KPMG UK Tech Monitor

Tech sector regains momentum in Q3 after pandemic setback

PMI® By IHS Markit

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KPMG UK Tech Monitor

Key findings

Solid increase in output after unprecedented drop in Q2

New orders close to stabilising and business optimism rebounds in Q3

Tech companies cut staffing levels at much softer pace than average UK firm

"The UK Tech sector shines a ray of light through the economic gloom. The sector has demonstrated huge resilience with a strong V-shaped recovery in business activity over the last quarter with a positive outlook for the future, in spite of the uncertainties presented by COVID-19. This growing confidence and resilience of an increasingly significant UK Tech Sector, should be good news for the government who want to rebuild a new future-proofed economy."

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.

Tech sector output rebounds in Q3, after record drop during Q2

The KPMG UK Tech Monitor Index showed that the sector jumped back into expansion mode during the third quarter of 2020, following a sharp decline in business activity in Q2.

At 53.3 in Q3, the headline Index posted above the neutral 50.0 level and was up sharply from 31.8 in Q2. The latest reading signalled the fastest increase in output at UK tech firms since Q1 2019.

Survey data from the KPMG UK Tech Monitor Index indicated a record drop in business activity during the early stages of the coronavirus disease 2019 (COVID-19) pandemic. Business closures among clients, project cancellations and lower overall corporate spending all combined to offset the boost in some areas from a surge in consumer demand for digital services during the lockdown period.

Tech sector output has now returned to a solid growth path in Q3 2020, as more parts of the UK economy reopened and clients resumed projects that had been delayed during the pandemic.

Encouragingly, growth momentum across the tech sector accelerated in each month of the third quarter and the rebound has taken hold in the absence of direct stimulus measures for the sector. By contrast, the speed of recovery in the UK economy slowed in September, with consumer-facing service providers experiencing a sharp drop in high-street footfall as the Eat Out to Help Out scheme ended.

Staff hiring close to stabilisation despite subdued new orders

Although activity across the tech sector increased as market conditions began to normalise in the third quarter, latest data pointed to subdued intakes of new work.

The index measuring new business rose from a record low of 29.7 in Q2 to 48.2 in Q3. This indicated relatively weak overall demand, albeit an improvement on the situation seen at an earlier stage of the pandemic.

A number of tech firms mentioned that corporate spending was pared back again in Q3 due to the highly uncertain global economic outlook and subsequent efforts to contain costs.

Despite a challenge from budget cutbacks among clients, staff hiring trends across the UK tech sector have been far more resilient than across the wider economy so far this year. The latest survey indicated that employment numbers among tech companies moved closer to stabilisation, which contrasted with another steep round of UK private sector job cuts in the third quarter.

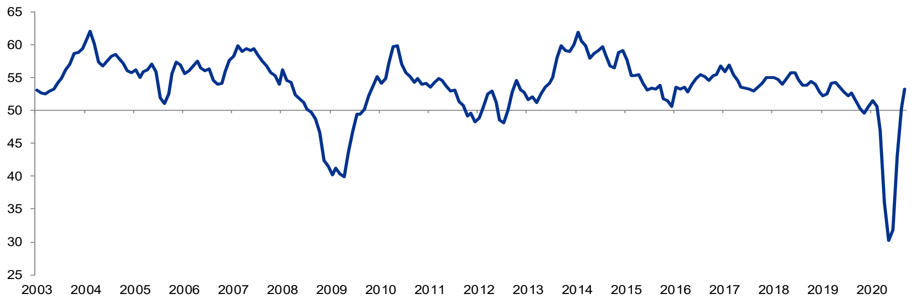
While some tech firms noted that stretched margins and rising staff costs had weighed on employment, there were also reports that rising business optimism had helped to stabilise workforce numbers.

Recovery in business optimism among tech companies

UK tech firms are optimistic overall about their prospects for growth in the next 12 months, reflecting hopes of a sustainable recovery in client demand. At 69.7 in Q3, the business expectations index was up sharply from 58.5 in Q2 and above that seen in the rest of the service sector.

