Q2

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 2, 2020

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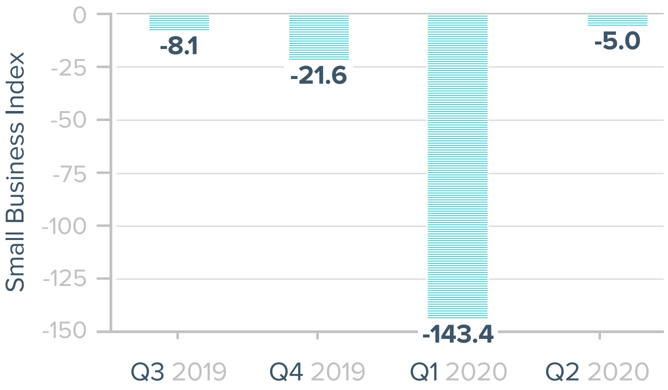
SBI Q2 2020

"**Small business sentiment polarises** as majority receive support but many do not"

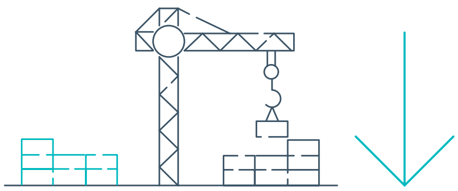


Headcounts reducing at record rate

23%

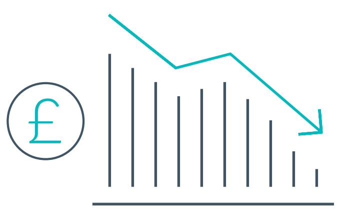
have **cut staff numbers** in the last quarter

Exporters see sales plummet

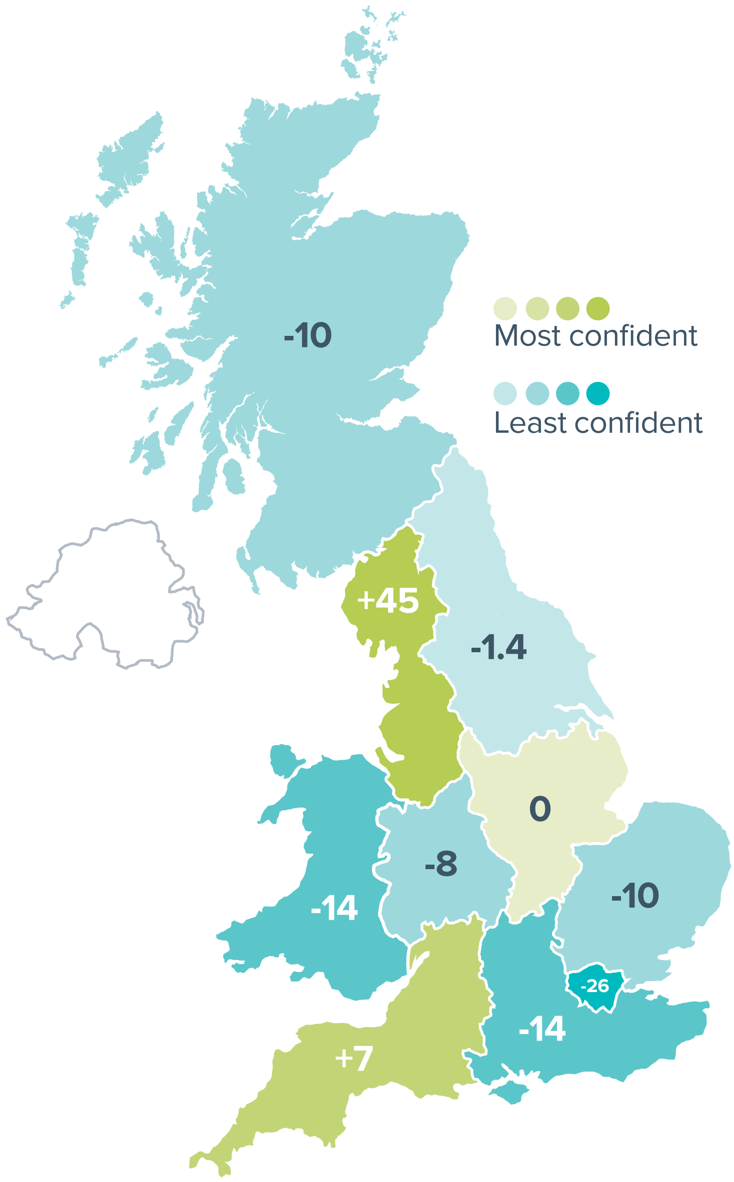


65% suffer a **drop in international demand**

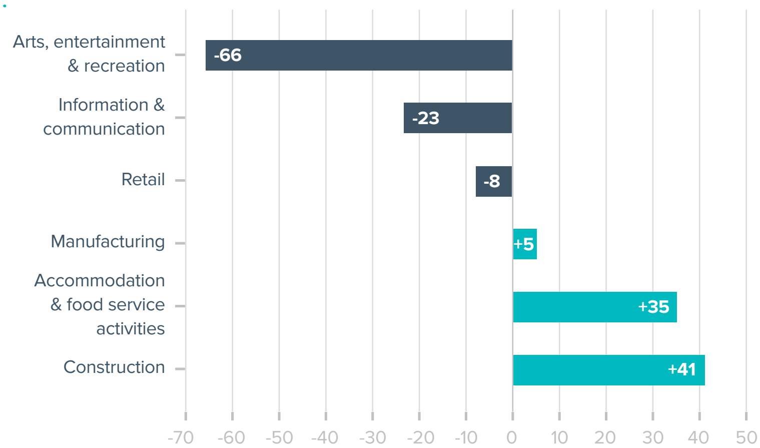
Record number say profits are down



75% report a **fall**



Small business confidence by sector



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FSB FOREWORD

As we enter the early stages of recovery, small businesses have demonstrated their well know resilience and adaptability – with business confidence bouncing back. However, while it is true that many small businesses have survived the national lockdowns through innovating, it is equally the case that many are now operating on wafer thin cash flow margins.

Government interventions in the first phase of the crisis have saved countless businesses and the millions of employment opportunities that they provide. But, with that support now coming to an end, be that the bounce back loan scheme or the ground-breaking furlough scheme, and with the spectre of a second wave of COVID-19 on the horizon, it is essential that the Government has all policy levers available to reinforce the support announced at the Chancellor's Summer Economic Update.

We may need to see an adapted furlough scheme for certain sectors of the economy, that supports furloughed workers to develop new skills and seriously consider self-employment or setting up a small business as a way to find meaningful work. We also want to see the bounce back micro loan scheme extended beyond November as small businesses contend not just with the coronavirus but also preparations for the transition period ending.

For small businesses, their staff are like family and they are working hard to make sure their premises are safe and secure for both staff and customers. This comes at cost. We are calling on the Government to make 'back to work vouchers' available for sole traders, micro and small businesses, to help to offset some of the costs that small businesses, including in the hospitality, leisure and retail sectors, have incurred to make their premises compliant with the Government's social distancing guidance.

With an upcoming Spending Review and Budget on the horizon, it is more important than ever that the Government takes a pro enterprise approach. Cuts to Employer's National Insurance Contributions are essential to support the creation and retention of jobs. Scarring of the economy as a result of unemployment can only be prevented if small businesses are empowered to remain the engine room of job creation. It goes without saying that now is clearly not the right time for tax hikes on business owners, whatever their legal structure.

With the end of the transition period on the horizon – small businesses need cash flow to be able to adapt. Small businesses are pragmatists. They have long moved away from ideological debates about leaving the EU and are instead focused primarily on making sure the transition to a new relationship with the bloc is a smooth process for them. That's why we are calling for transition vouchers to support small businesses with the costs attached to this. The Treasury has shown a refreshing willingness to put aside concerns about deadweight through the extremely successful Eat Out to Help Out Scheme. The same bold approach needs to be taken to supporting small businesses with the costs attached to a successful transition out of the EU.

Mike Cherry,
National Chairman

Martin McTague,
National Vice Chair,
Policy and Advocacy

ECONOMIST'S VIEW

The first half of 2020 has been a period of unprecedented extremes for the FSB Small Business Index (SBI). Following a record fall of 121.8 points in small business confidence in the first quarter, the latest update shows that businesses are again looking more optimistically to the future, prompting a record increase of 138.4 points in Q2 2020. At -5.0, small business confidence is now at the same level as in Q1 2019 when the prospect of a global pandemic seemed the stuff of Hollywood movies.

The second quarter started off with what we now know to have been the nadir of the lockdown-induced slump in economic activity. As restrictions were eased throughout May and June in particular, businesses reopened, consumers returned, and spending began to increase. The rise in the SBI shows how these cautious signs of hope have translated into improved business sentiment. Despite the V-shaped recovery in the index, it would be premature to proclaim that small businesses have the worst behind them. The economic recovery remains fragile as living with the virus will require some forms of social distancing to continue for the foreseeable future. Moreover, much hinges on how businesses react to the tapering of the Government's job retention scheme, which starts in August.

At the end of June, the announcement that pubs and restaurants would be able to reopen from 4 July onwards across England lifted spirits even in the especially hard-hit accommodation and food services sector. Accordingly, the sector saw the largest SBI increase of any industry, rising by 221.6 points to 34.7. Only the construction sector recorded a higher overall index score in Q2 (40.7) as activity on construction sites resumed. Businesses in the arts, entertainment and recreation sector were the least confident with a score of -66.3 as restrictions on larger indoor and outdoor gatherings remain in place, effectively shutting down large parts of the industry.

Looking at the regional picture, London remains the least confident region with an SBI score of -25.6. The capital has been at the bottom of the confidence table for three consecutive quarters now, despite a 130.8 point increase between Q1 and Q2. The North West has seen the strongest comeback from the depths of the Q1 2020 SBI, recording an increase of 184.4 points to stand at 45.0 in Q2. Other regions with positive confidence readings include Wales and the South West with 14.3 and 6.8 points respectively, while the East Midlands showed a neutral score of 0.0.

The remainder of the year will be characterised by government efforts to keep the virus under control while supporting economic recovery. It will be a tricky balance to strike, as shown by the raft of measures announced in the Chancellor's Summer Economic Update in early July. So far, government action has helped many affected businesses to manage temporary cashflow problems and supported household incomes. Despite these efforts, the economic consequences of the pandemic will be severe this year, with GDP expected to contract by a record 11.6%. Keeping businesses afloat and helping people to find new jobs quickly are preconditions for a strong recovery 2021.

Nina Skero,
Director and Head
of Macroeconomics,
Cebr

Q2

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **Following the record fall witnessed in Q1, small business confidence saw a substantial recovery in Q2.** The FSB Small Business Index now stands at -5.0, its joint highest level since Q3 2018.

- **There is significant regional variation in small business confidence levels.** The least confident region was London, with an SBI score of -25.6. Small businesses in the North West saw a significant improvement in confidence. With an index reading of 45.0, it is the most optimistic region in Q2.

- **Three quarters (75.3%) of small businesses report falling confidence looking ahead to Q3 as a direct result of the coronavirus outbreak.** This is a slightly more muted figure than that witnessed in the previous quarter, when 87.7% of small businesses suffered a reduction in confidence looking ahead to Q2 as a result of coronavirus-linked disruption.

- **The construction and manufacturing sectors are benefitting from the restarting of operations, though confidence remains subdued amongst most industries.** A return to positive sentiment was seen amongst small businesses in the construction, manufacturing, and accommodation and food services sectors. The majority of industries remain in net negative territory, however, with the arts, entertainment, and recreation sector recording the lowest SBI score (-66.3).

- **Small businesses are cutting employment levels at the fastest rate ever.** One in five (22.8%) small businesses report a fall in the number of people they employ, with customer-facing businesses, such as those in the accommodation and food services sector, seeing the highest rate of job cuts (37.7%).

