Q4

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 4, 2021

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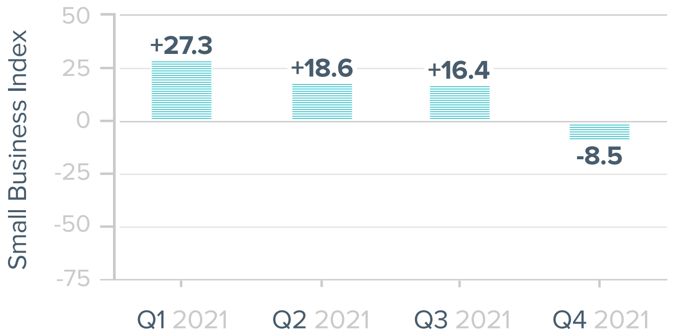
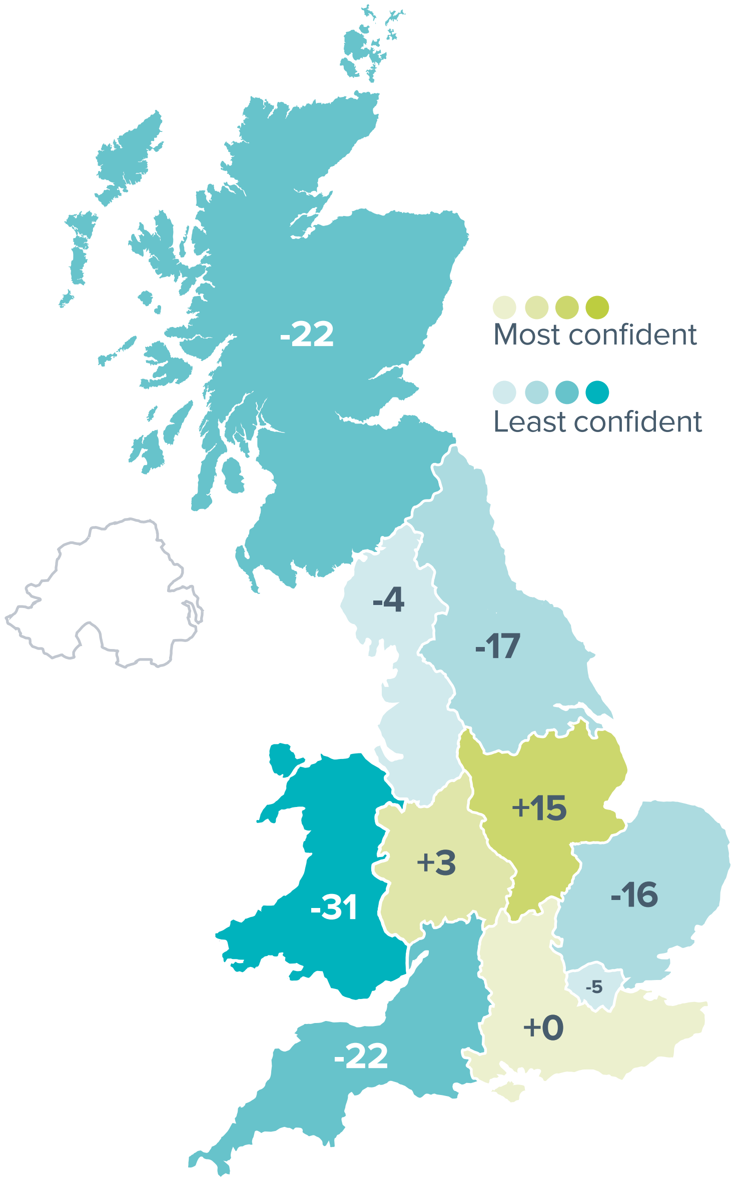
SBI Q4 2021

“Small business confidence hits one-year low after consecutive quarterly falls”





Cost pressures hit seven-year high

78%

say **outgoings** have increased

Late payment stifles cashflow

31%

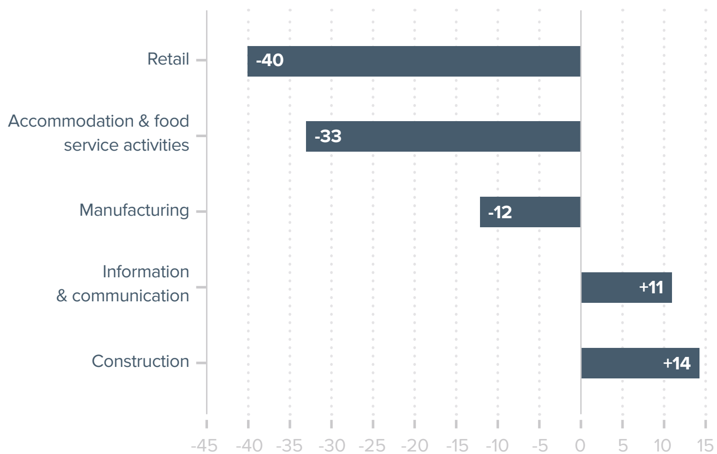
report that **late payments have increased**

Trade admin weighs heavy

38%

of exporters say **international sales are down**

Small business confidence by sector



CONTENTS

FSB FOREWORD

The final three months of 2021 sadly had something of a Groundhog Day feel for the small business community. Surging Covid cases, mass event cancellations, last-minute changes to trading rules and staff shortages – there was much in the challenges facing firms over this festive period that rang true for the last.

This time round though, there was also the inflation element: the proportion of small businesses saying costs are increasing is now at its highest point in seven years. Amid continued supply chain disruption, and surging wholesale gas prices, inputs and utilities are the most flagged sources of higher outgoings.

As if that wasn't enough for business owners to get their heads around, they have, whilst trying to make ends meet, been trying to prepare for the imposition of full import checks for EU goods on 1 January 2022 and a deeply concerning moment in April when, as things stand, firms will be hit by hikes to national insurance, fresh business rates bills (now shorn of any discounts for those hardest-hit) and an increase in the National Living Wage.

We're hurtling towards that moment at a time when finances are already incredibly stretched. The majority of firms which participated in this quarter's SBI report that profits are down. That's in a climate where a million small businesses are holding emergency debt and the pandemic has exacerbated an already deeply damaging late payment crisis – more than 400,000 small firms' futures are threatened by poor payment practice.

The upshot of these stresses and strains is that the headline UK SBI confidence measure stands at -8.5 for Q4 2022 – the first negative reading in a year, marking the fourth straight quarter on quarter drop in optimism. Worryingly, many small businesses responded to this survey before the Government announced a move to "Plan B" measures, so it is likely that confidence will have dropped further in the meantime.

As such, it needs to be new year, new policies for this Government if it's to have any hope of reversing that trend and securing a substantial economic recovery.

Front of mind for far too many firms at this juncture is personnel. The struggle to recruit and retain the right people, which already existed pre-pandemic, is now colliding with mass self-isolation to cause a real headache for thousands. We were once promised a world-beating testing infrastructure. The Government must now deliver. Installing an education system which finally puts vocational qualifications on a par with academics alongside an immigration system that works for firms of all sizes and sectors is another must when it comes to addressing staff shortages.

Then there's the steps policymakers can take to reduce the cost burden. The near £1 billion package of support unveiled at the back end of Q4 – encompassing fresh cash grants and Time To Pay commitments from HMRC – was a start. Crucially, that package included the return of the Covid Statutory Sick Pay Rebate for small businesses, a reinstatement we urged the Chancellor to make in our conversations with him.

That said, more will be needed to secure the futures of the many great businesses which were thriving pre-pandemic but are now hanging by a thread.

Given the harsh trading conditions highlighted in this report, the Government's plan to hike the jobs tax that is national insurance looks increasingly misjudged. It should reconsider.

And with lockdowns accelerating the shift to online retail, our business rates system is looking more and more like a relic from a bygone age. The current administration should follow the Opposition's lead in adopting our proposals to take 200,000 more small firms out of the rates system altogether, primarily in levelling-up target areas, by increasing the rateable value threshold at which firms start to pay rates to £25,000.

Where late payment is concerned, the Government promised FSB in 2019 at an event in 11 Downing Street to push ahead with reforms. However, these have not materialised. It's time to make Audit Committees responsible for poor payment practices, and publish details of those practices in Annual Reports. This move should be central to the Department for Business's Audit Reform package and Enterprise Strategy, both of which are due shortly. If we want to give firms the confidence to invest in net zero measures and productivity-enhancing tech, we have to bring our late poor payment culture to a definitive end.

In addition, we urgently need initiatives that can get ambitious small firms on the front foot again. Lessons should be learned from the roll-out of the SME Brexit Support Fund, with new grants made available to help those with international ambitions achieve their goals – grants which are genuinely easy to access for the smallest firms.

There's also more to do to help small businesses contribute to the Government's net zero aims, too. A Help To Green scheme – modelled on Help To Grow – would supercharge investment and behaviour change.

Small firms have once again shown their resilience over the past two years, tirelessly adapting and innovating, and soldiering on through yet another incredibly stressful golden quarter.

What they need now is for this Government to rediscover its pro-enterprise, reforming zeal and come forward with the policies that will empower a small business-led recovery, whilst eschewing tax hikes that will hurt communities and stifle growth.

Mike Cherry,
National Chair

Martin McTague,
Vice Chair,
Policy & Advocacy

ECONOMIST'S VIEW

Kay Daniel Neufeld, Head of Forecasting and Thought Leadership, Cebr

The Small Business Index saw a steep fall in the last quarter of 2021, declining by 24.9 points to reach -8.5 in Q4. This marked the biggest drop in the index since Q3 2020 and the lowest overall score since Q4 2020, highlighting the impact of the new Omicron variant on the UK's small businesses.

On 8th December last year, Prime Minister Boris Johnson announced that England would move to 'Plan B' restrictions, which include a recommendation to work from home where possible, compulsory mask wearing in most public indoor venues and a requirement to show proof of vaccination or a negative test to visit certain venues. These restrictions were accompanied by a sharp rise in new Covid-19 infections, shattering previous records for daily new cases. Wales, Scotland and Northern Ireland introduced further measures just after Christmas with the intention of limiting social contacts. The twin forces of tighter Government restrictions and heightened apprehension among consumers due to the rampant spread of the virus have clearly had a chilling effect on small business confidence.

