Lloyds TSB | Commercial

Business in Britain

A Survey of Business Opinions and Trends | 38th edition July 2011

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A Survey of Business Opinions and Trends

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Introduction

Welcome to the latest edition of our bi-annual Business in Britain survey, which offers an invaluable guide to past business performance and future expectations of companies, particularly in the SME market. The latest survey has canvassed opinions of 1,812 companies covering all industry sectors and regions of the British economy.

The key message from the latest results is that the economic recovery is fragile, but remains intact. Sales and turnover in the first half of the year improved, especially for companies able to benefit from strong export demand. Profitability, however, remained weak despite a rise in prices charged, suggesting a further squeeze on margins resulting from higher costs, mainly from materials and energy. Employment and investment spending weakened a little in the past six months.

Looking ahead, our measure of business confidence (which takes into account expectations of sales, orders and profits in the next six months) rose slightly, but remained around levels consistent with a moderate pace of recovery. Companies remained cautious about increasing staff levels and capital spending in the current uncertain economic environment.

Sales and turnover were the strongest in the manufacturing and transport services sectors in the past half year and are expected to be the most buoyant in hospitality and leisure, manufacturing and business services in the next six months. In terms of investment spending trends for the second half of the year, healthcare and business services came top, suggesting good medium-term prospects in these sectors.

From a regional perspective, sales and turnover in the past six months were the strongest in the South East, London and the Midlands, and weakest in Scotland and the North West. Looking ahead, business confidence was the strongest in London, with Wales recording the biggest improvement.

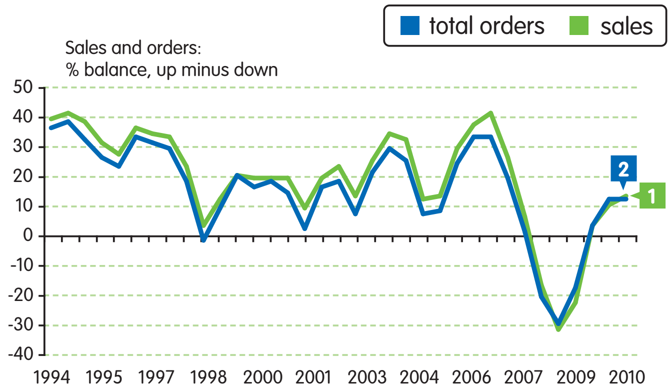
I would like to thank all those companies that have taken the time to provide us with such a comprehensive view of developments in the UK SME space and recent trends in the economy.

John Maltby
Managing Director,
Lloyds TSB Commercial

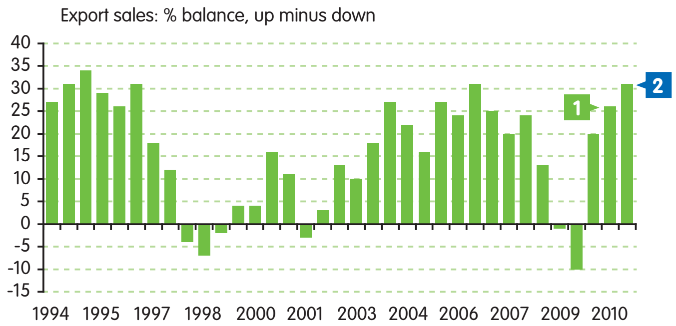
Recent trends in the SME market.

The economic recovery remains fragile, but intact.

Sales, orders and export sales balances over the last six months.



1. The net balance for sales in the past six months rose to **13%** (up from **10%**), with 42% of companies reporting stronger sales and 29% reporting weaker sales. The net balance has risen for the fourth consecutive survey, but it remains below the long-term historical average of 19%, suggesting that the economic recovery – while still intact – remains fragile.
2. The net balance for total order book levels remained unchanged at **12%**, a level consistent with only a moderate pace of recovery.



1. In the previous survey, the net balance for export sales increased to **26%**...
2. ...and there was a further improvement in the latest survey to **31%**, indicating buoyant international demand, compared with a more subdued domestic demand backdrop.

