



BDC STUDY

# HIGH-IMPACT FIRMS: ACCELERATING CANADIAN COMPETITIVENESS

May 2015



Canada

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# INTRODUCTION

**The need to accelerate Canadian firms' competitiveness is not only pressing but crucial for maintaining Canada's standard of living.**

A company's competitiveness determines its ability to sell its products and services in the domestic market and outside the country. Since the end of the 2008-2009 recession, Canadian businesses have increased their exports, especially to the United States. However, our exports remain much weaker than they were in previous economic cycles, reflecting a competitiveness challenge for Canadian firms. As the world has become more global, competition has become much stronger for Canadian businesses here in Canada and abroad. The need to accelerate Canadian firms' competitiveness is not only pressing but crucial for maintaining Canada's standard of living. How can we improve Canadian competitiveness?

There are a million firms in Canada, from small to large. All firms don't make the same journey. Many remain small for many years. However, some firms invest more, innovate constantly and expand into international markets. These firms play a disproportionately large role in the Canadian economy in terms of both job creation and GDP growth. Consequently, these "high-impact" firms deserve special consideration when it comes to enhancing Canadian competitiveness.

This study, based on surveys conducted by BDC, looks at how these Canadian firms have achieved their outsized role. It defines the concept of high-impact businesses and examines the challenges they face in their efforts to become more competitive and grow. We also propose actions to support their growth in order to accelerate Canada's competitiveness.

## DEFINING HIGH-IMPACT FIRMS

**American researchers concluded that economic policy should be focused on cultivating high-impact firms rather than on trying to increase entrepreneurship overall.**

David Birch, from the Massachusetts Institute of Technology, was the first to link job creation to firm characteristics.<sup>1</sup> His 1981 study<sup>2</sup> showed that firms with 20 or fewer employees created two-thirds of new jobs. He characterized job creators as small and young firms. This conclusion had a major impact on public policy regarding support of firm creation and very small firms.

In 1994, Birch and Medoff<sup>3</sup> undertook a new analysis focused on a small group of firms that exhibited high growth and presumably accounted for the bulk of employment creation. They concluded that a small number of firms created a disproportionately large share of all new jobs in the United States. They defined these firms as "gazelles," which are characterized by not only size but also by great innovation.

Acs, Parsons and Tracy revisited the gazelle concept in 2008 for the U.S. Small Business Administration.<sup>4</sup> They concluded that high-growth small and young firms were not the only ones responsible for job creation in the U.S. They demonstrated that a small number of growing companies with an average age of 25 years were also responsible for a large amount of job creation and revenue growth in the U.S. They called these two types of companies "high-impact firms" and found that they existed in all industries and almost all regions. They concluded that economic policy should be focused on cultivating high-impact firms rather than on trying to increase entrepreneurship overall, supporting very small firms or supporting specific economic sectors.

Audretsch, in his report to the OECD/DBA international workshop, also concluded that "high employment growth firms are not necessarily newly founded entrepreneurial startups but rather tend to be larger and more mature firms."<sup>5</sup>

1 David L. Birch, "Who Creates Jobs?" *National Affairs* 65 (Fall 1981): 3–14

2 Based on a sample of 5.6 million businesses between 1969 and 1976.

3 David L. Birch and James Medoff, "Gazelle," in *Labor Markets, Employment Policy and Job Creation*, eds. Lewis C. Solomon and Alec R. Levenson (Boulder: Westview Press, 1994), 159–168.

4 Zoltan J. Acs, William Parsons and Spencer Tracy, *High-Impact Firms: Gazelles Revisited* (Washington: Small Business Administration, 2008).

5 David B. Audretsch, *Determinants of High-Growth Entrepreneurship*, report prepared for the OECD/Danish Business Authority workshop *High-Employment-Growth Firms: Local Policies and Local Determinants*. Workshop held in Copenhagen, Denmark, March 28, 2012.

Canada's mid-sized businesses represent:

1.6%

OF CANADIAN FIRMS

12%

OF GDP

16%

OF EMPLOYMENT

11%

OF ALL EXPORTERS

17%

OF TOTAL EXPORT VALUES

This study looks at Canadian firms that have a disproportionate impact on economic growth. We go beyond the concept of high-growth firms to include larger firms that also have a great impact on the Canadian economy. We have defined for Canadian purposes high-impact firms as having the following three characteristics.

## 1. Size

Size matters. Canada's mid-sized businesses (100 to 500 employees) have a greater impact on the economy because they have enough resources to invest, innovate and export. Despite accounting for a very small proportion of Canadian firms (1.6%), they are responsible for 12% of GDP and 16% of employment. Furthermore, mid-sized businesses represent 11% of all exporters and their exports account for 17% of total export values.

