

Sage small business tracker - Q3 2023

A Sage report in partnership with
Smart Data Foundry and Cebr

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Sage

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Headline Q3 findings

The Sage small business tracker revealed that small businesses remained resilient in the face of challenging economic headwinds in Q3 2023. Despite revenues falling on an annual basis, profits continued to grow strongly, supported by falling overheads for small businesses. The decline in revenue comes amidst a broader slowdown in the UK economy, with small businesses contending with weaker economic demand.

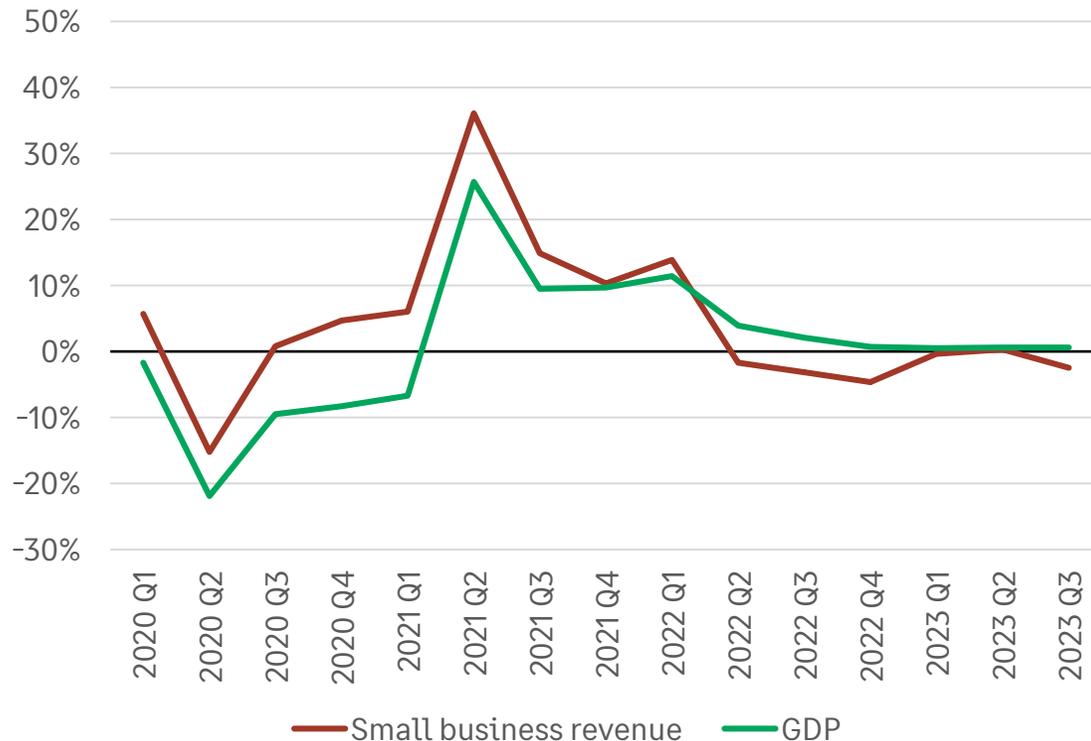
However, while profits remained robust this quarter, the forward outlook for the wider economy remains weak. This viewpoint has been reflected in business investment decisions, with capital expenditure by small businesses falling notably on an annual basis. Consequently, we expect the trend of weak revenue performance to continue in the coming quarters. Although, the consequent impact this has on profits will depend on how much further average real overheads fall.

Some of the key findings of this report by topic are:

- i. Small business revenues were down by 2.5% on an annual basis in Q3** – average real revenues for small businesses contracted by 2.5% on a year-on-year basis in Q3 2023. Real revenue growth has been relatively weak since mid-2022 onwards which is reflective of the relative stagnation the broader economy.
- ii. Despite this, profitability grew by 14.1% in Q3** – the average real EBITDA of small businesses grew by 14.1% year-on-year in Q3. This represents a slight deceleration from the 17.1% increase in Q2 2023.
- iii. This has been partly driven by falling expenditure and overheads** – Real overheads fell by 5.8% in the year to Q3, the largest annual decline since Q2 2020. Real expenditure fell by 5.3% in the same period.
- iv. Capital expenditure by small businesses continues to fall sharply, also supporting profit growth** – On an annual basis, capital expenditure fell by 10.3% in Q3 2023, following a decline of 20.4% in the previous quarter. Capital expenditure has now declined on an annual basis for eight consecutive quarters.
- v. Nominal wages continue to grow sharply amidst falling small business productivity** – The latest Sage data shows nominal wages grew by 12.4% in Q3 2023. Meanwhile, annual real productivity growth for the average small business declined by 5.2% in Q3 2023, following a 1.0% decline in Q2 2023. This is due to a combination of falling average revenue and increasing average employee counts.

Small business revenue falls in Q3 amidst slowing UK economy

Year-on-year change in real revenue for the average small businesses and UK GDP, in 2019 prices (Quarterly)



Source: Sage, Smart Data Foundry, ONS, Cebr

- Average real revenues for small businesses contracted by 2.5% on a year-on-year basis in Q3 2023. This follows growth of 0.3% in Q2 2023.
- Revenue growth has been relatively weak since mid-2022 onwards. This reflects the relative stagnation the broader economy has experienced during this period, with the economy growing by only 0.6% in the year to Q3 2023.
- The economic slowdown seen over the past year is mainly attributable to the wave of inflation that hit due to the post-pandemic demand boost and the tighter monetary policy environment implemented to tackle inflation.
- Inflation is beginning to ease as higher interest rates exert downward pressure on activity by increasing the cost of borrowing and encouraging saving. However, with consumer price growth at 4.6% in October, the Bank isn't expected to ease monetary policy till mid-2024.
- Given this, the trajectory for growth is expected to remain weak. In annual terms, Cebr projects weak growth rates of just 0.5% and 0.4% across 2023 and 2024, respectively.

