Intuit QuickBooks
Small Business Index Annual Report 2023

Policymaker insights
and recommendations

Introduction

Small businesses within the US, Canada, and the UK play a vital role in their economies, representing **98%** of all firms and providing a third to almost half of all jobs in each country's workforce.

Small businesses are the engines of our global economy, powering prosperity through job creation and innovation. As highlighted in the [2023 Intuit QuickBooks Small Business Index Annual Report], small businesses within the US, Canada, and the UK play an even more vital role in their economies, representing 98% of all firms and providing a third to almost half of all jobs in each country's workforce.

This year's report focuses on an in-depth analysis of the contributions, health, and struggles of **employer firms with 1-100 employees**. While new and growing startups help pioneer breakthrough innovations and foster economic dynamism, we encourage policymakers to ensure small business support programs are structured in a way that helps their resilience and success.

While overall employment levels have trended upward in these countries in 2023, small business employment has been less resilient and we've seen declining numbers—especially in the first half of the year. This is affecting jobs. With smaller workforces and less access to critical resources, small businesses remain exposed to size-specific vulnerabilities. These vulnerabilities include persistent issues with cash flow and financing—resulting in many small businesses starting and operating at a significant disadvantage—and cost-prohibitive challenges adopting technology with speed.

Key findings from this year's report reveal that **small business owners are more than twice as likely to use their own savings to fund their business—usually from working other jobs—as they are to use loans from banks or other commercial lenders**. These trends in the small business landscape exacerbate economic inequality, stifling opportunities for rapid growth and dragging down global industrial productivity. Compounding small business challenges, complex regulatory processes can often be added and costly, creating unnecessary barriers to growth.

The good news is that in-depth analysis from this year's report indicates a **correlation between higher use of digital tools and better business performance**. Small businesses using digital technology to run their businesses are more likely to expand their workforce and grow revenue faster. At Intuit, we are proud to serve over 10 million small businesses around the world, ensuring they have the tools to help power their prosperity as well as make financial decisions that are best for their business. With access to resources scaled to meet their needs, small businesses can continue to thrive and promote a robust economy. For policymakers, crafting meaningful and lasting small business policy requires an acute awareness of small businesses' most pressing pain points.

Based on this year's analysis of the small business landscape, we encourage policymakers to foster an environment that is conducive to small business economic growth and resiliency by:

- Encouraging bank-fintech partnerships to ensure small businesses have access to a diverse set of lenders.
- Modernizing payment systems, providing faster, easier-to-use, more transparent, and lower-cost payment services for small businesses.
- Encouraging the adoption of digital tools through scaling government resources in a way that helps small businesses modernize their business.
- Minimizing regulatory and licensing barriers to starting small businesses, which lack the financial and human resources of large companies to comply with burdensome regulations.

Access to credit

Small businesses at any age need money and liquidity in order to survive and thrive. Yet, access to capital remains a top challenge for small businesses across the globe. To meet their varying needs, small businesses secure financing in several ways, whether it be through personal sources of capital, credit from a financial institution, or an online lender. While credit has always been an essential financing tool for small businesses as they start, grow, and operate, macroeconomic policies that have impacted the cost and availability of financing, such as raising interest rates, have translated to negative outcomes for small businesses.

One in 3 small businesses across the US, Canada, and the UK indicate that the cost and availability of financing has worsened over the past 12 months. The impact on small businesses extends beyond hobbled financing and includes most notably a decline in employment. While monetary policies across the US, Canada, and the UK have achieved the goal of slowing employment, they have also resulted in a tightening in the small business credit market and ultimately, small businesses being forced to cut down on operations and investments. The Intuit QuickBooks Small Business Index has captured this evolving situation. Since the Index was launched in March 2023, the growth rates of employment and vacancies in the US and the UK have been negative, only moderately reversing during July and August.

Increasing access, variety, and choice in the global small business credit market, coupled with faster payments will help ensure that small businesses have the necessary funds to grow. An analysis that combines official administrative statistics and anonymized QuickBooks Payroll records reveals the following themes that impact small businesses' access to credit.

