

Q2

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 2, 2016

 @fsb_policy

fsb.org.uk

fsb⁰³
Experts in Business

CONTENTS

Q2 Snapshot	4
FSB National Chairman	5
Economist’s view	6
FSB executive summary	7
UK macroeconomic overview	8
Small Business Index.	9
Regional small business indices	11
Sector small business indices	13
Revenue and profitability	16
Exports	18
Costs and inflation	20
Capacity	23
Employment and wages	25
Growth aspirations and challenges.	28
Credit	31
Investment	35
Methodology	37

Q2 2016 SMALL BUSINESS CONFIDENCE

“ Small businesses are less optimistic, cutting headcount, curbing investment intentions and reporting declining profits ”

The National Living Wage and ongoing rollout of auto-enrolment are both contributing to higher labour costs



Almost **50% of small businesses** report **labour costs** as the main cause of changing business costs

58% of small businesses report that the domestic economy is a barrier to achieving their growth aspirations

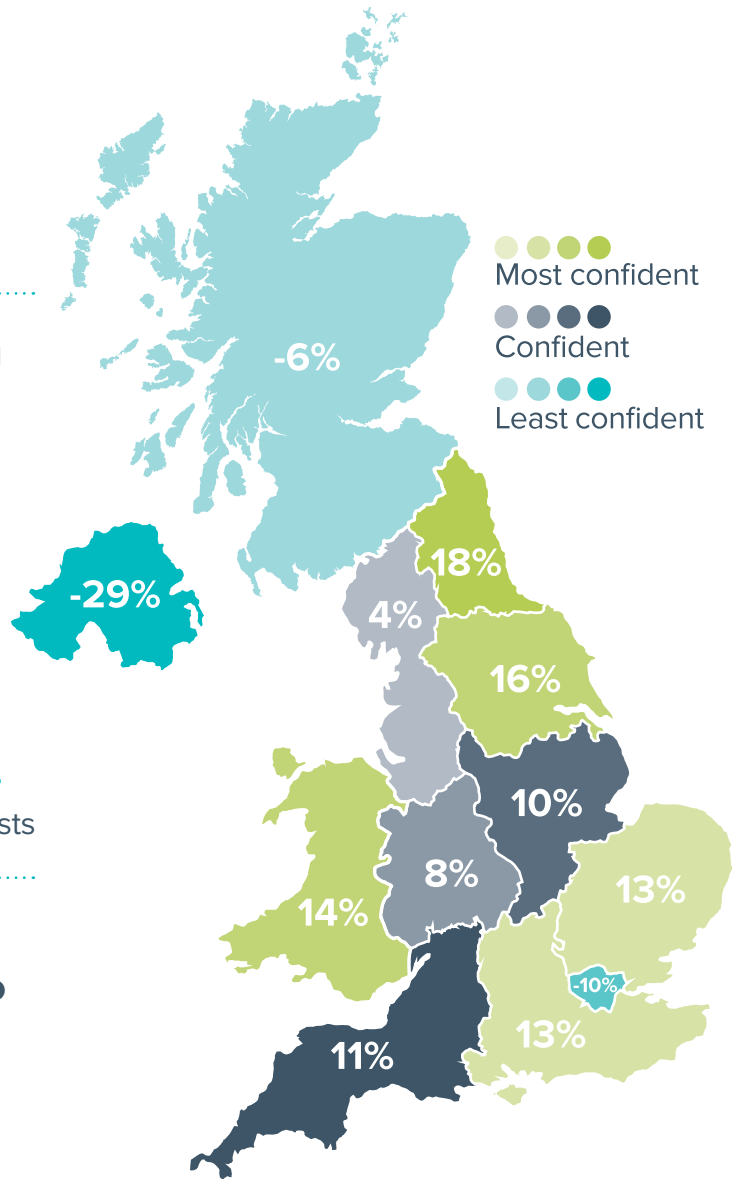


Up from 50% this time last year and reflects the **loss of momentum** seen in the UK economy in recent months

Credit conditions continue to improve



Credit availability and affordability indices stand at a **record high** this quarter



Small businesses are reducing headcount



The **second consecutive quarter** reporting a **decline**, down by **1.9%**

FSB NATIONAL CHAIRMAN

The survey underpinning this Q2 report was in the field ahead of the referendum on the UK's membership of the European Union, with the report being drafted and printed before the vote on 23 June.

Continuing pressures on the UK economy, combined with a series of policy challenges affecting small firms, have seen small business confidence sink to its lowest level since the end of 2012. Confidence stands at just +4.3, down from +37.9 in the same quarter last year. This is the largest annual drop in confidence that we have seen since the SBI began in 2010.

The importance of small businesses to the success of the economy means that the Government needs to be proactive in providing further support for the business community. Delivering planned improvements in both digital and physical infrastructure, simplifying the tax regime and investing in workplace skills will all help small businesses to increase their productivity and contribution to the economy.

More businesses are reporting that labour and taxation costs have risen significantly following the introduction of the National Living Wage, the ongoing roll-out of pensions auto-enrolment and changes to the tax treatment of dividends introduced in April this year. The cumulative impact of these reforms is beginning to affect growth aspirations among small businesses. For the second consecutive quarter, small businesses have reported that they are reducing headcount.

Confidence has clearly continued its downward trend. The survey and this report were drafted before the referendum took place. The extent to which uncertainty caused by the upcoming referendum has affected confidence is unclear, with other factors likely also to have weighed on small business confidence. Our data does, however, suggest that uncertainty about the outcome of the referendum is likely to have had an impact on confidence, with investment decisions also being deferred. Investment intentions have now fallen to the lowest level since Q3 2012.

Confidence has fallen in every UK region, with falls being most apparent in London. Businesses in London are particularly exposed to the global economy, suggesting that the weak growth picture in many of our trading partners across the world – as well as the uncertainty of the referendum outcome – is acting as a drag on confidence for London-based businesses.

Setting aside measures of confidence, there are a number of worrying indicators that small businesses are reducing headcount, curtailing investment intentions and reporting negative profit margins. The number of businesses which report that they aspire to grow is also sharply down on a year ago.

While much of this report presents a negative picture of the UK economy, there are some positive signs – particularly with regard to the availability and affordability of credit. Credit is cheaper, and more readily available, than at any previous index, with 71 per cent of credit applications being accepted in the previous quarter. Much of this reflects the increased availability of alternative forms of finance, which small business owners are increasingly making use of. However, over half of credit applications (52%) are being used to manage cash flow rather than to expand the business or invest in new machinery. And with only 16 per cent of small businesses applying for credit in the last three months, this further highlights the muted investment and growth aspirations among many small firms.

Small businesses are operating under tight financial constraints, but remain resilient in the face of a variety of different challenges. FSB will continue to make the case to Government about how they can help this vital sector to achieve its full potential.



Mike Cherry,
FSB National Chairman

ECONOMIST'S VIEW

This quarter's FSB Small Business Index suggests that there has been a further decline in the business environment in the UK in Q2 2016, with almost all of the key indicators tracked in this report pointing to an economic slowdown. Small businesses are less optimistic, cutting headcount, curbing investment intentions and reporting declining profits.

Some have attributed the UK's economic weakness at the start of 2016 to the uncertainty caused by the referendum on membership of the EU. While this has probably led to a postponement of major investment decisions, the reality is that the slowdown can be put down to a number of factors. Small businesses find themselves in a world of intense price competition, particularly in sectors such as retail. This is leading to a significant squeeze on profit margins and businesses that are unable to cope with a sustained period of lower selling prices are in for a very tough time.

In addition, several aspects of government policy have increased the cost pressures faced by businesses. The latest Small Business Index shows a sharp increase in the share of businesses identifying rising labour costs as a problem, probably reflecting the impact of the introduction in April of the National Living Wage on employment costs. April's changes to dividend taxation and the continued roll-out of auto-enrolment are also increasing the cost of doing business at a time when other forces are reducing profit margins.

The share of small businesses operating below capacity remains elevated, suggesting that there is a lot of slack in the economy. This suggests that much-needed growth in productivity is likely to remain elusive and supports Cebr's view that the Bank of England should not plan to raise interest rates any time soon. We expect the Bank to keep rates on hold until mid-2017 at the very earliest.

There is good news with respect to access to finance. The availability and affordability of credit has improved further this quarter, which should help support investment once business sentiment improves. Compared with a year ago, businesses have significantly diversified their sources of credit, and are increasingly turning to non-bank financing to raise the capital they need.

Unfortunately, this easing in credit conditions comes at a time when businesses seem relatively unwilling to invest. According to this quarter's Small Business Index, a net balance of just 12.2% of firms report that they anticipate increasing capital investment over the next 12 months – less than half the 31.9% seen in the same period a year ago. Without a more favourable economic and policy environment, investment-driven economic growth will remain elusive.



Scott Corfe,
Director, Cebr

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index continues its downward trend this quarter.** The Small Business Index (SBI) fell to +4.3, the lowest level since the final quarter of 2012. Confidence has been on a downward trend since the recent peak score of +37.9 recorded in Q2 2015, and the year-on-year decline in business confidence on the latest data is the largest on record.
- **Nearly three fifths (58.2%) of small businesses report that the domestic economy is a potential barrier to achieving their growth aspirations this quarter.** This is up from half (50.4%) at the same point last year and reflects the loss of momentum seen in the UK economy in recent months.
- **There has been a significant change in small business confidence in London.** Business confidence in the capital stands in negative territory this quarter, with high property prices, reduced international investment and volatility in financial markets all taking their toll on the capital's economy.
- **Small business are reducing headcount.** A net balance of small businesses report a decline in employee headcount this quarter for the second consecutive quarter. While the overall UK unemployment numbers continue to fall, rising labour costs and falling profits appear to have led to a deterioration in the small business labour market.
- **There has been a significant increase in the proportion of small businesses citing labour costs as a main cause of changing business costs.** This quarter, the share stands at 46.7%, up from 38.4% in Q2 2015. The National Living Wage (NLW) and the ongoing roll-out of auto-enrolment are both contributing to higher employment costs. Wage inflation is also strongest in sectors with higher incidence of low pay, such as accommodation and food services, driven by the introduction of the NLW in April 2016.
- **The number of businesses reporting that taxation was a main cause of changing costs almost doubled compared with a year ago.** Those reporting taxation as a major cause of changing business costs rose from 9.6% to 18.6%. Dividend tax rules changed in April, with the old system of dividend tax credits being abolished. Many business owners, who often pay themselves predominantly in dividends rather than salary, will lose out as a result of these changes.
- **Investment intentions have fallen sharply.** A net balance of just 12.2% of firms report that they anticipate increasing capital investment over the next 12 months – less than half the 31.9% seen in the same period a year ago. This is the lowest net balance since Q3 2012, when it stood at 9.9%.
- **On the upside, credit conditions continue to improve.** Our credit availability and affordability indices both stand at a record high this quarter, although the percentage of firms applying for credit has remained relatively low at 16% during the past three months.

