

Productive Business Index

Outlook for 2021



Foreword

by Anthony Impey, CEO, Be the Business



The roll-out of the long-awaited vaccine is underway, and it looks like there may finally be some light at the end of the tunnel. However, many small and medium-sized businesses are still coming to grips with yet another lockdown, the latest in what feels like a never-ending series of challenges for their businesses. In spite of what seem like relentless setbacks, businesses have risen to the occasion. They have pivoted to new business models, developed new products, and invested in new technologies – all under conditions of extreme uncertainty.

We believe it is vitally important to measure how the external pressures over the past 12 months have changed business behaviours and what the impact of this may be over the longer term. The transformation we have seen across the UK business community may have been driven by necessity and with survival in mind, but it will undeniably have an impact on business productivity and performance. Businesses in different sectors and regions have reacted and adapted to the external threats in distinct ways, and we will investigate how this is shaping the evolution of the UK economy.

This Business Productivity Outlook will not be a standalone report, but rather the starting point for an Index tracking the various actions small businesses are taking to make their business more productive and the effect this is having over time. Although many businesses view these actions as necessary rather than an optional productivity booster – they are almost certain to influence productivity and tracking this will tell us a lot about where we should be focusing our efforts to support small businesses, and whether we are moving closer to solving our national ‘productivity puzzle’.

Productivity means a lot of things to a lot of people. But we hope that the new Productive Business Index will make tackling what productivity means for small businesses more straightforward and provide a blueprint on where we’re headed.

Executive Summary

The rate and scale of the transformations that have taken place amongst UK small businesses over the past year has been incredible. Our research over the course of 2020 tells us that micro, small and medium sized businesses are innovating, changing management structures and business models, and adopting technology in huge numbers. These changes are driven by external pressures brought by the impact of Covid-19 and more recently, Brexit, but they will have a longer term impact on firm level productivity.

We want to measure the changes small businesses are making now to assess the impact on their performance and productivity in the future. We also want to explore whether, having gone through the difficult processes of managing business change and innovation, there will be a fundamental shift towards a focus on continuous improvement by small business owners. Importantly, we plan to track any changes over time using a bespoke index model, developed in partnership with Oxford Economics.

We track business performance against key metrics such as revenue, number of employees, and new business orders, measuring both current performance and future expectations. We also track what actions small businesses are taking to improve their business. We will measure actions already taken in the past 12 months, and actions planned over the next 12 months. Assigning a score to performance and capability improvement, we generate a single index number to represent the productive health of UK small businesses. We will also rank the top constraints to growth as identified by the businesses themselves.

In this first survey of 1500 micro, small and medium sized enterprises, we have uncovered some rich insights:

- Business conditions have stagnated or deteriorated with almost half (47%) of micro, small and medium sized businesses experiencing a worsening of their general operating conditions over the last three months.
- Only 15% of businesses believe there will be an improvement in general business conditions in the next three months.
- Businesses which generate some or all of their revenues from exports have been less affected by the impact of the pandemic and generally feel more optimistic about the future. 16% of exporters have seen business conditions improve in the last quarter versus only 9% of non-exporters.
- Manufacturers appear to have made significant changes to their business over the course of the Covid-19 pandemic with 41% having launched a new product offering in the last 12 months and 44% plan to do so in the next 12 months.
- Of our five productivity areas, management and leadership is ranked by business leaders as the most important factor in improving company productivity.
- Around half (48%) of businesses say their investment in tech has achieved the benefits they expected.
- There has been a flurry of innovation amongst small businesses with a third of companies having launched new products, services or sales or marketing initiatives over the past twelve months.
- UK businesses consider themselves to be efficient, with around four times as many businesses believing their operations are efficient versus those who don't.
- Flexible working in small businesses is here to stay with 44% of those who have some flexible working activities expecting it to increase in the next 12 months.
- The top three constraints to growth identified by businesses are 1) the current economic climate, 2) insufficient demand, and 3) competition within their sector.

We plan to use the Productive Business Index and its insights as a means of measuring the 'productive health' of the UK SME community. This will not only help us to design our strategy and programmes to better support small businesses, but will help inform the work of the broader business support ecosystem.

Tracking the key elements of a productive business

British business has long had a productivity problem.¹ The UK has exceptional businesses in every sector and some individual firms are amongst the best in the world. However, across our business community, the average productivity of the typical business is below that of our peer nations in Europe and elsewhere.²

Covid-19 may have put a focus on national productivity on the back burner temporarily, yet many of the traits that have driven business resilience in the face of the pandemic relate closely to the drivers of productivity.

Since our creation in 2017, Be the Business has extensively researched the productivity puzzle and identified the key drivers of a productive and high performing business. We have identified five distinct areas that are major drivers of company level productivity.³ Through this research project, designed in conjunction with Oxford Economics, we set out to measure the capability of micro and small and medium businesses in these five areas.

- **Management and Leadership:** does the business have a plan for the future and a strategy to get there?
- **Technology Adoption:** is technology, in various guises and even at the simplest levels, embraced?
- **Training, Development and HR:** is the environment to learn and improve built into the company systems and structures?
- **Operational Efficiency:** is there a constant focus on improving elements of everyday performance?
- **Innovation and Ideas:** are the conditions fostered to create and test new ideas that will enhance the business?

We know from our research that any movement in these critical factors influences the productivity of a firm. To date however, there has not been a research project to consistently track the focus on these critical areas within UK businesses.

Based on our research, micro, small and medium sized businesses appear to have undertaken a huge amount of activity in making improvements in these areas. This is likely as a result of the external pressures of Covid-19, Brexit preparations, changed consumer trends and uncertainty around labour. In turn, it has led to unprecedented action focused on performance improvement. We want now to measure and analyse the impact this activity has on these businesses going forward.

In doing so we will produce a new Index measure of micro and SME performance. Based on frequent market research among UK micro, small and medium sized businesses (which we define as employing between 2 and 250 employees), the new Index will track changes in the five key areas noted above, as well as general operating conditions, main barriers to growth and expectations for the future. This first report provides an initial outlook on UK businesses as we move into 2021.

From here, we will begin to measure positive and negative changes in company performance and performance improvement activity, based on past company behaviour and planned future activity – on a consistent basis. This will enable us to build up a clear picture of whether UK businesses are collectively taking the steps needed to improve their business capabilities, which in turn contributes to solving our national productivity puzzle.

Specifically, the insights we gather from our research will be used to create a master Index. This will provide a headline figure which interprets how focused UK micro and SMEs are on improving the performance of their business and addressing productivity challenges on a regular basis.

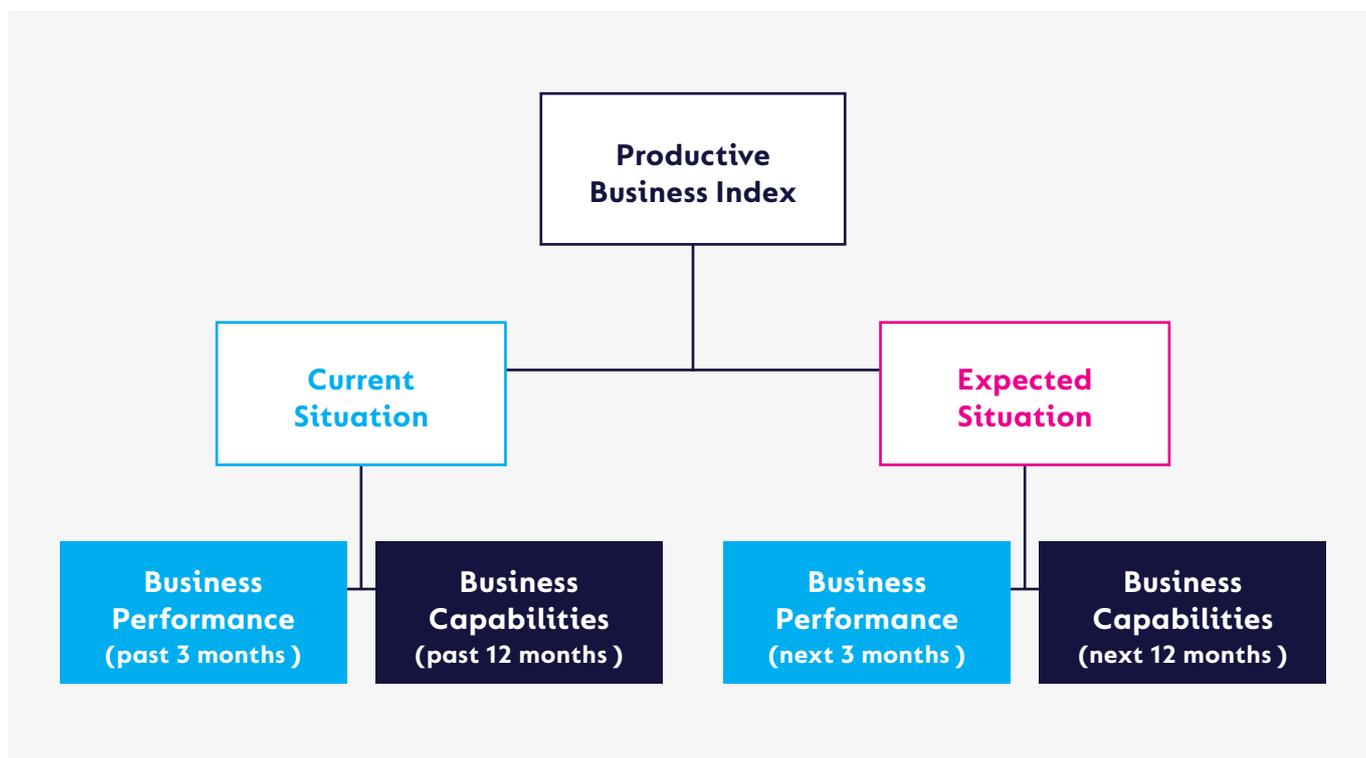
¹ <https://www.mckinsey.com/featured-insights/regions-in-focus/solving-the-united-kingdoms-productivity-puzzle-in-a-digital-age>

² International comparisons of productivity - Office for National Statistics

³ These five priority areas were identified as part of research conducted with McKinsey & Co. to develop a framework detailing the core drivers of productivity that are within a company's control

Within this Index number we will measure actions already taken to improve performance as well as firm's plans to invest or allocate resources to such efforts going forwards. We will do this by measuring:

- Business Performance measures trading conditions and company sentiment.
- Business Capabilities assesses activity in the key areas that can drive productivity improvements within the business.
- In both Performance and Capabilities we assess the current situation, as well as asking for future expectations.
- This enables us to produce a business Performance Index and a business Capabilities Index. By combining Performance and Capabilities, we produce assessments of the overall Current and Expected situation, which are combined to form our overall Productive Business Index figure.⁴



It is clear that firm level productivity can be improved, and it is clear how. This Index will do its part to chronicle whether and how fast this is happening as business begins to emerge and rebuild in years to come from the Covid-19 pandemic.

