

SCOTTISH BUSINESS MONITOR

Q3 2023



MORE IMAGINATION MORE IMPACT



INTRODUCTION

THIS REPORT SUMMARISES THE KEY RESULTS FROM OUR LATEST FRASER OF ALLANDER INSTITUTE (FAI) SCOTTISH BUSINESS MONITOR, PUBLISHED IN PARTNERSHIP WITH ADDLESHAW GODDARD.

The survey sampled 323 firms in September and October from across the Scottish economy, examining business sentiment in Q3 2023 and the outlook for the year ahead.

The survey response rates was lower than is normally the case, and for this reason, there are no industry breakdowns reported in this publication. These results will be provided to survey respondents for information, but cannot be published as normal due to concerns over robustness of sample size. The economy wide estimates are still considered to be robust.

Q3 2023 was a difficult period for business in Scotland. Over the quarter, businesses typically experienced a deterioration across all activities. More firms reported a fall in business sales and new business than reported an increase.

Looking ahead, there is a positive balance of businesses expecting the volume of business activity to increase in the next 6 months.

OUR LATEST RESULTS ALSO SHOW THAT:

- Nearly half of firms report having cancelled or delayed planned investments in the past 12 months. This is higher than the 2 in 5 firms reported last quarter. Compared to last quarter, affordability and economic uncertainty have become less of an issue, and government policy decisions have become more of an issue.
- 2 in 3 firms that have experienced increasing costs over the quarter, with workforce costs continuing to be the largest cost pressure. Energy costs have eased slightly over the quarter, although it remains a concern for the vast majority of businesses, with half expecting energy costs to increase over the next 6 months.
- Expected cost pressures mean that 2 in 3 firms expect to increase prices over the next 6 months.
- Firms are continuing to find it difficult to fill vacancies, with a lack of skills and applications persistently driving labour supply challenges. **25%** of businesses report difficulties in retaining current staff, a similar level reported last quarter and **71%** of businesses are more concerned than normal about staff retention.
- The number of firms expecting the cost of credit to increase has come down (38% this quarter compared to 50% last quarter. 2 in 5 firms expected to invest in their business over the next 12 months, but the vast majority would do so with their own funds rather than a bank loan, or through other means such as private equity.



CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

CURRENT BUSINESS ACTIVITY

- Business activity has worsened in Q3 2023. Across every measure, firms reported deteriorating business conditions.
- The net balance of firms reporting an increase in volume of sales has fallen to -1.2 percentage points meaning that more firms have seen a decline in activity than have seen a rise.
- The measure of new business has deteriorated significantly with a net balance of -9.6 percentage points compared to an equal number of businesses reporting an increase as a decrease last quarter (net balance of 0).
- The net balance of firms reporting an increase level of employment in business remains positive this quarter (1.9 percentage points), but the figure is lower than Q2 2023 (2.2 percentage points).
- Levels of new capital investment and export activity measures remain negative (more firms reporting falls than increases). An equal number of firms reported an increase in turnover as reported a decrease, leaving the net balance at 0.

Table 1:

Net balance (%) of firms experiencing an increase in activities over the past three months, Q2 2021 – Q3 2023

	2021			2022				2023		
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
VOLUME OF BUSINESS ACTIVITY (I.E., SALES)	30	26	27.1	30.1	15.3	4	-2.2	9.1	3.0	-1.2
VOLUME OF NEW BUSINESS ACTIVITY	20.8	21.9	10.4	24.9	8.8	0	-4.9	5.7	0.0	-9.6
VALUE OF BUSINESS ACTIVITY (I.E., TURNOVER)	23.7	18.7	12.8	32.3	15	6.4	-0.7	8.1	3.7	0.0
LEVEL OF EMPLOYMENT IN YOUR BUSINESS	6.4	5.7	10.8	15.5	10.2	8.5	-5.4	-0.5	2.2	1.9
LEVEL OF NEW CAPITAL INVESTMENT	4.2	3	7.6	6.3	1.2	-5.9	-14.7	-4.4	-12.1	-16.7
EXPORT ACTIVITY	-19.5	-18.1	-11.8	-8	-9	-9.2	-11.5	-8.4	-11.4	-11.5