Expanding Access through Technology-Driven Innovation and Partnerships

Diverse fintech products and services provide novel, convenient, and expanded access to the financial system for small businesses. These products range from mobile money services for basic banking services and payments to digital applications for long-term investing or securing credit. Fintechs and online lending marketplaces provide innovative and competitive solutions for small businesses, especially new starts and entrepreneurs.

Many fintechs also partner with commercial lending institutions of all sizes to extend valuable digital financial tools to millions of small businesses. In fact, 65% of banks and credit unions partnered with a fintech over the past three years, and nearly 9 in 10 view fintech partnerships as critical to their businesses.[1] These partnerships often serve as a vital lifeline to help small, mid-size community lenders compete and meet the

[1] https://www.ftassociation.org/everything-you-need-to-know-about-bank-charters-fintech-and-washington/

technology expectations of their customers. They are subject to well-established regulatory frameworks that govern legacy providers in the financial services industry. For these reasons, we believe policymakers should encourage bank-fintech partnerships and support effective oversight.

Expanding Access for Underserved Entrepreneurs

Demographics are a determinant in accessing affordable credit, especially as more small businesses rely on personal savings to finance their firms. As highlighted in the report, **small businesses owned by underrepresented racial groups are twice as likely to say getting funding is their biggest challenge**. Uneven access to credit also plays a role in uneven business creation. According to research by the Ewing Marion Kauffman Foundation[2], if Americans of color owned businesses at the same rate as white entrepreneurs, the US would have more than 1 million additional employer businesses and 9.5 million additional jobs. Relatedly, a recent analysis by Stanford University's Graduate School of Business concluded that closing the "opportunity gap" between white and Hispanic entrepreneurs would add $1.5 trillion to the US GDP annually. In the UK, the National Federation of Self Employed and Small Businesses, along with the Aston Business School[3] highlighted that ethnic minority entrepreneurs add £25 billion to the country's gross value-added economy and if Black and minority ethnicities were fully utilized the economy could receive a £24 billion boost.[4]

Difficulties obtaining financing are also exacerbated among women-owned businesses. According to this report, **in the US, Canada, and the UK, the overwhelming majority (60%+) of men believe they can get the funding they need for their businesses over the next 12 months, compared to over 50% of women**. According to the Brookings Institute, although women-owned businesses make up almost 30% of small companies in the US, they account for only 16% of conventional small business loans and 4.4% of the total dollar value of these loans.[5] In addition, the data in this year's report indicates that women business owners are more inclined toward entrepreneurship as a means to balance family responsibilities versus being motivated to be their own boss.

Regardless of the motivation, given that new businesses create jobs globally 1.5 times faster than the global average, we encourage policymakers to address the higher barriers to entry faced by women and underrepresented racial groups looking to succeed with entrepreneurship.

[2] Access to Capital for Entrepreneurs: Removing Barriers
[3] https://www.fsb.org.uk/resource-report/unlock.html
[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/594336/race-in-workplace-mcgregor-smith-review.pdf
[5] Minority and Women Entrepreneurs: Building Capital, Networks, and Skills

Expanding Access in Banking Deserts

Physical access to lending institutions plays an important role in access to credit. For solo and small firms, it is difficult to find credit if the nearest lending institution is hours away. In the US for example, most of the credit-constrained states are in the South[6] where there are fewer banks, whereas small businesses in the Northwest and Northeast have found credit more readily available. Small businesses are also facing bank consolidation, which may have a negative impact on the availability of credit. Findings from this year's report reveal small businesses that applied for credit from banks that were well-financed before recent interest rate rises received more funding than those working with less well-financed banks.

Beyond scarcity of options, obtaining credit can be laborious and time-consuming for solo and small firms. According to a 2014 Harvard Business School study, about 45% of small business owners do not even apply for credit, while an additional 18% get discouraged by the process. About 43% of those who do apply get none or only some of the credit requested. The study also found that 80% of small businesses want loans under $500K, which aren't profitable for banks.[7] Increasing the level of digital engagement with small businesses and reducing the number of manual processes for approval will help these firms access the credit they need and in turn, allow financial institutions to obtain new customers.

