Overcoming Disruption in 2022

UK Powerhouse Autumn/Winter 2021

Foreword

About the report

Welcome to the latest edition of our UK Powerhouse report.

Produced in partnership with the Centre for Economic and Business Research (Cebr), this study aims to explore critical themes and issues faced by businesses as we move into 2022.

The previous 12 months has seen unprecedented disruption for many businesses. Whether it's fuel shortages, labour supply issues or supply chain problems, organisations have struggled with a range of challenges – many of which are likely to remain in 2022 and beyond.

With this in mind and in addition to our regular look at the economic performance of 50 of the largest city economies, we consider the economic disruptors and how they're impacting on different sectors.

On the back of COP26 and the growing importance of ESG on the corporate agenda, our report also explores the impact of a longer term disruptive impact – the drive towards net zero.

Finally, disruption often provides an opportunity for businesses to innovate and transform, therefore we take a deeper dive into how important concerns about the economy are for driving forward innovation. In addition to the insight provided by our lawyers, we've also called upon experts at the CBI and Department for International Trade for their input into this important topic.

I hope you find this report to be of use and interest. I look forward to hearing your feedback.

Hannah Clipston
Director of Strategic Growth (Corporates & Institutions)

About The Report

Official economic data sources for the UK's cities are often dated and fail to provide a reliable snapshot of the UK's localised economies. The last set of regional economic accounts corresponds to 2019.

To more accurately estimate current economic activity, Cebr has used a range of timely indicators to create a nowcast of gross value added (GVA) and employment indicators for the 50 locations in the UK with the largest GVA. Cebr also models the economies of these cities in order to produce a forecast of their performance a year ahead.

The analysis of this data gives us a picture of how the UK's regional economies performed in Q4 2021 and how they're expected to perform in Q4 2022.

We also analyse how different environmental concerns and wider disruptors are impacting businesses, and look at how enterprise innovation across UK regions and constituent nations can help overcome them.

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Authorship and acknowledgements

This report has been produced by Cebr, an independent economics and business research consultancy established in 1992. The views expressed herein are those of the authors only and are based upon independent research by them.

London, December 2021

The State of the UK Economy

A deep dive into the UK's recovery from its worst contraction on record

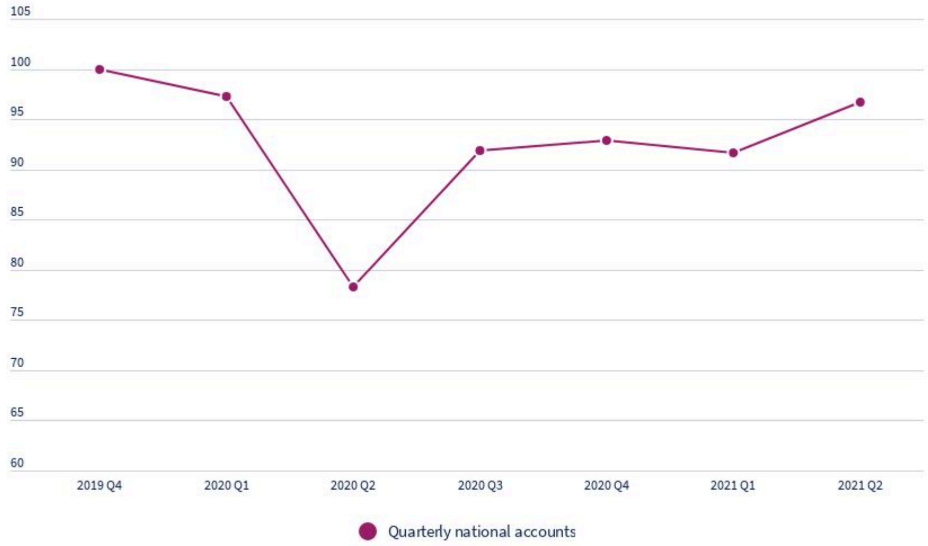
The State of the UK Economy

The story of the UK economy throughout 2021 has been one of recovery. This is despite GDP decreasing by 1.4% in Q1 2021, compared to Q4 2020, as the UK dealt with further lockdown measures, which remained in place until mid-April.

Restrictions eased and businesses opened up again in Q2, leading output to grow by 5.5% compared with the previous quarter. This left the UK's GDP at the end of Q2 2021 3.3% below GDP in Q4 2019 – the last full quarter that was unaffected by the pandemic.

In addition to the ongoing spectre of COVID-19 and the threat of new variants, concern over fuel and food shortages, rising inflation squeezing household budgets and the likely increase to the cost of borrowing, has led to growing pessimism.

Figure 1 –UK GDP, quarterly index, Q4 2019 = 100



Source: Office for National Statistics, Cebr analysis

Sectors driving the UK's GVA growth

GVA growth in 2021 was largely driven by the construction and services sectors.

The construction sector grew by 3.8% over Q2, while services showed the highest growth in output, at 6.5%. The single largest acceleration in growth was in the accommodation and food services industry, where GVA grew by 87.6% in Q2 2021. Education also saw strong growth in Q2 of 20.6%. This is mainly due to the reopening of many schools over 2021 and the fact that most higher education courses were delivered online in Q2 2021.

But production only featured moderate increases in output. The latest data shows that Q2 production output grew by just 1% in Q2 compared to the previous quarter.

The poor performance of the production sector, relative to construction and services, can in part be explained by the weaker output of mining and quarrying, which decreased by 15.9% from Q1 2021. Similarly, automotive output is being depressed by global shortages of semiconductors.

Employment also on the rise

The decrease in the UK unemployment rate – from its near-term peak of 5.2% during the three months to December 2020 – also reflects the economy's recovery.

Joblessness decreased throughout 2021, reaching 4.5% in the three months to August 2021. For comparison, the unemployment rate was 3.9% in the last three-month period that was unaffected by the pandemic (November 2019 to January 2020).

While it appears that the unemployment rate is slowly approaching natural levels again, the impact of the end of the furlough scheme's yet to be seen in the numbers.

irwinmitchell

City Growth Tracker

The performance of 50 UK Powerhouse cities, based on GVA and employment growth.

UK Powerhouse City Tracker

Southampton's predicted to have the highest annual GVA growth out of the 50 UK Powerhouse cities in Q4 2021 at 9.2%, followed by Milton Keynes at 9%

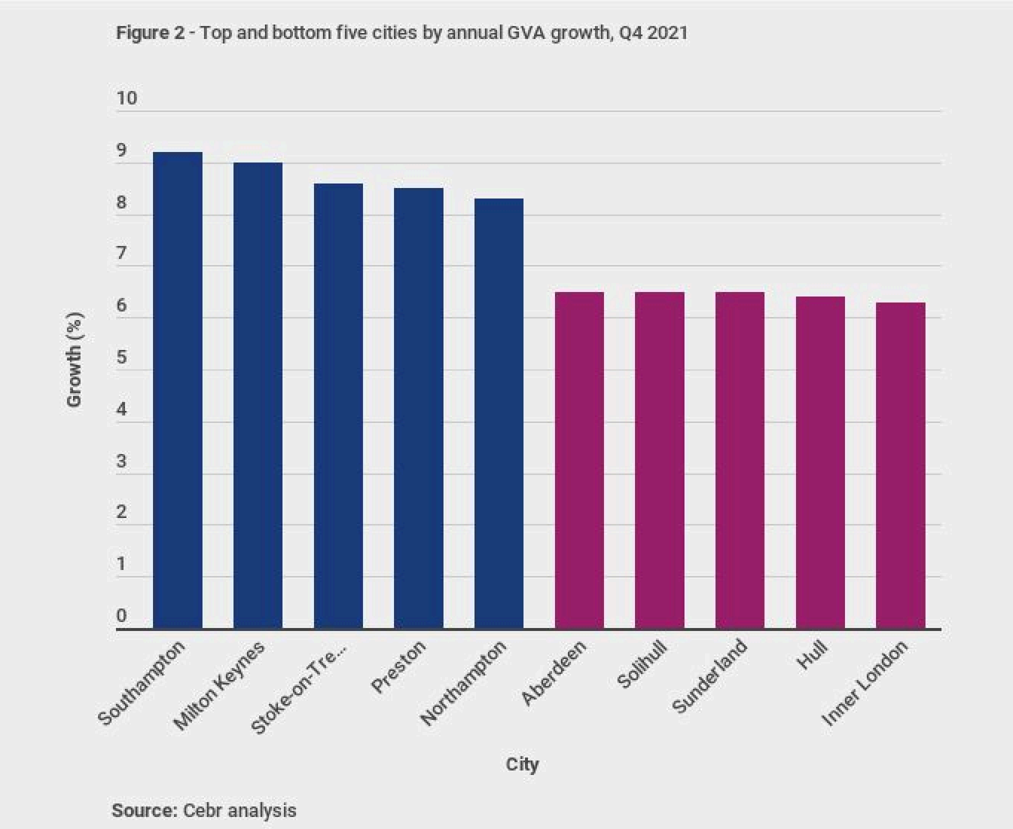
Both cities are centres for the transportation industry and benefitted from the pandemic's need for online shopping to be delivered

Strong GDP growth rates of the UK's cities illustrate the return of economic activity

Other services-focussed cities such as Oxford, Cambridge and Reading are likely to perform well in 2022.

Inner London performs poorly in Q4 2021 but is projected to have strong employment growth in Q4 2022

Use of the furlough scheme masked changes in employment, as jobs were protected during the pandemic



Transport drives south coast growth – a look at GVA across UK cities

GVA decreased in all cities in 2020, as the pandemic and associated lockdown measures played havoc with businesses' productivity and consumer spending. But Q4 2021 saw positive changes across the board.

