

# Sage small business tracker

A Sage report in partnership with Smart Data Foundry and Cebr

March 2023

Sage



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# Headline Q3 findings

In Q3 2022 the Sage small business tracker revealed growth and profitability are increasing in small businesses with average revenue rising and the average EBITDA reaching its highest level in our data series in Q3. Moreover, small businesses have shown a four-year trend in improving the time to pay invoices, signalling they are able to meet their obligations. Conversely, data on average overheads show a marked increase in input costs for small businesses and the average cash position is also worsening in Q3 2022 relative to previous years.

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

**i. Growth** – average real revenue for small businesses rose by 10.1% year-on-year in Q3 2022. This marked the highest average real revenue of any quarter since the start of this data series in 2015, with business performance proving strong in the face of several economic headwinds.

**ii. Profitability** – the average real EBITDA of small businesses reached its highest seasonally adjusted value in Q3 2022, up 12.1% year-on-year. This followed a 2.5% YoY contraction in Q2, which was the first annual contraction in the measure since the initial impact of lockdowns induced by the Covid-19 pandemic.

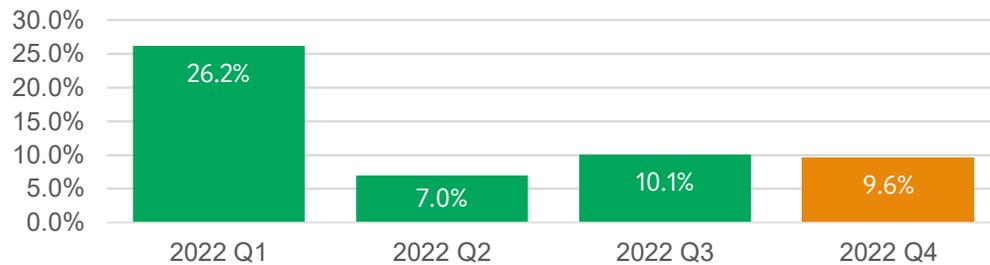
**iii. Inflation** – average overheads for small businesses have seen a dramatic rise over the past two years. In Q3 2022, average overheads were 13.3% higher than in Q3 2021.

**iv. Resiliency** – small businesses show a sustained period of increased resilience between Q1 2018 to Q3 2022, with the average number of days to pay an invoice dropping by 12.5 days. Small businesses have also been able to maintain their cash balances amid a difficult trading environment.

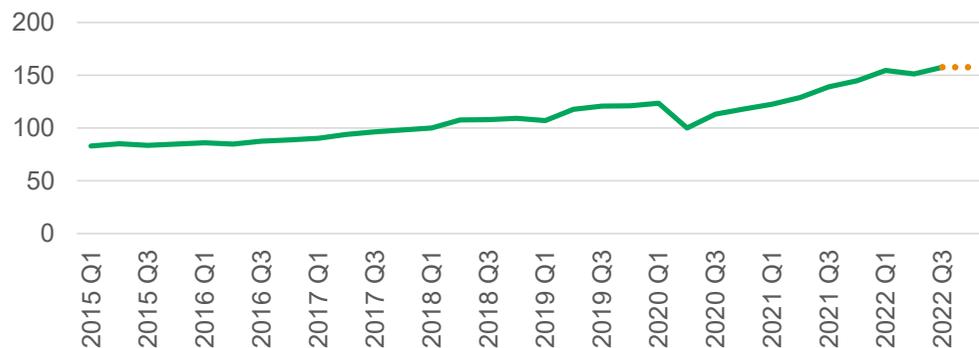
**v. Q4 2022 estimates** – more timely data from a smaller subset of businesses allows Cebr to estimate small business performance in Q4 2022. Results show average revenue growth is projected to stay strong in Q4, despite slowing macroeconomic activity, while overheads are anticipated to have seen slower growth as price pressures on businesses started to ease slightly.

# Small businesses estimated to see solid revenue growth in Q4 2022

Year-on-year change in real revenue for small businesses in 2015 prices (Quarterly)



Seasonally adjusted overheads for small businesses (nominal, indexed values, Q1 2018 = 100)

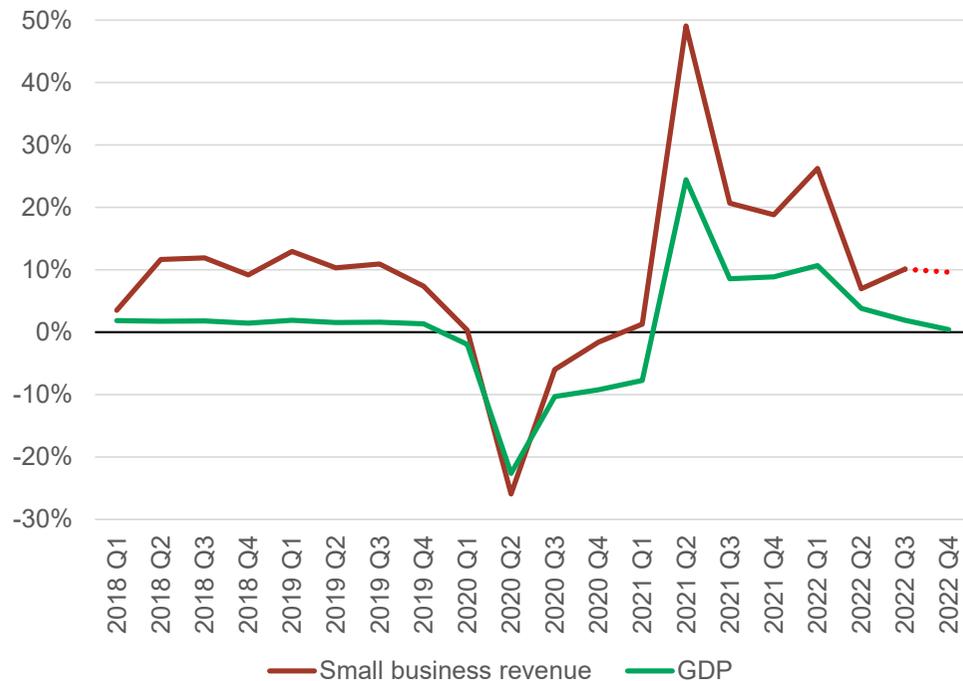


Source: Sage, Smart Data Foundry, ONS, Cebr

- Cebr has estimated the quarterly growth rate of financial variables using a subsection of only VAT-registered companies, which provide data up to Q4 2022, assuming growth rates of the larger business sample will follow a similar trend.
- Small business revenue is estimated to have grown by 9.6% year-on-year in Q4 2022. This would mark a slowdown in revenue growth from Q3, though would be a solid result in the face of the broader high-cost environment faced by businesses at present.
- This projected small business revenue growth comes in spite of a broader slowdown in the UK economy, with recent data from the ONS showing GDP grew by just 0.4% in Q4 2022 compared to a year earlier. This marked a significant slowdown in output growth since the start of last year.
- The average real EBITDA in small businesses is estimated to grow by 23.5% year-on-year in Q4 2022. This points to strong profitability despite the wider slowdown in economic activity.
- Overheads growth is estimated to have slowed in Q4 2022, to an annual rise of 8.8% from 13.3% in Q3. Nominal overheads are a key indicator of business cost

