

INTRODUCTION

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

The survey sampled 400 firms in December from across the Scottish economy.

The survey examined business sentiment in the final quarter of 2022 and the outlook and expectations for the year ahead.

The net balance of all of our core business activity indicators for Q4 2022 are negative for the first time since Q1 2021. However, after slipping into the red last quarter, business sentiment bounced back ever so slightly and has returned to positive territory.

OUR SURVEY RESULTS ALSO SHOW THAT:

- 9 in 10 Scottish firms have seen their costs increase over the past year, with over 1/4 of manufacturing and 40% of hospitality and construction firms experiencing their costs increase by more than 50%.
- Just under half of the businesses surveyed this quarter expect to reduce their operations this year due to higher energy bills, and the share of firms expecting to reduce operations by a large extent is up from 4% last quarter to 7% this quarter.
- However, more than 60% of firms reported that the current energy crisis has encouraged them to make energy-efficient improvements to their business. But, 60% of businesses say that price point is a barrier to making these energy-efficient improvements to their businesses.
- The labour market continues to cool slightly, with the number of firms with vacancies down again on last quarter. However, filling these vacancies remains a challenge, with 80% of firms reporting applicants to lack the skills required for the job.
- This quarter, the most common concerns among responding businesses were the costs of energy (88%) and the price of inputs (87%). However, looking toward the next 6 months, the majority (75%) of businesses expect total employee costs to be the key cost driver in the economy.
- Overall sentiment for the Scottish economy continues to worsen, with around 3 in 4 firms expecting growth in the Scottish economy to be weak or very weak over the coming year.
- Just 5% of firms felt more confident about the outlook for their business following the Scottish Budget, and just 12% felt more confident after the UK Government's Autumn Statement.



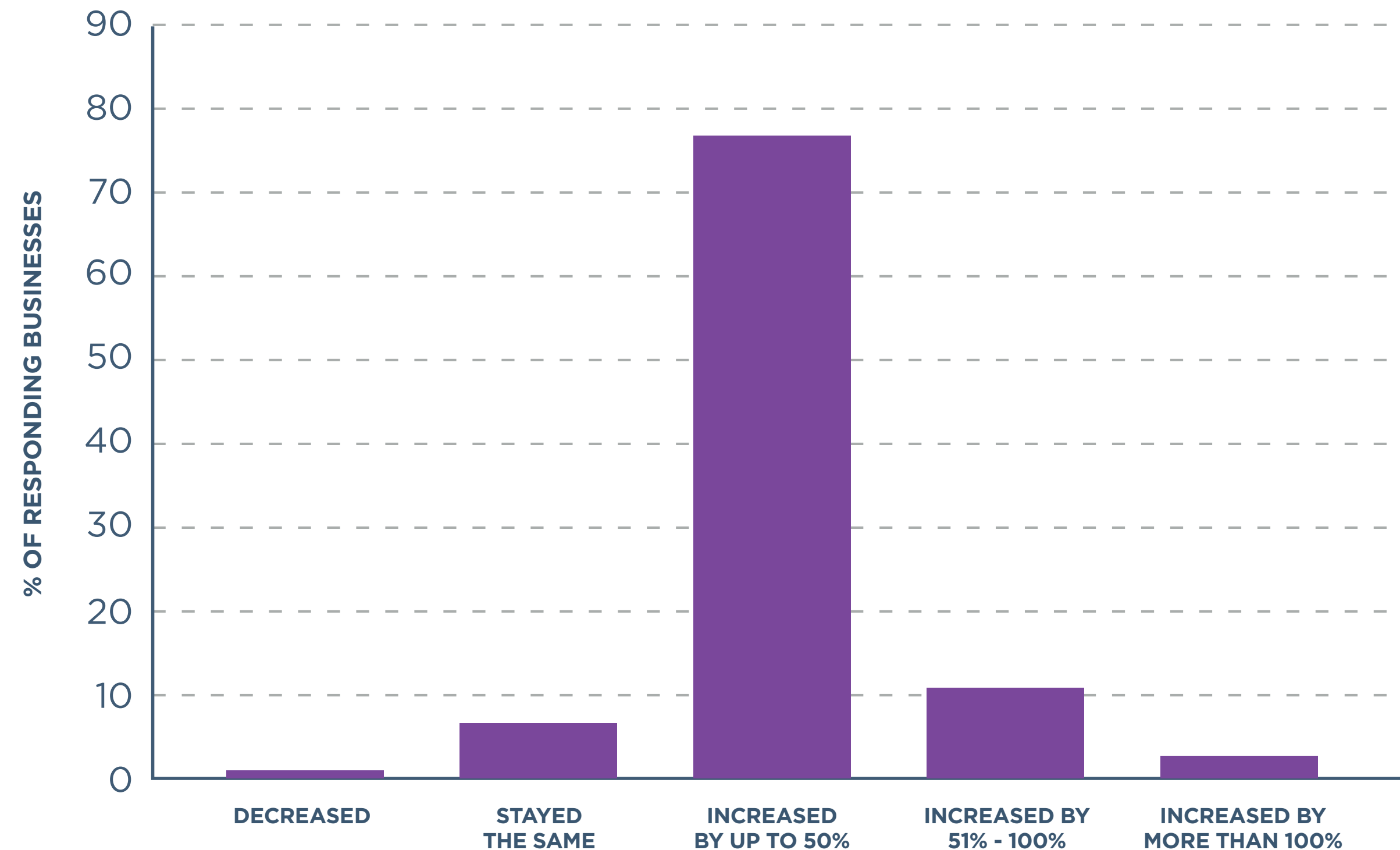
KEY RESULTS

BUSINESS COSTS

- This quarter we asked businesses across Scotland how their costs have changed over the past year.
- 90% of Scottish firms have seen their costs increase, with the majority (77%) experiencing increased costs of up to 50%.
- Professional services firms are among those least impacted by rising costs, with 11% reporting that their costs have stayed the same over the past year.
- On the other hand, just over 1 in 4 of manufacturing firms and 2/5 of hospitality and construction firms have seen their costs go up by more than 50%.
- 5% of manufacturing firms have experienced their costs more than double over the past year.