Small business profit remains resilient in Q3 despite falling revenues

Year-on-year change in real EBITDA for the average small business, in 2019 prices (Quarterly)

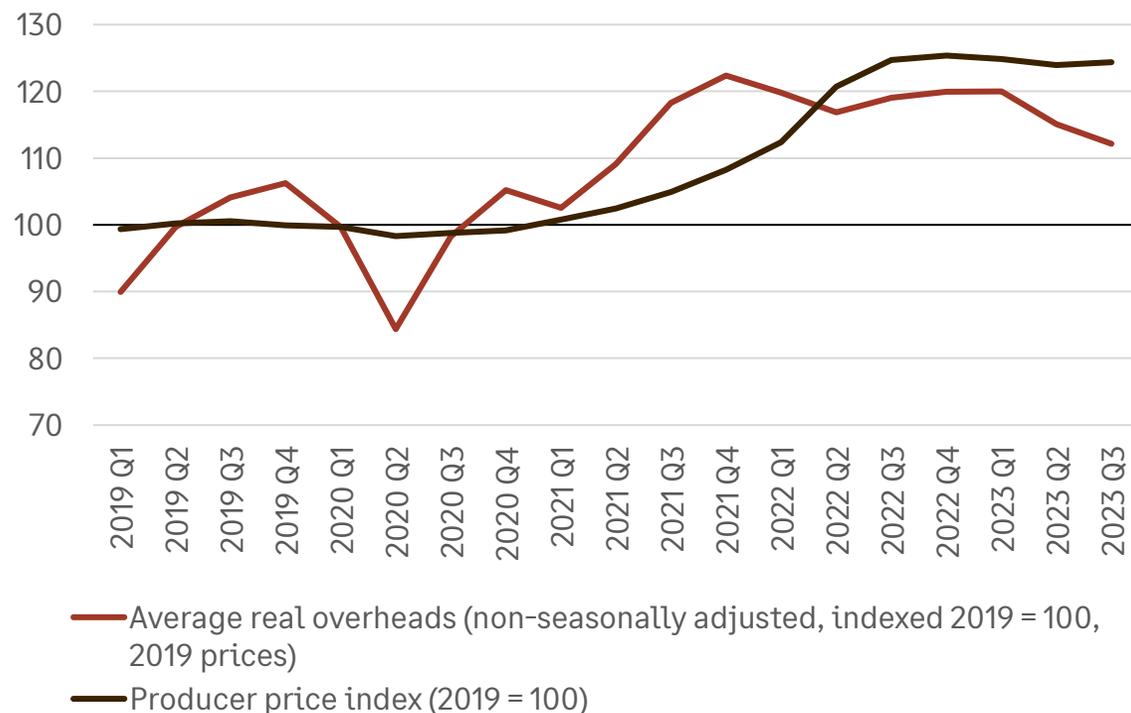


Source: Sage, Smart Data Foundry, ONS, Cebr

- On an annual basis, EBITDA for the average small business grew by 14.1% in Q3 2023. This represents a slowdown from the 17.1% annual growth figure witnessed in the previous quarter. Nonetheless, this quarter's growth figure looks very robust, given falling revenues. Profits have been helped by falling real average overheads and easing cost pressures. Additionally, expenditure by small businesses also fell in Q3 2023 on an annual basis.
- Our data measures small business profit using the EBITDA (Earnings before interest, taxes, depreciation and amortization) measure. This is derived as $EBITDA = Revenue - Expenditure - Overheads$ and helps understand profitability in our sample.
- The ONS produces figures for the net rate of return for all businesses, allowing us to compare our data for small businesses to the average business more generally in the economy. According to the latest data from the ONS, the net rate of return for all businesses, a common measure of company profitability, fell slightly following three consecutive quarters of improvement.
- Average profit in our sample of small businesses is more volatile than that of the ONS net rate of return for all businesses. This suggests that smaller businesses are subject to more uncertainty and are perhaps more susceptible to broader macroeconomic conditions.

Real overheads for small businesses fall sharply amidst easing energy costs

Non-seasonally adjusted real overheads (2019 prices, indexed values, 2019 = 100) and input producer price index

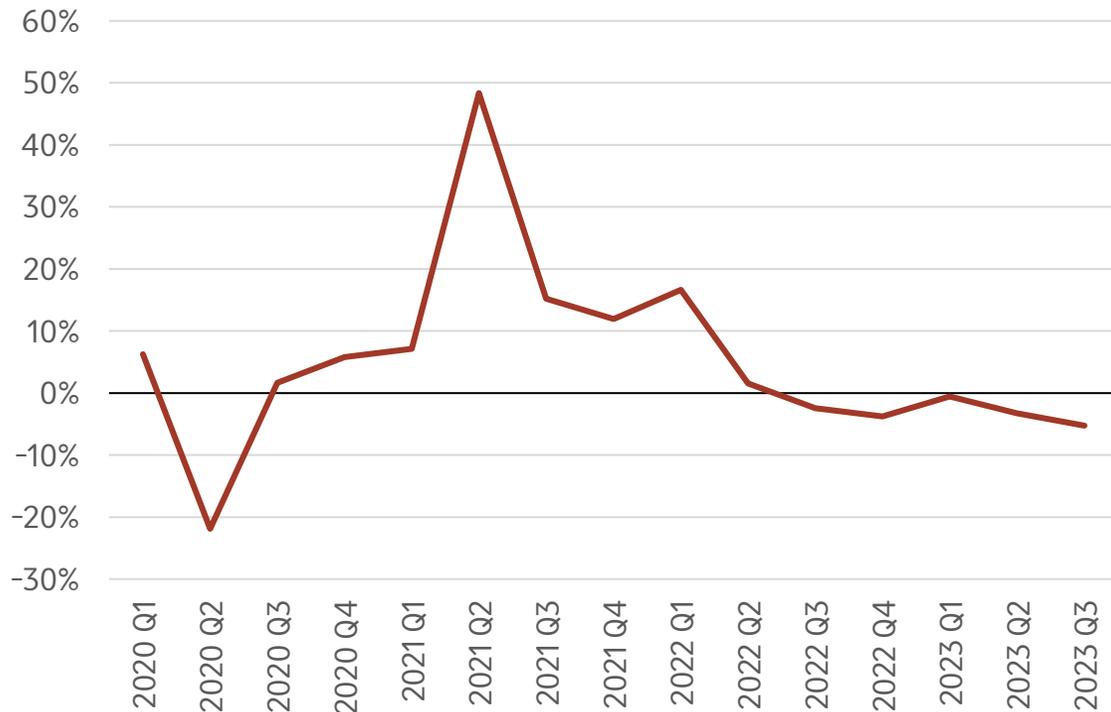


Source: Sage, Smart Data Foundry, ONS, Cebr

- In this report, we look at overheads, which include fixed and semi-variable overheads such as rent, energy and utility bills. Therefore, overheads can be driven by changes in prices and any shifts in production, which would affect factors such as rent or utilities.
- The years 2021 and 2022 witnessed a marked escalation in overhead costs, driven by a confluence of factors. Initially, the disruption of global supply chains caused by the Covid-19 pandemic, coupled with the subsequent surge in demand as lockdowns eased, exerted significant upward pressure on costs. This was further exacerbated by Russia's invasion of Ukraine, which triggered an energy crisis and a substantial spike in oil and gas prices. Indeed, in Q1 2021, overheads for small businesses grew at an annual rate of 29.3%.
- More recently, Sage's data points to a substantial easing in real overheads in Q3 2023. Real overheads are estimated to have fallen annually by 5.8% in Q3, the largest annual decline since Q2 2020. This represents a significant change in overheads for small businesses. Compared to the previous quarter, overheads fell by 2.6%.
- This is in line with official data from the ONS on producer prices, which have shown a marked slowdown in growth throughout the supply chain. On an annual basis, there was a 0.2% fall in the cost of production in the UK in Q3 2023. This was down from the 18.8% peak witnessed in the same quarter a year prior. It represents the weakest annual rate since Q4 2020. Lower energy costs have trickled down through the supply chain, alleviating price pressures for businesses.

