Q3

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 3, 2020

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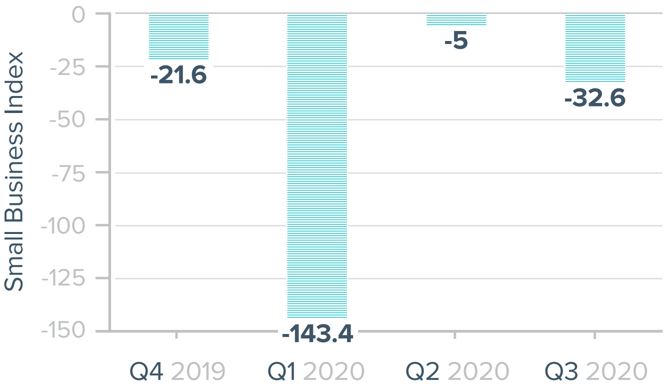
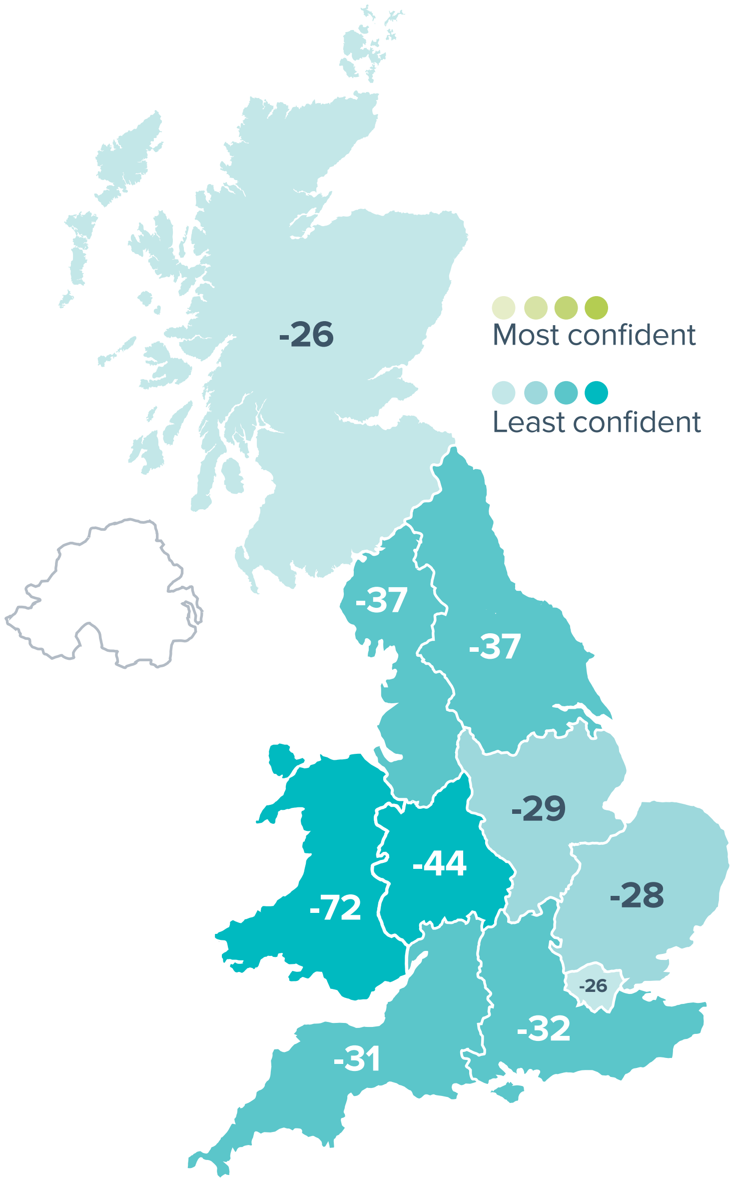
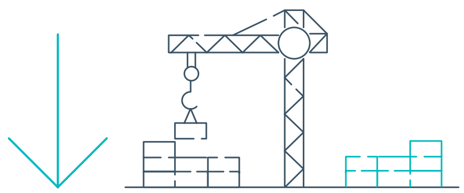
SBI Q3 2020

"Small business confidence suffers two-year losing streak amid calls for further government action"



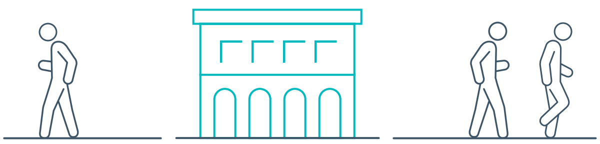


Exporter optimism remains suppressed



43% expect a **drop in international sales** next quarter

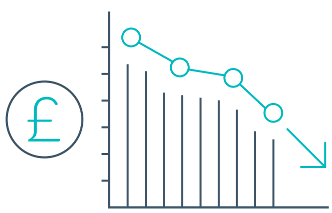
Headcounts continue to fall



25%

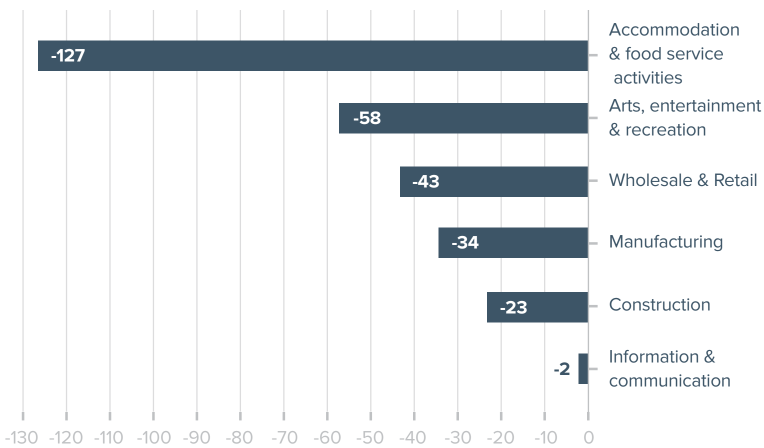
cut staff numbers in the last quarter

Revenue growth down to lowest recorded ebb



56% report a **drop**

Small business confidence by sector



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FSB FOREWORD

We have, regrettably, been reporting for some time on entrenched pessimism within the small business community. First it was five straight negative readings of the Small Business Index (SBI), then six, then seven and now, sadly, eight. Confidence among small firms has been in negative territory since the summer of 2018, when Prime Minister Theresa May was only two-thirds of the way through her time in office. Though minds are rightly focussed on the Covid pandemic, it's important to remember that small firms were already up against political uncertainty and surging operating costs before it hit.

This quarter has provided some respite – if short-lived – for many of the hardest-hit firms. The vital Eat Out to Help Out sparked a flurry of summer activity across the retail, leisure and hospitality sectors. Consumers were again content to dine at restaurants, visit non-essential retailers and staycation – GDP has soared.

And yet, small firms were still rightly concerned about future bumps in the road. Only one in three expect performance to improve in the critical three months leading up to Christmas – the remainder expect the opposite. Despite the summer bounce, firms still report a record drop in revenues, while the number planning to let staff go is at an all-time high. Exporters – still without any significant clarity around what the future holds for trade with Europe – say international sales have plummeted.

Off the back of our recommendations, the support on offer to businesses continues to evolve. Extending the ability to furlough staff on generous terms until 2021 will provide many with reassurance as they plan for the unpredictable months ahead.

But there is still more work to do. The value of the cash grants now on offer to small firms pale in comparison to those provided throughout the first lockdown. Often, they don't even cover the rent. Many have been thrown-out by the withdrawal of the job retention bonus – an injection of future funds that had been factored into medium-term planning.

Elsewhere, thousands are still struggling to access the bounce back loans they need to see them through what the PM has warned could be at least another six months of disruption – many banks have unhelpfully closed their doors to new customers. And, after all this time, still so little help for the thousands of company directors, new business owners, firms down supply chains in hard-hit industries, swathes of the night-time economy and home-based businesses that were almost entirely overlooked when the first round of rescue measures were drawn-up.

The UK Government should urgently address these cracks in the small business landscape whilst bringing down the costs of doing business that were stifling firms pre-pandemic, especially where employment is concerned. At the local level, we need to see authorities exercising ingenuity to ensure their discretionary schemes reach those in the small business and self-employed community who are most in need.

Such efforts, combined with pro-business trade deals with the EU and other key international markets, should help give our entrepreneurs hope. As we look to Q4, there are indeed new reasons to be hopeful. Talk of promising vaccine trials have spurred markets and more small firms by the day are adapting their operations to suit a new normal where ecommerce and contactless delivery – already an increasing part of business life over the past decade – are now ever-more present.

That said, we've always stressed that delivery of the world-beating test-and-trace infrastructure we were promised months back will be crucial to our ability to rebound. That very much remains the case. Only by resolving business support shortcomings, striking pro-business trade deals and enhancing our Covid-fighting efforts can we hope to end this extremely concerning run of negative SBI readings and return to optimism once again. Our economic recovery and future growth in a world permanently changed by this pandemic will hinge on the success of the small business community. Every policy decision from here on in should be carefully assessed for its potential to spur start-ups, encourage business investment and drive commercial innovation.

Mike Cherry,
National Chairman

Martin McTague,
National Vice Chair,
Policy and Advocacy

ECONOMIST'S VIEW

Following a strong recovery in the second quarter, the FSB Small Business Index (SBI) fell back again in the third quarter as the country finds itself in the grip of a second wave of coronavirus cases. Over the summer, as the number of new infections fell, restrictions were loosened and the economy was gradually reopened, leading to a strong bounce back in the GDP figures. However, local outbreaks in places like Leicester, Lancashire and Rochdale over the summer and a return to exponential growth in new infections nationally in September have forced the government to once again tighten social distancing restrictions. This has dealt a severe blow to business confidence in the third quarter and led to a fall in the SBI to -32.6, the second-worst reading on record.

While a second wave of coronavirus cases in the autumn and winter has long been touted as a distinct possibility, the speed with which case numbers have shot up over recent weeks not only in the UK but also in Europe and the US has taken both business and the government by surprise. In spring, the government reacted swiftly and decisively, pledging ongoing support for businesses to cover payroll costs as well as further help in the form of loans and grants. However, at the end of October the government's flagship programme, the Coronavirus Job Retention Scheme (CJRS), ran out and was replaced by the less generous Job Support Scheme (JSS). Since its original announcement there have been various top-ups and extensions to the JSS, showing how the government is reacting to concerns that a lack of pandemic support might lead to a sharp decline in household incomes and aggregate demand.

In England, the government introduced a three-tiered lockdown system in order to be able to react to local spikes in coronavirus cases. More recently, following the second national lock-down, the government announced that some aspects of these tiers were to become even more restrictive. Higher tiers include restrictions on households mixing indoors and on trading arrangements for pubs and bars. These new measures have added to worries for businesses in the accommodation and food services sector as well as the arts and entertainment sector, many of whom have only barely made it through the seven months to September. As a result, the two industries have recorded by far the most negative SBI readings of -126.8 and -58.0, respectively, in the third quarter.

