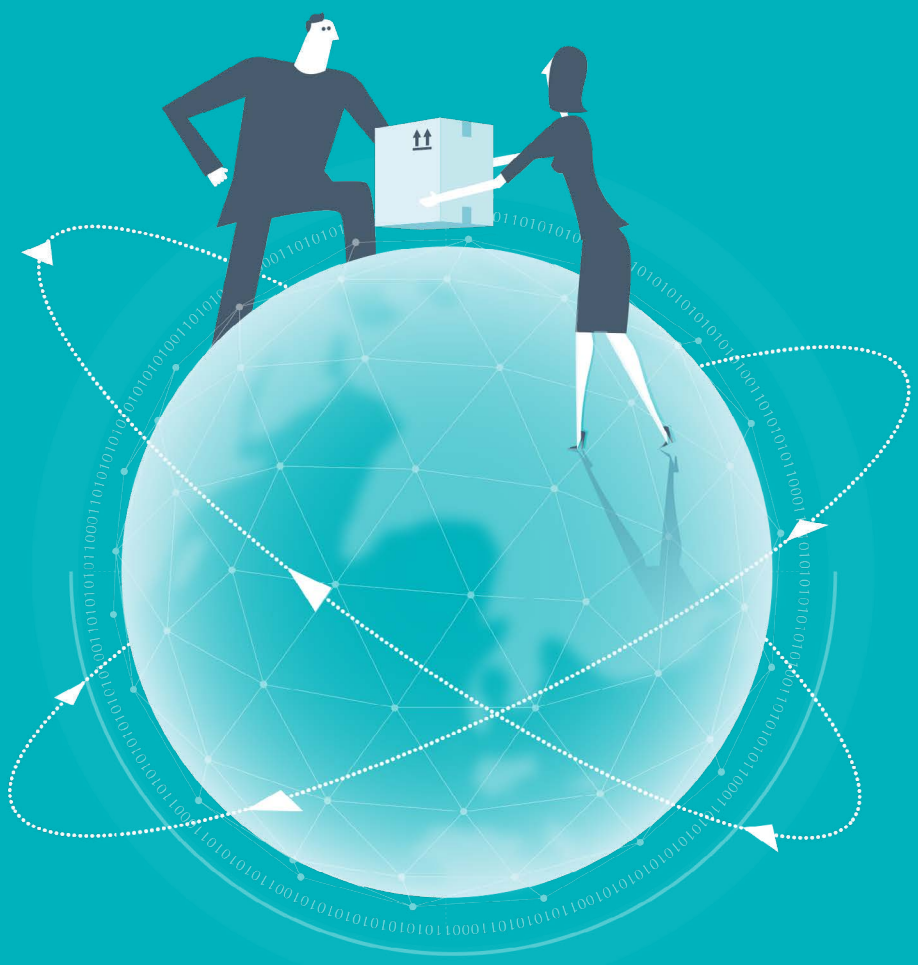
KEEP TRADE EASY

WHAT SMALL FIRMS WANT FROM BREXIT



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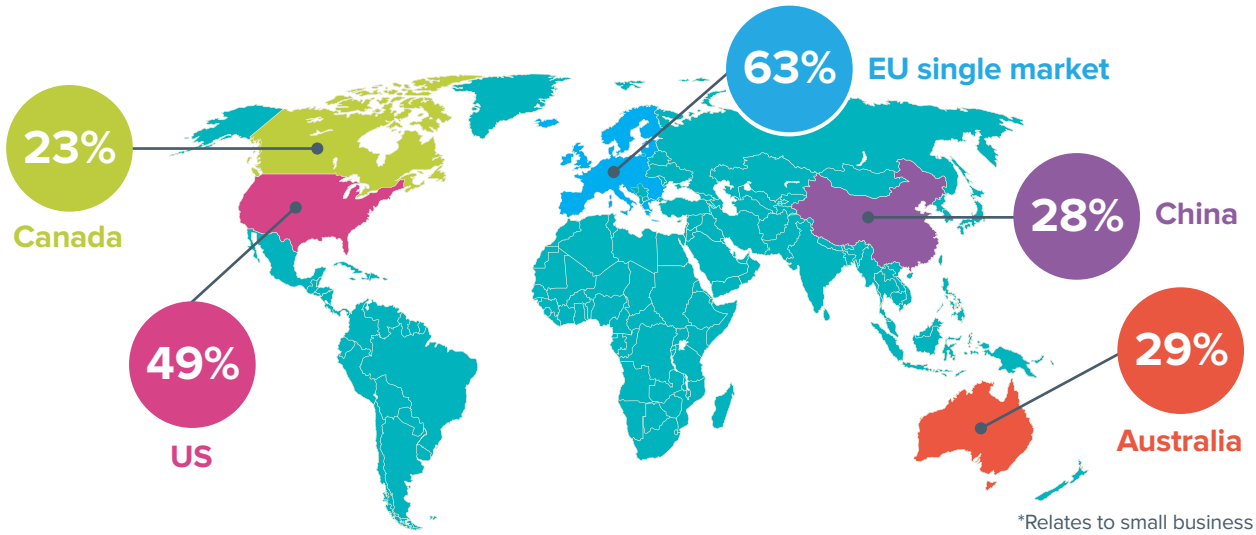
KEEP TRADE EASY

WHAT SMALL FIRMS WANT FROM BREXIT

Top five priority markets small firms want UK trade deals with post Brexit*



*Relates to small business exporters

Majority of **exporting small firms** trade with both the **EU** and **non-EU**

72% export to **both**
21% export **just to EU**
6% export **just to non-EU**

Is it **easier to trade** with the **EU single market** than non-EU markets?

58% of small firms find it **easier**

6% of small firms find it **harder**

Average turnover of small firms that export

to **China £1,512,908**
to **North America £901,500**
to the **EU £893,203**

Impact of Brexit

Impact on trade

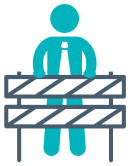
29% expect to **export less**
v
20% expect to **export more**

31% expect to **import less**
v
7% expect to **import more**

1 in 5 small firms with an **EU supply chain** will consider **moving more or all** of their supply chain to the EU

Trade barriers impact how small businesses trade overseas*

More than half say **non-tariff barriers** play a role in **where they trade**



More than 1 in 4 say **any tariff** would **deter them from trading** with the EU in the future

*Relates to small business exporters and importers

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FOREWORD

Growing small business exports has long been an FSB priority – exporting is linked to faster growth and innovation. Government also recognises these benefits and has been working to significantly increase both the value and volume of UK exports. To realise this ambition, the focus must be on supporting small businesses to trade internationally.

With the UK leaving the EU, it is imperative that small businesses are supported in order to both capitalise on the trade opportunities that will emerge and mitigate the risks from leaving the EU single market and full EU customs union.

Our previous research – 'Destination Export: the small business export landscape' – demonstrates the as yet untapped potential of small firms to contribute to the UK's economy through overseas trade. One in five (21%) small businesses currently export, and our research shows that with the right support there is potential to double this figure.[1] Our research also revealed that around 16 per cent of small businesses – of which, only around two-fifths (38%) are actually exporters – are part of supply chains where the end product is exported.[2]

A successful Brexit will rest on policymakers ensuring that the potential from small businesses is not lost in the uncertainty of future trade arrangements with the EU and other countries. This is why FSB is calling for a comprehensive free trade agreement (FTA) to be secured with the EU – one that provides the easiest and least costly access to the EU single market – alongside new FTAs with priority markets identified by small firms.

Crucially, we also recognise that many of the opportunities to emerge from Brexit will come from new and enhanced trade relations with countries outside the EU. The majority (78%) of small businesses exporting already do so with non-EU markets.

We are keen to understand how the UK can better exploit the ease of trade with big markets in the Anglosphere and the Commonwealth – where the UK shares similarities around language, culture and history. However, increasing trade with any market, let alone new non-EU markets, will be challenging for many small firms, particularly emerging markets.

Small firms that currently trade exclusively within the EU single market, or where proximity of trade is paramount, will also require bespoke support.

Disruption is never easy for small businesses; however, change also brings opportunities. With the right support, small firms will no doubt rise to the challenge. This is why FSB has undertaken such extensive research with our members to ask what small firms want from Brexit.

We are delighted to be able to contribute to this important agenda and look forward to representing the small business view in future discussions, with Government and industry, to secure the best deal possible for small businesses in a post-Brexit landscape.

Martin McTague
FSB Policy Director

1 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

2 Ibid

EXECUTIVE SUMMARY

Strengthening the UK's global trade has never been more important than it is now. Leaving the EU has expedited the long standing drive, from Government and industry, to grow UK exports. Furthermore, the Prime Minister's confirmation that the UK will also leave the EU single market and full EU customs union[3] has initiated a fundamental shift in the UK's relationship with major international trade partners.

For small businesses, the opportunities and risks of Brexit are complex. However, before small firms can be supported to better understand what Brexit might mean for their business, and prepare accordingly, the Government and wider industry must understand the possible impact of Brexit on small firms.

FSB's previous research, including its report 'Destination Export: the small business export landscape', demonstrates the role exporting small firms play in the UK's economic growth and a thriving enterprise culture, working across every sector and region. The report also revealed the potential to double the contribution of exporting small firms given the right support and opportunities.[4]

In respect of this, how small businesses are likely to react to the changes that result from the UK leaving the EU single market – currently the biggest market for small business exporters and importers – is of critical importance to the success of the UK economy post-Brexit. This will inform both the trade negotiations between the UK and EU (as well as other FTAs beyond the EU) and the type of support that small firms will need in the medium to longer term in order to capitalise on the new opportunities to emerge from Brexit.

This report is structured to reflect the journey FSB has taken to understand the impact of Brexit on small businesses:

1. The first section – **Current state of international trade** – provides an overview of the fundamental features that characterise the small business international trade landscape.
2. The second section – **Opportunities and risks in a post-Brexit trade landscape** – explores the possible impact that Brexit may have on small business trade, in terms of both opportunities and risks.
3. The third section – **Priority markets for a global UK** – looks at the future trade landscape and identifies the priority markets with which small businesses want the UK to secure trade agreements.
4. The fourth section – **Recommendations** – presents a set of recommendations to support small firms to flourish post-Brexit.

The UK leaving the EU single market and the full EU customs union will affect various groups of small firms: most obviously those trading internationally as an exporter and/or importer but, perhaps less obviously, those that may be affected via their reliance on global supply chains. Importantly, Brexit will not just affect international trade as it currently stands, it will affect the future trade landscape. This means the views of small firms that do not currently trade overseas, but would consider doing so in the future, also need to be factored in.

The different groups of small firms – not necessarily exclusive from each other – that feature in this report are:

- Current Exporters (small firms that currently export).
- Current Importers (small firms that currently import).
- Potential Exporters (small firms that do not currently export, but would consider doing so).
- Potential Importers (small firms that do not currently import, but would consider doing so).
- Non-considerers (small firms that do not currently export or import and would not consider doing so).
- Small firms that have some relationship with global supply chains – either their business is part of another company's global supply chain or they operate their own global supply chain.

3 When the UK leaves the full EU customs union, it will have the ability to agree FTAs with third countries. Currently, as a member of the customs union, it cannot do this. Full membership of the EU Customs Union requires members to comply with the common commercial policy and implement the common external tariff on all goods imported from outside of the EU. The common commercial policy is an area of exclusive EU competence. The UK Government has expressed interest to seek a new customs arrangement with the EU, which allows goods to be traded freely with no tariffs.

4 FSB's report - Destination Export: The Small Business Export Landscape, July 2016 – revealed that 21 per cent of small firms are currently exporting and that another 21 per cent of small businesses do not currently export, but would consider doing so in the future.

This report presents the findings from extensive research undertaken with small firms – via a nationwide survey and a series of focus groups – on their experiences and views on future trade with the EU and non-EU markets.[5]

KEY FINDINGS:

Current state of international trade

- **The EU is the largest trading partner for small firms**. Nine out of 10 exporting small businesses trade with the EU (92% of exporters and 85% of importers). One in five (21%) exporting small firms trade exclusively within the EU single market. However, the majority also trade outside the EU (78% of exporters and 67% of importers), which means that most small firms trading overseas do so both with the EU and non-EU markets (72% of exporters and 53% of importers).
- **Based on ease, cost and value (in terms of growth) of trade, small firms are significantly more likely to favour the EU single market over non-EU markets**. However, ease of trade is felt to be the biggest difference between trading with the EU and non-EU markets.
- **The top non-EU countries with which small firms currently trade, and want prioritised in the future for FTAs, share similar characteristics with the UK**. Alongside the UK and Ireland, the US, Canada, Australia and New Zealand are collectively referred to as the Anglosphere, sharing the same national language and similar culture, history and politics. Three-quarters (77%) of exporting small firms trade with these countries, with the US ahead of the pack because of its large market size.
- **There is a growing attraction towards certain emerging markets as top trade destinations**. On average, one in five (19%) exporting small firms trade with at least one of the top four emerging markets: the United Arab Emirates (UAE), South Africa, China or India. However, China and India are the most prominent, featuring in the top 10 priority markets across both small firms that currently trade overseas and those considering doing so in the future.
- **Small firms that trade with emerging markets are more likely to have higher turnovers than those that trade with more mature or established export markets**. Those that export to China have an average turnover of £1,512,908. While the average exporting small firm's turnover is £892,732 and they are most likely to trade within the EU single market or with North America. Small firms that trade with emerging markets are also likely to be more dependent on exporting (as part of their turnover) than those that trade with mature markets.

Opportunities and risks in a post-Brexit trade landscape

- **Exporting small firms are split between those expecting very little or no change (42%) to their levels of trade and those expecting material change (49%)**. Of the small business exporters that expect change, a greater proportion expect to export less overall than more (29% compared to 20%).
- **The majority (55%) of small business importers expect very little or no change to their levels of trade**. Those that do expect material change are four times more likely to expect to trade less overall than more (31% compared to 7%).
- **Of those that export to both the EU and non-EU markets, the majority expect very little or no change to levels of trade with either the former (50%) or latter (60%)**. Of those that expect material change, while a greater proportion expect to export less than more to the EU (32% compared to 10%), this is roughly balanced by those that expect to export more than less to non-EU markets (26% compared to 8%).
- **Tariffs play a role for around half (47%) of where small business exporters trade – one in three (29%) state tariffs play a moderate or big role.** By contrast, 42 per cent state that tariffs play no role.

5 See Methodology for more detail.

- **However, potential exporters and importers anticipate tariffs will play a more significant role in where they export** – 76 per cent of Potential Exporters expect tariffs to play a role, and more than half (56%) expect it will play a moderate or big role. Only 12 per cent anticipate it will play no role.
- **One in three (34%) small business exporters say they would be deterred from trading with the EU if a tariff rate between two and four per cent (the range within which the EU's average applied tariff, under WTO rules, tends to have fallen over the past few years) is introduced**. However, the most vulnerable are the 21 per cent who trade exclusively within the EU – these firms are half again more likely to say any tariff rate (i.e. anything above 0%) would deter them compared to those that export to both the EU and non-EU markets (39% compared to 26%).
- **Non-tariff barriers and tariffs are of equal importance to small businesses**. More than half of small firms state that non-tariff barriers play a role in where they export (53%) or import (59%). The biggest concern is increased administrative burdens, such as those associated with complying with rules of origin (ROO), which would pose a real challenge and cost to small businesses trading.
- **One in five (20%) small firms that operate their own global supply chains, which move through the EU single market, will consider relocating more or all of their supply chain to the EU**. This is double the proportion (9%) that will consider relocating more or all of their supply chain to the UK.
- **The overriding reason that triggers or is likely to trigger exporting for the first time is ease of trade both in terms of reacting to direct demand or exploiting easy markets**. This is true for current international traders as well as potential international traders.
- **Current exporters were twice as likely to have exported for the very first time to the EU as to a non-EU market** (68% compared to 32% respectively).
- **Potential exporters are also more likely to consider exporting for the first time to the EU single market compared to non-EU markets**. However, the gap between the EU and non-EU markets is narrower (77% compared to 54% respectively).

Priority markets for a global UK

- **The US and Germany are seen as priority markets with which the UK should prioritise trade deals, (based on small firms that currently trade or are considering doing so)**. Around half of both Current Exporters and Current Importers selected the US and/or Germany as a priority market (49% of exporters and 45% of importers chose the US, and 47% of both exporters and importers chose Germany). As it will not be possible to negotiate a trade agreement solely with Germany, separate from the EU, the UK will need to prioritise securing a trade deal with the EU.
- **China and India are making strong headway as priority markets**. Both countries feature in the top 10 priority markets for small firms. Around one-quarter of current exporters (28%) and current importers (27%) prioritise China, and one in five Current Exporters (20%) and Current Importers (18%) prioritise India.

RECOMMENDATIONS:

1. Secure the easiest and least costly access to the EU single market

The UK Government's plan for negotiating a new trade agreement with the EU must be underpinned, first and foremost, by the aim to ensure as free and easy access to the Single Market as possible. This means the trade agreement must be comprehensive in securing barrier-free access, covering both goods and services, across all sectors. While small firms can be agile in the face of change, the magnitude of the changes which will result from the UK leaving the EU single market means that it is essential to avoid a cliff-edge and provide sufficient time to enable small businesses to adapt to the new trading landscape. Therefore, FSB also calls for a sensible transitional/implementation period to be put in place as part of the negotiation plan for the UK to leave the EU.

2. Identify and protect vulnerable small firms by sector and trade experience

A significant proportion of small businesses trade exclusively within the EU single market – one in five (21%) Current Exporters and one in three (37%) Current Importers. It is likely that these small businesses will find adapting to exporting or importing from outside the EU single market particularly difficult. Small firms with perishable products will also find trading with markets further away more challenging. The more severely a subset of small firms is likely to be affected by Brexit – the so-called 'cliff-edge' – the more time should be allocated to support them through this change, be this via a longer implementation process or a specific transitional arrangement.

3. Prioritise easy non-EU markets for first-time and occasional traders

In addition to the EU, the UK should prioritise securing FTAs with the US, Australia and Canada. Designing support – specific to country, region or sector – and a strong narrative around the ease of trading with these markets, should create an attractive and accessible proposition for small businesses considering exporting beyond the EU. This is likely to be particularly effective with first-time exporters or importers.

4. Prioritise emerging markets for more ambitious and growth-orientated small firms

The UK should prioritise securing FTAs with China and India, as well as other prominent emerging markets, such as South Africa and the UAE. Bespoke export support and messaging around these priority markets should focus on small businesses that are more ambitious and geared for growth. To make real inroads with emerging markets, small firms would require more support from intermediaries, such as translators, agents and distributors.

5. Introduce export vouchers to incentivise and accelerate small business exports

Export vouchers will enable small firms to access the support that would be most beneficial to them. For example, using the vouchers for translation services, agents or small business trade missions. The latter would be particularly useful as the cost of attending trade missions is prohibitive for most small firms. The UK can learn from previous and existing voucher initiatives to develop a scheme fit to meet the ambitious demands of a post-Brexit export environment.

6. Explore export tax credits to incentivise strategic exporting

A large proportion of small business exporters trade on a reactive or ad hoc basis. Government should explore the benefits and different tax credit models (subject to any state aid constraints) which could incentivise small firms to export more strategically. For small businesses, this would be a timely incentive that could help cut through the uncertainty of Brexit and reflect the serious ambition of the UK to support small business exporters.

7. Spotlight on Brexit's hidden impact on importers and small firms in global supply chains

The impact of Brexit on overseas trade – both positive and negative – is not isolated to exports. Small business importers and those that operate or are part of global supply chains will be equally affected. Both groups require dedicated support to mitigate the risks and disruption caused by Brexit, and to ensure that they can prosper in the post-Brexit landscape.

8. Champion small business brands – in sectors and industries where the UK has a competitive advantage – to target markets abroad

Efforts to increase awareness of exporting among UK small firms must be matched by efforts to raise awareness of the UK as a desirable destination to source products. Growing the profile of UK small business brands, from sectors where the UK has a strong competitive advantage, will drive demand directly to small firms and trigger many to start exporting, capitalising on the reactive behaviour of small business exporters.

9. Include a small business chapter in all FTAs

The inclusion of a small business chapter must form a key objective in any FTA that the UK negotiates. The UK Government should further consult small business representative bodies, such as FSB, to develop a robust position on what a UK small business chapter should look like. This consultation should be undertaken through a formal mechanism of which small businesses and their representatives form an integral part and which allows for genuine co-design. A possible model might be comprised of an official working group that feeds into Government discussions on what a small business chapter should cover. This working group should be facilitated by senior government officials who specialise in small business trade policy matters and are dedicated to ensuring small firms are supported in realising their exporting and wider trade ambitions.

CURRENT STATE OF INTERNATIONAL TRADE

Trade status – where small firms export and import

The UK's export performance has been fairly static over the past few years.[6] In terms of small business exports, FSB research shows that, consistently, around one in five small firms export.[7] Widening this out to include importers, around one in three small businesses either export and/or import.[8] It is worth noting that the majority of exporters – around two-thirds (69%) are also importers.[9]

Furthermore, a significant proportion of small businesses contribute to UK exports by being part of supply chains where the end product is exported. Previous FSB research revealed that around 16 per cent of small businesses are part of such supply chains – of which, only around two-fifths (38%) are actual exporters.[10]

There is also a high level of consistency regarding where small businesses trade overseas – at least in terms of the most common export destinations. The profile of these markets and the attraction for small business exporters was explored in a previous FSB report – 'Destination Export: the small business export landscape' – the findings from which are built upon in this report.

Note on markets

For the purposes of this report, the term 'market' or 'markets' is used in its loosest sense. The term can refer to an individual country or a geographic region and, also, to groups of countries which are not necessarily defined by geography: the use of EU single market[11] is self-explanatory and, in turn non-EU markets; the rest of the non-geographic-based markets – the Anglosphere[12], BRICS[13] and Commonwealth[14] – have frequently featured in the public discourse around Brexit as the types of markets the UK should prioritise after it leaves the EU single market. Therefore, the significance of these markets will be explored within the relevant sections in this report.[15]

6 EY, Improving UK Export Performance, November 2015, available at: http://www.ey.com/uk/en/issues/business-environment/financial-markets-and-economy/improving-uk-export-performance

7 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

8 FSB report, Small Business Index Survey, Q4 2015, available at: http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q4-2016---jan-11-2017.pdf?sfvrsn=1

9 FSB survey on Future of Trade with the EU and Non-EU 2016.

10 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

11 While the EU single market is not technically the same as Europe (as a geographic region), it does include the vast majority of territories considered to be in Europe – the difference in the findings between the EU single market and Europe (when treated as separate trade markets) is marginal. For the purposes of this report, therefore, the EU single market also represents Europe in a practical sense.

12 The term Anglosphere is not a legal definition and can, therefore, have various meanings. In its broadest sense, it is commonly used to describe a group of countries that were formally part of the British Empire and where English is an official language. For example, using a broad definition, the Anglosphere may include all the Commonwealth countries. However, for the purposes of this report, the term Anglosphere is used in its most restricted sense and defined as: a set of nations where English is the official and majority spoken language, with similar cultural roots, based upon populations that originated from the British Isles which today maintain close political and military cooperation. The only countries that are, therefore, included within this term (and referred to as being part of the Anglosphere in this report) are: the United Kingdom, Ireland, the United States, Canada, Australia and New Zealand.

13 BRICS is the acronym for Brazil, Russia, India, China, and South Africa. The acronym BRIC was coined by economist Jim O'Neill, in 2001, in Goldman Sachs Global Economics Paper, "The World Needs Better Economic BRICs", which posited that the economies of Brazil, Russia, India and China would individually and collectively be amongst the world's largest economies in the next 50 years or so. BRIC was expanded into BRICS with the inclusion of South Africa at the BRIC Foreign Ministers' meeting in New York in September 2010.

14 An international association of 52 member states that were mostly former territories of the British Empire.

15 While within certain countries there are sub-national regions which are recognised to be particularly attractive as trade destinations for small firms, this level of country break down will not be covered in this report.

