FUTURE IMPACTS
The changing nature of risk facing small businesses in the UK

November 2016
Taking on an element of risk is a necessary part of driving growth for any small business. Risk can bring opportunities, but it is crucial that growing businesses manage their risk effectively so they can thrive in what is a challenging economic climate. Whether it is the risk posed by a changing economic landscape or the rapidly-evolving impact of technology on every sector and every corner of the country, the challenges faced by SMEs in delivering continued growth are significant.

This evolution has created new opportunities and ways through which businesses can expand their customer base, however, it has also brought with it new risks, which many businesses are failing to address.

As a valuable tool used by businesses to protect themselves against risk, insurance provides additional support so they can take measured risks in order to drive growth. However, a lack of awareness of what insurance options are available to SMEs is a stumbling block and something the insurance industry must work to rectify. It is important that business owners accurately understand their risks, as well as what can (and cannot) be insured against, so they can take appropriate steps to ensure their growth ambitions are realised.

This report has been produced to highlight the mismatch between the realities SMEs face and their action to get ahead of the curve and ensure the growth of their business is protected. This research provides SMEs, brokers, policymakers, and anyone interested in the growth prospects of small businesses, with a clear insight into what risks SMEs face and what action can be taken to ensure they continue to grow.

The fact that 28 percent of SMEs in the UK say they would go out of business if faced with an unexpected bill of £50,000 is case in point. A cyber-attack could easily cost even more than that as the average cost of a cyber security breach to small businesses is between £75,000 and £311,000. This could have significant implications for the UK economy as a whole given the important role SMEs play in the UK: according to the Federation of Small Businesses, SMEs contribute to 60 percent of all private sector employment and had a combined annual turnover of £1.8 trillion in 2015.

With uncertain times ahead, the UK needs its army of small business owners to continue to create jobs, increase exports and drive economic growth across the country like never before. At RSA, understanding the hopes and fears of SMEs is extremely important if we are to provide them with the tools they need in order to succeed. Protecting this vital part of the economy must be a top priority for all of us if the UK is to continue to thrive.

Russell White, Schemes and Deals Director, Regions and SME, Commercial Risk Solutions at RSA


The role of SMEs in the economy

At the start of 2016, 99.9% of all private sector businesses were small or medium-sized.

Total employment in SMEs was 15.7 million; 60% of all private sector employment in the UK.

The combined annual turnover of SMEs was £1.8 trillion, 47% of all private sector turnover in the UK.

THE SME VIEW: The reality of the risks facing small businesses today

The SME risk landscape

Despite short term economic uncertainty caused by events such as Brexit, small businesses’ key concerns are more long standing risks, with increasing competition and cash flow issues being amongst the main risks faced by SMEs.

Brokers take a slightly different view. They perceive the top three risks faced by SMEs as rising business costs, cash flow and loss of a major client or buyer. The biggest difference in the perception of risk related to cybercrime, with 41 percent of brokers compared to 14 percent of small businesses placing it as a top three risk. Additionally, a separate PwC report found 74 percent of SMEs had suffered an information security breach in 2015, indicating this risk is much more prominent than many think.

THE SME VIEW: we have a responsibility to help SMEs get ahead of emerging risks to their business

Brokers can identify with the challenges highlighted by SMEs in this report and often share the same concerns. Cash flow and rising business costs, are examples of issues for businesses large and small regardless of sector. However, SMEs tend to consider macro-level risks to their business as more significant, while brokers tend to place more weight on specific threats, such as cyber. Brokers are looking for ways to help their clients where they can, so it makes sense that they identify areas of risk where they can see solutions.

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Do you expect the revenue of your business to grow or shrink in the coming 12 months?

- 6% DON'T KNOW
- 14% SHRINK
- 57% STAY THE SAME
- 24% GROW
Small businesses do not see a negative long-term impact on their growth as a consequence of the Brexit vote. In our survey of SMEs, which was conducted in September 2016, most (70 percent) said Brexit will either have no impact at all (43 percent) or will be positive (27 percent) for their business. Less than a quarter of SMEs (23 percent) said it would have a negative impact on their own growth and less than one-in-five (17 percent) ranked Brexit as one of the top three risks to their growth in the next 12 months.

