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THE SME BAROMETER

QUARTERLY SMALL & MEDIUM SIZED BUSINESS INSIGHTS.

THE CHILL OF RECESSION THREATENS TO BITE

A DETAILED LOOK AT THE CHANGING PRIORITIES FACING SMEs IN 2024

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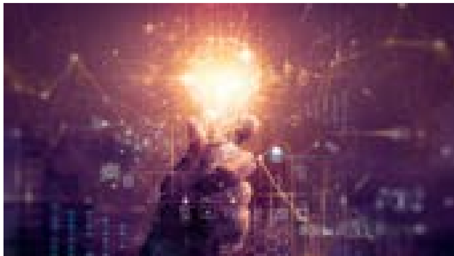

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FOREWORD

SMEs face a tough year ahead as wages continue to outpace inflation and the impact of 14 consecutive interest rate rises bite

Despite the Chancellor's rose-tinted 'Going for Growth' Autumn statement, and the King's speech cited by business groups as a missed opportunity to help business transform and grow in challenging times, a cut in the interest rate ahead of Christmas could have provided some relief for firms already hit by the twin shock of an inflation crisis and increased borrowing costs. But if the markets were hoping that Bank Governor Andrew Bailey would put a festive twist on his "sexy turtle" nickname for Christmas, they were to be disappointed.

"The decision to hold rates flat in December was accompanied by a dovish set of Monetary Policy Committee's minutes revealing that there was to be no "sexy turtle dove" in the pear tree at Christmas," comments Nicholas Hyett, Investment Manager, Wealth Club. "Whilst there's logic to holding rates steady now – central banks have a history of folding under the economic pressure and declaring victory on inflation too early. But as we have seen before, leave rate cuts too long and there's a risk the interest rate cure becomes worse than the inflationary disease."

Understandably, the Bank of England (BOE) is unwilling to loosen its grip on inflation by dropping rates any time soon. At its December meeting, the Monetary Policy Committee (MPC) voted by a majority of six to three to maintain the base rate at 5.25% – holding the interest rate steady for the third time in a row.

Uncertainty continues to overshadow the UK economy, leaving the MPC with very little room to manoeuvre. Hiking rates too aggressively could trigger a recession, while cutting too early could re-stoke the inflationary fire that the Bank of England has been dousing for many months.

"With 5.25% base rate remaining steady, recent UK data would suggest the Bank of England must be getting near to the point where they start hinting at interest rate cuts," says David Johnson, Founding Director, Halo Financial. "The markets appear to be factoring in a 25-basis point interest rate cut as soon as May. But if the BOE alludes to a softening of its stance, sterling is likely to weaken across the board as it has done ahead of the MPC's December meeting."

According to the British Chambers of Commerce (BCC) Insight Unit, 46% of firms report a direct negative impact from the current interest rate, with the biggest negative impact being felt by 61% of firms in the business-to-consumer sector (such as retail and hospitality). Nearly half of all firms say that the cost of borrowing is negatively impacting on their business, with just under 10% of firms say that the current interest rate was having a positive impact on their businesses particularly when it came to higher returns on cash reserves.

Source:
https://www.britishchambers.org.uk/news/2023/09/fresh-insight-into-interest-rate-pain-for-business/)

Monetary Policy Report projections for November forecasts the bank rate remaining around 5.25% until Q3 2024 before gradually declining to 4.25% by Q4 2026. "The Bank of England is walking a tightrope and needs to be careful not to inflict excessive damage on the UK's contracting economy," warns Jatin Ondhia, CEO, Shojin. "It's an unenvious task, but we should welcome the fact that for now the base rate is likely to hold at 5.25% in the short-to-medium-term."

Since the MPC's previous meeting, advanced-economy government bond yields have fallen, and whilst Global GDP growth has been a little stronger than projected in its November Report, UK GDP fell by 0.3% in October and is predicted to be broadly flat for the first half of 2024. The fiscal measures announced in the Autumn Statement are provisionally estimated to increase the level of GDP by around 0.25% over the coming years.

The International Monetary Fund's (IMF) forecasts that the prospects for the UK economy are being weighed down by the need to keep interest rates high to control inflation, making it the slowest growing developed country in 2024. According to the IMF, the UK faces five more years of high interest rates.

> **THE UK ECONOMY HAS ACCELERATED MORE SHARPLY INTO REVERSE, AS THE PAIN OF INTEREST RATES TAKES AN EVEN BIGGER TOLL ON COMPANIES AND CONSUMERS,**

says Susannah Streeter, Head of Money and Markets, Hargreaves Lansdown. "An Autumn of adversity has emerged and there is little prospect of a fast turnaround. Output shrank in every sector in October, particularly manufacturing where it fell by 1.1%. Although the mighty Services sector was expected to stay on more of an even keel, it also shrank by 0.2% and construction too suffered a 0.5% contraction. Across the three months, output was flat, with the contraction cancelling out the better-than-expected performance in September. The UK is still mired deep in stagnation territory and a fast rebound looks unlikely."

But with the Consumer Price Index (CPI) falling to 3.9% in the year to November 2023, down from 4.6% in October, SMEs are looking for clues as to when interest rates will start to fall. "Inflation has been a hard nut to crack. It's been fuelled by the pent-up frenzy for goods and services after the pandemic, squeezed supply chains, and the shock of the Ukraine war," adds Streeter. "The Bank of England's tools for cutting down rampant inflation are blunt, so the financial pain has been unevenly inflicted."

In our Q4 2022 SME Barometer, Nick Hood, Senior Advisor, Opus Business Advisory Group warned 30,000 SMEs were forecast to go bust during 2023. "A year on, the greatest fear factor for SME's right now is the interest rate situation. Despite the rate hold, the Bank of England is signalling that rates will not be coming down any time soon, with some hints that rates may even have to rise further in 2024," warns Hood.

"Many smaller businesses took on more debt during the pandemic and for those with variable rate loans, the extra burden of servicing these borrowings will be the last straw. Too many have only survived this long because interest rates were ultra-low for a decade or more. Sadly, a final reckoning beckons for them in 2024."

SMEs have been battling economic issues for three and a half years now, and corporate insolvency numbers are rising as directors run out of options. "Businesses are being battered from all sides," comments Nicky Fisher, President of R3, the UK's insolvency and restructuring trade body. "Costs have increased, demands for wages are incoming and people are spending less as they look to save ahead of the winter and to make sure they have enough left to cover the basics. If the Christmas trading period doesn't bring a wave of new income, insolvencies will continue to rise in the new year."

