

Small Business. Big Opportunity.

The challenges and prospects for UK SMEs



TABLE OF CONTENTS

FOREWORD BY ED THORNE, DUN & BRADSTREET	3
FOREWORD BY PROF. ROBERT BLACKBURN, SMALL BUSINESS RESEARCH CENTRE.....	4
CHAPTER 1 – A NATION OF CONFIDENT CHALLENGERS	5
CHAPTER 2 – THE DESTRUCTIVE FORCE OF LATE PAYMENTS	7
CHAPTER 3 – BREXIT AND EVERYTHING AFTER.....	9
CHAPTER 4 – THE PATH TO NEW BUSINESS.....	11
CONCLUSION	13

Foreword

Small to medium enterprises (SMEs) are the lifeblood of the British economy

Ed Thorne, Managing Director

Dun & Bradstreet UK

In 2016, 99.3% of all private firms in this country were SMEs, according to the Federation of Small Businesses. And they earned more than £1.8 trillion in revenue, accounting for 47% of private sector turnover in the UK.

Dun & Bradstreet closely monitors the SME market, and our data has shown unprecedented increases in the number of new business being formed.

The small business owners we've spoken to tell us they're confident about what's ahead but recognise there are also challenges to overcome, going into 2018 and beyond.

These challenges include the uncertainty caused by the political and socioeconomic changes sweeping the country and the new General Data Protection Regulation (GDPR), all of which are forcing SMEs to look at the way they use data across their organisations.

Late payments are also a major headache for SMEs – so much so that many feel their business is at serious risk of folding altogether as a result.

But despite the challenges, the SME owners we surveyed felt confident they will be able to grow.

The majority of respondents still think Britain is a great place to start a small business, and most believe they'll enjoy success in the coming years. This is positive news for them, and for the overall health of the UK business environment.

There's no doubt that there will be bumps along the road with further challenges looming, but we believe smaller businesses who take a pragmatic and measured approach have a good chance of thriving in future.

The results of this report reassured us about the resilience of UK small and medium businesses. The key themes echo what our data has been indicating and I hope you find this an interesting and useful read.

In 2016, 99.3% of all private firms in the UK were SMEs, according to the Federation of Small Businesses.



Foreword

The Small Business Research Centre,
Kingston University

Professor Robert Blackburn

Small Business Research Centre,
Kingston Business School, Kingston University

There's no doubting the importance of SMEs to the UK's economy. Of the 5.5 million businesses in the UK, 99% of them employ less than 250 people, according to the Office for National Statistics.

SMEs are substantial employers. Overall, they employ 15.7 million people, the equivalent of 60% of everyone employed in private sector employment.

They also produce almost half of all UK output, acting as suppliers to other organisations as well as selling goods and services to consumers.

SMEs encompass a wide range of businesses and services, vary in size and are set-up to serve many different purposes. But the one common factor is that their owners are tenacious, determined and often quick to adapt to changing or difficult times.

They often have close relationships with their customers and are able to adapt to their changing needs and shifts in market forces or technological changes, much sooner than larger organisations.

However, their very size can make them particularly vulnerable to certain adverse factors, including economic uncertainty, late payment and changing trade regulations, to name a few.

In a challenging business environment, it's in everyone's interests for SMEs to succeed. In this context, government has a key role to play: making regulation smarter, penalising serial late payers and, where possible, choosing SMEs when making procurement decisions.

Larger organisations can also help, by adopting the best payment practices and supporting the smaller businesses who supply them.

But as always in challenging times, SMEs must also look to help themselves, by being agile and arming themselves with the knowledge and tools to meet difficulties and grasp opportunities head on.

It is in this context that this new report provides some insights into the challenges and opportunities that SMEs are currently facing. I do hope you will find the report both stimulating and useful.

SMEs produce almost half of all UK output, acting as suppliers to other organisations as well as selling goods and services to consumers.

A nation of confident challengers

One point came out loud and clear from our research: SMEs are not the underdogs of the business world – they’re on the up. However, the path ahead is not without its challenges.

