Q3 2020

ECONOMIC IMPACT REPORT

Focusing on access to finance and business obstacles

Herefordshire & Worcestershire Chamber of Commerce

MIDLANDS ENGINE Investment Fund

Delivered by British Business Bank

Financing growth for Midlands businesses

CONTENTS

Sharon Smith
Chief Executive
Herefordshire & Worcestershire
Chamber of Commerce

Herefordshire & Worcestershire Chamber of Commerce, in partnership with British Business Bank, have released the results of the latest Quarterly Economic Report, outlining the impact of Coronavirus on businesses between July and September. Data collection was conducted between Monday 24 August and Monday 14 September 2020.

As the strictest elements of the Coronavirus lockdown were gradually lifted from June onwards, we have seen a dramatic increase in sales from the all-time low recorded last quarter. However, the percentage remains negative meaning most businesses have experienced fewer sales this quarter. These findings are reinforced by the latest GDP data released by the Office of National Statistics (ONS). GDP grew by 8.7% in June and 6.6% in July as Coronavirus restrictions were loosened. However, the July figure is still 11.7% below the levels seen in February 2020.

There can be no denying that businesses have faced another three months of immense uncertainty and unprecedented challenges.

A quarter of businesses have reduced their headcount over the last quarter. Almost half (42%) have experienced reduced cash flow. And only 30% have been operating at full capacity.

The pandemic has had a particularly devastating impact on sectors unable to operate fully under the current constraints including tourism, hospitality, arts and entertainment. 75% of tourism and hospitality businesses and 63% of those in arts and entertainment have reported reduced cash flow this quarter. With new restrictions recently introduced and fears that a second wave will be more likely during the cold winter months, those sectors will continue to face significant challenges.

There has been a lot of speculation about how the end of the Job Retention Scheme on October 31 will affect employment levels. In response, the Chancellor has designed a new Job Support Scheme to alleviate fears of a cliff edge and mass redundancies. The scheme may allow some businesses to bring back their furloughed staff on reduced hours and benefit from some government contribution to wages. However, it will not help industries that simply can't open while the current restrictions are still in place and there is currently no sign of any targeted help for those most badly affected.

Adding to the uncertainty is the ongoing EU Exit trade negotiations. With less than 100 days to go before the UK leave the European Union a trade agreement has still not been agreed. Fisheries and state aid remain contentious issues despite numerous rounds of negotiations. The British Chambers of Commerce have outlined important areas where there is insufficient information for businesses to prepare for the end of the transition period. Key issues such as whether businesses can expect added administrative costs or what level of tariffs they will face are yet to be decided.

The continued uncertainty is having a profound impact on businesses, both in terms of their confidence in future profitability and their willingness to commit to extensive investment plans. A third of businesses expect their turnover to decrease over the next 12 months. Although that is a vast improvement on the 59% expecting a decrease last quarter, there is still a long way to go to return to pre-Covid confidence levels. As we have seen time and time again when business confidence is low, so are investment intentions. A third of businesses have revised their investment plans down this quarter, adding to the already subdued levels caused by years of EU Exit uncertainty.

A second lockdown would be catastrophic for business and must only be introduced as a last resort. The government's approach to keep as much of the economy open as possible is a good one. However, more support should be introduced to help businesses experiencing the negative impacts of a local lockdown as well as supporting sectors who, through no fault of their own, are unable to operate fully in the current climate. The next six months are going to be critical for businesses. Demand needs to continue to improve for businesses to have any chance of weathering the ongoing storm that the pandemic has triggered.

Ken Cooper
Managing Director,
British Business Bank

In 2018 British Business Bank worked with local partners, including the 10 Local Enterprise Partnerships (LEPs) in the Midlands area, to create the Midlands Engine Investment Fund (MEIF). The fund was designed to transform the financial landscape for smaller businesses in the region by making £250m available to companies that might not otherwise be able to secure investment to help them realise their growth ambitions.

The Midlands Engine Investment Fund published an early assessment report earlier in the year which found that the rationale for setting up the MEIF remains robust and highly relevant, spotlighting its impact in improving the delivery of equity finance in the Midlands after supporting 20% of all equity deals in the region. By helping individual firms to grow we are having a positive impact on the region's economy.

The Fund has now helped to create 659 jobs, and the recent early evaluation report found that 37% of the jobs created were paying above the starting point of the UK upper quartile salary band of £36,500 a year. To date we have invested a total of £5.6m into SMEs in the Herefordshire and Worcestershire areas.

Despite the current uncertainties brought about by the Covid-19 pandemic, the MEIF is continuing to invest via its seven Fund managers and we are seeing some good deals being done. However, it is clear from the results of this survey that we still have work to do in raising awareness of the funding that is available through the Fund. The survey shows us that whilst businesses may be aware of equity finance for example, they were less aware of who to approach and how to go about securing that funding. This survey has been an important part of a growing evidence base that we will use as we continue to work with our Fund managers, stakeholders and partners across Herefordshire and Worcestershire in order to ensure businesses across the two counties and beyond are able to access the funding they need to stabilise and to grow.

METHODOLOGY

During Quarter 3 (Q3) 2020, 306 businesses in Herefordshire and Worcestershire responded to the Quarterly Economic Survey (QES). Data collection took place between Monday 24 August 2020 and Monday 14 September 2020. Any reference to Quarter 2 (Q2) 2020 refers to the data collection period from Monday 18 May 2020 to Monday 8 June 2020.

In this document some of the QES results are presented as balance figures. Balance figures show the difference between the increase and decrease in activity. If the figure is a plus, it indicates an expansion of activity. If the figure is a minus, it indicates a contraction of activity against the previous quarter.

BUSINESS SECTOR CLASSIFICATION

Throughout the document business sectors are used to make comparisons of activity. The sectors are defined below.

MANUFACTURING SECTOR:

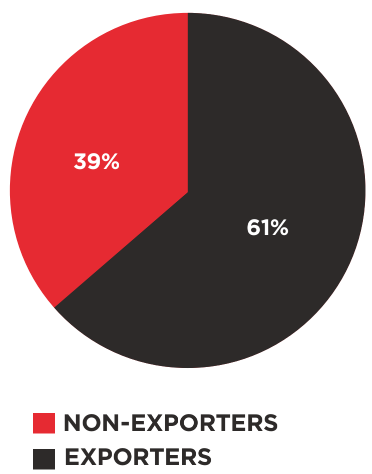
Main business activity includes manufacturing of goods (including electronic or information technology goods) and production of raw materials, construction, agriculture, fishing, mining or utilities.

SERVICE SECTOR:

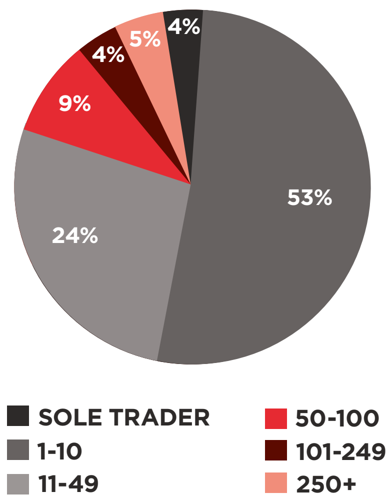
Main business activity provides a service to businesses as well as final consumers (including retail/wholesaling, professional services and marketing).