Small business expenditure falls in Q3, aiding the resiliency seen in profits

Year-on-year change in real expenditure for the average small business, in 2019 prices (Quarterly)

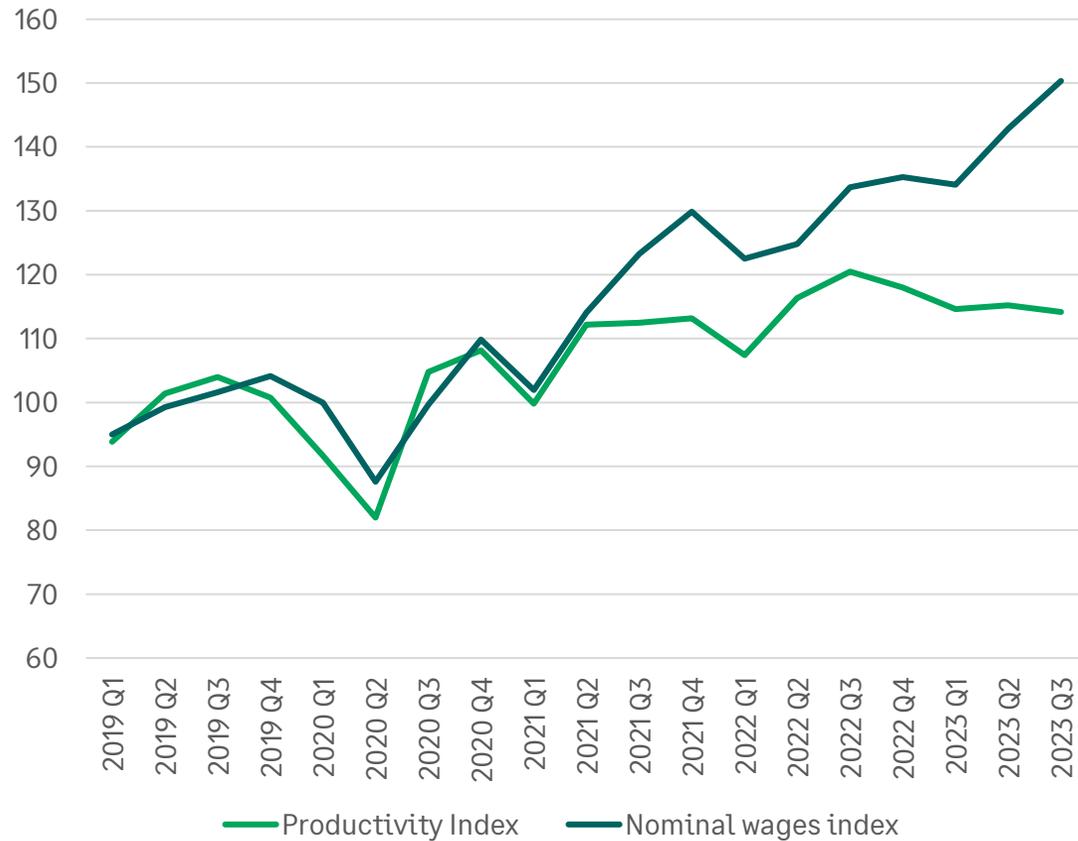


Source: Sage, Smart Data Foundry, ONS, Cebr

- On an annual basis, real expenditure for the average small business fell by 5.3% in Q3 2023. This is the largest annual decline in expenditure observed in the post-pandemic era, with the largest fall in Sage's dataset occurring in Q2 2020 when expenditures fell by 21.9% on an annual basis.
- The ongoing decline in real average expenditure for five consecutive quarters mirrors the broader economic slowdown, with UK GDP growth exhibiting sluggishness since mid-2020. The contraction in real expenditure for the average small business in Q3 2023 underscores the waning economic demand and activity currently prevalent in the UK economy.
- The decline in expenditure coupled with the alleviation of cost pressures has enabled small businesses to achieve real profit growth despite marginal revenue dips. While small businesses have experienced revenue declines, their outgoings have decreased at a faster rate.
- Between Q2 2023 and Q3 2023 real expenditure for the average small business fell by 1.1%.

Wages and Productivity

Non-seasonally adjusted nominal wages and real productivity, index 2019 = 100



Source: Sage, Smart Data Foundry, ONS, Cebr

- Productivity in our large sample of small businesses is measured by revenue divided by the number of employees within a business.
- Annual real productivity growth for the average small business declined by 5.2% in Q3 2023, following a 1.0% decline in Q2 2023. This is due to a combination of falling average revenue and increasing average employee counts. Indeed, the average number of employees has been slowly rising in Sage’s data set, averaging 5.4 in the first three quarters of 2023 compared to 4.3 across 2018. This indicates that despite tough economic conditions small businesses are continuing to retain employees, indicative of the current tightness in the labour market.
- Nominal wages within small businesses have made strong gains following the pandemic. This is reflective of the tight labour market in the UK throughout this period, which has given workers increased bargaining power. Given the inflationary environment in the UK, with costs rising significantly during this period, workers have bargained for wage increases to maintain their living standards.
- The latest Sage data shows nominal wages grew by 12.4% in Q3 2023. However, this represents a slight deceleration when compared to the 14.4% growth witnessed in Q2 2023.
- This follows official ONS data, which showed that average total pay grew by 7.9% in Q3 2023. Sage’s data is proving more volatile compared to the ONS data, indicating small businesses experience more wage growth variability than the wider UK economy.

