



cutting through complexity

Tech Monitor

A most up-to-date source
of UK tech sector data and
analysis each quarter

Compiled for KPMG by Markit
February 2015

Tech Monitor/UK

/ flip page

A snapshot report for the tech industry, giving an informative overview of market performance and expert insight on trends and outlook.

For the first time, a special feature on the growth of UK Tech Start-ups and their survival rates.

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Tech sector emerges as star performer in a faltering UK recovery

The volatile financial market newsflow so far this year provides a warning that the rising economic tide of 2014 can no longer be relied upon to lift all boats.

UK growth prospects are diverging across industry sectors as a result. Our latest *Tech Monitor UK* survey illustrates the widest performance gap between the tech sector and the rest of the UK economy for around six years.

Overall UK economic growth fell short of expectations at the end of 2014, as less favourable global economic conditions started to drag on the recovery. It seems that choppy international waters are back on the horizon, as euro area uncertainties, potential U.S. rate hikes and persistent emerging market growth worries all reverberate across global markets.

Set against this, there have been some positive developments for UK growth, with the oil price collapse set to boost discretionary household spending. Meanwhile, the launch of quantitative easing by the European Central Bank is intended to reinvigorate lending and growth in the single currency area, though this has also pushed up the sterling / euro exchange rate.

Worldwide economic events therefore frame our core assessment of the latest *Tech Monitor UK* survey, which is that different areas within the UK economy are now moving at vastly contrasting speeds.

Not only does the latest survey present an image of the UK tech sector with the wind still in its sails, but it is also gathering momentum in the face of unusually turbulent global economic conditions. The latest survey illustrates that the tech sector bucked the overall UK private sector slowdown in Q4, and has opened up its widest performance gap since late-2008.

Tech sector job creation and new business trends also exceeded UK-wide benchmarks by substantial margins in the final quarter of last year, with firms citing a wave of new product launches and greater investment spending.

Looking at business activity expectations for 2015 as a whole, the proportion of tech sector optimists (53%) exceeds the pessimists (7%) by more than seven-to-one. As such, there is ample

reason to believe that tech sector performance will remain a bright spot even if UK growth momentum fades elsewhere.

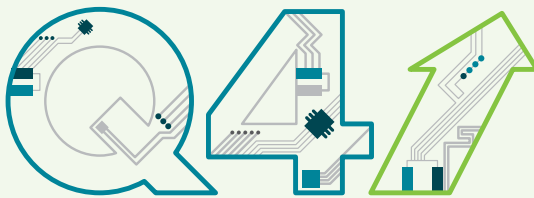
However, tech companies have tempered their business confidence this winter, broadly mirroring overall UK service sector patterns, with the latest survey pointing to the lowest level of optimism for two years.

Nonetheless, while some darker clouds may be gathering over the wider UK economy, tech sector companies continue to report especially positive intentions in terms of staff recruitment, planned R&D expenditure and expected pipelines of new work in 2015.

The identification of economic growth engines is likely to come under ever greater scrutiny as the General Election approaches in May. With that in mind, the message from the latest *Tech Monitor UK* survey is clear; the tech sector remains a star performer of the economic recovery, and the future looks resoundingly bright in terms of industry growth and job creation.

OVERVIEW

Key points from the Q4 2014 data:



Tech sector companies registered **stronger growth trends in Q4**, and therefore avoided the slowdown seen across the wider UK economy.



The latest report indicates the **widest performance gap between UK tech companies and the rest of the private sector** for six years.



Tech Sector **job growth accelerates again**, delivering sustained growth that now stretches to 5 years. Slower cost inflation boosts profits.



