Q4

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 4, 2022

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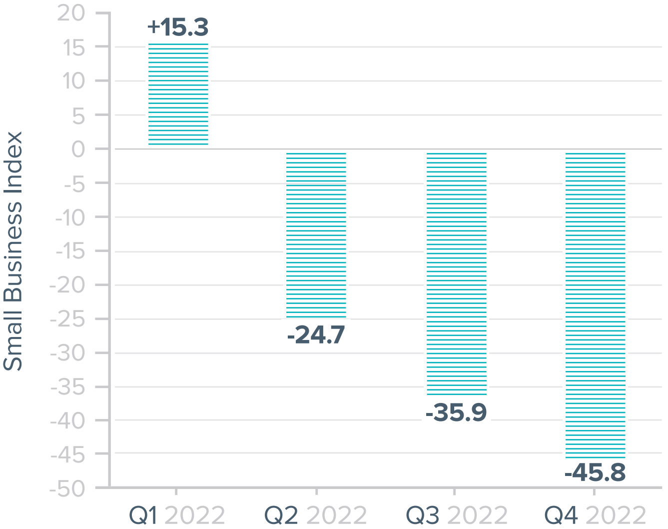
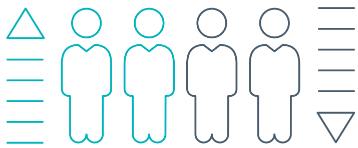
SBI Q4 2022

“Fourth quarter fall in confidence sees 2022 end on a record low outside periods of lockdown”

Small business confidence near a level last seen in the **second national lockdown in Q4 2020**



More small firms **decreasing staff numbers:**



16%

of small businesses **decreased staff levels** in Q4, while only **10%** saw them **increase**

Finance access concerns:

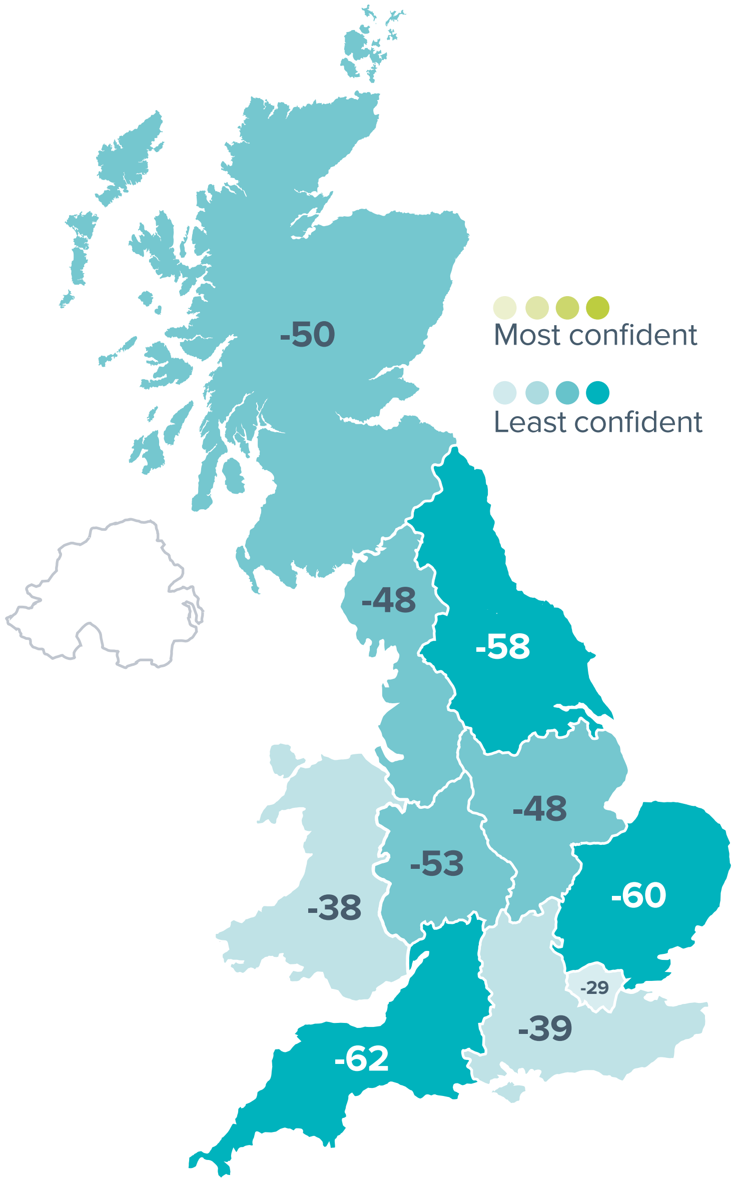
51%

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

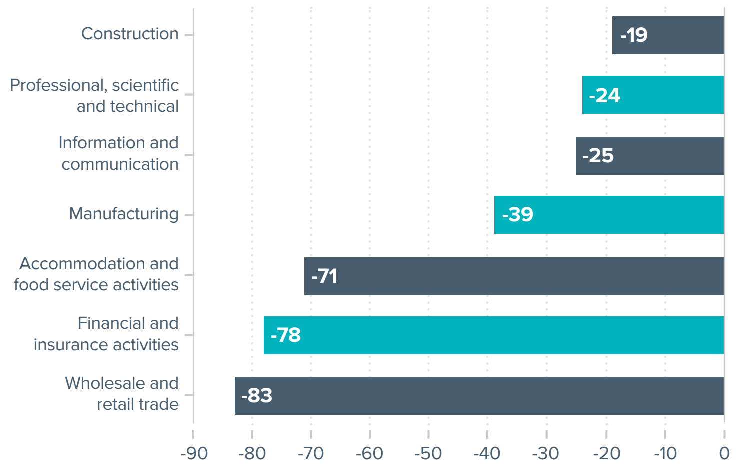
Revenue expectations are subdued:

44%

of small firms expect their **revenues to decrease over the next quarter**, while only **29% expect them to increase**



Small business confidence by sector



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FSB FOREWORD

The latest headline Small Business Index confidence reading does not tell a happy story about the state of the UK's 5.5 million-strong community of small businesses and self-employed people. Appropriately enough for the winter edition of our quarterly temperature check of small businesses, the -46 points measured is well into deep freeze territory, having fallen steadily from the relatively sunny outlook which small firms reported in the first quarter of 2022, the last time it was in positive territory.

The auguries for the Q4 report were far from promising, as – a week before the quarter began – the short-lived Truss administration unveiled the mini-Budget, which was not well-received by markets, to say the least, and which sparked economic turmoil which was only brought under control by swift action from the Bank of England, while a new Prime Minister and Chancellor took up their posts. Like everyone else, small firms felt the effects of this upheaval in different ways, from reduced consumer spending to higher rates on loans and mortgages.

There's no denying the scale of the challenge that small firms are facing – the findings of this report speak for themselves in that regard. With persistently high energy prices (and with the end of the Energy Bill Relief Scheme looming at the end of March, to be replaced by the far less generous Energy Bill Discount Scheme), trouble finding staff with the right skills, and higher costs for just about every input you care to mention, small businesses are up against it to a degree not seen since the height of the pandemic.

This gloom can be found in all major sectors, and in every region and nation. Retail and hospitality are the least optimistic industries, a worrying finding when the last quarter of the year is one in which we'd usually hope to hear the sound of tills ringing amid festive cheer. Industrial action made it harder for some businesses to operate, especially retailers whose deliveries were delayed or cancelled due to postal strikes, while the low levels of consumer confidence registered in the final quarter underlined the fact that huge numbers of households are reining in their spending.

Revenue growth is another indicator which is flashing red on current performance, as well as sounding a warning about the coming quarter. Ten percent more small firms reported a fall in revenues over Q4 than enjoyed a rise, the third time in a row this has been the case, while the net balance looking ahead to Q1 2023 was -14%, a finding which sends a chill down the spine, as various economic institutions – from the IMF to the Bank of England – forecast that the UK economy will see at very best only anaemic growth this year, with a contraction also on the cards.

Interest rates have continued their upward climb, and small businesses' credit confidence has taken another tumble, with our credit availability and affordability tracker falling to -29 points. The proportion of small firms now offered an interest rate of 11% or higher has quadrupled over the course of 2022, from 7% in Q1 to 28% in Q4, while two in five of those who applied for credit in Q4 were unsuccessful. Meanwhile, the cost rises which have prompted the Bank of England to hike rates repeatedly are showing little sign of easing, with the highest ever net balance of firms in the Small Business Index's history – 86% – reporting operating costs greater than in the same quarter the previous year.

More small firms shed than took on staff in Q4, with a net balance of -6% reporting growth in employee numbers, although it is a notable – and hopeful – sign that the proportion expecting to expand their workforce in Q1 2023 barely outweighs those expecting to shrink, at 3% net balance. However, the share of small firms anticipating growth slipped between the third and fourth quarters, from 47% to 45%, yet another unwelcome harbinger of problems ahead.

