



Federation of Small Businesses

The UK's Leading Business Organisation

FSB Voice of Small Business Index

John Walker, FSB National Chairman

It is no surprise that it has been a difficult start to the year for small businesses. In the run up to the General Election small businesses continue to struggle with the economic conditions in the UK. The Federation of Small Businesses (FSB) is concerned that a majority of small firms up and down the UK are running their businesses below capacity.

The rise in unemployment between December and February is reflected in the drop in employment small businesses have seen in the last three months. The recovery of our economy is fragile and the tentative signs of predicted growth in the next six months with 12% of businesses looking to increase employment, contrasts with the large number of businesses that continue to operate below capacity. The FSB advocates a policy to give existing small businesses a NICs holiday for the first four employees they take on in the next financial year.

With the General Election just weeks away, it is the economy and ensuring that small businesses are able to grow and flourish in the UK, that should be at the heart of every election promise.

Economist's View – Charles Davis, Senior Economist, cebr

The FSB Voice of Small Business Index¹ provides further evidence that the UK economic recovery is continuing, but also illustrates that the economy is running far below capacity and that the recovery is still at a fragile, early stage. While the results show small businesses expect performance to improve over the next three months – with businesses more confident about overall business prospects and revenue growth performance – the clear majority of small businesses are still running below capacity and keeping employment plans on hold.

Overall, the results probably fit with economic growth in the first quarter of 2010 of around 0.4% and point towards a possible acceleration in the second quarter. However, the results also show that it is a mixed picture and that talk of labour market stabilisation may be premature, as job creation from the small businesses that employ some 58% of the private sector workforce still looks relatively weak. The Bank of England has discussed the role that spare capacity will play in helping to bring down the annual rate of inflation through 2010; the FSB survey implies that there are still likely to be downward pressure on prices as 70% of businesses tick over below capacity.

¹ This report is based on the March 2010 FSB-ICM 'Voice of Small Business' Panel survey of FSB members. All panel members (3,952) were invited to take part in an online survey. Reminders were sent to all non-respondents. 1,418 responses were received, a response rate of 36%. Fieldwork took place between 18-31 March 2010. Data has been weighted to the profile of the FSB Membership.

KEY FINDINGS THIS QUARTER:

- The majority of businesses are operating below capacity – seven in ten firms operated below capacity in the three months to March and 57% of businesses expect to be below capacity in the next three months.
- Employment intentions are still muted; most businesses are keeping headcount on hold for now; there was a net decline in employment in the three months to March although firms expect a net expansion in workforces over the next three months.
- Businesses expect performance to improve over the next quarter but recovery is still finely balanced.
- Sales growth was weak still relatively over the last quarter, with more than two fifths of businesses reporting declines in revenue.

The key variable ahead of course is the General Election and how the Government of the day will deal with the enormous public sector deficit. Financial markets and businesses of all sizes need to see a credible plan for reducing the deficit that does not rely on over-optimistic assumptions about economic growth in the next few years. Whatever happens, the next Parliament will have to see a record consolidation of the public finances. Crucial for small businesses will be whether this occurs through public spending cuts or tax rises; the extent to which the latter can be limited will provide the best situation for the engine room of the United Kingdom economy to drive growth forward, creating jobs, prosperity and tax revenue for the public sector.

The election outcome appears too close to call, with a marginal Conservative majority and hung parliament both eminently possible. But with the private sector recovery still fragile, we expect the Bank of England will keep interest rates low into 2011 and extend quantitative easing if the next government tightens fiscal policy aggressively. There are short term risks to the inflation outlook, as illustrated by the rise in consumer price inflation to 3.4% in March, stemming largely from commodity prices and the effects of sterling depreciation. However, earnings growth remains muted and it is clear that most businesses are still operating far below capacity, so inflation should fall back through 2010 allowing the Monetary Policy Committee to keep interest rates on hold for a while longer. The key risk would come from a further depreciation in sterling if there was post-election policy ambiguity.