In October 2023, the number of registered corporate insolvencies (also known as 'company insolvencies') stood at 2,315, representing a 17.6% rise from the month before when the number of corporate insolvencies recorded was 1,969. During October 2023 there were 256 compulsory liquidations, 1,889 creditors' voluntary liquidations (CVLs), 146 administrations, and 23 company voluntary arrangements (CVAs). Compared to a year ago when October 2022 recorded 1,954 corporate insolvencies, figures for October 2023 show a 18.5% rise.

Since October 2021 when the figure stood at 1,410 the number of corporate insolvencies has soared by 64.2%.

This is higher than levels seen while the Government support measures were in place in response to the corona virus (COVID-19) pandemic and **56.7% higher than pre-pandemic** numbers of 1,477 recorded for October 2019.

Businesses undergoing a Creditors' Voluntary Arrangements (CVAs) – a voluntary mechanism for business rescue that must be supervised by licensed insolvency practitioners – were four times higher than those recorded for October 2022.

Source: https://www.gov.uk/government/statistics/monthly-insolvency-statistics-october-2023)

"The figures show that CVLs and Administrations are at the highest levels we've seen in October in more than four years, and this reflects the tough trading climate and the level of director fatigue among the business community in England and Wales," says Fisher. "In these kinds of circumstances, it's critical that directors are alert to the signs of financial distress, and act if any of them present themselves. Cash flow problems, stock piling up and issues paying rent, taxes or suppliers are all signs that a business is distressed and need to be acted upon before they get any worse whilst the business still has a range of potential solutions open to it as possible."

THE LATEST INSOLVENCY STATISTICS FOR NOVEMBER TAKE 2023'S CORPORATE INSOLVENCY FIGURES TO THE HIGHEST ANNUAL TOTAL SINCE 2009. NOVEMBER 2023 RECORDED 2,466 CORPORATE INSOLVENCIES, A RISE OF 6.4% ON THE OCTOBER FIGURE, AND A 21.4% INCREASE COMPARED TO A YEAR AGO WHEN THE FIGURE STOOD AT 2,032 IN NOVEMBER 2022.

Of the 2,466 registered corporate insolvencies in November 2023, CVLs grew by 23% to stand at 1,962 compared to November 2022, whilst compulsory liquidations rose by 22% to 359, and CVAs grew by 22% to stand at 12, compared to the

same month a year before. The only fall was seen in administrations which fell by 1% to stand at 133 compared to the figure recorded for November 2022. Since November 2021 when the figure stood at 1,676 there has been a 47.1% increase, and a 63.9% rise compared to the pre-pandemic level of 1,505 recorded for November 2019.

Source:
https://www.gov.uk/government/statistics/monthly-insolvency-statistics-november-2023)

IT LOOKS LIKELY THAT THE UK COULD ACHIEVE AN UNWANTED RECORD AFTER THE SURGE IN NOVEMBER'S CORPORATE INSOLVENCY NUMBERS AND BUST THE RECORD FOR THE MOST BUSINESS FAILURES IN A YEAR,

eclipsing the previous high of 26,556 in the midst of the global financial crisis in 2009. Tragically, SME's will have borne the brunt of this financial pain," says Hood.

"The big problem in 2023 has been the rapid rise in CVLs, as SMEs recognised that their businesses have no future even with a rescue plan or a restructuring, preferring instead to call a halt while they're still in control. CVLs are a whopping 86% higher than before the pandemic and now represent 80% of all insolvencies, compared to only 67% in 2019. The present failure crisis is not about aggressive creditor enforcement, it's about SME owners calling it a day."

"People may try to blame the rise in corporate insolvencies on the aftermath of the pandemic, but the reality is what SME owners and managers are dealing with are more recent issues. They're grappling with negative financial impacts all over their business models, whether it's lower consumer spending, lower margins from input cost inflation, higher staff costs, the tight labour market restricting their workforce or sharply higher interest costs," explains Hood.

According to industry commentators 38% of all unsuccessful startups failed due to running out of cash or not being able to raise capital. (source: CBS Insights). A record number of series B+ startups (businesses in their second round of funding) are shutting down and preparing for an exit. "With so few Mergers & Acquisitions (M&As) on the table, founders are proactively preparing for an exit before their business hits the red zone, in order to have the best chance of a positive outcome in the current climate," says Claire Trachet, M&A expert and CEO, Trachet. "As startups attempt to navigate a turbulent market of continued interest rate rises and several other macroeconomic challenges exits become a more attractive proposition, yet founders often find it difficult to relinquish control or fully let go of their business. This means them missing out on their opportunity to cash in on a deal."

This correlates with a recent PRISM research survey that found 72% of all SMEs have no planned exit strategy. Additionally, only 24% have considered such a plan, but have yet to follow it through.

72% PLANNED EXIT STRATEGY

24% CONSIDERED SUCH A PLAN

Source: PRISM research

Staffing continues to challenge SMEs. The ongoing skills shortage is creating a bullish employment market as employers of all sizes battle to retain and attract talent amidst the labour market's inability to match jobs with skilled workers.

AS WE CONTINUE TO PUT 200 SMES UNDER THE MICROSCOPE, BUSINESSES ARE BATTLING THROUGH A TOXIC MIX OF RAMPANT INFLATION, SOURING INTEREST RATES AND BROKEN SUPPLY CHAINS. NOW WITH FALLING GDP RE-IGNITING RECESSIONARY FEARS SMES ARE GOING TO NEED A STEADY HAND ON THE TILLER – AHEAD, THERE'S A STORM BREWING!

BUSINESS CONFIDENCE GROWS AS AUTUMN STATEMENT GIVES HOPE TO BUSINESS

The Chancellor's Autumn Statement was an attempt to boost the UK economy and restore the government's financial reputation in the aftermath of the short-lived Truss era, and while it seemed some-what 'rose-tinted' in general industry bodies have welcomed the Statement.

Warnings that the UK economy is heading in the wrong direction were gathering after the Office of National Statistics (ONS) announced the gross domestic product (GDP) fell by 0.3% in October 2023, following a growth of 0.2% in September 2023 fuelling speculation that the economy is heading for recession.

