Q2

FSB VOICE OF SMALL BUSINESS INDEX

QUARTER 2, 2023

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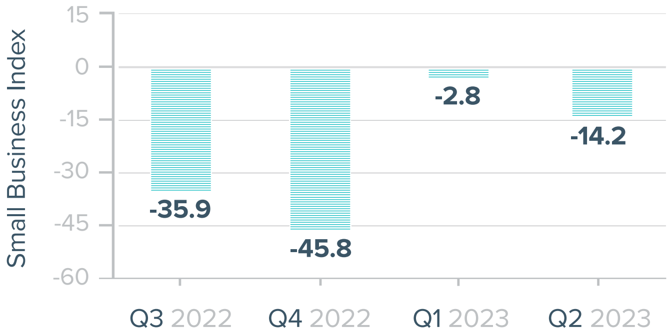
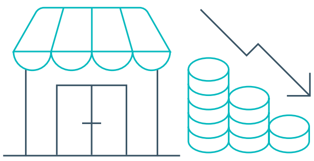
SBI Q2 2023

“Small business confidence loses momentum to fall further into negative territory”



Revenues fall for fifth consecutive quarter



41%

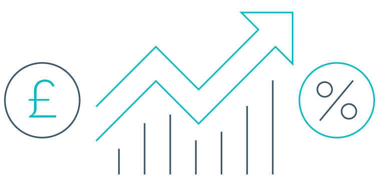
of small businesses saw **revenues decrease over the last three months**, outweighing the one in three (33%) who said their sales increased

Majority anticipate growth over next year

51%

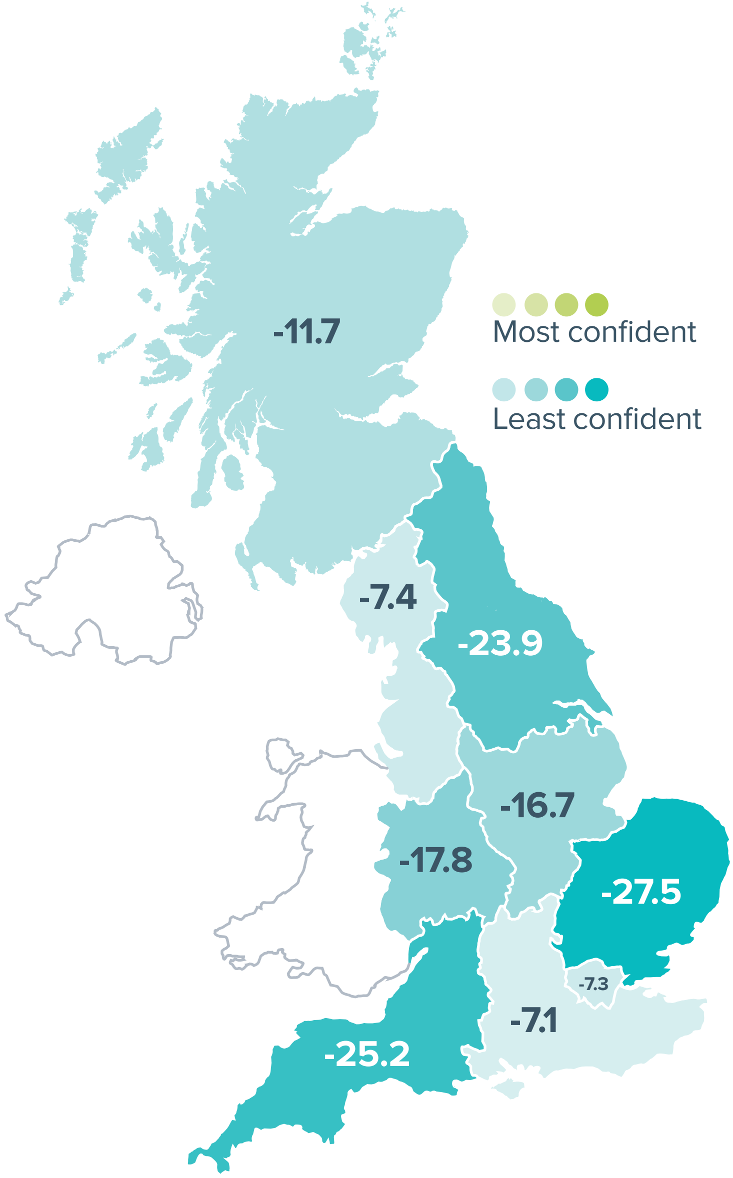
of small businesses **plan to grow over the next 12 months**, the first majority on this measure since Q1 2022

Interest rates continue to bite into small businesses



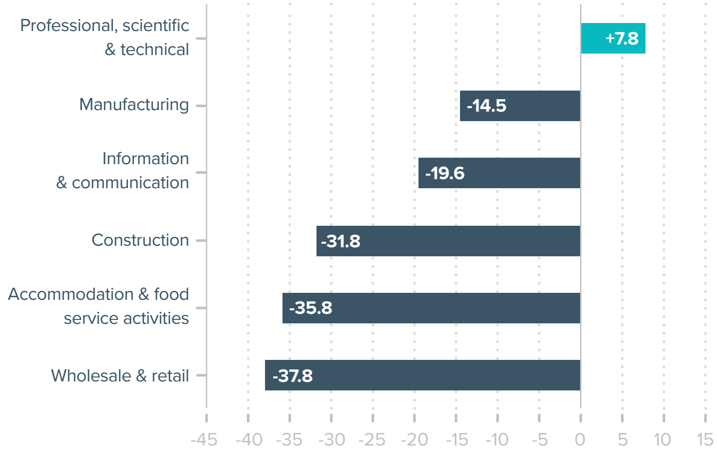
30%

of small businesses who applied for finance were offered an **interest rate of 11% or greater**



Please note: sample sizes for Wales and Northern Ireland are insufficient for accurate reporting. The North East is combined with Yorkshire and the Humber to produce a combined region, due to low sample sizes for the former region.

Small business confidence by sector



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FSB FOREWORD

Tina McKenzie, FSB Policy and Advocacy Chair

It's not really the result any of us wanted to see. The strong recovery in confidence seen in the first quarter did not carry through into this most recent research, as the upward momentum created by small firms' optimism about the coming year took a tumble following base rate hikes and stickier-than-anticipated inflation.

Still, there are green shoots of hope to be found, demonstrating once again the tenacity and resolve of small business owners. The headline confidence reading itself is a good deal higher than this time last year, when Russia's invasion of Ukraine caused energy prices to spike, causing immense financial distress to small firms hit by utility bills which rapidly headed into the stratosphere.

The second quarter of 2023 was difficult revenue-wise for many small firms. Two in five small firms reported a fall in sales, outweighing the one in three who saw a rise, as higher interest rates made consumers charier about spending. On the plus side, consumer confidence levels rose steadily over the second quarter, albeit remaining in negative territory.

Looking ahead, revenue expectations are something of a mixed bag, although it's definitely good news that a majority of small firms – 51.3% - expect to grow over the next twelve months, the first time that over half have said this since Q1 of last year. The shorter-term outlook is a bit less positive, with the proportion of small businesses expecting sales to increase, at 32.4%, slightly outnumbered by those bracing for a fall, at 35.5%.

Another small bit of relief can be found in the proportion of small firms reporting higher costs than in the same quarter last year. In the Q1 research, this reached a record high of 91.8%, underlining the incredibly challenging conditions small firms were having to cope with in the midst of a vicious and seemingly relentless cost of doing business crisis. The fall-back of this figure to 84.9% is therefore to be welcomed as the first tentative sign that inflation might be starting to recede as a major concern. It's definitely not worth pre-counting chickens, of course, but the bigger than predicted fall in inflation in the most recent post-Q2 figures is another hopeful indicator.

Now, small firms fear the prospect of interest rates overshooting the mark, staying too high for too long, and risking a recession. GDP growth over Q2 was hardly buoyant, and many small firms have as a result not been able to rebuild cash reserves worn thin over the course of the pandemic and the inflation crisis. This leaves them potentially vulnerable to external shocks, especially at a time when over half of small firms (52.0%) rate the affordability and availability of new credit as poor.

The upward march of the rates offered to finance seekers continued, with a record 30.4% of successful applicants offered a rate of 11% or more; in the same quarter last year, the equivalent figure was 12.2%. The 4.6% of finance applicants offered a rate of up to 4% is a record low, and a sharp tumble from 36.7% offered that rate in Q2 last year.

Small firms appear to be battening down the hatches to an extent around employment levels; over the next quarter, 15.5% expect to increase their payroll, down from 16.8% who expected the same in the first quarter, while 9.4% expect their employee numbers to decrease, up from 8.3%. It is however a small relief more small firms on balance expect to increase than decrease their employee numbers in the coming quarter, even though more small firms decreased (14.2%) than increased (11.8%) their staffing levels in the second quarter.

Exports recovered somewhat, with the proportion of small exporters who said their export levels had increased over the second quarter, at 33.4%, at the highest level since Q1 2019, and up from just 22.4% who reported an increase in the first quarter. Correspondingly, the level who said their export volumes had decreased fell from 40.2% in Q1 to 36.3% in Q2. And while expectations for export volumes in the coming quarter are relatively unchanged for the optimists (27.9% of small exporters in Q2 expect them to increase over the next three months, compared with 27.2% who said the same in Q1), there has been a decrease in pessimism, with 28.5% bracing for a fall in Q2, against 33.6% in Q1.

