As we patiently wait for the easing of restrictions that will follow over the next few months, we can take this chance to reflect on how small and medium-sized businesses have fared over the last year. With a year of lockdown orders under their belts, coupled with a changing relationship with the EU, UK businesses have had to respond to extraordinary challenges and have demonstrated extraordinary resilience. Many of the strategic changes, innovations and technological adoptions we have seen them undertake were driven by necessity. But these choices have the potential to bring about an economic reset that will put many UK businesses in a stronger position for a post-covid world.

Our daily lives have been completely changed by the pandemic but as in other times in history where we’ve witnessed periods of terrible upheaval, innovation and change are brought to the forefront. One outcome of the traumas inflicted on businesses could be a productivity boost that lasts for years to come. Very often we need to be shocked to make changes – and for many businesses this pandemic has been the shock bringing a reset to how we work. We see this in the Productive Business Index (PBI) highlights which show more than half (51%) of SMEs are open to the four day week, of which 5% are doing it already, 17% actively considering, and 29% might consider in future.

Tracking the actions small businesses are taking to make their businesses more efficient, profitable and productive has never been more important. The PBI shows that businesses are slowly feeling more optimistic about the future, with 29% expecting an increase in revenues over the next three months compared to 21% in the first edition of the index. It is essential that we closely look at how the changes brought by the pandemic are reflected in business behaviours as we look to building a more prosperous and productive future for SMEs across the UK.
Understanding productivity as we emerge from Covid-19

Productivity hasn’t been on the agenda for many businesses over the past year. Survival has. Yet before Covid-19, British business had a productivity problem. As lockdown ends for the third time and vaccines roll out, this issue is likely to grow in prominence.

The UK does have exceptional businesses in every sector. Individual firms are among the best in the world in their industry. However, the average productivity of a typical UK business remains below that of our peers in Europe and elsewhere. This continues to be a problem that negatively impacts British business and the people it employs.

There is now a renewed urgency and impetus to make progress on this challenge in the short term. The pandemic has caused the UK to suffer the largest fall in GDP in 300 years, and the OBR forecasts a 4% long term reduction in productivity associated with leaving the EU. This comes at a time when public debt levels have spiralled due to the need to fund supports over the course of pandemic. Servicing this debt and rebuilding the economy will require rapid and widespread improvements in the productivity and performance of UK SMEs.

The first step to addressing any problem is understanding its root cause and the changes that can fix it. Since 2017, Be the Business has researched the productivity puzzle. Today, we can say with a high degree of confidence that we understand the key drivers of productivity.

In particular, five areas drive a productive, high performing business:

- **Management and Leadership**: does the business have a plan for its 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 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?

Movement in any one of these critical factors influences the productivity of a firm. This is why we created the Productive Business Index. It is designed to track not just firm performance, but also recent investments and focus, as well as plans for investment in these key areas.

The Index focuses on micro, small and medium sized businesses in the UK, which we define as employing between 2 and 249 employees. We track changes in the five key areas noted above, as well as general operating conditions, barriers to growth and expectations for the future. This is our second Index report following an initial publication in January 2021.

The data we collect is analysed and combined in a number of ways to produce our Index:

- **Business Performance** measures trading conditions and company sentiment.
- **Business Capabilities** assesses activity in the five areas that drive productivity improvements.
- In both Performance and Capabilities we assess the current situation, as well as asking about future expectations and plans for improvements.
- We then produce a business Performance Index and a business Capabilities Index.
- These are combined to produce assessments of the overall Current and Expected situation.
- And finally these combine to form our overall Productive Business Index figure.

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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
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
Q1 2021

The headline Productive Business Index has increased from 102.88 to 108.77

- The Productive Business Index has increased by around 6 points, reflecting increased optimism amongst UK SMEs.
- On our Index scale, a figure of 0 represents the worst possible score, 100 no change, and 200 the best possible score.
- The Business Performance Index has improved strongly and the Business Capabilities Index again scores highly.

