Q3

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 3, 2021

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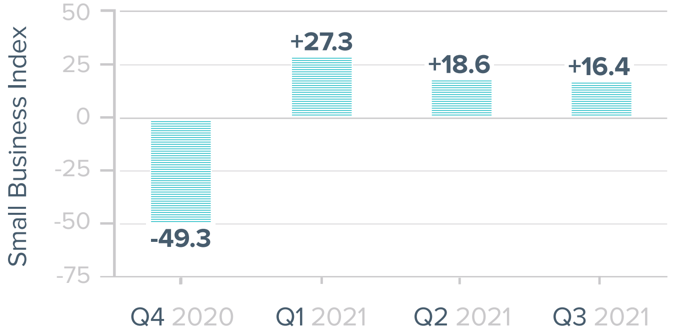
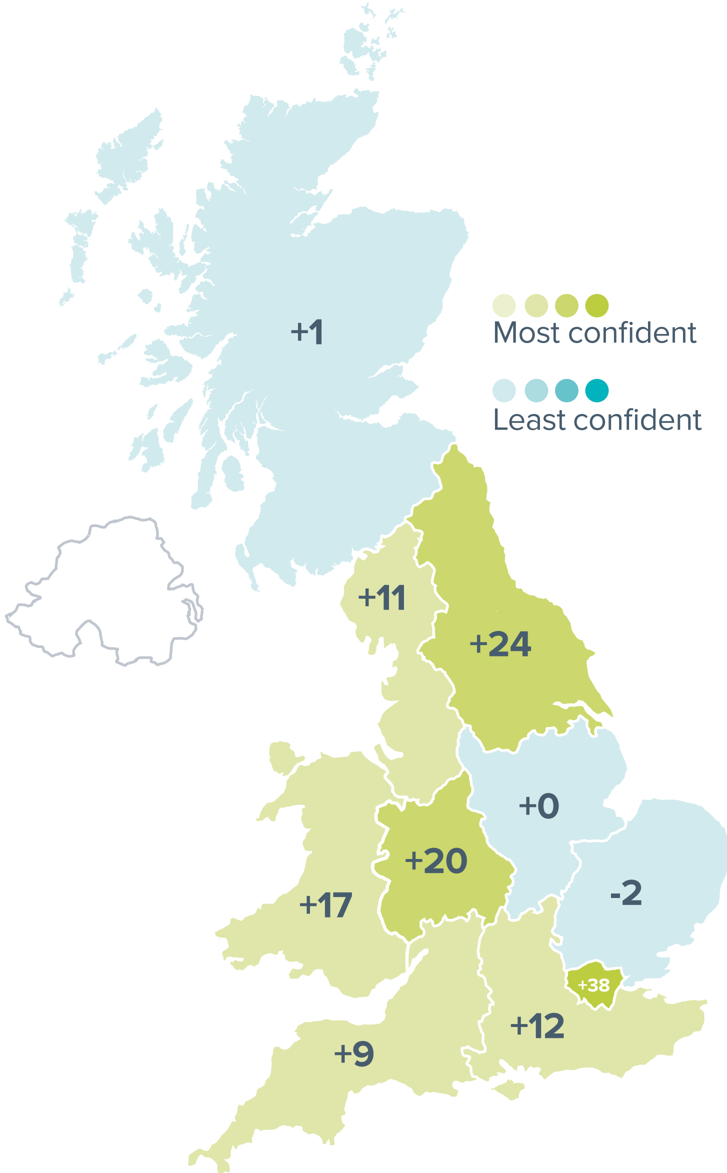
SBI Q3 2021

“Small business confidence rally loses steam amid spiraling costs”





Concern about tax burden hits two-year high

16%

see it as a top three **barrier to growth**

Costs reach highest point in five years

76%

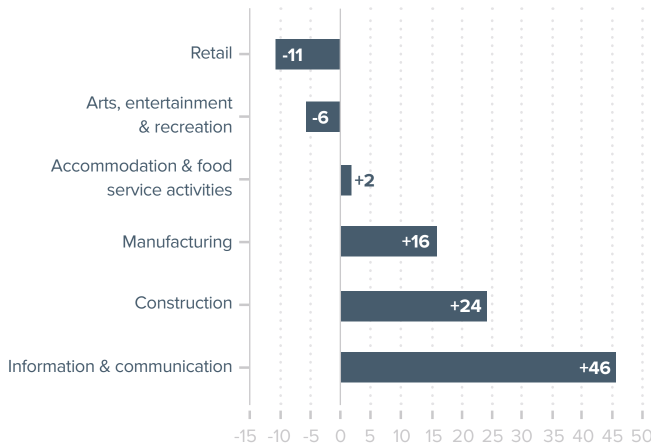
flag rising **operating expenditure**

Struggles recruiting hold back expansion

38%

say **lack of appropriately-skilled staff** is holding them back

Small business confidence remains positive but fails to hit Q1 high



CONTENTS

FSB FOREWORD

The past two years have thrown up all kinds of economic quirks and firsts, as markets shift in response to Covid-linked disruption and new ways of working. To the growing list of unexpected stats and forecasts, the Small Business Index can now make its own contribution: confidence among firms dropping for two straight quarters as trading restrictions lift.

Counterintuitively, the headline SBI confidence measure has fallen more than two points this quarter compared to last to stand at +16.4, and is now down more than ten points on Q1 of this year. A positive reading of any kind, after last year's rock-bottom index scores, is to be welcomed.

But that statement comes with significant caveats.

The SBI is a forward-looking confidence measure, with respondents setting out how they expect their business to perform over the coming three months compared to the previous three. At the time of writing, Q4 is set to be unique – the first round of largely unencumbered festive season spending for what will, for many, feel like a very long time indeed. As such, we should be seeing a small business community that's bullish, high-spirited and raring to make up for lost time after a prolonged period of on-again, off-again restrictions.

In reality, whilst a significant proportion are forecasting an improvement in performance, the majority are not, and close to one in three expect a deterioration.

The main clues as to what's driving this drop-off in optimism reside in responses to question nine of the SBI. This is where we ask respondents to list their three biggest perceived barriers to business growth over the coming year.

The proportions flagging the 'domestic economy' and 'consumer demand' fell dramatically this quarter, reflecting a measure of relief as restrictions ease. By contrast, the shares stating that the 'tax burden', 'fuel costs', 'labour costs', 'input costs', and access to 'appropriately skilled staff' are holding them back have all soared over the last twelve months, in many cases to levels not seen in years.

This was the quarter in which the Government declared that National Insurance contributions – an indiscriminate charge on all employers, employees and sole traders – will be hiked by 1.25 percentage points in the spring. Directors too, who were excluded from the Government's income support initiatives, will be hit by a dividend tax increase.

We estimate that the move will mean at least 50,000 more people becoming unemployed once it takes effect, and we also asked members how they would respond to the change as part of this SBI.

Among employers – when coupled with a 6.6 per cent increase in the National Living Wage – one in three say they would be forced to increase prices, further adding to existing inflationary pressure. One in four say they would absorb the additional cost personally, and the same proportion say they would recruit less and/ or reduce existing worker hours. So, in short, unless the Government does more to help small firms with the spiralling costs of utilities, employment and fuel, it's risking a real flashpoint in April.

And whilst we've conducted and published a thorough and transparent risk assessment of the NICs hike, policymakers are yet to. To enact such a significant change without analysis of likely outcomes is reckless at best.

It should also be mentioned that shipping costs too are going through the roof, adding to the myriad pressures faced by firms that trade globally.

This SBI finds that one in five exporters have either permanently or temporarily halted overseas sales. Fresh admin resulting from a new EU-UK trade agreement, supply chain disruption – delays in moving products, and even losing them in transit altogether, are now, sadly, par for the course – as well as the increase in the cash needed to ensure products reach clients have all taken their toll.

Fundamentally, the Government's optimistic talk of a "low-tax, high-productivity economy" is not currently matched by sentiment on the ground. There is still time to act to deliver this commendable vision, and act policymakers will need to if we're to avoid a third straight quarterly decline in small business confidence.

With all eyes on GDP figures as we seek to recover from one of the most severe economic shocks in modern history, this is a moment when we need optimism and confidence among the small businesses that can make all the difference to be the stuff of lived realities, not just speeches.

Mike Cherry,
National Chair

Martin McTague,
Vice Chair,
Policy & Advocacy

ECONOMIST'S VIEW

The Small Business Index saw another decline in Q3, falling by 2.2 points to reach 16.4. Though this suggests that the number of businesses expecting an improvement in performance outweighs the number of businesses expecting their performance to worsen, the prevalence of the positive sentiment is weakening. This narrative largely fits with a number of notable trends across the economy.

Many of the near-term gains associated with the easing of Covid-19 restrictions have been exhausted. This is clearly illustrated in the most recent GDP figures. Monthly growth rates of 2.8%, 0.6%, and 1.4% were seen in April, May and June, respectively, when the stages of the Government's roadmap allowed for certain sectors to return to operations after the winter lockdown, leading to a concentration of activity amongst consumers and businesses alike. Growth rates have since slowed notably, with output actually declining by 0.1% in July, followed by 0.4% growth in August.

