



Federation of Small Businesses
The UK's Leading Business Organisation

FSB Voice of Small Business Index

Quarter 3, 2015

Q1 Q2
Q3 Q4

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Voice of Small Business INDEX Q3, 2015

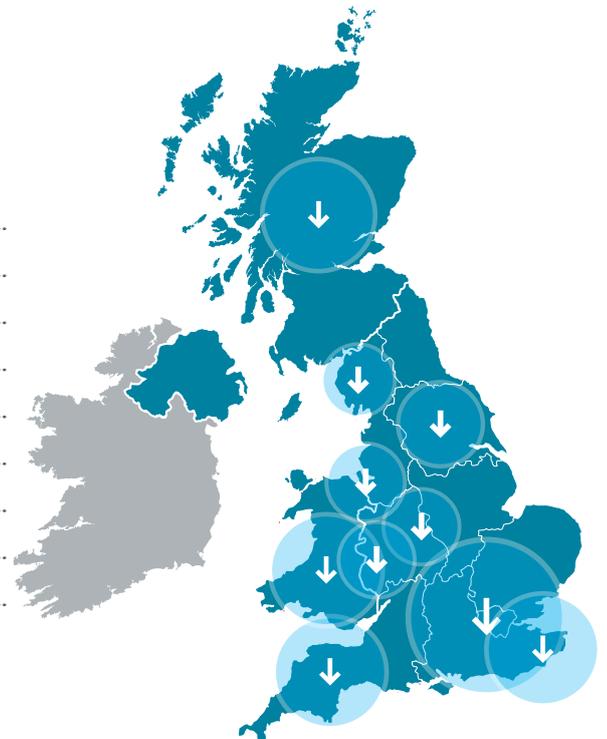
Q3 2015 Small Business Index shows confidence cooling



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

UK business confidence in Q3 2015

| | Q3 2014 | Q3 2015 | Change |
|----------------------|---------|---------|--------|
| ▶ W. Midlands | 43 | 35 | -8 |
| ▶ E. Midlands | 44 | 33 | -11 |
| ▶ Eastern | 38 | 30 | -8 |
| ▶ North West | 35 | 30 | -5 |
| ▶ South East | 52 | 28 | -24 |
| ▶ South West | 46 | 22 | -24 |
| ▶ Yorkshire & Humber | 36 | 21 | -15 |
| ▶ London | 43 | 8 | -35 |
| ▶ Wales | 23 | 3 | -20 |
| ▶ Scotland | 26 | 2 | -24 |



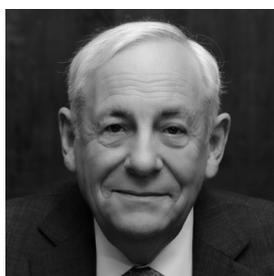
Credit conditions **improving** for small firms

62% of those who applied for a loan were successful in last three months

Availability of skilled workers a **barrier to business**

29% Q3 2014 **36%** Q3 2015

FSB Voice of Small Business Index



**John Allan,
FSB National
Chairman**

This third quarter FSB Small Business Index (SBI) follows a Summer Budget which presented a number of challenges to small businesses, including changes to the tax treatment of dividends and a steep increase to the National Minimum Wage. It is perhaps unsurprising, therefore, that FSB member confidence has fallen back sharply this quarter.

Headline confidence remains in positive territory at +20.3, however the significant fall from +37.9 in the previous quarter and +41 from the previous year is concerning. While a majority of members (58.7 per cent) have aspirations to grow over the coming year, this figure has itself fallen from 65.3% in the previous quarter. Along with a dip in intentions to invest, this indicates a cooling in business confidence that all policymakers must take into account.

Looking beneath the headline results, the picture is mixed across the nations and regions of the UK, and across sectors in the economy. Confidence is strongest in the Midlands and East of England but Scotland, Wales and the south of England, particularly London, have experienced significant falls. The most confident sectors remain administrative support, transport and the storage industry.

Despite a benign inflationary environment, our members report that the costs of doing business are rising. Wage costs in particular are affecting confidence in labour-intensive sectors such as social work, accommodation and food services, where the outlook for the next quarter is weakest. This is likely to be linked to the proposed steep increases in the National Living Wage, which will put considerable pressure on these firms at a time when they are also having to contend with the costs of pensions auto-enrolment.

Small businesses continue to recruit new staff, however this is at a slower rate: a net balance of 5.3% of firms have increased staff numbers, down from 8.8% in the previous quarter. Furthermore, members are reporting deepening skills shortages which, unless addressed, will undermine small firms' growth plans over the coming months.

Despite these challenges, small firms remain steadfast in their ambitions to grow and tap into new markets, highlighting their resilience and adaptability. Though export performance in this quarter was weaker than expected, the result of sterling's strength and a challenging international environment, small exporters have strong intentions for the next three months, and there is potential for more small and first-time exporters to develop and grow if they receive the assistance they need.

Importantly, credit conditions are improving with more small firms now better able to find affordable finance when they need it. Perhaps most encouraging for policymakers is the strong rise in small business productivity, which registered an increase this quarter to 3%. This compares to 0.3% in the wider economy, and represents a significant increase over the last year from 0.6% in Q3 2014. Counterbalancing this positive news is the growth in the number of small businesses expecting to operate with spare capacity over the next quarter. The Bank of England will be watching this closely when deciding when to raise the interest rate.

We ask policymakers to pay special attention to this quarter's survey results. While there is positive news on productivity, the significant fall in confidence must be taken on board when policy decisions are made. The FSB will work with Ministers to mitigate the impact of upcoming changes, but the Enterprise Bill, Comprehensive Spending Review and Autumn Statement must contain measures that are positive for small business.

Tackling late payments, reforming business rates and utilities, investing in infrastructure to rebalance the economy and improving public procurement are the areas where members want to see action. The right commitments will drive confidence levels back up, feeding into higher economic growth, increased investment, more start-ups and more jobs. In short, we need to see policymakers look to support small business sentiment and put in place the right framework for small businesses to flourish, in order to secure the gains from the economic recovery.

Economist's View

This quarter's FSB SBI findings paint a picture of sustained business growth tempered with a bit more caution among the UK's small companies. The trading environment still looks positive, but the economy does not appear quite as upwardly mobile as it did at this point last year. Small businesses expect conditions to improve, but optimism is not as buoyant as in recent quarters: firms predict that turnover and profit will continue to rise at a stable, rather than an accelerating, pace.

This continued business expansion is bringing benefits to UK households. Small companies are creating jobs, while wage growth has picked up on last year and is projected to rise again over the next 12 months. With inflation currently at its lowest since the Consumer Price Index (CPI) began, this rise in cash-terms wages is passed through completely into higher spending power in real terms. As a result, consumer spending is supporting the economy this year.

Although domestic demand remains relatively strong, this quarter's findings highlight how export prospects remain tough. Only a small net balance of exporters report rising overseas sales and with the vast majority targeting the EU for customers, weak economic growth in the Eurozone may be weighing on performance. Sterling being near an eight year high against the Euro compounds this problem, although it does help to reduce costs for the quarter of small firms that import goods or services.

Another positive aspect emerging from this quarter's figures is that credit availability and affordability appears to be improving. More firms are successfully being granted access to finance, average interest rates are falling and perceptions of credit conditions are on the up. This is a positive development for businesses requiring credit for day-to-day cash flow or larger financing options for investment purposes, and may help to encourage capital investment.

Overall, this quarter's Index suggests that 2015 as a whole will be a relatively stable year of economic growth, but that some challenges are starting to loom on the horizon.



Rob Harbron,
Senior Economist,
Cebr

Q3

Executive summary

Key findings this quarter:

-
- **The Small Business Index fell back this quarter to stand at +20.3.** This is down on Q2 2015 and significantly lower than at the same point a year before, pointing to cooler prospects ahead than had previously been expected. However, confidence still remains well into positive territory.
 - **Small business confidence is highest in the Midlands.** At the other end of the scale are the devolved nations of Wales and Scotland. London has also seen a significant deterioration in confidence over the past 12 months.
 - **Business revenue and profitability growth continues fairly steadily.** A slightly lower balance of firms report growth in these metrics this quarter, but this is projected to pick up again in the next three months.
 - **Low cost inflation is likely helping to support business bottom lines.** The much lower price of oil is feeding through into lower business costs for transport and utilities.
 - **Export conditions are tough, with a net balance of just 2.1% reporting an increase in overseas sales.** With more than four out of five small exporters targeting EU countries for customers, weak growth in the Eurozone and strong sterling may be holding back performance.
 - **Investment intentions fell back this quarter, with a balance of 22% expecting to increase spending over the next year.** This cooling of intentions reflects a reduced share of small businesses aspiring to grow over the coming 12 months, and suggests renewed caution over the medium to long term outlook.
 - **Spare capacity may have plateaued for now, with a 48% net balance of firms reporting operating below capacity.** This figure is marginally above the same point a year before.
 - **Small firms continue to create jobs, with a balance reporting increased headcounts this quarter, and more expecting to do so over the next three months.** Alongside continued hiring, firms are also reporting accelerating pay growth.
 - **Small business productivity growth continues to speed up, rising over the past year by 3.0%.** This follows a general accelerating trend in recent quarters, in contrast to the economy as a whole, which saw a slowdown in productivity growth in the latest data.
 - **Firms continue to report improving credit conditions.** Fewer firms are being turned down for credit, average interest rates are falling, and perceptions of credit affordability and availability are improving.

UK macroeconomic overview

2015 sees steady economic growth, but a labour market shift is taking place

After a sluggish start to the year, the UK economy expanded by 0.7% in Q2, taking quarterly growth back to the rates seen across much of 2014. This steady pace is expected to continue across the second half of 2015, although weaker performance in Q1 means growth for the year as a whole will be slower than in 2014.

Although there is relative stability in the overall economy's rate of expansion, there are signs that the labour market has reached a turning point. The last 12 months have seen some of the fastest job creation in recent history, with unemployment falling notably. However, overall employment growth is now slowing, from almost 3% year on year in the first half of 2014 to around 1% by Q2 2015. This growth has slowed so much in fact that the unemployment rate climbed from 5.5% in Q1 this year back up to 5.6% in Q2. While this small increase is likely to be a blip, rather than the start of an upward trend, the fact is that the unemployment rate is reaching near pre-financial crisis lows, and so any further declines are likely to be much slower.

