KPMG UK Tech Monitor

UK tech sector rebounds in Q1 despite global economic headwinds and Brexit anxiety

PMI® By IHS Markit

30 April 2019

kpmg.com/uk

KPMG UK Tech Monitor

Key findings

Rebound in UK tech sector growth during the first quarter of 2019

Strongest rise in new work since Q2 2018

Tech firms indicate the weakest business optimism for 10 years

"The latest KPMG UK Tech Monitor Index outlines the resilience of the UK tech sector, and the strength of its ability to compete globally. Despite concerns about global economic headwinds and ongoing Brexit anxiety, confidence is buoyed by long term trends where the UK has a track-record for innovation such as AI-enabled enterprise software and fintech."

Bernard Brown, Vice Chair, KPMG in the UK

Welcome to the KPMG UK Tech Monitor Index

We have compiled the quarterly UK Tech Monitor Index by taking a representative sample of tech companies from IHS Markit's widely-watched Purchasing Managers' Index® (PMI®) surveys. The tech sector is defined in this report as technology software, technology services and manufacturing of technology equipment. Historical data is available since Q1 2003 and full details are in the methodology section.

Our panel of tech sector executives are asked about actual changes in business activity, new work, backlogs, employment, costs and charges. The headline UK Tech Monitor Index measures changes in business activity on average over the most recent quarter. Results are seasonally adjusted. Index numbers vary between 0 and 100, with readings above 50 indicating an overall increase and below 50 a decrease.

Stronger tech sector performance

UK tech companies appear to have recovered from the slowdown seen towards the end of 2018, when business activity expanded at the weakest rate for three years. Our latest survey reveals a robust overall growth rate for the sector in the first quarter of 2019.

The rebound in business activity was highlighted by a rise in the KPMG UK Tech Monitor Index to 54.4 in Q1, up from 52.3 in the previous quarter and the highest since Q2 2018. This compared favourably with the equivalent index for the overall UK economy in Q1 2019 (50.6), which signalled the weakest growth for over six years.

Softer domestic economic conditions and heightened political uncertainty are nonetheless acting as a headwind to growth, and this has led to escalating concerns about the near-term business outlook among UK tech sector companies.

New business growth accelerates

Latest data revealed a solid rebound in new work received by tech sector firms during the first quarter of the year. Survey respondents cited successful product innovation, diversification into new overseas markets and strong demand from US clients as key growth drivers.

Improved sales volumes did not appear to translate into a sizable uplift in job creation, with the rate of employment growth remaining among the weakest since 2013.

Higher wages continued to push up operating expenses in Q1 2019. Tech firms often reported on shortages of suitably skilled candidates to fill vacancies and a corresponding rise in salary payments. That said, the overall rate of input cost inflation was still much softer than the survey-record highs seen in 2017. .

Tech businesses highlight concerns about near-term growth prospects

Despite a growth rebound in Q1, UK tech companies indicated that they have become less upbeat about the near-term business outlook than at any time over the past decade.

Worries about growth prospects for the year ahead were linked to concerns about corporate spending in both domestic and export markets. Tech companies cited Brexit-related delays to decision-making and a more subdued global economic outlook as key factors likely to dampen client demand.

More fragile confidence about future sales contributed to a drop in the index measuring tech sector profits expectations to its weakest since Q4 2011, when the euro area debt crisis led to a slide in corporate spending.

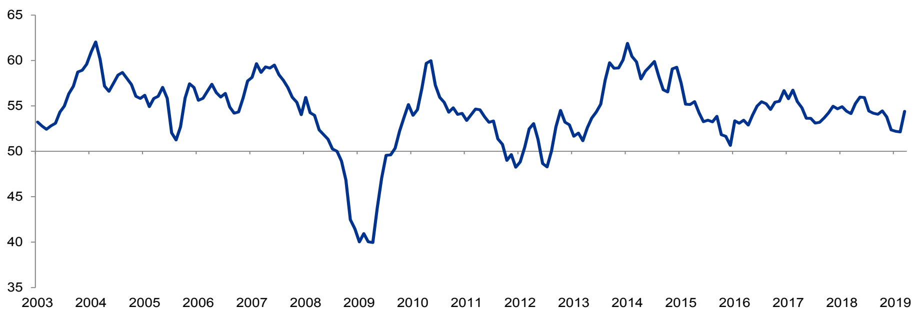
Positivity continues for capex and staff hiring in the next 12 months

Confidence about staff hiring and capital expenditure plans continues to outstrip the rest of the UK economy. Around 43% of tech firms expect to boost their workforces in the next 12 months, while only 11% anticipate a fall in employment.

