Q2

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 2, 2022

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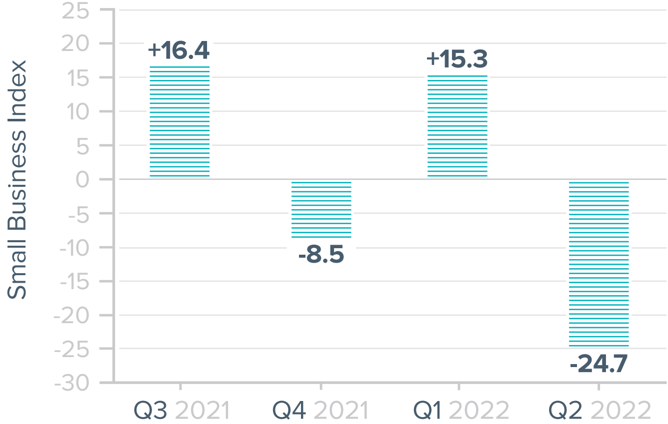
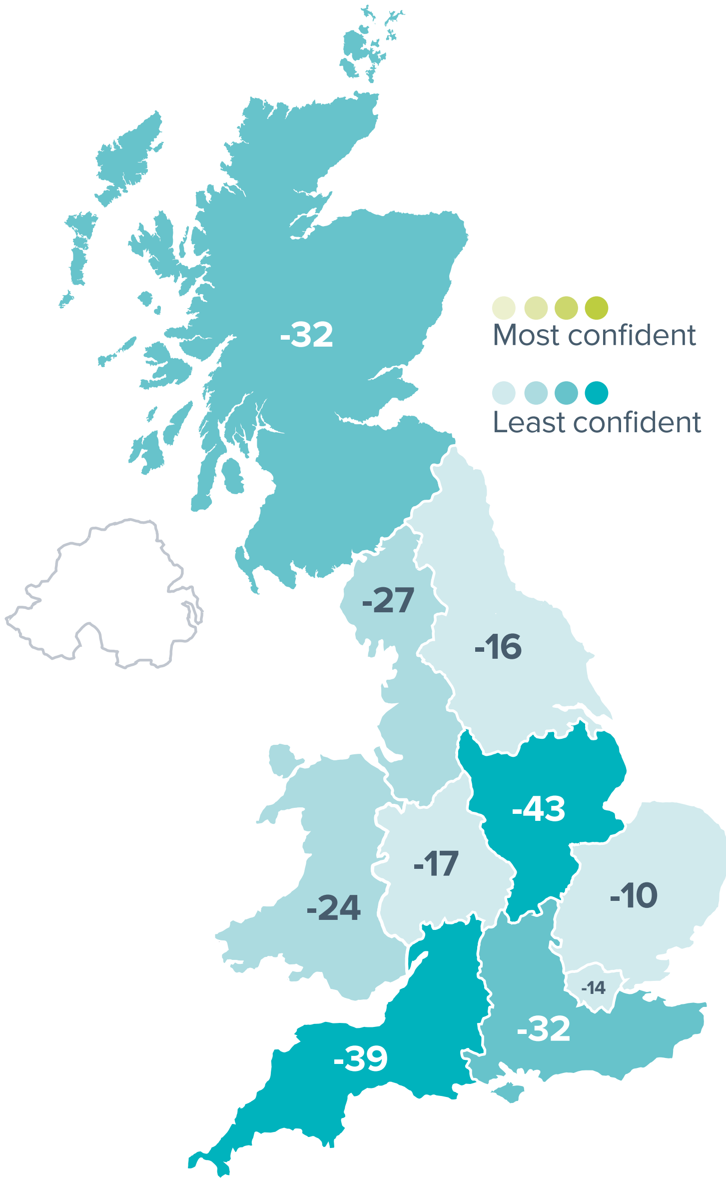
SBI Q2 2022

"Small business confidence lowest on record outside of lockdowns"



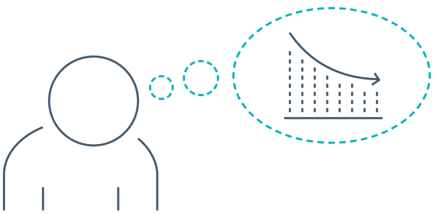


Costs reach new high

89%

of small businesses **report higher costs** compared to a year ago

Ambition for growth is falling



Only **47%**

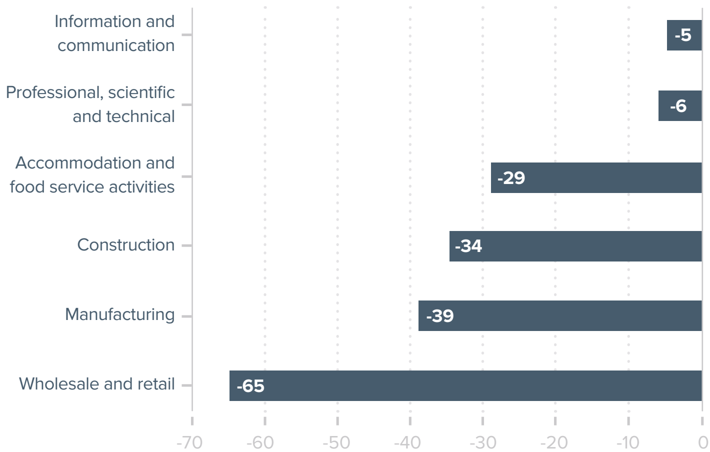
aspire to grow over the next 12 months

Small businesses are struggling to access finance

Just **45%**

of **financial applications** were successful in Q2

Small business confidence by sector



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FSB FOREWORD

The second quarter of 2022 will not be remembered with much fondness by the majority of small business owners. After a surprisingly upbeat start to the year, with the headline Small Business Index reading back in positive territory in Q1 following an Omicron-induced return to the negative zone at the end of Q4, the Q2 2022 temperature check for small firms is once more deeply negative. Indeed the change from +15.3 in Q1 to -24.7 in Q2 is the second-largest fall in the Index's history, and is surpassed only by the quarterly fall registered in Q1 2020, when the pandemic first hit the UK.

With the economic impact of the Covid-19 pandemic less apparent in Q2 than during the previous two years, the main culprit for this precipitous drop in small business confidence levels must be inflation, which during the quarter in question reached a 40-year high.

Every conversation FSB has had with our members over the past few months has touched on two issues - spiralling costs, and a stark shortage of labour. Cost increases are now affecting everything from the price of petrol to cooking oil to timber to orange juice to laundry detergent, and much more besides. Inflation is the overriding economic concern among FSB's membership, with the series-high reading of 89.0% of firms reporting higher costs than a year ago a stark illustration of the toll it is taking. The cost of doing business crisis, which we raise frequently with politicians and the media, is in turn adding to the cost of living crisis affecting households, as businesses have no other choice than to pass on higher costs, creating a vicious circle. The cost of doing business crisis has exacerbated a crunch on small businesses being able to recruit talent, which may mean this autumn businesses having to close their operations on days without staff cover, and to save on exponential energy bills.

The suppression of small businesses' ability to grow and invest, by making it impossible for all too many of them to think about anything beyond survival, is a sign that the UK's long-running 'productivity puzzle' looks set to stay in place for some time yet. Some say certainty is what small businesses crave; however, a certainty of rocketing costs and prices into the medium term will do the opposite, making many small businesses simply unviable. It's hardly surprising that they are battening down the hatches, focusing on the essentials, and looking to cut costs wherever they can, rather than seeking funding to invest in new technology, premises, or processes.

Growth is firmly off the menu for the majority of small businesses, with 38.7% planning to stay the same size, and 14.7% - one in seven – expecting to downsize or even close their business over the next 12 months. The success of small firms' credit applications remained well below the pre-pandemic trend, at 44.9%, while the number of firms reporting they had even applied for finance in the first place was 11.5%, up from the record low of 9.1% in Q1 2022. The credit on offer has also ticked up in price, a predictable consequence of the rise in the Bank of England base rate seen over the quarter, but an additional pressure on budgets nonetheless, and one likely to get worse in the coming quarter, given the 50 basis point rise decided in August.

Likewise, the first fall in employee numbers since Q1 2021 was recorded, falling far short of relatively buoyant hiring intentions in last quarter's survey, and showing the speed with which inflation pressures have overtaken many firms' plans. Access to skilled staff also ticked upward as a cited barrier to growth, up to 33.9% in Q2 from 31.3% in Q1, with the domestic economy however far and away the most-cited barrier to growth, at 65.1%, up from 58.6% in the previous quarter.

It is beyond clear that the Government needs to act, to help businesses facing acute pressures. The next Prime Minister must affirm their commitment to small businesses, self-employed people, and entrepreneurialism, and take swift action on urgent sources of pain which threaten the survival of countless firms. A reversal of the National Insurance hike, which came into effect during Q2, cuts to VAT and fuel duty, a fresh look at business rates, and help for small businesses with soaring energy bills must all be on the agenda. The economic devastation that inaction would cause must spur decisive intervention, before it is too late for countless small businesses.

