Virgin Money Business Pulse

September 2020

MONEY Virgin | Clydesdale Bank | Yorkshire Bank

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September 2020

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FOREWORD

Over recent months, SMEs have needed to navigate some of the choppiest economic waters since the second world war.

Following the introduction of the national lockdown in March, many faced an overnight fall in demand, significant restrictions on operations and severe disruptions to supply chains. Even with restrictions gradually lifting throughout the summer, as well as some positive movement in GDP, conditions remain very challenging.

Against this background, the Virgin Money Business Pulse provides a detailed look at how UK SMEs fared during the first stage of the COVID-19 pandemic and how they feel about the months ahead. As a Bank dedicated to supporting these businesses, we wanted to gain a deeper understanding of the challenges faced as a result of COVID-19, as well as where we go from here and how we can assist our customers in the most innovative ways possible.

We surveyed over 500 companies, spanning a range of sectors and regions. Many are understandably worried about the future. Most are unsure how long it will take to return to pre-COVID 19 trading levels and are fearful about the impact of further lockdowns or restrictions. As the Government's Coronavirus Job Retention Scheme ends in October, and the new Job Support Scheme that replaces it is less generous, retaining staff who have been placed on furlough is also causing concern. Brexit, meanwhile, continues to drive uncertainty in the background. With all of this in mind, the prospect of permanent closure is all too real for some.

There are, of course, pockets of hope. SMEs operating in sectors which have seen heightened demand as a result of the virus – such as food stores and producers of PPE – have performed better. We have also seen a display of resilience and adaptability. For example, due to the urgent and significant increase in demand for PPE, one of our customers, Crest Medical, adapted its supply chain to switch from sea freight to air freight, reducing the delivery period from China to the UK from around four weeks to four days, getting essential supplies to hospitals and care homes as quickly as possible.

Interestingly, the COVID-19 crisis also has the potential to be an inflection point for the UK's regional rebalancing agenda. The establishment of new working patterns and reduced levels of activity in cities could provide an opportunity to work towards closing the regional divide. Our new Regional Rebalancing Tracker – contained within the report - highlights the scale of the task at hand, with London and the South East having pulled further away from the rest of the UK over the last six years.

However, while the COVID-19 pandemic could prove a catalyst for change, it could equally become a headwind for levelling up and closing the north/south divide, since the fiscal pressures associated with COVID-19 could undermine planned investments outside of London and the South East.

Final thoughts

Many SMEs face a difficult set of circumstances in the wake of this pandemic. Here at Virgin Money, we continue to focus relentlessly on how we can best assist the businesses we work with through this challenging time. We responded quickly to proactively engage with our business customers early in the crisis with our experienced Relationship Managers offering speedy support. To the end of June, we had provided around 25,000 business customers with lending facilities, including Coronavirus Business Interruption Loans (CBILS) and Bounce Back Loans (BBLS).

The future is always hard to predict, perhaps more so now than ever, but we will aim to be the best partner we can be as the UK navigates through the economic recovery from the pandemic.

Gavin Opperman
Group Business Banking Director

EXECUTIVE SUMMARY

SMEs are the backbone of the UK economy, accounting for 99.9% of all businesses, 60% of private sector employment and the majority of business turnover. The Virgin Money Business Pulse provides a comprehensive insight into the performance of the UK's 5.9 million SMEs and the health of the business environment in which they operate.

This report presents the results of the Virgin Money Business Pulse in the first half of 2020. This period covers the worst of the COVID-19 crisis that plunged the UK economy into its deepest recession on record. The scale of the crisis is reflected in the Virgin Money Business Pulse, which sank to the lowest level on record in Q1 before registering a further dip in Q2.

Based on findings from a survey of more than 500 SMEs commissioned for this report, it is estimated that 616,000 SMEs feel it is likely that they will be forced to close permanently within the next 12 months as a result of the COVID-19 crisis. This figure rises to 960,000 in a scenario where the UK is forced to enter into a second lockdown during the autumn or winter.

Despite the partial economic recovery that has taken place in recent months, SMEs remain at the early stage of the rebuilding process. At the start of September, SMEs reported that profits over the previous 30 days were on average 18% lower as a result of COVID-19-related disruption. This is only a slight improvement on a figure of 23% in April.

The report also presents the findings from the Regional Rebalancing Tracker, which combines a variety of metrics such as employment opportunities, investment and wages in order to monitor the UK's progress in reducing economic inequalities between London and the South East and the rest of the country. The research finds that London and the South East has widened the gap with the rest of the UK since 2014, with the Regional Rebalancing Tracker falling from 44.1 in Q1 2014 to 38.6 in Q2 2020.

The East of England is the part of the UK that was closest to convergence with London and the South East in Q2. This result is driven by the relatively high earnings in the region, which stood at 85% of the level in London and the South East in 2019. The lowest level of convergence is seen in the North East of England and the East Midlands, where productivity languishes at around 70% of the level seen in London and the South East.

KEY FINDINGS

- The Virgin Money Business Pulse fell as the COVID-19 crisis began to take hold in March. The Q1 reading was at the time the lowest level recorded since data collection began in 2014. However, the Virgin Money Business Pulse plumbed new depths in the second quarter of 2020.
- Year-on-year, UK GDP was down by 21.7% in Q2, which pushed down the corresponding indicator. This also led to sharp falls in the business confidence, revenue and capacity indicators, which each sank to their lowest level since comparable records began in 2014.
- While there were also falls in the employment and business creation indicators during the first half of the year, these have so far been less affected by the COVID-19 crisis than the other indicators monitored by the Virgin Money Business Pulse. In the case of the employment indicator, this is due to the success of the Coronavirus Job Retention Scheme in safeguarding jobs, while business creation figures have been distorted by the suspension of voluntary strike-off action by Companies House.
- The decline in the Virgin Money Business Pulse in Q2 was tempered by strong gains in the business costs and lending indicators. Rock bottom commodity prices and falling wages pushed business costs into deflationary territory in Q2, providing some relief for SMEs. Meanwhile, the availability of government-backed loans as part of the fiscal response to the COVID-19 crisis led to a record jump in SME borrowing.