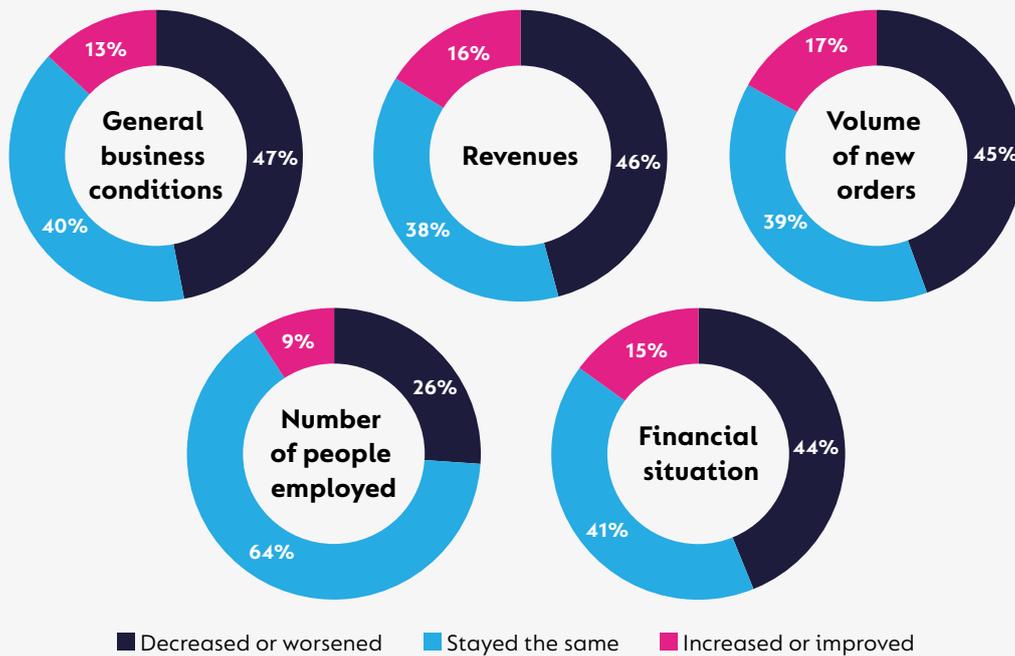
⁴ Performance being a more dynamic variable is measured over 3 months, while capabilities which take a longer time to embed in a business are measured on a 12- month horizon. A note on methodology is in the appendix.

Headline findings from the Productive Business Index outlook for 2021

Operating conditions are difficult, and will remain so

- Business conditions have stagnated or deteriorated with almost half (47%) of micro, small and medium sized businesses have experienced a worsening of their general operating conditions over the last three months.
- A similar proportion (46%) have faced declining revenue, a reduced new business pipeline (45%) and tougher overall financial situation (44%).

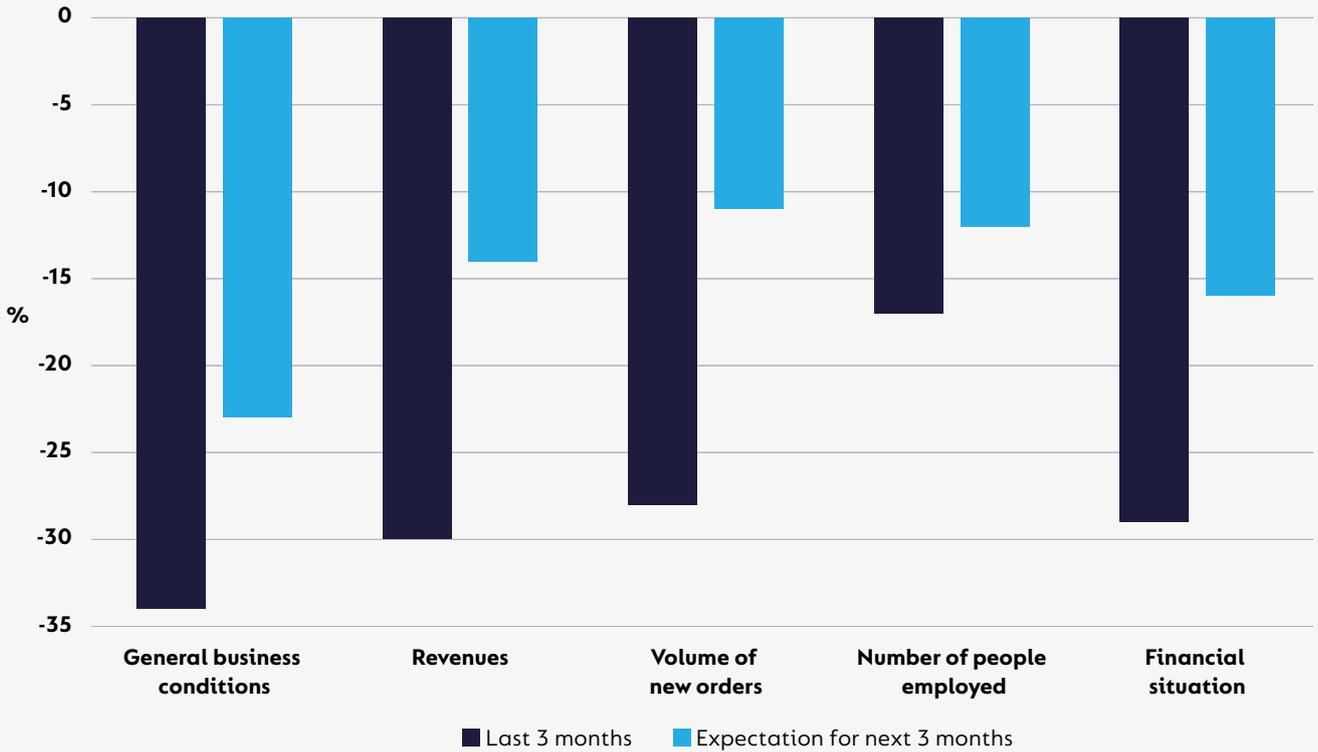
Figure 1: Business performance over the past 3 months.



Some businesses believe this quarter to be better, but vast majority will continue to struggle

- While only 15% of businesses believe there will be an improvement in general business conditions, a fifth (21%) forecast revenues to improve and a similar proportion (23%) anticipate an increase in new business, perhaps demonstrating how businesses are innovating in response to trading conditions.
- Overall, a larger proportion of businesses expect their business conditions to remain steady, suggesting the impact of the pandemic has begun to plateau as businesses adapt and evolve their operations to meet external challenges.
- However, in spite of some expectations of an improvement in performance, we can see the expected net change in business performance continues to be negative.

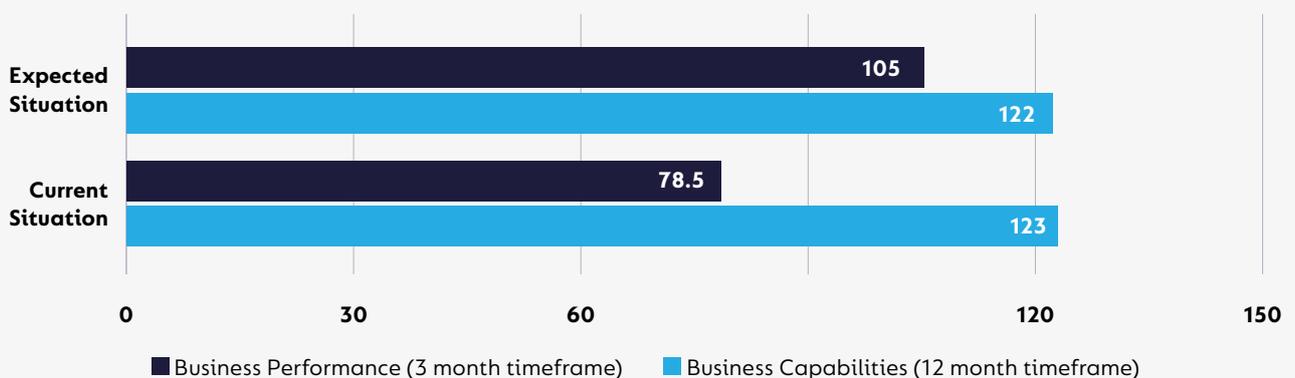
Figure 2: Net change in business performance over the last 3 months and expectations for next 3 months.