In recent weeks, the economy has faced some even stronger headwinds. Disruption to global supply chains has brought a multitude of ripple effects, ultimately impacting businesses' ability to satisfy demand. Difficulties in obtaining input goods due to shortages have put pressure on producer prices, cutting margins and reducing capacity. This has been further exacerbated by soaring fuel and energy costs amidst price growth in commodity markets. It is clear that these factors are already impacting small businesses, as underlined by survey responses on cost pressures and potential barriers to growth.

Rising prices are of course not merely affecting businesses, but consumers too. This is particularly the case in terms of rising fuel and utility costs, which are largely considered to be essential spending categories, and thus significantly impact households' bottom lines. If such price rises adversely impact living standards and trigger some general cautiousness amongst consumers, then this will dampen their willingness to spend and thereby pose a risk for business revenues.

The labour market presents a further hurdle for small businesses to navigate at present. Businesses have faced considerable difficulties in hiring staff, with this being driven by a number of factors, including skills shortages and a generally lower level of labour supply. Such shortages have been particularly clear in industries such as road haulage, hospitality and social care. Nevertheless, they are being witnessed on a near economy-wide basis, as shown by record vacancy figures. The results of the latest Small Business Index survey highlight how pertinent the labour supply issue is for businesses. 23.1% of businesses state that it is difficult to find individuals with the right skills in their area, while 38% of small businesses aspiring to grow consider finding appropriately skilled staff as a potential barrier to that growth over the coming year.

Ultimately, Cebr expects the combination of these factors to result in a further growth slowdown. Our latest forecasts for the UK economy show quarterly GDP growth falling to 1.1% in Q4, with even slower rates across much of 2022. Despite this somewhat negative narrative, it should be noted that this would represent a normalisation of the growth rate, as the economy converges to a growth path similar to that seen prior to the pandemic.

Nina Skero,
Chief Executive,
Cebr

FSB EXECUTIVE SUMMARY

Key findings this quarter:

The Small Business Index (SBI) slipped by 2.2 points between Q2 2021 and Q3 2021, reaching 16.4. This marks the second consecutive quarterly fall in the Index, following the near-term high of 27.3 in Q1.

- **The Small Business Index witnessed a decline in nearly all regions.** Only London and the combined region of the North East and Yorkshire and the Humber saw their SBI readings increase compared to Q2. Nevertheless, all regions but the East of England and the East Midlands exhibited positive readings in Q3, suggesting that sentiment of improved performance is well-spread geographically.
- **Most major sectors expect improved performance in the final quarter of the year.** Of the sectors with sufficiently large sample sizes, only wholesale and retail exhibited a negative SBI reading in Q3, standing at -10.5. This pessimism can be explained by the recent experience of countercyclical retail activity, as well as fears that supply shortages could disrupt trading in the busy festive period.
- **The net balance of small businesses reporting an increase in operating costs increased further in Q2, reaching a more than two-year high of 69.5%.** This reflects the near-global phenomenon of rising producer prices.
- **Inputs were the main driver of changing business costs in Q3.** This category was cited by 47.0% of small businesses when considering sources of cost pressure. Fuel and utilities represented the next most commonly cited categories, being selected by 37.3% and 36.5%, respectively, reflecting rising prices in oil and gas markets.
- **The net balance of small businesses expecting their employment levels to increase in Q4 stands at 11.5%, although employers report negative growth in employment in the last quarter – contrary to previous expectations.** There is considerable regional variation in employment expectations, with a net balance of 19.8% of businesses in London expecting employment growth in Q4, compared to just 2.8% in the East Midlands.
- **The share of businesses aspiring to grow over the next twelve months decreased slightly, reaching 53.1%.** Growth aspirations are most prevalent amongst businesses in the information and communication sector, with greater adoption of technology in the wake of the pandemic being one likely factor behind such positivity.
- **The domestic economy remains the most commonly cited potential barrier to growth, amongst those with aspirations to grow. T**hough this was the case for 54.6% of respondents, this was the fifth consecutive quarterly fall in the proportion of businesses citing this option.
- **The proportion of small businesses applying for credit reached its lowest level since data collection for the SBI began.** Just 10.4% of businesses applied for credit in Q3. This could reflect the fact that businesses' operations are beginning to normalise, thus reducing the need for short-term cash flow support, as well as some lingering uncertainty reducing the incentive to invest.

UK MACROECONOMIC OVERVIEW

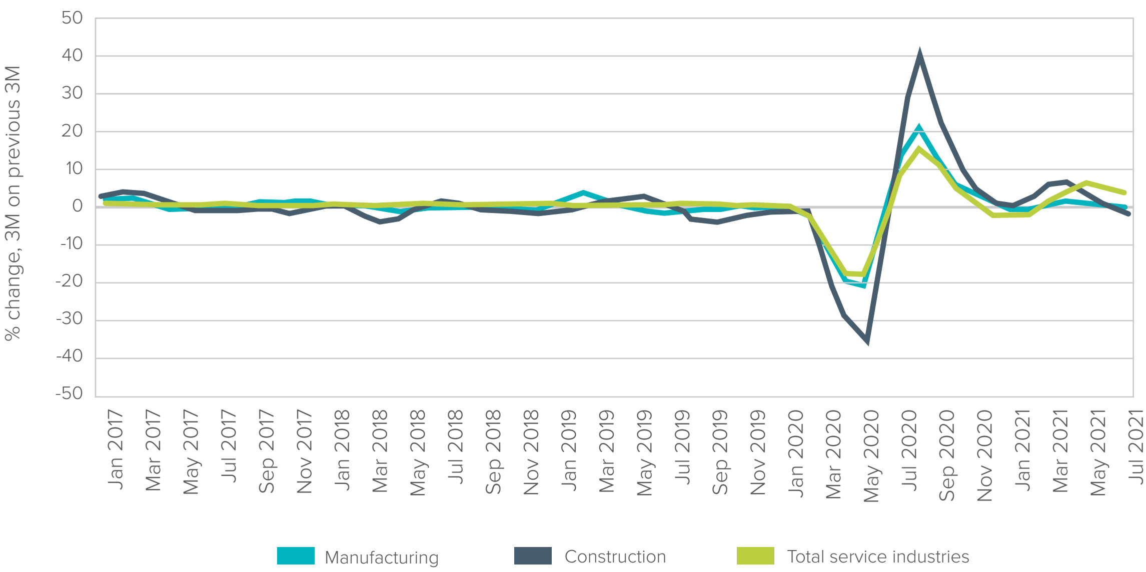
Economic activity slows in Q3 amidst supply chain pressures

The quarter began with certain restriction measures still in place, notably those mandating the closure of businesses such as nightclubs, while curtailing the capacity of others. Such measures were removed in England from July 19th, however, with legal requirements related to Covid-19 subsequently being limited to the test, trace and isolate system and international travel. Despite this final easing of restrictions, growth was initially considered to be muted in July, with a monthly increase in output of just 0.1%. A recent revision to this estimate now puts July's change in GDP in negative territory, amounting to a decline of 0.1%. As such, activity exhibited a cooling-off in the first month of the quarter, having witnessed a prior surge in line with the easing of restriction measures in previous months, particularly from the consumer side.

Though the economic recovery has since reverted to its course, with monthly GDP growth of 0.4% in August, there are fears that more recent developments will lead to a slowdown at the very least. Shortages have contributed to supply chain disruption, both domestically and globally. This has curtailed businesses' ability to meet demand levels in the latter stages of the quarter, while putting pressure on businesses from the perspective of costs, covering input goods, labour, and fuel. For instance, the Manufacturing PMI slipped to 57.1 in September, a seven-month low, reflecting a slowdown in output and new orders. The Construction PMI exhibited a similar trend, falling to 52.6 in September, and showing the slowest recovery rate since January. Though the services sector has experienced this disruption from the perspective of labour shortages, other issues have been less prevalent, meaning the sector's PMI increased slightly in September, reaching 55.4.

Looking ahead, the economic recovery is set to continue, albeit at a slower rate than that witnessed in recent quarters. This slowdown is set to be driven by the fact that many of the gains from easing restriction measures have been exhausted on the demand side, with activity levels being subject to a normalisation towards pre-pandemic trends. Meanwhile, the supply side is set to provide further headwinds, with logistics issues showing little sign of receding.

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 confidence dips slightly amidst slowing economic recovery

The Small Business Index slipped by 2.2 points between Q2 2021 and Q3 2021, reaching 16.4. This marks the second consecutive quarterly fall following the near-term high of 27.3 in Q1. Nevertheless, the Index remains firmly in positive territory, with the proportion of small businesses expecting an improvement in performance over the coming quarter exceeding the proportion of those expecting performance to worsen. Having experienced considerable volatility even prior to the pandemic, this is the first time that the Index has stood in positive territory for three consecutive quarters since Q3 2017.

