. This is much higher than for larger firms. It in part reflects the fact that small businesses are more prevalent in customer-facing services, which were disproportionately impacted by lockdowns (graph 1). Indeed, these sectors continue to lag the overall recovery.

GRAPH 2

Energy prices and wages are an ongoing concern for small businesses



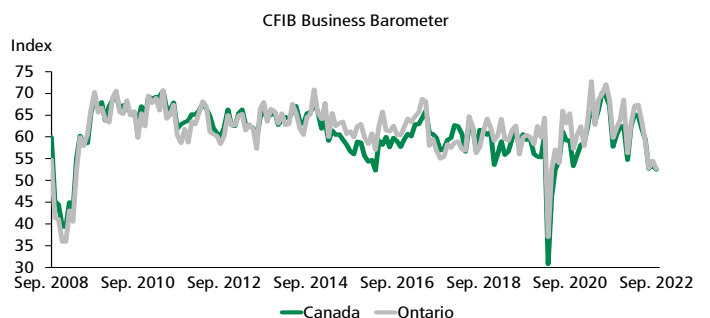
Sources: Canadian Federation of Independent Business (CFIB) and Desjardins, Economic Studies

[Independent Business's \(CFIB's\) August 2022 Business Barometer](#) confirms that energy is the top input cost causing difficulties for Canadian small businesses (graph 2). Wages are an acute concern for businesses as well, particularly for customer-facing sectors like accommodation and food services which expect inflation to be a major driver of increases in compensation. With other input prices also rising rapidly, it's reasonable to think that these too may be passed on to consumers. Higher input costs are expected to erode the profitability of Canadian companies as well, as higher operating expenses outpace rising sales.

Taken together, higher input costs, rising wages due to labour shortages and an uncertain economic outlook are starting to weigh on business sentiment in Canada. However, the magnitude of the sentiment deterioration differs from one survey to another. For instance, according to the Q2 2022 [Bank of Canada Business Outlook Survey](#), overall business sentiment remains positive, and is only gradually coming down from its peak at the end of 2021. In contrast, the CFIB's Business Barometer for July and August 2022 fell to the lowest level since April 2020 as small businesses soured on the prospects for sustained revenue growth in the coming year (graph 3). And with business insolvencies rising from pandemic lows, who could blame small businesses for feeling more pessimistic about their near-term prospects?

GRAPH 3

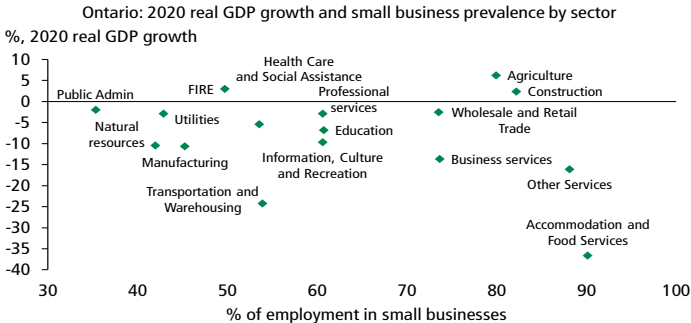
Small business sentiment is the lowest since 2020



Sources: Canadian Federation of Independent Business (CFIB) and Desjardins, Economic Studies

GRAPH 1

Small businesses in Ontario bore the brunt of the pandemic downturn



Sources: Statistics Canada and Desjardins, Economic Studies

Further, smaller firms are more constrained in their ability to access debt for investment in technology in order to adapt to changing market circumstances or to ride out economic volatility. Looking ahead, half of Canadian businesses expect rising input costs to be an obstacle in the next three months, according to the [Canadian Chamber of Commerce Business Data Lab](#). When it comes to energy prices specifically, their analysis illustrates that those sectors that expect to pass along higher energy prices to consumers are the same ones that are dominated by small businesses. Responses from the [Canadian Federation of](#)

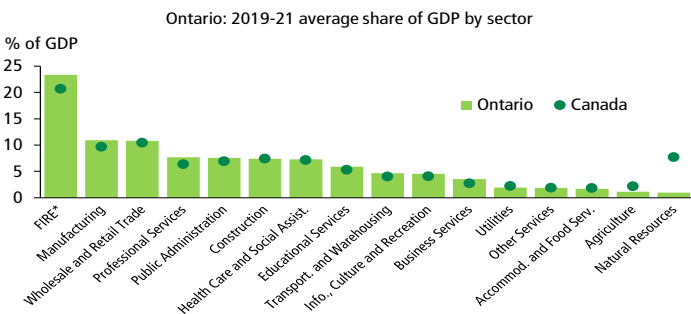
¹ Statistics Canada defines a [small business](#) as having between 1 and 99 paid employees, as compared to 100 to 499 and more than 500 employees for medium-sized and large businesses, respectively.

What role do small businesses play in Ontario's economy?

According to [Industry Canada](#), roughly 98% of companies in Canada are small businesses. They employ about two in every three working Canadians. Over half of those workers are with a business with less than 20 employees. By way of comparison, around 60% of workers in Ontario are employed by a small business. But there is significant variation across regions and sectors in the province. Take the prevalence of finance, insurance, real estate and leasing (FIRE) as well as manufacturing in the Ontario economy. These industries have a greater share of large companies, which helps to explain the lower prevalence of small business employment in Ontario relative to the country as a whole (graph 4).

Within goods-producing sectors, less than half of employees in manufacturing, utilities and natural resources (e.g., forestry, fishing and mining) work for small businesses. In contrast, more than 80% of workers in agriculture and construction are employed by small businesses. These sectors also have a large number of sole proprietors. The construction sector is particularly notable as it has been rising as a share of Ontario's economic activity, from a low of nearly 4.5% of output in 1997 to over 7.5% in 2021 (graph 6).

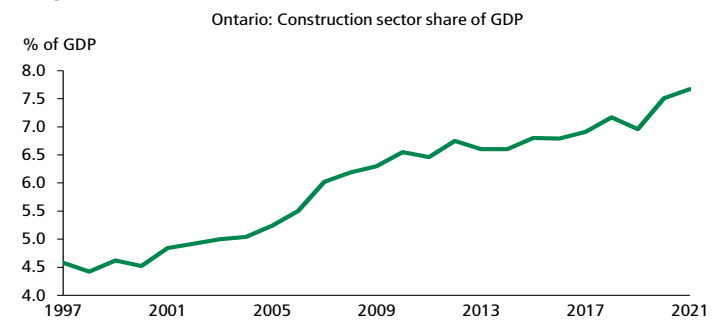
GRAPH 4
The financial and real estate sectors dominate Ontario's economy



*FIRE refers to Finance, Insurance, Real Estate and Leasing
Sources: Statistics Canada and Desjardins, Economic Studies

Roughly the same proportion of workers is employed by small businesses within the goods- and services-producing sectors in Ontario, at around 60%. However, goods-producing sectors, like construction and manufacturing, make up only about 20% of employment and real economic activity whereas services-producing sectors make up closer to 80% (graph 5). As such, the bulk of employees working for small businesses in Ontario can be found in the services sector.

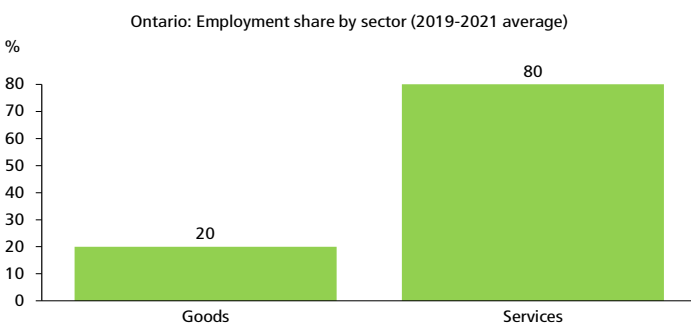
GRAPH 6
Ontario's construction share of GDP has nearly doubled in 25 years



Sources: Statistics Canada and Desjardins, Economic Studies

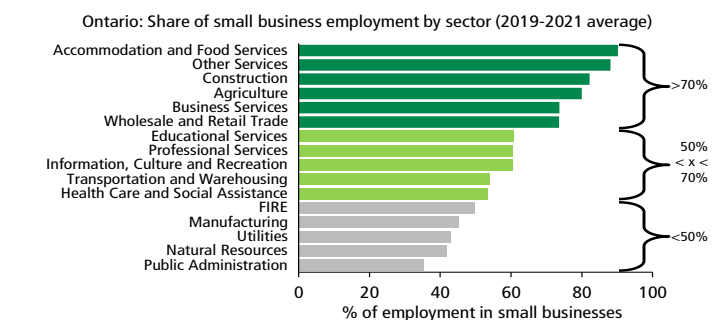
At the same time, services-producing sectors with the largest share of employees in Ontario are wholesale and retail trade as well as health care and social assistance. Over half of these workers are employed by small businesses. However, small businesses are even that much more prevalent in employing Ontarians in accommodation and food services (over 90% of employees), other services (nearly 90% of employees), and business, building and other support services (nearly 75% of employees) (graph 7). In contrast, less than 50% of employees in FIRE and public administration are employed by small businesses in Ontario.

GRAPH 5
Services dominate total and small business employment in Ontario



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 7
There is significant variation in small business prevalence by sector

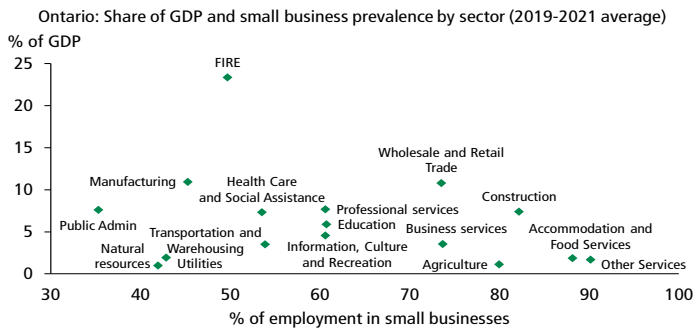


Sources: Statistics Canada and Desjardins, Economic Studies

Notably, there is little relationship between the share of employment by small businesses in a sector and that sector's share of GDP in Ontario (graph 8). Indeed, if anything the relationship is slightly negative, with those sectors with a greater prevalence of small business employment making a proportionately smaller contribution to GDP than sectors dominated by larger employers.

But this lower contribution to GDP from sectors dominated by small businesses may reflect a couple of other considerations specific to the Ontario context. The first is that larger businesses tend to export more, which encourages competitiveness and technological adoption. In contrast, small businesses have a disproportionately large share of proximity businesses (food and restaurant, small retailers, services) which do not export. Additionally, FIRE (Ontario's largest sector, composed of some very large businesses) contributes disproportionately heavily to Ontario's economy relative to other provinces.

GRAPH 8
Sectors with more small business presence are a smaller share of GDP



Sources: Statistics Canada and Desjardins, Economic Studies

Sectors are the small business story

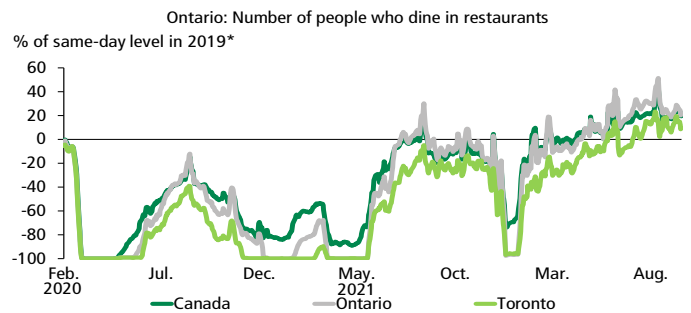
Digging deeper into those sectors of Ontario's economy where there is a significant small business presence, several really stand out (graph 7 on page 3). These are accommodation and food services, wholesale and retail trade, construction, and agriculture. Business, building and other support services and other services (e.g., repair and maintenance, personal and laundry services, etc.) also have a meaningful small business presence, but tend to be less regionally concentrated. We also briefly touch on manufacturing and financial services given their regional relevance, although these industries tend to be dominated by larger companies.