Southampton

The south coast city of Southampton is predicted to enjoy the highest growth rate, with GVA estimated to have increased 9.2% compared to Q4 2020.

Transportation and storage dominates the city's GVA, but it only employs a relatively small part (7%) of its workforce. In comparison, the largest source of employment is in human health and social work services, with 20.2% in 2019.

The impact on the pandemic on the transportation industry was ambiguous. Passenger transport decreased during the lockdowns, and increased when restrictions eased. But demand for shipping and courier services increased as consumption shifted online. UK exports to EU countries have recovered after plummeting in January 2021, while imports from non-EU countries in 2021 are higher than they were in 2020. This increased trade volume led to greater activity in business ports in the UK, such as Southampton.

Milton Keynes

Milton Keynes recorded the second largest GVA growth, increasing by 9% compared to the previous year. At the same time, employment in the city is also estimated to increase by 4.8%. The Buckinghamshire city's been particularly active in the construction industry, with 684 newly built houses per 100,000 inhabitants, placing it top in the UK.

Milton Keynes also benefits from its location between Oxford and Cambridge. These cities tend to see faster employment growth than other cities because of their large research and life sciences industries. Similar to Southampton, Milton Keynes has an above average share of employees working in the transportation and storage industry, which has benefitted from increased demand for home deliveries.

Manchester

In Manchester, annual GVA growth is estimated to be 7.3% in Q4 2021, with a 7.1% increase in Greater Manchester. In the year to Q4 2022, both areas are forecast to show the same growth in GVA, at 2.5% each.

In contrast, annual employment growth in Q4 2021 differs to a substantial degree. The number of workers in Central Manchester is estimated to have increased by 4.6% , while growth in Greater Manchester stands at 2.3% over the same time period. This signals a slower jobs market recovery in areas outside the city centre.

The city's labour market composition made it relatively robust to disruptions caused by public health measures. Retail trade makes up a smaller share of employment than in other cities in the UK, at 11.9% in 2019. While Manchester's labour market employs an above-average share of hospitality workers, they make up only a minor portion of the city's overall labour force, which is characterised by professional services.

The University of Manchester is another large factor for the local economy, as it has established itself as one of the country's leading institutions of higher education.

Sheffield

Manchester's neighbouring city of Sheffield didn't perform as well with regards to GVA, which is set to increase by 6.9% in the year to Q4 2021. Similarly, the city's estimated labour market performance is weaker, with only 2% employment growth in the year to Q4 2021. This comes despite a relatively large decrease in employment in Q4 2020, such that recovery growth may have been expected.

There are more than 60,000 students enrolled in the city's two universities, which also employ more than 12,000 people combined. As education was largely remote in 2021, the consumption stemming from students is likely to have been dampened. Entertainment and food services are expected to have suffered from this loss.

Sheffield also doesn't have good projected growth in Q4 2022, with the expected GVA growth of 2.2% being the sixth lowest out of the UK Powerhouse cities. The city's home to a Boeing manufacturing site, but aircraft manufacturing has suffered due to the reduction in air travel and has only partially recovered over 2021.

Solihull

Solihull is estimated to have seen the second strongest increase in employment in Q4 2021, after Oxford. Employment increased by 5.4% compared to Q4 2020. Over the course of the pandemic many households relocated from city centres to smaller towns, and this was reflected in a migration from Birmingham to Solihull.

While this migration doesn't have an impact on Solihull's GVA, as those moving into the city still work in Birmingham, it's contributed to an increase in employment. A major employer in Solihull is Jaguar Land Rover, where around 9,000 people work.

Birmingham

Despite people leaving the city, Birmingham's GVA is estimated to have increased by 7.5% in Q4 2021 and employment's forecast to have increased by 3.9% relative to Q4 2020.

Education and health and social services make up large shares of Birmingham's labour force. Health services in particular have benefitted from being able to offer non-COVID-related services again.

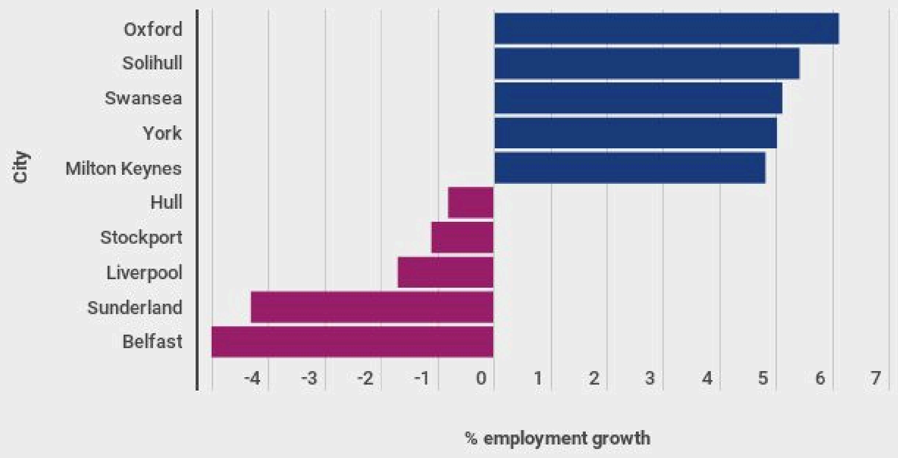
Retail trade, which made up the third largest share of GVA in 2018 with 11%, was also among the key beneficiaries of restrictions being lifted.

Birmingham's GVA outlook for the year to Q4 2022 is relatively good, with a predicted growth of 2.9%. The city's large automobile industry has been affected by global supply shortages, but these are expected to be resolved in 2022.

Swansea

Swansea's estimated to have seen a sizable increase in its employment rate in Q4, which is up 5.1% on Q4 2020. The public sector employs a large portion of Swansea's workforce, which protected jobs during COVID-19. As a result, the end of the furlough scheme might not have a significant impact on employment in the Welsh city.

Figure 3: Top and bottom five cities by annual employment growth, Q4 2021



Source: Cebr analysis

York

In the North, York's employment is estimated to increase by 5% in Q4 2021, compared with the previous year. The historic city's labour market is dominated by the hospitality industry, with accommodation and food services employing 10.3% of the city's working population. This sector has seen the largest growth rates throughout 2021, after being one of the hardest hit by lockdown measures.

Looking ahead to Q4 2022

As the growth of transport and storage eases, Oxford and Cambridge are forecast to be among the cities with the highest projected GVA growth at the end of 2022, at 3.3% each on a year-on-year basis.

The two university cities are also expected to show some of the highest annual growth in employment, at 3.2% in Oxford and 2.5% in Cambridge. The two local economies are dominated by the universities and the surrounding array of services and research-based firms. Milton Keynes, located between Oxford and Cambridge, is also set to perform well in Q4 2022, with GVA increasing by 3.3% compared to a year earlier.

In the South East, GVA's expected to grow by 3.4% year-on-year in the service-based economy of Reading. This further suggests that cities with a strong service sector such as Reading, where Microsoft has based its UK headquarters, or Oxford and Cambridge are likely to have higher growth rates.

After showing increasing employment in Q4 2021, Solihull's GVA is expected to increase by 3.1% in the year to Q4 2022. A potential driver of this growth is the easing of the current supply shortages hampering the global automobile industry. Another factor that might be contributing to Solihull's higher GVA is the influx of employed people in 2021, who may contribute more to the local economy through increased consumption.

Powerhouse tables, Q4 2021

GVA (click to enlarge)

	GVA Q4 2021, £mn*	Growth (YoY)
Southampton	7,300	9.2%
Milton Keynes	13,500	9.0%
Stoke-on-Trent	5,600	8.6%
Preston	4,200	8.5%
Northampton	11,600	8.3%
Huddersfield	7,300	8.2%
Doncaster	5,500	7.8%
Exeter	5,400	7.7%
Birmingham	26,100	7.5%
Bristol	14,300	7.5%
Brighton	8,200	7.5%
Liverpool	12,600	7.5%
Warrington	7,200	7.5%
Oxford	21,300	7.5%
Nottingham	9,800	7.4%
Chelmsford	4,800	7.3%
Portsmouth	5,600	7.3%

*(annualised, CVM constant prices)

Employment Level (click to enlarge)

	Employment, Q4 2021	Growth (YoY)
Oxford	145,700	6.1%
Solihull	114,200	5.4%
Swansea	133,900	5.1%
York	128,600	5.0%
Milton Keynes	185,900	4.8%
Chelmsford	87,500	4.8%
Manchester	507,400	4.6%
Birmingham	637,300	3.9%
Leeds	495,500	3.7%
Huddersfield	161,500	3.5%
Nottingham	244,800	3.2%
Southampton	177,600	3.2%
Doncaster	134,500	3.2%
Cardiff	248,700	3.0%
Swindon	119,200	2.9%
Wolverhampton	132,600	2.9%
Coventry	197,900	2.9%

Powerhouse tables, Q4 2022

GVA (click to enlarge)

	GVA Q4 2022, £mn*	Growth (YoY)
Reading	8,600	3.4%
Oxford	22,000	3.3%
Cambridge	19,500	3.3%
Milton Keynes	14,000	3.3%
Peterborough	6,400	3.1%
Solihull	9,800	3.1%
Aberdeen	16,100	3.0%
Exeter	5,500	3.0%
Warrington	7,400	3.0%
Stoke-on-Trent	5,800	2.9%
Derby	7,100	2.9%
Winchester	5,200	2.9%
Birmingham	26,800	2.9%
Portsmouth	5,800	2.8%
Swindon	9,200	2.8%
Outer London	140,500	2.8%
Northampton	11,900	2.8%

*(annualised, CVM constant prices)

Employment Level (click to enlarge)

	Employment, Q4 2022	Growth (YoY)
Oxford	150,300	3.2%
Chelmsford	89,700	2.5%
Cambridge	153,800	2.5%
Inner London	3,615,500	2.3%
Leeds	506,600	2.2%
Stoke-on-Trent	130,500	2.2%
Birmingham	651,400	2.2%
Manchester	518,500	2.2%
Cardiff	253,900	2.1%
Edinburgh	375,700	2.0%
Solihull	116,400	2.0%
Exeter	112,600	1.9%
London	5,413,700	1.9%
York	130,800	1.8%
Aberdeen	184,400	1.7%
Wolverhampton	134,800	1.6%
Swindon	121,100	1.6%

Drivers of Disruption

The headwinds affecting businesses' post-pandemic recovery

Drivers of Disruption

Businesses are facing unprecedented levels of disruption.

