



# UK BUSINESS CONFIDENCE MONITOR

## Q4 2010



# WELCOME



The message coming out of this quarter's *ICAEW / Grant Thornton UK Business Confidence Monitor* (BCM) is that we can't take the economic recovery for granted. Confidence is continuing to decline, suggesting that business leaders are becoming less sure about the UK's economic prospects for 2011 and beyond.

The challenge facing the Coalition Government is becoming increasingly clear. With the *Comprehensive Spending Review*, it has set out how it intends to cut public spending to tackle the fiscal deficit. It now has to focus on getting the private sector onside – reducing the regulatory burden and improving access to finance – as well as ensuring that the UK can compete to attract inward investment.



Michael D M Izza  
Chief Executive  
ICAEW



Business confidence has undeniably been shaken by concerns over the future of the economy and the impact of the Spending Review. Yet, while 2011 will undoubtedly be another difficult year with forecasts currently softening, businesses are still predicting that exports, turnover and profits will be higher overall over the next four quarters than in 2010.

Businesses have become used to dealing with difficult conditions and will continue to review their own prospects in terms of financing, order books and opportunities. For some, the coming year will be difficult but there are many dynamic companies, including exporters buoyed by the relative weakness of sterling, that are looking to invest in their long-term futures. The picture is far from perfect but the outlook at the end of 2010 is more positive than a year ago.



Scott Barnes  
Chief Executive Officer  
Grant Thornton

# ECONOMIST'S VIEW



The latest *ICAEW / Grant Thornton UK Business Confidence Monitor* (BCM) shows that business confidence fell sharply in Q4 2010. The data imply that economic growth will slow, but remain positive, in the final quarter of the year.

The preliminary estimate of quarterly economic growth in Q3 2010 was considerably higher than had been expected, at 0.8%. This is the second quarter in which UK economic growth has surprised on the upside, suggesting the recovery has thus far proved more resilient than initially feared. However, we still think that a slowdown in growth is on the way, with many challenges to recovery in the pipeline.

## KEY ISSUES EMERGING THIS QUARTER

- The decline in the Confidence Index which began in Q2 2010 has accelerated this quarter. This partly reflects ongoing uncertainty about the path of the UK economy over the coming years.
- Annual turnover and profit growth rose this quarter. However, expectations for growth over the coming year have weakened.
- Export growth has continued to rise, which raises hopes of an export-led recovery emerging over the next year.
- More than two fifths of businesses report customer demand as a greater challenge to business performance than a year ago.
- Annual input price growth has risen. However, businesses are only expecting modest selling price increases over the next 12 months, suggesting profit margins will be squeezed.

The October *Comprehensive Spending Review* set out where the axe would fall across government departments. The Chancellor stuck to his Budget plans, despite rumours of a possible change in the timing of pre-announced spending cuts.

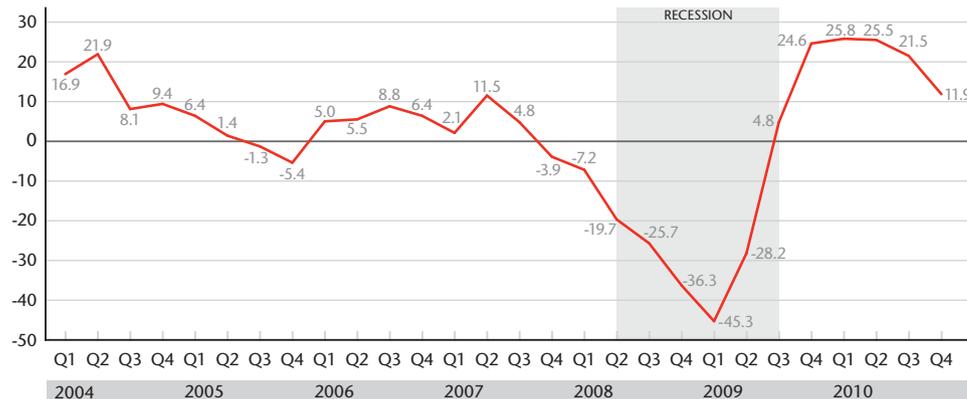
An estimated 490,000 public sector jobs will be lost over the next four years, with the task of creating alternative employment falling to the private sector. Data for August and September showed rising Jobseeker's Allowance claimants, which casts doubt on whether the private sector is yet in a position to absorb such a large number of job losses. We continue to expect loose monetary policy to accommodate the fiscal austerity, with the Bank of England base rate held at 0.5% throughout next year and further quantitative easing to help bolster the private sector recovery.