*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

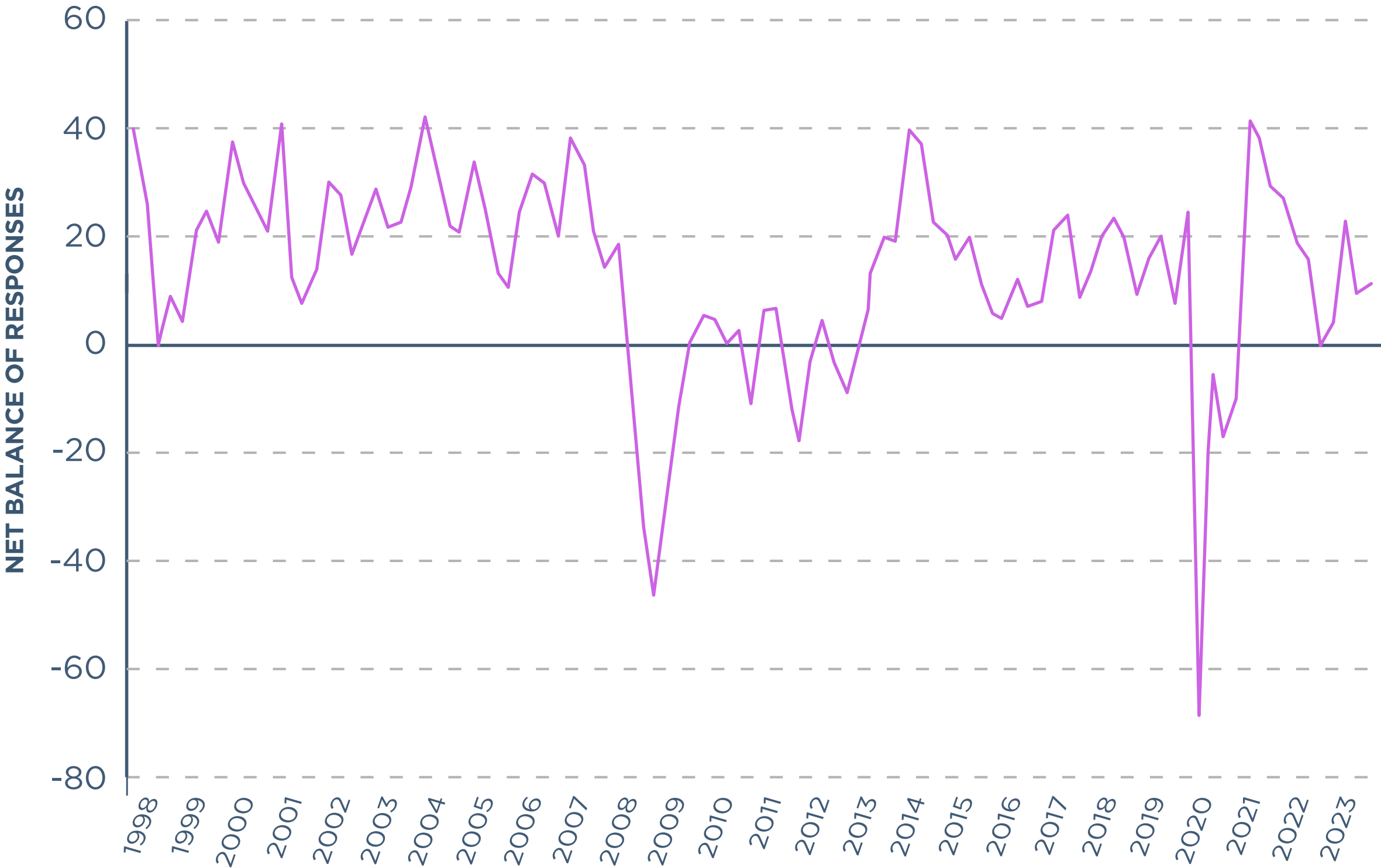
KEY RESULTS

EXPECTED BUSINESS ACTIVITY

- Despite falls in reported business activity over the past three months, the expected volume of business over the next six months has remained fairly steady this quarter compared to the previous quarter.
- Positive net balances have continued this quarter for expectations of new business activity, turnover and employment in the coming six months.
- However, negative net balances have also continued for expected capital investment (-5 percentage points) and export activity (-5 percentage points)
- We asked Scottish firms what they expect to be important to their business over the coming quarter.
- Most businesses expect economic/ business uncertainty (**84%**), staff availability (**79%**), and political uncertainty (**74%**) to be important or very important over the next three months. These are similar levels as reported last quarter.

