



Study

January 2019

Investment Intentions of Canadian Entrepreneurs

An Outlook for 2019

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Introduction

The more an entrepreneur invests in his or her business, the more competitive it becomes.

Business investment generates strong growth

Investment matters. Businesses with fewer than 500 employees make up 99.7% of Canada's private sector companies and employ nine out of 10 private sector workers. With small to mid-sized businesses being so numerous, the cumulative effect of their capital spending makes an important contribution to economic growth. Studies show that businesses that invest more experience strong growth and generate more profit. In addition, by increasing spending on productive assets that generate profit and cash flow, small businesses become more productive and innovative, and are able to pay higher wages. Put simply, the more an entrepreneur invests in his or her business, the more competitive it becomes.

To get a full picture of what 2019 will look like in terms of small business investment, BDC asked more than 4,000 business owners about their investment plans for the year. This report summarizes their views on their spending intentions, their motivations for investing and the factors that may change their plans.

For the first time, BDC is using the balance of opinion results to measure the 2019 investment intentions of entrepreneurs, conforming to what the Bank of Canada uses to gauge sentiment. This study provides insights for both entrepreneurs and decision-makers. While presenting statistics on investment intentions, it also looks at the challenges entrepreneurs must overcome to invest in their businesses. Business owners may wish to use the results to benchmark their company's investment against that of other companies in their region.

We are pleased to present our fourth annual report on entrepreneurs' investment intentions. We trust you'll find this study useful.

Highlights

Nearly half of business owners will spend money to adopt new technologies in 2019.

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- Overall, business leaders remain optimistic and will continue investing in 2019. However, they will spend roughly the same as they did in 2018.
 - The labour shortage is the top-cited reason for holding back on investment, with over half of business owners saying they will limit investment because of it.
 - Business confidence in the Canadian economy varies across the country. Confidence is higher in Quebec and lower in the Prairies.
 - Canada's exporters and business-oriented sectors lead investment intentions.
 - Nearly half of business owners will spend money to adopt new technologies in 2019, investing mainly in intangible assets, such as software, training and intellectual property. This marks a shift in investment away from tangible assets, such as equipment and machinery.
 - A quarter of all businesses that will allocate all of their investment to new technologies expect revenues to grow by 20% or more this year, compared to only a tenth of all businesses that will allocate their investment differently.
 - A minority of businesses will account for the majority of investment, with 10% of entrepreneurs accounting for 71% of total capital spending.
 - Another investment obstacle facing entrepreneurs is that their businesses are not generating enough cash. They could invest more if they borrowed, because credit conditions remain favourable in Canada, but they prefer to avoid taking on debt.
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What do we consider business investment?

Business investment, or capital spending, is money that a business spends to buy tangible or intangible assets.



Tangible assets are the machinery, equipment and materials workers use in their jobs, and the buildings where production takes place.



Intangible assets are non-physical things—such as intellectual property, software, research and development, and marketing—that businesses depend on to prosper in a modern economy. Intangible assets also include investments to improve worker skills.



Business acquisitions are another form of investment. A business may purchase a supplier or a customer to leverage economies of scale and secure access to inputs, such as raw materials and other resources; or it may buy a rival to expand its market share. A business may even buy a company to acquire its technology or its key employees and their know-how.

Business investment excludes the purchase of shares, bonds and other securities. It also excludes residential investments and everyday expenditures, such as fees for maintenance, repairs or the day-to-day operations of the business.

How do we measure investment intentions?

For the 2019 study, BDC is using the **balance of opinion** to measure a region's investment outlook. The balance of opinion provides a better measure of investment trends than previously used approaches. Simply put, it's the difference between the percentage of entrepreneurs who plan to invest more and the percentage who plan to invest less. A positive balance sends a signal that investment intentions are up, while a negative value means they are down.



Balance of opinion

=



% spending more

-



% spending less

1

Business and investment outlook in 2019

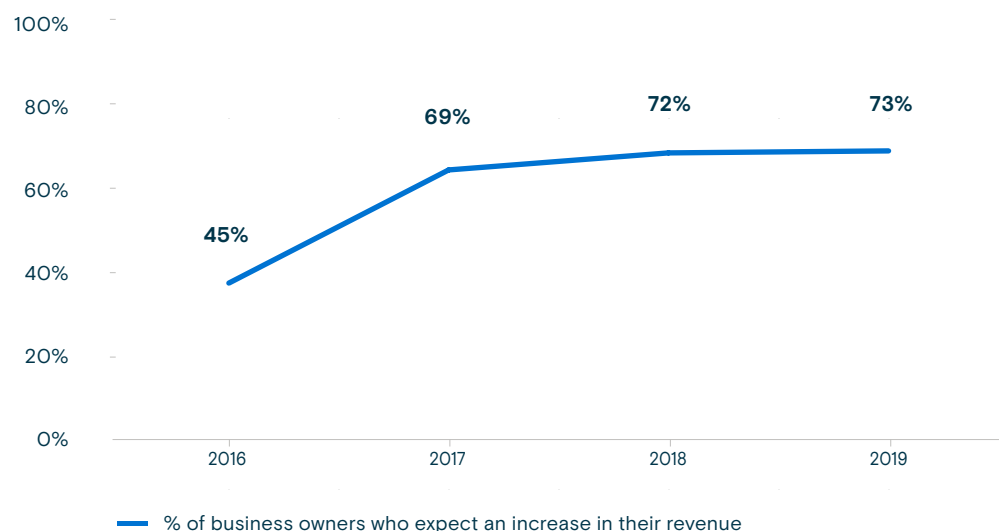
1.9%
expected growth of the economy in 2019.

