Q1

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 1, 2021

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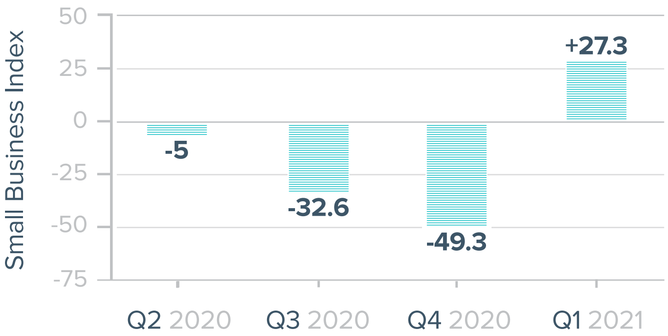
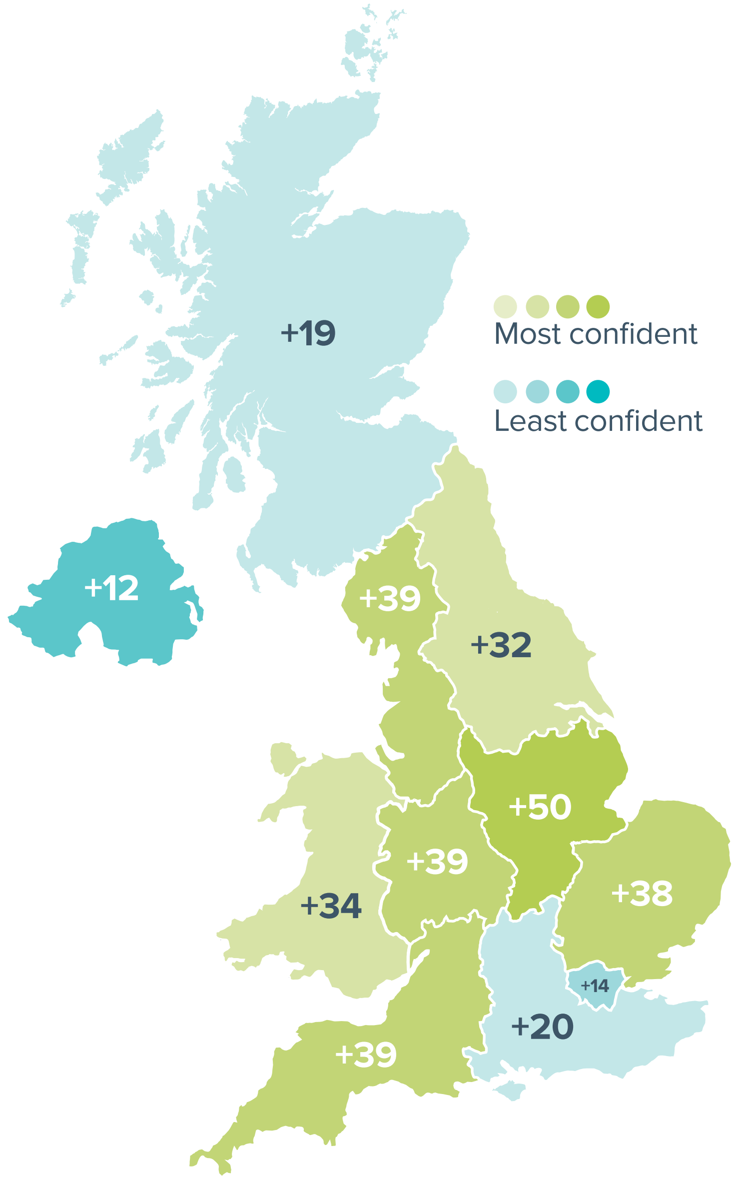
SBI Q1 2021

“Small business confidence rebounds to highest point since 2015 as shops re-open in England and Wales”



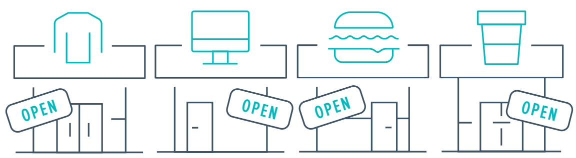


Half of firms forecast increased revenues

51%

expect an **improvement next quarter**

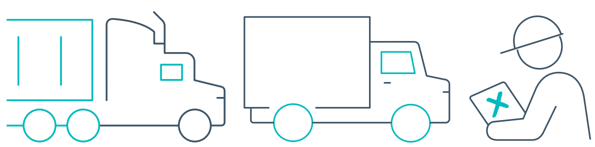
Majority hope to grow



53%

Aspire to **expand operations** over next year

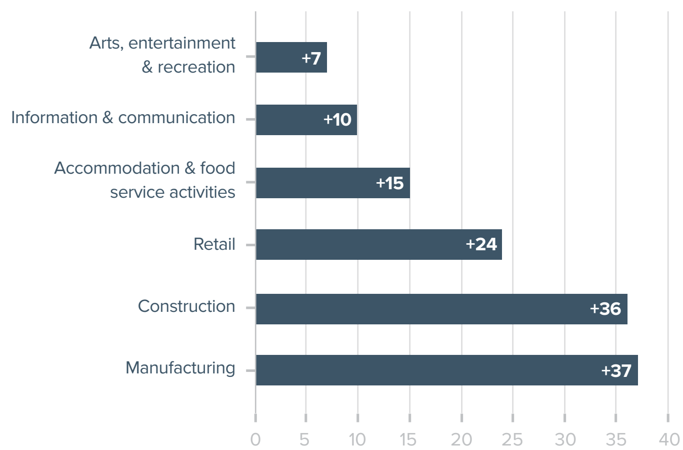
Exporters suffer fall in sales



47%

report **reduction** over last quarter

Small business confidence by sector



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FSB FOREWORD

The word unprecedented has been a go to for economic and political commentators for all the wrong reasons over the past year. The economic shock suffered by small firms and the self-employed since last Spring, as well as the measures installed by governments to help them manage it, are unheard of in modern peace time.

As we head into the summer, we live in hope that the term can also be applied to an altogether more positive development: rebounding commercial activity as trading restrictions ease.

The UK Small Business Index has finally returned to positive territory after more than two years, posting its highest reading since the autumn of 2014. The majority of small business owners expect their performance to improve, revenues to increase and the size of their firm in the round to grow over the months ahead.

It is absolutely crucial that this optimism is now converted into cashflow. Cash reserves in many small businesses are now perilously low and many are submerged in debt, with repayments on government-assisted loans about to start. These pressures are felt at a moment when broader demand remains weak, and will do so until the unlock process is complete.

It's been a torrid twelve months, but a combination of critical government assistance, community support and rapid innovation by business owners has helped many to get to a point where they can now, tentatively, start to plan for the future again.

That increased certainty is key. There's no use in having another summer mini boom if it's followed by the same chopping and changing we had last autumn and in the run-up to the vital Christmas trading period. Better to unlock more slowly and get it right than rush and fail to learn the lessons of history. A repeat of last year's chaos would spell the end for many great businesses.

It's also important to stress that optimism was in short supply even before the pandemic struck. The challenges faced then are faced still.

They include the persistently high non-wage costs of employment – chiefly the jobs tax that is employer national insurance contributions – which serve as a barrier to both keeping people on and creating vacancies. One in seven business owners with staff fear redundancies over the coming months as the furlough scheme winds down. When cashflow tightens, the ability to recruit or maintain employment is further undermined.

Cashflows are also profoundly affected by the UK's deepening £23bn late payment crisis, with more corporations treating suppliers like free credit lines as sales dry up, imbuing their supply chains and the economy as a whole with stress and vulnerability.

In the meantime, a lot of small firms that export have been hit with unfamiliar rules of origin and custom declaration paperwork as a new trade deal with the EU takes full effect. A quarter have halted sales to the bloc for the time being, with some already opting to throw in the towel permanently rather than spend time and money on the paperwork now required to reach clients across the Channel.

In short, confidence has returned for the majority, but for this to remain so we must make sure that cashflows recover in the next quarter. Policymakers cannot afford to treat this rebound as job done. We continue to engage with them regarding our recommendations for lowering operating costs, getting firms paid on time and helping more of them to export, making them more innovative and profitable in the process.

We're also stressing the need to support those thinking about launching an enterprise for the first time as the economy shifts.

Small firms and the self-employed played a fundamental role in our economic recovery after the last recession, not least through business creation. If we want them to do so again then policymakers should help them capitalise on this burst of confidence with an ambitious evolution of business and start-up support. Only then can we pave the way for an economic bounce back like none ever witnessed before.

Mike Cherry,
National Chairman

Martin McTague,
National Vice Chair,
Policy and Advocacy

ECONOMIST'S VIEW

Small business confidence has seen a dramatic improvement in Q1 2021 as SMEs across the countries have pinned their hopes on the roadmap out of lockdown, expecting a substantial improvement in trading conditions in the coming months. The FSB Small Business Index (SBI) rose to 27.3 in the first quarter of this year, the highest level since Q2 2015. Looking at the year-on-year growth reveals an even more dramatic increase of 170.7 points, as the baseline is now Q1 2020 when the pandemic led to the first national shutdown and, subsequently, the steepest decline in economic activity on record. Given the forward-looking nature of the SBI, which asks SMEs about their expected business performance over the next three months, it is reasonably safe to say that UK businesses are very optimistic about their outlook. Moreover, there is a sense of hope that the country will be able to get on top of the virus in a more definitive manner, helped by the successful vaccination campaign which targets giving UK adults a jab by the end of July.

In line with the road map, non-essential businesses have been allowed to reopen in mid-April together with outdoor hospitality and a number of other service businesses such as hairdressers and nail salons, that have been forced to close since January. In the following months, restrictions on social gatherings and other businesses will be gradually lifted further if the virus remains under control. This expected easing of restrictions explains the large gains seen in the SBI for businesses in the accommodation & food services sector, the arts & entertainment sector and the retail industry which saw increases of 123.1, 105.7 and 103.7 points, respectively. Nevertheless, the most optimistic sector in Q1 2021 is the manufacturing sector which has shown greater resilience throughout the lockdown months and also benefits from an improving global economic outlook.

In line with the evidence of a stronger manufacturing sector, the East and West Midlands are the two regions with the highest SBI scores this quarter at 50.0 and 39.1, respectively. At the bottom of the regional ranking, we see that small business optimism is less pronounced but still positive in London with a score of 13.5 and Scotland at 18.8. More so than any other region, London has seen a massive displacement of economic activity over recent months as millions of commuters were working remotely, depriving many of the capital's small businesses of their regular revenues.