UK MACROECONOMIC OVERVIEW

The UK economy looks vulnerable

The UK economy has lost momentum since the end of last year. Business confidence has deteriorated dramatically, growth slowed in the first quarter of 2016 and the uncertainty created by the referendum on the UK's membership of the EU has held back business investment in recent months.

Economic growth could easily dip below the 2% mark this year, reflecting the weakness of business investment and exports. This would be the weakest annual performance for the economy since 2012. Cebr expects economic growth of just 1.9% across the UK as a whole this year, and growth looks set to slow further to 1.7% in 2017. The Bank of England is consequently very unlikely to raise interest rates in 2016.

For now, the consumer side of the economy is keeping things afloat, with household spending power supported by rising earnings and very low inflation. The Consumer Confidence Index that Cebr produces with YouGov shows that households remain relatively optimistic and willing to spend. This consumer strength means that we are seeing a modest slowdown rather than something more severe.

A key concern is that this consumer-driven growth is unsustainable in the long run. Inflation is likely to rise over the coming months and into next year, which will curb further increases in household spending power. Furthermore, the data suggests that much of this growth is being driven by an increase in household debt levels. Bank of England data show a rapid acceleration in growth in unsecured consumer credit in recent months, moving towards the double-digit

rates that were seen leading up to the financial crisis. Worryingly, the UK appears to have reverted rapidly to the debt-driven growth model that categorised the economy before the downturn of 2008 and 2009.

It is clear that there is fragility in the UK economy, and reason to believe that the Chancellor's plans for deficit reduction are based on growth forecasts that may be too optimistic.

The UK's international trading position is also a major concern. The current account, which measures the UK's financial position against that of the rest of the world, showed a record high deficit of 7% of GDP in the final quarter of last year – now greater than the fiscal deficit. Essentially, the country's poor position on exports and overseas investment means that the UK is now borrowing a large sum of money from the rest of the world each year. Unless financial markets respond to this and sterling depreciates sharply, it is hard to see this being resolved in the near future.

Some recent policy decisions also appear to be affecting economic performance. The National Living Wage has been introduced at a time when profit margins in sectors such as retail are already under pressure, which could lead to job losses. Both the Bank of England and the Government are making and proposing measures to restrict buy-to-let investment in the property market – something which could increase rents, reduce house prices and in turn erode consumer confidence. Beyond this, a challenging global economic environment is likely to have contributed to difficulties for the small business sector in the UK.

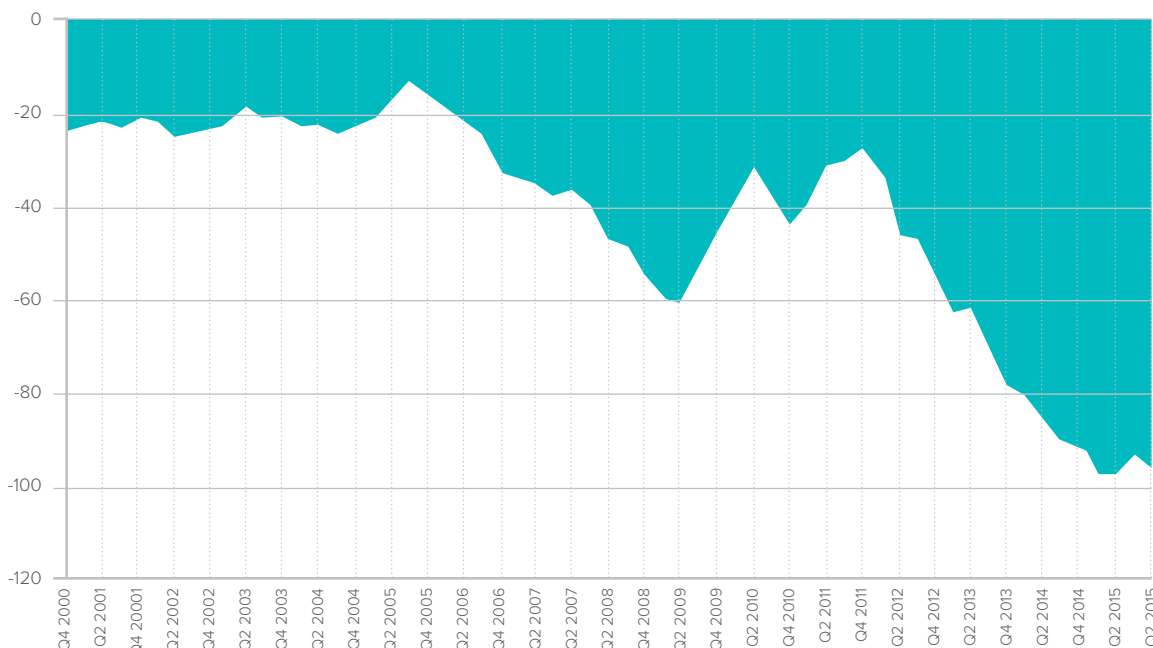


Figure 1: UK current account deficit, £ billions, four quarter rolling total.

Source: Office for National Statistics.

SMALL BUSINESS INDEX

Business confidence falls further

This quarter, the Small Business Index fell to +4.3, the lowest level since the final quarter of 2012. Confidence has been on a downward trend since the recent peak score of +37.9 recorded in Q2 2015, and the year-on-year decline in business confidence in the latest data is the largest on record. The Small Business Index is a leading indicator, as shown in Figure 4, and suggests that economic growth has continued to slow in the second quarter of 2016.

The decline in confidence is likely to reflect a wide range of factors rather than one particular issue, such as the uncertainty about the outcome of the referendum on the UK's membership of the European Union. In addition to the referendum, businesses have had to contend with a challenging global environment, which has affected demand for exports. Domestic policies – such as the National Living Wage, pension auto-enrolment and the changes to the tax treatment of dividends, which came into effect in April – have also increased the cost of doing business.

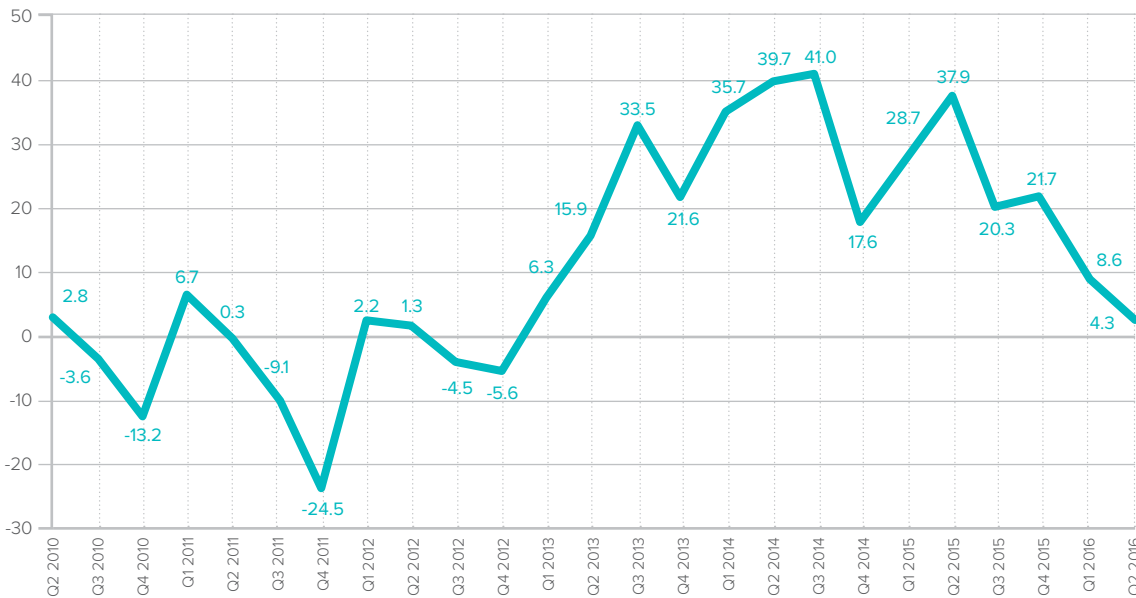


Figure 2: The FSB SBI¹: small business prospects over coming three months.

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.

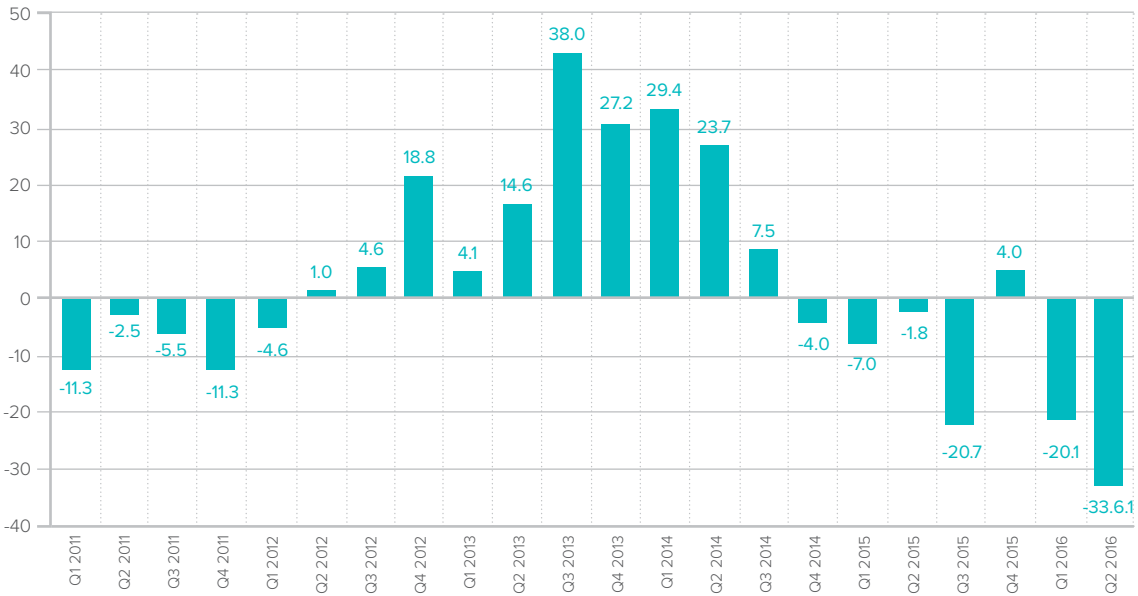


Figure 3: Year-on-year change in the FSB SBI.