The regional picture
- Eight out of 12 regions were more positive than negative about the long-term impact of the vote.
- 32 percent of SMEs in the North West and East of England said Brexit will be positive for their businesses, the most positive out of all regions.
- The South West had an equal split of businesses thinking positively and negatively about Brexit.
- Wales was most pessimistic, with 35 percent of SMEs saying it will have a negative impact.

The sectoral picture
When looking at specific industries a more balanced picture presents itself. Of the 18 sectors surveyed, eight were net positive about the impact of Brexit, eight were net negative, and two were evenly split. Some sectors – notably manufacturing (45 percent) and IT (43 percent) – were significantly more positive than the norm (27 percent).
The broker view on Brexit
Brokers generally had a positive view on the impact of Brexit. When asked what impact exiting the EU will have on their own long-term business growth, one third (32 percent) said it would be positive compared to just 17 percent who said it would be negative. Nevertheless, to mitigate against the potential impact of Brexit on the industry, the British Insurance Brokers’ Association (BIBA) has called on the government to consider a number of key points in the negotiation process.

BIBA considerations for government in Brexit negotiations

1. Many of our member firms enjoy the benefits of tariff-free cross-border trade within the European Union (EU) and European Economic Area (EEA).
2. Partly as a result of this freedom, the UK is the third largest insurance market in the world and enjoys a balance of trade surplus in insurance-based products.
3. Much of this will be at risk if the UK were to lose the ability to trade freely with the EU. The issues we raise in this letter have been shared and agreed with both the London Market Group (LMG) and the London and International Insurance Brokers’ Association (LIIBA). We also share the concerns raised by the CBI and their 5 main principles.

When asked what impact Brexit will have on their SME clients’ long-term growth, brokers responded in the same proportions (32 percent positive and 17 percent negative).

The RSA view: bigger issues than Brexit facing UK SMEs

The disparity between the overall positive outlook SMEs have about Brexit with the economic uncertainty that SMEs perceive as the most major risk is notable; while Brexit is not perceived as a risk in itself, the uncertainty it is causing could be having an indirect impact. But this disparity also points to the softening of business growth irrespective of Brexit. The Federation of Small Businesses’ Voice of Small Business Index shows small business confidence has been relatively subdued since Q2 2014, and has declined since the beginning of 2016. This view is consistent among both brokers and their small business clients alike.
A DANGEROUS GAP:
SMEs not protecting themselves against their key risks

Insurance is a key resource businesses can use to help manage their own risk. However, SME decision-makers are too often not realising a need to take out additional cover for the major risks they face. **43 percent of businesses have not reviewed their business insurance for over a year**, which suggests that business owners are not putting sufficient time into understanding their risks and what they can do about them to protect their future.

**58 percent of SMEs are not insured against any of their top three risks.** Not all of these risks are directly insurable, but there are policies that businesses can take out which would alleviate the impact that these risks could have, such as business continuity insurance which businesses could use to cover loss of income. Underinsurance is considered a concern among SMEs, according to almost **nine out of ten brokers (88 percent)**.

Both uninsurance and underinsurance are significant issues for SMEs, potentially leaving many at risk. The importance for brokers to work with SMEs on regular reviews is clear, with just over half (54 percent) of businesses having reviewed their insurance in the last 12 months.

**What would happen to your business if you faced a loss of £50,000 for which you were not insured?**

<table>
<thead>
<tr>
<th>Option</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>We would go out of business</td>
<td>28%</td>
</tr>
<tr>
<td>We would pay for it from my/our savings/ by remortgaging/ by asking family, friends etc.</td>
<td>20%</td>
</tr>
<tr>
<td>We would reduce other expenditure</td>
<td>17%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>13%</td>
</tr>
<tr>
<td>We would take out a bank loan</td>
<td>11%</td>
</tr>
<tr>
<td>Other</td>
<td>6%</td>
</tr>
<tr>
<td>We would reduce our wage bill</td>
<td>5%</td>
</tr>
</tbody>
</table>

Whether by choice or due to lack of awareness, SMEs are essentially self-insuring against some major risks. More than a quarter of SMEs would go out of business if faced with a £50,000 cost not covered by their insurance. In the South West, 40 percent of SMEs would go out of business if this was to happen.