Sage small business tracker: Indicators by key themes



Deep dive – revenue growth by business size

Year-on-year change in real revenue for the average small business, in 2019 prices



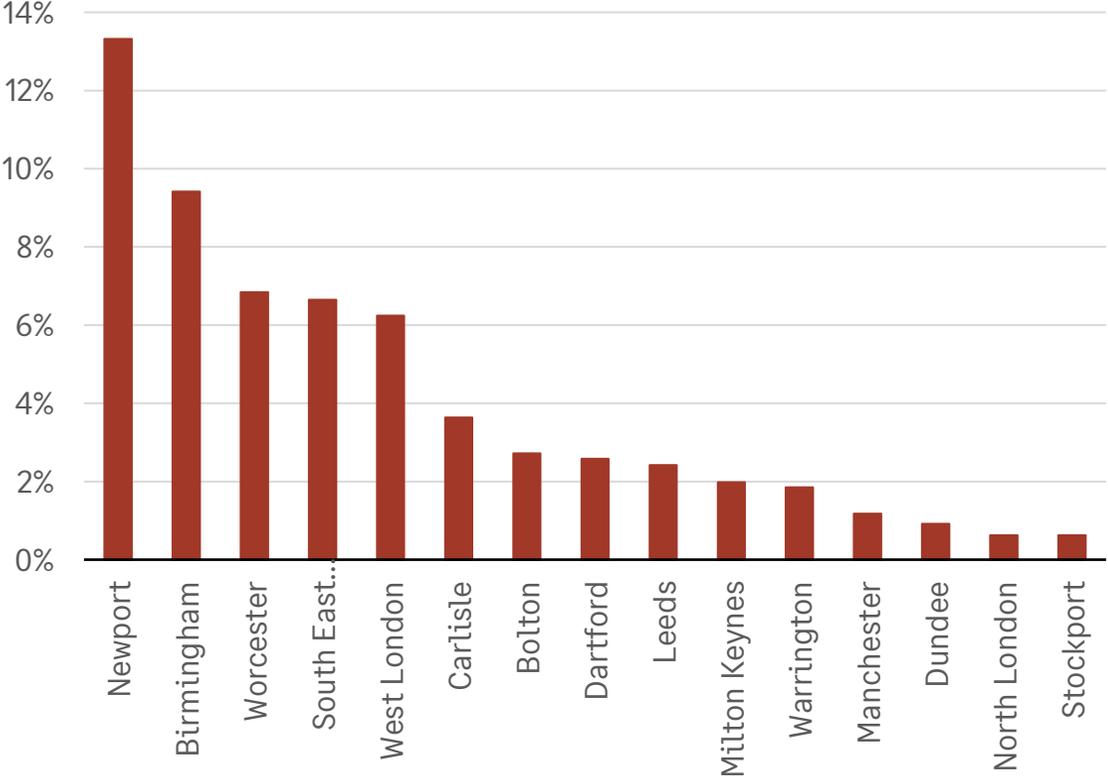
Source: Sage, Smart Data Foundry, ONS, Cebr

The smallest businesses in our sample recorded the strongest real revenue growth on an annual basis across 2023. However, these businesses have also faced the largest increases in overheads

- Looking at business revenue across our three subgroups of size shows that small (S) and extra small (XS) sized businesses have exhibited very similar trends across the whole history of our data. The trend of these businesses has broadly followed that of the wider economy, exhibiting a strong recovery post-pandemic and then tailing off during the period of sluggish economic growth witnessed over the past two years.
- However, nano-businesses (XXS), the smallest businesses in our sample, have exhibited a different trend. Over the past two years their average real revenue growth has been notably more volatile than their larger counterparts. In addition, they have also bucked the trend of falling real revenues, recording average real revenue growth of 7.6% on an annual basis in Q3 2023. Although it is worth noting that real revenue for nano-businesses (XXS) was particularly weak in 2022.
- During the period of strong real revenue growth over the previous three-quarters, nano-businesses also experienced the largest increases in annual overheads. In Q3, nano businesses (XXS) reported nominal overheads standing 17.4% higher than a year earlier. Meanwhile extra small (XS) and small businesses (S) saw overheads fall in Q3 2023, by 8.4% and 4.5%, respectively.

Deep dive – the fastest growing cities and towns over the past two years

Growth in average real business revenue between Q3 2021 and Q3 2023, 2019 prices, top 15 cities



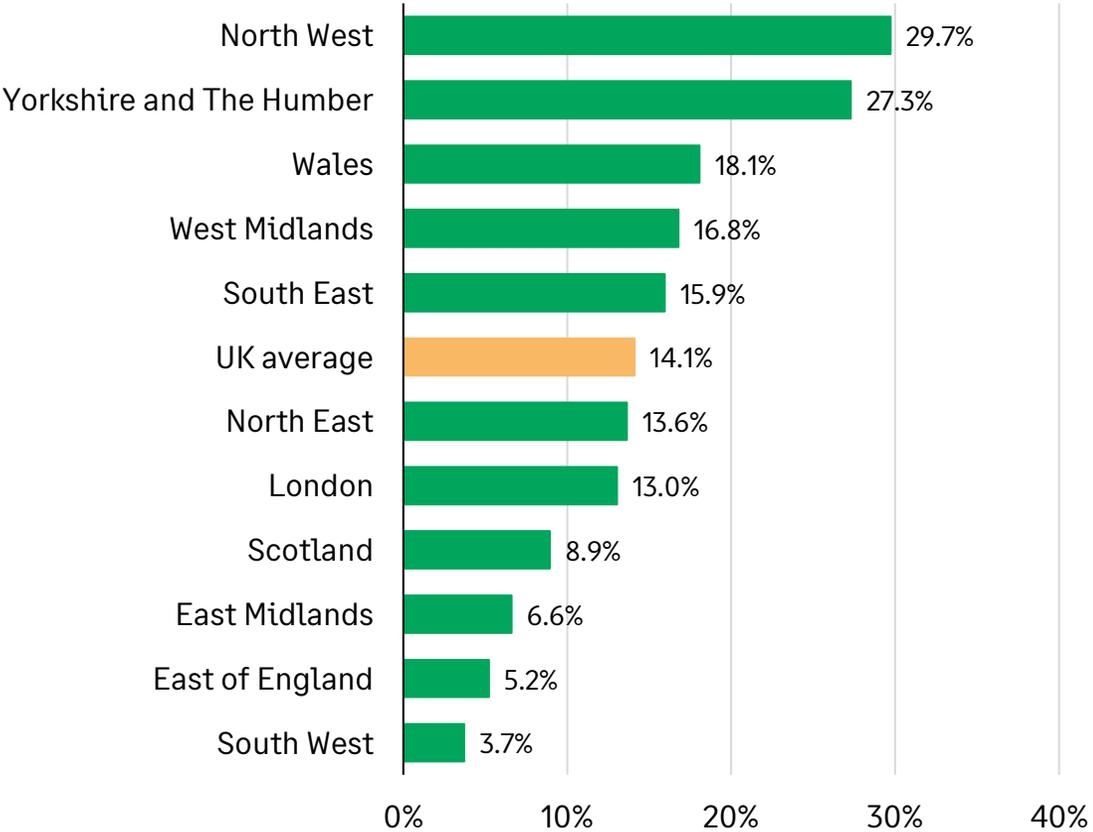
Source: Sage, Smart Data Foundry, ONS, Cebr
Minimum sample size: 1500 businesses

Over the two years between Q3 2021 and Q3 2023, revenue growth varied greatly by postcode region. From over 100 areas across the UK, 25.7% saw average real small business revenue increase.