However, although the headline unemployment rate is reaching near historical lows, looking deeper into the figures shows the labour market still has quite a bit of spare capacity left in it. As illustrated in Figure 1 below, the proportion of people across the economy as a whole working part-time because they can't find a full-time job

remains much higher than before the 2008-09 recession, and has recently been falling only relatively slowly. This suggests that businesses (of all sizes) are hiring staff, but have not yet seen robust enough growth conditions to make the commitment to increasing hours.

As such, Cebr expects 2015 to be a year where total employment growth continues to slow, but anticipates that businesses will start to make greater use of the workers they already have, switching people from part-time and temporary contracts to full-time and permanent staff status. There are signs that this is already happening, with the latest figures showing annual growth of 1.6% in full-time employment, against zero growth in part-time work.

With slack in the labour market falling back this year, the challenge of skills shortages is likely to worsen. Already businesses are reporting this is a rising concern, and as such, skills shortages may start to constrain economic growth without investment in staff development from the private sector. This trend is also likely to provide additional upward pressure on wage growth – something that we're starting to see come through in the SBI and Office for National Statistics (ONS) figures. Spare capacity is a measure that the Bank of England's Monetary Policy Committee monitor closely when making interest rate decisions, and with pre-crisis levels of slack drawing closer, pressure will mount for raising the base rate.

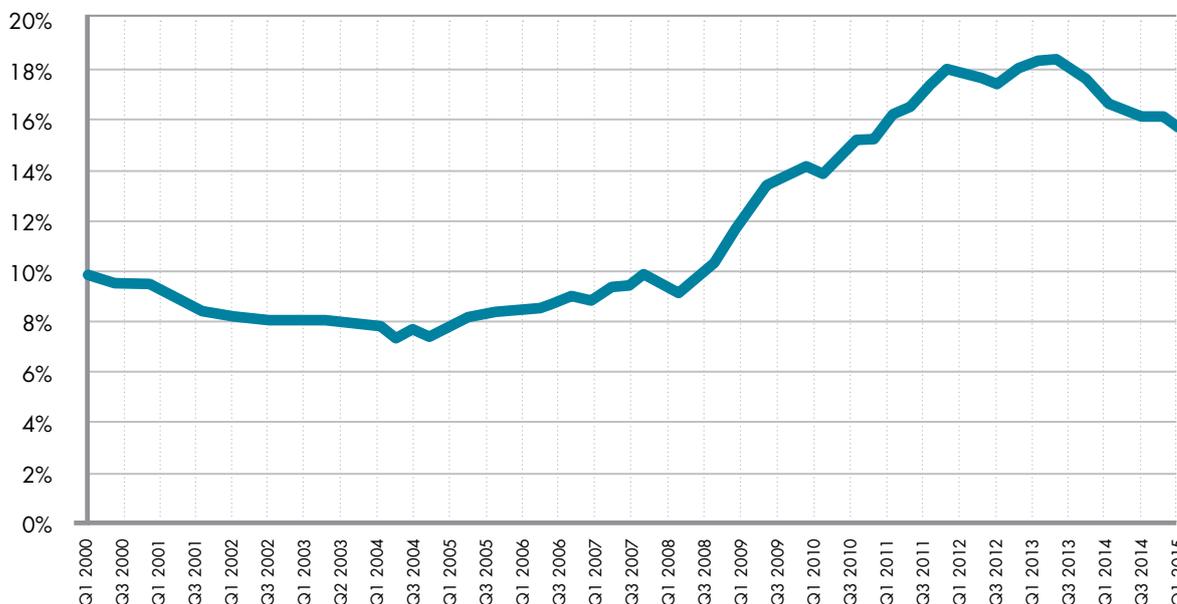


Figure 1: Share of employees across entire UK economy working part-time because full-time work was unavailable

Small Business Index

Business confidence positive but sliding back

This quarter, the SBI fell back to +20.3, indicating reduced confidence in the outlook for trading prospects over the three months ahead. This latest movement comes following a time of change, with a General Election and a new Budget for the coming Parliament. Although the level of the Index is now below the +41 seen at the same point during 2014, it still indicates overall positive confidence. As such, the latest results suggest that growth will continue, but firms may face a slightly more difficult business environment than previously expected.

Looking at the Index results in more detail further illustrates this point. The share of firms this quarter expecting conditions to improve has fallen back, while the proportion of those expecting things to remain the same or to worsen climbed this quarter. The SBI in 2015 on average remains below results in 2014, suggesting that economic growth across the year as a whole will be slower than 2014's rapid growth. This mirrors the Office for Budget Responsibility's July forecasts, which projected GDP rising by 2.4% this year, down from 3% growth across 2014.

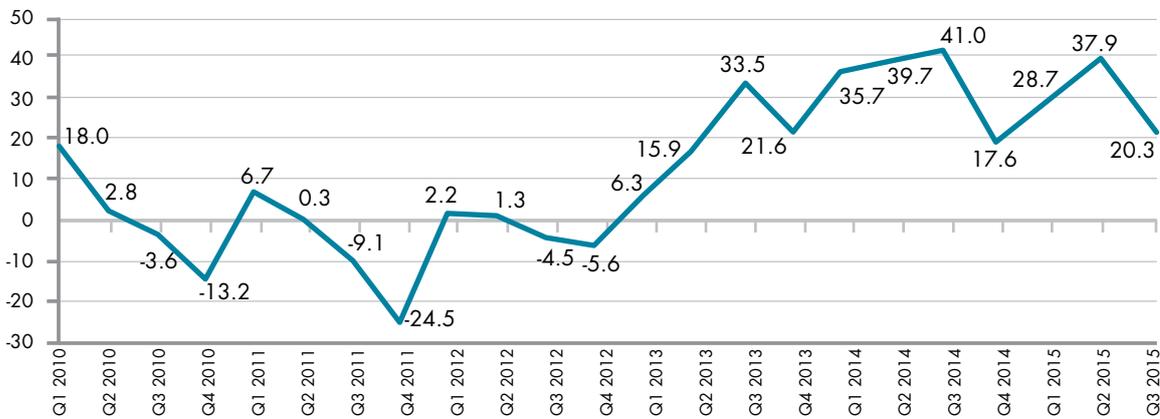


Figure 2: The FSB SBI: small business prospects over coming three months

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

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.

Regional Small Business Indices

The confidence decline is particularly noticeable in London where the Index has fallen from +43 to +8 in 12 months.

Confidence remains strong in the Midlands

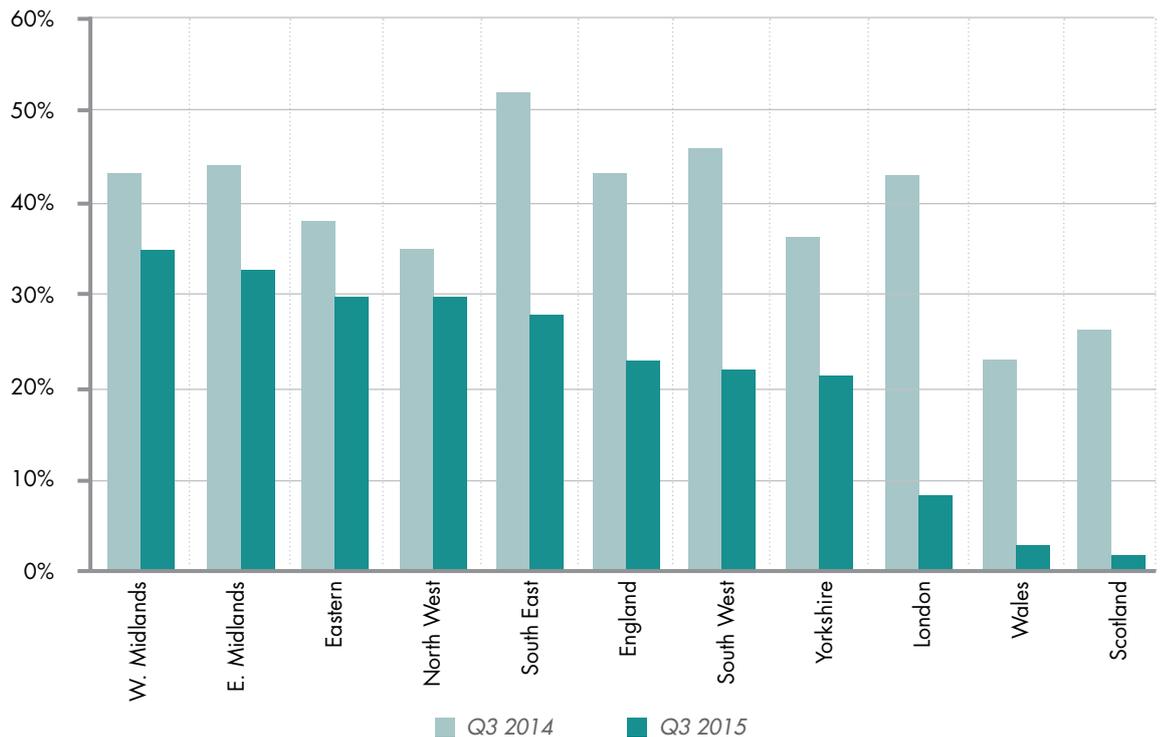
Small business optimism levels have fallen back year-on-year this quarter in every part of the UK, suggesting trading conditions have cooled to some extent nationwide. This confidence decline is particularly noticeable in London, where the Index has fallen from +43 in Q3 2014 to just +8 this quarter. There are some signs growth in London has slowed recently, with employment and total hours worked starting to plateau, according to the ONS. In addition, according to the ONS, the share of people working part time because they can't find a full time job is falling back more slowly in the capital than across the UK as a whole.

Meanwhile at the top of the table, confidence among small businesses in the Midlands is holding up. Year-on-year declines in optimism there are notably smaller than elsewhere in the UK, and leave the Index values at around +35 in both areas. The West Midlands in

particular has seen a strong labour market recovery recently, with unemployment falling year-on-year by 1.7 percentage points in Q2 2015, while the unemployment rate in the East Midlands is one of the lowest in the UK.