In terms of the regional picture, London has moved from being the most pessimistic region in Q2 to the least pessimistic in Q3, despite being put into tier 2 lockdown in mid-October. At -25.8, the capital's SBI score was just a notch below the Q2 reading. Welsh business confidence, meanwhile, took a considerable hit, falling by 85.9 points to stand at -71.6 in Q3, making the nation the most pessimistic place in the UK as the nation entered a fire-break lockdown, forcing a large number of non-essential stores to shut. The North West has also seen a significant fall in Small Business confidence, of 82.0 points between the second and third quarter, underlining the economic fall-out stemming from the tightening of lockdown restrictions in the region's most important cities, including Liverpool and Manchester.

The economic outlook for the reminder of the year will be closely linked to any progress made in halting the spread of the virus and the ability for businesses to trade in the run up to the busy Christmas period. Q3 data was collected before any announcements had been made with regard to vaccines and before the second national lockdown in England was confirmed..

Kay Daniel Neufeld,
Head of Macroeconomics,
Cebr

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **Following the partial recovery witnessed in Q2, small business confidence subsided once more in Q3. The FSB Small Business Index now stands at -32.6, the second-lowest reading on record.**

- **All of the UK's countries and regions witnessed a fall in confidence between Q2 and Q3.** All countries and regions also recorded a negative index reading in Q3. Wales was the least confident region of the UK, exhibiting a score of -71.6, while London recorded the highest score at -25.8.

- **Unanimous negativity was witnessed across sectors, though there was some variation in scale.** The least negative index readings were witnessed amongst businesses in professional, scientific & technical activities and information & communication, recording -1.5 and -1.8, respectively. Overwhelming negativity was observed amongst those in accommodation & food services and arts, entertainment & recreation, however, reflecting the extent to which these businesses have been affected by the re-imposition of restrictions to slow the spread of coronavirus, as well as faltering demand levels.

- **The rate at which small businesses cut employment levels increased even further in Q3.** 24.7% of small businesses reported a fall in the number of people they employ, up from the then record high of 22.8% witnessed in Q2. Looking ahead to Q4, 34.3% of businesses in accommodation & food services expect cuts to their workforce, the highest proportion of any sector.

- **More than half (56.2%) of small business reported falling revenue levels during Q3.** Small businesses are only slightly less pessimistic looking ahead to the next quarter, with 50.1% expecting another quarter of falling revenue.

- **A greater percentage of firms (44.5%) expect to grow in the next 12 months than was the case in Q2 (38.8%).** The domestic economy and consumer demand remain the most commonly cited barriers to growth, with concerns over the labour market also manifesting.

- **The credit availability and affordability indices sat in positive territory simultaneously for the first time in their histories.** This has been facilitated by government support programmes for small businesses, with the likes of the Bounce Back Loan Scheme providing facilities for approximately 1.3 million businesses.

- **Looking ahead to Q4, more firms expect to increase investment than decrease investment.** The proportion of firms expecting higher investment levels in the fourth quarter sat at 24.9%, while the corresponding figure for firms expecting cuts to investment was 24.2%. As such, for the first time this year the number of firms expecting increased investment levels exceeds the number of firms expecting a decrease.

UK MACROECONOMIC OVERVIEW

Reopening of the economy prompts return to growth for major sectors in Q3

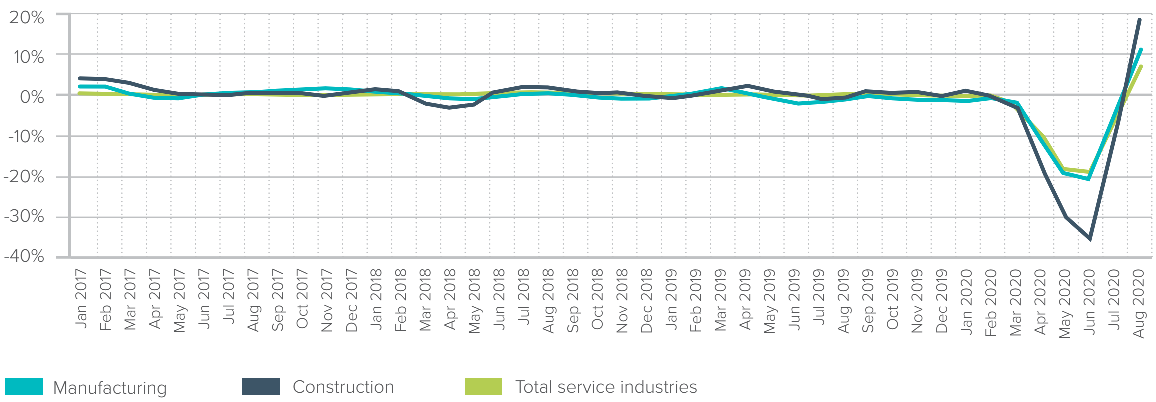
Following on from the significant curtailment of economic activity that characterised much of Q2, a gradual reopening of the economy took place throughout Q3. This has seen the end of forced business closures and restrictions on non-essential travel, while also witnessing significant efforts from both the public and private sector to re-stimulate consumer activity and confidence. Nevertheless, as the latest round of the FSB Small Business Index suggests, the positive effects of the reopening of the economy for UK firms were outweighed by the renewed tightening of restrictions from September onwards, as a second wave of coronavirus infections sweeps across the country.

The reopening of the economy saw output increase across all major sectors throughout the summer. In August, the manufacturing, construction, and services sectors, exhibited three month rolling growth rates of 11.3%, 18.5%, and 7.1%, respectively. Meanwhile, the wholesale & retail trade sector had seen a return to growth a month prior to that. Indeed, the retail sector has been one of the success stories of recent months, with retail sales having completed a V-shaped recovery following the historic lows witnessed at the beginning of the crisis. Sales volumes exceeded February's pre-crisis levels for the first time in July and have since seen two months of further growth, standing 5.5% above those witnessed prior to the pandemic. Key to the performance of the retail sector has been an increase in consumer uptake of e-commerce, with online sales as a proportion of all retail sales remaining considerably elevated compared to historic trends, sitting at 27.5% in September. Nevertheless, looking at Q4, the retail sector is expected to face some increased turbulence, following the re-introduction of tighter restriction measures, including the national lockdowns in England, Wales and Northern Ireland and subsequent return to a variety of tiered regional and devolved restrictions across the whole of the UK. Of course, these measures look set to affect the entire economy, not just the retail sector. As such, a double dip recession could be on the cards across several sectors, with accommodation & food services and arts, entertainment & recreation looking most at risk.

Despite the increased economic activity witnessed throughout much of the quarter, the labour market has continued to weaken. Though the Coronavirus Job Retention Scheme (CJRS) has thus far helped to quell major job losses, there have still been an estimated 693,000 redundancies since the start of the crisis. Some positivity was found in Q3, however. Some workers were brought back from furlough, with considerable improvements made in August. The return of such workers put positive pressure on wages, which returned to annual growth during the month, having exhibited year-on-year contractions for the prior four months. However, the return of lockdown restrictions across much of the UK brought a return to furloughing for many employees heading into Q4.

The anticipated weakness of demand conditions provides further justification for policy intervention in the coming months. Amongst other policies, new channels of government support for businesses affected by the tiered system of lockdown restrictions will help to keep public borrowing elevated. Meanwhile, the Bank of England has not altered its course for some time, with the base rate of interest at a record low of 0.1% since March and the scale of asset purchasing unchanged since June.

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



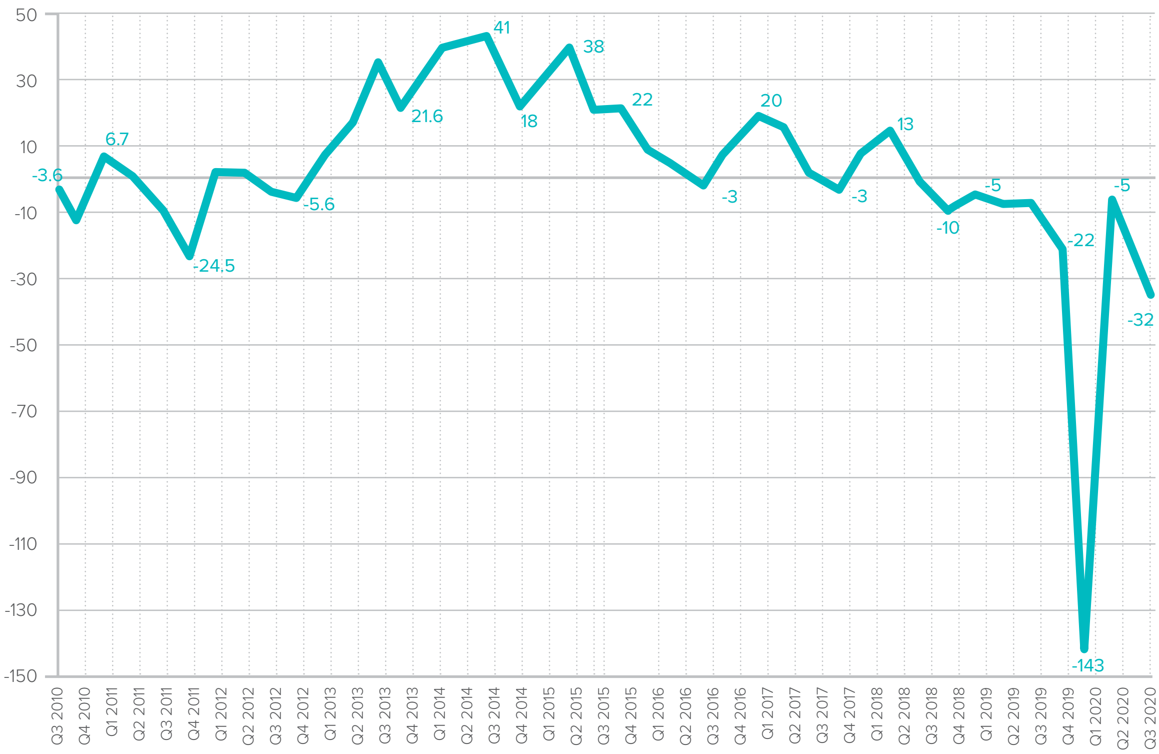
SMALL BUSINESS INDEX

The Small Business Index falls once more amidst second wave of coronavirus infections

Following the partial recovery in the Small Business Index (SBI) between Q1 and Q2, confidence saw a further decline in Q3, falling by 27.6 points to reach -32.6. This fall takes the index to its second lowest level in its history, outweighed only by that witnessed in Q1 this year. These latest figures bring the index into its ninth consecutive period of negative territory, with little sign to suggest an end to this trend.

Data releases showed an uptick in activity across much of the economy in Q3. The economy has now experienced four consecutive months of monthly GDP growth following the historic depths earlier in the crisis, with collective gains of 21.7% between April and August. Meanwhile, when looking at sector-by-sector performance, positive readings were witnessed across the board for the UK Purchasing Managers' Index (PMI), with respective highs of 55.2 and 58.8 seen for the manufacturing and services PMIs during the month of August. This increase in activity over the summer months largely reflects the reopening of the economy and lifting of restriction measures, which saw businesses return and consumer confidence pick up. Such data points seem to justify the relative optimism of SMEs expressed within the Q2 SBI reading, which had reached its highest level since Q3 2018.