Small businesses are resilient and astute, and skilled at adapting their operations to fit prevailing conditions with an eye to the future. But there is a limit to what they can cope with. They are looking now to the Budget in March, where the Government has an opportunity to set out an agenda for growth. We have come up with proposals to help small firms on issues ranging from late payment, to helping economically inactive people back into work, to promoting small businesses' investment in R&D and their ability to reduce emissions, as well as mitigating the impact of the pre-profit taxes which deter risk-taking and entrepreneurship. With a less than encouraging sounding of small business sentiment in the final quarter, we are calling on the Government to take action and turn the economic forecast from wintry chill to something with more of a hint of spring to it.

Martin McTague,
National Chair

Tina McKenzie,
Policy Chair

ECONOMIST'S VIEW

Kay Daniel Neufeld, Head of Forecasting and Thought Leadership

The latest reading of the Small Business Index (SBI) shows that small business sentiment deteriorated further in the last quarter of 2022, with the index dropping by 9.9 points to stand at -45.8. This represents the lowest score since Q4 2020, when the country went into a second national lockdown for a four-week period, highlighting the exceptional degree of pessimism currently evident across the UK's small business community.

Pressures from rising interest rates, slowing consumer demand and high energy costs weighed on businesses' growth outlook for the majority of 2022. Additionally, the UK saw heightened political volatility during the final months of last year. On 23 September, then-Chancellor Kwasi Kwarteng presented his so-called mini-Budget which contained a range of unfunded tax cuts and which was, unusually, not accompanied by fiscal projections from the Office for Budget Responsibility. As a result, financial conditions in the UK deteriorated rapidly, with the Bank of England having to intervene to stabilise financial markets and limit the rise in gilt yields. Shortly after, Kwarteng was replaced as Chancellor by Jeremy Hunt, while Liz Truss resigned on 25 October, becoming the shortest-serving Prime Minister in history. The previously announced cuts to the basic rate of income tax, dividend tax, and a freeze in Corporation Tax were all reversed by the new Chancellor, amounting to a significant tightening of fiscal policy. This was further underscored by measures in the Autumn Statement aimed at raising more tax revenue. One of the few measures that was kept was the scrapping of the 1.25 percentage point increase in National Insurance rates.

Looking at small business confidence by sector reveals that all major industries reported negative sentiment in Q4 2022. Information and communication, the only sector to report positive business confidence in the previous quarter, recorded the largest fall of any sector in Q4, going from 12.2 points in the third quarter to -25.2 points. The industries with the most negative outlook are wholesale and retail trade at -83.3 points and accommodation and food service activities at -71.4 points, underlining the fact that consumer-facing sectors are particularly exposed to the economic downturn. While manufacturing and construction saw improvements on the previous quarter, their scores remained in negative territory at -39.3 and -18.6 points, respectively.

All regions and constituent countries of the UK reported a negative SBI reading at the end of last year. Between Q3 and Q4, only London recorded an improvement in the SBI score, taking its reading to -29.2 and making it the least pessimistic region. The East of England and the West Midlands, on the other hand, exhibited the largest quarterly falls in confidence, at -26.4 and -20.8 points respectively. The East of England therefore remains stuck towards the bottom of the regional ranking recording a score of -59.7, with only the South West reporting a gloomier outlook in Q4 at -61.7 points.

While the outlook for small businesses remains challenging at the start of the new year, some preliminary data suggest that the expected economic downturn might not be as deep as initially feared. Consumer confidence, while still in negative territory, ticked up in both November and December according to the YouGov/Cebr Consumer Confidence Index, possibly aided by residual pandemic savings. Meanwhile, the upside surprise to November's GDP figures means that the UK economy retained enough momentum to avoid recession in the second half of 2022. Perhaps most importantly, wholesale energy prices have been on a steep downward trend since the start of the year, reaching levels last seen prior to Russia's invasion of Ukraine. However, even in the case that current market trends persist, and prices don't rise again as temperatures drop, energy bills won't come down for another couple of months at best, as energy is bought well in advance by providers. Energy prices will be closely monitored by business owners as the Government's Energy Bills Relief Scheme will be replaced by the substantially less generous Energy Bills Discount Scheme from April, leaving businesses more exposed to volatility in electricity and gas markets. While the UK's small business community is sure to welcome any positive economic data, including falling inflation and energy prices, the challenges to the growth outlook for 2023 remain evident and many of the impacts of tighter financial conditions and falling demand are yet to be felt.

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index (SBI) fell to -45.8 in Q4 2022.** This marks a third consecutive quarterly fall, having stood at -35.9 in Q3, and the third consecutive quarter in which the Index has stood in negative territory.
- **All UK regions saw a negative reading on the SBI in Q4.** With the exception of London, all regions also saw their SBI reading worsen in Q4, relative to Q3.
- **All major industries saw negative SBI readings in Q4 2022.** Most major industries saw a worsening score in Q4 relative to Q3, with only manufacturing and construction witnessing improvement.
- **The net balance of small businesses reporting revenue growth over Q4 2022 stood at -10.1%.** This marked the third consecutive negative reading on this measure, with businesses experiencing difficult trading conditions.
- **The net balance of small businesses reporting an increase in operating costs stood at 86.1% in Q4.** This marks an increase from the net balance of 85.4% seen in Q3, and is the highest net balance figure on this measure since data collection began.
- **Utilities represented the most commonly cited cause of changing costs amongst businesses in Q4, being the case for 61.3% of survey respondents.** The percentage of respondents who attributed rising costs to taxation saw an increase from 17.0% to 23.1% in Q4. This is likely a reflection of the policy measures introduced by November's Autumn Statement.
- **A net balance of -6.1% of small businesses reported growth in employee numbers in Q4.** This marked the worst reading on this measure since Q4 2020, when the UK economy was facing the second national lockdown.
- **44.7% of small businesses expect to grow over the coming year, down on the share of 47.4% expecting growth when asked in Q3.** Weakening growth aspirations align with the general pessimism witnessed across the economy. Given the anticipated headwinds at the aggregate level, the ability of small businesses to grow is set to be tested over the coming year.
- **The domestic economy is the most commonly cited potential barrier to growth amongst businesses that expect to expand over the coming year, being selected by 63.7% of respondents.**
- **Finding appropriately skilled staff overtook consumer demand as the second-most cited threat to growth aspirations, with 32.7% of respondents selecting this.** Despite recessionary pressures, the labour market remains tight and firms are still facing difficulties in filling vacancies amidst labour shortages.
- **Q4 2022 saw the third consecutive quarterly rise in the share of small businesses applying for credit. At 13.8%, this share rose to its highest level since Q1 2021.**
- **Given the changing monetary policy environment, there has been some upward pressure on the rates offered to small businesses recently when applying for credit.** For instance, while the proportion of successful credit applications quoted an interest rate less than 5% fell to 38.1% in Q4, down from 41.4% in Q3, the share of applications being quoted a rate in excess of 11% rose to 28.2%, up from 20.2% previously.

UK MACROECONOMIC OVERVIEW

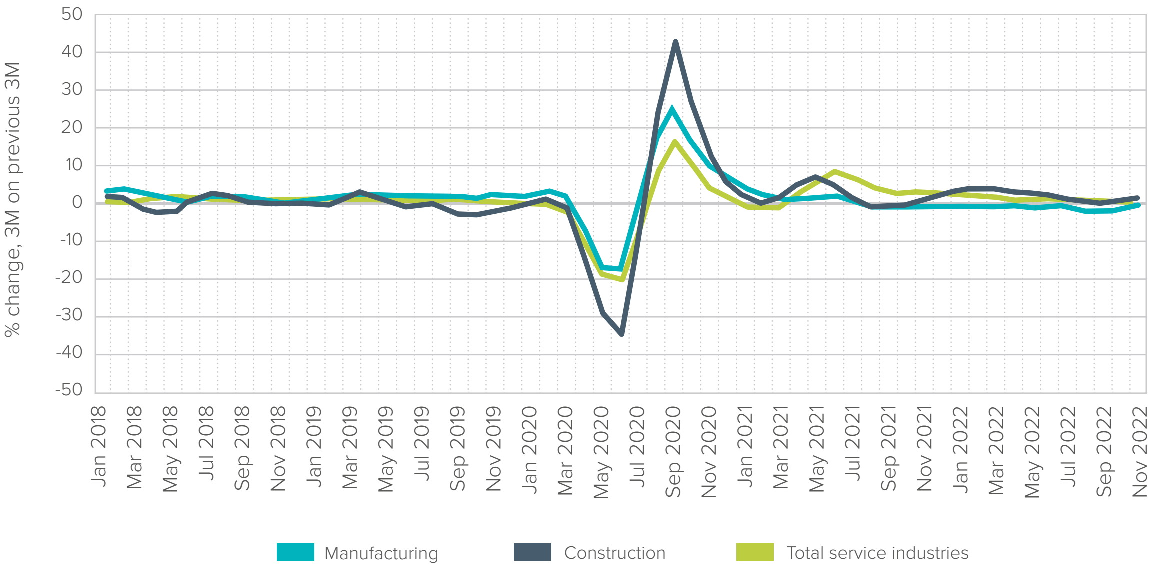
UK narrowly avoids recession in 2022, with outlook remaining gloomy for 2023

The latest data from the Office for National Statistics (ONS) show that UK GDP flatlined in Q4 2022. Following a 0.2% output fall in Q3, the economy therefore avoided a technical recession in 2022.