Businesses expect the next 12 months will be a time of increasing focus on improving performance.

- There is a significant difference between business performance and trading in the last three months versus expectations for the first quarter of 2021
- Assessment of business capabilities now versus the year ahead shows a smaller predicted increase in such capabilities.
- Overall, although the predicted net change remains negative, pessimism is lower than 2020, and some businesses are predicting steadier incomes.

Figure 3: How current and future performance and capabilities score using our Index model.



Businesses who export are in a stronger, more productive position

- Businesses which generate some or all of their revenues from exports have been less affected by the impact of the pandemic over the last three months, and generally feel more optimistic when looking forwards.
- 16% of exporters have seen business conditions improve in the last quarter vs only 9% of non-exporters. Similarly, exporters are more optimistic for the quarter ahead.⁵
- Nearly half (44%) effectively use e-commerce versus just a third of non-exporters. Exporters are also more likely to use data to improve efficiency and decision-making.
- Exporters are also almost twice as likely to have developed and launched new products or services in the past year.

Most sectors have found it tough, but manufacturing and retail are making clear plans to invest in key areas to drive performance in the year ahead

- Manufacturers appear to have used the Covid-19 pandemic to make significant changes to their business.
- While not enjoying the level of revenue or profits that the technology, financial services and construction sectors have, manufacturers have spent the pandemic putting in place a range of measures that should drive productivity in the future.
- The sector is innovating at scale: 41% have launched a new product offering in the last 12 months and 44% plan to do so in the next 12 months.
- Manufacturers are also planning to invest in new technology to drive efficiencies (31%) and upskill staff on digital skills (36%).
- Meanwhile, retail businesses have already spent significant time and resources innovating over the past year and show no sign of letting up. As might be expected, they have also invested heavily in e-commerce and will continue to do so.

Management and leadership emerge as the most important area of focus for most sectors

- As businesses across the UK continue to feel the effects of Covid-19, strong management and leadership has taken on prime significance among businesses.
- Of our five productivity areas, management and leadership is ranked by business leaders as the most important factor in improving company performance at present.
- While true at a national level, there are some variations in the data across industry sectors. Operating efficiency for example is held to be a higher priority in sectors such as motor trades, transport, mining and utilities

Capabilities to improve business performance (highest to lowest) across the UK as a whole

Capability	Rank	Score 1 most important to 5 least important
 Management and leadership	1	2.2
 Operating efficiency	2	2.5
 Technology	3	3.1
 Innovation	4	3.3
 Human Resources	5	3.5

⁵ This survey was undertaken prior to the end of the Brexit transition period.

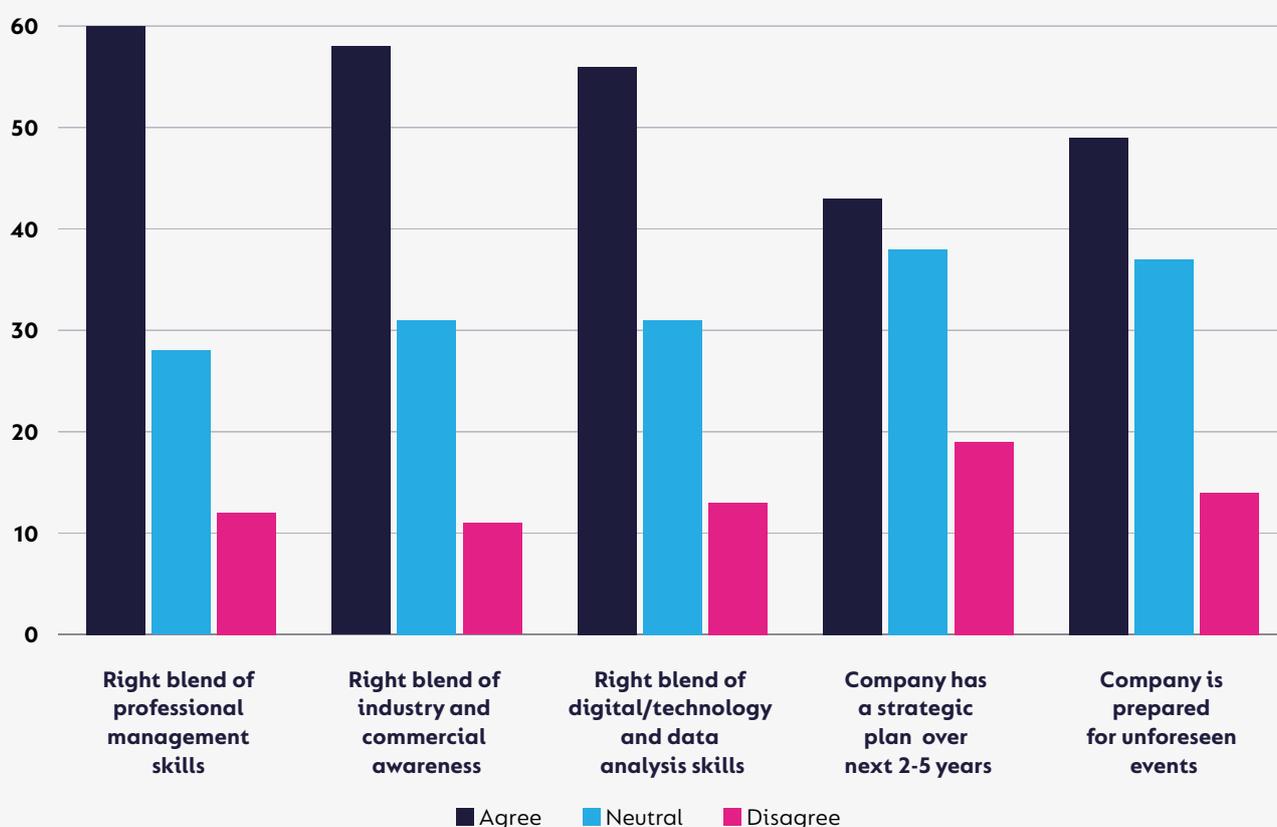
Key drivers of productivity – and whether businesses are focusing on them

Management and Leadership

Confidence is generally high among business owners and managers when it comes to their company's management ability. This matters, given that research shows that effective leadership and management can often be considered the most important driver of productivity and is ranked as the most important capability by the majority of companies surveyed.

The majority of businesses are confident in their management's industry and commercial awareness, professional skills, and technology and digital skills. While confidence about longer-term planning and risk management are lower, overall a net positive picture remains.

Figure 4: Decision makers views on leadership and management skillset within their own business.



There is also a clear belief that over the last 12 months, business decision makers feel the ability of management within micro and small and medium businesses has increased.

In a range of areas – management skills, ability to plan strategically and over longer time horizons, ability to make decisions, assessment of risk and financial forecasting – more businesses believe their ability to do so has improved, not worsened since this time last year.

Business owners and leaders also indicate a clear desire to keep a focus on improvement in this area. Many state plans to continue to devote significant time and attention to these areas, with around 95% of small businesses saying they will have some activity in this area in the next 12 months and over 30% saying they will increase their level of activity in this area. Whether this stated focus on Leadership and Management continues into 2021 or is a side effect of the immediate Covid-19 crisis is one of the areas Be the Business is most excited to track over the coming year.

Figure 5: My company's effectiveness in leadership and management increased in the past 12 months through taking action in the following areas:



Figure 6: Plan to increase level of activity in the following area in next 12 months:



Technology adoption

Research⁶, including our own⁷, consistently shows that the effective adoption of technologies like accounting software, customer relationship management systems and other automated processes, have a significant impact on company productivity and performance. Our research tells us that there has been widespread adoption of tech by micro and small and medium businesses as they respond to the pandemic.

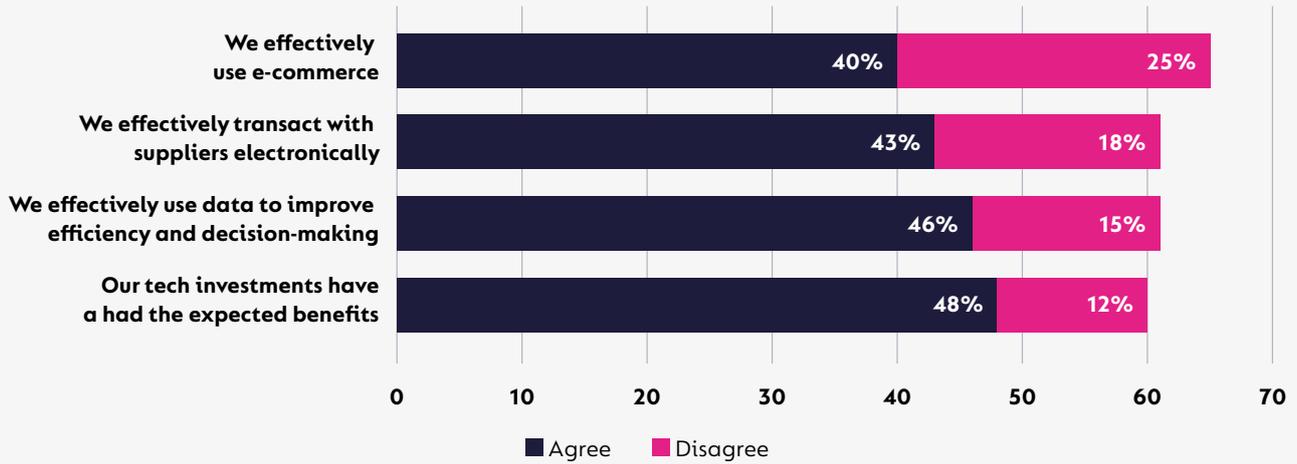
On the whole, we found that businesses are more confident than not about their use of technology. 40% of businesses report they use e-commerce effectively with both customers and suppliers and three times as many believe they use data effectively when taking business decisions.

