

Q1

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 1, 2019

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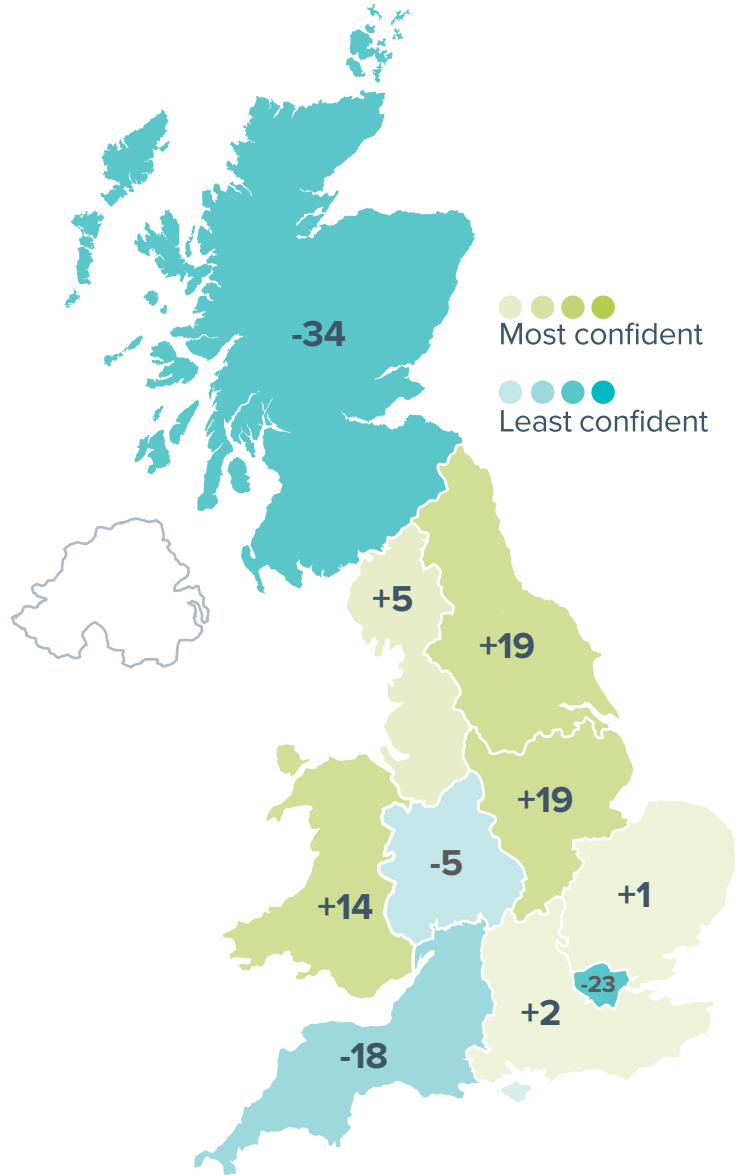
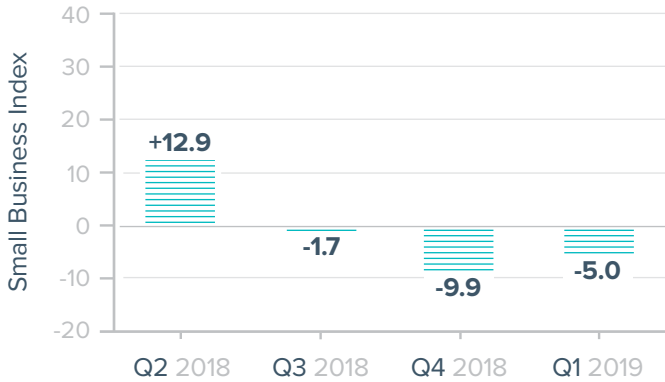
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Experts in Business

SBI Q1 2019

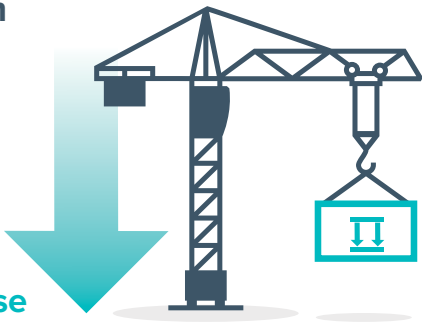
“Small business confidence in **negative territory** for three straight quarters for first time in SBI history”

Pessimism proves persistent



Export optimism at record-low

73% of exporters **not expecting increase** in international sales



Operating costs at seven-year high

74% of small firms say **expenditure is up** compared to last year

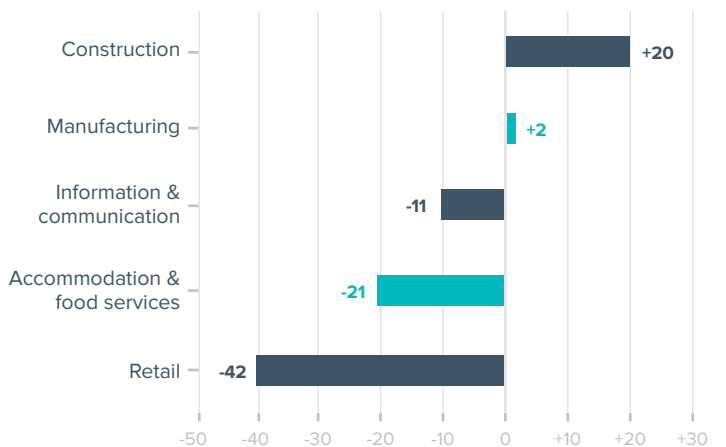


Investment plans on hold

72% of small firms **not planning to increase capital investment**



Small business confidence by sector



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FSB FOREWORD

The levels of political and economic uncertainty that smaller businesses have had to endure reached a new peak over the past three months. And although small businesses will have breathed an exasperated sigh of relief that a chaotic cliff edge no deal scenario on 29 March was averted, that did not bring an end to the huge uncertainty around the Brexit process. Small business's trademark resilience has been worn thin – reflected in an unprecedented third consecutive quarter of confidence remaining in negative territory and at the second-lowest level recorded since 2012.

The severity of the impact of the Brexit stalemate is illustrated by the fact that the export growth expectations of our exporters have turned negative for the first time in the history of the Small Business Index. Exporters have benefited from the prolonged depreciation in sterling since the outcome of the EU referendum. But the sustained uncertainty which, until very recently, included the risk of a no deal scenario on 29 March – with small exporters potentially facing tariffs, rules of origin requirements and additional non-tariff barriers, including completing customs declarations – has weighed on actual export performance. The net balance of small businesses reporting an increase in the value of their exports has decreased for the third consecutive quarter to stand at 6.8% in Q1 2019, down 9.0 percentage points on Q1 2018.

Small businesses have been a consistent powerhouse of job creation. However our latest data shows that small businesses have reduced staff numbers for the first time since 2016. The impact of Brexit uncertainty on small business appetite to hire and invest has been laid bare. Therefore, it is not a surprise that small business revenue growth has stagnated over the first quarter of 2019.

From the beginning of April, VAT-registered small businesses will need to comply with new data reporting requirements as a result of the Making Tax Digital programme. Small employers will need to contend with additional costs as a result of increases in the National Living Wage and employer contributions to pensions auto-enrolment schemes. Some smaller businesses will also experience business rates increases as transitional caps come to an end. This is all at a time when small business cost pressures have risen to the highest level since 2011.

Small businesses need urgent help from Government. That is why we are calling on Government to introduce Brexit vouchers for smaller businesses to help them prepare for the future.



Mike Cherry,
National Chairman



Martin McTague,
Chairman,
Policy and Advocacy

ECONOMIST'S VIEW

Although the FSB Small Business Index rose 4.9 points in Q1 2019, this is little cause for celebration. Even after the partial recovery, the index remains firmly in negative territory at -5.0 – the second lowest reading since 2012.

The subdued small business confidence mimics recent developments in consumer confidence which has also been near-record low levels according to various measures. Worries about the future quickly translate into a decreased willingness to spend, which hits consumer-oriented businesses especially hard. With this in mind, it is perhaps unsurprising that small businesses in the wholesale and retail sector are least confident with an index reading of -41.9.

A further factor putting pressure on retail businesses is a slowdown in the growth of household borrowing. This trend is unlikely to reverse anytime soon as households continue saving their disposable income to support spending in the uncertain times ahead.

In addition to consumer expenditure, another economic pressure point that this edition of the SBI highlights is export prospects. In Q1 2019, export growth expectations turned negative for the first time in the history of the Small Business Index, meaning that more small businesses expect the value of their exports in the next three months to decline than expect it to rise.

These lacklustre expectations are in line with a deteriorating economic picture seen across a few key trade partners. For example, Germany escaped a recession by the skin of its teeth in the final quarter of 2018 after a 0.2% contraction in Q3. The rest of the Eurozone, China and Japan all saw various signs of economic strain in recent quarters with the United States one of the few advanced economies to have posted a strengthening performance in the past year.

The domestic picture is worrisome as well. Over 2018, the UK economy expanded by 1.4%, the joint weakest growth rate since 2009. The latest GDP data are similarly disappointing with growth of just 0.2% recorded in the three-months to January 2019.



Nina Skero,
Director and Head
of Macroeconomics,
Cebr

Q1

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **Small business confidence remains in negative territory despite a small Q1 rebound.** The FSB Small Business Index recovered 4.9 points of the 8.2 fall seen in Q4 2018 but despite this the index remains firmly in negative territory at -5.0.
- **The level of confidence between regions has diverged further.** The gap between the index scores of the most confident region (Yorkshire and the North East, +18.9) and least confident region (Scotland, -34.5) has widened to 53.4 points.
- **Small wholesale and retail trade businesses are the least confident.** Smaller businesses in the wholesale and retail trade sector saw a 2.6 point increase in their confidence reading from -44.5 in Q4 2018 to -41.9, but are now comfortably the least confident by sector after a major improvement among accommodation & food services firms.
- **Export growth expectations turn negative for the first time in the history of the Small Business Index.** The net balance of small businesses reporting an increase in the value of their exports decreased for the third consecutive quarter to stand at 6.8% in Q1 2019, down 9.0 percentage points on Q1 2018. Notably, the net balance of exporters who believe the value of their exports will grow in the next three months has turned negative this quarter for the first time in its nine-year history.
- **Small business revenue growth fell flat in Q1 2019.** The net balance of small businesses which saw revenues rise was only 0.1% in the first quarter of 2019. The stagnation in small business revenue growth represents a substantial fall of 5.8 percentage points since Q3 2018.
- **Small businesses reduce headcounts for the first time since 2016.** After ten consecutive quarters of increases, the net balance of small firms reporting a larger workforce stood at -1.0% in Q1 2019. This was a decline of 4.9 percentage points since Q4 2018.
- **Small business cost pressure rises to the highest level since 2011.** A net balance of 70.6% of small businesses report an increase in operating costs during the past three months compared with the same period a year ago. After remaining relatively stable throughout 2018, the 7.4 percentage point spike this quarter means the highest net balance reported since Q4 2011, when it stood at 74.0%.