The latest monthly GDP data showed a return to economic contraction, however. Output was 0.5% smaller in December than in November. Though some of this decline could be attributed to widespread industrial action during the month, the continuation of existing economic headwinds was also a major factor. The services sector saw a particularly large decline, with output falling by 0.8% month-on-month. Services businesses are particularly exposed to demand-side pressures at the moment, with consumer activity being weaker amidst continually elevated inflation and general economic uncertainty. Away from services, the construction sector stagnated in December, while production output grew by 0.3%.

Though a recession was avoided in 2022, the wider pressures facing the economy have not dissipated. As such, Cebr anticipates the economy to shrink further in the early months of 2023, culminating in a recession across Q1 and Q2. In addition to the effect of inflation on household spending power, other headwinds facing the economy include higher interest rates and continued supply chain pressure. Across 2023 as a whole, Cebr is forecasting the UK economy to contract by 1.3%. As such, further weak values on the FSB Small Business Index should be expected.

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

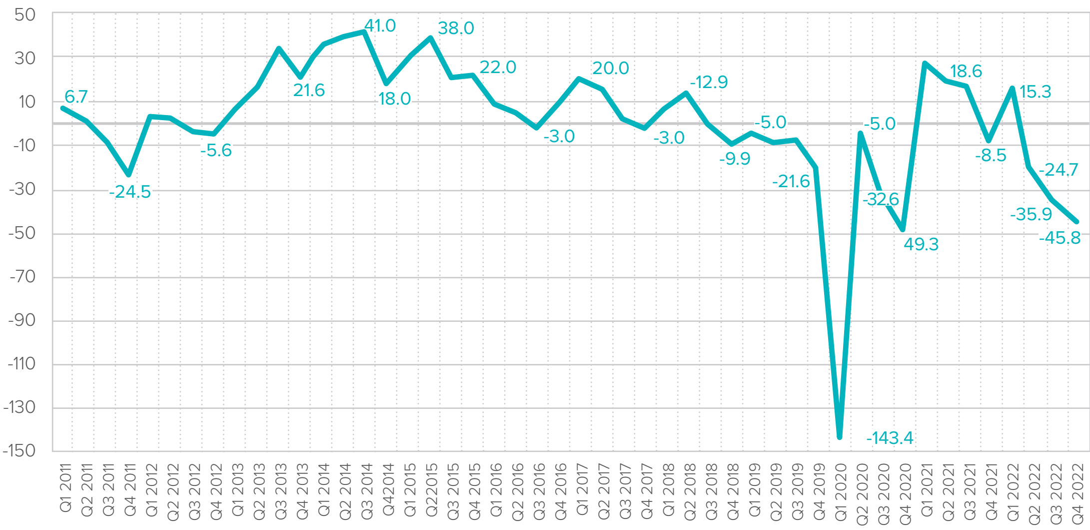
Small Business Index sinks as economy tested by numerous headwinds

The Small Business Index (SBI) fell to -45.8 in Q4 2022. This marks a third consecutive quarterly fall, having stood at -35.9 in Q3, and the third successive 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 exceeded 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 restrictions.

On an annual basis, the SBI suffered a fall of 37.3 points, a slightly weaker drop than the 52.3-point fall recorded in Q3. Nevertheless, this is still the third-largest annual fall in the Index's history, highlighting the extent to which sentiment amongst small businesses has changed over the past year.

The considerable quarterly and annual falls in the SBI reflect continued pressure on the wider economy and small businesses in particular. Amongst a number of headwinds affecting the economy are rising interest rates, continued cost-of-living pressures for consumers, and lingering supply chain pressures for businesses. These trends are expected to continue into 2023, meaning weak output performance is expected. This is likely to be matched by continually negative SBI readings.

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

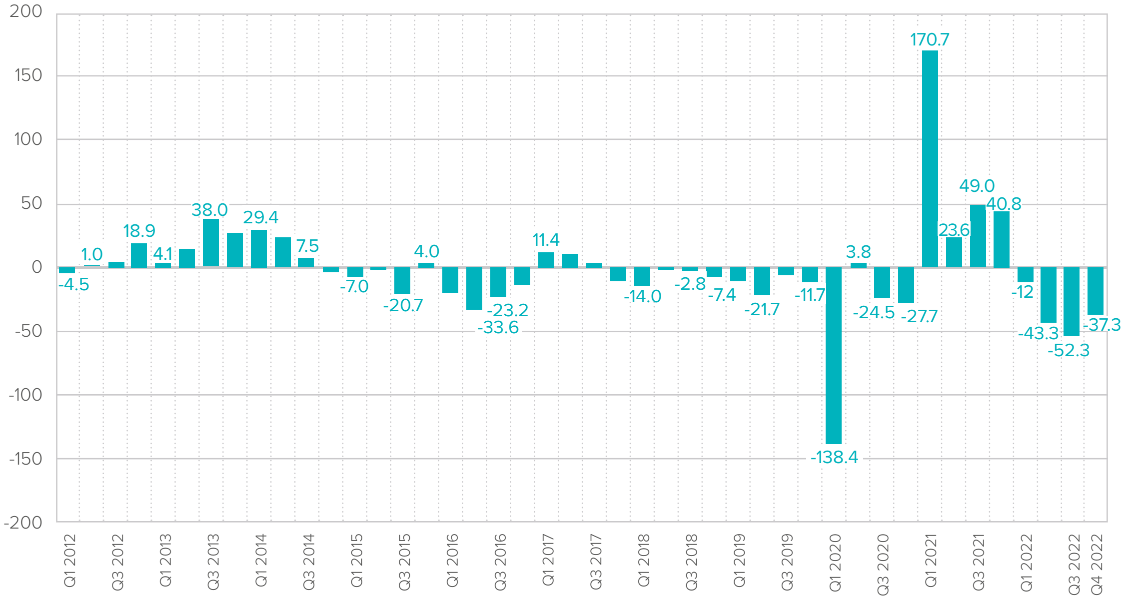
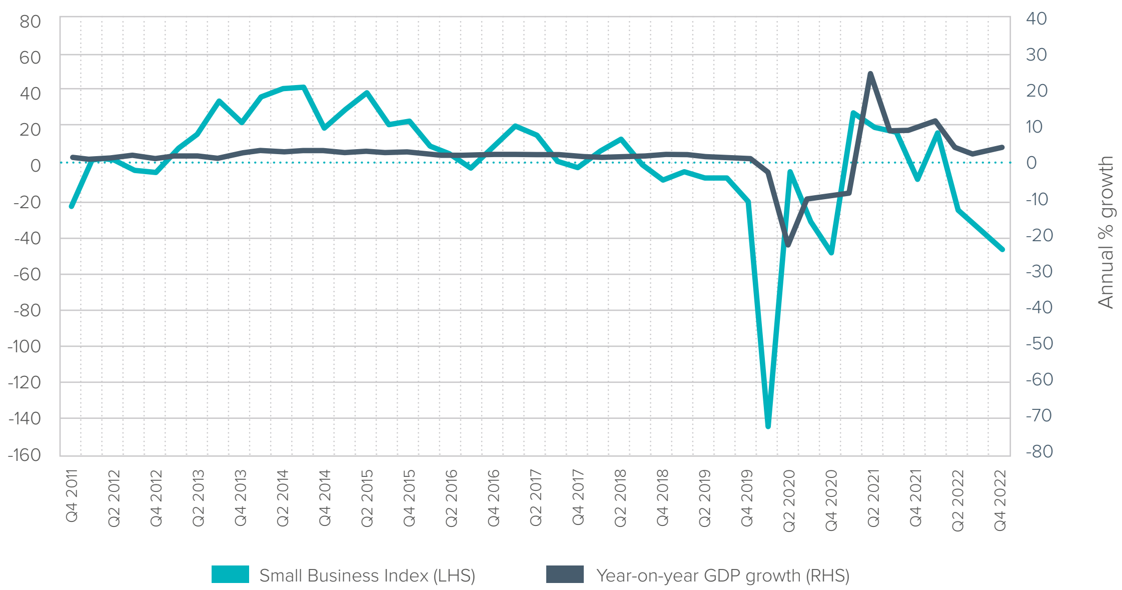