We expect investment intentions will remain roughly flat in 2019 compared to 2018, even if business optimism remains high among entrepreneurs. Rising concerns about the economy and rising capacity constraints—especially with the ongoing shortage of qualified labour—all weigh on investment intentions.

The economy in 2019 is expected to perform well at a steady pace—the same pace as last year and just a little slower than two years ago. The economy will grow by 1.9% in 2019, compared to 2.1% in 2018 and 3.0% in 2017.¹

With strong growth in recent years and steady growth this year, optimism is still quite high among owners of small and mid-sized businesses (Figure 1). Almost three-quarters of business owners expect their revenues will grow in 2019, about the same proportion as in 2018. However, the plateau in business optimism suggests that the economy may be reaching its full potential.

Figure 1 – Business optimism is still high, but plateauing



Source: BDC, *Investment Intentions Survey*, 2015, 2016, 2017 and 2018. Base: All respondents.

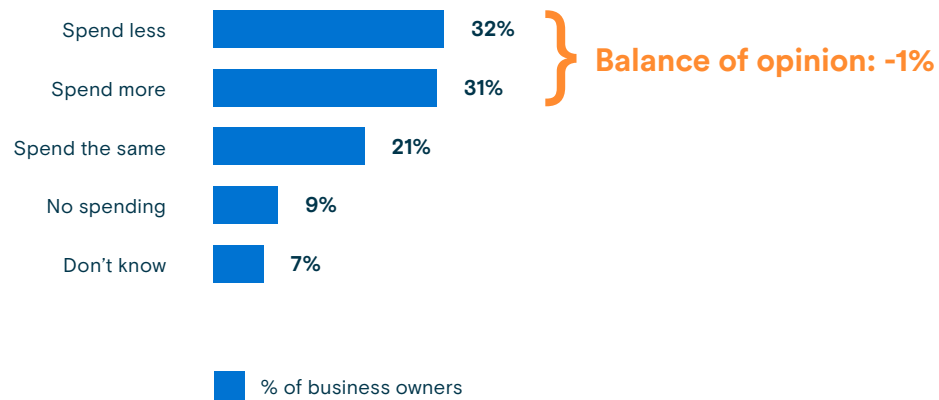
¹ Consensus Forecasts (London: Consensus Economics Inc., December 2018)

High business optimism fails to translate into higher capital spending for 2019.

Investment intentions will remain roughly flat in 2019

Our survey results for the coming year are mixed in terms of investment intentions. The high business optimism observed in Figure 1 fails to translate into higher capital spending for 2019. Indeed, the **balance of opinion** on investment intentions in Canada remains roughly flat, at -1 percentage point (Figure 2). This means that the number of entrepreneurs who want to cut back on spending (32%) offsets those planning to spend more (31%). A fifth of business owners plan to spend the same amount as last year (21%), while 16% will not or do not know whether they'll invest in their business.²

Figure 2 – Investment intentions will remain roughly flat in 2019



Source: BDC, *Investment Intentions Survey*, 2018. Base: All respondents (n=4,024).

² At the time of writing, the federal government's new tax measures to stimulate business investment had not yet been announced. These measures will likely encourage some businesses to invest more. The findings presented in this study do not reflect the impact of these new measures. For more information, please read BDC's December 2018 *Economic Letter*.

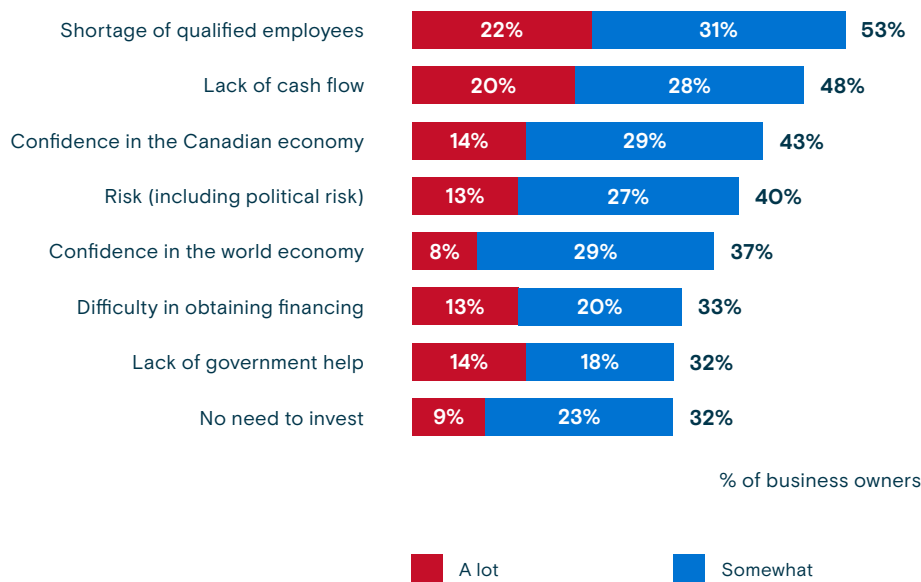
53%
of entrepreneurs
say that the
shortage of qualified
employees will
limit their investment.