More than half (54%) are increasingly confident about their future success, while 70% have a clear business strategy in place. As a result, 75% believe they can achieve financial growth in the next five years.

In fact, they’re significantly more confident than their larger corporate competitors. Forty percent of SMEs consider themselves at an advantage vs. just 6% that feel behind large firms.



By contrast, figures from the ICAEW Business Confidence Monitor show that overall business confidence has been negative for five of the last six quarters, as of Q4 2017.



Could the start-up boom be helping to drive this sense of optimism? After all, the UK broke its record for the number of new businesses created in 2016– 657,790 in total.

And with 72% of those we surveyed agreeing the UK is a great place to start a small business, we’ll likely see this figure keep rising.

NOT WITHOUT HURDLES

SMEs are in a strong position, but it’s not all smooth sailing.

Only one-third of SMEs believe there is sufficient support for small businesses in the UK.

And there are other challenges too:

1. Keeping ahead of the competition (40%)
2. Finding new customers to target for growth (33%)
3. Uncertainty around the impact of Brexit (32%)
4. Keeping business stable in an uncertain economy (32%)

There are some nuances to the above concerns, however. When you dig into specific sectors, the importance of particular challenges changes.

Weathering the current economic fluctuations and keeping the business stable is a significant concern for those in the professional services and manufacturing sectors, being cited by 37% in each case.

Only 22% of SMEs are ‘very’ confident they fully understand all the regulations that apply to their business

For those in the education sector, complying with recent legislation such as the General Data Protection Regulation (GDPR) is the second-biggest challenge, with 29% citing it as a concern.

Our findings also hint at a lack of understanding around the changing regulatory landscape and the impact on SMEs across the sectors.

Only 22% said they are ‘very’ confident they fully understand all the regulations that currently apply to their business, while 51% could only say they’re ‘quite’ confident.

And only 58% have a full understanding of the regulations they’re supposed to comply with.

TOOL THAT COMPANIES WOULD FIND MOST USEFUL, BY SECTOR:

Professional services

30%

More detailed information on those I do business with

Retail

36%

More detailed information on those I do business with

Health

29%

More detailed information on those I do business with

Manufacturing

29%

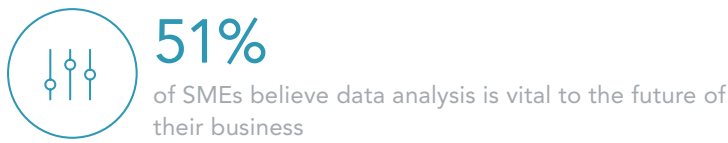
Automated checks on new suppliers or partners

Education

31%

I don’t find any tools or information beneficial to support the financial success of my business

This lack of confidence continues as we move into the supply chain, with half of SMEs saying they have ‘some’ knowledge of their supply relationships rather than detailed information.

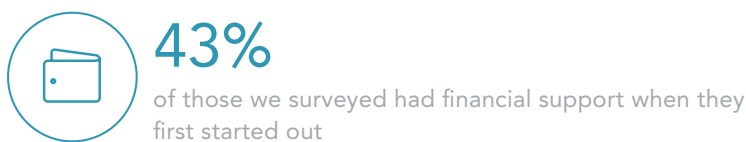


The problem here could simply be down to a lack of resources, with 39% of those we surveyed saying they just don’t have time to collect the necessary information.

But even if they had the resources, for many this isn’t a priority. Thirty-two percent don’t consider supply chain information critical to their business, while 25% said it’s too difficult to obtain.

SEEKING SUPPORT

Anyone who has started their own business will know how important financial and even non-financial support can be. Often it can be the difference between success or failure.



But what does that support look like for UK SMEs? Just under half (43%) of those we surveyed had financial support when they first started out.

