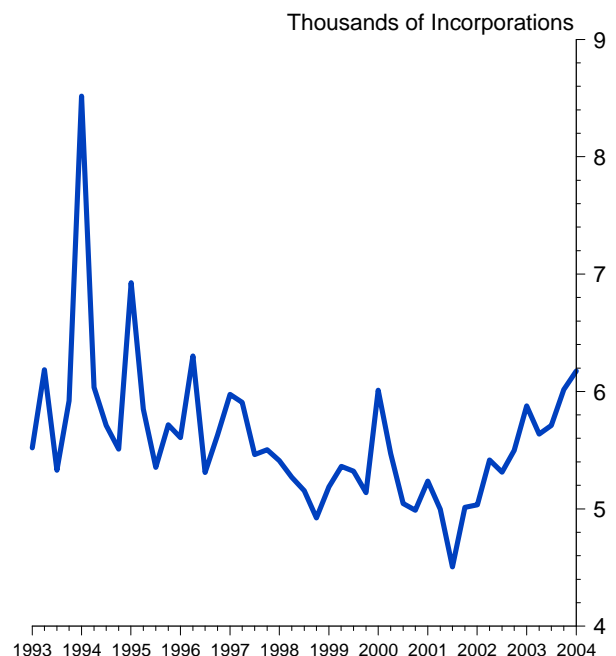


## Small Business Quarterly ♦ 1<sup>st</sup> Quarter 2004

- The number of self-employed in BC continued to climb in the first quarter (+3.3% year-over-year). Both self-employed with (+2.2%) and without paid help (+4.2%) contributed to the rise. This was the twelfth consecutive quarterly increase in self-employed without paid help.
- The number of small businesses in BC (excluding self-employed persons) edged up 0.7% in the fourth quarter compared to the same period in 2002.
- Employment in all British Columbia businesses edged up 0.6% in the fourth quarter of 2003 compared to the same period a year earlier. Most of the growth was due to a 1.6% jump in employment in small businesses. Employment in larger businesses (50 or more employees) was flat (+0.1%). Over the entire year, small business employment expanded 1.3%, slightly greater than employment in larger businesses (+0.8%).
- The number of new business incorporations grew 5.1% in the first quarter of 2004 compared to the same quarter in 2003. This marked the eighth consecutive quarter in which there has been an increase.
- Business bankruptcies dropped considerably in the first quarter compared to the same period a year earlier (-19.5%). Consumer bankruptcies also experienced a significant decline, falling 6.8%. This is the sixth consecutive quarter where there has been a decline in the numbers of both business and consumer bankruptcies.
- Both commercial and industrial building permits issued in BC experienced substantial growth in the first quarter. Commercial permits increased 30.3% year-over-year, mostly on the strength of a 61.7% jump in permits issued in Vancouver. Industrial permits rose 16.0% despite a 56.1% drop in permits issued in Vancouver.
- The balance of opinion of manufacturers in BC is that production in the second quarter will increase, but there is still significant concern over both working capital and skilled labour shortages, particularly for smaller manufacturers that ship less than \$10 million annually. Of these smaller manufacturers, 13% were experiencing a working capital shortage and 19% were looking at skilled labour shortages.

The number of new business incorporations in BC has been rising over the last two years

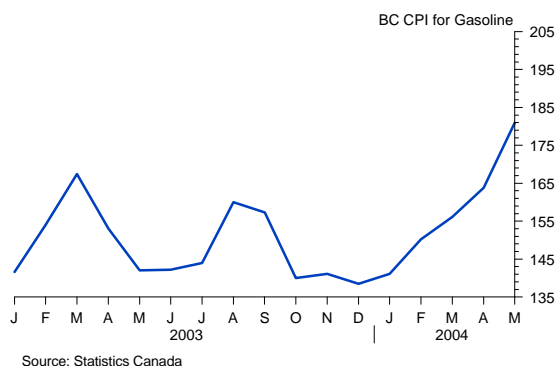


## Small Business Suffers Gas Pains

Anyone who drives a car is aware that the price of gasoline has soared in recent months. While the price at the pump is an obvious indicator of one source of increased cost to consumers, there are other expenses involved with higher fuel costs that are less obvious. The rising price of gasoline is also a cost for businesses and sometimes this additional expense is passed on to the consumer.

Since April, the average price of gasoline in British Columbia jumped from approximately 82 cents a litre to just short of a dollar a litre early in June. This sudden hike is proving to be a burden for many businesses, particularly smaller businesses that have a small profit margin to begin with. While some of these businesses can pass the additional cost on to the consumer, for others it might be enough to push the customer away to substitute products.

