

# Q3

---

## FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 3, 2016

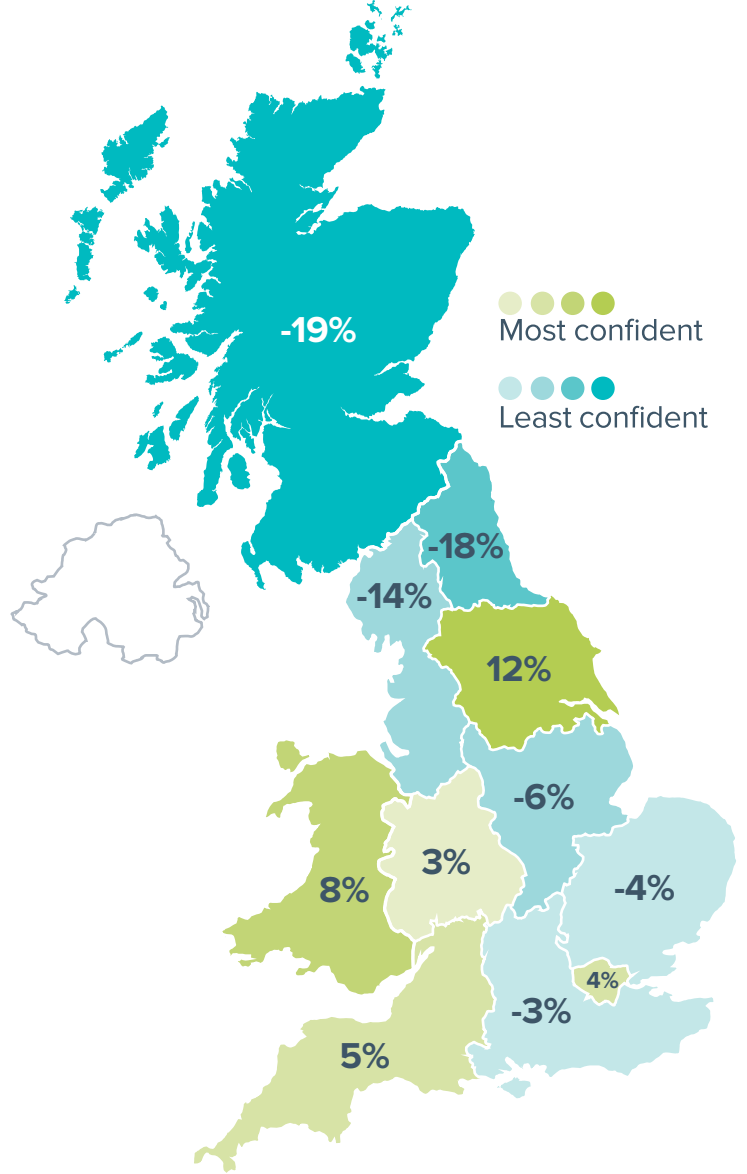
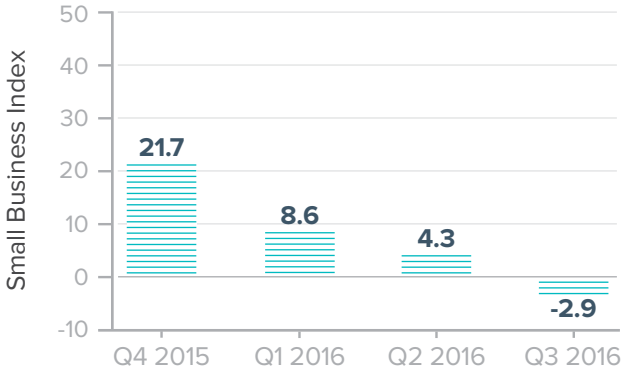
---



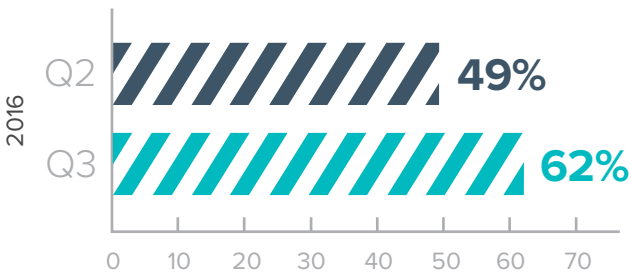
# SBI Q3 2016

“ Small business confidence in **negative territory** for the first time since 2012 ”

## Small business confidence in decline



## More businesses say **domestic economy** is barrier to growth



## Export performance is **improving**



**12%** net balance  
↑  
of small businesses report **growth in exports**

## Main causes of rising **business costs**

**48%** cite labour costs



## Small businesses **hiring** new staff



**7%** net balance of businesses report **increasing headcount**



1 in 5 cite **exchange rates**, up from 1 in 20 last year



# CONTENTS

---

FSB National Chairman . . . . . 6

Economist’s view . . . . . 7

FSB Executive Summary . . . . . 9

UK macroeconomic overview . . . . . 10

Small business index . . . . . 11

Regional small business indices . . . . . 13

Small business sector indices . . . . . 15

Financial performance . . . . . 18

Exports . . . . . 20

Costs and inflation . . . . . 22

Capacity . . . . . 25

Employment . . . . . 27

Growth aspirations and challenges . . . . . 30

Credit . . . . . 33

Investment and productivity . . . . . 37

Methodology . . . . . 39

# FSB NATIONAL CHAIRMAN

The data in this quarter's Small Business Index (SBI) is the first major dataset on UK small business gathered since the result of the EU referendum on 23 June.

For the first time since 2012, small business confidence has fallen into negative territory. This means the number of small firms feeling confident is outweighed by the number feeling the opposite. This is the second largest annual drop in confidence on record, following on from the steeper fall seen in the second quarter of this year.

However, beyond the headline measure, there are positive economic signs – fewer firms reporting unused spare capacity in their business, access to finance becoming easier, and more businesses increasing their headcount for the first time this year. Taken together, this data indicates small business resilience in the face of a range of pressures – concern about the domestic economy, rising employment costs, and fluctuating exchange rates.

Political turmoil since the referendum will have had an impact on business confidence. However, many small businesses seem to have factored in the potential result of the referendum in advance of the vote. The decline in business confidence for three quarters suggests that this is a longer-term trend, driven by a series of policy changes that small businesses are now having to cope with. These include the introduction of the National Living Wage, more small employers facing pensions auto enrolment staging dates, and changes in the treatment of tax dividends affecting small business owners with modest incomes.

The number of small businesses viewing the domestic economy as a barrier to achieving their growth aspirations (62.1%) is sharply up from just under half (49.4%) the same quarter a year ago, but has only slightly risen since the first half of this year (58%). Labour costs remain the most cited (41.7%) reason for changing business costs and pay growth (1.8%) is slowing. Concern about the business environment clearly predates the result of the referendum. It is clear that small firms require domestic policy interventions to sustain their businesses in an increasingly uncertain climate, to help boost their productivity and to have the confidence to take risks, invest and grow.

However, more positively, a net balance (6.8%) of small businesses report increasing headcount this quarter. This is an important reminder that it is through supporting small businesses that high employment levels can be sustained and increased. The vast majority of those unemployed, economically inactive or furthest from the job market who then start work in the private sector do so in a small business. The share of small businesses aspiring to grow over the next 12 months increased for the first time this year to 55.3%. Unused spare capacity is declining, and our credit availability and affordability indices stand at their highest levels since our records began at the start of 2012.

Businesses will keenly watch the first Autumn Statement from the new Chancellor of the Exchequer. They will seek pro-business, pro-growth measures that demonstrate the new Government backs small firms – unblocking infrastructure projects, improving the skills base, supporting small exporters, delivering on business rates pledges and upgrading the Annual Investment Allowance.

We are encouraged that the new Government has quickly set about seeking the views of small businesses as it moves to exit the EU, with FSB around the Cabinet Table at Prime Minister Theresa May's first event at No. 10. FSB is clear on our initial priorities for the negotiations with the rest of the EU, focusing on ensuring small businesses have simple access to the single market, easy access to the labour and skills they need, assurance on the future funding for key EU schemes and the need for clarity on future regulatory frameworks. These will be a key determinant of the future success of Britain's economy.

Although it is clear that overall small business confidence has declined, the underlying picture in this survey is decidedly mixed. What is clear to us at FSB is that, now more than ever, Government must back small business for economic growth.



Mike Cherry,  
FSB National Chairman

# ECONOMIST'S VIEW

---

The data in this quarter's FSB SBI is the first gathered since the result of the referendum on whether the UK should leave or remain in the EU. This quarter's report provides some important insights relating to the on the ground economic picture at present.

The referendum result was followed by a sharp devaluation in sterling as well as significant financial market volatility. It is highly likely that these events have fed through into the deterioration in small business confidence that we see in the latest FSB SBI. The Index is in negative territory for the first time since 2012.

Some indicators do however suggest that the decline in confidence may be more to do with uncertainty than a deterioration in on the ground conditions for small businesses. Encouragingly in this quarter's report, small businesses are hiring new staff after two quarters of reported decline. The environment for exports has also improved and fewer businesses are operating below capacity. In addition, both the availability and affordability of credit continues to improve on the latest data, which should support business investment going forward.

There is therefore a reasonable amount of good news in this quarter's report. But there are also numerous areas of concern. Productivity growth remains very weak, something which is likely to persist so long as capital spending intentions are subdued. In addition, the regional and sectoral economic picture remains very mixed.

Forecasting the economy has become significantly more difficult following the outcome of the EU referendum. The impact on growth will depend on a wide range of factors: the extent to which businesses remain willing to invest in the UK, how subsequent trade negotiations with the EU progress and the duration of the negotiations, to name a few. Cebr's best assessment is that the economy will slow significantly next year, as business investment falls back and rising inflation hampers consumer spending. But we fully acknowledge that there is a wide range of uncertainty around our central view. The latest FSB data suggest that we should be cautious about the short term outlook for the UK, but that there is scope for some optimism.

Policymakers need to prevent a self-fulfilling economic slowdown by providing households and businesses with the assurance they need to spend and invest. The Bank of England has already taken steps to do this by cutting interest rates and announcing further monetary loosening. What we need now is for government to step up a gear and create a policy environment that demonstrates that the UK is open for business.