- **More than half (53.4%) expect gross profits to fall over the next three months.** Small businesses are slightly more optimistic looking ahead to the next quarter compared to their performance in recent months, during which 74.9% saw falling profitability.

- **One fifth (21.9%) of small businesses expect to downsize in the next year.** The domestic economy and consumer demand are the most commonly cited barriers to growth, with fears over the foreign economy and regulation also prevalent.

- **Credit availability and affordability both picked up considerably in Q2.** Easily accessible loans provided by the Government have contributed to a soaring credit application success rate (80.7%), while a record-low Bank of England base rate has reduced the cost of loans.

UK MACROECONOMIC OVERVIEW

Lockdown measures led to unprecedented fall in activity in Q2, though tentative recovery now underway

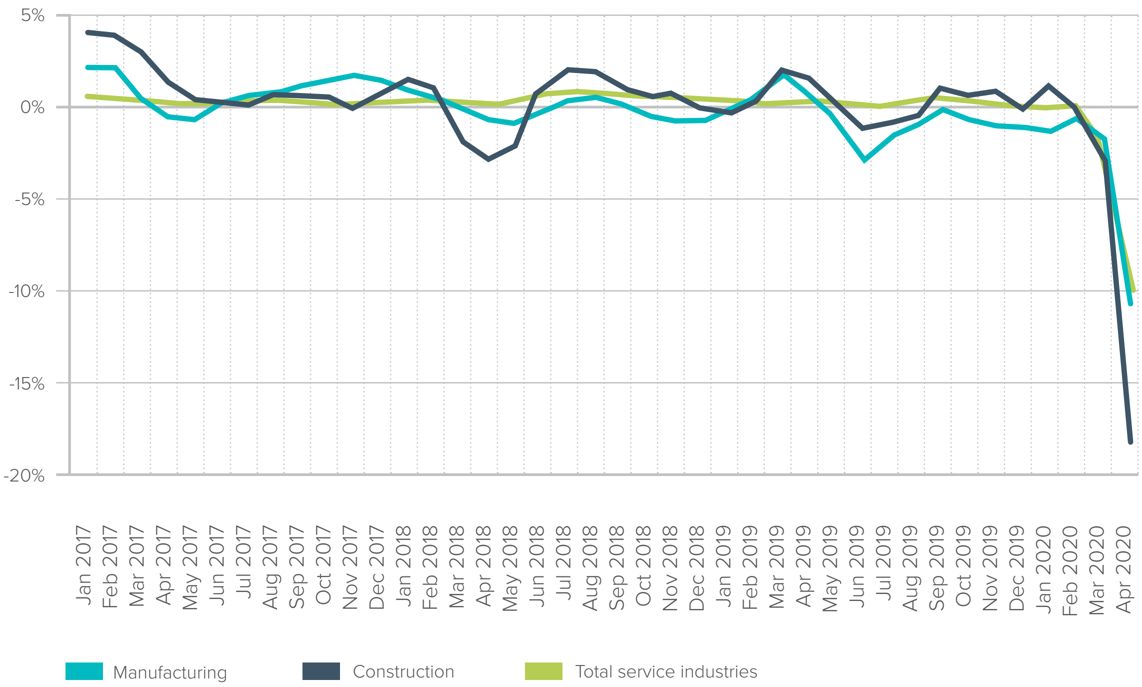
The restriction measures in place over the past three months have been more stringent than at any other time in modern, post-war history. As the spread of coronavirus gained traction, the UK was placed into a national lockdown from 23 March, resulting in the forced closure of businesses, restrictions on non-essential travel, and the widespread adoption of remote working practices. With such restrictions in place for the majority of the quarter, the end result has been that of an entirely unprecedented economic landscape, with policy intervention of unparalleled scale and many economic indicators plunging to record depths. Though the gradual lifting of such restrictions has since encouraged a slight pickup in activity, the overall economic picture at the end of Q2 was still one of subdued demand and prevailing uncertainty.

Economic activity was drastically curtailed across the board at the onset of the lockdown. April, the month of strictest lockdown stringency, saw a precipitous fall amongst all major sectors, with total output in the construction, manufacturing, and services sectors down by 44.2%, 28.2%, and 24.2%, respectively, on an annual basis. The retail sector too took a significant hit at the outset of lockdown. The value of retail sales fell by 18.7% between March and April, reaching a record low, reflecting the closure of all but essential stores. The lifting of restrictions on the retail sector has seen sales pick up significantly since then, with month-on-month growth of 11.8% seen in May, for instance. Retail activity still remains considerably below historic averages, however, with consumers reluctant to return to the high street while fears over the virus still linger, as well as being less willing to spend amid wider economic uncertainty.

With such a large-scale fall in economic activity, the impact on individuals' livelihoods has been stark. The forced closure of businesses has seen many workers temporarily spending time away from the workplace, with the number of people to have received support from the Coronavirus Job Retention Scheme reported to be upwards of 9 million. Meanwhile, months of significantly restricted revenue has likely seen some businesses forced into permanent closure, taking jobs with them. The headline unemployment rate has not yet reflected the spike in redundancies that would be expected given the scale of the fall in economic activity, though other information on the labour market points to considerable weakness. In addition to those on furlough, an estimated 649,000 payrolls have been lost since the start of the crisis, while the claimant count has spiked to upwards of 2.6 million. Looking forward, the outlook for the labour market continues to be negative and, as the furlough scheme unwinds later in the year, a further spike in redundancies is expected. This could well contribute towards a protracted recovery, with the increased threat of unemployment serving to stifle economic activity amongst consumers once more.

In light of the scale of the damage suffered by the economy in recent months, government interventions have been essential to short-term stability. Measures such as the furlough scheme, a wide range of grants to businesses, as well as additional spending to prevent further spread of the virus itself have seen government borrowing levels soar in recent months. Net borrowing from the public sector reached £55.2 billion in May, exceeding the Office for Budget Responsibility's pre-crisis borrowing estimate for the entire financial year and adding further to a national debt that now exceeds the value of GDP. Monetary easing has also been deployed at a large-scale, with the Bank of England base rate remaining at a record-low since March and further rounds of quantitative easing undertaken.

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



SMALL BUSINESS INDEX

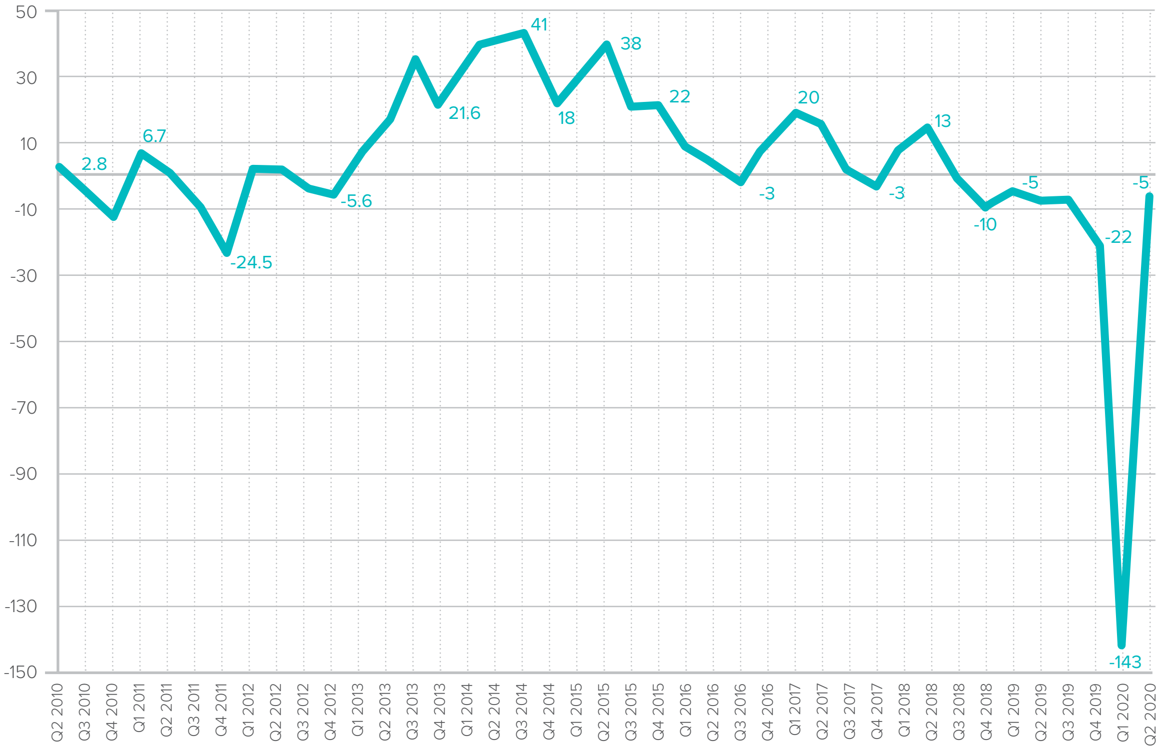
The Small Business Index picked up significantly in Q2 following easing of lockdown restrictions

Confidence among small firms saw a significant recovery in Q2 2020, rising by 138.4 points to reach -5.0. Following the record fall of 121.8 points witnessed in the previous quarter, Q2 represents a record quarterly increase, providing some degree of evidence of a V-shaped recovery in small businesses' fortunes. Though the Index remains in negative territory, it is currently at the joint-highest level in nearly two years, with a stronger reading not recorded since Q3 2018. The Index has now stood in negative territory for eight consecutive periods, however, as Brexit uncertainty, political turmoil, and now coronavirus have all served to restrict small businesses' confidence for two whole years.

Recent data releases have illustrated a largely similar trend to the Small Business Index. Many indicators plunged to record depths at the onset of the lockdown period, before picking up considerably as such restrictions were eased and a gradual return to economy activity encouraged. Record lows were witnessed across the board for the UK Purchasing Managers' Index (PMI), for instance, with readings of 32.6, 13.4 and 8.2 seen for the manufacturing, services, and construction sectors, respectively. Since then, these measures have picked-up considerably, with the readings for June standing just shy of pre-crisis levels in the case of manufacturing and services, while exceeding pre-crisis levels for construction.

The record fall in the Small Business Index coincided with a significant fall in GDP in Q1, which amounted to a 2.2% contraction on a quarterly basis. In an illustration of the scale of such a fall in activity, this far exceeds any monthly GDP contraction seen the financial crisis, whilst also marking the joint-third largest contraction since records began in 1955. Given that coronavirus-induced uncertainty only really hit the UK in March, it seems likely that an even more significant contraction will have occurred in Q2, fuelled by the extensive lockdown measures seen for the entirety of April and large parts of May. Recent data releases show that UK GDP in the three months to May was down by 19.1% compared to the three

Figure two: The FSB Small Business Index[1]: 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.

months to February, for instance. As such, there is a discrepancy between the outlook of small businesses, with their large recovery in confidence, and the state of the wider economy.

Having passed the nadir of the crisis, small business confidence is unlikely to fall anywhere near the record-lows witnessed earlier in the year. Nevertheless, it is unclear whether the pickup in confidence will be sustained. Instead, as the longer-term fallout from coronavirus becomes apparent, it may well be that we see business confidence falter once more, particularly as government support comes to an end. The prospects of persistent economic uncertainty, a lingering demand slump, and the threat of increased unemployment all represent potential causes of subdued business confidence in the coming months.