## 2. Growth

High-impact firms include the larger companies defined above that are growing more quickly than their overall sector is growing (i.e., they are typically gaining market share). Smaller firms with particularly high growth are also included in this group. Much has been written about the importance and impact of true high-growth firms. An Industry Canada report found that high-growth firms (firms growing by 20% or more annually for three years) were responsible for nearly 1 million of the nearly 1.8 million net jobs created over a 15-year period.<sup>6</sup>

## 3. Mindset

Though growth and size are important criteria in defining high-impact firms, the mindset of the executive team is a critical factor for competitiveness. Without the right mindset, the other criteria become far less predictive.

<sup>6</sup> Profile of Growth Firms: A Summary of Industry Canada Research, 2008.

**Characteristics of the typical high-impact small and medium-sized firm in the survey**

**\$15 M**  
ANNUAL REVENUE

**60**  
NUMBER OF EMPLOYEES

**25%**  
AVERAGE ANNUAL GROWTH RATE

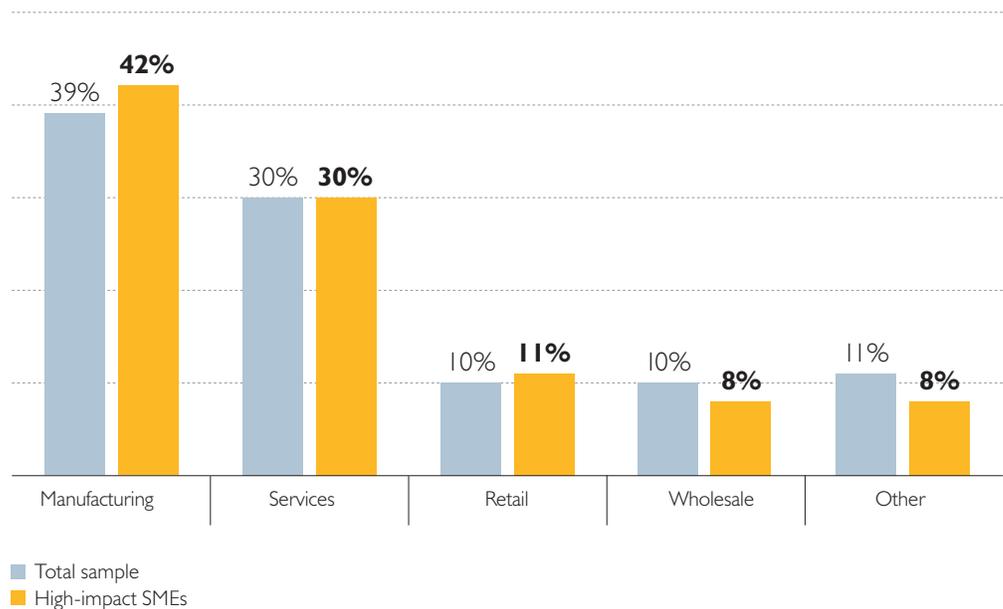
**20%**  
PROPORTION OF SALES THAT ARE INTERNATIONAL

**15%**  
INVESTMENTS IN INNOVATION  
(as a percentage of sales)

Key ingredients include a strong desire to achieve and high risk tolerance. These spur an entrepreneur to unrelentingly pursue innovation and higher growth by investing and taking appropriate risks. In our survey, we found that entrepreneurs with higher risk tolerance had 10% greater revenue growth and 9% more international sales, and invested 5% more in innovation than moderately ambitious entrepreneurs. We observed similar, though less pronounced, results for highly ambitious entrepreneurs with moderate risk tolerance.

High-impact firms can be found across all sectors. As shown in Chart 1, high-impact companies make up a similar proportion of companies in each sector. Although the economic strength of a sector or a region affects a company's growth, high-impact businesses are also found in less dynamic sectors or regions. Innovation makes these firms thrive in declining sectors.

**CHART 1: High-impact firms can be found across all sectors and reflect the composition of the Canadian economy — Sector distribution**



Source: BDC competitiveness survey (2014)

