SME CONFIDENCE TRACKER

Q3 2018

BIBBY FINANCIAL SERVICES

FOREWORD

BREXIT FOG LINGERS FOR SMES

In the Q2 SME Confidence Tracker, I commented on the strong correlation between the progression of Brexit negotiations and the confidence of UK SMEs. Three months later, we are still seeing the same story reflected in a further fall in confidence in the third quarter.

Business saw very little progress on Brexit this summer, which started with a slew of Cabinet resignations and settled down into a period of little tangible action. Confidence was somewhat buoyed by the record hot weather, but this took a downturn when both sides agreed that the original deadline for a final withdrawal agreement may no longer be set in stone.

Fears were confirmed in October as the EU summit in Brussels failed to deliver concrete progress.

It's not complex to see why confidence continues to stall with Sterling rising and falling on the headlines of deal speculation. It remains an uncertain time for UK businesses that are finding it difficult to accurately plan for the year ahead. This issue is particularly acute for those relying on overseas trade.

This haziness is reflected in our Tracker findings. A quarter of SMEs (25%) state that the uncertain economic environment is a barrier to investment, and over half (55%) of those importing say they would find it difficult to find another supplier outside of the Bloc should a 'no deal' scenario become reality.

Despite a lack of clarity, there has been some resilience from UK PLC. On 2 August 2018, the Bank of England (BoE) increased the interest rate to 0.75 per cent - its highest since March 2009. The rise, according to the Tracker, had little impact on business operations, with almost two-thirds of SMEs (63%) saying that it had no effect to date and a further 28 per cent stating that it is too early to tell.

On November 1 2018, the BoE downgraded 2018 GDP growth forecasts from 1.4 per cent to 1.3 per cent as Brexit continues to command the Monetary Policy Committee's (MPC) agenda. BoE Governor, Mark Carney, stated that the nature of EU withdrawal is not known at present, and the MPC's actions will be in accordance with the progression of Brexit. However, Carney clearly cleaves to the view that this will have little impact on interest rate normalisation, which could gradually rise to 1.5 per cent by 2021.

While interest rate rises are scheduled to take place incrementally, such an upwards trajectory can't be said for business investment. Our research shows that SMEs plan to invest £71,525 in their businesses in Q4, a 45 per cent decrease from Q1 2018. As broadly expected, economic uncertainty in the UK is the most prominent cause for businesses not investing, with a quarter of SMEs (25%) discouraged from investment as a result.

It's not only UK SMEs that are feeling the effects of the Brexit fog. The Tracker data reveals that over a third (36%) of Irish SMEs aren't planning to invest over the coming months due to Brexit uncertainty and continued ambiguity over the Irish border question.

With just over five months until the deadline, the Brexit hourglass is almost at an end with another quarter of negligible progress. For yet another quarter, businesses are on the back foot. Without imminent progress, SMEs will continue to delay investment and growth plans, with UK SMEs most omitted from broader continental economic growth.

EDWARD WINTERTON

UK Chief Executive,
Bibby Financial Services
October 2018

@TedWinterton

Edward Winterton

KEY FINDINGS IN Q3 2018

61.3 Q2 2018 → 60.8 Q3 2018

The SME confidence Index decreased for the second consecutive quarter to 60.8 in Q3 2018, down from 61.3 in Q2 2018

42% ↑

Over two-fifths (42%) of SMEs expect sales to increase in Q4 2018, matching their expectations for Q3 2018

A third of SMEs (33%) with EU suppliers would not be able to operate without imports from the bloc

£ ↓

Three-fifths (61%) of SMEs with EU suppliers said that they would see a decline in profits without imports from the bloc

SMEs plan to invest £173,644 on average in Q4 2018

↑1% ↓30%

Almost a third (30%) of SMEs said profits would be reduced if the Bank of England Base Rate increased to 1%