Chart 1:

Over the past year, roughly how have your business costs changed?



*6% of businesses responded N/A; therefore, percentages will not sum to 100%

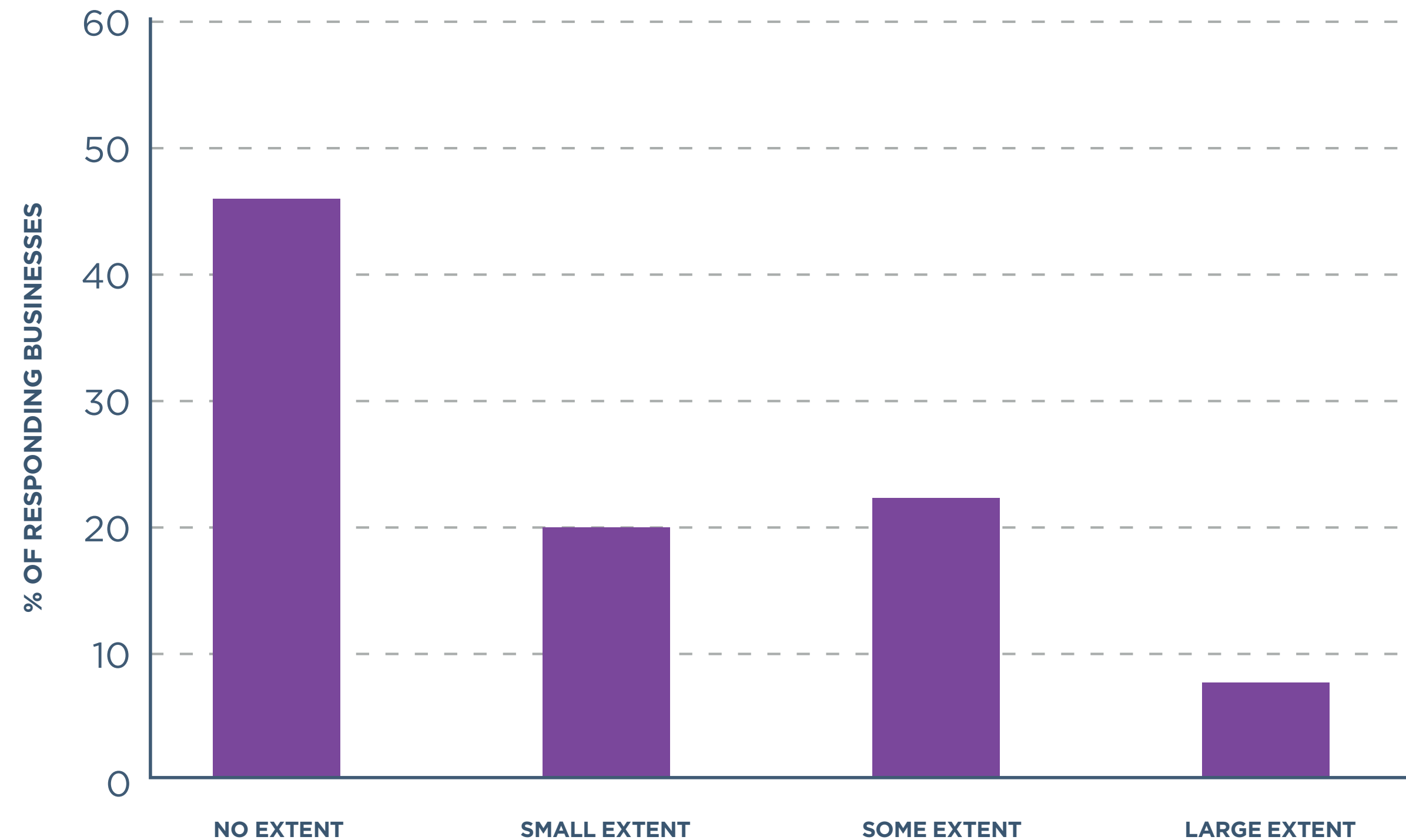
KEY RESULTS

ENERGY COSTS

- We continued to ask firms about energy costs and how this is expected to impact their operations.
- Similar to our last survey, just under half of the businesses surveyed this quarter expect to reduce their operations this year due to higher energy prices.
- However, the share of firms expecting to reduce operations by a large extent is up from 4% last quarter to 7% this quarter.
- But, there were improvements in the hospitality sector, where 68% of firms expect to reduce operations due to higher energy costs, down from 75% last quarter.

Chart 2:

To what extent do you expect to reduce operations this year due to increases in energy (electricity, gas, or fuel) prices?



*6% of businesses responded N/A; therefore, percentages will not sum to 100%

KEY RESULTS

ENERGY EFFICIENCY AND SUSTAINABILITY

- In our latest survey we continued to ask firms if the ongoing energy crisis has sped up considerations to make energy-efficient improvements to their business.
- Almost 3/5 of firms reported that the ongoing energy crisis has increased their focus on adopting energy-efficient processes.
- The majority (81%) of large firms (250+ employees) surveyed said that the current crisis had increased their energy efficiency focus. This compares to 51% of the smallest (1-10 employees) businesses in our sample.
- Of those firms with an increased focus on energy efficiency, the majority plan to increase the energy efficiency of business property (64%).
- This was followed by those that plan to increase the energy efficiency of processes (46%), install energy-efficient appliances (38%), invest in microgeneration (i.e., solar panelling or heat pumps) (23%), invest in draughtproofing and/or double/triple glazed windows (17%) and install a smart meter (12%).
- When asked what the barriers are in making energy-efficient improvements, just over 60% of businesses said the cost of making improvements stops them, while 43% reported that improvements were infeasible for their business.
- Our latest results indicate that smaller firms face greater barriers than larger firms when it comes to making energy efficient improvements.
- Overall, 63% of firms agreed that sustainability is important to their business strategic vision, while only 8% disagreed.
- Almost all (97%) large firms in our sample agreed that sustainability is important to their business strategy, compared to 59% of small firms.