UK MACROECONOMIC OVERVIEW

UK growth subdued amid political uncertainty

The UK economy expanded by 0.2% in the three months to January 2019, the same rate of growth recorded in the final quarter of 2018. Compared to the same period last year, the UK economy has grown by just 1.3%, compared to 2.6% in January 2017.

The latest data also show that the manufacturing sector is locked in a particularly bad run of poor performance. Compared to the previous three months, output in the sector declined by 0.7%, making this the fourth consecutive period of negative growth. Construction output also recorded a decline of 0.6% over the same period. The more volatile single-month data indicate some respite, however, with both sectors returning to growth in January after sharp contractions in output during December 2018.

The slowdown is global in nature and, outside the UK, growth in China and a number of major Eurozone members slowed in 2018. Similarly, growth in the US decelerated in the final quarter of the year as the impact of the Trump administration's tax cuts faded and the escalation of protectionist policies impacted global trade. In the three months to January 2019 the UK trade deficit widened as an improved surplus in services trade was outweighed by a goods deficit that increased due to higher imports and lower exports of goods.

The service sector, which forms the backbone of the UK economy, continued to grow, albeit more slowly over the second half of last year. The latest data indicate a slight uptick as rolling three-month growth accelerated by 0.1 percentage points to 0.5%. The improvement was just about sufficient to offset the fall in output from production industries and construction to keep the economy ticking over. It is telling that the largest contribution to growth in services came from wholesale and retail trade, which grew by 1.1%,

and the ONS notes that it was wholesalers leading the way. These firms in particular will have benefited from businesses stockpiling in an attempt guard against Brexit-related disruption to their supply chains. The Government's failure to win a vote on its Brexit Withdrawal Agreement ahead of the Christmas recess seems likely to have boosted this activity as the risk of no deal increased.

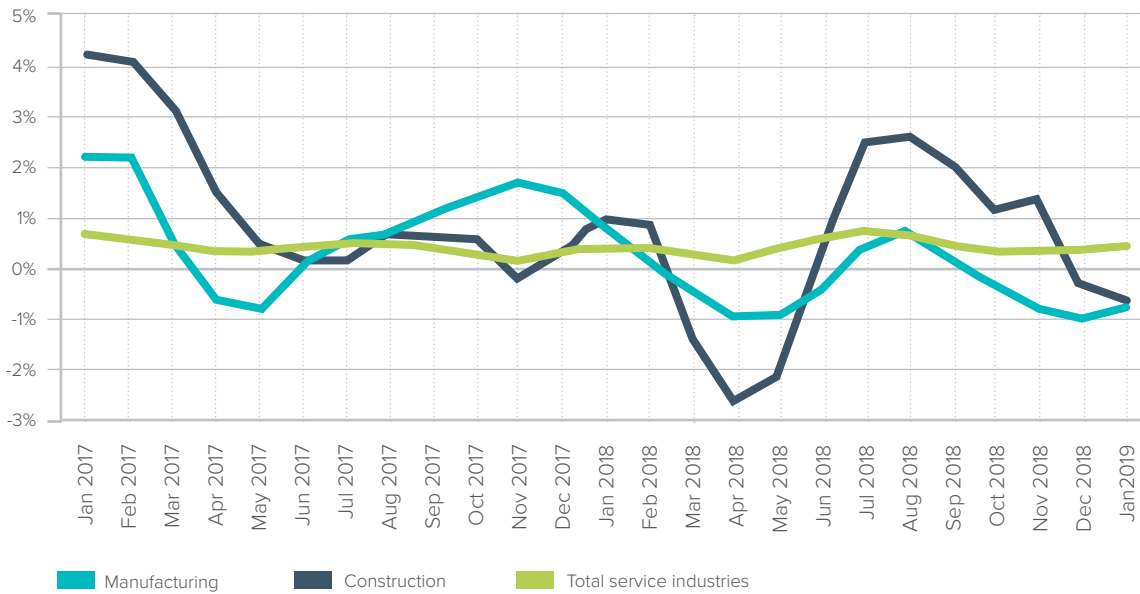
Although the labour market has remained resilient through the recent slowdown, the outlook for consumer-facing industries is still poor. The employment rate has continued to improve and now stands at the highest rate since comparable records began in 1971, while the rate of wage growth, at 3.4%, is only 0.1 percentage points off the highest level recorded since 2008. But due to persistently high inflation, which has only recently started to fade, real earnings growth is just 1.5% (including bonuses). In fact, following a long period of poor wage growth in the aftermath of the global financial crisis, average weekly earnings have still not recovered to their pre-crisis levels.

Though working households will find their financial situation improving as better pay feeds through into bank balances, this is unlikely to translate directly into higher spending. External factors are creating uncertainty which has dampened consumer confidence and, having borrowed to fund consumption through a long slow recovery from the 2008 recession, households are quite heavily indebted. This combination is making consumers more debt-averse and the Bank of England reports that annual growth in consumer credit slowed to 6.5% in January, well below its recent peak of 10.9% in November 2016.

Businesses have also been suffering from weaker confidence and are shying away from committing to larger spending plans. Business investment contracted in every quarter of 2018 and, at -1.4%, the Q4 performance was the worst since Q1 2016. While bank lending to large businesses looked strong in January, increasing by 6.4% year-on-year, the Bank of England reports that small and medium-sized enterprises only increased borrowing by 0.5% over the same period.

As businesses and households alike hold back on committing to non-essential spending, the prospects for an upturn in 2019 look slim. Until the global economy is on a firmer footing, the UK looks set to continue on a slow-growth trajectory.

Figure one: Monthly growth rates by sector of the UK economy, latest three months on previous three months. Source: Office for National Statistics.



SMALL BUSINESS INDEX

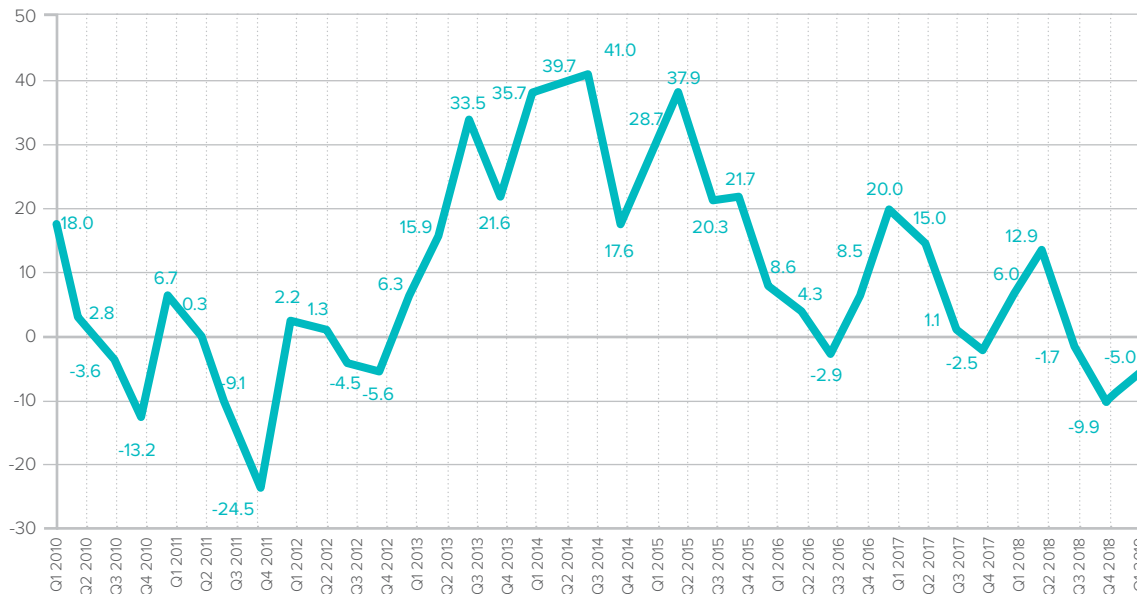
Small business confidence remains negative

Business confidence among small firms rebounded somewhat after two consecutive quarterly declines in Q1 2019. The FSB Small Business Index increased to -5.0, a rise of 4.9 points from the -9.9 recorded in the final quarter of 2018. Year-on-year the index fell by 11.0 points, and (excluding Q4 2018) remains lower than every other quarter since Q4 2012.

The UK services Purchasing Managers' Index (PMI) rose in February to 51.3. This was a 1.2 point increase from the 50.1 recorded in January, which marked the lowest level in two-and-a-half years. While the small rebound is a positive in comparison to the January data it represents a very weak start to the year. With an average of 50.7 over the first two months in 2019, the index sits just above the 50 mark that separates an expansion in output from a contraction. The construction PMI indicates the sector has started contracting, dropping to 49.5 in February, while manufacturing recorded a small decline of 0.6 points to 52.0.

Across the UK, businesses of all sizes are indicating that uncertainty has been clouding their outlook, and this is feeding through into investment, stockpiling and hiring decisions. Some impacts will be short-lived, for example holding back on spending decisions during the final weeks of Brexit negotiations. Others, like the decision by a business to close a UK plant or an EU national to emigrate will have longer-term implications for the strength of the UK economy.

Figure two: The FSB Small Business Index¹: small business prospects over coming three months
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



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

Figure three: Year-on-year change in the FSB Small Business Index.
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.