MONEY
BUSINESS PULSE

IMPACT OF COVID-19 ON SMEs

1 million SMEs at risk of closure due to COVID-19:

↓ 616,000 may close permanently in the next 12 months

↓ 960,000 may close if there is a second national lockdown

↓ 66% recorded lower profits in April

↑ 10% recorded higher profits in April

↑ 55% expect a more than six-month recovery to return to pre-pandemic profit levels

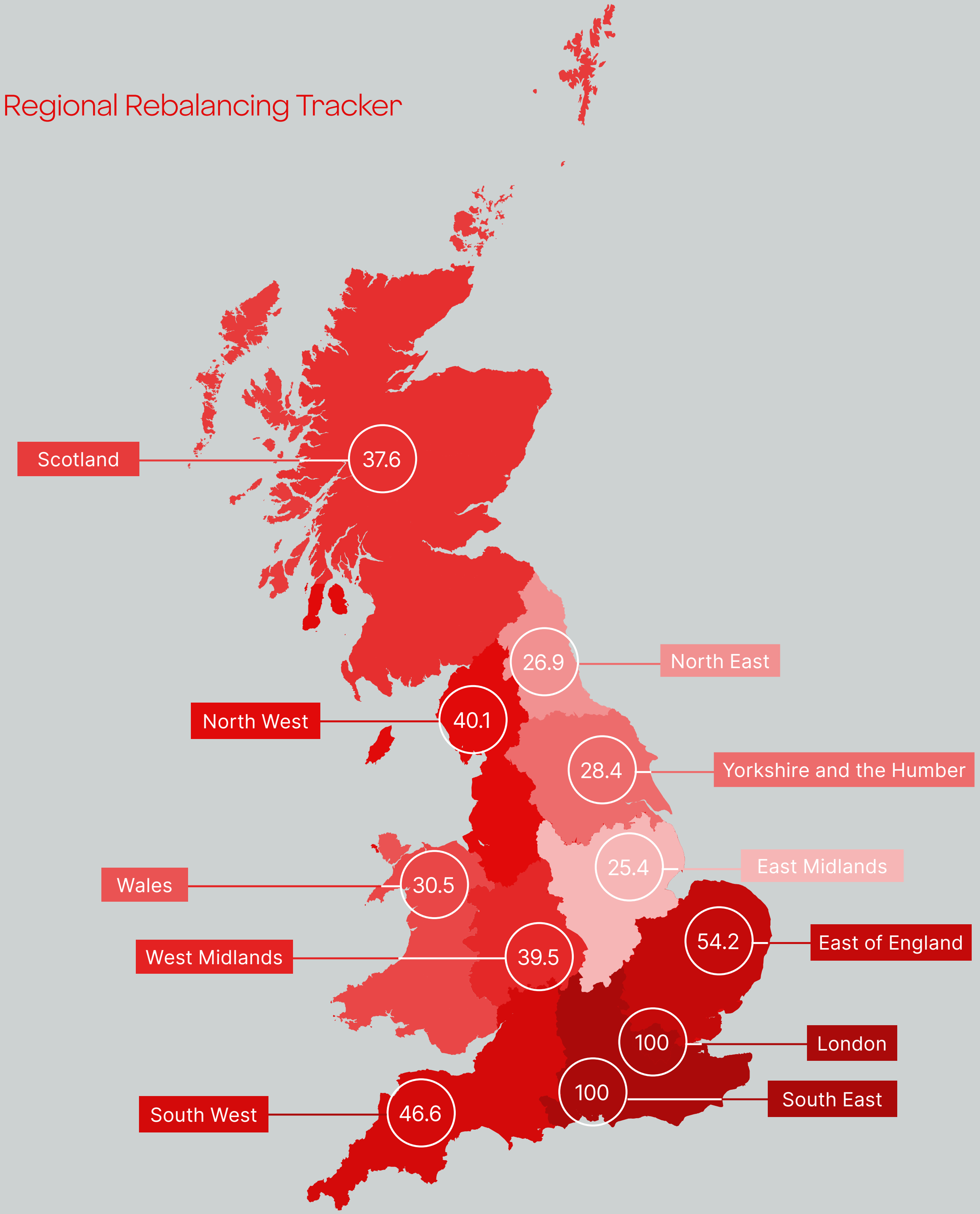
↓ 42% of SMEs (excluding sole traders) expect their workforce to shrink between September and December

Survey of 500 SME decision makers conducted by Censuswide between 4th September and 7th September 2020

Gavin Opperman
Group Business Banking Director

The UK's SMEs have experienced unprecedented strain, with sales and profits affected by workplace closures, supply chain disruption, diminished productivity and declining household incomes. Despite the pickup in economic activity in the summer months, businesses are by no means out of the woods. As we head into the autumn and winter months with newly introduced restrictions, the next six months will be critical for many businesses.

Regional Rebalancing Tracker



Regional rebalancing is defined in this report as the process through which levels of economic opportunity and prosperity in the UK's regions and nations converge to the levels observed in London and the South East of England. This is assessed on the following metrics: earning opportunities, employment opportunities, productivity, wealth, enterprise and investment. A score of 100 represents full convergence with London and the South East.

Virgin Money Business Pulse indicator scores

	Overall	Business Costs	GDP	Capacity	Lending	Business Confidence	Business Creation	Employment	Revenues
Q4 2019	44	47	51	43	45	43	36	47	44
Q1 2020	40	49	41	52	45	37	31	50	14
Q2 2020	33	76	0	5	100	0	28	39	14

1. UK MACROECONOMIC ENVIRONMENT

During the first half of 2020, the UK underwent a scale of economic and societal transformation that is without precedent in its peacetime history. On 23rd March, the UK Government introduced a national lockdown in a bid to contain the COVID-19 pandemic. It led to the most abrupt and severe economic shock since records began, with operations in many sectors grinding to a complete standstill.

The UK economy contracted by 22.1% during the first six months of the year. The bulk of the losses were sustained in March and April, which recorded monthly declines in GDP of 6.9% and 20%, respectively. This coincided with the height of the lockdown, which took place between 23rd March and 10th May, after which point the Government gradually began to ease restrictions. The key milestones so far in the transition to a "new normal" are the re-opening of non-essential shops on 15th June, the re-opening of pubs, restaurants and hotels on 4th July, and the full return of children to school at the start of September.[1] So far, the gradual re-opening of the economy has helped to breathe life into some sectors. Indeed, the UK economy expanded by 2.4% in May, 8.7% in June and 6.6% in July. However, the UK remains at the foothills of the economic recovery, with GDP in July still 11.7% lower than it was before the worst of the pandemic in February 2020.

It is not only in the volatile GDP swings that the UK has moved into unchartered territory. At the end of July, the UK's public sector debt surpassed £2 trillion for the first time, with the debt to GDP ratio standing at 100.5%. This reflects the unprecedented fiscal stimulus that the Government rolled out in response to the COVID-19 crisis, which included numerous support schemes for households and businesses.

A defining feature of the initial stages of the COVID-19 crisis is the disjoint between the performance of the labour market and that of the wider economy. Although significant job losses have been recorded, these are far more limited than would be expected considering the extent of economic disruption that has taken place. This reflects the impact of the Coronavirus Job Retention Scheme, which at its peak covered 8.9 million workers. This has provided a crucial buffer between households' finances and the wider economic downturn, which has supported spending as restrictions have been eased. Indeed, retail sales volumes in July were 3.0% above pre-pandemic levels.