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.

Since then, there has been a noticeable upward trajectory in coronavirus infections, bringing new restriction measures and increased economic fragility. More recent data releases have reflected this trend, with PMI readings in September and October showing a slight decline, suggesting lesser business confidence. The latest round of the Small Business Index provides further evidence for an environment of heightened economic uncertainty, with businesses across regions and sectors seeing their confidence diminish considerably compared to that witnessed ahead of Q3.

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

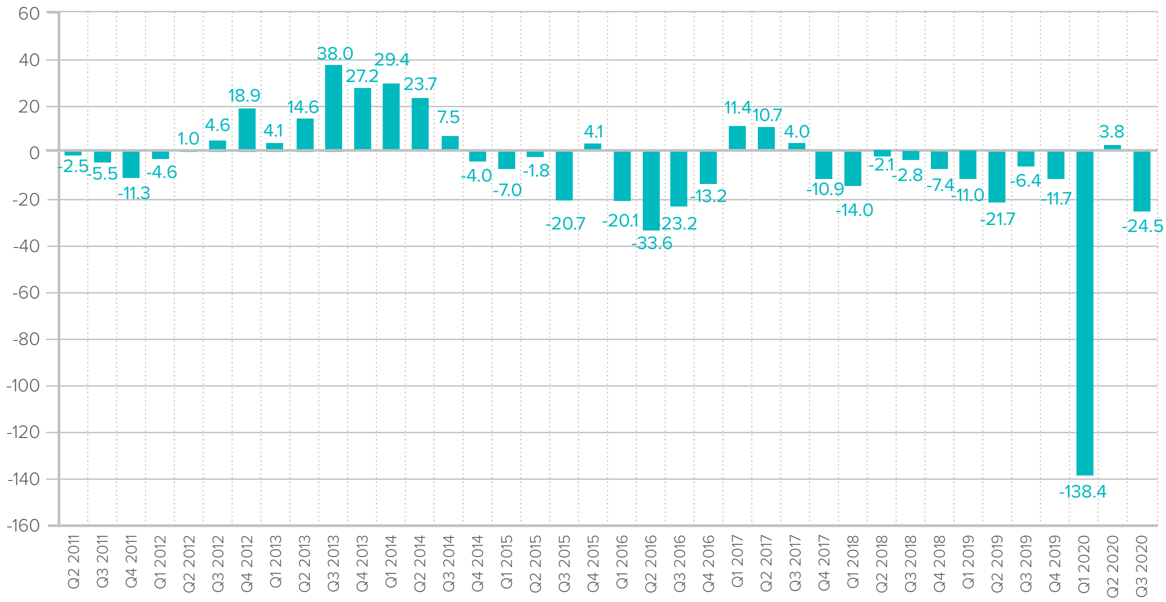
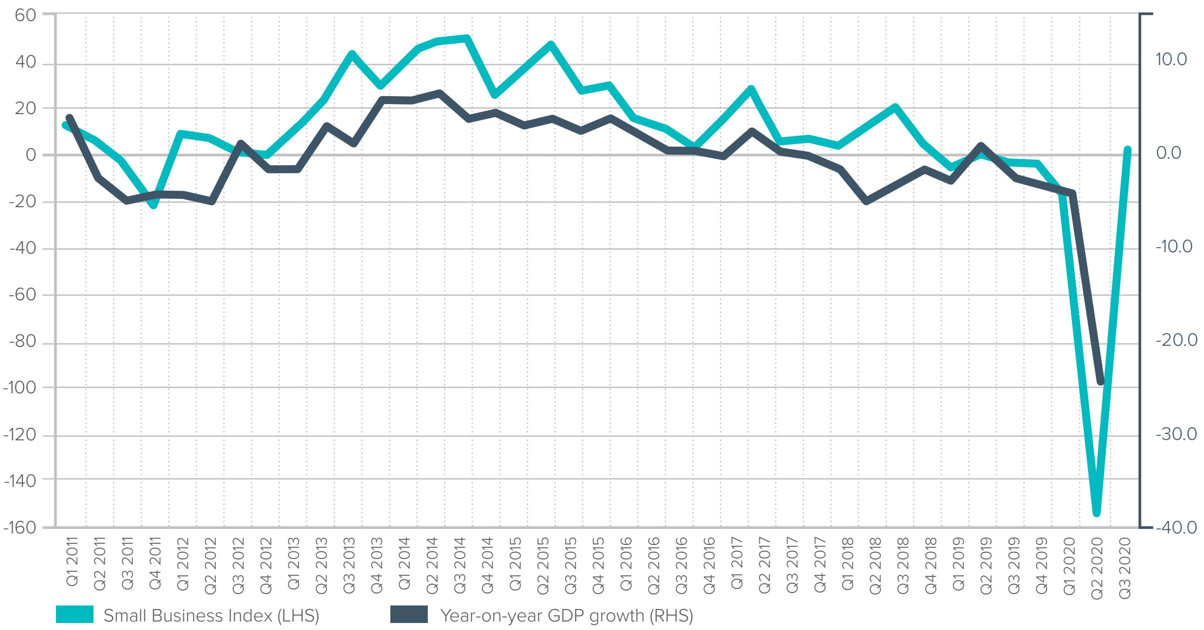


Figure four: UK SBI against year-on-year UK GDP growth.
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

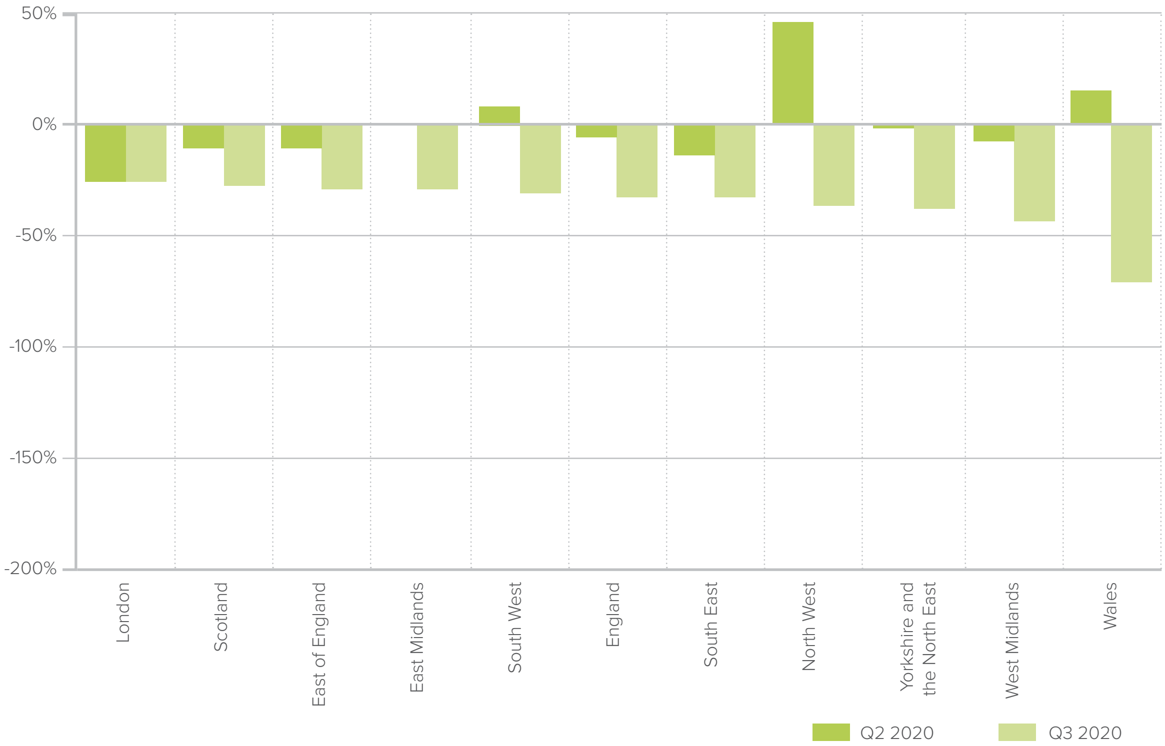
SMALL BUSINESS INDEX IN NEGATIVE TERRITORY ACROSS ALL REGIONS AND COUNTRIES

The Small Business Index returned to unanimous negativity in Q3, having witnessed a degree of regional variation in Q2. All of the UK's constituent regions and countries exhibited a fall in the Small Business Index between Q2 and Q3, with this being enough to take all measures into negative territory.

Though negative scores were witnessed across the board, some regions were noticeably less confident than others. For instance, Wales recorded by far the lowest score at -71.6. This comes as little surprise given that the country has ratcheted up its coronavirus strategy for certain regions since early September. Welsh business pessimism will be further tested by the 'firebreak' lockdown, recently imposed nationwide, which will see some of the strictest restrictions in the whole of the UK in place until at least 9 November. Wales' pessimism was followed by the West Midlands, Yorkshire and the North East, and the North West, receiving scores of -44.0, -37.2, and -37.0 respectively. Again, this negativity aligns with the recent picture in terms of coronavirus restrictions, with these regions being more heavily affected by localised measures over recent months. This has restricted household mixing and non-essential travel, while new measures have also prevented the opening of certain business establishments, such as pubs in bars in areas of England classified under Tier 3. Wales and the North West exhibited the largest quarter-on-quarter changes in the index, having both stood in positive territory in Q2.

While London was the least confident region in Q2 looking towards Q3, the tables have turned when considering the national picture looking ahead to Q4. Of the UK's constituent regions and nations, London exhibited the least negative reading on the latest round of the Small Business Index, with a score of -25.8, just below the Q2 reading of -25.6 Nevertheless, this is barely cause for celebration, instead reflecting the continued pessimism witnessed by small businesses in the capital since Q3 2018.