Reduced consumer footfall over the festive period as well as in the New Year is a major concern for the wholesale and retail sector which had hoped to make up for lost sales in the previous year. Accordingly, the industry score for the sector recorded a sharp drop, falling from -10.5 in Q3 2021 to -40.3 in Q4. Similarly, the accommodation and food services sector, which is particularly exposed to the most recent pandemic wave, has recorded a reading of -33.0 in Q4. To cushion the blow for these businesses, the Chancellor Rishi Sunak announced a £1 billion support fund just before Christmas, covering one-off grants of up to £6,000 for businesses in the hospitality and leisure sector in England. However, there have been calls to increase both the scale and scope of this support given the size of the challenge faced by businesses which rely on consumer footfall.

Meanwhile, small businesses in the manufacturing sector also reported a sizeable decline in confidence. In Q3 2021, businesses in this sector were still upbeat about the prospects for the remainder of the year with a positive score of 15.5. However, sentiment turned negative at the end of the year as the sector recorded a drop of -27.5 points to reach -12.0 in Q4. While the more pessimistic outlook is likely also influenced by the Omicron wave, UK manufacturing businesses have had to contend with more difficult trading conditions even before the emergence of the new strain. Global supply chain disruptions and soaring prices for inputs have added to economic headwinds for manufacturing businesses during the second half of 2021 and these pressures are expected to remain in place for some time to come. In fact, the share of small businesses reporting that operating costs have increased rose to a decade-high of 72.9% in Q4 2021, with greater expenses for inputs, fuel, utility and labour being the main causes.

This illustrates that the UK economy was already facing a difficult Q4 even before the emergence of Omicron. In October last year, GDP expanded by just 0.1% as growth in the services sector was nearly entirely offset by contractions in the production and construction sectors. Many of the factors leading to weak output growth in October will have also remained present during November and December, suggesting modest growth at best for the quarter. For the year as a whole, we expect the UK economy to have expanded by 6.6% in 2021, slightly down from our previous forecast. Looking ahead, some optimism can be found in the fact that the labour market seems to have coped reasonably well with the end of the furlough scheme in September, with only a small uptick in unemployment expected for Q4. Moreover, initial data seems to suggest that the Omicron wave might be intense but relatively short-lived, raising hopes of a relaxation of the situation in the second half of Q1 2022 and an uptick in growth in the following quarters.

FSB EXECUTIVE SUMMARY

Key findings this quarter:

The Small Business Index (SBI) fell by 24.9 points between Q3 2021 and Q4 2021, reaching -8.5. This marks the third consecutive quarterly fall in the Index and the first negative reading since Q4 2020.

- **The SBI declined in all regions except the East Midlands.** This almost unanimous fall in confidence saw all regions except the East Midlands, the West Midlands and the South East entering negative territory in Q4.
- **On a sectoral basis, expectations of worsening performance in the first quarter of 2022 were concentrated in manufacturing, accommodation and food services, and wholesale and retail trade.** The four other sectors with sufficiently large sample sizes saw a positive, albeit falling, SBI reading in Q4. The largest quarterly falls among sectoral SBI readings were seen in accommodation and food services, which fell by 35.4 points to stand at -33.0, and information and communication, which saw a reduction of 35.1 points to stand at 11.4.
- **A net balance of 4.8% of responding small businesses reported a fall in gross profits in Q4.** Furthermore, looking ahead, more small businesses expected their profitability to reduce than increase in Q1 2022, although this saw a smaller net balance reading of -3.3% compared to the actual experiences in Q4.
- **Exporters fared worse than they had expected in Q4.** The net balance of exporting businesses reporting growth in the value of their exports amounted to -12.3% in Q4, up from -20.0% in Q3. However, at the end of Q3, a net balance of -4.6% of exporters had anticipated export growth in Q4, such that activity in the latest quarter was worse than expected.
- **Rising costs of production continued to represent an area of concern for businesses in Q4.** Over a fifth (20.3%) of responding firms noted experiencing a significant increase in operating costs (a rise of over 10%) in the final quarter, compared to the same period one year previously, with over three-quarters (78.2%) experiencing an increase of any size. The Q4 net balance reading represents the highest since Q4 2011, the last period of comparable cost pressure.
- **Being selected by 48.7% of firms, inputs remained the most common source of cost changes for the fourth consecutive quarter.** As was the case in Q3, this was followed by fuel costs (45.6% of firms) and utilities costs (44.8%), whilst rising labour costs also continued to bite (38.0%). These areas of influence on costs reflect the broader pressures caused by supply chain disruptions and soaring energy costs in the second half of 2021.
- **The number of survey respondents reporting an increase to the size of their workforce in Q4 outweighed the number reporting a decrease.** With a net balance of 3.3% experiencing growth, up from -0.2% in Q3, workforce numbers returned to growth in the final quarter. This favourable picture for employment in the final quarter came despite the termination of the Coronavirus Job Retention Scheme (CJRS) at the end of September. Even greater optimism was seen with regard to business employment in Q1 2022, with a net balance of 9.8% of firms expecting growth, despite concerns over the emergence of the Omicron COVID-19 variant.
- **The share of businesses aspiring to grow increased by 1.0 percentage points in Q4 to reach 54.1%.** The domestic economy remains the most common barrier to growth, being selected by 56.7% of responding businesses. Q4 saw the first quarterly rise in the share of firms citing this option since Q2 2020, a potential reflection of increased uncertainty in light of the Omicron wave. Among the next key barriers, access to appropriately skilled staff became less significant in Q4 compared to other factors, whilst consumer demand became of greater concern.
- **Following the previous record low in Q3, the proportion of businesses applying for credit fell further to 9.5% in Q4.** This represents the lowest level for this measure since SBI data collection began. The credit availability and affordability indices worsened to levels not seen since Q1 2020, with readings of -10.8 and -11.4, respectively. Affordability is likely to worsen further in Q1, following the Bank of England's December rate hike.

UK MACROECONOMIC OVERVIEW

Omicron wave likely to drive disappointing output growth in Q4

Whilst Q3 saw the lifting of remaining restriction measures and continued, albeit slowed, growth toward pre-pandemic levels of activity, Q4 has seen a gloomier economic outlook. Following monthly GDP growth of 0.6% in September, output grew by just 0.1% in October, falling short of consensus expectations of stronger growth. This left output in October 0.5% below the pre-pandemic levels seen in February 2020.

A key aspect of Q4 has been continued sharp increases in prices, seeing inflation reach ten-year highs, amid soaring energy costs and continued disruption to supply chains. Inflation as measured by the Consumer Prices Index (CPI) rose by 4.2% in the twelve months to October. This was largely driven by the 12% increase in the energy price cap in the same month, following months of increasing wholesale energy costs, as well as rising petrol prices. These developments continued into November, when 5.1% annual inflation was recorded. With increasing signs of a wage-price spiral emerging, the Bank of England's Monetary Policy Committee voted to raise interest rates for the first time since August 2018. This decision will slow economic activity in the hope of bringing inflation down to the Bank's 2.0% target at a faster rate.

Despite increasing concerns over the cost of living, consumer demand in the initial months of Q4 remained robust. Retail sales grew monthly in both October and November, reaching 7.2% above pre-pandemic levels (February 2020) in the latter month. This has likely been supported by impressive resilience in the labour market following the termination of the CJRS at the end of Q3, with unemployment continuing to remain low. In addition to this, GDP data for October showed the services sector returning to pre-pandemic levels.

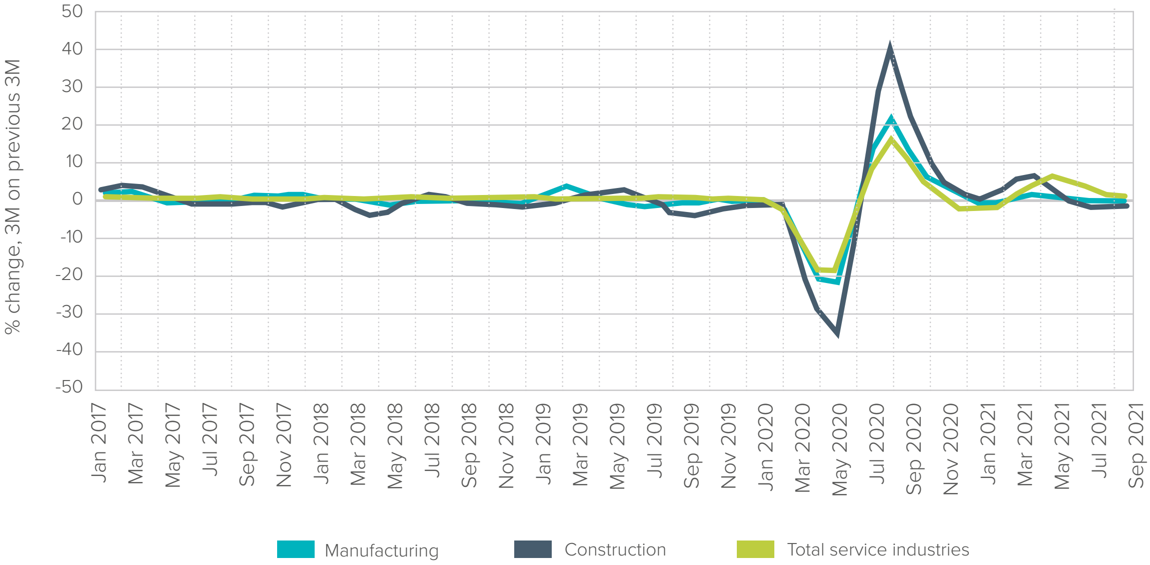
Business activity throughout November remained relatively resilient, reflecting an improving broader economic picture. For instance, the Manufacturing PMI rose to a three-month high of 58.1 in the month, with an accelerated expansion of output and domestic orders, although input costs remained a barrier to further growth. Similarly, the Construction PMI picked up to stand at 55.5 in November, reflecting the fastest expansion of construction output in four months. Meanwhile, the services sector continued to expand, signified by a Services PMI reading of 58.5, only a small slippage from October's three-month high.

