The effect of change and unpredictability on small businesses in the UK

A report for O_2 Business

October 2020

This report was produced by the Centre for Economics and Business Research (Cebr) for O_2 Business.

Executive Summary

- Small businesses are particularly vulnerable to swings which affect business performance, such as shifts in demand and consumer confidence, economic downturns and unexpected events such as poor weather and key staff resigning.
- To gain insight into the highs and lows that small businesses experience throughout the year, this study analyses 'non-seasonally adjusted' data for a range of indicators. In addition, a survey of 500 small businesses owners was commissioned by O_2 Business to understand what impacts these swings in small business performance throughout the year can have.
- The most common month for peak activity is March, which coincides with the UK fiscal year-end. This suggests that many companies intensify their efforts to meet targets and improve performance 'in time' for year-end. Another common peak period is October, when businesses and consumers accelerate their activity in preparation for the festive season.
- Winter months are a quiet period for many sectors, particularly manufacturing and the hospitality sector. August is another common quiet period, where a slowdown in activity coincides with the summer holidays.
- Annual swings in household expenditure have remained relatively stable across 2004 to 2019 with an average rate of volatility of 7.5% (excluding 2008 which was 1.1%). Discretionary spending on areas such as clothing and footwear, restaurants and hotels and general household goods have greater volatility through the year than 'essential' spending on areas such as education and health.
- For small retailers, 2019 was the most volatile sales year since 2014. Small retailers saw a 32% swing between the high and low month in 2019. Overall retail sales have been on a steady increasing trend since 2013.
- Orders data indicate that manufacturing sectors may find it difficult to offset monthly swings in domestic orders with export sales, as their peak export months tend to occur close to peaks in domestic demand.
- Data on input prices show that materials costs tend to rise the most in Q1, while fuel costs swing upwards in Q4. The price of B2B services tend to rise the most sharply in Q2.

Executive Summary

- The summary of the survey below is with respect to results for 2019. The impact of 2020 is discussed on the following slide.
- Unnecessary fixed or inflexible business costs can hamper the performance of small companies, and hinder their ability to adapt to peaks and troughs in activity throughout the year. The survey findings show that on average inappropriate fixed-term contracts represent 16.2% of monthly business costs.
- The survey found an average of 35.4% of small businesses agreed that their phone costs remained the same even when headcount falls, representing a significant fixed cost.
- Changes to government policy and disruptive weather are the most common unanticipated factors that affect small business performance.
- Local competition impacted small businesses in the architecture, engineering and building sector the greatest, with 6.0% of turnover being affected compared to an average of 4.2% across the balance of sectors.
- Small businesses had a staff turnover rate of 14.2%, with businesses in the architecture, engineering and building sector experiencing the greatest rate at 18.1% and manufacturing and utilities the lowest at 11.0%.
- The most commonly cited reason for staff leaving was that the employee was ‘seeking opportunities elsewhere’ (60.6%) followed by ‘employees changing careers’ (28.3%).
- From when an employee gives notice, it takes an average of 13.5 weeks (3.1 months) to fully replace them and have their replacement be fully efficient in their role. This is greatest in IT and telecoms, taking 20.3 weeks (4.7 months).

Executive Summary

- 2020 has been a very tumultuous year, with GDP falling 20.4% in quarter two. COVID-19 and the subsequent social distancing and lockdowns has cause significant headwinds to businesses in the UK. Although some recovery occurred in June, July and August, monthly GDP by the end of August was still 9.2% below that of February.
- Given small businesses typically have smaller cash reserves for emergencies than larger organisations, the economic shutdown has likely impacted them disproportionately.
- The survey revealed that 71.9% of small businesses that have been negatively affected by unanticipated factors in 2020 cite COVID-19 as the most important explanation. This is owing to a breakdown in their supply chains, closure of business due to lockdown and inability to facilitate social distancing and having to furlough staff.
- Small businesses have also found that replacing staff takes longer in 2020 than it did in 2019. The average time taken to fully replace a staff member has increased by 2.1 weeks to 15.6 weeks total (3.6 months).
- This peaks for those in the financial sector at 28.0 weeks (6.5 months), up from 13.5 weeks (3.1 months). On a relative basis, businesses in the sales, media and marketing sector have faced the greatest increase from 6.1 weeks (1.4 months) to 21.0 weeks (4.8 months) – an increase of 343%.

Introduction

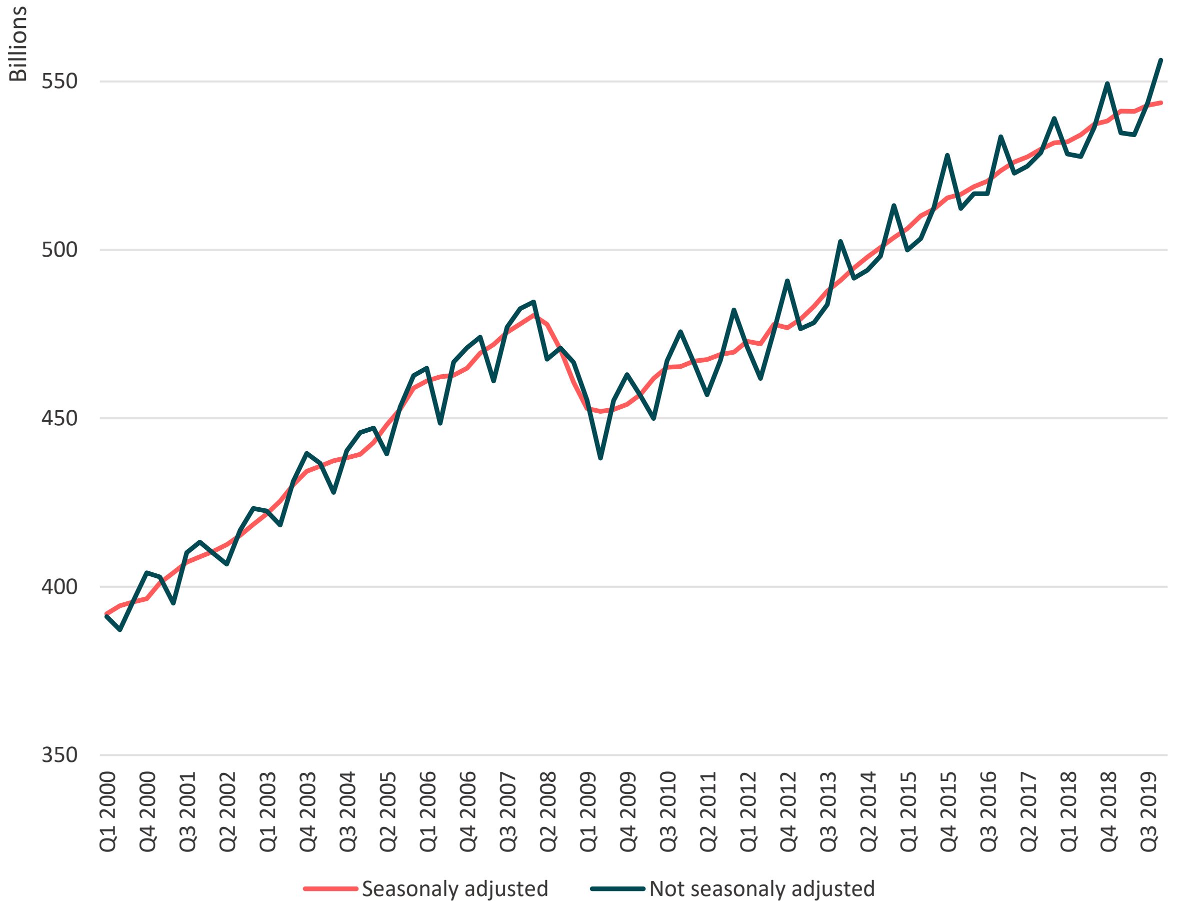
Overview of the study

- This study is a refresh of Cebr's previous 2015 report for O_2 on the effect of change and unpredictability on small businesses in the UK. The objective is to gain insight into the highs and lows that small businesses face throughout the year.
- Small businesses, as a function of their size, tend to be more vulnerable to shocks and unanticipated events than larger businesses. This is due to a range of factors such as a reduced ability to employ economies of scale and having smaller cash reserves help weather uncertain times.
- As a result of this, small businesses are often more susceptible to shocks in the economy arising from shifts in demand, changes in consumer confidence, economic downturns and internal issues such as staff turnover and disruptions in their supply chains.
- To examine these issues, this study analyses non-seasonally adjusted data covering:
    - Business costs;
    - Demand and competition; and
    - Staff turnover.
- In addition, Censuswide was commissioned to conduct a survey of 500 small businesses in order to highlight the impacts of these swings in the business environment throughout the year. This survey provides primary data to showcase issues faced by small businesses.
- It is worth noting that given that this is a refresh, data has been updated holistically. This means that many of the datasets used throughout this iteration are the most recent available. This may mean that the data itself has been updated retroactively such that a data point for, 2005, for example, in this report may not necessarily match that in the previously report, despite being the same metric. Where appropriate, this report updates figures to 2019.

Seasonal adjustments mask volatility throughout the year

- Seasonal adjustment is often applied to macroeconomic variables to ‘filter’ out the variation throughout the year. This variation is a result of:
    - Seasonal factors; events occurring at a given point in the year and that repeat yearly such as Christmas.
    - Trend factors; the general direction of the data.
    - Cyclical factors; regular fluctuations unrelated to calendar effects.
- The reason macroeconomic variables are adjusted is that it allows users of the data to view the ‘underlying’ trends which are used within analyses and policy planning.
- This adjustment, however, masks the volatility seen within years.
- The figure opposite highlights this by comparing non-seasonally adjusted (NSA) and seasonally adjusted (SA) UK GDP between 2001 and 2019. As can be seen, the trend is the same; generally upwards, with a contraction during the 2008 financial crisis. However the SA trend smooths the troughs and peaks seen each year.

UK quarterly gross domestic product level (GDP), constant prices £bn, 2000-2019



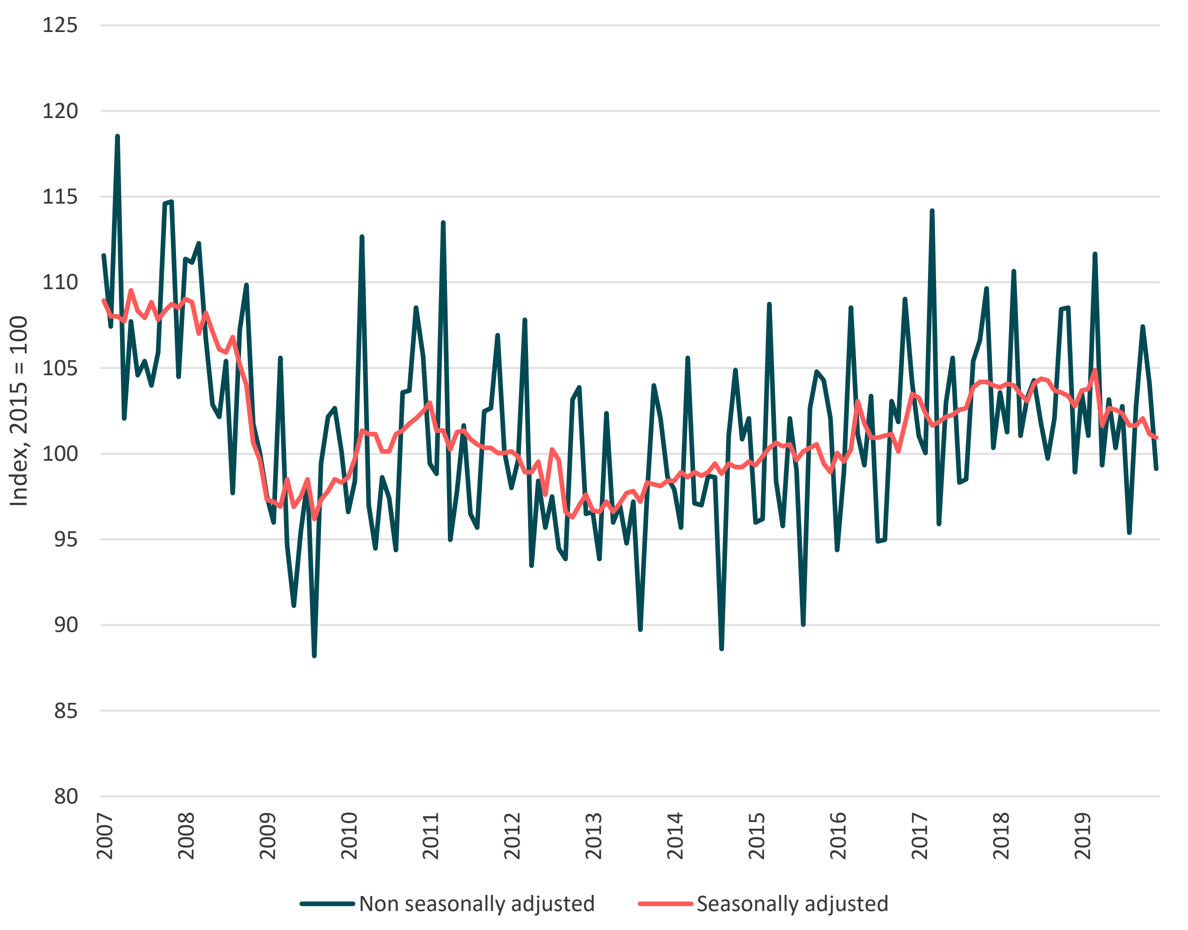
Source: Office for National Statistics and Cebr analysis

2020

Volatility within sectors is greater than at the economy-wide level

- Several factors influence the volatility of the data being measured. One primary factor is size. The GDP of an economy, given it measures everything, tends to even itself out with respect to volatility. This is because as one part of the economy fluctuates up, it may be evened out by another fluctuating down.
- A second factor is the frequency of data. The previous GDP chart was a quarterly series. Monthly data will capture more volatility as it picks up additional swings which may get evened out when summed to quarterly levels.
- The figure opposite compares the SA and NSA series for the UK's monthly Index of Production, covering the mining, manufacturing and utilities sectors.
- It is clear the volatility is far greater, even in the SA series. This is a result of the two series being measured monthly and that the size being measured is much smaller than total GDP.
- This serves as an illustrative example of the volatility that businesses face throughout the year.

