



Beautiful business

Beating the 'digital drag':

Unleashing the potential of the UK's
smallest businesses



Size matters: why all small businesses aren't the same

The UK's smallest businesses — those employing up to nine people — play a vital part in the country's economy. They make up 15% of the UK's turnover, and provide over a quarter of total jobs. But despite this key role, many are lagging behind in digitalisation. They are often overlooked by tech suppliers or government initiatives that target larger SMEs and fail to recognise the unique needs and priorities of smaller businesses. In this report, we look at what's preventing them from fully embracing technology and what can be done to help.

Note: throughout this report, “small business” refers to sole traders and small businesses employing up to nine people.

Broader definitions of small and medium sized businesses go up to 250 or more employees. Those “medium”, or “larger small” businesses look, feel and behave very differently from those in the small business economy.

Unless otherwise stated, the figures in this report are drawn from one piece of research Xero commissioned from economics consultancy Cebr and market research firm Opinium. As part of this, Opinium conducted a survey to understand how businesses harness technology and digitalisation, along 1,294 UK SMEs, with 684 respondents from businesses employing up to nine people, in July 2023.

Report at a glance

Foreword: why we need to beat the “digital drag” 4

Seizing the opportunities could mean

£77.3bn

extra income for the small businesses,
or almost £15,000 for each business

1. Small businesses: the heart of the UK economy 5

Small businesses deliver

£934.8bn

of total private sector turnover and one
in four jobs (almost nine million)

2. Digital tools fuel growth 8

Small and medium-sized businesses that
digitalised most over the last four years
grew their revenue by

8.1%

3. Size matters: why all SMEs are not the same 13

30% of small businesses (0-9 employees)
have increased their use of digital tools since
2019, compared with

69% of larger SMEs (10-249 employees)

41% of small businesses report using
advances such as AI, compared to 77% of
larger SMEs

4. Billions in potential growth 15

If all small businesses had digitalised at the
rate of the top 20% of adopters, their collective
revenue would be £77.3 billion more

5. Barriers to digitalisation holding businesses back 17

40% of small businesses say they fail to
see the relevance of additional technologies
to their business

6. The way forward: helping small businesses to thrive 19

How tech companies, governments and
businesses can support the smallest firms to
digitalise and grow

Foreword: why we need to beat the 'digital drag'

Small businesses matter. They fuel economic growth and create millions of jobs. And when small businesses embrace digital tools and technologies, they can reach new levels of success.

But, as this report shows, a 'digital drag' is preventing a lot of the smallest businesses from seizing these opportunities. Many aren't convinced of the benefits of digitalisation and are reluctant to make it a priority. Because of this, they face a progress paralysis.

Small business interventions and initiatives are often folded into the broader definition of 'small and medium-sized enterprises (SMEs)', that can include businesses of up to 249 people. Yet the needs and priorities of the smallest businesses are very different. This is the "SME fallacy": not all businesses are the same.

This report shows that the smallest businesses are not taking up digital tools as much as larger SMEs. If all small businesses digitalised at the pace of the top 20%, then small business turnover would be £77.3bn higher, creating a further 885,000 jobs.

Given how important these businesses are to the UK economy, a range of stakeholders have a vested interest in breaking down these barriers, including tech providers, policymakers — and small businesses themselves.

Our report looks at what these groups can do to help speed up digitalisation and unleash the potential of the small business economy. Because when small businesses thrive, everyone benefits.



By Alex von Schirmeister,
Managing Director,
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SECTION 1:

**Small businesses:
the heart of the UK
economy**



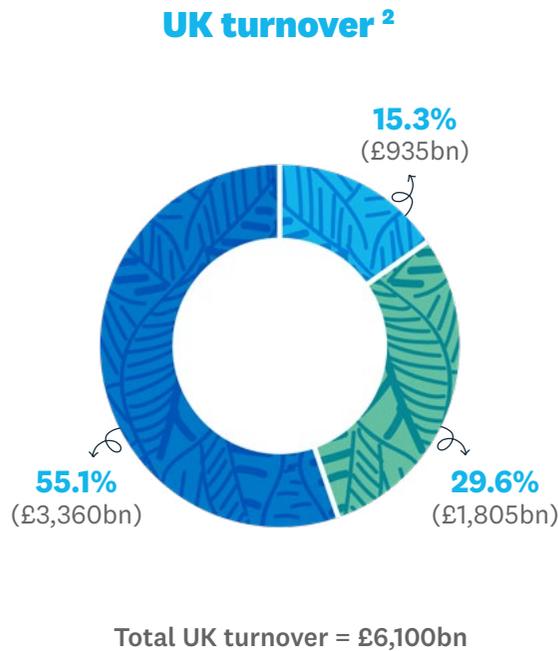
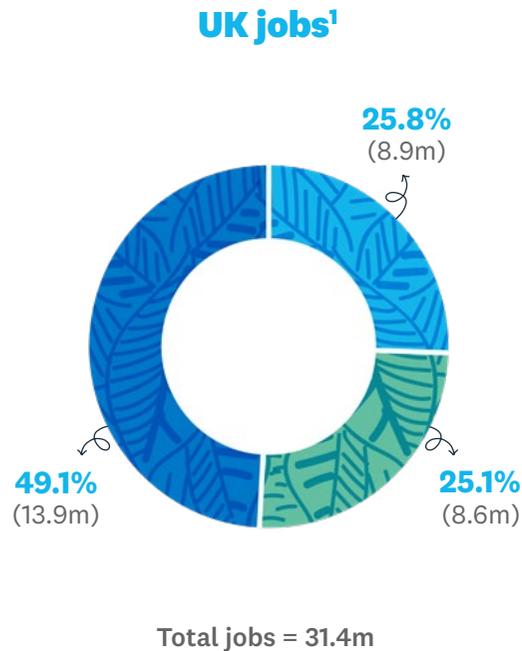
Small businesses: the heart of the UK economy

