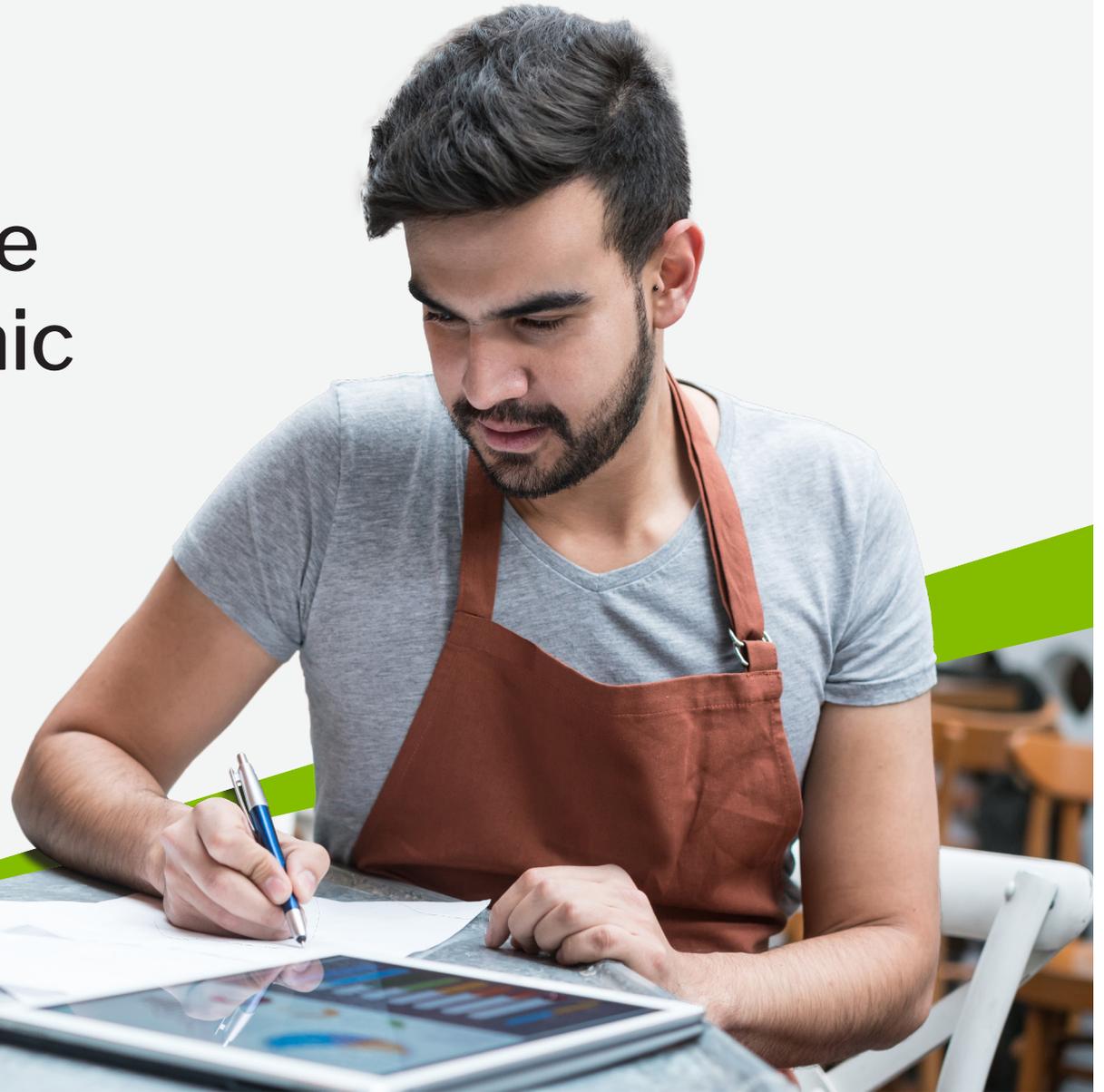




Resilience in the face of economic headwinds

How UK SMEs are targeting growth and continuing to invest despite growing economic pressures





An introductory note from John Phillipou

The economy and politics have dominated the news agenda over the past two months, with uncertainty and instability swirling around us.

The recent changes at the head of the Government and reversal of the mini-budget seems to have calmed markets, but dark clouds remain overhead.

But while the challenges facing our economy are real, the widespread negativity reported daily is certainly not what we are seeing from our customer base. In fact, I would describe the general mood of the majority of SME owners and managers I speak to as cautious pragmatism.

Yes, it's difficult, yes, it's challenging, but SMEs are doing what they have always done; they are working the problem, trying to find solutions, attempting to find a way through these difficult times.

We recently commissioned independent research from Opinium of over 1,000 SMEs and they are showing resilience in the current environment.

Despite wider economic challenges, 43% of SMEs expected to record growth over the next 12 months – with a further 30% of SMEs expecting no change.

The predicted growth for SMEs is mirrored by investment plans, with 42% increasing investment in their businesses over the last 12 months and a further 37% maintaining their level of investment – compared with only 20% reducing investment.

Nearly a quarter of businesses (23%) expect turnover growth of up to 5%, with 14% forecasting growth of between 5% and 10%. A further 7% expect growth of above 10% during the period.

A similar proportion of companies (48%) said that their business had grown over the previous 12 months despite the economic challenges and the pandemic, with 29% saying turnover had reduced.

When asked how they considered the current position of their business, a third of SMEs described their business as thriving, with half stating their business was stable.

Just 1% of companies said they were struggling to keep the business afloat, with 13% stating the company was recovering.

Of course, businesses aren't blind to the challenges on their doorstep, but we have to remember that they have been through pretty unstable and volatile market conditions since the middle of the last decade, when the Brexit referendum was held.

This was followed by two years of the deal or no deal debate, which flowed into the pandemic and then the inflationary environment of the past 12 months. SMEs are battle hardened, they have learnt how to handle adversity and challenging conditions.

While the research highlights predicted turnover growth and increased investment in the year ahead it also has identified the challenges SMEs are preparing for.

Businesses identified rising inflation and cost increases as their biggest challenge, whilst the shadow of the pandemic still looms over many firms, particularly as we head into the winter months with a senteeism expected to rise as Covid cases once again increase.

Other issues cited by respondents to the survey include ongoing supply chain disruption, access to funding and Brexit.

But despite these challenges, SMEs continue to invest to grow their business.

We are in for some turbulent times and there will undoubtedly be challenges to be faced. But there's also underlying resilience across UK PLC and reasons to be confident that, once again, SMEs will help lead the UK economy towards recovery.

The economy needs the nation's SMEs not just to survive but thrive. At Paragon, we are proud to support them – and we look forward to continuing to do so in the year ahead.



John Phillipou
Managing Director
SME Lending
Paragon Bank

SMEs remain resilient

Despite the economic headwinds, growth is still on the agenda for UK SMEs

In the face of rising inflation and economic uncertainty, UK SMEs remain resilient. We commissioned leading research agency Opinium to gather the views of over 1,000 SMEs with a turnover of up to £40 million and they found that companies continue to target growth and investment.