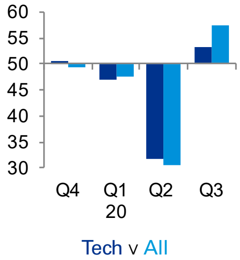
KPMG UK Tech Monitor Index

Above 50 = business activity growth, seasonally adjusted



Tech Sector Output: Business Activity Index

Q3 '20
53.3

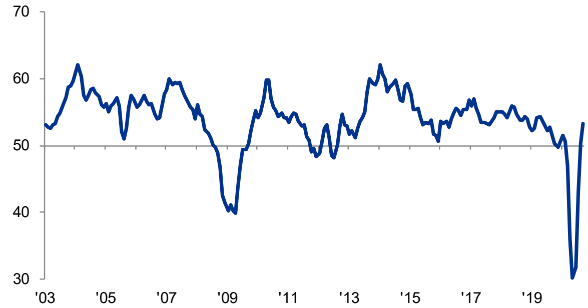


Tech sector activity rebounds in Q3 2020

After falling at the sharpest rate on record in Q2 2020, business activity across the UK tech sector rose solidly during Q3. This was highlighted by the seasonally adjusted index rebounding from 31.8 in Q2 to 53.3. The upturn in output was the quickest since Q1 2019.

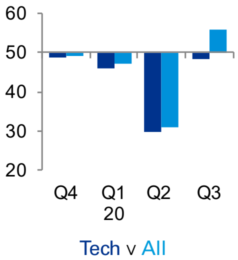
Growth was also seen across the UK as a whole as businesses reopened after the pandemic (index at 57.5). Tech firms often linked rising activity to a return to work among clients in Q3.

Business Activity Index
Above 50 = growth, seasonally adjusted



Tech Sector Sales: New Business Index

Q3 '20
48.2

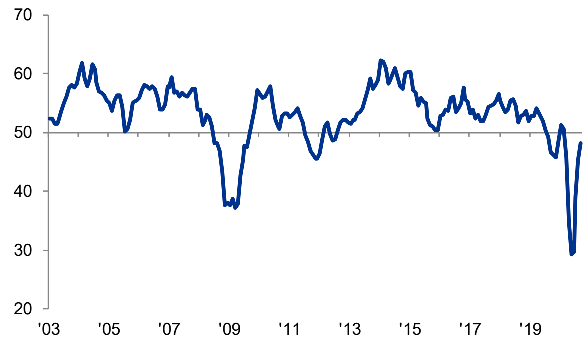


New business moves closer to stabilisation

At 48.2 in Q3, the index measuring new orders received by tech firms rose from 29.7 in Q2 and moved much closer to the neutral 50.0 level. Therefore, the latest reading signalled only a modest drop in sales, following the unprecedented decline in Q2.

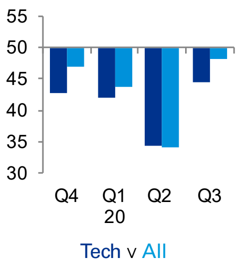
Tech businesses indicated that the COVID-19 pandemic continued to weigh on market confidence and corporate spending over the third quarter.

New Business Index
Above 50 = growth, seasonally adjusted



Tech Sector Capacity: Outstanding Business Index

Q3 '20
44.5

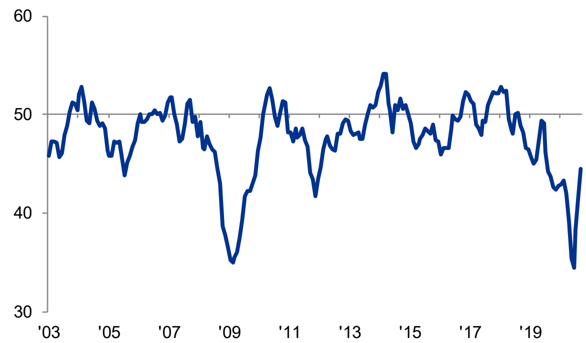


Backlogs fall amid lack of pressure on business capacity

The seasonally adjusted Outstanding Business Index registered 44.5 in Q3, to signal a further marked decline in unfinished work at UK tech firms. That said, the rate of depletion was considerably slower than that seen in Q2 (index at 34.5), and was the least marked since Q2 2019.

Anecdotal evidence indicated that tech companies had sufficient capacity to reduce backlogs due to relatively muted inflows of new work.

