

Productive Business Index

Edition Three

Q3 2021



1. Foreword

by *Anthony Impey, CEO, Be the Business*



'Productivity' is the word of the moment. Once again dominating headlines, it represents the most sustainable way to boost wages and raise living standards – both high on the Prime Minister's 'Build Back Better' agenda.

However, despite recent ONS statistics reporting that UK productivity in Q2 of 2021 was 1.7% higher than the 2019 average, we cannot afford to be complacent – UK productivity still remains behind that of our European counterparts and has done for over a decade. This discourse is reflected in our Productive Business Index: while many small and medium-sized business leaders are feeling more

positive about the prospects of their business' recovery and growth, they are also facing up to the reality of rising input costs, further compounded by the on-going energy crisis, rising inflation and wage demands.

As a former small business leader myself, I understand the confusion when it comes to 'productivity'. Often seen as just another economist buzzword – as opposed to a useful measure that can be effectively applied in-firm – productivity is also a multifaceted issue that cannot be solved by the flip of a switch.

To reflect the different decision areas that impact overall business performance, our Index measures five key drivers of business productivity: Management Capability, Technology Adoption, Training, Development and HR, Operational Efficiency and Innovation and Ideas.

From our Index, we understand that business leaders see management as the most important route to better performance and greater productivity. At Be the Business, we know that improved leadership and management skills are crucial for a successful business. As a result, we have long prioritised this key performance driver in our two flagship programmes, Mentoring and Boards, while simultaneously emphasising the importance of tech adoption amongst small business leaders.

The challenges facing small business leaders in the coming months are undeniable, yet we must continue to strive for greater business productivity despite the adversity. Fortunately, our Index points to a community of business leaders that's preparing to meet these challenges directly.

UK Productivity – back on top of the agenda

Rising inflation, wage demands and increased costs of doing business has pushed productivity to the top of business and political agendas. Should supply chain disruption continue and inflation continue to rise, this focus will only intensify. But the UK's productivity underperformance is longstanding¹ and the average productivity of a typical UK business remains below that of our peers in Europe and elsewhere.²

The effects of low productivity are numerous for British businesses and the people they employ, reducing the ability of business leaders to grow profits and put themselves in a position to increase wages or hire new employees.

The first step to addressing any problem is understanding its root cause and the changes that can fix it. Since 2017, Be the Business has researched the productivity puzzle. Today, we can say with a high degree of confidence that we understand the key drivers of productivity. In particular, we know that there are five key areas that drive a productive, high performing business:³

- **Management and Leadership:** does the business have a plan for its future and a strategy to get there?
- **Technology Adoption:** is technology, in various guises and even at the simplest levels, embraced?
- **Training, Development and HR:** is the environment to learn and improve built into company systems and structures?
- **Operational Efficiency:** is there a constant focus on improving elements of everyday performance?
- **Innovation and Ideas:** are the conditions fostered to create and test new ideas that will enhance the business?

Movement in any one of these critical factors influences the productivity of a firm. This is why we created the Productive Business Index. It is designed to track not just firm performance, but also recent investments and focus, as well as plans for investment in these key areas.

The Index focuses on micro, small and medium sized businesses in the UK, which we define as employing between 2 and 250 employees. We track changes in the five key areas noted above, as well as general operating conditions, barriers to growth and expectations for the future. This is our third Index report following an initial publication in January 2021.

The data we collect is analysed and combined in a number of ways to produce our Index:

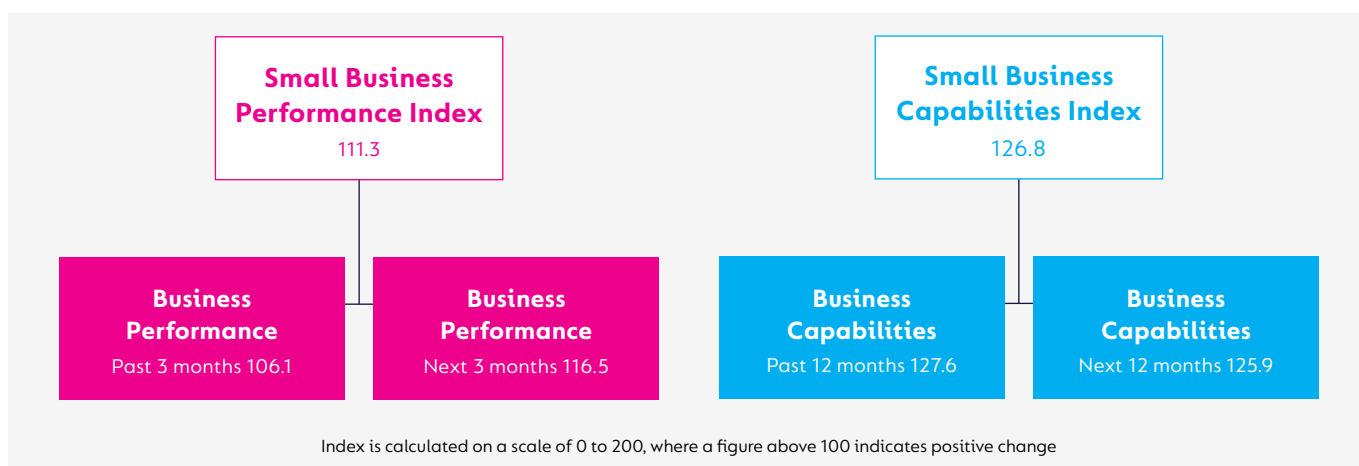
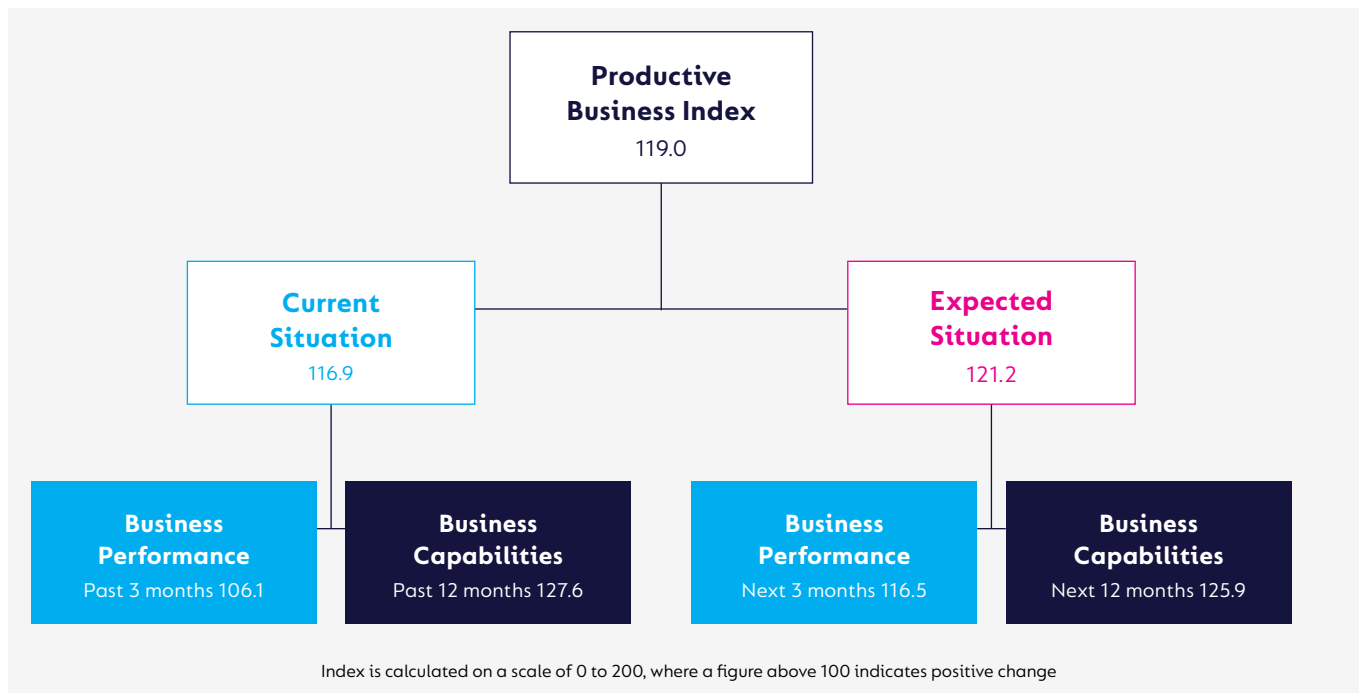
- **Business Performance** measures trading conditions and company sentiment.
- **Business Capabilities** assesses activity in the five areas that drive productivity improvements.
- In both **Performance** and **Capabilities** we assess the current situation, as well as asking about future expectations and plans for improvements.
- We then produce a business **Performance Index** and a business **Capabilities Index**.
- These are combined to produce assessments of the overall Current and Expected situation.
- And finally these combine to form our overall **Productive Business Index** figure.⁴

1 <https://www.mckinsey.com/featured-insights/regions-in-focus/solving-the-united-kingdoms-productivity-puzzle-in-a-digital-age>

2 International comparisons of productivity - Office for National Statistics

3 These five priority areas were identified as part of research conducted with McKinsey & Co. to develop a framework detailing the core drivers of productivity that are within a company's control

4 Performance being a more dynamic variable is measured over 3 months, while capabilities which take a longer time to embed in a business are measured on a 12- month horizon. A note on methodology is in the appendix.