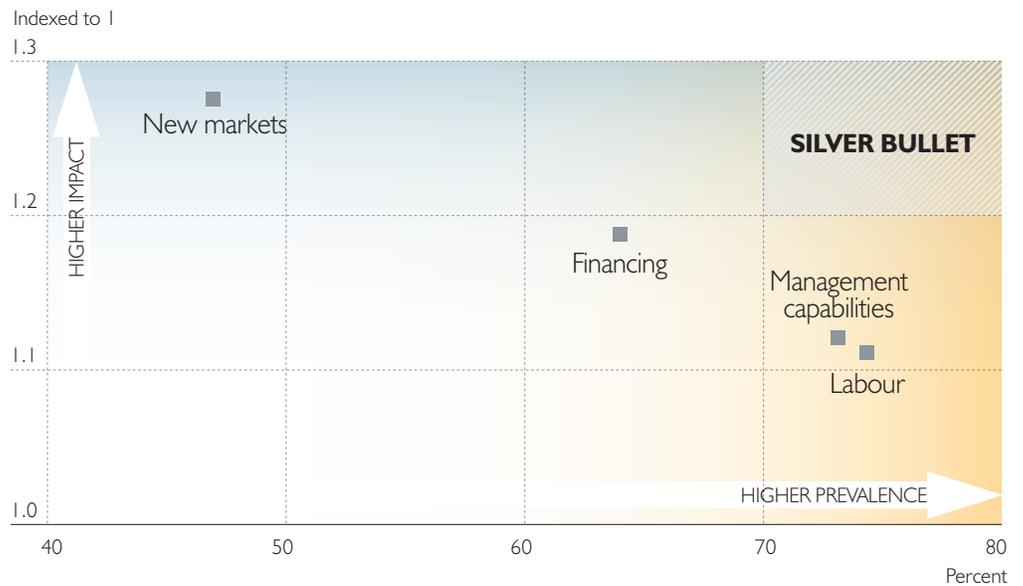
While these high-impact companies tend to be larger, faster growing and more innovative with the potential to become industry leaders, they also face specific barriers.

## 2. CHALLENGES

High-impact firms face a distinctive set of competitiveness challenges that, if resolved, can have a great impact on the economy and improve Canadian competitiveness.

High-impact companies have diverse challenges, which can be grouped into four main categories: management capabilities, new markets, financing and labour. As shown in Chart 2, our survey revealed that no business challenge ranked highest in both impact and prevalence. The lack of a “silver bullet” reinforces the point that any offering to high-impact firms should address a diverse set of needs in order to make a difference.

**CHART 2: Our survey results revealed no single “silver bullet” challenge to solve**



**I. Management Capabilities: Canadian entrepreneurs identify the need for more capability.**

In our survey, four of the top five challenges that entrepreneurs identified are related to management capabilities (optimizing operations, developing and executing sales plans, setting overall strategy, and ensuring human resources capacity for growth). Survey respondents believed that solving these challenges would best help their business.

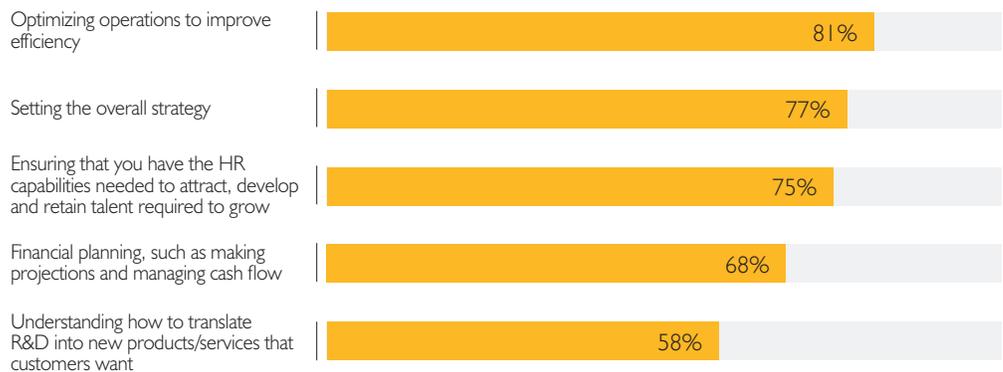
As these companies grow, their leaders struggle to define the right strategy to expand into new markets, scale up their operations and professionalize their management team. Optimizing operations to improve efficiency and developing overall business strategies are the most important challenges facing high-impact firms.

A lack of financial management skills is also a significant challenge that can limit growth and cause financial difficulty for many growing businesses, as expressed by a software developer we interviewed.

“We had a hard time with planning and it showed. We were selling, then doing, selling, then doing. We needed better financial management to get anywhere with the banks.”

– Software developer

**CHART 3: Management challenges among high-impact firms**



Source: BDC competitiveness survey (2014)

“I don’t have time for strategic planning: where do we see this going over the next seven to 10 years and how do we get there?”

