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THE SME BAROMETER

QUARTERLY SMALL & MEDIUM SIZED BUSINESS INSIGHTS. SUMMER 23.

IN THE INFLATIONARY STORM...

A DETAILED LOOK AT 2023 CHALLENGES FOR UK SMEs

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FOREWORD

SMEs face long-term liquidity concerns as higher wage demands fuelled by spiralling inflationary costs take their toll as consumers and businesses struggle to outmanoeuvre the impact of the Bank of England's repeated interest rate hikes.

With interest rates rising again in August – for the 14th time in a row – industry groups have accused the Bank of suffocating growth as they try to 'manufacture' a recession in the fight to bring prices down.

The theory being that if it's more expensive to borrow money or carry a balance on a credit card, consumers will spend less. When spending declines, demand will fall and, eventually, so will the price of everyday goods. However, it also means that businesses borrow less, making them less likely to create jobs, and more likely to cut staff. The onus is on the Bank of England to choose its move carefully; the combination of higher borrowing costs, high inflation, and slower growth could easily tip the economy into a recession.

For the time being at least, it looks as though the Bank of England's tough financial medicine may just appear to be working. Both the Government and the Bank of England would have been breathing a sigh of relief after the Office for National Statistics reveals the rate of price growth had fallen to 7.9% in June (the lowest since March 2022), a fall of 0.8% from May's figure of 8.7%, and down from the peak of 11.1% recorded in October 2022 when the consumer price inflation (CPI) had stood at its highest annual inflation rate since 1981.

Easing in the annual inflation rates in June 2023 principally reflected price changes in transport costs where the reduction in motor fuels from 1.3% in May to 1.7% for June had a notable downward effect on food prices and was the first time that the rate had turned negative since August 2020.

Food and non-alcoholic beverage prices rose by 0.4% between May and June 2023, compared with a rise of 1.2% between the same two months a year ago. June 2023 recorded an annual rate of 17.4%, a drop of 1.8% compared to March 2023 when food inflationary prices had stood at their highest annual rate seen for over 45 years. While the easing of food prices has been welcomed by the restaurant and hotel sectors which recorded an annual inflation rate of 9.5% in June 2023, down from 10.3% in May, with accommodation services falling to 11.3% in June compared to 14.4% the month before as the holiday season kicks in, consumers have yet to feel the effect of the drop in food prices and the Government is urging supermarkets to pass on the savings to customers.

"As the headline figure was stagnant at 8.7% throughout both April and June, the modest decline to 7.9% in June may signal to investors that economic pressures are gradually easing," says Giles Coghlan, Chief Market Analyst, HYCM. "However, core inflation continues to be a thorn in the central bank's side at 6.9%, highlighting the risk that domestic inflationary pressures are here to stay for now."

Whilst the latest statistics from the Office of National Statistics fuels the narrative that we are through the worst, the Chancellor Jeremey Hunt is warning now is not the time to become complacent.

"Core inflation is only easing slightly, and the Bank of England will be concerned that inflation in the services sector proves persistent," says Kitty Ussher, Chief Economist, Institute of Directors (IOD). "With ONS data showing that inflation is lower than expected, the Bank of England will be hoping that this will cause business leaders and others to lower their expectations of future inflation, which could then become self-fulfilling."

"The August rate rise is a signal that the Bank of England's Monetary Policy Committee is moving towards a more dovish stance. Central banks are mostly in the same place as far as tightening monetary policy is concerned, reaching somewhere near the end of their upward trajectory on base rates. It's the timing of that change of mood that is occupying most minds," adds David Johnson, Founding Director, Halo Financial.

"The latest rise in interest rates is yet another blow to businesses, amidst the already challenging and delicate balancing act between managing inflation and signalling a recession. Stubbornly high inflation and only small increases in GDP data have highlighted the economic rollercoaster that lies ahead. SMEs must take this as a reminder to review their existing lending structures and ensure they are prepared for further challenges," says Douglas Grant, Group CEO, Manx Financial Group PLC.

"Many SMEs prepared for these hikes by listening to lenders and locking in their debt into fixed rate structures, but other businesses that were not as forward-thinking face damaging knock-on effects. According to our recent research, 40% of SMEs – compared to 27% last year – have had to stop or pause an area of their business due to a lack of external financing, whilst 15% of SMEs that needed external finance and/or capital reported that they were unable to access it. The unavailability of finance is exacting a toll on SMEs and the UK economy, impeding growth precisely when it is most needed. The magnitude of the hindered growth is substantial and calls for novel solutions to bridge this funding gap," continues Grant.

"Since the economic upheaval caused by the pandemic, we have been advocating for a government-backed loan scheme that provides targeted support for specific sectors, bringing together both traditional and alternative lenders to secure the future of SMEs. As the government looks for ways to curb the highest rates of inflation in decades, the significance of implementing a permanent scheme cannot be underestimated. It could be the crucial factor that determines the survival or failure of many companies and, consequently, the overall economy."

With insolvencies rising again, the Insolvency Service reports that the number of registered company insolvencies had risen by 27% in June 2023 to stand at 2,163 compared to 1,698 for the same month a year before.

source: https://www.gov.uk/government/statistics/monthly-insolvency-statistics-june-2023

This was higher than levels seen while the Government support measures were in place in response to the coronavirus (COVID-19) pandemic and also higher than pre-pandemic numbers indicating that the predictions reported in our Q4 2022 Barometer in December, when insolvency and business expert Nick Hood, Senior Advisor, Opus Business exclusively revealed that 30,000 SMEs were forecast to go bust in 2023 is on target.

"June's business failure numbers were a bleak reminder that despite all the optimism about the sharp drop in inflation, some parts of the business community are in big trouble. As every month goes by, the predictions of up to 30,000 company insolvencies in 2023 look more solid. Even if the anticipated peak level of interest rates has fallen back a little, SMEs are particularly vulnerable if they are already on a variable rate borrowing facility or if their fixed rate deal ends soon," says Hood.

In June 2023 there were 1,759 Creditors' Voluntary Liquidations (CVLs), 422 less than the previous month, but still 21% higher than in June 2022. "The monthly fall in corporate insolvencies is driven by a reduction in Creditors' Voluntary Liquidations, but numbers for this process are still higher than they were pre-pandemic as a sizeable number of directors are still choosing to close their businesses while the choice is still theirs to make," says Nicky Fisher, President of R3, the UK's insolvency and restructuring trade body.

"Despite the monthly fall in corporate insolvencies, levels are higher than they were this time last year – and well above what they were this time two, three and four years ago, as the hangover from the pandemic combines with a challenging trading climate caused by several economic issues."

