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Entrepreneurship in Canada: Overcoming risks to reap the rewards

Contents

Entrepreneurs are driven by both passion and profit. The decision to start a business involves a cost benefit analysis – while entrepreneurship carries significant risk, the rewards can be great. Having a great idea is not enough. In order to achieve profitable growth – and a sustainable business – entrepreneurs must consider the personal financial implications, in addition to corporate factors such as taxation and government funding, and how they shape entrepreneurship.

What drives an entrepreneur?

As the popular saying goes, "do what you love, and you'll never work another day in your life." This also applies to entrepreneurs, as a majority of Canada's small and medium business owners consistently report that passion is a stronger motivator for them than personal financial gain. This applies regardless of age – millennial entrepreneurs[1] and boomer entrepreneurs[2] alike have reported[3] being passionate about what they do.

For most boomers, entrepreneurship is a planned stopover on the road to retirement. Over half reported they have already started or are considering starting a small business before they retire. Of these, most stated that their main motivation was a desire to be their own boss. Meanwhile, Canadian business owners are becoming older,[4] with approximately half of all entrepreneurs in the 50 to 64 age range.

Other than motivation, and a desire to turn passion into a career, what makes an entrepreneur? There are certain positive qualities of business owners, which the Business Development Bank of Canada suggests evaluating in an entrepreneurial potential self-assessment.[5]

If you see possibilities where others see problems, if you are not afraid to take on initiatives, and if you are curious and continually in search of discovery, you're off to a good start.

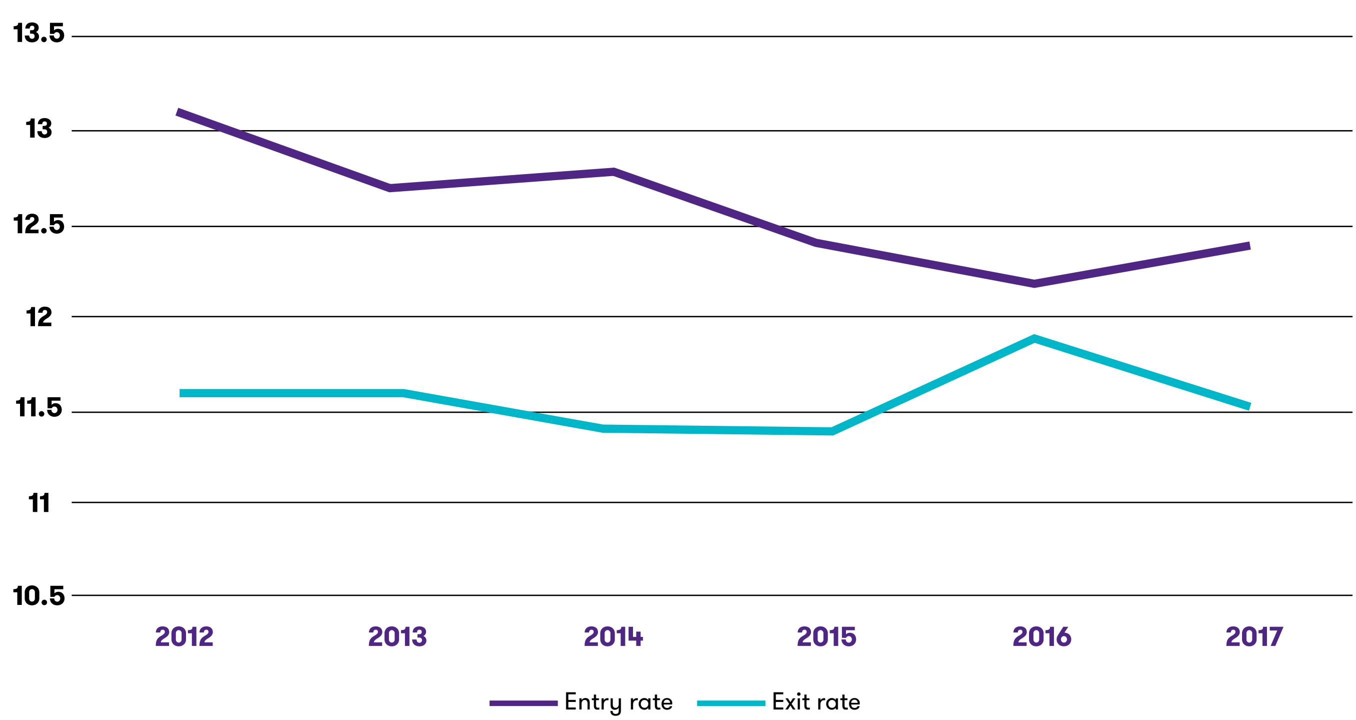
State of play: Canada is an appealing place to start a business, but fewer are choosing to do so