Operating conditions remain tough for many, but the balance has shifted decisively

- The proportion of businesses forecasting a decline in business conditions, revenues, volumes of orders or hiring over the next three months have all declined compared to the previous edition of the Index.
- 29% now forecast an improvement in revenues over the next three months versus 21% in the first edition of the Index; and 30% forecast an increase in the volume of new orders versus only 23% last time round.
There is a small increase in the proportion of companies planning activities that drive productivity improvements

- SMEs continue to show high levels of activity focused on capability improvements.
- More companies will spend more time on management and leadership initiatives and invest more in business technology. A third will increase the number of products and services they launch in the coming year.
- Driving operating efficiencies is on the agenda for a large minority of businesses as well. This continues to be more common among SMEs with over 50 employees.

Brexit will have less of an effect on many firms, both short and long term, than Covid-19

- Many SMEs believe that Brexit will have no impact on their business with over 42% saying it has made no difference in the short term.
- 60% of SMEs surveyed believed that the Covid crisis is more of a concern than Brexit, and 56% believed the Covid crisis will be more costly to their business than Brexit.

The Four Day Week is becoming a reality for UK businesses

- One in 20 micro, small and medium size companies has already adopted a four day week for employees who normally work five days.
- And nearly a fifth (17%) are in the process of considering this change.
- 29% of business decision makers might consider it in the future.

Most industry sectors are turning the corner as the third lockdown ends

- While some sectors including hospitality reported tough trading conditions over the last three months, nearly all forecast a more positive picture over the next quarter.

Management and Leadership remains the dominant area of focus for business performance improvement

- We ask businesses to rank the five areas of productivity improvement in order of importance to their business. There were only slight movements in how the five key areas of productivity improvement are ranked in this edition of the Index.
- While the importance of management and leadership declined slightly, it remains the biggest focus, followed by operating efficiency.

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

<table>
<thead>
<tr>
<th>Capability</th>
<th>Score (1=most important to 5=least important)</th>
<th>Change between current and previous Index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current Index</td>
<td>Previous Index</td>
</tr>
<tr>
<td>Management and leadership</td>
<td>2.3</td>
<td>2.2</td>
</tr>
<tr>
<td>Operating efficiency</td>
<td>2.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Technology</td>
<td>3.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Innovation</td>
<td>3.4</td>
<td>3.3</td>
</tr>
<tr>
<td>Human Resources</td>
<td>3.4</td>
<td>3.5</td>
</tr>
</tbody>
</table>
Performance and sentiment

We asked businesses to rate their performance over the past three months across a range of business metrics.

**Figure 1:** Performance by businesses over the last 3 months on a range of metrics

- **Input costs**
- **Selling prices**
- **Financial situation**
- **Backlogs of work**
- **Number of people employed in your company**
- **Volume of new orders/new business**
- **Revenues**
- **General business situation/conditions**

Expectations for the future are improving across all metrics when compared with Q4 2020. The percentage of businesses predicting an increase in revenues has increased from 21% to 29%, those predicting an improvement in general business conditions has moved from 15% to 25%. Businesses who predict an improved financial situation over the next three months has moved from 19% to 26%.

**Figure 2:** Expectations for performance over the next 3 months

- **Input costs**
- **Selling prices**
- **Financial situation**
- **Backlogs of work**
- **Number of people employed in your company**
- **Volume of new orders/new business**
- **Revenues**
- **General business situation/conditions**
Where and what businesses are focusing on to drive productivity

Management and Leadership

In the first edition of the Index, confidence was generally high that management ability was strong inside businesses. With management and leadership continuing to be ranked the number one area that can drive performance improvement, this remains a closely watched area of the Index.

The picture in this second edition remains very similar. The majority of businesses are confident about management’s commercial awareness, professional skillset, and technology and digital skills.

One area where change is clear is longer-term planning. Just under half (47%) of firms now have a 2 – 5 year plan, compared to 43% the first time the Index was produced.

Similar proportions of firms believe their management and leadership skills have improved over the last year as in the first Index edition.

However, perhaps in preparation for the economic recovery, there has been a slight increase in the number of firms who say they will spend more time on management and leadership skills over the next year. If this trend continues, it could signal a greater focus on one of the key areas to drive productivity improvements where UK SMEs have typically lagged behind international peers.
Technology adoption

Effective adoption of business technologies like accounting software and customer relationship management (CRM) has been consistently shown to improve company productivity. The Government’s recently announced Help to Grow scheme has been designed, in part, to encourage this kind of productivity improving tech adoption.

We know from previous research that there has been widespread adoption of tech by micro, small and medium businesses as they responded to the pandemic.