SAMPLE SUMMARY:

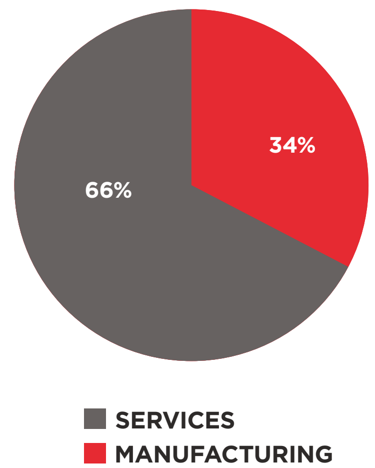
Responses by Exporter



Responses by Business Size



Responses by Sector



EXECUTIVE SUMMARY: KEY FINDINGS

DOMESTIC & OVERSEAS MARKET

The percentage of businesses experiencing increased UK sales is negative for the second quarter in a row at -9%. However, that is a significant improvement on the -66% recorded last quarter.

The percentage of businesses experiencing increased overseas sales is negative for the third quarter in a row at -17%. Overseas sales have not recovered at the same rate as UK sales.

2020

CASH FLOW

Almost half of businesses (42%) have experienced reduced cash flow this quarter.

WORKFORCE

A quarter of businesses have reduced their workforce over the last 3 months.

TURNOVER

A third of businesses expect their turnover to decrease over the next 12 months, compared to 59% last quarter.

Only 30% of businesses were operating at full capacity this quarter.

BUSINESS PERSPECTIVE

IN THEIR OWN WORDS:

We suffered badly during the initial lockdown but since retailers were allowed to reopen, we have seen quite buoyant sales.
• Retailer employing 11-49 people

Following the end of the lockdown we returned to a very busy situation, completing orders that were put on hold and new orders from companies that were also restarting. However, since the beginning of August orders have reduced considerably and unless there is a general return to work by those still furloughed, I can't see this improving at all. A second lockdown would almost certainly cause us to close as cash flow, which is already strained, would not be sustainable and we have decided that we will not borrow simply to keep afloat, unless there were positive signs that a vaccine for Covid-19 was imminent.
• Manufacturer employing 1-10 people

I hope that the government agree a deal with the EU before December 31. The sooner it's agreed the better.
• Retailer employing 1-10 people

We are unable to work at present and still do not have an official confirmed date from the government for restarting but furlough is ending.
• Events business employing 1-10 people

Continued employee costs will be too high based on trading position and current sales performance. The business needs to recover to normal monthly turnover volumes to avoid potential further cost cuts prior to next financial year.
• Manufacturer employing 11-49 people

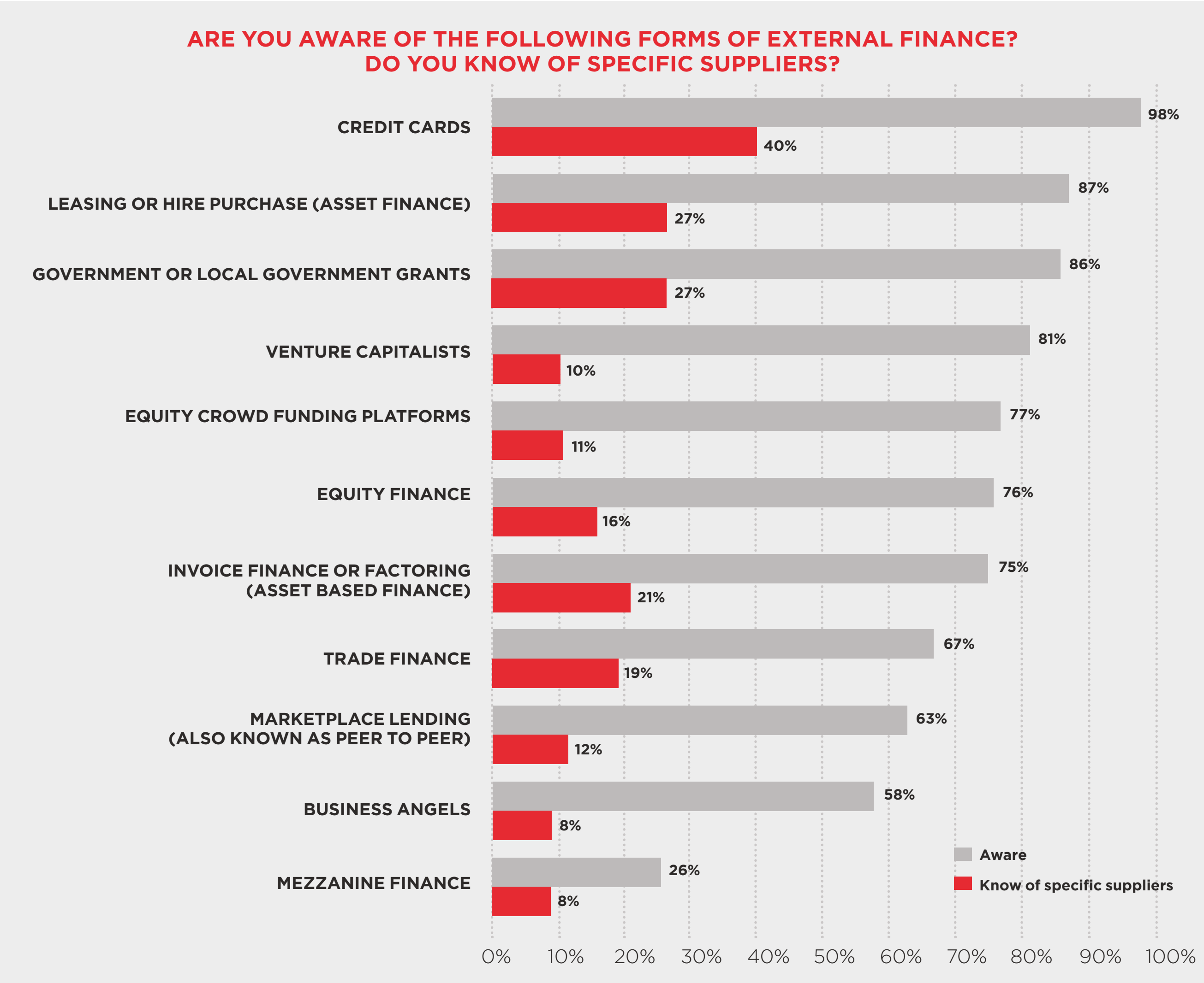
We work with international FMCG brand owners mainly in Europe and Brexit uncertainty is our biggest cause for concern as we trade predominantly with the EU, both imports and exports. No deal would mean more complexity, potentially punitive tariffs and significantly higher costs for our clients. We have made contingency plans that we can activate quickly to relocate to the EU if there is no agreement.
• Professional services business employing 1-10 people