On average, 43% of firms said they will grow turnover in the next 12 months, with a further 30% forecasting no change. Of those forecasting growth, 23% expect up to 5% turnover growth, 14% between 5% and 10%, with the remainder over 10%.

This optimistic view of the future comes on the back of growth recorded over the past 12 months. Nearly half (48%) of SMEs said they had increased turnover over the previous year, with a further 23% maintaining turnover levels.

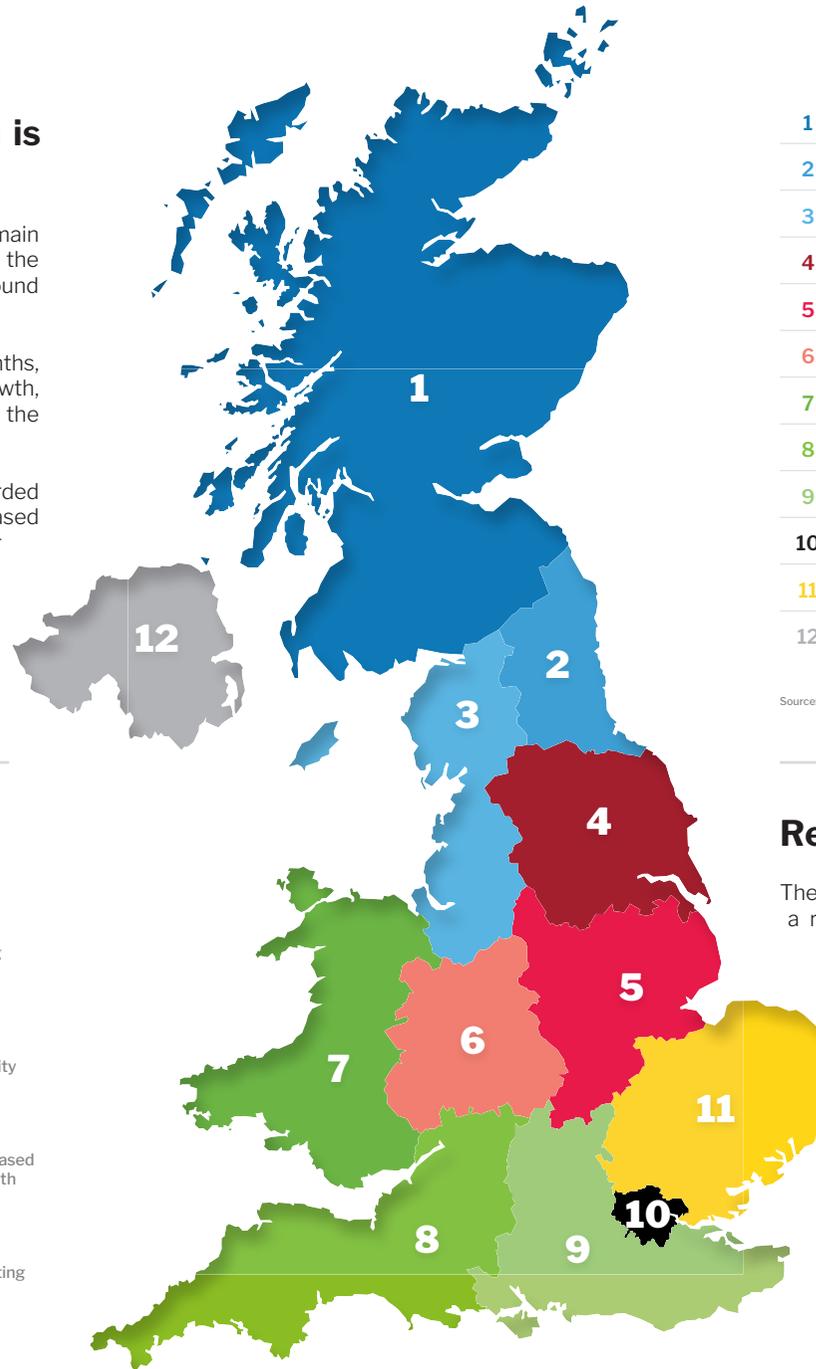
Half of businesses view their position as stable and they expect that to continue, with over a third describing themselves as thriving. Just 1% of companies said they are struggling to keep the business afloat.

How would you describe the current state of your business?



- 1%** Struggling to keep the business going
- 13%** Recovering and striving for stability
- 35%** Thriving with increased probability of growth
- 51%** Stable and expecting to stay so

Source: Opinium



Turnover expectations by region

		Grow	Reduce
1	Scotland	+54%	-23%
2	North East	+47%	-30%
3	North West	+56%	-22%
4	Yorkshire & Humber	+53%	-23%
5	East Midlands	+38%	-37%
6	West Midlands	+40%	-20%
7	Wales	+43%	-23%
8	South West	+49%	-17%
9	South East	+50%	-21%
10	London	+33%	-34%
11	East of England	+48%	-29%
12	Northern Ireland	+60%	-10%

Source: Opinium

Regional view

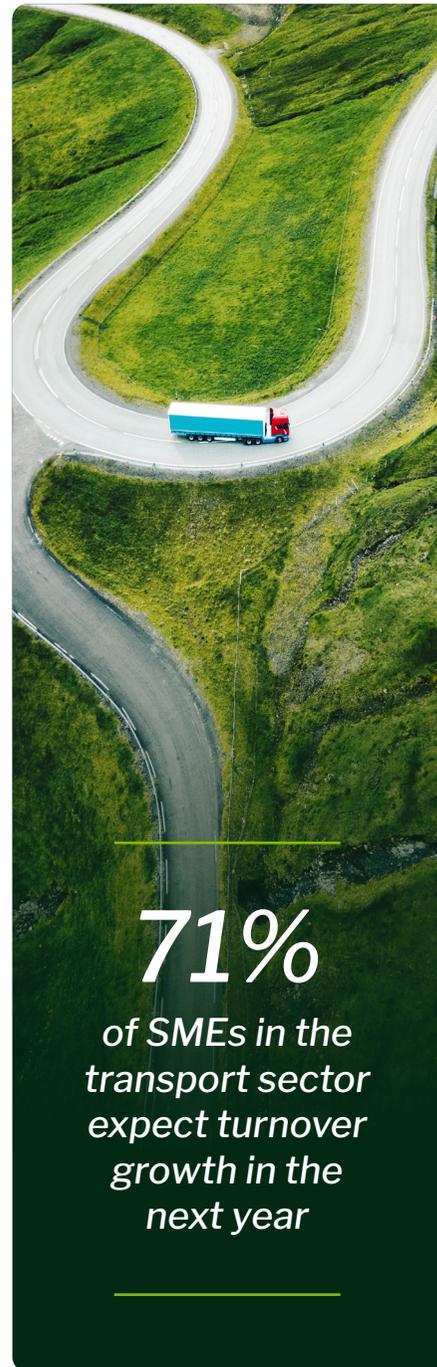
The national view doesn't reflect the variances on a regional level, with some regions demonstrating greater levels of confidence than others. SMEs in Northern Ireland, Scotland and the North West top the chart, with a high proportion of companies in Yorkshire and the South East also targeting turnover growth.