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

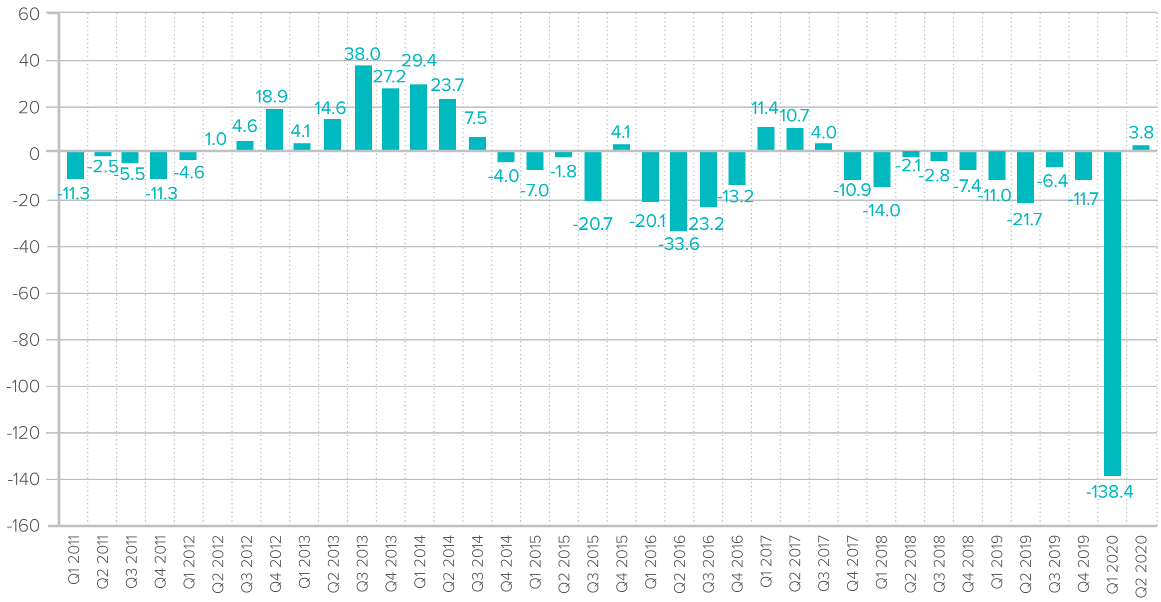
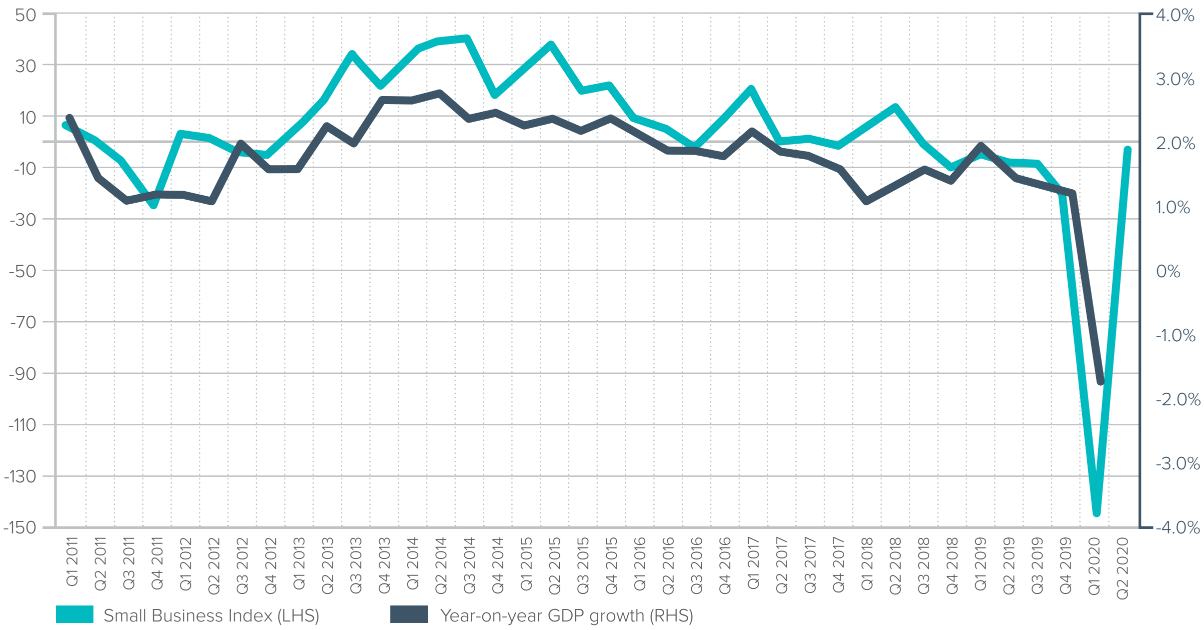


Figure four: UK SBI against year-on-year UK GDP growth.
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.

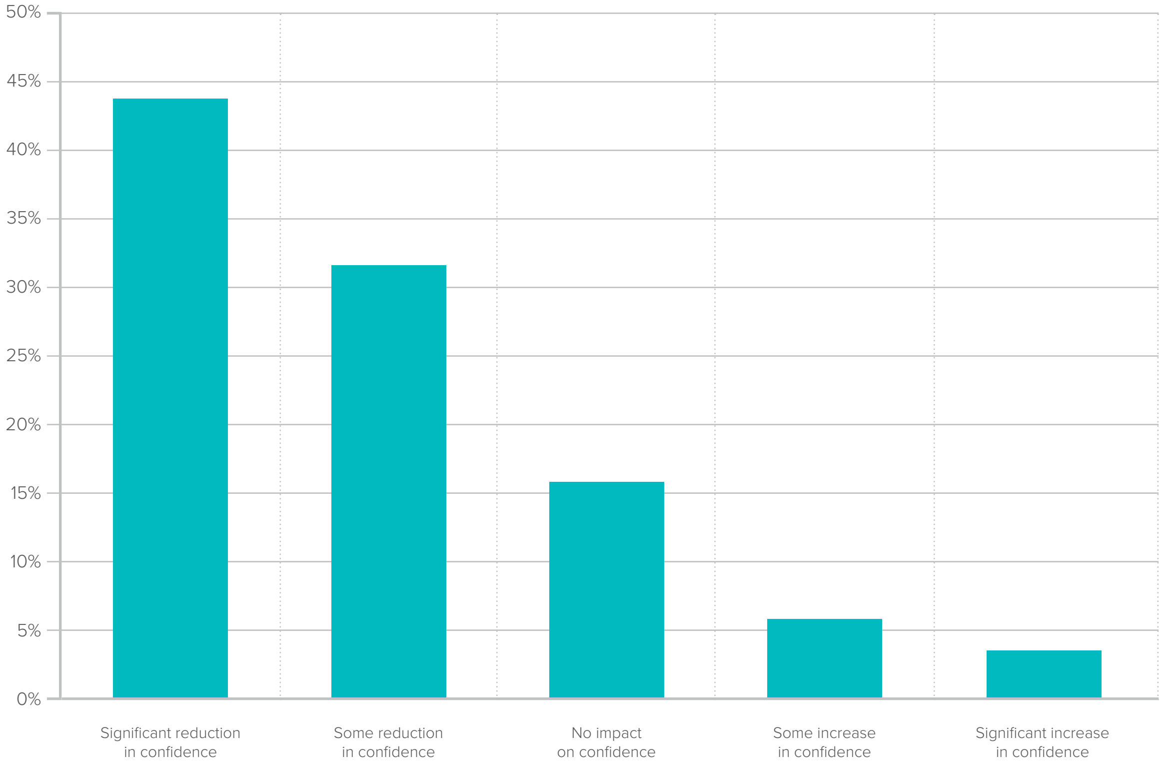


Three quarters of small businesses report reduction in confidence for coming quarter as a direct result of coronavirus

The vast majority of small businesses experienced a reduction in confidence regarding the coming quarter as a result of the ongoing pandemic. The proportion of firms reporting a reduction in confidence was, however, slightly lower than the corresponding figure witnessed in Q1, when firms were giving their outlook for Q2. This would be expected, given that the Small Business Index has seen a significant recovery over that time period, although it remains in net negative territory. Just over three quarters (75.4%) of small businesses report some reduction in confidence regarding the coming quarter as a result of coronavirus, down from the corresponding figure of 87.6% recorded in Q1. At the other end of the scale, the proportion of businesses with a more positive outlook more than doubled between Q1 and Q2. While only 4.2% of small businesses expected an improvement in confidence over the coming three months when asked in Q1, this figure had risen to 9.3% by Q2.

There remain stark differences between business confidence levels across industries, largely reflecting the extent to which coronavirus restriction measures have impacted business operations. For instance, the least confident industries looking forward to Q3 are those that are more reliant on face-to-face contact, and thus the most directly affected by the need for social distancing and general caution among the population. 87.3% of small businesses within the accommodation and food services sector reported a reduction in confidence as a direct result of coronavirus looking forward to Q3. Similarly, 87.5% of businesses within the arts, entertainment and recreation industry reported a reduction in confidence as a direct result of the pandemic. Meanwhile, those in the construction industry, where normal workplace operations have been encouraged since May, are among the most optimistic businesses. In fact, looking forward to Q3, 10.1% of small businesses within construction reported a direct increase in confidence as a result of coronavirus. A similar picture can be painted when looking at the information and communication industry, one of the industries most suited to remote working, where 12.2% of small businesses reported an improvement in confidence as a direct result of coronavirus.

Figure five: Impact of coronavirus on small business confidence – proportion of respondents.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

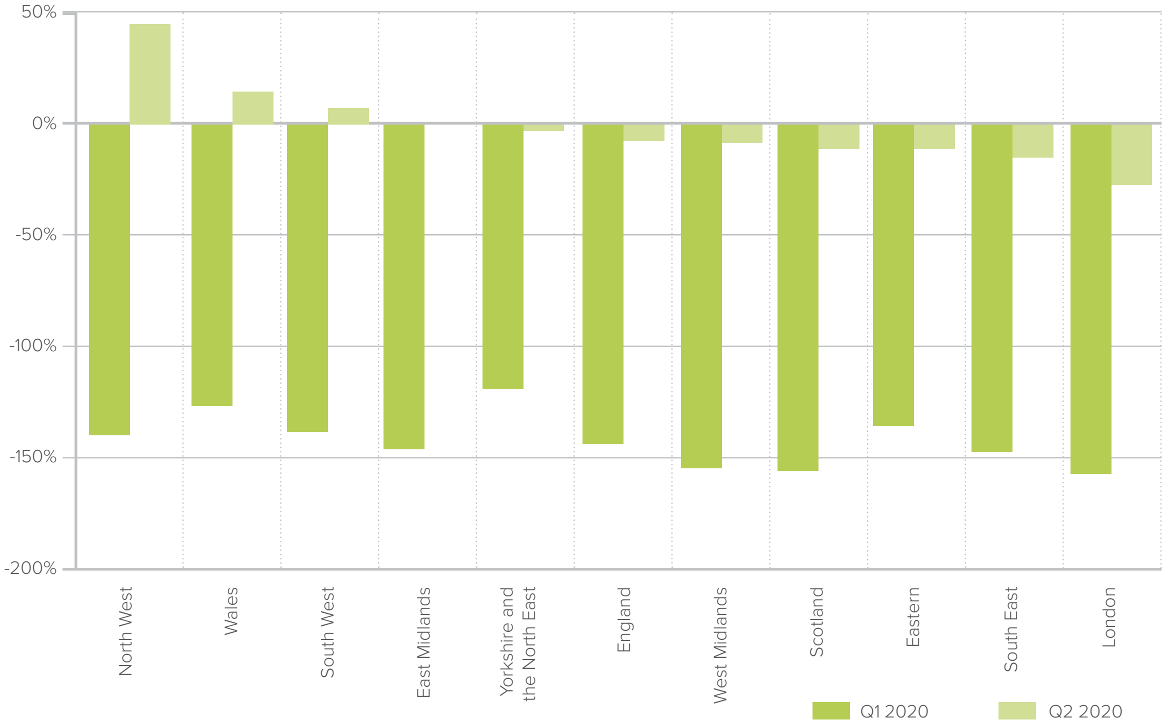
RECOVERY IN SMALL BUSINESS CONFIDENCE SUBJECT TO REGIONAL VARIATION FOLLOWING PREVIOUS COUNTRY-WIDE SLUMP

While every one of the UK's constituent regions and countries recorded a large collapse in small business confidence in Q1 2020, the regional picture for confidence in Q2 represents a much more mixed bag. The North West, Wales, and the South West all report positive Small Business Index figures, reaching scores of 45.0, 14.3, and 6.8 respectively. The East Midlands recorded a neutral score of 0.0, while all other constituent regions saw negative figures.

