

Q3

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 3, 2018

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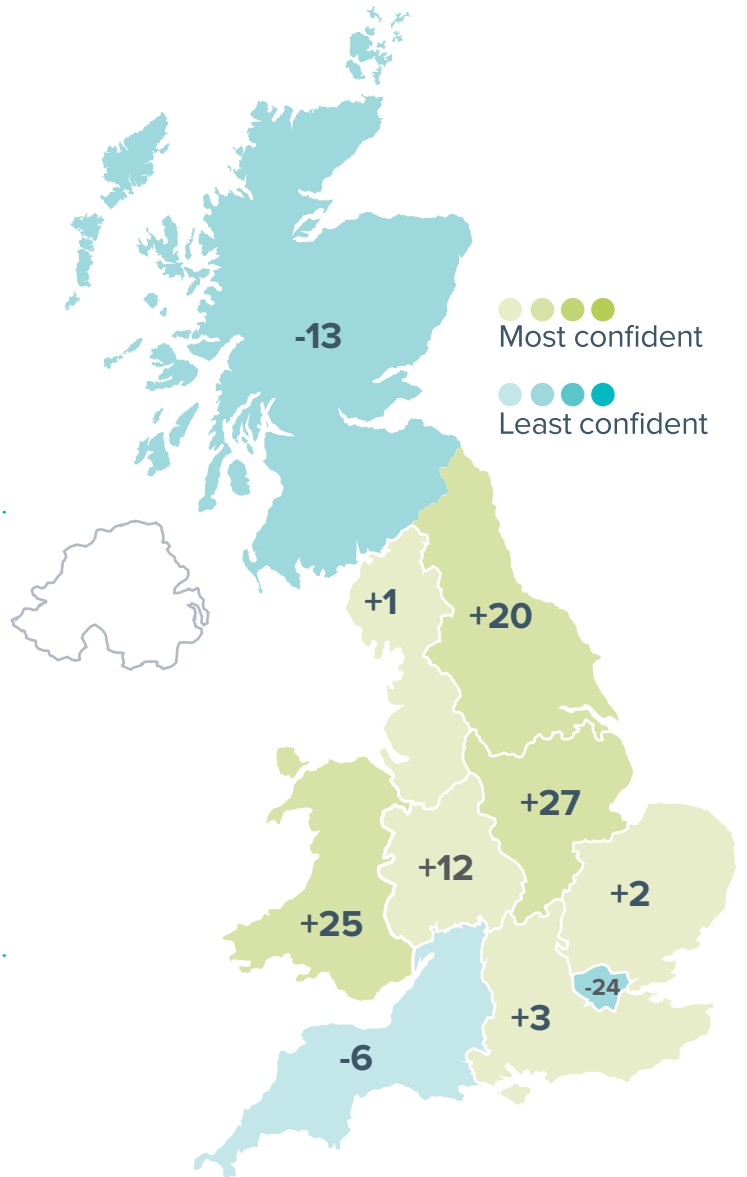
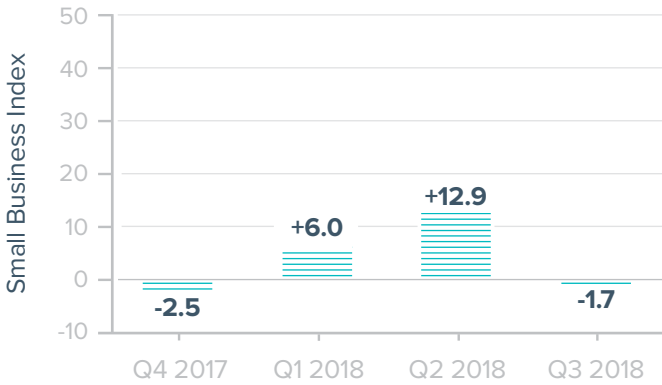
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Experts in Business

SBI Q3 2018

“Small business confidence falls into **negative territory** for **second time in 12 months** as **Brexit talks reach critical phase**”

Drop in optimism among small firms



Exports fall 27%



Of **exporters** report **falling international sales**

Wage bills rise 28%



Offering **pay increases** of **4% or more**

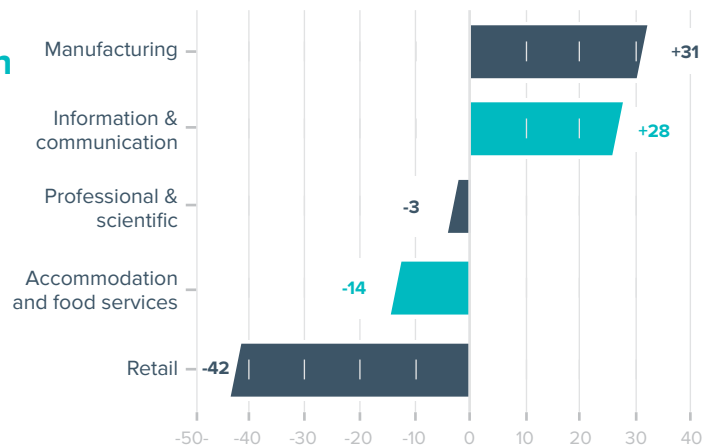
Concerns about fuel costs reach all-time high

37%



Say **fuel** is a **main cause** of **rising business costs**

Small business confidence by sector



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FSB FOREWORD

Small business confidence has dipped into negative territory for only the third time since the start of 2013. Confidence has fallen in all regions and nations within the UK, with the exception of the West Midlands. FSB will be looking to the Government for a pro-business Autumn Budget to bolster small business confidence. This is definitely not the time for deep cuts to business support programmes or benefits such as the New Enterprise Allowance. Nor is it the time for the addition of new grit to the taxation system through, for example, IR35 rules that currently apply to the public sector being extended to the private sector. We hope the Chancellor will announce a positive package of reforms to create a favourable tax system for smaller businesses and sole traders. We are very disappointed by the decision to abandon the pledge to abolish Class II National Insurance Contributions. We now urgently need to see reforms to Universal Credit and specific new policy interventions, such as creating an Adoption Allowance.

A combination of uncertainty as a result of the ongoing Brexit negotiations, anxiety in relation to the possibility of a disorderly 'no-deal' scenario, global trade wars and a downturn in global growth, are now weighing on small business performance. This is supported by the fact that, despite a fall in the value of the pound, there has been an increase in the percentage of smaller businesses saying the value of their exports has decreased compared to the previous quarter. There has also been an increase in the proportion of small businesses reporting that the availability of appropriately skilled staff is a barrier to their growth aspirations. The continued risk of 'no-deal' Brexit creates a damaging lack of certainty over the ability to recruit staff from the EU. As the labour market tightens, and the Office for National Statistics report that last year the total number of EU migrants fell to its lowest level since 2012, small businesses are struggling to find the skills and talent they need to grow and become more productive. Small businesses simply don't know what the economic framework they will be operating in from 29 March 2019 onwards looks like – around 200 days away.

Whilst we want to see a good, pro-small business deal for the UK delivered through the Brexit negotiations, FSB agrees that the Government should help smaller businesses to start planning for the possibility of a 'no-deal' scenario. Small businesses are the most likely to be disproportionately impacted by a disorderly 'no-deal' scenario and yet have the least resources to prepare for such an eventuality. If the time comes in October/November when there needs to be a shift from thinking about the consequences of a 'no-deal', to actually taking action (such as buying new software, appointing consultants or establishing new business relationships with freight forwarders and customs

brokers), the Government should make provision for concrete financial support to smaller businesses. Whatever form Brexit takes, if we are serious about helping grow trade around the world, small business export vouchers could play a critical role in doubling the number of small business exporters, and encouraging existing exporters to find new markets.

International and global considerations must not eclipse the need for action regarding domestic concerns. More than half of smaller businesses now say the domestic economy is a potential barrier to growth. More small businesses report that the cost of their premises, labour and fuel, as well as exchange rates are now barriers to growth. The sharp increase in those reporting fuel price concerns this quarter means we will be pressing the Chancellor to maintain the fuel duty freeze that has been a lifeline for small businesses across the country.

Worryingly, both the proportion of smaller businesses successfully applying for credit and those receiving offers of credit at low interest rates, fell in this quarter. The rise in the Bank of England's Base Rate will clearly have played a part in this. However there are wider, systemic challenges both in relation to the supply of, and demand for, external finance. Indeed this quarter saw the highest proportion of credit applications turned down since the end of 2015. External finance is essential to support growth and, given current uncertainty, the Government should use the upcoming budget to support the provision of external finance for smaller firms. Without this, growth will be severely hampered as is evidenced by our data showing that this quarter the proportion of small businesses that expect to grow over the next 12 months fell to its lowest level ever.

At a sectoral level, confidence in the wholesale and retail trade sector has seen the sharpest fall. The challenges facing firms on high streets, particularly as a consequence of rising business rates and poor local transport infrastructure, cannot be ignored. FSB will be looking to the forthcoming Budget for concrete interventions to support these small firms, particularly in relation to ameliorating the pressure from an out-of-date and regressive business rates system. Taxation has failed to keep up with changes in the use of digital technology by consumers. In the upcoming Budget, we will be looking to the Chancellor to strike the right balance between addressing the unfair tax advantage that large, often international, online platform firms benefit from and supporting the business community at large. This must be done in a way that works for smaller firms – many of whom who are on the high street and are proactively adapting to the changing environment by developing online components to their businesses.



Mike Cherry,
National Chairman



Martin McTague,
Chairman,
Policy and Advocacy

ECONOMIST'S VIEW

After a strong recovery in the second quarter, the FSB Small Business Index has fallen back into negative territory. At -1.7, the Q3 headline figure marks only the third time since 2013 that the index has dipped below zero.

The decline in confidence is visible across much of the country. The only region where confidence rose over the last quarter (from +4.8 to +12.4) was the West Midlands. Meanwhile, Wales recorded one of the most substantial declines, from +43.6 to +25.3. Despite the fall, small businesses in Wales retained the highest level of confidence in the UK.