And it came from the following areas:

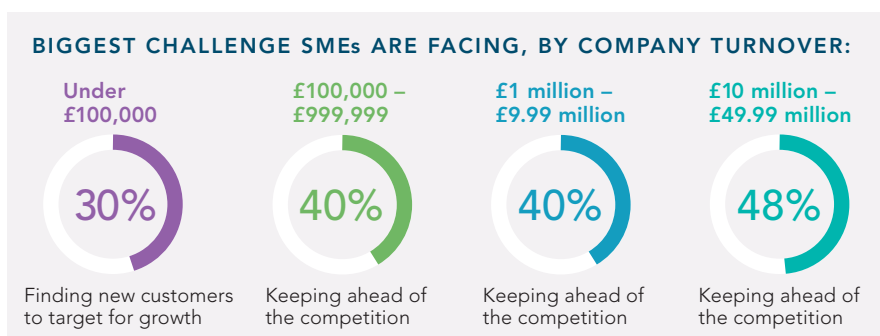
1. Business loan from a bank (58%)
2. Personal loan from friends or family (26%)
3. Private investor (25%)
4. Government scheme (24%)

Non-financial support can be just as critical in the early stages of a start-up, so it’s concerning to see only a third of those we surveyed received advice and support.

For those that did, it came from the following areas:

1. Local government (27%)
2. Banks and insurance companies (27%)
3. Membership associations (19%)

As for the tools that would financially benefit them the most, 30% pointed towards automated checks on new suppliers and partners, while 29% cited more detailed information on those they do business with. Fifty-one percent of respondents believe data analysis is vital to the future of their business.



Ed Thorne, Managing Director Dun & Bradstreet UK:

What can SMEs do to overcome some of the challenges highlighted above?

“Although there are still many unanswered questions surrounding Brexit and future trade arrangements, it was interesting to see that this wasn’t the top concern for SMEs in our survey. Ensuring they maintain a competitive edge and identify new prospects for growth was more of a priority and suggests that businesses are getting on with ‘the day job’ despite the uncertainty.

“Across the board, we’re seeing small and medium-sized businesses taking on a challenger mentality, which is impressive and exciting. Making smart use of technology, and particularly data, will be important in enabling them to realise their ambitions. SMEs can effectively use data to support these key activities: finding out more about competitors and identifying the right prospects to go after.”

Professor Robert Blackburn, Kingston University:

How are SMEs approaching the current business environment?

“SMEs are great survivors and their owners are typically optimistic, even during macro-economic conditions of uncertainty. As smaller organisations, SMEs tend to be more agile and able to thrive on disruption, finding the niches that appear when conventions break down.

“Growth amongst SMEs is beneficial for all: those running SMEs, their employees and the economy more broadly. At present, the UK is an easy place to start a business; we must ensure that SMEs are supported throughout their lifespan. It’s important that they receive the appropriate financial support, have access to trade and market advice and operate in an environment that helps them realise their ambitions. It’s also important that regulation acts as an enabler, rather than creating unnecessary burdens.”

The destructive force of late payments

The idea of late payments causing problems for SMEs is nothing new, but our research has uncovered exactly how this problem impacts small firms and some of the reasons why.

More than a quarter (26%) of SMEs said timely payments are the most critical factor for their financial success.

SMEs are owed an average of £64,000 in late payments. 11% of SMEs are owed between £100,000 and £250,000.

And while 52% of payments are made at the point of supply, 45% occur on credit.

All of this means holes in the balance sheet that can add up to thousands of pounds. At any one time SMEs are owed an average of £64,000 in late payments, with 11% owed between £100,000 and £250,000.

51% say late payments are more of a problem than they were three years ago

When you split it by sector, manufacturing firms suffer most with an average of £83,000 owed in late payments, while retail follows closely with an average of £76,000.

58% say late payments are putting their business at risk of failure

And the problem is growing – 51% of SMEs say late payments are more of a problem than they were three years ago, with 58% going as far as to say this issue is putting their business at risk of failure.

Clearly something has to give. But who are the worst offenders when it comes to paying SMEs late?

In terms of company size it's a pretty even split between large and small firms (27% and 26% respectively) and government organisations (27%).

When you break it down by industry, however, things begin to look a bit less even. 30% of health SMEs and 33% of education SMEs are badly impacted by late payments from the public sector, while the manufacturing sector is disproportionately impacted by late payments from large firms (at 35%).