Brokers also understand this perilous position, as 80 percent say that their SMEs clients are not financially prepared for a such a cost.

**The RSA view: the implications of underinsurance are potentially catastrophic**

The implications of these findings are hugely significant and demonstrate the perilous state many SMEs would be in if faced with an uninsured or underinsured claim. When considering the fact that a majority of small businesses have no cover in place for the major risks they themselves have identified, serious questions have to be asked about how SMEs are protecting themselves and their future growth.

Some may think that because they have insurance they are covered against all losses, but many might find themselves underinsured if they are not updating their insurance coverage as their business develops and changes over the years. A claim worth £50,000, for example, will not be fully covered if their total sum insured is too low, meaning that the business would need to foot part of the bill if they don’t have the right cover. It is vital that brokers work with the SME community to ensure their clients understand the potential implications of not having cover in place and what products would best suit their needs.

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1. Our findings echo an FCA report that found that in 22 percent of claims files the sums insured on some aspect of the cover proved to be inadequate to cover the actual loss suffered by the policy holder.
A notable lack of awareness and action

The fact that many businesses have not prepared themselves by putting measures in place to protect against their core risks suggests that SMEs are not aware of how they can protect themselves and what is available to them. When asked why they did not have relevant insurance for the risks they themselves have identified, the most common response was that they do not require the cover (38 percent) and the cost of premiums (28 percent), even though people often do not know what their needs are and could have an incorrect perception of how much insurance actually costs.

22 percent of respondents admitted that they did not know what types of insurance cover exist for their needs. This lack of awareness is a major challenge for the insurance industry and brokers of small businesses across the UK.

Underinsurance outlook

There is a significant opportunity for brokers to be even more proactive in ensuring their SME clients fully understand the potential implications of underinsurance for their business.

WILL SMES EXPAND THEIR COVER IN THE NEXT 12 MONTHS?

Only 14 percent of SMEs plan to increase their cover in the next 12 months.

74 percent of small businesses said that they plan to keep their insurance coverage the same in the coming 12 months.

28 percent of brokers, however, thought their SME clients would expand their coverage.

The RSA view: we must proactively raise awareness of what insurance is available for an SME’s risks

There is a need for SMEs to better protect themselves against their risks. Many are putting themselves in a precarious position by not having anything to fall back on if they are hit with unexpected costs.

88 percent of brokers stated that they see underinsurance as a problem among SME clients either frequently (26 percent) or sometimes (62 percent), and only seven percent said they never see this as a problem. Brokers need to act on this issue by providing support and carrying out regular, robust reviews with their SME clients. This will not only boost brokers’ revenue but also help to fortify UK businesses and their contributions to the UK economy.
Technological imperative: The changing nature of SME risk

There are more new and emerging technologies than ever before. Businesses are minimising the distance with their customers through digitalisation, known as ‘Uberisation’. This has created new operational models for businesses that use existing assets or human resources with very little or no transactional costs, allowing SMEs to grow at a rapid pace. A Tech Nation report revealed the UK’s digital technology industries are growing 32 percent faster than the rest of the economy. These changes present unprecedented opportunities, but also create new uncertainties.

73 percent of businesses surveyed identified new risks their company faces that were not present when they started. Despite this, 82 percent have not altered or increased their insurance coverage as a result of technological change. While more traditional risks still hold a fundamental threat to businesses of all sizes, newer and less transparent risks are growing quicker than businesses are protecting themselves against them.

The RSA view: SMEs are behind the technological curve when it comes to risk

The UK is becoming a leader in the tech sector and SMEs are at the forefront, often less constrained and more willing to innovate. As insurers we want to be able to support these tech pioneers as much as possible by protecting them and their assets and enabling them to take the necessary risks to innovate. The strong growth in this sector is highlighted by a report from Tech Nation, showing that 80 percent of tech clusters in the UK saw growth in turnover or jobs in the last year. For most businesses, digitalisation is no longer a luxury but a requirement if they are to remain competitive and expand.