At the other end of the scale, business confidence is only just above the zero mark in Wales and Scotland, at +3 and +2 respectively this quarter. The expected impacts of planned government spending cuts may be weighing on optimism at small companies in these parts of the UK. In both Wales and Scotland, public sector workers are a greater share of total employment than anywhere in England, and as such, government job cuts are likely to constrain growth in consumer demand. This is particularly the case if low confidence levels among small firms stops them from increasing employment levels.

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



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

Sector Small Business Indices

The administrative support sector has the highest confidence readings for the second consecutive quarter.

Business support services and logistics firms are the most confident

Small firms in the administrative support sector have the highest confidence readings for the second consecutive quarter, with SBI reading of +40. This is a sector that has seen strong growth recently, with the ONS showing year-on-year output growth of 4.7% in Q2 2015, well above the 2.7% seen across the services sector as a whole. With small businesses in the administrative services sector confident about prospects in the next three months, this trend of rapid growth could well continue.

Small companies in the transport and storage industry are the second most confident this quarter, with an Index reading of +39, up from +36 at the same point a year ago. Figures from the ONS also show rapid year-on-year expansion here, with output rising by 6.0% in Q2 2015 in land transport services. Higher business activity in this sector may be good for overall UK productivity levels, as fuller vans and lorries mean more economic output for the same amount of equipment and labour.

At the lower end of the confidence spectrum, small firms in the real estate sector have lost a fair amount of confidence over the past year. This quarter, their Index reading stands at -23, down from +17 in Q3 2014. This is one sector that has seen slower economic growth than the overall services industry recently. One factor that may be weighing on optimism in the sector is a slowing UK housing market. Annual growth in the number of mortgages for house purchase has been sliding towards zero in recent months, down from the year-on-year increases of over 10% seen at the same point in 2014.

² Some business service activities fall under the “professional, scientific and technical activities”.

Q3

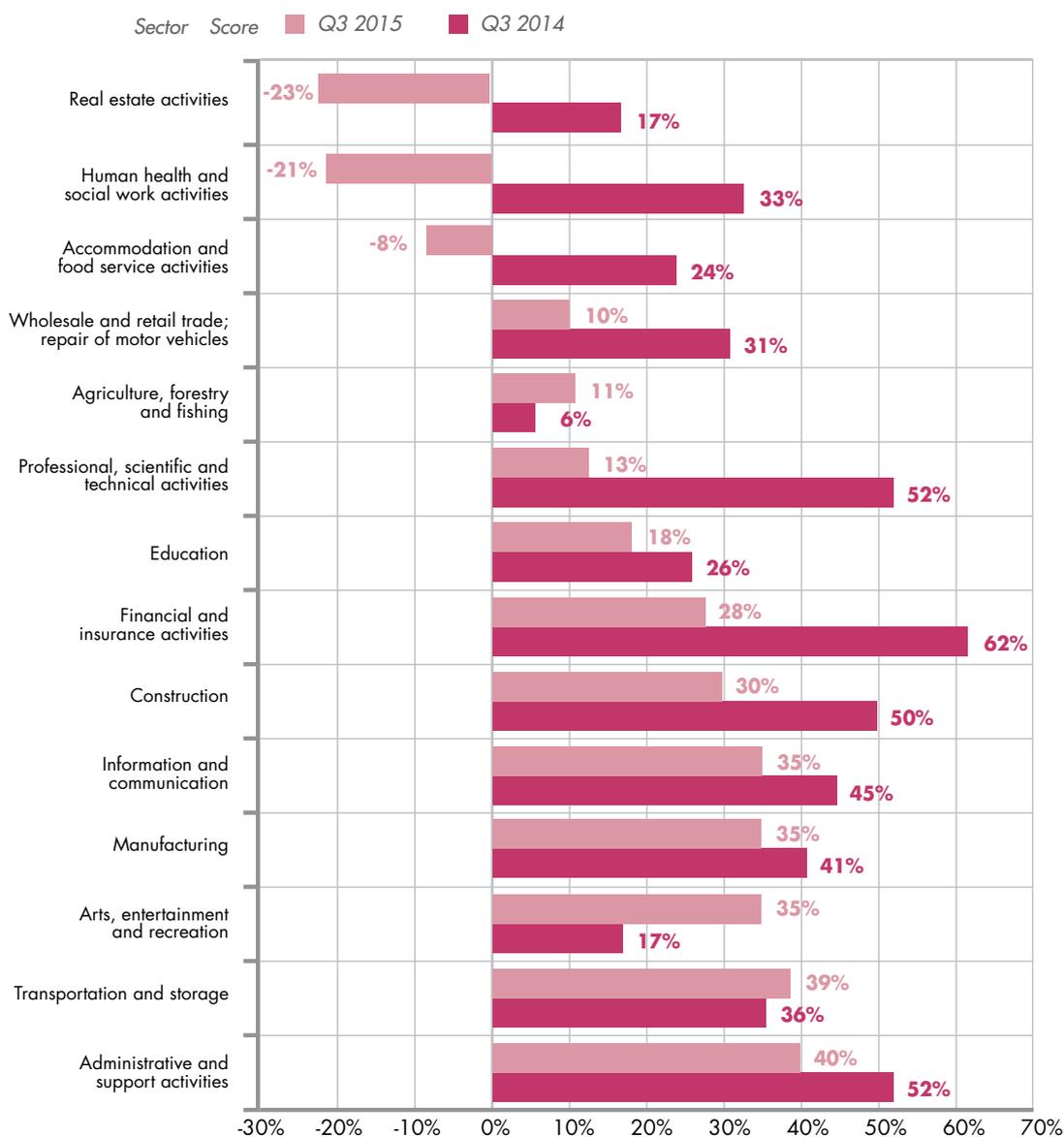


Figure 5:
SBI by sector - small business prospects over coming three months

Source: FSB- Verve 'Voice of Small Business' Panel Survey. *Note: the classification of sectors uses the Standard Industrial Classification 2007 (SIC07) since Q1 2015. This changes the grouping such that some sectors have no exact equivalent from Q3 2014.

Revenue and profitability

A net balance of 26% of small firms predict an increase in revenue in the next three months.

Financial performance holding broadly steady

This quarter, a net balance of 19% of small businesses report turnover rising over the past three months. This share has remained largely stable since the second half of 2014, small fluctuations notwithstanding. Firms are expecting revenue growth to pick up in the next three months, however, with a net balance of 26% predicting an increase. The same trends can be seen for profitability, with a balance of between 10% and 20% of firms reporting growth in gross profits each quarter since late 2014.

This continued growth in small company revenues is helping to bring down the level of business insolvencies in the UK. In Q2 2015, there were just 3,900 business failures in England and Wales according to the Government's Insolvency Service. This is the lowest figure since 2007, before the financial crisis and economic downturn. With further turnover growth expected on average, the number of insolvencies could continue to drop further.

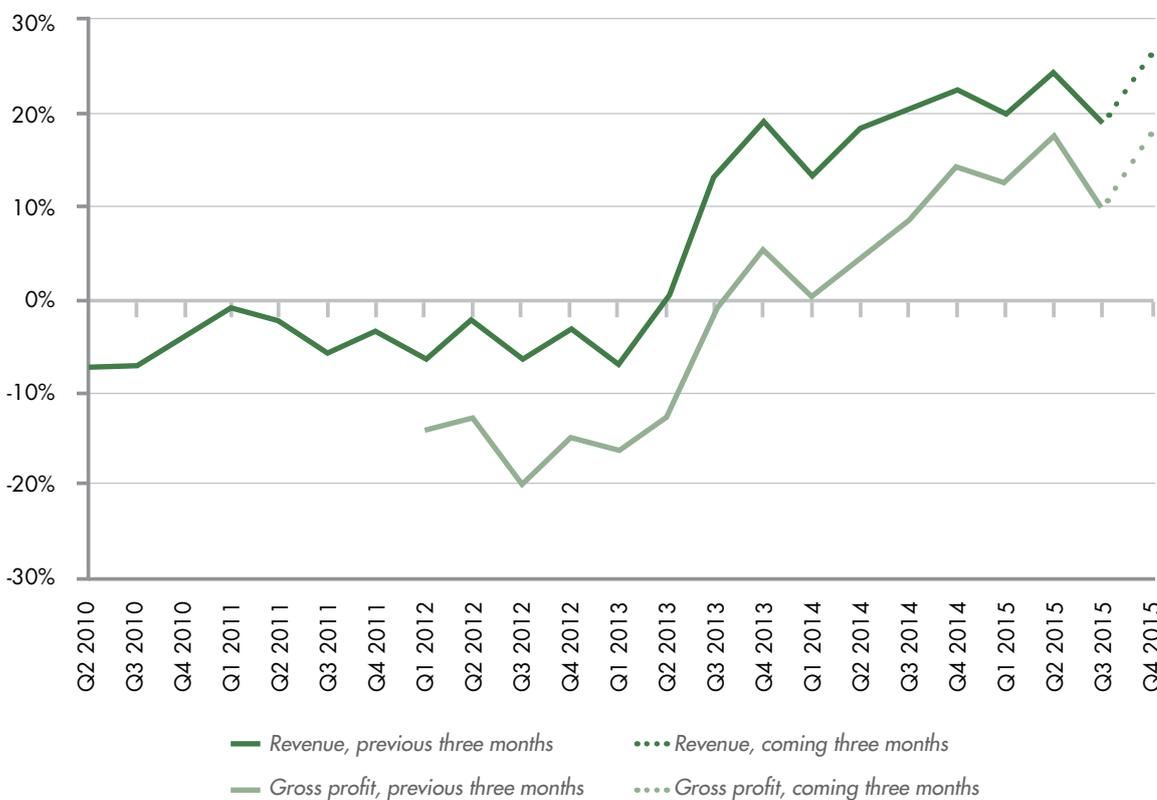


Figure 6: Small business revenue growth and gross profit, net percentage balance – proportion reporting increase less proportion reporting decrease

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

Exports

More than four out of five small exporters (82%) target countries within the EU.

Export performance weak but firms remain optimistic

The latest SBI results illustrate how the export environment remains tough, as this quarter a net balance of just 2.1% of small exporters report a rise in their overseas sales. One factor weighing on export performance is likely to be dependence on the Eurozone for demand – this quarter’s findings indicate more than four out of five small exporters (82%) target countries within the EU. The Eurozone economy continues to perform sluggishly, with just 1% year-on-year growth seen in recent quarters. In addition, the value of sterling has gained significant strength against the euro in recent months, rising from €1.38 on average in April to €1.41 in July, and by much more since the start of the year. Some firms are targeting the more solidly growing USA (39% export to North America) and the more rapidly emerging markets (16%), but these shares are relatively small, and are unlikely to be enough to offset the difficulties with exporting to the UK’s nearer neighbours.