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



SMALL BUSINESS SECTOR INDICES

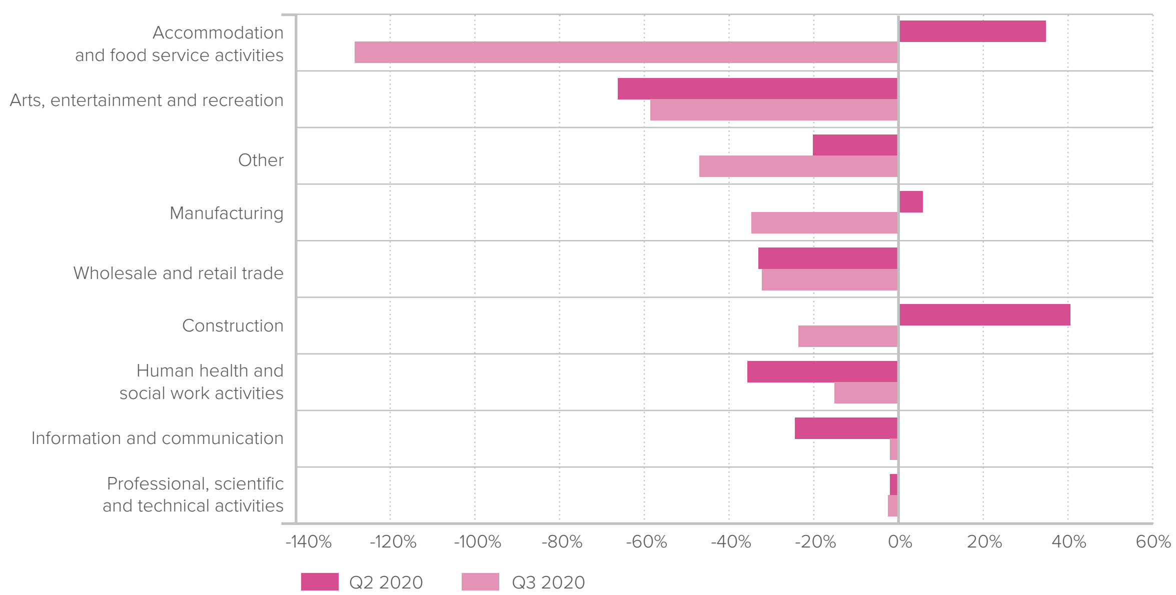
NEW RESTRICTION MEASURES SEVERELY IMPACT BUSINESSES IN CONSUMER-FACING SECTORS

The latest round of the index shows unanimous negativity on a sector-by-sector basis. Industries exhibited varying levels of pessimism, however, with readings ranging from borderline negativity of -1.5 to an overwhelmingly negative score of -126.8. Highlighting again the sectoral impact of the coronavirus crisis, there was also some considerable variation in the quarter-on-quarter changes in the index, with some sectors seeing modest improvement in Q3 compared to Q2 and others seeing further falls.

Professional, scientific & technical activities and information & communication were the least negative sectors in Q3, with index readings of -1.5 and -1.8 respectively. The fact that businesses in these sectors are considerably less pessimistic than their counterparts across the rest of the economy largely reflects their general adeptness and smooth transition to remote working. In the face of further restriction measures, businesses in these sectors look set for considerably less disruption to their operations than firms more reliant on a physical workspace or face-to-face interaction. Indeed, for businesses in the information & communication sector, the outlook has picked up considerably since Q2, reflecting the relative success of widespread homeworking in previous months. The sector's index reading rose by 21.4 points between Q2 and Q3, a larger increase than any other sector.

The outlook amongst businesses in the arts, entertainment & recreation and accommodation & food services sectors is considerably more negative, with these sectors exhibiting index readings of -58.0 and -126.8 respectively. These sectors have been amongst the hardest hit by coronavirus restriction measures, while a change in consumer behaviour has likely impacted such businesses' revenue streams due to cuts in discretionary, non-essential spending. The effect of restriction measures on these businesses shows little sign of respite, with new measures such as the 10pm curfew and bans on household mixing in certain regions having further hit the sector. This has served to reduce capacity levels and business profitability. The outlook for these sectors makes particularly grim reading from the perspective of jobs. 41.4% of businesses in the accommodation & food services sector stated that they foresaw redundancies in the coming three months, the highest proportion of any sector.

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



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FINANCIAL PERFORMANCE

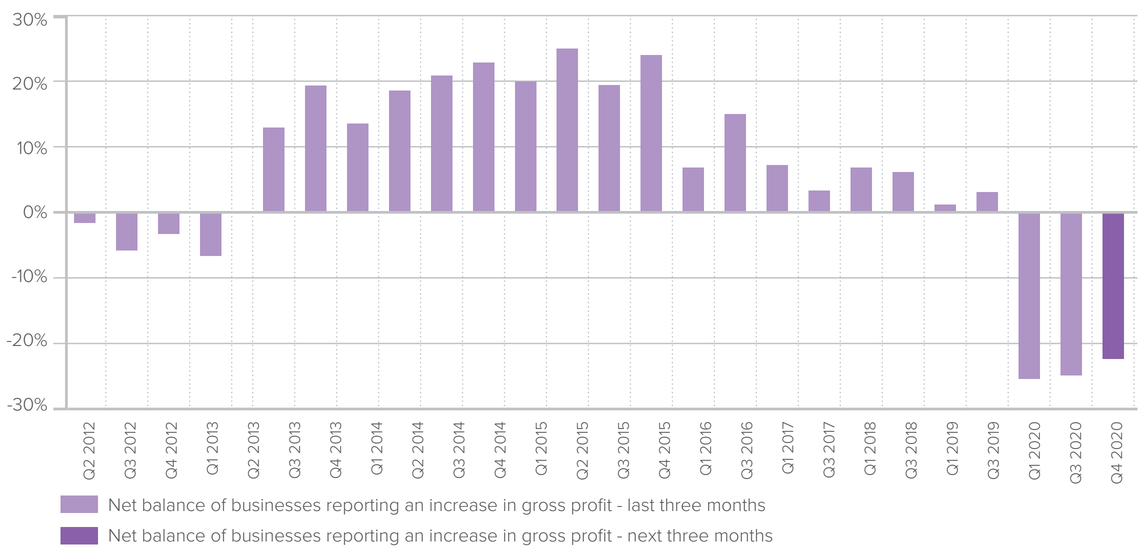
MORE THAN HALF OF SMALL BUSINESSES EXPECT DECLINING REVENUE LEVELS OVER COMING THREE MONTHS

The net balance of small businesses reporting revenue growth over the previous three months stood at -25.1% in the third quarter of 2020. Across the country, more than half (56.2%) of small businesses reported a fall in revenue levels during the quarter, with 39.8% reporting a significant fall of more than 10%. The net balance figure does represent a slight improvement of 0.9 percentage points compared to Q1 2020, the last time this question was posed to respondents, though it is still easily the second-worst reading on record.

A negative net balance was witnessed in all of the UK's constituent regions and countries, showing that falling revenues were experienced nationwide. There was some variation in performance, however. Somewhat contrary to London's SBI score – the least negative of all regions – businesses in the capital exhibited the most negative net balance in terms of Q3 revenue, reaching -36.2%. London businesses were also the most likely to report a decline in revenues, with 62.8% of businesses doing so. This figure was closely followed by the East Midlands, where 59.0% of businesses reported falling revenues in Q3. The region's score was likely impacted by the local lockdowns seen in Leicester for much of the summer, as well as more recently imposed restrictions on other areas in the region. In terms of sectoral performance, negative net balance scores were witnessed in all sectors of suitably large sample size. In line with the negativity witnessed amongst businesses in the arts, entertainment & recreation and accommodation & food services sectors on the main index, revenue levels in these sectors appear to have taken the largest proportional hit with 66.1% and 65.4% of businesses in these sectors respectively reporting falling revenues in Q3. Much greater resilience was shown by businesses in construction and wholesale & retail. Nevertheless, falling revenues were still reported by 43.5% and 50.7% of such businesses respectively.

Expectations of business revenues over the coming three months remain in net negative territory, though a net balance figure of -21.9% suggests a slightly less pessimistic outlook compared to firms' experiences in Q3. Nevertheless, just over half (50.1%) of firms expect some decrease in revenues over the next three months. In accordance with the above accounts of revenue generation in Q3, businesses in arts, entertainment & recreation and accommodation & food services are the most likely to expect further falls to revenue in Q4. In a stark illustration of the hardship set to hit firms in these sectors, the figures are of even greater magnitude than those exhibited in Q3, with 69.7% and 81.4% of such businesses expecting declining revenues in Q4.

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



EXPORTS

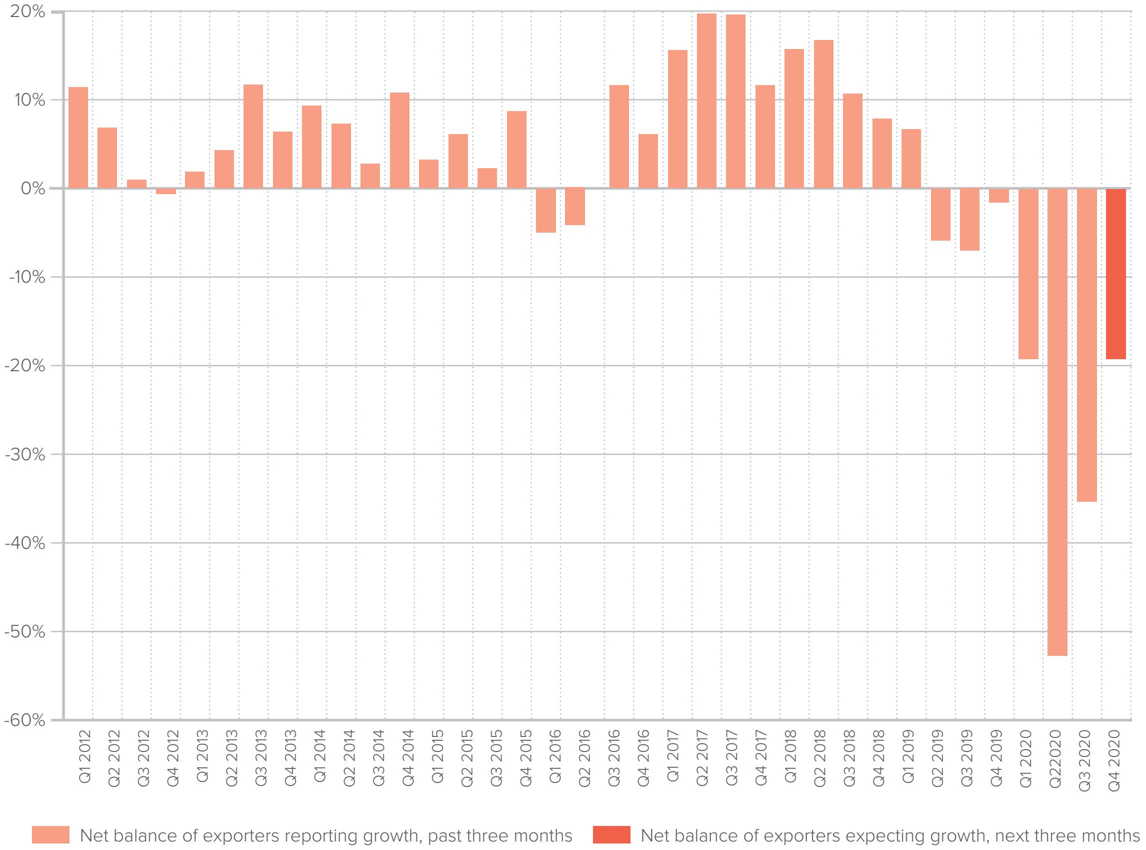
IMPROVED FOREIGN DEMAND CONDITIONS YIELD LESS NEGATIVE OUTLOOK FOR EXPORTING FIRMS

The proportion of small businesses reporting a decrease in the value of their exports fell back slightly in Q3 to 52.5%, having reached a record share of 65.3% in the previous quarter. Correspondingly, there was a slight uptick in the net balance figure compared to Q2, though this still remains overwhelmingly in negative territory at -35.2%.