Our business is reliant on the hospitality industry, predominantly conferencing and events. Lockdown has had and still continues to have a severe impact on our business in terms of enquiries, orders and cashflow.
• Manufacturer employing 11-49 people

As a new start-up business in January 2020 I feel that I have been totally abandoned by the government and have had to use my own personal finances to stay afloat.
• Sole trader

The events industry has been badly hit by Covid-19. After not trading for 180 days we are not receiving any new enquiries for next year which is unheard of at this time of year. In 2021 we had initially planned to trade at 1/3 capacity and are hopeful that by 2022 the industry will be back, but are not sure whether we will survive until then. A hospitality grant allowed us to pay ongoing bills for just 1 month. With furlough now due to stop we are desperately trying to stop our business from folding. With no income and ongoing bills to pay it feels as though there is just one way we can now go, which is such a shame after 25 years of trading.
• Hospitality business employing 1-10 people

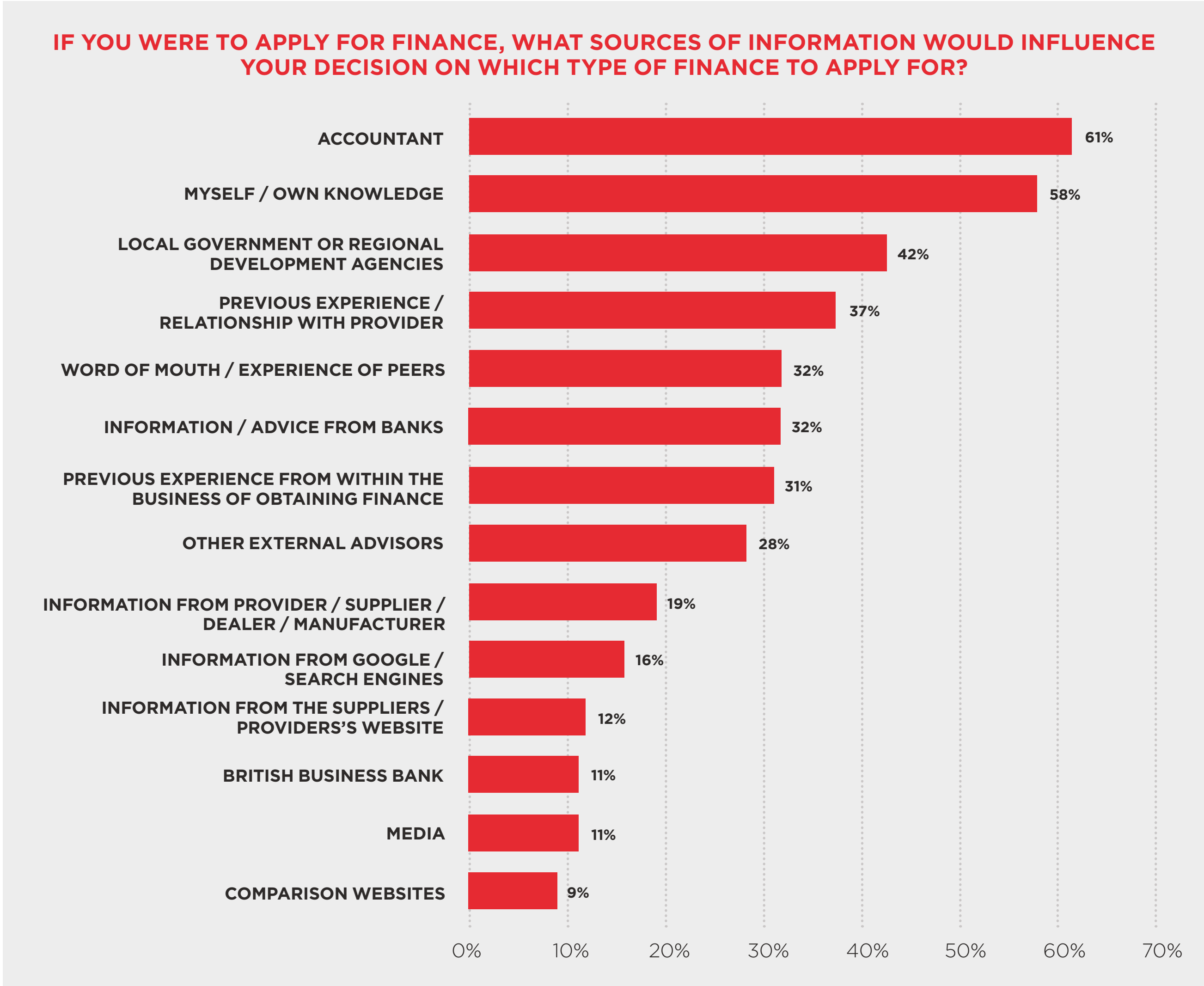
ACCESS TO FINANCE



The sources of finance that most businesses are aware of are credit cards, leasing/hire purchasing and government grants. Only a quarter of businesses (26%) are aware of mezzanine finance. Across the board a much smaller percentage of businesses are aware of specific suppliers, even when they are aware of that type of finance.

In our Quarterly Economic Report from Q1 2020, we found that only 7% of businesses would speak to suppliers offering equity investment when seeking finance. This quarter's results show that fewer businesses know of specific equity investment suppliers even when a higher percentage are aware of a certain type of equity finance. For example, although 81% are aware of venture capitalists, only 10% know of specific suppliers.

In the same report from Q1 2020, we found that only 15% of businesses would approach an alternative debt funding market outside of the traditional banking sector. This quarter's results suggest evidence of lower awareness of other debt funding options such as peer to peer lending and trade finance which 67% and 63% of local businesses are aware of respectively.



Most businesses (61%) would be influenced by their accountant's advice when deciding on types of finance. A similar percentage (58%) would use their own knowledge. Other external advisors were approximately half as popular (28%) with information from banks at 32%.