A similar share of small firms import as export (roughly one in four), and 71% of these buy goods or services from the EU. This means that these firms are likely to be benefitting to some extent from the higher value of sterling through reductions in their import costs. In addition, exporters are more optimistic about their overseas sales prospects for the three months ahead, with a net balance of 16% predicting a rise.

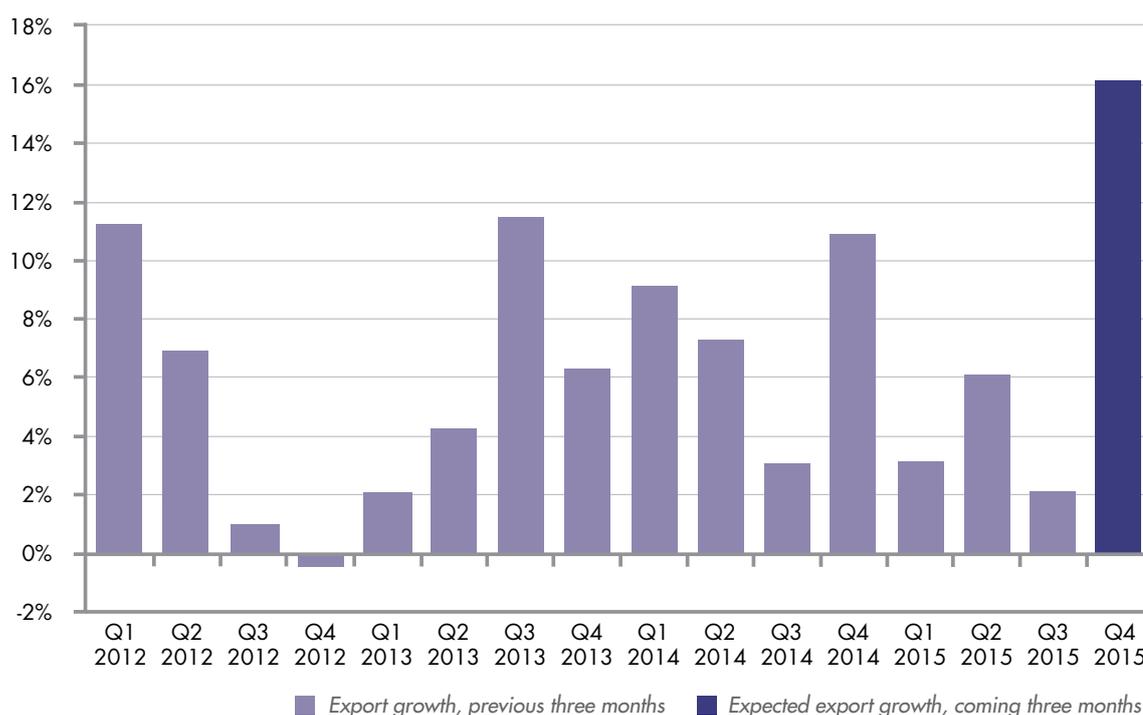


Figure 7: Changes in value of exports – previous three months and expectations for coming three months; net percentage balance, proportion reporting increase less proportion reporting decrease

Costs and inflation

A net balance of half of small firms report increased operational costs during the past three months.

Cost pressures remain low but slowly on the up

This quarter, a net balance of half of small businesses report an increase in their overall cost of operation during the past three months, having crept up slowly since the start of the year, when the share stood at 44.4%. One of the key drivers of this uptick in cost growth comes from labour inputs, as wage growth is faster now than previously and is expected to rise further ahead (see Section XII for more detail).

However, despite these recent increases in the balance of those reporting cost increases, the proportion still remains below the 54% reporting this at the same point in 2014. This year-on-year decline in reported cost inflation is in large part due to the lower price of fuel and energy. This quarter, just 15.3% of small firms report that fuel prices are a main cause of the cost increase, compared with 34% at the same point a year before. As the price of petrol has fallen to 117.2 pence per litre in July 2015 from 131.6

pence per litre in July 2014 this is unsurprising, and with the price of crude oil expected to remain relatively low for at least the short-term, this trend is likely to continue. There are also lower prices for utility inputs such as gas – just a quarter of small firms (25.7%) report utilities as a key driver of costs this quarter, compared to 44% in Q3 2014, alongside ONS figures showing that gas prices for manufacturers were 1.2% lower in June 2015 than a year before.

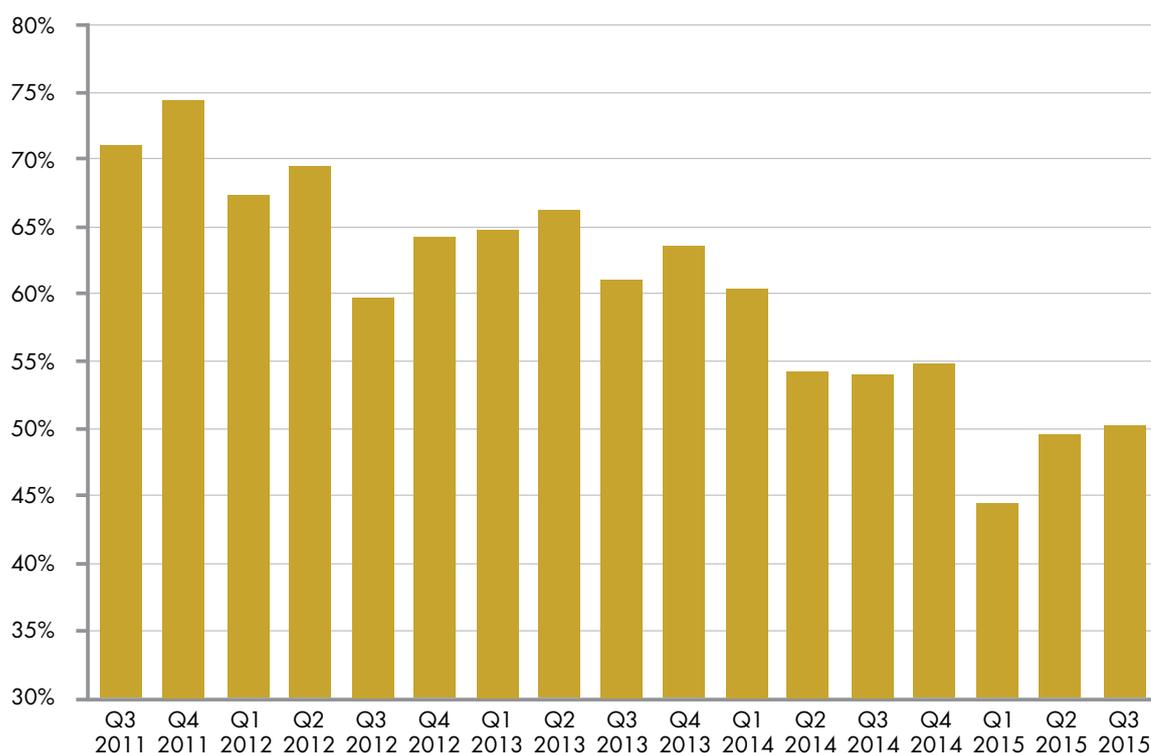


Figure 8: Small businesses reporting an increase in overall cost of operation over past three months; net percentage balance

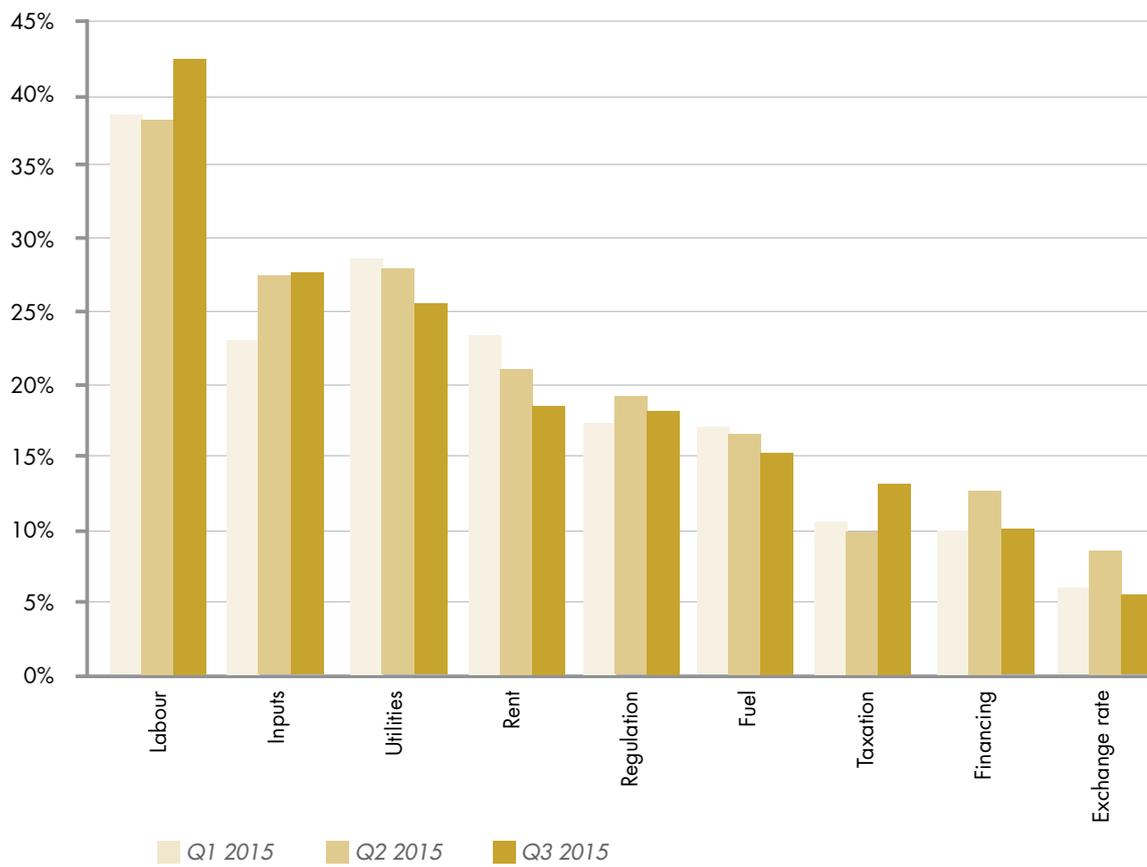


Figure 9: Main causes for changing business costs (firms may give multiple answers)

Capacity

48% of small firms report spare capacity in the last three months.

