



**Federation of Small Businesses**  
*The UK's Leading Business Organisation*

# FSB Voice of Small Business Index

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Quarter 3, 2014

Q1 Q2  
Q3 Q4

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# Voice of Small Business INDEX Q3, 2014

**Small business confidence at highest**  
for next three months since Q1 2010



**Confidence growing fastest in**



Health and social work

Q3 2013    Q3 2014

-2    +33



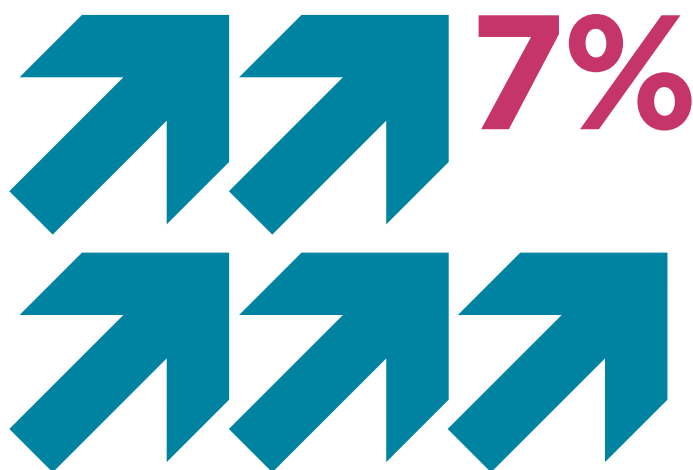
Bar and restaurant work

+2    +24



Personal services

+36    +54



**Net balance of 7% of firms are expecting to increase their staff levels up from 1% in the same quarter last year**

**33%**



Firms expect turnover growth in Q4

**17%**



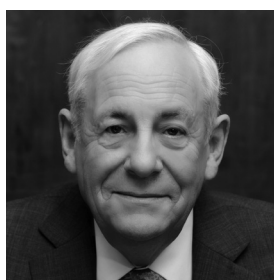
Firms expect profits to rise in Q4



**61%**

**Businesses expect to grow in the next 12 months**

# FSB Voice of Small Business Index



**John Allan,  
FSB National  
Chairman**

I am delighted to report that confidence among our members is at an all-time high, confirming the central role of small businesses in the economic recovery and the remarkable rate of job creation seen in recent times. Optimism is firmly in positive territory across the country, with regions that had lagged London and the South East now catching up. What is even more encouraging is that our members' outlook remains positive, shown by their intentions to take on new workers, invest and seek export markets. That bodes well for growth through to the remainder of 2014, and should provide positive momentum through to next year.

Further encouragement that economic growth may gradually be rebalancing away from consumption can be found in our members' investment and export intentions. Around one in four of our members expect to increase investment over the coming year, which should lay solid foundations for their future growth. Despite the challenging conditions in the Eurozone and the strength of the pound, our exporters remain optimistic about their prospects in the coming months, with a net balance of 23% of firms expecting the value of their products sold abroad to grow during the final quarter of 2014.

Looking in more detail at the labour market findings, hiring intentions have reached their highest level seen since our survey started in 2010. This trend looks set to continue into the last quarter of the year, which should provide further encouragement to policymakers. Wage growth however remains subdued, with our members reflecting the wider economic situation in their pay settlements. Where pay rises have been above inflation, most notably in the IT and construction sectors, skilled labour is in high demand and optimism in these sectors is most buoyant.

That throws into relief the longstanding issue of skills in the economy, something the FSB has high on its agenda and an issue that has become increasingly prominent in recent surveys. Nearly one in three of our members say skills are a major barrier to growth, despite large numbers still unemployed. If the UK is to see a sustained recovery that delivers well-paid jobs, then we must equip our workforce and especially our school leavers with the skills for a modern, fast moving economy. I urge all parties to make this one of their highest priorities as they formulate their Manifestos for next year's General Election.

For policymakers, therefore, the message from these results must be to lock-in this optimism and continue to back our self-employed and small businesses through pro-enterprise policies as they are the ones that form the backbone of the recovery. This means creating a tax system encouraging them to create jobs and invest, and to reward our entrepreneurs for their efforts. It means delivering on apprenticeship reforms so our workers and firms have the skills they need, and ensuring regulations meet the small business test. It means supporting them through a sharper, more joined up suite of business support tools to realise their aspirations, and for UKTI to maintain a long term focus on helping our start-ups and small businesses to think global, a point made so clearly at the recent International Festival of Business.

By improving business support, investing in UK infrastructure, reducing the costs of doing business and making markets such as energy and banking work better for small business - the confidence indicated in our survey can be transformed into significant additional economic growth. I therefore look forward to the forthcoming Autumn Statement to see what proposals the Government has to back our members' aspirations, and of course to all the political parties' policy platforms heading in to the General Election.

# Economist's View

These latest set of figures from the FSB's 'Voice of Small Business' Index (SBI) show that confidence is holding strong among the UK's legion of small business, as the economy enjoys the best year of economic growth since before the financial crisis.

As the results show, there are plenty of bright spots in the economy, with small business hiring continuing to be robust, helping to further drive down the unemployment rate. The current favourable inflationary environment also means less pressure on both household incomes and business bottom lines. Companies in the manufacturing and construction sectors are some of the most confident in these latest results, highlighting the ongoing recovery in these previously struggling parts of the economy.

This is certainly all positive news at the headline level, but scratch a little deeper and a more nuanced picture emerges. Confidence levels are indeed high but the pace of growth has eased, in comparison to the marked upward trend that we had observed earlier in the year and in 2013. At Cebr, we see these latest results as tying in with a number of other indicators to suggest that although conditions are still buoyant, we have started to enter a period of cooling. These results add to evidence that peak growth has arrived, and the UK will move toward a more measured rate of expansion over the next few years, following the bounce-back boom seen thus far in 2014. This easing shouldn't be seen solely in a negative light though: growth in recent years has been driven largely by consumer spending running ahead of income increases. Although we expect expansion to run more slowly over the medium term than it is currently, it's looking as though business investment will play much more of a role in fuelling growth over the next few years. This is an important and welcome differentiation, as investment is a necessary component of long term sustainable expansion, leading as it does to innovation and productivity gains.

Other causes for concern remain worth noting. Weak export markets, in particular the Eurozone, and continued signs of a skill shortage in certain sectors of the economy highlight factors that are likely to constrain growth over the short term. In addition, while it may be an often-made point, the fact that substantial government cutbacks will be required under the next parliament in order to bring down the deficit is an important factor to consider in the overall outlook.

On balance then, the UK outlook for the next few years appears to be one of stabilisation and consolidation rather than one of breakneck growth, but after the tumultuous five years behind us, a little time to catch one's breath may be welcome.



**Rob Harbron,**  
**Senior Economist,**  
**Cebr**

# Q3

# Executive summary

## Key findings this quarter:

- The Small Business Confidence Index (SBI) rose to +41 this quarter, up from last quarter's figure of +39.7.
- We have seen a balancing out of confidence levels between different regions, although a degree of imbalance between different parts of the UK remains. The areas with the highest levels of confidence are now the South East, South West, North East and East Midlands. The region seeing the greatest gains compared to a year ago is the North East.
- This is in contrast with earlier stages of the recovery, during which we had seen far higher confidence in London and the South East compared to the North and the devolved nations.
- The most optimistic sectors of the economy are financial, business and personal services, with buoyant consumer sentiment supporting the gain in the latter sector. Agriculture, automotive and real estate have seen declines in confidence compared to the same period a year ago.
- A net balance of 20% of firms reported turnover growth during the past three months, while 8% reported growth in profits. Profitability continues on an upward trend for small firms, and is now comfortably positive for the second consecutive quarter.
- Costs inflation for firms is also relatively low, with the cost of imports and some physical inputs falling back.
- A net balance of 23% of firms expects their exports to increase over the coming three months. However, headwinds are emerging that may constrain exports performance: the pound has recently been trading at its highest levels in a year, and growth in the Eurozone economy has slowed to zero over the past quarter.
- Over the past three months, 58% of firms reported running below capacity, while only 11% were above. During the next quarter, a net balance of 42% of firms expects to be running below capacity.
- Record numbers of firms report that they plan to increase their productive capacity by increasing headcount over the coming three months.
- The proportion of firms expecting to grow during the next twelve months stands at 61%, with a share of 11% expecting to grow rapidly. Important factors cited by firms as an impediment to growth include the domestic economy, weak consumer demand and once again, skills shortages.
- For the first time, credit has been reported as unaffordable by fewer than half (47%) of firms. Firms reporting credit as unavailable is slightly higher, at 52.5%, but still the lowest on record.

# UK macroeconomic overview

## UK economic growth moderating after rapid expansion over first half of 2014

During the second quarter of 2014, the UK economy grew by 0.8%, meaning that after six years it has finally surpassed the pre-crisis peak attained in Q1 2008. However, while growth remains robust, recent signs suggest that the rate of expansion may be cooling. So while many indicators have continued to show strong performance in the first half of the year, some degree of moderation has been observed in some of the most recent data. The Q2 output figures showed increases in the two main production and services categories, but a surprising fall in the construction sector. A further sign of easing came from June's production data, which showed growth of just 1.2%, the weakest for almost a year.

More timely data has showed a dip in confidence on August's YouGov/Cebr Consumer Confidence Index reading, which stood lower than seen in the previous three months. This chimed with the slowdown in retail growth and also in house price rises: while retail growth is supported by consumer confidence, house price rises creates confidence among consumers, so the movements in the three are linked. This means that the recovery will have to find momentum from elsewhere, as it has so far derived considerable impetus from the consumption side of the economy.