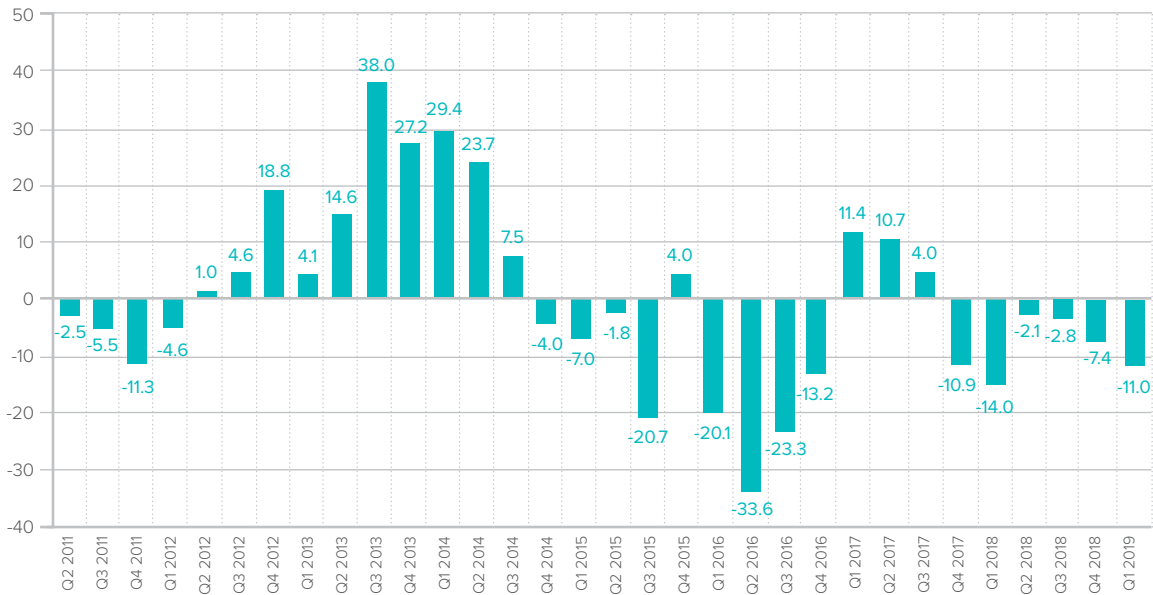
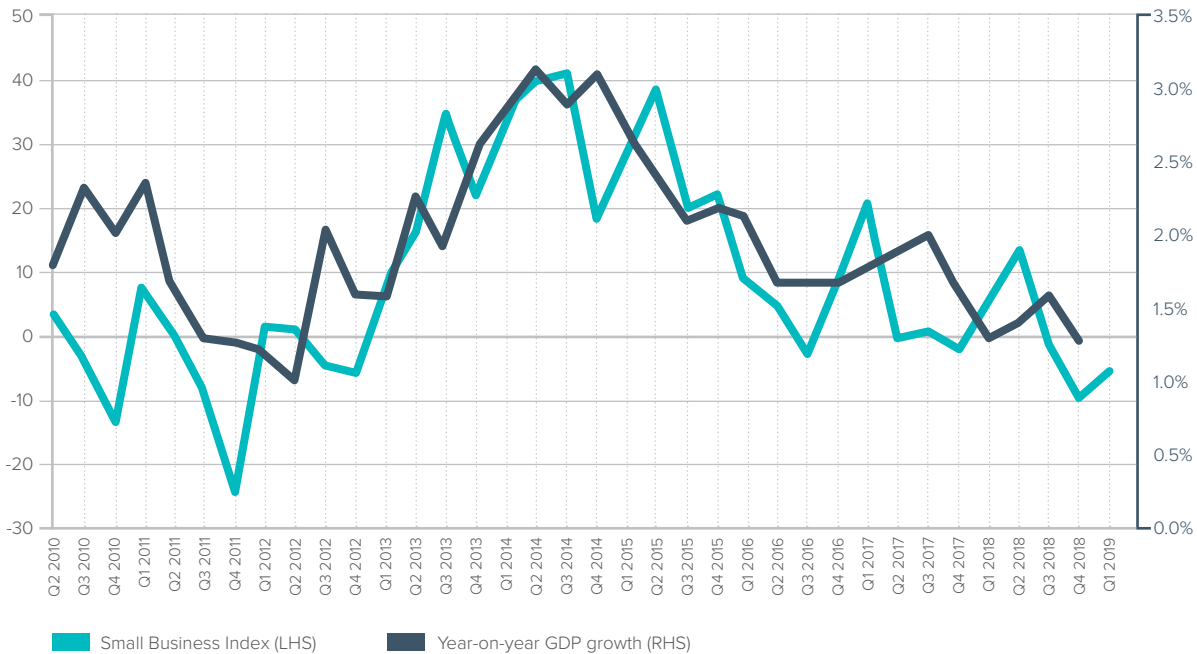


Figure four: UK SBI against year-on-year UK GDP growth.
 Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

East more confident than west

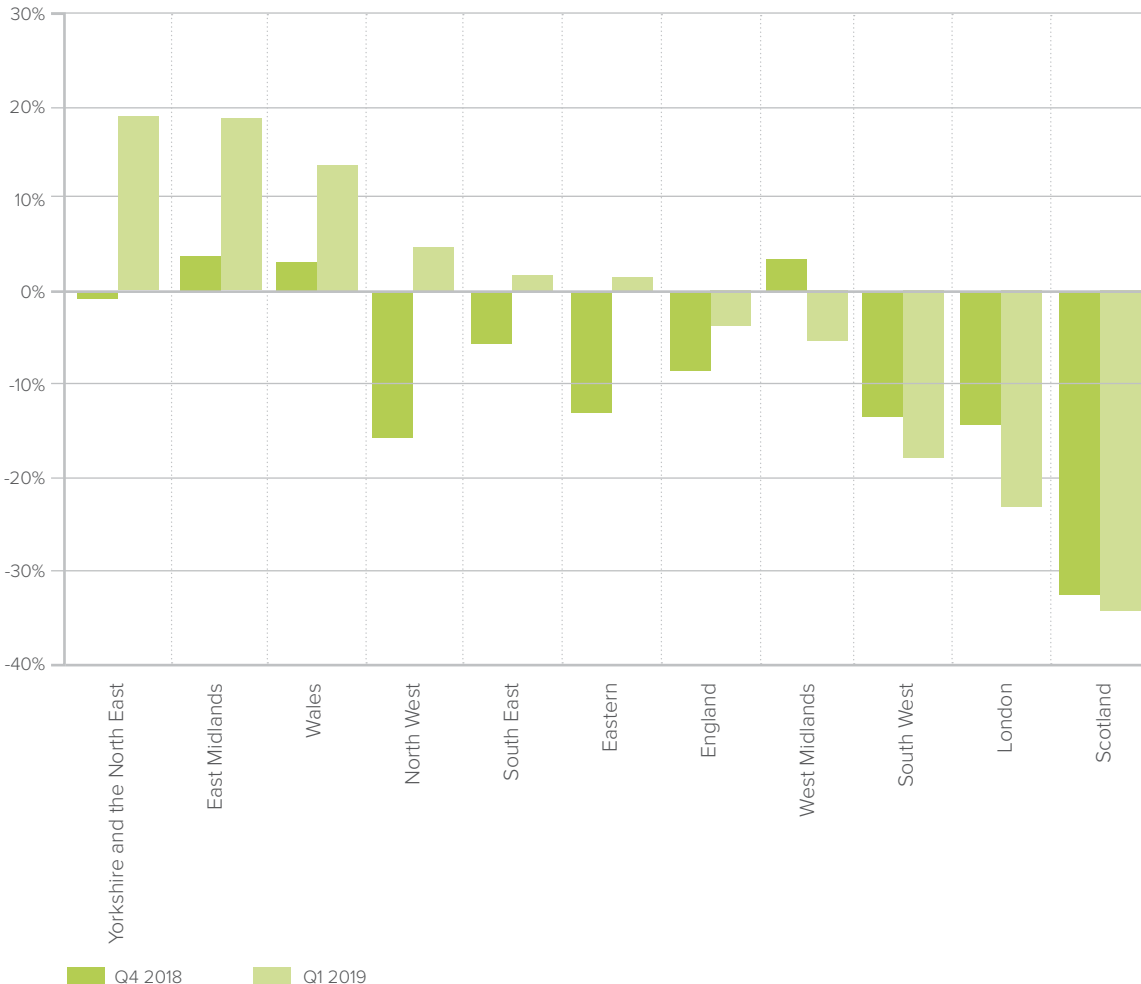
SMALL BUSINESS CONFIDENCE DIVERGES ACROSS REGIONS

Small business confidence has moved in opposite directions across the different nations and regions of the UK between Q4 2018 and Q1 2019. This has pushed the gap between the most confident region (Yorkshire and the North East, +18.9) and least confident region (Scotland, -34.5) to 53.4 points, up from 36.4 points in Q4 2018. The increase in confidence of 19.7 points in Yorkshire & the North East was exceeded only by the North West where the score rose by 20.2 points to +4.6. Double digit increases in confidence were also recorded in the East Midlands, East of England and Wales where the index increased by 14.9, 14.5 and 11.0 respectively.

The overall index has recovered somewhat in Q1 2019 driven by large improvements in regions experiencing higher confidence. However, this was still outweighed by the negative sentiment across the rest of the country. In stark contrast to the positive moves in the north and east of England, declining confidence left Scotland (-34.5), London (-23.2) and the South West (-17.7) deep in negative territory in Q1 2019. The steepest decline was recorded in the West Midlands, however, where the index fell from amongst the highest in Q4 2018 by 9.0 points to -5.4 this quarter.

Year-on-year, almost all regions have faced a decline in confidence, with the annual change in the North West (+7.6) and Eastern (+1.3) regions of England being the only exceptions.

Figure five: FSB Small Business Index – regional variation in small business prospects over coming three months
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.