Export sales continued to outperform.

Expectations for total sales and orders in the next six months continued to improve, with the net balances at 24% and 22%, respectively. Still, these net balances remain below their respective long-term historical averages and indicate a moderate pace of growth.

	2011 H2	2011 H1
Expected sales: up	43%	40%
Expected sales: down	19%	22%
Balance	**24%**	**18%**

	2011 H2	2011 H1
Expected orders: up	36%	35%
Expected orders: down	14%	17%
Balance	**22%**	**18%**

Expectations for export sales in the next six months increased for the fifth consecutive survey, with the net balance rising to 38%, the strongest level since 2004. Forty-six percent of companies expected exports to rise, while 8% expected them to fall.

	2011 H2	2011 H1
Expected exports: up	46%	42%
Expected exports: down	8%	8%
Balance	**38%**	**34%**

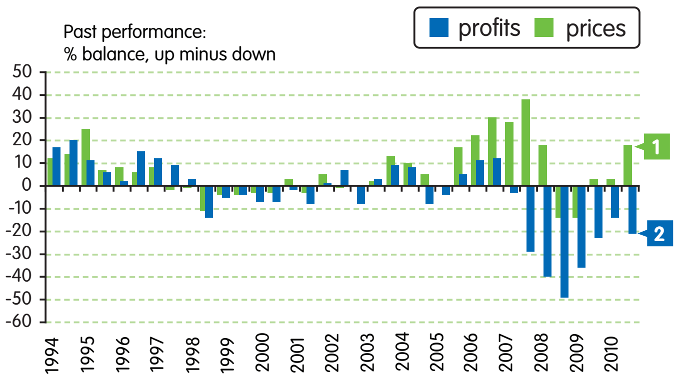
	2011 H2	2011 H1
Expected imports: up	38%	37%
Expected imports: down	8%	9%
Balance	**30%**	**28%**

Domestic demand remained weak.

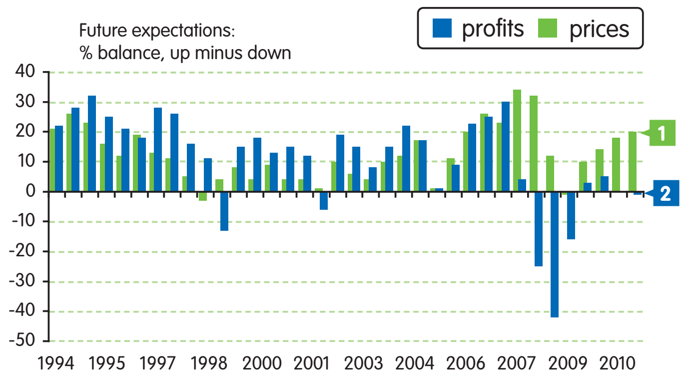
Total sales improved in the past six months and are anticipated to rise further in the next six months, boosted by the strongest anticipated export sales since 2004. The strength of international demand, however, belies a much more subdued outlook for companies more reliant on domestic spending. Indeed, our survey shows that weak UK demand was cited by more than half (56%) of companies as the greatest threat to their business, a much higher proportion than costs and availability of finance (23%) and regulation (19%).

Profitability stayed weak.

Prices and profits: past performance and future expectations.



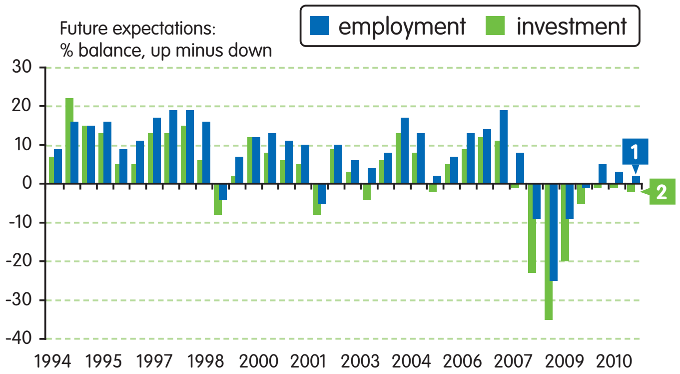
1. The net balance for prices charged in the past six months rose to **18%** from **3%**, the strongest level for three years and in line with expectations in the last survey.
2. Despite higher prices charged, the net balance for profits in the past six months was weaker than anticipated in the last survey and fell to **–21%** from **–14%**, suggesting that higher costs have squeezed margins.