The labour shortage is the main barrier to investment

Businesses invest when they have the capacity and the confidence to do so. Our survey reveals that over half of business owners will restrict their investment because of labour-related capacity constraints, followed by a lack of financial resources and lower confidence in the economy (Figure 3).

Figure 3 – Lack of qualified employees and a lack of cash are the top reasons cited for limiting investment

Will the following elements limit your investment in Canada in 2019?



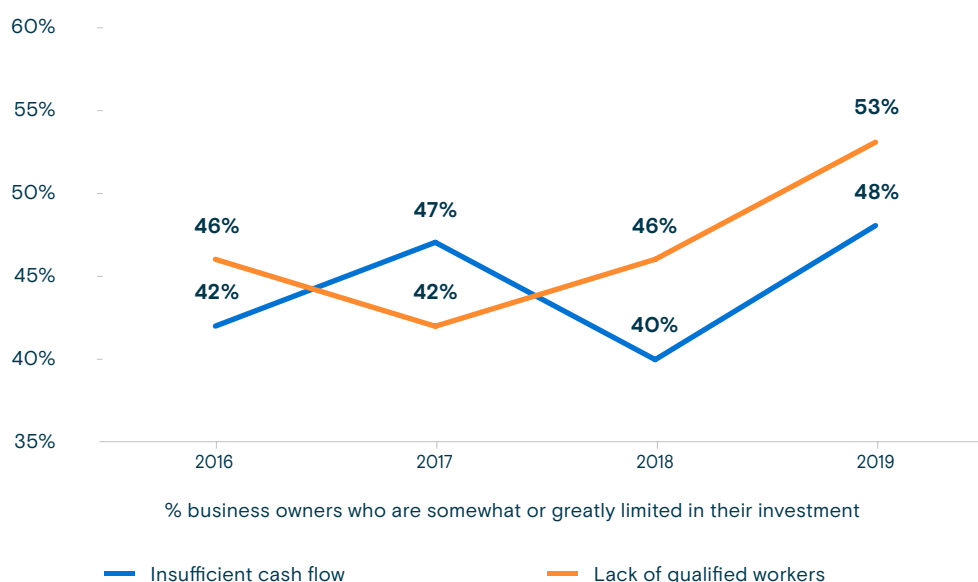
Source: BDC, *Investment Intentions Survey*, 2018. Base: All respondents (n=4,024).

Demographic changes will make chronic labour shortages worse over the next decade.

Businesses can't find qualified workers to grow their companies

For the second year in a row, Canada's labour shortage is the top factor limiting the ability of many entrepreneurs to invest in their businesses, and this issue is becoming increasingly acute (Figure 4). A recent BDC study found a direct link between the shortage of workers and slower growth in a company's sales. What's more, demographic changes will make chronic labour shortages worse over the next decade.³

Figure 4 – Labour and cash constraints are becoming increasingly important



Source: BDC, *Investment Intentions Survey*, 2015, 2016, 2017 and 2018. Base: All respondents.

Insufficient cash flow limits spending

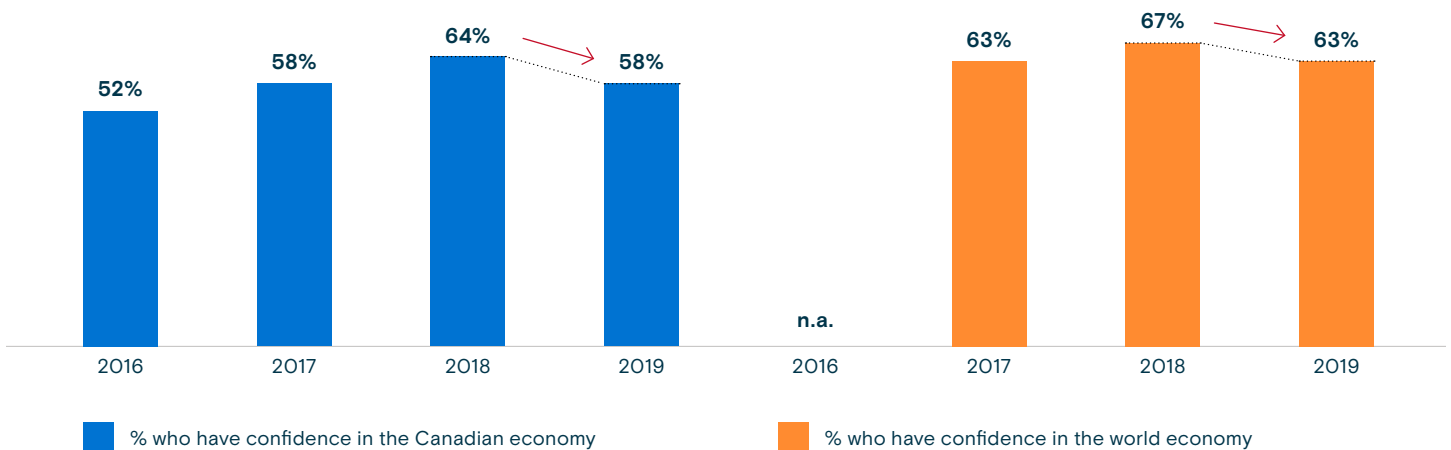
Another investment obstacle of increasing importance is insufficient cash flow generated by businesses. In this regard, it's important to note that the majority of business owners prefer to pay for their investments with their own cash, instead of taking on debt. Entrepreneurs could invest more if they borrowed; credit conditions remain favourable in Canada, with interest rates remaining low by historical standards.