Figure four: UK SBI against year-on-year UK GDP growth
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey



REGION AND NATION SMALL BUSINESS INDICES

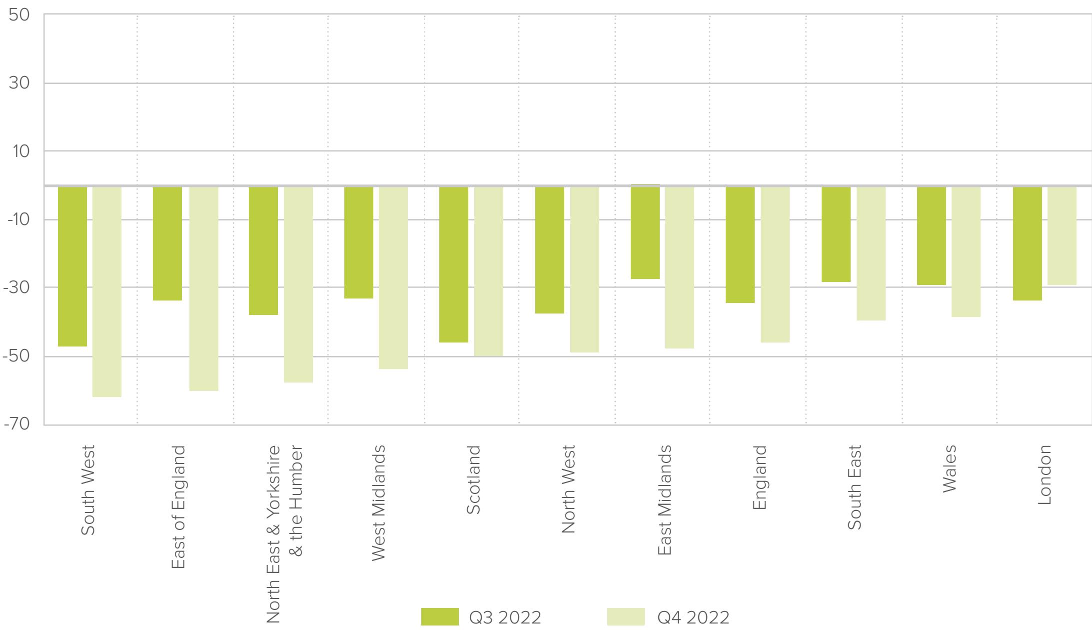
SMALL BUSINESS INDEX IN DEEP NEGATIVE TERRITORY ACROSS THE ENTIRETY OF THE UK, WITH LONDON ONLY REGION TO SEE IMPROVEMENT IN Q4

All UK regions and nations saw a negative reading on the regional SBI in Q4 2022. With all areas standing firmly in negative territory, this indicates that the proportion of small businesses expecting a worsening in performance in the coming quarter significantly exceeds the proportion expecting an improvement.

All regions and nations also saw a contraction in the measure in Q4 when compared to Q3, with the exception of London. At -29.2, up by 4.1 points on the quarter, the capital recorded the least negative reading among all regions. With the quarter characterised by the build-up and celebration of the winter festive season, London's high concentration of consumer-facing businesses may have meant businesses benefited from the usual associated seasonal increase in consumer activity, and therefore are slightly less pessimistic about the quarter ahead. However, this impact is likely limited, and consumer prospects remain bleak due to the ongoing cost-of-living crisis.

Meanwhile, as was the case in Q3, the sharpest quarterly downturn was seen in the East of England, where the regional SBI sank by 26.4 points to -59.7. After two large consecutive falls, the East of England is now the second-lowest ranking region, with only the South West recording a lower reading. The South West ranked lowest for the second consecutive quarter in Q4, standing at a sizeable -61.7. Bleak business confidence for the three months ahead is reflective of the challenging economic environment for businesses, in which firms must grapple with both weakening consumer demand and supply-side cost pressures. Notably, the high energy price pressures that businesses across the UK increasingly suffered throughout 2022 may worsen still in April, as the Government moves from a price cap policy to a discount. This will leave firms more exposed to any changes in wholesale energy prices. Those regions with a high concentration of energy-intensive businesses, such as primary industry, and those who struggle to absorb utility costs, are expected to suffer as a result.

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

MANUFACTURING AND CONSTRUCTION READINGS IMPROVE AS BUSINESSES GAIN ACCESS TO ENERGY BILL SUPPORT

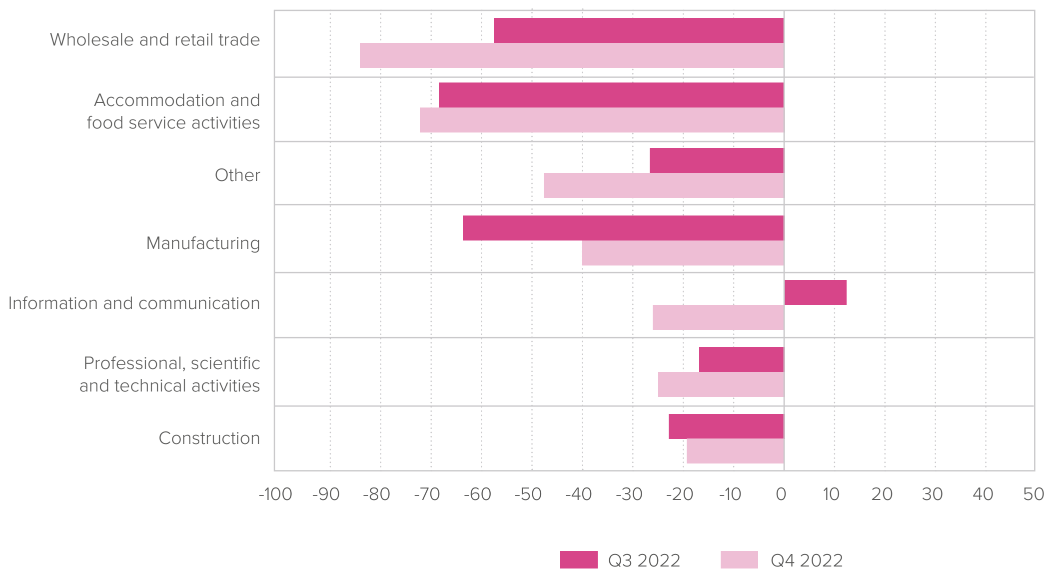
All major industries saw negative SBI readings in Q4 2022. Only manufacturing and construction saw an increase on Q3, while all other major industries saw a quarterly worsening.

The sharpest contraction was observed in information and communication, which moved into negative territory with a reading of -25.2. This industry has proven less sensitive to recent falls in household finances due to its relatively lower dependency on consumer spending. However, the impact of growing wage demands, due to double-digit inflation, will be a concern for this high-wage industry, as well as recent increases in interest rates. The high costs of new technology within this sector often require a large upfront investment, the returns on which may only be enjoyed in the distant future. The recent rise in borrowing costs may therefore have dented sentiment for small businesses in this space.

After experiencing the largest fall in Q3, the wholesale and retail sector fell once again in Q4, with a significantly negative reading of -83.3. This sector is acutely feeling the impacts of the cost-of-living crisis. Data from the ONS show that workers' wage increases are unable to keep pace with soaring inflation, meaning less real discretionary income for households. Demand for goods deemed non-essential has therefore dropped, adversely impacting activity in this sector. Likewise, the SBI reading for the accommodation and food service sector fell to -71.4 in Q4, reflecting this industry's sensitivity to the level of consumer demand as well as the broader headwinds facing the wider economy.

Manufacturing saw an increase in its SBI reading in Q4, up from -62.9 previously to -39.3. The energy-intensive nature of some businesses within this sector means this increase may be caused by the Government's Energy Bill Relief Scheme, which provides a cap on the wholesale cost of energy for businesses between October 2022 and March 2023. Construction, which is also a relatively energy-intensive sector, was the only other industry to record an improvement in its SBI reading in Q4. However, sentiment in both industries remains deep in negative territory. Looking ahead, as the Government moves to a discount scheme in April 2023, businesses will be more susceptible to changes in the price of wholesale gas and electricity. While energy prices are expected to remain high, businesses are expected to benefit from a reduction in these pressures across much of 2023.

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

REVENUE IN SMALL BUSINESSES SEES THIRD CONSECUTIVE CONTRACTION IN Q4

The net balance of small businesses reporting revenue growth over Q4 2022 stood at -10.1%. This means that the proportion of small businesses reporting a decrease in revenue levels over the last three months was greater than the proportion reporting an increase. It also marked the third consecutive negative result on this measure.