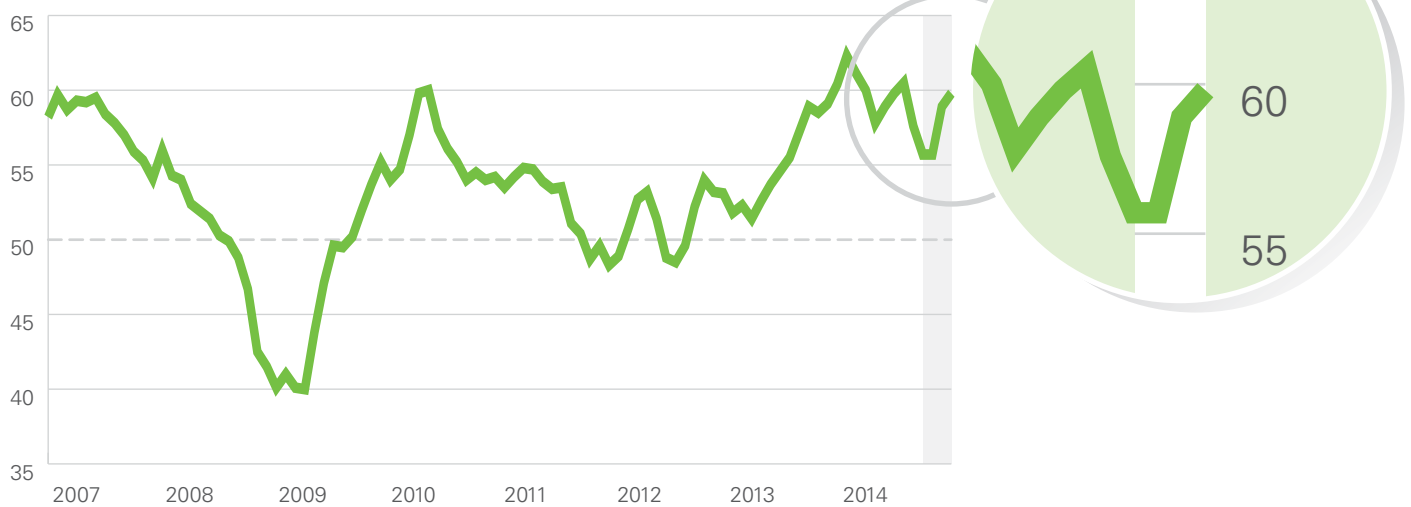
More than half of the survey panel **(53%) expect a rise in business activity over the next 12 months** while only 7% forecast a reduction.



Tech sector **job hiring intentions and capex plans remain upbeat for the next 12 months**, but are less positive than those reported in mid-2014.



Number of tech **start-ups hits fresh high** as business conditions continue to strengthen.

Tech PMI Business Activity Index, 50 = no change**Commenting on the latest Tech Monitor UK results, Tudor Aw, Technology Sector Head at KPMG said:**

// This quarter's Tech Monitor report shows two fantastic pieces of news. Firstly, the concerns highlighted in our previous survey about the UK Tech Sector entering into storm clouds have been misplaced. Secondly, the UK Tech Start-up scene is not only growing, but survival rates are impressively high.

Our previous survey showed that while the Tech Sector business activity had been strong, the rate of expansion had slowed noticeably. Taking this slowdown with what the Chancellor George Osborne described in his Autumn Statement as 'warning lights flashing over the global economy', there was genuine concern that we would see a decline in business activity. It is therefore reassuring to see that the tide has turned accompanied by sustained job creation in the Sector. Remarkably, this marks a period of sustained job creation in the Sector that now stretches to five years, something we should celebrate loudly and ensure is given prominence when comparing the UK's Tech scene to other sectors.

This edition also includes, for the first time, a special report on the UK start-up scene. The results confirmed my personal view that the UK Tech Start-up scene is vibrant and far outstripping other sectors. For those naysayers, it also shows that they have a higher survival rate than the UK average for all start-ups. I sense momentum is building and that it is only a matter of time when we begin to rival the west coast.

//

Tech growth: Tech rebound contrasts with UK private sector slowdown in Q4

TECH GROWTH

Tech Monitor UK uses a specially selected panel of tech sector executives within the Markit UK *Purchasing Managers' Index*® (PMI®) surveys, to provide a unique and up-to-date assessment of the sector's economic performance. Growth and jobs trends are benchmarked against Global PMI® series and other key economic indicators.

Main findings in Q4 2014*

UK tech sector business activity rebounded strongly from the growth slowdown experienced through the third quarter of 2014, according to the latest KPMG/Markit Tech Monitor UK survey.

Strengthening tech sector business conditions stood in contrast with weakening UK private sector output growth in Q4 2014, and this resulted in the widest performance gap for nearly six years. Latest data also showed that tech companies avoided the wider slowdown in private sector job creation during Q4, and continued to register much sharper rates of new business expansion than the UK economy as a whole.

At 59.8, up sharply from 55.7 at the end of Q3, the headline KPMG/Markit Tech Monitor UK Business Activity Index remained well above the 50.0 threshold that separates expansion from contraction. Sustained growth of UK tech sector business activity has now been recorded for almost two-and-a-half years. Moreover, the latest index reading was well above the UK all-sector benchmark at the end of the year (55.2), which recorded the weakest rise in private sector output since mid-2013.

Reports from survey respondents attributed rising business activity to the launch of new products, particularly those related to cloud-based initiatives, alongside continued strong demand for tech-enabled business services and greater marketing efforts. A number of firms cited favourable underlying economic conditions and a supportive funding landscape, although some also noted a degree of caution about the outlook for business investment spending among clients.

Tech sector demand patterns

A strong and accelerated upturn in new business volumes underpinned the divergence between tech sector growth and the wider UK economy at the end of 2014.

At 60.1, up from 57.9 at the end of Q3, the index measuring new orders received by the UK tech sector was well above the 50.0 no-change value. The latest reading also signalled a far steeper expansion of new work than the long-run series average (53.7). In contrast, the equivalent UK all-sector index indicated the slowest rise in new business levels for around a year-and-a-half at the end of 2014.

