



# ICAEW BUSINESS OPINION

## IMPACT OF PUBLIC SECTOR CUTS ON BUSINESSES IN THE PRIVATE SECTOR

March 2011 Research Report

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# FOREWORD

The increase in the fiscal deficit of advanced economies as a result of the economic crisis was caused by a combination of increased government spending and reduced tax revenue. Many governments are now dealing with this legacy of the crisis by taking strong measures to reduce public spending.

In the UK this has been a priority for the coalition government. The Emergency Budget and Comprehensive Spending Review in 2010 saw action taken to reduce expenditure in central and local government. The impact of these cuts is now beginning to be felt as public sector jobs are starting to be cut. Schemes previously central to government policy, such as Building Schools for the Future, have been scrapped.

The effect of such cuts on the private sector has been less immediate and apparent. Seen as the key to UK economic growth, there is an expectation that business will be able to 'pick up the pieces'. This includes hiring those who have been made redundant in the public sector as well as providing the impetus that the economy requires to ensure that the UK's economy returns to growth.

What has been forgotten though is the extent to which the private sector is a supplier to the public sector. Whether it is services, materials or equipment, firms of all sizes and from all sectors have had work either directly or indirectly from government organisations, national as well as local. These relationships are either under threat or have already been terminated.

ICAEW Chartered Accountants who work within businesses supplying the public sector are ideally placed to anticipate the challenges this creates and strategies for addressing them. At a time when competitive and inflationary pressures are also mounting, the expectations for UK plc have never been higher.



Michael D M Izza  
Chief Executive  
ICAEW

# INTRODUCTION

Between 25 October 2010 and 26 January 2011, we interviewed 1,000 ICAEW Chartered Accountants who work in industry and commerce (ie, outside accountancy practice). We asked them about the impact of recent public sector cuts on their business turnover, and possible effects of these cuts in the future.

We also asked members about the measures they have undertaken to mitigate the negative effects of the cuts as well as the ones they are likely to implement in the future if their turnover reduces. With a strong private sector viewed as an essential driver of the UK's economic recovery, the survey also investigated the extent to which businesses are confident they can lead the way to future growth.

The report highlights that very few firms expect the cuts to have any positive effect on their revenue. One fifth of businesses have already experienced a reduction in their turnover while twice as many expect to be adversely affected in the next 12 months. While new revenue streams have been employed to counter the negative effects of the cuts, cost-cutting measures have also included reductions in staff numbers. Similar measures are likely to be undertaken in the future which could dampen the pace of growth in the next couple of years. Facing an uncertain economic outlook, it is unsurprising that businesses are cautious about the ability of the private sector to lead the UK economic recovery in 2011.

The individuals interviewed came from micro, small, medium and large companies across all regions of the UK and industry sectors. You can find information about the profile of the organisations covered in this research in the technical details section on page 8.

ICAEW works in the public interest to promote enterprise, innovation and sustainable growth in a socially responsible business environment. Our strength and knowledge is drawn from the expertise of over 136,000 members worldwide, who hold world-class finance qualifications. Their experience gives us a detailed understanding of the dynamics that drive our economy.

# FINDINGS

Recent public sector cuts have had a detrimental effect on one fifth of firms.

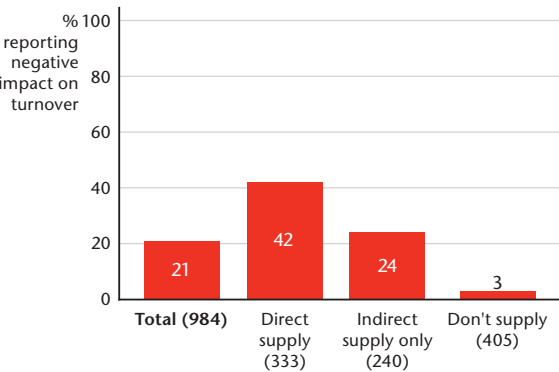
The public sector remains an important source of revenue for many private sector firms, with a third of businesses (34%) reporting that they supply the sector **directly** with goods and/or services. An additional quarter of firms (24%) supply only **indirectly**, as their customers provide the sector with goods/services.

The public sector cuts have adversely affected the revenue of around one fifth of businesses over the last 12 months (Fig 1).

