State of Industry Report

Q3 2022

Executive summary

- Industry's confidence fell further in Q3 2022, to its lowest level since the FDF's series started in Q1 2018. Overall, we see a pessimistic outlook for Q4, with over half of respondents expecting business conditions to continue to deteriorate in Q4 compared to Q3.
- Persistent cost rises have eroded margins and businesses expect this to continue. In response, nearly 50% have cut or paused capital investment projects.
- Labour shortages remain a significant brake on the industry's growth, with the vacancy rate increasing to 9.1% in Q3, up from 6.3% in Q2. These vacancies range from high-skilled roles (engineers or scientists) to production operatives (machine operators or drivers).
- Energy costs are unprecedentedly high. Energy reached 22% of operating costs in Q3 2022, up from 12% in Q3 2021. 73% of businesses are worried about the outcome of new energy contract negotiations.
- Businesses are prioritising investments that can help alleviate internal cost pressures. A key priority for manufacturers is to ensure an efficient use of energy and continued new product development (including packaging).
- Manufacturers are looking for a range of government support to help them through this period, with 53% keen for tax incentives to support capital investment and 44% wanting to see a reduction in the costs and burdens of moving goods between the UK and the EU.

Contents

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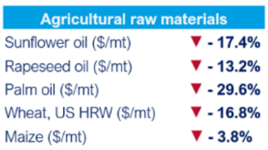
Read more from FDF business insights and economics

Prices dashboard

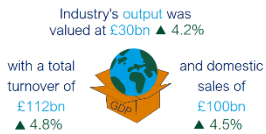


Agricultural raw materials	
Sunflower oil ($/mt)	▼ - 17.4%
Rapeseed oil ($/mt)	▼ - 13.2%
Palm oil ($/mt)	▼ - 29.6%
Wheat, US HRW ($/mt)	▼ - 16.8%
Maize ($/mt)	▼ - 3.8%

Inflation commentary

Trade snapshots

Industry facts and stats



Growing cost pressures and heightened uncertainty

Relentless inflationary pressure and uncertainty defined Q3 for the UK's food and drink manufacturers. Energy prices remain volatile, with gas prices four times higher on average than in 2021, while unfavourable weather conditions hit global crop yields. Global food prices were down from their March 2022 peak, but remain 46% higher than pre-pandemic levels. Continued uncertainty around the Black Sea Grain Initiative poses a further threat to rising global prices.

This survey was carried out against a backdrop of heightened economic, political and geopolitical uncertainty. More than a third (35%) of UK companies report that economic uncertainty is impacting turnover.

Consumer spending and business activity have been slowing, while further interest rate rises are expected. At the same time, continued uncertainty exacerbated by UK political instability has been impeding investment and growth.

The UK's food and non-alcoholic drink inflation was the highest in 42 years at 14.6% in September – the 14th consecutive month of accelerating price inflation. 38 of 49 food categories saw double-digit inflation, with dairy products most impacted. Low-fat milk was up 42.1%, whole milk 30.2% and butter 28.1% (Chart 1).