However, amid the emergence of the highly transmissible Omicron COVID-19 variant, the level of economic activity in December is set to have taken a hit. The first UK Omicron cases were recorded on 27th November, with a subsequent surge seeing over 240,000 cases of the variant confirmed by the end of December. The rapid spread of Omicron, and uncertainty over its severity, prompted the UK Government to move to implement its 'Plan B' measures on 8th December, comprising of guidance to work from home, as well as mandated Covid certification and mask wearing for certain venues. Whilst light in comparison to those introduced in winter 2020, these measures, alongside tightened travel restrictions, are likely to have depressed output growth in the final month of Q4.

A perhaps more significant impact of the Omicron wave on growth in December will have been caused by increasing consumer cautiousness. This saw the cancellation or postponement of hospitality bookings as well as a slippage in retail footfall, particularly in city centres, in both sectors' important festive season. Increasing staff absences due to rising infections have compounded matters further. Industry leaders have warned on an increasingly grim outlook, in response to which the Chancellor announced limited support in the form of grants. The impact of worsened performance on employment, in the absence of the previous buffer provided by the furlough scheme, will become evident in the weeks to come.

Looking ahead, the introduction of additional restrictions in Scotland, Wales and Northern Ireland in the post-Christmas period will weigh on the nations' growth into January. However, if confirmed, increasingly promising data on the severity of the Omicron variant, and the fact that England has thus far refrained from tightening measures, are likely to prevent significant damage to growth into Q1 2022. Moreover, a seeming turning point in the surge in oil prices is likely to somewhat ease the input cost burden on producers.

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 worsens significantly amid Omicron concerns in Q4

The Small Business Index (SBI) fell by a sizeable 24.9 points between Q3 2021 and Q4 2021, reaching -8.5, marking the first negative index reading since Q4 2020. As such, for the first time in 2021, the proportion of small businesses expecting a worsening in performance over the coming quarter exceeded that of firms expecting an improvement. The magnitude of the negative reading, however, is less severe than those seen in the final two quarters of 2020, suggesting that the outlook for small businesses in the first quarter of 2021 is more promising than at previous points of intensification in the pandemic.

Q4 began with continuing concern over supply chain disruptions, labour shortages and rising inflation, and ended with a strong resurgence of COVID-19 cases, driven by the spread of the highly infectious Omicron variant. The former developments had already seen slips in the SBI in Q2 and Q3, whilst the latter was significant enough to push the index into negative territory in Q4.

GDP data for early Q4 came in below expectations, showing only 0.1% growth in October, down from 0.6% in September. This poor output performance came alongside growing concern over rising inflation for both consumers and producers, which persisted into November. The latest reading on the Producer Price Index (PPI) showed annual input price growth of 14.3% in November, up from 13.7% in October. Among the factors driving the significant increase in producer input costs are sharply rising oil, fuel, metal and mineral prices.

Despite increasing cost pressures, firms reported generally robust business activity in October and November, according to the Purchasing Managers' Indices (PMI) for the months. The Composite PMI, capturing activity across the economy, increased by 2.9 points to 57.8 in October, and slipped only slightly to 57.6 in November. Whilst supply constraints are likely to have held back growth from its full potential, the UK economy continued its journey back to pre-pandemic levels of activity at the start of Q4.

However, the surge of the Omicron variant in December has seen the re-introduction of government restrictions, heightened consumer caution and an increasing staff absence due to infection, providing cause for concern for businesses across the country as they look into the new year. This is reflected in the most recent reading of the Composite PMI, which showed the index falling 4.4 points to 53.2 in December. Despite signs of improvements in supply chain disruptions in the month, leading to an acceleration in manufacturing output, a stronger fall in services spending saw the index return to a low not seen since February. A similar trend is seen with respect to small businesses, with the SBI falling sizeably into negative territory in Q4 for the first time in 2021.

Uncertainty remains around the severity of the new variant and thus the outlook for further restrictions and the state of demand in the new year. If initial promising signs of reduced severity are confirmed in Q1, and the prospects of COVID-19 cases overwhelming the healthcare system become more remote, the UK economy can be expected to enjoy something of a bounce-back, potentially surpassing pre-pandemic levels.

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

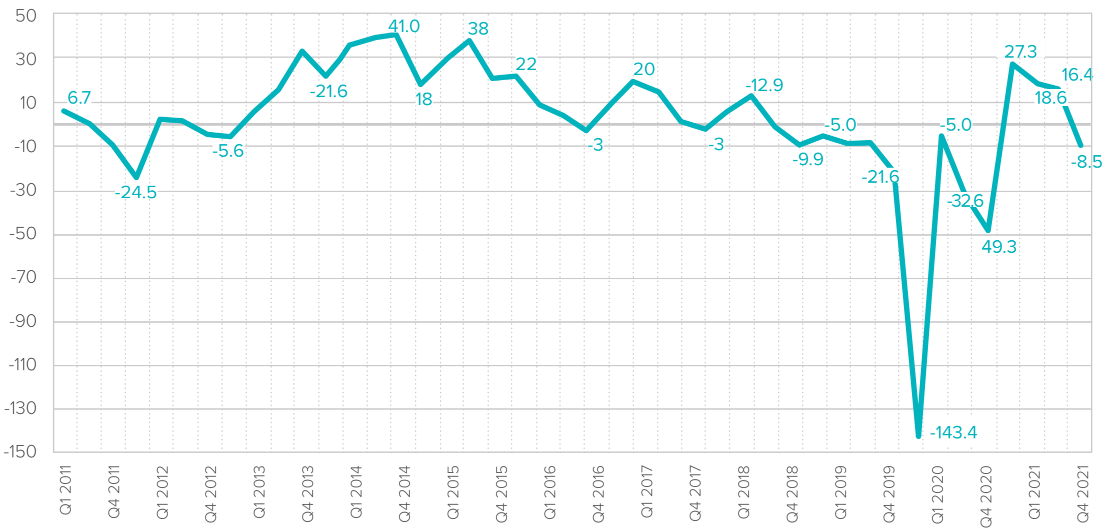
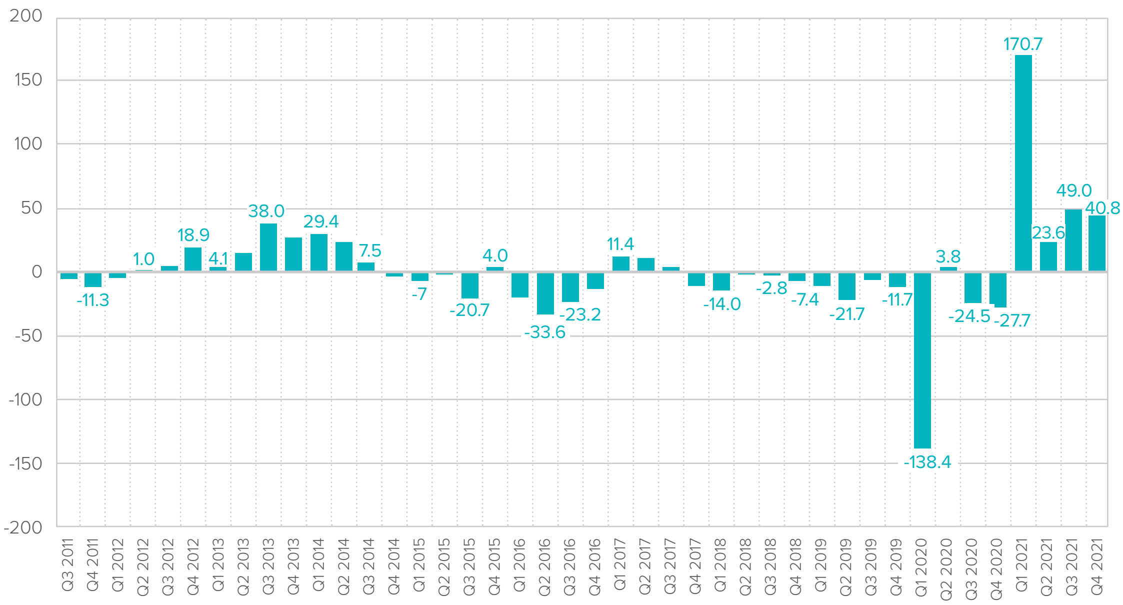
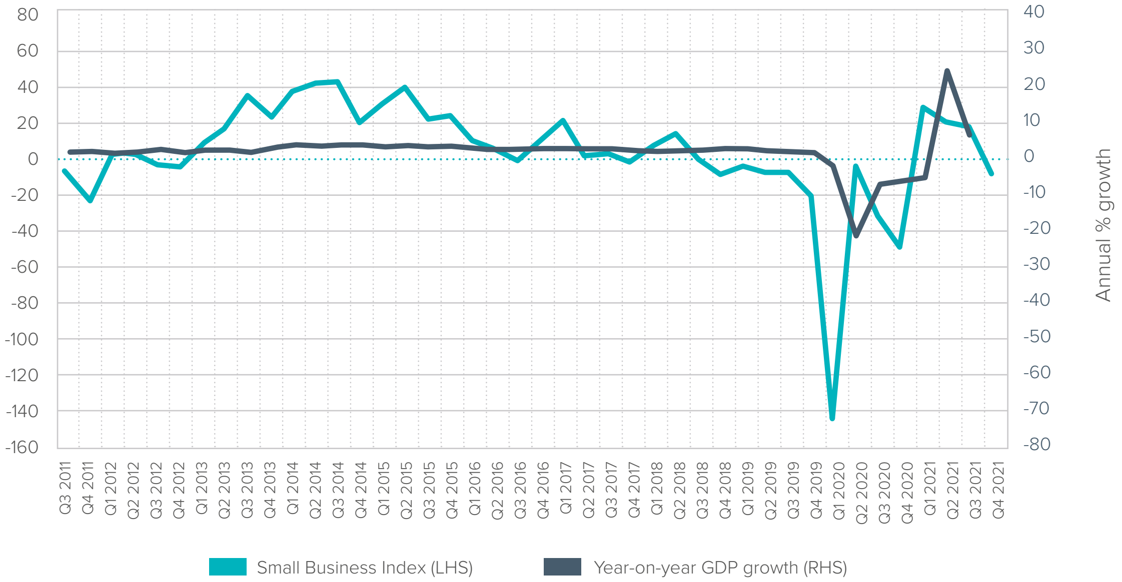


Figure three: Year-on-year change in the FSB Small Business Index
Source: FSB- Verve 'Voice of Small Business' Panel Survey