³ For more information on this topic and what businesses can do to respond to this challenge, consult BDC, *Labour Shortage: Here to Stay—Worker Scarcity in Canada and What Businesses Can Do to Respond* (Montreal: BDC, September 2018).

Business confidence: Clouds on the horizon?

Higher interest rates,⁴ trade uncertainties⁵ and commodity price fluctuations⁶ are starting to weigh on business confidence. We observe that a lower number of business owners show high confidence in both the Canadian and world economies, compared to last year (Figure 5). Lack of confidence is more pronounced on the Canadian Prairies; it is the number-one issue for business owners in Alberta and Saskatchewan (Figure 6).

Figure 5 – Some business owners are losing confidence in the economy



Source: BDC, *Investment Intentions Survey*, 2015, 2016, 2017 and 2018. Base: All respondents.

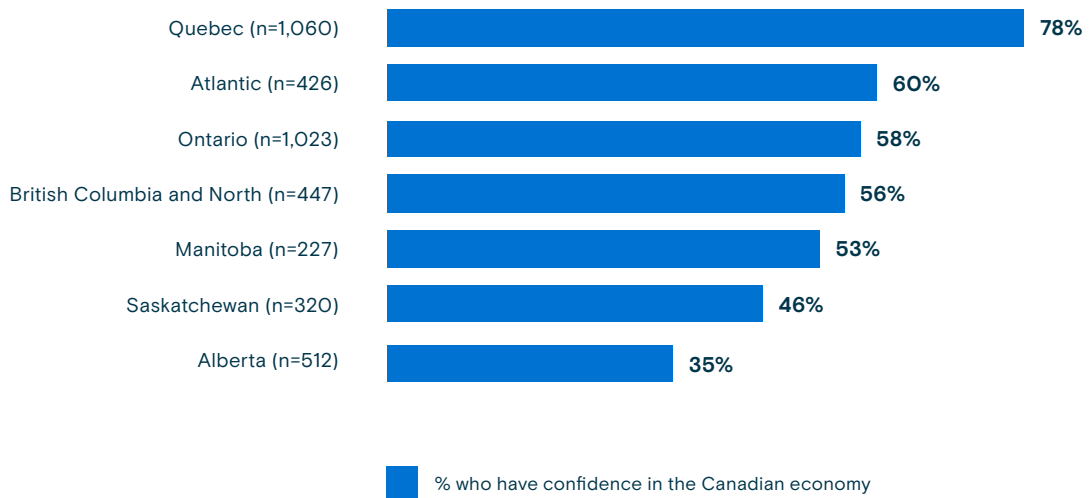
As a result, many business owners may delay their capital spending. Those who are struggling with a labour shortage or little money do not have the resources to invest, while the weaker economic growth outlook may convince others to postpone their investment.

4 Higher interest rates in Canada, coupled with high levels of household debt, are slowing purchases of big-ticket items bought on credit, such as cars and major appliances. Higher interest rates also make buying or renovating a home more challenging. As a result, both retail sales and residential investment have slowed down in 2018.

5 The new trade deal with the U.S. and Mexico was signed during the collection period of this survey, which should have boosted confidence and investment intentions. However, the U.S. and Mexican governments have not yet ratified the deal, and the fact that tariffs on steel and aluminum remain in place despite the new agreement could be a factor keeping businesses cautious about investment.

6 According to Bank of Canada data, commodity prices largely recovered from their 2016 low in the first half of 2018, but declined in the second half of the year.

Figure 6 – Business confidence in the Canadian economy varies across the country in 2019