Accommodation and food services

Accommodation and food services is particularly notable given how hard it was hit in the pandemic. During the depths of the lockdowns in April 2020, employment in accommodation and food services in Ontario fell by roughly 45% relative to the pre-pandemic level in February 2020. Since then, employment has gradually recovered in fits and starts depending on

public-health policies, and is now roughly 5% below its pre-pandemic level. In contrast, when we look to data on the number of people who are dining at restaurants as compared to the same day prior to the pandemic, we see that it was roughly 40% higher at the end of summer 2022 than three years earlier (graph 9). This speaks to the labour shortages being felt throughout the sector in Ontario, which has seen the job vacancy rate nearly triple from its pre-pandemic average. Wages have increased rapidly as a result, helping to further push up food prices beyond the cost of raw inputs themselves, which have also risen.

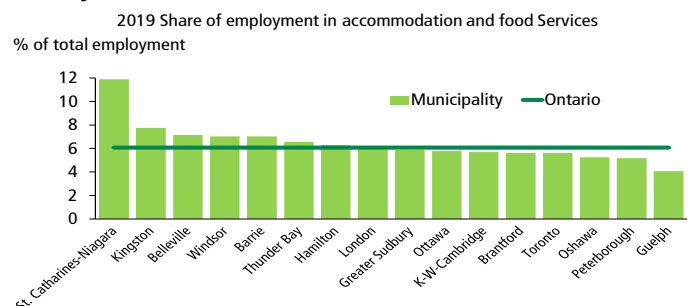
GRAPH 9
With the economy reopened, people are flocking back to restaurants



*7-day moving average
Sources: OpenTable and Desjardins, Economic Studies

This rebound is more relevant to some Ontario communities than others, depending on the role that tourism plays in their respective economies. For instance, St. Catharines-Niagara dwarfs all other metropolitan areas in Ontario in regard to the share of employment in accommodation and food services (graph 10). This is thanks to its preponderance of wineries and other attractions. That said, employment in accommodation and food services also deserves an honourable mention in cities such as Kingston, Belleville, Windsor and Barrie.

GRAPH 10
St. Catharines-Niagara dominates the province in tourism activity



Sources: Statistics Canada and Desjardins, Economic Studies

Wholesale and retail trade

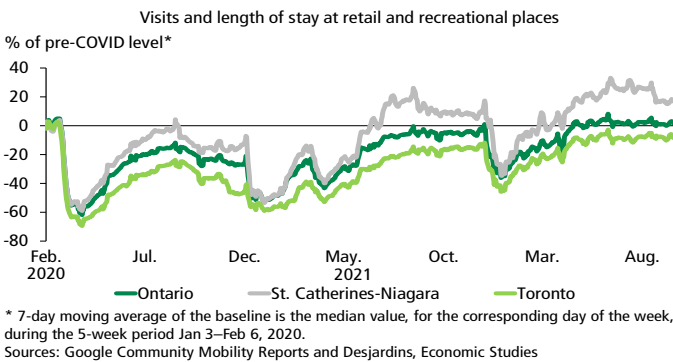
The pick up in activity in accommodation and food services is to a large extent mirrored by the resurgence in retail and recreational activity (graph 11). At a local level, the data is more sparse, but these also suggest a return in consumer foot traffic back to or beyond pre-pandemic levels (graph 11). Indeed, parts of the province which derive significant economic activity from tourism have tended to see the greatest resurgence in activity in retail and recreation activity.

on more debt than those in accommodation and food services, further reinforcing their more solid footing coming out of the pandemic.

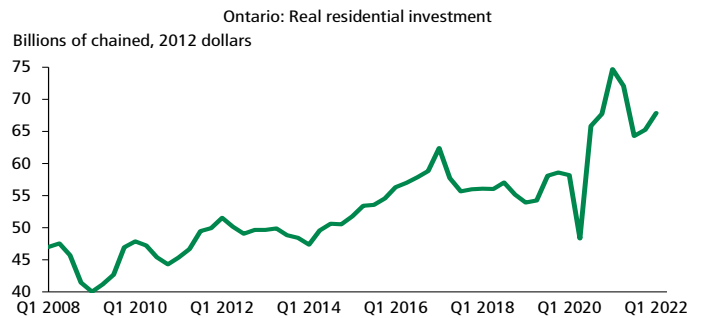
Construction

In contrast to these sectors, construction was one of the economic bright spots during the pandemic. Residential investment boomed on the back of a sharp rise in home sales and prices, which spurred renewed renovation and new home construction activity (graph 13).

GRAPH 11
Consumers are hitting the streets, looking for deals and eats



GRAPH 13
Residential investment was booming in Ontario during the pandemic



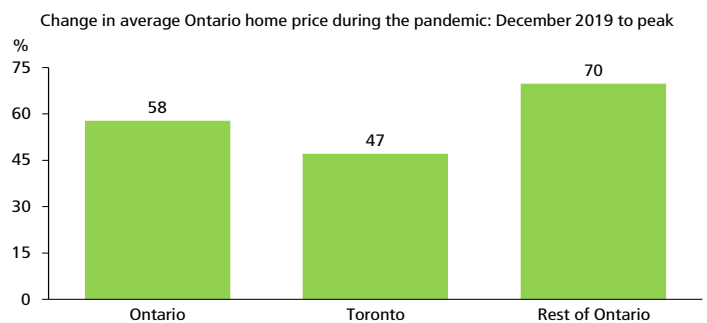
With its relatively high share of small business prevalence, wholesale and retail trade is the most prominent sector in terms of employment in many communities in Ontario. Importantly, the sector fared relatively well during the pandemic when compared to accommodation and food services, according to the [Canadian Chamber of Commerce Business Data Lab](#). In part, this may reflect increased investments in online sales or e-commerce capabilities during the pandemic as companies in the sector, especially retailers, faced an imperative to adjust their business model in order to survive. Looking ahead, wholesale and retail trade continue to have sector-leading plans to make additional investments in e-commerce over the next 12 months (graph 12). Companies in the sector also say they are better able to take

Construction is an industry with a particularly high concentration of small businesses. And while it was especially robust in the Greater Toronto Area (GTA) in the lead up to the pandemic, smaller communities saw the sharpest gains in activity as people increasingly worked from home. Average home sales prices in the GTA rose by a robust 47% from December 2019 to their peak earlier this year, but the rest of the province saw home values surge by an even more torrid 70% (graph 14). This was in response to a surge in sales activity which drove prices nearly-exponentially higher through to February 2022, and provided an incentive for developers to build at a near-record pace. As a consequence of this frenetic pace of activity, the

GRAPH 12
Retail and wholesale businesses are investing in innovation



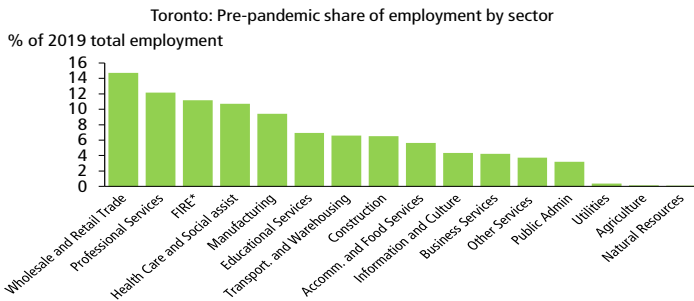
GRAPH 14
The biggest price swings in Ontario have been outside of the GTA



construction sector has experienced among the most acute labour shortages of any industry. Companies expect the labour market to remain tight in the near term despite recession fears mounting by the day.

While communities outside of the GTA tended to see the greatest increase in home prices and sales activity during the pandemic, the GTA also benefitted indirectly from the spillovers to financial services. Indeed, the GTA is much larger and more economically-diversified than other communities in Ontario, and financial services and real estate play a leading role in its economy. This said, small business prevalence tends to be relatively low in this sector. However, even FIRE can't hold a candle to wholesale and retail trade when it comes to the share of total employment in the GTA (graph 15).

GRAPH 15
Toronto has a well-diversified and services-heavy economy



*FIRE refers to Finance, Insurance, Real Estate and Leasing
Sources: Statistics Canada and Desjardins, Economic Studies

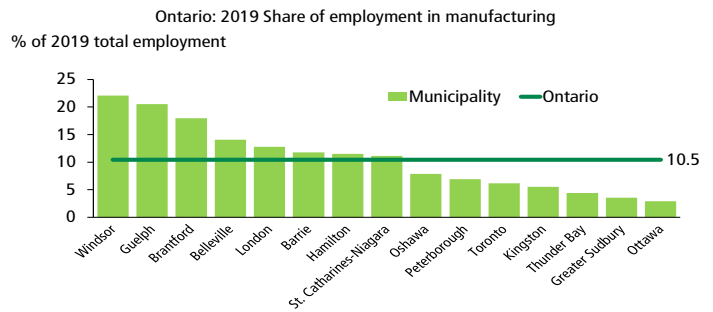
Manufacturing

Southwestern Ontario is well known for its prowess as a center for manufacturing in Canada, particularly when it comes to auto production. And while the auto sector was hit hard by the pandemic, looking ahead it is poised for a meaningful rebound in 2022 and 2023, according to estimates from Wards Automotive. In Ontario as a whole, manufacturing makes up about 11% of the province's output – well below FIRE but roughly equivalent to wholesale and retail trade. Importantly, the share of manufacturing employment is as much as double the provincial level in communities like Windsor and Guelph (graph 16). And although manufacturing is not particularly small-business intensive, sectors like accommodation and food services in these regions no doubt benefit indirectly from the high-paying manufacturing jobs.

Agriculture

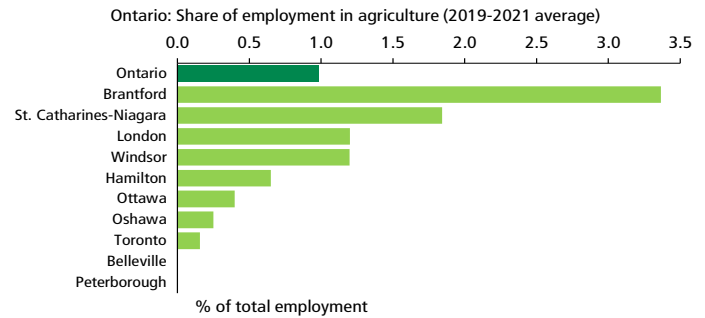
Southwestern Ontario is also a source of substantial agricultural activity, which is a sector where small businesses play a very prominent role. And while a relatively small share of employment and economic activity in the region, it remains an important part of Ontario's economy in communities like Brantford, St. Catharines-Niagara, and London (graph 17).

GRAPH 16
The Southwest dominates the province in manufacturing activity



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 17
Agriculture is a small but small business critical part of the economy



Sources: Statistics Canada and Desjardins, Economic Studies

How are small businesses in Ontario faring?

Looking at key indicators of financial health for Canadian businesses, some sectors are in a stronger position than others coming out of the pandemic. But among those industries expected to face more headwinds in 2023 are some with high prevalence of small-business employment (table 1 on page 7). Sectors "to watch" in this group include arts and recreation, accommodation and food services, transportation and warehousing, construction, other services, and agriculture and forestry. In contrast, professional services, information & cultural, and retail & wholesale trade industries made it through the pandemic comparatively well. This said, we expect softening demand to slow down retail & wholesale activity in the near term as consumers tighten their purse strings.

