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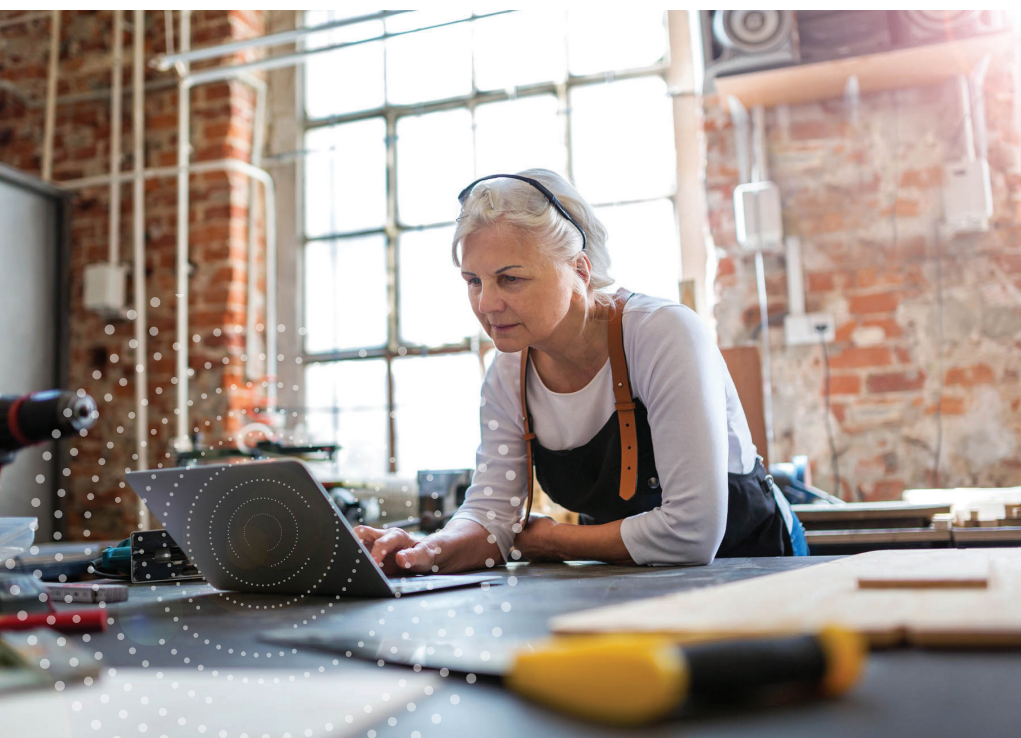
White Paper

The Small Business Recovery

How lenders can help small businesses now,
and post-pandemic

Statistics Canada reported that 58,000 active businesses shut down across the country in 2020. A Léger survey for Equifax in August 2021 indicated five per cent of businesses had closed for good, and 23 per cent did not expect their businesses to recover in 2022. Various projections put the casualty rate for small business as a result of the pandemic at between seven per cent and 21 per cent.

Even those continuing to operate have seen a deterioration in their balance sheets. Collectively, small and medium-sized businesses (SMBs) took out an additional \$135 billion in loans in 2020. Lenders that want to keep their businesses are going to have to get more hands on, recognizing that their clients' balance sheets may have suffered over the past two years, and help them navigate the recovery.



Surviving the pandemic lockdowns

After 11 years running the successful Restaurant Les Cavistes in Montreal, Maude Thérroux-Séguin and her partner, Robert Herrera, were ready to expand. They planned to open a wine bar and café called Cerise just a block away in April of 2020.

The COVID-19 pandemic had other plans. By mid-March, the Quebec government had ordered not only restaurants but also construction sites closed. And while Les Cavistes had a takeout and delivery service up and running by April 1, even after work resumed at Cerise, it was painfully slow due to shortages of manpower and materials. "I was supposed to receive my windows," Thérroux-Séguin recalls. "We've been waiting for lamps for six months."

Cerise eventually opened in August of 2020. But just two months later, Quebec imposed a second lockdown. Without having established a relationship with its customers, the new café had no option to offer to-go service. It would stay closed until restrictions were lifted in May 2021.

Despite it all, Thérroux-Séguin considers herself lucky. Having a loyal customer base for Les Cavistes and having enjoyed a roaring rebound business this past summer, she and Herrera were able to continue paying the rent on their other operation. They also took advantage of the restaurant recession to pick up a nearby Frite Alors! burger franchise at a bargain-basement price and open an ice cream parlour, Angele & Douglas.