While businesses have also benefited from government support schemes, including business rates relief, VAT deferrals and access to government-backed loans, for some, the hit to revenues during the lockdown has delivered a fatal blow. In April, one in seven businesses surveyed in the Cebr-Opinium Business Distress Tracker[2] said that there was a high risk of them entering insolvency as a result of COVID-19-related disruption. Five months on, it is likely that at least some of these may have closed for good.

The UK's road to economic recovery is littered with obstacles. The new Job Support Scheme, which will come into force on 1st November after the termination of the Coronavirus Job Retention Scheme on 31st October, is considerably less generous than the furlough scheme. It therefore represents a significant withdrawal of fiscal stimulus which will likely drive up unemployment and place significant pressure on consumer spending. Moreover, a "no-deal" type outcome in the Brexit negotiations would take the wind out of the sails of any nascent economic recovery going into 2021. Meanwhile, in addition to the obvious human costs, a second wave of COVID-19 infections in the autumn and winter months would have devastating economic implications if it necessitates the re-imposition of lockdown restrictions.

1 The pace of re-opening has varied across the UK's constituent nations. The figures cited refer to restrictions in England.
2 Survey of 500 business decision makers conducted by Opinium between 23rd April and 28th April 2020.

2. VIRGIN MONEY BUSINESS PULSE

The Virgin Money Business Pulse shines a light on SMEs, which are a crucial element of the economy, delving into both their performance and the wider macroeconomic environment in which they operate by tracking eight key areas: GDP, employment, revenues, capacity, business confidence, lending, business costs and business creation.

This report presents the results of the Virgin Money Business Pulse for the first six months of 2020, during which time SMEs and indeed the whole of the UK was plunged into the most severe economic downturn on record as a result of the COVID-19 crisis.

COVID-19 crisis pushes Virgin Money Business Pulse to weakest point on record

The first half of 2020 was a highly tumultuous period for SMEs. This is reflected in the dramatic swings recorded in each of the indicators that feed into the Virgin Money Business Pulse. The overall effect of these movements is that the Virgin Money Business Pulse plunged from 44.5 in Q4 2019 to 32.9 in the second quarter of 2020. This is the lowest recording since data collection began in 2014.

The lockdown placed many SMEs into a state of suspended animation. This is reflected in the revenue and GDP indicators, which both fell to record lows during the first half of this year. The 1.7% and 21.7% year-on-year declines in GDP in Q1 and Q2, respectively, drove down the score for the corresponding indicator from 51.4 in Q4 2019 to 40.9 in Q1 2020 and then 0.0 in Q2 2020.

Losses were tempered by large gains in the business costs and lending indicators.

The collapse of commodity prices in the early months of 2020 together with a significant weakening of wage growth pushed business costs into deflationary territory, with the annual rate of growth falling to 1.7% in Q1 2020 and -0.2% in Q2 2020.

Loan guarantee schemes have been a central pillar of the government's strategy to support businesses during the COVID-19 pandemic. As a result, the value of new loans issued to SMEs (excluding overdrafts) soared to £46.9 billion in Q2 2020 – a more than three-fold increase on pre-crisis levels. It is important to stress, however, that this growth in lending largely reflects the highly distressed nature of SMEs' finances during lockdown.

Falling employment costs were a key contributor to the decline in overall business cost inflation in Q2. While the Coronavirus Job Retention Scheme has been successful in supporting levels of employment so far this year, the sudden hit to revenues brought about by the COVID-19 pandemic led many employers to bring in pay cuts or reductions in hours. This fuelled a 3% decline in average weekly earnings between February and April.

Commercial rental prices have also declined throughout the COVID-19 crisis. Demand for commercial space inevitably plummeted due to the lockdown restrictions and spread of home working. However, even after restrictions are fully lifted, the new working patterns that have established themselves since the onset of the pandemic mean that commercial rental prices could experience further pressure going forward.

3. REGIONAL REBALANCING TRACKER

Regional inequality in the UK is among the highest in the developed world, with a disproportionate share of economic output concentrated in London and the South East. There are numerous drivers of this phenomenon, including levels of investment in education and infrastructure and proximity to major international transport hubs. London is also the UK's largest urban centre by a considerable distance. There is an array of inherent economic advantages that come with this, including the ability to attract skilled workers, the knowledge spill overs that occur due to the high concentration of people and businesses, increased opportunities for specialisation and reduced transport costs.

Before the COVID-19 pandemic struck, regional rebalancing, or "levelling-up" was a central part of the UK Government's agenda. Regional rebalancing is a multi-faceted concept, encapsulating a variety of distinct themes such as job opportunities, levels of wealth, rates of investment and overall productivity. The Regional Rebalancing Tracker combines these threads together to form the first comprehensive measure of regional inequalities in the UK and how these have evolved over time.

Regional rebalancing is defined in this report as the process through which levels of economic opportunity and prosperity in the UK's regions and nations converge to the levels observed in London and the South East of England. This is assessed along the following metrics:

1. Earning opportunities, as measured by median annual earnings.
2. Employment opportunities, as measured by the share of 16-64 year olds currently in work.
3. Productivity, as measured by output per hour worked.
4. Wealth, as measured by average house prices.
5. Enterprise, as measured by rates of new business creation.
6. Investment, as measured by per capita levels of public spending in education, health and economic affairs (including transport, science and technology spending).

For each indicator, a score of 100 is assigned to regions that have fully closed the gap with London and the South East. Meanwhile, an indicator score of 0 is assigned to regions when the distance to London and the South East is larger than has been observed in any other UK region at any point in time since 2014.