- Small businesses in Newport and Birmingham saw the strongest revenue growth in the two years to Q3 2023, at 13.3% and 9.4%, respectively. It is worth noting that Birmingham and Manchester (which is also in the top 15) ranked highly on Cebr’s investment attractiveness index. Both cities have a large, economically active population, providing a large number of workers available for businesses seeking to invest in the city.
- Meanwhile, Worcester and South East London witnessed the second and third strongest growth in average revenues, recording 6.8% and 6.7%, respectively.
- London has performed strongly over the past two years, with South East London, West London, and North London all making it into the top 15 cities for real revenue growth.
- Cities and towns in the North East saw performances that could be described as generally ‘middle of the pack’. Newcastle ranked 49th out of 92 cities and towns with sufficient samples, while Teeside was 41st and Durham was 59th.

Profitability

Growth in average real EBITDA between Q3 2022 and Q3 2023, in 2019 prices, by UK regions



Source: Sage, Smart Data Foundry, ONS, Cebr

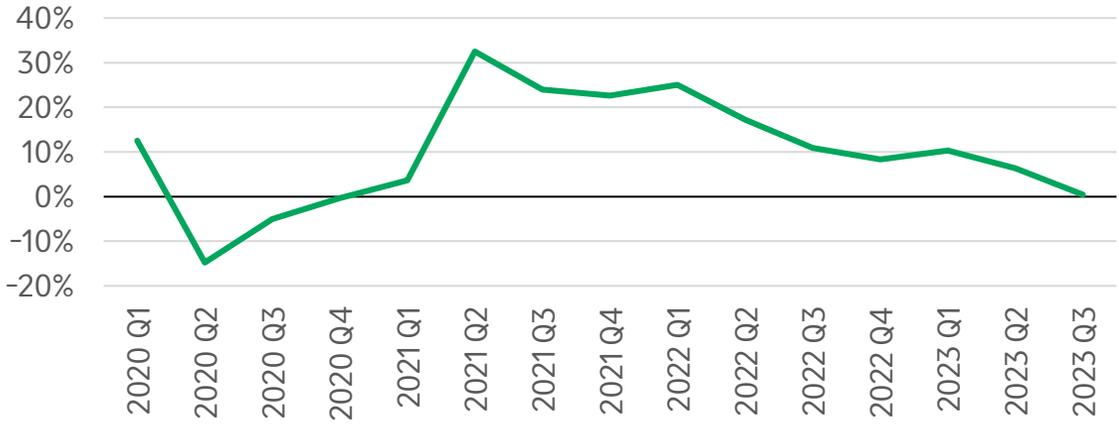
*Northern Ireland omitted due to sample size

The average small business EBITDA rose by 14.1% YoY in Q3 2023, with the North West recording the strongest growth of any UK region

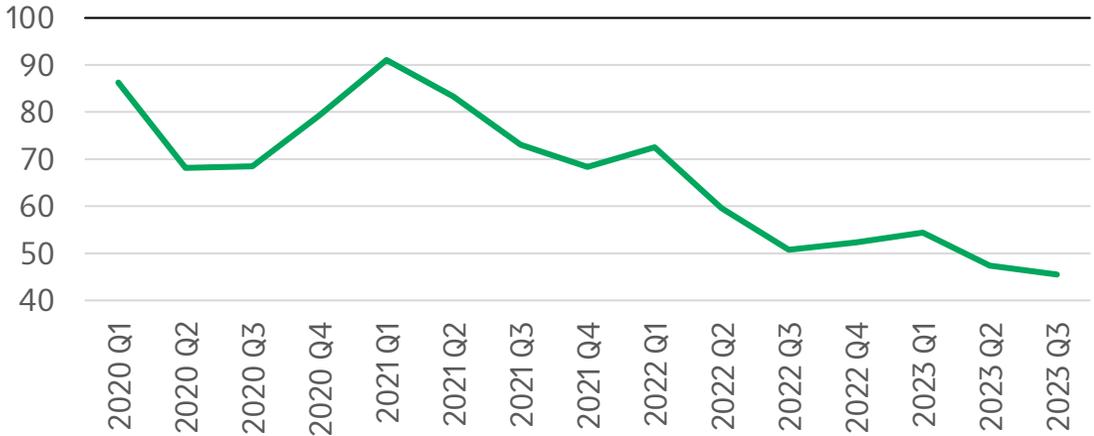
- EBITDA (earnings before interest, taxes, depreciation, and amortization) is a leading measure of profitability and business performance. Sage’s data shows the average small business saw a 14.1% rise in EBITDA in Q3 2023 on an annual basis.
- Looking at small business profitability over the past two years shows different results across the UK regions, however. All regions saw profit growth across this period.
- Looking at regions in England, the North West saw the largest annual increase in profitability, up by 29.7%. Meanwhile, Yorkshire and The Humber and the West Midlands also performed strongly. These three regions account for eight of the fifteen fastest growing UK cities and towns over the past two years year in terms of average real business revenue growth.
- Wales had the third strongest annual profit growth of any UK region in Q3 2023. Newport, one of the largest cities in Wales, had the strongest real revenue growth of any UK city or town in the two years to Q3 2023, at 13.3%
- The South West saw the slowest growth, although it remained positive. Profits in this region grew by just 3.7% annually in Q3 2023. It is worth noting that businesses in the South West saw the largest annual increases in nominal overheads of any UK region in Q3 2023 at 7.2%.

Prices and spending

Year-on-year change in cost of nominal overheads per small business



Real, non-seasonally adjusted capital expenditure, indexed 2019 = 100



Source: Sage, Smart Data Foundry, ONS, Cebr

Overheads grow at slowest rate since Q4 2020 as energy costs decline. Meanwhile, capital expenditure falls amidst elevated borrowing costs

- Over the past two years, small businesses have faced a significant surge in average overheads, with cost growth reaching its peak in Q2 2021, in line with the impacts of the energy crisis. This was followed by a period of steadied easing of cost pressures.
- However, the latest data for Q3 2023 indicates cost pressures are easing, with annual growth in overheads continuing the downward trend seen since their peak in Q2 2022. This is partially attributable to lower wholesale energy prices, which have fallen significantly since their peak.
- Small business capital expenditure refers to the acquisition or upgrading of long-term assets, such as equipment or property. This measure has been adversely affected by the challenging trading environment caused by high inflation, interest rates, and weak economic output growth.
- It's worth noting that capital expenditure will not capture all types of investments made by businesses, especially when a business loans or subscribes to an asset or service rather than purchases that asset outright. This is especially pertinent for the services sector.
- On an annual basis, capital expenditure fell by 10.3% in Q3 2023, following a decline of 20.4% in the previous quarter. Capital expenditure is now 37.8% lower than it was pre-pandemic (Q4 2019).
- The Bank of England's tightening campaign has made borrowing for capital investment much more expensive. This has significantly impacted small business's decision-making over long-term investments.