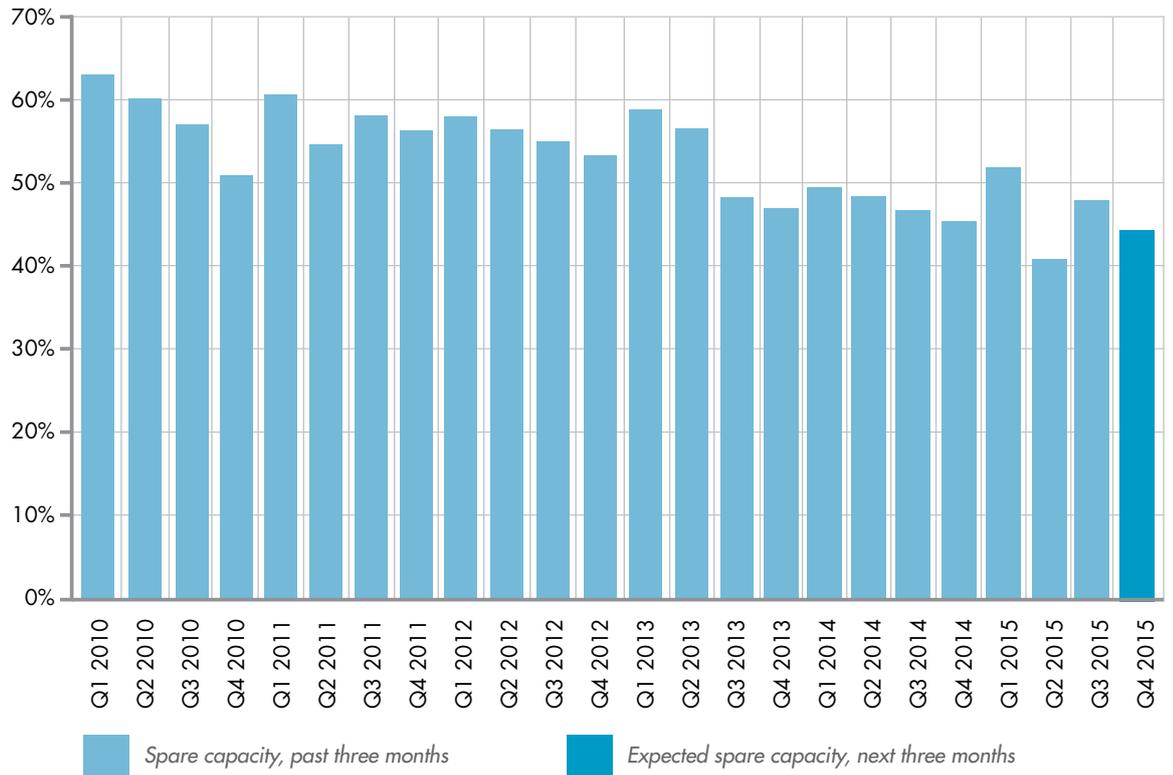
Spare capacity plateauing for now

The gradual downward trend in spare capacity seen during the start of 2014 shows some signs of having reached a plateau. This quarter, 48% of small firms report having spare capacity in the past three months, broadly in line with the 47% reporting the same in Q3 2014. These latest findings reflect the fact that, although businesses continue to report turnover growth, this trend has also stabilised, with no obvious acceleration emerging.

In the Bank of England's latest inflation report, the members of the Monetary Policy Committee estimate that the margin of spare capacity in the economy is likely to be eliminated within the next year or so, and as such, the time for starting to raise interest rates is drawing closer. However, a share of 45% of firms expect to be operating

with capacity to spare next quarter, again largely in line with the 44% reporting the same in Q4 2014. As such, the Bank of England is unlikely to recommend any immediate rise in the base rate, and Cebr expects no increase in the base rate to come before the first quarter of 2016.

Figure 10:
Net percentage balance of businesses running below capacity: proportion below capacity less proportion above capacity



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

Employment

A net balance of 5.3% have expanded headcount in the last three months.

Rapid job creation expected to continue

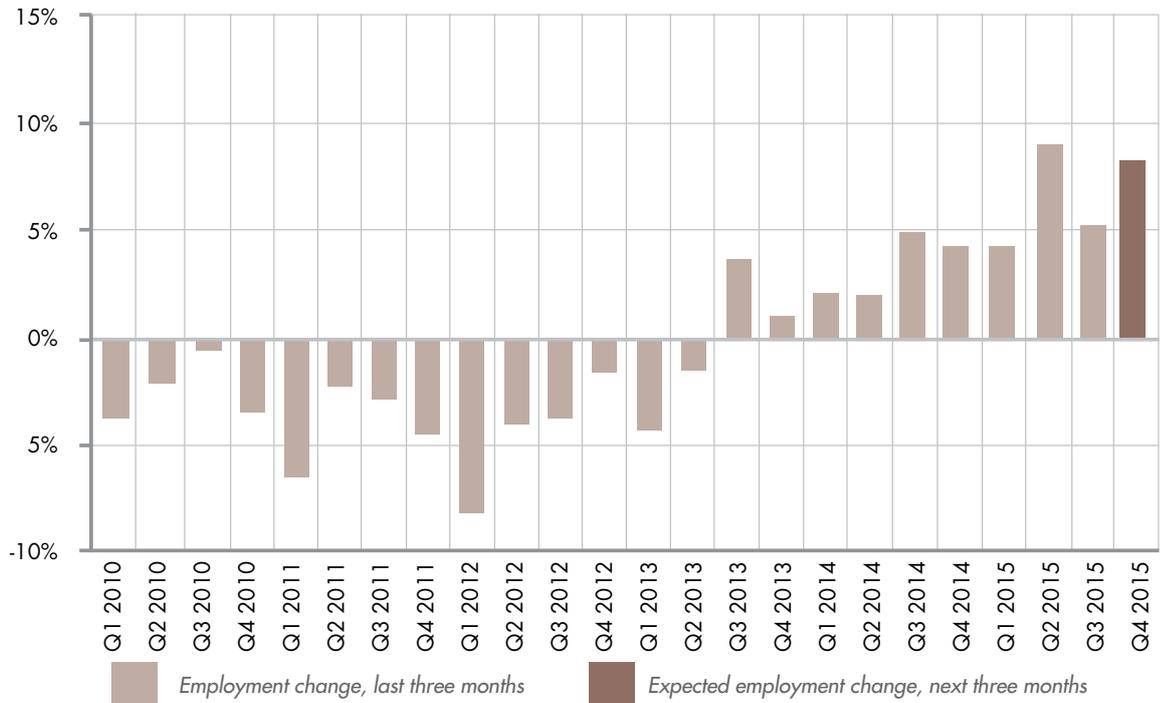
Small businesses this quarter continue to report significant increases in headcounts, with a net balance of 5.3% expanding employment during the past three months, continuing a trend that has persisted now for more than a year. Robust job creation in the small business population has helped to bring down the unemployment rate of 5.6% in Q2 2015, broadly in line with the rate seen during much of 2006, before the financial crisis.

In addition, a net balance of 8.2% of small firms expect to make further hires over the three months ahead. It is encouraging for the UK's economic prospects that private sector hiring intentions remain buoyant, as the Government plans to make significant headcount reductions over the course of this parliament. However, with unemployment levels nearly back to the lows seen in

2005, businesses may find it harder to find the right new staff. The effect of this is already partly coming through in increased expectations for pay growth, as illustrated in the next section.

Looking in more depth at these findings, London and Wales have the lowest hiring intentions for the coming quarter. A net balance of just 3% and 4% of firms in these parts of the UK expect to hire new staff in the short term, compared to 14% in the East of England and South East, and 13% in the West Midlands, largely reflecting the regional confidence ratings reported earlier.

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



Pay growth gradually picking up and expected to do so further

Average pay growth reported by small businesses has cautiously accelerated in 2015, standing at 1.9% in Q2 and Q3 2015. This is up from around 1.5% in the previous three quarters (when this time series began). Although this remains well below the economy-wide average rate of wage growth before the financial crisis of over 4%, it comes during a time of 'no-flation'. Inflation on the CPI has stood around zero now for most of 2015, which is the lowest that CPI inflation has ever been. As such, wages are currently seeing their fastest increases in real terms since the early 2000s, despite still growing relatively weakly in nominal cash terms.

Inflation is expected to pick up towards the end of this year and into 2016, as the effects of last year's sharp oil price declines come out of the annual comparison. However, as illustrated in the chart below, small businesses expect to increase wages at the faster rate of 2.6% in the year ahead, helping to offset this uptick in price growth. These latest findings help to support the OBR's view that consumer spending will continue to grow relatively robustly in 2016, remaining one of the key drivers of overall economic expansion.

