Q3

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 3, 2023

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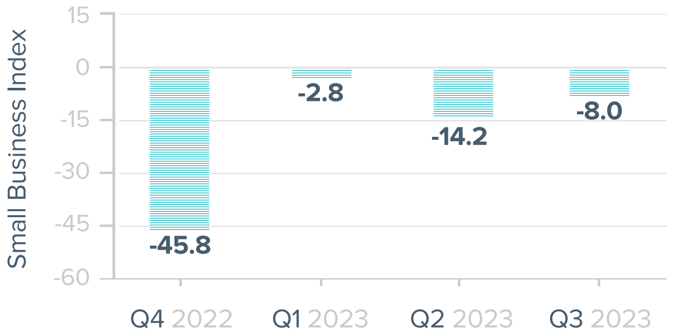
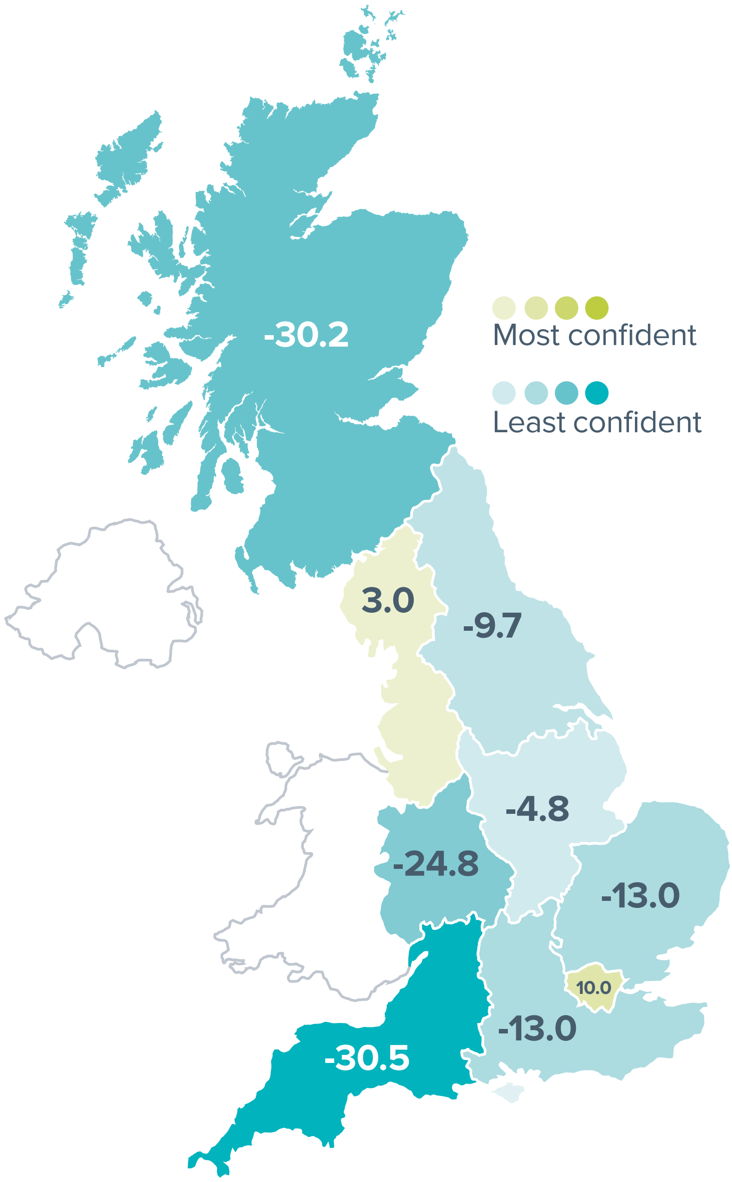
SBI Q3 2023

"Small business confidence regained some ground between Q2 and Q3 2023, but is still in negative territory for the sixth quarter in a row"





Please note: Sample sizes for Wales and Northern Ireland are insufficient for accurate reporting. The North East is combined with Yorkshire and the Humber to produce a combined region, due to low sample sizes for the former region.

Exports conditions stabilise in Q3 after a rocky start to the year

49%

of small businesses say the **value of exports stayed approximately the same** over the third quarter, up from just three in ten who said the same thing in Q2

Finding appropriately skilled staff continues to be a barrier to growth in the IT sector

39%

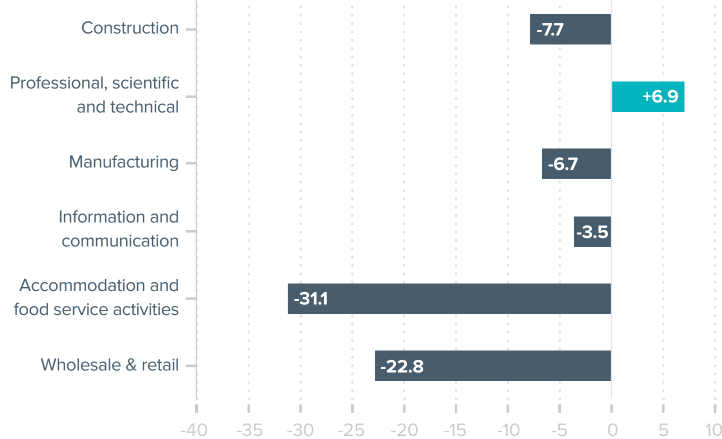
of information and communication small businesses say **finding appropriately skilled staff is a barrier to their growth aspirations** (all sectors: 22%)

The affordability and availability of credit continues to worsen

53%

of small businesses rate the **availability and affordability of new finance as poor**

Small business confidence by sector



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FSB FOREWORD

Tina McKenzie,
Policy Chair

The summer of 2023 was a bit of a damp squib weather-wise, with grey skies and unusually high rainfall levels dampening what should have been three months of greater leisure and enjoyment. It's therefore perhaps fitting that the Small Business Index's headline confidence measure stayed in negative territory, thanks to a variety of factors.

Perhaps we shouldn't read too much into weather-related metaphors; after all, the same quarter last year saw scorching temperatures and seemingly endless sunshine, and also a near-record low for small business confidence, due to the cost of doing business crisis, especially the dizzying spike in energy prices which caused so much pain to the small business community. We can be thankful that price rises and gas and electricity bills have fallen back, compared to the punishing heights of this time last year, but inflation is still far higher than we'd like it to be, while an upward trend in fuel prices is causing unease.

The Q3 confidence measure reading of -8 points is also higher than the second quarter's finding of -14.2 points, which is cause for some relief – even if the economic indicators for the final quarter of the year look less than glowing.

Overall, the message coming from the Q3 report is one of tentative stabilisation in some areas, with slight falls in proportions of firms reporting or hoping for growth, or experiencing or fearing a contraction.

Among exporters, for example, the percentage reporting that export volumes remained approximately the same over the past three months leapt from three in ten (30.3%) in Q2 to nearly half (48.7%) in Q3. The proportion of all small firms who expect to remain approximately the same size over the next year ticked up from 34.6% in Q2 to 37.7% in Q3. Capital investment expectations for the coming quarter were expected to stay approximately the same for 52.3% of small firms in Q2, and for 55.5% of small firms in Q3. The proportion of small firms who said their late payments had neither improved nor worsened over the previous quarter edged up from 23.6% in Q2 to 25.9% in Q3.

Revenues over the previous quarter were marginally better than those reported in Q2, in keeping with the small recovery in confidence levels. A third (33.5%) of small firms reported that revenues increased over Q3, essentially unchanged from the previous quarter (Q2: 32.7%). Meanwhile, the proportion of small businesses reporting a drop in revenues over Q3, at 39.4%, was slightly lower than the 41.3% saying the same thing in Q2.

Given the turbulence of the recent past, this is welcome to a degree, but we must be wary that stabilisation does not turn into stagnation. There are also external signs of a potentially difficult winter ahead, such as a fall in consumer confidence levels in October, anaemic GDP growth in August following a notable drop of 0.6% in July, and indications from the labour market survey that unemployment levels may be rising and vacancies falling.

The findings of our research echo these warnings. The consumer-facing sectors of hospitality and retail have confidence readings far below the overall rate for small firms (-31.1 points for accommodation and food service activities; -22.8 points for retail and wholesale businesses; -8 points for all firms). The domestic economy is once again the most commonly-cited barrier to growth, named by over three fifths of small firms (63.5% in Q3, against 61.5% in Q2). Hiring intentions for the coming quarter have also fallen back, with 11.7% of small firms planning to take on new employees, down from 15.5% who planned to do the same in the previous quarter.