In the coming months, the economic fortunes of the UK's small businesses will continue to depend to a substantial degree on progress made in fighting coronavirus case numbers. However, with infection and death rates falling and vaccinations being administered faster than in most comparable countries, there is a sense that the planned easing of restrictions in the spring and summer is indeed the beginning of a return to normality rather than yet another false dawn. Businesses and consumers alike seem keen to seize the opportunities of the coming months and we expect this to be reflected in a temporary boom in consumer spending and higher levels of employment. Having said this, businesses will face tough decisions in Q4 of this year when the furlough scheme is finally wound up, potentially leading to a large spike of redundancies.

Kay Daniel Neufeld, Head of Macroeconomics, Cebr

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index (SBI) increased by 76.6 points between Q4 2020 and Q1 2021, marking the first rise in the index since Q2 2020. The index now stands at 27.3, the first positive index reading since Q2 2018.**
- **Unanimous positivity across all regions was observed on the latest round of the Small Business Index.** The East Midlands, West Midlands and North West stand out as the areas with the highest rate of business confidence in Q1.
- **All major industries returned to optimism on the latest round of the SBI,** after two quarters of unanimous pessimism in Q3 and Q4 2020. Accommodation and food services saw the largest rise in optimism. Meanwhile, the manufacturing sector saw the highest SBI score in Q1 2021, of 36.9.
- **More than half of small businesses experienced a fall in revenues over past three months in Q1.** A negative net balance was witnessed in all of the UK's constituent regions and countries, showing that weak revenues were experienced nationwide.
- **There was a fall in the net balance of exporters reporting growth in the value of their exports in Q1 2021** with the figure standing at -28.4%, down from -16.0% in Q4 2020. Looking ahead to the next quarter, more firms anticipate an improvement in the export landscape than was the case in the previous round of the SBI, with the net balance of firms expecting growth in export values standing at -9.8%, up from a net balance of -29.0% in the previous report.
- **The net balance of small businesses reporting an increase in operating costs fell in Q1,** to 23.3%, having previously stood at 27.7% in Q4 2020. This is down by 25.9 percentage points compared to Q1 2020. Of the different categories of business costs, fuel saw the largest increase. The proportion of firms citing fuel as a main source of cost increases stood at 19.3%, representing an uptick of 4.3 percentage points between Q4 and Q1. Energy prices have been rising recently, with the recovery of global oil prices being a key contributing factor.
- **Only 12.5% of survey respondents reported cuts to the size of their workforce in Q1, down from 22.3% in Q4 2020, marking a significant improvement.** This is the lowest figure seen since 2019, highlighting the impacts of the CRJS scheme in protecting jobs. Looking ahead, the net balance of expectations stands at +12.0%, suggesting that the easing of restrictions on the economy is likely to cause an associated rise in employment.
- **The share of businesses aspiring to grow increased by the most on record this quarter,** with the share of businesses saying that they are aspiring to grow over the next 12 months increasing from 39.9% in Q4 2020 to 52.7% in Q1 2021.
- **The domestic economy and consumer demand are the two most commonly cited options when considering potential barriers to growth.** The foreign economy became less of a concern to businesses in Q1, which might be partially explained by the conclusion of the Brexit deal, which was agreed in the final days of 2020, removing the danger of a more disruptive no-deal outcome.
- **Credit availability and affordability indices improved compared to the previous quarter in Q1, but remain below the record levels seen in Q3 2020.** 35.2% of SMEs said that the overall availability of new credit for small businesses was very good or quite good in Q1, up from 29.3% in Q4 2020.

UK MACROECONOMIC OVERVIEW

Q1 lockdown causes dip in output, but hope for home businesses relies on government roadmap

Q1 2021 was marked by a return to lockdown for the majority of the quarter. On 4th January, England was placed into a strict lockdown, with Wales, Scotland and Northern Ireland taking similar measures. These restrictions only started to ease at the end of the quarter, with schools in England opening on 8th March, but non-essential retail and hospitality businesses remaining closed.

The forced closure of many businesses for the entirety of the first three months of 2021 has been a strain on the economy, with millions of workers placed back on the furlough scheme as their employer faced little or no demand especially in sectors dependent on social contacts. However, the impact of the third lockdown in England does not appear to have had as negative an impact as the first, with retail sales seeing a smaller contraction and monthly GDP data showing that the decline in output in January 2021 was much smaller than in April 2020.

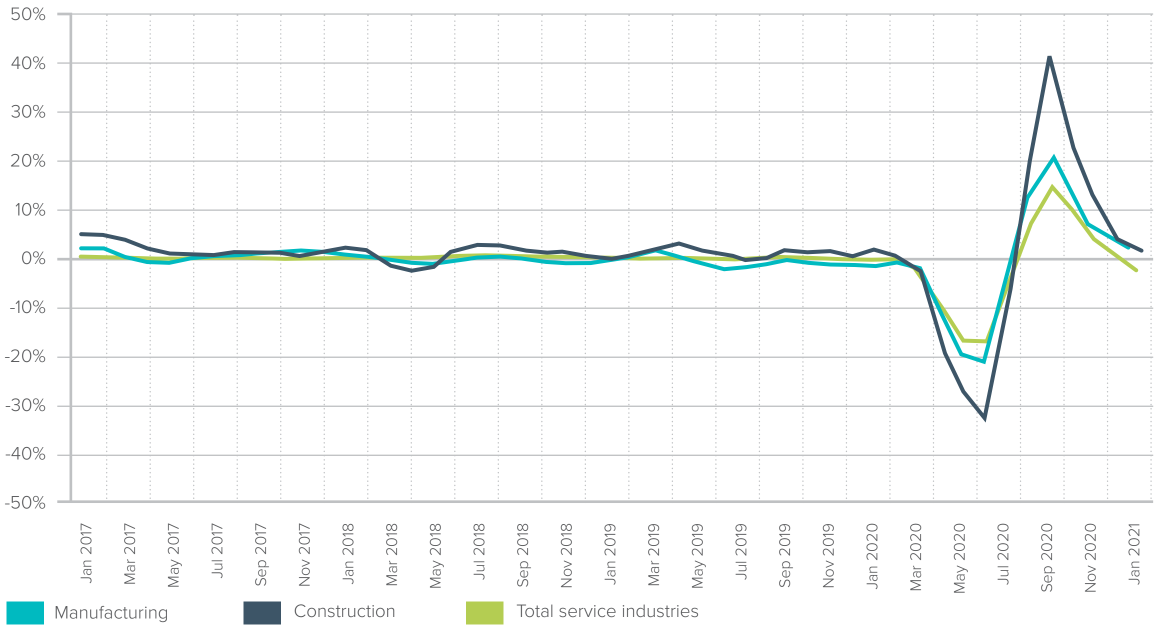
One source of consumer and business optimism amid the third English lockdown has been the successful rollout of vaccines to the most at-risk groups of individuals. The Government met its target to vaccinate 15 million people by mid-February and has since gone on to provided doses to millions more individuals. As more individuals are protected from the effects of the virus, the chances of the economy opening up successfully increase.

Looking ahead, the near-term outlook is fairly optimistic, with shops, hairdressers and outdoor hospitality having opened in mid-April, allowing many businesses to start to see revenues for the first time since December. Additionally, with social distancing policies already in place from when businesses were open in 2020, the easing of restrictions from this lockdown will be simpler logistically for most enterprises.

Keen to support the economy as restrictions ease, the Chancellor's Budget Statement on 3rd March made various provisions for businesses affected by lockdown. In particular, non-essential retail businesses will get up to £6,000 per premise through the Restart Grant scheme to help them reopen. Businesses which are planned to open in May will get even more, at £18,000 per premises. The extension of the furlough scheme to the end of September, also announced in the budget, will have been a lifeline for many businesses which would not have been able to pay their workers if the scheme had ended in April.

Yet, there are concerns about another wave of coronavirus cases on continental Europe and the emergence of new strains of the virus, which could spread to UK shores and threaten the easing of coronavirus restrictions into Spring and Summer. Therefore, while businesses have much to hope for as we exit the latest lockdown, risks to future revenues from coronavirus do still remain.

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 rises to highest level since Q2 2015

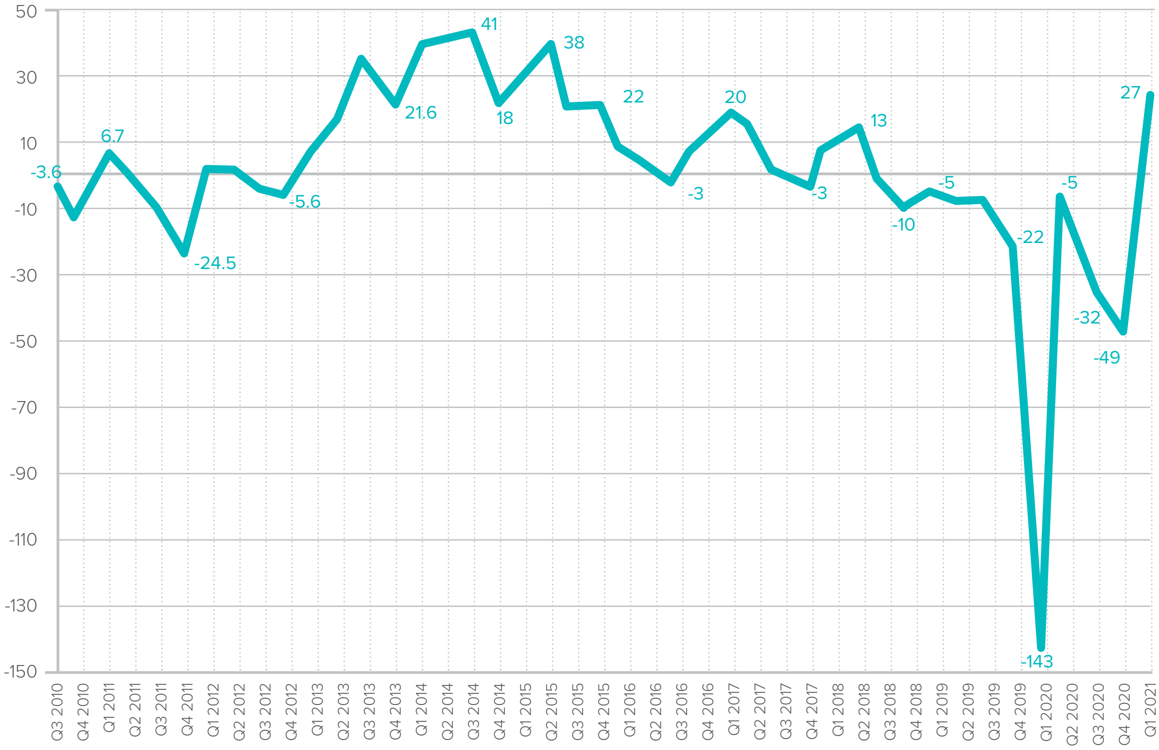
The Small Business Index (SBI) increased by 76.6 points between Q4 2020 and Q1 2021, marking the first rise in the index since Q2 2020. The index now stands at 27.3, the first positive index reading since Q2 2018. The index has also not been higher than its current reading since Q2 2015 – 23 quarters ago. Despite the harsh trading conditions in Q1 2021, much optimism will have been drawn from the success of the UK's vaccine rollout and the prospect of a return to more normal trading conditions in the coming months.