The Government also needs to endeavour to get the best trade deals possible with the EU and the rest of the world. UK exports have become more competitive following the recent devaluation of the pound. If this is combined with trade deals that are beneficial to UK businesses, there is potential for developing solid export driven growth going forward.

Some consequences of the referendum are more immediate than others. More than one in five (21.2%) businesses report the exchange rate as one of the main causes for changing business costs, up from just over one in twenty last year.

The longer term implications of the UK exiting the EU are unclear. The UK has the potential to build new free trade agreements with non-EU countries, potentially bolstering exports to markets across the globe. However, the UK could also potentially face new tariff and/or customs and/or non-tariff barrier costs when exporting to much of Europe, depending on the deal that is agreed with the EU. Plans to restrict migration from the EU to the UK could create skills and labour shortages for businesses of all sizes, depending on the measures introduced. There will clearly be a lot to play for over the next couple of years.



**Scott Corfe,**  
Director, Cebr





# FSB EXECUTIVE SUMMARY

## Key findings this quarter:

- **The Small Business Index (SBI) is in negative territory for the first time since 2012.** The SBI fell to -2.9, the lowest level since the final quarter of 2012 and the third consecutive quarter of decline. The SBI is a leading indicator so this suggests that economic growth will slow in the second half of 2016. It is also the second largest annual drop in confidence on record, only exceeded by the fall seen in the second quarter of this year.
- **The performance of the domestic economy has risen as a concern.** Over three fifths (62.1%) of small businesses report the domestic economy as a barrier to achieving growth aspirations in Q3 2016. This is sharply up from just under half (49.4%) in the same quarter a year ago. However, this figure is only slightly higher than the 58% seen in Q1 and Q2 2016, suggesting that concerns about the domestic economy predate the referendum result.
- **Compared to a year ago, confidence has declined in every part of England, and is most negative in Scotland, the North East and the North West of England.** The largest fall in confidence has been in the North West, reducing from 29.5 in Q3 2015 to -13.6 in Q3 2016. Scotland has the lowest confidence, in line with the latest economic data for the country.
- **Export performance is improving.** A net balance of 11.7% of small firms report that their exports grew over the past three months in Q3 2016, following two consecutive quarters in which a net balance of businesses reported declining exports. Furthermore, a net balance of 17.9% of businesses expect their exports to grow over the next three months.
- **More small businesses aspire to grow.** The share of small businesses aspiring to grow over the next 12 months has ticked up this quarter, after declining for the first two quarters of this year. It now stands at 55.3%, the highest since the end of 2015. The share of businesses expecting to downsize, close or pass on the business has also fallen to 10.9% this quarter.
- **Despite concerns over the economic backdrop, spare capacity is declining.** A net balance of 45.8% of small businesses report operating below capacity in Q3 2016, down from 57.4% in the previous quarter and the lowest level since Q4 2015.
- **Small businesses are hiring new staff again.** A net balance of 6.8% of small businesses report an increasing headcount this quarter. This is the first time this year that a net balance of small companies report that they intend to increase rather than decrease headcount, and hiring is expected to continue into the final quarter of 2016.
- **Credit availability is continuing to improve.** Our credit availability and affordability indices stand at their highest levels since records began at the start of 2012.

# UK MACROECONOMIC OVERVIEW

## Significant uncertainty over UK economic outlook

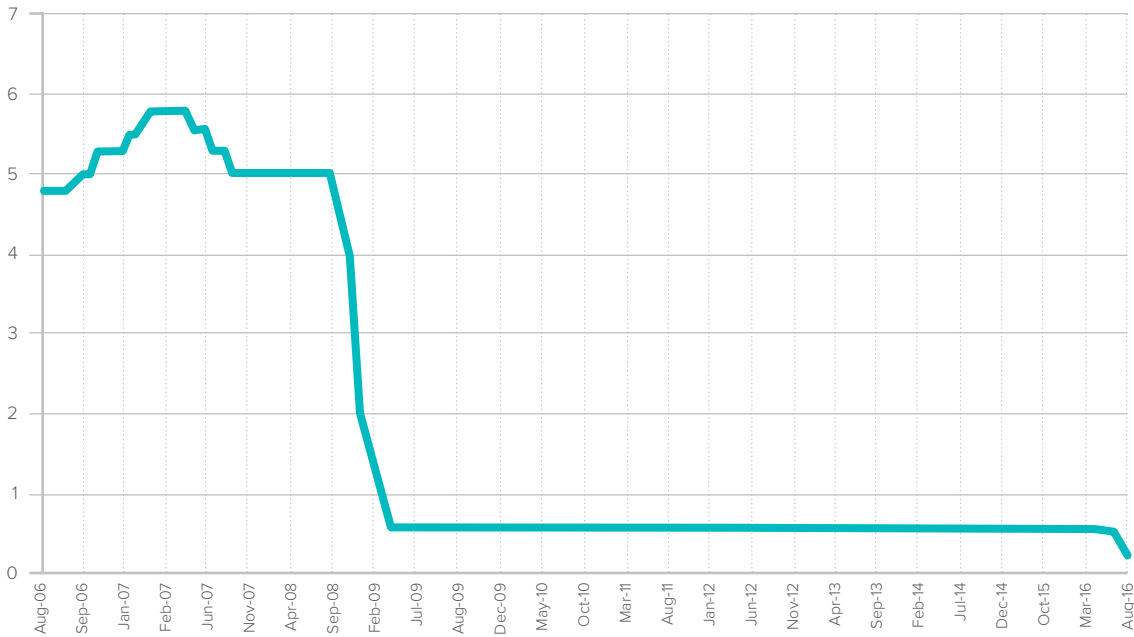
Following the result of the EU referendum, there is significant uncertainty over the economic outlook – both in the short and longer term.

Over the next 12 months, risks appear to be on the downside. In its August Inflation Report, the Bank of England stated that its central growth forecast is for the UK economy to slow significantly from 1.7% in 2016, to just 0.8% next year.

This slowdown is likely to be driven by a number of factors. First, many businesses are expected to rein in their investment decisions whilst they wait to better understand the consequences of the EU referendum. Furthermore, the consumer side of the economy is expected to be impacted by a slower rate of job creation, as well as a squeeze on living standards created by the recent sharp devaluation in sterling. This will translate into higher prices for imported goods over the coming months. On the upside, the currency devaluation should boost export competitiveness and generate trade-driven economic growth.

Policymakers have started to respond to the changing economic environment, with the Bank of England cutting the base rate of interest even further. The base rate, which had been on hold at a record low of 0.5% since 2009, was cut further to 0.25% in August. The Bank also announced an expansion of its programme of quantitative easing in a bid to improve the economic outlook. There have been growing calls for the Government to urgently introduce measures to maintain growth, with many calling for infrastructure projects to be expanded or brought forward to stimulate additional economic growth and job creation.

Figure one: Bank of England Base Rate, %.



Source: Bank of England.

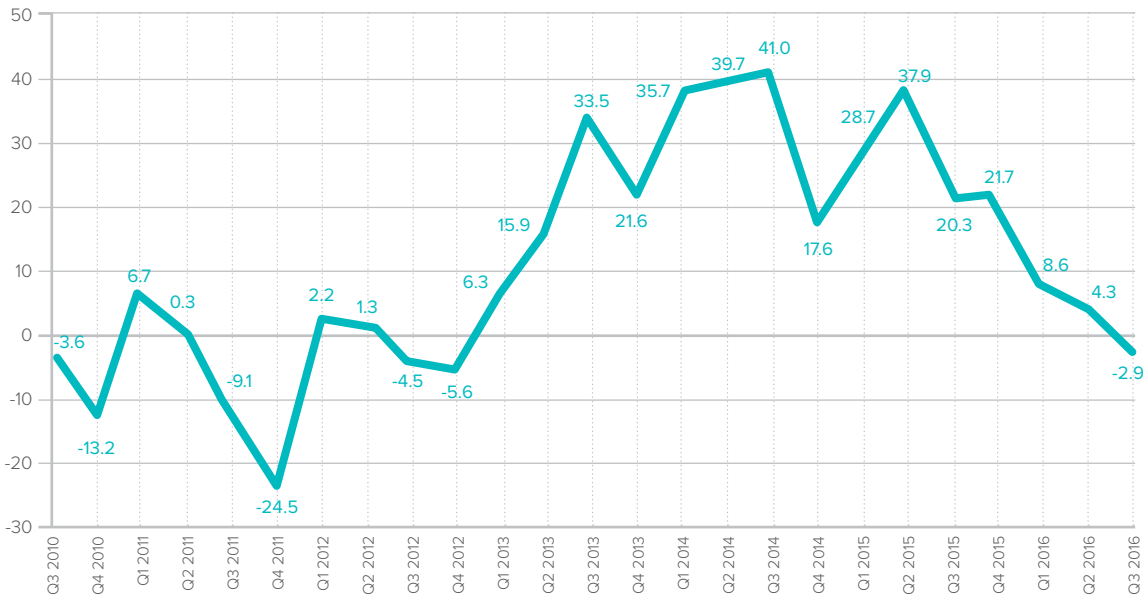
# SMALL BUSINESS INDEX

## Business confidence falls into negative territory

This quarter, the SBI fell to -2.9, the lowest level since the final quarter of 2012 and the third consecutive quarter of decline. This is the first time since 2012 that the Index has been in negative territory. It is also the second largest annual drop in confidence on record, only exceeded by the fall in the second quarter of this year, as shown in Figure 3. The Small Business Index is a leading indicator, as shown in Figure 4, and suggests that economic growth will slow in the second half of 2016.

Since the recent peak in confidence in Q2 2015, there has been a marked change in small companies' views about the performance of their businesses. In Q2 2015, 58% of small businesses felt that their company's performance will improve over the next three months, while only 20.1% thought that their performance would worsen. On the latest data, the share of businesses thinking performance will worsen has doubled to 41.2%, while the share expecting an improving performance has declined to 38.3%.

