Federation of Small Businesses
The UK's Leading Business Organisation

FSB Voice of Small Business Index

Quarter 4, 2014

Q1 Q2
Q3 Q4

Contents

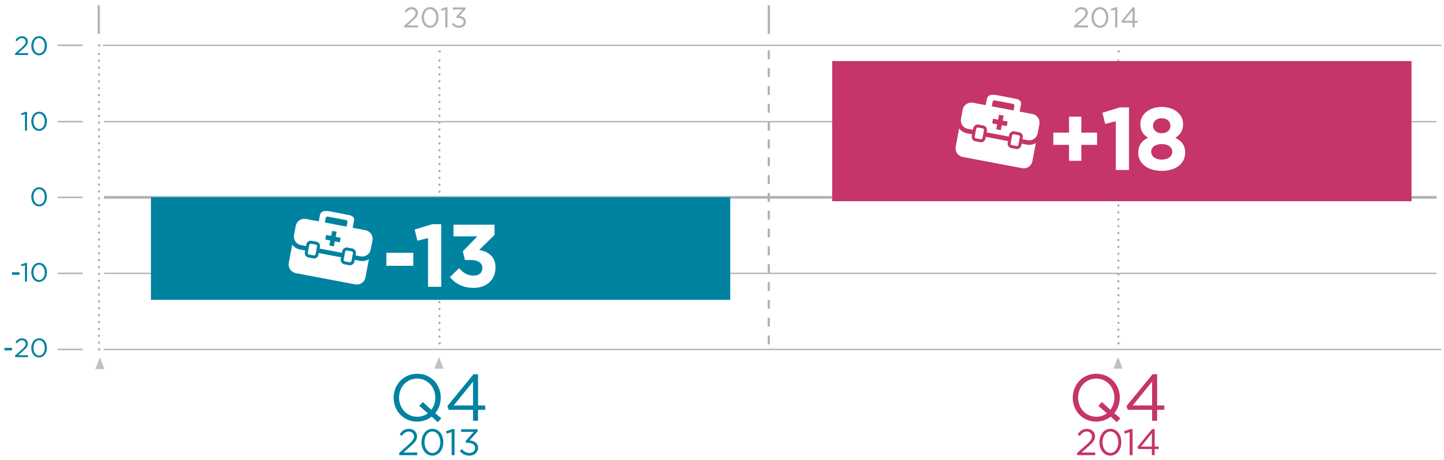
PRODUCTIVITY

Productivity is up **1.1%** in the year to Q4 2014

EMPLOYMENT

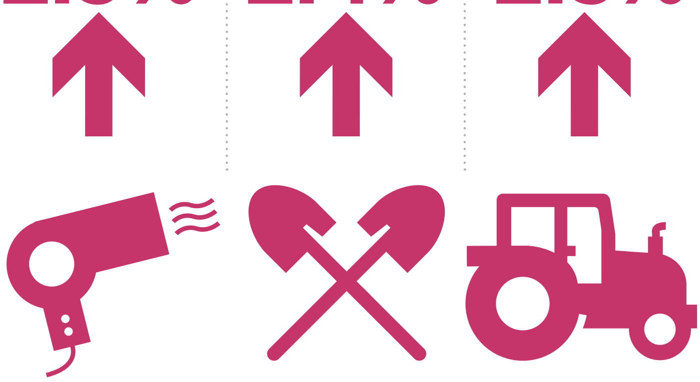
Nearly **16%** of small businesses have hired more staff in the last quarter

HEALTHCARE



PAY INCREASE

2.9% **2.4%** **2.3%**



Personal Services **Construction** **Agriculture**

EXPORTS

25% of firms are exporting up from 23% in Q1 2012.

FSB Voice of Small Business Index

John Allan, FSB National Chairman

The FSB's latest Small Business Index (SBI), a measure of our members' confidence, remains firmly in positive territory at +17.6. While the rapid growth of the past few quarters has as expected begun to slow, it has not stopped our members from recording greater profits – a trend that is expected to continue into the New Year.

The dip in the overall results this quarter reflect the seasonal trend – our surveys consistently show confidence easing in the fourth quarter - and perhaps more uncertainty in the market place than that present in recent quarters. These factors therefore paint a slightly more complex picture than previously. Increased turnover and a benign inflationary environment suggest the outlook remains positively balanced against reduced export confidence across different sectors as weak conditions persist in the Eurozone.

Our new Productivity Index developed with CEBR produces interesting insights into the performance of our members. It shows that in line with the rest of the economy, in recent years productivity growth among small firms has been weak. However, it has shown encouraging signs of increasing over the past two quarters, moving into consecutive quarters of growth, which bodes well for future prospects and a further sign of the resilience and sure footedness of small businesses. From the wider policy perspective, increases in productivity allow for real wage growth and here there are signs that wage growth is increasing even in sectors where confidence for the next three months has dipped such as personal and financial services.

Sectorally, computer and related activities has the highest levels of confidence and aspiration - with an impressive 88% of members planning to expand – though in line with our headline index, confidence in the sector has slipped back. Sectors where confidence has increased markedly include transport, health and safety and finally hotels, catering and restaurants, the latter possibly reflecting greater discretionary spending among consumers. Retail confidence did however fall as warmer weather affected sales across our high streets.

At the regional level, confidence remains variable. Only West Midlands, eastern England, and London have greater confidence than this time last year. What we need to see if the economy is to be rebalanced away from London and the South East is a sustained period of confidence in these other regions. That is why the FSB has been so supportive of investment in regional transport and a concerted effort to turn the potential of our great regional cities into reality in terms of jobs and wealth creation.

As always, to translate our members' confidence into growth, they need access to finance. While conditions have improved, with the Funding for Lending Scheme having a beneficial impact on loan pricing, policymakers need to keep the focus on addressing the challenges faced by small businesses. It also needs to continue to support the British Business Bank and deliver on banks sharing credit data and referring rejected applications to alternative finance providers. This will help diversify the market. A similar focus is needed in our export efforts where there remains much to be done to raise the UK's performance especially against the backdrop of sluggish growth in Europe and increased global risks. Recent announcements for further funds for UKTI to encourage first-time exporters are therefore to be welcomed. The key now is to ensure that level of commitment is sustained into the long-term, and to avoid any 'stop-start' to policy.

Economist's View

The latest edition of the FSB's SBI points to cooling but still very positive growth conditions. The headline confidence index has posted its first year-on-year decline since the beginning of 2012, but this is from a high base and comes following a year of very rapid economic expansion, so we don't see it as cause for concern. Businesses remain optimistic about the longer term prospects, with more aspiring to growth and more planning to invest in the future.

At a regional level, small businesses in the South of England and in particular, the Midlands, remain very positive. Overall unemployment in West Midlands and London has fallen sharply over the past year, partly boosted by job creation among small firms. Looking at the sector breakdown, optimism among business services and IT firms are the most buoyant – these are industries that we see as being likely to provide a strong boost to overall UK GDP over the medium term. However, sharp increases in confidence have also been seen in the leisure and hospitality industries, as consumer spending power starts to rise.

Another positive sign for the UK economy is that our new productivity indicator published for the first time shows productivity among small businesses is now estimated to be on the rise, for the first time since comparable data began in 2011. Productivity growth is needed for living standards to rise over the long term, so this is encouraging news for UK consumers – particularly as wage growth is typically linked with increases in productivity. With a rising share of small firms expecting to increase capital investment spending over the next 12 months, it looks as though output per worker is likely to continue on its upward path.

Although the UK government continues to have its hands fairly tied in terms of the fiscal outlook by the still significant amount of deficit that needs to be cut, there are areas where changes in policy would benefit the business sector. A growing number of small firms are reporting that regulation and taxation are a greater source of cost growth for their business over the past 12 months. This could be an area of much debate in the run up to the 2015 election. This quarter, accessing finance looks to be becoming more difficult for the UK's small businesses: fewer are reporting successful applications for new credit, and more businesses are reporting that the availability of finance is worse and less affordable. Although various schemes have been introduced to help small firms to access financing, this is of concern and will need careful monitoring should it persist.

To sum up, although the UK economy and small business prospects are likely to be affected by continued public sector austerity and a weakening global environment, the outlook remains bright. With definite growth sectors and a strong will to expand among small firms, the UK economy in 2015 is set to be another strong performer.

Rob Harbron, Senior Economist, Cebr

Executive summary

Key findings this quarter:

- The headline small business confidence index fell back year-on-year this quarter for the first time since Q1 2012. However, this is from a high base, and optimism levels remain well into positive territory.
- Confidence is higher among small businesses in the West Midlands than anywhere else in the UK. Generally, businesses from the southern regions of England are more confident this quarter than those in the devolved nations and northern English regions.
- Computer services are the most confident sector, closely followed by business services and transport services. Construction and manufacturing are close behind them, positive news from the point of view of a balanced recovery between economic sectors.
- The net balance of firms reporting positive revenue growth grew from +20% last quarter to +22% this quarter. For profits, the net balance of firms reporting growth was higher this quarter than last, at +14% compared to +8%.
- The balance of firms reporting export growth is holding up, despite ongoing weak economic prospects in the UK's main export markets. In addition, a higher proportion of firms expect export growth in the three months ahead.
- A smaller proportion of small businesses are reporting rising costs compared to a year ago, alongside the slump in commodity prices and the very low rate of producer price inflation in the UK economy. This quarter, a net balance of +55% of respondents reported rising costs, up from +54% last quarter, but significantly down on a year ago.
- Firms report an improvement in their aspirations for 2015 as a whole, despite the short term dips in confidence reported. A net balance of 62% of firms hope to grow, compared to 61% last quarter, while the proportion planning to downsize or close their business fell.
- Small businesses are still contributing to the ongoing reduction in unemployment, reporting net job creation.
- Spare capacity continues to decline among small businesses, although a net balance of almost half of firms still reports running at below full capacity.
- Employees in personal services firms, construction and agriculture are gaining the largest pay increases, according to small businesses.
- Slightly fewer firms see the state of the domestic economy as a barrier to their aspirations now compared to a year ago, but it is still the most-cited concern. Coming next are concerns regarding labour costs and appropriate staff.
- Productivity in small businesses has exhibited two quarters of meaningful growth. This has encouraging implications for wage growth in the near future.