The implementation of a lockdown by the Government in order to curtail coronavirus cases brought about an inevitable reduction in economic output. UK GDP fell by 2.9% in January 2021, compared to the month before, taking GDP to 9.0% below the pre-pandemic levels seen in February 2020. However, the fall in January was far smaller than the first national lockdown in April 2020, when GDP contracted by 18% in a single month.

Early views on the lockdown's impacts on the remainder of the quarter can be inferred from the UK Purchasing Managers' Index, with both the services and composite PMIs standing in contractionary territory during February at 49.5 and 49.6, respectively. However, optimism about the roadmap out of lockdown allowed a pickup in activity in March when business activity across the UK private sector increased and the rate of expansion was the fastest for seven months. This was fuelled by a rise in new orders for the first time since September 2020, taking the UK composite output index to 56.6 in March.

Further optimism in March will have been fuelled by the policies announced by the Chancellor of the Exchequer in the Budget, including the extension of the Coronavirus Job Retention Scheme (CJRS), which continues to support employment and keep redundancies at a relatively low level compared to the scale of the economic contraction.

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



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

The impact of the Q1 lockdown, which has shut thousands of businesses and curtailed movements and social interactions among Brits, means that it comes as a surprise to see the most positive business sentiment in nearly six years on the latest round of the SBI. However, positive news in the form of the vaccine rollout and continued government support in the form of the CRJS will have added to business confidence and give hope for a forceful economic recovery in the coming months.

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

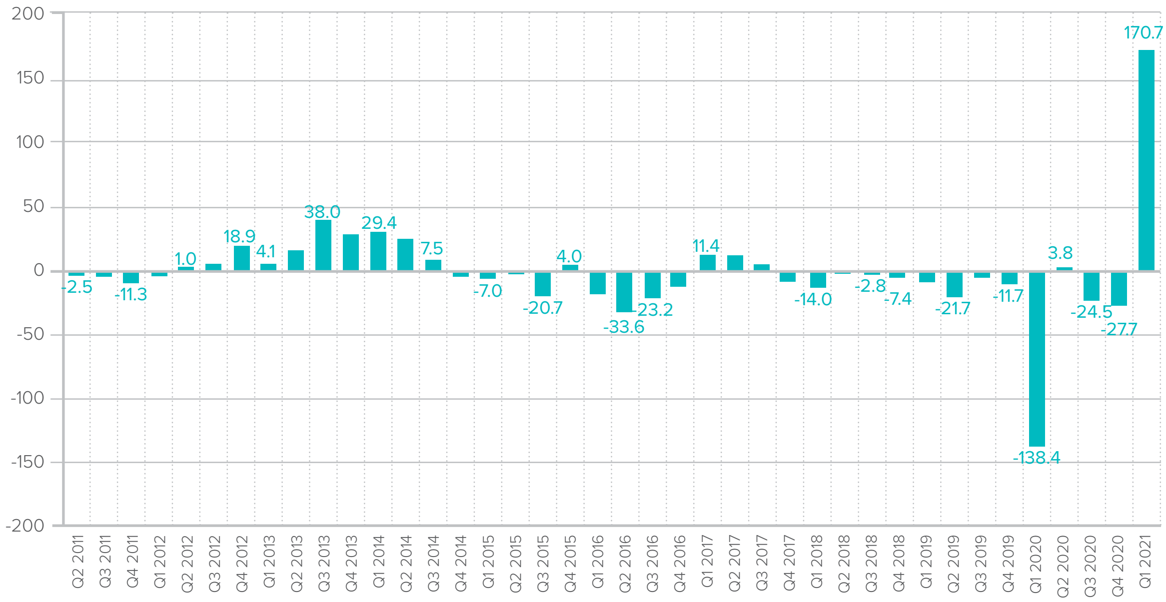
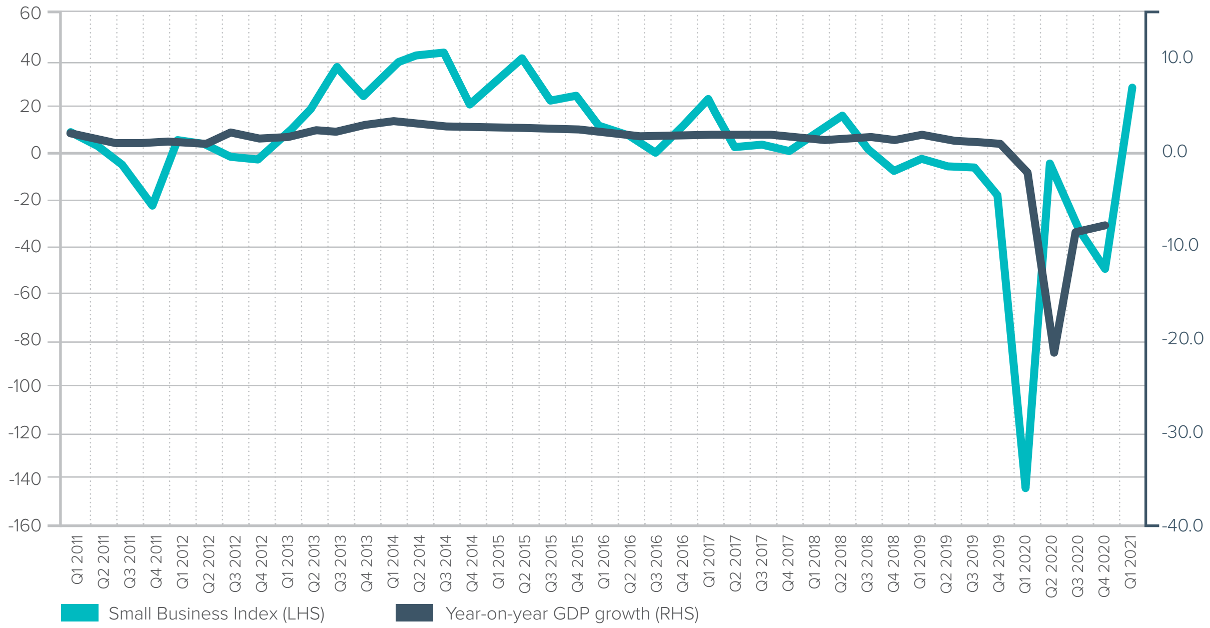


Figure four: UK SBI against year-on-year UK GDP growth.
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

SMALL BUSINESS INDEX TURNS POSITIVE FOR ALL OF THE UK'S CONSTITUENT REGIONS AND COUNTRIES

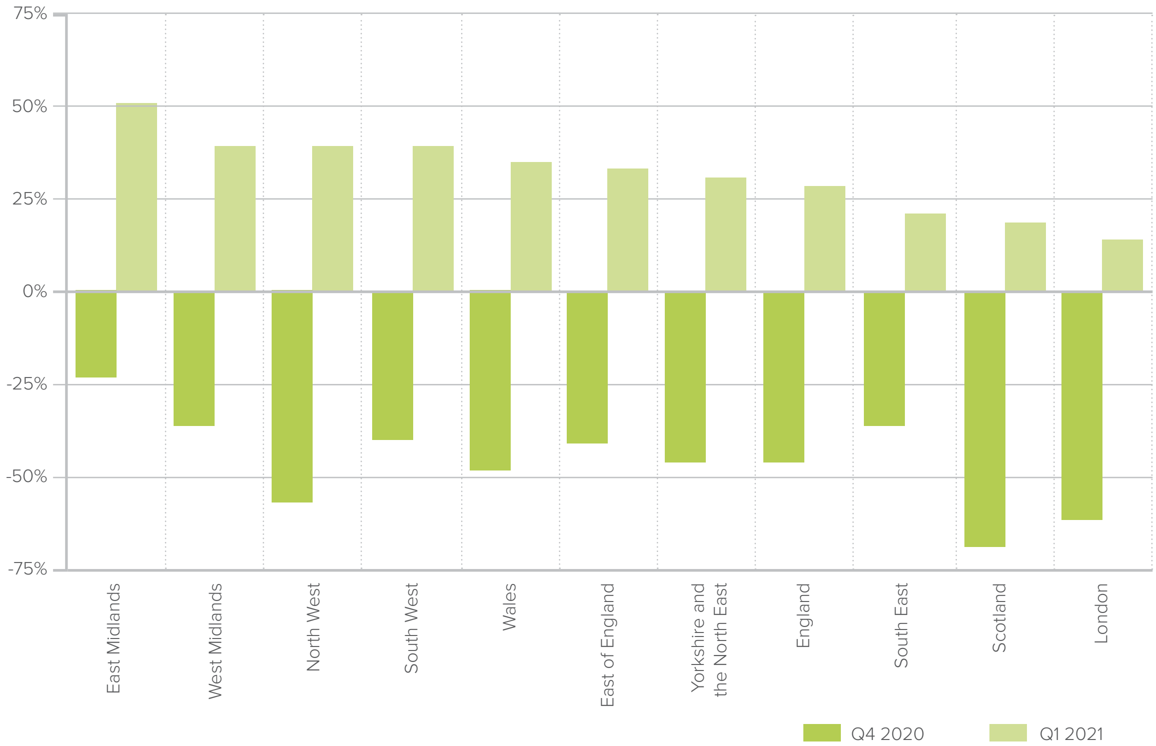
Unanimous positivity across all regions was observed on the latest round of the Small Business Index, after two quarters of negativity across all 12 regions. As such, all regions saw an improvement in the latest quarter, with the North West seeing the largest rise in the index reading.

The East Midlands, West Midlands and North West stand out as the areas with the highest rate of business confidence in Q1, reporting index scores of 50.0, 39.1 and 38.8, respectively. As with the increase on the headline SBI measure, this large rise in optimism amongst businesses reflects the success of the vaccination programme allowing for a roadmap out of lockdown in the spring months.

As a devolved nation, Scotland has managed its own response to the pandemic, meaning restriction measures have differed slightly to the rest of the UK. Scotland has the second-lowest level of SBI confidence, at 18.8 in Q1, although it also reported the second-largest rise compared to the Q4 reading (an increase of 87.8 points). Scotland has announced a relatively slower path out of lockdown, with non-essential retail opening two weeks after the planned date for England.

Businesses in London were the most pessimistic in Q1, seeing an index reading of 13.5. This can be partially attributed to the impact of Brexit on the large service sector in London, with free trade in services between the EU and UK no longer applying, since the UK transition period ended at the end of 2020.