Given these difficult circumstances for small businesses around the world, innovation in the financial services space is key for small business growth. It ensures small business owners from all locations and backgrounds can access the capital they need to start and scale their businesses. By leveraging technology and nontraditional data (e.g., cash reserves, deposits, withdrawals, etc.), fintechs can better serve small businesses and fill the credit access gap left by traditional lenders, particularly in tough economic times.

Faster Payments

Even for small businesses that are able to diversify their sources of credit, legacy payment systems with inherent delays can create uncertainty, making it difficult for small businesses to accurately determine their complete financial health. Not having a clear picture of how much money is in their accounts at any given moment can have a significant impact. Delays in legacy payment processes mean that small businesses run the risk of overdrawing their accounts, leveraging personal credit, or missing payments when they do not have enough cash on hand. According to the report, almost half of small business owners in the US, Canada, and the UK have used personal savings at some point to fund their businesses. This practice can be risky, putting personal assets on the line should the business fail.

[6] New York Federal Reserve
[7] Harvard Business School State of Small Business Lending

Report insights highlight the negative impact of cash flow challenges for small businesses. Findings reveal that cash-strapped businesses have been increasingly relying on credit to manage cash flow problems—**jumping from an average of 40% in September 2022 to an average of 62% in April 2023**. And while small businesses have used credit cards as a top source of funding over the past 12 months, it may come at a cost, with credit card usage trending upwards.

Accelerating payments and updating payment infrastructures means that small businesses can have on-demand fast access to their liquidity, helping them better manage their business and avoid operational setbacks. Sixty countries around the world have already implemented 24x7x365 instant payment systems, including the US, Canada, and the UK.[8] While the potential benefits of instant payments are evident, widespread adoption with small businesses depends on their banks' readiness and ability to adopt these solutions. This coupled with the lack of awareness and understanding about instant payments among small businesses adds to the challenge of scaling the solution.

Fintechs can play a pivotal role in educating small businesses about the benefits of instant payments, helping them navigate the transition and hasten the elimination of the delays associated with legacy payment methods, enhancing small business cash flows, and boosting their financial operations.

Policy recommendations:

- Policymakers should continue to encourage bank-fintech partnerships and support effective oversight, ensuring small businesses have access to a diverse set of lenders.
- Policymakers should support modernizing payment systems, providing faster, easier-to-use, more transparent, and lower-cost payment services for small businesses.
- Policymakers should ensure fintechs have access to instant payment systems like Federal Reserve accounts and FedNow in the US, ensuring their ability to deliver these services directly to small businesses as well as bolstering implementation among smaller financial institutions that lack the technological resources to do so.

[8] https://www.bis.org/publ/othp62.pdf

Digital transformation and adoption of digital technologies

The COVID-19 pandemic accelerated a significant digital shift for small businesses. Now, in the years following, the global economy is more connected than ever. Small businesses have been forced to digitize to survive in the modern landscape. Despite the pressures of worsening access to financing and stunted employment growth, small businesses that incorporate more technology platforms into their operations are more likely to report revenue and workforce growth.[9] **Across the US, Canada, and the UK, 1 in 2 small businesses using 8 or more apps to run operations report revenue growth—whereas only 3 in 10 businesses using up to 2 apps report the same**.

Internationally, governments are recognizing the economic benefits of digital adoption. In the spring of 2021, the UK announced the £520 million 'Help to Grow' initiative, aimed at boosting productivity and innovation in small businesses, in part through funding digitization vouchers to help small businesses access vital resources.

Small business digital transformation is fundamental to building inclusive and resilient economies. Although the data shows there has been a steady upward trend in the uptake of digital technologies by small businesses over the last decade, the gaps with large businesses remain large, contributing to inequalities among firms. For small businesses, digital gaps are strongly correlated with disparities in productivity, employment, scaling, innovation, and growth, which not only impact economic growth but also inclusion into the technology-driven economy.