UK macroeconomic overview

UK outlook still looking strong, though global backdrop provides risks

The UK economy continues to expand at a robust pace. The latest year-on-year GDP growth rate was recorded at 3% for Q3 2014, slightly down on the 3.2% reached in Q2, but a strong pace nonetheless. Growth continues to be balanced, with all major sectors – construction, production and services – contributing.

A key development in recent months has been the sharp decline in inflation, with the consumer price index rising by just 1.3% over the year to October. The outlook for prices over the coming 12 months also looks benign. This has in large part been the result of a significant downward trend in global commodity and oil prices – the cost of a barrel of Brent crude stood at just above $70 by the end of November, down from just over $100 at the end of August.

This has positive implications for all UK businesses and consumers. With the cost of essential items such as petrol and home utilities holding steady or falling back, pressure is reduced on household budgets, helping discretionary spending power to rise. This is likely to provide a boost to total consumer spending in 2015, acting to push up private sector revenues. Businesses are also expected to gain from reduced stress on their bottom lines, as costs of physical inputs and energy fall back.

However, one of the reasons that global commodity prices are falling back is due to weakness in economic growth from the Eurozone and from emerging economies such as China. This same trend is likely to weigh down on export prospects for the UK as a whole, as demand conditions cool for overseas sales. The Eurozone is a particular risk to the outlook, as roughly 50% of the UK's total goods exports are sent there.

With inflation remaining weak and risks to the outlook emerging from the global backdrop, the Bank of England is likely to hold off on raising interest rates for longer, with markets pricing in no increase before the second half of 2015. Keeping the base rate lower for longer will also help to support consumer spending in the short term, as doing so keeps the cost of mortgage payments down.

One additional factor that is likely to weigh down on overall UK growth is the effect of government cutbacks. Bringing the public spending deficit down has been much talked about since the start of the current parliament, but much progress still needs to be made. In the 2014 – 15 fiscal year to date, borrowing is higher than at the same point in 2013-14. As such, difficult decisions on government budgets will need to be made over the next parliament, and potentially beyond.

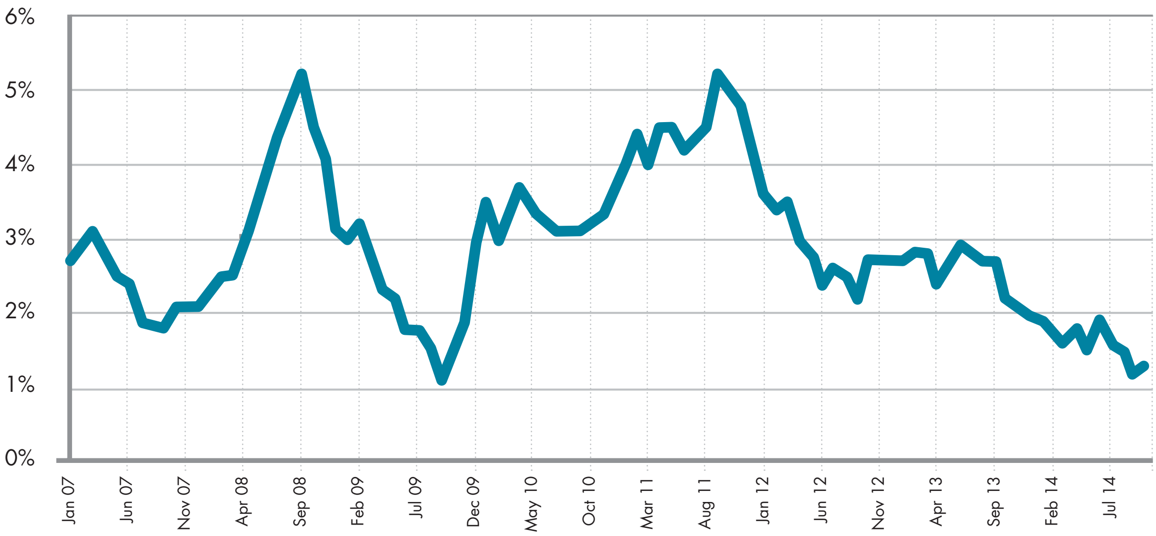


Figure 1: UK inflationary environment easing as global commodity prices fall back

Source: YouGov/Cebr Consumer Confidence report November 2014

Small Business Index

Business confidence still strong, but down year-on-year

The SBI stood at +17.6 in Q4, still well into positive territory. However, there are signs that the recent upsurge in optimism has come to an end, as this quarter's result is down year-on-year for the first time since Q1 2012. The confidence Index also fell back on the previous quarter, but this dip is in line with the movement usually observed in the final quarter of the year.

Despite the fall in the latest figures, this cooling of confidence should be seen as something of a moderation after a year of stellar growth conditions for the UK as a whole, rather than as an indication of an economic downturn. Within the headline figures, the more detailed results still give a bright picture. More than one in three small businesses (37%) expect their business performance to improve over the next three months compared to the past quarter. In addition, a further 42% of firms expect conditions to remain broadly the same as over the past three months; this in itself is positive, given the strength of the UK economy recently. Just 21% of small businesses expect their performance to weaken ahead, although this figure is up from 14% in Q3.

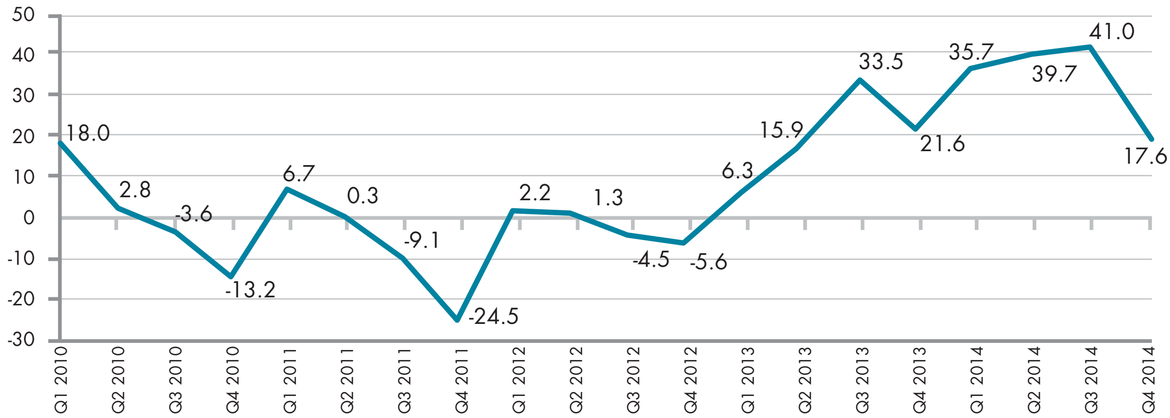


Figure 2: The FSB SBI[1]: small business prospects over coming three months

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

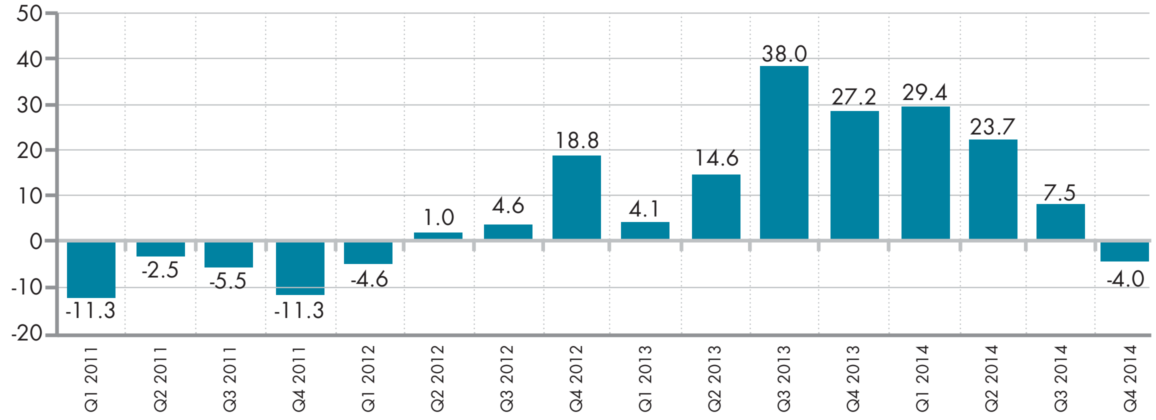


Figure 3: Year-on-year change in the FSB SBI

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

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

Regional Small Business Indices

Firms in London, the West Midlands and Eastern England are more confident in Q4 2014 than in the same quarter of 2013.