1. In the next six months, prices charged are expected to remain elevated with the net balance at **20%**.
2. Profits in the next six months, however, are expected to remain below the long-term historical average, with the net balance at **–1%**, suggesting that higher costs will continue to weigh on profitability.

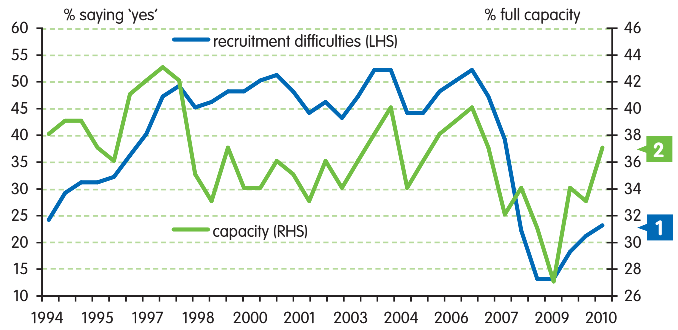
Hiring and capital spending intentions remained subdued.

Investment, employment and capacity trends.



1 The net balance for expected employment in the next six months fell slightly to **2%** from **3%**, with 17% of companies expecting to increase staff levels and 15% expecting to reduce them. The majority of companies expected to maintain the same staff levels.

2 The net balance for investment spending in the next six months remained subdued, falling to **–2%** from **–1%**, with only 19% of companies expecting an increase.



1 The percentage of companies reporting difficulties in recruiting skilled labour rose for the third consecutive survey to **23%**, but it remains below the historical average, suggesting that unit wage costs should remain relatively subdued.

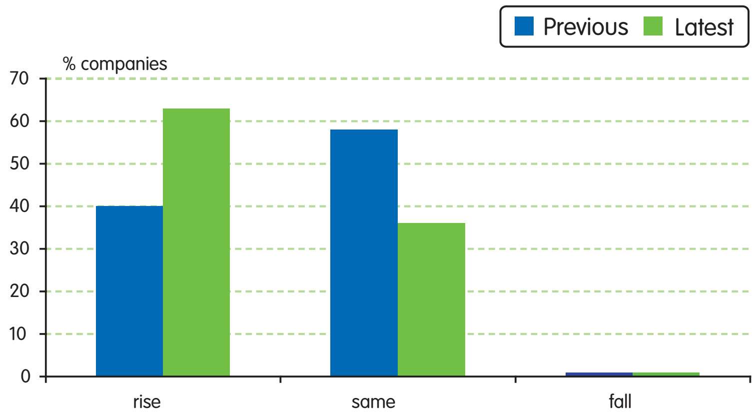
2 The proportion of companies working at full capacity increased to **37%**, the strongest level since 2007. Despite that, investment trends remained weak.

Higher costs weigh on profitability.

Despite higher prices charged, profitability is expected to remain weak, suggesting that higher costs will continue to erode margins. Difficulties in recruitment of skilled labour rose slightly, but remained low by historical standards, indicating that growth in unit wage costs is likely to remain relatively muted. Investment and employment trends remain subdued, highlighting companies' uncertainty about domestic demand prospects, with exporters tending to be more positive about prospects for capital spending and staffing than companies reliant on domestic demand.

Most companies now expect interest rates to rise in the next six months.

Interest rate expectations in the next six months.