The moderate improvement in performance amongst exporting business largely fits the pattern of increasing demand over the summer months. Following the reopening of businesses and the relaxation of social distancing rules, many economies were considerably more open in Q3 than in Q2, prompting an increase in activity amongst consumers and firms alike. This has been the case for most Eurozone economies as well as for the US. In terms of the recovery from the first wave of coronavirus cases, China has come the furthest among large international economies, adding substantially to international demand for exports. This has been to the benefit of UK businesses dependent on external markets, be that through the export of final consumer goods or that of intermediate goods for further use in international supply chains.

Looking ahead to Q4, exporting businesses expect further improvement, with the net balance of firms expecting an increase in the value of their exports compared to those expecting a decrease standing at -18.9%. This would represent a further improvement on the performance witnessed in Q3, though once more would be insufficient for a return to positive territory.

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



COSTS AND INFLATION

RETURN TO INCREASING OPERATING COSTS OBSERVED IN Q3

The net balance of small businesses reporting an increase in operating costs turned positive again in Q3, having fallen into negative territory for the first time on record in Q2. As such, more businesses saw costs increase than decrease during the quarter. The net balance figure stood at 12.2%, representing a 19.3 percentage point increase compared to that recorded in Q2. While the proportion of businesses reporting an increase in their costs rose by 9.2 percentage points over the quarter to reach 39.6%, it remained well below historic averages. Conversely, the proportion of businesses reporting a decrease in their costs remained at historically elevated levels at 27.3%, down from 37.5% in the previous quarter.

The most commonly cited source of changing costs for firms in Q3 was that of labour costs, with this being reported by 31.4% of respondents. This likely reflects short-term changes to employment patterns that took place over the quarter. In line with an improvement in wider demand conditions, many employers brought workers back from furlough in Q3 and, as such, would have witnessed quarter-on-quarter increases in their wage bills. This change can be evidenced by the fall in the number of furloughed workers, with data from the ONS suggesting that half of workers on furlough in May had returned to work by mid-August. Further evidence stems from the month-on-month increases in average weekly earnings that took place in July and August, amounting to 1.6% and 2.4% respectively, according to the ONS.

Inputs represent a further commonly cited source of changing costs, being selected by 25.2% of respondents. Again, this likely stems from wider demand conditions, with the uptick in economic activity encouraging greater production levels for small businesses. In order to meet such demand, we would expect variable costs to have risen in line with output. This will have resulted in higher costs in pound terms than those witnessed in the preceding months, when activity was significantly more curtailed.

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

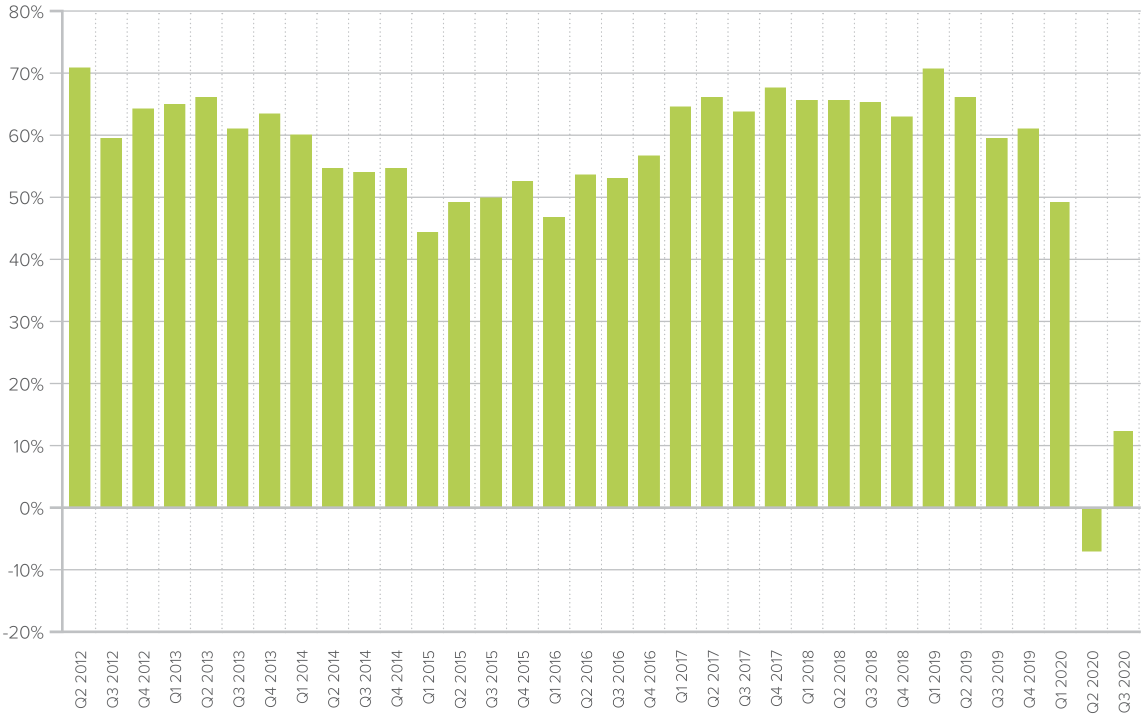
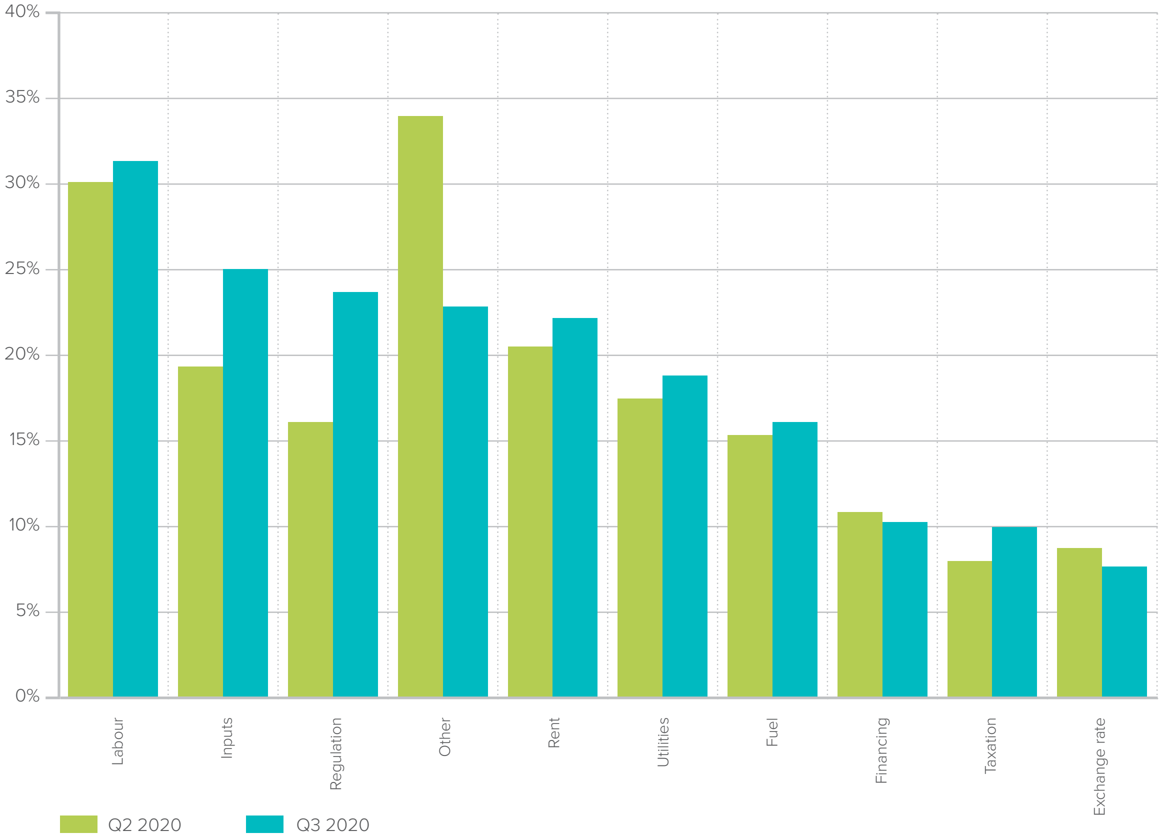


Figure 10: Main causes for changing business costs (firms may give multiple answers).
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



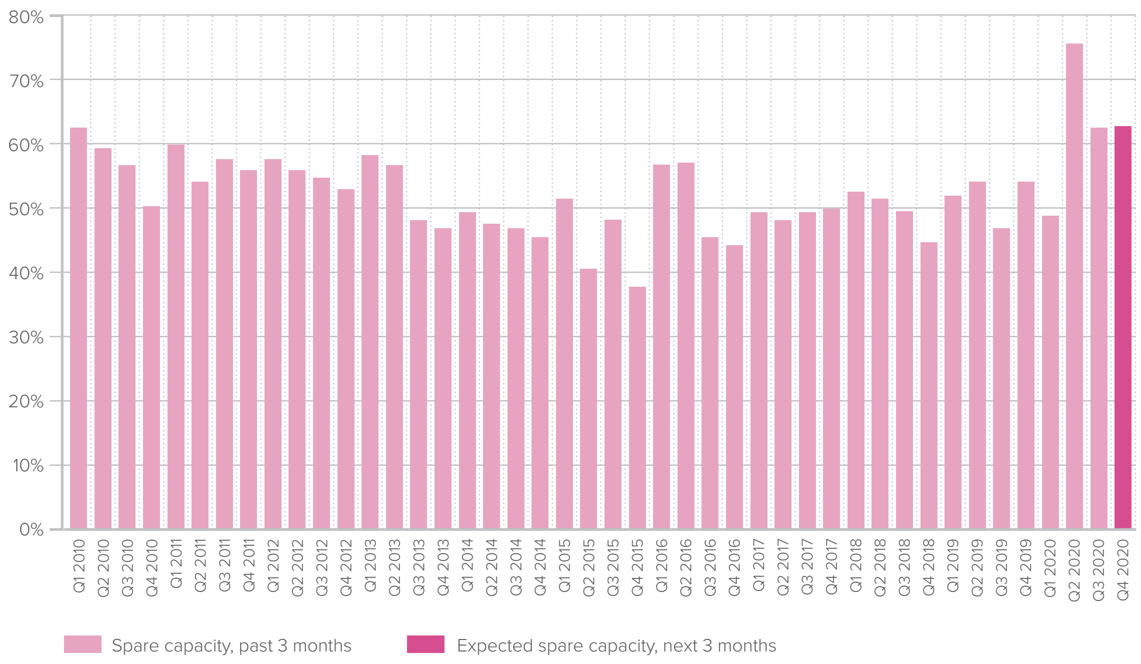
CAPACITY

OVERWHELMING MAJORITY OF BUSINESSES OPERATED BELOW CAPACITY IN Q3

The proportion of small businesses reporting that they were operating below capacity stood at 71.5% in Q3. This marks a slight fall compared to the figure witnessed in Q2, though the share remains considerably elevated compared to historic levels. Those in the accommodation & food services and arts, entertainment & recreation sectors were amongst those most likely to be operating below capacity, as would be expected given the challenges faced by businesses in the sectors. 78.3% and 86.4% of such businesses, respectively, reported running below capacity in Q3. Meanwhile, businesses in London and Yorkshire and the Humber were the most likely to be operating below capacity, with this being reported by 77.4% of businesses in each of these areas.

