

# AXA International Small Business Report 2011

November 2011



redefining / standards



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## Foreword

I am delighted to be introducing this important piece of research on behalf of AXA UK.

Being part of a global company that operates in 61 countries with 214,000 employees and tied agents and 95 million policyholders across the globe does provide a very real insight into the workings of different markets – such as small to medium enterprises (SMEs). These businesses are the lifeblood of major economies throughout the world and will play a pivotal role in helping to expand worldwide economic growth to its pre 2008 levels. SMEs have also been touted as the future job creators as European nations attempt to move forward from the Eurozone sovereign debt crisis.

The UK is not alone in wanting an environment where SMEs can thrive. In understanding the economic climate in which they operate, I was disappointed with the lack of a real knowledge base from which to appreciate how easy – or difficult – it is for this sector to expand. At the same time it would be helpful to know whether the UK is in a better – or worse – position to grow than our overseas competitors. This explains my desire for some fresh research into SME markets across the main developed nations.

This research has revealed some stark results. While the fieldwork was undertaken in the summer of 2011, shortly before the Eurozone debt crisis took hold, I was struck by the high levels of business optimism across the countries selected to take part. However, the role that energy prices play is clearly one of the major challenges that SMEs face across the globe.

In the UK I was particularly taken by the fact that our SME businesses are much less reliant on bank debt than similar sized firms in other countries – a surprising result when you consider the attempts that the coalition Government have made via project Merlin to make finance more widely available to all UK businesses. I was also disappointed to learn that business continuity planning among SMEs in the UK is not as advanced as it is in many other countries. Anecdotal evidence tells us that a high proportion of SMEs who suffer an interruption to their business never recover which is disappointing given the fact that a few short-term preparatory measures can often pay longer-term dividends in terms of business survival.

I hope that you find the report to be a useful evaluation of the difficulties that SMEs – around the world – face in growing their businesses.



Amanda Blanc  
CEO – AXA Commercial

## **Introduction**

The AXA Small Business Report 2011 examines a wide range of issues currently affecting the small business community in a number of major economies. The report seeks to improve our understanding of how these issues will affect the prospects for growth of small and medium sized enterprises during the remainder of 2011 and 2012. As part of this assessment, the first section of this report introduces the AXA Small Business Barometer which shows the outlook of our respondents across a range of key business indicators including revenue, profitability and headcount.

With the financial crisis of 2008 and subsequent economic downturn during 2009 triggering renewed public interest in the relationship between the financial services industry and the wider economy, we find there has been much debate as to the requirements for small and medium sized businesses to raise finance, particularly through bank lending. Part two of the report looks in detail at factors SME owners expect to constrain their business growth during 2011-12. This reveals that not only has business finance been overplayed as a major concern, but that other pressing concerns are being downplayed at many firms in our survey revealing major gaps in risk management.

In part three, we look at issues such as current approaches to business continuity planning, cash flow management and the uptake of business insurances - all areas that could make a significant contribution to improving business resilience in the current economic climate but where many firms clearly need greater protection. In part four, we discuss how the insurance industry can contribute in meeting that need.

### **The economic context for our survey**

The wider economic backdrop to this report remains uncertain. The financial crisis which first arose in 2007 and deepened in 2008 is still with us, as is apparent with the sovereign debt crisis and continuing weakness in the banking sector. The overhang of both public and private debt following years of expansionary credit markets and the need to rein in debt to more sustainable levels is now causing a drag on economic growth and looks likely to persist for the foreseeable future.<sup>i</sup>

Not surprisingly, the need to achieve economic growth has become a major public policy priority for developed countries, leading to a range of policy initiatives that aim to stimulate economic growth across all businesses, large and small. Much of the world has already undergone one steep economic downturn. By and large, the business community has proved to be quite resilient as a result of greater flexibility within the workforce, renegotiating pay and pensions.

The prospects of a double dip economic recession receded during 2010, but now we are once again faced with stagnant or declining economic output. In September, the National Institute of Economic and Social Research (NIESR) monthly estimate of GDP suggested that UK output grew by just 0.2 per cent in the three months ending in August 2011 after growth of 0.6 per cent in the three months ending in July 2011.<sup>ii</sup> This represents a significant slowdown, which is being replicated in other major industrialised economies. The most recent assessment by the OECD shows that growth in the Eurozone economies will now average just 1.6% in 2011. This compares with 1.5% in the US and 1.1% in the UK.

## **The distinctive contribution of small and medium sized businesses**

SMEs will play an important role over the medium to long-term in returning stalling economies in Europe and North America to growth. A great deal of academic research<sup>iii</sup> has focused on how high-growth SMEs, so-called “gazelles”, have in recent years contributed towards key growth factors such as innovation. According to a recent BIS paper, “gazelles” account for around 6% of all UK firms with more than 10 employees; yet they also account for more than a quarter of net growth in jobs in existing businesses.<sup>iv</sup> These are the firms that are likely to become the large firms of tomorrow.

The presence of a large contingent of high-growth SMEs in an economy brings further indirect benefits, such as increases in the level of private sector employment growth – an increase in 5% of the employment share of high-growth firms leads to a 3.5% increase in private sector employment growth. Export markets too are very important for the UK’s high-growth SMEs.<sup>v</sup>

On the basis of the findings contained in this report, much can still be done to ensure that these economic growth engines are placed on a firmer financial footing enabling them to grow and contribute to the wider economy as outlined above.

### **Research methodology**

We conducted our fieldwork between 25<sup>th</sup> July and 2<sup>nd</sup> August 2011. During the fieldwork stage we interviewed 650 small and medium-sized enterprises across 10 countries in Europe, North America and Asia. These 10 countries were chosen to give a full picture of the small business environment in Europe as well as comparative points from North America and a key emerging market in Asia. The countries included in our survey were:

- Belgium
- France
- Germany
- India
- Ireland
- Poland
- Spain
- Switzerland
- UK
- USA

One of the initial problems in attempting to question the SME business community across ten different countries is the different definitions used to identify the small business community. Of our survey countries, seven were located within the European Union (EU), which uses a definition based on a combination of both headcount and turnover to include all firms with a headcount of below 250 and *either* a turnover of €50 million or less, *or* a balance sheet total of €43 million or less. Additionally, small enterprises are defined as having a headcount of less than 50 and a turnover/ balance sheet of less than €10 million; and micro enterprises have a headcount of less than 10 and a turnover/balance sheet of less than €2 million.

This report draws heavily upon the EU’s Small Business data sets which make use of the definitions outlined above and so this is the standard generally used throughout the report. One important distinction is that our definition of medium-sized enterprises only covers those firms which employ between 50 and 99 employees, which mean that the findings are

not directly comparable with EU data. Within this, we further refined our target firms to include sole traders, micro-businesses (fewer than 10 employers), small businesses (employing 10-49 employees) and medium-sized firms (employing 50-99 people).

### **Executive summary**

- The SME business community is largely upbeat about the overall economic outlook in the coming 12 months with more firms expecting revenue and profitability to experience growth compared with those expecting a fall in revenues or profitability.
- This positive outlook does not look likely to lead to major job growth, with only a small minority (18%) of SME firms looking to increase headcount in the coming year. If SMEs are to be an important motor for job creation then they will need to be more appropriately ambitious and confident of their short-term prospects.
- In India, firms are unwilling to increase headcount due to lack of appropriately skilled staff, whilst more developed countries are not hiring due to economic worries.
- Concerns over access to bank credit in the UK appear to have been somewhat overplayed by the media. Firms in the UK are less likely to be relying on bank loans to finance their operations compared to firms in the other countries we surveyed.
- The increasing cost of energy is viewed by SMEs as their biggest single threat over the next year, squeezing margins significantly. Combined with downward pressure on prices, SMEs face real challenges in maintaining profitability in the short and medium terms.
- The smaller the firm, the greater the concern over increasing costs and prices, reflecting sole traders and micro firms smaller capacity for effective risk management and their greater exposure to sudden market shocks.
- Taxes and tax compliance costs are a major concern of SMEs, and may be severely restricting their ability to grow. Smaller firms lack the resources to manage their financial matters cost effectively, and so waste valuable time (325 hours a year in Poland) filing tax returns.
- Only a small minority of firms were concerned about the growing costs of civil litigation (19%), but we found widespread concern about the cost of compliance with health and safety legislation.
- SMEs are unlikely to be exporters - just one-in-six of our SME survey currently export - thereby missing out on the benefits of being exposed to consumers in multiple markets.
- The Single Market and Euro area facilitate the export business of SMEs; Euro area exporters show less concern than non-Euro area SMEs over the costs of exchange rate fluctuations.
- When we asked respondents to mention unprompted what they thought were the key risks facing their business many struggled to identify *any* risks. In total one quarter of respondents (25% of SMEs) couldn't name any risks.

