Q3

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 3, 2022

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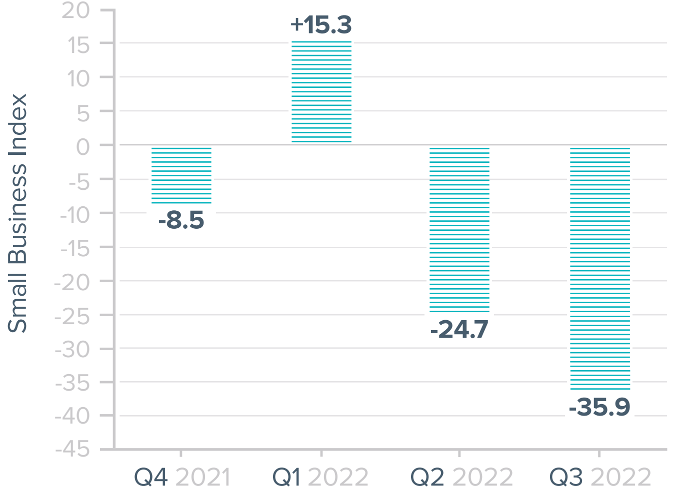
SBI Q3 2022

"Confidence plummets to lowest on record outside of lockdowns"

Small business confidence reading falls to **record low outside lockdowns**



Growth ambitions reflect **challenging environment**

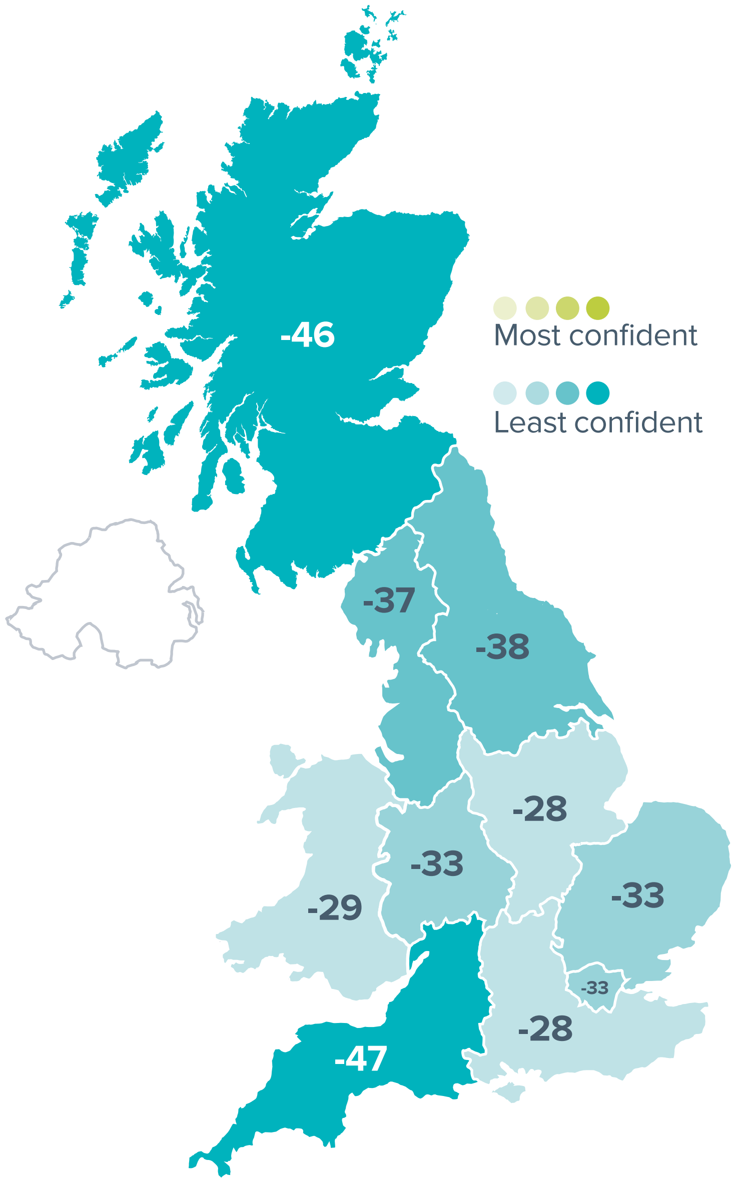
Just **47%** of small businesses **aspire to grow** over the next 12 months

Small businesses finding **international trade increasingly difficult**

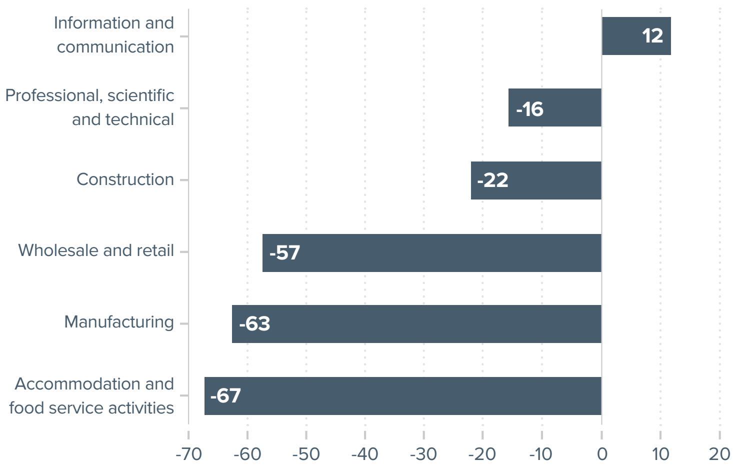
41% of small businesses who export saw a **decrease in their export value** in Q3

Cost of finance continues to grow

More than 20% of small businesses applying were **offered interest rates above 11%**



Small business confidence by sector



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FSB FOREWORD

The third quarter of 2022 has been another downbeat one for small businesses, following on from the plunge back into negative confidence in the second quarter.

The biggest business story of the summer and early autumn was without doubt the shocking rise in energy bills, with FSB members reporting manyfold increases compared to a year ago. Some business owners, when receiving their new bills, initially thought the amounts listed were misprints because they were so out of line the numbers were with what they had previously been paying.

FSB worked tirelessly to get this issue onto the media and political agenda, and our efforts paid off when one of the first acts of the short-lived Truss administration was to announce a package of support for businesses as well as households on energy costs.

However, the damage to small businesses' margins caused by spiralling gas and electricity prices has clearly been reflected in the Q3 confidence reading, the lowest ever outside periods of lockdown.

Businesses in accommodation and food services saw their confidence reading plunge from -29.1 in the second quarter to a staggering -67.5 in the most recent survey, as consumer confidence fell to new record lows and staff shortages persisted for many firms. The appalling reading for the hospitality sector is also a reminder that businesses in sectors outside those officially designated as "energy-intensive" will need confidence that the rises in their utility bills will be tempered – a small café whose coffee machine is too expensive to run, a boutique hotel which needs to heat rooms for guests, or a bakery which can't afford to turn the ovens on are affected by rising bills just as much as a steelmaker or a chemical plant.

Adding to the pain, inflation for more or less everything else, not just energy, continued to rise across the quarter. Once again, this impact was reflected in the proportion of respondents saying that prices were higher than in the same quarter last year, which matched nearly exactly the Q2 finding for this, at 88.7% (Q2: 89.0%).

There were economic warning signs in many other areas, too, from a net balance of -4.4% of small firms reporting a rise in employee numbers over the quarter – the lowest such reading since the second lockdown in Q4 2020 – to concerns about consumer demand rising to become the second-most cited barrier to growth, cited by 32.9% of respondents, behind concerns about the domestic economy (60.6%).

Revenues generally suffered over the period: those reporting revenue growth or a flat performance were outnumbered by those noting a drop in revenues, with a net balance of -11.8%. Hopes for the future look to be subdued, with small businesses expecting to see their revenues increase over the coming quarter outweighed by the proportion expecting to see a drop-off (30.8% expect revenues to increase against 40.6% who expect them to decrease).

In marginally better news, the net proportion of small businesses aspiring to grow over the next 12 months grew slightly, from 46.6% in Q2 to 47.4% in Q3, while the corresponding figure of those expecting to contract fell very slightly, from 14.7% to 14.1% over the same period. However, both readings are notably worse than those registered in the same quarter last year (53.1% expected to grow and 11.2% expected to contract), showing how small businesses' expectations have deteriorated over the previous 12 months.

The summer was taken up on the political scene by the race to become the next Prime Minister. The measures included in the mini-Budget at the end of September have since been largely unwound, although we were glad to see that the reversal of the increases to National Insurance was retained, ameliorating a significant cost pressure for small businesses and self-employed people. It was, however, disappointing that the increase to the dividends tax was not reversed alongside NICs, an oversight which has caused much financial pain to many in the small business community.