SMALL BUSINESS SECTOR INDICES

Consumer-facing firms
continue to struggle

PERSISTENT RETAIL WEAKNESS CONTINUES INTO 2019

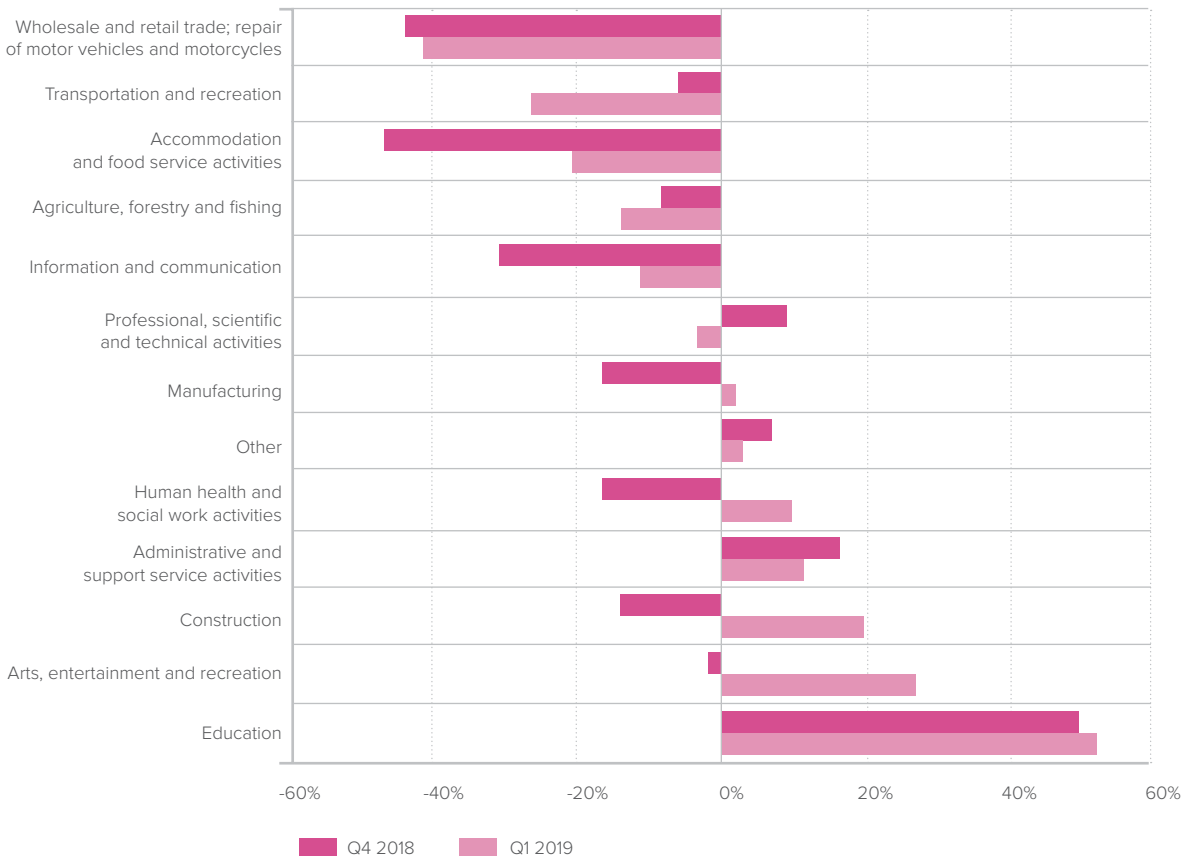
Confidence amongst small professional, scientific and technical services businesses fell by 12.3 points, dipping into negative territory from +9.5 in Q4 2018 to -2.9 in the first quarter of 2019. Although confidence did improve among a number of sectors over the last quarter, in many cases it was not by a large enough margin to overcome the highly negative outlook recorded in Q4.

Smaller wholesale and retail trade businesses saw a marginal 2.6 point increase from -44.5 in Q4 2018 to -41.9 in Q1 2019, making retail the least-confident sector in this quarter. Following a weak Christmas period, the Office for National Statistics did record an uptick in retail sales in January, but a falling rate of consumer credit growth suggests that higher spending is not a priority for UK households as the economy slows. This is likely to hold back retailers, many of whom face cost pressures, over the course

of the coming year. Similarly, accommodation and food services and information and communication firms were still demonstrating a significant lack of confidence, despite Q1 rebounds of 26.9 and 19.8 points respectively. In Q1 2019 these industries reported negative index scores of -20.6 and -11.0.

The largest improvement of the major industry groups came from construction, which reported a reversal of fortunes. A 30.0 point drop between Q3 and Q4 of 2018 was undone by a 33.7 point increase this quarter. However, it is likely that this is partly a seasonal effect: year-on-year confidence in the sector is down by 2.4 points. Manufacturing businesses have a more balanced outlook, scoring +1.7 after recording an 18.2 point rise in confidence in the latest quarter. Nevertheless this marks an annual reduction of 30.0 points.

Figure six: FSB Small Business Index by sector – small business prospects over coming three months. Source: FSB - Verve 'Voice of Small Business' Panel Survey.



FINANCIAL PERFORMANCE

Uncertainty hurts bottom lines

SMALL BUSINESS REVENUE GROWTH FALLS FLAT

While 37.6% of small businesses experienced improved revenues over the past three months, 37.5% saw revenues decrease. As a result, the net balance of small businesses which saw revenues rise was only 0.1% in the first quarter of 2019. The stagnation in small business revenue growth represents a substantial fall of 5.8 percentage points in the net balance figure since Q3 2018 when this question was last asked. It is the lowest net balance figure recorded since Q2 2013 when the balance was -0.4%.

Small businesses in Scotland, where a net balance of -20.2% indicates a widespread slowdown in revenue growth, performed particularly poorly. The West Midlands also recorded a negative net

balance (-10.9%) which may explain why confidence in the region fell faster than in any other between Q4 2018 and Q1 2019. In-line with core confidence results, growing revenues were reported across the construction and manufacturing industries over the last quarter, and are expected over the next three months.

Looking at revenue expectations for UK firms as a whole indicates that firms believe revenues should return to growth over the next three months. A net balance of 7.1% of small businesses expect better revenues in Q2 2019. This time last year, 27.8% of firms expected an improvement in revenues.

Figure seven: Small business revenues, net percentage balance – proportion reporting/ expecting increase less proportion reporting/expecting decrease.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



EXPORTS

International sales tumble
amid uncertainty

SMALL BUSINESS EXPORT EXPECTATIONS TURN NEGATIVE FOR FIRST TIME

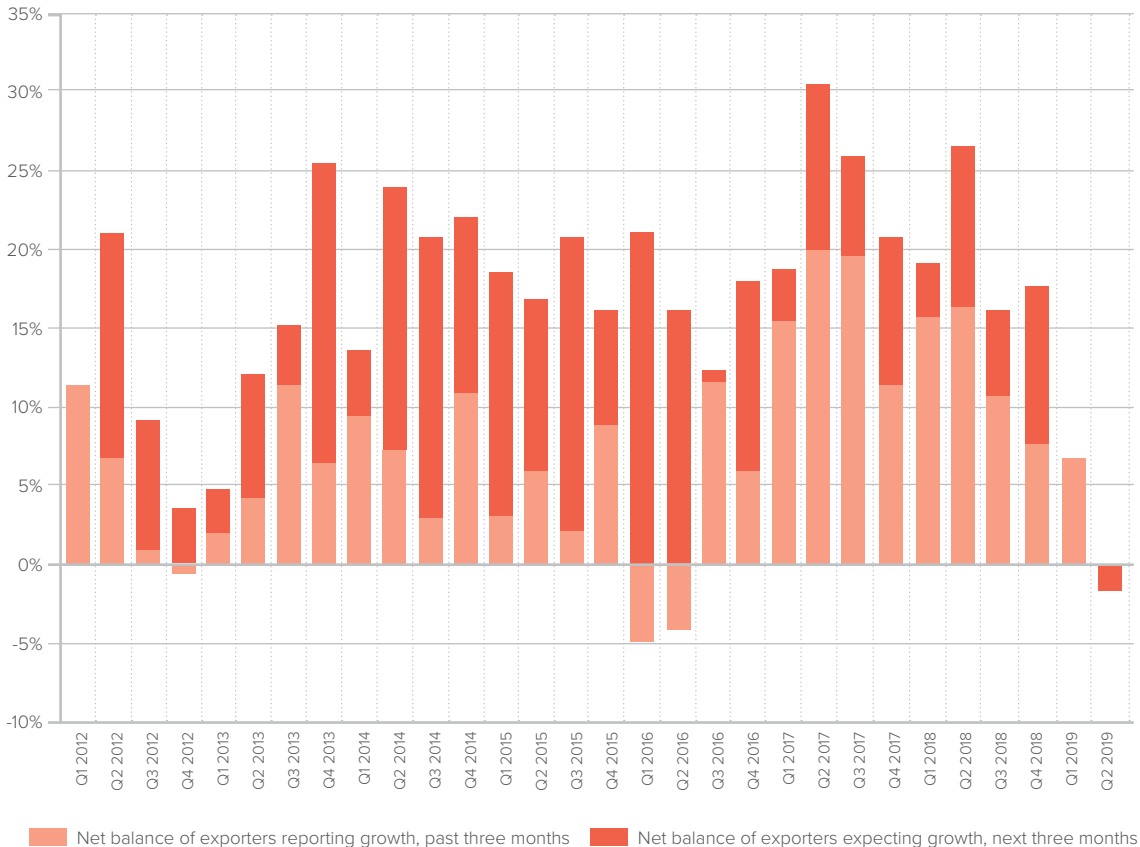
The net balance of small businesses reporting an increase in the value of their exports decreased for the third consecutive quarter to stand at 6.8%. This is down 0.8 percentage points from 7.6% in Q4 2018 and 9.0 percentage points on Q1 2018.

The latest official trade statistics show the UK's total trade balance moving further into deficit, standing at £10.4 billion in the three months to January 2019. An expansion in the services surplus was outweighed by a larger widening in the goods deficit. Goods and services imports rose while goods exports fell compared to the previous three-month period. Regulatory issues and slowing global demand in the car industry had a large impact on the exports of cars, while the value of imports and exports of fuels were heavily affected by the falling global oil price towards the end of 2018. Smaller businesses providing

goods and services to the global car and oil and gas production industries are likely to have felt the effects as these changes have passed through supply chains.

The net balance of firms expecting an increase in exports in Q1 2019 was -1.6%. This is the first time that more exporting firms have expected a reduction in the value of their exports than have expected growth since this question was introduced to the FSB Small Business Index in 2012. Political uncertainty could be driving some EU buyers to seek suppliers within the single market, outside of the UK, to avert the risk of trade disruption. Meanwhile, some small businesses may simply be factoring lower international sales into their business plans until there is more certainty over future trading arrangements.

Figure eight: Changes in value of exports – previous three months and expectations for coming three months; net percentage balance, proportion reporting increase less proportion reporting decrease.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



COSTS AND INFLATION

Operating expenditure soars

SMALL BUSINESS OPERATING COSTS SPIKE TO HIGHEST LEVEL SINCE 2011

A net balance of 70.6% of small businesses report an increase in operating costs during the past three months compared with the same period a year ago. After remaining relatively stable throughout 2018, the 7.5 percentage point spike in the net balance is the fastest increase in costs recorded since the SBI launched in 2010. Moreover, this is the highest net balance reported since Q4 2011 when the figure stood at 74.0%.