Figure one: Export markets of Current Exporters
Source: FSB future trade with the EU and non-EU markets survey

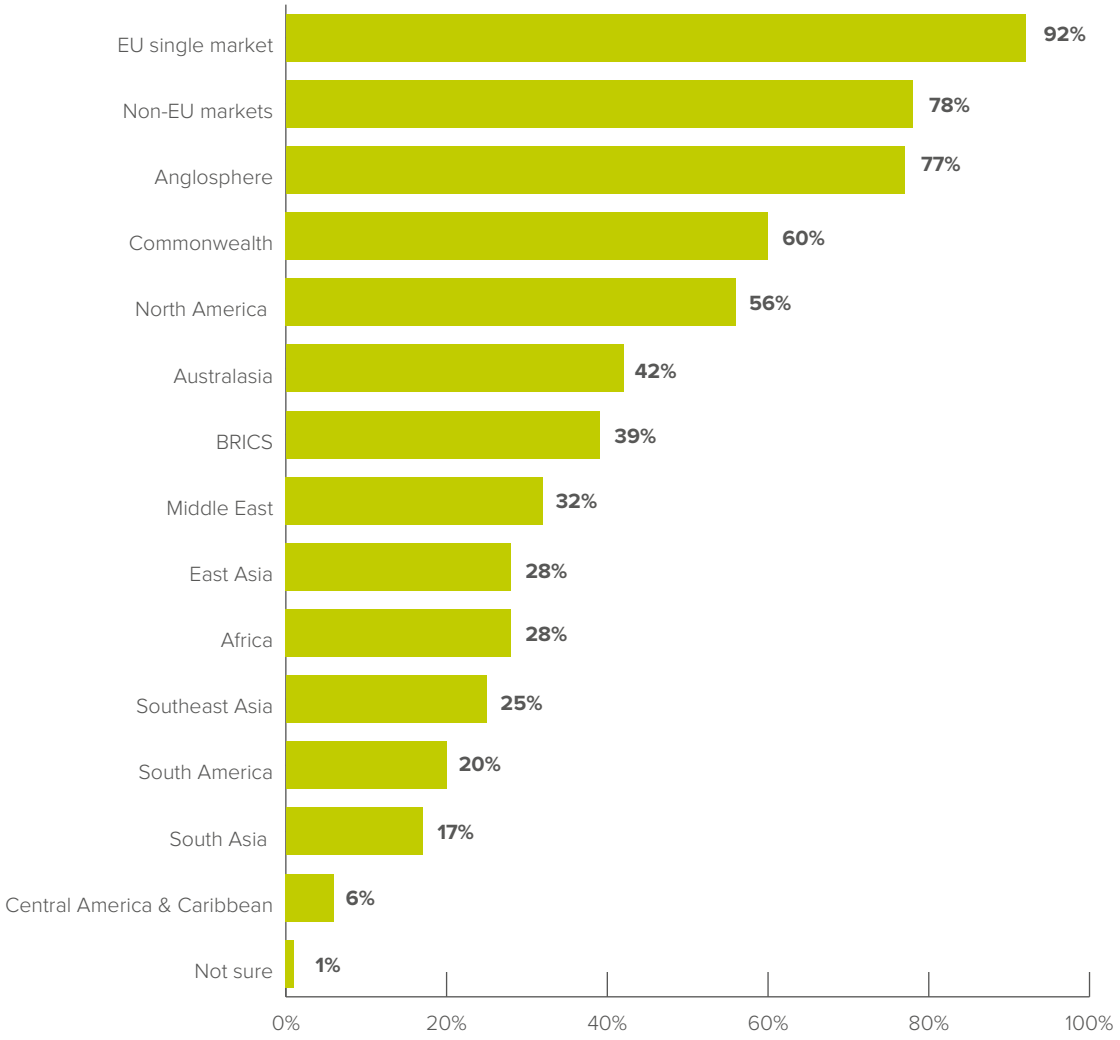
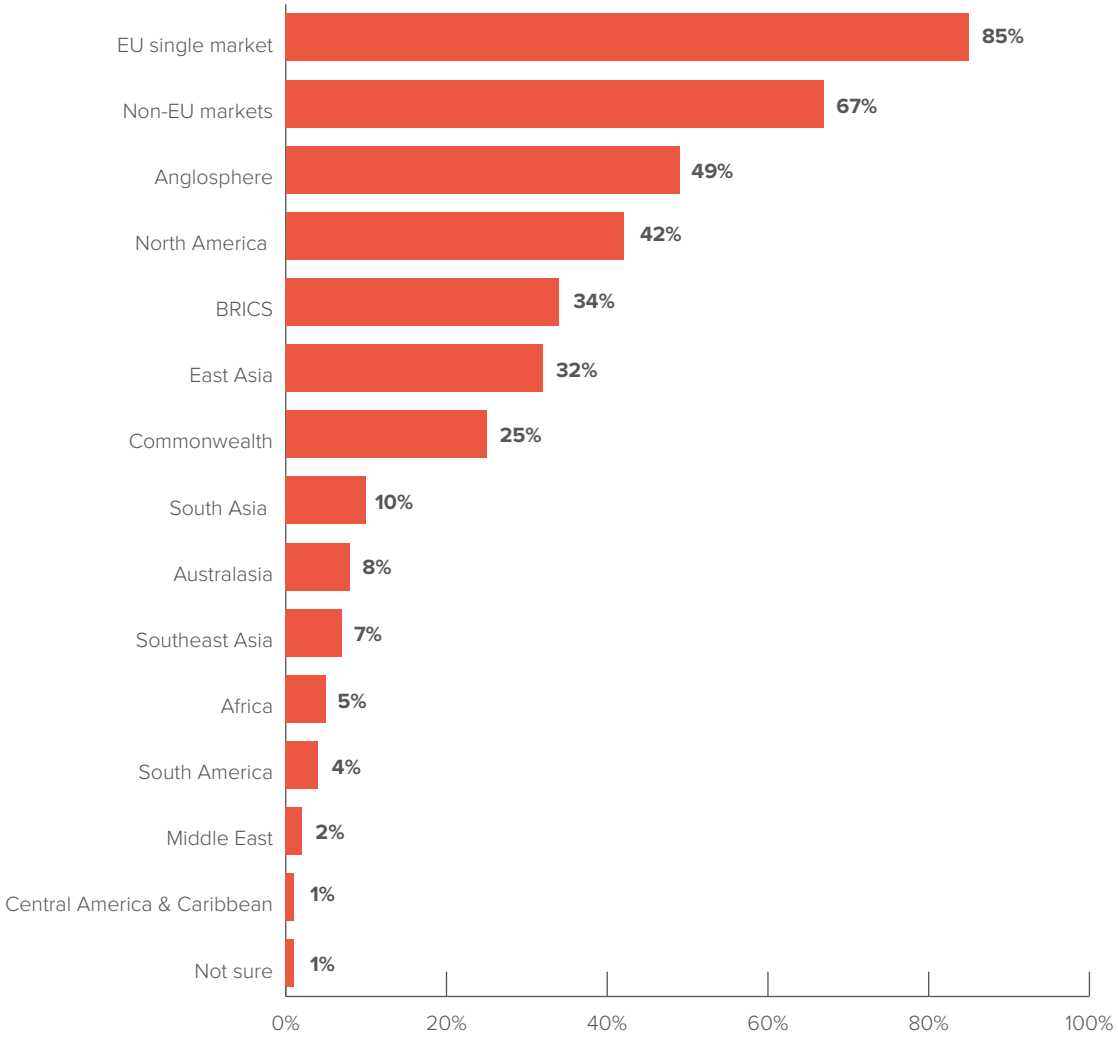


Figure two: Import markets of Current Importers
Source: FSB future trade with the EU and non-EU markets survey



The EU single market is the largest overseas market for small businesses trading internationally. Around nine out of 10 Current Exporters (92%) and Current Importers (85%) trade within the EU single market. A smaller proportion trade with countries outside the EU market (non-EU markets); however, this is still a majority of Current Exporters (78%) and Current Importers (67%). How these two trading groups – EU single market and non-EU markets – overlap is shown in Figures three and four.

Figure three: Overlap of small businesses exporting to EU single market and non-EU markets
Source: FSB future trade with the EU and non-EU markets survey

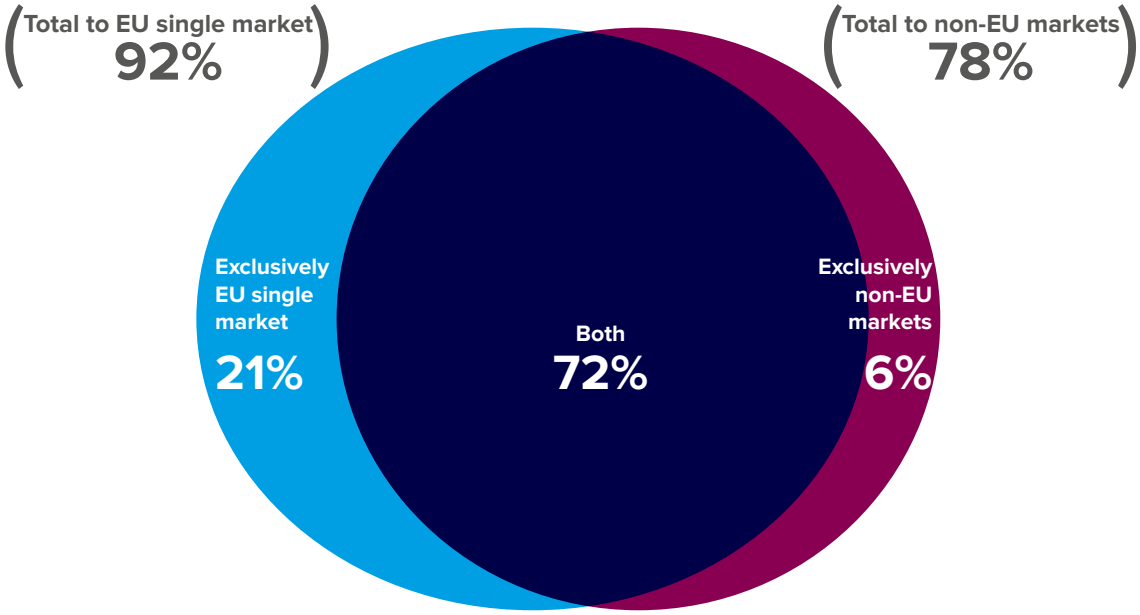
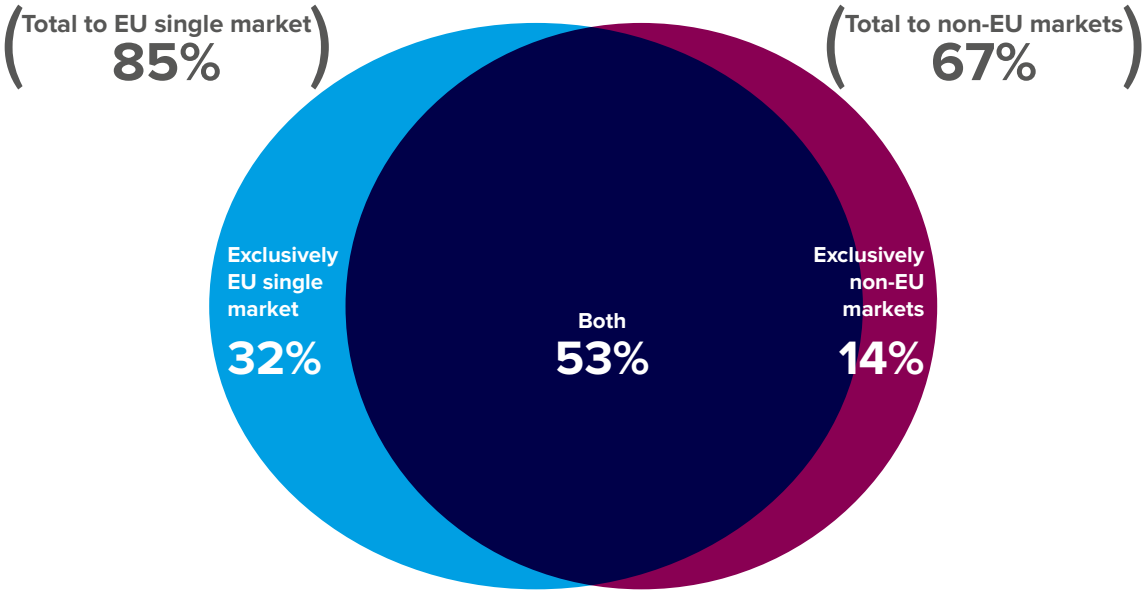


Figure four: Overlap of small businesses importing from within EU single market and non-EU markets
Source: FSB future trade with the EU and non-EU markets survey



This means that most small businesses currently trading overseas do so both within the EU single market and with non-EU markets; this is the case for almost three-quarters of Current Exporters (72%) and around half of Current Importers (53%).

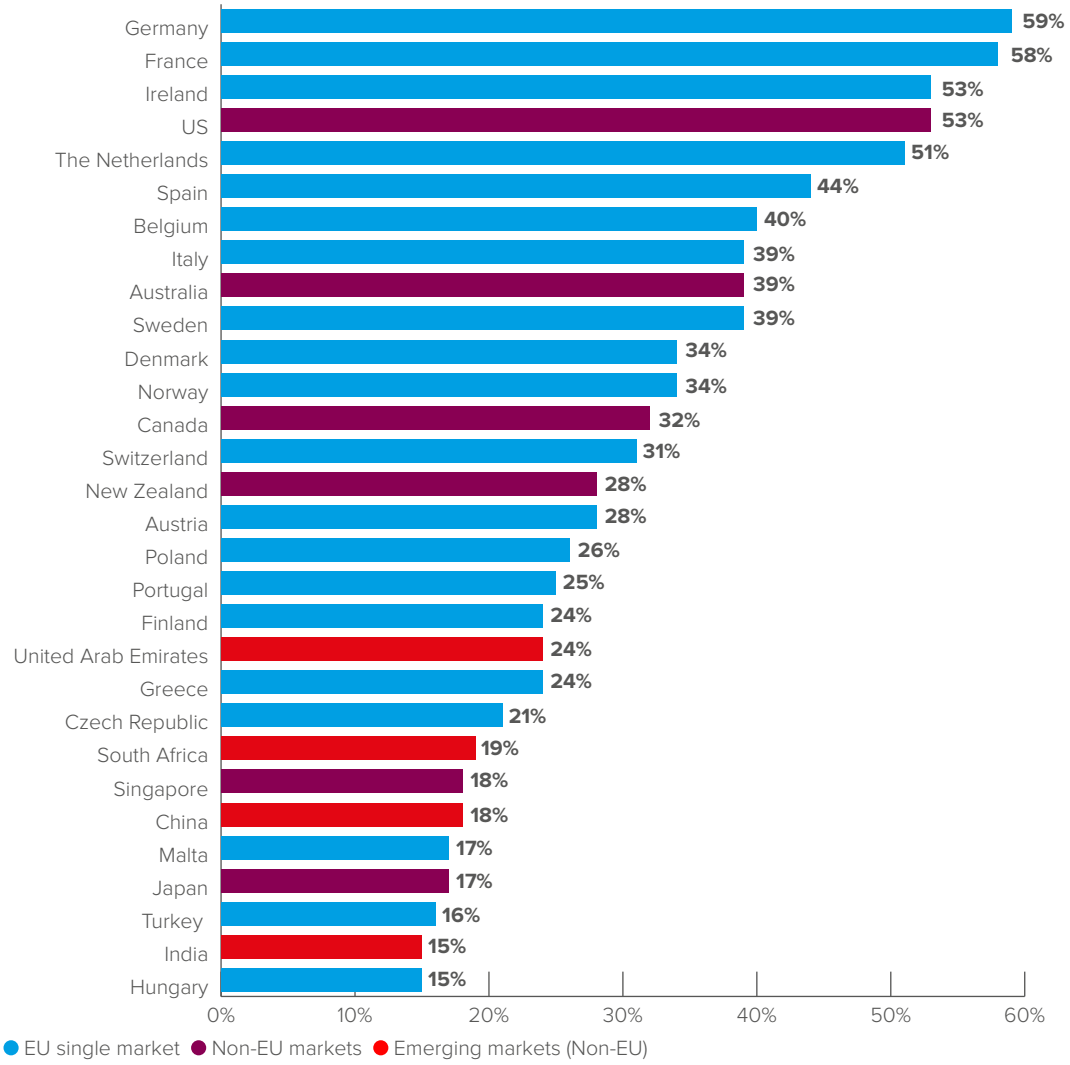
However, this leaves a significant proportion of small firms that trade exclusively within the EU single market, (21% of Current Exporters and 32% of Current Importers), a similar proportion to that revealed in FSB's previous research.[16] This is three times the proportion of Current Exporters (6%) that export exclusively to non-EU markets. Current Importers are also twice as likely to trade exclusively within the EU single market (32%) than with non-EU markets (14%).

Gap between small firms favouring trade with the EU over non-EU markets narrowing

The EU single market is also the most common export destination among small firms that currently do not export or import, but would consider doing so in the future. Around two-thirds (67%) of Potential Exporters would like to export there, compared to around half (55%) that would consider non-EU markets. A similar proportion of Potential Importers would consider trading with the EU single market (43%) compared to those that would consider non-EU markets (49%).[17]

While the EU single market is the top region for small business trade, it by no means has a monopoly on UK trade overseas. Figure one shows that, after the EU single market, North America is the second most common export region, with over half of Current Exporters (56%) selling there; it is also the second most common export region that Potential Exporters would consider (39%). Australasia is the third most common export region for both Current Exporters (42%) and Potential Exporters (31%).

Figure five: Top 30 export destinations of Current Exporters broken down by country
Source: FSB future trade with the EU and non-EU markets survey



16 FSB's 2016 Destination Export report found that 18% of small businesses export exclusively within the EU single market.

17 However, it should be noted that over one-third (36%) of Potential Importers are not sure where they would consider importing from, if they were to start – this is the largest proportion of small businesses within a particular group that selected 'don't know/not sure' regarding the question on current export destination or potential export destination.

The innate attraction of Anglosphere countries

In terms of individual countries, Germany and France top the table in Figure five - over half of all Current Exporters trade with at least one of these markets (59% and 58%, respectively). Of the top 10 export destinations, the US and Australia are the only two non-EU export destinations for small firms, with respectively 53 per cent and 39 per cent. Notably, these two export markets, as well as the following two non-EU countries – Canada and New Zealand – are ones that share some fundamental characteristics with the UK, namely English as the national language and roots in British culture and history.

> *"Australia was the first place [I exported to] five or six years ago. The reason was they speak the same language, and could read the website..." [on recommending as an export market] they do speak our language, literally, they've got a similar culture...."*
>
> FSB member, Current Exporter, based in Oldham

Countries which share these characteristics – the UK, Ireland, the US, Canada, Australia and New Zealand – are commonly referred to, collectively, as the 'Anglosphere'. These shared characteristics understandably play a role in facilitating trade and make it easier to do business. The prominence of these countries as common export destinations was discussed in FSB's previous export report.[18] It is also worth noting that Canada, Australia and New Zealand are also members of the Commonwealth[19] and, as such, also share a political history.

In light of Brexit, understanding the role these Anglosphere countries can play in the UK's future global trading environment takes on a greater sense of importance and will be explored further in this report.

The growing attraction of emerging markets

Another trend that emerged from previous FSB research is the growing attraction of emerging markets[20] to both Current Exporters and Potential Exporters. [21] A larger proportion of small firms are exporting to emerging markets – including China, India, South Africa and the Middle East – than in previous years.[22] This reflects the increasing role that technology plays in facilitating trade overseas - making it easier to connect, communicate and do business with markets further afield.

Emerging markets were also ranked higher up the list of countries that Potential Exporters would most likely consider exporting to, compared to in the ranking of actual export destinations by Current Exporters.[23] Though not directly comparable, this suggested a growing awareness of the export opportunities associated with emerging markets – a finding that was also supported by the qualitative research undertaken. [24]

The growing attraction and awareness of emerging markets as trade destinations is a recurring theme in this report. Figure five shows that of the top 30 countries with which Current Exporters trade, four of them are emerging markets – the UAE, South Africa, China and India – the same top emerging markets identified in FSB's previous research.[25] On average, around one in five (19%) trade with at least one of these emerging markets.

It is also worth noting that a similar proportion of Current Exporters trade with Singapore (18%) and Japan (17%) – neither are emerging markets or strictly Anglosphere (as defined in this report).[26] However, they are both mature economies, with Singapore consistently being ranked as one of the easiest countries to do business with,[27] and Japan consistently ranked as one of the largest economies in the world.[28]

18 FSB, Destination Export: The Small Business Export Landscape, July 2016.

19 See footnote 11.

20 Emerging market is a term that investors use to describe a developing country, in which investment would be expected to achieve higher returns, but be accompanied by greater risk (Financial Times, Definition of emerging markets, available at: http://lexicon.ft.com/Term?term=emerging-markets). The emerging markets identified in this report are based on MSCI Emerging Markets Index, available at: https://www.msci.com/market-classification.

21 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

22 Ibid.

23 Ibid.

24 In addition to survey work, FSB's 2016 export report was also based on 30 in-depth qualitative interviews with current exporters and potential exporters.

25 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

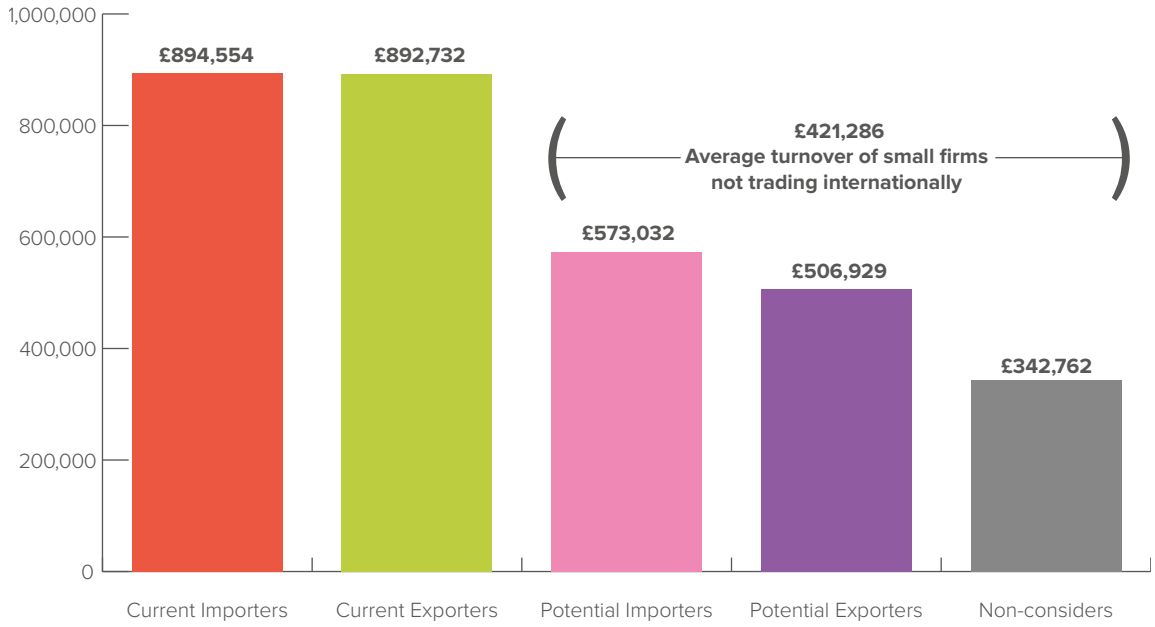
26 See footnote 11.

27 World Bank, Doing Business - Economy Rankings, 2016, available at: http://www.doingbusiness.org/rankings.

28 Ranked as the world's third largest economy in 2016, based on GDP, according to the IMF's World Economic Outlook Database, available at: https://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx.

The virtuous circle of growth and trading internationally

Figure six: Average annual turnover by Current Exporters, Current Importers, Potential Exporters, Potential Importers and Non-considerers
Source: FSB future trade with the EU and non-EU markets survey



Trading internationally is associated with business growth, innovation and productivity.[29] FSB's previous report on the exporting landscape supports this association with growth, and shows that small business exporters, on average, earn more than double the turnover of those that do not export.[30] Figure six reinforces this previous finding – the average Current Exporter (£892,732) receives more than double the turnover of the average small firm that neither exports nor imports (£421,286).

Small firms that import have similarly higher turnovers compared to their non-overseas trading counterparts. Therefore, importing can be seen as an indicator that a small firm is more competitive or growth orientated than the average small business. It is also worth noting that the majority (69%) of small business exporters are also importers, and vice versa (64%).

There is a significant gap, in average turnover, between the small firms that do not currently trade overseas but would consider doing so, compared to those that do not currently trade overseas but would not consider doing so. Potential Exporters, on average, have turnovers (£506,929) that are almost 50 per cent higher than a small firm that will not or cannot consider exporting (£342,762); a similar difference exists for Potential Importers (£573,032) and Non-considerers.

Not only are small firms that export or import more likely to be growth-orientated, those that would consider exporting or importing are also more likely to be growing or show potential for growth. This reinforces the view expressed by many small firms that trading overseas is a catalyst to growth acceleration.[31] On the other hand, this also reflects the view that trading overseas can be disproportionately more challenging – either in perception or reality – for businesses smaller in size.[32]

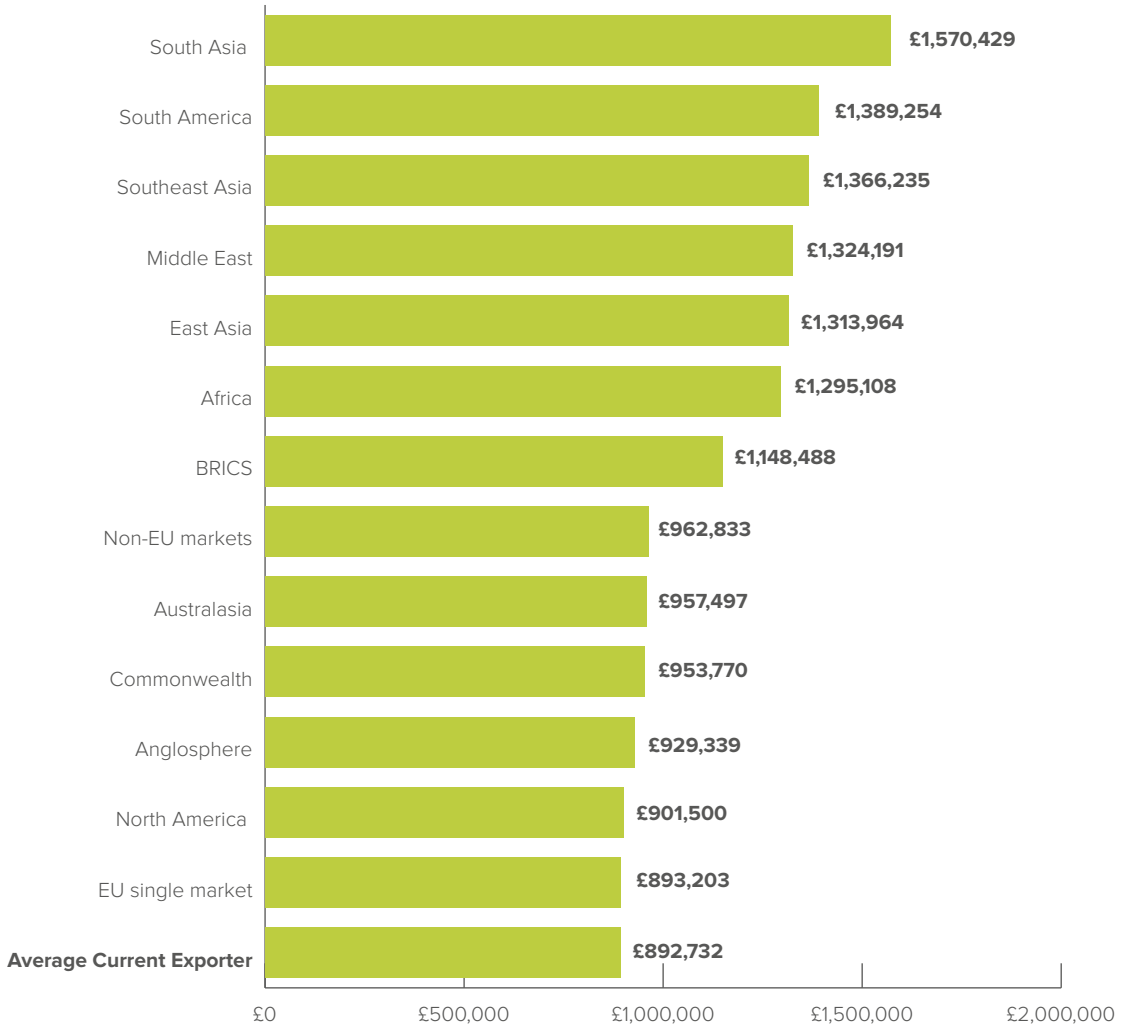
29 Enterprise Research Centre, SME Innovation, Exporting and Growth, April 2013, available at: https://www.enterpriseresearch.ac.uk/wp-content/uploads/2013/12/ERC-White-Paper-No_5-Innovation-final.pdf

30 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

31 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0 and FSB focus groups on Future of trade with the EU and non-EU markets 2016.