There were two main narratives surrounding the economy in Q3. Initially, the quarter was marked by stark optimism, reflecting the final stages of the Government's roadmap and the accompanying easing of restrictions. Considering restriction measures in England, July 19th marked the final loosening of restriction measures, for example, allowing certain businesses, such as nightclubs, to return to operations for the first time since the pandemic began. Many other businesses also benefited, particularly those with consumer-facing elements, due to the removal of capacity constraints and burgeoning consumer confidence.

Since then, the narrative surrounding the economy has shifted completely, amidst volatility on the supply side. Disruptions to global supply chains have prompted input shortages, limiting businesses' production capacity and, ultimately, curtailing their ability to match demand. Such shortages have put upward pressure on input prices, which has further added to the near-term difficulties faced by businesses. For instance, the latest reading on the Producer Price Index (PPI) showed that annual growth in input prices stood at 11.0% in August, marking a near 10-year high. There are also market-specific issues to consider, notably heightened prices of wholesale gas and other fuels, reflecting rising global demand and wider geopolitical factors, in addition to dwindling supply.

Firms are also facing a difficult labour market at present. There is currently considerable demand for new workers, reflecting businesses' attempts to increase their output. This is illustrated by data on vacancy levels, which showed a record high of 1.1 million job openings in Q3. Supply of labour is not matching up to demand, however, further adding to the shortages faced by enterprises. This has been particularly pertinent in such industries as road haulage and hospitality, which saw particularly high concentrations of EU nationals in the workforce prior to the pandemic and the UK's departure. The combination of these factors seems to be exacerbating shortages in these industries.

Ultimately, the economy remains in a state of recovery. Overall economic output has not yet returned to pre-pandemic levels, meaning that there are further gains to be exhausted. In light of this, businesses still expect their performance to improve over the final quarter of 2021. It is notable, however, that the rate of this expected improvement is diminishing, reflecting the impact of the many supply constraints facing the UK's small businesses. These issues are themselves showing little sign of subsiding. As such, business output may be similarly constrained for the foreseeable future, prompting further falls in the SBI.

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

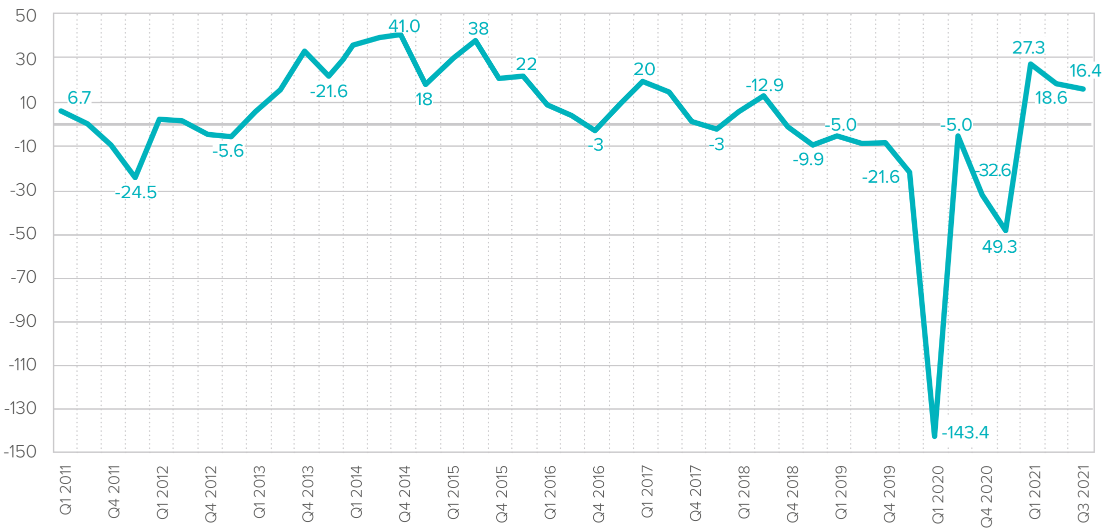
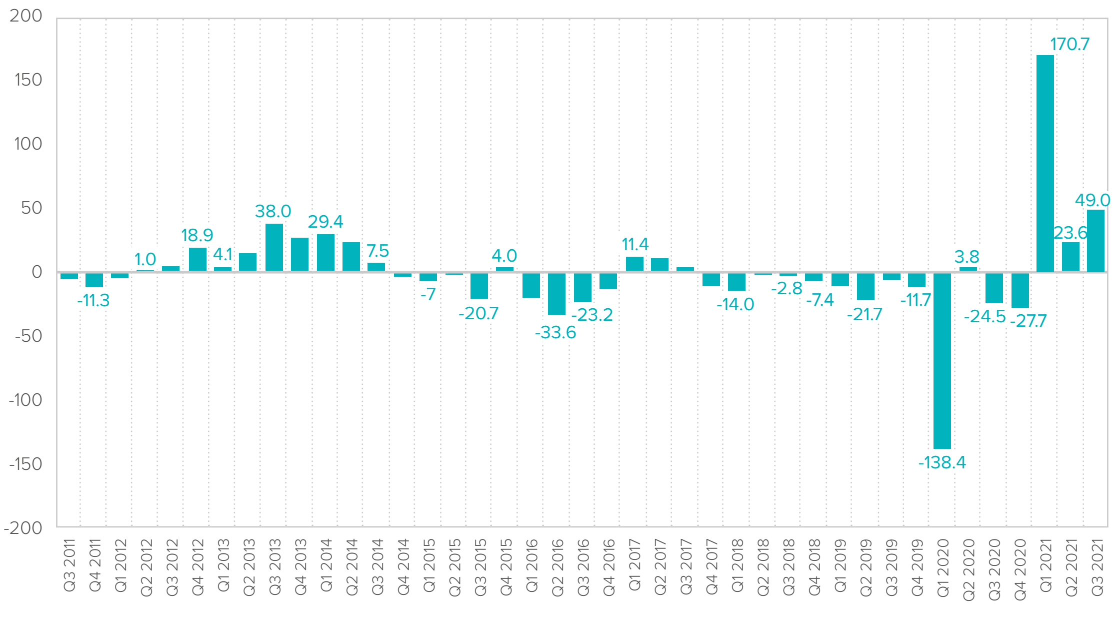
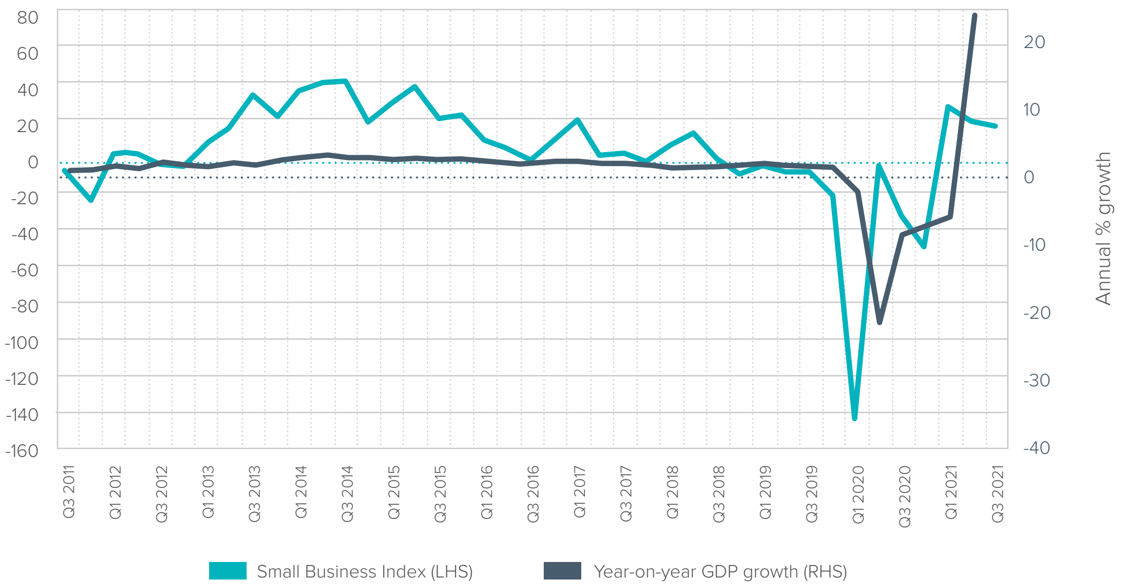


Figure three: Year-on-year change in the FSB Small Business Index
Source: FSB- Verve 'Voice of Small Business' Panel Survey



1 The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' The share of firms reporting 'much improved' are given the following weightings: 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 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