- Small businesses account for £934.8bn of total private sector turnover and generate one in four (25.8%) of the UK's jobs
- But in reality, their contribution counts for far more. For every £1 a small business makes in turnover, it creates 59p more in the wider economy
- Small businesses' contribution to the economy creates or supports 12.6 million jobs

Small and medium-sized businesses (SMEs) – those employing up to 249 people – contribute 45% of the country's turnover, and provide more than half (51%) of the employment.

Within this group, there are 5.3 million sole traders and small businesses employing up to nine people, representing 94.8% of UK companies.

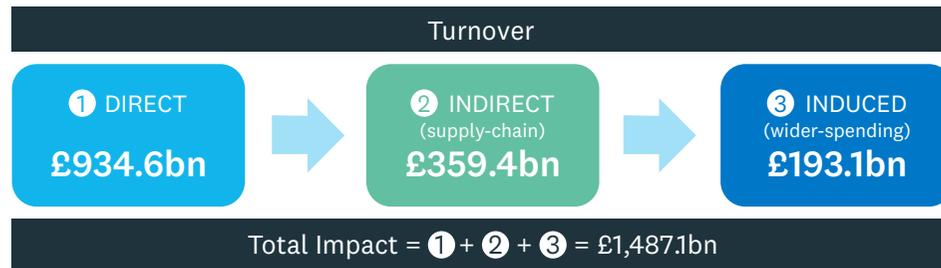
They provide over a quarter (8.9m) of the country's jobs and account for £935 bn, or 15.3%, of total UK turnover.



- Small businesses (up to 9 employees)
- SMEs (10-249 employees)
- Large (250+ employees)

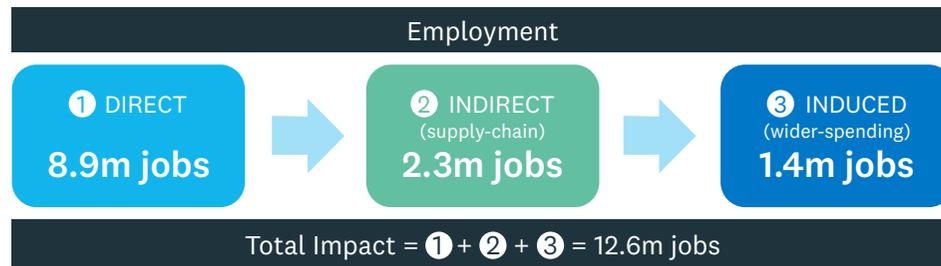
In addition, the overall impact of small businesses on the wider economy is huge.

- Every £1 of turnover generated by small businesses creates a further 59p in the wider economy, making a total of £1,487bn of turnover



Source: ONS, Nomis, Cebr analysis
Note: Figures may not add up due to rounding.

- For every job in a small business, a further 0.42 jobs are supported in the wider economy, making a total of 12.6m jobs, or 36.7% of the workforce



Source: ONS, Nomis, Cebr analysis
Note: Figures may not add up due to rounding.

