



How rising inflation impacts small businesses in the United Kingdom?

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I. Introduction

This paper examines how rising inflation in the United Kingdom is impacting small businesses (SMEs). Inflation is when the costs of goods and services go up, which makes it more expensive to buy materials, pay wages and cover everyday costs. In recent years during 2022 to 2025, the UK has faced instances of high inflation driven by various factors, such as trade changes from Brexit, the COVID-19 pandemic, energy supply disruptions and global geopolitical tensions, all that contributes to the increase in the consumer price index (CPI), which is a measuring tool for inflation. Producer price inflation (PPI) which measures the costs of inputs business need was also high. Although inflation in the UK has started to fall after 2023, the effects on business especially smaller businesses have still continued. Small businesses play a crucial role in the UK economy, representing 99% of all enterprises, providing jobs for a significant portion of the workforce and generating almost half of the national revenue. This paper explores three main areas: financial health (profit margins, costs, borrowing), operational decisions (pricing, inventory, labour) and survival risk (insolvencies, business closure) of small businesses in the UK, drawing on data from the Office for National Statistics (ONS), the predation of small business (FSB) and government insolvency statistics. This paper also aims to provide a balanced picture of SME resilience during a period of economic turbulence while also highlighting lessons for future policy support. The structure is: literature review, methodology, empirical findings, discussion, conclusion and recommendations.

II. Literature Review

2.1. Theoretical background

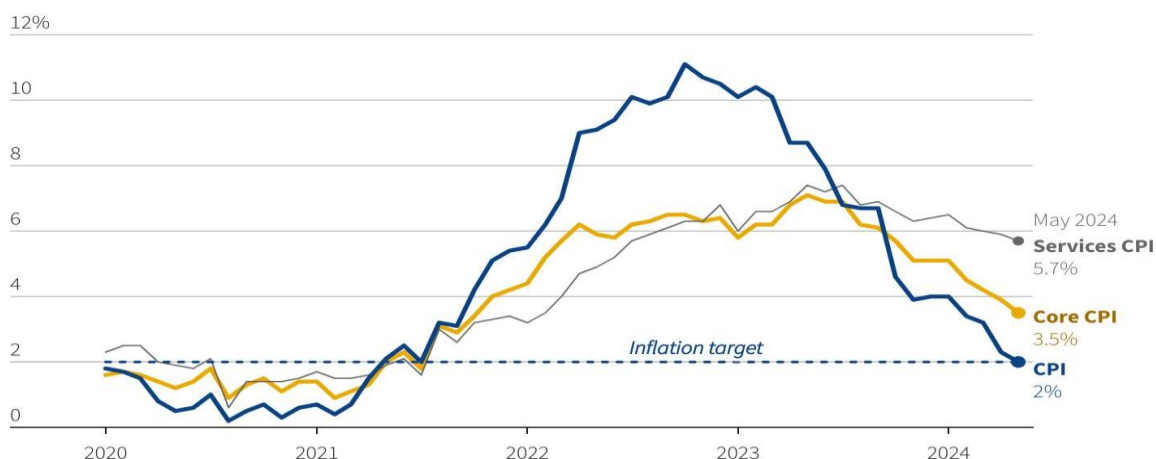
According to economic theory, firms are potentially impacted by inflation in a number of various manners. Friedman along with other monetarists view inflation primarily as a monetary phenomenon, caused by excessive growth in the money supply. While this perspective highlights the role of central banks and monetary stability, it tends to overlook firm level variations especially the uneven effects on smaller businesses. Unexpected inflation distorts real wages, erodes savings and creates uncertainty according to both Keynesian and Post Keynesian theories. Such uncertainty often discourages firms from making long term investments as they cannot confidently predict demand or input costs. Smaller businesses suffer more given that they have fewer resources to make quick adjustments and frequently face higher relative costs, according to microtheories like the real balance effect, information asymmetries, and menu costs (costs of changing prices).

