Small business as usual: Government support, the COVID-19 crisis and zombie firms
Research Note
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Executive Summary

The onset of the COVID-19 economic crisis resulted in a unique and unprecedentedly large shock to economies across the globe. Governments responded with enormous support, particularly in the form of wage subsidy schemes, to prevent large-scale job losses and business closures during lockdowns. But there were concerns that this support could artificially prop up unviable and unproductive businesses and create “zombie” businesses. If this happened, it would hinder the normal process of creative destruction that occurs during downturns – where unproductive businesses close, making space for highly productive businesses to grow and drive the recovery.

New academic research undertaken by the OECD and Accenture using Xero Small Business Insights (SBI) data on small businesses in Australia, New Zealand and the United Kingdom examines this question (Andrews, Charlton and Moore 2021). This collaboration combines Xero SBI’s rich and timely data with world-leading researchers to shed light on a key question for policy makers much faster than has been possible in previous crises.

This research finds that this “zombification” did not occur. The most productive small businesses performed better than their less productive counterparts: they had smaller job losses and a faster jobs recovery from the pandemic. This resilience of the most productive firms is important for policy and the outlook for growth in the recovery. Losing the most productive firms would have imparted lasting scars, reduced the outlook for growth, and undermined small businesses’ ability to adapt to the pandemic.
One of the key drivers of sustainable economic growth is productivity. In this context, productivity is about “working smarter” to produce more by better combining inputs e.g. from new ideas, technological innovations, and organisational practices.

Economy-wide productivity can grow in two ways: i) businesses can themselves become more productive via innovation and adoption of leading business practices; or ii) the most productive businesses grow faster than other businesses (by hiring and investing) and the least productive businesses shrink or exit completely. This latter “reallocation” channel is typical in well-functioning economies and is critical to how economies grow: workers leave low productivity firms for fast-growing, dynamic ones, allowing these firms to upscale and drive economic growth. Recessions can speed up this “creative destruction” process, as the least productive firms fail, creating space for the most productive firms to emerge and fuel the recovery.

1.1 But the COVID crisis could have hindered this normal process and created “zombie” businesses

While this reallocation process is normal, the COVID-19 economic crisis was a unique and unprecedentedly large shock, which could have disrupted this process of creative destruction.

Xero SBI data demonstrates the scale of the downturn (Figure 1): following the onset of the pandemic, sales fell by 12% in Australia, 44% in New Zealand and 26% in the United Kingdom (in year-on-year terms). Significant downturns are also evident in other activity measures, such as GDP, in all three countries.

**Figure 1**
The COVID-19 economic crisis was an unprecedentedly large shock: sales fell as much as 44% in New Zealand

**Small business sales growth**
% year-on-year, monthly

Source: Xero Small Business Insights, Accenture
In response to this crisis, governments provided large-scale support to businesses and their employees. Key among these policies were job retention schemes: JobKeeper in Australia, the Wage Subsidy Scheme in New Zealand, and the Coronavirus Job Retention Scheme in the United Kingdom. These schemes provided payments to employers for their eligible employees and were designed to prevent job losses while businesses were closed due to lockdowns.

This unique policy response could have hindered the normal process of creative destruction. These schemes incentivised firms to hold on to their employees; as such they were designed to curb job destruction and thus reallocation. In the worst case, government subsidies might have propped up unviable “zombie” businesses that would have closed without government support.

Whether productivity-enhancing reallocation was hindered is an important question. If it did decline, the outlook for growth in the recovery and over the years ahead will be significantly worse. This is not a purely academic concern because, as we saw post GFC, as much as one-quarter of the slowdown in labour productivity was due to declining reallocation.1

2. New research finds that productive businesses were more resilient during the COVID crisis

New academic research undertaken by the OECD and Accenture using Xero SBI data examines the impact of the pandemic on reallocation (Andrews, Charlton and Moore 2021). This collaboration combines Xero SBI’s rich and timely data with world-leading researchers to shed light on this critical question for policy makers up to five years earlier than the 2007/08 Global Financial Crisis.2

This new research finds that COVID (and the job retention schemes) did not sever the link between job reallocation and productivity, and so did not create a wave of unproductive zombie businesses. The most productive businesses had smaller job losses during the crisis and a faster recovery coming out of the crisis than did their least productive counterparts (Figure 2).