"This was the backdrop facing the Chancellor of the Exchequer Jeremy Hunt as he commenced the delivery of his Autumn Statement to the House of Commons at 12.30pm on Tuesday 22nd November 2023. By the time he had finished, he had the melancholic look of a man who had hoped to drink from the cup of life but instead found a dead worm at the bottom," comments Paul Rowland, Senior Partner, Invictus Risk Solutions LLP.

"With the Autumn Statement likely to be the current government's last ahead of a general election planned for October 2024, the Chancellor has grasped the thorny rose by accepting the responsibility needed to make a host of difficult decisions that will in time cut inflation by 50% and drive positivity back into the heart of the UK economy."

The ONS reports widespread declines in manufacturing with production output falling by 0.8% in October 2023 after showing no growth in September 2023. The construction sector – looking as though it was on its way up – fell back in October by 0.5% after growing 0.4% in September.

Source:
https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/october2023)

THERE IS VERY LITTLE COMFORT IN THE LATEST GDP FIGURES. THE EMERGING PICTURE IS ONE OF A SINKING ECONOMY. THE POSSIBILITY THAT WE WILL MOVE INTO RECESSION NEXT YEAR HAS INCREASED,

warns Dr Roger Barker, Director of Policy, Institute of Directors (IoD). "October was an exceptionally wet and windy month, so, declining output in sectors like construction, retail and hospitality was not entirely unexpected. However, declines in service sectors such as computer programming, consultancy and the media may be suggestive of more persistent economic weakness."

The main driver to the fall in the services output arises from information and communication and its subsections: computer programming, consultancy and related activities such as motion picture, video and TV production – which collectively witnessed a fall of 1.7% in October 2023, following growth of 0.4% in September 2023. Consumer-facing services remains 7.3% below pre-pandemic levels with legal activities being the largest contributing industry falling by 2.8% in October, although businesses in the wholesale, retail trade, and vehicle repair sectors grew by 2.2%.

Despite all the negativity around the fall in GDP for October, research by Lloyds Banking Group reveals a 42% rise in business confidence in November 2023 – the highest level recorded since February 2022. Regionally, the North West was up 20 points (54%) and is now in second place behind London in terms of the level of confidence. Business confidence in the North East and East of England stood at 48% and 46% respectively, with Scotland recording a 15 points rise (41%) meaning it is almost on a par with the UK average. However, business confidence in Yorkshire & the Humber remains below the national average standing at 50% (down by two points).

Source:
https://www.lloydsbankinggroup.com/media/press-releases/2023/lloyds-bank-2023/november-2023-business-barometer.html)

Many SMEs report a rise in trading prospects and anticipate stronger activity in 2024. "We have seen a real turnaround in sentiment for manufacturers, with business confidence now at a five-month high, reflecting the expectation among many firms that interest rates have now peaked and may begin to fall next year," comments Paul Gordon, Managing Director for Relationship Management, Lloyds Bank Business & Commercial Banking.

"However, recent increases in energy costs and rising oil prices will undoubtedly have an impact on consumers and businesses alike. If businesses can look to their future financial stability now and ensure cash flow remains a priority, that should put them in good stead for the months ahead."

The widespread decline in confidence within the manufacturing sector previously reported by the IoD could now see an up-kick with many manufacturers highlighting that new product launches, technological advancements, and reshoring prospects might bolster their output according to the Accenture/S&P Global UK index.

Source:
https://newsroom.accenture.co.uk/english-uk/news/2023/uk-business-confidence-falls-to-its-lowest-in-2023

"Our research shows that UK business respondents are more optimistic than firms in Europe and around the world. However, it's no surprise that corporate confidence has wavered in the face of ongoing change, with wider economic challenges impacting interest rates and high prices putting a dent in consumer spending," says Ewan Mackay, Strategy and Consulting Lead, Accenture.

"While projections for the next 12 months remain positive, it's important that businesses act now to turn expectations into reality even if the economic picture remains uncertain. Now is the time to stay the course with strategic investments where possible, hiring the best skills and embedding the right technologies throughout the core of their business to position them for future growth."

Although retail confidence is continuing to climb with shop price annual inflation remaining at 4.3% in December, the British Retail Consortium believes that retailers have been sold out by the Chancellor's statement. "The Autumn Statement does not do enough to support shops, shoppers, and an industry that employs over three million people, and many more across its supply chains. The Chancellor has poured fuel on the fire spreading across our high streets with a tax hike on shops and other businesses," says Helen Dickinson, Chief Executive, British Retail Consortium.

"His decision to increase the business rates standard multiplier will cost retailers hundreds of millions every year. This tax hike comes at a time when retail sales volumes have hit their lowest level in two years. Yet business rates must be paid in full before a business sells a single product or service. This flawed tax continues to wreak havoc on our town and city centres, closing shops and costing jobs, and with the Chancellor introducing the largest increase to National Living Wage on record, retailers are under ever increasing cost pressures, even as the Government withdraws its support," continues Dickinson.

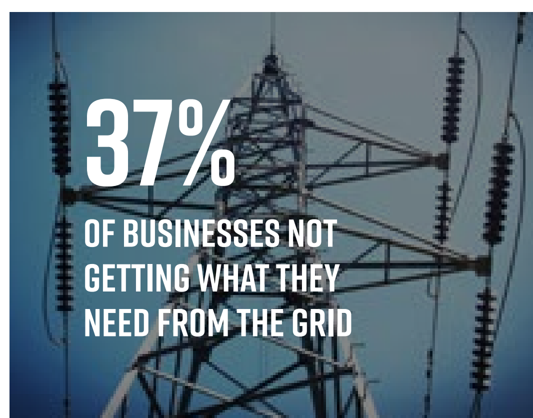
"The Chancellor has done little to prevent the decline of our town and city centres and his decision will see thousands of stores pushed into the red, jeopardising their commercial viability. This will lead to inevitable consequences for shops and jobs on high streets, right across the country."

"Predictably, the thorny subject of business rates reform remains lost deep in the government's long grass, with the threat of yet another £400 million being added to retailers' costs in April 2024. But without any action to level the playing field between bricks and mortar retailers and online players or correct the tax's other shortcomings, significant parts of the retail industry will face almost insurmountable challenges in what is bound to be a difficult 2024." adds Nick Hood, Senior Advisor, Opus Business Advisory Group. "The UK's retail sector has always presented a mixed picture, with winners and losers at both sub-sector and individual business levels. The recent collapse of the Wilko chain has highlighted that failure is possible even in the most apparently advantaged part of the market."