UK monthly Index of Production, 2007-2019, index 2015=100

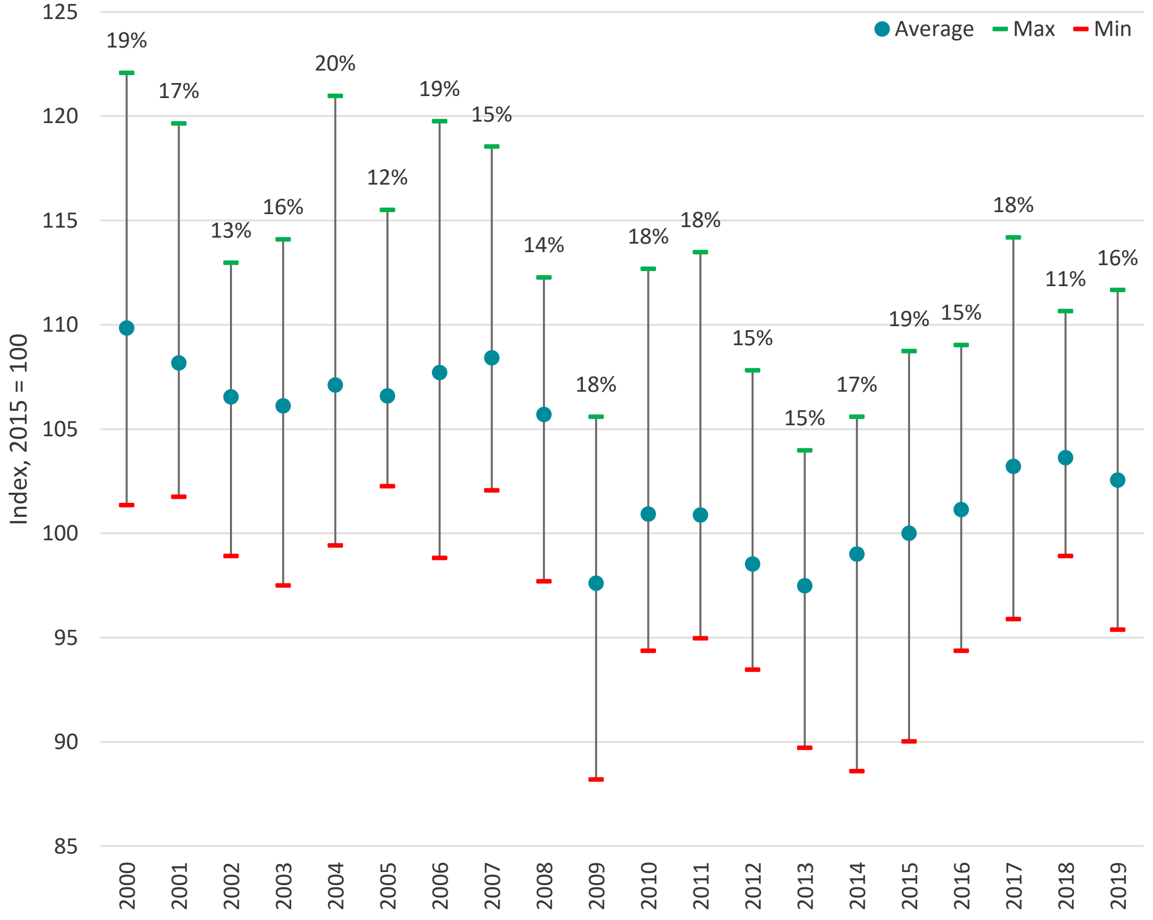


Source: Office for National Statistics and Cebr analysis

Error bars are another way to present volatility in data

- Error bars like those presented in the figure opposite express the spread of data for a given period. Spread of data is often presented as standard deviation, which expresses the average distance by which a datapoint deviates from the average.
- However, when discussing the variable conditions that businesses face, the average distance is not the only important variable; the largest distance from the mean is also worth noting.
- This highlights the extent of the volatility within a given period – in this case a year. The high/low bars in the figure opposite highlight this distance.
- Throughout this report, we also cite another metric – the rate of variability (ROV). This is the percentage figure above each high/low line. This percentage refers to the maximum minus the minimum, divided by the average. For the years with the greatest spread, this percentage is larger and vice versa.
- As can be seen, 2018 has the least variability, with an ROV of 11% and 2004 has the greatest with an ROV of 20%.

UK monthly Index of Production, annual averages and high/low monthly readings, 2000-2019, index 2015 = 100



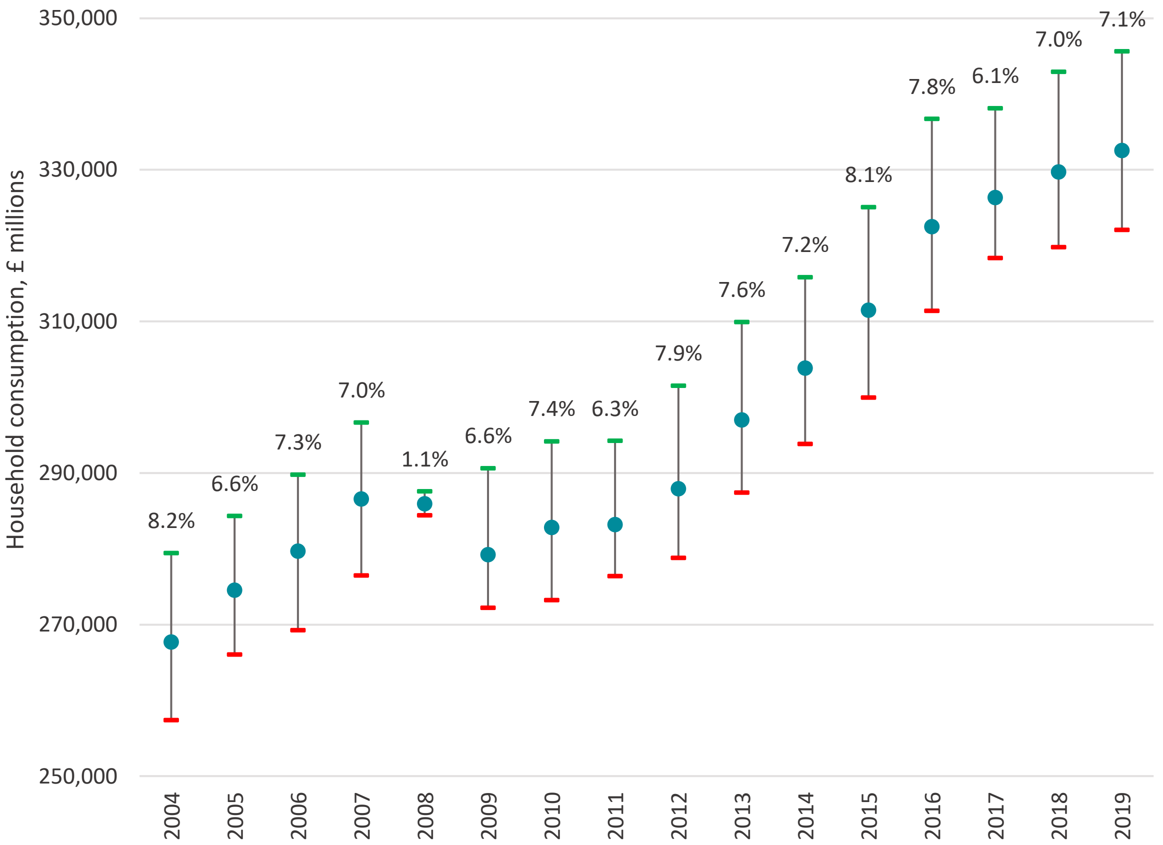
Source: ONS Index of Production and Cebr analysis

Factors affecting small business performance

Household consumption has a relatively constant variability year-to-year

- Throughout the period 2004 to 2019, household consumption volatility has remained relatively consistent year-to-year, bar 2008.
- The period started with an ROV of 8.2% in 2004 and finished with an ROV of 7.1% in 2019, with 2017 having the smallest volatility excluding 2008.
- 2008 saw the lowest level of volatility with an ROV of 1.1%. This very small rate is likely a result of the economic turmoil the UK was facing. During uncertain times, consumers tend to limit consumption as consumer confidence falls, minimising peaks and troughs within a given year.
- Typically, as consumer confidence grows and the economy continues to expand, the volatility of household consumption is also expected grow as variable spending increases throughout a year.

Quarterly volumes of UK household consumption, annual averages and high/low levels, £m constant prices, 2004-2019



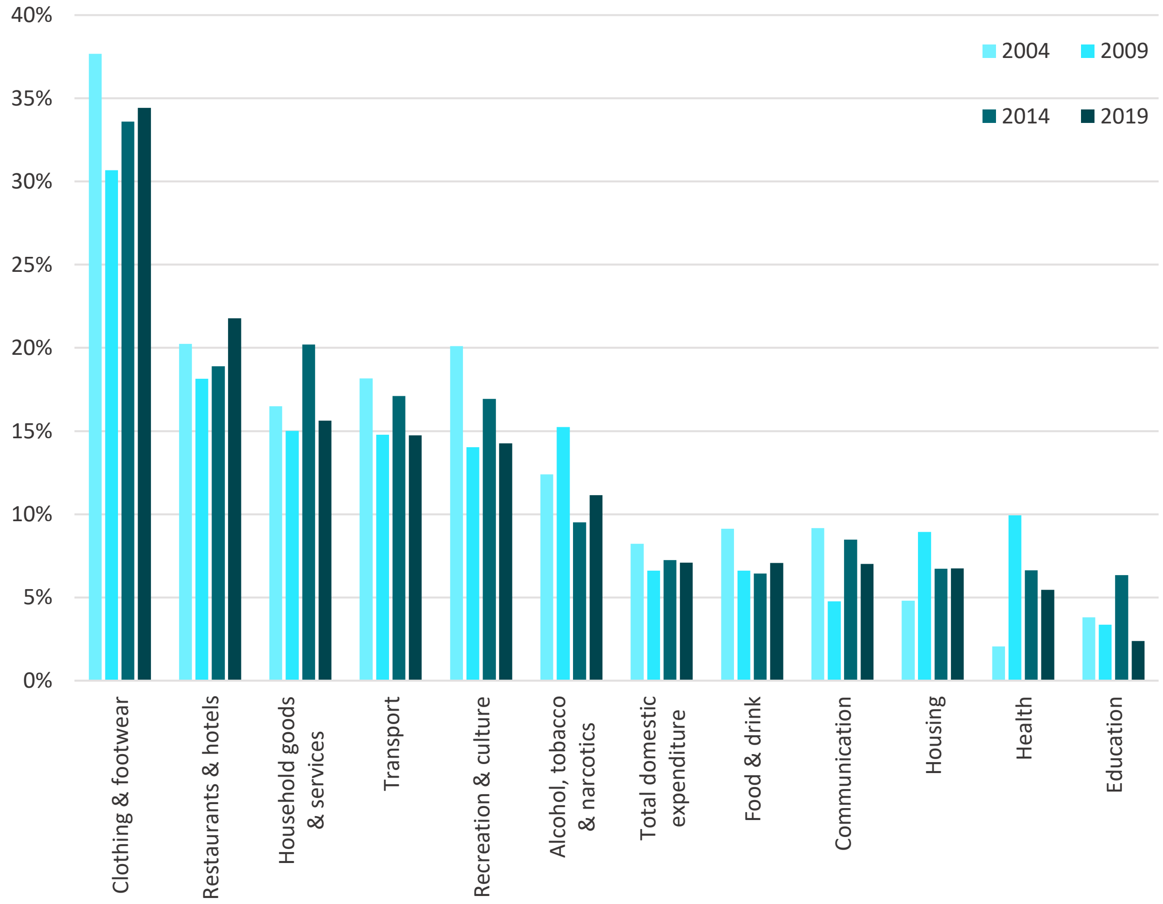
Source: ONS Consumer Trends and Cebr analysis

2020

Discretionary goods and services face the greatest variability

- Variability of consumer spending can be disaggregated further, highlighting that not all goods and services face the same volatility.
- 'Essential' spending has the least volatility given its importance. As seen in the figure opposite, categories with the least volatility across all four years are education, health, housing and communication.
- On the other end of the spectrum, the figure shows spending on clothing & footwear and restaurants & hotels face the greatest volatility.
- Within each year, consumer spending peaks in Q4 for almost all categories. There are some notable exceptions to this:
    - Purchase of automotive vehicles peaks in Q1;
    - Water supply and gas & electricity peaks in Q1; and
    - Restaurants and cafes peak in Q3.
- Restaurants and cafes peaking in Q3 follows a general trend of consumer spending during summer months as cultural services (sports admissions, cinemas, museums and theatres etc.) also peak in this period.