51% of SME owners are using personal savings to cover the shortfall from late payments

But what do these late payments actually mean for the companies involved?

According to the SMEs we spoke to, the consequences are potentially very damaging.

The top three problems highlighted were:

1. Cash flow difficulties (35%)
2. Delayed payments to suppliers (29%)
3. Reduced profit performance (24%)

It's clear from the above list that late payments are having a huge financial impact on small businesses, not to mention causing a negative ripple effect as those firms are then unable to make their own payments on time.

To make matters worse, 15% of SME owners told us they're using personal savings to cover the shortfall.

AMOUNT SMEs ARE OWED IN LATE PAYMENTS, BY SECTOR:





36% of SMEs don't credit check any customers

So is there anything SMEs could do to make this problem go away?

Promisingly, the answer might be yes. We discovered that 31% of SMEs only credit check the customers they deem to be high risk, while a worrying 36% don't credit check any customers.

If small businesses could do more to investigate potential financial issues at the start of their customer relationships, they could significantly reduce the number of late payments they receive.

Professor Robert Blackburn, Kingston University:

Are late payments a bigger issue today than in previous years?

"Late payment of debts is a perennial challenge for SMEs. This seems to worsen during difficult economic times thus adding pressure on the cashflow of SMEs. Although many SMEs are able to tighten their belts during an economic slowdown, late payment adds further pressure on the survival of SMEs.

"Although SMEs have the statutory right to claim interest on late payments, the majority will not do so for fear of damaging relations with customers – or even being blacklisted in the future. It's up to everyone to address this situation. The public sector could be a key part of the solution; by incorporating rules on timely payments into their procurement models, public sector bodies can help to change the behaviour of big businesses and reduce the prevalence of late payments."

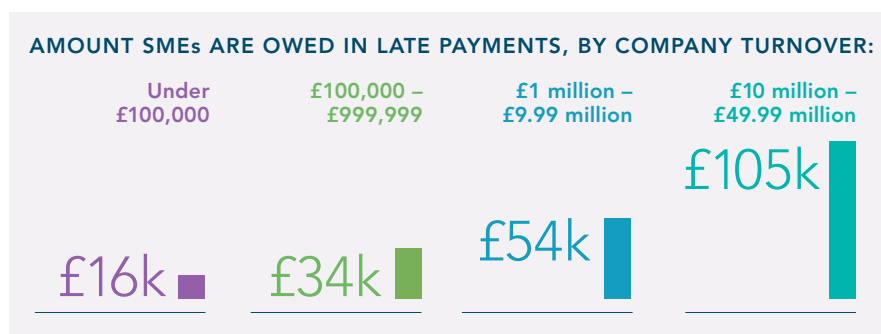
Tim Vine, Head of European Trade Credit, Dun & Bradstreet:

What can SMEs do to reduce the risk of being paid late?

"There are steps that SMEs can take to reduce the risk of late payments. First, independently assess the financial and payment risk of customers prior to agreeing credit terms. Most SMEs don't have the luxury of turning away business, but it is valuable to understand customers' likely payment behaviour based on past performance. At the very least, this can help to forecast cashflow from perennial slow payers. At the other end of the spectrum, it can be the difference between taking a bad debt hit or not.

"Second, seek alternative sources of finance. Historically, factoring and asset-based lending has been the domain of the medium-large organisation. But the doors are opening wider to smaller businesses; single-invoice financing (where finance can be secured on one invoice with one key customer) can provide a much-needed back-up option when cashflow is being squeezed. Sure, the lender will take their cut, but rates are relatively low so this is a good option to investigate.

"Finally, track the ongoing health of your customer base. Although two thirds of SMEs assess the credit risk of their customers, the vast majority are only checking new customers and not once a relationship is in place. However, the real financial risk is presented when goods and services are actually provided on credit terms. Tracking the ongoing financial performance of existing customers, and taking action when behaviour meaningfully changes, can be the difference between being paid first and paid last."