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

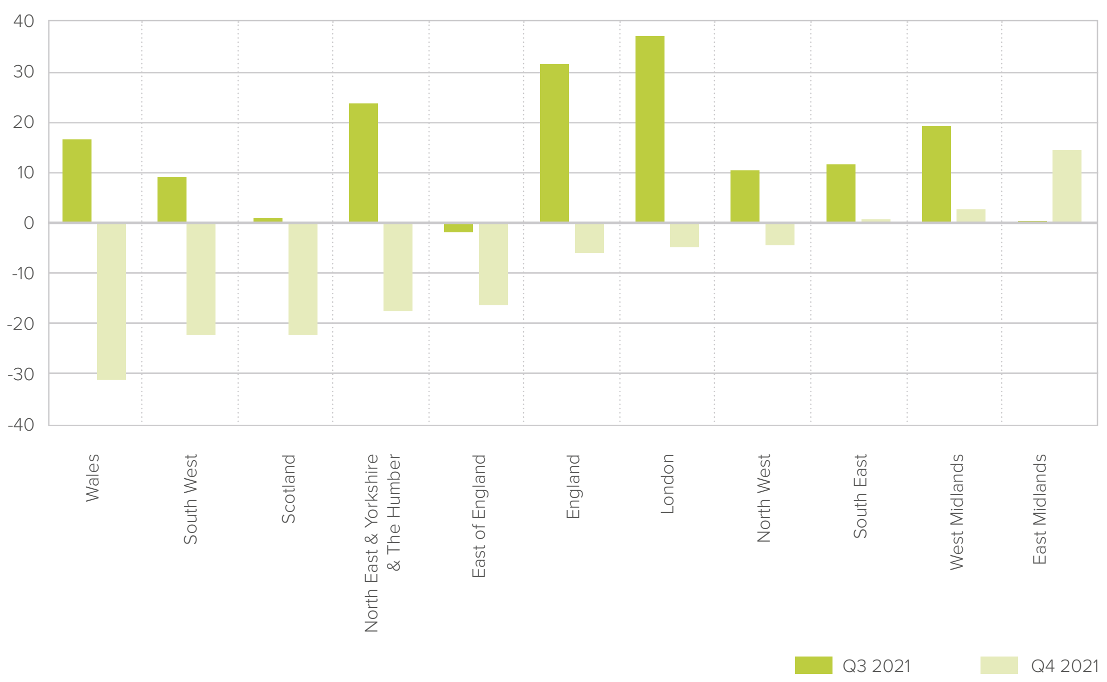
SMALL BUSINESS INDEX IN NEGATIVE TERRITORY FOR ALL BUT THREE OF THE UK'S CONSTITUENT REGIONS AND NATIONS

Most UK regions saw a negative reading on the SBI in Q4, with the exceptions of the East Midlands, West Midlands and South East. As such, in most regions of the UK, the proportion of small businesses expecting a worsening in performance in the coming quarter exceeded the proportion expecting an improvement. In addition to this, all regions except the East Midlands saw a fall in their SBI reading in the quarter.

Among the different constituent regions and nations in the UK, the sharpest falls in the SBI were witnessed in Wales and London, with reductions of 48.1 and 42.3 points, respectively. Small businesses in Wales also were the most pessimistic about their performance outlook among all regions, with a reading of -31.1 in Q4. This is likely in part a reflection of the relatively harsher government restrictions imposed in the country than in England in an attempt to stem the spread of the Omicron COVID-19 variant. London, with the next-sharpest fall in the SBI, has been at the epicentre of the Omicron surge in December. Retail, leisure and hospitality businesses, an important component of the capital's economy, have suffered from reduced footfall and bookings as a result of increased consumer nervousness. Occurring in such businesses' busier festive period, this is likely to have had a significant negative impact on profitability and confidence, with a degree of pessimism expected to persist into early 2022. Having represented the region with the greatest small business confidence in Q3, London's reading of -4.6 in Q4 brought it roughly in line with that of -5.8 across England as a whole.

Meanwhile, small business confidence remained robust in the East and West Midlands, where SBI readings of 14.9 and 3.1 were recorded for Q4, respectively. The former saw the only increase in the SBI across all regions in Q4, with a rise by 14.9 points from a neutral reading in the previous quarter.

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

Q4 SEES SHARP CONTRACTIONS IN CONFIDENCE ACROSS MOST MAJOR INDUSTRIES

All major UK industries with sufficiently large sample sizes saw a contraction in confidence on the latest round of the SBI. However, all sectors except manufacturing, accommodation and food services, and wholesale and retail trade remained optimistic in Q4.

The lowest sectoral SBI readings in Q4 were seen in wholesale and retail trade, and accommodation and food service activities, recording values of -40.3 and -33.0, respectively. These readings were down by 29.8 and 35.4 points, respectively, on those seen in Q3. The sharp growth in pessimism in both sectors is likely to reflect the effects of the significant spread of the Omicron COVID-19 variant in December. With significant growth in COVID-19 cases ahead of the festive season, increasing consumer caution caused a reduction in footfall in many city centres and other busy consumer-facing environments even before limited restrictions were introduced, leading to increasing calls from retailers and hospitality owners for government support.

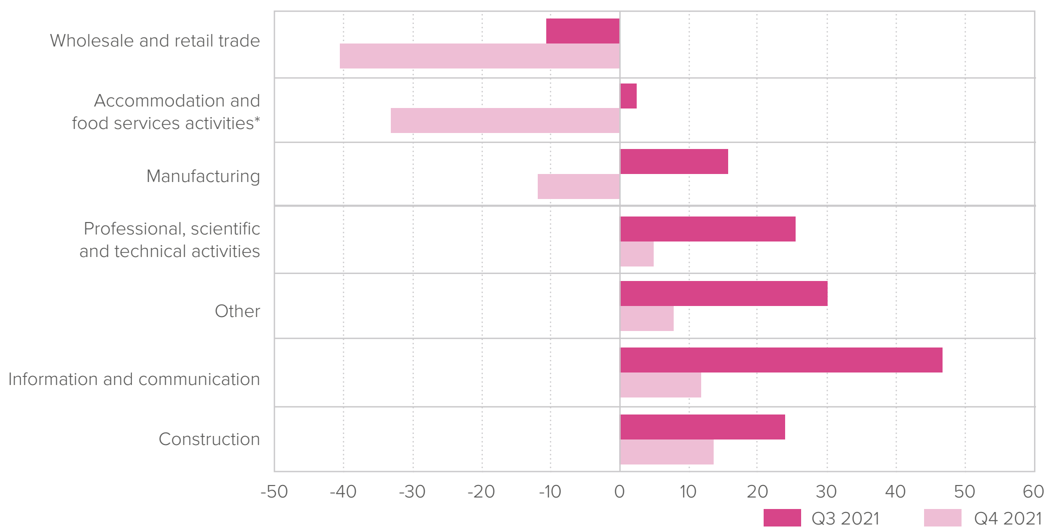
A fall of 27.5 points in the SBI reading for manufacturing was sufficient to bring the sector into negative territory, at -12.0, marking the first time that manufacturing firms expect performance to worsen since Q4 2020. Meanwhile, the largest fall in the SBI reading in Q4 was seen in information and communication. The sector saw a reduction by 35.1 points in the final quarter, to reach 11.4, but does remain in positive territory. This, along with falls in the SBI among all other major industries, provides evidence of a worsening outlook for the UK economy more broadly as it moves into 2022, as indicated by the most recent Composite PMI data.

Nonetheless, firms in the majority of major industries remained optimistic on balance, expecting an improvement in performance in the coming quarter, albeit at a slower pace. If early signals of relatively lower severity of the Omicron variant, compared with previous mutations, are confirmed in early 2022, consumers and thus industries can be expected to become more optimistic in Q1.

Late payment also continues to be a major issue for small businesses, often resulting in a slowdown of productivity, cashflow issues and casting uncertainty on future plans. Seeing fewer small business suffering from late payment is a bellwether sign that day-to-day finances of the UK economy are in good health, and that businesses are not delaying payments unfairly to give their own reserves a temporary boost.

In the latest period one in three (31%) small businesses reported that they had suffered from late payment increases. This is a sizeable minority of the small business community that is seeing cashflow restricted. Concerningly, only six per cent of small businesses reported that instances of late payment have been agreed between their customer, meaning many instances of late payment are unplanned and unaccounted for. As a result, affected businesses may either have to look at their own reserves, or find alternative means of unlocking the necessary cashflow to operate.

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



*Note: due to a small sample size, the Q3 results for accommodation and food service activities should be interpreted with caution.

FINANCIAL PERFORMANCE

BUSINESSES REPORT FALLING PROFITS IN Q4, WITH FURTHER POOR PERFORMANCE EXPECTED IN Q1

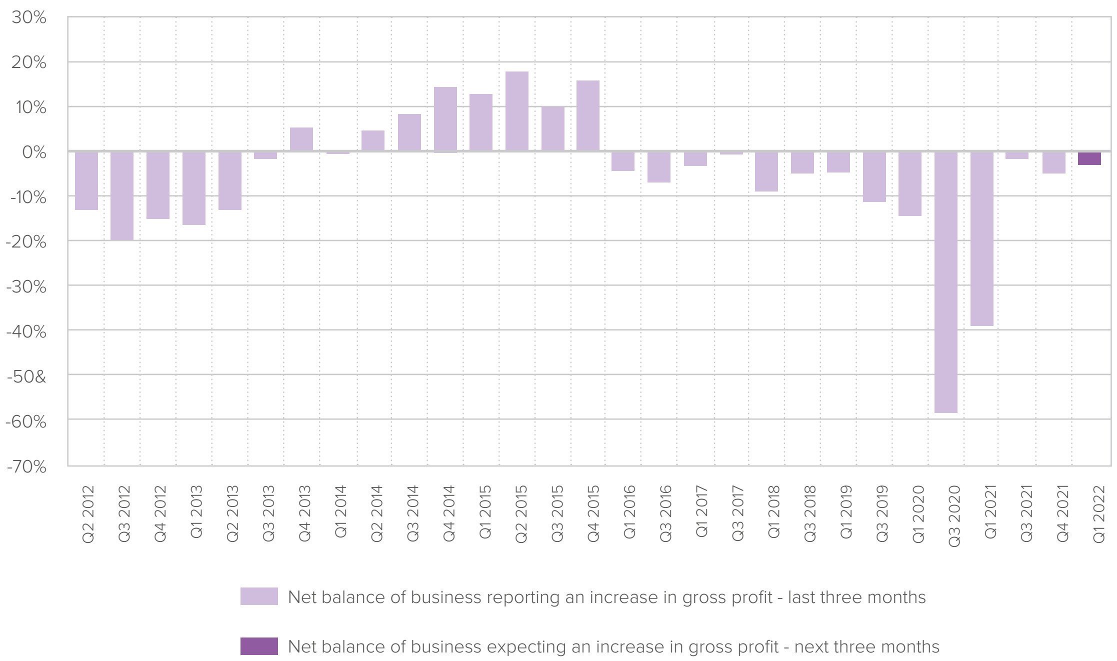
The net balance of small businesses reporting gross profit growth over the previous three months stood at -4.8% in Q4. As such, the number of small businesses reporting an increase in gross profit levels was outweighed by the number reporting a decrease. The reading for Q4 is below that of -1.4% seen in Q2, suggesting a worsening of performance, but significantly less negative than those seen earlier in the pandemic. Indeed, a positive reading has not been seen on this biannual SBI question since Q4 2015. Among major UK industries, the proportion of businesses reporting a fall in gross profits in Q4 was the largest in accommodation and food services, with a net balance of -31.4% experiencing growth.[2]