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

OPTIMISM REBOUNDS ACROSS ALL INDUSTRIES

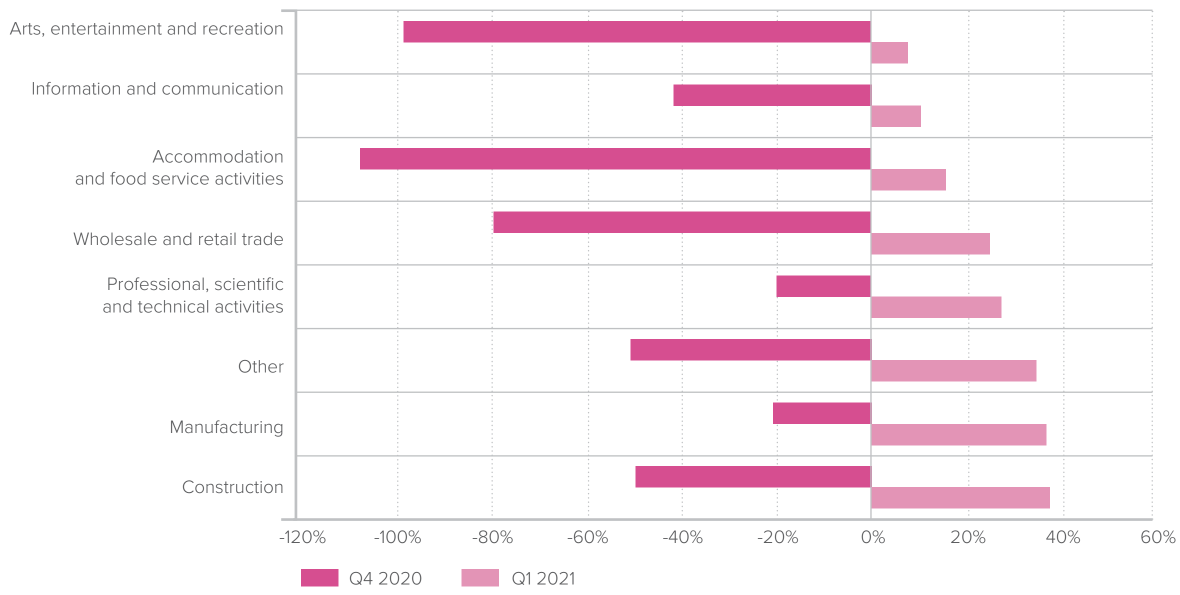
All major industries returned to optimism on the latest round of the SBI, after two quarters of unanimous pessimism in Q3 and Q4 2020. Accommodation and food services saw the largest rise in optimism.

The manufacturing sector saw the highest SBI score in Q1 2021, of 36.9. The industry has been able to remain open to business for the third lockdown, as those not able to work from home were permitted to visit their workplace, as long as social distancing restrictions are in place, which all businesses will have adjusted to by 2021.

One industry that has faced a noticeable barrier to activity through restriction measures is that of arts, entertainment, & recreation. The sector's index score was the lowest in Q1 2021, at 7.0, although this is a return to positive territory, after a reading of -98.7 was observed in Q4 2020. Even though formal restrictions were imposed through the quarter, the sector will have become more hopeful about a reopening in Spring and Summer, in line with the government roadmap.

Accommodation & food services is one of the sectors most severely impacted by coronavirus restriction measures. Nevertheless, it saw a 123.1 rise on the SBI, to stand at 15.0 in Q1 2021. The news of grants supplied to businesses as they reopen in this industry will have brought increased financial security, as will have the extension of the CRJS.

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

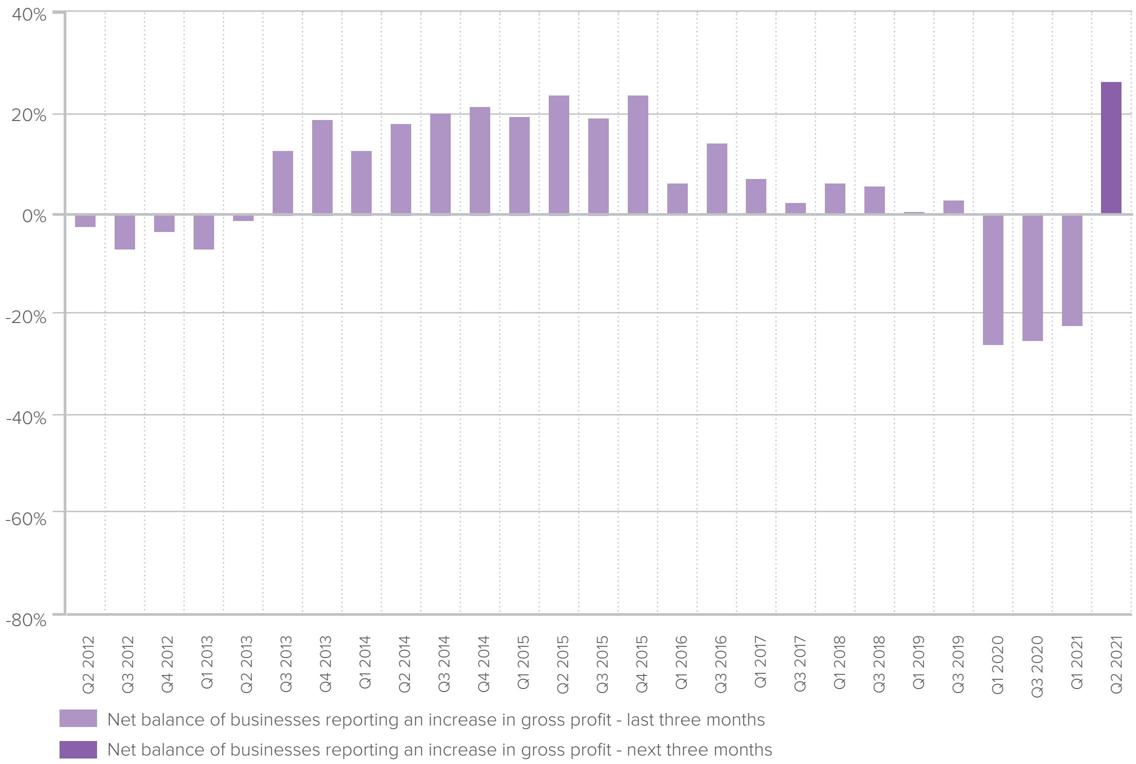
MORE THAN HALF OF SMALL BUSINESSES EXPERIENCED A FALL IN REVENUES OVER THE PAST THREE MONTHS

The net balance of small businesses reporting revenue growth over the previous three months stood at -22.6% in the first quarter of 2021. Across the country, more than half (51.3%) of small businesses reported a fall in revenue levels during the quarter, with 37.0% reporting a significant fall of more than 10%. The net balance figure represents a slight improvement of 2.5 percentage points compared to Q3 2020, when this question was last asked, taking it to the third-worst reading on record.

A negative net balance was witnessed in all of the UK's constituent regions and countries, showing that weak revenues were experienced nationwide. Across the four constituent nations of the UK, businesses in Scotland saw the biggest fall, with the net balance of small businesses reporting revenue growth over the previous three months standing at -45.0%. In terms of sectoral performance, negative net balance scores were witnessed in all but one sector of suitably large sample size. The professional, scientific and technical activities sector saw a net balance of 4.1%, with 37.5% of businesses reporting an increase in revenue. This sector has seen an increase in demand for scientific and pharmaceutical research as a result of the pandemic highlighting the importance of these activities.

Expectations of business revenues over the coming three months experienced a resurgence with the net balance figure standing at 27.0%. This highlights the optimism that businesses have about the plans for lockdown easing in Q2 2021.

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



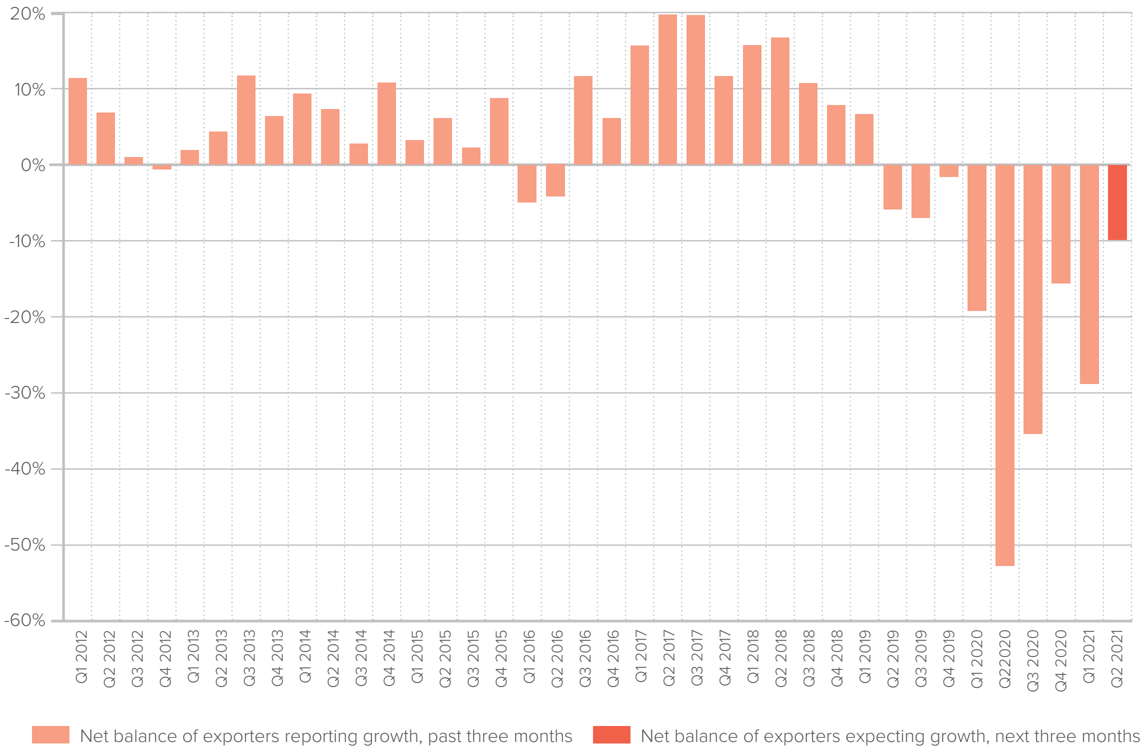
EXPORTS

BREXIT CONTINUES TO CAUSE EXPORT PESSIMISM

There was a fall in the net balance of exporters reporting growth in the value of their exports in Q1 2021 with the figure standing at -28.4%, down from -16.0% in Q4 2020. Although, the Q1 2021 figure is considerably up on the figures witnessed in Q2 2020 (-52.8%) and Q3 2020 (-35.2%).