The Q3 survey also raises a cautious alarm over inflation, which only fell by 0.1% over the three months in question, according to the ONS. The series record high of 91.8% of small firms who said their cost of doing business was higher than in the same period a year ago was recorded in Q1 2023, and fell back to 84.9% in Q2. However, hopes that this fall would continue were confounded, as 86% of small firms in Q3 said their running costs were higher than in the same quarter in 2022. The main culprits for higher running costs were utilities (57.3%), inputs (43.1%), and labour costs (42.8%). Fuel came next in the list, at 40.4%, up from 37.3% in the previous survey – and with pump prices rising, we are concerned that small firms will be hit by higher petrol and diesel costs as the year rolls on.

One point of relief in Q3 came in September as the Bank of England decided on a knife-edge 5-4 decision to hold the base rate at 5.25%, following 14 successive increases. With access to finance rated as poor by 53% of small firms in Q3, and with three in ten successful finance applicants (30.1%) offered a rate of 11% or more, we think there is a strong case for the Bank not to hike the base rate any further, especially with much of the pain of rate rises yet to hit in full.

Small firms are paying close attention to the stalls being set out by political parties as the next general election gradually comes into view. But in the short-term, as the festive season approaches, the 'golden quarter' becomes vital for sectors like hospitality and retail facing challenges. Improving their operating environment will benefit the economy over the next few months and the distant horizon, as well as delivering political dividends.

ECONOMIST'S VIEW

Kay Daniel Neufeld, Head of Forecasting and Thought Leadership

The Small Business Index remained in negative territory in the third quarter, despite a partial recovery which saw the score rise to -8.0 points, up from -14.2 in the previous quarter. The UK's small business community has welcomed easing energy costs and a slightly less tight labour market, though as the survey shows, overall cost pressures remain a prime concern, as do high interest rates and the general weakness of the domestic economy.

The weakness in small business sentiment reflects the disappointing growth path of the wider economy this year. Recent revisions to the national accounts data have shown that the UK economy has overall fared less badly than previously thought in the aftermath of the Covid-19 pandemic, recording a smaller contraction in 2021 and stronger growth in 2022 than initial estimates showed. This means that by Q2 this year, the UK economy was 1.8% larger than during the last pre-pandemic quarter in Q4 2019. Despite these upward revisions, the recent growth trajectory remains lacklustre, with quarterly growth rates this year coming in at just 0.3% (Q1) and 0.2% (Q2) thus far. This is in no small part due to the knock-on effects of the Bank of England's attempts to bring inflation back down to target through tighter monetary policy. Higher borrowing costs are having a dampening effect on consumer spending and business investment. However, as interest rates affect the economy with substantial lags, we are likely yet to feel the full impacts of the cumulative 515 basis points increase in the bank rate that we've seen since November 2021.

A silver lining on interest rates has emerged, however, as it now seems more likely the Bank of England has reached the end of the current rate hiking cycle, following the narrow decision to keep the bank rate unchanged at 5.25% in the September meeting. The prospect of having reached the top of the rate hiking cycle might be one of the factors which have led construction sector SMEs to report a less negative outlook on the SBI this quarter. After a steep fall in Q2, sentiment rose by 24.1 points, marking the largest improvement across all sectors, in Q3, though it remained in overall negative territory at -7.7. Given the challenging outlook for the housing market where further price falls are expected over the coming quarters, it is unsurprising to see that the overall sentiment for SMEs in the construction sector remains negative. Similar moves of improving sentiment towards a less negative overall score were observed for information and communication, wholesale and retail trade, manufacturing and accommodation and food services. The only sector with a positive SBI score, professional, scientific and technical activities, saw a small drop of 0.9 points to stand at 6.9 in Q3.

A majority of the regional SBI scores saw an improvement in Q3, though only for London and the North West was this enough to lift them into an overall positive reading at 10.0 and 3.0, respectively. London also saw the largest quarter-on-quarter increase in the score as the capital remains somewhat more resilient in the face of economic challenges. Scotland meanwhile recorded the largest quarterly drop of 18.5 points to stand at -30.2, just a shade above the South West at -30.5, Q3's worst performer.

Overall, the Q3 scores on the SBI are reflective of the difficult economic situation the UK finds itself in. Given that we expect growth to slow further in the coming quarters, with a winter recession remaining a possibility, this is unlikely to change any time soon. Nearly two-thirds of surveyed businesses (63.5%) said the domestic economy was the biggest hindrance to their growth aspirations, further underlining this point. However, with inflation gradually subsiding and cost pressures easing, an uptick in growth should materialise in the second half of 2024. This also coincides with our expectations for the first interest rate cuts by the Bank of England which could give a boost to investment intentions, and lower debt servicing costs.

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index (SBI) increased to -8.0 in Q3 2023.** This marked a return to improvement, following Q2's fall to -14.2. Q3 represented the SBI's sixth consecutive negative reading.
- **Just two UK regions saw a positive reading on the regional SBI in Q3 2023.** Nevertheless, five regions saw an improvement in the measure when compared to Q2 2023.
- **Many sectors recorded negative readings in Q3, despite quarterly improvements.** This highlights the continuing negative sentiment amongst small businesses across vast swathes of the economy.
- **The net balance of small businesses reporting revenue growth over the previous three months stood at -5.9% in Q3 2023.** This marked the sixth consecutive negative reading for the revenue net balance figure.
- **A net balance of -2.6% of exporting businesses said that the value of their exports increased in Q3 2023.** Although this marked the eighteenth consecutive negative quarterly reading, the latest result was the highest since Q4 2019.
- **In Q3, the net balance of small businesses reporting an increase in their operating costs rose to 83.5%.** This elevated share emphasises the continued financial strain that small businesses are experiencing from broad-based cost pressures.
- **A net balance of -0.2% of small businesses reported growth in employee numbers in Q3.** This marks a sixth consecutive sub-zero value on this metric, though Q3's reading was less negative than the preceding five quarters.
- **Appropriately skilled staff is a barrier to growth over the coming year for 22% of small businesses.** By sector, it is a barrier to growth for 45% of construction and 38% of information and communication small businesses.
- **The share of small businesses expecting to grow over the coming year decreased slightly to 49.6% in Q3.** This marked a return to a situation in which only a minority of small businesses expect to grow over the next twelve months.
- **12.0% of small businesses reported that they applied for credit in Q3 2023.** This was down on the 12.7% recorded in Q2 2023. The share has now declined for three consecutive quarters.
- Perceptions of credit affordability and availability continued to worsen in Q3. **The credit index remains deeply in negative territory at -31.3, the second-weakest value on record.**
- **The net balance of small businesses expecting to increase their investment declined to 5.7% in Q3, down from 7.0% in Q2.** Falling investment intentions reflect the tighter monetary policy environment in the UK economy.

UK MACROECONOMIC OVERVIEW

UK economy expected to experience recession this winter

The latest data from the Office for National Statistics (ONS) show that UK GDP grew by 0.2% in August. This marked a return to expansion following July's downwardly-revised contraction of 0.6%. Recent revisions to historic data mean that GDP now stands firmly above pre-pandemic levels. Output in August was 2.1% higher than February 2020's level.

The services sector was the main contributor to August's GDP growth, with output picking up by 0.4%. There was mixed performance amongst services subsectors, however. For instance, output amongst consumer-facing services fell by 0.6% on the month in August, a second consecutive monthly decline. These businesses continue to contend with demand-side headwinds, with consumer activity being impacted by high inflation and weaker spending power. By contrast, all other services witnessed monthly output growth of 0.6%. Elsewhere, output across production and construction both declined in August, at rates of 0.7% and 0.5%, respectively. These sectors continue to face supply-side constraints, notably from input price pressure and increased borrowing costs.

Despite August's return to growth and historic data revisions, the outlook for the UK economy remains weak. The economy has suffered from a poor growth trajectory so far this year, due to the effects of high inflation and rising interest rates. This is set to worsen in the near term, with Cebr currently forecasting a recession across Q4 2023 and Q1 2024. Weak quarterly growth rates are projected for the remainder of 2024 beyond Q1. The main drivers of the possible recession are falling household consumption and business investment. Both of these factors are affected by the higher interest rate environment and its impact on borrowing affordability.

