UK businesses face a challenging future as a result of expected inflation growth, sterling depreciation, pension auto-enrolment, the apprenticeship levy, looming business rate increases, and wider economic instability.

SMEs represent 99.9 percent of UK businesses, employing 15.7 million people, and play a vital role in the economy. They also innovate and boost competition in markets that may otherwise become stagnant, with 37 percent of SMEs engaging in innovative activity. This incentivises other businesses to improve their services, which in turn benefits consumers.

Yet SMEs also tend to have more limited cash flow compared to larger companies and are more vulnerable to a challenging economic environment. It is therefore crucial for the Government and anyone interested in economic growth to consider the pressures facing UK business and how these pressures could be alleviated.

In line with this, we have produced our Economic Imperative report to measure the impact of changes to the business environment on SMEs, and how this could influence future stability and wider economic growth.

It is crucial that businesses plan ahead so they are prepared for the harsher business conditions they are likely to experience in the coming years. Ultimately, SMEs need to be supported as much as possible to ensure that employment and revenue continue to grow.

RSA believes that protecting our small businesses is absolutely central to securing wider economic growth. Providing SMEs with the tools and help they need to continue to thrive in adverse conditions should be a top priority for all of us.

Almost 4 million of the UK’s 5.4 million SMEs (71%) expect revenues to shrink or stay the same this year.

An increase in business rates could exacerbate this issue for many, with the average shop expected to see business rates rise by 8.4%. Those in Central London could see increases of up to 100%.

Inflation, which is due to hit 2.7% this year, could increase SME costs by £6.8bn.
SMEs are likely to be affected by a range of factors in the coming years. These include:

- **Inflation** is expected to hit 2.7% in 2017, up from 1.6% in 2016.¹
- **Sterling** has fallen by around 15% since January 2016 and is expected to remain volatile.²
- **Business rates** are set to increase in April 2017.
- **Auto-enrolment costs**
- **The Apprenticeship Levy** will be introduced in April 2017.

These developments are likely to increase costs for SMEs at the same time as the price of imported goods increases. Rises in inflation are also likely to reduce consumer spending power, which could affect SME revenues further.

The economic climate is therefore likely to stretch businesses’ finances and challenge profitability in the coming years. Although the UK economy continues to perform well, predicted to be the fastest growing economy of the G7 in 2017, businesses should ensure that they are prepared for whatever the future may bring.

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CASE STUDY

Executive Search firm, Cartwright James, is based in Leeds and opened an office in the City of London in October 2016. Like many other SMEs, it is having to adapt to the harsher economic climate.

Henry Bell, Head of London at Cartwright James, said: “The current economic climate is, of course, having an effect on how we run our business. For starters, we are moving the location of our London office in March 2017 in order to reduce high rental costs. Despite a healthy international client base, we have noticed a slowdown in business within the UK which we suspect is a result of clients tightening their purse strings. It’s common that an unstable economic environment sees a slowdown in both job moves and new hires as company spending power and confidence is reduced.”

“Similarly, as an international executive search firm, the majority of our clients are based abroad. The devaluation of the pound has a knock-on effect to our fees, meaning that we assume changes to our profit margins, though we are still expecting to see revenue growth over 2017.”

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¹ [Source](http://www.bankofengland.co.uk/publications/Pages/news/2016/011.aspx)
These wider economic pressures have the potential to affect SMEs in a way that may push many owners to question whether their firms will survive the coming years. Research found that in Q2 2016, SMEs hoped to invest an average of £102,000 into growing their businesses. This number decreased dramatically to just £49,000 by Q4.

In April, the average shop will see business rates rise by 8.4 percent while those in Central London could see increases of as much as 100 percent, dampening profits. This increase could exacerbate the unfavourable business conditions SMEs are likely to face in the coming years, and is likely to be one of the key reasons why 51 per cent of SMEs said they do not think the Government is doing enough to support them.

Given that the business environment is likely to become much tougher in the coming year, the Government should think about means by which it can mitigate the negative effects that increasing business costs could have on the economy. One solution could be increasing the small business rate relief threshold so that it includes properties with a rateable value below £20,000 rather than £12,000. Employing such a strategy could result in the Government generating more money than it would have done in the long run by boosting business growth.

SMEs play a significant role in the UK, with a combined annual turnover of £1.8 trillion, employing 15.7 million workers and accounting for 99.9 per cent of the private sector. SME growth or depreciation therefore can have a significant impact on the wider economy.
HOW CAN BUSINESSES PROTECT THEMSELVES FROM ADVERSE CONDITIONS

There are a wide-range of steps business could take to help prepare for increasing costs or dips in revenue.

**Business Plan:** Regularly review your business plan to ensure it is up-to-date and fits in with the current market environment.

**Cash Flow:** Review your business cash flow and access to capital. This will allow you to check how much headroom you have and whether more should be done to put your business in a stronger position and make it more resilient to dips in revenue, rising costs or unexpected bills.

**Monitor the market:** Keep up-to-date with economic forecasts and current trends so that you can identify and quickly adapt to any changes in the market.

**Review Costs:** Spring clean your costs and reduce any unnecessary payments for 2017.

**Speak to an adviser:** A financial adviser can review your business, assess your risks and recommend a number of options which could potentially help to boost growth and weather any financial shocks which may occur in the future.

While economic issues such as rising business costs, cash flow problems and inflation cannot be directly insured against, businesses can plan ahead to make their business as resilient as possible. At a time of financial strain part of this planning should involve SMEs protecting themselves against unexpected costs to fortify the business and secure its longevity.

Around 594,000 (11%) SMEs made an insurance claim in the last 12 months. 8,316 of those claims were for £50,000 or more. If those businesses did not have insurance in place to cover those costs, 2,328 SMEs would have gone bankrupt, resulting in a £776.2m hit to the economy.

Insurance keeps thousands of businesses afloat each year, but those that do not have sufficient insurance in place are at risk. Unexpected costs arising from things such as fires, flooding or cyber breaches, can tip businesses over the edge, with 28% of businesses stating that they would go bust if faced with a £50,000 bill not covered by their insurance.

Based on data from RSA’s customers, retrieved in February 2017.
ABOUT RSA

With a 300 year heritage, RSA is a multinational quoted insurance group. Focusing on general insurance, RSA’s core markets are the UK & Ireland, Scandinavia and Canada, with the capability to write insurance business in over 100 countries. RSA’s core businesses have around 13,500 employees with net written premiums of £5.7bn in 2015.

RSA’s previous report, Future Impacts, can be read online here: https://www.rsagroup.com/media/1911/rsa-future-impacts-research-findings-30-november-2016.pdf

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