– Sports equipment distributor

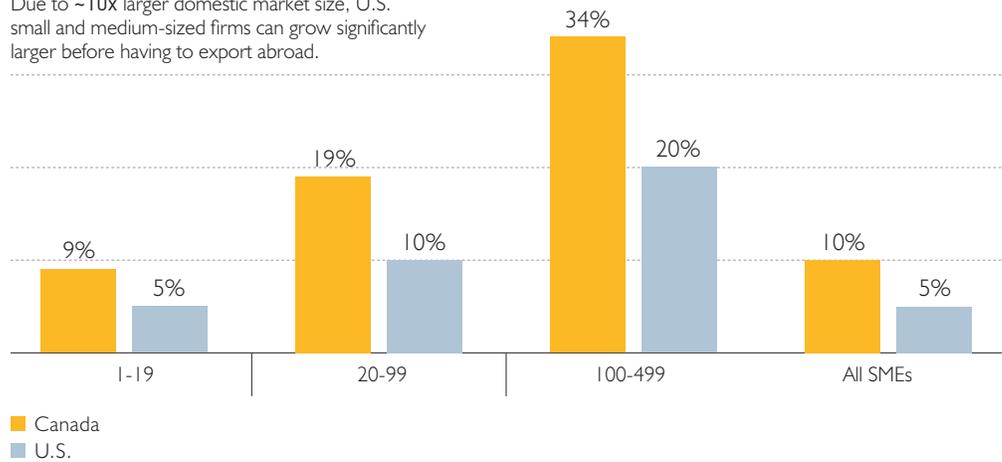
A 2012 Statistics Canada study showed that exporting manufacturers outperformed their non-exporting peers in terms of productivity.

**2. New Markets: Small Canadian businesses are under more pressure to expand abroad.** Because of a smaller domestic market, more Canadian businesses need to export earlier and to a greater extent than their U.S. counterparts. As an illustration, a company based in California need not even cross state lines to gain access to a larger market than Canada's.<sup>7</sup> When it does seek new markets, it can do so simply by crossing state lines rather than national borders.

**CHART 4: More Canadian businesses need to leave the nest earlier than their U.S. counterparts**

Fraction of exporters by business size (number of employees), 2011

Due to ~10x larger domestic market size, U.S. small and medium-sized firms can grow significantly larger before having to export abroad.



SME: Small and mid-sized firms

Sources: Office of Trade and Industry Information, U.S. Department of Commerce; Survey on Financing and Growth of Small and Medium Enterprises 2011, Statistics Canada; Industry Canada; Small Business GDP: Update 2002-2010, Small Business Administration; U.S. Small Business Administration, based on data provided by the U.S. Census.

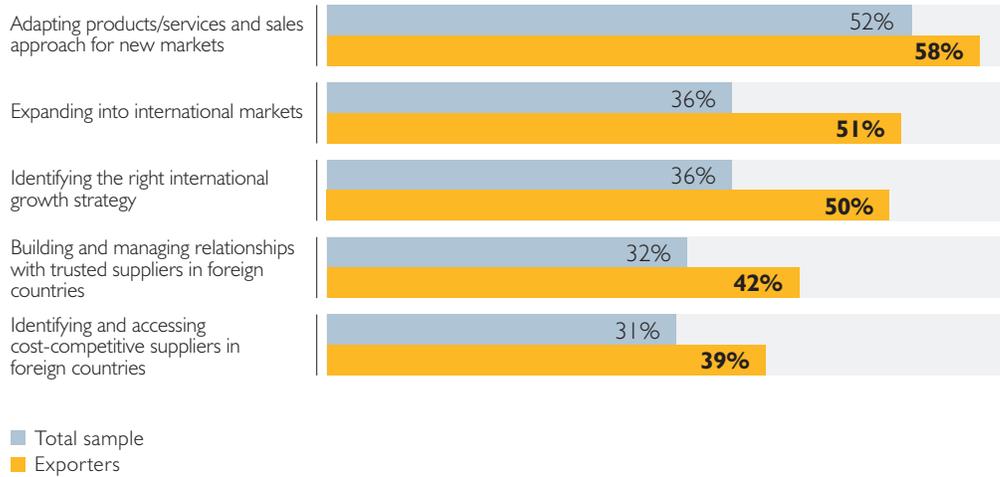
Since the Canadian population is aging, the need to export to grow is becoming even more pressing for Canadian businesses. As the Bank of Canada has previously forecasted, the aging population is slowing down Canadian labour force growth and, consequently, economic growth. In this context, external markets will be the main sources of growth for Canadian businesses.

Doing business outside Canada forces firms to improve. A 2012 Statistics Canada study showed that exporting manufacturers outperformed their non-exporting peers in terms of productivity. However, exporting is also challenging. By competing globally earlier in their life cycle, Canadian companies take on a number of risks (related to currency, culture, lack of networks and so on) in addition to facing stiffer competition from global players.