Canadian businesses have generally seen their quarterly profits trend higher in the past year. However, certain sectors have experienced the opposite. This includes some with a high prevalence of small businesses such as construction, agriculture, and other services (see graph 18 on page 7). Accommodation, food services, arts and recreation haven't only seen its profits trend lower but the industry as a whole is still registering losses. And while profit margins are back to pre-COVID levels in most

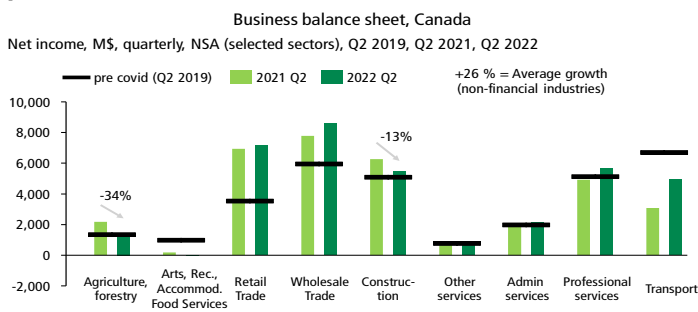
TABLE 1
Challenges faced by businesses are having differentiated impacts across sectors

Industries	Overall business outlook	FINANCIAL SITUATION CHALLENGES					LABOUR
		Profits & margins	Rising interest rates and debt	Leverage (ratio and trend)	Insolvencies (# and trend)	Active businesses and net closures	Labour shortage: obstacle
Arts, recreation, accommodation and food services	●	●	●	●	●	●	●
Transportation and warehousing	●	●	●	●	●	●	●
Construction	●	●	●	●	●	●	●
Agriculture, forestry, fishing, hunting	●	●	●	●	●	●	●
Other services (personal services, maintenance, repair, etc.)	●	●	●	●	●	●	●
Administrative services & waste management, etc.	●	●	●	●	●	●	●
Healthcare and social assistance, educational services	●	●	●	●	●	●	●
Manufacturing	●	●	●	●	●	●	●
Professional services	●	●	●	●	●	●	●
Information & cultural industries	●	●	●	●	●	●	●
Wholesale trade	●	●	●	●	●	●	●
Retail trade	●	●	●	●	●	●	●
Mining, oil & gas extraction	●	●	●	●	●	●	●
Real estate services	●	●	●	●	●	●	●

Legend ● Challenged ● To watch ● Above-average

Notes: Insolvency data based on Industry Canada's Insolvency statistics (Canada only). Profits & margins data based on Statistics Canada's quarterly balance sheet, income statement and selected financial ratios, non-financial industries (Canada only). Rising interest / debt and Labour shortage are based on Canadian Survey of Business Conditions Q3 (Ontario). Business outlook is based not only on latest data, but also considers our forward-looking perspective.
Sources: Statistics Canada, Industry Canada, and Desjardins, Economic Studies

GRAPH 18
While generally on an upward trend, profits are lower than pre-covid in Arts, recreation, accommodation and restaurants

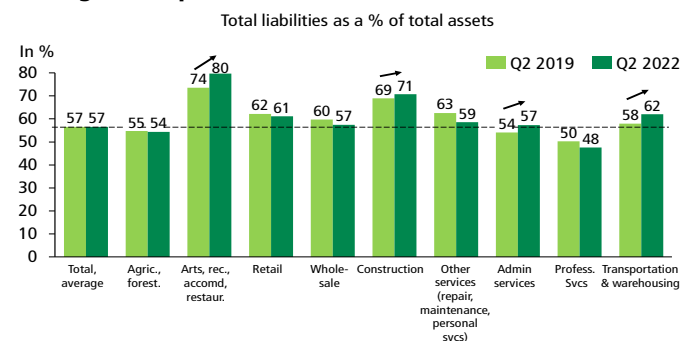


Sources: Statistics Canada and Desjardins, Economic Studies

industries, arts and recreation and accommodation and food services continue to lag behind.

Turning to business balance sheets, leverage ratios (liabilities over assets) are broadly similar to pre-COVID levels and have not seen worrying trends in the last few quarters. That said, there are again some small-business-intensive exceptions, such as arts and recreation, accommodation and food services, and construction, which are more leveraged than in 2019 (graph 19).

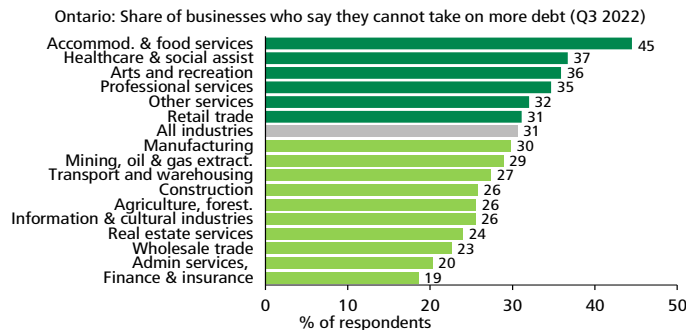
GRAPH 19
Canada: Some sectors are slightly more leveraged, other less leveraged than pre-covid



Sources: Statistics Canada et Desjardins, Economic Studies

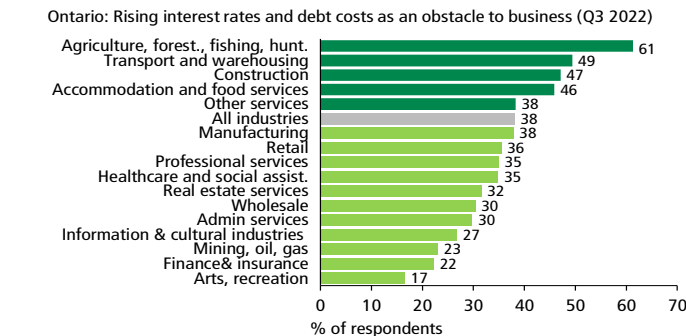
Taking a closer look at the more vulnerable sectors of Ontario's economy, recent business surveys show that arts and recreation and accommodation and food services are most exposed to rising debt costs, reduced profit margins and potential rise in closures and insolvencies. They are also facing the added challenge of steeper labour shortages than in other industries. In Q3 2022, nearly 45% of Ontario businesses in accommodation and food services reported that they could not take on more debt (versus 36% for arts and recreation and 31% on average) (graph 20 on page 8). Meanwhile, over 60% of businesses in

GRAPH 20
Small business intensive sectors are least able to take on more debt



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 21
Small business intensive sectors are most concerned by rising debt costs



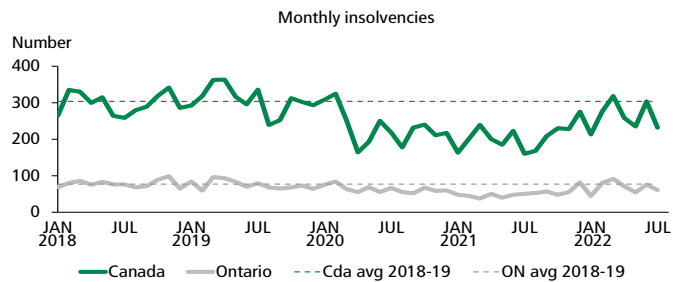
Sources: Statistics Canada and Desjardins, Economic Studies

agriculture & forestry (another sector with high share of small business employment) cited rising interest rates and debt costs as obstacles in the next three months. Businesses in both transportation and construction sectors also had nearly 50% of respondents cite the cost of servicing debt as an obstacle (graph 21).

Insolvencies were on the rise in the last 12 months, but the longer-term trend shows levels similar to pre-COVID (graph 22). This said, certain sectors have seen a spike in insolvencies so far in 2022, and some are above their pre-pandemic monthly average (including transport, arts and recreation, and other services) (graph 23).

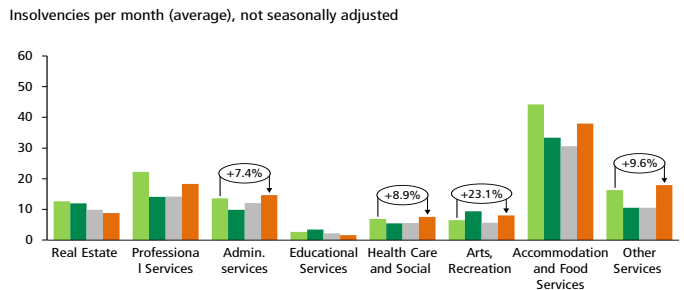
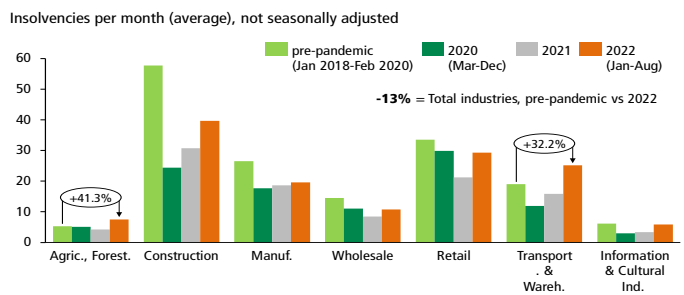
Finally, looking at business creation, most sectors in Ontario have seen more openings than closures so far in 2022. However, two industries have registered net closures: agriculture and forestry and transportation and warehousing. The number of active businesses is still below pre-pandemic levels for those sectors, as is also the case for wholesale trade and other services. Notably, signs of consolidation were already observed over the longer term for agriculture and forestry and wholesale trade, so this isn't necessarily a sign of weak sectoral performance (graph 24 on page 9).

GRAPH 22
Insolvencies are trending higher to the longer-term, pre-COVID trend



Sources: Industry Canada and Desjardins, Economic Studies

GRAPH 23
Certain sectors have seen a spike in insolvencies in 2022, in some cases to levels above the pre-pandemic average



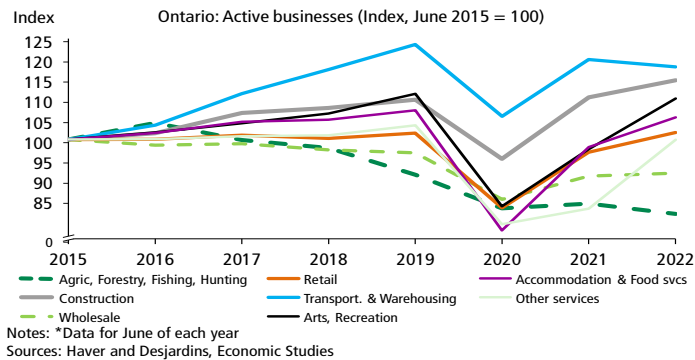
Sources: Industry Canada and Desjardins, Economic Studies

According to the latest [Canadian Survey on Business Conditions](#), businesses with 1 to 19 employees are those most likely to say they cannot take on more debt, with nearly a third of respondents (graph 25 on page 9). These businesses are also the ones that are the most concerned with maintaining sufficient cash flow. This illustrates the fragile financial state in which many businesses find themselves now after managing to survive the many challenges brought by the pandemic.