Perhaps most importantly, given that businesses can often express frustration with the technology adoption process, around half say their investment in tech has achieved the expected benefits. Only 12% feel the opposite.

⁶ Enterprise Research Centre, 2018, State of Small Business Britain report. Retrieved from enterpriseresearch.ac.uk/publications/state-small-business-britain-report-2018

⁷ Be the Business, 2020, The UK's Technology Moment

Figure 7: Views on effectiveness of use of technology and data in your business.

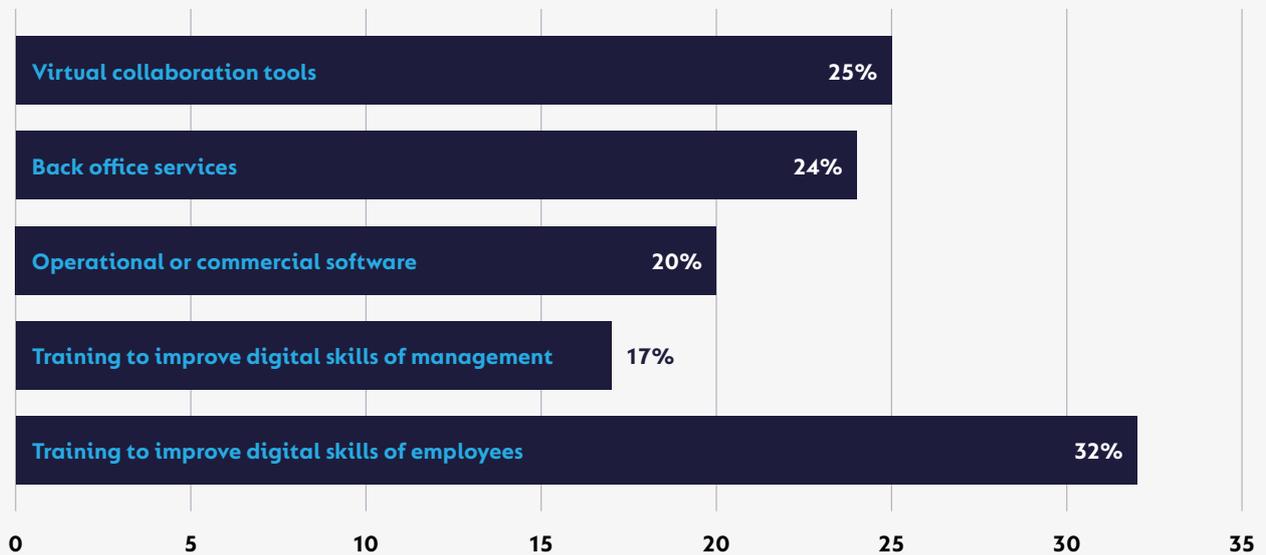


The picture on whether adoption of technology has increased digital readiness is a little more mixed.

Over the last 12 months, between 25% and 35% of businesses point to a beneficial effect on their digital readiness from adopting technologies like back office services or undertaking specific digital skills training. However, the proportion who say their level of digital readiness has remained the same is around double these percentages.

Recent studies undertaken by Be the Business in association with McKinsey⁸ and Lloyds Banking Group⁹ have highlighted the challenge of tech adoption for micro and SMEs. This new data suggests that effective tech adoption still appears to be a challenge for businesses.

Figure 8: Investing in the following technologies has improved my company's digital readiness over the last 12 months.

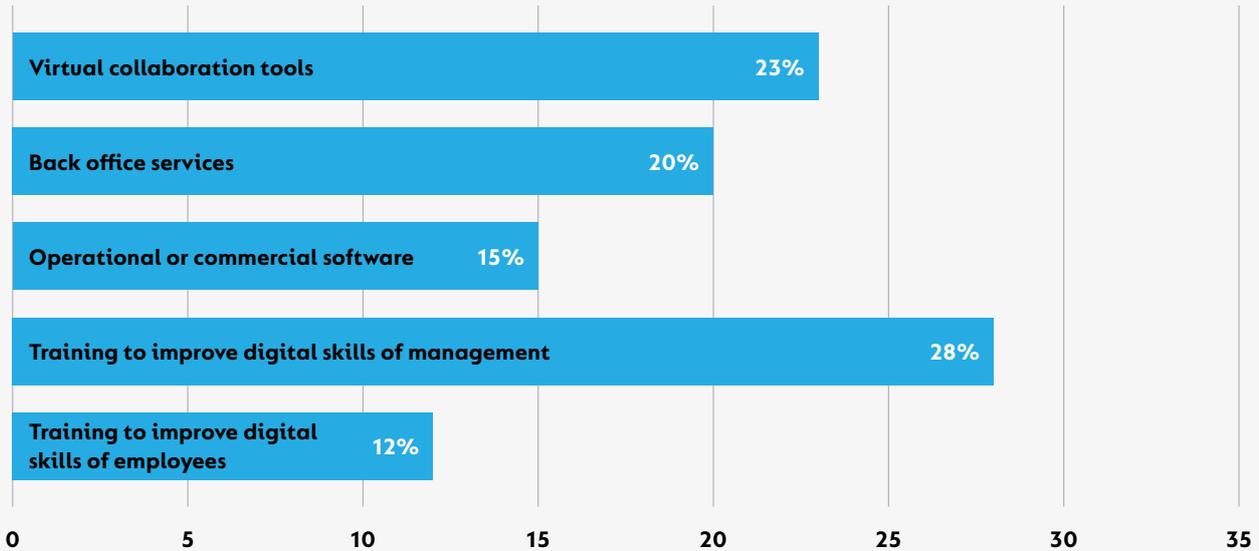


Looking ahead, the increased focus on tech adoption by UK businesses looks set to continue. A sizeable minority plan to increase levels of technology investment, though most companies will continue at the current level of spending on tech. Across various technologies, between a fifth and a third of businesses plan to increase their investment in digital technologies over the next year.

8 <https://www.bethebusiness.com/wp-content/plugins/pdf-analytics/tracking.php?file=https://3yglje27ycx92yxpww1mc32m-wpengine.netdna-ssl.com/wp-content/uploads/2020/09/The-UKs-Technology-Moment.pdf>

9 <https://www.lloydsbank.com/assets/resource-centre/pdf/businessdigitalindexreport2020.pdf>

Figure 9: Our company plans to increase our levels of activity in this area over the next 12 months.



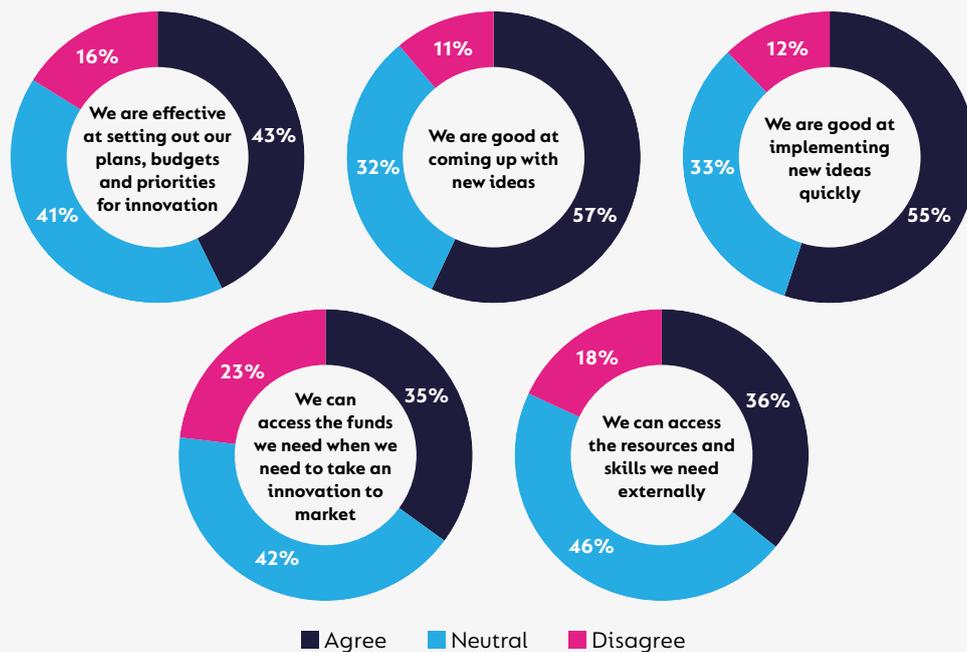
Innovation

Innovation can be a key driver of productivity and performance improvement, however it is often considered the territory of high performing or hi-tech businesses, and not something that the average small or medium business ‘does’.

However, we found that confidence in the ability to innovate is generally high among business owners and managers. The ability to generate new ideas, create the right environment to foster them, and then effectively implement them are generally ranked positively by owners. This is in contrast with research which has historically shown smaller UK businesses struggle with innovation compared to larger ones in the country.¹⁰

Interestingly, confidence is less high about accessing the funds required to bring innovations to market, or in finding the right external partner for innovation.

Figure 10: Decision makers views on how effective the innovation process is in their business.