Turning to the sectoral figures, the small business picture echoes recent developments observed across the broader economy. The FSB Small Business Index for wholesale and retail firms plummeted to -42.0. This fits in with the results of the latest retail sales data release from the Office for National Statistics. Retail sales volumes grew by 2.9% year-on-year in June, compared to 4.1% in the year to May. The overall performance would have been even worse if it weren't for the warm weather, royal wedding and World Cup boosting food and drinks sales.

Setting aside one-off factors, the economic climate remains challenging for retailers and wholesalers. The displacement of bricks-and-mortar stores by online platforms and depressed real wage growth have already caused severe problems for certain retailers over the past year. These factors have resulted in a number of high-profile businesses being forced into restructurings or, in some cases, liquidation.

A forward-looking indicator which gives reason for hope is employment expectations. A net balance of +7.4% of small firms expect to employ more staff over the next three months, indicating that the already robust labour market is set to strengthen further.

Despite some bright spots, the overall takeaway from the latest SBI is that these are challenging times for UK small businesses, and the economy more generally. More small businesses are citing the domestic economy as a barrier to growth, which is understandable given the relatively low GDP growth over the first half of 2018. With numerous trade disputes and slowing growth in various regions, including the Eurozone, the potential for small businesses to grow their exports is reduced. Although the depreciation of the pound will have helped some businesses earn more from their overseas trade, the proportion of firms reporting the value of their exports has decreased, jumped from 19.2% in Q2 to 27.2% in Q3, suggesting the slowdown in global trade is having an impact.



Nina Skero,
Head of
Macroeconomics,
Cebr

Q2

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **Small business confidence has returned to negative territory.** The FSB Small Business Index fell from +12.9 in Q2 2018 to -1.7 in Q3 2018. This is only the third time the index has dipped below zero since the start of 2013.
- **Confidence is in decline across most of the UK's nations and regions in this quarter.** The only region to experience an increase in confidence is the West Midlands. Despite a substantial fall, small businesses in Wales retain the highest level of confidence, at +25.3.
- **Confidence plummets in wholesale and retail industries.** Confidence fell by around 40 points in the wholesale and retail sector to -42.0 in the face of weak wage growth. By contrast, manufacturing confidence bounced back somewhat from a dip in Q2 to register the highest confidence index of any sector at +31.1.
- **Export growth slows in Q3 despite sterling weakness.** Although more exporters saw the value of their exports grow than decline, the balance fell by 5.8 percentage points, to 10.7% in Q3. As sterling continues to weaken there is greater potential for export growth. A net balance of 17.8% of firms anticipate that their export values will pick up in the next three months.
- **Small businesses expect to increase employment and decrease spare capacity.** This quarter, the proportion of small businesses operating below capacity fell by 1.2 percentage points to 50.2%, and only 40.9% expect to operate below capacity in the next 3 months. The balance of firms expecting to employ more staff over the next three months, despite already record-high levels of employment, rose to +7.4% against a backdrop of less spare capacity in the economy.
- **Credit availability and affordability continue to decline for small businesses.** The decision in August by the Bank of England's Monetary Policy Committee to raise interest rates was widely anticipated and is likely to increase the cost of finance for small businesses. On top of this, businesses are facing tighter credit conditions, with the proportion of firms that saw their credit applications rejected rising by 6.8 percentage points in the last three months to 29.6%.
- **More small businesses cite the domestic economy as a primary barrier to growth.** This quarter, 60.1% of small businesses say that the domestic economy is a primary barrier to their growth. The proportion of small businesses citing a lack of appropriately skilled labour as a barrier to growth is also on the rise, increasing by 6.1 percentage points to 34.3%. With historically low unemployment, and the rate of EU migration falling, finding workers with the right skills may prove more difficult until there is further certainty around the ability of small businesses to recruit EU workers after Brexit.
- **The proportion of small businesses that expect to grow over the next 12 months is down to its lowest level ever.** In Q3 2018 fewer than half of small businesses (47.7%) aspire to grow, a 1.4 percentage point reduction from Q2, and down 3.3 percentage points compared to Q3 2017.

UK MACROECONOMIC OVERVIEW

Manufacturing output falls in Q2 as services and construction rebound

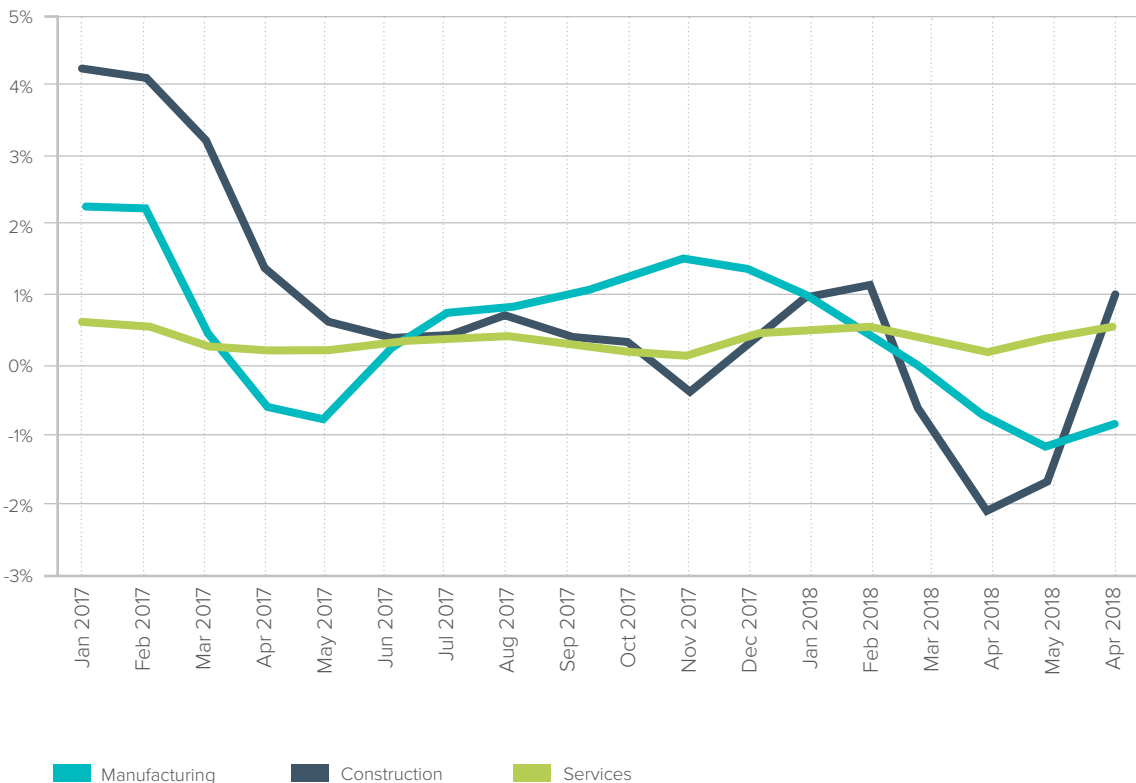
The first estimate of GDP growth for Q2 2018 suggests that the UK economy expanded 0.4% in the three months to June when compared to the previous three months. This follows a string of underwhelming statistics showing that extreme cold weather limited growth to only 0.2% in Q1. As a consequence, economic growth over the first half of the year remains in line with the second half of 2017: positive but modest by historical standards.

Services and construction firms experienced faster growth as both sectors caught up from weak output in the first quarter, increasing by 0.5% and 0.9% respectively. This was partially offset by a decline in the manufacturing sector, where output fell by 0.9% over the same period. This is the second consecutive quarterly decline in manufacturing output, marking the start of a technical recession for the industry.

Despite the somewhat lacklustre rate of economic growth, the Bank of England’s Monetary Policy voted to raise its base rate to 0.75% in August. This is the highest rate in nine years and clearly signals a move away from the ultra-loose monetary policy that has been in place since the financial crisis.

The Bank of England made the decision on the back of high employment and limited slack in the economy. Under these conditions, without a compensating burst of productivity growth, even limited extra economic growth can be sufficient to pull up inflation. Currently resting at 2.5% annual growth, the Consumer Price Index (CPI) is well above the Bank of England’s target of 2%. The Bank aims to manage inflation back down to that target gently. In order to do this without risking an unnecessary shock that could cause substantial unemployment, a series of incremental rate rises are expected over the next few years.

Figure one: Output by sector, 3 month change.
Source: Office for National Statistics.



SMALL BUSINESS INDEX

Small business confidence falls back into negative territory

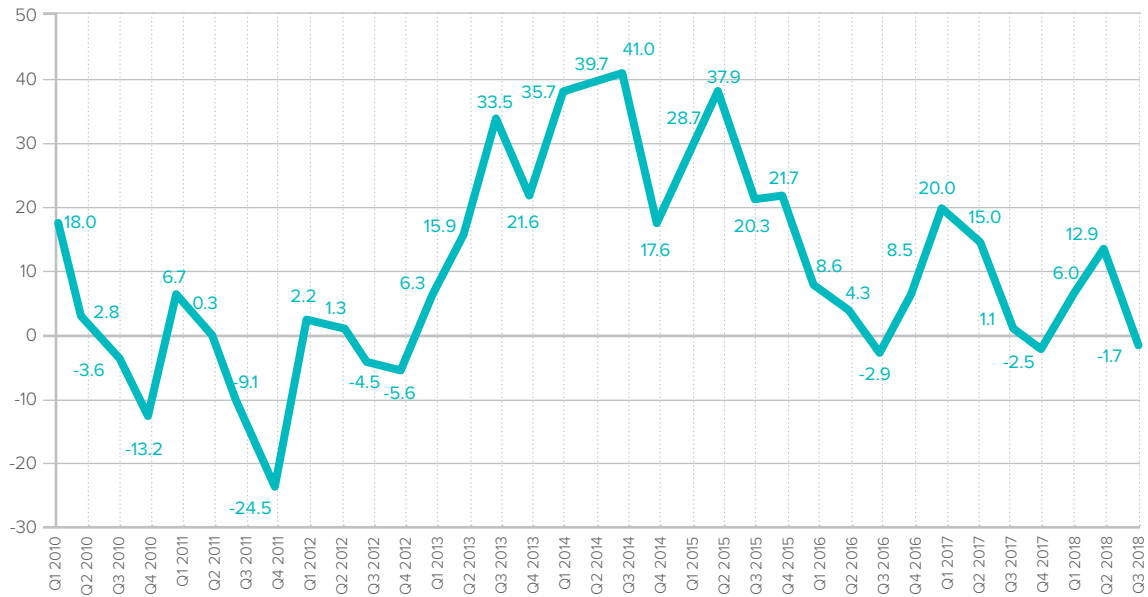
Business confidence among small firms dipped in the third quarter of 2018, reversing almost all the gains recorded during the first half of the year. The FSB Small Business Index fell 14.6 points, decreasing from +12.9 in Q2 2018 to -1.7. Year-on-year the Small Business Index is down by 2.8 points.