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

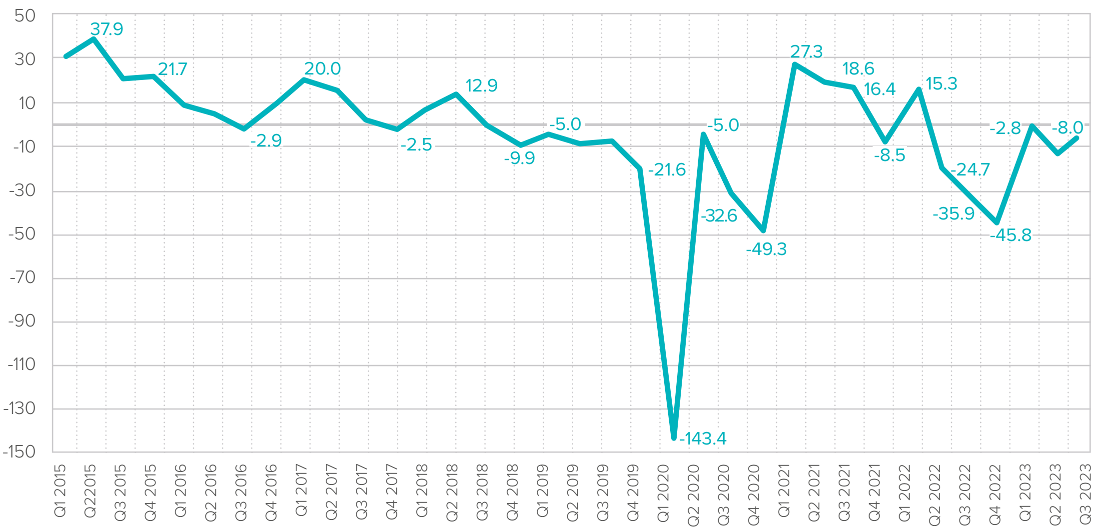
Small Business Index improved in Q3 but remains in negative territory

The Small Business Index (SBI) increased to -8.0 in Q3 2023. This marked a return to quarterly improvement, following Q2's fall to -14.2. Despite the improvement, the SBI remains in negative territory, meaning that the share of businesses expecting their performance to worsen over the coming quarter outweighs the share expecting their performance to improve.

Q3 marked the sixth consecutive negative reading on the SBI. Such prolonged negativity reflects the weak growth trajectory the economy has faced recently, with output suffering from a number of headwinds including elevated interest rates and curtailed household spending power.

The economy's weakness at the macro level is feeding into small business sentiment. Further periods of negative SBI values are likely over the coming quarters, as a result of the possible recession.

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

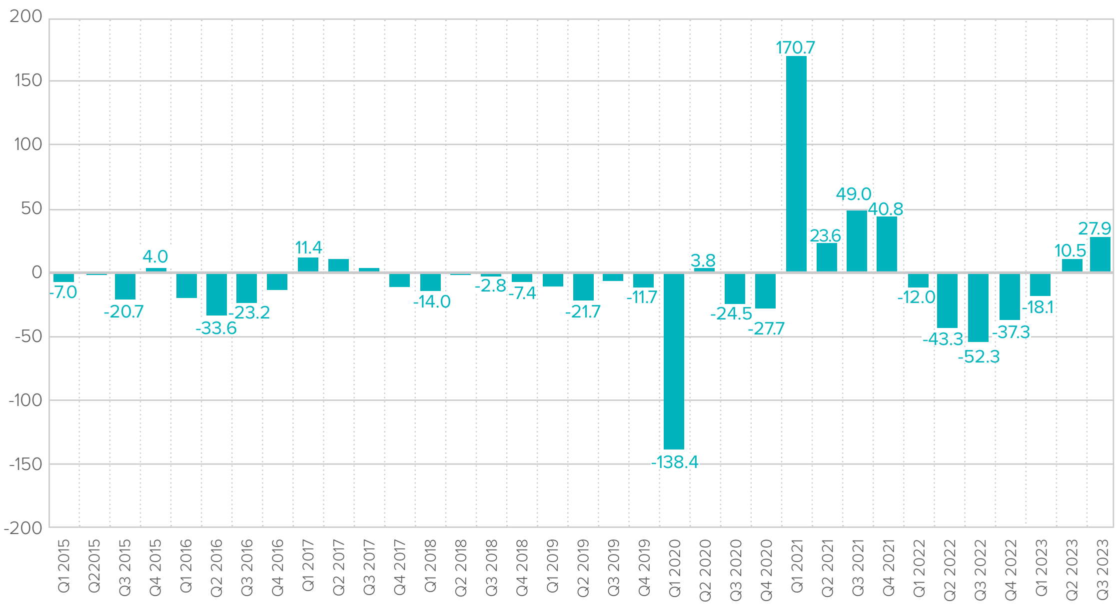
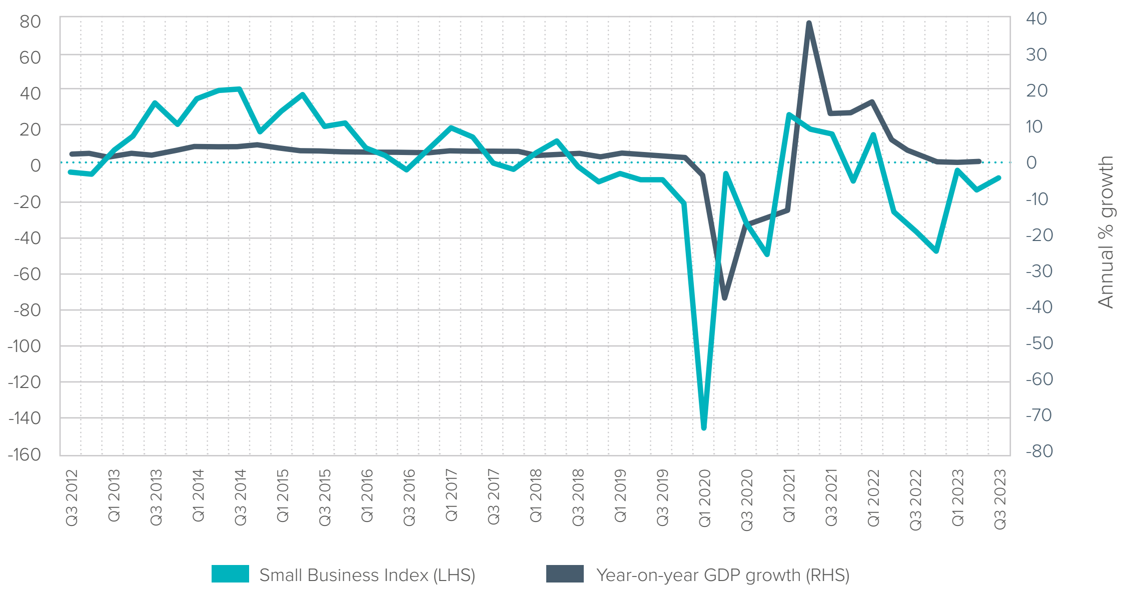


Figure four: UK SBI against year-on-year UK GDP growth
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey



REGION AND NATION SMALL BUSINESS INDICES

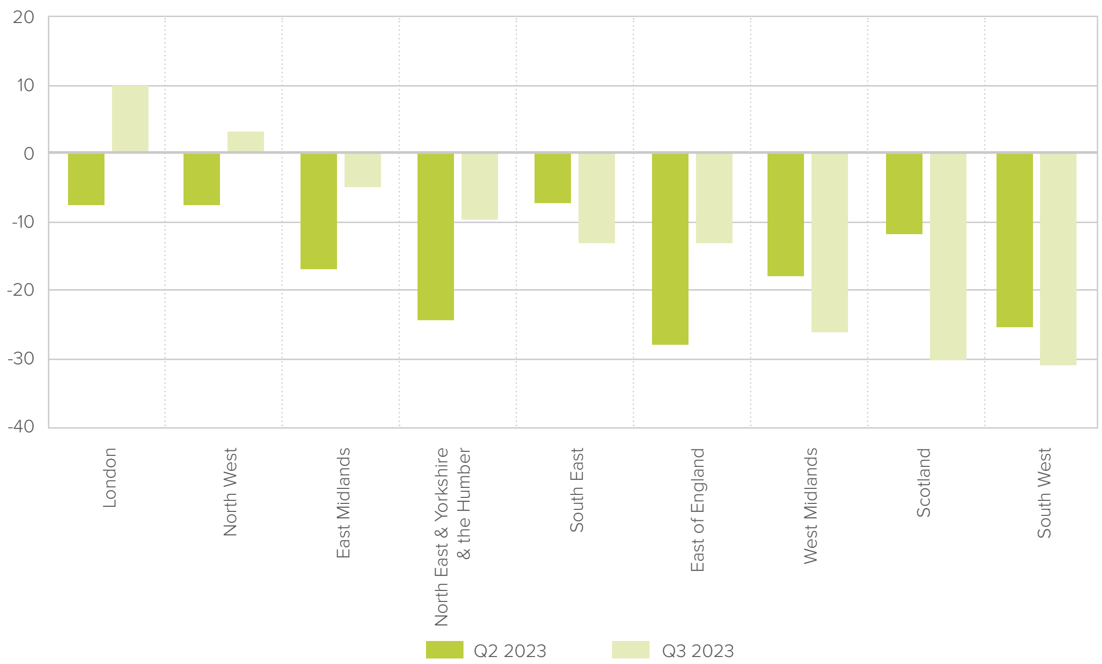
SMALL BUSINESS INDEX IMPROVES IN MOST REGIONS AND NATIONS, THOUGH SCORES REMAIN NEGATIVE FOR THE MAJORITY IN Q3

Two UK regions saw a positive reading on the regional SBI in Q3 2023, while the remainder remained in negative territory. Five regions saw an improvement on the measure in Q3 when compared to Q2 2023. For most regions the proportion of small businesses expecting a worsening in performance in the coming quarter still exceeds the proportion expecting an improvement, indicating that economic pessimism remains.