# Small business resilience highlighted by revenue boost in Q3

Year-on-year change in real revenue for the average small businesses and UK GDP, in 2015 prices (Quarterly)



Source: Sage, Smart Data Foundry, ONS, Cebr

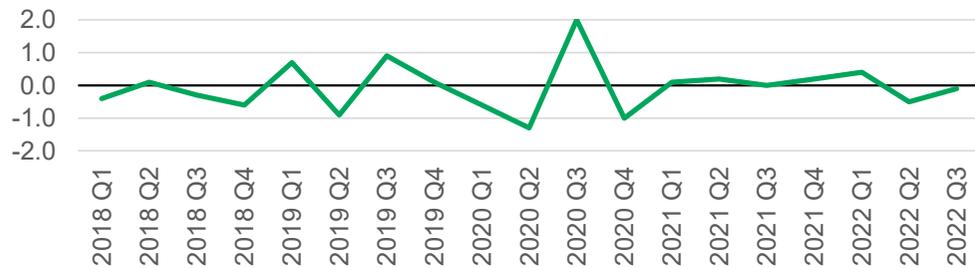
- Average inflation-adjusted revenues for small businesses grew by 10.1% on a year-on-year basis in Q3 2022. This was higher than the annual 7.0% growth in Q2 and exceeded the pre-pandemic average growth rate of 9.6%. Looking ahead to the estimate for Q4 2022, growth is expected to have slowed slightly to 9.6%.
- The UK economy grew by 1.9% on an annual basis in Q3 2022, marking a significant slowdown from 3.8% annual growth in Q2, as a result of both demand and supply side headwinds. On the demand side, the economy began to suffer from slowing consumer activity due to the cost-of-living crisis. Meanwhile, on the supply side, the production sector has been disrupted by rising input costs and other sources of supply chain disruption putting downward pressure on output generally.
- Despite decelerating GDP growth during Q3, Sage's data points to a solid annual increase in revenue within this large subset of small businesses.
- Small businesses may have been able to maintain revenues by innovating and appealing to customers despite the pressures from inflation.
- Looking ahead, both supply and demand side macroeconomic headwinds remain strong and, though the UK economy narrowly avoided a recession during the second half of 2022, Cebr expects one to materialise during the first half of 2023. This will likely lead to a deceleration in revenue growth as lower consumer activity resulting from the cost-of-living crisis hurts small business performance.
- More generally, annual changes in average small business revenue outperformed GDP in every quarter bar Q2 2020, where the emergence of the pandemic induced a 20+% contraction in both indicators.
- Cebr forecasts UK GDP to contract by 0.4% in 2023, due to the impact of elevated inflation, high interest rates and supply chain issues. For small businesses, this suggests revenue growth could decelerate in the period ahead, though the demonstrated resilience during economic challenges in Q3 2022 is an encouraging sign of their ability to cope with a decelerating economy.

# Small business profitability recovered in 2021/22

Year-on-year change in real EBITDA for the average small business, in 2015 prices (quarterly)



Quarter-on-quarter change in net rate of return for total businesses, percentage points (quarterly)

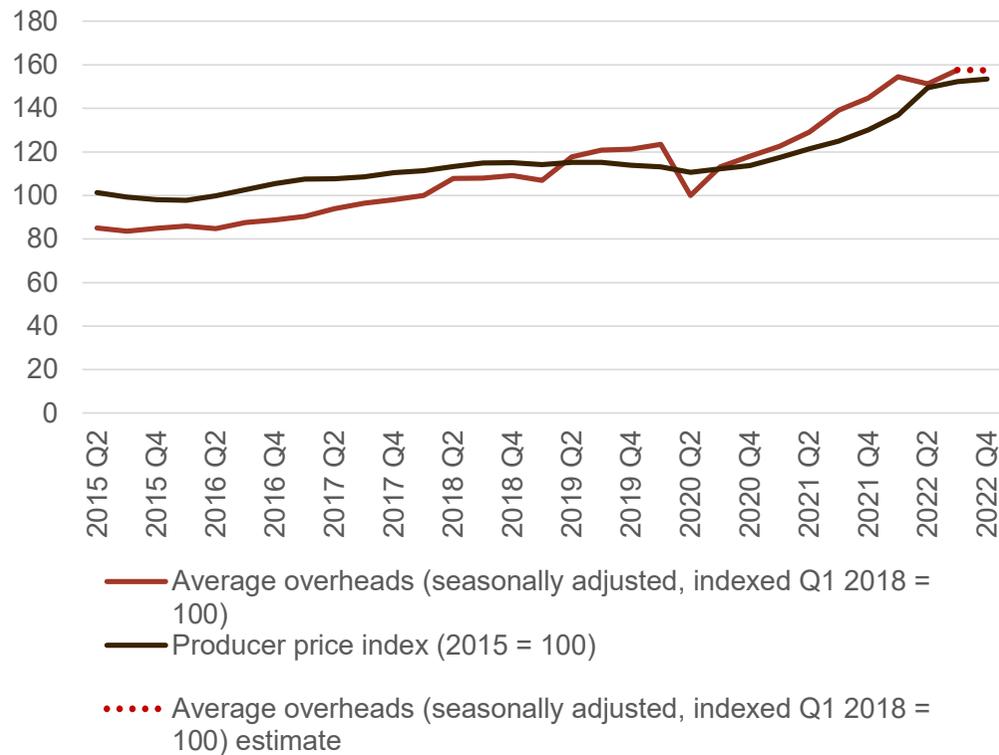


Source: Sage, Smart Data Foundry, ONS, Cebr

- On an annual basis, the real EBITDA for the average small business grew by 12.1% in Q3 2022, signalling strength in the profitability of small businesses despite the wider economic slowdown.
- This followed a 2.5% contraction in Q2 2022, which itself was the only YoY contraction in the EBITDA since the initial pandemic period during the first half of 2020.
- In Q4 2022, Cebr estimates point to a further annual acceleration in small business profitability, highlighting their resilience.
- Meanwhile, data from the ONS used to measure company profitability shows the net rate of return of total businesses in the UK fell by 0.1 percentage points in Q3 2022. This was the second consecutive quarter of falling rates of return, with the profitability measure now 0.6 percentage points below its near-term peak observed in Q1 2022.
- The pandemic induced a sizeable drop in both indices of profitability, with the average small business experiencing an 18.4% contraction in the EBITDA in Q1 2022, while the rate of return for total businesses was down 0.5 percentage points on the year before.
- Data for Q3 2022 show a divergence in the two profitability indicators, with average small businesses seeing a solid annual increase in profitability, as measured by the EBITDA, while total businesses have seen a fall in profitability during the same quarter. This highlights the resilience of small businesses despite the current economic downturn. The rise in profits could also suggest that in response to soaring input costs, businesses have themselves been increasing prices, passing this cost over to consumers.