Douglas McWilliams  
Chief Executive, cebr  
ICAEW Economic Partner

# BUSINESS CONFIDENCE IN Q4 2010

**FIG. 1 TREND OF UK BUSINESS CONFIDENCE**



The latest ICAEW / Grant Thornton UK Business Confidence Monitor (BCM) shows a significant decline in business confidence in Q4 2010.

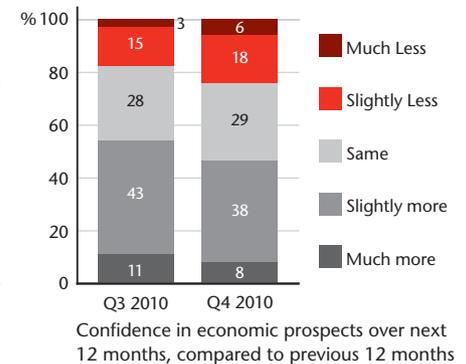
The Confidence Index has declined for the third consecutive quarter, falling from 21.5 in Q3 to 11.9 in Q4, with the pace of decline accelerating compared to the previous two quarters. However, the index still remains above typical pre-recession levels.

## DECLINE IN CONFIDENCE INDEX ACCELERATES

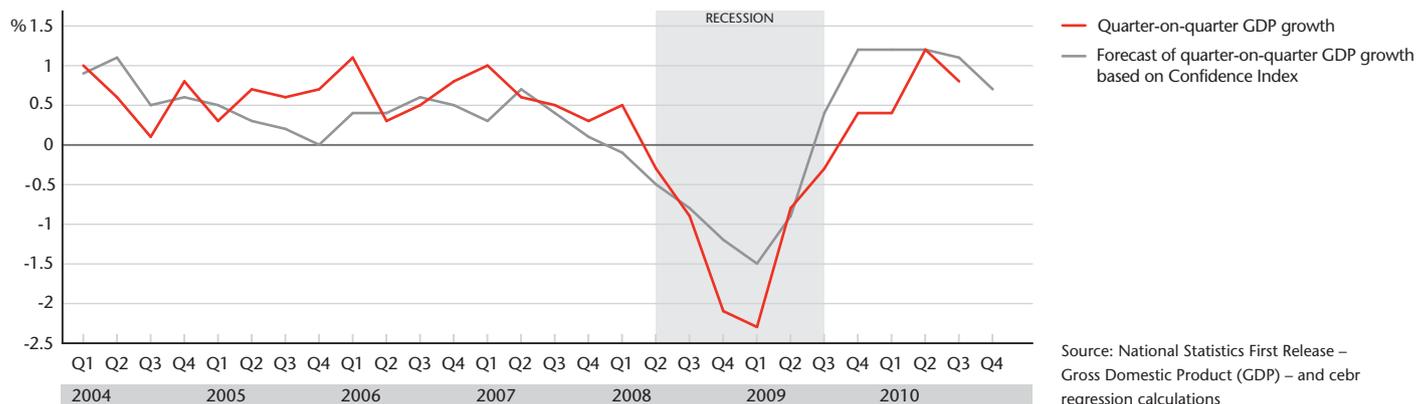
The latest findings from BCM show the Q4 2010 Confidence Index has fallen to 11.9, almost 10 points below last quarter. The proportion of businesses less confident about the coming 12 months has risen from nearly one in five (19%) to nearly one in four (24%) between Q3 and Q4.

The Confidence Index fell significantly during the economic downturn, and then rose sharply in Q3 2009, signalling the end of the recession. Between Q4 2009 and Q3 2010 the Confidence Index reached

**FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES**



**FIG. 3 FORECAST OF QUARTERLY GDP GROWTH BASED ON ICAEW CONFIDENCE INDEX**



The latest BCM Confidence Index points to continued expansion in Q4 2010, although at a slower rate than in Q3 2010. Preliminary estimates from the Office for National Statistics (ONS) showed the economy growing at 0.8% quarter on quarter in Q3 2010. This was twice the median estimate among independent analysts, and suggests the economic recovery to date has proved more resilient than initially feared.