Although the service sector grew faster than the rest of the economy in Q2, the UK services Purchasing Managers' Index (PMI) slowed in July to 53.5, down from 55.1 in June. This is still expansionary territory but perhaps marks the end of the boost to consumer spending driven by atypical factors such as the good weather. The manufacturing PMI shows a

similar softening, falling to a 25 month-low of 52.8 in August, but is still above the no-change mark of 50.0. Prospects for the construction sector have also dipped, with the sector's PMI dropping from 55.8 in July – the fastest rise in overall construction output since May 2017 – to 52.9 in August.

The combined view across business surveys is one of caution, now that most industries have had the opportunity to bounce back from disruption in the first quarter. However, with the possible exception of the construction sector, there is little momentum to carry forward faster growth into the second half of 2018.

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.

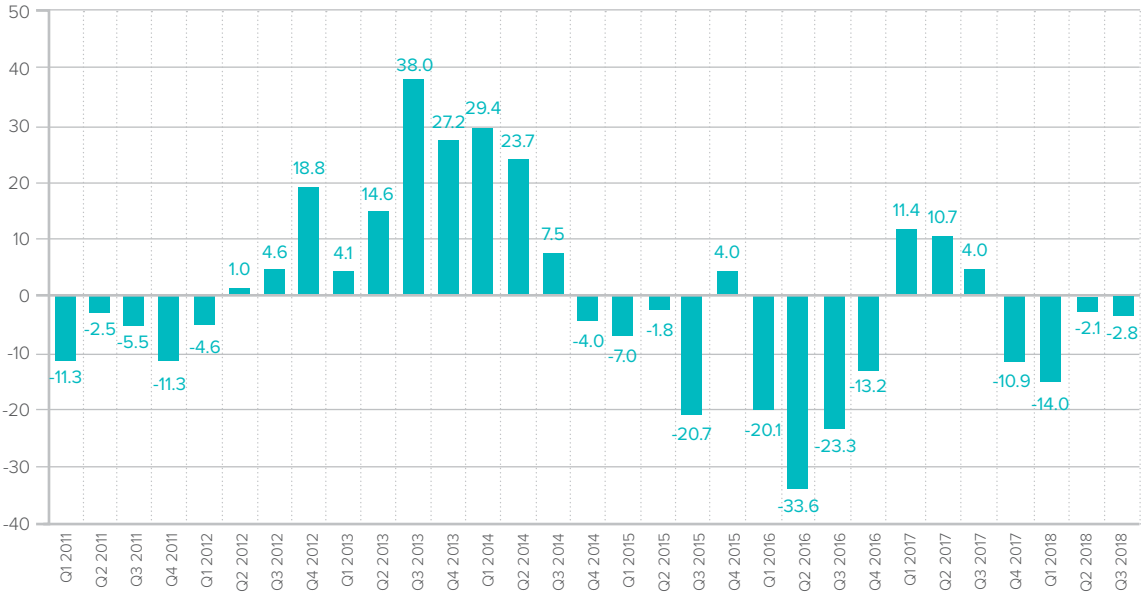


Figure four: UK SBI against year-on-year UK GDP growth.
 Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

Confidence drops across
England and Scotland

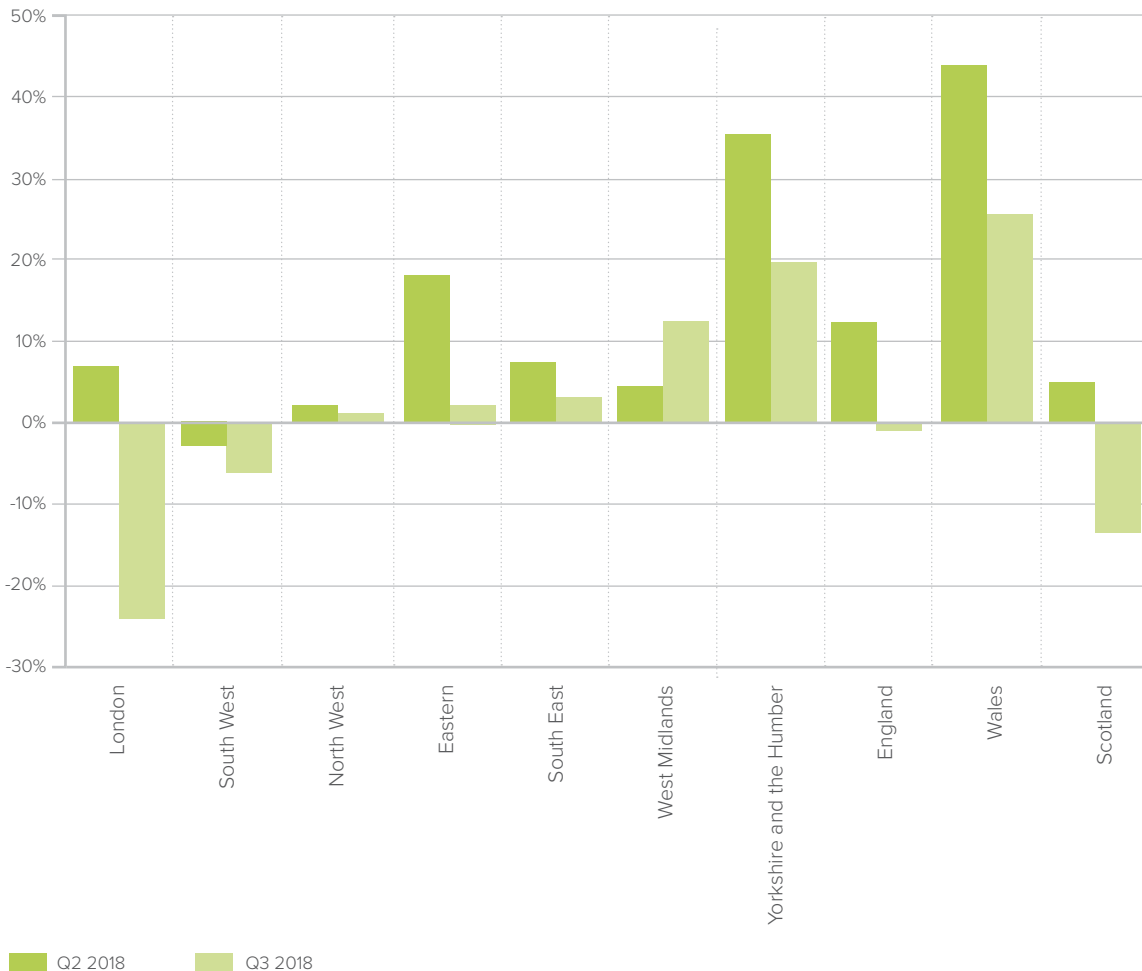
CONFIDENCE DECLINES IN MOST OF THE UK'S NATIONS AND REGIONS

Small business confidence is in decline compared to Q2 across most of the UK's regions and nations in Q3 2018. The only increase over the last quarter was seen in the West Midlands, where confidence climbed from +4.8 in Q2 to +12.4. Year-on-year, confidence in the West Midlands grew by 20.8 points, the largest annual uplift of any region. Confidence in Scotland, on the other hand, returned to negative territory. After reaching +5.1 in Q2, the only quarter of positive sentiment recorded in the country since 2015, the index fell back to -13.2 in Q3. This is still higher than the same period last year, however, when the confidence index for Scotland was -15.3. Having fallen behind the UK average GDP growth rate during 2017, the last quarter's positive reading was cause for greater optimism in Scotland. The lack of business confidence raises concerns over whether the economy may continue to suffer.

In England, confidence is only slightly negative at -0.9, but with even the most confident regions presenting a less optimistic outlook compared to the beginning of the year, the national index has fallen back from +12.9. Divergence across the most and least confident regions has also grown, with small businesses in London much less confident (-24.0) than their counterparts in Yorkshire and the North East (+19.6). Across the other regions, results are more balanced, with the South West (-6.2), the North West (+1.1), South East (+3.2) and Eastern (+2.3) regions all hovering close to 0.

Small businesses in Wales remain the most confident across the UK's regions and nations despite also seeing a significant fall in confidence from +43.6 to +25.3. Even after this large quarterly fall, confidence in Wales was still 3.2 points higher than in Q3 2017.