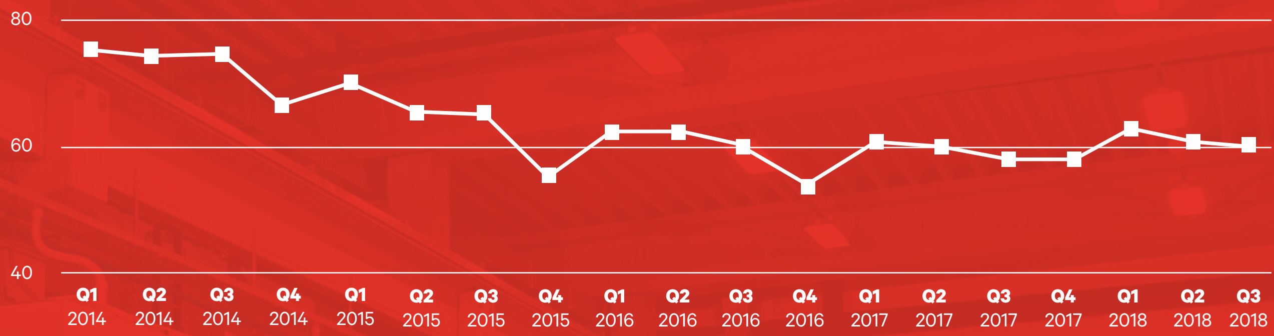
SME CONFIDENCE INDEX

The SME Confidence Index is compiled by equally weighting SME sales performance over the past three months with expected sales performance over the three-month period ahead.

The Index for Q3 2018 showed a decrease in confidence for the second consecutive quarter, falling by 0.5 points to 60.8, down from 61.3 in Q2 2018. While confidence has fallen since the beginning of 2018, the Index is higher than the same period last year (58.7 in Q3 2017).

Overall, the decline in confidence reflects broader signals in the UK economy, with the Office for Budget Responsibility[1] expecting UK GDP growth to be 1.6 per cent this year, down from the 2 per cent prediction it made last year.

CONFIDENCE INDEX



[1] The Office for Budget Responsibility, Economic and fiscal outlook – March 2018

CONFIDENCE CONTINUES TO SLIDE

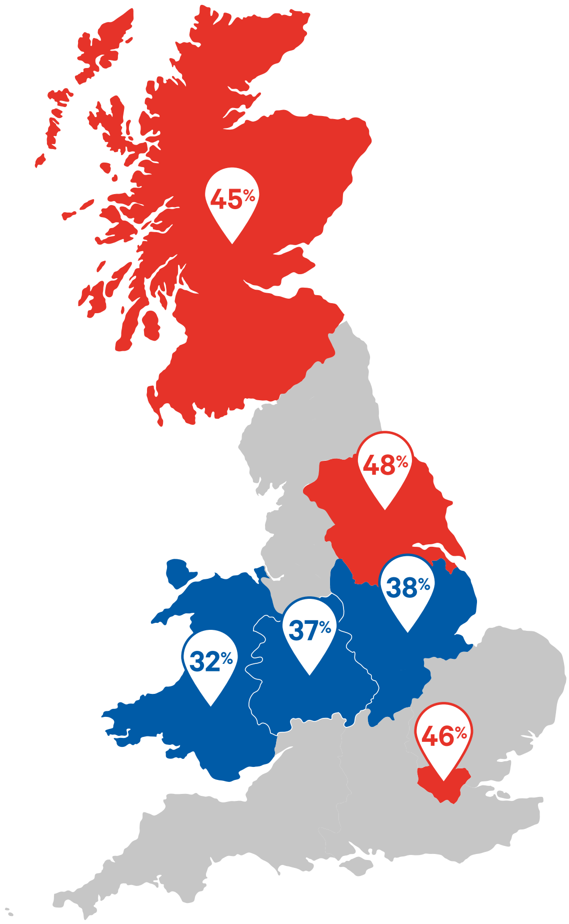
Confidence among UK SMEs continued to slip further from levels seen in Q1 2018, when SME confidence was at its highest level since Q2 2015. Over the next three months, sales expectations remain flat, with over two-fifths (42%) expecting sales to increase in Q4 2018, equal to expectations in Q3 2018.