Figure 2
The most productive firms saw smaller job losses during the crisis and a faster recovery in jobs as the crisis receded

Change in employment from February 2020
% (log difference) change from February 2020 to month shown on x-axis; productivity based on revenue per employee in 2019

Source: Andrews, Charlton & Moore (2021) Xero Small Business Insights


2 For example, the seminal paper on the impact of the Great Recession on productivity-enhancing reallocation first appeared – in working paper version – six years after Lehman Brothers collapsed (Foster et al., 2014).
These results are derived from comparing the growth in jobs for the most productive 25% of businesses within an industry to the growth for the least productive 25% firms within the same industry. That is, it does not compare growth across industries. Different industries experienced very different shocks through the crisis due to the nature of lockdowns, and so had very different jobs outcomes. This approach abstracts from this cross-industry dimension and focuses purely on differences in productivity. The results also control for firm size and location, which controls for the fact that the pandemic hit firms of a given size harder in the hospitality sector in London than it did in Auckland. For full details on the econometric methodology, see the accompanying research paper (Andrews, Charlton and Moore 2021).

2.1 Part of this outperformance of productive firms is that they are more likely to use apps

The COVID-19 economic crisis was also unique in that it forced many businesses online. Businesses had to shift to online tools to connect with their customers, effect sales and manage their staff and operations.

Part of why more productive firms did better through the crisis is that they were more likely to already have these types of channels in place. Before the crisis, 11% of the most productive firms had five or more apps connected to their Xero account – a proxy for being highly digitally enabled. By comparison, just 7% of the least productive firms did (Figure 3).

**Figure 3**

Part of this outperformance of productive firms is that they are more likely to use apps

![Image](https://example.com/figure3.png)

Source: Andrews, Charlton and Moore (2021), Xero Small Business Insights

Being better prepared for doing business digitally paid off: even among the most productive firms, those using apps before the crisis did better during the crisis (Figure 4). On average across all three countries, firms with five or more apps connected saw jobs growth 1 percentage point faster than similarly productive firms that had fewer than five apps connected (or none).
3. The resilience of the most productive firms will underpin the recovery

These findings are promising for the recovery outlook. Fast-growing and dynamic firms are the key driver of jobs growth. Losing those firms through COVID would have been a worst-case scenario. This worst-case was not realised: the most productive firms were more resilient and fared better. The usual process of creative destruction continued unabated, despite the unprecedented nature of the COVID crisis.

Similarly, this result allays one of the key worst-case-scenario concerns with wage subsidy policies: that they would create widespread “zombie” businesses. These policies can be effective tools for future crises to provide emergency support and minimise the long-term damage of unemployment. And this research shows that these policies need not impede the recovery process, provided they (a) are temporary, (b) evolve a conditions change and (c) have a well-defined exit strategy.

Remarkably, we know the answers to these policy-critical questions already – before the crisis is even fully completed. Timely data from Xero Small Business Insights enables this type of research far faster than has been possible in the past.
Methodology

The key results are derived from a firm-level regression of the change in employment between February 2020 and the relevant month on dummy variables that indicate which quartile of productivity the firm is in, plus fixed effects for firm size, industry, region and country (and all interactions).

- Employment change is measured as the log change in the number of employees that received any non-zero payment in the relevant month.
- Productivity quartiles are calculated as revenue per work for calendar year 2019, within industry (and by country). That is, we do not compare productivity across industries.


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Xero is a cloud-based accounting software platform for small businesses with over 2.7 million subscribers globally. Through Xero, small business owners and their advisors have access to real-time financial data any time, anywhere and on any device. Xero offers an ecosystem of over 1,000 third-party apps and 300 plus connections to banks and other financial partners. In 2020 and 2021, Xero was included in the Bloomberg Gender-Equality Index and in 2020, Xero was recognised by IDC MarketScape as a leader in its worldwide SaaS and cloud-enabled small business finance and accounting applications vendor assessment.

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About Xero Small Business Insights

The aim of Xero Small Business Insights is to create insights to help inform decision makers in support of the small business economy as a whole.

These report was prepared by Accenture, with the support of Xero, for Xero Small Business Insights based on research undertaken in partnership between the OECD, Accenture and Xero SBI (Andrews, Charlton and Moore 2021). The principal source of small business insights in this report is customer data from Xero - a small business platform that supports online accounting and a range of other applications. The data used was aggregated and anonymised to ensure the privacy of Xero subscribers, and the people they interact with, including customers, suppliers and employees. Xero is a responsible custodian of their customers' sensitive data and does not release any data that could identify individual businesses.

Disclaimer

This report was prepared by Accenture with the support of Xero, to summarise research undertaken in partnership between the OECD, Accenture and Xero SBI (Andrews, Charlton and Moore 2021). The research was undertaken for the purpose of informing and developing policies to support global small business. This report was commissioned by Xero Limited and prepared by Accenture.

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