While there are signs of the economy cooling, the overall picture is still one of improvement. Unemployment has fallen to 6.4% in the April to June figures, the sixth consecutive monthly fall, as the economy has added 820,000 jobs compared to the same period a year ago. Of these, the majority had been looking for work, but 130,000 were new entrants to the labour force who had stopped actively trying to find a job. This suggests that the recovery has picked up enough to attract discouraged workers back to the labour force.

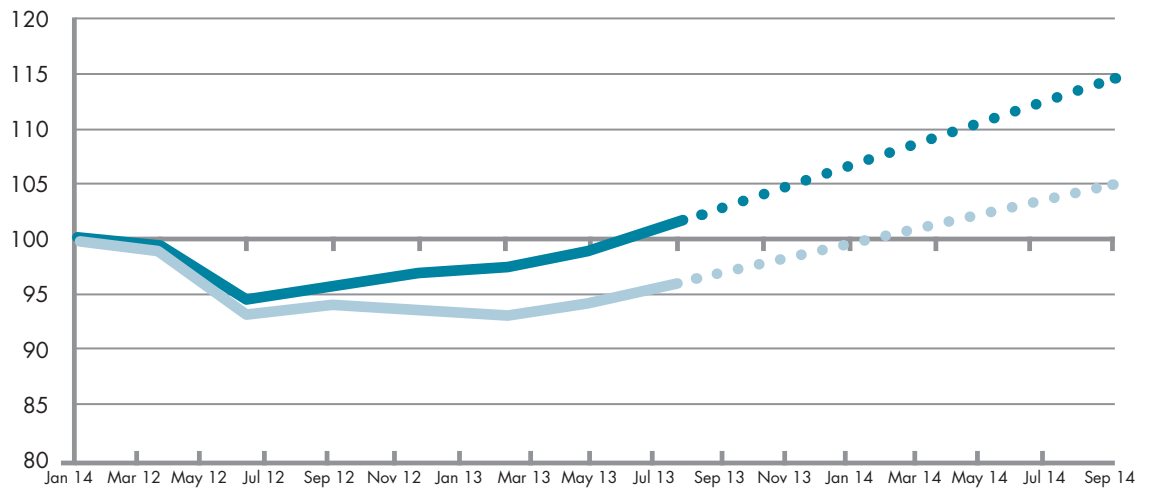
The Bank of England estimates that the amount of spare capacity has fallen marginally, and puts its latest August estimate at around 1%, down from the figure of between 1% and 1.5% estimated in May. Spare capacity has become an important factor guiding when to make the anticipated rate rise, which should raise the base rate from its record low of 0.5% at some point within the next 12 months.

The low base rate keeping the cost of credit down has been one of a range of factors controlling input prices for firms. Input inflation for manufacturers in particular is very low at the moment. The overall price index for manufacturers from the ONS, which measures materials and fuel inputs, fell by 7.3% in the year to July. Several factors have contributed to the fall, including weak growth in the Eurozone, low oil prices and a strong pound. For service firms, the most important cost is wages. Wage growth has been very weak, the most recent figures showing a 0.2% fall in wages over the year to the April to June period. Low real wage growth has been the weakest element of the recovery and may pose problems itself especially from a consumer spending point of view; however, its effect on firms is generally supportive of expansion as they benefit from low pay settlements.

Growth in the housing market appears to be slowing, a relief to policymakers who had been concerned about a bubble arising. The Office of National Statistics (ONS) index showed a small fall from 10.4% in May to 10.3% in June. Slower price growth is expected to emerge partly as a result of supply increases, as the stock of houses under construction comes onto the market. The Bank of England's Financial Policy Committee introduced a 'knockout clause' to control house price inflation should it start to pose a risk to financial stability, which is also a restraining factor. This limited the volume of loans that could be lent at multiples of income of 4.5 or higher.

In summary, economic sentiment is higher than last quarter and the recovery is continuing. But the indications are that overall growth has peaked, with some risks remaining for small businesses. Retail firms especially are vulnerable to slowing sales amid lacklustre wage gains constraining growth in disposable incomes, while businesses that have seen booming activity from the burgeoning housing market will find maintaining that growth more difficult. Overall, despite these notes of caution and as these latest results from the FSB show, small businesses remain optimistic about the economic outlook and growth, albeit at a lower pace, looks set to continue through to the end of the year and beyond.

**Figure 1:**  
**YouGov/Cebr**  
**Consumer Confidence**  
**Index (note: value of**  
**95.5 represents the**  
**average consumer**  
**confidence reading**  
**since the Index began**  
**in 2007)**



Source: YouGov/Cebr Consumer Confidence report August 2014

■ UK GDP      ■ UK GDP per capita

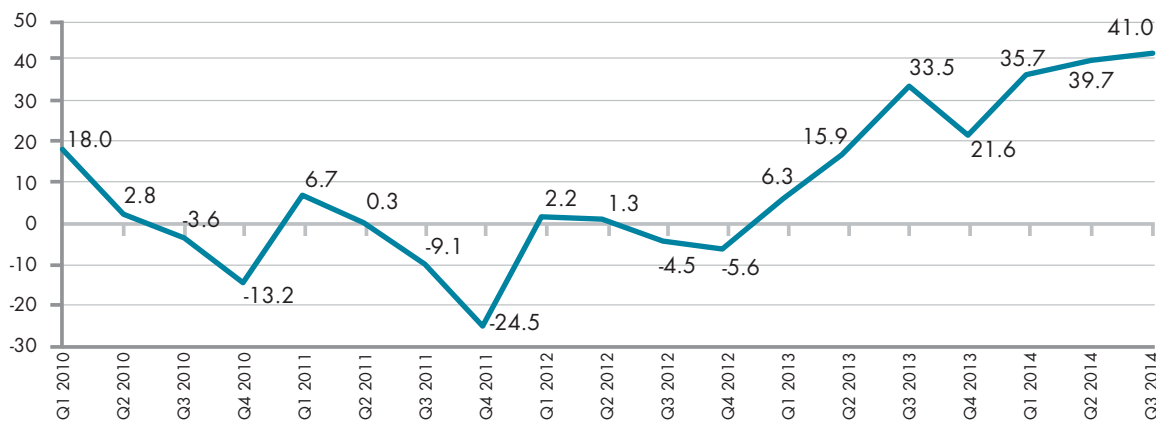


# Small Business Index

## Small business confidence reaches new highs

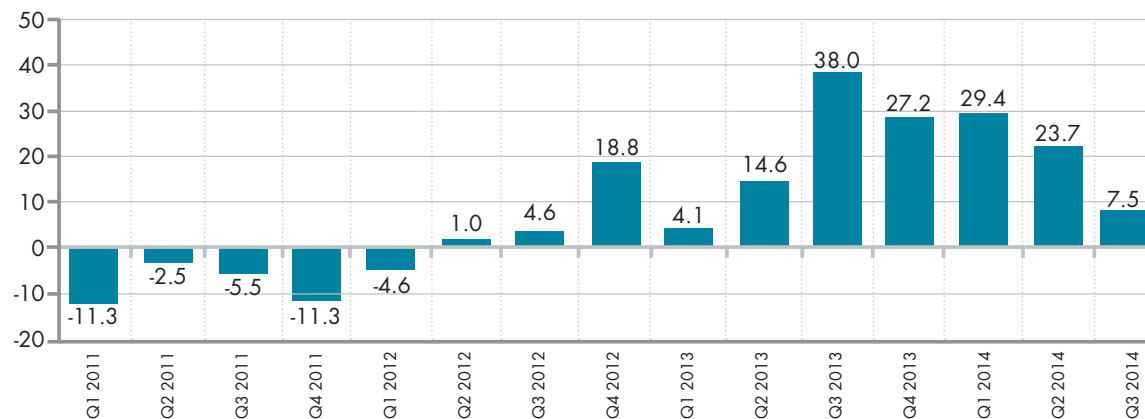
The SBI rose to +41 this quarter, its highest value since it was created in 2010. The Index measures confidence among small businesses, specifically the net balance between those firms that expect business conditions to improve and those who expect conditions to deteriorate over the next three months. Though the Index has reached a new high, it is notable that the pace of its rise has slowed: the most recent rise for Q3 is a modest +1.3 above Q2's score of +39.7. Moreover the size of the year-on-year rise is +7.5, significantly less than last quarter's gain of +23.7.

Of the firms surveyed, 48% expect conditions to be better over the next three months – the highest proportion recorded so far – while 14% expect a deterioration. This implies that the small business economy will continue to grow strongly over the next quarter, providing strong support to UK GDP throughout the second half of the year. The latest estimate of GDP found that the economy grew by 3.2% between Q2 2013 and Q2 2014, which puts 2014 on course to see the highest growth since 2008.



**Figure 2:** The FSB SBI<sup>1</sup>: small business prospects over coming three months

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



**Figure 3:** Year-on-year change in the FSB SBI

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

<sup>1</sup> The SBI 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 SBI is derived from the sum of these factors.

# Regional Small Business Indices

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Every region and nation has seen a significant improvement in their outlook over the 12 months.