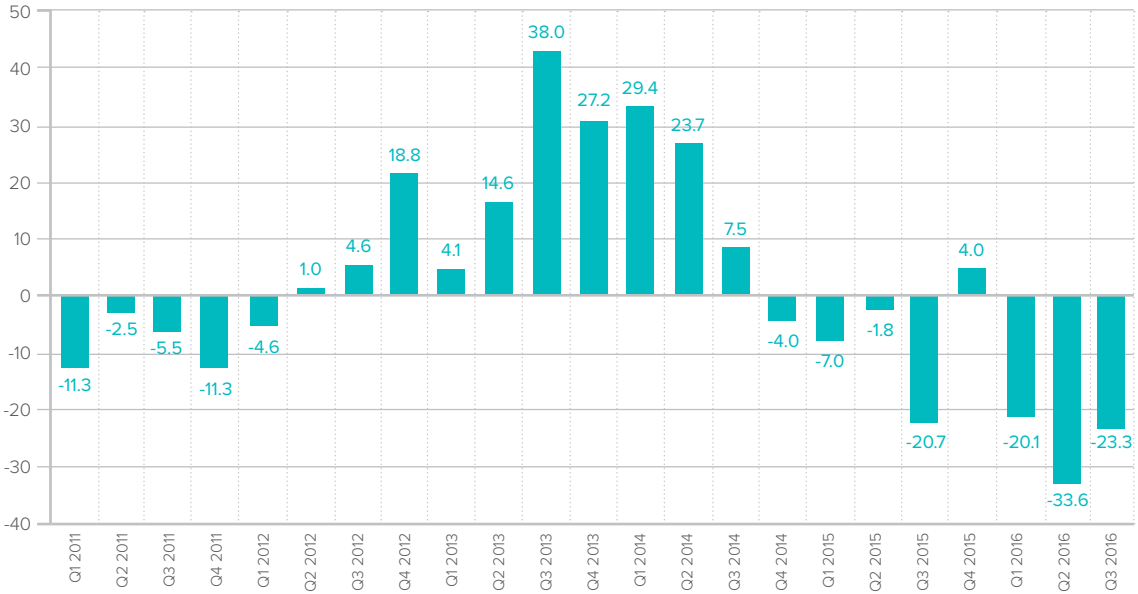
Figure two: The FSB SBI<sup>1</sup> small business prospects over coming three months.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

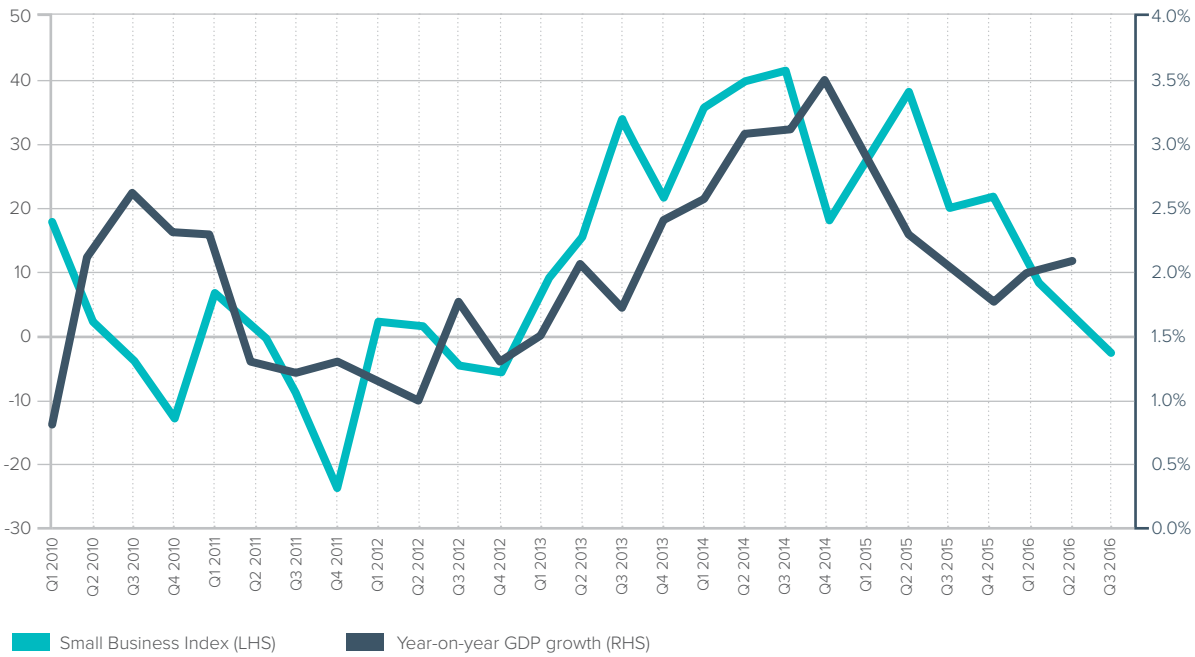
1. The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' The share of firms reporting 'much improved' are given the following weightings: +2, slightly improved +1, approximately the same 0, slightly worse -1 and much worse -2; the Small Business Index is derived from the sum of these factors.

Figure three: Year-on-year change in the FSB SBI.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

Figure four: FSB SBI against year-on-year UK GDP growth.



Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.

# REGIONAL SMALL BUSINESS INDICES

---

Confidence has declined in every part of England, and is lowest in Scotland

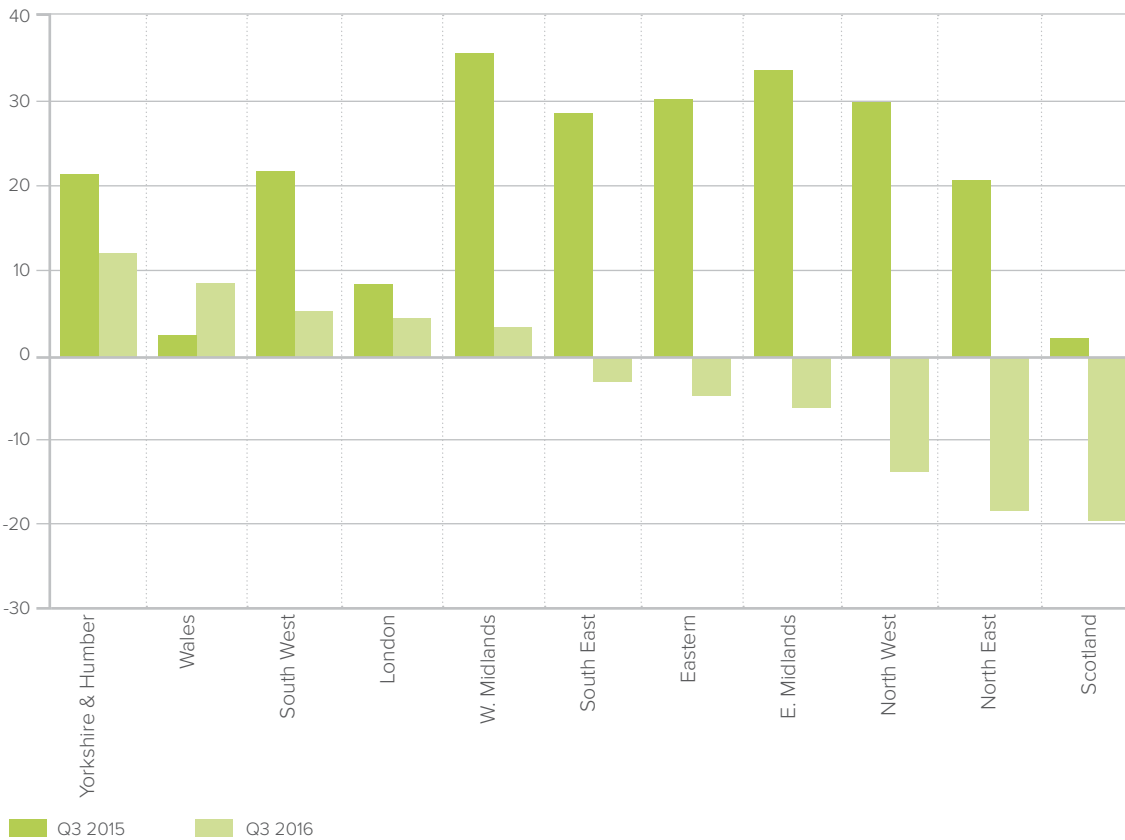
# SHARP DECLINES IN MOST REGIONS

Compared to a year ago, confidence has declined in every part of England, and it is most negative in Scotland, the North East and the North West of England, as shown in Figure 5.

The largest fall in confidence has been in the North West, reducing from 29.5 in Q3 2015 to -13.6 in Q3 2016. Sharp declines in several English regions underline the importance of local devolution settlements in addressing local needs.

Scotland has the lowest confidence, in line with the latest economic data for the country. Figures released by the Scottish Government in July suggest that the Scottish economy saw zero growth in Q1 2016. However, the latest labour market figures from the Office for National Statistics show that the rate of unemployment in Scotland between May and July had fallen to 4.7%. The Scottish rate is now below the UK-wide figure of 4.9% and is down from the 6.2% seen in the first quarter of 2016

Figure five: FSB SBI – regional variation in small business prospects over coming three months.



Source: FSB - Verve 'Voice of Small Business' Panel Survey. Survey data for Northern Ireland is not included in this graph due to a low volume of responses from Northern Ireland being received this quarter.

# SMALL BUSINESS SECTOR INDICES

---

Small business confidence  
declines in sectors that make up  
large share of UK output

# CONFIDENCE FALLS SHARPLY IN MULTIPLE SECTORS

---

Compared with a year ago, small business confidence has declined sharply in a number of sectors which account for a large share of the UK's total economic output.

Small business confidence in the wholesale and retail sector is now strongly in negative territory. The sector has faced rising cost pressures associated with the National Living Wage introduced in April, and ongoing price competition has created an environment in which profit margins are under pressure.

Rising import prices due to the devaluation of sterling following the result of the EU referendum are likely to squeeze margins still further, while there are some concerns that economic uncertainty will cause households to save more and spend less in the shops.

On the upside, there are a number of sectors where small business confidence remains in positive territory this quarter. The information and communication sector, which accounts for a rising proportion of UK economic activity, amid rapid rates of technological change, continues to show relatively robust levels of confidence. A majority of small businesses in the sector (56.3%) expect prospects for their business to improve over the next three months.