Prices: overheads by sector and business size

Annual growth in nominal average overheads, by business size

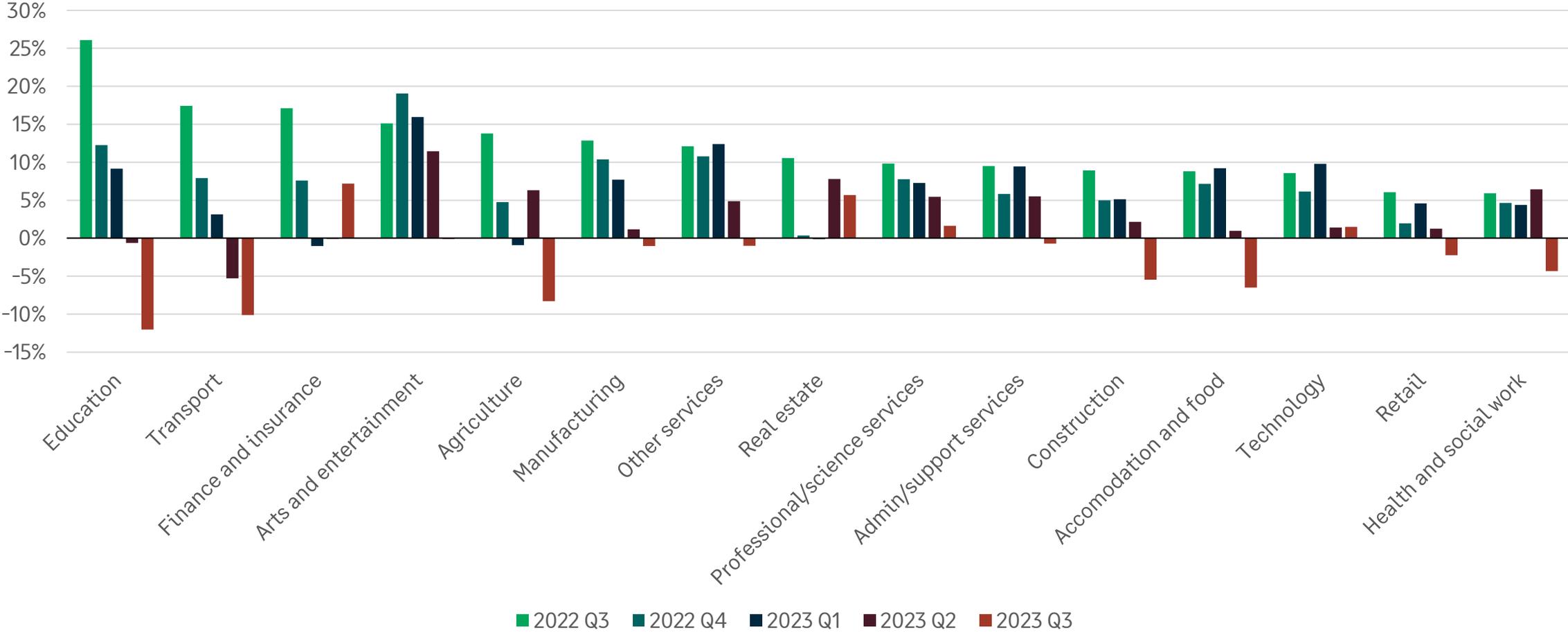


Source: Sage, Smart Data Foundry, Cebr

The smallest businesses in our sample have experienced notable annual increases in overheads in Q3, while larger small businesses have seen significant falls

- Breaking down overheads data by business size shows how different types of businesses have been affected by rising prices.
- The smallest businesses have tended to see the fastest overheads growth in 2023. In Q3, nano businesses (XXS) reported overheads standing 17.4% higher than a year earlier. Meanwhile extra small (XS) and small businesses (S) saw overheads fall in Q3 2023, by 8.4% and 4.5%, respectively.
- This trend may reflect that nano businesses are more exposed to variations in input costs as they tend to have less bargaining power with their suppliers. Although, it's worth noting the rate at which overheads are growing for these businesses has decelerated for two consecutive quarters.
- On the next slide, annual overheads growth by sector is shown. Most sectors recorded lower overheads in Q3 2023 when compared to a year prior. Industries mainly comprising of professional services can be grouped as the few to experience annual growth in overheads. This is likely due to a greater proportion of expenditure on services rather than goods in these sectors, with goods inflation currently easing more notably.
- Meanwhile, education and transport witnessed the largest falls in overheads, falling by 12.0% and 10.1%, respectively. Transport has benefitted significantly from fuel prices falling on an annual basis. According to the ONS, they fell by 9.7% in September 2023.

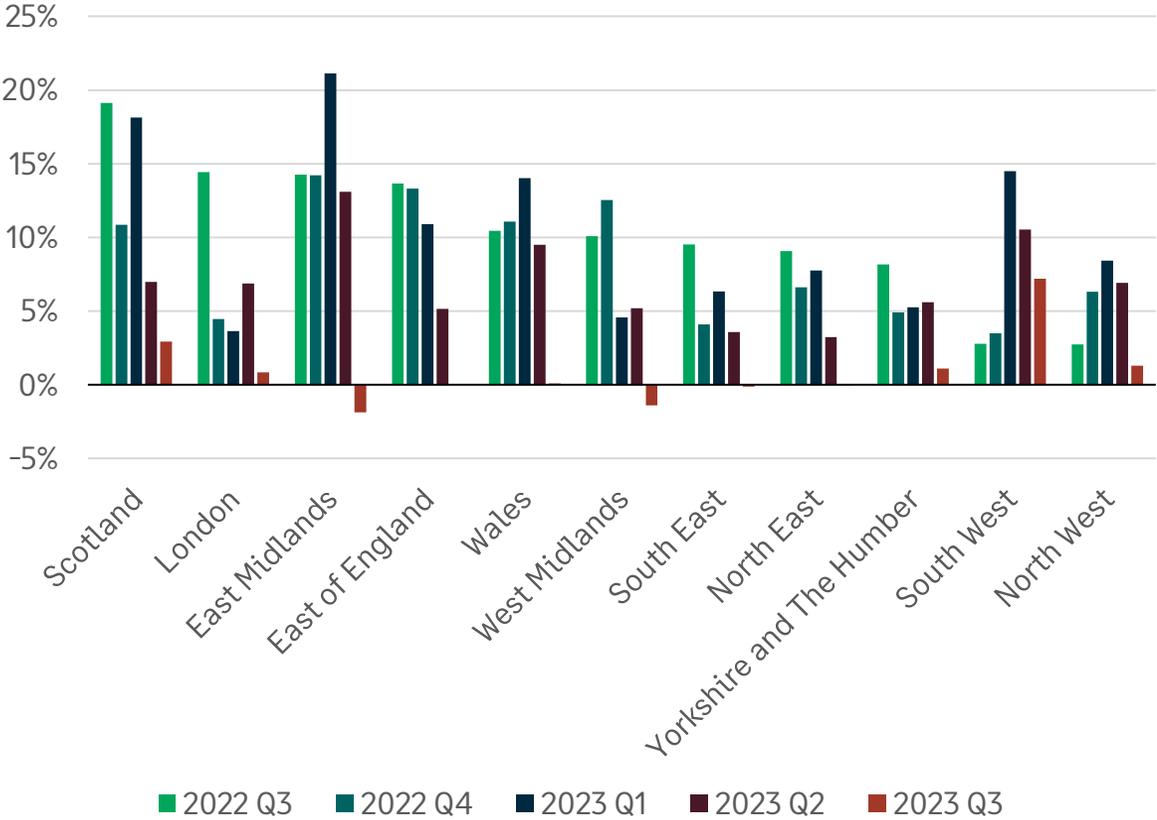
Prices - Annual growth in nominal overheads by industry



