



# SMEs and payments - challenges and opportunities

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# 1 Documentation information

## 1.1 Copyright statement

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## 2 Foreword

Small and medium-sized enterprises (SMEs) are the backbone of the UK economy, making up 99% of all businesses. They drive economic growth by generating local jobs and boosting communities. They are highly-valued and widely appreciated by these communities for providing unique products and services, as well as offering a customer-centric experience.

As the UK's retail payments system operator, we exist to power payments, champion innovation, and give the UK choice in how it pays. This means that we need to understand why and how SMEs make their payment choices, so that we can better support them with the infrastructure, products and services they need to thrive in an increasingly digitalised world.

The following paper provides an overview of the SME research that we commissioned, constituting our first comprehensive investigation of one of the most important end-user groups in the payments ecosystem. The compelling insights provide a picture of the payment challenges faced by SMEs and the opportunities that exist for innovation. As a platform leader, we will look to take these findings forward to develop, enable and facilitate solutions that will ensure we are the smartest way to move money, now and in the future.

*Kate Frankish*  
*Chief Business Development Officer*  
*Pay.UK*



## 3 Introduction

We run the UK's retail payments operations, which includes the Bacs Payment System, the Faster Payment System and the Image Clearing System.

Our infrastructure and services enable individuals, organisations and businesses to make payments that are quick, safe and simple to use.

Small- and medium-sized enterprises (SMEs) make up 99.9% of all UK businesses and were responsible for 49% of all business turnover in 2021. They are a significant driver of the UK economy, making it crucial for us and the wider payments ecosystem to support SMEs by providing them with the infrastructure, products and services they need to operate and thrive.

Given the importance of SMEs, we commissioned the research agency Revealing Reality to help us understand the payment challenges faced by SMEs, and highlight what opportunities exist for us and the wider payments ecosystem to help drive the UK economy forward. Understanding why and how SMEs make their payment choices will help us in our work to realise our purpose: to power payments, champion innovation, and give the UK choice in how it pays.

The research is helping us to build a picture of:

- SME payment and banking behaviours
- Drivers and barriers to adopting new payment methods
- 'Pain points' that SMEs have with their current payment systems that are impeding their business activities
- Awareness and attitudes to new and emerging payment methods and technologies.

### 3.1 Methodology

For this research, we use the UK government definition of SMEs – businesses with fewer than 250 employees. We look to explore the experience of a set of diverse businesses, varied across employment, turnover, sector, payment methods used and payment complexity<sup>1</sup>. This involves a mix of both qualitative and quantitative field work and includes:

- Interviews with fintechs and other organisations involved in innovation for SMEs
- Interviews with our stakeholders
- In-depth interviews and site visits with 30 SMEs – to explore needs and behaviours in detail and identify payment challenges<sup>2</sup>
- An online survey, with more than 500 SMEs, to further explore and scale challenges identified in the qualitative phase of the research.<sup>3</sup>

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<sup>1</sup> Ibid - House of Commons Library Business Statistics 2021 p12

Payment complexity is the amount of administration or management time required when SMEs are receiving or sending a payment to customers/ suppliers. Complex payments would involve a high volume of incoming and outgoing payments, large fluctuations in when payments are taken/ received, and multiple payment methods.

<sup>2</sup> Took place in June and July 2021, when some Covid-19 restrictions were in place and means that most were conducted remotely

<sup>3</sup> Took place in September 2021, which may have had an impact on the use of cash.

## 4 SME research project: the payment needs and behaviours of SMEs

### 4.1 What challenges do SMEs face?

Many SMEs have expansion plans – some are planning to expand their products and services, whilst others are looking to hire their first or additional employees. However, growth can be risky for SMEs, with concerns of taking on more business costs – especially given the economic impact of the Covid-19 pandemic. Research from Ernst and Young found that 74% of SMEs had been negatively impacted by the pandemic, resulting in sharp declines in revenues and profit.<sup>4</sup> As a result, some SMEs have focused efforts solely on staying afloat, some have faced struggles in continuing to operate, and some have had to adapt their payment methods as people use less cash. This provides the crucial context for the challenges below that SMEs are experiencing:

- **32% experienced delays in payments from customers**, which often results in serious disruption at a day-to-day level; impacting cash flow and the ability to operate. Barclays found that 40% of SMEs are more likely to experience late payments as a result of Covid-19. According to the business current account provider Tide, late payments have amounted to more than GBP 50 billion – with the average SME chasing five outstanding invoices at any one time.<sup>5</sup> These problems are also faced by SMEs in other countries – in the euro area, 43% of SMEs have had difficulty meeting financial commitments due to late payments.<sup>6</sup>
- **One in four reported high costs and lengthy times associated with manual reconciliation.** On average, SMEs spent approximately 3.6 hours a week manually reconciling payments. There are many reasons for this, including: having to reconcile payments that have come in via different payment methods; having problems categorising incoming payments; and using out-of-date systems for reconciliation.
- **35% felt that card costs and the time associated with managing them were either ‘significant’ or ‘noticeable’.**
- **Too much friction in the payment journey delayed payments to suppliers or prevented customers from completing purchases.** Friction included Confirmation of Payee and extra steps when logging in to systems or approving payments.
- **Costs associated with insecure or international payments.** Research from the Banking Circle found that only 15% of SMEs did not experience any problems arranging cross-border

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<sup>4</sup> [The voice of the SME \(ey.com\)](#)

<sup>5</sup> [New research: UK SMEs chasing £50bn in late payments | Tide Business](#)

<sup>6</sup> [Survey on the Access to Finance of Enterprises in the euro area – April to September 2019 \(europa.eu\)](#)

payments.<sup>7</sup> Given the increasingly connected and globalised world we live in, it is understandable that SMEs expect cheaper and faster cross-border payments.

- **A quarter of businesses were using personal bank accounts, based on familiarity, that were not the most effective.** Many were not switching because of the perceived time and effort involved, even though SMEs are identified by the Competition and Markets Authority as a segment that can benefit the most from our Current Account Switch Service. Despite this, research we conducted in 2020 found that 20% of SMEs use personal current accounts for business banking.<sup>8</sup>

Whilst these problems are not unique to SMEs, there are some characteristics specific to SMEs that exacerbate these challenges.

## 4.2 How are SMEs approaching challenges?

One in 10 SMEs surveyed had not thought to resolve or mitigate payment issues they face. This is for several reasons:

- **Some SMEs do not know there are solutions available** - Whilst some of the sampled SMEs consistently explored and updated their payment systems to keep up with the best technology, most did not recognise they could be operating in a better way.
- **Some know solutions exist but have not looked into them because they have other priorities** - 18% felt they had 'bigger problems to deal with', and 14% said they simply 'don't have time' to look into solving all of their payment problems. This reflects the finding that many SMEs may just be trying to stay afloat, and some do not see that there is a link between better systems and a more profitable business.
- **Some SMEs know there are solutions and have looked into them, but found them too complicated** - A wide range of products and systems exist to assist SMEs, but some felt current products offer a huge number of features that they do not need or understand. Fintechs interviewed also recognised that the terminology used in some products was often not accessible and that there was more that could be done to address this.
- **Changing systems can feel too risky** - Some SMEs felt that 'change' would cause more problems than it would solve. 18% of SMEs felt it would be difficult to make changes to their current payment systems.

Our findings show us that it is not just about creating new solutions for SMEs, but enabling existing solutions to be adopted by SMEs. Each SME is at a very different stage in their journey to accepting new solutions or changing their behaviour around payments, and we have uncovered many factors that inhibit them from doing so. Undoubtedly, there are new products and services that

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<sup>7</sup> <https://www.bankingcircle.com/wp-content/uploads/2020/05/Mind-the-Gap-white-paper-Banking-Circle.pdf>

<sup>8</sup> [the-impact-of-covid-19-on-sme-business-banking.pdf \(wearepay.uk\)](#)



can be developed to address certain challenges, but unless we consider the experience of operating as an SME and the barriers to payments uptakes, alternative products will never be effective.

### 4.3 What are the biggest opportunities for innovation?

There are two key areas that may provide fruitful ground for innovation, as they constitute the most common and/or impactful challenges across the SMEs consulted in our research:

#### 1. The cost and time associated with reconciliation

Reconciliation is the accounting process of comparing two sets of records to check that figures are correct and in agreement. Typically, reconciliation involves matching bills and invoices to bank statement lines on an online accountancy platform. It also involves categorising each payment for tax and financial reporting purposes. Many of the SMEs we spoke to were using digital accountancy software – often recommended from outsourced accountants – to manage reconciliation. Some of the smaller, or less innovative, SMEs reconciled on spreadsheets.

