Financial health of SMEs

Survey results

December 2023

Economic Research and Analysis Team

This document analyzes the results of a BDC survey of 1,505 business owners conducted between September 7 and 18, 2023. All charts are taken from that survey.

Rising interest rates and economic slowdown weigh on SMEs

Introduction

After the 2020 pandemic and the inflation associated with the surge in business activity in 2021 and 2022, small and medium-sized businesses must now reckon with higher interest rates and weaker growth. This document explores the current financial situation of businesses and their ability to cope with these new business conditions.

While household data paints a detailed picture of their situation, business data is often aggregated. Although this data sheds light on the situation for large companies, it does not always show what is happening with smaller ones.

The aim of the study is to provide detailed information by business type to identify the key differences based on business size.

Some highlights:

- The effects of the economic downturn are uneven from one business to another
- About one third of business loans have variable rates
- Small businesses with debt face higher rates and are more exposed to rising interest rates because they are more likely to have variable-rate loans
- Nearly half of SMEs believe it is harder to pay off debt today than it was 12 months ago
- Businesses with variable-rate loans are more likely to cancel or put off their investments if rates increase

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1. Small SMEs face higher rates

Small SMEs (<$3M in sales) face higher interest rates on their debt than larger SMEs (>$10M in sales).

The gap is the widest on non-mortgage business loans, where small SMEs face interest rates almost twice those of larger SMEs (12.7% versus 6.5%, a gap of 6.2 points).

Small SMEs have probably a harder time accessing credit because they are more fragile financially and need smaller loans, which can be less profitable for lenders.

In the current context of recent rate increases, the gap is also partly due to the type of rates paid by businesses.

Nearly four in ten small SMEs with a non-mortgage business loan have a variable rate, compared to just 13% of larger SMEs. Small SMEs have therefore been harder hit by the recent rate hikes.

Larger SMEs have more resources allocated to financial planning, which has enabled them to better anticipate rising rates and opt for fixed rates.

Chart 1: Gap in interest rates faced by SMEs with over $10M in sales and SMEs with less than $3M in sales, in percentage points

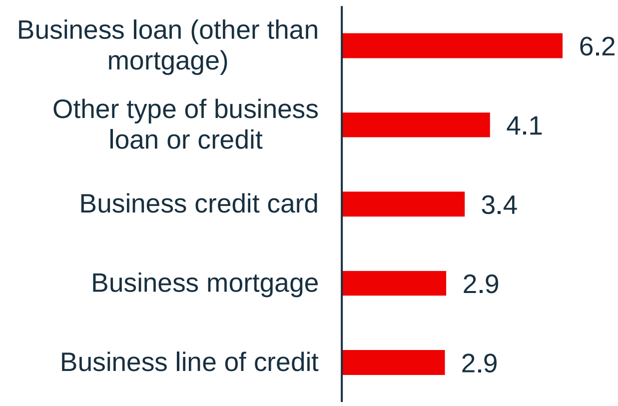


Chart 2: Percentage of non-mortgage business loans with a variable or adjustable rate