Variability in quarterly consumer expenditure on given consumption categories, volume terms, 2004-2019

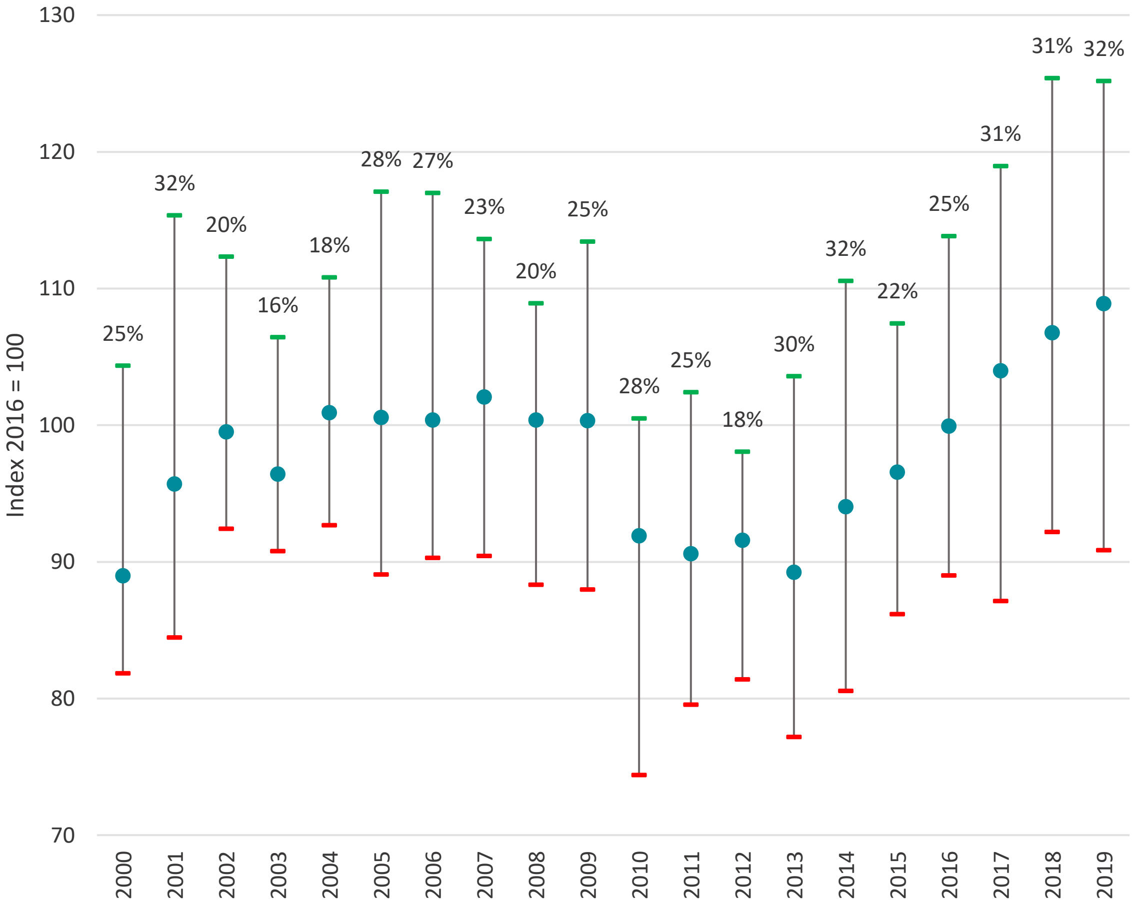


Source: ONS Consumer Trends and Cebr analysis

Small business sales volatility has been on an upward trend

- As demonstrated by the previous figure and the figure opposite, consumer spending within the retail sector exhibits high volatility throughout the year.
- Retail spending is driven by seasonal trends. Since 1986, sales in November and December have accounted for approximately 19% of total sales each year. This emphasises how important festive sales can be to retailers, taking in one fifth of their entire years sales in two months.
- In 2019, small businesses recorded £133.4 billion of sales. The sector has seen continuous year-on-year growth since 2013, increasing from £109.1 billion.
- Volatility over the period has been increasing. In 2000, the ROV was 25%. This reached a low in 2003 at 16% from which it has been on a general upward trend, reaching 32% in 2019.
- 2019's lowest sales month was January at £8.5 billion. It's highest sales month was December at £14.6 billion – a difference of £6.1 billion.

UK monthly retail sales – small businesses, annual averages and high/low monthly readings, 2000-2019, index 2016=100

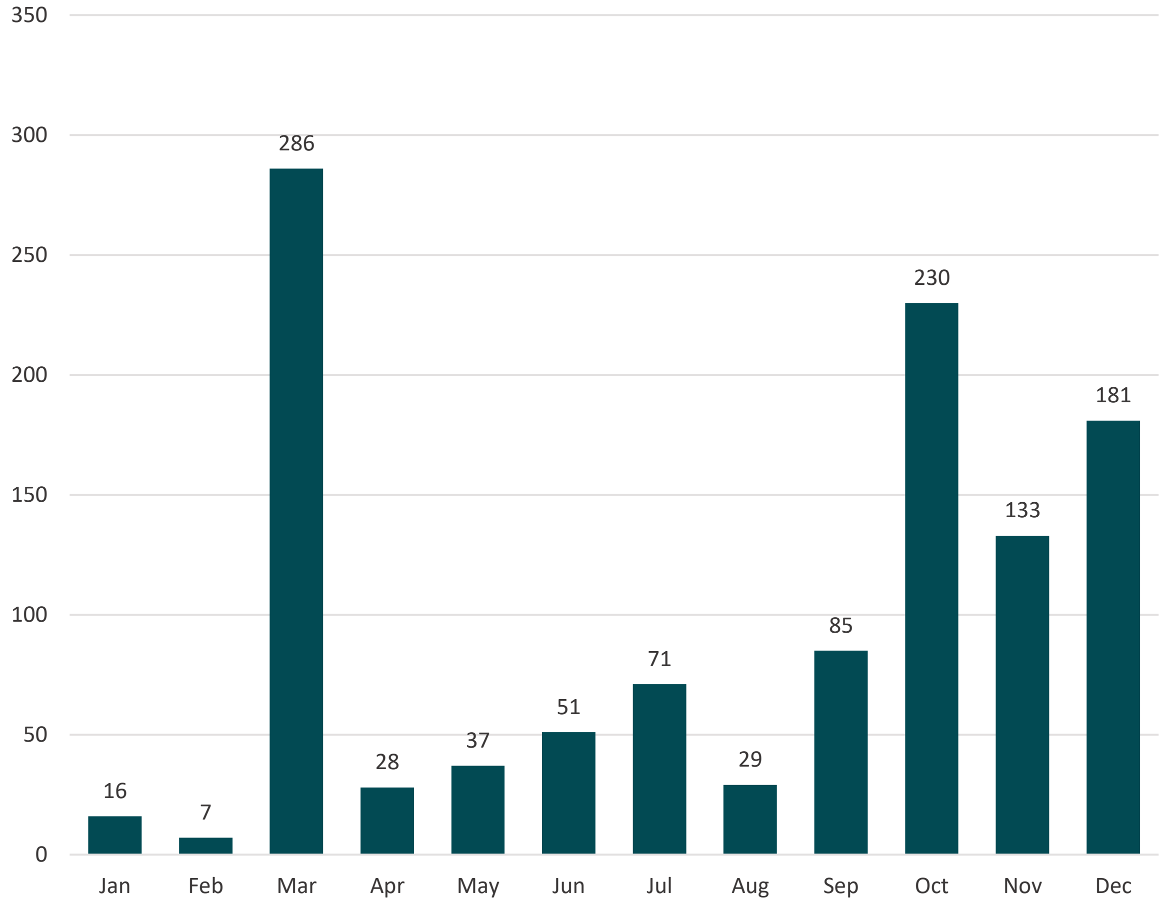


Source: ONS Retail Sales Bulletin and Cebr analysis

Many sectors see activity peak at financial year-end

- The time of year in which businesses see peak demand also depends heavily upon their sectors of operation. The chart opposite summarises data from 68 sectors over 2000-2016. It presents the number of times each month saw an annual peak or trough in sectoral turnover.
- The data edge for this and Slide 16 (overleaf)'s figure is 2016. This is due to a discontinuation of the data series by the ONS. The most recent data is for September 2017, but for this analysis, we require the last full year available to present the month in which peaks (or troughs) occur.
- Over this 17 year period, the most common peak in turnover occurs in March. This is the end of the fiscal year in the UK, suggesting that many companies work towards this artificial deadline, bolstering performance 'in time' for year end.
- Q4 also sees a significant number of annual peaks, likely as a result of the festive season accelerating purchasing activity.

Number of occasions when annual peaks in turnover fell in given month, 68 sectors, 2000-2016



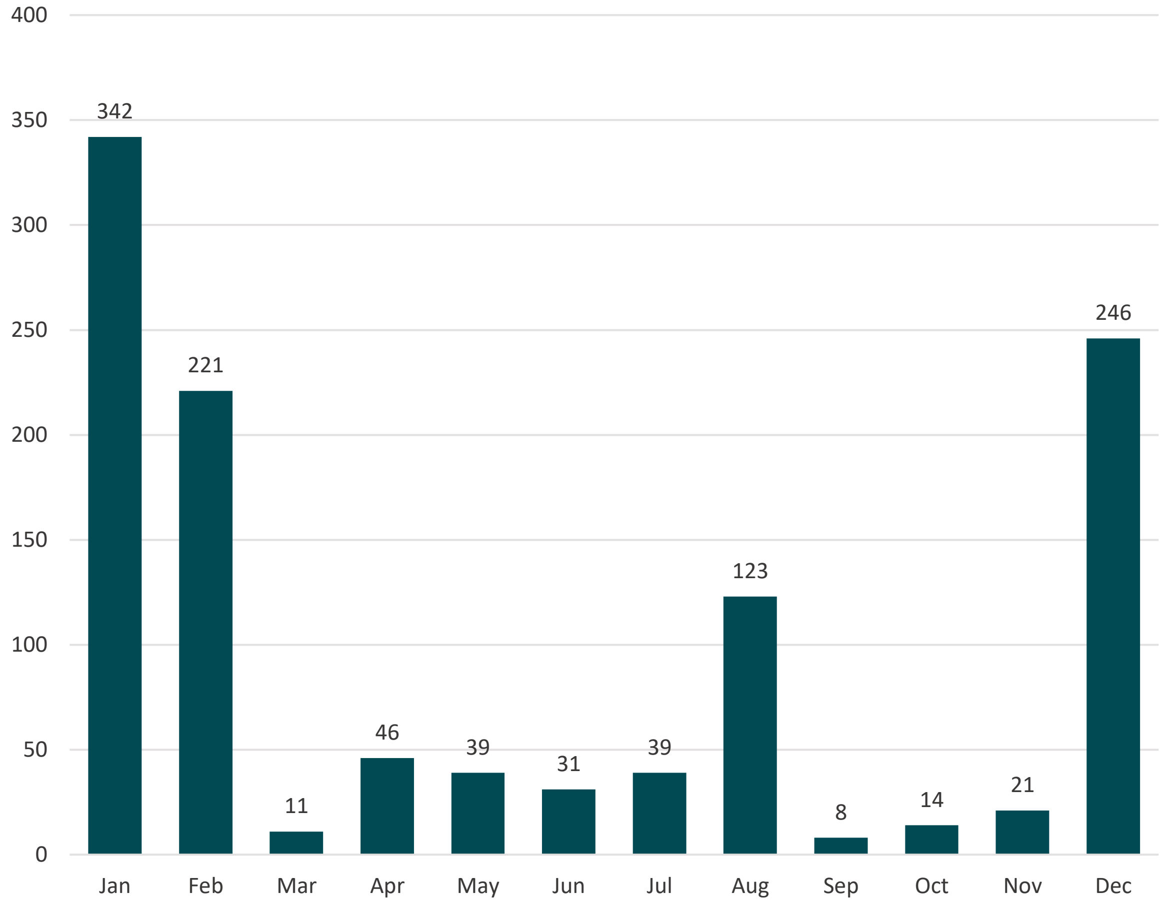
Source: ONS TOPSI and Cebr analysis

2020

Winter months see activity drop for many sectors

- Although December is a busy month for many sectors, it also represents a quiet period for many UK industries along with the winter months of January and February.
- Many manufacturing sub-sectors see their lowest monthly turnover accrue during January. This is also the case for the service sector broadly, with food and beverage services also seeing their lowest monthly turnover accrue in January.
- August is also a relatively quiet month for many sectors. This may be due to the seasonal trend of summer holidays, where many consumers reduce UK-based activity while on holiday overseas.

Number of occasions when annual troughs in turnover fell in given month, 68 sectors, 2000-2016



Source: ONS TOPSI and Cebr analysis

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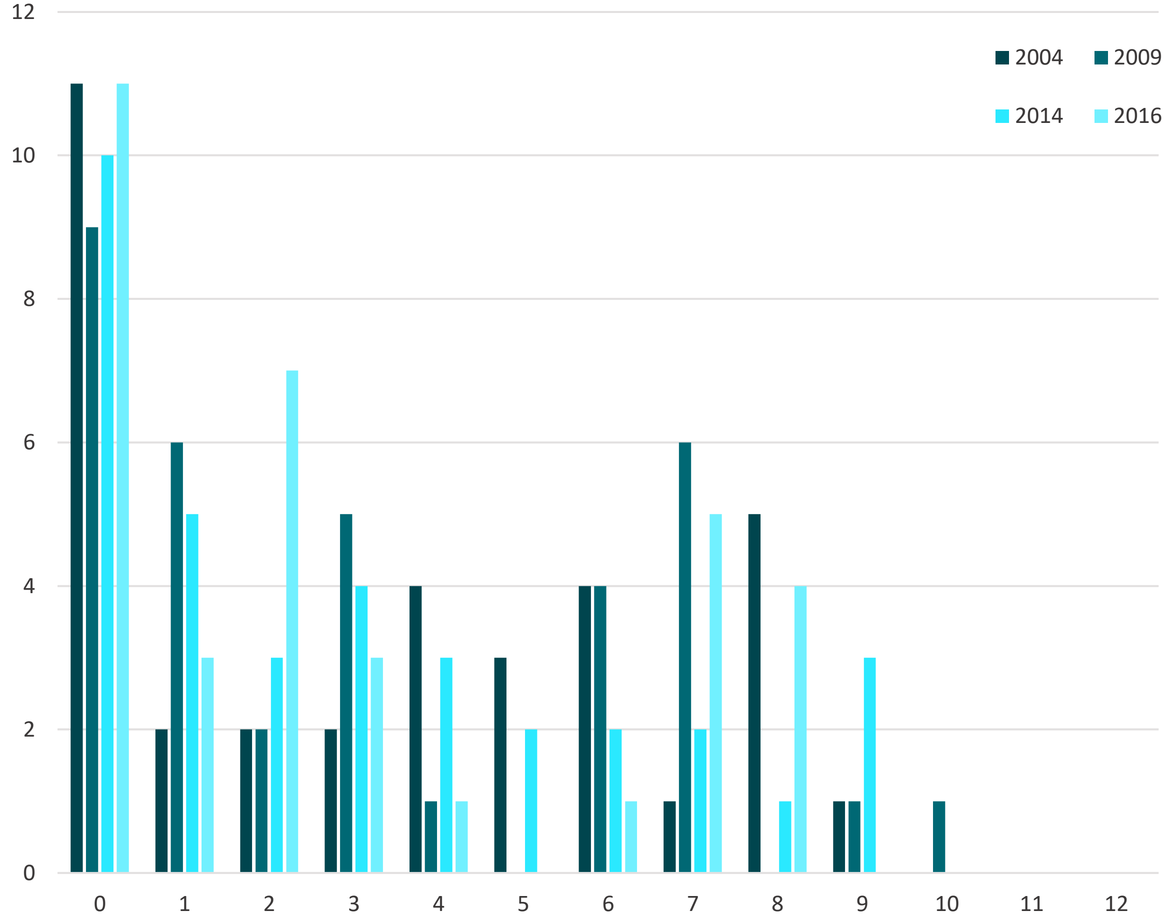
Exporting does little to offset volatility in manufacturing sectors