Source: Sage, Smart Data Foundry, Cebr

Prices: overheads by region

Annual growth in average nominal overheads by UK region between 2022 Q3 and 2023 Q3

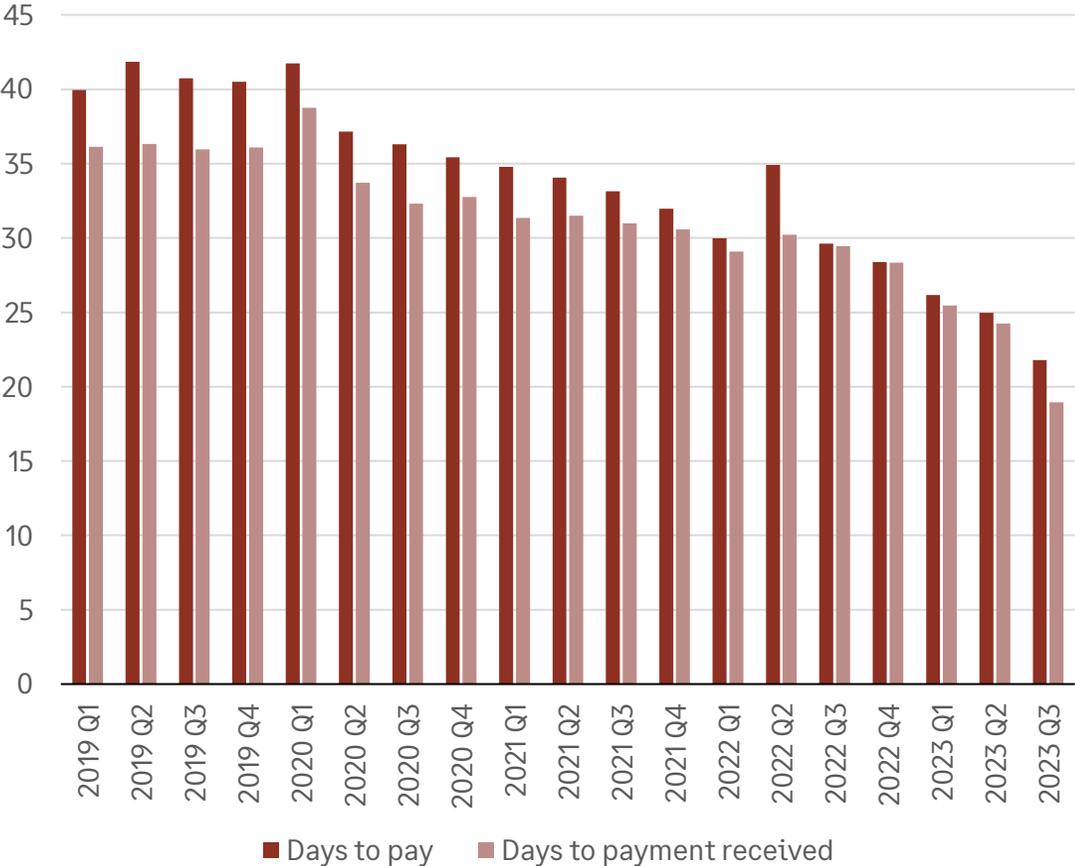


*Northern Ireland omitted due to sample size
 Source: Sage, Smart Data Foundry, Cebr

- Businesses across the UK nations and regions have seen overheads growing at different rates over the past year. Annual growth in overheads across all regions was particularly high across 2022 and in early 2023 but has broadly eased in Q3 2023.
- The most recent data for Q3 2023 shows, on an annual basis, overheads contracted in four of the eleven regions of the UK for which we have a representative sample. Annual declines in overheads were most prominent in the East Midlands and West Midlands, down 1.9% and 1.4%, respectively. The remaining regions with positive annual growth rates in overheads all saw a deceleration compared to the previous quarter.
- Businesses in the South West and Scotland saw the most significant annual increases in overheads in Q3 2023, at 7.2% and 2.9%, respectively. While all regions have seen an ease in cost pressures this quarter, it has not been felt evenly across the UK. Changing input prices takes time to feed through the supply chain and impacts small businesses differently depending on their exposure.
- For most small businesses across regions, average nominal overhead costs have fallen compared to the previous quarter, further signalling that cost pressures are easing.

Resiliency: time to pay

Average number of days taken to either pay invoice or be paid per small business, by quarter



Source: Sage, Smart Data Foundry, ONS, Cebr

- Small businesses on average received payment on invoices after 19 days, down by 5.2 days on last quarter. This represents a halving in time to be paid from 2020 Q1 (38.8 days).
- This data is great news for small businesses, as late payments can present a huge strain on cash flows, given that many small firms have little credit or cash balances, and such invoices can often represent a large proportion of their revenues.
- The average number of days small businesses took to pay an invoice was 21.8 in Q3 2023. This marked an improvement of 3.2 days from last quarter. In fact, with the exception of Q2 2022, the average days to pay have decreased in every quarter since the start of 2020.
- This data series shows that small businesses are making a concerted effort to streamline their payment processes and become more efficient in paying invoices. By paying their bills on time, small businesses can establish a good credit history, build strong relationships with suppliers, and avoid late fees or penalties. This could ultimately lead to greater stability and growth for small businesses.
- Despite the difficult circumstances that businesses have faced during the pandemic and the subsequent high inflation environment, there have been improvements in the time it takes to make payments. It is possible that these recent crises have motivated small businesses to prioritise enhancing their payment processes in order to boost their overall resilience during difficult economic circumstances. It is also positive that the time taken to receive payments has fallen, which supports cash flow resilience.