<sup>7</sup> California's GDP in 2013 was C\$2.3 trillion, while Canada's GDP was C\$1.9 trillion.

The takeaway for entrepreneurs is not to avoid seeking new markets; rather, they need to acknowledge that globalization is an imperative for Canadian businesses and that they will face a number of risks that are not easily recognized, prioritized or managed.

### CHART 5: Exporters face particular challenges



Source: BDC competitiveness survey (2014)

“Understanding local customs and culture is key when selling into a new market. We really need help on this. It’s expensive to learn this the hard way.”

– Fabric manufacturer

Exporters in our survey identified management capabilities as the most important barrier. In addition, they reported challenges in developing new markets and finding suppliers in foreign countries. For these business executives, enhancing their ability to expand into international markets will have a great impact on their business.

As well as opportunities, globalization creates challenges for Canadian businesses, such as deciding which markets to target and dealing with increased competition in traditional Canadian export markets, such as the United States.

“We have doubled the size of our company three years in a row. I would need \$20 million to do it again next year. Unless they want my dog, I have nothing else to give as a guarantee.”

– Home furnishings manufacturer

**3. Financing: High-impact firms cite greater difficulties in obtaining higher risk financing.** Among all companies, 91% agree that traditional financing is readily available in Canada. However, high-impact firms often have financing needs that are more difficult to meet, such as obtaining capital on flexible terms for new projects or markets. For example, we met with a small telecommunications company providing services to large energy companies in northern British Columbia. It could not finance its growth with traditional financing products because it was growing too rapidly.

In other cases, high-impact firms have asset-light business models that the market is less likely to understand. For example, a software development firm wanting to expand into the U.S. may need financing that cannot be guaranteed by traditional “hard” assets. Alternative forms of financing designed to meet these needs are referred to as higher risk financing.

Based on our survey, Canadian businesses cite higher risk financing challenges twice as often as U.S. companies do. The survey showed this is especially true for smaller firms and more ambitious entrepreneurs. Financial institutions are slowly getting more comfortable with higher risk financing, but these markets remain underdeveloped in Canada.

“We actually had to slow down because financing couldn’t keep up!  
We were told to come back at the end of the year.”

– Mechanical services company owner

Financing challenges are more prevalent among Canadian small and mid-sized firms than those in the U.S.

- **58% on average** versus 36%

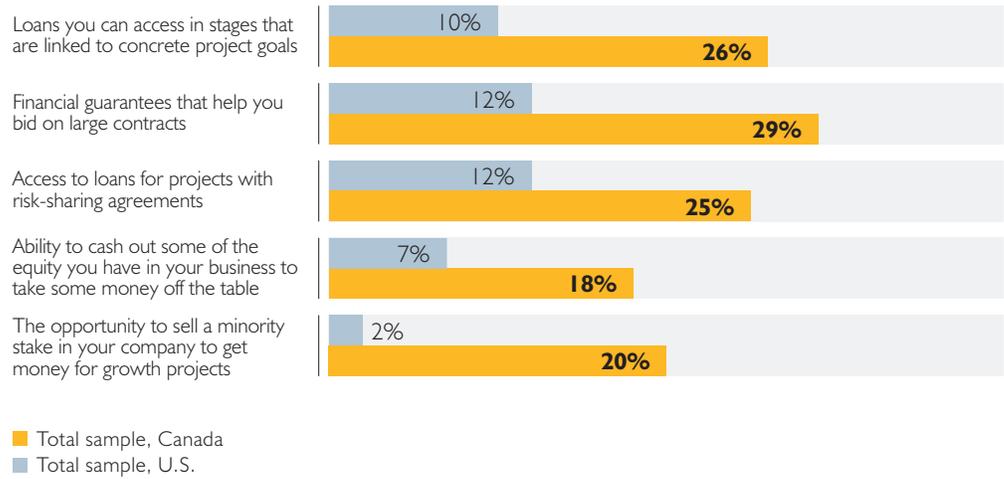
Addressing key financing barriers also has the potential to have more impact on Canadian small and mid-sized firms than those in the U.S.

- **24% revenue lift on average** versus 13%

Indicates that, in general, **Canadian entrepreneurs struggle more with higher risk financing versus their peers in the U.S.**

Not surprisingly, Canadian businesses value innovative financing solutions much more than their American counterparts do. Chart 6 shows that Canadian businesses rated financial solutions such as flexible financing tools for new projects and equity solutions as extremely valuable.