Regional imbalance becoming more evident again

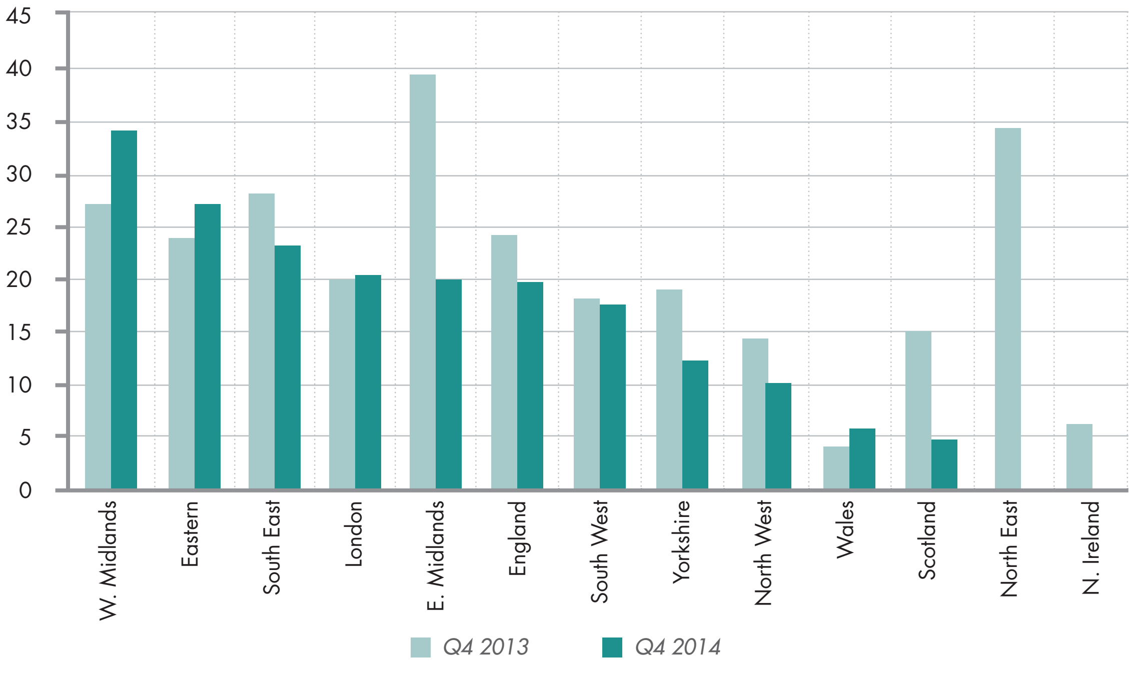
Compared to a year ago, firms have become less optimistic in most parts of the UK, except for London, the West Midlands, Eastern England and Wales. The West Midlands currently has the highest Index reading, where a strong seven-point gain drove it to the top of the list. A net balance of +34% of firms in the region now expect to see further improvement over the next three months.

The regions with the highest small business confidence this quarter are concentrated in southern England and the Midlands. As noted, the West Midlands in particular has shown dynamism recently, as a rapidly strengthening labour market led to a 2.2 percentage-point year-on-year decline in unemployment in Q3. The only region to see the unemployment rate decline by more was London, for which the equivalent was 2.7 percentage points.

At the other end of the spectrum are the northern regions of England and the devolved nations. The North East and Northern Ireland have seen an especially sharp worsening in confidence, as the Index scores have both fallen to zero this quarter. The decline in the North East is a rapid turnaround, as it was the most confident region just two quarters ago. This reading comes alongside weakness in the local labour market, as unemployment in the North East fell by less than the UK as a whole over the past year and currently has the highest rate of all UK regions.

These confidence readings also reflect the latest regional figures for house price growth, which tend to indicate the general strength of local economies. Price increases remain fastest in London at 18.8% in the year to September. The East and the South East follow. At the other extreme, the three slowest growing regions in house prices are Wales, Yorkshire and the Humber and the North East. It is not necessarily desirable to have annual house price growth of over 10%: the pace in some of the fastest growing regions may be unsustainable. But the implications of this difference in terms of economic dynamism are clear.

Figure 4: FSB SBI – regional variation in small business prospects over coming three months



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

Sector Small Business Indices

The IT sector is the most optimistic about the next three months.

IT firms most optimistic, but transport, hospitality and healthcare sectors see largest boosts to confidence

In line with the national picture as a whole, sentiment among small businesses across most industries has cooled over the past year. However, some sectors buck this trend, with small firms in health services, transport, leisure and the hospitality industry all seeing a year-on-year increase in confidence.

Confidence in the health sector has seen a particular strong boost to optimism, with the Index moving from -13 in Q4 2013 to +18 this quarter. One regulatory change that may be helping to boost confidence in the sector is the Care Act, which recently came into force and has simplified the framework for paying into care homes, partly by moving more of the burden from the individual onto the state. It is also intended to encourage a market for the provision of insurance against paying for care.

Sentiment among small hospitality firms (i.e. those in the hotels, bars and catering trade) has also sharply improved, moving from a score of -26 in Q4 2013 to -1 this quarter. This improvement comes alongside a significant easing of inflationary pressures on household budgets and sustained growth in discretionary incomes in cash terms[2]. With greater discretionary spending power, consumers may be helping to boost revenues in the hospitality sector, as well as the leisure industry – another area where small businesses have seen a rise in confidence.

Small construction businesses have seen their optimism levels remain broadly unchanged year-on-year this quarter. This year has provided strong opportunities for the construction sector as a whole, with the number of completed new houses 36% higher in the first three quarters of 2014 than at the same point a year ago. In addition, with 15% more houses where building has been started over the same period, construction activity is likely to be supported at least in early 2015.

However, despite an uptick in house building, the residential retail market has been slowing, with the number of mortgage approvals well down in October 2014 from both a peak earlier in the year and from the same point in 2013. This may be one factor weighing on optimism among small real estate firms, whose confidence Index has dropped over the past year.

Another industry where the decline in confidence is particularly marked is in financial services. This quarter, small businesses in the sector recorded a confidence score of +20, well down from +58 at the same point in 2013. This potentially reflects a weakening of UK equity markets in the final quarter of 2014, as concerns are raised over global growth. However, despite this slowdown, confidence among small financial services firms remains well into positive territory, and in fact these businesses are still planning to recruit over the next three months.

The manufacturing industry also saw a marginal cooling of confidence over the past year. Despite this, small businesses in the sector remain some of the most optimistic in the UK. As this year to date has seen the strongest growth in the industry as a whole since 2010, this slight downtick most likely represents a stabilisation of prospects, rather than the start of a downturn.

[2] Asda Income Tracker November 2014

Q4

Figure 5: FSB SBI by sector – small business prospects over coming three months

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

Revenue and profitability

23.4% of businesses expect turnover growth in the next three months.

Profits to increase with increasing turnover and subdued cost pressures

A net balance of +22% of firms reported that their revenues grew over the last three months. Meanwhile, a balance of +14 % reported the same for gross profits. On both counts, firms display cautious optimism, expecting the next quarter to deliver marginally better results than this one. The balance expecting higher revenues ahead is at +23.4%, while that expecting higher profits is +19%.

As illustrated in Figure 6, below, the share of small businesses reporting profit growth has drawn closer to the proportion of those reporting rising revenues in recent quarters, as subdued cost pressures have supported profitability. Low inflation is expected by the Bank of England for the year ahead, which is likely to give a further boost in the form of rising spending power among consumers assuming wage growth continues to pick up. This means that, without firms necessarily seeing large wage bill increases, they will see rising demand for their products as consumers find their monthly bills falling in price, leaving more money to spend on discretionary items. For each US $10 reduction in the price of a barrel of oil, world GDP growth rises by around 0.2–0.3 percentage points. Since the summer, oil has fallen from around $100 during the summer to close to $70 at the time of writing, and with no clear pressures expected to raise it in the near term, UK businesses are set to see this effect in action.

Figure 6: Small business revenue growth and gross profit, net percentage balance – share reporting increase less share reporting decrease

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

Exports

25% of small businesses exported goods or services in the third quarter of 2014.

Small business exports holding up despite weakening global outlook

A slowly rising proportion of UK small businesses are exporting their goods or services overseas, according to the latest Voice of Small Business survey. This quarter, 25% of firms reported that they export, up from 23% when comparable data began in Q1 2012. In addition, a further 6% of businesses estimate that it is likely that they will start to sell overseas in the future. With over half (51%) reporting that exporting isn't relevant to their business, these are encouraging figures.

At the same time, export sales for those who do sell to overseas customers appear to be on the up. This quarter, a net balance of +11% of small exporters report an increase in sales over the past three months, up from last quarter and broadly in line with reported growth over the first half of the year.

In addition, a positive trend is expected ahead, as a net balance of 19% of firms anticipate export growth in the three months. Although these expectations help to highlight small businesses' overall expansion plans, there are signs that this performance may be tricky to realise, given a weakening global outlook. In particular, the Eurozone looks as though it may weigh on prospects for exporters. The OECD in their November 'Economic Outlook' warned that much more expansionary monetary and fiscal policy is needed to stop the threat of ongoing economic stagnation in the currency zone. Without this, the Euro area poses a major threat to the global economy. To achieve buoyant export growth over the medium term, small UK businesses may do well to look further afield and for government support for exporters to be sustained.

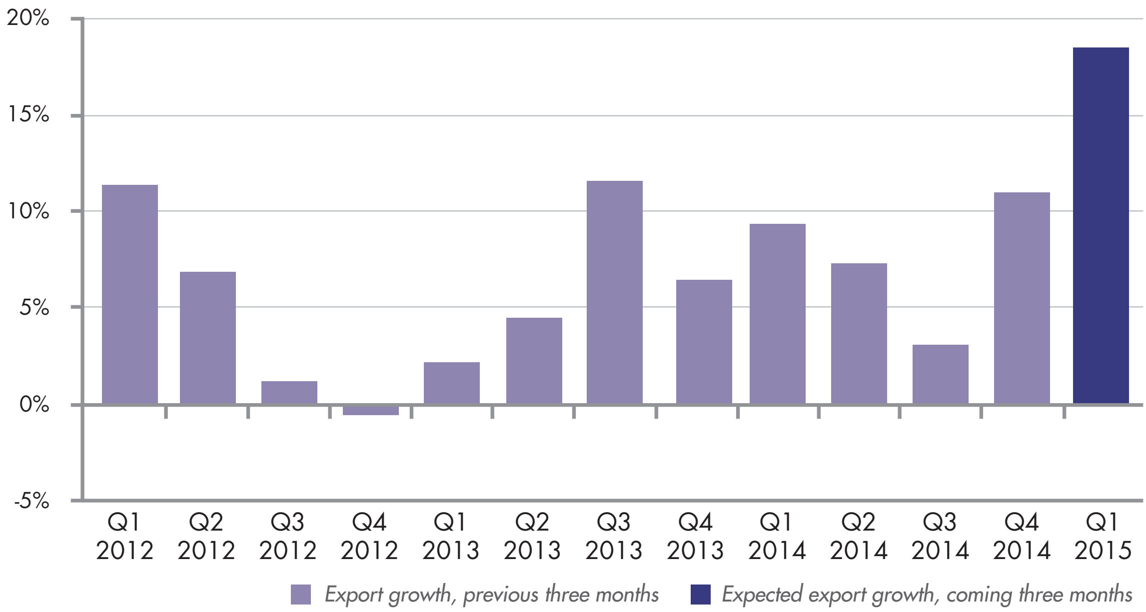


Figure 7:
Changes in exports – previous three months and expectations for coming three months; net percentage balance, share reporting increase less share reporting decrease

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

Costs and inflation

Small firms citing fuel and utility costs as a major cost is considerably lower.

