

Q2

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 2, 2019

bigvoice
Making change happen

 @fsb_policy

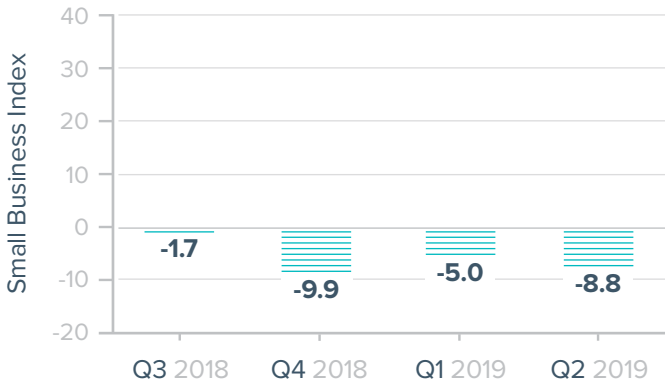
fsb.org.uk

fsb⁰³
Experts in Business

SBI Q2 2019

“Small business confidence in **negative territory** for an **unprecedented** fourth straight quarter”

Confidence on the slide



Business decisions on hold



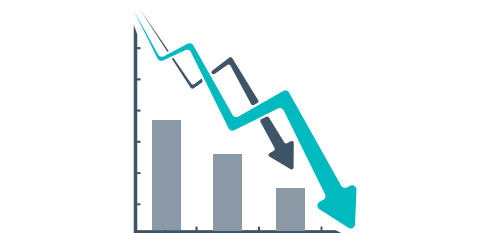
72% not planning to increase investment

Operating costs on the rise

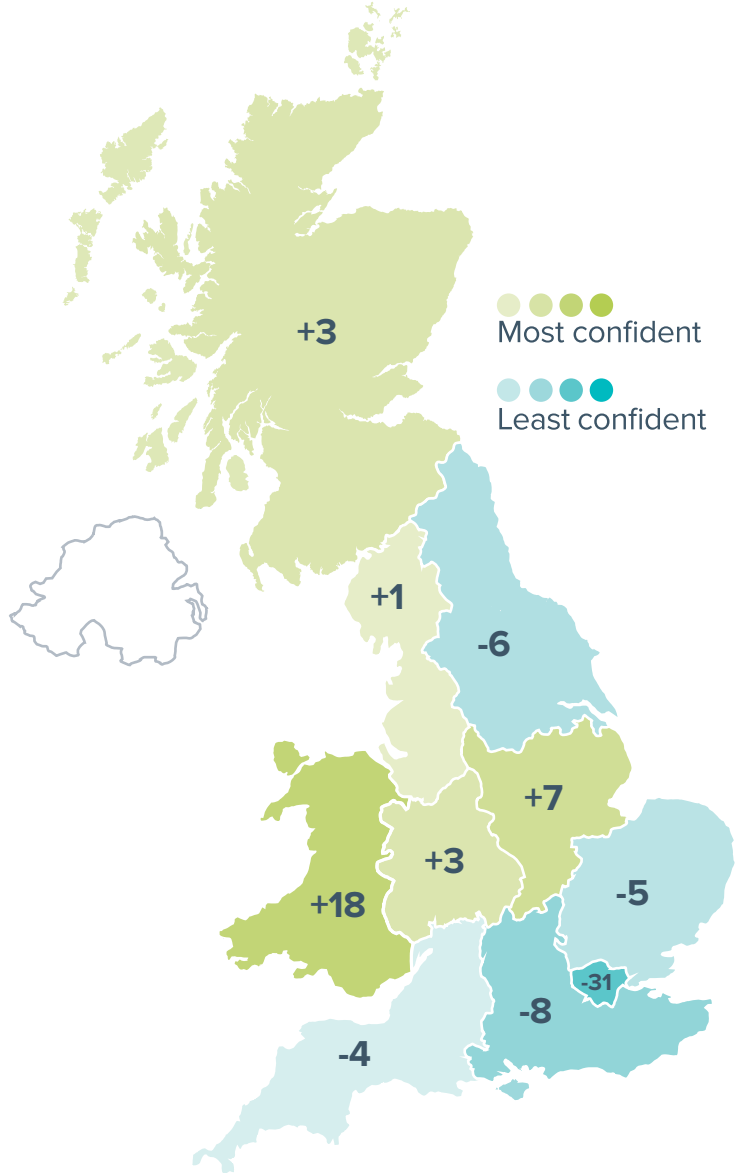


48% say **labour costs** are a main cause of **higher outgoings**

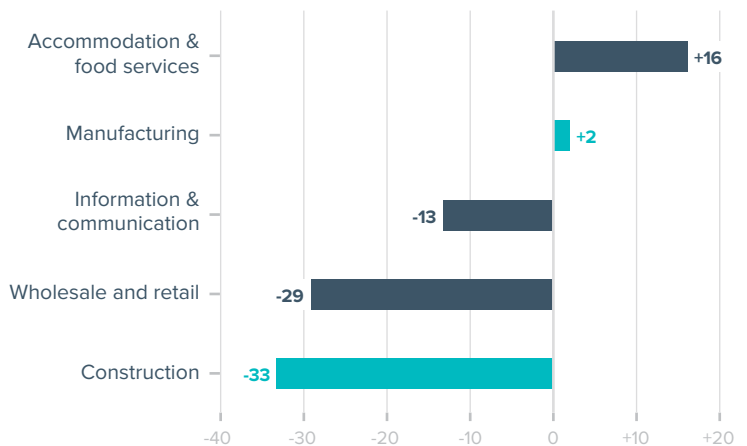
Exporters report falling values



34% say **international sales** have **dropped**



Small business confidence by sector



CONTENTS

FSB Foreword 4

Economist’s view 5

FSB executive summary 6

UK macroeconomic overview 7

Small business index. 9

Regional small business indices 11

Small business sector indices. 13

Financial performance 15

Exports 17

Costs and inflation 19

Capacity. 22

Employment. 24

Growth aspirations and challenges. 27

Credit 30

Investment and productivity. 34

Methodology 36

FSB FOREWORD

With negotiations on leaving the EU stalled, and political uncertainty escalating as we await a new Prime Minister, small business sentiment has fallen by 3.8 points in quarter two, from its already low base in quarter one. This means that, for a fourth consecutive quarter, small business confidence remains deep in negative territory. Our headline UK SBI confidence measure stands at -8.8 for the second quarter of 2019, down by 22 points compared to this time last year. This reflects the largest annual decline in small business confidence since the EU referendum.

Real damage is now being done to the 5.6 million small firms that make up 99% of the business community within the UK. And for the first time in two decades, the UK's small business community has shrunk.

One of the UK's acknowledged structural economic challenges is to increase the country's productivity. The sustained uncertainty as a result of Brexit is having a chilling effect on firms seeking to increase investment. The share of smaller businesses seeking to expand their capital investment plans is now at its lowest level since Q3 2017.

Exporting and 'internationalisation' more generally is associated with higher levels of productivity. Therefore it is deeply concerning that, for the first time since Q2 2016 (pre-EU referendum), smaller businesses are reporting that the value of their exports over the last three months decreased rather than increased.

Perhaps most worrying is the downbeat outlook for growth prospects. The proportion of smaller businesses that are looking to grow over the course of the next 12 months has fallen to its lowest level since 2012. Declining business confidence seems to have been partially driven by small businesses seeking to scale-back their operations over the next year. Seven in ten smaller firms are not expecting their performance to improve over the coming three months. Four in ten expect it to worsen.

In the here and now, the share of small businesses reporting an increase (as opposed to decrease) in gross profits fell to its lowest level since Q2 2013. And the proportion of smaller businesses reporting that labour costs are the main contributor to the increasing costs of doing business has reached a record-high (48%).

Concerns about labour costs, and the costs of doing business more generally, are not surprising given small businesses would have been pricing in a raft of new rules, regulations and costs for businesses that took effect in April 2019. This includes the requirement to submit quarterly online VAT returns via HMRC-approved software under the Government's Making Tax Digital (MTD) initiative. The average year-one cost of it to a small business in scope will be £564 – a figure which does not cover the time, admin and training needed to get up to speed with new reporting demands.

April also saw the hourly National Living Wage rate rise to £8.21 – marking a 14 per cent increase since its introduction just three years ago. Elsewhere, the minimum total contribution to auto-enrolment pension schemes rose to eight per cent of qualifying employee earnings on 6 April, up from five per cent last year. Employers will now be required to shoulder three per cent of total auto-enrolment contributions.

Certain sectors are particularly struggling. The challenges faced by retailers on high streets are well documented. Rising business rates have helped spark a 27-point drop in the SBI reading for small retail and wholesale businesses compared to this time last year. The new Prime Minister must make radical reform of rates a priority. The SBI readings for the labour-intensive manufacturing and construction sectors have also plummeted over the past 12 months by 25 and 56 points respectively.

What smaller businesses now desperately need is the certainty to give them the ability to plan three, five and ten years in advance.

With that in mind, we now need to see both prime ministerial contenders provide clear, considered and comprehensive plans for how they would support the millions of entrepreneurs that are the backbone of the UK economy. As well as resolving the Brexit impasse, it will be just as important to focus on the barriers in the here and now that are inhibiting entrepreneurial growth, including fundamental change to the regressive business rates system and reducing the costs of doing business for smaller firms.



Mike Cherry,
National Chairman



Martin McTague,
Chairman,
Policy and Advocacy

ECONOMIST'S VIEW

The latest FSB Small Business Index (SBI) as well as the most recent economic data releases largely paint a worrisome picture.

Turning first to the SBI, in Q2 2019 confidence among small businesses declined 3.8 points quarter-on-quarter to sit at -8.8. Year-on-year, the index fell by 21.7 points, the largest annual fall in the index since Q3 2016, when a fall of 23.2 was recorded in the aftermath of the EU referendum.

Construction and wholesale and retail trade were two of the least-confident sectors. Weak business investment and subdued housing market activity have created concerns for commercial and residential projects alike, which explains the low confidence among small construction firms. It is also unsurprising that wholesale and retail firms are witnessing experiencing a lack of optimism, given the various headlines about high-profile store closures.