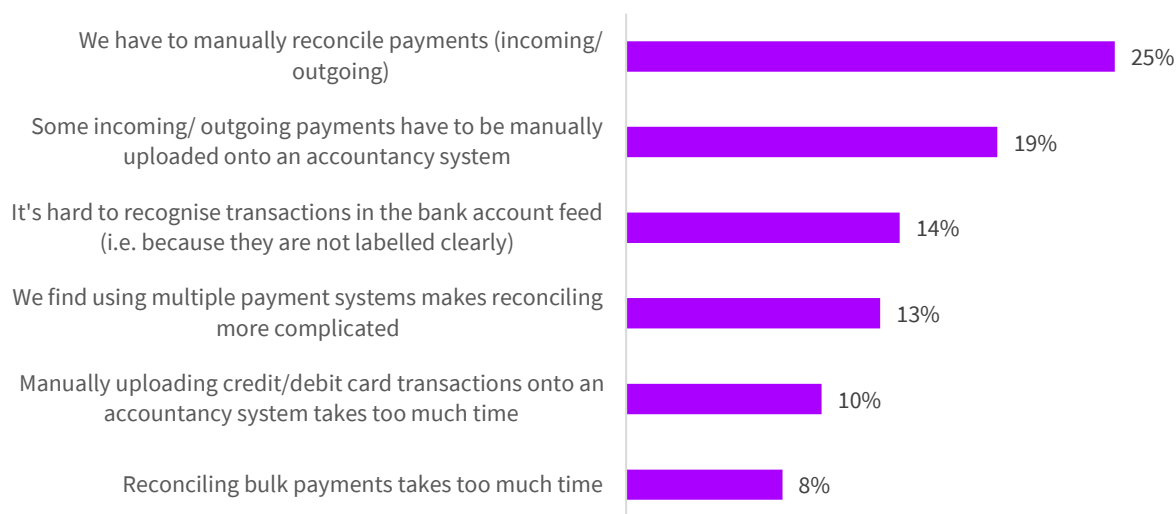
*“It seems a small thing, but when you are having to do it five times a day, five days a week, and it takes somebody five minutes each time... Well then that’s 25 minutes a day, that is two hours each week, that is five to 10 per cent of someone’s time so if they are being paid 25K to 30K a year then it is actually quite expensive.” - Online Food Delivery Service*

For many SMEs, reconciliation can be a process that:

- **They are less familiar with** - For newly established SMEs, it may be the first time that they have had to reconcile their accounts.
- **They have to do infrequently** – For smaller SMEs, with less complex sales channels, they may only need to reconcile infrequently across the year.
- **Has to be done by someone without a financial background** - With fewer employees, bookkeeping responsibilities can fall to people in other roles.

These factors mean that reconciliation can take up a large amount of time and, ultimately, cost the business money.

## Common issues with reconciliation among the SMEs surveyed



More issues occur when carrying out manual reconciliation, particularly where:

- Customers use multiple payment methods** – 13% of SMEs state this makes reconciliation more complicated. However, delivering an enhanced customer experience trumps the need to reduce the administration time for reconciliation. More payment methods mean more opportunity to maximise conversions, appeal to wider demographics, enhance brand perception by positioning themselves as a flexible and credible business, and provide a more seamless checkout experience for customers.<sup>9</sup>
- Multiple product and service lines exist** – SMEs can struggle to quickly identify which payments are related to what product or service, becoming even more complex if they offer different payment methods.
- Third party payment processors send payments in a way that complicates the process** – Providers can have different ways of paying businesses – from monthly instalments or daily payments – requiring a different reconciliation approach.
- They receive bulk payments** – Nearly one in 10 (8%) of SMEs find this makes reconciliation longer, and this is significantly more prevalent among small (12%) and medium (27%) businesses.
- Out of date systems are used for reconciliation** – This may be for several reasons: SMEs are not aware of better accountancy systems; they do not see the benefits of switching to a newer system; or they prefer the friction that manual reconciliation gives as it provides a better level of oversight over finances. *“The biggest problems we see SMEs facing are around*