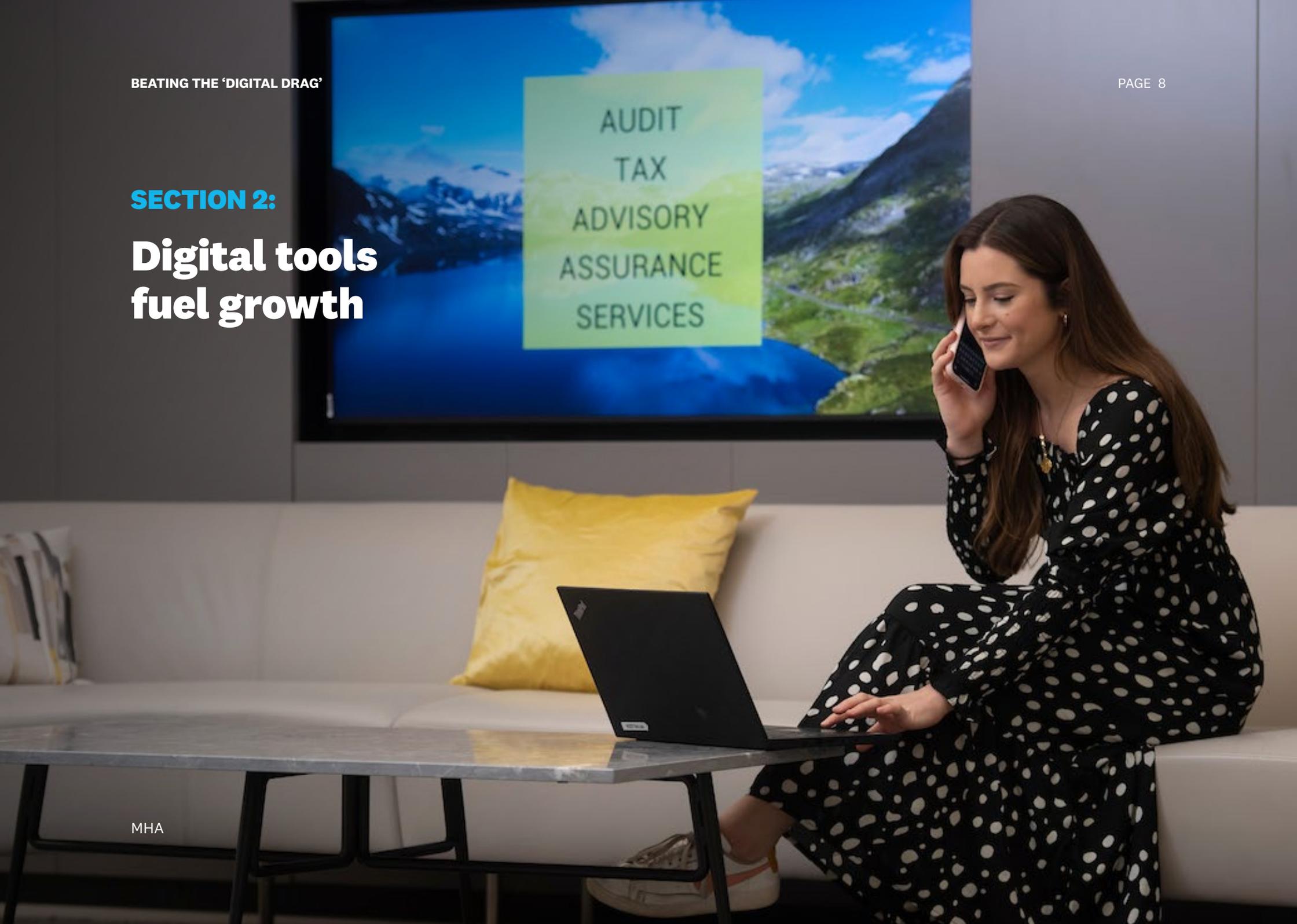


The small business economy also contributed £92.2bn in direct taxes in 2022.

This came from a combination of corporation tax, VAT payments, PAYE and national insurance contributions. In taxes alone, this is enough to pay for the UK's schools budget each year³.

SECTION 2:

**Digital tools
fuel growth**



AUDIT
TAX
ADVISORY
ASSURANCE
SERVICES

Digital tools fuel growth

- **The more digital the business, the better the performance**
Businesses that digitalised the most grew their revenue by 8.1% between 2019 and 2022. The slowest suffered a decline of 4.7%
- **Cloud computing, communications tools and digital assistants are driving digital adoption**
These are the most commonly used operational, communications and emerging technologies by small businesses
- **Improved efficiency and reduced costs are the biggest benefits**
New technologies also help businesses build their customer base

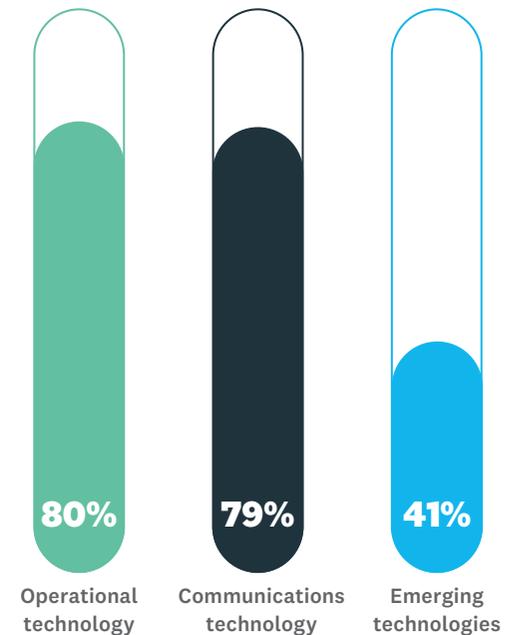
When small businesses embrace digitalisation, their business grows. They run more efficiently, generate more income and reach new customers.