- While the negative effects of the cuts are felt most by those **directly** supplying the public sector, a quarter of **indirect** suppliers also report that the cuts are negatively affecting their revenue. This suggests that firms are experiencing the knock-on effect of the cuts from their customers who supply the sector.

**Fig 1. Negative impact of public sector cuts on business turnover in the last 12 months – by type of supply**

In the last 12 months, have public sector cuts had any impact on your organisation's turnover? Overall, has the net impact on your turnover been positive or negative?



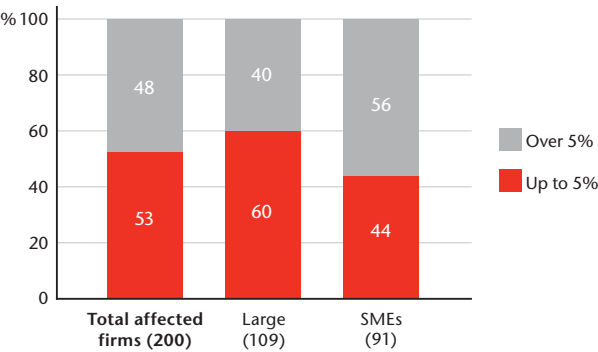
Half of affected businesses report a turnover reduction of over 5%. SMEs are more likely to have seen a larger decrease in their turnover.

Among the firms that have been negatively affected by the cuts, half report a decrease in turnover of over 5%.

- SMEs affected by the cuts are more likely to have experienced more than 5% decrease in their turnover, compared to those Large firms that have also been affected (Fig 2). This suggests that SMEs may not have the same capacity to absorb the effects of these cuts as quickly as Large firms.

**Fig 2. Percentage decreases in business turnover – by size of business**

Approximately by how much has your organisation's turnover decreased as a result of public sector cuts?



Base: Those whose turnover has decreased in the last 12 months

Firms adversely affected by the public sector cuts respond with a range of measures.

Firms affected by the cuts are employing a range of actions to mitigate the negative effects of these cuts on their turnover (Fig 3).

- The majority of affected firms have sought to expand their customer base outside the public sector, suggesting further competition within the private sector.
- 45% of affected firms have renegotiated contracts with their suppliers – indicating how public sector cuts can indirectly affect the turnover of a third party and/or a supply chain.
- Nearly half of affected firms have reduced the number of permanent staff in order to keep their costs down – this equates to one tenth (10%) of all businesses surveyed.

Fig 3. Business responses to decreased turnover

Which measures, if any, did your organisation undertake in response to this reduction in turnover?



Base: Those whose turnover has decreased in the last 12 months (209)

The extent to which businesses have been able to reduce their headcount and/or renegotiate supply contracts in the past year has largely depended on the size of the business (Fig 4).

Fig 4. Business responses to decreased turnover – by size of business

Which measures, if any, did your organisation undertake in response to this reduction in turnover?

	Large (118)	SME (91)
Sought new customers outside of the public sector	79%	76%
Reduced number of permanent staff	55%	37%
Renegotiated supply contracts	53%	35%
Reduced number of contract/temporary staff	40%	32%
Diversified public sector offer	36%	30%
Reduced prices	31%	31%
Increased/starting outsourcing	17%	16%

Base: Those whose turnover has decreased in the last 12 months

More businesses anticipate to be negatively affected by the public sector cuts within the next 12 months, as the impact of the cuts spreads through the economy. Few see opportunities resulting from the cuts.

45% of firms expect public sector cuts to have a detrimental effect on their turnover in the next 12 months. This is a substantial increase compared to a number of firms affected in the last 12 months (Fig 5).

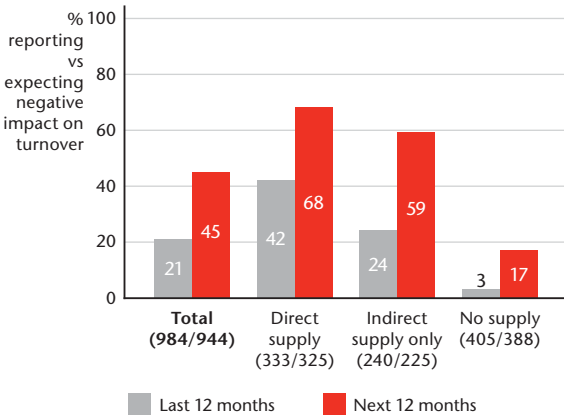
This increase is driven by the businesses that supply the public sector only **indirectly** (via their customers) or not at all, as the effect of the cuts spreads more widely through the economy. Nearly 6 in 10 of indirect suppliers and almost one fifth of firms that do not supply the sector (either directly or indirectly) expect to feel the negative effect of the cuts in next 12 months.