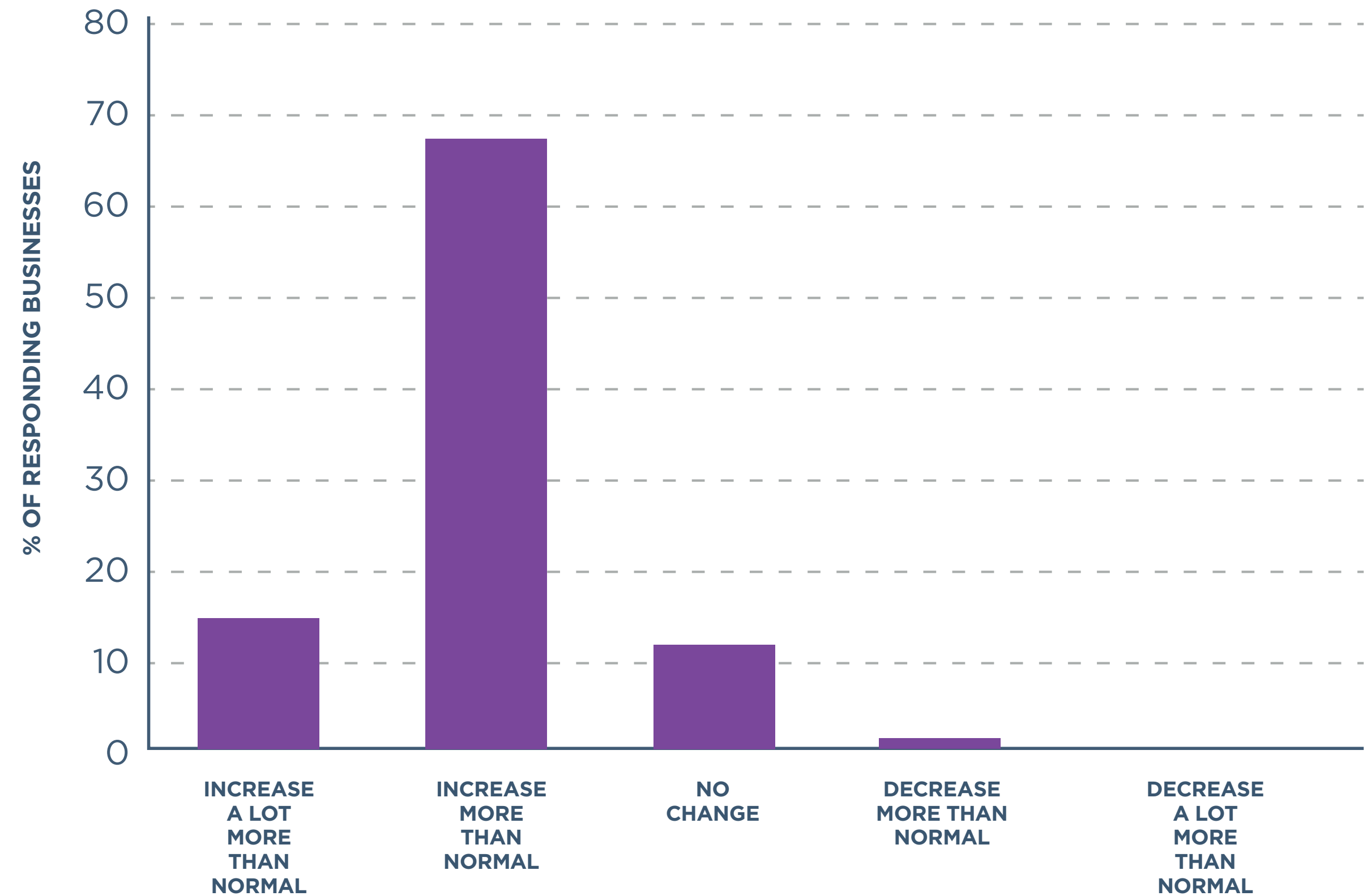
KEY RESULTS

INFLATIONARY PRESSURES

- Inflationary pressures have begun to ease slightly, with 81% of firms expecting to increase their prices by more than, or a lot more than normal, over the next 12 months, down from 85% last quarter.
- 95% of accommodation and food services firms expect their prices to increase, followed by 93% of firms in the wholesale and retail sector, both up 3-percentage points on the last quarter.

Chart 3:

Over the next 12 months, how do you expect the prices of your goods and services to change compared to normal?