Gasoline prices have soared recently



It is already likely that many consumers are cutting back on other purchases to make room in their budgets for the higher cost of gasoline. This could cause some short-term pain for small businesses. However, in the longer-term, it is likely that if higher prices of gasoline persist, then consumers will adjust their behaviour by switching to a more fuel-

efficient mode of transport. Already there appears to be an increased demand for fuel-efficient hybrid vehicles and motorbikes, and purchases of gas-guzzling SUVs are falling.

Businesses that stand to lose the most from gasoline inflation are those involved in transport. Independent truckers who don't have a lot of leeway in what they can charge their customers could stand to incur a significant loss. Companies that deliver products, such as florists, fast food franchises and so on, are another example of businesses that will see their costs rise. Taxi drivers could be doubly cursed by the high cost of gas. Not only will they pay more to fuel their cars, but also they could see fewer tourists using their services as airlines are forced to raise their prices, possibly pushing costs high enough to discourage travellers. Already Air Canada and West Jet Airlines have boosted their ticket prices marginally to recoup some of the costs of higher fuel prices. There is the possibility of even greater hikes to come.

In addition to higher airfare, the extra expense involved in filling a tank could discourage many of those people planning to travel by car. The potential for a decline in tourists could be extremely damaging for small businesses that rely on tourist spending, particularly following on the heels of a poor year due to the effects of SARS, the war in Iraq, and the forest fire situation in the BC Interior.

With all the potential domino effects that could work their way through the economy, it is not surprising that in a survey of its members, the Canadian Federation of Independent Business

found that energy prices were near the top of their list of concerns, second only to insurance premiums.<sup>1</sup> Of those responding to the survey, 64% said that energy prices have negatively affected performance in the last year, compared to 68% who cited insurance premiums as being harmful.<sup>2</sup> This was prior to the rapid inflation in gasoline prices that has occurred recently, so it is likely that in the next quarterly survey, this number will be even higher.

The skyrocketing price of gasoline has businesses and consumers alike pointing the finger, trying to assign blame. Often it is the independent retailer who is held responsible, but in fact, gasoline marketing margins have not changed much over the last year. Rather, it is the cost of refining the gasoline that has been responsible for a great deal of the price surge, along with rising prices for crude oil. The refiner margin, which is the difference between the price of crude oil and the wholesale price of refined gasoline, has risen significantly over the last few months.

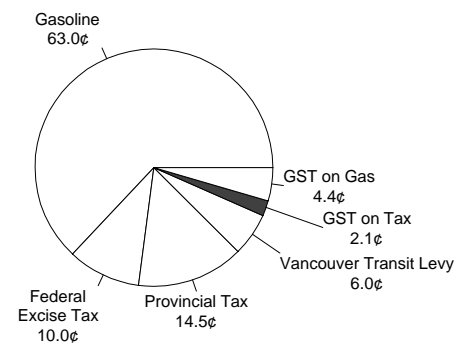
The price incline has resulted from demand outstripping supply. The reason for the scarcity of supply is mainly due to a shortage of refining capacity. There simply aren't enough refineries in North America to keep up with burgeoning demand and the high cost of building a new refinery makes it unlikely that this situation will abate anytime soon.

In addition to crude oil, the refining margin and the marketing margin, the

other significant portion of the cost of gasoline is the tax component. At current prices, taxes make up between 30 and 40 percent of the price of gasoline.

If a litre of gasoline were priced at one dollar in Greater Vancouver, 37.0 cents of that would be comprised of taxes. This includes a provincial levy of 14.5 cents per litre, the federal excise tax of 10.0 cents per litre and a regional transit levy of 6.0 cents per litre.<sup>3</sup> The remainder of the tax is the GST, including 2.1 cents that is actually a tax upon the other taxes.