2. Headline findings from the Productive Business Index Q3 2021

The headline Productive Business Index has increased sharply from 108.77 to 119.0

- A very large increase in the overall index of eleven points compared to a six point rise from Q3 2020 to Q1 2021
- The index is positive across all sizes, ages and sectors of business, however larger businesses with between 50 and 249 employees are at 122.3 compared to 117.6 for businesses with fewer than 50 employees
- Areas outside of London are performing particularly well – with the North East at 125.6 and the North West at 123.9 while for businesses in London the index is 116.9
- Operating conditions have significantly eased over the last 6 months
- The proportion of companies forecasting a decline in major areas of their business – trading conditions, revenues, volume of orders, backlog of work, financial situation, input costs and hiring conditions – all declined compared to the previous edition of the Index
- Financial conditions in particular show significant improvement. Only 14% of businesses predict a worsening financial situation over the next three months – compared to 28% in the Q1 2021 Index

Though concerns regarding cost and selling price inflation persist

- More than a third of companies forecast increases in selling prices and input costs
- 37% forecast an increase in selling prices over the next three months – a rise from 26% in the last Index
- And 31% forecast an increase in input costs during the next three months – up from 20% in the last Index

Use of digital, online and ecommerce continues to rise strongly

- Nearly four in ten (38%) companies plan to increase their investment in ecommerce over the next year, a rise of 5% from the last Index
- At present, 42% believe they effectively use ecommerce versus 38% in the last Index
- And use of broader technology continues to increase, though investment in training declines
- For the first time since the Index began, over half of companies now believe they effectively use data in their business decision making
- Six in ten businesses also believe their employees have the digital skills required to be effective in their jobs
- However, the proportion of businesses planning to increase investment in digital skills training has declined since the last Index from 40% to 35%

Meanwhile, companies are increasing time and resources devoted to innovation

- Nearly six in ten (58%) companies believe they are good at generating new ideas and a similar number believe they are good at implementing those ideas
- The pace of innovation looks to have sped up over the past 12 months, with more companies having innovated or attempted to innovate
- Looking ahead, the picture is similar with more companies planning to launch new products or services, enter new markets, or launch internal innovation drives

Management and Leadership continues to be the dominant place to focus attention to improve overall business performance

- As has been the case in previous editions of the Index, effective Management and Leadership is ranked as the most important capability to improve business performance
- Operating Efficiency and effective use of Technology continue to rank second and third respectively, as in previous editions

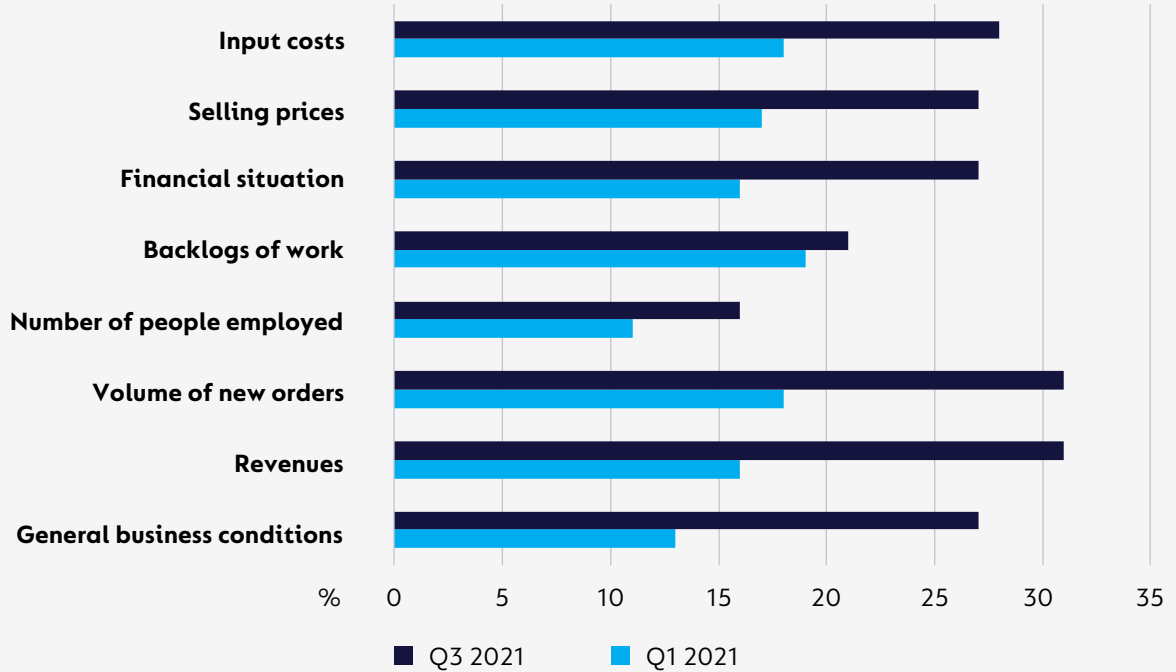
Evolution of HR and workplace practices continues 18 months after the Covid-19 pandemic began as hiring challenges increase

- More than half of companies (53%) are seeking to hire new employees currently
- However, of those seeking to hire, around a third are finding this more difficult than before the Covid-19 pandemic began
- Measures taken specifically to improve the attractiveness of their company to new recruits include introducing flexible working practices (32%), increasing pay (30%), introducing remote working (28%) and adding new employee benefits (25%)
- Meanwhile, 57% of companies expect average pay of their employees to increase across the rest of 2021 as inflation and the war for talent intensify

3. Business performance and sentiment

Based on a review of their last three months, many businesses paint a more positive picture of performance than in the previous Index, conducted late in the first quarter of this year. However, while general business conditions have improved, input costs are reported to be significantly higher than the previous quarter.

Figure 1: Businesses reporting improved conditions over the last 3 months on a range of metrics

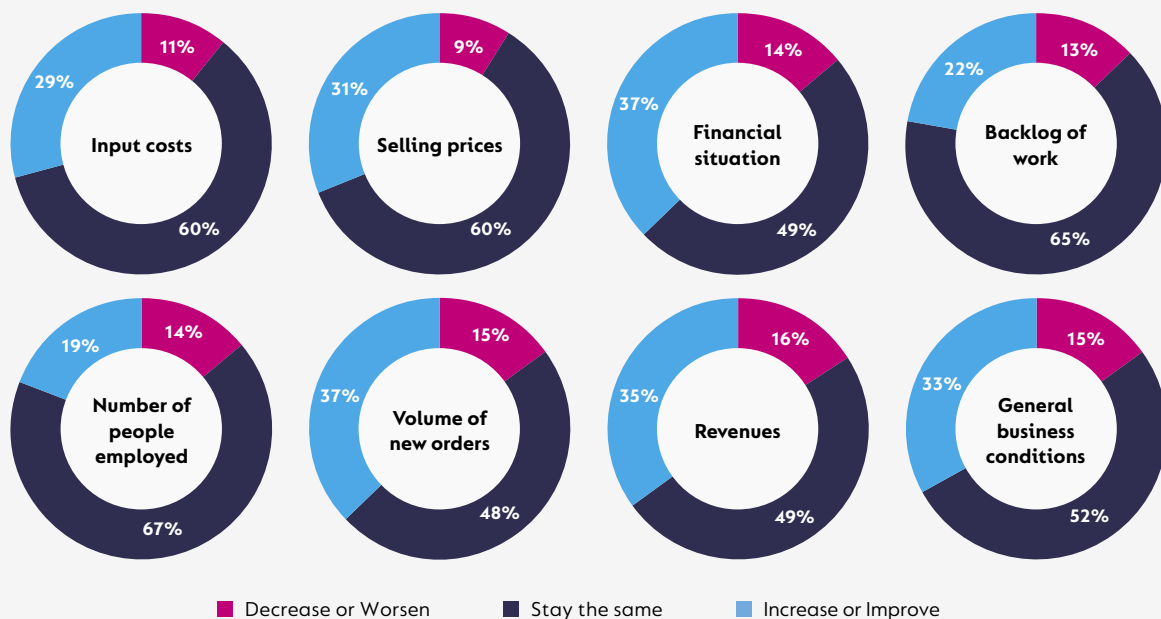


Looking ahead, businesses also report better expectations for the next three months than we have seen previously. Over a third (36%) forecast an increase in revenues in the quarter ahead compared to just 29% in the last edition of the Index. Similarly, 37% forecast an increase in new order volumes versus 30% in the previous Index.