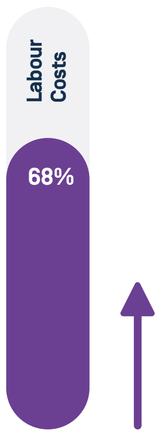
"Firms are trading in a time of cautious consumer spending and rising costs, which are hitting margins and profits hard. Directors expect costs and wages to rise further as the year goes on, and if these don't translate into more demands for goods and services, it could be the final blow for those businesses that are just managing to survive," continues Fisher.

"While firms' costs are now much higher than a year ago, the fall in the input rate will give some hope that consumer price inflation will soon start to ease. However, the drivers of price rises have shifted with labour costs are now the most significant factor. This may slow down the rate of CPI decline – due to the high number of job vacancies," says Alex Veitch, Director of Policy, British Chambers of Commerce.

"SMEs have struggled with the requests for wage increases and rising costs in recent months. The increase in energy costs has been an additional expense at a time when businesses really needed to keep costs as low as possible, while the demands from staff for salary and wage increases has meant several firms have had to choose between losing key staff to better paying jobs or taking another financial hit to retain them," says Fisher.

"Coping with soaring interest costs as well as ever higher wage demands from staff is a real challenge for businesses. Even more worrying for entrepreneurs are the predictions of a 10% plus fall in house prices, which will cut the security held by lenders as support for their facilities, potentially de-stabilising this key relationship. The remainder of this year and 2024 is going to be an unpleasantly bumpy ride," warns Hood.

According to the British Chambers of Commerce, 68% of firms are now citing labour costs as a key pressure in driving up inflation



Source: https://www.britishchambers.org.uk/news/2023/07/bcc-quarterly-economic-survey-signs-inflation-pressure-easing)

which is why the Government has been desperately trying to hold down wage rises despite strikes by public sector workers.

"The stubbornly high inflation and interest rates that the UK is experiencing are cause for concern. We've seen a member of Jeremy Hunt's economic advisory council call for the UK to be pushed into a recession in order to rebalance this issue, yet such blunt measures, if implemented, are aiming to tackle a deeply multi-layered and complex problem," says Matt Weston, Senior Managing Director, UK & Ireland, Robert Half. "While the current economic climate has been influenced by a myriad of unprecedented events over the last few years, the tight UK labour market, squeezed by chronic skill shortages, is substantially adding to inflationary pressures."

Robert Half's Job Confidence Index produced in partnership with the Centre for Economics and Business Research shows that almost two-thirds of workers (62%) feel confident about their job prospects for the next six months, and a further 45% say they felt confident about their future career prospects over the coming five years.

source: https://www.roberthalf.co.uk/jobs-confidence-index).

"The simple fact is

PEOPLE KNOW THEIR WORTH AND RECOGNISE THAT THEY CAN CALL THE SHOTS AT THE MOMENT

– and with the cost of living increasing, they want better pay or they'll happily move on which puts further pressure on businesses and the economy. A tight labour market plagued by widening skills shortages could fuel a deeper wage/price spiral, further worsening the economic outlook and fuelling the UK's inflationary woes."

With inflationary pressures continuing to impact on the financial strength of UK SMEs, 92% of firms say they worry about the future and their ability to pay bills on time. As staff demand higher wages to deal with the cost-of-living crisis, some firms are fearing that the added pressures on the payroll could cause the business to collapse. (source: PRISM research).

"We urge anyone who is worried about their business finances to seek advice as soon as possible," says Fisher. "It can be very hard to admit your firm is struggling – especially in the SME sector as lots of business owners are either founders or have inherited the business from family members – but doing so when the business's problems are at an early stage gives you more options, more time to take a decision and usually results in a better outcome than if you'd waited till the issue became more severe."

"Business owners remain worried about customer demand, rising costs and the state of the economy, while high interest rates may affect access to rescue funding and could deprive saveable firms of a lifeline. Unless the economic picture improves, it's likely more businesses will need an insolvency process to help resolve their financial issues," says Fisher.

Globally, inflation is slowing across the Western world. Australia is on the brink of ending interest rate hikes and achieving an economic first of beating inflation without a recession. In the US, the inflation rate is falling after the Federal Reserve raised its key federal funds rate ten times since March 2022 – something it hasn't done as aggressively since the 1980s – as it attempts to evoke a 'soft landing'. The Fed has however, "pencilled in a couple of more rate rises before the end of 2023, to really bring inflation back to the U.S. central bank's 2% goal," says Mary Daly, San Francisco Fed President.

source: https://www.reuters.com/markets/rates-bonds/feds-daly-two-more-rate-hikes-likely-needed-this-year-2023-07-10/).

Across Europe, the inflation rate continues to fall with the region recording an annual inflation of 5.5 % in June 2023, down from 6.1 % in May 2023. However, despite the fall in the core rate – which excludes volatile items such as food and energy – picked up to 5.5% and remains close to a recent peak of 5.7% supporting the view that European Central Bank policymakers are likely to continue raising rates in the upcoming months.

In the UK, City economists are urging the Bank of England to continue to raise interest rates whilst inflation continues to run significantly above target, noting that the UK will probably still have higher rates of inflation than elsewhere for a while yet, but at least it is now following the global trend.

source: https://www.cityam.com/bank-of-england-must-keep-raising-rates-to-finally-kill-off-inflation-city-experts-say/).

"The UK economy is weakening. The labour market is slowing down, and productivity is falling. Increasingly there is a realisation that the Bank of England is already overdoing it," warns Carsten Jung, Senior Economist, IPPR. "By raising interest rates to 5.25% in August, the Bank is tightening the screws too much and causing excessive harm for households and businesses."

"Instead of further rate rises, we need a more balanced approach to tackling inflation, using more government support," says Jung. "Countries like Spain have kept energy prices lower, temporarily limited rent increases and tackled excessively high profits through taxation. Their inflation rate has recently fallen back to target. The UK should take inspiration from their example."

Economists are still expecting interest rates to soften during the year, ending the year at 5%, and the Bank of England will need a careful balancing act to keep the economy from collapsing into the deep freeze and triggering a painful recession. "The MPC is sitting on the fence. Recent strength in wage growth has clearly got the Bank of England worried. But there's also a recognition that the past rate rises are starting to weigh on economic activity, which has led to a slight slowdown in rate rises," comments Nicholas Hyett, Investment Manager, Wealth Club.

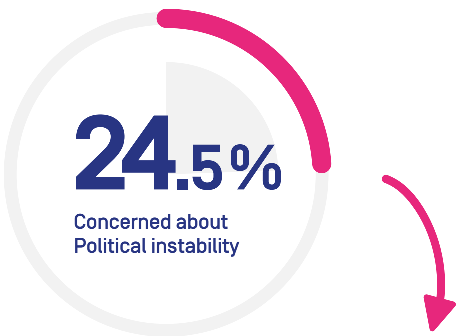
"The Bank of England has made it clear, if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required. This means the Bank is determined to keep its eyes on the monetary road regardless of the noises coming from the backseat."