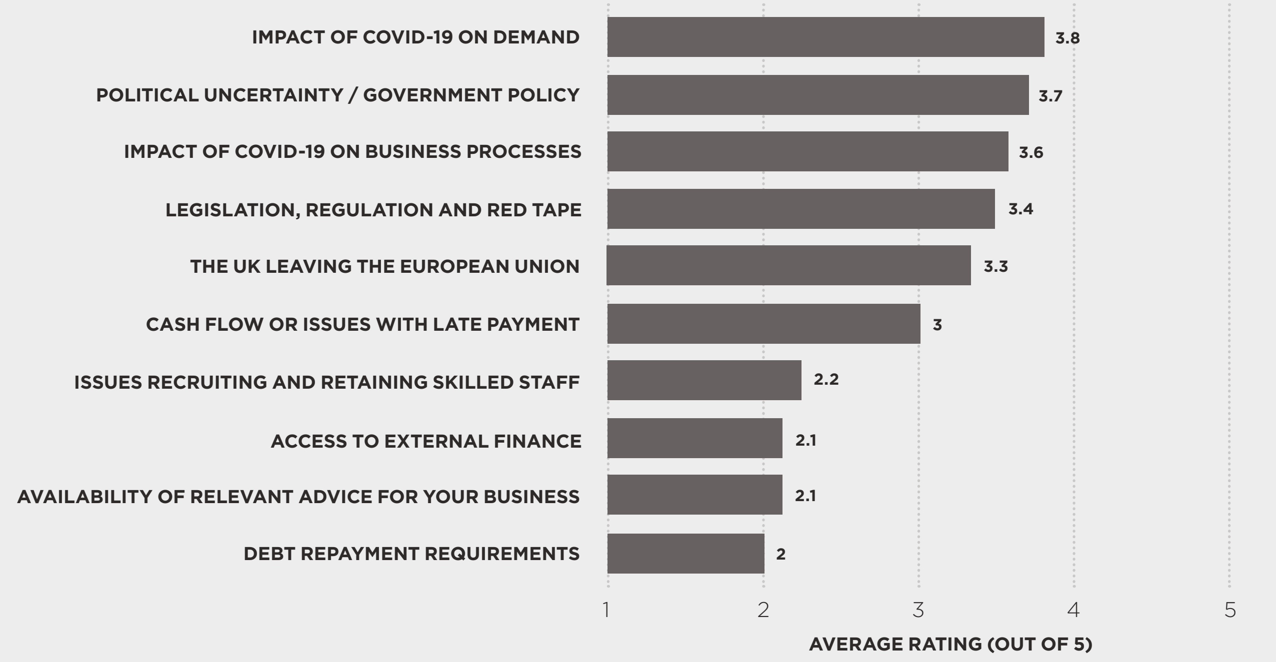
Previous experiences were also important. 37% would use their relationship with a specific provider, 32% would use the experience of peers and 31% would use previous business experience of obtaining finance.

Much less popular were methods relying on information available online. Only 16% would use information from Google or other search engines, 12% would use information from the provider's website, 11% would use the media and 9% would use comparison websites.

BUSINESS OBSTACLES

TO WHAT EXTENT DO YOU THINK THAT EACH OF THE FOLLOWING WILL PRESENT AN OBSTACLE TO THE RUNNING OF YOUR BUSINESS AS YOU WOULD WANT IN THE NEXT 12 MONTHS?

(WHERE 1 IS NOT AN OBSTACLE AT ALL, 5 IS A MAJOR OBSTACLE)



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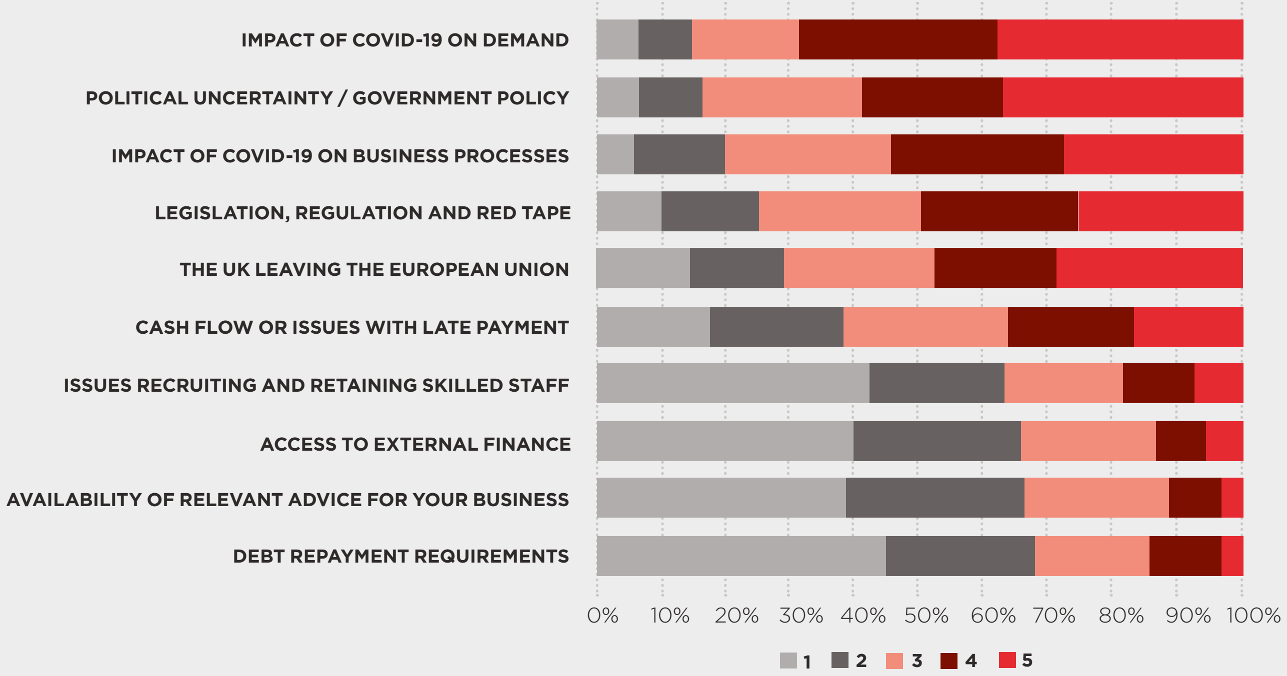


Businesses selected the impact of Covid-19 on demand, political uncertainty and the impact of Covid-19 on business processes as the top three obstacles to running their business over the next twelve months.

If we only considered the percentage of businesses who see an issue as a major obstacle (i.e. a rating of 5), the UK leaving the EU would rank more highly. Whereas Covid-19 has impacted most businesses, some businesses don't see leaving the EU as a big obstacle resulting in a lower average.

Sector	Top Three Obstacles	Average Score
Manufacturing	Impact of Covid-19 on demand	3.77
	Political uncertainty / government policy	3.75
	The UK leaving the European Union	3.56
Professional Services	Political uncertainty / government policy	3.79
	Impact of Covid-19 on demand	3.78
	Impact of Covid-19 on business processes	3.41
Retail & Wholesale	The UK leaving the European Union	4.06
	Political uncertainty / government policy	4.00
	Impact of Covid-19 on demand	3.85
Tourism, Hospitality & Culture	Impact of Covid-19 on demand	4.00
	Political uncertainty / government policy	3.59
	Impact of Covid-19 on business processes	3.48
Marketing & Media	Impact of Covid-19 on demand	4.04
	Impact of Covid-19 on business processes	3.81
	Political uncertainty / government policy	3.77

The table above shows the top three obstacles chosen by businesses in different sectors. All five sectors chose impact of Covid-19 on demand and political uncertainty/government policy in their top three obstacles. Three of the sectors chose impact of Covid-19 on demand as their main obstacle. 56% of Tourism, Hospitality & Culture businesses and 53% of Marketing & Media companies rated the impact of Covid-19 on demand as a major obstacle (i.e. a rating of 5).