- SMEs hold a wide range of financial products to help them manage their finances, however our study reveals gaps in preparedness amongst SMEs. While there is wide uptake of banking services and products, and general insurance such as buildings and contents cover, this prudence is not repeated when it comes to protection from health related risks such as critical illness, income protection or key man insurance.
- Crucially, SMEs have particular "key man" risks such as over reliance on a small number of directors (in many cases a single director) to win new business, manage client relationships and oversee day-to-day operations. The loss of a senior director represents a key risk to these businesses, but goes unrecognised in 80% of SMEs.
- In a similar vein, only 39% of businesses surveyed claim to have business interruption cover, leaving the majority at risk to events such as the recent riots in the UK – where businesses were forced to close due to the business interruption costs they incurred – uninsured.
- 40% of firms do not currently have a business continuity plan in place, a shortcoming that is most present amongst the smallest businesses, which often believe themselves to be 'too small' to have to think about this issue.
- Over half of the SMEs we surveyed have less than two months of revenue reserved for working capital, falling short of a three-month benchmark and suggesting too many SMEs are placing themselves at risk of short-term cash flow crises, which are far more common during economic downturns.
- SMEs could benefit from a more holistic approach to financial planning. At present nearly all SMEs have a relationship with a bank of some sort, and consequently tend to rely on accountants and their banks for advice to the detriment of protection planning.
- E-commerce is one of the fastest expanding areas of economic activity, but our research suggests that SMEs may not be taking full advantage of the possibilities of online business, with only 38% using it for business planning purposes.
- Where SMEs do use the internet, they find it has many distinct utilities, with large proportions using it for marketing (52%), sales (47%), supplier sourcing (45%) and financial management (40%).
- Respondents agreed that the internet is the preferred source of information about financial services products, through direct marketing via e-mail. However a significant proportion still value the personal touch, with 29% preferring to receive information via their bank manager and 16% via their broker.
- Our report concludes with recommendations for SMEs and governments trying to encourage them:
  - The need for SMEs and governments to focus on *broad financial risks* rather than narrow finance needs.
  - The need for more business continuity planning at the SME level.
  - A need for more understanding of business critical risks and the protection against them that is available.

## Part One: The SME Business Barometer 2012 - The outlook for the year ahead

In this section we assess the sentiment of SME business owners to see how they view current market conditions and the medium-term outlook for profitability and job creation. We asked our respondents to state whether business revenues had increased, decreased or stayed the same during the last three months, covering the trading period in the second quarter of 2011. The timing is critical in helping to explain the findings. While there had been talk about the softening of the economic recovery during the early summer of 2011, it was only after we had completed our fieldwork that economic prospects took a distinct turn for the worse. On the 4<sup>th</sup> of August the European Central Bank warned about the sovereign debt crisis afflicting the Eurozone; a day later, the ratings agency Standard and Poor downgraded US government bonds.<sup>vi</sup> These two developments prompted a major slump in equity markets and prolonged economic uncertainty as the future health of the Euro and Eurozone hang in the balance.

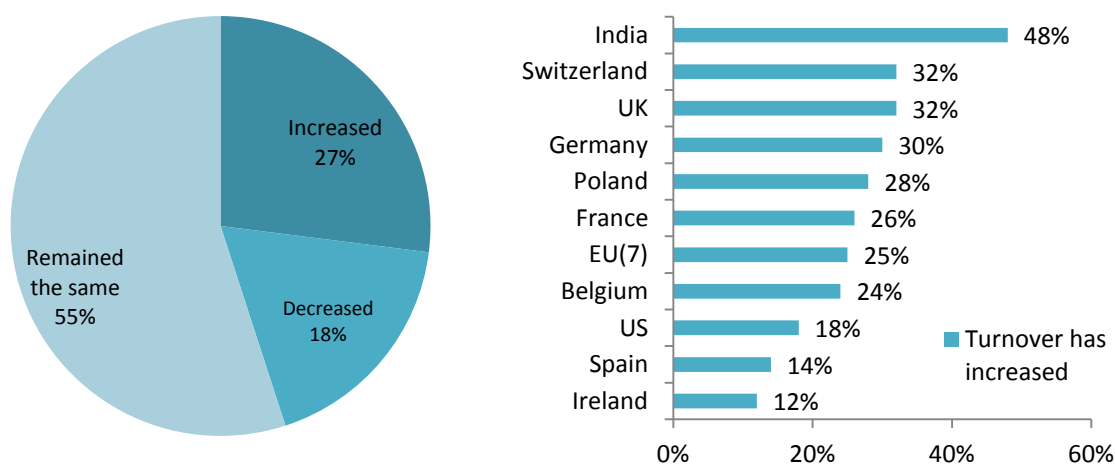
### SME Turnover during the last three months

55% of businesses responding to our survey had experienced no change in turnover during the last three months suggesting that the majority of SMEs have been resilient in the face of economic uncertainty. However, there were important differences by country and SME type.

- The most optimistic picture emerges from India, with 48% of SMEs reporting an increase in turnover;
- The UK and Switzerland were the next best performers with 32% reporting an increase;
- Ireland (12%), Spain (14%) and the US (18%) were the worst performing in terms of SMEs reporting increased turnover. All three are faced with heavily indebted household sectors which in turn leads to weak consumer demand;
- The larger end of the SME market (firms with turnover over £5m) is proving to be the most resilient with 35% reporting increased turnover in the last three months;
- This falls to 21% among firms with turnover of <£50,000 per annum. Around one-third of these firms (32%) saw turnover decrease.

Chart 1: SME firms have proved to be resilient during the second quarter of 2011

Q: Over the past three months has your turnover increased, decreased or remained the same?



## SME expectations in the near future

We also asked firms to gauge what they thought would happen to the trading environment over the coming year across three key business indicators – revenue, profitability and headcount – to provide us with a picture of business sentiment in the coming 12 months.

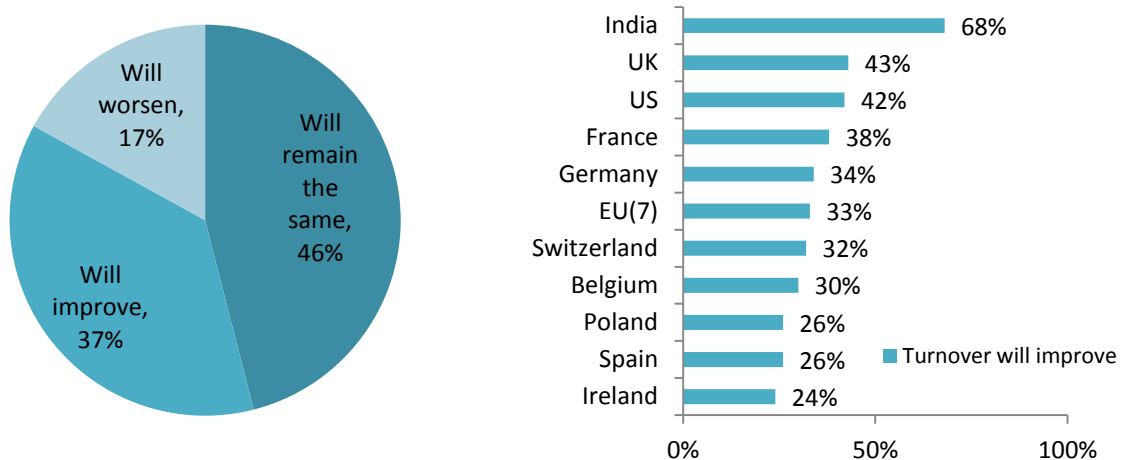
Respondents are generally more optimistic than pessimistic over the coming 12 months across our three business indicators. In spite of the widespread concerns for economic growth in 2011, only one-in-six expect turnover to decrease during the coming 12 months. Nearly two-fifths expect turnover to increase. The outlook on profitability is less positive with 21% expecting profitability to worsen and 32% expecting it to improve. However, while we see that a large majority of firms expect both turnover and profitability to increase or remain stable over the coming year this does not translate into expected growth in employment levels. This suggests that SME firms will be looking to grow margins without increasing headcount in 2012, collating with data showing employment levels stagnate in most developed markets.<sup>vii</sup>

### Turnover in 2011-2012

While revenues might be expected to increase in 2011-12, this will be on narrower margins with 62% of SMEs agreeing that "Pressure to keep consumer prices down" will adversely affect their business. Nearly one-third (29%) expect this to have a major impact.

- Only 17% expect turnover to worsen during the coming 12 months;
- 37% expect an improvement with 68% of SMEs in India expecting turnover to improve;
- In the UK - the next most positive - the figure was 43%, closely followed by the US with 42%;
- The outlook for smaller firms looks less certain with only 23% of sole traders expecting turnover to increase. Among larger SMEs (those with 50-99 employees) over twice as many (51%) expect turnover to improve.

*Chart 2: UK is among the most upbeat in terms of SME expectations on business turnover*  
Q: Over the coming 12 months do you believe that turnover will improve, worsen or remain the same?

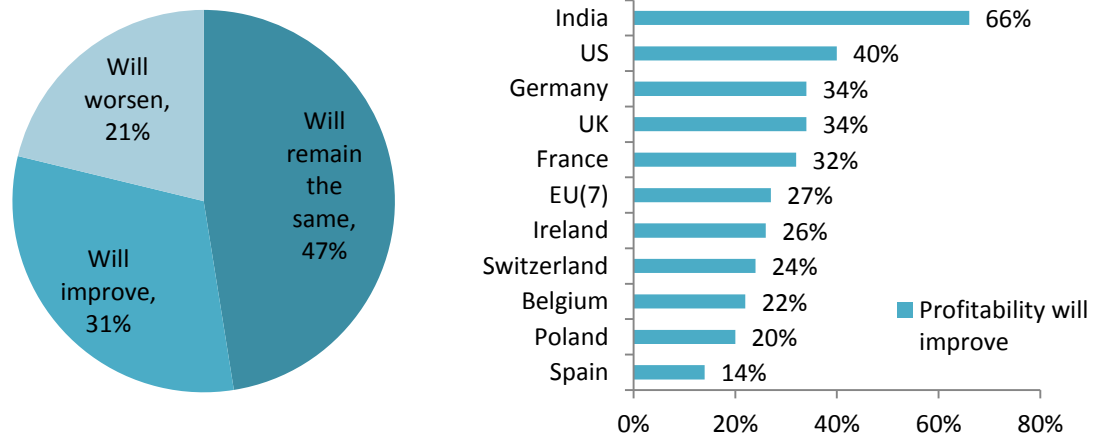


### Return to profitability

- Nearly one-third of firms (31%) expect profitability to improve, with India most positive where 66% of SMEs expected higher profits in 2011-12. Next highest was the US on 40%;
- Again, smaller firms are less confident, with only 25% of sole traders thinking profitability will improve in the coming year compared to 38% of larger SMEs (those with 50-99 employees).