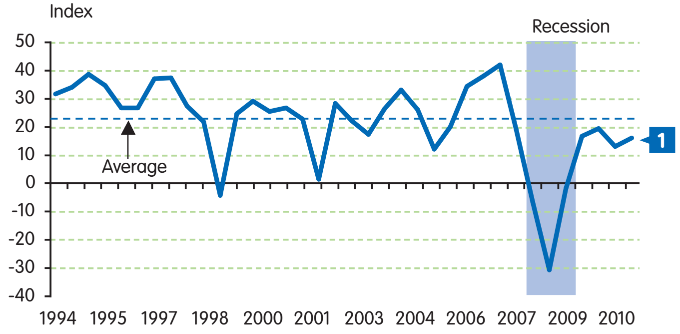


Nearly two-thirds (**63%**) of companies expect interest rates to rise in the next six months, compared with only **40%** in the last survey. This increase was mirrored by a fall to **36%** from **58%** in the proportion of companies anticipating interest rates to remain unchanged. Only **1%** of companies anticipated interest rates to fall, the same as the last survey.

Overall business confidence rose in the current survey, consistent with a moderate pace of growth in the second half of the year.

Business confidence.

Our business confidence index tracks companies' expectations for total sales, total orders and profits over the next six months.



1 Our measure of overall business confidence, which tracks total sales, orders and profits expectations in the next six months, increased to **15** from **12**. This is a level consistent with a moderate, rather than strong, pace of economic recovery.

Summary – economic recovery is on track but subdued.

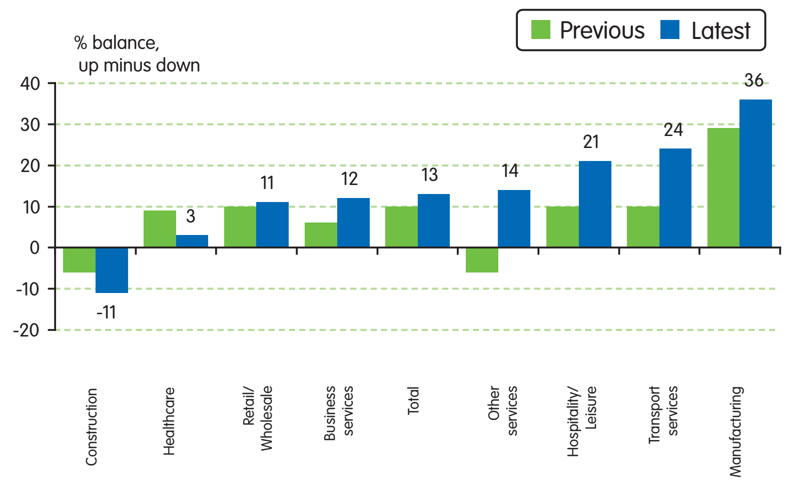
The key take out from the latest Business in Britain survey is that companies expect the economic recovery to continue in the second half of the year, but are cautious about its strength. Indeed, companies cited weak UK demand as the greatest threat to their business, while a majority now expect interest rates to rise in the next six months.

Export sales have continued to perform strongly although companies reliant on domestic demand, remained cautious about raising employment and capital spending levels. Profitability remained subdued, despite higher prices charged, implying a significant impact of higher costs on margins. Unit wage costs, however, are likely to stay weak given that difficulties in recruiting skilled labour remained at historically low levels.

The industrial picture.

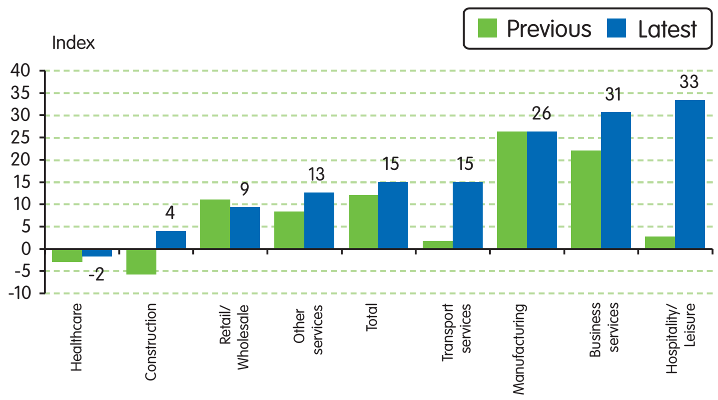
Hospitality & leisure the most positive sector...