Northern Ireland also had the lowest proportion of companies expecting a reduction in turnover, followed by the South West.

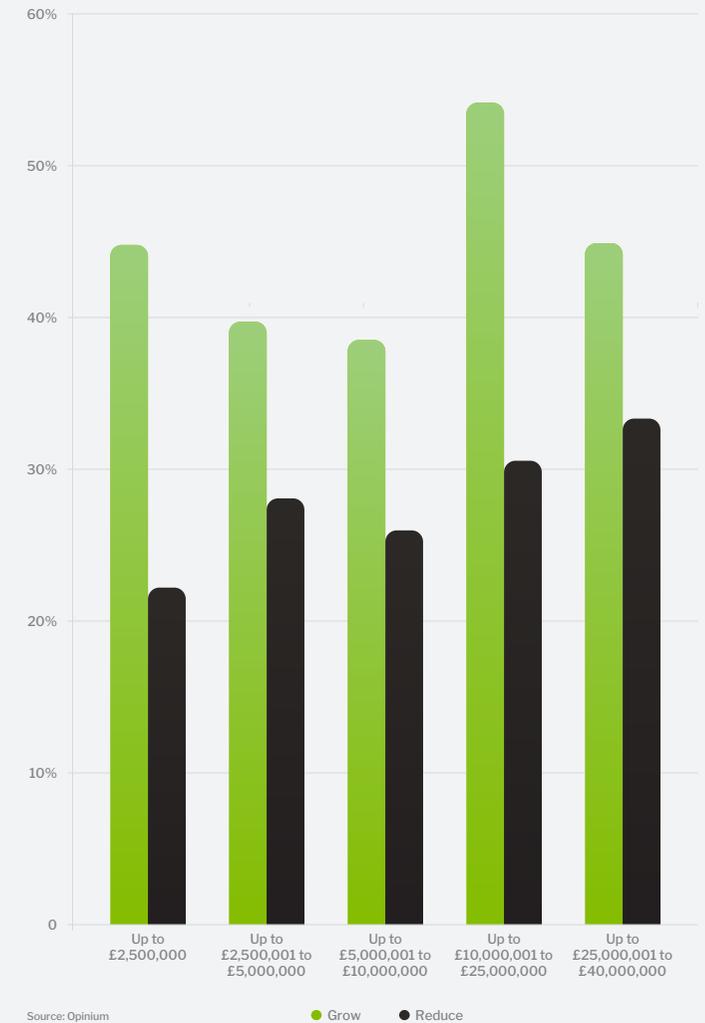
Sector focus

On a sector level, SMEs in the transport space led the positive table, perhaps reflecting the general growth experienced by the logistics and distribution industry in recent years. Turnover growth was also robust in real estate, wholesale, food and drink and construction.

At the other end of the scale, SMEs in hospitality and leisure are forecasting more difficult times ahead.



Turnover expectations by company size



Company size

There is a correlation between company size and growth expectations, with larger businesses having a higher expectation of growth. Conversely, these businesses also have a higher proportion of respondents that forecast decreasing turnover.

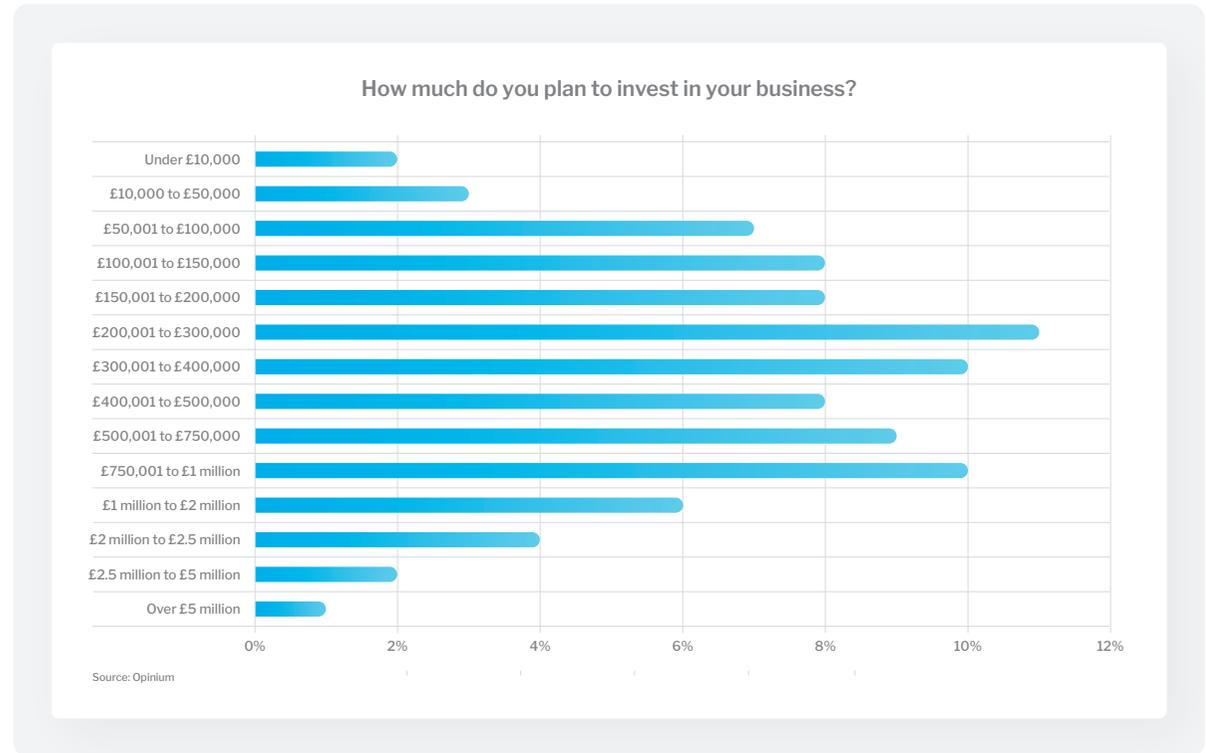
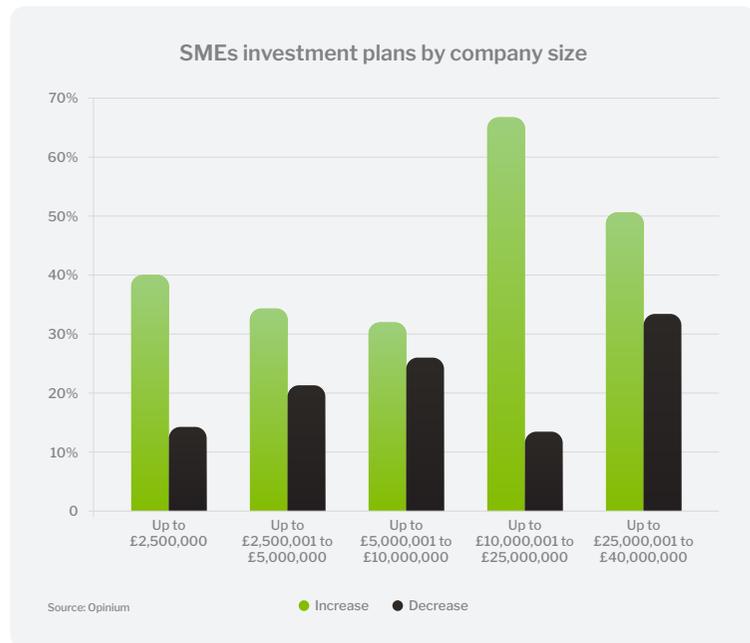
A focus on investment