"As the era of cheap money has hurtled to an end, retailers relying on cheap financing are likely to face a precarious 2024, if they need to roll over loans. Many stores in town and city centres could be faced with a triple whammy of the cost-of-living crisis, hybrid working limiting footfall and higher borrowing costs," adds Susannah Streeter, Head of Money and Markets, Hargreaves Lansdown. "It's not a surprise that there are predictions of another wave of shop closures across the UK. The Local Data Company, that crunches the numbers on retail outlets, is forecasting that there will be between 8,000 and 15,000 fewer stores by the start of 2025."

For other markets, the Chancellor's Autumn Statement looks more pleasing. "We are glad the Chancellor has listened to our calls to help businesses deal with the current economic challenges and welcome the decision to make 'full expensing' permanent will be a boost to companies wanting to invest. Our research shows that 34% of businesses have already benefited from the policy, rising to 47% for manufacturers," says Shevaun Haviland, Director General, British Chambers of Commerce (BCC).

"We have long called for the electricity grid to be upgraded to help companies transition to net-zero. In our recent net-zero survey, more than a third (37%) of businesses told us they were not getting what they needed from the grid, in terms of energy supply and connectivity.



If we can we reduce grid connection times it will make a big difference. Likewise, the planning reforms and investment announced by the Chancellor will tackle this huge infrastructure problem and help businesses trying to invest in a low carbon future at a speedier path to grid connection."

Overall, there were several very impactful and positive changes announced in the Autumn Statement to reflect the UK Government's confidence and desire to drive the UK economy ever forwards and upwards. "The Chancellor has chosen to take a sharp blade to the National Insurance to reform and simplify the programme of taxes by lessening the burden paid by the self-employed," says Rowland. "Of great relief to the community high street shops and pubs is the act of freezing business rates for small businesses. A tax relief has been introduced vis-à-vis a full expensing for business investments, while the continuation of the alcohol duty freeze will help enormously the ailing hospitality and pub sector."

But late payment issues continue to worry SMEs and impact on business confidence. "Late payments, especially by large businesses delaying settlements to smaller ones, have been a bone of commercial contention for decades. Beyond the devastation it causes to the cash flow of the victims, capital investment is often inhibited and at a time when this is so badly needed to boost the UK's faltering GDP growth," says Hood.

"Every time an invoice is paid late, it creates a problem for the supplier. When it happens to a struggling SME, battling to survive after three years of the worst business and financial disruption in living memory, the risk is that their stakeholders lose money and jobs are destroyed. It is unacceptable that larger, better-funded companies can wreak this havoc without any effective accountability."

"In theory, an unpaid creditor can charge statutory interest at 8% plus the Bank of England base rate on overdue accounts but fears of disturbing or destroying business relationships deters many from doing so, especially when there is an imbalance of financial power as regards a much larger debtor, or if the delinquent customer is significant to the business," continues Hood.

According to a recent poll, 65% of MPs support the introduction of a compulsory Prompt Payment Code [PPC] to protect SMEs cash flow, with over 50% of MPs agreeing that the Small Business Commissioner should be able to impose financial penalties for persistent non-compliance with the Code.

Source:
https://www.thisismoney.co.uk/money/smallbusiness/article-12457125/MPs-want-crackdown-late-payments-small-firms-really-help.html?]

Established in December 2008 and administered by the Office of the Small Business Commissioner, the Prompt Payment Code [PPC] is a voluntary code of practice for businesses and sets standards for its signatories to encourage that invoices issued by SMEs are paid within the first 30 days of being sent. It is an initiative championed by various business organisations, but most notably by the Chartered Institute of Credit Management.

"FOR TOO LONG, SMEs ACROSS THE COUNTRY HAVE BEEN SUBJECT TO THE PLIGHT OF LATE PAYMENT CULTURE. IN THE CURRENT CLIMATE, THE SME COMMUNITY REQUIRES ALL THE HELP IT CAN GET IN COMBATTING LATE PAYMENT. WITH MANY 60% OF UK STARTUPS FAILING TO SURVIVE, NOW IS THE TIME FOR SWIFT AND MEANINGFUL ACTION FROM THE GOVERNMENT,"

SAYS LYNNE DARCEY QUIGLEY, CEO AND FOUNDER, KNOW-IT.

Source:
https://www.businessmanchester.co.uk/2023/06/06/the-growing-struggle-for-uk-smes-why-the-startup-failure-rate-is-at-60/]

"SMEs and startups are being put through the financial ringer and it has been the same pressurised scenario for several years now. Technological innovation can counter a late payment culture, but it is one that should be avoided in the first place. Meaningful government action would see bringing an end to voluntary PPC arrangements and making it compulsory. Delivering a product or service and then issuing an invoice can no longer be viewed as a favour by debtors – 30 days should be plenty of time for businesses (particularly larger outfits) to make payment."

In the Autumn Statement the Chancellor Jeremy Hunt announced plans to deal with the late payment culture. "The Federation of Small Businesses say that the biggest thing I could do to help their members is end the scourge of late payments," said the Chancellor. "The Procurement Act we have passed means that the 30-day payment terms which are already set for public sector contracts will automatically apply throughout the sub-contract supply chain."

"With £32 billion in late payments owed to small businesses, this bottleneck of funds has taken a vice like grip on the UK SME business community's lifeblood of cash flow," says Rowland. "In the Autumn Statement the Chancellor inexplicably chose not to introduce a programme of legislation to fast track the enforced payment of these outstanding account receivable payments that could in turn bring £2.5 billion back into the UK economy. Additionally, the Chancellor did not seek to enforce the alleviation of the impact of increasing energy costs on the UK SME business community. As costs spiral by 25%-50% more per month juxtaposed to 2022, a specific mechanism of support would have been so very welcome to focus on assisting SMEs to meet these costs."

Ongoing late payment issues and rising energy costs continue to add to the fiscal challenges influencing SME business confidence.

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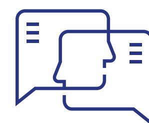

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SMES STRUGGLE TO INVEST

Obstacles in accessing banking and funding continue to challenge SMEs who will need to reassess their current lending structures against a backdrop of falling GDP and be ready for economic turbulence in 2024. In the Autumn Statement the Chancellor was keen to stress 110 growth measures which the Government would be putting in place including supporting entrepreneurs in raising capital and unlocking direct foreign investment.

