



KPMG UK Tech Monitor

**Tech sector gears up for growth as
job creation nears two-year peak**



April 2021

kpmg.com/uk



Foreword

Tech sector gears up for growth as job creation nears two-year peak

Like many sectors, our tech businesses started this year in a perfect storm of another UK lockdown, which put the brakes on spending, along with new trading relationships internationally and new trading arrangements with the EU, which ushered in a degree of risk aversion, especially among overseas customers.

But despite this, the survey data from this KPMG UK Tech Monitor Index has highlighted that the technology sector remained in expansion mode during Q1 2021.

Following a poor start to the year, output soon picked up in February and March, leaving the tech sector recovery on a healthy trajectory by the end of the first quarter.

Resilient demand conditions and greater adoption of technology across a wide spectrum due to the pandemic also led to the fastest rise in employment since Q2 2019 and the strongest output growth projections for

nearly seven years.

With the UK now in phase two of the Government's roadmap to recovery and businesses starting to adjust to regulatory changes and supply chain issues post Brexit, the tech sector is now looking to get back to growth as a vital employment contributor and economic driver in the UK.

An acceleration in jobs growth to its fastest for almost two years provides a clear signal that tech companies are confident about future workloads and expect to receive a boost from improving UK economic prospects. The successful vaccine rollout combined with announcements in the Budget on a new "super-deduction" for investment in new plant, machinery and equipment has led to renewed optimism about corporate technology investment and were key factors helping to drive up business expectations to a seven-year high in the first quarter of the year.

As a result of the pandemic there has been accelerated

technology adoption across a range of areas, particularly the focus on new remote and hybrid working arrangements, new spending priorities for businesses around IT infrastructure, automation and the huge shift to online retail, which are likely to provide a long-term boost to sales in the tech sector.

Tailwinds from favourable global demand and the reopening of the UK economy will both help our vital tech sector to gain speed in their growth plans during 2021.

These trends, combined with the Government's efforts to secure new trade arrangements, will provide a platform for growth which will see many of our UK tech businesses enter new overseas markets as the surge in demand for tech products and services plays to the UK's strength as a global tech leader.

**Bina Mehta, Chair,
KPMG in the UK**



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The successful vaccine rollout and optimism around corporate technology investment were key factors helping to drive up business expectations to a seven-year high in the first quarter of the year. 

**Bina Mehta, Chair,
KPMG in the UK**



KPMG UK Tech Monitor

Key findings

Output growth projections strongest for nearly seven years

UK tech companies hire staff at fastest pace since Q2 2019

Shortages of electronic components and higher shipping costs lead to sharp rise in input prices

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.

Job creation heats up as UK tech sector outlook improves in Q1

Survey data from the KPMG UK Tech Monitor Index highlighted that the technology sector remained in expansion mode during Q1 2021, despite a jolt to activity at the start of the national lockdown in January. Output soon picked up in February and March, leaving the tech sector recovery on a healthy trajectory by the end of the first quarter.

Resilient demand conditions also led to the fastest rise in employment since Q2 2019 and the strongest output growth projections for nearly seven years.

Tech sector jobs growth strongest for almost two years

The index measuring UK tech employment rose from 51.5 in Q4 2020 to 51.8 in Q1, which indicated the strongest rate of job creation since Q2 2019. Sustained efforts to boost staffing numbers contrasted with another slight drop in UK private sector employment in Q1.

Confidence highest since Q2 2014

A key factor driving employment growth across the tech sector was stronger optimism towards the 12-month business outlook. At 77.3

in Q1, the index measuring growth expectations rose from 74.7 in Q4 and hit its highest level since Q2 2014. Optimism was stronger than in all other parts of the UK private sector, except for Hotels & Restaurants.

Upbeat forecasts were frequently linked to vaccine progress and the prospect of rapid economic growth once restrictions are eased. There were also mentions of previously delayed product launches and greater investment in areas such as cloud technology, e-commerce platforms and AI software.

Business activity falls modestly

At 48.3 in Q1, the headline Business Activity Index dropped from 51.5 in Q4 2020 and signalled an overall loss of recovery momentum since the end of last year.

The third national lockdown, combined with Brexit disruption, drove a substantial drop in business activity during January. Although growth emerged in February and March, the initial decline weighed heavily on the index reading for Q1.

Business activity also fell across the UK private sector as a whole during the opening quarter, largely

reflecting a slump in consumer services. However, the economic downturn was much softer than seen at the start of the coronavirus disease 2019 (COVID-19) pandemic.