Chart 1:

Net balance of firms expecting an increase in their volume of business over the next six months, Q1 1998 – Q2 2023



*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

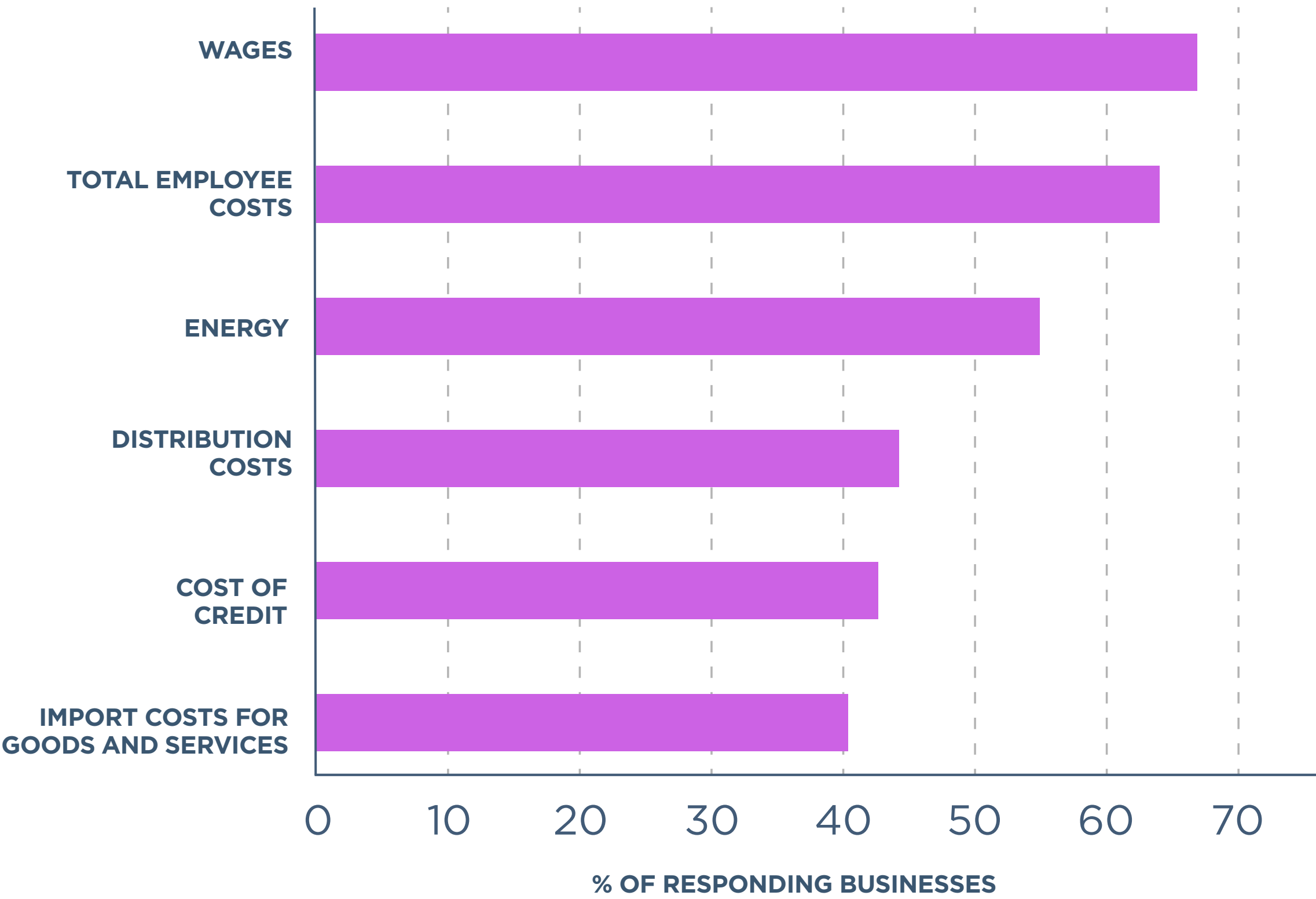
KEY RESULTS

COST PRESSURES

- This quarter we continued to ask businesses across Scotland how their costs have changed over the past year. **78%** of firms in Scotland have seen their costs increase over the last 12 months with **66%** saying that costs have increased over the quarter.
- **83%** of firms state that they remain more concerned than normal about the costs facing the business. Total employee costs and wages have remained the most common cost pressure for businesses.
- Energy costs continue to have an impact on business activity. **83%** of firms stated that they were more concerned than normal about the costs of energy but the number of firms stating that energy costs have increased compared to the previous quarter has fallen slightly.
- **68%** of firms are more concerned than normal about the impact of interest rate rises, a similar proportion as last quarter. The proportion of firms who believe that the Bank of England should increase interest rates to bring down inflation has fallen since last quarter.

Chart 2:

Proportion of businesses responding that costs were higher this quarter compared to the previous 3 months.