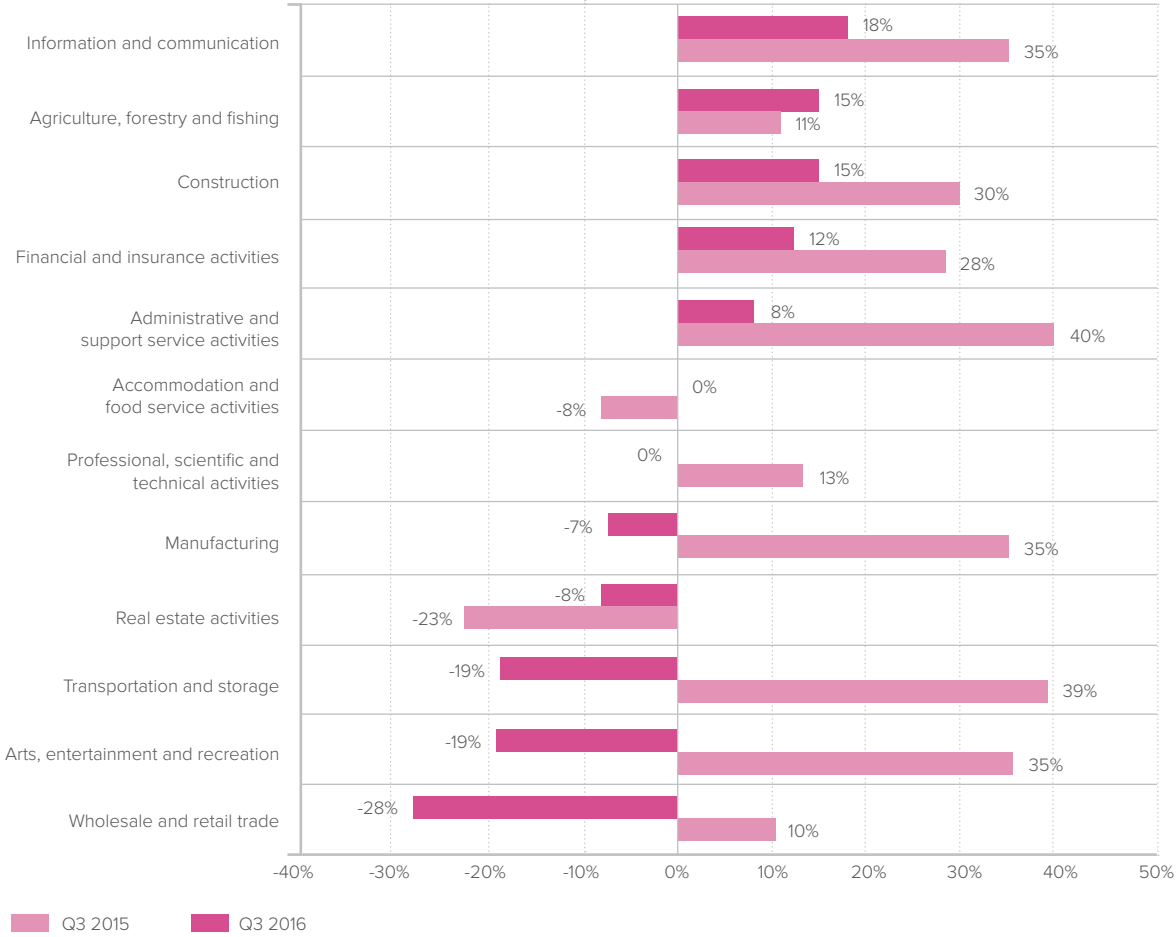
A net balance of small businesses report a decline in gross profits this quarter – the second consecutive quarter in which this has been the case. Only a small net balance of businesses (1.1%) expect profits to increase over the next three months.

This decline in profits is likely to reflect negative pressures on turnover combined with increasing costs. Beyond the increases in costs due to the National Living Wage, challenges in some export markets and intense price competition in the UK consumer market are limiting opportunities to increase revenue.

In the wholesale and retail sector, where supermarket price wars have contributed to sustained downward pressure on selling prices, a net balance of 27.3% of businesses report a decline in gross profits – much greater than the 6.9% seen across the wider business population. According to ONS statistics, selling prices across the retail sector declined by close to 3% over the 12 months to April 2016.



Figure six: FSB Small Business Index by sector – small business prospects over coming three months.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

# FINANCIAL PERFORMANCE

---

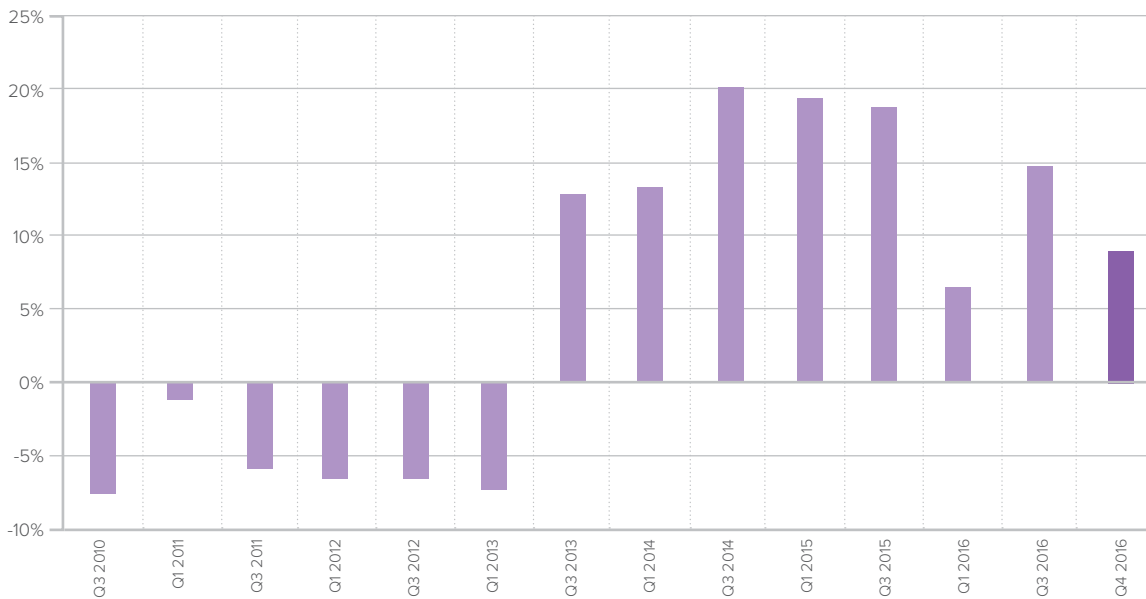
Revenue up from the start of the year, but growth expected to decline next quarter

# REVENUE GROWTH LIKELY TO SLOW

A net balance of 14.6% of small businesses reported an increase in revenues this quarter, up from 6.5% at the start of the year. However, this net balance is expected to decline to 8.8% over the next three months, in line with indications that economic growth is likely to slow later this year. The balance of businesses reporting revenue growth this quarter is discernibly lower than the same period a year ago, suggesting a weaker picture this year compared with 2015.

In recent quarters, companies in the UK have been supported by a strong consumer environment, driven by declining unemployment and low inflation. However, this looks set to weaken over the coming months as rising import prices lead to higher inflation and reduced household spending power. On the upside, there are signs of an improving picture for export revenues.

Figure seven: Small business revenue, net percentage balance – proportion reporting increase less proportion reporting decrease.



Source: FSB – Verve 'Voice of Small Business' Panel Survey.

# EXPORTS

---

Export performance  
bounces back

# EXPORT OUTLOOK IMPROVES

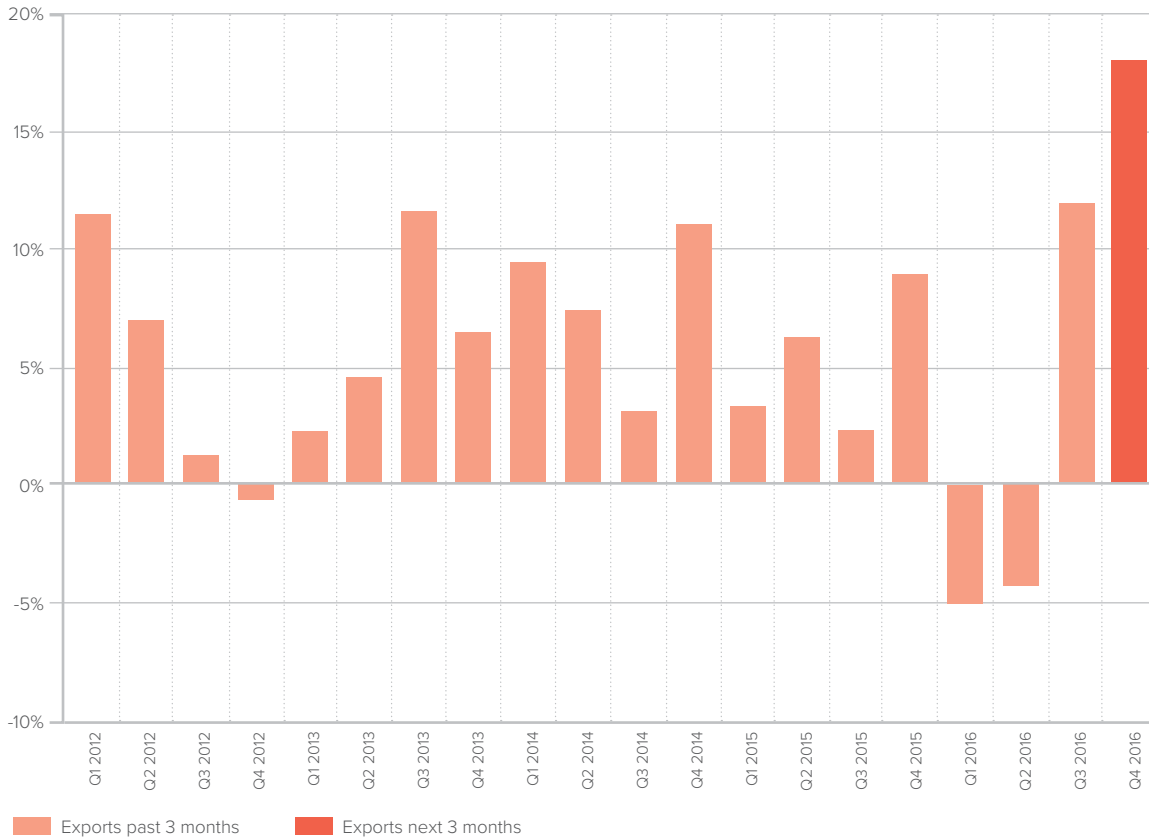
The latest SBI shows an improved outlook for exports. A net balance of 11.7% of small firms report that exports increased over the past three months in Q3 2016, following two consecutive quarters in which a net balance of businesses reported declining exports. Further, a net balance of 17.9% of businesses expect their exports to grow over the next three months.