UK SMEs are targeting an increase in investment in spite of economic challenges

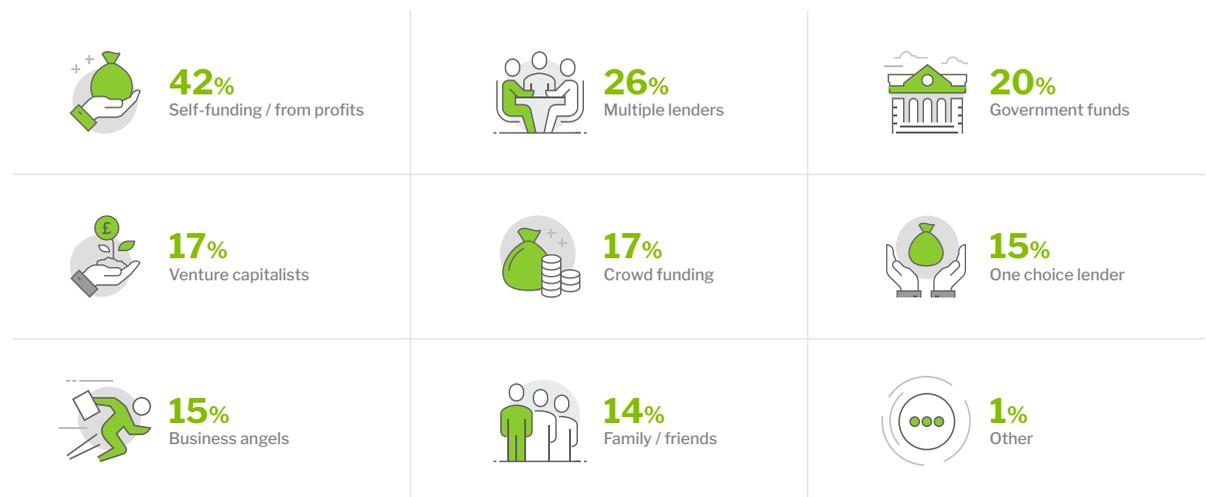
Investment remains an important element of SMEs' business plans, with four in 10 (42%) companies stating they will increase investment compared to the last 12 months, and a further 37% of SMEs maintaining investment level. One in five businesses will decrease investment.

Unsurprisingly, larger businesses have a greater propensity to invest – 67% of companies with a turnover of between £10 million and £25 million will increase investment, with half (51%) of firms with a turnover of up to £40 million increasing their investment spend. Smaller businesses are less likely to increase investment.

On average, companies plan to invest £656,000 to achieve their business objectives, although that average is pulled up by higher levels of investment by larger companies. Businesses with a turnover of over £25 million plan to invest £1.75 million, with those with turnovers of between £10 million and £25 million investing £969,000, on average. Companies with a turnover of between £2.5 million and £5 million will invest a more modest £445,000.



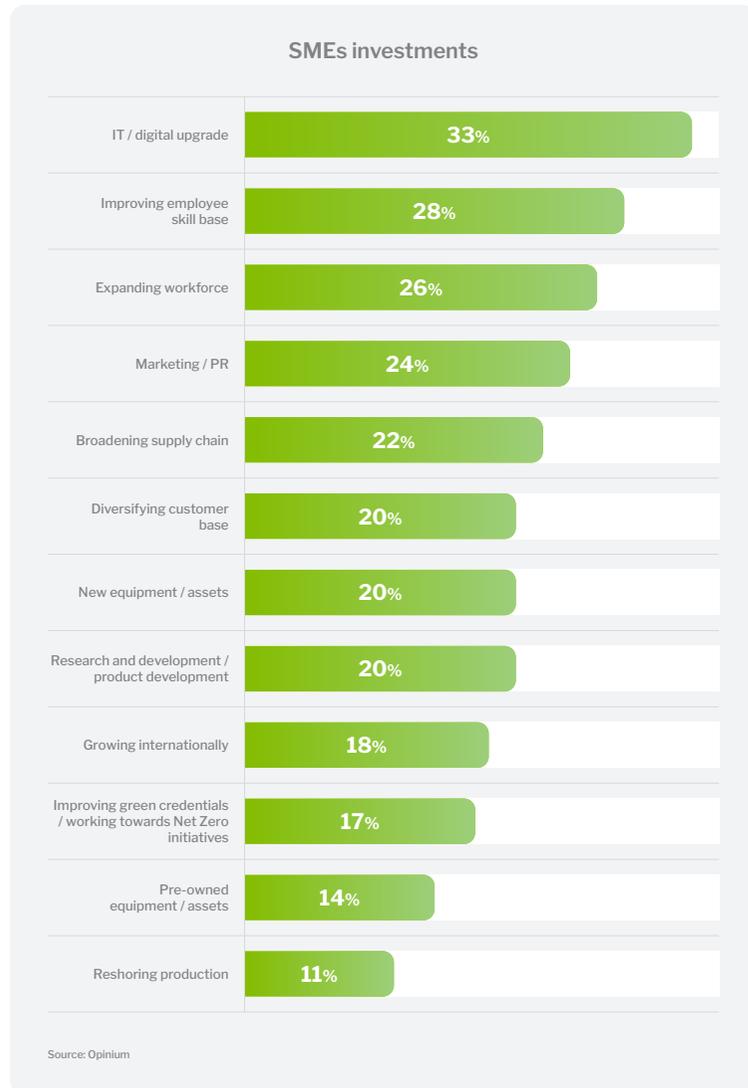
How will you fund business investment?



What will companies invest in?

The most common focus for investment is in IT or digital upgrades, followed by improving employees' skill base and workforce. A fifth of companies intend to invest in new assets, with 14% planning to purchase used assets or equipment.

Research & Development is a target for one in five SMEs, whilst a similar percentage (18%) are targeting international expansion.