Only Manufacturing and Retail & Wholesale businesses included the UK leaving the European Union in their top three obstacles. Retail & Wholesale chose it as their main obstacle. 50% of Retail & Wholesale businesses and 37% of manufacturers ranked leaving the EU as a major obstacle.

UK MARKET

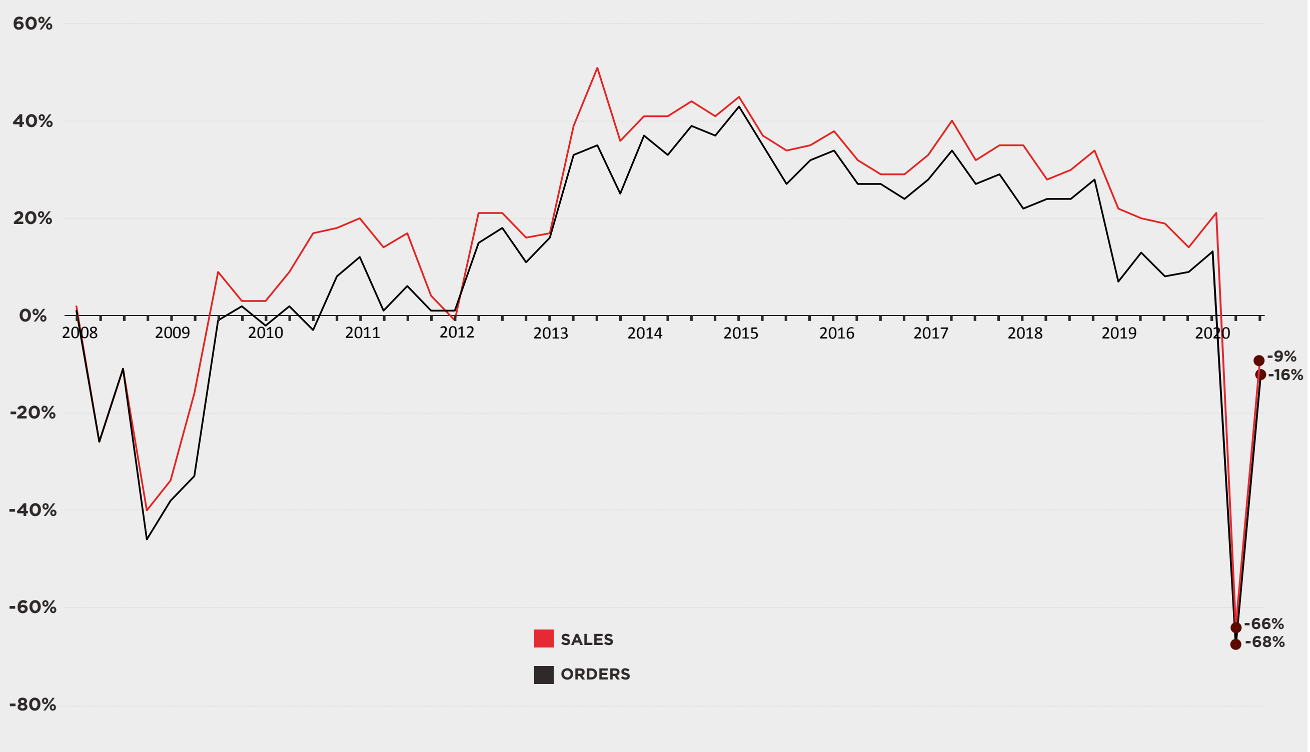
UK sales have increased dramatically this quarter after the strictest lockdown rules were gradually lifted. However, they remain negative at -9% meaning more businesses this quarter have experienced fewer sales than those who have seen increased sales. The UK sales percentage last quarter was a record low of -66%.

This trajectory is echoed by the latest GDP data released by the Office of National Statistics (ONS). GDP grew by 8.7% in June and 6.6% in July as Coronavirus restrictions were loosened. However, the July figure is still 11.7% below the levels seen in February 2020 (ONS, GDP monthly estimate, UK: July 2020).

The extent of the recovery has depended a lot on business sector. Retail sales volumes increased by 0.8% in August, the fourth consecutive monthly increase, and are 3% above pre-pandemic levels in February 2020 (ONS, Retail sales, Great Britain: August 2020).

However, the events, tourism and hospitality industries have struggled despite more people taking UK holidays and the popularity of the Eat Out to Help Out Scheme. 50% of tourism and hospitality businesses reported a decrease in UK sales this quarter. With new restrictions recently introduced to combat a rise in Covid-19 cases, businesses relying on large-scale events for income are likely to experience difficulties for some months yet.

OVER THE PAST 3 MONTHS, HAVE UK SALES AND ORDERS INCREASED, REMAINED CONSTANT OR DECREASED?



MANUFACTURING SECTOR INSIGHT:

The percentage of manufacturers reporting increased UK sales increased dramatically from -74% (Q2 2020) to -6% (Q3 2020). Similarly, for UK orders there has been an increase from -75% (Q2 2020) to -10% (Q3 2020).

SERVICE SECTOR INSIGHT:

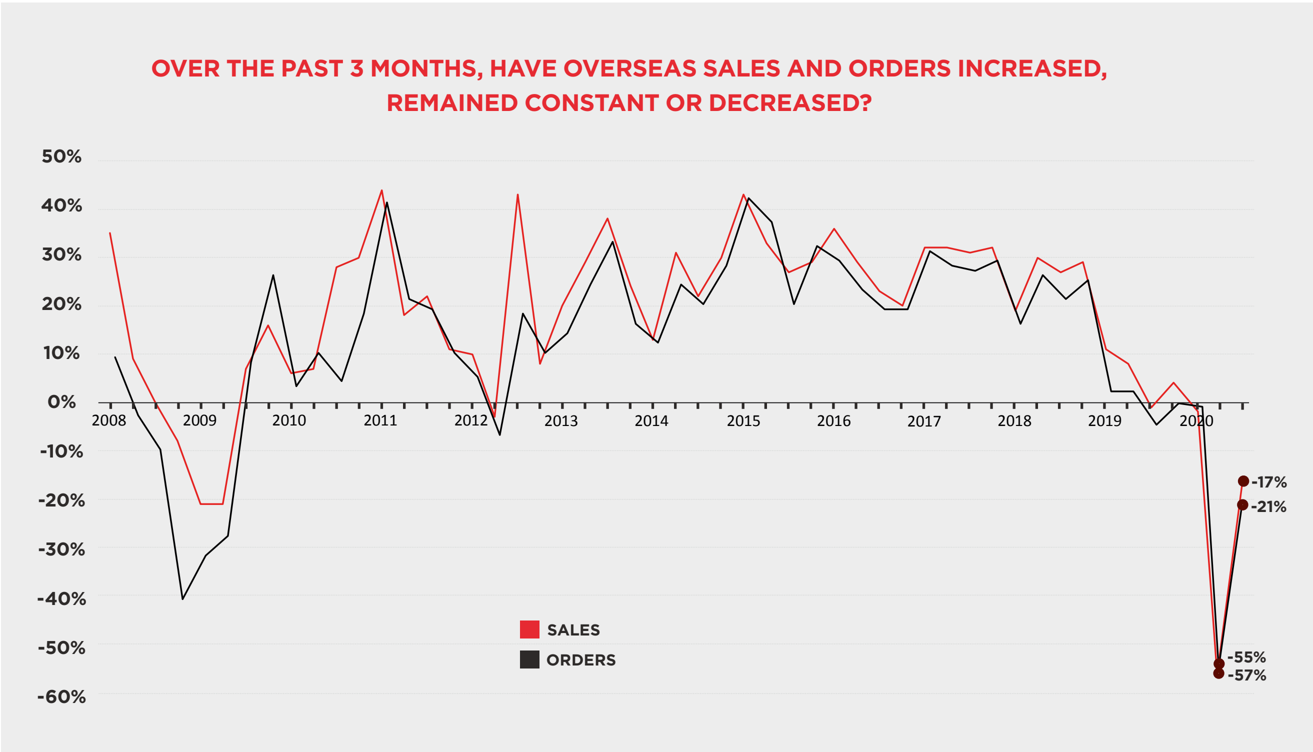
The percentage of services companies reporting increased UK sales increased dramatically from -66% (Q2 2020) to -11% (Q3 2020). Similarly, for UK orders there has been an increase from -64% (Q2 2020) to -3% (Q3 2020).