The global economy seems to have stabilised somewhat since the start of 2016, when there were significant concerns about weaknesses in major economies such as China. This means that the export

environment for the UK has become more favourable. In addition, the sharp but sustained devaluation of sterling since the result of the EU referendum has left UK exports significantly more price competitive, which will support small businesses attempting to boost their overseas sales.

Crucially, the longer-term outlook for UK exports over the coming years will be determined by the outcome of negotiations between the Government and the rest of the EU, as well as trade agreements with other markets.

Figure eight: Changes in value of exports – previous three months and expectations for coming three months; net percentage balance, proportion reporting increase less proportion reporting decrease.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

# COSTS AND INFLATION

---

Exchange rates rise as source  
of increasing costs

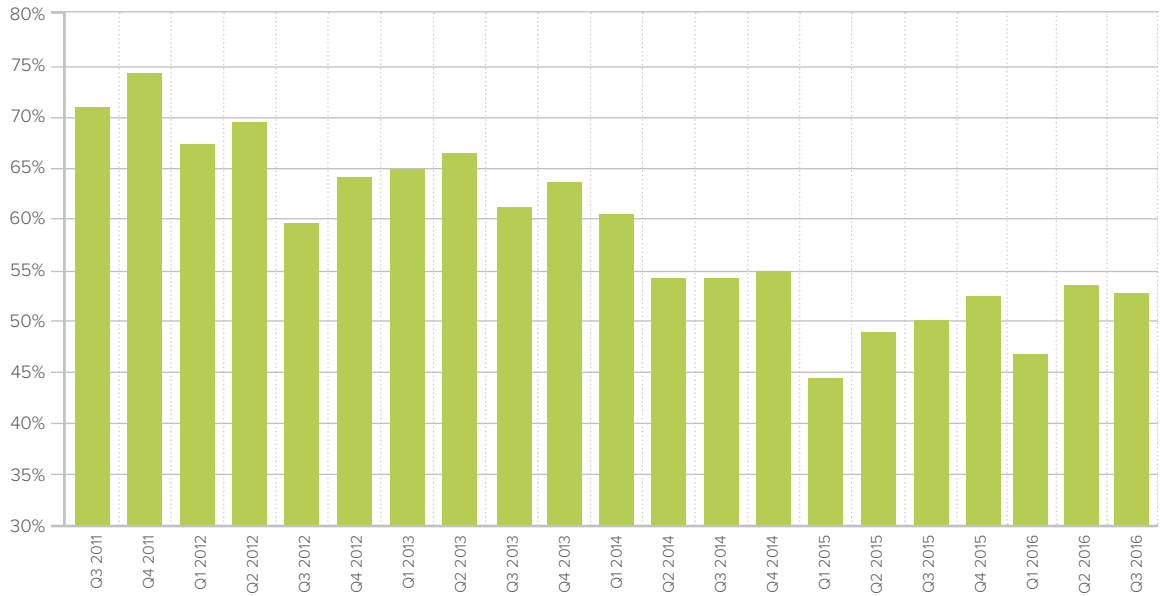
# COST PRESSURES REMAIN CONTAINED FOR NOW

This quarter, a net balance of 52.8% of small businesses reported an increase in their overall cost of operation during the past three months, compared with the same period a year ago. This is broadly unchanged from that seen in the previous quarter.

Reflecting the weakness of sterling at present, the share of businesses reporting exchange rates as a main cause of rising business costs has increased strongly from 5.6% in Q3 2015 to 21.2% this quarter. This is translating into rising costs for a range of goods such as fuel, which our data suggests has also become more of an issue for small businesses. Unleaded petrol prices rose by close to 9% between early January 2016 and early August 2016, according to data produced by the Department of Energy and Climate Change.

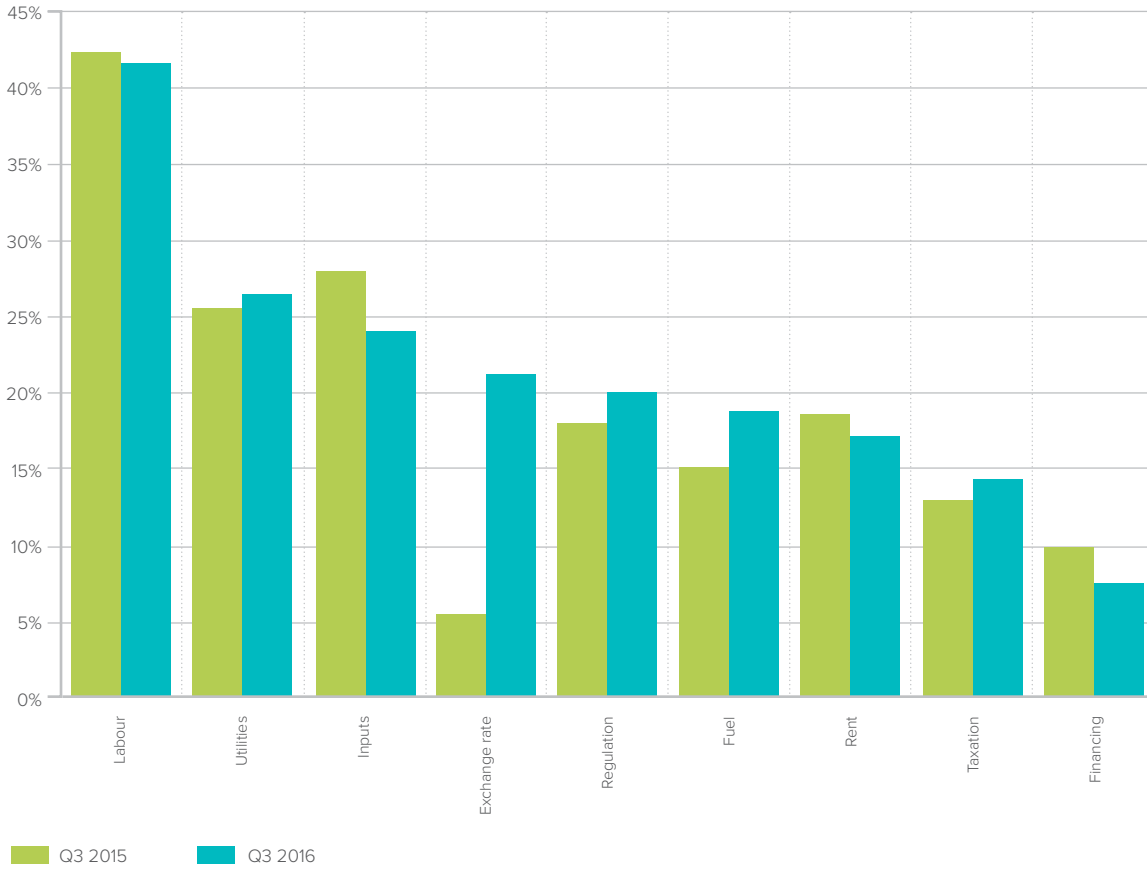
Labour costs remain the most cited cause of rising business costs. The introduction of the National Living Wage, and anticipated future increases of the NLW, means that many businesses, particularly in sectors such as wholesale and retail, accommodation and food services, are likely to continue to face increasing costs. Data from the Office for National Statistics show that wage growth in the economy as a whole is fairly modest, with average regular earnings in the three months to May 2016 up just 2.2% compared with a year ago. This is about half the annual growth of about 4% per annum which was seen between 2001 and 2007.

Figure nine: Small businesses reporting an increase in overall cost of operation over past three months, compared with the same period a year ago; net percentage balance.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

Figure 10: Main causes for changing business costs (firms may give multiple answers).



Source: FSB - Verve 'Voice of Small Business' Panel Survey.



# CAPACITY

---

Balance of 45.8% of firms report  
operating below capacity

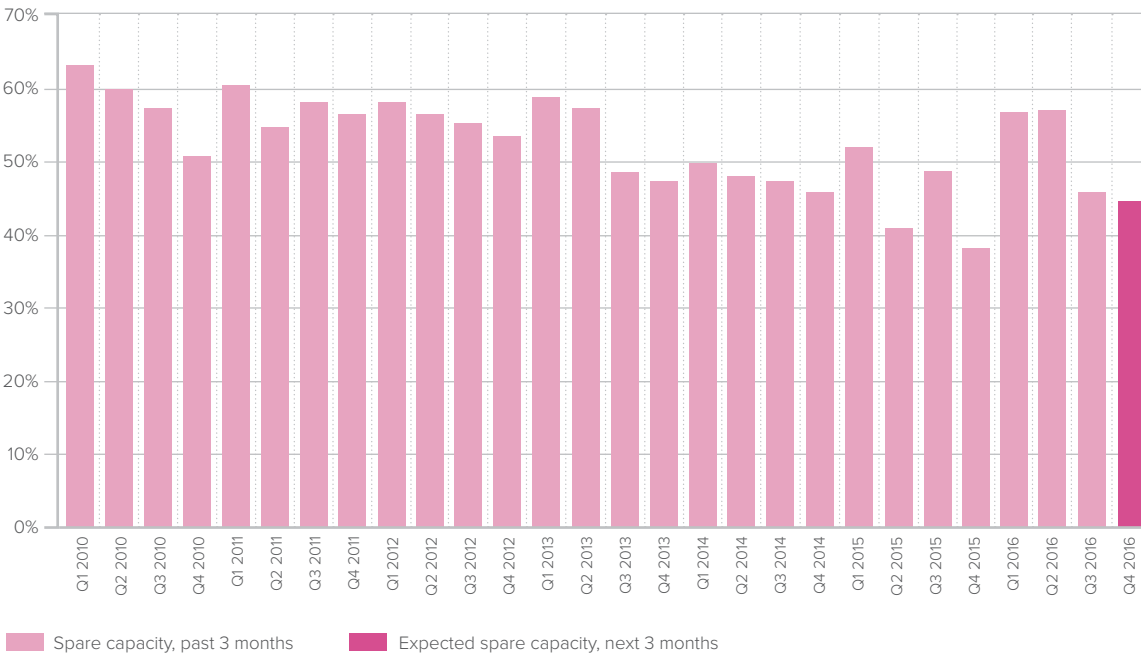
# SHARE OF BUSINESSES OPERATING BELOW CAPACITY FALLS BACK

Encouragingly, despite concerns over the economic backdrop and wider domestic economy, there has been a sharp decline in the number of businesses operating below capacity this quarter. A net balance of 45.8% of businesses report operating below capacity in Q3 2016, down from 57.4% in the previous quarter and the lowest level since Q4 2015. One in ten small businesses report that they are operating above capacity.