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



SMALL BUSINESS SECTOR INDICES

High streets under the cosh

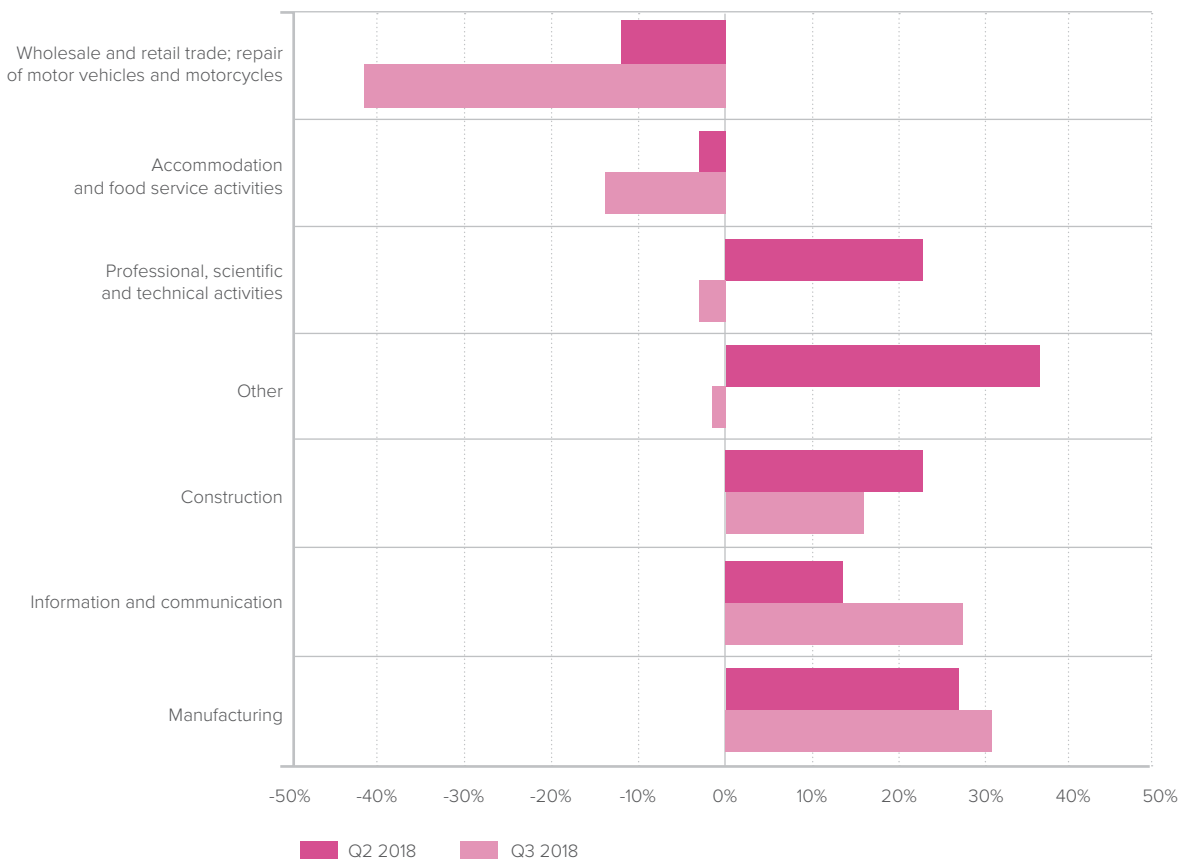
CONFIDENCE IN WHOLESALE AND RETAIL TRADE SECTOR PLUMMETS IN Q3

Manufacturing businesses bounced back from a dip in Q2 to become the most confident sector in Q3 2018. Confidence in the sector recovered 3.8 points in the last quarter, having dropped 4.4 points between the first and second quarters of the year. As a consequence, manufacturing firms report a buoyant index score of +31.1, 20.8 points higher than the same period last year. The only other sector recording an increase in confidence between Q2 and Q3 was information and communication.

Data for the three months to June 2018 show that manufacturing output has fallen 0.9% compared to the previous three months, dragging the overall index of production down. This suggests the lower confidence among small manufacturers recorded in the FSB Small Business Index in Q2 was more than borne out in actual performance. With confidence on the rise, the sector's small businesses could now be better positioned for growth.

The opposite trend is visible in the wholesale, retail and motor trades sector where, despite growth of 0.2% in the three months to June compared to the previous three months, Q3 saw a significant collapse in confidence. The sectoral index for these businesses fell by around 40 points to -42.0. This was 21.6 points lower than in Q3 2017 and coincides with a fall in output in the sector over the month of June (-1.7%) which offset some of the growth experienced in April (+0.3%) and May (2.7%). The slowing of real wage growth, and increase in interest rates in August are likely to reduce the prospects for consumer-facing retailers. Similarly, a slump in the value of sterling will raise costs for importers over the coming months, with higher oil prices dampening demand in the motor industry.

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



FINANCIAL PERFORMANCE

A mixed picture across the UK

REVENUES STABLE AS BALANCE OF FIRMS REPORTING GROWTH TICKS DOWN

The balance of small businesses reporting growth in revenues over the past three months declined slightly from +6.2% in Q1 2018 to +5.9% in Q3. The change was driven by a slightly larger fall in the proportion of businesses seeing their revenues increase rather than decrease year-on-year, however, the revenue net balance has increased by 3.3 percentage points, from +2.6% in Q3 2017.

Welsh businesses reported the best growth in revenues over the last quarter, with a net balance of 39.1% seeing an increase in revenues. By contrast, a

greater number of businesses in the West Midlands and the North West saw their revenues declining rather than growing in Q2. The net balance for these two regions was -7.9% and -2.3% respectively.

Expectations for revenues in the next quarter are more positive. The net balance of businesses expecting an increase in revenues over the next 3 months is +10.7%, up from +6.2% in Q1 2018. The most optimistic areas for revenue growth are Wales (+34.5%) and Yorkshire and the North East (+20.0%).

Figure seven: Small business gross profits, net percentage balance – proportion reporting increase less proportion reporting decrease.

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



EXPORTS

International sales drop
despite weak pound

EXPORT GROWTH SLOWS IN Q3

The net balance of small businesses reporting an increase in exports over the past three months decreased to stand at 10.7% in Q3. This is down from 16.5% in Q2 2018 and represents a fall of 8.8 percentage points compared to the same period last year. The latest quarterly decline was driven by an 8 percentage point increase in the proportion of firms that reported the value of their exports as falling, compared to Q2.

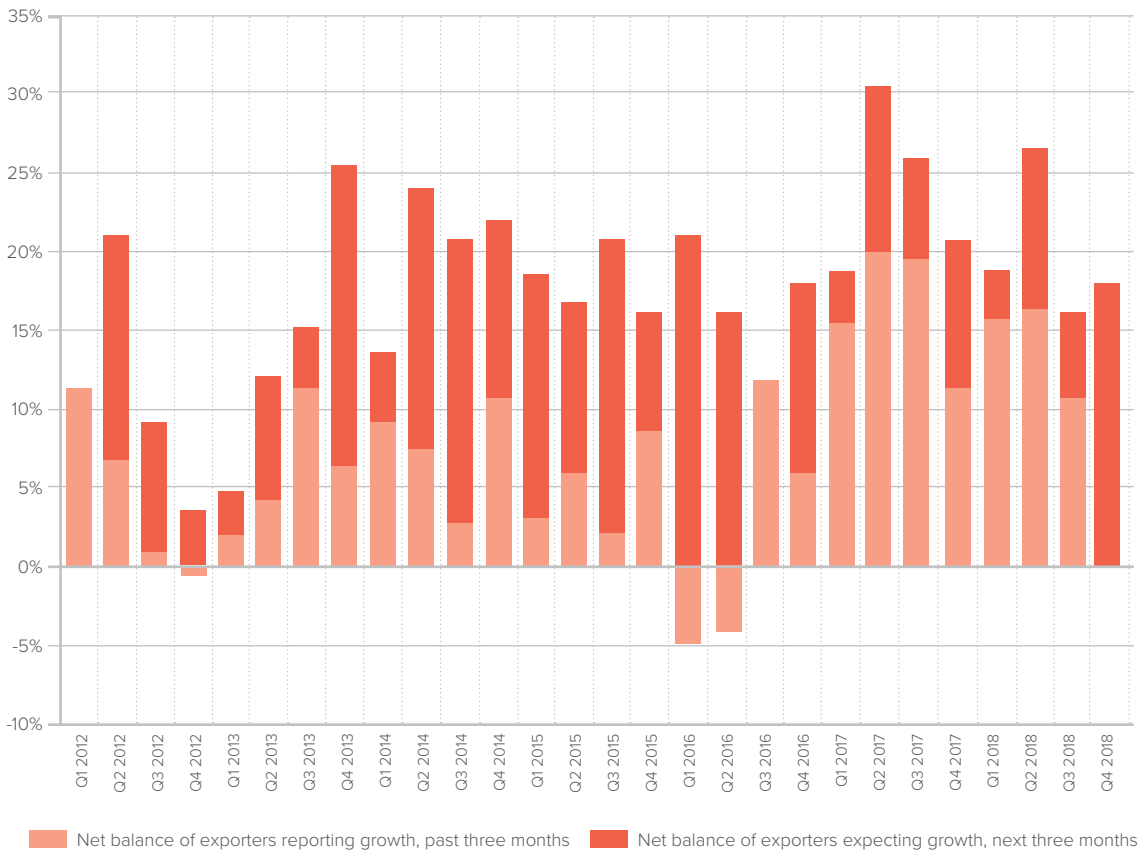
Official statistics show that export volumes fell in the three months to June, causing the trade deficit to widen as goods imports rose. This change occurred despite the weakness of sterling over the first half of 2018, which should have made UK exporters more competitive abroad. Under these conditions, even if exporting businesses maintain steady prices and volumes abroad i.e. in foreign currency, they can increase the UK value of their exports once they are converted back into pounds. There have been anecdotal reports that firms based within the EU are attempting to reduce the level of inputs they source from the UK, however, to avoid the risk of customs problems in the event of a ‘no-deal’ Brexit. With less

than a year until the UK leaves the EU, this type of contingency planning may have affected exporters’ performance over the last three months.

Nevertheless, SBI expectations for export growth over the next three months have bounced back during the last quarter. While this is positive news, expectations of export growth tend to outperform the actual growth in exports recorded in the relevant quarter (see Figure 8). This proved to be the case in Q2 when a net balance of 16.0% of businesses expected their exports to grow over the following three months, 5.3 percentage points higher than the 10.7% balance of those which actually went on to realise export growth in Q3.