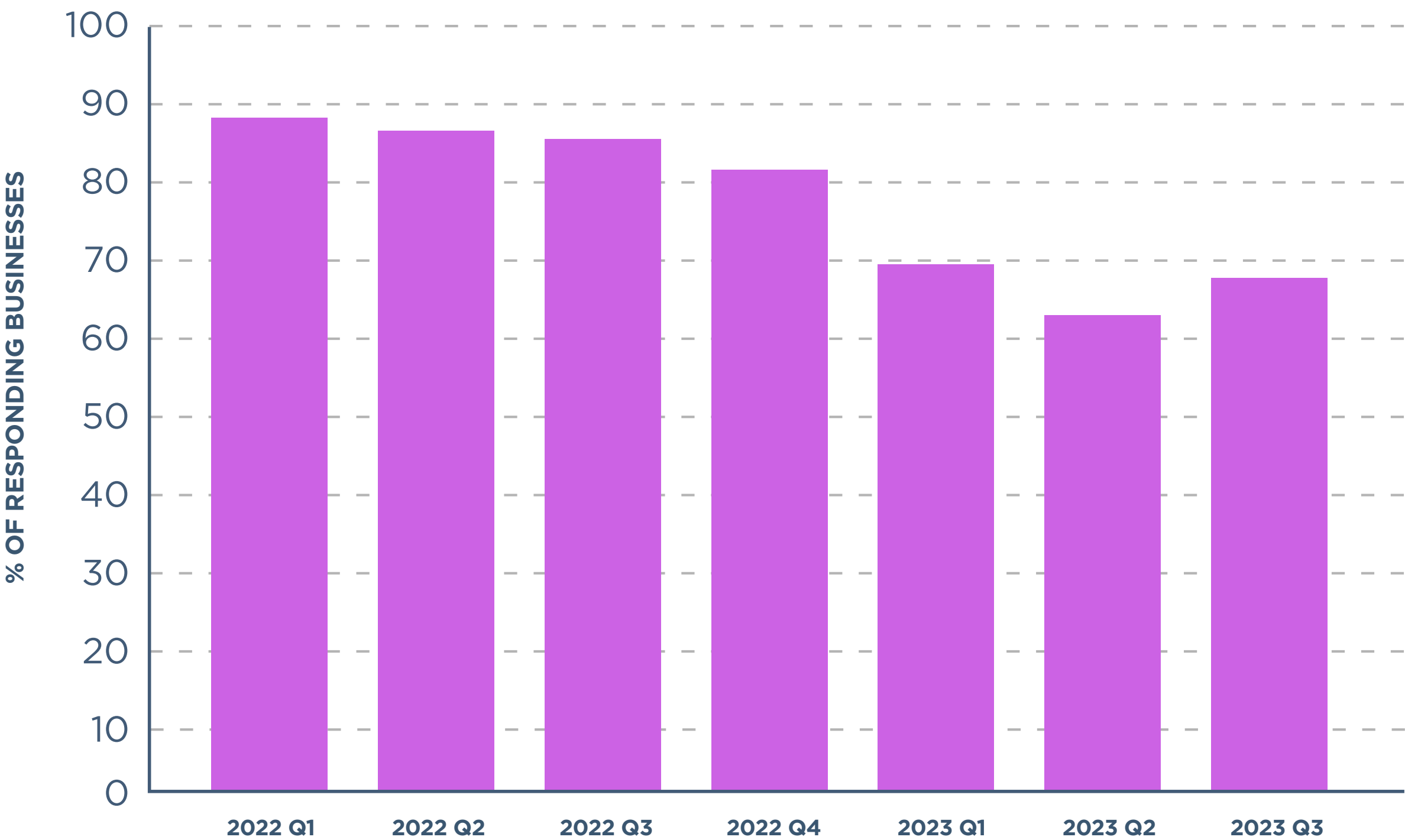
KEY RESULTS

COST AND PRICE EXPECTATIONS

- **67%** of firms reported that they expected total business costs to be higher in the next 6 months.
- Wages and total employee costs were expected to be the key driving factors, with **65%** and **64%** respectively saying that they expect costs to be higher for these factors over the next 6 months. These are marginally lower than reported last quarter.
- **48%** reported that they expect energy cost pressures to be higher over the next 6 months. This is slightly higher than reported last quarter. Around a third of businesses expected to reduce their operations due to energy prices.
- The number of firms expecting the cost of credit to increase has come down (**38%** this quarter compared to **50%** last quarter).
- **67%** of firms surveyed said that they expect to increase their prices by more than normal over the next 12 months. This is a slight increase compared to last quarter.