<sup>9</sup> Benefits of Multiple Payment Options for Businesses | GoCardless

*accounting, payment management, invoicing, collecting money from clients and looking professional to clients (e.g. sending professional invoices)” (escrow infrastructure service provider).*

Overall, our study found that 25% of SMEs reported manual reconciliation as a problem, spending an average of 3.6 hours each week on the issue. Accounting for the number of VAT/PAYE registered SMEs in the UK of each size, that’s **nearly 700,000 hours a week, and over 33 million hours a year**, amounting to **nearly £320 million worth of employee time** for someone who earns the National Living Wage.<sup>10</sup>

These challenges can be addressed by better supporting SMEs to use newer and more automated systems, and by improving existing or developing new products to make reconciliation easier and less time-consuming. Better labelling on incoming payments, such as the new ISO 20022 standard that our next-generation payments platform, the New Payments Architecture, will utilise, will help businesses to identify and categorise payments more quickly.

*“Data is always useful to businesses, but for it to be useful to SMEs it would have to be packaged up in some form, with some analysis and actions, as a whole package – otherwise they won’t know what to do with it... Doing the analysis themselves is a burden. You need to give them a solution. You need to add a value layer.” - Real-time payments provider*

## **2. The cost of cards and associated time in managing them**

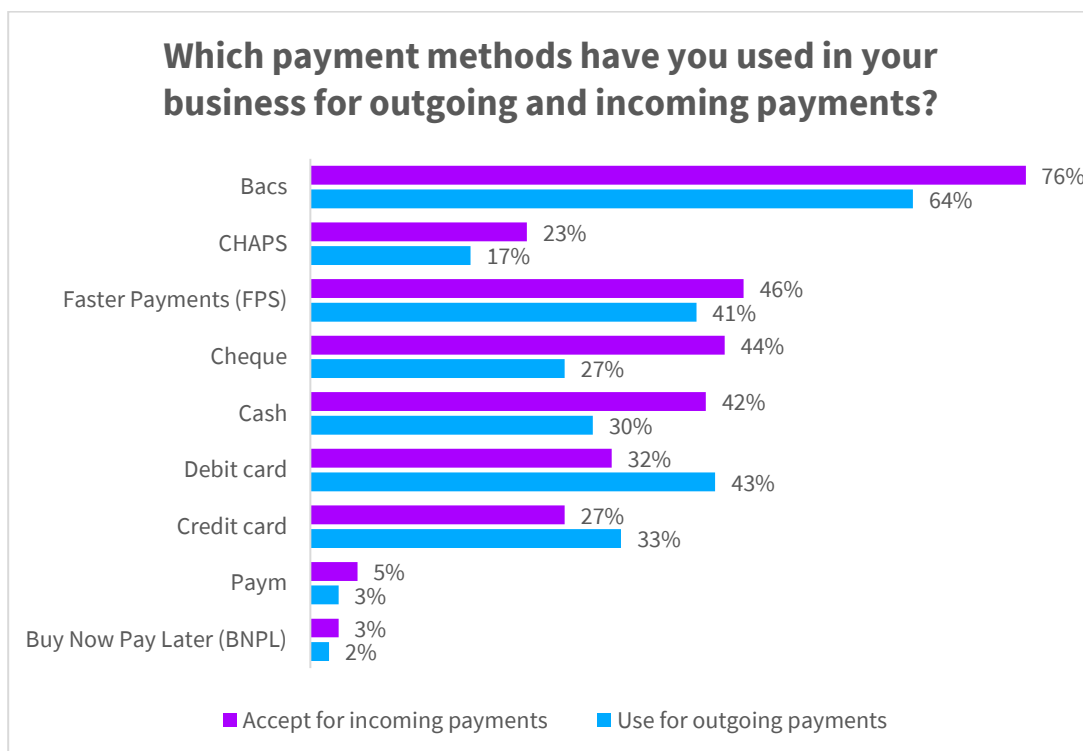
An aspect highlighted by our research is that SMEs use a wide range of payment methods, with most using multiple methods at any one time, for both incoming and outgoing payments. Bacs is the most commonly used and accepted method, with more than three quarters (76%) accepting Bacs for incoming payments and 64% using it for outgoing payments. Faster Payments, debit and credit cards, and cheques are also heavily used by SMEs, with one in three accepting credit (27%) and debit (32%) for incoming payments, while nearly half accept Faster Payments (46%). 5% used Paym, the UK’s mobile payment system.