The state of entrepreneurship in Canada is healthy overall, and compares favourably to other developed economies, but there are fewer new businesses than before, and most owners of small and medium-sized businesses are getting older.

The **Ease of Entrepreneurship Index**[6] issued by the Conference Board of Canada finds that Canada ranks fourth out of 16 developed countries for best locations to start a business, in part because it has relatively low regulatory and administrative barriers to entrepreneurship. The Organization for Economic Cooperation and Development (OECD) findings were even more favourable, as a recent study[7] found that Canada ranks second only to New Zealand worldwide in the World Bank Doing Business survey for ease of starting a business, as measured by the time and cost it takes to establish a limited company. However, simply measuring the time and cost to establish a limited company does not take into account the significant hurdles an entrepreneur faces relative to access to capital, financial planning and human resources.

1	U.K	9	Austria
2	Netherlands	10	Norway
3	Sweden	11	U.S.
4	CANADA	12	France
5	Denmark	13	Germany
6	Australia	14	Finland
7	Ireland	15	Japan
8	Switzerland	16	Belgium

Variation in active employer businesses in Canada, 2012 to 2017



Sources: Statistics Canada, *Business Dynamics Measures, by industry*, Table 33-10-0164-01; Statistics Canada, *Experimental quarterly estimates of business entry and exit*, Table 33-10-0165-01.

Although it is relatively easy to start a business, data issued by Statistics Canada found that business entry and exit rates have steadily decreased[8] over the last 30 years. The entry rate in particular has declined from 24.5 percent in 1983 to 13.1 percent in 2012, and remained relatively flat at 12.4 percent in 2017, while the exit rate (which is closely correlated with the entry rate) was 11.5 percent in 2017.

The entry rate is significant, because it means there are fewer new firms entering the Canadian economy, which is a key indicator of economic health. This rate of business "churn" – that is, the sum of business entries and exits – placed Canada eighteen among 20 OECD countries in 2012, and has declined since 2006. Compared with other OECD countries, Canada also has a relatively small share of startups and young firms, and a large share of old firms among its small businesses. In 2014, it ranked[9] nineteenth out of 20 OECD countries for the percentage of 0 to 2 year old businesses as compared to all businesses.

Despite these challenges, small and medium-sized businesses continue to outperform[10] the Canadian economy. In fact, these businesses account for nearly all firms in Canada (97.9 percent), and proportionally play a large role in job creation.

From 2005 to 2015

87.7%

of net new jobs were attributable to small businesses alone while medium-sized and large businesses created the remainder.

Plotting a successful course in the current environment

Although there are many personal reasons to start a business, including a desire to make a difference or be your own boss, this decision is also based on the business environment. If you are considering starting your own business, you should build a strong business case that considers the following:

- What is your hiring plan?
- How much R&D investment would your business require?
- Can you build your product or service using local or contract labour here in Canada?
- Where are your target markets?
- Does your idea require equipment or plant expansion?
- Can you leverage funding in order to delay dilution of your ownership in the business?