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



Figure 4: FSB SBI against year-on-year UK GDP growth.

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

REGIONAL SMALL BUSINESS INDICES

Confidence has declined in
every region of the UK

SHARP REVERSAL OF FORTUNES IN THE CAPITAL

Compared with a year ago, confidence has declined in every region of the UK, as shown in Figure 5. Confidence is highest in the north east of England, Yorkshire and the Humber, and Wales, while there has been a pronounced deterioration in sentiment in some of the recent growth hotspots in the south of the country. Business confidence is lowest in Northern Ireland.

There has been a remarkable change of sentiment in London, which is the second least confident region this quarter, with the confidence index standing in negative territory at -9.8. The capital's economy has

been hit by a number of headwinds of late, which have undoubtedly filtered through into lower business confidence. High housing costs are creating problems for companies in the capital, pushing up wages and increasing employee turnover. Overseas investment in London has also been held back by uncertainty over the EU membership referendum. Subdued mergers and acquisition (M&A) activity and volatility in financial markets are also having an impact on the performance of the financial and business services firms that account for a significant share of the capital's economy.

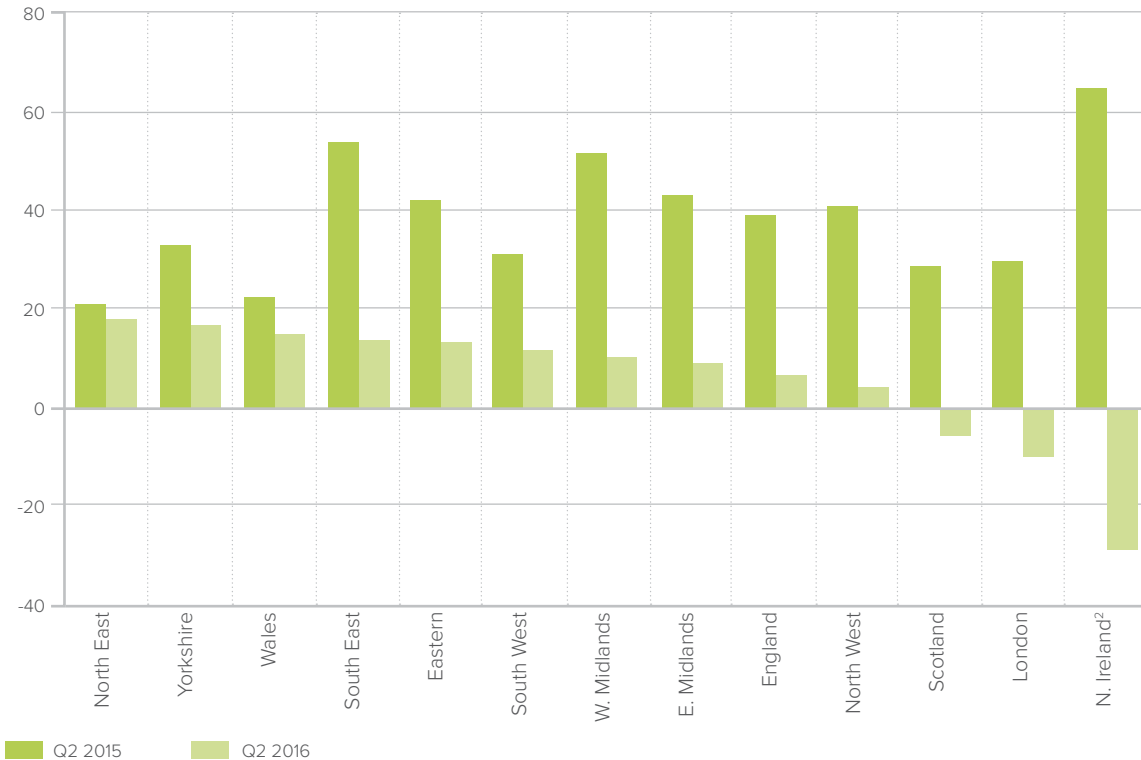


Figure 5: FSB SBI² – regional variation in small business prospects over coming three months.

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

2. The number of responses from Northern Ireland was below the level required for statistical validity – so the large drop in confidence in Northern Ireland in the past year may be the result of fluctuations in the sample rather than a reflection of actual changes in business confidence.

SMALL BUSINESS SECTOR INDICES

Small business confidence has declined in almost every sector

CONFIDENCE IN NEGATIVE TERRITORY FOR A NUMBER OF SECTORS

Compared with a year ago, small business confidence has declined in almost every sector, with a number of industries seeing confidence falling into negative territory.

One such sector is real estate. After a strong start to the year, there are signs of a dramatic slowdown in the housing market. The introduction of a new 3% stamp duty surcharge on second-home purchases appears to have led to a sharp decline in buy-to-let demand for housing, according to data from the Royal Institute of Chartered Surveyors.

Despite continued growth in consumer spending power – supported by low inflation and rising earnings – small business confidence has also fallen into negative territory in the wholesale and retail sector. Small businesses in the retail trade are struggling with intense competition, primarily driven by the ongoing supermarket price wars. When this is combined with the increase in retail employment costs caused by the National Living Wage, firms are seeing a significant squeeze on their profit margins, which is likely to persist over the coming quarters.

This quarter, a net balance of 6.5% of small businesses report rising turnover over the past three months, sharply down from the 19.5% seen in Q1 2015. Furthermore, the net balance of small businesses reporting rising gross profits has fallen from 12.5% in Q1 2015 to -4.3% this quarter, with more businesses reporting that profits have fallen, rather than increased over the past three months. The fact that profits have declined at a time of rising revenues points to a squeeze on small business profit margins in early 2016. Notably, this took place before increases in employment costs such as the National Living Wage.

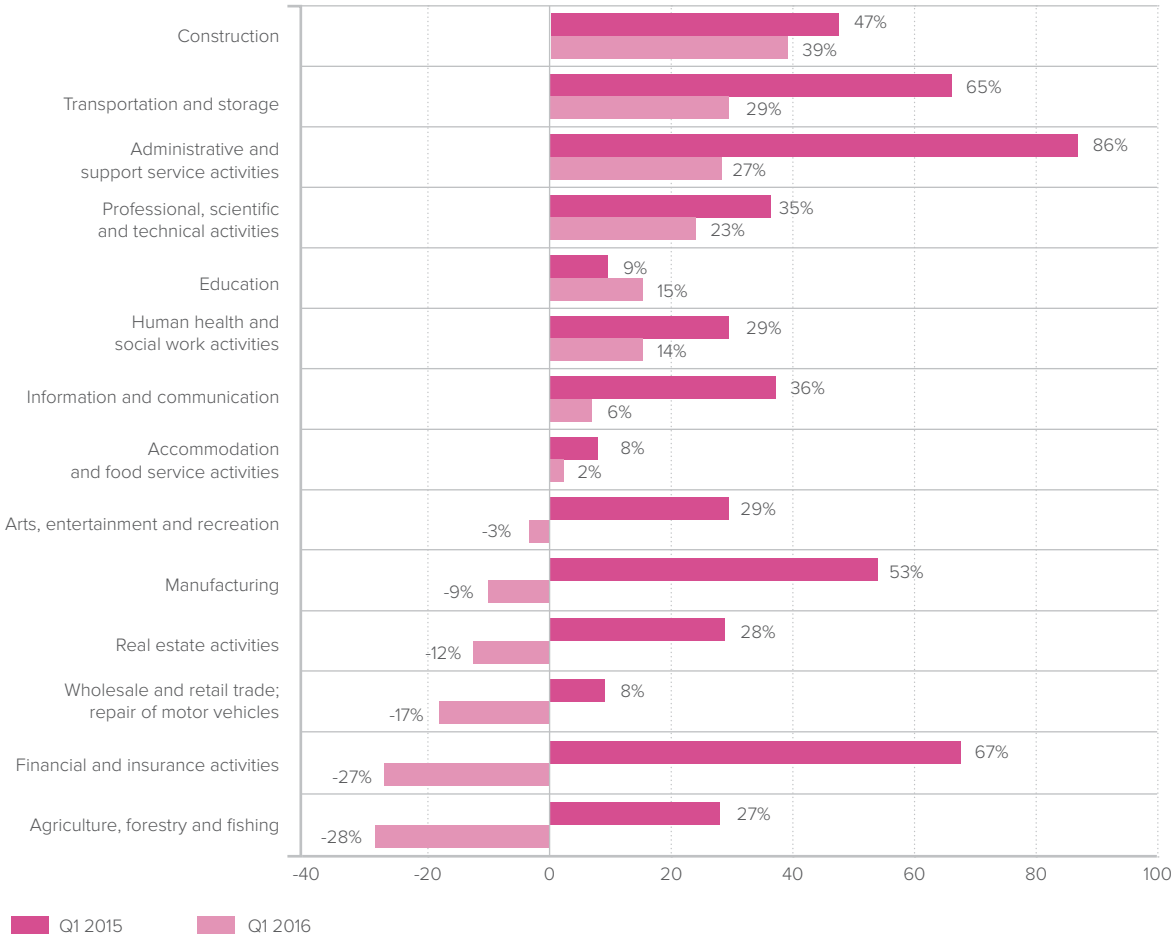


Figure 6: FSB SBI by sector – small business prospects over the next three months.