Inflationary pressures on small businesses remain broadly stable

The net balance of small businesses reporting increasing costs this quarter has remained at a similar level compared to the last two quarters. However, compared to a year ago, cost pressures are significantly softer. Overall, 9% of firms reported that their costs had fallen over the past three months, which is the highest figure to have given this response since comparable data began.

Figures from the Office for National Statistics show that total input prices for manufacturing firms have fallen by 8.4% over the year to October. The main contributor has been falling commodity prices, particularly oil. New "unconventional" sources of oil supply have coincided with falling growth in demand to drive the price to around $70 per barrel, its lowest level since 2010. Current developments in the oil industry, particularly regarding the Organisation of Petroleum Exporting Countries (OPEC's) failure to cut supply at its latest conference, suggest that the price will fall even further over the next three months. In line with this, the proportion of small firms citing utilities as a major contributor to cost increases is also considerably lower than it was at the same point in 2013.

For services firms, wages are a more important component of total costs than utilities or fuels. Although a slightly higher proportion of small businesses report that labour costs are a greater source of overall cost growth this quarter than in Q4 2013, average reported wage growth remains relatively low this quarter, at just 1.4% over the past year. This figure remains well below the 4% average wage increase that was seen across the UK as a whole in the years preceding the financial crisis. As such, this is a further factor holding down overall cost inflation for businesses.

A larger proportion of small businesses this quarter are reporting that taxation and regulation are a greater driver of cost increases this quarter than at the same time a year ago. With the 2015 General Election looming, these findings suggest that the next government could support small businesses more in these areas.

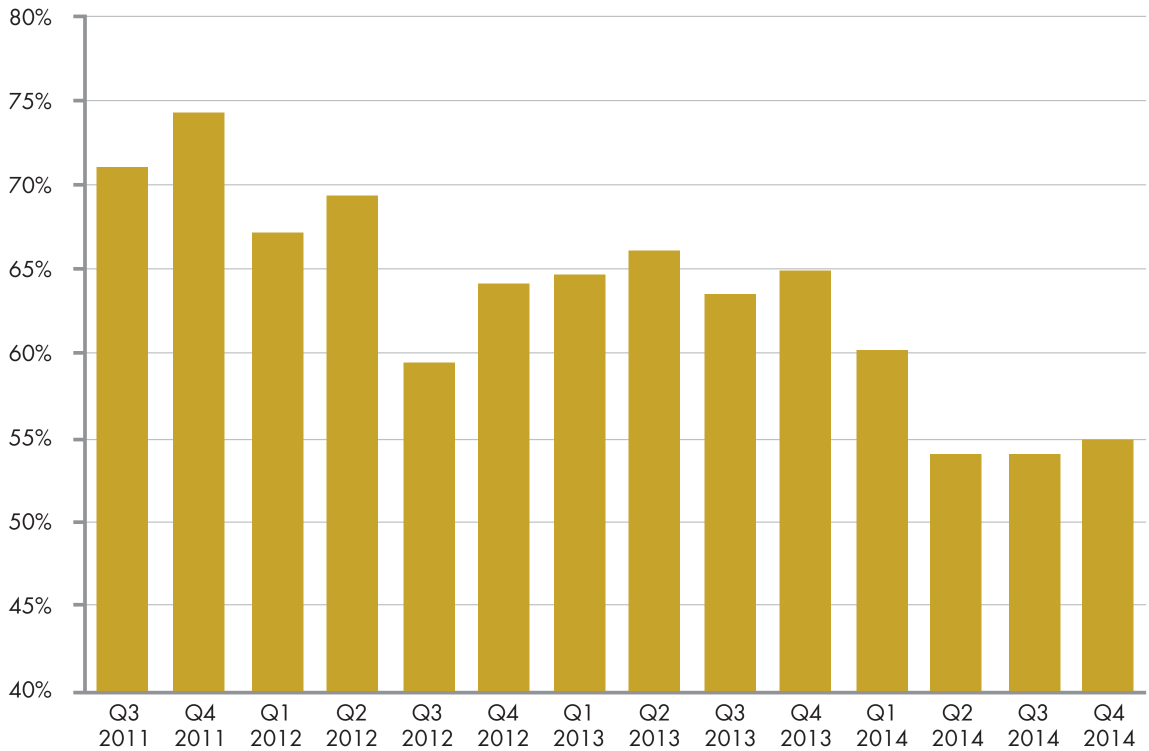


Figure 8: Small businesses reporting an increase in overall cost of operation; net percentage balance

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

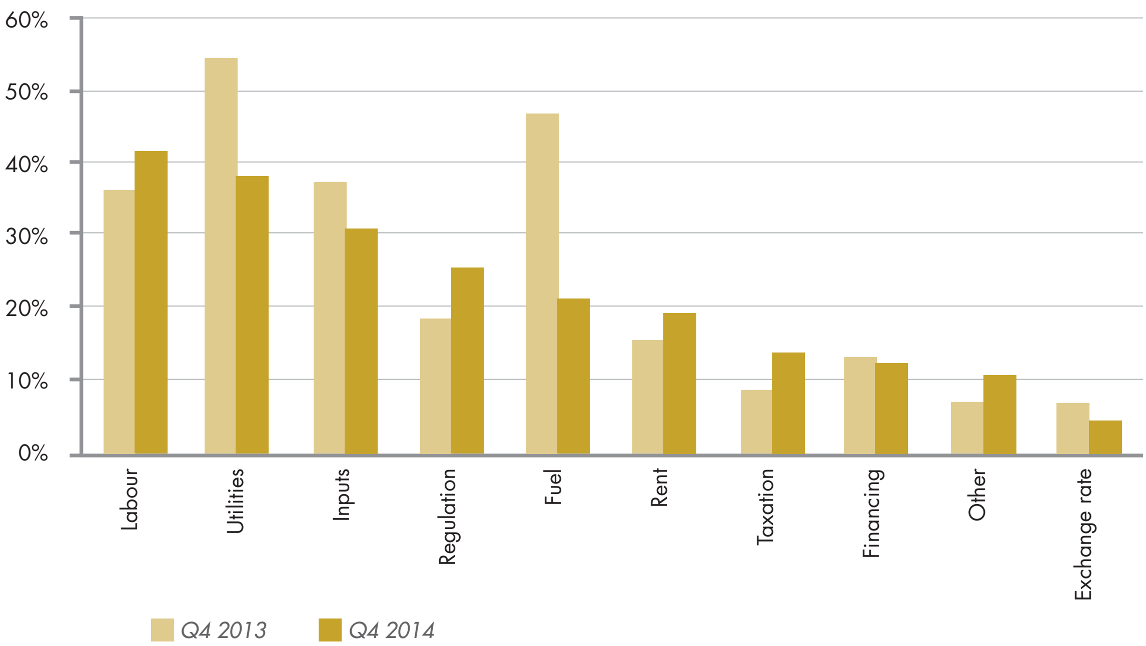


Figure 9: Main causes for changing business costs (firms may give multiple answers)

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

Capacity

A net balance of 42% of firms expect to run below capacity over the next quarter, continuing the recent downward trend.

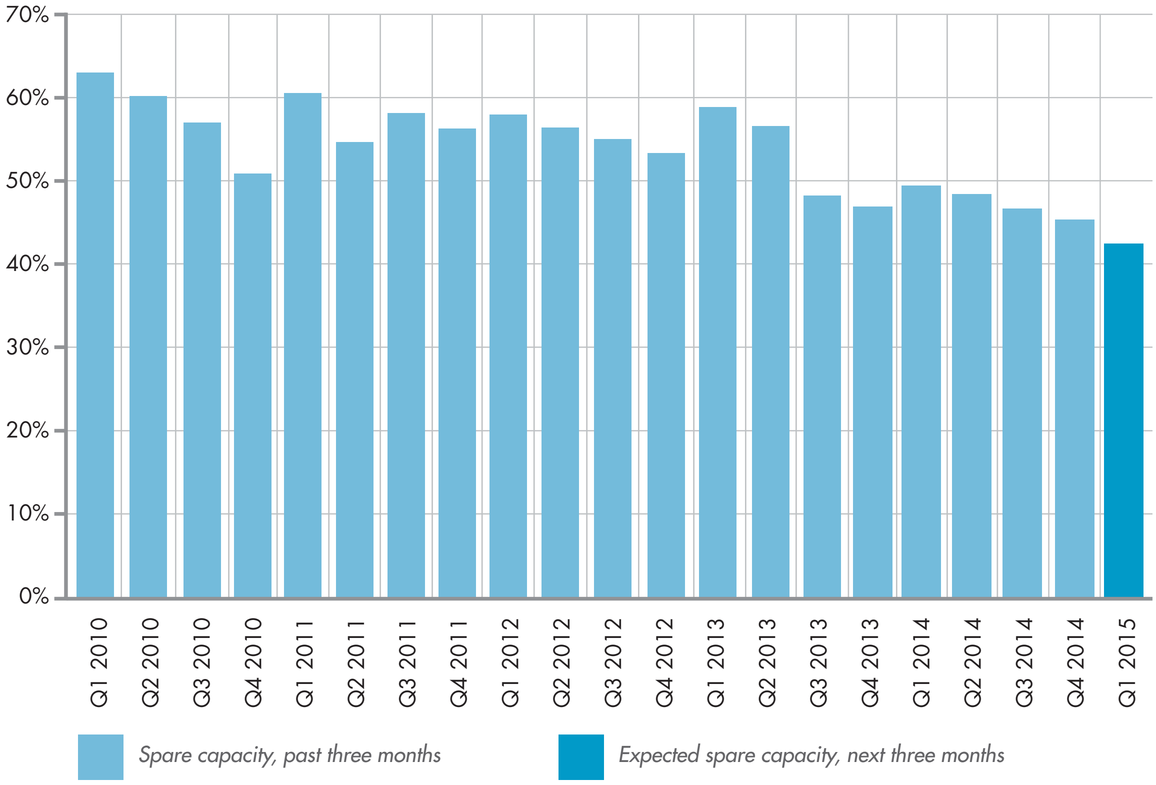
Gradual downward trend in spare capacity set to continue

The net balance of firms reporting running below capacity has decreased marginally this quarter to 45.6%, from 47% in Q3 2014. This indicates that almost half of small businesses still have enough physical capital and available labour power to produce greater output, should demand rise. Having increased in response to the fall in demand after the crisis and resulting recession, the amount of spare capacity in small firms has been on a gently downward trend since Q1 2013.