### BCM INDICATES SLOWER, THOUGH STILL ROBUST, GROWTH IN Q4

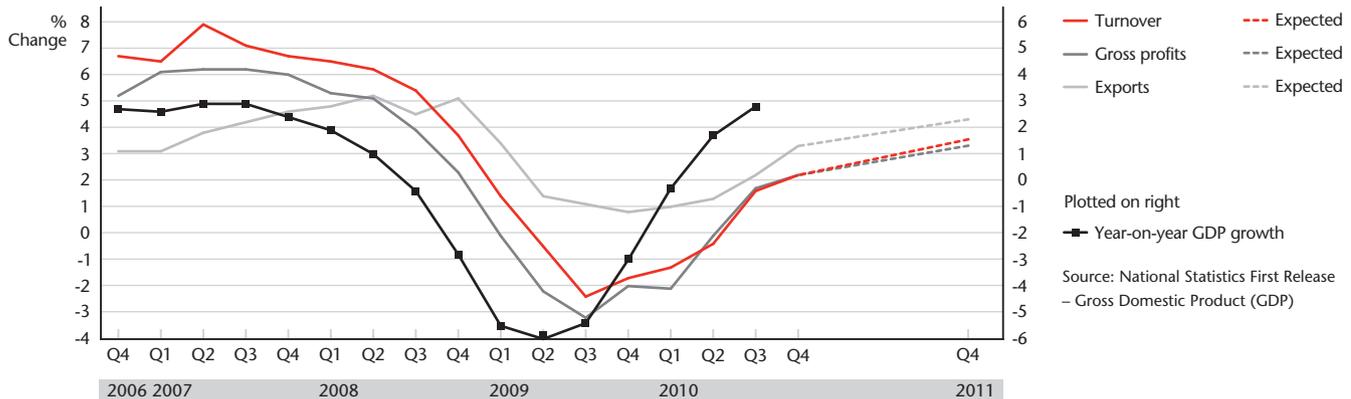
The ONS published its first estimate of Gross Domestic Product (GDP) for Q3 2010 in October, showing quarter-on-quarter economic growth of 0.8% – higher than had been expected. This is the second quarter in which independent analysts have been overly pessimistic about the strength of the recovery. Moreover, growth was fairly broad-based, with services, construction and production industries all expanding. Growth was particularly strong in the Construction sector, which expanded by 4% quarter on quarter in Q3.

The growth figures were particularly surprising as many other economic indicators suggested a notable slowdown in economic performance in the third quarter of the year – Jobseeker’s Allowance claimant numbers rose in August and September, while very weak house price growth and mortgage approval statistics have raised the prospect of a double dip in the UK housing market.

Given the ongoing weakness of these indicators, a slowdown in the fourth quarter of the year still seems very likely. The Confidence Index suggests that growth will slow in Q4 to a quarterly rate of 0.7%.

# BUSINESS FINANCIAL PERFORMANCE

FIG. 4 AVERAGE % CHANGE OVER 12 MONTHS TO...



**Business financial performance continues to improve in Q4 2010.** The latest BCM financial performance indicators show continuing improvement in businesses' financial results. Annual growth rates of business turnover, profit and export performance all rose in Q4 2010 compared to the previous quarter.

## BUSINESS PERFORMANCE IMPROVES, THOUGH FORECASTS WEAKEN

BCM findings in Q4 2010 suggest business financial performance continues to improve in the final quarter of the year, but remains notably down on pre-recession norms. Annual average turnover growth rose from 1.6% to 2.2% between Q3 and Q4, while gross profit growth rose from 1.7% to 2.2%. Annual export growth also improved to 3.3% from 2.2%. This will strengthen hopes for those banking on an export-led recovery emerging next year.

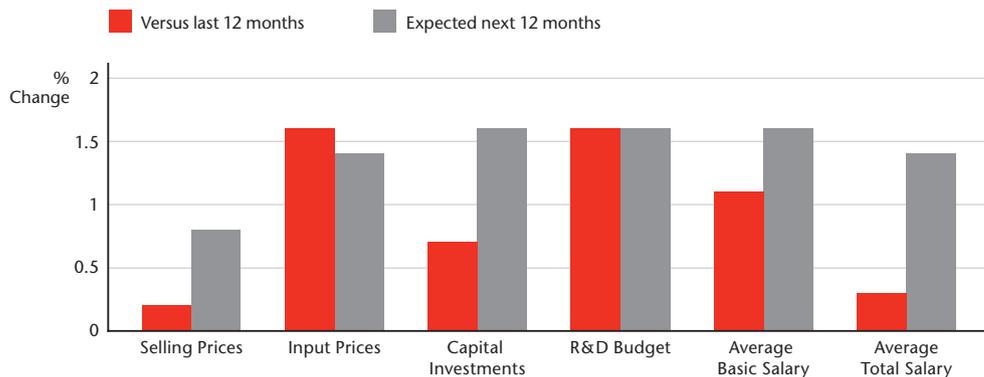
Expectations for future growth have softened notably this quarter. Forecast turnover growth over the next 12 months has declined from 4.9% in Q3 2010 to 3.5% in Q4 2010,

while expected gross profit growth has fallen from 4.4% to 3.3%. The softening in expectations is likely to reflect a downward shift in growth projections for next year as government spending and benefits cuts start to bite.