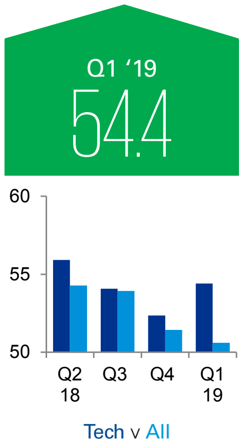
Survey respondents cited a range of positive long-term developments, including AI-enabled enterprise software, a supportive environment for UK fintech innovation and strong demand for cloud technologies.

KPMG UK Tech Monitor Index

Above 50 = business activity growth, seasonally adjusted



Tech Sector Output: Business Activity Index



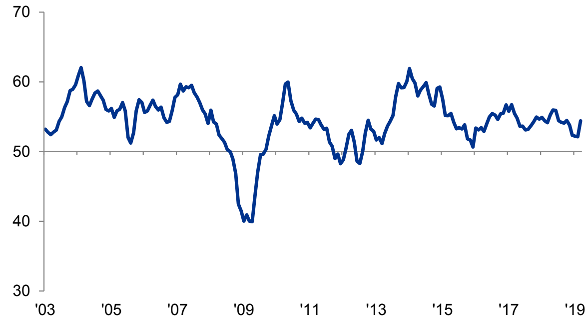
UK tech firms report a rebound in business activity

The latest survey reveals an improvement in business activity growth at tech sector companies, following the three-year low seen at the end of 2018. A recovery in momentum was achieved despite headwinds from slower economic growth across the UK and euro area at the start of this year.

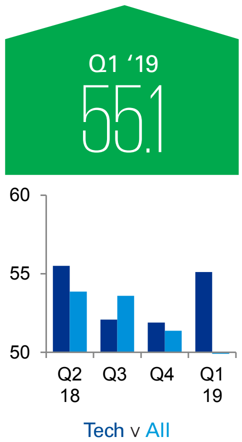
Survey respondents noted that strong corporate demand for technology services and a healthy pipeline of new product launches had helped to fuel growth in Q1 2019.

Business Activity Index

Above 50 = growth, seasonally adjusted



Tech Sector Sales: New Business Index



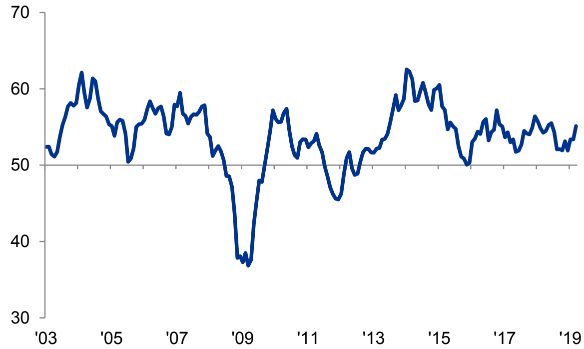
Strong improvement in new order volumes

The New Business Index picked up to 55.1 in the first quarter of 2019, from 51.9 in Q4, to signal a robust and accelerated rise in sales volumes. This contrasted with a decline in new work across the UK private sector as a whole in the first three months of the year.

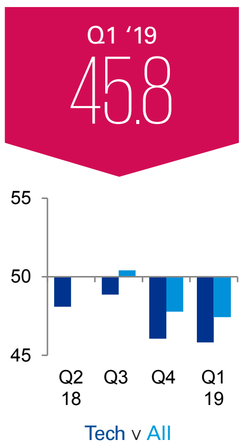
Tech firms linked sales growth to resilient US demand and diversification into new overseas markets. There were also reports that some European clients had brought forward purchases to avoid Brexit-related disruption.