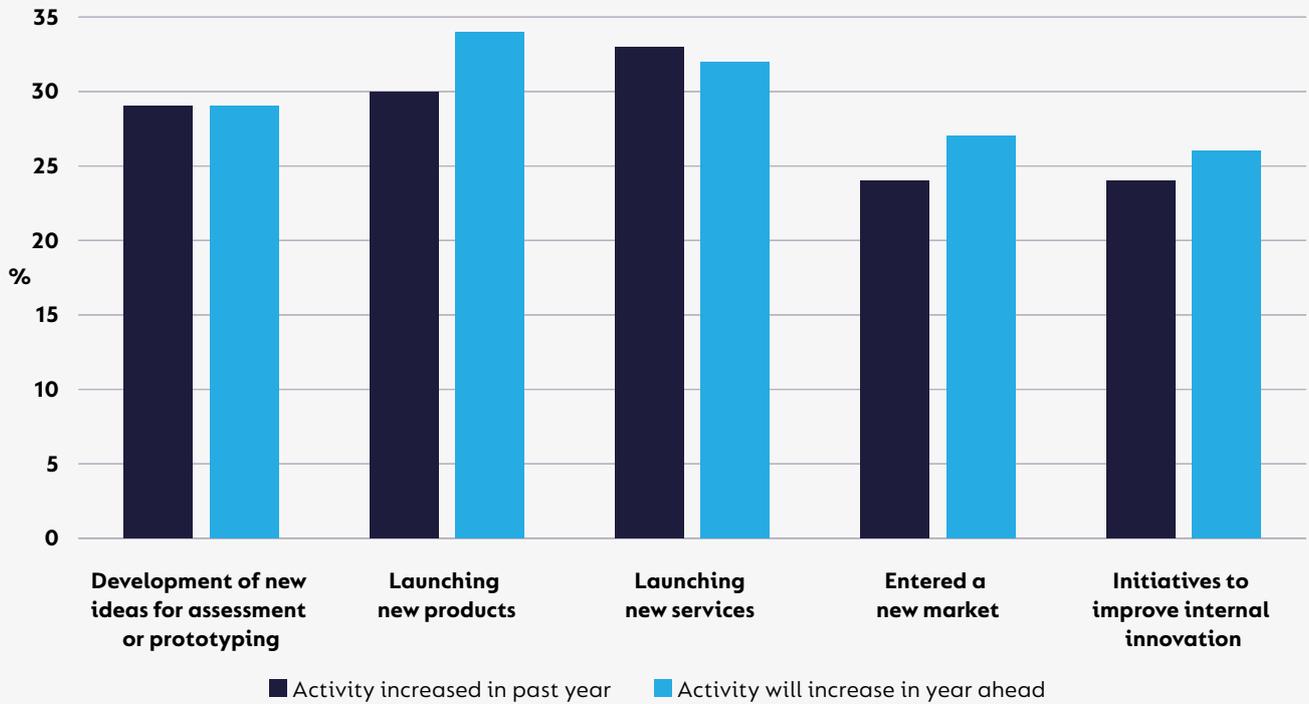


¹⁰ <https://www.scaleupinstitute.org.uk/wp-content/uploads/2019/11/unlocking-uk-productivity.pdf>

As for tangible signs of innovation, Be the Business research has previously found a wave of innovation taking place among micro, small and medium sized businesses. The new data supports this view. There have been huge levels of innovation in UK business, with around a third of companies increasing the level of innovation activity to launch new products, services and sales or marketing initiatives over the past twelve months.

Crucially, looking ahead for the next year, this innovative behaviour shows no sign of slowing down.

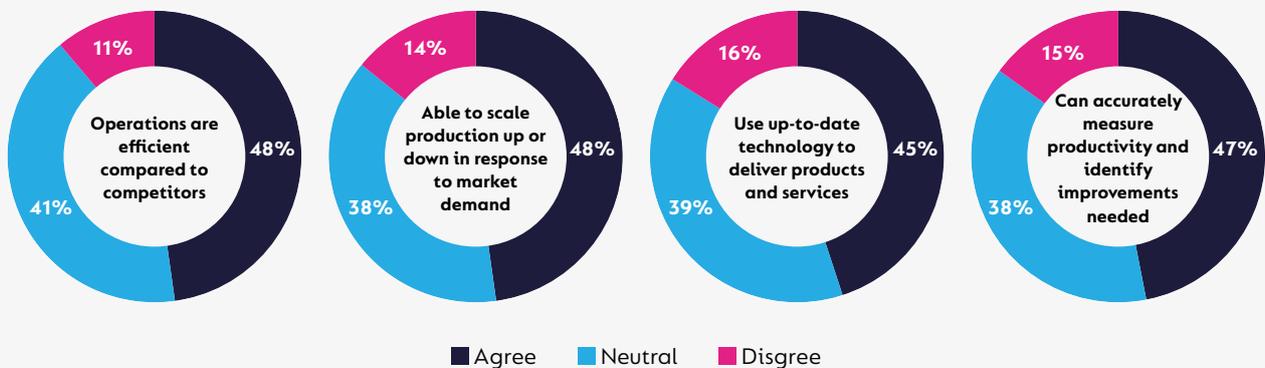
Figure 11: Levels of innovation related activity in the past 12 months and plans for next 12 months.



Operational efficiency

The ability to find efficiency savings has been urgently tested with the challenging trading conditions during the Covid-19 pandemic. Businesses, on the whole, are more confident than not in their ability to increase efficiency when it matters. Around four times as many businesses believe their operations are efficient, make good use of technology and can measure productivity versus those that think they don't.

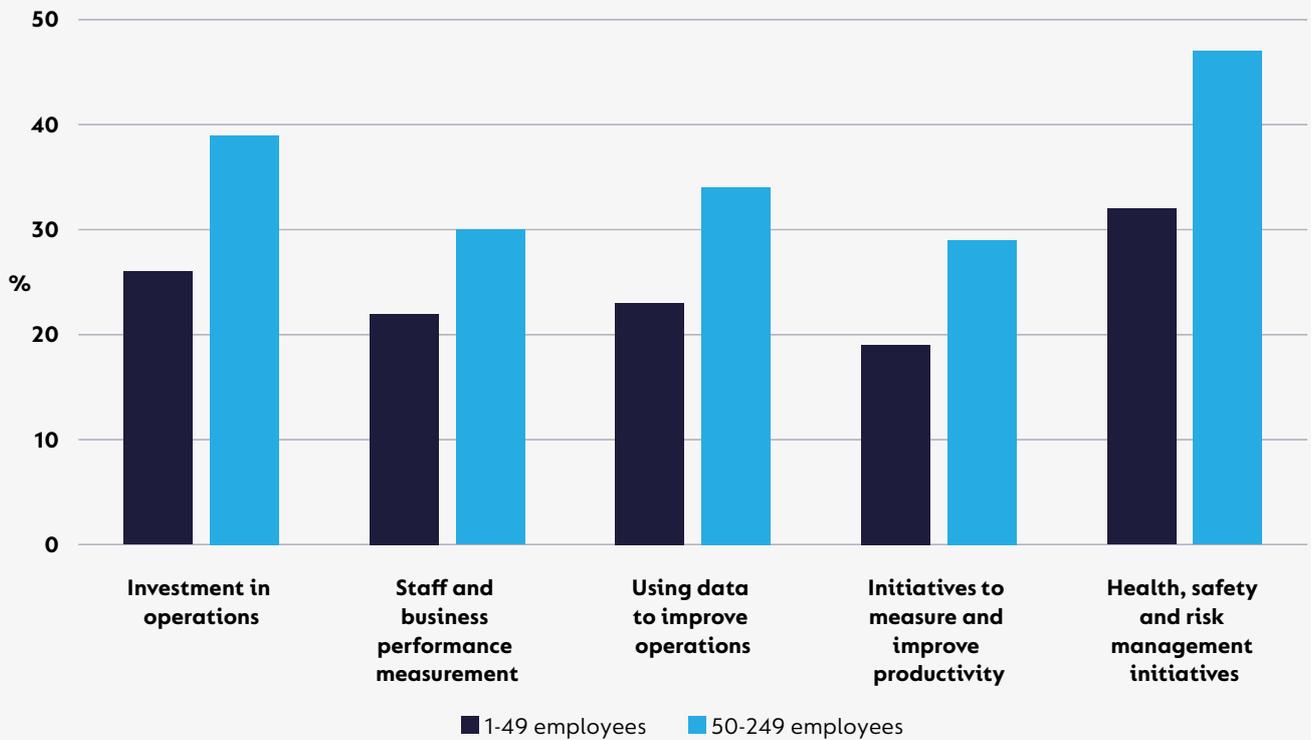
Figure 12: How do you rate your company's operational efficiency?



On a practical level, investment in operations, health and safety, and risk management initiatives are felt to have driven the greatest operational efficiency improvements in the past year. The picture is similar looking ahead to 2021.

Interestingly, smaller businesses have a challenge in realising benefits from activities to increase operational efficiency. Their expectations of their ability to increase their operational efficiency by making changes within their business processes is significantly less than their bigger counterparts.

Figure 13: Percentage of business leaders – by size of business – who believe that the following measures have improved productivity over the past 12 months.