Martin McTague, National Chair

Tina McKenzie, Policy & Advocacy Chair

ECONOMIST'S VIEW

Nina Skero,
Chief Executive,
Cebr

The Small Business Index fell significantly in Q2 2022, dropping by 40.0 points to re-enter negative territory at -24.7. Having recorded a positive score of 15.3 at the end of Q1, the deterioration reflects the emergence of a number of headwinds in recent months, which have dampened the growth outlook for the UK economy.

Inflation has been one of these headwinds. Though price pressures have been present for some time, inflation has recently spiralled to multi-decade highs for both businesses and consumers. For the former, shortages and supply chain disruptions have put upward pressure on the prices of key input goods, cutting into bottom lines. Recent geopolitical events, including Russia's invasion of Ukraine and lockdowns in China, have only aggravated this situation. Businesses passing on some of these costs in the form of higher prices has subsequently driven consumer inflation. This has become increasingly broad-based in recent months, having previously been concentrated amongst utilities and fuel.

Rising consumer prices have put downward pressure on households' living standards, bringing knock-on effects for businesses. Q2 saw a particularly stark SBI reading for the wholesale and retail sector, with a score of -65.2. This likely reflects the slowdown in consumer activity, as households look to cut down on non-essential spending in the face of significant price rises. For comparison, much greater resilience was seen amongst businesses in information and communication and professional, scientific and technical activities, two sectors that are less directly exposed to developments in the consumer sphere. Another sector with a below average score was manufacturing, at -39.0; it is one of the sectors to be most affected by input price pressures and supply chain issues.

These mounting challenges have further contributed to widespread uncertainty, which represents an additional obstacle in and of itself. The YouGov/Cebr Consumer Confidence Index provides firm evidence of this, with household optimism having weakened for seven consecutive months. Q2's SBI readings provide further support from the business perspective.

Pessimism amongst businesses is observable across the country. The worst performance was seen in the East Midlands, with a score of -43.4. At the other end of the scale was the East of England, at -10.3. With even the strongest performer recording a negative score in Q2, this highlights the widespread nature of the pressures facing the economy, which are feeding into business performance regardless of geography.

Thanks to the combination of these factors, the economic outlook is arguably at its weakest point since the depths of the Covid-19 pandemic, when restriction measures were curtailing output. At the aggregate level, Cebr expects output to contract over the coming months, while longer-term growth prospects have also been clouded, with our forecasts for 2023 showing annual GDP growth of just 0.4%. As a result, the UK's small businesses should brace themselves for a challenging period.

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index (SBI) fell to -24.7 in Q2 2022, a drop of 40.0 points.** This marks the second largest fall in the history of the Index, only being outweighed by the drop of 121.8 points in Q1 2020, when the Covid-19 pandemic first hit the UK.
- **The SBI fell across all regions in Q2 2022 compared to Q1.** Furthermore, all regions showed a negative reading, ranging from -43.4 for the East Midlands to -10.3 for the East of England. This highlights the widespread nature of the pressures facing the economy, which are feeding into business performance regardless of geography.
- **The SBI deteriorated across all major industries in Q2 2022.** In addition, SBI readings for all industries are now in negative territory. This is in stark comparison to Q1, when only two industries, wholesale and retail trade and manufacturing, saw a sub-zero score.
- **The net balance of small businesses reporting revenue growth over the previous three months stood at -6.0% in Q2 2022.** A negative reading was last witnessed in Q1 2021, when businesses' revenue streams were significantly curtailed by the third national lockdown and the accompanying slump in economic activity.
- **The net balance of small businesses reporting an increase in operating costs increased for the fifth consecutive quarter in Q2, reaching a new series high of 85.9%.** This illustrates the extent to which businesses have experienced cost pressures in recent months.
- **Increased costs are being driven by fuel, utilities, and broader inputs amidst shortages and market volatility.** There was also a stark increase in the share of firms reporting the exchange rate as a source of increased costs, reflecting the weakening of sterling in recent months.
- **The net balance of small businesses reporting growth in employee numbers stood at -3.6% i**n Q2, down from 2.9% in Q1. This marked the first negative reading on this metric in over a year.
- **A net balance of 31.9% of small businesses expect to grow over the coming year.** This is a considerable deterioration from Q1, when the net balance stood at 39.1%, highlighting the dampened economic outlook that has emerged in recent months. The domestic economy remains the most commonly cited barrier to growth amongst respondents.
- **The rate of credit applications ticked up in Q2, to 11.5% of businesses in Q2.** This was up from just 9.1% in Q1 and likely reflects businesses' attempts to cover mounting cost pressures.
- **After investment intentions had already fallen in Q1, the deterioration continued in Q2 2022.** 22.7% of businesses planned to increase their capital investments over the coming quarter. This is down from 23.4% in Q1 and the lowest share since Q1 2020. Widespread uncertainty and increased borrowing costs represent two key factors behind this slump in investment intentions.

UK MACROECONOMIC OVERVIEW

UK economic outlook weakens further as headwinds bring recessionary risk

The UK economy continued its expansion in Q1 2022, as output grew by 0.8% compared to the final quarter of 2021. This growth came amidst the emergence of economic headwinds, however, which have since put significant pressure on the economy. Price growth has spiralled, driven by input shortages, supply chain disruption, and geopolitical events, which has impacted businesses and consumers alike. For the former, a key question is whether to squeeze margins or to pass input price inflation, which reached 24.0% for producers at the aggregate level in June, on to customers. Evidence from official inflation readings suggests that at least a portion of these costs is being passed on to final consumers. The rate of CPI inflation reached a near 40-year high of 9.4% in June, putting upward pressure on the cost of living, and subsequently downward pressure on living standards.

This impact on living standards has added to the general uncertainty surrounding the economy. Survey data show that households' estimates of their own financial situation, both over the past month and looking ahead to the coming year, have reached record lows. It is expected that consumers will cut back on certain aspects of their expenditure as a result of these pressures, prompting a period of economic contraction or, at the very least, a slowdown in growth.

A slowdown has already manifested in several economic data sources. For instance, PMI readings have been much weaker in recent months. The UK composite PMI stood at just 53.1 in May, before increasing slightly to 53.7 in June. A similar movement was seen for the services PMI, which stood at 53.4 and 54.3 in May and June, respectively. Meanwhile, the manufacturing PMI fell from 54.6 to 52.8 between May and June. These values compare to near-term highs of 60.9, 62.6 and 58.0 for the composite, services, and manufacturing PMIs, respectively, with each of these figures being observed in Q1.

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

SMALL BUSINESS INDEX

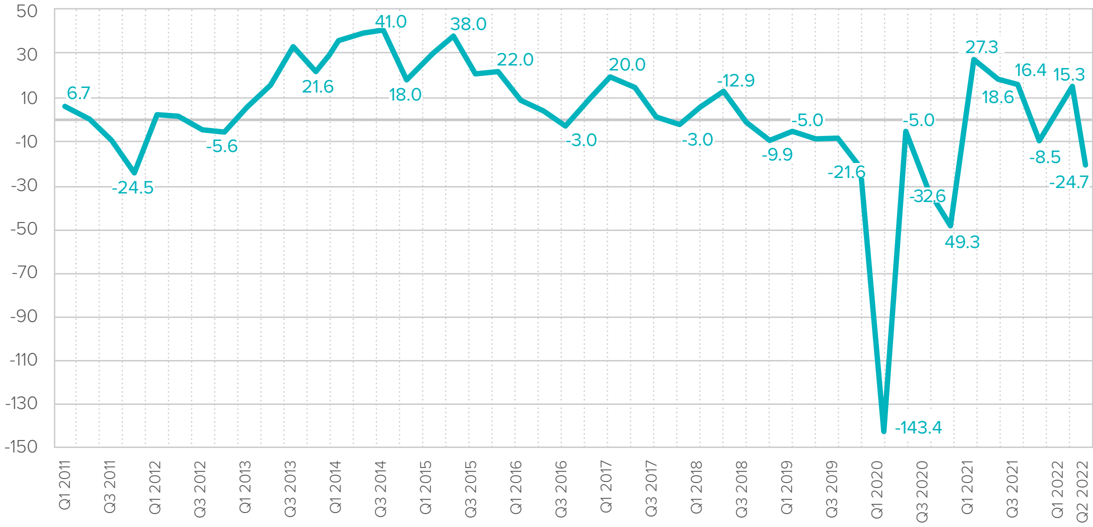
Small Business Index suffers second largest ever fall

The Small Business Index (SBI) fell to -24.7 in Q2 2022. The negative reading means that the proportion of small businesses expecting an improvement in performance over the coming quarter is exceeded by the proportion of firms expecting performance to worsen. Indeed, the SBI is now at its weakest point since Q4 2020, when the UK experienced the second national lockdown and was just about to enter a third round of national restrictions. Meanwhile, the quarterly fall in Q2 2022 amounted to 40.0 points, the second largest in the history of the Index. This was only outweighed by the drop of 121.8 points in Q1 2020, when the Covid-19 pandemic first hit the UK.