# Overheads pushed up by rising prices

Seasonally adjusted overheads (nominal, indexed values, Q1 2018 = 100) and input producer price index



Source: Sage, Smart Data Foundry, ONS, Cebr

- In this report, data on overheads is studied which includes fixed and semi-variable overheads such as energy and utility bills. Therefore, overheads can be driven by changes in prices and any shifts in production which would affect factors such as employee numbers, rent and utilities.
- In the UK and across the world, supply chain issues and rising energy costs have driven up inflation, which has affected business costs. Looking at the input producer price index measure of inflation, there was a 21.9% increase in the cost of production in the UK on an annual basis in Q3 2022. Meanwhile, small business overheads increased by 13.3%.
- In Q4 2022, it is estimated that annual growth in overheads slowed to 8.8%. This follows the slowdown in producer input prices, which also saw a 4 percentage point slowdown in the rate of annual growth between Q3 and Q4.
- Rising overheads have been driven by the invasion of Ukraine affecting the energy market, and significantly increasing energy bills. Indeed, the fuel component of input producer price inflation doubled in the year to Q3 2022. However, there are signs that energy prices are falling in 2023, with crude oil costs falling in January 2023 compared to a year earlier. Indeed, Cebr expects inflation in the UK to halve between Q4 2022 and Q4 2023.
- Another factor which has been pushing up costs for businesses is wage growth. Annual growth in average weekly earnings in Q3 stood at 6.0%. Despite being below the overall rate of inflation, this rate is still high compared to historical averages. Furthermore, there are fears that high wage growth can be persistent, meaning that overhead growth may take some time to slow.

# **Sage small business tracker: Indicators by key themes**

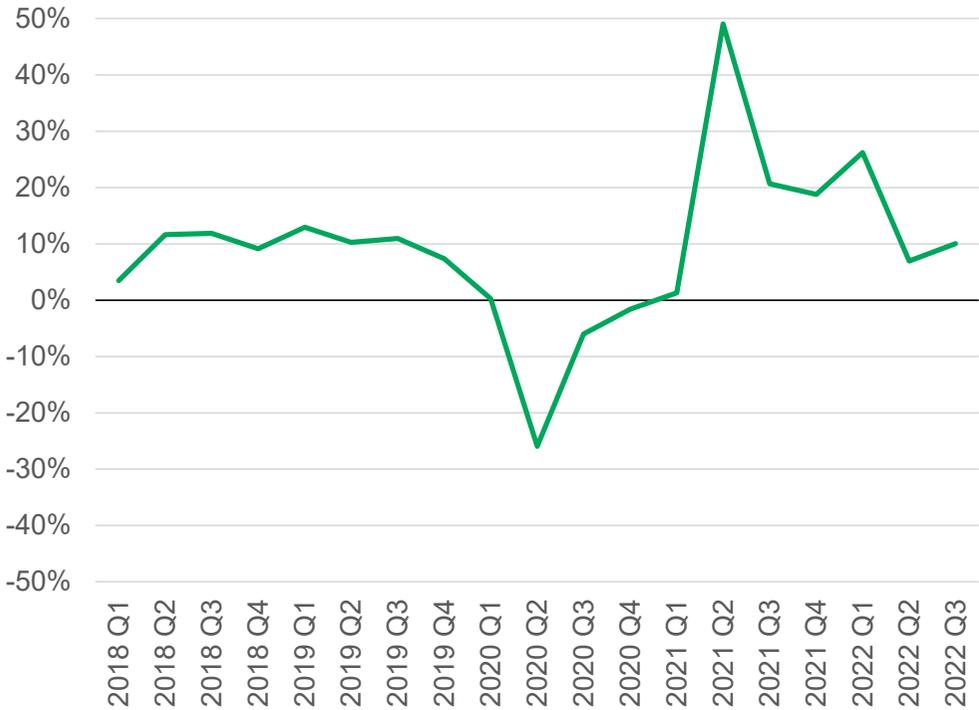


Sage

# Growth

Average revenue rose by 10.7% YoY in Q3 2022 with small business output performance proving resilient during the inflationary crisis.

Year-on-year change in real revenue for the average small business, in 2015 prices