Conditions for many companies which have already experienced a reduction in revenue are likely to remain tough: the vast majority (84%) predict their revenue will be negatively affected in the next 12 months as well.

Despite the suggestions that reduced public sector expenditure could lead to new opportunities for the private sector, only 3% of firms believe the cuts may lead to revenue growth in the next 12 months.

**Fig 5. Expected negative impact of public sector cuts on business turnover in the next 12 months – by type of supply**

In the next 12 months, do you anticipate that public sector cuts will have any impact on your organisation's turnover? Overall, do you anticipate this net impact on your turnover to be positive or negative?



Firms will be likely to undertake similar measures again (as they did in the last 12 months), in response to the possible reduction in their turnover. Some of these measures, if employed, could affect the pace of growth in the next couple of years.

- Two fifths (41%) of businesses anticipating to be adversely affected by the cuts will be likely to reduce their permanent headcount, if they experience a reduction in turnover. This equates to one in five (18%) of all businesses surveyed.

**Businesses are cautious about the ability of the private sector to lead a recovery in 2011.**

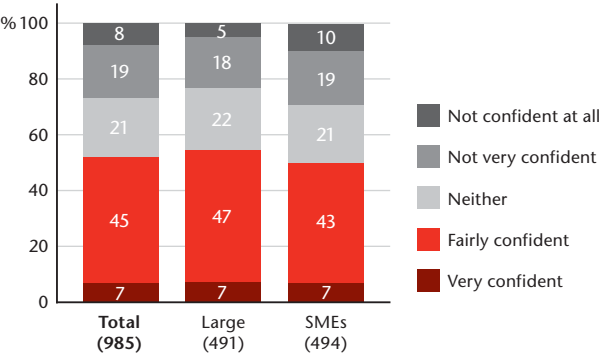
Over half (52%) of businesses are ‘very or fairly confident’ that firms like theirs in the private sector can lead the UK economic recovery in 2011, with only 7% being ‘very confident’ (Fig 6).

Given the present economic climate and further public sector cuts expected, it is unsurprising that businesses don’t feel very confident that firms similar to them can lead the country’s economic recovery.

SMEs (in particular Medium and Micro businesses) are significantly less confident than the Large firms that organisation like theirs can lead the way to future growth.

**Fig 6. Level of confidence in the private sector leading the UK economic recovery in 2011 – by size of business**

How confident are you that organisations like yours in the private sector can lead the UK economic recovery in 2011?



Where businesses are more optimistic about the future, their confidence is often based on their strength and resilience in the economic climate, the limited impact they expect public sector cuts to have on them, or on their expectations that their future growth will come from exports:

- “ We are a relatively small company and we can grow proportionately well.
- “ The measures we have taken across the last 12 months to make the company leaner will turn out to be a good platform from which to improve the business on in the coming 12 months.
- “ Due to the demand that we have seen in Europe in the last two to three months we are more positive.

Those less confident cite a number of issues that include direct or indirect references to public spending cuts:

- “ As the government are reducing their spending on transport it is having a knock on effect on our business.
- “ Because the public sector is such a large part of our business and at the moment there is no sign that the private sector is creating new construction projects.
- “ Demand will go down and small businesses can not pick up those that were made unemployed.

### **Businesses in the Construction sector are particularly exposed to the public sector cuts.**

Across different sectors, businesses in the Construction sector are most adversely affected by the public sector cuts, with nearly half of firms experiencing a reduction in their revenue in the past 12 months (see appendix for details). Furthermore, businesses in this sector also predict that their turnover will be negatively impacted in the next 12 months – significantly more than any other sector.

The cuts are also having a negative effect on around a third of businesses in the Business Services, IT and Other Services sectors.

Looking ahead, businesses in the Banking, Finance and Insurance, Manufacturing, and Primary sectors expect to be less affected by the cuts in the next 12 months than other sectors.