*5% of businesses responded N/A; therefore, percentages will not sum to 100%

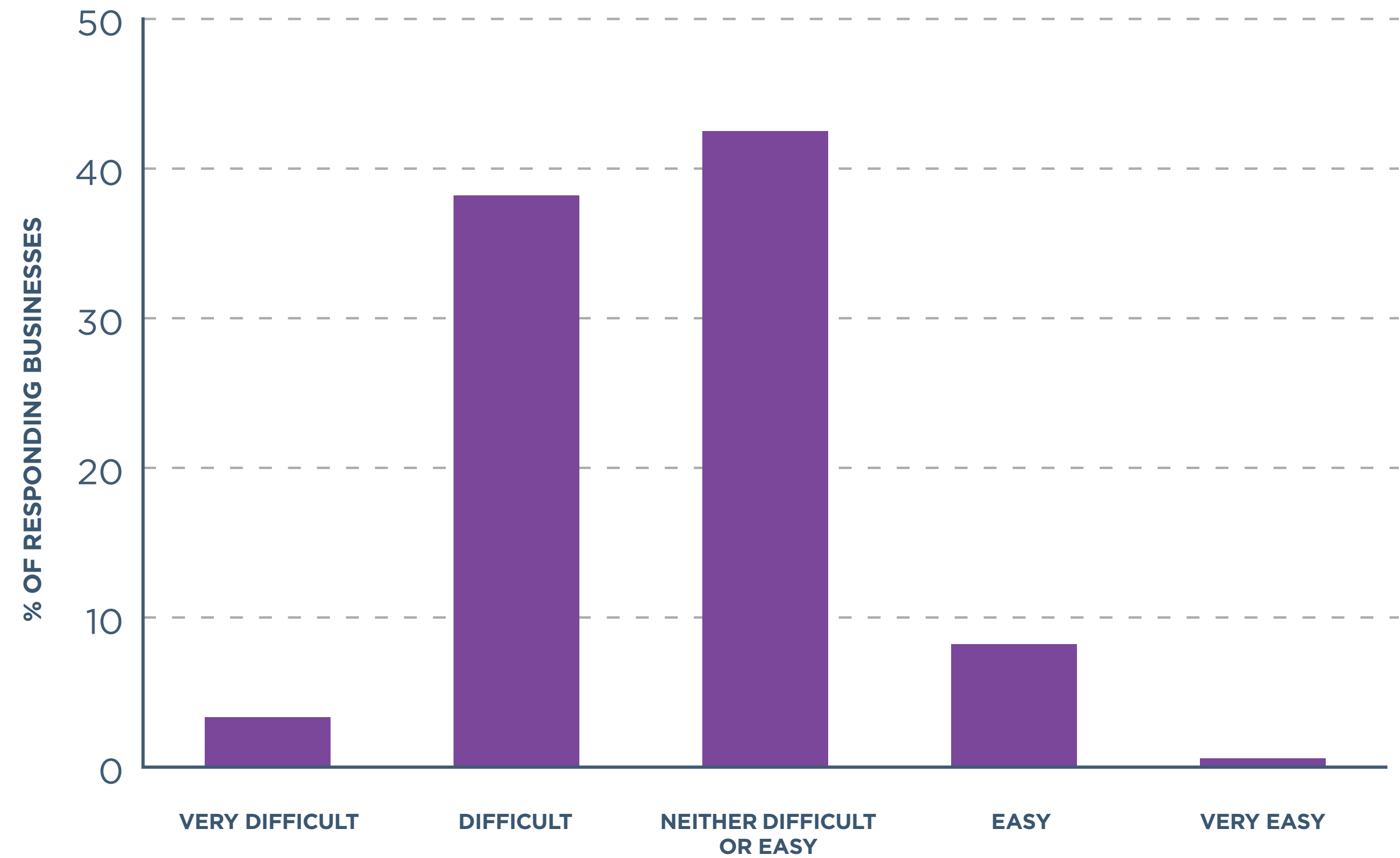
KEY RESULTS

SUPPLY CHAIN ISSUES

- Given ongoing supply chain challenges, we continued to ask firms about their experience sourcing goods and services.
- 41% of businesses reported that they were finding it difficult, or very difficult, to purchase goods and services – up slightly on the last quarter.
- A lack of UK supply continued to be the most common factor affecting firms' ability to source goods and services, with 78% of firms stating this in the latest survey, up 5-percentage points from last quarter.
- Other common factors included freight availability and delays (46%) and a lack of international supply (41%).
- The share of firms reporting that the price of goods and services was causing supply chain issues has fallen from 71% last quarter to 41% in Q4 2022, indicating that many firms have potentially adjusted to the higher level of prices in the market, found cheaper suppliers, or perhaps find other issues more pertinent.
- It is important to note that almost 10% of responding firms were finding it easy to source goods this quarter, a share that has been creeping up over the past few surveys.

Chart 4:

How easy or difficult are you finding it to source available goods and services your business purchases?