At a regional level, all areas saw confidence fall compared to Q2 2018. The largest decline (41.5 points) compared to a year ago was recorded in Yorkshire and the North East. In the most recent quarter, confidence among small businesses was highest in Wales, at 18.3, although this still represents a significant decline from the 43.6 recorded in Q2 2018.

Looking next at the broader economic landscape, after a strong Q1 2019, the UK economy contracted by 0.4% over the month of April. For most of Q1 it was believed that the UK would be leaving the EU on 29 March. Therefore, many businesses were preparing for all possible outcomes, including a no-deal. This boosted manufacturing production significantly, as businesses stockpiled imported goods from the EU. However, firms do not want to store these stocks indefinitely, as trends change and storage space can become costly. Therefore, April saw a significant monthly decline (-3.9%) in manufacturing output, as many firms have started to cut back production while they draw down their excess stocks.

Ironically, the Brexit-related uncertainty may be contributing to a strong labour market picture. Unemployment is at record low levels, as businesses looking to expand choose to hire more workers rather than pursue less reversible forms of investment. This is reflected in this quarter's SBI. The net balance of firms expecting to increase hiring activity over the next three months is very high at 10.2% - an increase of 3.1 percentage points compared to the previous survey.



Nina Skero,
Director and Head
of Macroeconomics,
Cebr

Q2

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **In Q2 2019 small business confidence has experienced the largest year-on-year fall since the aftermath of the EU referendum in 2016.** The FSB Small Business Index fell 21.7 points compared to Q2 2018. The 3.8 point fall from Q1 leaves the index at -8.8 in Q2 2019.
- **The level of confidence among small businesses in Scotland jumped 37.5 points to +3.0 in Q2 2019.** Despite the large quarterly swing, year-on-year the SBI in Scotland is down by 2.1 points, and in fact all regions saw confidence fall compared to Q2 2018.
- **Confidence among construction companies stands deep within negative territory, at -33.2, following a 52.9 point drop in the second quarter.** This was the largest decline in confidence among the major industry groups.
- **The proportion of exporters reporting an increase in sales less the proportion reporting a decrease fell to -5.8%, the lowest level on record.** This represents a quarterly decline of 12.6 percentage points. The net balance was last negative in Q2 2016, when it stood at -4.2%.
- **The share of firms stating that gross profits are up minus the proportion reporting a fall reached the lowest level since Q2 2013.** The net balance fell to -11.4% in Q2 2019. Only 30.6% of businesses reported an increase in profit over the quarter, while 42.0% reported a decrease.
- **Spare capacity rises for the second consecutive quarter.** The latest survey results show that the share of small businesses operating below capacity continued to rise in the second quarter of 2019, while the proportion operating above capacity contracted: a net balance of 54.6% are operating below capacity, a 2.4 percentage point increase over the first quarter of the year.
- **For the second consecutive quarter, the proportion of businesses reporting that their workforce has reduced in reduced size exceeded those that have seen employment increase:** quarter-on-quarter, the net balance fell by 0.5 percentage points to stand at -1.5% in Q2 2019. This represents a decline of 2.3 percentage points over the same period in 2018.

UK MACROECONOMIC OVERVIEW

Stockpiling boosts Q1 GDP growth to an 18-month high, though April sees a slowdown

The UK economy experienced a notable uptick in economic growth in the first quarter of 2019. The quarterly GDP growth rate accelerated from 0.2% in the final three months of 2018 to 0.5% in Q1 2019. Compared to the same period last year, the UK economy had grown by 1.8%, the highest annual rate of growth since Q3 2017. However, April data shows the economy immediately falling back and GDP declining by 0.4%.

Indeed, while the latest quarterly data are superficially quite impressive, much of the reported increases in output were caused by businesses building-up stockpiles of either imported inputs, for their production processes, or their own finished products. As the 29 March deadline for the UK to leave the EU approached with no agreement in place between the UK and the EU concerning future trading arrangements, businesses sought to minimise the risk of potential trade disruption.

Sector breakdowns for the latest monthly GDP data highlight this stockpiling effect. While the three-month growth rate of the manufacturing sector had been languishing at -0.1% in January 2019, the fourth consecutive month of negative growth, by March the ONS was recording growth of 2.2%. For manufacturers that rely on the movement of physical products across borders, the heightened uncertainty around any changes to customs procedures and tariffs led them to ramp-up inventories ahead of a potential no-deal Brexit. Now that the prospect of a cliff-edge no deal has been delayed until at least 31 October, faster Q1 growth has proved transitory and manufacturing output fell by 3.9% between March and April. The selling-off or use of excess inventories from this point will likely translate into weaker growth.

The concrete impacts of Brexit adjustments can be seen most clearly in the automotive industry, as a number of car manufacturers brought forward their annual factory closures to April in order to mitigate the potential effects of Brexit. Accordingly, car production slumped by 24% month-on-month in April.

The major success story over recent quarters for the UK economy, on the other hand, has been the labour market. In the three months to April, the UK's employment rate was 76.1%, the joint-highest estimate on record, while the unemployment rate fell to 3.8% – the lowest rate since the final quarter of 1974. Despite such strong employment levels, average weekly earnings including bonuses increased by just 3.1% compared to a year earlier over the same period, 0.4 percentage points lower than the December to February period. On top of modest pay growth, households continued to rein in their borrowing in April, and the year-on-year growth rate of consumer credit is now five percentage points below its peak of November 2016, with household borrowing in the midst of a cyclical downswing.

The UK has also felt the impact of a slowdown in growth around the world, and particularly in some European economies such as Germany and Italy which are significant trading partners. Combined with uncertainty over Brexit, this has knocked the confidence of consumers and businesses alike. The combination has also had a profound impact on business investment, which fell every quarter in 2018. While there was a slight uptick in Q1 2019, the level of business investment is still down by 1.4% when compared to the same period last year.

This lack of investment and consumer borrowing continues despite the Bank of England (BoE) holding interest rates at just 0.5%. The annual rate of growth in the Consumer Prices Index (CPI) was 2.1% in April, up 0.2 percentage points from March, and now sits above the BoE target. Although some inflationary pressure is starting to build, it is likely to be tolerated by the BoE while the exact nature of the UK's future trading relationship with the EU is clarified. Businesses are likely holding back large capital investments for the same reason.

As a consequence, UK productivity and growth are probably going to remain sluggish as employees are left operating outdated equipment, and opportunities for expansion are allowed to pass by.

Figure one: Monthly quarter-on-quarter UK economy growth rates by sector.
Source: Office for National Statistics.



SMALL BUSINESS INDEX

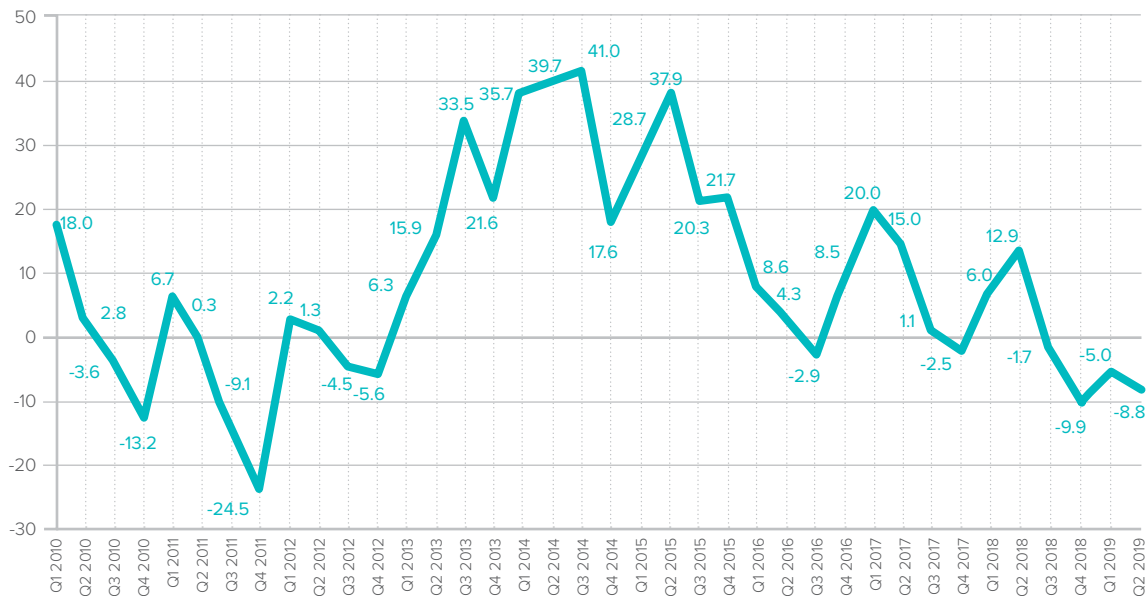
Largest annual decline in small business confidence since EU referendum aftermath

Business confidence among small firms fell back in Q2 2019 after a small rise in the previous quarter. The UK Small Business Index sits at -8.8, a decline of 3.8 points from the first quarter of 2019. Year-on-year, the index fell by 21.7 points, its largest annual drop since Q3 2016, when a fall of 23.2 was recorded in the wake of the EU referendum.

Other business sentiment indicators paint a similar picture. The Bank of England's Agents' summary of business conditions for Q1 highlights weakness in manufacturing investment intentions and construction output. Similarly, while the UK services Purchasing Managers' Index (PMI) rose in May to 51.0, registering a small expansion in output, the equivalent surveys for construction and manufacturing made for grim reading. The construction PMI fell to 48.6, indicating that the sector was in contraction for the third time in the last four months. Meanwhile, the manufacturing PMI was also in contraction territory for the first time since July 2016, falling 3.7 points to 49.4.

The decline in sentiment stands in stark contrast with GDP growth data for the first quarter of 2019, which indicated the economy expanded faster than it had during the second half of 2018. The impact of Brexit-related uncertainty has, in this instance, broken the usual link between confidence among small businesses and total economic output. The stockpiling seen in Q1 led to a temporary boost in output, born not out of confidence in future prospects, but out of fear of major disruption. Although a hugely disruptive chaotic no-deal outcome is yet to materialise, the continued uncertainty of ongoing negotiations is likely still weighing on sentiment.