London, with a reading of -25.6, continues to be the least confident region of the UK. One explanation for this is its large business base in food, hospitality and other services which rely on daily commuters. Spending from this group has been all but wiped out as a result of social distancing and the encouragement of home working. This has meant small businesses in the region have faced the prospects of restricted footfall and passing trade, severely impacting their customer base. Factor-in the higher rent costs in the capital, and it is clear that small business profitability is likely taking an even greater hit than their counterparts across the rest of the country.

Although seven of the constituent regions and countries continue to hold a negative outlook for the coming three months, all such regions and countries saw an improvement on the Small Business Index between Q1 and Q2. Though perhaps it would be inaccurate to say that small businesses across the country are overwhelmingly more confident now than they were three months ago, 'less unconfident' would be a fitting description. The gradual lifting of lockdown restrictions has brought with it a tentative return to economic activity in the past few months, with businesses likely to see steady improvement in their prospects for as long as this continues. Due to lingering economic uncertainty, however, such activity may not return to pre-crisis levels for some time even as further restrictions are lifted. Many businesses are thus likely to face the prospects of limited activity and subdued revenues, which is likely to contribute to some persistent negative drag on the index in the near future.

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



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SMALL BUSINESS SECTOR INDICES

RELAXING OF SOCIAL DISTANCING MEASURES SEES ACCOMMODATION AND FOOD SERVICES BUSINESSES RETURN TO POSITIVE OUTLOOK

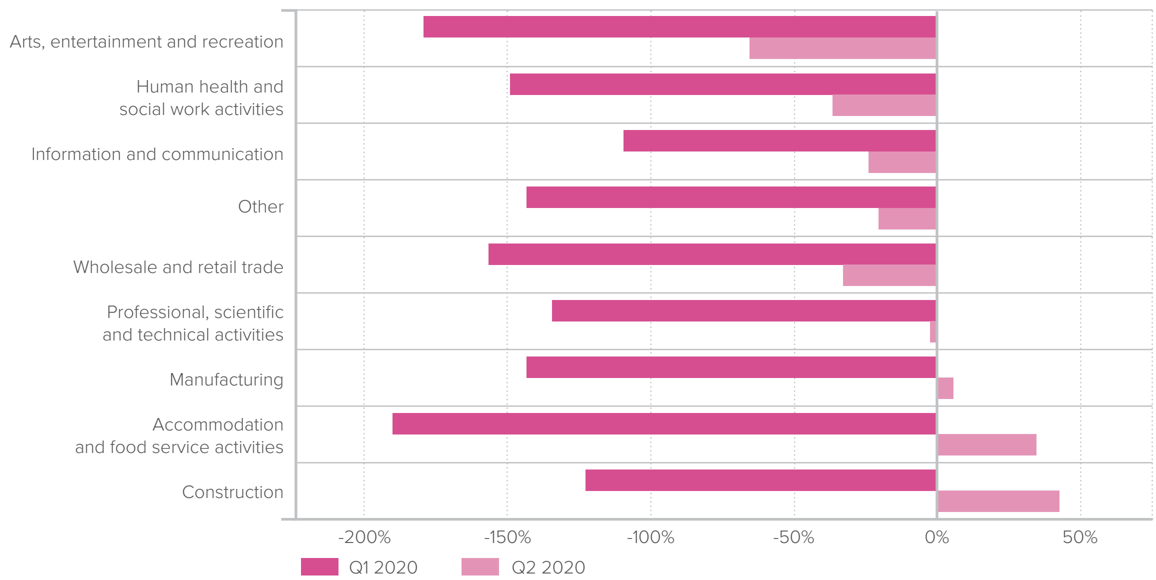
In a similar story to small business prospects at a regional level, the outlook for business confidence is less negative on a sector-by-sector basis than was the case for the last round of the index. Higher scores are recorded across all sectors, though confidence remains in negative territory for most. Nevertheless, there has been a return to positive scores for those in manufacturing, construction, and accommodation and food services, with businesses in these sectors on average expecting an improvement in performance over the next three months.

Given that those in the manufacturing and construction trades were among the first to return to work following the national lockdown, businesses within these sectors have seen a significant improvement in fortunes in recent months after operations almost ceased completely at the end of March and into April. This return to normal operations is reflected in PMI readings for the industries, which have now both recovered to near pre-crisis levels, having reached record lows in April. Data on industrial production adds further evidence to the pickup in activity within the manufacturing sector in particular, with output rising by 6.0% between April and May and further recovery expected to have occurred between May and June. Though output remains down considerably on a year-on-year basis, the coming three months still look positive for businesses within these sectors, certainly in comparison to the prospects of factory and site closures faced this time three months ago.

Despite being among the sectors most directly affected by coronavirus, businesses within accommodation and food services are also more positive looking to the next three months, reaching an index score of 34.7. A new phase of reopening the economy was outlined by the Prime Minister on 23 June, with the relaxation of social distancing rules allowing for the reopening of pubs, restaurants, and hotels from 4 July onwards. Though the continued need for some social distancing will restrict capacity for the time being, that these businesses are able to return at all after three months with next to no activity provides a general rationale for the improved confidence outlook.

Having been the second least-confident industry looking forward to Q2, the arts, entertainment, and recreation sector now stands at the bottom of the confidence table ahead of Q3, scoring -66.3. With activity within the sector almost unviable so long as social distancing remains in place, there were significant warnings regarding businesses' survival. A sector-specific emergency support package, consisting of £1.6bn of grants and loans has since been announced by the government, with the aim of protecting both businesses and jobs. This was not unveiled until early July, however, and so came too late to affect this round of confidence readings.

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



FINANCIAL PERFORMANCE

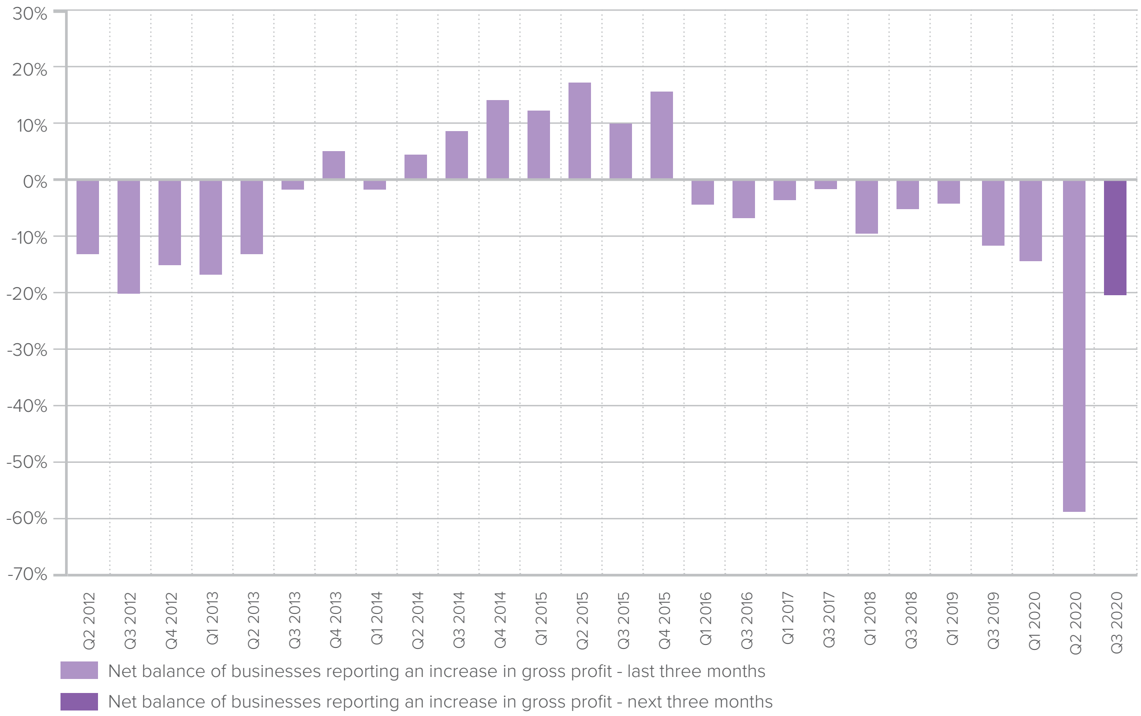
MORE THAN HALF OF SMALL BUSINESSES EXPECT DECLINING PROFITABILITY OVER THE COMING THREE MONTHS

The net balance of small businesses reporting growth in gross profits fell to -58.7% in the second quarter of 2020. Across the country, nearly three quarters (74.9%) of small businesses reported a fall in gross profit levels during the quarter, with 63.3% reporting a fall of more than 10%. The net balance figure represents a decline of 44.3 percentage points compared to Q4 2019, the last time this question was posed to respondents.

A negative net balance was witnessed in all of the UK's constituent regions and countries, showing that falling gross profits were experienced nationwide. There was some variation, however, with businesses in the North West seeing the least negative figure at -47.4% and those in Scotland scoring most negatively at -71.9%. In terms of sectoral performance, all sectors also exhibited a fall in gross profits, albeit to varying degrees. Of those sectors with a suitably large sample size, the most resilient performance was demonstrated by businesses in construction, though the net balance was still firmly in negative territory at -47.1%. As with other business performance categories considered in this report, the weakest figure was again witnessed amongst businesses in the arts, entertainment, and recreation sector, for which the net balance stood at -88.2%. A figure of similar magnitude (-87.3%) was also witnessed for businesses in accommodation and food services, highlighting once more how the lockdown period and continued need for social distancing have effectively wiped out profitability in such consumer-facing sectors.

Expectations of business profitability over the coming three months remain in net negative territory, though a reading of -20.4% suggests a much less pessimistic outlook compared to that actually experienced by firms in the past three months. Nevertheless, more than half (53.4%) of firms expect some decrease in gross profits over the next three months. In line with the wider outlook for business prospects, this figure is highest in London (58.0%) and lowest in the North West (42.3%), when considering the figures across regions. Meanwhile, on a sector-by-sector basis, 70.8% of small businesses in arts, entertainment, and recreation anticipate falling profits over the next three months, compared to just 42.5% of those in construction.