Annual capital investment growth also returned to positive territory for the first time since Q1 2009, with businesses reporting capital investment 0.7% higher than 12 months ago. However, this rate of growth is weaker than typical pre-recession levels, and expected growth in capital investment for the coming 12 months also weakened to 1.6% this quarter from 2.0% in Q3.

IMPROVEMENT IN BUSINESS FINANCIAL RESULTS CONTINUES • EXPECTATIONS FOR FUTURE GROWTH SOFTEN

**FIG. 5 Q4 2010 – AVERAGE % CHANGE IN...**



**Salary growth is expected to rise, although it remains well down on pre-recession norms.**

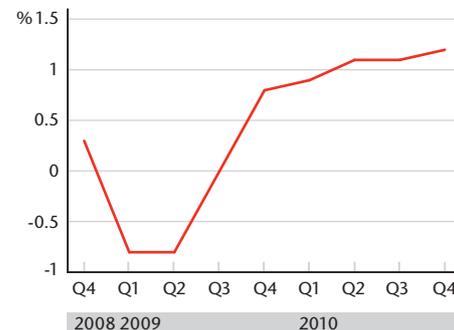
This quarter, annual basic and total salary growth both rose to their highest levels since Q2 2009, to stand at 1.1% and 0.3% respectively. Expected salary growth for the coming year remains well below pre-recession levels – average total salaries are expected to rise by 1.4%, compared to a pre-recession norm of about 3.0%.

### RISING INPUT PRICES COULD SQUEEZE BUSINESS MARGINS

In Q4 2010 firms report an average annual increase in input prices of 1.6%, the highest since Q2 2009 and up from the 1.0% increase reported in Q3 2010.

This rise in input price growth fits with recent trends in the prices of various commodities. Cotton futures traded at a 15-year high recently, while wheat futures remain elevated after drought in Russia led to a poor harvest earlier in the year. Despite rising input prices, pressure on consumer prices seems limited.

**FIG. 6 EXPECTED AVERAGE % CHANGE IN EMPLOYEE NUMBERS**

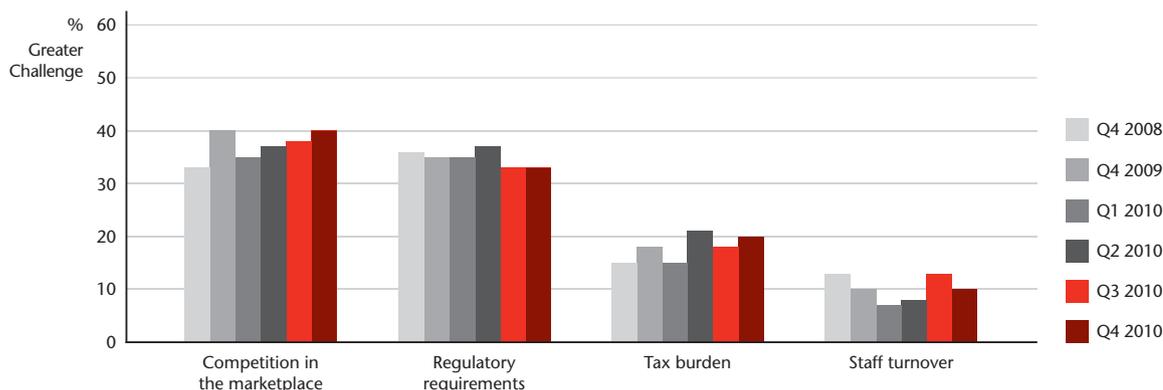


Firms are only expecting to raise their selling prices by 0.8% over the next 12 months, which would suggest a squeeze on margins next year.

Businesses report that their number of employees has fallen by an average of 0.4% in the 12 months to Q4 2010. However, employment is forecast to grow over the next 12 months, with firms expecting to hire 1.2% more employees on average. While encouraging, this forecast for employment growth remains weaker than before the recession when average growth of about 1.8% was typically expected.

# FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

FIG. 7 IMPACT ON ORGANISATION'S PERFORMANCE – CHANGE VERSUS 12 MONTHS AGO (UK AVERAGE)



An increasing proportion of businesses report competition in the marketplace as a greater challenge to organisational performance. Two fifths (40%) report that competition in the marketplace in Q4 2010 is a greater challenge than 12 months ago, up from 35% at the start of the year. This suggests market conditions remain tight for many firms.