- We also sought to investigate whether selling to external markets allows UK manufacturers to 'smooth out' some of the variability in demand which is observed in their domestic markets.
- While at individual firm-level, diversified sources of demand will help assuage volatility, there is limited evidence of this at the sectoral level.
- Of the 35 manufacturing sub-sectors considered, in 2016 only seven accrue greater turnover from exports than from the domestic market:
    - Processing of fish and crustaceans;
    - Agrochemical manufacturing;
    - Petrochemical manufacturing;
    - Pharmaceutical production;
    - Computer, electronics and optical products manufacturing;
    - Aerospace manufacturing; and
    - Aerospace repair.
- As shown by the chart opposite, annual peaks in domestic and external demand typically occur in the same month. But there are instances where there is significant duration between them

Number of months between annual peak in domestic demand and annual peak in export demand, across 35 manufacturing sub-sectors, 2000-2016



Source: ONS TOPSI and Cebr analysis

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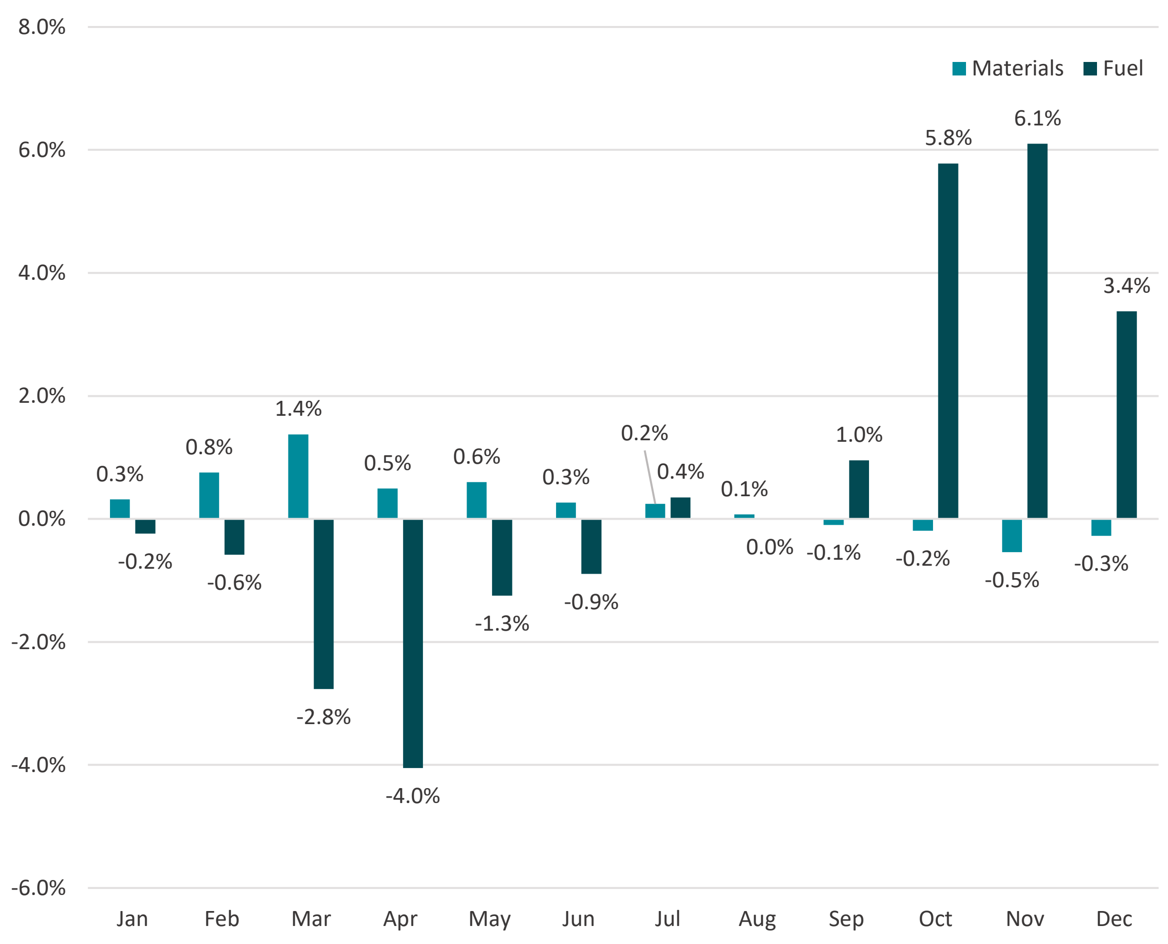
Factors affecting small business operations

2020

Fuel costs vary more significantly throughout the year than material costs

- The costs facing businesses also see sharp swings at different times of the year. The chart opposite sets out the typical month-on-month changes in industrial input prices, disaggregated into materials and fuel.
- Fuel price movements throughout the year are related to the seasonal patterns in fuel demand. In the run-up to the UK's winter season, heating demand places additional upward pressure on the costs of energy and fuels. This tends to cause strong price increases in October, November and December – by contrast, the spring and summer months tend to see fuel prices which are broadly flat, or falling.
- Material costs, on the other hand, are less volatile through the year, increasing by a max of 1.4% in March, and contracting by 0.5% in November compared to 6.1% and -4.0% for fuel.

Average month-on-month changes in industrial input price indices, 2000-2019

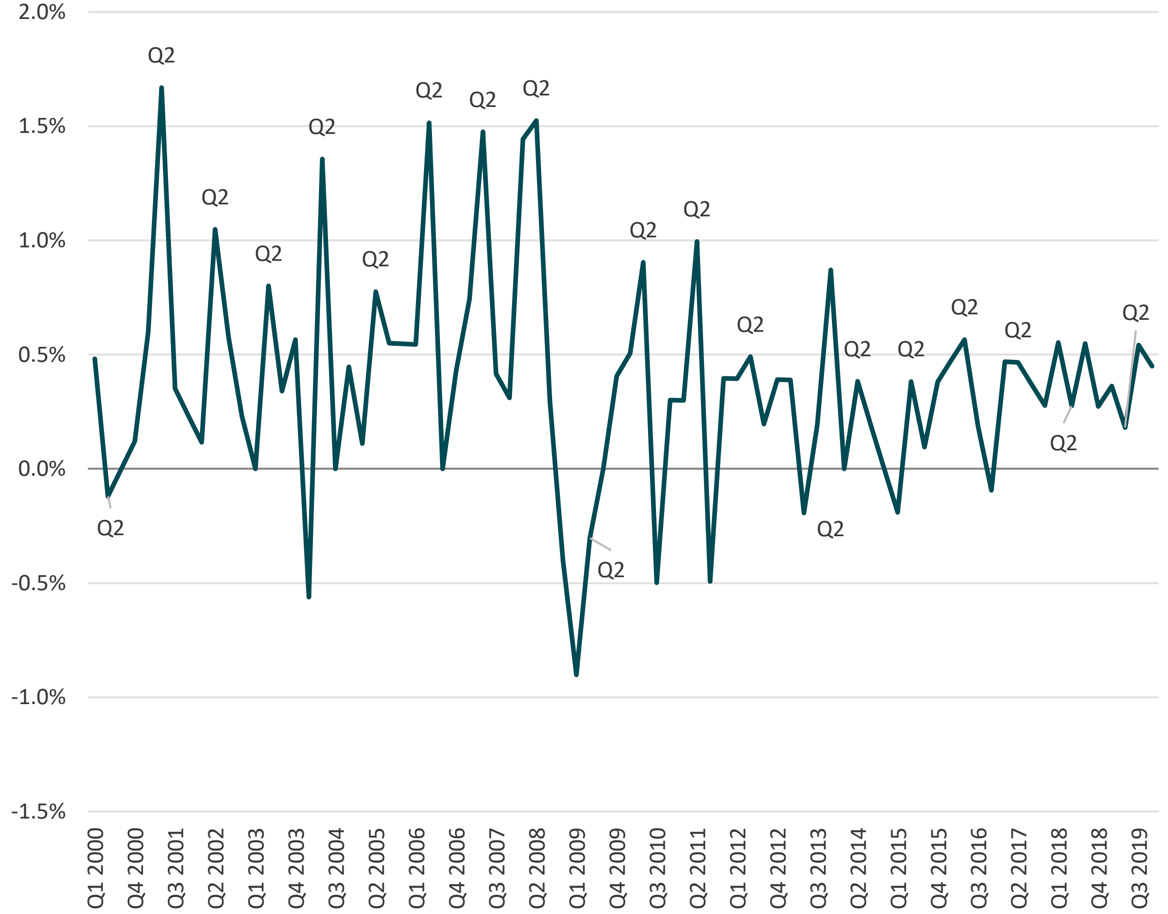


Source: ONS Producer Price Index and Cebr analysis

Service costs tend to spike in Q2

- When looking at UK firms’ B2B purchases from the services sector, seasonal patterns in the prices paid for these inputs can be observed.
- Taken on aggregate, the costs of B2B services tend to rise most sharply in Q2. As shown in the chart opposite, over the years 2000-2019 about 75% (16 of 21) of the ‘peaks’ seen in the quarterly inflation rate occurred during Q2.
- Over the period under analysis, average quarter-on-quarter inflation on the SPPI measure was 0.7% in Q2.
- This is higher than the 0.3% average seen in both Q1 and Q4, and well above the equivalent figure for Q3, which is 0.2%.
- It is clear that the volatility between quarters is decreasing, with the peaks and troughs closer together towards the end of the period presented compared to the start.

Quarter-on-quarter percentage change in Services Producer Price Index (SPPI), 2000-2019



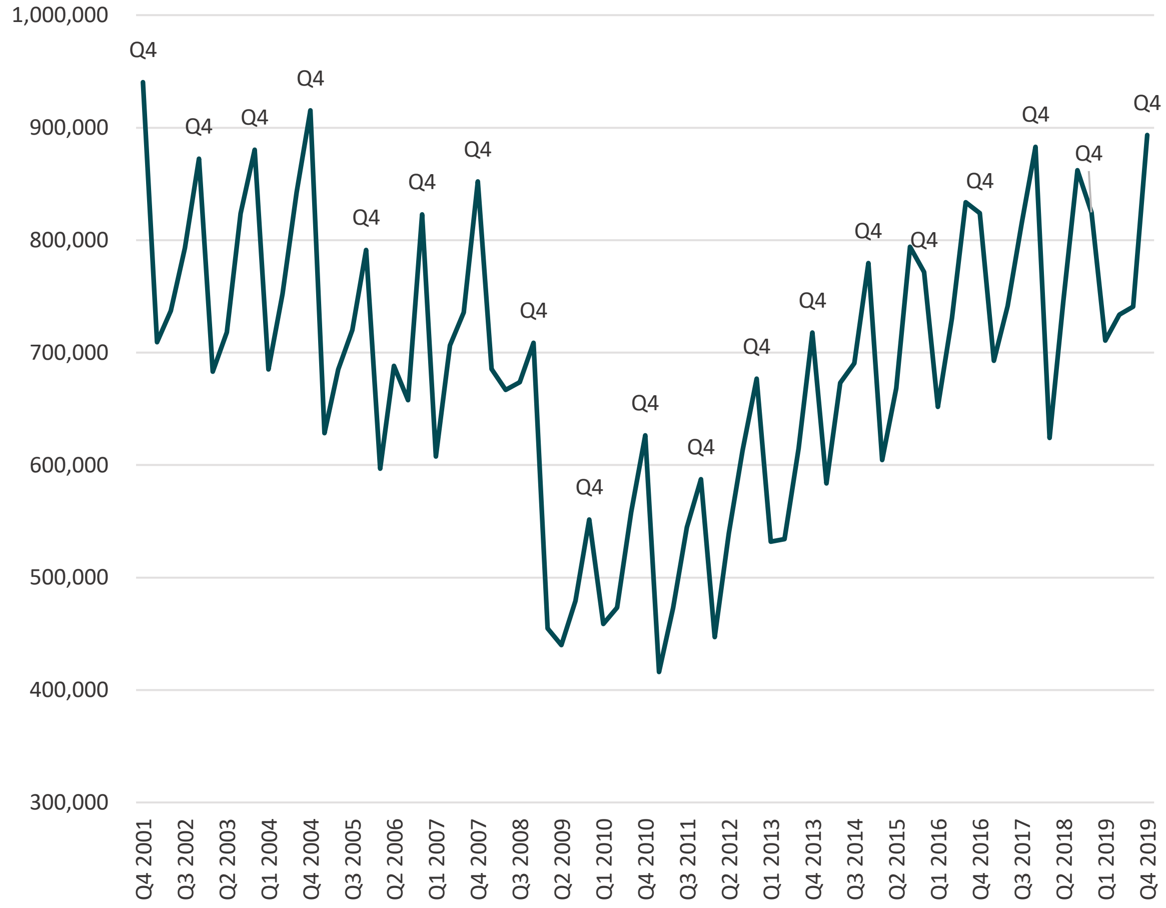
Source: ONS Services Producer Price Index and Cebr analysis

2020

Job transitions peak between Q3 and Q4

- There are also highly seasonal patterns in the dynamics of employees departing their jobs in order to take up new ones. The chart opposite sets out the number of employees, by quarter, who were working in a different job to the one they were occupying in the prior quarter.
- While some degree of this ‘churn’ takes place throughout the year, it can be clearly seen that the busiest time of year for such switching occurs between Q3 and Q4.
- This suggests that, on average, employees are more likely to depart their jobs at the end of the summer period, and are in-place in new positions by Q4.
- Since 2008, the number of job transitions has been on a generally upward trend, where by Q4 2019, the number reached approximately 893,000 – approximately the same level seen in Q4 2004.