Brexit and everything after

Like any other type of organisation, SMEs are impacted not only by what's happening in their business and their market but also wider socioeconomic issues.

And there are few such issues bigger than the UK's impending exit from the European Union.



Brexit has had a more negative impact on SMEs than any other external issue. Almost one in three (32%) said it has negatively affected their confidence in their business' success.

This is closely followed by the fluctuation of the pound (30%) – which itself has been hugely influenced by Brexit – and the result of the UK general election (28%).

Those in retail and manufacturing felt most strongly about Brexit, as did the majority of London-based firms. And of all the SME owners we spoke to across every region and industry, not one of them told us Brexit has made them more confident their business will succeed.

The external factors that have positively impacted them, however, include technological developments (47%), business rates reform (25%) and changing data protection regulations (22%).

When we asked SMEs specifically about the challenges they're facing we discovered a similar pattern – dealing with Brexit and weathering economic fluctuations scored equally high at 32%.



Split by sector, those in manufacturing see Brexit as a bigger challenge than any other industry, while 34% of retailers and 35% of manufacturers say evaluating the impact of Brexit is a priority for the next 12 months.

But while we can clearly see SMEs are generally concerned about Brexit, we also wanted to know why it's such an issue for them and where specifically it's impacting their day-to-day operations.

Trade relations are one major factor – 29% said trading opportunities with other markets provide a real opportunity to grow their business.

This latter figure rises to 48% for manufacturers, which might partly explain why these SMEs are particularly worried about Brexit.



And it's important to note that these worries have in many cases turned into tangible action.

More than a third (35%) of SMEs have cancelled or postponed expansion plans as a direct result of the Brexit vote, while 34% have rewritten their business plan in a bid to overcome the ongoing economic and political uncertainty.

A third say their business won't survive if Brexit negotiations go badly

EXTERNAL ISSUE WITH BIGGEST NEGATIVE IMPACT ON SMEs' BUSINESS CONFIDENCE, BY SECTOR:

Professional services

29%

Brexit

Retail

43%

Brexit

Health

32%

Result of the UK General Election

Manufacturing

48%

Fluctuating value of the pound

Education

34%

Result of the UK General Election

Perhaps the most alarming finding of all, however, is that a third of SMEs believe their business simply won't survive if the Brexit negotiations go badly.

It isn't all doom and gloom, however. Fifty-nine percent of the SMEs we spoke to told us they have complete confidence in their success despite the current economic climate.

So while external factors are significant, SMEs still believe that they have enough control over their own destinies to ensure that they succeed.

Markus Kuger, Senior Economist, Dun & Bradstreet:

How can SMEs ensure they have the best possible chance of success in these uncertain times?

"The importance of SMEs for the British economy should not be underestimated. Although the main focus of the current Brexit debate is on large multinational companies there is no doubt that SMEs will also be significantly impacted. For more than 40 years, EU law provided the legal basis for doing business in the UK, while freedom of movement – especially since 2004 – has given UK companies easy access to workers from abroad. At the same time, access to the single market has also made it much easier for the UK's SMEs to source from and sell to fellow EU member states.

"The outlook remains very uncertain. Our baseline scenario at Dun & Bradstreet predicts the successful negotiation of a free-trade agreement between London and Brussels over the medium term. This will mitigate risks somewhat and help to stimulate real GDP growth. However, the more immediate outlook for the next two years is less optimistic. Investment activity will be suppressed because of the elevated levels of uncertainty, while household consumption will be undermined by relatively high inflation rates and rising interest rates.

"To compensate for the elevated levels of uncertainty, we recommended that SMEs delay long-term decision-making for as long as possible. Operating conditions could change dramatically – especially for importers and exporters – once Brexit is completed, though so far progress in negotiations has been limited. We also suggest that companies should factor in two additional interest rate rises in the UK over the next two years – these rises, however, will not be enough to provide upward pressure for the British pound. Until talks with the EU deliver noteworthy results, SMEs that source from or sell to the euro zone can count on the weakness of the pound to last."