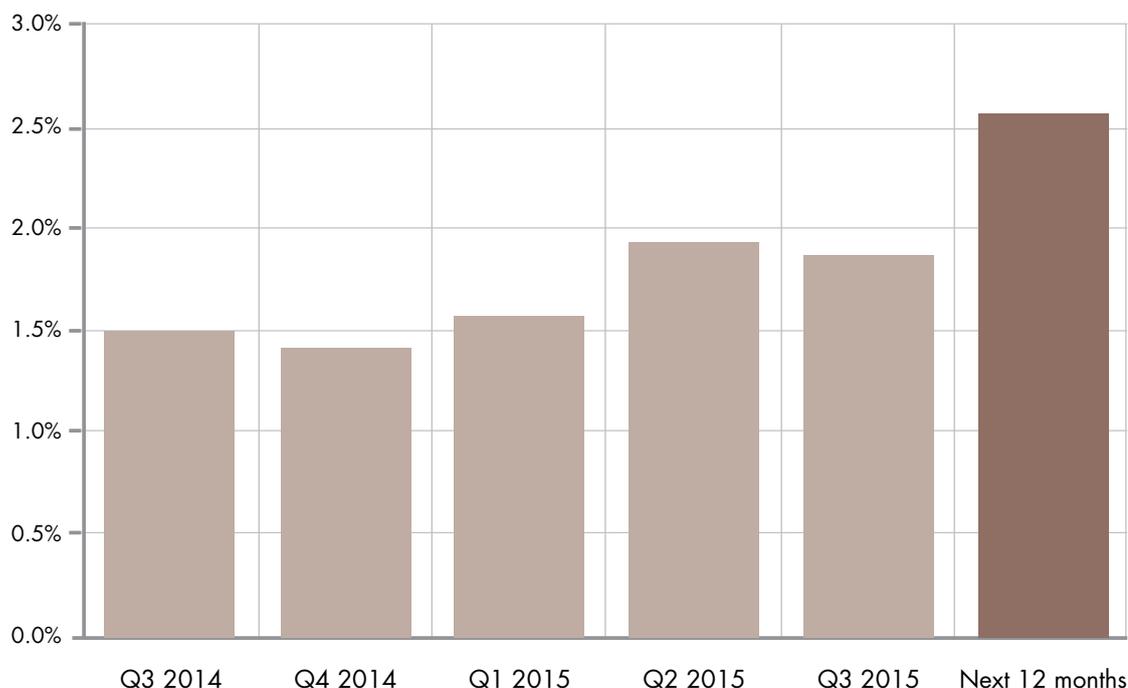


Figure 12:
Average salary increase awarded, this quarter versus a year before

Productivity

The small business population is seeing more growth in productivity per worker than the economy as a whole.

Productivity growth continues to pick up among small firms

This quarter, productivity growth among small businesses continued to gradually rise, reaching 3% over the year to Q3 2015. This is measured as turnover per employee, adjusted by inflation in the economy as a whole. Productivity growth now stands well above its level of 0.6% at the same point last year.

Very low levels of inflation are certainly one factor helping to support buoyant productivity growth in real terms over the past few quarters, but continued average turnover growth in businesses is also helping to drive these increases. Once inflation starts to rise into 2016, however, we could see this growth start to slow or taper off.

These latest findings from the SBI suggest that the small business population is seeing more buoyant growth in productivity per worker than the economy is as a whole. The latest figures from the ONS show year-on-year growth in output per worker slowing in Q1 2015 from the previous quarter to a 1% increase. This compares to growth in the small business measure (illustrated below) of 1.6% in the same quarter, highlighting how small firms are helping to drive productivity increases.

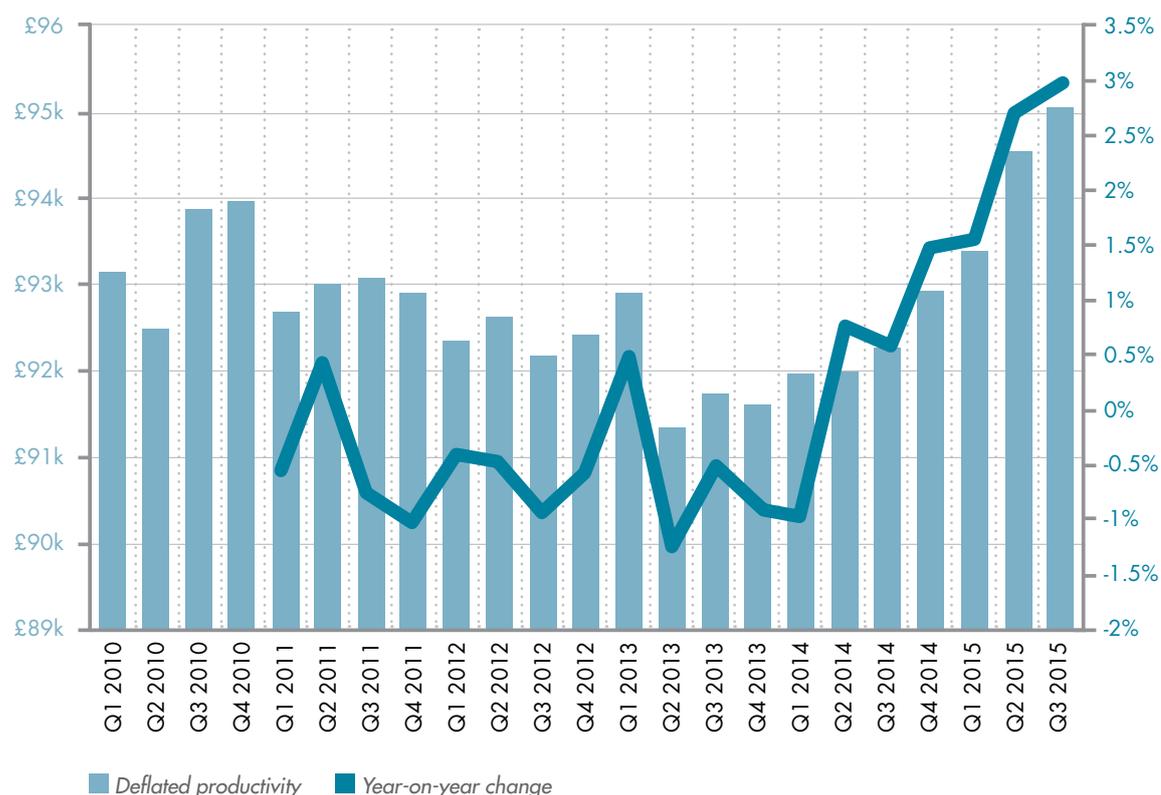


Figure 13: Small business productivity and year-on-year change (inflation-adjusted turnover per employee)

Growth aspirations and challenges

36% of small firms find getting skilled staff a barrier to growth, up from 29% a year ago.

Most firms still aspiring to grow

Nearly six in ten small businesses (58.7%) this quarter report having aspirations to grow moderately or quickly over the next 12 months. Although this is down on the 61% reporting the same in Q3 2014, it still represents a solid majority of small businesses with positive growth aspirations.

In addition, a further 30.2% of small firms expect to remain about the same size over the year ahead, pointing towards stable business conditions. Encouragingly, only 6.6% expect to downsize or consolidate, and just 2.7% expect to close. In addition, 1.9% of firms expect to sell or hand on their company.

Looking by industry, business support activities such as administrative services, as well as ICT, financial services and manufacturing are all the most optimistic. In these sectors, more than 70% expect to grow over the next year. At the other end of the scale, hotels and restaurants, health, and transportation services are less optimistic, with under half expecting to grow in the coming 12 months.