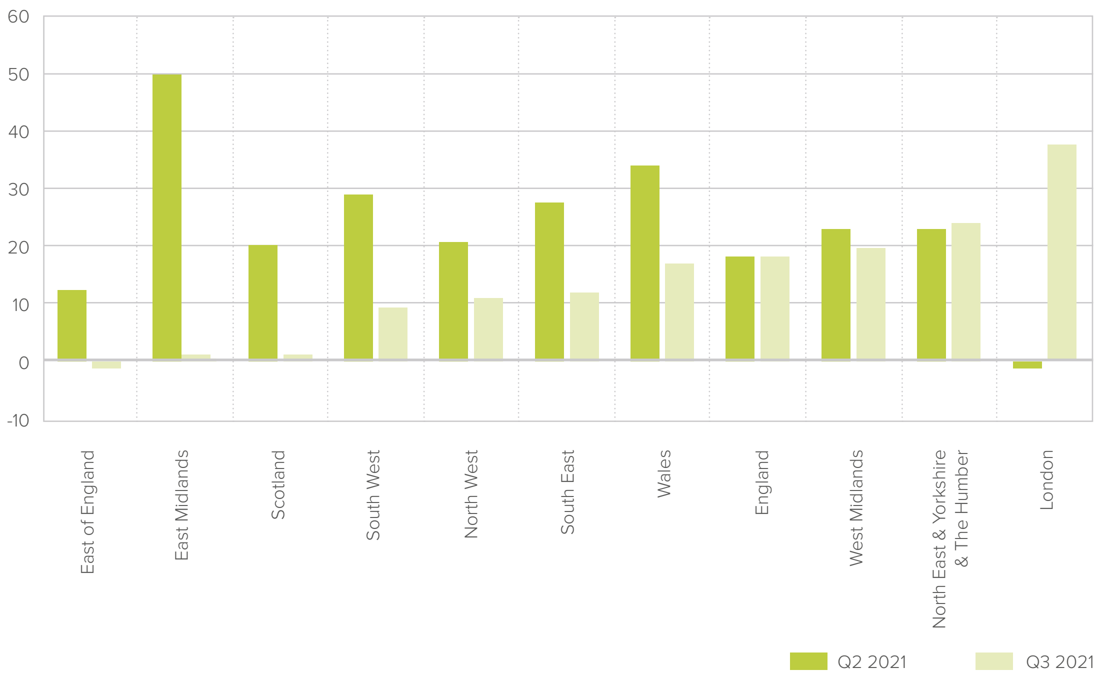
DECLINE IN SMALL BUSINESS INDEX SEEN ACROSS NEARLY ALL REGIONS

Positive SBI readings were nearly unanimous when analysing trends on a regional basis. Only the East of England exhibited a negative score in Q3, at -1.4, while the East Midlands' score was neutral, at exactly 0.0. All other regions saw a positive score, meaning that the proportion of small businesses expecting improvement in the coming quarter exceeded the proportion expecting a worsening performance. The highest reading was witnessed in London, at 37.7.

While positive scores were witnessed almost across the board, it should also be noted that many regions saw a decline in their SBI reading compared to Q2. Indeed, only London and the combined region of the North East & Yorkshire and the Humber saw a quarterly uptick, amounting to increases of 38.6 and 0.5 points, respectively. All other regions saw declines, with this being most stark in the East Midlands, for which a 50.0-point quarterly fall was recorded. As such, the regional picture largely conformed with the headline figure, suggesting that businesses expect a slowdown in the rate of improvement looking ahead to the final quarter of 2021.

London's position as the highest scorer in Q3 likely reflects the fact that the capital was the lowest scorer in Q2. Businesses in London were the least optimistic when looking ahead to Q3, being the only region to exhibit a negative score. If businesses' presuppositions in other regions did indeed come to fruition, it follows that they have already exhausted a lot of the demand-side gains from easing restriction measures over the summer months. On the other hand, if performance in the capital did lag, as per businesses' previous expectations, then there is greater scope for improvement in the final quarter. Away from the statistical drivers of this change, the structure of London's economy likely also contributes to its greater optimism looking ahead to Q4. London's sizeable cluster of entertainment and hospitality businesses will likely benefit from the first full quarter without restriction measures since the beginning of the pandemic, if indeed further measures to combat the pandemic are avoided over the winter months.

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

RETAIL SECTOR EXHIBITS CONSIDERABLE PESSIMISM AHEAD OF Q4

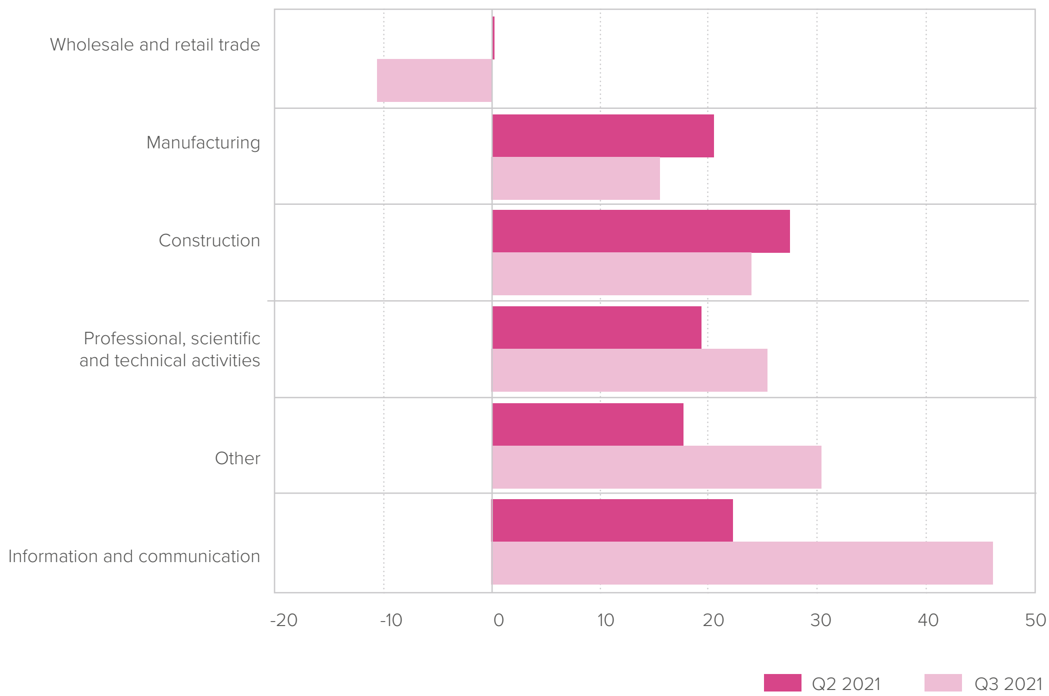
Most major industries are in a net positive position looking ahead to Q4. The wholesale and retail sector provides a notable exception to this, however, exhibiting a score of -10.5.

The negative reading on the SBI for wholesale and retail provides further supporting evidence of countercyclical activity in the sector. Though the lifting of Covid-related restriction measures via the Government's roadmap has brought a considerable uptick in activity across the economy, such activity has been concentrated in other areas in recent months, at the expense of the retail sector. In terms of consumer expenditure, this can largely be described in terms of displacement, whereby greater levels of social expenditure have been preferred to retail spending. Consumers' substitution of spending away from retail can be explained by the fact retailers have been able to serve consumers in some capacity for the entirety of the pandemic, while non-essential retailers were able to open without restrictions at an earlier date than businesses in hospitality or entertainment, for instance. As such, there is less of a novelty and sense of making up for lost time when it comes to retail spending. A further factor behind retailers' pessimism ahead of Q4 stems from potential supply shortages, which may curtail their ability to meet heightened demand levels in the pre-festive period.

Nonetheless, strong positive scores were witnessed at the other end of the scale. This was particularly the case amongst non-consumer-facing service sectors, with information and communication witnessing the highest score, at 46.5. This sector has benefited from the resurgence in the business-to-business space in recent months, a trend that businesses expect to continue in line with the wider economic recovery.

Along with the retail sector, the manufacturing and construction sectors saw quarterly declines in their SBI readings. These falls amounted to 3.4 points for construction and 4.7 points for manufacturing. The readings remain firmly in positive territory in both cases, however, at 23.9 and 15.5, respectively. This suggests that these sectors are expecting an improvement to performance in the coming quarter, albeit at a slower pace. As such, there is clear alignment with the latest sector-specific PMI data, which exhibited similar trends of positive yet slower growth.

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

NET BALANCE OF BUSINESSES REPORTING REVENUE GROWTH REACHED FIVE-YEAR HIGH IN Q3

The net balance of small businesses reporting revenue growth in Q3 stood at 7.8%. This means that the proportion of small businesses reporting an increase in revenues outweighed the proportion reporting a decrease. This marks the first positive score on this metric since the 3.1% net balance in Q3 2019 and, indeed, the highest score since the 14.6% net balance in Q3 2016. This positive revenue growth reflects the uptick in demand levels witnessed in the economy, with activity being stimulated by the easing of lockdown restrictions and remaining elevated.

Businesses are even more optimistic about revenue growth in the coming quarter. A net balance of 20.1% of small businesses expect their revenue to increase in Q4. This once more reflects the uptick in demand levels from the wider economic recovery. Importantly, this suggests that businesses do not expect the ongoing supply shortages and disruption to cause a reduction in their revenues.

On a sector-by-sector basis, businesses in information and communication are the most likely to expect revenue growth. This is the case for more than half (53.5%) of such businesses, with an overall net balance figure of 37.3%. At the other end of the scale, the wholesale and retail sector is least likely to expect revenue growth, with this being the case for 36.1% of such businesses, yielding an overall net balance of just 7.5%. These figures align with the relative rankings on the broader measures of positivity encompassed by the SBI reading, highlighting the clear link between revenue performance and business optimism.