*8% of businesses responded N/A; therefore, percentages will not sum to 100%

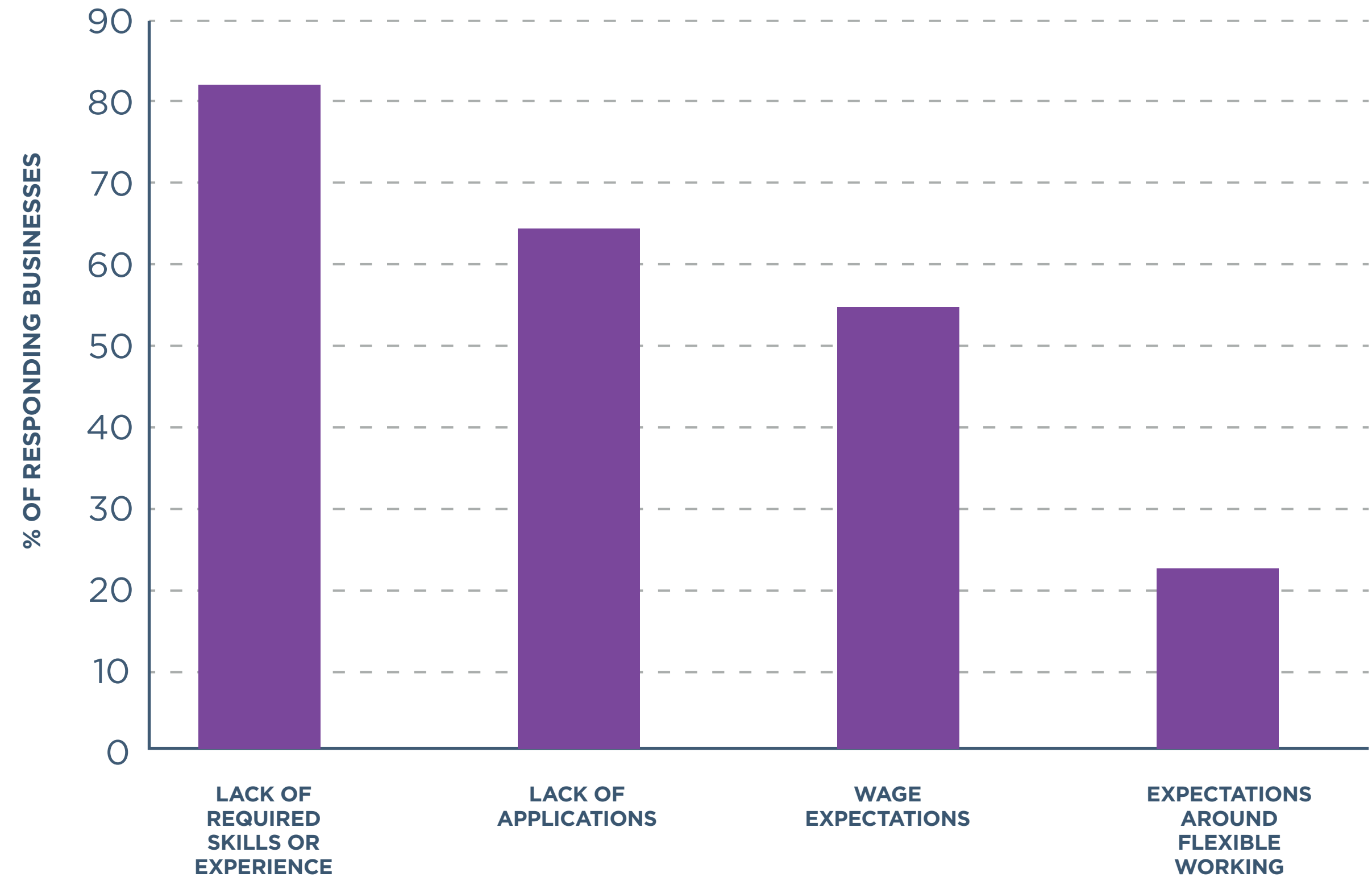
KEY RESULTS

VACANCIES

- The share of businesses reporting that they had vacancies to hire new staff members continued to fall, with 49% of firms reporting vacancies in Q4, down 1-percentage point from Q3.
- Of the firms that reported vacancies, just over 80% reported that they were finding it difficult, or very difficult, to fill these vacancies, down from 90% in Q3.
- However, 83% of firms reported a lack of required skills or experience as the greatest challenge in filling these vacancies in the latest quarter, up 6-percentage points.
- Fewer firms reported a lack of applications (65%) and wage expectations (55%) as key factors this quarter compared to last.
- Firms are also finding it slightly less challenging to retain their current workforce, with just over a quarter of firms reporting difficulties retaining existing staff.

Chart 5:

What factors have made filling vacancies difficult?



CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

CURRENT BUSINESS ACTIVITY

- The net balance of firms reporting an increase, over the fourth quarter¹, in their volume of business activity, volume of new business activity, value of business activity, level of employment, level of capital investment, and export activity are all negative for the first time since Q1 2021

Table 1:

Net balance (%) of firms experiencing an increase in their volume of business over the past three months, Q4 2020 – Q4 2022

	2020	2021				2022			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
VOLUME OF BUSINESS ACTIVITY (I.E., SALES)	-39.1	-7.1	30.0	26.0	27.1	30.1	15.3	4.0	-2.2
VOLUME OF NEW BUSINESS ACTIVITY	-40.2	-1.9	20.8	21.9	10.4	24.9	8.8	0.0	-4.9
VALUE OF BUSINESS ACTIVITY (I.E., TURNOVER)	-39.2	-8.8	23.7	18.7	12.8	32.3	15.0	6.4	-0.7
LEVEL OF EMPLOYMENT IN YOUR BUSINESS	-32.3	-13.0	6.4	5.7	10.8	15.5	10.2	8.5	-5.4
LEVEL OF NEW CAPITAL INVESTMENT	-35.8	-9.9	4.2	3.0	7.6	6.3	1.2	-5.9	-14.7
EXPORT ACTIVITY	-29.6	-21.6	-19.5	-18.1	-11.8	-8.0	-9.0	-9.2	-11.5

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

¹ Q4 2022 compared to Q3 2022

CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

CURRENT BUSINESS ACTIVITY – SECTORAL ANALYSIS

- The majority of sectors reported a negative net balance for the volume of business in the fourth quarter of 2022, with construction, manufacturing, and hospitality hardest hit.
- There were positive net balances for all sectors, except manufacturing, admin services and construction for the value of business activity (turnover).
- Most sectors also reported a negative net balance for the level of employment, with the exception of transport and storage, professional, scientific and technical, and information and comms.

Table 2:

Net balance (%) of firms experiencing an increase in their volume of business over the past three months, Q1 2021 – Q4 2022

	2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
MANUFACTURING	5	45	36	4	22	2	24	-21
ACCOMMODATION & FOOD SERVICES	-77	46	31	18	14	17	17	-11
CONSTRUCTION	14	55	40	3	29	26	16	-25
TRANSPORT & STORAGE	-36	32	15	25	41	21	9	25
INFORMATION & COMMS	3	44	29	33	27	14	7	7
RETAIL & WHOLESALE	-11	18	17	39	30	17	-1	-4
PROFESSIONAL, SCIENTIFIC, AND TECHNICAL	15	24	32	14	31	14	-5	9
ADMIN & SUPPORT SERVICES	-13	26	7	0	31	3	-14	-6