The most optimistic region in Q3 was London, with an SBI score of 10.0. London has a large cluster of businesses in professional, scientific and technical services, which was the only major sector to produce a positive SBI score in Q3. The North West was the only other region to record a positive SBI reading, at 3.0. Both of the positive scoring regions saw above average shares of businesses expecting performance to improve looking ahead to Q4, at 40.0% and 44.8%, respectively.

The most pessimistic region in Q3 was the South West, with an SBI reading of -30.5. A majority, 51.2%, of businesses in the South West expect their performance to worsen in Q4 relative to Q3. Scotland saw a similarly weak SBI score in Q3, at -30.2. This was driven by 50.0% of businesses expecting performance to worsen, as well as a below average share of businesses expecting performance to pick up, at 19.8%. This was the lowest share amongst all regions of the UK.

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

CONTINUED NEGATIVITY WITNESSED ACROSS MAJORITY OF MAJOR SECTORS

In line with the headline SBI, many sectoral readings saw continually negative readings in Q3, despite quarterly improvements. This highlights the continuing negative sentiment amongst small businesses across vast swathes of the economy.

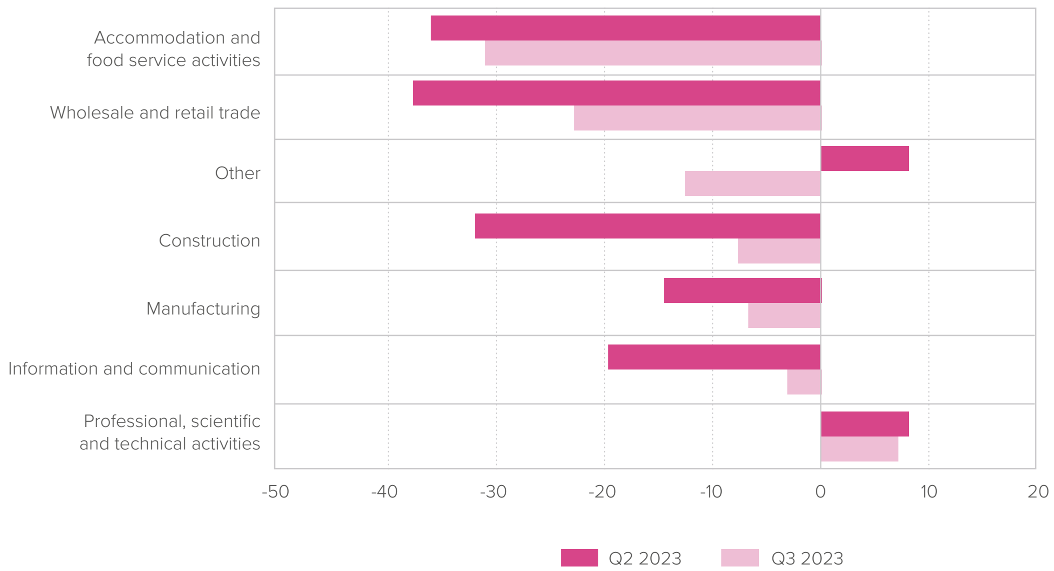
The weakest sentiment in Q3 was observed amongst businesses in accommodation and food services, with an SBI reading of -31.1. Though this represented a mild improvement of 4.7 points on Q2, this marked a further quarter in which this sector has recorded net negative sentiment. Such continued negativity largely reflects demand-side headwinds. Businesses in this industry are suffering from weak consumer demand, reflecting the adverse impact of elevated inflation on spending power. Indeed, Cebr forecasts output in this sector to contract in Q4, mirroring the projected decline across the wider economy.

Wholesale and retail recorded the second-weakest sentiment amongst major sectors in Q3, with an SBI reading of -22.8. This sector is also experiencing the demand-side headwinds affecting accommodation and food services businesses and is similarly expected to see contracting output in Q4.

Manufacturing and construction both recorded negative SBI readings in Q3, at -6.7 and -7.7, respectively. These sectors are particularly exposed to supply-side constraints at present, including elevated input prices and higher borrowing costs.

Professional, scientific and technical activities was the only major sector to record a positive SBI score in Q3, at 6.9. The nature of operations is helping professional services to weather the storm of weaker macroeconomic conditions, it is one of the few sectors expected to continue growing this winter. This sector is not as exposed to demand-side headwinds, given that businesses are less consumer-facing. Meanwhile, supply-side constraints are also less of a factor, reflecting the fact that such businesses are less input intensive.

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

SMALL BUSINESSES REPORT FALLING REVENUES FOR SIXTH CONSECUTIVE QUARTER

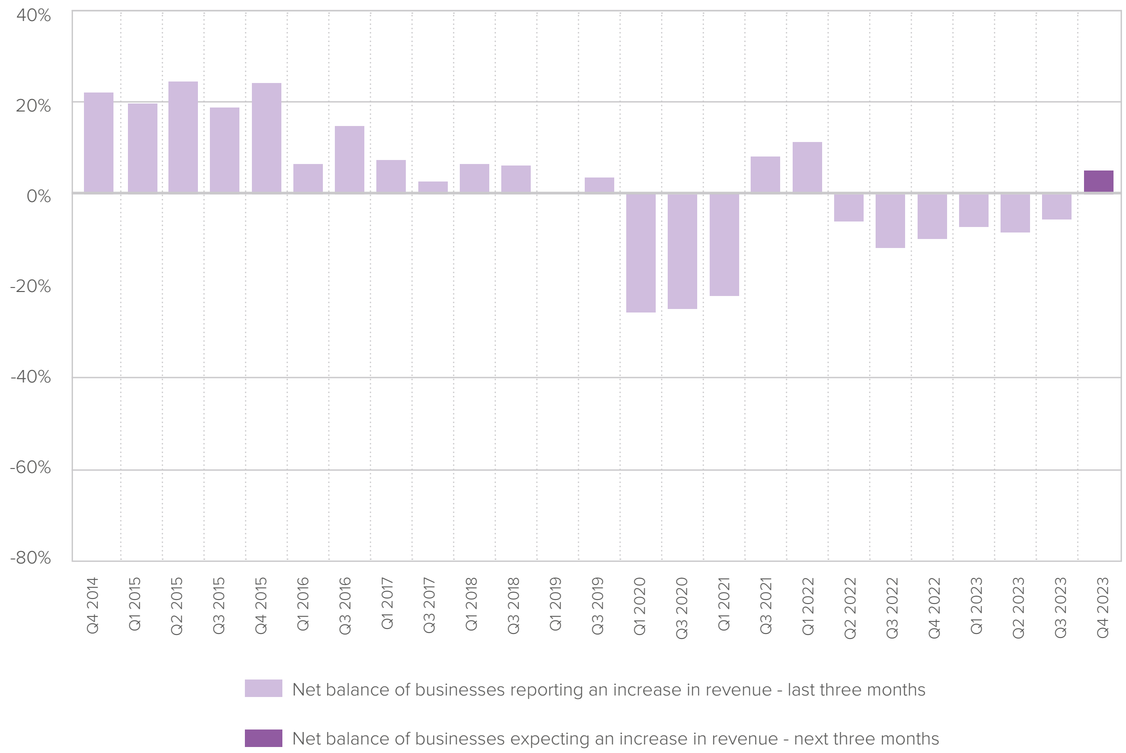
The net balance of small businesses reporting revenue growth over the previous three months stood at -5.9% in Q3 2023. The negative figure means that the number of small businesses reporting a decrease in revenue levels over the last three months outweighed the number reporting an increase.

This marked the sixth consecutive negative reading for the revenue net balance figure. The headline SBI has also recorded negative readings in each of these periods, highlighting the link between near-term revenue performance and business sentiment.

Amongst major sectors, wholesale and retail recorded the weakest revenue net balance figure in Q3, at -19.1%. This likely reflects the demand-side pressures faced by these businesses, with reduced spending power impacting consumer activity. This finding is partially corroborated by official retail sales data, with sales volumes figures for the first two months of Q3 being down on the corresponding period of Q2.