Number of UK employees who changed jobs between last quarter and current quarter, Q4 2001 – Q4 2019

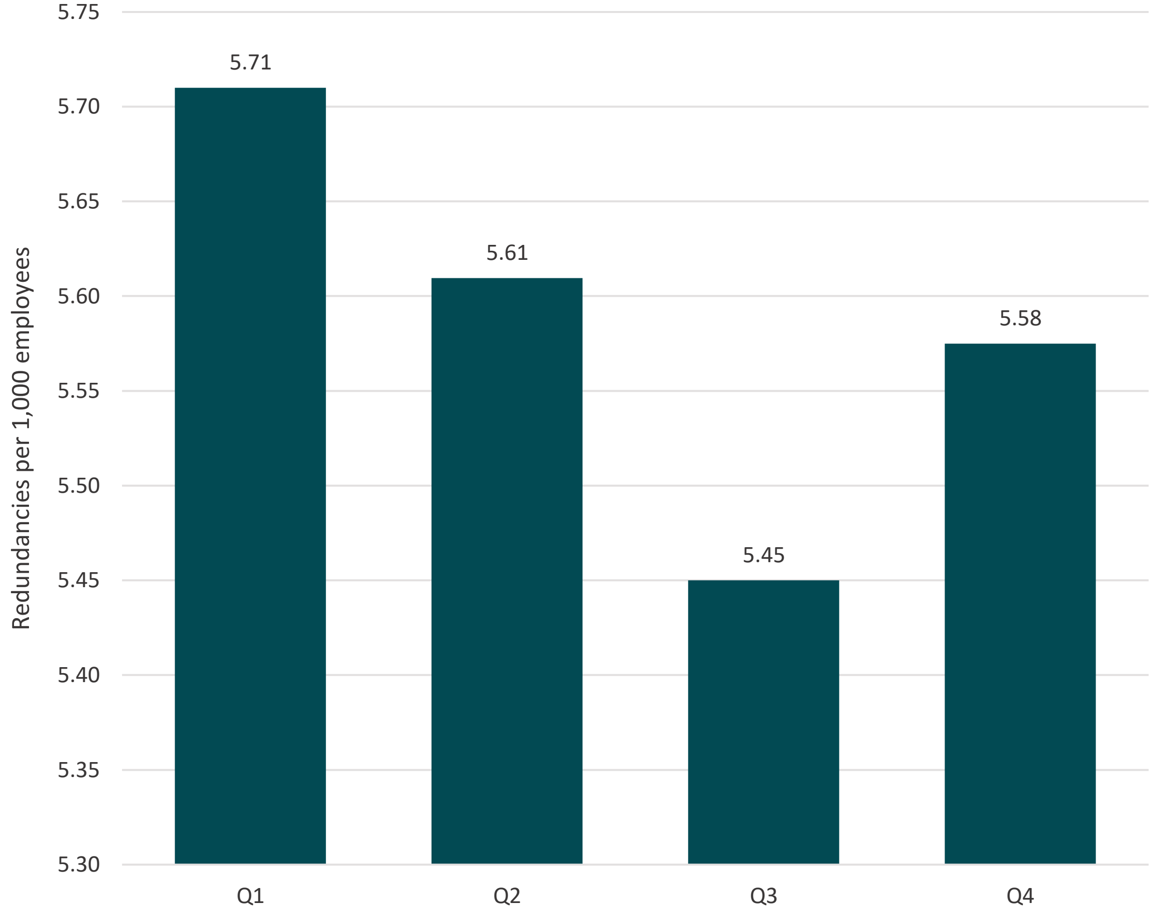


Source: ONS LFS Longitudinal data and Cebr analysis

Job redundancies peak in the first three months of the year

- The chart opposite shows the average quarterly 'redundancy rate' per 1,000 employees in the UK labour market for the years 2001 to 2019.
- Redundancies are highest in Q1, reaching 5.71 redundancies per 1,000 employees. This is 4.8% greater than in Q3.
- When presented in this way, this figure fails to capture the fact that the number of redundancies by year has been steadily falling since the beginning of the century. However, in light of the economic turmoil in 2020, this trend may flatline or reverse.
- In 2001, the average rate of redundancies per 1,000 employees in the UK was 7.4. By 2019, this had fallen to 3.8, a 48.1% decrease.
- Thus there exists volatility in the quarters when individuals are made redundant, but the rate at which this is occurring is decreasing overall.

Average quarterly redundancies in the UK per 1,000 employees, Q1 2001 – Q4 2019



Source: ONS and Cebr analysis

2020

Drivers behind fluctuations in performance according to small businesses

What are the drivers behind fluctuations in performance amongst small businesses?

- The previous sections demonstrate the extent to which small businesses experience peaks and troughs throughout the year in terms of demand, costs, and staff turnover. These are the main phenomena responsible for the ups and downs that small businesses experience.
- To understand the drivers of this observed variability in performance, it is necessary to ask small businesses directly about the factors that affect their firms over the year.
- In order to do this, O2 Business commissioned Censuswide to survey 500 small business owners across the UK. Small businesses are defined as those with between 1 and 50 employees – sole traders were excluded from the sample. The survey was conducted during October 2020. For the purpose of the direct refresh work, responses reflecting the 2019 business environment were used, owing to the anomalous nature of 2020. Responses reflecting the environment in 2020 were used for the supplementary work in the latter chapter of this report.

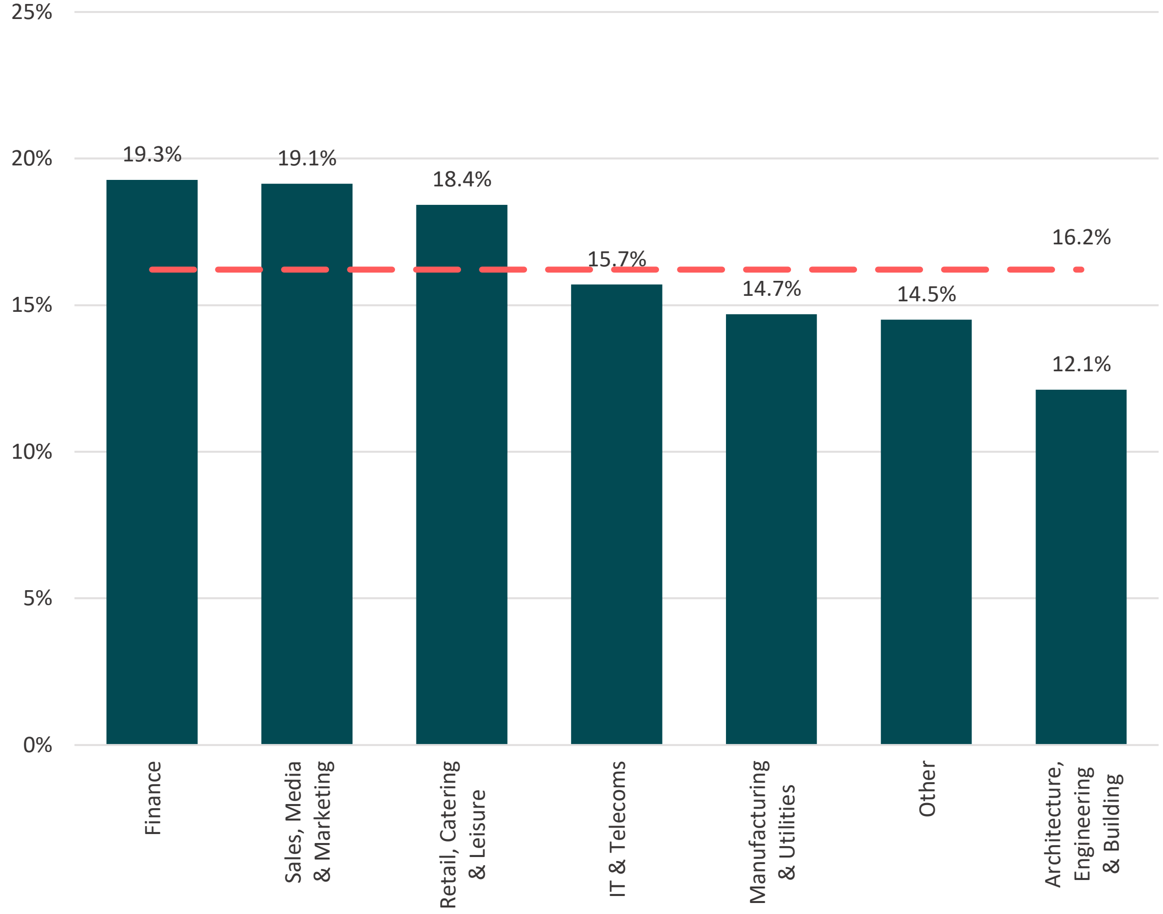
The survey asked questions covering three key areas:

1. Business costs – the extent to which small businesses have inappropriate fixed or inflexible business costs which limit the companies ability to adapt to peaks and troughs in activity throughout the year.
2. Demand and competition – how unanticipated local competition and sudden fluctuations in demand for the companies' products and services can affect the performance of small businesses.
3. Staff turnover – the reasons why staff leave the company, the rate of staff turnover and the length of time it takes for replacement staff to get up to speed. Long downtime periods when staff leave impose substantial costs and disruption to the operations of small businesses while placing additional burden on remaining staff.

Inappropriate fixed-term contracts account for 16.2% of monthly business costs

- Having flexible costs are one way which small businesses can navigate the volatility of the business cycle.
- Retaining fixed-term contracts that are no longer required can mean that business costs cannot be adjusted during periods when activity is unusually high or low.
- Results from the survey indicate that the average small business has unnecessary (i.e. no longer appropriate) fixed-term contracts equivalent to 16.2% of their monthly costs. This is markedly highly than the average of 2.6% reported by the previous survey in 2015.
- Inappropriate fixed-term contracts are the highest in the financial sector, accounting for 19.3% of total monthly costs. This is followed closely by sales, media and marketing sector at 19.1%.
- Previously, the sector (of those surveyed) with the highest proportion of fixed-term contract costs was IT & Telecoms with a 4.3% (increasing to 15.7% in 2019).
- On the other end of the scale, architecture, engineering and building have the lowest rate of fixed costs at 12.1% of total.

Fixed-term contracts no longer appropriate for the business environment, as a proportion of overall monthly business costs, weighted average by sector, 2019

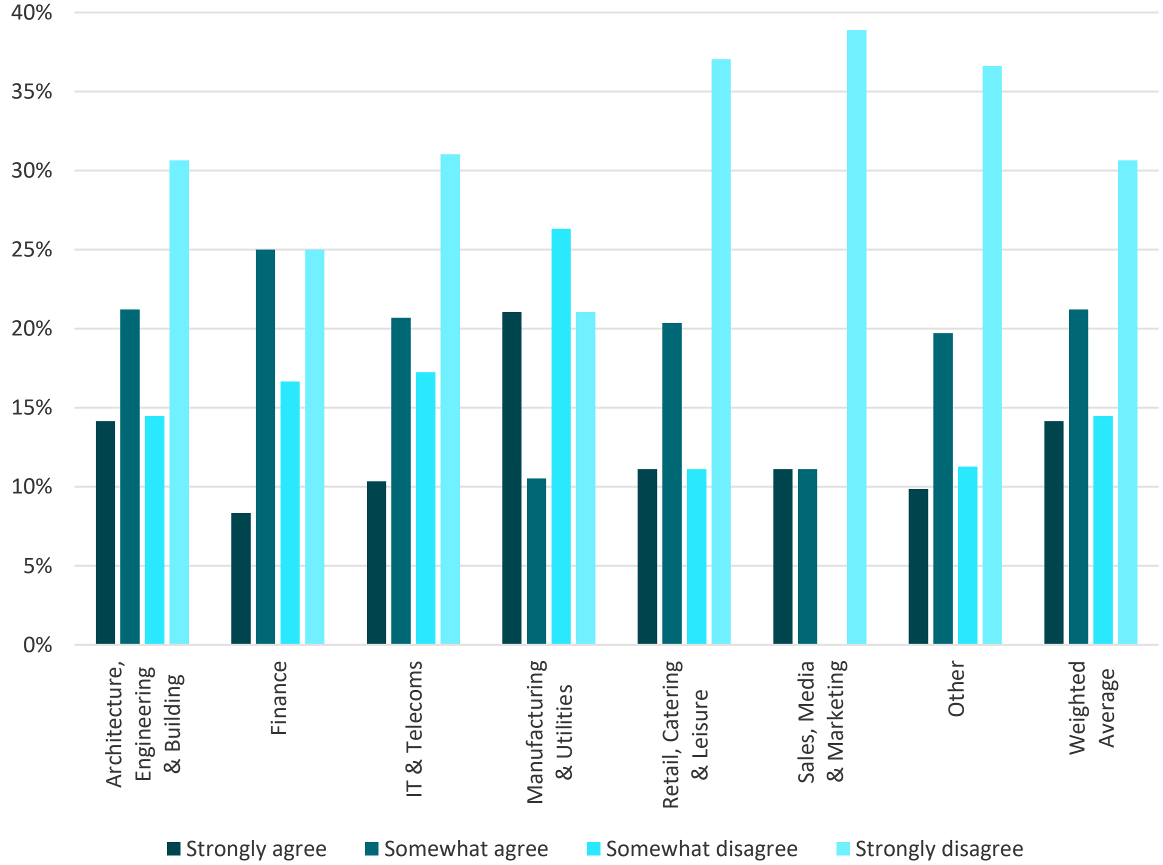


Sample n=176

Inflexible phone contracts are a common source of fixed costs

- From the perspective of a small business, it is optimal for phone costs to scale when employees leave and/or when headcount rises.
- Survey respondents were asked to what extent they agreed with the following: "**We had company mobile phone contracts that could not be transferred between employees – i.e. our mobile phone costs remain the same even if our headcount falls**"
- On average, 35.4% of respondents agreed with the statement and 14.1% strongly agreeing.
- The manufacturing and utilities sector had the greatest share of businesses that strongly agreed with the statement at 21.1%.
- This is broadly consistent with findings from the previous survey, where the manufacturing sector was also found to have the largest proportion of companies with non-transferable phone contracts.