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



EXPORTS

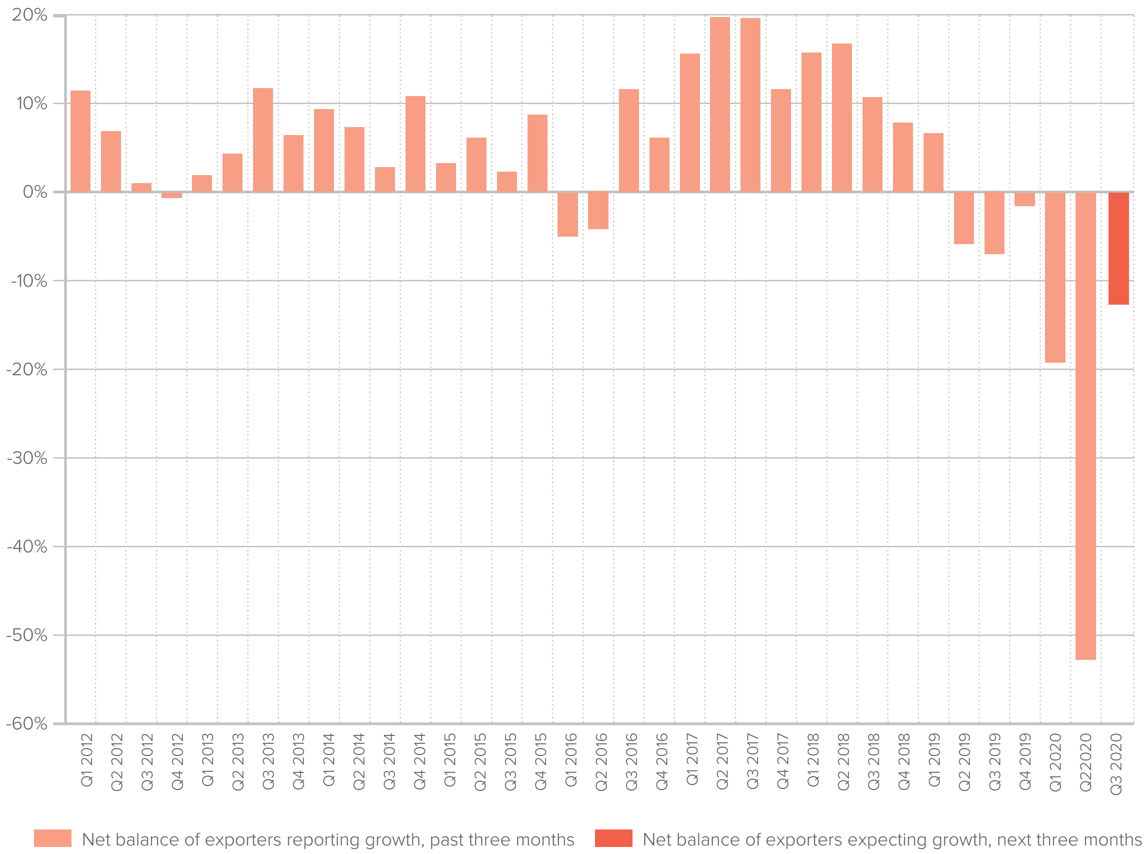
EXPORT GROWTH PLUNGES EVEN FURTHER IN Q2, THOUGH THE OUTLOOK FOR Q3 IS IMPROVING

In the second quarter of 2020, the proportion of exporting small businesses reporting a decrease in the value of their exports reached a record high of 65.3%, outweighing the previous record of 40.4% set in Q1 of this year. As a result, the net balance figure plunged even deeper to -52.8%, from an already record low of -19.2% in Q1.

The slump in consumer demand witnessed in recent months has certainly not been exclusive to the UK, with similar patterns witnessed in almost all major economies. Indeed, month-on-month global trade volumes were down by 12.1% in April, according to the CPB World Trade Monitor. Such subdued economic activity has weighed heavily on UK small businesses reliant on exports, meaning a reduction in demand for their goods and services.

As countries reopen their economies, a pickup in global activity could help UK exporters return to optimism. Nevertheless, there is still uncertainty regarding the pace of that pickup, with the potential for persistent subdued demand levels. This is reflected in UK small businesses' expectations for their export value looking ahead to Q3. Q3 performance is expected to be less significantly affected than that of Q2, with 31.6% of exporters expecting an increase in the value of exports. 44.4% expect a further decrease in the value of their exports, the net balance figure remains in negative territory, at -12.8%.

Figure nine: 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

SMALL BUSINESSES REPORT FALLING OPERATING COSTS IN Q2

The net balance of small businesses reporting an increase in operating costs fell into negative territory for the first time on record in Q2. As such, businesses on the whole saw costs fall during the quarter. The net balance figure stood at -7.1%, representing a 56.3 percentage point fall compared to that recorded in Q1. That businesses experienced a fall in costs during Q2 comes as little surprise, given that lockdown measures implemented during the quarter saw many businesses forced to temporarily close their doors. Variable costs, such as labour, fuel, and inputs, are dependent on output levels by their very nature. With lockdown measures placing a significant output restriction on many small businesses, a necessary consequence of this is that such variable costs have witnessed a corresponding fall, providing one explanation behind the negative net balance figure.

While all previous editions of this report have considered the sources of cost increases amongst firms, the negative net balance figure suggests that the major sources of cost changes amongst businesses were in the opposite direction in Q2. Labour costs, so often cited as a major source of cost increases, have instead been a major source of falling costs for small businesses. 30.4% of small businesses highlighted the category as a main source of changing business costs during the quarter. The widespread adoption of the Coronavirus Job Retention Scheme provides one explanation for this, allowing firms to keep workers who would otherwise have been made redundant on the payroll, while having wages covered by a government subsidy. Indeed, the proportion of firms reporting labour costs as a major cause of changing business costs was most prominent in the accommodation and food services (39.9%) and construction sectors (47.4%). These represented two of the top three sectors in terms of furloughing rates at the beginning of the crisis. Away from the furlough scheme, pay cuts and reduced working hours have been commonplace for workers that remained active during the lockdown period, providing a further source of falling labour costs. Such effects were manifested in the fact that average regular pay witnessed a year-on-year fall of 0.4% in the three months to May, according to figures from the Office for National Statistics (ONS).

With more than one third (33.8%) of businesses citing 'Other' as a major source of changing costs, this was the most common response category for the first time ever. This is perhaps a result of the unprecedented nature of economic activity during the pandemic, with specific costs related to coronavirus somewhat unattributable to any of the more precise categories.

Figure 10: 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.

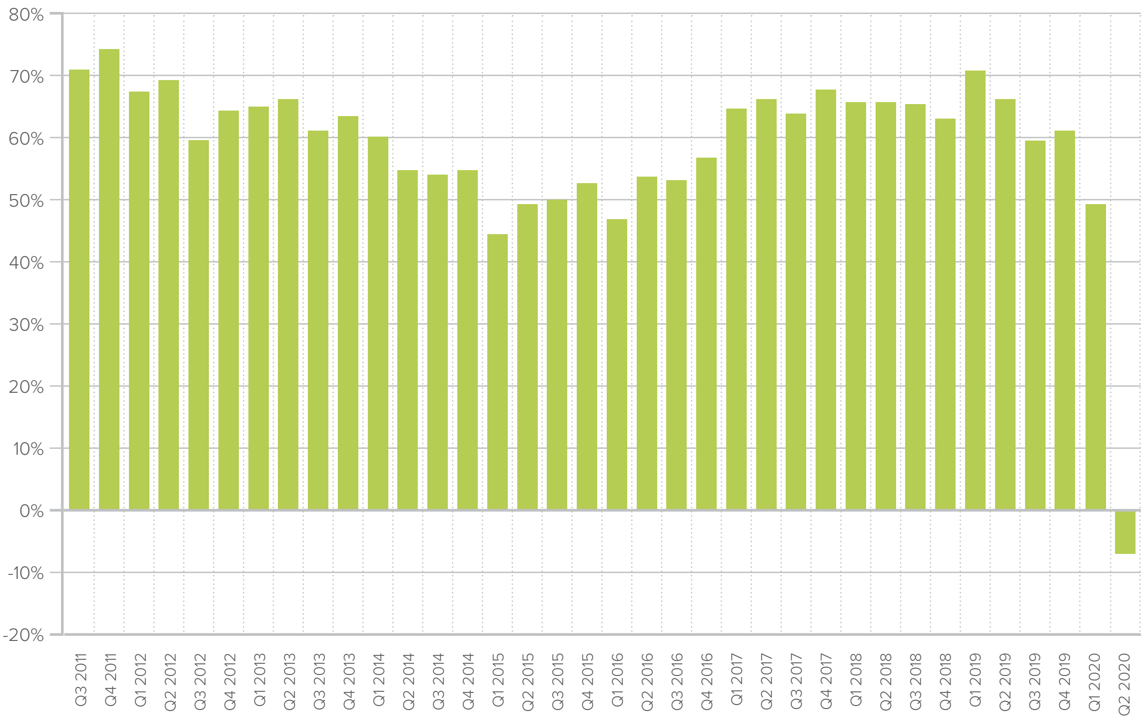
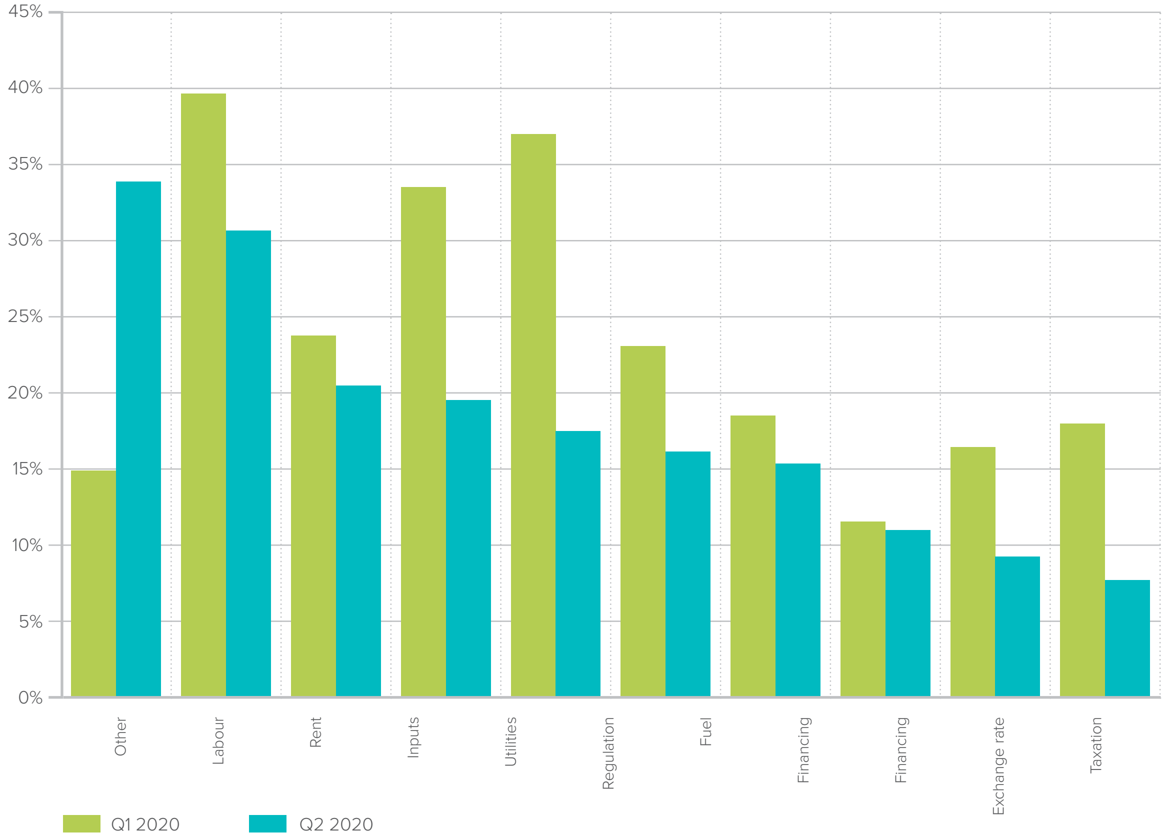


Figure 11: Main causes for changing business costs (firms may give multiple answers).
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