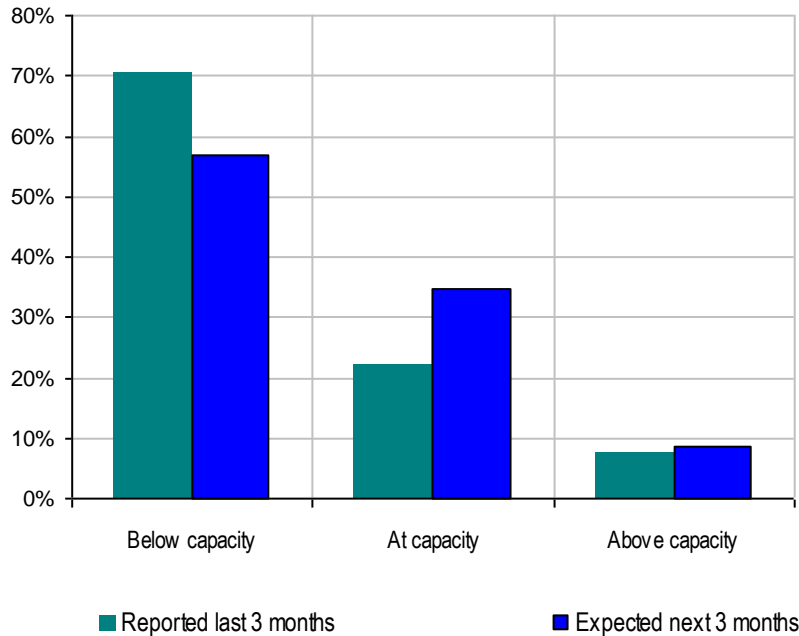
UK economy running below capacity

While there are signs of improvement in the UK economy, the FSB Voice of Small Business Index shows that the depth of the recession has left the majority of small businesses running below capacity. Over the three months to March, seven in ten small businesses reported operating below capacity. Just 22% were running at capacity and only 8% above capacity.

This reflects the depressed level of economic activity across the UK economy; although the economy grew by 0.4% in the final quarter of 2009, economic output is still some 5.8% lower than pre-recession levels.

Reflecting the general trend towards continued, steady recovery in the UK economy, 14% fewer businesses expect to be operating below capacity in the next three months than were in the previous quarter. Overall, 35% of businesses expect to operate at capacity in the next three months as demand improves. However, with just 9% of businesses expecting to operate above capacity, there is little doubt that considerable spare capacity remains in the United Kingdom economy at present and still demand has a long way to recover.

Figure1: Small businesses currently operating at, below or above capacity



Source: FSB-ICM 'Voice of Small Business' Panel Survey (March 2010)
Questions asked : Over the last three months, has your business been running at capacity or above or below capacity?
Over the next three months, do you expect your business to be running at capacity or above or below capacity?

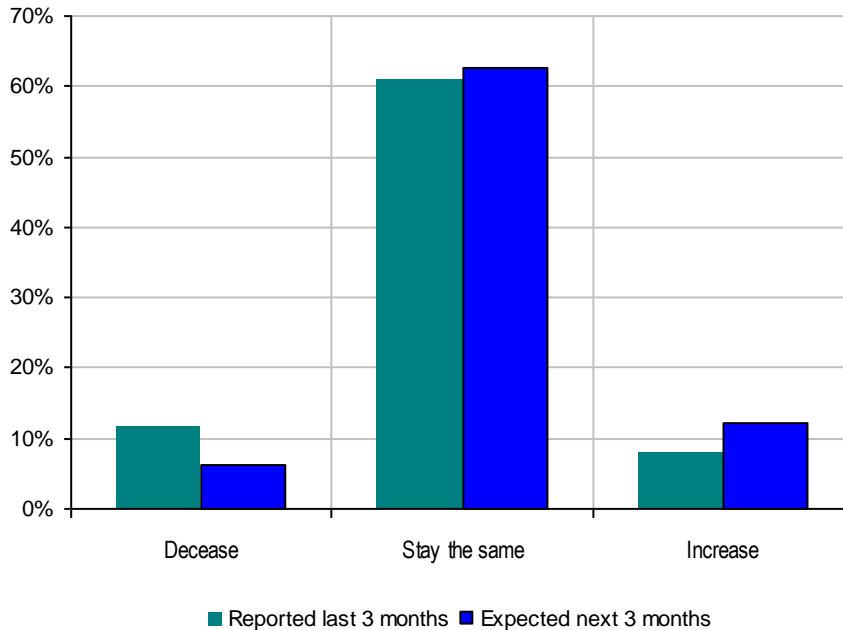
FSB Voice of Small Business Index points to continued labour market fragility

In line with the mixed picture of a gradual recovery in economic activity, most businesses kept the size of the workforce on hold over the three months to March. Reflecting the continued fragility and belt tightening firms are having to undertake, a net balance of 4% of businesses reported reducing their employment levels over the three months to March.

So, although the labour market has shown signs of stabilisation in early 2010, with claimant count unemployment declining in four of the last five months to March, the FSB Voice of Small Business Index implies job creation remains relatively weak. Businesses are still cautious about whether the recovery is strong enough to justify taking on more staff.

Looking forward, again businesses paint a slightly more positive picture. Over the next three months 12% of small businesses expect to increase their headcount, while 6% think they will reduce employment. While this is a positive sign, the clear majority (63%) of businesses expect to keep employment levels on hold, so the evidence does not point towards economic growth supporting robust job creation as yet.

Figure 2: Small business employment intentions



Source: FSB-ICM 'Voice of Small Business' Panel Survey (March 2010)²
Questions asked: Over the last three months, how has the number of people employed by your business changed?
Over the next three months, how do you expect the number of people employed by your business to change?