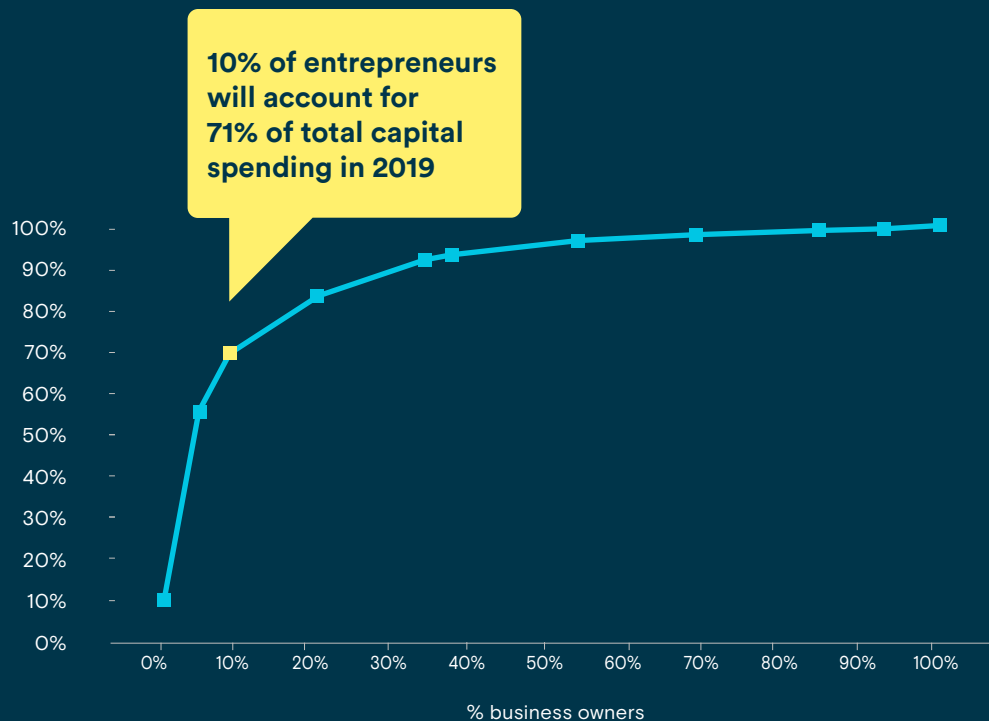


Source: BDC, *Investment Intentions Survey*, 2018. Base: All respondents (n=4,024).

A minority of businesses account for most investment

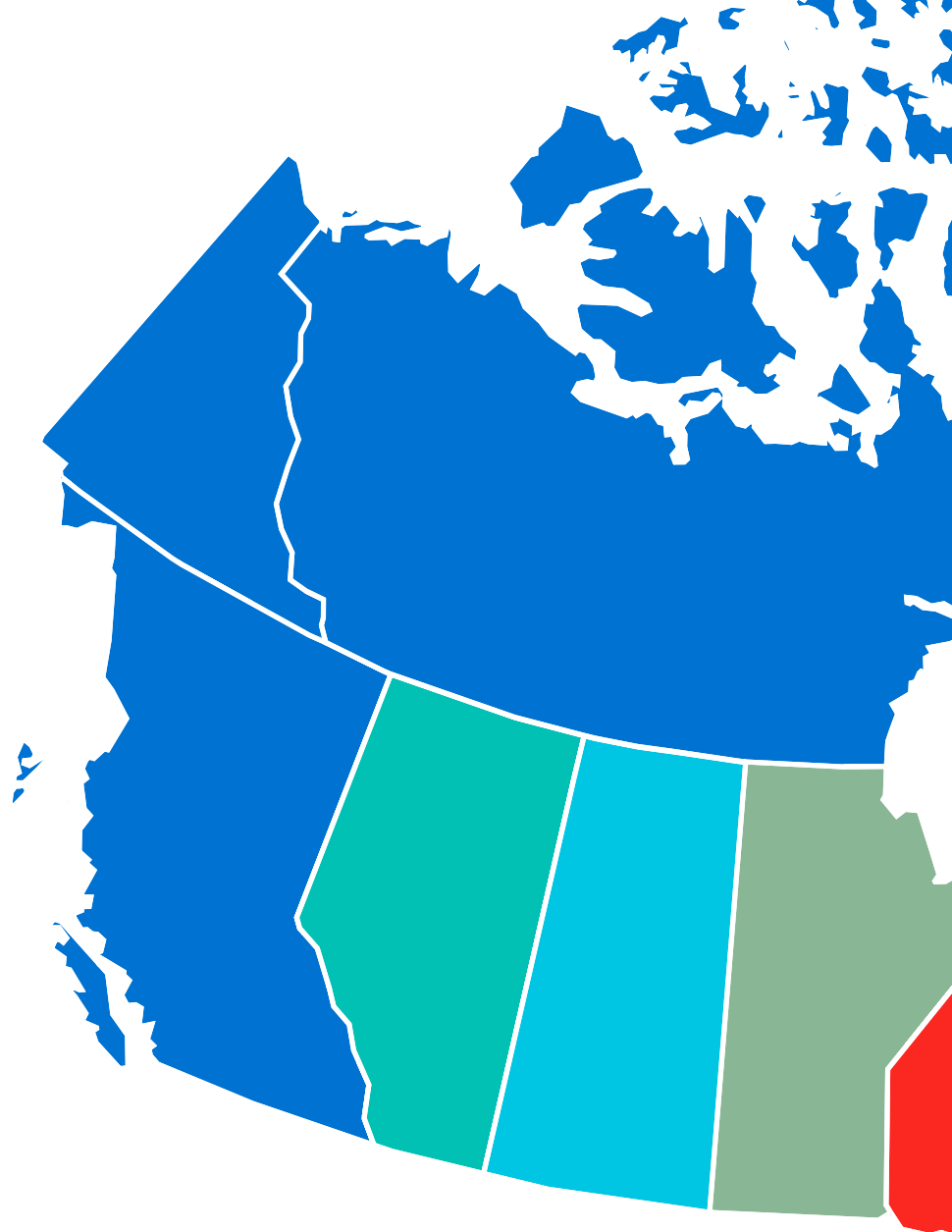
In 2019, 10% of entrepreneurs will account for 71% of total capital spending (Figure 6). This means that large projects from a few entrepreneurs can have a significant impact on total small business investment estimates from one year to the next.