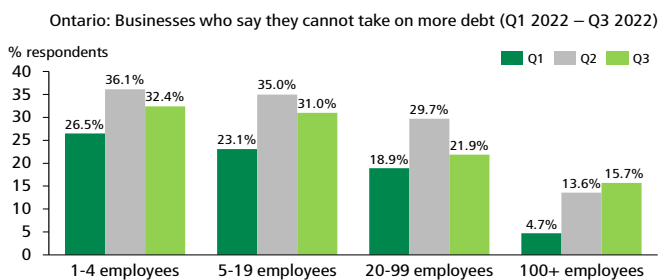
The near-term Ontario outlook is challenging

Just as Ontario's economy has begun to find its footing again after two years of disruptions, there are some storm clouds

GRAPH 24
Consolidation in agriculture and wholesale pre-dates the pandemic

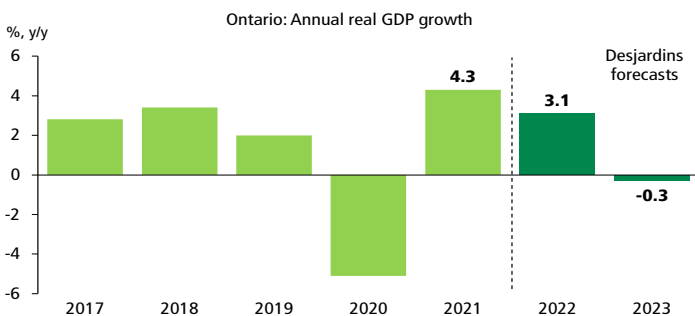


GRAPH 25
A larger share of small businesses say they cannot take on more debt



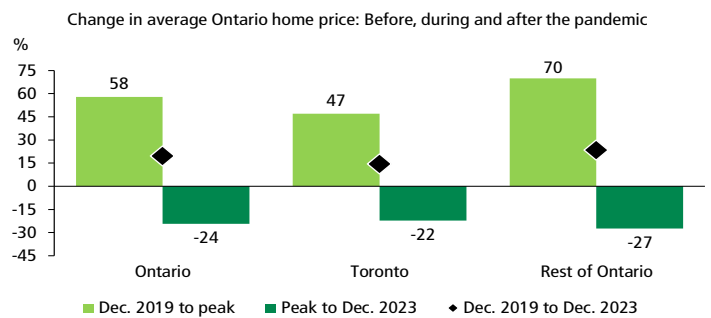
developing on the horizon. We anticipate that the expansion in Canada's largest province will cool to 3,1% in 2022 in 2022 and a possibly contract in 2023 (graph 26). This is because Ontario's economy is particularly vulnerable to the ongoing housing market correction brought about by rapidly rising interest rates and stretched affordability.

GRAPH 26
Economic activity will slow considerably through the end of 2023



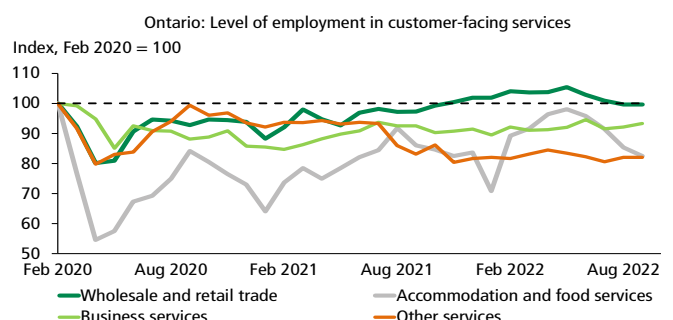
This is especially relevant to those communities that saw a substantial increase in housing market activity during the pandemic, which have largely begun to correct this year (for more information, see our most recent [Economic Viewpoint](#) on the Canadian housing market outlook). Generally, these communities fall within a couple of hundred kilometers of the GTA, including some major centers such as London, Hamilton, St. Catharines-Niagara, and Windsor (graph 27). In contrast, communities further afield, such as Sudbury and Thunder Bay, are expected to see more modest housing market slowdowns. As a result, most communities in Ontario should see a moderation in construction sector activity over the next couple of years, easing labour shortages and cooling wage growth.

GRAPH 27
The biggest price swings in Ontario will ultimately be outside the GTA



While the adjustment in construction and real estate is relatively well understood, at least directionally, the more challenging outlook is for other small business-intensive sectors. Take accommodation and food services. As the Canadian economy moves further away from the volatility caused by lockdowns, economic activity in the sector is converging to a more typical pace. In Ontario, employment in the sector has even declined in past few months (graph 28). The same can be said for other sectors with high small business prevalence, such as wholesale and retail trade

GRAPH 28
Employment in customer-facing services is gradually trending lower

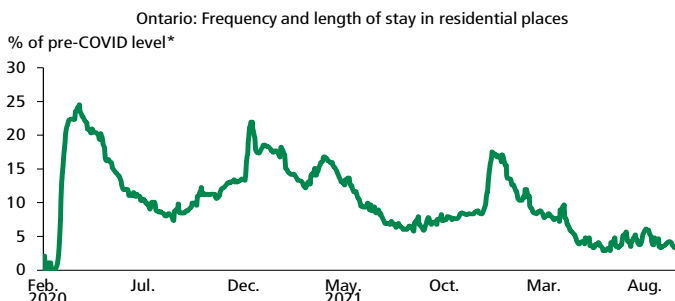


and other services. Unfortunately, these are also the sectors that said they were least able to take on more debt in the most recent Canadian Survey of Business Conditions.

But there is some room for optimism. The coming economic slowdown is likely to have characteristics more typical of those in the 1980s and 1990s, which resulted from rising interest rates. These recessions are generally felt most acutely in goods-producing sectors, whereas small businesses are most commonly found in services-producing sectors. Additionally, we expect the unemployment rate to rise, but the labour market is anticipated to remain relatively healthy when compared to past recessions. A cooling of the economy should also help to reduce the strain from input cost inflation and labour shortages that are proving so challenging. Finally, while elevated inflation has eroded the purchasing power of deposits and falling asset values have eroded wealth, the level of household savings remains elevated.

This said, a notable uncertainty in the near-term outlook for small businesses in Ontario is the return to work following the pandemic. Ontarians are returning to work, albeit gradually (graph 29). According to the Canadian Survey of Business Conditions, a majority of companies in most industries in Canada plan to work exclusively onsite in the near term. But there are exceptions. These include professional services, information and culture, and finance and insurance, which make up nearly 20% of employment in Ontario and more than 20% of GDP.

GRAPH 29
People are working from home less and less frequently



* 7-day moving average of the baseline is the median value, for the corresponding day of the week, during the 5-week period Jan 3–Feb 6, 2020.

Sources: Google Community Mobility Reports and Desjardins, Economic Studies

The activities of these sectors have important implications for small businesses in Ontario, and much more so in parts of the province where they make up a larger share of economic activity. Going forward, employees in these sectors may continue to work exclusively remotely and in hybrid circumstances or they may revert to pre-COVID practices. Only time will tell.

Taking the long view on Ontario's economy

While Ontario's economy is likely to slow into 2023, we expect any potential recession to be short and shallow. At the same time, there are long-term structural drivers that will help to support the Ontario economy and, by extension, small businesses.

The first is the outlook for immigration. From 2022 through 2024, the [Government of Canada](#) intends to admit roughly 445,000 immigrants annually, or more than 1.3 million in over three years. Between 2015 and 2020, the share of international immigrants destined for Ontario has risen from over 36% to more than 47%. While elevated commodity prices may redirect some of the impending immigrants to resource-rich provinces, Ontario is likely to remain the primary destination for international migration to Canada. This will help to offset the economic and fiscal drag from an ageing population. It will also help to address the labour shortages that the CFIB's Business Barometer has identified as a key factor limiting the ability of small businesses to increase sales or production. (see Appendix 1 for more information on how labour shortages are impacting small businesses and what they are doing to address them.)

Second, geopolitical tensions and the pandemic have reinforced the need for 'just-in-case' supply chains. According to [Bloomberg](#), references to 'onshoring', 'reshoring' and 'nearshoring' in Q2 2022 earnings calls hit an all-time high. This could help to deepen supply chain integration in North America, with direct and indirect benefits for small businesses in Southwestern Ontario and beyond (e.g., small manufacturers or wholesalers could pick up new contracts that had previously benefitted overseas suppliers). It could also help to improve productivity as Canadian firms adopt new technologies and processes. But it's important to keep in mind that the move to greater supply chain reshoring remains in its infancy, and that not all industries will benefit at the same pace or to the same degree. (see Appendix 2 for more information on supply chain disruptions and what business are doing to correct them.)

Third, the energy transition has reinforced the need for security in critical minerals. Northern Ontario has a wealth of these resources, many of which have been identified but remain untapped. Much like manufacturing, the development of these resources will be dominated by large players given the long investment horizons. But it will have important knock-on benefits for small businesses in communities benefitting of the expected resource boom. (see Appendix 3 for more information on how the green transition is impacting Canadian businesses.)

Finally, greater investment in technology and digital solutions will help small businesses to alleviate the challenges of labour shortages, supply chain disruptions, and the energy transition. In Ontario, organizations like [MaRS](#) focus on giving Canadian science and technology companies access resources to support every stage of growth. Among its many initiatives is accelerating

the integration of artificial intelligence (AI) across the supply chain industry. These sorts of activities are helping to drive down the cost of investing in technology and digital solutions. At the same time, other organizations help companies gain access to resources to support investment as well as broader knowledge to accelerate business development.

Conclusion

The pandemic was difficult for all businesses, but particularly small businesses. And after a brief resurgence following the end of lockdowns, the outlook is again uncertain as the economy slows on rising borrowing costs. This will pose challenges for small businesses in all sectors of the economy this year and next.

But looking beyond the near term, the outlook for economic growth in Ontario and, by extension, small businesses is more positive. Elevated levels of immigration, reshoring in response to geopolitical tensions and the pandemic, and Ontario's endowment of critical minerals needed for the energy transition position the province and small businesses well for future prosperity.

Appendix I

How are small businesses coping with labour shortages?

The current labour shortage in Ontario and beyond is in no way a small-business-specific issue. In fact, labour shortage concerns are more prevalent among Ontario businesses with 100+ employees (54%) and 20-99 employees (60%). In contrast, the smallest businesses say they are less impacted (25% for those with 1-4 employees, 43% for those with 5-19 employees), according to Q3 Canadian Survey of Business Conditions (graph 1.1).

GRAPH 1.1
Ontario: Labour shortage concerns are highest among businesses with 20+ employees

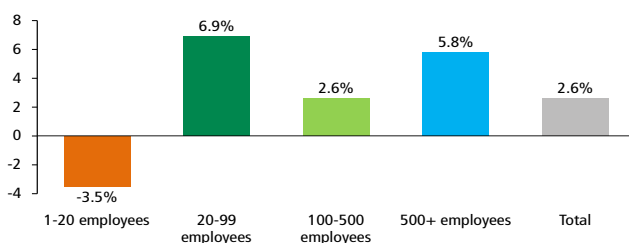


Sources: Statistics Canada and Desjardins, Economic Studies

Still, very small businesses appear to be struggling to hire at the same speed as their larger counterparts, according to the latest employment figures in Canada. Employment grew fastest in businesses with 20-99 employees (+6.9%) and those with 500+ employees (+5.8%), while very small businesses (1-20 employees) saw a decline in year-over-year employment through September 2022 (graph 1.2).

GRAPH 1.2
Canada: Businesses with less than 20 employees have seen a decline in employment over the last 12 months

Growth in employment (%) by business size, Canada, September 2022 vs September 2021



Sources: Haver and Desjardins, Economic Studies

While still a pressing concern for businesses, there may be some easing of labour shortage pains in the coming months as a result of an expected cooling of the red-hot Canadian labour market. We may already be seeing early signs of this. In September, the [CFIB's Business Barometer](#) signalled a decrease in its skilled labour shortage indicator, with 51% of businesses indicating skilled labour shortage limited their ability to increase sales & production (down from its peak of 56% in July 2022).