New Business Index

Above 50 = growth, seasonally adjusted



Tech Sector Capacity: Outstanding Business Index



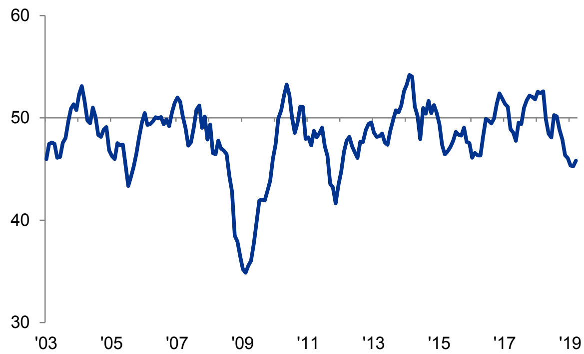
Backlogs fall at sharpest rate since Q4 2011

UK tech companies continued to clear their backlogs of incomplete work in the first quarter of 2019. At 45.8, the index dipped from 46.1 in Q4 and signalled the fastest rate of decline for just over seven years.

Survey respondents indicated that the soft patch for sales growth at the end of 2018 had enabled them to catch up on unfinished work. Greater investment spending was also cited as a factor helping to boost tech sector productivity and business capacity.

Outstanding Business Index

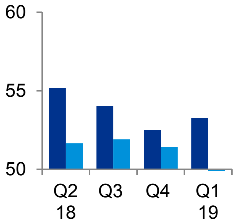
Above 50 = growth, seasonally adjusted



Tech Sector Jobs: Employment Index

Q1 '19

53.3



Tech v All

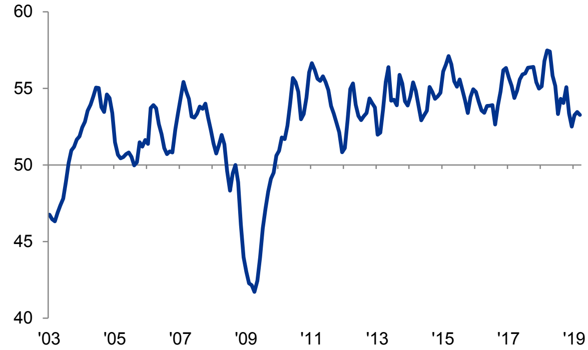
Subdued employment growth persists at the start of 2019

The seasonally adjusted Employment Index edged up to 53.3 in Q1, from 52.5 in the final quarter of 2018. However, the latest reading indicated that the rate of tech sector job creation remained weak in comparison to its recent trend.

A number of companies pointed to more cautious hiring strategies in 2019, linked to heightened uncertainty about the business outlook. Tech firms also noted that shortages of suitably skilled staff had held back their recruitment plans.

Employment Index

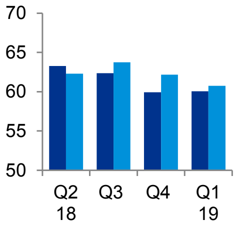
Above 50 = growth, seasonally adjusted



Tech Sector Costs: Input Prices Index

Q1 '19

60.0



Tech v All

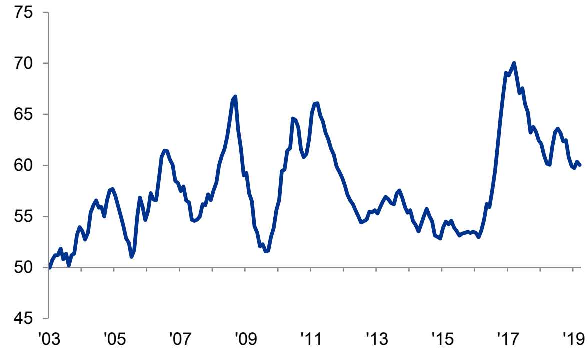
Rising staff salaries continue to drive up business expenses

Latest data revealed another sharp increase in average cost burdens across the tech sector. The rate of inflation nonetheless remained much softer than the survey-record highs seen in 2017 following a slide in sterling against the US dollar.