The SBI's deterioration in Q2 reflects the general uncertainty that has hit the UK economy in recent months. As outlined in Section IV, the economy has faced a number of headwinds, which has put downward pressure on growth and increased the likelihood of a recession. With activity expected to worsen at the aggregate level, this is manifesting in businesses' expectations of their performance.

There was unanimous negativity in the SBI across all UK regions. Meanwhile, negative scores were also witnessed across all major sectors, albeit to varying degrees. This variation reflects different levels of exposure to economic headwinds. For instance, the worst performance was seen amongst businesses in wholesale and retail, one of the sectors set to be most impacted by the weakening of consumer spending power, while a weak score was also seen for manufacturing businesses, which have been particularly impacted by input shortages and other supply chain issues. Nevertheless, there were also negative scores across services sectors, such as information and communication and professional, scientific and technical activities. Ultimately, this highlights that businesses are experiencing adverse impacts, regardless of geography or industry.

Figure two: The FSB Small Business Index[1]: small business prospects over coming three months
Source: FSB- Verve 'Voice of Small Business' Panel Survey



1 The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' The share of firms reporting are given the following weightings: 'much improved' +2; 'slightly improved' +1; 'approximately the same' 0; 'slightly worse' -1; and 'much worse' -2; the Small Business Index is derived from the sum of these factors.

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

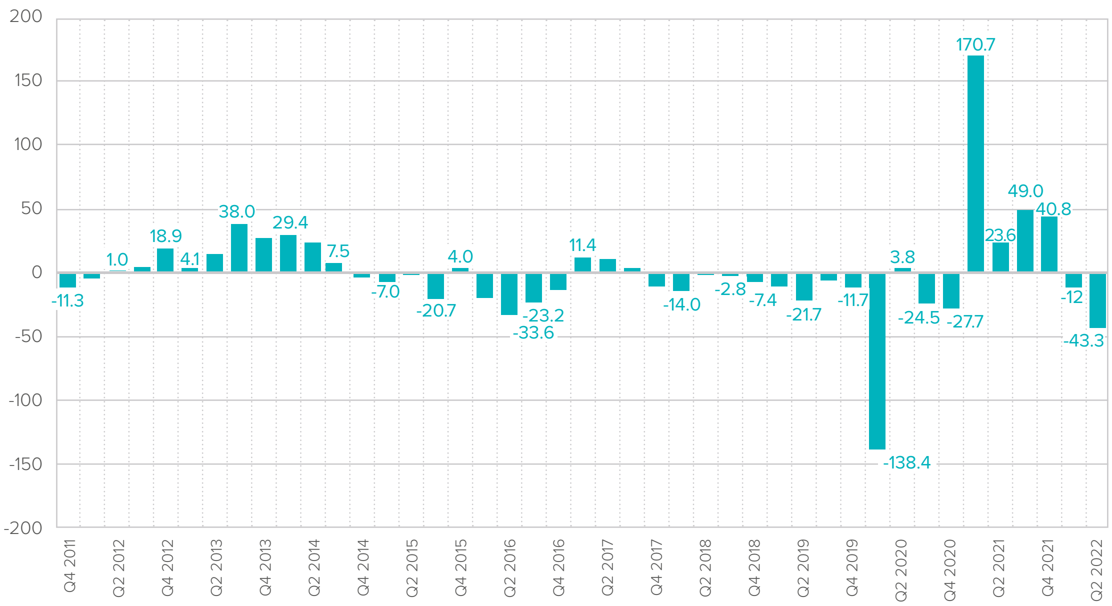
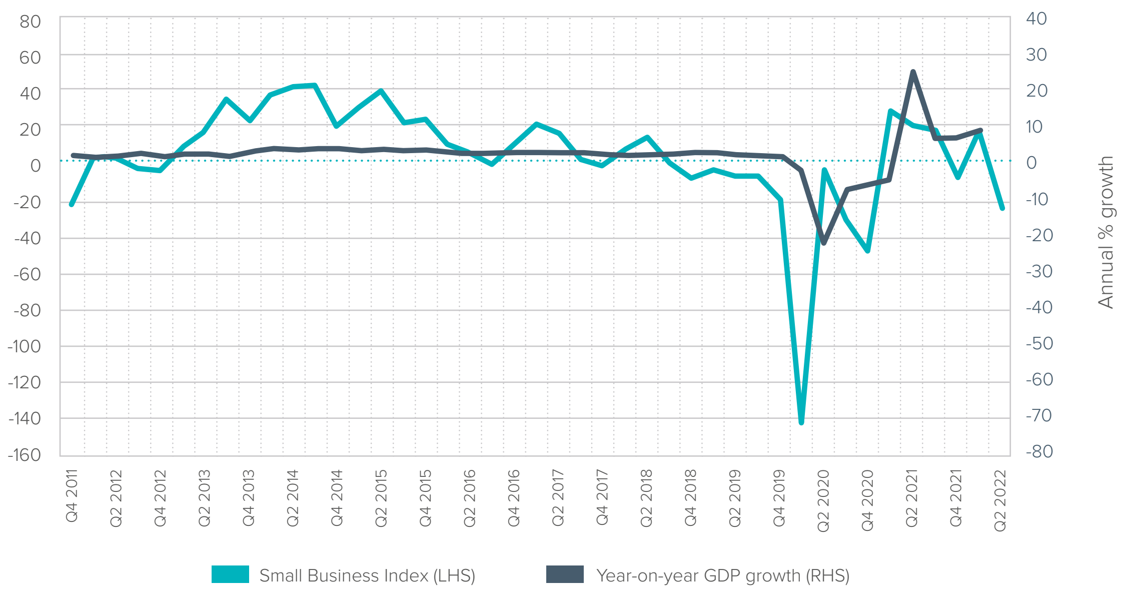


Figure four: UK SBI against year-on-year UK GDP growth
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey



REGION AND NATION SMALL BUSINESS INDICES

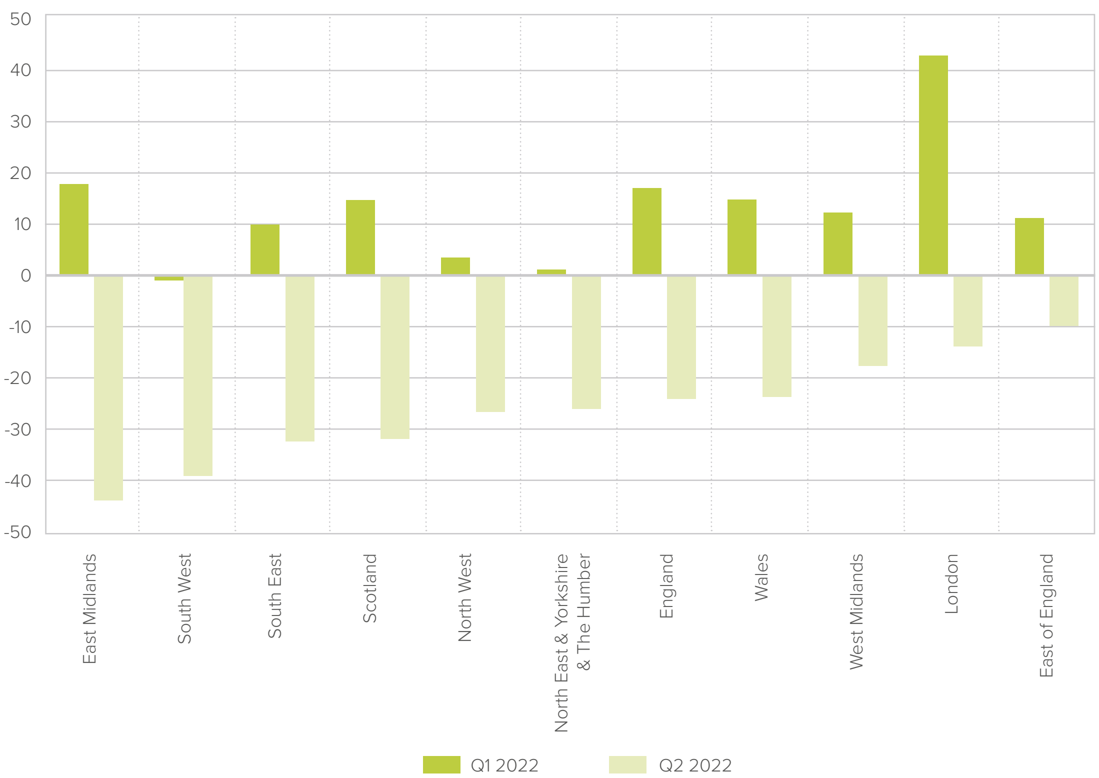
AFTER A SHORT-LIVED IMPROVEMENT IN Q1, THE SMALL BUSINESS INDEX FALLS ACROSS ALL REGIONS IN Q2

After a widespread change towards positive sentiment in Q1, worsening economic prospects have prompted drastic falls in businesses' optimism. Across all regions the regional SBI fell in Q2 2022 compared to Q1, with all regions also showing a negative reading.