MOST CONFIDENT REGIONS Q3 2018

Yorkshire **48%**
London **46%**
Scotland **45%**

LEAST CONFIDENT REGIONS Q3 2018

Wales **32%**
East Midlands **37%**
West Midlands **38%**



BEST PERFORMING SME SECTORS Q3 2018

43% Manufacturing

43% Transport

42% Wholesale

WORST PERFORMING SME SECTORS Q3 2018

40% Services

38% Construction

BREXIT WEIGHS ON THE 1.1 MILLION SMES THAT IMPORT FROM THE EU

33%

A third of SMEs with EU suppliers would not be able to operate without imports from the bloc, meaning 376,200 businesses are at risk of collapse post-Brexit

61%

More than three fifths would see a decline in profits without EU imports

55%

More than half said they would struggle to find an alternative supplier outside the EU

COUNTDOWN TO BREXIT

KASH AHMAD
UK Specialist Director,
Bibby Financial Services

Kash Ahmad
@KashAhmadBFS

With around five months to go until the UK leaves the EU, SMEs are at a crossroads. The process behind how they trade with the bloc could fundamentally change, but the lack of political certainty means that businesses still don't know how the UK's future trade relationship will work.

The EU is the UK's largest trading partner, accounting for £274 billion worth of UK exports (44% of all exports) and £341 billion of UK imports (53% of all imports) in 2017.[2] Despite this reliance, a recent study by the British Chamber of Commerce and Bibby Financial Services showed that 62 per cent of UK firms have not yet undertaken a risk assessment of the impact of Brexit on their businesses.[3]

With limited time left to prepare, businesses must not hold out for a Brexit deal that may never come. To adequately prepare, businesses that work with suppliers and customers based in the Single Market should look to communicate with their overseas partners and agree contingency plans, should UK and EU trade fall back to World Trade Organisation rules post-29 March.

Business owners should use this time to deepen their relationships with key suppliers and negotiate discounts on goods. One way to secure a discount could be to offer to pay suppliers for goods in advance of them being shipped.

This can be achieved by accessing funding to pay suppliers earlier in the trade cycle, alleviating cashflow pressure and enhancing bargaining power. Potential discounts could partly offset the cost of any tariffs that might be imposed after the UK leaves the EU. While the government is working to negotiate a frictionless trade deal with the EU, businesses must still prepare for a no deal scenario in case negotiations are unsuccessful. An option that SMEs can consider is the application to be an Authorised Economic Operator (AEO), giving businesses faster access to simplified customs procedures when trading in EU markets. While this approach isn't a complete fix, it will help UK SMEs experience fewer customs delays in the event of trading complexities after the completion of Article 50.

Ultimately, suppliers are more likely to offer favourable rates if businesses work to establish themselves as trusted and loyal partners. If approached sensitively, negotiations will benefit both sides, protecting relationships with suppliers while also securing discounts. While this will not be easy amid continuing uncertainty, businesses that take steps to prepare for Brexit in advance will ultimately be better placed to flourish once the UK leaves the EU.

"Our strategy when it comes to Brexit is to hope for the best, but plan for the worst. Expanding into markets like Japan and the USA should not only provide new revenue streams for the business, but also reduces our reliance on markets that may be more exposed to Brexit."

MARK CLIFFORD
Founder, Clifford Sells

[2] https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7851
[3] https://www.britishchambers.org.uk/news/2018/09/six-months-to-brexit-major-new-bcc-survey-finds-investment-and-recruitment-would-be-cut-in-the-event-of-no-deal

UK SMES INVEST IN TRAINING TO TACKLE THE SKILLS SHORTAGE

36%

More than a third (36%) of SMEs plan to invest in staff training and development in Q4 2018, making it the most common area for planned SME investment

20%

Additionally, a fifth (20%) of SMEs plan to invest in recruitment in Q4 2018

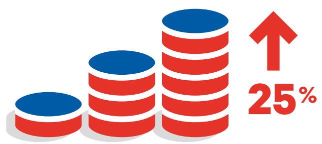
12%

SMEs identified the lack of skilled staff as the third most significant challenge their business currently faces, with 12 per cent of SMEs identifying the skills gap as an issue