Companies reporting an increase in their operating expenses during Q1 often cited strong wage pressures. Higher global electronics prices were also widely cited by survey respondents.

Input Prices Index

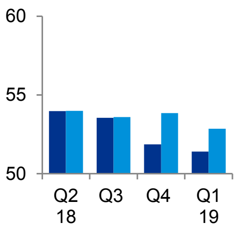
Above 50 = growth, seasonally adjusted



Tech Sector Margins: Prices Charged Index

Q1 '19

51.4



Tech v All

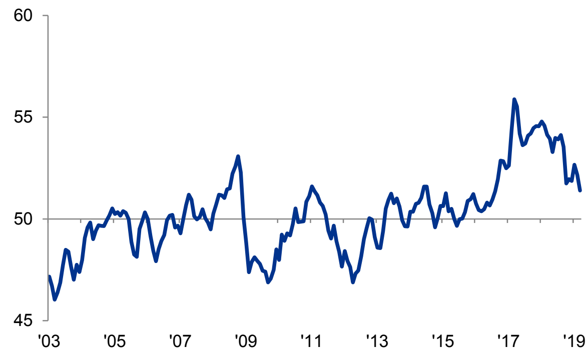
Margin pressures intensify

There were signs that the strong improvement in sales volumes had been achieved at the expense of operating margins in Q1 2019. This was highlighted by a fall in the seasonally adjusted Prices Charged Index to 51.4, down from 51.9 in Q4 and the lowest reading for almost three years.

Those companies reporting an increase in their average selling prices mainly commented on the need to pass on the cost of higher salary payments.

Prices Charged Index

Above 50 = growth, seasonally adjusted



Tech sector outlook

Business optimism drops to 10-year low

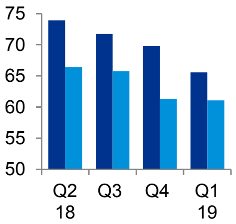
Tech firms remain more upbeat about the year ahead business outlook than the UK private sector as a whole, but the degree of optimism eased sharply since the end of 2018. This was highlighted by a fall in the Business Activity Expectations Index to 65.6, down from 69.8 in Q4 last year and the lowest reading since Q1 2009.

Survey respondents widely commented that Brexit-related uncertainty and a more subdued global economic outlook had the potential to dampen corporate spending in the coming 12 months. A number of tech companies also cited concerns about tight labour market conditions and a corresponding lack of suitably skilled candidates to fill vacancies.

Despite a slide in business confidence to its weakest for a decade, companies continue to report a range of long-term trends likely to support tech sector growth in 2019. These include advances in AI-enabled enterprise software, fintech innovation and strong demand for cloud technologies.

Q1 '19

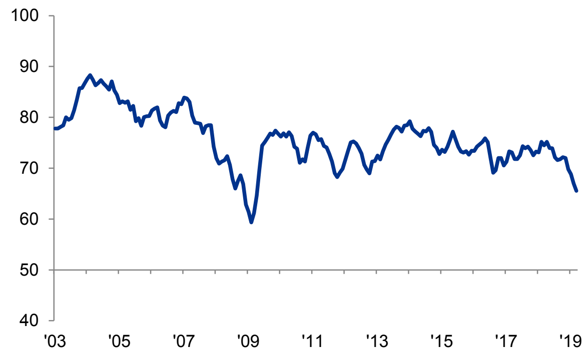
65.6



Tech v All

Business Activity Expectations Index

Above 50 = growth in the next 12 months



UK tech sector outlook survey Q1 2019

In this section we ask UK tech firms about their plans for employment, capital spending, profits and pricing over the next 12 months. The latest survey was compiled in Q1 2019, using a panel of respondents to IHS Markit's tri-annual Global Business Outlook Survey. All figures are presented as percentage net balances.