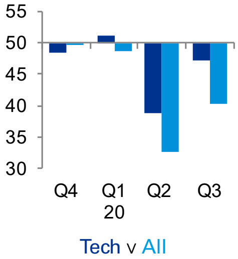
Outstanding Business Index
Above 50 = growth, seasonally adjusted



Tech Sector Jobs: Employment Index

Q3 '20

47.2



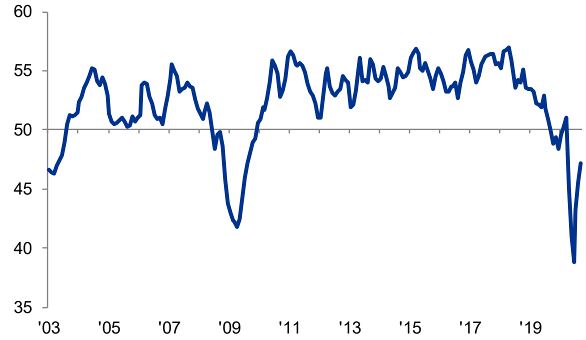
Job shedding eases notably in the third quarter

Adjusted for seasonal factors, the Employment Index posted 47.2 in Q3, up from 38.8 in Q2. This pointed to only a moderate fall in tech sector employment, to suggest that staff numbers moved closer to stabilisation as the economy recovered from the pandemic. The reduction in staffing was also much slower than the UK-wide trend.

Lower workforce numbers were often linked to company restructuring efforts.

Employment Index

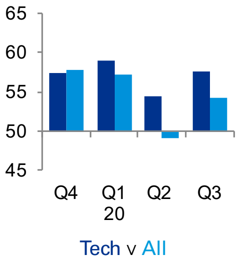
Above 50 = growth, seasonally adjusted



Tech Sector Costs: Input Prices Index

Q3 '20

57.6



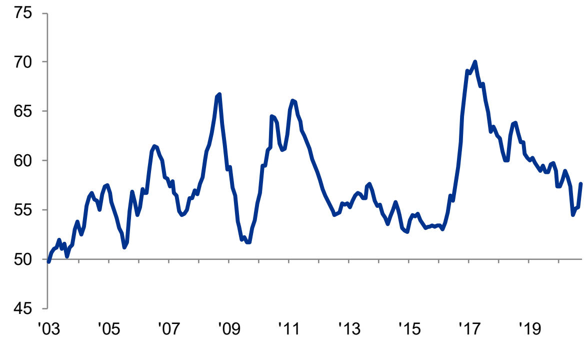
Sharper increase in input costs

Operating expenses faced by tech companies rose at a quicker pace in Q3. At 57.6, the respective index picked up from 54.5 in Q2. This signalled a sharp rate of inflation that was faster than the long-run series average. Furthermore, the increase in business expenses was steeper than the UK economy average.

Higher cost burdens were frequently linked to increased salary payments, unfavourable exchange rate movements and, in some cases, stretched manufacturing supply chains for technology components.

Input Prices Index

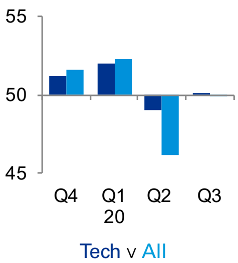
Above 50 = growth, seasonally adjusted



Tech Sector Margins: Prices Charged Index

Q3 '20

50.2



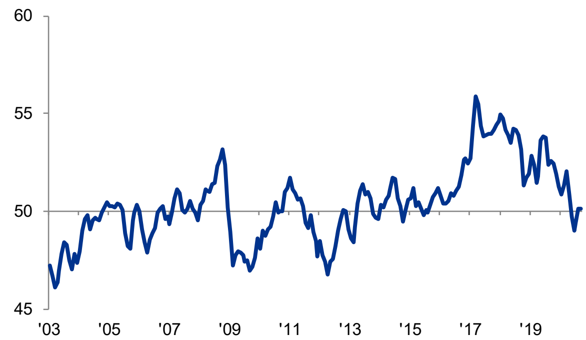
Selling prices rise only slightly as firms seek to boost sales

The seasonally adjusted Prices Charged Index rose from 49.0 in Q2 to 50.2 in Q3. This signalled a fractional rise in prices charged by tech firms after a marginal reduction in the second quarter. This was similar to the trend seen for the UK as a whole, where selling prices were broadly unchanged over Q3.