The following types of digital tools are proving popular across industries and business sectors*:

80% of small businesses use at least one **operational technology**. These include tools such as cloud computing (48%), accounting software (35%) and graphic design applications (29%).

79% deploy at least one **communications technology**. Online media is the most used at 58%, followed by video conferencing (46%).

41% use **emerging technologies** such as digital assistants (24%) and artificial intelligence (22%).



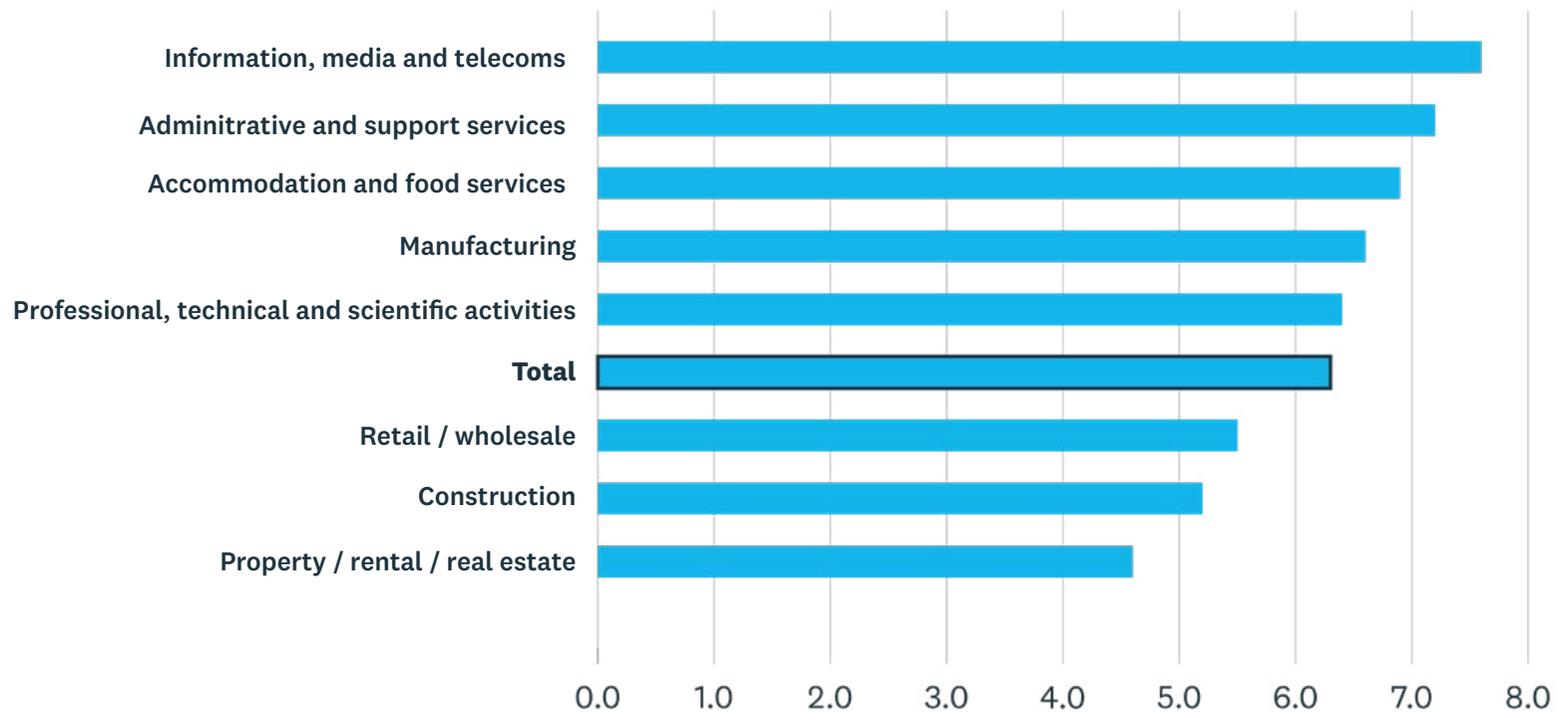
*A detailed breakdown of operational, communication and emerging technologies is included at Appendix 1

Tech adoption by sector

Take up of digital tools differs by industry. Unsurprisingly, the most tech-intensive sectors are information, media and telecoms, averaging 7.6 different tools each. Three sectors - retail, construction and property - fall below the all-business average.

Regardless of sector, greater digitalisation can lead to a range of operational, communications and financial benefits.