Fiscal challenges now facing the SME sector have been likened to the environment of 'a recession like no other'. Backed up by independent research, and commentary from some of the leading industry experts, in our Q2 2023 Barometer we put 200 SMEs under the microscope as they battle across the choppy inflationary sea of fiscal instability.

BUSINESS CONFIDENCE REMAINS IN A STATE OF FLUX DESPITE SPRING BUDGET PROMISES

Business confidence amongst SMEs is still in a state of flux as inflationary woes, coupled with the tumultuous financial and political events at the back end of 2022, continues to erode business confidence with 75% of SMEs saying these factors have impacted on business performance, although less than a quarter of firms say they believe there has been no adverse impact.

Source: PRISM research



Despite this, 24.5% of firms say they are concerned about the political instability in the UK Government.

Source: [https://www.iod.com/news/uk-economy/iod-press-release-business-confidence-marching-upwards-but-policy-action-needed-to-really-shift-the-dial/].

Over half (51%) of IOD members report to be uneasy about the state of the economy, compared to 92% of SMEs surveyed by PRISM saying that concerns over what the current economic climate is likely to bring in 2023 is the top priority. Just under half (47%) of SMEs surveyed say they feel pessimistic when it comes to the growth of their businesses in 2023 citing lack of opportunities to develop overseas partnership and trade due to issues surrounding Brexit, with some saying that they could not envisage things improving in the next six years.

Source: PRISM research

According to the ONS, SMEs continue to report import and export problems with the biggest challenge revolving around changes in transportation costs cited by over half of businesses (55.9%), while additional paperwork burden was cited by 48%. Despite this, only 17.6% of firms reported disruption at UK borders with 4.9% of firms saying that changes to border restrictions at destination countries were proving challenging especially with the time taken for checks at borders causing further delays.

Source: [https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/bulletins/businessinsightsandimpactontheukeconomy/9march2023#exporting-and-importing].

The Prime Minister's newly announced trade deal with Northern Ireland/EU – the so called, Windsor Framework, appears at first read to be a win for the UK Government and for both the business community and people of Northern Ireland. "The European Union appears to have been more than reasonable in moving boundaries to facilitate this agreement," says Myton.

"There has been significant movement by the EU in areas of customs, VAT, product labelling, the movement of agri/food/plant products to Northern Ireland from Great Britain and the movement of parcels in all scenarios including B2B, B2C and C2C. The EU has agreed to cease legal action against the UK whilst the UK will in return drop the Northern Ireland Protocol Bill. Finally, a Stormont Break gives the Northern Ireland assembly a mechanism to stop the application of amendments to or the replacement of EU law as applied to Northern Ireland."

'GREEN LANE'

With the creation of a 'green lane' to allow goods such as food, seeds and parcels to move freely to Northern Ireland from Great Britain most without customs checks, the goal is to dramatically cut paperwork although companies will have to sign up for 'trusted trader' status to use the system, which the haulage industry fears still implies some bureaucracy as according to the Prime Minister, 5% of visual checks would remain.

The Chancellor's announcement of a freeze in fuel duty has been welcomed by both motorists and the logistics sector. "The 5ppl cut in fuel duty is to be retained for a further 12 months is very welcome news for logistics businesses, particularly SMEs – who make up 99% of the industry, and traditionally operate on low margins," says David Wells, Chief Executive, Logistics UK.

"Logistics is at the heart of every sector of the economy; this decision recognises the importance of managing logistics costs to avoid further inflationary pressures on business and consumers. This should help to ensure businesses have the funds to invest in productivity, growth and greener technologies, alongside the new policy for full capital expenditure announced as the successor to the super-deduction (providing it encourages the transition to a zero-carbon economy)."

"DECARBONISATION, BREXIT, NEW TECHNOLOGY AND OTHER DISRUPTIVE FORCES ARE DRIVING CHANGE IN THE WAY GOODS MOVE ACROSS BORDERS AND THROUGH THE SUPPLY CHAIN.

Logistics has never been more important to UK plc than it is now, and we are dismayed by the lack of support to help businesses with energy costs and our sector's transition to a low carbon economy, something which the government has urged industry to commit to. This is a missed opportunity," says Wells.

This was reiterated by Neil Campbell, Director and Senior Consultant at accounting and environmental specialists, Red River Management Ltd who identified "an enormous opportunity of embracing net zero to build business resilience, especially in supply chains, and to cut bills through targeted consumption initiatives and adopting carbon efficient solutions. Additionally, the UK is becoming more aware and concerned about climate change causing a shift in consumer preferences and an opportunity globally for forward-thinking organisations to build a robust business in tune with the public mood. Whilst SMEs faced a disappointing budget increase in corporation tax, there are still allowances for investment in green projects and significant local initiatives for funding solutions and grants within this sector."

Over the next 12 months, 38% of firms say they expect to stay the same size, whilst 16% say they expect to shrink, with a further 6% believing it will be necessary to sell or close their businesses.

Source: https://www.british-business-bank.co.uk/wp-content/uploads/2023/02/J0222_BBB_SMEFinanceSurveyReport_2022_V3.pdf

Despite this 52% of UK SMEs report to being optimistic about their business's chances of growth in 2023, with 50.5% of firms saying they are taking active measure to support staff with cost-of-living issues.

Source: PRISM research

Almost half of all firms surveyed (46%) say the UK does not have the right balance of SME growth support, and that the Government could do more to support the SME sector. Over 40% of firms say they are worrying about economic uncertainty, whilst 26.5% of firms say that worries about taxation issues, and access to finance and lending are proving particularly troubling.

"There is a lot that can and should be done by the Government and by other bodies to improve the funding landscape for small first firms, getting productive capital into businesses with enormous potential for growth," says Martin McTague, National Chair, Federation of Small Business.

"Government clearly recognises that its decision to cut tax relief for all SMEs in November undermines its ambition to make Britain the next Silicon Valley. The structure the Chancellor ran through sounds sensible and clear, with 40% of spend being a straightforward figure and goal for others to work to," says Mark Smith, Partner R&D Incentives and Grants, Ayming UK.

"However, it is a lot more targeted and therefore not as accessible. Spending 40% on R&D is very high, so only a very small portion of UK businesses will be eligible. The government estimates about 8,000 businesses could benefit, which is about 10% of current claimants. All other small businesses that don't meet the threshold will still see a cliff edge in funding, which will most certainly have an impact on the UK's innovation as a result."

"While its definition of 'research-intensive SMEs' is clear, we don't know which companies and what activity will be eligible. It would be great to see green innovation incorporated into this, and it was disappointing not to hear more mention of funding relating to R&D in environmental technologies," continues Smith. "To drive forward the sustainable transition, specific tax incentives must be considered around green R&D. This would provide a much-needed boost both to our innovation and net-zero objectives."