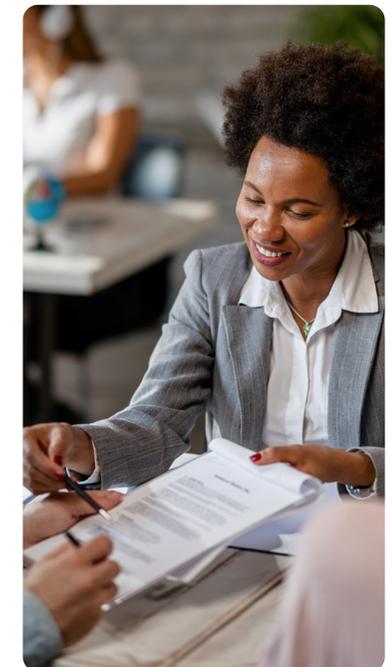
↑ Investment up ↓ Investment down

Sector focus

Given its focus on growth, it's unsurprising to see SMEs in the Transport sector most likely to increase investment, as well as one of the smallest proportions of companies intending to reduce investment.

SMEs in the Agriculture sector also have a high propensity to invest, typically as it's an asset intensive industry sector, whilst surprisingly the Hospitality and Food & Drink sectors also show high percentages of companies planning to invest in growth.

Conversely, companies in the IT/ Computing sector show the greatest propensity to reduce investment, along with Agriculture, Business Services and Healthcare.



SMEs face a myriad of challenges

UK SMEs are facing challenging economic conditions

UK SMEs have endured a turbulent number of years after relative economic stability following the Global Financial Crisis of the late noughties. Stability was broken by the Brexit vote in June 2016, which led to a change in Prime Minister and two years of Deal or No Deal debate.

The Covid 19 pandemic shattered any hope of a post-Brexit deal bounce and the global economy went into turmoil. UK Government financial support and the introduction of the furlough scheme no doubt saved many businesses from going to the wall, but the ramifications of the pandemic live on.

The restart of economies across the world led to surging demand for energy, kickstarting the rampant inflation we are experiencing currently, exacerbated by geopolitical tensions, mainly surrounding Russia's invasion of Ukraine.

Businesses cited inflation impacting customers as their main challenge over the past 12 months, as well as cost increases impacting their own companies.

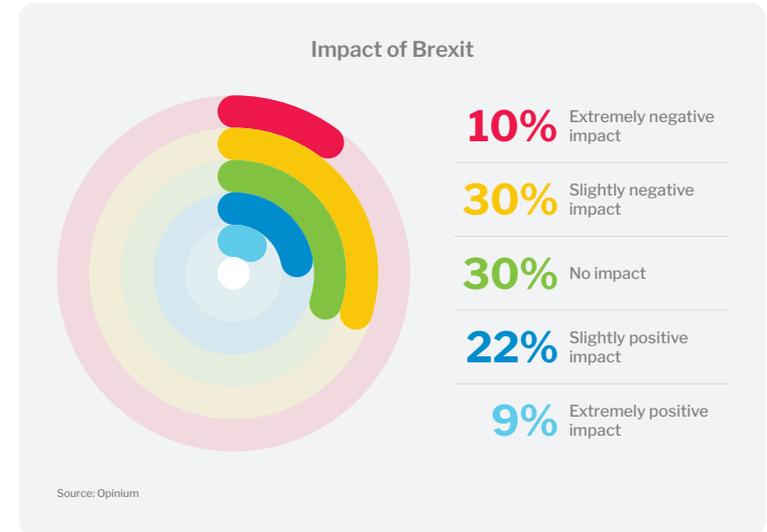
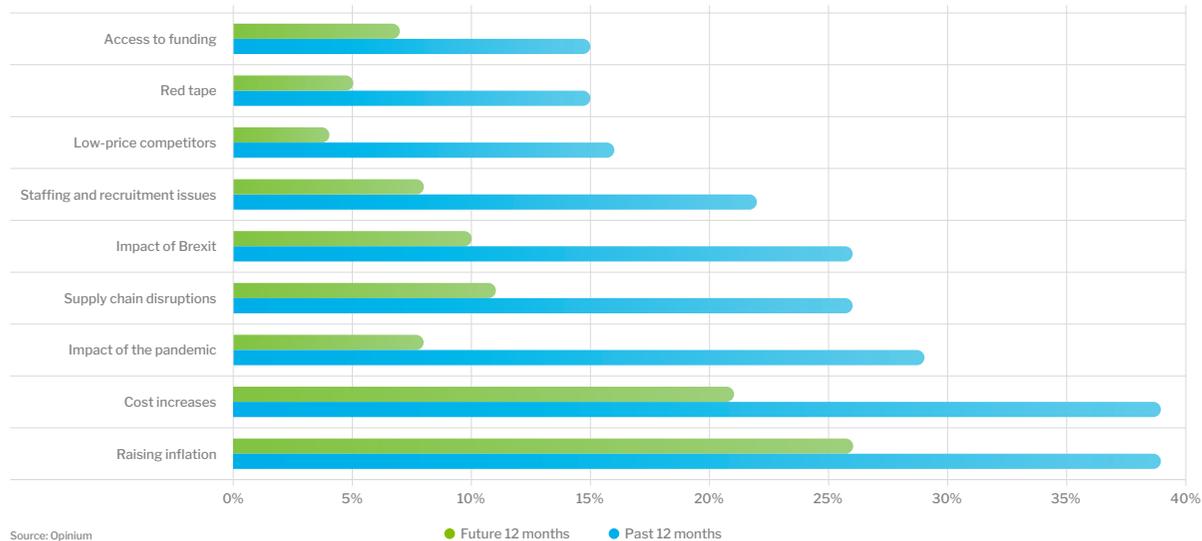
These two issues look certain to remain over the coming year, which is reflected in their outlook.

The pandemic continued to affect companies, particularly with the growth of the Omnicom variant in December 2021, whilst supply chain disruption was also an issue for many companies, as we examine later in this report.

On Brexit specifically, the split of companies reporting a negative impact was 40%, with 30% of companies citing a positive impact and the remaining 30% experiencing no change.

What SMEs have demonstrated throughout recent years is the ability and agility to react to adversity, to pivot their businesses, innovate and find new markets. As we navigate difficult economic waters, SMEs will need to demonstrate this resilience once again.

Main challenges facing SMEs



Supply chain strain

Supply chains have come under strain this year as the pandemic continued to impact on companies' ability to source goods. The research found that 86% of companies had experienced some form of supply chain issue.

The most common issue was rising cost of goods and services, reported by 41% of firms, followed by the availability of goods (34%). Meanwhile a quarter were concerned about the financial stability of a supplier (24%).

Other issues businesses have experienced is suppliers prioritising other clients (18%) and poor ESG practices from suppliers (16%).