The impressive end to 2014 helped mark the strongest calendar year of new business growth across the tech sector since the survey began in 2003 (new business index 59.9, vs. UK all-sector average of 58.3 in 2014). That said, the rate of expansion during Q4 was still slightly weaker than the peaks seen in the first half of 2014. Survey respondents noted that strong sales and marketing initiatives had underpinned new business growth at the end of the year, alongside new product launches and, in some cases, successful acquisitions.

Tech PMI Business Activity Index, 50 = no change

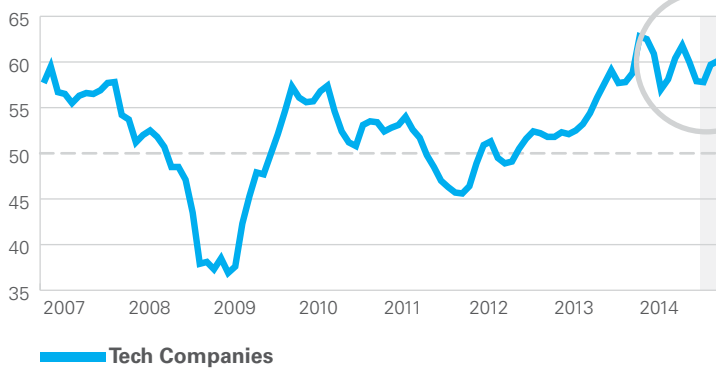


Source: Markit/KPMG.

*Index numbers vary between 0 and 100, with levels of 50 signalling no-change from the previous month. Readings above 50 signal an increase since the previous month, whilst postings below 50 indicate a decrease. The greater the divergence from 50, the greater the rate of change signalled by the reading.

Methodology notes can be found on page 18.

Tech PMI New Orders Index, 50 = no change



Tech growth: Profitability rises at second-fastest pace since Q4 2007

TECH GROWTH



The index measuring work-in-hand (but not yet completed) posted 51.0 at the end of Q4, down slightly from 52.1 in Q3 but still above the 50.0 no-change value. Moreover, a further modest rise in backlogs of work contrasted with the marked reduction seen in the second quarter of 2014.

Anecdotal evidence mainly linked the latest accumulation of unfinished work to stronger pipelines of new business. Some tech firms reporting an increase in work outstanding cited recruitment difficulties amid strong demand for suitably skilled staff at the end of 2014.

Overall cost pressures moderate again

The latest survey pointed to a slowdown in input price inflation across the tech sector, thereby mirroring the moderation in cost pressures seen across the UK economy as a whole at the end of Q4.

Survey respondents highlighted that lower fuel prices and energy bills had helped constrain overall input cost inflation. However, there were again widespread reports that tightening labour market conditions had led to rising salary payments across the tech sector. At 53.7 in Q4, the index measuring overall cost burdens was slightly above the UK all-sector figure (53.2), but down from 54.5 in Q3 and close to its lowest level since 2009. Meanwhile, the prices charged index registered 51.1 at the end of Q4, to signal only a marginal increase in average prices charged by tech sector companies.

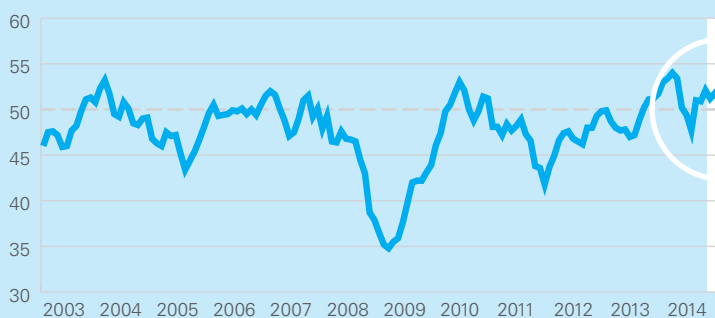
Profitability improves at faster pace in Q4

UK tech sector firms indicated a robust and accelerated improvement in profitability during the final quarter of 2014. According to survey respondents, stronger rises in profitability mainly reflected new business gains and the success of new products. At 55.8 in Q4, the index measuring tech sector profitability was the second-highest for any quarter since Q4 2007.

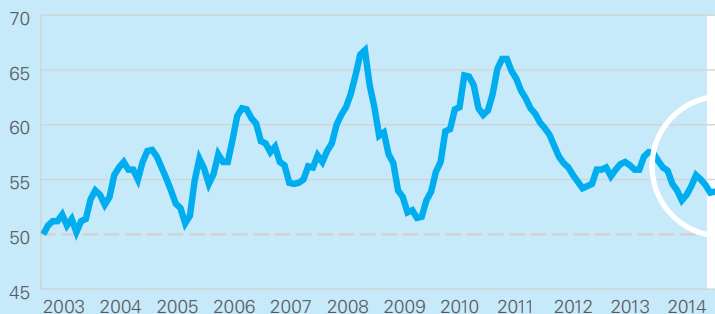
Source: Markit/KPMG.