Chart 3: More SMEs are expecting to see a positive trend on profitability

Q: Over the coming twelve months do you believe that profitability will improve, worsen or remain the same?



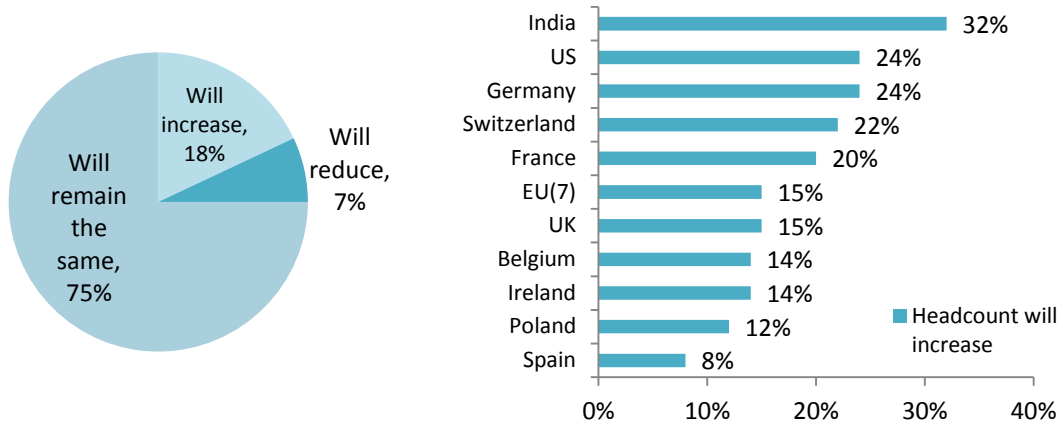
### SMEs: no motor for job creation

The weakness of the economic recovery is apparent in respect of prospects for job growth. With SMEs seen by many as an engine of growth and job creation, only one-in-six firms (18%) across our 10 countries believe that headcount will increase during the coming year, confirming fears of a mostly jobless recovery. SMEs will be looking to keep costs down and grow margin and profitability ahead of increasing headcount.

- SMEs most likely to be increasing headcount in 2012 are to be found in India (32%), Germany (24%) and the US (24%);
- Ireland was the only country in our survey where more SMEs are likely to make reductions in headcount than adding to it. Here 14% thought that they would be hiring new workers while 18% thought that they would be laying people off;
- As a sign of the economic headwinds, 75% expect that headcount will remain the same reducing the role of SMEs as a driver of economic growth and job creation; and,
- Reflecting the generally positive outlook in India, SMEs here are more likely to report capacity issues (such as hiring skilled workers) as a likely problem in 2012, compared with their counterparts in the US and Europe.

**Chart 4: SME firms unlikely to provide a major source of job creation**

Q: Over the coming twelve months do you believe that headcount will improve, worsen or remain the same?



It will be interesting to see what actually happens to SME employment levels in the coming months and whether the smaller firms are right to take a less sanguine view of their financial prospects. Whether firms are able to grow and prosper will depend on whether governments can act quickly enough to remove the growth barriers facing small and medium sized firms.

## **Part 2: Obstacles to growth - businesses faced with profits squeeze as costs rise and prices stagnate**

The clear message from respondents is that business costs are set to rise over the next year, while pressure on prices will result in lower margins. The biggest two threats to business growth in the coming year are the cost of energy and commodity prices. Firms risk being faced with a 'double whammy' of increasing operating costs combined with continued downward pressure on household incomes causing downward pressure on consumer prices. Increasing revenues will not necessarily mean increased margins, 37% of our respondents expect to see an increase in revenues, but only 32% expect this to filter through into increased profitability.

The Governor of the Bank of England has predicted that the UK is facing the biggest squeeze on living standards since the 1920s.<sup>viii</sup> In September 2011 The IMF downgraded the UK's growth forecast to 1.1% from 2% for 2011 due to the persistent headwinds affecting the UK economy.<sup>ix</sup> These headwinds, such as weak growth in the US and the debt crisis in the Eurozone, are affecting all major economies. The prospect for another economic downturn emerges as one of the biggest risks facing SMEs: 96% of SMEs in Spain thought this was a risk to their business compared with 58% of SMEs in France and 50% in Belgium. Even in the otherwise upbeat SME community in India, 64% see an economic downturn as a risk. The figures for the UK and Ireland were 67% and 78% respectively.

### **Fears over business financing have been overplayed**

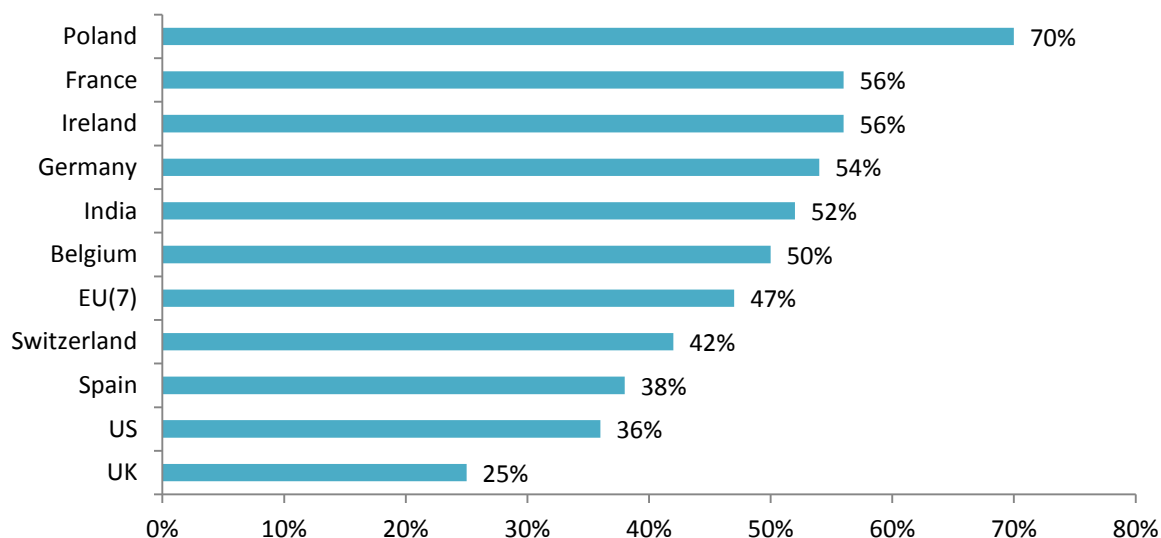
Faced with the fears of an economic downturn, the governments of many countries have developed economic strategies intended to provide additional support to the business community. The UK government has announced a raft of policies to help boost the private sector, and ensuring adequate finance is in place to fund that growth remains a critical issue. Project Merlin was announced in February 2011 and followed pressure by the UK government upon banks to increase lending to the SME community.<sup>x</sup> However, in a statement published by the major banks at the time of the announcement, this call for greater debt financing came at a time when there had in fact been "muted patterns of customer demand ... evidenced by lower net lending balances than a year ago".<sup>xi</sup>

In short, there has been a degree of deleveraging among the business community as firms, including SMEs, seek to place their balance sheets on a firmer financial footing where they are less exposed to debt financing. Recent figures by the British Bankers' Association (BBA) showed that only 15 per cent of SMEs had sought finance in the past year and 13 per cent of those seeking finance wanted overdrafts, not loans.<sup>xii</sup> In the BBA survey, only around 2 per cent cited securing finance as an obstacle to growth in the next three months. Our findings confirm this picture in revealing that no SME firms surveyed in the UK mentioned access to credit as a potential barrier to growth in 2011-12.

As shown below, firms are more concerned about the prospects of increasing fuel and commodity prices, as well as the increasing burden of taxation harming their potential for growth. Furthermore, we also find that many UK SMEs have already taken steps in recent years to reduce their dependence on bank financing.