While our research showed SMEs’ heavy reliance on cards, it also found that card fees can be costly; one in three recognise cards as a significant (9%) or noticeable (26%) cost to the business. The cost of using cards ranges significantly between SMEs depending on business type, the number of transactions and card provider contracts – with SMEs reporting monthly card costs ranging from GBP 3 to GBP 4,000. While some SMEs have considered moving to other cheaper methods - such as Direct Debit - to improve their margins, there are also SMEs that have not properly considered the impact of this cost or not realised there are cheaper ways to run a business. This highlights the scale of the opportunity involved in making it easier for SMEs to move more payments to interbank rails and at a

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<sup>10</sup> Estimates for the number of VAT/PAYE registered businesses in the relevant size brackets for 2021 are 2,480,140 micro, 232,815 small and 41,650 medium. Using VAT/PAYE registered businesses is a conservative estimate of the total number of businesses as this excludes those who are not registered. However, for the purposes of this estimate, meeting the threshold for VAT or PAYE registration is considered a useful proxy for being a business active enough to be likely to expend time on manual reconciliation. Multiplying a quarter of these businesses with the respective one or two hours per week sums to 699,064 hours.!

reduced cost. Yolt, an Open Banking operator, estimates that Open Banking-initiated payments could save the average SME online retailer GBP 19,000 on card transaction fees each year<sup>11</sup>.



Cost was not the only issue surrounding card use by SMEs, with many highlighting that the time to manage card payments was a challenge. It is clear that SMEs find uploading card transactions onto accountancy systems problematic, with 10% reporting that it takes ‘too much time’, rising to 20% for medium SMEs (50-250 employees) and that it can take up to 40 hours each week. Not only does this represent a significant hidden cost, similar to the reconciliation issue mentioned previously, but also a large diversion of time from running the business.

Although delays in card payments showing up in bank accounts was not an issue for the majority of SMEs, it can still impact cash flow and an SME’s ability to operate effectively. 10% of SMEs report delays in card payments appearing in bank accounts and, among these businesses, 50% report that this had a ‘significant’ or ‘noticeable’ negative impact on their cash flow. The use of Faster Payments has the potential to reduce these delays to near instant. With Open Banking-initiated payments already proving successful in an online retail environment, its further use across other sectors and the rollout of Variable Recurring Payments has a great potential to ease cash flow issues for businesses that need it.

*“We are mainly working on QR codes that can be scanned in the physical world, not through traditional online check out – so targeting people like traders and plumbers...they can receive the money more quickly so it’s better for cash flow...and the fees are lower than with card.” - Mobile payments provider*

<sup>11</sup> Yolt report Open Banking could save online retailers over £19,000 a month (ffnews.com)

*“I think it is just easier for the customer. I mean, to be honest, we pay a fee if they pay by card, whereas with bank transfer, for the most part it doesn’t cost us anything. But I think it is about having the options for guests.” - Holiday Rental Company*

Despite the disadvantages of using card payments, their use is still prevalent for several reasons:

- SMEs believe customers expect to pay by card, inevitably driving SME payment choices despite the high costs.
- Cards are seen as providing better protection for customers and businesses, which remains a high priority for SMEs.
- Incoming payments can be made on the move more easily. Increased adoption of contactless payments around the globe, in a range of settings, makes card payments more convenient, simple and frictionless. Although interbank payments solutions, such as QR codes, are currently being developed, most SMEs are not aware of these.

Underlining the importance of protection, our survey found that eight in 10 (78%) SMEs report it as ‘very important’ to provide customers with a trusted payment method. Therefore the use of cards, despite the cost, appears logical when considering that three quarters (74%) of SMEs confirmed that customers feeling protected by using card was an important consideration behind accepting card payments. However, businesses saw the level of payment protection provided by interbank (Faster Payments) and Bacs payments at a par with the protection debit cards provides for their customers, and only slightly below that of credit cards (Bacs 29%, Faster Payments 28%, debit card 28%, credit card 36%). Therefore, a disparity exists between the perception of protection and use of card, considering its drawbacks.