“We have moved to 3 shifts running 24 hours to manage demand and customer expectation. We’re hitting record figures, and from where we were 12 months ago we are significantly different business... for the better!”

Amanda L., Manufacturing & Engineering, 100 – 149 employees

Figure 2: Expectations for performance over the next three months



In line with the last edition of the Index, companies still identify the most pressing barriers to growth as the general economic climate, followed by sector competition and insufficient demand.

It is notable however that the percentage of businesses reporting the economic climate as a key barrier has dropped from 40% to 33%. Elsewhere, the cost of labour has risen from joint sixth to joint fourth on the list of key barriers to growth.

4. The five areas businesses are focusing on to improve productivity

Looking across their companies, business owners and managers have consistently ranked Management and Leadership as the most important area to prioritise development and investment in to drive productivity since our Index began.

The data in this edition continues the trend, with operating efficiency and technology also continuing to rank as the second and third most important areas respectively.

Figure 3: Ranked importance of different areas to improving company performance

| | Ranking in this Index | Ranking in previous Index | Ranking in the first Index |
|---------------------------|-----------------------|---------------------------|----------------------------|
| Management and Leadership | 1st | 1st | 1st |
| Operating efficiency | 2nd | 2nd | 2nd |
| Technology | 3rd | 3rd | 3rd |
| Innovation | 4th | Joint 4th | 4th |
| Human Resources | 5th | Joint 4th | 5th |

Despite this consistency, there are notable changes to how companies are investing and prioritising activity within each of these areas however.

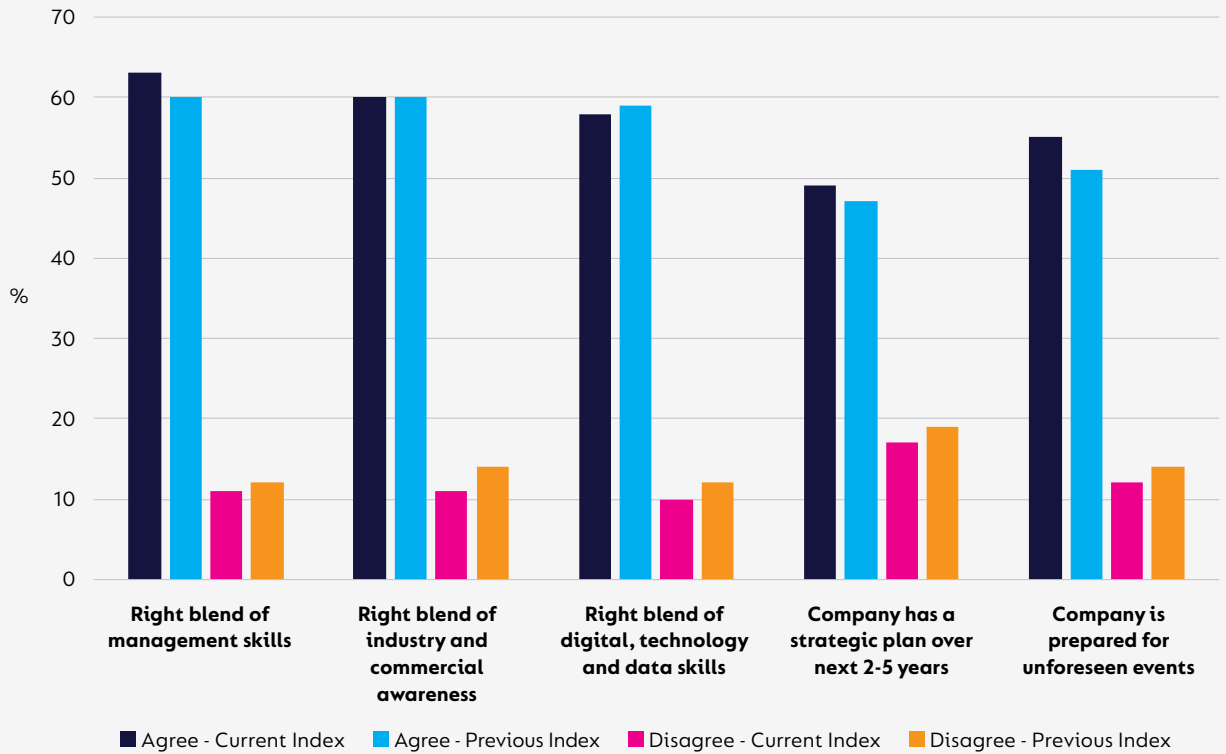
Management and Leadership

The majority of businesses continue to believe that their company has the right blend of professional management skills and abilities. While six in ten thought this to be the case in the last edition of the Index, the figure has now risen further to 63%.

Other areas of management and leadership have a similarly high degree of confidence. Businesses believe they have the right blend of industry and commercial awareness (60%), digital and data skills (58%) and preparation for unforeseen events (55%).

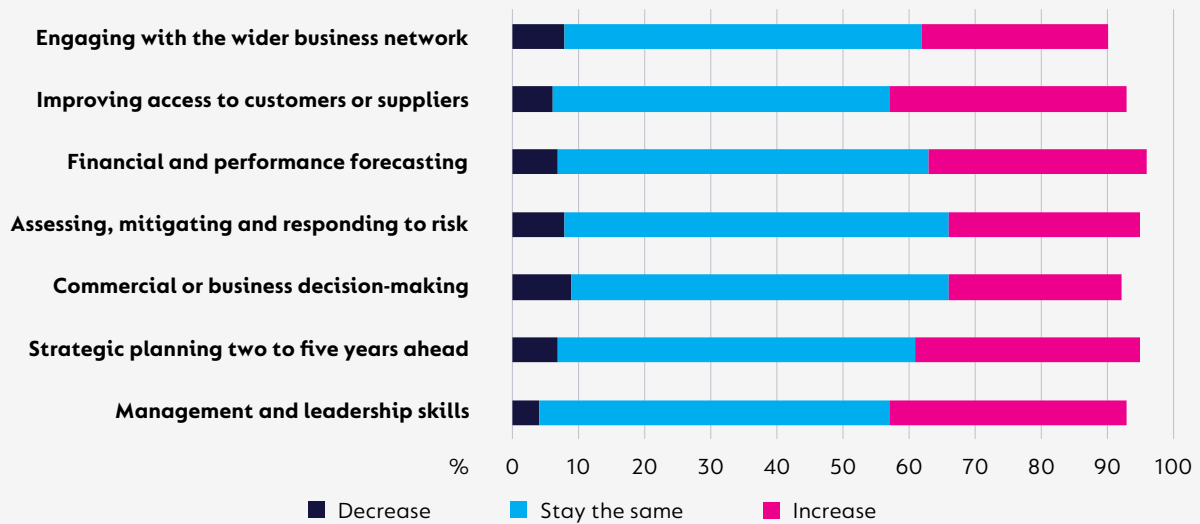
There is one area – the ability to plan strategically for the long-term – where fewer than 50% of companies are still confident of their abilities. However, there has been steady improvement in the percentage of businesses confident in this area, rising from 43% in the first edition of the Index to 49% today.

Figure 4: Views on strength of company leadership and management skills



Looking ahead, far more companies plan to increase rather than decrease the level of activity in key business areas over the next 12 months. Again, building capacity in leadership and management skills is seen as the highest priority area to do so, alongside improving access to customers and suppliers.

