

SCOTLAND Q2 2016 SMALL BUSINESS INDEX

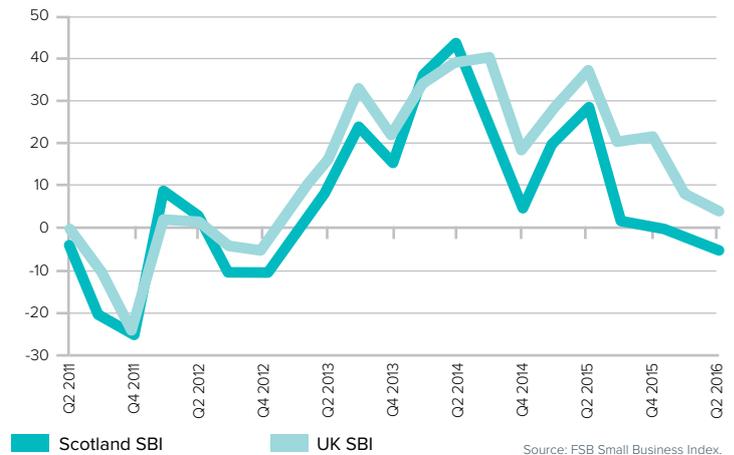
Small business confidence in Scotland declined further in the months prior to the referendum on the UK's membership of the EU. The Small Business Index stands at -5.5, down from +28.5 at the same point a year ago. This is the second consecutive quarter in which small firms which expect business conditions to deteriorate have outnumbered those expecting an improvement. In fact, confidence has now stood around or below zero for the past year.¹

Similarly, confidence among small businesses across the UK as a whole has also fallen. The UK Small Business Index fell to +4.3 at the latest reading. While still in positive territory, this represents a notable fall from the +37.9 recorded in Q2 2015. Overall, the results suggest that, after slowing in the first quarter of 2016, the UK economy has slowed further in the second quarter of the year. Therefore, it is unsurprising to see bodies such as the Office for Budgetary Responsibility (OBR) and the Bank of England cutting their growth forecasts for the UK in 2016.

The continuing decrease in small business confidence reflects low Scottish economic growth. The latest figures from the Scottish Government show that output rose by just 0.9% year on year in the final quarter of 2015, well below the 2.1% seen across the UK as a whole and down from 3.0% in the same period a year earlier. Household spending remains a consistent driver of growth in Scotland, but government spending and fixed capital investment both saw a year-on-year contraction in Q4 2015. The manufacturing sector has been particularly affected by the slowdown in activity across Scotland, contracting 1.1% year on year over the course of 2015 as a whole.² The labour market in Scotland also appears to reflect a weakening economy. The rate of unemployment in Scotland stands at 5.8% compared with the 5.0% recorded across the UK as a whole.

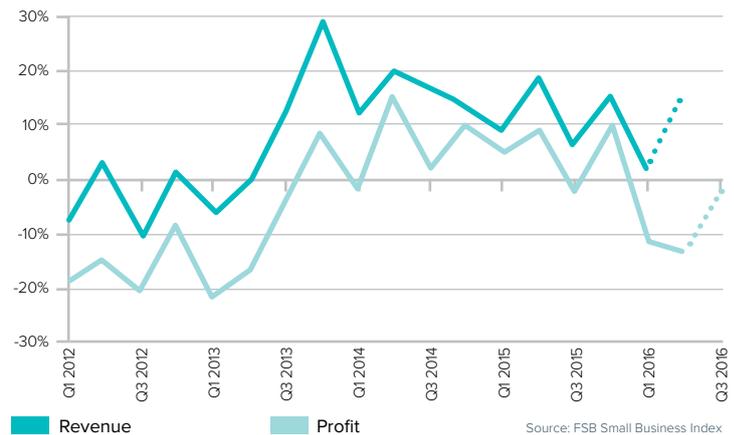
A declining proportion of businesses are expecting profits and revenues to grow. This quarter, a net balance of 13% of small businesses in Scotland report a fall in profits over the last three months, down slightly on the balance recorded in the previous quarter. It's not just current performance that is waning, however. In line with the fall in confidence in the latest quarter, expectations for profit growth in the next three months have weakened. In fact, expectations suggest that the third quarter of the year will see a third consecutive drop in profits, with a net balance of 3% of firms expecting profits to fall in the coming three months. While a decline in demand is one factor feeding into reduced profits in recent months, pressures from rising input prices also appear to have increased in the latest reading.

Small Business Index



Source: FSB Small Business Index.

Net balance of small firms in Scotland reporting revenue/profit growth



Source: FSB Small Business Index.

¹ Source: FSB Voice of Small Business Survey. Sample of 1570 small businesses across the UK, with 180 small businesses surveyed across Scotland.
² The Scottish Government: Quarterly National Accounts Quarter 4 2015.

A higher share of small businesses are reporting that regulatory requirements are pushing up business costs. This quarter, a net balance of 60% of small firms report that the overall cost of running their business has increased compared with the same period a year earlier. This is a sharp increase from the net balance of 38% recorded in Q1 2016.

The introduction of the National Living Wage in April and the ongoing introduction of pension auto-enrolment have contributed to the fact that labour costs, as in the same quarter last year, are the most significant driver of cost increases.

Looking at year-on-year changes, 31% of businesses highlighted regulatory requirements as a main cause of rising costs, compared with 19% at the same point in Q2 2015. At the same time, pressures from the costs of utilities and finance appear to have reduced over the past year.