## GOVERNMENT MUST CREATE ENVIRONMENT FOR GROWTH

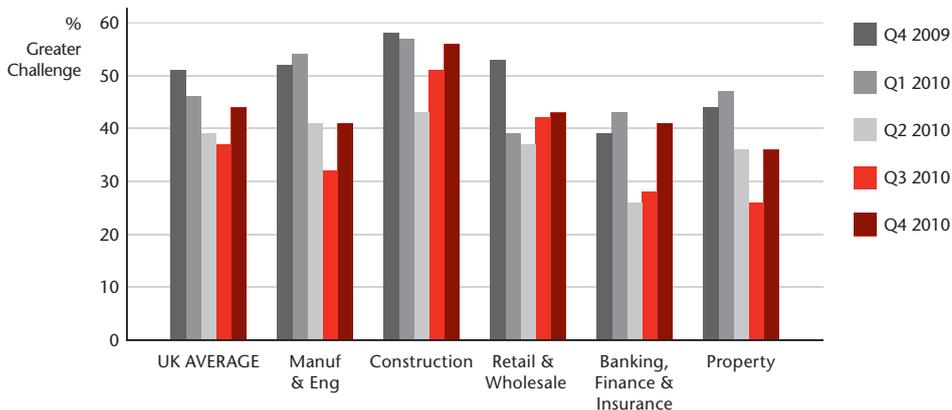
BCM has found a fairly consistent level of concern about regulatory requirements over the past two years, with a third of firms in each quarterly survey reporting the challenge posed by regulation as worse year on year. In Q4 2010, only 1% of businesses report regulatory requirements to be less of a challenge to their performance than 12 months ago, while 33% of businesses report them to be more of a challenge.

Further, only 3% of businesses report the tax burden to be less of a challenge, while 20% report it to be a greater challenge than 12 months ago.

This suggests the coalition government has its work cut out convincing firms that the UK is 'open for business' and that the regulatory burden placed upon them will ease.

On the positive side, the loose labour market at present means relatively few firms report staff turnover as a greater challenge to performance than 12 months ago.

**FIG. 8 CUSTOMER DEMAND – CHANGE VERSUS 12 MONTHS AGO**



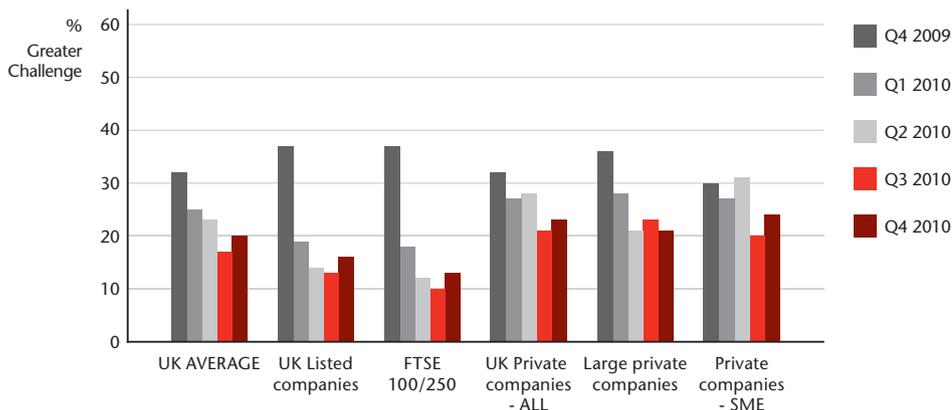
**CUSTOMER DEMAND BECOMES A GREATER CHALLENGE**

This quarter over two fifths of businesses (44%) report customer demand as a greater challenge than 12 months ago, up from 37% in Q3 2010. The proportion in the Banking, Finance & Insurance sector reporting this trend rose notably from 28% to 41%. This reflects the findings of the Bank of England's October *Trends in Lending* report, which found that demand for credit from businesses and individuals remained subdued.

Other sectors where customer demand seems a greater cause for concern this quarter than previously are Manufacturing & Engineering and Property, while in Construction, a similar trend which began in the spring continues.

As in Q3 2010, this quarter private companies are more likely than listed companies to report access to capital as a greater challenge to business performance than 12 months ago. Private companies are more reliant on bank finance as a means of raising capital, while listed companies have the option to issue equities and bonds. Tight bank credit conditions at present are therefore likely to be making access to capital more difficult for non-listed businesses.