OVERSEAS MARKET

Overseas sales have not recovered at quite the same rate as UK sales although there has been an improvement. The percentage of businesses experiencing increased overseas sales is negative for the third quarter in a row at -17%, up from -55% last quarter.

With less than 100 days to go before the UK leaves the European Union, there is no sign of a trade agreement while fisheries and state aid remain contentious issues. The British Chambers of Commerce have outlined 26 key questions where there is insufficient information for businesses to be able to prepare for the end of the transition period (British Chambers of Commerce, Guidance Dashboard, September 2020).

The Chamber's recent business engagement has suggested that two thirds of local businesses have not yet prepared for EU Exit. Anecdotal reports show that some companies are concerned about the impact EU Exit will have on tariffs, increased administration and supply chains. But overall the fact that the UK is leaving the EU has been overshadowed by the Coronavirus pandemic and the continued difficulties it brings.



MANUFACTURING SECTOR INSIGHT:

The percentage of manufacturers reporting increased overseas sales increased dramatically from -66% (Q2 2020) to -11% (Q3 2020). Similarly, for overseas orders there has been an increase from -65% (Q2 2020) to -17% (Q3 2020).

SERVICE SECTOR INSIGHT:

The percentage of services companies reporting increased overseas sales has improved since last quarter but not as much as the manufacturing improvement. The percentage has risen from -49% (Q2 2020) to -21% (Q3 2020). Similarly, for overseas orders there has been an increase from -51% (Q2 2020) to -22% (Q3 2020).

EMPLOYMENT & RECRUITMENT

A quarter of businesses have reported a reduction of their workforce in the last three months. Although the UK unemployment rate has only risen slightly to 4.1%, redundancies increased by 48,000 on the quarter to 156,000, the largest quarterly increase seen since 2009 (ONS, Labour market overview, UK: September 2020).

With the Job Retention Scheme still open it's difficult to get a true picture of the unemployment rate. Preliminary government figures suggest that 5 million people were still furloughed on 31 July down from a peak of 8.9 million in early May (HMRC, Coronavirus Job Retention Scheme statistics: September 2020).

Anecdotal evidence from the Chamber's weekly Coronavirus Impact Survey has shown that some businesses are concerned about the end of the Job Retention Scheme. Due to reduced sales and the resulting constraints on cash flow, there are concerns that it simply won't be affordable to retain previously furloughed staff. The Bank of England's Monetary Policy Committee expect unemployment to peak at 7.5% in Q4 2020 once the Job Retention Scheme ends (Bank of England, Monetary Policy Report, August 2020).

Despite these concerns only 16% of local businesses are expecting to reduce their workforce in the next three months, although the figure rises to 21% of manufacturers.

Those percentages may now change as on September 24, the Chancellor unveiled a new Job Support Scheme to replace the Job Retention Scheme from November 1. Under the scheme employers can bring their employees back to work on reduced hours and if they work at least a third of those hours, the government will contribute towards the rest of their wages, although businesses will also have to contribute. It remains to be seen how the scheme will be received although it is unlikely to work for sectors who are unable to reopen at all such as the arts and entertainment sector.

MANUFACTURING SECTOR INSIGHT:

For the second quarter in a row almost a third (29%) of manufacturers have reduced their workforce over the last three months. 21% of manufacturers are expecting to reduce their workforce in the next three months.

SERVICE SECTOR INSIGHT:

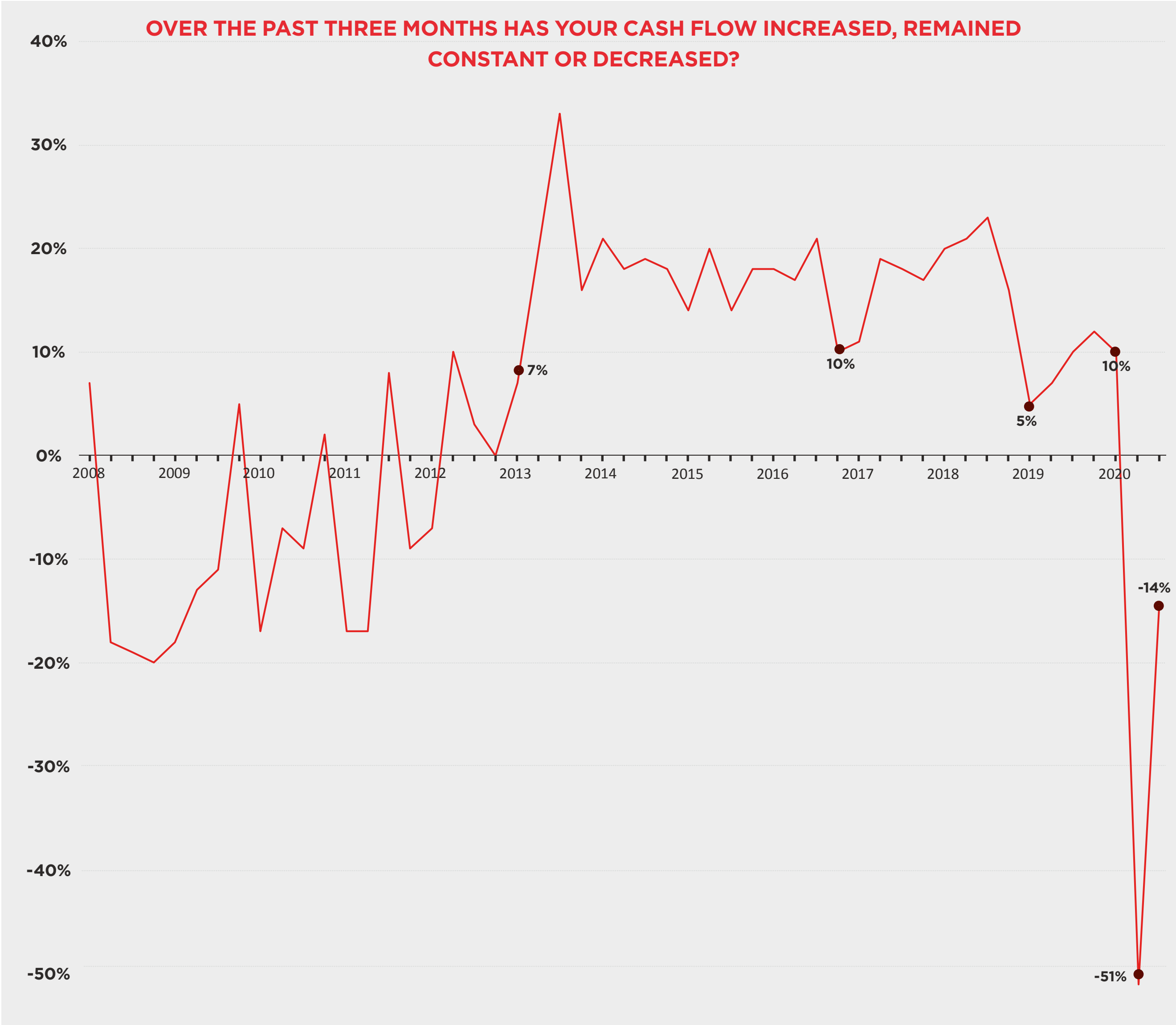
About a quarter (26%) of services companies have reduced their workforce this quarter. Only 13% of services companies are expecting to reduce their workforce in the next three months.