Looking forward to Q4, small businesses don’t expect a substantial improvement in their workload. 69.4% of firms anticipate spare capacity in Q4, with this being a slightly greater figure than the 68.1% of firms that expected spare capacity in Q3 when asked in Q2. This provides further evidence that firms are less optimistic heading into the fourth quarter than the third, potentially driven by the announcement of forced business closures in Tier 3 lockdown areas, as well as other restrictions affecting consumer demand across the country. Similarly, the proportion of firms anticipating being above capacity in Q4 (5.1%) has witnessed a slight fall compared to the corresponding figure for Q3 (5.2%). The same can be said for the proportion of firms expecting to operate at capacity, with this falling from 26.7% to 25.6%. The net balance score for firms expecting to operate below capacity in the fourth quarter therefore stands at 64.3%, just above the 64.1% score recorded in the third quarter.

Figure 11: Net percentage balance of businesses running below capacity: proportion below capacity less proportion above capacity.
Source: FSB - Verve ‘Voice of Small Business’ Panel Survey.



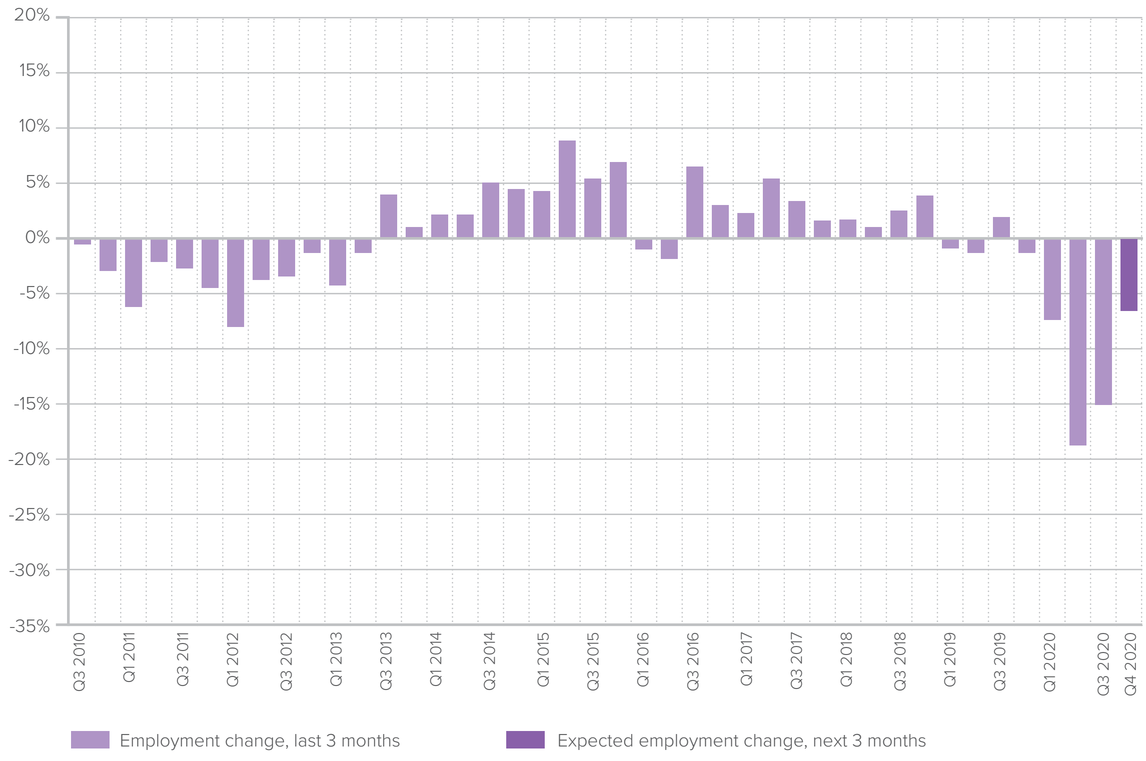
EMPLOYMENT

SMALL BUSINESSES FORCED TO LAY OFF MORE EMPLOYEES IN Q3

The rate at which small businesses cut their workforce increased even further in Q3, with nearly a quarter (24.7%) of firms reporting a decrease in the number of workers employed. This follows the 22.8% of firms reporting cuts to their workforce size in Q2. Nevertheless, there was also an increase in the proportion of firms reporting an increase in the size of their workforce, rising from just 3.8% in Q2 to 9.5% in Q3. As such, the net balance figure increased slightly in the third quarter, reaching -15.2% up from -19.0% in Q2. On a regional basis, cuts to workforces were most prevalent in London and Yorkshire and the Humber, with 29.8% and 28.0% of businesses reporting a decline in employees, respectively. Meanwhile, the region with the highest rate of job growth was the South West, with 15.7% of respondents reporting an increase to the size of their workforce. Over the summer, the region benefitted from an increase in 'staycations' giving at least temporary employment to people in the hospitality sector.

The fast rate of cuts to workforces reported by small businesses corroborates with official data on the labour market. Recent figures have pointed to approximately 693,000 lost payrolls between March and September, while the number of redundancies in the three months to July saw their highest annual and quarterly increases since 2009. Unfortunately, there is cause for further pessimism in the coming months, with the termination of the furlough scheme likely to lead to additional redundancies and increased unemployment, in spite of the outlining of new support programmes to replace the scheme. Looking ahead to Q4, businesses in the accommodation & food services sector were the most likely to expect job losses, with 34.3% anticipating cuts to their workforce. This reflects the wider pessimism associated with businesses in the sector, while also reflecting the fact that the sector has been amongst the most dependent on the furlough scheme. 593,000 workers in accommodation & food services were still on furlough at the end of August, for instance, a higher figure than any other sector.

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.

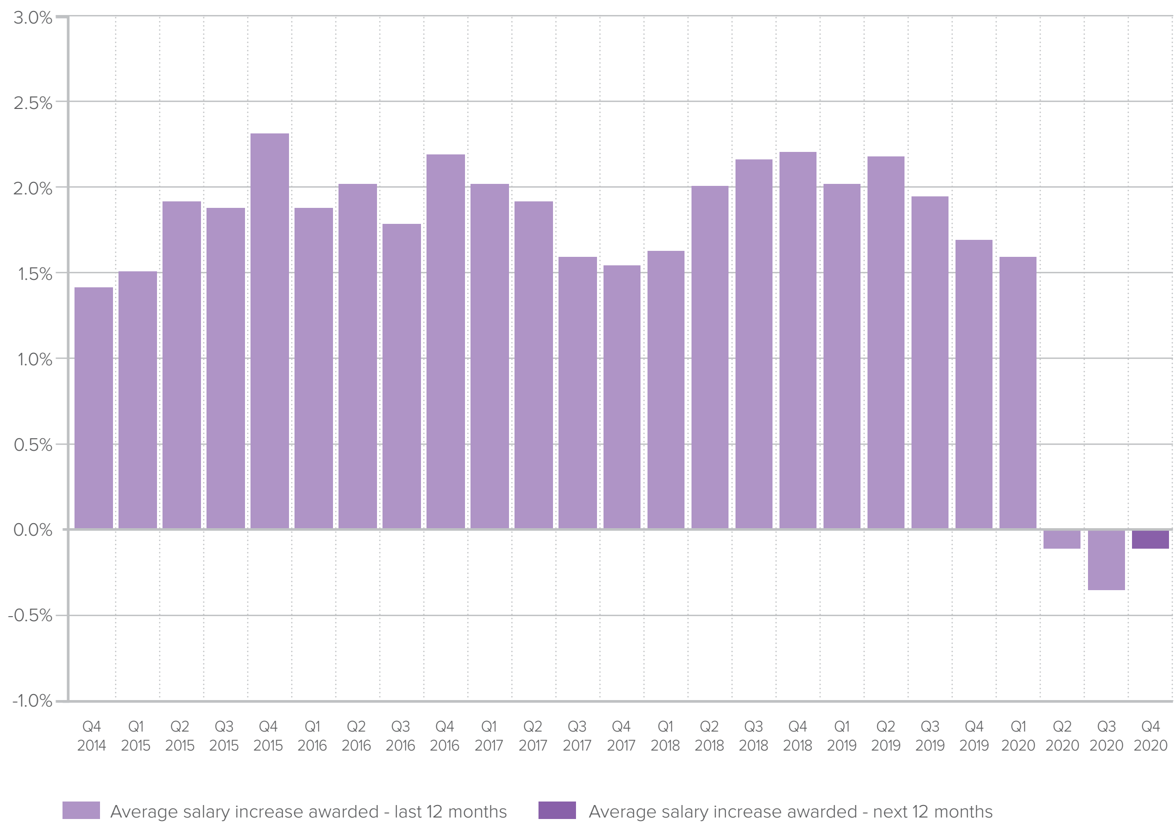


AVERAGE SALARIES OFFERED BY SMALL BUSINESSES WITNESS SECOND CONSECUTIVE ANNUAL FALL

The average salary change awarded by small businesses exhibited a further annual fall in Q3, having also done so in Q2. The magnitude of the fall increased in Q3, however, with wages contracting at a rate of 0.4%. This follows a fall of 0.1% in Q2. The wage constraint shown by small businesses stands somewhat in contrast to the more volatile economy-wide wage growth figures released by the ONS. Labour market data show a much steeper annual decline of 2.4% amongst private sector employees in Q2, before slowing to a 1.1% annual decline in July, and returning to annual growth in August. By keeping wages in check, UK SMEs might try to preserve cash flow in order to prevent an even larger number of layoffs.

On a regional basis, falling wages have been most likely amongst employees in London and Wales. Here, businesses reported annual falls in the average salary awarded in 23.1% and 19.7% of cases, respectively. Wage cuts were much less prevalent in the North West and in the combined region of Yorkshire and the North East, with reductions in average salary being reported by 11.8% and 10.5% of firms.