OVER HALF (54.5%) OF ALL SMEs SURVEYED SAY THEY BELIEVE THE UK CAN BECOME A LEADING SCALE UP ECONOMY.

However, 41% remain unconvinced of this despite the Chancellor announcing 12 new enterprise zones in the Spring Budget. "All eyes are now on which specific areas will become investment zones in the regions listed by the Chancellor. It will likely be an area in close proximity to a university, where the local government bodies believe that a high-tech "hub" could be developed – with particular focus on creative industries, green industries and advanced manufacturing," explains Toby Ryland, Corporate Tax Partner, HW Fisher.

> "The next step is for local councils to apply to become an investment zone. If successful, they would be allocated funding to attract businesses to the zone. This can be through incentives such as zero stamp duty land tax, reduced business rates, enhanced capital allowances and employer national insurance contributions relief. There will also be relaxations for planning applications, potential grants for R&D and similar support."

"These new investment zones – primarily in the Midlands, Yorkshire, Liverpool, Manchester and the Tees Valley – will create new employment opportunities but residents in these areas need to recognise that the process to become an investment zone takes time. It could take a while for the benefits to be felt by local communities, and for areas in the south west of England, they could be forgiven for feeling forgotten from the Chancellor's 'Budget for Growth,'" warns Ryland.

The announcement of funding for carbon capture, usage and storage (CCUS) and nuclear power plants – classifying nuclear as "environmentally sustainable" – saw the Chancellor confirming that the technology will have the same investment incentives as renewable energy. The launch of Great British Nuclear, a state-owned company to support new nuclear builds aims to provide 25% of the country's electricity by 2050, ensure energy security in the UK, help the Government's meet its net zero commitments, and create 50,000 jobs.

PUSHING FORWARD ON THE GREEN AGENDA, RESEARCH SHOWS THAT OVER 30% OF SMEs ARE KEEN TO INVEST IN RENEWABLE TECHNOLOGY COMPARED TO ONLY 10% LAST YEAR, WITH 19% SAYING THAT THEY ARE NOT YET READY TO GO 'GREEN'.

Source: PRISM research

SMEs STRUGGLE TO ACCESS FUNDING

The Government's scramble to secure an emergency deal to protect the tech and life sciences sectors in the UK from the collapse of Silicon Valley Bank (SVB) saw that even fintech and challenger banks weren't immune to liquidity problems.

As the biggest bank collapse since 2008, President Biden, Prime Minister Rishi Sunak, and financial regulators around the world rushed to announce that the banking system remains stable despite the SVBs collapse spooking investors, whilst European banks share prices plummeted, and US banking giants saw their share prices crash as volatile financial markets panicked.

JOE BIDEN'S WORDS OF REASSURANCE DID LITTLE TO CALM MARKETS AS WORRIES RACED AROUND THAT OTHER SMALLER US BANKS COULD BECOME THE LATEST DOMINOS TO FALL.

"His admission that fresh regulations may be needed to stop further failures exposes weaknesses in the current system and now lawmakers will be asked to toughen the rules. So, even though the collapse has centred on a small tech-focused corner of the financial system, the fall-out risks spreading," says Susannah Streeter, Head of Money and Markets, Hargreaves Lansdown. "The era of cheap money has hurtled to an end and investors are waking up to some dramatic highly unintended consequences"

As liquidity and insolvency expert, Nick Hood, Senior Advisor, Opus Business Advisory Group explains, "Fintech and challenger banks are now lending more to SMEs than traditional high street banks, which presents business owners with a whole new set of challenges. Research by the British Business Bank showed that...

...the new breed of lenders provided £35.5 billion to small and medium businesses in 2022, compared to £29.9 billion from traditional sources."

"SME's need to ask a whole set of questions before taking the plunge with a new-style lender: about the cost, the flexibility, the range of services available, whether personal guarantees will be required, the capacity to support growth with further funding and how much support might be available if the business runs into difficulties. Having an experienced finance broker on their side in such uncharted waters will help steer them on the right course to a safe new funding harbour."

"What the SVB collapse has shown is that it is not just borrowers who need to know more their bank, but also those with cash to deposit," says Hood. "Significant numbers of the UK's brightest and best small and growing tech companies came within an hour of being locked out of their accounts and unable to use their own money to pay their staff and their bills, with going into insolvency the only way out."

Despite HSBC buying SVB's European arm in the UK, SVB's collapse in the US caught Signature Bank in the crossfire, and it also fell. Both banks were overly exposed to assets whose values came under pressure from rising interest rates. But with almost a quarter of its deposits coming from the cryptocurrency sector many in the financial sector are saying that the fall of Signature Bank highlights the vulnerability of crypto banking.

In the wake of collapses, banking shares around the world are under pressure and the reluctance of banks to lend could increase. The escalating crisis at Credit Suisse – with its largest shareholder refusing to inject more cash into the bank – triggered panic in the markets forcing the Bank to seek a $54 billion lifeline from the Swiss National Bank, before being bought by its rival UBS for $3 billion.

$54 BILLION

LIFELINE FROM THE SWISS NATIONAL BANK

The deal backed by Swiss authorities is designed to calm market jitters, but with the collapse of three banks, and the scramble to rescue others, traders continue to worry about the risks to the global banking system. Christine Lagarde, President of the European Central Bank is keen to stress that the "European banking market is reliant", while the Chancellor Jeremy Hunt and the Bank of England have said that the UK banking system is "well capitalised and funded and remains safe and sound".

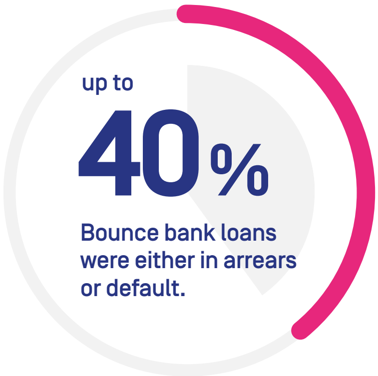
"The lightning speed of the global fall-out of Silicon Valley Bank's collapse has shaken the banking sector, and prompted investors spotting weaknesses in other institutions, to race for the exit. The speed at which Credit Suisse with its 167-year-old history deteriorated, when it was previously deemed too big to fail, has rocked the banking sector. As the shockwaves continue to ripple central banks have taken rear guard action to reduce the risks of contagion," says Streeter.

"It is not yet known exactly where more pain will emerge in the banking sector, but investors fear the problems are not yet over, amidst a greater worry that banks will become more cautious in their lending, and its impact on the global economy."

Access to funding is key for business growth and stable banking is vital and we could see the fallout from SVB resulting in tighter lending standards for all banks which will have a direct impact on SMEs. "We know we have a tough year ahead. With costs piling up on their doorsteps and so much uncertainty on Government policies, there is currently little incentive for firms to risk either their dwindling cash reserves or fresh loans on new projects," says Shevaun Haviland, Director General, British Chambers of Commerce.