In terms of regions, the weakest net balance was observed for the South West, and for the combined region of the North East & Yorkshire and the Humber, both at -17.4%.

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

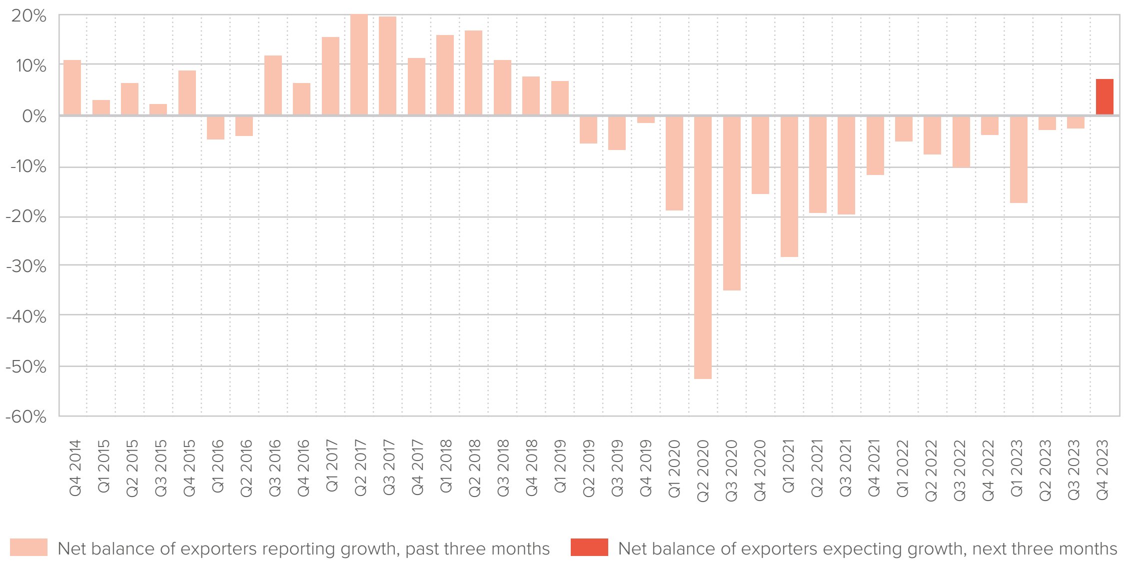
EXPECTATIONS FOR EXPORTS REMAIN NEGATIVE BUT VALUES EXPECTED TO INCREASE IN THE NEXT QUARTER

A net balance of -2.6% of exporting businesses said that the value of their exports increased in Q3 2023. Although this marked the eighteenth consecutive negative quarterly reading, the latest result was the highest since Q4 2019. Looking ahead, a net balance of 7.3% expect export value growth in Q4, the first positive reading on this metric in 2023 and an indication that small exporting businesses are optimistic of improvements over the coming quarter.

This export sentiment reading comes as the latest official data show that the value of UK exports among all businesses expanded by 0.2% across the three months to July 2023. This was driven by the increased exportation of goods and services to non-EU countries. Indeed, several key European markets, including the Eurozone's largest economy, Germany, have experienced weak growth, stifling demand for imports from the UK. Meanwhile, other key international markets, such as the US, have posted stronger than expected growth.

UK exporters have been further helped by the recent weakening of sterling. The pound suffered its worst performance for a year against the US dollar in September, while also losing value against other major currencies as markets reacted to the Bank of England's decision to pause its interest rate hikes. This movement will have increased the competitiveness of British exports, which may have provided some boost to demand among the exporters surveyed, in addition to creating a more positive outlook amongst exporters for the months to come.

Figure eight: Changes in value of exports over the previous three months and expectations for the 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

SHARE OF BUSINESSES FACING INCREASED COSTS RISES IN Q3, AMIDST VOLATILE FUEL PRICES

In Q3, the net balance of small businesses reporting an increase in their operating costs rose to 83.5%. This marked a return to a rising share of businesses reporting cost increases, following the first quarterly fall on this metric since Q3 2022 in the previous quarter. This emphasises the continued financial strain that small businesses are experiencing from broad-based cost pressures.

The rise in costs was partially driven by increased fuel prices, which picked up across the quarter following volatility in global commodity markets resulting from production cuts from key oil exporters. The number of small businesses selecting fuel as a main cause for changing business costs rose from 37.3% in Q2 to 40.4% in Q3 2023, representing the largest uptick across all categories. Rising fuel prices are problematic for small businesses as they increase cost pressures throughout the supply chain, resulting in higher costs more generally for businesses. This is highlighted by the continually high share of businesses reporting inputs as a source of rising costs, with this option being chosen by 43.1% of businesses in Q3.

Several other categories were selected as a source of rising costs at an even more frequent rate than fuel. Utilities continues to be the most commonly-cited source of changing business costs. The share of businesses selecting this fell slightly to 57.3% in Q3, down from 61.9% in Q2. Meanwhile, labour was selected by 42.8% of respondents. This is reflective of the currently tight UK labour market, in which workers have enjoyed historically elevated nominal pay growth. However, recent upticks in the unemployment rate provide early signals that the UK labour market may be starting to cool.

Financing remains a notable source of cost pressure: 19.8% of businesses selected this as a source of changing business costs in Q3. This is roughly in line with Q2's figure of 19.9% which represented the record high for this measure. Interest rates remain elevated which has impacted borrowing costs for businesses. Indeed, the Bank of England implemented a further 0.25 percentage point hike in the base rate in Q3, although it did pause its interest rate rises at its September meeting.

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

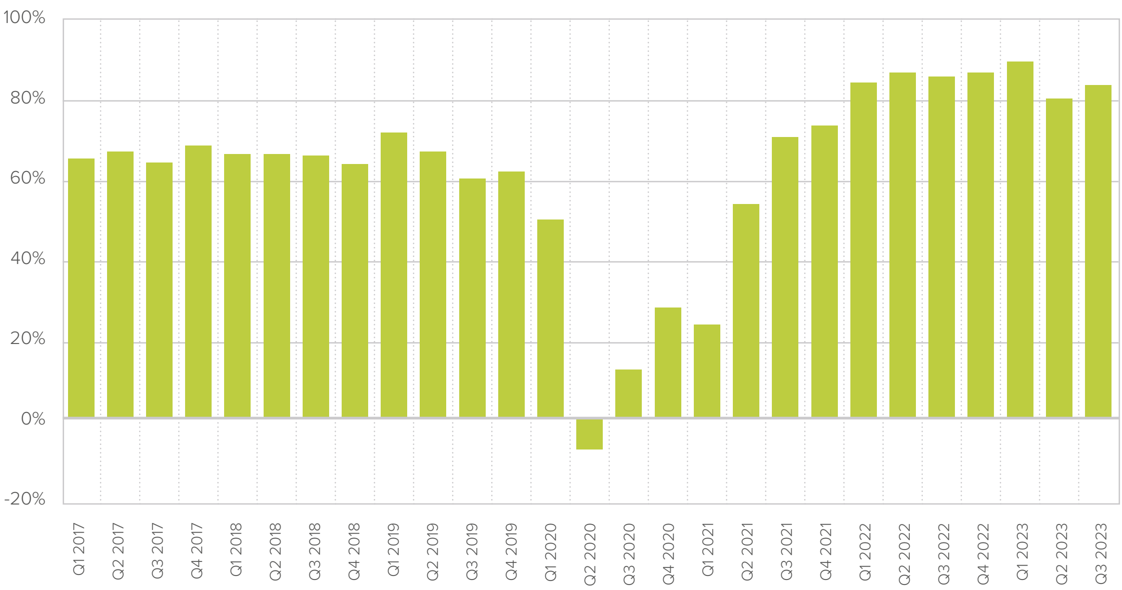
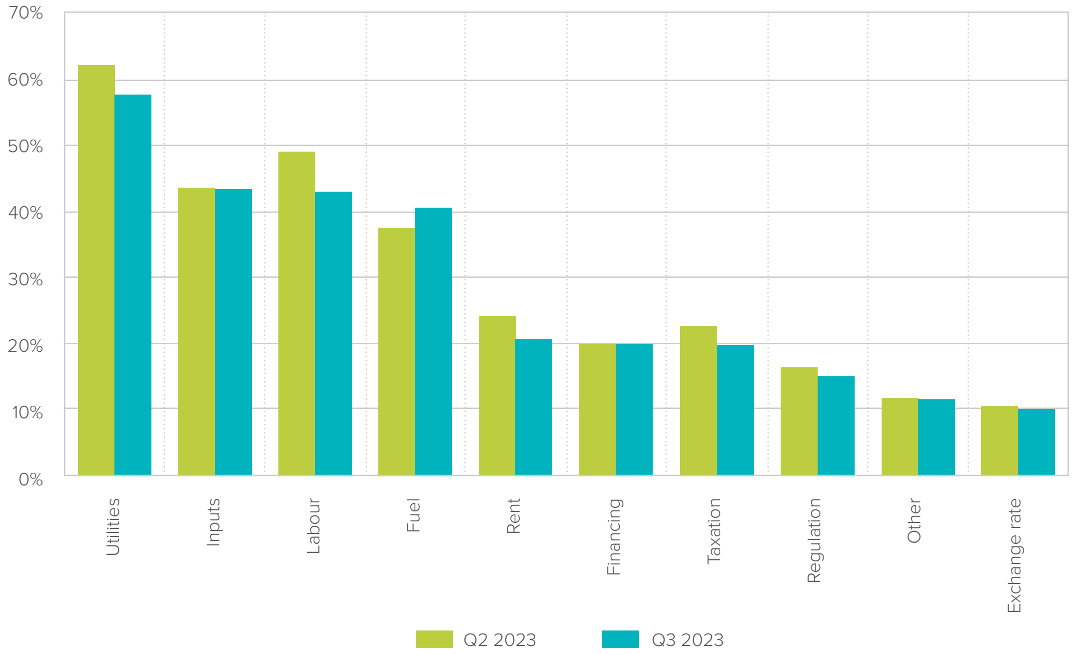