Although labour remains the most frequently cited (39.7%) cause of rising costs for small businesses in Q1 2019, the net balance of small businesses referring to rising labour costs fell by 2.9 percentage points compared to Q4 2018. This coincides with a 0.1 percentage point decline in the rate of wage growth in the three months to January 2019 compared with the final quarter of 2018, when average weekly earnings reached 3.5%, the fastest rate of growth since 2008. The survey data suggest that, as the economy cools, the level of competition for labour may have started to subside over the first quarter of 2019.

Fuel was the only other main category, aside from labour, where the share of businesses citing it as a cause of rising costs fell between the last two quarters. The 7.6 percentage point reduction in the proportion of businesses referencing fuel as a source of cost pressure was largely expected as the oil price fell towards the end of 2018, bringing down the pump price of fuel. Instead, other sources of cost pressure are now taking precedence for small businesses, driving a broad-based increase in operating costs. The largest changes were seen in the proportion of firms flagging the increasing costs of utilities and taxation, which increased by 5.3 and 4.7 percentage points respectively.

Figure nine: Small businesses reporting an increase in overall cost of operation over past three months, compared with the same period a year ago; net percentage balance.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.

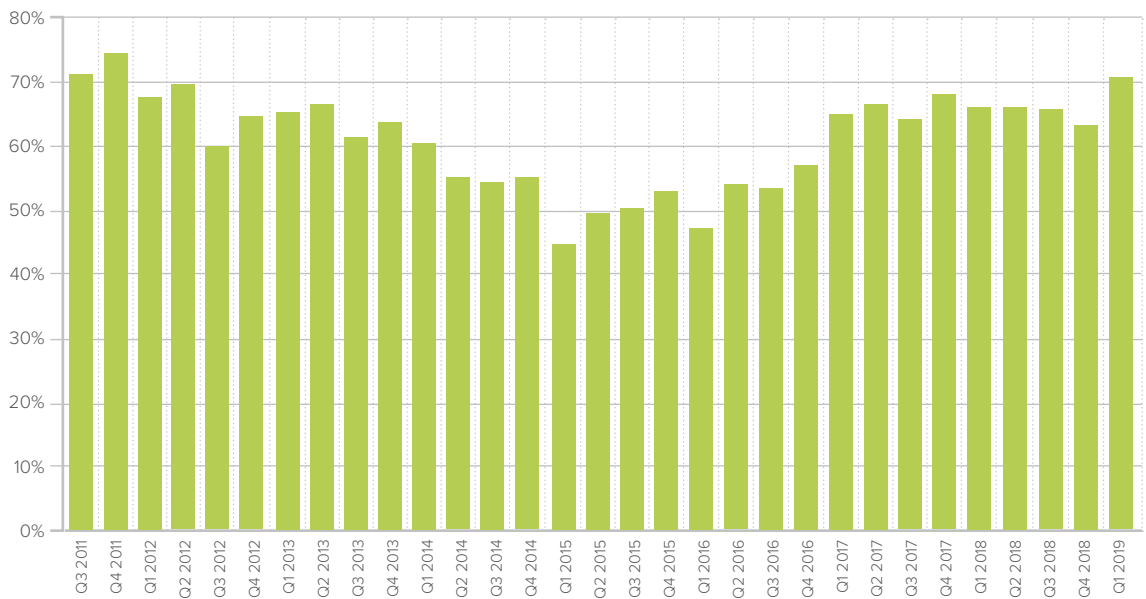
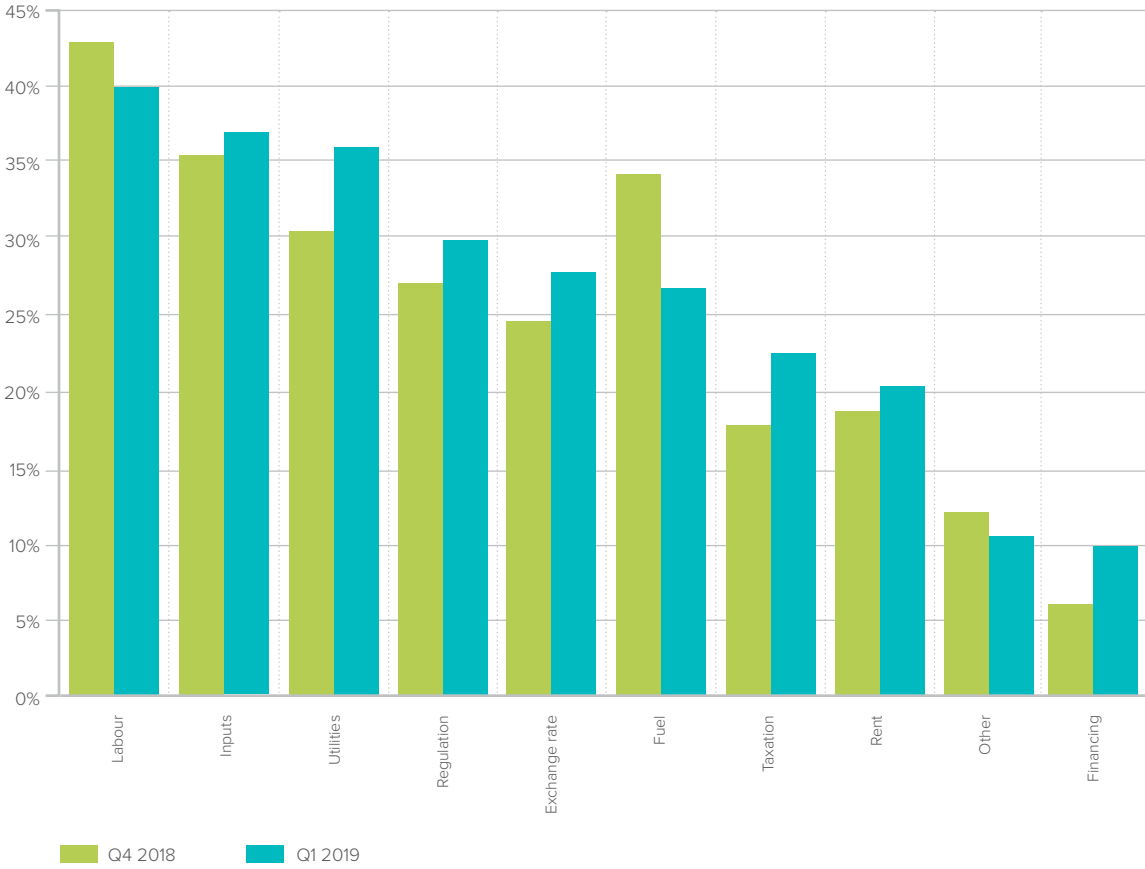


Figure 10: Main causes for changing business costs (firms may give multiple answers).
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CAPACITY

Fewer firms running at capacity

SPARE CAPACITY INCREASES BUT IS EXPECTED TO REDUCE IN TIME

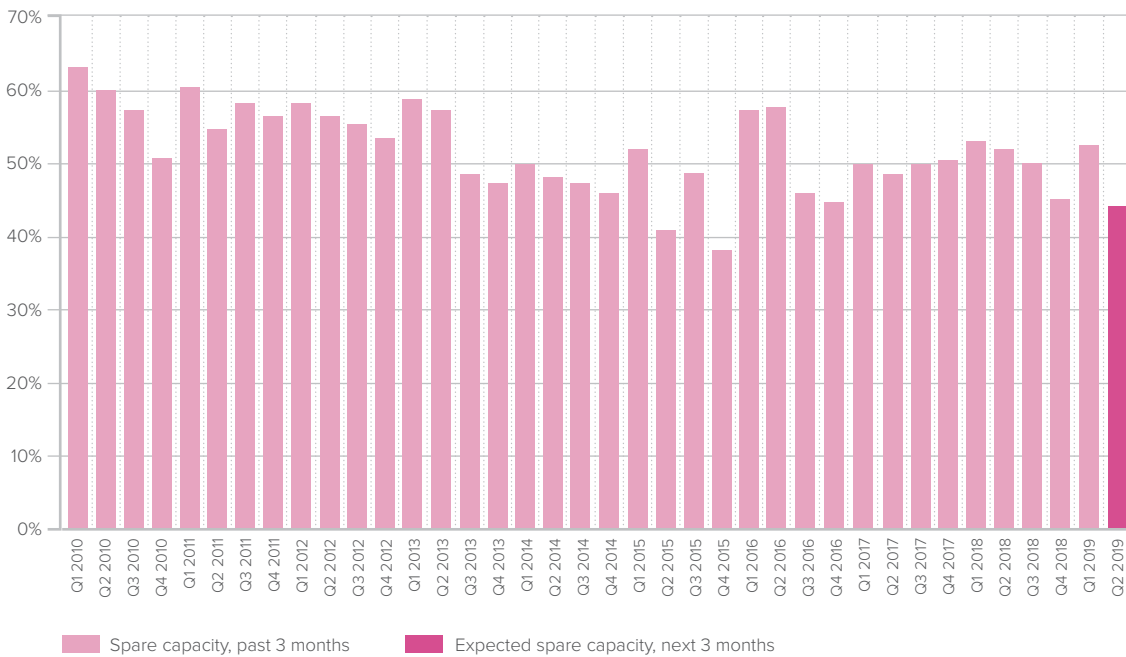
The latest survey results show that the share of small businesses operating below capacity jumped in the first quarter of 2019. A net balance of 52.2% of firms operated below capacity in Q1 2019, which represents an increase of 7.1 percentage points since the last quarter of 2018. The last spike almost entirely reverses three consecutive quarterly declines to leave the net balance only 0.2 percentage points lower than in Q1 2018. A net balance of 62.5% of small businesses in the North West had spare capacity in Q1, significantly higher than the UK average.

A significantly lower net balance (44.5%) of small businesses expect to have spare capacity over the next three months. The 0.8 percentage point improvement on the expectations net balance recorded in Q4 2018 indicates some optimism from small businesses regarding their ability to utilise more capacity in the coming months.

The expected reduction in spare capacity in the coming three months chimes with the slight improvement in the overall index. While some of this excess capacity may be absorbed by improvements in output, the more concerning prospect is that businesses may in fact be planning to scale back operations to align with a lower growth environment.