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.

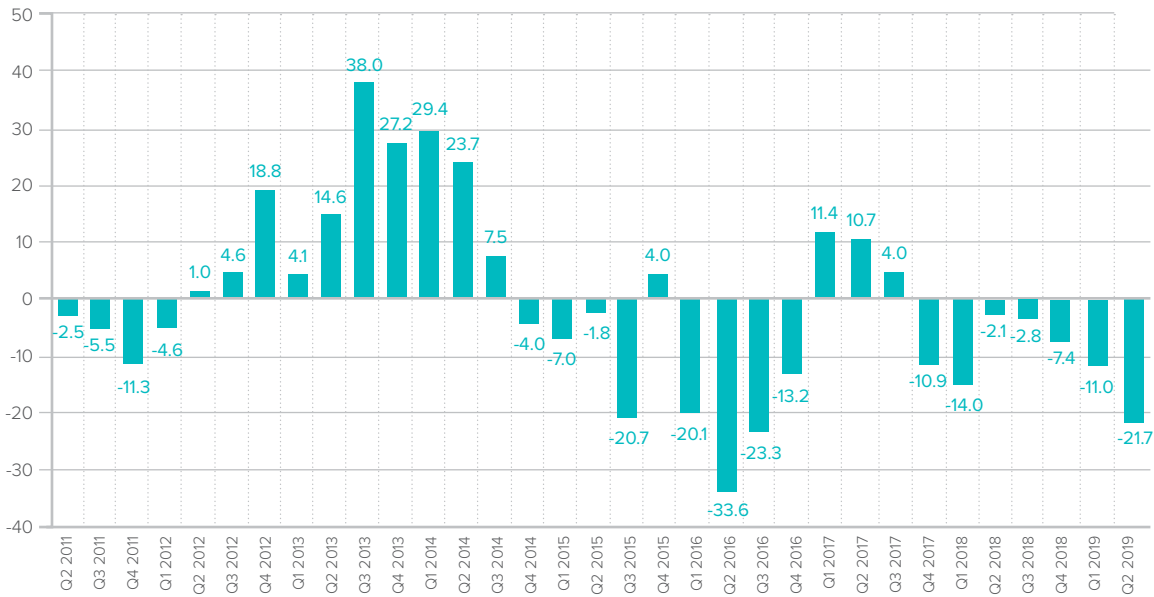
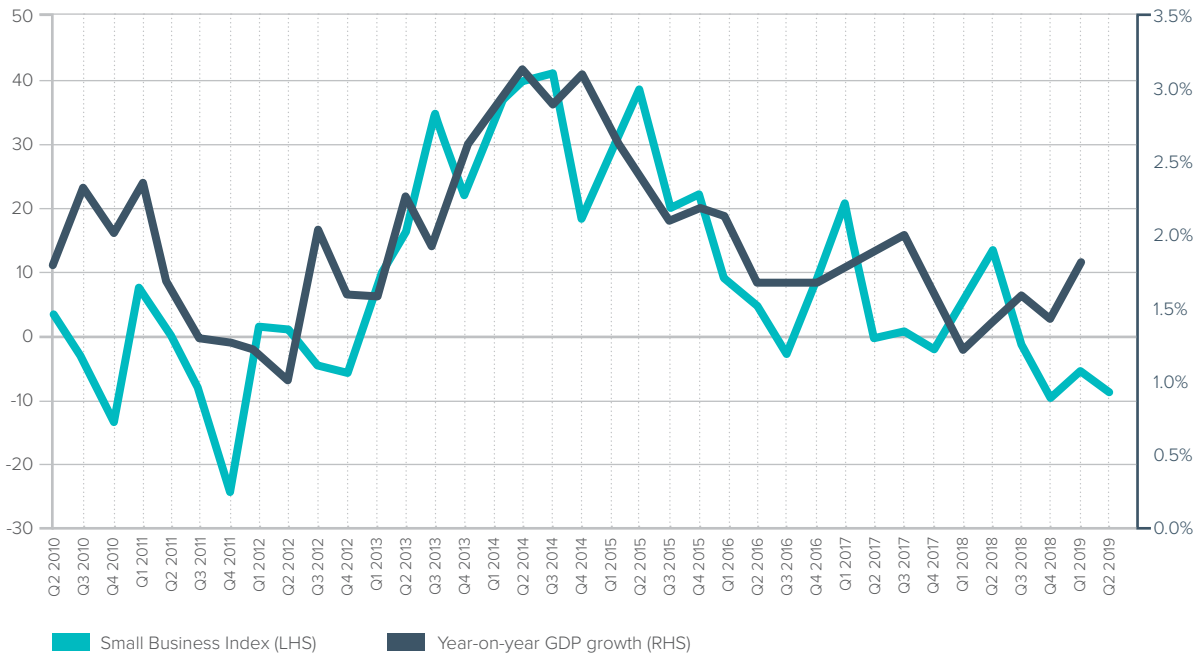


Figure four: UK SBI against year-on-year UK GDP growth.
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

Pessimism across the board

YEAR-ON-YEAR CONFIDENCE FALLS ACROSS ALL REGIONS AND COUNTRIES

Scottish small businesses recorded the largest quarter-on-quarter improvement in sentiment in Q2 2019. After only one positive SBI reading since Q1 2016, the Scottish index jumped 37.5 points to +3.0. Increases were also recorded in the South West (+13.4), the West Midlands (+8.8) and Wales (+4.4). Despite the large quarterly swing, the level of confidence in Scotland is down by 2.1 points year-on-year, and in fact all regions saw confidence fall compared to Q2 2018.

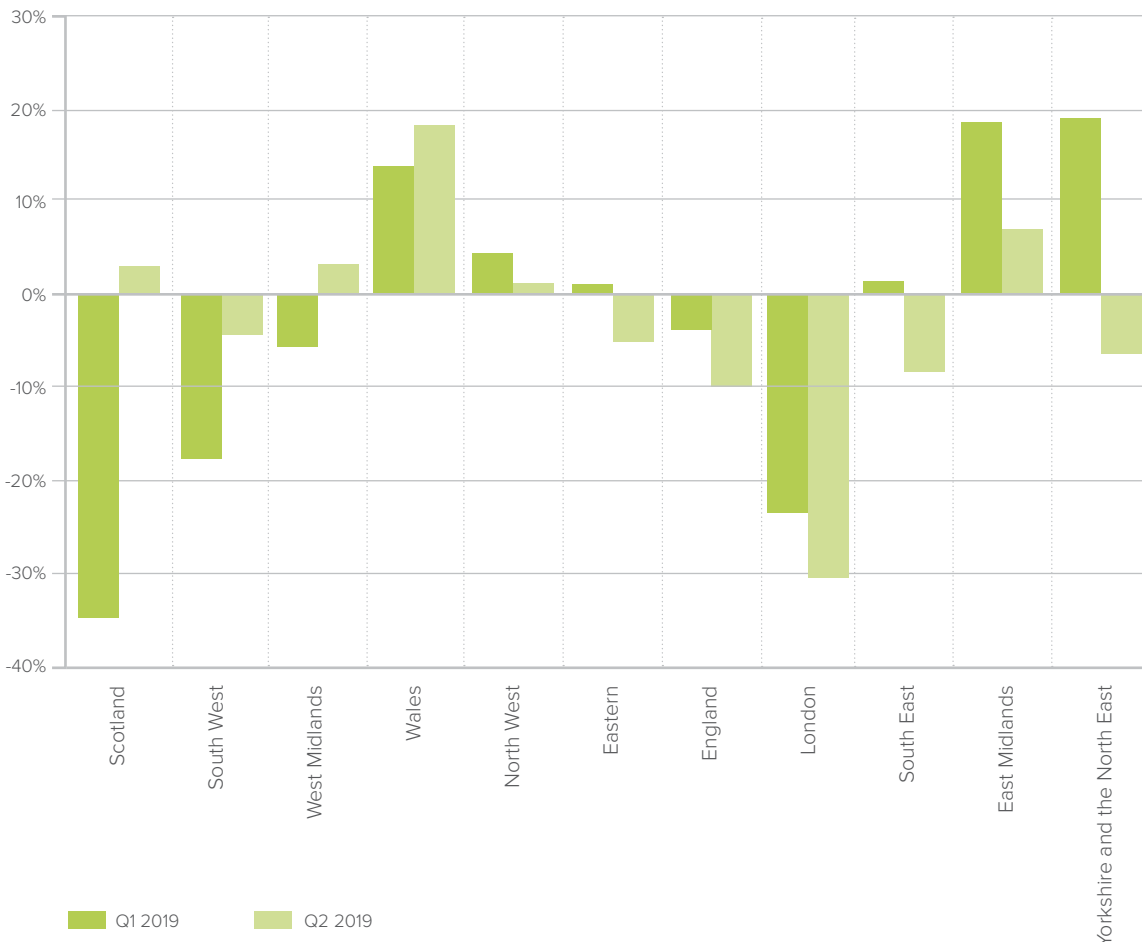
The largest decline compared to Q2 2018 was recorded in Yorkshire and the North East: confidence in the region fell by 41.5 points to sit at -6.2. Confidence among small businesses was highest in Wales in Q2 2019 (+18.3) although this still represents a significant decline from Q2 2018 (+43.6).

As the Article 50 deadline for the UK to leave the EU was extended, and Parliament indicated it was not willing to accept a no deal outcome on 29 March or 12 April that could have caused major disruption to business, it is possible that this inspired a major confidence boost among businesses that feel most exposed to this outcome. With confidence in Scotland having suffered severely since the EU referendum, it seems likely that this was a factor in the reversal in its index reading between Q1 and Q2 2019.

Nevertheless, the continuation of political uncertainty and slow economic growth are taking their toll across the board as confidence weakens in all parts of the UK.