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

EXPORTERS HINDERED BY SUPPLY CHAIN DISRUPTION IN Q3

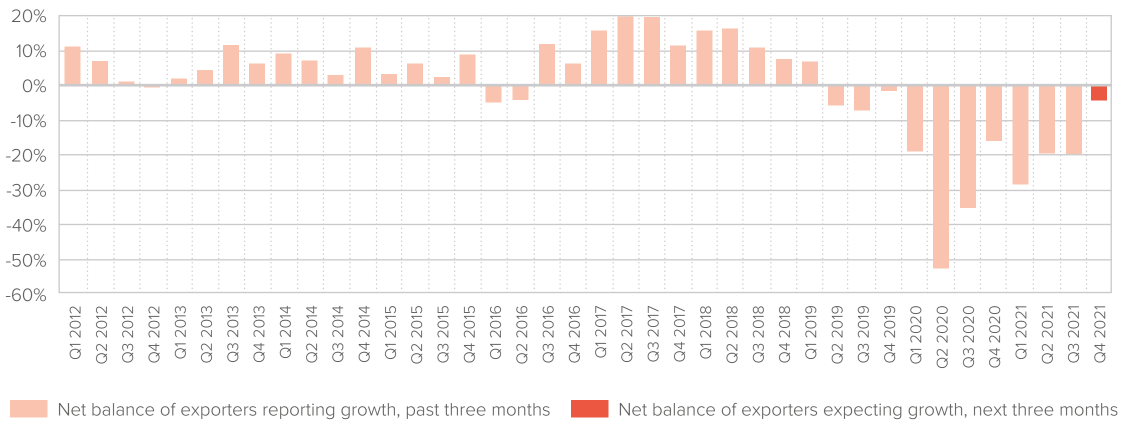
A net balance of -20.0% of exporting businesses reported growth in the value of their exports in Q3. As such, the proportion of businesses witnessing an increase in the value of exports was outweighed by the proportion experiencing a decrease.

When businesses were asked at the end of Q2 about their export expectations for the coming quarter, a net balance of -11.2% had expected growth. As such, Q3's export performance was considerably worse than businesses had anticipated. This can be explained by ongoing supply chain disruption; input shortages have meant that supply amongst producers has been curtailed, reducing their capacity to produce finished goods and subsequently export to overseas customers. Further difficulties have stemmed from the labour market, with personnel shortages being particularly stark in the haulage industry. This has hampered businesses' ability to ship goods from production sites and distribution centres to ports, subsequently putting downward pressure on exports. Q3's export performance was particularly weak amongst retail and manufacturing businesses, with net balances of -58.9% and -24.6%, respectively.

Issues relating to the UK's departure from the EU are still prevalent. In a series of new questions added to the SBI this quarter, 16.6% of exporting businesses stated that they had temporarily stopped exporting to the EU.

Businesses expect a further quarter of weak export performance in Q4, with a net balance of -4.6% expecting growth in the value of exports. This suggests that businesses anticipate further disruption to supply chains. It should be noted that the magnitude of this net balance is smaller than the actual experience of Q3, however.

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

MORE THAN THREE-QUARTERS OF SMALL BUSINESSES EXPERIENCED HIGHER OPERATING COSTS IN Q3

The net balance of small businesses reporting an increase in operating costs picked up for a second consecutive quarter in Q3, reaching 69.5%. This marks the highest reading on this metric since Q1 2019 and reflects the near-global phenomenon of rising producer prices. In the UK, input prices picked up by 11.0% annually in August 2021, the highest rate of growth since September 2011. Within the net balance figure, more than three-quarters (76.1%) of small businesses reported an increase in operating costs in Q3.

By curtailing supply levels, disruption to global logistics has put upward pressure on input prices. This has also been coupled with an uptick in demand, reflecting the global economic recovery from the pandemic. Such circumstances have combined to put significant upward pressure on the prices of raw materials. Inputs were the most commonly cited category when small businesses were asked about drivers of cost changes in Q3, being noted by 47.0% of respondents.

Price pressures have been particularly prevalent in commodity markets. For instance, Brent crude prices increased to a three-year high in September, with annual price growth of 71.5% for Q3 as a whole. Meanwhile, wholesale gas markets have also seen a multiple-fold increase in prices. These factors have clearly impacted businesses' cost sources. They are key inputs to fuel and utilities, the next most common response categories, being cited by 37.3% and 36.5%, respectively.

Labour costs were also commonly cited by businesses as a source of pressure. This was the case for 36.4% of respondents. Amidst personnel shortages, businesses have faced difficulties in the hiring process. This has contributed to record high vacancy levels, with the number of unfilled posts hitting 1.1 million in Q3. Meanwhile, wages remain heightened, with annual growth of 7.2% witnessed in the three months to August. Though this is slightly down on the record growth of 8.8% witnessed in Q2, firms may resort to offering even higher wages in an effort to incentivise new hires, which could add further to labour 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

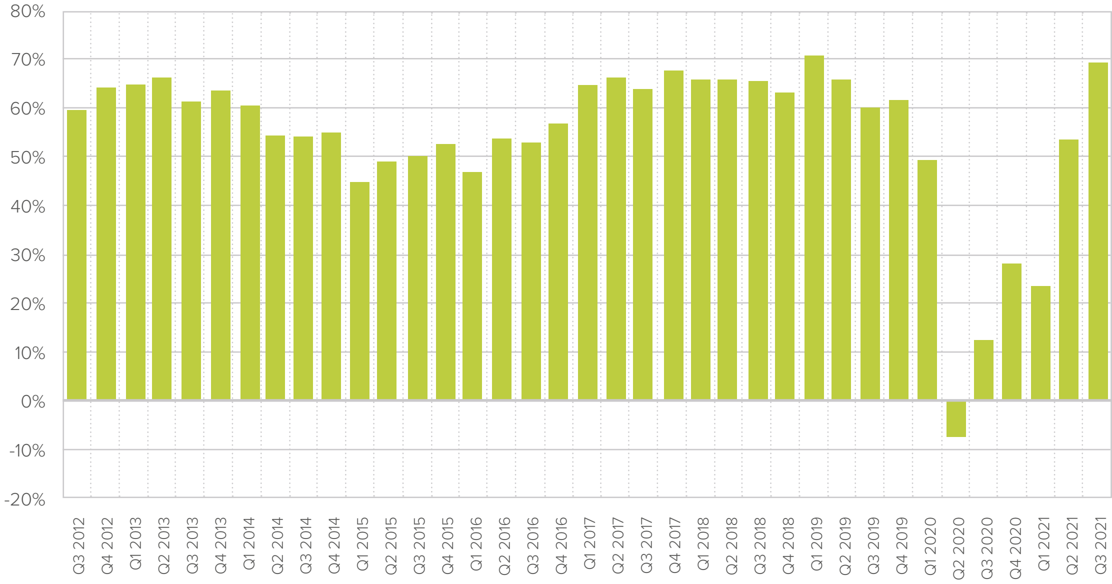
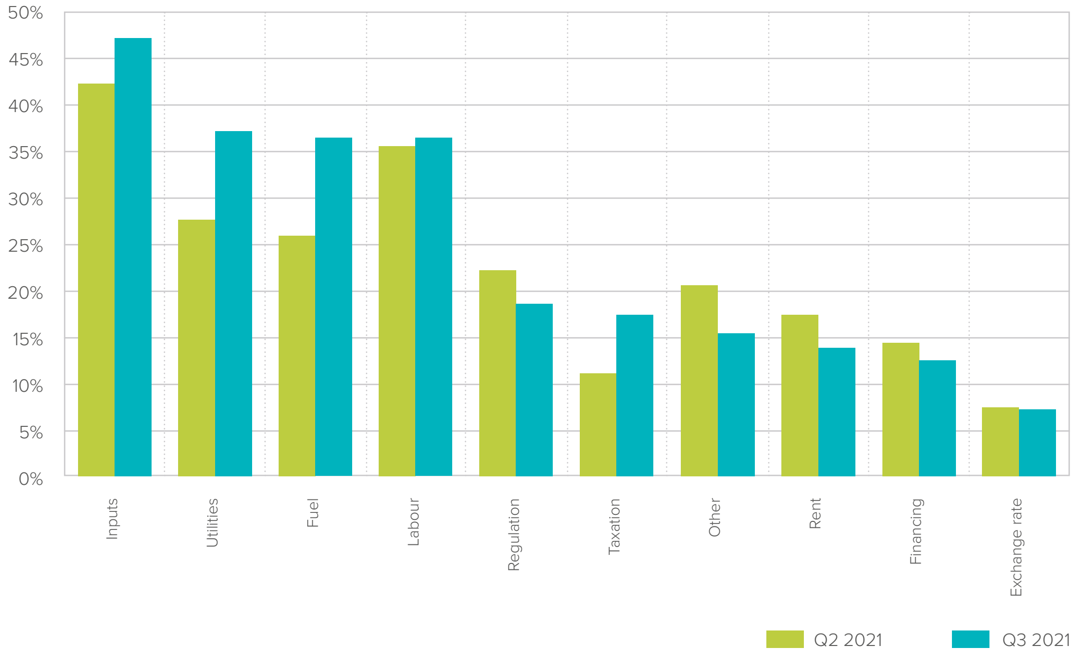