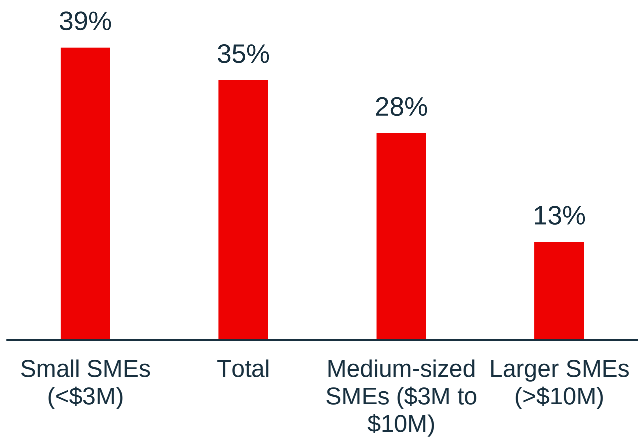


Table 1: Interest rates on SMEs debt**, %**

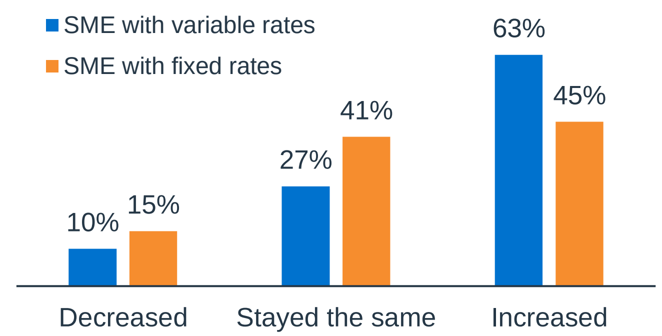
	Business loan (other than mortgage)	Business mortgage	Business line of credit	Business credit card	Other type of business loan or credit
All SMEs	11.8%	7.9%	10.2%	17.5%	11.0%
Small SMEs (<$3M)	12.7%	8.3%	10.7%	17.4%	11.6%
Larger SMEs (>$10M)	6.5%	5.4%	7.8%	14.0%	7.5%

2. SME debt is on the rise

Half of SMEs have seen their debt levels go up over the past 12 months due to flagging economic activity and rising rates.

SMEs with variable-rate loans were more likely to see their debt level increase (63%) than those with fixed-rate loans (45%).

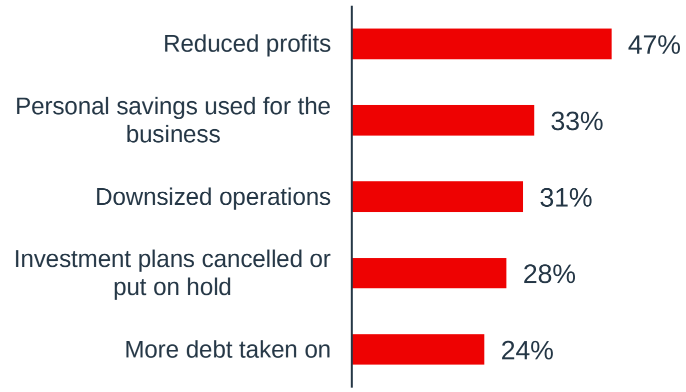
Chart 3: Changes in debt levels over the past 12 months



Roughly half of businesses with rising debt levels reduced their profits, while one third had to dip into their personal savings, and more than one quarter had to cancel investments or put them on hold.

SMEs with variable-rate loans were hardest hit by the rise in debt. More of them had to reduce profits (55%) and cancel or put off investments (35%).

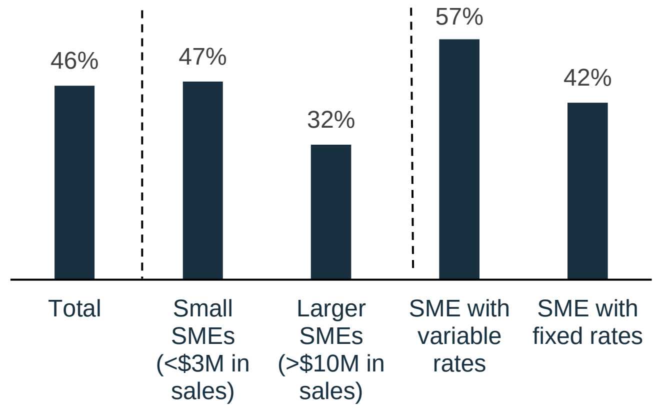
Chart 4: Effects of higher debt levels on affected businesses



During the pandemic, many SMEs took on debt more to stay afloat than to grow their business. With rising rates and declining economic activity, many are now struggling to repay their loans.

Almost half (46%) of SMEs are finding it harder to pay down debt today than 12 months ago. Again, smaller businesses and those with variable-rate loans are having the hardest time.