Chart 5: UK small businesses are less reliant on bank debt than SMEs in other countries

Q:What financial products and services does your business currently hold? A. Bank Loan



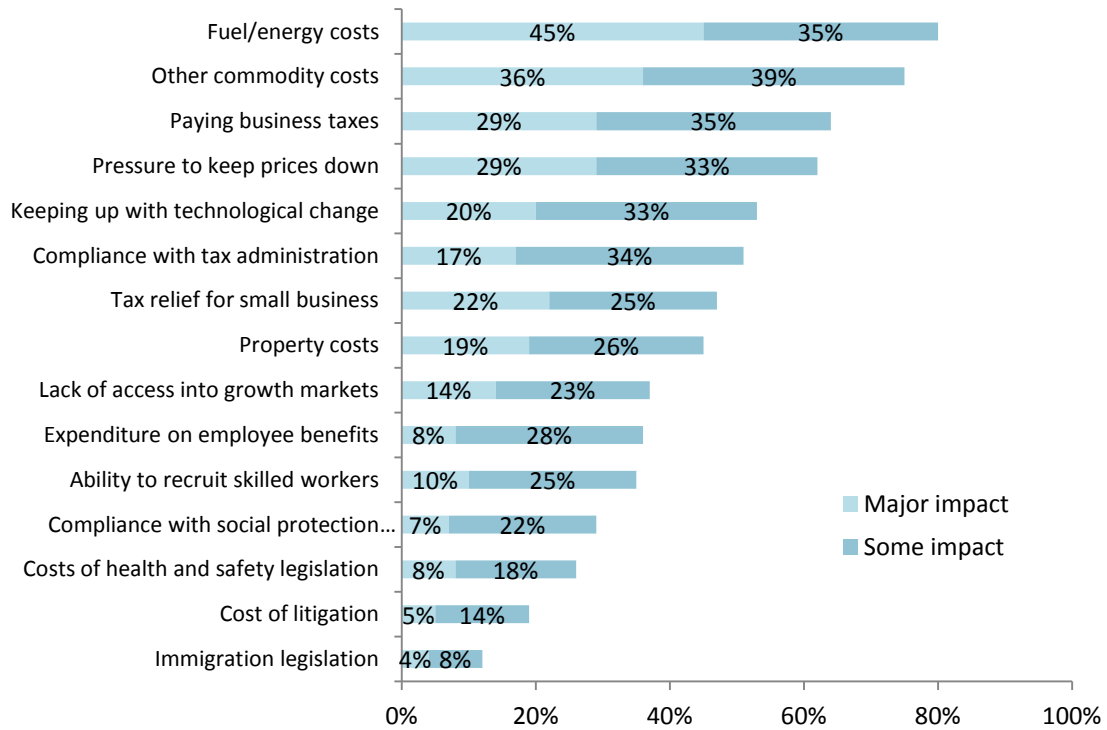
- When compared with SMEs in other countries, the UK sector is less likely to be using a bank loan. Only one quarter (25%) of the firms we surveyed had a bank loan, compared to 47% across the EU average. The UK also came out below the international average in terms of use of bank overdraft facilities.
- Banks are used for SME financing in France, where 56% had a bank loan and 72% make use of an overdraft facility.
- The use of bank overdraft facility is widespread, with 53% of SMEs making use of them.
- Reliance on bank loans is more prevalent among larger SMEs. Of those firms with turnover >£5 million per year, 55% have a bank loan compared to 32% of those with turnover <£50,000 per year.
- Firms with bank loans are also more likely to expect turnover and profitability to fall in the coming year.

With the current debate about business support in the UK and elsewhere overly focused on business financing, in particular the role of bank lending to SMEs, this debate overlooks the broader issue of how small businesses are helped to cope with periods of uncertainty and how they might seek to identify and manage all their financial risks at a time when the prospects for growth are becoming ever more pessimistic. We look at some of these issues in more detail in part three.

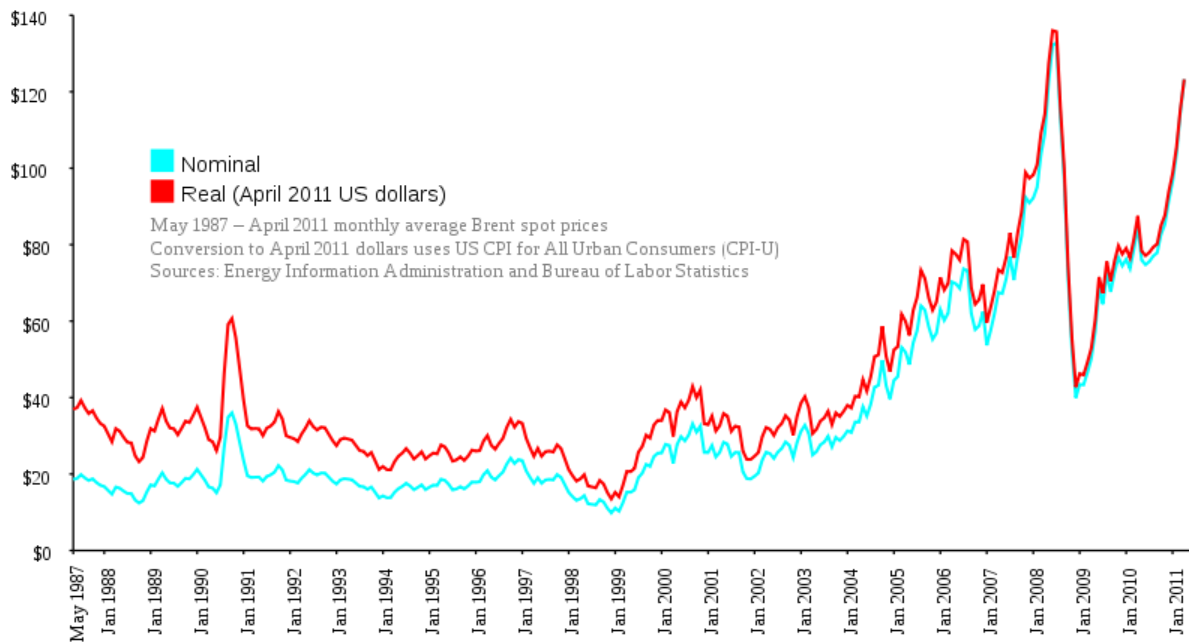
### **The cost of energy – the biggest single threat to growth**

The emergence of rising fuel costs as a major business concern comes as no surprise given the unprecedented long-term trend for fuel price inflation. Since 1987 we have seen the real price for crude oil increase from \$40 per barrel to over \$120 per barrel by September 2011, and this increase has fed into higher fuel prices at the pump. This massive real-terms price increase, combined with increasing volatility since 2006, is clearly reflected in our findings.

**Chart 6: Rising fuel costs represent the biggest single constraint on business growth in 2012**  
 Q: What impact will the following have on your business growth over the coming twelve months?



**Chart 7: Oil price inflation (Brent Crude spot prices since 1987)**



80% of all SMEs expected fuel costs to have an impact on their business in the coming year with 45% (nearly half) claiming that the impact would be major. Furthermore, 75% were concerned by the rising cost of other commodity prices.

Across our EU sample 84% of SME firms believe that rising fuel costs adversely affect their business. This ranges from 98% in Poland to 60% in Spain. The UK reported a figure of 88% with Ireland 94%. Swiss SMEs were least concerned on 58% while only 68% of US SMEs were concerned about the cost of fuel. The impact is most likely to be felt by smaller firms (those employing less than 10 people) and sole traders, who emerged as being the most concerned. Among those firms expecting profitability to decrease in the coming year, 59% thought that rising fuel costs would have a major impact on their business compared with 45% of all SME firms.

### **The consumer price squeeze**

The pressure to keep prices down in an increasingly competitive market place was another major threat. SME firms in Ireland were most concerned by the pressure to keep consumer prices down: 54% said this would have a major impact on their business in the coming year. SMEs in Spain also rated this concern highly (36%) compared with an EU average of 31% and just 16% in the US. Clearly, sentiment is being affected by a range of issues including over-indebtedness in the consumer sector, the scale of the banking crisis, government backed deflationary measures, and poor prospects for economic growth. In India, which is experiencing relatively high levels of inflation, 62% of firms believe that pressure to keep consumer prices down will have either some impact (40%) or a major impact (22%).

Across our ten survey countries, sole traders are particularly feeling the pressure to keep prices down: 36% believe that low inflation will have a major impact on their business and a further 26% thought it would have some impact.

### **The growing tax burden on SME businesses**

The burden of paying tax bills emerged as another major theme. Governments such as the UK Coalition recognise the importance of setting low tax rates but their efforts can neglect the SME community. A number of countries in our survey have made great efforts since 2008 to promote the competitiveness of their domestic tax systems in order to attract international businesses. For example, the Irish Government fought to defend its 12.5% corporation tax rate as part of the terms of its IMF-EU-ECB bail out in early 2011. The UK Government has committed to reduce its corporation tax rate from 28% to 23% by 2015, with the aim to make the UK among the most competitive in the G20.

However, reducing the corporation tax rate may have limited value to SMEs. Our survey reveals that the cost of tax compliance is an equally important problem to the overall tax rate. SMEs in India, Poland and Spain are most likely to report that compliance with tax administration will have "a major impact" on their business. India has the second longest tax code anywhere in the world and the UK the longest.<sup>xiii</sup> The administrative burden of business taxes is considered greatest by respondents in Ireland and Poland. This is somewhat surprising, since according to the World Bank in 2010 it took the average Polish business 325 hours to pay its taxes, compared to just 76 for the average Irish business. Perhaps given the low-tax and light-touch regulatory culture of Ireland, any tax compliance burden is seen as onerous.

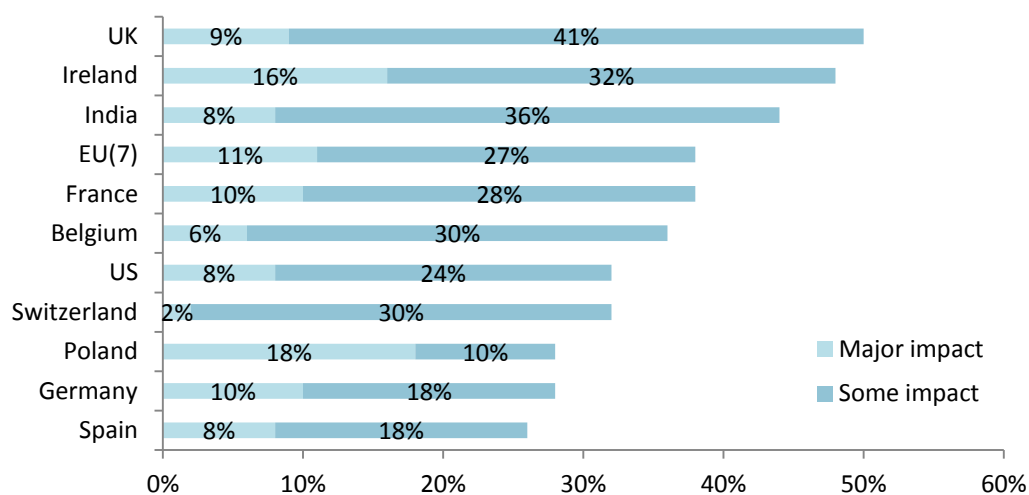
Tax compliance can be most difficult for the smallest firms, which lack specially trained professionals to handle their tax matters. Accordingly, it is sole traders who think that business taxes will have the greatest impact on their business (37% reported they would have a major impact).