**FIG. 9 ACCESS TO CAPITAL – CHANGE VERSUS 12 MONTHS AGO**

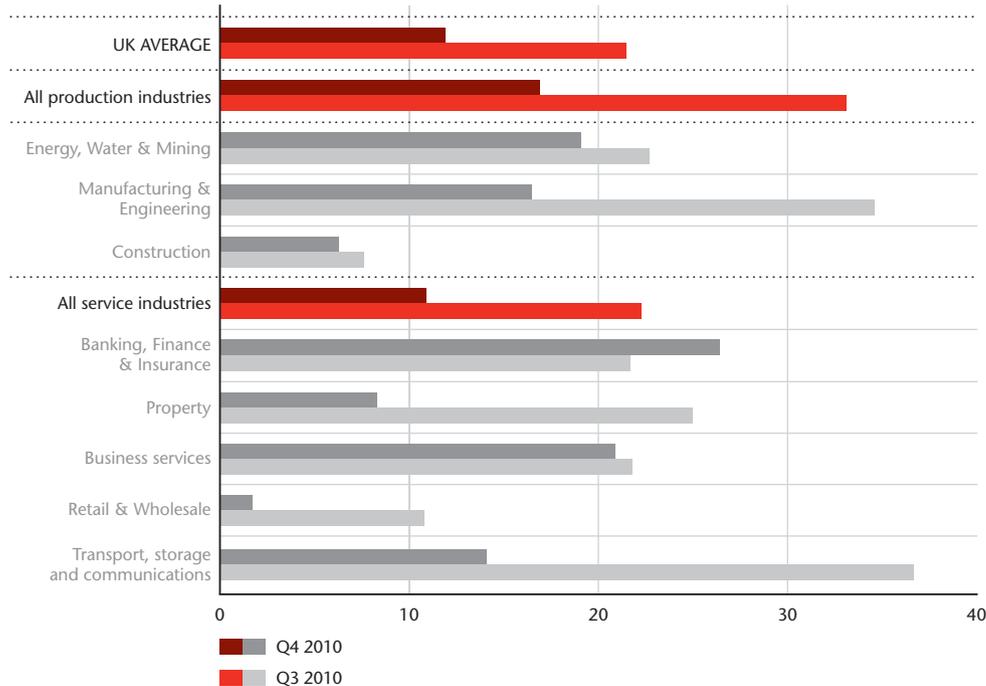


**CUSTOMER DEMAND A CONCERN FOR MANY • FUNDING GREATER CONCERN FOR PRIVATE THAN LISTED FIRMS**

# TRENDS IN BUSINESS CONFIDENCE

## INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



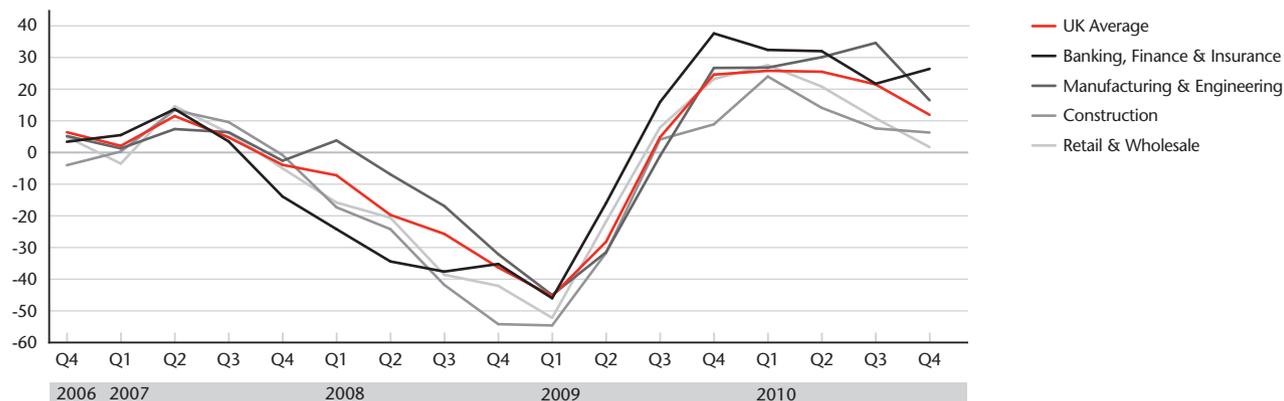
While confidence has fallen sharply across most sectors, it has held up in Business Services and improved in Banking, Finance & Insurance. The Confidence Index fell sharply across most industry sectors in Q4 2010. Confidence has risen in the Banking, Finance & Insurance sector, from 21.7 to 26.4, making it the highest-ranking sector this quarter.

### CONFIDENCE FALLS IN MOST SECTORS

The Confidence Index fell sharply in most industry sectors this quarter. Confidence in production industries (16.9) continues to outstrip services (10.9). However, the decline in production industry confidence between Q3 and Q4 (16.2 points) was greater than in service industries (11.4 points). A large part of growth in Manufacturing & Engineering industries earlier this year can be attributed to the inventory cycle – firms worldwide restocking in the post-downturn environment. This led to a surge in economic activity for manufacturers which has now started to wane.