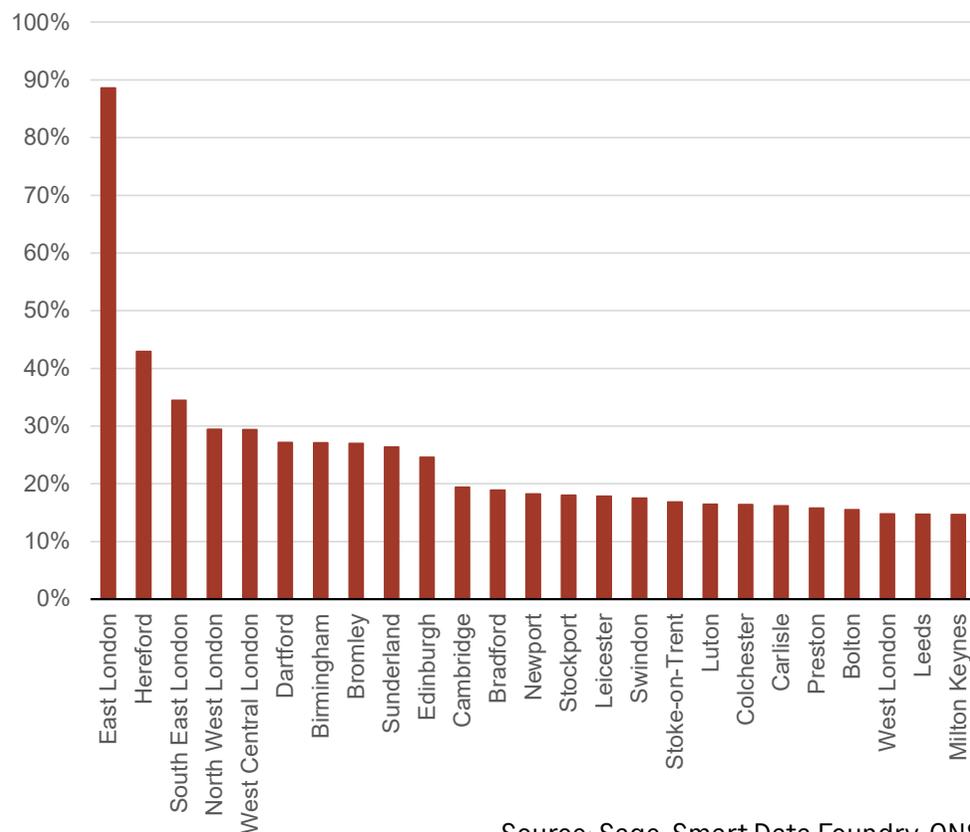


Source: Sage, Smart Data Foundry, ONS, Cebr

- On an annual basis, real revenue for the average small business grew by 10.7% in Q3 2022, which was higher than the 7.0% growth seen during Q2. Indeed, Q3’s result was higher than the 9.6% average annual revenue growth across the two-year period preceding the pandemic (2018-2020), emphasising the strength of this result.
- The pandemic had a profound impact on average small business revenue, particularly during Q2 2020, with the measure falling by 26.0% YoY, and was then followed by two successive quarters of negative growth.
- The first national lockdown was announced on 23rd March 2020 and lasted until June 2020. The novel nature of events meant many business operations were halted and this is reflected in Sage’s data.
- Revenue data shows subsequent national lockdowns had a less significant impact on average revenue in small businesses, as some businesses adapted to the new climate and found innovative ways to keep operations running.
- 2021 marked a year of strong recovery in revenue from the particularly low base in 2020, with revenue for the average small business growing by 19.8% on an annual basis in 2021.

# Deep dive – fastest growing cities and towns for small business revenue

Annual growth in average business revenue in Q3 2022, 2015 prices, top 25 cities

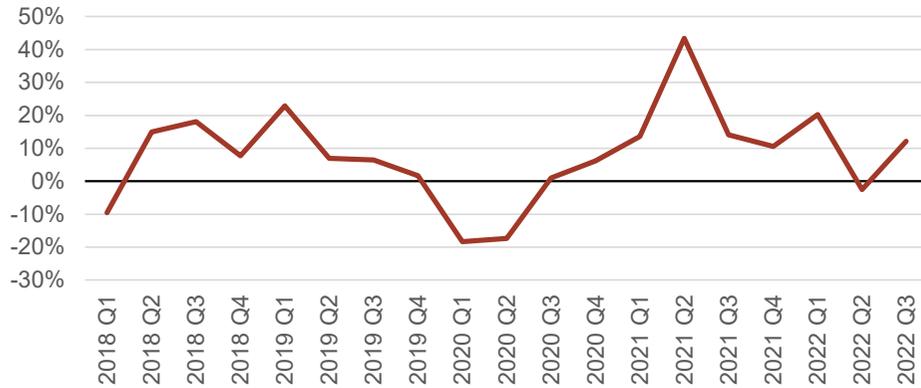


Source: Sage, Smart Data Foundry, ONS, Cebr  
Minimum sample size: 850 businesses

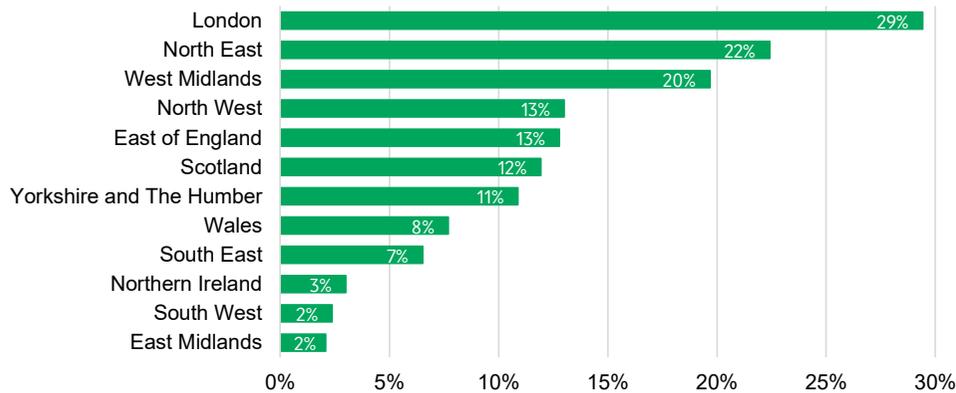
- London dominated the top of the rankings in terms of average small business revenue growth during Q3 2022, with four of the top five postcode groupings in cities and towns falling within the capital.
- East London was by far the largest growing city grouping in Q3 2022, up 88.6% year-on-year, though this was largely resultant of the poor performance a year earlier in Q3 2021. Meanwhile, the South East, North West and West Central areas of London grew by 34.5%, 29.5% and 29.4%, respectively.
- The strength of small businesses in London is corroborated by official data and Cebr’s in-house forecast. Economic output in London, as measured by gross value added (GVA), is expected to have grown by 4.5% across 2022, marking the highest growth of all twelve nations and regions in the UK.
- Higher productivity is one of the reasons behind London’s strong economic performance, which is a structural feature of its economy, with official ONS data showing that London has had the highest productivity level of any UK region since 1998.
- Sage’s data shows small businesses are contributing to this relatively strong economic performance in the capital.
- Elsewhere, small businesses in Hereford were the second strongest performer in terms of annual revenue growth in Q3 2022.

# Profitability

Year-on-year growth in real EBITDA for the average small business, in 2015 prices



Year-on-year growth in real EBITDA for average small business in Q3 2022 in 2015 prices, by UK region



Source: Sage, Smart Data Foundry, ONS, Cebr

The average small business EBITDA grew by 12.1% YoY in Q3 2022 to reach highest seasonally adjusted value since the start of this data series in 2015.

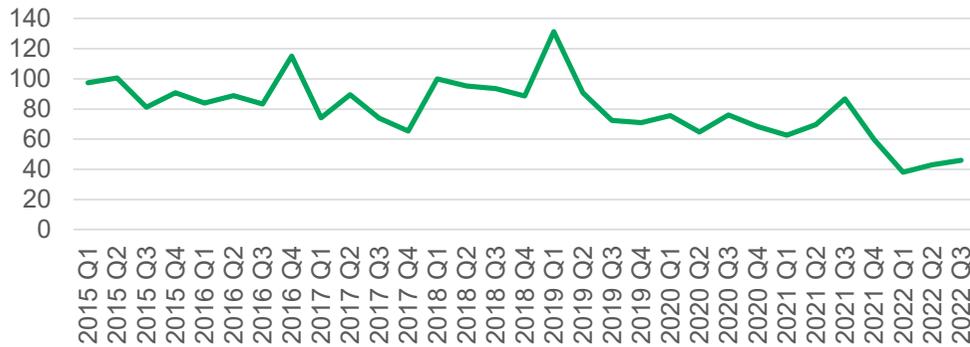
- The EBITDA (earnings before interest, taxes, depreciation, and amortization) is a leading measure of profitability and business performance. Sage's data shows the average small business saw 12.1% annual growth in the EBITDA in Q3 2022 (adjusted for inflation). This followed a relatively mild 2.5% contraction in Q2 2022.
- Looking back, profitability fell by 18.4% and 17.4% in Q1 and Q2 2020, respectively, as the emergence of the pandemic forced firms to halt or at least reduce activity.
- Following this initial pandemic impact, the average EBITDA for small businesses has seen a strong recovery, with positive YoY growth in every quarter bar Q2 2022 up to the most recent data.
- By business size, extra-small (XS) businesses saw the largest share of firms reporting a positive net margin position in Q3 2022, which increased by 1.0 percentage point on the previous quarter.
- Looking at performance across all twelve UK regions shows profitability increased by the highest rate in London and the North East in Q3 2022, with the EBITDA up by 29.4% and 22.4%, respectively.