Our insight from sector-based analysis shows five key themes:

1. Staff shortages
2. Supply chain issues
3. A worrying economic outlook
4. Brexit
5. The rise of innovators.

Staff shortages

The pandemic has changed the way people think about work and life.

With job shortages across many sectors, largely due to the end of the freedom of movement through Brexit, employees are realising that their skills are in demand. This gives them the opportunity to look for and negotiate a better deal elsewhere.

Employees expect more from their employers and will move jobs if they don't feel valued, engaged and looked after. Indications are that 40% are likely to move in 2022, of which 18% are certain to move. This move is being termed 'the Great Resignation.'

Staff shortages are being played out across a range of sectors, and having a detrimental impact on their performances.

The UK Manufacturing Output PMI – a measure of the sector's performance – stood at an eight-month low in October 2021. This is despite an uptick in the rate of new orders.

Job vacancies in the sector are 79% higher than they were in February 2020 (the last month of normal, pre-pandemic activity), according to the Financial Times. This headwind is likely to affect the sector into 2022 and continue to restrict output. The story's similarly reflected in the consumer sector, where vacancies are 91.6% higher than they were before the pandemic.

Many of these issues are highlighted by the Vistage CEO Confidence Index, which says that 75% of CEOs expect to increase their employee numbers over the next 12 months.

With so many vacancies and so few candidates, employers have been forced to increase wages to both attract and retain talent. According to Vistage, in Q3, 70% reported difficulties in recruiting and retaining talent.

As a result, 71% have increased wages to compensate. The number of vacancies has impacted on retention too. Almost a third of CEOs are seeing greater levels of employee churn, and four-in-10 leaders are seeing it impact on their ability to operate at full capacity.

Expert Insight

"Severe staff shortages are a major disruptor across all sectors.

"Employers need to work hard to understand what their employees want and why they're leaving. Is it about pay? Or are they unhappy with other elements of the working environment?

"It's important to work on 'employee brand' to sell yourself to candidates, given we're in a market where recruitment is fast becoming a race to attract and secure the best candidate. Conducting regular surveys are a good way to test the pulse of your organisation and may help you to understand what your employees expect and are motivated by.

"Investing in training is also important. Make sure that your staff know how you can help them improve their skills and make progress within your organisation. Upskilling staff in this way not only helps them to keep up to date with new and emerging technologies and the skills required in their role, but it will make them feel valued.

"Line managers have an important role in setting the tone of the organisation. Some are naturally good at handling people issues, but many aren't. If you help them improve, they'll be better placed to deal with issues promptly, prevent many from escalating, and get the best out of their teams.

"Businesses are competing against each other to fill vacancies, and you need to think carefully about what your organisation can offer that others don't.

"Attracting staff isn't just about the amount you pay them. What other benefits do you offer?

If you positively support work/life balance and give work flexibility, this is particularly attractive for many – hybrid working or supportive policies such as time off work or access to health benefits to help staff through 'life's ups and downs' will pay dividends, as will a good strategic investment in resource to looking after staff wellbeing."

Jenny Arrowsmith
Partner
Employment

Supply chain issues

Many businesses have been affected by the global semiconductor chip shortage, which isn't expected to improve until 2023.

Transport equipment manufacturers reported a 16.5% fall between May and June 2021, with factory shutdowns featuring increasingly in the news. Jaguar Land Rover halted production at its two primary factories in Halewood and Castle Bromwich from April into mid-May. In Turkey, Ford's deprioritisation of chip supply to a Turkish plant assembling the Ford Transit for sale in the EU market, meant production completely shut down in early June.

Companies with large delivery and transport operations integral to their core business have felt it the most – an obvious area for additional costs being unplanned maintenance of older stock.

Games companies and the consumer electronics sector have fared much better with their forecasting, keeping semiconductor supplies more closely aligned to consumer demand.

Protectionist steps are now being taken by foreign governments to produce their own semiconductors. And a change in approach may now be on the horizon for the UK.

In early July, having initially waived the deal through, the Prime Minister has ordered a review by the National Security Advisor into the purchase of Newport Wafer Fab Ltd by a Chinese manufacturer.

A consortium is reportedly gathering with UK companies gearing up to put in an alternative bid for the Welsh semiconductor manufacturer.

On top of this, the staffing problems covered earlier have been evident in logistics and transportation. Brexit and the end of freedom of movement for EU workers, combined with COVID-19 restricting people's ability to travel and the introduction of IR35, has led to a shortfall of 100,000 qualified HGV drivers. The situation led to a logjam of shipping containers, further disrupting the supply chain.

In response, the government's introduced temporary visas for 5,000 foreign drivers to work in the UK. But more long-term planning needs to be done, including a review of pay and working conditions, to overcome the challenges presented by the great resignation in the sector. Looking beyond this, supply chains are expected to come under further pressure as they adjust to the need to showcase their green credentials.

Expert Insight

“The property sector, like so many others, has been affected by supply chain and labour shortages. This has led to logistical issues for developers which, in turn, has impacted on deals that we’re negotiating across the sector.

“Tenderers are coming back with longer lead-in times, and costs are increasing. Developers are having to factor this into their commercial contracts . For instance, where a developer has an obligation to commence on site by a certain date, these dates are being pushed out and developers are having to approach contractors to tee them up ahead of contractual commitments.

“Perhaps a way to avoid some of these issues to use modern methods of construction (MMC) where buildings, machinery and equipment are prefabricated in a factory environment and then assembled on site.

“Whilst MMC can be beneficial in terms of sustainability, as well as quality control, safety and efficiency, it does have its disadvantages.

“MMC is in an evolutionary phase – lenders, investors and valuers are all finding their way. Practical issues, such as size logistics and site access, also must be considered.

“But MMC is gaining traction, and we know players such as Legal & General are involved. The government’s also launched an MMC task force with £10m seed funding and a remit to accelerate its use in public procurement. We believe it will become much more prevalent.

“If build-to-rent providers are going to go down this route, we need to make sure commercial contracts are watertight and comfortable with the provider.”

Michelle Beaumont
Partner
Real Estate

Economic outlook

Concerns over fuel and food shortages, rising inflation squeezing household budgets and the cost of borrowing likely to increase as interest rates rise has led to growing pessimism. And those are on top of the ongoing spectre of COVID-19.

Consumer confidence has declined for the third consecutive month, and stood at -17 points in the GfK Consumer Confidence Index in October 2021.

In the real estate sector, pent-up demand, the desire for more space, and inflationary pressures have caused prices to rise markedly. This has left prospective homeowners struggling to afford new houses, leading to a drop in the sector's growth.

Although the real estate sector is forecast to grow by 0.6% and 2.5% in 2021 and 2022 respectively, the economic outlook on the whole looks gloomier than it did in April 2021, when lockdown restrictions eased. This current economic situation is prompting consumers to be less willing to loosen their purse strings and spend more.

Expert Insight

“With businesses fighting for every consumer pound spent, we’re likely to see an increase in innovation and adaptation as companies seek to make their offering the most attractive on the market. The rise of ‘experiential’ consumer businesses has led that drive, from the use of virtual reality to Instagrammable pop-up shops and bars.

“The rise of online shopping seems to show no sign of stopping, but innovative use of bricks and mortar has seen Ikea purchase the old Topshop site on Oxford Street. It’s unlikely we’ll see a swath of Billy bookcases being carried onto the Tube. Instead, it will be a base for them to show off their wares, complemented by a delivery service.

“It seems people still like to see what they’re buying. ‘Showrooms,’ displaying a collection of key items, may become the norm as we move forward.

“Being able to deliver your promises is key for consumer companies. Often that means getting your delivery process right – quite literally. Consumers expect to receive what they’ve ordered in record time, with many large organisations offering next-day or even same-day delivery as standard.

"That means having a slick logistics operations, and using technology to create efficiencies and speed up the process.

“In order to win the battle for consumer spending businesses are using technology and adapting their offering to what consumers really want – meaning that getting client feedback, and acting quickly on it, will become ever more crucial.”

Faye Bargery
Regional Managing Partner

Brexit

It'll still take some time before all Brexit-related issues are laid out and represented in economic data.

The financial and insurance activities sector could see a loss of £2.2 billion (in 2018 prices) in GDP per year over the long term, according to a Cebr report.

Despite this, jobs and businesses lost to other financial centres as a result of the UK leaving the single market isn't as severe as initially feared.

The government remains firmly committed to muting the effects of Brexit and the pandemic to help the UK remain competitive globally. The Chancellor's Autumn Budget confirmed a cut in the bank surcharge from 8% to 3%, resulting in a combined tax rate of 28%, as opposed to the originally proposed rate of 33% (an outcome of an increase in corporation tax rates from 19% to 25%).

This, along with the four-fold increase in the annual bank surcharge allowance from £25 million to £100m, aims to alleviate some of the impact of increased corporation taxes in the sector.