"Firms know that the UK's finances are tight, but the Chancellor needs to show more faith in the ability and talent of our businesses. If they can see the Government is prepared to back them, by acting on childcare, energy costs, green funding and investment, then the future could soon look a lot rosier and greener."

"As a country, we cannot afford to have a repeat of the post-credit crunch scenario, where the dreams of thousands of entrepreneurs and business owners were crushed by a withdrawal of finance options, leaving them unable to continue, and deepening the UK's economic woes," explains Martin McTague, National Chair, Federation of Small Business. "Many small firms now are in a highly precarious position, carrying debts from the pandemic, with the Bank of England raising the base rate, and with funding options getting scarcer and costlier."



Repaying of Coronavirus loans along with the need to service other debt is proving a huge drain on financial resources for companies, with reports that in some sectors up to 40% of bounce bank loans were either in arrears or default in October 2022.

"Putting that into context in terms of insolvency it means that

MORE THAN 600,000 COMPANIES MAY BE UNABLE TO PAY THEIR BILLS

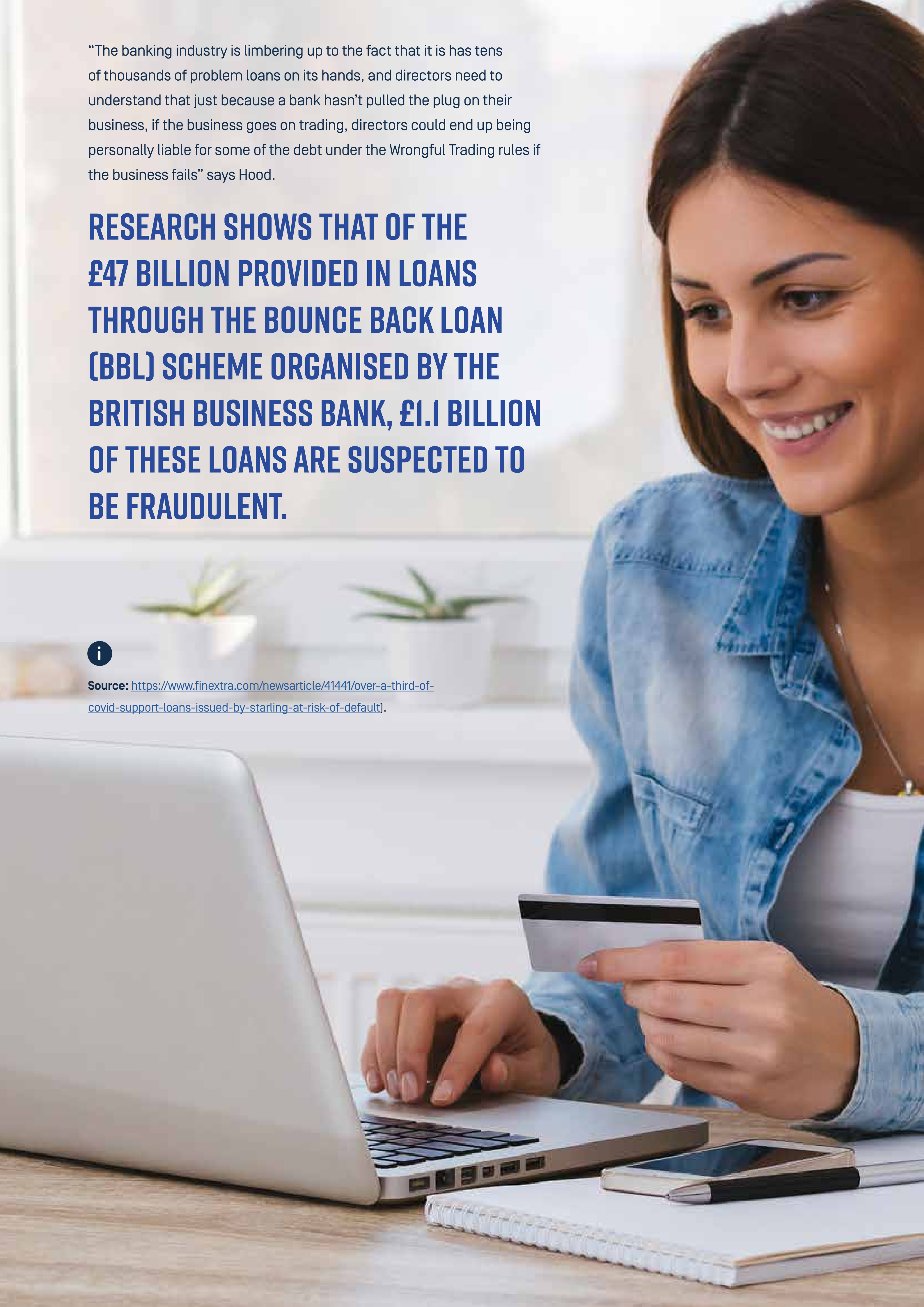
as they fall due and could therefore be technically insolvent," says Hood.

So why aren't the insolvency numbers higher? "As one American real estate business rescue man once said, 'the pig isn't all the way through the snake yet' – which explains the situation well," says Hood. "But the first straws are in the wind. Litigation funding specialists, Manolete Partners have teamed up with Barclays Bank to run a pilot scheme for recovering a representative sample of 100 defaulting bounce back loans. More enforcement action and lots of it will surely follow."

"" THIS YEAR WE COULD SEE UNIMAGINABLE NUMBERS OF BUSINESSES GO BUST

"Right now, the problem is crystalising and even if the default rate is 15% of all covid loans, that means this year we could see unimaginable numbers of businesses go bust, more by a factor of several than anything seen before in the UK. Some directors have their heads stuck in the sand when it comes to repaying bounce back loans," continues Hood. "Just because the government said that it would guarantee the loan, directors seem to lack incentive to pay, despite their primary responsibility to repay as the borrower. Some seem to expect the government to step in and pick up the bill. But unless the bank has shown that it has made all reasonable efforts first to recover the money from the borrower, the government will not reimburse the bank."

As they were unable to take security for bounce back loans, banks rank as an ordinary unsecured creditor, and therefore do not have the right to appoint an administrator without going through a complex and expensive court process. To overcome the problem, banks are considering issuing Winding-Up Petitions and forcing companies into Compulsory Liquidation through the Official Receiver.



"The banking industry is limbering up to the fact that it is has tens of thousands of problem loans on its hands, and directors need to understand that just because a bank hasn't pulled the plug on their business, if the business goes on trading, directors could end up being personally liable for some of the debt under the Wrongful Trading rules if the business fails" says Hood.

RESEARCH SHOWS THAT OF THE £47 BILLION PROVIDED IN LOANS THROUGH THE BOUNCE BACK LOAN (BBL) SCHEME ORGANISED BY THE BRITISH BUSINESS BANK, £1.1 BILLION OF THESE LOANS ARE SUSPECTED TO BE FRAUDULENT.