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

Retailers and builders suffer

CONSTRUCTION CONFIDENCE COLLAPSES AS UNCERTAINTY TAKES ITS TOLL

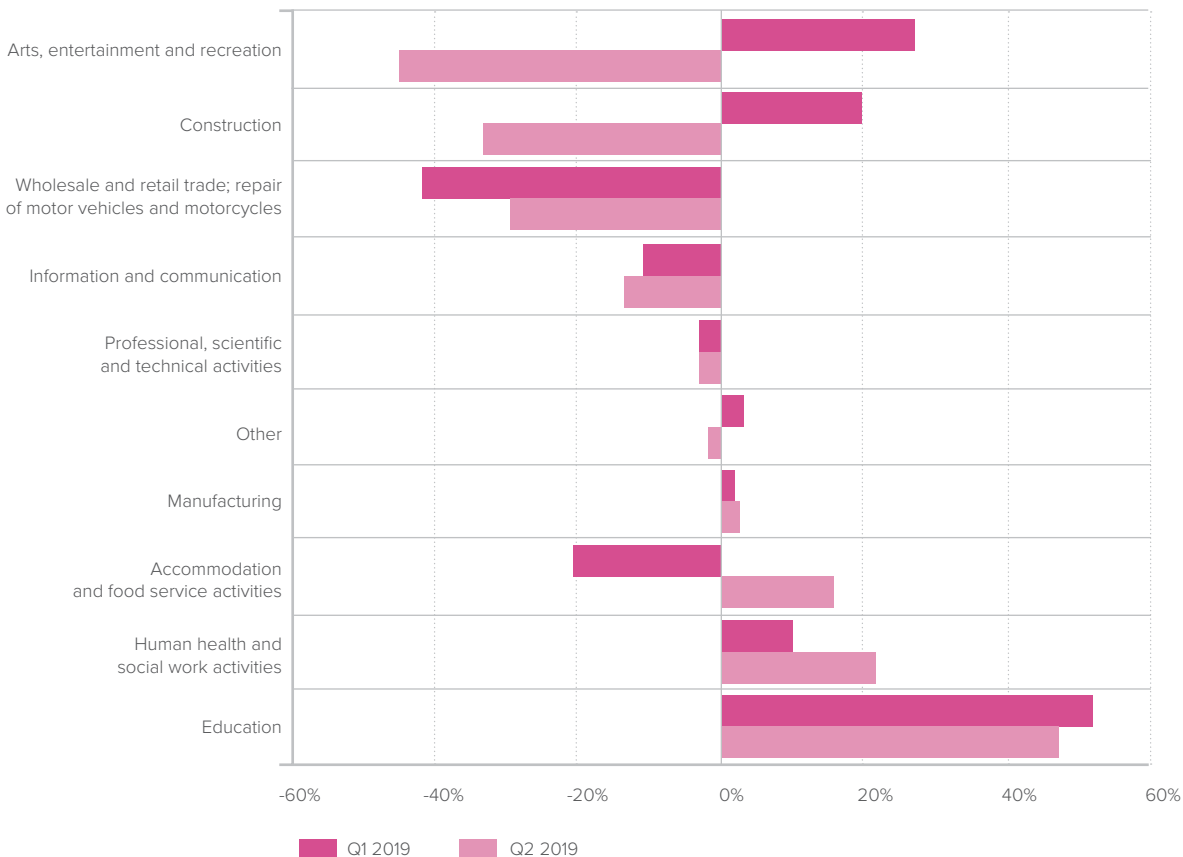
Confidence amongst small businesses in the UK's professional, scientific and technical services sector was, at -2.9, unchanged between Q1 and Q2 2019. Year-on-year, however, the index for the sector was down by 25.9 points. Quarter-on-quarter, manufacturing firms also saw very little change in their SBI reading, with just a small uptick from 1.7 in Q1 to 2.1 in Q2 2019.

Small wholesale & retail businesses experienced a second consecutive increase in confidence during the second quarter of 2019, moving to -29.4, from -41.9 in the first quarter. The Office for National Statistics reported that, in April, retail sales volumes grew by 5.2% compared with the same period a year earlier, with non-store retailers performing especially well. While this may explain the partial improvement in

confidence over the quarter, a slowdown in real wage growth and a falling rate of consumer credit growth suggest that consumer spending is likely to remain subdued. Confidence among smaller retailers is down by 27.1 points compared to Q2 2018. Confidence among small firms in the accommodation & food services industry saw an even larger quarterly improvement, increasing by 36.4 points, to +15.8.

The largest sectoral decline in confidence came within construction. A 52.9 point drop takes the sector's level of confidence (-33.2) deep into negative territory. This aligns with other survey data which suggest uncertainty is starting to derail some construction projects, weakening prospects for the coming months.

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

Margins increasingly squeezed

PROFIT GROWTH HITS LOWEST LEVEL SINCE Q2 2013

The proportion of small businesses reporting growth in profits minus those reporting a decrease fell to -11.4% in Q2 2019. Only 30.6% of businesses reported an increase in profit over the quarter, while 42.0% reported a decrease – the worst figures since Q2 2013. The decline in the net balance represents a substantial fall of 7.1 percentage points since Q4 2018, when this question was last asked.

The net balance was lowest in London (-16.3%) where only 24.5% of small businesses have seen profits rise over the past three months, while 40.8% saw profits decline. The East Midlands was the only region to record a positive net balance, at +1.7%, and this helps to explain why small business confidence in the region is second only to Wales.

The net balance of UK smaller businesses expecting their profits to increase over the next three months is -4.6%. While this suggests a measure of optimism relative to the previous three months, it is due to a 6.1 percentage point fall in the proportion of businesses that believe their profits will fall. There is only a marginal improvement (+0.7 percentage points) in the proportion of firms that believe their profits will increase over the next three months.

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



EXPORTS

International sales growth
hits rock bottom

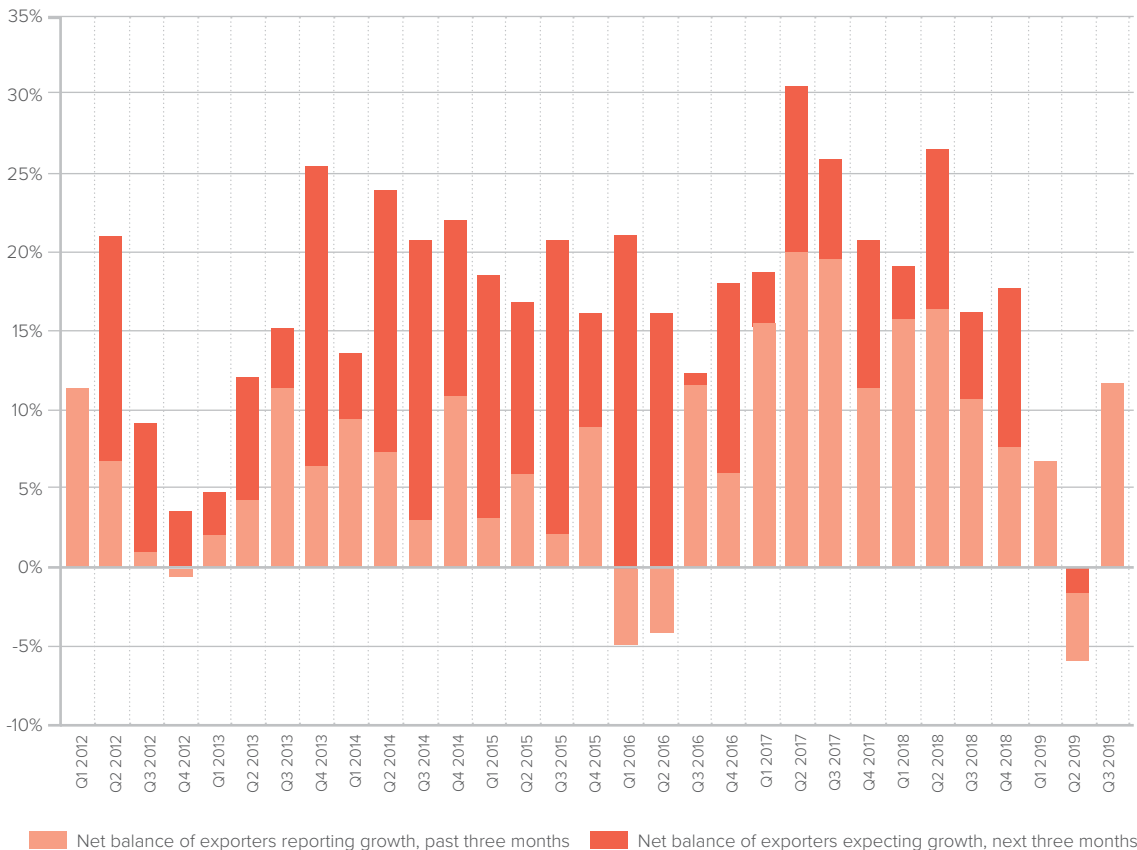
SMALL BUSINESS EXPORT GROWTH TUMBLES TO RECORD LOW

In the second quarter of 2019, the proportion of small businesses reporting an increase in the value of their exports was lower than the proportion reporting a decrease for the first time since Q2 2016. The net balance for export value growth fell to -5.8%, the lowest level on record, representing a quarterly decline of 12.6 percentage points.

The latest official trade statistics show that the UK's total trade deficit increased by a record £8.9 billion in the three months to March 2019 when compared to the three months to December. A £3.9 billion fall in the value of service exports outweighed an increase in the value of exported goods of £2.5 billion. Data from the Bank of England show that the value of the pound increased by around 4% relative to a basket of currencies in the first quarter which may have reduced the value of export earnings to small businesses. Meanwhile, the global export environment weakened as the US ramped-up protectionist measures.

The net balance of firms expecting an increase in exports in the coming quarter is in positive territory, however, at 11.4%. This may reflect a measure of increased certainty following the extension of Brexit negotiations, allowing firms to continue trading with no disruption for the time being. Following a slowdown in export values over the previous quarter, smaller exporters may expect to recover some lost momentum. But, with a further escalation in US protectionism on the cards, the risks to exporters remain elevated.

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

Fuel and wages weighing
on small firms

LABOUR COST CONCERNS JUMP TO RECORD LEVEL AS WAGE INCREASES BITE

The proportion of small businesses reporting an increase in operating costs during the past three months less the share reporting a decrease stands at 65.9%. Between Q1 and Q2 2019, the net balance fell by 4.8 percentage points. The decline brings the figure down from a seven-year high in Q1 to stand 0.3 percentage points higher than in Q2 2018.