Insight from the Department for International Trade

“The Department for International Trade (DiT) has launched an ambitious new ‘Made in the UK, Sold to the World’ export strategy to help businesses across the UK increase exports and sell their world-class products around the globe.

“The UK exported £600bn in goods and services last year, but only around one-in-10 GB businesses currently export. By unlocking the UK’s exporting potential, we’ll help level up the country and boost the UK’s economy.

“We know exporting supports millions of jobs, enables small businesses to increase their productivity, and extends the UK’s economic ties across the globe.

“Our export plan lays the groundwork for UK exporters to thrive. We’re fundamentally an open and liberalised economy that is ready to do business and trade with the world.

“Now is a pivotal moment for UK exporters. Free trade is evolving, and the UK has an important opportunity to trade more and trade differently.

“We’re embarking on a new era in our trading relationships, negotiating innovative, world-leading free trade agreements with the markets of the future.

“By aligning our agreements and relationships to UK priorities, we’re creating export opportunities that work for all parts of the UK so we can Build Back Better.”

Expert Insight

"There are undoubtedly risks but equally opportunities for the UK as we adapt to a post-Brexit environment.

"The problems associated with non-tariff barriers and bureaucracy are well documented, but Brexit also provides regulatory autonomy.

"The introduction of Freeports, new trade deals with global markets such as Singapore, India, Japan, Australia, New Zealand and Canada, and the success of the COVID-19 vaccine rollout means businesses remain keen to invest into the UK and use it as a key landing point for access to trade across the rest of the world.

"Reskilling the workforce and developing infrastructure will also boost the economy and stimulate the jobs market nationwide.

"For businesses already based and formed here in the UK, we're fully behind the DiTs recently announced export strategy. Through our global network of trusted legal and financial advisers (which extends to 200 countries), we're helping educate British businesses on cross-border opportunities, enabling them to exploit new trade, supply and investment links.

"With the right responses from business, in partnership with local and national government, there's much to be positive about in the coming years."

Bryan Bletso
Head of International

Innovators

The shift to online retail over bricks and mortar stores during the pandemic has led to the loss of a number of household brands from our high streets or the closure of their stores. These include the likes of John Lewis, Topshop and Debenham's.

The future of retail looks set to be propelled by the adoption of technology and advanced analytics to meet consumers' changing expectations. The outlook of individual retailers will be highly dependent on how well they integrate technological optics into their daily functions.

The financial and insurance activities sector has also been disrupted by the emergence of fintech start-ups.

The likes of Monzo and Starling Bank have grown to become much more than just prepaid card services that integrate with mobile applications.

By offering targeted solutions at consumers' fingertips, they've provided a level of accessibility to financial services that has never been seen before. With the two banks attaining banking licenses while doing so, you can expect fintech start-ups of similar ilk to continue to transform the sector.

The onset of the pandemic has pulled forward digital disruption in the financial services industry. It's fuelled the demand of services provided by such fintech start-ups, given that in-person banking services were unavailable when lockdown measures were in place.

With new fintech disruptors entering the market, it's imperative for incumbents to appeal to digital natives by bundling online banking solutions that promote transparency, convenience, and established functionality.

More than three-quarters (77%) of senior leaders within UK financial institutions have stated that technology, automation and digital investment is a top strategic priority for 2022. Close to half (46%) of financial services firms plan to extend their relationships with fintech firms in 2022, compared with a third (32%) who stated that they will do so in 2021. Of these firms, developing new products and services (66%) was the top priority, followed by improving client experiences (53%) and driving growth (49%).

Expert Insight

“The impact of the pandemic and the extension of government-backed lending to businesses has presented a window of opportunity to fintechs and challenger banks in the market. There’s been a significant amount of lending activity outside of the major High Street banks, and the opportunity now is for these smaller banks and alternative lenders to capitalise upon this.

“Technology and its application will be a driving factor in this, as seen in the data quoted above. Removing barriers to banking and finance – providing services at the click of a button at a point when customers are increasingly moving away from face-to-face banking – could drive a new wave of fintech growth. More established lenders and High Street banks will need to consider the changing wants and needs of their customer base in response, or face the prospect of being left behind.

“And it’s not limited to just banking and finance. Institutional money managers are under similar pressure from trading apps and online platforms, providing a new generation of investors with low cost, easy

access to financial markets.“The so called ‘democratisation’ of financial markets and the associated cultural shift in attitudes towards investment and market access not only disrupts, but challenges, established service models of banks and financial institutions.

“In spite of this, as they experience growth, fintechs must remain aware of the challenges posed by regulation.

“As we’ve seen in Europe, and recently in the UK with the Financial Conduct Authority, regulators will scrutinise these emerging market disruptors and the risk of shortcomings in their governance. It’s important to bear in mind that identifying regulatory compliance will remain an important consideration.”

Sean Scott
Partner
Banking & Finance

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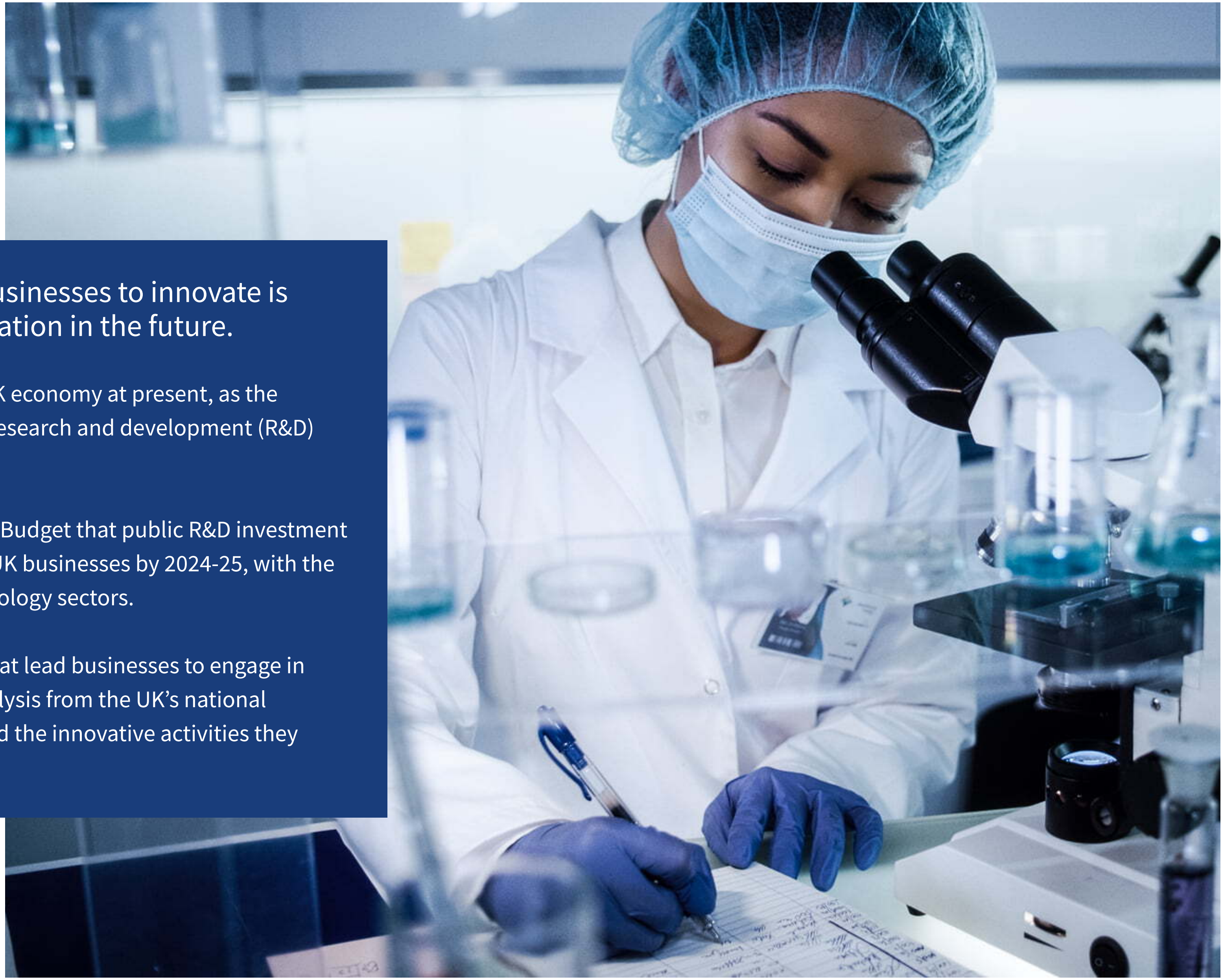
Overcoming Disruption Through Innovation

How environmental and business resilience concerns lead to enterprise innovation in different UK regions



Understanding what drives businesses to innovate is key to supporting more innovation in the future.

This is particularly of interest to the UK economy at present, as the government looks to increase public research and development (R&D) spending.

It was announced in the 2021 Autumn Budget that public R&D investment is set to provide £20bn in funding for UK businesses by 2024-25, with the aim of boosting the science and technology sectors.

This section looks at the key factors that lead businesses to engage in these innovating activities. It uses analysis from the UK's national innovation survey to better understand the innovative activities they conduct and any regional disparities.

Innovation-active businesses are defined as those which have engaged in one of the following:

- The introduction of a new or significantly improved product (good or service) or process
- Engagement in innovation projects not yet complete, scaled back, or abandoned
- New and significantly improved forms of organisation, business structures or practices, and marketing concepts or strategies.

Broader innovators are businesses conducting one of the three activities above or innovative activities in areas such as:

- Internal research and development
- Training
- Acquisition of external knowledge or machinery and equipment.

In 2018, there were 282,000 active enterprises with 10 or more employees in the UK. Data from the UK Innovation Survey shows that 38% of these were innovation active between 2016 and 2018 – equating to around 106,000 businesses.