Firms that raised their charges indicated this was due to rising input costs. However, there were reports that challenging market conditions had increased competition for new work and restricted overall pricing power.

Prices Charged Index

Above 50 = growth, seasonally adjusted



Tech sector outlook

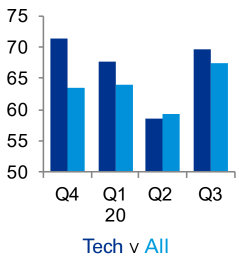
Sharp improvement in UK tech sector business expectations

UK tech companies expressed stronger optimism towards the one-year outlook for output in Q3. The Business Activity Expectations Index rose from 58.5 in Q2 to 69.7 in Q3, to mark the strongest level of positive sentiment since Q4 2019. Tech firms were also more upbeat than the average UK company in the third quarter (respective index at 67.5).

Growth forecasts were underpinned by expectations that customer demand and activity levels will rebound at home and overseas once the pandemic is brought under control.

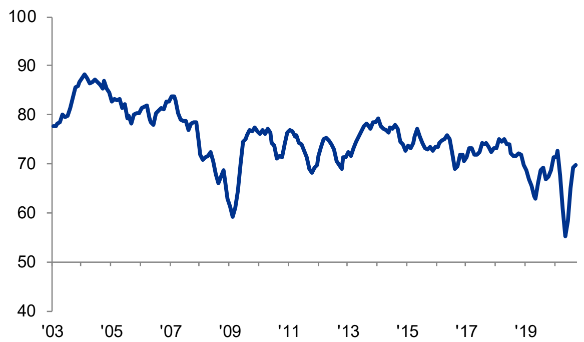
That said, uncertainty around the trajectory of the COVID-19 outbreak, the prospect of tighter public health measures and Brexit-related concerns were all cited as factors that could limit activity over the next 12 months.

Q3 ‘20
69.7



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.

Third quarter data for the UK private sector as a whole revealed a sharp expansion of business activity from the extremely low levels seen during the lockdown period. Survey respondents often commented on a partial rebound in activity amid the reopening of the UK economy, a return to work among clients and successful adaptations of business operations to meet social distancing guidelines.

However, monthly figures illustrate that the speed of recovery eased during September for the first time since the turnaround began in May, largely reflecting a slowdown in the service sector.

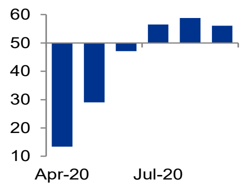
Growth remains highly uneven within the service economy, with renewed COVID-19 restrictions and the removal of temporary government schemes hitting leisure and hospitality businesses during September.

In contrast, the software & services sub-category recorded an accelerated expansion of business activity since August. Business-to-Business services and Financial Intermediation also gained momentum in September, which provides a positive signal for the near-term recovery in corporate spending on tech services.

UK Services

Business Activity Index

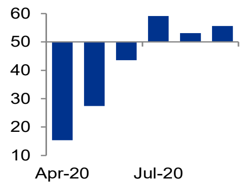
Above 50.0 = growth, sa



UK Software & Services

Business Activity Index

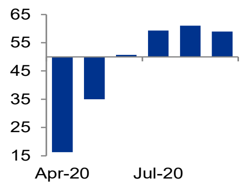
Above 50.0 = growth, sa



UK Manufacturing

Business Activity Index

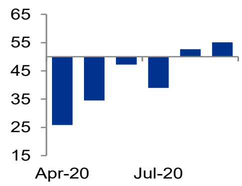
Above 50.0 = growth, sa



UK Tech Equipment

Business Activity Index

Above 50.0 = growth, sa



UK sector rankings

Optimism regarding prospects for growth picked up across the UK economy in the third quarter, following a slump during the early stages of the COVID-19 pandemic.

Growth projections among tech firms are stronger than those seen across the rest of the UK economy, helped by an expectation that demand for digital products and services will prove resilient to a wider global economic slowdown. Moreover, survey respondents noted that changes in business operations among clients through the lockdown period had boosted demand and spurred investment in new products. Some tech firms nonetheless cited concerns about the labour market outlook and prospects for consumer spending.