"We had company mobile phone contracts that could not be transferred between employees – i.e. our mobile phone costs remain the same even if our headcount falls" – 2019

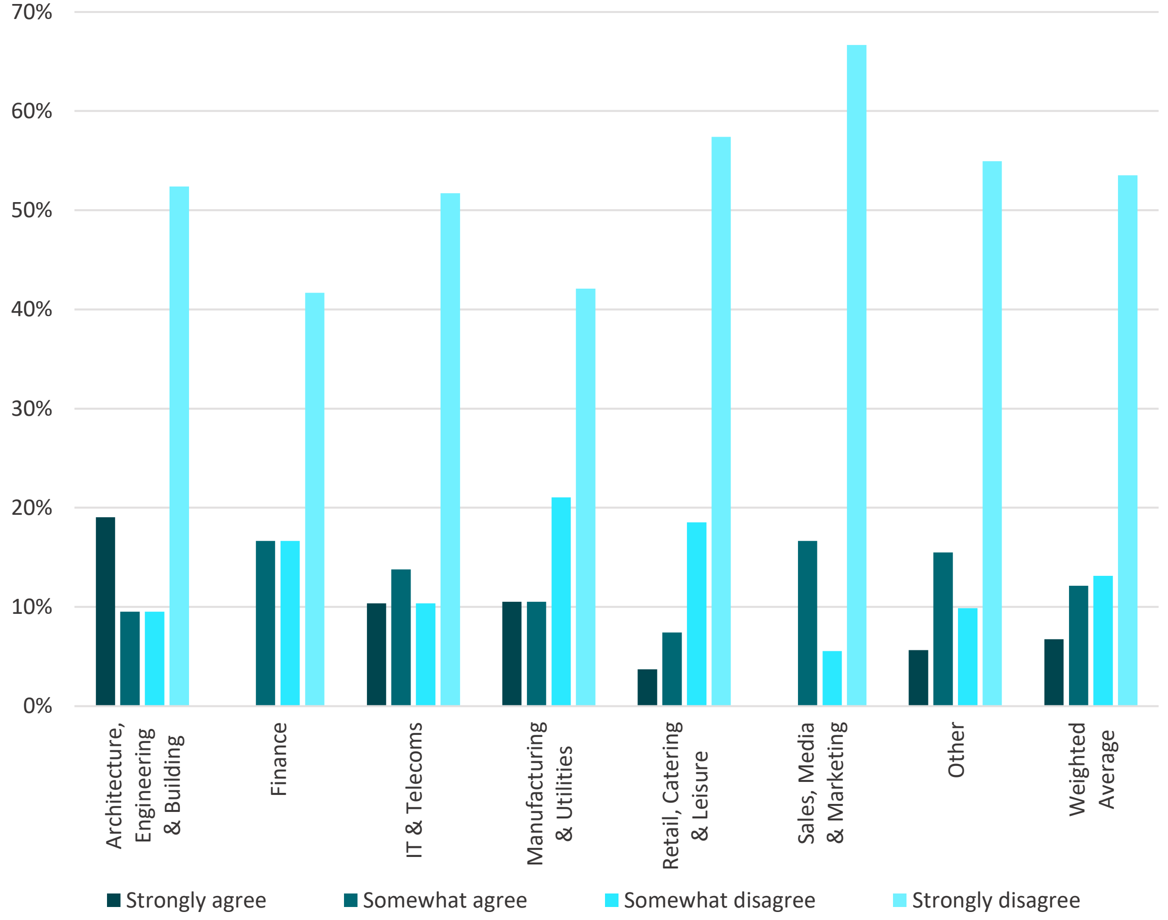


Sample n=297, "neither agree nor disagree" not presented in the figure

The majority of small businesses purchase IT equipment as opposed to leasing

- IT equipment has become a vital capital investment for most firms, allowing them to operate efficiently.
- The majority of small businesses surveyed tend to purchase their IT equipment rather than lease: 66.7% disagreed with the following statement: **“In general, we leased office IT equipment (such as laptops, tablets or mobile phones) rather than purchasing them outright”**
- The sectors which tended to agree, and in particular, strongly agree, are those that may require more specialist IT equipment.
- Approximately 19.0% of small businesses in the architecture, Engineering and building sector responded with strongly agree to the above question and had the greatest share of total agreement at 28.6% compared to the weighted average of 18.9%.
- Similarly, 24.1% of small businesses in the IT and telecoms sector also agreed with the statement suggesting the need for more specialised equipment, the greater share of leasing.

“In general, we leased office IT equipment (such as laptops, tablets or mobile phones) rather than purchasing them outright” – 2019

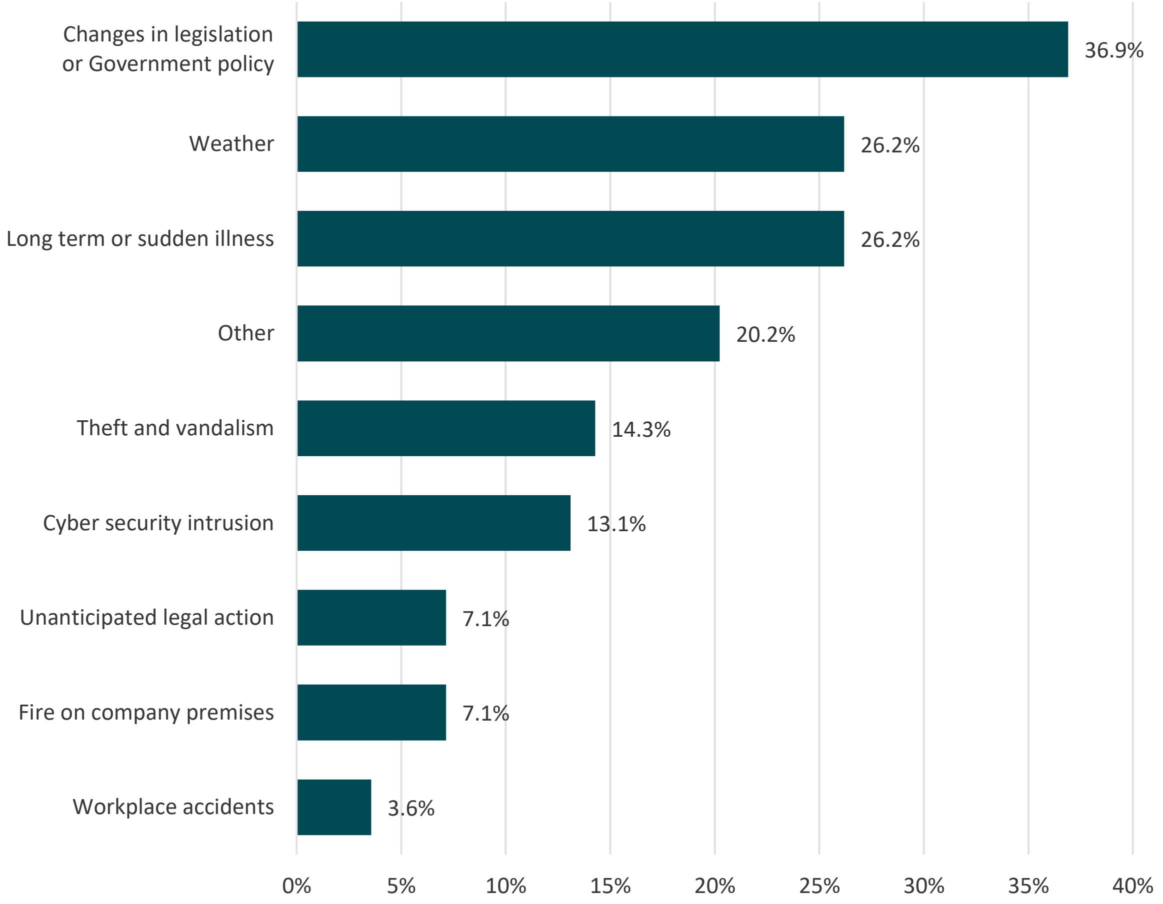


Sample n=297, “neither agree nor disagree” not presented in the figure

Changes in government policy and the weather are the most common unanticipated events that affect performance

- Small businesses can experience a range of unanticipated events which can affect business performance throughout the year.
- For those companies that have been subject to factors outside their control, the most commonly cited issue is changes in legislation or Government policy – this affected 36.9% of firms.
- The same event was also the most commonly cited in the previous survey, however the proportion of firms reporting the issue was substantially less (14.0%)..
- This issue is most commonly-cited in the architecture, engineering and building sector, where it affected 40.0% of such firms.
- Sudden illness of employees is another factor that particularly impacts the performance of small businesses, with 26.2% reporting such.

Most important unanticipated factors (outside the control of the business) that have had a negative impact on performance – 2019

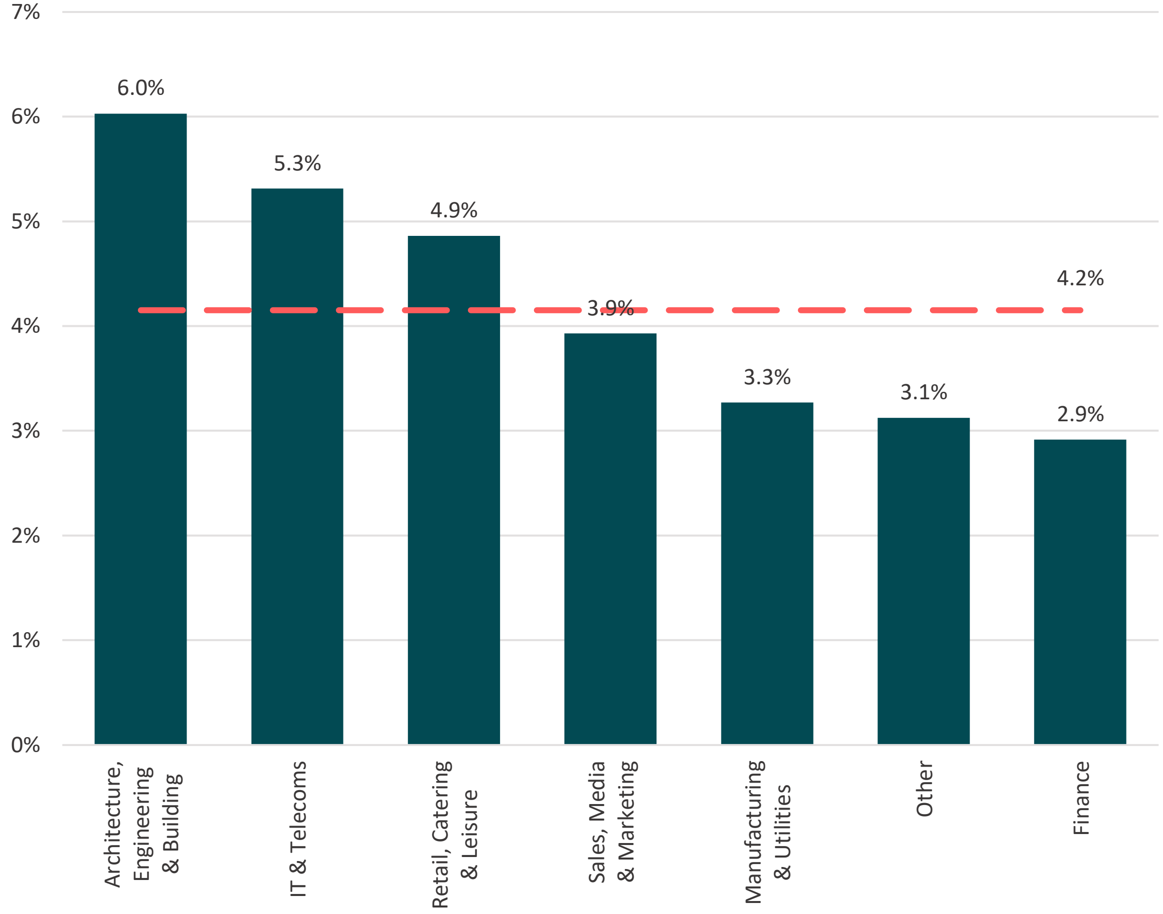


Sample n=84, excludes firms that have not been negatively affected

The financial sector is the most resilient to local competition

- The arrival of new competitors into a company's traditional market (geographical catchment area) can absorb some of their market share, significantly impacting business performance. These issues tend to be most pronounced where the market is static or in decline.
- The architecture, engineering and building sector is particularly sensitive to local competition, reporting that local competition impacted 6.0% of their turnover.
- The IT and telecoms sector follows closely with an impact equivalent to 5.3% of their turnover and 4.9% of the retail, catering and leisure sector's turnover.
- This is a larger impact compared to the 2015 findings, wherein the IT & Telecoms sector was the least impacted sector (of those surveyed), reporting an impact equivalent to 2.3% of turnover.
- This may be due to the competitive nature of the industries and the relatively small market catchment areas typically associated with such firms.