# APPENDIX

## KEY FINDINGS BY SECTOR

	Manufacturing & Engineering N=156 %	Construction N=67 %	Retail & Wholesale N=135 %	Transport & Storage N=70 %	Banking, Finance, Insurance N=111 %	Property N=100 %	Business Services N=89 %	Primary N=71 %	IT N=57 %	Other Services N=63 %
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In the last 12 months, have public sector cuts had any impact on your organisation's turnover?  
Overall, has the net impact on your turnover been positive or negative?

Negative	17	48	17	13	12	22	29	4	32	27
No impact	83	51	82	84	86	78	71	96	68	70

	Manufacturing & Engineering N=149 %	Construction N=66 %	Retail & Wholesale N=130 %	Transport & Storage N=67 %	Banking, Finance, Insurance N=105 %	Property N=94 %	Business Services N=87 %	Primary N=69 %	IT N=55 %	Other Services N=62 %
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In the next 12 months, do you anticipate that public sector cuts will have any impact on your organisation's turnover?  
Overall, do you anticipate this net impact on your turnover to be positive or negative?

Negative	36	70	52	48	32	49	53	20	44	52
No effect	62	26	48	51	65	49	39	80	49	40

	Manufacturing & Engineering N=155 %	Construction N=66 %	Retail & Wholesale N=138 %	Transport & Storage N=72 %	Banking, Finance, Insurance N=111 %	Property N=100 %	Business Services N=88 %	Primary N=70 %	IT N=57 %	Other Services N=62 %
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How confident are you that organisations like yours in the private sector can lead the UK economic recovery in 2011?

Very/Fairly confident	57	35	49	50	66	45	42	57	60	56
Not very/Not at all confident	25	48	25	31	14	33	30	19	19	24

## KEY FINDINGS BY SIZE OF BUSINESS

	Large N=485 %	SMEs N=499 %
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In the last 12 months, have public sector cuts had any impact on your organisation's turnover?  
Overall, has the net impact on your turnover been positive or negative?

Negative	25	18
No impact	74	81

	Large N=465 %	SMEs N=479 %
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In the next 12 months, do you anticipate that public sector cuts will have any impact on your organisation's turnover?  
Overall, do you anticipate this net impact on your turnover to be positive or negative?

Negative	51	39
No effect	45	58

# TECHNICAL DETAILS AND ACKNOWLEDGEMENTS

Between 25 October 2010 and 26 January 2011, we interviewed 1,000 ICAEW Chartered Accountants who work in industry and commerce (ie, outside accountancy practice).

The interviews were conducted by telephone as part of the *ICAEW/Grant Thornton UK Business Confidence Monitor*.

Those interviewed are from Micro, Small & Medium, and Large organisations, located across the UK and based in a broad range of industry sectors. One half of those surveyed (502) are from Micro, Small and Medium-sized enterprises (up to 249 employees); the other half (498) represent companies of 250 or more employees.

When reading the results, bear in mind that the sample of Micro, Small and Medium businesses, compared to Large ones, is not in line with the incidence of sizes of these businesses in the UK as a whole.

The figures in this report are based on those answering each question (they exclude the 'Don't know' responses). The actual base of those being able to answer a question is shown in each case.

The table on the following page describes the profile of the organisations contacted in this survey.

## ACKNOWLEDGMENTS

Interviewing was undertaken by Kudos Research.

Kudos Research specialises in premium quality, custom-tailored UK and international data collection, as well as data analysis and research advisory services. Kudos Research interviews customers, stakeholders, business leaders and opinion formers across the globe, online and by telephone, as well as recruiting them for focus groups and depth interviews.

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THE PROFILE OF THE ORGANISATIONS CONTACTED IN THE SURVEY

REGION	No of interviews	SECTOR	No of interviews
London	159	Banking, Finance, Insurance	113
South East (excl London)	140	Business Services	91
South West	80	Construction	67
East England	85	IT	57
East Midlands	70	Manufacturing and Engineering	159
West Midlands	75	Other Service	64
North West	100	Primary*	71
Northern England	70	Property	100
Yorkshire and Humberside	80	Retail and Wholesale	139
Scotland	70	Transport and Storage	73
Wales	70		
TOTAL	1,000	TOTAL	1,000

\*Primary includes agriculture and fisheries, energy, water and mining

SIZE (EMPLOYEES)	No of interviews
Micro (1 – 9)	107
Small (10 – 49)	196
Medium (50 – 249)	199
Large (250+)	498
TOTAL	1,000



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