The impact of this adoption is visible in the second edition of the Index, with small increases in the proportion of firms who believe technology is proving beneficial for them. There are notable increases in the proportion who are transacting with suppliers electronically, using digital tools to market themselves, and using data to improve decision making.
Looking to the 12 months ahead, the majority of businesses will maintain investment levels on technology adoption and improvement as they do now. However, a very sizeable minority—and one slightly higher than the first Index—plan to increase time and investment.

**Figure 6:** Planned level of activity and/or investment in technology over the next 12 months

<table>
<thead>
<tr>
<th>Service</th>
<th>Increase - Current Index</th>
<th>Increase - Previous Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Back Office services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational or Commercial software</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New IT equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Training to improve digital skills of Management</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Training to improve digital skills of Employees</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Innovation**

Businesses innovating has been one of the key trends during the pandemic. Last year our research suggested three years’ worth of innovation had taken place in just three months during the first wave of Covid-19.5

Innovation is often considered only to be the territory of frontier firms or hi-tech businesses, yet our research suggested this is not the case.

The second edition of the Index also confirms this, with the majority of micro, small and medium sized businesses confirming they have maintained or increased their level of innovation over the last year.

**Figure 7:** Levels of activity in innovation categories over past 12 months

- Initiatives to improve internal innovation: 26% stayed the same, 11% increased, 63% decreased
- Entered a new market: 26% stayed the same, 10% increased, 64% decreased
- Launched new services: 33% stayed the same, 10% increased, 57% decreased
- Launched new product or product variants: 29% stayed the same, 9% increased, 62% decreased
- Developed new ideas to put forward for assessment or prototyping: 31% stayed the same, 7% increased, 62% decreased

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Confidence amongst SMEs in their ability to effectively innovate also remains high, and indeed seems to be increasing. Nearly half (45%) of firms believe they are effective at setting out plans and budgets for company innovation. Only 15% believe they are not. And the majority of companies (56%) believe they are effective at implementing new ideas quickly versus only 12% who don’t.

Looking ahead, the vast majority of micro, small and medium sized companies intend to continue with the same level or increase the time and resource spent on innovation. This mirrors the picture seen in the previous edition of the Index.

Figure 8: Increases in activity in innovation categories in the past 12 months and planned for the next 12 months

Operating efficiency

Efficiency continues to draw heavy focus among business owners and managers, with little change in our Index results since the first edition.

A sizeable minority of businesses (typically between a quarter and a third) have increased their time and resources spent on a range of efficiency measures, including performance and productivity measurement, investments in new plant, machinery and software, and greater use of data.

Very few businesses report decreasing time or resources on these areas over the last year. And the proportion planning to increase efforts in this area for the year ahead paints a similar picture to the past 12 months.
One notable trend that does continue is for businesses with a larger number of employees to focus more on measures to address efficiency and productivity. Companies with more than 50 employees are significantly more likely to have done this – and to plan to do it in the future – than smaller firms.

Training, Development and HR

Businesses continue to invest in their people, regardless of the pandemic’s disruption. One year into Covid, the vast majority of companies have maintained or increased the effectiveness of their training programmes, level of investment in HR processes, and reviews of employee performance. This behaviour will continue through 2021 according to owners and managers surveyed.
Figure 11: Effectiveness of HR and employee focused measures over the last 12 months

There is also a small change noticeable in the level of employee-focused activities planned for the year ahead compared to the first edition of the Index.

While subtle, it does suggest more employers are considering more measures to improve welfare and drive employee wellbeing and productivity as the UK exits lockdown.

Figure 12: Focus of businesses on employee welfare-related areas in past and next 12 months

The Four Day Working Week: is it about to become a reality?

Spain recently announced the trial of a four-day working week for companies in the country. Other countries including Germany and New Zealand have also examined or experimented on a small scale with the idea.

This latest edition of the Productive Business Index confirms that there is significant appetite amongst UK SMEs to follow suit.

While the proportion of companies who have already implemented this idea is small (just 5%), nearly one in five (17%) say the idea is under consideration and 29% say they would consider in the future.
Within the business community, there are significant variations in how this idea is perceived. Companies run by younger owners or managers are more keen on the idea, as are companies with 50 or more employees.

London features the most firms to have already committed to the idea (9%), but businesses in the East of England are far more likely to be considering it. Our data also suggests that companies who have seen growth in the bottom line over the last three years are more likely to consider this move than companies who have shrunk.