The Bank of England's estimate of spare capacity has been around 1% of GDP in both the November and August inflation reports, indicating that it has changed little recently. This is a whole-economy figure; it includes all firms and also unemployed workers. As such, that would suggest that interest rates are set to remain on hold.

The balance of firms expecting to be running below capacity next quarter is +42.4%, slightly lower again. As firms expect to invest in capital and to increase their headcounts on average in the near future, firms are expecting demand to rise and are increasing their capacity to meet it.

Figure 10: Net percentage balance of businesses running below capacity – share below capacity less share above capacity



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

Employment

Over the past quarter, a net balance of 4.4% firms increased their number of employees.

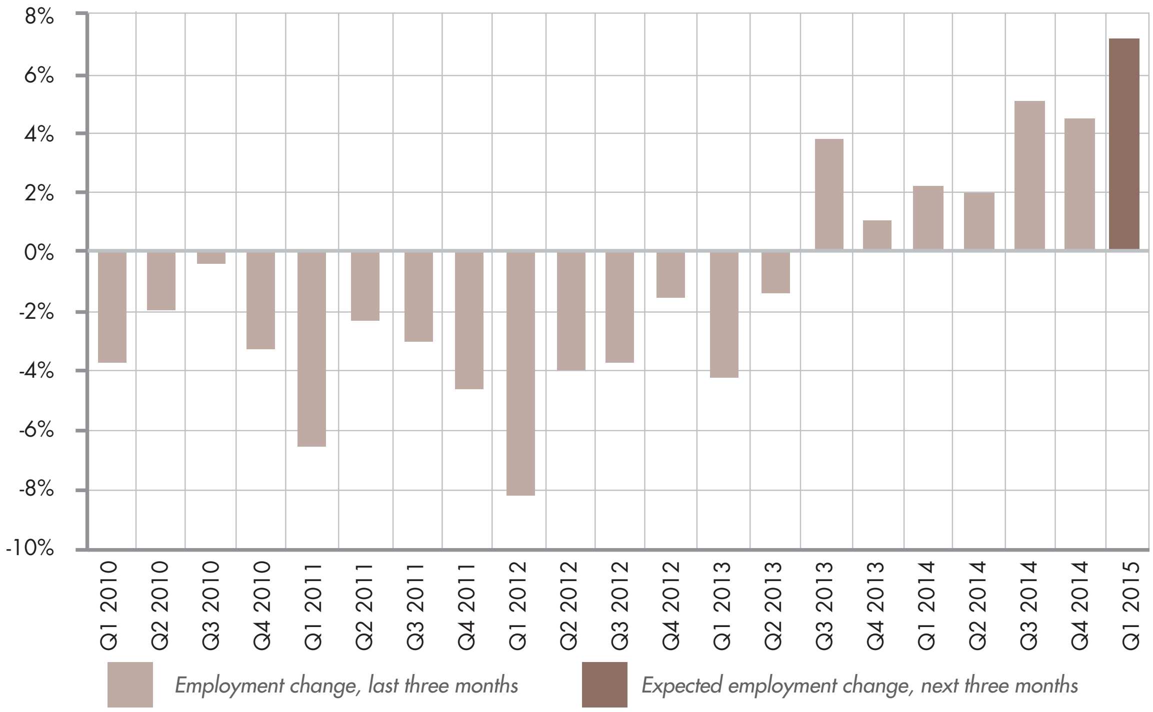
Small businesses continue to boost employment

Over the past quarter, a net balance of 4.4% of small businesses increased their headcount. This is a very positive result and just short of the record of 5% last quarter. Nearly 16% of firms have increased employment compared to 11% that have reduced it. This highlights small businesses' contribution to the record-breaking decline in unemployment: in Q3 2014, unemployment fell year-on-year by 1.7 percentage points from 7.7% to 6%, as 694,000 more people found employment.

Firms are also optimistic about hiring over the next three months. The net balance increasing headcounts is expected to rise to 7.1%. The strongest hiring intentions are in the health and social work, financial services and wholesale sectors – all of which have broadly optimistic views regarding the next three months, but are by no means the most confident of all sectors. Hiring intentions are also positive in the financial services industry, in which a net balance of +11% of firms plan to increase headcounts over the next three months, despite the sharp drop in small business sentiment in that sector.

Although small businesses are helping to bring down the overall unemployment rate in the UK back towards pre-financial crisis levels, there still remains some fragility in the labour market. The number of people working part time only because they cannot find a full time job remains elevated, and is unlikely to reach the levels seen before the 2008-09 downturn over the next 12 months.

Figure 11: Net percentage balance change in number of people employed – share reporting increase less share reporting decrease



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

Personal services firms leading pay increases

Annual wage growth is running at roughly the same pace as last quarter according to small businesses. It has dipped slightly from 1.5% to 1.4%, which is close to the average of 1.3% reported across the economy. Leading the way this quarter was the personal services sector, in which salaries increased by an average of 2.9%. Second is construction, a sector in which companies have been citing skills shortages, and one in which past wage growth has been strong. Financial services and health and social work, the two foremost sectors in terms of hiring intentions, report 1.9% and 2.1% respectively in salary increases. In addition, the agriculture, forestry and fishing industry has seen the sharpest uptick in salary growth, from just 0.4% over the year to Q3 2014 to 2.3% over the past 12 months.

At the opposite end of the table are education and real estate, two sectors with year-on-year declines for the second consecutive quarter. In real estate, this corresponds with businesses' stated intentions of reducing headcounts: a net balance of -4% of firms expect to employ fewer people next quarter in line with the general loss of confidence in the sector. Employees of small businesses working in the education sector have seen the largest fall of 1% on average, compared to government policy which mandates a year-on-year rise of 1% for teachers in the public sector over this year and last.

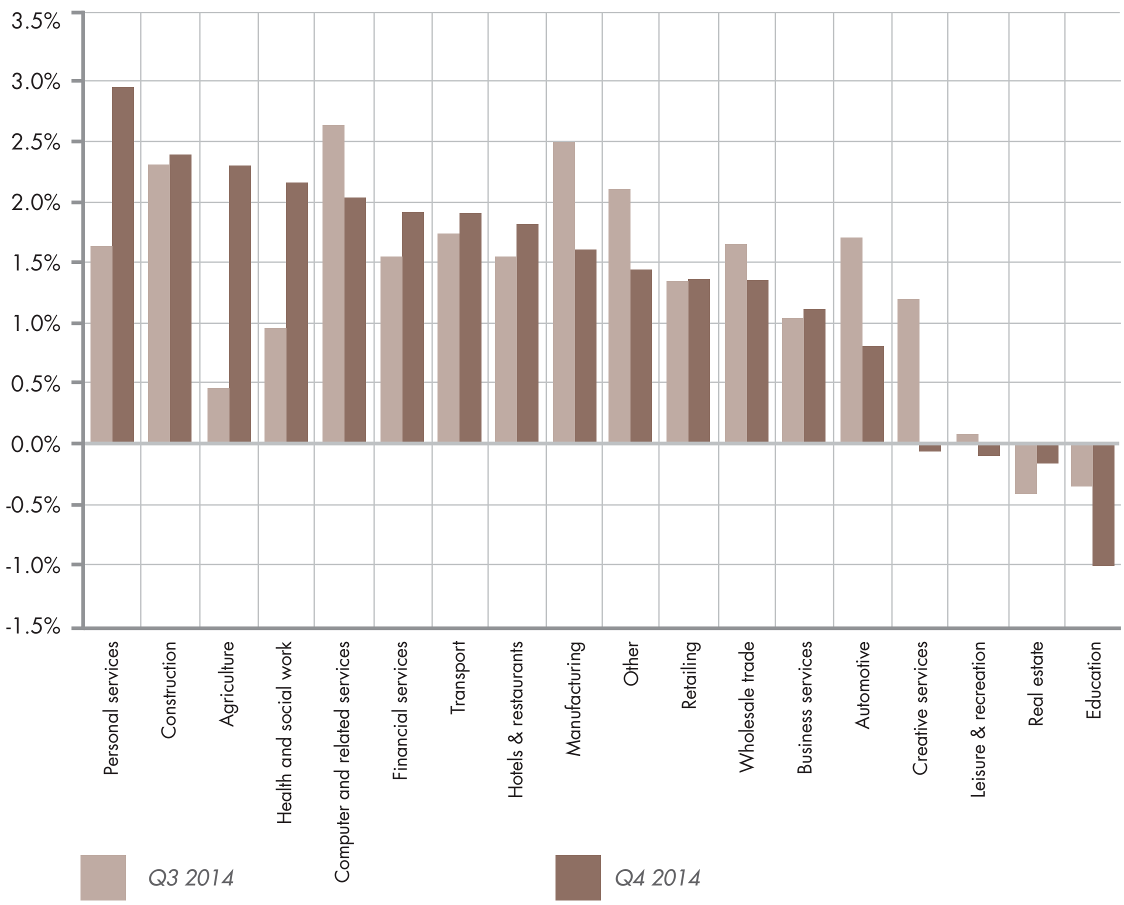


Figure 12: Average salary increase awarded, this quarter versus a year before

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

Productivity

Improving productivity points to positive wage growth in 2015.