The recent Autumn Statement was far from a recipe for economic growth, meanwhile, and will add considerably to the tax burden borne by small firms and self-employed people. Stealth taxation will eat away at margins already hard-pressed by recessionary forces, with alarm bells ringing over GDP, which fell in the third quarter. We will continue to make the case that supporting the UK's 5.5 million small businesses must be as high as possible on the political agenda, as their success is integral to the economy's prospects, and there can be no growth if small firms are left behind.

Martin McTague,
National Chair

Tina McKenzie,
Policy & Advocacy Chair

ECONOMIST'S VIEW

Kay Daniel Neufeld, Head of Forecasting and Thought Leadership

The Small Business Index (SBI) continued its downward trend as it fell to -35.9 points in Q3, down by 11.2 points from the previous quarter. The index now stands 52.3 points lower compared to the same quarter last year, which amounts to the largest annual fall on record, with exception of Q1 2020, during the initial phases of the pandemic. The large annual decline highlights the deterioration in the economic outlook over the past months as high energy prices, weakening consumer demand, and rising interest rates have created a perfect storm for UK small businesses.

On energy costs, the Government unveiled the Energy Bill Relief Scheme in September, which provides a discount on the wholesale cost of electricity and gas for businesses between October 2022 and March 2023. A similar price cap for households will be in place for at least as long, limiting the annual cost for a typical household at £2,500. The measures will help to mitigate the impact of rising energy costs for both households and businesses over the winter, which had threatened to cause severe financial hardship. We also now expect inflation to peak earlier and at a lower rate, compared to our forecasts prior to the introduction of the price cap. Despite this, the increasingly broad-based nature of inflation means that the Bank of England is likely to continue its course of monetary tightening. Rising borrowing costs will act as a drag on growth in the coming months, something that is acutely felt by UK SMEs. Indeed, the credit availability and affordability index fell back to -21.7 in Q3, down from -19.8 in Q2.

Looking at small business confidence by sector reveals the exceptionally bleak outlook for the accommodation and food services industry, where sentiment fell further into negative territory. The SBI score for the sector decreased by 38.4 points to -67.5 points in Q3. Despite the government's intervention in energy markets, consumers are still on track for a record fall in real disposable household incomes this year, which points to weaker consumer demand for often non-essential hospitality services in the coming months. The information and communication sector continues to show relatively stronger performance, with the SBI rising on the quarter to stand at 12.2 points, making it the only sector to exhibit a positive reading.

The widespread deterioration in the economic outlook is reflected in the regional SBI scores. With the exception of the South East and the East Midlands, all of the UK's regions and constituent nations have recorded a quarterly fall in small business confidence. The largest decline was seen in the East of England (-23.0 points), followed by London (-19.5 points), highlighting the fact that pessimism is rising also in the regions that are home to a large number of businesses in high value-added industries such as life sciences, tech and finance. The South West recorded the lowest SBI score in the third quarter, at -46.6 points, followed by Scotland, at -45.7 points. Meanwhile, the North East saw the highest score, at-18.2 points, followed by the East Midlands, at -27.5 points.

The outlook for the coming months remains a challenging one, as economic growth continues to slow. Our central forecast scenario shows the UK economy falling into recession by the end of the year and continuing to contract during the first quarter of 2023. High inflation and low consumer confidence mean that worries about the domestic economy and consumer demand remain the top two concerns for UK SMEs when asked about barriers to achieving their growth aspirations. The political and economic turmoil of recent weeks provides a further headwind for businesses, as the Government first announced a large set of unfunded tax cuts in a 'mini-budget' on 23rd September, only to then reverse almost the entire set of measures three weeks later in a bid to calm financial markets and lower the cost of borrowing. The frequent and abrupt changes in the tax code and the ongoing uncertainty about the direction that economic policy is headed will add to uncertainty and weigh on businesses' decision making in the coming months.

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index (SBI) fell to -35.9 in Q3 2022.** This marks a second consecutive quarterly fall as well as the second consecutive quarter in which the Index has stood in negative territory.
- **For the second consecutive quarter, the SBI stood in negative territory across all regions in Q3.** Only two regions, the East Midlands and South East, recorded a quarterly improvement, which saw the former become the highest-ranking region, with a reading of -27.5 points.
- **The SBI deteriorated across most major industries in Q3 2022.** The sharpest contraction was seen amongst businesses in accommodation and food services, amounting to a quarterly fall of 38.4 points. These businesses have been particularly impacted by the cost-of-living crisis, with consumers withdrawing cutting back on discretionary spending.
- **The net balance of small businesses reporting revenue growth over the previous three months stood at -11.8% in Q3 2022.** This marked the second consecutive negative reading on this measure. Wholesale and retail, another sector disproportionately impacted by the cost-of-living crisis, saw a particularly weak reading on this measure, of -26.05%.
- **The net balance of small businesses reporting an increase in operating costs stood at 85.4% in Q3. This followed a net balance of 85.9% in Q2, marking the first quarter since Q1 2021 in which this reading has fallen, albeit only marginally.** It should be noted that the 85.4% figure remains the second-highest net balance figure on this measure since data collection began. This illustrates the extent to which businesses continue to face cost pressures.
- **Utilities represented the most commonly cited cause of changing costs amongst businesses in Q3, being the case for 60.3% of survey respondents.** There was a sharp uptick in the portion of firms citing the exchange rate as a source of cost changes, reflecting the weaker pound towards the end of the quarter.
- **A net balance of -4.4% of small businesses reported growth in their employee numbers in Q3, down from -3.6% in Q2.** This marked the most negative reading since Q4 2020, when the UK grappled with its second national lockdown.
- **As of Q3 2022, 47.4% of small businesses expect to grow over the coming 12 months. The share of businesses expecting to downsize or close stands at 14.1%.** The net balance thus stands at 33.3%, slightly up on Q2's figure of 31.9%. The net balance remains relatively weak. For comparison, the net balance stood at 41.9% this time a year ago.
- **The domestic economy is the most commonly cited potential barrier to growth amongst businesses expecting to expand over the coming year, being cited by 60.6% of respondents.** There was an increase in the share of businesses citing consumer demand, reaching 32.9%, reflecting expectations that consumer demand will weaken significantly as a result of falling real household incomes.
- **The share of small businesses applying for credit rose to 12.6% in Q3, from 11.5% in Q2.** This came despite a near doubling of the Bank of England's base rate over the quarter and could point to a growing need for businesses to cover cost shortfalls.

UK MACROECONOMIC OVERVIEW

UK economy set to enter recession with weakness seen across major sectors

The UK economy grew by 0.2% in Q2, according to the latest data from the Office for National Statistics (ONS). This was upwardly revised from an initial estimate of a 0.1% contraction. Despite this upward revision, it is clear that growth is weakening, having slowed for four consecutive quarters and the latest monthly figures showing a 0.3% contraction in August.

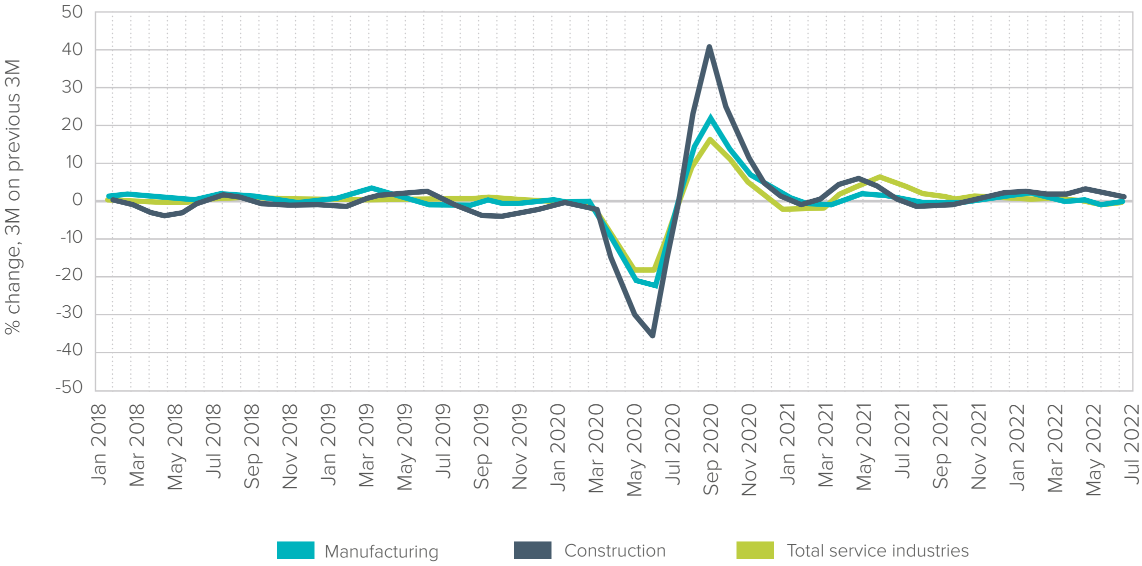
A worsening of this trend is anticipated, with the UK economy expected to enter a recession in the second half of this year. Cebr is currently a forecasting contractions in Q3 and Q4 2022, as well as in Q1 2023. This recession is set to be driven by a number of economic headwinds from both the demand- and supply-side, including from the cost-of-living crisis, rising input costs, and tighter monetary policy.