2.2. Empirical Studies: UK and international

Empirical research shows that small businesses experience a decline in their profit margins throughout periods of high inflation due to rising input prices (energy, raw materials). In 2022, the Federation of Small Businesses (FSB) stated that consumer price inflation (CPI) was approximately 9% and input price growth had hit a record high of roughly 18.6%. The discrepancy between input and output inflation emphasizes the pressure on margins because, despite the double digit cost increase, businesses could not raise customer prices by the same amount without running the risk of declining demand. According to ONS data, producer input and output inflation is also high, indicating an increase in many upstream costs.

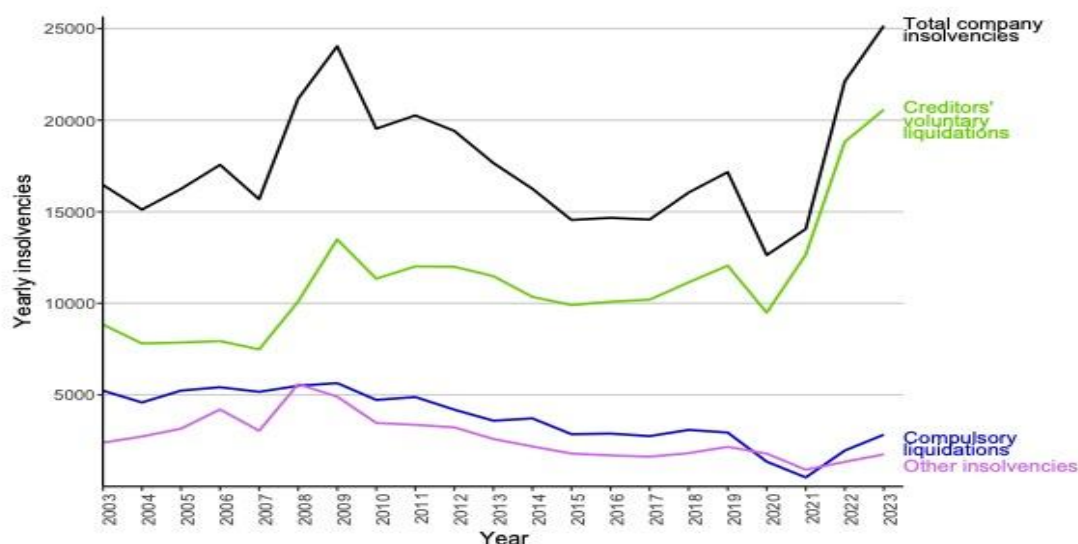
UK inflation returns to target for first time since 2021

British consumer price inflation returned to its 2% target in May for the first time since July 2021. But services price inflation, which the Bank of England views as a source of medium-term price pressures, fell less than expected.



Note: Core CPI is CPI excluding energy, food, alcohol and tobacco prices.
Source: LSEG Datastream | Reuters, June 19, 2024 | By Pasit Kongkunakornkul

Data on insolvencies also suggests an increase in business failure; for instance in March 2025, there had been almost 1,992 company insolvencies were registered in England and Wales, representing a 9% increase over March 2024. Insolvencies rose mostly in sectors like construction, retail and accommodation and food services. These industries are vulnerable because they rely on discretionary consumer spending and face high energy or raw material inputs.



International comparisons support these findings. In the eurozone, small businesses in countries like Italy and Spain also faced high insolvency rates during the inflation surge. Especially in hospitality and construction exactly similar to the UK pattern.

2.3. Gaps in the literature

There are limited studies that concentrate on microbusinesses or very small SMEs, the majority focus on large companies or industries, often because these businesses produce more data and are easier to capture to national statistics. Less frequently, sectoral breakdowns and regional variation are thoroughly examined. Less qualitative data (interviews, case studies) can be obtained regarding how small business owners view and adapt to inflation. Therefore research relies heavily on quantitative indicators such as inflation rates, profit margins and insolvency statistics.

By bringing together quantitative and qualitative data, emphasizing sectoral and regional variation, and focusing on SMEs (businesses with fewer than 250 employees), this paper seeks to make a contribution.