32 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

Figure seven: Export markets by average turnover of Current Exporters
Source: FSB future trade with the EU and non-EU markets survey

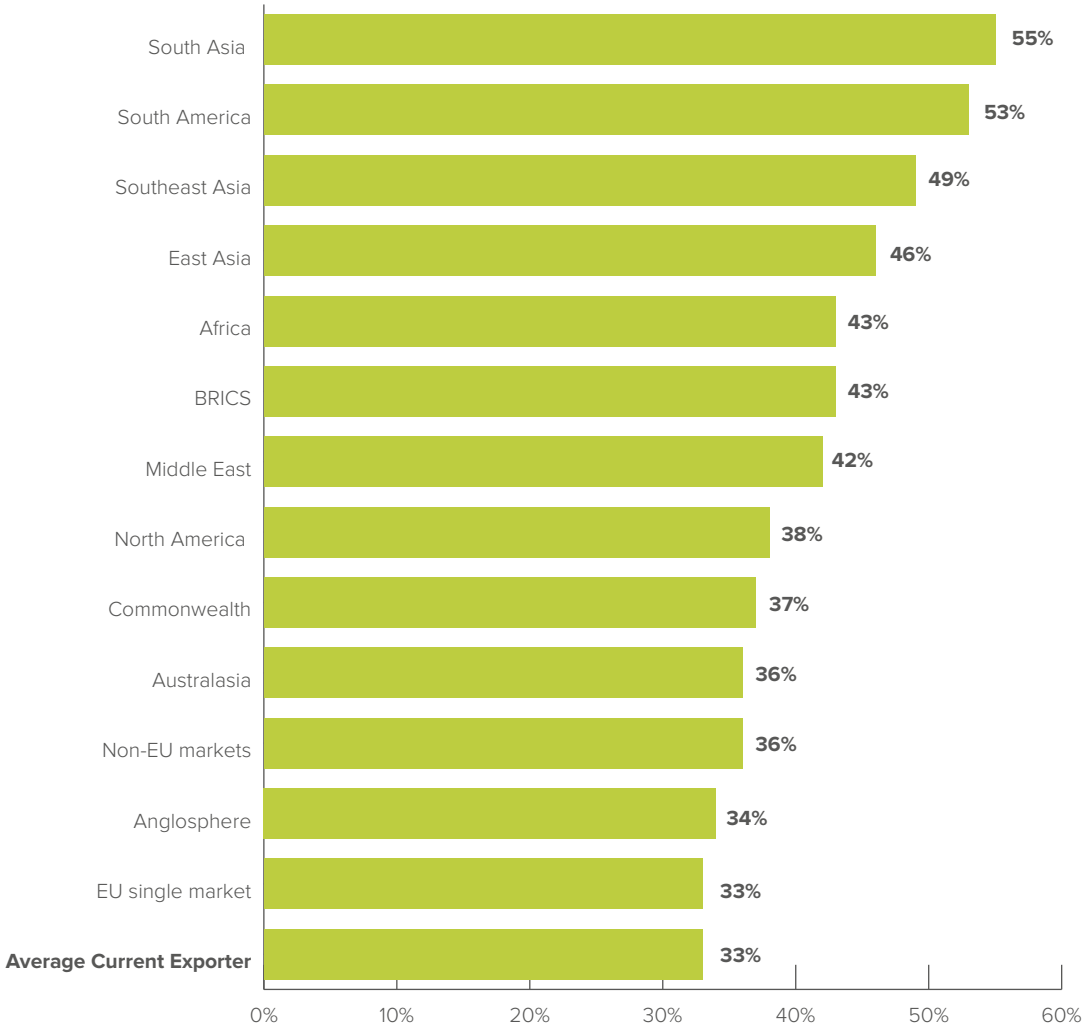


Small firms exporting to emerging markets are more likely to have higher-than-average turnovers

The turnover size of a small business does not only have an impact on the likelihood of whether it will export, it also plays a role in where small businesses are likely to export to. Figure seven shows that there is a clear relationship between the less common export regions and the higher average turnover of small businesses that export there.

The major export destinations in these less common export regions are primarily emerging markets. On average, Current Exporters trading with China (average turnover of £1,512,908), the UAE (£1,428,108) and India (£1,359,351) are more likely to have higher turnovers than those trading with the EU single market or the Anglosphere. The average Current Exporter, in terms of turnover, is most likely to trade with countries that are part of the EU single market.

Figure eight: Export markets by the average percentage of turnover derived from exporting of Current Exporters
Source: FSB future trade with the EU and non-EU markets survey



Small firms trading with emerging markets are likely to be more dependent on exports

In addition to turnover size, how dependent a Current Exporter is on its exporting activities – measured as the percentage of turnover derived from exporting - is also an indicator of where it is likely to export to.[33] Figure eight shows that small firms trading with emerging and less common export markets are likely to be more dependent on exports, compared to those trading with mature markets.

While the EU single market and the Anglosphere are the most common markets for the majority of small firms, it is especially the case for businesses on the smaller scale of small firms (based on turnover), and those where exports does not form a core part of their business. The average Current Exporter derives 33 per cent of their annual turnover from exporting activities and is often characterised by ad hoc and reactive exporting behaviour.

The similar rankings between Figure seven and Figure eight suggests there is a link between how dependent a small business is on exporting and how high its annual turnover is. Those exporting to emerging markets are not only more likely to have higher-than-average turnovers, but also to have a higher-than-average dependency on exporting.

33 This relationship was initially identified in FSB's 2016 Destination Export report.

This supports the long-held view among global business and investor communities that exporting to emerging markets is likely to yield higher returns. A higher-than-average turnover could be indicative of a small firm's higher-than-average growth aspirations, which would explain why these firms would be particularly attracted to these types of markets. The association also suggests that small firms with higher turnovers may be better equipped (if higher turnover is taken as a proxy for greater access to resources) to consider exporting to these less mature markets in the first place.

The drivers of international trade – ease, cost and value

The specific factors which ultimately drive small businesses to trade with a particular market or set of markets are diverse, complex and, often, unique to the individual firm. However, there are some fundamental factors that tend to drive small firms to trade with certain markets.

The majority of small firms export, to some degree, on a reactive basis. FSB research has shown that around three-quarters (76%) of decisions behind why small firms export to a particular market are, at least in part, driven by a direct demand from an overseas buyer.[34]

Small firms follow the path of least resistance

In addition, most small firms export by following the path of least resistance, usually based on how easy it is to sell to a market.[35] In many cases, ease of trading is closely assoicated with the cost of such transactions, particularly when cost is understood in terms of time and resources. The costs associated with trading overseas are also particularly important in light of the real possibility that tariffs and additional non-tariff barriers will be introduced to UK-EU trade, when the UK leaves the EU single market and the full EU customs union.

Another dimension to what drives small firms to trade with certain markets is how valuable that market is in terms of business growth. This value is often understood in terms of competitive advantage or the level of niche market opportunity that the business can exploit. It can also be expressed as the potential of the market for future business, for example, how fast the economy is growing.

Importantly, each small business will define value, in regards to business growth, differently. While some businesses may define value in terms of rapid growth for the business, others might define value in terms of growth that is more incremental and sustainable over a long period. However it may be defined, for many small firms, the value of a market is considered to be of equal or even greater importance than ease of trade.[36]

EU single market fares more favourably all-round as a trade destination compared to non-EU markets

These fundamental factors are not mutually exclusive. Some markets, at least in principle, tick most or even all of the boxes for many small firms. However, not all small firms value the same factors to the same extent, and importantly, as already discussed, the majority of Current Exporters export on a reactive basis, assessing each opportunity as and when they come along.

> *"Assess each opportunity. Look at the advantages, look at the disadvantages, what it looks like. As a business we do that even in the UK... Opportunities don't fall into black and white, either low cost, or low opportunity... not that clear cut."*
>
> FSB member, Current Exporter, based in Bristol

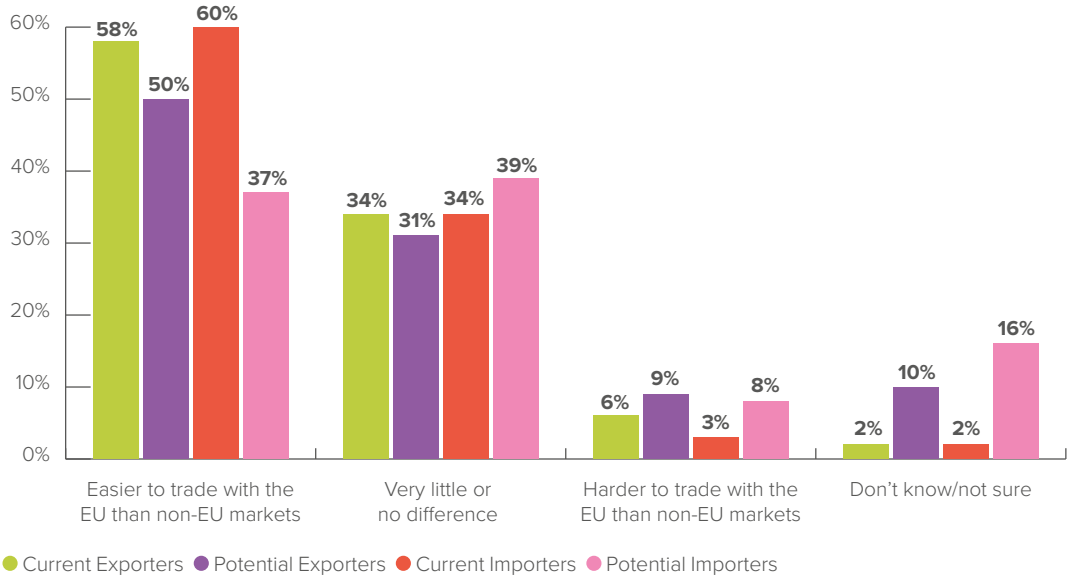
34 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

35 Ibid.

36 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

How Current Exporters and Current Importers – that trade both within the EU single market and with non-EU markets - assess the ease, cost and value of trading with the EU compared to non-EU markets should provide a strong indication of how important, these markets are to small firms. Crucially, it should also shed some light on why there is a significant group of small firms that only trade with either the EU single market or non-EU markets.

Figure nine: Ease of trade with the EU compared to non-EU markets by Current Exporters, Potential Exporters, Current Importers and Potential Importers[37]
Note: Only Current Exporters and Current Importers that trade with both the EU and non-EU markets are included
Source: FSB future trade with the EU and non-EU markets survey



Ease of trade is the biggest difference between the EU and non-EU markets

Based on the ease, cost and value of trade with the EU single market compared with non-EU markets, Current Exporters are most likely to find a difference in terms of the former. Figure nine shows that around two-thirds of Current Exporters (64%) find a meaningful difference between selling within the EU single market and to non-EU markets.[38] Around half of Current Exporters find a difference in terms of cost (54%) and value (52%) between the EU and non-EU markets.

Current Importers are most likely to find a difference in terms of ease (63%) and cost (61%) of trade compared to the value of trade (51%) between the two markets.

The majority (58%) of exporting small firms find that it is easier to trade within the EU single market than with non-EU markets. Indeed, of this group, around three-quarters (71%) believe that it is 'much easier' (as opposed to 'moderately easier') to export within the EU single market. Around one in 20 (6%) Current Exporters believe the reverse is true (it is harder to trade with the EU than non-EU markets), and only three per cent believe it is 'much harder' (as opposed to 'moderately harder') to trade within the EU single market than outside of it.

It is clear from our FSB held focus groups that, while the potential of non-EU markets is recognised - in particular emerging markets such as China and India - for most small firms, the overriding factor driving where they end up exporting is still ease.

> *"China has massive potential. But, for very small businesses, it's the ease. We'd rather send to the Netherlands because of the ease than send to China, which is unrealistic."*
>
> FSB member, Current Exporter, based in Cheltenham

37 'Easier to trade with the EU than non-EU markets' combines two sets of responses: those that selected 'much easier' to trade with the EU than non-EU markets and those that selected 'moderately easier' to trade with the EU than non-EU markets'. 'Harder to trade with the EU than non-EU markets' combines two sets of responses: those that selected 'much harder' to trade with the EU than non-EU markets or 'moderately harder' to trade with the EU than non-EU markets.

38 Meaningful difference refers to both 'easier to trade with the EU than non-EU markets' and 'harder to trade with the EU than non-EU markets'.

Potential Exporters also follow the trend of Current Exporters and are five times more likely to believe that trading within the EU single market is easier than with non-EU markets (50% compared to 9%, respectively).

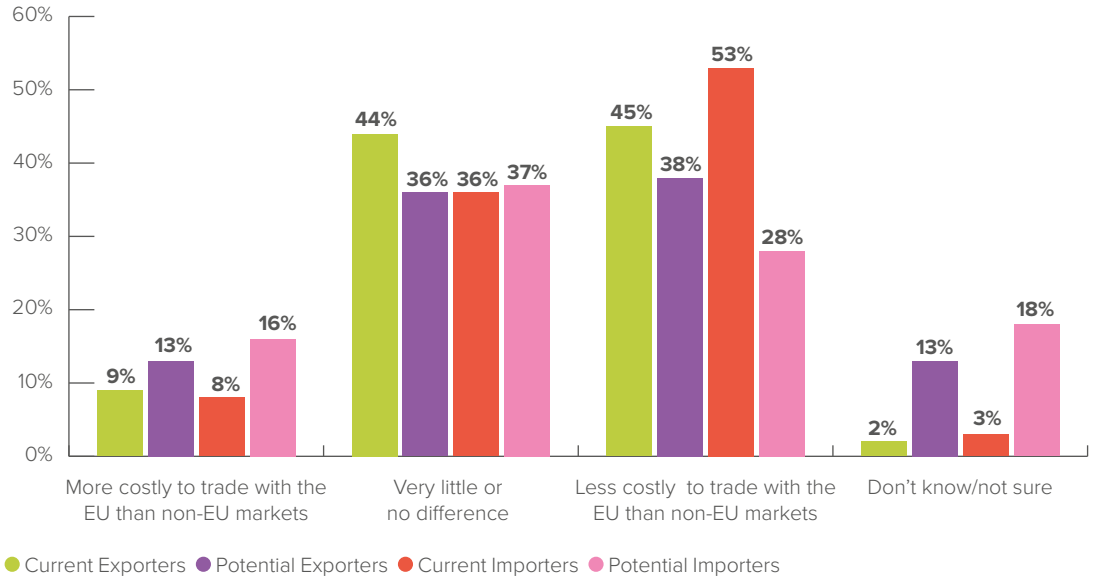
Discussions on the benefits of the UK being a member of the EU single market frequently highlight the ease with which businesses can trade with other member countries – it is as easy to sell to another EU country as it is to somewhere in the UK.

> *"Exporting to the US is the most difficult thing to do. Everybody takes a cut! Distributor, agent, broker. Means prices of our products are so high they become uncompetitive."*
>
> FSB member, Current Exporter, based in Scotland

> *"From a smaller business's point of view sending to Birmingham and Barcelona is the same thing ... in two and half years' time it might not be the same thing and that is the worry."*
>
> FSB member, Current Exporter, based in Oldham

> *"[The EU has] got the same product standards and regulations, so it's easier if you manufacture products to UK standards to have a product accepted around EU... not going through the hoops of having it conformity checked."*
>
> FSB member, Clients are Current Exporters, based in Manchester

Figure 10: Cost of trade with the EU compared to non-EU markets by Current Exporters, Potential Exporters, Current Importers and Potential Importers[39]
Note: Only Current Exporters and Current Importers that trade with both the EU and non-EU markets are included
Source: FSB future trade with the EU and non-EU markets survey



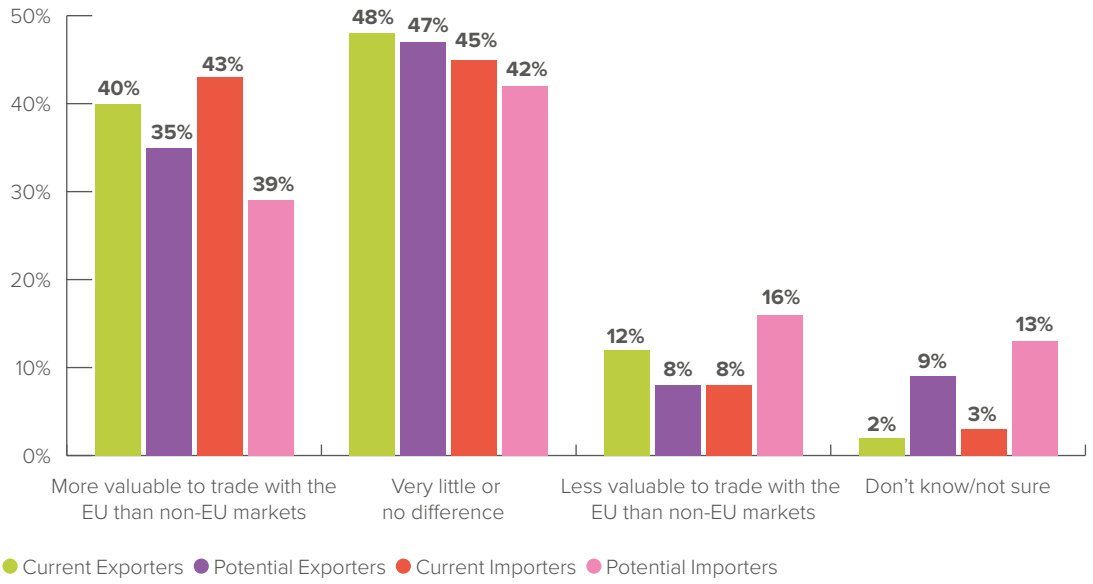
Trading within the EU single market costs less than trading with non-EU markets

In addition to being the easier market to trade with overall, Figure 10 shows that the EU single market is also less costly to trade with. While 44 per cent of Current Exporters find very little or no difference, a similar proportion (45%) find it to be less costly. This is significantly more compared to the nine per cent that find it to be more costly. Furthermore, almost two-thirds of this 45 per cent state that it is 'much less costly' (as opposed to 'moderately less costly') to trade with the EU single market.

39 'More costly to trade with the EU than non-EU markets' combines two sets of responses: those that selected 'much more costly' to trade with the EU than non-EU markets and those that selected 'moderately more costly' to trade with EU than non-EU markets'. 'Less costly to trade with the EU than non-EU markets' combines two sets of responses: those that selected 'much less costly' to trade with the EU than non-EU markets and those that selected 'moderately less costly' to trade with the EU than non-EU markets.

Current Importers are also much more likely to find trading within the EU single market less costly than with non-EU markets. In fact, small firms are six times more likely to find it cheaper than those who find it more costly to trade with the EU (53% find it less costly compared to 8% that find it more costly).

Figure 11: Value of trade with the EU compared to non-EU markets by Current Exporters, Potential Exporters, Current Importers and Potential Importers[40]
Note: Only Current Exporters and Current Importers that trade with both the EU and non-EU markets are included
Source: FSB future trade with the EU and non-EU markets survey



EU trade is better value for the majority of small firms compared to non-EU trade

Following the trend of ease and cost factors, Figure 11 demonstrates that small firms are more than three times more likely to find trading within the EU single market to be of greater value to their business than trading with non-EU markets (40% compared to 12%, respectively). Of this 40 per cent, the majority (60%) find it to be 'much more valuable' (as opposed to 'moderately more valuable'). By contrast, one in 10 (12%) Current Exporters find trading with non-EU markets to be more valuable. A similar pattern can be seen for Current Importers and Potential Exporters and Potential Importers.

On balance, small firms that trade both within the EU single market and outside of it are significantly more likely to value trade with the former. In addition, it also suggests that, while over the past few years small firms have become more diversified in where they export,[41] the EU single market still remains their primary and most important trading relationship. Any post-Brexit strategies that rely on small firms increasing their trade with non-EU markets must fully appreciate this reality.

In principle, most small firms are not averse to trading outside the EU single market, and the majority already do. However, their ability to quickly pivot more towards trading – either in an increased capacity or new capacity - with non-EU markets, even in recognition of the potential opportunities on offer, is a real challenge from the outset.

40 'More valuable to trade with the EU than non-EU markets' combines two sets of responses: those that selected 'much more valuable' to trade with the EU than non-EU markets and those that selected 'moderately more valuable' to trade with the EU than non-EU markets'. 'Less valuable to trade with the EU than non-EU markets' combines two sets of responses: those that selected 'much less valuable' to trade with EU than non-EU markets and those that selected 'moderately less valuable' to trade with the EU than non-EU markets.

41 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

Most small firms are not ignorant of the different benefits and trade-offs involved in doing business with markets outside of the usual suspects. For example, many small firms recognise that, compared with many European countries, emerging markets may offer higher growth opportunities. However, equally, many small firms are content with the value they derive from doing business with their traditional trading partners, where ease, familiarity and an already established relationship are factored in.

Furthermore, the upfront investment that is often required to trade with less mature markets, from human resources to capital investments, is a leap too far for many small firms – either in perception or reality. Indeed, FSB's previous research showed small firms that export to emerging markets were more likely to use intermediary services, such as agents, distributors and translators – an additional investment in their export operation.[42]

"If you take the EU, yes it's an established market, it's well serviced, you're going to have to find a niche and be good at it to get in to it. But, on the other hand you understand regulations, trading is easy, the language is very easy to sort out, travel is easy. On the other hand, if you want to go into India, [it's a] fantastic market, growing, aspiring and middle class and so on. But, at the end of the day, they are a very expensive country to try and export to. Somewhere like that we are going to start off with a price penalty before we even set foot in the country. There are pros and cons and I think we would assess each opportunity on its advantages and disadvantages."

FSB member, Current Exporter, based in Manchester

Small businesses typically run on tight margins and, depending on their business model, are likely to have little flexibility built into their operations or cashflow. Trading relationships commonly take a long time to develop and usually start off organically, off the back of a random advantage that the business exploits (discussed further in this report). Any abrupt change to a small firm's trading environment, which disrupts business-as-usual, is likely to be costly and will not be easily absorbed on its own.

"You can't sacrifice an existing market on the basis that you might sell more later ... you've only got limited resources now, you can't defocus on where you're making money now and lose business on the hope you'll make money in the future."

FSB member, Current Exporter, based in Bath

"Small businesses are concerned that, if it gets more complicated and more difficult with tariffs, they won't be able to deal with [exporting]. Bigger companies are more resilient, they've more experience, and they have more people to deal with it."

FSB member, Current Exporter, based in Cheltenham

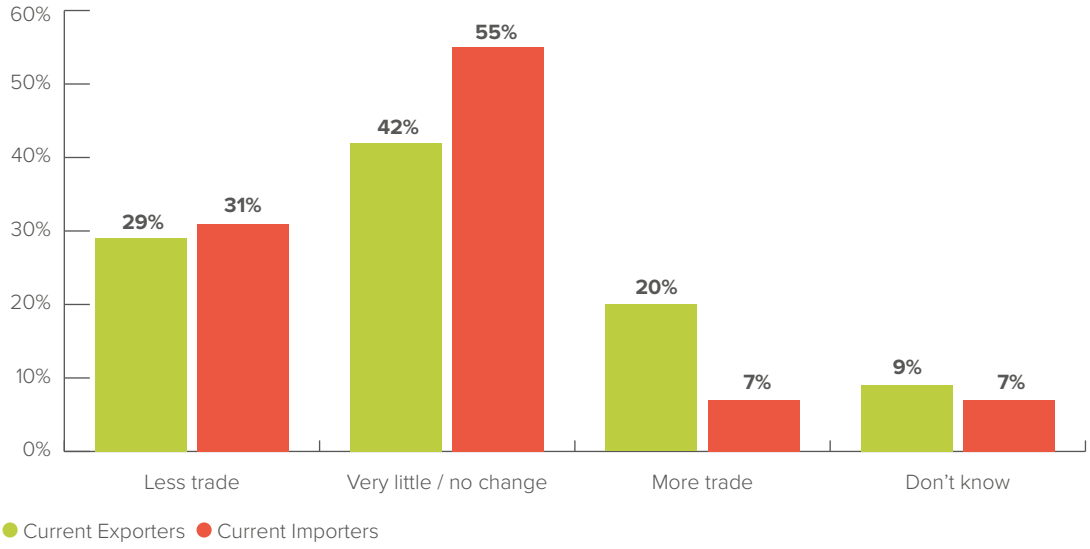
42 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

OPPORTUNITIES AND RISKS IN A POST-BREXIT TRADE LANDSCAPE

The outcome of the negotiations around the UK's future trade relationship with the EU will not be known for some time. Small firms are, however, already considering their options based on how Brexit may affect their business and are preparing their response. How small businesses feel about Brexit will, therefore, have a material impact on the economy overall. For example, small business confidence plays a role in how firms spend, invest and recruit.

Levels of future trade overall

Figure 12: How much Current Exporters and Current Importers expect their level of trade to change[43] as a result of Brexit
Source: FSB future trade with the EU and non-EU markets survey



Of the small firms that expect a material change to their levels of trade, a greater proportion expect to trade less as a result of Brexit

Current Importers are the group most likely to expect very little or no change as a result of the UK leaving the EU (55% expect very little or no change). Of those that do anticipate change to their level of importing (38%), the vast majority (82%) expect to be importing less.

With regards to Current Exporters, around two-fifths (42%) expect very little or no change. However, 49 per cent of exporting small firms expect their level of exporting to change, as a result of the UK leaving the EU. Of the 49 per cent, the majority (59%) expect to export less compared to more (41%).