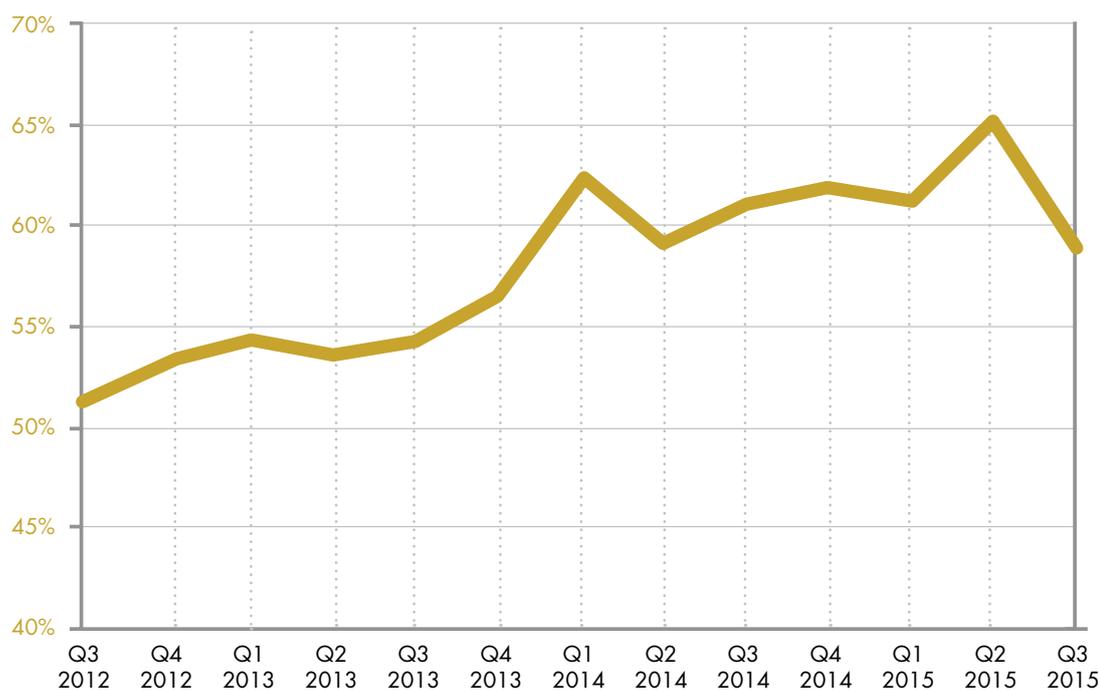


Figure 14:
Growth aspirations for next 12 months

Skills shortages and domestic demand are rising concerns

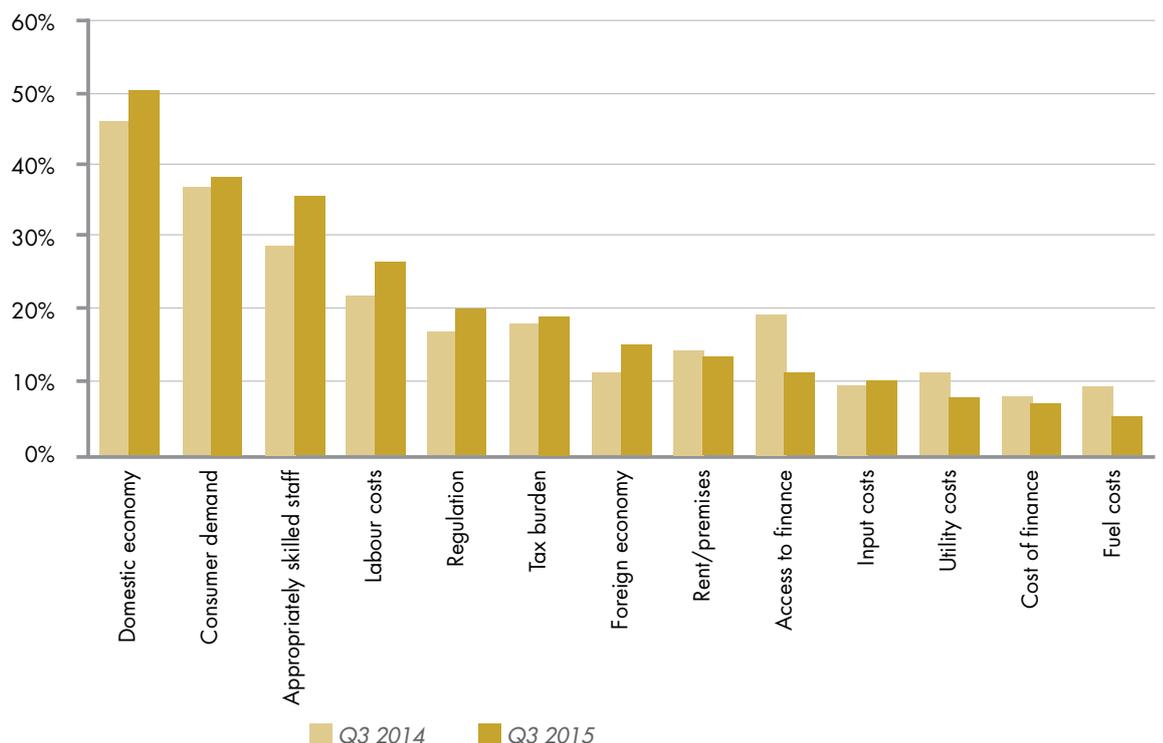
Almost half of small businesses (49.4%) report that the domestic economy is a potential barrier to achieving their growth aspirations this quarter, up from 46% at the same point last year. Although relatively low inflation is likely to continue supporting growth in household real incomes and consumer spending over the next year, one domestic factor that may be weighing on business minds is the prospect of a Bank of England base rate. As discussed earlier in this report, Cebr believes the case will become clear for a rate rise by the end of Q1 2016, at which point borrowing costs will likely become higher for firms and consumers alike, potentially reducing demand growth.

Although in third place behind consumer demand as a potential barrier, skills shortages have intensified over the past year. This quarter, 36% of small firms report finding appropriately skilled staff is a concern, up from 29% in Q3 2014. Skills shortages could become more prevalent over the coming months, as unemployment is expected to fall further into 2016, and may start to constrain growth

at small firms and economic expansion as a whole. Small firms involved in business support services such as professional or administrative services are the most likely to be reporting skills shortages. Although firms in administrative services are the most confident, this reflects the fact that strong growth has recently been seen in the industry – this is likely to start slowing over the next year as skills shortages start to constrain growth potential.

One factor that has fallen back over the past year as a potential barrier to growth is access to finance. This quarter, just 11.3% of small businesses report this as a concern, down from 19% at the same point in 2014. As will be discussed in the next section, it appears credit conditions may be easing for the UK's small business population.

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



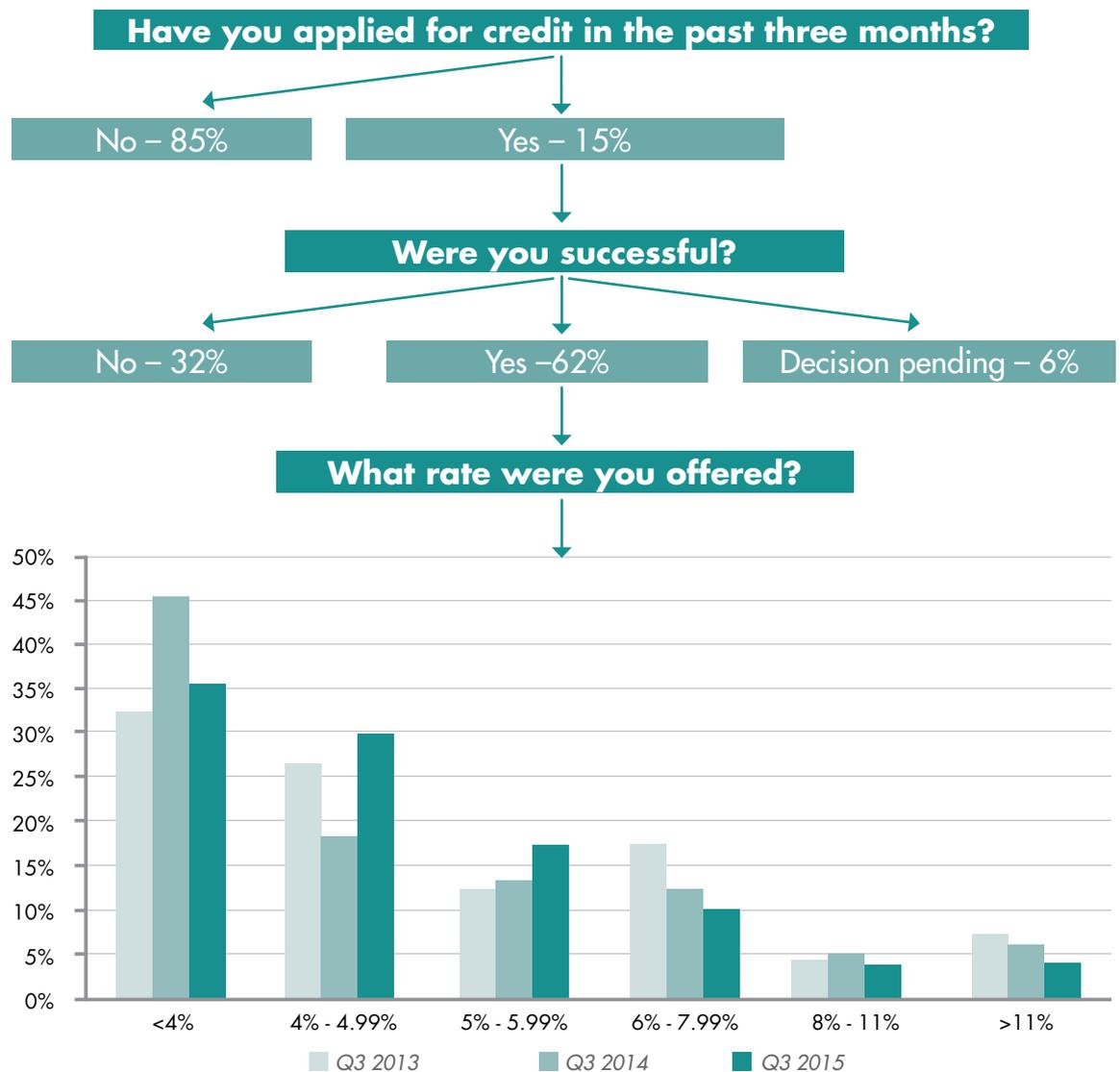
Source: FSB-Verve 'Voice of Small Business' Survey

Credit

A record share of businesses (62%) were successful accessing credit in the last quarter.

More firms successful in credit application

Figure 16:
Credit applications and interest rates offered



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

Although the proportion of firms applying for credit this quarter remained broadly stable at 15%, the share of successful applicants continued to climb. A record share of 62% were successful in the past three months, the highest since the series began at the start of 2012.

Larger 'small' firms were more likely to have applied for credit, with just 7.6% of those with no staff applying, compared to 20.3% of those with 21 to 50 employees. Small manufacturers were some of the most likely to have applied for credit, at 23.5% of firms, while just

Q3

5% of professional services firms did so in the past three months. As well as more firms being approved for credit, the average rate of interest being offered continued to gradually decline, to 4.9% this quarter from 6.2% at the start of the year.

For those that had applied for credit, an overdraft was the most popular product, with 60% of applicants desiring

overdraft credit. Next most popular was a bank loan, with 38%. Other kinds of financing, including export finance, seed capital, angel investors, venture capital or peer-to-peer lending were much less popular.

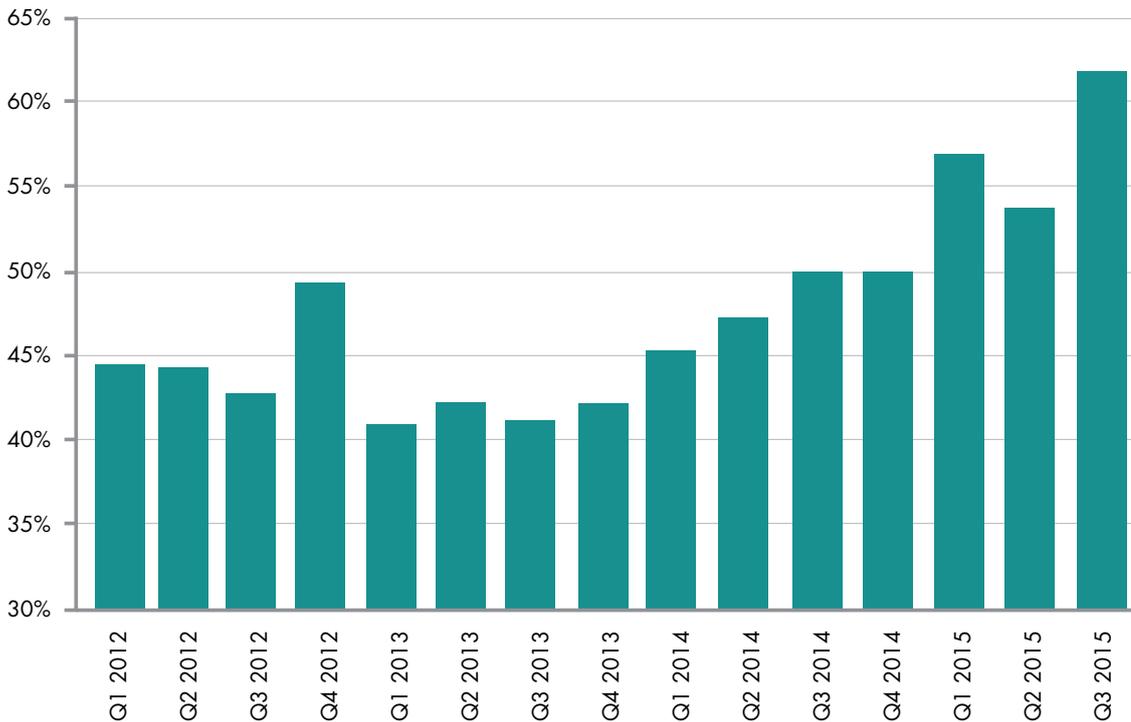


Figure 17: Proportion of small businesses successful in bank credit (e.g. loan or overdraft) applications in the past three months