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

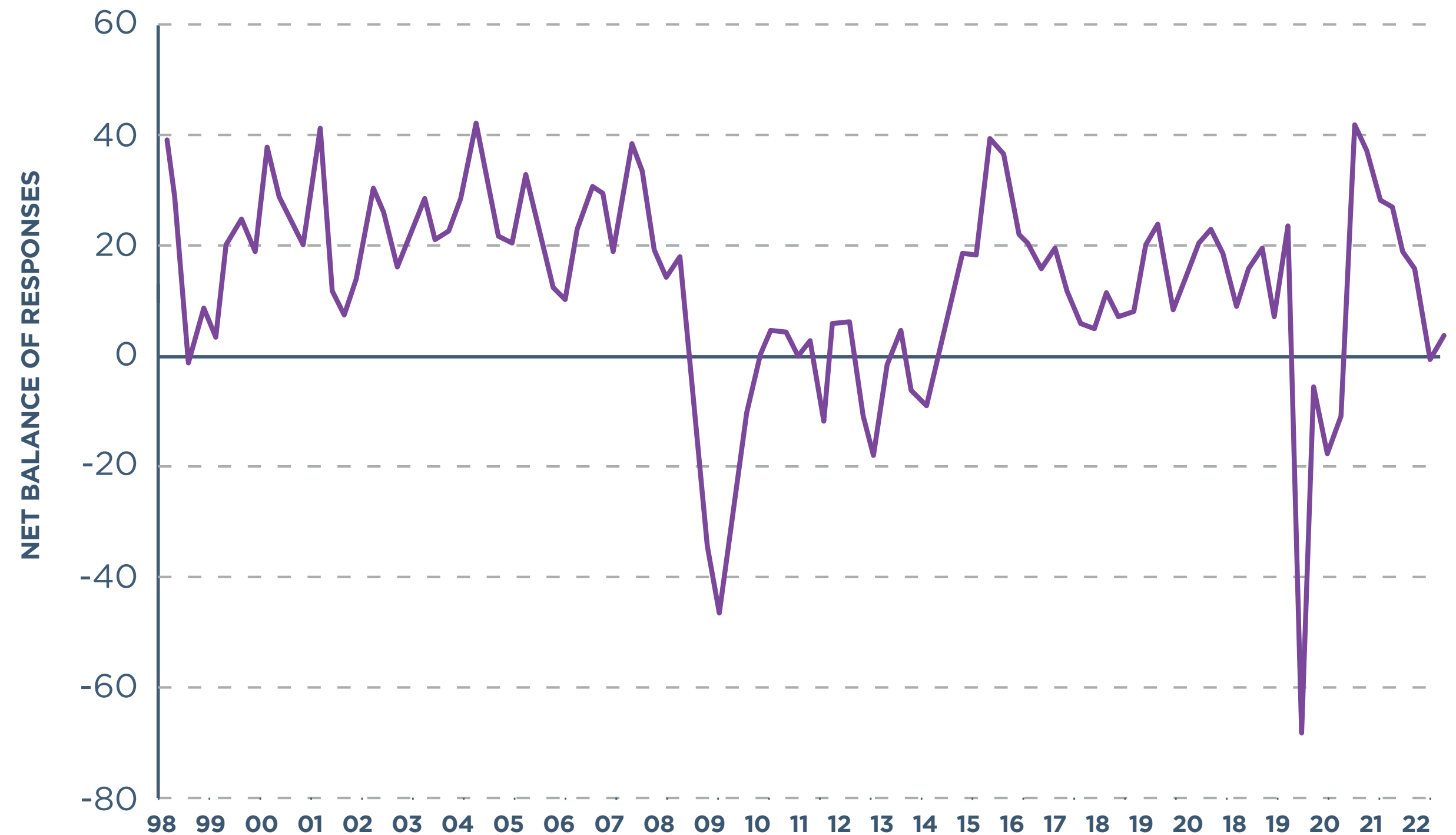
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

EXPECTED BUSINESS ACTIVITY

- On average, firms were slightly more optimistic about their expected volume of business over the next six months, with a positive net balance after falling negative last quarter.
- While there were also positive net balances in expectations for the level of employment and turnover in the coming six months, there continued to be negative net balances for expected capital investment and export activity.

Chart 6:

Net balance (%) of firms expecting an increase in their volume of business over the next six months, Q1 1998 - Q4 2022



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

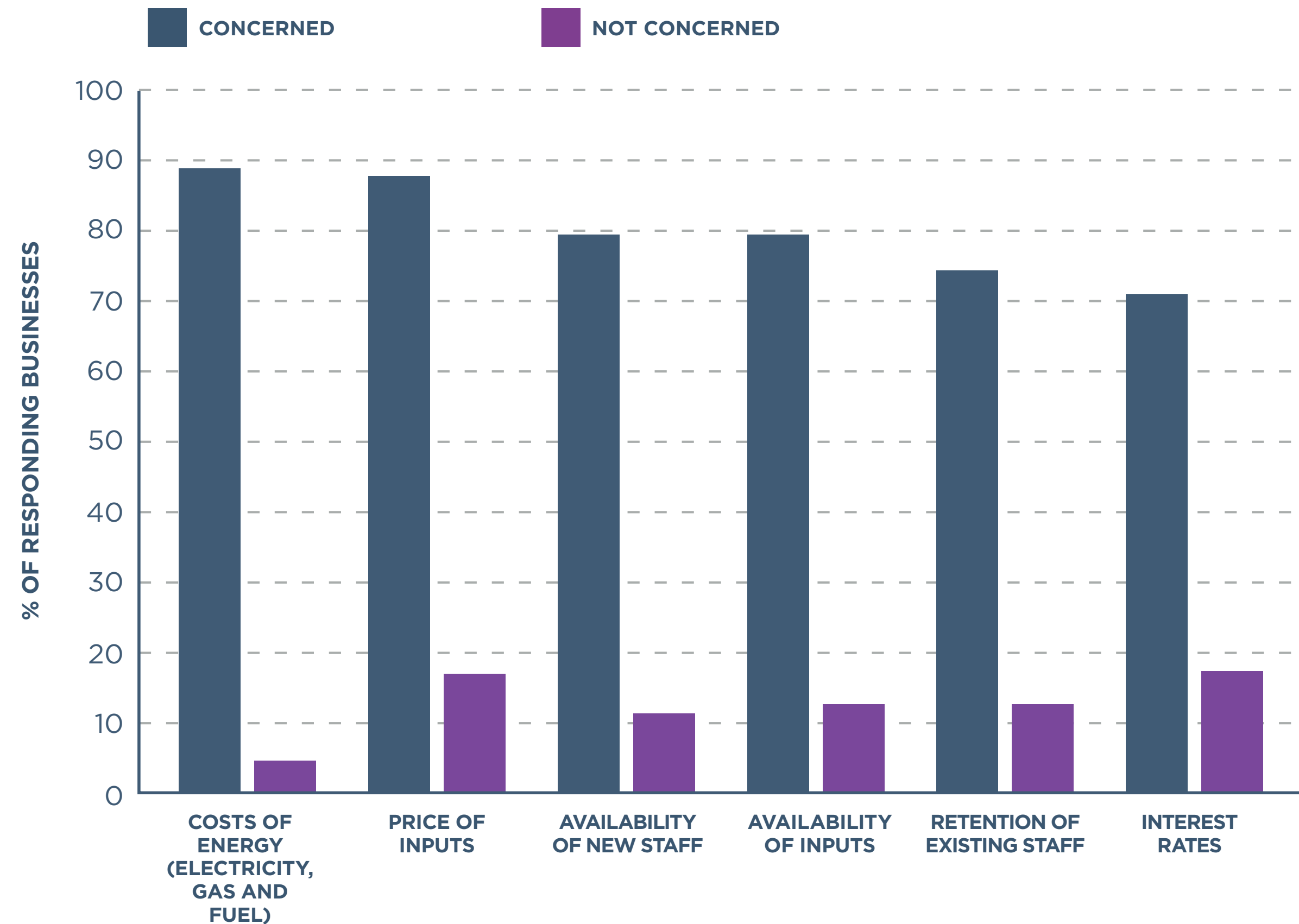
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