Furthermore, of the 29 per cent that expect to be exporting less, more than half (58%) expect to be exporting 'significantly less' (as opposed to 'moderately less').

It is worth noting that more than two-thirds (69%) of Current Exporters are also Current Importers and, therefore, may be doubly affected. For example, in terms of the immediate impact of Brexit, this means that the trade benefits associated with the depreciation of sterling, following the outcome of the EU referendum, is limited to small business exporters that do not import, or import considerably less than they export.

43 'Less trade' combines two sets of responses: those that selected 'moderately less trade' and those that selected 'significantly less trade'. 'More trade' combines two sets of responses: those that selected 'moderately more trade' and those that selected 'significantly more trade'.

"Impact of Brexit at the moment is in the exchange rate ... a lot of the things we sell have got imported products in them, so the price of selling is increasing, so this huge benefit in terms exporting more because the pound is cheaper is taken away because the components are imported anyway."

FSB member, Current Exporter and Importer

Uncertainty over Brexit is having an immediate impact on small firms

Until the UK's new trade relationship with the EU is finalised, every small business will base their expectations on different ideas of what this relationship will look like. Of those that expect a material change, the expected net decline in overseas trade therefore really reflects the impact that uncertainty over Brexit is having on small firms, on their level of confidence and future outlook.

The negative impact of uncertainty cannot be underestimated, and while it is difficult to quantify, there are many examples of it already causing real issues for small businesses. These issues also provide some insight into what is likely to happen if the UK leaves the EU single market without a new comprehensive FTA with the EU in place or no transitional arrangement in place..

Many of these issues centre on supply chains, where suppliers are hesitant to make decisions on new or existing contracts:

"I'm concerned because [the decision to leave the EU] is another layer of confusion in the market and the kind of people that I'm involved in selling to are looking for any excuse not to make a decision ... I anticipate business getting more difficult next year because of the uncertainty."

FSB member, Current Exporter, based in Huddersfield

Many small firms have existing relationships with European partners, and these are also being affected by uncertainty:

"We already have some impact ... companies we are trading with in the UK are pulling their marketing budget, because they had EU-funded projects and they are concerned about how they will continue working with their EU customers."

FSB member, Current Exporter, based in Salford

Some small businesses have seen an impact on their revenue generation:

"We've already seen a hit in training, companies don't want to spend. We provide training on customs procedures and we've had people saying 'can we cancel our course for next month?' We've lost 25% bums on seats since June and I just see that happening more and more."

FSB member, Clients are Current Exporters, based in Manchester

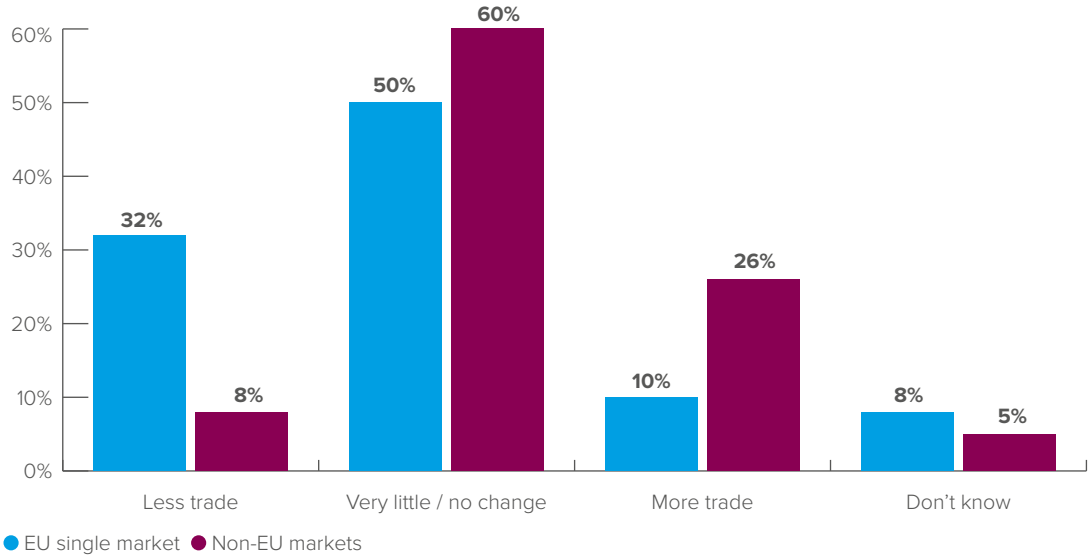
Small firms are also holding off making investment decisions until the uncertainty subsides:

"We had planned to open a new office in Germany before Brexit, but don't know how this might happen [now] and what regulations [will be] around this ... we need to wait to see what will happen."

FSB member, Current Exporter, based in Salford

Levels of future trade with the EU single market and non-EU markets

Figure 13: How much Current Exporters expect their level of trade to change[44], in respect of the EU single market and non-EU markets
Note: Only Current Exporters that trade both within the EU single market and with non-EU markets are included
Source: FSB future trade with the EU and non-EU markets survey



Of the small firms that expect a material change to their level of exports – roughly the same proportion expect to export less to the EU overall as those that expect to export more to non-EU markets overall

Figure 13 shows that of the 72 per cent of Current Exporters that export both within the EU single market and to non-EU markets, half (50%) expect very little or no change to their trading arrangements with the EU. Of those that do expect a material change, a greater proportion expect to export less in future with the EU single market than more (32% compared to 10%, respectively). Further, of the 32 per cent that expect to export less to the EU single market, the majority (75%) expect to export 'significantly less' (as opposed to 'moderately less').

A similar proportion (34%) of small firms that export exclusively within the EU single market (21%) expect to export less, while eight per cent expect to export more.

There has been a significant focus on how Brexit and the UK's departure from the full EU customs union has the potential to create new opportunities with non-EU markets – including countries with whom the EU has preferential trade arrangements[45], to which the UK is currently party.

As the UK already does a substantial amount of trade outside the EU, the desire is to both increase trade with already well established markets, such as the US, and to seek out new opportunities with emerging markets, which are seen to provide significant untapped potential.

In light of this, it is promising that Figure 13 shows that (of the firms that expect material change to their levels of trade), while a greater proportion expect to export less than more to the EU (32% compared to 10%), this is roughly balanced by the proportion of firms that expect to export more than less to non-EU markets (26% compared to 8%).

44 'Less trade' combines two sets of responses: those that selected 'moderately less trade' and those that selected 'significantly less trade'. 'More trade' combines two sets of responses: those that selected 'moderately more trade' and those that selected 'significantly more trade'.

45 The European Union (EU) has a number of preferential trade arrangements with certain individual countries or groups of countries outside the EU. These allow particular goods originating in the countries concerned to be imported and entered to free circulation at reduced rates of customs import duty.

However, these figures only represent the 72 per cent of Current Exporters that trade with both the EU and non-EU markets. It does not include the groups of Current Exporters that trade exclusively either within the EU single market (21%) or with non-EU markets (6%). Therefore, it is not known if a similar balance between the expected decrease overall in EU trade and the expected increase overall in non-EU trade will be likely if the remaining 28 per cent of Current Exporters are also factored in. Importantly, as 34 per cent of those that export exclusively within the EU single market expect to export less, a similar proportion will have to start exporting to non-EU markets in order to balance out this decrease.

Most small firms are in a wait-and-see mode with Brexit but particularly in regards to non-EU trade

It is noteworthy that the majority of Current Exporters (60%) expect very little or no change to their level of exporting to non-EU markets. This is a higher percentage compared to exporting within the EU single market, where one in two small firms (50%) expect their level of exporting to change very little or remain the same.

In regards to exporting to both the EU and non-EU markets, the high proportion of small firms expecting very little or no change reflects a wait-and-see mode that many small firms have adopted as their approach to dealing with Brexit. However, this seems to be particularly the case in regards to non-EU trade.

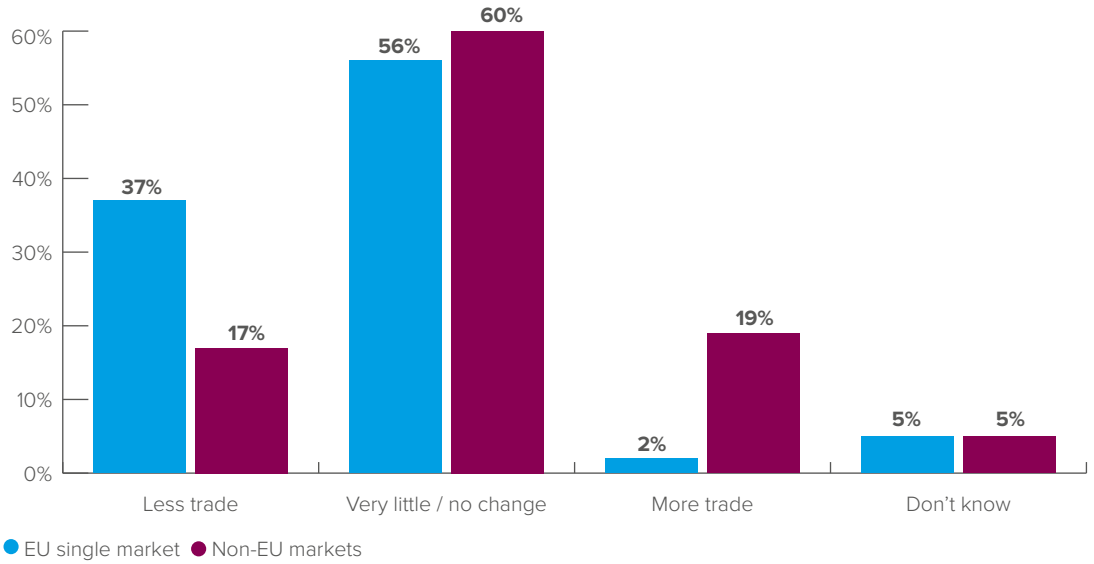
This attitude is typical for many small businesses as they tend to operate along tighter margins and resources compared to larger firms; the day-to-day operation and what affects them in the immediate term are paramount for most small business. It is likely then that many small firms have not got round to thinking about how Brexit may affect their trade with both the EU and, especially, non-EU markets (for example, if they should consider trading more outside the EU). At least in the short term, small firms are more concerned with the direct impact Brexit will have on their trade within the EU single market, relative to non-EU markets.

Many small firms, from the focus groups, also take the view that they cannot simply 'offset' the negative impact of Brexit on their trade with the EU by upping their trade with non-EU markets.

"You can say the market in Australia is every bit as big as it is in France, but you're not going to walk in there and take that business overnight. And you can lose business overnight. That's the issue everybody faces - how do you survive long enough between losing business overnight and recovering that business?"

FSB member, Current Exporter, based in Bath

Figure 14: How much Current Importers expect their level of importing to change[46], in respect of the EU single market and non-EU markets
Note: Only Current Importers that trade both within the EU single market and with non-EU markets are included
Source: FSB future trade with the EU and non-EU markets survey



Of the small firms that expect a material change in their levels of imports – more expect to import less from the EU than more from non-EU markets

The majority of small business importers expect very little or no change to their level of imports from both the EU single market (56%) and non-EU markets (60%). However, Figure 14 shows a greater proportion expect to import less than more from the EU (37% compared to 2%). This is a higher proportion than those that expect to import more from non-EU markets (19% expect to increase imports from non-EU markets compared to 17% that expect to import less).

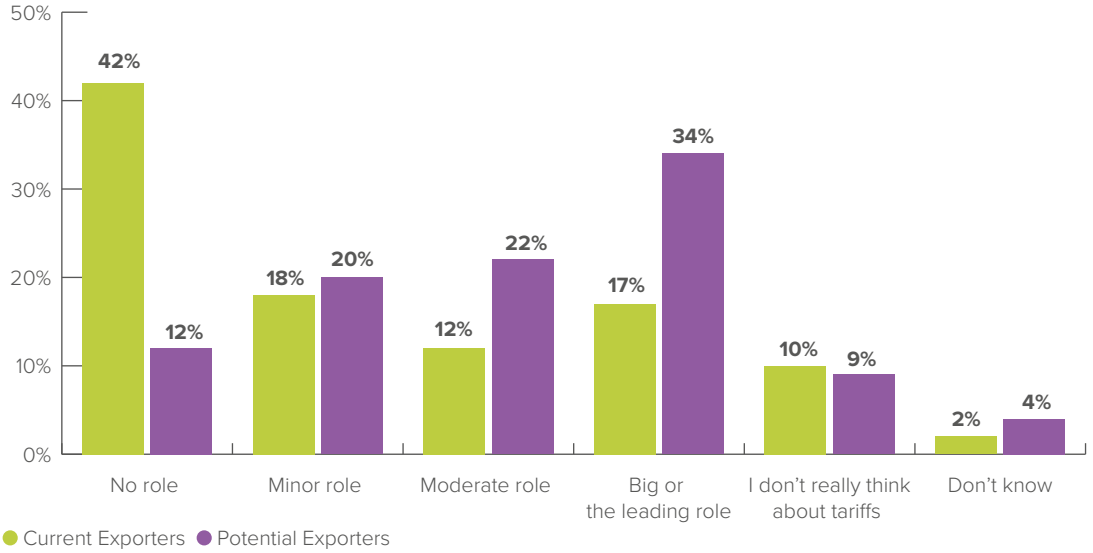
> *"We import 99 per cent of our products from all over the world, and are extremely concerned. Brexit means we're considering changing our business model entirely. Current membership of the EU makes importing a breeze and we pay no import taxes. It's easy and cheap for us to hop on a plane to Berlin to source products and meet suppliers, whereas the US is further away, requires a visa, is more expensive to get to stock takes longer to arrive and we have to pay import taxes. Our product range would be severely weakened if we limited our sourcing to the UK."*
>
> FSB member, Current Importer, based in Dorset

However, as with the Current Exporters, this is only representative of the group of Current Importers that trade both within the EU single and with non-EU markets (53% of all Current Importers).

46 Less trade' combines two sets of responses: those that selected 'moderately less trade' and those that selected 'significantly less trade'. 'More trade' combines two sets of responses: those that selected 'moderately more trade' and those that selected 'significantly more trade'.

Tariffs and non-tariff barriers

Figure 15: The role tariffs play in where Current Exporters and Potential Exporters decide to export
Source: FSB future trade with the EU and non-EU markets survey



Tariffs play a greater role in where Potential Exporters will trade than for Current Exporters

The introduction of tariffs[47] on goods traded between the EU and the UK is a distinct possibility when the UK leaves the EU single market. Of course, the issue of tariffs is not unique to negotiations around the EU, it will play a fundamental role in the UK's trade negotiations with any and all other markets once the UK has left the EU. It is, therefore, valuable to understand what impact, if any, potential new tariffs may have on small businesses trading overseas.

Figure 15 shows that tariffs play a role, to some degree, for around half (47%) of all Current Exporters on where they decide to export. However, a similar proportion (42%) of Current Exporters say that tariffs play no role in where they export. A further one in 10 Current Exporters state that they 'don't really think about tariffs' – reflecting the ad hoc and reactive nature of many small business exporters.

Of the 47 per cent of small firms that state tariffs play a role, around one-third (36%) say that it plays a big role or the leading role on where they export; the rest (64%) are roughly split between stating that tariffs play a moderate role (26%) or a minor role (38%).

Potential Exporters, however, anticipate that tariffs will play a much bigger role, overall. Three in four (76%) Potential Exporters anticipate that tariffs will play a role in where they decide to export. Of these small firms, almost half (45%) believe that tariffs will play a big role or the leading role.

47 A tariff is a tax imposed on imported products. Tariff rates may vary from country to country and differ according to type of product.

Figure 16: The role tariffs play in where Current Importers and Potential Importers decide to import from
Source: FSB future trade with the EU and non-EU markets survey

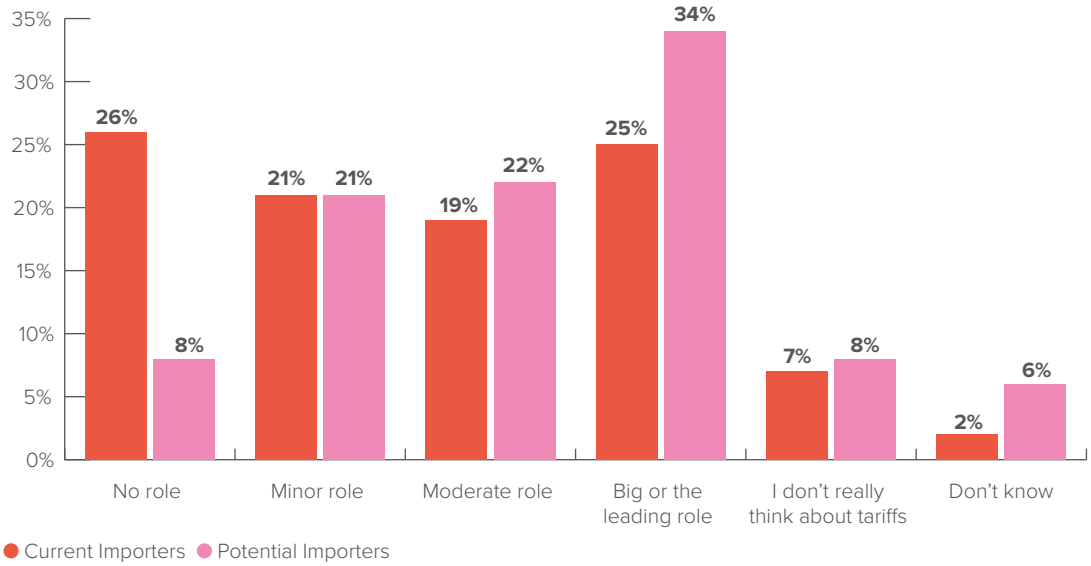
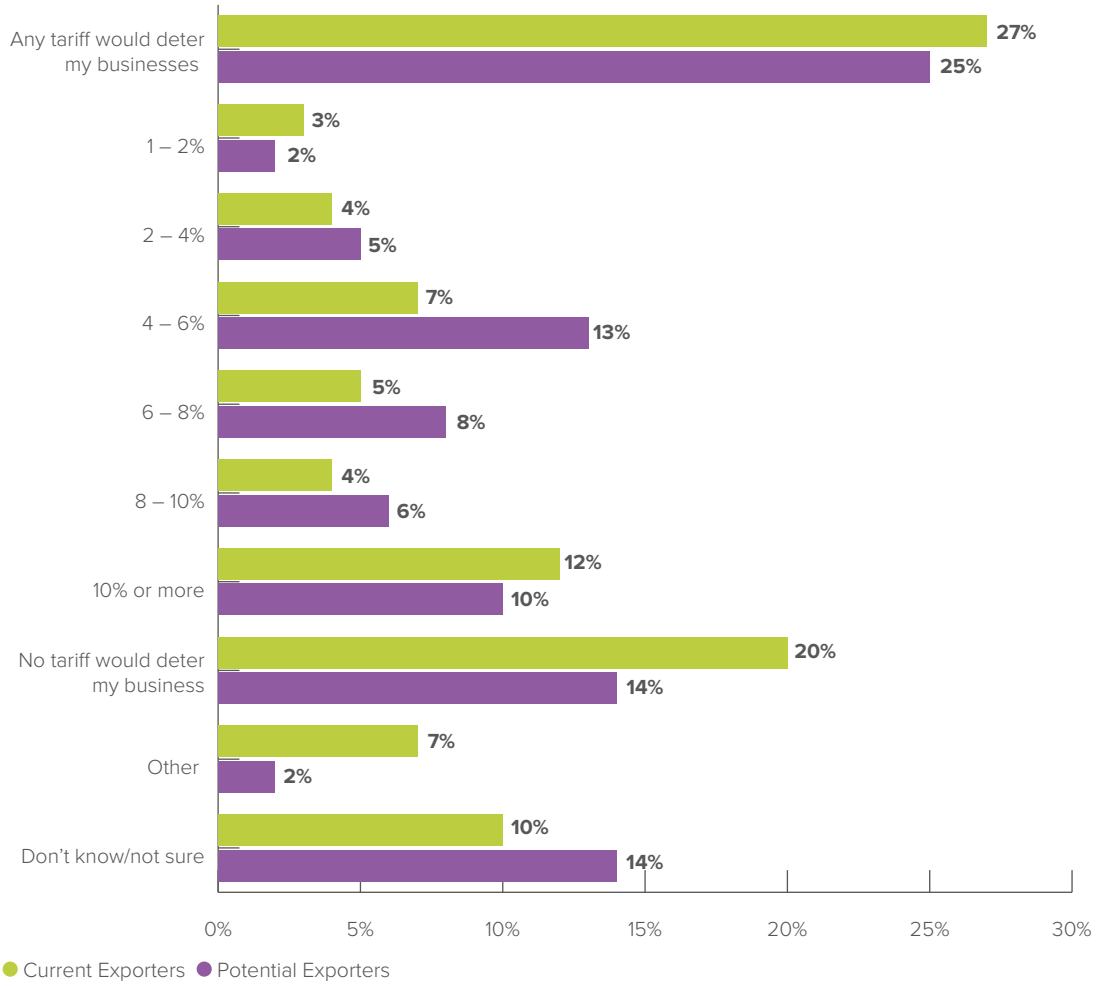


Figure 16 shows that tariffs are more likely to play a role in where Current Importers and Potential Importers buy from overseas, 65 per cent and 77 per cent, respectively. This is likely due to the fact that, in the majority of cases, it is the importer that pays the duties and is, therefore, more directly impacted by tariffs. Similar to the export trend, Potential Importers (34%) are more likely to believe tariffs will play a big role or the leading role, compared to Current Importers (25%).

Figure 17: Tariff rates that would deter Current Exporters and Potential Exporters from exporting to the EU
Source: FSB future trade with the EU and non-EU markets survey



Around one-third of exporters would be deterred from EU trade if EU's average applied tariff – under WTO rules – is introduced

Should tariffs be introduced, one very real concern is whether they will deter small firms from trading with the EU. The findings can also be taken as a wider indication of how small firms are likely to react to any new tariff schedules which may be part of other FTAs.

Figure 17 shows that the majority of both Current Exporters (62%) and Potential Exporters (69%) would genuinely be deterred, at various rates, from trading with the EU.[48] By contrast, around one in five Current Exporters (20%) and one in 10 Potential Exporters (14%) would not be deterred by any tariff rate, i.e. these small firms would export/import regardless of tariffs at any rate.

For some of these small firms, the niche market that they trade in or the unique appeal of their products affords them a greater level of protection against factors which can push up prices for the customer. These small firms are more confident in the competitiveness of their product, especially compared to other products which need to remain competitive on price alone.

> *"We operate in a niche market. I don't think tariffs would deter us from working with others who have a product or service that would add value to our customers."*
>
> FSB member, Current Exporter and Importer

48 Being 'deterred' does not necessarily imply that the respondents would either discontinue trading with the EU or be prevented from starting to trade with the EU.

"Any tariff imposed on our products will be met by purchasing customers. As we have a unique high value product that generates clean energy we would anticipate tariffs would be set lower rather than used to prevent buyers from importing our technology."

FSB member, Current Exporter

Should a UK-EU trade agreement not be reached by the time the UK leaves the EU, overseas trade will be based on World Trade Organisation (WTO) rules and tariffs. The principle of non-discrimination means that WTO members must not treat any member less advantageously than any other. There are exceptions for regional free trade areas and customs unions like the EU, but the principle implies that, outside of these, the tariff that applies to the 'most-favoured nation' (MFN) must similarly apply to all.[49]

Based on the EU's current MFN tariff regime, UK exporters are estimated to face a potential simple average tariff rate of between four to six per cent – the EU's simple average tariff rate in 2015 was 5.1 per cent,[50] and in 2014 it was 5.3 per cent.[51] Civitas – the Institute for the Study of Civil Society Europe – has also estimated that UK exporters will face a potential simple average tariff rate of 4.5 per cent.[52]

Certain industries, notably vehicles, food and agriculture, will face higher tariff rates. The EU tariff on cars, for example, is around 10 per cent.[53] Figure 17 shows that, should an average tariff rate that falls between four to six per cent be introduced, around two-fifths (41%) of Current Exporters would be deterred from trading with EU markets.

However, this is based on the potential simple average tariff and the trade-weighted average tariff (i.e. total tariff revenue as a proportion of the total value of imports) has tended to be lower. The most recent data available, from 2014, puts the EU's MFN tariff at 2.7 per cent,[54] and in 2013 it was 3.6 per cent.[55] Based on these averages, should an average tariff rate that falls between two to four per cent be introduced, this would genuinely deter around one-third (34%) of Current Exporters.

Many small firms operate on such thin margins that even the smallest increase in tariff rates can mean their product is no longer competitive in certain markets (after absorbing the costs of the tariff increase). Many small firms will simply not be able to absorb an increase in cost from the outset.

"We're already a premium brand, and if tariffs are added it could make a big difference to our appeal in terms of purchase price."

FSB member, Current Exporter, based in Essex

"We have little resources for anything other than selling, buying and making. Any extra laws or requirement, the harder that makes our jobs."

FSB member, Current Exporter, based in London

"For most exports, I'm selling retail – customer pays the UK list, less VAT if appropriate, plus the additional shipping and any import tariffs. If we leave the customs union, I expect EU sales will attract more duty than they save on VAT, with a consequent fall in my competitiveness. The complexity will also be a deterrent to retail customers."

FSB member, Current Exporter

49 Full Fact, What does leaving the EU mean for trade?, June 2016, available at: https://fullfact.org/europe/uk-leaving-eu-trade/

50 World Trade Organization, International Trade Centre, Conference on Trade and Development, World Tariff Profiles 2016, 2016, available at: https://www.wto.org/english/res_e/publications_e/world_tariff_profiles16_e.htm

51 World Trade Organization, International Trade Centre, Conference on Trade and Development, World Tariff Profiles 2015, 2015, available at: https://www.wto.org/english/res_e/publications_e/world_tariff_profiles15_e.htm

52 Protts, J., Potential post-Brexit tariff costs for EU-UK trade, October 2016, available at: http://www.civitas.org.uk/reports_articles/potential-post-brexit-tariff-costs-for-eu-uk-trade/.