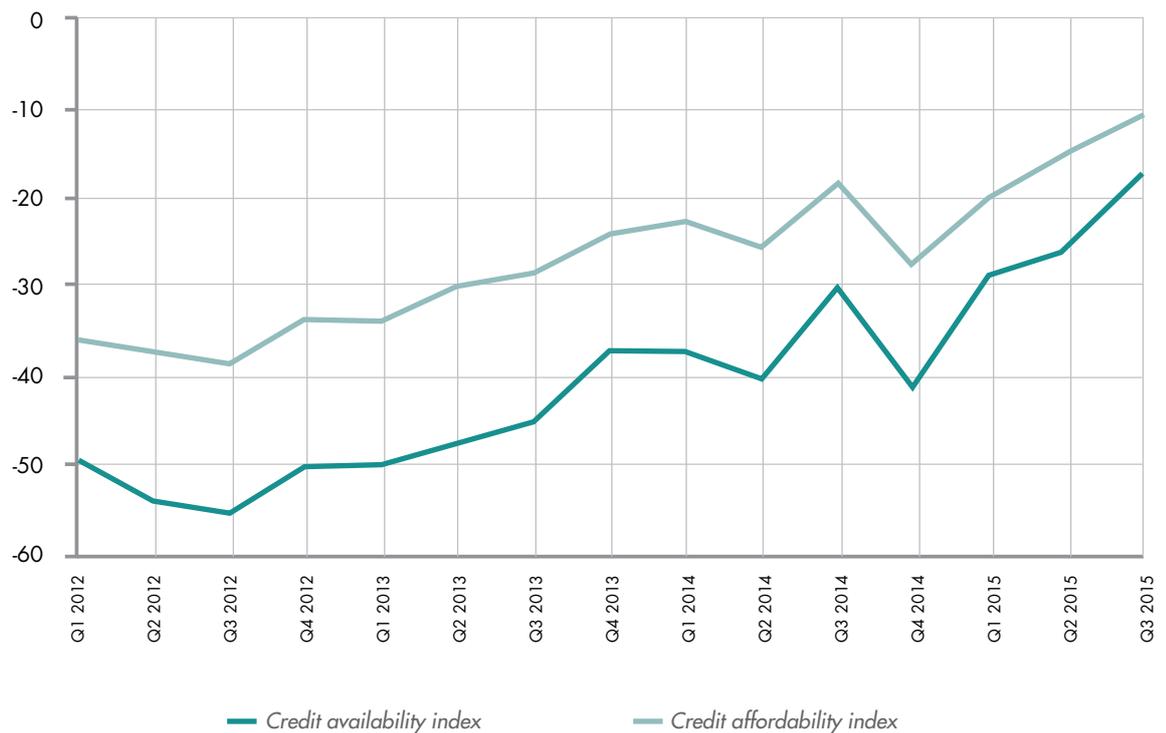
Credit conditions are improving for now

In line with the findings presented in the previous section, small businesses are now finding that both credit availability and affordability is markedly improving. A net balance of 10.5% of firms are still reporting that they find credit unaffordable, but this is the smallest share since the index began at the start of 2012. Likewise, a net balance of 16.3% of firms are reporting that they find credit availability good – still a negative figure, but higher than any other point in the series.

This is certainly an encouraging trend, with more firms able to apply for finance either to fund investment or to help with day-to-day cash flow. However, it may be one that starts to reverse in 2016, alongside potential rises in the Bank of England’s base rate. A higher base

rate would push the cost of borrowing out of reach for some businesses, and be more costly for those that can still access the finance. But the lending landscape has changed since the last time the base rate was higher than its current 0.5% rate, in 2009. There are many more alternative providers of finance than before the financial crisis, including peer-to-peer lenders and crowdfunding platforms. Although the share of firms currently accessing these channels is relatively low for now, as highlighted above, it may be one channel that sees greater uptake when the cost of more traditional lending rises alongside the base rate.

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



Investment

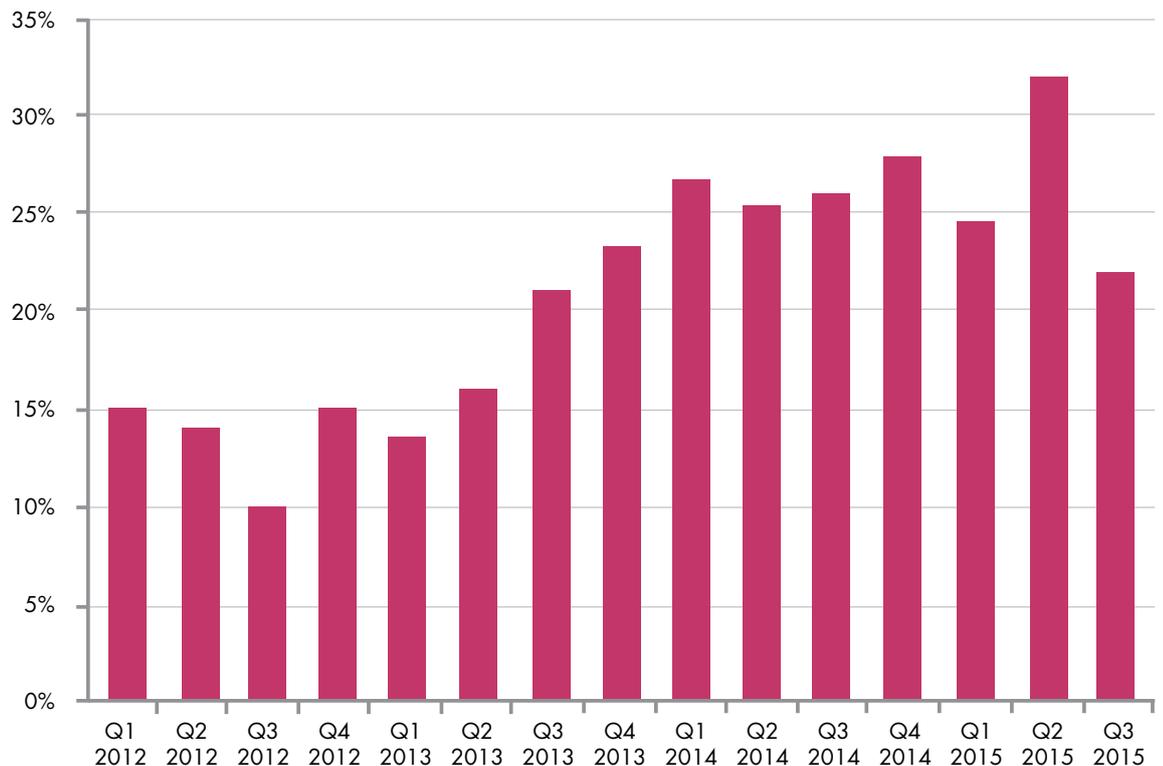
22% of firms will increase capital investment in the next 12 months, down from 26% a year ago.

Investment intentions cooling slightly but remain solid

This quarter, a net balance of 22% of firms report that they anticipate increasing capital investment over the next 12 months. This is slightly down from 26% at the same point a year ago, potentially reflecting uncertainties in the outlook at the moment. For instance, although the future of the Eurozone looks safer now than it did a few months ago, there still remain questions on whether or not Greece will stay in the single currency, which presents risks to small firms relying on exports. Closer to home, the referendum on the UK's membership of the European Union also presents challenges to businesses deciding on how much to invest for the long term.

However, wider picture is that a solid proportion of small businesses are still planning to invest over the next year. This is important and has knock-on effects for the rest of the economy, as investment spending eventually trickles down to consumers and also helps to drive productivity growth. In addition, it helps to spread the sources of economic growth out, moving the economy away from relying on consumer spending for driving expansion. The OBR's GDP forecast for 2016 relies on business investment as a whole picking up, and small companies could be a key contributor to this expansion.

Figure 19:
Net percentage balance in anticipated capital investment growth over next 12 months – proportion reporting increase less proportion reporting decrease



Method

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This report is based on the July - August 2015 research survey of FSB members carried out by Verve. All panel members (5,838) were invited to take part in an online survey. Reminders were sent to all non-respondents. 1,580 responses were received, a response rate of 27%. 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 20th July and 4th of August 2015.

Summary data table

| | Q3 2013 | Q4 2013 | Q1 2014 | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Small Business Index | +33.5 | +21.6 | +35.7 | +39.7 | +41 | +17.6 | +28.7 | +37.9 | +20.3 |
| Employment - previous three months | 3.7% | 1.0% | 2.1% | +2.0% | +5% | +4.4% | +4.2% | +8.9% | 5.3% |
| Employment - coming three months | 5.8% | 3.1% | 7.6% | +10.5% | +7% | +7.1% | +10.0% | +14.2% | 8.2% |
| Revenue - previous three months | 12.8% | 18.8% | 13.1% | +18.1% | +20% | +22.0% | +19.5% | +24.1% | 18.8% |
| Revenue - coming three months | 20.1% | 16.2% | 26.5% | +29.6% | +33% | +23.4% | +28.5% | +32.1% | 26.1% |
| Investment intentions – coming 12 months | 21.1% | 23.2% | 26.6% | +25.6% | +26% | +28.4% | +24.9% | +31.9% | +22.0% |
| Credit availability – rated good or very good | 12.4% | 12.7% | 13.5% | 12.5% | 17% | 13.3% | 16.2% | 16.6% | 23.5% |
| Credit availability – rated poor or very poor | 65.9% | 58.3% | 58.5% | 60.9% | 52% | 61.7% | 50.4% | 47.3% | 41.6% |
| Credit affordability – rated good or very good | 19.0% | 18.1% | 19.2% | 18.0% | 22% | 18.1% | 19.6% | 26.2% | 27.6% |
| Credit affordability – rated poor or very poor | 55.0% | 50.7% | 49.8% | 51.1% | 47% | 54.4% | 46.4% | 42.4% | 38.8% |

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.

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