Figure 10: Main causes for changing business costs (Respondents could select multiple answers)
Source: FSB - Verve 'Voice of Small Business' Panel Survey



EMPLOYMENT

SMALL BUSINESS EMPLOYEE NUMBERS CONTRACT FOR SIXTH CONSECUTIVE QUARTER

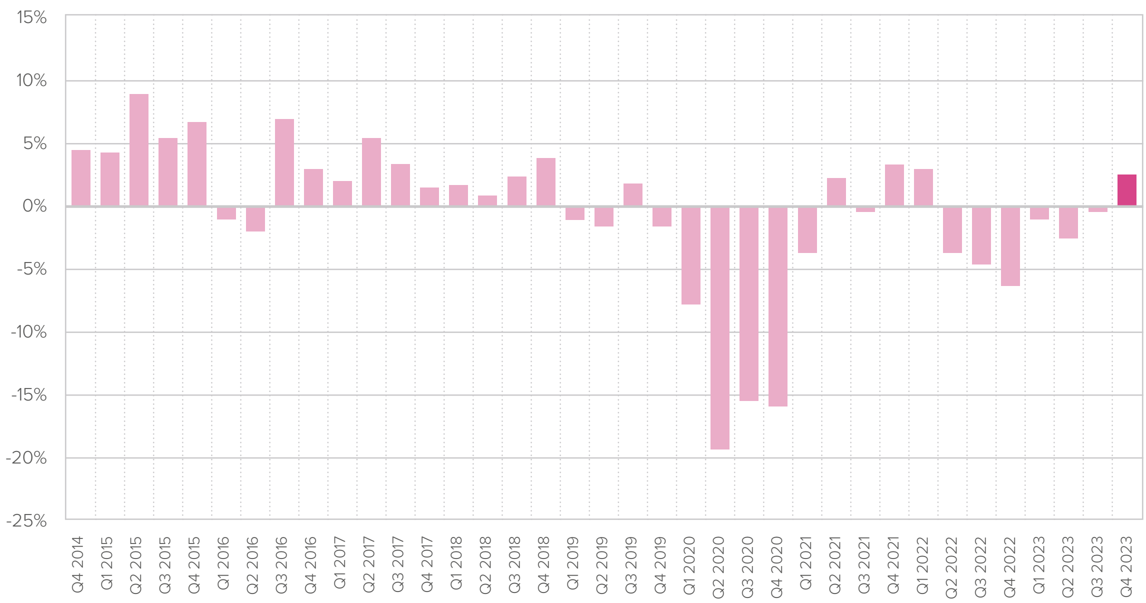
A net balance of -0.2% of small businesses reported growth in employee numbers in Q3. The negative reading means that the number of businesses expanding their workforce was outweighed by the number of businesses reporting a contraction in headcount. This marks a sixth consecutive negative reading on this metric, though it was less negative than the preceding five quarters.

This finding is in line with the latest data from the ONS which indicates further upticks in the unemployment rate. The metric increased to 4.3% in the three months to July, which marked the highest unemployment rate since the three months to September 2021. Meanwhile, the estimated number of vacancies fell further in the three months to August, which is consistent with a continued weakening of labour demand.

On a sectoral basis, the worst net balance score was seen in manufacturing, at -7.3%. Accommodation and food services recorded the next lowest net balance, at -6.3%. This sector continues to face the impacts of weaker consumer activity amidst a weak economic growth environment, which has reduced the demand for labour within the sector. In contrast, the sectors with the strongest net balance scores are information and communication, and professional, scientific and technical activities, which recorded net balances of 7.7% and 7.6%, respectively.

Despite the negative net balance, small businesses expect employee numbers to grow over Q3 2023, with a net balance of 2.6% expecting their headcount to increase over the next three months. While this more optimistic outlook of employment growth is shared across most major sectors, this is not the case for accommodation and food services, where respondents expect a further decline in their employee numbers in Q4..

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

INFORMATION AND COMMUNICATION BUSINESSES MOST LIKELY TO ANTICIPATE GROWTH OVER THE COMING YEAR

The share of small businesses expecting to grow over the coming year decreased slightly to 49.6% in Q3, following a 51.3% majority anticipating growth in Q2. This marked a return to a situation in which only a minority of small businesses expect to grow over the next twelve months.

Looking at businesses by sector, those in information and communication were the most upbeat, with 66.2% of respondents in this category expecting to grow over the next 12 months. These businesses are less exposed to the headwinds facing the economy at present, being less directly reliant on consumer activity and also less input-intensive.

At the other end of the scale, businesses in accommodation and food service activities were the least likely to expect growth over the coming year, being the case for 39.4% of respondents. Within the sector, the net balance was just 25.1%. Meanwhile for the wholesale and retail sector, the net balance stood at 29.2%. Both of these sectors continue to face pressure from weaker consumer activity amidst a weak economic growth environment. Nevertheless, it is worth noting that the shares of businesses expecting growth over the coming twelve months in both these sectors are higher than was the case in Q3 2022, indicating improved outlooks regarding growth when compared to a year prior.

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

DOMESTIC ECONOMY AND CONSUMER DEMAND REMAIN THE MOST COMMONLY CITED BARRIERS TO GROWTH AMIDST A RISING RISK OF RECESSION

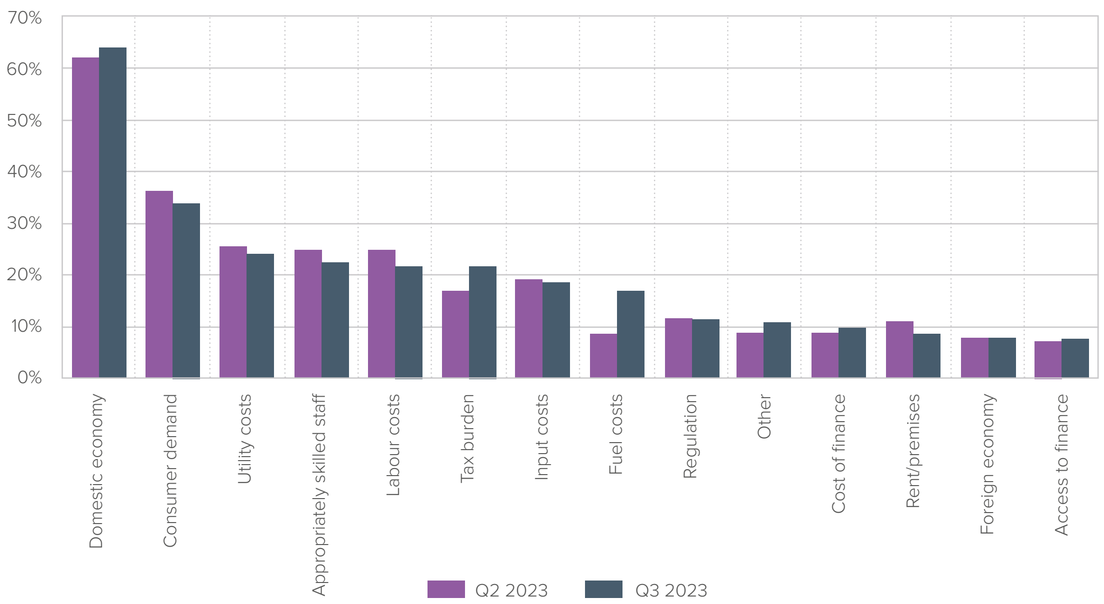
Among businesses expecting to grow over the next 12 months, the domestic economy was the most frequently cited potential barrier to such growth, being the case for 63.5% of respondents. This aligns well with our macroeconomic view for the next twelve months. Cebr is forecasting two consecutive quarters of GDP quarterly contraction in Q4 2023 and Q1 2024 (of 0.4% and 0.3% respectively), which would amount to a technical recession.