This quarter, the balance of firms which expect the value of their overseas sales to increase over the next three months is 17.8%, 2.8 percentage points down on Q3 2017. While the continuing decline in the value of sterling is likely to support exporters’ competitiveness, Brexit risks and a slowing global economy are expected to hold back export potential somewhat.

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 prices spiral

OIL PRICES PUSH UP FUEL COSTS FOR SMALL BUSINESSES

This quarter, a net balance of 65.2% of small businesses report an increase in operating costs over the past three months compared with the same period a year ago. This represents a small decline on the 65.6% seen in Q2 although the proportion of firms reporting their costs rising has increased by 1.4 percentage points since Q3 2017

Labour costs remain the most frequently cited (39.7%) cause of rising costs for small businesses, although this has fallen back from 45.7% in Q2. Compared to the same period in 2017, the proportion of businesses reporting labour cost increases has also fallen, by 2.4 percentage points. This reduction reflects the official data on earnings. Although tight labour market conditions have led to higher pay over the last year, the rate of wage growth slowed unexpectedly in the

three months to June. Total average weekly earnings grew by 2.4%, compared to the same period in 2017, down from 2.8% in the three months to February, reducing some business cost pressures.

Compared to the previous quarter, a greater proportion of smaller businesses report exchange rates and fuel as sources of rising costs. The percentage of businesses citing fuel as increasing their costs in Q3 2018 was up to 37.4% from 28.2% in Q2 and 18.1% in Q3 2017. Oil prices rose fairly sharply over the year to May 2018 and this has fed through to pump prices faced by consumers and businesses in the UK. Since oil is traded in dollars, the recent fall of sterling against the dollar has offset some of the benefit to UK consumers of oil prices softening.

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.

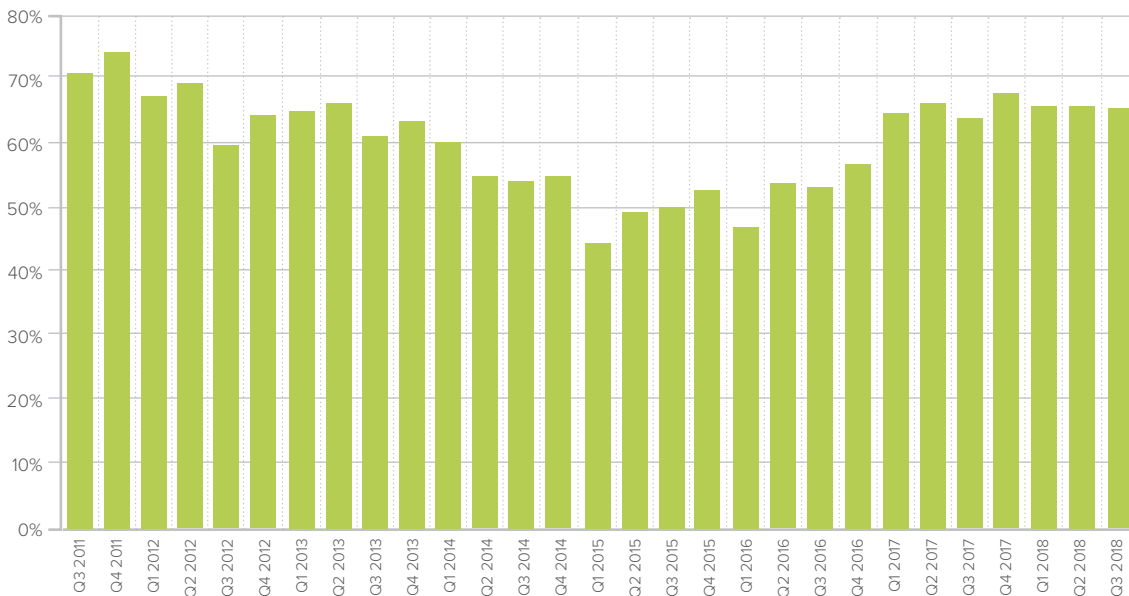
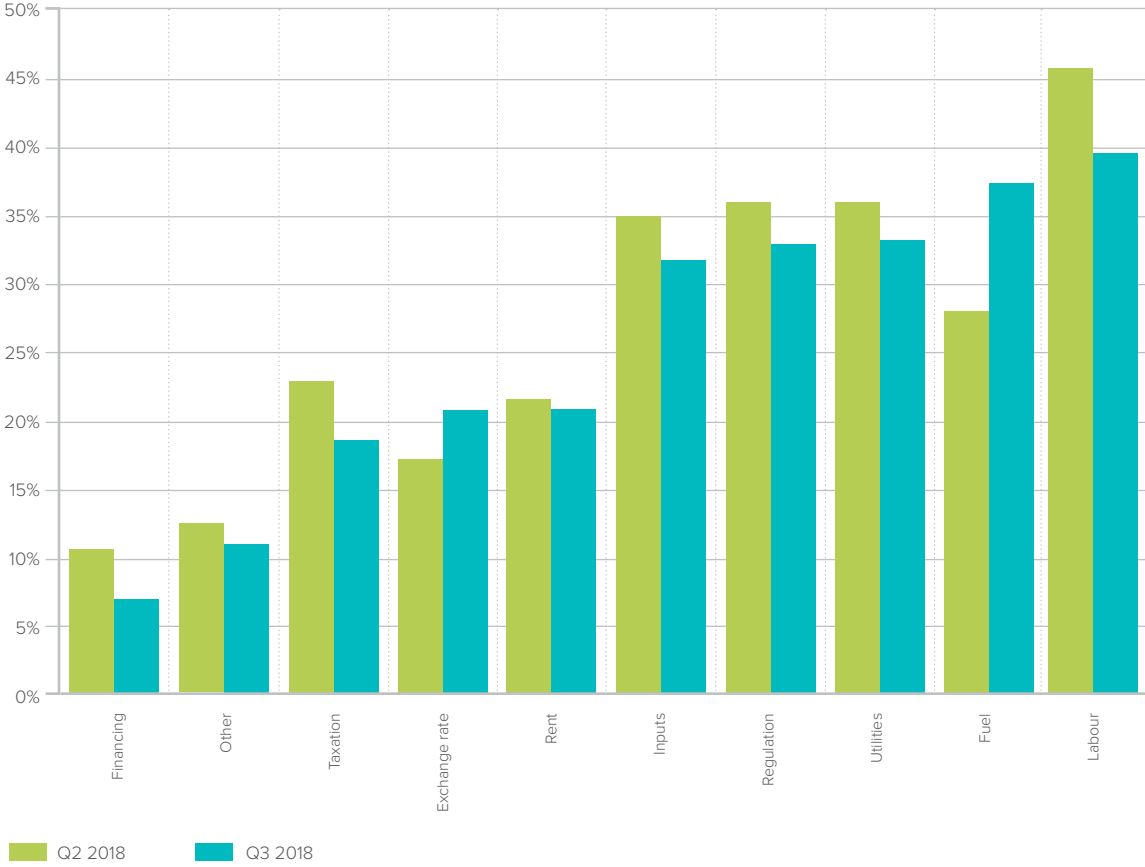


Figure 10: Main causes for changing business costs (firms may give multiple answers).
 Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CAPACITY

Steadily less slack in
the economy

SPARE CAPACITY CONTINUES TO FALL

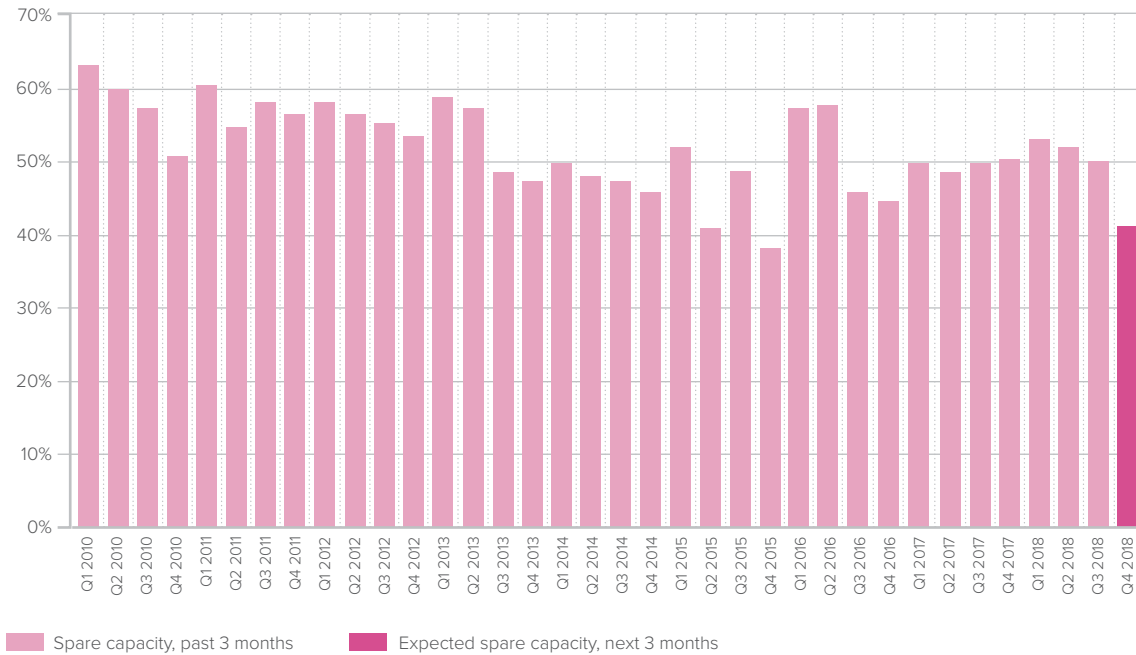
The latest survey results show that the share of small businesses operating below capacity continued to decline slightly this quarter. A net balance of +50.2% of firms operated below capacity in Q3. This is broadly in line with Q3 2017 (49.6%), but stands 1.2 percentage points down on the net balance of +51.4% of firms in Q2.