As has been the case since Q1 2017, labour costs were the most frequently cited cause of rising costs for small businesses in the second quarter of 2019. The proportion of small businesses referring to labour as a source of cost pressure rose by 8.3 percentage points compared to Q4 2018 to 48.0% – the highest level on record. This coincides with a 4.9% increase in the national living wage which came into force in

April. Given the higher proportion of staff affected by the minimum or living wage in these industries it is unsurprising that over half of respondents in the retail, and accommodation & food services sectors indicated that labour was a source of rising costs (55.9% and 64.0% respectively). By contrast, less than a third of smaller firms operating in professional, scientific and technical activities report that they are affected by increased labour costs.

Like labour costs, fuel is frequently cited as a source of cost pressure. A third (32.1%) of firms report an increase in their fuel costs. The figure is 5.6 percentage points higher than in the first quarter of 2019.

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.

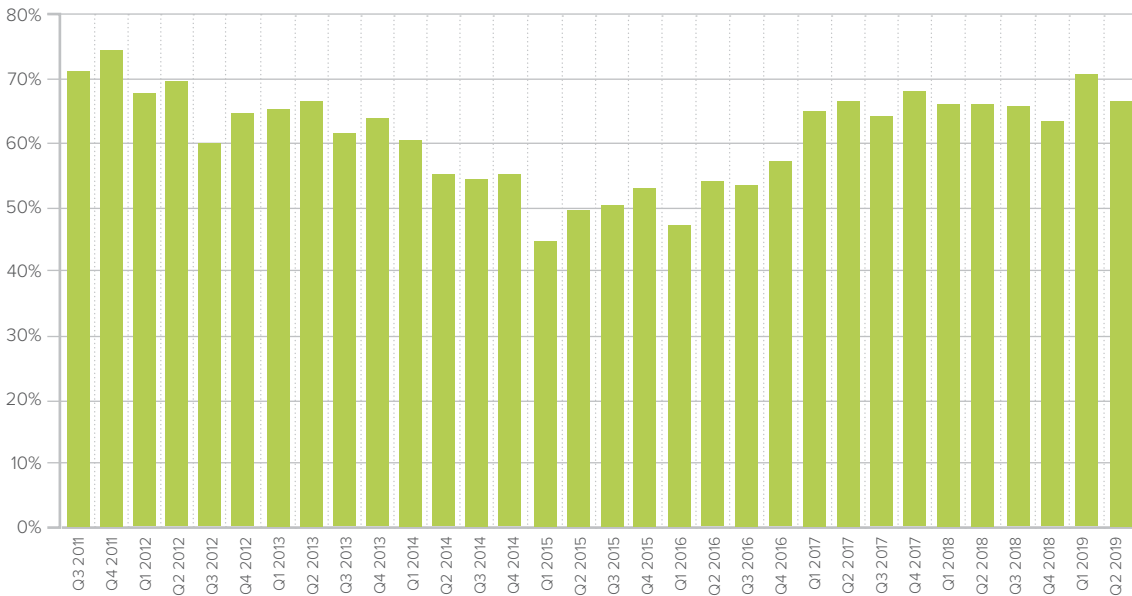
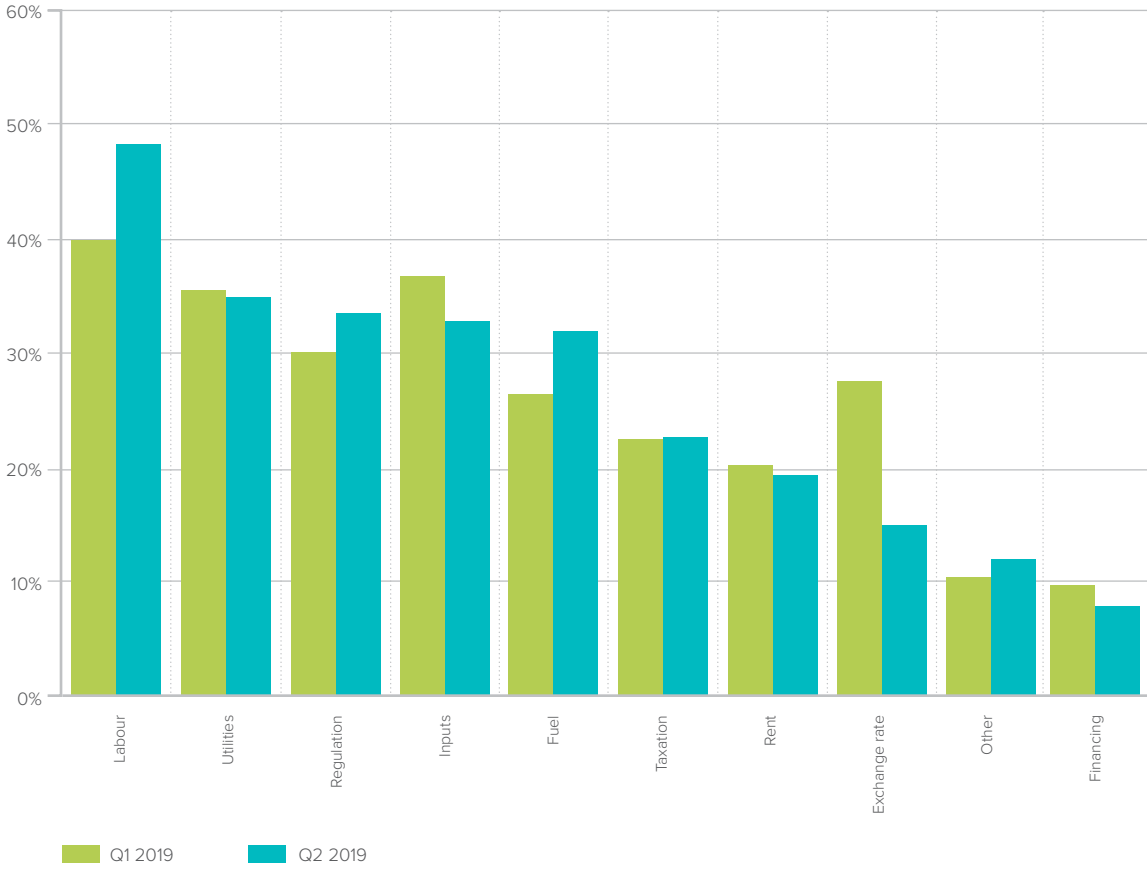


Figure 10: Main causes for changing business costs (firms may give multiple answers).
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CAPACITY

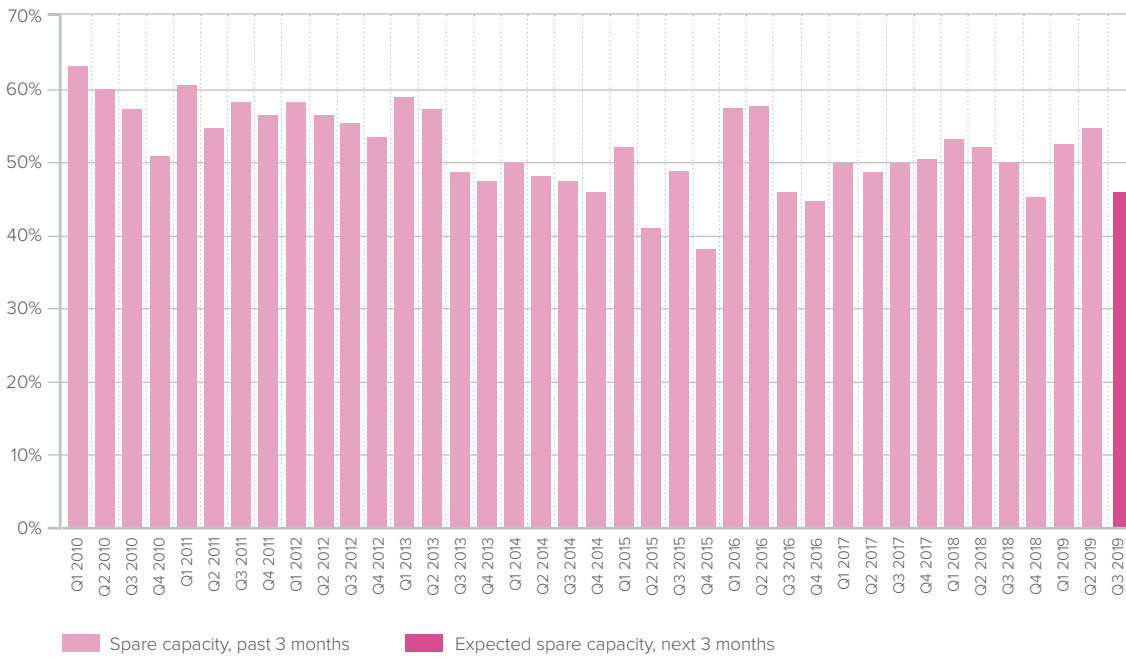
More firms struggling to
maximise potential

SPARE CAPACITY RISES FOR SECOND CONSECUTIVE QUARTER

The latest SBI results show that the share of small businesses operating below capacity continued to rise in the second quarter of 2019. A net balance of 54.6% of firms operated below capacity in Q2 2019, a 2.4 percentage point increase over the first quarter of the year. The net balance stands at its highest level since Q2 2016. The West Midlands and London had significantly higher than average spare capacity net balances, at 63.4% and 61.2% respectively.

A significantly lower net balance of small businesses (45.8%) expect to have spare capacity over the next three months, although expectations tend to be overoptimistic for this measure. Indeed, in the first quarter of 2019, the net balance of small businesses expecting to operate with spare capacity in the following three months was 44.5%.