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

REVENUE AND PROFITABILITY

A net balance of 1.1%
of businesses expect profits
to increase over the
next three months

PROFITS SHRINK FOR A SECOND CONSECUTIVE QUARTER

A net balance of small businesses report a decline in gross profits this quarter – the second consecutive quarter in which this has been the case. Only a small net balance of businesses (1%) expect profits to increase over the next three months.

This decline in profits is likely to reflect negative pressures on turnover combined with increasing costs. Beyond the increases in costs due to the National Living Wage, the challenging environment for exports and intense price competition in the UK consumer market are limiting opportunities to increase revenue.

In the wholesale and retail sector, where supermarket price wars have contributed to sustained downward pressure on selling prices, a net balance of 27.3% of businesses report a decline in gross profits – much greater than the 6.9% seen across the wider business population. According to ONS statistics, selling prices across the retail sector declined by close to 3% over the 12 months to April 2016. .

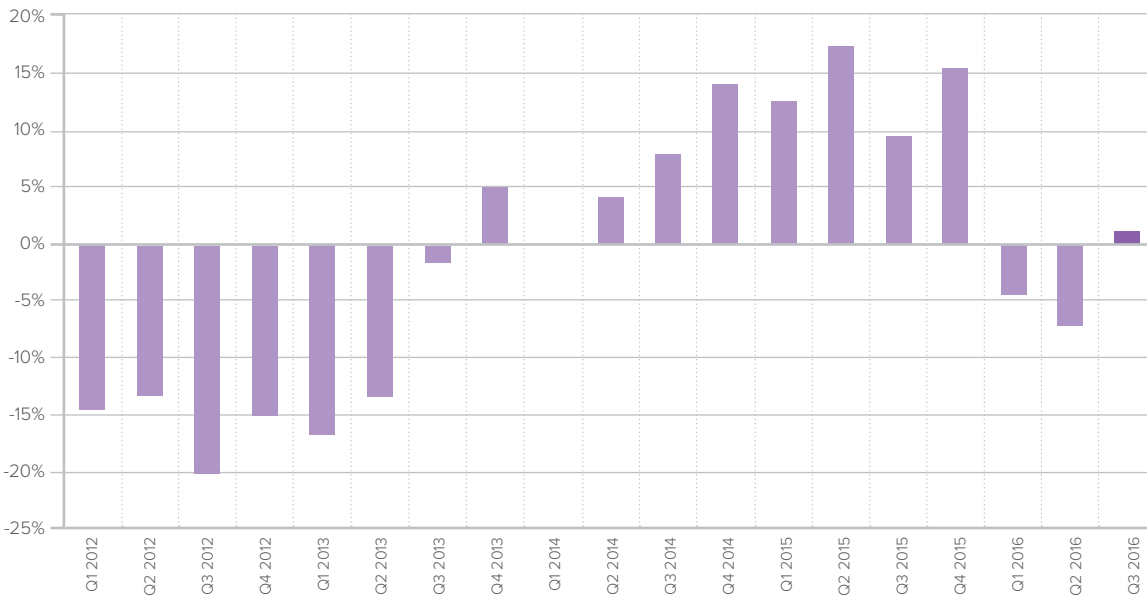


Figure 7: Small business gross profits, net percentage balance – proportion reporting increase less proportion reporting decrease.

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

EXPORTS

Exports remain weak for the second consecutive quarter

EXPORT WEAKNESS CONTINUES

The latest Small Business Index shows a second consecutive quarter in which a net balance of small businesses report a decline in export revenues over the past three months. The net balance stood at -4.2% this quarter, a marginal improvement on the -5.1% reporting a decline in export earnings last quarter, but still the second worst reading on record. In total, 24.2% of small businesses reported that they exported goods, products or services in the previous quarter.

Businesses expect a turnaround over the next three months, with a net balance of 12.0% believing that export values will rise. It should be noted, however, that similar predictions were made in Q1 2016, with these expectations not having come to fruition.

Global economic data remain volatile, with the latest official figures showing a more positive story than our data suggest. Considerable downside risks remain in the outlook for UK trade. Cebr expects growth

to decelerate slightly this year in both the US and Europe – the UK’s two largest export markets – and this is despite the continuing loose monetary policy from both the Federal Reserve and the European Central Bank, which is currently proving insufficient to solidify the recoveries in these markets.

The UK’s poor export position is a major drag on economic performance. The Office for Budget Responsibility (OBR) expects net trade to contribute to lower economic growth in each of the years up to 2020. This year, the OBR expects export volumes to rise by 2.5%, but the positive effects of this will be more than offset by a 3.5% increase in import volumes, driven by rising levels of consumer spending. All this points to the need for renewed vigour in the Government’s export policy, with targeted support needed for small firms looking to export.

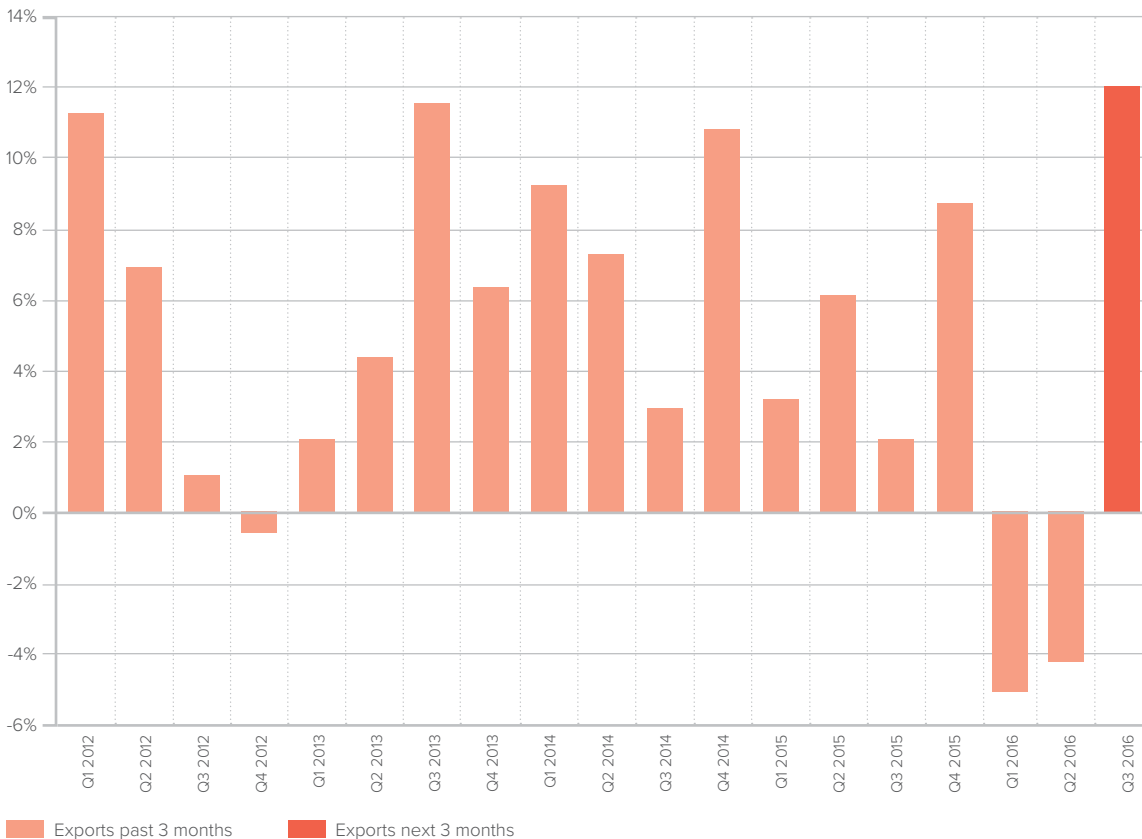


Figure 8: Changes in value of exports – previous three months and expectations for coming three months; net percentage balance, proportion reporting increase less proportion reporting decrease.

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

COSTS AND INFLATION

46.7% reported labour costs to be a main cause of changing business costs

COST PRESSURES RISE TO HIGHEST LEVEL SINCE Q4 2014

This quarter, a net balance of 53.5% of small businesses report an increase in their overall costs of operation during the past three months compared with the same period a year ago. This is up from 46.8% in Q1 2016 and is the highest share since Q4 2014.

Compared with a year ago, there has been a significant increase in the proportion of small businesses claiming labour costs to be a main cause of changing business costs. This quarter, the share stands at 46.7%, up from 38.4% in Q2 2015. This probably reflects the impact of the National Living Wage on employment costs. The ongoing roll-out of pension auto-enrolment is also increasing labour costs for many small businesses.

The share of businesses citing taxation as a main cause of changing costs almost doubled compared with a year ago, rising from 9.6% to 18.6%. Dividend tax rules changed in April, with the old system of dividend tax credits being abolished. Many business owners, who often pay themselves predominantly in dividends rather than salary, will lose out as a result of these changes.

Exchange rate costs have also become more of a problem, possibly reflecting the deterioration in the value of sterling against a number of currencies, such as the dollar and euro, over the past year. This has increased company import costs.