Average number of technologies used, by sector



Source: Opinium, Cebr analysis

Small businesses: reaping the benefits of digitalisation

Digital tools bring benefits to the businesses that use them. Some **71%** of small businesses said that digital tools brought at least one financial benefit. An even greater number, **84%**, noted an operational benefit and **71%** reported a communications benefit.

Different companies see different specific benefits. The most common benefits are:



Better cash-flow management means greater productivity

38%

Smooth operators - 38% of small businesses report that digitalisation made their business run more smoothly.

31%

Peak productivity - digital technology means higher productivity, according to 31% of small businesses. This can be as simple as reducing errors or the need for repeated data entry.

30%

Time savers - one in three (30%) found that digitalising internal processes saved time for employees. Streamlining workflows can make tasks like invoicing, inventory management and supply-chain operations all more efficient.

29%

Survivors - 29% believe that digitalisation helped them stay in business. One in four (24%) found that it improved internal communications such as with employees that work across multiple sites. This can make it easier to tap into a larger talent pool.

38%

Happy customers - 38% said that new tools and technologies improved the experience offered to customers. One in five can communicate better with customers and 35% have expanded their customer base thanks to technology.

27%

Stronger cash flow - for 27%, digital tools allow better control of finances, with fast access to real-time information. For 21%, this has led to improved cash flow.

32%

Cutting costs - by improving efficiency, a third (32%) of businesses said digitalisation led to reduced costs.

24%

New revenue streams - a quarter (24%) have been able to shift their business model and create new income streams.

28%

Prompt payment - digital payment systems also allow companies to get paid quicker.

Economic and social benefits

When small businesses embrace technology the entire economy and society benefits:

- **Increased productivity** - our [Upgrade report](#) shows that small businesses which adopt five key digital technologies (CRM, ecommerce, cloud-based computing, web-based accounting and computer-aided design) have higher rates of productivity in the following three years⁴
- **Economic growth** - recent Be the Business findings show that increasing SME performance by just 1% each year, for five years would grow the economy by £94 billion a year⁵
- **More jobs** - when businesses use digital tools to grow their company they may employ more people as a result
- **Higher tax receipts** - higher business profits and increased employment means higher total tax receipts
- **Global competitiveness** - the benefits of increased digitalisation help better position the UK internationally in both established and emerging sectors of the economy

The future of small business digitalisation

40%

of small businesses expect to use digital technologies more frequently over the next four years

47%

will increase their use of accounting/payroll software over the same period

74%

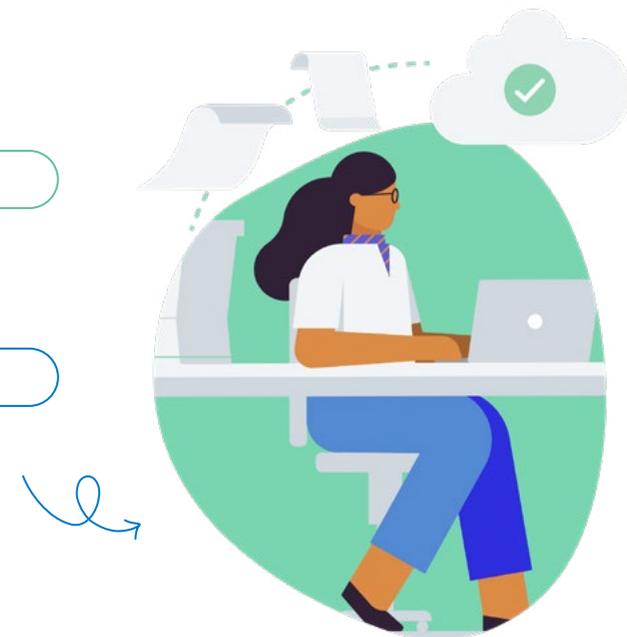
of those hope to do more with online media (e.g. company website, social media)

48%

expect to increase their use of AI

51%

plan to improve their cloud computing capabilities



SECTION 3:

**Size matters:
why all SMEs are
not the same**



Size matters: why all SMEs are not the same

- **Small businesses are failing to take advantage of technologies**
Just 30% of small businesses have increased their use of digital technologies since 2019. This compares to 69% for larger SMEs (10-249 employees)
- **Most smaller firms are reluctant to embrace emerging innovations such as AI**
Only 41% of small businesses use such innovations, compared to 77% of larger SMEs (10-249 employees)

When it comes to digitalisation, size matters. On almost every measure, larger SMEs have innovated faster than their smaller counterparts.

While 80% of small businesses use at least one operational technology, the figure for large SMEs (10-249 employees) is 97%. Almost all of these (97.7%) use one or more communications technology compared to just 79% of smaller outfits.