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



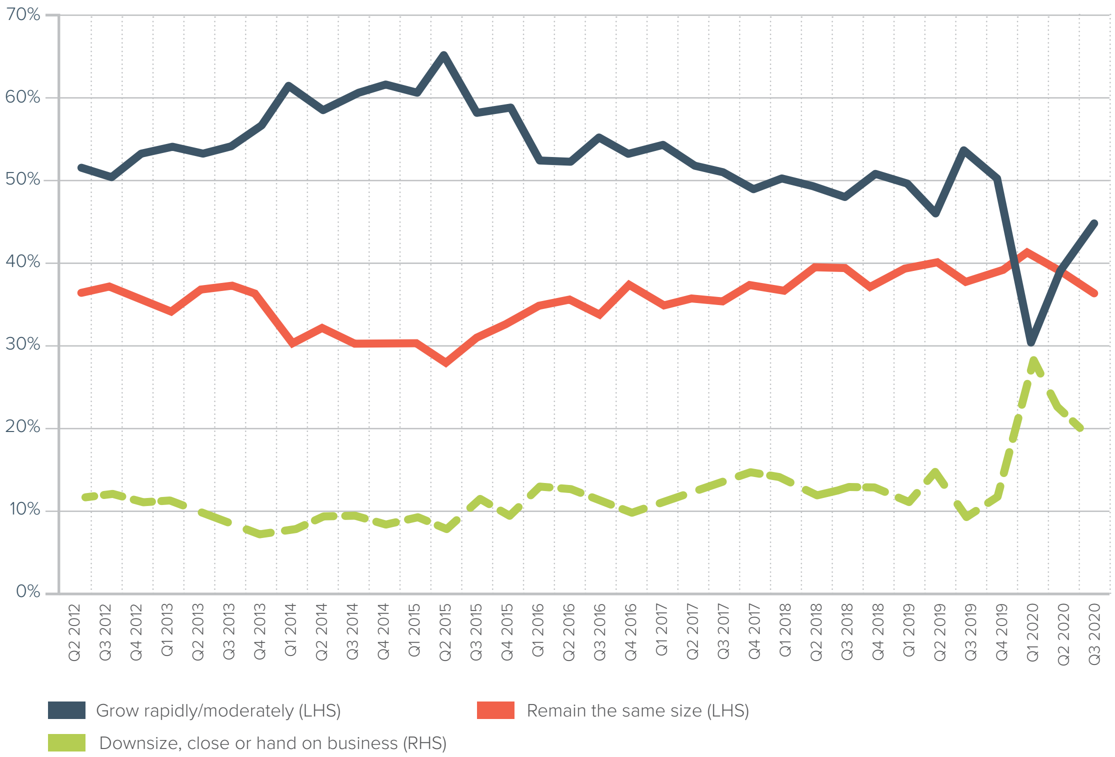
GROWTH ASPIRATIONS AND CHALLENGES

GROWTH ASPIRATIONS PICK UP, WITH PLANS TO DOWNSIZE ALSO SUBSIDING

The proportion of small businesses that aspire to grow over the course of the next 12 months picked up further in Q3, rising by 5.7 percentage points to reach 44.5%, the highest value since Q4 2019. As such, the increase has taken the proportion of small businesses expecting growth back into the realm of pre-crisis levels. The proportion of businesses expecting a contraction over the coming months complemented this encouraging picture, falling back for a second consecutive quarter to stand at 19.2%. The figure remains elevated compared to the levels witnessed prior to the pandemic. It is also noteworthy that the share of businesses which plan to remain about the same size has fallen to its lowest share since Q3 2017, suggesting that SMEs have embraced the challenges to their current business models.

On a sector-by-sector basis, firms in information & communication, as well as those in professional, scientific, & technical activities, are the most likely to report an intention to grow at 50.1% and 48.5%, respectively. This was also the case in Q2. This provides a further illustration of the relative successes of the sectors amidst the transition to mass remote working. Such businesses have been less impacted than those in other sectors in recent months and, as such, now have a greater propensity and ability to scale up their operations.

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



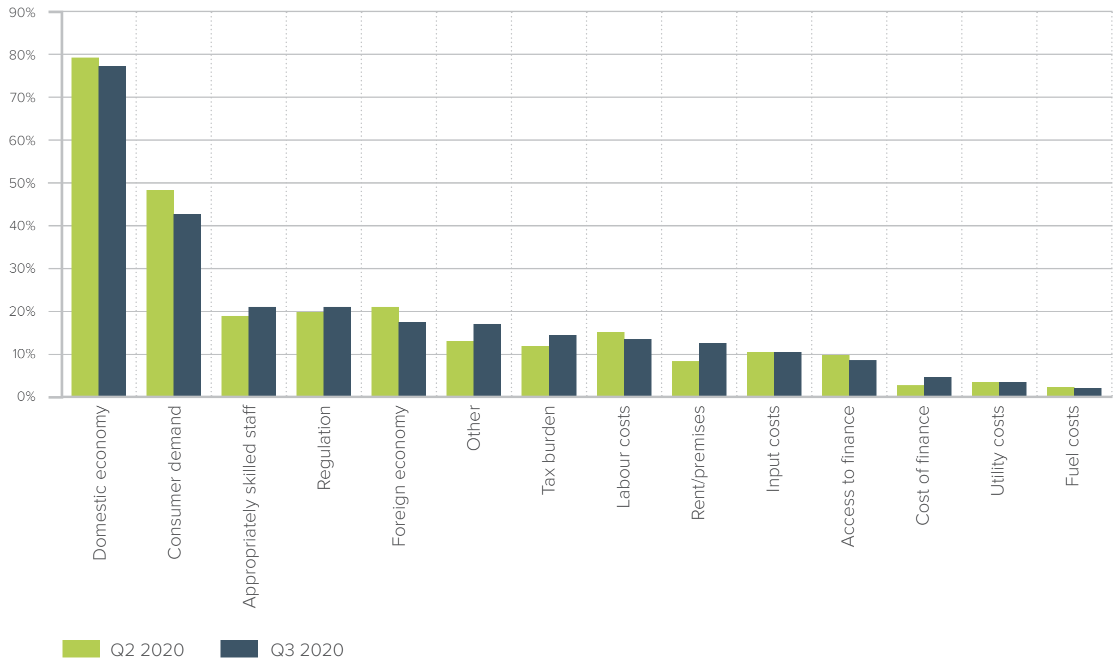
SUBDUED DEMAND WEIGHS HEAVILY ON FIRMS' GROWTH ASPIRATIONS, WITH FURTHER CONCERNS FROM THE LABOUR MARKET

Given the uncertainty and prolonged periods of curtailed activity since the onset of the crisis, it is no surprise that firms cite the domestic economy as the most likely barrier to their growth over the next 12 months, with this being reported by 76.8% of small businesses.

Consumer demand remains another major barrier for small businesses, being cited by 42.3% of respondents. Though confidence did pick up over the summer months, the outlook remains fragile. Consumer demand is likely to face some further turbulence in the coming months, through weakening labour market conditions and further implementation of restriction measures.

The labour market itself also presents a concern for firms. The end of the furlough scheme is set to bring a spike in redundancies, with firms having to cut costs in light of weak demand conditions. This has left small businesses with tough decisions over keeping workers, with 28.5% anticipating redundancies in Q4. As a result, many firms have expressed concerns over having appropriately skilled staff, with just over a fifth (21.1%) expecting this to be a barrier to their growth over the coming year.

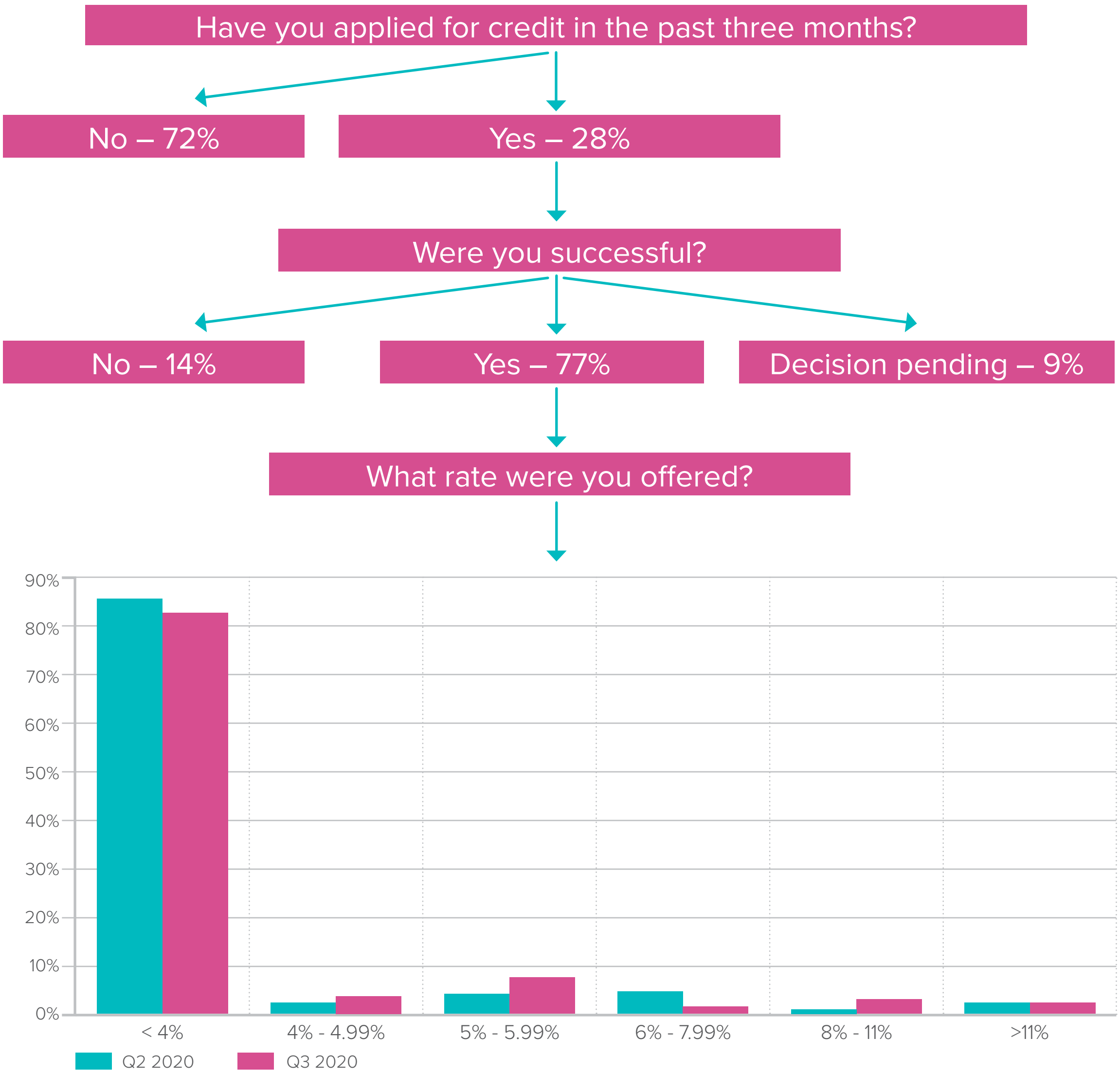
Figure 15: Potential barriers to achieving growth aspirations – multiple answers possible.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CREDIT