Figure 5: Planned level of activity over next 12 months in key areas of management practice

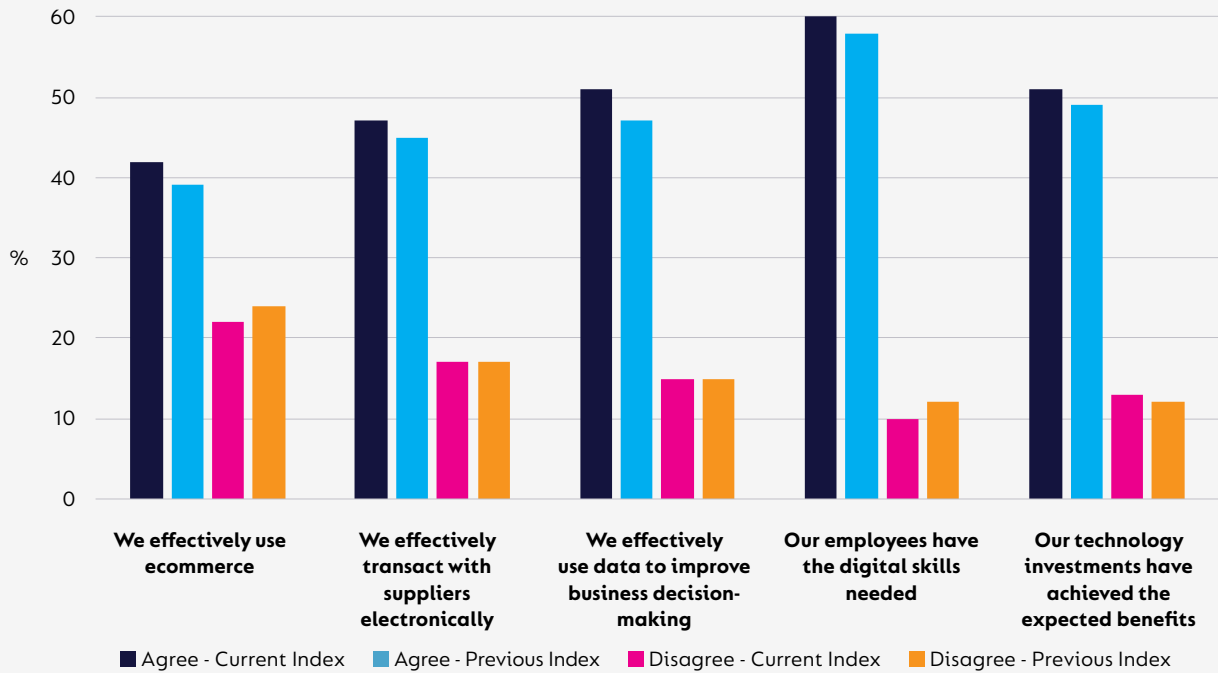


Technology adoption

Investment in ecommerce and other digital technologies has consistently increased since the Index began and our latest data continues to display this trend.

Over 40% of companies believe they use ecommerce effectively while higher proportions are confident in their ability to make data-driven business decisions and transact with suppliers electronically. Confidence about the digital skillset of employees is even higher, with 60% of companies happy this is the case.

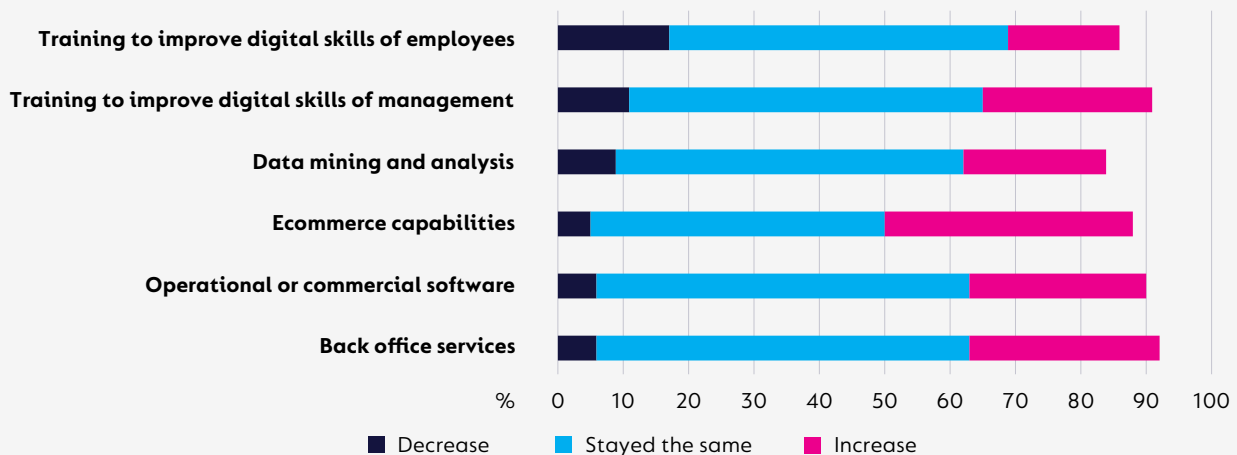
Figure 6: Use of technology and data inside companies



This level of confidence and investment in technology looks set to grow over the next 12 months.

Nearly four (38%) in ten businesses plan to increase their investment in ecommerce which marks a significant increase from the last Index. Similarly, over a third of companies plan further digital skills training for their employees, though fewer will invest in additional digital skills training for management.

Figure 7: Investment intentions by companies over the next 12 months on technology



“We’re adapting our website to appeal to a wider audience, to drive organic traffic to our site without the need to market to them.”

Alan S., Real Estate Activities, 10 – 49 employees

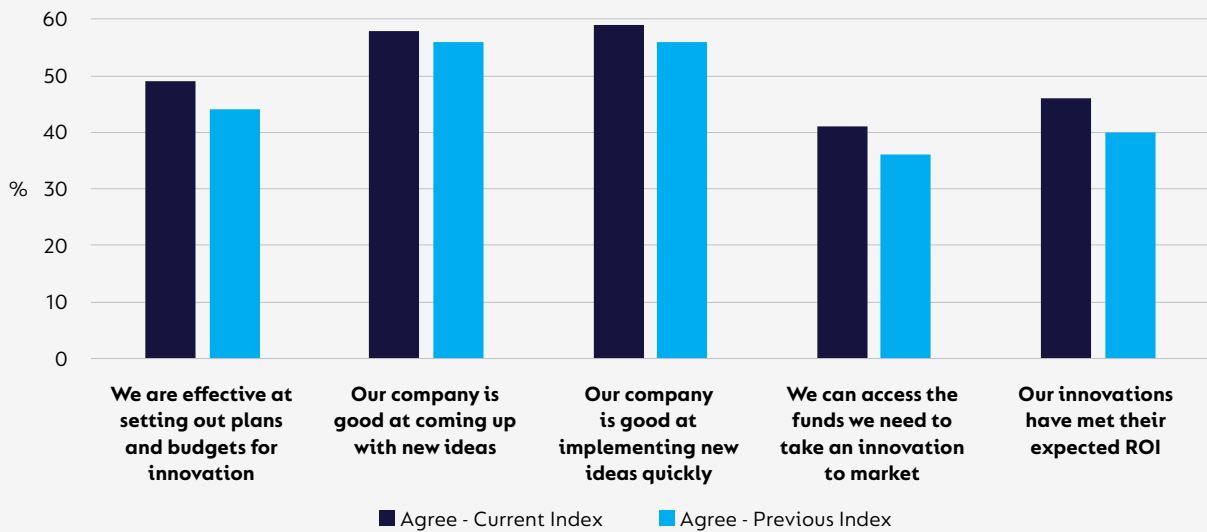
Innovation

A Be the Business report in 2020 identified a wave of innovation that took place during the early months of the pandemic. Technology adoption was at the heart of much of this productive period as three years of innovation occurred in just three months.

Today, many companies remain confident in their ability to innovate – and innovate successfully in a commercial way. In fact, there is evidence of a slight rise since the previous Index in the percentage of companies who believe their innovation is effective both in terms of the process and the outputs.

Nearly six in ten (58%) companies believe they are good at generating new ideas and a similar number (59%) also believe they are good at implementing those ideas. Confidence is lower in the ability to access the skills and funding to bring these ideas to fruition, but over 40% still believe this to be the case.