The levels of digitization vary across industries and firm sizes. Report data suggests aspirations and long-term goals of business owners play a crucial role in motivating the adoption of digital practices. **In Canada, companies that use 8+ digital tools for their operations are more than twice as likely to have the ambition of taking their firm public through an IPO than businesses only using up to 2 digital tools**. These size and industry nuances across the small business ecosystem are important to consider when assessing digitalization trends and designing policies to ensure as well as expand access to digital technology that can help small businesses prosper.

[9] Small Businesses Go Digital

Barriers

Lack of information and awareness, digital skills gaps, and insufficient capital to finance digital transformation represent long-standing hurdles to going digital for a large share of the small and medium-sized enterprises (SME) population. But while both of these challenges impact digital adoption for small businesses, data shows the prevailing barrier is insufficient capital. Across the US, Canada, and the UK, cost is the top reason small businesses do not adopt digital tools. In addition, smaller firms face heightened difficulties in overcoming challenges in the broader business environment, such as rapidly changing regulatory frameworks, dealing with digital security and privacy issues, or simply accessing high-quality and affordable digital infrastructure. Smaller firms are also less aware of public programs that they could leverage at low or no cost to sustain their digital transformation.

Policy recommendations:

- Seek to foster digital literacy and transformation by providing industry-specific digital educational resources to small businesses.
- Review, update, and create targeted government resources devoted to helping small businesses go digital.
- Leverage the private sector via public-private partnerships as a resource for digital education that can accelerate SME digitization, including resources and incentives to adopt digital tools.

Reducing Regulatory Barriers to Entry

Starting and growing a business is already a momentous challenge. Many small businesses and entrepreneurs experience a confusing puzzle of permits and outdated regulations when starting and growing their firms. An effective and transparent regulatory environment is key for entrepreneurship and small business development at all stages of the business life cycle, including entry, investment and expansion, transfer, and exit. Reducing the regulatory burden on small businesses can facilitate their participation in the formal economy, help improve their productivity and competitiveness, and enhance their participation in the global economy.

Cutting Red Tape for Small Firms

Startups make significant contributions to the economy by playing a pivotal role in the creation of jobs. **In the US, new businesses create jobs 1.6 times faster than the national average—creating 2% of all new jobs annually in comparison with the national average of 1.2%**. **Similarly in the UK, as young firms grow, they take on a greater share of employment, going from firms under one year old providing 6% of the UK workforce to firms 10 years or older accounting for 73% of all jobs**. Furthermore, startup activity fuels productivity because "newly established businesses are typically more productive than the firms that preceded them," reports the United States Congressional Budget Office. [10]

While fostering the growth of nascent firms is crucial for nurturing a healthy and robust economy, the number of new businesses with employees has fallen over recent decades. **In the US, the number fell from 10% in 2005 to roughly 8% in 2020, which could potentially weaken the pipeline for future job creation. And in Canada, the proportion of new businesses creating jobs decreased from almost 25% in 1984 to 13% in 2012**. Market conditions ranging from credit availability to entry barriers due to regulations and defensive actions by incumbent firms can be argued as drivers of this decline in addition to natural factors such as demographic changes and saturation in industries.

One staggering example of a barrier for small firms in the US as highlighted by the National Federal of Independent Businesses[11] is the annual cost per employee of complying with federal regulations is notably higher for smaller firms than larger firms. Although important progress has been made in the communication and simplification of rules and procedures, challenges persist related to tangled license and permit systems. Countries around the world are taking steps to address the complexity of license systems, and the US, Canada, and the UK should take further steps as well.

Policy recommendations:

- Digitize business processes such as registration and permitting where possible.
- Minimize regulatory and licensing barriers to starting SMEs, which lack the financial and human resources of large companies to comply with burdensome regulations.
- Promote guidance for small businesses on regulatory requirements and best practices for cyber, privacy, and data use practices and prioritize harmonized and consistent policies to avoid a patchwork of laws that are confusing for consumers and small businesses.

[10] CBO "Federal Policies in Response to Declining Entrepreneurship"
[11] https://www.nfib.com/advocacy/regulations/