# Prices

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



Real, seasonally adjusted capital expenditure, indexed Q1 2018 = 100

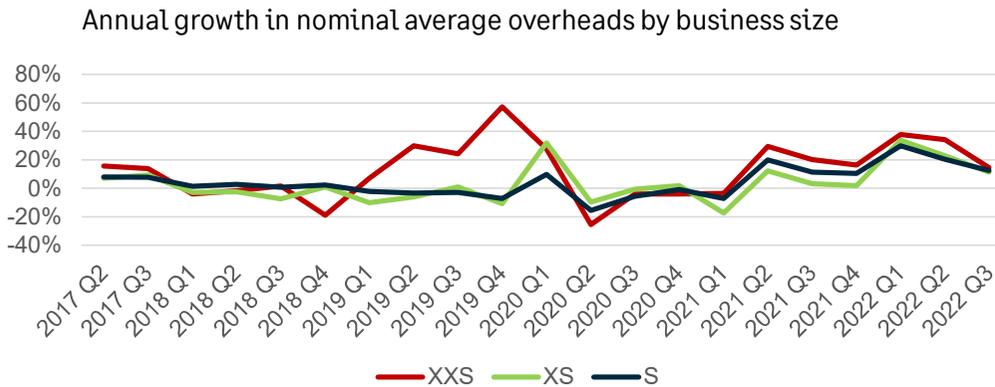
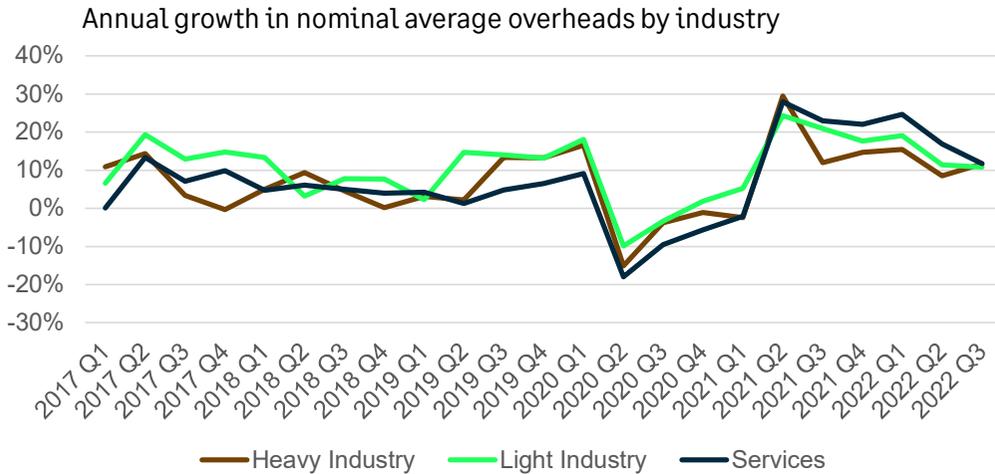


Source: Sage, Smart Data Foundry, ONS, Cebr

Average cost of seasonally adjusted overheads for small businesses rise dramatically in 2021 and 2022 due to post-pandemic bounce back and inflation running rampant.

- Average overheads for small businesses have seen a dramatic rise over the past two years. In Q3 2022, average overheads were 13.3% higher than in Q3 2021.
- The initial outbreak of the pandemic in 2020 and subsequent lockdowns led to a sizeable fall in average overheads, down 15.1%, followed by three consecutive quarters of negative YoY growth.
- Conversely, 2021 showed a marked increase in small business costs, with annual growth averaging 18.5% in each quarter during that year. This is likely a result of the reopening of global supply chains following the initial pandemic impact, which led to severe supply chain disruption due to a sharp uptick in demand. This has negatively impacted small businesses with demand outstripping supply for input goods leading to price spikes.
- Most recently, costs in 2022 also observed a sharp uptick, with overheads rising by 9.2% in Q3 compared to Q2. Indeed, the inflationary crisis in the UK has put significant pressure on business input prices. Namely, fuel input prices into production increased by 79.8% in the year to December 2022, driven by the fallout from the war in Ukraine.
- The difficult trading environment due to high inflation and weak economic output is likely to have led to lower capital expenditure in 2022. Real, seasonally adjusted capital expenditure fell by 47.0% in Q3 2022 compared to a year earlier.

# Prices: overheads by sector and business size



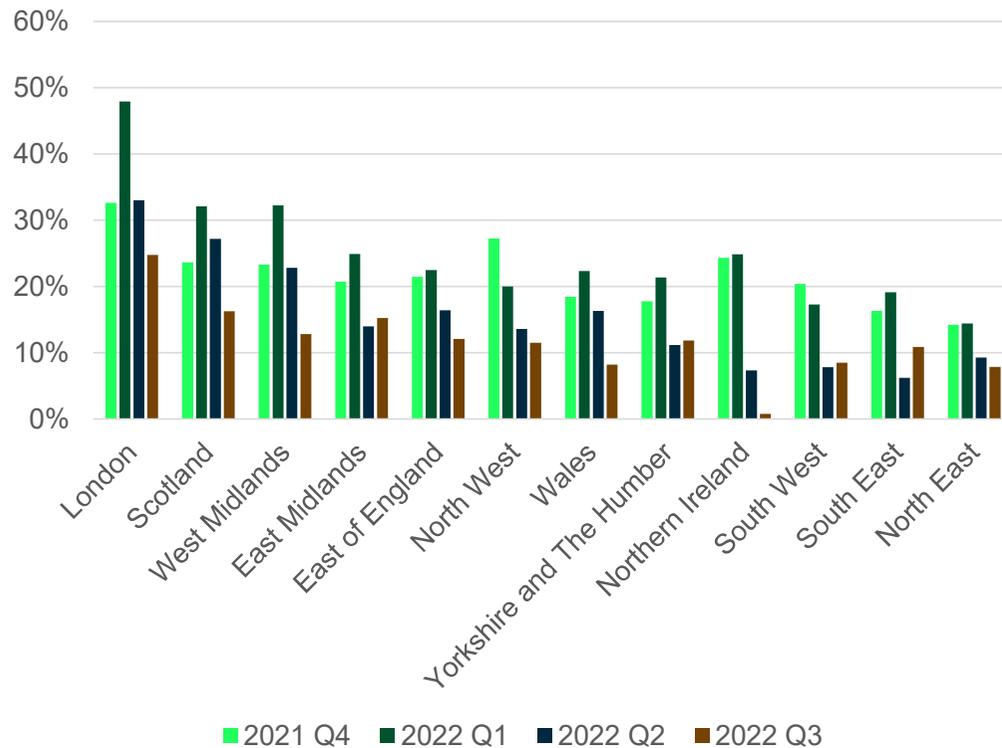
Source: Sage, Smart Data Foundry, ONS, Cebr