Firms anticipate a less negative export landscape looking ahead to Q2 2021, however. The net balance of firms expecting growth in export values stands at -9.8%, up from a net balance of -29.0% in the previous report. The continued negativity results in large part from Brexit, after the UK-EU transition period ended in December 2020. This terminated free trade in services, and added bureaucracy associated with international trade, even though free trade in goods had been agreed. Meanwhile, the prospect of dwindling global activity amidst the ongoing coronavirus pandemic is a further factor, putting pressure on the demand base for the UK's exporting businesses.

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

RISING FUEL PRICES PLACE UPWARD PRESSURE ON COSTS

The net balance of small businesses reporting an increase in operating costs fell in Q1, to 23.3%, having previously stood at 27.7% in Q4 2020. Although, this is down by 25.9 percentage points compared to Q1 2020.

As was also the case in Q4 2020, the two most commonly cited sources of changing costs were labour and inputs, being selected by 26.2% and 30.1% of respondents, respectively. For a high share of businesses, labour costs have been at least partly covered by the CRJS scheme. However, for businesses which have not made use of this scheme, or been forced to make their workers redundant, wages have been rising. Growth in average total pay (including bonuses) among employees for the three to months January 2021 reached 4.8%, and growth in regular pay (excluding bonuses) increased to 4.2%. This rise in the average wage rate will be increasing costs for businesses.

The proportion of firms citing fuel as a main source of cost increases stood at 19.3%, representing an uptick of 4.3 percentage points between Q4 and Q1, the largest increase of any category. Energy prices have been rising recently, with the recovery of global oil prices being a key contributing factor. Furthermore, looking at year-on-year comparisons in energy costs, the base effect associated with the collapse of energy prices in 2020, as the first wave of the Covid-19 pandemic took hold, will make the annual rise in costs more severe in magnitude.

Taxation was quoted by 9.1% of businesses as having a key impact on costs. It was announced in the Budget in March that corporation tax will increase from its current rate of 19% to 25% in April 2023, which will lead to a rise in tax costs for businesses in the coming years. However, only businesses with profits higher than £250,000 will need to pay the highest rates.

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

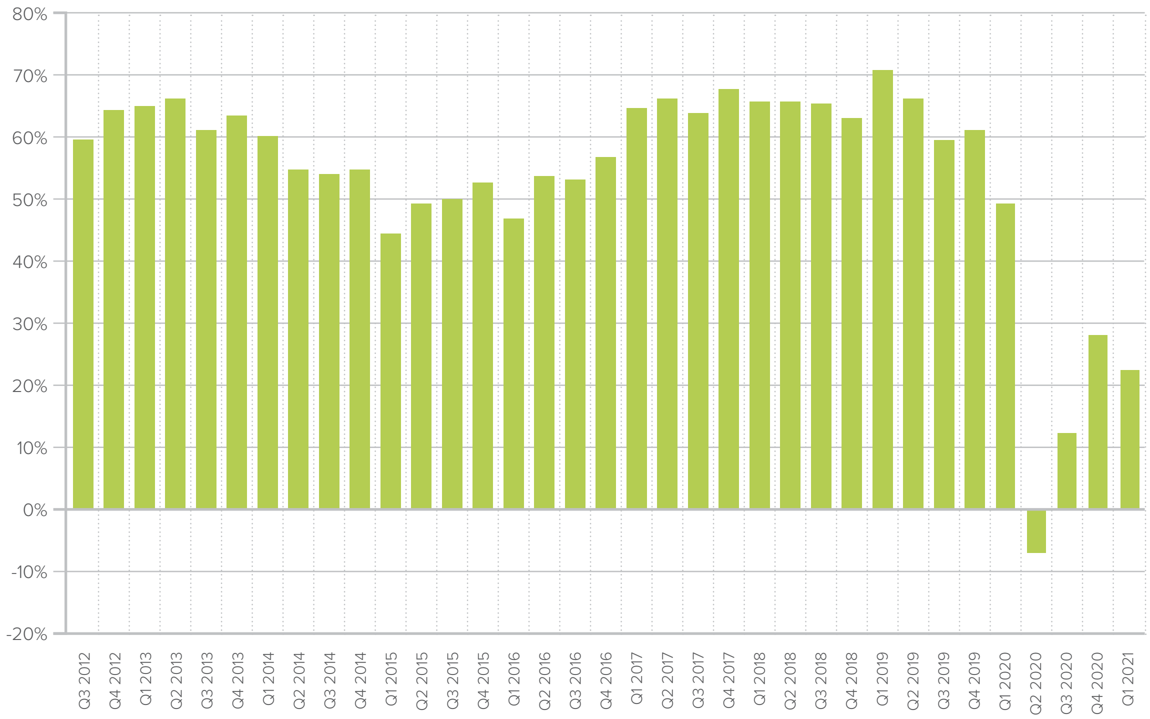
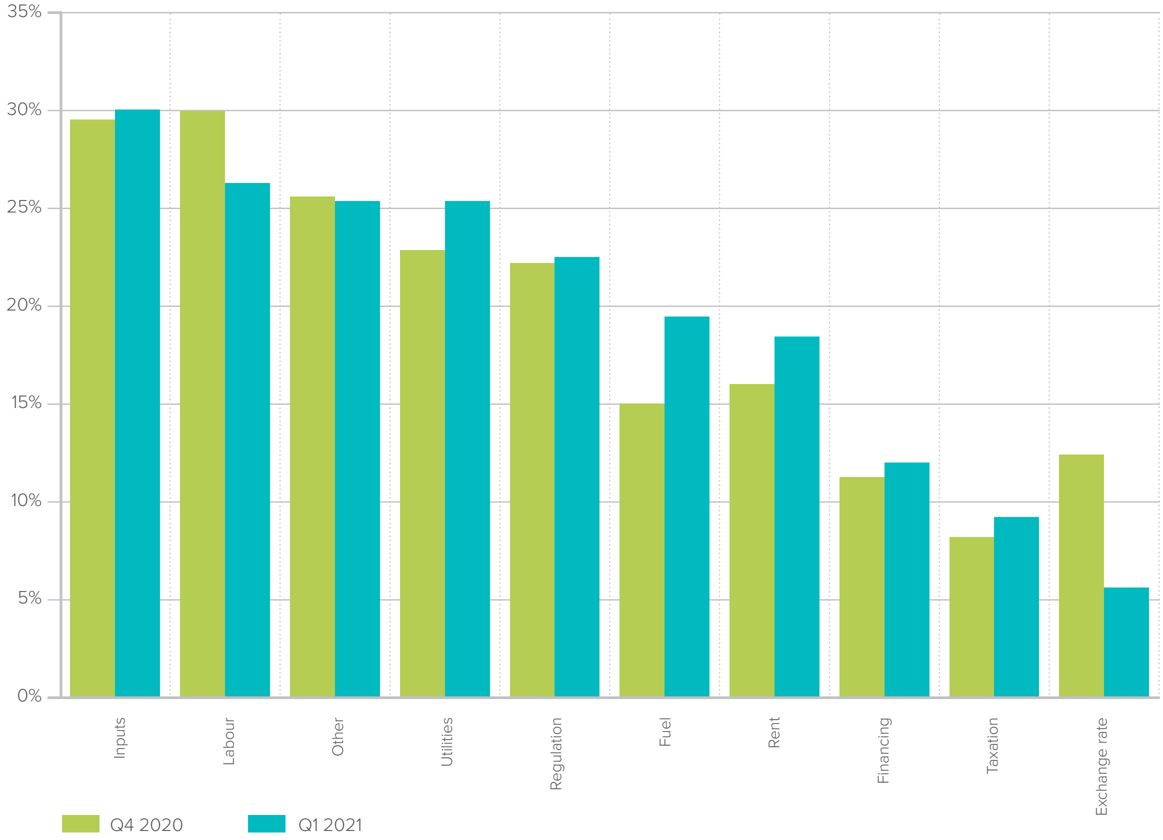


Figure 10: Main causes for changing business costs (firms may give multiple answers).
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CAPACITY

BUSINESSES' EXPECTATIONS OF SPARE CAPACITY IMPROVE TO LOWEST LEVEL IN A YEAR

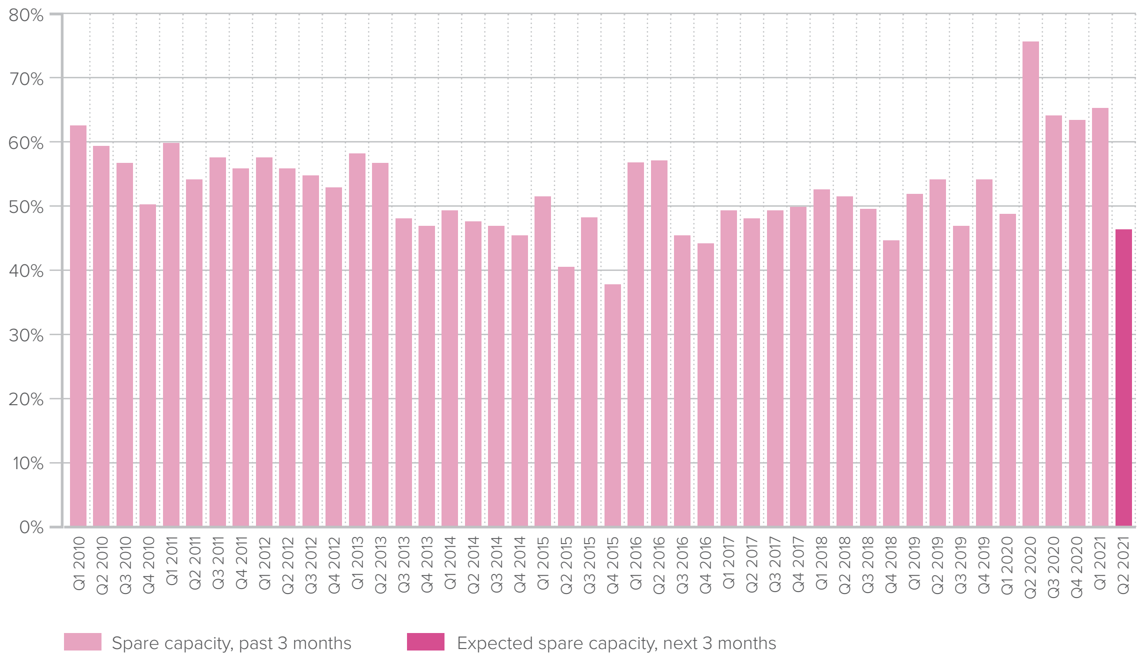
There was a high prevalence of businesses operating below capacity once again in Q1 2021. Businesses' assessments of their own capacity were largely unchanged from Q3 and Q4 2020. The net balance of businesses running below capacity was 65.3% in Q1, up slightly from 64.1% and 63.7% in Q3 and Q4 2020, respectively.

In the latest data, 72.1% of businesses reported below capacity operations. Meanwhile, the proportion of firms operating at or above capacity, stood at 27.9% in Q1.