Looking ahead to Q1 2022, businesses remain pessimistic about their profitability prospects, albeit to a lesser extent. A net balance of -3.3% of firms expect gross profit levels to increase, marking an improvement on the actual experiences of firms in Q4.

This suggests that firms expect the tide to somewhat turn in terms of the damage caused by the Omicron variant. On a sectoral basis, firms in the wholesale and retail trade are the most pessimistic about their profit levels in Q1, with a net balance of -26.1% expecting growth. This is followed by manufacturing, where a net balance of -11.1% expect growth. These findings mirror those showing pessimism in these two sectors, as explored in Section VII.

Meanwhile, businesses in professional, scientific and technical activities exhibit the most optimism regarding their profitability in Q1, with a net balance of 7.5% expecting an improvement. This is likely to reflect the less consumer-facing nature of business in this sector, compared to firms such as those operating in retail, and thus a reduced scope for nervousness around rising infections leading to lower demand.

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



2 Due to a sample size of less than 50 (44) for accommodation and food services, this result should be interpreted with caution.

EXPORTS

EXPORT VALUES CONTINUED TO DETERIORATE IN Q4

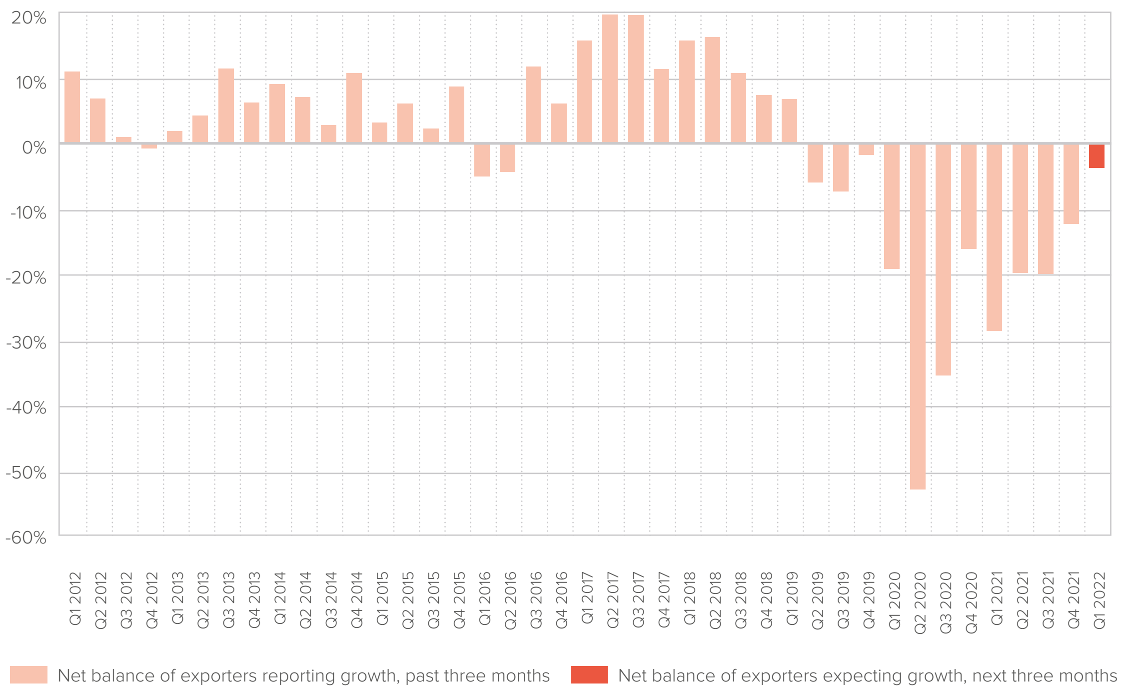
The net balance of exporting businesses reporting growth in the value of their exports improved slightly in Q4, reaching -12.3%, up from -20.0% in Q3. However, the proportion of business witnessing an increase in the value of exports continued to be outweighed by the proportion experiencing a decrease. Further, the reading for Q4 came in considerably worse than the expectations for the period by exporting firms at the end of Q3, when a forward-looking -4.6% reading was expected. Looking ahead to Q1 2022, more businesses expect a worsening in the value of their exports than those expecting a rise in value, with a net balance of -3.8% expecting growth.

These results indicate a continued disappointing outlook for exporters, amid ongoing supply chain disruption, labour shortages, and increasing frictions following the UK's full departure from the EU at the start of 2021. The latest ONS data show a fall in imports of machinery and transport equipment from EU and non-EU countries in October, partly attributable to an ongoing global shortage in semiconductors. Imports of chemicals and material manufactures were also seen to fall in October.

A reduction in the availability of such inputs for production limits the ability of exporters to meet demand. Moreover, with the rapid spread of the Omicron variant at the end of Q4, existing labour shortages experienced by exporters are likely to have worsened, amid increasing staff absences due to infection.

Additionally, UK exporters continue to face disruption following the country's departure from the EU. One in eight (12.4%) of exporting businesses noted that they had temporarily stopped exporting to the EU as of Q4. Whilst this is down on the proportion of 16.6% recorded in Q3, part of this reduction may be explained by a rising proportion of exporters that have decided to permanently stop exporting to the EU, which stood at 9.4% in Q4, up from 4.4% in Q3. Moreover, the proportion of firms that are considering ceasing exporting to the EU rose from 7.2% in Q3 to 9.4% in Q4. Additional trade frictions caused by Brexit are likely to be felt in Q1, with the full introduction of custom controls from 1 January. These may cause complications for exporters in terms of both importing the inputs necessary for production as well as selling their final output abroad.

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 Q4

The net balance of small businesses reporting an increase in operating costs increased for the third consecutive quarter in Q4, reaching 72.9%, having previously stood at 69.5% in Q3. This marks the highest reading on this measure since the series high of 74.0% recorded in Q4 2011. Over one-fifth (20.3%) of responding firms noted experiencing a significant increase in operating costs (a rise of over 10%) in the final quarter, compared to the same period one year previously, whilst only 5.3% saw a decrease in costs of any magnitude.

The SBI readings for business costs reflect continued increases in producer prices throughout Q4. Input prices according to the ONS's Producer Price Index (PPI) increased by 14.3% in the year to November, up from 13.7% in October and 12.4% in September. November's PPI reading marks the highest level of annual input inflation since that of 14.4% in July 2008. Among the factors driving the significant increase in producer input costs in November were sharp rises in the prices of: crude oil, which saw an 80.9% increase in the twelve months to November 2021; fuel, up 27.0% over the same period; metal and non-metallic mineral prices, which increased by 21.8% year-on-year; and chemicals, which were up 14.9%. Supply chain bottlenecks amid a recovery of global demand from the depths of the pandemic have driven significant price rises in commodity markets, causing increasing pressure on business costs. Unlike households, which are somewhat protected by the energy price cap, businesses are much more exposed to surging prices, relying instead on energy hedging.

These developments are reflected in the experiences of small businesses. Inputs remained the most common source of cost changes for the fourth consecutive quarter, being selected by almost half (48.7%) of firms. As was the case in Q3, this was followed by fuel costs (45.6% of firms) and utilities costs (44.8%). The proportion of firms citing fuel costs as a main source of cost increases saw an uptick of 9.1 percentage points between Q3 and Q4, the largest of any category for the second consecutive quarter. Meanwhile, an intensification of existing labour shortages, amid increasing staff absence due to the Omicron COVID-19 variant, was reflected in an increase in the share of firms citing labour costs as a source of pressure in Q4, at 38.0%, up from 36.4% in Q3.