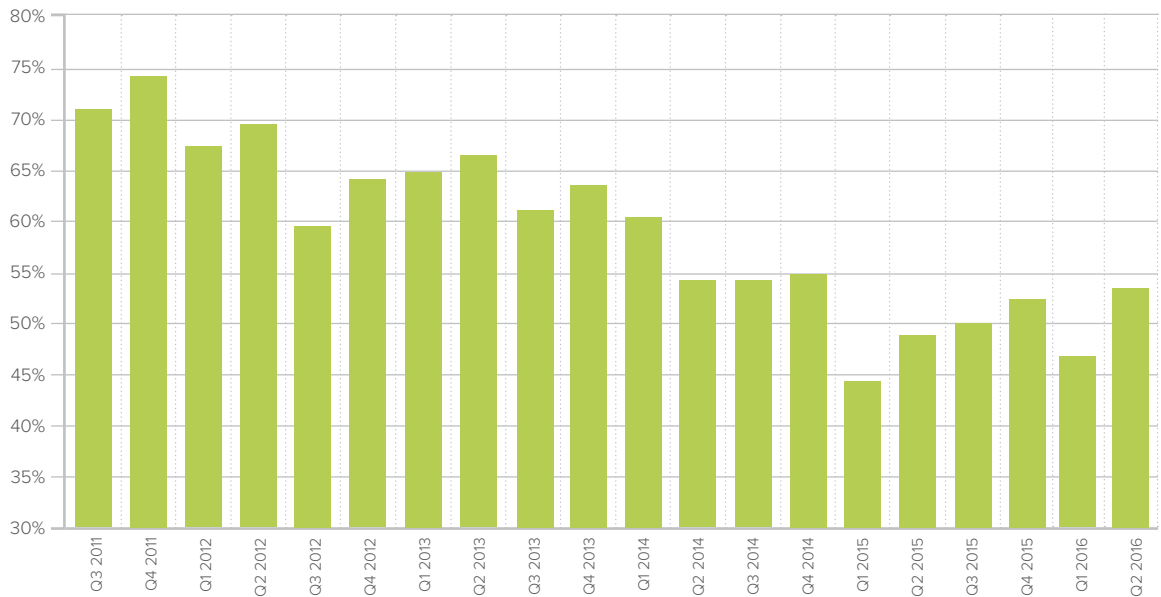


Figure 9: Small businesses reporting an increase in overall cost of operation over past three months, compared with the same period a year ago; net percentage balance.

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

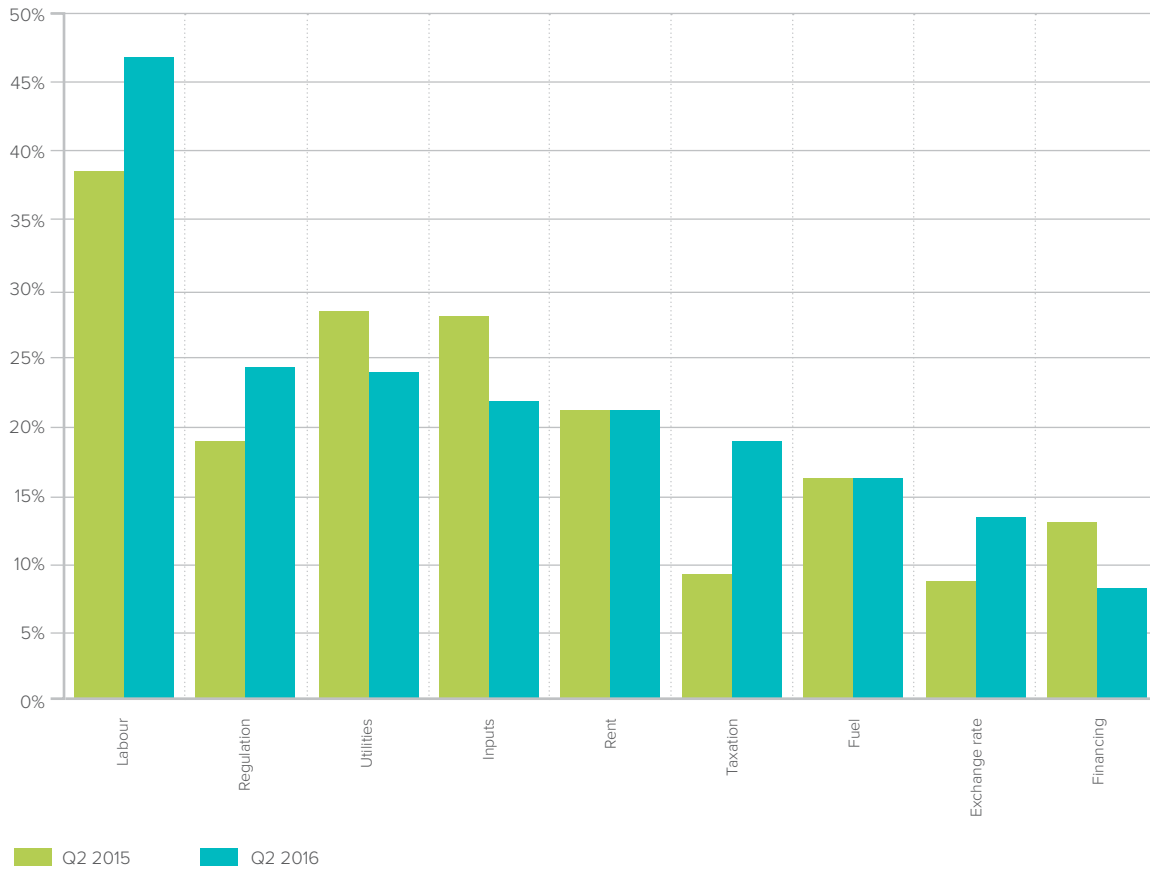


Figure 10: Main causes for changing business costs, firms may give multiple answers.

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

CAPACITY

57.4% of small businesses
reported operating below
spare capacity

SHARE OF BUSINESSES OPERATING BELOW CAPACITY REMAINS ELEVATED

A net balance of over half (57.4%) of small businesses reported operating below capacity over the past three months, marginally higher than that seen in the previous quarter, and sharply up from 40.7% a year ago. This is the highest proportion of businesses operating below capacity since the start of 2013. The net share operating below capacity is expected to decline to 45.9% over the next three months – still higher than that seen at the end of 2015.

If spare capacity in small businesses remains elevated, there are some potentially very significant economic implications. Firstly, spare capacity reduces the need for businesses to invest, which in turn leads

to a lower rate of economic growth. It also implies reduced operating efficiency within small firms, which in aggregate terms contributes to poor productivity performance at an economy-wide level. Furthermore, the future path of monetary policy will be determined by the amount of slack in the economy. With spare capacity relatively high, it is hard to see there being much in the way of inflationary pressure in the short-to-medium term, which drastically reduces the chance of a rate rise from the Bank of England. Cebr believes that the Bank will keep interest rates on hold until mid-2017 at the very earliest.

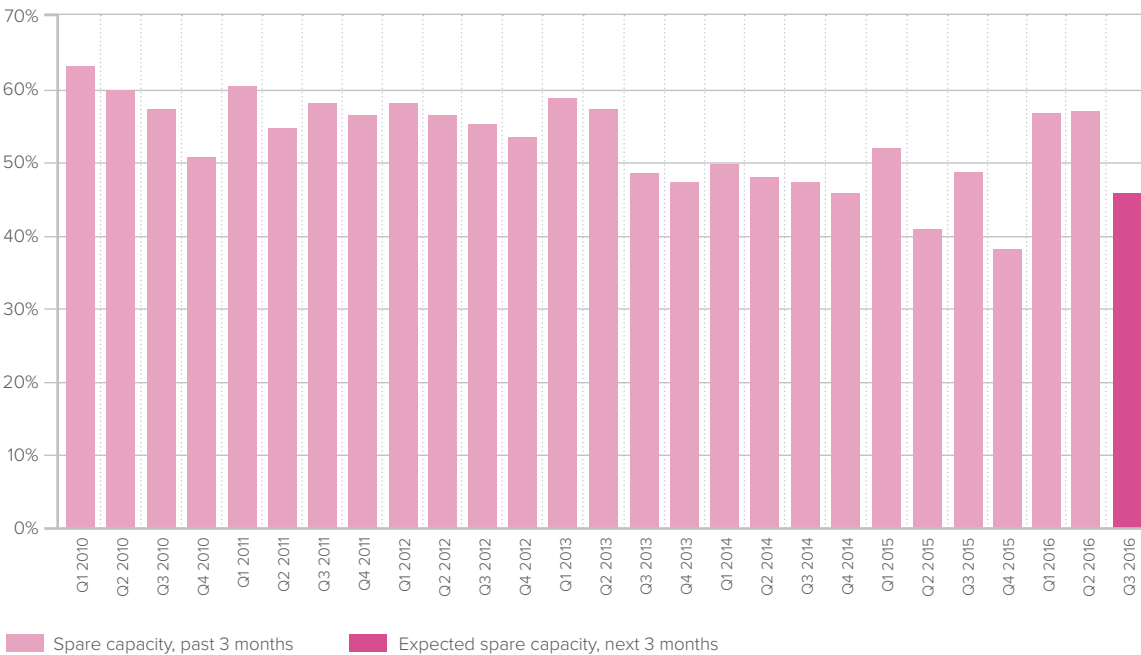


Figure 11: Net percentage balance of businesses running below capacity: proportion below capacity less proportion above capacity.

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

EMPLOYMENT AND WAGES

For the second consecutive quarter, small businesses reported a decline in employee headcount

HEADCOUNT REDUCTIONS CONTINUE

A net balance of small businesses (-1.9%) report a decline in employee headcount this quarter – the second consecutive quarter that this has been the case. The environment of rising labour costs and falling profits appears to have led to a drastic deterioration in the small business labour market compared to 2015.

For now, headline labour market data remain strong, despite headcount reductions among small businesses. According to the ONS, the employment rate reached a record high of 74.2% in the three months to March 2016 and the UK economy has added 409,000 jobs compared to the same period a year ago.

A net balance of 6.6% of small businesses expect staff headcount to increase over the next three months, though this may not materialise without further improvement in economic prospects.