Small businesses can lean on culture and workplace flexibility to attract talent

Small businesses can appear at a disadvantage competing for talent against bigger organizations. There are a few reasons for this: limited budget for recruitment, less brand recognition, lack of access to the same kind of cash flow, credit, and economies of scale that larger organizations enjoy. This makes it harder for small businesses to offer conditions like competitive wages or sign-on bonuses.

However, as workers are increasingly seeking so-called relational factors when accepting a job ("flexibility, community and an inclusive culture", according to [McKinsey](#)), small businesses can look to other strengths that distinguish them from larger corporations. These include, for example, opportunity for growth and development, flexibility to work remotely / to try new things, more influence on company's direction, access to company leaders, and distinctive company culture (e.g. community, family-friendly). When it comes to non-pay incentives, such as group benefits insurance plans (health, mental health, etc.), the Canadian Life and Health Insurance Association reported heightened interest in workplace plans, especially from smaller employers, in 2021 ([Globe & Mail, 2022](#)).

Relief from high inflation is on the way

With rising input costs and wage growth, small businesses may have an uneven capacity to pass through these costs to their customers. While some 60% of Canadian businesses are expecting to increase selling prices in the next 3 months, the question is: by how much? Sectors reporting being hardest hit by rising input costs like agriculture and manufacturing may be able to transfer some of the price increase. But consumer-facing sectors that are more responsive to changing demand will likely see their margins squeezed as a spike in prices could well discourage customers watching their discretionary spending. Given their discretionary nature, arts and recreation, accommodation and food services, and certain retail sectors could therefore be challenged. Still, 80% of accommodation & food services businesses planned price hikes in the next 3 months.

There may be relief on the horizon, however. The labour market showing signs of easing, which will reduce wage pressures. Inflation is also expected to subside, as the impact of the Bank of Canada’s interest rate hikes kicks in. This will reduce the likelihood of a wage-price inflationary spiral.

Using technology to address labour shortages

While some businesses are raising wages to attract workers, others are finding more success with alternatives like automation. According to a [December 2021 CFIB survey](#), the success rate of SMEs investing in automation to resolve staffing issues was the highest (81%) among a variety of approaches. In contrast, despite being used by more businesses, increasing wages had a much lower success rate (31%) (graph 1.3).

GRAPH 1.3
While increasing wages is the most common solution, its success rate is much lower than investing in automation



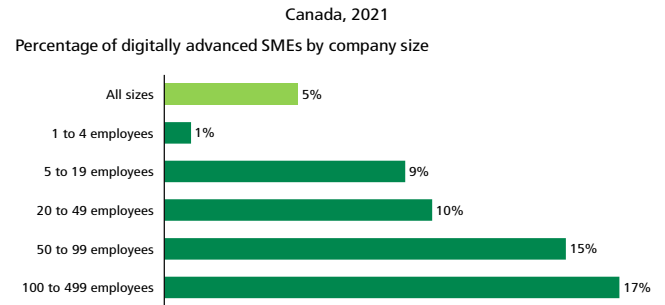
Sources: CFIB and Desjardins, Economic Studies

Automation is gaining traction in some sectors. These include computers and electronics, pharmaceuticals, chemical products, energy and logistics (via Internet of Things (IoT) technology, for instance), to name but a few. And with a preponderance of labour shortages, investments in automation have been made in the food industry as well, including restaurant chains ([Forbes, 2022](#)).

Nonetheless, there are some obstacles to a faster adoption of robotization. Topping the list are costs (which may appear prohibitive to small businesses), lack of skilled workers to operate the new machinery, compatibility issues (e.g., between different robotic devices), or a lack of interest of business owners for these types of investments.

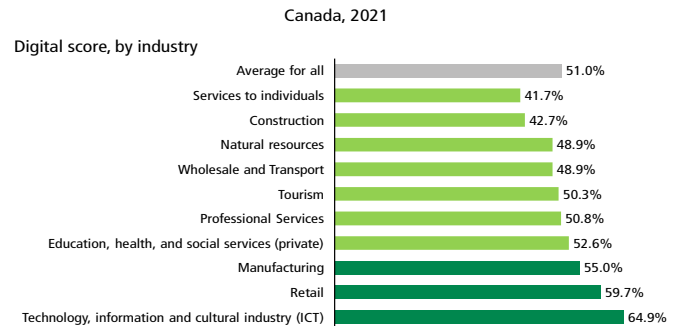
Another clear productivity-enhancing shift related to automation, but that goes even further, is digitization (spanning customer experience, data & analytics, etc.). A recent [BDC study](#) found that SMEs with greater digital maturity displayed stronger growth, less difficulty accessing financing, more innovation and investment, and greater resilience. And there is space for small businesses to grow in this area, since smaller SMEs scored lower on digitization (graph 1.4). While SMEs in the areas of information and communications technology (ICT) as well as

GRAPH 1.4
Larger SMEs tend to be more digitally mature



Sources: BDC (Digital Assessment Survey, 2021, 1,599 respondents)

GRAPH 1.5
ICT, Retail and Manufacturing SMEs have a higher digital maturity



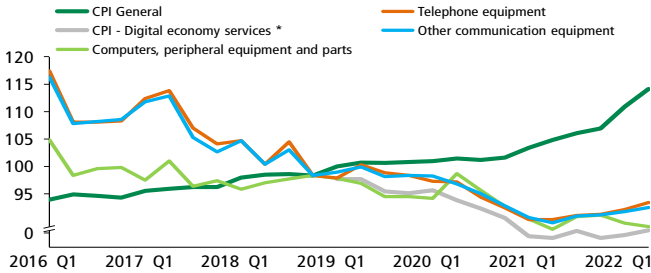
Sources: BDC (Digital Assessment Survey, 2021, 1,599 respondents)

manufacturing tend to score highest, other sectors like services to individuals and construction are lagging behind (graph 1.5). The main challenges to digitization include cost, cybersecurity, uncertain return on investment, and technology integration. According to BDC’s business survey, “It’s not just a matter of integrating the new technology with existing systems (a major challenge for 49% of businesses), but of finding the time and resources required to integrate the technology within the business (a major challenge for 62% of businesses).”

On the cost front, however, technology is increasingly affordable for small businesses (graph 1.6 on page 14), which will incentivize greater adoption. Publicly-funded programs are also encouraging adoption, such as [Boost Your Business Technology Stream](#), which offers financial support to Canadian SMEs, like small manufacturing and food operations, to adopt new technology.

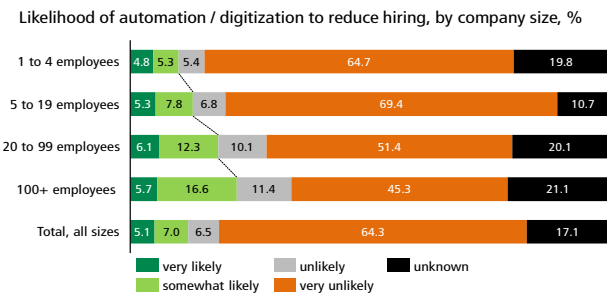
Looking ahead, only 10% to 20% of Ontario businesses surveyed in Q3 2022 said they were very likely or somewhat likely to adopt automation and digital technologies that may reduce hiring over the next 12 months (graph 1.7 on page 14). But it is encouraging that businesses with 20 to 99 employees are those with the highest proportion of “very likely” responses, ahead of even larger companies.

GRAPH 1.6
Good news for small businesses: the cost of technology is decreasing
 Digital technology price indices (Index Dec 2018 = 100)



Notes: Statistics Canada Table 18-10-0004-01 and 18-10-0269-01. *Series begins in 2019
 Sources: BDC, Statistics Canada, and Desjardins, Economic Studies

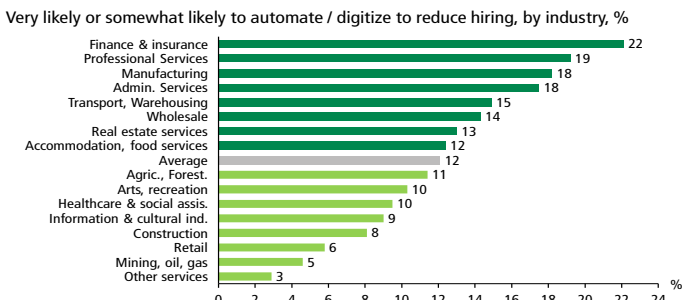
GRAPH 1.7
Likelihood to adopt automation and digital technologies to reduce hiring is fairly low, but is higher for businesses with 20+ employees
 Ontario, Q3 2022



Sources: Statistics Canada and Desjardins, Economic Studies

Looking at the industry level, those that say they are ‘very likely’ or ‘somewhat likely’ to automate and/or digitize to reduce hiring are finance and insurance, professional services, manufacturing, and administrative services (graph 1.8). Scoring lowest are other services, retail trade and construction – all with a high prevalence of small businesses – as well as mining, oil & gas. The uncertain outlook for the economy may explain the reluctance of

GRAPH 1.8
Likelihood to automate and digitize to reduce hiring is highest in Finance/insurance, Professional services and Manufacturing
 Ontario, Q3 2022



Sources: Statistics Canada and Desjardins, Economic Studies

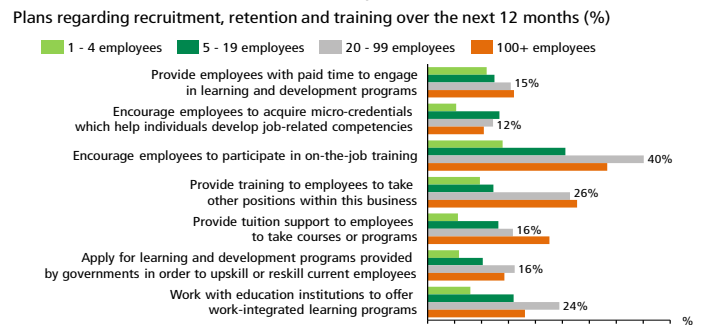
businesses in these industries in making significant investments at the moment. It will be interesting to watch how the trend evolves as the outlook unfolds. Even if a downturn alleviates labour shortages, the ageing of the labour force means that any respite will only be temporary, thus keeping investment in automation a top priority.

Training & credentialing in small businesses

Automation and digitization will continue to transform the types of skills and specializations required in many companies. But how are small businesses contributing to training and credentialing workers, and therefore improving productivity?

A Statistics Canada survey from the first quarter of 2022 shows that businesses with 20-99 employees are at least as likely as larger ones to engage in on-the-job training (40% of businesses having plans in that respect over the next 12 months). Working with educational institutions to offer work-integrated learning programs such as co-ops, internships and apprenticeships is also top of mind. That said, very small businesses (1-4 employees) are generally less likely to offer training programs than larger businesses (graph 1.9).

GRAPH 1.9
Businesses with 20-99 employees are active in training employees
 Ontario, Q1 2022



Sources: Statistics Canada and Desjardins, Economic Studies

Appendix 2

How are small businesses contending with supply chain challenges?

Canadian companies are no strangers to the turbulent waters of global trade. With one of the highest shares of total trade to GDP in the G7, Canadian companies have long learned to adapt to the ever-shifting global trade winds. They have contended with the emergence of China and other emerging markets on the global stage and the negotiation (and renegotiation) of the North American Free Trade Agreement (NAFTA), among other major developments. Through it all, Canadian exporters have weathered the storm.