Chart 5: Percentage of businesses finding it harder to pay down debt today than 12 months ago

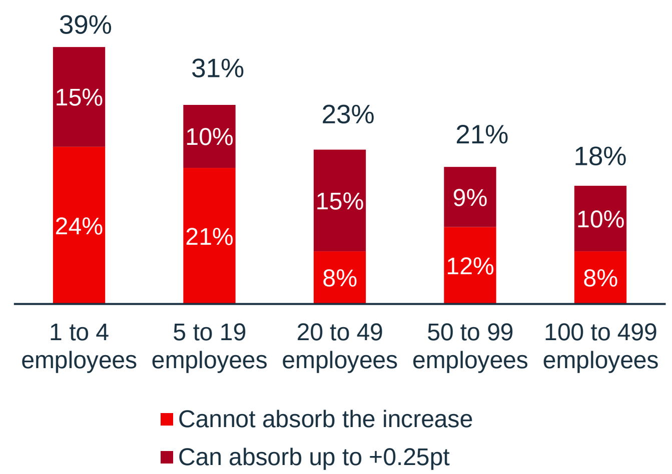


3. Micro-businesses would find it harder to absorb future rate hikes

Against this backdrop of heightened financial fragility, roughly one third of businesses may have trouble absorbing a rate increase of more than 0.25 percentage points. However, the larger the company, the better equipped it is to absorb rate hikes.

Micro-businesses are twice as likely to be unable to absorb a rate rise of more than 0.25 points than businesses with more than 100 employees.

Chart 7: Percentage of SMEs that would be unable to absorb a rate increase of more than 0.25 percentage points

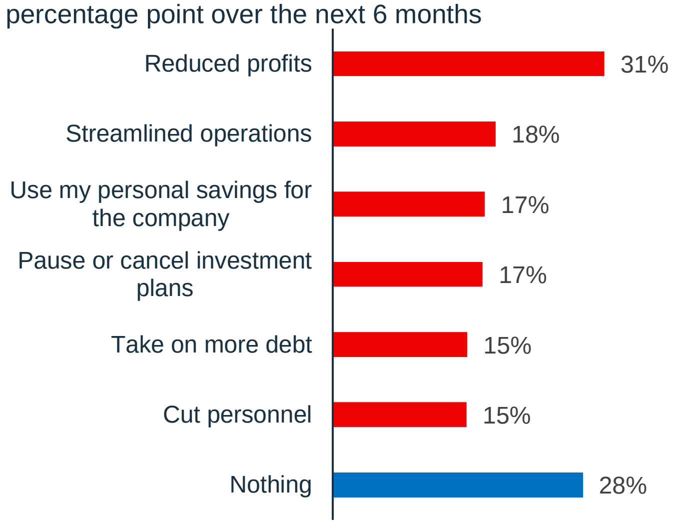


If rates rose by one percentage point over the next six months, almost one third of SMEs would cut profits, and 17% would reduce investments.

However, although 70% of SMEs would not be able to absorb an increase of more than one percentage point, some 20% could absorb up to two percentage points. So not all businesses are financially fragile.

Despite the slowdown, a significant minority of businesses—often the largest—continue to face strong demand and are on solid financial ground.

Chart 8: Impact on SMEs if interest rates rise by 1 percentage point over the next 6 months



Conclusion

As with households, the economic downturn and rising interest rates do not affect all businesses the same way. While the overall situation is not alarming, many small SMEs, particularly in sectors that were hardest hit by the pandemic, are on fragile financial ground.

This fragility of small SMEs is partly linked to their greater propensity to have variable-rate debt. SMEs with variable-rate loans are more likely to have seen their debt level increase, making it harder for them to repay their debts.

Micro-businesses may also have more trouble than large SMEs coping with further rate increases. In this context, a one-point increase in the interest rate could reduce profits for one third of SMEs.