CASH FLOW

Almost half of businesses (42%) have experienced reduced cash flow this quarter compared to 27% who have experienced an improvement. Last quarter the fastest ever quarterly decline was recorded as 63% of businesses experienced reduced cash flow, compared to just 12% who experienced an improvement.

The results of the latest ONS Business Impact of Coronavirus Survey, with responses collected between 24 August and 6 September, showed that 43% of businesses have less than 6 months cash reserves (ONS, Coronavirus and the latest indicators for the UK economy and society: 24 September 2020).

While the government schemes were a lifeline for many businesses in the early stages of lockdown, the amounts awarded via grants were too low to cover the multitude of costs businesses still had to pay, regardless of reduced sales. As some businesses have struggled with low demand for a considerable number of months, those initial funds are long gone with no clear evidence that the situation will improve soon. This effect is particularly stark in the tourism and hospitality sector, where 75% of businesses reported reduced cash flow this quarter and, in the arts and entertainment sector, where 63% of businesses reported reduced cash flow. Facing immense uncertainty, among recently tightened Covid-19 restrictions, such businesses are unlikely to see an improvement to their cash flow situation soon unless the government offer more targeted supported to those most adversely affected.



MANUFACTURING SECTOR INSIGHT:

The percentage of manufacturers reporting an increase in cash flow has increased significantly from -53% (Q2 2020) to -7% (Q3 2020) although the percentage remains negative.

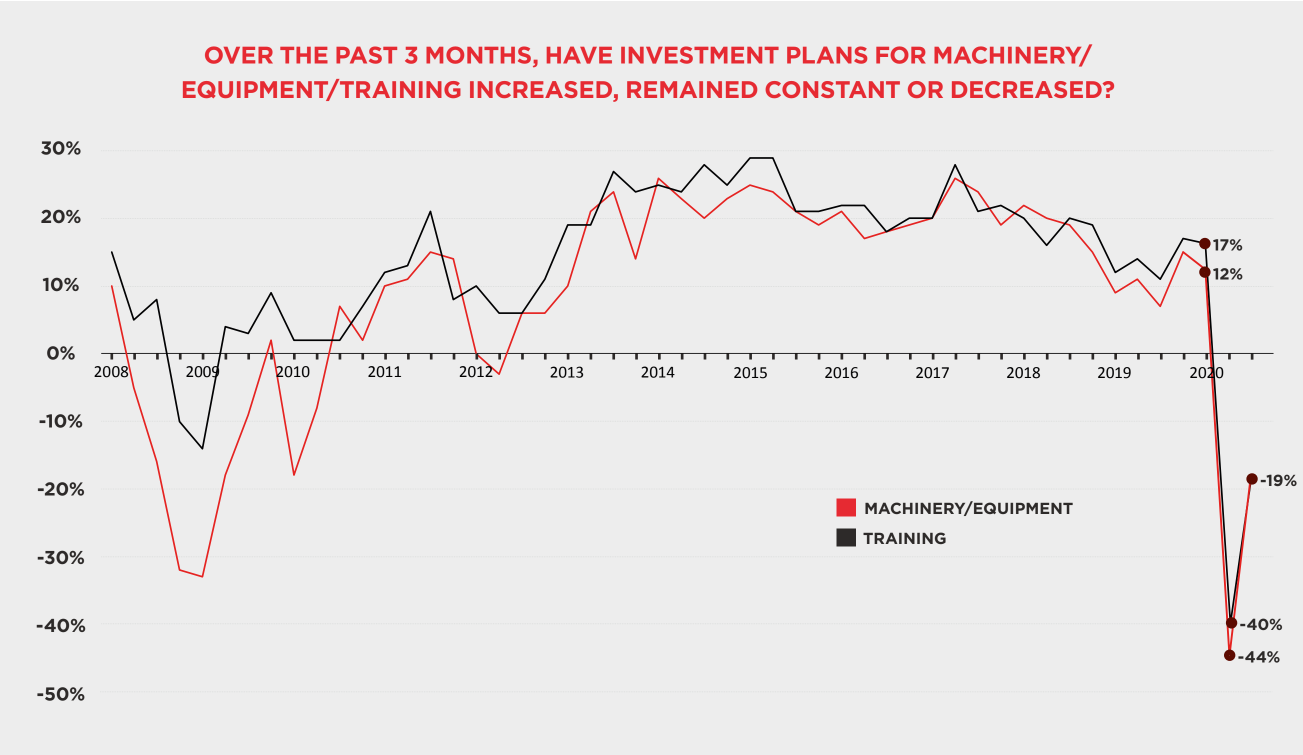
SERVICE SECTOR INSIGHT:

The percentage of services companies reporting an increase in cash flow has increased significantly from -58% (Q2 2020) to -19% (Q3 2020) although the percentage remains negative.

INVESTMENT

A third of businesses have revised their investment plans down this quarter. 36% of businesses have revised their capital expenditure plans down and 33% have revised their training plans down. While this is a welcome improvement on last quarter, by no means does it reverse the drastic decline in investment plans observed in our last report.