Sales over the last six months.



Manufacturing remained the strongest performing sector in terms of sales in the past six months, followed by transport services and hospitality & leisure. The sector with the weakest sales was again construction, followed by healthcare and retail & wholesale.

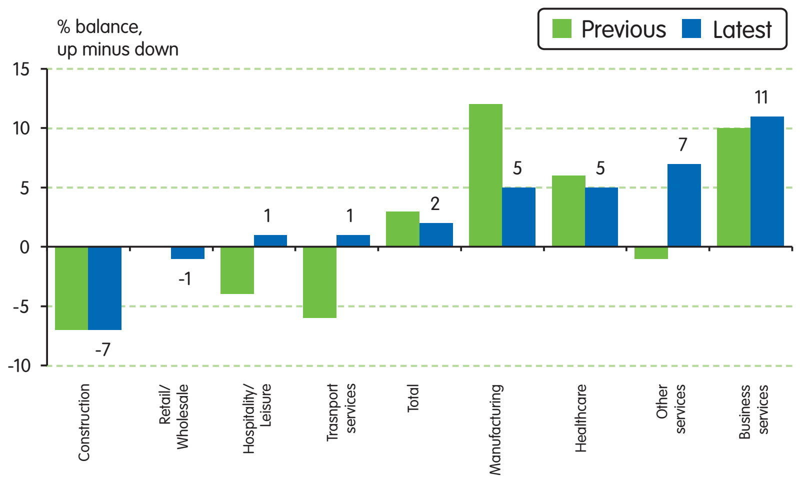
Business confidence.



Despite relatively subdued domestic demand conditions, hospitality & leisure was the strongest sector in terms of our measure of overall business confidence, which tracks total sales, orders and profits expectations in the next six months. Other sectors with a strong outlook were business services and manufacturing. In contrast, the least confident sectors were healthcare, construction and retail & wholesale.

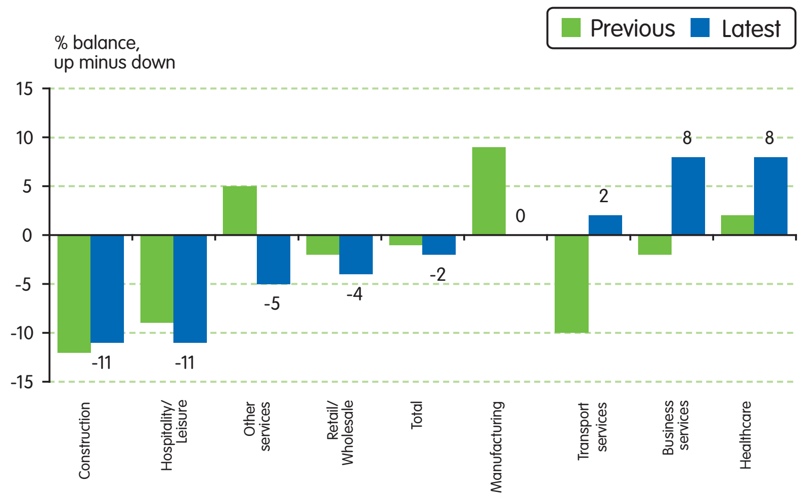
...but healthcare is the most optimistic in terms of investment trends.

Employment in the next six months.



Business services had the strongest employment outlook for the next six months, followed by other services and healthcare. Manufacturing had the strongest employment expectations in the last survey, but was less buoyant in the latest survey. The sectors least confident about employment prospects were construction, retail & wholesale and hospitality & leisure.

Capital spending in the next six months.