Spare capacity is a closely followed indicator, and the Bank of England has stated that the amount of slack in the economy will be a key determinant of the future path of interest rates, with more spare capacity providing a rationale for keeping rates lower for longer. The amount of spare capacity is also a determinant of future investment; businesses operating above or at capacity will usually need to invest in people and capital if they wish to expand further.

Despite an improvement since the start of the year, a majority of small businesses report that they are operating below capacity. This suggests that the Bank of England is right to continue to provide loose monetary policy and that there is still a lot of slack in the economy.

Figure 11: Net percentage balance of businesses running below capacity: proportion below capacity less proportion above capacity.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

# EMPLOYMENT

---

Headcount increases for  
first time in 2016

# SMALL BUSINESSES START HIRING AGAIN

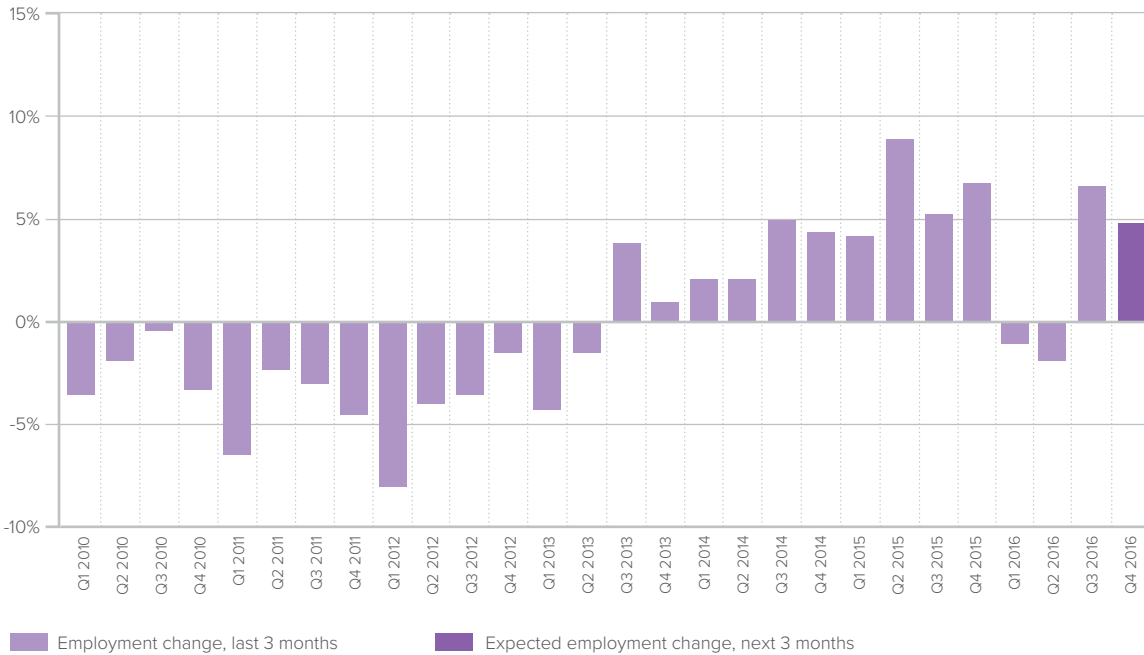
This quarter, a net balance of 6.8% of small businesses reported increasing headcount. This is the first time this year that a net balance of small companies report increasing rather than cutting their headcount, and active hiring is expected to continue into the final quarter of 2016.

In part, the latest findings could reflect the decline in the share of small businesses operating below capacity, which has probably prompted some companies to take on new staff.

The UK-wide labour market data remains strong at present. The unemployment rate over the three months to May 2016 was 4.9%, down from 5.6% a year earlier and the lowest rate of unemployment in over a decade.

Although the employment data came before the result of the EU referendum result, it suggested that companies did not significantly curb recruitment despite uncertainty related to the referendum. The employment rate – the proportion of 16 to 64 year olds in work – stood at the highest level since comparable records began in 1971, in the data for the three months to May.

Figure 12: Net percentage balance change in number of people employed – proportion reporting increase less proportion reporting decrease.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

# PAY GROWTH SLOWS

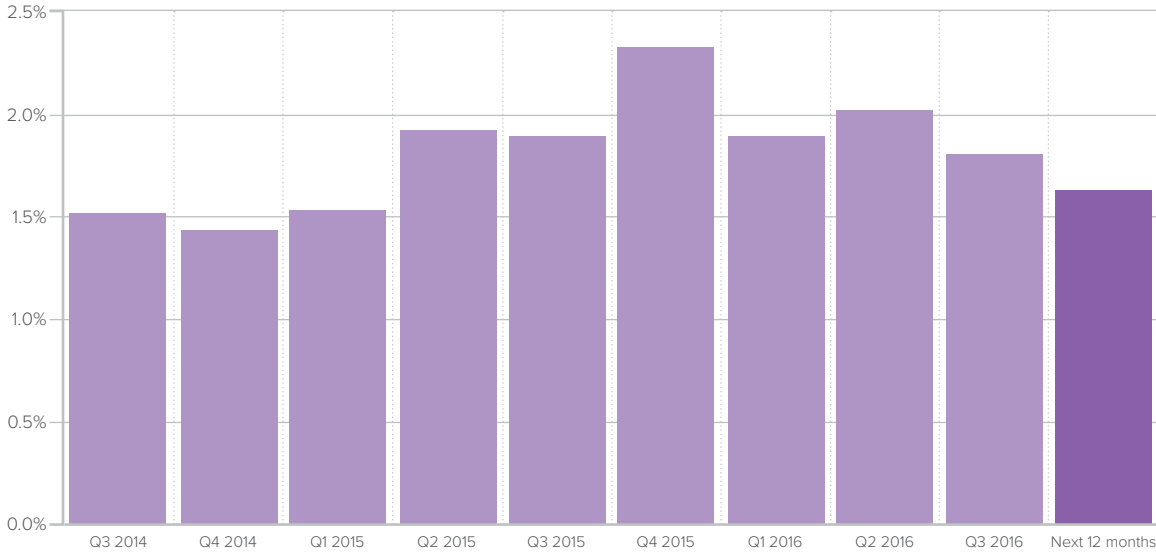
Year-on-year wage growth stood at 1.8% in Q3 2016, the lowest rate since Q1 2015. Pay growth is expected to slow further to 1.6% over the next 12 months.

Despite the introduction of the National Living Wage, the pressure to increase pay seems to be relatively modest across small businesses as a whole. However, there are signs of the policy having a significant impact on wage growth in certain sectors where pay is relatively low.

Over a third of small businesses in the wholesale and retail sector (34.8%), accommodation and food services sector (38.3%) report increasing pay by over 4% year-on-year this quarter. The comparable figure for small businesses in the higher paid professional, scientific and technical activity sectors is 18.8%.

The weakness of UK earnings growth since the financial crisis has surprised many forecasters, especially in the context of falling unemployment. This has traditionally been associated with rising wage growth as employees have more bargaining power and can move from job-to-job more easily. The reasons for the weakness are likely to be numerous. Low inflation means that although pay growth is weak, most employees are actually enjoying a rise in their spending power, as wage growth is outpacing the cost of living. In addition, productivity growth, a key driver of earnings growth in the long term, remains very weak by historical standards.

Figure 13: Average salary increase awarded, this quarter versus a year before.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

# GROWTH ASPIRATIONS AND CHALLENGES

---

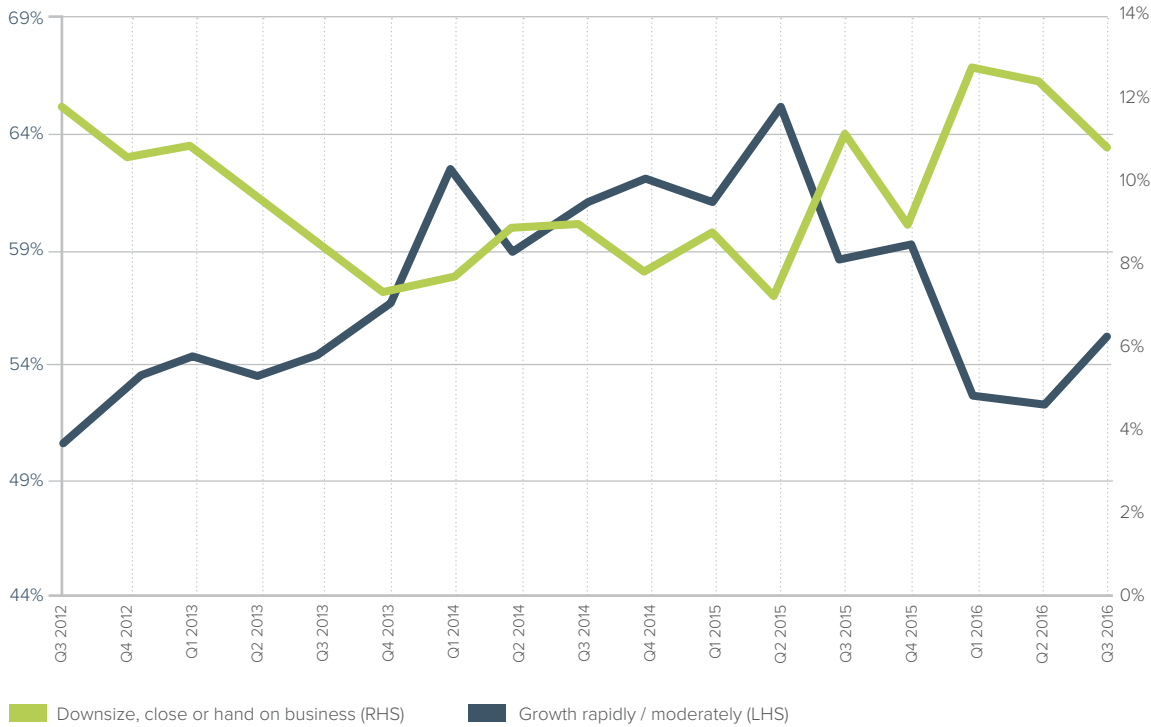
55.3% of firms aspire to grow

# SHARE OF BUSINESSES ASPIRING TO GROW TICKS UP

The share of small businesses aspiring to grow over the next 12 months has increased this quarter, standing at 55.3% which is the highest share since the end of 2015. The share of businesses expecting to downsize, close or pass on the business has fallen this quarter, standing at 10.9%.