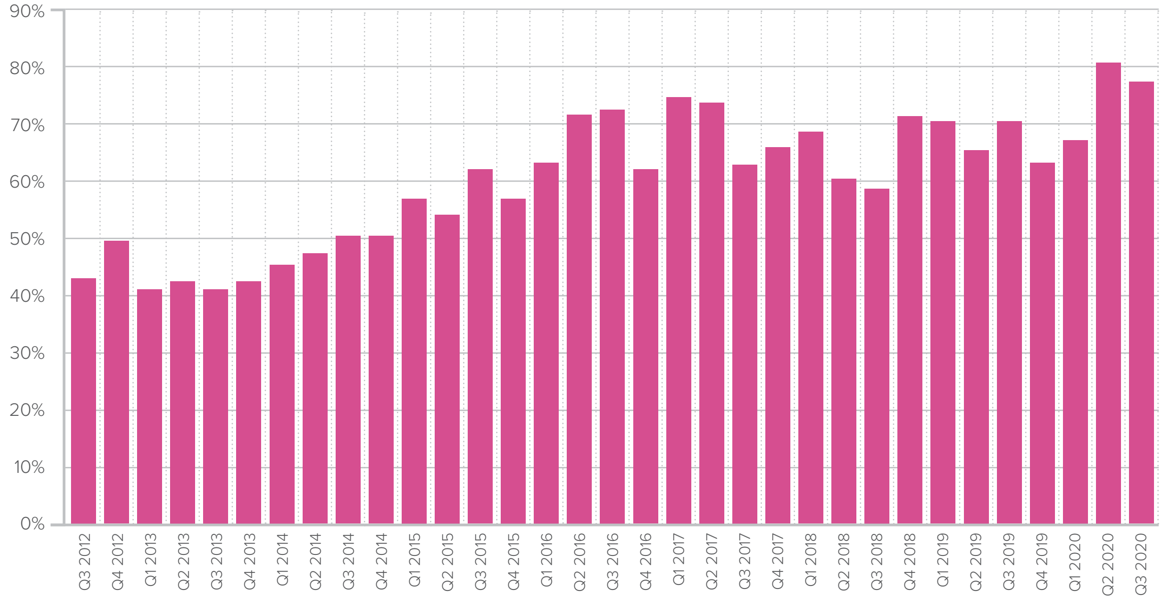
GOVERNMENT INTERVENTION CONTINUES TO SUPPORT BUSINESS CREDIT APPLICATIONS

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.



The rate of credit requests fell back slightly in Q3, with the proportion of businesses applying for credit reaching 28.4%, down from 33.9% in Q2. This figure remains considerably above historic averages, however, suggesting that firms continue to seek debt-financed support for cash flows in the face of wider uncertainty. The proportion of credit applications that were successful also fell back slightly, though the vast majority (77.0%) of applicants were able to access credit. Access to credit has been facilitated by government intervention over the past few months, via such channels as the Bounce Back Loans Scheme which has provided 12-month, interest-free loans of up £50,000 to small businesses. The latest data from the Treasury show that loans worth £40.2 billion have been provided via the facility, supporting over 1.3 million businesses.

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.

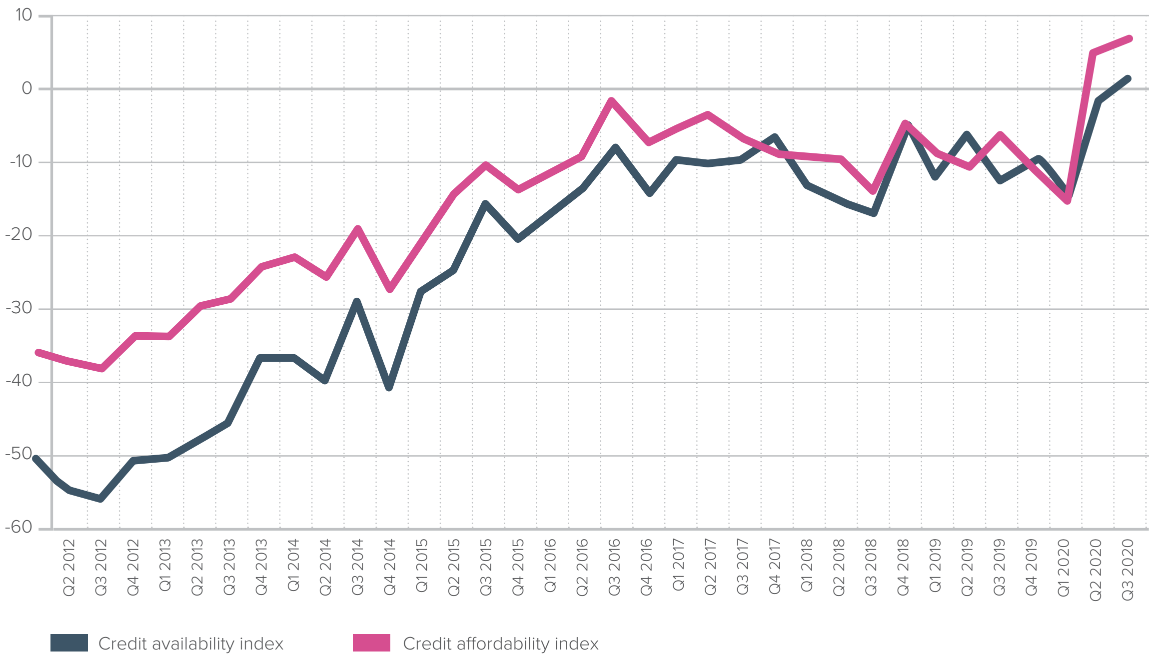


CREDIT AVAILABILITY AND AFFORDABILITY INDICES BOTH IN POSITIVE TERRITORY FOR THE FIRST TIME

Both the credit availability and credit affordability indices increased in Q3 compared to Q2. The credit availability index picked up by 3.0 points to reach 1.3, entering positive territory for the first time. Meanwhile, the credit affordability index picked up by 1.6 points, reaching an all-time high of 6.6.

The Bank of England base rate has remained at its historic low of 0.1% throughout the crisis so far. This has helped to lower commercial interest rates, providing a more favourable market for borrowers in addition to the government-backed credit lines for businesses affected by the crisis.

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



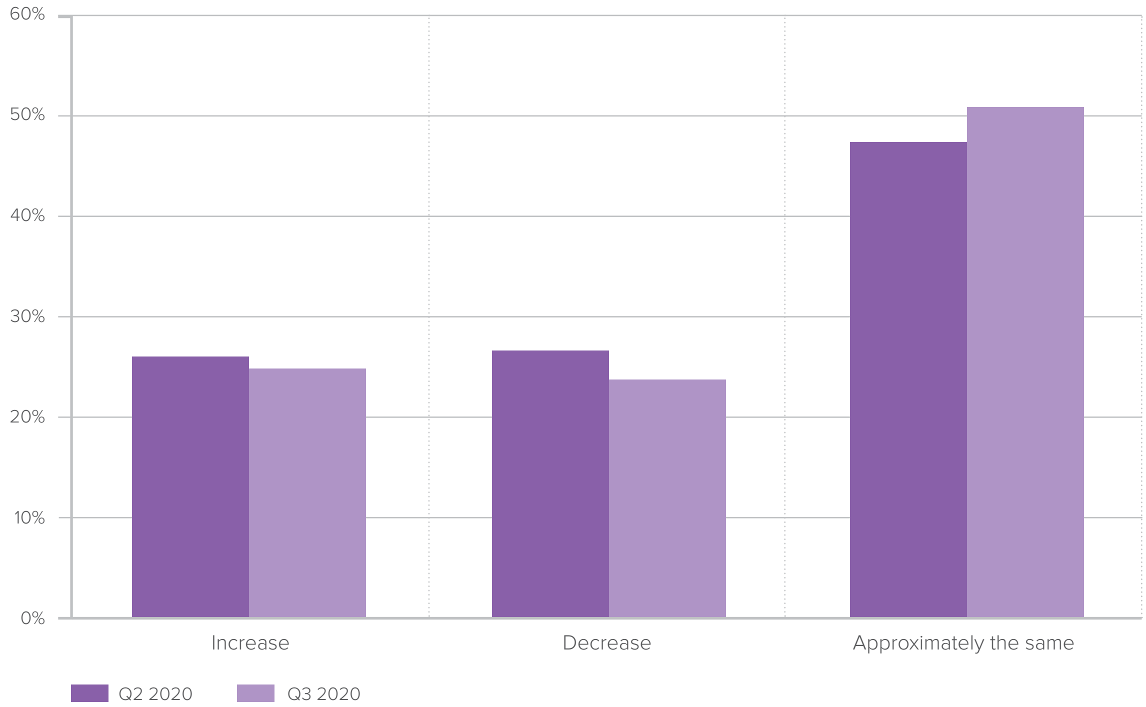
INVESTMENT AND PRODUCTIVITY

MORE FIRMS EXPECT INCREASED INVESTMENT THAN DECREASED INVESTMENT

Looking ahead to Q4, small businesses have displayed less of a willingness to increase investment than was the case when looking ahead to Q3. The proportion of businesses stating that they would increase capital investment fell slightly to reach 24.9% having previously stood at 26.0%. There was also a fall in the proportion of firms stating that they would decrease the scale of their investment, with the proportion of firms responding as such falling to 24.2%, having previously stood at 26.7%. The net effect of this is that, for the first time this year, a slightly greater proportion of firms expect to increase investment over the coming quarter than the proportion expecting a decrease. Meanwhile, there was an increase in the share of firms expecting their investment level to remain approximately the same, with this proportion increasing from 47.3% to 50.9%.

Manufacturing represents the sector with the largest proportion of firms anticipating an increase in their capital investment over the coming quarter, with 32.3% of firms expecting to do so. This is closely followed by the information & communication sector, with a corresponding figure of 27.3%. This largely reflects the relative successes of the two sectors in recent months, allowing for greater scope to apportion finances for the purposes of investment. At the other end of the scale, the sector least anticipating an increase in capital investment is that of arts, entertainment & recreation. Just 11.5% of firms in the sector expect an increase in capital expenditure over the coming quarter, with more than three-and-a-half times that anticipating a scaling back of investment.

Figure 19: Percentage of small businesses expecting to increase and decrease capital investment over next quarter, compared with previous quarter.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



METHODOLOGY

These tables are based on the Q3 2020 research survey of 1,564 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 25 September and 1 October.

SUMMARY DATA TABLE

	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Small Business Index	-9.9	-5.0	-8.8	-8.1	-21.6	-143.4	-5.0	-32.6
Employment - previous three months	3.9%	-1.0%	-1.5%	1.9%	-1.5%	-7.5%	-19.0%	-15.2%
Employment - coming three months	5.1%	7.0%	10.2%	5.1%	3.5%	-28.0%	-7.9%	-6.7%
Exports - previous three months	7.6%	6.8%	-5.8%	-7.1%	-1.6%	-19.2%	-52.8%	-35.2%
Exports - coming three months	0.2%	-1.6%	11.4%	-4.1%	-9.5%	-52.5%	-12.8%	-18.9%
Credit availability - rated good or very good	30.2%	28.5%	28.9%	25.7%	27.5%	24.4%	38.4%	36.4%
Credit availability - rated poor or very poor	34.4%	39.0%	33.7%	39.4%	34.7%	41.6%	34.9%	30.9%
Credit affordability - rated good or very good	32.2%	27.9%	27.3%	28.1%	28.1%	25.7%	41.8%	43.0%
Credit affordability - rated poor or very poor	36.1%	37.9%	43.2%	33.8%	39.9%	44.0%	31.9%	28.3%

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

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

Responses are also weighted according to regional gross value added.

Q3

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