"Some SMEs, anticipating stagnant GDP growth, have safeguarded themselves by securing fixed-rate debt structures. However, for less foresighted businesses, the economic situation could be catastrophic," warns Douglas Grant, Group CEO, Manx Financial Group. "The accessibility of financing holds immense importance for SMEs and national economic growth, particularly at a time when addressing the cost-of-living crunch is critical. Given the short-term loan schemes implemented in recent years, it is imperative for the government to look to extend efforts to enhance SME resilience."

The Federation of Small Businesses (FSB) recent super-complaint to the Financial Conduct Authority (FCA) highlights the harsh lending practices of banks that excessively demand personal guarantees for business loans. The FSB is particularly concerned that businesses are being put off from proceeding with loan applications, so forgo the capital necessary to grow, or are forced to seek out more expensive forms of capital. In some cases, expensive insurance is taken out in the hope to cover any loan default, but later proves invalid and therefore does not pay out, resulting in individuals and their families experiencing significant distress which is disproportionate to the loss or potential loss which the lender faces.

Worryingly FSB members are reporting that the presence of the personal guarantee is being used by the lender to gain influence over the decision-making process of distressed businesses to the lender's own advantage.

"Personal guarantees can be a 'straitjacket' on business growth, forcing entrepreneurs to put their homes or other assets on the line when taking out finance. This can be particularly paralysing when they are applied to small loans – leaving many business owners more likely to abandon their business growth plans or push them into being over-cautious in their decision-making and deterred from making bold choices," says Martin McTague, National Chair, FSB.

IT IS NO WONDER THAT MANY SMALL BUSINESS OWNERS IN THAT POSITION ARE TELLING US THEY ARE CHOOSING TO AVOID EXTERNAL FUNDING WHICH THEY COULD BE USING TO CAPITALISE ON NEW OPPORTUNITIES. IT'S BAD NEWS FOR THE INDIVIDUAL BUSINESS AND THE ECONOMY, AT A TIME WHEN WE ARE LOOKING FOR ECONOMIC GROWTH AND PRODUCTIVITY GAINS."

"For amounts which are triflingly small for banks – but potentially transformational for small business owners – a strong dose of proportionality is required rather than a blanket imposition of personal guarantees," continues McTague. "With interest rates having risen so sharply over the past couple of years, the availability and affordability of new finance for small firms has declined. Adding in personal guarantees on top of higher rates is clamping down on small firms' appetite and their ability to grow and invest."

HM Treasury's confirmation that the Enterprise Investment Scheme (EIS) that accounts for nearly £2.3 billion of investment into nearly 5,000 startups every year, and Venture Capital Trusts (VCT) should be extended beyond the current 2025 deadline has been welcomed. "The current challenge is that it is difficult for entrepreneurs to plan for the next three years without the certainty that the EIS would be available for their next fund raise. Typically, start-ups have an 18-month cash runway and that takes us past the current end to the EIS," comments Christiana Stewart-Lockhart, Director General, Enterprise Investment Scheme Association (EISA). "Without the extension, the sunset clause would have seen the current scheme ending in April 2025 which would be disastrous for several of the country's key high growth businesses across many sectors including medicine and technology."

Historically the majority of investment has gone to South East based businesses, and the EISA has been active in promoting the EIS in other key regional locations through a series of free events. Through the British Business Bank, there are a series of programmes working alongside the EIS to address regional imbalances including the Regional Angels Programme, Northern Powerhouse Investment Fund (NPIF), Midlands Engine Investment Fund (MEIF) and the Cornwall and Isles of Scilly Investment Fund (CIOSIF).

Broadening EIS's use and access to capital beyond London and the South East is already paying dividends in developing key technology centres of excellence across the country. An interim evaluation report published in April 2022 showed that the Northern Powerhouse Investment Fund has increased productivity, employment, and skills across the North.

Becoming an innovation nation requires the UK to attract, start and scale more innovative businesses. "The raft of measures announced by the Chancellor to pour more capital into UK science and technology companies are hugely welcome, as is the dedication of £20 million to support university spinouts specifically," says Rosalind Gill, Head of Policy and Engagement, National Centre for Universities and Business (NCUB). "We are pleased that the Chancellor recognised Lord Harrington's recommendations to attract foreign direct investment, with measures to make investment into the UK more attractive, but also better communicated and easier. Permanently committing to full expensing of business investment is an important move to boost levels of investment."

"However, a barrier to growth is lack of consistent focus on specific economic strengths. "The UK cannot be world leading in every area of scientific advancement," says Gill. "To distinguish itself from the major global trading blocks of the US, Europe and China, the UK must make, and commit to, choices about the areas where it does want to establish a world leading status. Attempts to prioritise strengths through a succession of strategies have failed to gain momentum or longevity. The UK needs a clear, long-term economic plan, genuinely shaped collectively by businesses, universities, and policy makers."

Creating a roadmap for business that boosts confidence and investment requires clear direction from policy makers. Over 45% of firms surveyed say they do not feel that the UK currently has the right balance of SME growth, and Government could do more to help the sector.

Source: PRISM research

STAFFING A BULLISH MARKET

To remain competitive SMEs need access to skilled talent, but whilst some businesses are optimistic that they can invest more in attracting staff, the reality is that the increase in post-pandemic non-student economic inactivity, innovation outpacing trading learning routes, and limited social mobility are continuing to weaken the labour market's ability to match jobs with skilled workers.

Data for the labour market continues to send mixed messages. As vacancies fall, unemployment and employment are remaining largely static, and pay growth is outstripping inflation. According to the Office of National Statistics (ONS), the estimated number of vacancies fell by 45,000 to 949,000 in September to November – the 17th consecutive period of decline since the peak of 1.3 million in the three months to May 2022 – as employers become increasingly cautious about hiring amid uncertain economic conditions.

Source:
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/december2023)

"The ONS has continued using its alternative estimates following concerns around the Labour Force Survey, which show the employment rate was largely unchanged on the quarter at 75.7% dip as the impact of higher interest rates is slowly being realised," says Richard Carter, Head of Fixed Interest Research, Quilter.