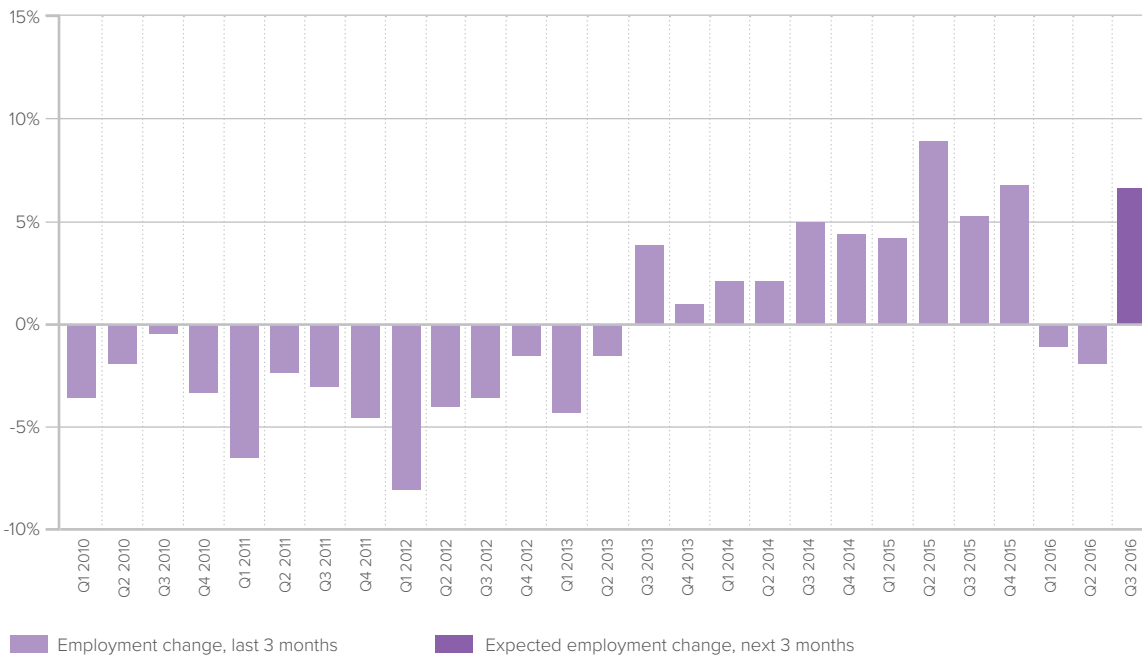


Figure 12: Net percentage balance change in number of people employed – proportion reporting increase less proportion reporting decrease.

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

SECTOR VARIATIONS IN PAY

Year-on-year wage growth stood at 2.0% in Q2 2016, a marginal increase from 1.9% in the previous quarter. Small businesses expect average salaries to rise by 1.9% over the next 12 months.

There are signs of significant sector variations in pay trends. Industries with higher shares of lower-paid workers, such as hospitality, have seen employment costs driven up by the National Living Wage. A net balance of 83.7% of accommodation and food services businesses report rising salaries over the last 12 months, much higher than the 51.9% seen for all small businesses.

Skills shortages may also be pushing up salaries in some sectors. Some 12.1% of construction firms report increasing average salaries by over 10% compared with a year ago, compared with 4.9% for all businesses. Skills shortages in parts of the construction sector have been widely reported in recent years, and these have left firms having to increase pay drastically to retain talented employees.

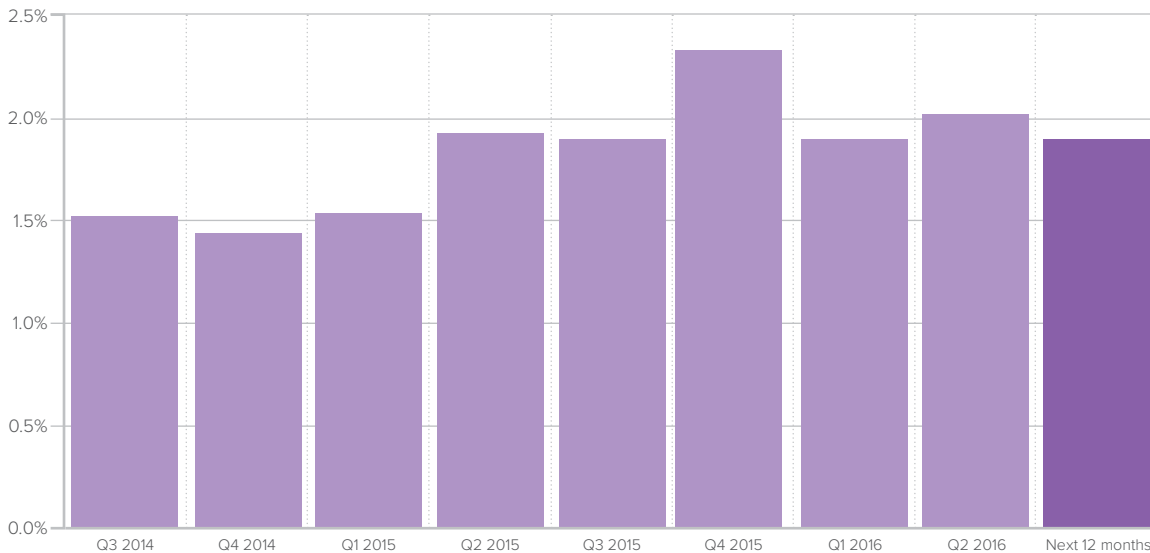


Figure 13: Average salary increase awarded, this quarter versus a year before.

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

GROWTH ASPIRATIONS AND CHALLENGES

12.4% intend to downsize, close
or hand on the business over
the next 12 months

SHARE OF BUSINESSES ASPIRING TO GROW STABILISES

Just over half (52.2%) of small businesses this quarter report having aspirations to grow moderately or quickly over the next 12 months – broadly unchanged from last quarter, though sharply down from the 65.3% seen in the same quarter a year ago. Just over one in ten companies (12.4%) intend to downsize, close or hand on the business over the next 12 months, also broadly unchanged from last quarter.

These trends are likely to reflect the prevailing economic climate. Slowing economic growth holds back the ability of small businesses to expand – particularly those in struggling sectors. While about two thirds (66.7%) of those in the information and communication sector expect to expand over the next 12 months, this falls to less than half (49.3%) among manufacturing companies.

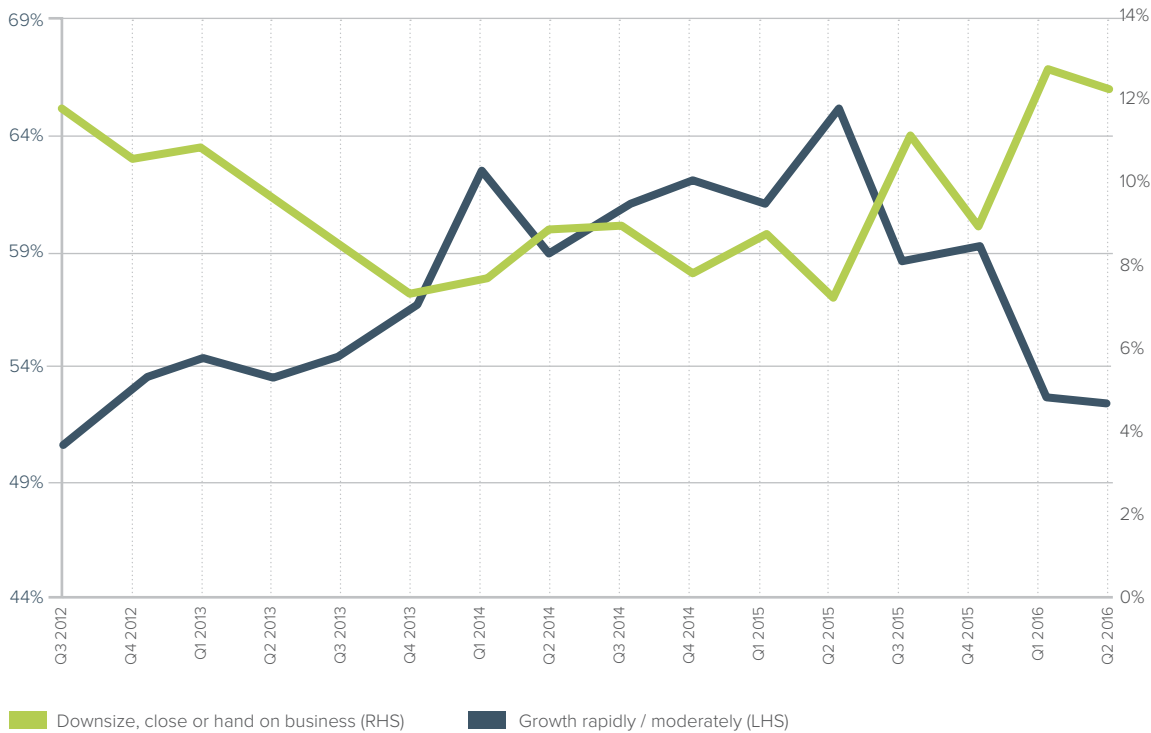


Figure 14: Growth aspirations for next 12 months.

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

ACCESS TO CAPITAL DECLINES AS A CONCERN

Nearly three fifths (58.2%) of small businesses report that the domestic economy is a potential barrier to achieving their growth aspirations this quarter, up from half (50.4%) at the same point last year, reflecting the loss of momentum seen in the UK economy in recent months.

On the positive side, the share of businesses citing access to finance as a barrier to growth aspirations stands at just 9.7% – down from 15.4% in the same quarter a year ago. FSB data presented later in this report suggest that small businesses are increasingly turning to new forms of non-bank lending in order to raise the capital they need to make investments.

Finding appropriately skilled staff is also less of a problem, with the share of businesses describing it as a barrier to growth aspirations falling from 35.4% in Q2 2015 to 30.6% this quarter. Rather than reflecting an increase in skill levels in the UK economy, this is likely to reflect the fact that small businesses appear to be shrinking rather than increasing headcount at the moment, making the matter less relevant to business owners.