53 Full Fact, What does leaving the EU mean for trade?, June 2016.

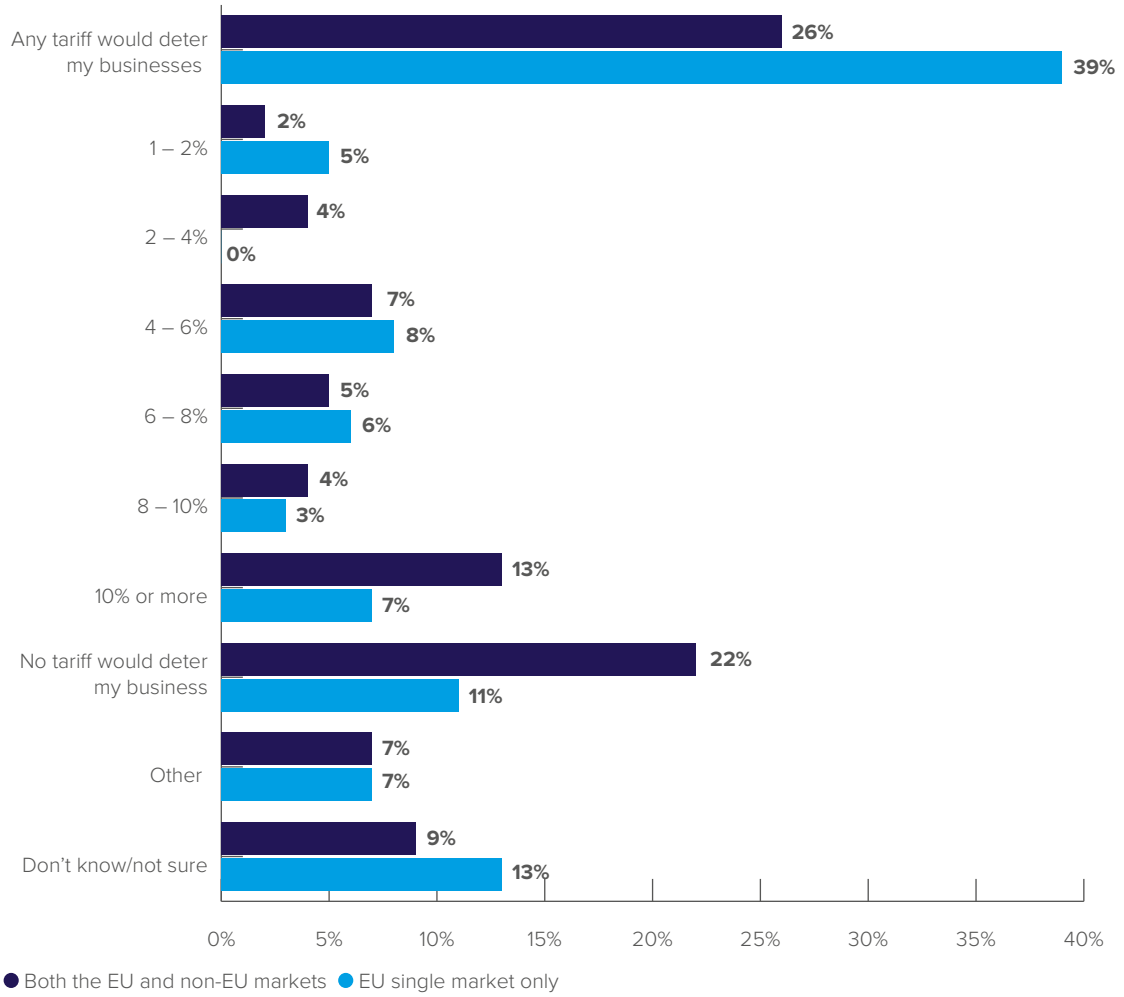
54 House of Commons International Trade Committee, UK trade options beyond 2019, March 2017, available at: https://www.publications.parliament.uk/pa/cm201617/cmselect/cmintrade/817/817.pdf

55 World Trade Organization, International Trade Centre, Conference on Trade and Development, World Tariff Profiles 2015, 2015, available at: https://www.wto.org/english/res_e/publications_e/world_tariff_profiles15_e.htm

> *"A higher tariff means higher costs of goods and then we either put up our prices with potential loss of business or cut costs elsewhere, such as in personnel."*
>
> FSB member, Current Exporter

Around one in four (27%) would be deterred by any tariff rate being introduced, i.e. any tariff rate that is not zero, as it currently is for trade between the EU and UK. This is similar to the findings for Potential Exporters.

Figure 18: Tariff rates that would deter Current Exporters that trade exclusively within the EU single market compared to Current Exporters that trade with both the EU and non-EU markets
Source: FSB future trade with the EU and non-EU markets survey



Tariffs would cause the greatest detriment to small firms that export exclusively within the EU single market

However, Figure 18 shows that Current Exporters that trade exclusively within the EU single market are half again more likely to state that any tariff rate would deter them, compared to those that trade with both the EU and non-EU markets (39% and 26% respectively). This suggests that small firms that export exclusively within the EU single market are significantly more likely to be negatively affected by any change to the status quo, in regards to tariffs. This is reinforced by other data points in Figure 18 – for example, Current Exporters to both the EU and non-EU markets are twice as likely as those that export exclusively with the EU to state that no tariff would deter their business from trading (22% and 11% respectively).

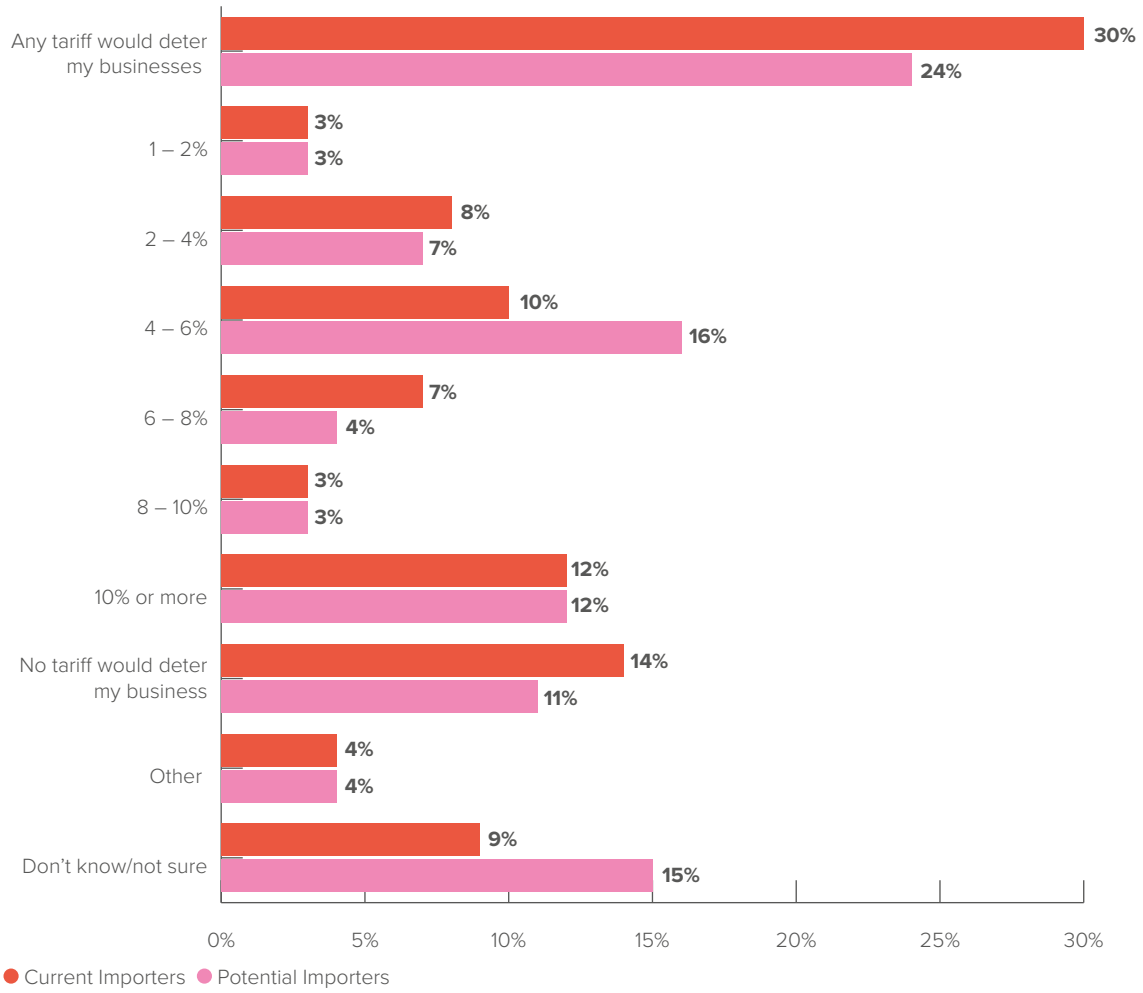
"Any tariff would deter my customers because it will raise my costs compared to EU-based competitors."

FSB member, Current Exporter

"We are fearful of all tariffs, not just because of cost, but further delays and issues in customs. My exports are direct purchases from consumers. If tariffs make us too expensive, there are retailers of the same products in Europe who will be cheaper."

FSB member, Current Exporter

Figure 19. Tariff rates that would deter Current Importers and Potential Importers from importing from the EU markets
Source: FSB future trade with the EU and non-EU markets survey



Around one-third of importers would be deterred from EU trade should any tariff be introduced

Around one-third (30%) of Current Importers state that any tariff rate would deter them from importing from the EU single market; however, around one in 10 (14%) would not be deterred by any tariff rate.

Overall, compared to Current Exporters, Current Importers are more likely to be deterred by the introduction of tariffs – including the lower range of tariff rates. For example, around half (51%) of Current Importers would be genuinely deterred from trading with the EU should they face a tariff rate that falls between four to six per cent.

"Tariffs would increase our costs – however, for the products we import from the EU there isn't a realistic alternative without changing our entire service line, so if we were able to pass costs on or absorb them we would be forced to do so."

FSB member, Current Importer

The growing importance and complexity of non-tariff barriers

Tariffs are, of course, not the only factor which may have a negative impact on small businesses exporting. Over time, trade liberalisation policies have reduced or eliminated many tariffs between nations, increasingly highlighting non-tariff barriers[56] and their impact on trade.[57] Indeed, as tariffs steadily decline, the significance of non-tariff barriers has grown as governments worldwide introduce more regulatory requirements to address, among other issues, health, safety or environmental concerns.[58] Minimising the effect of non-tariff barriers is widely seen to be of particular importance to service trades, including financial services.[59]

Financial services and the EU

The financial services sector is of critical importance to the UK economy. It employs nearly 2.2 million people[60] and contributed £190 billion to the UK economy in 2014, which represented 12 per cent of the UK's entire economic output.[61] It also plays an integral role towards maintaining the UK's future economic stability and growth. For these reasons, the UK's status as a leading global centre for financial services particularly across banking, insurance and FinTech – must be protected.

Small businesses directly participate in supply chains within the financial services sector, and also depend upon many of the key services it provides through its access to the EU single market. For example, UK small businesses also benefit from the harmonisation of regulated payments services across the EU Single Market, such as with card payments, direct debits and credit transfers. In particular, many UK small firms are reliant on the EU's Single Euro Payments Area (SEPA) to make and receive payments in euros. SEPA increases the efficiency of cross-border payments and reduces costs for small firms. The Government's negotiated settlement should, therefore, look to retain the UK's access to SEPA. In the event this access changes, steps should be taken to support the UK payments industry ensuring its operating systems and processes remain compatible with SEPA.

Passporting is a mechanism through which firms may exercise their right to provide services in an EU Member State, and it is an important component of the UK's current trading access across European markets. Passporting mitigates the regulatory and administrative challenges that would otherwise be caused by having to obtain separate authorisations across different individual EU Member States.

Consequently, a vast number of non-EU financial services institutions have chosen to locate their headquarters in the UK on the basis of access to the EU single market. Indeed, 250 foreign banks – more than any other financial centre – are based in London,[62] while 60 per cent of all European headquarters of non-EU firms are based in the UK.[63] The UK's decision to leave the EU has clearly raised important questions over how this economic activity will be affected by changes to existing passporting rights.

Another key issue is the impact to operations such as the clearing and settlement of financial

56 Non-tariff barriers can also sometimes referred to as non-tariff measures. While there can be technical differences attributed to these terms, in practice, these terms are often used interchangeably. For the purposes of this report, the widest definition of non-tariff barriers is used, whereby non-tariff barriers are defined as any trade restrictions that are not tariffs.

57 OECD, Looking Beyond Tariffs: The Role of Non-Tariff Barriers in World Trade, November 2005, available at: http://www.oecd.org/tad/ntm/lookingbeyondtariffstheroleofnon-tariffbarriersinworldtrade.htm.

58 European Commission, Technical barriers to trade, available at: http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150987.pdf 29 December 2016

59 Emmerson, C, Johnson, P. and Mitchell, I., The EU Single Market: The Value of Membership versus Access to the UK, available at: https://www.ifs.org.uk/uploads/publications/comms/R119%20-%20The%20EU%20Single%20market%20-%20Final.pdf

60 TheCityUK, Key Facts about UK Financial and Related Professional Services 2016, March 2016, available at: https://www.thecityuk.com/research/key-facts-about-uk-financial-and-related-professional-services-2016/

61 Ibid.

62 TheCityUK, Key facts about the UK as an international financial centre, November 2016, available at: https://www.thecityuk.com/assets/2016/Reports-PDF/Key-Facts-about-the-uk-as-an-international-financial-centre-2016.pdf

63 Ibid.

instruments, for example derivatives or interest rate swaps. For relevant small businesses, affordable access to such services is vital for managing currency risk and interest rate volatility. The UK (and particularly London) is a major hub for the clearing of instruments in a vast range of currencies. The size of this activity being carried out in the UK has led to economies of scale, from which many small firms subsequently benefit. The Government's negotiated settlement should give prioritisation towards protecting the current ability of UK banks and payment firms to offer products and services upon which small businesses rely – as well as protecting their ability to carry out eurozone clearing activities.

In order to maintain the flow of financial services, it is clearly in the interests of both the UK and the EU to maintain ongoing cooperation between relevant authorities. One key example is the EU's Capital Markets Union (CMU), which is seeking to enable the better matching of capital across European finance markets and, therefore, boost access to finance for small firms. Given the strength of the UK's capital markets (just under half of the EU's equity capital is already raised in the UK), mutual cooperation between the UK and the EU will be essential in achieving the successful implementation of such initiatives.[64]

In the short term, it is essential that a stable transition for the financial services sector towards any new trading relationship with the EU is secured, while also taking into account its impact on small businesses. In the longer term, the UK Government should work to ensure that the various products and services being developed out of the UK financial services sector retain regulatory equivalence with the EU single market so that trading access may be maintained.

The UN Conference on Trade and Development (UNCTAD) classifies 16 types of non-tariff barrier, ranging from measures favouring domestic industries to technical barriers to trade.[65] These non-tariff barriers can also be divided into three general groups based on their links with trade:

- Directly trade-related non-tariff barriers (e.g. import quotas, antidumping measures etc.).
- Non-tariff barriers that have a link with trade since their implementation is monitored at the border (e.g. sanitary and phytosanitary measures, packaging etc.).
- Non-tariff barriers that form part of wider general public policy (government procurement, investment restrictions etc.).[66]

Most small firms are not cognisant of the specificities of non-tariff barriers but are aware of the broad impact

Depending on how, what and the extent to which a small business trades overseas, the types of non-tariff barriers that they may encounter can vary hugely. Non-tariff barriers can be sector or industry specific, and the impact of non-tariff barriers can be more restrictive or widespread in particular sectors.[67] As such, individual non-tariff barriers and their impact on small businesses can be difficult to identify, distinguish and quantify. This can be particularly true for small businesses that are not very reliant on exporting (exporting small amounts or on an ad hoc basis) and are, therefore, less cognisant of non-tariff barriers and their effect on trade.

For small businesses, then, the impact of non-tariff barriers is often experienced and described in a broad sense, such as administrative burdens – "paperwork" – or additional requirements and delays at customs. It is clear that non-tariff barriers are as much about the impact they have on the ease of trade as about the cost of trade.

64 FT.com, Brexit and the Capital Markets Union, March 2016, available at: http://blogs.ft.com/ftdata/2016/03/24/brexit-and-the-capital-markets-union/.

65 UNCTAD, International classification of non-tariff barriers, 2012, available at: http://unctad.org/en/PublicationsLibrary/ditctab20122_en.pdf

66 EU, Eastern Neighbourhood Economic Potential and Future Development (ENEPO), A paper detailing the types of non-tariff barriers encountered in the EU and New Border Countries and their impact on trade, May 2006, available at: http://www.case-research.eu/sites/default/files/A%20paper%20detailing%20the%20types%20of%20non-tariff%20barriers%20encountered%20in%20the%20EU%20and%20New%20Border%20Countries%20and%20their%20impact%20on%20trade.pdf

67 WTO, World Trade Report 2012 - Trade and public policies: A closer look at non-tariff measures in the 21st century, available at: https://www.wto.org/english/res_e/booksp_e/anrep_e/wtr12-2d_e.pdf

"I import from the EU and that comes without any paperwork ... but when I import from America there are different hoops I've got to jump through ... For a small company selling lots of small value goods, it's the paperwork that's going to put us under. Because if you're selling something for £100 and you've got to do a customs declaration for every single one of those orders, the time you spend doing that is probably going to wipe out your net profit."

FSB member, Current Exporter and Importer, based in Oldham

"How many forms do I fill out to export into China? What's my limitation on currency? Do I have to retain funds in local country? It goes on and on and on ..."

FSB member, Current Exporter, based in London

"Within and out of Europe, we notice a massive difference. You can fulfil an order easily for Europe. America is a different kettle of fish, there is a lot more paperwork, and delivery time a lot longer... same coming into the UK. We've had things held for two weeks in British Customs."

FSB member, Current Exporter, based in Bath

"Difficult for us to export to USA ... there are a lot of hoops to jump through to sell alcohol... They operate very differently, you can only sell to wholesalers and, in every state, you have to apply to sell to a distributor."

FSB member, Current Exporter, based in Bristol

"We are a service industry and are quite nervous about possible [non-] tariff barriers. We would have to lower our fees to remain competitive."

FSB member, Current Exporter

In light of this, the likelihood of additional non-tariff barriers that businesses will face when the UK leaves the full EU customs union is particularly concerning for small firms. One much discussed non-tariff barrier that UK businesses do not currently face as members of the EU customs union, but are likely to face once outside of it, is ROO. Complying with ROO requires exporters to evidence the origin of their products, primarily for the purpose of applying the correct tariffs to them by the importing state.

A significant proportion of exporting small firms will not have encountered ROO before – especially, the 21 per cent that export exclusively within the EU single market. This means that there will be a familiarisation cost associated with ROO, in order for small firms to understand if it will be applicable to their exporting activities, in addition to any further costs required to comply.

Small businesses that operate their own global supply chain, that go through the EU single market, will be particularly affected. As discussed, global supply chains are becoming increasingly complex and complying with ROO can also include evidencing the level of processing that has taken place, to the product, in the specific countries it has gone through.[68] For specific sectors, such as manufacturing, globalisation of supply chains has been prevalent. For example, UK suppliers made up three-quarters of consumption of UK manufacturers in 1995 but this fell to around 64 per cent in 2011.[69]

ROO may require the firm to undertake a detailed level of supply chain analysis that was not required previously, as well as the actual cost of obtaining a Certificate of Origin[70]. Delays associated with ROO at customs – for example, verifying the necessary documentation – may also add to the overall cost of operating a global supply chain.

"Our goods are sensitive to time, so, if they are held up at customs then they degrade and we have to try again. This is a major issue when exporting to many non-EU countries. In addition, these hold ups are rather arbitrary."

FSB member, Current Exporter

68 This can be the case if the production of the product involves materials from more than one country.

69 Centre for Progressive Capitalism, Rebalancing the EU economy – a post Brexit Industrial Strategy, October 2016, available at: http://progressive-capitalism.net/wp-content/uploads/2016/10/Rebalancing-the-UK-economy-final-online-version.pdf

70 A Certificate of Origin is a document which identifies the origin of goods being exported and is issued by a Chamber of Commerce. It is required by customs in the buyer's country to determine tariff rates and determine the origin of the goods.

Figure 20: The role non-tariff barriers play in where Current Exporters and Potential Exporters decide to export
Source: FSB future trade with the EU and non-EU markets survey

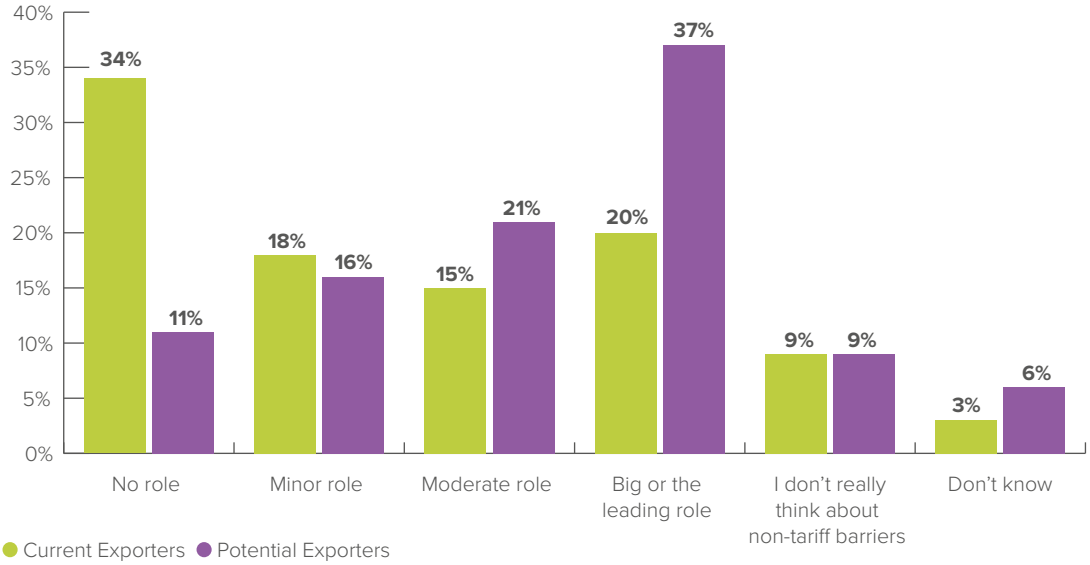
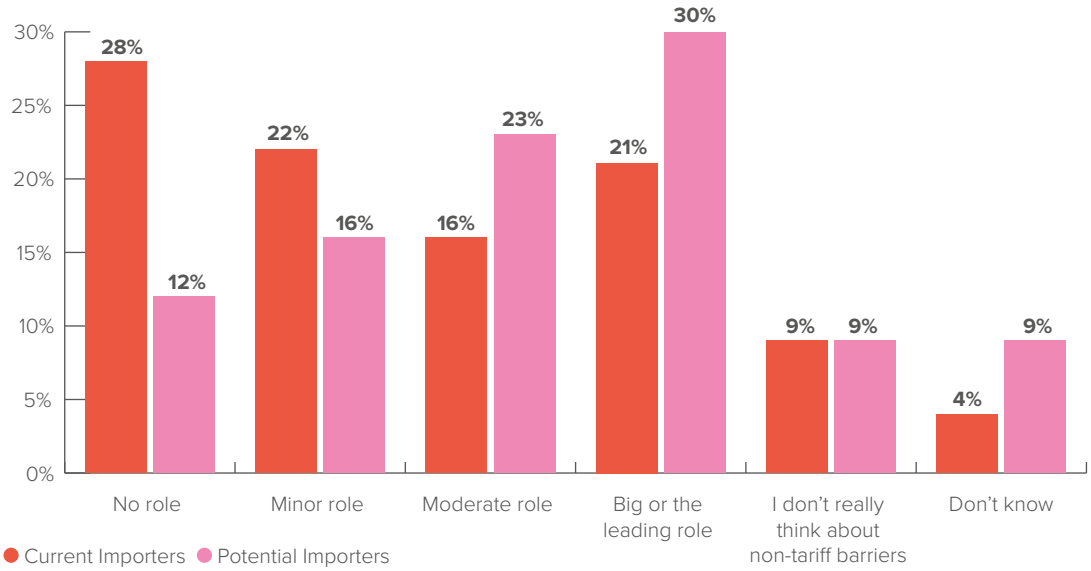


Figure 21: The role non-tariff barriers play in where Current Importers and Potential Importers decide to import from
Source: FSB future trade with the EU and non-EU markets survey



Tariffs and non-tariff barriers are of equal importance but particularly for potential traders

Figures 20 and 21 reinforce the view that non-tariff barriers are of equal importance to tariffs for small businesses. The majority of both Current Exporters (53%) and Current Importers (59%) say that non-tariff barriers play a role in where they decide to trade. Mirroring the trend for tariffs, around three-quarters (74%) of Potential Exporters and two thirds (69%) of Potential Importers anticipate that non-tariff barriers will play a role in where they trade. In fact, Potential Exporters are almost twice as likely to anticipate that non-tariff barriers will play a big role or the leading role compared to Current Exporters (37% compared to 20%, respectively).

Clearly, both tariffs and non-tariff barriers are given equal weighting in the minds of small firms in relation to with whom they trade. Crucially, both tariffs and non-tariff barriers appear to be given even greater consideration by Potential Exporters and Potential Importers. This difference suggests that

tariffs and non-tariff barriers are perceived to have more of a meaningful impact than they perhaps do in reality. A perception which is likely compounded by the uncertainty of what the UK's new trade relationships will mean for business, particularly for those with no experience of trading overseas.

On the other hand, this may also suggest that trade barriers play more of a role at the beginning of an exporter's or importer's journey – with experience, the firm is better at mitigating its impact, for example, by costing it into the business model.

Should new tariffs or additional non-tariff barriers be introduced, it is imperative that they do not form a deterrent – in perception or otherwise – for small firms to continue or start trading overseas.