London and South East widens the gap with the rest of the UK

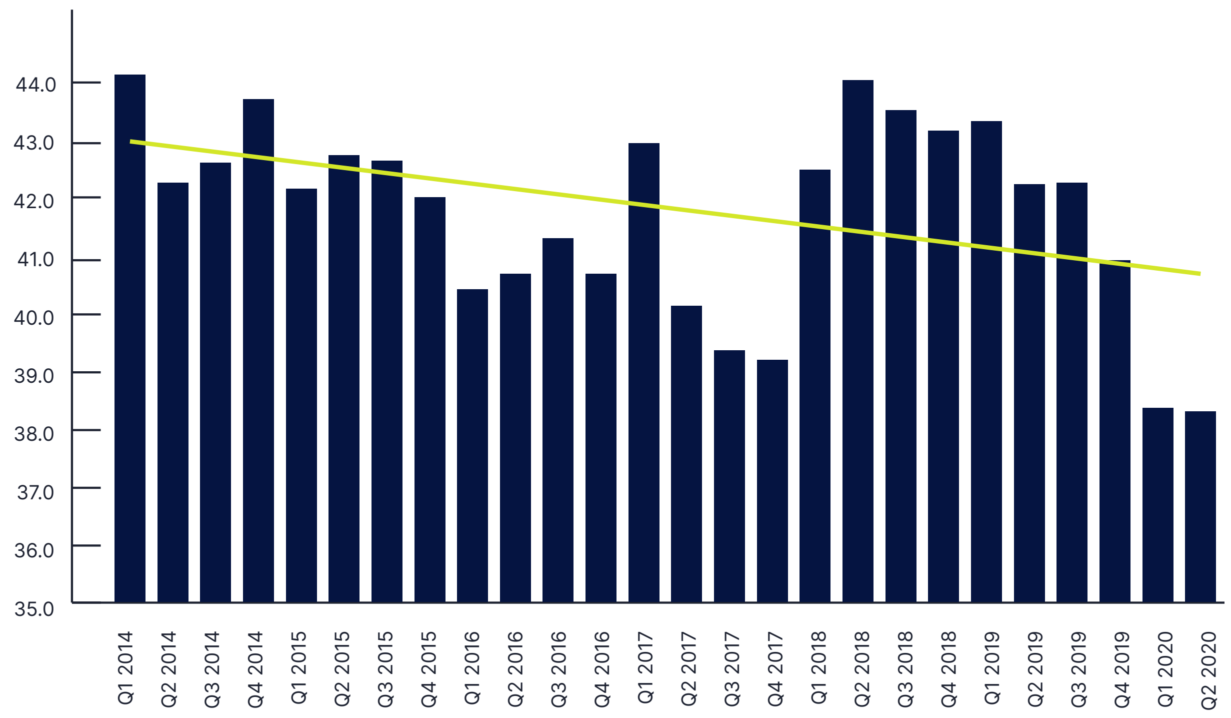
There has long been an economic divide between London and the South East and the rest of the UK. Over the past six years, this gap has widened. In Q1 2014, the combined Regional Rebalancing score for the UK's regions and nations was 44.1. This figure has fallen significantly in subsequent years, reaching 38.6 in Q2 2020 – the lowest the reading has been since data collection began in 2014 – as shown in figure 1.

One factor contributing to this trend is divergence in the rates of business creation in London and the South East and the rest of the country. In Q2 2020, the number of businesses registered per working age adult outside of London and the South East was at 42% of the level recorded in London and the South East. This compares to a figure of 53% as recently as Q3 2014. The gap in employment opportunities has also widened, with the employment rate differential between London and the South East and the rest of the UK widening from 1.4 percentage points in Q1 2014 to 2.4 percentage points in Q1 2020. However, the deterioration of the labour market in London since the onset of the COVID-19 pandemic has narrowed the gap somewhat. Meanwhile, the earnings opportunities indicator has remained very stable since 2014, with median annual earnings consistently hovering around 80% of the level in London and the South East.

The regions and nations outside of London and the South East have collectively clawed back some ground in the house price indicator over the past four years. In the first quarter of 2016, average house prices outside of London and the South East were at 45% of the level observed in London and the South East. By Q2 2019, this figure had reached 49%, although progress has stalled in recent quarters. The COVID-19 crisis is set to have lasting impacts on the housing market, changing where people work and the attributes they look for in their homes.

There is emerging evidence that demand for real estate is falling in central London as a result of these changing preferences. It remains to be seen, however, whether this will translate into a rebalancing of house prices across the country or merely a rebalancing of prices within London and the South East.

Figure 1 **National Regional Rebalancing score, Q1 2014 – Q2 2020**



Source: Office for National Statistics, Annual Survey of Hours and Earnings, Companies House, Cebr analysis

East of England leads the way in regional convergence with London and South East

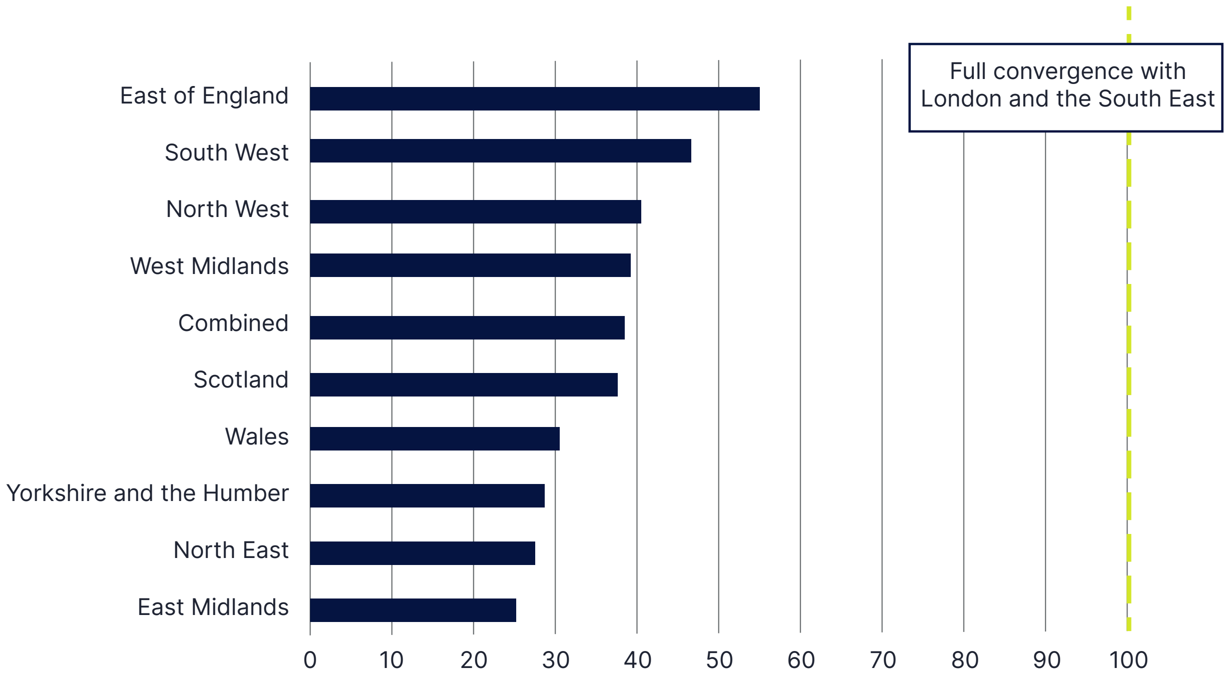
With a score of 54.2 on the Regional Rebalancing Tracker, the East of England was the region with the greatest degree of economic convergence with London and the South East in the second quarter of 2020. Median annual earnings in the region were £30,345 in 2019 – the highest in the UK outside of London and the South East. An abundance of high-skilled jobs in the professional, scientific and technical sectors will have played a role in the East of England's strong performance in the earnings indicator. However, average wages in the East of England still stand at just 85% of the level in London and South East, meaning that considerable progress is needed for the region to reach full convergence.