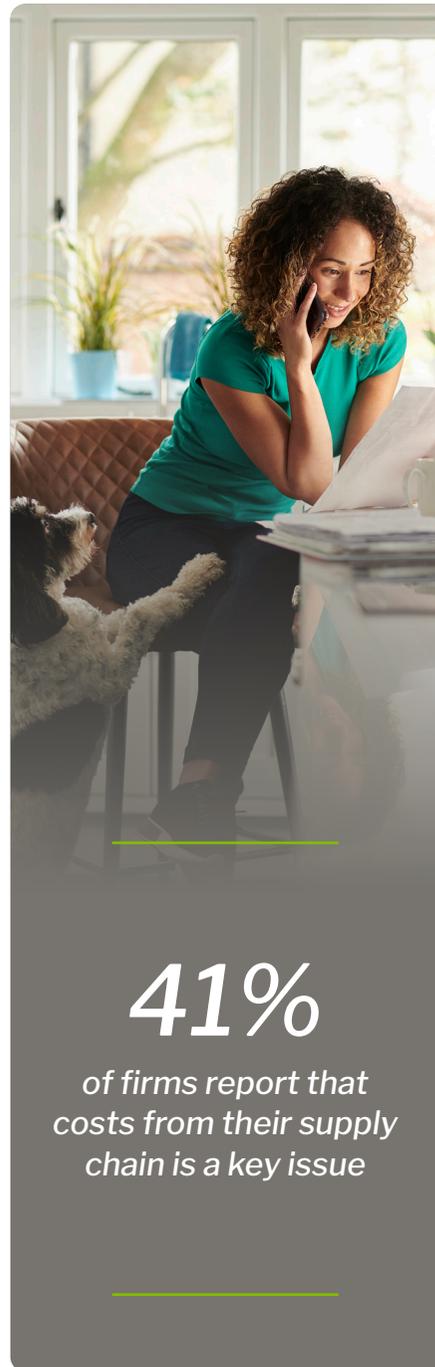
A third of businesses (37%) that have experienced supply chain issues found the disruption caused to be significant, with 49% experiencing a moderate impact.

Larger SME companies were more likely to report a significant impact to their organisations, with over half (54%) of companies with a turnover of between £25 million and £40 million experiencing significant supply chain disruption, falling to 36% for companies with a turnover of between £1 million and £2.5 million.

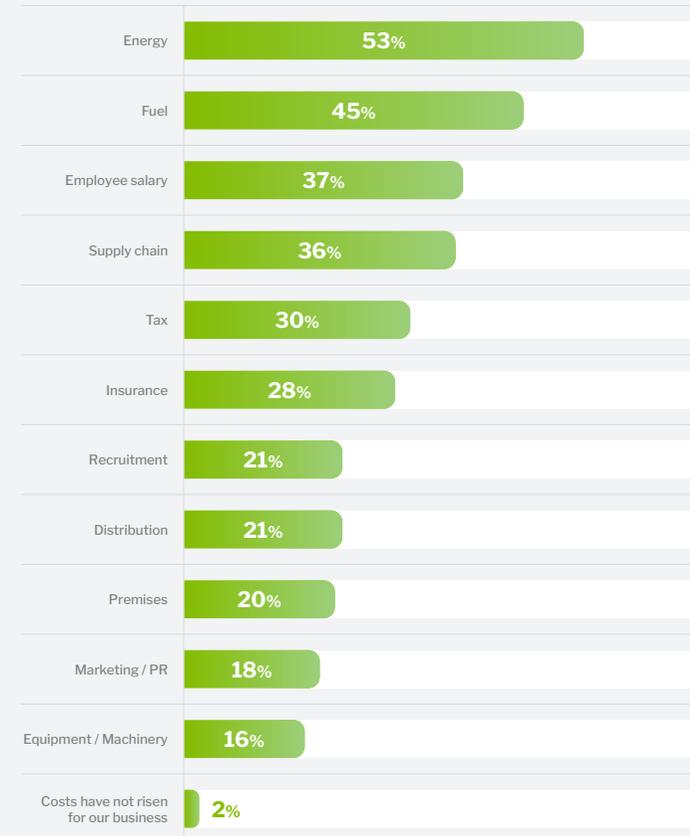
Main supply chain issue for SMEs

Costs of goods and / or services	41%
Availability of goods and / or services	34%
Financial stability of suppliers	24%
Supplier not hitting SLAs	21%
Supplier prioritising other clients	18%
Poor ESG practices from suppliers	16%

Source: Opinium



Areas SMEs have experienced cost increases in the past 12 months



Source: Opinium

SMEs contend with cost surge

The vast majority of businesses have reported cost increases over the past 12 months and, unsurprisingly, energy and fuel are the most common cost increases experienced by companies, followed by salaries.

Energy and fuel are also where companies have seen the greatest level of inflation, growing, on average, 13.9% and 13.8% respectively. This doesn't capture the increase in energy costs businesses have experienced in October, so we would expect this figure to increase. Fuel costs, conversely, are starting to fall.

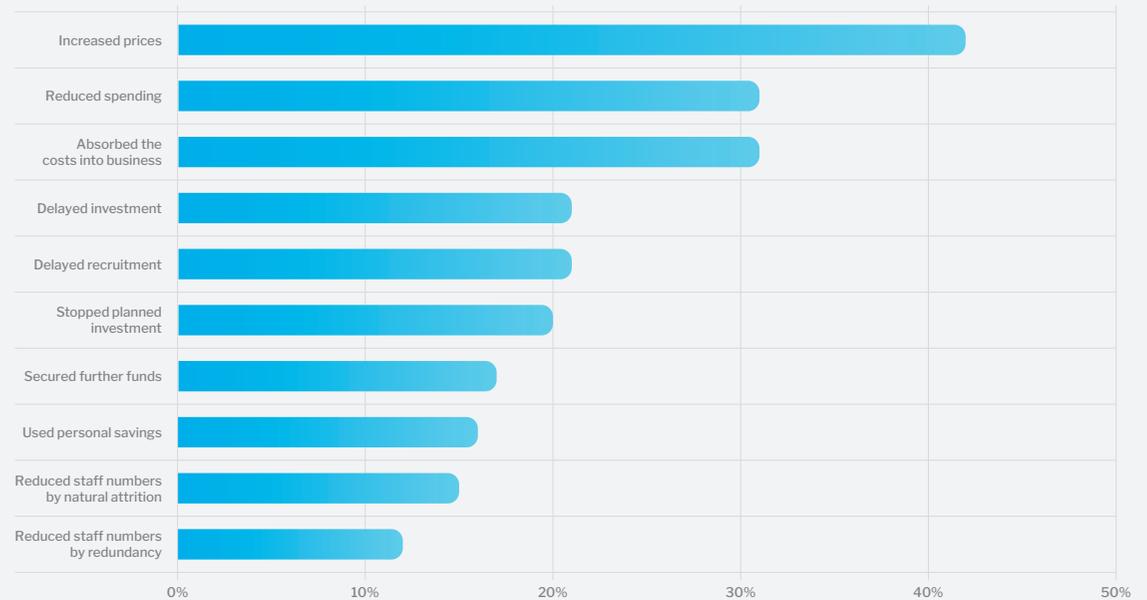
On average, by what % have costs increased in the following areas?



In response to their own cost increases, businesses have taken a number of actions, the most common of which is to raise their own prices. Additionally, nearly a third of SMEs have reduced spending or absorbed the costs into the business, whilst a fifth have delayed investment or scrapped it in total.