VAT and cross-border trade

Determining the future treatment of Value Added Tax (VAT) in terms of trade with the EU single market will be imperative for small businesses. This is in no small part due to the administrative challenges faced by small businesses when complying with VAT. These include difficulties relating to the ongoing filing requirements needed to comply with the domestic tax authority where the goods or services are being sold. The distortive effect of different VAT rates that exist across EU Member States is also a problem which impacts upon small firms, who are used to the comparatively high UK VAT registration threshold of £83,000. The low VAT thresholds in some EU member states means that UK small firms have to pay VAT on sales for which they wouldn't otherwise be charged domestically.

New VAT rules for sales of digital services from businesses to consumers were introduced in January 2015 (including across telecommunications, broadcasting and electronic services). These rules meant that business to consumer sales became taxed in the EU Member State where the customer – rather than the supplier – was located.[71]

Alongside these changes, the EU announced the establishment of a VAT 'One-Stop-Mini-Shop' (MOSS) scheme, which enables EU businesses subject to these rules to register for VAT cross-border trade with their domestic tax authority, instead of having to register for VAT in every EU Member State where they sell relevant services.[72] In December 2016, the European Commission announced proposals to extend VAT MOSS to cover a broader range of goods and services.[73]

FSB's November 2016 survey found that 59 per cent of small businesses have not used VAT MOSS.[74] This is unsurprising given the current scheme's narrow scope. However, for those that have, only six per cent of respondents experienced a reduction in their costs and administrative burden, while eight per cent saw an increase. It is evident from this data that further progress is required to simplify the VAT MOSS scheme. In particular, uncertainty regarding VAT treatment at EU Member State level continues to represent a major barrier towards greater uptake. Low levels of awareness also remain an issue, as do the more general issues of language and cultural differences that are associated with wider barriers to exporting for small firms.[75]

Following Brexit, the UK's status in relation to the EU will become that of a third country. The Government should look to ensure small firms are still able to access VAT MOSS and ensure all future changes are clearly communicated. However, if this is not achievable, it is important that the Government ensures small firms have access to an alternative scheme whose procedures are broadly similar to the existing approach. The Government should also continue to engage with the EU's Action Plan on VAT to ensure mutual forms of cooperation may continue for the benefit of enhancing cross-border trade between the UK and European markets.[76]

71 Business to business sales were left unchanged.

72 VAT MOSS registered businesses are also required to prepare separate returns that account for VAT collected from consumers living in the EU.

73 European Commission, Commission proposes new tax rules to support e-commerce and online businesses in the EU, December 2016, available at: http://europa.eu/rapid/press-release_IP-16-4010_en.htm.

74 FSB survey on future trade with the EU and non-EU markets, 2016

75 European Commission, VAT Aspects of cross-border e-commerce - Options for modernisation - Final report – Lot 1, October 2015.

76 These measures include extending the OSS mechanism for EU and non-EU countries' online sales of tangible goods; EU-wide measures for threshold simplification for ecommerce businesses; removal of VAT small consignment exemptions from non-EU suppliers so that EU suppliers stop being disadvantaged. The VAT initiative also entails measures specifically targeted at SMEs and measures are foreseen to include a simplification package to be presented in 2017.

Global supply chains

It is not only small firms that export or import – either currently or in the future – that are likely to be affected by the UK leaving the EU single market and full EU customs union. Small firms that have any relationship with global supply chains will also likely be affected to some degree.

For the purposes of this report, a supply chain is defined in its broadest sense as the sequence of processes involved, between a company and its suppliers, to produce and distribute a product to its customer. As a result, there is likely to be variation in how small firms choose to define a global supply chain. Therefore, the value of the findings below is more in how small firms with different supply chain relationships, in particular those that route through the EU single market and those that do not, compare in regards to what actions they will consider, as a result of Brexit.

Currently, as a member of the EU single market and full EU customs union, UK products can move freely across borders, within the single market, incurring zero import duties and are generally not subject to customs checks.[77]

Figure 22. Supply chain status
Source: FSB future trade with the EU and non-EU markets survey

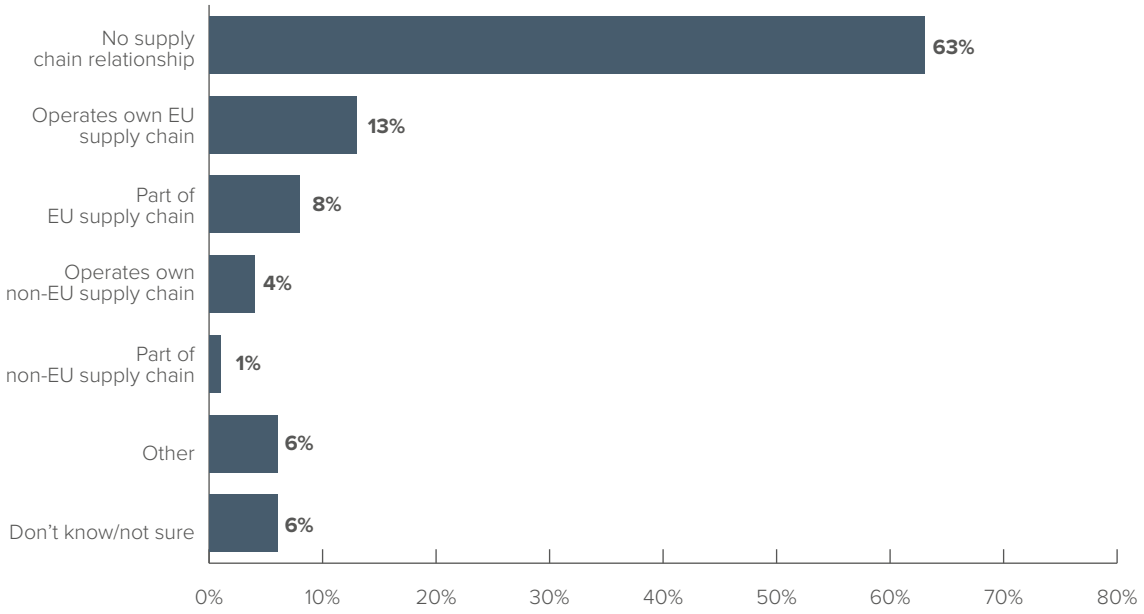


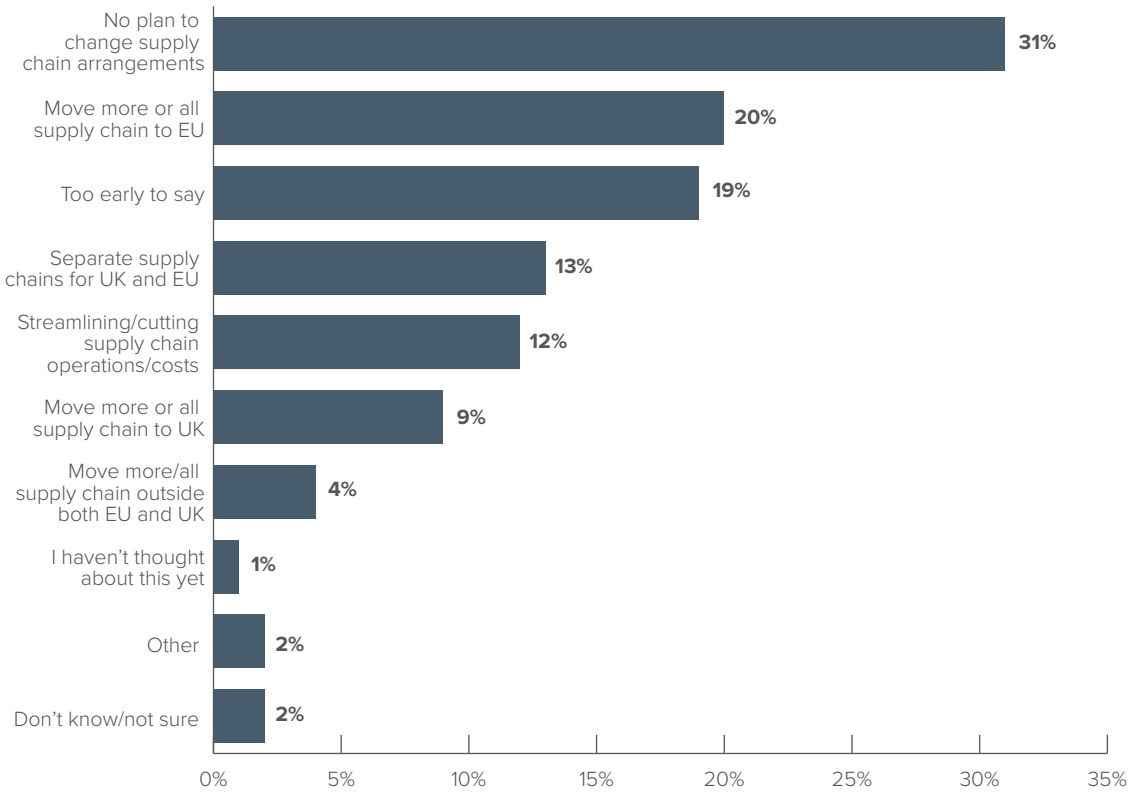
Figure 22 shows that almost one in five (17%) small firms operate their own global supply chain; around three-quarters of these supply chains (76%) move through the EU single market. Additionally, around one in 10 (9%) small firms are part of another company's global supply chain; the majority (89%) of these supply chains move through the EU single market. This means that around one in five (21%) small businesses could be meaningfully affected by changes to the status quo.

Supply chains have become increasingly globalised and complex over the past few decades.[78] As such, many small firms – which would typically be lower down the supplier chain – may not realise that they form part of a global supply chain. Therefore, the proportion of small firms that could be affected by changes to global supply chains is likely to be higher than Figure 22 shows.

77 Supply chains also involve human resources, which means people moving across borders in relation to the supply chain may also be affected. This will be explored in the next report in this Brexit series, which looks at access to labour, skills and doing business across the EU.

78 WTO, World Trade Report 2012.

Figure 23. Actions small firms with EU supply chains will consider as a result of the UK leaving the EU
Source: FSB future trade with the EU and non-EU markets survey



Small firms with EU supply chains are twice as likely to relocate more or all of their supply chain to the EU as the UK

The UK leaving the EU may also have an impact on businesses operating non-EU supply chains (4%) – around one in five (22%) would consider changing some aspect of their supply chain arrangements – although, the reasoning behind this is less clear. However, the majority (60%) of small firms operating non-EU supply chains have no plans to change their current arrangement; this is double the proportion of those with EU supply chains that have no plans (31%). This clearly demonstrates the considerable impact of the UK leaving the EU on small firms that operate their own global supply chains.

Almost half (45%) of small firms with EU supply chains will consider changing their supply chain arrangement as a result of the UK leaving the EU. Of the various forms of actions presented in Figure 23, one in five (20%) small firms will consider moving **more or all** of their supply chain to the EU single market, making it the most likely action being proactively considered. Of this group, around half (46% - making it 9% of total respondents with EU supply chains) will consider **moving all** of their supply chain to the EU single market.

By contrast, around one in 10 (9%) small firms will consider the opposite action, to move **more or all** of their supply chain to the UK. Of this group, only one-fifth (21% - making it 2% of total respondents with EU supply chains) will consider **moving all** of their supply chain to the UK.

"We import and export with other EU countries. If there are trade barriers we will be obliged to set something up on the continent."

FSB member, Current Exporter and Importer

"I can already see my input costs rising. At the same time, my export customer base is getting a bit shaky. Relocation of the business to the continent looks like the most viable solution."

FSB member, Current Exporter and Importer

Around one in five (19%) state that it is too early to say if they will consider any actions to change their supply chain arrangements.

The actions that small firms will consider highlight the obvious advantages of cross-border trade within the EU single market and full EU customs union. Many business models are predicated or heavily dependent on being able to take advantage of this 'borderless' trade – deliberately basing all or part of their business and supply chain within the EU single market and EU customs union. This includes many foreign companies that exploit the UK's position, being a member of the EU, as a gateway to conduct business and trade easily with other member states. This is likely to have an impact on the levels of foreign direct investment coming into the UK in the medium and longer term, once the UK has exited the EU.

Foreign Direct Investment

Foreign Direct Investment (FDI) refers to investment that "adds to, deducts from or acquires a lasting interest in an enterprise operating in an economy."[79] While not the same as capital expenditure on fixed assets which is a more direct indicator of productive investment, FDI does provide an important measure of international investment patterns between the UK and the rest of the world.

One possible impact of the UK leaving the EU is a change in the flow of FDI into the country. Foreign investors looking to establish and grow their presence in the UK may look to do so because they want trading access to the EU single market. This is particularly true for financial and professional services sectors, which is a disproportionately large recipient of FDI. Services accounted for 61 per cent of FDI with 26 per cent of this devoted to financial services.[80] An example of this can be seen with the rapid growth of the UK's FinTech industry. FDI in FinTech's credit and lending sectors accounted for 75 per cent of total European volumes in 2014 alone.[81] Therefore the way in which the UK's access to European markets changes – particularly in relation to current passporting rights – could have implications for both the inward flow of FDI the UK receives as well as the primary motivations of foreign investors.

In the short term it is worth noting that the sharp depreciation of sterling (by 18 per cent since November 2015)[82] may have had a positive impact on FDI flows into the UK. However, the Bank of England has publicly warned that such volatility, from a financial stability perspective, is likely to negatively impact upon FDI in the longer term due to increased risk of investor uncertainty.[83]

In terms of sources of FDI flows into the UK, Europe leads with £202 billion recorded in the four years up to 2015.[84] This reflects the fact that European owned firms contribute significantly towards productive investment to the UK economy. Indeed, in 2013, 46 per cent of assets held in the UK by overseas residents and businesses were attributable to the EU.[85]

The specific importance of FDI to UK small businesses can also be shown by highlighting its relevance to supply chains. Figure 23 below looks at the level of supply chain and production spending that is generated by non-UK European owned firms in each industry group.[86]

79 Office for National Statistics, 'Foreign direct investment (FDI) – further information', (1st February 2016), https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/methodologies/foreigndirectinvestmentfdifurtherinformation

80 Office for National Statistics, 'International perspective on UK foreign direct investment (FDI): 2014', (30th August 2016), https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/internationalperspectiveonukforeigndirectinvestmentfdi/2014

81 EY & HM Treasury, 'UK FinTech - On the cutting edge An evaluation of the international FinTech sector', (2015), p.7.

82 Bank of England, 'Inflation Report', (February 2017), 10, http://www.bankofengland.co.uk/publications/Documents/inflationreport/2017/feb.pdf

83 Treasury Committee, 'Oral evidence: The economic and financial costs and benefits of UK membership of the EU, HC 499', (Tuesday 8th March 2016), http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/the-economic-and-financial-costs-and-benefits-of-uks-eu-membership/oral/30246.html

84 Office for National Statistics, 'Foreign direct investment involving UK companies: Inward tables', (2nd December 2016), https://www.ons.gov.uk/businessindustryandtrade/business/businessinnovation/datasets/foreigndirectinvestmentinvolvingukcompanies2013inwardtables

85 Office for National Statistics, 'How important is the European Union to UK trade and investment?', (26th June 2015), http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/rel/international-transactions/outward-foreign-affiliates-statistics/how-important-is-the-european-union-to-uk-trade-and-investment-/sty-eu.html

86 In the context of this discussion only, EU specific data was not available so European firms refers to all firms registered outside of the UK in the European geographic area.

Figure 24: Supply chain and production spending by non-UK EU owned firms
Source: Annual Business Survey, Office for National Statistics, CEBR analysis[87 88]

Industry group	£bn
Production	119.5
Distribution, transport, hotels and restaurants	57.3
Government, health and education	40.9
Professional and support activities	25.0
Financial and insurance	17.7
Real estate	11.8
Information and communication	9.7
Construction	7.1
Other services	6.4
Agriculture	4.4

This contribution is defined in terms of intermediate consumption i.e. spending on goods and services used as part of the supply chain and production process. In 2012, the latest year for which data are available, non-UK European owned firms were responsible for £300 billion of intermediate consumption – 21 per cent of the UK total. Numerous businesses – many of which are small - depend on this investment to maintain operations and to grow.

Dealing with supply chains which go through non-EU markets can be associated with more risks, from having products "stuck at customs" or on "sunken ships". Even when very little risk is involved, the additional time it may take to send or receive a product can be problematic in terms of managing payments and cash flow.[89]

"[on supply chain delays with non-EU countries] ... it's further away for a start, you go through lots of different countries before you arrive at your destination. Ships dock in different ports and they've all got different procedures that can add to the timescales, whereas, in the EU, you put it on the truck and it gets there."

FSB member, Current Exporter, based in Manchester

87 FSB commissioned CEBR (Centre for Economic and Business Research), in 2015, to undertake an economic analysis of the implications of Brexit on FDI.

88 The methodology for calculating the figures presented in Figure 23 is as follows: Total intermediate consumption by industry group figures were taken from the ONS' 2012 supply and use tables. They were then adjusted to reflect just foreign-owned consumption using the foreign-owned/ UK-owned firm turnover figures from the Annual Business Survey. Finally foreign-owned consumption was further adjusted to isolate just European owned consumption. This was done using turnover by continent of owner data from the Annual Business Survey.

89 Future of trade with the EU and non-Eu markets focus group 2016.

Borderless trade is essential for Northern Ireland's economy

Easy and free access across member state borders is especially important, and valuable, for small businesses in Northern Ireland because of its shared land border with the Republic of Ireland.

A substantial proportion of small businesses rely on being able to cross the border freely for trade, both in terms of products and people.[90] While it is difficult to fully quantify the value that UK small firms derive from accessing this border, total cross-border trade (from both sides) in manufactured goods alone was £2.448 billion in 2014.[91]

Northern Ireland's economy is highly dependent on their agri-food sector and the perishable nature of the products means that proximity in terms of trade opportunities is paramount. A substantial eco-system has developed over time to service this sector, including businesses operating in value-added products and food processing. Lots of food products are sent across the border, from Northern Ireland to the Republic, and vice versa, to get processed. Any trade measures which delay this trade across borders, or result in additional costs, are likely to be highly damaging to small businesses working in this sector.[92]

In a broader context, the food and drink industry, among other industries, are highly integrated across the whole of the island, for example, certain livestock are predominately farmed in Northern Ireland while others in the Republic of Ireland.[93] Any border measures which disrupt this current arrangement would remove the advantages of integrating certain economies across the whole island, damaging Northern Ireland's economy.

Pipeline of small business exporters

Getting small firms to export for the very first time is key to ensuring a strong and growing pipeline of small business exporters. While every market throws up new barriers, having already exported previously or elsewhere often empowers small firms to take these challenges in their stride and continue exporting.

"I think there is an element of doing it the first time when you are exporting. I know when we've exported to China ... once you done it a few times it gets easier. There is a barrier about getting over doing exporting [for the first time]."

FSB member, Current Exporter, based in Bristol

It is important, therefore, to understand what triggers small businesses to export for the first time and to which export destination this relates. In turn, this should provide some insight into how the UK leaving the EU single market may affect the pipeline of small businesses becoming exporters.

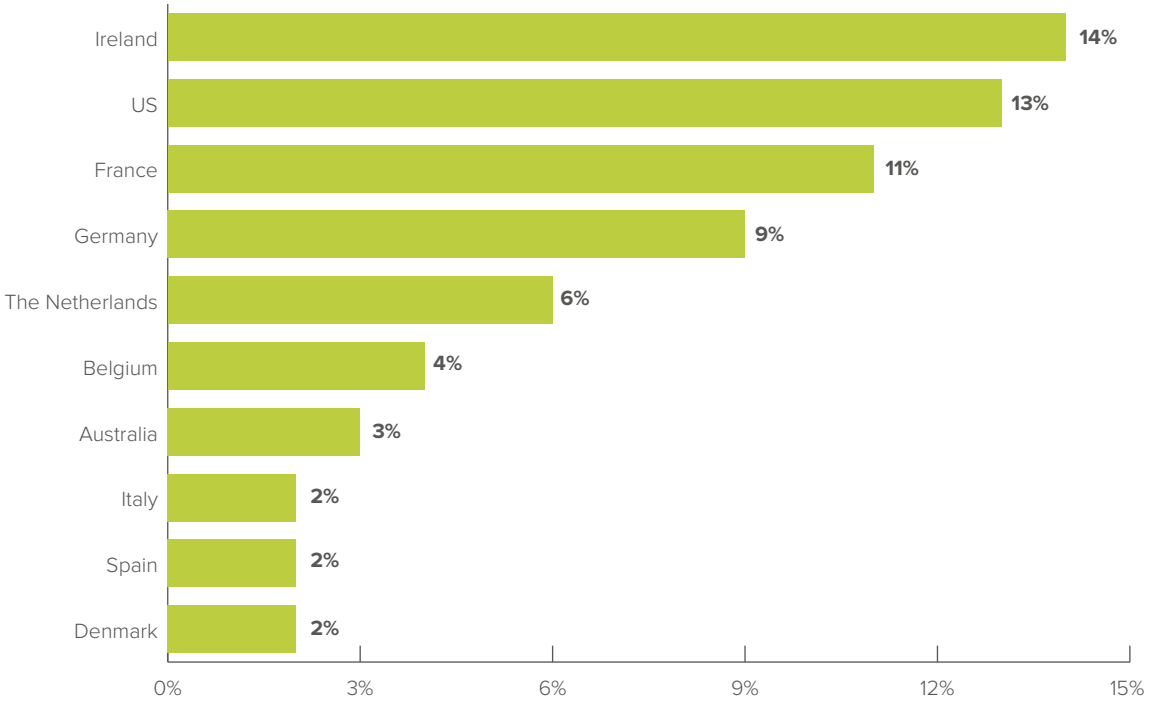
90 FSB meetings with Northern Ireland government officials and various political party representatives, and focus group on Future of trade with the EU and non-EU markets 2016.

91 InterTradeIreland, All-Island Trade Statistics, available at: http://www.intertradeireland.com/researchandpublications/trade-statistics/total_cross_border_trade/

92 FSB meetings with Northern Ireland government officials and various political party representatives, and focus group on Future of trade with the EU and non-EU markets 2016.

93 Ibid.

Figure 25: First country Current Exporters traded with
Source: FSB future trade with the EU and non-EU markets survey



Small firms are twice as likely to have exported for the first time with the EU as non-EU markets

The majority of exporting small businesses, around two-thirds (68%), made their first export to the EU single market – this is double the proportion of small firms (32%) that exported first to a non-EU market. Figure 25 shows that EU countries make up eight of the top 10 countries that Current Exporters first traded with outside the UK; only the US and Australia feature in this set of countries. The US was the first export destination for around one in 10 Current Exporters (13%) – making it the second most likely first country that a small business would have exported to.

Figure 26: Reasons why Current Exporters first exported to the EU
Source: FSB future trade with the EU and non-EU markets survey[94]

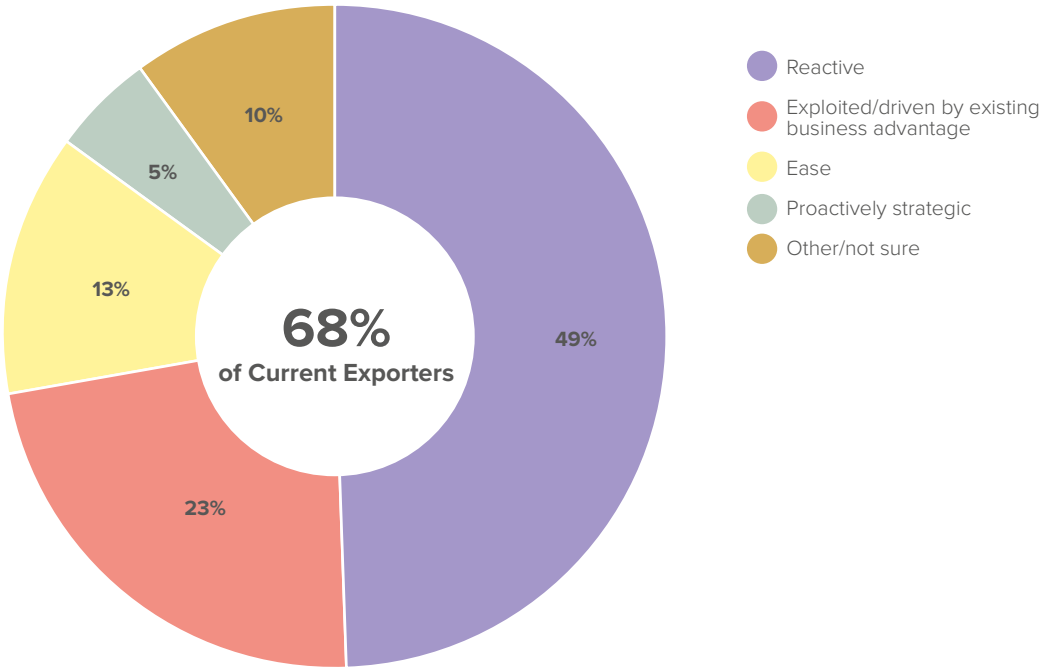
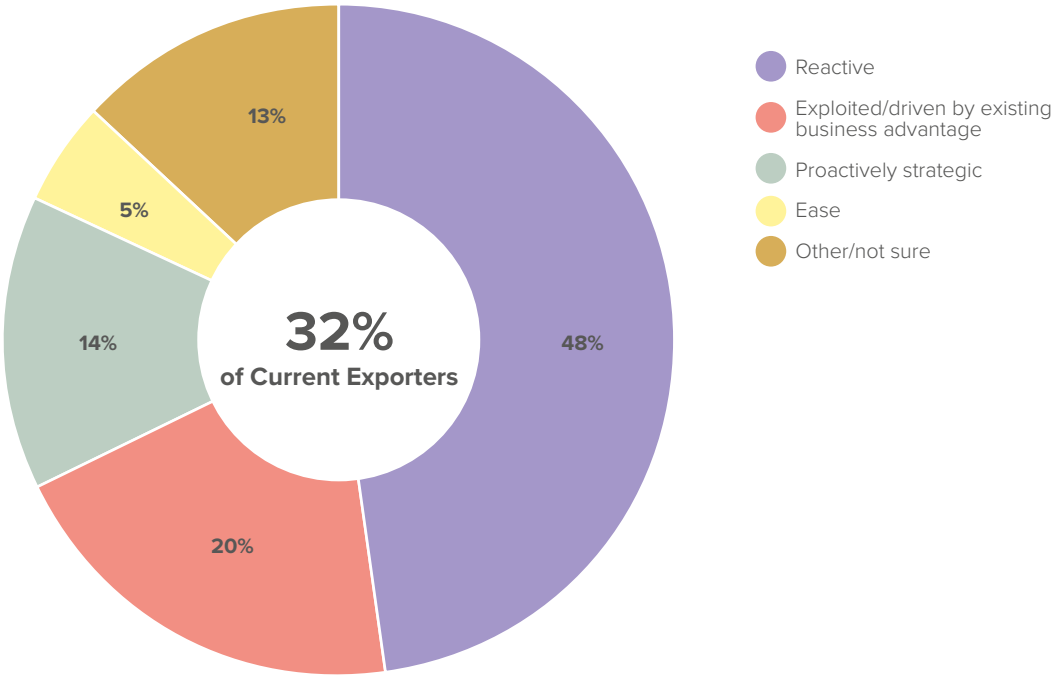


Figure 27: Reasons why Current Exporters first exported to a non-EU market
Source: FSB future trade with the EU and non-EU markets survey[95]



94 Findings represented in this pie chart are based on literals of respondents, which stated their first export destination was to a country that is part of the EU Single Market, explaining why they had exported to this country as their first export destination.