The latest survey data indicates that the tech sector continues to score strongly in terms of staff hiring and capital spending plans, with the 12 month outlook much more upbeat than the UK private sector as a whole. However, mirroring the trend seen for business activity expectations, tech companies are less confident than they were at the end of last year.

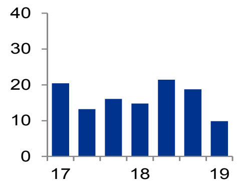
Around 43% of the survey panel intend to boost their payroll numbers during the year ahead, while only 11% forecast a reduction. At +31.1% in Q1, the net balance of tech companies expecting to expand staffing levels is the lowest since mid-2017. However, this remains well above the UK-wide figure, which slipped to a five-year low in Q1 2019 (+14.4%).

Softer employment growth projections among tech firms partly reflect concerns that Brexit-related disruption and domestic political uncertainty could act as a headwind to customers' willingness to spend this year. Survey respondents also suggested that rising global economic uncertainty had led to weaker business investment among clients and encouraged a shift towards more cautious recruitment plans.

UK tech companies appear to have reassessed their optimism regarding the near-term outlook for profits.

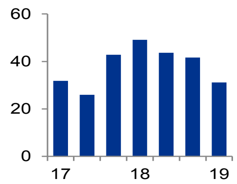
Capex plans

Net balance expecting growth



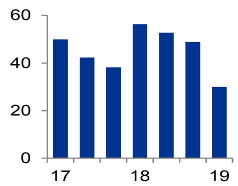
Staff hiring plans

Net balance expecting growth



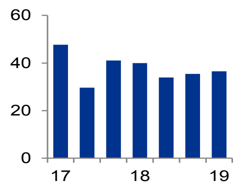
Profit expectations

Net balance expecting growth



Output charges expectations

Net balance expecting growth



KPMG

UK sector rankings

At +30.0, the net balance measuring tech sector profits expectations is down sharply from +49.8% in Q4 and the lowest since the euro area debt crisis led to a slide in business sentiment during Q4 2011.

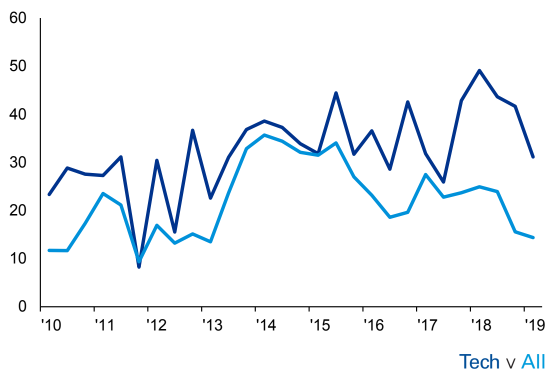
Reduced optimism on tech sector profits was linked to rising staff salaries, strong competitive pressures and the potential for tighter corporate budget setting in 2019.

Meanwhile, the proportion of UK tech firms intending to raise their average charges continued to increase in Q1. At +36.5%, the index for future selling prices is up slightly from +35.4% at the end of 2018, and at its highest level for one year.

Heightened uncertainty regarding the business outlook led some tech firms to pare back investment plans at the start of 2019, with the net balance the lowest recorded for nearly six years (+9.8% in Q1).