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

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



EMPLOYMENT

Recruitment plans paused

HIRING INTENTIONS TURN NEGATIVE FOR FIRST TIME SINCE 2016

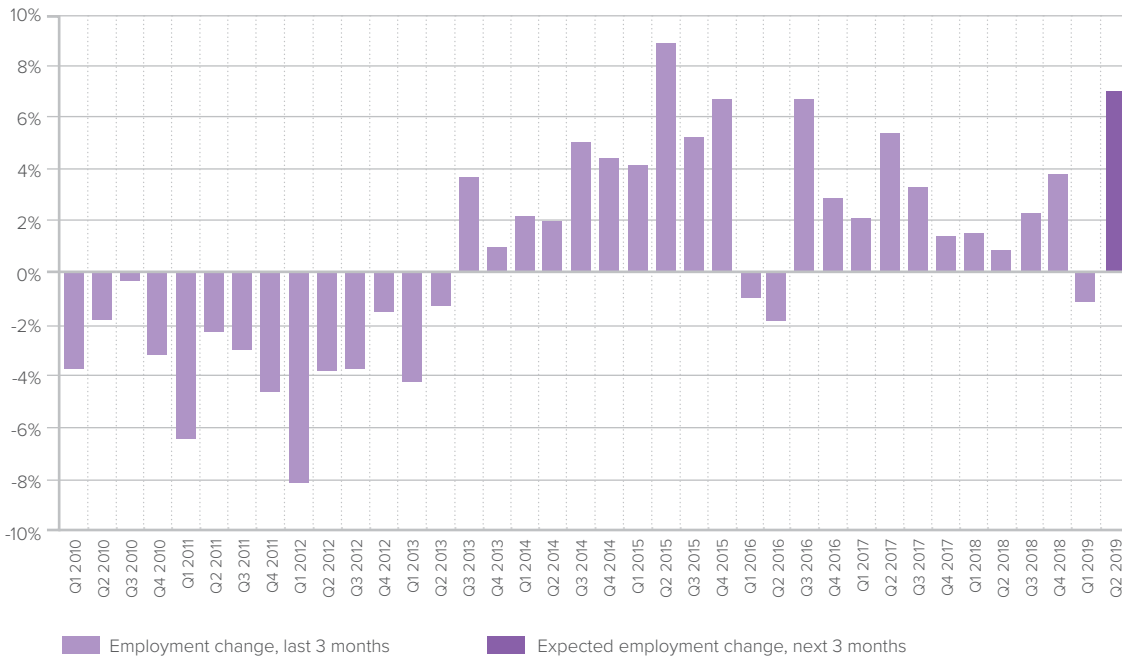
After ten consecutive quarters in which the net balance was positive, the proportion of businesses reporting a reduced workforce now exceeds those who report an increase in employment over the last three months. Following a decline of 4.9 percentage points since the last survey, the net balance of small firms reporting an increased workforce stood at -1.0% in Q1 2019.

The net balance of firms expecting to increase hiring activity over the next three months is significantly higher, at 7.0%. This represents an increase of 1.9 percentage points from the previous survey. Although the upward move suggests optimism among small businesses regarding staffing levels, the expectations net balance stands at 1.1 percentage points below the five-year average of 8.1%.

Data from the Office for National Statistics (ONS) show that in the three months to January the number of people in employment in the UK increased by 473,000 compared to the previous year. Over the same period, the number of people either inactive or unemployed fell by 194,000 and 112,000 respectively. Nevertheless, cracks may start to appear in the strength of the UK labour market as retailers continue to struggle and manufacturers in the car industry plan to scale back UK production with knock-on impacts for employment in those industries.

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

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

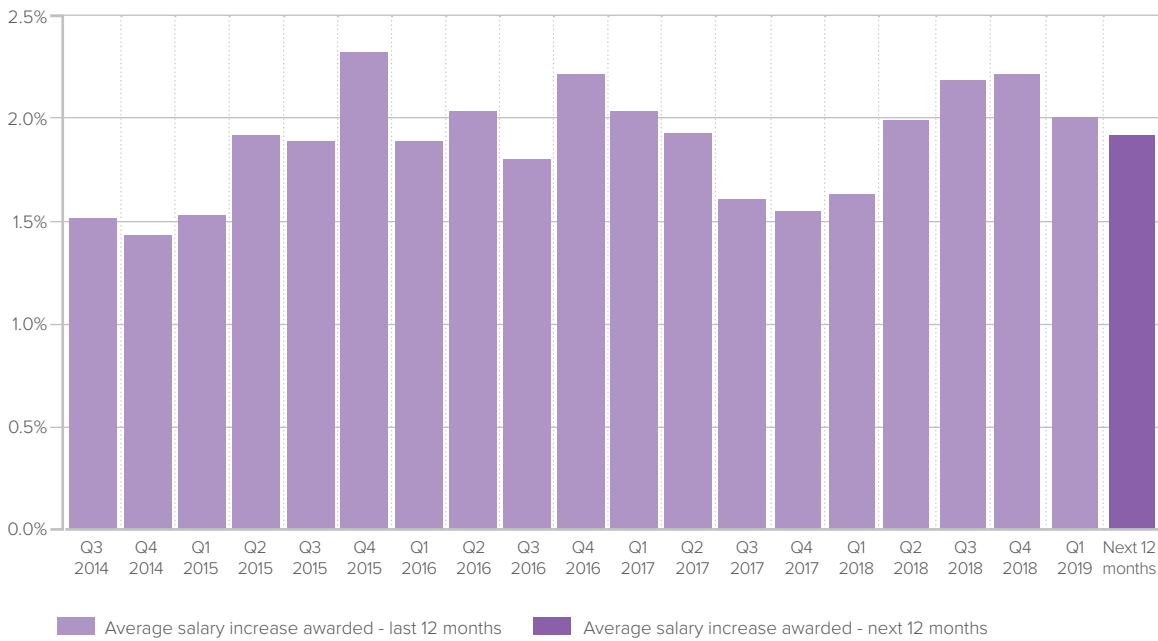


SMALL BUSINESS WAGE GROWTH DIPS AS EMPLOYMENT SLOWS

This quarter, annual average small business wage growth dipped by 0.2 percentage points to 2.0%, bringing wage growth back down towards the level recorded in Q1 2018. This finding is in-line with the decline in the proportion of businesses reporting labour as a driver of higher costs over the last quarter. As fewer businesses have reported a growth in their workforce over the latest quarter, the pressure to raise wages in order to attract new staff is waning.

The expected rate of wage growth over the next 12 months has also reduced, down 0.4 percentage points to 1.9%. A tight labour market means wage costs are unlikely to completely fall off the radar for most small business owners, however, as the retention of key staff will still require competitive pay. The latest ONS data show annual earnings growth in the three months to December was 3.4% across the UK. However, the SBI results suggest that, with a slower rate of growth in pay emerging in Q1, and even weaker prospects over the next 12 months, pay growth will start to plateau during 2019.

Figure 13: Average salary increase awarded, current quarter versus a year before.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



GROWTH ASPIRATIONS AND CHALLENGES

Ambitions stifled

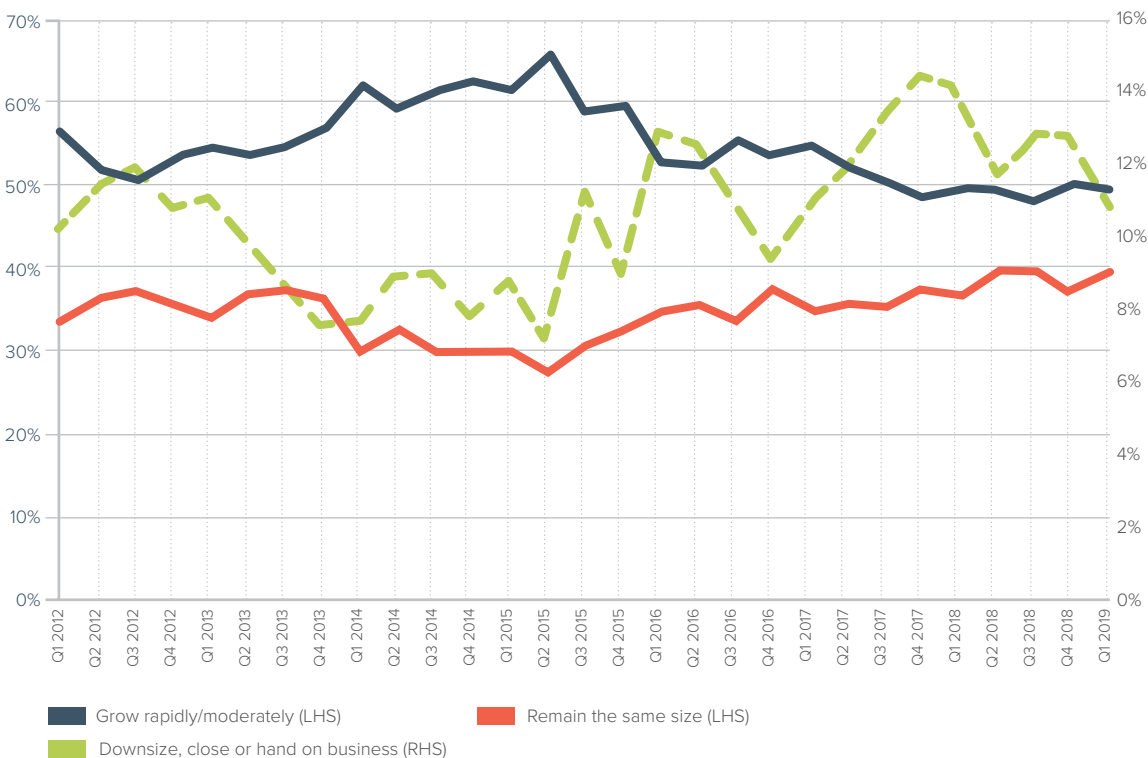
SMALL BUSINESSES TARGET STABILITY AS GROWTH ASPIRATIONS SLIP BACK

The increase in overall small business confidence in Q1 2019 was actually accompanied by a decline of 0.6 percentage points in the proportion of businesses that expected to grow over the course of the next 12 months. Rather, the increased level of confidence seems to have derived from a lower proportion of businesses expecting to scale back their operations over the coming year. The share of owners planning on downsizing, closing or handing on their business decreased by 1.8 percentage points, to 10.9%.

Businesses in London (58.9%) and the East Midlands (57.6%) seem the most optimistic about their ability to grow in the next 12 months. At the other end of the spectrum is Scotland, where only 42.2% of small businesses aspire to grow, while 16.5% expect to scale-back their operations.

In general, there has been a move towards maintaining businesses at their current level, with a trend emerging since early 2015 of firms maintaining their current size rather than risking attempts to grow. At 39.3%, the proportion of firms aiming to maintain their current size is just 0.3 percentage points off its highest ever level, recorded in Q3 2018.