Below capacity operations were most prevalent amongst businesses in Yorkshire and The Humber, being cited by 75.2% of SMEs in the region. Meanwhile, nearly all businesses in the accommodation & food services and arts, entertainment & recreation sectors were operating below capacity in Q1, with this being reported by over 96% of businesses in both industries.

On the upside, businesses' expectations of spare capacity in Q2 show a significant improvement. The proportion of firms expecting to run below capacity in the second quarter stands at 56.8%, down from a proportion of 70.5% expecting this in the previous quarter. Indeed, the net balance figure for Q2 expectations improved by 17.2 percentage points compared to expectations for Q1, reaching the lowest level since Q3 2019. This shows that the easing of lockdown has improved business optimism considerably.

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



EMPLOYMENT

FURLOUGH SCHEME PROTECTS JOBS IN Q1

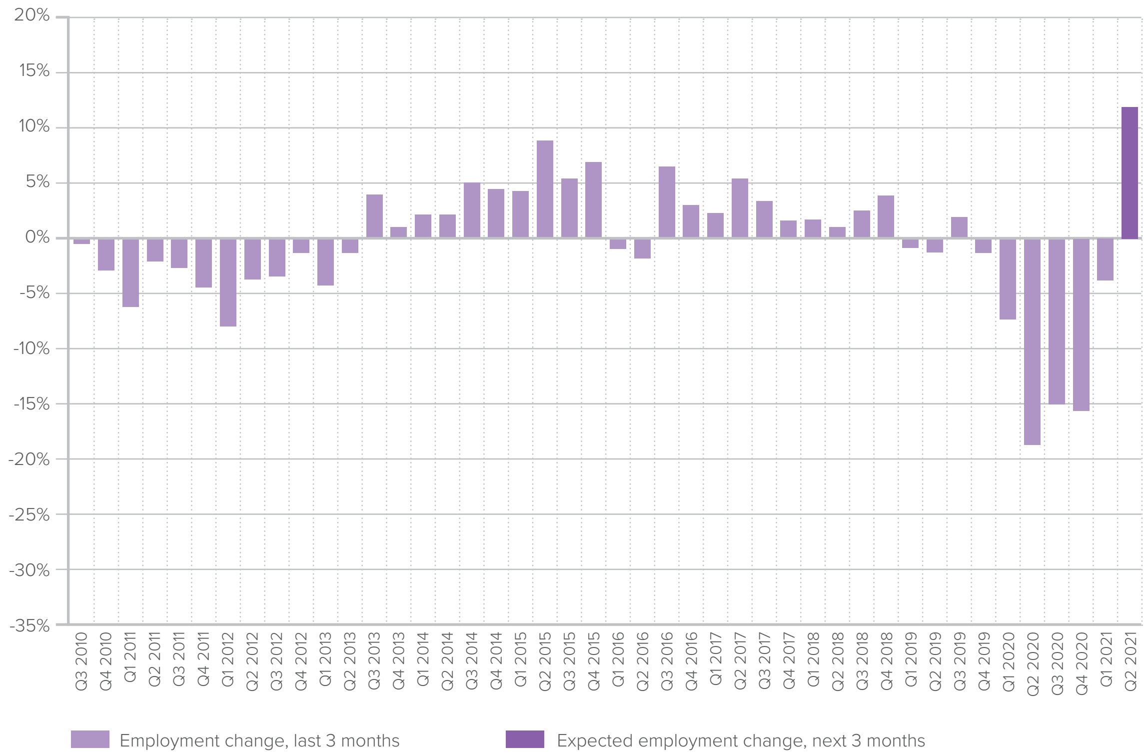
12.5% of our survey respondents reported cuts to the size of their workforce in Q1, down from 22.3% in Q4 2020, marking a significant improvement. This is the lowest figure seen since 2019, highlighting the impacts of the CRJS scheme in protecting jobs.

Looking at the data by region, workplace cuts were most prevalent the North East & Yorkshire and The Humber, where 16.1% of businesses saw decreases to the number of employees.

Considering the net percentage balance change in number of people employed, the figure rose to -3.5% in Q1 2021, up from -15.5% in Q4 2020. Looking ahead, the net balance of expectations stands at +12.0%, suggesting that the easing of restrictions on the economy is likely to cause an associated rise in employment. In the Budget, the Chancellor extended the furlough scheme, which will now run until the end of September, meaning government support for the labour market will continue throughout the entirety of Q2 and Q3.

Data from HMRC suggest that labour market conditions have stabilised in winter. There were an estimated 68,000 more people in payrolled employment in February than in January, for instance, marking the third consecutive month of improvement on this measure, despite lockdown measures. These figures suggest that the furlough scheme has been largely successful in “freezing” the labour market amid the winter wave of the Covid-19 pandemic. It is also important to note that the scheme was made more generous in November, by removing the requirement for employers to contribute 20% of furloughed employees’ wages, as had been the case in October.

Figure 12: Net percentage balance change in number of people employed – proportion reporting increase less proportion reporting decrease.
Source: FSB - Verve ‘Voice of Small Business’ Panel Survey.



FOURTH CONSECUTIVE QUARTER OF ANNUAL SALARY CONTRACTION AMONGST SMALL BUSINESS EMPLOYEES

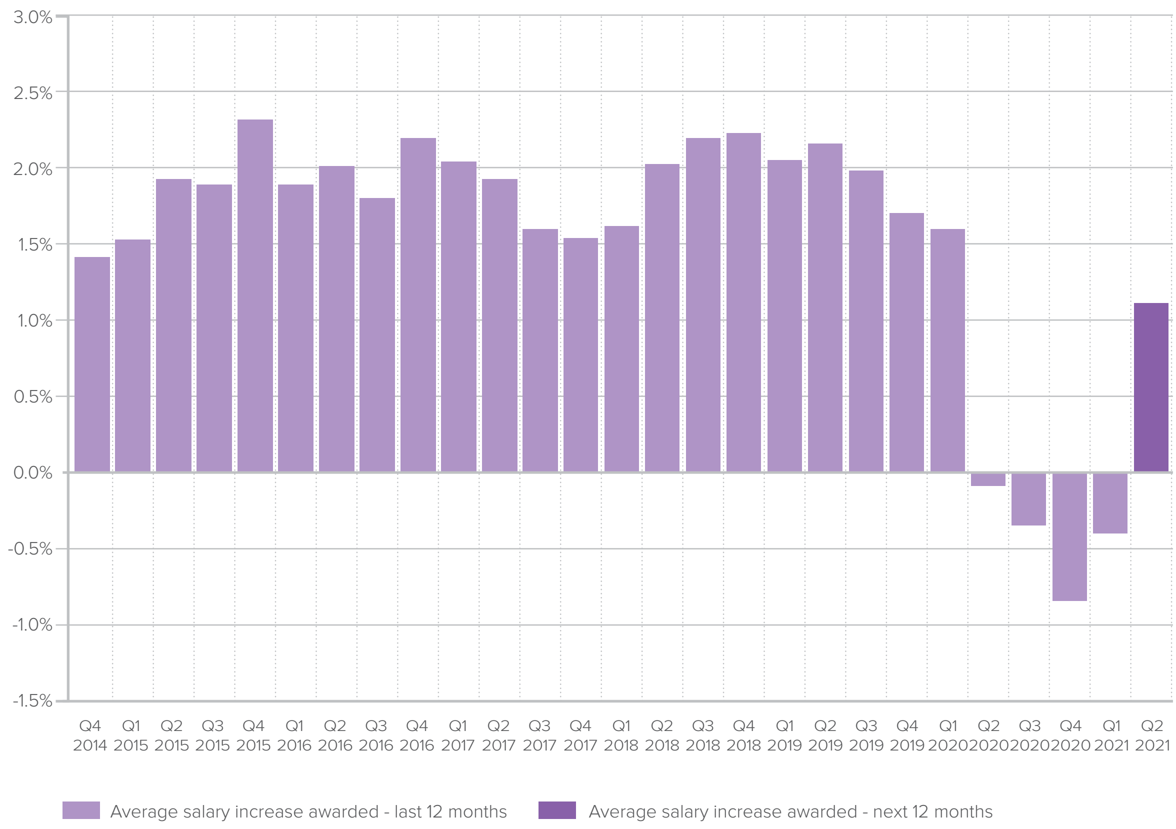
Wages at small businesses displayed a smaller contraction in Q1 than in Q4, with a 0.4% decrease. This does mark the fourth consecutive quarter of contraction, however. This continues to contrast with official data on the labour market, which have pointed to fairly strong wage growth in recent months. Annual growth in average employee pay continued to strengthen in the three months to January, with ONS data showing that growth in average total pay (including bonuses) increased to 4.8% in the three months to January 2021. However, much of this growth is being driven by compositional effects, such as the fall in the number and proportion of lower-paid employee jobs, as well as increased bonuses, which had been postponed earlier in 2020.

Another explanation for the discrepancy between the results in this report and official data is the differing experiences of small businesses compared to larger companies. With cash flows still weak and wider economic conditions fragile, small businesses are likely to have less capacity for wage growth compared to their larger counterparts, who may be better able to weather the storm due to economies of scale.

Looking across regions, wage cuts have been most frequent amongst firms in London, where 22.5% of firms reported an annual reduction in average salaries. Meanwhile, across industries with suitable sample sizes, accommodation and food service activities saw the highest share of businesses reporting wage cuts, at 27.7%.

Looking ahead, small businesses expect a return to wage growth in the coming year, with data pointing to an average salary increase of 1.1%. This likely reflects businesses' hopefulness for increasing revenues as the economy opens up.