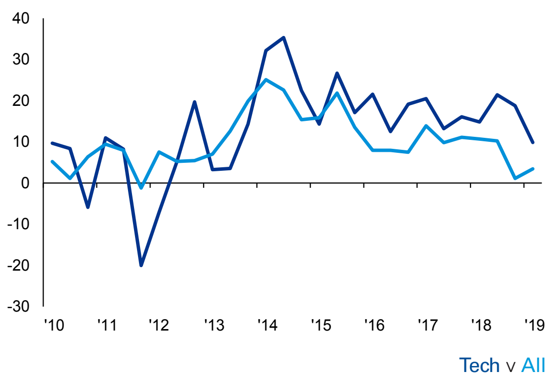
Employment Outlook

Net balance expecting growth, next 12 months



Capital Expenditure Outlook

Net balance expecting growth, next 12 months



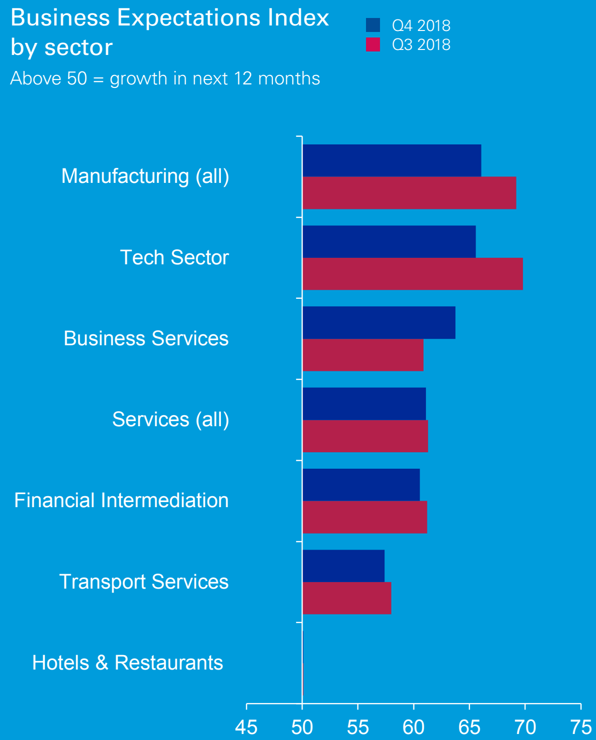
Business confidence towards the year ahead weakened further at UK services companies during the opening quarter of 2019. This was highlighted by the index monitoring optimism slipping from 61.3 in Q4 2018 to 61.1 in Q1. This marks the lowest reading since the start of 2009 when sentiment was hit by the global financial crisis. Manufacturers continued to express a stronger degree of optimism than their service-sector counterparts, although the index reading of 66.1 remained much weaker than seen on average over the series history.

According to survey respondents, heightened uncertainty regarding the UK's departure from the EU, weaker demand in key exports markets, global trade frictions and reduced business investment had all weighed on forecasts for the year ahead.

Furthermore, all monitored areas of the UK economy expressed less positive forecasts compared to the end of last year, with the exception of hotels & restaurants. Businesses in this sub-sector nonetheless continue to anticipate a stagnation of business activity over the next 12 months amid relatively weak household expenditure trends.

Business Expectations Index by sector

Above 50 = growth in next 12 months



Digital transformation: special feature

The adoption of digital technology has occurred at an accelerating pace in recent years, helping to transform business operations, boost productivity and drive innovation.

With this in mind, we asked over 1,000 UK employees about their perception of digital transformation and its impact on efficiency at their workplace. Survey responses are analysed for all UK employees, by region and across industry sectors.

Do employees feel that the integration of digital technology into their workplace is a key priority?

A clear majority of employees (71%) agree that efforts to embrace digital tools and resources at their workplace are a key priority, while just 12% disagree with this statement. While this is a strong signal that enterprises are prioritising the integration of digital technology, the survey also reveals large discrepancies between industry sectors and across UK regions.

Broken down by occupation, the perception that the integration of digital tech at work was a key priority is most widespread in finance/business services (91%), followed by those employed in the IT/Telecoms sector (85%).

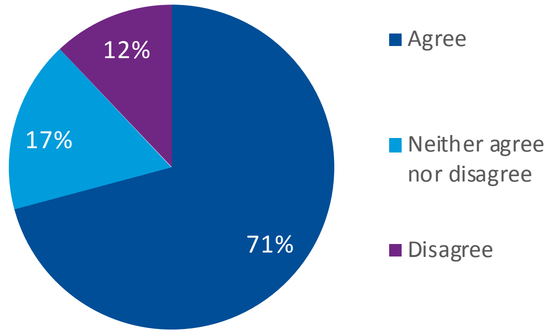
At the other end of the scale, just 57% of retail and 64% of manufacturing workers agreed that the adoption of digital technology was a major priority at their workplace.