Overall, larger SMEs (10-249 employees) use almost twice as many types of digital tools than their smaller counterparts and average 8 technologies each compared with 4.7 in small businesses. And while 65.9% of these larger SMEs intend to use more digital tools over the next four years, this is only true for 40% of smaller businesses.

Digitalisation transforms the performance of small businesses. So why aren't more of them adopting new tech tools?

One reason is that tech providers and policymakers often see 'SMEs' as one, homogenous category. Our research suggests that those invested in helping small businesses digitalise need to better understand the specific issues, barriers and circumstances facing smaller enterprises.



SECTION 4:

Billions in potential growth



Billions in potential growth

- *If all small businesses had digitalised at the rate of the top 20% of innovators, their collective revenue would have risen by £77.3 billion and an additional 885,000 jobs would have been created*
- *Among all SMEs, this increased rate of digitalisation would have added a further £165.3 billion in turnover and 1.7 million jobs to the UK economy*

Companies that digitalised most had the best revenue growth between 2019 and 2022, as well as the highest growth rate in jobs.

SMEs in the top 20% of digitalisers grew by 8.1% on average while those in the slowest 20% suffered an average loss of 4.7%.

If all SMEs had delivered the same rate of growth as these top 20% of digitalisers, aggregate SME turnover would have been £165.3 billion higher, an increase of 6.0%. This is equivalent to £30,000 per business.

These figures relate to SMEs as a broader category. **For the smallest businesses, revenue would have been an estimated £77.3 billion higher.**

Companies that use more digital technology also report stronger growth in jobs. The top 20% of SMEs saw headcount rise by 5.7% between 2019 and 2022, while the bottom 20% saw it fall by 0.9%. If all SMEs had digitalised at the same rate as the top 20% of adopters, this would have created an additional 1.7 million jobs.



Small business employment would have been 885,000 higher if all small businesses had delivered the same growth rate as the top 20% of digitalisers.

SECTION 5:

Barriers to digitalisation

Nubian Skin



Barriers to digitalisation

A belief that digital tools are not designed for smaller businesses is standing in the way of tech take up. Despite the benefits of digitalisation for businesses, the wider economy and communities, many businesses are still reluctant to embrace technology.

Only 11.5% of SMEs say there are no barriers to adopting more digital tools. This suggests tech providers are failing to convince small businesses on why they should use their digital tools and software.

Eight barriers holding back digitalisation

Our research identified the eight most common reasons small businesses give for not adopting digital technologies:

39%

Too expensive - if businesses cannot see the immediate value they will get from new technology they often feel that the benefit is not worth the cost.

18%

Lack of time - for businesses with few employees, time spent on development is often at the cost of delivering as usual.

40%

Not relevant - while technologies like data storage are useful to most businesses, other technology, such as 3D printing, is limited to a handful of sectors.

33%

Not suitable for a small business - many digital tools such as Customer Relation Management (CRM) systems are pitched at large businesses, so smaller ones feel they don't have the resources or expertise to capitalise on them.

22%

Other priorities - digitalisation may be appealing, but unclear benefits can mean it isn't a major priority for now.

20%

Lack of knowledge and/or skills - few small businesses have unlimited access to IT support or training, so mastering new technology comes at a higher cost.