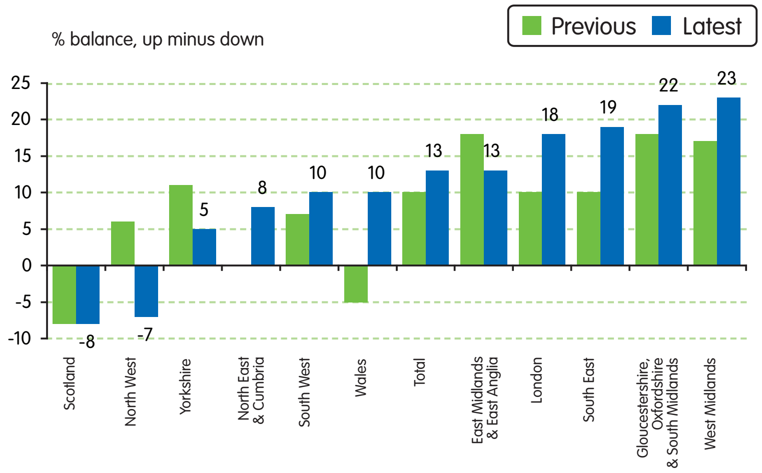


In terms of capital spending intentions in the next six months, healthcare and business services were the most positive sectors, likely reflecting favourable medium-term prospects. The transport services sector was also quite strong compared with a rather weak outlook in the last survey. The sectors least inclined to increase investment were construction and hospitality & leisure. Investment in manufacturing were the strongest in the last survey, but fell back to around the all-sector average in the latest survey.

The regional picture.

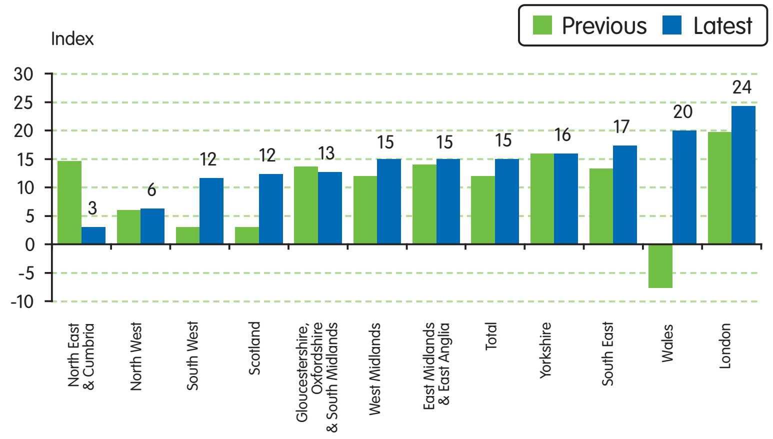
Business confidence strongest again in London, while Wales recorded the biggest improvement.

Sales over the last six months.



The net balance for sales in the past six months was the strongest in the West Midlands and South Midlands. In contrast, sales were the weakest in Scotland, the North West and Yorkshire. The North West, Yorkshire and East Midlands were the only regions where the net sales balance fell compared with the previous survey.

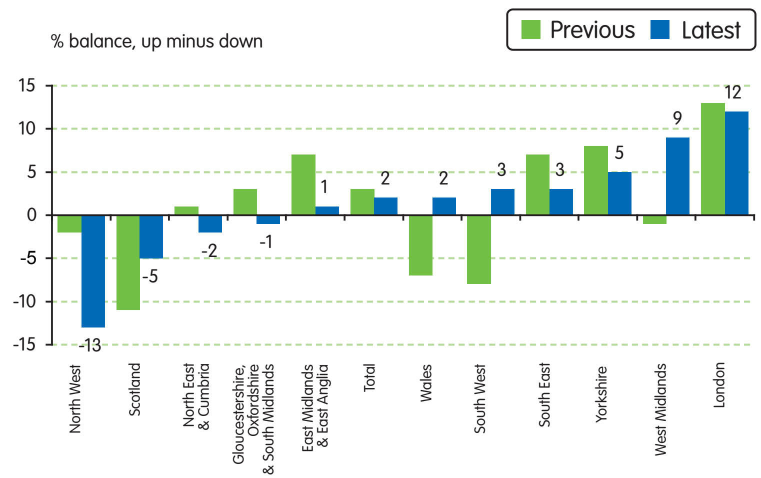
Business confidence.