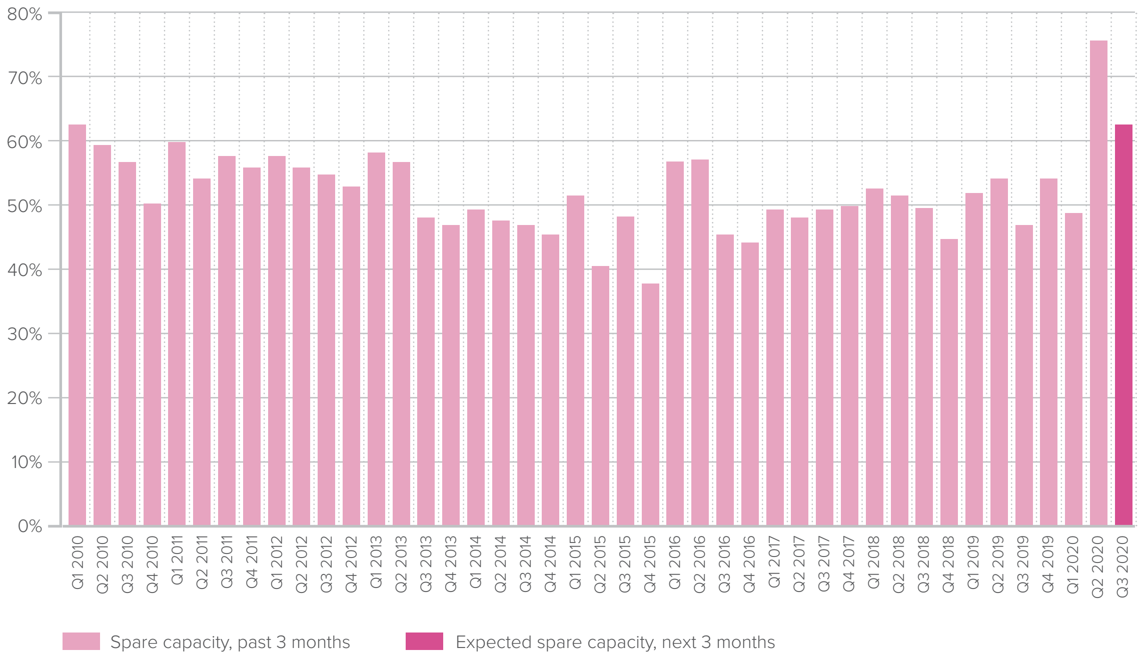
CAPACITY

MORE CONFIDENT OUTLOOK AMONG FIRMS HEADING INTO Q3, THOUGH MAJORITY STILL EXPECT SPARE CAPACITY

The proportion of small businesses reporting that they were operating below capacity rose significantly in the past three months, standing at 81.6%, having previously stood at from 57.5% in Q1. The proportion of businesses operating above capacity also fell slightly, reaching 6.1% having stood at 8.3% in Q1. The combination of these effects was that of a significant increase in the net below capacity figure, which reached a record level of 75.6%. Despite these record figures, they do not quite match the pessimism expected by firms when they were looking ahead to Q2. 84.6% of small businesses had expected to be below capacity in Q2 when responding in Q1, with just 3.6% excepting to be above capacity.

Looking forward to Q3, there is still a significantly more downbeat assessment from firms compared to historic averages. With lingering economic uncertainty, fragile consumer confidence, and the persistent need for social distancing likely to impact firms' output decisions in the coming months, the overwhelming majority (68.1%) still expect to be below capacity this coming quarter. Nevertheless, small businesses do look slightly more optimistic than they did this time three months ago. With a gradual return to economic activity also anticipated, a considerably higher proportion of firms expect to be at capacity (26.7%) than this time three months ago (11.8%).

Figure 12: Net percentage balance of businesses running below capacity: proportion below capacity less proportion above capacity.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



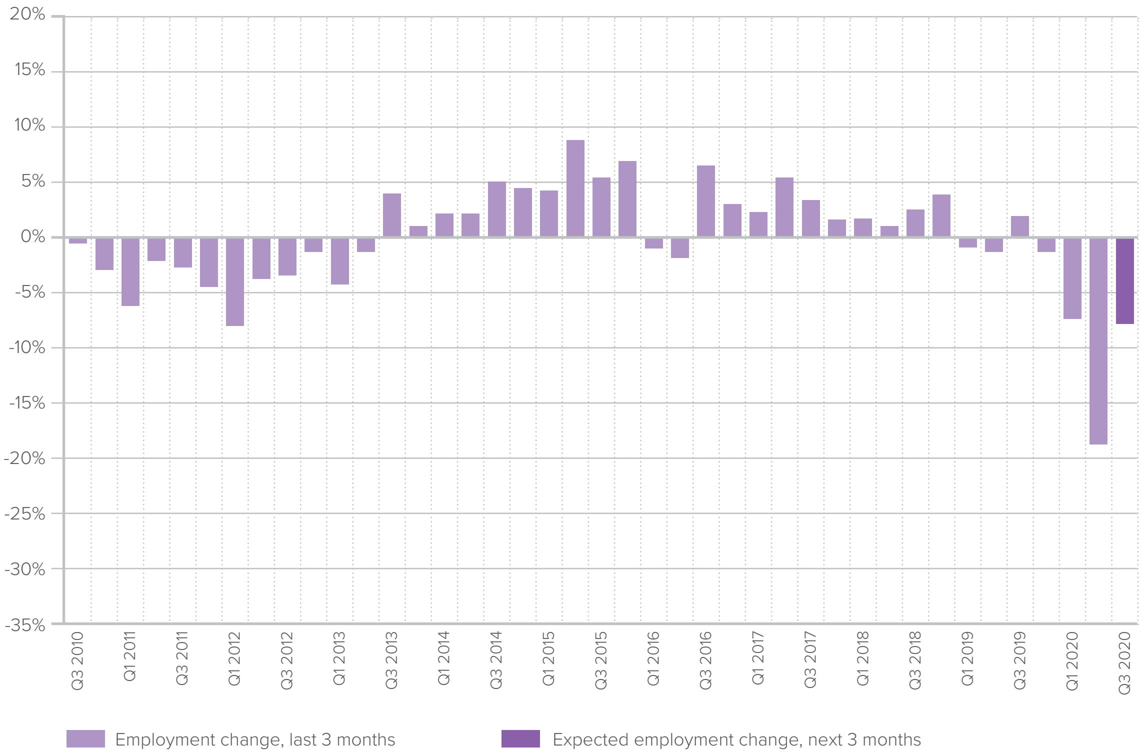
EMPLOYMENT

SMALL BUSINESSES CUT WORKFORCE AT FASTEST RATE ON RECORD

Given the significant curtailment in economic activity that took place over much of Q2, it is no surprise that small businesses recorded the most significant reduction in their workforce since this series began. 22.8% of small businesses reported a decrease in the number of people they employ over the course of Q2, considerably outweighing the previous record of 17.0%, set in Q1 2012. At the other end of the scale, the proportion of small businesses reporting an increase in the size of their workforce also fell to a record low, reaching just 3.8%. On a regional basis, cuts to workforces were most severe in the South West, where 26.9% of small businesses reported a decrease in employment numbers. The most resilience was witnessed in the East Midlands and London, within which job cuts were reported by some 17.4% and 17.8% of small businesses, respectively.

Though the government's furlough scheme has been of vital importance in preventing a severe spike in unemployment thus far, the above evidence suggests that many small businesses have been willing to cut jobs outright, rather than register their employees as temporarily away from work. Facing the prospects of subdued revenue levels, such firms have been forced to reduce costs in order to better assist their survival, with wages and salaries being one of the biggest sources of cost pressure. The prevalence of job cuts has been most evident in the accommodation and food services sector, within which 37.7% of small businesses reported falling employee numbers. This once more reflects the significant damage suffered by the sector amidst the lockdown and continued need for social distancing. The most resilience was shown by the likes of the information and communication sector, as well as within professional scientific, and technical activities. In respective terms, just 17% and 13% of small businesses within these sectors reported making job cuts in Q2, highlighting the extent to which such businesses have been better able to adopt home working practices.

Figure 13: 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.

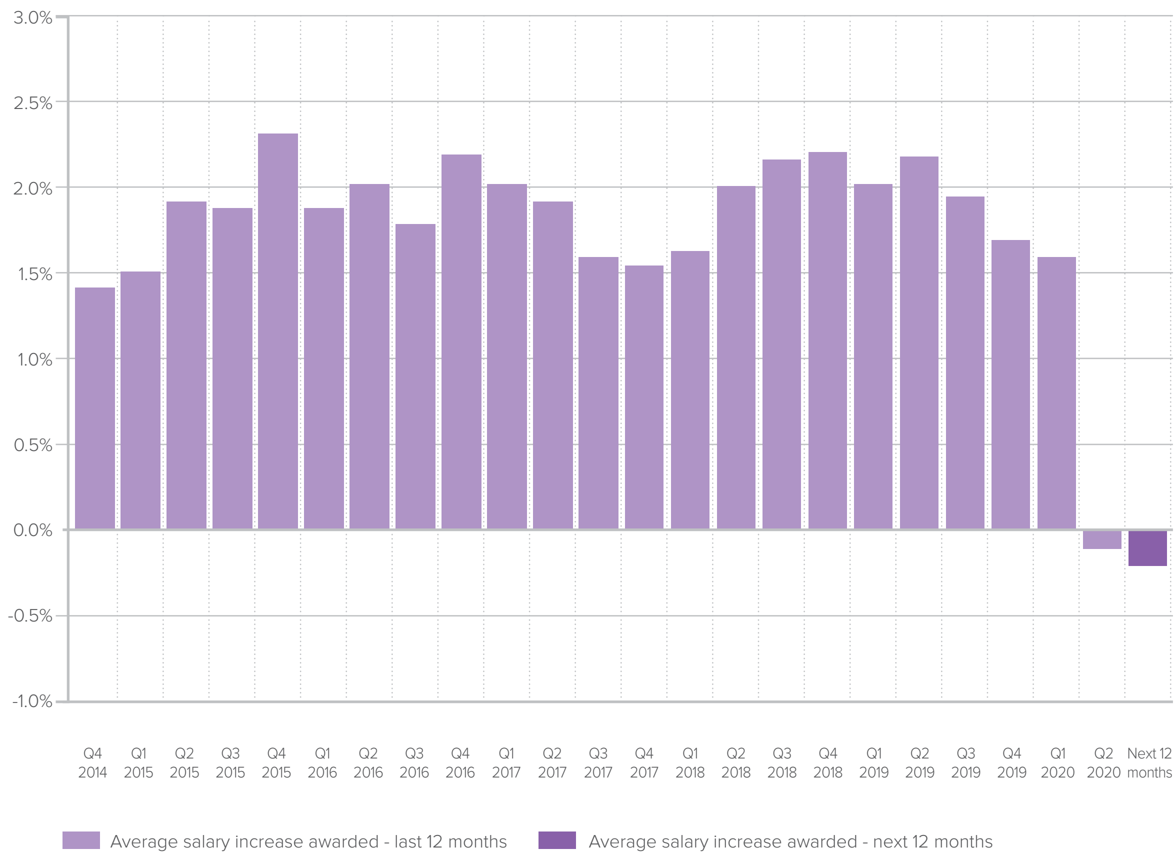


AVERAGE SALARIES OFFERED BY SMALL BUSINESSES FELL YEAR-ON-YEAR IN Q2

The average salary awarded by small businesses fell in Q2 2020 compared to that awarded in Q2 2019. The average salary in Q2 2020 was down by 0.1% compared to Q2 2019. This largely fits the pattern outlined in national data releases, which pointed to falling regular pay in the three months to May. Indeed, this was the first time regular pay growth has entered negative territory since the three months to June 2014. Such effects seem particularly prevalent amongst small businesses, with 16.6% reporting an annual decrease in the average salary awarded in Q2 2020, and a further 40.8% reporting a stagnation. Such figures are considerably higher than in ordinary circumstances, with averages of just 7.9% and 27.7% seen across 2019, for instance.

Individuals' incomes have largely been squeezed amidst the coronavirus crisis, with those on furlough only entitled to 80% of their usual salary up to £2,500 per month, for instance. Meanwhile, pay cuts have been commonplace amongst those still in work, representing a further contribution to the year-on-year reported fall in average salary. Businesses in the arts, entertainment, and recreation sector were the most likely to provide lower average salaries than this time a year ago, with 32.0% reporting a year-on-year decrease. This prevalence of cost-cutting measures once more comes as a result of the significant revenue curtailment suffered by firms within the sector, with minimised face-to-face contact effectively putting an end to normal service.