Figure 10: Main causes for changing business costs (firms may give multiple answers)
Source: FSB - Verve 'Voice of Small Business' Panel Survey



EMPLOYMENT

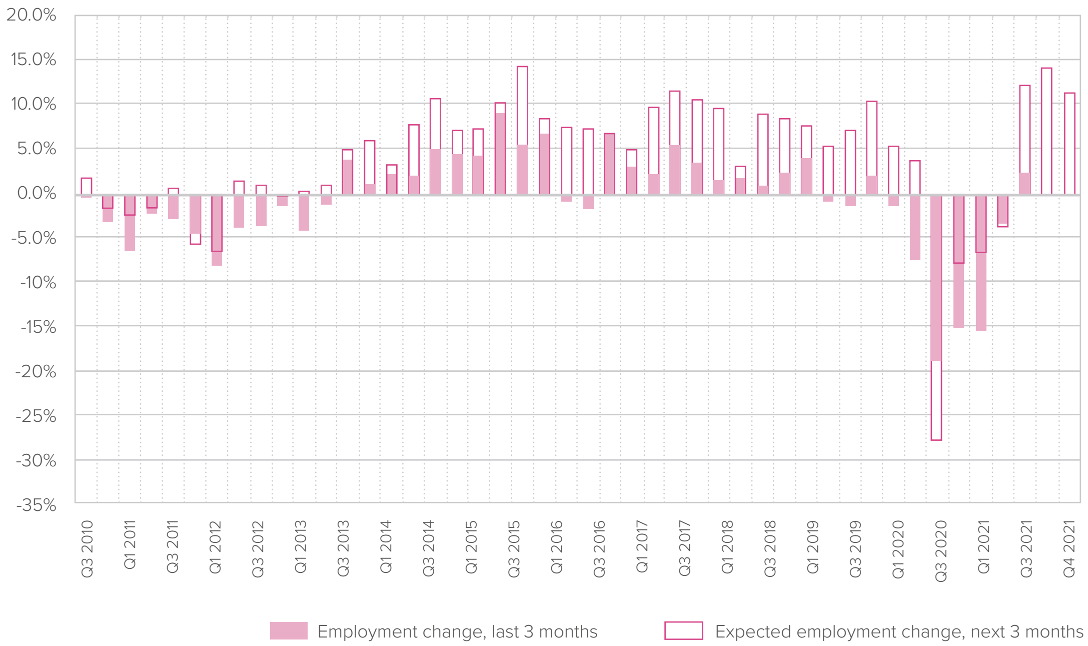
BUSINESSES EXPECT WORKFORCES TO INCREASE IN SIZE DESPITE TERMINATION OF FURLOUGH SCHEME, ALTHOUGH EMPLOYMENT GROWTH WAS NEGATIVE IN THE LAST QUARTER

The net balance of small businesses reporting growth in the number of people they employ stood at -0.2% in Q3. This marks a return to a negative figure following Q2's reading of 2.2% and suggests that the proportion of businesses witnessing an increase in workforce size was slightly outweighed by the proportion experiencing a decrease.

Positivity is witnessed in businesses' future outlook, with a net balance of 11.5% expecting their workforce to grow in size in Q4. This comes in spite of the recent termination of the furlough scheme, which is expected to put a degree of pressure on businesses. Overall, businesses' positivity likely reflects broader economic conditions, with demand for staff being residual from the ongoing recovery.

On a regional basis, small businesses in London exhibit the highest net balance when considering future employment prospects. A net balance of 19.8% of small businesses expect their workforce to increase in size in the final quarter of the year. This likely reflects the surge in activity amongst consumer-facing services, given that London is home to a significant cluster of these businesses. Meanwhile, the lowest net balance figures are found in the East Midlands and West Midlands, at 2.8% and 3.7%, respectively. In a series of new questions added to the SBI survey this quarter, businesses in these regions were the most likely to agree with the statement that "I don't plan to recruit because I do not have enough work to justify it". This was the case for 42.9% of businesses in the East Midlands and 38.8% in the West Midlands, compared to 29.7% nationally.

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

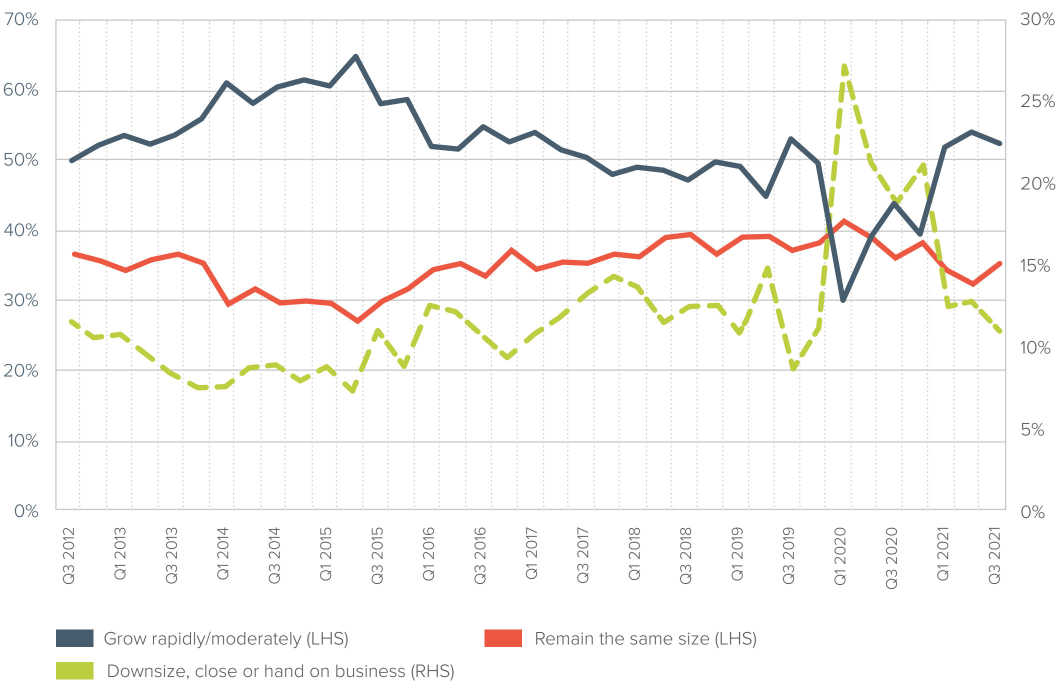
GROWTH ASPIRATIONS REMAIN PREVALENT, WITH MORE THAN HALF OF BUSINESSES SEEKING TO EXPAND IN THE NEXT TWELVE MONTHS

The share of businesses saying that they are aspiring to grow over the next twelve months decreased slightly in Q3, to 53.1%. This amounts to a quarterly drop of 1.3 percentage points. This was outweighed by the fall in the proportion of businesses expecting their business to shrink, however. This metric fell by 1.8 points between Q2 and Q3 to reach 11.2%. As such, the net balance of firms expecting to grow saw a quarterly increase of 0.5 percentage points, reaching 41.9% in Q3.

Growth aspirations were most common amongst businesses in the information and communication sector, reflected in their strong positive reading on the SBI. 64.6% of such businesses expect to expand over the coming twelve months, with the greater adoption of technology in the wake of the pandemic being one factor driving their growth. Meanwhile, businesses in professional, scientific and technical activities also exhibit a high prevalence of growth aspirations, with this being the case for 55.7%. Output in this sector tends to reflect residual demand from the wider economy and the greater need for business services during periods of heightened activity. As such, the continuation of the recovery is set to benefit such industries.

2.4% of businesses anticipate they will permanently close at some point in the next twelve months. Amongst sectors, this sentiment is most common amongst businesses in construction, being the case for 7.0%. This likely reflects the near-term impacts of labour and input shortages, and subsequent increases in costs.