Looking at the bigger picture, small businesses are at something of a turning point in economic terms; with inflation finally appearing to have started to fall at a reasonable rate, pressure on margins may begin to lessen, giving small firms some much-needed breathing space.

As we look ahead to the autumn and the return of Parliament, politicians of all stripes would be well advised to consider the needs and aspirations of small firms and self-employed people, and consider how they might best help create the best conditions for them to grow and succeed.

ECONOMIST'S VIEW

Kay Daniel Neufeld, Head of Forecasting and Thought Leadership

The recovery in the small business index which characterised the first three months of the year came to an abrupt halt in Q2, with the Small Business Index (SBI) showing a fall of 11.4 points on the quarter. While the Index is up by 10.5 points in year-on-year terms, this is largely due to base effects, given the start of the war in Ukraine in Q2 last year. The fall in the SBI to a score of -14.2 in Q2 clearly shows that the economic climate has worsened again in recent months.

Looking back at the beginning of the year, the improvement in small business sentiment in Q1 2023 was partly driven by a fall in wholesale energy costs. While reduced energy costs are still a benefit that businesses enjoy compared to the peaks seen in 2022, other economic factors are now presenting substantial challenges to businesses. Inflation has become more entrenched in the economy, which led the Bank of England (BoE) to increase the bank rate by a larger-than-expected 0.5 percentage points in June. Estimates for peak interest rates were revised up frequently over the second quarter, increasing the cost of debt for small businesses and hurting growth aspirations. Accordingly, 52.0% of small businesses in our survey rated the overall availability and affordability of credit as negative, up from 50.9% in the previous quarter.

Small business confidence fell across all industries with the largest drop recorded for the construction sector, for which sentiment fell by 59.2 points to -31.8. This steep drop reflects the fact that the construction sector is highly sensitive to interest rates and the health of the wider housing market. With rates likely to stay higher for longer, we expect an extended drop in house prices into next year and an associated drag on construction activity both for new builds and repair and maintenance work.

Businesses in the accommodation and food services sector as well as in the wholesale and retail sector recorded even worse Q2 scores at -35.8 and -37.8 points, respectively, though both sectors already stood in negative territory in Q1. The further drops in the SBI for both sectors are reflective of the fact that consumer-facing businesses find themselves in a challenging environment, given the ongoing cost-of-living crisis which is impacting households' budgets. The widely discussed increases in mortgage interest costs for borrowers will lead to a further drop in the budget available for discretionary spending for affected households.

The regional picture shows drops in small business confidence for all regions of the UK, with the exception of the North West, where the SBI increased by 3.2 points to stand at -7.4. Large moves were recorded in the West Midlands, where the SBI fell by 24.7 points to -17.8, and in Scotland, with business sentiment decreasing by 18.8 points to -11.7. The East of England was the most pessimistic region in Q2 with a score of -27.5, while the South East and London ranked highest with scores of -7.1 and -7.3, respectively, only just ahead of the North West.

The more positive economic outlook described in the Q1 report was unfortunately short-lived and the drop in the SBI in Q2 points to a renewed deterioration in small business sentiment. The UK's lacklustre growth performance is emblematic of the problems that small businesses face. When asked about the obstacles to achieve their growth aspirations, small business decision makers quoted the domestic economy as the number one concern, followed by consumer demand and labour costs. Meanwhile, the cost of finance was mentioned by the largest share of respondents since Q1 2015. Unfortunately, small businesses can expect that slow growth will continue for the rest of the year while interest rates are also expected to increase further as the Bank of England tries to get a handle on inflation. While we expect inflation to fall markedly by the end of the year, it is likely that the Bank of England will keep rates high well into 2024 to ensure that inflation doesn't spring back quickly, suggesting that the economic outlook will remain challenging over the coming months.

Q2

FSB EXECUTIVE SUMMARY

Key findings this quarter:

- **The Small Business Index (SBI) fell to -14.2 in Q2 2023.** This marked a return to contraction, following a sharp improvement in Q1. This had in turn followed three consecutive quarterly declines in 2022.
- **All UK regions recorded a negative SBI reading in Q2.** This highlights the widespread nature of the economic pessimism that has emerged across the UK. With the exception of the North West, every region saw a weaker SBI score in Q2 than in Q1.
- **After unanimous quarterly improvement in Q1, all major industries saw their SBI readings fall back in Q2.** This further highlights the widespread shift in sentiment amongst small businesses in recent months.
- **The net balance of small businesses reporting revenue growth over the previous three months stood at -8.6% in Q2 2023.** This marked a fifth consecutive negative reading, as businesses face the effects of weak domestic demand.
- **The net balance of exporters reporting growth in the value of their exports improved in Q2 2023.** However, the figure still remained negative, with a reading of -2.9%. Exporting businesses have on balance seen contracting export growth for the past seventeen quarters, amidst global economic pressures.
- **The net balance of small businesses reporting a rise in their operating costs fell to 80.4% in Q2.** This marked the first quarterly fall on this metric since Q3 2022 and the weakest reading since Q4 2021. It is important to note that this is still an historically elevated share, however.
- **As has been the case in recent quarters, utilities ranked as the most commonly cited source of changing business costs in Q2.** However, the share of businesses selecting this fell to 61.9% in Q2, down from 62.7% in Q1. There was a large increase in the share of businesses citing financing as a source of cost changes in Q2, likely reflecting recent interest rate hikes and their impact on commercial rates.
- **A net balance of -2.4% of small businesses reported growth in employee numbers in Q2.** This marks a fifth consecutive negative reading on this metric.
- **The share of small businesses expecting to grow over the coming year increased to 51.3% in Q2.** This put an end to four consecutive quarters in which only a minority of small businesses expected to grow over the next period.
- **The domestic economy remains the most commonly cited barrier to growth amongst small businesses, with 61.5% of respondents selecting the category.** This highlights the continued weakness posed by current demand conditions and corroborates with expectations of a recession later in the year. Meanwhile, there was a large fall in the share of respondents selecting utility costs as a potential barrier to growth over the coming year.
- **Perceptions of credit affordability and availability worsened further in Q2.** The share of businesses with positive opinions on overall credit availability and affordability fell to 11.8% in Q2, down from 12.3% in the previous quarter. Changing sentiment on credit also reflects recent interest rate hikes.

UK MACROECONOMIC OVERVIEW

UK economy expected to be in recession across Q4 2023 and Q1 2024

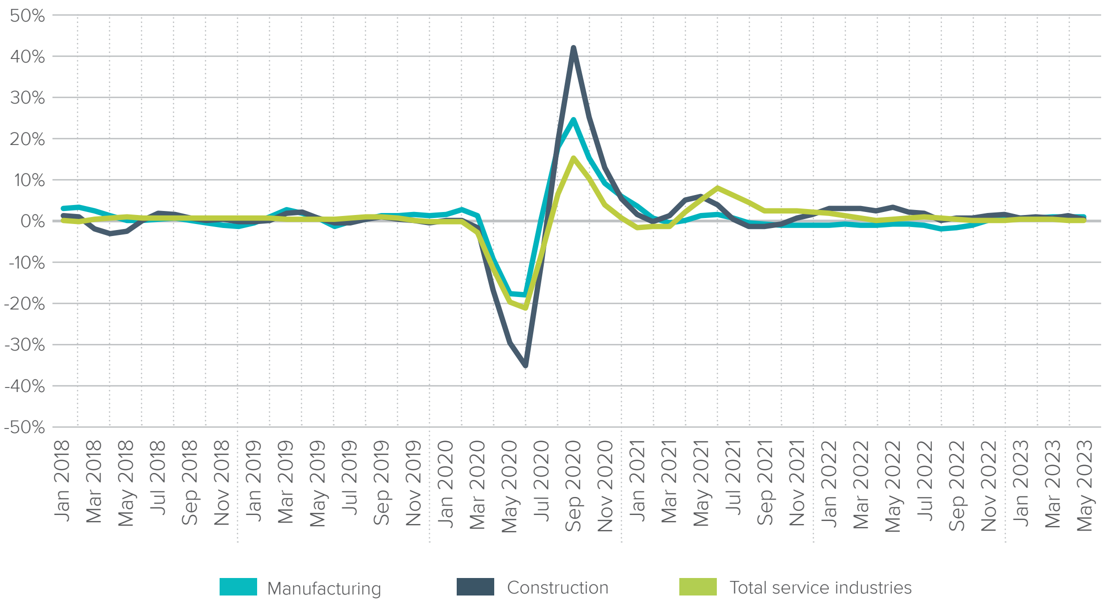
The latest data from the Office for National Statistics (ONS) show that UK GDP was stagnant in the three months to May 2023. This reflects the ongoing weak performance of the UK economy. Looking solely at monthly data, the economy contracted by 0.1% in May. Monthly output is currently just 0.5% above that witnessed at the end of 2021, highlighting the recent lack of economic growth.

The services sector mirrored the economy as a whole with no growth in the three months to May. Services performance would have been even weaker had it not been for output in the consumer-facing subsector. Here, growth amounted to 0.2% in the three months to May. Businesses in this subsector have been supported by stronger-than-expected consumer activity in 2023, with spending holding up well despite high inflation and subsequent impacts on living standards. Elsewhere within the economy, the production and construction sectors recorded growth of 0.4% and 0.2%, respectively, in the three months to May.