Manufacturing is one of the sectors most likely to be affected by supply-side problems, notably from the perspective of rising input and energy prices. There is evidence that this has impacted output across Q3, with the Manufacturing PMI having fallen below 50.0, the point dividing contraction from expansion, in both August and September.

The services sector is more likely to be impacted by the cost-of-living crisis. Within services, subsectors that are more consumer-focused will bear disproportionate effects, with consumers likely to reduce discretionary expenditures amidst weakening spending power. According to the latest Services PMI, output stagnated in September, with a reading of 50.0.

Construction has also experienced some weakness in Q3, with the PMI reading for the sector indicating contraction in both July and August. Similar to manufacturing, construction has been impacted by rising input prices, curtailing output. There was some near-term positivity in September, however, as the PMI returned to positive territory at 52.3.

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

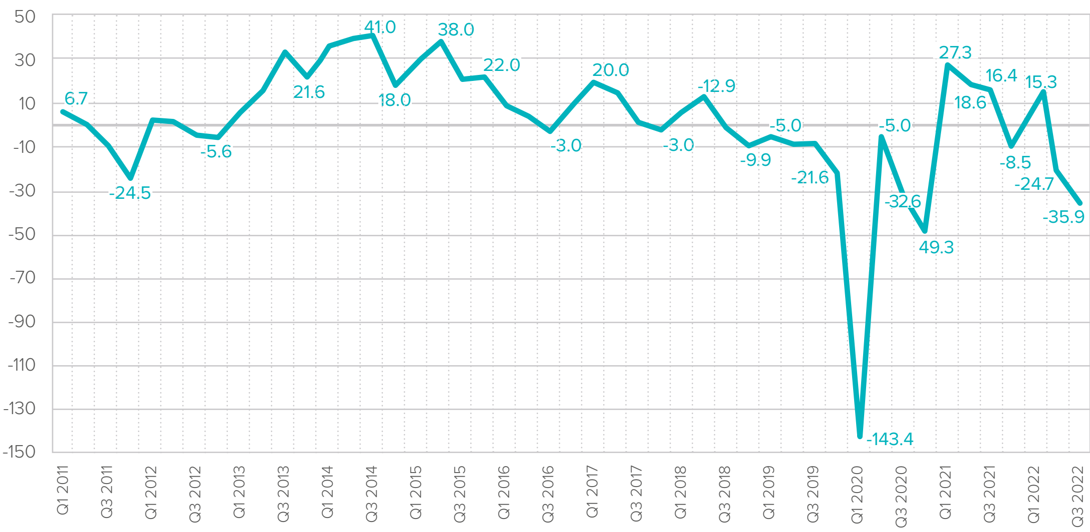
Small Business Index slumps again amidst expected recession

The Small Business Index (SBI) fell to -35.9 in Q3 2022. This marks a second consecutive quarterly fall and the second consecutive quarter in which the Index has stood in negative territory. The negative reading means that the proportion of small businesses expecting an improvement in prospects over the coming quarter is exceed by the proportion of firms expecting prospects to worsen. The SBI is once more at its weakest point since Q4 2020, when the UK experienced the second national lockdown and was just about to enter a third round of national restrictions.

On an annual basis, the SBI suffered a fall of 52.3 points. This is the second-largest annual drop in the Index's history, only being exceeded by the fall of 138.4 points in Q1 2020, when the pandemic first hit the UK. The stark annual fall in Q3 illustrates the significant change in the business landscape over the past year, as the optimism following the removal of pandemic restrictions was replaced by an unstable business environment, characterised by price pressures, lower consumer demand, and other headwinds.

These headwinds have had an adverse effect on economic output. The latest gross domestic product (GDP) data from the ONS showed a 0.3% monthly contraction in August. Further contractions are anticipated over the coming months, with this set to induce a recession. Cebr is currently forecasting contractions across Q3, Q4, and Q1 2023. During this period, additional weak readings on the SBI should be expected.

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

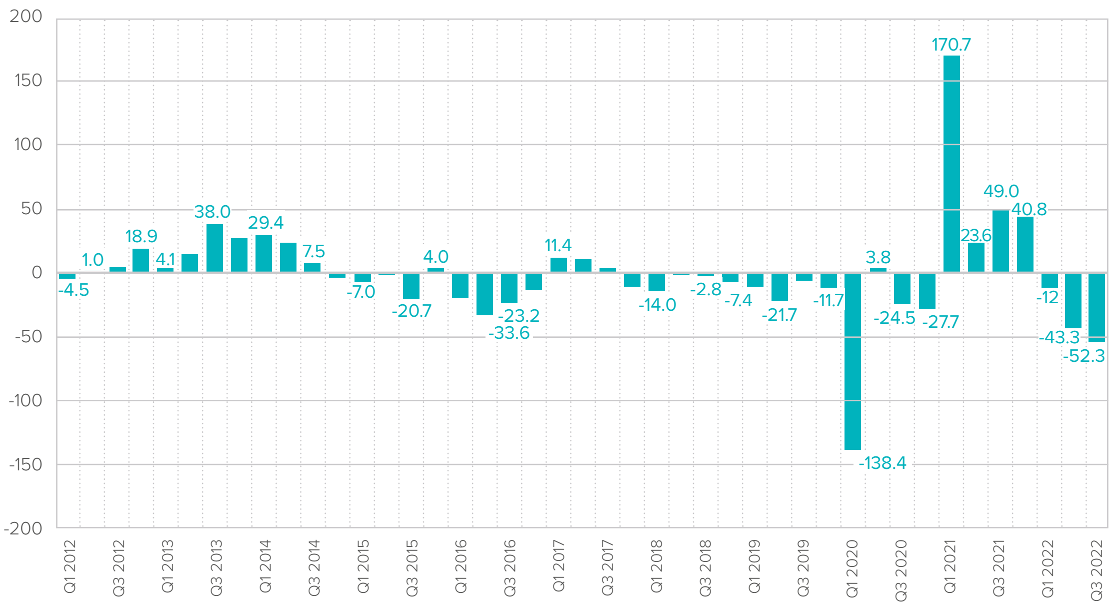
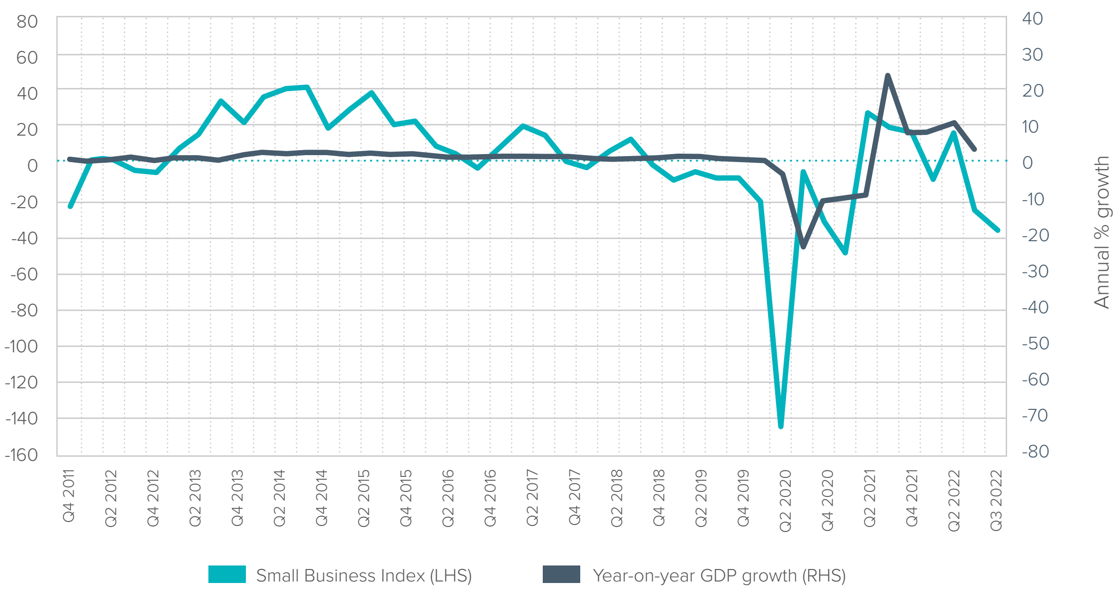


Figure four: UK SBI against year-on-year UK GDP growth
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey



REGION AND NATION SMALL BUSINESS INDICES

SMALL BUSINESS INDEX REMAINS FIRMLY NEGATIVE IN ALL REGIONS ACROSS Q3, WITH JUST TWO SEEING AN UPTICK

As was the case in Q2, all regions saw a negative reading on the regional SBI in Q3. A quarterly rise was seen in only two regions, the East Midlands and South East, which now have the least negative readings among all regions at -27.5 and -27.9, respectively. Meanwhile, the sharpest quarterly downturn was seen in the East of England, where the regional SBI fell by 23.0 points to stand at -33.3. This caused the East to lose its position as the highest-ranking region to the East Midlands. In London, the regional SBI fell by 19.5 points, the second-largest quarterly decline, to also reach -33.3.