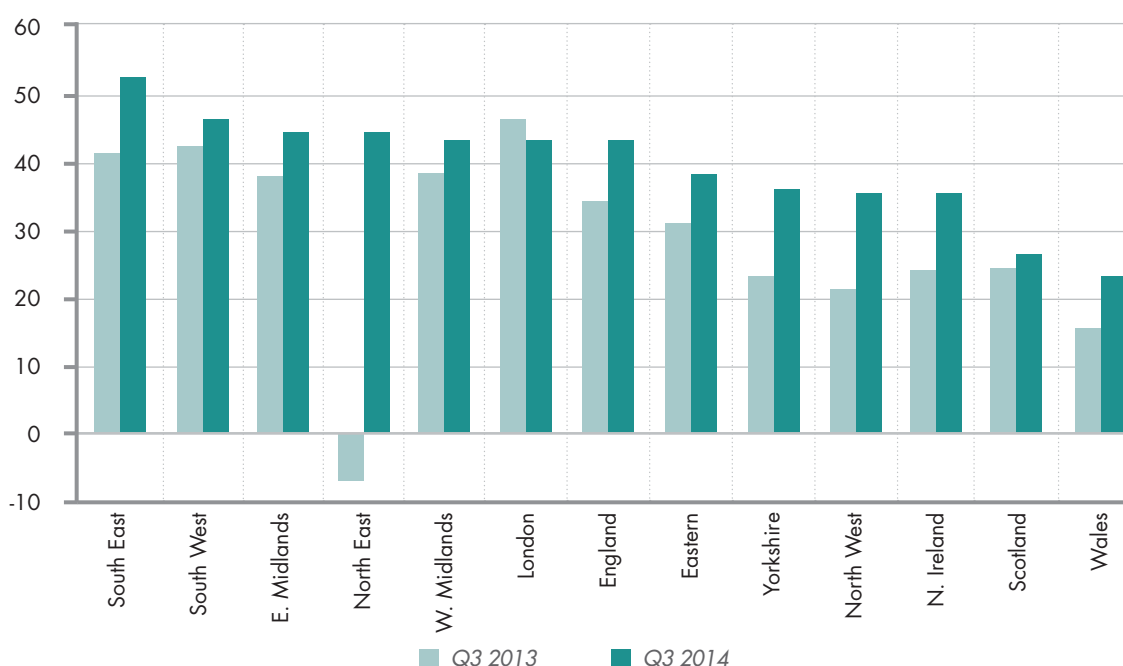
# Regional picture across the UK evens out

The latest SBI results highlight how the business environment is now improving around the whole of the UK. Every region and nation has seen a significant improvement in their outlook over the past year, with confidence levels well up in Q2 2014 on a year before.

The strongest confidence readings this quarter come from the North East. Positive readings from the region's small businesses are good news for the local economy and labour market in the coming months, as the region continues to have the highest unemployment rate of anywhere in the UK.

At the other end of the scale, confidence in Wales and the North West has also strengthened year-on-year, but remains below Index levels around the rest of the UK. While it is encouraging that business conditions look to be improving, Wales has generally had one of the lowest Index readings each quarter since the series began in 2010, and readings from the North West have been steadily slipping further behind other parts of the UK over the past few years.

The opposite is true for areas such as the South East and East of England, where confidence levels among small businesses have generally been higher than anywhere in the UK since the series began. For a long term recovery that is balanced between the South and the rest of the UK, a sustained uptick in business confidence in the North will be needed. However, regions in the North of England and the devolved nations may be disproportionately affected by government cutbacks in the coming years, a factor that will weigh down on the medium term outlook. The OBR projects that 700,000 government employees will be lost between 2013-14 and 2018-19 and regions such as Wales have the highest dependencies on public sector employment. Almost one in four workers in Wales in Q4 2013 (24%) were employed by the state, so a strong private sector performance will be needed to help offset cutbacks.



**Figure 4:**  
FSB SBI - regional variation in small business prospects over coming three months

# Sector Small Business Indices

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The financial services sector is the most optimistic about the coming three months.

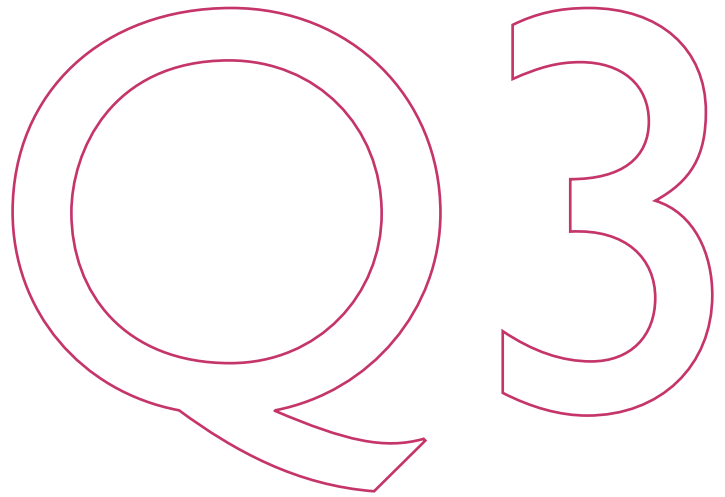
# Financial and business services leading optimism

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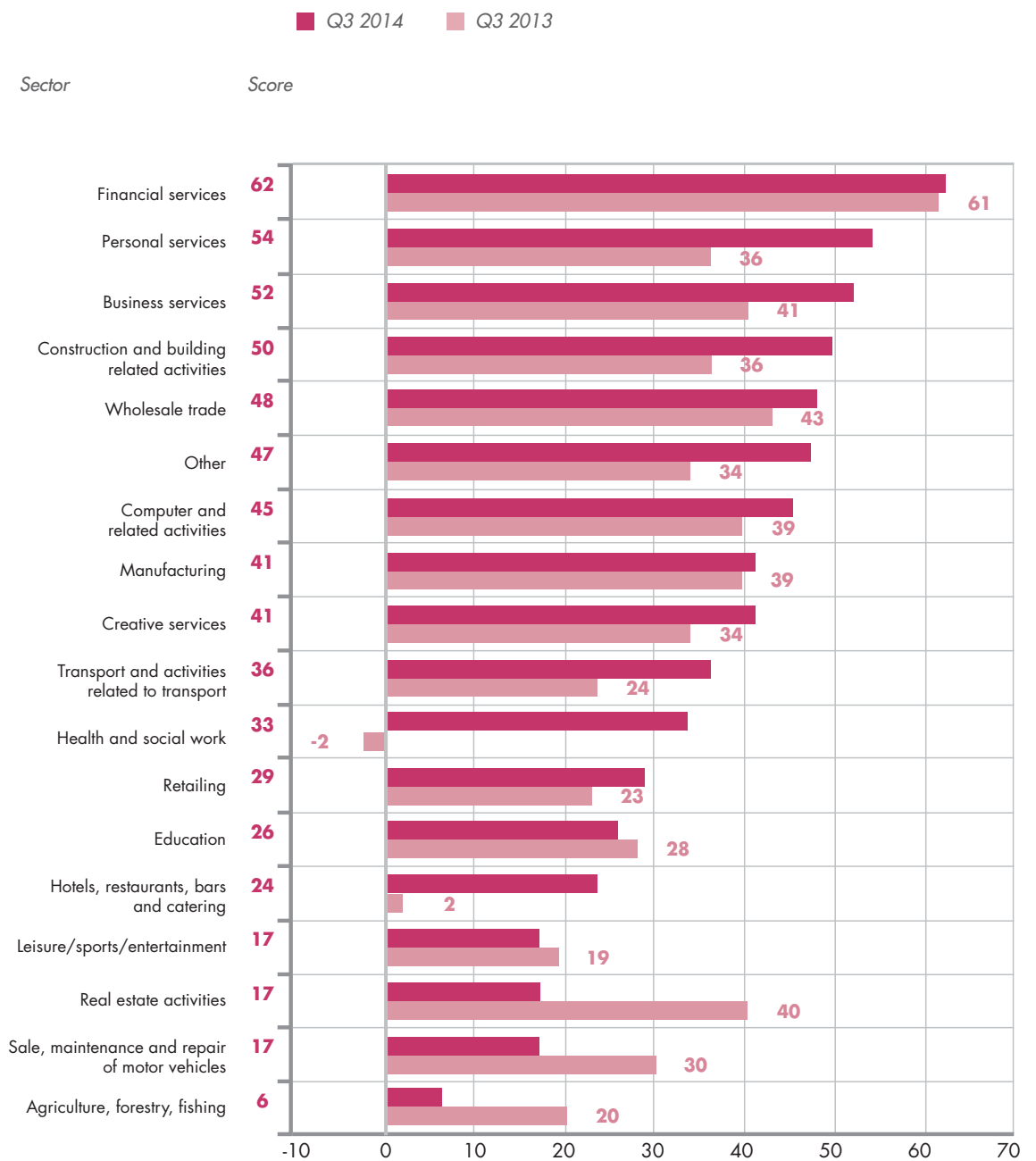
As it was at the same quarter last year, the financial services sector is the most optimistic about the coming three months, scoring +62 on the Index which is similar to levels seen a year ago. Business and personal services are the next ranked sectors, with manufacturing and construction also towards the upper end which is encouraging from the point of view of the overall balance of growth.

The sharply improved results over the past year for the personal services sector is particularly worthy of note. Although confidence among consumers appears to have plateaued in the latest readings, the level stands well above a year ago, boosted by stronger job security and house price gains. Such a gain is likely to have encouraged discretionary spending on personal services and in hotels and restaurants too, helping to support sentiment in these sectors.

Sectors that have seen declines include agriculture, automotives and the real estate sector. Real estate benefited from rapid house price growth in the early part of the recovery, but the market has begun to slow down in the latest readings, which is likely to have fed through into firms' confidence. As noted earlier, efforts have been made to cool increasingly unaffordable prices, including the Bank of England's Financial Policy Committee's move to limit the loan-to-income ratio among mortgages, will have lowered sentiment over the last quarter.



**Figure 5:**  
FSB SBI by sector  
– small business  
prospects over coming  
three months



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

# Revenue and profitability

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33% of businesses expect turnover growth in the next three months.