95 Findings represented in this pie chart are based on literals of respondents, which stated their first export destination was to a non-EU market, explaining why they had exported to this country as their first export destination.

Similar reasons drove first time exporters regardless of destination

While Current Exporters were more likely to have started trading with the EU single market than elsewhere, the reasons behind why they did so are remarkably similar to those that started trading with non-EU markets.

Figure 26 and Figure 27 show that around half were triggered to export for the first time because they were responding to a direct demand for their product (categorised as being 'reactive' in Figure 26 and 27). Around one in five small businesses' first export destinations were driven by an existing business advantage. These advantages vary hugely and tend to be unique to the individual business, but they can be anything that gives the business a competitive advantage in trading with a particular market, or something which would make it easier for them to trade with a particular market.

"Before setting up our UK company, we worked in Germany, and had trade contacts there that formed the core of our customer base."

FSB member, Reason for Germany being their first export destination

"That's where one of my UK customers moved production to."

FSB member, Reason for India being their first export destination

"We had good contacts in the US and they introduced us to certain customers, which has since grown considerably."

FSB member, Reason for the US being their first export destination

"Long familiarity with this country through previous professional career."

FSB member, Reason for Finland being their first export destination

However, there are a couple of noticeable, albeit small, differences between the small firms that exported first to the EU single market and those that exported first to non-EU markets.

Ease of trade appeared to play a bigger role driving exporters to the EU single market than non-EU markets. Small businesses highlight a variety of factors which made exporting to certain EU countries easier than elsewhere: the proximity of countries; low costs involved, including delivery; easy access to the markets; similarities in culture and business environment; and language (usually in reference to the prevalence of English being spoken in EU countries).

Some factors pertained to particular countries more than others, for example, small firms often remarked that trading with the Netherlands is easy "because they speak English very well". Ireland is uniquely attractive in its geography as it shares a land border with the UK. Many small firms traded with Ireland, in the first instance, because of its "close proximity", as the UK's natural "neighbour". This is especially the case for Current Exporters based in Northern Ireland.

"We are based in Northern Ireland – Ireland is physically close, same language, similar regulation, and same culture."

FSB member, Current Exporter, based in Northern Ireland

Some Current Exporters spoke about the ease of exporting within the EU single market in terms of the regulatory equivalence or mutual recognition that covers certain sectors or products.

"I could become a supplier approved by them because I was based in the EU."

FSB member, Reason for France being their first export destination

The focus group discussions emphasised the reciprocal nature and mutual benefit of the relationship between the UK and the members of the EU single market. The ease of exporting to other EU member states means the UK is similarly an easy country to import from. This explains why such a large proportion of exporting occurred and continues to occur because of direct demand from other countries in the EU single market.

By contrast, Current Exporters that first exported to non-EU markets were more likely to have been driven by a strategic approach to export to a particular market, rather than because the market was explicitly easy to export to. This seems especially true in terms of the US, with many small firms mentioning its sheer market size and potential. However, many of these responses are also coupled with factors relating to ease, such as a shared language and similar culture.

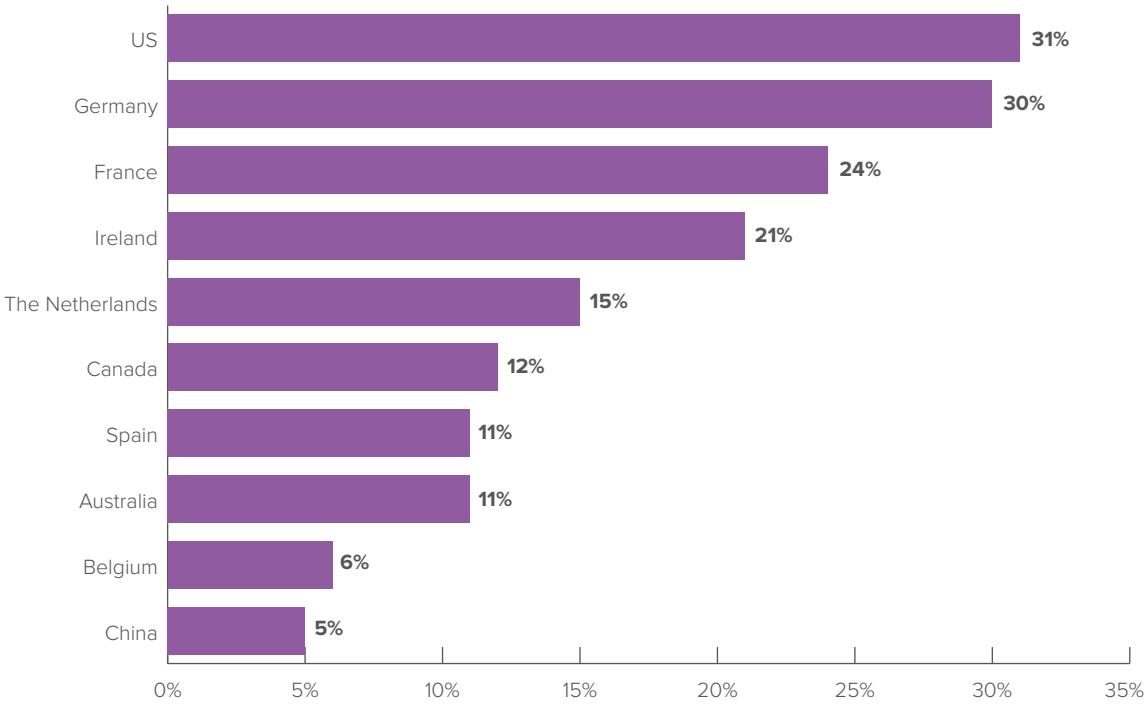
> *"Cultural similarities & large market – also willing customers."*
>
> FSB member, Reason for the US being their first export destination

> *"Large market and free enterprise spirit when dealing with them."*
>
> FSB member, Reason for the US being their first export destination

It is clear that small firms were twice as likely to start exporting within the EU single market as outside of it – cutting their exporting teeth, so to speak, in the easiest place afforded to them. When the UK exits the EU single market, there is a concern that the easy starting ground for small businesses to begin exporting to – either reactively or proactively – will be diminished.

Of course, the average Current Exporter has been selling overseas for 12 years – this is consistent with previous FSB research.[96] Furthermore, over recent years, with the development of e-commerce and technologies to better connect businesses globally, exporting should have become easier. Major geopolitical changes and shifts in the global economy have also taken place over the past decade. Therefore, it is also important to understand where Potential Exporters are most likely to consider exporting to for the first time, and why.

Figure 28: Countries Potential Exporters would consider exporting to first
Source: FSB future trade with the EU and non-EU markets survey



96 FSB report, Destination Export: The Small Business Export Landscape, July 2016, available at: http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-destination-export-report-2016.pdf?sfvrsn=0.

Potential exporters are still more likely to consider the EU but the gap has narrowed with non-EU

Figure 28 shows that small firms, if they were to start exporting, are still more likely to consider a country within the EU single market than a non-EU market. Of the markets that Potential Exporters would consider, around three-quarters (77%) are EU markets compared to half being non-EU markets (54%).[97] Germany (selected by 30% of respondents) is as likely to be considered as the US (31%), followed by France (24%), Ireland (21%) and the Netherlands (15%).

"Easy access in EU without too much admin, easier to chase debts, not as far to travel, transport/ postage costs reduced - travel costs for providing on-site support to customers much easier and cheaper."

FSB member, Reason for considering Germany, France and Poland as their first export destinations

However, compared to Current Exporters, the gap between choosing to export first to the EU and non-EU markets is not as wide. Of the top 10 export destinations that Potential Exporters are most likely to export to first, four are non-EU markets. Similar to the top 10 first export destinations for Current Exporters, the US ranks at the top; almost a third of Potential Exporters (31%) are likely to export there. Around one in 10 are likely to choose Canada (12%) or Australia (11%), and five per cent of Potential Exporters would consider China as one of its first export destinations. The appearance of these Anglosphere markets, higher up the rankings for Potential Exporters, suggests that these countries have become more attractive as export destinations.

Overall, the top 10 export destinations in Figure 28 reinforce the view that, in addition to exploiting existing business advantages (which again featured heavily in the reasons provided) ease of trading is the key driver for the majority of small firms. The top nine markets are all mature economic markets, which are either part of the EU single market or Anglosphere.

"Language. Size of market. Market maturity."

FSB member, Reason for considering Canada, US and Germany as their first export destinations

"Easiest to understand their trading rules; and the largest trading blocs."

FSB member, Reason for considering Germany, France and US as their first export destinations

Only China bucks this trend (and it is noteworthy that India directly follows China in the rankings with a similar share of small firms that would choose to export there first). The sheer size of both China and India's burgeoning middle class and the potential presented by their growing economies makes them particularly attractive to many small firms. As a member of the Commonwealth, India is also seen to be an attractive destination because of its prominent use of the English language and similarities with the UK's legal system.

While a significant minority (around one-third) of Potential Exporters would consider a combination of markets that comprise a mix of both EU and non-EU markets, the majority selected markets that were either exclusively EU markets or non-EU markets.

Geographic proximity continues to be an important factor for a significant proportion of small firms, particularly those that would consider exporting to the EU. As discussed in relation to Northern Ireland's economy, this is especially true for those working in certain sectors, such as food and agriculture; the perishable nature of products makes it more challenging to export further afield.

"For places like Australia, where we do have potential free trade deals, [because we make] a perishable product, it is not that appealing for our business. The closer for us the better, but not essential. We can start looking at places like China, but would have to invest in the machinery. For example, canning is very popular now for real ale beer if shipping and, of course, if you are shipping it that far cans weigh a lot less than bottles [which is what we would currently export]. Getting a canning machine, you're looking at £100,000, top range £300,000, so it's a lot of investment we would need to do, for not guaranteed business."

FSB member, Current Exporter, based in Bristol

97 Respondents were allowed to select up to three separate countries (both countries that are part of the EU single market and non-EU markets).

However, around half (54%) of Potential Exporters would also consider exporting to countries outside of the EU single market, and it is no coincidence that the most common ones are also strongly associated with ease, particularly, the US, Canada and Australia. This is an attractive message for small firms that may not have considered exporting outside the EU single market.

Other non-EU markets, such as China and India, will continue to be seen as increasingly attractive, as large emerging markets, but it is likely to be more difficult to convert this interest into actual exporting activity, given the added levels of complexity involved for a typical small business.

> *"In the SE Asian countries we are dealing with we have more issues... experience of a different culture is you have to formalise a lot more things, you have to make sure you get paid, and get a commitment in writing. In the US, an email is enough for an order and you can trust you're going to get paid. "*
>
> FSB member, Current Exporter, based in Bristol

Exit from EU could risk damaging the pipeline of small business exporters if not carefully managed

Overall, while Potential Exporters are more likely to start exporting, for the first time, outside the EU single market than their predecessors, a larger majority would still consider starting within the EU single market (55% compared to 74% respectively).

Further, it cannot be assumed that those that would consider exporting first outside the EU single market will end up doing so. The reactive nature of most small business exporters, coupled with the overriding driver to trade with the easiest market (which is still the EU single market for most) means there is likely to be a discrepancy between perception and reality in regards to where small firms will start exporting.

On balance, the majority of small businesses are indiscriminate about actual countries or regions in themselves; anywhere in the world is a possible market as long as it is easy to trade with. In this respect, the growing ambition to export further afield, even just in principle, is promising. The challenge is to ensure non-EU markets are as easy to trade with as possible.

In the meantime, though, the prevalence of the EU single market, as an export destination for first-time exporters, means that the UK's withdrawal from it needs to be carefully managed to mitigate any deterring effects it may have on small firms. Removing one of the easiest options for small firms considering exporting to for the first time, without a clear strategy to promote other accessible markets and to retain as easy access as possible with the EU, could damage the pipeline of small business exporters.

PRIORITY MARKETS FOR A GLOBAL UK

When the UK leaves the EU, we will lose our membership of the EU single market and the full EU customs union. This will reduce our ability to trade freely with the EU or countries with which the EU has negotiated a preferential trade arrangement (PTA). Instead, the Government has made it clear that it will seek a FTA with the EU that provides the "greatest possible access to the EU single market".[98] Additionally, the UK Government is looking to negotiate a new customs agreement, with the aim of "tariff-free trade with Europe and cross-border trade there to be as frictionless as possible."[99]

Crucially, leaving the full EU customs union means the UK will be in the position to negotiate its own FTAs with countries outside the EU.[100] With this new power, understanding with which non-EU markets the UK should prioritise is key.

The most obvious way to segment non-EU markets is by geography – individual countries or regions. However, other non-geographic factors can also be used, ones based on language, culture or trading environments. As discussed in this report, these non-geographic factors are often the drivers behind where small businesses end up trading and, therefore, useful indicators of which non-EU markets should be prioritised. This means that a priority market – such as the Anglosphere – can consist of countries that span across different geographic regions.

The value, or potential value, of a market is another factor which drives where small businesses trade. These include mature economies, but also emerging markets. While there are certain geographic regions which are perceived to present greater levels of trade potential – for example, Asia and Asia-Pacific[101] – again, there are also groups of individual countries, spread across different regions, which, together, form a target market for high trade opportunities. The most well-known group of such countries is BRICS (Brazil, Russia, India, China and South Africa). However, there are other similar groups which have emerged over time – for example, MINT (Mexico, Indonesia, Nigeria and Turkey) has been hailed as the new BRICS[102] – reflecting shifts in the global economy.

As the UK will be leaving the EU single market, the Government is keen to exploit other relationships which may offer trade opportunities of a similar scale. In this respect, the Commonwealth has been frequently advocated as a natural ally, where the UK should prioritise seeking a more formalised and enhanced trade relationship.[103]

98 Prime Minister's Office, 10 Downing Street, The Rt Hon Theresa May MP and Department for Exiting the European Union, The government's negotiating objectives for exiting the EU: PM speech, January 2017, available at: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech

99 Ibid.

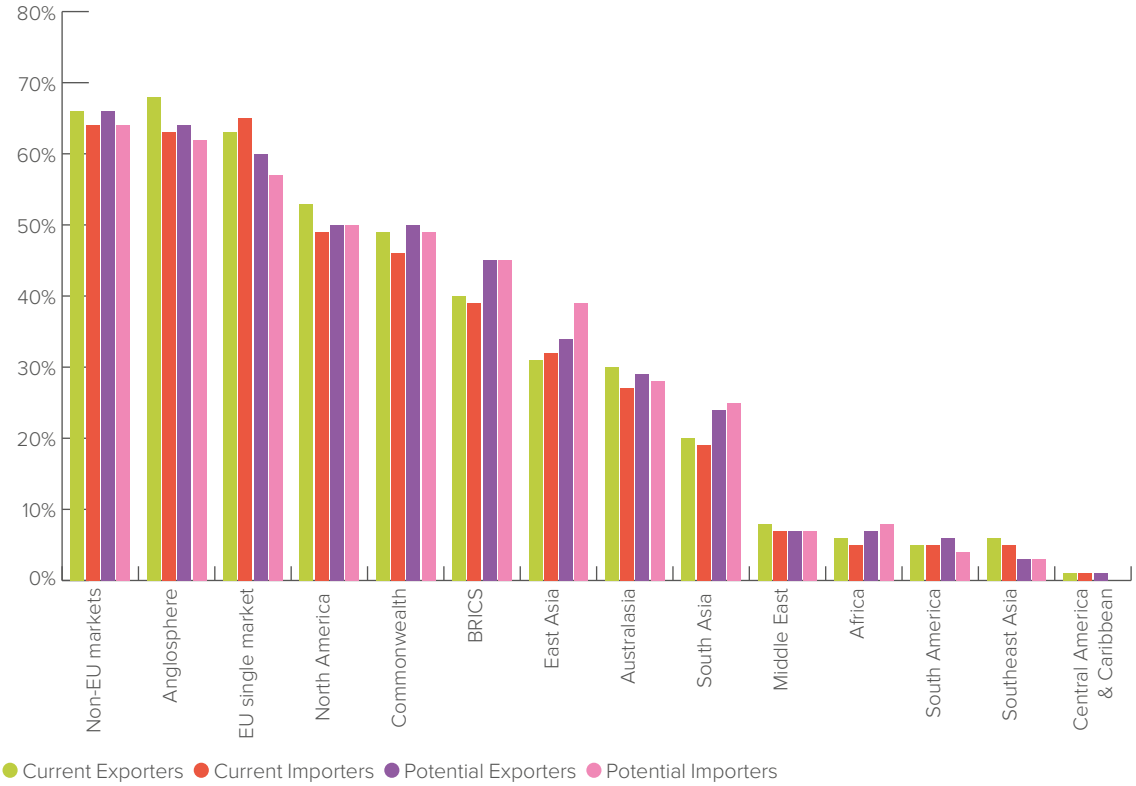
100 See footnote four.

101 IHS Markit, Emerging Markets in Asia Pacific Offer Brightest Prospects for Global FDI, IHS Study Finds, April 2016, available at: http://news.ihsmarkit.com/press-release/economics-country-risk/emerging-markets-asia-pacific-offer-brightest-prospects-global-.

102 BBC News, The Mint countries: Next economic giants?, January 2014, available at: http://www.bbc.co.uk/news/magazine-25548060.

103 Politico, UK should prioritize Commonwealth trade: report, October 2017, available at: http://www.politico.eu/article/uk-should-prioritize-commonwealth-trade-report/

Figure 29: Priority markets by Current Exporter, Current Importer, Potential Exporter and Potential Importer
Source: FSB future trade with the EU and non-EU markets survey



Note: It is not expected that all non-EU markets can or should be grouped together as a stand-alone priority market – its inclusion in Figure 29 is for comparison purposes only.

The priority markets in Figure 29 are presented from left to right, from the most frequently chosen market, combined across all four groups – Current Exporters, Current Importers, Potential Exporters and Potential Importers – to the least frequently chosen.

Overall, the Anglosphere and the EU single market are the markets with which small businesses are most likely to want the UK to prioritise securing trade deals. Around two-thirds of Current Exporters would prioritise countries that form part of the Anglosphere (68%) and EU single market (63%).

The proportion of small firms, across all four groups, that prioritise the EU single market is on a par with non-EU markets. This reinforces the importance of retaining the best possible access to the EU single market for small businesses post-Brexit. It is clearly a market that small businesses feel is of equal importance for both current and future trade.

Figure 30: Top 20 priority countries of Current Exporters
Source: FSB future trade with the EU and non-EU markets survey

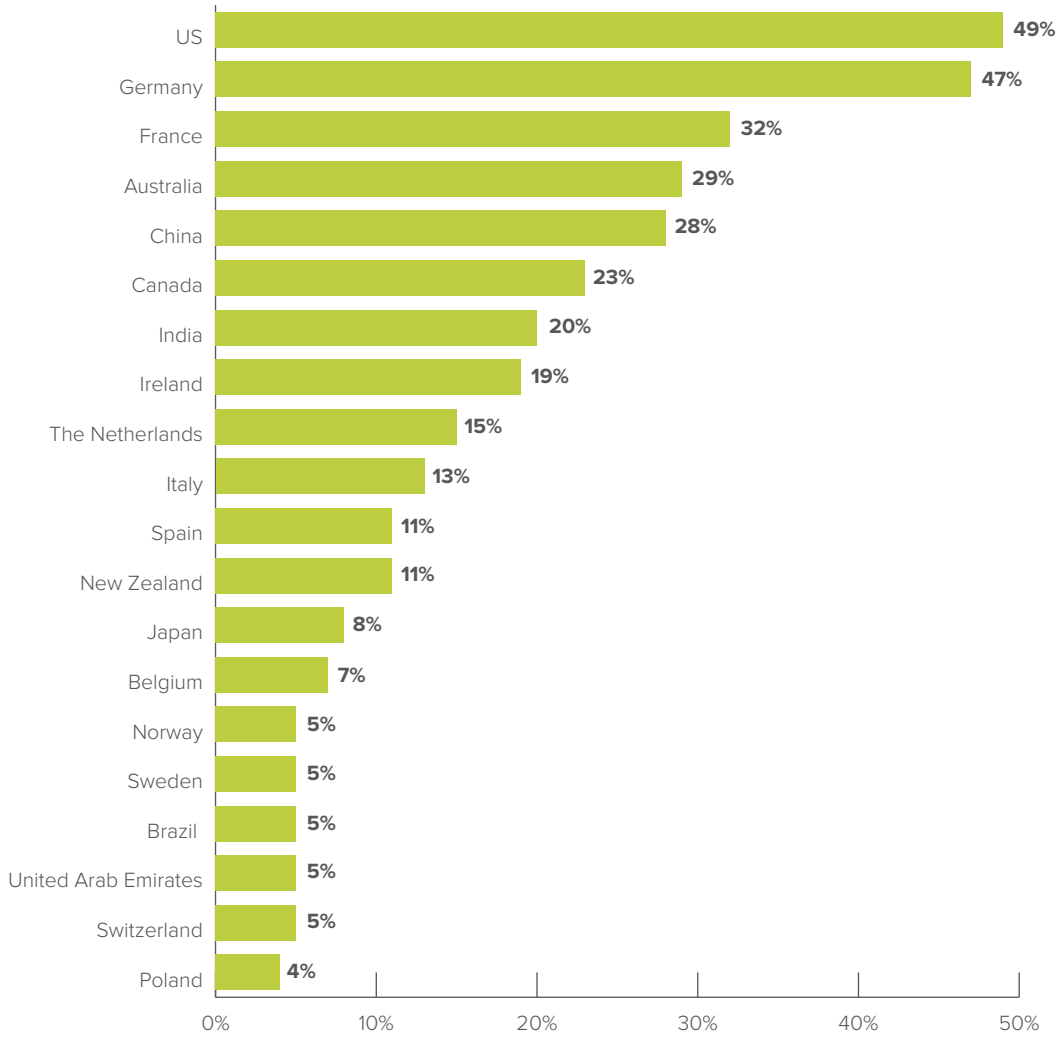
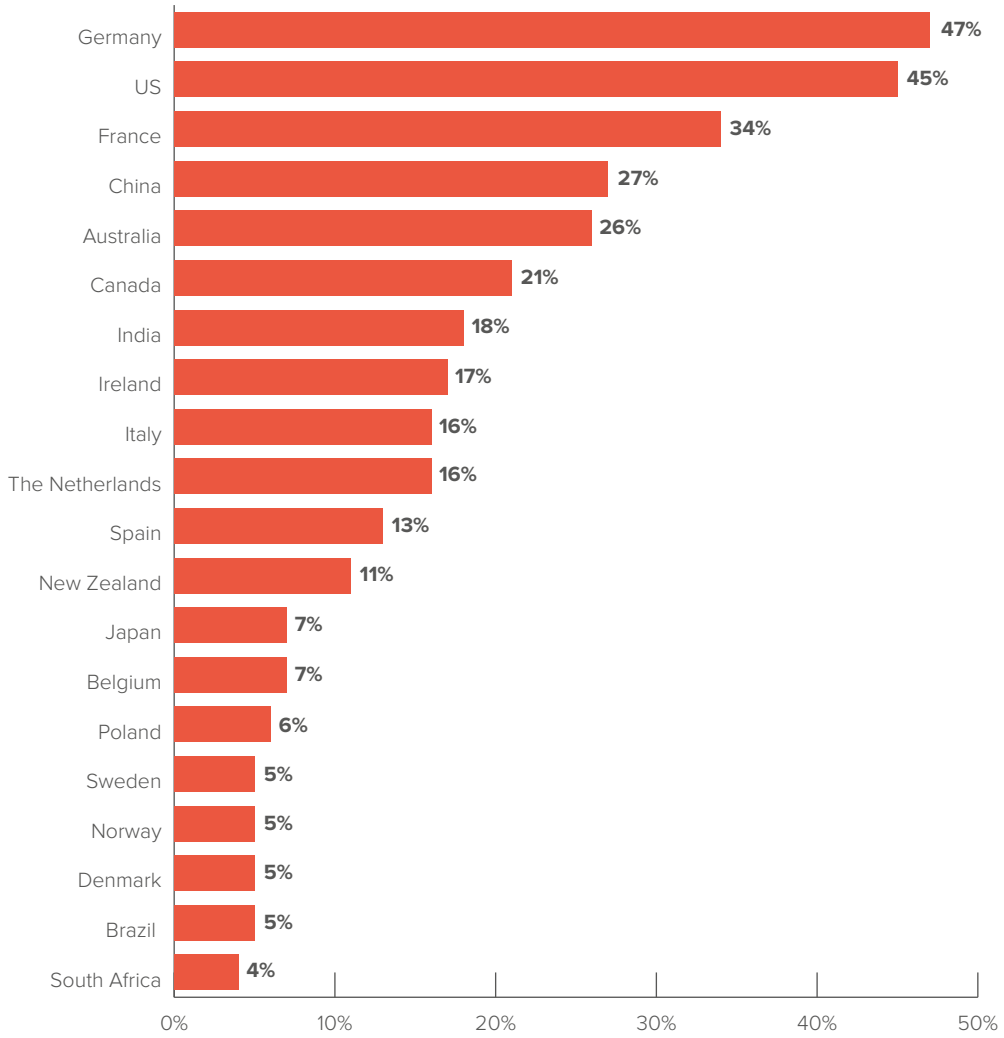


Figure 31: Top 20 priority countries of Current Importers
Source: FSB future trade with the EU and non-EU markets survey



Figures 30 and 31, for Current Exporters and Current Importers, repeatedly show that priority countries in the Anglosphere are most likely to be the US, Australia and Canada, and in the EU single market, Germany, France and Ireland. Around half of small firms from both groups would prioritise the US (49% for Current Exporters and 45% for Current Importers) and/or Germany (47% for both Current Exporters and Current Importers).