London remained the strongest region in terms of our measure of overall business confidence, which tracks total sales, orders and profits expectations in the next six months. Wales saw a remarkable turnaround with the second highest business confidence level, compared with the weakest in the last survey, boosted by strong sales and orders. The regions with the weakest confidence were the North East & Cumbria and North West.

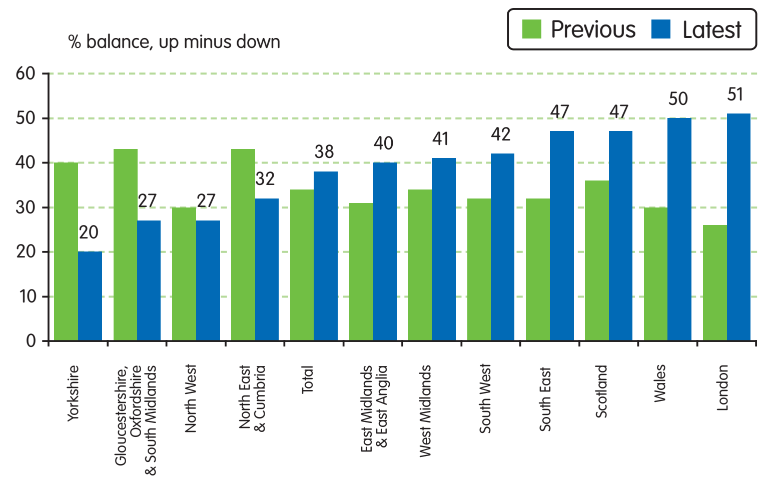
Employment and export sales in the next six months are expected to be the strongest in London.

Employment in the next six months.



The net balance for employment in the next six months was again the strongest in London, followed by the West Midlands. The South West also registered a notable improvement on the previous survey. However, employment trends in the North West and Scotland remained negative.

Export sales in the next six months.

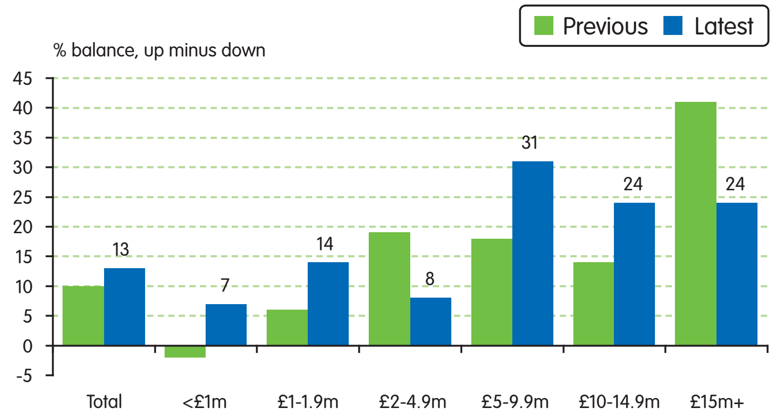


The net balance for export sales was the strongest for London and Wales, both of which saw notable improvements compared with the previous survey, followed by Scotland and the South East. Export sales balances were the weakest, but remained positive, in Yorkshire, South Midlands and the North West.

Analysis by size of firm.