Figure 7 – Investment intentions are concentrated among a small number of companies



Source: BDC, *Investment Intentions Survey, 2018*. Base: All respondents (n=4,024).

Western Canada



British Columbia and the North

We expect intentions to be slightly up in **British Columbia and the North**, driven by Vancouver and the export and technology sectors. Intentions should decline in the resources, retail and construction sectors. Business owners in the construction sector are particularly pessimistic, due to provincial and federal measures aimed at cooling down the housing market in Greater Vancouver.



Alberta

Investment intentions in **Alberta** remain positive, despite the fact that Albertan business owners are the most pessimistic in the country about the Canadian economy. Intentions are expected to increase in the services sector, but remain weak in natural resources and construction.



Saskatchewan

Investment intentions in **Saskatchewan** have plummeted. Difficulties in the uranium sector and below-average crop yields have seriously affected the confidence of the province's entrepreneurs.



Manitoba

Higher business optimism in 2019 will support investment intentions in **Manitoba**, especially in the technology and manufacturing sectors. However, lower confidence in the economy and rising labour and cash constraints may start to weigh on investment intentions.

Eastern Canada



Ontario

In **Ontario**, investment intentions should decline slightly, except among business owners in the Greater Toronto Area, technology companies, and wholesalers and exporters.



Quebec

In **Quebec**, the acute labour shortage is hindering investment despite high confidence in the economy and good growth prospects. The services sector and businesses outside Montreal are especially affected by the shortage and just don't have the capacity to act on their investment plans. On the upside, intentions will pick up in Montreal and in the export sector.



Atlantic Canada

A majority of companies in **Atlantic Canada** will reduce their investment, with the sharpest decline in Nova Scotia. However, Newfoundland and Labrador will break out of the pack, with the highest investment intentions in the region. The strong economic growth outlook in that province should lift private investment. GDP growth should rise to 1.8% in 2019 from 0.0% in 2018 in Newfoundland and Labrador, the largest percentage-point increase among Canadian provinces.*

* Based on the average economic forecasts of Canadian chartered banks, as of October 25, 2018.



Investment intentions, by sector

Investment intentions should pick up for exporters and business-oriented companies, while declining for consumer-focused companies and the goods-producing sector.

High optimism fuels investment intentions in business-oriented companies

The three sectors that have the highest optimism about future sales—technology, wholesale and business services—are also the ones with the highest positive balance of opinion for 2019 (Figure 8). These sectors are also more export intensive than others. The investment outlook is very positive for exporters, thanks to a low Canadian loonie and strong U.S. demand for Canadian goods and services, despite trade uncertainty with the United States.

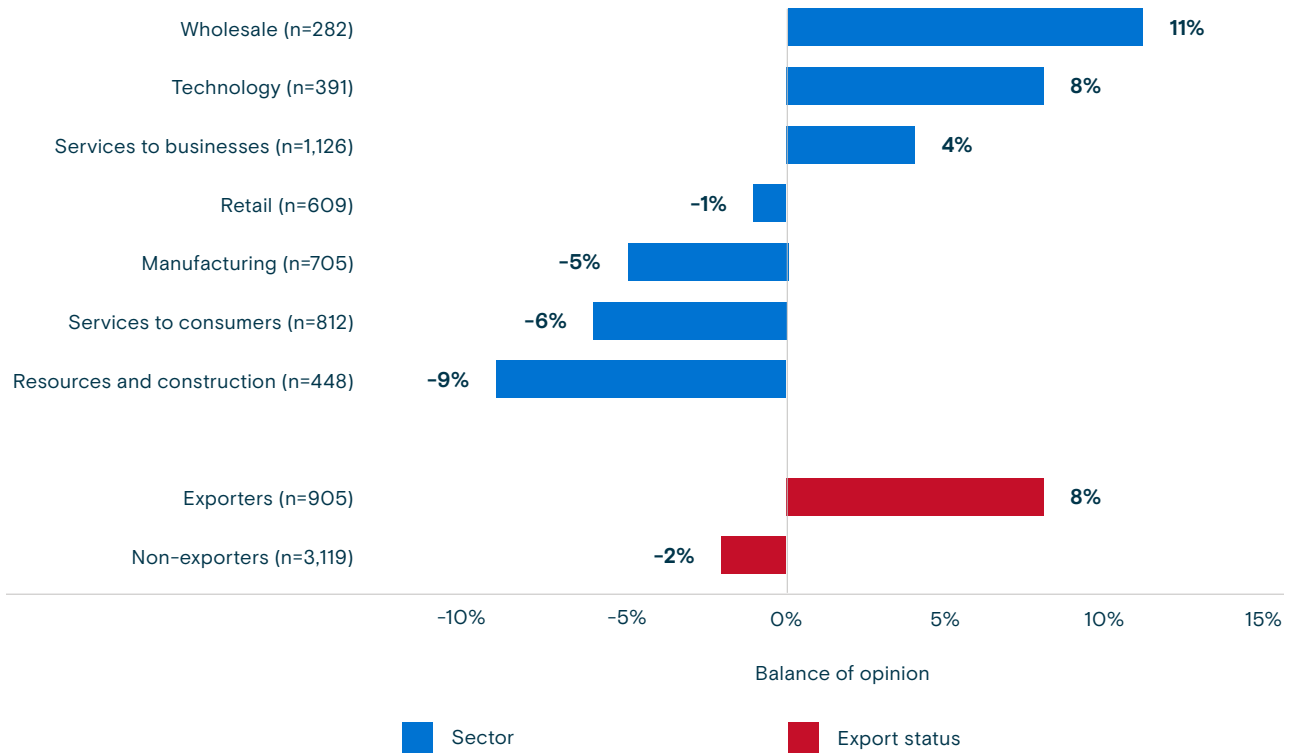
Higher interest rates decrease investment intentions for consumer-oriented companies