### Health and safety: a growing compensation culture?

UK SMEs came out top as the most concerned about the cost of compliance with health and safety regulations at work. Half (50%) of small and medium sized companies in the UK thought that the compliance costs of health and safety legislation would have an impact on their business. Nearly 10% thought this would have a major impact.

*Chart 8: Half of UK SMEs are concerned health and safety rules compliance will harm their business*

Q: What impact will the compliance costs of health and safety legislation have on your business growth over the next twelve months?



This is one business cost which has received growing policymaker attention in the UK given the increasingly disproportionate cost of civil litigation. So worried is the UK government that during 2010 it undertook a full scale review into the cost of civil litigation (undertaken by Lord Justice Jackson) and also the burden of health and safety legislation (undertaken by Lord Young).<sup>xiv xv</sup> The reviews represent a major effort to achieve a better balance between access to justice and burdens on business. In announcing the results of the Young Review, Lord Young commented that health and safety rules had become a "joke" and were responsible for endless form filling and bureaucracy.

On the threat of litigation, our findings suggest a mixed response from the business community. Concerns over litigation and the so-called "compensation culture" resonated with only a small minority of firms. Just 1-in-20 SMEs thought that this would have a major impact on their business. SMEs in continental European countries were most concerned about the cost of major litigation with 56% of SME respondents in Spain citing this as a risk, compared with 32% in France and 28% in Germany. The EU average was 28%. However, more widespread was the concern over the compliance costs of health and safety legislation. We found 37% of firms expecting this to adversely affect their business. Nearly 1-in-10 expected this to have a major impact. Given the aforementioned reviews

undertaken in the UK it is notable that SME firms there are particularly concerned that health and safety regulations will impede their ability to grow.

Perhaps what is most telling are the business risks that did not emerge in the findings. Risks such as the loss of a major contract or ill-health of a senior director were either downplayed or went completely unrecognized. We explore this further in part three below.

## Special report on SME exporters: Tapping into high growth markets overseas

The research gave consideration to the small minority of SME businesses who currently export goods and services. These businesses who sell their products internationally have more opportunities to experience high growth and therefore contribute more to employment - particularly in the European context where consumer demand in domestic markets continue to be suppressed as a consequence of debt.

A desire to assist SMEs in tapping into high exogenous growth in emerging markets has therefore become highly attractive to policymakers. Both the UK government and the European Commission have recently published papers on how to promote the internationalisation of the SME community. The EC data show that around 26% of EU SMEs are exporters, compared to 18% of our survey respondents, reflecting the fact that our definition of SME was focused more on small over medium-sized firms. Indeed, our exporters were concentrated among the larger SMEs employing between 50-99 people.

These firms may find themselves in a more favourable position compared with non-exporting SMEs given the benefits of diversifying their client base and revenues across various markets. However, diversification can bring with it additional risks and challenges.

- 73% of SME exporters agreed that receiving cross-border payments on time was a significant issue. This was by far the biggest single concern;
- 56% experienced problems dealing with exchange rate fluctuations;
- 52% were concerned by the level of local bureaucracy while 43% were concerned by compliance with local technical and regulatory standards; and,
- 44% had significant issues with having to pay customs duties or tariffs in export markets.

In contrast, language barriers, corruption, bribery and political uncertainty were all considered to be less prominent concerns.

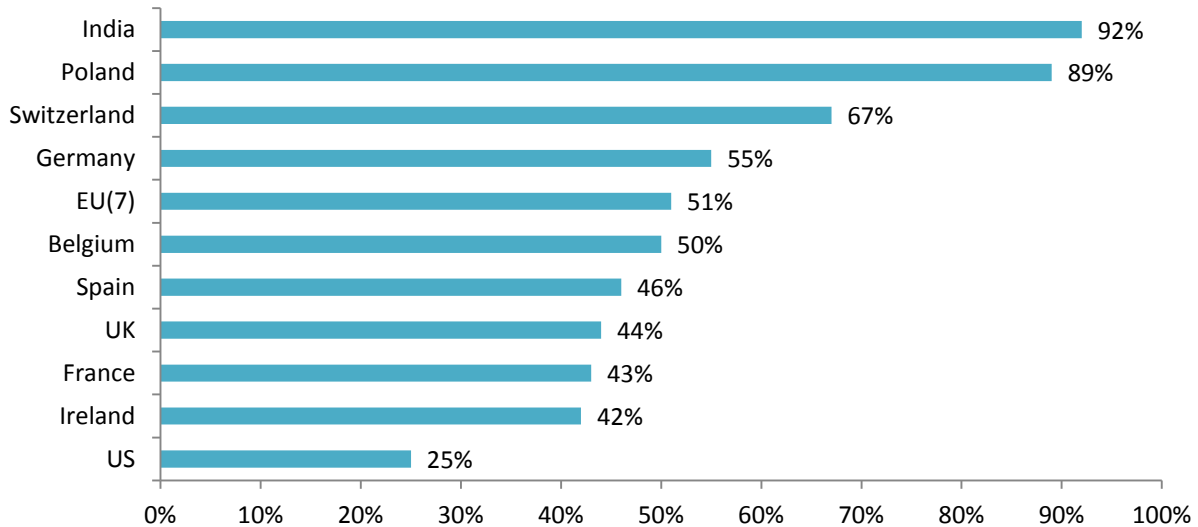
### *The European Union: a force for good in promoting cross-border SME trade*

It is telling that the significant concerns highlighted by SMEs who export overseas have been largely addressed within the context of the European Single Market, where the removal of internal customs duties and tariffs has benefited all countries. With the Single Market thought to contribute around 3.3% to European GDP the benefits to SMEs are often downplayed. Of course, there is always scope to further improve the situation - particularly for small businesses. For example, 25% of sole traders who export goods and services experienced problems in trading online in export markets. This increases to 47% of those exporting firms with 10-24 employees.

The creation of the Euro Area has removed a major barrier to cross-border business for many SME exporters in the shape of less fluctuations in exchange rates. Notably, the UK and Poland are two EU Member States contained in our survey which have yet to join the Euro Area. However, whereas 89% of SMEs in Poland were concerned about dealing with exchange rate fluctuations, only 44% in the UK felt this way. Surprisingly, this was *below* the EU average of 51%, notwithstanding the fact that most SME exporters will be exporting goods and services *within* the Eurozone area.

*Chart 9: UK exporters are less daunted than Eurozone exporters on exchange rate fluctuations*

Q. Would you say that dealing with exchange rate fluctuations is a significant issue when exporting to overseas markets? A. Significant



This positive view held by UK SMEs could well reflect recent exchange rate fluctuations which have seen the British pound lose around one-third of its value against the Euro since 2007. Such fluctuations have therefore helped to play an important role in keeping UK exports competitive in key markets such as the Eurozone and North America.

*Chart 10: Pound/Euro exchange rate fluctuations since 2006*



## **Accessing high growth markets**

Hindered by slowly growing domestic markets, SMEs in both Spain and Ireland revealed concerns about the lack of access to high growth markets. 48% of SMEs in both countries thought this would have either some impact or a major impact on their business. Both countries are currently grappling with belonging to the high-valued Euro undermining their competitiveness in many export markets.

In the UK the figure was 36% and just 28% in both France and Germany. Germany reported relatively high GDP growth in the first half of 2011 driven by increasing demand for exports. With the German growth outlook becoming much less positive in the second half (the OECD is predicting a slowdown of over 1% in the fourth quarter) largely as a result of declining trade hitting export markets, it will be interesting to see whether German SMEs become more concerned about market access in the coming year. Switzerland (where 30% of SMEs were concerned by the lack of access to high growth markets) has also enjoyed strong export growth in spite of the appreciation of the Swiss Franc during the recent financial turmoil. Moreover, its government has shown a willingness to buttress export businesses against currency fluctuations by using foreign exchange reserves to keep the value of the Franc from rising too high.<sup>xvi</sup>

### Part 3: Failure to recognise and manage business risk

This section considers how businesses identify and manage the risks they face. This is a basic business requirement in any trading environment. However, when faced with an uncertain economic outlook all firms, especially smaller businesses, need to be aware of the risks they face and ensure that they have appropriate contingencies in place to mitigate them. However, when asked to mention unprompted what they thought were the key risks facing their business, one quarter of respondents (25% of SMEs) couldn't name *any*.

- This peaked at 62% in Poland, followed by 40% in Spain and 32% in France. The UK on 23% was below the EU average of 27%;
- The failure to appreciate business risks was most notable among sole traders, 29% of whom couldn't name any risks facing their business;
- Even 25% of those businesses which claimed to be undertaking business continuity planning couldn't name any business risks unprompted.