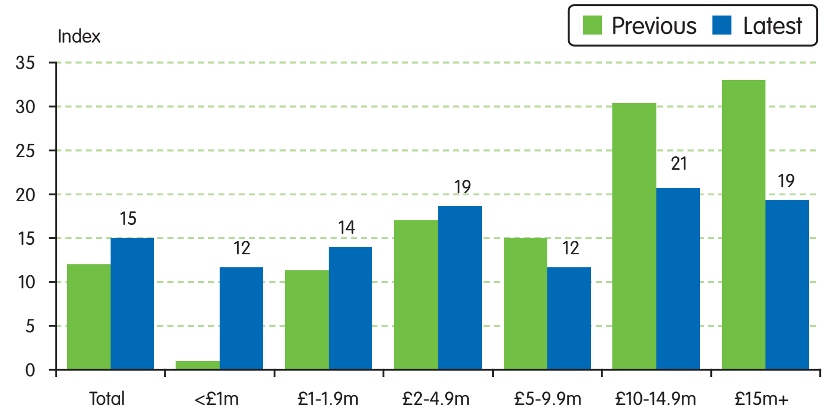
The gap between small and larger companies has narrowed.

Sales over the last six months.



There was a notable fall in the net balance for sales in the past six months for companies in the £2-4.9m and above £15m turnover categories, the latter weighed by weaker export sales. The net sales balance was strongest for companies with £5-9.9m turnover, while those with turnover below £1m and £2-4.9m recorded the weakest sales.

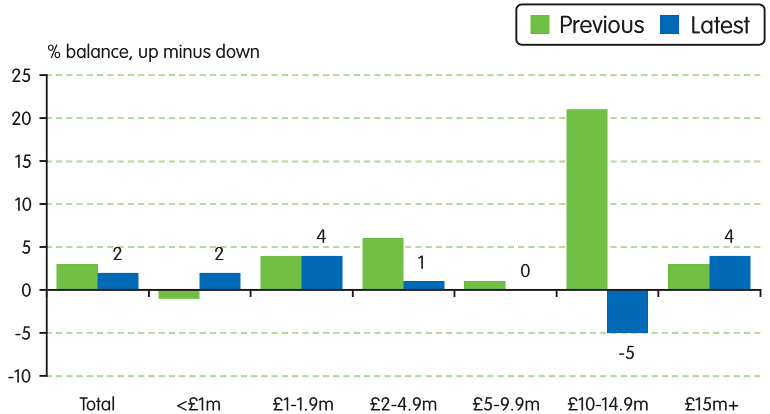
Business confidence.



There was a narrowing in the gap in business confidence between small and larger companies in the latest survey. Business confidence fell, in particular, for companies with turnover of £10-14.9m and above £15m, reflecting weaker total sales, orders and profitability expectations in the next six months. In contrast, companies with turnover below £1m recorded an 11-point rise in business confidence.

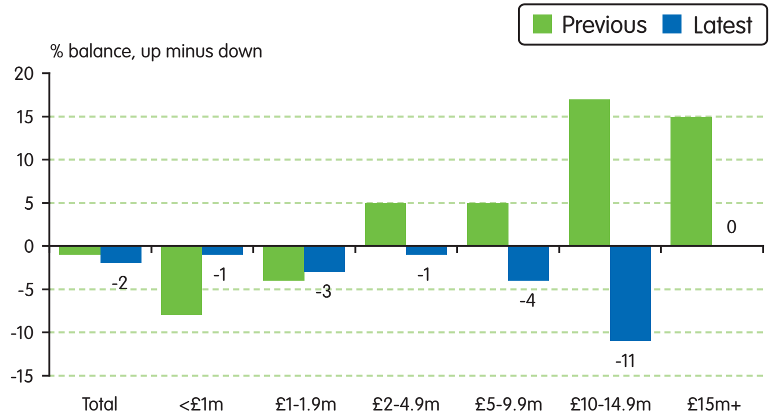
Investment intentions were weak across all company sizes.

Employment in the next six months.



The net balance for expected employment in the next six months fell back sharply for companies in the £10-14.9m category, following the surprisingly strong outturn in the previous survey. In other turnover categories, expected employment balances were little changed and reflected significant caution about intentions to increase staff levels.

Capital spending in the next six months.



Investment intentions were negative in all turnover categories, except for above £15m where the net balance was zero, though this was still a significant drop from the level in the previous survey. Companies with turnover of £10-14.9m recorded the biggest fall, with the net balance down 28 points to –11.

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