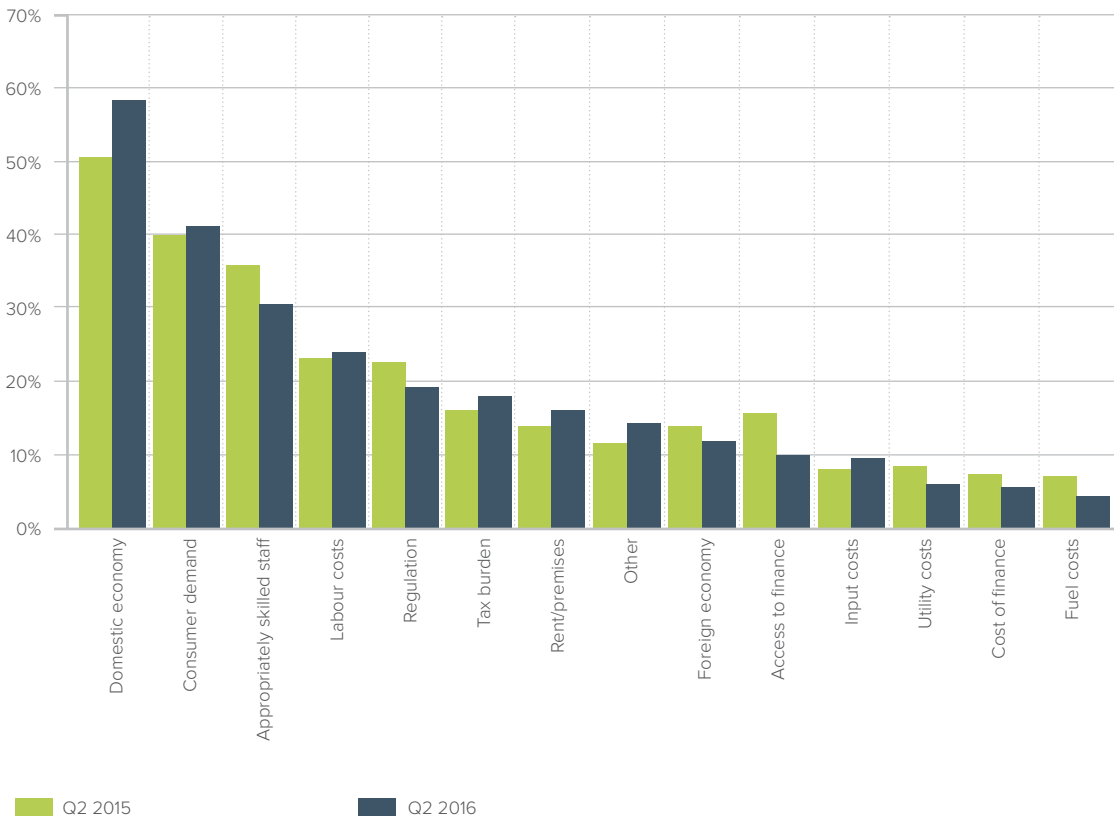


Figure 15: Potential barriers to achieving growth aspirations – multiple answers possible.

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

CREDIT

Credit accessibility and
availability at record highs

MORE FIRMS SUCCESSFUL IN CREDIT APPLICATION

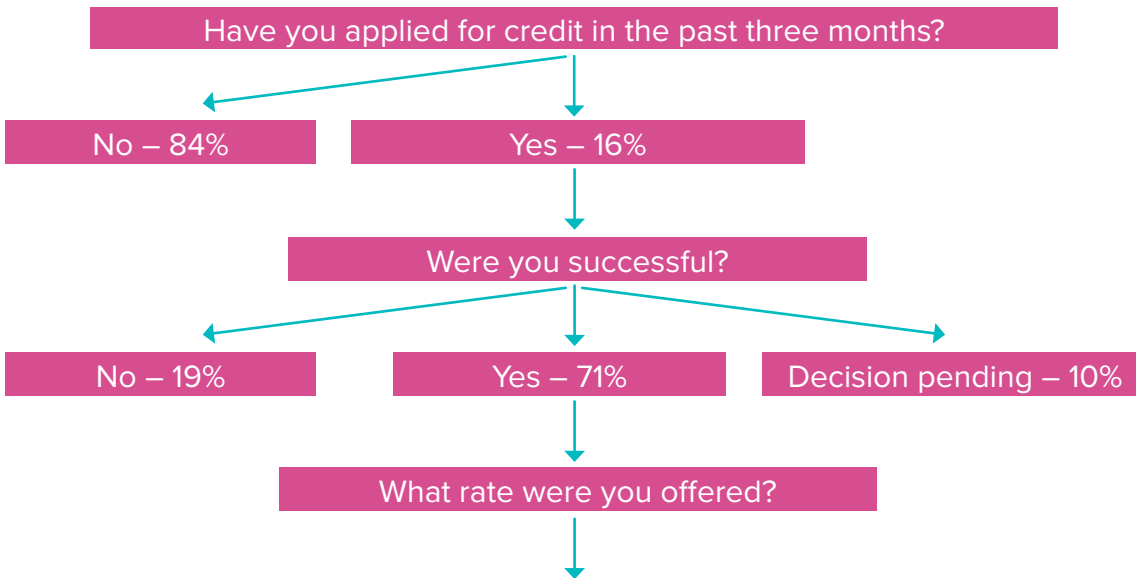
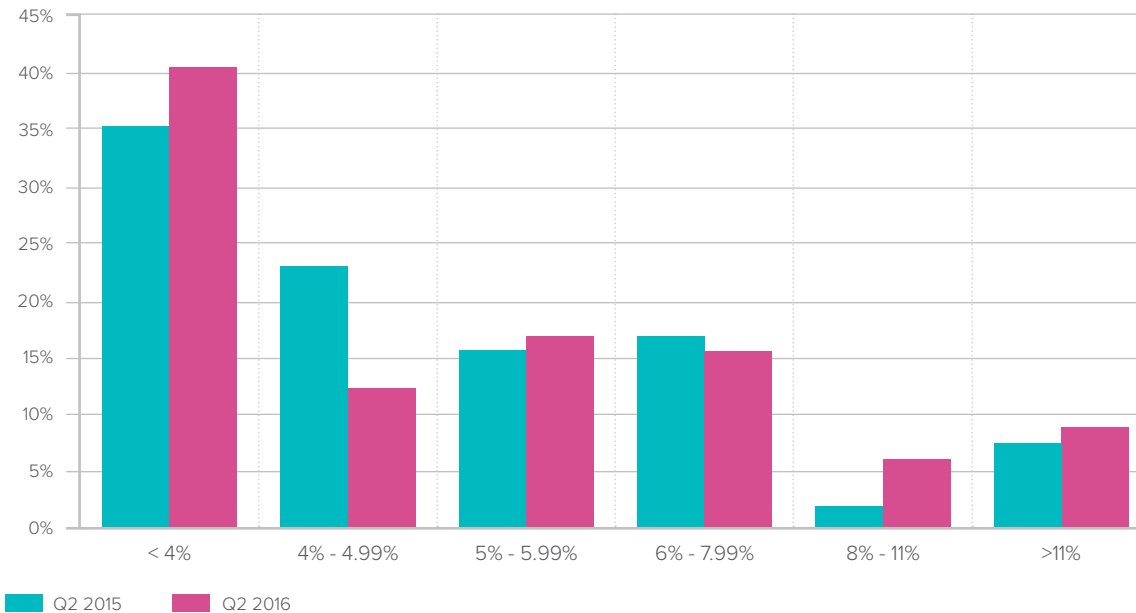


Figure 16: Credit applications and interest rates offered.



Source: FSB - Verve 'Voice of Small Business' Panel Survey. Respondents were able to give multiple answers to this question.

Although the proportion of firms applying for credit this quarter remained broadly stable at 16%, the share of successful applicants rose significantly. Some 71% of small businesses made successful applications for credit in the past three months, the highest since the series began at the start of 2012, and significantly

higher than the 54% seen in the same quarter a year ago, and last quarter's 63%. In addition, the share of businesses obtaining an interest rate of less than 4% on credit stood at 40.4% this quarter – higher than the 35.4% seen a year ago.

Among businesses applying for credit, the share seeking an overdraft stood at about half (48.8%) this quarter, down from three fifths (60.2%) in Q3 2015, when we first started collecting this data. Over the same period, the share applying for peer-to-peer credit rose from 3.9% to 9.0%, and the share seeking asset-based finance rose from 12.5% to 16.9%. Non-

bank financing appears to be growing in importance and this might be contributing to the sharp increase in successful credit applications seen in the latest FSB data. Small businesses now have more options available to them, which should increase their chances of obtaining credit.

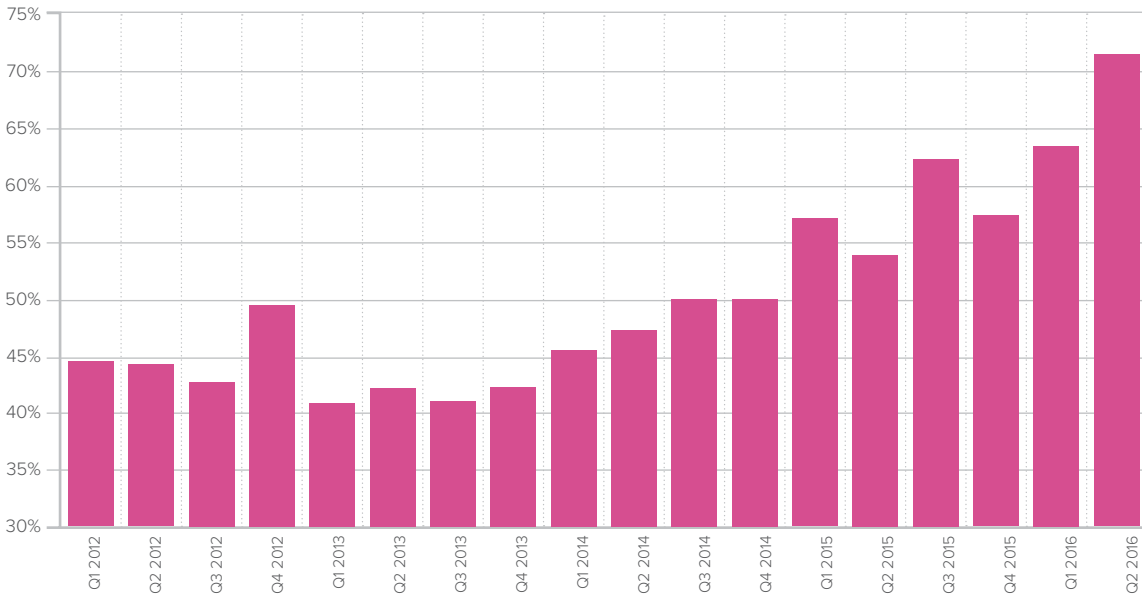


Figure 17: Proportion of small businesses successful in their credit applications in the past three months.

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

CREDIT AVAILABILITY CONTINUES TO IMPROVE

In line with the findings presented in the previous section, small businesses are reporting that credit availability is continuing to improve. The credit availability index stands at its highest level since our records began at the start of 2012. In part, this may reflect the rise of alternative finance, which has provided small businesses with more options for accessing capital. Nevertheless, more small businesses believe that the availability of credit is “poor” rather than “good”, suggesting that more needs to be done to ensure that companies can get access to the capital they need.