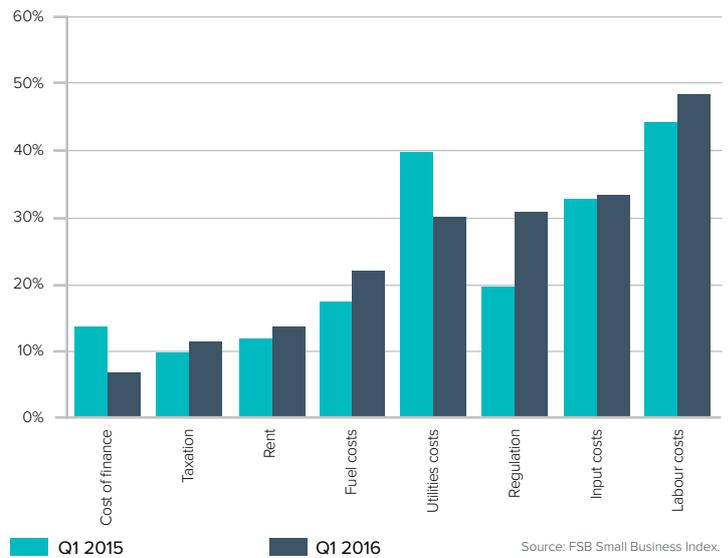
Employment levels continue to contract among smaller businesses in Scotland. The rate of unemployment across the country rose by 0.4 percentage points in Q1 2016 compared with the final quarter of 2015, a factor that will have an impact on household finances and expenditure. It is therefore unsurprising that a net balance of 9% of SBI respondents reported that they had reduced their headcount over the past three months. This represents the second consecutive quarter of contraction after a similar fall in the first quarter of the year and is a notable reversal from the consecutive expansions recorded in the three quarters prior to the beginning of 2016.

Investment intentions have fallen back despite improvements in the availability and affordability of credit. This quarter, a net balance of 7% of companies expect to increase their capital expenditure over the year. While still positive, this figure is well below the 19% recorded in the first quarter of 2016, a likely consequence of a difficult trading environment.

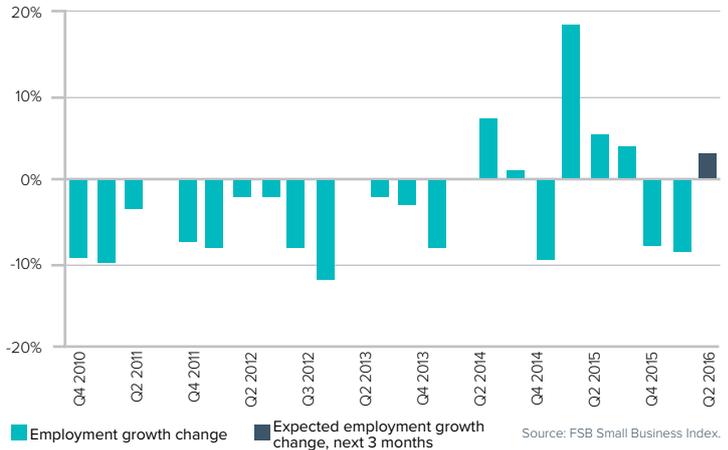
The fall in investment intentions comes despite an improving environment for credit. The balance of firms reporting that credit is both available and affordable continued its upward trend. The proportion of firms describing credit as unaffordable declined substantially, to 33.3% from 38.9% in Q1 2016. However, a lack of confidence in the wider economy looks as if it is outweighing improvements in the credit markets and keeping capital spending on hold for now.

Overall, the latest Small Business Index suggests that business conditions across Scotland remain challenging. In line with our first report of the year, these figures suggest that small businesses in Scotland expect conditions to deteriorate further over the next three months. Profits were down for the second consecutive quarter in Q2 and a net balance of small firms expect profits to reduce further over the next three months. Alongside the difficulties being faced by industries such as manufacturing and oil and gas, higher rates of unemployment than elsewhere in the UK are weighing on household spending power and domestic demand for certain goods and services.

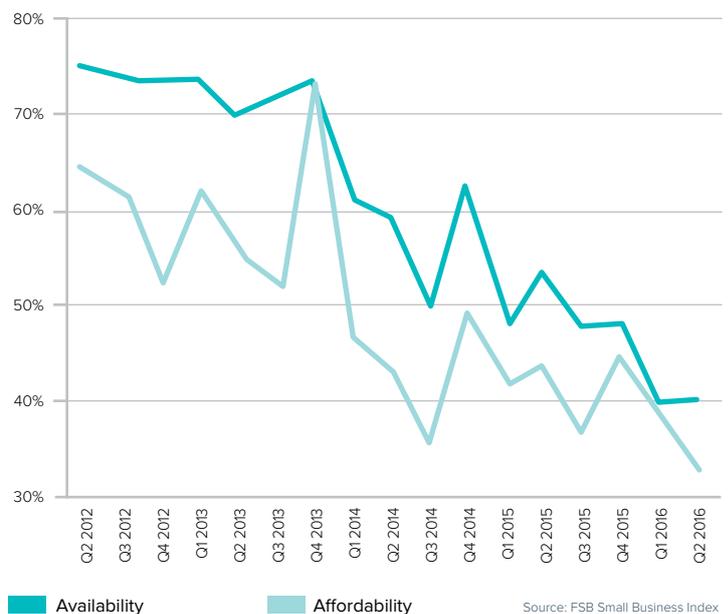
Share of firms reporting factor as a main cause of change in businesses costs, Scotland



Net balance of firms reporting employment growth, Scotland



Share of firms reporting poor availability/affordability of credit



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