With 78.1% of 16-64 year olds in employment in Q2 2020, the employment rate in the South West is higher than the average across London and the South East, meaning that the region has achieved full convergence in the employment opportunities indicator. This contributed to an overall score of 46.6 in the Regional Rebalancing Tracker – the second highest out of the regions covered. Other regions with a relatively high level of convergence with London and the South East are the North West and the West Midlands. Both of these regions' scores were boosted by a strong performance in the business creation indicator. Despite the economic turmoil associated with the COVID-19 pandemic and the associated lockdown, one business was registered in the West Midlands during the second quarter for every 249 working-age adults. However, this score still lags far behind London, where one business was registered for every 94 working-age adults in Q2. This result highlights that London has remained at the heart of entrepreneurial activity in the UK, despite the challenges posed by the COVID-19 crisis.

Productivity in Scotland is the highest in the UK outside of London and the South East. It is estimated that in 2020, workers in London and the South East generated on average £37.69 per hour worked. In Scotland, the corresponding figure is £30.13. This means that for every pound of output generated by workers in London and the South East, workers in Scotland generate an estimated 80 pence in the same amount of time. Scotland's Regional Rebalancing score was 37.6 in Q2 2020, with a weak rate of business creation weighing on the overall score. In Wales, weak scores in the business creation, earning opportunities and productivity indicators were all partially offset by the score in the government investment indicator, which was the second highest in the UK after Scotland in the 2018/19 financial year (the latest point at which data are available).

Yorkshire and the Humber recorded relatively low levels of convergence across each of the indicators, which contributed to a score of just 28.4 on the Regional Rebalancing Tracker. The regions with the lowest convergence with London and the South East in Q2 2020 were the North East and the East Midlands, which recorded scores of 26.9 and 25.4, respectively. House prices in the North East are the lowest in the UK. In Q2, the average house price in the region stood at just 31% of the level in London and the South East. The North East also performed poorly in the earning opportunities indicator, with median annual earnings the lowest out of any of the UK's regions and nations in 2019, at £27,187. Meanwhile, productivity in the East Midlands is the lowest in the UK, with output per hour worked standing at 69% of the level in London and the South East.

Figure 2 Regional Rebalancing scores, Q2 2020



4. SMEs IN THE AGE OF COVID-19

The COVID-19 pandemic and the associated lockdown have placed an unprecedented strain on the UK's SMEs and this report uses data from a survey of 500 SMEs[3] carried out for Virgin Money to shed light on how businesses' activities and prospects have been transformed by the COVID-19 pandemic, and the longstanding changes that the crisis is set to precipitate.

Impact of COVID-19 on SMEs' profits

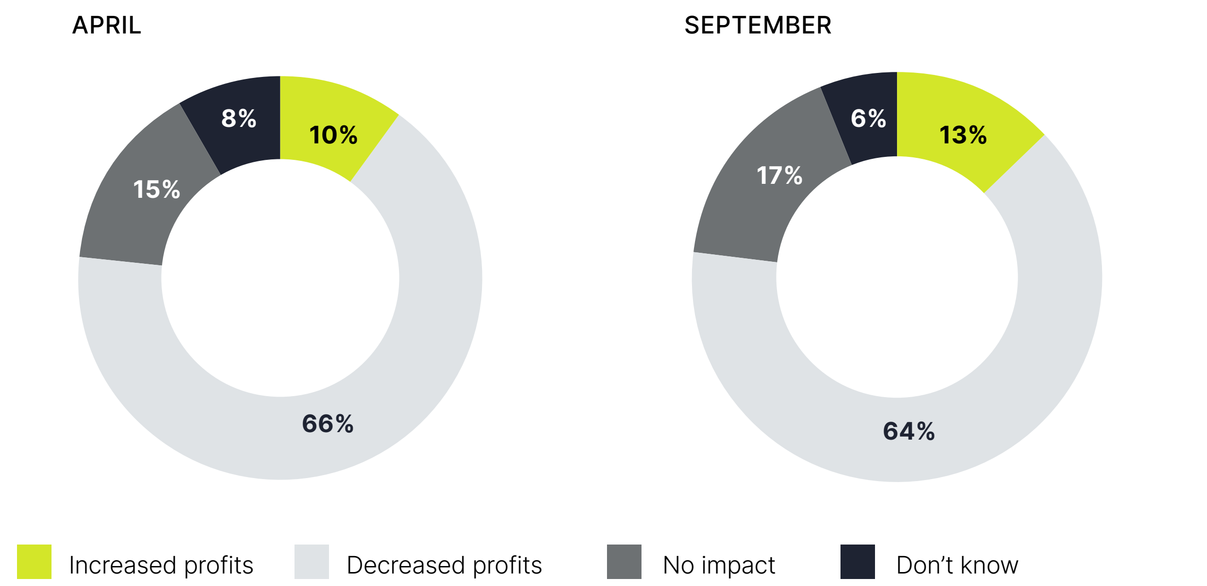
During the height of the lockdown in April, two-thirds (66%) of SMEs said that their profits were lower because of COVID-19-related disruptions. This includes more than a fifth (21%) whose profits took a hit of more than 50% in April. On the demand side, this was principally due to a drying up of sales due to the lockdown restrictions and the decline in household incomes. Meanwhile, supply chain disruptions and the closure of workplaces meant that many businesses' productive capacity was also heavily diminished.

Fifteen percent of SMEs stated their profits were not affected by COVID-19-related disruption in April, and one in ten (10%) said that their profits were higher. The sudden economic and societal changes that took place as the lockdown came into force created pockets of demand for specific goods and services, which will have boosted revenues for businesses that supply these products. Food stores and producers of personal protective equipment (PPE) are two examples. Meanwhile, others will have been supported through lockdown by a backlog of work from existing order books.

Despite the gradual lifting of restrictions throughout the summer, the survey results show that trading conditions remain highly challenging for most SMEs. At the start of September, when the survey was conducted, 64% said that their profits over the past 30 days were lower than they would have expected. This is barely an improvement on the 66% figure recorded in April.

At the start of September, SMEs who were surveyed reported that profits over the previous 30 days were on average 18% lower as a result of COVID-19-related disruption. This is only a slight improvement on the 23% figure recorded in April. This reiterates that, despite the progress in national GDP figures in recent months, for most SMEs the rebuilding process has only just begun.