Cebr's outlook for the UK economy is of continued weakness. Revisions to our forecasts now place the economy in recession across Q4 2023 and Q1 2024, driven predominantly by the tighter interest rate environment. Activity is expected to be stifled across a variety of sectors as borrowing becomes more costly, acting as a disincentive for investment and spending. Further weak values on the Small Business Index (SBI) are likely as a result.

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

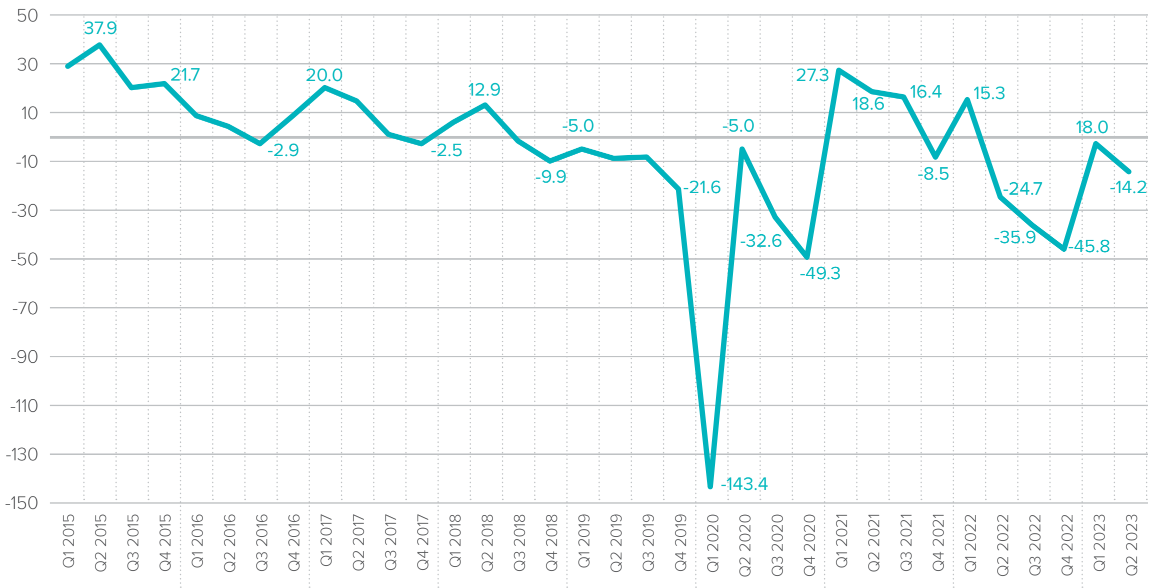
Small Business Index returns to decline, reflecting worsening business sentiment

The Small Business Index (SBI) fell to -14.2 in Q2 2023. This marked a return to contraction, following a sharp improvement in Q1. This had in turn followed three consecutive quarterly declines in 2022. Amidst these quarterly fluctuations, the SBI has now recorded a negative reading for five consecutive quarters. The negative readings signify that more businesses expect their performance to worsen over the coming quarter than improve.

Continued negative readings on the SBI reflect broader weakness across the macroeconomic environment. Though the economy has avoided a recession in 2023 so far, growth has been negligible. Indeed, when looking at monthly output, the economy was smaller in May 2023 than in the same month of 2022. This represented the first annual decline in the size of the economy since early 2021, when the country was in the midst of the third national lockdown.

It is clear that the economy is in a weak position, which is in part fuelling the net negative sentiment seen amongst the UK's small businesses. Given the anticipated recession across the end of this year and the beginning of next, further negative values on the SBI are likely.

Figure two: 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.

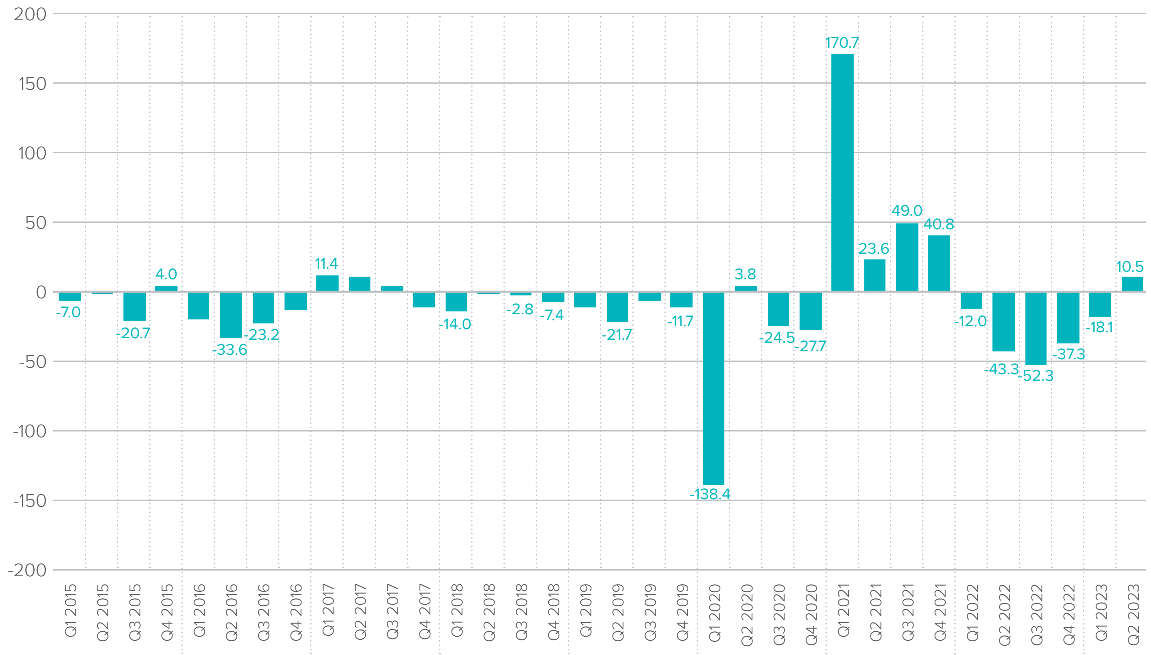
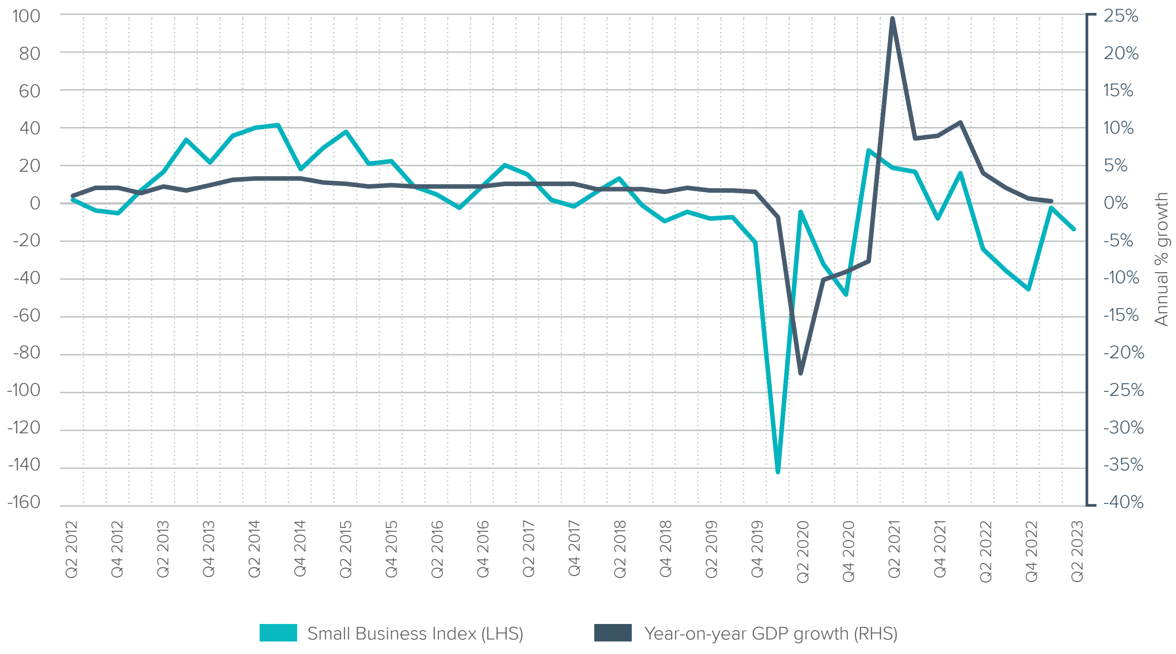


Figure four: UK SBI against year-on-year UK GDP growth.
Source: ONS, FSB - Verve 'Voice of Small Business' Panel Survey.