"Although the unemployment rate remains unchanged at 4.2%, recent 'experimental' data from the ONS's new Transformed Labour Force Survey suggests the unemployment rate fell to 3.5% in the spring and rose to 3.8% in the three months to August. This new data appears very difficult to trust right now and the ONS has warned against relying on it just yet, but its findings will still make the Bank of England's job even harder and potentially give it license to pursue its higher longer narrative for even longer."

THE UNCERTAINTY SURROUNDING STATISTICS FROM THE ONS'S NEW TRANSFORMED LABOUR FORCE SURVEY HIGHLIGHTS THE IMPORTANCE OF JUDGING THE LABOUR MARKET USING A RANGE OF DATA SOURCES.

WAGES

NOT AS POSITIVE AS IT SEEMS

When it comes to looking at wages, it seems all is not as positive as it seems. "Wage rises still have an awfully long way to go to make up for the spending power we've lost over the past couple of years. They've beaten inflation slightly for five months, but they had been growing slower than price rises for a full 18 months. This time last year, total pay was down 4% in a year, and the Office for Budget Responsibility (OBR) expects living standards in the coming financial year to be 3.5% lower than their pre-pandemic level," comments Sarah Coles, Head of Personal Finance, Hargreaves Lansdown.

"These wage rises aren't smoothly distributed either, with wages in the financial and business sectors up 8.3% and manufacturing 7.4%, compared with construction at 5.2%. It's also worth bearing in mind that inflation isn't being felt equally. Food inflation was still running at 10.1% in October. The lower your income, the bigger the proportion of it you spend on essentials like food, so the harder the hit. It means lower earners are still struggling disproportionately. If you were to compare wage growth to the previous quarter and then annualise that, they would be up just 4.2% – behind inflation again."

Although pay inflation may have peaked, vacancies are still above pre-pandemic levels and staff confidence remains high amidst the growing skills crisis. “While the current economic uncertainty is a top concern for businesses, the workforce isn’t showing the signs of diminishing confidence as we would usually see at this time. The health of the labour market and that of the wider economy have often been linked, yet at present they are less synced than anticipated,” says Matt Weston, Senior Managing Director UK & Ireland, Robert Half.

By analysing the job market through the lens of worker sentiment against a backdrop of key macroeconomic and cultural factors, the latest Robert Half Jobs Confidence Index (JCI) produced in partnership with the Centre of Economics and Business Research (Cebr) reveals that while job confidence fell in Q3 2023 to 45.8 – down 1.4 points from the previous quarter from Q2 2023 (47.2), it remains at its second highest level since Q1 2022, indicating high job confidence.

Source:
https://www.roberthalf.com/gb/en/insights/jobs-confidence-index]

JOB SECURITY CONFIDENCE PILLAR

“Of the JCI’s four pillars – ‘Job Security Confidence’, ‘Pay Confidence’ ‘Job Search and Progression Confidence’ and ‘Macroeconomic Confidence’ – the strongest Q3 2023 reading was seen in the job security confidence pillar, a trend that has persisted for eight consecutive quarters, with over half (58.4%) of surveyed employees saying that they feel confident about their job looking ahead to the next six months,” comments Weston.

“The job search and progression confidence pillar is the only pillar to show improvement in Q3 2023 to stand at 46.8 up from 32.4 recorded in Q2 2023. Overall, 47.4% of survey respondents for the latest wave of the JCI said that they feel confident or very confident about their future career prospects with 41.9% reporting confidence in their ability to progress their career over the coming five years.”

Robert Half’s job search and progression confidence pillar is the only major JCI constituent to improve in Q3 2023 climbing 14.4 points on the quarter rising to its highest reading since Q4 2019 during the pandemic.

Despite the upward trend in real earnings, the JCI reported a decline in pay confidence (down to 33.5 from 2.85 for Q2 2023) – although it remains firmly in positive territory – as a larger share of workers report having unpredictable wages. This aligns with Cebr’s view that real wage growth will remain positive in the coming months but has likely peaked.

The JCI’s macroeconomic confidence pillar displayed the most weakness falling by 2.2 points to 0.8, indicative of the tough economic headwinds facing the UK economy. “Our research show job and business growth confidence on the rise, but the widespread skills shortages and economic inactivity will take much longer to tackle,” comments Weston. “Employers are less likely to be in the driving seat in 2024, and being agile with their talent strategies and workforce models will be key.”

In line with the JCI, Robert Half’s 2024 Salary Guide reveals that while 69% of businesses feel confident in their growth prospects for 2024 and 47% plan to increase permanent headcount next year, a staggering 75% are already concerned about their ability to attract and retain skilled talent.

Factors such as Brexit, the Great Resignation and the pandemic have changed access to skilled talent creating a major shortage of skills across the economy that is holding back productivity and growth. "Every day, employers are struggling to fill jobs, so it's essential that everyone who wants to work is given the opportunities and training they need to do so, urgently. Government must do all it can to help businesses invest more in apprenticeships, technical education, and upskilling people in work," says Jane Gratton, Deputy Director of Public Policy, British Chambers of Commerce (BCC). "The Autumn Statement included some welcome steps, but with the immigration system now looking out of reach for most businesses, the Government must encourage investment in skills training and set out a stable, long-term strategy to support this."

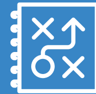
AI ENHANCING PRODUCTIVITY

The Department for Science, Innovation and Technology has recently set out new draft Guidance to support businesses in upskilling their workers with the tools they need for jobs alongside Artificial Intelligence (AI). Developed in partnership with the Innovate UK BridgeAI programme and The Alan Turing Institute, the Guidance marks a first step with the UK government continuing to work closely with the business community and experts to further develop the Guidance and draw concrete actions which can be implemented by businesses across the country – ahead of publishing a final version.

"Businesses are increasingly interested to learn how AI could enhance their productivity and competitiveness, but they also want to ensure they have the skills and competencies to adopt these technologies safely and ethically," says Matt Forshaw, Senior Advisor for Skills, The Alan Turing Institute. "The new framework clarifies routes to workforce upskilling and will support businesses across the country to harness the value of AI. This project is underpinned by strong partnership working and we look forward to seeing the impact of this project on the current and future AI workforce."

"Making sure workers up and down the country have the skills they need for their jobs with and in AI is a key part of our strategy in making the UK an AI powerhouse and ensuring the skills of our workforce keep pace with this rapidly developing technology," says Viscount Camrose, Minister for AI. "This Guidance will be vital in helping us realise that ambition, continuing an important conversation with businesses across the UK to make sure the steps they can take are practical, functional, and successful. Having a workforce which is equipped to work alongside AI will drive growth for businesses and allow us to realise the enormous opportunities AI presents in every sector of our economy."