Given the widespread nature of the energy price pressures faced in Q3, in addition to those caused by rising interest rates, it is perhaps unsurprising that all regions remain firmly in negative territory, with most continuing to free-fall. Looking ahead, regions with core industries specialising in luxury goods and services, including tourism, may be expected to suffer most severely from the anticipated recession and weakening consumer demand. However, also businesses that struggle to absorb higher utility costs will also be put under pressure. This is expected to particularly bite following Q1 2023, when Government support for businesses under the Energy Bill Relief Scheme is set to expire.

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

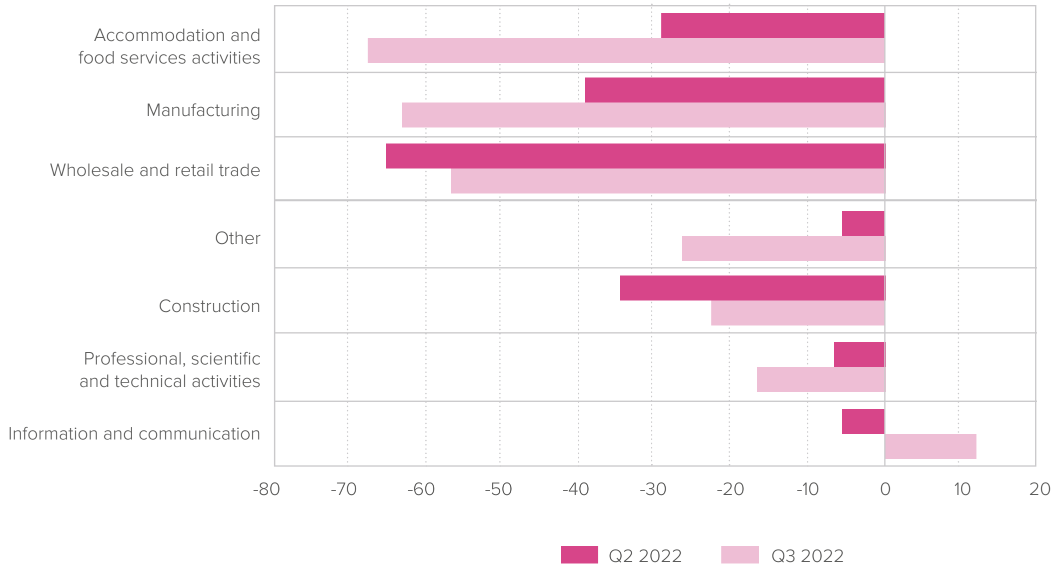
WEAK ECONOMIC CONDITIONS RESULT IN NEGATIVE SBI READINGS FOR MOST MAJOR INDUSTRIES

The SBI deteriorated across most major industries in Q3 2022, relative to Q2. The sharpest contraction was seen amongst businesses in accommodation and food services, amounting to a quarterly fall of 38.4 points. Most major industries saw a negative SBI reading in Q3, with information and communication proving to be the only exception, rising into positive territory with a reading of 12.2.

Accommodation and food services saw the weakest SBI reading in Q3, at -67.5. This sector has been hit particularly hard by the cost-of-living crisis. Amidst rising inflation and a shortfall in wage growth, real spending power has fallen considerably over recent months. Activity has fallen as a result, with consumers reducing the more discretionary elements of their expenditure. Similar trends have also impacted the retail sector, which was another of the SBI's weakest sectoral performers in Q3, with a reading of -56.6.

Manufacturing also saw a particularly low score in Q3, with a reading of -62.9. Manufacturing has faced considerable disruption in recent months as a result of soaring input prices. Input price inflation has been stoked by continued supply chain pressures and, more recently, a weakening currency, as well as geopolitical events, such as Russia's invasion of Ukraine and the reimplementation of strict Covid-19 restrictions in major Chinese cities. Official data have shown record high rates of input price inflation this year, being in excess of 20.0% in each month since April. Such price pressures have added a considerable supply-side constraint to output amongst these businesses.

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

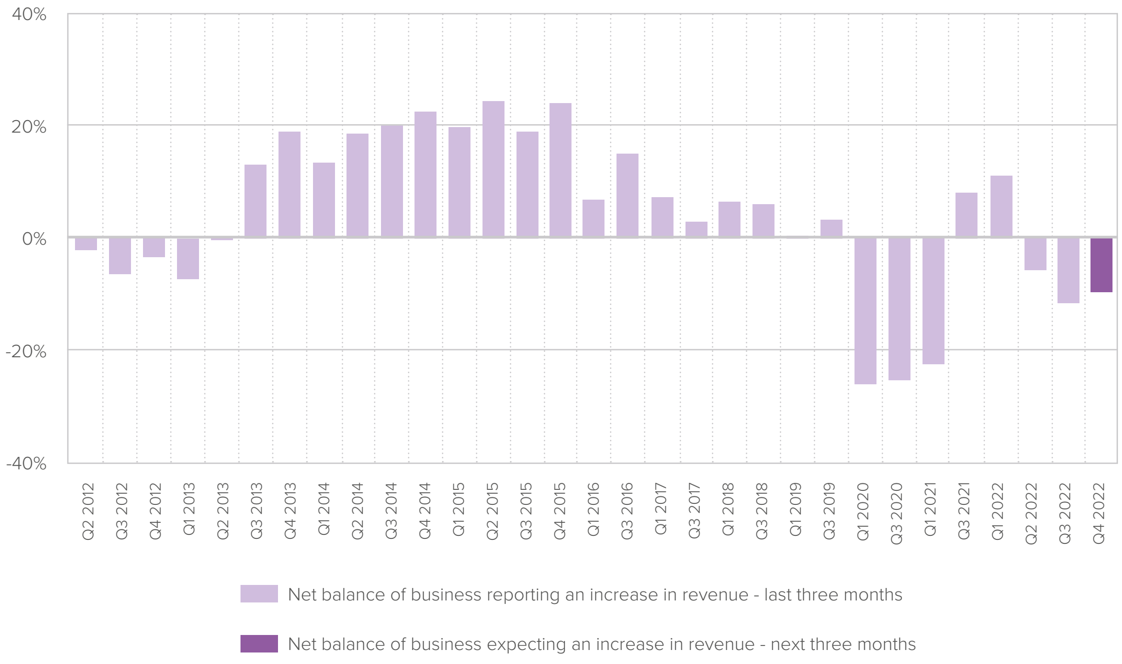
Q3 BRINGS SECOND CONSECUTIVE QUARTER OF FALLING REVENUE, WITH ANOTHER CONTRACTION ANTICIPATED FOR Q4

The net balance of small businesses reporting revenue growth over the previous three months stood at -11.8% in Q3 2022. The negative figure means that the proportion of small businesses reporting an increase in revenue levels over the last three months was outweighed by the proportion reporting a decrease. This marked the second consecutive negative reading on this measure.

Most major sectors recorded negative readings on this measure. As with the headline SBI reading, information and communication provided a notable counterexample. A net balance of 24.1% of these businesses reported revenue growth in Q3. These businesses are less exposed to consumer activity, meaning they are not subject to the adverse effects of the cost-of-living crisis. They are also less input-intensive and are accordingly not as exposed to supply chain pressures relative to other businesses. These factors partially explain the industry's stronger position. Information and communication businesses are also the most likely to anticipate revenue growth in Q4, with a net balance of 32.2% of these businesses expecting this to be the case.

Wholesale and retail businesses recorded the weakest figure in Q3, with a net balance of -26.0% seeing revenue growth over the quarter. Within this figure, 53.7% of retailers saw revenues fall. This stark finding aligns with the themes discussed in Section VII, with consumers reducing their spending levels as a result of living cost pressures. This trend is set to continue into Q4, when inflation is set to peak, putting even further downward pressure on spending power. Looking ahead to Q4, a net balance of -22.9% of retailers expect revenue growth. Within this figure, 51.6% expect a quarterly contraction in revenues. Even more severe forward-looking values are recorded for the accommodation and food services sector, with a net balance of -45.0% anticipating revenue growth in Q4. Within this figure, 62.6% are anticipating a slump in revenue.

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

EXPORTS CONTINUE TO SUFFER DESPITE SHIPPING COST AND CURRENCY FALLS

Over Q3 2022, a net balance of -10.8% of exporting businesses said that the value of their exports increased. This marks the second consecutive quarterly deterioration from Q1's reading of -5.3%. It also represents the 14th consecutive negative quarterly reading, pointing to a continuing decline in export values since Q2 2019. However, the latest negative balance is still far from the lows seen during early pandemic lockdown periods.