Figure 9: 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

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

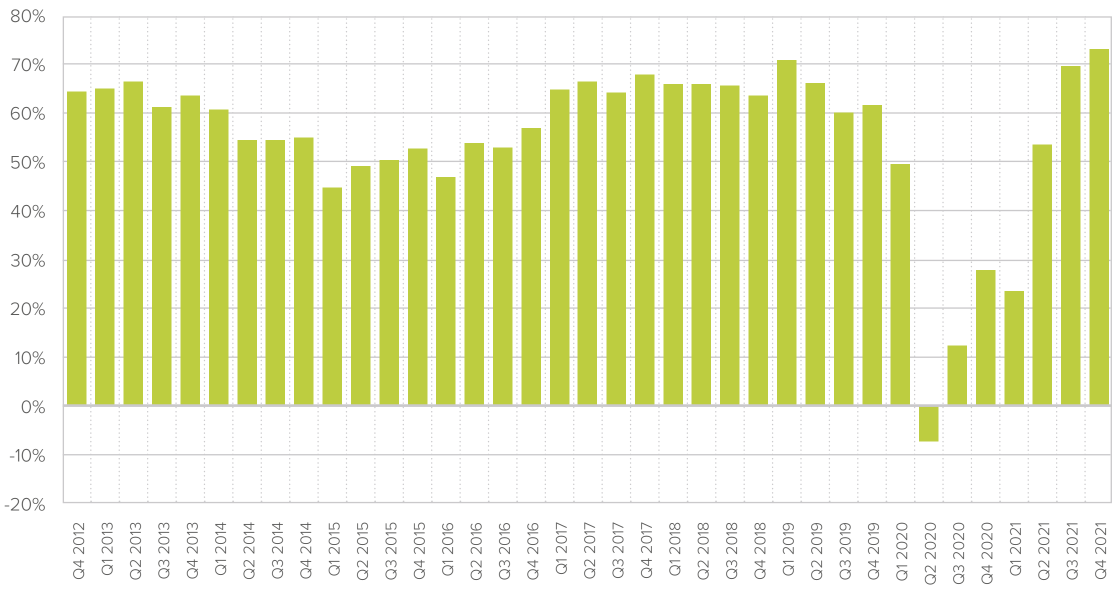
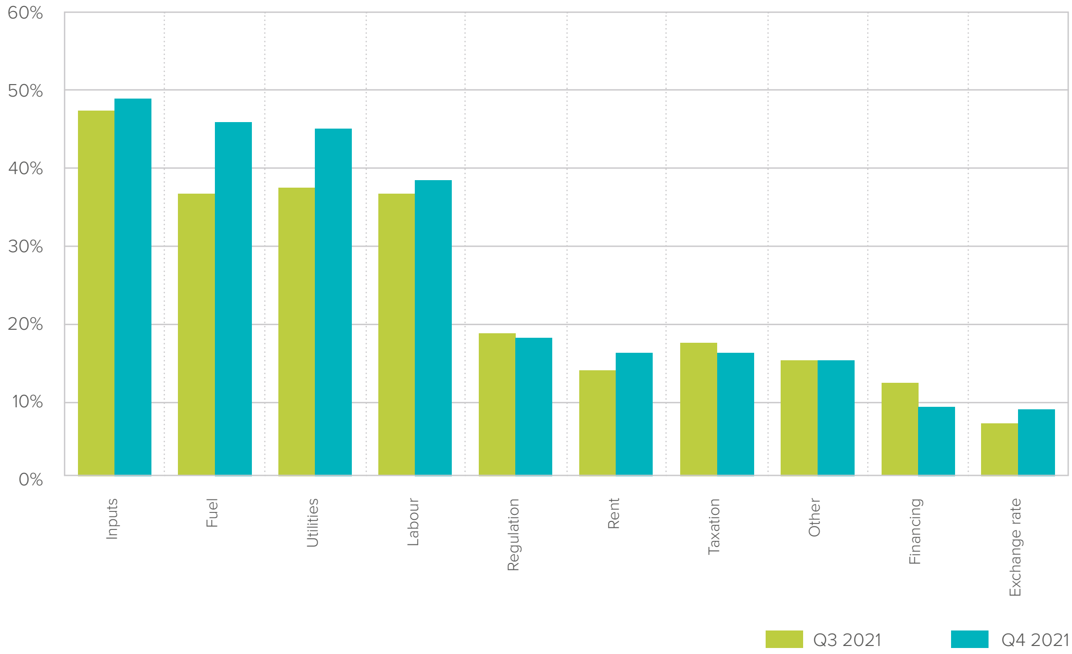


Figure 10: Main causes for changing business costs (firms may give multiple answers)
Source: FSB - Verve 'Voice of Small Business' Panel Survey



EMPLOYMENT

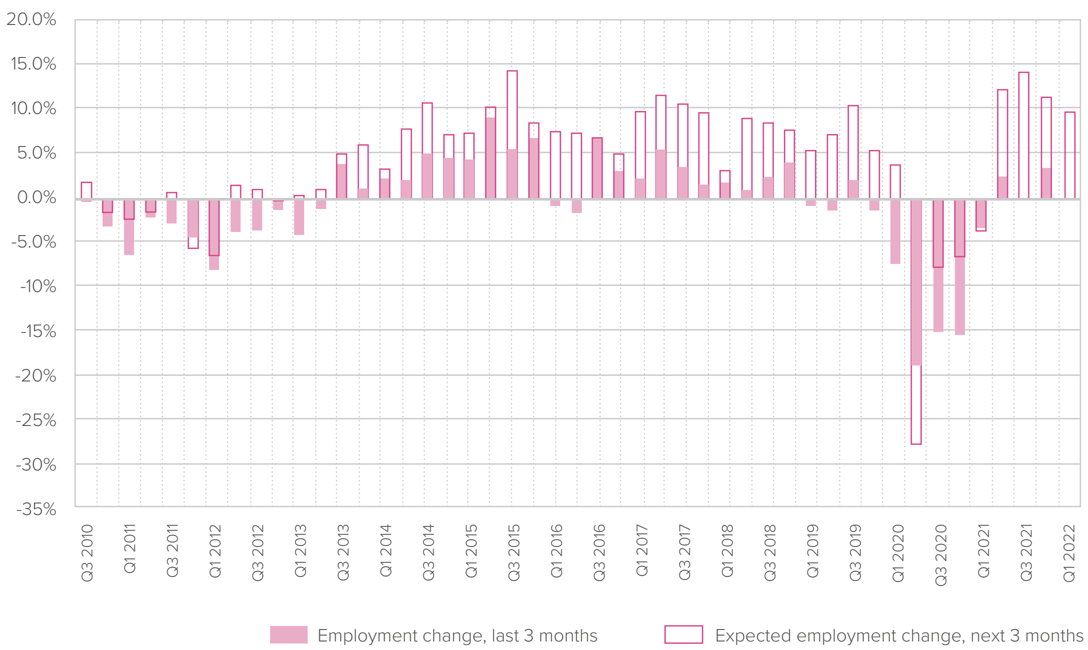
UPTICK IN Q4 EMPLOYMENT DESPITE WITHDRAWAL OF GOVERNMENT SUPPORT

The net balance of small businesses reporting growth in the size of the workforce stood at 3.3% in Q4. As such, the number of businesses seeing their workforce increase in size outweighed the number of businesses seeing a contraction in employee numbers. This marks a return to workforce growth from the negative net balance figure of -0.2% in Q3. Only 12.8% of firms noted reducing the size of their workforce in the three months to December 2021, the lowest reading since Q1 and the second lowest since the start of the pandemic. Meanwhile, a larger share of 16.1% of responding firms increased their workforce numbers in Q4, the largest share since Q2 2017.

The findings for Q4 reflect broader trends of falling unemployment, rising employment and record vacancies in the final months of 2021. According to the most recent data available from the ONS, the UK unemployment rate stood at 4.2% in the three months to October, down by 0.4 percentage points compared to the previous three-month period to July and up only 0.4 percentage points on the equivalent period in 2019, prior to the pandemic. Meanwhile, vacancies reached a new record of 1.2 million in the three months to November. The figures, as well as the findings of the Q4 SBI, provide further evidence of resilience in the labour market even following the termination of the Coronavirus Job Retention Scheme at the end of September, with any downside effects more than outweighed by the upside effects of the ongoing economic recovery.

Even greater optimism was seen with regard to business employment in Q1 2022, with a net balance of 9.8% of firms expecting growth, suggesting that the recovery is leading to a continued expansion in employment, and that the emergence of the Omicron COVID-19 variant is not perceived to pose a significant risk to workforce numbers even in the post-furlough era. On a regional basis, the highest net balance of small businesses expecting an increase in employment in Q1 was seen in London, as was the case in Q3. Nonetheless, the net balance of 16.5% of firms expecting employment growth in London was slightly down on that of 19.8% in Q3. Whilst firms in the capital remain largely optimistic, the reduction in this forward-looking measure suggests that the significant spread of the Omicron variant has somewhat hampered expectations of consumer demand and thus hiring requirements.

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



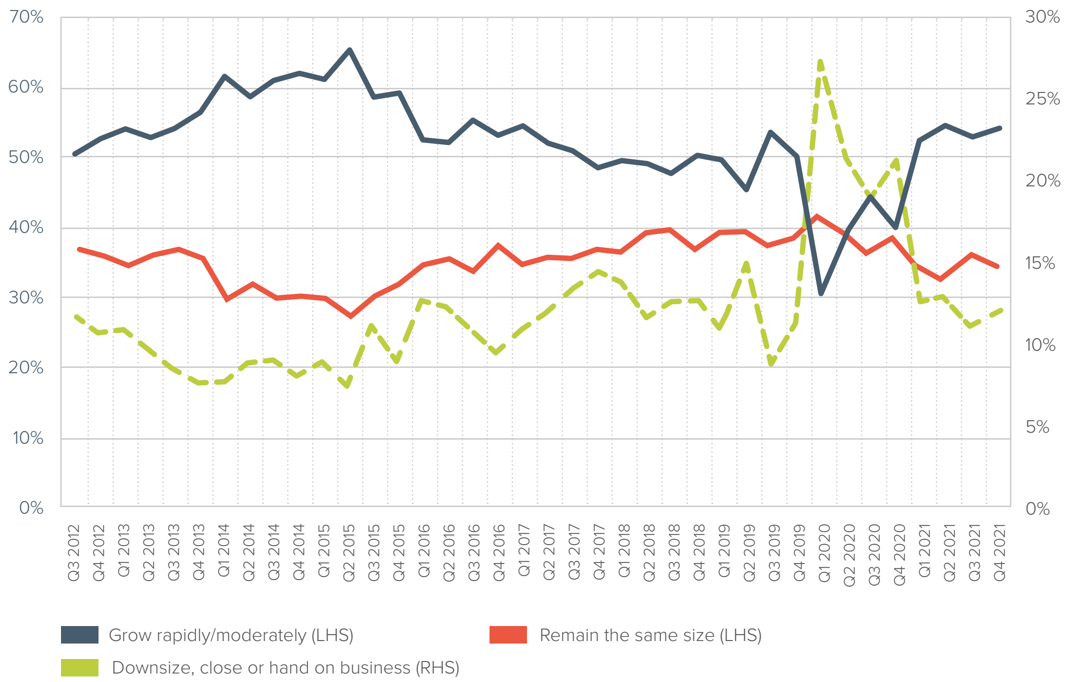
GROWTH ASPIRATIONS AND CHALLENGES

THE SHARE OF FIRMS ASPIRING TO GROW IN THE NEXT TWELVE MONTHS CONTINUES TO TICK UP IN Q4

The net balance of firms expecting to grow their operations in the next twelve months saw a quarterly increase of 0.3 percentage points in Q4, reaching 42.2%. This was driven by an increase by 1.0 percentage points in the share of businesses aspiring to grow, reaching 54.1%, outweighing an increase of 0.7 percentage points in the share foreseeing a contraction, which stood at 11.9% in the final quarter. The net balance of firms aspiring to grow was last higher in Q3 2019, when it stood at 45.0%.

