

## 3. Review of Scottish Business Surveys

Eleanor Malloy, Fraser of Allander Institute

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### Abstract

This section provides an overview of key recent business survey evidence in Scotland. The latest findings suggest that although recovery has its ups and downs most of the recent Business Surveys have shown a distinct improvement in the recent economic climate; indeed many of the Surveys show that trends in key indicators are stronger than a year ago and net balance figures are returning to pre-recession levels of late 2007, perhaps indicating that the worst of the recession may now be over. However some warn that the recovery still remains fragile and further action may be required to ensure that it is sustainable.

### Private Sector

The Scottish Purchasing Managers Index (PMI), published monthly by Lloyds Banking Group, has indicated that growth in the private sector is continuing although the rate of increase is easing. The September 2013 PMI saw output grow at a record pace; October saw the upturn continue; November saw the growth easing and December saw a further easing. Although still solid in the context of historical survey data the December PMI reported that growth in activity levels was the weakest since May 2013. The December Index also highlighted the slower pace of job creation as the rate of increase in new work eased. Additionally the December Index showed stronger inflationary pressures. Encouragingly, the January 2014 PMI indicated that growth in the private sector had gained some momentum after easing at the end of 2013.

### Production

According to the Scottish Business Monitor (SBM) conducted by the Bank of Scotland, the net balance of turnover for firms in the production sector in the three months to end November 2013 was +12%. This is down on the +24% of the previous quarter but remains well up on the +1% of the same quarter one year ago. There was an improvement in the total volume of new business. The sterling exchange rate has long been of concern to production businesses and the importance attached to the exchange rate increased dramatically at the end of 2008 but has now fallen back to the levels of six years ago.

### Manufacturing

During the final quarter of 2013 business confidence continued to improve for a net of 22% of SCBS firms, a significant improvement from the 1.1% reported for Q4 2012. Only 13% of firms reported being less confident compared to Q3 2013. Respondents to the Scottish Engineering Quarterly Review (SEQR) reported that overall, optimism remained positive during the first quarter of 2014; small and medium firms reported higher levels of business confidence.

In the fourth quarter of 2013 SCBS firms reported that the trend in orders remained buoyant with a net balance of 13.1% reporting a rise; more than a third of firms reported a rise in total new orders and only a fifth reported a decline. Respondents continue to remain optimistic as to the trends in future orders

during Q1 2014 (+13.5%). Average SCBS capacity utilisation rose again (from 77.5% to 78.1%) and was almost more than two percentage points higher than the fourth quarter of 2012. Only small SEQR respondents reported a rise in total orders in the first quarter, although the overall net balance remained positive. UK orders continued to improve but there was a net decline in export orders, although a rise is forecast for Q2

Turnover and profitability are expected to rise further for a net balance of SCBS firms over the coming 12 month period.

The trends in investment in plant/machinery improved during Q4 2013 for a net balance of SCBS manufacturing respondents (+11%). New investment continues to be directed towards replacement (38%) or to improve efficiency (31%) although a significant number are now reporting expansion as a reason (22%). Similarly SEQR respondents reported rising investment trends and that capital and training investment both strengthened.

During the three months to the end of December a net balance of Chamber of Commerce firms reported a rise in total employment levels (+16%) the highest net balance in five years. A quarter of firms increased pay during Q4 and the average increase was marginally up from the previous quarter at 3.3%. 47.9% (compared to 33% in the previous quarter) reported seeking to recruit staff, and more than a third of these firms reported recruitment difficulties. In the Q1 2014 survey SEQR firms reported and expect a rise in total employment levels

## **Construction**

The long term decline in business optimism ended for SCBS respondents in Q4 2013 with a balance of firms reporting the first positive net balance of optimism since 2007; only 11.5% reported a decline in business optimism. Similar to the Chamber of Commerce Survey, the Federation of Master Builders in its survey headlined that Scotland's construction sector experienced the biggest pick-up among the four home nations during the final three months of 2013 and the survey showed its first positive reading since the onset of the financial crisis. Respondents to the Scottish Construction Monitor conducted by the Scottish Building Federation were slightly less optimistic and reported that confidence dipped slightly compared to Q3, though the net balance remained positive.

Unexpectedly, the trend in total new SCBS orders/contracts improved and the net balance was the highest recorded level since 2007. Orders generally improved, although concerns remain over public sector orders. More than half of firms reported an increase in private commercial orders and a net of respondents expect a further rise in Q1 2014. Capacity utilisation improved marginally from 80.8% to 82.3%, higher than previous fourth quarters. During the final three months of 2013 orders from all areas, save from the public sector are forecast to rise.

Notwithstanding the above, cash flow trends continued to deteriorate for a net balance of SCBS construction firms (-11.5%) although the decline eased from the previous quarter (-22.2%). Turnover (+23.1%) is now expected to improve although profitability (-7.7%) is still expected to be weak over the next 12 months suggesting continued pressure on margins. In Q4 2013 more than half of responding firms expected tender margins to worsen during the coming year in this fourth quarter survey concerns had eased with fewer than a third expecting margins to decline.

The Q4 2013 issue of the Scottish Construction Monitor to some extent focused on costs. Its main results suggest a fragile recovery with, on average, firms spending 32% of their annual turnover on materials/supplies and many firms indicated that they were unable to pass on the rising costs to clients thus reducing profit margins. The main costs were noted as fuel and building supply costs.