- The credit affordability index also stands at a record high this month. With interest rates lower now than a year ago, the cost of credit has diminished over the past 12 months.
- In the future, the increased availability and affordability of credit should support business investment. At present, however, investment is being held back by economic rather than financial factors. This quarter, over half of small businesses obtaining credit used it to manage cash flow (51.6%), while just a quarter (27.7%) used it to update old equipment.

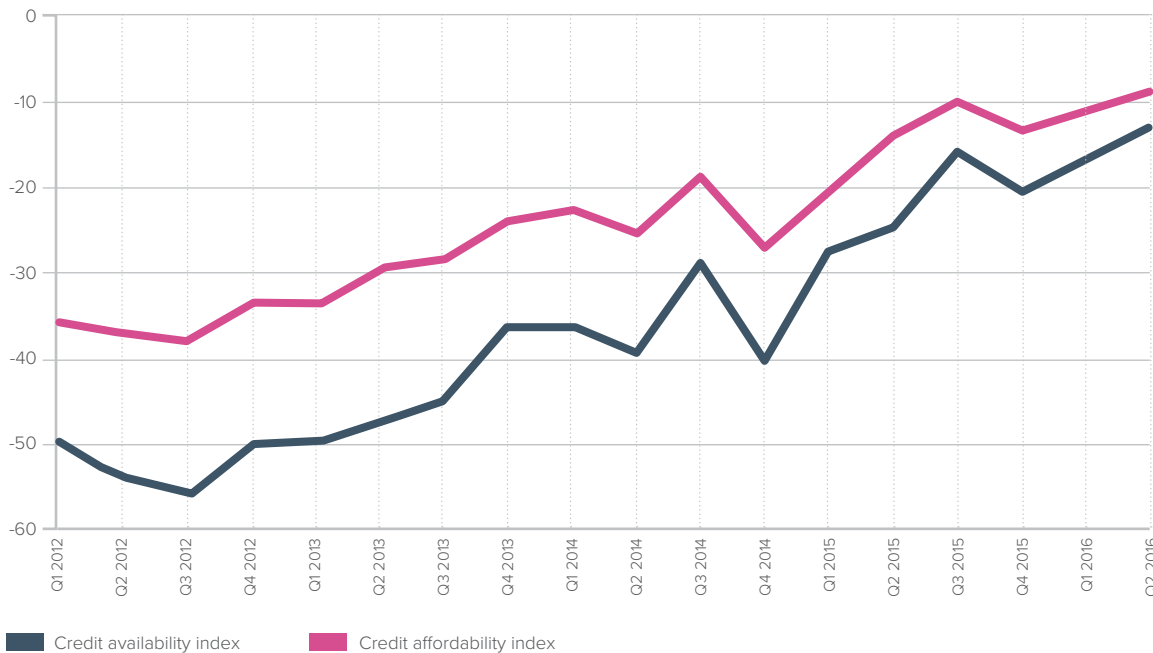


Figure 18: Indices of credit affordability / availability perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses.

Source: FSB - Verve "Voice of Small Business" Panel Survey. Figures were derived from a weighted net balance of those with negative responses subtracted from those with positive responses.

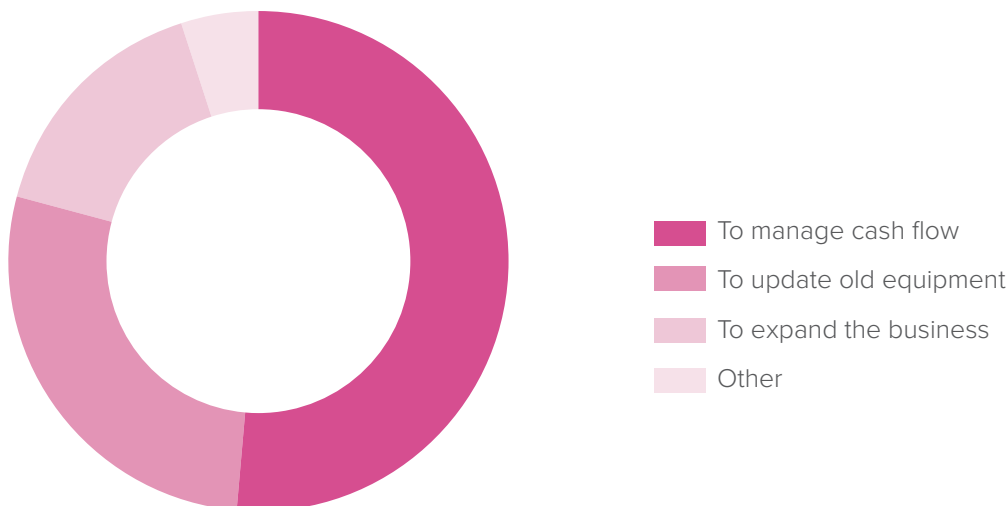


Figure 19: Access to credit: What have you used/do you want to use the finance made available to you for?

Source: FSB- Verve "Voice of Small Business" Panel Survey. Data relate to Q2 2016.

INVESTMENT

A balance of just 12% of firms
anticipate increasing capital
investment over the next
12 months

SHARP DECLINE IN INVESTMENT INTENTIONS

This quarter, a net balance of just 12.2% of firms report that they anticipate increasing capital investment over the next 12 months – less than half the 31.9% seen in the same period a year ago. This is the lowest net balance since Q3 2012, when it stood at 9.9%.

The latest investment data are worrying and probably reflect the decline in confidence seen in the latest Small Business Index. The decline in small business investment intentions comes at a time when larger businesses have significantly reined in capital spending plans amid global economic volatility and uncertainty created by the referendum on the UK's membership of the EU. Data from Bloomberg suggest that deal-making activity fell to an eight-year low in Q1 2016, as uncertainty led to a decline in high-value M&A activity.

Without investment, productivity growth in the UK is likely to remain low, which could translate into weaker economic growth in the medium term, as well as subdued increases in living standards. Without business investment, the economy will also remain overly reliant on consumer spending to drive growth.

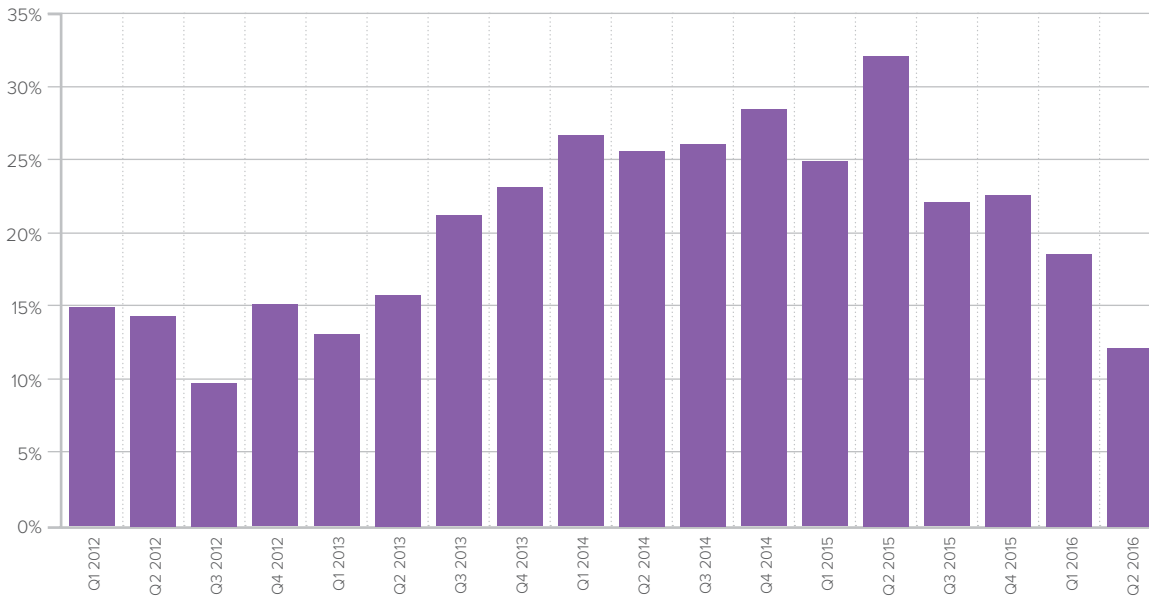


Figure 20: Net percentage balance in anticipated capital investment growth over next 12 months – proportion reporting increase less proportion reporting decrease.

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

METHODOLOGY

This report is based on the April – May 2016 research survey of FSB members carried out by Verve. All panel members (6,129) were invited to take part in an online survey. Reminders were sent to all non-respondents. 1,104 responses were received: a response rate of 18%. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 21 April and 6 May.

SUMMARY DATA TABLE

	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016
Small Business Index	+39.7%	+41.0%	+17.6%	+28.7%	+37.9%	+20.3%	+21.7%	+8.6%	+4.3%
Employment - previous three months	+2.0%	+5.0%	+4.4%	+4.2%	+8.9%	+5.3%	+6.7%	-1.0%	-1.9%
Employment - coming three months	+10.5%	+7.0%	+7.1%	+10.0%	+14.2%	+8.2%	+7.3%	+7.1%	+6.6%
Revenue - previous three months	4.2%	8.0%	14.0%	12.5%	17.4%	9.7%	15.4%	-4.3%	-6.9%
Revenue - coming three months	18.7%	18.0%	19.0%	19.1%	28.0%	17.4%	18.2%	7.0%	1.1%
Investment intentions - coming 12 months	+25.6%	+26.0%	+28.4%	+24.9%	+31.9%	+22.0%	+22.5%	+18.5%	+12.2%
Credit availability - rated good or very good	12.5%	16.8%	13.3%	16.2%	16.6%	23.5%	18.2%	20.8%	26.0%
Credit availability - rated poor or very poor	60.9%	52.5%	61.7%	50.4%	47.3%	41.6%	43.6%	39.1%	39.6%
Credit affordability - rated good or very good	18.0%	22.0%	18.1%	19.6%	26.2%	27.6%	23.3%	24.9%	25.3%
Credit affordability - rated poor or very poor	51.1%	47.0%	54.4%	46.4%	42.4%	38.8%	40.7%	37.7%	37.4%

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