Other actions include reducing staff numbers by redundancy or natural attrition, securing additional funds or using personal savings.

What actions have you taken to cope with rising costs?



Source: Opinium

Recruitment, retention and skills challenge

Recruiting and retaining employees is becoming increasingly difficult for SMEs, with many companies turning to flexible working practices to attract talent

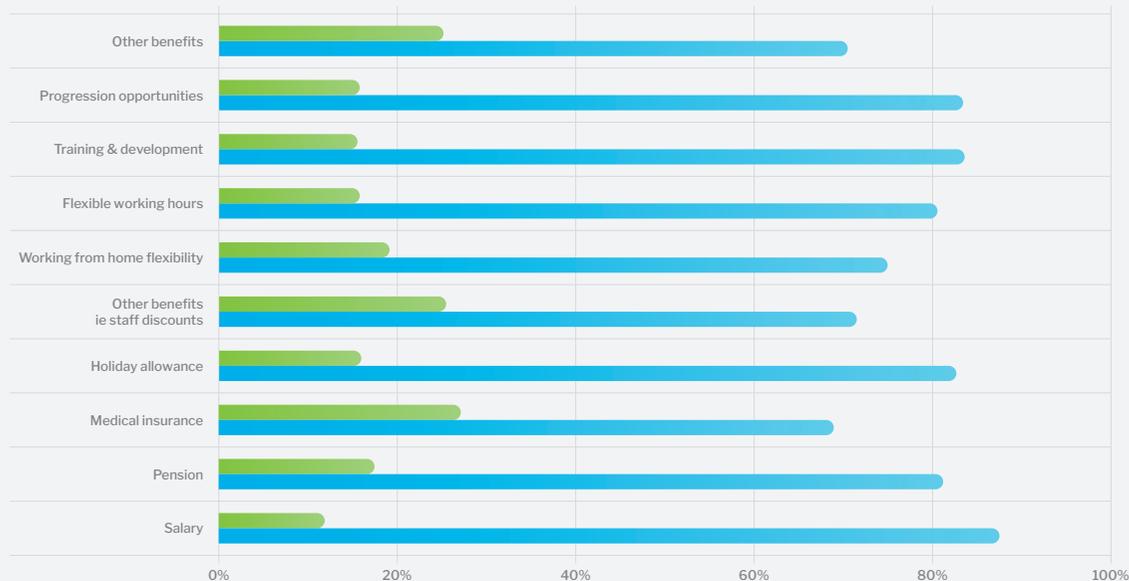
Skills, recruitment and retention is becoming increasingly challenging for SMEs — 61% of companies report a skills shortage for their sector, with 59% stating it has become increasingly difficult to retain employees over the past 12 months. Meanwhile, 65% of companies said they have had to increase salaries to recruit candidates.

Sectors where skills shortages are most acute include agriculture (79% of business report skills shortages), education (78%), hospitality (71%), IT (68%) and healthcare (67%).

Working from home and flexibility had helped companies attract employees. Nearly six in 10 companies (58%) said working from home arrangements had enabled them to recruit from a wider talent pool, whilst companies said that flexible working hours is now nearly as important as pay and benefits for many employees.

Flexible working hours was cited by 81% of SMEs as being important to new recruits, equal to pension and just below training and development (84%). Salary was, understandably, the key driver for new recruits (87%).

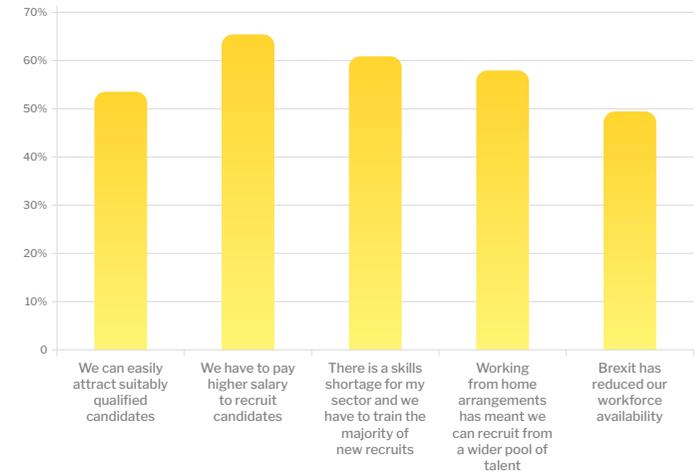
Importance to new recruits



Source: Opinium

● Unimportant ● Important

Business are facing higher salaries and skills shortages



Source: Opinium

Flexibility is key

Six in 10 companies said they had introduced flexible working practices as a result of the pandemic, with 17% of firms already having flexible working in place. Those businesses that introduced flexible working practices highlighted improvements across a number of areas in their companies, highlighted below.



68%
Operating cost reduction



70%
Productivity



72%
Staff retention



73%
Employee morale



74%
Recruitment

Export for growth

Despite the stereotype of SMEs being mainly domestic businesses, the majority export their goods or services

Nearly nine in 10 SMEs generate some of their income through exports – only 15% of businesses said they didn't export at all.

More than half (58%) generate up to a quarter of revenues from overseas sales, with nearly one in 10 (8%) earning over half of income from exports.

On a sector level, companies in transport (29%), education (23%), agriculture (21%) and manufacturing (11%) were most likely to earn over half of their revenue from overseas sales.

Larger companies also had a greater propensity to generate a significant proportion of income from overseas sales. A third (36%) of companies with turnover in excess of £10 million generated between a quarter and half of sales from exports, compared to 15% for companies with a turnover of up to £5 million.

The weak pound may make UK exports more attractive, so levels of exports could increase in future waves of this survey.