*Table 1: Widespread failure to identify business risks*

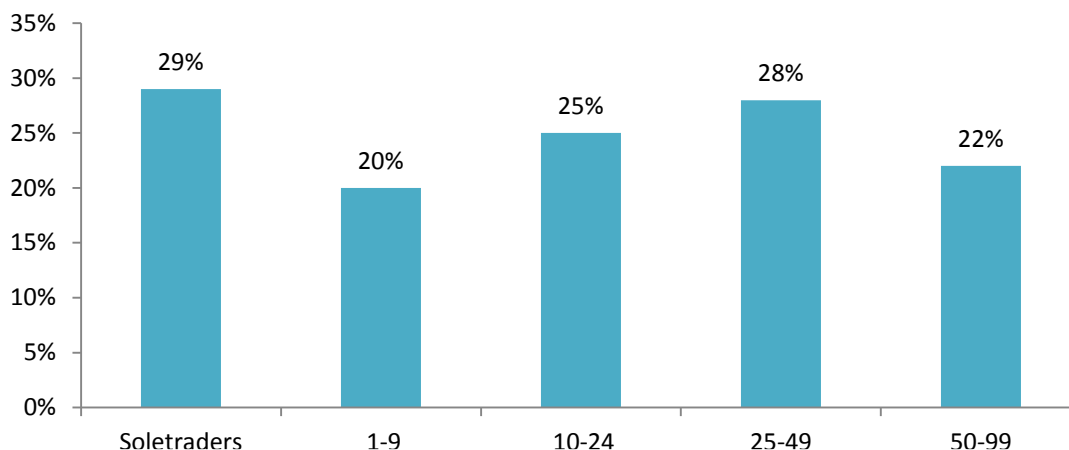
Q: What are the key risks facing your business? (Unprompted)

A: Those responding "Don't Know"

Country	% who couldn't mention any risks
<b>Ireland</b>	6%
<b>Germany</b>	12%
<b>Switzerland</b>	12%
<b>Belgium</b>	16%
<b>India</b>	20%
<b>UK</b>	23%
<b>US</b>	24%
<b>Global average</b>	25%
<b>EU average</b>	27%
<b>France</b>	32%
<b>Spain</b>	40%
<b>Poland</b>	62%

Chart 11: Sole traders are most likely to not identify the risks facing their businesses

Q. What are the key risks facing your business (unprompted) A. Don't know



These findings demonstrate that, while businesses are faced with many risks on a daily basis, both at the macro-economic level and within their own firm, many of those people managing SMEs do not consider what those risks might involve, and as shown below, large numbers of SMEs consequently fail to put in place robust risk-management plans to mitigate the consequences of those risks materialising. Clearly, once business managers have been prompted to think about a particular set of risks we see a different picture emerge.

Unprompted, a quarter of SMEs could not specify any risks facing their businesses, a figure that fell to only 3% after respondents were presented with a list of possible risks. This suggests that most of those who previously stated "don't know" are largely ignorant of the risks they face, especially key-man risks. After prompting, 26% of SMEs acknowledged that the death or incapacity of a director or partner was a key business risk. Without prompting, not one firm we questioned mentioned that this constituted a risk to their business. We explore the implications of this finding in part four.

SMEs that could identify risks without prompting focused on macro issues rather than firm-specific threats. The findings revealed major gaps in firms' risk assessments. For example, with so many businesses admitting to using overdraft facilities and bank loans, the potential for interest rates (i.e. the cost of borrowing) to rise was, surprisingly, not seen to be a key business risk. For example, 70% of SMEs in Poland have a bank loan, while none raised concerns about interest rates being a potential business risk.

*Table 2: SMEs make extensive use of bank loan facilities, which does not translate into concern over interest rates*

Q: What are the risks facing your business?

A: Those responding "interest rates" (unprompted)

Country	SMEs with a bank loan	SMEs concerned over interest rates (unprompted)
<b>UK</b>	25%	2%
<b>Ireland</b>	56%	0%
<b>France</b>	56%	2%
<b>Germany</b>	54%	0%
<b>Belgium</b>	50%	0%
<b>Spain</b>	38%	0%
<b>Poland</b>	70%	0%
<b>EU Average</b>	47%	1%
<b>Switzerland</b>	42%	4%
<b>US</b>	36%	0%
<b>India</b>	52%	4%
<b>Global average</b>	46%	1%

#### *The failure to appreciate key-man risks*

Insurance, and its cost as a significant business risk, was mentioned by only 1% of respondents globally. The cost of insurance as a business risk was most recognised in Ireland (10%) and India (4%). Generally speaking, the risk that a business may be blown off course by totally unforeseen risks did not register as a threat to growth in 2011-12. This is particularly true of smaller businesses where the loss of a key director will be particularly hard felt. Yet only one-third (31%) of companies employing less than 10 people thought that the death or incapacity of a director or partner was a key business risk.

The figure for sole traders was 28% even though in most cases the business would cease to exist if the sole trader became unable to work. Even among those SMEs who are currently undertaking continuity planning, 71% failed to identify the death or incapacity of a key employee as a business risk.

Spanish SMEs scored highest in identifying this risk with 56% seeing the death of a director or partner as a business risk, compared with just 12% of Polish respondents.

### Gaps in business risk management

Types of business insurance cover	Current penetration levels
<b>Key man insurance</b>	<p>Only 47% had key man insurance in place. This falls to 37% in the UK. Only in the US - on 22% - did we find fewer SMEs with this type of insurance.</p> <p>Just 21% of sole traders had key man insurance in place.</p>
<b>Creditor insurance</b>	<p>Only 23% had creditor insurance in place.</p>
<b>Private Medical Insurance (PMI)</b>	<p>PMI was provided by 60% of SMEs. This proved to be a relatively popular product among SMEs of all sizes.</p>
<b>Business property insurance</b>	<p>Business property insurance was more popular still with 71% of firms questioned having this policy in place. Penetration was particularly high in Ireland (86%), France (84%) and Switzerland (86%).</p> <p>Only 44% of sole traders had property insurance, compared to 82% of larger SMEs (those with 50-99 employees).</p>
<b>Contents insurance</b>	<p>Contents insurance was equally popular with 72%. This time Ireland (88%), the UK and Spain (both 80%) emerged as the most insured.</p> <p>Only 55% of sole traders insure their business contents.</p>
<b>Critical Illness Cover</b>	<p>Only 39% currently have critical illness cover for partners or directors. Even among businesses with continuity plans in place, over half (54%) did not have this type of insurance in place</p>
<b>Income Protection</b>	<p>Only 26% hold income protection for directors or partners</p>
<b>Business interruption cover</b>	<p>Only 36% currently have some form of business interruption protection to cover lost business income arising from unforeseen events. Among those SMEs with a continuity plan in place, again over half (56%) still did not have this kind of protection in place.</p>

Even among SMEs with continuity plans in place, many do not place sufficient emphasis on making sure that the appropriate types of business insurance are in place.

*Gaps in coverage by number of employees*

Table 3: Penetration of key insurances which help to protect the financial well-being of key employees

Size	Key Man Insurance	Critical Illness	Income Protection
<b>Sole trader</b>	21%	30%	15%
<b>1-9 employees</b>	40%	40%	28%
<b>10-24 employees</b>	59%	46%	31%
<b>25-49 employees</b>	50%	33%	26%
<b>50-99 employees</b>	54%	43%	28%

Across all three selected products it is those employing 10-24 people who are best protected. Sole traders are the least well protected.

**Case study: Business interruption cover**

During the summer of 2011, the UK made unwanted media headlines around the world following a series of riots which swept through many of its major cities. The riots saw thousands of businesses affected. Many shops and other business premises were damaged as a result of arson attacks, vandalism and looting.

With many businesses - in particular small independent traders - forced to close their doors during the riots, and faced with massive clean-up costs, the benefits of insurance become apparent. UK insurers are expected to pay out over £100 million in claims.<sup>xvii</sup>

This figure could have been higher had more businesses enjoyed more comprehensive insurance cover. Among our UK respondents we find that only:

- 73% of SMEs have insurance on their business property;
- 80% have a contents insurance policy; and,
- 39% claimed to have business interruption cover to protect against lost income resulting from unforeseen events

Business interruption cover is specifically designed to deal with the sort of events which affected businesses in August 2011. The fact that there is such low penetration, helps to explain at least some of the difference between the value of claims made (above) and the total cost in terms of lost business income and repairs to damaged buildings, which was conservatively estimated to be in the region of £133 million.<sup>xviii</sup>

In effect, many SMEs are self-insuring themselves (paying the cost out of their own pockets) against the sort of events that took place in the UK when insurance could prove to be far more cost-effective.

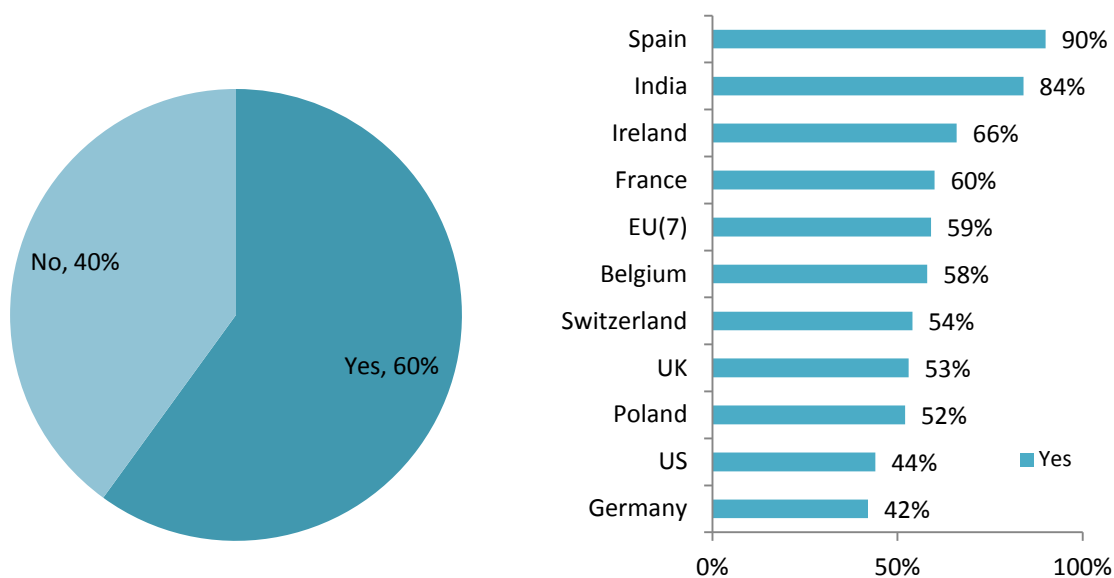
## Gaps in business continuity planning

When considering the risks that businesses face it is important to consider their level of preparedness in managing those risks. This can be measured in numerous ways, including the extent to which they have put in place business continuity plans to help them deal with the unexpected, as well how they manage cash flow and by looking at which financial services products are held by SMEs to help them manage their finances. As described above, many SMEs currently have significant gaps in insurance cover.