Most major sectors recorded negative readings on this measure in Q4. This near-unanimous negative reading for revenue reflects the wider economic slowdown occurring in the UK, resulting from a variety of factors including higher interest rates, higher input costs, supply chain issues, and weakening consumer activity.

On a sectoral basis, wholesale and retail businesses recorded the weakest figure in Q4, with a net reading of -30.3%. This aligns with wholesale and retail witnessing the lowest sectoral headline SBI reading, and reflects the fact that businesses in this sphere are particularly exposed to the slowdown in consumer activity resulting from ongoing cost-of-living pressures. Meanwhile, small businesses within the information and communication industry were the only major sector to record a positive reading for Q4, with a net balance of 8.3% reporting revenue growth.

Looking ahead, small businesses are even more pessimistic, with a net balance of -14.2% expecting their revenue to grow in the first three months of 2023. The largest net balances of pessimistic small businesses were seen within consumer-facing services, with readings of -51.3% and -38.1% for the wholesale and retail and accommodation and food service industries, respectively. Small businesses expressing poor revenue sentiment despite rising prices is a cause for concern, pointing to significant declines in sales volumes.

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 PERFORMANCE BECOMES LESS GLOOMY AS SHIPPING RATES FALL FURTHER AND FUEL PRICES EASE

A net balance of -3.3% of exporting businesses said that the value of their exports increased in Q4. Although this marked the 15th consecutive negative monthly reading, the latest reading was the highest since Q4 2019. Moreover, looking ahead, a net balance of 7.9% expected export value growth in Q1, the strongest reading on this indicator since Q1 2022.

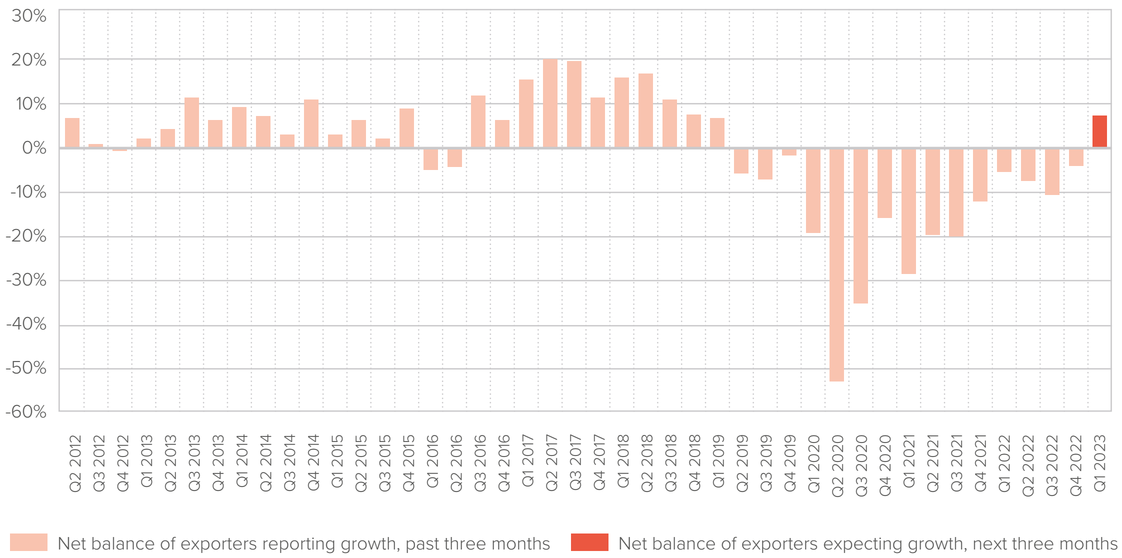
This latest export sentiment reading comes as the latest official data show that the value of UK exports among all businesses expanded by 0.3% across the three months to November 2022. This was driven by trade in services and in goods to non-EU countries.

While much of this expansion of value is explained by inflation, a number of other developments also improved the situation for exporters into Q4. For instance, amid a global slowdown and China's zero-Covid approach, shipping rates fell back further in Q4, marking a welcome development for exporters. The Baltic Index showed that shipping costs for a typical 40-foot container averaged £1,444 across Q4, down by 6.2% on the quarter and a staggering 50.5% annually. So far in January, rates have fallen below the £1,000 mark, a development that will help exporters to remain competitive in Q1.

Moreover, exporters' input costs are likely to have been eased by falling fuel prices in Q4. Wholesale gas prices have fallen back as a result of several factors, including an exceptionally warm winter, high levels of storage, and a weakened Chinese economy. This improves the picture for particularly energy-intensive exporters into Q1.

Finally, sterling weakened further in Q4, not least following the market fallout from late September's mini-Budget. According to the Bank of England's trade-weighted effective exchange rate index, sterling was 5.2% weaker in Q4 than its level in the first quarter of the year. By increasing the competitiveness of British exports, this may have provided some boost to demand among the exporters surveyed.

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 HITS HIGHEST LEVEL IN SBI'S HISTORY

The net balance of small businesses reporting a quarterly increase in operating costs stood at 86.1% in Q4. This marks an increase from the net balance of 85.4% in Q3, and is the highest net balance figure on this measure since data collection began. This emphasizes the ongoing and severe financial strain that businesses are experiencing from broad-based cost pressures.

As in Q3, when asked about the main causes of changing business costs, the most frequently-named option was utilities, selected by 61.3% of respondents, with fuel and inputs cited by 53.8% and 48.0% of small businesses, respectively. This cost pressure is reflected in official statistics from the ONS. In October, the Producer Price Index (PPI) for inputs grew by 19.2% in the year to October, with the largest contributors to annual increases in input prices stemming from energy and (imported) food. Though the measure has been decelerating since its June peak, it remains well above historical averages, with Russia's invasion of Ukraine a significant factor. Indeed, Ukraine is a key exporter of grain and other commodities, while ongoing economic hostility between Russia and Europe has left energy prices elevated. The Government-led Energy Bill Relief Scheme has helped limit the level of exposure of businesses to wholesale energy prices between October 2022 and March 2023. However, this support is being changed in April, to provide a discount rather than a cap, which will both be less generous and leave businesses more exposed to future volatility in energy prices.

The percentage of respondents who attributed rising costs to taxation saw an increase from 17.0% to 23.1% in Q4. This is likely due to the tax measures introduced in the Autumn Budget in November 2022, which included a freeze on the thresholds for employer National Insurance until April 2028. This raises costs for businesses, and the potential longevity of the policy means businesses will have to absorb or pass on this increased cost for the foreseeable future. Looking ahead, tax is likely to feature more as an important cost factor as the Corporation Tax rate rises from 19% to 25% from April.

Meanwhile, the share of small businesses citing rent as a source of rising cost increased to 20.5% in Q4. Increases in rent are reflective of the broad price pressures in the economy, with many landlords pushing up prices as their own costs of borrowing rise.