*Index numbers vary between 0 and 100, with levels of 50 signalling no-change from the previous month. Readings above 50 signal an increase since the previous month, whilst postings below 50 indicate a decrease. The greater the divergence from 50, the greater the rate of change signalled by the reading.

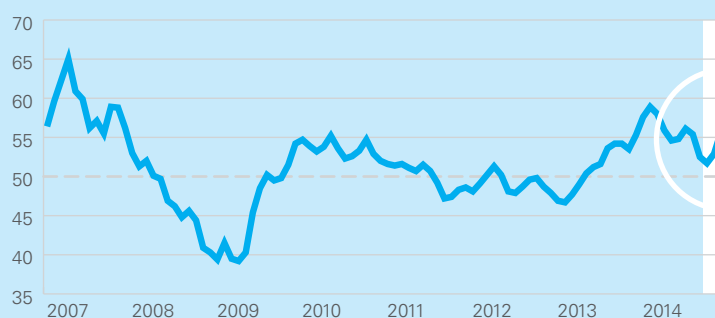
Methodology notes can be found on page 18.

Tech PMI Backlogs of Work Index, 50 = no change

Tech Companies

Tech PMI Input Price Index, 50 = no change

Tech Companies

Tech PMI Profitability Index, 50 = no change

Tech Companies

**Tudor Aw,
Technology Sector
Head at KPMG,
commented:**

"UK Tech companies are currently benefiting from lower input prices and strong order books, resulting in the second fastest pace of profitability rises since 2007. Looking forward, the main risk to this is a potential tightening in labour market conditions that may lead to an increase in payroll costs."

Employment trends: Tech sector job creation accelerates again in Q4

EMPLOYMENT TRENDS

In this section of Tech Monitor UK we compare tech sector employment trends against equivalent indices from Markit's *UK Purchasing Managers' Index® (PMI®)* surveys, providing a timely barometer of tech hiring patterns in the context of overall UK private sector labour market developments.

The main findings for Q4 2014* are:

The latest KPMG/Markit *Tech Monitor UK* survey indicated that staff hiring picked up further during the final quarter of 2014, which contrasted with the lull seen over the summer. Moreover, tech companies bucked the modest slowdown in overall UK private sector employment growth at the end of 2014.

At 55.0, the index measuring UK tech sector employment picked up from 54.5 at the end of Q3 and was comfortably above the long-run series average (52.1). The current period of sustained job creation now stretches to five years, which is the longest recorded since the survey began in 2003.

Anecdotal evidence from survey respondents cited new product launches, strong sales growth and improving underlying business

conditions as key factors driving staff recruitment at their units.

Some tech firms also noted that rising R&D spending had contributed to additional job hiring during the final quarter of 2014.

Looking at 2014 as a whole, KPMG/Markit *Tech Monitor UK* data highlights a fifth consecutive calendar year of employment growth across the sector. At 54.3, the average index reading for 2014 was fractionally above that seen in 2013 (54.2) and only surpassed by the survey-record high in 2011 (54.4).

UK tech companies remain upbeat about their expectations for staff recruitment over the next 12 months, with 39% of survey respondents intending to raise their workforce numbers and only 5% forecasting a reduction. That said, the degree of positive sentiment eased to its lowest since mid-2013 (see Section 4 for full details on the tech sector business outlook).

Tech sector job hiring trends; company size breakdown

Tech Monitor UK data indicated that small tech companies (those that employ fewer than 50 people) hired additional staff at a solid pace during the final quarter of 2014. Survey respondents mostly attributed rising employment to new contract wins and expectations of rising business activity at their units. Some firms also reported ongoing recruitment difficulties, related to strong competition for suitably skilled staff and associated rises in salaries.

At 52.1, the index measuring employment at small tech companies was down from 54.0 at the end of Q3, but still above the neutral 50.0 threshold.

Source: Markit/KPMG.

*Index numbers vary between 0 and 100, with levels of 50 signalling no-change from the previous month. Readings above 50 signal an increase since the previous month, whilst postings below 50 indicate a decrease. The greater the divergence from 50, the greater the rate of change signalled by the reading.

Methodology notes can be found on page 18.