Figure 8: View of companies on their ability to successfully innovate



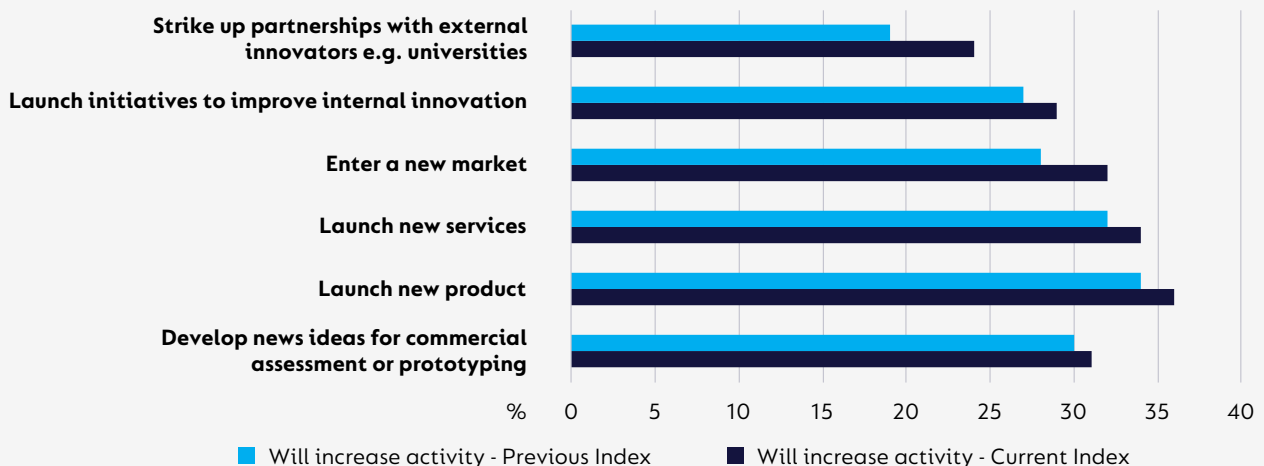
The pace of innovation also looks to have sped up, with more companies having innovated or attempted to innovate over the past 12 months than in the previous Index.

Looking across the next 12 months the picture is similar. There are clear, if small increases in the proportion of companies planning to launch new products or services, enter new markets, or launch initiatives to improve their ability to innovate.

“We are reviewing our outgoings and introducing new products at a higher price ... testing and trying out things to see if it works for us.”

Antigone A., Hospitality, 10 – 49 employees

Figure 9: Plans by companies to innovate over the next 12 months

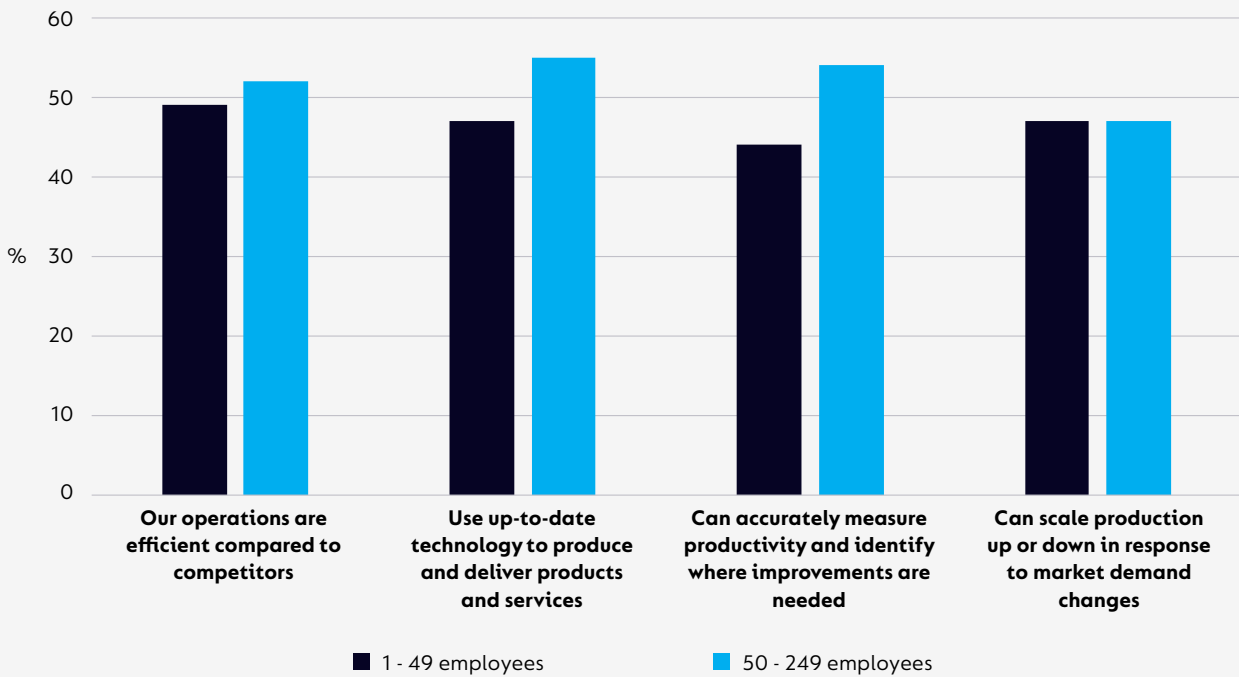


Operating efficiency

Efficiency and productivity continues to be a focus for many businesses. According to this latest edition of the Index, fully half of companies now believe their operations are efficient compared to their competitors. A similar proportion (47%) believe they can accurately measure business productivity and identify areas for improvement.

As we have seen in previous editions of the Index, older owners and managers, as well as larger companies, tend to believe more strongly in their ability to measure and improve efficiency in their organisations.

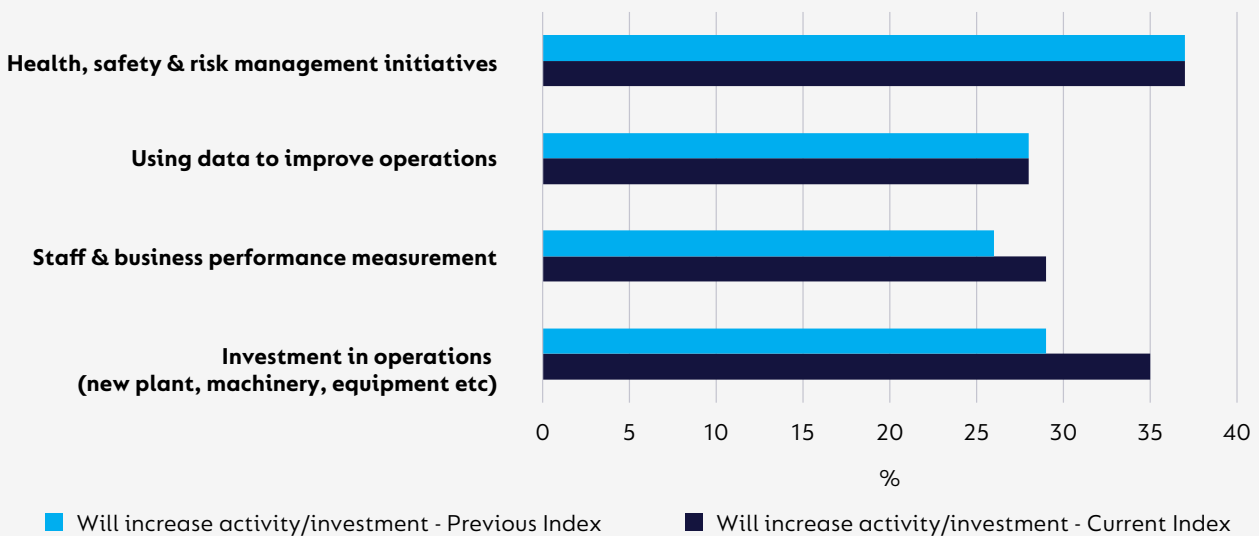
Figure 10: Companies - by size - who agree with statements on their operating efficiency



Positive drivers of productivity and efficiency over the last 12 months have included investment in new buildings, plant and machinery (35% believe this has driven an increase in efficiency), staff and business performance measurement (28%), better use of data (32%) and health, safety and risk management initiatives (37%).

Forecasting ahead, more businesses plan to spend more time on efficiency measures than was the case in the last edition of the Index.