Slight drop in new orders

Stricter government stringency measures and subsequent disruption to clients' business operations drove a slight reduction in new order intakes at tech firms during Q1.

Some survey respondents mentioned that export sales to European clients were adversely impacted by uncertainty after the end of the Brexit transition period. Encouragingly, monthly data showed that total new orders returned to growth in March as the vaccine rollout and roadmap for reopening the economy helped to boost demand.

Inflationary pressures pick up

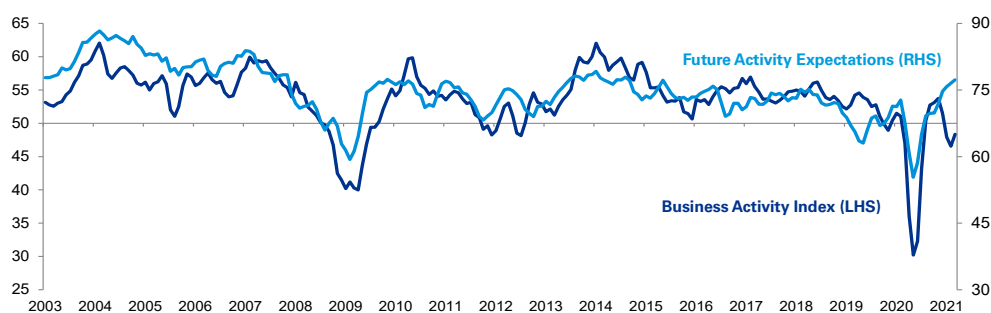
Rising costs for staff, transportation and electronic components led to the sharpest increase in tech sector input prices for nearly four years in Q1.

Technology firms sought to alleviate the squeeze on margins from higher costs, with prices charged raised at the fastest pace since Q2 2019.

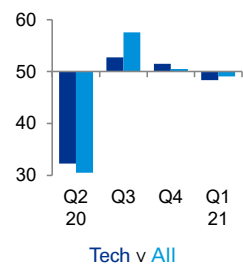
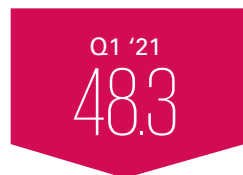
KPMG UK Tech Monitor Index

Above 50 = business activity growth, seasonally adjusted

Above 50 = growth in the next 12 months



Tech Sector Output: Business Activity Index



Marginal drop in tech sector activity over Q1

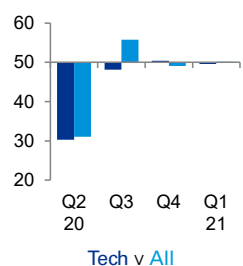
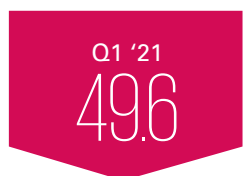
Tech sector activity fell modestly over the opening quarter of 2021, as shown by the respective index slipping from 51.5 in Q4 2020 to 48.3. Panel members stated that the third national lockdown and Brexit led to a sharp fall in activity at the start of the year. Monthly data showed that output returned to expansion in February as vaccine progress boosted confidence. Business activity also fell at the national level over the first quarter, led by a slump in consumer services.

Business Activity Index

Above 50 = growth, seasonally adjusted



Tech Sector Sales: New Business Index



New business falls slightly

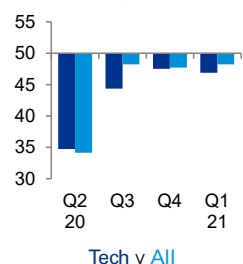
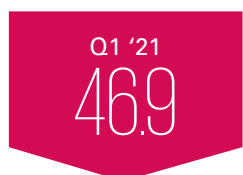
After an uptick in Q4 2020, new business received by tech sector firms lost some momentum in the first quarter of 2021. That said, the rate of reduction was only marginal, as highlighted by the respective index falling from 50.4 to just below the neutral 50.0 value at 49.6 in Q1. Monthly data showed a steep decline in sales at the start of 2021 amid tight COVID-19 restrictions and Brexit concerns. However, a strong upturn emerged during March as client demand improved in anticipation of the roadmap for reopening the UK economy.

New Business Index

Above 50 = growth, seasonally adjusted



Tech Sector Capacity: Outstanding Business Index



Backlogs decline at quicker pace amid spare capacity

UK tech companies continued to clear their backlogs of incomplete work during Q1 2021. At 46.9, the respective index fell from 47.3 in Q4 and pointed to a solid rate of reduction overall. The fall was also quicker than that seen at the national level (index at 48.2).