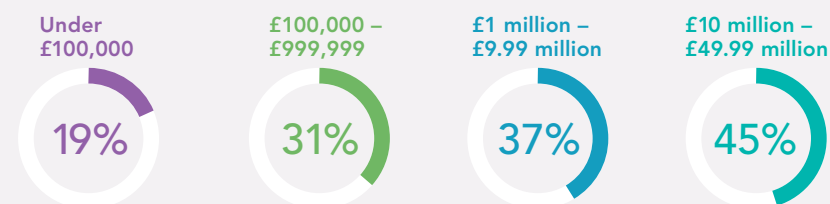
Professor Robert Blackburn, Kingston University:

Are SMEs particularly vulnerable to external factors?

"SMEs have fewer internal economic resources to absorb external shocks to their system, or switch between more lucrative product and service lines. They are also much more sensitive to external shocks and have to act quickly to meet the changing needs of the marketplace.

"Brexit is a major challenge for many SMEs as it brings with it uncertainties that are new and difficult to assess. If SMEs are to turn Brexit to their advantage, there needs to be clarity over what it will mean for them. Understanding the changing marketplace is critical for their survival. This assuaging of uncertainty may allow entrepreneurs to flourish in a new regulatory and market environment."

PROPORTION OF SMEs THAT HAVE CANCELLED OR POSTPONED PLANS TO EXPAND POST-BREXIT, BY COMPANY TURNOVER:



The path to new business

It might seem like stating the obvious to say SMEs are better off when they have more customers. And it likely comes as little surprise that SMEs see generating demand for their products and services as more important than anything else, with 44% citing this as the thing that will most impact financial success.

But this report is about digging into the detail. We wanted to explore why finding new business is more of a challenge for some SMEs than others, and what they could do to learn more about the people they want as customers.

A third say finding new customers to target growth is a key challenge

A third of those we surveyed said finding new customers to target growth is a key challenge for them, and identifying new potential customers to target was named as a key opportunity for growth by the majority (45%) of respondents, rising to 54% in professional services and 50% in manufacturing.

As for where they seek and how they identify new business relationships, it seems that our respondents felt it really is ‘who you know’ that can make a difference.



Almost half (44%) of the SMEs we spoke to said they use their network of personal relationships to find new opportunities.

Other sources of new business include:

1. Recommendations by existing customers (41%)
2. Social media (33%)
3. Online searches (28%)



External data is also a major source of new customer opportunities for SMEs, but this significantly changes in line with their revenue.

Just 3% of those turning over £10,000 or less buy data to identify new prospects. But for those with revenue from £10 million to £49.99 million, this rises to 24%.

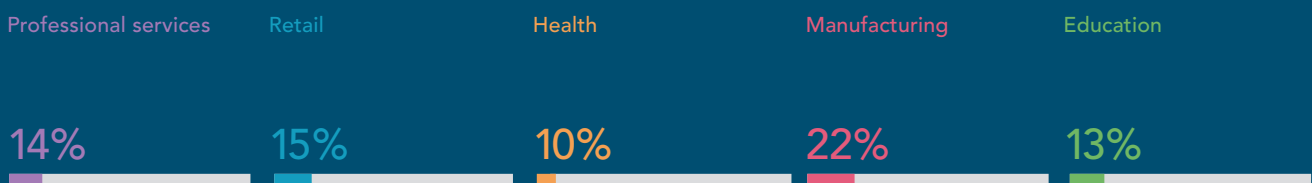
Breaking it down by sector, manufacturers are most likely to buy external data to identify new customers, while retailers are most likely to use social media.



Is there anything more SMEs could do to improve their chances of pinpointing valuable prospects?

According to 22% of those we surveyed, the answer could lie in having a qualified list of sales targets.

SMEs BUYING EXTERNAL DATA ON PROSPECTS, BY SECTOR:



**Adam Leslie, European Sales & Marketing Solutions Leader,
Dun & Bradstreet:**

How can SMEs find and target new customers more effectively?

“Most SMEs rely on personal contacts and recommendations as the optimum route to new business opportunities. But this is only the tip of the pyramid and isn’t normally enough to grow a small business. Additional routes of similar efficiency – which is paramount for an SME – need to be sought.