The business environment is always changing, and factors such as taxation and government incentives can impact your risk-reward calculation. The key is life-cycle planning of your business expenditures and revenues in the near and long term in order to access the most advantageous funding at the appropriate time, while reducing immediate and long term tax risks.

Taxation and incentives balance risk-reward calculation

Recent changes to federal tax policies[11] – particularly the new limitations on income splitting and passive investment for private companies – are a source of concern for current and potential entrepreneurs, and understandably so. If your effective tax rate increases, this escalates the perception among business owners that the overall level of risk is increased compared to the potential financial gain. As the measures are still recent, it is too early to tell how much of an impact they will have on the entrepreneurship rate in Canada.

In the recent 2018 Fall Economic Statement,[12] the government added a number of tax related incentives to invest in manufacturing and other business related capital. Among these, the government introduced the Accelerated Investment Incentive,[13] which is a capital cost allowance for businesses of all sizes, in all sectors of the economy. In addition, funding is being made available to expand exports into the European Union and emerging markets. These changes should provide additional support for certain businesses but may not be impactful across the spectrum of entrepreneurs in Canada.

Although taxation does have a major impact on the risks connected with business ownership, the current business environment offers many sources of funding which may help mitigate taxation risk.

This paper provides practical solutions for accessing government funding in the form of tax credits, grants and loans.

There are more choices than ever for financing your business by leveraging government funding. This allows business owners to delay the need to seek external equity investors or venture capital, therefore increasing the company's value and delaying dilution. The Federal and Provincial governments are inclined to fund promising and innovative projects to improve the competitiveness of the Canadian economy. Because of this shared enthusiasm for entrepreneurship, many structures are in place to help get your business started.

Increasing levels of student debt might be impacting youth entrepreneurship

One of the challenges faced by recent graduates is higher levels of student debt, and there is some speculation this might be preventing millennials from taking on additional financial risk.

In Canada, three out of four recent graduates with student debt have expressed regret[14] about their debt.

Graduates who owed money typically owed approximately $22,000, and data published by Statistics Canada shows regular increases[15] to tuition fees for degree programs. A yearly increase of a little over 3 percent may not seem like much, but over a decade it means that undergraduates now pay

40% more in tuition than they did 10 years ago.

Perhaps because of this increased burden, recent graduates may be less willing or able to take on the additional financial risk associated with starting a new business. It may take time to measure the impact on entrepreneurship, as most entrants into self-employment and business ownership are between the ages of 35 and 54.[16]

There are, however, encouraging signs of growth because the rate of business ownership for younger Canadians has been slowly increasing[17] in recent years. Despite this increase, youth entrepreneurship rates remain the lowest when compared to all other age groups. Although entrepreneurship has declined across most age groups since 1981, the age group 25-34 made the largest contribution[18] to the drop in entrepreneurship rates, according to data published by the Bank of Canada.

Grants, tax credits and loans – a range of options for growing businesses

The speed of entrepreneurship can be a break-neck pace. We have discussed our top 7 issues facing tech companies[19] in their early years but the most lucrative for them can be learning to leverage government funding. This section explores a range of incentives,[20] including seed funding, grants and refundable/non-refundable tax credits.

Seed funding and grants

Grant opportunities are diverse, and change depending on the economic development goals of the federal or provincial governmental funding agency. It is important to understand the project-specific funding which may target particular industries, demographics or regions.

Direct funding allows you to match planned expenditures in hiring, training, capital investment or market expansion with dollars from the government to offset those costs as you incur them. Successful early stage revenue generating companies often maximize this type of 'up-front' government funding in order to keep the doors open and make payroll. Those that apply though should be aware of the requirement in some programs to pay back the funds if milestones or targets are not met as well as the

requirement to include all grants received as income to the business, which is therefore taxable.

Initiatives targeting young entrepreneurs

As mentioned above, we have seen rapid declines to the entrepreneurial talent in the post-graduation age bracket potentially due to student loan burden. Recognizing the challenges faced by younger entrepreneurs, each level of government has created or supported many funding programs specifically for youth. These include national programs such as Futurpreneur Canada, the BDC's Young Entrepreneur program, the Youth Social Innovation Capital Fund and the CBDC Youth Loan, to name a few.