## Smaller businesses are more affected by rising overheads

- Breaking down overheads data by industry and business size shows how different types of businesses have been affected by rising prices. Businesses across all sectors and business sizes all saw overheads fall in 2020 as the pandemic led to lower prices and many businesses pausing production, followed by a rebound in 2021.
- In 2022, the services sector saw the fastest growth in overheads from the three broad sectors on average, with annual growth of 24.6%, 16.9% and 11.7% in Q1, Q2 and Q3, respectively. This comes despite the fact that the services sector has been less affected by rising energy and goods import prices than the production industry. Therefore, some of this rise in overheads in the services sector may be due to rising output affecting some semi-variable overheads. Indeed, GDP data shows that the services sector saw output rise in each of the first three quarters of 2022, while production output contracted.
- Looking at overheads by business size shows that the smallest businesses have tended to see the fastest overheads growth in 2022. In Q3, nano businesses (XXS) reported overheads standing 14.5% higher than a year earlier, compared to 12.5% for small (S) businesses. Very small businesses may be more exposed to inflation as they may have less bargaining power with their suppliers, which would help them negotiate lower prices.

# Prices: overheads by region

Annual growth in average nominal overheads by UK region between 2021 Q4 and 2022 Q3



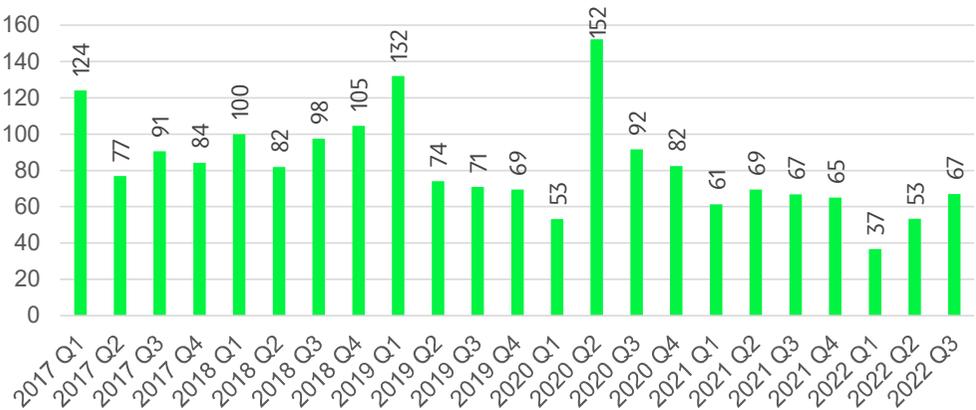
Source: Sage, Smart Data Foundry, ONS, Cebr

## London businesses see fastest rise in overheads

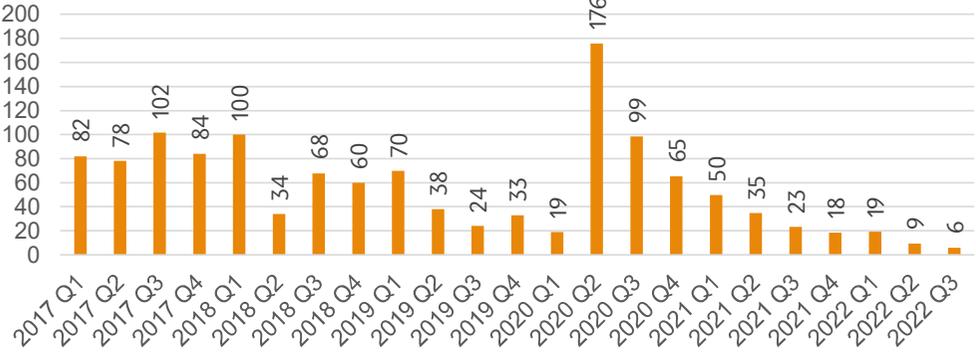
- Businesses across regions have seen overheads growing at different rates in 2022. Annual growth in overheads across all regions was particularly high in Q1 2022, as there was a coronavirus lockdown a year earlier which led to lower overheads.
- Overheads growth remained high in Q2 and Q3 2022, as rising prices meant that businesses purchasing the same quantity of inputs faced higher prices.
- In Q3 2022, businesses in London, Scotland and the East Midlands faced the highest growth in overheads at 24.8%, 16.3% and 13.5%, respectively.
- London, in particular, has seen fast GDP growth in 2022, with the latest ONS data showing 9.5% annual growth in Q2, suggesting the rising overheads may be due in part to businesses expanding, alongside rising prices. However, the East Midlands, known for its large manufacturing sector, is likely to have seen faster overheads growth due to rising input prices from factors such as energy.
- Comparatively, overheads for small businesses in the North East of England have seen less stark annual increases, especially during 2021 Q4 and 2022 Q1. This may indicate business costs such as rent have risen less in this region in relative terms.

# Resiliency: cash and debt

Real cash balances (seasonally adjusted, 2015 prices) index (Q1 2018 = 100)



Real debt position (seasonally adjusted, 2015 prices) index (Q1 2018 = 100)