Chart 3:

Proportion of firms that expect to increase prices by more than normal over the next 12 months (2022 Q1 to 2023 Q3)



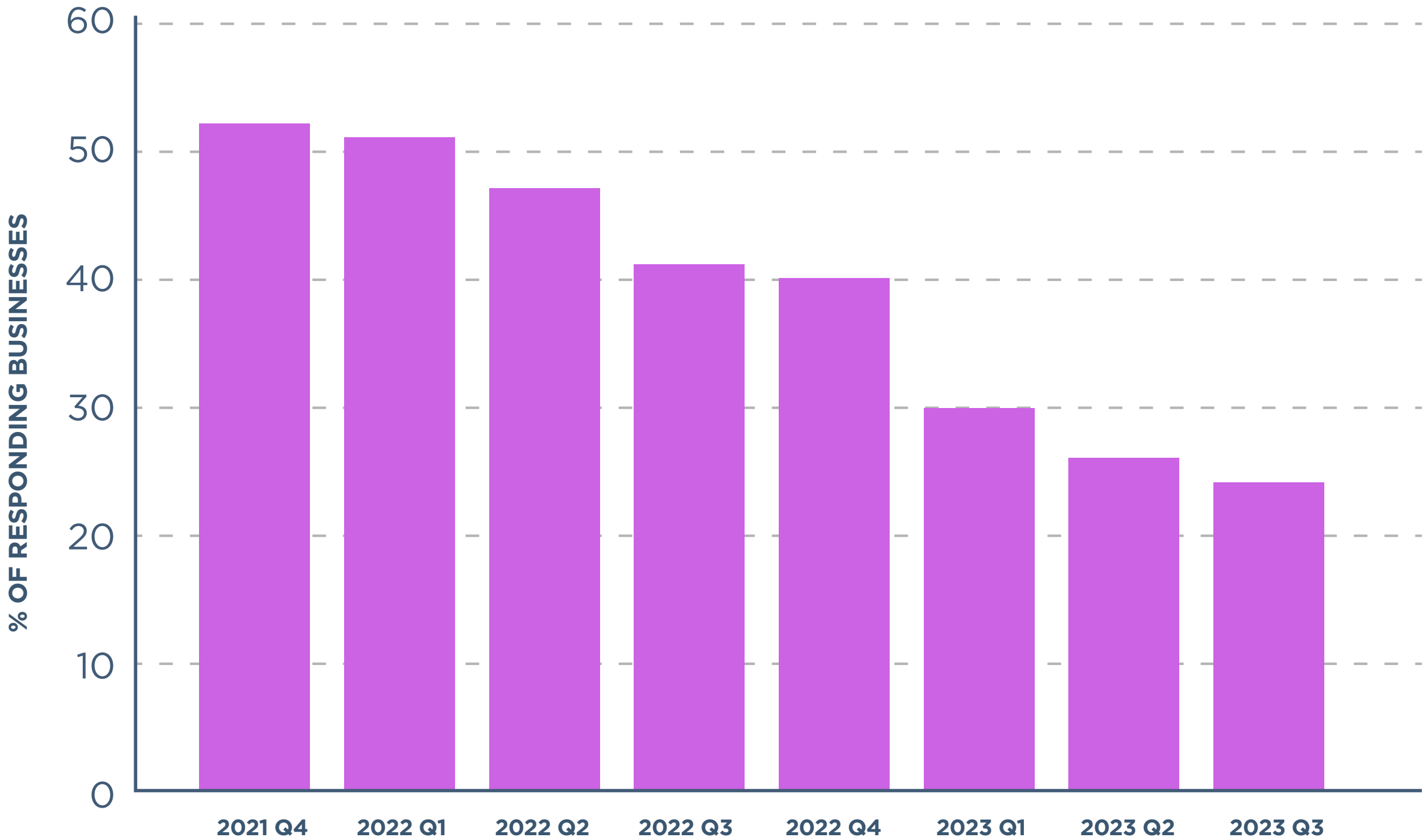
KEY RESULTS

SUPPLY CHAIN ISSUES

- We continued to ask businesses about their experience sourcing goods and services.
- The easing in supply chain issues appears to be continuing.
- **24%** of firms report finding it difficult or very difficult to source goods and services, well down from the 2021 Q4 peak, where **52%** of firms reported difficulty.
- A lack of UK supply continued to be constraining firms' ability to source goods and services, with **82%** of firms reporting who reported difficulty in sourcing goods and services stating this a factor, up slightly from last quarter.
- The price of goods and services is the second most common issue, with **69%** of firms reporting that price was a factor in sourcing goods and services, compared to **66%** last quarter.