# More firms reporting turnover and profit growth

This quarter, a net balance of 20% of small businesses reported revenue growth over the past three months, while 8% of firms reported growth in profits. This profitability indicator has been on a general upward path since mid-2013, and is now the second consecutive quarter of a convincingly positive balance of firms reporting an increase in gross profits. However, a still worryingly low share of firms are seeing profits rising, highlighting the challenging conditions remaining in the economy and therefore the ability of small firms to increase their margins.

Companies are also optimistic about the quarter ahead, with a balance of 33% expecting turnover growth and 17% projecting an increase in profits. While small business optimism is encouraging, headwinds are likely to pick up in the coming months. The cooling of consumer confidence has already fed through into slower retail sales growth and could well start to put the brakes on more consumer-facing sectors over the short term, as household income growth continues to struggle to outpace inflation. As noted in the following section, weak export markets in the Eurozone are likely to have some impact too.

**Figure 6:**  
Small business revenue growth and gross profit, net percentage balance – share reporting increase less share reporting decrease



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



# Exports

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A net balance of 23% of firms expect the value of their products sold abroad to grow during the final quarter of 2014.

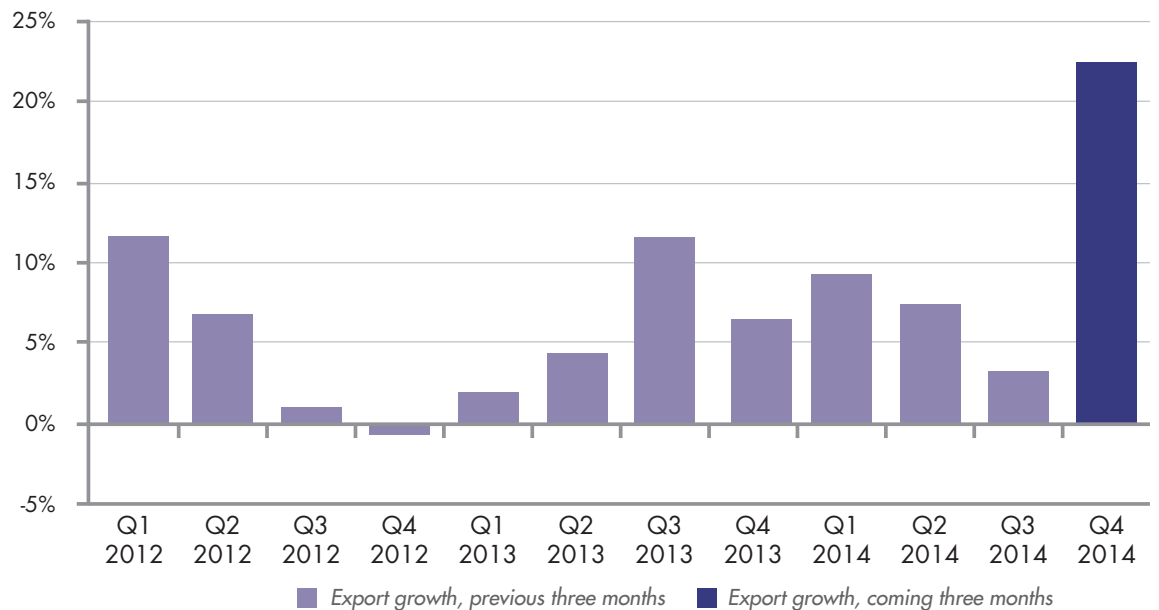
# Optimism on export growth despite recent slowdown

Although the balance of firms reporting growth in their exports has fallen since last quarter, there is still significant optimism regarding the next quarter. In the first quarter of the year, a net balance of 9% of firms reported increased values for export production, but the share has fallen since and a net balance of only 3% of firms experienced increased exports last quarter. Two main factors are likely to lie behind that trend.

First, a strengthening pound has eroded the competitiveness of British firms in international markets over the past year. The IMF warned at the end of July that sterling was overvalued, having risen 11% since a year ago against a trade-weighted basket of currencies. Second, the UK's largest export market, the Eurozone, has failed to start a sustained recovery since its debt crisis. The latest economic data from the Eurozone suggest that its stagnation is not yet at an end, with problems in the Ukraine adding to the negative outlook.

Nevertheless, despite these two factors that are likely to persist certainly in the near term, a net balance of 23% of firms expect the value of their products sold abroad to grow during the final quarter of 2014. If these expectations are realised it would be welcome news for overall UK economic growth, as the latest consensus forecasts compiled by HM Treasury show that net trade is only expected to make a marginal positive contribution to GDP over 2014 and 2015.

**Figure 7:** Changes in exports – previous three months and expectations for coming three months; net percentage balance, share reporting increase less share reporting decrease



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

# Costs and inflation

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23% of small firms report rent as a major driver of cost increases, the highest seen since the series began.

# Inflationary pressures continue to fall back

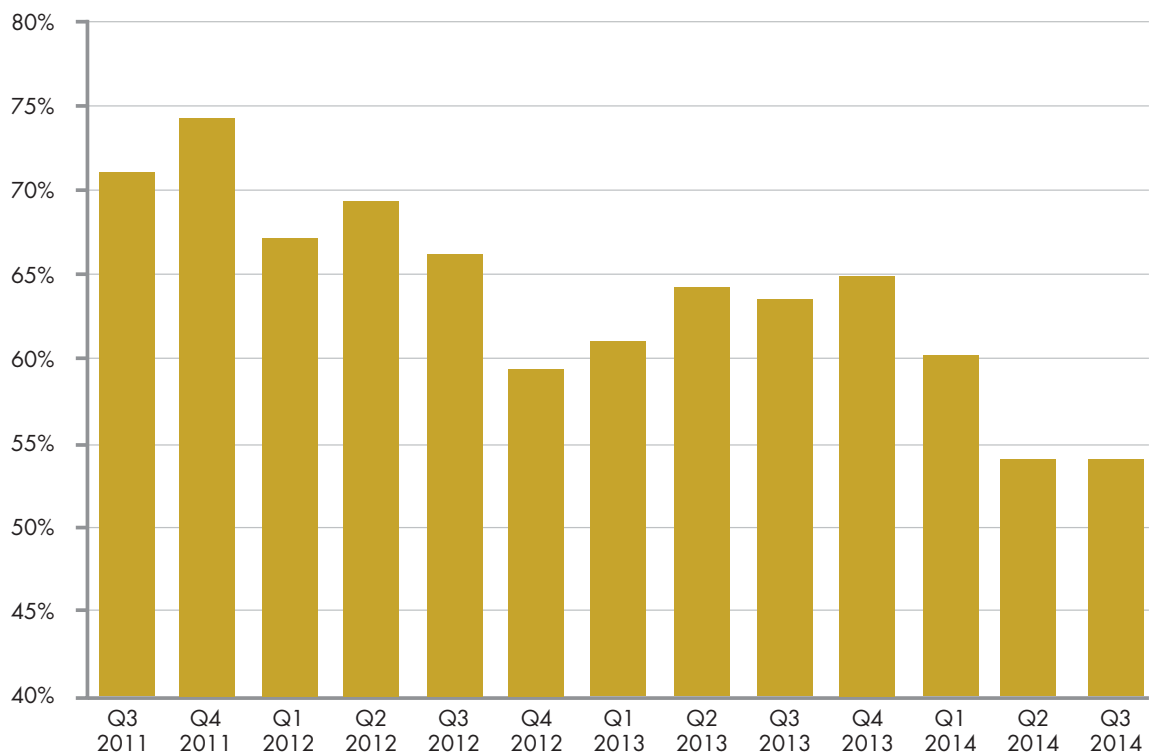
The balance of small businesses reporting an increase in their operating costs remains broadly unchanged since last quarter, at 54%, but well down from the 61% reporting the same in Q3 2013. This chimes with evidence from the ONS on easing business cost inflation. The latest figures from the Producer Price Index show that input prices for manufacturers fell back year on year by 7.3% in July, as cooling global commodity prices and strength in Sterling has helped to reduce the cost of imported raw materials. This is reflected in these 'Voice of Small Business' findings, which encouragingly show a falling share of businesses reporting utilities, fuel and physical inputs as main drivers of cost increases. In addition, with the recent strengthening of the pound, just 4% of small firms report the exchange rate as a driver of cost growth, compared with 10% at the same time a year before.