Cost component breakdown of a litre of gasoline priced at \$1/litre in Greater Vancouver



Despite the additional 6.0 cents per litre transit levy applied in Greater Vancouver, it does not rank as the jurisdiction with the highest percentage of taxes (based on a cost of \$1 per litre) in Canada. That distinction goes to Montreal where consumers pay only a 1.5 cents per litre transit levy, but where the provincial sales tax of 7.5% is applied on top of all the costs, including the GST. If gasoline costs \$1 per litre, only 54.1 cents of it is the gasoline component, with the remainder made up of various taxes, a total of 45.9 cents out of every

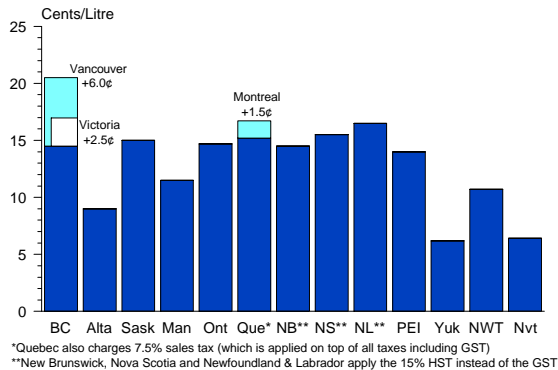
<sup>1</sup> See the article "Cost of Insurance is the Top Concern for Small Business in BC" in the 3<sup>rd</sup> Quarter 2003 issue of the *Small Business Quarterly* for a discussion of that issue.

<sup>2</sup> Canadian Federation of Independent Business, *Quarterly Business Barometer*, 2004 No. 1 (March 2004).

<sup>3</sup> This 6.0 cents per litre applies only to the GVRD. Victoria also pays a transit levy, but it is only 2.5 cents per litre. For the rest of the province, there is no additional levy.

dollar. This is compared to 37.0 cents in Vancouver.

Taxes on gasoline vary widely by province



The rest of Quebec and the three provinces that have harmonized their sales taxes with the GST (New Brunswick, Nova Scotia, Newfoundland and Labrador) are the only other areas of the country where consumers pay a larger portion of taxes per litre of gasoline than Greater Vancouver (or Victoria, which pays a transit levy of 2.5 cents per litre).

Predictably, the historically high cost of gasoline has resulted in people lobbying for lower taxes. One of the prime targets is the portion of the GST that is a tax on other taxes.<sup>4</sup> Equally predictably, since this is an election year, several federal politicians have stepped up to either offer tax breaks or to suggest that a greater portion of taxes collected be returned to the provinces for purposes of road building and improving transit.

It remains to be seen whether or not taxes on gasoline will fall, but it is unlikely that the underlying price of gas will drop back to levels seen just several months ago. The growing demand for fuel coupled with a limited supply should keep prices at higher levels, al-

<sup>4</sup> In Quebec, where the provincial sales tax is applied after all other taxes have been added on, including the GST on top of the other taxes, consumers must pay a tax on a tax on a tax!

though they may abate somewhat from where they are currently skirting the \$1 per litre mark. If this is indeed not a temporary phenomenon, then both consumers and businesses will have to adjust to the higher cost. Perhaps they will be offered some relief from taxes, but it is likely that prices of 60 cents per litre of gasoline are gone for good. For businesses where the cost of fuel is a significant component of expenses, a choice will have to be made: either accept a smaller profit margin, or pass the costs on to consumers.

As mentioned earlier, for some companies, passing on the entire cost may not be a feasible option. Another problem is that, in some cases, the consumer is another business, which then is faced with the same options.

The overall effect of higher fuel costs may not make a substantial dent in the economy,<sup>5</sup> but it could have a more significant impact on some small businesses that simply do not have the option of raising their prices. In general, larger businesses have a wider range of options to deal with cost increases, including ramping up production to increase efficiency. For many small businesses, this is just not feasible.

On the other hand, situations like this are opportunities for entrepreneurs to invent a product substitute and small businesses with some foresight could grow into large businesses as a result. A case in point is Ballard Power, which has grown into a world leader in fuel

<sup>5</sup> According to an article in *The Globe and Mail*, the International Energy Agency calculated that a \$10 increase in the price of oil would cause only a 0.5 percentage point decline in global GDP growth (Little, Bruce, " \$41 crude long way from shock territory," *The Globe and Mail*, May 15, 2004), which is significant, but not catastrophic by any means.

cell technology. Perhaps the high cost of fuel will help that particular company take the next step toward bringing its technology to the mass market, or perhaps another company will come up with an alternative fuel or an alternative form of transportation that will diminish the demand for gasoline.

Time will tell what effect higher gasoline prices will have on the BC economy, but in the short-term it is almost certain to be a drag on small businesses and consumers. Over the longer term, both consumers and businesses alike may adapt by changing their gasoline consumption habits and substituting different products for ones in use now, whether they be more fuel-efficient vehicles, different methods or procedures for transporting goods, or a new product altogether that uses fuel cell or other technology.

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