56%

OF SMES ARE YET TO PREPARE FOR A HIGHER INTEREST RATE ENVIRONMENT

SMES RAISE PRICES TO PREPARE FOR AN INCREASE IN INTEREST RATES

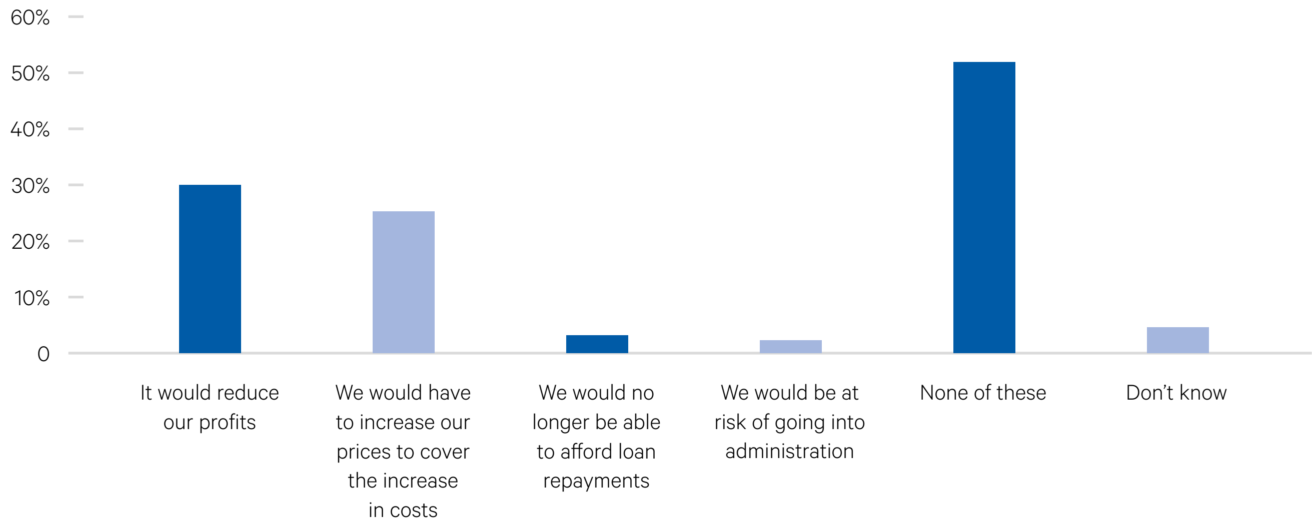


A quarter (25%) of SMEs say they would have to increase their prices to cover costs if the Bank of England Base Rate increased to 1 per cent this year

30 per cent of SMEs say it would reduce their profits if the Base Rate increased to 1 per cent