Then into the highly-integrated but politically-vulnerable global trade environment came the COVID-19 pandemic. As manufacturing in Europe and North America largely ground to a halt due to public-health-mandated lockdowns, vulnerabilities became painfully evident. Countries weren't able to get access to even the basic products they needed to keep their health systems and economies running, such as personal protective equipment (PPE). This led to international competition for necessary products.

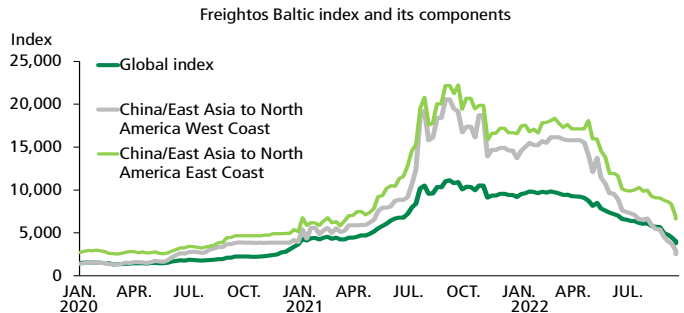
But it wasn't just necessities. Access to all finished and intermediate goods became significantly challenged across the globe (graph 2.1). This posed significant challenges for businesses, forcing them to dramatically increase their orders to meet surging demand and depleted inventories, driving up shipping costs in the process (graph 2.2). And with a majority of goods seeing decades-high price gains, substitution for lower-cost goods became very difficult.

GRAPH 2.1
Supply chain pressures have eased



Sources: Federal Reserve Bank of New York and Desjardins, Economic Studies

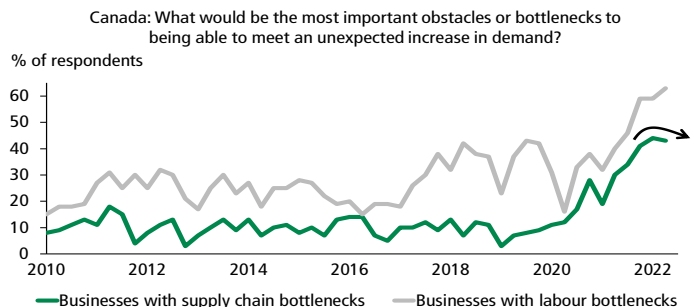
GRAPH 2.2
Container rates continue to normalize



Sources: Datastream and Desjardins, Economic Studies

Fortunately, [our research](#) suggests that the worst of the supply chain snarls are likely behind us. But while the worst may be in the rear view, supply chains continue to remain very constrained. According to the Bank of Canada's most recent [Business Outlook Survey](#), the share of firms pointing to supply chain bottlenecks as the most important obstacle to being able to meet an unexpected increase in demand has only come down slightly from its record high in the first quarter of this year (graph 2.3). The latest Canadian Survey of Business Conditions from Statistics Canada only reinforces that supply chain challenges continued into the third quarter of 2022. Looking more closely to small and medium-sized enterprises (SMEs), responses to the Canadian Federation of Independent Business' (CFIB) [Business Barometer](#) survey suggest they are also struggling with easing but still highly-constrained supply chains (graph 2.4 on page 16).

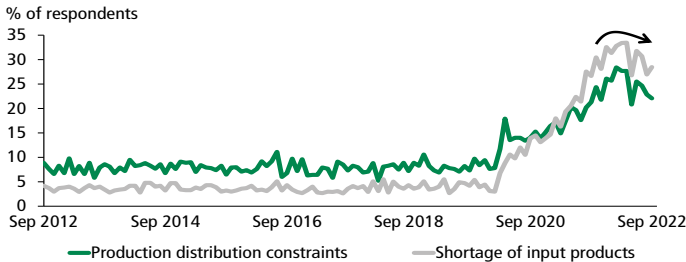
GRAPH 2.3
Supply chain issues continue to be a major roadblock for Canadian businesses



Sources: Bank of Canada and Desjardins, Economic Studies

GRAPH 2.4
Supply chain constraints are easing but remain elevated for SMEs

Canada: What factors are limiting your ability to increase sales or production?

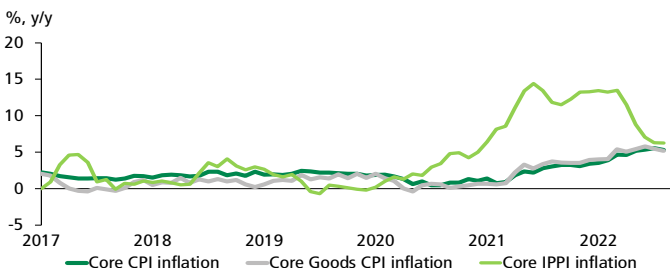


Sources: Canadian Federation of Independent Business (CFIB) and Desjardins, Economic Studies

Importantly, easing supply chain constraints have already begun to show up in rapidly-slipping producer prices, even when excluding food and energy (graph 2.5). And while this downshift in goods inflation is just starting to be reflected in core consumer prices, research from [Flexport](#) – a technology platform which draws insights from logistics-related information – suggests reduced logistics pressure in the US and Europe is primarily being driven by slowing demand. Weaker consumer demand is in large part the result of higher interest rates by central banks to control inflation (graph 2.6). Rising interest rates tend to hit interest-rate sensitive parts of the economy earliest and hardest, such as housing and goods consumption, and the trade data from China and elsewhere suggest they are starting to have their intended impact.

GRAPH 2.5
While still elevated, core inflation is beginning to ease

Canada: Various measures of core inflation*

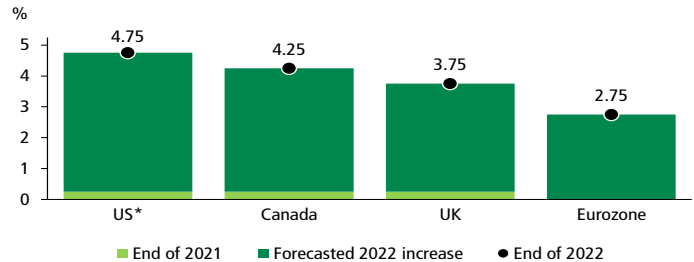


*Core inflation is defined here as all items less food and energy; CPI refers to Consumer Price Index and IPPI refers to Industrial Product Price Index
Sources: Statistics Canada and Desjardins, Economic Studies

Despite the improving environment for supply chains, there is still a long way to go before they return to normal. And there remain material risks on the horizon, such as lockdowns in China due to its zero-COVID policy. A further escalation in geopolitical tensions related to events such as the war in Ukraine also pose a risk. To date, the Russian invasion of Ukraine has had meaningful consequences for the supply chains globally as well

GRAPH 2.6
Major central banks are hiking rates aggressively to combat inflation

Policy interest rates of major economies



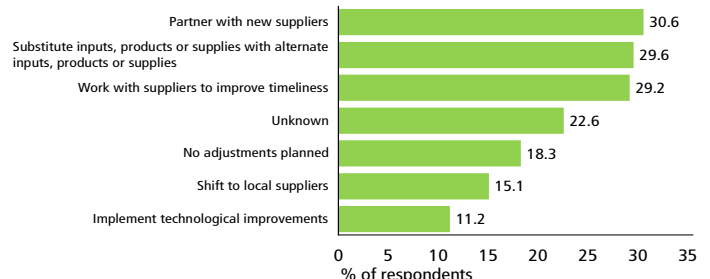
* Upper bound of the target range for the federal funds rate
Sources: Datastream and Desjardins, Economic Studies

as for Canadian businesses. According to [Supply Chain Canada](#), while most companies surveyed believed international sanctions on Russia would impact their supply chains, less than one fifth had sufficient insight to prepare for the potential disruptions. This speaks to the challenges facing Canadian companies when contending with shocks to global supply chains due to the opacity of their supplier networks.

These factors and the events of the pandemic have put renewed focus on 'just-in-case' inventory management as opposed to 'just-in-time'. But what are companies actually doing to reduce the risks of future supply chain disruptions? According to analysis from [Statistics Canada](#) for the third quarter of this year, Canadian businesses are not taking supply chain disruptions laying down (graph 2.7). Many plan to work with existing suppliers to improve timeliness, partner with new suppliers and/or substitute inputs, production or supplies with alternatives. No surprise there, as these are tried and tested approaches to dealing with supply chain issues. Still others are looking to shift supply chains more locally (e.g., reshoring or nearshoring) or to invest in technology and research & development. And that's really where we would expect to see a meaningful change in business behaviour in relation to supply chains if one is actually occurring.

GRAPH 2.7
Companies plan to make adjustments to supply chains going forward

Canada: Business plans to adjust supply chains over the next 12 months (Q3 2022)



Sources: Statistics Canada and Desjardins, Economic Studies

Bringing supply chains closer to home

Looking first at shifting supply chains more locally, this has been a frequent topic of conversation since Donald Trump was elected US President in 2016 on the promise to reduce the trade deficit with China and renegotiating NAFTA. In the US, the [Reshoring Initiative](#) found reshoring accelerated through the pandemic and into 2022 as a result of supply chain disruptions, a destabilizing geopolitical environment and climate change considerations. In contrast, [analysis undertaken by BDC and Deloitte](#) in 2021 on reshoring in Canada concluded that: “Some reshoring does appear to be occurring in a few Canadian sectors, but the trend isn’t as strong here as in the U.S. ... only three of 16 Canadian industries examined show strong evidence of reshoring: machinery manufacturing, medical equipment and supplies manufacturing, and beverage and tobacco product manufacturing.” A few manufacturing industries show what the report calls a “modest likelihood of reshoring”: food, wood products, chemical manufacturing, plastics and rubber products, and fabricated metal products (table 2.1). At the same time, one industry—motor vehicles and parts—did show evidence of a parallel phenomenon called “nearshoring.” This is the trend of bringing production closer home to a nearby country, such as Mexico.

TABLE 2.1
A small subset of industries look to be actively reshoring in Canada

Canada: Likelihood of reshoring among select Canadian industries

INDUSTRY	LIKELIHOOD OF RESHORING
Beverage and tobacco product manufacturing	Strong
Machinery manufacturing	Strong
Medical equipment and supplies manufacturing	Strong
Food manufacturing	Modest
Wood product manufacturing	Modest
Chemical manufacturing	Modest
Plastics and rubber products manufacturing	Modest
Fabricated metal product manufacturing	Modest
Petroleum and coal product manufacturing	Low
Motor vehicle and parts manufacturing	Low

Sources: Business Development Bank of Canada (BDC) and Desjardins, Economic Studies

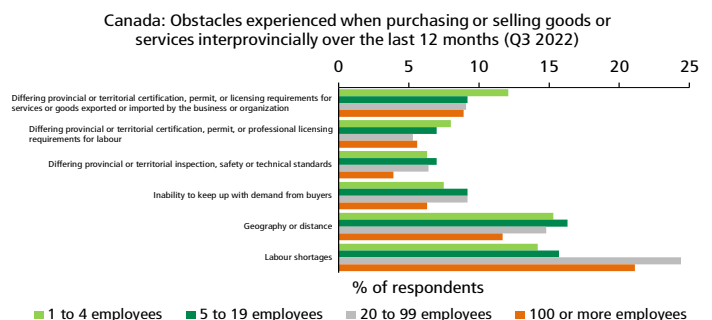
Importantly, this analysis for Canada was conducted prior to the recent acceleration in inflation and the subsequent ramp up in interest rates, both of which have raised costs considerably for businesses. But even then, an updated look at reshoring in Canada using BDC’s approach doesn’t suggest the lackluster trend has reversed yet. This is reinforced by firms indicating it was more difficult to replace foreign direct suppliers than domestic ones as recently as the third quarter of 2022 ([Canadian Chamber of Commerce](#)). This is the case in almost all industries, including those with high small business prevalence like construction, accommodation and foods services, and wholesale and retail trade. As such, small businesses don’t look to be reshoring or nearshoring any more than large businesses do.