Businesses expect performance to improve as fragile recovery continues

The FSB Voice of Small Business Index shows evidence that business sentiment is still finely balanced as the United Kingdom continues to recover after the deepest, longest recession since records began. A net balance of 16% of small businesses expect their overall business performance to improve over the next three months compared with the previous three months. This provides evidence that the recovery is continuing steadily; a double dip recession should be avoided but the evidence certainly does not point to a robust bounce back.

Despite evidence of an overall improvement in the economy and business performance, the recovery is still fragile. Almost one in four (23%) businesses expects their performance to worsen over the next quarter while almost two in every five expect no overall change in business performance. So, evidence on the strength of improvement in business performance is mixed but the results imply growth should continue in the second quarter of 2010.

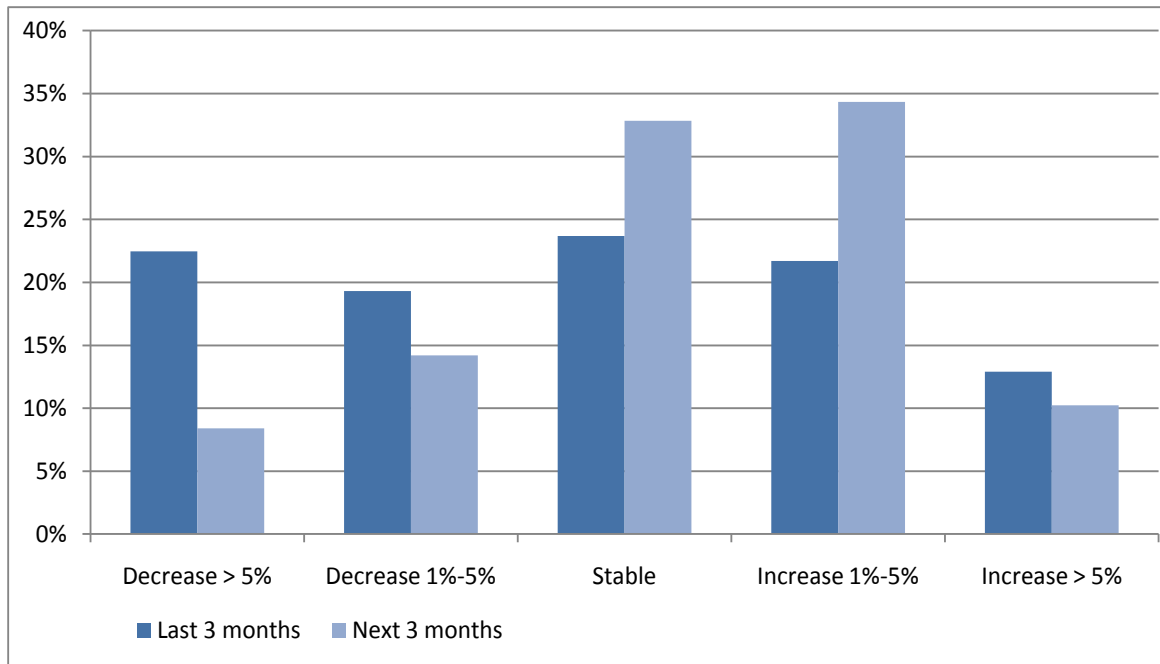
Businesses expect revenues to edge up

A net balance of 7% small businesses reported a decrease in sales over the three months to March, in a clear reflection that the economic recovery is still at an early stage. Businesses are optimistic that sales

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will rise over the next three months, with a net total of over one in five businesses expecting an increase; so businesses expect a significant improvement in trading performance through the second quarter of 2010.

Figure 3: Small business revenue growth over the last and next three months



Source: FSB-ICM 'Voice of Small Business' Panel Survey (March 2010)

Questions asked:

Ignoring any normal seasonal variations at this time of the year, how much has the revenue/sales of your business changed over the last three months?

Ignoring any normal seasonal variations at this time of the year, how much do you expect the revenue/sales of your business to change over the next three months?

The FSB Voice of Small Business Index implies that business conditions were still relatively tough in the first quarter of 2010. This fits with the official data on retail sales, trade and industrial production, which all pointed to a disappointing start to 2010 as the VAT cut was reversed and exceptionally bad weather struck.

The Voice of Small Business Index adds insight to this; showing that over one in five small businesses saw a seasonally adjusted fall in sales of over 5% over the last three months while just less than one in five saw a small decrease in sales. However, the official data has pointed to improvement since January and the FSB survey illustrates this: while 35% of businesses saw sales increase over the three months to March, 45% of businesses expect sales to expand over the next three months.

Importantly, the clear majority of businesses expect sales to increase over the next three months; the number of businesses reporting expected declines was at 23% compared to 42% in the quarter just gone; while the number expecting sales to increase was at 45%, ten percentage points higher than the share of businesses that reported growth in the previous quarter.