But she knows better than most just how difficult it will be for smaller operators with fewer resources to survive the pandemic's painful aftermath. "The months to come are going to be hard on the entrepreneurs," Thérroux-Séguin says. As if caught in a flood, "everyone's holding their businesses on top of their heads." They're exhausted, they're still not back at full operation, and now that the government supports they've been leaning on are being withdrawn, there's a risk that a great many will simply drop their loads and swim for shore.

Pandemic takes a toll

Business disruption was by no means limited to the hospitality and travel sectors, as is commonly assumed. Almost half of the 300 businesses that responded to an Equifax-Léger survey in August 2021 said they suffered a loss of revenue as a result of COVID-19. Nearly three-quarters—72 per cent—said their industry had permanently changed. Veteran business owners who'd been operating six or more years were actually *less* confident than new business owners that their fourth quarter of 2021 would see an improvement from 2020.

At the start of the pandemic David and Karrie Fraser of Erin, Ont., had two businesses: DCF Wedding Music, which had been booking a network of freelance performers for weddings for 13 years, and Bunkie Life, an upstart manufacturer creating kits to build tiny backyard cabins. The pandemic experience for each venture was very different. The wedding business basically shut down; the manufacturing business took off. "Everyone and their mom wanted to build a deck and/or a bunkie," David Fraser says. "We were in the right place at the right time."

The biggest issues for Bunkie Life, like many small businesses, has been the supply of materials and manpower. By raising its prices and requiring customers to put up a deposit worth half the cost of their cabin up front, the company mitigated the financial strain of supply-chain delays. Still, Fraser lived through the frustration of having millions of dollars of inventory sailing the high seas or stuck in port. They "lost a week of our lives," he says, when, one time, the customs broker informed him there was no permit required for his shipment. He later realized he had to produce an official letter confirming no permit was required in order to get his goods released.

Equifax's August survey also found that the recruitment and retention of employees was the most prevalent challenge not directly related to COVID-19, affecting one in four businesses. "Everyone is struggling with this employee shortage," says Thérroux-Séguin. During the off-and-on lockdowns, many of her food service workers opted to switch occupations or go back to school, she says. The disruption of immigration shut off another channel of human resources. Though business is now brisk, she's had to cut opening hours by a third to ensure her remaining staff members don't get burned out.

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Maude Thérroux-Séguin

Government relief—and its consequences

Of all the government assistance programs made available during the pandemic, SMBs view the Canada Emergency Wage Subsidy (CEWS), which chipped in 75 per cent of employees' compensation (at first) for organizations whose revenues had declined 30 per cent or more since 2019, as a lifeline. "If it had not been for CEWS we would have shut down," Thérèse-Séguin says.

The Canada Employment Response Benefit (CERB), a form of expedited employment insurance, made it easier for SMBs to pair back employment knowing that their staff would receive government assistance. That made Fraser feel comfortable about passing the wedding music business onto an employee.

Perhaps the most widely used form of assistance for small businesses, however, was the Canada Emergency Business Account (CEBA). Through their usual lenders, SMBs were able to borrow up to \$40,000—later raised to \$60,000—interest-free, with the interest covered by the federal government up until the end of 2022. Three in four SMBs across the country took the government up on its offer. "Whether you were a have or a have-not, chances are you took these loans," says [Jeff Brown, Head of Small and Medium Business Strategy & Innovation for Equifax Canada](#).

While there is a consensus these loans were necessary to ensure business continuity during the lockdowns, "there weren't a lot of checks and balances when these loans went out," Brown says. That makes the matter of servicing or retiring the loans before regular interest rates kick in tricky.

As Gary Schwartz, president of the Canadian Lenders Association (which represents the financial technology sector) asks: "How will borrowers be able to access capital as we drive toward economic recovery? What happens post-COVID as the sovereign safety net recedes and incumbent lenders are no longer a viable lending resource?"

As an incentive, Ottawa announced it would forgive up to \$20,000 of each loan for those who pay up by December 31, 2022. However, for those unable to repay the loans on time, Brown says, "it sets you up for higher accumulated interest over a longer period of time" than they would likely have experienced without having taken them out in the first place.



Who's at risk?

"The credit degradation that has happened since the start of the pandemic is evident," Brown continues. According to our [most recent small business data](#), about one in eight businesses are in severe delinquency with their loans. Since the pandemic began, that figure has risen to one in seven across Canada. In some regions it's worse than others. In Alberta, where the pandemic effects combined with an existing energy bust, the ratio is one in five.