However, one factor that has increased as a concern for businesses is the cost of labour. This quarter, 45% of

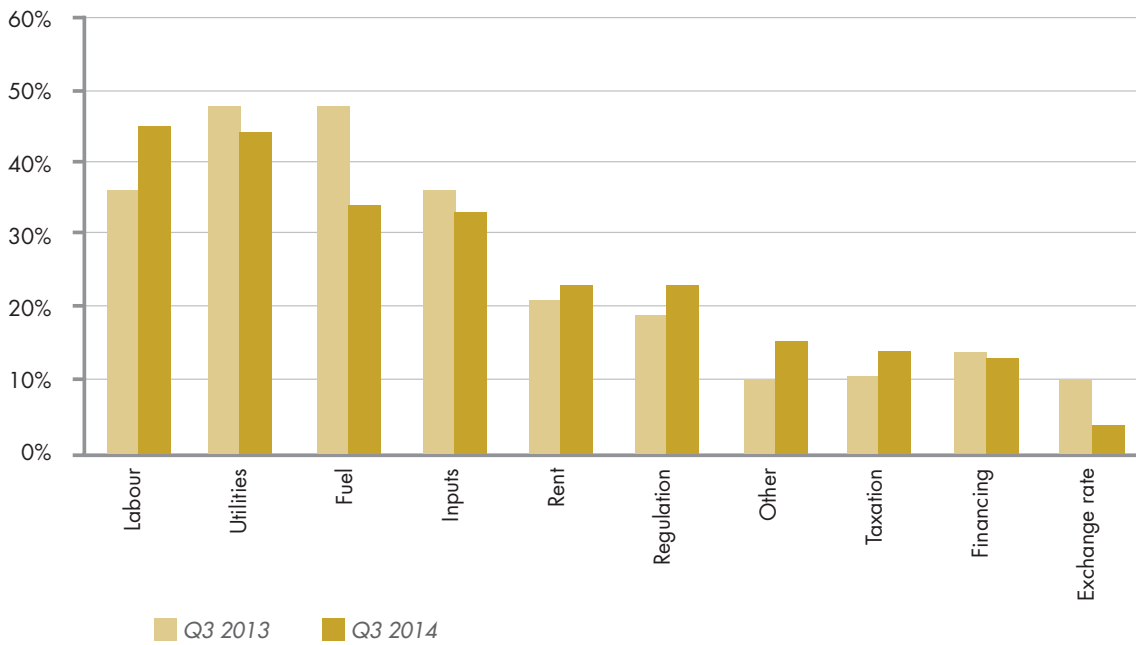
businesses report wages as a driver of cost increases, up from 36% in Q3 2013. Although overall pay growth in the UK remains particularly weak according to the ONS, these latest findings suggest that for the small business economy at least, pay growth is becoming more of an issue.

A further source of inflation for businesses this quarter is rent. The 23% of small businesses reporting this as a main driver of cost increase is the highest since the series began in 2011. As the economy continues to recover, what is likely to lie behind the increase is a greater premium being placed on office space and other business premises; and against the positive economic backdrop and tightening supply of premium premises, landlords being more bullish in their rental demands. Evidence of this is given by the CBRE prime commercial property rent monitor, which showed a 1.8% year on year increase in July 2014, a steady upward growth trend from the annual declines seen before mid-2013.

**Figure 8:**  
Small businesses reporting an increase in overall cost of operation; net percentage balance



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



**Figure 9:**  
Main causes for  
changing business  
costs (firms may  
give multiple  
answers)

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

# Capacity

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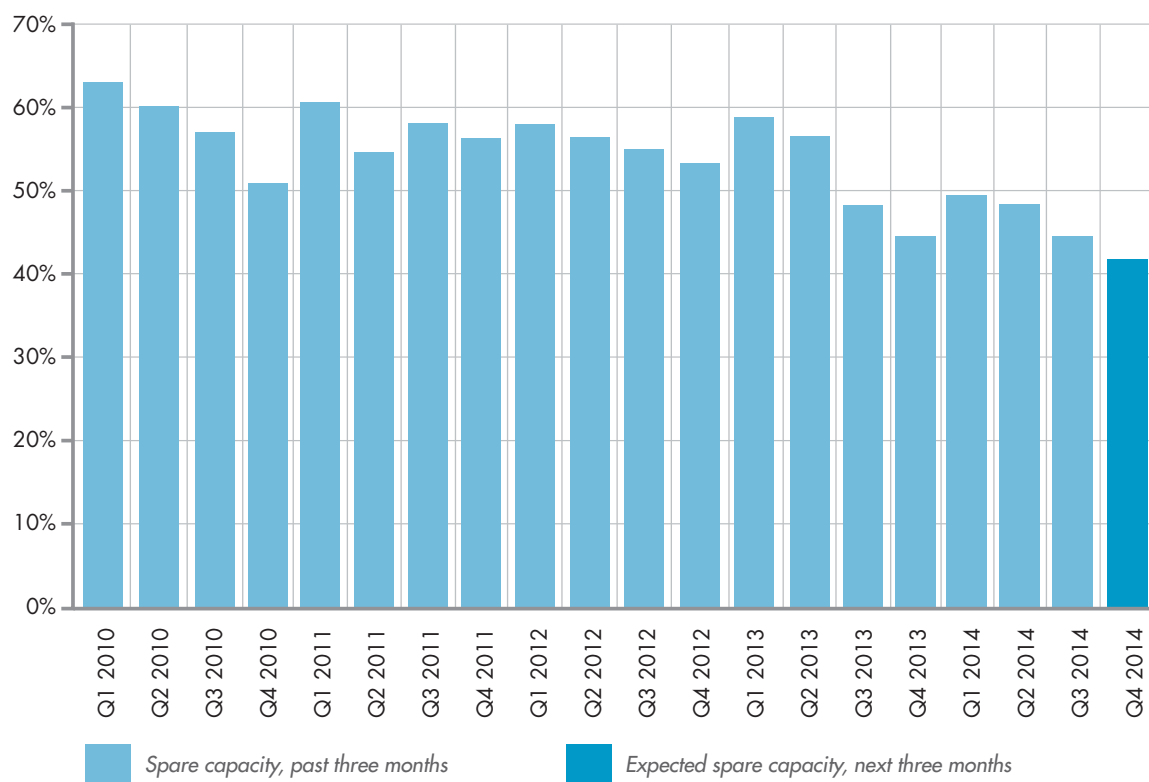
A net balance of 42% of firms expects to run below capacity over the next quarter, continuing the recent downward trend.

# Spare capacity continues to slowly diminish

This quarter, 58% of firms were running below capacity, while 12% reported operating above capacity. This gives an overall net balance of 46% of small businesses with spare capacity, a drop of just one percentage point from the previous quarter and down from 49% in Q3 2013.

In addition, a net balance of 42% of firms expects to run below capacity over the next quarter, continuing the recent downward trend. These latest figures highlight how the strengthening economy is gradually employing more of its under-utilised resources, and comes after the

Bank of England revised down their estimates of how far the economy is below full capacity. The estimate from August's Inflation Report stood at 1%, down from "between 1 and 1.5%" in May's edition. Although the Monetary Policy Committee is now considering wage growth and the international economic environment as indicators for when to raise interest rates, the fact that spare capacity is on the way down suggests that the need for a rate rise is drawing closer.



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

# Employment

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Over the past three months, a net balance of 5% of firms increased their number of employees.

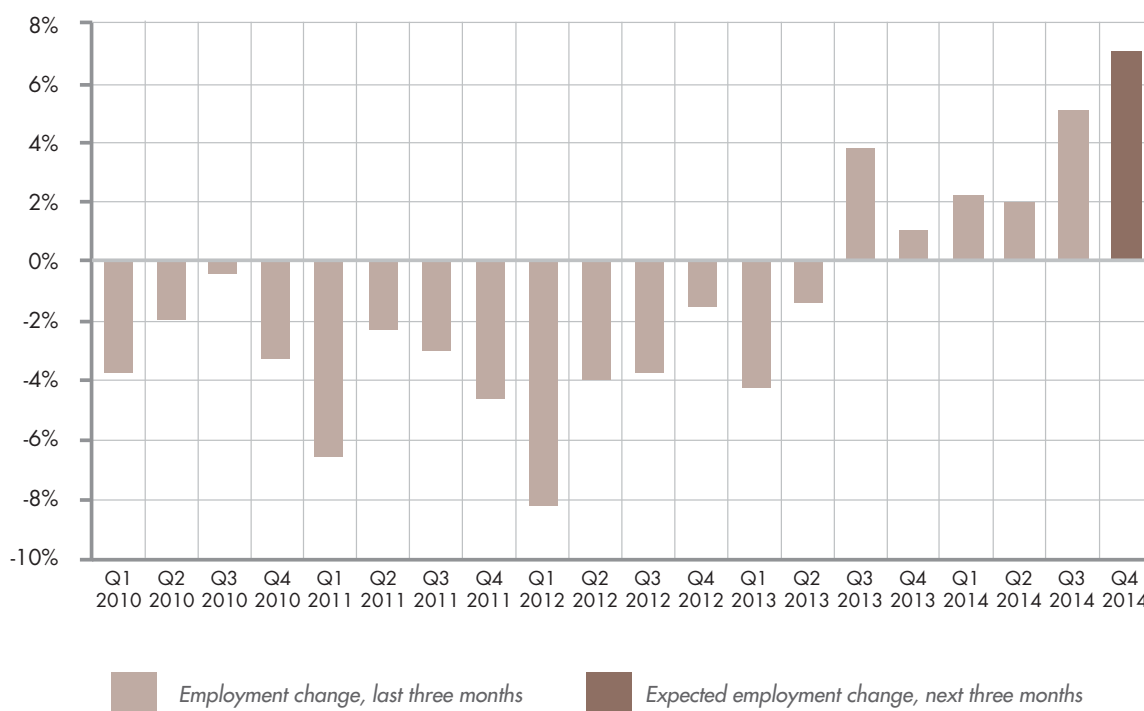


# Record number of small firms have increased headcounts

Over the past three months, a net balance of 5% of firms increased their number of employees. This is the largest increase in the history of the index and reflects the strong growth in employment seen throughout the economy. The second quarter of 2014 saw 167,000 more jobs in the economy compared to the quarter before, and after six consecutive monthly falls the unemployment rate fell to 6.4% during the April to June period – the lowest since late 2008.

Over the next three months, the trend looks set to continue with a further balance of 7% of small businesses expecting to increase their headcount. Again, these figures chime with wider forecasts of a continued fall in

unemployment and should provide encouragement to policymakers. However, living standards are one area of the economy that has notably struggled to recover, despite significant gains to GDP, with weak wage growth reported again in the results below. Underemployment remains fairly widespread in the labour market, as 16.6% of people working part time are only doing so because they cannot find a job with longer hours. This is well above pre-financial crisis levels of around 8%. With small businesses planning to create further employment over the next quarter, more people should be lifted out of underemployment or out of unemployment altogether, helping to raise household spending power.