### CHART 6: Canadian firms rated innovative financing solutions more positively than their U.S. counterparts

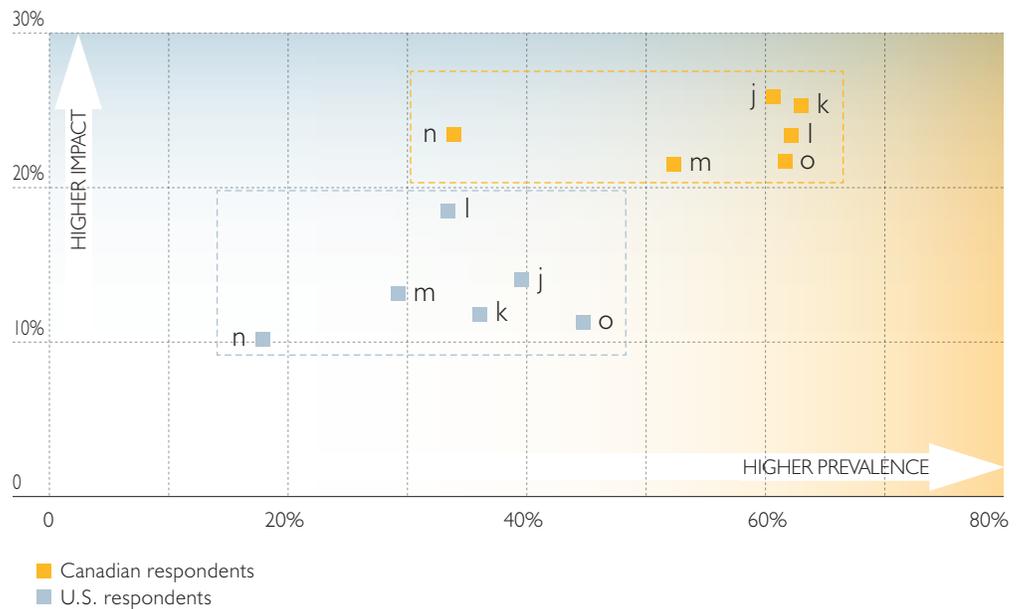


Source: BDC competitiveness survey (2014). Results are presented in terms of the percentage of respondents who rated the solution as "extremely valuable."

### CHART 7: Canadian entrepreneurs struggle more with higher risk financing compared to their U.S. peers

#### Canada vs. U.S. small and mid-sized firms — Financing challenges

Expected impact on revenue



Note: Financing challenges – access to capital for j) purchasing new machinery or technology; k) developing new products, services and/or processes; l) expanding capacity; m) acquiring other companies; n) expanding into international markets; o) marketing and sales.

Source: BDC competitiveness survey (2014).

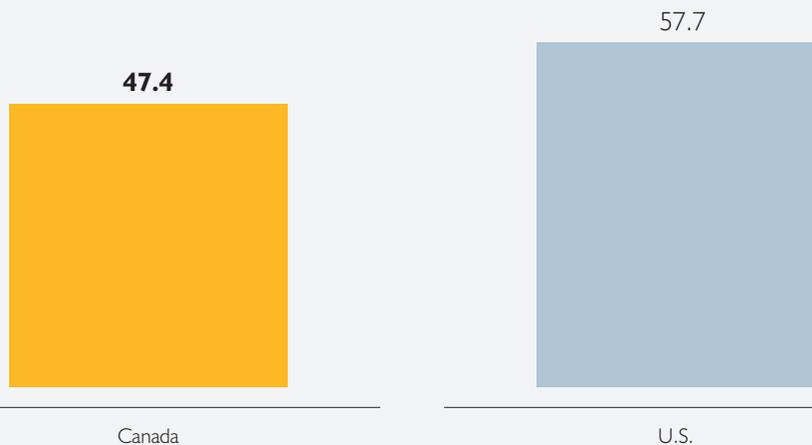
**4. Labour.** Labour remains an important issue for high-impact firms. The Canadian labour force is not increasing quickly and will, in fact, remain flat in the next decade due to the aging population. Recruiting specialized labour is often cited by Canadian entrepreneurs, and which our survey confirmed, as an important challenge.

We know that finding employees to expand and scale their business ranks as one of the top challenges identified by entrepreneurs. Other labour issues include retaining employees, and ensuring that a business has the right HR capabilities needed to attract, develop, and retain the talent required for growth.

**Risk Aversion: Canadian business leaders are less likely to take risks.**

In addition to these four categories, several business leaders and influencers have identified risk aversion as another barrier to growth. Surveys of Canadian and U.S. businesses show similar *self-reported* risk tolerance appetites. However, when studies are done on *demonstrated* risk tolerance, U.S. entrepreneurs appear more likely to engage in behaviour that shows a higher risk tolerance than do Canadian business leaders. For example, the Deloitte Executive Risk Behaviour Index (presented in Chart 8) shows that Canadian business leaders are more risk averse than American business leaders. The difference in risk tolerance may have multiple sources, such as a smaller domestic market, more risk-averse financial institutions or cultural differences. In any event, lower risk tolerance can lead to underinvestment and have an adverse impact on competitiveness.