Figure 14: Growth aspirations for next 12 months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



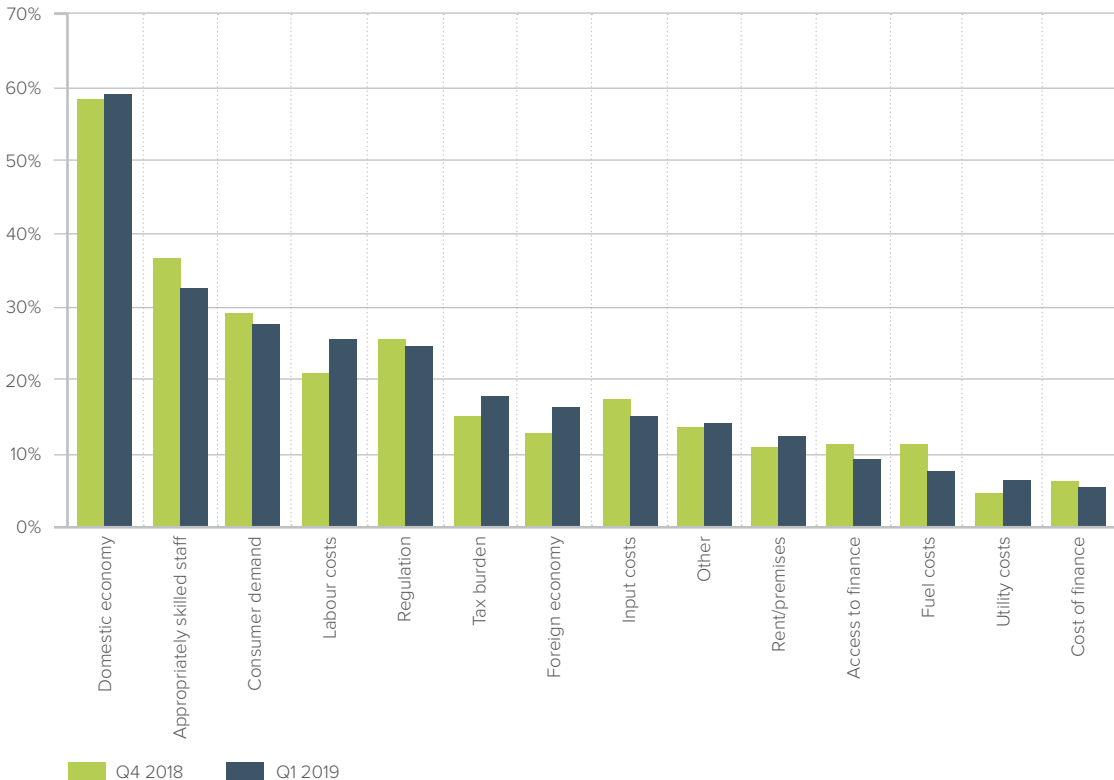
DOMESTIC ECONOMY REMAINS KEY BARRIER TO SMALL BUSINESS GROWTH

The domestic economy continues to stand head and shoulders above other factors in limiting the growth potential of UK small businesses. Following a 0.1 percentage point increase from the previous quarter, the proportion of firms citing it as a barrier to their growth aspirations stood at 58.3% in Q1 2019. This result is unsurprising as quarterly UK growth slowed to 0.2% in the three months to January 2019.

One of the drivers of subdued UK growth is the influence of a weakening global economy reducing the opportunities for UK firms abroad. With many major economies also seeing their demand for goods and services stagnate, it is unsurprising that the foreign economy is considered a barrier to the growth aspirations of 15.8% of firms. This marks a 3.2 percentage point increase from the final quarter of 2018, the second-largest increase in a single category after labour costs.

Despite a reduction in the pace of wage increases, referred to earlier in this report, labour costs have moved sharply up the agenda for firms that aspire to grow in the next 12 months. A five percentage point increase compared to the previous quarter leaves 25.5% of businesses concerned that labour costs will hold back their expansion plans. This is the highest level since Q2 2016. Meanwhile, concerns around the cost and availability of finance have fallen back as the prospect of further interest rate rises have diminished. The minutes of the Bank of England’s Monetary Policy Committee’s latest meeting suggest a slower pace of rate rises is inevitable due to a sluggish growth outlook.

Figure 15: Potential barriers to achieving growth aspirations – multiple answers possible.
Source: FSB - Verve ‘Voice of Small Business’ Panel Survey.

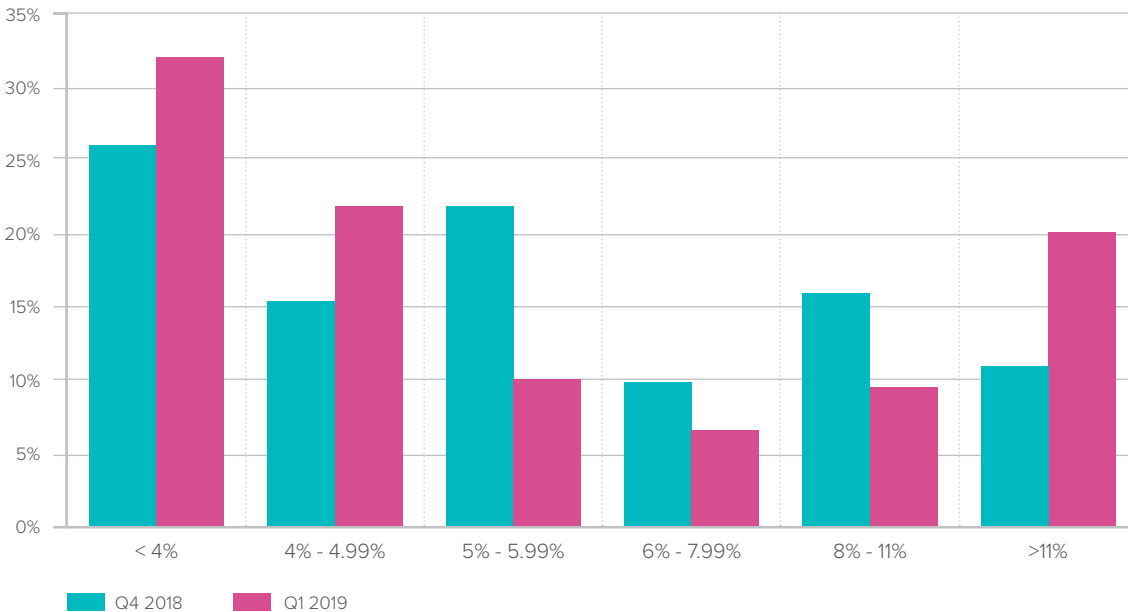
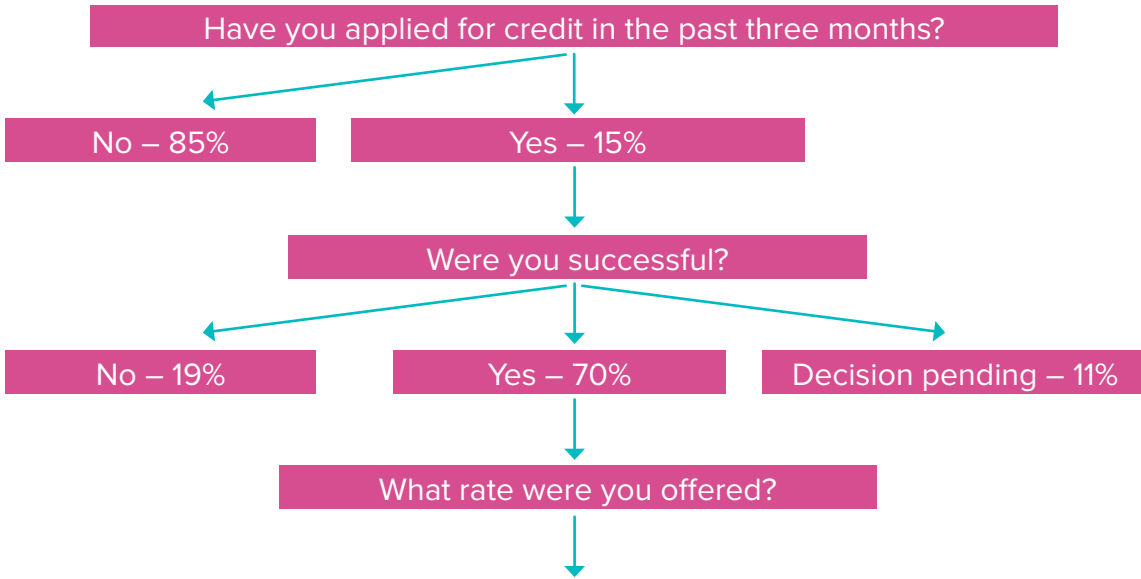


CREDIT

Accessing finance remains
a challenge

FEWER BUSINESSES APPLY FOR CREDIT

Figure 16: Credit applications and interest rates offered.
 Source: FSB - Verve 'Voice of Small Business' Panel Survey. Respondents were able to give multiple answers to this question.



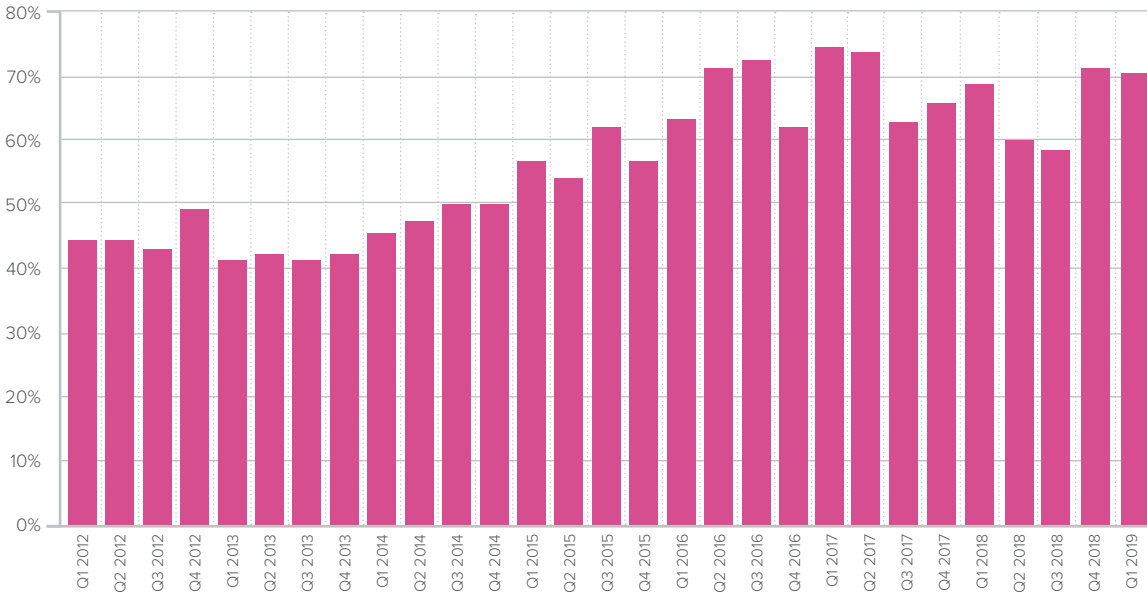
This quarter, the proportion of small businesses successful in their credit applications stands at 70.3%, down by 0.5 percentage points on the final quarter of 2018. However, the figure is up 1.8 percentage points on Q1 2018, and well above the 61.3% average recorded over the previous five years. Due to an increase in businesses awaiting a decision on their

application to 11%, the proportion of businesses that were declined credit also fell to 19% in Q1 2019. The Bank of England reports that annual growth in business borrowing is in-line with these findings: bank lending to small and medium-sized enterprises grew by a modest 0.5% year-on-year in January 2019.