Figure 14: Average salary increase awarded, this quarter versus a year before.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



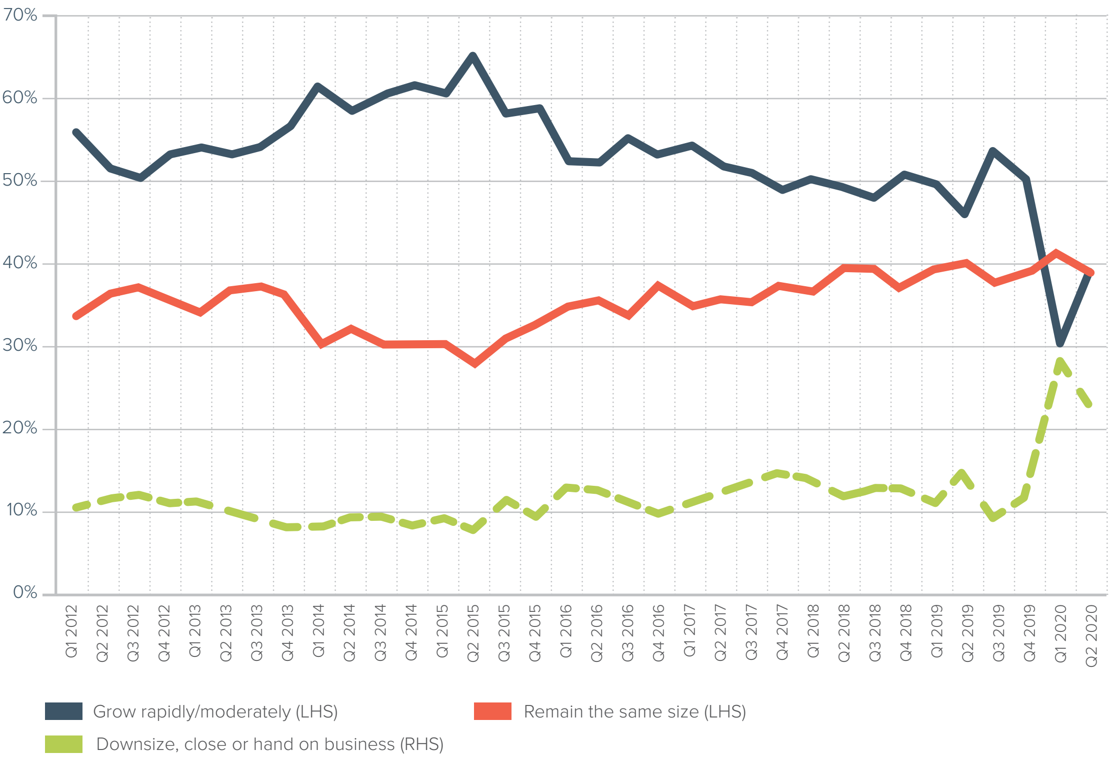
GROWTH ASPIRATIONS AND CHALLENGES

PLANS TO DOWNSIZE LESS WIDESPREAD THAN IN Q1 BUT ONE FIFTH OF FIRMS STILL EXPECT TO SHRINK

The proportion of small businesses that aspire to grow over the course of the next 12 months picked up slightly in Q2, rising by 8.3 percentage points to reach 38.8%. Despite this slight increase in optimism, the proportion of small businesses expecting growth stands at the second lowest level on record, outweighed only by the record depths witnessed in Q1. This provides a stark illustration of the extent to which small businesses' future plans have been curtailed by coronavirus, with as many as half of all small businesses expecting annual growth as recently as Q4 2019. The figures for businesses wishing to scale back their operations demonstrate a largely similar trend, with Q1 2020 representing record downsizing and business closure intentions, before slight improvement in Q2. 27.9% of small businesses expected their operations to shrink or close over the next 12 months when posed this question in Q1, while this has since dropped to 21.9%. This figure still remains considerably above historic averages, with lows of just 8.8% witnessed as recently as Q3 2019.

In-line with the general positivity suggested by the headline Small Business Index, small businesses in the North West are the most likely to exhibit growth expectations, with exactly half (50.0%) expecting to upscale in the coming 12 months. On a sector-by-sector basis, firms in information and communication, as well as those in professional, scientific, and technical activities, are the most likely to report an intention to grow at 45.8% and 41.0%, respectively. This can once more be explained by their adeptness to remote working, which has seen activity in such sectors significantly less impacted than others in recent months.

Figure 15: Growth aspirations for next 12 months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



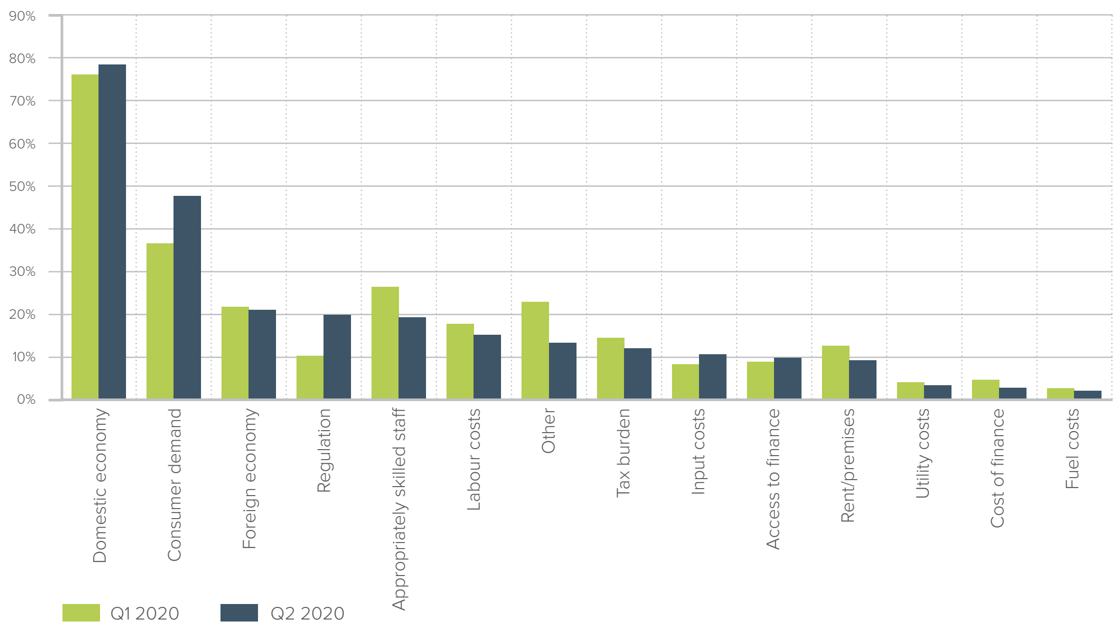
CORONAVIRUS-INDUCED DEMAND SLUMP POSES SIGNIFICANT THREAT TO SMALL BUSINESS GROWTH, WITH FEARS OF A GLOBAL RECESSION

The domestic economy remains the dominant concern holding back growth among small businesses. With the coronavirus-induced lockdown leading to the most dramatic fall in output in modern peacetime history, the UK now faces a considerable period of subdued economic activity amidst a potentially long and sluggish recovery. Small businesses recognise these difficult economic conditions ahead, with a record 78.5% expecting the domestic economy to present a barrier to their growth over the next year.

Within such a weakened economic landscape, small businesses cite limited consumer demand in particular as a potential barrier to their growth aspirations. Consumer confidence is likely to be somewhat fragile over the coming months, fuelled by the threat of unemployment, wider economic uncertainty, and lingering fears over the virus. Ultimately, consumers look set to be more cautious spenders so long as economic conditions remain treacherous, with small businesses to be amongst the most affected parties. Indeed, 47.8% of small businesses reported that consumer demand represents a potential barrier to their growth, an 11.5 percentage point increase on Q1.

Concerns over the foreign economy still remain prevalent, with over a fifth (20.6%) of firms citing this as a potential barrier to growth. The global economy has largely followed a similar pattern to that of the UK in recent months, with the onset of lockdown measures leading to a significant slump in demand and wider economic activity. Such subdued foreign demand levels will weigh particularly heavy on those small businesses reliant on exports, while a global recession will certainly not facilitate a return to domestic consumer confidence. The issue of the Brexit transition period, which is set to end on 31 December, also represents a potential barrier to growth from a foreign economy perspective. Leaving the single market in the absence of a trade deal is likely to pose significant further disruption to UK small businesses who would have to adapt to new regulation and trading arrangements. This fear is reflected in the considerable rise in the proportion of small business citing regulation as a potential barrier to their growth, which rose by 8.9 percentage points to reach 19.4%.

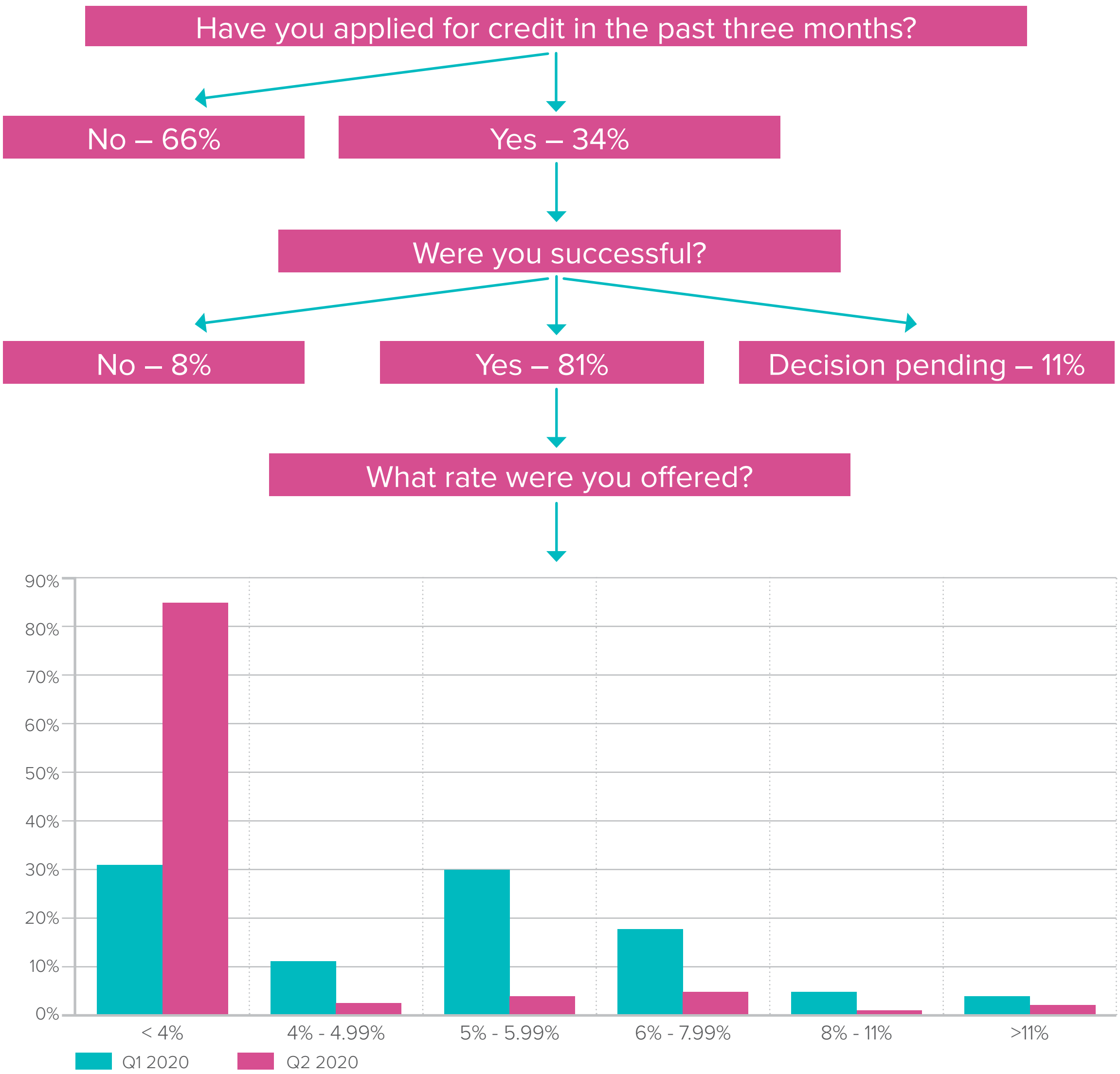
Figure 16: Potential barriers to achieving growth aspirations – multiple answers possible.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CREDIT