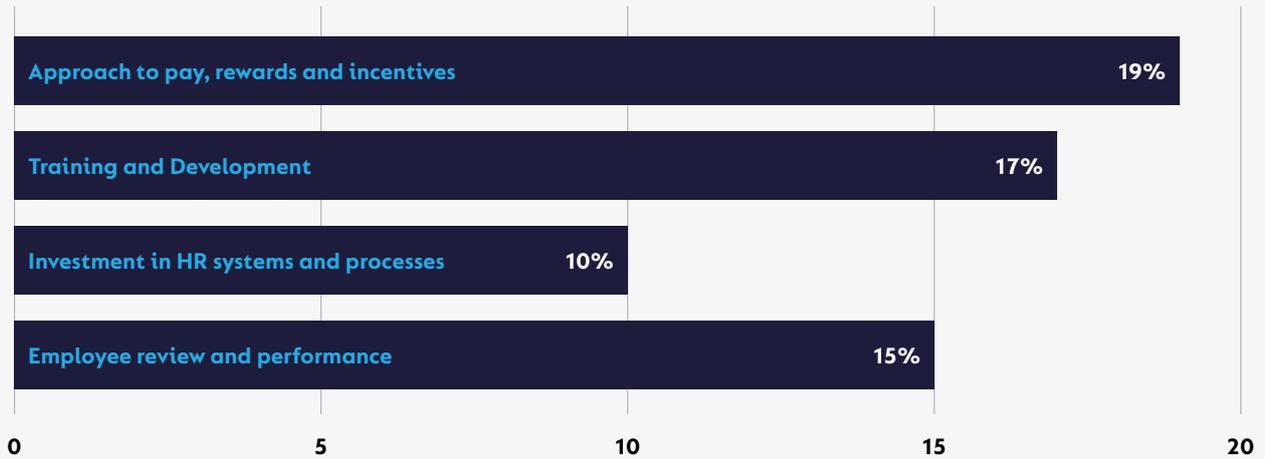
Perhaps as a result of this challenge, smaller businesses are also less likely to spend more time and resources targeting operational efficiencies over the coming year. Less than a quarter of firms with fewer than 50 employees plan to increase resources dedicated to performance measurement for example. In contrast, 32% of companies with 50-250 employees will do so.

The picture is similar for initiatives specifically focused on productivity, risk management, new plant, machinery or software, and the use of data.

Training, Development and HR

Despite the pandemic and the disruption it is causing, businesses have continued to invest in their people. The vast majority of companies believe they have either maintained or increased the effectiveness of training programmes, investment in HR processes, and reviews of employee performance. This behaviour will continue through 2021 according to owners and managers surveyed.

Figure 14: Percentage of business leaders who believe the following HR and employee focused measures have improved productivity over the past 12 months.

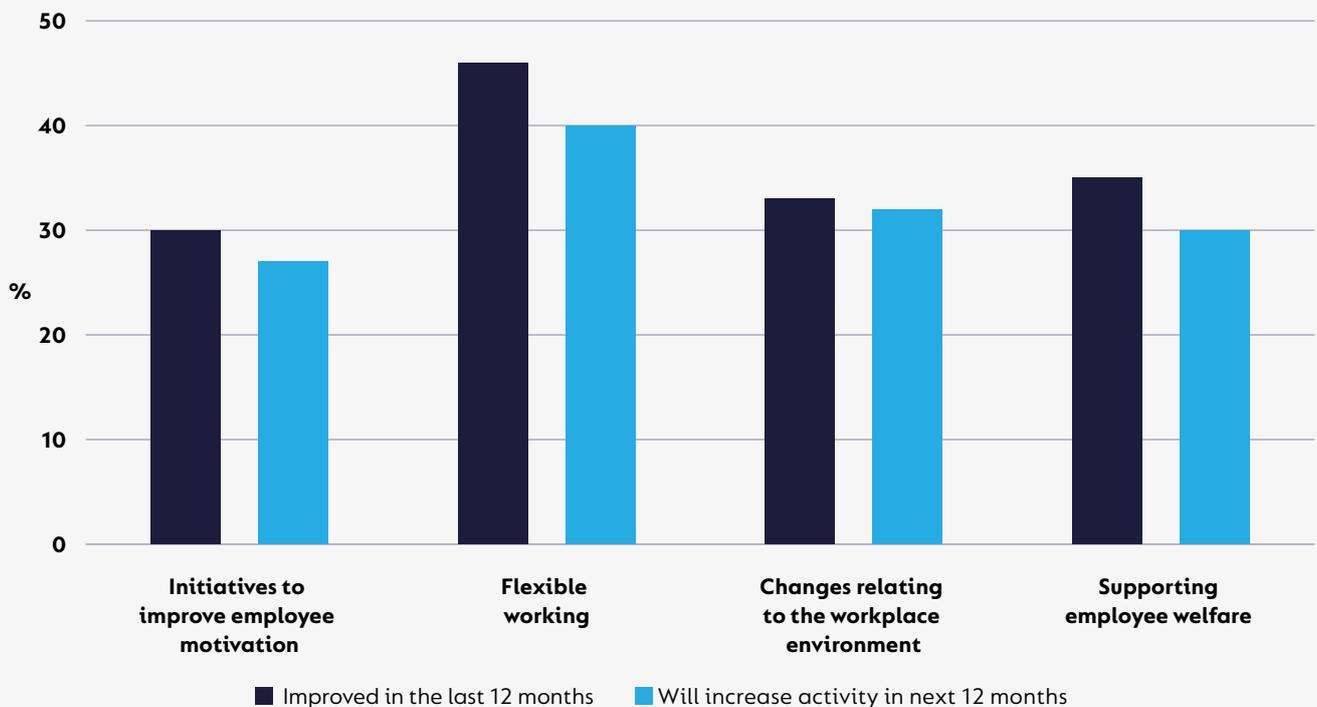


Unsurprisingly, there has also been a significant focus on employee wellbeing during the last year. Approaches to flexible working, employee mental health and changes to working conditions have all had significant focus. As a result, many companies feel they have made discernible improvements to these areas of their business.

One significant finding is that flexible working amongst many small businesses is here to stay. Expectations are that flexible working will continue to be important, with 44% of those with activity in this area expecting it to increase in the next 12 months.

Reassuringly, a focus on investing in employees and their welfare is set to remain a priority over the next 12 months as well.

Figure 15: These activities have improved our performance over the past 12 months. We will increase our activity in these areas in the next 12 months.

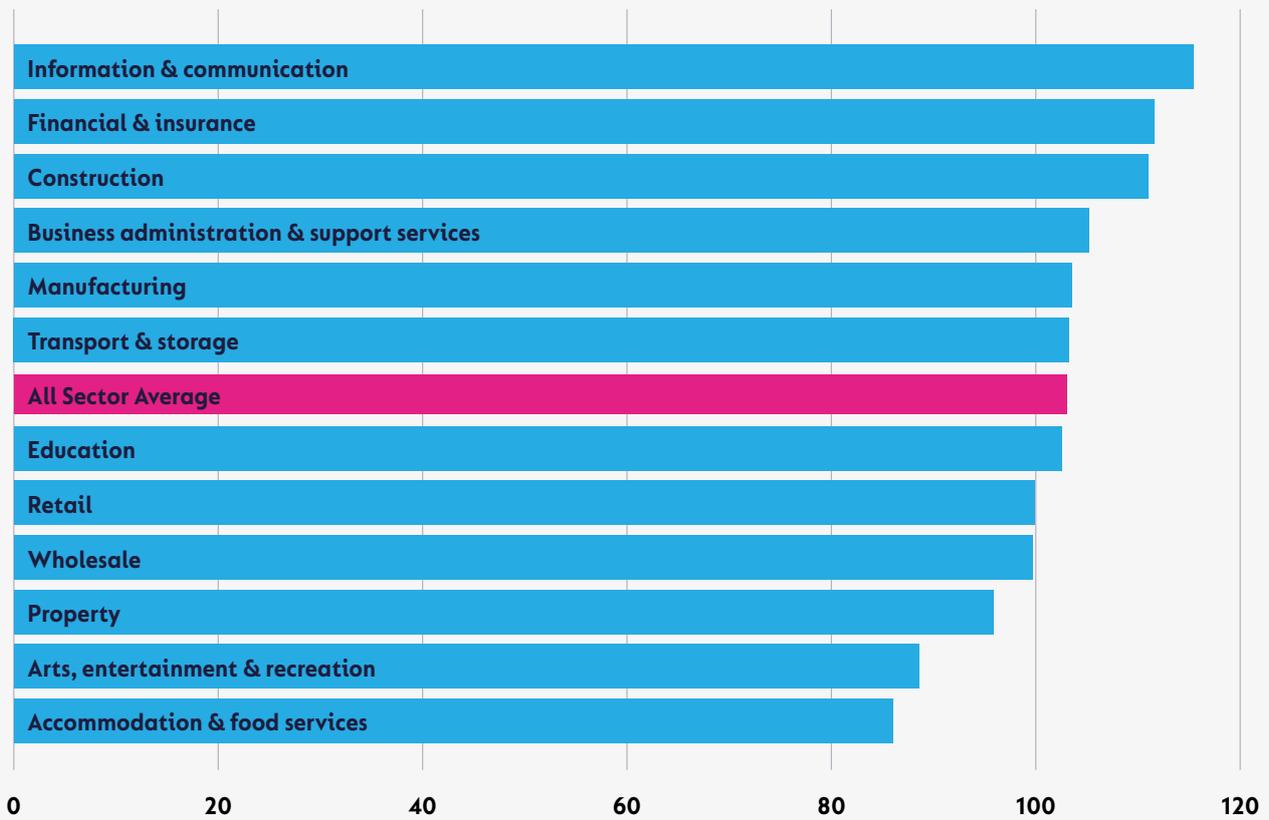


Industry by Industry: manufacturers lead the way on productive performance

The different impacts of Covid-19 on different sectors has been well documented. Consumer facing industries for example – travel, hospitality and retail – have struggled greatly with the loss of custom and footfall.

Overall, we find some sectors are clearly focusing on investing in performance improvements – and stand to reap the productivity benefits in the future – more than others.