The largest quarterly fall in the SBI was observed in the East Midlands, where the measure fell to -43.4, after standing at 17.2 in Q1. London experienced a similar plunge, with the measure falling by 56.3 points from 42.5 to -13.8. London's SBI reading in Q1 had been the highest in the country. The capital was able to benefit from the lifting of remaining Covid-19 restrictions during the first quarter, being home to a cluster of consumer-facing businesses. London saw one of the least negative readings in Q2 despite this significant fall, suggesting somewhat greater resilience.

The South West was the region with the second-lowest reading in Q2, at -38.7, a 37.6-point deterioration from Q1. That region is particularly exposed to current economic pressures in the form of rising inflation and ongoing supply chain disruptions, with tourism and transport and logistics being two key industries in the South West. As households are struggling to make ends meet, many consumers are likely to be less willing to spend on non-essential activities, such as tourism. Meanwhile, businesses engaged in transport and logistics continue to be affected by supply chain disruptions.

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



SMALL BUSINESS SECTOR INDICES

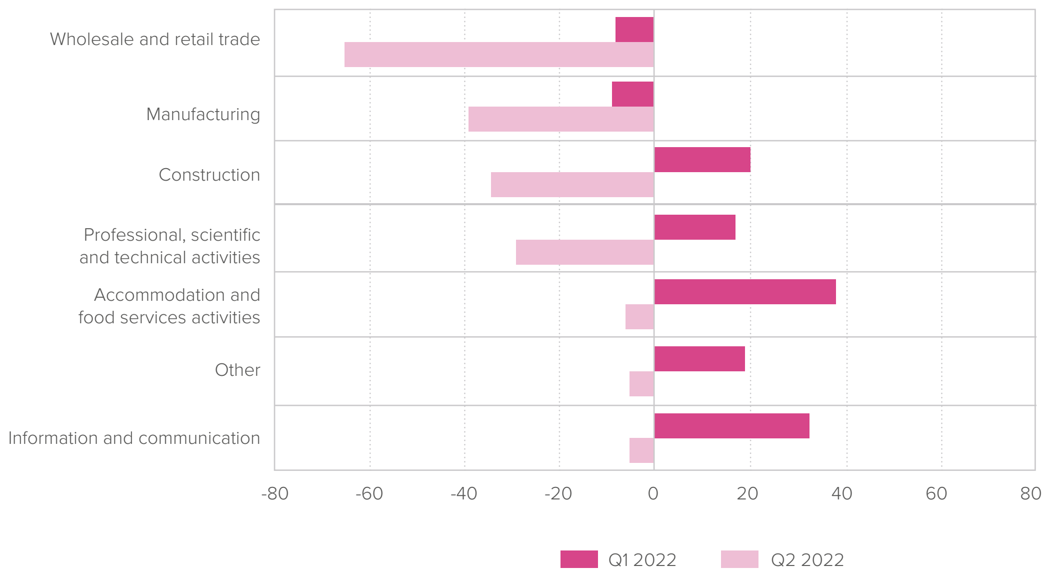
THE SBI ENTERS NEGATIVE TERRITORY ACROSS ALL INDUSTRIES, WITH RETAILERS AND MANUFACTURERS BEING THE MOST PESSIMISTIC

The SBI deteriorated across all major industries in Q2 2022. Furthermore, SBI readings for all industries are in negative territory, after only two industries, wholesale and retail trade and manufacturing, saw negative readings in Q1. The wholesale and retail sector was hit particularly hard by changes in the economic environment, with the reading plunging by 57.0 points. This was followed closely by the construction sector, which saw its reading fall by 54.2 points relative to Q1, taking it to -34.3.

Supply chain disruptions have been providing challenges to businesses for much of the past two years. Businesses in the logistics sector are likely to have been affected by these issues to a disproportionate degree. Supply chain disruptions also pose a major challenge for firms in the manufacturing sector, as many firms are struggling to source the inputs needed for their production. Consequently, the SBI for the manufacturing sector fell to -39.0 in Q2, after it had already been one of only two sectors with a negative reading in Q1. Manufacturing firms, similar to other industries and also private households, are also struggling in light of surging energy prices, due to the energy-intensive nature of their business.

Rising prices are of particular concern to the retail sector, which saw the weakest SBI reading of all major sectors in Q2, at -65.2. CPI inflation had already accelerated over Q1, averaging 6.2% over the first three months of the year, and the rate of price growth has picked up further in Q2, rising to 9.4% in June, the highest rate since the early 1980s. Cebr's latest forecasts point towards even more drastic price increases in the last quarter of the year, with inflation expected to average 10.7% in Q4, after a slight deceleration in Q3. Rising price levels are eroding households' purchasing power, which is likely to lead to a reduction in non-essential spending, which will impact the retail sector.

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



FINANCIAL PERFORMANCE

REVENUE SLUMP WITNESSED IN Q2, WITH SMALL BUSINESSES EXPECTING FURTHER CONTRACTION IN Q3

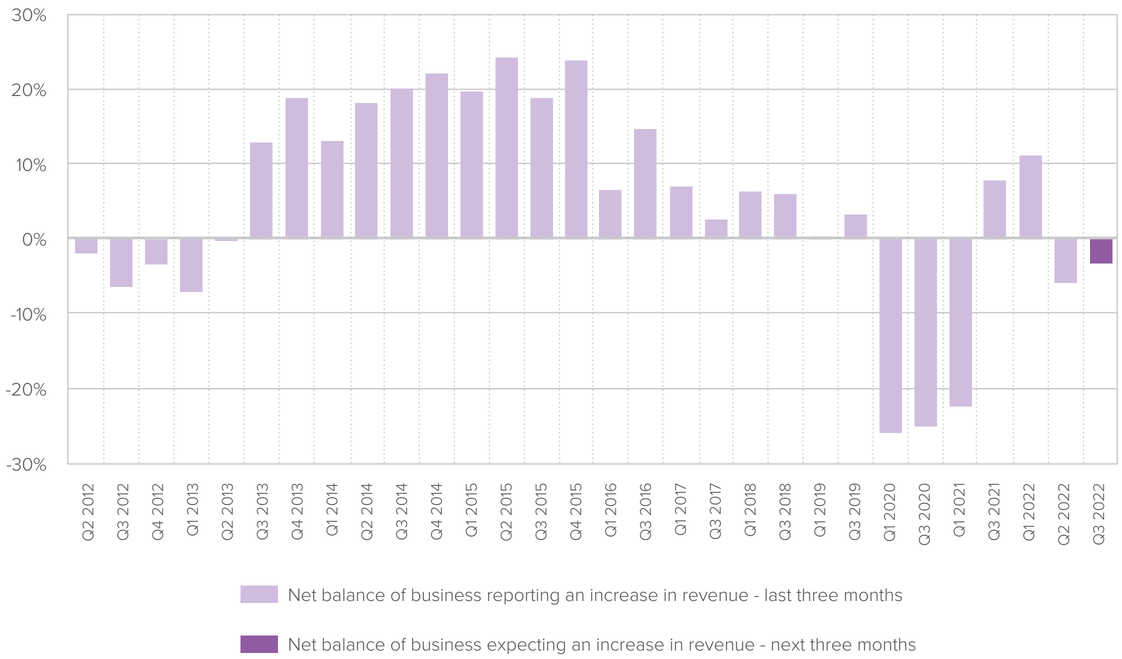
The net balance of small businesses reporting revenue growth over the previous three months stood at -6.0% in Q2 2022. The negative figure means that the proportion of small businesses reporting an increase in revenue levels over the last three months was outweighed by the proportion reporting a decrease. A negative reading was last witnessed in Q1 2021, when businesses' revenue streams were significantly curtailed by the third national lockdown and the accompanying slump in economic activity.

Most major sectors recorded negative readings on this measure. Wholesale and retail businesses recorded the weakest figure, with a net balance of -29.1% of such businesses reporting revenue growth in Q2. This aligns with the sector also recording the weakest score on the headline SBI. Businesses in this sector are particularly vulnerable to consumers withdrawing their activity as a result of cost of living pressures, with retail spending likely to fall at the expense of precautionary saving. Indeed, at the aggregate level, Cebr expects wholesale and retail to be one of few sectors to witness an annual fall in GVA in 2022. Compared to 2021, activity is forecast to be 0.9% lower this year.

A similar cutback in consumer behaviour is likely to be witnessed for hospitality and leisure. This explains the negative reading for businesses in accommodation and food services, for which a net balance of -12.9% of respondents reported revenue growth in Q2.

Looking ahead, a net balance of -3.4% of businesses expect their revenue to increase in Q3 2022, aligning with Cebr's forecast of declining activity at the aggregate level over these months. Wholesale and retail again recorded the weakest value on this measure, at -29.8%.