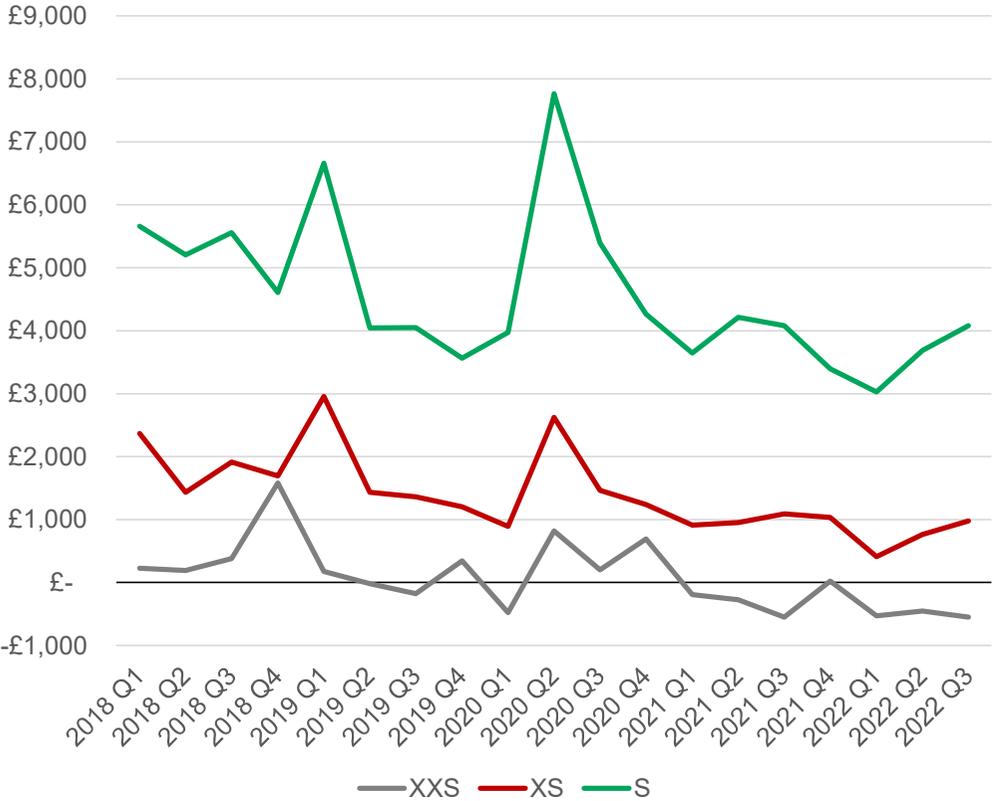


Source: Sage, Smart Data Foundry, ONS, Cebr

- At the start of 2022, small businesses saw lower cash balances (made up of current accounts and savings). In Q1 2022, seasonally adjusted real cash balances fell by 40.1% on average. However, by Q3 2022, these balances had recovered to the same level a year earlier.
- The fact that many businesses have been able to maintain their cash balances amid difficult trading conditions highlights the resiliency of UK small businesses.
- The higher interest environment in 2022 acts to encourage savings. However, with many businesses facing higher costs and weaker consumer demand, it has been more difficult to maintain cash balances.
- The Bank of England raised its base rate to 4.0% in February 2023, after being gradually raised throughout 2022 from 0.25% at the start of the year. While encouraging saving, this also disincentivises businesses from taking out loans. The impact of this is clear in the data showing the use of debt by small businesses.
- In Q3 2022, credit card and other debt balances for small businesses stood 75.0% lower than a year earlier. This suggests that few businesses are borrowing to invest in equipment such as technology or machinery, which is likely to be due to concerns about the UK macroeconomic environment.
- Though some businesses will be struggling amid the more challenging macroeconomic environment, the debt position data also highlights the fact that very few are needing to borrow to deal with any cash flow issues. This highlights both the resiliency of small businesses, but also the fact that time to pay is improving among small businesses.
- Tighter credit conditions are also feeding into the falling real debt position. The latest FSB Small Business Index shows that of the small businesses that applied for credit in Q4 2022, 44.1% had their loan approved, down from 46.2% in Q3. Aside from Q1 2022, the last time this share was smaller was in Q4 2013.

# Resiliency: cash by business size

Average real cash balances (seasonally adjusted, 2015 prices) by business size



- Cash balances by business size data highlights how the smallest businesses often struggle to maintain a healthy level of cash in their accounts.
- The average nano business (XXS) in the dataset had -£552 in their bank accounts in Q3 2022 (after adjusting for inflation and seasonality). This highlights how the finances of these businesses have become more fragile in recent years.
- Meanwhile, real cash balances of small (S) businesses stood at £4,079 in Q3 2022, the same level as a year ago.
- Looking at the data by industry, real, seasonally adjusted cash balances in the services sector were lower than in industry in Q3 2022 at £1,411. This was also 9.1% lower than a year earlier.
- Cash balances in the heavy industry sector were 23.7% higher than a year earlier in Q3 2022 at £1,814. This highlights an increased resilience for these businesses.

Source: Sage, Smart Data Foundry, ONS, Cebr

# Resiliency: time to pay

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



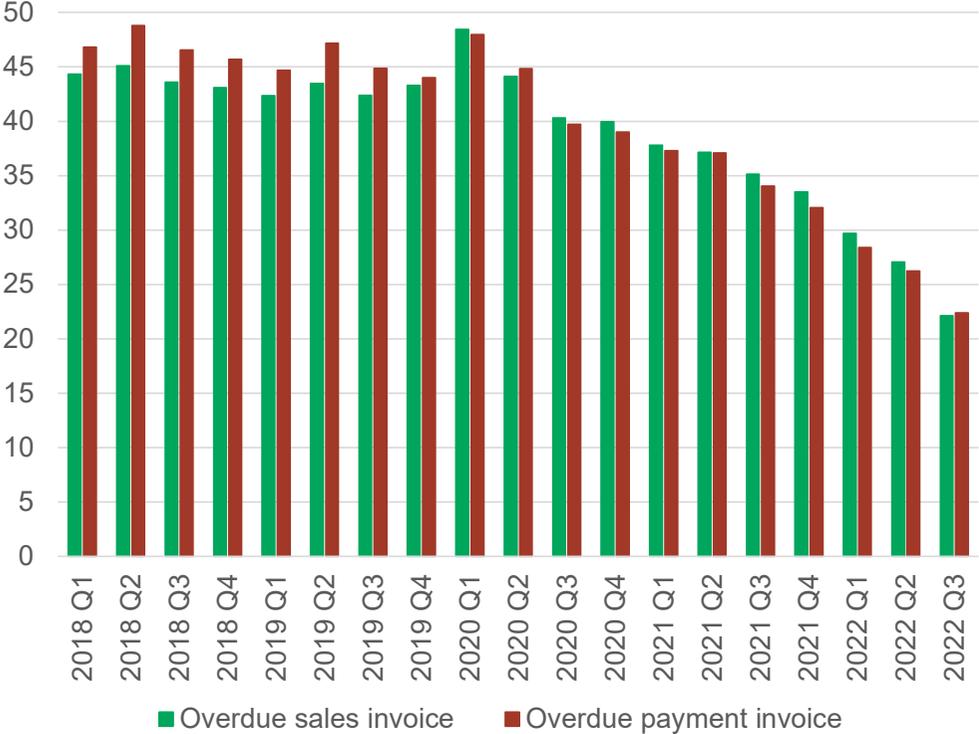
Small businesses show a sustained period of increased resilience between Q1 2018 to Q3 2022, with the average number of days to pay an invoice dropping by 12.5 days.