Despite a low level of overall confidence among small businesses, many continue to aspire to expand, possibly reflecting some other indicators tracked in this survey. Although there is a great deal of uncertainty at the moment, the share of businesses operating below capacity has been declining, small companies are hiring more staff and they are reporting growth in exports, which are all positive signs.

Figure 14: Growth aspirations for next 12 months



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

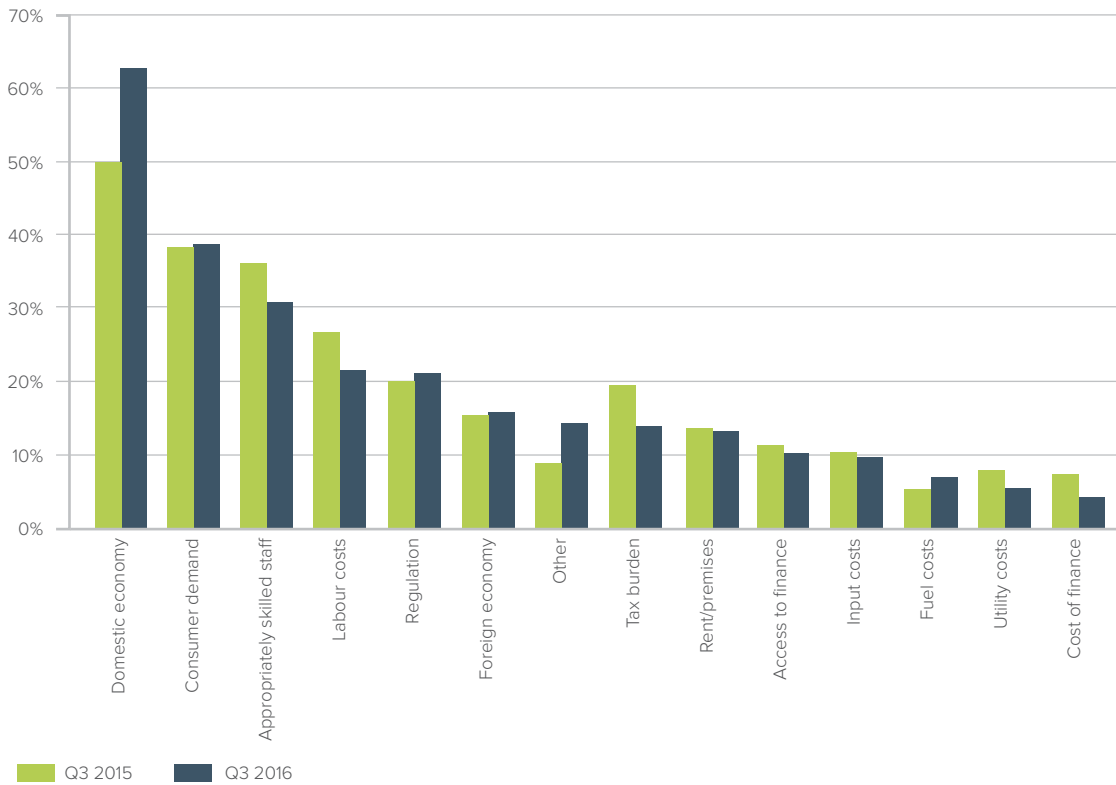
# DOMESTIC ECONOMY RISES AS A CONCERN

Over three fifths (62.1%) of small businesses cite the domestic economy as a barrier to achieving growth aspirations in Q3 2016, sharply up from just under half (49.4%) in the same quarter a year ago. However, this figure is only slightly higher than the 58% seen in Q1 and Q2 2016, suggesting that this cannot be attributed entirely to concerns following the result of the EU referendum. Indeed some leading indicators, including business confidence, have been pointing to a loss of momentum in the UK economy since the start of the year.

In line with declining wage growth, the share of businesses reporting labour costs as a barrier to achieving growth aspirations fell from 26.5% in Q3 2015 to 21.4% this quarter. The share of businesses reporting finding appropriately skilled staff to be a barrier also fell from 35.8% to 30.5%, although it remains the third most cited barrier among small companies.

The least-cited barrier to growth this quarter was the cost of finance, with just 4.2% of small businesses reporting this as a barrier, reflecting the findings of our credit availability and affordability indices.

Figure 15: Potential barriers to achieving growth aspirations – multiple answers possible.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.



# CREDIT

---

Unsuccessful credit applications  
continue to decline

# UNSUCCESSFUL CREDIT APPLICATIONS HALVED

Figure 16: Credit applications and interest rates offered.



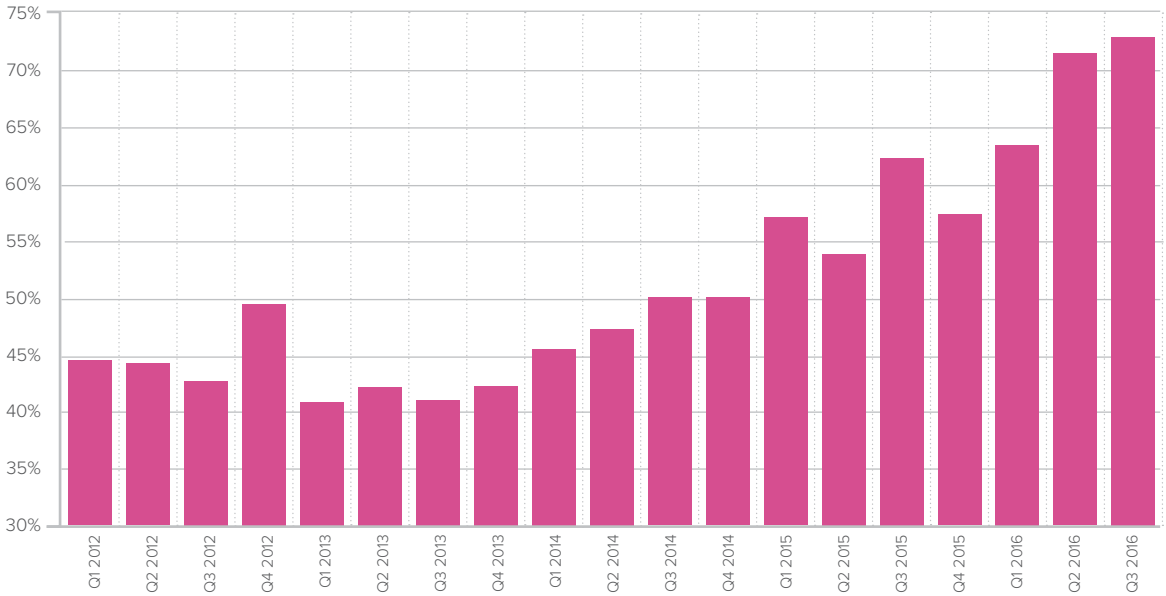
Source: FSB - Verve 'Voice of Small Business' Panel Survey. Respondents were able to give multiple answers to this question.

The share of small businesses unsuccessful in their credit applications has continued to decline significantly over the past year, pointing to improved credit availability. This quarter, 14% of small businesses that made a credit application report that they were unsuccessful, less than half the 31.6% seen in Q3 2015.

However, there has been a sharp increase in small businesses awaiting a decision on their credit applications, suggesting that there are some problems with slow processing times. 13.5% of small businesses in this quarter report that they are awaiting a decision on their credit application, double the 6.5% seen in the same quarter a year ago.

Among businesses applying for credit, the share seeking an overdraft has fallen drastically. 37.2% applied for an overdraft, compared with 60.2% in Q3 2015. This quarter's SBI suggests that small firms are continuing to increase their use of alternative finance. In particular, in Q3 2016 about a quarter (25.4%) of credit applicants applied for asset-based, invoice-based or trade financing, which is about double the 12.5% seen in the same quarter a year ago.

Figure 17: Proportion of small businesses successful in their credit applications in the past three months.