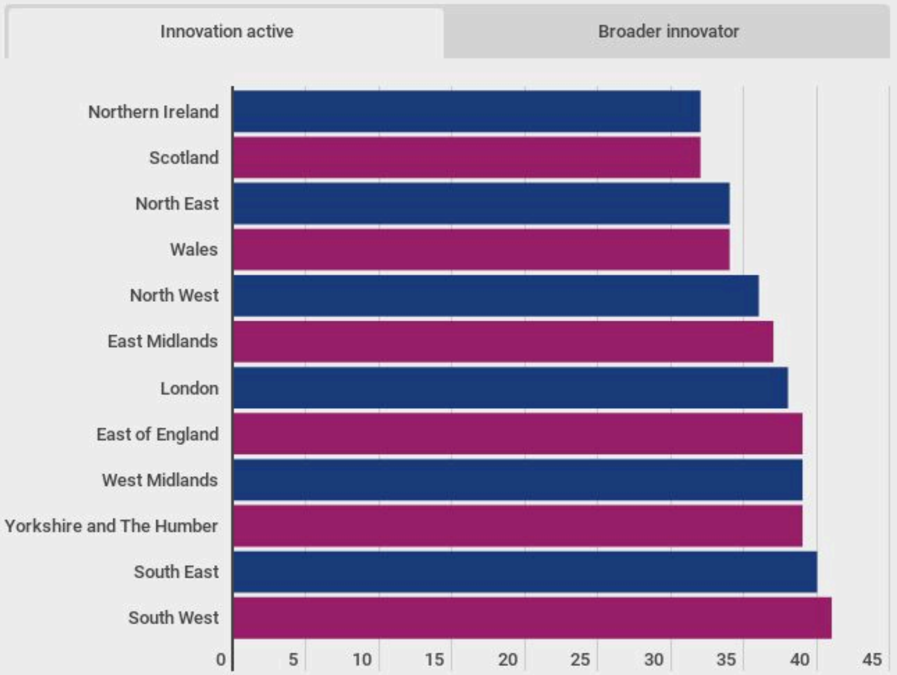
Innovation levels across the UK

The South West has the highest share of innovation active businesses, at 41%, followed closely by the South East at 40%. This equates to 9,900 businesses actively innovating in the South West, and 16,100 in the South East.

London has the sixth highest share of businesses being innovation active in the UK. It enjoys the highest total number due to having the most businesses out of the 12 UK regions, at 18,900.

The definition of being a broader innovator is slightly looser, resulting in a higher share of businesses in each region falling under this definition. Overall, 39% of UK businesses are defined as broader innovators.

Figure 4: Share of businesses engaging in innovation activity by region, 2016-18



Source: UK innovation survey, Cebr analysis

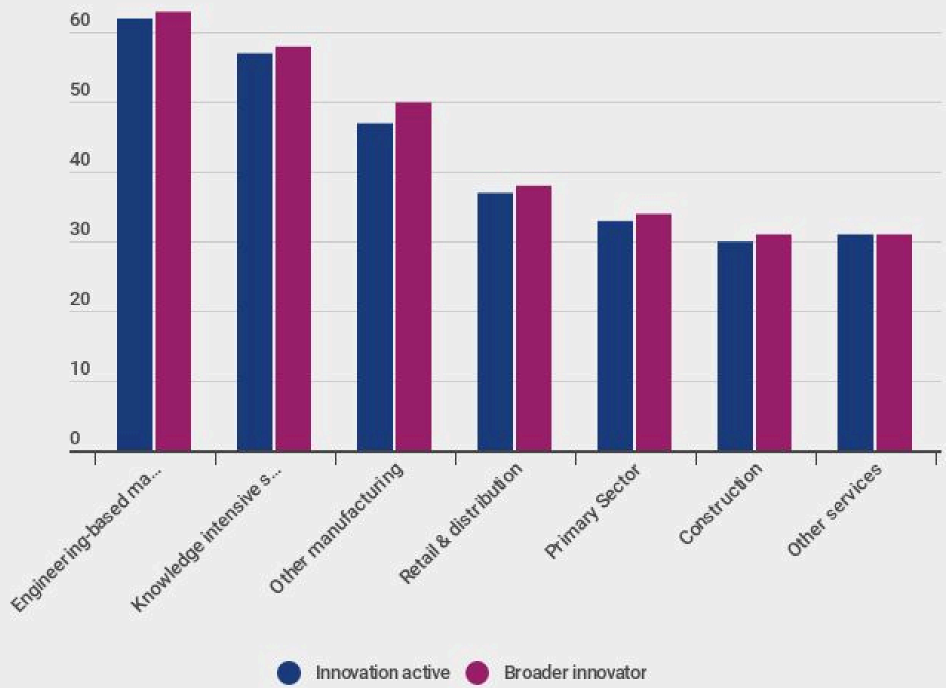
Innovative industries

Breaking the results down by industry shows that engineering-based manufacturing is the industry with the highest share of enterprises engaging with innovation.

At the other end of the spectrum, the construction and other services industries engage in the least innovation.

The share of businesses engaging in innovation activity has fallen by 15 percentage points since 2012-14, when it stood at 53%. Assessing the factors that might incentivise businesses to innovate more is key to raising this share back towards 2012-14 levels.

Figure 5: Share of businesses engaging in innovation activity by industry, 2016-18



Source: UK innovation survey, Cebr analysis

Why innovate?

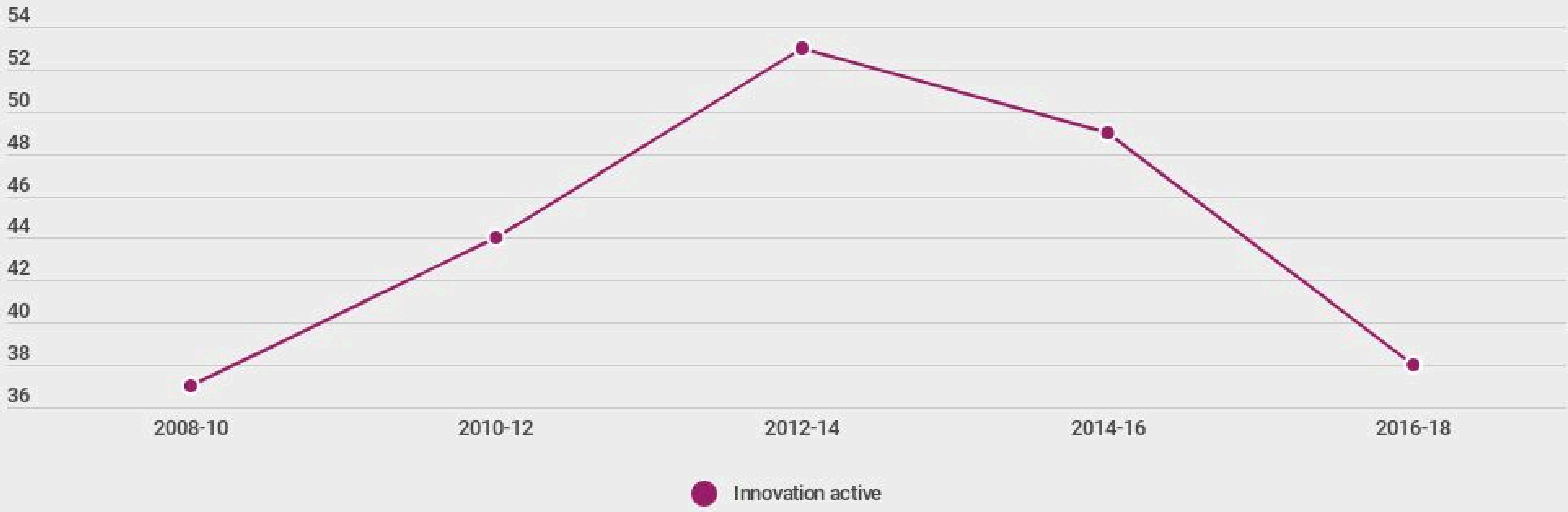
What are the drivers considered to be important for their innovation? How important are business resilience and environmental concerns?

The desire to improve the quality of goods and services provided to customers is by far the biggest driver of innovation, selected by 43% of broader innovators.

This is likely to be driven by a need to be competitive and offer better products than competitors.

Following this, 37% of businesses said that replacing outdated products or processes is highly important to their innovation.

Figure 6: Share of businesses engaging in innovation activity



Source: UK innovation survey, Cebr analysis

Expert Insight

"In spite of some recent decline in the share of businesses engaging in innovation activity, it's been fascinating to watch how the businesses we work with have responded to the new trends in business. Their agility means they've identified and capitalised on opportunities early. It's always inspiring to support them on the journey to realise their innovative goals.

"It comes as no surprise that the desire to improve the quality of goods and services is the biggest driver of innovation, since we know how customer-oriented our clients are and recognise their constant need to remain competitive.

"Businesses consider continual adaptation of their products and processes as key to managing changing markets. Retaining and expanding their customer bases is something we also see reflected in our clients' goals for innovation.

"It's interesting to note that the range of industries leading in innovation activity spreads across such a variety of sectors. Despite the highest levels of innovation activity remaining in the South East and South West, it's encouraging to see high levels of innovation-active businesses right across the UK.

"But the relative decline in numbers of innovation-active businesses up to 2018 demonstrates some room for development, particularly in those industries and regions falling behind in the polls.