There are also areas of vulnerability related to the kind of business and their owners. Restaurants could still face capacity limits under public health orders, even with dine-in resuming. In-person health and fitness services, meetings and events, and anything dependent on international travel, such as the cruise-ship industry, suffered complete shutdowns—some ongoing. Industries that still had willing customers, like construction, faced challenges with everything from the availability of skilled trades to the spiking cost of lumber. Automotive dealerships could not keep their showrooms stocked with cars.

Companies owned by women as well as Indigenous peoples and Black Canadians face unique challenges, too. As was mentioned in a recent Equifax [panel discussion](#), lenders often look for personal collateral such as home equity to bolster a loan application, for example, but this isn't available to Indigenous entrepreneurs living on-reserve. "The pandemic created this whole pool of have-not businesses," Brown says.

How lenders can help

Now is the time, then, for financial institutions to step up their customer service. "There's a lot of credit education that has to happen with small businesses. We haven't seen that so far from lenders or government," Brown says. "We're really looking to these lenders to give solid advice."

Specifically, there are four actions they can take:

Make small-business clients aware of their credit score

Equifax's [survey](#) indicated that only 59 per cent of SMB owners even know they can obtain a credit report for their business, while just 40 per cent know what their own credit score is and 30% know where to get it. Lenders need to ensure their clients are not only aware of their credit score but also how it affects their access to credit and the interest rates they pay. Help them ensure their use of CEBA and other government assistance improves—rather than worsens—their credit standing.

Give them ample notice of deadlines

SMB owners need a reminder that interest will be applied to their CEBA loans beginning in a year's time. "SMB owners shouldn't get reminders about their loans just one or two months prior to the deadline" restaurateur Thérioux-Séguin says. For the small operators for whom \$60,000 may far exceed their profit for the year, "it's too late."

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Identify products and programs they can take advantage of

Bunkie Life's Fraser, who graduated from a small business line of credit at his local bank branch to commercial banking in the course of the pandemic, says that lenders should give their clients a high-level overview of his financial status, then recommend the best available government programs and loans for their business.

Look beyond scores, grids and ratios

Many small businesses have yet to return to their pre-pandemic activity levels, yet this is when they need to increase their lines of credit most. Thérèse-Séguin suggests that bankers go beyond quantitative measures and find out how the business is regarded in its neighbourhood and among its employees. "If you're a good owner, you're a good leader. You're able to attract good people around you," she says. "The people who stuck with us [through the pandemic] are like family. This is how you survive."

For lenders, it's about remembering the last of the five Cs of credit: character. (The other four are capital, cash flow, conditions and collateral.) The traditional credit metrics often fail to recognize intangible sources of value, even in prospering businesses like Bunkie Life. Owner David Fraser notes that his company has invested more in its brand—including creating a YouTube channel of how-to videos and publishing a book for bunkhouse owners—than its shed-building competitors. "We invested in things that will pay dividends over five to 10 years," he says.

At this, financial institutions may point out they have their own challenges, whether wrought by the pandemic or not, so why bother devoting all this time and effort to holding the hands of their SMB customers? Brown has a pointed answer: "If you don't change your ways, there is a pool of alternative lenders that are going to come in and steal your customers if you aren't providing that kind of support." Many financial technology companies inside and outside Canada are seeking just such an opening to gain market share, he warns.

Ultimately the SMB sector will rebound and resume its long-term growth trajectory. Two-thirds (68 per cent) of respondents to Equifax's August survey said they expect their business to recover in 2022.

There is a potential upside to the pandemic for small business, Brown adds. Just as COVID-19 accelerated some trends already evident in the marketplace, it also accelerated the pace of change within individual organizations. It's given owners pause to reflect on how their companies operate. Which staff positions and services offered are most important? Which trade relationships are expendable? Should we pare down what we do, or pivot to something different? That re-evaluation will likely see this generation of survivors emerge stronger and more sustainably profitable in the decade to come.



How Equifax can help your small business clients

There are many aspects to [running a small business](#). Is risk management one of your clients' top priorities? Reputational risk, operational risk and financial risk are real concerns for Canadian business owners and all need to be handled with care.

Equifax has a long history of helping small and medium-sized businesses manage their financial and operational risk, while also providing best practices and solutions for maintaining a positive reputation.

Maintaining a healthy business credit profile is important for the reputation and future growth of a business. Regularly checking their [business credit report](#) enables your clients to know what lenders, service providers and potential partners are learning about their business. Let us help improve your business credit portfolio and make it easier to help small businesses grow.

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* Equifax Canada commissioned Leger to conduct an online survey with 300 Canadian small (255) and medium-sized (45) business owners/leaders/decision makers within the Food, Construction, Retail, and Travel Industries. It was completed between August 20 and 29, 2021, using Leger's online panel.

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