Source: FSB - Verve 'Voice of Small Business' Panel Survey

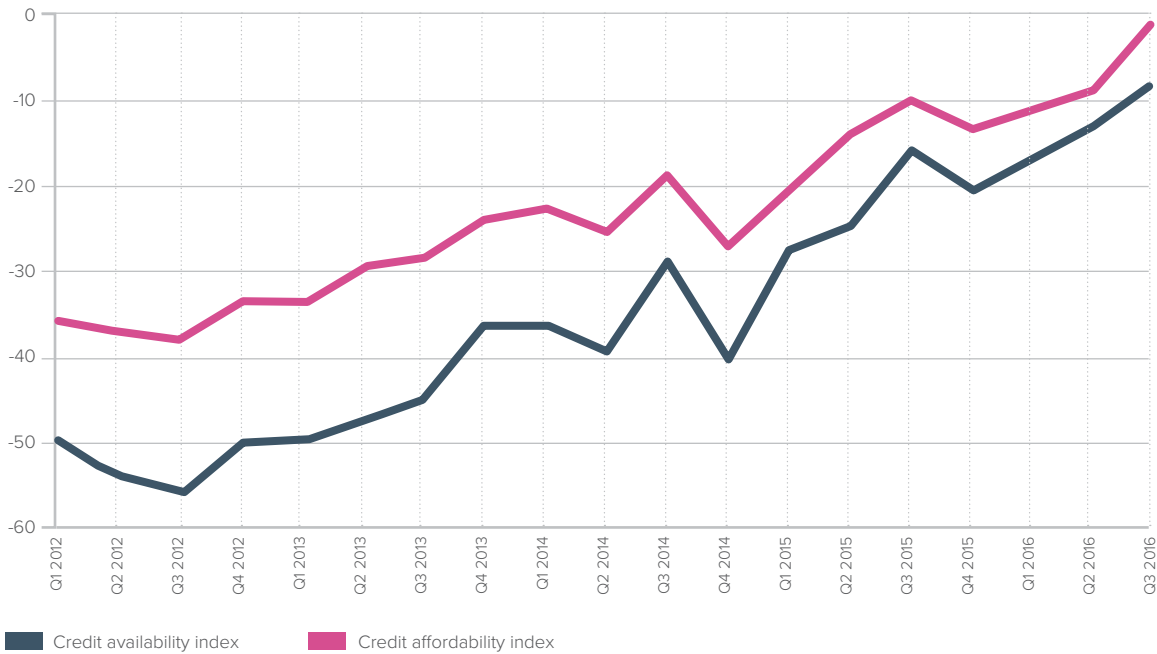
# CREDIT AVAILABILITY CONTINUES TO IMPROVE

Small businesses are reporting that credit availability is continuing to improve. This quarter, the FSB credit availability and affordability indices stand at their highest levels since records began at the start of 2012.

Monetary policy from the Bank of England should continue to support credit affordability and availability going forward. In response to economic uncertainty following the result of the EU referendum, the Bank of England cut the base rate to a new record low of 0.25% in August. The rate had been on hold at the previous record low of 0.5% since 2009.

In addition, the Bank of England announced a £100bn Term Funding Scheme, which aims to reinforce the transmission of cuts in the base rate to the interest rates actually faced by households and firms. The scheme will provide funding for banks at interest rates close to the base rate, which should enable lenders to pass on lower rates to their customers.

**Figure 18:** Indices of credit affordability / availability perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses.



Source: FSB - Verve 'Voice of Small Business' Panel Survey.

# INVESTMENT AND PRODUCTIVITY

---

54.6% of small businesses  
expect capital spending to  
remain unchanged

# INVESTMENT INTENTIONS REMAIN SUBDUED

This quarter, a net balance of 11.4% of small businesses reported that they intend to increase capital investment over the next quarter, compared with the previous quarter, which is broadly unchanged from Q2 2016. A majority of small businesses (54.6%) expect capital spending to remain unchanged, while 17% intend to reduce their capital spending.

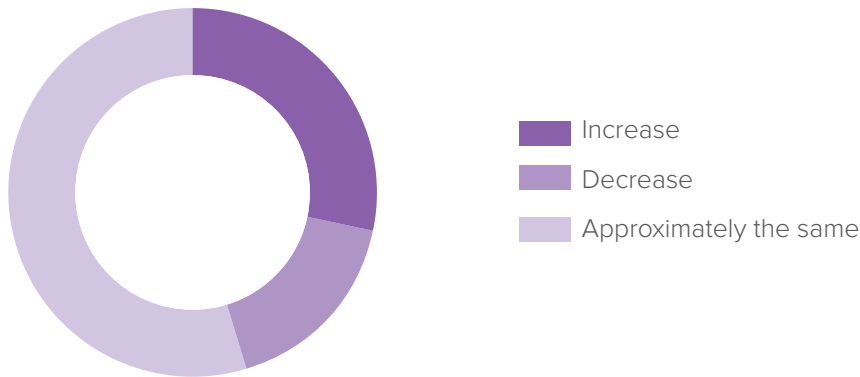
Uncertainty over long-term economic prospects in the UK may be holding back some investment decisions at present. This highlights the need for policymakers to provide assurances that they will do all they can to support growth going forward.

A lack of capital investment could limit the UK growth outlook over the coming years. Spare capacity has

shown some signs of diminishing since the start of 2016 and without investment, some small businesses may find it difficult to expand.

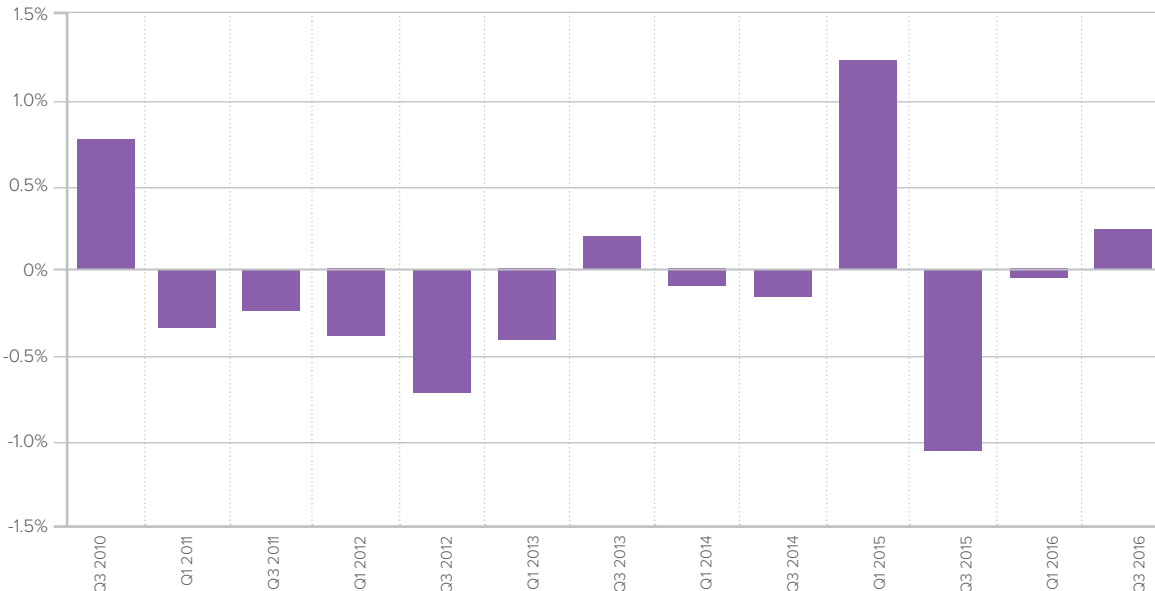
Some firms may be deciding to invest in new employees rather than new capital, as reflected in the latest FSB hiring data. However, this labour-intensive, capital-light type of expansion is often bad for productivity because investments in tools and technology is often required to make workers more productive. Without investment in capital, which requires some degree of certainty over long term economic prospects, productivity growth will remain subdued, as will the wage growth of many employees. As shown in Figure 20, productivity growth is weak in the small business community at present.

Figure 19: % of small businesses expecting to increase and decrease capital investment over next quarter, compared with the previous quarter, Q3 2016.



Source: FSB - FSB - Verve 'Voice of Small Business' Panel Survey.

Figure 20: Quarter-on-quarter growth in small business productivity.



Source: FSB - Verve 'Voice of Small Business' Panel Survey. Productivity defined as inflation-adjusted turnover per employee.

# METHODOLOGY

---

This report is based on the July-August 2016 research survey of FSB members carried out by Verve. All panel members (6,276) were invited to take part in an online survey. Reminders were sent to all non-respondents. 1,035 responses were received, a response rate of 18%. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 12 July and 1 August 2016.

# SUMMARY DATA TABLE

	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Small Business Index	41.0	17.6	28.7	37.9	20.3	21.7	8.6	4.3	-2.9
Employment - previous three months	5.0%	4.4%	4.2%	8.9%	5.3%	6.7%	-1.0%	-1.9%	6.8%
Employment - coming three months	7.0%	7.1%	10.0%	14.2%	8.2%	7.3%	7.1%	6.6%	4.9%
Exports – previous three months	3.0%	10.9%	3.1%	6.1%	2.2%	8.8%	-5.1%	-4.2%	11.7%
Exports – coming three months	22.0%	18.6%	16.5%	20.7%	16.1%	21.0%	15.9%	12.0%	17.9%
Credit availability - rated good or very good	16.8%	13.3%	16.2%	16.6%	23.5%	18.2%	20.8%	26.0%	26.3%
Credit availability - rated poor or very poor	52.5%	61.7%	50.4%	47.3%	41.6%	43.6%	39.1%	39.6%	36.5%
Credit affordability - rated good or very good	22.0%	18.1%	19.6%	26.2%	27.6%	23.3%	24.9%	25.3%	32.3%
Credit affordability - rated poor or very poor	47.0%	54.4%	46.4%	42.4%	38.8%	40.7%	37.7%	37.4%	34.2%

The Small Business Index weights strong responses (much improved or much deteriorated conditions) double and subtracts the weighted proportion of firms reporting deterioration in business prospects over the coming three months from the weighted proportion expecting an improvement.

The Employment and Revenue indicators are net percentage balances, with the proportion of firms reporting a decrease subtracted from the proportion reporting an increase.

Responses are also weighted according to regional gross value added.





# Q3

---

© Federation of Small Businesses

---

[fsb.org.uk](http://fsb.org.uk)

---

 [federationofsmallbusinesses](https://www.facebook.com/federationofsmallbusinesses)

 [@fsb\\_policy](https://twitter.com/fsb_policy)

---

If you require this document in an alternative format please email:  
[accessability@fsb.org.uk](mailto:accessability@fsb.org.uk)

---

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of FSB. While every effort has been made to ensure the accuracy of the facts and data contained in this publication, no responsibility can be accepted by FSB for errors or omissions or their consequences. Articles that appear in the report are written in general terms only. They are not intended to be a comprehensive statement of the issues raised and should not be relied upon for any specific purposes. Readers should seek appropriate professional advice regarding the application to their specific circumstances of the issues raised in any article.

This report can be downloaded from the FSB website at [www.fsb.org.uk](http://www.fsb.org.uk)

**fsb**<sup>08</sup>  
Experts in Business