REGIONAL SMALL BUSINESS INDICES

UNANIMOUS NEGATIVITY ON THE SMALL BUSINESS INDEX ACROSS UK REGIONS

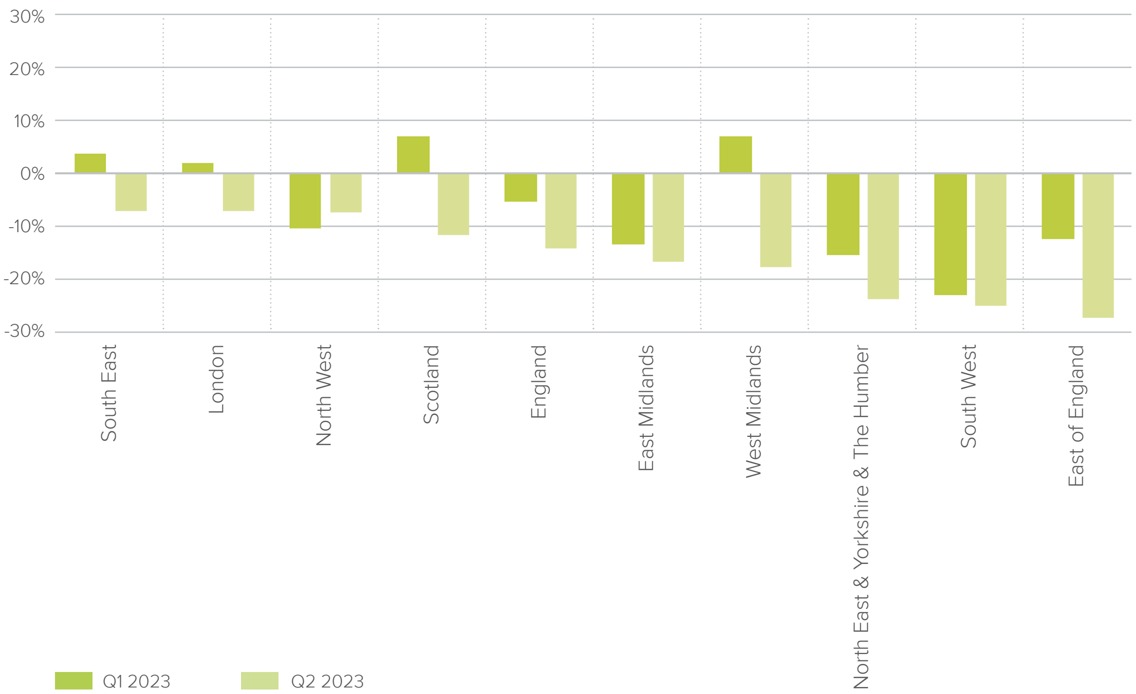
All UK regions recorded a negative SBI reading in Q2. This highlights the widespread nature of the economic pessimism that has emerged across the UK. With the exception of the North West, every region saw a weaker SBI score in Q2 than in Q1.

The most pessimistic region in Q2 was the East of England, with an SBI reading of -27.5. A majority, 53.8%, of businesses in the East of England expect their performance to worsen in Q3 relative to Q2. This is the largest share of any region. The South West saw a similarly weak SBI score in Q2, at -25.2. This was driven by a majority, 51.3%, of businesses expecting performance to worsen, as well as a below average share of businesses expecting performance to pick up, at 26.1%. Meanwhile, the region with the smallest share of businesses expecting their performance to improve in Q3 was the combined region of the North East and Yorkshire and the Humber, at 22.3%.

The region displaying the most resilience in Q2 was the South East, with an SBI score of -7.1. London was the second highest scorer at -7.3. Both of these regions saw above average shares of businesses expecting performance to improve in Q3, at 31.2% and 32.7%, respectively. These regions have a large cluster of businesses in professional, scientific and technical services, which was one of the few sectors to produce a positive SBI score in Q2. The performance of these enterprises will likely have supported the SBI readings of these regions.

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

MOST MAJOR SECTORS RECORDED NEGATIVE SBI READINGS IN Q2

After unanimous quarterly improvement in Q1, all major industries saw their SBI readings fall back in Q2. As with the regional discussion, this highlights the widespread shift in sentiment amongst small businesses in recent months amid an economic environment marred by higher interest rates and weak growth.

The scale of the fall varied across sectors. Manufacturing showed the smallest change in sentiment between Q1 and Q2, with its SBI reading falling by just 0.1 point. At the other end of the scale, construction saw the largest swing, with its SBI reading falling by 59.2 points. The construction sector is particularly exposed to the current environment of elevated interest rates, given that this raises the cost of finance for property developers and has negative impacts on demand in the private property market due to mortgage affordability concerns.

Two sectors recorded even lower scores. Accommodation and food services witnessed an SBI reading of -35.8 in Q2, while the wholesale and retail trade scored the lowest of all major sectors, with a reading of -37.8. These sectors are exposed to continued pressures on the consumer side of the economy, notably continued inflation and its subsequent impact on household spending power. Wholesale and retail is also a sector with particularly low profit margins on average. This means it is under particular strain from rising input costs, such as rising wages and logistics costs.

Alongside the 'other' category, professional, scientific and technical activities recorded a positive reading in Q2, at 7.8. This sector is less exposed to some of the current headwinds facing the economy, including interest rate increases and consumer pressures. However, the sector is facing difficulty from labour shortages at present, which is pushing up employment costs. This headwind likely prevented professional services from recording a more positive score in Q2.

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

SMALL BUSINESSES REPORT FALLING REVENUES FOR FIFTH CONSECUTIVE QUARTER IN Q2

The net balance of small businesses reporting revenue growth over the previous three months stood at -8.6% in Q2 2023. The negative figure means that the number of small businesses reporting a decrease in revenue levels over the last three months outweighed the number reporting an increase. This marked the fifth consecutive negative reading for the revenue net balance figure.

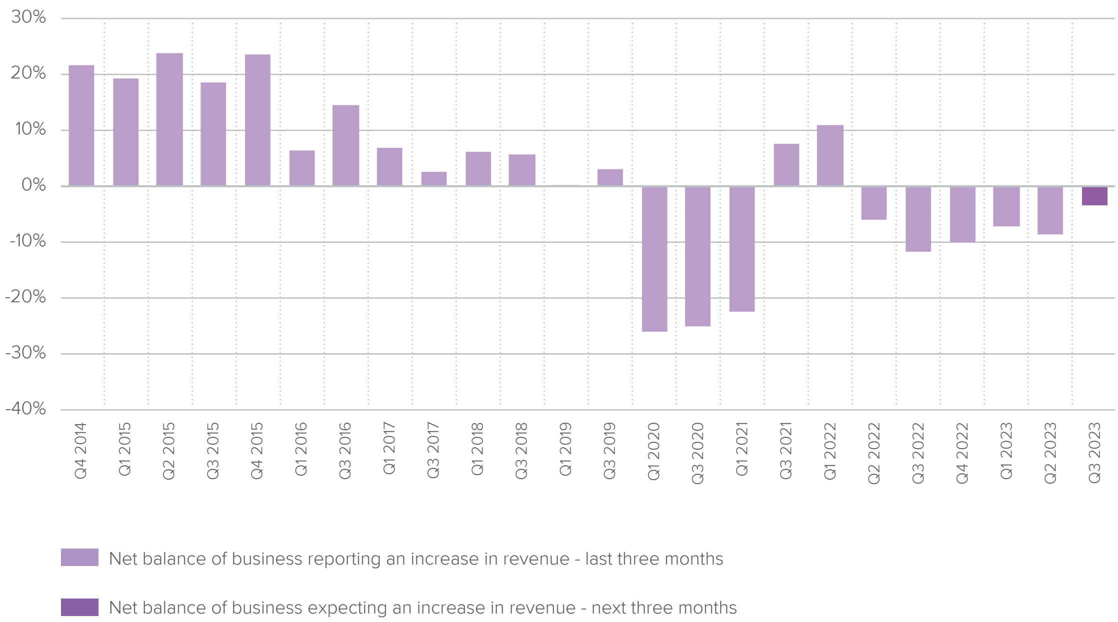
Amongst major sectors, the consumer-facing services of wholesale and retail and accommodation and food services recorded the weakest revenue net balance figures in Q2, at -29.4% and -23.2%, respectively. Despite consumer activity being stronger-than-expected across 2023 so far, these negative readings suggest that small businesses in consumer-facing sectors are struggling and that economy-wide improvements are instead being driven by resilience amongst larger businesses.

Even professional, scientific and technical activities, which recorded a positive score on the overall SBI, saw a negative revenue net balance figure in Q2. Though 31.5% of businesses in this sector saw revenue improve over the last three months, this was outweighed by the 32.1% of businesses reporting a revenue fall, yielding a net balance of -0.6%. This finding suggests that even businesses in the most optimistic sector are facing a difficult trading environment in terms of their financial performance.

Looking ahead, small businesses expect revenue to fall even further, with a net balance of -3.2% projecting a revenue decline over the next three months. Mirroring their position as the weakest region on the overall SBI, businesses in the East of England reported the lowest net balance when considering revenue increases over the coming quarter, at -15.0%.

Figure seven: Small business gross profits, net percentage balance – proportion reporting/expecting increase less proportion reporting/ expecting decrease.

Source: FSB - Verve 'Voice of Small Business' Panel Survey.