Provincial programs include The Youth Entrepreneurship Partnership Program (Ontario), Jeunes Promoteurs (Québec), the Rotary Alberta Youth Entrepreneurship Camp, the Young Entrepreneurs Program (Manitoba), and many other provincial and territorial programs.

Canada-Provincial Job Grants

Provincial streams of the Canada Job Grant, specifically target small business training. It provides varying levels of funding (based on the number of employees), up to a maximum of $10,000 per employee being trained. Eligible categories of training include colleges and university courses, third party training but does not include mandated training such as HACCP, or ISO registration.

Industrial Research Assistance Program

This program is administered by the National Research Council of Canada and helps small and medium-sized businesses undertake technology innovation. Its two streams of funding aim to support technology innovation projects and youth employment programs. The basic eligibility criteria are for-profit incorporated businesses with 500 or fewer full-time employees with a goal of growth and profits through development and commercialization of innovative, technology-driven new or improved products, services, or processes in Canada.

Export Market Access Program

This is a program administered by the Ontario Ministry of Economic Development, Job Creation and Trade, to provide Ontario businesses with funding to export their goods and services abroad. The program covers 50 percent of the eligible costs for direct contacts, market research, marketing tools and foreign bidding projects. Non-repayable contributions generally range from $5,000 to $30,000.

Scientific Research & Experimental Development (SR&ED)

SR&ED[21] is a tax incentive program developed by the Canada Revenue Agency, and is the Federal government's largest program to foster research and development (R&D) in Canada. Those that qualify for federal SR&ED tax credits can also apply for the accompanying provincial tax credits,[22] which are refundable or non-refundable at various rates of eligible expenditures. Canadian Controlled Private Corporations that meet certain taxable income and taxable capital thresholds are eligible to receive a 35 percent fully refundable federal tax credit. This means that most pre-revenue Canadian start ups will get a refund from CRA as a function of the R&D expenses.

Government loans provide additional funding options

Federal and provincial governments have also created extensive and diverse loan programs for entrepreneurs. These are developed to support specific industries (from biotechnology to forestry), regional development, First Nations development, women-owned businesses and social enterprises, to name a few.

Provincial and federal wage subsidies further boost investment

Both levels of government have adopted various wage subsidies that support businesses that invest in workplace training, hire recent graduates, hire persons with disabilities, boost employment in remote areas, create green projects and otherwise innovate in their respective sectors.

Where should you plan future investment?

In the current environment, entrepreneurs seeking opportunities related to overseas investment may benefit from some guidance.

Trade policies and related matters have added to the challenges here – for example, two-thirds of manufacturers[23] responding to our recent survey identified controlling and reducing costs as their main challenges for the next three years. While most plan to invest in Canada, 18 percent are holding off and 10 percent intend to make new investments in the United States instead of Canada. Of those manufacturers turning to the US, about two-thirds cited high costs in Canada, and half cited proximity to customers as the main reasons for the move. They also cited tax reform (including lower corporate taxes), the avoidance of issues related to tighter borders, concerns about a border adjustment tax, protectionist policies, US tax or cash incentives, and more relaxed environmental or climate regulations.

Take advantage of opportunity now and into the future

At Grant Thornton we continue to monitor industry trends, legislative changes, and economic policy to effectively support the business community. Our advisors provide the most up to date advice to clients, to support strategic decisions and highlight growth opportunities.

Your Grant Thornton advisor is here to help you chart a clearer path to entrepreneurial success by leveraging funding and minimizing your tax burden in a changing environment.

Contributors

Heath Moore
National Tax Leader
T +1 902 491 7750
E Heath.Moore@ca.gt.com

Martha Oner
National R&D and Government Incentives Leader
T +1 519 744 2333
E Martha.Oner@ca.gt.com

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