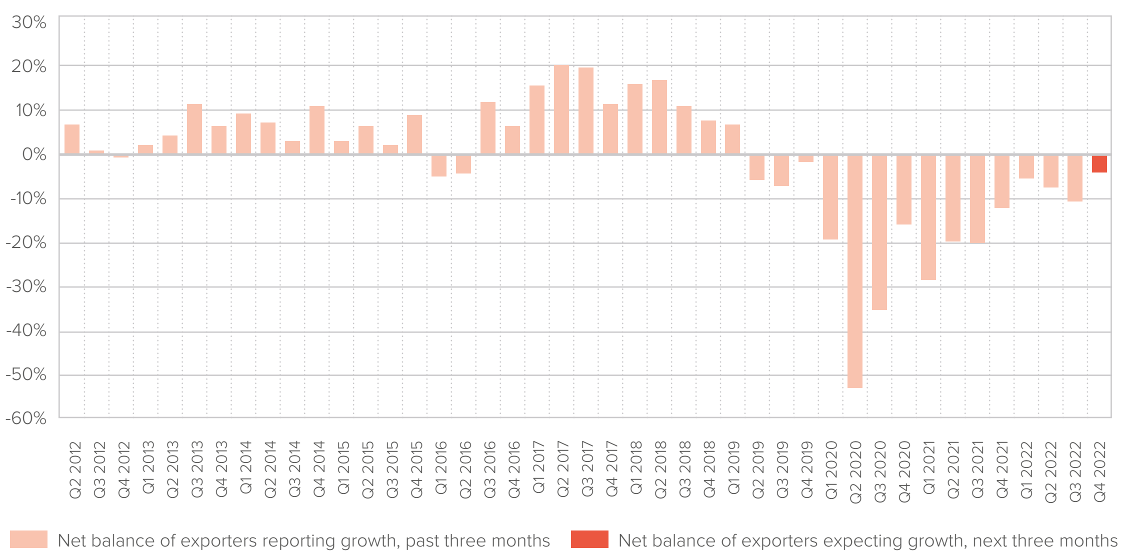
This result comes despite a general easing of supply chain disruptions experienced over the past two years and amid improved lead times for manufacturers and availability of components. These factors have been reflected in reduced shipping rates, improving exporters' elasticity of supply. For instance, the Baltic Index showed that shipping costs for a typical 40-foot container averaged £5,545 across Q3, down by almost a third (31.5%) since Q2.

Although an improved picture on supply constraints will have supported export growth in Q3, a gloomier picture emerges when considering the demand-side of the equation. In line with monetary policy tightening among much of the world, exporters are vulnerable to falls in global aggregate demand and consumers' ability and willingness to pay for imports. China's zero Covid policy is also likely to have had a dampening effect.

Moreover, while the global picture for supply is likely to have improved, UK exporters are competing for workers in a historically tight labour market that is, as per the latest ONS data, 1.4% smaller than pre-pandemic levels. With many individuals choosing to leave the workplace as a result of changing priorities or long-term sickness, record vacancies suggest that exporters may be finding it difficult to expand production in light of labour shortages.

Finally, a weakening currency poses both upside and downside risks to exporters. On a trade-weighted basis, sterling was 4.9% weaker in Q3 than Q1, according to the Bank of England's effective exchange rate index. Comparing September with January, sterling was down by 7.6%. While this may support demand by making UK exports cheaper in foreign currencies, those exporters dependent on imported inputs will struggle with higher input costs as a result. The less negative reading for expectations of export value growth in Q4, with a net balance of -4.3%, may point to anticipated demand growth on the back of the weaker currency in the final months of the year.

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

SHARE OF BUSINESSES FACING INCREASED COSTS FALLS, BUT REMAINS AT SECOND-HIGHEST LEVEL IN HISTORY

The net balance of small businesses reporting an increase in operating costs stood at 85.4% in Q3. This followed a net balance of 85.9% in Q2, marking the first quarterly fall in this reading since Q1 2021. It should, however, be noted that the 85.4% figure remains the second-highest net balance figure on this measure since data collection began. This illustrates the extent to which businesses continue to face significant cost pressures.

There was a marginal fall in the share of businesses reporting cost increases in Q3. This amounted to 88.7% of respondents, having stood at 89.0% in Q2. This broadly aligns with the trajectory of input prices for all businesses in recent months, as per ONS data. Though still elevated by historic averages, input price inflation reached 20.4% in August, down from a high of 24.2% in June.

Energy has been a key driver of this input price inflation, with prices spiking as a result of supply shortages and geopolitical events, notably Russia's invasion of Ukraine. When asked about the main causes of changing business costs, the most commonly cited option was utilities, selected by 60.3% of respondents. Looking ahead, the Energy Bill Relief Scheme will limit the extent to which businesses will be exposed to rising wholesale energy prices, though bills will still be considerably higher than under usual circumstances.

There was a sharp jump in the share of respondents citing the exchange rate as a source of rising costs. Having been selected by 15.6% of respondents in Q2, this increased to 20.1% in Q3. Towards the end of the quarter, sterling depreciated sharply against other major countries as markets reacted to the Government's fiscal plan. All else equal, a weaker pound makes imports more expensive, increasing costs for businesses reliant on foreign imported inputs.

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

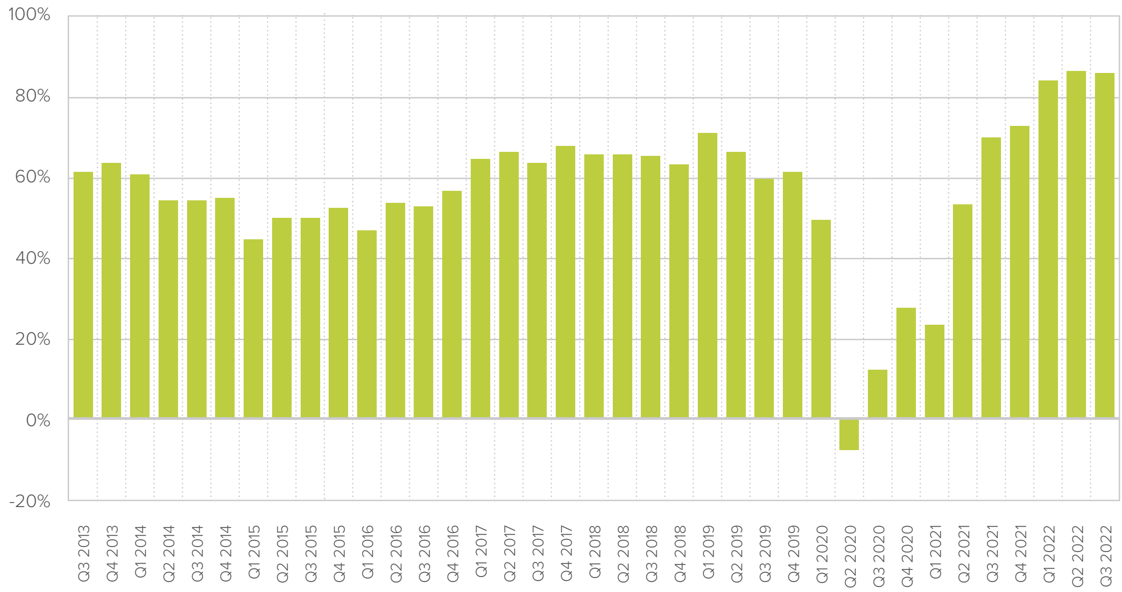
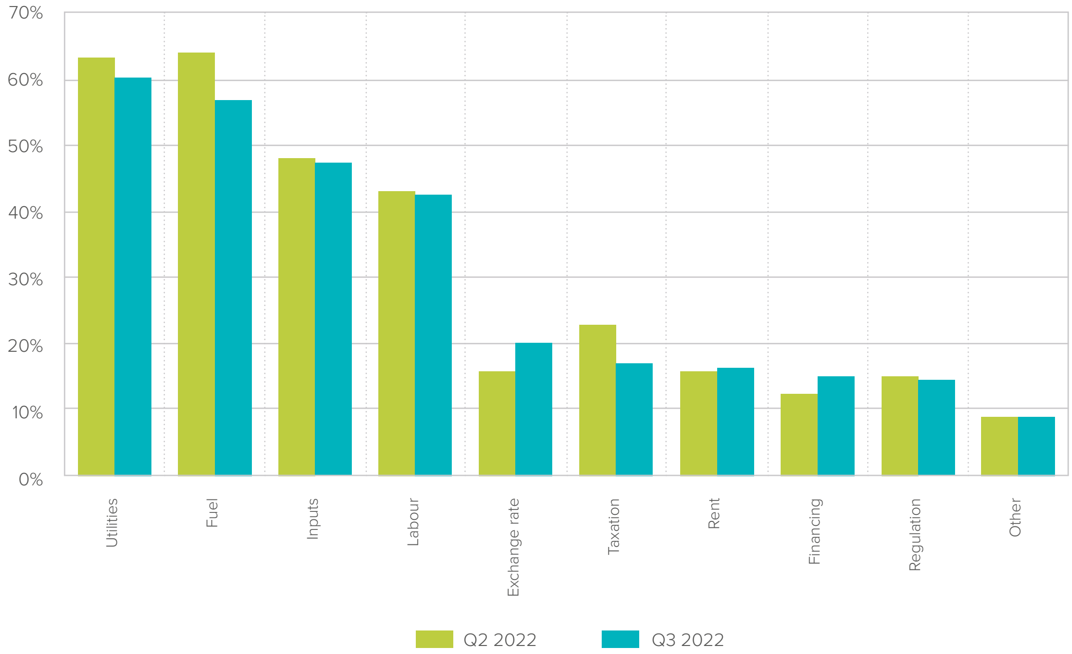