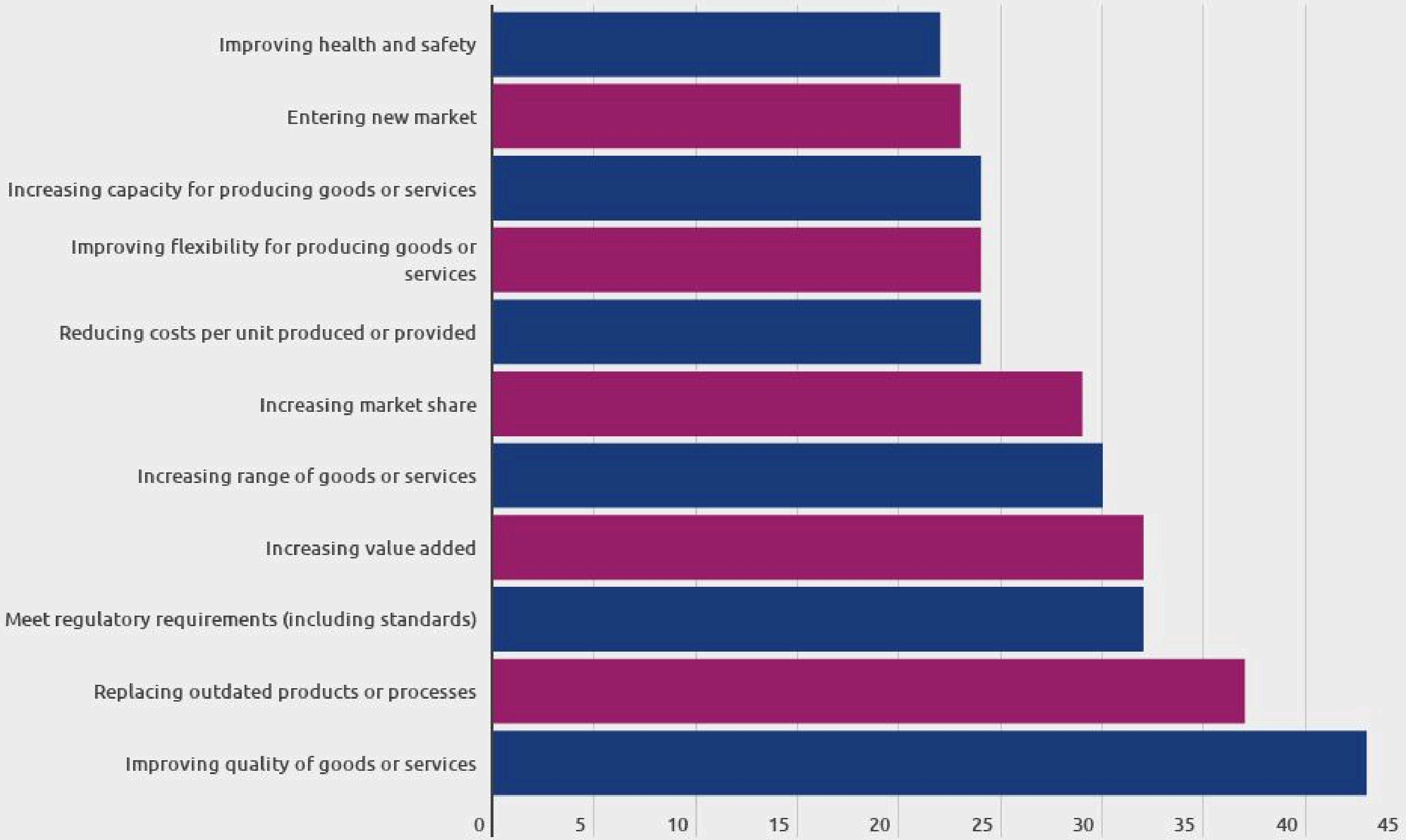
"The continuing impact of Brexit and the pandemic remain to be seen, but it may prove to be a catalyst for innovation in certain fields."

Aurelia Butler-Ball
Partner
Commercial

Resilience and innovation

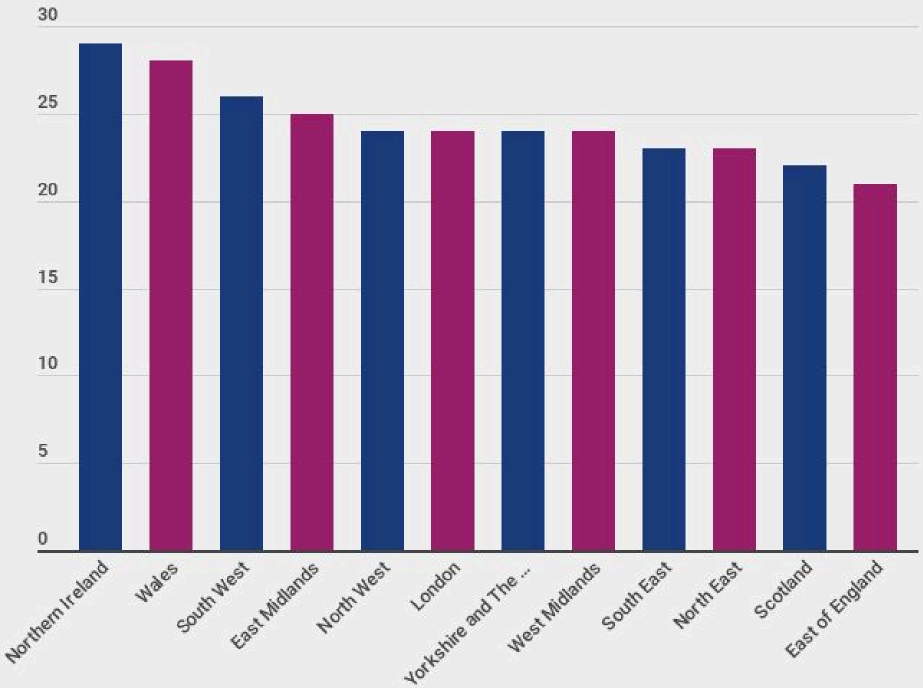
A drive towards being a resilient business encourages innovation. As does the need to improve flexibility for providing goods or services, or to reduce production costs. These are regarded as two key ways to improve the resilience of a business. Having the flexibility regarding production and costs to change business output in a recession will help firms withstand periods of economic hardship.

Figure 7: Drivers of innovation – % of broader innovators rating listed factors as "highly important", 2016-18



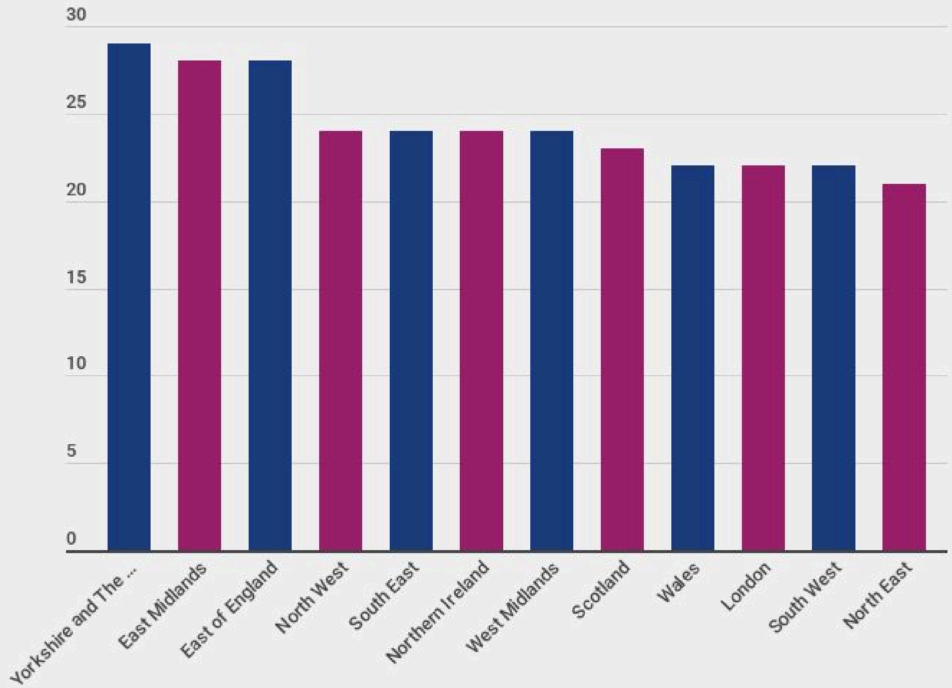
Source: UK innovation survey, Cebr analysis

Figure 8: Share of innovating businesses listing 'improving flexibility for producing goods or services' as a highly important factor driving innovation, by region, 2016-18



Source: UK innovation survey, Cebr analysis

Figure 9 :Share of innovating businesses listing 'reducing costs per unit produced or provided' as a highly important factor driving innovation, by region, 2016-18