Deep dive – time to pay by business size

Average number of days taken to pay an invoice per small business by business size, by quarter

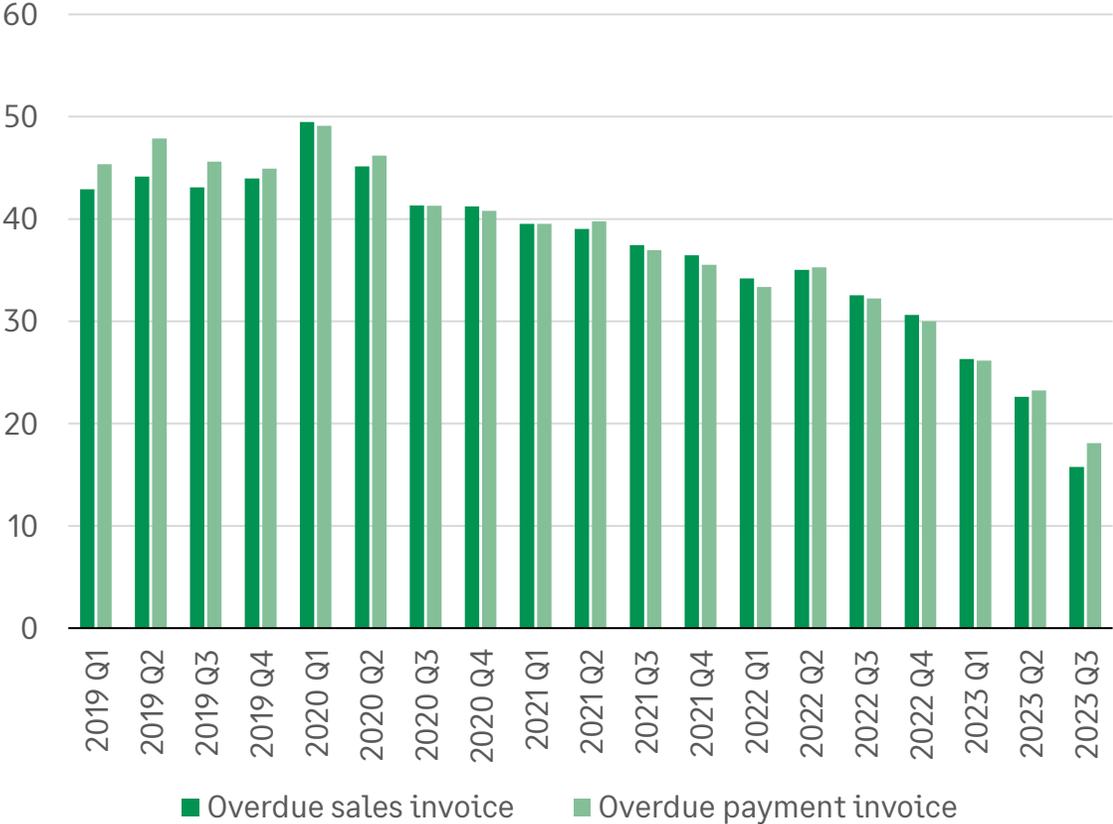


- Average time to pay an invoice by business size data shows that the smallest businesses have seen the largest improvement in the time they took to pay an invoice.
- The average nano business (XXS) in the dataset took 14.3 days to pay an invoice in Q3 2023. This marks a strong improvement from an average of 22.7 days recorded in the same quarter a year earlier.
- For the smallest businesses, financial constraints necessitate a consistent cash flow to meet operational expenses. Therefore, prompt payment collection is important. Moreover, timely invoice payments foster positive business relationships, leading to favourable credit terms and a more resilient supply chain.
- The small (S) grouping had the highest average days to pay in Q3 2023. At 23.4 days, however, this was a notable improvement from one year earlier when these businesses took an average of 31.3 days to pay an invoice.

Source: Sage, Smart Data Foundry, ONS, Cebr

Overdue invoice payment times fall markedly

Average number of days overdue to either pay invoice (payment) or be paid (sales) per small business, by quarter



- The average number of days for small businesses to be paid a sales invoice for those that were overdue was 15.8 days. This represents a halving in time to be paid for overdue invoices since 2022 Q4.
- The average number of days small businesses were late to pay an invoice for those that were overdue was 18.1 days in Q3 2023.
- This marked an improvement from a year earlier, which saw an average of 32.2 days in Q3 2022, as well as a much better result when compared to before the pandemic. Indeed, in 2019, the average number of days a small business is overdue on their invoice when they are overdue was 45.9 days.
- Improved credit control practices and strengthened relationships between businesses and their customers could be driving this positive trend. Additionally, during periods of economic uncertainty, businesses may be putting in extra effort to collect their outstanding payments.

Source: Sage, Smart Data Foundry, ONS, Cebr



Methodology

Methodology and data

- The Sage Small Business Tracker uses data from Sage's accounting and payroll software. The Smart Data Foundry aggregates and cleans the data, before Cebr deflates and analyses the data ahead of its publication. The data is not currently seasonally adjusted due to the length of back history available for analysis.
- Filters are applied to the data to ensure it is not impacted by outliers. This includes a maximum monthly revenue figure of £1m and a maximum annual payroll figure of £1.1m.
- Earnings before interest, taxes, depreciation and amortization (EBITDA) is a common measure of business performance. It is derived as $EBITDA = \text{Revenue} - \text{Expenditure} - \text{Overheads}$
- Net rate of return is used as the measurement of company profitability for total businesses. The rate of return is calculated as the economic gain (profit) shown as a percentage of the capital used in production obtained from the ONS.
- Small businesses are classified by size groupings via their average annual revenue within Sage's data. The categories are as follows: nano/extra-extra small (average annual revenue less than or equal to £50,000), extra-small (average annual revenue greater than £50,000 and less than or equal to £200,000) and small (average annual revenue greater than £200,000).

Our small business sample

- In Q3 2023, our sample of over 134,000 businesses contained the following demographics.

Size

- 39% were small (S) businesses (average annual revenue greater than £200,000).
- 35% were extra-small (XS) businesses (average annual revenue greater than £50,000 and less than or equal to £200,000)
- 27% were nano (XXS) businesses (average annual revenue less than or equal to £50,000)

Region

- Within the sample, 123k of businesses identified their region.

Region	South East	Yorkshire and The Humber	North West	West Midlands	East of England	South West	Scotland	London	East Midlands	North East	Wales	Northern Ireland
Share	14%	10%	10%	10%	10%	9%	9%	8%	8%	5%	4%	3%

Sector (of the 63k of businesses for which we know the sector)

- 14% were in heavy industry
- 10% were in light industry
- 76% were in services

Payroll (our data for productivity and workforce related variables are based on a smaller sub-sample of 22k small businesses)

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