For those that were able to secure finance, a higher proportion were offered a rate of less than 4%. The share increased by 6.1 percentage points, from 26.0% in Q4 2018 to 32.1% in Q1 2019. More than half (54%) of applicants were offered an interest rate of less than 5%.

At the other end of the scale there was also a 9.1 percentage point increase in the proportion of businesses receiving offers of credit at interest rates over 11%. In Q1 2019, 20.0% of businesses were offered rates at or above this level.

Figure 17: Proportion of small businesses successful in their credit applications in the past three months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.

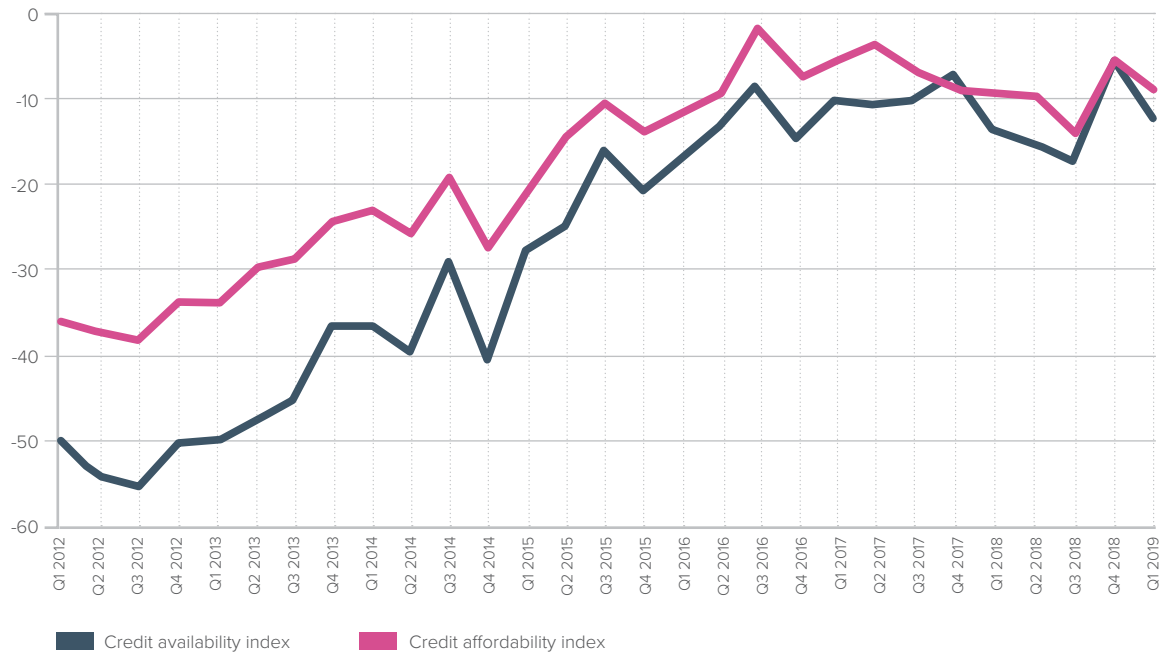


CREDIT AFFORDABILITY AND AVAILABILITY REMAIN STRONG DESPITE Q1 DECLINE

Following a dramatic increase in the FSB credit indices in Q4 2018, both the affordability and availability of credit scores have fallen back in Q1 2019, by 7.0 and 3.7 points respectively. Despite this decline, the credit availability index remains 1.5 points higher than in Q1 2018. Similarly, the credit affordability index is 0.7 points higher than at the same point last year. Notably, in a sign of increasing polarisation of the credit market, the proportion of businesses reporting that credit availability is very poor has risen to 17.5%. This marks a 4.4 percentage point increase since the final quarter of 2018.

Interest rates remain historically low and the Bank of England indicated in the minutes of its February monetary policy decision that this is set to remain the case for longer than anticipated in Q4 2018. On that basis, the stage is set for credit conditions to remain favourable, unless economic conditions decline so badly that lenders have to increase the premium they charge to guard against the risk of businesses defaulting.

Figure 18: Indices of credit affordability/availability perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



INVESTMENT AND PRODUCTIVITY

Business owners hold back

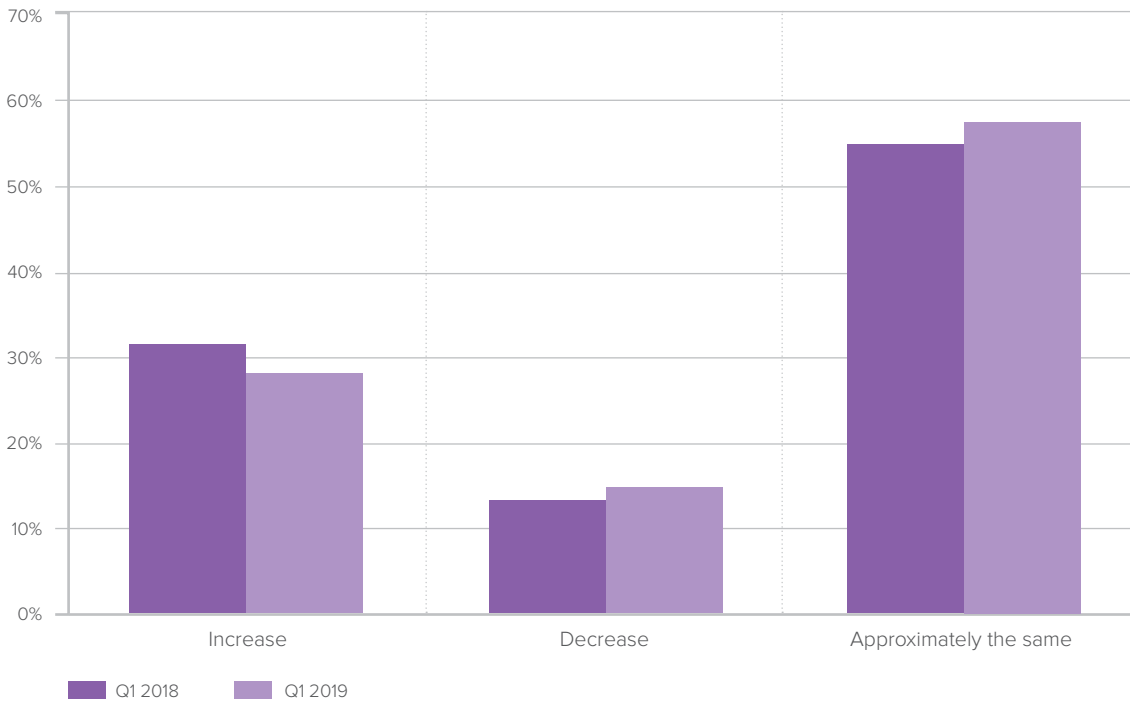
SMALL BUSINESSES CONTINUE TO PAUSE INVESTMENT PLANS

The share of small businesses expecting to increase capital investment over the next quarter fell by 4.6 percentage points compared to the final quarter of 2018, to stand at 28.1% in Q1 2019. This is 3.7 percentage points down on the first quarter of 2018. By contrast, the share of firms intending to decrease their level of investment rose by 1.3 percentage points over the year, to stand at 14.6%.

Official statistics, published by the ONS, show that business investment fell in every quarter of 2018. At -1.4%, the Q4 performance for business investment was the worst since Q1 2016. This trend looks set to continue as more small businesses plan to maintain their current level of investment. The proportion holding their plans steady rose by 4.9 percentage points over the last quarter to 57.3%. Businesses seem set on holding off committing to larger spending plans while it remains unclear what will happen to UK-EU relations after Brexit.

Figure 19: Percentage of small businesses expecting to increase and decrease capital investment over next quarter, compared with 12 months ago.

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



METHODOLOGY

This report is based on the February 2019 research survey of FSB members carried out by Verve. 6,226 panel members were invited to take part in an online survey as well as through an open link shared with FSB members. Reminders were sent to all non-respondents. 1,094 responses were received, a response rate of 16.75% for the panel. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 6 and 20 February 2019.

SUMMARY DATA TABLE

	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Small Business Index	15	11	-2.5	6	12.9	-1.7	-9.9	-5.0
Employment - previous three months	5.3%	3.2%	1.4%	1.6%	0.8%	2.3%	3.9%	-1.0%
Employment - coming three months	10.3%	9.4%	2.9%	8.7%	8.2%	7.4%	5.1%	7.0%
Exports - previous three months	20.0%	19.5%	11.5%	15.8%	16.5%	10.7%	7.6%	6.8%
Exports - coming three months	25.8%	20.5%	18.8%	18.8%	16.0%	17.8%	0.2%	-1.6%
Credit availability - rated good or very good	28.0%	24.1%	26.0%	24.1%	21.9%	24.1%	30.2%	28.5%
Credit availability - rated poor or very poor	37.9%	35.2%	31.7%	39.3%	40.0%	42.5%	34.4%	39.0%
Credit affordability - rated good or very good	30.4%	28.8%	24.8%	25.3%	25.4%	23.7%	32.2%	27.9%
Credit affordability - rated poor or very poor	33.2%	38.3%	36.1%	39.2%	35.3%	41.7%	36.1%	37.9%

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

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

Responses are also weighted according to regional gross value added.

Q1

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