III. Methodology

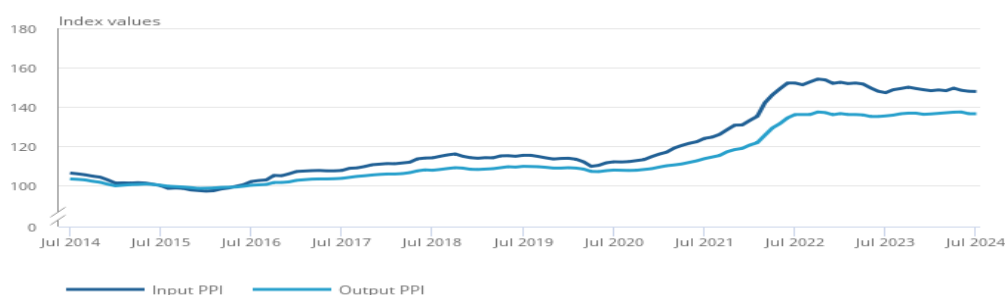
To capture the statistical trends and the wider business implications of inflation on small businesses (SMEs) in the United Kingdom, this study uses a descriptive and analytical research design. The primary sources are:

- The Office for National Statistics (ONS) provides figures on CPI, producer input prices and output inflation. This data then allow to identify cost pressures facing firms at different stages of production.
- Company insolvencies are tracked over time using government statistics from the Insolvency Service (England and Wales) which offers information on how long businesses survive inflation.
- Federation of Small Businesses (FSB) reports provide qualitative and survey-based data regarding the tactics used by SMEs to deal with labour issues, pricing decisions and growing costs.

The timeframe being examined is roughly 2022-2025. Throughout this period, inflation was elevated and subsequently eased, allowing us to witness both maximum impacts and initial recovery.

Figure 1: Input PPI fell slightly while output PPI stayed the same in July 2024

Input and output Producer Price Index (PPI) values, UK, July 2014 to July 2024



Source: Producer Price Index (PPI) from the Office for National Statistics

Figure 1: The annual input PPI inflation rate was negative in May 2024 while the annual output PPI inflation rate was positive

Input and output Producer Price Index (PPI) annual inflation rates, UK, May 2014 to May 2024



Source: Producer Price Index (PPI) from the Office for National Statistics

Procedures in the examination:

1. Analyze inflation rates (CPI, input producer prices) over time and link them to the insolvency and turnover rates in SMEs.
2. Break down insolvency (failures) by region and industry (such as retail, hospitality, and construction).
3. To gain insight into how SMEs are reacting in terms of labor, pricing, and inventory, use data from FSB reports.
4. Make suggestions for causal relationships while recognizing their limitations.

IV. Findings

4.1. Inflation trends and input costs

Significantly inflationary pressures were experienced by UK's SMEs between 2022 and 2025. The office for National Statistics (ONS) reports that in 2022 and 2023, producer input prices - which represent the prices that companies pay for energy, raw materials - rose significantly. For instance, compared to July 2024, the annual increase in input prices was roughly +0.4%. In the meantime, output inflation was roughly +0.8%. An 18.6% increase in input prices was mentioned in the FSB's 2022 press release, highlighting the burden on SMEs.

4.2. Business failures and insolvencies

Business failure rates are high, according to insolvency statistics which confirms SMEs struggled to survive under these conditions. In March 2025, England and Wales experienced 1,992 company insolvencies, marking a 9% increase compared to March 2024. In January 2025, there were 1,971 bankruptcies, reflecting an 11% rise compared to January 2024. The industries most impacted are retail, hospitality, food services and construction. The cost of steel, cement and lumber increased for construction companies, while energy costs and consumer demand declined for retail and hospitality establishments.

There were also apparent regional variations. Due to faster access to funding and larger consumer markets, SMEs in London and the South East typically had marginally higher survival rates compared to businesses in the North.