On a regional basis, perceptions on the importance of the adoption of digital technology at work were also notably varied. Workers in London were by far the most in agreement (78%), followed by those in the South of England (73%).

Meanwhile, those based in the North of England and the Midlands expressed the least upbeat sentiment about the prioritisation of digital technology at their workplaces (67% and 69%, respectively).

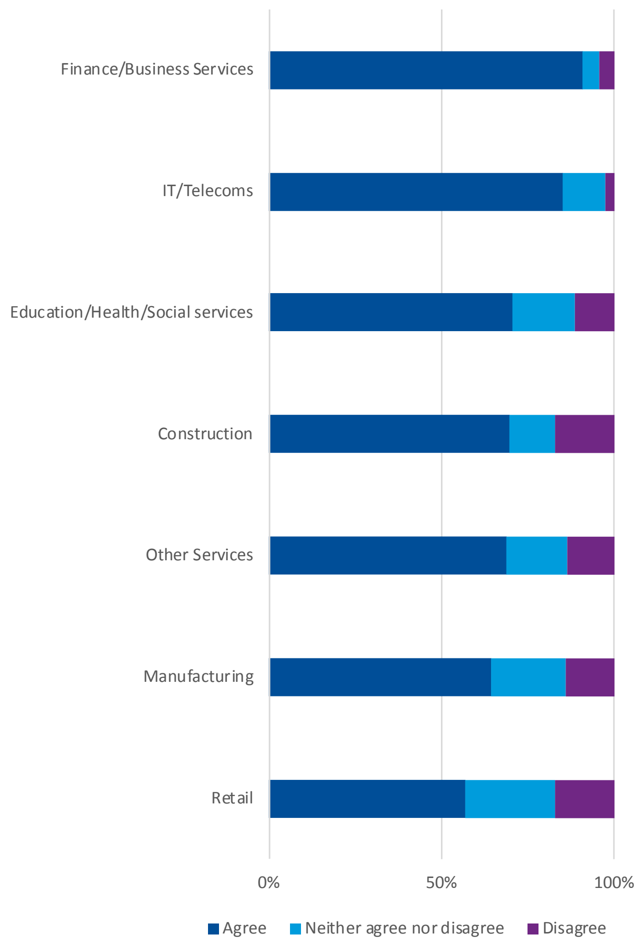
The integration of digital technology into my work-place is a key priority?

All employees



The integration of digital technology into my workplace is a key priority?

Results split by industry sector



Do employees feel that digital transformation improves efficiency at their workplace?

Not only do most people see digital technology as a priority at work, but they also generally believe it has improved efficiency. Around 72% of UK employees report that efficiency has improved through digital transformation, compared to just 9% that disagree.

Finance/business services stands out as an area that has seen the biggest improvement in efficiency, according to the survey results. Of those employed in finance/business services, around 89% agree that digital transformation has had a positive effect on efficiency in their workplace. IT/Telecoms (87%) and Construction workers (76%) also strongly agree that productivity has improved.

Perhaps surprisingly, the manufacturing sector registered the lowest proportion of workers to note gains via the adoption of digital tech (62%).

Regional results showed similar results for the perceived importance of digital tech, with employees in London the most likely to agree that workplace efficiency has improved (78%). Efficiency gains were nonetheless reported across the UK, with at least 70% of workers in each region agreeing that efficiency has improved via digital transformation.

Methodology

The fieldwork dates were Thursday 7th March to Tuesday 12th March 2019, based on a representative sample of 1,000 UK employees.

Q. Please indicate the extent to which you agree or disagree with each of the following statements:

a) The integration of digital technology into my workplace is a key priority

b) Digital transformation improves efficiency at my workplace.