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

Hiring on hold

EMPLOYMENT IN SMALL BUSINESSES ON THE SLIDE

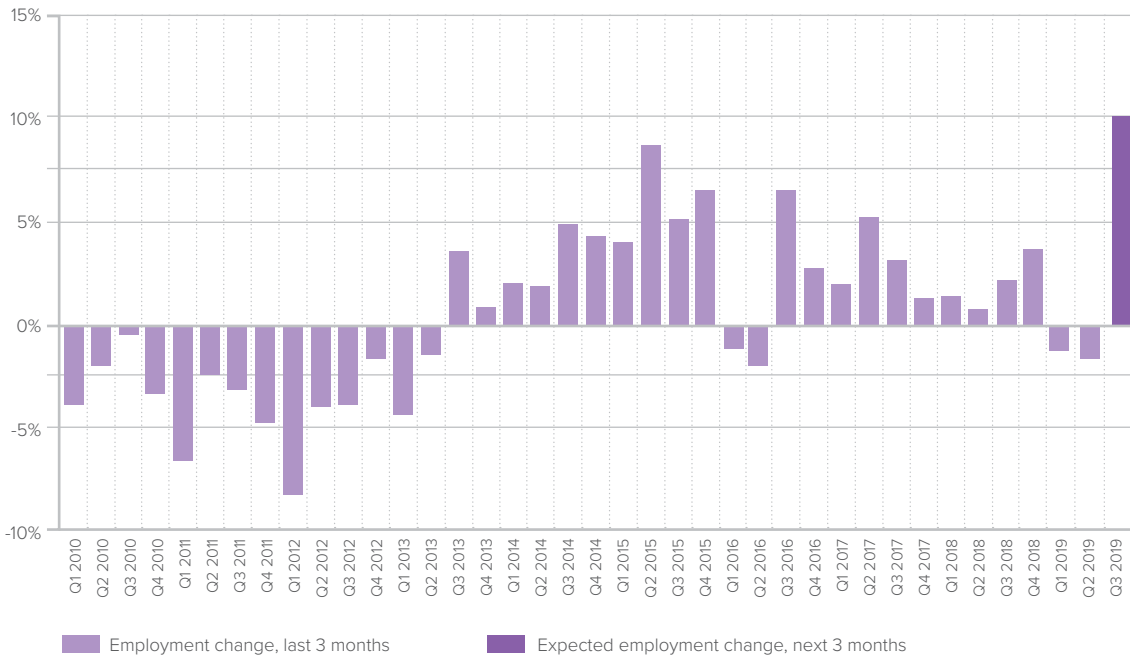
For the second consecutive quarter, the proportion of businesses reporting that their workforce has reduced in size exceeded those that have seen employment increase over the last three months. Quarter-on-quarter, the net balance fell by 0.5 percentage points to stand at -1.5% in Q2 2019. This represents a decline of 2.3 percentage points over the same period in 2018. Negative net balances were particularly pronounced in Scotland (-8.9%) and the South East of England (-8.1%).

The net balance of firms expecting to increase hiring activity over the next three months is significantly higher, at 10.2%. This represents an increase of 3.1 percentage points compared to the previous survey. While the proportion of firms expecting to increase employment in the next three months has risen by just 0.2 percentage points over the quarter, the number of businesses expecting to reduce employment fell by 2.9 percentage points. This suggests any increased optimism around employment is muted as more businesses opt to maintain their current headcounts.

ONS employment estimates for February to April 2019 show 357,000 more people were in employment than was the case a year ago. The employment rate stands at 76.1%, the joint-highest on record, partially driven by changes to the state pension age keeping more women in the workforce for longer. The decline in small business employment could be indicative of just how tight the labour market has become, with smaller employers finding it difficult to fill vacancies with appropriately skilled staff.

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.

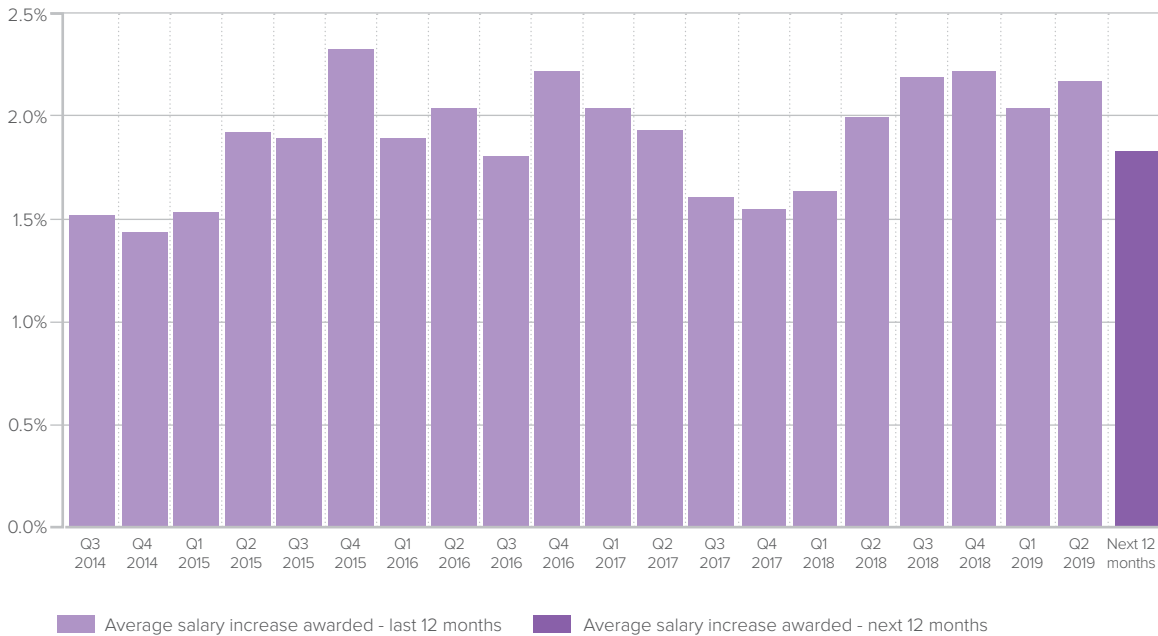


SMALL BUSINESS WAGE GROWTH ON THE RISE

In Q2 2019, the average annual rate of wage growth within small businesses recovered the 0.2 percentage point decline registered in the first quarter, rising back to 2.2%. This brings wage growth back in-line with the rates recorded in the second half of 2018, and reflects the record-high net balance of businesses reporting labour as a driver of higher costs over the last quarter. The largest wage increases were recorded in the information and communication, manufacturing and accommodation & food service industries.

The latest ONS data show that in the three months to April, annual earnings growth including bonuses was 3.1% across the UK, down from 3.5% in the three months to February. With unemployment at 3.8%, a rate not seen since the 1970s, pay will need to remain competitive to retain and attract staff. Despite this, the expected rate of wage growth over the next 12 months is 0.3 percentage points lower than the current annual rate of growth, at 1.8%. While productivity growth is weak, the appetite among businesses to continually increase pay is perhaps waning, reflected in the lower wage growth expectations among small business owners.

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



GROWTH ASPIRATIONS AND CHALLENGES

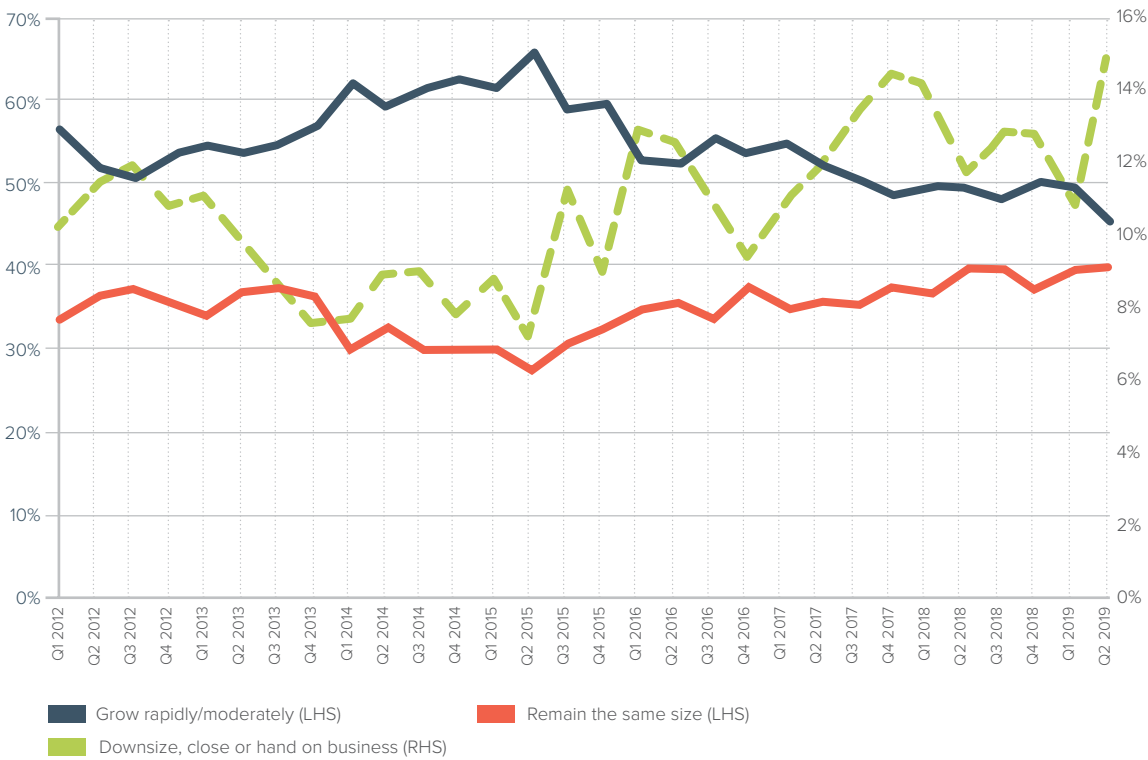
More business owners planning
to shut up shop

SMALL BUSINESSES PUT EXPANSION PLANS ON ICE

The proportion of small businesses that aspire to grow over the course of the next 12 months has fallen to its lowest level since the start of 2012. Only 45.5% of firms are attempting to grow, down by 4.3 percentage points from the first quarter of the year. The falling level of business confidence across the UK has caused more business owners to consider scaling-back operations over the coming year. The share of small firms planning on downsizing, closing or handing on their business increased by 4.2 percentage points, to 15.1%, the highest level since the start of 2012.