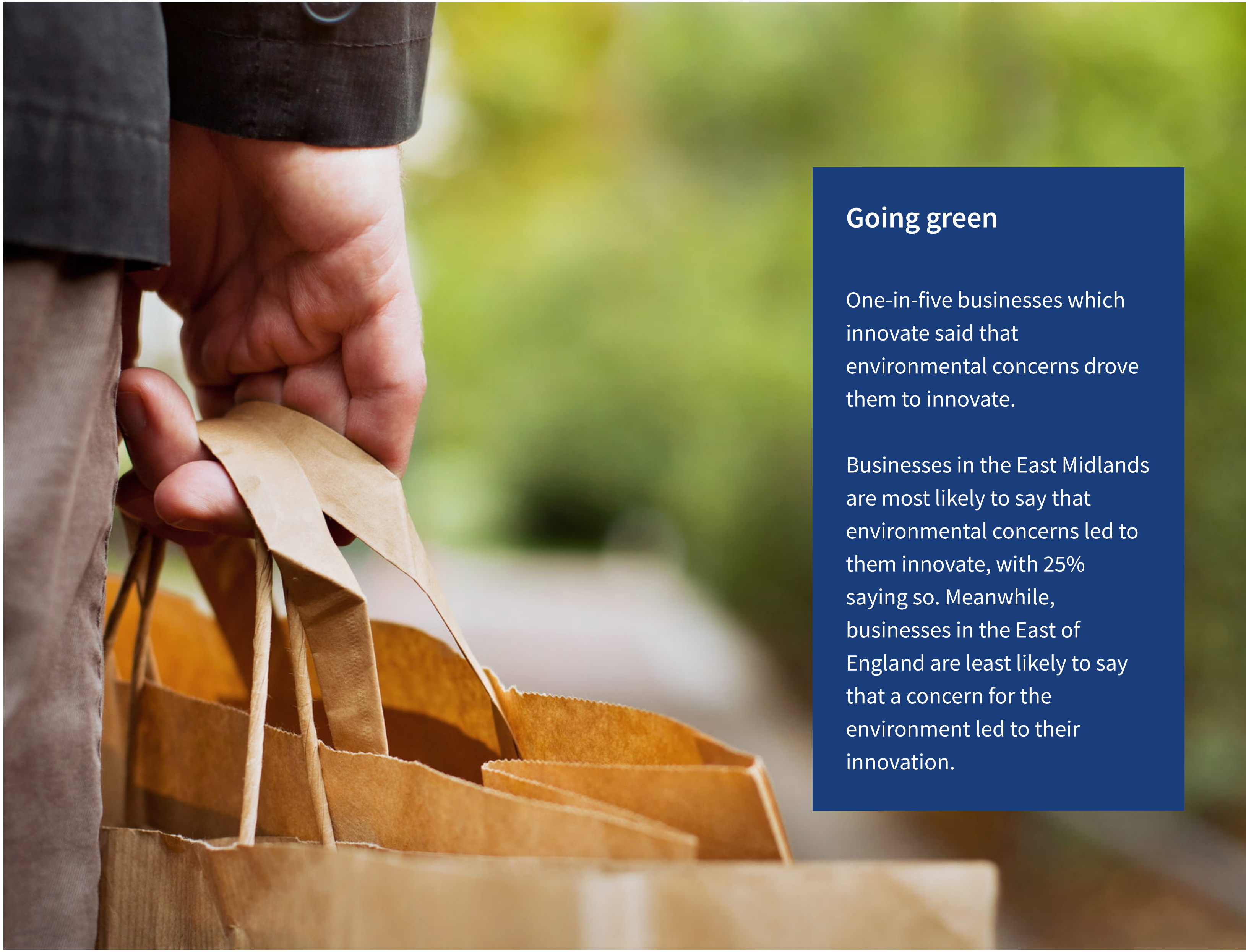
Source: UK innovation survey, Cebr analysis

29% of broad innovator businesses in Northern Ireland say that improving flexibility for producing goods or services is a highly important factor driving their innovation.

This suggests that the desire to improve resilience is a key force for innovation there. Also an important factor for innovators in Wales and the South West.

Lowering costs

Yorkshire and the Humber is the region with the highest share of businesses (29%) that say reducing costs per unit is a key driving force for their innovation. Meanwhile, 28% of innovating businesses in the East Midlands and East of England said that reducing unit costs was a force that led them to innovate. At the other end of the spectrum, reducing unit costs only drove 21% of innovating businesses in the North East.

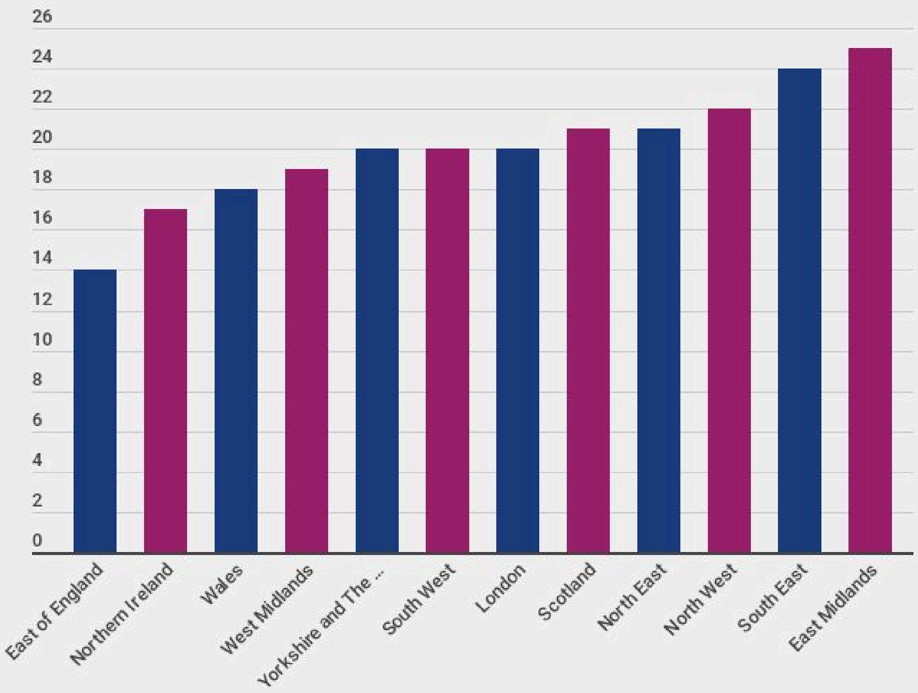


Going green

One-in-five businesses which innovate said that environmental concerns drove them to innovate.

Businesses in the East Midlands are most likely to say that environmental concerns led to them innovate, with 25% saying so. Meanwhile, businesses in the East of England are least likely to say that a concern for the environment led to their innovation.

Figure 10: Share of innovating businesses listing 'reducing environmental impact' as a highly important factor driving innovation, by region, 2016-18



Source: UK innovation survey, Cebr analysis

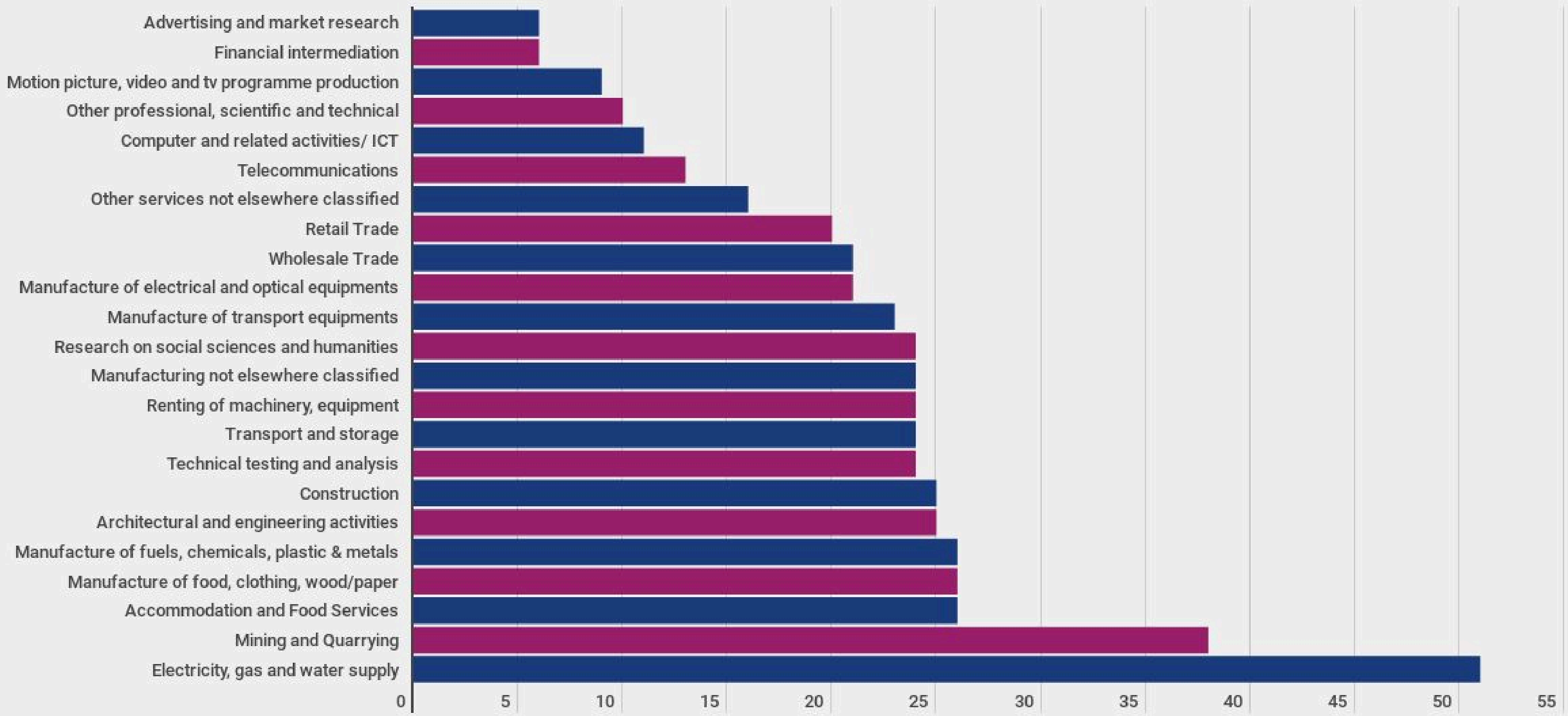
One of the driving forces behind the regional differences in environmental concerns leading to innovation is the different industry makeup of each region. There's a significant disparity between industries as to how environmental concerns are an important factor for innovation.

By far the industry most concerned with the environment for innovation is utilities (electricity, gas and water supply).