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



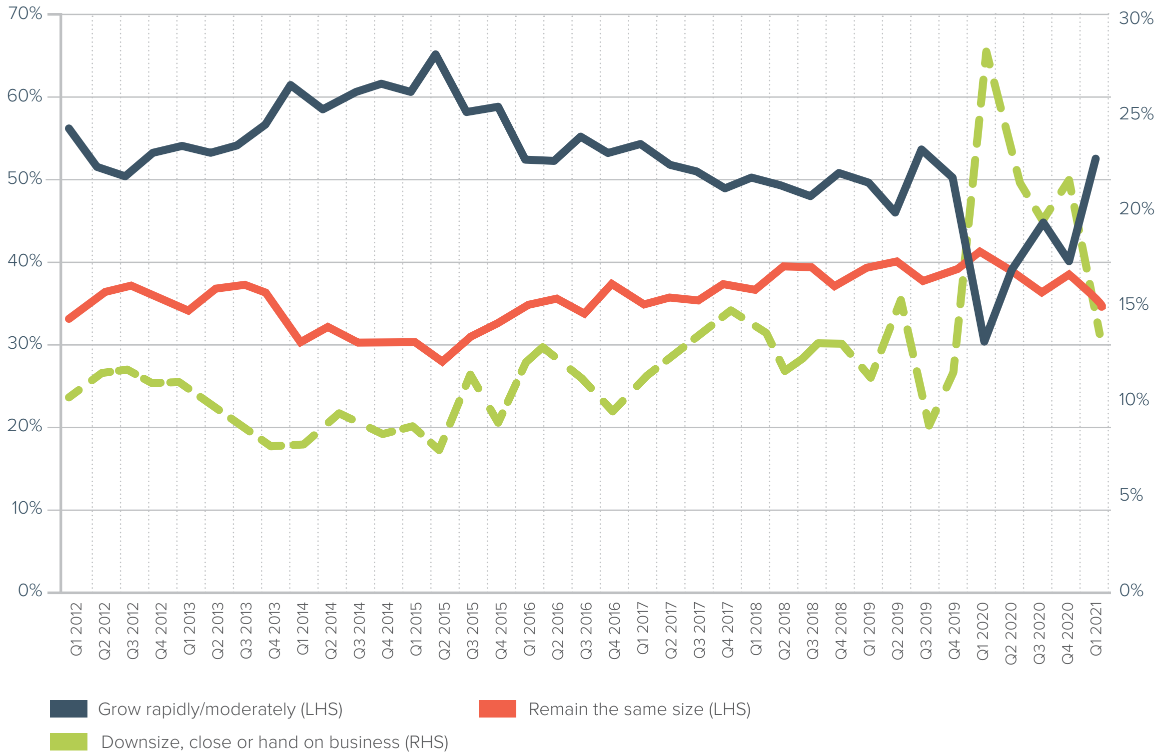
GROWTH ASPIRATIONS AND CHALLENGES

SHARE OF BUSINESSES ASPIRING TO GROW RISES BY MOST ON RECORD

The share of businesses saying that they are aspiring to grow over the next 12 months increased from 39.9% in Q4 2020 to 52.7% in Q1 2021, which is a 12.8 percentage point increase. This is also the largest quarterly percentage point rise since records began in 2012. Meanwhile, the share expecting to shrink fell to 12.8%. Across the four nations of the UK, businesses in England were most likely to say they aspire to grow, at 53.7%.

1.9% of respondents anticipated closing their business for good in the coming 12 months, the joint lowest since Q2 2017. Out of the 12 regions of the UK, businesses in Scotland were most likely to say that they expected to close down, at 4.8%.

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



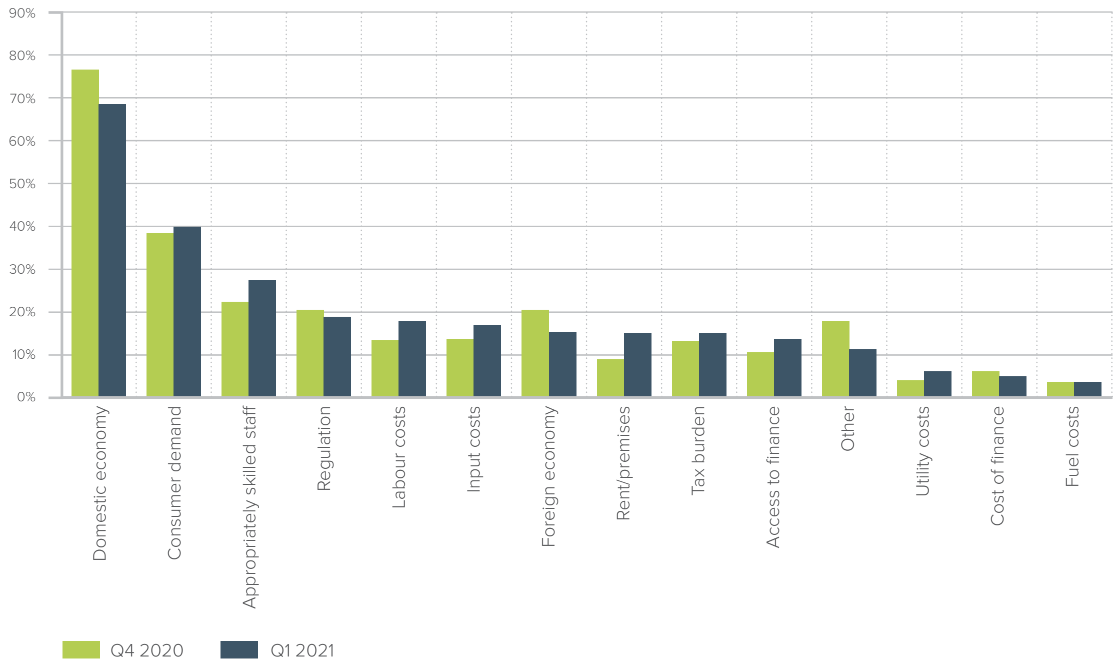
BREXIT DEAL ALLEVIATES FOREIGN TRADE WORST FEARS

As was the case in Q4, the domestic economy and consumer demand are the two most commonly cited options when considering potential barriers to growth. Respectively, 68.5% and 39.5% of businesses considered these categories as growth barriers in Q1 2021. The figure for consumer demand was up compared to Q4.

The share of businesses reporting appropriately skilled staff as a potential barrier increased to 27.3% in Q1, up from 22.7% in Q4. With many UK workers having been on furlough for many months, they are likely to have experienced a deterioration of their skills due to lack of use. It may be that many employers are required to update their workers' skills before they return from furlough.

The foreign economy became less of a concern to businesses in Q1, falling from 19.8% to 14.9% of businesses considering it to be a growth barrier. The Brexit deal was agreed in the final days of Q4 2020, meaning that Q4 was marked by much uncertainty for exporting businesses, which was alleviated in Q1. Although the deal meant that businesses cannot trade as smoothly with the EU as was the case when the UK was a member state, the deal ensured free movement of goods, meaning most disruption is confined to service-based businesses.

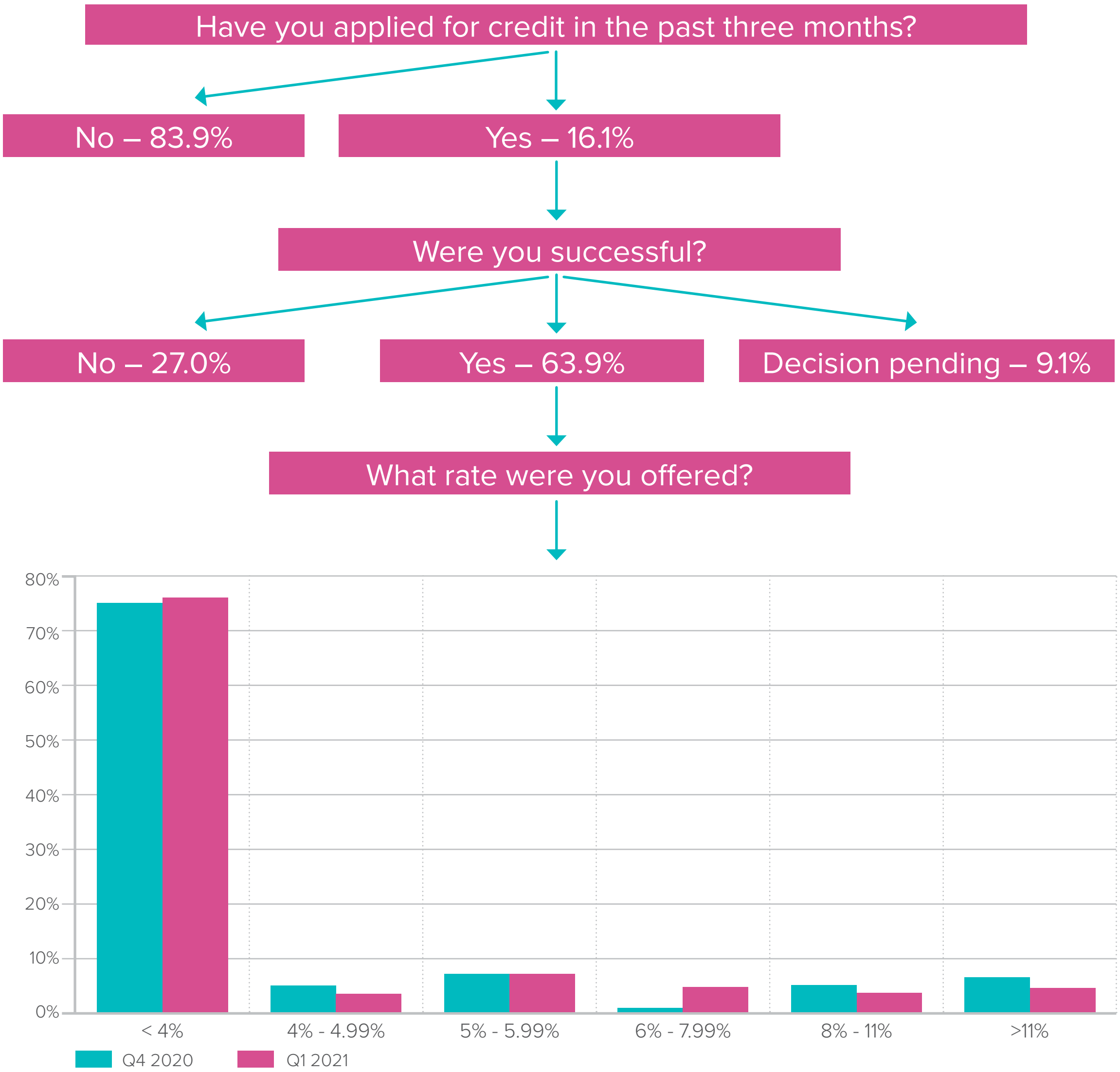
Figure 15: Potential barriers to achieving growth aspirations – multiple answers possible.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CREDIT

SHARE OF BUSINESSES MAKING CREDIT REQUESTS FALLS AGAIN

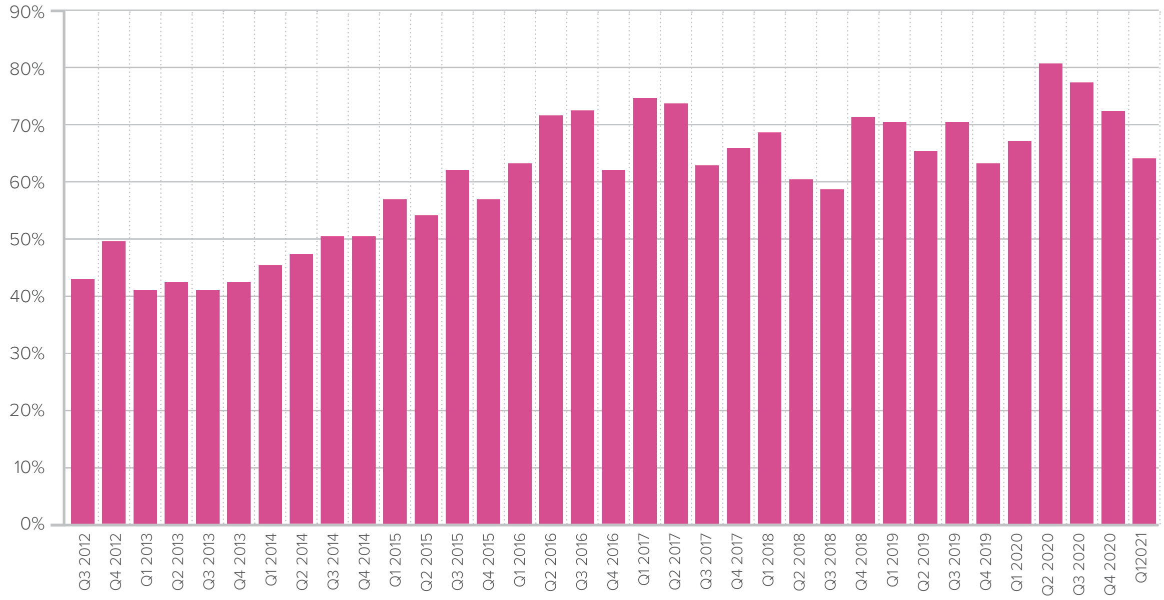
Figure 16: Credit applications and interest rates offered.
Source: FSB - Verve 'Voice of Small Business' Panel Survey. Respondents were able to give multiple answers to this question.