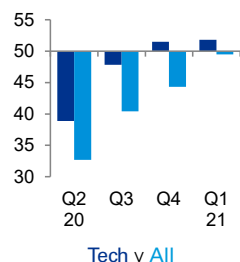
There were some reports linking lower backlogs to productivity gains. However, other companies that recorded lower volumes of outstanding business linked this to subdued sales, which freed up capacity to deal with unfinished work.

Outstanding Business Index

Above 50 = growth, seasonally adjusted



Tech Sector Jobs: Employment Index



Strongest increase in employment since Q2 2019

Latest data showed that tech companies continued to add to their workforce numbers during Q1. At 51.8, the respective index was up from 51.5 in Q4 and signalled the strongest rate of job creation for nearly two years. The upturn contrasted with a marginal drop in employment across the UK as a whole.

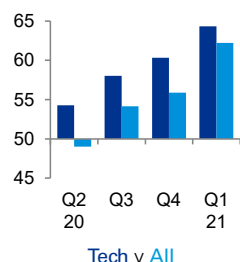
Anecdotal evidence indicated that tech firms hired additional workers due to upgraded forecasts of customer demand and efforts to launch new products.

Employment Index

Above 50 = growth, seasonally adjusted



Tech Sector Costs: Input Prices Index



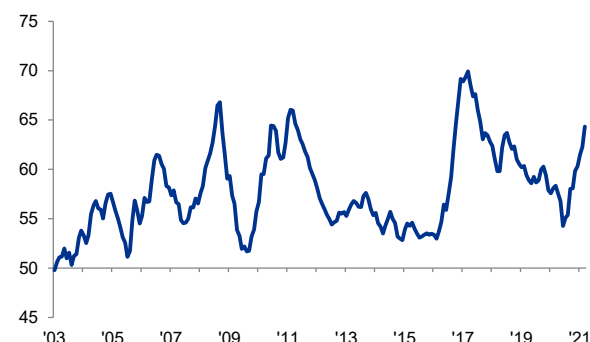
Input cost inflation intensifies to sharpest since Q2 2017

Cost pressures continued to build across the UK tech sector, with input costs rising rapidly in Q1. The respective index posted 64.3, up from 60.3 in Q4, to signal the sharpest rate of inflation since Q2 2017. The increase in operating expenses also outpaced the UK all-sector average (index at 62.2).

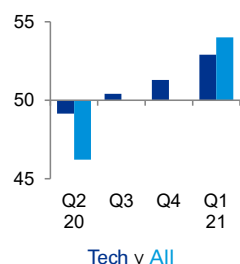
Survey respondents indicated that electronic component shortages, greater shipping costs and higher salary payments were key drivers of inflation over the opening quarter of 2021.

Input Prices Index

Above 50 = growth, seasonally adjusted



Tech Sector Margins: Prices Charged Index



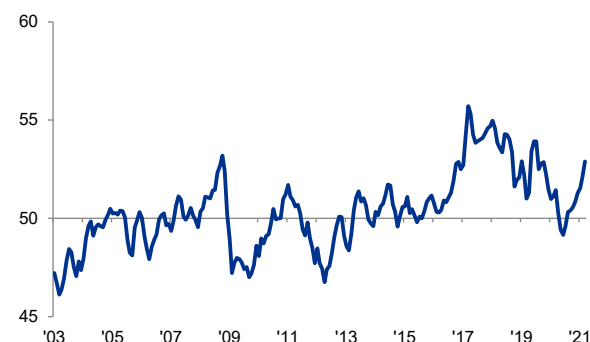
Fastest increase in selling prices for nearly two years

In line with the trend for operating expenses, prices charged by tech companies rose at a steeper rate in Q1. The rate of inflation was the fastest recorded since Q2 2019, as signalled by the respective index rising from 51.3 in Q4 to 52.9. Companies often mentioned raising their charges to help cover sharp increases in input costs.

Selling prices also rose across the UK as a whole during Q1, and at a slightly quicker rate than seen in the tech sector (index at 54.0).

Prices Charged Index

Above 50 = growth, seasonally adjusted

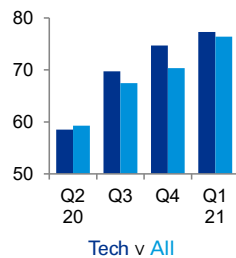


Tech sector outlook

Vaccine rollout and plans to ease lockdown lifts business confidence to near seven-year high

Confidence regarding the 12-month outlook for business activity improved further in the opening quarter of 2021. At 77.3, the Business Activity Expectations Index was up from 74.7 in Q4 and pointed to the strongest degree of optimism since Q2 2014. Tech companies were also slightly more upbeat than the average UK firm (index at 76.4).