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



EXPORTS

CONTINUOUSLY HIGH SHIPPING RATES PROVE TO BE A CHALLENGE FOR EXPORTERS, BUT SOME IMPROVEMENT TO COME IN THE FUTURE

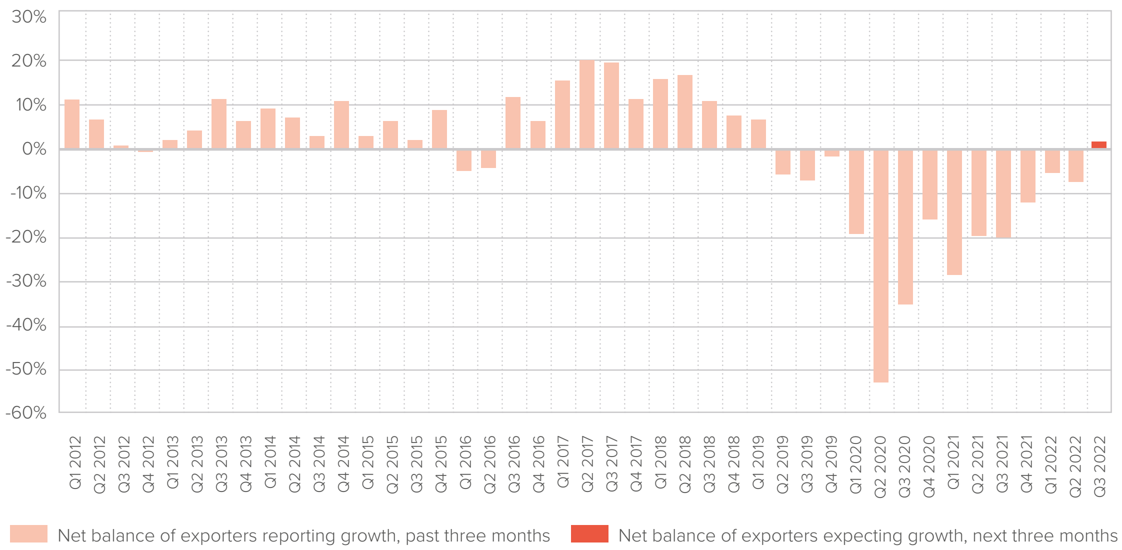
A net balance of -7.7% of exporting businesses say that the value of their exports increased over Q2 2022. This is a deterioration from the -5.3% net balance in Q1, but it is still a marked improvement from the balances observed in earlier quarters, such as Q4 2021 when the net balance stood at -12.3%.

Many of the headwinds affecting the economy at the aggregate level are also hindering businesses' ability to export, most notably ongoing supply chain disruptions. These are not only a challenge to businesses because they hamper production, but because they also directly impact exports and shipments due to increased rates and difficulty in sourcing shipping slots. During Q2 2022, the Freightos Baltic Index, a measure for the cost of shipping goods via containers, was roughly twice as high as at the beginning of 2021.

Further threats to exporting firms come from a global downturn in economic activity, with recessions expected in many large economies, including the UK and the Eurozone. This general economic downturn would translate into muted aggregate demand, likely to result in a lower volume of trade and consequently weaker quarters for British exporters.

However, shipping rates, measured via the Freightos Baltic Index, have been declining since early March 2022, from around $9,800 for 40 containers, to around $6,500 in early July. Whilst still at an elevated level – in February 2020, before the pandemic, the measure varied between $1,300 and $1,500 – some of the pressure on exporters is easing. In a likely reflection of this trend, a positive net balance of 1.4% of exporting firms expect growth in the value of those exports in Q3 2022. Furthermore, after appreciating considerably over the course of 2021, the pound has weakened relative to the euro in May 2022. Weaker sterling would make UK exports more attractive to European buyers, helping stimulate exports from the UK to its most important trading partner.

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



COSTS AND INFLATION

COST PRESSURES BEING FACED BY NEARLY NINE IN TEN SMALL BUSINESSES

The net balance of small businesses reporting an increase in operating costs increased for the fifth consecutive quarter in Q2, reaching a new series high of 85.9%. The respective components of the net balance figure showed that 89.0% of small businesses reported higher costs compared to a year ago, while just 3.1% reported a decrease. The former figure represents a series high, illustrating the extent to which businesses have experienced cost pressures in recent months.

Cost pressures have continued in Q2, driven by input shortages and disruption to global supply chains. These factors have worsened due to geopolitical events, including Russia's invasion of Ukraine and the reimposition of COVID-19 restriction measures in key Chinese cities. Collectively, these factors have contributed to new record high rates of inflation for producers, with input inflation reaching a record high of 24.0% in the year to June 2022.

Oil markets particularly have felt the impact of the fallout from the Russian invasion. This has had residual effects on fuel and utility prices, the two most commonly-selected sources of price rises amongst survey respondents in Q2. 64.2% and 63.5% of respondents, respectively, reported rising prices over the last year for these categories.

There was a stark increase in the share of respondents reporting the exchange rate as a source of cost pressures over the past three months. While just 8.2% of respondents selected this category in Q1, this increased to 15.6% in Q2. Sterling has weakened significantly in recent months. All else equal, this makes imported goods more expensive, putting upward pressure on businesses' costs.

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

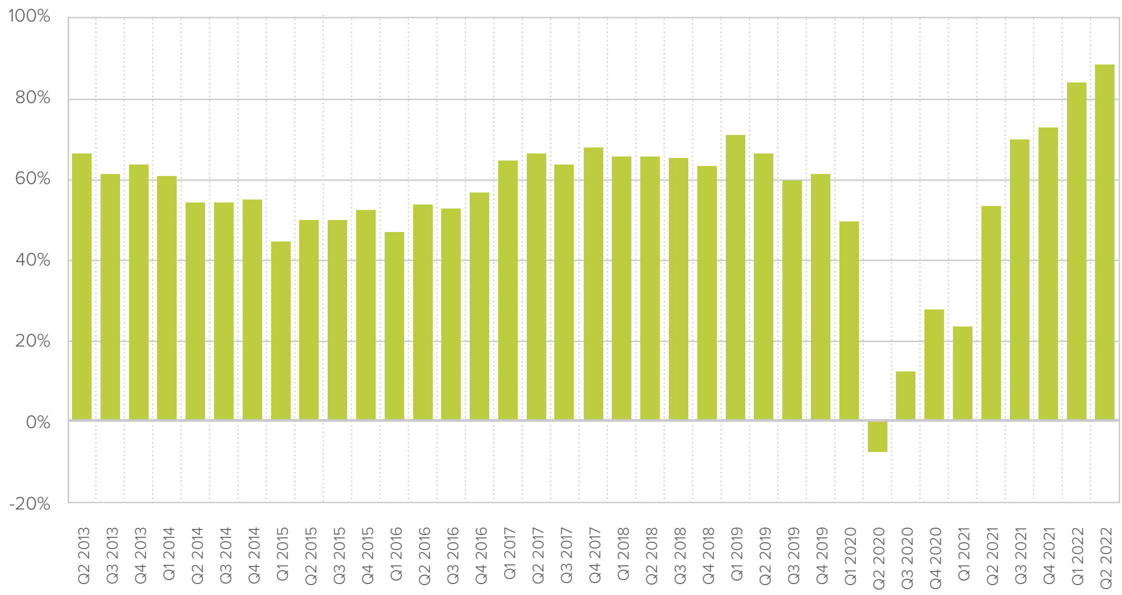
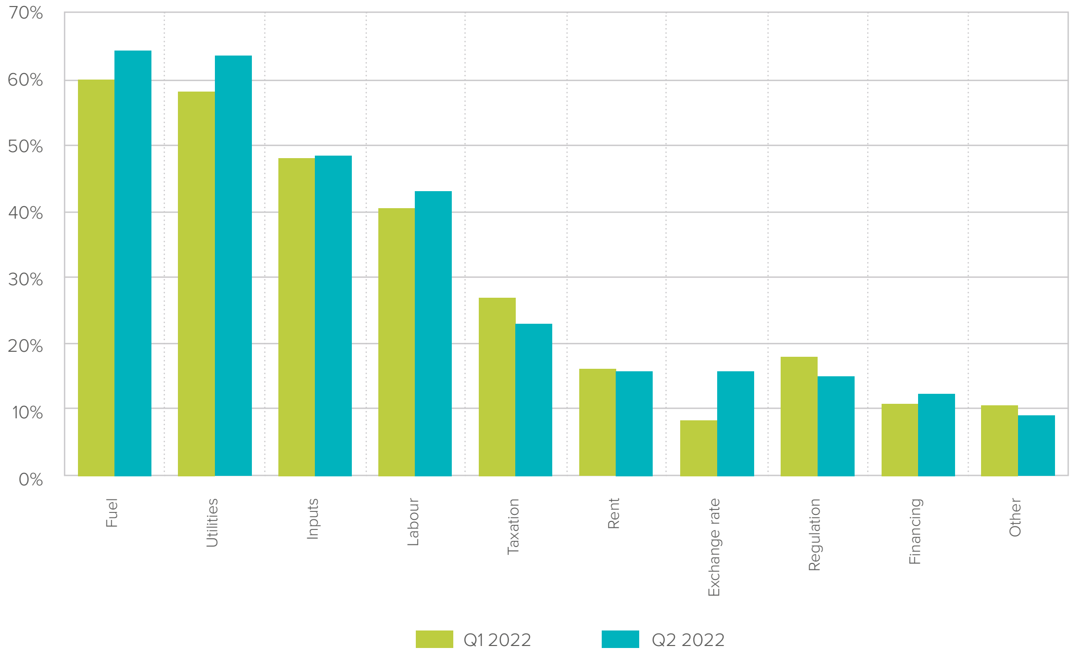