SMEs also fall short in terms of their planning - currently, only 60% of respondents have a business continuity plan in place.

*Chart 12 Two-fifths of small businesses do not undertake continuity planning*

Q. Does your business have a continuity plan in place?



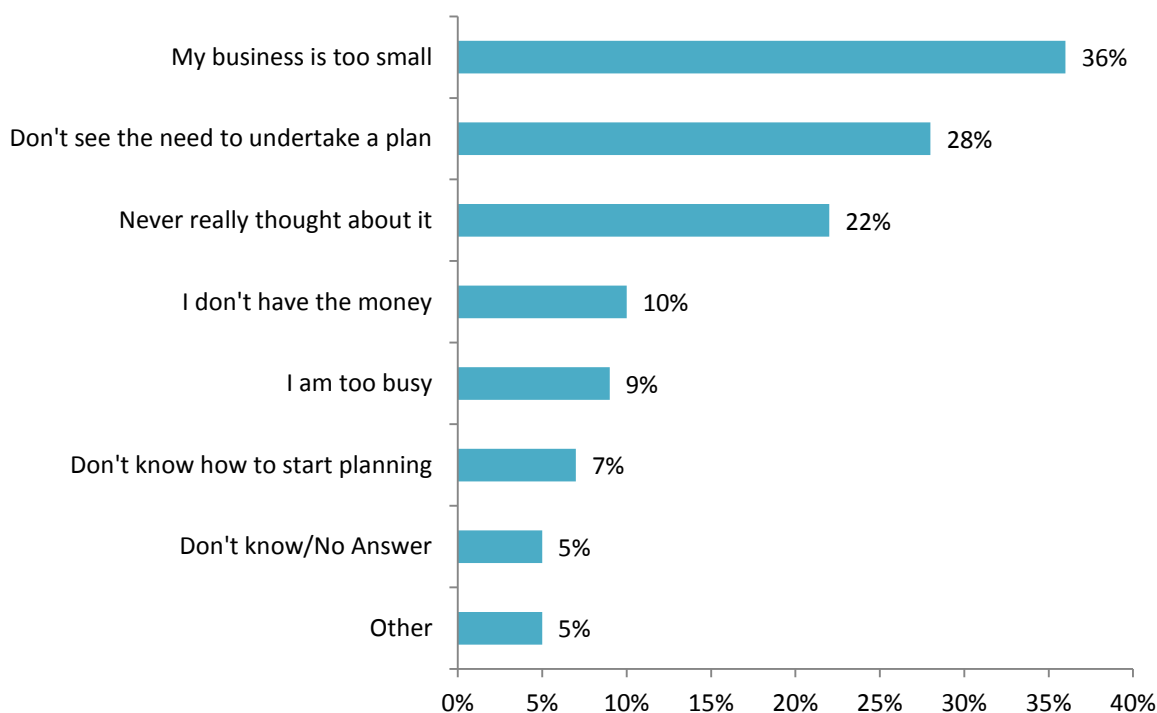
- 40% of SMEs do not currently have a business continuity plan. This rises to 59% of sole traders and 47% of micro-businesses (those employing fewer than 10 people).
- Continuity planning is least common among firms in the UK, Poland, Germany and the US.
- Typically, SMEs simply think that they are too small to think about continuity planning. 36% of those with no plans agreed with the statement "my business is too small" while 28% did not see the need to make a plan.
- Lack of perceived need is not consistent with the risks small businesses face. The number of firms without business continuity plans rose to 47% of SMEs who expect turnover to fall in the coming year and 43% of those who expect profitability to fall. So even where firms have a negative outlook, and have identified that they risk losing revenues, they are still not planning for every eventuality.

*Why don't small businesses undertake continuity planning?*

There is a problem in business perceptions of continuity planning with 36% claiming that they are too small to think about it and a further 28% who do not see the need. In reality,

the OECD suggests that small businesses can be among the most vulnerable to a lack of planning since they are more exposed to short-term shocks and may find that certain business risks, such as dealing with key man risks, are amplified because of their size.<sup>xix</sup> Interestingly, this perception that the business is too small to undertake continuity planning is found in one-fifth (20%) of those relatively large firms with between 50 and 99 employees.

*Chart 13: One-third of SMEs think that they are too small to make a contingency plan*  
Q. Why doesn't your business have a continuity plan?



### The three-month revenue benchmark

SMEs are more likely than larger-sized employers to suffer from cash-flow problems. Operating on lower revenues and lower margins can make it difficult to accrue sufficient working capital to keep creditors at bay. Managing creditors and cash flow was a concern for 30% of SMEs. Only one-third of SMEs in our survey achieved the benchmark of holding three-month's business in cash flow. Cash flow problems were greatest among SMEs in Ireland (46%) and Spain (48%) both of which have a particularly challenging economic outlook compared with other countries surveyed here. In the UK less than one-third (29%) of SMEs cited cash flow as a risk while in the US the figure was less than one-quarter (24%).

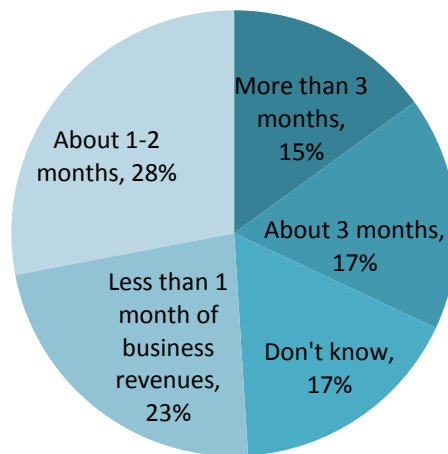
The risk of SMEs simply running out of cash is a very real concern. This is particularly true during a downturn when suppliers often seek to delay their payment terms.<sup>xx</sup> With suppliers legally permitted in many countries to make payments for goods and services up to 90 days after receiving them, it is advisable that all firms - including SMEs - seek to hold up to 3 month's business revenues to help manage cash flow. Based on the findings of this study, few SMEs hit this three-month benchmark. While our figures suggest that 32% of SMEs either hit this benchmark (or exceeded it) many more are falling short.

- 23% of firms surveyed hold less than one month's business revenues in cash flow;
- In Poland, the figure is 40% which means that SMEs in that country are the least resilient against financial shocks. This is followed closely by Spain (38%) and Ireland (34%). In the US, the figure is 30%;
- Over half of all firms surveyed in the EU (51%) held less than two-month's business revenues in cash flow;
- Sole traders are particularly exposed to cash flow difficulties with as many as 38% holding less than one-month's business revenues in cash. In total, two-thirds (66%) held less than two-month's revenues in cash;
- 40% of those SMEs who experienced falling revenues in the last three months are holding less than one-month's business revenues in cash;
- 30% of those who expect revenues to fall in the coming year find themselves in the same position. At some point, the danger is that the money will simply run out, or they will find themselves looking to secure debt financing to bridge the income gap.

A worrying 17% of SME business managers did not know how many month's worth of revenues they currently held in cash flow. Furthermore, only 32% of businesses currently hit the three-month benchmark deemed necessary to manage short-term cash flow. The fact that half (51%) of all SME firms held less than two months revenue in cash could put them in difficulties if the kind of risks identified earlier were to be realised over the coming 12 months.