For the second consecutive quarter, consumer demand ranked as the next most commonly selected barrier to growth over the coming year, being selected by 33.3% of small businesses. Consumer demand has been hit particularly hard by reductions in real incomes, which is partially a result of historically elevated inflation. Indeed, economic activity is expected to remain downbeat for the coming quarters, suggesting concerns for consumer demand will persist. This is a particularly notable concern for small businesses as it will significantly impact decisions over key variables such as hiring and investment.

Access to appropriately skilled staff was selected by 22.0% of small businesses as a potential barrier to growth over the coming year. This is down 2.3 percentage points from Q2's reading of 24.3%, as the labour market shows signs that it has started to loosen. However, notably, 38.3% of small businesses in the information and communication sector report a lack of appropriately skilled staff as a barrier. This sector requires consistent upskilling, and amongst a digital skills shortage and facing competition from large businesses, small firms have struggled to fulfil their labour demand.

There was a particularly large rise in the share of respondents selecting fuel costs as a potential barrier to growth over the coming year. This was selected by 16.2% of respondents, over double the amount recorded in the previous quarter. Fuel prices rose notably in Q3 following volatility in global commodity markets. This was a result of production cuts from key oil exporters.

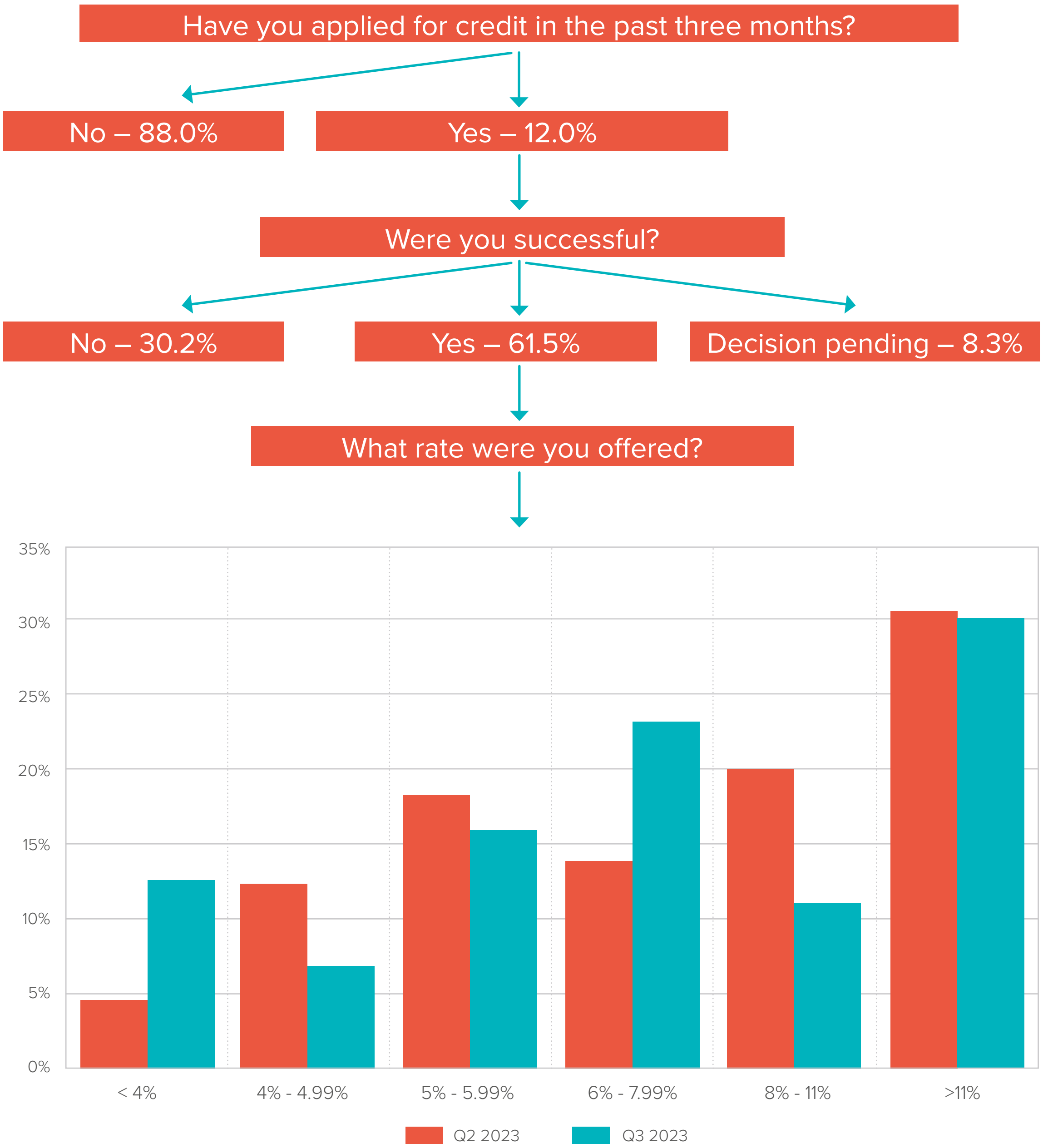
Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey



CREDIT

SHARE OF CREDIT APPLICANTS BEING QUOTED THE HIGHEST RATES INCREASED FURTHER IN Q3

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.



12.0% of small businesses reported that they applied for credit in Q3 2023. This was down on the 12.7% recorded in Q2 2023. The share has now declined for three consecutive quarters. The decline in the share of businesses reporting credit applications likely reflects recent increases in the cost of borrowing, with interest rates having risen as a result of the Bank of England's monetary tightening campaign.

The share of credit applicants reporting that they were successful in their application increased on the quarter, reaching 61.5%, up from 60.9% in Q2. This followed a sharp jump in the share of applicants being successful between Q1 and Q2.

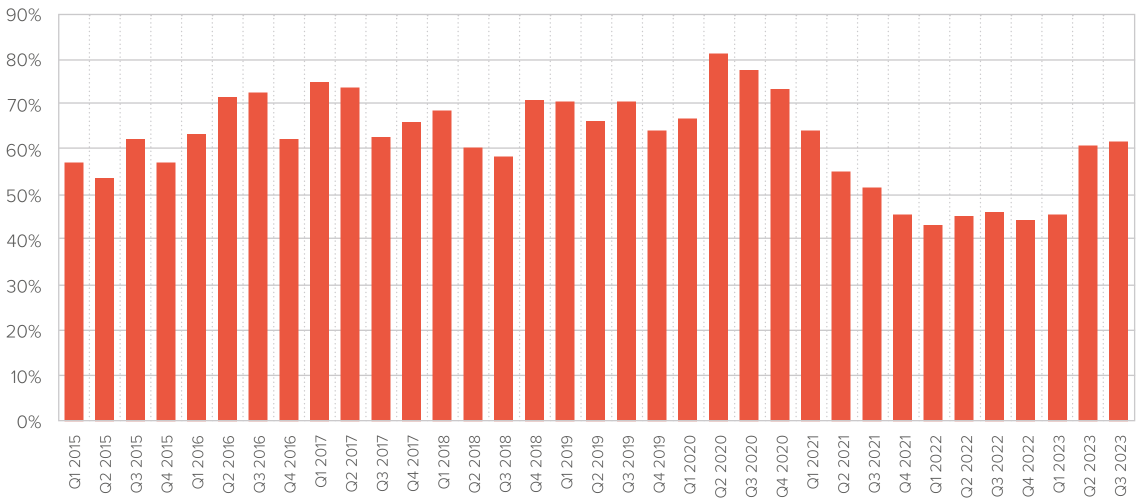
Amongst sectors, businesses in accommodation and food services were the most likely to report making a credit application in Q3, being the case for 23.6% of respondents. As outlined in Section VII, businesses in accommodation and food services showed the weakest sentiment of any sector in Q3, contending with significant demand-side headwinds. These businesses are likely turning to borrowing to support their liquidity amidst subdued demand.

Construction businesses were also amongst the most likely to report a credit application in Q3, at a rate of 16.0%. The large-scale nature of many construction projects means that such businesses tend to seek financing more frequently.