Source: https://www.finextra.com/newsarticle/41441/over-a-third-of-covid-support-loans-issued-by-starling-at-risk-of-default).

According to the British Business Bank's Small Business Finance Markets 2022/23 report, challenger and fintech banks now have a 55% share of the banking market, lending over £35.5 billion.

Source: https://www.british-business-bank.co.uk/wp-content/uploads/2023/02/J0222_BBB_SMEFinanceSurveyReport_2022_V3.pdf]

Over 60% of firms with turnover between £50,000 and £250,000 sought finance to help with working capital, while 48% of firms sought funding for help with purchasing fixed assets. For those struggling to get the amount applied for, 15% applied to more than one lender to make up the difference, 28% cancelled their plans, while 20% put their plans on hold.

60% OF FIRMS — SOUGHT FINANCIAL HELP

48% OF FIRMS — SOUGHT FUNDING FOR HELP WITH PURCHASING FIXED ASSETS

Source: https://www.british-business-bank.co.uk/wp-content/uploads/2023/02/J0222_BBB_SMEFinanceSurveyReport_2022_V3.pdf]

Across the UK, there was a substantial variation in knowing where to obtain information. Over 72% of firms in the East Midlands, 67% in North East, and 67% in Northern Ireland all say they felt the most confident in knowing where to obtain information about external finance. This compares sharply to firms in Wales where only 28% said they were confident, and only 24% in the North West.

Source: https://www.british-business-bank.co.uk/wp-content/uploads/2023/02/J0222_BBB_SMEFinanceSurveyReport_2022_V3.pdf]

OFFSHORE ATTRACTS SMEs

The ability to save costs, and access to cheaper labour and lower office rents means that Offshoring can be a very attractive proposition for SMEs and were elements cited by 10% of survey respondents as the main factors in moving their business or part of it offshore.

Source: PRISM research

Offshore companies can often provide SMEs with access to better infrastructure and legal frameworks. Regulations in different parts of the world could prove to be restrictive for businesses by preventing foreign entities from launching factories, buying property, or investing in local companies. In this instance, setting up an offshore company can help in completing transactions and provide you with the ability to hold any local assets necessary.

With the lowest corporate tax rate in Europe at 4% and R&D tax credits of 45%

Source: https://canaryislandshub.com/fiscal-incentives/]

Source: https://canaryislandshub.com/ict/],

the Canary Islands is providing a popular destination for digital businesses. But it is not just new companies who are finding the Islands attractive, existing companies looking to establish an online business will only need to install one of its headquarters in the archipelago to take advantage of other tax incentives through the Canary Islands Economic and Tax Scheme.

The tax incentives and a better work/life balance in areas such as Canary Islands for instance, needs to be balanced not only with access to highly skilled talent, but also with the right compliance and regulatory controls. For startups wanting to tap into the Canarian ecosystem of universities, research centres, and tech-clusters there is waiting a young tech-savvy population all eager for collaboration.

STARTUPS NEED TO COMMIT TO GENERATING FIVE JOBS IN THE ISLANDS DURING THE FIRST SIX MONTHS FOLLOWING ITS REGISTRATION AND MAY NOT REDUCE ITS WORKFORCE FOR FIVE YEARS.

Source: https://canariaszec.com/].

In addition to looking for startups which provide digital services, the area is also looking to attract film, television, and music production companies, as well as businesses involved in scientific, biotechnological, renewable energies, and maritime and aerospace industries.

Under the umbrella of the 'Connecting Europe' (https://wayback.archive-it.org/12090/20221222151902/https://ec.europa.eu/inea/en/connecting-europe-facility), The European Commission announced this year it will invest EUR 38 million to improve connectivity and digital infrastructure in the Canary Islands. Additionally, the Canary Islands Land of Digital Entrepreneurs initiative is designed to position the islands in an international context offering three key characteristics: connectivity, competitiveness, and training

Source: https://www.gobiernodecanarias.org/conocimiento/CanariasTerritorioDE/index.html),

and is helping to grow innovation in the area. According to Eurostat, the Canary Islands ranks eighth in terms of high-tech job creation in any European region.

The Canary Islands are a natural oasis to tackle environmental challenges, and sustainability is at the heart of its strategy for tourism and socioeconomic development. It has already adopted a more sustainable model of tourism, and with tightening environmental standards across the region, it hopes to attract higher-spending tourists who have greater interests than just swimming and sunbathing to spend their money more widely in the islands thereby helping to create a fairer and more equitable economy. For example, visitors to the islands will be given the option of offsetting the emissions from their carbon footprint of flying by contributing to green projects in the archipelago, such as reforestation and renewable energy plants.

However, despite all the advantages, there is a downside. The Paradise Papers, published in 2017, when an estimated 13.4 million leaked documents exposed insider details of many individuals and offshore companies – including high-profile names – who were using tax havens illegally to avoid corporation tax. Nearly six years later, and news outlets continue to reveal the names of those who played the system today, resulting in a hefty penalty for those individuals.

"Whatever the tax advantages for businesses in moving their domicile to an offshore jurisdiction, the owners of these businesses need to be aware of the downside risk of ending up on the wrong side of the growing public debate about entities which don't appear to pay their fair share of UK tax and which hide their ownership and some of their business dealings behind the opaque corporate curtains of a sun-drenched island," says Hood.

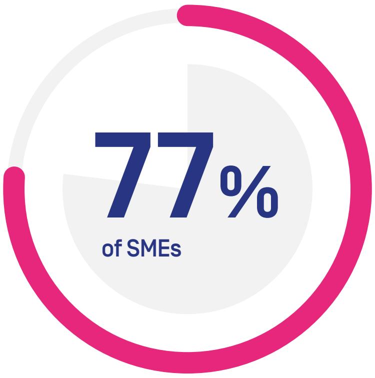
One of the fundamental reasons for setting up an offshore company is often privacy. Moving assets or setting up a business is often done in a country that offers more tightly protected data security, has a robust legal framework and a network of service providers that streamline the setting up process.

ANOTHER REASON SMEs SHOULD CONSIDER SETTING UP AN OFFSHORE COMPANY IS TAX EFFICIENCY.

Tax advantages are offered by different jurisdictions. For example, Singapore has one of the lowest corporate tax rates, while the Cayman Islands might be more ideal for freelancers who are looking to minimise the effective tax rate on their businesses. Offshore companies provide SMEs with the ability to mitigate risks that arise from political instability or currency volatility. Whatever the reason, spreading operations across jurisdictions may be the best long-term business strategy SMEs can adopt to secure future growth.