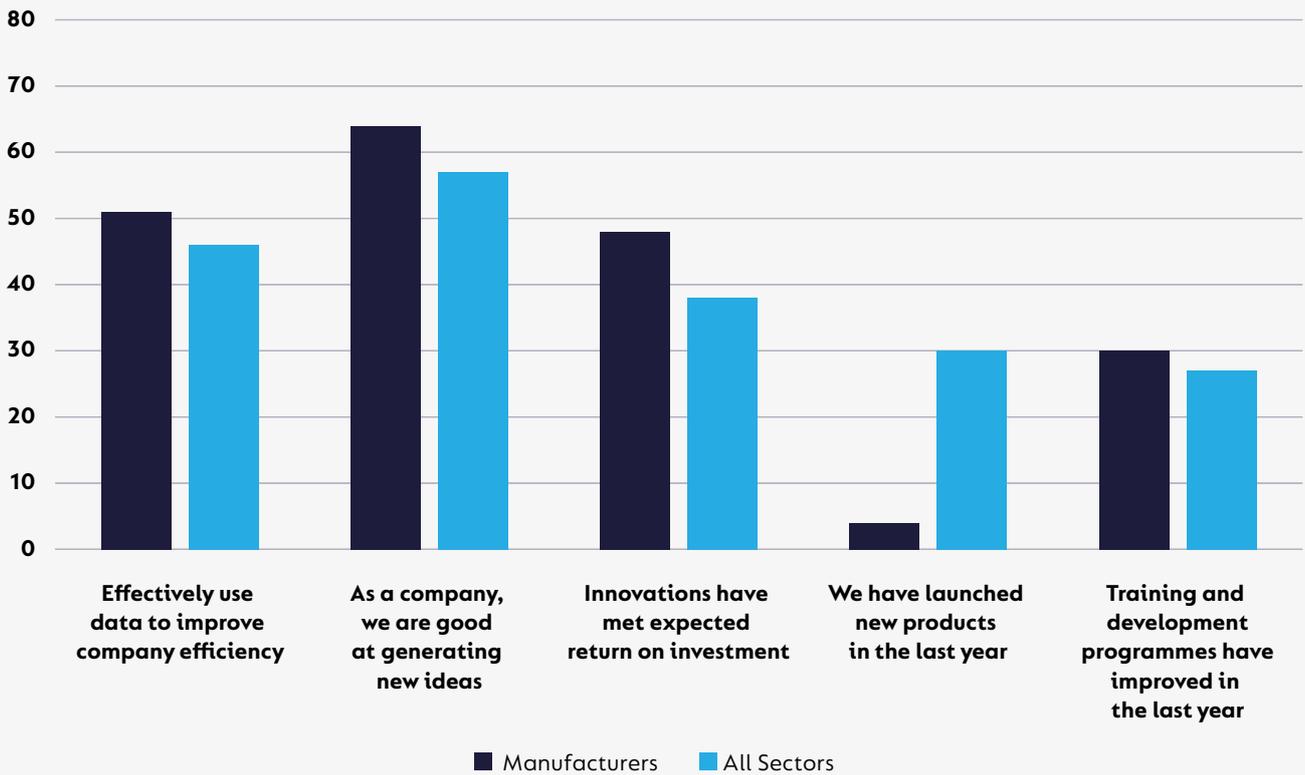
Figure 16: How industry sectors rank when scored using our Productive Business Index methodology.



However, beneath the headline findings, some sectors such as Retail and Manufacturing do look as though they may be better placed than the overall picture suggests.

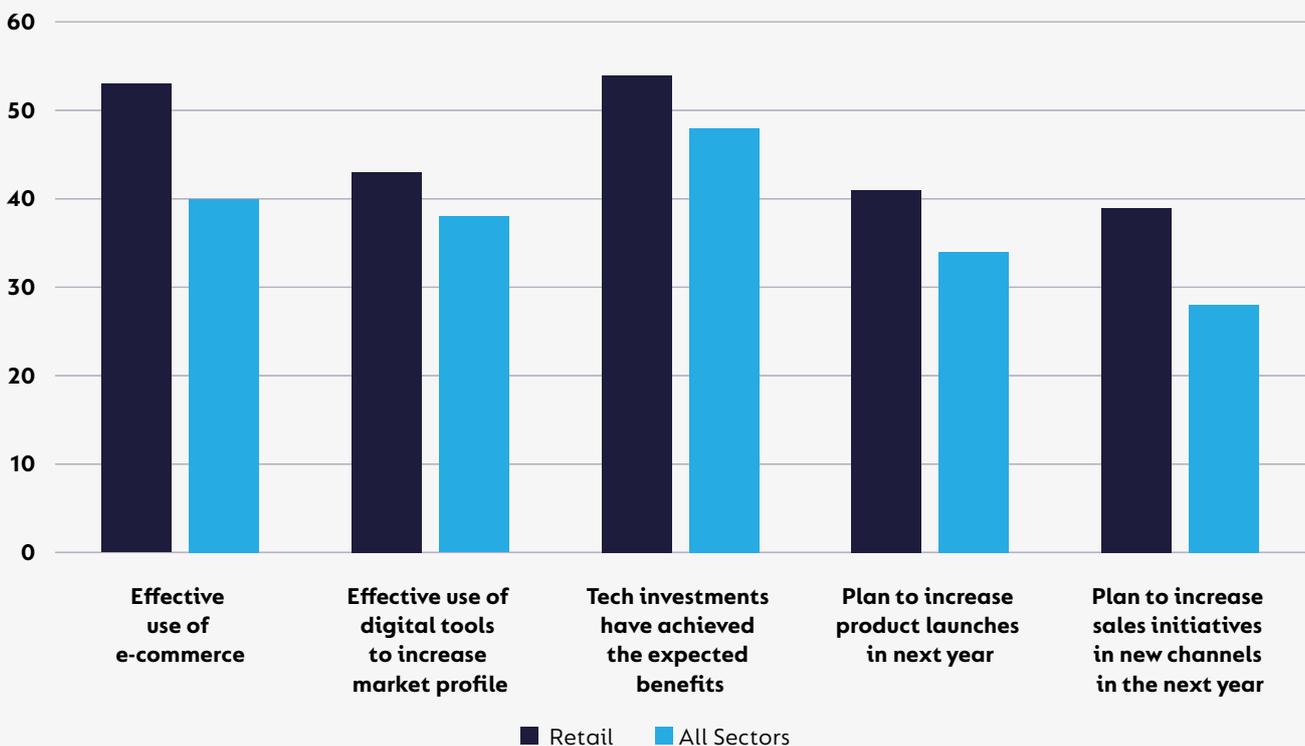
Manufacturers for example have continued to invest and enjoy the benefits of their innovation programmes during the last year. They plan to continue doing so in the year ahead as well, although they do note that access to the right skills and external sources of funding to help with this innovation continue to be problematic.

Figure 17: Compared with other sectors, retailers are better reaping the benefits of digital adoption, and have more plans to innovate in the future.



In the retail sector, there are also signs that businesses are focused on building increased resilience for the future. Several indicators, including time spent innovating and investment in e-commerce suggests retail could be primed for a better year ahead, or at least more resilient to further economic strains.

Figure 18: Retailers are realising digital benefits more often and are planning an innovation drive.

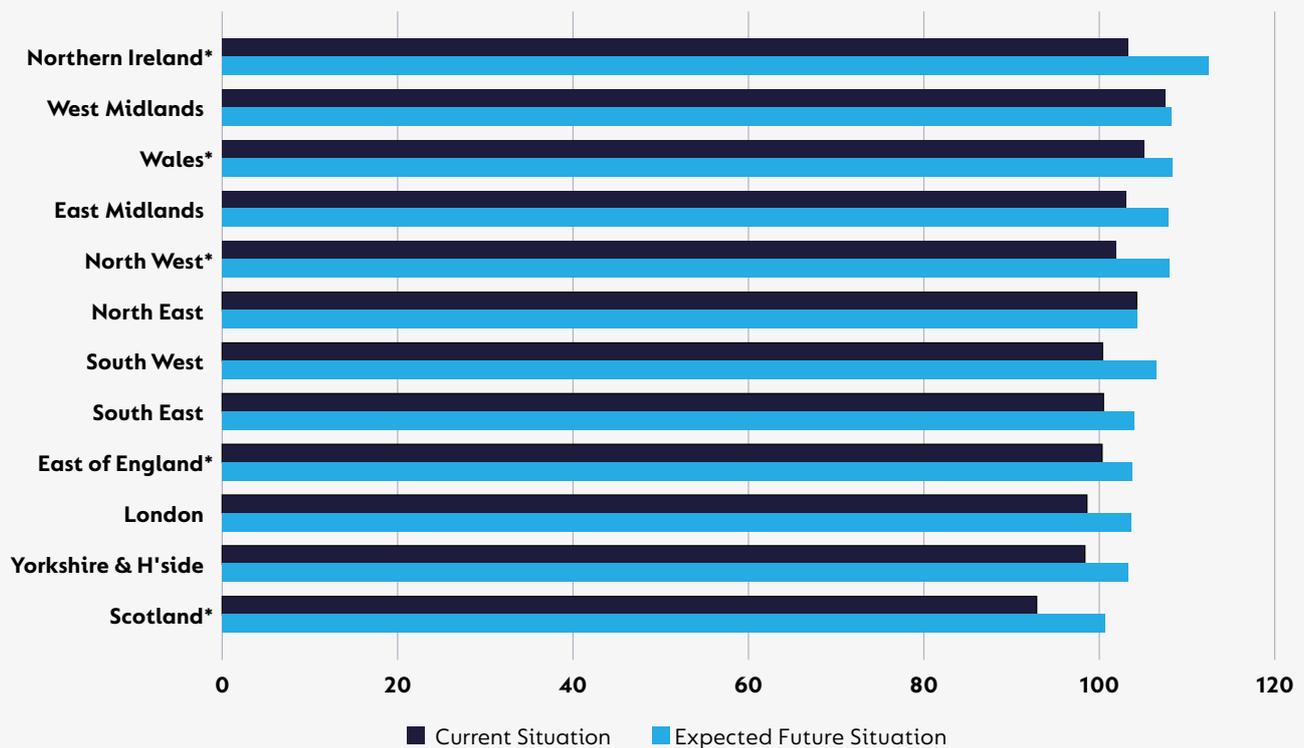


Region by Region: Productivity focus now and in the year ahead

Many people tend to assume that London and the South East are the regions most focused on productivity and performance improvement. However, our new data suggests that other regions are more focused on putting in place measures that can drive productivity both now and in the year ahead.