BUSINESS CONCERNS

- In the latest quarter, we asked Scottish firms what they expect to be important to their business over the coming quarter.
- The majority of firms expect economic and business uncertainty (87%), staff availability (82%), and policy uncertainty (77%) to be important, or very important, to their business over the next 3 months.
- Additionally, firms were asked what the biggest concerns for their business were likely to be over the next quarter.
- Very similar to previous quarters, the most common concerns among responding businesses were the costs of energy (88%) and the price of inputs (87%).

Chart 7:

Compared to normal, how concerned is your business about the following factors?



*Some businesses responded N/A; therefore, percentages may not sum to 100%

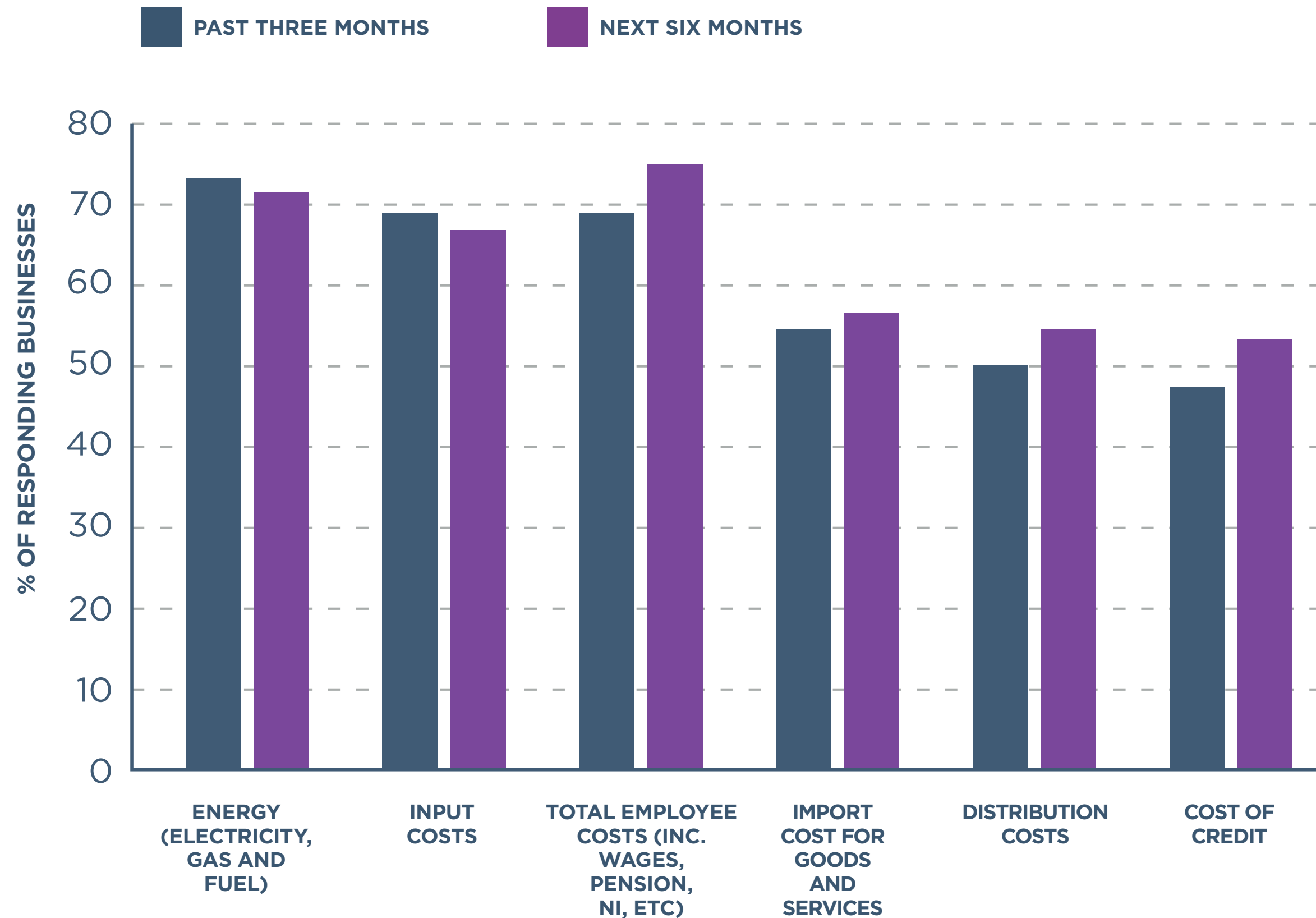
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

THE OUTLOOK FOR THE NEXT YEAR...