Productivity growth returns to small businesses

Much of the UK economy remains in a 'productivity puzzle', as growth in overall output per worker has stagnated far below its long-term rate. To understand this further, the FSB has developed its own productivity index which shows that small businesses at least appear to be seeing the first signs of productivity growth. Small businesses' revenues have been growing in real terms at a greater rate than their employment, meaning each worker's average output is increasing. Productivity measured on this basis grew year-on-year in the second half of 2014 for the first time since comparable data began in 2010, rising by 1.1% in the year to Q4 2014.

This is an encouraging sign for the both economy as a whole and workers in particular, as wage growth is typically linked to productivity increases. However, the level of output per worker is still below that seen in 2010 and productivity growth must be sustained longer for the effects to translate into strong wage growth. Therefore it is imperative that firms continue to invest in physical capital, as that is a key determining factor for workers' productivity. On that front, the investment intentions demonstrated in this report are encouraging.

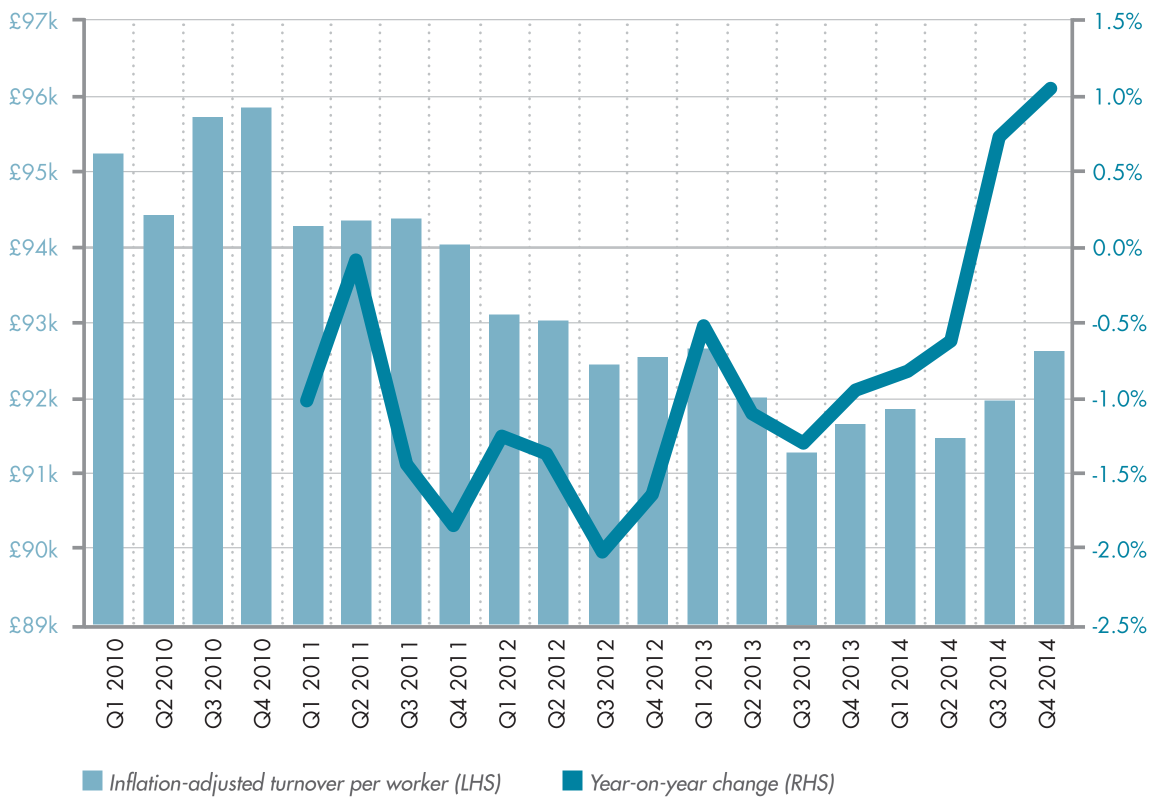


Figure 13: Small business productivity and year-on-year change (inflation adjusted turnover per employee)

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

Growth aspirations and challenges

62% of firms expect to grow in the next 12 months.

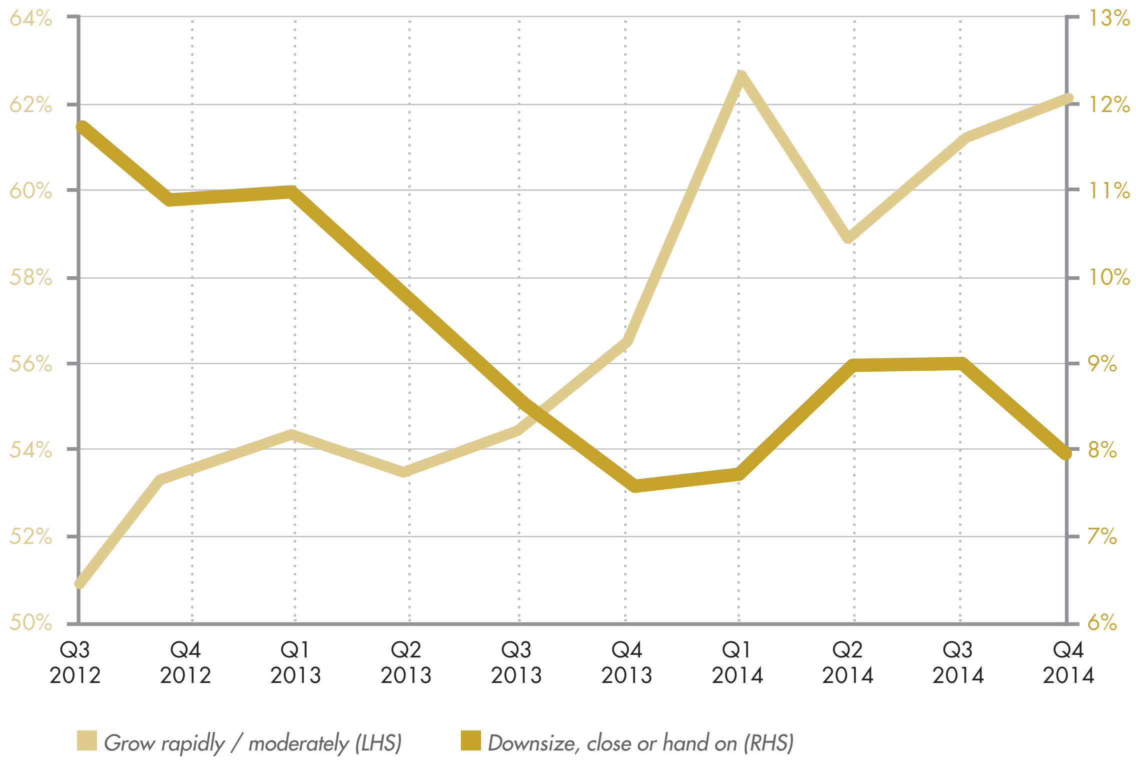
Aspirations remain strong despite short-term challenges

Although confidence as measured by the SBI has fallen this quarter, firms' aspirations have continued to improve. On the same period 12 months ago, the proportion of firms expecting to grow rapidly or moderately over the next year is up 5.3 percentage points to 62%. Meanwhile – and despite falling this quarter – the percentage expecting to downsize, close or hand on the business is slightly up on the year at 7.9%.

This suggests that although small businesses may feel more uncertain regarding the next three months, in part likely due to the forthcoming General Election, firms are more optimistic for 2015 as a whole. With these aspirations, small businesses are likely to be a key driving force behind continued economic recovery over the next year: the IMF expects UK GDP to rise by 2.7% in 2015, a slight slowdown from the previous year but remaining generally buoyant.

At a sector level, aspirations are highest in the computer services industries. Only 1% of firms in the sector expect to downsize or close their businesses, while 88% plan to expand – giving a net balance of +87%. Wholesale trade and financial services are close behind, on 66% and 63% respectively.