Engaging in greater interprovincial trade

Closer to home, companies can also increase their integration in Canadian supply chains by engaging more in interprovincial trade. According to Statistics Canada’s Canadian Survey of Business Conditions for Q3 2022, the obstacle businesses are most likely to experience currently when purchasing or selling goods or services interprovincially are labour shortages. But this is very specific to the current economic circumstances. Geography is also an obstacle that ranks high among Canadian businesses but is one for which there is no quick fix as it requires meaningful new investment in interprovincial transportation infrastructure.

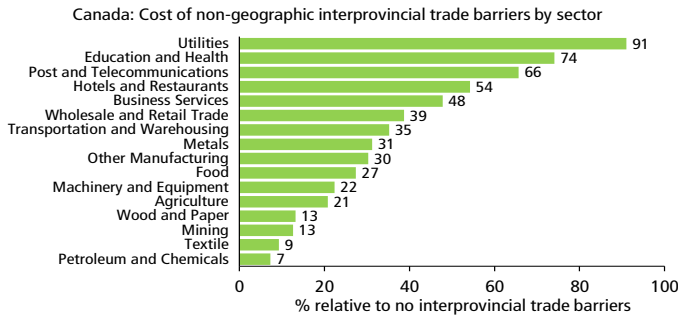
In contrast, other longstanding non-geographic barriers to interprovincial trade that stand out include prohibitive (provincial/territorial law that unintentionally prohibit interprovincial trade, such as restrictions on the sale of alcohol), technical (sector-specific regulations that differ across provinces and territories, such as vehicle weight standards), and regulatory and administrative barriers (provincial and territorial permits, licensing, and other paperwork requirements imposed on business that operate in multiple jurisdictions such as business registry regulations) ([Deloitte, 2021](#)). These internal trade barriers for goods and services are felt disproportionately by small businesses (graph 2.8) ([Canadian Chamber of Commerce](#)). At an industry level, among those sectors experiencing the highest cost of cross-Canada trade barriers are accommodation and food services and wholesale and retail trade, both of which have a very high prevalence of small businesses. Alvarez, Krzmar and Tombe (2019) [estimate](#) that the impact of removing interprovincial trade barriers would be to raise the level of provincial real GDP per capita in the range of 7% to over 22%, with smaller and more remote provinces being the biggest beneficiaries (graph 2.9 on page 18). While at the lower end of this range, in part because Ontario companies of all sizes are more likely to engage in interprovincial trade than those in other provinces, it would still be a net economic beneficiary (graph 2.10 on page 18).

GRAPH 2.8
Small businesses are more impacted by non-geographic trade barriers



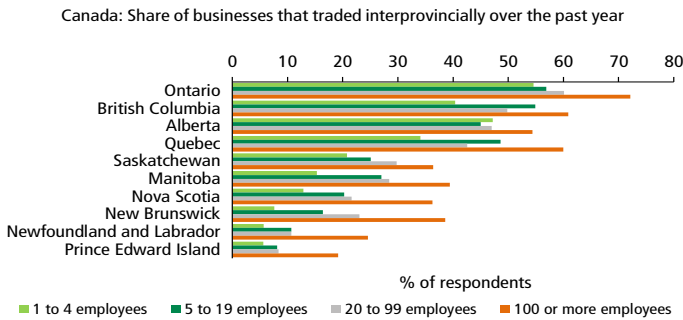
Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 2.9
Non-geographic trade barriers are very costly to Canadian businesses



Sources: Alvarez, Krznar and Tombe (2019) and Desjardins, Economic Studies

GRAPH 2.10
Ontario leads every other province in interprovincial trade activity

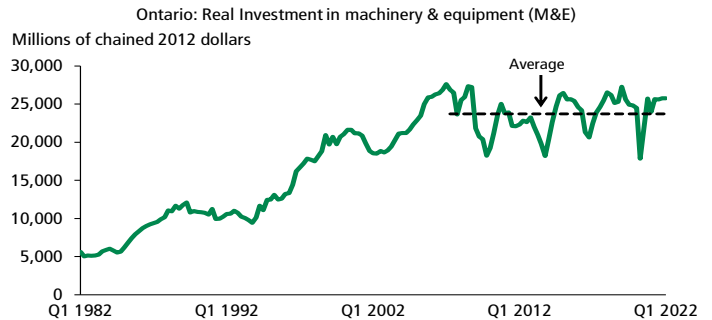


Sources: Statistics Canada and Desjardins, Economic Studies

Investing in technology and digital solutions

Another approach firms are taking to adjust to supply chain disruptions is to invest in technology and digital solutions. According to analysis from the [Canadian Chamber of Commerce Business Data Lab based on Statistics Canada’s Canadian Survey of Business Conditions for Q3 2022](#), “[s]upply chain issues are improving, but most businesses experiencing problems expect them to persist into 2023.” However, over the 12 months following August 2022, only 11% of business plan to implement technological improvements to make adjustment to their supply chains. And this number continues to fall as supply chain constraints ease. In Ontario, real investment in machinery and equipment peaked in Q1 2007 and has been broadly unchanged since (graph 2.11). This is of concern as it suggests companies in Ontario are not meaningfully investing in technological solutions to contend with snarled supply chains. However, digging into the more granular national data, real investment in computers and computer peripheral equipment in Canada continues to increase at a healthy pace, rising at an annualized rate of nearly 15% in the first half of 2022. As such, Ontario companies may be investing in technological solutions to address supply chain challenges but it’s just flying under the radar because of a lack of data.

GRAPH 2.11
Investment in M&E in Ontario has flatlined since 2007



Sources: Ontario Ministry of Finance and Desjardins, Economic Studies

In order for businesses to manage the risk of future supply chain disruptions, the [Business Development Bank of Canada \(BDC\) recommends](#) "... some successful practices that could protect you from supply chain turmoil." These include:

- ▶ Proactively protect your production
 - Maintaining higher inventories
 - Hiring procurement specialists
 - Insisting on fixed-price contracts
- ▶ Improve your business processes
 - Digitize your company
 - Assess the profitability of each product or service
 - Find operational efficiencies
 - Reach out to your lenders
- ▶ Assess your need for additional financing

At the same time, the [Ontario Chamber of Commerce](#) recommended several policy initiatives that the Government of Ontario could introduce to support businesses experiencing supply chain disruptions. These include:

- ▶ Public and private sector collaboration is a must
- ▶ A workforce development strategy is required
- ▶ We need to bring our ports and infrastructure into the 21st century

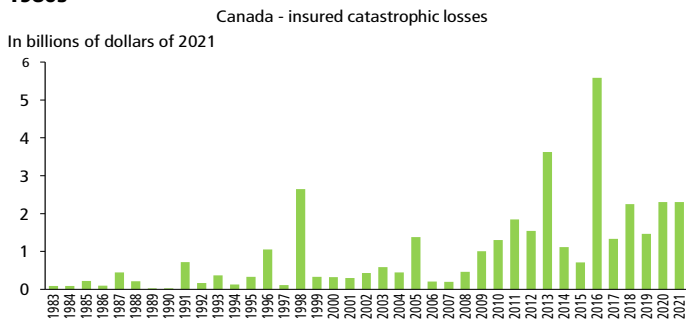
Appendix 3

Are small businesses ready for the green transition?

What are the costs and risks of climate change for businesses?

With the increased frequency and severity of extreme weather events (floods, hailstorms, wildfires, etc.), businesses in Canada and across the globe are facing an imperative to adapt, assess, and mitigate the risks related to climate change. Case in point: commercial losses due to catastrophic events have steadily increased over the past four decades in Canada (graph 3.1).

GRAPH 3.1
Catastrophic losses in Canada have steadily increased since the 1980s



Notes: Loss + loss adjustment expenses in 2021 dollars. 2021 data is preliminary.
Sources: IBC Facts Book 2022 and Desjardins, Economic Studies

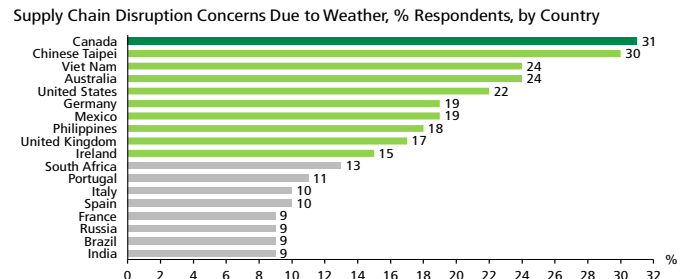
According to the [WTO](#), “climate events, from droughts to floods, pose serious challenges for small businesses in a broad range of sectors, many of which are tied to international trade, such as agriculture and tourism”. Other sectors exposed to climate risks include forestry and fishing, as well as manufacturing and retail and wholesale trade – which are sensitive to global supply chain disruptions.

Are small businesses worried?

According to global surveys, the answer is mixed when it comes to small and medium-sized businesses. A July-August 2021 global survey by Meta of 35,000 micro, small and medium-sized enterprises (MSMEs) showed that respondents are evenly split between those who are worried / somewhat worried (46%) and those that are not at all worried or not very worried (46%). Notably, “respondents from economies located in relatively warmer climate zones and coastal areas had higher shares of respondents reporting being “very worried” (e.g., Italy, Portugal, Spain and Chinese Taipei)” ([WTO, 2022](#)).

Interestingly, nearly a third (31%) of Canadian MSMEs surveyed were concerned by supply chain disruptions due to weather, the highest percentage among the countries surveyed (graph 3.2). The WTO concludes: “Respondents in economies more closely

GRAPH 3.2
Nearly a third of Canadian small businesses express concern over supply chain disruption due to weather



Question: Do you expect any of the following to be challenges to your business over the next 2-5 years? (Supply chain disruptions due to natural disasters and/or severe weather) – Yes
Sources: World Trade Organization (Data: Meta – Facebook Global State of Small Business Data 2022), and Desjardins Economic Studies.

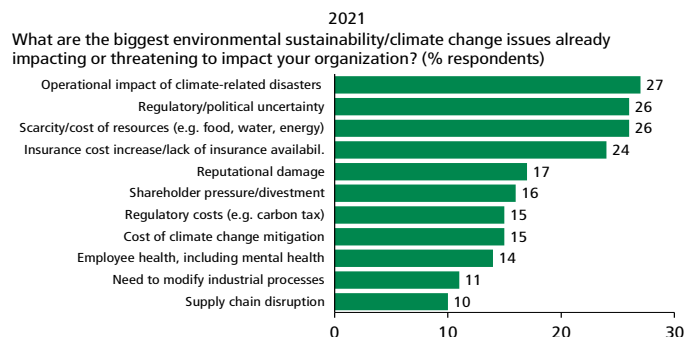
linked to Global Value Chains (GVCs), like Canada, Chinese Taipei and Viet Nam, appear to be more concerned about the effects of severe weather on supply chains.”

The survey also indicates that MSMEs are concerned with costs to be incurred to their operations, as a result of climate change policies and regulations. This is material for some sectors that are known for having higher greenhouse gas emissions as well as small business prevalence, such as construction and agriculture.

How can small businesses assess the risks and costs of climate change?

Climate change is having a clear impact on costs for businesses, according to [Deloitte Global’s Climate Check Report \(2021\)](#) (graph 3.3). This includes operational costs from facilities damage and workforce disruptions, increased insurance costs and, for some, reputational damage.