Chart 4:

How easy or difficult are you finding it to source available goods and services your business purchases? (Business responding 'difficult or very difficult between 2021 Q1 – 2023 Q3)



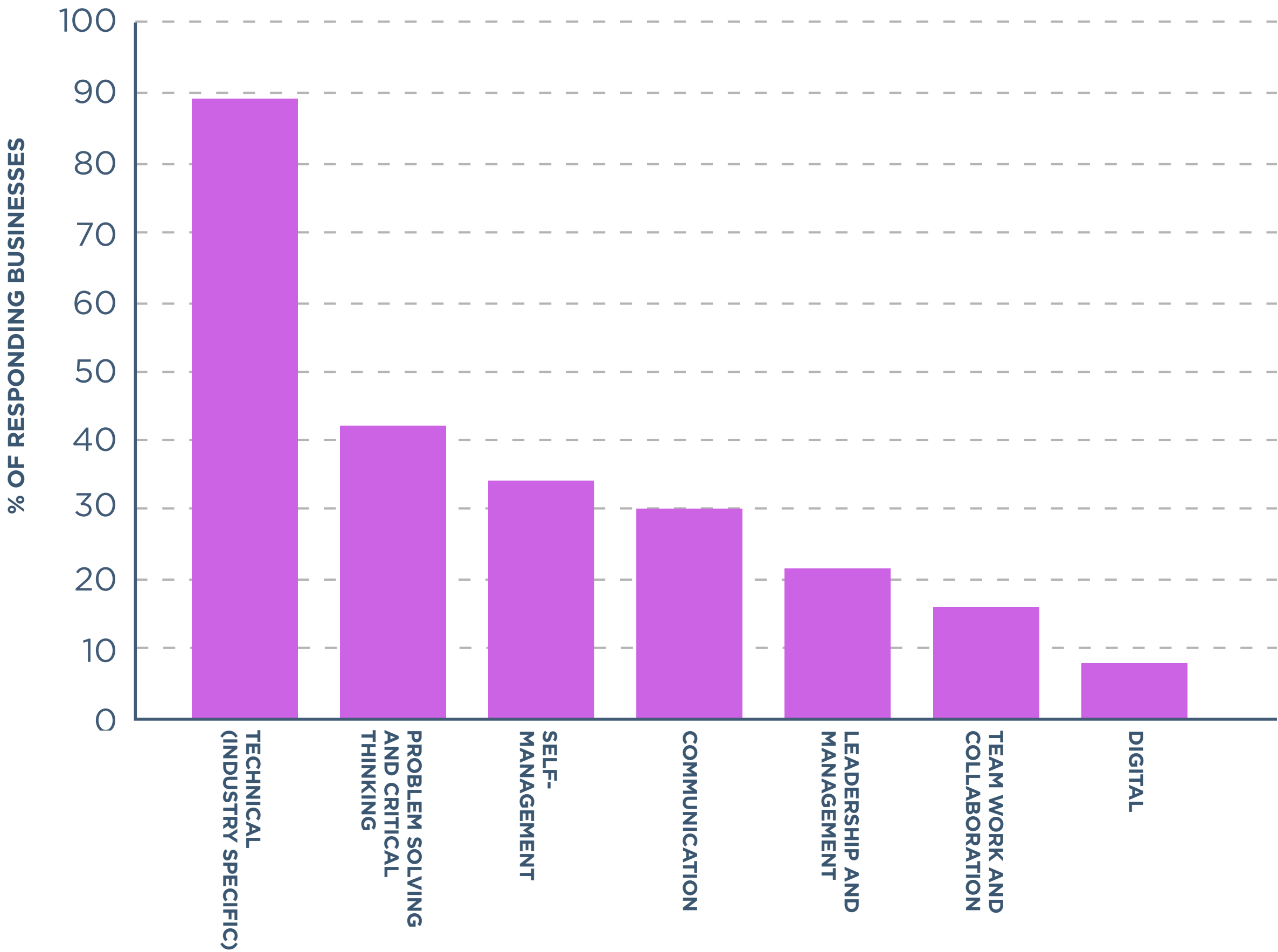
*16% of businesses responded N/A; therefore, percentages will not sum to 100%

KEY RESULTS

WORKFORCE

- Businesses are continuing to report high vacancy levels and difficulties in finding new staff. **75%** of all firms state they are more concerned than normal about availability of new staff.
- **45%** of businesses in the survey have current vacancies, down marginally from **49%** in 2023 Q1.
- **86%** of these firms report they have found it difficult or very difficult to fill these vacancies, which is marginally higher than last quarter.
- The main reason for difficulty in filling vacancies continues to be a reported lack of required skills or experience (**80%**, a large increase on last quarter)
- Within this, technical (industry specific) skills gaps were the main issue reported (**79%**) followed by problem solving and critical thinking (**42%**).
- Other factors that stated for difficulty in filling vacancies include a lack of applications (**60%**), wage expectations (**60%**) and expectations around flexible working (**30%**).
- **25%** of businesses report difficulties in retaining current staff, a similar level reported last quarter and **71%** of businesses are more concerned than normal about staff retention.

Chart 5:
What skills are applicants lacking in?