When taking an SME offshore it is important to get the right professional advice. In research, 77% of SMEs say they feel unsure about moving their business operations offshore due to lack of knowledge of the processes involved, although many believed that the advantages would outweigh the challenges. When setting up a business, the where is often as important as the how, and knowing what to expect in terms of company formation regulations and requirements is key. For SMEs offshoring, the entrepreneurial journey needs to start off on the right foot.

UNSURE ABOUT MOVING THEIR BUSINESS OPERATIONS OFFSHORE



Source: PRISM research

PLANNING EXIT FOR BUSINESS GROWTH

Due to ongoing fiscal and political instability, over of a quarter of SMEs say they are now planning exit strategies for their businesses, with just 24% saying they are looking to be acquired as part of someone else's Mergers and Acquisitions (M&A) strategy.

Source: PRISM research

This is particularly true for UK startups who in the absence of funding, navigating a potential M&A becomes their only alternative, particularly for those businesses with a high cash burn. As Business advisor, Claire Trachet, CEO & Founder of Trachet explains, "It usually takes at least 3-6 months to execute an M&A, from devising a step-by-step plan, identifying the right companies, and closing the deal. When there's a forecasted cash flow issue this is the window for startups to develop the best possible terms for an exit strategy."

As the well of easy and cheap money dries up, both late and early-stage startups are becoming compromised. Considering what's happening in the capital markets one course of action may be for those businesses to consider an exit, or conversely there may be another company worth acquiring to fortify and expand existing operations.

"The point is to keep moving forward," says Trachet. "That means being diligent with the business's cash management and optimising cash flow, keeping company culture alive amidst layoffs and reviewing the contracts you have with your clients. Applying this mentality to the whole of the organisation is going to be key in 2023, whether you're entering a fundraising round or considering an exit – ideally startups should be doing both."

IN FOR THE LONG HAUL

Source: PRISM research

Research shows that over 70% of SMEs do not have a planned exit strategy indicating that they are planning to be in for the long haul – despite the uncertainty of firm survival – with 53% saying that the recent political and economic events are having no effect on their decision to adopt an exit plan.

TIGHT LABOUR MARKET AND WIDENING SKILLS SHORTAGES FUELLING INFLATION

Low unemployment rates and high vacancy levels mean the labour market is currently tight and has been cited by the Bank of England's Monetary Policy Commission (MPC) as a contributory factor putting upward pressure on inflation.

Source: https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2023/june-2023).

Unemployment in the UK stands at an historic low of 4%. In the last quarter, the number of vacancies fell, and over the year, to 1.03 million in April to June 2023, but remain 233,000 above pre-pandemic levels. Employment levels have increased and now stand 68,000 above pre-pandemic levels.

source: https://commonslibrary.parliament.uk/research-briefings/cbp-9366/).

In March to May 2023, the number of full-time employees was 815,000 above pre-pandemic levels, compared to the number of part-time employees of 154,000 below its pre-pandemic level. There has, however, been a fall in the number of full-time employees, and an increase in the number of part-time employees, over the last year, but the Office of National Statistics is attributing this to people describing themselves as employees rather than self-employed after the furlough scheme was created.

High inflation since 2021 has meant despite growth in nominal wages, real wages have been falling. "While above-inflation pay rises aren't sustainable for many firms, another talent exodus could soon be on the cards if retention plans are not implemented," warns Matt Weston, Senior Managing Director UK & Ireland, Robert Half.

"The high jobs confidence we're seeing in the employment market at a time when the economy is sluggish is understandably putting pressure on corporate budgets as higher salaries are increasingly sought. The challenge for employers will be finding the right balance of financial and non-financial incentives to ensure unrealistic pay rises don't have a detrimental impact on the bottom line. However, leaders need to be mindful of the fact that, while they can appease staff and new recruits with modest pay rises, with skills in short supply, competitors could easily poach their most valuable resource."

Wage rises is piling yet more pressure on businesses at a time when interest rates are rising. According to latest data from the ONS, more than one in six (17%) trading businesses reporting they expect staffing costs to increase over the next three months, with SMEs in the accommodation and food service activities industry expecting the largest rise.

source: [https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/bulletins/businessinsightsandimpactontheukeconomy/13july2023).](https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/bulletins/businessinsightsandimpactontheukeconomy/13july2023)

Big firms are no longer aggressively recruiting, instead we are seeing a rebalancing towards SME businesses who traditionally have struggled to win talent. SMEs need to strike the right balance between offering competitive remuneration, progression plans and providing other benefits such as learning and development opportunities if a sustainable talent attraction solution is to be developed.

“This year’s Spring Statement was billed as the ‘Back to Work’ budget. To remove barriers to work, the Chancellor wants to provide targeted support to those over 50, to those inactive due to sickness or disability, and to help with childcare costs for those on Universal Credit. All of these including the Chancellor’s announcement of a boost for childcare is great news for employers trying to deal with the skills shortage,” says Weston. “We see this having very positive effects in recruitment as more potential candidates, who today feel excluded from participating fully in the labour market come forward to plug the skills shortage gap.”

One of the Chancellor's biggest changes announced was support for childcare to help parents return to the workplace extending the 30 hours a week of free childcare to all youngsters from nine months old until they start school. Set to kick in by September 2025 – the move is designed to encourage 60,000 parents into employment and make a dent in the country's record vacancies.

According to recent data from business finance leader, Sonovate,

78%

OF SMEs IN LONDON HAVE INCREASED THEIR RELIANCE ON CONTRACT OR FREELANCE WORKERS

while 56% report an increase in permanent staff requesting a move to temp or contract positions. "As the battle for top talent continues to ramp up and with more staff actively seeking contract and temporary positions, businesses are going to continue to face challenges in their recruitment," comments Weston.

Across the UK job confidence has grown. The June 2023 Robert Half Jobs Confidence Index (JCI) (**source:** https://www.roberthalf.co.uk/jobs-confidence-index) created in association with the Centre for Economics and Business Research (Cebr) reveals that 62% feel confident about their job prospects for the next six months, with a further 45% saying they feel confident or very confident about their future career prospects over the coming five years.

"Compared to our previous JCI, the 62% represents a quarterly uptick on the 53% of the workforce saying they are confident about their job security. This is largely influenced by improvements in macroeconomic confidence, which rose 23.1 points quarter-on-quarter at the beginning of 2023, though it remains in negative territory," explains Weston.

With the JCI predicting that the economy will grow by around 0.2% year-on-year in 2023 at a time when skills shortages remain prevalent, jobs confidence is expected to continue an upward trajectory, despite the Index showing a significant contraction in real employee earnings weighing on the pay confidence indicator of the report. While average total pay was up by 5.8% annually in nominal terms, it was down by 3.0% after adjusting for inflation in Q1 2023.

"Our June 2023 Jobs Confidence Index reveals a complex labour market – one where dissatisfaction with real earnings is leading employees to feel increasingly confident in the value they bring against a skill shortage backdrop, all the midst of a cost-of-living crisis," says Weston. "With wage rises on the scale that some are demanding potentially unrealistic for a number of firms, the concern is that another en masse talent exodus is on the horizon."