Within the overall service sector, confidence among Business Services firms has held up fairly well, while Retail & Wholesale confidence fell by 9.1 points to 1.7. This probably reflects concern among retailers about whether household demand will remain robust in an era of benefit cuts, relatively slow income growth and rising VAT. Similarly, Property sector confidence fell from 25.0 to 8.3, reflecting weakness in the UK housing market which continued to develop in recent months. Confidence among construction firms also remains low.

**FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY**



**The Manufacturing & Engineering sector lost a great deal of momentum in Q4 2010.** The Confidence Index for Manufacturing & Engineering has fallen sharply from a peak of 34.6 in Q3 2010 to 16.5 in Q4. Before this, the sector's Confidence Index had strengthened each quarter since Q1 2009. However, it still stands above levels seen during and before the recession, reflecting the boost to competitiveness provided by relatively weak sterling.

### RETAIL CONFIDENCE HEADS TOWARDS NEGATIVE TERRITORY

Confidence in the Retail & Wholesale sector has been in continuous decline since the beginning of 2010. If the current trend persists, confidence in the sector could reach negative territory by Q1 2011. However, retail growth may experience a boost towards the end of this year as businesses promote the run-up to Christmas as an opportunity to make purchases before VAT rises.

The latest ONS retail sales statistics suggest that households are still cautious about making big ticket purchases. Household goods store sales volumes were 2.0% down on a year ago in September of this year

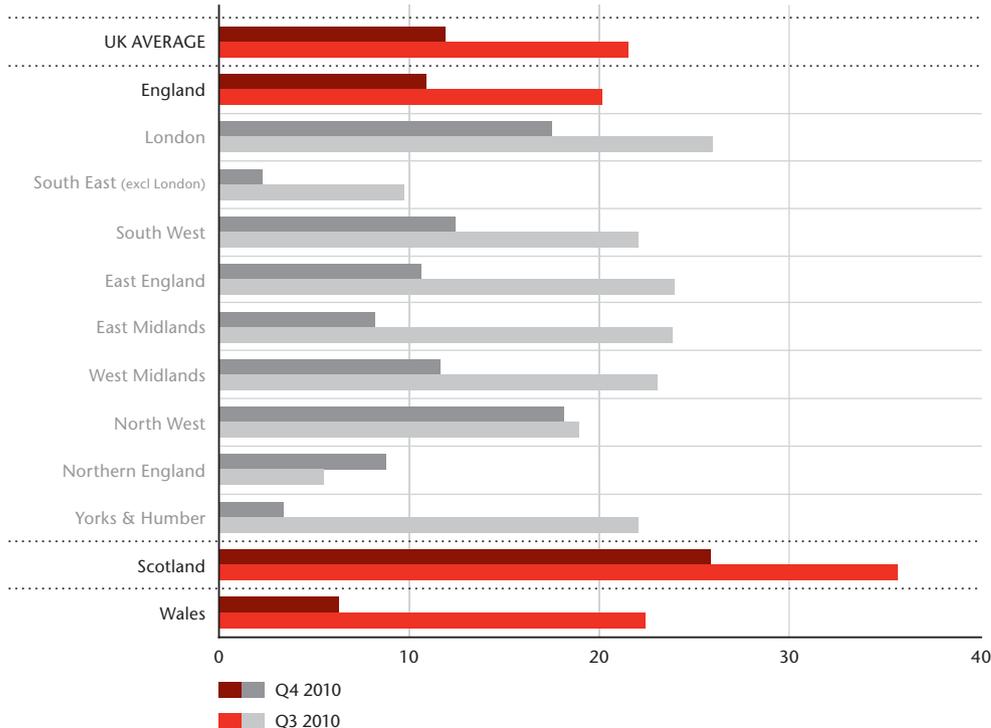
– the second consecutive quarter of contraction. Poor household goods sales are also likely to be a result of ongoing weakness in the housing market.

The Confidence Index for Banking, Finance & Insurance has risen from 21.7 in Q3 to 26.4 in Q4. This is despite continuing uncertainty about the emerging financial regulatory regime, and the Chancellor's announcement during his *Comprehensive Spending Review* speech that the government is aiming to 'extract the maximum sustainable tax revenues from financial services'.

# TRENDS IN BUSINESS CONFIDENCE

## REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



The BCM Confidence Index weakened in virtually all UK regions this quarter. Confidence fell most sharply in Yorkshire & Humberside, and continues to be particularly low in the South East compared to the rest of the UK. Confidence in London declined from 25.9 in Q3 to 17.5 in Q4, although London remains the third most confident region, behind Scotland and the North West. Confidence still remains above pre-recession norms in most regions.

### SOUTH EAST CONTINUES ON DOWNWARD PATH

Confidence in the South East continued on a downward path in Q4 2010. The index has fallen from 9.7 to 2.3, making the South East the least confident UK region. The region has also seen a greater fall in confidence year on year than any other, having declined by 21.7 points since Q4 2009.