On the down side, higher interest rates and high levels of household debt will continue to curtail retail sales, hurting consumer-oriented companies. Indeed, purchases of products bought on credit, such as cars and major appliances, slowed down in 2018 compared to 2017.

In the goods-producing sector, high constraints on both labour and cash reserves are restricting investment in the manufacturing sector. However, there is one notable exception among manufacturers: Those that export their products plan to spend more in 2019.

The labour shortage will also put a lid on capital spending in the resources and construction sectors. Another factor hindering investment is fluctuating commodity prices, which have increased risk and put pressure on the liquidity reserves of most companies.

Figure 8 – Investment intentions pick up in export and business-oriented sectors



Source: BDC, *Investment Intentions Survey*, 2018. Base: All respondents (n=4,024).

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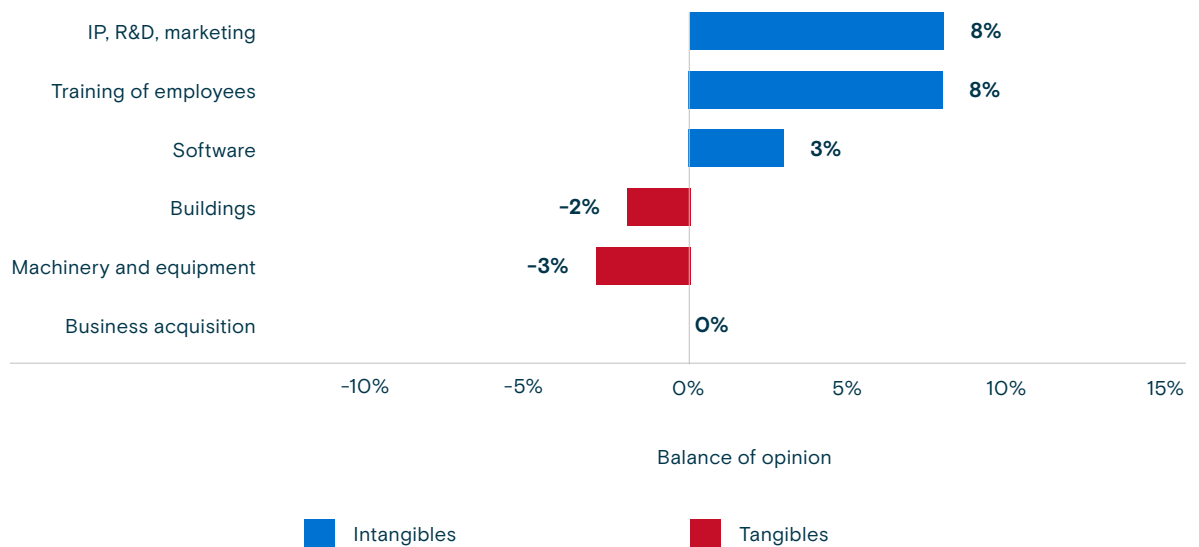
Investment intentions, by asset category

43%
of businesses will
spend to adopt new
technologies.

Nearly half of business owners will spend money to adopt new technologies in 2019. They will invest principally in intangible assets, marking a shift in investment patterns.

This year's survey provides additional evidence that Canadian entrepreneurs are changing the way they invest in their businesses. More entrepreneurs will invest in intangible assets—such as intellectual property (IP), research and development (R&D), software, and training for employees—while spending on tangible assets is expected to decline (Figure 9).