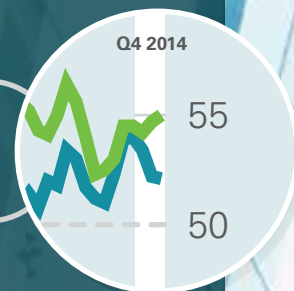
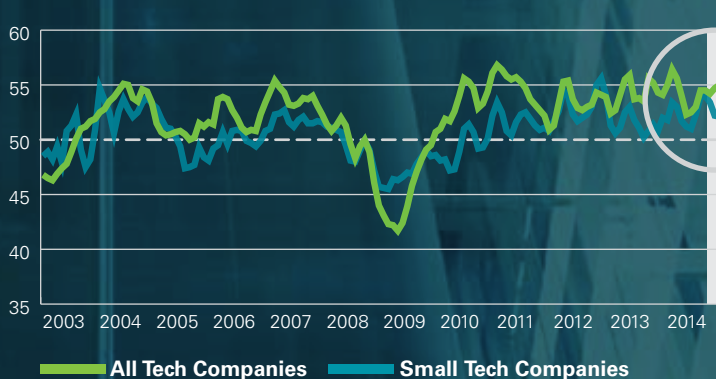
Annual Average PMI Employment Index, 50 = no change



Tudor Aw, Technology Sector Head at KPMG, commented:

"In a world where economies are facing 'jobless recoveries', it is fantastic to see the UK Tech Sector combine its increase in business activity with strong job creation. This period of sustained Tech sector job creation now stretches to 5 years."

PMI Employment Index, 50 = no change



Economic context: Tech sector growth picks up while UK economy slows

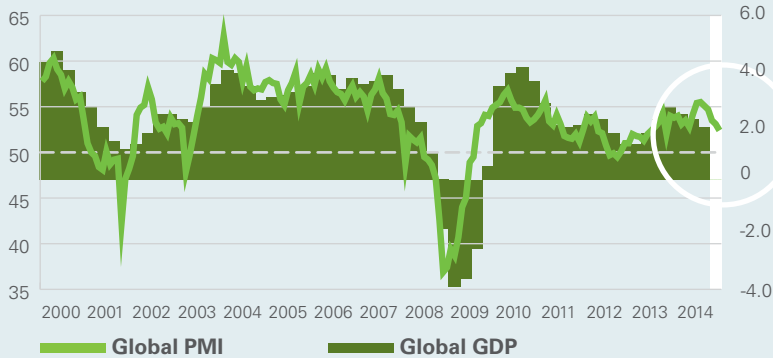
ECONOMIC CONTEXT

This section examines recent economic developments and how they relate to UK tech sector business conditions.

Global PMI and economic growth

JPMorgan Global Composite PMI

Global GDP annual % change

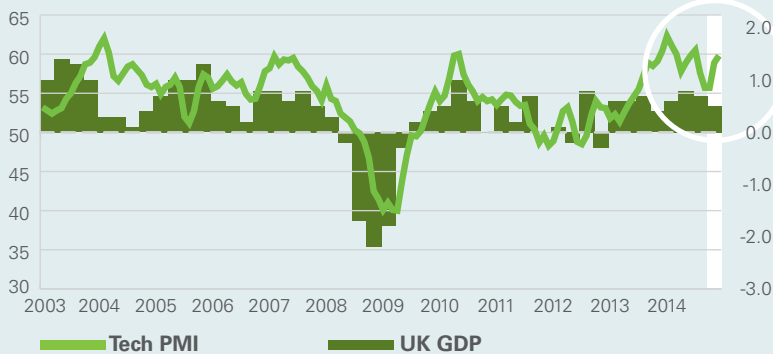


At the end of 2014, the NASDAQ was up just over **13%** year-on-year

UK tech business activity mapped against UK GDP

Tech PMI, 50 = no change

UK GDP, qoq % change



UK tech business activity mapped against the NASDAQ

Tech PMI, 50 = no change

NASDAQ yoy % change



Sources:

Global PMI® data sourced from JPMorgan/Markit.

UK GDP data sourced from the Office for National Statistics. At the time of writing, figures were available up to Q4 2014.

Stock market data sourced from Reuters EcoWin.

The main findings for Q4 2014 are:

The UK economy expanded by 0.5% in the final quarter of 2014, according to preliminary data. Although the pace of economic expansion cooled since Q3 (0.7%), latest GDP data confirm that the UK enjoyed its strongest annual performance since the global financial crisis, with the service sector remaining a key source of growth for the wider economy.

Equity markets continue to improve

The NASDAQ composite index, the benchmark for US technology stocks, was up by more than 5% on a quarterly basis in Q4 2014, pointing to year-on-year growth of just over 13% for 2014 as a whole. Following corrections in tech stock valuations earlier in the year and mixed sentiment among investors, the index has shown a sustained recovery and is back within sight of its highest level since the dotcom peak of over 5,000.

Global economic growth slows at end of year

According to the JPMorgan/Markit Global PMI™ series the global economy lost growth momentum at the end of Q4 2014, with the Composite Output Index posting at a 14-month low of 52.4. The fall was generally attributed to slightly softer expansions in the US and the UK, while growth remained muted in the emerging markets.