12%

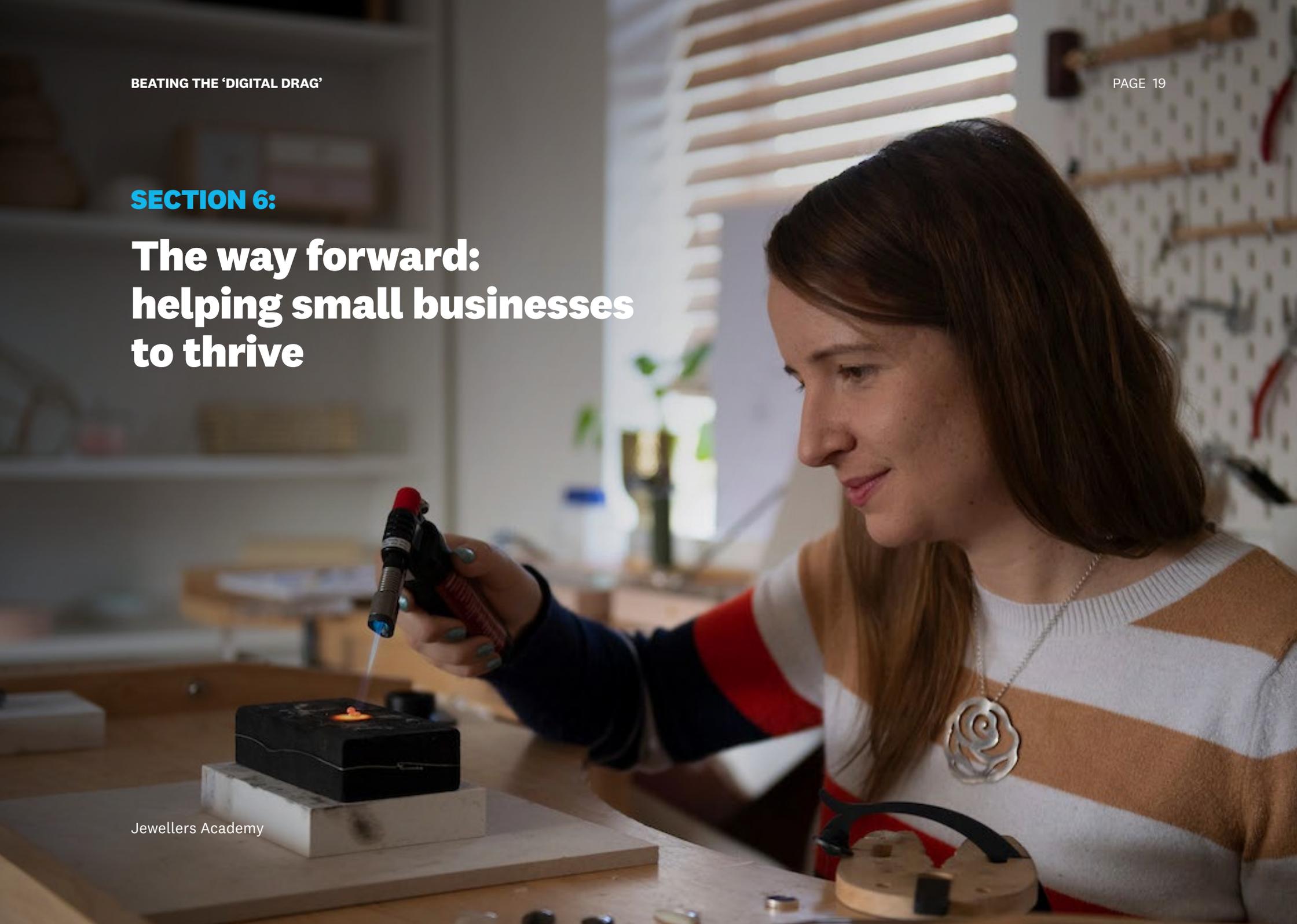
Difficulty of integration - legacy systems, time constraints and lack of skills can all add to the risks of getting started.

12%

Security concerns - from worries about data leaks and cyber threats to the fear of the unknown.

SECTION 6:

**The way forward:
helping small businesses
to thrive**



The way forward: helping small businesses to thrive

- *Tech and software providers, and business groups, should recognise that small businesses have unique needs and priorities*
- *Small businesses can take a simple and systematic approach to upgrading their digital approach*
- *Governments and regulators can do more to level the playing field so small firms can reap the benefits of new technologies*

Improving the performance of small businesses benefits everyone. Various groups have a vested interest in getting this right. This section includes:

- Advice for business groups and small businesses
- Policy recommendations to Governments

Talk the language of small businesses - more than half (57%) of employees don't understand what 'digital transformation' means⁶. Tech providers should talk to small businesses in their own language.



Advice for small businesses: keep things practical, focused and relevant

1. Set clear expectations: big firms invest huge sums in change management. A PwC study found that financial institutions spend, on average, 14% of their operating costs on ensuring staff are change-ready⁷.

Helping staff embrace new technologies is not just about technical skills. It involves tackling psychological and behavioural barriers. Part of this is talking plans through so everyone knows what's expected of them, and how the technology will help them do their jobs.

2. Prioritise the right tech: it is essential that the technology you choose is suited to your business. Just 27% of businesses believe they get their tech and software choices right⁸.

Start by prioritising the technology options which will have the most impact and be easiest to implement. What small changes will make the most difference? Consider a range of options

and think not just about what the tech can do, but how it will fit within your company culture.

3. Predict trouble spots: think about all the things that could go wrong (what if the technology doesn't work? What if it is too difficult to use?) and how you might meet those challenges.

Change can feel risky because it involves giving up control, but we often overlook the risks of staying the same. Advance planning can reveal any hidden threats and help avoid any problems with introducing new technology.

4. Balance costs and benefits: create a list of the costs and the benefits. An objective approach helps overcome that innate resistance to change by identifying exactly what is at stake, rather than leaving it to the imagination.

5. Put into practice: change is challenging for a small business, but there are lots of resources to help. Check out relevant training and support from industry bodies, groups or trade associations. Working with a mentor or advisor (like your accountant) is also a great way to develop a strategy and boost your skills in key areas.

6. Learn and adapt: reach out to people in your network to ask about their digital journeys. For instance, an accountant might be able to offer insight into how similar businesses have digitalised, and what benefits they have enjoyed. Find out what did and didn't work for others.