There was a further drop in the proportion of businesses applying for credit in Q1, with only 16.1% of surveyed SMEs doing so in the first three months of 2021. This is down from 28.4% in Q3 2020 and 18.5% in Q4 2020. This return to more normal rates of borrowing suggests that firms are in a more stable financial situation than in the height of lockdown in 2020, and the immediate aftermath.

A higher share of businesses were unsuccessful in their application for credit than previously, at 27.0% in Q1 2021, compared to 13.2% in Q4 2020. This is perhaps reflective of greater risk sensitivity amongst lenders in a landscape of continued uncertainty as the pandemic rages on. A larger proportion of requestees were offered a rate of less than 4% in Q1 than in Q4, at 76.1%.

Figure 17: Proportion of small businesses successful in their credit applications in the past three months
Source: FSB - Verve 'Voice of Small Business' Panel Survey.

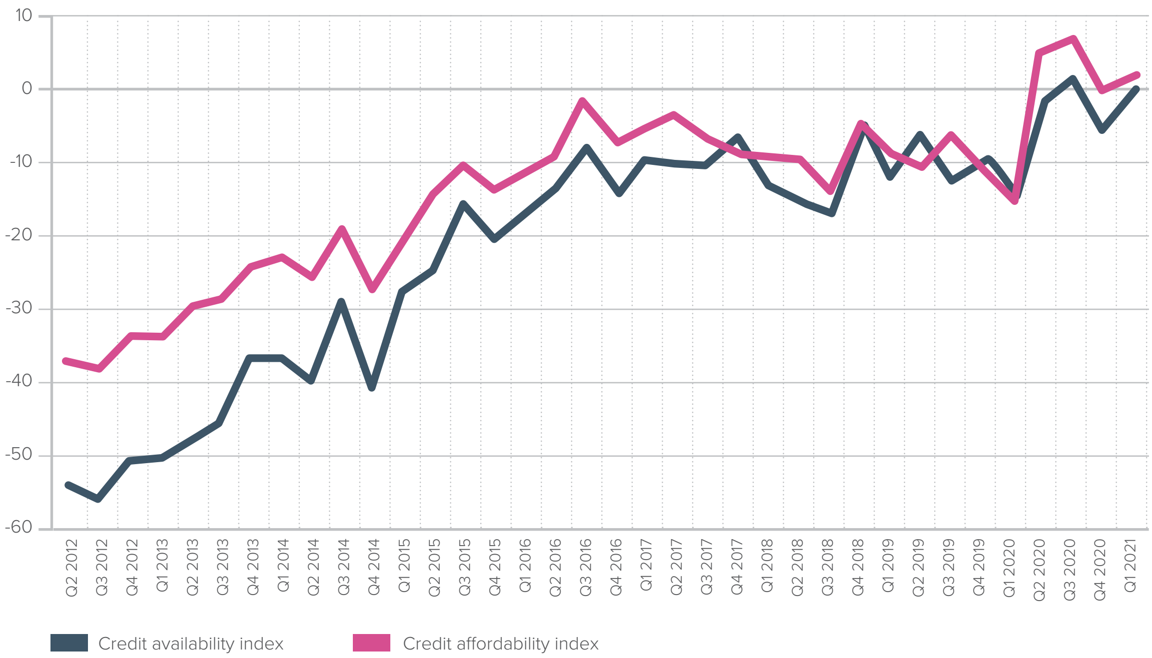


CREDIT AVAILABILITY AND AFFORDABILITY INDICES RISE, BUT STAND BELOW Q3'S RECORD LEVELS

35.2% of SMEs said that the overall availability of new credit for small businesses is very good or quite good in Q1, up from 29.3% in Q4 2020. This allowed the credit availability index to pick up to -0.5, from -5.2 in the previous quarter. Although, this is still lower than the Q3 value of 1.3. Since the coronavirus crisis has hit the economy, and businesses in particular, the government has introduced policies to make credit more accessible, by guaranteeing a proportion of the loans that lenders offer.

Furthermore, the share of businesses reporting that they would rate the overall affordability of new credit as affordable stood at 38.3% in Q1, compared to 31.2% who said unaffordable. This meant that the affordability index rose to 1.9 in Q1, up from -0.1 in Q4.

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



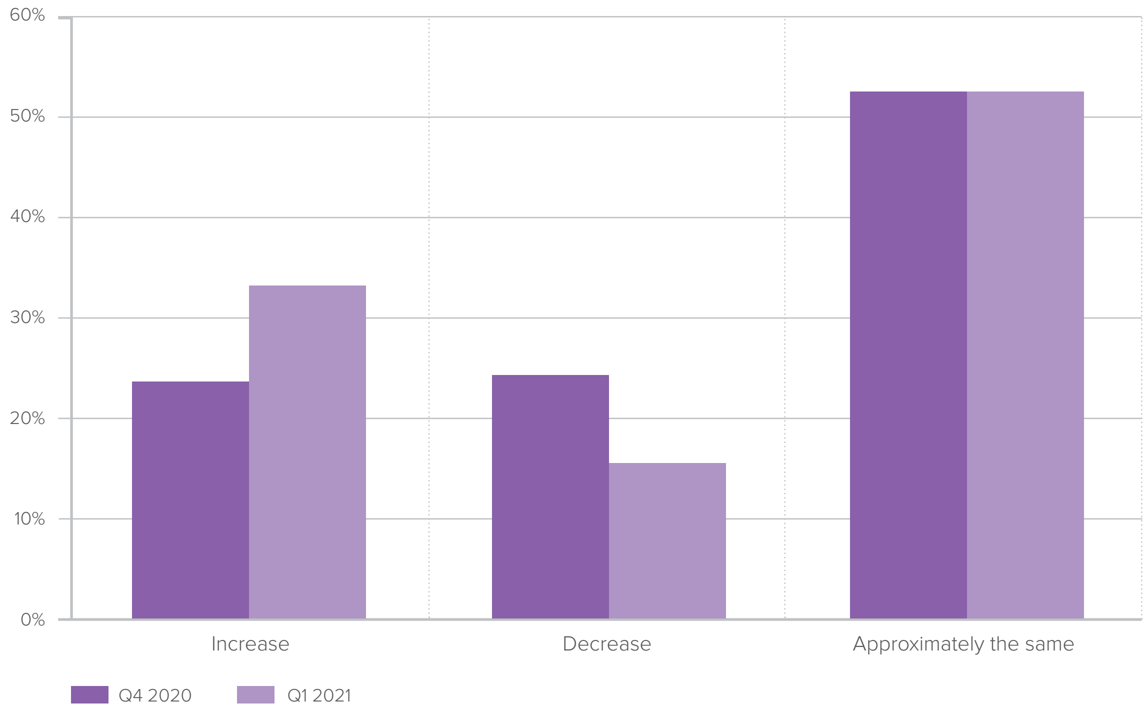
INVESTMENT AND PRODUCTIVITY

INVESTMENT OUTLOOK IMPROVES IN Q1 THANKS TO BUDGET ANNOUNCEMENTS

The latest results show that 32.8% of respondents anticipate increased investment levels in the coming quarter, compared to only 15.0% expecting investment cuts. As such, the net balance of firms anticipating investment growth jumped back into positive territory, after standing in negative territory in Q4. The planned opening up of the economy according to the Government's roadmap has allowed businesses to hope for a pickup in activity for the rest of 2021. Furthermore, the announcement in the Budget of a tax super-deduction for business investment will be encouraging businesses to increase spending in this capacity. The deduction means that when companies invest, they will be able to reduce their tax bill by 130% of the cost of the investment. This will only be of benefit to businesses already paying enough tax to cover the 130% deduction and will only be applicable to investments in plant and machinery assets. Nevertheless, the Office for Budget Responsibility does expect that it will bring forward a large amount of planned investment.

Looking across the regions of the UK, businesses in the North West were the most likely to say that they anticipate an increase in investment, with this being cited by 38.9%. Across industries, those in the manufacturing sector were most likely to expect an increase, at 38.3% of respondents. Businesses in this industry are most likely to be able to take advantage of the super-deduction, given the scope of applicable investments.

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



METHODOLOGY

These tables are based on the Q1 2020 research survey of 1,684 FSB members carried out by Verve. The data is weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 8th and 22nd March 2021.

SUMMARY DATA TABLE

	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Small Business Index	-8.8	-8.1	-21.6	-143.4	-5.0	-32.6	-49.3	27.3
Employment - previous three months	-1.5%	1.9%	-1.5%	-7.6%	-19.0%	-15.2%	-15.5%	-3.5%
Employment - coming three months	10.2%	5.1%	3.5%	-27.9%	-7.9%	-6.7%	-3.8%	12.0%
Exports - previous three months	-5.8%	-7.1%	-1.6%	-19.1%	-52.8%	-35.2%	-16.0%	-28.4%
Exports - coming three months	11.4%	-4.1%	-9.5%	-52.4%	-12.8%	-18.9%	-29.0%	-9.8%
Credit availability - rated good or very good	28.9%	25.7%	27.5%	24.4%	38.3%	36.4%	29.3%	35.2%
Credit availability - rated poor or very poor	33.7%	39.4%	34.7%	41.6%	34.9%	30.9%	30.5%	30.1%
Credit affordability - rated good or very good	27.3%	28.1%	28.1%	25.7%	41.8%	43.0%	36.5%	38.3%
Credit affordability - rated poor or very poor	43.2%	33.8%	39.9%	44.0%	31.9%	28.3%	30.3%	31.2%

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.

Q1

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