Figure 10: Main causes for changing business costs (firms may give multiple answers)
Source: FSB - Verve 'Voice of Small Business' Panel Survey



EMPLOYMENT

SMALL BUSINESS EMPLOYEE NUMBERS CONTRACT FOR SECOND CONSECUTIVE QUARTER AS RECESSIONARY RISKS MOUNT

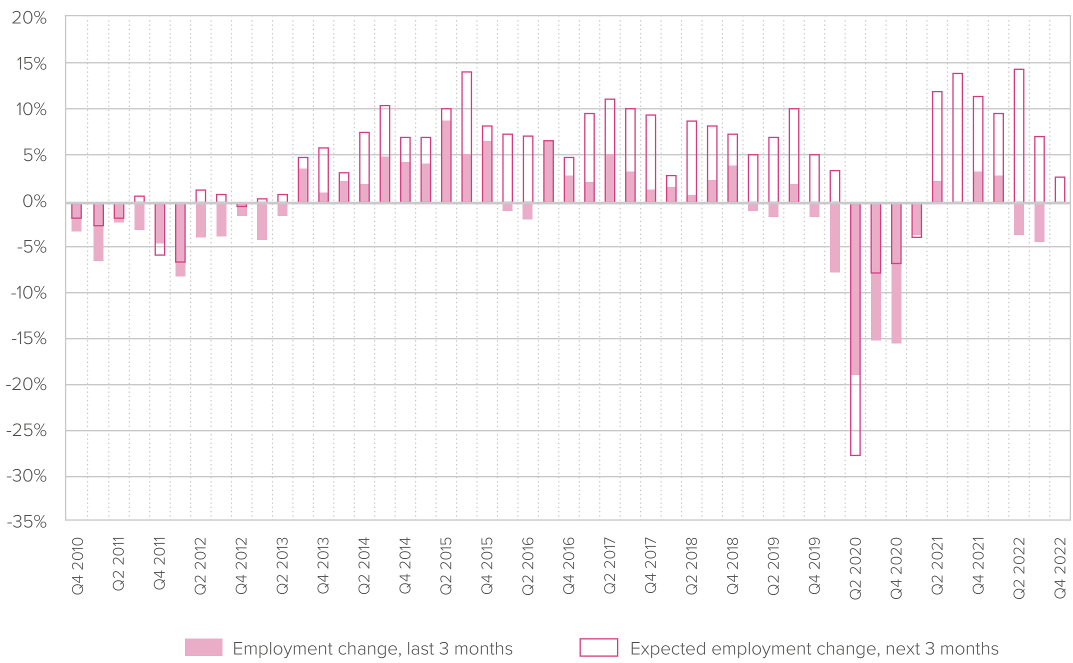
Across Q3, a net balance of -4.4% of small businesses reported growth in their employee numbers. This negative reading means that the number of businesses expanding their workforce in Q3 was smaller than the number seeing a contraction. The latest quarter therefore saw a deterioration from Q2's net balance of -3.6% and marked the most negative reading since Q4 2020, when the UK grappled with its second national lockdown. The Q3 outcome was significantly worse than expected. At the end of Q2, a positive net balance of 7.2% expected to increase employee numbers over the following quarter.

These findings align with ONS labour market data covering all business sizes, which show the UK employment rate falling on a quarterly basis in June to August 2022, from 75.8% to 75.5%. This comes following an upward trend in the employment rate since early 2021 and provides early signals of the impact of a slowdown in demand, in addition to the impact of rapidly rising energy costs that have, until October this year, been uncapped for businesses.

On a sectoral basis, the most negative net balance of businesses recording an increase in employee numbers was seen in accommodation and food services, at -34.7%. This followed net balance readings of -7.6% and -8.5% in Q2 and Q1, respectively, and points to an accelerated downturn for the sector, which initially had to content with staff shortages and now finds itself experiencing the first impacts of a slowdown in consumer spending.

Despite the negative net reading seen in Q3, businesses on balance expect employee numbers to grow over Q4. This is the case for a net balance of 2.7% of small businesses. On a regional basis, the strongest reading is seen in the East of England, where a net balance of 8.6% expect their employee numbers to grow over Q4. Meanwhile, in the North West, which recorded the most negative reading on actual employee growth in Q3, at -15.1%, a net balance of -6.4% expect growth in Q4, also representing the lowest reading.

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



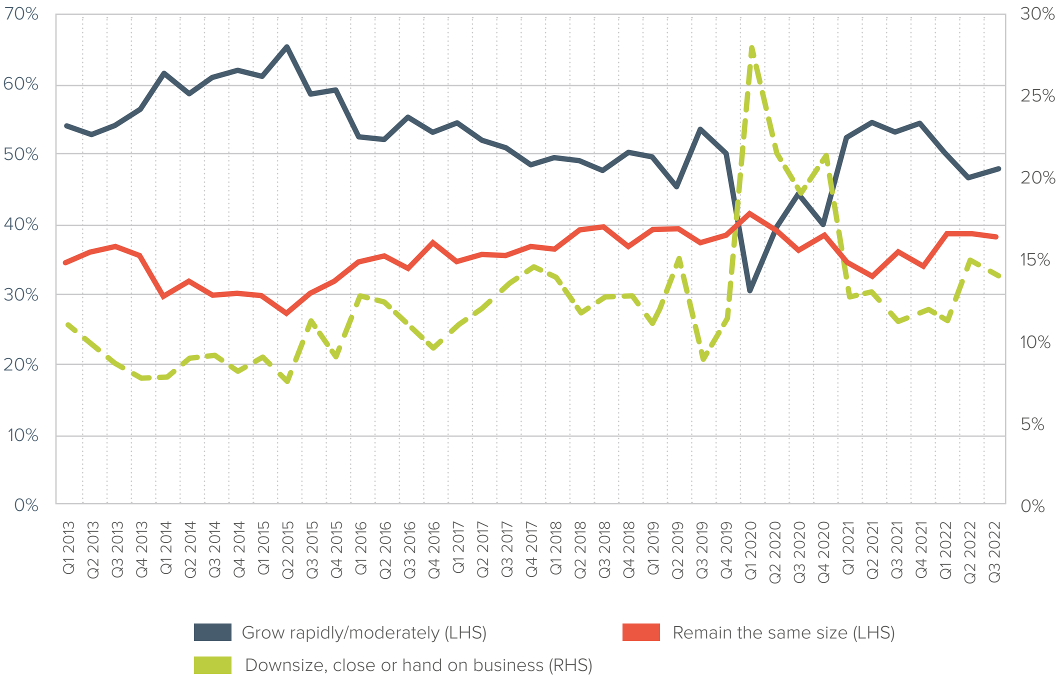
GROWTH ASPIRATIONS AND CHALLENGES

BUSINESSES' GROWTH OUTLOOK WORSENED IN Q3 2022, WITH THE INFORMATION AND COMMUNICATION SECTOR DEFYING THE DOWNTURN

As of Q3 2022, 47.4% of small businesses expected to grow over the coming 12 months. The share of businesses expecting to downsize or close stood at 14.1%. The net balance thus stood at 33.3%, slightly up on Q2's figure of 31.9%. The net balance does, however, remains relatively weak. For comparison, the figure stood at 41.9% across Q3 2021.

Mirroring their relative performance on the headline SBI reading, firms in accommodation and food services have the weakest growth expectations looking ahead to the next year. A net balance of 2.7% of these businesses expect to expand. Given that these businesses are set to be amongst the most affected by the cost-of-living crisis and the ensuing recession, their ability to fund themselves through growth will be limited. Also mirroring the headline SBI, firms in information and communication are the most likely to anticipate expansion over the coming year, with a net balance reading of 54.9%.