How governments can help: Xero's recommendations

Xero would like to see the following steps from governments and regulators to help small businesses take better advantage of digital tools.

1. A cross-government, small business digital taskforce:

- With small business and Cabinet-level representation, to coordinate activity on issues like the digitalisation of tax, prompt payments, smart data, digital trade, digital ID and government-backed mentoring and advice schemes.

2. Look at tax treatment and funding:

- Allow companies to write off digital technology investments, help them move online or to remote operations, and make investment more tax-efficient for digital tools, training and equipment.

3. Make advice more accessible and scalable

- Promote accountants and bookkeepers as the key small business advisors
- Introduce a scheme offering a Chief Technology Officer (CTO) as a service,

- providing access to the most up-to-date tech know-how
- Scale short online mentoring schemes
- Back and scale Growth Hubs.

4. Crack regulatory issues

- Simplify the complex tax system for small businesses
- Assess whether Making Tax Digital is structured in the right way
- Ensure small businesses have a clear picture of expectations and timings for any new pilots and regulations.

5. Boost skills:

- Expand the remit of the Small Business Commissioner to include digital skills
- Work with partners to improve access to digital, financial and business training.

6. Tackle infrastructure:

- Improve connectivity and address the rural-urban broadband connectivity gap.

7. Make it simple:

- Recognise that bureaucracy presents big barriers to small businesses. Accessing government help and support must be as simple as possible
- Consider a single API-driven, small business digital ID to boost access to finance, build trust and increase efficiency.



Lessons from overseas: Singapore leads the way

Singapore leads the digital way globally. It has encouraged the expansion of the digital economy by addressing key barriers faced by business-owners, including financial constraints, skills gaps, attitudes and awareness⁹.

It is also an example of what strong, committed government investment into digitalisation can do for an economy.

Singapore's Go Digital programme includes:

- **Funding** towards competitively priced, pre-approved solutions
- A **chief technology officer-as-a-service** allowing businesses to identify needs, access proven solutions and engage digital consultants
- A **foundation plan** offering competitively priced digital solutions that are supported with grants
- An **advancement programme** to build depth in digital activities from entry-level to more-advanced digitalisation
- A nationwide **e-invoicing** system that digitalises invoicing for all participants
- **Easy application** (and approval) through an online portal for government business grants.

Small and Mighty

The UK Government's Help to Grow Digital programme was originally targeted at businesses with five or more employees. But it is smaller companies that need the most support. Small Business Britain - along with Anglia Ruskin University - has set up a **Small and Mighty** programme¹⁰ to provide education and mentoring to the smallest businesses.



Sponsored by Xero, it will have enabled over 1,400 small businesses to thrive and get access to free education by the end of 2023.

Appendix 1: types of operational, communication and emerging technologies

Operational technologies

1. Accounting/payroll software (e.g. Xero, NetSuite, QuickBooks)
2. Cloud storage (e.g. Dropbox, iCloud, Google Drive)
3. Customer analytics tools (e.g. Google Analytics, Hubspot)
4. E-commerce platforms (e.g. Shopify, GoDaddy, Wix Stores)
5. Graphic design software (e.g. Canva, Photoshop)
6. Online booking software (e.g. Calendly, HubSpot Meetings Tool, Setmore)
7. Payment processing software (e.g. Xero, Stripe, Thyrv, Square Payments)
8. Project management software (e.g. Wrike, SmartSheet, Monday.com)
9. Virtual private network (e.g. NordVPN, Surf Shark, TunnelBear)
10. Inventory management software (e.g. NetSuite, Salesforce, JIRA)
11. Digital Point of Sales (e.g. Shopify, SumUp, Lightspeed)

Communication technologies

1. Communication apps (e.g. Microsoft Teams, Slack, Twist, Flock)
2. Marketing automation/email marketing software (e.g. Campaign Monitor, Mailchimp)
3. Online media (e.g. company website, social media)
4. Video conferencing software (e.g. Microsoft Teams, Zoom, Google Meet)

Emerging technologies

1. Artificial intelligence (e.g. ChatGPT, Google Machine Learning Engine, IBM Watson)
2. Digital assistants (e.g. Google Assistant, Amazon Echo, Cortana)
3. Internet of Things tools (e.g. Arduino, Flutter, Kinoma)
4. Virtual/augmented reality (e.g. Retail VR, Breakroom, Unity)

Appendix 2: survey methodology

This report is substantially based on research by economics consultancy Cebr and market research firm Opinium, which conducted a survey to understand how businesses harness technology and digitalisation.

The survey was conducted among 1,294 UK SMEs with 684 respondents from businesses employing up to nine people, during July 2023.

The results were broken down by firm size, sector, business age, turnover size and average profit margin. Within the survey, respondents were asked to state how their annual revenue, profit margin and employment changed in recent years to understand how better use of technology can benefit small businesses.

Appendix 3: References

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