GRAPH 3.3
Climate change is having clear impacts on costs for businesses



Sources: Deloitte and Desjardins, Economic Studies

To assess the risks they are facing, businesses generally consider three categories of risks: physical risks (physical damage to people, property and transport links), transitional risks (potential costs to businesses as the world moves to a fossil-free economy – the energy industry being the most vulnerable to this type of risk, as well as mining) and liability risks (linked to regulatory and legal compliance: companies that pollute being more exposed to potential litigation) (Zurich, 2022).

This said, businesses need access to relevant information and tools to guide them in these assessments, but these may be lacking for smaller businesses. According to the BDC, one way for businesses to mitigate climate risks is to first measure their carbon footprint. But only a small share of small businesses do so. In Canada, less than 5% of small businesses had measured (or planned to measure within 12 months) their environmental footprint vs 15% for companies with over 100 employees. Additionally, over a third have no environmental practices in place or planned within 12 months (according to Statistics Canada’s Canadian Survey of Business conditions, Q3 2022) (graph 3.4).

are likely to require a more regular and systematic assessment of their carbon emissions. Yet, it could also suggest that smaller businesses find it more difficult to measure their carbon footprint, and greater adoption could be achieved by signposting them to the appropriate guidance or support.”

What role do small businesses play in the green transition, and what hurdles do they face?

A review of different surveys worldwide leads to converging conclusions:

1. Even though small businesses may individually be small carbon emitters, their collective size means they are critical to achieve decarbonization targets.

In the UK, SMEs, in aggregate, are estimated to account for about half of industrial emissions.

2. Small businesses that do not participate in the green transition face risks

This is especially true for those small businesses that supply large corporations that are increasingly looking to create sustainable supply chains. And these large firms depend on their suppliers, including SMEs, to decarbonize. According to the Financial Times (2022), PepsiCo estimates that 92 per cent of its carbon emissions come from outside the firm’s own operations but only 8 per cent of its suppliers have approved climate targets (in line with the Science-Based Targets initiative).

This means that small businesses have a role to play in reaching net zero supply chains : 20 to 30% of total estimated investment needed should come from small businesses, according to a BCG-HSBC report.

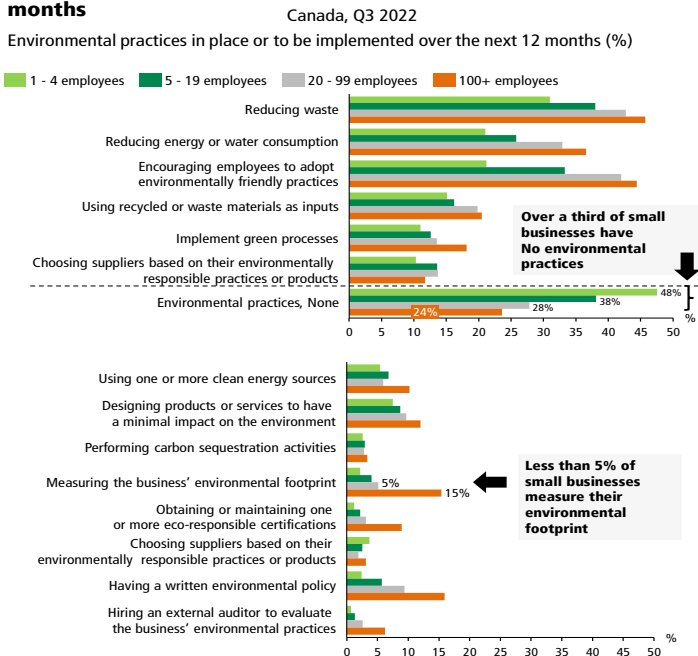
And there is increased pressure from investors. Small businesses looking to sell to a private equity firm or strategic buyer, or to raise venture capital, should know these firms increasingly include sustainability criteria in their investment decisions (see BDC).

3. Small businesses are lagging to translate their awareness into actions

According to the British Business Bank, the level of maturity and preparedness of SMEs to green transition is lagging in many respects. “Over three in four businesses (76%) are yet to implement comprehensive decarbonisation strategies”. Lack of awareness does not appear to be the key challenge (nearly 60% of SMEs surveyed reported reasonable awareness of key net zero concepts).

4. SMEs face information and cost hurdles when it comes to carbon reduction

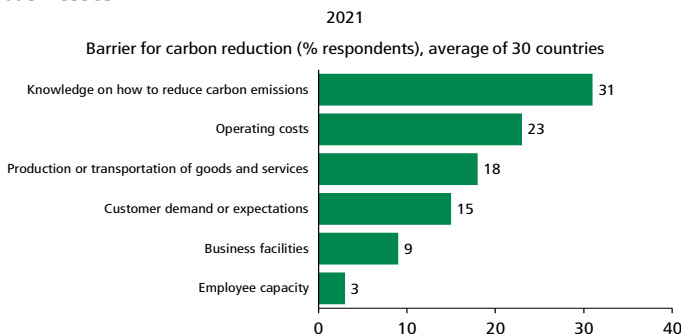
GRAPH 3.4
Larger businesses are more likely to have environmental practices in place or planned to be implemented over the next 12 months



Similar results are found in other developed economies, like the UK: only 6% of SMEs have measured their carbon footprint in the last five years, according to a 2021 British Business Bank survey. The government-funded bank concludes: “Larger SMEs and those with high awareness of net zero concepts and who prioritise reducing carbon emissions are most likely to measure their carbon footprints. This is expected, as larger businesses

According to the WTO: “micro, small and medium-sized enterprises (MSMEs) are aware of climate change, and know that they need to adopt decarbonization practices in order to participate in supply chains, but they face obstacles, especially in accessing information about the changes to be made in their businesses and the cost of change.” Top barriers to carbon reduction, based on a 2021 global survey by Meta, are knowledge on how to reduce carbon emissions (31%), followed by operating costs (23%) (graph 3.5).

GRAPH 3.5
Knowledge and operating costs are the top barriers for small businesses



Sources: WTO (data: Meta 2021) and Desjardins, Economic Studies

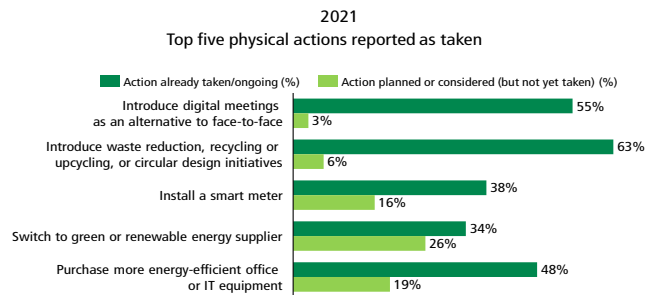
Among British SMEs, the most commonly perceived barriers to net-zero action were around cost, notably upfront costs (35% of respondents) and feasibility (32%). “Lack of control over actions was a key driver of feasibility concerns. This included limitations due to tenancy arrangements or supply chain partners. (...) For actions already taken, the most common driver by far was that it ‘made financial sense’ (51%) (...). Lack of knowledge is affecting uptake of net zero actions, reflected in the 12% of respondents that explicitly mentioned barriers relating to information.”

What strategies are small businesses taking to decarbonize?

The top 3 environmental strategies cited by small businesses in Canada are reducing waste, reducing energy and water consumption, and encouraging employees to adopt environmentally friendly practices (graph 3.4 on page 20).

The experience of the UK provides some useful insight. According to the [British Business Bank](#), the top 3 physical actions by SMEs to reach net zero in the UK are: 1) Introducing waste reduction, recycling or upcycling or circular design initiatives; 2) Introducing digital meetings as an alternative to face-to-face; and 3) Purchasing more energy-efficient office or IT equipment (graph 3.6). Other actions reported as being planned by 20% or more SMEs included the introduction of very-low-emissions business vehicles, switching to green or renewable energy supplier, and purchasing lower-carbon goods and services for their business.

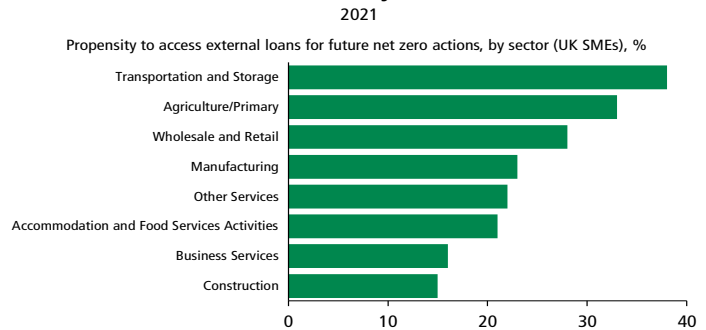
GRAPH 3.6
Physical actions taken or planned by UK SMEs to reach net zero



Sources: British Business Bank and Desjardins, Economic Studies

Looking at specific industries, the UK results indicate that the construction sector – which has high small business prevalence – is generally lagging in both awareness and concrete actions. It also shows the lowest propensity to access external loans for future net zero actions (graph 3.7).

GRAPH 3.7
The construction sector stood out as less mature than other industries, in the British SME survey



Sources: British Business Bank and Desjardins, Economic Studies

Who stands to gain from the green transition?

The green transition has the potential to unlock new opportunities. These include new technologies and innovation in products and services to mitigate climate-change risks, reduce consumption of energy and emissions, adjust to new ESG investor criteria, etc. From primary industries like agriculture to transportation, manufacturing, construction, IT and other services: gains can be made by businesses who adapt and innovate. Research also shows that there is enormous potential for job creation as part of the energy transition as well ([World Economic Forum, 2022](#)).

Sectors exposed to a net-zero transition include not only the fossil fuel sector, but also sectors like motor vehicle production and construction which play a key role in Ontario’s economy. The decarbonization of the construction sector involves for example improving energy-efficiency of building (through insulation),

and low-emissions systems for heating. With regards to auto production, Ontario is looking to grow its auto sector by building at least 400,000 electric and hybrid vehicles by 2030, according to a [KPMG study](#). The Canadian and Ontario governments have invested in a \$5 billion joint venture with two private sector companies that will create Canada's first large-scale domestic EV battery manufacturing facility, in Windsor. The plant, that will produce lithium-ion battery cells and modules, is expected to create an estimated 2,500 new jobs, according to KPMG.

These chains are intertwined, and small businesses, given their collective weight, will continue to be key players in achieving global climate outcomes. We can expect them to seek guidance, tools, and financing, in order to contribute their fair share.

The mining sector will play a major role in the energy transition, given that many metals and minerals are essential to transport electrification (notably battery material) and the development of greener technologies. In Canada, the federal government has confirmed its support to the development of zero-emissions vehicle value chain : \$3.8 billion over eight years, announced in the [2022 federal budget](#), as part of Canada's first [Critical Minerals Strategy](#). The Government of Ontario has also introduced its own Critical Mineral Strategy, which looks to support the development of mining opportunities in the north. Ontario stands to benefit further as the Toronto Stock Exchange (TSX) and TSX Venture Exchange (TSXV) are the world's primary listing venues for mining and mineral exploration companies. Beyond large corporations, the mining sector in Ontario also depends on smaller suppliers of products and services down the value chain, who stand to gain from this transition.

Conclusion: two sides of the same coin

To conclude, when it comes to green transition, businesses need to consider two related chains of interactions: 1) reducing the impact of the environment on their business' operations (via climate risk mitigation), and 2) reducing their business operations' impact on the environment (via decarbonization and other waste- and emissions-reduction initiatives, such as a circular economy approach) (Figure 3.1).

FIGURE 3.1
Environment and business operations : a two-way feedback loop