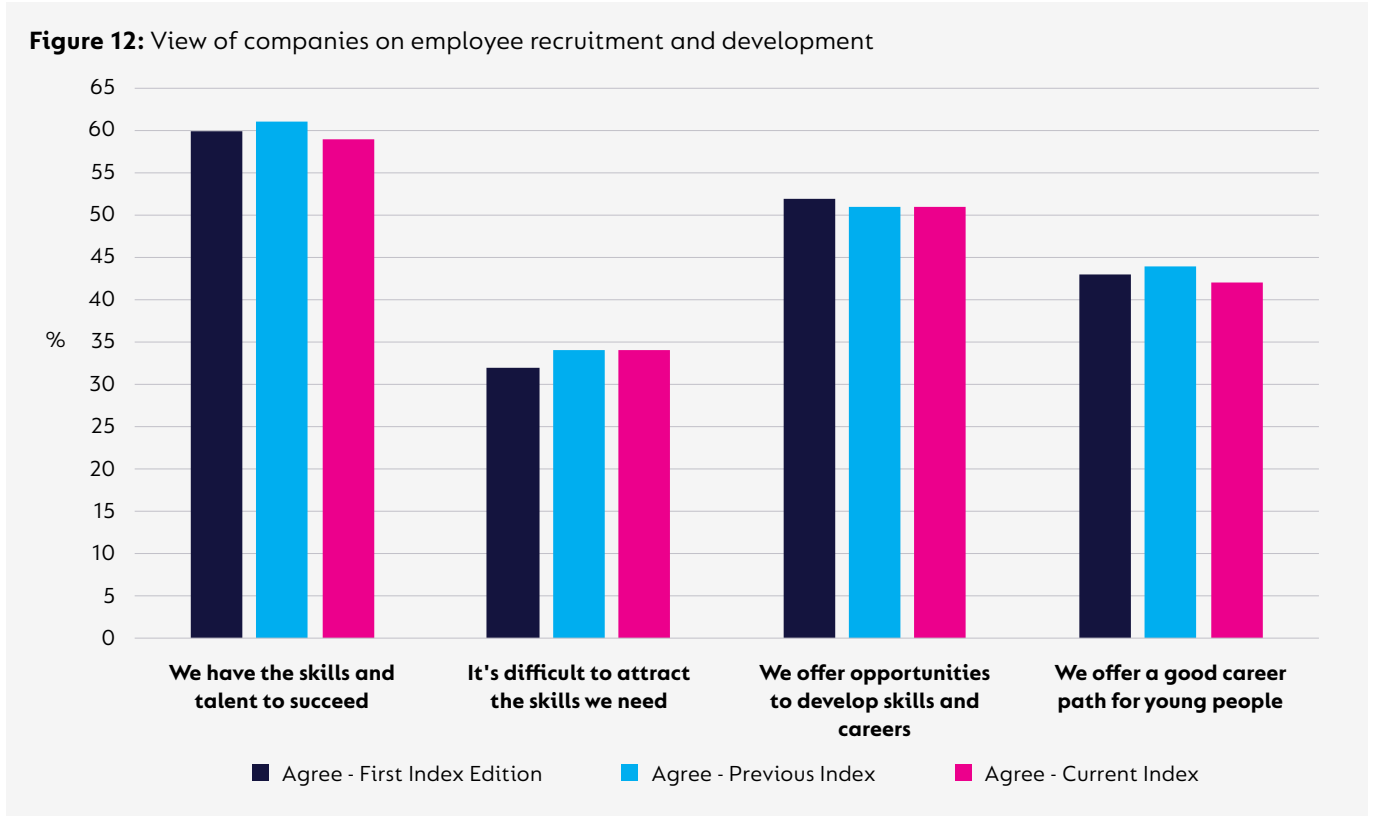
Figure 11: Percentage of companies planning efficiency investments over the next 12 months



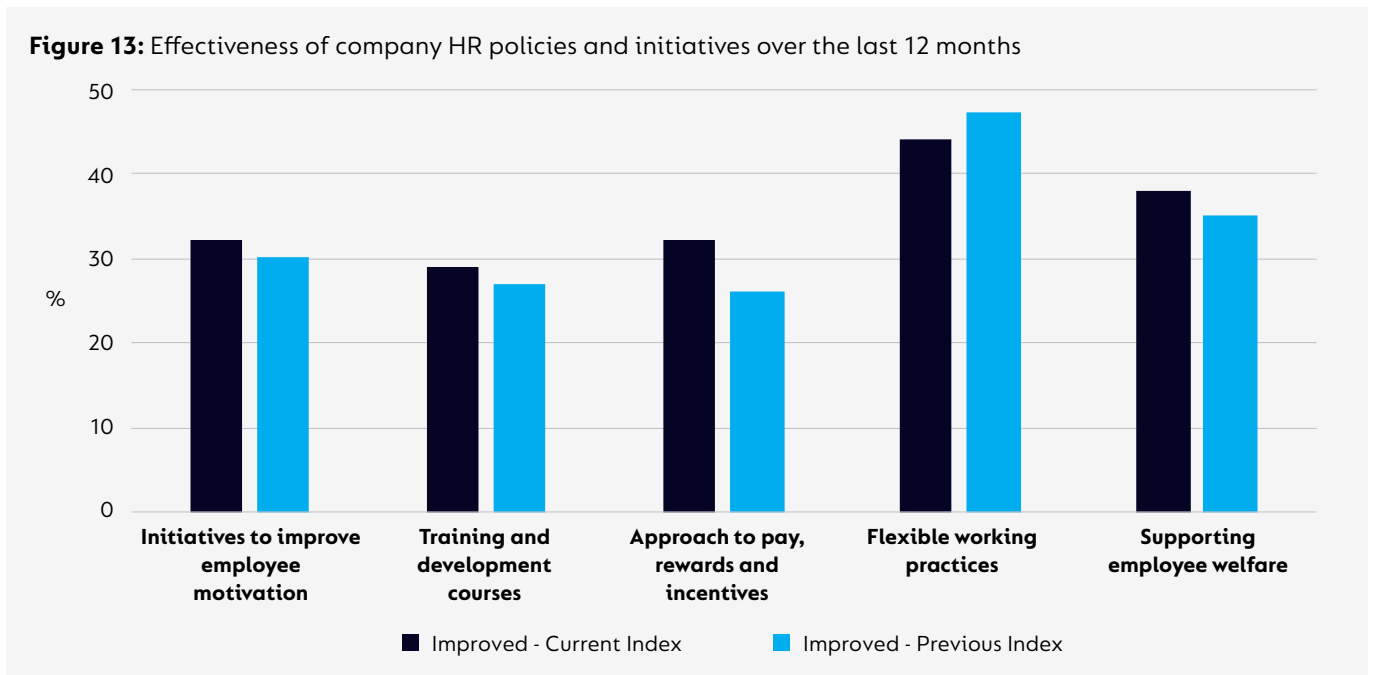
Training, Development and HR

With the challenge of hiring and retaining good employees high in the news agenda in many sectors currently, the results from the Index on the subject of training, development and HR are worth noting.

The majority of companies still believe they have the right mix of skills and talent in their organisations – and believe they offer a good environment for development. There are some slight declines in this level of belief compared to the last Index but companies on the whole continue to believe in the quality of their teams.



The impact of HR and training efforts by companies is also improving according to the Index. More companies think their investment in employee welfare, motivational initiatives, training courses and especially pay and rewards are having a positive impact than in the previous Index.



Companies also believe this positive effect will continue over the year ahead as they invest at similar or higher levels in the same kinds of programmes.

5. The challenge of hiring in 2021

Companies are on a hiring blitz according to the Index. Over half (53%) are currently seeking to hire new employees and only 39% have not hired someone in the last six months.

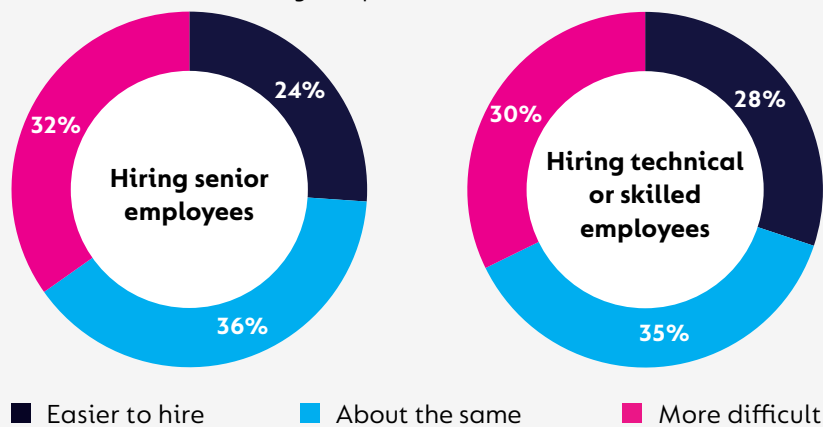
Larger companies – those with 50 to 249 employees – in particular are highly focused on hiring with 73% looking to do so at present. This is also a nationwide trend, with hiring hotspots beyond the South East in the West and East Midlands, North East and North West. Manufacturers, construction firms, financial services and information and technology companies are all intending to hire at pace.