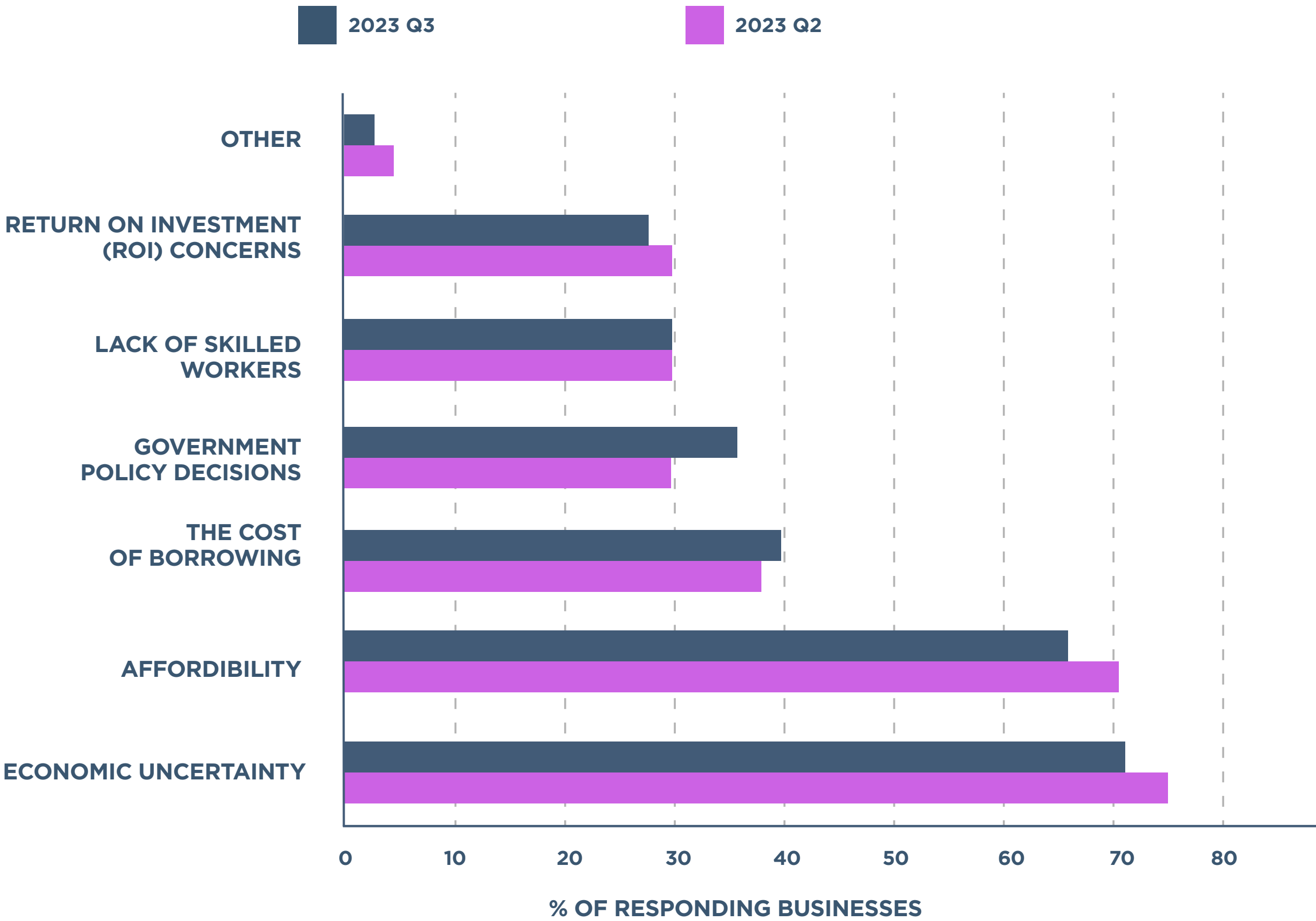
KEY RESULTS

BUSINESS INVESTMENT – PAST YEAR

- This quarter we also asked Scottish firms about their planned business investment.
- **47%** of firms report having cancelled or delayed planned investments in the past 12 months. This is higher than the **40%** reported last quarter.
- The majority of this delayed or cancelled investment has been in physical assets (**74%**) but has also included investment in the workforce (**41%**) and technology and information systems (**36%**).
- The most common reasons for cancellation or delay of investment have been economic uncertainty (**71%**), affordability (**66%**), and the cost of borrowing (**40%**).
- Compared to last quarter, affordability and economic uncertainty have become less of an issue, and government policy decisions have become more of an issue.

Chart 6:

What factors have contributed to the cancellations or delays in your investment plans?