The Government has already invested £290 million in a broad package of AI skills and talent initiatives since 2018, giving people the tools they need to work effectively alongside AI, and builds on a wide-ranging skills package unveiled in October which encompasses postgraduate research centres and scholarships, putting the UK on a strong footing with a high-skilled workforce fit for the digital age.

 Strategic Consulting

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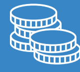 Fundraising

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"In the dynamic realm of start-ups, SMEs and even Corporates, innovation and adaptability are the keys to success.

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Andrea Maria Cosentino
Founder & CEO – Impact Fundry

GLOBAL HORIZONS BECKON BUT CAPITAL REMAINS TIGHT

SMEs play a crucial role in global economic development, but with up to $42 trillion now estimated to be locked up in global supply chains, SMEs are under pressure to unlock the working capital or face recurring cash shortages when trading globally.

Source: Taulia

A shortage of raw materials caused by environmental concerns, geopolitical tensions, and trade disruptions creates severe fluctuations in commodity prices and a rise in operational costs. Research found that over 30% of SMEs cite access to finance when exporting as a major concern.

Source: PRISM research

"The mismatch between liquidity pools for domestic and cross-border trade can be a major blocker for SME access to credit. Cross-border financing for SMEs requires the additional consideration of financial exchange movements, payment controls, and reliance on financial institutions located in a handful of international markets. This means when it comes to sourcing capital, SMEs require greater capital consideration because they carry a higher financial risk. On a global level, SMEs end up fighting for the scraps," comments Ali Ansari, Managing Director and Product Lead, Taulia.

"POOR FINANCIAL INFRASTRUCTURE OR GOVERNANCE MATURITY OF SOME REGIONS MAKES THE COST OF ACQUIRING AND SERVICING SME CUSTOMERS PROHIBITIVE,"

says Ansari.

"When you take everything into account, lending only happens at high rates and with terms that are too hard to stomach for a lot of SMEs."

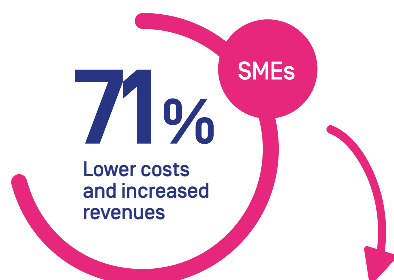
Growing in popularity among businesses looking to improve their working capital position are supply chain finance (SCF) programs – also known as reverse factoring – a fintech financing solution that allows businesses to offer their suppliers early payment on their invoices through third party funding.

In an inflationary environment cash-squeezed customers tend to take longer to pay their invoices. Today's environment demands modern solutions. Under SCF, a supplier uploads an invoice onto the supply chain finance platform. The buyer approves the invoices and uploads the approved invoice data (its payables as well as any applicable payment offsets such as credit/debit) to the SCF platform. The supplier selects chosen invoices for early payment via supply chain finance, and receives payment straight away, with a small fee deducted. The buyer then pays the funder in full on the invoice due date.

Since funds from the financial institution are advanced based on the buyer's promise to pay on the original maturity date, financing rates are based only

on the buyer's risk, not the supplier's risk. Therefore, financing rates are very attractive, often ten times lower than traditional factoring or other traditional financing solutions.

CUMULATIVE BENEFITS



Research reveals 71% of SMEs expect their company to achieve cumulative benefits including lower costs and increased revenues by digitalising their supply chains over the next five years, with a further 28% saying they plan to capture high-margin business through improved customer insights using data analytics acquired from supply chain data.

Source: PRISM research.

Bottlenecks in global supply chains have been an important driver of inflationary pressures across the world. In the three months to October 2023, the UK's total trade values showed a significant drop on the previous quarter. "Some of this can be put down to volatility in European and global markets in the trade of fuels, but there was also a decline in other goods categories," says William Bain, Head of Trade Policy, British Chambers of Commerce (BCC).

"The bright spot in the figures was growth in services trade continues to lead the way for the UK. Export volumes were 11% above pre-pandemic levels, but the momentum from 2022 has slowed significantly."

According to BCC research, almost two thirds (60%) of firms trading with the EU say it is now more difficult to do so than it was a year ago, with 97% saying they face difficulties using the Trade and Co-operational Agreement (TCA) leading to 49% of SME exporters reporting that the Brexit deal is hindering sales growth.

Source:
https://www.britishchambers.org.uk/news/2023/12/brexit-at-three-fresh-trade-challenges-growing/).

Customs checks, tariffs and regulation are the top three barriers to exporting cited by respondents to the BCC survey. While, transportation costs (37%), volatile exchange rates (31%), political and economic uncertainty (27%) and rules of origin requirements (23%) were others cited as obstructions.

Difficulties in using TCA, extreme inflationary pressures, the war in Ukraine, the conflict in the Middle East, and attacks in the Red Sea disrupting commercial shipping routes and global supply chains, adding to the aftershocks from the pandemic already being felt by SMEs, the BCC reports that more companies say they are now looking to withdraw from exporting. Additionally, with BP announcing that it was pausing all Red Sea shipments after rebel attacks, and there are fears of higher oil prices and the effect on global trade.

"The cost of shipping raw materials or finished products via maritime routes might be affected by decisions made months or years earlier, such as long-term contracts, fuel pricing agreements, or investments in shipping infrastructure," says Captain Steve Bomgardner, Vice President Commercial Markets, Pole Star Global. "The maritime industry often operates on extended timelines due to the nature of shipping contracts and the time it takes for vessels to move across oceans. Therefore, pricing dynamics in the maritime sector may not always align with immediate events but could be linked to earlier decisions and circumstances."

According to ONS data for October 2023, exports to the EU fell by £0.9 billion (5.8%) because of a £0.3 billion decrease in exports of chemicals (mainly due to reduced exports of organic chemicals to Ireland and fall in medicinal and pharmaceutical products to Germany), and a £0.2 billion fall in the export of material manufactures, and food and live animals.