Figure 3 Impact of Covid-19-related disruption on profits over past 30 days



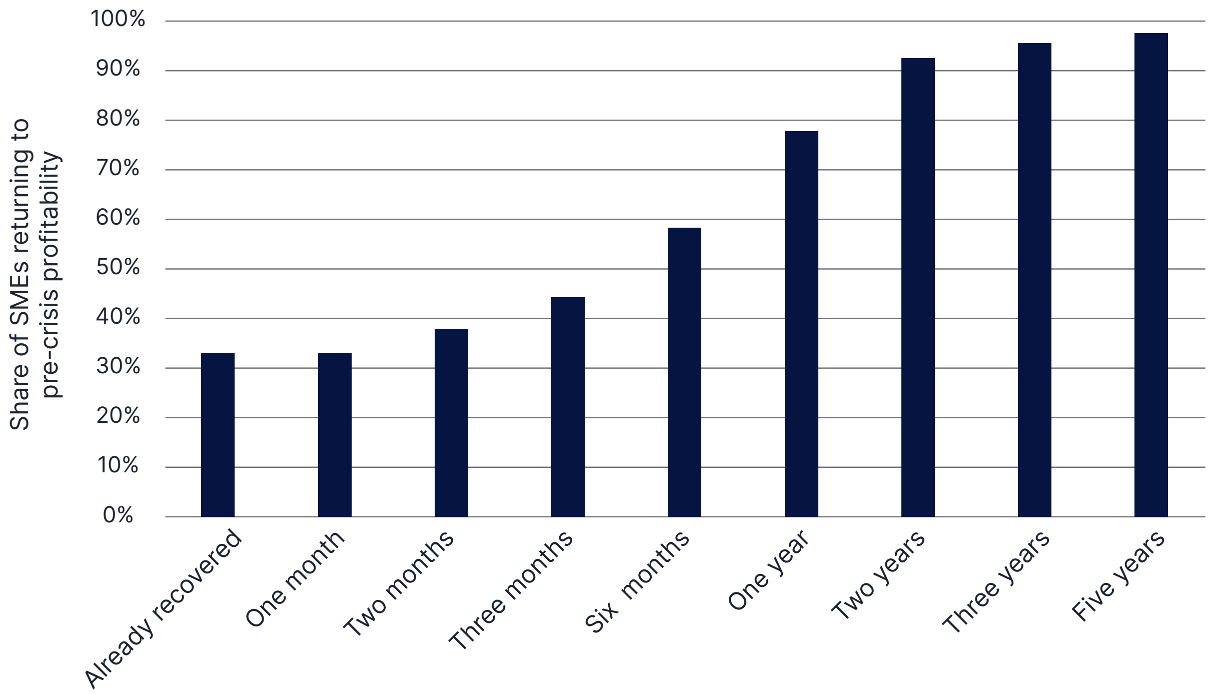
Source: Censuswide, Cebr analysis

3 Survey of 500 SME decision makers conducted by Censuswide between 4th September and 7th September 2020

Among the almost two-thirds of SMEs whose profits remain subdued, 55% believe that it will be more than six months before their profits return to pre-pandemic levels. Meanwhile, only one in six (17%) expect their profits to recover to pre-crisis levels within the next three months. On average, SMEs that have not yet returned to pre-crisis levels of profitability expect that it will be 11 months before they are able to do so. This, together with the large number of otherwise viable businesses that will have been forced to close, provides further evidence to suggest that the UK's economic recovery will be a protracted one.

The most frequently cited barriers to the recovery of profits are the continued restrictions that remain in place, as well as low levels of demand in the UK. Both reasons were listed by 37% of SMEs. Supply-side factors are also having an effect, with 12% stating that reduced access to domestic inputs and foreign inputs is an obstacle impeding their recovery. One in ten (10%) SMEs that have not yet returned to pre-pandemic levels of profitability, identified the loss of skills or experience as a result of workforce departures as a barrier to their future recovery. This indicates that the severance of longstanding employer-worker relationships is a key element of the long-term economic damage brought about by the COVID-19 pandemic.

Figure 4 **Amount of time needed by SMEs to return to pre-crisis levels of profitability**

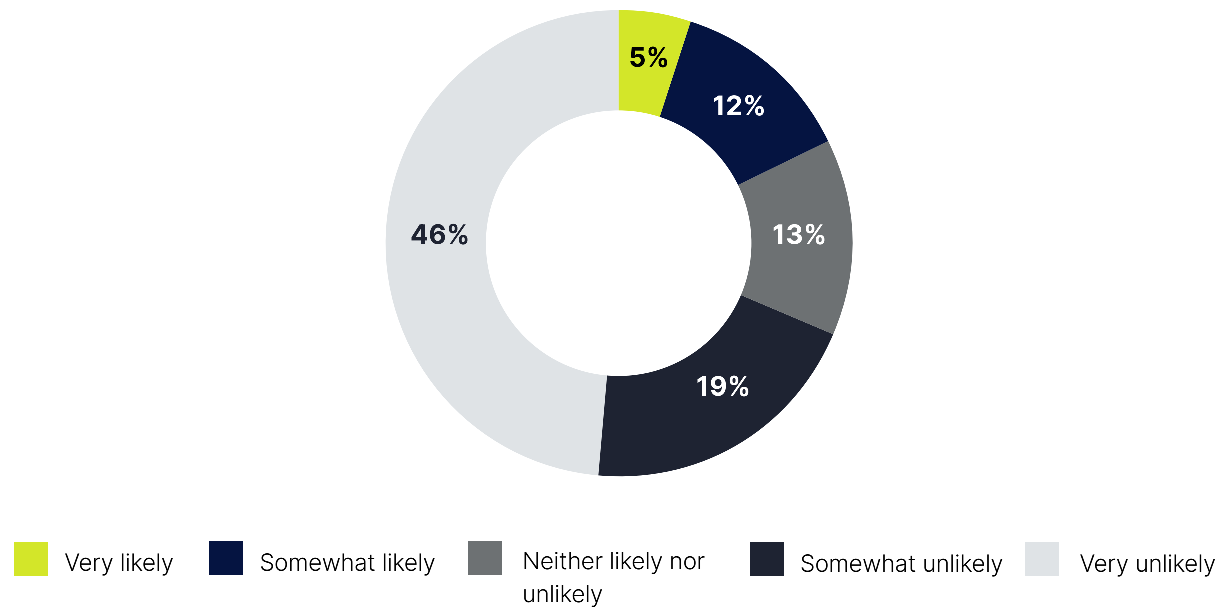


Source: Censuswide, Cebr analysis

Outlook for SMEs over the next 12 months

One in twenty (5%) SMEs feel it is very likely that they will close permanently within the next 12 months. More than one in ten (12%) say it is somewhat likely they will be forced to shut permanently, while less than half (46%) state that this is very unlikely within the next 12 months. These findings emphasise the highly precarious situation that SMEs remain in. As government support is gradually phased out, the coming months are set to be a testing time for many businesses. Indeed, based on the survey results among different business sizes, an estimated 616,000 SMEs feel it is very likely or somewhat likely that they will close within the next 12 months.