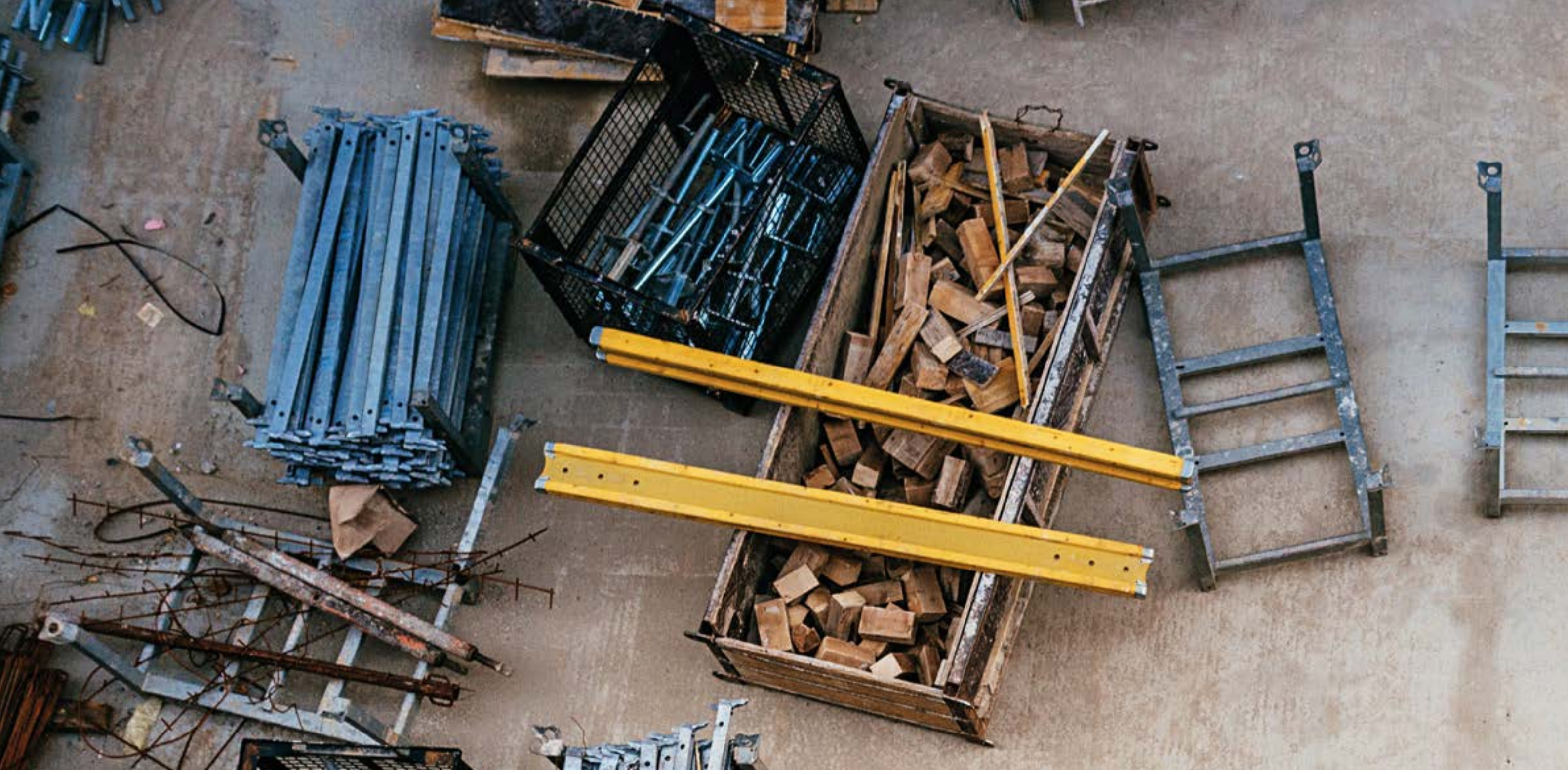
A quarter of businesses (25%) are cutting costs to prepare for a future increase in interest rates, while one-in-ten (11%) have begun paying off their debts

EFFECTS OF FUTURE INTEREST RATE INCREASE



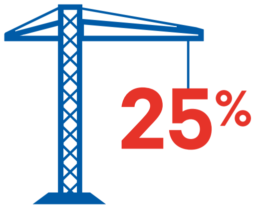
"With rates still at rock bottom, a further increase in the Bank of England Base Rate could push up costs, putting additional pressure on SMEs at a time when business confidence is in decline. It is encouraging that some small businesses have already started to prepare for a higher rate environment. However, there is more to be done, with the majority (56%) yet to take steps to prepare."

EDWARD WINTERTON
UK CEO, Bibby Financial Services

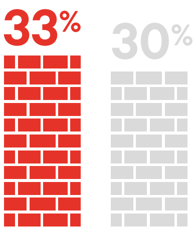


CONSTRUCTION SMES MOST AFFECTED BY CASHFLOW CHALLENGES

Cashflow is the second most significant challenge facing construction subcontractors (14%), compared to the fifth top challenge for SMEs across all sectors