Despite genuine concerns around the cost-of-living crisis and the sharpest downturn in real wages since Q1 2009, Robert Half warns that businesses face an uphill battle for talent – and those that cut back on staff now will struggle to replace them when needed.

It is a sentiment shared by PRISM research which shows that nearly 60% of SMEs are reluctant to recruit additional team members in the coming year citing budgetary constraints, although 41% say they will take on staff to deal with individual projects suggesting that contractor workers are a more attractive opportunity to swell the workforce.

NEARLY 80% (78.5%) OF SMES NOW SEE REMOTE AND HYBRID WORKING AS A POSITIVE FOR THEIR BUSINESSES

"There's no shying away from the fact that the UK economy is facing challenges ahead. With the complex macroeconomic environment impacting business confidence in recent months, we have already begun to see changes to talent strategies that we predict will continue. Employers have had to be more innovative than ever before when planning and managing human capital, and we expect companies to lean on more agile flexible staffing models, as well as developing permanent employees through upskilling and reskilling programmes," says Weston.

Technology will be vital in the workplace of the future, but many businesses are in danger of forgetting the lessons learnt during the pandemic – that staff can be trusted working remotely. Nearly 80% (78.5%) of SMEs now see remote and hybrid working as a positive for their businesses, with many seeing staff deliver a much higher level of productivity.

Source: PRISM research

Flexible working arrangements, progression opportunities, and access to training are in the top five most valued perks after salary according to Robert Half's Job Confidence Index, with 35% of those surveyed saying they were willing to take a pay cut in exchange for remote or flexible working arrangements – offering cost saving potential for SMEs, despite the push to get people back into offices.

INFLATIONARY SOUTH CONES HOISTED – COULD BE TROUBLE AHEAD!

There's a storm brewing in the choppy inflationary sea of fiscal instability facing SMEs. After a swift beginning to the recovery from the sharp falls in economic activity seen earlier in the Covid Pandemic, the UK economy has stagnated.

ACCORDING TO ANDREW BAILEY, GOVERNOR OF THE BANK OF ENGLAND IN HIS REPORT TO THE HM TREASURY, FOUR CLEAR SUPPLY SHOCKS ARE TO BLAME FOR RISING INFLATION:

1

An unexpected persistent shift in demand from services to goods, saw a sharp rise in the prices of globally traded goods adding 2 percentage points to the level of inflation in the UK consumer price index (CPI) over the past year.

2

Russia's invasion of Ukraine and the ongoing conflict continues to drive up wholesale gas prices in European markets. Although energy prices make up less than one twentieth of the CPI basket in the UK, this has been the largest single contributor to CPI directly adding 3.5 percentage points to overall UK inflation.

3

Disruptions to Ukraine's supply of agricultural products to the global markets due to the war, continues to drive up food prices. Annual CPI inflation for food and non-alcoholic beverages in the UK has risen from 5.9% in March 2022 to 19.1% in March 2023. With this giving a 12% weighting to UK's CPI food prices alone, this is contributing more than 2 percentage points to inflation.

4

In stark contrast to the steadily growing workforce (representing ¾% per year) during the preceding decades, between December 2019 and July 2022, the number of people not taking part in the labour market rose by more than 800,000. A further drop of 130,000 people from October 2022 to January 2023 and the continued shrinkage in the workforce of ½% is giving rise to further challenges for SMEs trying to retain and recruit staff in a tightening labour market.

These four factors are creating a 'perfect storm' of macro-economic events. The government remains committed to ensure that inflation returns to the 2% target sustainably. "These big external shocks continue to account for a large part of the inflation overshoot above target," says Bailey. "In turn, by worsening the terms on which we trade with the outside world, and the rise in external prices has reduced our real national income."

"There's still concern that companies will continue to be under pressure to pass on wages hikes through to higher prices, especially with consumer spending proving so far to be more resilient than forecast," says Susannah Streeter, Head of Money and Markets, Hargreaves Lansdown. "With interest rates rising yet again in August and inflation shocking in its stubbornness, the Bank of England opting for a super-size interest rate rise, and more hikes expected, investors are increasingly concerned about the knock-on effect on the wider UK economy."

"For businesses the pain is far from over, and many bosses are trapped between soaring input costs, workers' demands for pay rises and shrinking margins. We can expect to see redundancies rise still further as companies are forced to live within their means, and growth will remain sluggish for the short to medium term," says Dr. Ventsislav Ivanov, Economics Expert, Oxford Business College. "With signs that inflation is becoming embedded, it's becoming increasingly clear that politicians trying to resurrect the economy have no miracle cure."

With interest rate cuts not expected until Q2 2024, the Bank of England is being urged to balance interest rates carefully and without any overtly aggressive moves if we are to see inflation decline in a steady fashion and the economy moving in a more favourable direction.

Economists warn that if the Bank of England fails to appreciate that the UK could turn out to be the exception to the rule of fast-falling inflation across advanced economies, then even the protection of healthy household and corporate balance sheets will not stop the economy from free-falling into recession.

"Monetary policy setters, especially in the UK, have a highly difficult conundrum to solve – defeat inflation with the blunt weapon that are interest rates without breaking the economy and consumer," comments Charles White Thomson, CEO, Saxo UK. "The risk for further policy failure is real and the stakes are getting increasingly high."

The recent announcement that the distinguished and former Chair of the Federal Reserve, Dr. Ben Bernanke, has agreed to lead a review into the Bank of England's forecasting and related processes supported by the Bank's Independent Evaluation Office shows just how crucial it is for the Bank to continuously learn and adapt as an organisation. "Forecasts are an important tool for central banks to assess the economic outlook. But it is right to review the design and use of forecasts and their role in policymaking, in light of major economic shocks," says Dr. Bernanke as he undertakes an independent and objective look at the processes which underpin the MPC's policy decisions.

"The UK economy has faced a series of unprecedented and unpredictable shocks. The review will allow us to take a step back and reflect on where our processes need to adapt to a world in which we increasingly face significant uncertainty," comments Bailey.

In the rocky fiscal landscape that lays ahead, SMEs will need to rely on partners who can support their growth. This includes having access to the right financial services provider. According to payments provider Neo, the fallout of the collapse of Silicon Valley Bank (SVB) in March led to 75% of SMEs needing to spread their deposits amongst several banks just to maintain their own financial stability.

Fintech has proven itself to be reliable at providing SMEs with funding and continues to disrupt the traditional banking scene. In our Q3 2023 Barometer we will be taking a deeper look into the fiscal landscape and discuss how fintech are working to support SMEs.

LOOK OUT FOR THE NEXT EDITION OF THE SME BAROMETER

THE SME BAROMETER

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