A weakening in the pace of global growth adds to a picture of growing economic uncertainty for both investors and businesses as we head into 2015. Furthermore, geopolitical tensions, a struggling eurozone, and a lack of momentum in emerging markets adds to the concern that the global economy may struggle to expand as quickly as it did in 2014.

However, the UK technology sector continues to be a bright spot for growth in a fading global recovery, among a handful of other developed nations. Improved economic fundamentals have also helped to lift business spending and investment in the UK, which have been key drivers of tech sector growth. The solid performance of technology companies highlights its role as an engine of growth ahead and bodes well for the UK as a whole, especially as growth continues to slow in other areas of the economy.

Tudor Aw, Technology Sector Head at KPMG, commented:

“The importance of the UK Tech Sector is exemplified by the way it outstrips UK GDP and highlights that it is a key engine of growth. These statistics provide a strong case for the sector to be prioritised.”

Tech outlook: Business optimism dips to two-year low in Q4

TECH OUTLOOK

This section contains analysis of our survey data on UK tech firms' business expectations for 2015. Figures for future business activity are drawn from monthly PMI® surveys; those on employment and capex are based on Markit's tri-annual Global Business Outlook survey.

The main findings for Q4 2014* are:

Optimism among UK tech firms regarding future activity has slipped to its lowest since early-2013. The net balance of companies anticipating activity growth over the next 12 months averaged +45.6% in Q4, the lowest quarterly reading for two years.

Nevertheless, the latest figure remains indicative of a robust level of positive sentiment, with tech firms continuing to report a more upbeat outlook than the average across all UK industry sectors (+43.2%). This is in line with the broad trend observed since data were first available in 2003.

The introduction of new product ranges, innovative marketing and promotional strategies, increased business opportunities resulting from technological change, and diversification into new markets were among the factors cited by UK tech firms that forecast activity growth over the next 12 months.

However, a number of survey respondents commented that strong competition, skill shortages, macroeconomic uncertainties and geopolitical issues continued to weigh on business sentiment.

Hiring and capex intentions moderate

Tech companies' employment expectations remain positive, but the planned rate of jobs growth is the slowest since mid-2013. The latest Markit Global Business Outlook Survey, which was conducted in October 2014, signalled that 39.0% of UK tech companies plan to expand their staffing levels, versus 5.1% that expect to trim headcounts. The resulting net balance is +33.9%, down from +37.3% last summer.

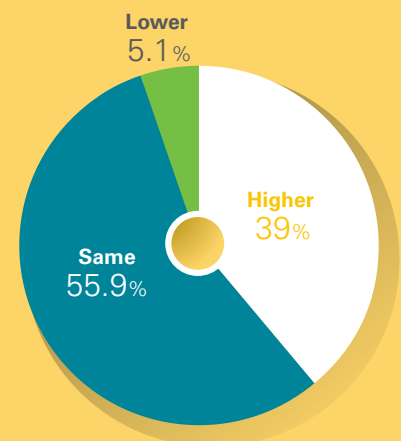
Tech firms are still more upbeat regarding jobs than the average across all sectors, however. The net balance for employment across all UK industry sectors is +32.1%.

Confidence regarding capital investment among tech firms has similarly eased, but remains stronger than the UK average. The tech sector net balance for capex intentions is +22.4%, compared with +15.4% across all industries.

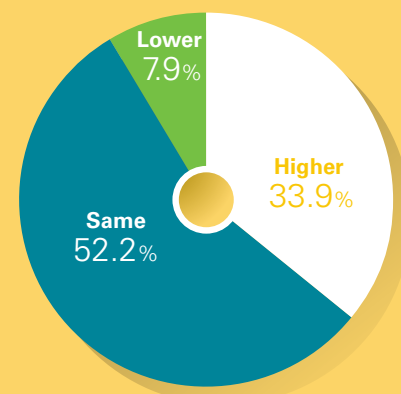
Markit Business Outlook Survey October 2014

"Do you expect employment at your business to be higher, the same or lower in 12 months' time than the current levels?"

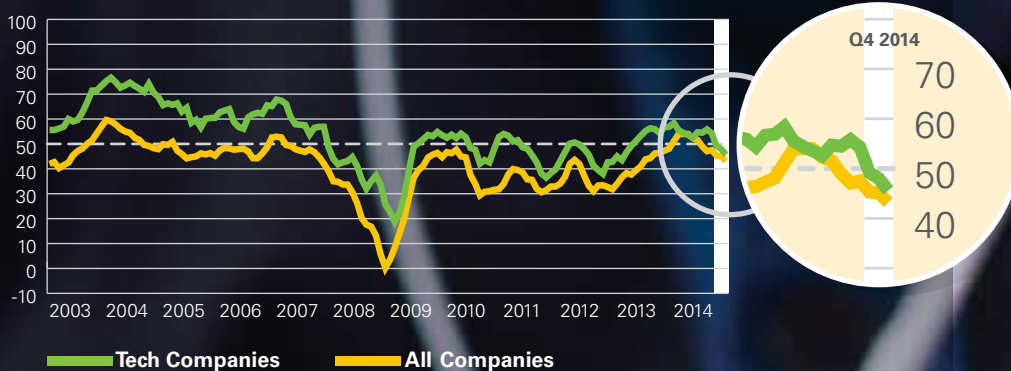
Tech companies employment expectations: net balance +33.9%