However, around a third of companies believe hiring conditions are more challenging than before the pandemic. This is particularly the case for hiring senior employees and managers.

“The talent shortage continues, and within the global business it is only getting worse. Everyone is looking for the next generation of digital, diverse leaders. And it is a candidate market. The top talent has choices, and there is a high demand for talent with similar profiles.”

RY K., Telecommunications, 200 – 249 employees

Figure 14: Company views on the ease of hiring compared to before Covid-19

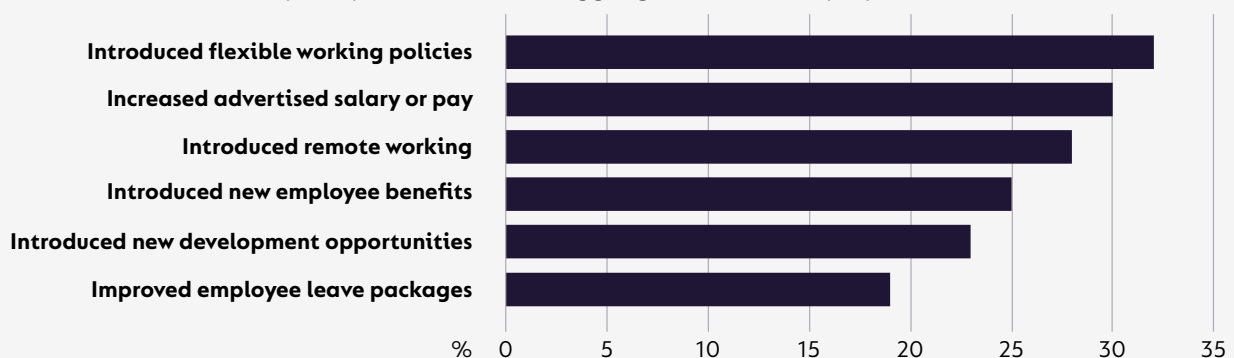


In response to these challenges, companies are taking a range of additional measures to attract new employees. These include increasing pay and benefits, adding new flexible and remote working policies, and changing holiday and leave entitlements.

“We are holding recruitment days, offering higher salaries, all full time positions, increased benefits.”

Stephen G., Hospitality, 150 – 199 employees

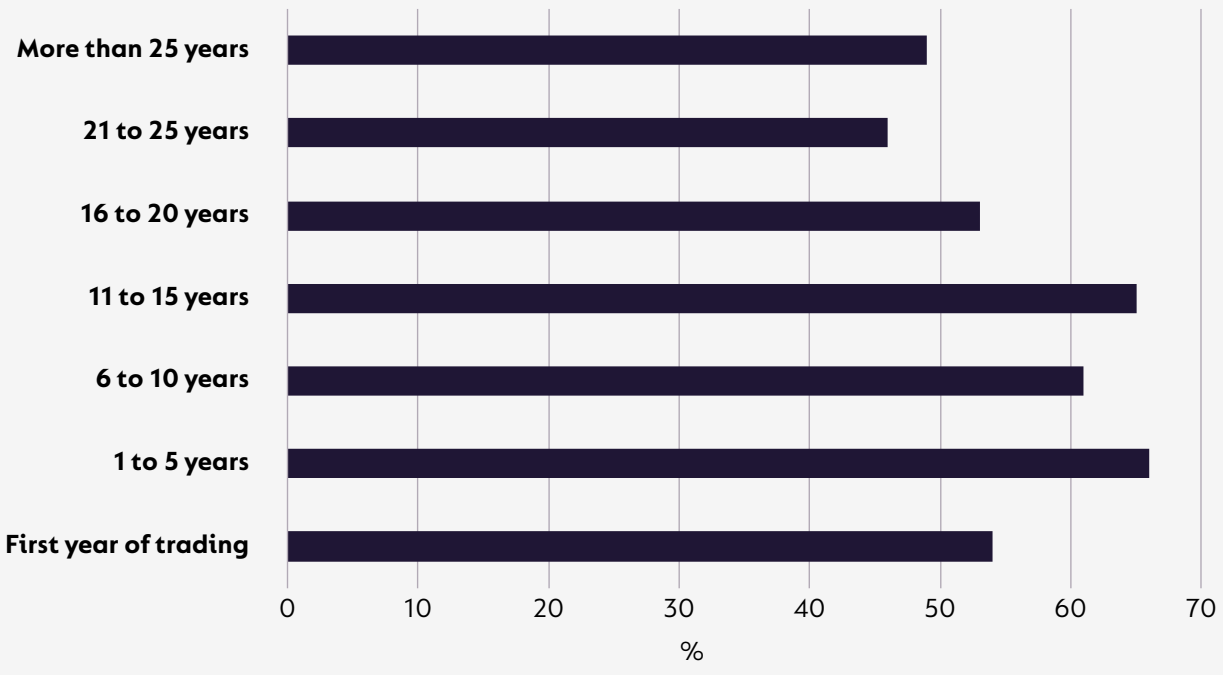
Figure 15: Measures taken by companies who are struggling to hire new employees



More generally, the majority of companies are also expecting to increase salaries during the rest of 2021. One in ten companies expect to increase pay by more than 5%. For companies with between 50 and 249 employees over 14% expect to increase pay by more than 5%.

Pay increases are expected at firms of all sizes and revenues, though there is a clear trend for more pay increases in firms with higher turnover. Interestingly, younger firms look set to reward their employees with pay rises this year more than older, more established firms will.

Figure 16: Companies who expect the average pay of employees to increase this year – by age of company



“Staffing is our biggest concern – being able to deliver events we have booked in currently, having to rely on agency staff, prices have increased and this ... means we are just breaking-even on several events.”

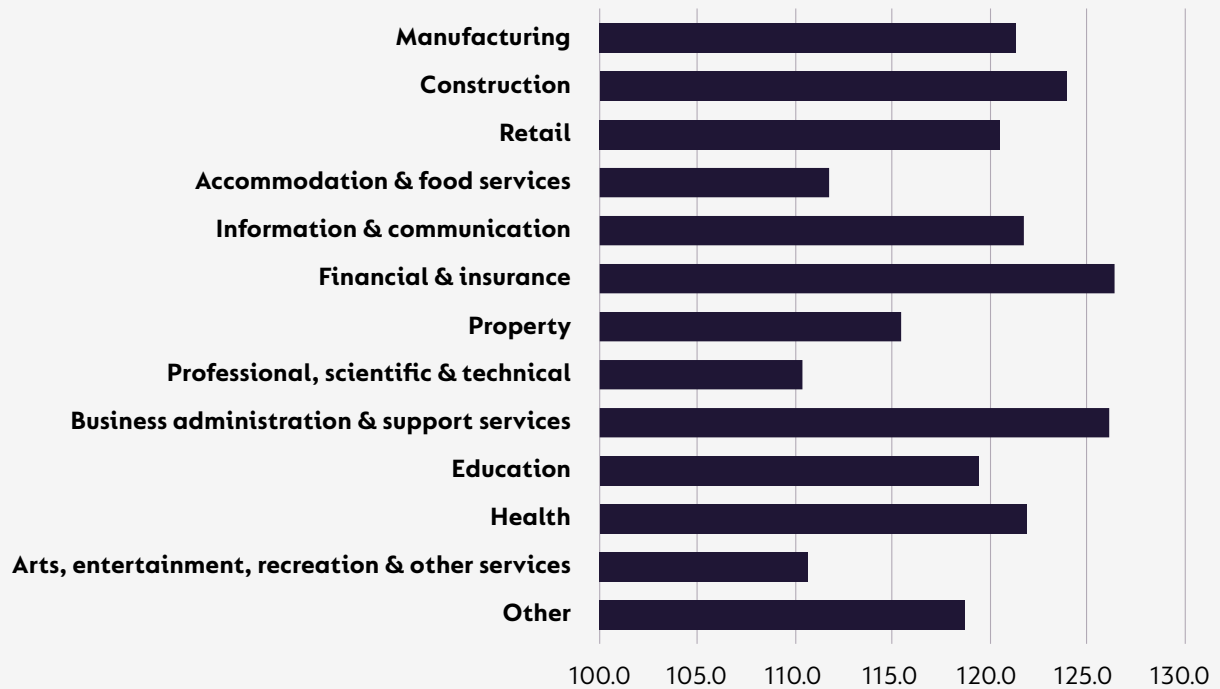
Stephen G., Hospitality, 150 – 199 employees

6. Looking across industries

The picture is positive for all industries. There are however some sectors where the productivity and business picture is significantly less positive. Two of these sectors, accommodation & food services, and arts, entertainment & recreation will have been particularly hard hit through the pandemic and were among the last to reopen fully. This has meant that many are experiencing staff shortages.