**Figure 11:** Net percentage balance change in number of people employed – share reporting increase less share reporting decrease

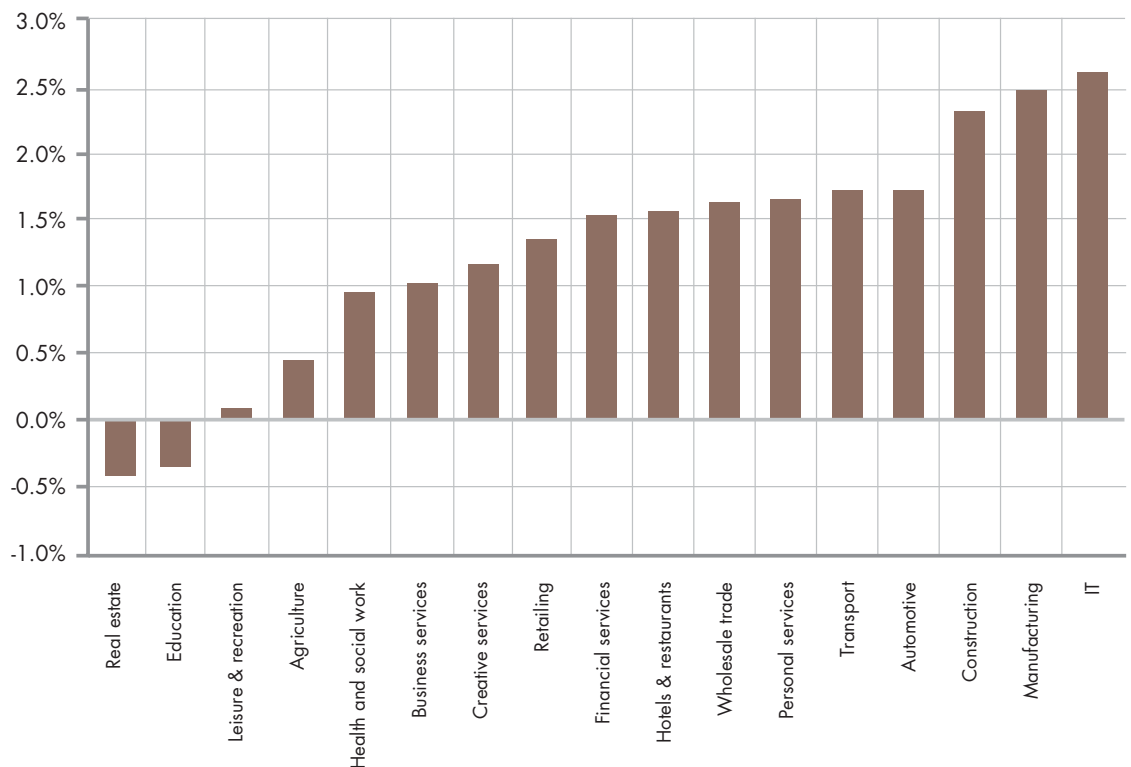
Source: FSB-Verve 'Voice of Small Business' Survey

# Wage growth highest in small manufacturing, construction and IT firms

Construction, IT and manufacturing are three of the sectors with greatest share of small firms reporting that skills shortages are a barrier to growth. As such, the wage bargaining power of those with the right experience is heightened, and this appears to be feeding through into average salary growth seen in these results, albeit at modest levels. In the IT sector, small firms report pay increasing on average by 2.6% over the past year, while those in manufacturing and construction have seen wages rise by 2.4% and 2.3% respectively. Manufacturers and IT firms expect this trend to continue over the coming year as well, as business conditions remain strong and over the short term, the supply of labour with the right skills remaining tight.

At the other end of the scale however, pay conditions appear constrained in the real estate and education sectors. Although the housing market has picked up significantly during 2014, more than one in ten (12%) small real estate firms report that salaries fell on average by more than 10% year-on-year. Small businesses in the private education sector may be being constrained by public austerity measures, a factor that may be affecting their pay settlements.

**Figure 12:**  
Average salary increase awarded, this quarter versus a year before



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

# Growth aspirations and challenges

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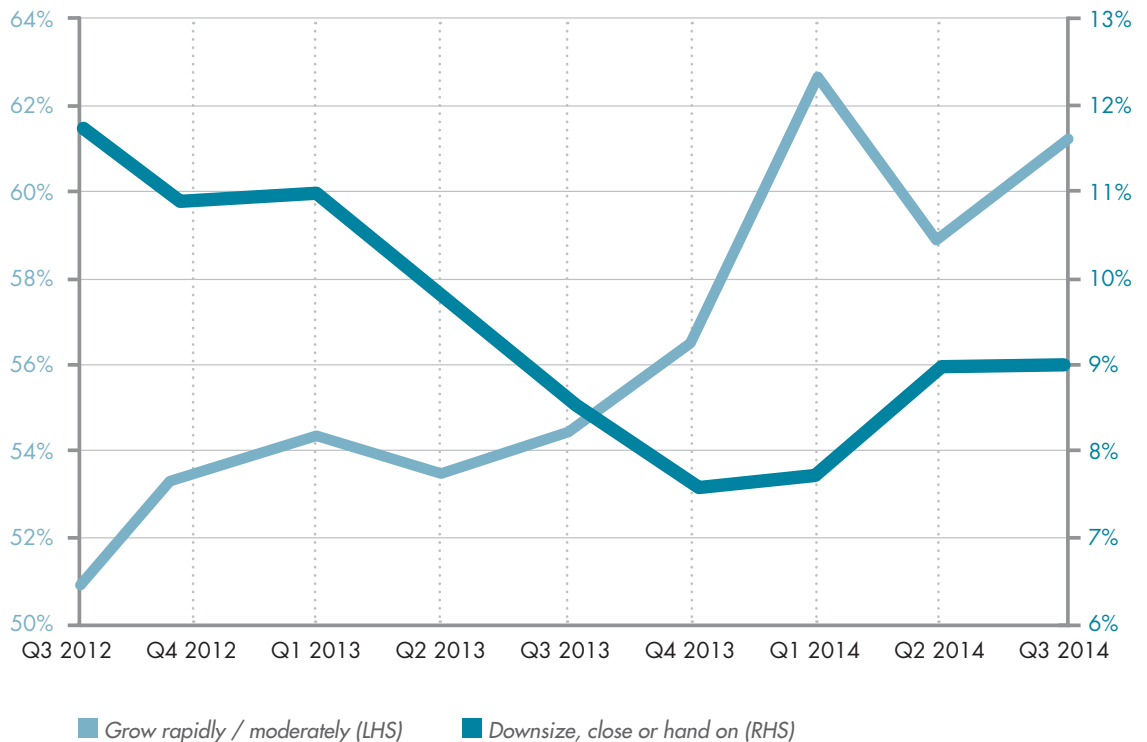
The lack of appropriately skilled staff remains a barrier for a significant proportion (29%) of firms surveyed.

# Aspirations cool, though still more buoyant than a year ago

After experiencing a dip last quarter, small business aspirations have increased again this quarter. The proportion expecting to grow rapidly or moderately over the next 12 months has risen by two percentage points from 59% to 61%, while the those expecting to downsize, close or hand-on their business was broadly unchanged at 9%. While sentiment among the businesses surveyed is therefore down from its peak in Q1 2014, it is still significantly above that seen in the same period a year ago. Only 54% of firms were expecting rapid growth in that period, while the proportion of firms expecting to downsize, close or hand on their business was around the same at 8%.

The proportion expecting to grow rapidly has not been higher than the current 11% reporting this aspiration since the series began in 2012. Health and social work and business services are the sectors with the highest proportions of firms in the rapid growth category, with 21% and 18% respectively. Within the computer and related services sector, 88% of firms expected to grow, the largest net balance for any sector.

**Figure 13:**  
Growth aspirations for next 12 months



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

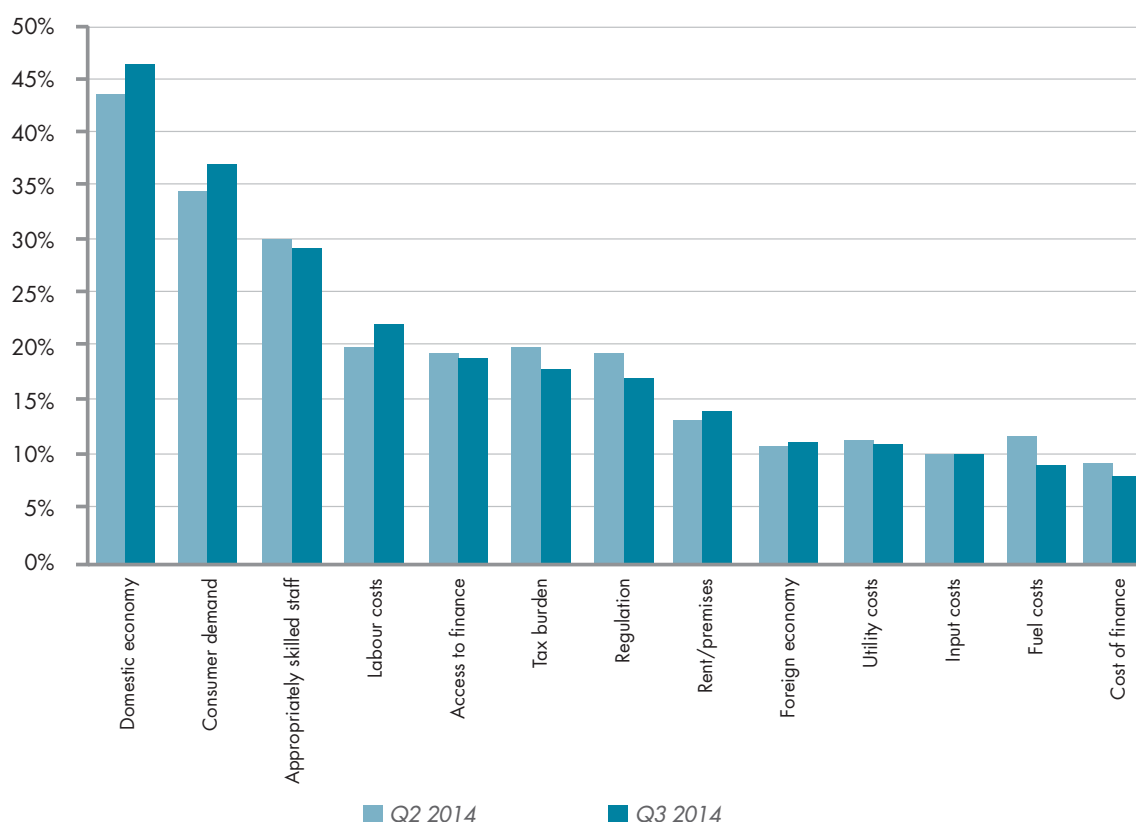
# Skills shortages continue to affect certain sectors