There was an unexpected net fall in total employment levels in Q4 for SCBS construction firms although most firms reported no changes; a net balance (12%) expect a further rise in Q1. Recruitment activity strengthened (from 38% to 46%) and recruitment problems eased. Average pay increases decreased marginally from 3.2% in Q3 to 2.9%.

### **Services**

Service businesses among SBM respondents displayed a pattern of improvement in performance. The overall net balance for turnover for the three months to the end of November was +17% (lower than the +22% of the previous quarter but much improved on the -16% of the same quarter one year ago). The pace of growth has eased since the summer but remains robust. Service firms are slightly more optimistic than production firms, with service firms showing an overall net balance for turnover for the next six months at +17% compared to +14% for production firms.

### **Wholesale distribution**

The downward trend in business optimism amongst SCBS wholesalers continued in Q12014, although two thirds reported no change. The downward trend in sales eased further from -6.7% in Q3 to -5.6% and once again the net balance in sales was better than expected. A net balance of -6.7% expect a decline in the first quarter of 2014. Three-quarters of wholesalers continued to report increased pressures from transport costs and to a lesser extent firms also remain under pressure from raw material costs (67%). More than half of firms (61.1%) expect to increase prices over the next three months. The downward trends in both turnover and profitability continued in Q4. Two thirds of firms continued to report no change to investment plans.

SCBS wholesale respondents unexpectedly continued to report a net decrease in overall employment levels during Q4. More than half sought to recruit staff (55.5%) and 47% of these firms reported recruitment difficulties. The average pay increase in Q4 was 2.5% compared to 2.3% in Q3.

### **Retail distribution**

Business confidence among SCBS retailers improved further in Q4 for a net balance of 4.2%; in stark contrast to the -41.2% of Q4 2012. The trend in overall sales once again improved, with a net of 18.8% of firms reporting an increase; the highest net balance since 2006. No net change is forecast for Q1 2014. In January 2014 the Scottish Retail Consortium reported that Scottish sales had increased by 4.3% compared to January 2013; like for like sales increased by 2.5% on January 2013 when they had increased by 1.1%.

Cost pressures among SCBS remain historically high and continued to increase in the three months to the end of December 2013. Utility costs, transport costs and raw material prices continued to be of particular concern and firms also reported pressures from pay settlements. Pressures on margins

continued to ease in Q4. A net balance of 16% expect a rise in turnover and a net of -2.1% expect a decline in profitability (compared to -10.4% previously); the highest positive net balances since Q3 2007.

Though the trend in total SCBS employment levels continued to rise in Q4, a net balance expect to shed staff in Q1. Fewer than a third of firms reported increasing pay, and the average increase rose from 5.3% to 6.5%.

## **Tourism**

The SCBS tourism results should be viewed with an element of caution as a number of hotels indicated that they were closed for the winter season. Slightly more than a third of hotels reported an increase in optimism. This is the fourth consecutive increase and the highest balance of optimism since 2006. The Scottish Hotel Occupancy Survey by Visit Scotland reported that more than two thirds of hotels and almost 80% of Bed & Breakfast establishments were 'quite confident'.

The outturn in demand exceed expectations with more than half of hotels reporting an increase total new orders in the fourth quarter. More than two thirds expect no change to demand levels in Q1 2014. Demand from all areas improved and only demand from abroad is expected to decline in Q1 2014.

Average occupancy among SCBS hotels fell back from 75% to 65%, though despite the decline this is a higher level than previous fourth quarters. During the fourth quarter of 2013 trends in bar/restaurant trade improved although the use of conference/ function facilities continued to decline. A net balance (+30.6%) unexpectedly reported a rise in the average daily room rate, although no net change is expected in the three months to the end of March. The Scottish Hotel Occupancy Survey by Visit Scotland reported a rise in year-on-year occupancy from 49% in December 2012 to 52% in December 2013.

Seventy-one percent of Scottish Chamber of Commerce member hotels (compared to 63% previously) reported a lack of tourist demand as their primary business constraint. Competition, poor transport infrastructure, high fuel costs and weak area marketing also remained a concern to hotels. Almost two thirds of hotels sought to recruit staff and recruitment problems remained low with only 15% of these hotels reporting recruitment difficulties. However, as forecast, employment trends declined and are set to decline further in Q1.

## **Outlook**

Respondents to recent surveys generally have a positive outlook in the short term. The rises in business confidence are welcome, but significant challenges and concerns remain. Previous surveys have indicated a stagnating economy but these latest results indicate a return to pre-recession levels of confidence. The sense is that the pace of the recovery in the Scottish economy is accelerating and becoming more broad based than previously however for some sectors trading conditions remain harsh. Much will continue to depend on the rate and extent of recovery in our major markets and on Government measures adopted over the medium term.

Current trends in Scottish Business are regularly reported by a number of business surveys. This report draws on:

Lloyds TSB Business Monitor Issue 65 August 2013 –November 2013;

Scottish Chambers' Business Survey Q4 2013

Scottish Engineering Quarterly Review Q1 2014;

The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices (PMI) for September 2013  
– January 2014;

The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitor for January 2014

Visit Scotland Occupancy surveys for Q4 2013.