Panellists linked improving output projections to expectations of strong global economic growth as government stringency measures are eased and vaccine rollouts progress. There were mentions of greater research and development spending, investments in emerging technologies and efforts to enter new overseas markets. Survey respondents also cited hopes of a longer-term boost to spending on technology products and services due to changes in business operations and consumer habits during the pandemic.



Business Activity Expectations Index

Above 50 = growth in the next 12 months



How has the COVID-19 pandemic impacted tech sector prospects?

In this section, we assess the impact of the COVID-19 pandemic on the UK economy and tech sector prospects.

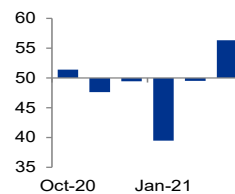
The trajectory of the UK economy followed a 'V-shaped' pattern in the first three months of 2021 as the third national lockdown and Brexit-related disruptions during January were swiftly followed by more stable business conditions in February and a strong recovery by March.

Technology service providers experienced a much shallower drop in business activity than the rest of the service economy in January and returned to growth more vigorously during the remainder of the first quarter. While some areas of client spending decreased in response to the worsening pandemic situation at the start of 2021, this was often offset by stronger UK business investment in digital assets and e-commerce opportunities.

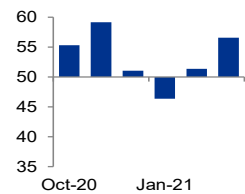
In the UK manufacturing sector, production volumes expanded throughout the first quarter of this year, but the rate of growth slowed considerably in January and only started to regain momentum by March. Manufacturers of technology equipment reported a volatile start to 2021, with a rapid drop in output in January followed by an impressive rebound.

Despite the adverse impact of lockdowns, global supply chain issues and Brexit regulatory challenges, the recovery seen in March points to strong momentum for the UK tech sector in the second quarter of 2021.

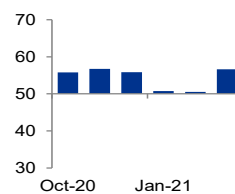
UK Services
Business Activity Index
Above 50.0 = growth, sa



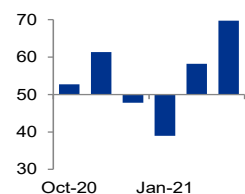
UK Software & Services
Business Activity Index
Above 50.0 = growth, sa



UK Manufacturing
Business Activity Index
Above 50.0 = growth, sa



UK Tech Equipment
Business Activity Index
Above 50.0 = growth, sa



UK sector rankings

Surge in global spending on technology assets

Longer-term prospects for the UK tech sector are of course closely aligned with the global economic outlook and the demand cycle for technology products and services around the world.

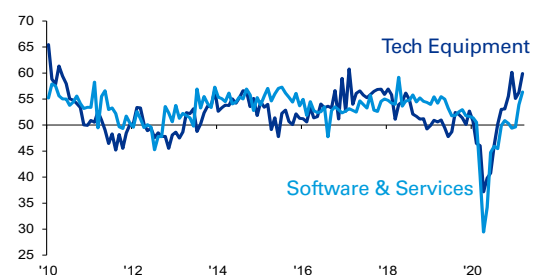
On this front, there were more positive signals in the first quarter of 2021, according to Global PMI data compiled by IHS Markit. Business activity has continued to recover this year as economies around the world become more resilient to lockdown restrictions and vaccine rollouts spur rising confidence about the pandemic situation.

By major region, the United States has outperformed recoveries seen elsewhere in recent months, while consistent growth in the Asia-Pacific contrasted with a bumpy ride for European economies. For export-focused UK tech companies, this has often meant an uneven road to recovery and a desire to pivot investments towards new overseas markets.

Looking at the worldwide performance of technology companies in the first quarter of 2021, strong growth rates have broadened out from the manufacturing supply chain to software & service providers. Both categories are vigorously adding to staff numbers. These are clear signals that the global demand cycle remains highly favourable, and this should help to boost the UK tech sector in the coming months.