4.3. Operational responses by SME's

According to FSB reports and surveys, SMEs reacted to these pressures in a variety of ways. While some concentrated on reducing expenses. Others cautiously raised prices out of concern for losing customers. To manage cash flow, common tactics included cutting back on staff hours, delaying investments and restricting inventory purchases. Businesses that used a lot of energy may found their energy bills particularly expensive.

V. Discussion

5.1. Why SMEs suffer disproportionately?

SMEs are particularly vulnerable to inflation compared to larger firms. Although monetarist viewpoints contend that inflation is a monetary phenomenon, they frequently overlook the differing impacts on different businesses. Unexpected inflation distorts real wages, lowers purchasing power and raises uncertainty which deters investment according to Keynesian and Post Keynesian theories. Due to their smaller profit margins, fewer cash reserves and restricted credit availability, smaller businesses are more affected.

5.2. Policy implications

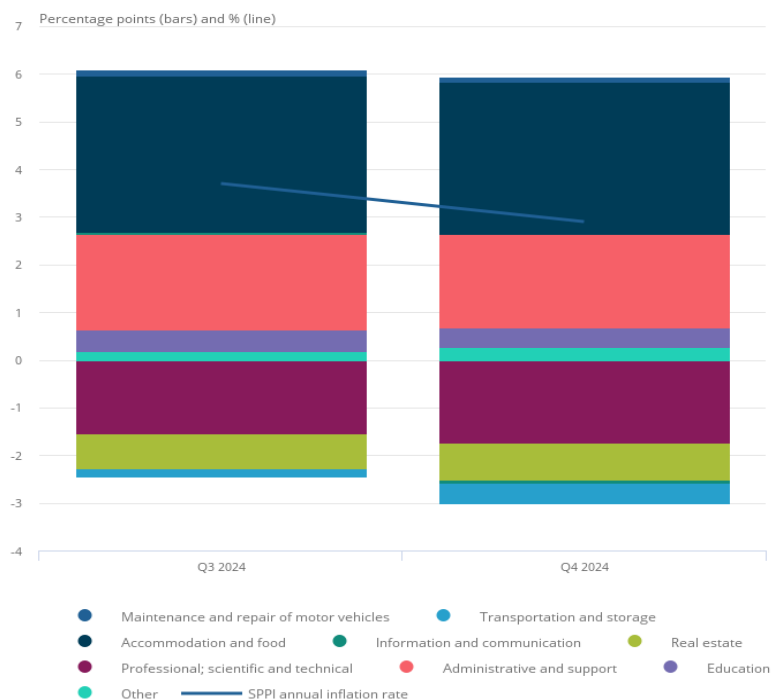
Policymakers might consider rules to avoid supplier monopolies, tax incentives, credit assistance (low interest loans) and specific subsidies. Cost pressures might be lessened by targeted grants or subsidies for vital inputs like energy or raw materials, especially in sectors that depend heavily on imports or energy. Enhancing the availability of reasonably priced, fixed rate credit would enable SMEs to manage cash flow or make investments without being negatively impacted by rising interest rates.

VI. Conclusion

As per this study, small businesses (SMEs) in the UK were significantly impacted by inflation between 2022 and 2025. Tighter financial conditions, high consumer price inflation and rising input costs put pressure on cash flow, profit margins and the viability of businesses as a whole. Construction, retail, hospitality and food services were among the industries most impacted and due to regional variations, SMEs in London and South East fared better than those in the North.

Figure 5: Accommodation and food services made the largest upward contribution to the SPPI annual inflation rate in Quarter 4 2024

SPPI, percentage point contributions to the annual inflation rate, UK, Quarter 3 (July to Sept) and Quarter 4 (Oct to Dec) 2024



Recommendations:

- The government ought to keep an eye on input inflation, particularly for SMEs, and provide prompt assistance.
- Enhance the availability of reasonably priced credit, particularly fixed rate financing.
- Offer sectoral support initiatives to industries that are at risk, such as construction, retail and hospitality.
- Encourage SMEs to work together on procurement.
- Survey SME sentiment on a regular basis to inform policy.

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