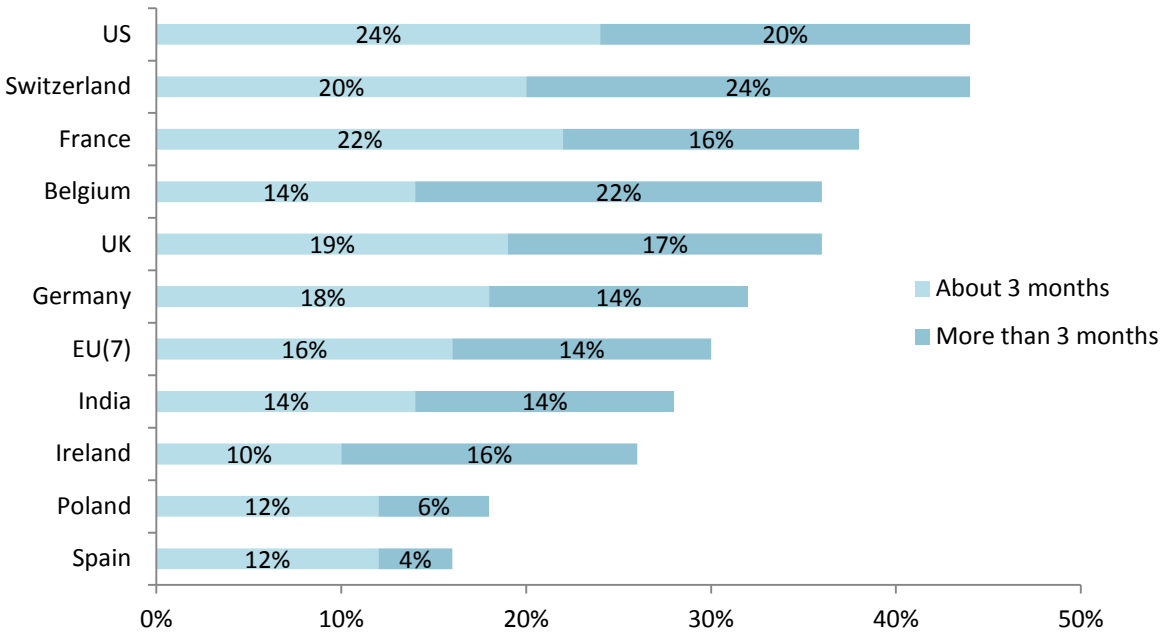
*Chart 14: Half of SMEs have less than two months' revenue in cash flow; one-in-six didn't know*

Q: How much revenue does your company hold in cash flow?



SMEs displayed very different approaches to cash-flow management in different countries. Both the US and Switzerland were among the most cash rich. In both countries nearly a half of all SMEs hit the three-month benchmark. This fell to just over one-third (36%) of SMEs in the UK. SMEs in Spain (where 16% held three-months revenues in cash) and Poland (18%) were the most cash-poor and therefore least resilient.

*Chart 15: less than half of SME businesses hold sufficient working capital*  
 Q: How much revenue does your company hold in cash flow?



## Part Four: Putting risk management strategies in place

As shown in part two, around one-quarter of respondents were unable to mention any business risks they faced without being given prompts. After offering a selection of potential risks, there was a marked increase in the extent to which business managers were able to acknowledge the risks they face. This demonstrates the potential value of interventions through financial advice and marketing campaigns aimed at raising awareness, turning that awareness into deeper understanding, and eventually encouraging more to become predisposed to make better use of financial protection products to safeguard their businesses.

### Promoting more diverse sources of financial advice

Our results demonstrate the importance of the banking sector to SMEs; over 99% have a bank account; over half (53%) currently have an overdraft facility and 46% had a bank loan in place. Due to their role in providing start-up funding, banks often have a 'special relationship' with SMEs. Furthermore, the reliance on bank advisers and accountants - which emerged from our research as the most prominent sources of professional advice for business planning - may help to explain why SMEs are more likely to insure their property than they are to put in place insurances which help to protect their employees.

Across our 10 country survey a plethora of business advice sources were identified, with financial services providers vying with accountants for the most popular source of advice. What is clear is that insurers are not commonly seen as a "go to" source of advice in the same way that other major financial providers are.

- One-third (34%) of companies relied on their accountant for financial advice;
- These findings were skewed by the results in the UK where over half (54%) and Ireland where three-quarters (76%) of firms used an accountant;
- German SMEs were most likely to visit a tax planner (36%) followed by a bank or insurance broker (both 22%);
- Spanish SMEs were most likely to go to their bank (36%);
- The Swiss were most likely to visit an insurance broker (24%) or a tax planner (22%);
- US SMEs were most likely to take no advice at all (38%). Where they did seek advice, they were most likely to turn to an accountant (28%);
- Sole traders (37%) and micro-companies (fewer than 10 employees) (44%) were most likely to rely on accountants.

*Table 4: Which of the following sources of professional advice does your business most rely on when undertaking financial planning?*

Advice Source	% of total respondents
<b>Accountant</b>	34%
<b>Bank small business adviser</b>	14%
<b>None</b>	12%
<b>IFA</b>	9%
<b>Insurance broker</b>	8%
<b>Insurance company</b>	4%
<b>Local business organisation</b>	2%

So while uptake of buildings and content insurance is high (72% had contents insurance in place, 71% had business property insurance in place) the utilisation of financial protection for employees is low; only 47% currently had key man insurance to protect the business against the loss of a key director; only 38.5% currently had critical illness cover in place to protect partners or directors.

Only 8% of SMEs are likely to consult an insurance broker when undertaking business planning. Moreover, just 4% consult an insurance company. This might have to explain why certain business insurance needs are more likely to go unmet. Almost none of the businesses we surveyed (>1%) currently made use of government-funded small business support services suggesting that they need to be better publicised or that public funding could be diverted towards more effective forms of business support.

### **Communicating with SMEs and the use of e-commerce**

While SMEs could clearly benefit from being prompted to take action, they retain a reputation as being a "hard-to-reach" group given their sheer number and diversity (both by geographic location and sector). The internet is potentially a cost-effective route to communicate with SMEs.

EU research conducted in 2009 suggests that e-commerce is important to SMEs, with 76% of EU SMEs claiming to use it in some form or another.<sup>xxi</sup> 11% offer a full online service where both orders and payments can be processed there; 1% of SMEs are purely online enterprises. This situation is likely to have changed given the continued expansion of e-commerce combined with a severe recession that assailed traditional business models. Nevertheless, our research shows that 62% of SMEs do not use the internet for business planning purposes. Where it is used we find that no specific website or type of website is overwhelmingly popular: Google being the most used on 18%. Banks and financial services providers' websites are used by 6% and industry-specific sites are used by 7%.

Where SMEs use the internet, they use it for a wide range of business activities.

Of those who use the internet:

- 52% use it for marketing and new business acquisition;
- 47% use it as a sales channel;
- 45% use it to find suppliers;
- 40% use it to manage their finances;
- 39% use it for the purpose of networking.

As well as being a potential opportunity for businesses, the internet also brings with it business threats. With firms now using the internet for such a wide variety of business functions, it is perhaps surprising that only 11% have insurance to cover e-risks such as cyber attacks and hacking. As might be expected, firms in the telecoms sector were more aware of these risks: 33% of them were insured against online threats.

The internet also emerged as the single most important channel for receiving information about financial services products. Though, interestingly, this was not in the form of website search engines, or going to financial services companies web sites unprompted, but rather through direct marketing via email.

- Direct marketing is seen as the preferred route for receiving information about financial products. 54% of SME respondents said that they would prefer DM via email while 19.5% preferred mailshots.
- 29% preferred a face-to-face approach via a bank, while 15.5% preferred a face-to-face approach with a broker.
- Traditional media such as television and radio failed to make much of an impact with the SME community; only 7% chose either of these channels.
- Social media sites ranked poorly with only 4% of SMEs preferring to receive information about financial products via social media and blogs; just 2% preferred micro-blogging sites such as Twitter.

## Conclusions

The first AXA Small Business Report reveals a number of broad findings.

### 1. A positive economic outlook though with important caveats

It is a welcome sign that firms take a positive view of the economy in the coming 12 months with firms more likely to report expected increases in profits and revenues. However, the economic situation remains uncertain with rising input costs, particularly fuel and commodity prices, and consumer prices remaining flat. The prospects for job creation among small businesses will remain limited. Businesses need to properly audit their risks and assess what strategies will help them to manage those risks.

### 2. The need to shift both SMEs and government's attention from financing needs towards broader financial risks

To date, governments have placed much of the emphasis on businesses financing requirements during the current economic downturn. Yet while many firms are actively restructuring how they finance their business on a more sustainable footing, other areas of the businesses finances are receiving less attention. The macro-economic outlook is rightly a major concern for firms though SME's could benefit from concentrating on business risks which are closer to home. There are many insurable risks where firms are currently going unprotected including key man and critical illness which will provide protection against the loss of a key person in the business, basic property cover in the form of buildings, stock and contents and business interruption to help an SME to keep operating following a major event.

### 3. More need for business contingency planning

Too few firms are actively preparing their businesses for the worst case scenario. Business continuity planning is practiced by less than two-thirds of all SMEs. Many of those who do not prepare contingency plans wrongly believe themselves to be too small to plan; however, business continuity planning really can make the difference between an SME folding after a relatively minor insured event or recovering to a stronger position. Insurance intermediaries and companies have gathered a wide range of risk management knowledge and techniques and can be a useful sounding board in the development of a structured continuity plan that can make all the difference should disaster strike.

### 4. More emphasis on the business critical risks which often go unseen

SME financial product holdings show a skew towards banking products and general insurances revealing gaps in other important insurance needs, such as the need to protect the health and incomes of senior directors. Too much of the current effort to identify and manage business risk focuses on general insurances such as business property; these are the high-frequency, low-value business risks. The less frequent risks, such as a director being unable to work for an extended period, could represent the equivalent of a 'business heart attack' for which in many firms no plans have been made.

Too few SMEs have a robust financial safety net in place if unforeseen events occur. Working capital represents less than 2 months revenue in the average SME business. Worrying, one in six firms could not state how much working capital they have at their disposal.

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- <sup>xvi</sup> [http://www.snb.ch/en/mmr/speeches/id/ref\\_20110906\\_pmh/source/ref\\_20110906\\_pmh.en.pdf](http://www.snb.ch/en/mmr/speeches/id/ref_20110906_pmh/source/ref_20110906_pmh.en.pdf)
- <sup>xvii</sup> ABI Guidance on legal position of Riot Compensation, August 2011
- <sup>xviii</sup> Home Affairs Select Committee, 6 September, 2011
- <sup>xix</sup> <http://www.oecd.org/dataoecd/36/27/42514077.pdf>
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