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



LABOUR ISSUES PRESENT SIGNIFICANT BARRIER TO GROWTH FOR SMALL BUSINESSES

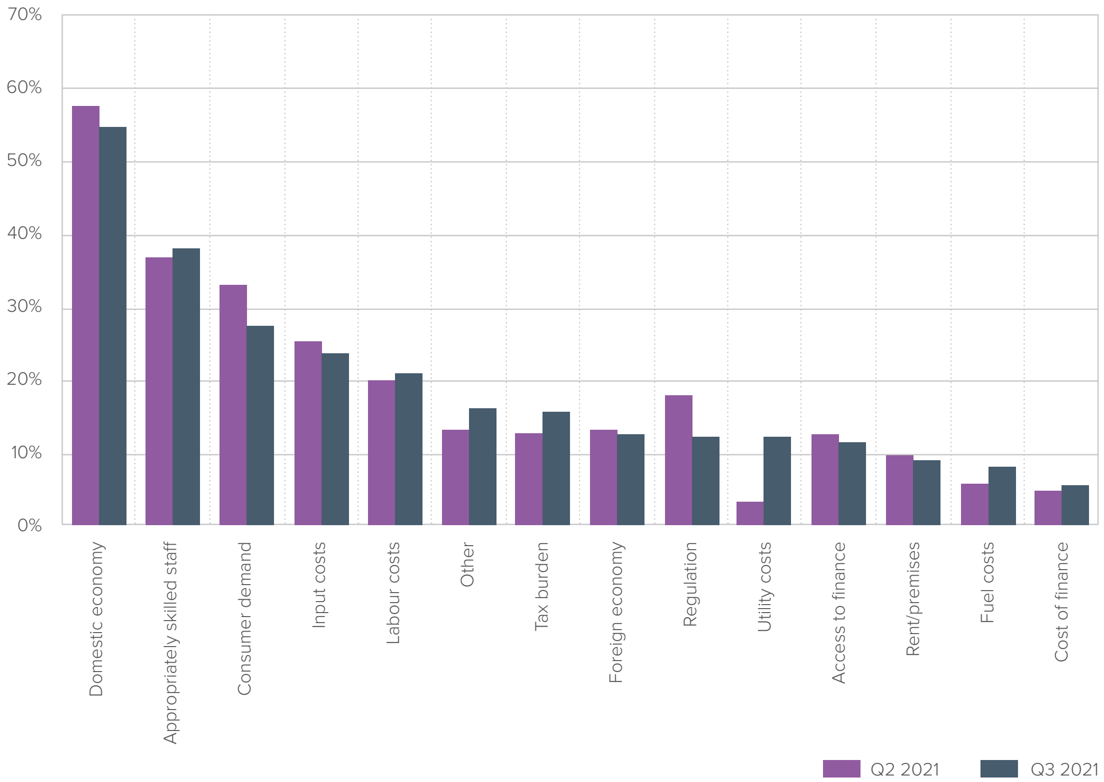
Amongst businesses aspiring to grow, the most commonly cited potential barrier to this growth is the domestic economy. This was the case for 54.6% of respondents. Despite being the highest figure amongst all categories, the proportion of businesses citing this option fell for the fifth consecutive quarter.

A large plurality of respondents cited appropriately skilled staff as a potential barrier to growth. This was the case for 38.0% of businesses, making it the second most commonly cited category. This was also the largest figure for this metric in the history of the series, outweighing the previous record of 37.2% of respondents in Q4 2019. This highlights the scale of labour shortages at present.

Skills mismatches represent one source behind these labour shortages. In a series of new questions added to the SBI this quarter, 23.1% of businesses agreed that it is difficult to find individuals with the right skills in the area in which their business is located. This sentiment was most prominent in the East of England, amounting to 33.9% of such respondents. This region was also one of the most likely to cite a lack of appropriately-skilled staff as a barrier to business growth, with this being the case for 41.9% of such respondents. This was only outweighed by the measure for the South East, which stood at 46.4% of respondents.

There was a significant jump in the proportion of firms citing utility costs as a barrier to growth. This saw an uptick of 8.4 percentage points between Q2 and Q3, the largest change of any category. Now, more than one in ten (12.0%) small businesses believe utility costs to be a barrier to their growth aspirations over the coming year. This reflects the considerable hike in utility prices, as outlined in Section X, as well as the expectation of further upward pressure into 2022.

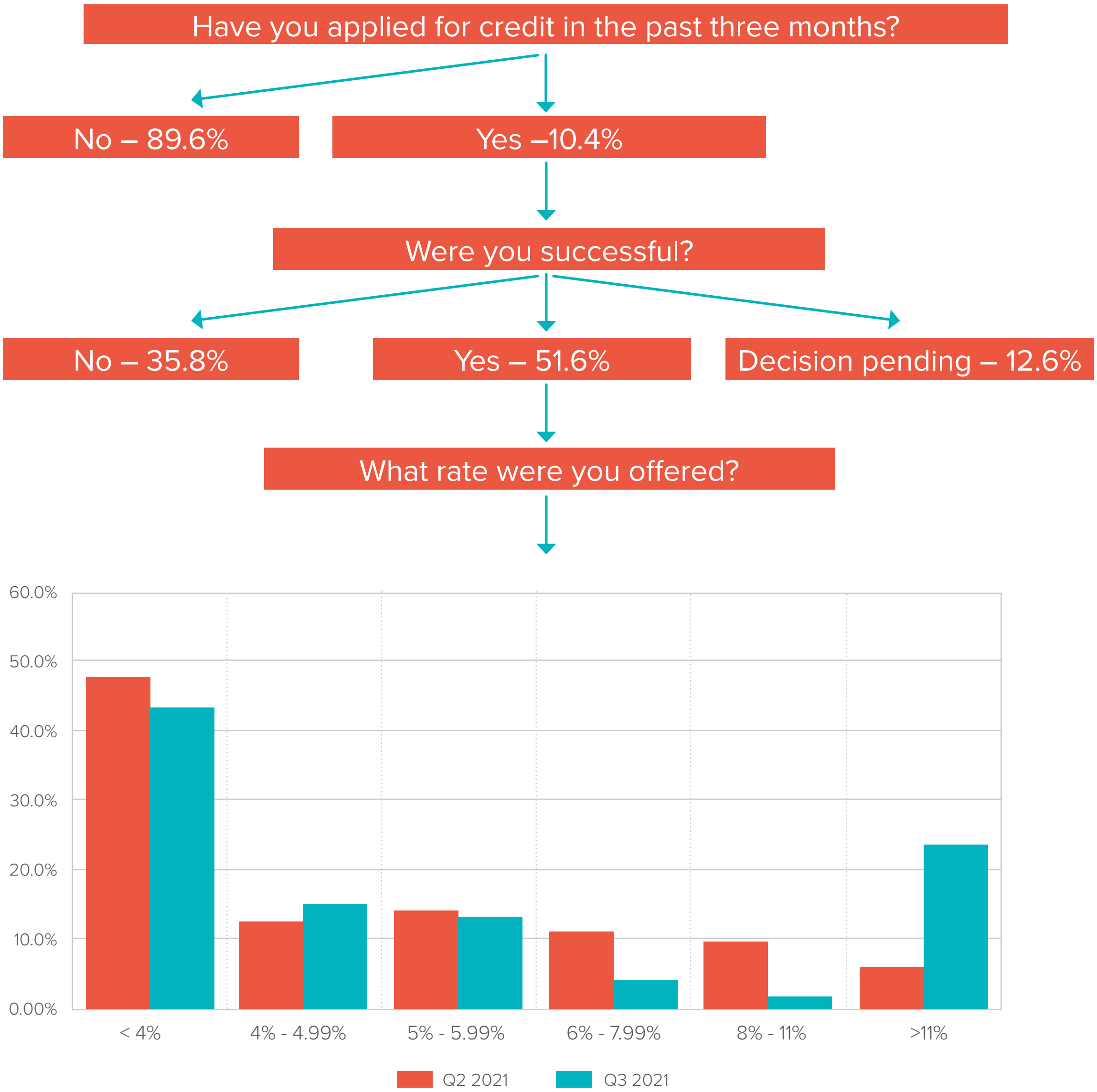
Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey



CREDIT

CREDIT REQUESTS FALL TO LOWEST LEVEL SINCE DATA COLLECTION BEGAN

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.

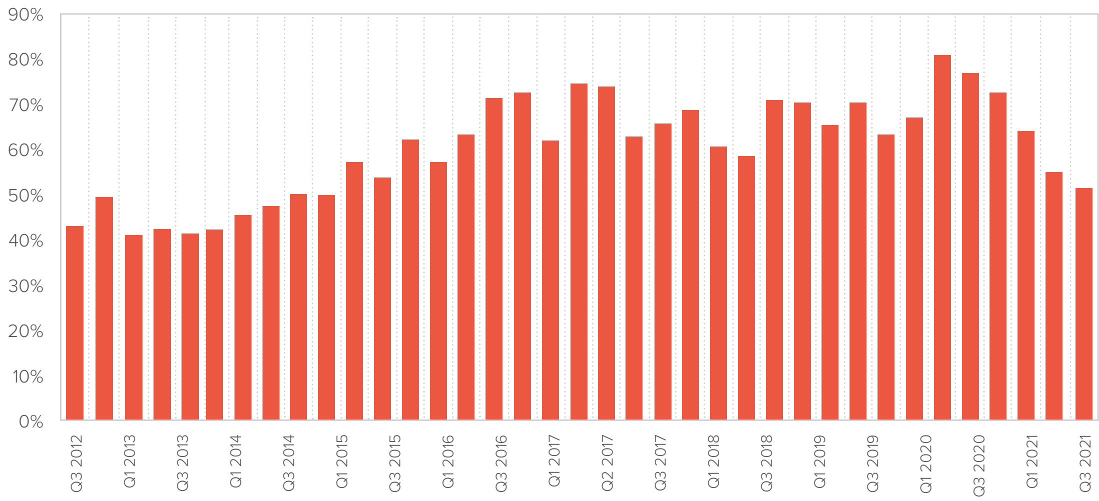


The proportion of small businesses applying for credit saw a fifth consecutive quarterly fall in Q3. Only 10.4% of survey respondents said they had applied for credit in the past three months, the lowest proportion since data collection for the SBI began. This reflects that businesses' operations are beginning to normalise, reducing the need for short-term cashflow support. Another factor is that some lingering uncertainty from the pandemic is simultaneously reducing incentives to invest.