Source:
https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/october2023)

Exports to non-EU countries grew by £1.2 billion (8.2%) in October 2023, driven by a £0.7 billion rise in exports of material manufactures, primarily the result of increased exports to India. There was also a £0.4 billion rise in exports of fuels resulting from an increase in crude oil exports to China, and a £0.3 billion rise in chemical exports.

Against this background, ONS data for October 2023 shows that the value of goods imports from both EU and non-EU countries increased by £3.6 billion (8.2%) mainly due to the rise of imports of machinery and transport equipment – particularly the import of cars from Germany, and a rise of £0.3 billion in the imports of refined oil from the Netherlands, Denmark and Sweden.

With imports of electrical machinery from China; gas from Norway; organic chemicals from Canada; and medicinal and pharmaceutical products from Switzerland all rising, imports from non-EU countries grew by 10.9% to £2.1 billion.

However, according to December's JPMorgan Global Manufacturing Purchasing Managers' Index™ (PMI®) compiled by S&P Global, manufacturing has subsequently fallen from 49.3 recorded in October down to 49.0 in November as new orders fell and manufacturers prepare for lower production requirements in 2024. The fear is now that as supply chain disruptions lengthen supplier delivery times, this will create an environment whereby demand exceeds supply and the renewed upward trend in prices cause inflation to rise again.

Source:
https://www.spglobal.com/marketintelligence/en/mi/research-analysis/global-factory-job-losses-gather-pace-as-demand-weakness-persists-at-close-of-2023-Jan24.html)

According to the latest forecast from the Office for Budget Responsibility's (OBR), UK trade volumes remain below their pre-pandemic level, and are expected to stagnate in the medium term with exports predicted to grow by just 0.1% a year between 2024 and 2027.

"THE PUSH TOWARDS INCREASING THE AMOUNT OF TRADE WE DO DIGITALLY HAS THE POTENTIAL TO SMOOTH THE FLOW OF GLOBAL TRADE, BUT WE NEED TO GET MORE INTERNATIONAL PARTNERS ON BOARD," SAYS BAIN.

“”

BOOSTING THE UK’S EXPORTS IS A CRUCIAL PART OF SOLVING THE COUNTRY’S PRODUCTIVITY PUZZLE AND GETTING THE ECONOMY BACK TO GREATER GROWTH. BUT WE FACE AN UPHILL CHALLENGE IN PERSUADING MORE FIRMS TO TRADE OVERSEAS WHEN SO MANY OF THEM ARE PUT OFF BY RED TAPE, COSTS, AND PAPERWORK,

adds Liam Smyth, Managing Director of the BCC’s brokerage service, Chamber Customs. “That’s why the shift to an on-line system can ensure that checks can be carried out away from the border, removing a big chunk of the uncertainty for traders. This is especially important for smaller firms, given the challenges of the current economic climate. The UK Government also needs to focus on pushing awareness of free trade deals, especially among smaller businesses, and take decisive action on reducing some of the removable EU red tape costs for traders.”

According to the Centre for Economic and Business Research (Cebr), the UK is forecast to grow faster than France and Germany in the longer term. But the CBI warns that UK exports will lag behind other advanced economies throughout 2024 and will not pick up until 2025.

SMEs BRACE FOR TOUGH 2024

Businesses are gearing up for a tough year ahead after the ONS revealed monthly GDP figures had fallen by 0.3% in October 2023, following a growth of 0.2% in the previous month reigniting recessionary fears. Companies are taking a hard look at their overheads and pursuing a cautious approach to staffing levels and investment, as weak demand and ongoing cost pressures continue.

Industry commentators predict the UK economic growth will remain sluggish throughout 2024 with the growth rate falling to 0.4% in 2024 nudging up only slightly to 0.6% in 2025.

Source:
https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/october2023].

British Chambers of Commerce (BCC) forecasts that the interest rate has reached its peak but will remain higher for longer with the UK GDP growth flatlining for the next three years.

Over 75% of SMEs believe that fiscal instability and political events have impacted their firm's performance during 2023.

Source: PRISM research.

"The UK economy remains one of the most advanced in the world, but it's difficult to see where further growth will come from as inflation, interest rates, policy churn, and trade barriers with the EU prevent many firms from making long-term investment plans," says David Bharier, Head of Research, BCC.

According to the Monetary Policy Committee's minutes, Bank staff now expect GDP to be flat in Q4 2023, compared with the 0.1% growth that had been projected in the November Report.

Source:
https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-summary-and-minutes/2023/monetary-policy-summary-and-minutes-december-2023.pdf]

"Despite the pick-up in GDP growth, it remains below the average seen in the aftermath of the 2008/9 financial crisis (around 2%). Amid the sheer degree of headwinds that the economy has faced over the last couple of years, businesses and households have shown remarkable resilience. Let's not forget that even the weak growth we've seen is better than expectations of a recession this time last year. But that is by no means job done. Businesses are gearing up for another tough year ahead, and we forecast weak growth to persist over 2024. Given that this is coming after an already challenging few years, it's clear that the 2020s have yet to roar," says Louise Hellem, Chief Economist, CBI.

Dr. Roger Barker, Director of Policy at the Institute of Directors (IoD) agrees, "The latest findings from our Directors' Economic Confidence Index reveals that director sentiment ended the year in a relatively depressed place falling back -28 in December from -21 in November. According to our members, confidence in the economy has been stuck in the doldrums since last Summer. Although aspects of the business environment have improved in the last couple of months, particularly regarding inflation, this is not yet exerting a meaningful impact on business decision-making. Business leaders remain extremely cautious about the outlook for the wider economy over the next 12 months, although they are more optimistic about the prospects for their own organisations."

"In the coming months, the Bank of England will be considering its next step in terms of interest rates. Based on the evidence of our survey, an early cut in interest rates would be justified to kick-start business confidence and help drive meaningful economic growth in 2024," comments Barker.

With a general election around the corner, it's imperative that consensus is maintained around growth-enhancing measures in the Autumn Statement. Looking for a vote winner, the Chancellor's Spring Statement on 6 March 2024 will be a make-or-break moment for the Conservatives.

After being heavily criticised over its wrong inflationary predictions, pressure is mounting on the Bank of England to cut interest rates as early as March. If not, it will be left to the Government to reassure the country that it can indeed be 'Going for Growth' – otherwise just like a train being cancelled on-route as it pulls into the station, the announcement will be 'All Change, please!"

LOOK OUT FOR THE NEXT EDITION OF THE SME BAROMETER

THE SME BAROMETER

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