Figure 10: Main causes for changing business costs (firms may give multiple answers)
Source: FSB - Verve 'Voice of Small Business' Panel Survey



EMPLOYMENT

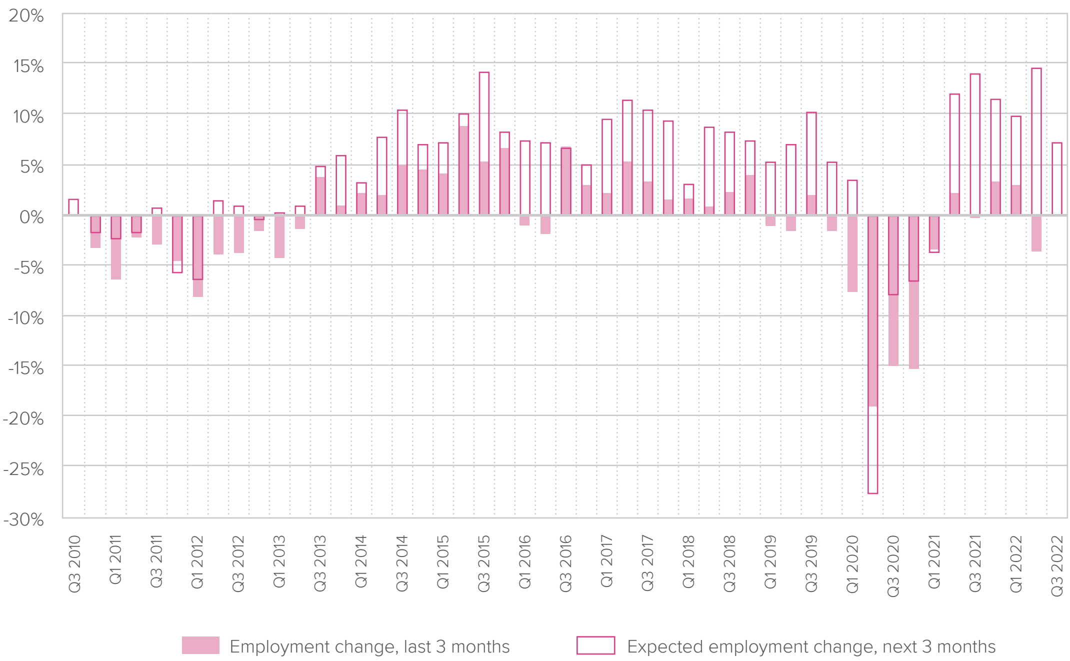
SMALL BUSINESSES REPORT FIRST FALL IN EMPLOYEE NUMBERS SINCE Q1 2021

The net balance of small businesses reporting growth in employee numbers stood at -3.6% in Q2, down from 2.9% in Q1. The negative figure means that the number of businesses seeing their workforce increase in size was outweighed by the number of businesses seeing a contraction in employee numbers. A negative score on this metric has not been seen since Q1 2021. Q2's experience was significantly below businesses' expectations when looking ahead to the quarter. When asked at the end of Q1, a net balance of 14.5% of respondents had expected their employee numbers to increase over the coming quarter.

This reported contraction in employee numbers amongst small businesses largely defies aggregate labour market trends. Many labour market indicators have shown considerable strength in recent months, despite wider economic headwinds. On a regional basis, businesses in the East Midlands reported the weakest net balance, at -9.1%. This region has a large base of manufacturing businesses, which have been significantly affected by recent input price inflation and other supply pressures, likely reducing their capacity to maintain staff levels.

Looking ahead, businesses expect a return to growth in employee numbers. A net balance of 7.2% of respondents anticipate their employee base increasing in size in Q3. The strongest score on this metric was seen for businesses in professional, scientific and technical activities, with a net balance of 12.4%. These businesses are less directly exposed to consumer developments, and so are likely to fare better amidst the anticipated slowdown in consumption. Relative to other sectors, their capacity to retain staff will be stronger. Conversely, the weakest score was seen amongst businesses in wholesale and retail, with a net balance of -3.5% of businesses in this sector expecting employee numbers to increase in Q3.

Figure 11: Net percentage balance change in number of people employed – proportion reporting increase, less proportion reporting decrease
Source: FSB - Verve 'Voice of Small Business' Panel Survey



GROWTH ASPIRATIONS AND CHALLENGES

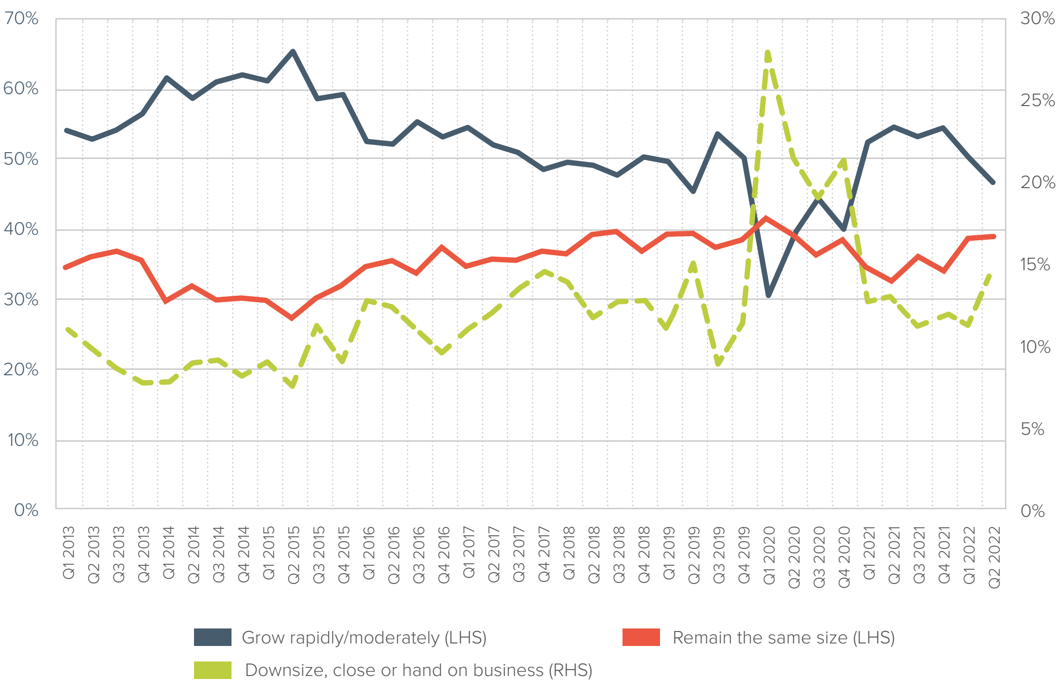
BUSINESSES' GROWTH OUTLOOK WORSENED IN Q2 2022, WITH THE INFORMATION AND COMMUNICATION SECTOR DEFYING THE DOWNTURN

In Q2 2022, 46.6% of businesses expected to grow over the coming 12 months, whilst the share of firms expecting to downsize or even close their business amounts to 14.7%, leaving a net balance of 31.9%. This is a considerable deterioration from Q1, when the net balance stood at 39.1%. The share of firms expecting to shrink increased significantly from Q1, up by 3.5 percentage points, whilst the share of businesses expecting to grow fell by 3.7 percentage points.

Firms in the wholesale and retail trade have particularly low growth expectations, with a net balance of 12.8% of firms expecting to grow. Many retail businesses were hit hard by the pandemic, as the combination of high infection rates and public health measures drove consumers away from brick-and-mortar shops. Whilst restrictions were lifted in March 2022, Q2 still saw the sector struggle. Inflation, which reached 40-year highs in Q2, erodes households' purchasing power, leading to lower consumer demand and translating into weaker retail activity.

At the other end of the range is the information and communication sector, with a net balance of 53.5%. The pandemic has accelerated the uptake of digital technologies. Consequently, just 9.5% of firms in this sector are expecting to shrink over the next twelve months.