Figure 14: Growth aspirations for next 12 months



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

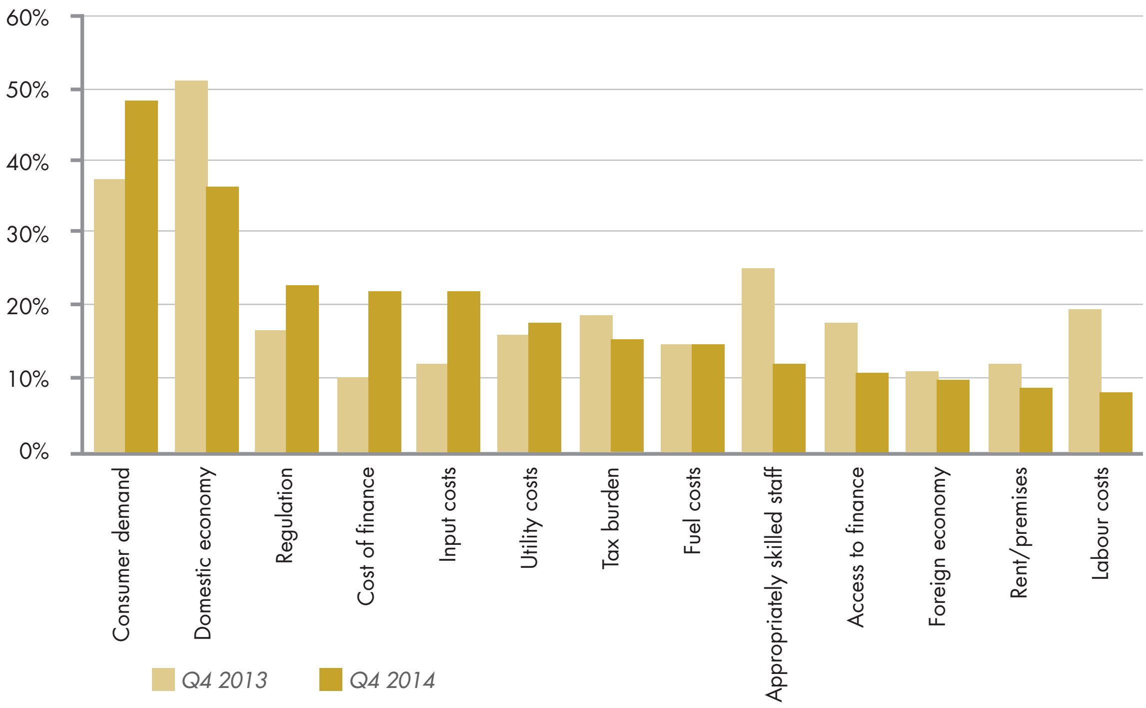
Regulation and cost of finance rising as barriers to growth

The proportion of small businesses concerned about the domestic economy has fallen slightly since a year ago in line with the economic recovery. However, concerns about consumer demand remain high, with 48% of small firms highlighting this as a risk, suggesting that some concerns over the business environment remain.

One area that has significantly risen as a concern for businesses is the cost of finance. This quarter, 22% of small businesses report this as a potential barrier to growth, up from 10% at the same point a year ago. As highlighted in the next section, this is one area where more attention might be needed to ensure small firms gain access to finance. Another area is regulation, which more businesses note this quarter as a bigger potential barrier to growth than before.

Two factors that have eased this quarter as a source of concern on achieving growth aspirations are labour costs and the availability of appropriately skilled staff, both of which are cited by fewer firms. As noted earlier in the report, wage growth still remains relatively weak, despite a tightening labour market. However, as unemployment falls further, skills shortages are likely to become more of a concern.

Figure15:
Possible barriers to achieving growth aspirations – multiple answers possible



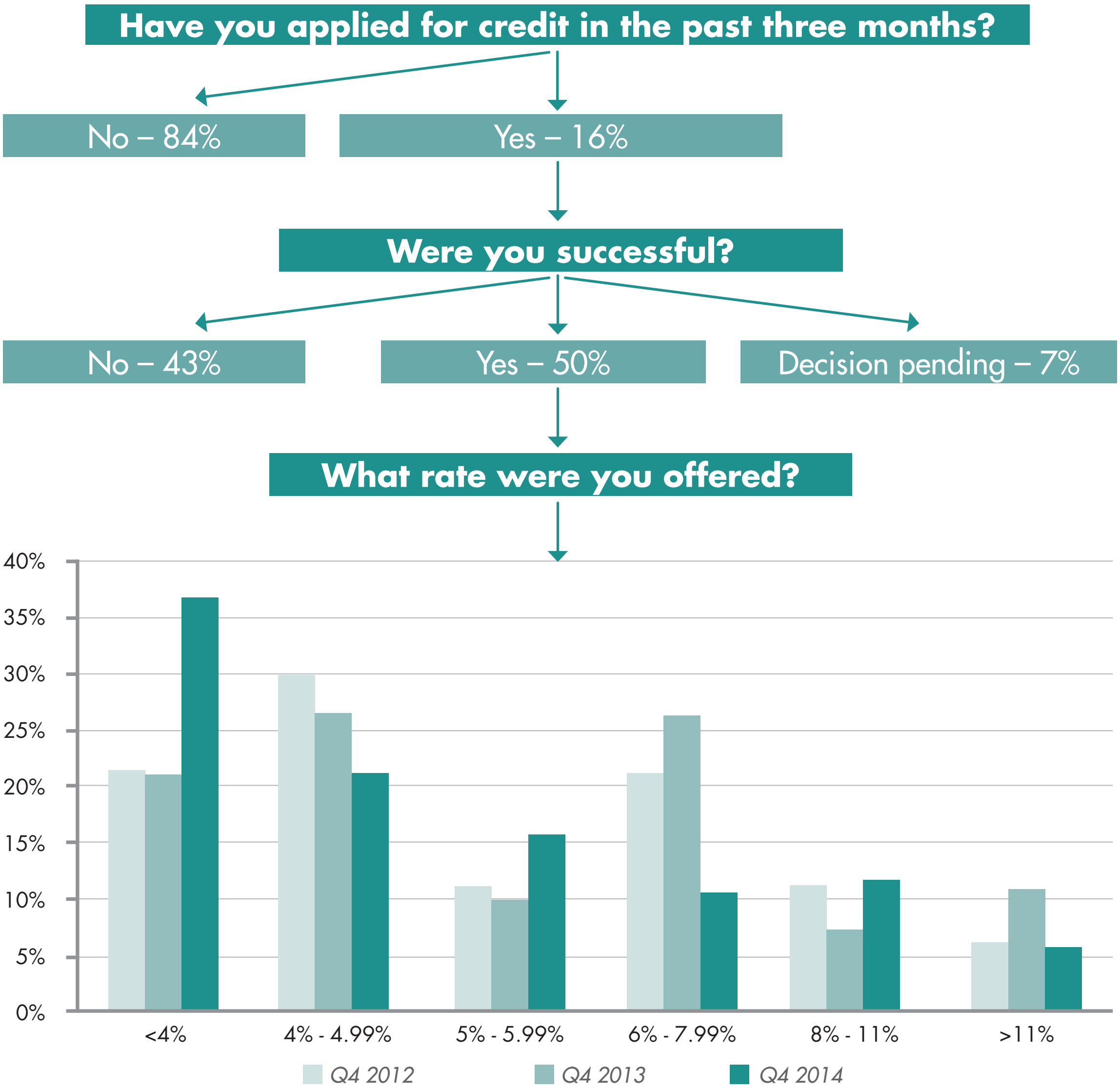
Source: FSB-Verve 'Voice of Small Business' Survey

Credit

The average interest rate offered to small businesses is 5.3%, up from 4.9% in Q3 2014.

Businesses demanding more credit, but only half are successful – unchanged from last quarter

Figure 16:
Credit applications and interest rates offered



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

The cost of credit rose this quarter, with an average interest rate offered to small businesses of 5.3%, up from 4.9% in Q3 2014. This coincides with the share of businesses reporting that finance is a greater source of business costs now than a year ago. Despite this latest movement, the broader picture regarding the cost of credit for small businesses is of an improvement over the past few years. In Q1 2012, the average rate offered on new credit to small businesses was higher at 6.8%, highlighting the general easing of credit conditions since the financial crisis.

Q4

Although more businesses have applied for credit this quarter than last, the percentage of firms being rejected has risen from 35% to 43%. This is because fewer firms are awaiting a decision. However, the share of successes remains unchanged at 50%. This suggests that credit conditions remain difficult for small businesses in the UK.

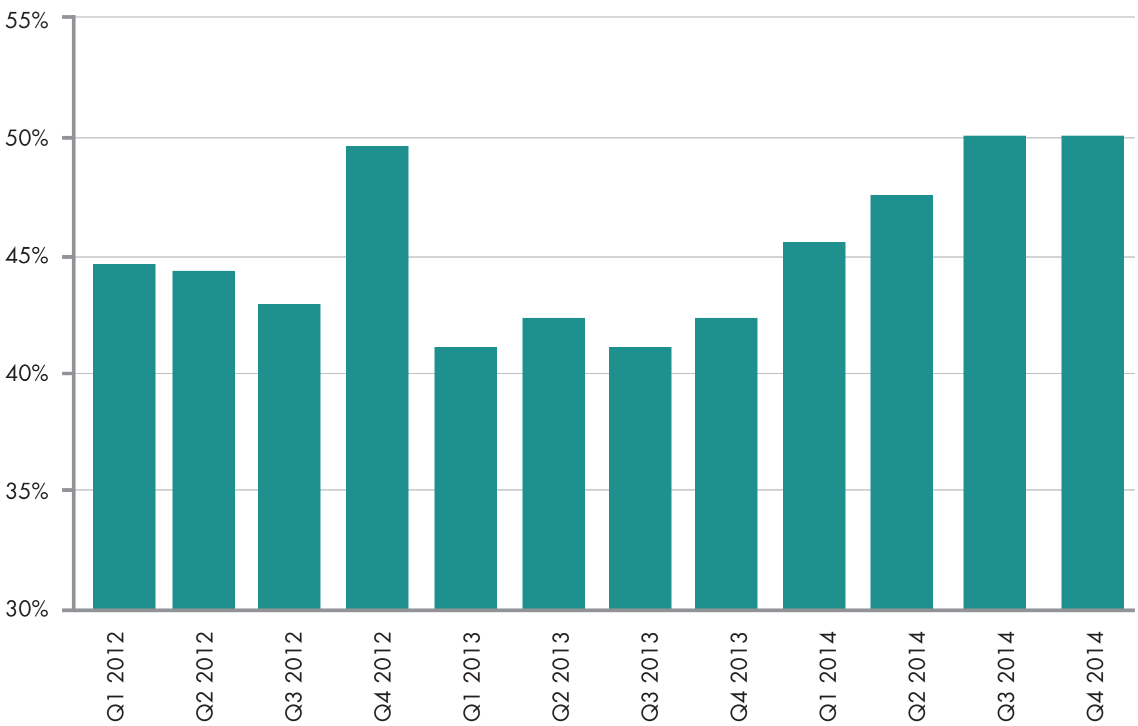


Figure 17: Proportion of small businesses successful in bank credit (e.g. loan or overdraft) applications in the past three months