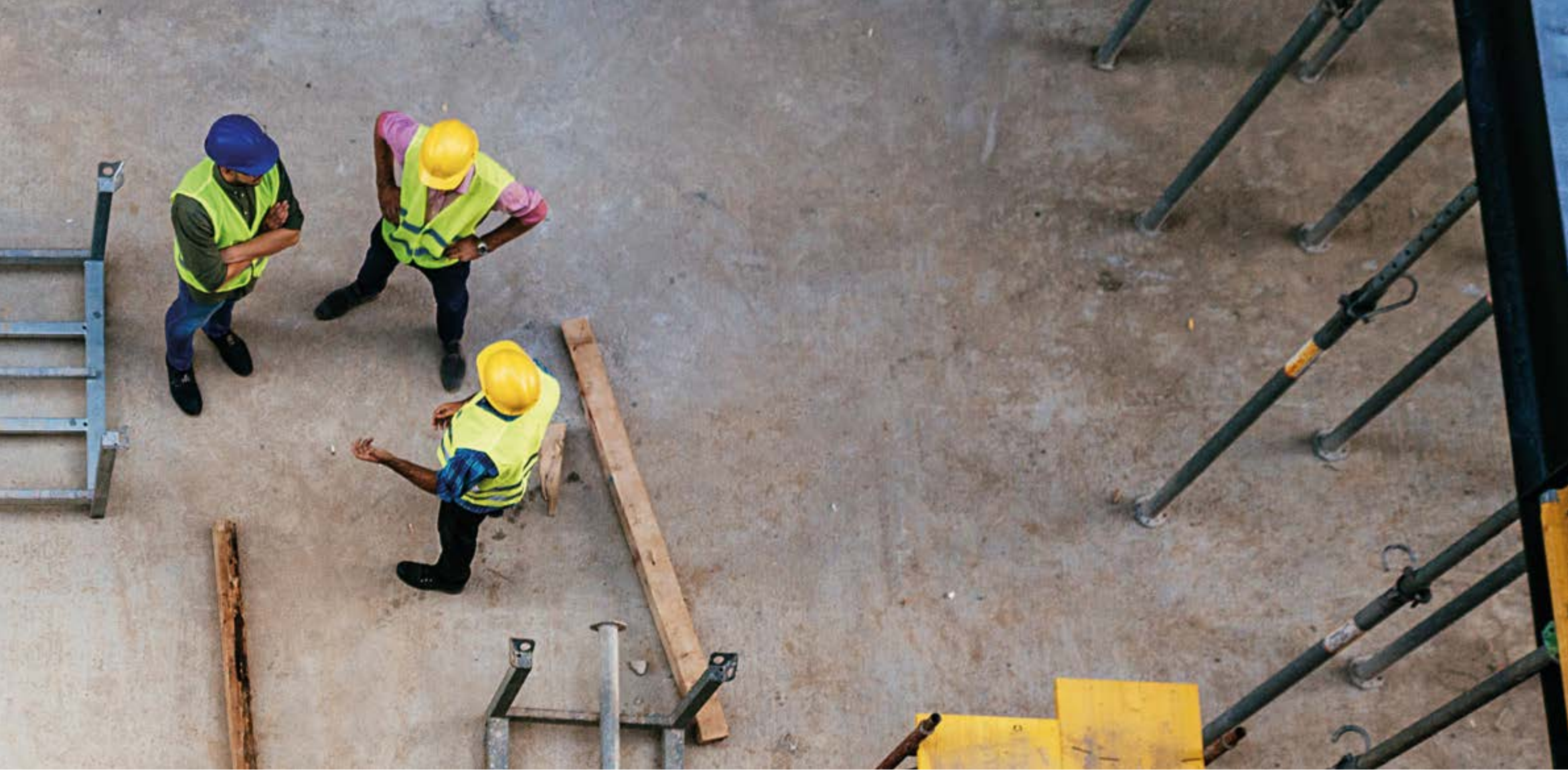
Cashflow overtook rising costs to become the top barrier to investment in Q3 2018, holding 25 per cent of construction SMEs back, up from 20 per cent in Q2 2018



A third of subcontractors (33%) have suffered from bad debt, compared to 30 per cent across all sectors

UK construction firms imported £17bn of materials from overseas in 2017, leaving them exposed to currency fluctuations[4]

[4] https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/articles/constructionstatistics/number192018edition



@HelWheeler

Helen Wheeler

"Construction firms import a large quantity of materials from overseas, with the industry's imports being valued at £17bn in 2017, more than double the value of exports. With the weak pound making imports more expensive, the high upfront costs faced by construction subcontractors has left them more exposed to cashflow challenges compared to other sectors. As a result, many are entirely dependent on funding to purchase materials and meet labour costs, so they can access the resources they need to take on new projects and grow their business.

"Following the Brexit vote and the Carillion collapse earlier in the year, several high-street lenders are more cautious about funding subcontractors. Now isn't the time for purse strings to be tightened. Subcontractors need access to liquidity. With that in mind, it's no surprise that cashflow is now ranked as the second most significant challenge they face this quarter, moving up from third place in Q2 2018.

"It is crucial that the sector supports construction SMEs, so they can continue to serve the supply chain and help build the infrastructure the UK economy needs to thrive. According to data from McKinsey, the UK needs to spend an extra 0.5% of GDP between 2017 and 2035 to close its infrastructure gap. This means we need construction firms, from the smallest to the largest, to be firing on all cylinders to make this happen."