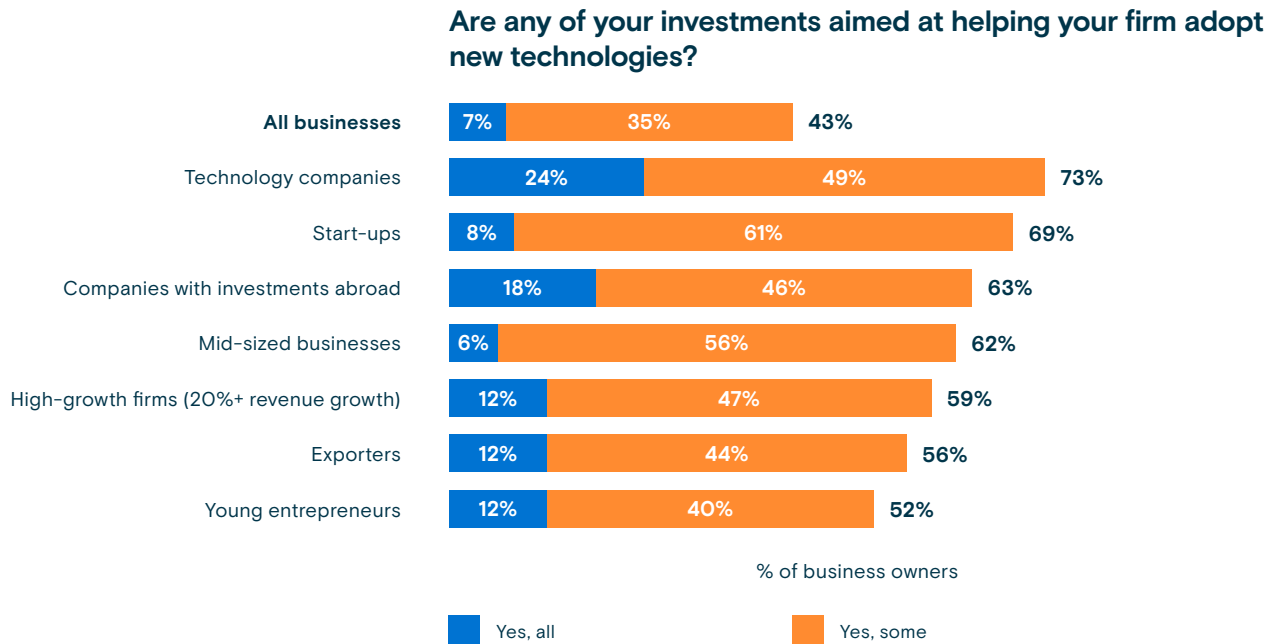
Figure 9 – Investment patterns are shifting



Source: BDC, *Investment Intentions Survey*, 2018. Base: All respondents (n=4,024).

The shift toward intangible assets is part of the broader digital transformation of the Canadian economy. Our survey indicates that 43% of businesses will spend some or all of their investment to adopt new technologies. The proportion rises to over 50% for young entrepreneurs, exporters, high-growth companies, mid-sized firms, international businesses, start-ups and technology companies (Figure 10).

Figure 10 – Technology is at the heart of business owners’ motivations



Source: BDC, *Investment Intentions Survey*, 2018. Base: Investing businesses (n=3,660).
 Note: Totals may not add up due to rounding.

In an economy that is increasingly automated and digitized, these assets are at the heart of a business’s capacity to produce goods and deliver services competitively. According to BDC’s research, top-performing businesses invest more in intangible assets, allowing them to be more innovative and profitable.⁷

We find similar statistics in our survey. A quarter of businesses that will allocate all of their investment to new technologies expect revenues to grow by 20% or more this year, compared to only a tenth of firms that will allocate their investment differently.

⁷ BDC, *Built for Performance: Discover Strategies Used by Canada’s Leading SMEs* (Montreal: BDC, May 2018).

Conclusion

Canadian entrepreneurs are shifting the way they invest in their businesses.

The Canadian economy has been performing well in the last few years; economic growth was strong in both 2017 and 2018, and we should see slower but steady growth in 2019. Both governments and businesses have reinvested, unemployment has remained low, and the U.S. demand for Canadian goods and services has remained high, despite trade uncertainty. The economy is running at full capacity.

In this context, Canadian business owners are optimistic about their business prospects. Almost three-quarters of business owners expect their revenues to grow in 2019.

However, businesses are hitting capacity and cannot find the qualified workers they need to grow. The labour shortage that has plagued Canada for two years is holding back investment. This is the top-cited problem in all provinces except Alberta and Saskatchewan, where many business owners are losing faith in the economy.

This year's survey provides additional evidence that Canadian entrepreneurs are shifting the way they invest in their businesses. More entrepreneurs will invest in intangible assets, while spending on tangible assets is expected to decline. The need to adopt new technologies to remain competitive in the rising digital economy is a key factor supporting this trend.

Annex A

Survey methodology

We asked the research firm SOM to conduct a telephone survey of 4,024 business owners with two to 499 employees. The survey was carried out between August 1 and October 12, 2018. Non-proportional, stratified sampling was used to obtain a sufficient number of respondents in each region of the country and in each sector, based on their size and industries. The results were then weighted according to region, business size and industry to ensure they were representative of businesses in Canada.

The maximum sampling error for all respondents is 2.0%, 19 times out of 20.

Caution regarding forward-looking statements

This paper contains forward-looking statements about future events. In this context, the forwardlooking statements pertain to our forecasts of the future business and financial performance of small and mid-sized Canadian businesses. These statements contain terms such as “wants,” “anticipates,” “expects,” “intends,” “plans,” “has the intention,” “believes,” “could,” “should” and “would be.” By their very nature, forward-looking statements cover topics that can, to varying degrees, be uncertain.

Various risks and uncertainties could substantially change the results presented in this report. Those risks include, without being limited to, the performance of industries and firms, the impact of a change in regulation or policy, the performance of the national or international economy, and any other regional, national or international change, including changes of a political or economic nature, or changes related to the business environment.

All of the information contained herein is verified to the best of our ability and constitutes our judgement at the time of publication; it does not constitute general or specific financial, legal, tax or accounting advice of any kind. This report is based on data collected between August 1 and October 12, 2018, and any error or omission is not BDC's responsibility. Readers bear sole responsibility for any use they may make of this information.

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