As with previous quarters, the domestic economy and subdued consumer demand continue to be the most important barriers to small business growth, with 46% and 37% respectively of small businesses reporting these as their most important challenges. This indicates that though the economy is improving and firms' optimism is increasing in general, many firms are still to see the improvement in the economy feeding through into demand for their particular products and services.

As noted in previous surveys, the lack of appropriately skilled staff remains a barrier for a significant proportion (29%) of firms surveyed. Shortages vary considerably across sectors, from just 16% in retailing to 45% in transport and related activities. For computer and related services, 35% of firms in the sector have reported this as a barrier, while it affects 42% of firms in health and social

work and 43% of firms in construction. This demonstrates that matching the needs of businesses with the skills of workers remains an ongoing challenge to the economy, in particular providing school leavers with a firm grounding in STEM subjects (science, technology, engineering and maths) and certain technical occupations. For instance, a recent survey of construction companies found that 54% of UK respondents state that there are insufficient numbers of quantity surveyors in the second quarter of 2014, compared to 41% in the first quarter.

Among the less-cited factors, and confirming results noted earlier around cost pressures, fuel costs have eased as a barrier to growth, the proportion falling from 12% to 9%. As looked at in more detail in the following section, the cost of finance has also diminished slightly as a barrier to growth.



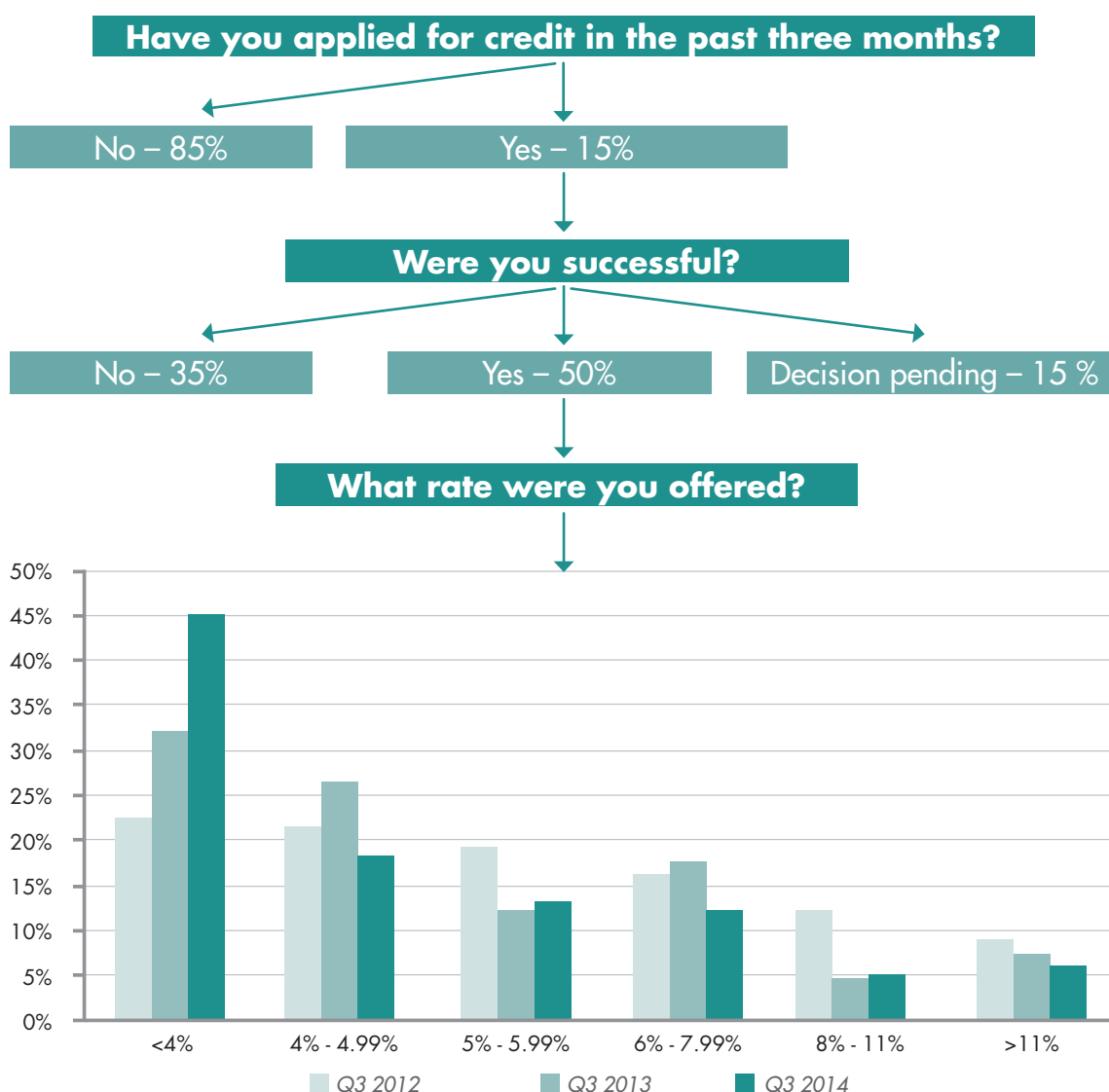
**Figure 14:** Possible barriers to achieving growth aspirations – multiple answers possible

# Credit

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This quarter, just 15% of small firms had applied for bank credit, compared to 22% at the same point 12 months ago.

# Credit conditions easing for small businesses



**Figure 15:** Credit applications and interest rates offered

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

This quarter, there is increasing evidence that the credit environment for small businesses continues to improve. One in every two (50%) applicants for a loan are now reporting success, up from 47% last quarter and just 41% a year ago. This is now the highest rate since comparable data began, at the start of 2012. In addition, for successful applicants, credit continues to get cheaper, which is likely to be a result of the impact of Funding

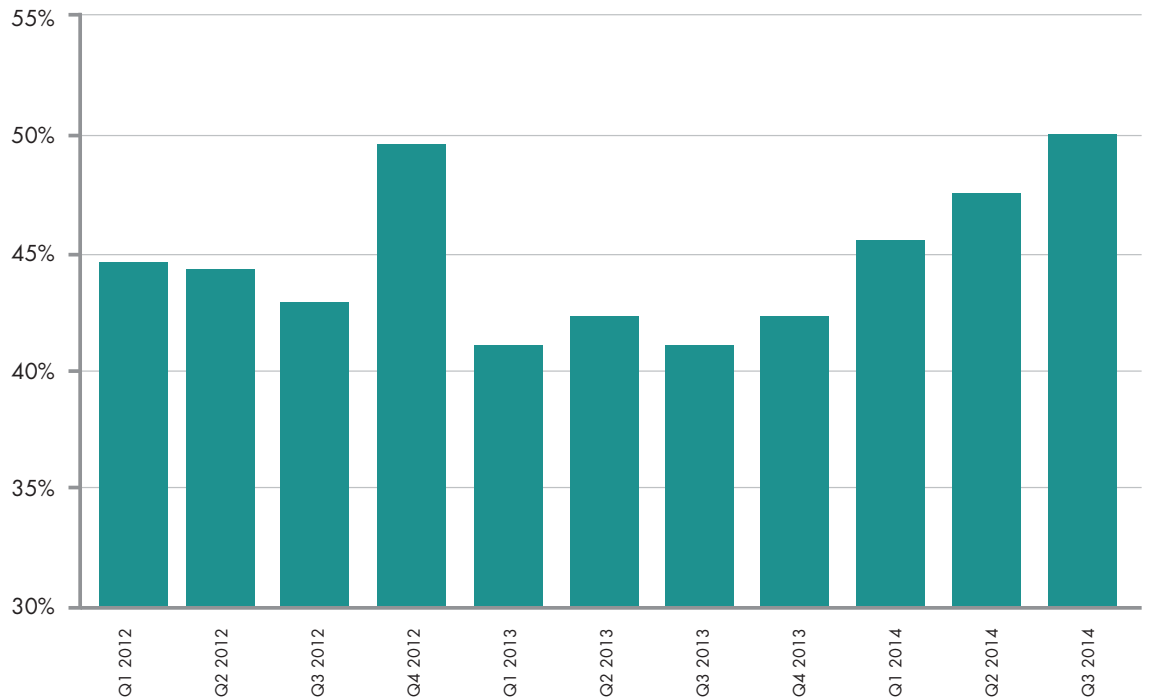
for Lending Scheme (FLS). This quarter, 45% of firms that were approved a loan were offered an interest rate of 4% or less, well up from the same point a year ago and in 2012. At the other end of the scale, now just over one in twenty small businesses (6%) that were granted a loan were offered a rate of 11% or over, down from 9% two years ago.