Helping SMEs disrupt the status quo

Many SMEs are leading this disruptive technology, with many having conceived new businesses that have boosted growth for other SMEs. This is positive disruption, bringing flexibility and innovation to the marketplace. But small businesses need to consider the associated risks, as well as the benefits, that this innovation brings so that they can manage them effectively. Brokers can play a major role in highlighting these risks to SMEs and ensure they have appropriate cover in place.

KEY STATS:

- 27 percent of SMEs do not think their business faces any new risks today compared to when they first set up.
- Just seven percent see the impact of emerging technologies as a main risk to the growth of their business in the next 12 months.
- One third of SMEs have never thought about taking out a new insurance policy to protect their business against a specific risk.
- PwC data shows that nine-in-10 large organisations and three-quarters of SMEs had experienced some form of a cyber-attack in 2015, yet SMEs do not seem to be acting on the clear threat posed by this.

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Cyber threats are one of the most common risks facing SMEs, a trend that is only likely to grow in the future. While SME decision-makers may often believe they are below the threat radar, government figures show that a quarter of all businesses detected one or more cyber security breaches in the last 12 months alone. The issue affects a significant proportion of UK businesses, and is likely to affect more as technology advances further.

Only 16 percent of SME decision-makers that do not currently hold cyber insurance said that they have considered taking out such cover, however, only 9 percent actually have it in place. While it is possible that some of those businesses that have not considered it have cover in place through other policies, it is likely that a majority consciously made this decision. Perhaps most surprisingly, two-thirds (64 percent) of IT and computing companies compared to an average of 78 percent across the UK have not considered protecting themselves against cyber threats, despite having greater exposure to the technology space.

Businesses’ failure to adequately protect themselves from cyber threats is echoed by government data, which found that approximately a third of firms had formal written cyber security policies and only 10 percent have separate cyber cover in place.

Just 14 percent of SMEs identify cyber risk as a top three issue for their business.

Yet 26 percent of SMEs said they are concerned about the threat posed by a cyber-attack. 49 percent were not concerned.

Only nine percent of businesses have separate cyber cover in place.

56 percent of those without cover say that this is because their business does not require it.

82 percent of businesses have not altered or increased their insurance policy to respond to technological change, including cyber.

Cyber risk is identified by nearly one-fifth (19 percent) of businesses as a risk facing them today that did not exist when they were set up.

**The RSA view: lack of awareness of cyber threat is huge risk for a majority of SMEs**

*SMEs can find it hard to relate headline-grabbing stories about cyber and data loss to their own businesses. Unfortunately, however, they are increasingly the target of lower level attacks, which can be just as damaging for their business as many of the cyber breaches that make the headlines. Cyber-attacks harm not only the ability of a business to continue as normal but can also have a significant impact on an SME’s reputation and customer confidence, which ultimately has a longer lasting impact on a growing business.*

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REGIONAL VARIATION:
Risk mapping the UK

**CYBER**
- North East: 8%
- North West: 9%
- Yorkshire & Humberside: 12%
- East Midlands: 9%
- West Midlands: 11%

**BUSINESS**
- North East: 26%
- North West: 23%
- Yorkshire & Humberside: 35%
- East Midlands: 22%
- West Midlands: 22%

**BUSINESS**
- Wales: 31%
- Scotland: 29%
- Northern Ireland: 35%*

**CYBER**
- Wales: 6%
- Scotland: 3%
- Northern Ireland: 0%**

**BUSINESS**
- East of England: 14%
- London: 12%
- South East: 6%
- South West: 8%

- East of England: 33%
- London: 20%
- South East: 34%
- South West: 40%

*Northern Ireland low base size (n=17)
**Northern Ireland low base size (n=12)
REGIONAL VARIATION:
A different view to risk

There are significant differences in how SMEs view risk across the UK. **40 percent of SMEs in the South West** would go out of business if faced with an uninsured £50,000 claim, versus a **national average of 28 percent**. This was the highest figure reported, while **SMEs based in London would be the least likely to go out of business** (20 percent).