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

Credit affordability and availability deteriorate compared to last quarter

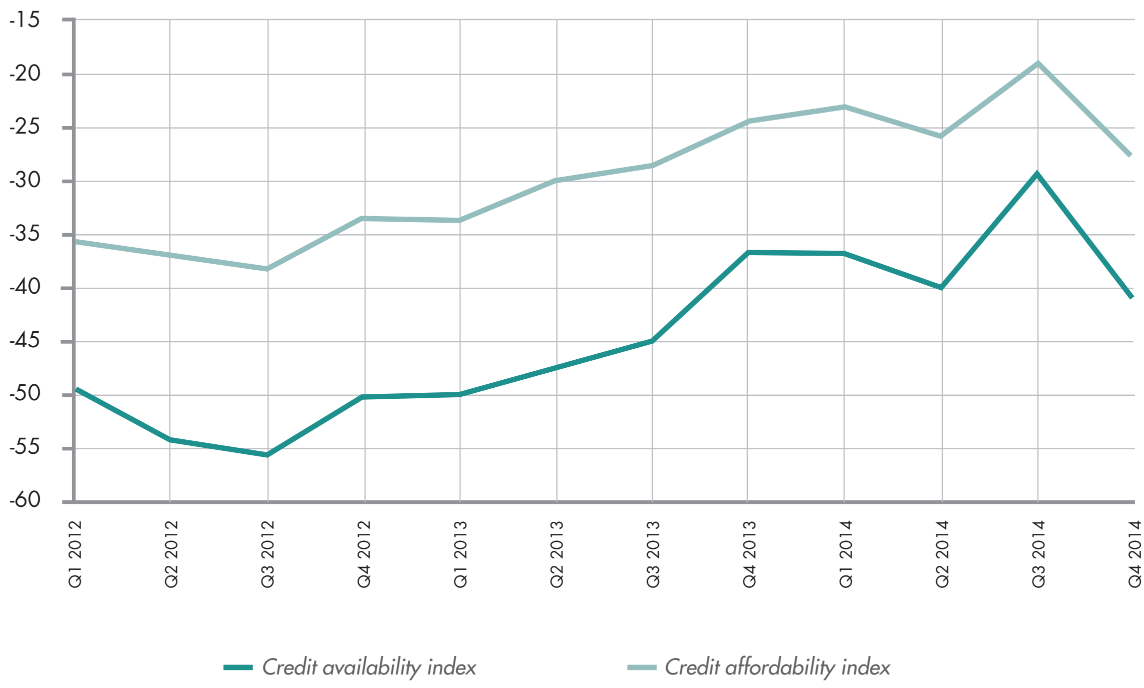
The credit affordability index has fallen on the quarter to -27.6, down from -24.3 last quarter and from -19 at the same point a year ago. This concurs with the observed rise in interest rates for small businesses compared to last quarter.

The availability index was also sharply down, at -40.7 compared to -29.2 last quarter, and even stands lower than its level a year ago. It was driven by a large increase in firms describing availability as "very poor": 34% of firms now describe it as such, while only 25% were of that view last quarter. This is in line with the increase in rejected credit applications reported in the section above.

Looking deeper into these headline results, it is micro sized firms and sole traders that find accessing credit both the most difficult and unaffordable. Just 11% of small businesses with zero employees (just the owner or partners) report that they find new credit affordable, compared to 44% of those with 51 or more staff. Similarly, just 5% of sole traders report that credit availability is good, compared to 25% of firms with over 50 staff.

The Funding for Lending Scheme, which incentivises banks to lend for real-economy purposes by subsidising credit, was tweaked at the start of 2014 to focus on small businesses. Despite this, this did not stop lending to small businesses from falling during all of 2013 and every period during 2014 so far. On the positive side, net lending figures have become progressively less negative for the past three quarters, and the Q3 2014 figures are now close to positive territory at -£0.1 billion, compared to a 2013 average of -£1 billion. Therefore there is a good chance the scheme is helping, and that small businesses would have worse access to credit if not for the scheme. In addition, as illustrated earlier in the report fewer small businesses are reporting that access to finance is a barrier to achieving growth aspirations – suggesting that firms may expect credit conditions to improve over the next twelve months.

Figure 18: Indices of credit affordability/ availability perceptions over time, a weighted net balance of those with negative responses subtracted from those with positive responses



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

Investment

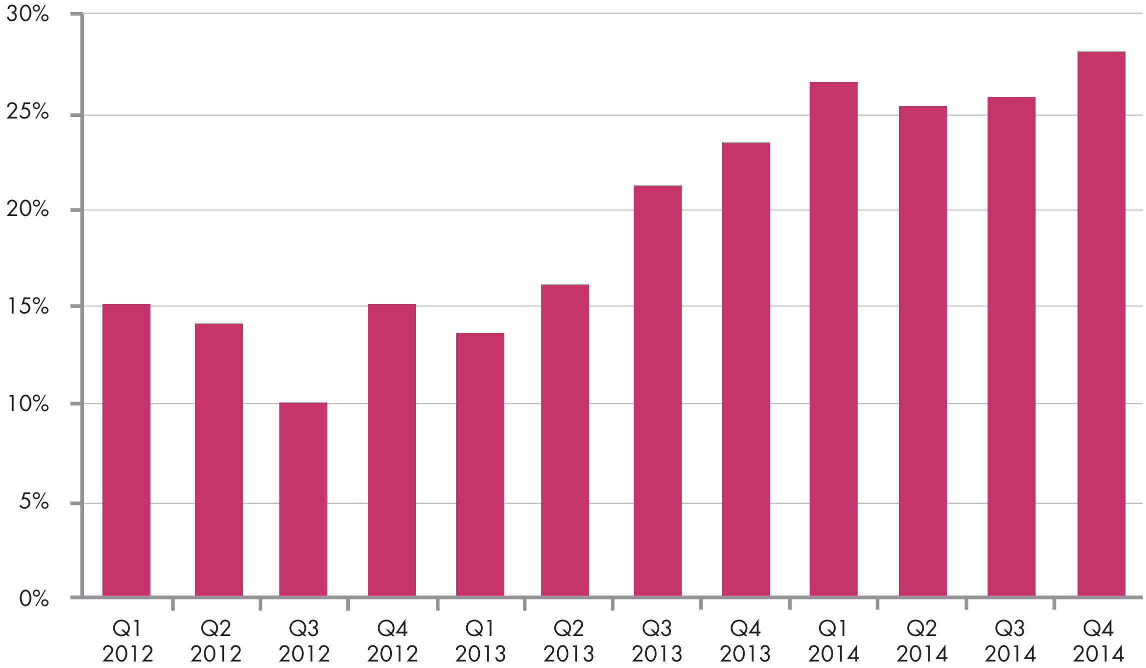
This quarter 25% of companies expect to increase investment.

Small businesses find greater appetite for investment

In Q4, small businesses reported higher investment intentions than they did last quarter, with the percentage balance of those intending to invest rising from 26% to 28.4%. This latest figure takes the share of small firms expecting capital spending growth to the highest since comparable data began in Q1 2012. This is encouraging news for the UK economy, as business investment helps to drive productivity increases, as workers require physical capital such as computers, machinery and other equipment to be productive. In turn, this would suggest the UK is likely to see more buoyant wage growth for small businesses over the next year, as companies can afford to pay workers more contingent on their increasing output. It also points to small firms being generally positive about business conditions in 12 months' time and beyond.

The results are set against business investment as a whole for the UK, which according to the latest GDP statistics fell during Q3 by 0.7% quarter on quarter. Small businesses, growing numbers of which are reporting increasing capital investment in Q3 and Q4, are therefore appear to be bucking the trend.

Figure 19: Net percentage balance in anticipated capital investment growth over next 12 months – share reporting increase less share reporting decrease



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

Method

This report is based on the November 2014 research survey of FSB members carried out by Verve. All panel members were invited to take part in an online survey. Reminders were sent to all non-respondents. 1,782 responses were received. The data is weighted by regional gross value added to match the profile of small businesses across the UK and this accounts for the slight variation in results from previous FSB 'Voice of Small Business' panel surveys. The survey was undertaken between 3rd and 14th November 2014.

The FSB is the UK's leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. The FSB in non-party political, and with around 200,000 members, it is also the largest organisation representing small businesses in the UK.

The data presented in this FSB report written by the CEBR in Q4 2014 is weighted differently to the FSB reports and therefore the results may differ slightly.

For more information please contact erin.flood@fsb.org.uk

Summary data table

	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014
Small Business Index	- 5.6	6.3	+15.9	+33.5	+21.6	+35.7	+39.7	+41	+17.6
Employment - previous three months	-1.5%	-4.2%	-1.4%	3.7%	1.0%	2.1%	+2.0%	+5%	+4.4%
Employment - coming three months	0.0%	0.8%	+4.8%	5.8%	3.1%	7.6%	+10.5%	+7%	+7.1%
Revenue - previous three months	-3.5%	-7.2%	-0.4%	12.8%	18.8%	13.1%	+18.1%	+20%	+22.0%
Revenue - coming three months	-3.4%	5.7%	11.3%	20.1%	16.2%	26.5%	+29.6%	+33%	+23.4%
Investment intentions – coming 12 months	15.1%	13.0%	15.8%	21.1%	23.2%	26.6%	+25.6%	+26%	28.4%
Credit availability – rated good or very good	8.0%	9.0%	9.7%	12.4%	12.7%	13.5%	12.5%	17%	13.3%
Credit availability – rated poor or very poor	68.2%	71.1%	67.5%	65.9%	58.3%	58.5%	60.9%	52%	61.7%
Credit affordability – rated good or very good	14.4%	13.8%	14.1%	19.0%	18.1%	19.2%	18.0%	22%	18.1%
Credit affordability – rated poor or very poor	58.5%	59.7%	54.8%	55.0%	50.7%	49.8%	51.1%	47%	54.4%

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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