*“Customer loyalty is important. It’s important for businesses to make payments as easy as possible.” - Payments Consultancy*

A significant problem in reducing the impact of card cost and time is that SMEs are not currently aware of alternative solutions. Where they are already in use, they often still suffer from friction and require some way to go before these alternatives are embedded into standard practice. There is also a need to increase awareness of current solutions and the commercial viability of using these in practice for SMEs. Together, the payments ecosystem can work to challenge the high costs and time associated with cards and make interbank payments more attractive and easier to use.

### **Further questions to be considered / next steps**

- How can interbank payments offer sufficient protection in payments, and reassure SMEs that this is the case?
- How can interbank payments be made easy to use in quick sales transactions and ‘on the go’?
- How can interbank payments be an attractive alternative for customers, and in doing so motivate SMEs to choose this as their preferred payment option?

## 5 Recommendations

This research project was our first major investigation into the payment challenges faced by SMEs, and its intention is to provide a baseline picture of the needs of SMEs and the opportunities for innovation.

It is clear that SMEs face several payment-related challenges, particularly around reconciliation (25% of SMEs) and high transaction fees and lengthy times associated with card payments (35% of SMEs). This is exacerbated by the fact that many SMEs are more focused on developing and running their product or service, thus neglecting and being less experienced in running finances. They are less likely to have dedicated finance staff to manage payments and prevent or address payment challenges. In addition to existing challenges, the recent increases in energy costs, inflation and tax puts even more financial pressures on SMEs. National Insurance contributions increased by 1.25% in April, and two-thirds of SMEs are already spending 20% of their business costs on energy<sup>12</sup>.

There are a huge number of payment products and services that already exist that can help SMEs with these challenges. Our role as a platform leader within the payments ecosystem can be broken down into three approaches to industry innovation:

- Developing innovative solutions and supporting competition - where a market failure requires us to **take the lead in delivering a solution** and where we have the ability to deliver, either as a stand-alone proposition or as an integral part of our platform. We and other fintechs are already taking steps to relieve SME pain points – for example, by developing new products, working groups and interoperable systems. For example, Variable Recurring Payments will allow businesses to use authorised payments providers to collect a recurring payment on the customer’s behalf, without the customer needing to authorise each individual payment. NatWest has already signed agreements with Open Banking platform TrueLayer and payment service providers GoCardless and Crezco to offer Variable Recurring Payments to businesses and consumers<sup>13</sup>.
- Enabling innovation and competition **by making enhancements to our current and future payments platform** - such as improvements to a number of key processes supporting Direct Debit and Direct Credit, that will allow overlay providers to develop propositions that help SMEs, ensuring that solutions are compatible with our platform, or potentially developing supporting rules and standards for the industry.
- Facilitating innovation and competition **by providing deep insights into the behaviour and needs of SMEs** and encouraging market collaboration.

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<sup>12</sup> SMEs hit by triple whammy of energy, inflation and tax - Raconteur

<sup>13</sup> NatWest Group to offer Variable Recurring Payments as payment option

However, what is equally important is a recognition that SMEs are at very different stages in their journeys to accepting new solutions or changing their behaviour around payments. The adoption of more efficient systems is prevented by lots of factors, recognised both by us and the ecosystem:

- Some SMEs are not aware they could do things differently and are not aware of potential solutions: *“There’s a need to support businesses to make the change to interbank payments with customers. We need more messaging around it.” (Instant payments provider)*
- For some SMEs change is low priority in comparison with other areas of their business: *“SMEs are focused on staying afloat, maintaining customers...they have no time to dedicate to thinking about effective payment methods.” (Real-time payments provider)*
- For some SMEs change feels risky: *“One of the barriers to uptake is that we are having to prove the ease of it” (Mobile payments provider).*

Introducing more efficient products and systems is essential to bolster competition and innovation, but these will not work unless we think about the context of SMEs and how these solutions will be adopted in practice. To support SMEs into the future, there is a need to not only think about the product, but to address the barriers to uptake at each of these levels.

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