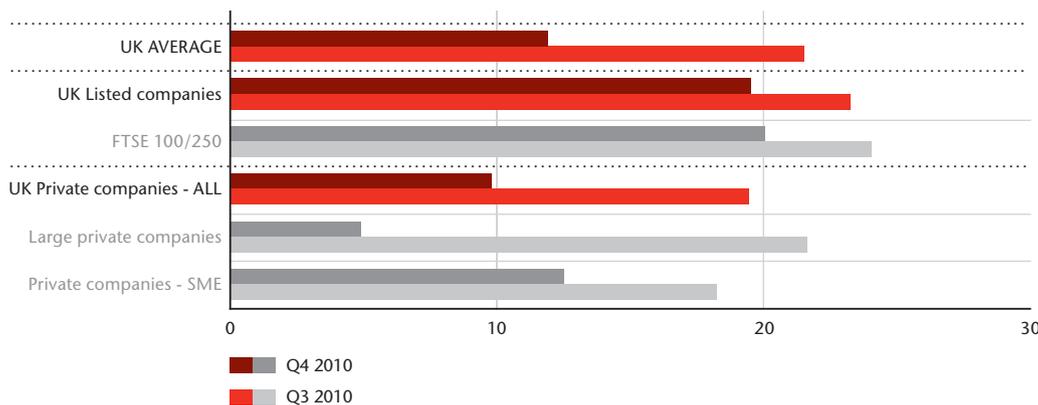
Confidence in Yorkshire & Humberside has declined substantially this quarter, and in Northern England also remains below the UK average.

This quarter, confidence in Scotland is notably down on the 35.6 recorded in Q3. However, at 25.8 the Confidence Index for Scotland remains stronger than for the rest of the UK, and Q4 2010 is the third consecutive quarter that confidence in Scotland has been above every region of England and Wales. Scottish GDP statistics released in October showed the Scottish economy grew by 1.3% between Q1 2010 and Q2 2010, a slightly higher rate of growth than the 1.2% seen for the UK as a whole. The recession was also shorter and shallower for Scotland compared to the UK as a whole.

# TRENDS IN BUSINESS CONFIDENCE

## TYPE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



**Confidence has proved more resilient among listed companies, which tend to be more internationally focussed.** While the Confidence Index has fallen by almost ten points to 9.8 for private companies between Q3 and Q4, it declined by only about four points for listed companies. Confidence is strongest among the top FTSE companies, at 20.0.

### CONFIDENCE DECLINES FOR LARGE PRIVATE COMPANIES

While the Confidence Index has weakened marginally for SMEs and held up fairly well for listed companies, among large private companies it has fallen significantly, from 21.6 to 4.9. The decline in confidence among large private companies is perhaps attributable to their greater exposure to the public sector than SMEs, with large firms more likely to hold public sector contracts. Larger firms therefore face an additional risk to expansion as contracts are withdrawn over the next few years.

The higher confidence among listed firms could in part be a result of private firms' reliance on bank finance, access to which remains historically tight according to the Bank of England's October *Trends in Lending* report. The largest listed companies are also likely to be operating internationally; hence their fortunes are more closely tied to global rather than UK economic trends, so they are likely to be less affected by weak domestic demand in the UK.

# ABOUT BCM

BCM is one of the largest and most comprehensive quarterly reviews of UK business confidence and provides a regular snapshot of the economy, informed by senior business professionals running all types of businesses across the UK. It is shared with a range of national and regional policy-makers, the business community, academics and researchers. It is a credible predictor of GDP and economic change and supports policy decision-making.

The report is based on 1000 telephone interviews conducted 28 July–21 October 2010, with ICAEW members working in industry and commerce. These probed opinions on past performance and future prospects for members' businesses, as well as investigating perceived changes in impact of factors such as availability of skills, government regulation and the tax regime. Data are weighted to represent the UK economy by value.

## BUSINESS CONFIDENCE INDEX METHODOLOGY

The Business Confidence Index is calculated from the responses to the following:

**'Overall, how would you describe your confidence in the economic prospects facing your business over the next 12 months, compared to the previous 12 months?'**

A score was applied to each response as shown to the right, and an average score calculated.

Using this method, a Confidence Index of +100 would indicate that all survey respondents were much more confident about future prospects, while -100 would indicate that all survey respondents were much less confident about future prospects. Further technical details on the design of the survey are available upon request.

Variable	Score
Much more confident	+100
Slightly more confident	+50
As confident	0
Slightly less confident	-50
Much less confident	-100

# ACKNOWLEDGMENTS

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## Kudos Research

Interviewing and data analysis was undertaken by Kudos Research.

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