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



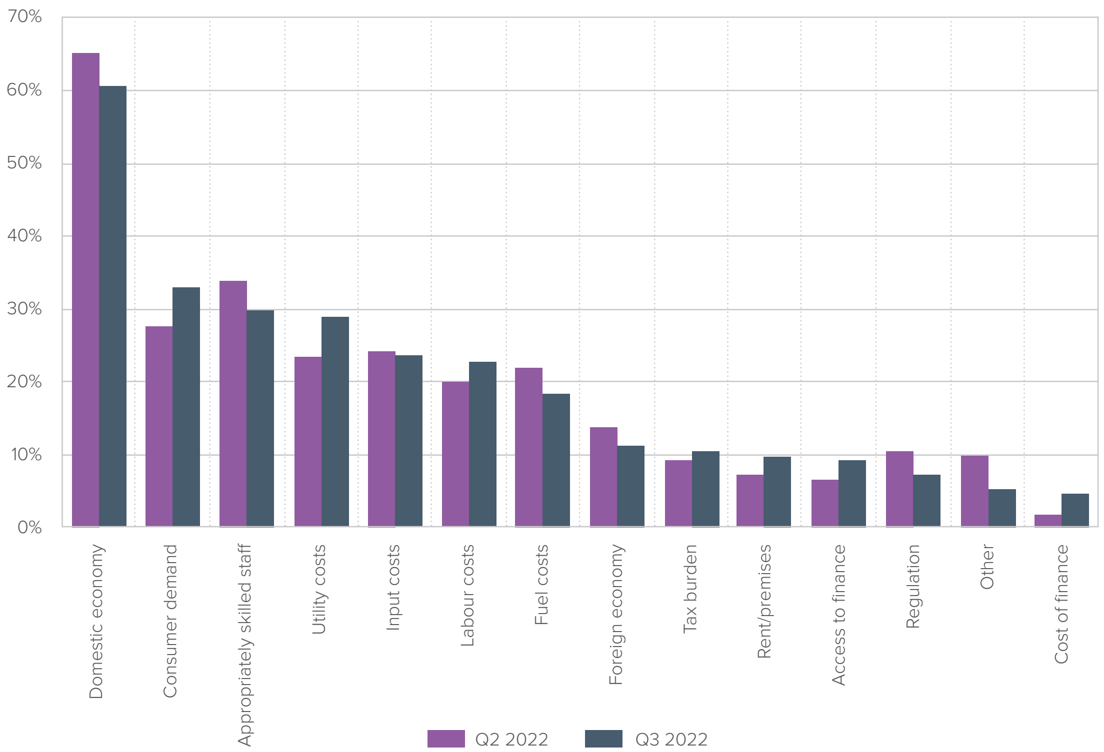
GROWING SHARE OF BUSINESSES EXPECT CONSUMER DEMAND AND UTILITY COSTS TO BE BARRIERS TO GROWTH

Among businesses who expected to grow over the next 12 months, the domestic economy was most frequently cited as a barrier to such growth. This was case for 60.6% of respondents, down from Q2's reading of 65.1%.

Consumer demand was the second-most cited threat to growth aspirations, with 32.9% of respondents selecting this. Up on Q2's share for this option, which stood at 27.4%, this suggests that businesses are coming to terms with the weakened consumer landscape, fuelled by the cost-of-living crisis and weakening of spending power. This aligns with Cebr's forecasts for consumption, which currently show contractions in Q4 and Q1 2023.

Both consumer demand and utility costs saw the largest increase prevalence as a barrier to growth between Q2 and Q3, with both cited by a 5.5 percentage point higher share on the quarter. 28.8% of businesses identified utility costs as a potential barrier to growth in Q3, up from 23.3% of respondents in Q2. As a result of increases in wholesale energy prices, utility bills are set to rise for businesses over the winter. The extent to which this will be the case will be limited by government support measures, however, such as the Energy Bill Relief Scheme, which will stem rises in energy bills at least until April.

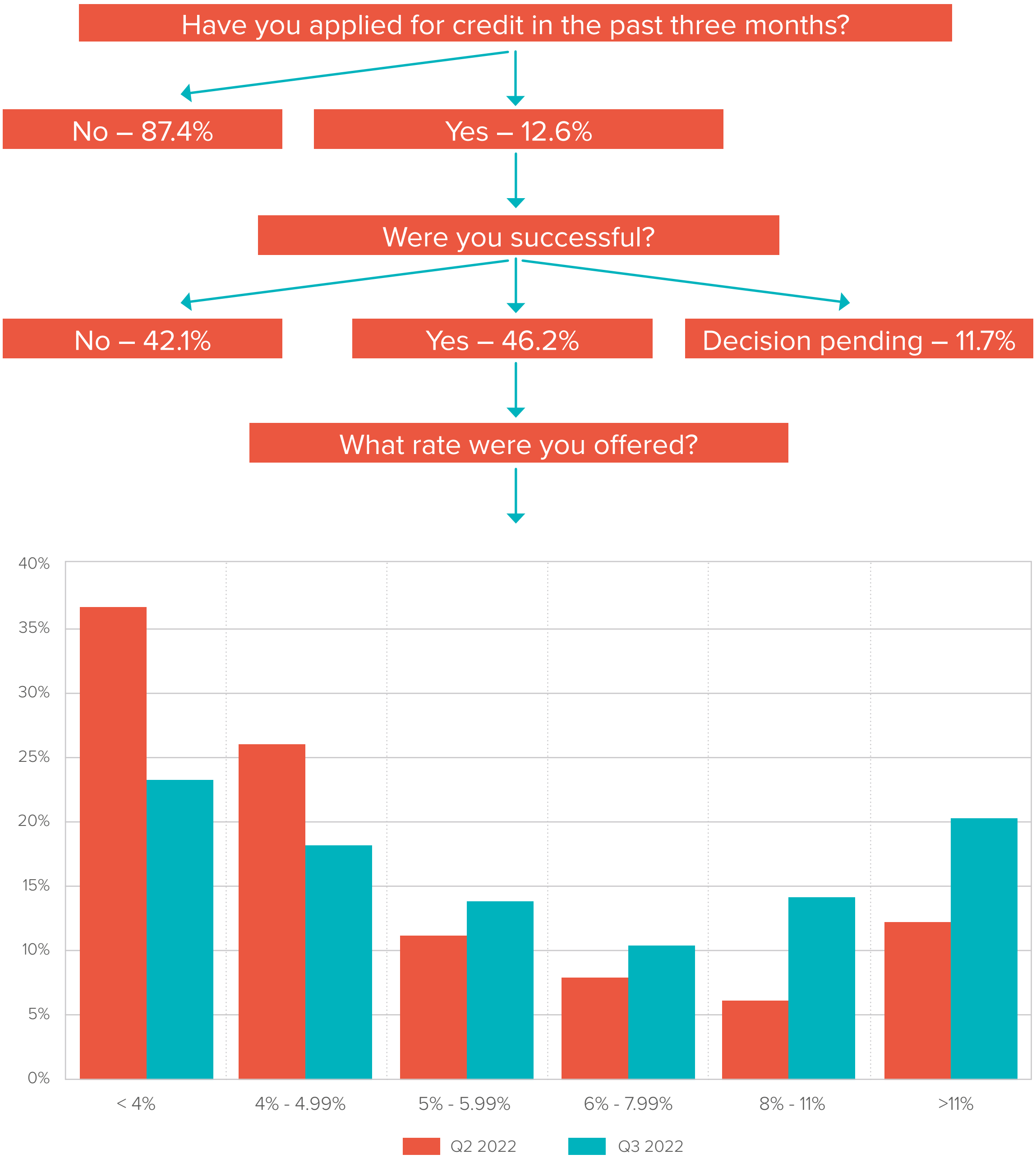
Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey



CREDIT

SHARE OF SMALL BUSINESSES APPLYING FOR CREDIT REACHES HIGHEST LEVEL SINCE Q2 2021 AS COST PRESSURES BITE

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.

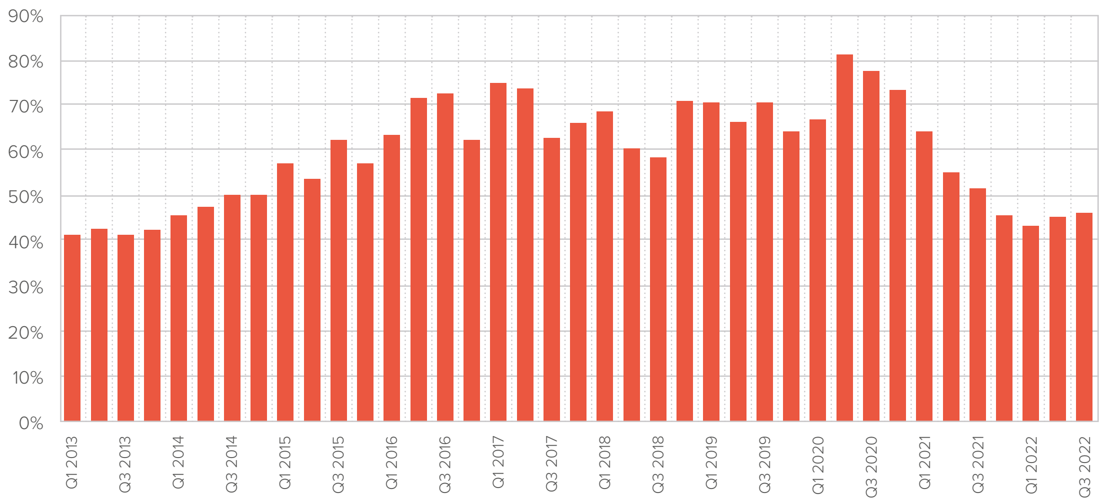


The proportion of small businesses applying for credit rose to 12.6% in Q3 2022, up from 11.5% in the previous quarter. Prior to Q2, this share had fallen every quarter since the initial lockdown period in Q2 2020. The latest reading brings the credit uptake share to its highest level since Q2 2021.