EXPORTS

EXPORT EXPECTATIONS REMAIN NEGATIVE AS BUSINESSES EXPOSED TO THE FOREIGN ECONOMY FACE DIFFICULT TRADING CONDITIONS

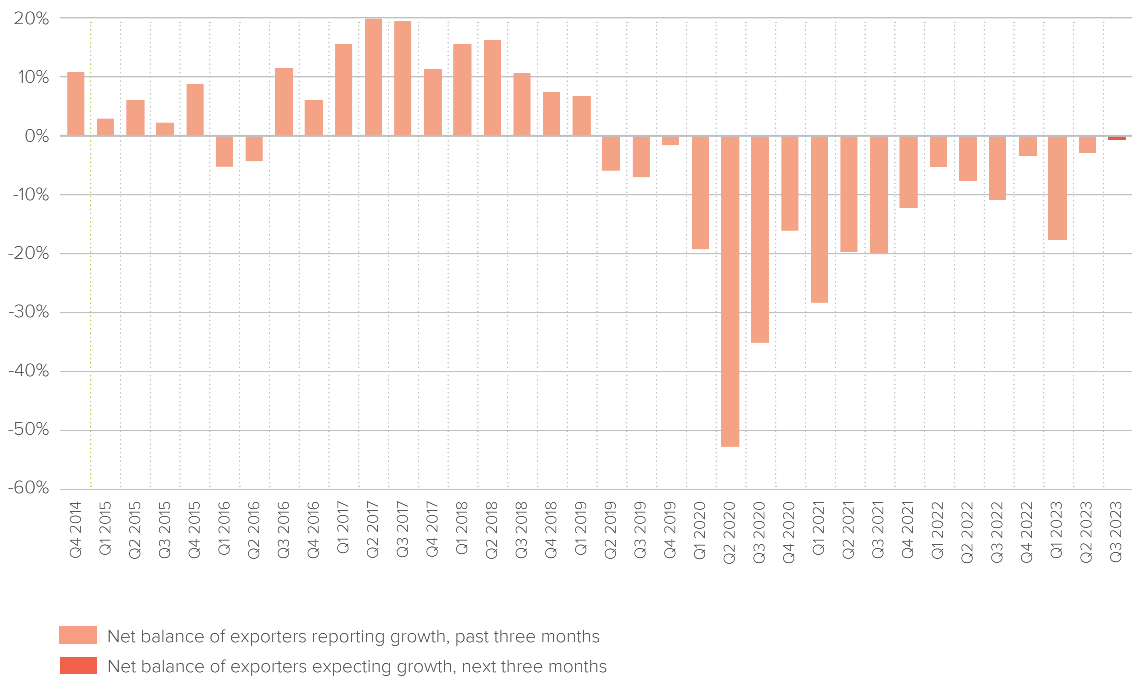
The net balance of exporters reporting growth in the value of their exports improved in Q2 2023. However, the figure still remained negative, with a reading of -2.9%. The latest reading means exporting small businesses have on balance seen contracting export growth for the past seventeen quarters.

Over this extended period, exporters have faced a difficult environment, with notable impacts from the pandemic and uncertainty due to Brexit. More recently, weak economic conditions in key international markets have hurt demand for UK exports, with many economies facing difficulties from inflation and other economic headwinds. The strengthening of sterling against major currencies, such as the euro and dollar, has also reduced the affordability of UK exports for foreign purchasers in recent months.

The improving net balance figure in Q2 does suggest that exporters' trading difficulties are easing. This has been supported by reduced supply-side disruption across the global economy.

Exporters expect a further decline in the value of their exports, with a net balance of -0.6% looking ahead to the next three months. As a component of overall economic output, falling exports will play a role in the expected recession in the UK at the end of this year.

Figure eight: Changes in value of exports – previous three months and expectations for coming three months net percentage balance – proportion reporting increase less proportion reporting decrease.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



COSTS AND INFLATION

SHARE OF BUSINESSES REPORTING INCREASED FINANCING COSTS REACHES RECORD HIGH IN Q2, THOUGH OVERALL BUSINESS COST PRESSURES EASE

In Q2, the net balance of small businesses reporting a rise in their operating costs fell to 80.4%. This marked the first quarterly fall on this metric since Q3 2022 and the weakest reading since Q4 2021. It is important to note that this is still an historically elevated share, however.

The decline in the share of businesses reporting increased operating costs corroborates with aggregate trends on business inflation. According to the ONS, producer input price inflation turned negative in June 2023, with prices falling by 2.7% on the year. This was particularly driven by falling oil and petroleum prices. Services producer prices, on the other hand, rose by 4.8% year-on-year in Q2.

As has been the case in recent quarters, utilities ranked as the most commonly cited source of changing business costs in Q2. However, the share of businesses selecting this fell slightly to 61.9% in Q2, down from 62.7% in Q1. Labour ranked as the second most commonly cited source of cost changes in Q2, being selected by 48.9% of respondents. Amidst a tight labour market, which is only showing slight signs of slowing, workers enjoy increased bargaining power when negotiating compensation with employers. This is resulting in elevated wage growth in nominal terms, putting pressure on businesses' costs.

The category witnessing the largest quarterly uptick when considering cost changes was financing. 19.9% of businesses stated that this was a source of cost pressures in Q2, up from 14.7% in Q1 and marking a record high for this measure. This aligns with recent changes to the interest rate environment, with the Bank of England raising rates on two occasions in Q2 in an attempt to reduce inflation. Increases to the base rate have fed through to commercial products offered to businesses, raising the cost of borrowing.

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.

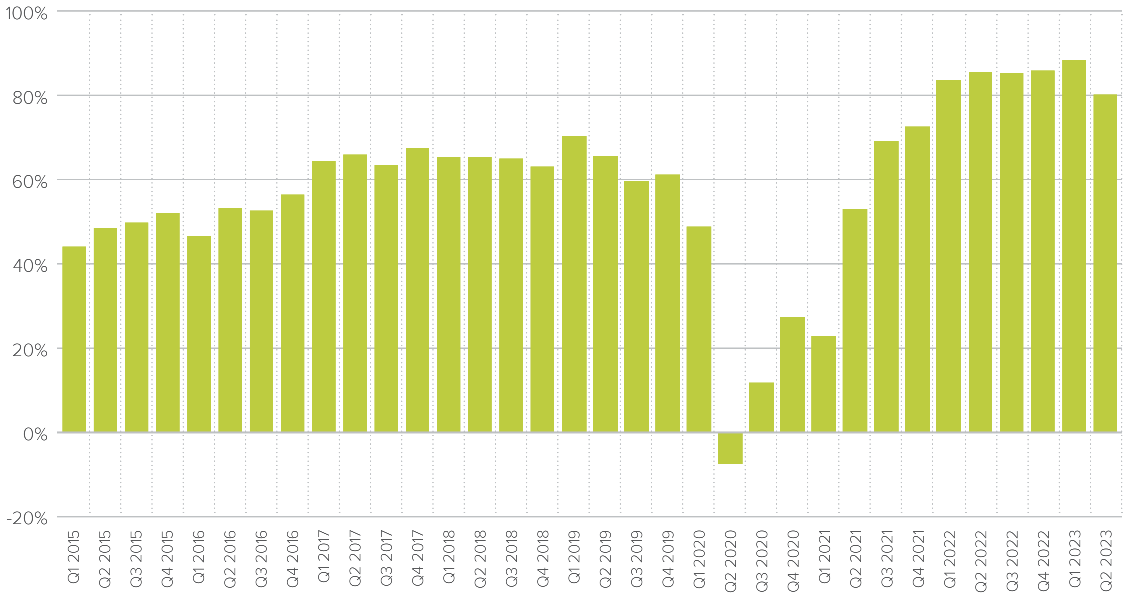
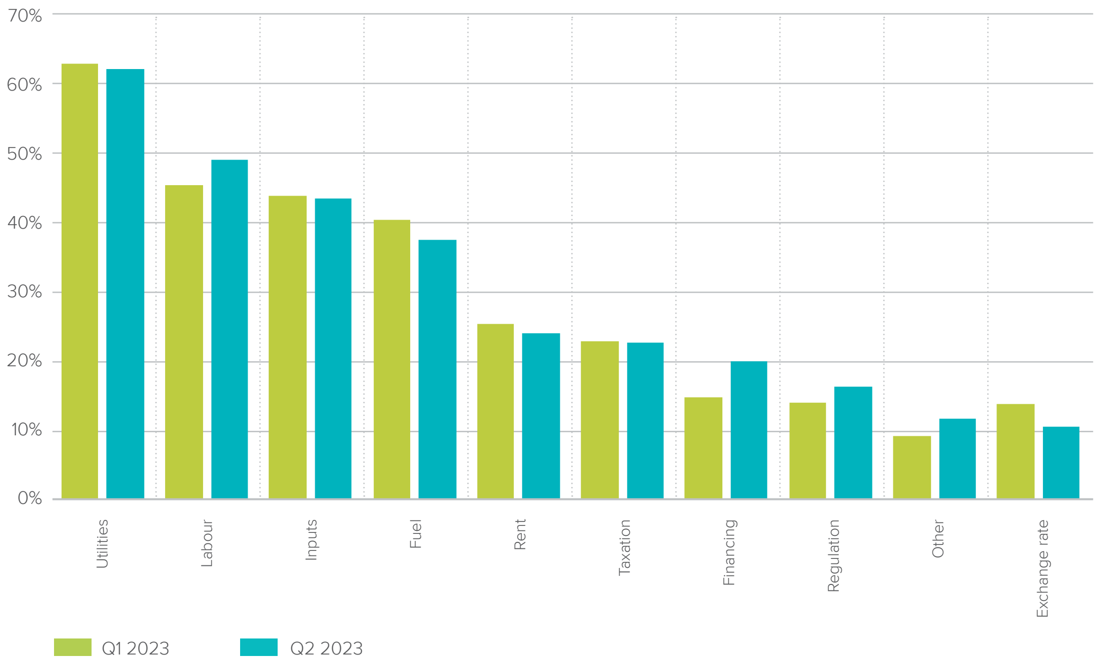


Figure 10: Main causes for changing business costs (firms may give multiple answers).
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



EMPLOYMENT

SMALL BUSINESS EMPLOYEE NUMBERS CONTRACT FOR FIFTH CONSECUTIVE QUARTER

A net balance of -2.4% of small businesses reported growth in employee numbers in Q2. 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 fifth consecutive negative reading on this metric.