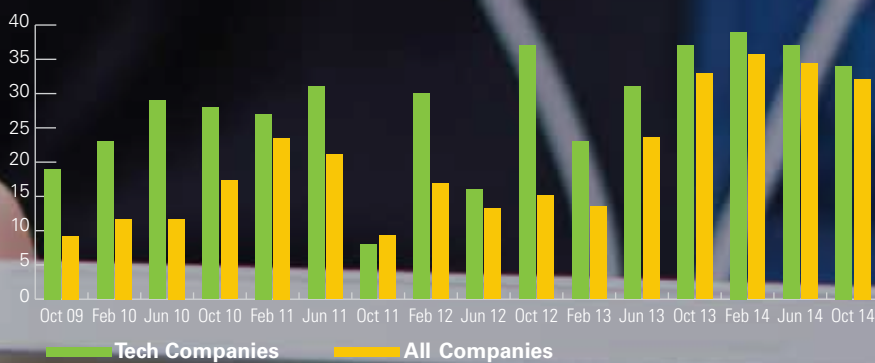
All companies employment expectations: net balance +32.1%



Business activity expectations (3 month avg), net balance %



Expectations for employment, net balance %



Tudor Aw, Technology Sector Head at KPMG, commented:

"While employment hiring intentions remain positive, there continues to be a hangover from our previous survey of concerns over the outlook for the next 12 months. We believe this reflects a combination of geopolitical risks as well as the uncertainties associated with the upcoming election."

Source: Markit/KPMG.

* Methodology notes can be found on page 18.

Special feature: UK tech start-up numbers look to have risen rapidly in 2014

SPECIAL FEATURE

In this section we evaluate the health of the UK tech sector since the onset of the financial crisis by bringing together enterprise count, birth and survival rate data published by the ONS. Tech sector enterprises are based on our usual technology sector industry groups (see methodology notes), and compared against overall UK trends.

Steep rise in UK tech sector start-ups

The number of new tech start-ups is rising rapidly and looks to have reached a seven-year high in 2014, after falling sharply in the direct aftermath of the global financial crisis.

Official figures suggest that tech sector start-up numbers first rebounded in 2010, which coincided with a strong improvement in business conditions and new policy initiatives to boost UK tech investment.

KPMG/Markit Tech Monitor UK data has proven a leading indicator of tech enterprise births in recent years, suggesting in advance a slowdown in tech start-up growth during 2012, but a steep rebound from 2013 onwards.

Based on the strength of our Tech Monitor UK survey in 2014, start-up numbers are likely to have risen by around 40% year-on-year and hit a post-crisis peak in absolute terms.

Tech sector survival rates exceed UK average

Official data highlight that the two-year survival rate of new tech companies has remained relatively robust from 2008-2013, and beaten the UK average throughout this period.

We estimate that tech sector companies have a two-year survival rate of approximately 80% since the financial crisis, compared with 74% for the average UK company.

Moreover, according to the latest available official data, tech sector and UK average survival rates both improved in 2013, though the tech sector (82%) remains comfortably above the UK-wide survival trend (76%).

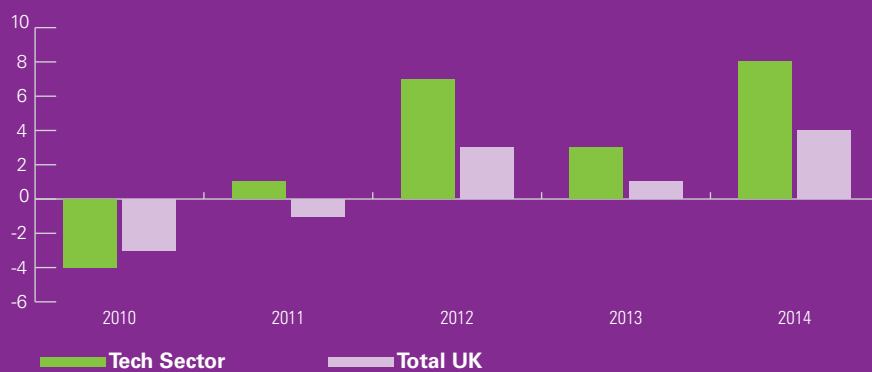
Tech sector enterprise counts pick up again in 2014

The tech sector saw an earlier recovery in total enterprise counts than the UK as a whole; tech counts have been rising since 2011 on an annual basis, compared with 2012 for the UK as a whole.