On a regional basis, growth aspirations were highest in London in Q4, with a net balance figure of 57.0%, compared to the lowest figure of 29.2% in the combined North East/andYorkshire and The Humber regional cluster. Studying the results by major UK industries reveals that firms in the information and communication sector were most likely to aspire to grow in the next twelve months, with a net balance figure of 51.6%, followed by a reading of 51.2% in professional, scientific and technical activities. Meanwhile, a net balance of only 36.1% of manufacturing businesses expected growth, with 2.5% anticipating that they will permanently close at some point in the next twelve months. This finding mirrors the increasing pessimism exhibited by manufacturing firms, as explored in Section VII.

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



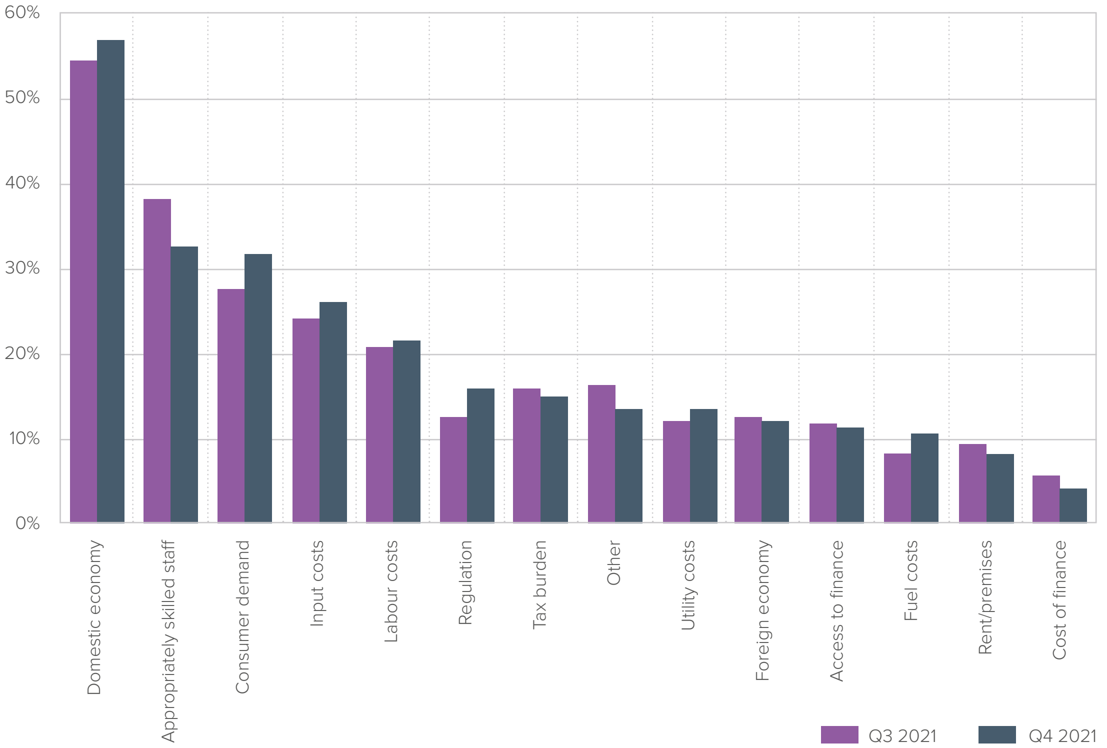
SPREAD OF THE OMICRON VARIANT SEES THE STATE OF THE DOMESTIC ECONOMY BECOME A GREATER BARRIER TO GROWTH

Amongst businesses aspiring to grow, the most frequently cited potential barrier to this growth continued to be the domestic economy in Q4. Selected by 56.7% of responding firms, up from 54.6% in Q3, Q4 saw the first quarterly rise in the share of firms citing this option since Q2 2020. This is likely to reflect the increased level of uncertainty over the prospects for the UK economy in light of the significant spread of the Omicron variant in December, which saw both the introduction of government restrictions and increasing nervousness among consumers. Indeed, in London, which has been the hardest hit by the Omicron variant, almost two-thirds (63.6%) of responding firms cited the domestic economy as a key challenge to their growth aspirations.

Following concerns relating to the domestic economy, access to appropriately skilled staff and the state of consumer demand represented the next most commonly cited barriers to growth, being selected by 32.6% and 31.6% of firms, respectively. The share of firms citing skilled staff shortages as a key barrier to growth did, however, see the largest reduction among all options between Q3 and Q4, with a fall of 5.4 percentage points. The largest increase among all barriers was seen with respect to consumer demand, with the share of firms citing this option rising by 4.1 percentage points. These developments suggests that, whilst remaining a key concern, the severity of labour shortages is beginning to ease, driven by lower expectations of labour requirements in line with anticipated falls in demand.

On a sectoral basis, whilst concerns around the domestic economy represented the key barrier to growth for firms in the vast majority of UK industries with sufficiently large sample sizes, input costs were the most commonly cited barrier cited by manufacturing firms. Being selected by almost two-thirds (65.6%) of such firms, this suggests that ongoing supply chain bottlenecks and high energy prices are a particular concern for the manufacturing industry, likely driven by its relatively high intensity of energy usage and reliance on imported inputs.

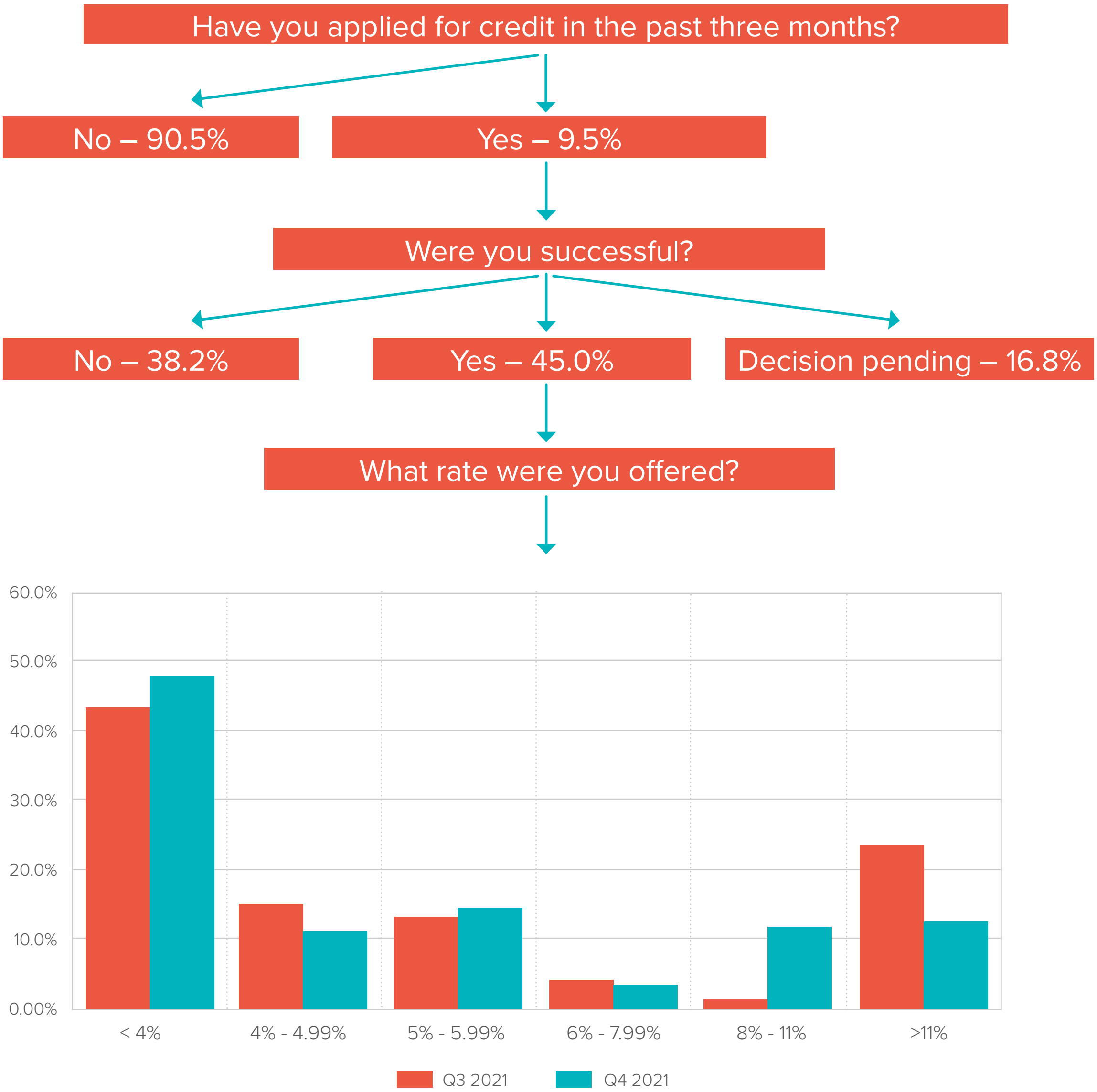
Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey



CREDIT

APPLICATIONS FOR CREDIT REACH A FURTHER RECORD LOW, WHILST BORROWING COSTS DIP

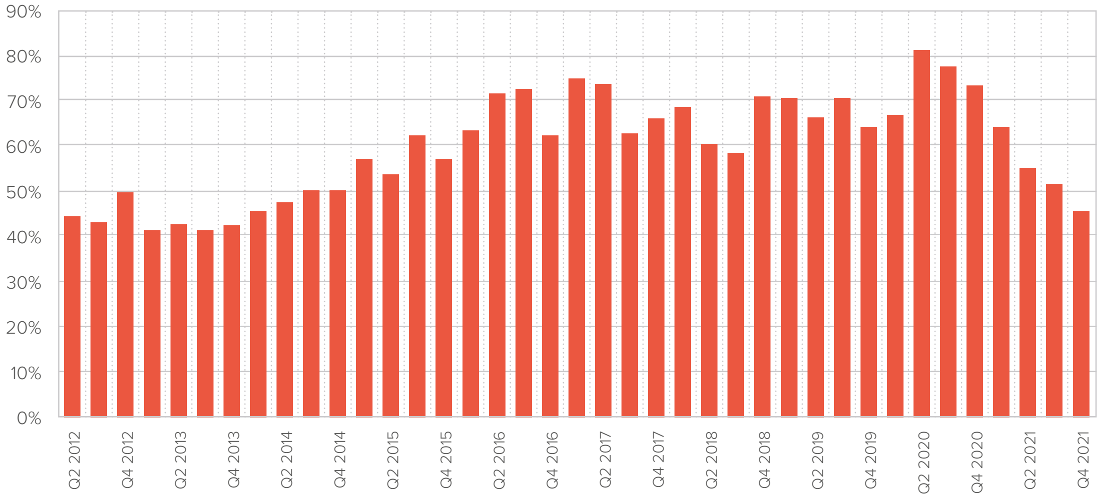
Figure 14: Credit applications and interest rates offered
Source: FSB - Verve 'Voice of Small Business' Panel Survey.
Respondents were able to give multiple answers to this question.