Small business expectations suggest that spare capacity will decline further over the next three months: a net balance of 40.9% of small businesses

expect to be operating below capacity over the quarter. Such a decline is broadly in line with the Bank of England's assessment of supply-side conditions. The Bank, which studies the slack in the economy as it assesses inflationary pressures, judged that a very limited degree of slack remains in the UK economy. This assessment was crucial in the unanimous decision made on 02 August by the Bank's Monetary Policy Committee to raise its benchmark interest rate to 0.75%.

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

Small businesses still hiring

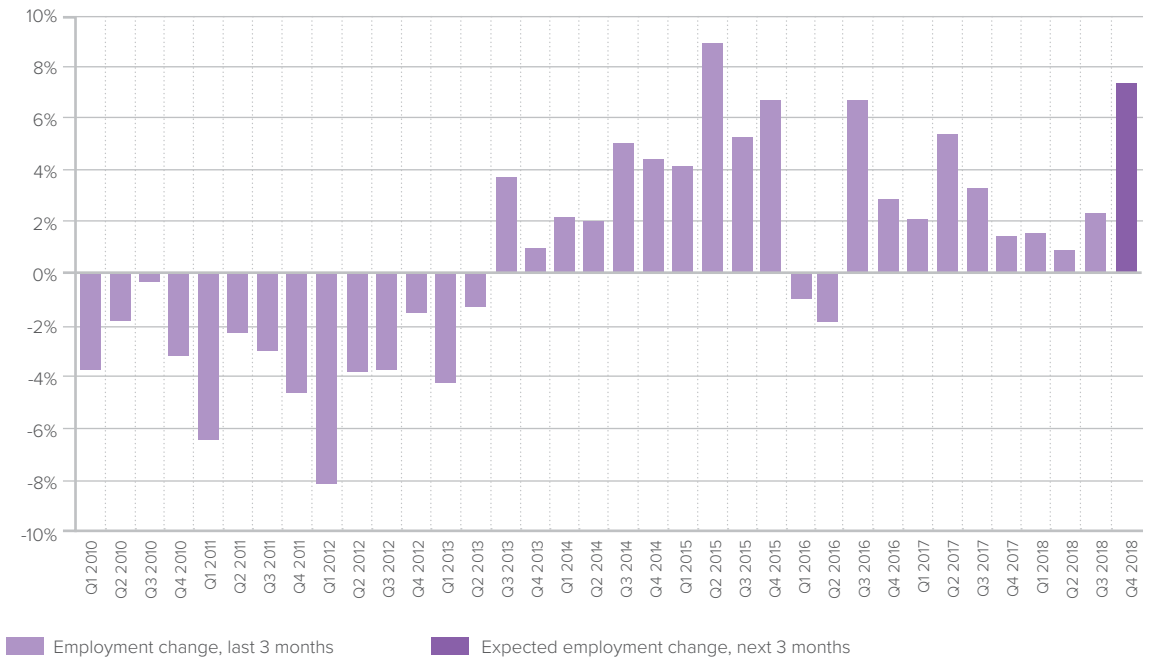
EMPLOYMENT GROWTH SHOWS NO SIGNS OF SLOWING

This quarter, a net balance of +2.3% of small firms report that they've increased the size of their workforce. This is the ninth consecutive quarter in which more small businesses have reported employment increasing rather than reducing, albeit at a lower rate than the +3.3% net balance recorded in the same period last year. The balance of firms reporting an increase grew by 1.5 percentage points from +0.8% in Q2. A net balance of +7.4% of firms also expect to increase their headcount in the next three months.

The official statistics show that employment across the UK remains close to record levels. Data released by the Office for National Statistics (ONS) show that in the three months to June 2018 the employment rate, i.e. the share of people aged 16-64 who are in work, was 75.6%. This is just 0.1 percentage point off the highest rate since records began, which was recorded over the three months to May 2018.

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.

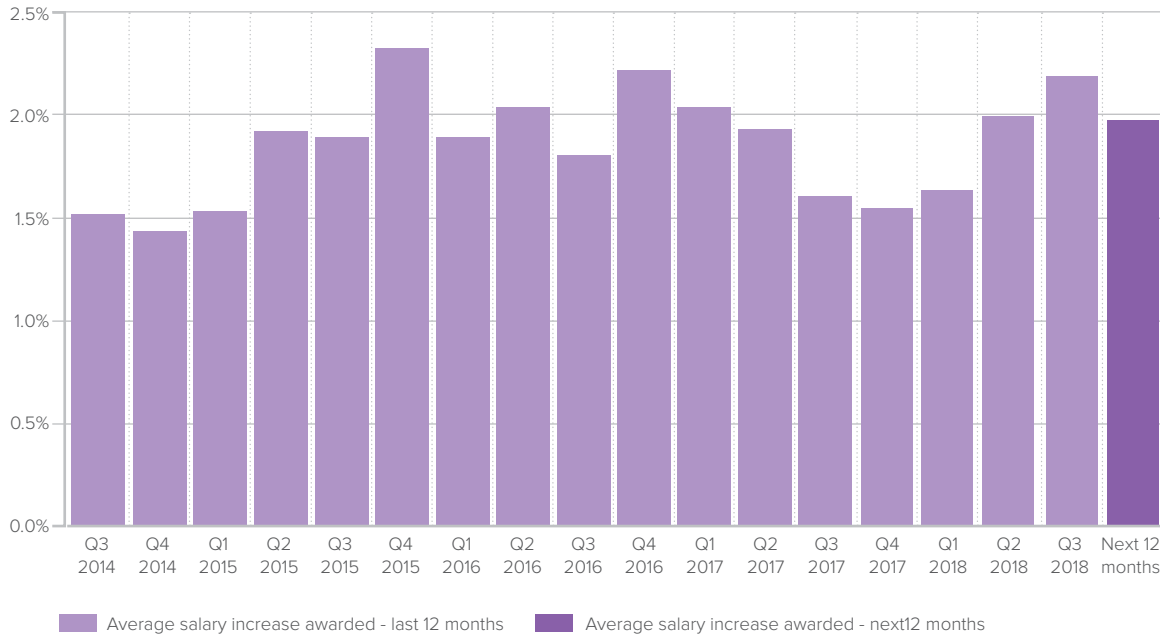


SMALL BUSINESS WAGE BILLS SET TO CONTINUE GROWING

This quarter, the average annual wage growth within a small business accelerated to 2.2%. This is in line with small businesses citing labour as the main driver of increased costs, as noted earlier in this report. This level of wage growth is the joint highest (equal to Q4 2016) rate since the fourth quarter of 2015 when wage growth amongst smaller businesses peaked at 2.3%.

The latest data show both the number of unemployed and economically inactive people decreasing, supporting the record high levels of employment and causing the readily available pool of workers to reduce. Once that pool of labour has been exhausted firms will have to compete to attract new staff from other companies. This has the potential to drive further wage growth. In Q3 small business owners expected to see wages in their businesses increase by an average of 2.0% in the coming year.

Figure 13: Average salary increase awarded, current quarter versus previous 12 months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



GROWTH ASPIRATIONS AND CHALLENGES

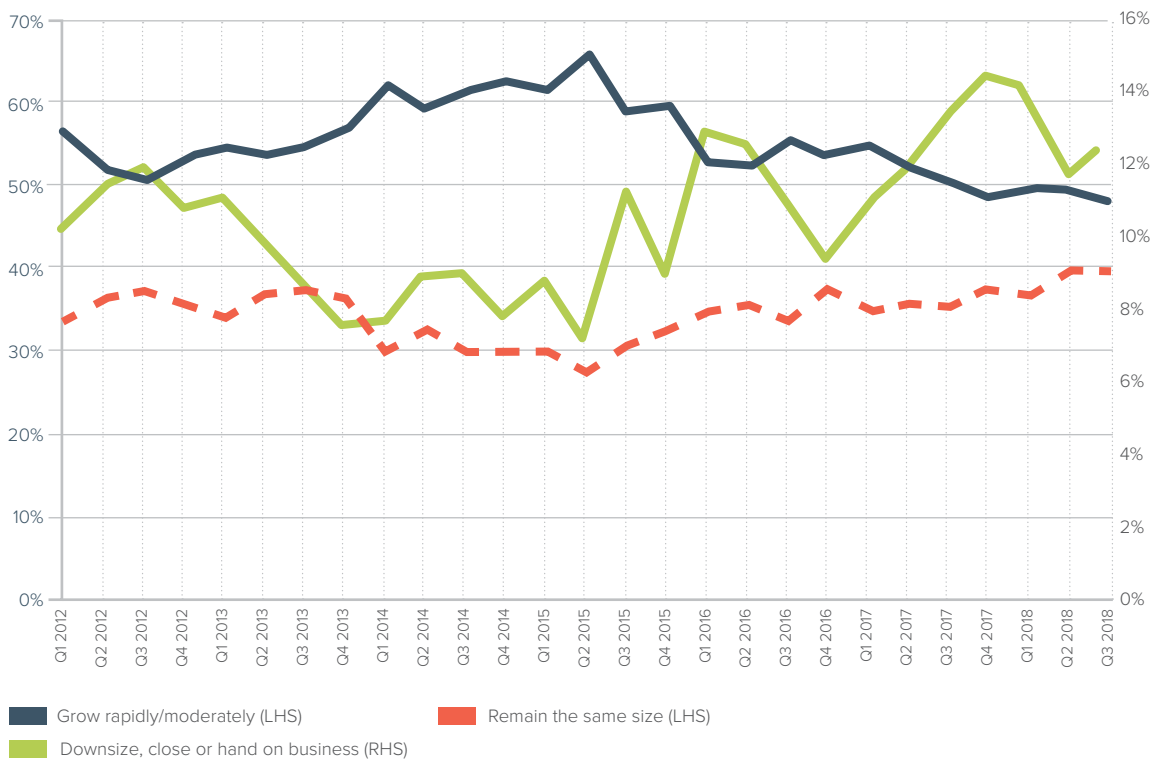
Expansion plans hit all-time low

GROWTH ASPIRATIONS FALL TO THE LOWEST LEVEL ON RECORD

The proportion of small businesses that expect to grow over the next 12 months is at its lowest level ever. In Q3 2018 fewer than half of small businesses (47.7%) aspire to grow, a 1.4 percentage point reduction from Q2, and 3.3 percentage points down on Q3 2017.