Negative impact of local competition in 2019, % of annual turnover, weighted average by sector

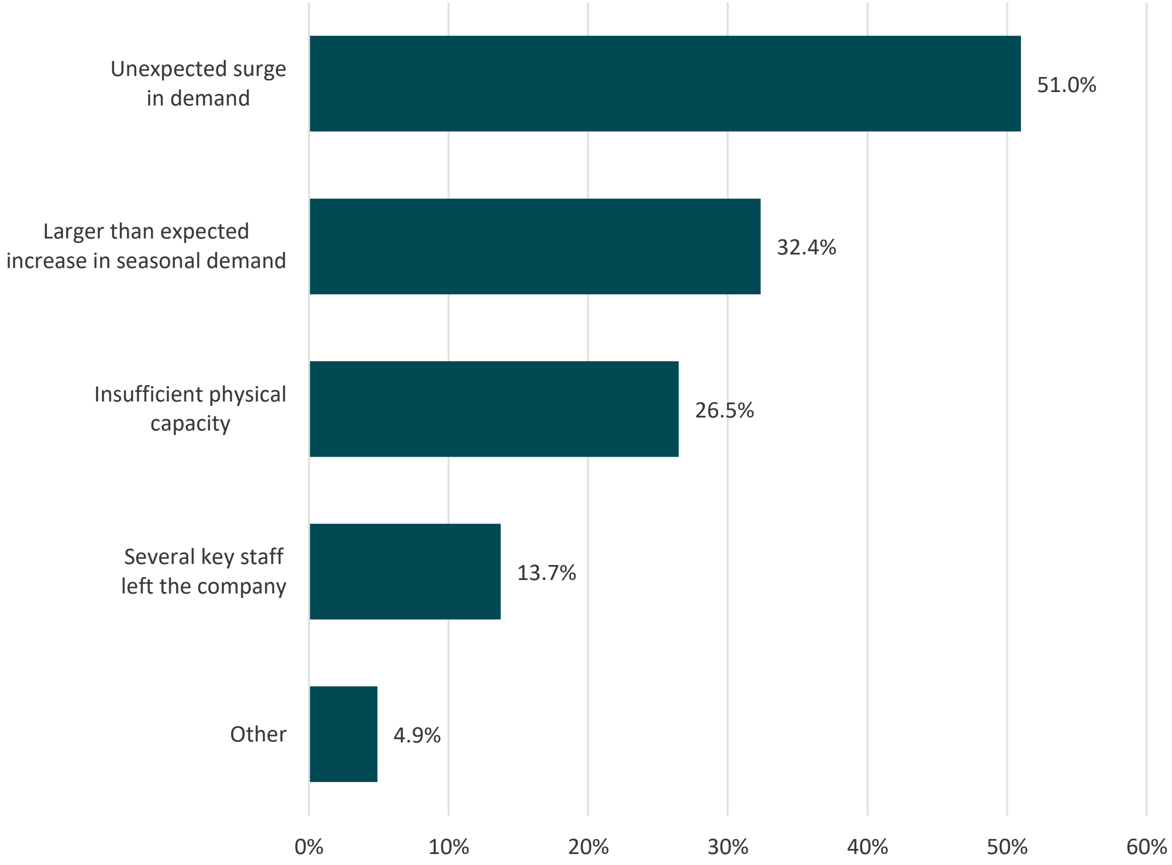


Sample n=427, excludes "Don't know" responses

Reasons why companies experience capacity constraints

- Most companies experience peaks and troughs in business activity throughout the year. Being unable to capitalise on periods of peak demand can limit the performance of firms.
- Of the businesses that reported being unable to meet demand using existing capacity, ‘unexpected surges in demand’ was the primary reason cited (51.0%, up from 31.4% in the 2015 study)
- In a similar vein, ‘larger than expected increases in seasonal demand’ was the second most common answer with 32.4% of small businesses citing it.
- Previously, ‘insufficient physical capacity’ was cited as the most common reason for being unable to meet demand, reported by 46.2% of firms; in 2019, this reason is cited by 26.5% of respondents.
- This emphasises that the volatility throughout a year and even between years may be difficult to predict accurately, limiting the ability for the firms to capitalise on the increases.

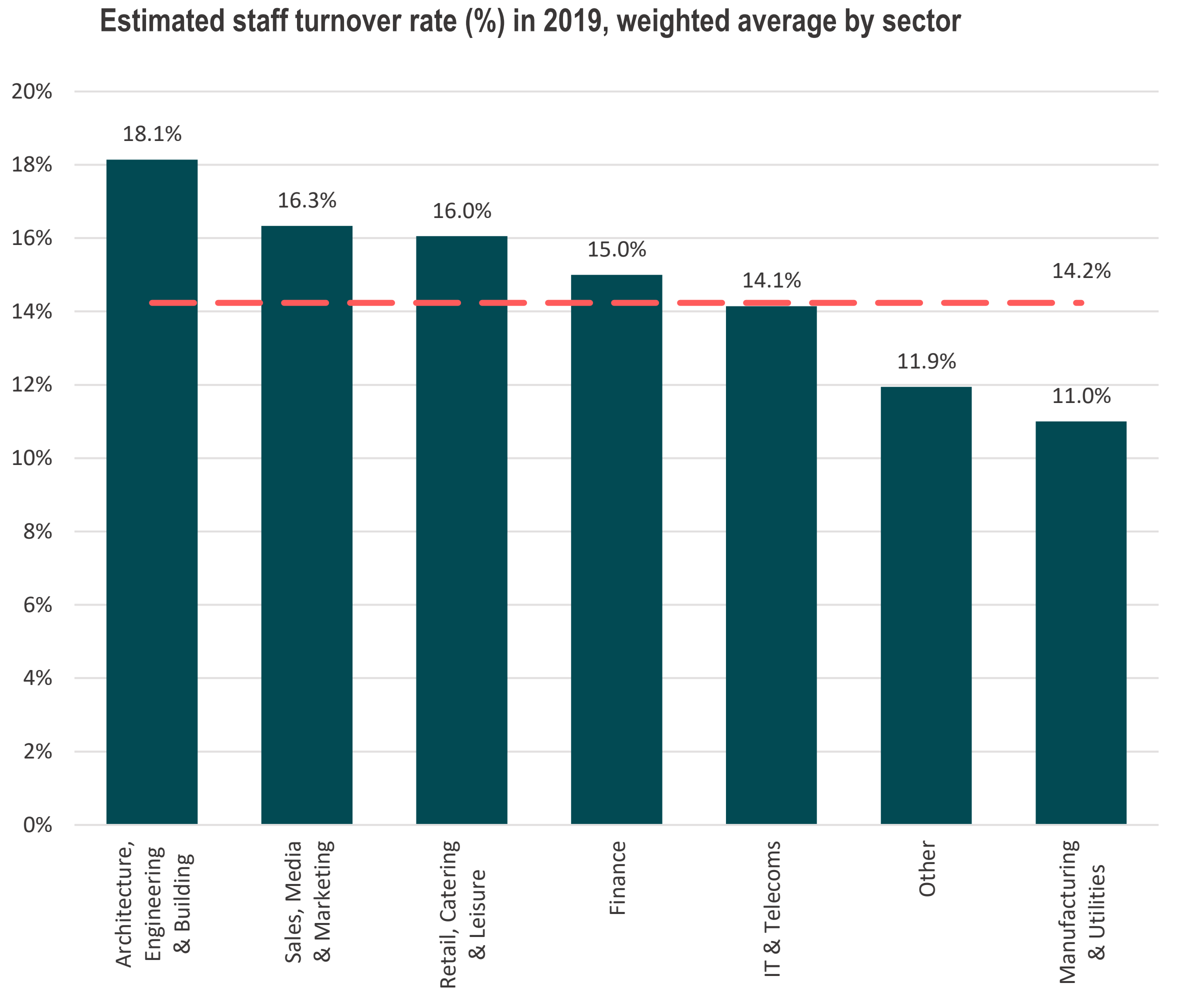
Reasons why businesses experience a period when they were unable to meet demand using existing capacity, % of respondents that reported being unable to meet demand at peak times – 2019



Sample n=102

Staff turnover is the greatest in the architecture, engineering and building sector

- The reported staff turnover rate amongst small businesses averaged 14.2% over 2019, up from 5.4% in 2015. This is the share of employees leaving an organisation compared the total number of employees in said organisation.
- Just over a third (37%) of small businesses report no change in personnel in 2019. Sales, media and marketing had the lowest share with only 27% of businesses reporting no change in personnel.
- Overall, small businesses in the manufacturing and utilities sector reported the lowest rate of staff turnover in 2019 at 11.0%; 3.2% below the weighted average.

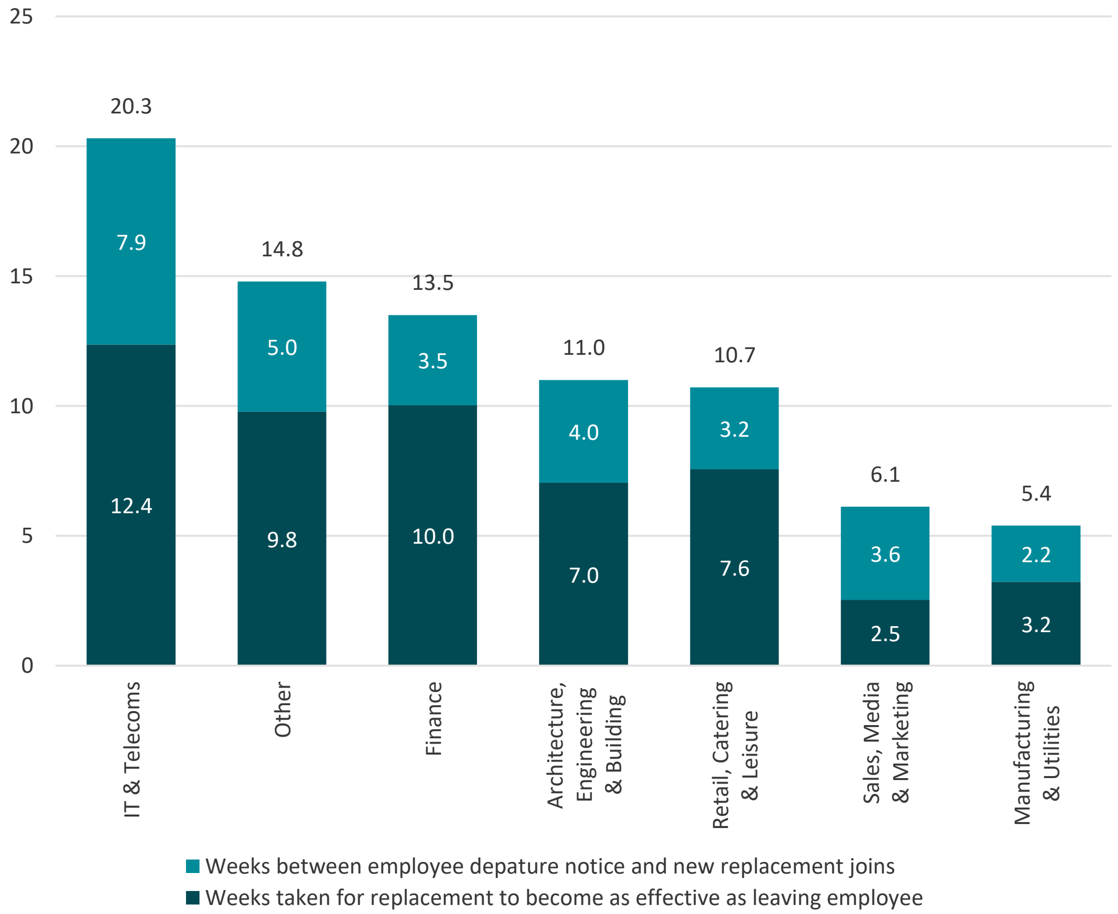


Sample n=410, excludes “Don’t know” respondents

In 2019 it took an average of 13.5 weeks to fully replace an employee

- On average it takes 4.5 weeks from the time an employee gives notice to when their replacement starts work. It takes a further 9.0 weeks for the new employee to reach the level of effectiveness of the departing employee.
- This is equivalent to a 3.1 month period of lower productivity when an employee leaves a small business.
- The IT and telecoms sector has the greatest period of time between an employee leaving to a new employee being fully efficient at 20.3 weeks (4.7 months).
- On the other end of the scale, the manufacturing and utilities sector has the shortest period between departing employees and fully efficient new employees at 5.4 weeks (1.2 months).
- There are a wide variety of reasons why a staff member might choose to leave a company - from dissatisfaction with work opportunities to issues around insufficient pay and lack of promotion issues.

Number of weeks between employee giving notice and replacement reaching same level of effectiveness, weighted by sector – 2019



Sample n=122, excludes “Not sure” respondents

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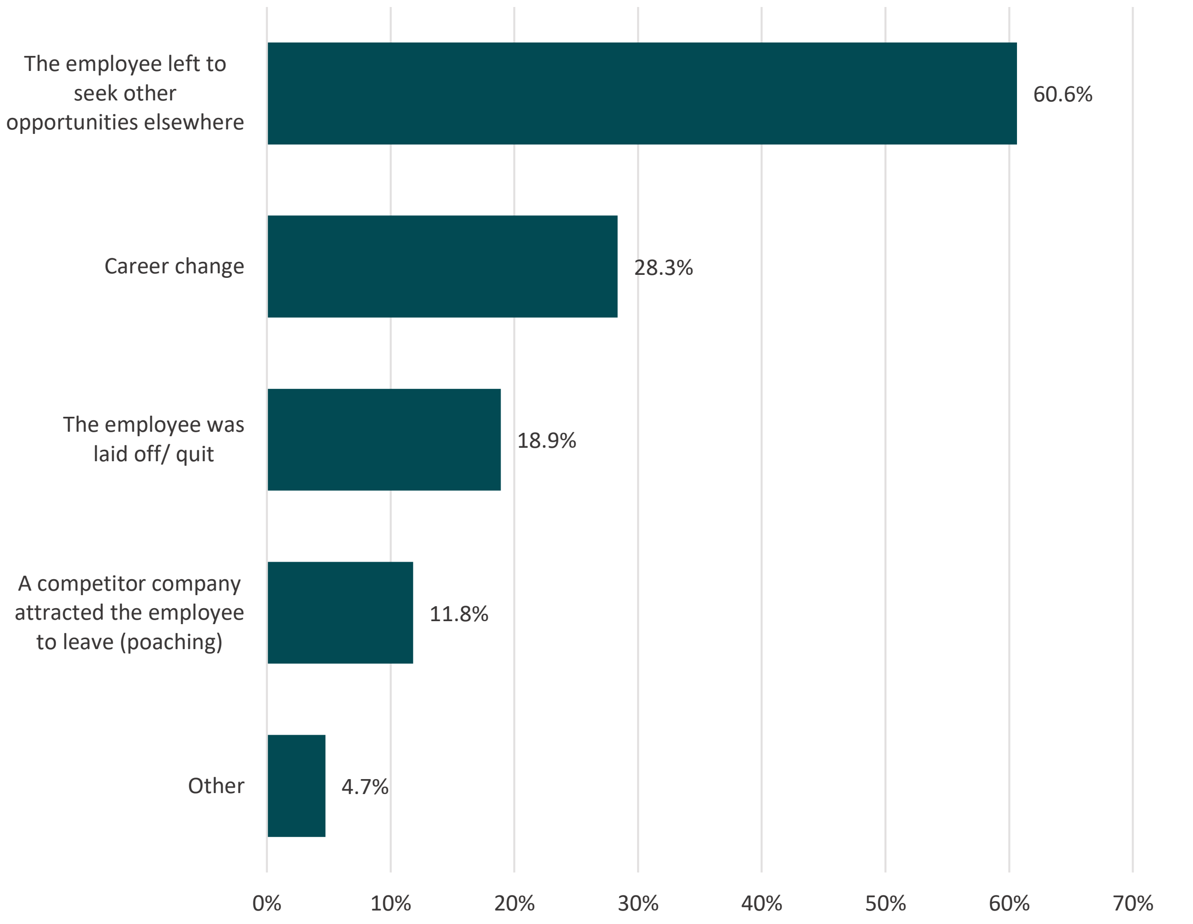
‘Seeking opportunities elsewhere’ was the most commonly cited reason for staff leaving

- Staff turnover imposes a real cost on small and medium sized businesses. A 2019 estimate conducted by *Accounts and Legal* put the cost of replacing staff at £12,000 for SMEs.
- This cost comprises of areas such as job screening, interviewing, handovers and training as well as job-specific extras such as software licenses.
- From the survey, the most commonly cited reason for staff turnover was that employees left to seek other opportunities (60.6%). This is in line with the 2015 findings.
- Poaching was the most common within the sales, media and marketing sector, with 50% of firms reporting this as a cause.
- Career change is the second most common reason across all industries, but peaks in IT and telecoms, with 41% of businesses citing this compared to the 28.3% average.