Figure 5 **Likelihood of permanent closure within the next 12 months as a result of COVID-19 crisis**



Source: Censuswide, Cebr analysis

The picture becomes even starker when considering the effects of a second lockdown. Eight percent (8%) of SMEs said that it is very likely they would close down permanently within the next 12 months if lockdown restrictions similar to those seen in March and April were to be re-imposed for a period of one to two months this autumn or winter. A further 16% state that this outcome is somewhat likely. Scaling these figures up to a national level implies that 960,000 SMEs feel it is likely they would be forced to close for good in the event of a second lockdown.

A key issue for the UK economy is whether SMEs will be confident enough to retain furloughed workers following the termination of the Coronavirus Job Retention Scheme at the end of October. Excluding sole traders, more than two in five (42%) SMEs expect the size of their workforce in December to be smaller than it was in September. This is more than four times the share (9%) who anticipate an increase in the size of their workforce between September and December. Among micro businesses in the sample (those with fewer than 10 employees), the average anticipated reduction in the workforce size between September and December is 5%. The corresponding figures for small (10 – 49 employees) and medium (50 – 249 employees) sized businesses are 6% and 3%, respectively. If these expectations materialise, it would equate to 538,000 job losses in the final four months of 2020 among micro, small and medium sized businesses alone.

It is important to note that businesses were asked about their workforce expectations prior to the announcement of the latest Job Support Scheme, which will allow workers to be retained on a part-time basis. Under this scheme, an employee working 33% of their original hours would be paid 55% of their original salary by their employer and an additional 22% from the Government. This scheme is considerably less generous than the furlough scheme and given that hourly wage costs would actually increase for part-time retained workers, it is likely that the new policy will not be sufficient to fundamentally reshape SMEs' workforce decisions.

After retreating from the front pages as the UK battled with the COVID-19 pandemic, the issue of Brexit is once again near the centre of the economic and political discourse. Although the UK formally left the EU on 31st January 2020, the subsequent transition period has meant that the UK-EU relationship has yet to undergo significant changes. However, with the transition period expiring at the end of the year and two sides currently embroiled in a number of disagreements, a no-deal type outcome remains a distinct possibility.

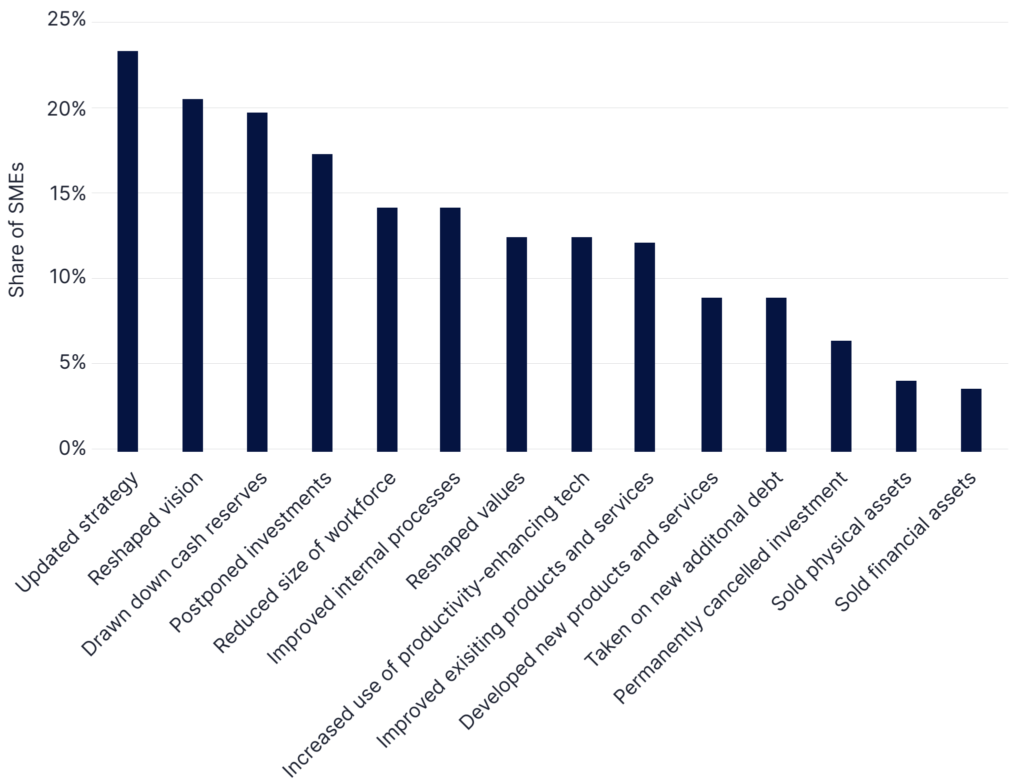
In order to assess the impact of this on SMEs, businesses were asked to choose between whether a no-deal type outcome in the Brexit negotiations or whether a second COVID-19-induced lockdown would have a greater impact on their prospects over the next 12 months. Sixty-two percent (62%) of respondents stated that a second lockdown would have the greatest impact, while 21% selected a no-deal type outcome in the Brexit negotiations. With memories of the first lockdown still very much alive in the minds of SMEs, the fact that more than a fifth see a no-deal type Brexit outcome as having a greater impact on their prospects than a second lockdown speaks to the severe nature of the disruption that this would create for many businesses.

Changes brought about by the pandemic

The COVID-19 pandemic has fundamentally transformed the business environment for SMEs, through restrictions on certain operations, lower levels of demand, and the evolution of consumer preferences. For many SMEs, the tumultuous period has also been a time of internal reflection, leading to a shift in focus or approach. Indeed, nearly a quarter (23%) have updated their strategy while more than a fifth (21%) have reshaped their vision and 12% have reshaped their values.

More practical adjustments that have been widely implemented include the drawing down of cash reserves (carried out by 20% of SMEs) and the postponement of planned investments (carried out by 17% of SMEs). Meanwhile, more than one in twenty (6%) have permanently cancelled planned investments. This is consistent with the 31.4% decline in business investment in the UK in Q2 2020, with the climate of subdued demand and intense uncertainty understandably quelling the appetite for investment. The results of the survey suggest that low levels of investment are likely to persist for some time to come. Indeed, less than one in ten (9%) SMEs that have postponed investments now plan to carry out all of these investments within the next 12 months. Meanwhile, a third (33%) of these businesses do not plan to carry out any of their postponed investments over the next year.