**CHART 8: Canadian business leaders' behaviour is more risk averse than that of their American counterparts**



Source: Deloitte, *The Future of Productivity Report*. The Deloitte Executive Risk Behaviour Index is calculated from survey responses (n=902).

The manufacturing sector accounts for:

**10%**

OF TOTAL EMPLOYMENT

**11%**

OF CANADA'S GDP

**49%**

OF PRIVATE SECTOR R&D

**62%**

OF TOTAL EXPORTS

## THE MANUFACTURING SECTOR: A CRUCIAL ROLE

The manufacturing sector plays a crucial role in the Canadian economy in terms of employment, innovation and exports. It accounts for 11% of Canada's GDP and 10% of total employment. Canadian manufacturers are responsible for half (49%) of private sector R&D spending in Canada. Their R&D commitment is also higher: on average, they allocated 4.3% of their operating expenses to R&D in 2012, compared to 2.0% on average for all Canadian businesses. Finally, the sector is responsible for 62% of Canadian exports. Many high-impact firms are manufacturers; do they face different challenges?

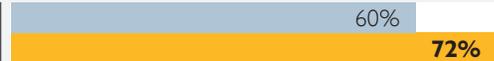
**CHART 9: The manufacturing sector faces different challenges**

### Access to financing

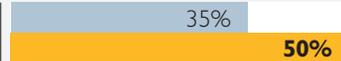
Developing new products, services and/or processes



Purchasing new machinery or technology to improve productivity



Expanding into international markets

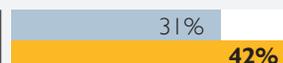


### Exporting

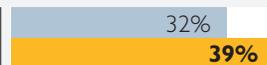
Identifying the right international growth strategy



Identifying and accessing cost-competitive suppliers in foreign countries



Building and managing relationships with trusted suppliers in foreign countries



■ Total sample  
■ Manufacturers

Source: BDC competitiveness survey (2014). Results are presented in terms of the percentage of respondents who face that challenge.

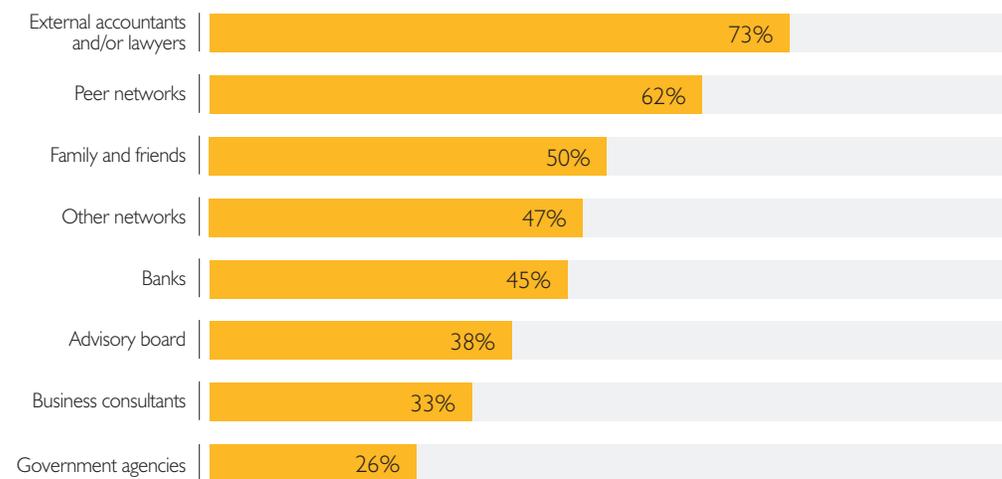
Like all firms, manufacturers aim for greater efficiency. Those surveyed believe optimizing operations to improve efficiency would have the greatest impact on their business.

Access to financing and exporting are issues for all high-impact firms in Canada; they are even greater for manufacturers. Defining the right export strategy and finding foreign suppliers are also significant challenges for this sector.

### 3. HIGH-IMPACT FIRMS' NETWORK

When it is time to look for advice, high-impact firms turn primarily to external accountants and lawyers, but they also get assistance from peer networks such as business groups or associations. Our survey shows that regardless of size, sector, region or type of entrepreneur, business managers are always eager to network and value sharing their experience with peers. Respondents to our survey highly value help in becoming better managers.

**CHART 10: High-impact firms' various networks**



Source: BDC competitiveness survey (2014). Results are presented in terms of the percentage of respondents who selected a given answer.