HELEN WHEELER

Managing Director for Construction Finance, Bibby Financial Services

SMES: RECRUITING IN A CHANGING ENVIRONMENT

SUSAN FARMER
Head of Recruitment Finance, Bibby Financial Services

Susan Farmer

Finding and retaining talent can be a frustrating activity for SMEs, with lower migration and high employment creating a difficult environment for sourcing the right staff. The latest government figures show that the UK unemployment rate is just 4 per cent, the lowest level since 1975. Furthermore, demand for job candidates is ever increasing. As many SMEs employ workers from within the EU, a 'no deal' or 'hard' Brexit could potentially exacerbate this skills shortage even further.

It is therefore no surprise that SMEs are planning to invest in training existing staff i n Q4 2018. With competition heating up for the limited number of workers on the market, more than a third (36%) of SMEs are choosing to put money into developing the talent they already have, up from 32 per cent the previous quarter. This has meant that direct recruitment has remained flat, as one in five (20%) plan to invest in this area in Q4 2018, compared to 21 per cent in Q3 2018.

Despite good intentions, a significant amount of work remains to be done if businesses are to close the skills gap. Businesses are reacting with increased focus on training, but only time will tell if they're reacting quickly enough. The talent shortage is a substantial challenge that is likely to take time and further investment to address, but many are holding back due to the uncertainty caused by Brexit. It is unclear whether this will continue into Q4 2018, but it is assumed that the political uncertainty will dampen the level of investment in recruitment when it should be high up on the agenda of SMEs.

BAD DEBTS RETURN

10%

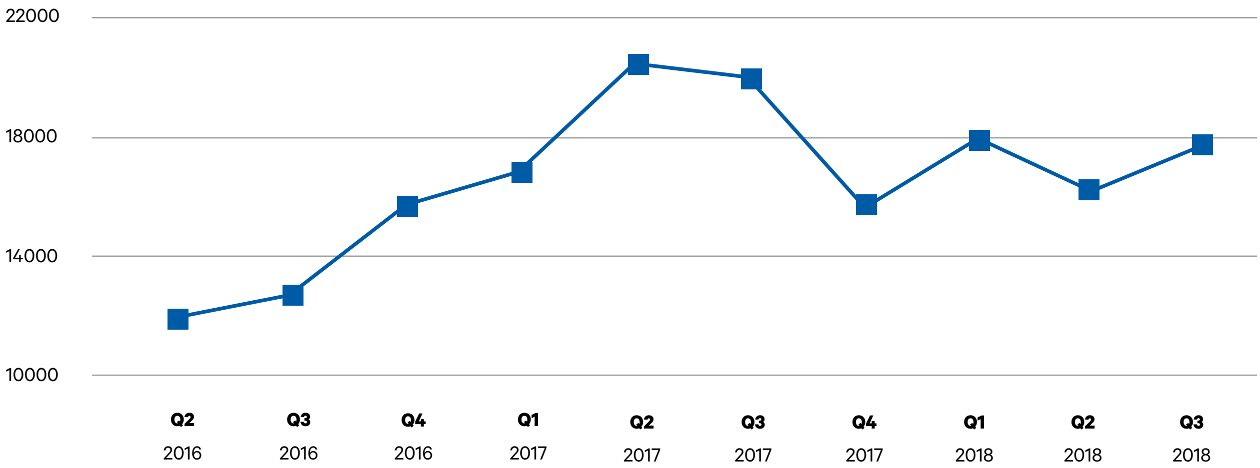
Bad debt written off by SMEs has increased by 10 per cent to £17,809 in Q3 2018, compared with £16,185 in Q2 2018

35

It took an average of 35 days for SMEs to receive payment in Q3 2018, a similar level to Q2 2018 (36 days)

Almost a third of SMEs (30%) suffered from bad debt in the past 12 months, a slight decline from 33 per cent in Q2 2018

BAD DEBT (£)



Small Business Commissioner

"Bad debt is a major issue for SMEs and can lead to delayed growth or in some cases lead to insolvency.

"I would urge SME businesses affected by late payments to contact the Small Business Commissioner's office for help and advice and not write off those bad debts, as we are here to help you recover them.