It is worth noting that the top 10 priority countries for Current Exporters and Current Importers are the same. These are also the same countries for Potential Exporters and Potential Importers, with the exception of Spain instead of Italy for the former, and Japan instead of Italy for the latter.

Around half of small firms, across all four groups, would prioritise North America and the Commonwealth. However, within the latter, it is clear that the countries that all four groups are most likely to prioritise are Australia, India and New Zealand, as opposed to other commonwealth nations.

Balancing risk and reward with emerging markets

Two fifths (40%) of Current Exporters and Current Importers (39%) would prioritise the BRICS market. However, it is clear from Figures 29 and 30 that the majority of these small firms are significantly more likely to be focusing on China (28% of Current Exporters and 27% of Current Importers) and India (20% and 18%) over Brazil, South Africa or Russia.

It is noteworthy that not all the emerging markets are being prioritised to such a large extent. For example, Figure five shows that a similar proportion of small businesses export to the UAE and South Africa as to China and India. However, neither the UAE or South Africa feature as highly in Figure 30. Of course, China and India have both seen relatively impressive economic growth over the past few years.[104] The public discourse around these two fastest growing emerging markets is likely to have influenced small businesses when it comes to thinking about which markets should be prioritised for trade deals.

A slightly larger proportion of Potential Exporters (45%) and Potential Importers (45%) would also prioritise BRICS – again, with the majority choosing China or India. Indeed, they are the only two emerging markets that rank in the top 10 countries for both groups – around one-third of Potential Exporters (32%) and Potential Importers (37%) would prioritise China, and around a quarter for India (24% and 25%, respectively).

This reinforces the view that emerging markets, albeit some more than others, are becoming more attractive export and import destinations.

> *"A customer on the other side of the world could be richer pickings than the very competitive EU. If you really take a step back, where is the growth in the world – China's growing markets, emerging markets, maybe Hong Kong, Singapore? You can make more money sending a pallet there than you can sending it to Germany."*
>
> FSB member, Current Exporter, based in Bristol

However, based on turnover size and dependency on exports, emerging markets are likely to be a more realistic proposition for businesses that are on the larger scale of small firms or are more ambitious and geared up for growth. It is likely that exporting to these markets on a meaningful basis will require a higher upfront investment compared to more established and typically easier markets, such as the EU single market and Anglosphere.

> *"Disparity between small and large companies... the larger you are, the cost of exporting relative to the value and profit from the export is much smaller. To an SME that might decide to go and sell my [product] in Brazil, that would be a massive undertaking, it's going to cost me £5,000 to go to Brazil to see people, etc., and I may never get on order, so that's a risk I wouldn't take."*
>
> FSB member, Current Exporter, based in Manchester

104 Khan, M., Growth star India overtakes China as world's fastest growing major economy, The Telegraph, February 2017, available at: http://www.telegraph.co.uk/finance/economics/12146579/India-overtakes-China-as-worlds-fastest-growing-major-economy.html

Therefore, many small firms will find it more challenging – or perceive it to be more challenging – to export to emerging markets. Even for the small firms that could comfortably export to such markets, they may decide that the additional investment – for example, to contract intermediaries, such as agents, distributors and translators, or the additional market research involved – is not worthwhile when there are other viable and easier options. Of course, many small firms do not tend to make these types of calculations, especially if they export primarily on a reactive or ad hoc basis.

Priority markets for small firms need to be put in a wider context of UK trade overall

It is clear that many of the larger Anglosphere counties are high up on the list of priority markets for small businesses. Alongside the growing attractiveness of certain emerging markets, this reflects the steady increase of UK trade with markets outside the EU. The proportion of UK trade with the EU has been falling since 1999. In 2015, 44 per cent of UK goods and services were exported to the EU, compared to 56 per cent to non-EU markets.[105]

However, when this is broken down at individual country level, it is clear that certain countries– both within the EU single market and non-EU markets – dominate as UK trading partners, in both goods and services. In 2014, of the top 10 countries that the UK traded with in goods and services, eight of them were part of the EU single market (Germany, Netherlands, France, Ireland, Belgium and Luxembourg (combined), Italy, Spain and Switzerland); the remaining two countries were the US and China.[106] Of this group, the US was the country with the single largest share of UK exports of goods and services.[107]

This group of top 10 UK trading partners broadly reflects the top countries that small businesses currently trade with. However, as Figure five shows, the notable exception is that China is not a top 10 export destination for Current Exporters, although it is for Current Importers.

The value of these individual non-EU markets should also be compared to the value of the UK's trade with the EU. While Figure five shows that Australia is the tenth biggest trading partner for small business exporters, put in the wider perspective of current UK trade overall, its value is still a fraction of that of the EU's. In 2014 the UK's exports to Australia were worth £7.1 billion[108], in comparison to UK exports to the EU which were worth £229 billion[109]. This highlights that while Australia, and other non-EU markets, are and should be priority markets for small businesses, the importance of securing a comprehensive FTA with the EU is paramount.

"As part of the EU, we have taken advantage of the large, accessible European market as we look to grow and expand. I'm worried that a hard Brexit will particularly disadvantage scale-ups like ourselves as our ability to compete for business abroad is hampered by more bureaucracy and regulatory barriers, reducing our potential market. We should be building bridges, not putting up walls."

FSB member, Current Exporter, based in Cardiff

105 ONS, UK Perspectives 2016: Trade with the EU and beyond, May 2016, available at: http://visual.ons.gov.uk/uk-perspectives-2016-trade-with-the-eu-and-beyond/ .

106 Ibid.

107 Ibid.

108 Australian Government, Australian Trade and Investment Commission, Market profile, Export Markets – United Kingdom, 2017, available at: http://www.austrade.gov.au/Australian/Export/Export-markets/Countries/United-Kingdom/Market-profile.

109 Full Fact, Do half the UK's exports go to Europe?, November 2015, available at: https://fullfact.org/europe/do-half-uks-exports-go-europe/.

RECOMMENDATIONS

The opportunities of leaving the EU – including the EU single market and full EU customs union – while potentially transformative for the UK's economy and future global standing, are likely to be realised in the medium to longer term and will require real support for small businesses. The UK is set on a long journey to negotiate and secure a new FTA with the EU and, thereafter, with other priority markets.

Regardless of the processes involved, this journey will be fundamentally disruptive for many businesses. Small firms, in particular, will require support to both minimise any disruption to their business and place them in the best position possible to benefit from future trade opportunities.

The potential trade opportunities resulting from a "truly Global Britain"– as articulated by the Prime Minister in her Plan for Britain speech[110] – outside of the EU single market is recognised by many small firms. However, in order to take advantage of these opportunities, small businesses will need to explore new opportunities in markets further afield, either in an increased capacity or through new relationships. Critically, this will be an easier change for some small firms to adapt to than others. However, for a significant proportion of firms this will be a real challenge.

Therefore, the following recommendations are intended to reflect the broad chronology of the Brexit process, factoring what needs to be achieved for small firms in both the immediate to short term – focusing on the negotiations for a new trade relationship with the EU – and, the medium to longer term – focusing on how small firms should be supported in order to realise the trade opportunities outside the EU. This includes mitigating the risks that small businesses are likely to face, as a consequence of leaving the EU.

Immediate to short term – negotiating the best deal for small firms:

1. Secure the easiest and least costly access to the EU single market

As the UK prepares to leave the EU single market, it is important that future trade overseas is not seen as a zero sum game between negotiating FTAs with the EU and non-EU markets.

Presently, the EU is the largest and most important trading partner for small businesses – overall, it is the easiest, most valuable and least costly market to trade with. This is the case for small firms, regardless of whether they trade in goods or services. This is why around nine out of 10 exporting and importing small businesses trade with the EU single market.

For small firms, maintaining this 'borderless' trade is paramount. This is particularly important for small businesses trading overseas on thin margins and with limited resources; any additional costs or administration burdens, which could perhaps be more easily absorbed by larger firms, can be prohibitive to small firms. It is, therefore, essential to avoid a cliff-edge for small businesses and provide sufficient time to enable them to adapt to changes to the trading landscape. FSB calls for a sensible transitional/implementation period to be put in place as part of the negotiation plan for the UK to leave the EU.

Any new tariffs or additional non-tariff barriers that result from the UK leaving the EU single market and full EU customs union will make trading with the EU harder and more costly. Crucially, non-tariff barriers – the most complex of trade barriers – play an equally important role as tariffs in where small firms trade. The prospect of any new trade barriers being introduced is also a deterrent to the majority of small firms considering exporting or importing. On an individual level, the impact of such barriers is likely to result in small firms reducing their level of trade overall, at least in the short term.

The UK Government's plan for negotiating a new trade agreement with the EU must be underpinned, first and foremost, by the aim to ensure as free and easy access to the single market as possible. This means the trade agreement must be comprehensive in securing barrier-free access, covering both goods and services, across all sectors.

110 Prime Minister's Office, 10 Downing Street, The Rt Hon Theresa May MP and Department for Exiting the European Union, The government's negotiating objectives for exiting the EU: PM speech, January 2017.

2. Identify and protect vulnerable small firms by sector and trade experience

A significant proportion of small businesses trade exclusively within the EU single market – one in five (21%) Current Exporters and two fifths (37%) of Current Importers. It is likely that these small businesses will find adapting to exporting or importing from outside the single market particularly difficult. This will especially be the case if their reasons for trading exclusively are based on current features of the UK's membership of the EU single market which will change post-Brexit, notably, the current absence of tariffs and reduced non-tariff barriers.

Small firms working in certain sectors will also find trading with markets further away more challenging. For example, those trading perishable products in the food or agriculture sectors.

To varying degrees, small firms will need time to acclimatise to the changes brought about by Brexit. To make a success of Brexit, all small firms must be supported to not only take advantage of new trade opportunities, but, crucially, to ensure that the associated risks are mitigated. Efforts should be taken to identify small firms in particularly vulnerable positions and extra consideration needs to be taken to buffer them from any negative effects and disruption caused by Brexit.

The diversity of small businesses means that this support should consist of a variety of measures and approaches. The vulnerability of certain sectors – particularly where trade is most affected by proximity – should be factored in to all trade negotiation plans, but especially with the EU as our nearest trading partner. The more severely a subset of small firms is likely to be affected by Brexit – the so-called 'cliff edge' – the more time should be allocated to support them through this change, be this via a longer implementation process or specific transitional arrangement.

Tailored export and import support should also be considered – for example, supporting small firms that trade exclusively within the EU single market to diversify their markets. Open communication on the support that will be provided, to address sector-specific concerns, will also go a long way to ensure that businesses do not take actions – such as moving their supply chains to the EU – which may prove to be unnecessary.

Medium to longer term – supporting small firms to flourish post-Brexit:

3. Prioritise easy non-EU markets for first-time and occasional traders

Small firms export or import for a variety of reasons. However, the leading factor driving small business exports and where they export is ease – be this reacting to direct demand, or identifying markets based on proximity, language, or administration. Small businesses tend to follow the path of least resistance. Post-Brexit trade opportunities will, therefore, gain the greatest traction with small businesses if they are communicated in terms of ease.

In respect of priority markets with which the UK should aim to secure an FTA, in addition to the EU, countries that are mostly likely to appeal to small businesses should be prioritised. This should include the US, Australia and Canada on the basis of their shared language, similar culture and the size and maturity of these markets. This, in turn, means that these markets should also be the most appealing trade destinations in the short to medium term.

This is important because should a comprehensive FTA with the EU not be achieved by the time the UK leaves the EU single market, this may result in a lull or decline in small business exports until a favourable agreement is reached. This is especially the case as the UK will not be able to formally negotiate and secure FTAs with countries outside the EU until the UK leaves the EU.

Even though a sizeable proportion (26%) of small firms expect to increase their exports to non-EU markets post-Brexit, this will take time and require support. In order to mitigate the risk of a lull or decline in small business exports, and refocus trade opportunities beyond the EU, trade relations should be prioritised with countries that small businesses are most likely to find easier to trade with.

Designing support – specific to country, region or sector – and a strong narrative around the ease of trading with these, and similar, markets, should create an attractive and accessible proposition for exporting beyond the EU. This is likely to be particularly effective with first-time exporters or importers, and small firms that export on an occasional or ad hoc basis, and are not able or willing to become more export-orientated than they currently are.

4. Prioritise emerging markets for more ambitious and growth-orientated small firms

Emerging markets, especially China and India, are becoming increasingly attractive destinations for small business trade. Their growing economies, less saturated in many sectors and industries compared to more mature markets, being the driving factor.

The UK should prioritise securing FTAs with China and India, as well as other prominent emerging markets such as South Africa and the UAE – in addition to the 'easy non-EU priority markets'. However, while there is a growing desire to trade more with these nations, in practice, this is more of a challenge, compared to say the US or Australia, for a variety of reasons.

Overall, small businesses that trade with emerging markets are consistently shown to be bigger and more dependent on their trade overseas (both in relation to turnover) than the average small firm. Physiologically, these emerging markets are also more distant because of their unfamiliarity in terms of culture, language, business practices, legal and political systems.

Bespoke export support and messaging around these priority markets should, therefore, focus on small businesses that are more ambitious and geared for growth. For example, small businesses that are already exporting and are looking to expand and diversify their markets, start-ups that plan to trade globally from 'birth', or more mature small businesses with higher turnovers.

This should not exclude other small businesses – many of which already trade with these markets – however, these firms tend to do so on a more ad hoc and reactive basis. Therefore, support should focus on the types of small businesses that are realistically more able and willing to meaningfully exploit the opportunities offered by these emerging markets.

To make real inroads with emerging markets, small firms are likely to require more support. The small firms that trade with emerging markets are more likely to use intermediaries, such as agents, distributors and translators. In general though, among exporting small firms, there is low awareness of these types of intermediaries, and the space is not well mapped. This intermediary space needs to be better understood and, in turn, become more accessible for small firms.

5. Export vouchers to incentivise and accelerate small business exports

The relationships that are necessary to facilitate exports or imports can take a long time to develop, and may include upfront investment in resources and bespoke product development. Small businesses will also have to consider the intrinsic risks involved when exporting to a new market. This is particularly in regards to more unfamiliar markets, such as emerging markets.

The uncertainty of Brexit only exacerbates the existing risks associated with new exporting activity, and is a deterrent for many potential exporters, who may adopt a 'wait-and-see' approach. More than ever, small business exporters need to be encouraged to continue or start exporting – an incentive, packaged as an export voucher, could help small firms to accelerate this exporting process or mitigate some of the risks or costs involved.

Similar to the principles behind the Growth Voucher Programme[111] and Innovation vouchers[112] – export vouchers will enable small firms to access the support that would be most beneficial to them. For example, using the vouchers towards translation services, agents or small business trade missions. The latter would be particularly useful as the cost of attending trade missions is prohibitive for most small firms. The conditions of the voucher should align with the priority markets with which the UK seeks to develop better trade relations, to ensure the objectives are clear and targeted, and also to maximise their impact to support the UK's strategic trade goals.

111 The Growth Vouchers programme was designed to help small businesses to find strategic advice from private sector suppliers who could help their business to grow. This was a joint programme between the Department for Business, Innovation and Skills (BIS) and the Behavioural Insights Team in Cabinet Office was launched on 27 January 2014 and rolled out over 15 months. The scheme is now closed. More information available at: https://www.gov.uk/government/collections/growth-vouchers-programme.

112 Innovation vouchers allowed small businesses to claim up to £5,000 towards the cost of expert advice. This could include advice on an innovative idea, learning more about using design within their business or how they should make the most of intellectual property. More information available at: https://www.gov.uk/government/news/innovation-vouchers-for-all.

In fact, export vouchers are not a new idea. The US Small Business Administration's (SBA) State Trade Expansion Program funds a voucher scheme in Washington State.[113] The UK Government also issued export vouchers as a component of its Passport to Export scheme which, while no longer available, was generally considered to be an effective service for small businesses.[114] Businesses that participated in this scheme were provided with an export voucher, worth £3,000, which had to be match-funded by the business itself. The voucher could be used to meet the cost of putting their export plans into practice.

The UK can learn from previous and existing voucher initiatives, both from the UK and abroad, to develop a scheme fit to meet the ambitious demands of a post-Brexit export environment. This should include exploring models based on match-funding and subsidies.

If marketed effectively, export vouchers should also raise awareness of the benefits of exporting overall. The small firms that end up using export vouchers can be showcased to foster confidence within the small business community about trading overseas. UK small businesses need a boost to make the best of what Brexit can potentially offer; introducing export vouchers now, as a part of wider support, would be especially timely.

6. Explore export tax credits to incentivise strategic exporting

A large proportion of small business exporters trade on a reactive or ad hoc basis. For the majority, exporting is not a core part of their business model – on average, small firms receive 33 per cent of their turnover from exporting. If these small firms could be encouraged and supported to increase their level of exports – this would aggregately contribute significantly to the UK economy and lessen the trade deficit.

There is also a positive relationship between how dependent a small firm is on exporting (based on their turnover) and the likelihood that they will export to emerging markets – which is associated with greater opportunities for business growth. Small firms that trade with emerging markets are more likely to have higher turnovers than those that export to more mature markets such as North America or the EU single market.

Government should explore how an export tax credit could work best to incentivise small firms to export more strategically.[115] This can be qualified in various ways, from the percentage of turnover derived from exporting activities, or an increase in the level of exports over a period of time. Export tax credits could also be broadly modelled on research and development (R&D) tax credits, where businesses can get a rebate against qualifying expenditure. For exporters, this could be in relation to expenditure on certain activities, such as trade missions, market research, or the cost of using certain intermediaries such as agents or export brokers.

Export tax credits could also work in tandem with or to complement export vouchers – where each initiative is targeted to a different audience or priority market. Indeed, export tax credits should be relatively targeted to ensure that the impact is measurable and it can be clearly marketed.

One channel to market the tax credit would be via existing and trusted intermediaries in the enterprise eco-system. Introducing an export credit would also encourage intermediaries, such as accountants, finance advisors and business advisors, to raise the possibility and benefits of exporting to their clients. For small businesses, an export tax credit would be a timely incentive that could help cut through the uncertainty of Brexit and reflect the serious ambition of the UK to support small business exporters.

113 The Washington State Department of Commerce's Export Voucher program, funded in part by the US Small Business Administration's (SBA) State Trade Expansion Program, offers qualified companies new to exporting or expanding into new export markets up to $5,000 for export-related expenses (a minimum 25% cash match is required). More information available at: http://www.exportwashington.com/programs-and-services/export-grant-loan/export-voucher-program/Pages/default.aspx.

114 The Passport to Export scheme was designed to assist new and high-technology exporters with a year's package of up-skilling, advice and support to help them succeed overseas. The scheme received a generally positive review from the House of Lords Select Committee on Small and Medium Sized Enterprises, 2013, available at: https://www.publications.parliament.uk/pa/ld201213/ldselect/ldsmall/131/131.pdf, and evaluation from UK Trade and Investment's (UKTI) Performance and Impact Monitoring Survey (PIMS), March 2015, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/417841/Summary_Results_PIMS_38_-_D1.pdf

115 Explorations to create an export tax credit will need to factor in any restrictions, such as state aid rules. As a member of the EU, the UK is currently subject to state aid rules. These rules are designed to monitor and restrain selective measures by the state that threaten to distort competitive forces in the EU market. A measure that constitutes state aid can take the form of grants, subsidies, loans, guarantees and tax credits. If the UK does not agree any special trade arrangements with the EU post Brexit, the UK will likely be bound by WTO rules, which may have implications for the design and delivery of an export tax credit.

7. Spotlight on Brexit's hidden impact on importers and small firms in global supply chains

The impact of Brexit on overseas trade – both positive and negative – is not isolated to exports. Small business importers and those that operate or are part of global supply chains will be equally affected. Small business importers that expect their level of trade to change, as a result of leaving the EU, are less confident about the impact of Brexit on their trade than exporters. Further, a larger proportion (37%) of small business importers trade exclusively within the EU compared to their exporting counterparts (21%). However, despite this, these small firms have not received nearly the same level of attention as exporters in the Brexit debate.

Currently, there is very little information and support available for small business importers compared to exporters. This was less of an issue before the EU referendum – where the focus was largely on reducing the trade deficit. While this is still a priority, Brexit means that a significant proportion of importers will be disrupted as never before – indeed, many have been affected by the sharp depreciation in sterling following the outcome of the EU referendum. As such, they require dedicated support to mitigate the risks and disruption caused by Brexit, and to ensure that they can prosper in the post-Brexit landscape.

Dedicating support to importers is doubly important if we also factor in the exports perspective – over two-thirds (69%) of small business exporters are also importers. For these firms, importing and exporting both play a part in their overall business model – impact in one of these areas will have direct knock-on effects on the other.

Around one in five (21%) small businesses are also at risk of being disrupted because they either own or are part of global supply chains that are routed through the EU single market. This is especially the case for the latter, as these small firms will not be the overall decision-makers for the supply chain. Small firms with global supply chains (that move through the EU single market) are twice as likely to consider relocating more or all of their supply chain to the EU than the UK (20% compared to 9%, respectively).

Current providers of export support, including the Department for International Trade, should develop support and information dedicated in respect of Brexit to small business importers and global supply chains. The Great.gov.uk market place platform can allow small businesses to search for suppliers and supply chain opportunities.

8. Champion small business brands – in sectors and industries where the UK has a competitive advantage – to target markets abroad

Current trading relationships are typically triggered and developed organically – exploiting an existing business advantage or responding to direct demand. As such, efforts to increase awareness of exporting among UK small firms must be matched by efforts to raise awareness of the UK as a desirable destination to source products.

The British Food Unit[116], from the Department for Environment, Food and Rural Affairs (Defra), was created to drive food exports abroad, targeting specific markets that will be particularly interested in such products. Building on this initiative, other sectors or industries – based on where the UK has a competitive advantage, such as those identified in the Government's 'Building Our Industrial Strategy' green paper[117] – should be supported to promote their products abroad.

Crucially, to build a cohesive and strong brand for British products abroad, all the different clusters of sector or industry-based products should be promoted under the Great.gov.uk banner. However, there needs to be an explicit focus on small business brands and products as well as large corporate ones.

Growing the profile of UK small business brands, and products in general, will drive the demand directly to small firms, triggering many to start exporting and capitalise on the reactive behaviour of small business exporters.

116 A Great British Food Unit has been established today to turbo-charge UK food exports and support industry growth plans, like their target of increasing manufactured food exports to £6 billion by 2020. More information available at: https://www.gov.uk/government/news/great-british-brands-to-take-world-by-storm-through-new-british-food-unit.

117 HM Government, Building our Industrial Strategy Green Paper, January 2017, available at: https://beisgovuk.citizenspace.com/strategy/industrial-strategy/supporting_documents/buildingourindustrialstrategygreenpaper.pdf

9. Including a small business chapter in all future trade agreements

It is clear that, even within the small business community, many differences exist between various subgroups or profiles. These differences can be more fundamental or nuanced, but, importantly, they cause small firms to behave and react differently to trade opportunities and risks. This dynamic will only be magnified when comparing small businesses with far larger businesses, underlying the importance of ensuring that small business interests are explicitly considered in all future trade agreements between the UK and other nations.

The inclusion of a small business chapter must form a key objective in any future trade agreement that the UK negotiates. The Transatlantic Trade and Investment Partnership (TTIP) was envisaged to include a small business chapter – the first of its kind in any FTA – to help small businesses take full advantage of access to new lucrative markets and raise awareness of the opportunities available to them through trade negotiations.

There have already been numerous policy discussions around what this small business chapter should entail. Regardless of the final outcome from the TTIP negations, the UK Government should tap into this body of knowledge, and further consult small business representative bodies, such as FSB, to develop a robust position on what a UK small business chapter should look like.

This consultation should be undertaken through a formal mechanism of which small businesses and their representatives form an integral part, and allows for genuine co-design. A possible model might comprise of an official working group that feeds in to Government discussions on what a small business chapter should cover. This working group should be facilitated by senior government officials who specialise in small business trade policy matters and are dedicated to ensure small firms are supported in realising their exporting and wider trade ambitions.

METHODOLOGY

This report is based on FSB members' experiences and views on their business future trade with the EU and non-EU markets. FSB undertook a mixed method approach for the research consisting of a quantitative online survey and a series of qualitative focus groups.

The sampling frame for the survey was the UK-wide FSB membership database. The survey was nationwide in its reach and members were invited to participate in the survey via email and social media channels. The survey was administered by the research agency Verve and was in the field for two weeks from 27 October 2016. The survey questionnaire was completed by a total of 1,758 small businesses.

The survey findings are all weighted according to FSB membership weighting (to reflect the demographic balance of FSB members throughout the UK). All percentages are rounded up to the nearest whole number, which is why the percentages presented in the figures do not always add up to 100 per cent.

FSB also facilitated an initial forum discussion with members of its Big Voice Panel (this consists of FSB members who volunteer to be part of a panel that gets surveyed frequently throughout the year) to collect views on any immediate impact that the EU referendum result had on their business. This forum discussion was open for two weeks from 16 August 2016. Some findings from this exercise were also used to inform the report findings.

The focus groups were conducted in various parts of the UK in order to represent as much geographic diversity as possible. In total, four focus groups were conducted, in: London, Manchester Bristol and Newry. These focus groups were conducted across a one-month period from 24 October 2016 to 24 November 2016. However, findings from other focus groups conducted in other locations, as part of the wider Brexit research programme, were also used to inform the report findings.

The sampling frame for the focus groups was also the UK-wide FSB membership database, although there was a focus on recruiting members from the respective areas where the focus groups were taking place. Members were invited to participate in the research via email and social media channels. Each focus group had from six to 10 participants – all small businesses that are currently trading overseas in an export and/or import capacity.