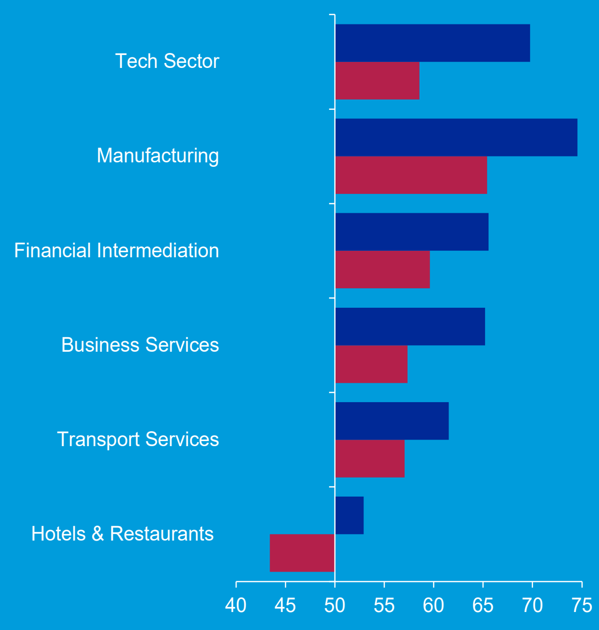
Tech companies are more confident about the year ahead outlook than all major parts of the private sector with the exception of manufacturing. Many manufacturers are still operating far below pre-pandemic production capacity, so business expectations in this sector are largely from a low base.

At the other end of the scale, consumer-facing sectors remain highly uncertain about the business outlook. Hotels & Restaurants and Transport Services were the least optimistic in the third quarter of 2020, despite confidence rising slightly since the spring.

Business Expectations Index by sector

Q3 2020
Q2 2020

Above 50 = growth in next 12 months



Recovery in exports of Asia tech equipment provides positive growth signal

UK tech sector resilience has broadened out to manufacturers of tech equipment, with output in this sub-category returning to growth in August and strengthening again during September. This category had previously struggled in the summer amid disruptions to global supply chains and shortages of critical inputs as manufacturers in China shut down factories at the start of the pandemic.

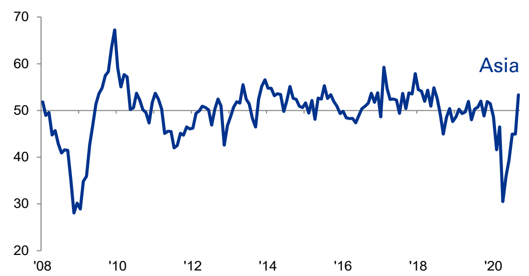
On a positive note for the reopening of global supply chains and recovery in end-user demand, September data indicated that new export orders across the Asia technology equipment sector expanded to the greatest extent since June 2018.

Recovering order books among manufacturers of technology equipment in Asia have typically provided an advance indication of improving market conditions in developed markets.

In fact, September data also showed signs of stabilisation in technology equipment export sales across Europe as a whole. These figures offer hope of a general turnaround in international demand conditions for UK manufacturers of tech products during the final quarter of 2020.

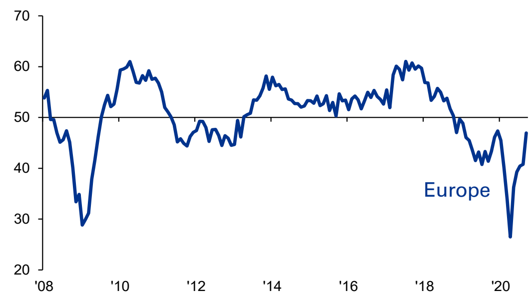
Asia Tech Equipment: New Export Orders Index

Above 50.0 = growth, sa



Europe Tech Equipment: New Export Orders Index

Above 50.0 = growth, sa



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KPMG LLP, a UK limited liability partnership, operates from 22 offices across the UK with approximately 17,600 partners and staff. The UK firm recorded a revenue of £2.40 billion in the year ended 30 September 2019. KPMG is a global organization of independent professional services firms providing Audit, Tax and Advisory services. We operate in 147 countries and territories and have more than 219,000 people working in member firms around the world. Each KPMG firm is a legally distinct and separate entity and describes itself as such. KPMG International Limited is a private English company limited by guarantee. KPMG International Limited and its related entities do not provide services to clients.

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IHS Markit (NYSE: 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).

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