The proportion of small businesses applying for credit fell for a sixth consecutive quarter in Q4, with this being the case for just 9.5% of responding firms. As was the case in Q3, this marks the lowest proportion of firms applying for credit since data collection for the SBI began. It is likely that this development in part reflects a continued reduction in the need for cashflow support, in line with the broader economic recovery. However, increased uncertainty over the prospects for growth in 2022, amid the resurgence of the pandemic in Q4, is also likely to have caused some hesitancy to invest in Q4, putting further downward pressure on the demand for credit.

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.

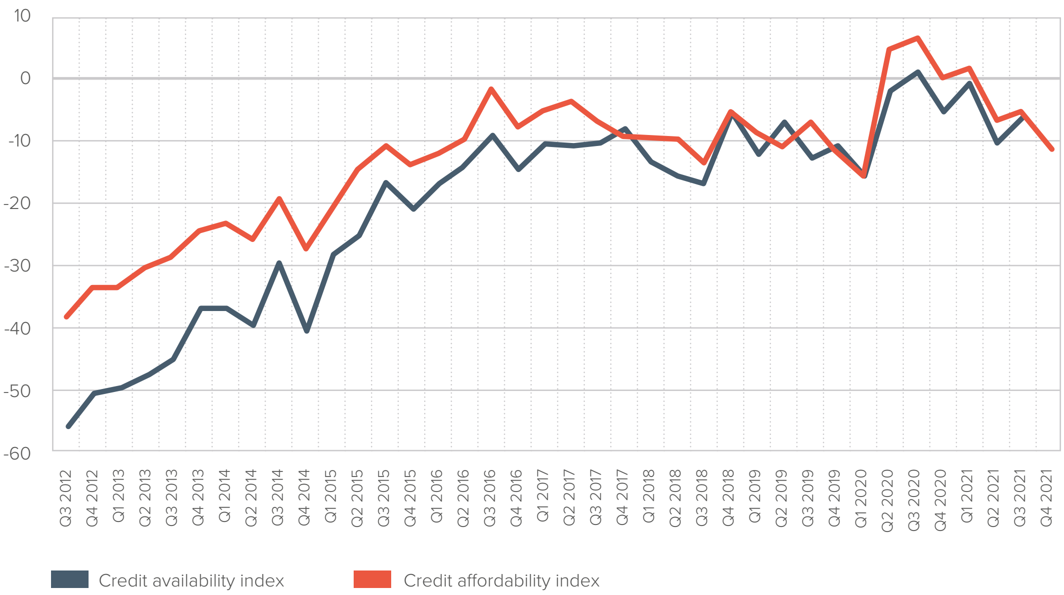


CREDIT AVAILABILITY AND AFFORDABILITY INDICES FALL TO LOWS NOT SEEN SINCE Q1 2020

The proportion of small business describing the availability of credit as 'good' or 'very good' continued its downward trend in Q4, reaching 26.4%. This marked the third consecutive quarterly fall in the reading, and the lowest share since Q1 2020. Meanwhile, the share of businesses describing the availability as 'poor' or 'very poor' rose to 36.0% in Q4 from 32.3% in Q3. As a result, the credit availability index fell in Q4, reaching -10.8, marking the lowest reading since Q1 2020.

The proportion of small businesses describing the affordability of credit as either 'affordable' or 'very affordable' fell to just over one quarter (25.8%) in Q4, from 31.5% in Q3. This reading is just 0.1 percentage point above the recent series low of 25.7% seen in Q1 2020. Meanwhile, the proportion of small businesses describing the affordability of credit as 'unaffordable' or 'very unaffordable' rose to 38.0% in Q4, from 33.4% in Q3. These two developments saw the credit affordability index fall by 6.5 points to -11.4 in Q4, the worst reading since that of -15.6 in Q1 2020. This came despite a fall in the reported average interest rates offered to small businesses.

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.



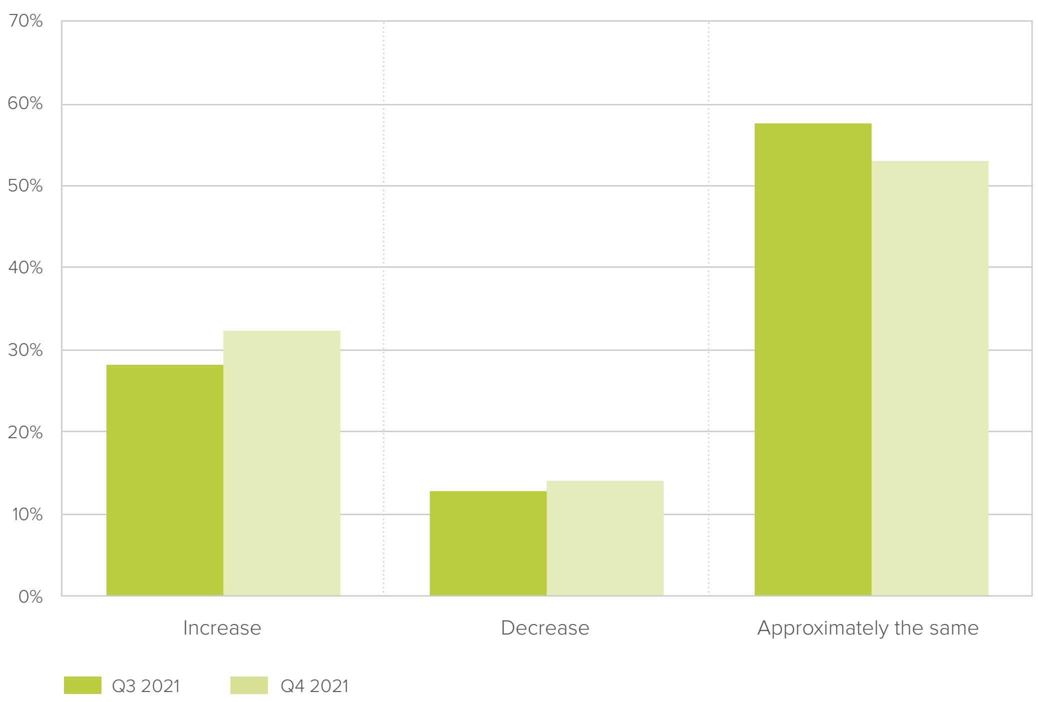
INVESTMENT

INVESTMENT AMBITIONS RISE TO A THREE-YEAR HIGH IN Q4

For the second consecutive quarter, the proportion of small businesses expecting an increase in investment levels over the coming quarter grew in Q4. The share rose by 3.9 percentage points in the final quarter to reach 32.5%, the highest reading since that of 32.8% in Q1. Meanwhile, the proportion of businesses anticipating a reduction in investment in the coming quarter picked up slightly from Q3's low of 13.2%, reaching 13.9% in Q4. As such, the net balance of businesses expecting to increase their investment stood at 18.6% in Q4, the highest reading since that of 19.2% in Q3 2018.

This increase in investment ambitions came despite the increased uncertainty caused by the surge of COVID-19 cases in the final quarter, suggesting that firms view the disruption caused as largely temporary. Amongst sectors, investment ambitions were particularly prevalent in information and communication, with a net balance of 31.7% of firms expecting to increase their capital investment over the coming quarter, up sharply from 21.5% in Q3. Manufacturing firms also saw an increase in investment plans between Q3 and Q4, albeit with a smaller rise from a lower base, with a net balance figure of 21.2% in Q4, up from 17.7% in Q3. This more subdued foreseen increase in investment mirrors the previously explored relative pessimism observed in the sector.

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 December research survey of FSB members carried out by Verve. 5,797 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. 566 responses were received, a response rate of 9.8% for the panel. The survey was then shared with the wider FSB members and received a total of 1,217 responses. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between the 2nd and 13th of December 2021.

SUMMARY DATA TABLE

	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
Small Business Index	-143.4	-5.0	-32.6	-49.3	27.3	18.6	16.4	-8.5
Employment - previous three months	-7.6%	-19.0%	-15.2%	-15.5%	-3.5%	2.2%	-0.2%	3.3%
Employment - coming three months	-27.9%	-7.9%	-6.7%	-3.8%	12.0%	14.0%	11.5%	9.8%
Exports - previous three months	-19.1%	-52.8%	-35.2%	-16.0%	-28.4%	-19.8%	-20.0%	-12.3%
Exports - coming three months	-52.4%	-12.8%	-18.9%	-29.0%	-9.8%	-11.2%	-4.6%	-3.8%
Credit availability - rated good or very good	24.4%	38.3%	36.4%	29.3%	35.2%	30.0%	29.6%	29.6%
Credit availability - rated poor or very poor	41.6%	34.9%	30.9%	30.5%	30.1%	35.0%	32.3%	32.3%
Credit affordability - rated good or very good	25.7%	41.8%	43.0%	36.5%	38.3%	31.4%	31.5%	31.5%
Credit affordability - rated poor or very poor	44.0%	31.9%	28.3%	30.3%	31.2%	35.0%	33.4%	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.

Q4

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