The average interest rates offered to businesses taking out loans increased between Q2 2021 and Q3 2021, however. This was driven by a sharp uptick in the proportion of borrowers being charged interest rates in excess of 11%. This was the case for 23.7% of borrowers in Q3, up from just 5.6% in Q2.

Meanwhile, the proportion of credit applications being successful reached just 51.6% in Q3. This marks the lowest figure since Q4 2014.

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.

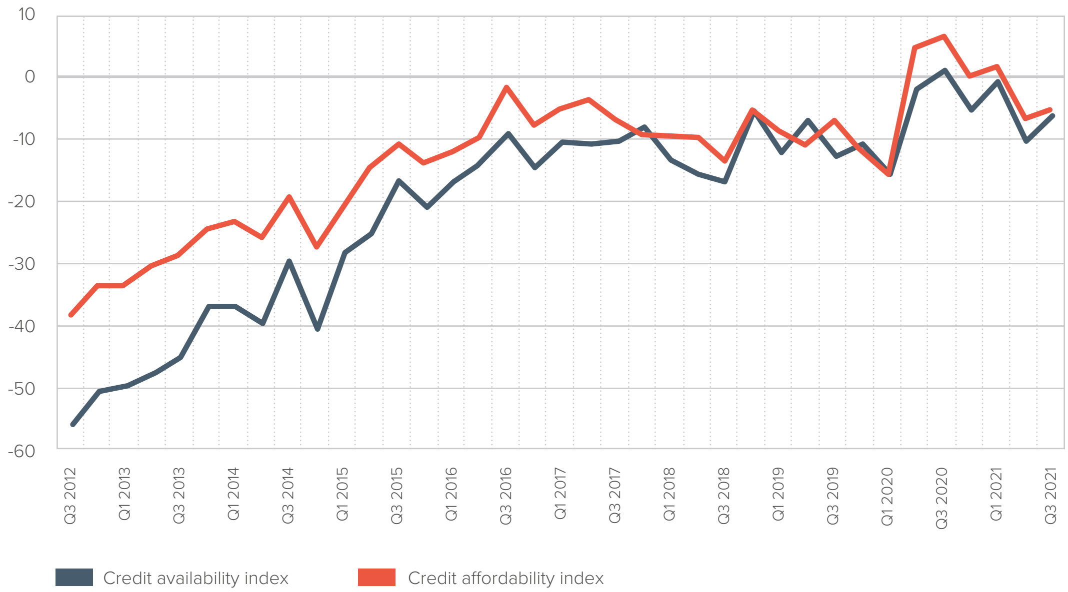


CREDIT AVAILABILITY AND AFFORDABILITY INDICES EXHIBIT SLIGHT UPTICKS, DRIVEN BY LESS PREVALENT NEGATIVE SENTIMENT

The proportion of small businesses that described the availability of credit as 'good' or 'very good' fell slightly in Q3, reaching 29.6%. This is down from 30.0% in Q2. There was also a fall in the proportion of small businesses describing the availability of credit as 'poor' or 'very poor'. This reached 32.3%, having stood at 35.0% in Q2. Since the latter fall was larger in magnitude than the former, this put upward pressure on the credit availability index, which rose from -10.2 in Q2 to -6.0 in Q3.

The proportion of small businesses describing the affordability of credit as either 'affordable' or 'very affordable' increased slightly in Q3, reaching 31.5%. This marks an uptick of just 0.1 percentage point on Q2's value. Meanwhile, the proportion of small businesses describing the affordability of credit as 'unaffordable' or 'very unaffordable' fell by 1.6 percentage points between Q2 and Q3, reaching 33.4%. This comes in spite of the stark uptick in the proportion of borrowers being charged rates in excess of 11% in Q3. These factors meant that the credit affordability index increased in Q3, reaching -4.9, having stood at -6.5 in Q2.

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



INVESTMENT

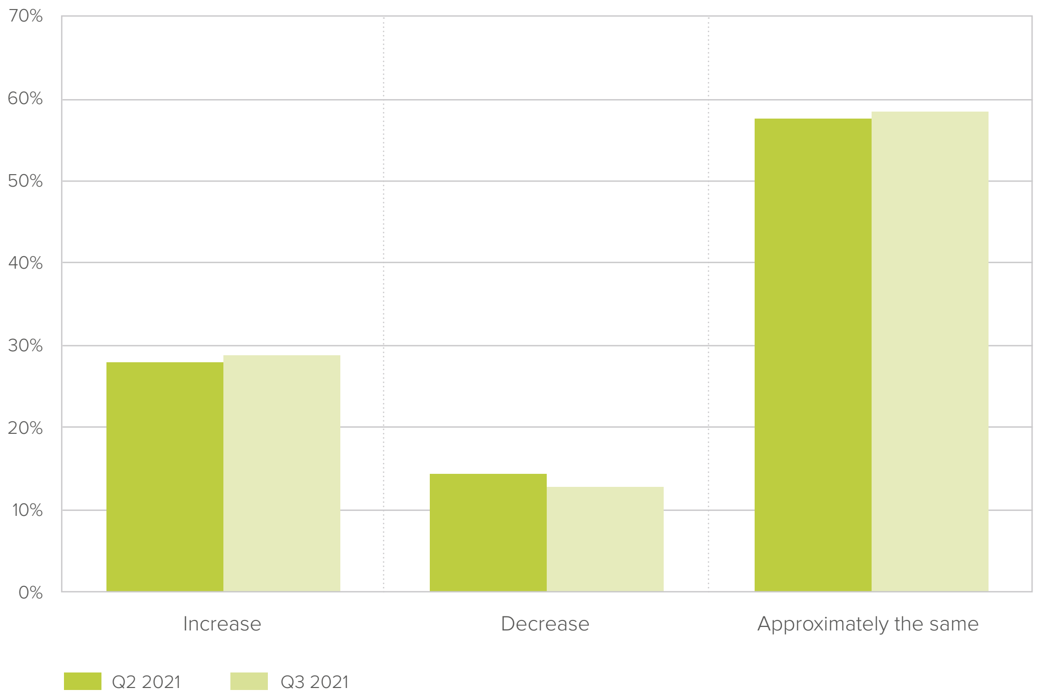
INVESTMENT OUTLOOK EXHIBITS SLIGHT IMPROVEMENT LOOKING AHEAD TO Q4

The proportion of small businesses expecting an increase in investment levels over the coming quarter saw a slight uptick in Q3, reaching 28.6%. This marks an increase of 0.7 percentage points on Q2's value. The net balance of businesses expecting to increase their investment stands at 15.5%.

Amongst sectors, the strongest net balance figure was seen in information and communication, at 21.5%. This reflects the sector's status as the most optimistic looking ahead to Q4, having also exhibited the highest SBI reading. This is followed by the manufacturing sector, for which a net balance of 17.7% of businesses are expecting to increase their investment levels in the final quarter of 2021. This sector has benefited from the tax super-deduction, which allows companies to cut their tax bill by an amount proportional to their investment in capital and plant machinery.

The weakest investment intentions are seen amongst those in wholesale and retail, exhibiting a net balance of 11.4%. This further aligns with the relative optimism outlined by the headline SBI reading, with the sector exhibiting the lowest score looking ahead to Q4.

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 and October research survey of FSB members carried out by Verve. 5,646 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. 506 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 1,383 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 21 September and 1 October 2021.

SUMMARY DATA TABLE

	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Small Business Index	-21.6	-143.4	-5.0	-32.6	-49.3	27.3	18.6	16.4
Employment - previous three months	-1.5%	-7.6%	-19.0%	-15.2%	-15.5%	-3.5%	2.2%	-0.2%
Employment - coming three months	3.5%	-27.9%	-7.9%	-6.7%	-3.8%	12.0%	14.0%	11.5%
Exports - previous three months	-1.6%	-19.1%	-52.8%	-35.2%	-16.0%	-28.4%	-19.8%	-20.0%
Exports - coming three months	-9.5%	-52.4%	-12.8%	-18.9%	-29.0%	-9.8%	-11.2%	-4.6%
Credit availability - rated good or very good	27.5%	24.4%	38.3%	36.4%	29.3%	35.2%	30.0%	29.6%
Credit availability - rated poor or very poor	34.7%	41.6%	34.9%	30.9%	30.5%	30.1%	35.0%	32.3%
Credit affordability - rated good or very good	28.1%	25.7%	41.8%	43.0%	36.5%	38.3%	31.4%	31.5%
Credit affordability - rated poor or very poor	39.9%	44.0%	31.9%	28.3%	30.3%	31.2%	35.0%	33.4%

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.

Q3

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