- We also asked businesses what the main cost drivers have been over the last quarter, and what effect they might have over the next 6 months.
- Over the latest quarter, energy prices were the most common cost for businesses (73%), followed by input costs (69%).
- Interestingly, total employee costs (75%) have overtaken energy costs (71%) when it comes to the key cost drivers' businesses are expecting in the next 6 months.

Chart 8:

Thinking about the key cost drivers for businesses, what is your business' assessment of the following cost pressures over the past 3 months and the next 6 months?



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

- We then asked businesses about their outlook for growth in the Scottish economy over the next 12 months.
- Overall, the outlook of firms has worsened over the last quarter.
- More than 3 in 4 firms expect growth to be weak or very weak over the coming year, up 5-percentage points on Q3.

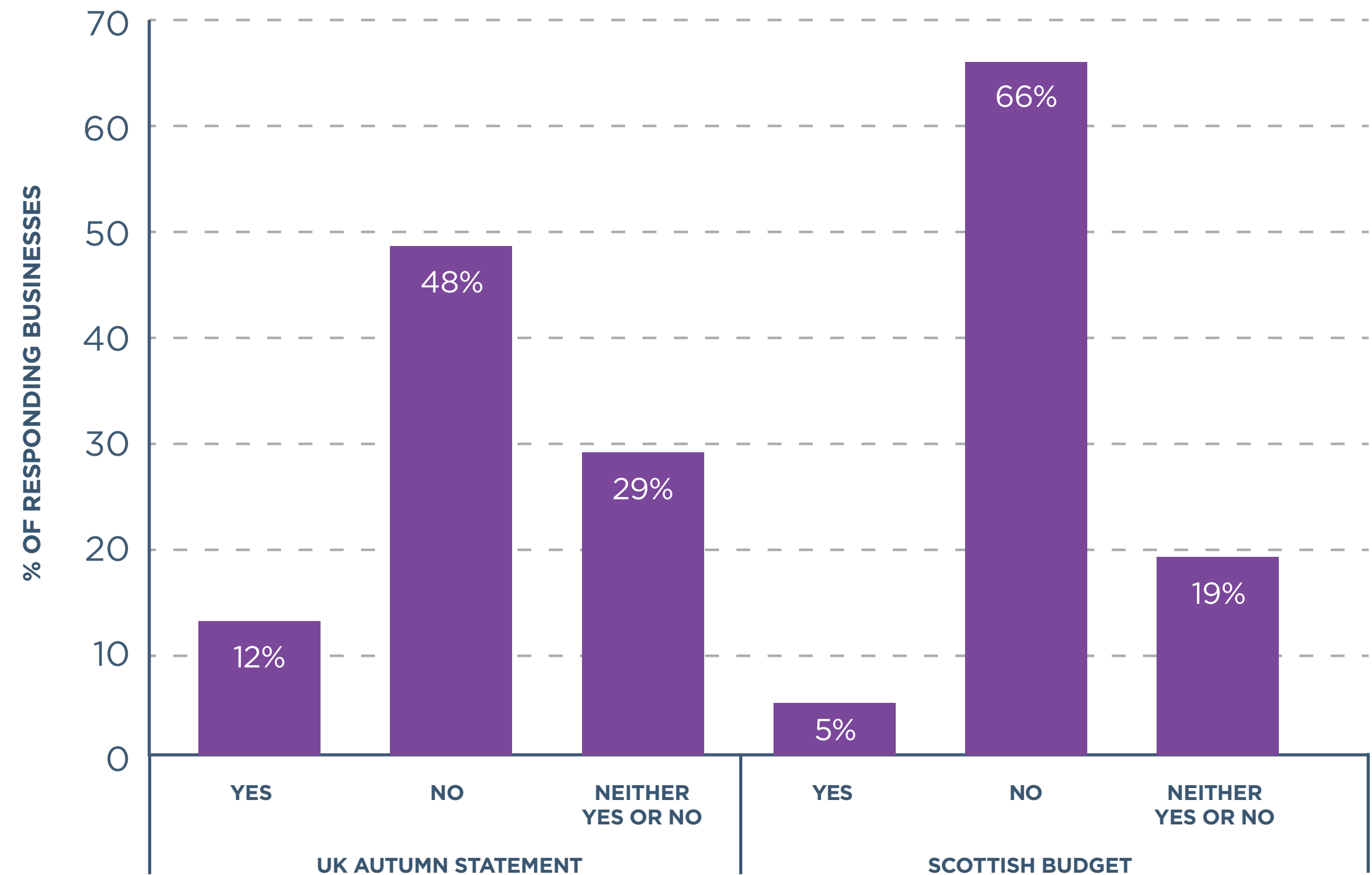
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

BUSINESS CONFIDENCE

- Lastly, firms were asked whether they felt more confident about the outlook for their business over the next year following the UK Government's Autumn Statement on the 17th of November 2022 and then the Scottish Government's Budget on the 15th of December 2022.
- Just 5% of Scottish firms felt more confident about the outlook for their business following the Scottish Budget, and 12% felt more confident after the UK Government's Autumn Statement.
- Similarly, 2 in 3 businesses reported that they felt less confident following the Scottish budget, and less than half felt this way after the Autumn Statement.
- Overall, both governments have some work to do to increase business confidence.

Chart 9:

Do you feel more confident about the outlook for your business over the next 12 months following the UK Government's Autumn Statement and the Scottish Government's Budget?



*Some businesses responded N/A; therefore, percentages may not sum to 100%

MORE IMAGINATION MORE IMPACT

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