Reasons why employee(s) left the company in 2019, % of respondents



Sample n=127

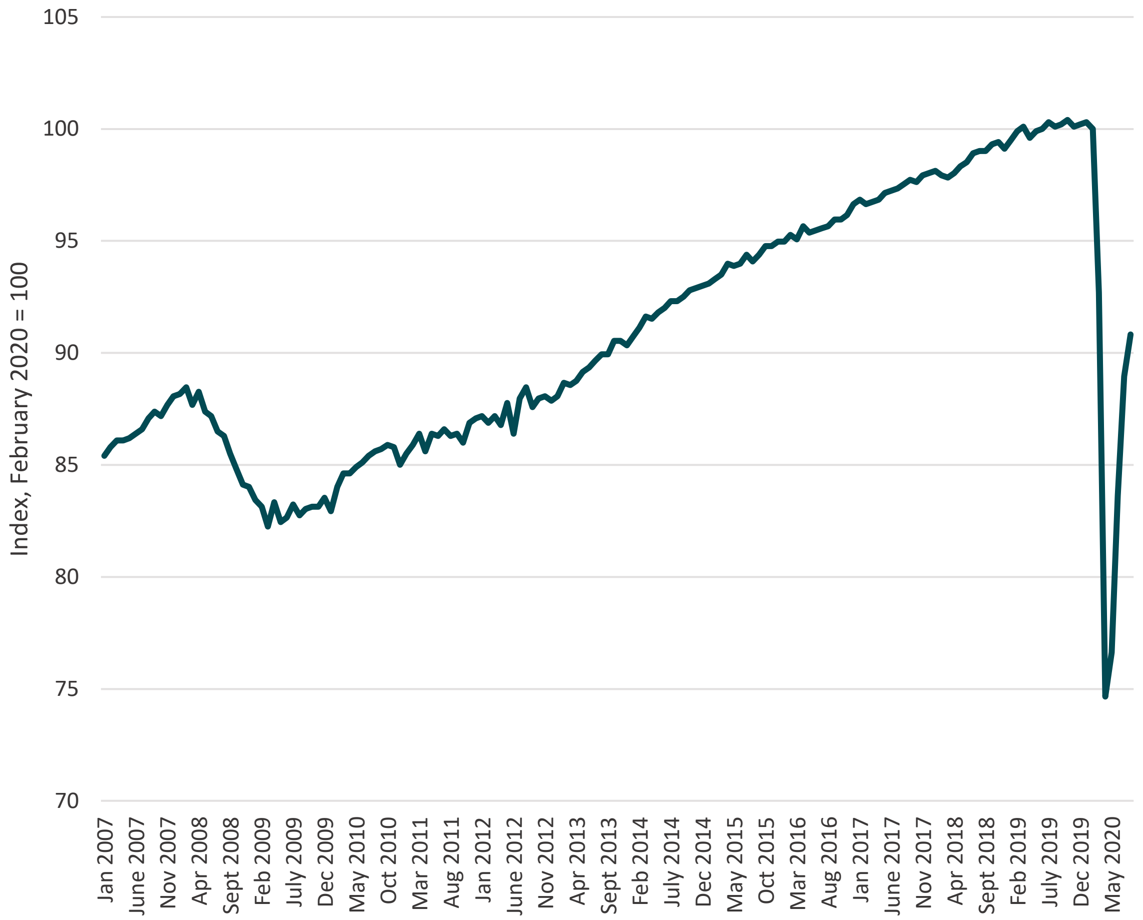
2020

The effects of COVID-19 on small businesses in 2020

COVID-19 has caused significant economic headwinds to the UK economy

- COVID-19 and the subsequent economic turmoil that has occurred in 2020 will have undoubtedly placed many small businesses in a difficult position. The typical volatility that small businesses may prepare for within years will have done little to offset the effects of months of lockdown and rapid economic decline.
- GDP in the UK was estimated to have fallen by 20.4% in quarter 2 of this year [1] , technically pushing the country into recession. Although some recovery has occurred, GDP in August remained 9.2% below the February 2020 level [2].
- With lockdown beginning on 23 March 2020 [3] and only easing in the latter half of June, many businesses had to rely on furloughing staff and government support to survive.
- Small businesses without the cash reserves that larger organisations have will likely have felt this sudden shock of closure more severely.

Monthly GDP index, January 2007 – August 2020, February 2020 = 100



Source: ONS and Cebr analysis

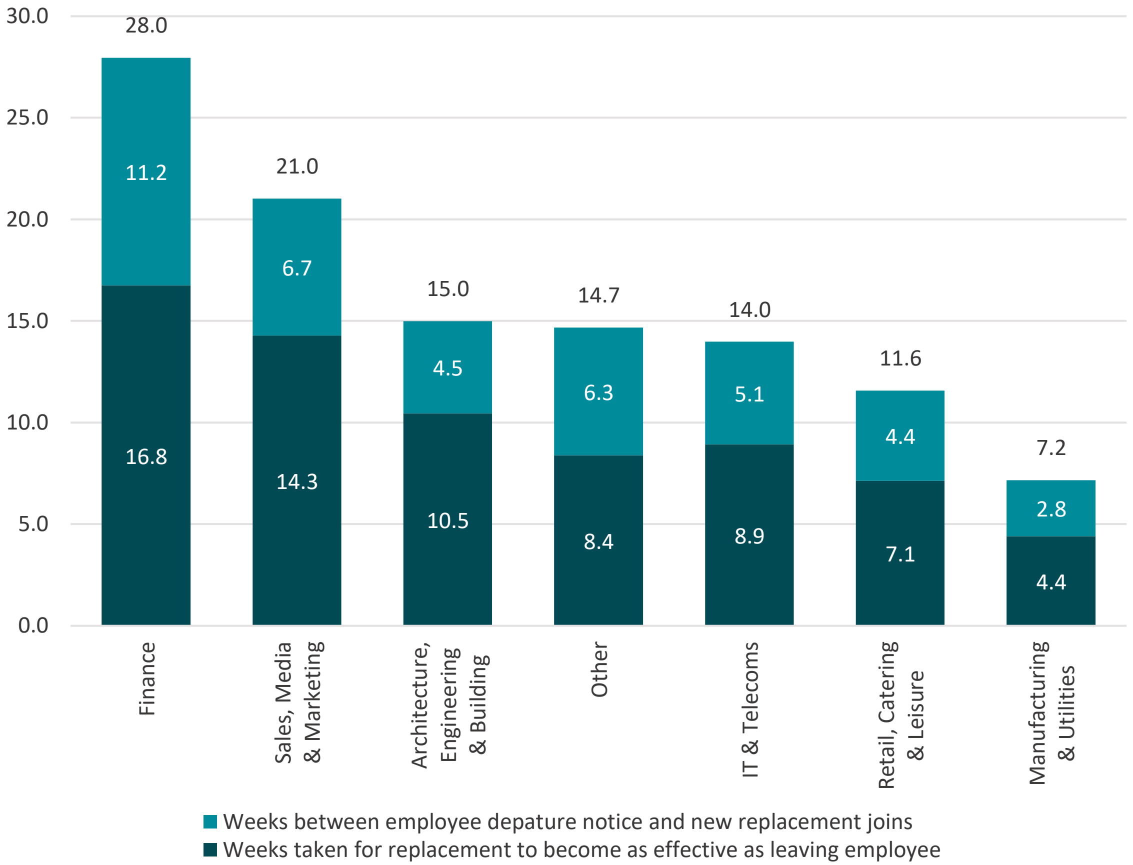
[1] ONS. 'GDP first quarterly estimate, UK: April to June 2020'.
[2] ONS. 'GDP monthly estimate, UK: August 2020'.
[3] Full Fact. 'When did lockdown begin in the UK?'.

2020

Time taken to effectively replace an employee has increased in 2020

- On average in 2020, the time taken from an employee giving notice to a replacement becoming fully efficient has increased to 15.6 weeks (3.6 months). This is 2.1 weeks longer than in 2019 (see Slide 32).
- The effects of COVID-19 and the economy shutting down has likely exacerbated this impact, with many organisations struggling to effectively train and acquire new staff given the uncertainty and constraints on businesses.
- Given the turmoil most small businesses will be facing in 2020, the increased time to fully replace employees is likely an additional headwind further increasing the issues faced this year.
- The increase is the most stark for companies in the financial sector, increasing from 13.5 weeks (3.1 months) in 2019 to 28.0 weeks (6.5 months) – more than double.
- In relative terms, companies in sales, media and marketing have experienced the greatest increase, from 6.1 weeks (1.4 months) in 2019 to 21.0 weeks (4.8 months) – an increase of 343%.

Number of weeks between employee giving notice and replacement reaching same level of effectiveness, weighted by sector – 2020

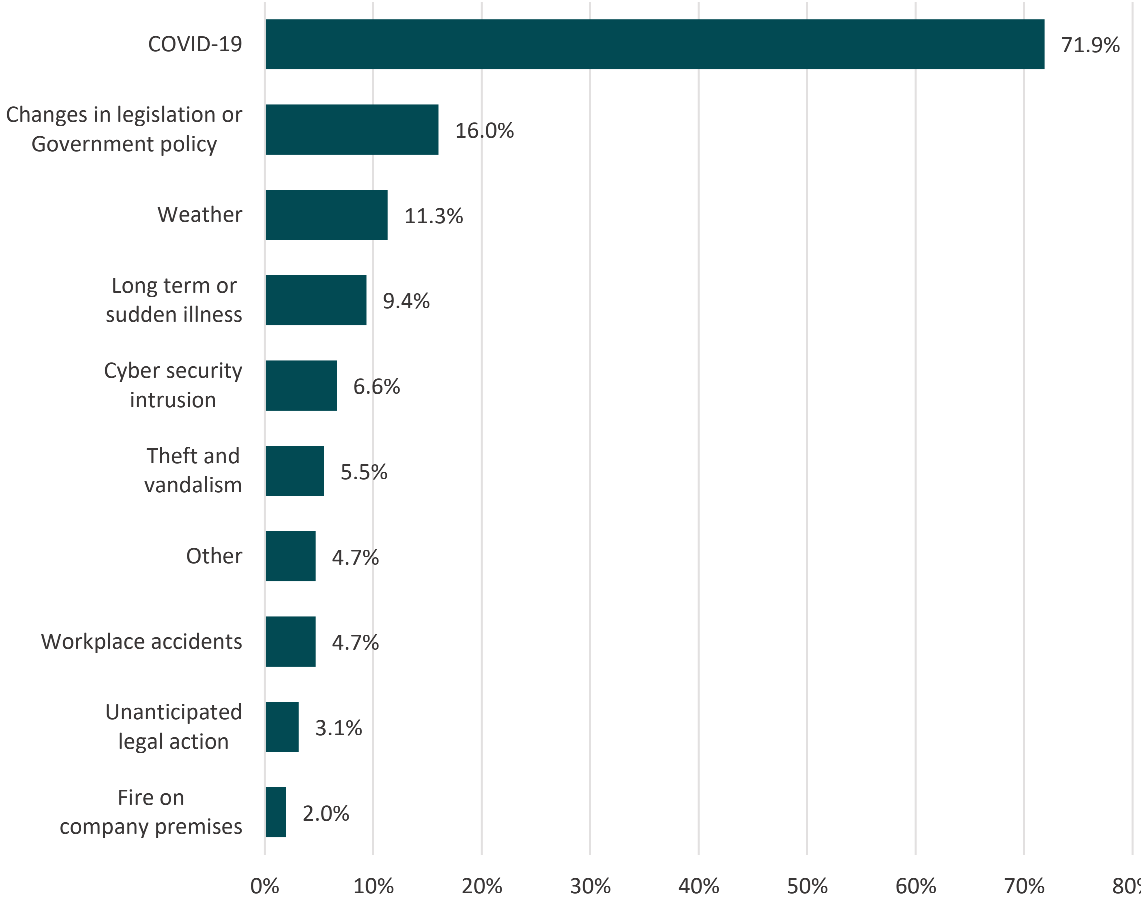


Sample n=156, excludes “Not sure” respondents

72% of small businesses cite COVID-19 as the cause of negative performance in 2020

- On average, for small businesses that have had factors outside their control negatively affecting performance in 2020, COVID-19 was the most commonly cited cause at 71.9%.
- This varies significantly between sectors; only 36.4% of small businesses in finance cite COVID-19 as one of the most negative factors compared to 75.0% in sales, marketing and media.
- On top of this, 28.5% of all small businesses also cite COVID-19 as a reason for shortfall in capacity in 2020. The reasons for this are numerous:
  - A breakdown in their supply chains;
  - Closure of business during lockdown period;
  - Their premises was not large enough to allow for social distancing; and
  - Having to furlough staff.

Most important unanticipated factors (outside the control of the business) that have had a negative impact on performance – 2020



Sample n=256, excludes firms that have not been negatively affected

Cebr

2020

Contact

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