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

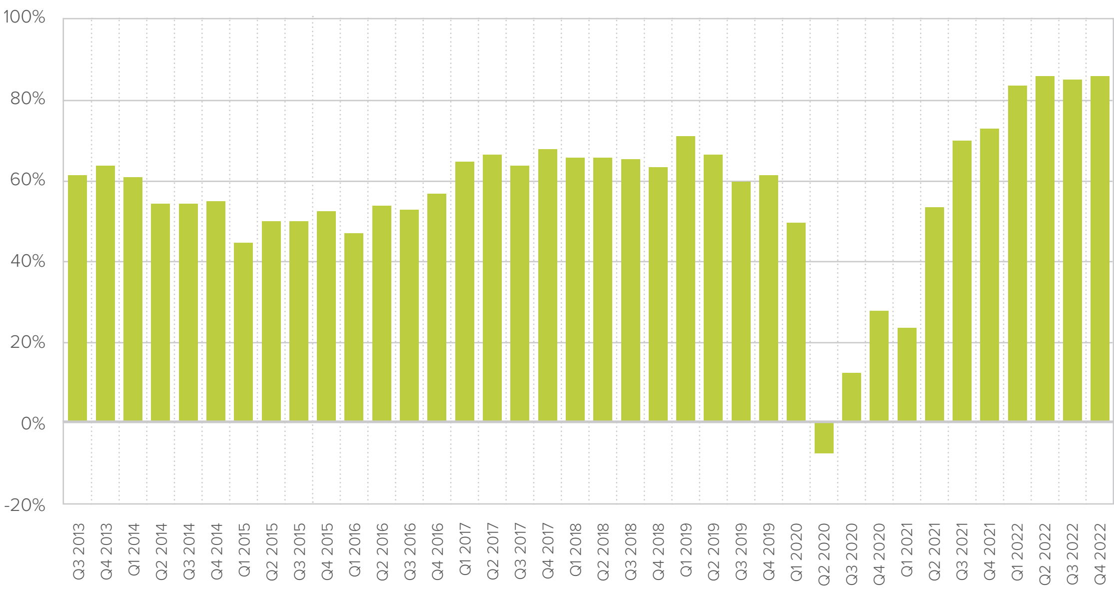
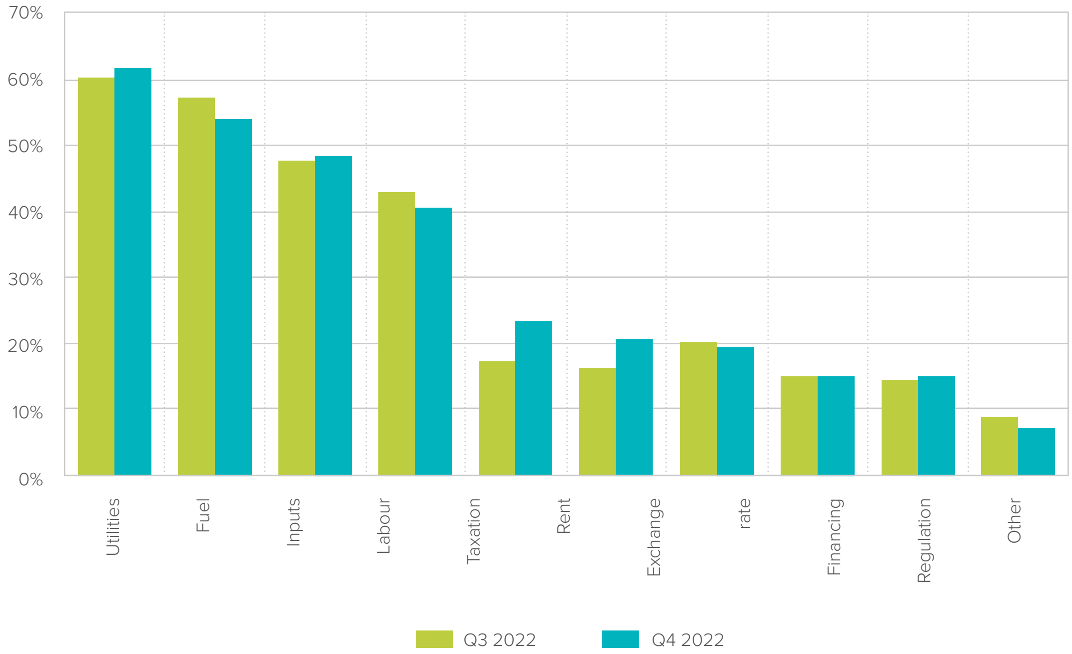


Figure 10: Main causes for changing business costs (firms may give multiple answers)
Source: FSB - Verve 'Voice of Small Business' Panel Survey



EMPLOYMENT

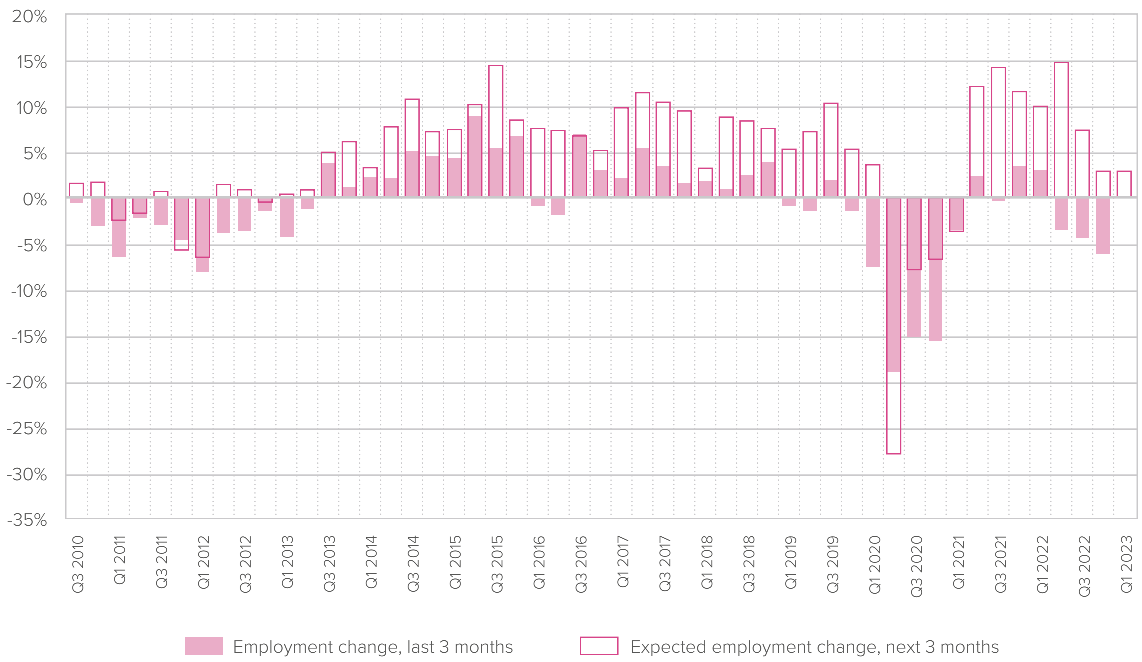
SMALL BUSINESS EMPLOYEE NUMBERS CONTRACT FOR THIRD CONSECUTIVE QUARTER

A net balance of -6.1% of small businesses reported growth in employee numbers in Q4. The negative reading means that the number of businesses expanding their workforce was outweighed by the number of businesses reporting a contraction in headcount. This marks a third consecutive negative reading, following net balances of -3.6% and -4.4% in Q2 and Q3, respectively. The latest reading also represented the worst performance on this measure since Q4 2020, when the UK economy was being hampered by the second national lockdown.

On a sectoral basis, the worst performance was seen amongst businesses in wholesale and retail and accommodation and food services, with net balances of -13.9% and -23.9%, respectively. These sectors are being particularly hit by the demand-side slowdown, driven by the cost-of-living crisis and its behavioural impacts on consumers. As such, their ability to maintain staffing levels is even weaker than the average small business's.

Despite the negative net balance seen in Q4, businesses expect employee numbers to grow over Q1 2023, with a net balance of 3.2%. This would contradict Cebr's macroeconomic view for the early months of 2023, during which we expect a further output contraction at the aggregate level and a further decline in employment. It should also be noted that businesses had expected employment growth in Q4, before reporting their worst employment reading for two years.

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



GROWTH ASPIRATIONS AND CHALLENGES

GROWTH ASPIRATIONS WORSEN AMIDST CONTINUED ECONOMIC HEADWINDS

Under half (44.7%) of small businesses expect to grow over the coming year, down on the share of 47.5% expecting growth when asked in Q3. As of Q4, the share of businesses expecting to downsize or close over the coming year stood at 15.7%. This was up on Q3's share of 14.1% and marked the worst reading since the 21.6% recorded in Q4 2020.

Weakening growth aspirations align with the general pessimism witnessed across the economy. The ability of small businesses to grow is set to be tested over the coming year, given the numerous headwinds affecting the economy. Growth aspirations are particularly weak amongst small businesses in retail, where a net growth balance of just 37.5% was recorded. Construction also saw a low value of 38.4%, with this sector continuing to grapple with supply chain pressures. At the other end of the scale, businesses in professional, scientific and technical activities are the most likely to expect growth over the coming year, this being the case for 53.8% of respondents in this category. This sector is not as exposed to the headwinds facing the economy at present, as it is less directly reliant on consumer activity and also less input-intensive.