At the other end of the scale, businesses in information and communication were the least likely to report making a credit application in Q3. This was the case for just 1.6% of respondents in this sector.

The share of successful credit applicants being offered a rate greater than 11% remained elevated in Q3, at 30.1%. This marked a second consecutive quarter in which the share has exceeded 30.0%, representing the two highest values on record.

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

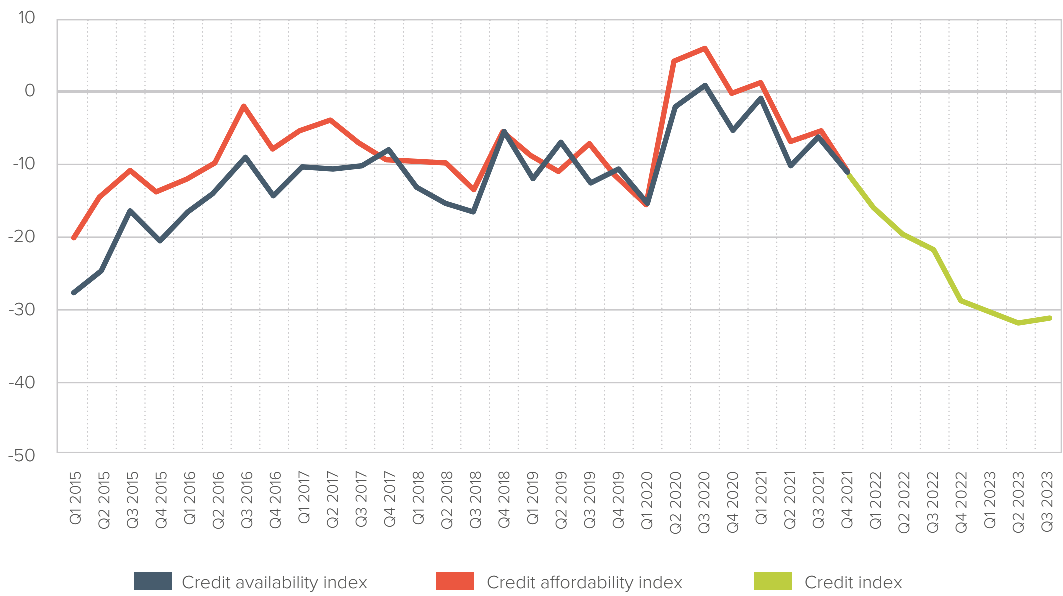


BUSINESSES' PERCEPTIONS OF CREDIT AVAILABILITY AND AFFORDABILITY IMPROVE SLIGHTLY BUT REMAIN DEEPLY NEGATIVE

Perceptions of credit affordability and availability improved marginally in Q3. The credit index increased by 0.7 points on the quarter. Despite this improvement, the index remains deeply in negative territory at -31.3, the second-weakest value on record. Such negative sentiment towards credit likely reflects the Bank of England's recent monetary tightening campaign, which has put upward pressure on borrowing costs.

The marginal improvement in Q3 was driven by an increasing share of small businesses reporting positive attitudes towards credit availability and affordability. This share picked up to 14.4%, from 11.8% in Q2. There was a simultaneous uptick in the share of businesses reporting negative attitudes towards credit availability and affordability, with 53.0% of small businesses rating the availability and affordability of credit as poor. However, this increase was smaller in magnitude, with the share picking up by 1.0 percentage point on the quarter, meaning the overall index rose.

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[5]



5 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

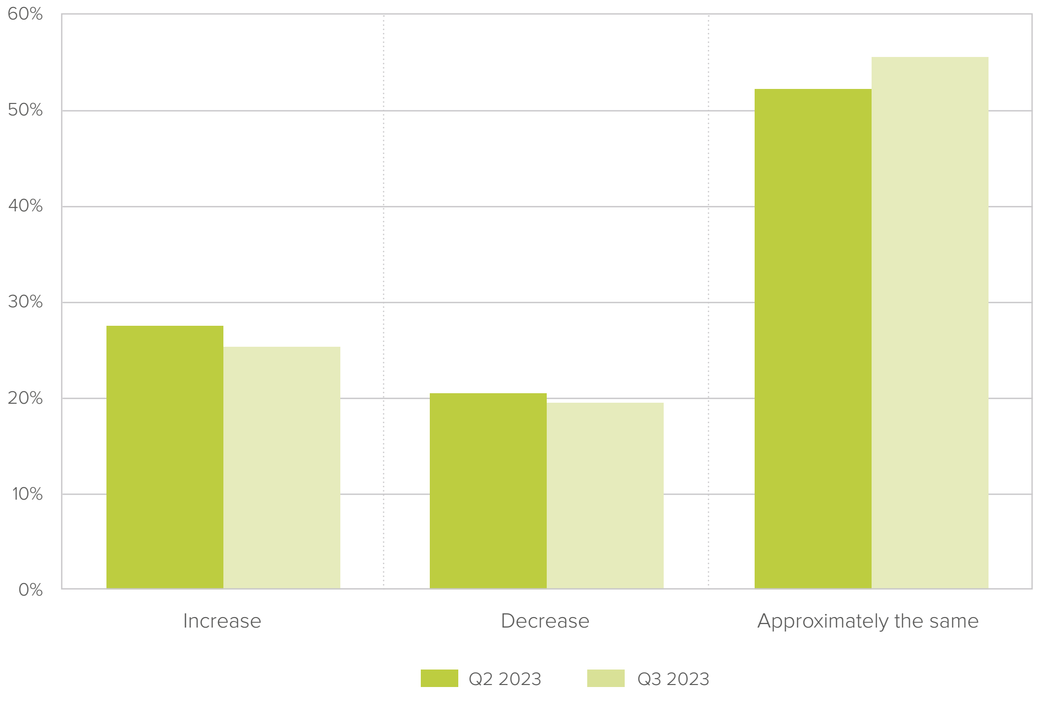
INVESTMENT AMBITIONS WEAKEN SLIGHTLY AMIDST HIGHER BORROWING COSTS

The share of small businesses expecting to increase their capital investment over the coming quarter declined in Q3, reaching 25.1%, having stood at 27.3% in Q2. There was also a fall in the share of businesses expecting to cut back on their investment, which fell to 19.4% in Q3 from 20.3% in Q2. Since the fall on the former metric was larger than the latter, the net balance of small businesses expecting to increase their investment declined to 5.7% in Q3, down from 7.0% in Q2.

These changes came amidst the Bank of England deciding to implement a further 0.25 percentage point hike in the base rate in Q3. Rising interest rates discourage investment by small businesses by increasing borrowing costs. However, it is worth noting the central bank did pause its interest rate rises at its September meeting, indicating we may have reached, or at least be nearing, the peak of its monetary tightening campaign. Hence, small businesses are likely delaying investments in anticipation of better borrowing rates further into the future.

On a sectoral basis, businesses in accommodation and food services were the worst performers on this metric, with a net balance of -7.5% expecting to increase their investment over the coming quarter. This was down from the 8.3% net balance recorded in Q2. Meanwhile, businesses in construction were the most upbeat regarding their investment over the next quarter, with a net balance of 29.8% expecting to increase their capital investment compared to the previous quarter. Reflecting their overall positivity on the SBI measure, businesses in information and communication scored the second highest net balance when looking at investment intentions, at 12.5%. Businesses in professional, scientific and technical activities, which face a similar trading environment to those in information and communication, scored next highest, at 8.5%.

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



METHODOLOGY

This report is based on the September 2023 research survey of FSB members carried out by Verve. 5,409 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. 816 responses were received, a response rate of 7% for the panel. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 14-28 September 2023.

SUMMARY DATA TABLE

	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023
Small Business Index	-8.5	15.3	-24.7	-35.9	-45.8	-2.8	-14.2	-8.0
Employment - previous three months	3.3%	2.9%	-3.6%	-4.4%	-6.1%	-0.8%	-2.4%	-0.2%
Employment - coming three months	9.8%	14.5%	7.2%	2.7%	3.2%	8.3%	6.1%	2.6%
Exports - previous three months	-12.3%	-5.3%	-7.7%	-10.8%	-3.3%	-17.7%	-2.9%	-2.6%
Exports - coming three months	-3.8%	10.4%	1.4%	-4.3%	7.9%	-6.4%	-0.6%	7.3%
Credit availability and affordability - rated good or very good	-	19.5%	17.6%	17.4%	14.7%	12.3%	11.8%	14.4%
Credit availability and affordability - rated poor or very poor	-	36.5%	42.3%	44.1%	50.5%	50.9%	52.0%	53.1%

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

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

Responses are also weighted according to regional gross value added.

Q3

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