- The average number of days small businesses took to pay an invoice was 24.2 in Q3 2022 while the average days to a payment being received was 23.4 days. This marked an improvement from the preceding quarter. In fact, since Q1 2020 the average days to pay has decreased in every quarter signalling an increased resilience from small businesses in the face of both the pandemic and the cost-of-living crisis in the UK.
- Improvements in days to pay show small businesses are able to meet their financial obligations. This comes as data shows overheads have increased dramatically over the last two years and though this will hurt businesses their ability to meet their obligations to pay invoices has only increased over this time.

Source: Sage, Smart Data Foundry, ONS, Cebr

# Resiliency: late payments

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



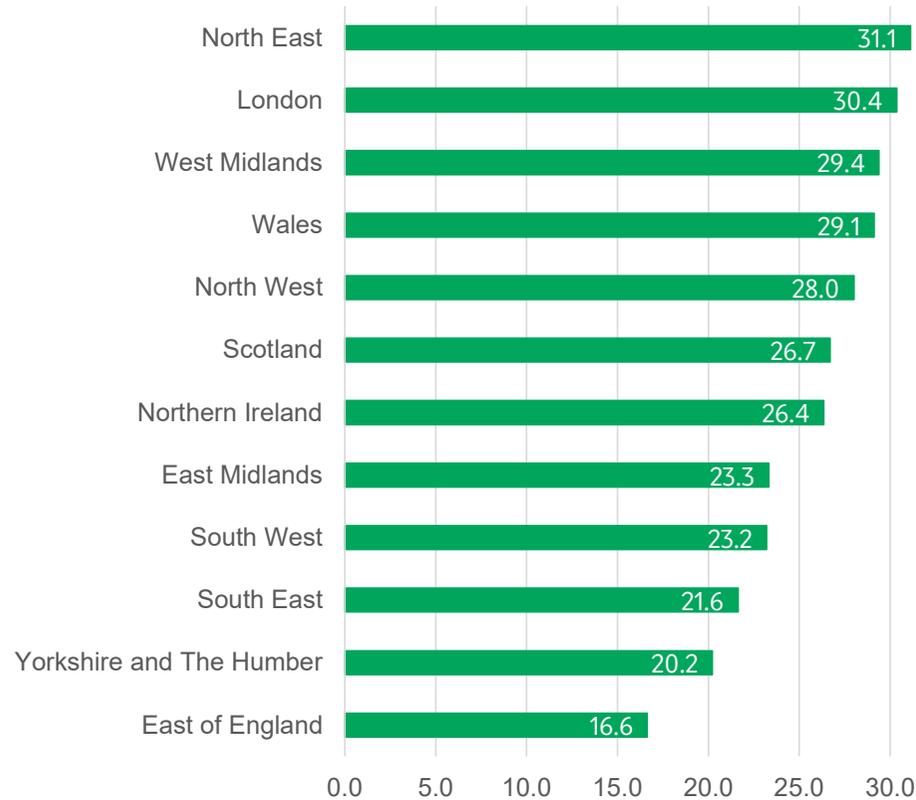
Source: Sage, Smart Data Foundry, ONS, Cebr

Since the initial impact of the pandemic, the average number of days an invoice is overdue has shown a continual period of improvement in small businesses. The overall share of invoices which are late has stayed stable between 2018 and 2022 at roughly 43%.

- The average number of days small businesses were late to pay an invoice, for those which were overdue, was 22.4 days in Q3 2022. This marked a significant improvement on the beginning of the year, which saw an average of 28.4 days in Q1 2022, as well as a much better result when compared to Q1 2018, which saw an average value of 46.8 days.
- In every quarter since the initial impact of the pandemic in Q2 2020, the average number of days a small business is overdue on their invoice, when they are overdue, has improved in every quarter. The largest annual improvement occurred in Q3 2022, our most recent quarter of full data.
- These results indicate small businesses have improved their ability to both collect payments and manage outgoings more effectively. This suggests the implementation of better credit control practices as well as an improved relationship between businesses and their customers. Both technology and awareness will likely be key factors in driving this improvement. Furthermore, amid times of economic uncertainty, businesses may be trying harder to collect the payments they are due

# Deep dive – late purchases by region

Fall in average number of days overdue to pay invoice per small business (Q1 2018 vs Q3 2022), by UK region



Source: Sage, Smart Data Foundry, ONS, Cebr

The North East shows the greatest improvement in the average number of days overdue small businesses were late to payment between Q1 2018 and Q3 2022.

- In all UK nations and regions, small businesses have seen significant improvements in the average days to pay an overdue invoice over the past four years.
- Since Q1 2018, the average number of days to pay an overdue invoice by small businesses in the North East reduced by 31.1 days, to average 22.0 days in Q3 2022.
- The smallest fall in average days is observed in small businesses in the East of England. However, at 39.0, this region saw the lowest regional result recorded in Q1 2018. Moreover, in Q3 2022 small businesses in the region recorded an average overdue period of 22.3 days, which was just below the UK average in Sage's data (22.4 days).
- Consistent cash flow is vital for performance and profitability. Improvements in the overdue period will enable small businesses to invest in growth opportunities as well as ensure they meet financial obligations such as paying their own bills and workers' salaries on time.



# Methodology

# Methodology and data

- Seasonally adjusted data is calculated using a central moving average, which adjusts quarterly data based on a quarter's historical strength/weakness to allow for a better quarter-on-quarter comparison.
- Earnings before interest, taxes, depreciation and amortization (EBITDA) is a common measure of business performance. It was derived as  $EBITDA = Revenue - Expenditure - Overheads$
- Within Sage's data around a third reported their net margin position. A positive net margin is defined as 10%+, while a negative net margin is defined as less than -10%, a firm breaking even falls within the -10% to 10% net margin cohort.
- 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).
- The Q4 financial data has been restricted to VAT-registered companies, using SAGE for VAT, who have up-to-date VAT returns to the end of Q4 2022 (just under 10% of all companies).
- In estimating Q4 2022 data for all small businesses, Cebr has forecasted the quarterly growth rate using our subsection of VAT-registered companies, assuming growth rates of the larger business sample will follow a similar trend.

# Our small business sample

- This report looks at data from over 300,000 small businesses. In Q3 2022, these businesses contained the following demographics.

## Size

- 30% were small (S) businesses (average annual revenue greater than £200,000).
- 36% were extra-small (XS) businesses (average annual revenue greater than £50,000 and less than or equal to £200,000)
- 34% were nano (XXS) businesses (average annual revenue less than or equal to £50,000)

## Region (of the 94% of businesses for which we know the region)

Region	South East	London	Yorkshire and The Humber	North West	East of England	South West	West Midlands	Scotland	East Midlands	North East	Wales	Northern Ireland
Share	14%	10%	10%	10%	10%	10%	10%	9%	7%	5%	4%	3%

## Sector (of the 46% of businesses for which we know the sector)

- 28% were in heavy industry
- 21% were in light industry
- 51% were in services

# Contact.

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