At the same time though, fewer businesses are reporting applying for credit at all. This quarter, just 15% of small firms had applied for bank credit, compared to 22% at the same point 12 months ago. This finding, in conjunction with the significantly lower average rates being offered, could well be indicative of the strengthening business environment, as fewer firms are finding themselves requiring emergency overdrafts and short term loans to

stem cash flow issues, rather than falling demand for finance to fund investment. Indeed, the latest Bank of England Credit Conditions Survey suggests that overall demand for credit among small businesses is on the up. Though the overall volumes in the market remain small, it could also indicate that firms are looking to non-bank sources of finance such as peer-to-peer providers to meet their needs.

**Figure 16:**  
Proportion of small businesses successful in bank credit (e.g. loan or overdraft) applications in the past three months



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

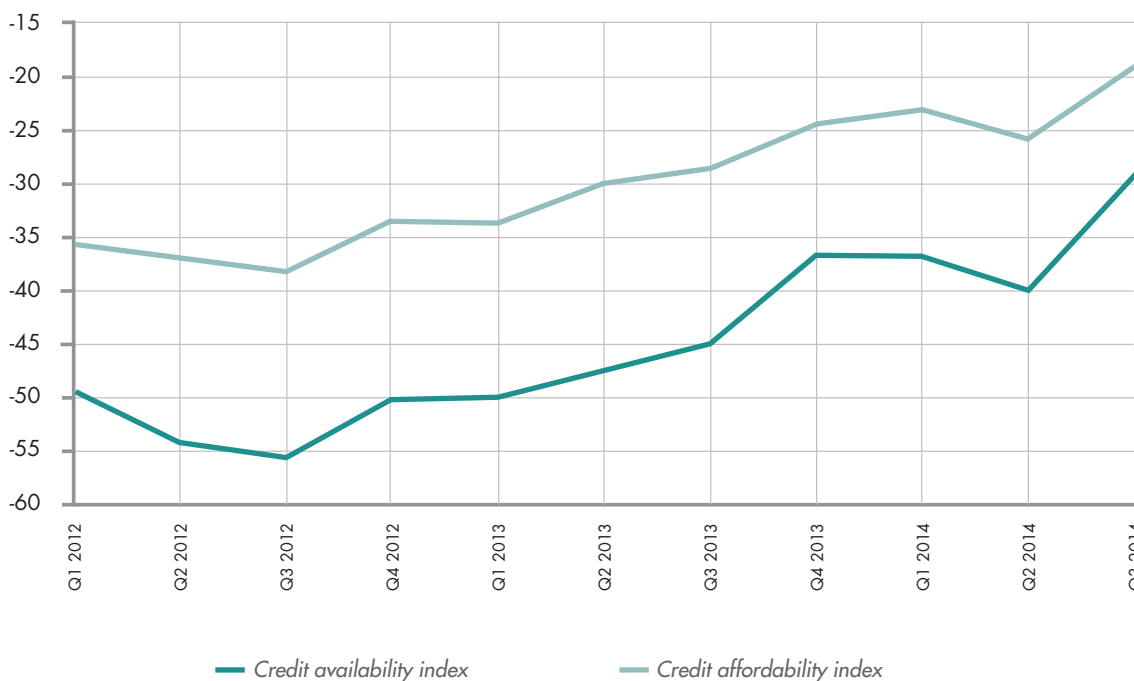


# Credit affordability and availability strongest on record

A further indication of the improvements to the lending environment comes from the latest results of the FSB Small Business Credit Availability and Credit Affordability Indices. This quarter's readings are both the strongest since the series began at the start of 2012.

Fewer than half of small firms (47%) now rate credit as being unaffordable for the first time since the results began, while the share of those reporting credit as

unavailable has fallen to its lowest on record (52.5%). Just one in four firms (24.8%) find that the availability of credit is 'very poor' now, well down from 44.6% two years ago. These results follow general improving trends over the past two years as the financial crisis has fallen further into the rearview mirror, suggesting that cost barriers to investment spending are slowly being removed, in part aided by Government initiatives such as FLS noted earlier.



**Figure 17:** 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' Survey

# Investment

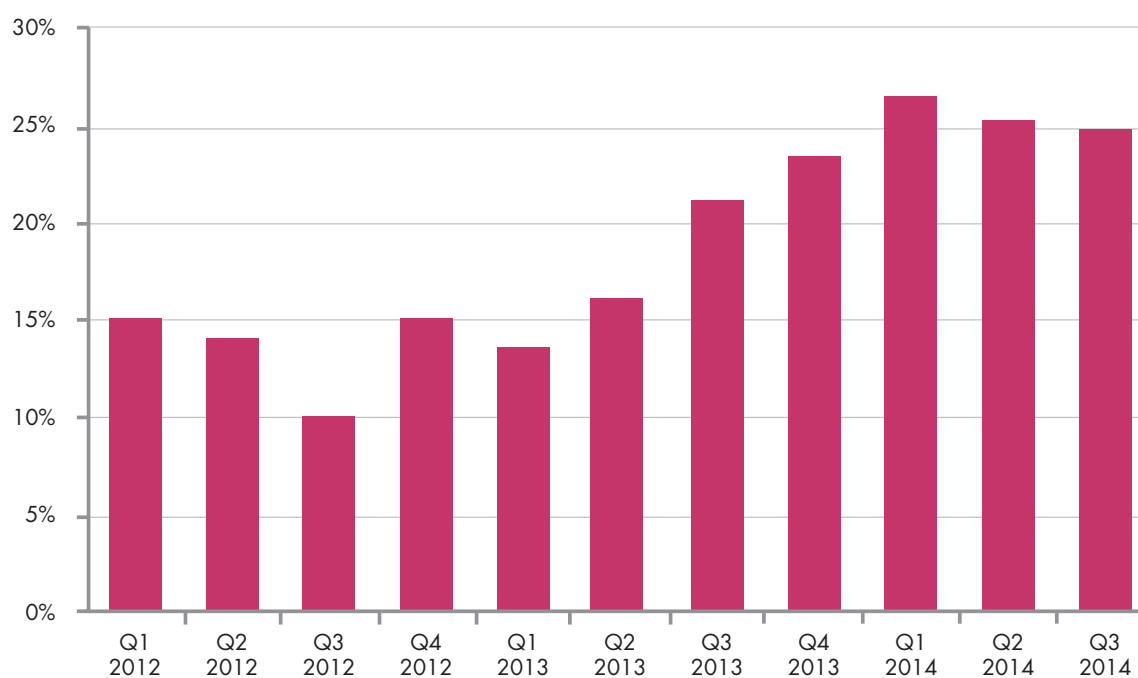
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This quarter, 25% of companies expect to increase investment.

# Investment intentions remain strong

In line with small business expectations for the growth environment, a stable share of firms report they anticipate increasing capital investment over the next 12 months. This quarter, 25% of companies expect to increase investment, broadly in line with results from the previous two quarters. These findings also corroborate those of the Bank of England's Credit Conditions Survey suggesting that greater overall demand for credit is likely, with more investment expected over the coming year.

After a long period of consumer spending being the main driver of UK economic growth, capital expenditure is now starting to have more weight in growth. In Q1 2014, business investment contributed 0.4 percentage points to quarter-on-quarter growth, significantly above that seen in recent quarters. The latest findings from the SBI suggest that this trend could well continue into the GDP readings for the rest of 2014.



**Figure 18:**  
Net percentage balance in anticipated capital investment growth over next 12 months – share reporting increase less share reporting decrease

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

# Method

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This report is based on the August 2014 research survey of FSB members carried out by Verve. All panel members (7,372) were invited to take part in an online survey. Reminders were sent to all non-respondents. 2,137 responses were received, a response rate of 29%. The data is weighted by regional gross value added to match the profile of small businesses across the UK and this accounts for the slight variation in results from previous FSB 'Voice of Small Business' panel surveys. The survey was undertaken between 30th July and 13th August 2014.

# Summary data table

	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014
Small Business Index	4.5	5.6	6.3	+15.9	+33.5	+21.6	+35.7	+39.7	+41
Employment - previous three months	-3.7%	-1.5%	-4.2%	-1.4%	3.7%	1%	2.1%	2%	+5%
Employment - coming three months	-0.4%	0%	0.8%	+4.8%	5.8%	3.1%	7.6%	10.5%	+7%
Revenue - previous three months	-6.5%	-3.5%	-7.2%	-0.4%	12.8%	18.8%	13.1%	18.1%	+20%
Revenue - coming three months	-4.4%	-3.4%	5.7%	11.3%	20.1%	16.2%	26.5%	29.6%	+33%
Investment intentions – coming 12 months	9.9%	15.1%	13%	15.8%	21.1%	23.2%	26.6%	25.6%	+25%
Credit availability – rated good or very good	6.9%	8%	9%	9.7%	12.4%	12.7%	13.5%	12.5%	17%
Credit availability – rated poor or very poor	74.7%	68.2%	71.1%	67.5%	65.9%	58.3%	58.5%	60.9%	52%
Credit affordability – rated good or very good	10.9%	14.4%	13.8%	14.1%	19%	18.1%	19.2%	18%	22%
Credit affordability – rated poor or very poor	61.9%	58.5%	59.7%	54.8%	55%	50.7%	49.8%	51.1%	47%

The SBI 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



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