When reviewing insurance plans and the extent of cover, **SMEs in the North East (20 percent) and London (19 percent)** have the greatest plans to increase their cover over the next 12 months. On the whole, 74 percent of SMEs plan to keep the same cover.

When it comes to actively reviewing insurance, the West Midlands and Scotland are most up to date, with **63 percent and 61 percent** respectively reviewing their insurance cover in the last year. London SMEs are the least proactive in reviewing their cover, with **only 46 percent doing so in the past 12 months**. This could be driven by the concentration of businesses in these regions, with some being impacted more directly by a changing risk landscape.

**28 percent of London SMEs** have considered cyber cover, the most out of any region, which could be as the two most common types of businesses we surveyed in London were IT/computing companies and professional, legal or business services firms.

**21 percent of SMEs in Wales** see cybercrime as a top risk, which is higher than London (18 percent).

**The South West and South East** are the furthest behind when it comes to cyber insurance with **94 percent and 88 percent** respectively, not having considered the cover yet.
The types of risk that firms face vary depending on their sector. However, our research has found that there is a gap between the risks that worry business owners and the action they take to mitigate against them.

SECTOR SPLIT:
How different industries approach risk

Nearly 40 percent of wholesale, retail and franchising businesses would go out of business if faced with a claim of £50,000 for which they were not insured.

83 percent of professional services firms have not considered cyber insurance despite it being one of the biggest emerging threats facing SMEs.

IT/computing industry are among those that review their insurance cover least frequently, where 58% have not reviewed their insurance in the last year.

More IT/computing companies perceive increased risk for their business as a result of technological change (39 percent) compared to other sectors, and are also most likely out of all sectors to have altered/increased their insurance coverage as a result of technological change (26 percent). However, 71 percent of IT/computing firms have not increased their insurance coverage.

IT/computing firms are also the most likely to reduce their insurance coverage in the coming 12 months (9 percent compared to the average of 5 percent across all businesses surveyed), while manufacturing firms are more likely to increase their insurance coverage over the same period (19 percent compared to the average of 14% across all businesses surveyed).

The RSA view:
While it is clear from this data that businesses perceive the nature of risk differently depending on what sector they operate in, it is important that businesses across all sectors take action against the factors they could be affected by. Understanding and managing risk is absolutely crucial to business security and a key part of planning for future growth.
RSA will
1. Continue to develop and refresh our products to ensure they meet the needs of our SME customers.
2. Share our knowledge, providing guidance and support material to our brokers and customers.
3. Continue to provide a claims service that meets the needs of small businesses, so that when insured incidents occur our SME customers can be confident that they can continue to trade with the minimum possible impact on their business.

SMEs should
1. Ensure they review their insurance annually.
2. Speak to a broker as part of their review to discuss any emerging risks they should be aware of. Broker advice is free for SMEs and BIBA provides a useful directory to help them find a suitable broker here: https://www.biba.org.uk/find-insurance/
3. Strongly consider the impact of technological risk to their business, notably cyber cover. Many SMEs will have an element of cover here within other policies and they should check their policies or speak to their broker to ensure they clearly understand.

Brokers should
1. Note the degree of disconnect highlighted in this report between what brokers think their SME clients’ views are on their insurance cover compared to what SMEs actually think. Notably, the differing opinions regarding cyber and other emerging technology risks.
2. Be even more proactive in speaking to SME clients about the longer-term and emerging risks their businesses face.
3. Use the data and information in this report to highlight to clients and prospective clients, the importance of getting ahead of the curve and considering future risks to their business as it grows.

Government can
1. Resist the temptation to raise Insurance Premium Tax from 12% in future budgets.
2. Build post-Brexit opportunities to cut red-tape and enable small businesses to thrive.
3. Ensure the UK remains a global economy leader, at the forefront of responding to cyber threat and maximising digital opportunities.
About RSA
RSA is a leading insurer in the SME market, providing insurance to a wide variety of businesses from pubs, restaurants and hotels to tradespeople and homeworkers. Working together with our SME insurance broker partners, we use industry insight and data to develop the most suitable products and services to help support SMEs’ ambitious growth plans.

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