Businesses in Scotland (19.0%), Yorkshire & the North East (18.4%) and the North West (18.0%) are the most likely to scale-back activity over the coming year. Growth aspirations are greatest in London and Wales, where over 50% of businesses are planning to expand. Firms in the information and communication sector are particularly bullish, with 62.2% aspiring to grow in the coming year. With political uncertainty prolonged, and outcomes still unclear, pushing for growth may be a step too far for many small businesses.

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



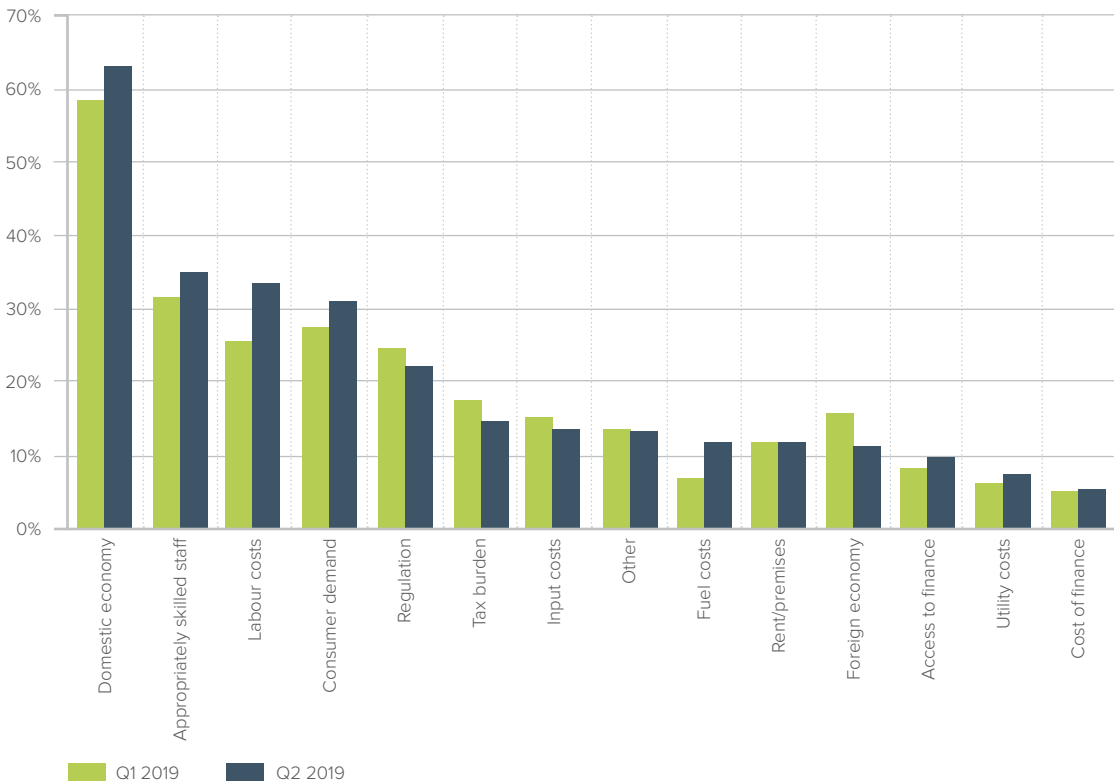
DOMESTIC ECONOMY AND LABOUR COSTS HOLD BACK SMALL BUSINESS GROWTH

The domestic economy is increasingly flagged as a growth constraint by small businesses. A 4.8 percentage point increase from the previous quarter brought the proportion of firms citing the domestic economy as a barrier to their growth aspirations to 63.1% in Q2 2019. The uplift in economic activity recorded at the start of 2019, with GDP growth accelerating from 0.2% in Q4 2018 to 0.5% in Q1 2019, is largely attributed to stockpiling ahead of a potential no-deal Brexit. The latest data have subsequently shown GDP declining by 0.4% in April as the danger passed and production was reduced.

The vast majority of smaller businesses in the retail and wholesale trade sector (79.4%) cite the domestic economy as a barrier to further growth. While wage growth has broadly been increasing since the start of 2018. The rate of real wage growth is low compared to historical standards. Combined with slowing growth of consumer credit and falling consumer confidence, the prospect of higher domestic spending looks slim.

The proportion of businesses highlighting labour costs as a barrier to growth rose 7.8 percentage points between Q1 and Q2, meaning it is the third most frequently cited barrier to small business growth. Year-on-year, the proportion has increased by 12.2 percentage points to the highest level on record. Across the whole economy, the ONS estimates that wage growth has run ahead of productivity growth which, over time, will have a negative impact on profitability.

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

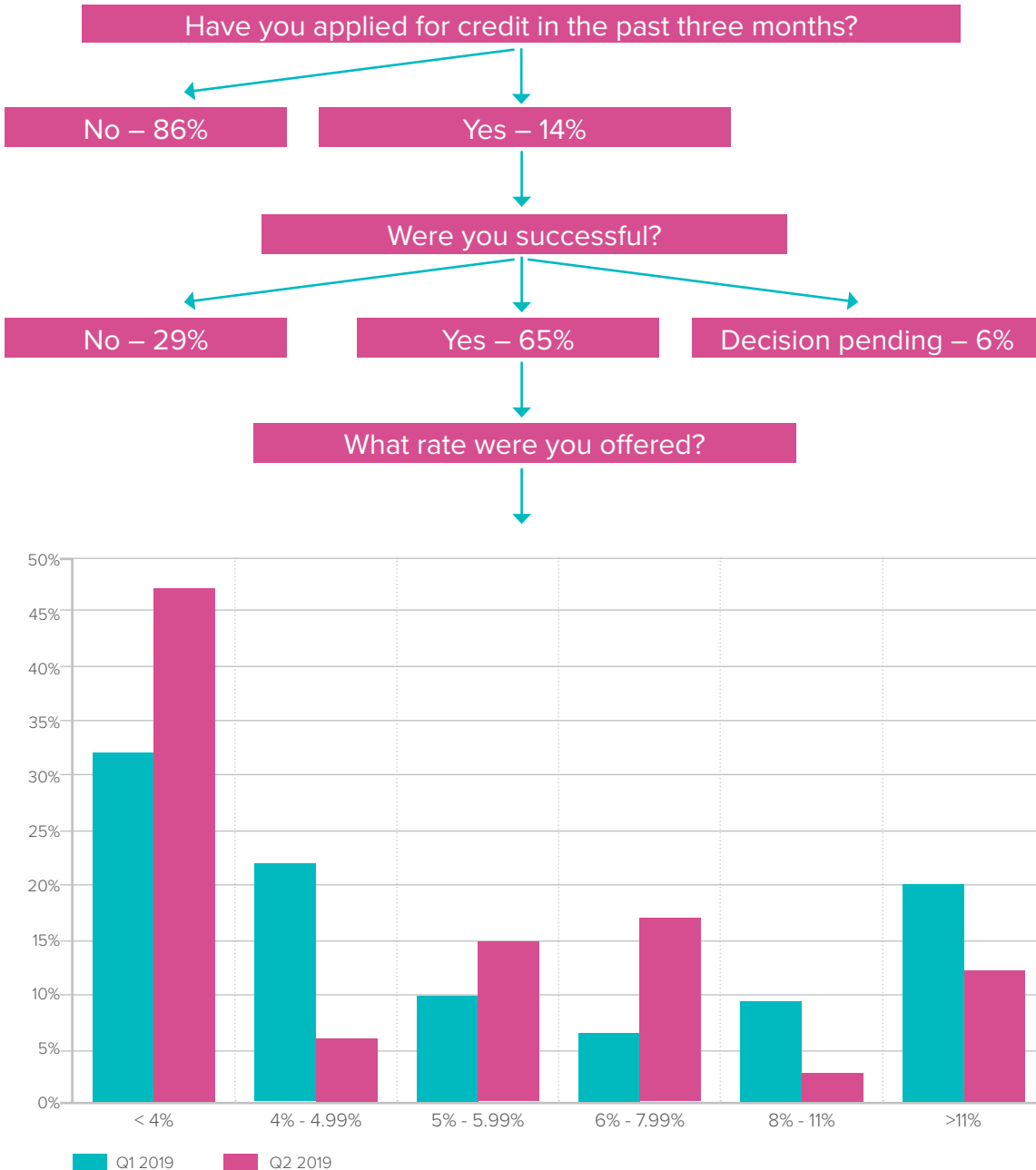


CREDIT

More firms have
applications declined

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.



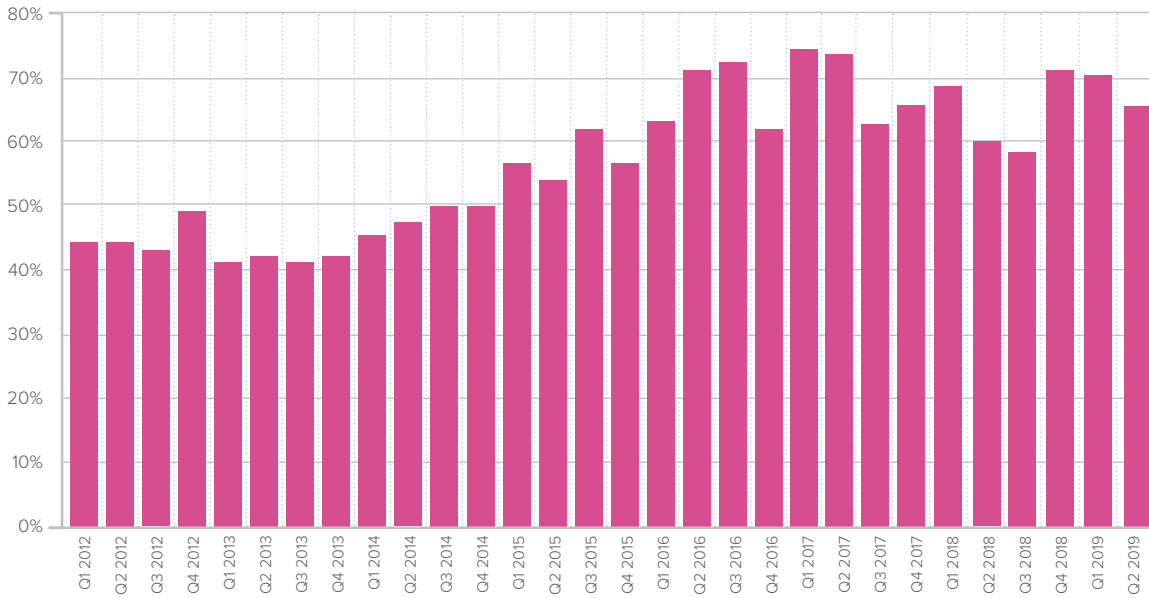
In the second quarter of 2019, the proportion of small businesses that applied for credit declined by 0.8 percentage points. The proportion of these applications that were successful declined by 4.9 percentage points compared to Q1 but, at 65%, the

figure is up on Q2 2018. The proportion of businesses that were declined credit in Q2 rose quite sharply, increasing 9.8 percentage points compared to the previous quarter to stand at 29%.