Brexit’s impact on SME sentiment

We asked businesses whether the Brexit deal made them feel more positive or negative about the short or long term future.

For over 40% of businesses, the Brexit deal has made no difference to their future expectations in the short term. Broadly speaking as many are positive about the future as are negative, with a net positive score of 27% and net negative of 28%.

Over the longer term, the trend shifts to a more positive picture with a move to net positive of 35% and net negative of 26%. Nearly a quarter (23%) of businesses feel more positive about the longer term and 12% feel a lot more positive.
We also asked businesses to estimate the impact of Brexit on the value of their trade with countries within the EU and outside the EU. Again, as we might expect, for many SMEs (over 50%) it will mean no change.

In fact, more businesses believe they will increase their levels of trade post-Brexit. This holds for expectations of trade to countries both within and outside the EU.
When it comes to costs, 37% of businesses believe that Brexit has increased costs, while 28% believed that Brexit will present opportunities to win new business.

**Figure 17: Brexit Costs versus Opportunities**

Finally, we asked businesses whether Brexit or the Covid crisis is more of a concern and which event they expect to be more costly. The vast majority of those surveyed identified the pandemic as a greater concern and believed it would prove more costly to their business.

**Figure 18: Which is a bigger concern for SMEs: Brexit or Covid**
Constraints to increasing sales or improving business situation

As optimism about current and future trading conditions improve, there has been a notable shift to growth. Some factors, such as general economic conditions and lack of demand, have reduced as concerns though these are still two of the dominant issues facing companies.

Other barriers are beginning to rise as challenges. In particular, concerns about the regulatory environment are on the rise, as are concerns about business cashflow and other areas of finance.

Figure 19: Barriers to Growth

The picture across industries: Retail, Construction and Financial Services start to bounce back

Certain industries have had well-documented struggles over the last year. While some sectors continue to experience headwinds, several sectors are more upbeat about their prospects.

Trading conditions, revenues and volumes of orders were either flat or increased for significant proportions of companies in the manufacturing, construction, retail and financial services sectors over the last three months.

The biggest step changes are in hospitality-focused sectors. Trading continued to be tough during the last quarter, but optimism is increasingly shifting higher for the quarter ahead.
The headline numbers for the Productive Business Index confirm this more positive picture. Only five of the 18 industries the Index tracks have seen a decline in the headline figure since the first edition. It is worth noting however, that industries which have seen a significant positive change including property, arts and recreation, and accommodation and food remain below the overall Index figure for UK businesses.
Region by Region: What are the main barriers to growth

What we can see, which mirrors the growing optimism for the quarter ahead noted earlier in this report, is the significant reduction in two key barriers to growth right across the country. The proportion of companies noting that lack of demand and the general economic climate are barriers to growth has dropped dramatically in some regions.

Businesses in the South West, East Midlands, South East, Scotland and London all share this view, though regions such as the North East do remain more cautious.
Notably however, concerns about financing growth are on the rise in many regions. This includes businesses in the North East, Yorkshire, the East Midlands and the East of England among others.

**Figure 24:** Financial factors limiting the ability of businesses to increase sales or improve their business position – current vs previous index

![Financial factors limiting business growth](chart)

What to look for in 2021

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

- Firstly, whether the belief about the impact of Brexit on business performance continues to hold true. As things stand it presents less of a hindrance than Covid-19. However, if the pandemic recedes, we may see more companies looking for help and advice on the opportunities and challenges of Brexit.
- Secondly, whether the increased optimism about the months ahead translates into real improvements in trading conditions and revenues.
- Thirdly, and perhaps most crucially, whether we see a greater appetite for investment in management and leadership skills, technology adoption and innovation. While there was a surge in trading optimism in this edition of the Index, we are yet to see a similar surge in the desire to improve business performance to take advantage of this.
- Lastly, whether the early signs of appetite for a four day week turn into concrete action by UK SMEs. The experiments elsewhere in the world are likely to be closely watched for signs of their impact on both revenue and productive performance.
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 an attractive 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 will be 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:

$$\text{Index} = 2 \times (\text{percentage of respondents reporting an increase}) + (\text{percentage of respondents reporting unchanged})$$

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 1000 directors and above working in companies of 2 - 249 employees conducted by Opinium between 18/02/21 - 25/02/21.