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



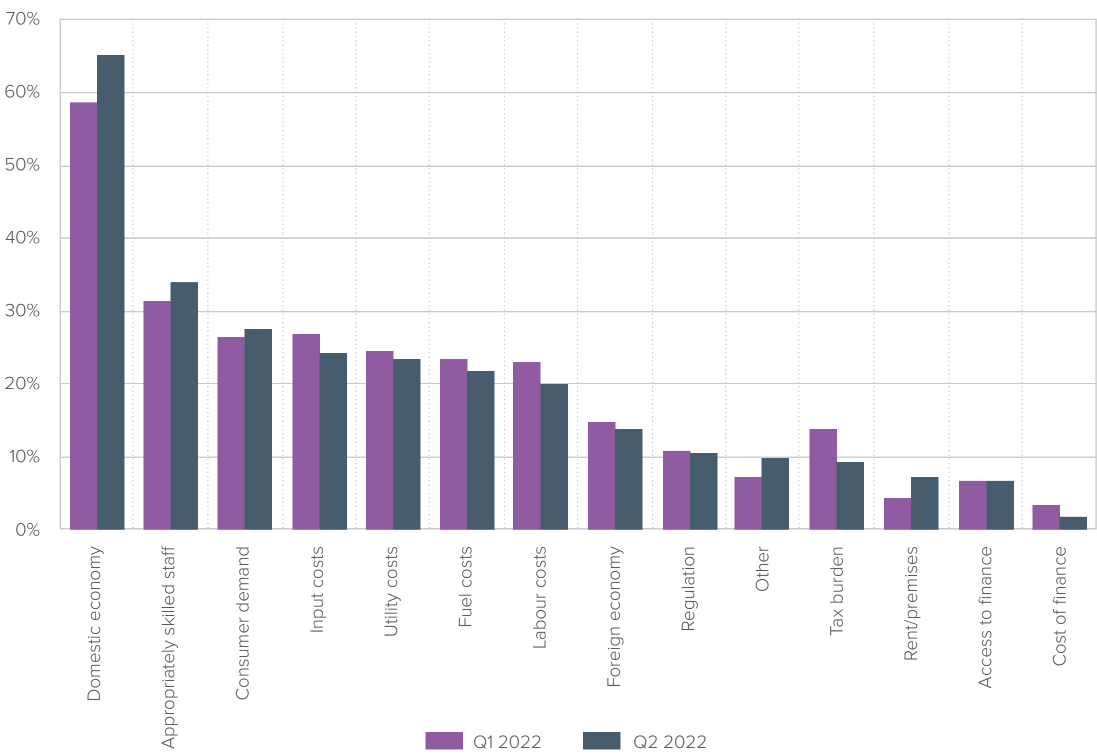
THE DOMESTIC ECONOMY IS SEEN AS A BARRIER TO GROWTH BY ALMOST TWO THIRDS OF BUSINESSES HOPING TO GROW, AS A RECESSION LOOMS

When asking businesses expecting to grow over the next 12 months about the potential barriers to such growth, the domestic economy was cited most often, being mentioned by 65.1% of respondents. This is up from 58.6% in Q1. Since Q1, the economic outlook for the UK has worsened considerably, with a technical recession now expected in 2022.

A lack of sufficiently skilled staff was the second-most cited threat to growth aspirations, with 33.9% of respondents citing this. Official data published by the Office for National Statistics confirm this sentiment, with the number of vacancies rising to a fresh record of 1.3 million in the three months to May, highlighting the degree to which labour demand exceeds supply.

Consumer demand has been depressed chiefly by the worsening cost-of-living crisis, with inflation reaching 9.1% and 9.4% in May and June, respectively, marking the highest rates since the early 1980s. Consequently, consumer demand has been muted, as a number of households are struggling to buy even essential goods. In light of rising prices, consumer confidence has also waned. It is thus no surprise that 27.4% of businesses with positive growth expectations see consumer demand as a potential threat to their performance over the coming year.

Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey



CREDIT

RATE OF CREDIT APPLICATIONS TICKS UP AS BUSINESSES SEEK TO COVER COST PRESSURES

Figure 14: Credit applications and interest rates offered
Source: FSB - Verve 'Voice of Small Business' Panel Survey
Respondents were able to give multiple answers to this question.

Have you applied for credit in the past three months?

No – 88.5%

Yes – 11.5%

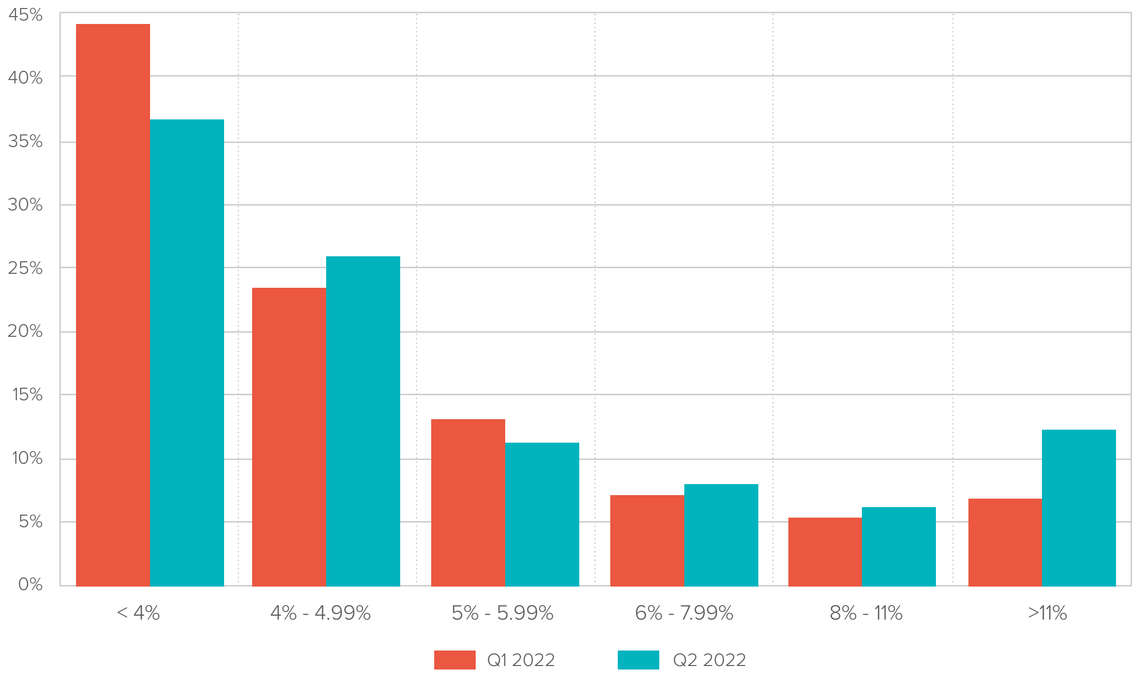
Were you successful?

No – 39.5%

Yes – 44.9%

Decision pending – 15.6%

What rate were you offered?

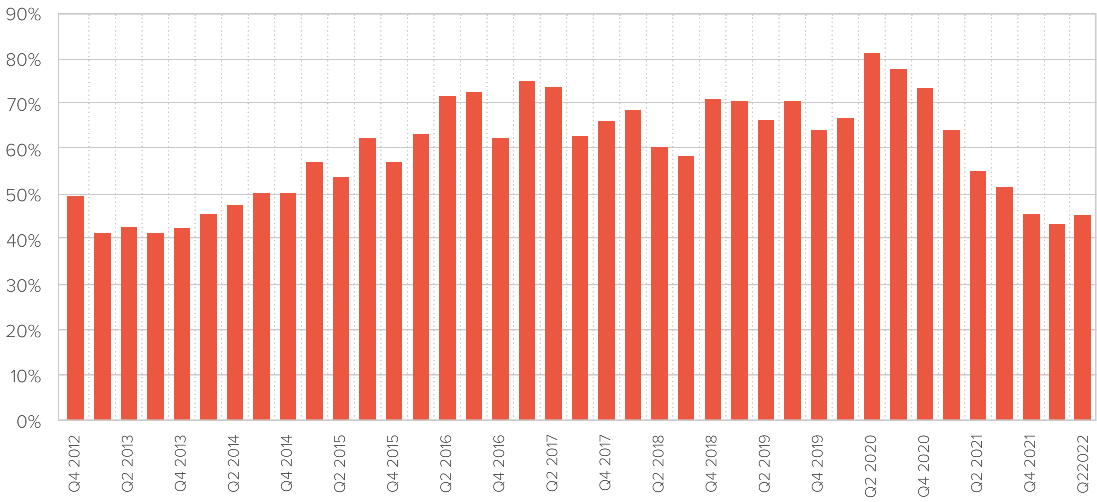


The proportion of small businesses applying for credit increased sharply in Q2 2022, reaching 11.5%. This put an end to seven consecutive quarters in which the proportion of small businesses seeking credit fell. Q1 had seen a near-term low rate of credit application, amounting to 9.1%.