For those that were able to secure finance, a significant proportion (47.0%) were offered rates of less than 4%. This is a year-on-year increase of 10.3 percentage points, from 36.7% in Q2 2018. Just over half (53.1%) were offered an interest rate of less

than 5%, a decline of 0.9 percentage points. At the other end of the scale, the proportion of businesses receiving offers of credit at interest rates over 11% fell 7.7 percentage points from Q1 2019 to 12.3%.

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.

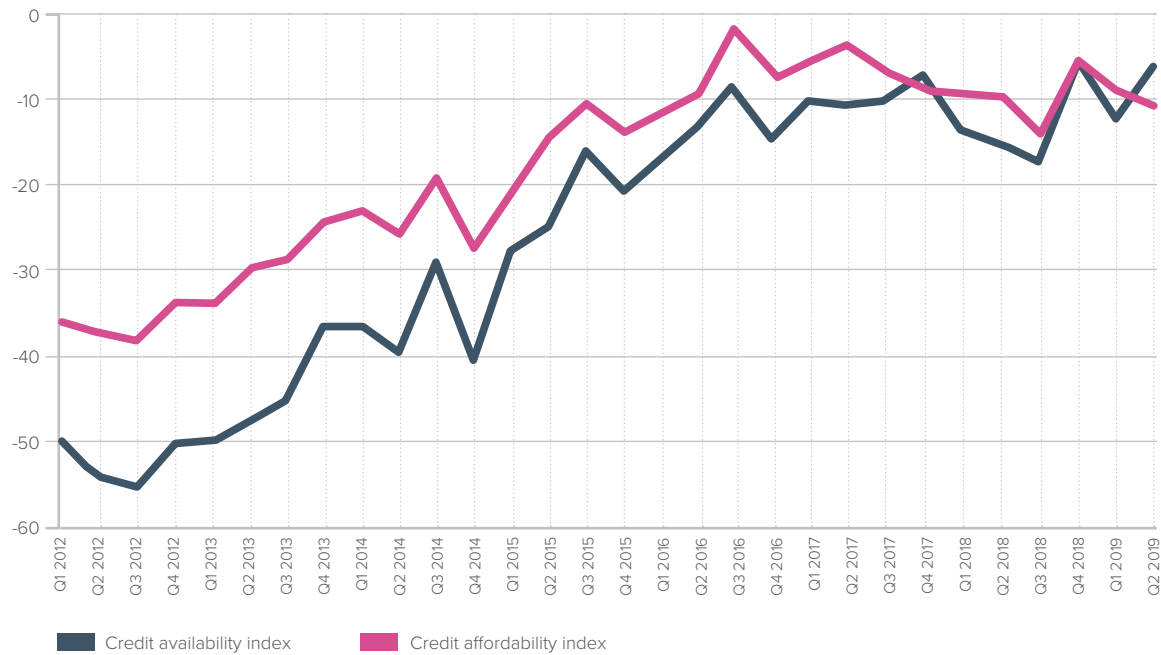


CREDIT AVAILABILITY UP BUT AFFORDABILITY DOWN

The small business credit availability index rose by 5.4 points to -6.6 in Q2 2019. This brings the index to within 1.6 points of the 5.0 recorded in Q4 2018, its highest level since 2012. By contrast, the credit affordability index fell for the second consecutive quarter to -11.0. The index now sits 1.3 points lower than it did in Q2 2018.

Interest rates remain near historic lows and the Bank of England has suggested that, due to the noisy economic data emerging as a consequence of widespread uncertainty over Brexit, there is no clear case for raising rates at this time. On that basis, the stage is set for cheap credit to make its way to small businesses. However, the decline in the credit affordability index suggests that lenders may consider that the probability of default for small firms has risen and are now increasing 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

Productivity gap set to persist

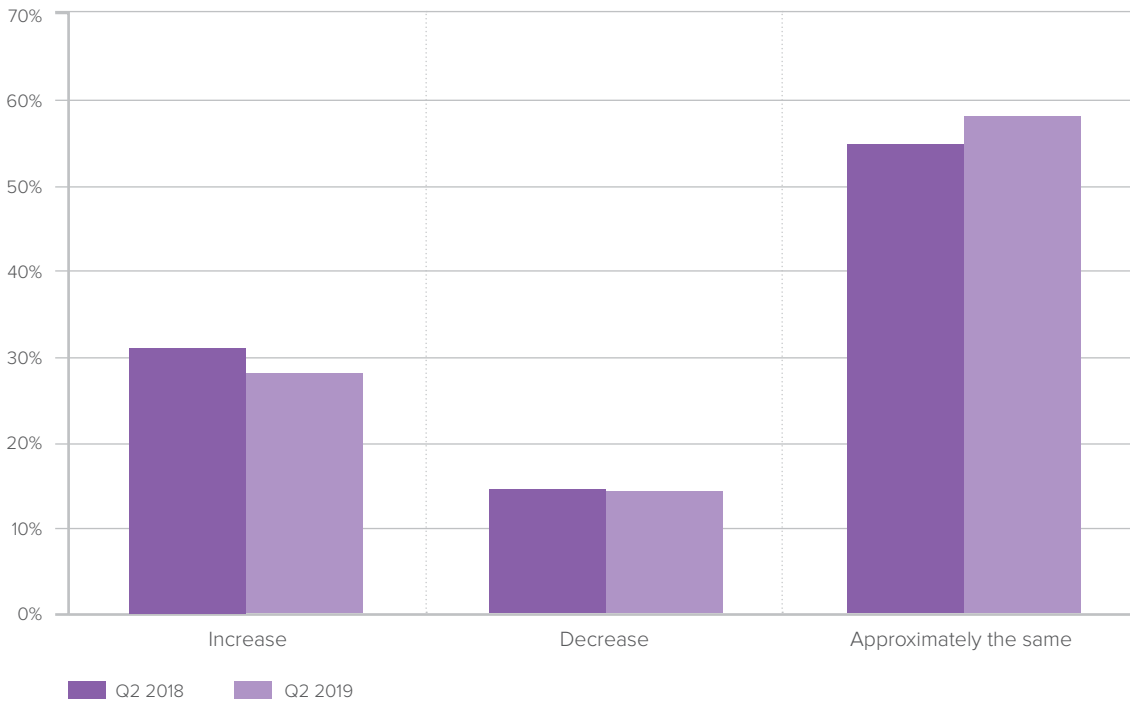
SMALL BUSINESSES CONTINUE TO HOLD BACK INVESTMENT

The share of small businesses expecting to increase capital investment over the next quarter fell by 3.1 percentage points compared to Q2 2018, to 27.7% in Q2 2019. Although this only represents a marginal decline (0.4 percentage points) relative to the first quarter of 2019, the share of businesses intending to expand their capital investment plans is now at its lowest level since Q3 2017. Quarter-on-quarter, the share of firms intending to decrease their level of investment also fell, by 0.3 percentage points, to stand at 14.3%. The majority of businesses are intending to hold investment constant.

Official statistics indicate that, after falling in every quarter of 2018, business investment grew by 0.5% in the first quarter of 2019, driven by investment in IT equipment, although year-on-year business investment is still down by 1.4%. In-line with other business surveys, the Small Business Index suggests that, given low levels of confidence, smaller businesses look less inclined to invest in the months ahead.

Figure 19: Proportion 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 May research survey of FSB members carried out by Verve. 6,100 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. 982 responses were received, a response rate of 16% 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 13 and 27 May 2019.

SUMMARY DATA TABLE

	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Small Business Index	+1.1	-2.5	+6	+12.9	-1.7	-9.9	-5.0	-8.8
Employment - previous three months	3.2%	1.4%	1.6%	0.8%	2.3%	3.9%	-1.0%	-1.5%
Employment - coming three months	9.4%	2.9%	8.7%	8.2%	7.4%	5.1%	7.0%	10.2%
Exports - previous three months	19.5%	11.5%	15.8%	16.5%	10.7%	7.6%	6.8%	-5.8%
Exports - coming three months	20.5%	18.8%	18.8%	16.0%	17.8%	0.2%	-1.6%	11.4%
Credit availability - rated good or very good	24.1%	26.0%	24.1%	21.9%	24.1%	30.2%	28.5%	28.9%
Credit availability - rated poor or very poor	35.2%	31.7%	39.3%	40.0%	42.5%	34.4%	39.0%	33.7%
Credit affordability - rated good or very good	28.8%	24.8%	25.3%	25.4%	23.7%	32.2%	27.9%	27.3%
Credit affordability - rated poor or very poor	38.3%	36.1%	39.2%	35.3%	41.7%	36.1%	37.9%	43.2%

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.

Q2

© Federation of Small Businesses

fsb.org.uk

 [federationofsmallbusinesses](https://www.facebook.com/federationofsmallbusinesses)

 [@fsb_policy](https://twitter.com/fsb_policy)

If you require this document in an alternative format please email:
accessability@fsb.org.uk

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of FSB. While every effort has been made to ensure the accuracy of the facts and data contained in this publication, no responsibility can be accepted by FSB for errors or omissions or their consequences. Articles that appear in the report are written in general terms only. They are not intended to be a comprehensive statement of the issues raised and should not be relied upon for any specific purposes. Readers should seek appropriate professional advice regarding the application to their specific circumstances of the issues raised in any article.

This report can be downloaded from the FSB website at www.fsb.org.uk

fsb⁰⁸
Experts in Business