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

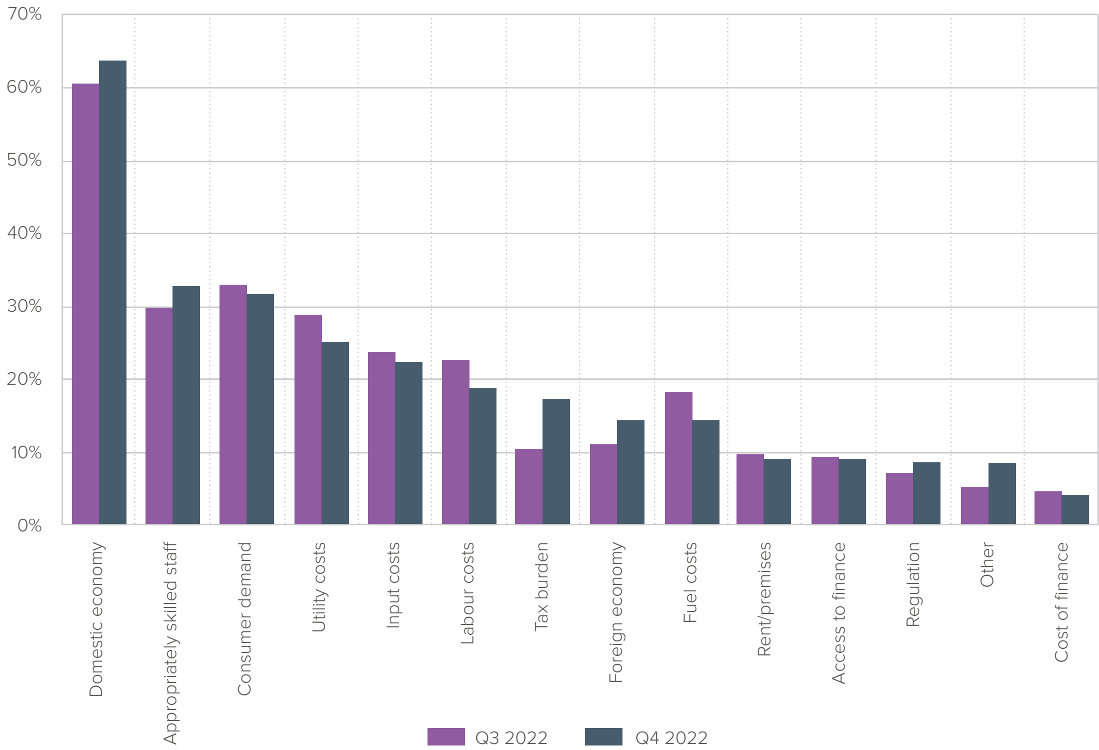
DOMESTIC ECONOMY REMAINS THE MOST COMMONLY-CITED BARRIER TO GROWTH, THOUGH STAFF SHORTAGES ARE BECOMING INCREASINGLY PROMINENT

Among businesses expecting to grow over the next 12 months, the domestic economy was the most frequently-cited potential barrier to such growth, selected by 63.7% of respondents. Again, this aligns with our macroeconomic view, with an economic contraction expected across 2023.

Finding appropriately skilled staff overtook consumer demand as the second-most cited threat to growth aspirations, with 32.7% of respondents selecting this. The labour market remains tight and firms are still facing difficulties in filling vacancies amidst labour shortages. These labour market conditions reflect a number of factors, including the impact of the UK's withdrawal from the EU and heightened economic inactivity since the pandemic.

There was a fall in the share of businesses citing fuel costs as a potential barrier to growth over the coming year. This option was cited by 14.2% of respondents in Q4, down from 18.2% in Q3. After significant volatility in commodity markets in the first half of 2022, wholesale prices saw a largely downward trajectory in the latter half. The share of businesses citing fuel costs as a major barrier to growth is now firmly down on the peak of 23.2% recorded in Q1 2022.

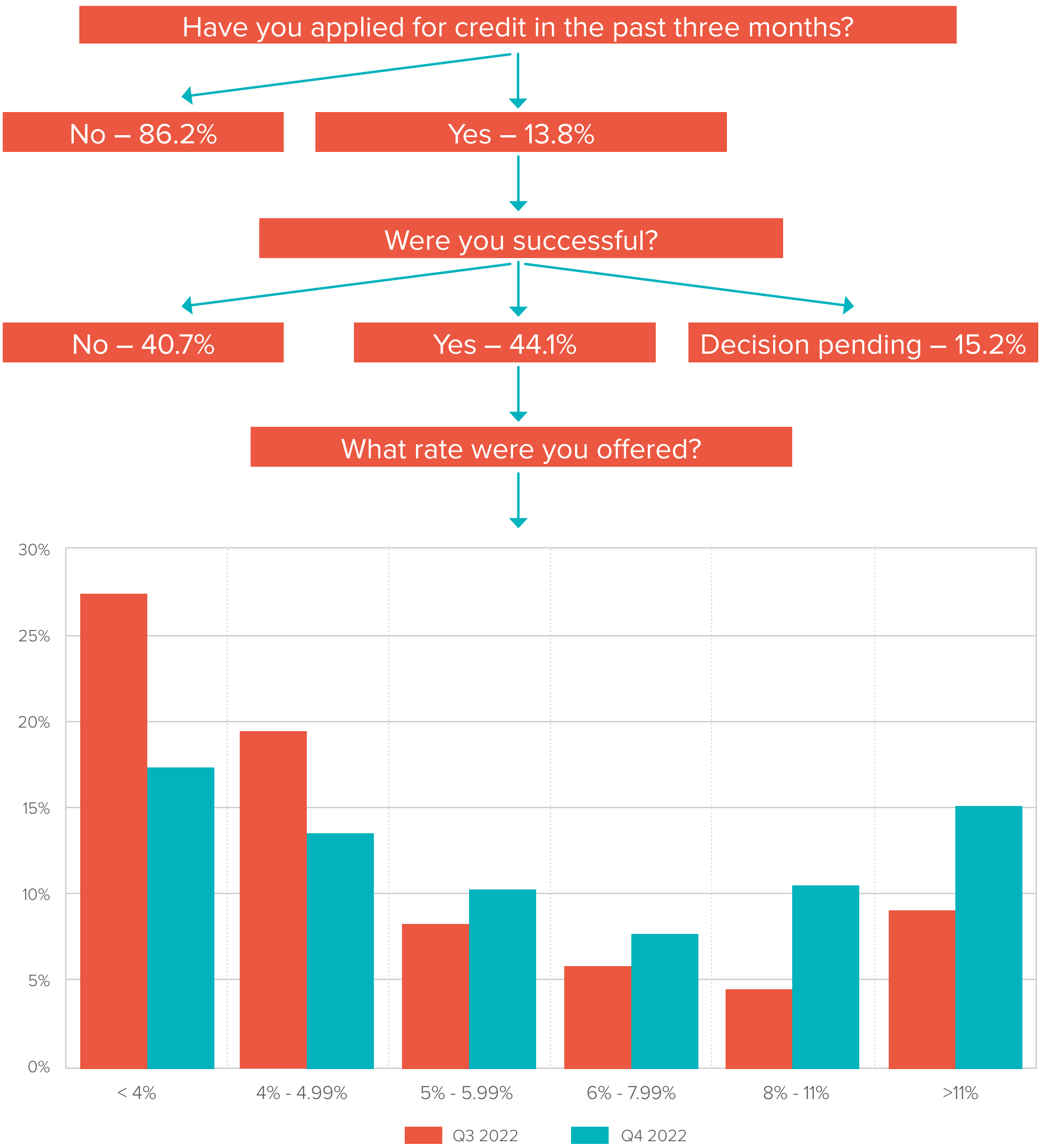
Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey



CREDIT

CREDIT APPLICATIONS AMONG SMALL BUSINESSES HIGHEST IN ALMOST TWO YEARS

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.

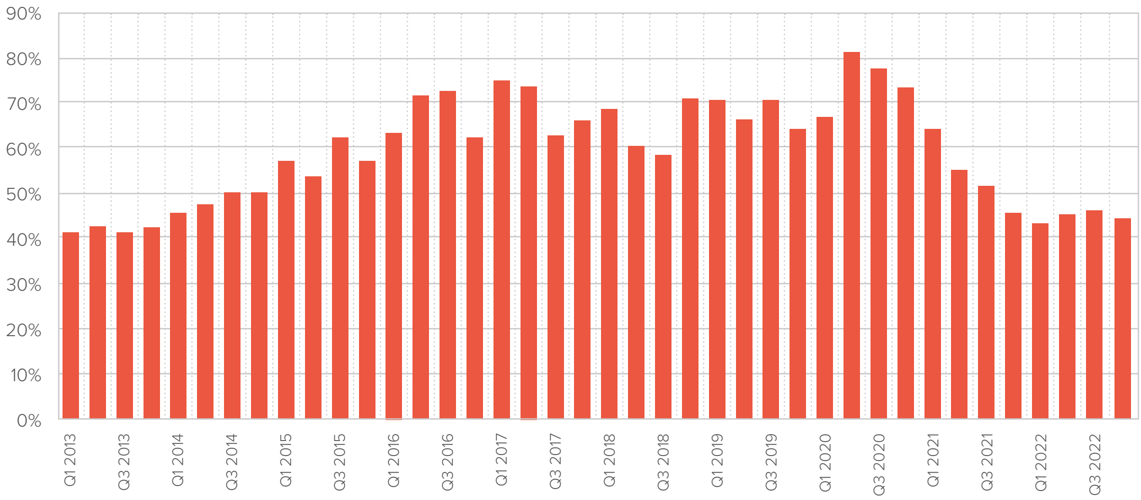


Q4 2022 saw the third consecutive quarterly rise in the share of small businesses applying for credit. At 13.8%, this proportion rose above the three-year pre-Covid average (2017-2019) to reach its highest level since Q1 2021. Of these businesses, 44.1% of credit applicants had their loan approved, down from 46.2% in Q3. With the exception of Q1 2022, the last time this share was lower was in Q4 2013.