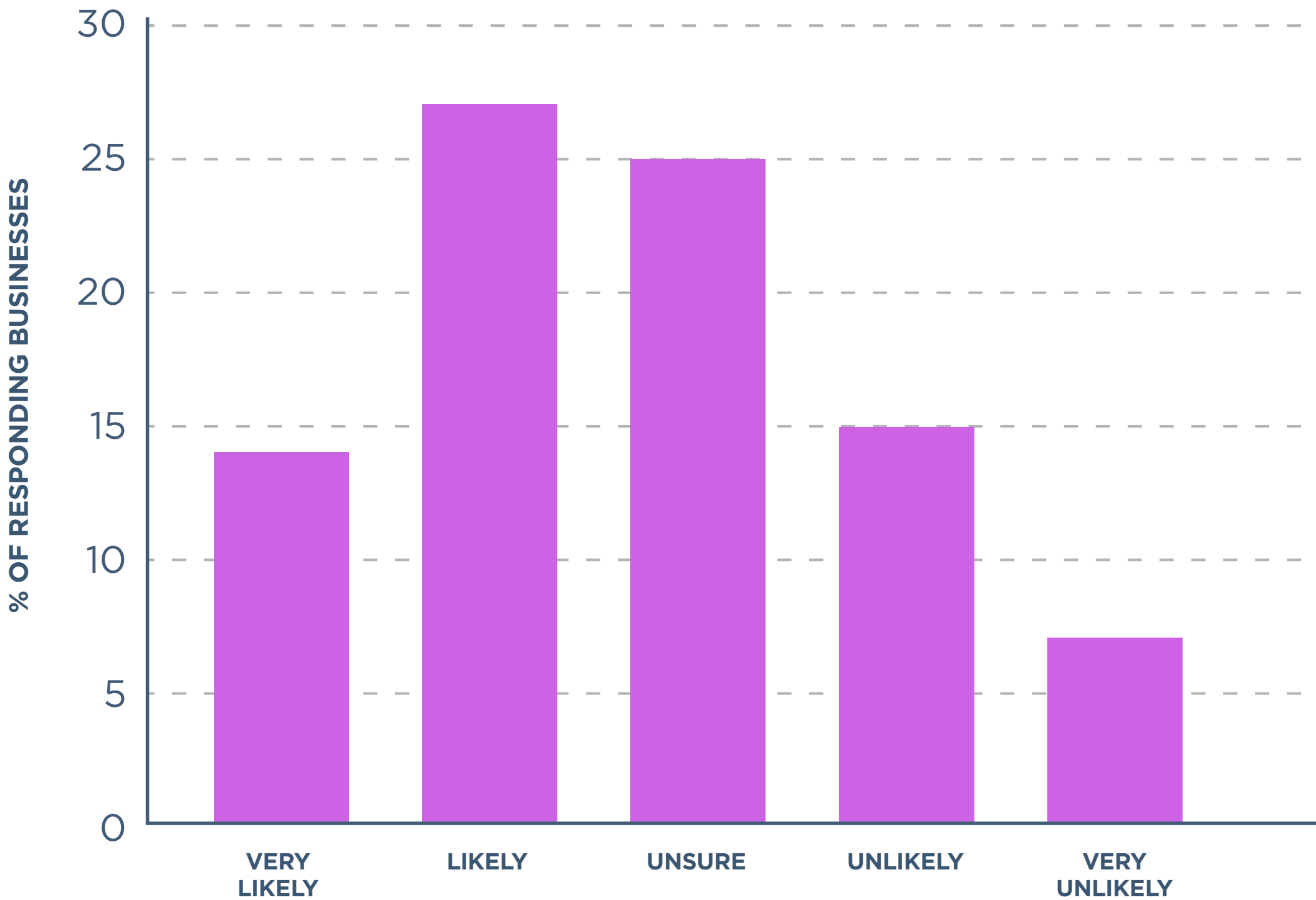
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

BUSINESS INVESTMENT - FUTURE

- We also asked firms how likely they are to engage in business investments over the next 12 months.
- **42%** of firms stated that they were likely, or very likely, to engage in business investment over the next 12 months.
- Of those businesses, **75%** stated that they would likely invest in physical assets, **68%** stated they would invest in their workforce (hiring and training) and **57%** stated they would likely invest in technology and information systems.
- To fund new investment, **78%** of firms said they would use their own funds, **10%** would pursue a bank loan, and 4% said they would use private equity.
- For those not intending to use private equity, we asked about factors that prevent them from pursuing this funding route. The most common reason was the loss of control/ownership (**48%**), followed by being incompatible with business goals (**32%**) and a preference for other funding sources (**30%**).

Chart 7:

How likely are you to engage in business investments over the next 12 months?



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