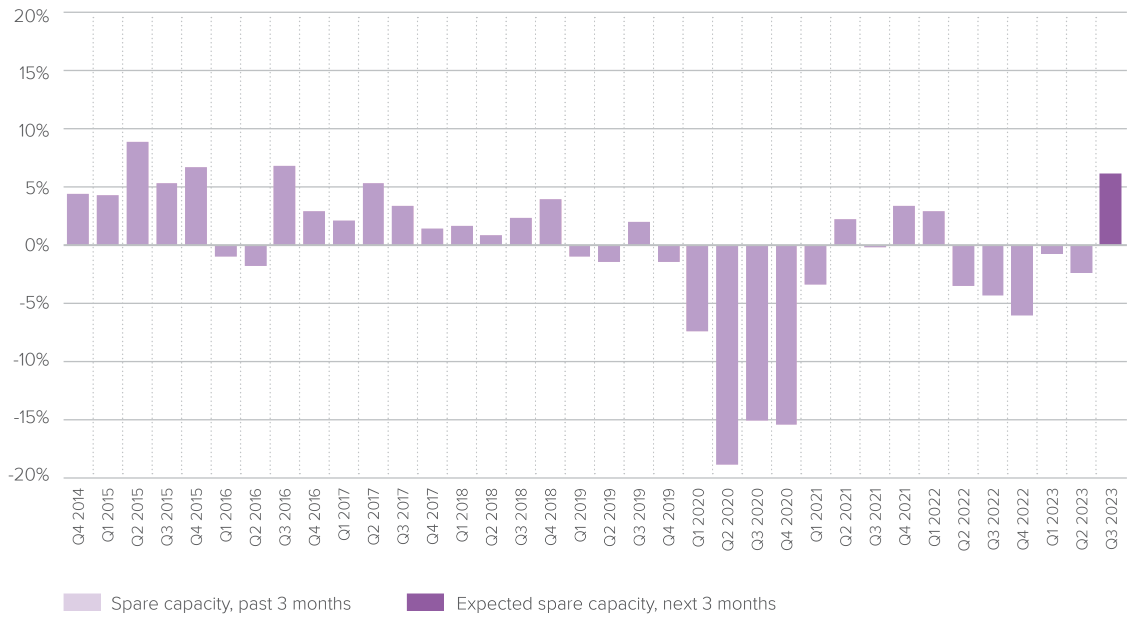
There was a continuation of recent labour market trends in Q2. Data from the ONS showed a further uptick in the unemployment rate in the three months to May, reaching 4.0%. This marked the highest rate since the three months to January 2022. Meanwhile, the number of vacancies fell on the quarter, albeit from an elevated level, indicating that labour demand has started to weaken.

By sector, the worst net balance score was seen in accommodation and food services, at -22.3%. Wholesale and retail recorded the next lowest net balance, at -11.6%. As the weakest sectors on this quarter's overall SBI, this highlights the link between maintaining staffing levels and business sentiment. This is further corroborated by the fact that professional, scientific, and technical activities recorded the highest net balance figure when considering employment, at 6.4%.

Looking ahead, small businesses expect their staffing levels to expand. A net balance of 6.1% expect their headcount to increase over the next three months. Though this more optimistic outlook in terms of employment is shared across most major sectors, this is not the case for wholesale and retail, where respondents expect a further decline in their employee numbers over the coming period.

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

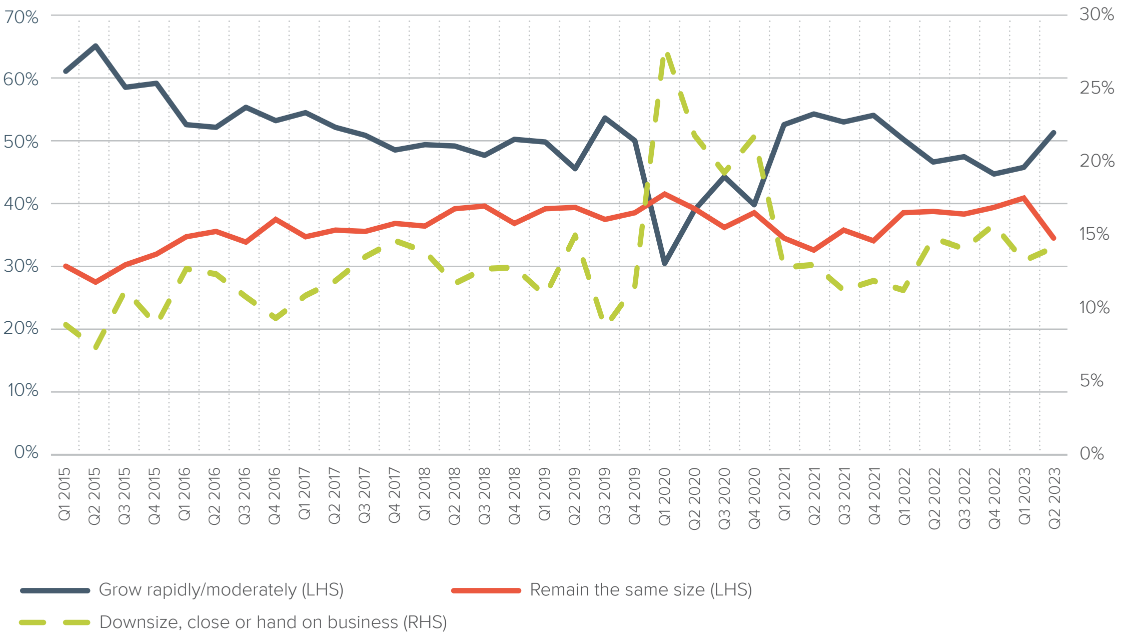
CONSTRUCTION BUSINESSES LEAST LIKELY TO ANTICIPATE GROWTH OVER THE COMING YEAR

The share of small businesses expecting to grow over the coming year increased to 51.3% in Q2. This put an end to four consecutive quarters in which only a minority of small businesses expected to grow over the next period.

Looking at businesses by sector, those in information and communication were the most likely to expect growth over the next 12 months, being the case for 65.1% of respondents. These businesses are less exposed to the current headwinds facing the economy, since they are more likely to benefit from greater spending on existing and emerging technologies and are also less directly linked to consumer developments.

At the other end of the scale, businesses in construction were the least likely to expect growth over the coming year, with this being the case for just 30.3% of respondents. These businesses are particularly exposed to the interest rate headwind, given that construction projects often require external financing. Pressures on financing costs are therefore limiting their growth prospects, as is the expected downturn in the housing market, which is a further consequence of the steep increase in interest rates.

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



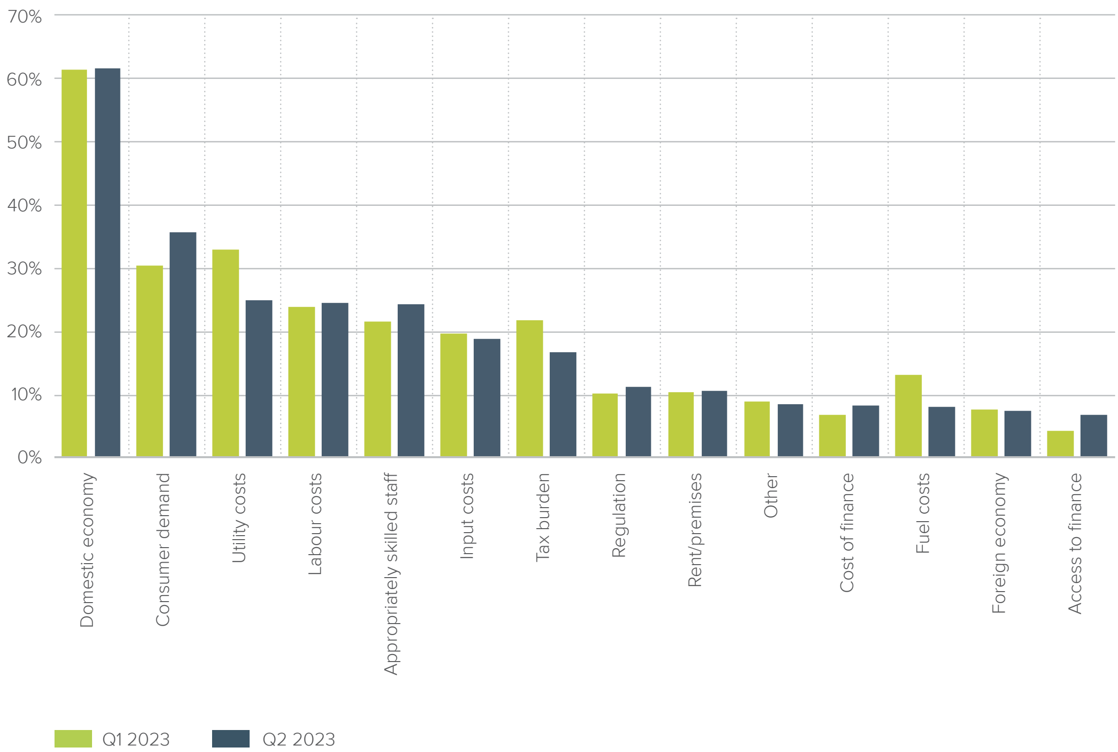
DOMESTIC ECONOMY REMAINS THE MOST COMMONLY CITED BARRIER TO GROWTH FOR SMALL BUSINESSES AHEAD OF RISING RISK OF RECESSION

The domestic economy remains the most commonly cited barrier to growth amongst small businesses, with 61.5% of respondents selecting the category. This highlights the continued weakness posed by current demand conditions and corroborates with expectations of a recession later in the year. The share was up by 0.2 percentage points on Q1's value.