On a sectoral basis, construction businesses remained the most likely to apply for credit, with this being the case for over a fifth (22.9%) of those surveyed in Q4. This was, however, down from the proportion of 23.7% in Q3. Credit applications also fell back among hospitality businesses, 15.2% of whom applied for credit in Q4, down from 19.7% in Q3. This was not a uniform trend, though, with firms in manufacturing, wholesale and retail trade, and professional scientific and technical activities seeing an uptick in demand for credit.

Interest rates continued their upward climb in Q4, reflecting the two sizeable steps of monetary tightening announced by the Bank of England during this period, as well as market nervousness following September's mini-Budget. The Bank of England increased its base rate by 75 basis points in its November Monetary Policy Committee meeting, the sharpest rise in 33 years, with a further 50 basis points added in December. The base rate accordingly ended the year at 3.5%, its highest level since October 2008. This upward movement in interest rates is mirrored in the latest survey results: the proportion of successful credit applications that were quoted an interest rate less than 5% fell from 41.4% in Q3 to 38.1% in Q4. Meanwhile, the share quoted a rate in excess of 11% rose sharply from 20.2% to 28.2%. With policy rates set to rise to their peak in Q1 and remain persistently high thereafter, the average rates accessed by businesses are likely to creep higher yet.

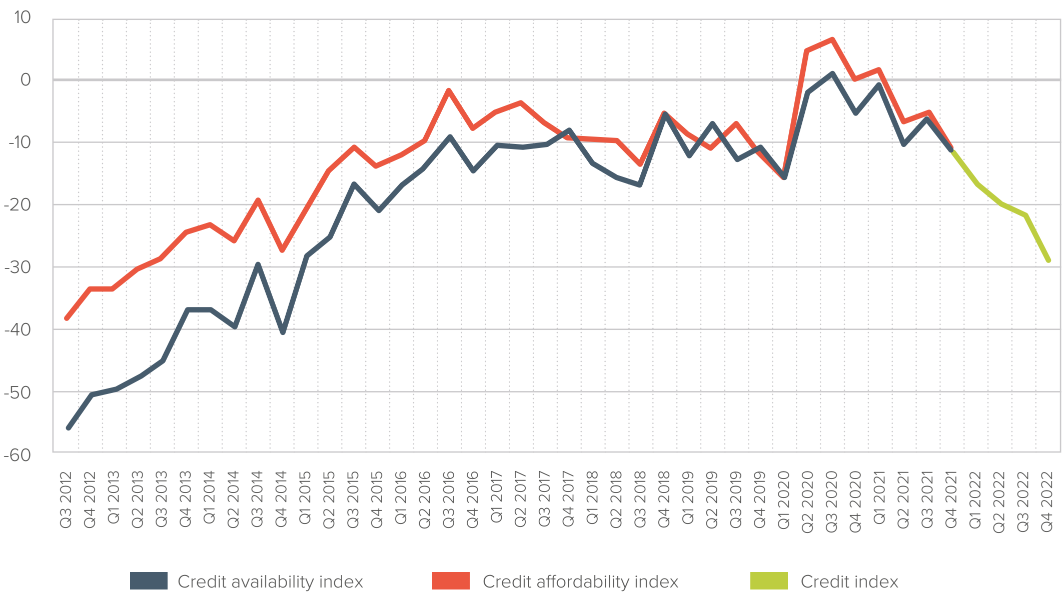
Figure 15: Proportion of small businesses successful in their credit applications in the past three months
Source: FSB - Verve 'Voice of Small Business' Panel Survey



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

Perceptions of credit affordability and availability worsened further in Q4. The share of businesses with positive opinions on overall credit availability and affordability fell from 17.4% in Q3 to 14.6%, while the share with negative views rose from 44.1% to 50.6%. Negativity towards these aspects of credit generally reduce with business size. For example, 54.0% of respondents with no employees reported negative views, compared to 44.2% among those with at least 10 employees. These trends saw the overall credit index fall back sharply in Q4, from -21.7 to -29.0.

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 CONTINUE TO BECOME MORE POSITIVE AS SIGNS OF PEAKING PRICE PRESSURES EMERGE

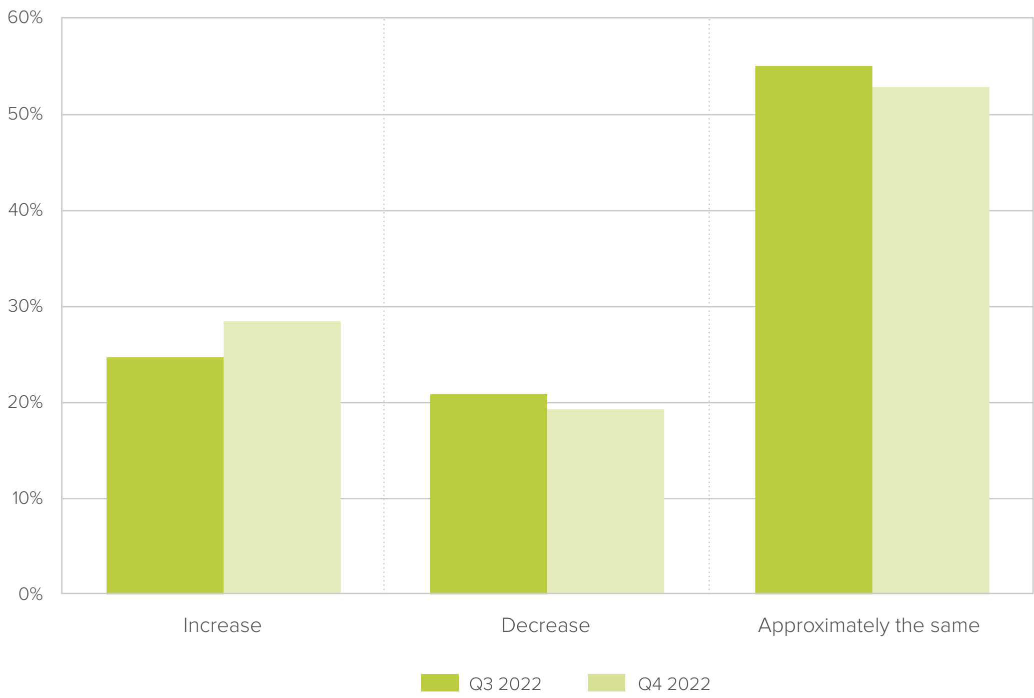
Q4 saw an increase in the share of businesses expecting to increase their investment over the coming quarter, up from 24.6% in Q3 to stand at 28.3%. The last time this was higher was one year earlier, in Q4 2021. Meanwhile, the share expecting to decrease investment levels fell back from 20.6% to 19.0%.

As such, the net balance of businesses expecting to increase investment increased from 4.0% to 9.3%, the highest reading of the year. However, it is worth noting that investment ambitions remained notably subdued across 2022, compared to the previous year. For instance, the net balance figure averaged 16.3% across 2021, a year still impacted by lockdown restrictions, while the equivalent figure in 2022 saw a sharp reduction to 6.2%. This comes amid the intense strain placed on businesses by rising input costs during 2022 and an increasingly bleak outlook for consumer demand and growth, all of which have eroded retained profits for investment.

The near-term improvement in investment ambitions likely reflects emerging signs that input price pressures may soon have peaked, aided by falling fuel prices and shipping costs. Moreover, recent GDP figures have surprised on the upside, with the prospect of a recession in the latter half of 2022 avoided.

On a regional basis, small businesses in London signalled the strongest investment intentions, with a net balance of 33.3%. Between major sectors, the strongest reading, at 19.4%, was seen among information and communication businesses, as was also the case in Q3. Meanwhile, accommodation and food services was the only major sector in which a negative net balance was recorded, at -14.8%.

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 2022 research survey of FSB members carried out by Verve. 5,583 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 1,083, a response rate of 8% for the panel. The data are weighted by regional gross value added to match the profile of small businesses across the UK. The survey was undertaken between 7 and 23 December 2022.

SUMMARY DATA TABLE

	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Small Business Index	27.3	18.6	16.4	-8.5	15.3	-24.7	-35.9	-45.8
Employment - previous three months	-3.5%	2.2%	-0.2%	3.3%	2.9%	-3.6%	-4.4%	-6.1%
Employment - coming three months	12.0%	14.0%	11.5%	9.8%	14.5%	7.2%	2.7%	3.2%
Exports - previous three months	-28.4%	-19.8%	-20.0%	-12.3%	-5.3%	-7.7%	-10.8%	-3.3%
Exports - coming three months	-9.8%	-11.2%	-4.6%	-3.8%	10.4%	1.4%	-4.3%	7.9%
Credit availability and affordability - rated good or very good	-	-	-	-	19.5%	17.6%	17.4%	14.7%
Credit availability and affordability - rated poor or very poor	-	-	-	-	36.5%	42.3%	44.1%	50.5%

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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