Over the past couple of years, we have witnessed a gradual decline in investment intentions as businesses faced the uncertain outcome of the EU Exit negotiations. The arrival of the Coronavirus pandemic created yet more uncertainty and investment plans plummeted as a result. With negotiations still ongoing and a recent rise in Covid-19 cases there is unlikely to be a significant improvement in investment plans until businesses are facing more positive conditions.



MANUFACTURING SECTOR INSIGHT:

Over a third of manufacturers (37%) have decreased their machinery and equipment investment plans over the past three months. Similarly, 40% of manufacturers have decreased their training investment plans.

SERVICE SECTOR INSIGHT:

Over a third of services companies (36%) have decreased their machinery and equipment investment plans over the past three months. Similarly, 32% of services companies have decreased their training investment plans.

BUSINESS CONFIDENCE

A third of businesses (32%) expect their turnover to decrease over the next 12 months, compared to 59% last quarter. Slightly more businesses (37%) expect an increase in turnover over the next 12 months resulting in a modest positive percentage of 5%.

Despite the significant challenges the Coronavirus pandemic has presented local businesses have consistently demonstrated their resilience and taken a positive approach to adapting their services. According to our weekly Coronavirus Impact Survey, conducted since the start of lockdown, 33% of local businesses have adapted their products and services to cater for changing demand amidst the 'new normal' conditions being faced. Even though the situation has been difficult and uncertain, and may continue to be for some time, businesses appreciate there are still opportunities out there.

Confidence in profitability has not recovered to quite the same extent which is likely due to a range of factors. To ensure their workplaces are Covid-secure, businesses have faced increased costs such as sourcing PPE, installing screens and maintaining more thorough cleaning. Some anecdotal evidence has also suggested increased costs in the supply chain, partly due to increased transportation costs, and partly due to suppliers increasing prices. With EU Exit negotiations not yet concluded businesses lack certainty on key issues such as whether they can expect added administrative costs or what level of tariffs they will face.

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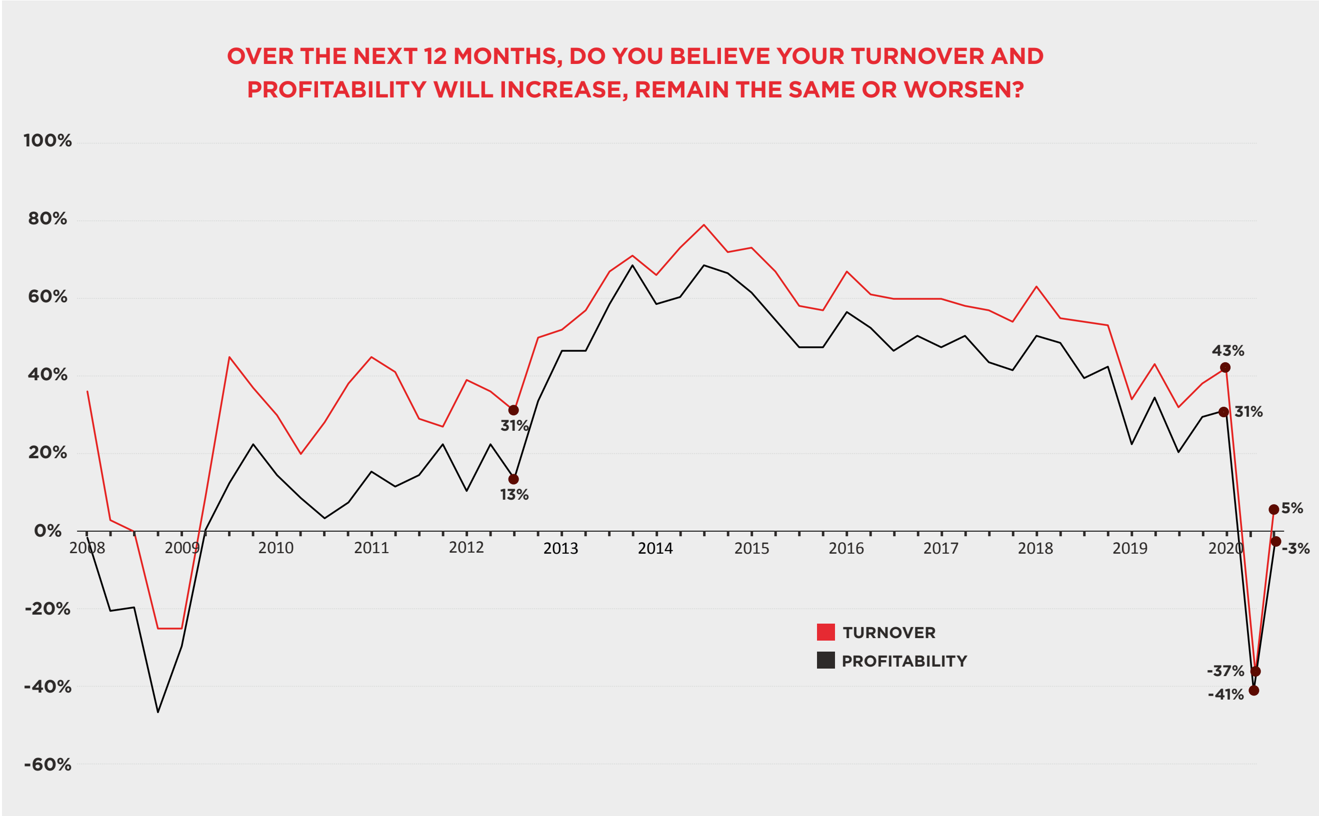

BUSINESS CONFIDENCE

MANUFACTURING SECTOR INSIGHT:

Manufacturer confidence in turnover has increased significantly this quarter. 36% of manufacturers expect increased turnover over the next twelve months compared to just 14% last quarter. Although confidence in profitability has also improved, 35% of manufacturers are expecting their profitability to decrease in the next twelve months compared to 34% who are expecting an increase. The remaining 31% expect no change.

SERVICE SECTOR INSIGHT:

Service sector confidence in turnover has increased this quarter. 36% of service companies expect increased turnover over the next twelve months compared to 23% last quarter. Although confidence in profitability has also improved, 38% of services companies are expecting their profitability to decrease in the next twelve months compared to 32% who are expecting an increase. The remaining 30% expect no change.

CHAMBER POLICY CONTACTS

LISA TITSHALL
Policy, Research & Public Affairs Executive

ARJUN HEIR
Policy Executive

2020 QUARTERLY ECONOMIC SURVEY DATES

Q4 2020

Fieldwork: 2 November to 23 November.

Publication: TBC - mid January 2021

WORCESTERSHIRE OFFICE (HEAD OFFICE)
Severn House
Prescott Drive
Warndon Business Park
Worcester
WR4 9NE
01905 673 600

For further information or to find out about our next Quarterly Economic Survey, sponsorship opportunities and data collection, contact:
policy@hwchamber.co.uk

policy@hwchamber.co.uk
www.hwchamber.co.uk
@hw_chamber
Herefordshire & Worcestershire Chamber of Commerce

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& Worcestershire
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