Moreover, the share of small firms planning to downsize, close or hand on their business also increased by 1 percentage point to 12.7%.

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



CONCERNS OVER ACCESS TO SKILLED WORKERS INCREASE

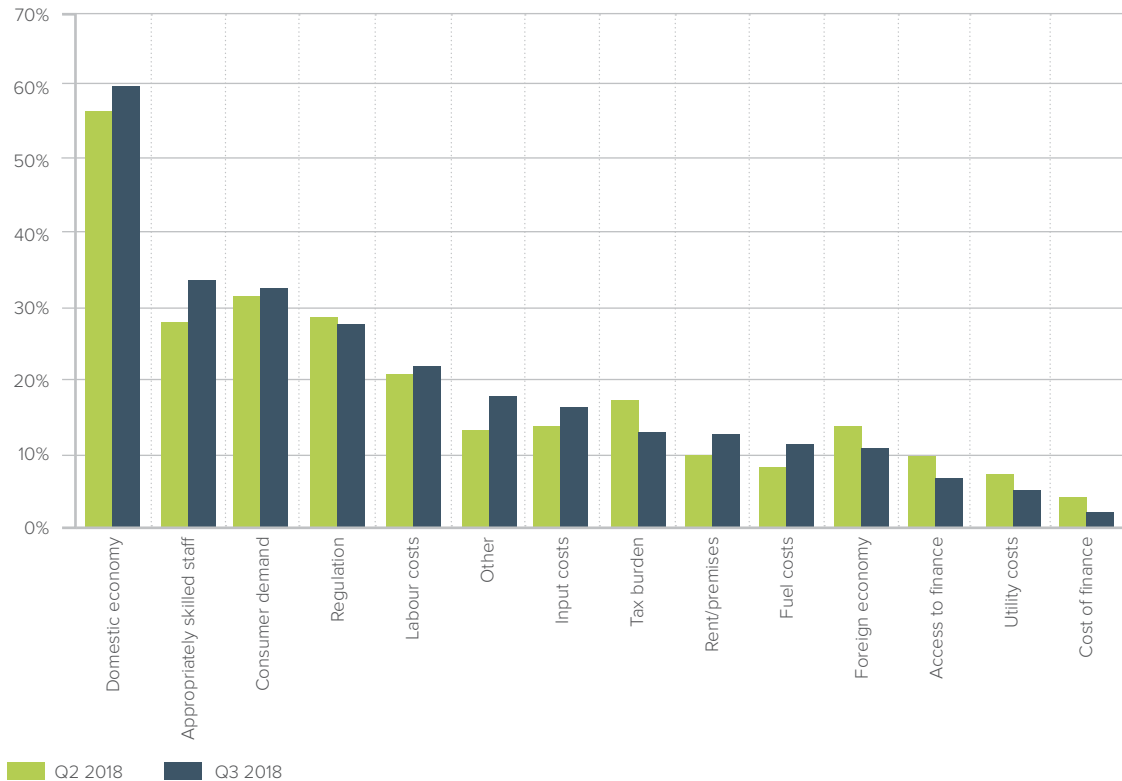
The domestic economy continues to be the most frequently cited barrier to growth for small businesses, with 60.1% of small businesses highlighting this as an issue in Q3. Although this represents an increase of 3.6 percentage points from Q2, the domestic economy represents less of a barrier to growth aspirations than at the same time last year when 63.2% of businesses cited this as a concern.

The proportion of small businesses reporting that access to appropriately skilled staff is a barrier to their growth aspirations increased by 6.1 percentage points between Q2 and Q3 2018. Now standing at 34.3%, this represents the highest reading for small business concerns over skilled labour since Q3 2015, and is the second most widely referenced concern. By contrast, in Q3 2017 only 28.0% of small businesses cited access to skilled labour as a potential barrier to growth.

In the year to March 2018, the level of net EU migration fell to +87,000. This marks the lowest level of net EU migration recorded since 2012, and is down 54% compared to the period leading up to the EU referendum in 2016. Given there have been no domestic labour market reforms in recent years to substantially affect the supply of labour, the slowing flow of EU workers is likely to have played a role in this decline.

As the threat of a disorderly Brexit rises, with no guarantees in place over the future of EU workers' rights or the nature of the immigration system once the UK leaves the EU (post any transition period), many Europeans may not be electing to move in search of work. As the labour market tightens this will make the pool of available workers with the right skills smaller. Furthermore, without the administrative capacity found in larger firms, smaller businesses will be worst placed to navigate the bureaucracy that may be involved in arranging work visas/permits under any future regime.

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

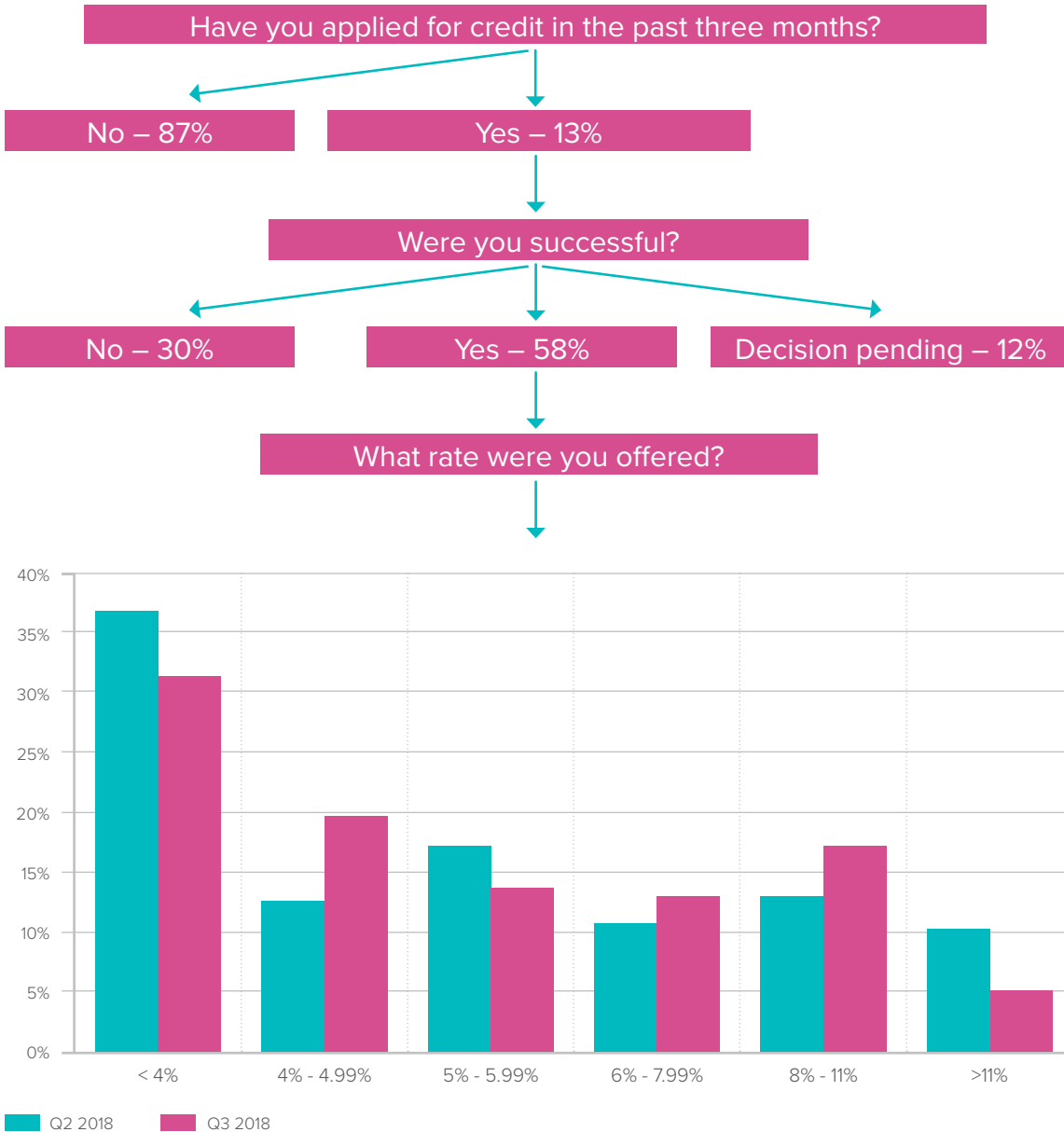


CREDIT

Number of successful
applicants plummets

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.