“As part of this, smaller companies need to utilise real time ‘trigger alerts’ or what you could call hand raisers. Data providers can scour millions of websites, social media channels and blog posts every day to alert an SME of an event a company has undertaken that triggers a need for the SME’s services; for example, if a company is opening a new subsidiary in Poland then this may trigger a need for haulage services or foreign payment solutions. With these ‘triggers’ the SME can take timely action before its competitors.

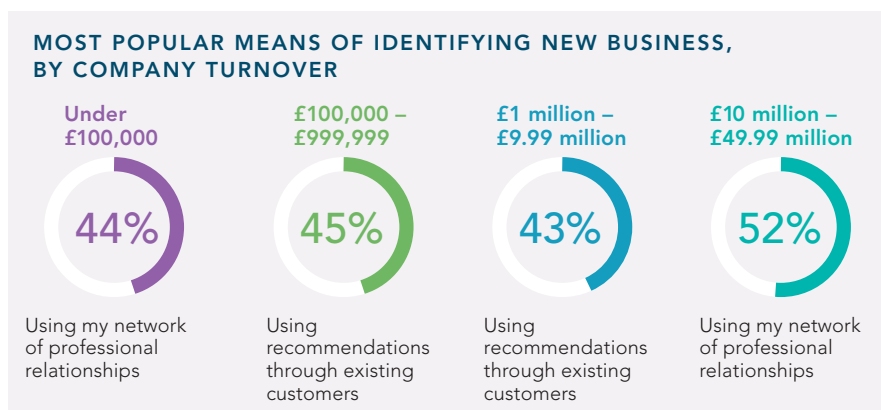
“Looking further down the pyramid, SMEs could then refer to the family tree of their existing customers; there’s every chance an SME is already doing business with much larger companies, so they can then look to cross-sell to other relevant companies within the same larger organisation. Going in ‘cold’ with a prospect is a play that’s never as fruitful as internal references from customers sharing the same ultimate parent: this will always work in SMEs’ favour.”

Professor Robert Blackburn, Kingston University:

What is the biggest challenge SMEs face when identifying new customers?

“SMEs face risks and challenges every day. Among the greatest challenge is retaining and finding new customers. Market information is crucial for them to develop goods and services but this information is not always easily obtained. In reality, SMEs seeking to extend their market footprint and go beyond their conventional customer base have to rely on imperfect information and thus incur higher levels of risk.

“Understanding the marketplace, its tastes and needs is the greatest challenge for many SMEs looking to expand. This can involve utilising their existing network contacts as well as developing new ones, to ascertain relevant data. This information can then help SMEs to fine-tune their goods and services to meet the specific requirements of diverse markets.”



Conclusion

Our report shows that while there are more opportunities than ever for small firms to thrive, and they are largely confident they can do so, there are also a number of challenges for SMEs to overcome before they can reach their full potential.

With the start-up economy booming, competition is increasingly fierce, and it can be difficult to find new customers and win them over.

Financial and economic uncertainty is also causing a headache for the SME owners we spoke to – largely caused by Brexit and the as-yet-unknown impact it might have on UK business, and their suppliers, employees, customers and markets.

And when you add in the continuing issue of late payments that's putting many SMEs at risk of collapse, it's fair to say being a small business owner today is not for the faint-hearted.

But despite these challenges, we've uncovered a strong sense of optimism amongst SME owners.

SMEs believe they can weather the storms ahead and succeed. And they're even more confident than their much larger and more established competitors.

Of course, SMEs are going to need help to get there. And by investing in tools and data that could help them learn more about the people they want to sell to, they could significantly improve their chances.

METHODOLOGY

Research for this study was undertaken by Censuswide, an independent research company based in London. Responses were gathered from 500 managers/business owners in UK companies with 2-250 employees in manufacturing, retail, professional services, health and education.

The online survey was conducted in September and October 2017.



GROWING RELATIONSHIPS THROUGH DATA

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ABOUT DUN & BRADSTREET

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