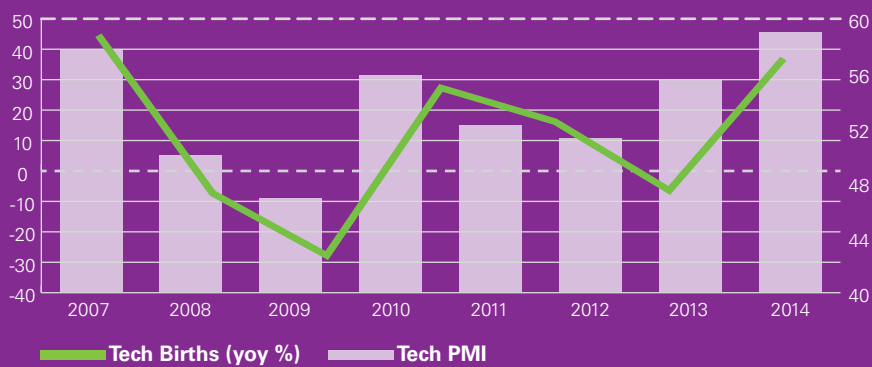
Furthermore, the latest official data show a persistent outperformance for the tech sector against UK-wide trends. Between 2009 and 2014, the number of tech companies was up by over 16%, while the total count of UK private sector enterprises increased by less than 5%.

Overall, 2014 saw the strongest annual rise in tech companies since the global financial crisis (up by approximately 8%). The growth rate was around twice the UK all-sector figure, likely driven by both strengthening survival rates and a steep upturn in start-up numbers within the tech sector.

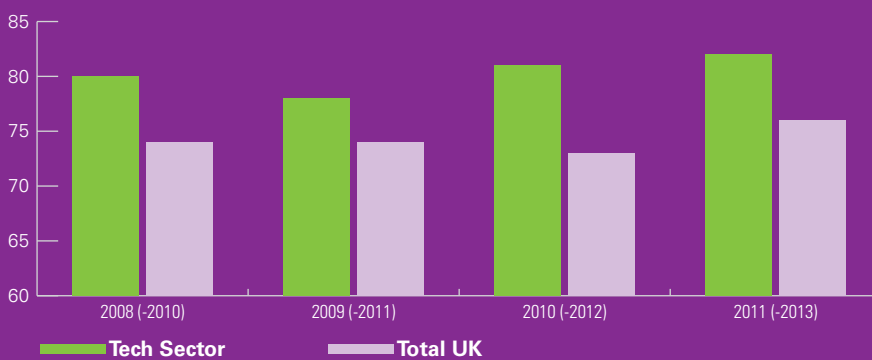
Enterprise Count (yoy % change)



Tech Enterprise Births and Tech PMI



Tech Start-Ups: Two-year Survival Rates



Tudor Aw, Technology Sector Head at KPMG, commented:

"For those who decry the entrepreneurial spirit of UK Tech Start-ups compared to their overseas counterparts, these results show that the Tech start-up scene is not only vibrant but that they have a high survival rate."

Sources: Markit/KPMG, ONS and Methodology notes can be found on page 18.

Tech Monitor UK: Methodology notes

METHODOLOGY NOTES

UK Tech Sector Purchasing Managers' Index® (PMI®) survey data

UK tech sector PMI data is derived from a representative sub-category of approximately 150 tech companies within Markit's regular PMI® surveys of UK manufacturers and service providers. Tech is defined in this report as technology software, technology services and manufacturing of technology equipment. All figures are seasonally adjusted and smoothed using a three-month moving average, to better highlight underlying trends in the data.

UK Tech Sector Business Outlook Survey data

Business activity expectations data are drawn from the monthly PMI® surveys question on companies' expectations for their activity/output over the next 12 months. Prior to July 2012, only service sector companies were asked this question.

Employment expectations data are based on responses from UK services and manufacturing firms participating in Markit's tri-annual Global Business Outlook survey, which is based on the same panel of companies as the PMI® surveys.

'Technology Sector' industry groups:

- Software publishing (SIC 582).
- Computer programming, consultancy and related activities (SIC 620).
- Data processing, hosting and related activities; web portals (SIC 631).
- Manufacture of computer, electronic and optical products (SIC 26).
- Manufacture of electrical equipment (SIC 27).

Enterprise Count, Births and Survivals

The enterprise data included in this report are calculated from an annual snap-shot of the Inter-Departmental Business register, which contains information on VAT traders and PAYE employers in a statistical register, and is published by the Office for National Statistics (ONS). The industry sectors measured by the ONS are based on Standard Industrial Classifications (SICs), which categorise business establishments by the type of economic activity in which they are engaged. To ensure consistency, our technology sector definition follows the same tech industry groupings as shown above.



For more methodology details,
see the October 2013
Tech Monitor UK report.



➔ [Click here to download.](#)





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