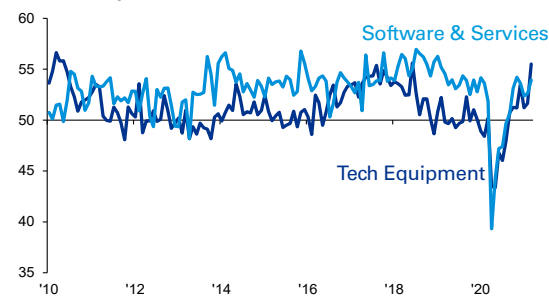
Global Tech Sector: Output Index

Above 50.0 = growth, sa



Global Tech Sector: Employment Index

Above 50.0 = growth, sa



Although the national lockdown and Brexit weighed on overall economic performance in the first quarter of 2021, business optimism about prospects for the year ahead continued to improve. Companies across all sectors of the economy mostly pinned their hopes on the successful rollout of COVID-19 vaccines and the loosening of pandemic-related restrictions in the months ahead. Notably, all six monitored sectors recorded stronger confidence towards the 12-month outlook in Q1 compared to those seen in Q4 2020.

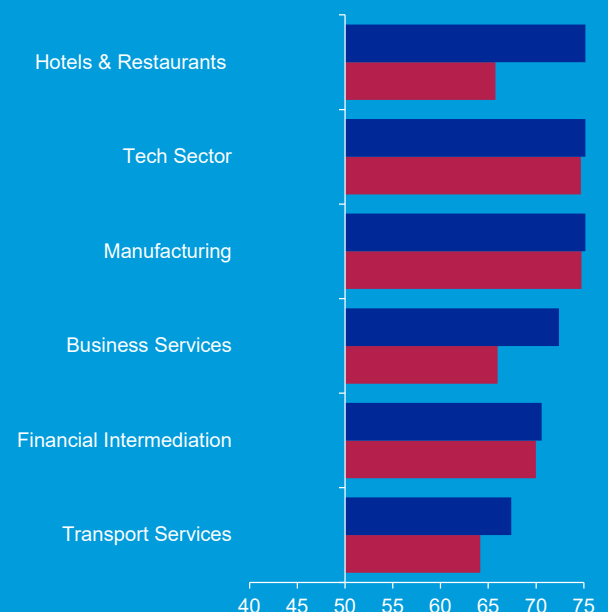
Tech sector confidence remained more upbeat than other parts of the UK economy. The only area to register higher optimism than tech companies was Hotels & Restaurants, which recorded the strongest degree of optimism for nearly two decades and by far the steepest improvement in sentiment of all monitored areas. The reopening of consumer-facing businesses and easing of social distancing rules is forecast to drive a strong rebound in activity at Hotels & Restaurants, albeit from a low base in Q1.

The weakest level of optimism was once again seen in the Transport sector, though even here confidence picked up to its highest since Q2 2014.

Business Expectations Index by sector

■ Q1 2021
■ Q4 2020

Above 50 = growth in next 12 months



KPMG's Outlook

People



It's not surprising that we see a significant increase in employment in the tech sector. We are seeing that leading tech companies are sourcing talent more creatively than previously: they are building their own or leveraging talent acquisition platforms such as Upwork to capture key roles such as data scientists, cyber security experts, product owners. As the digitisation agenda hits all sectors and organisations, the ability to source the right talent calls on advanced sourcing strategies against the 5Bs (buy, build, borrow, bot, base). //



Anna Marie Detert
Partner, KPMG LLP (UK)
Corporates People Consulting

Pricing



Costs in the tech sector are increasing in 2021 at their fastest rate for nearly four years and following years of intense competition, companies are taking the opportunity to increase prices and restore profitability. To illustrate, annual price hikes of up to 4.5% have been implemented in Q2 by most of the main telecom providers and with further inflation on the horizon, we expect this upward price trend to continue. //



Robert Browne
Partner, KPMG LLP (UK)
Strategy Group

Supply Chains



Supply chains have had a turbulent 18 months with the combined effects of Covid and Brexit thrusting them into the spotlight. We see the leading companies using this moment of transition to reshape their supply chains, with resilience, end to end visibility and reduced carbon footprint as key elements of their future fit supply chains. //



Maureen O'Shea
Partner, KPMG LLP (UK)
Operational Transformation and
Supply Chain

M&A



The jump in the Cost Index has been driven by supply chain pressures, only partially offset by an output charge increase. This means that Tech companies will need to protect profit margins by continuing to develop highly differentiated service offerings. We expect bolt on M&A to play an important role to accelerate the implementation of successful competitive strategies. //



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UKTech 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.

UKTech 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).

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