The other sectors with less positive Index scores have very little in common, for example Arts and Entertainment and Professional, Scientific and Technical. While Accommodation & food services has reported staff shortages, the lower Index score for the professional categories is harder to explain.

Figure 17: Headline Productive Business Index score by industry

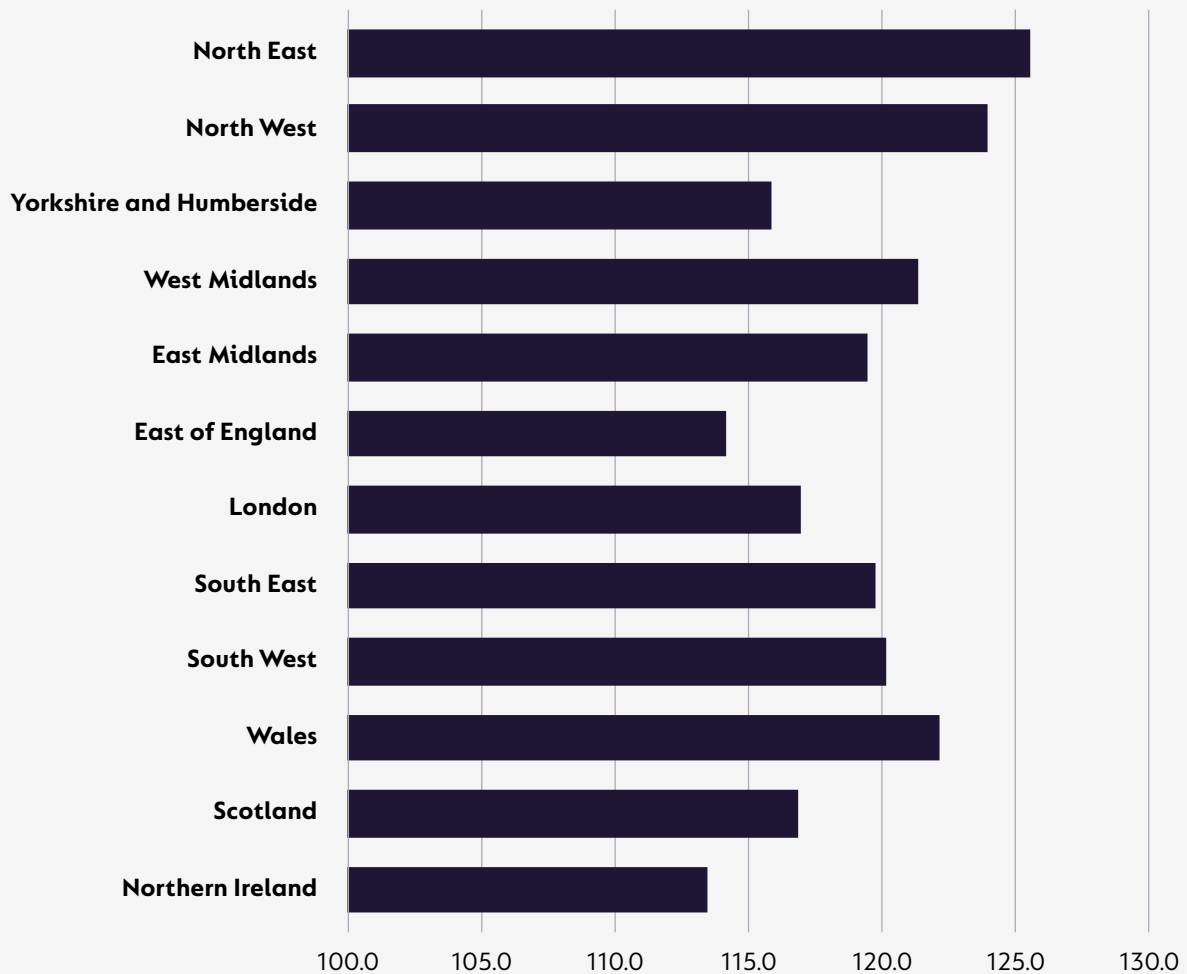


7. Region by Region

The performance by region is less uneven than the breakdown by industry type. The headline index varies from 125.6 in the North East to 113.5 in Northern Ireland, indicating that improvement is visible across the whole of the UK.

The North East, North West and West Midlands are the outstanding performers with 125.6, 123.9 and 121.4 respectively. London, in contrast is at 116.9, closer to the bottom of the regional table than the top. The Index is built from a number of inputs, however it is notable that London had the lowest figure (23%) reporting that general business conditions had improved over the last 3 months, and the second highest (28%) reporting a worsening of general business conditions.

Figure 18: Headline Productive Business Index score by UK region



"Inflation, material price rises, increased cost of skilled labour when available, increased transport costs, increased utility costs. We are a manufacturer and the price of our core raw material (steel) has increased by 140% since October 2020 and shows no sign of falling back any time soon.

We are also seeing our suppliers and sub-contractors ... putting their prices up"

Gary D., Manufacturing & Engineering, 10 – 49 employees

Three key trends for businesses over the coming months

1. Firstly, the ability for micro and small businesses to remain competitive and productive over the coming months will be critical to ensuring a sustained post-pandemic recovery. The threat of rising input costs, particularly labour costs, has the potential to jeopardise the productivity of many small businesses.
2. The battle for talent is intensifying, with more and more firms competing for a smaller pool of labour. This is likely to become particularly acute in the run up to the Christmas season. Many businesses are offering increased wages, but we are also seeing a new prominence being given to flexible working and remote working arrangements. It will be interesting to see how many businesses move to major switches to working practices such as the 4 Day Week or fully remote working in order to retain talent.
3. The impact of Covid was uneven across sectors. It remains to be seen as to how the rate of recovery will differ across sectors and regions. The relatively low score of the London area when compared with the Northeast or the Northwest regions and the very uneven Index scores of very different sectors gives an indication of how economic recovery won't be uniform across the UK.

8. Model & Methodology

The **Be the Business Productive Business Index (“Headline Index”)** is comprised of **four clearly defined elements**:

1. Performance of business;
2. Expected performance of business;
3. Actions taken to drive sustainable growth;
4. Planned actions to drive sustainable growth.

Working with Oxford Economics, we have developed a high-level nested structure for the Headline Index **around two core themes (1) Business Tendency** (a ‘PMI’ for SMEs) and **(2) Business Capabilities**, exploring key capabilities, and actions taken, driving sustainable and productive growth.

For each theme, the Headline Index will include **backward and forward-looking components** across the same underlying topics, providing an attractive symmetry to the index structure and allowing the user to delve deeper e.g., how does the current index value compare to expectations for the future, which helps to follow and predict turning points in the business cycle.

This framework also facilitates the development of **separate indices for each theme** e.g., an **SME Business Performance Index**, which focuses on business performance only, and an **SME Business Capabilities Index**, which focuses on the actions SMEs have and are taking to drive productivity growth.

The purpose of the Headline Index is to provide an indication of the **direction of change**, as well the level of conviction in that direction of change. It is composed of responses to questions framed using a **Likert scale** i.e., multiple choice scale from one extreme to the other, with clearly defined positive and negative alternatives.

The Headline Index will be formed using a **‘diffusion Index’** methodology. A diffusion index aggregates multiple indicators by examining whether they are trending upwards or downwards, allowing the combination of multiple and unrelated time series data into a common indicator, and is often used to present business survey data e.g., PMIs. It is envisaged that the diffusion index will be calculated as follows:

Index = 2 * (percentage of respondents reporting an increase) + (percentage of respondents reporting unchanged). This means the Headline Index will vary from 0-200, whereby 100=no-change, while values above 100=a rising trend and values below 100=decreasing trend.

In addition, while not incorporated within the Headline Index, our framework **includes a third** theme on **(3) Business Constraints**, exploring the different external factors that are inhibiting growth in SMEs). This feeds into the **SME Business Constraints Index**.

Survey Data

The data inputted to the model is derived from a large scale survey of 1000 directors and above working in companies of 2 - 249 employees conducted by Opinium between 27/08/21 - 03/09/21.

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