## 4. RECOMMENDATIONS FOR SUPPORTING HIGH-IMPACT FIRMS

**Focusing a limited quantity of resources on a group of high-potential entrepreneurs can yield significant benefits.**

While our research concluded there is no “silver bullet” for high-impact firms (no business challenge was ranked highest in both impact and prevalence), improving management capabilities will help on all fronts. As a result, providing support in developing strategy, enhancing efficiency or expanding into international markets would have the greatest effect on Canadian high-impact firms.

In recent years, many development banks around the world have launched initiatives designed to improve competitiveness and have shown that focusing a limited quantity of resources on a group of high-potential entrepreneurs can yield significant benefits. These institutions have also found that non-financial solutions can be highly useful. As an example, several have found that bringing together high-impact firms in shared forums can yield important indirect benefits.

Given the results of our research, we believe that taking a similar approach toward Canadian high-impact firms would be equally effective and have a disproportionate impact on economic activities.

## 5. NEXT STEPS FOR BDC IN SUPPORTING HIGH-IMPACT FIRMS

BDC has always known that it takes a lot more than money to succeed. That's why we've offered consulting and training, in one form or another, for over 30 years. And over the past two years, we have been transforming our consulting service offering, with a view to taking it to a whole new level. But this study has proven that the need to solve the issue of gaps in management capabilities is even greater than we had previously thought. The limitations of entrepreneurs are the limitations of their business, which, when taken collectively, can have a negative impact on Canada's prosperity.

As Canada's development bank, we are uniquely positioned to be a catalyst in helping high-impact firms grow to the next level. To do this, we are creating a new business unit called BDC Advantage. First, we will move our existing consulting business – which has some 1,400 active clients – into BDC Advantage. We will also create a small team within BDC Advantage that will be dedicated to increasing the competitiveness of high-impact firms. This team will work in collaboration with third parties to facilitate high-impact firms' access to other services that exist – or need to be developed – in the entrepreneurial ecosystem. The initial focus of the team will be in the following areas:

- 1. Develop the ability to provide long-term, unbiased advice.** Entrepreneurs have said that one of their greatest management challenges is getting long-term, unbiased advice. Because BDC is more than just another financial institution, we can offer the kind of objective, insightful advice that high-impact firms need. We will expand our advisory team with highly-experienced individuals who can help entrepreneurs assess their needs, and provide advice on a long-term and objective basis.
- 2. Develop a service offering specifically tailored for high-impact firms.** This study has identified the key competitiveness challenges faced by high-impact firms. To address these challenges, in addition to its existing service offerings, new BDC offerings for high-impact firms could include formal management training, peer-to-peer networking, and other highly-tailored non-financial services. We will offer these services by leveraging our own expert resources and consultant networks and also by partnering with third-party organizations.

Along with the activities of BDC Advantage, BDC's financing business line and BDC Capital will:

- 3. Provide financial services adapted for high-impact firms.** Entrepreneurs appreciate more flexible financing tools, including more patient capital, flexible payment schedules, and instruments that do not dilute their equity—solutions we already provide. We will also strive to expand and improve our financial offerings to meet the specific needs of high-impact firms.

We will continue to innovate along these lines, presenting our financial and non-financial service offerings in an integrated manner, to help ensure the success of high-impact firms.

# APPENDIX:

## METHODOLOGY

To assess the small and medium-sized business ecosystem, barriers to competitiveness and development trends around the world, we conducted research using primary and external sources, including the following:

1. *Small and medium-sized business ecosystem*

- > Review of key Canadian company reports and databases
- > Interviews with business experts who have broadly recognized expertise in the small and medium-sized business ecosystem
- > Interviews with BDC personnel across Canada

2. *Small and medium-sized business barriers to competitiveness*

- > BDC asked Leger Marketing to conduct a phone survey of 866 entrepreneurs across Canada to assess the prevalence and severity of their needs, and their preferences for potential solutions. Of the 866 responses, 55% came from companies that were not BDC clients and 212 came from high-impact firms as defined in section 1
- > More than 80 one-on-one interviews with entrepreneurs across Canada
- > The survey targeted business-owners, CEOs and presidents (over 60% of the sample), as well as other key decision-makers, including general managers and other executives
- > Survey of 200 American entrepreneurs; compared their responses on key challenges, solutions and mindsets with those given by Canadian entrepreneurs

3. *Case studies of other development banks*

- > Review of case studies of development banks around the world, including interviews with their senior personnel

4. *We targeted companies with:*

- > more than 20 employees that had positive growth over the past three years
- > fewer than 20 employees that were growing by at least 20% annually or have over \$10 million in annual revenues and were growing positively

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