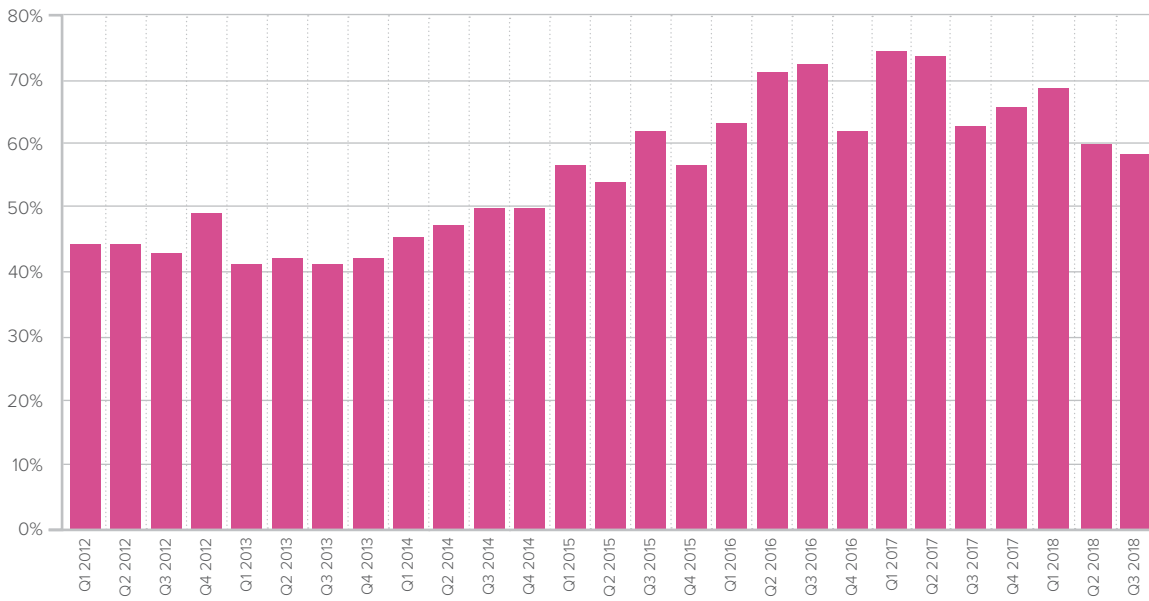
This quarter, the proportion of small businesses successful in their credit applications stands at 60%, down eight percentage points on the first quarter of the year. As a result a higher proportion of small businesses applying for credit are still awaiting a decision, illustrated by the 17% of credit applicants listing their status as decision pending.

The proportion of businesses being offered a rate of up to 4% has fallen from 46.6% in Q2 2018 to 36.8% in Q3 2018. This follows the Bank of England raising interest rates by 25 basis points in November 2017 and signalling future rate rises.

The proportion of businesses being offered an interest rate of 4% or less has fallen from 36.7% in Q2 to 31.4% in Q3 2018. This is down by 7.6 percentage points compared to Q3 2017. Given the widespread expectation of the Bank of England rate rise

announced on 02 August this is likely due to lenders pricing in the decision in advance. The higher refusal rate may also be indicative of lenders taking a more risk averse view of small businesses credit quality.

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.

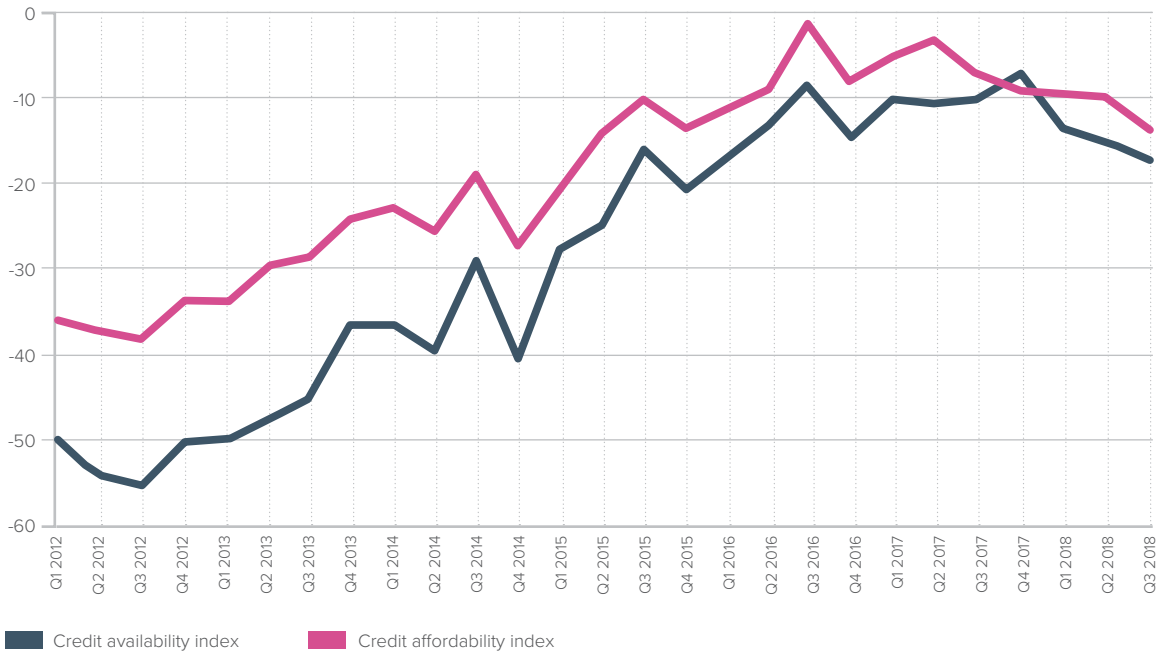


CREDIT AVAILABILITY CONTINUES TO DECLINE

This quarter, the FSB credit affordability and credit availability indices are both down, by 3.8 and 1.4 points respectively. While the Bank of England base rate has reached its highest level in nine years, it still remains historically low as indicated by the high levels of credit affordability.

The tightening of credit availability for small firms was also recognised by the Bank of England’s Agent’s Summary of Business Conditions survey for Q2 2018 which suggested that the ability to access traditional bank finance is becoming increasingly difficult. This contrasts with more widespread availability of bank credit for medium-sized and large companies.

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

One in three small firms
investing more

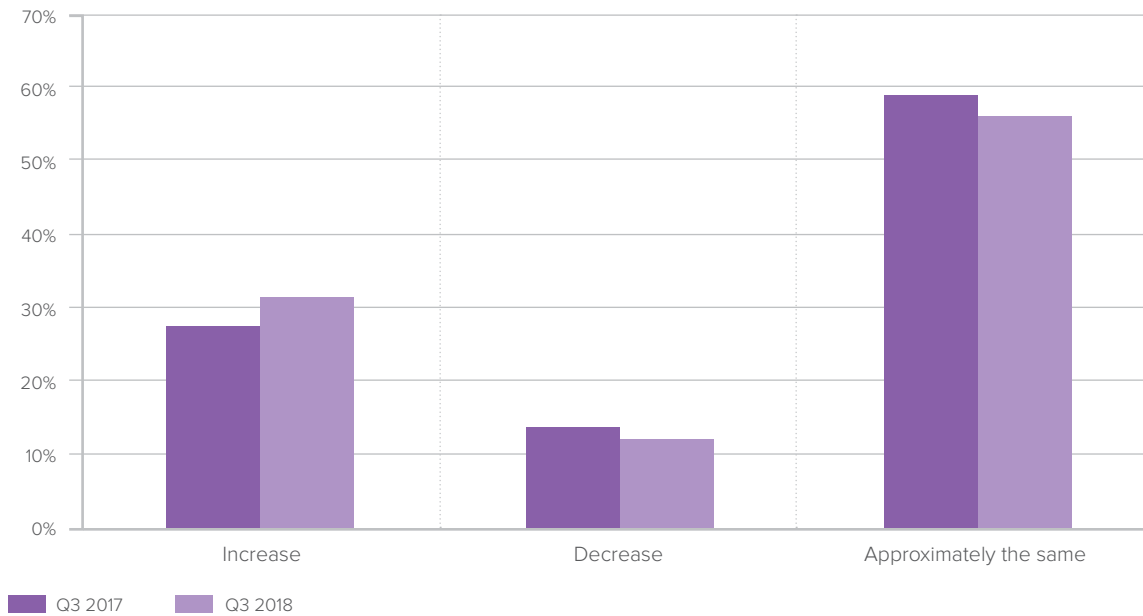
SMALL BUSINESSES LOOK TO INCREASE CAPITAL INVESTMENT

Despite the lower proportion of firms seeking and being given access to credit, the share of firms expecting to increase capital investment over the coming quarter increased to 31.5% in Q3 2018. This is up 4.1 percentage points on Q3 2017. A lower share of firms (12.3%) expect to decrease capital investment over the same period, down 1.5 percentage points on Q3 2017.

The increasing cost and lower availability of labour may be one factor driving small businesses to invest in labour-saving or productivity-enhancing capital. Once spare capacity in the economy is exhausted, increased productivity will be key to any future economic growth.

Figure 19: Percentage of small businesses expecting to increase and decrease capital investment over next three months, compared with the previous three months.

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



METHODOLOGY

This report is based on the July 2018 research survey of FSB members carried out by Verve. All panel members (6,346) were invited to take part in an online survey and an open link sent to non panel members. Reminders were sent to all non-respondents. 984 responses were received, a response rate of 14% for the Big Voice 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 10 July and 26 July 2018.

SUMMARY DATA TABLE

	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018
Small Business Index	8.5	20.0	15.0	1.1	-2.5	6.0	12.9	-1.7
Employment - previous three months	2.9%	2.1%	5.3%	3.2%	1.4%	1.6%	0.8%	2.3%
Employment - coming three months	9.6%	11.3%	10.3%	9.4%	2.9%	8.7%	8.2%	7.4%
Exports - previous three months	6.1%	15.6%	20.0%	19.6%	11.5%	15.8%	16.5%	10.7%
Exports - coming three months	18.6%	30.4%	25.8%	20.5%	18.8%	26.4%	16.0%	17.8%
Credit availability - rated good or very good	23.7%	25.8%	28.0%	24.1%	26.0%	24.1%	21.9%	24.1%
Credit availability - rated poor or very poor	39.1%	36.4%	37.9%	35.3%	31.8%	39.3%	40.0%	42.5%
Credit affordability - rated good or very good	27.5%	29.1%	30.4%	28.8%	24.8%	25.3%	25.4%	23.7%
Credit affordability - rated poor or very poor	36.9%	36.1%	33.2%	38.3%	36.1%	39.2%	35.3%	41.7%

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.

Q3

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