This uptick in the share of businesses seeking credit likely reflects the cost pressures being faced at present. Seeking external funding sources, such as credit, can serve as a buffer for businesses to maintain their output levels in the face of input cost pressures, while also compensating for lack of revenue from weaker consumer demand.

There was also an increase in the average interest rate offered to successful credit applicants in Q2. This likely reflects the Bank of England's recent monetary tightening in the face of spiralling inflation. The base rate has increased from 0.75% at the end of Q1 to 1.25% by the end of Q2. Accordingly, the average interest rate reported by successful credit applicants in our sample has increased from 4.7% to 5.5%.

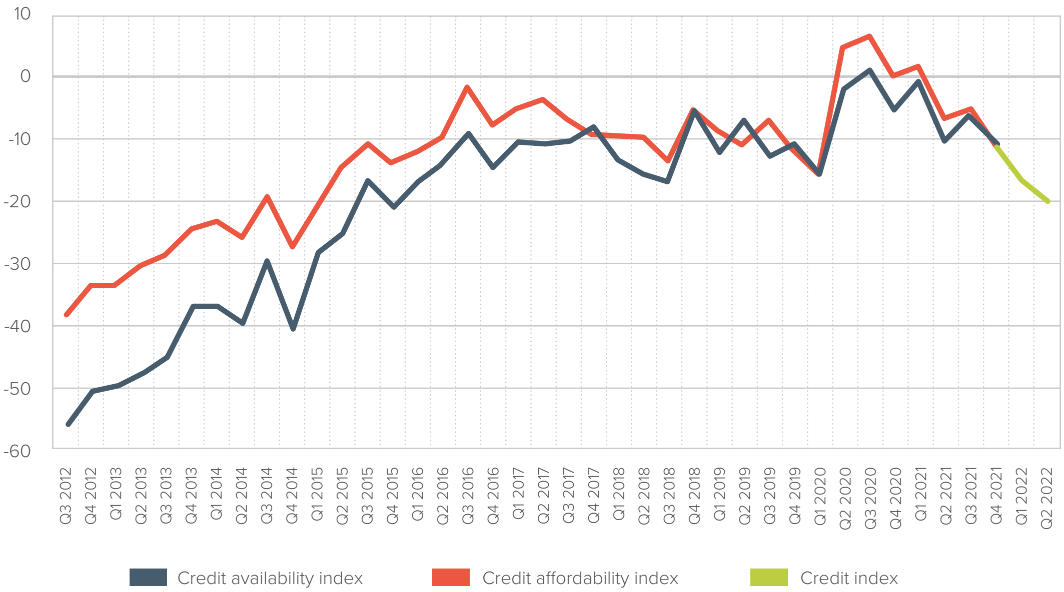
Figure 15: Proportion of small businesses successful in their credit applications in the past three months
Source: FSB - Verve 'Voice of Small Business' Panel Survey



BASE RATE HIKES PROMPT BUSINESSES TO BECOME MORE NEGATIVE ON CREDIT AVAILABILITY AND AFFORDABILITY

The proportion of small businesses with positive views on credit availability and affordability fell to 17.6% in Q2 2022. The proportion of businesses with negative views on credit availability and affordability increased to 42.4%. The Bank of England's base rate hikes, and the subsequent increase in rates implemented by commercial lenders, are likely to have been key factors behind this changing sentiment. Accordingly, the credit availability and affordability index slipped to -19.8 in Q2, having stood at -16.6 in Q1.

Figure 16: Indices of credit perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses
Source: FSB - Verve 'Voice of Small Business' Panel Survey[2]



2 Due to methodological changes to the survey, the Credit Availability and Credit Affordability Indices have been superseded by a composite Credit Index, taking into account both of these factors.

INVESTMENT

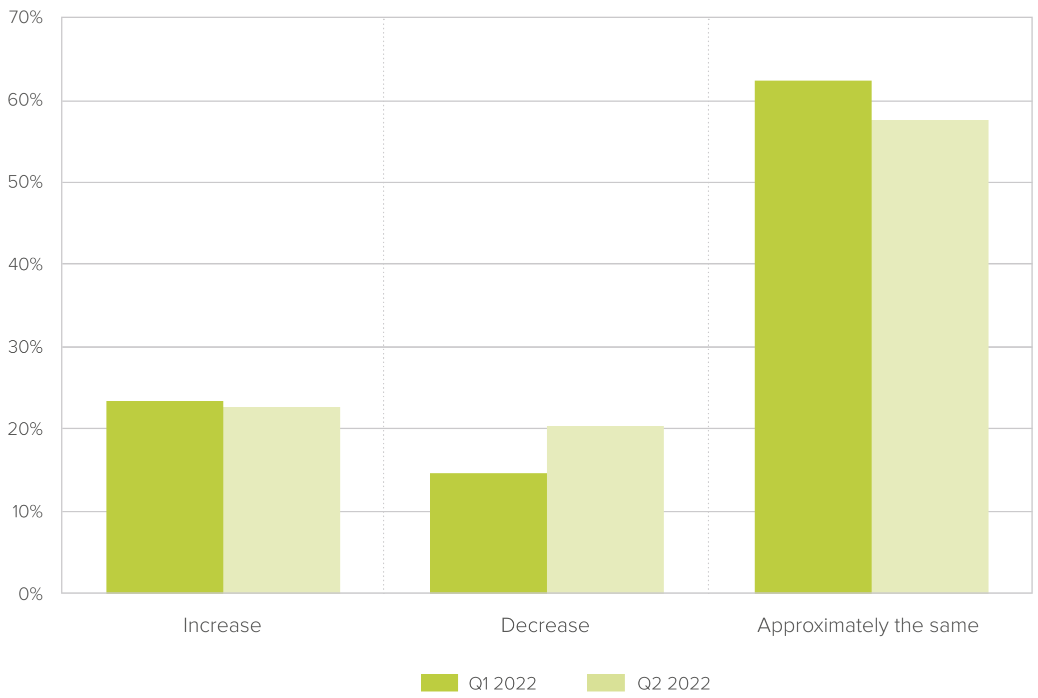
INVESTMENT AMBITIONS FALL FURTHER AS ECONOMIC CONDITIONS WORSEN AND BORROWING BECOMES MORE EXPENSIVE

After investment intentions fell in Q1, the deterioration continued in Q2 2022. The proportion of businesses planning to increase their capital investments over the coming quarter was 22.7%. This is down from 23.4% in Q1 and the lowest share since Q1 2020, when the UK first entered a national lockdown, illustrating the degree to which business sentiment has worsened over recent months. Within the net balance figure, 20.1% of responding businesses say that they are planning to decrease their capital investment.

One factor likely to have contributed to the reduction in business investment is the increase in the Bank of England's base rate. After the rate stood at 0.75% at the beginning of Q2, it has since been raised to 1.25%, in an effort to combat surging inflation. Cebr expects the Bank of England to continue this anti-inflationary policy, taking the base rate to 1.75% by the end of Q3 and to 2.00% by the end of 2022. This higher rate of interest is likely to increase the cost of borrowing, making investment more expensive for businesses.

The war in Ukraine has created an environment of uncertainty. As a consequence, there is the possibility that businesses are deferring investment decisions, due to the higher perceived risk at present. The expected onset of a recession is likely to further fuel businesses' concerns.

Figure 17: % of small businesses expecting to increase and decrease capital investment over next quarter, compared with previous quarter
Source: FSB - Verve 'Voice of Small Business' Panel Survey



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METHODOLOGY

This report is based on the research survey of FSB members carried out by Verve. 5,660 panel members were invited to take part in an online survey as well as through an open link shared with FSB members. Reminders were sent to all non-respondents. 509 responses were received, a response rate of 9% for the panel. The survey was then shared with the wider FSB members and received a total of 1,317 responses. The data are weighted by regional gross value added to match the profile of small businesses across the UK.
The survey was undertaken between the 20th of June and 1st of July 2022.

SUMMARY DATA TABLE

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022
Small Business Index	-32.6	-49.3	27.3	18.6	16.4	-8.5	15.3	-24.7
Employment - previous three months	-15.2%	-15.5%	-3.5%	2.2%	-0.2%	3.3%	2.9%	-3.6%
Employment - coming three months	-6.7%	-3.8%	12.0%	14.0%	11.5%	9.8%	14.5%	7.2%
Exports - previous three months	-35.2%	-16.0%	-28.4%	-19.8%	-20.0%	-12.3%	-5.3%	-7.7%
Exports - coming three months	-18.9%	-29.0%	-9.8%	-11.2%	-4.6%	-3.8%	10.4%	1.4%
Credit availability - rated good or very good	36.4%	29.3%	35.2%	30.0%	29.6%	26.4%	-	-
Credit availability - rated poor or very poor	30.9%	30.5%	30.1%	35.0%	32.3%	36.0%	-	-
Credit affordability - rated good or very good	-	-	-	-	-	-	19.4%	17.6%
Credit affordability - rated poor or very poor	-	-	-	-	-	-	36.5%	42.4%

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

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

Responses are also weighted according to regional gross value added.

Q2

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