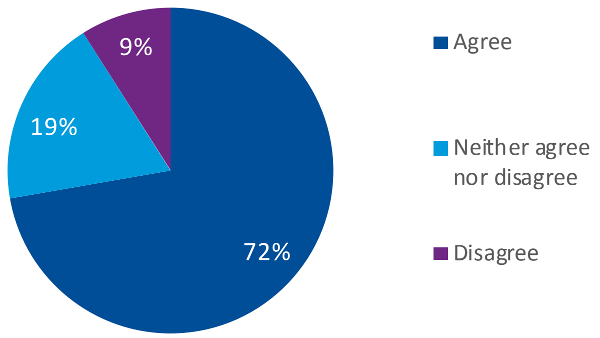
Definitions:

Digital Technology describes the use of digital resources (e.g. computer applications, internet tools, programming tools, coding, software) to effectively find, analyse, create, communicate, and/or use information in a digital context.

Digital Transformation is the process of using digital technologies to create new — or modify existing — business processes, culture, and customer experiences to meet changing business and market requirements.

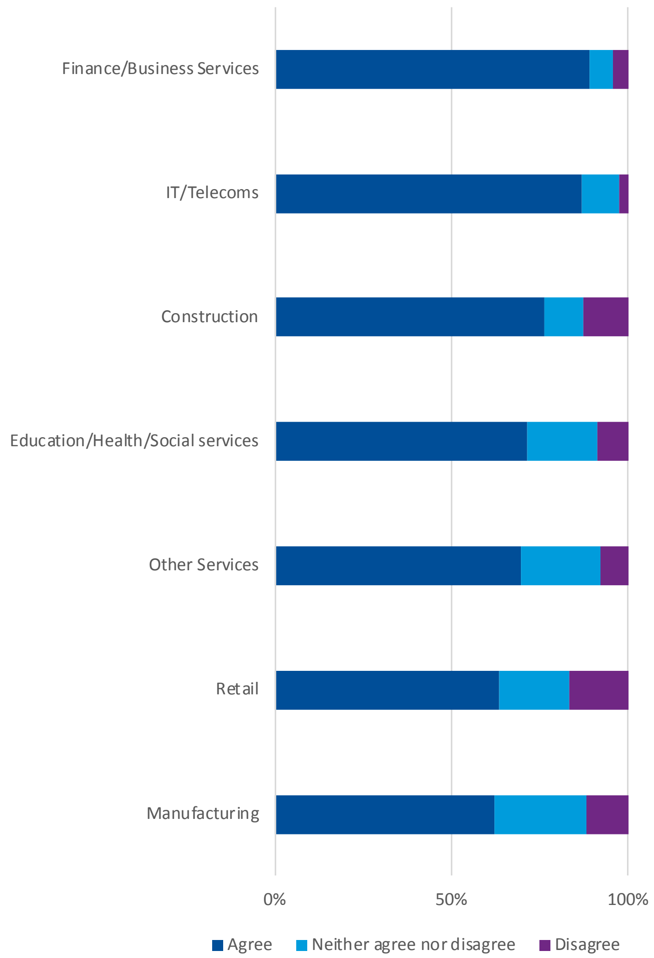
Digital transformation improves efficiency at my workplace?

All employees



Digital transformation improves efficiency at my workplace?

Results split by industry sector



Contacts

KPMG

Bernard Brown
Vice Chair, KPMG in the UK
T +44 (0)207 311 6605
E Bernard.Brown@kpmg.co.uk

IHS Markit

Tim Moore
Associate Director
T +44 (0)149 146 1067
E Tim.Moore@ihsmarkit.com

www.kpmg.com/uk

For full details of our professional regulation please refer to 'Regulatory Information' at www.kpmg.com/uk

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

About KPMG

KPMG LLP, a UK limited liability partnership, operates from 22 offices across the UK with approximately 16,300 partners and staff. The UK firm recorded a revenue of £2.338 billion in the year ended 30 September 2018. KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 153 countries and territories and have 207,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

About IHS Markit

IHS Markit (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 business and government customers, including 80 percent of the Fortune Global 500 and the world's leading financial institutions.

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

UK Tech Monitor Index data is derived from a representative sub-category of approximately 150 tech companies within IHS 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 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, capex, profits and input cost expectations data are based on responses from UK services and manufacturing firms participating in IHS 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).

Disclaimer