Consumer demand ranked as the next most commonly selected barrier to growth over the coming year, being selected by 35.7% of small businesses. This share increased by 5.3 percentage points on the quarter, representing the largest uptick of any category. As a subcomponent of the domestic economy, weakening consumer demand due to reductions in real incomes is feeding into wider negative sentiment about the economy as a whole.

There was a large fall in the share of respondents selecting utility costs as a potential barrier to growth over the coming year. This was selected by 24.8% of respondents, down by 8.0 percentage points on the previous quarter. With wholesale energy prices having shown a negative trend, businesses' bills are also on the way down. Particular falls in utility bills are expected from Q3 onwards. Similar trends saw the share of businesses selecting fuel costs as a potential barrier to growth fall in Q2, exhibiting a quarterly drop of 5.2 percentage points.

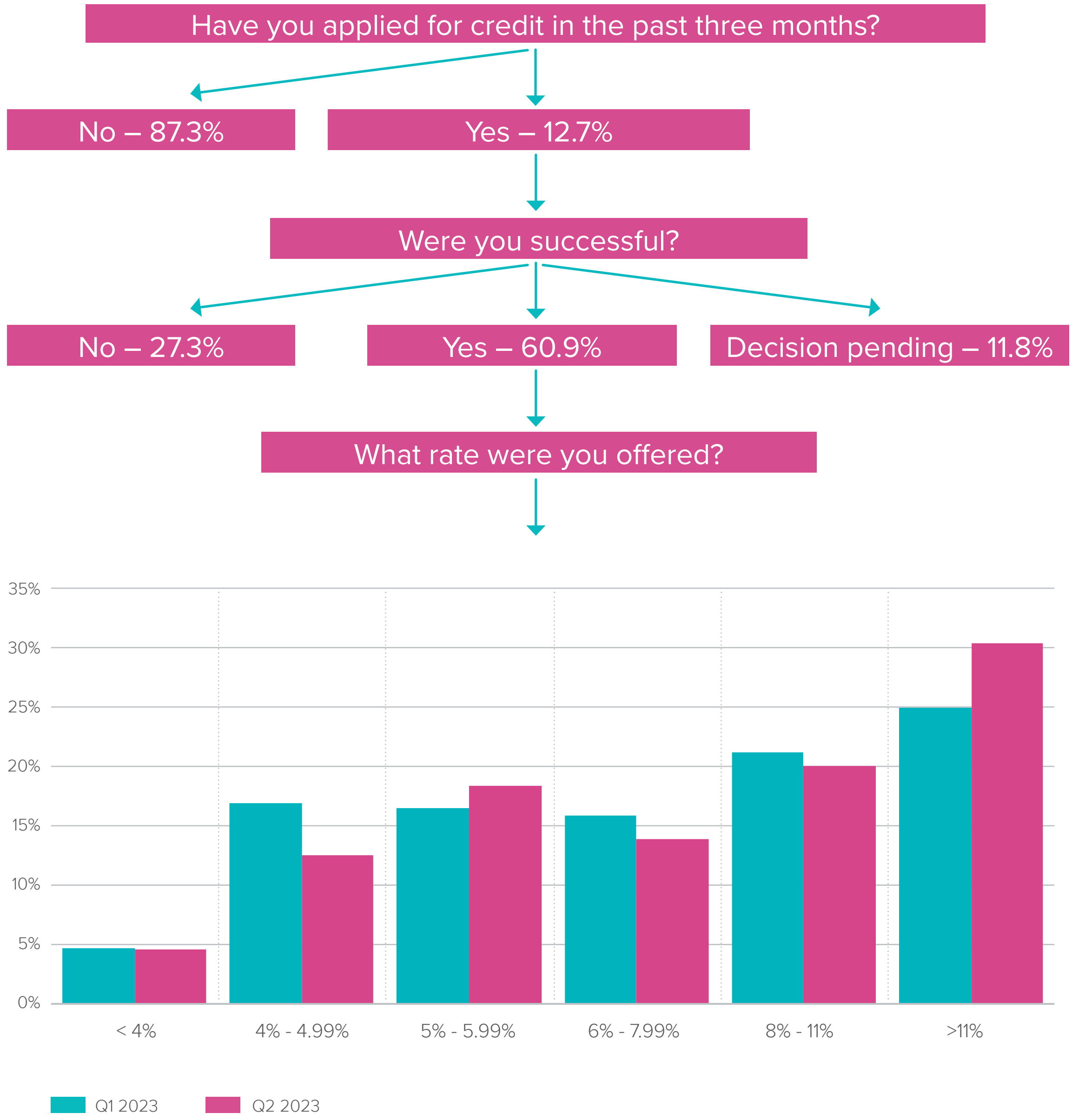
Figure 13: Potential barriers to achieving growth aspirations – multiple answers possible
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



CREDIT

SHARE OF CREDIT APPLICANTS BEING QUOTED THE HIGHEST RATES JUMPED UP IN Q2

Figure 14: Credit applications and interest rates offered
Source: FSB - Verve 'Voice of Small Business' Panel Survey



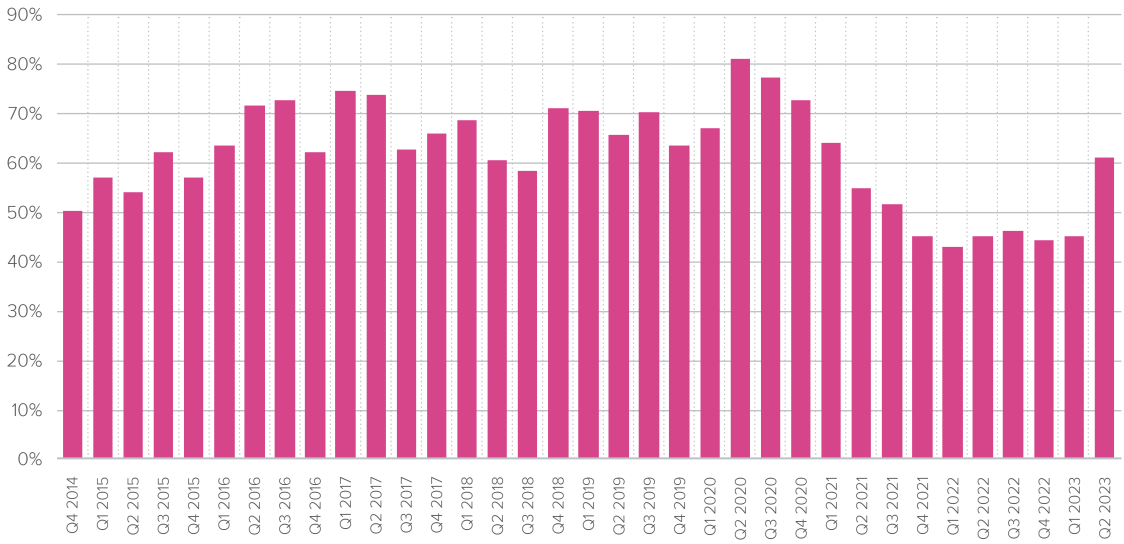
12.7% of small businesses reported that they applied for credit in Q2 2023. This was slightly down on the 13.7% recorded in Q1 2023. The share has now declined for two consecutive quarters. The share of credit applicants reporting that they were successful in their application increased sharply on the quarter, reaching 60.9%, up from 44.9% in Q1. Given the increase in the cost of borrowing, this may be a result of a self-selection process where only businesses with high creditworthiness apply for loans at the current rates.

Amongst sectors, businesses in manufacturing were the most likely to report having made a credit application in Q2. This was the case for 19.8% of these businesses. Manufacturing continues to face a number of economic headwinds, including weak demand from both domestic and international customers. Indeed, international business surveys show that manufacturing sectors across Europe and the US are suffering from similar problems, with output standing in contractionary territory.[2] These factors are likely driving businesses to turn to credit in order to support their operations.