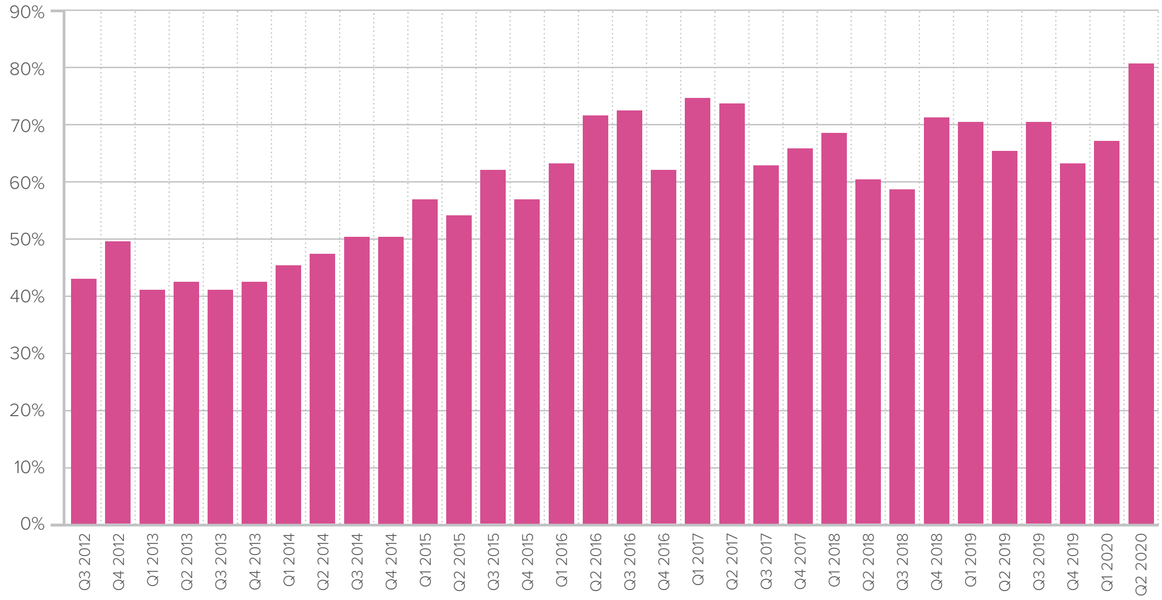
GOVERNMENT INTERVENTION TO HELP SMALL BUSINESSES SEES CREDIT APPLICATION SUCCESS RATE SOAR TO 81%

Figure 17: 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.



The rate of requesting credit picked up significantly in Q2, with more than one third (33.9%) of firms making applications. Such an increase in demand for credit can be explained by firms seeking to support their cash flow in the absence of any predictable revenue stream during the lockdown period. The proportion of those credit applications that were successful also picked up considerably, reaching 80.7%. The corresponding figure for Q1 was just 66.9%. This access to credit has been facilitated by further government intervention to support the economy, such as through the Bounce Back Loans Scheme which has provided 12-month, interest-free loans of up £50,000 to small businesses. Such affordable credit is further reflected in the fact that the proportion of successful applicants being offered an interest rate of less than 4% picked up significantly, reaching 84.9%.

Figure 18: Proportion of small businesses successful in their credit applications in the past three months.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.

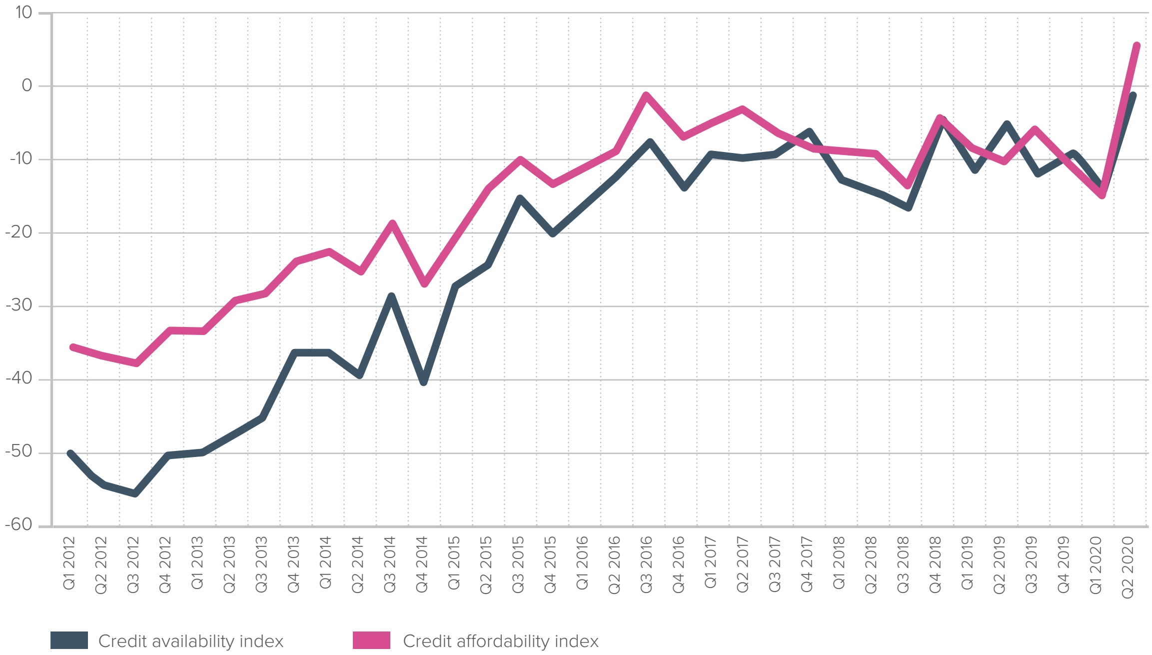


CREDIT AVAILABILITY AND AFFORDABILITY BOTH IMPROVE IN Q2

In-line with the analysis above, both the credit availability and credit affordability indices rose in Q2 compared to Q1. The credit availability index increased by 14.0 points to reach -1.7, while the credit affordability index picked up by 20.6 points, reaching positive territory at a score of 5.0.

In addition to the government support measures outlined above, commercial interest rates have also been lower in recent months. This has largely stemmed from the historic lows witnessed in the Bank of England base rate, which has remained at 0.1% throughout the crisis. Other monetary measures have also been provided in recent months, with the aim of shoring-up markets, ensuring business solvency, and supporting cash flow.

Figure 19: 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.



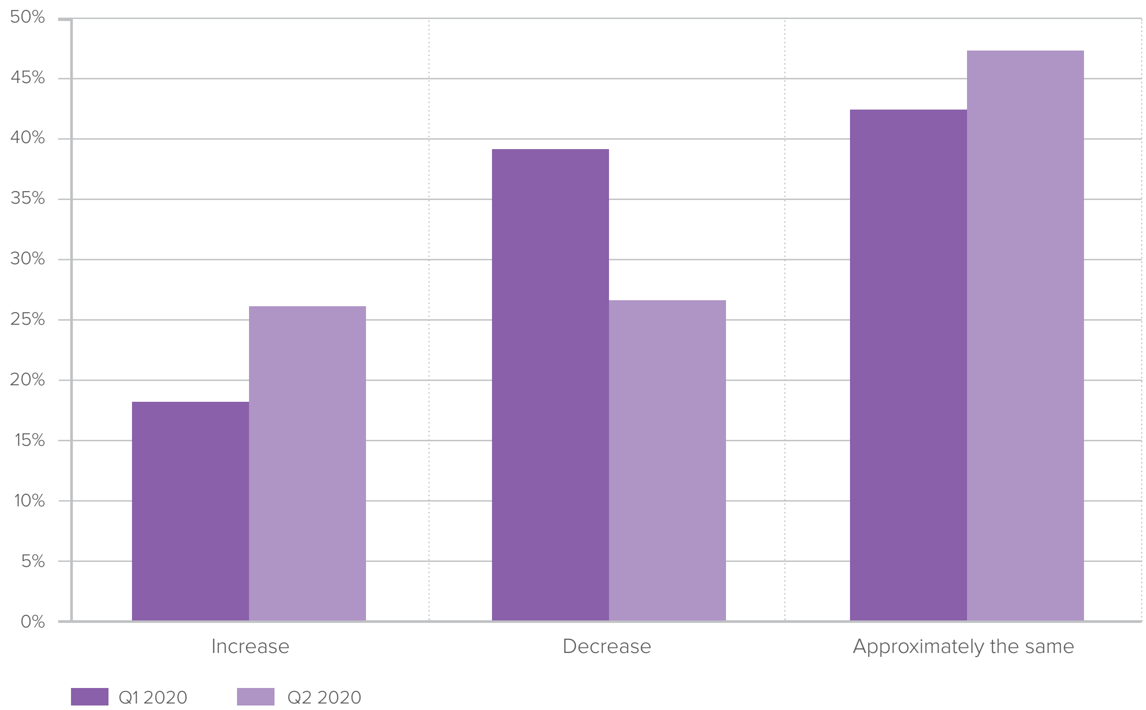
INVESTMENT AND PRODUCTIVITY

SMALL BUSINESS INVESTMENT PLANS SEE SLIGHT PICKUP IN Q2

There has been a slight return to optimism with regards to small businesses' capital investment plans for the coming three months. 26.0% of small business expect to increase their capital investment looking ahead to Q3, representing a sizeable increase on the 18.3% of firms that expected to do so when looking to Q2 from Q1. The share of small businesses expecting to scale back their capital investment has also seen a fall. While 39.3% of small businesses expected to cut their investment levels in Q2, just 26.7% expect to do so in Q3. This is a roughly similar figure to the proportion of small businesses expecting to increase investment, leaving the net balance figure at just -0.6%, considerably up from the -21.0% witnessed in Q1 looking ahead to Q2.

As wider economic activity has resumed, businesses that were under forced closures earlier in the crisis have been able to make a tentative return to operations. In order to reopen their doors, many businesses have had to reconsider their processes to ensure the health and safety of staff and customers alike, with significant capital outlay likely required in order to do so. The purchase of protective equipment, new machinery to limit face-to-face contact, and wider restructuring of capital operations are all likely to present up-front capital costs, as businesses seek to adapt to 'new normal' practices.

Figure 20: Percentage of small businesses expecting to increase and decrease capital investment over next quarter, compared with 12 months ago.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



METHODOLOGY

These tables are based on the Q2 2020 research survey of 1,486 FSB members carried out by Verve. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 24 June and 3 July 2020.

SUMMARY DATA TABLE

	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
Small Business Index	-1.7	-9.9	-5.0	-8.8	-8.1	-21.6	-143.4	-5.0
Employment - previous three months	2.3%	3.9%	-1.0%	-1.5%	1.9%	-1.5%	-7.5%	-19.0%
Employment - coming three months	7.4%	5.1%	7.0%	10.2%	5.1%	3.5%	-28.0%	-7.9%
Exports - previous three months	10.7%	7.6%	6.8%	-5.8%	-7.1%	-1.6%	-19.2%	-52.8%
Exports - coming three months	17.8%	0.2%	-1.6%	11.4%	-4.1%	-9.5%	-52.5%	-12.8%
Credit availability - rated good or very good	24.1%	30.2%	28.5%	28.9%	25.7%	27.5%	24.4%	38.4%
Credit availability - rated poor or very poor	42.5%	34.4%	39.0%	33.7%	39.4%	34.7%	41.6%	34.9%
Credit affordability - rated good or very good	23.7%	32.2%	27.9%	27.3%	28.1%	28.1%	25.7%	41.8%
Credit affordability - rated poor or very poor	41.7%	36.1%	37.9%	43.2%	33.8%	39.9%	44.0%	31.9%

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

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

Responses are also weighted according to regional gross value added.

Q2

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