51% of innovating businesses in this industry said that reducing their environmental impact was key. Electricity companies, for example, are increasingly interested in providing renewable energy to customers, and this is a major area of research for most of these businesses.

But only 6% of innovating businesses in the financial intermediation, advertising & market research, and real estate activities sectors said reducing their environmental impact led them to innovate.

Figure 11: Share of innovating businesses listing 'reducing environmental impact' as a highly important factor driving innovation, by industry, 2016-18



Source: UK innovation survey, Cebr analysis

“Our latest report highlights that only 20% of innovators rated reducing environmental impact as highly important for driving change in their organisation. Although manufacturers ranked it more highly than other sectors, I was quite surprised at how low it was.

“I think that with the recent COP26 and ESG moving further up the corporate agenda, the move towards the UK becoming fully carbon neutral by 2050 will drive significant change from now on.

“If you look at manufacturing, the automotive sector has for some time been responding to the need to develop more environmentally friendly electric vehicles. Food manufacturing is making big strides too, with the Food & Drink Federation announcing an ambition to reach net zero by 2040. It also announced that its members had reduced onsite carbon emissions by 55% – five years before its 2025 target.

“Generally speaking, the issues manufacturers should be thinking about in relation to the environment fall into three categories.

“The first relates to product, and whether environmental pressures will lead to a shrinking market. Secondly, there’s the issue of how carbon intensive a business’ production process is and whether it can be changed.

"A final area is market opportunity, and the possibility for manufacturers to adapt their products, their brand and to utilise existing skills and people.

“The need to decarbonise the economy should be viewed through a positive lens, and I don’t think there should be an agenda of fear. Businesses will at some point need to adapt but, at the same time, I completely understand that any change has to lead to a tangible benefit to the business in the here and now.

“I think that the environment offers plenty of opportunities. A recent study by the TUC said over 600,000 jobs could be at serious risk if the UK continues to fall behind other countries in the amount it invests in green infrastructure.

“Many businesses, including a lot of manufacturers, have already considered their response to becoming zero carbon. This includes having the necessary green skills, and people with the innovative and creative thinking, to allow you to lower your carbon footprint.

"If you already have them, are you protected if a competitor looked to lure them away?

"Do you have the right premises and are they in the right location? Do they need to be the same size in the next 10 years? Perhaps now is the time to sell or even make a strategic bolt-on acquisition? Do you need the support of another business to help innovate and collaborate? If so, are you protected from an IP point of view? Do you have the right level of funding, and what, if any, grants are available for doing what you want to do in the future?

“The environment is now a huge disruptor in the corporate world. Whether you consider yourself an innovator or not, now is the time to act.”

Dorrien Peters
Head of Manufacturing

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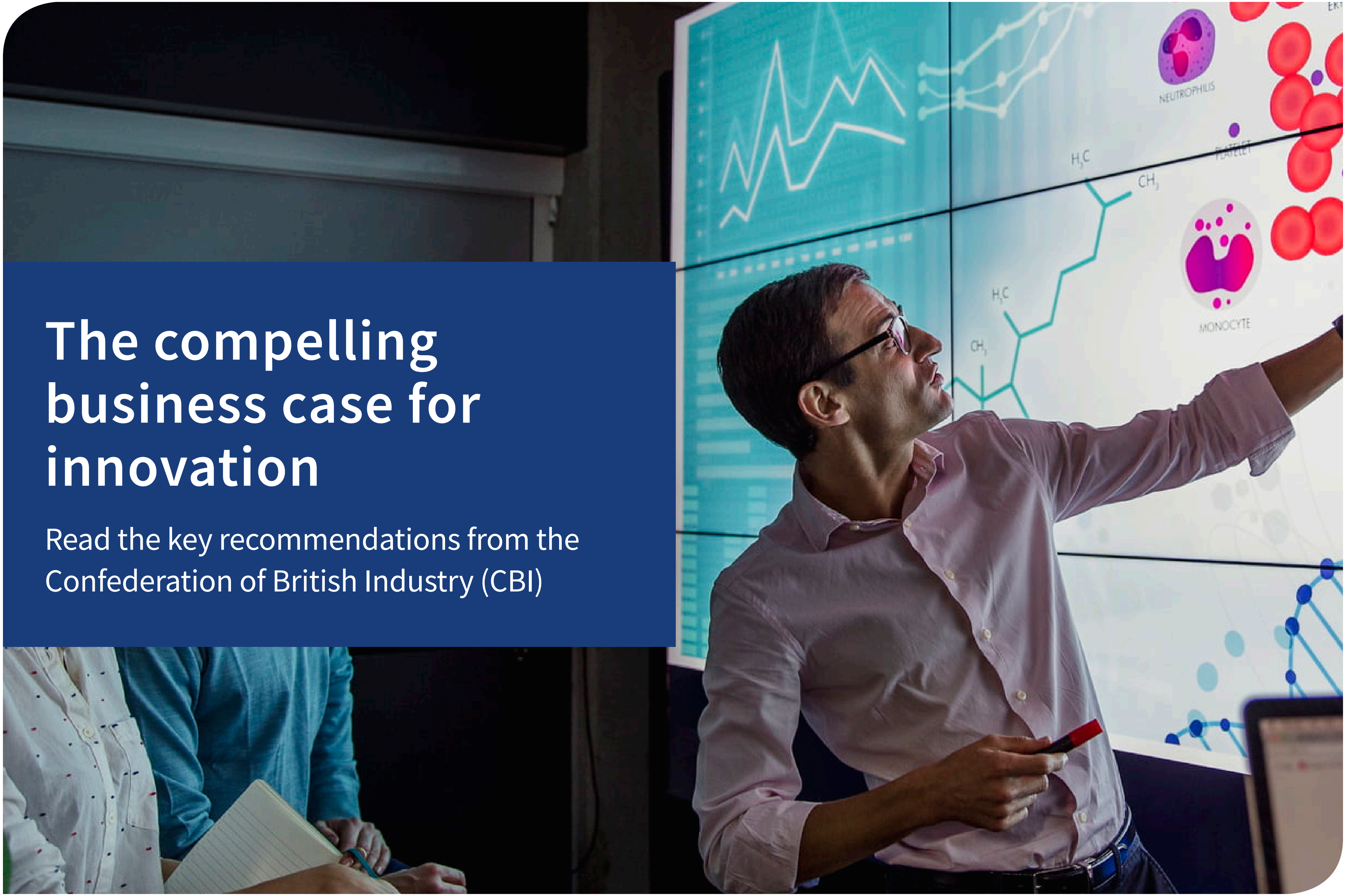
The compelling business case for innovation

Read the key recommendations from the Confederation of British Industry (CBI)



The compelling business case for innovation

Vanessa O'Donnell, Senior Policy Adviser at the CBI, looks at recommendations for businesses ahead of 2022.

"This report has shone an important light on the disruptors impacting everyday businesses operations and the areas that will be prioritised in the future. While the pandemic, recent and systemic labour shortages, and the road to net zero each present unique challenges, they all share the ability to turbocharge innovation.

Embrace technology

"From productivity improvements, new products and services, and refreshed business models, here at the CBI, we've seen first-hand how many businesses are prioritising investments into cutting-edge technologies. This has unlocked growth, increased resilience and boosted agility.

"The business case for innovation is clear – those who invest in R&D and adopt new technologies enjoy increased turnover and profits, and are more likely to experience higher levels of productivity and growth. As our economy fires up again and we chart our path to net zero, the role that innovation will play in powering the success of individual businesses and the wider economy, as well as addressing societal challenges, is set to grow even further.

Provide employees with the skills you need

"While the onset of the pandemic saw an acceleration of tech adoption, we're now at risk of losing this momentum. Research undertaken by CBI Economics chimes with the findings of this report that the key barrier to tech adoption is now skills. This puts into sharp focus the urgent need to tackle labour shortages if we're to avoid our access to talent from holding back the economy.

Learn from others

"The risks are particularly acute for less digitalised firms and we must act now to prevent the gaps in adoption translating into significant gaps in business performance. One way this can be addressed is through best practice sharing. Our recent study showed that over half of organisations accessing tech support did so by learning from peer companies and business networks.

"The CBI has been leading the charge on these issues and our project Big Fish, Little Fish offers businesses a series of vital tools, as they seek to collaborate on innovation initiatives.

"But the government must also do more to support the trend towards digitalisation. This is crucial in our drive towards a more productive and levelled-up economy, with a high-wage, high-skill workforce.

"The new innovation strategy provides a valuable opportunity to foster a more supportive ecosystem, which better connects the various players across the system.

"Current changes to the regulatory framework and data protection regime must also ensure we incentivise rather than deter innovation.

"The CBI are now working with BEIS and DCMS to ensure the strategy, wider regulatory framework and the Spending Review settlement deliver a truly world-leading innovation offer, which unlocks further business-led innovation.

Go green

"Environmental sustainability is now firmly a boardroom issue, with two-thirds of organisations now citing this as a consideration when determining supply chain relationships, as well as new products and services.

"This transition offers real benefits for all businesses, with the potential to deliver growth through job creation and boosting exports. Embracing this disruptor also offers businesses a strong value proposition that can put them ahead of the game, with strong climate credentials being likely to lead to increased customer share, improved attraction and retention of talent and greater favourability with investors.

Innovation is key

"While we're experiencing unparalleled levels of disruption to traditional business practices, there's much to be gained for those that embrace these shocks.

"Innovation is key to achieving this successfully and strategically, and we look forward to continuing to support our members as they chart their path through these unprecedented times."

Thank you for reading

Overcoming Disruption in 2022

Visit irwinmitchell.com to find out how we can help you or your business with legal support and financial planning.