What is clear – and perhaps not surprising – is that businesses in every region are lining up for a more productive year ahead than they have just been through.

Figure 19: Regional variations exist both for 2020 performance and 2021 prospects (N.B. business sample sizes for some regions is below 100 respondents as denoted by an*).



Different regions will prioritise their resources to improve business performance in different ways however.

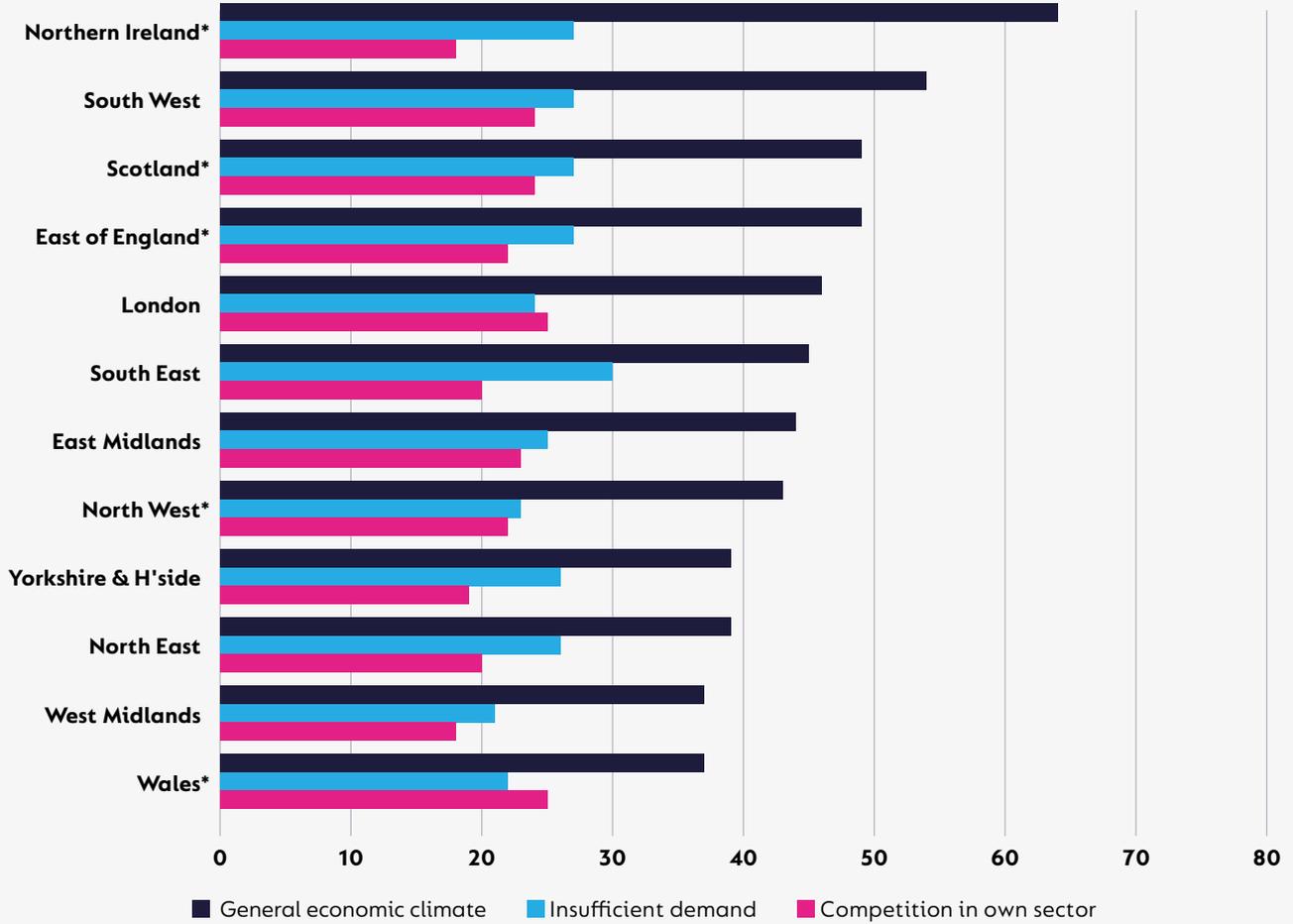
In the North East, nearly half of businesses will increase resources spent on launching new products. Entering new markets will also be a significant focus. Businesses in the East and West Midlands are thinking similarly say their owners.

Technology adoption is also a focus in the North East, and likewise across Yorkshire and parts of Wales. Installing new back office services, operational software and upgrading e-commerce capabilities are all being lined up as projects for the year ahead by companies operating in these regions.

While there is some variation in business focus, constraints on company activity are typically more consistent. In almost every region, the three chief constraints businesses highlight as impeding performance and growth are the 1) current economic climate, 2) insufficient demand, and 3) competition within their sector.

Various aspects of regulation, lack of skills and lack of available labour are by and large not seen as significant constraints at the present time.

Figure 20: Factors limiting the ability of businesses to increase sales or improve their business situation (N.B. business sample sizes for some regions is below 100 respondents as denoted by an*).



What to look for in 2021

This report raises several questions for small and medium sized business owners heading into 2021. While forecasting future intention with certainty is more difficult than assessing past performance, there are several key trends still to watch:

- Firstly, the impact of Brexit on business performance and on the ability to plan ahead and address deeper performance or productivity issues within the company.
- Secondly, whether the optimistic plans for the months ahead translate into reality in improved trading performance and investment in areas like management capability, innovation and technology adoption.
- Thirdly, whether the effects of the Covid-19 vaccination programme encourage or deter continued innovation by micro, small and medium sized businesses across the UK. Our research has consistently highlighted the strength of the innovation reaction during Covid-19, but whether this spirit continues or a 'return to normal' mindset sets in will be key to see.
- And lastly, how the balance in terms of competing priorities among business owners shifts. At the moment, of the five areas that our evidence suggests tangibly improve business performance and productivity, Management and Leadership is deemed the most important by business leaders. Interestingly, despite the well-publicised challenges of motivating and getting the best from workforces during the pandemic, HR and employee efforts ranks last.

Appendix:

A note on responses on future plans:

A large number of firms surveyed report that they plan to make improvements over the next 12 months. This is highly ambitious, and we might question whether all of these firms will follow through on these plans. Some of this may be down to a self-reporting bias but given the current challenged business environment, many micro and SMEs probably do wish to make improvements in the next year. If this does not transpire, it is worth raising the question as to why not? What prevents SMEs following through on their improvement plans.

Model & Methodology

The **Be the Business Productive Business Index (“Headline Index”)**: is comprised of four clearly defined elements:

1. Performance of business;
2. Expected performance of business;
3. Actions taken to drive sustainable growth;
4. Planned actions to drive sustainable growth.

Working with Oxford Economics, we have developed a high-level nested structure for the Headline Index **around two core themes (1) Business Tendency** (a ‘PMI’ for SME’s) and **(2) Business Capabilities**, exploring key capabilities, and actions taken, driving sustainable and productive growth.

For each theme, the Headline Index will include **backward and forward-looking components** across the same underlying topics, providing symmetry to the index structure and allowing the user to delve deeper e.g., how does the current index value compare to expectations for the future, which helps to follow and predict turning points in the business cycle.

This framework also facilitates the development of **separate indices for each theme** e.g., an **SME Business Performance Index**, which focuses on business performance only, and an **SME Business Capabilities Index**, which focuses on the actions SMEs have and are taking to drive productivity growth.

The purpose of the Headline Index is to provide an indication of the **direction of change**, as well the level of conviction in that direction of change. It is composed of responses to questions framed using a **Likert scale** i.e., multiple choice scale from one extreme to the other, with clearly defined positive and negative alternatives.

The Headline Index is formed using a **‘diffusion Index’** methodology. A diffusion index aggregates multiple indicators by examining whether they are trending upwards or downwards, allowing the combination of multiple and unrelated time series data into a common indicator, and is often used to present business survey data e.g., PMIs. It is envisaged that the diffusion index will be calculated as follows:

Index = 2 * (percentage of respondents reporting an increase) + (percentage of respondents reporting unchanged). This means the Headline Index will vary from 0-200, whereby 100=no-change, while values above 100=a rising trend and values below 100=decreasing trend.

In addition, while not incorporated within the Headline Index, our framework **includes a third theme on (3) Business Constraints**, exploring the different external factors that are inhibiting growth in SMEs). This feeds into the **SME Business Constraints Index**.

Survey Data

The data inputted to the model is derived from a large scale survey of 1500 directors and above working in companies of 2 - 249 employees conducted by Opinium between 05/11/20 - 19/11/20.