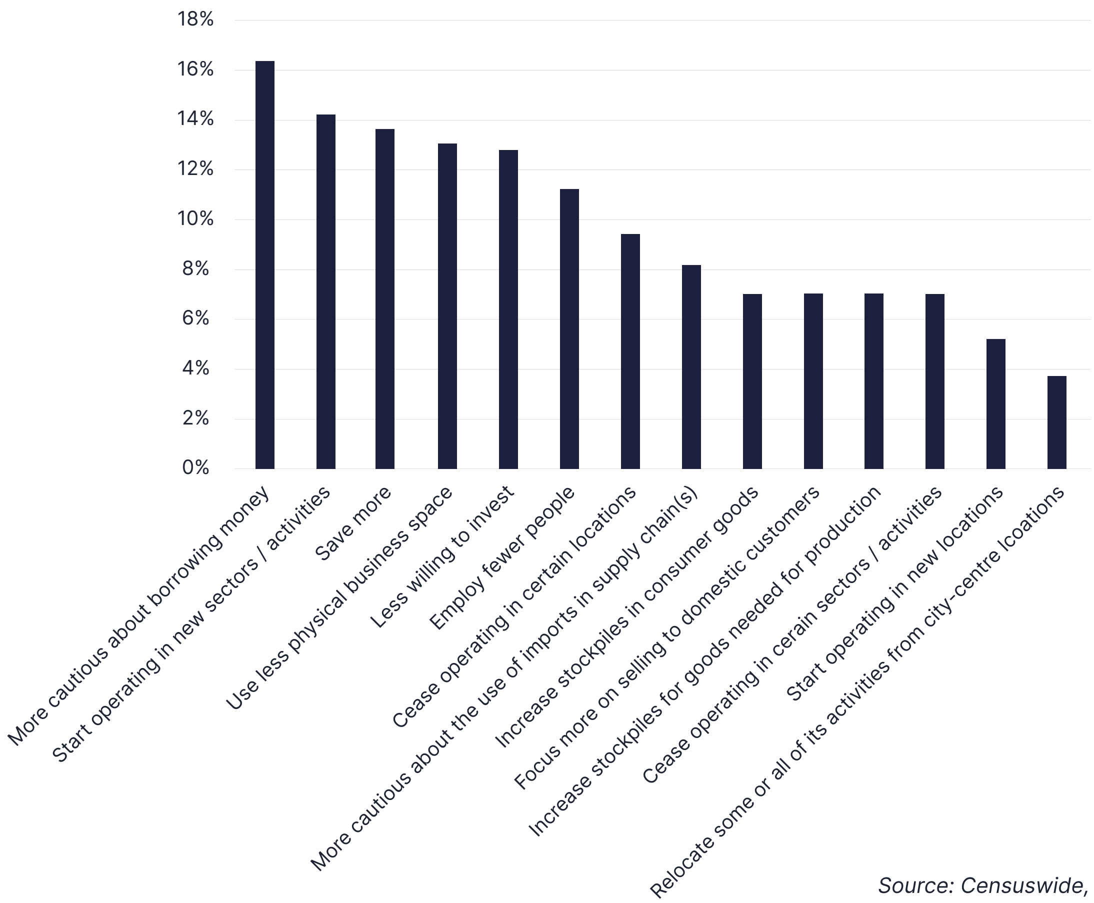
Figure 6 Changes that have taken place within SMEs as a result of the COVID-19 crisis



Source: Censuswide, Cebr analysis

The dramatic nature of the economic and societal shifts that have taken place since the onset of the pandemic mean that it is likely to impart long-term changes on SMEs' attitudes and approaches. Around one in six (16%) SMEs said that they will be more cautious about borrowing money in the long-term. Meanwhile, 14% stated that they would save more and 13% said that they would be less willing to invest. This points to a more conservative and risk-averse approach among many SMEs. There is also evidence that the COVID-19 pandemic could lead to a limited degree of "de-globalisation", with 8% of SMEs indicating they will be more cautious about relying on imported goods in their supply chains and 7% stating that they would increase their focus on domestic customers.

Figure 7 Long-term changes brought about by the COVID-19 crisis



Source: Censuswide, Cebr analysis

While the national lockdown compelled thousands of businesses to suspend their operations altogether – temporarily and in some unfortunate cases permanently – many more have adapted to the restrictions by expanding their remote working capabilities. Prior to March 2020, SMEs (excluding sole traders) on average said that 26% of the employees worked from home in some capacity during a typical week. This figure rose considerably during the period of lockdown. Moreover, the survey results suggest that increased homeworking will remain a permanent fixture of SMEs' working patterns. On average, SMEs estimated that 33% of their employees will work from home in some capacity during a typical week, even once all restrictions are lifted. This shift will be driven both by workers and employers.

Fifty-three percent (53%) of SMEs that expect to expand homeworking even after restrictions are lifted said that employees can be more productive while working from home. This highlights how the mass remote working experiment has pleasantly surprised many employers, with technology enabling staff to remain productive despite being away from their physical place of work. Meanwhile, employees have also been provided with a glimpse into an alternative pattern of work which many would like to carry into the future. Forty-nine percent (49%) of SMEs that expect homeworking to be more prevalent in the future said that this was due in part to demand from their employees. Lower rental costs for business space is also an important factor, cited by a quarter (25%) of SMEs in the survey.

5. METHODOLOGY

The Virgin Money Business Pulse is designed to assess the performance of SMEs while also monitoring the health of the macroeconomic environment in which they operate. The following measures are included:

Indicator	Description	Data source(s)
Business costs	This indicator measures the annual change in costs faced by SMEs. Higher business costs are associated with a more difficult trading environment, since companies will either have to pass these on to their customers or accept lower profit margins in order to secure market share.	ONS
Capacity	This indicator measures the proportion of SMEs operating below capacity. High numbers of firms operating below capacity signals low levels of demand and can have negative implications for hiring and investments decisions.	FSB
Confidence	This indicator measures how confident businesses were about their prospects going into the latest quarter.	FSB
Employment	This indicator analyses the annual change in employment figures. Higher employment figures are associated with an improving macroeconomic environment and signals improved business sentiment.	ONS
Gross Domestic Product	This indicator captures the year-on-year growth rate of GDP each quarter, which reflects the overall level of activity in the economy.	ONS
Lending	For the lending indicator, we used data from UK Finance to calculate the annual change in the value of new loans taken out by SMEs each quarter.	UK Finance
Net business creation	This indicator measures the annual growth rate in the number of registered companies. The higher the growth rate, the higher the score.	Insolvency Service
Revenue	This indicator measures the net percentage balance of SMEs reporting an increase in revenues.	FSB

A score of 100 is assigned when the value of the indicator is at least three standard deviations above the average value of that indicator across all regions since 2014. Meanwhile, a score of 0 is assigned when the value of the indicator is at least three standard deviations below the average value of that indicator. For both the national and regional trackers, the average score across each of the eight indicators is calculated in order to arrive at an overall score.

Data history

Virgin Money UK has collected economic data on SMEs since 2014. This was previously published within the SME Health Check Index and has been included here to show historical trends.

Head Office:
40 St. Vincent Place
Glasgow
G1 2HL

Registered Office:
Jubilee House
Gosforth
Newcastle upon Tyne
NE3 4PL

virginmoneyukplc.com