"By eliminating the cash flow problems that arise due to late payments, I believe that many firms that have been struggling to 'keep their head above water' would be able to grow and expand.

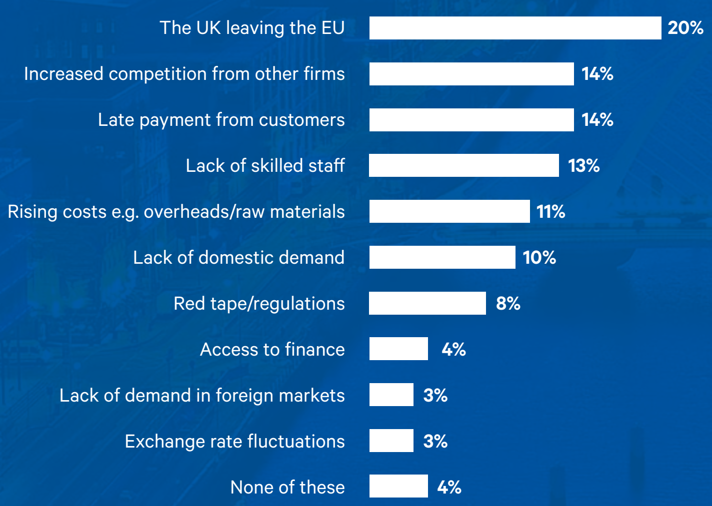
"In turn, working capital as well as cash flow would be significantly improved for the wider UK economy. The uncertainty around Brexit makes improving the velocity of cash flow for SME critical. We need to work collaboratively to address the decline in confidence as outlined in this report."

PAUL UPPAL
Small Business Commissioner

THE VIEW FROM IRELAND

- Almost two thirds (65%) of Irish SMEs expect sales to increase in Q4 2018
- A fifth (20%) said Brexit is the biggest challenge to their business
- More than half (56%) of Irish SMEs are taking steps to prepare for Brexit, with 38 per cent exploring new markets and 26 per cent diversifying their business
- The majority of SMEs (80%) plan to invest in their business over the next three months, with 43 per cent investing in staff training and development and 33 per cent investing in digital technology

BUSINESS CHALLENGES



"When it comes to the UK Brexit negotiations, Irish SMEs fail to garner the attention that their UK counterparts do. It's important to note that Brexit is the biggest challenge to over 50,000 Irish businesses, who equally need the clarity and direction of a trade deal in order to operate with confidence".

MARK O'ROURKE
Managing Director, Bibby Financial Services Ireland

@MarkORourke9

Mark O'Rourke

KEY FINDINGS FROM IRELAND:

65%

of SMEs expect sales to increase in the next three months

80%

of SMEs plan to invest in their business in Q4 2018

39%

of Irish SMEs suffered a bad debt in the past 12 months

33

It takes 33 days on average for SMEs in Ireland to be paid

88%

of SMEs want more support from the Government

WHAT IS THE SME CONFIDENCE TRACKER?

The SME Confidence Tracker surveys over 1,000 of the UK's small and medium sized businesses on a quarterly basis. The Tracker charts the confidence of owners and senior decision-makers of businesses in manufacturing, construction, wholesale, transport and services sectors. Field work for Q3 2018 took place throughout August and September 2018 and respondent businesses had average annual turnover of £1.8m.

ABOUT BIBBY FINANCIAL SERVICES

Bibby Financial Services is a leading independent financial services partner to more than 7,000 UK SMEs.

Our total funding capability exceeds £1bn and through our network of 19 regional offices we handle annual client turnover of £6bn.

Formed in 1982, we are a member of UK Finance, supporting the growth of businesses in over 300 industry sectors.

In 2011, 2012, 2014, 2015, 2016, 2017 and 2018 the company was awarded a place in The Sunday Times 100 Best Companies to Work For, ranking 48th in the most recent poll.

To find out more about Bibby Financial Services, visit:
www.bibbyfinancialservices.com

CONTACT

SEAN CASEY
Head of External Corporate Communications
Bibby Financial Services

sean.casey@bibbyfinancialservices.com

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THE SUNDAY TIMES 100 BEST COMPANIES TO WORK FOR 2018