% of revenue generated from exports



38% 0% revenue generated

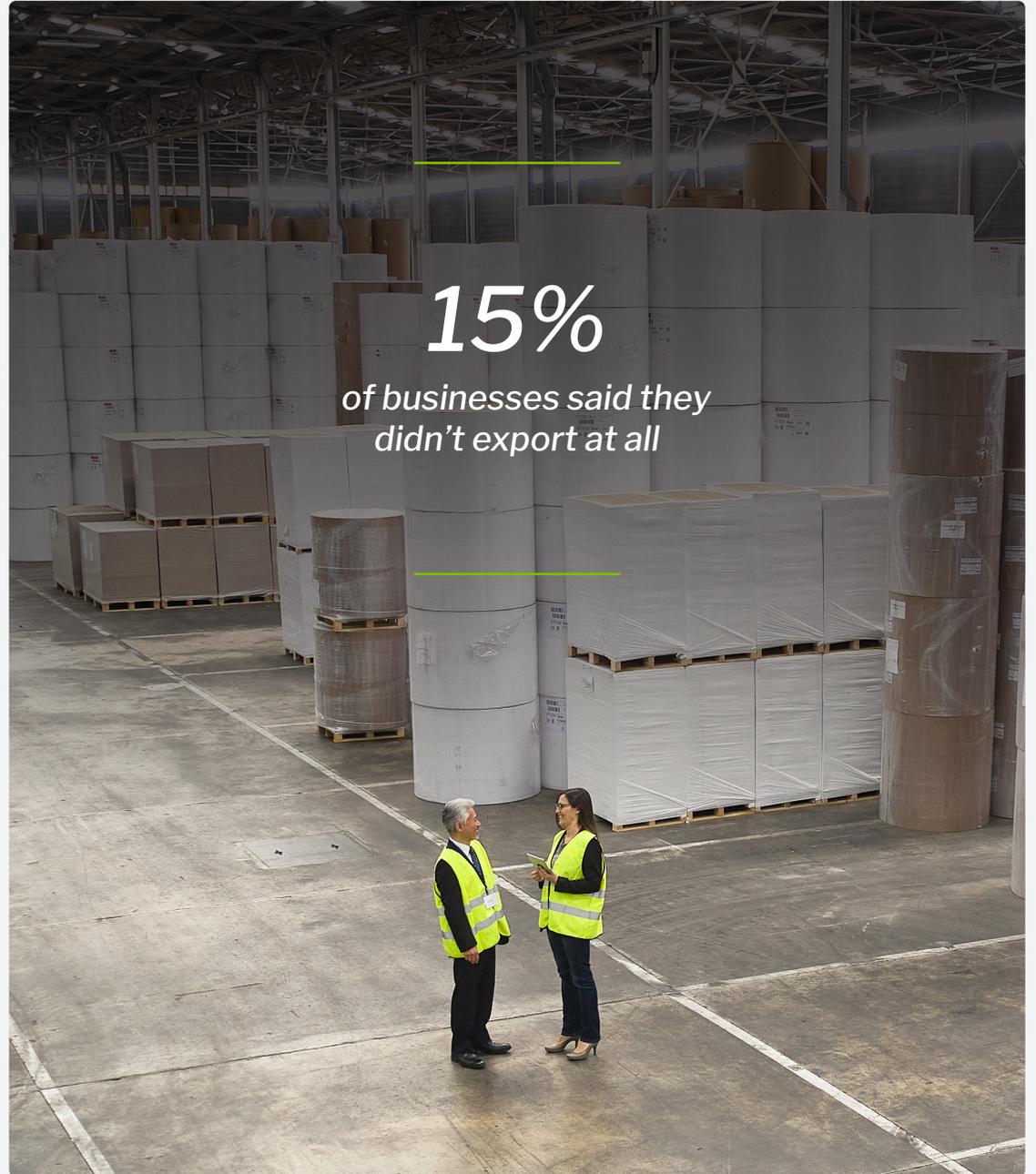
20% 0.1% to 10% revenue generated

19% 10.1% to 25% revenue generated

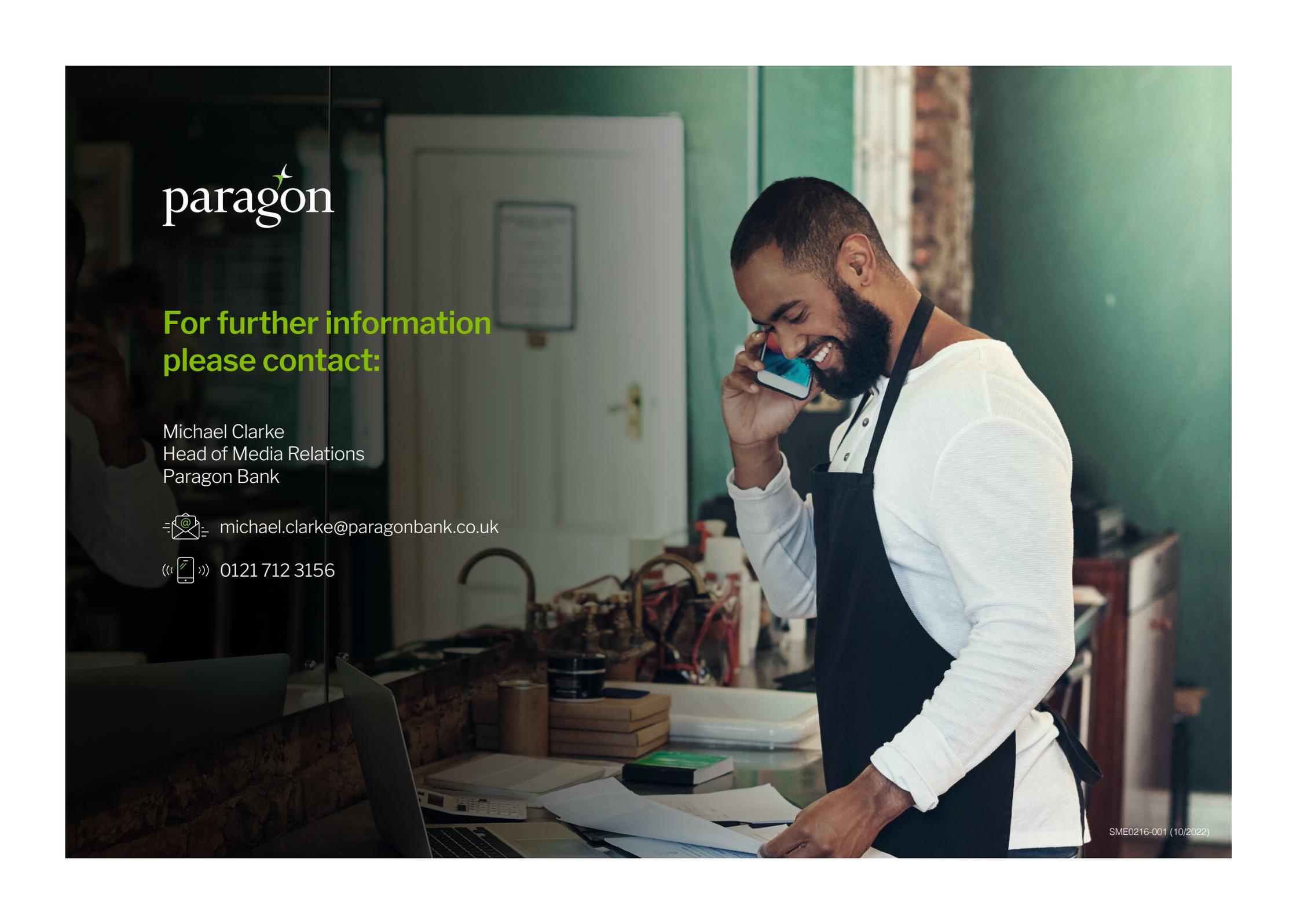
15% 25.1% to 50% revenue generated

9% 50.1% to 75% revenue generated

2% More than 75% revenue generated



15%
of businesses said they
didn't export at all

A man with a beard, wearing a white long-sleeved shirt and a black apron, is smiling while talking on a blue mobile phone. He is standing in a workshop or kitchen area with a white door and a sink in the background. The scene is dimly lit, with a greenish tint to the background.

paragon

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