Businesses in professional, scientific, and technical services were the least likely to report making a credit application in Q2. This was the case for just 7.3% of respondents in this category.

There was a large jump in the share of successful credit applicants beings offered a rate in excess of 11%. 30.4% of credit applicants were quoted a rate above this value in Q2, up from 25.0% in Q1. This reflects the recent monetary tightening campaign conducted by the Bank of England, with the higher base rate feeding through into commercial credit products for businesses.

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



2 https://www.theglobaleconomy.com/rankings/pmi_manufacturing/

BUSINESSES' PERCEPTIONS OF CREDIT AVAILABILITY AND AFFORDABILITY WORSEN FURTHER AMIDST TIGHTER INTEREST RATE ENVIRONMENT

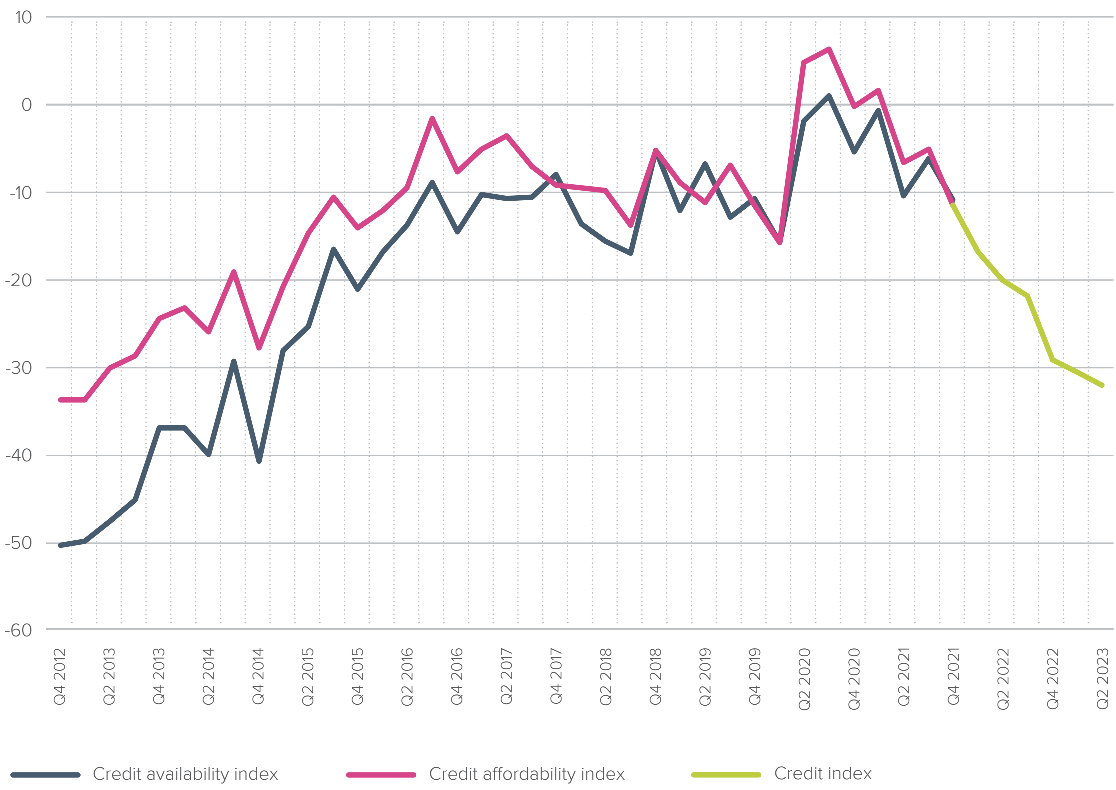
Perceptions of credit affordability and availability worsened further in Q2. The share of businesses with positive opinions on overall credit availability and affordability fell to 11.8% in Q2, down from 12.3% in the previous quarter. The share expressing negative views on credit availability and affordability increased to 52.0% in Q2 2023, up from 50.9% in the previous quarter.

Businesses in the South East were particularly likely to express negative sentiment on credit availability and affordability, with this being the case for 59.8% of small businesses in this region.

As a result of this worsening sentiment, the credit index fell once more in Q2, reaching -31.9. This marks the worst reading since the credit availability and credit affordability indices were amalgamated in Q1 2022.

Figure 16: Indices of credit perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses[3]

Source: FSB - Verve 'Voice of Small Business' Panel Survey



3 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 IMPROVE DESPITE TIGHTER INTEREST RATE ENVIRONMENT

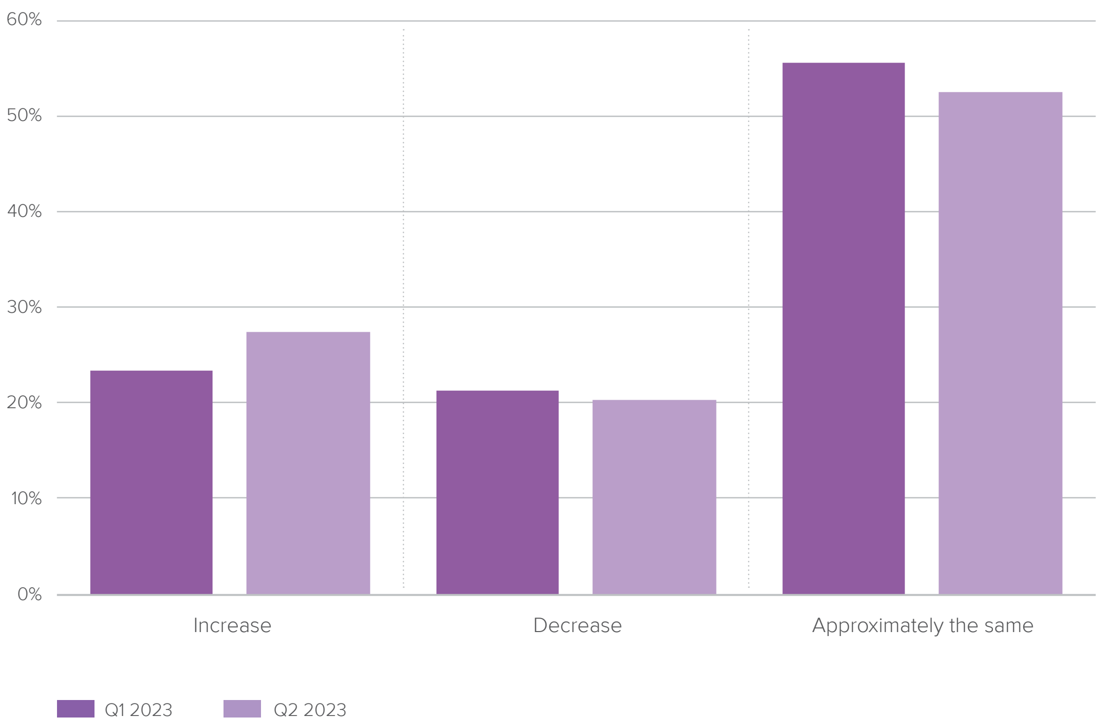
The share of small businesses expecting to increase their investment over the coming quarter picked up in Q2, reaching 27.3%, having stood at 23.3% in Q1. Simultaneously, there was a fall in the share of businesses expecting to cut back on their investment, which fell to 20.3% in Q2 from 21.2% in Q1. As such, the net balance of small businesses expecting to increase their investment rose to 7.0% in Q2, up from just 2.1% in Q1.

These changes came in spite of further increases in interest rates, which would ordinarily be expected to discourage investment due to increased borrowing costs. However, one rationalisation for this finding is that market expectations for future interest rates surged in Q2. As such, it may be the case that businesses are bringing forward their investment plans, in order to avoid even costlier borrowing in the near future.

Businesses in wholesale and retail were the worst performers on this metric, with a net balance of -5.7% expecting to increase their investment over the coming quarter. However, this was up from the -7.1% net balance recorded in Q1. Mirroring their overall positivity on the SBI measure, businesses in professional, scientific and technical services scored amongst the highest net balances when looking at investment intentions, at 17.7%. Nevertheless, this was not the highest share recorded in Q2. Businesses in information and communication, which face a similar trading environment to those in professional services, scored highest, at 21.2%.

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 June 2023 research survey of FSB members carried out by Verve. 5,461 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. 882 responses were received, a response rate of 7% 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 22 June and 7 July 2023.

SUMMARY DATA TABLE

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Small Business Index	16.4	-8.5	15.3	-24.7	-35.9	-45.8	-2.8	-14.2
Employment - previous three months	-0.2%	3.3%	2.9%	-3.6%	-4.4%	-6.1%	-0.8%	-2.4%
Employment - coming three months	11.5%	9.8%	14.5%	7.2%	2.7%	3.2%	8.3%	6.1%
Exports - previous three months	-20.0%	-12.3%	-5.3%	-7.7%	-10.8%	-3.3%	-17.7%	-2.9%
Exports - coming three months	-4.6%	-3.8%	10.4%	1.4%	-4.3%	7.9%	-6.4%	-0.6%
Credit availability and affordability - rated good or very good	-	-	19.5%	17.6%	17.4%	14.7%	12.3%	11.8%
Credit availability and affordability - rated poor or very poor	-	-	36.5%	42.3%	44.1%	50.5%	50.9%	52.0%

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.

Q2

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