The rather swift rise in the share of businesses applying for credit over recent quarters is likely to reflect the sharp rises in input costs that many businesses have had to grapple with, higher utility costs as well as a worsening outlook for consumer demand. On a sectoral basis, construction businesses were most likely to apply for credit in Q3, with this being the case for 23.7%, with the lowest share, at 10.5%, seen in both manufacturing and professional, scientific and technical services.

Among those who applied for credit, the average interest rate offered rose sharply from 5.5% in Q2 to 7.1% in Q3. This comes as the Bank of England increased its base rate by 50 basis points in both of its Q3 Monetary Policy Committee meetings in attempts to slow inflationary pressures. The first hike, in August, was the sharpest since 1995. Accordingly, the base rate ended Q3 at 2.25%, almost twice the 1.25% level at which it entered the quarter. Interest rates across the economy have risen accordingly, with further upward pressure anticipated across Q4, as inflation is expected to accelerate further.

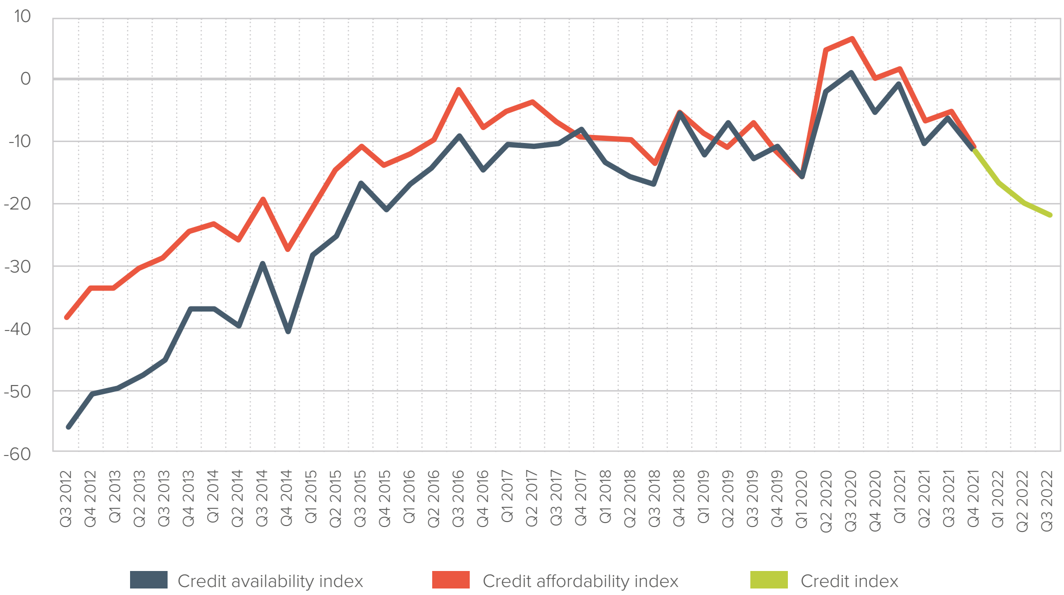
Figure 15: Proportion of small businesses successful in their credit applications in the past three months
Source: FSB - Verve 'Voice of Small Business' Panel Survey



SENTIMENT AROUND CREDIT AVAILABILITY AND AFFORDABILITY SLIPS FURTHER AS BORROWING COSTS RISE SHARPLY

Q3 saw a further fall in the share of small businesses with positive views on credit availability and affordability fell, down from 17.6% in Q2 to 17.4%. Meanwhile, the proportion with negative views on credit availability and affordability rose from 42.4% to 44.1%, the highest reading since Q2 2015. The aforementioned sharp rises in official bank lending rates almost certainly lie behind this increased perception of credit availability and affordability, particularly with regard to the latter. These Q3 movements saw the credit availability and affordability index fall back to -21.7 in Q3, down from -19.8 in Q2.

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



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

INVESTMENT

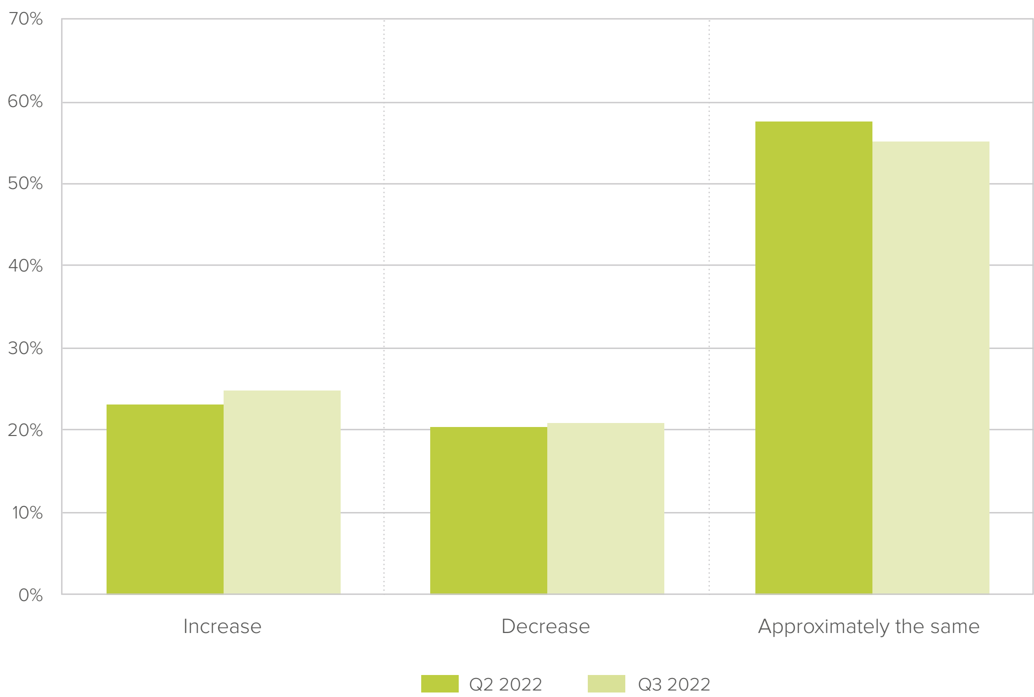
INVESTMENT AMBITIONS INCREASE BUT REMAIN WEAK BY HISTORIC STANDARDS

The share of businesses expecting to increase their investment over the coming quarter increased to 24.6% in Q3. This followed a share of 22.7% in Q2. Though this represents a quarterly increase in the share, it is down on an annual basis, having stood at 28.6% in Q3 2021. Meanwhile, the share of businesses expecting to cut their investment in the coming quarter also increased to 20.6% in Q3, having stood at 20.1% in Q2. The net balance of respondents expecting to increase their investment therefore stands at 4.0%, up from 2.6% in Q2.

The fact that investment intentions are down on an annual basis reflects the generally more uncertain economic environment at present. Amidst an anticipated recession, weak consumer demand, tighter interest rates, and geopolitical pressures, investment now looks like a less attractive option compared to a year ago, when businesses benefited from a bounce back in activity following the lifting of restrictions.

Mirroring the performance on the headline SBI, investment intentions are particularly weak amongst accommodation and food services, with a net balance of -15.1% of such businesses set to increase investment. This compares to the strongest net balance reading of 18.6% among information and communication businesses.

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 research survey of FSB members carried out by Verve. A total of 5,609 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. We received 505 responses, 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 conducted between 20 September and 4 October 2022.

SUMMARY DATA TABLE

	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
Small Business Index	-49.3	27.3	18.6	16.4	-8.5	15.3	-24.7	-35.9
Employment - previous three months	-15.5%	-3.5%	2.2%	-0.2%	3.3%	2.9%	-3.6%	-4.4%
Employment - coming three months	-3.8%	12.0%	14.0%	11.5%	9.8%	14.5%	7.2%	2.7%
Exports - previous three months	-16.0%	-28.4%	-19.8%	-20.0%	-12.3%	-5.3%	-7.7%	-10.8%
Exports - coming three months	-29.0%	-9.8%	-11.2%	-4.6%	-3.8%	10.4%	1.4%	-4.3%
Credit availability and affordability - rated good or very good	-	-	-	-	-	19.4%	17.6%	17.4%
Credit availability and affordability - rated poor or very poor	-	-	-	-	-	36.5%	42.4%	44.1%

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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