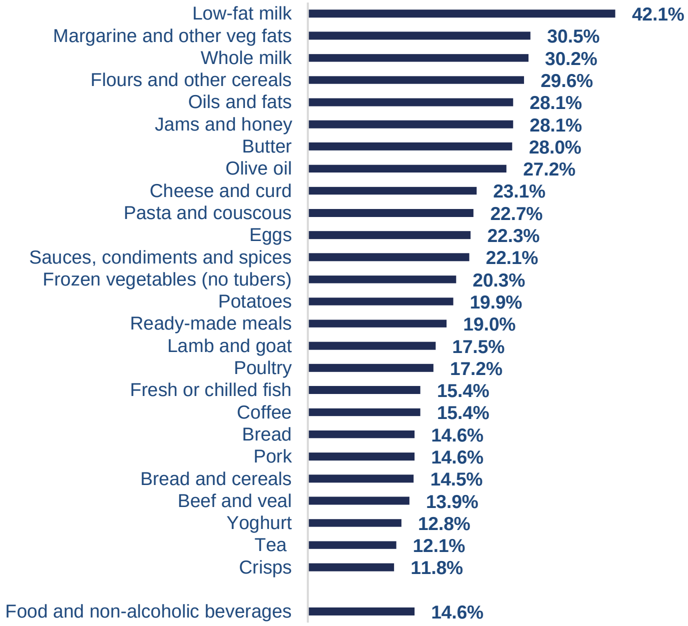
Cost pressures showed no sign of slowing and manufacturers have been facing continued ingredient price rises. UK-produced ingredients were 16.7% more expensive while imported ingredients were up 27.8%. The relentless increase in production costs means inflation will remain high in 2023 as it takes between seven and twelve months for cost rises to feed through to consumer prices.

Both food manufacturing and non-alcoholic drink manufacturing were larger than pre-pandemic levels, and growing, having expanded in Q2 compared to Q1. However, the performance of sub-sectors varies. Compared to Q4 2019, non-alcoholic drink, dairy and bakery sectors were significantly larger in Q2, whereas all other sectors remain smaller (Chart 2).

Employment has been trending upwards since Q1 2021, with 3,000 jobs added in Q2, bringing total employment to 478,000. However, labour shortages persist and in Q3 manufacturers reported a vacancy rate of 9.1% where they continue to struggle to recruit required staff.

The impact of these challenges on the UK's food and drink manufacturing industry was laid bare in the first nine months of 2022, with more insolvencies in our industry than during the whole of 2019. The same figures are lower for both manufacturing as a whole and for Great Britain businesses, indicating current economic conditions are hitting our sector hardest (Chart 3).

Chart 1: Food and drink inflation by category



Source: ONS

Chart 2: Food and drink manufacturing growth by subsector, Q2 2022

Gross value added (GVA), chained volume measures	Q2 2022 on Q1 2022	Q2 2022 on Q4 2019	Share of food manufacturing (Q2 2022)
Food manufacturing	**0.5%**	**1.9%**	
Meat and meat products	-0.4%	-5.9%	19.6%
Fish, fruit and vegetables	-0.6%	-3.1%	10.6%
Vegetable and animal oils and fats	-9.1%	-11.8%	0.5%
Dairy products	2.3%	9.2%	11.0%
Grain mill and starch products	2.5%	-11.1%	4.0%
Bakery and farinaceous products	2.1%	12.9%	18.9%
Other food products	-0.9%	-0.8%	28.4%
Non-alcoholic drink manufacturing	**0.5%**	**16.2%**	

Source: ONS

Chart 3: Number of insolvencies

	2019	2022 (Jan-Sep)	2022 insolvencies as a percent of 2019 insolvencies
Food manufacturing	95	125	132%
Drink manufacturing	27	47	174%
Great Britain	18,204	16,923	93%
Manufacturing	1,540	1,314	85%

Source: The Insolvency Service, gov.uk

Confidence sinks to record low in Q3

The mood of manufacturers was more pessimistic in Q3, with industry's confidence at its lowest level since FDF began these surveys in Q1 2018. Confidence has been falling since Q2 2021, with the FDF's net confidence tracker reaching a record low of -79% in Q3 from -72% in the preceding quarter (Chart 4).

The FDF's net confidence score is calculated as the difference between those who think general business conditions have improved in Q3 2022 compared to Q2 2022 and those who believe conditions have deteriorated. In Q3, the share of those who thought conditions worsened exceeded the share of those who thought conditions improved by 79 percentage points.

Ongoing market disruption appears to have had more negative impacts on large businesses during Q3. All companies with a turnover exceeding £500m perceived market conditions to have worsened in Q3 compared to Q2. That compared to only 85% of mid-sized companies and 67% of SMEs (Chart 5).

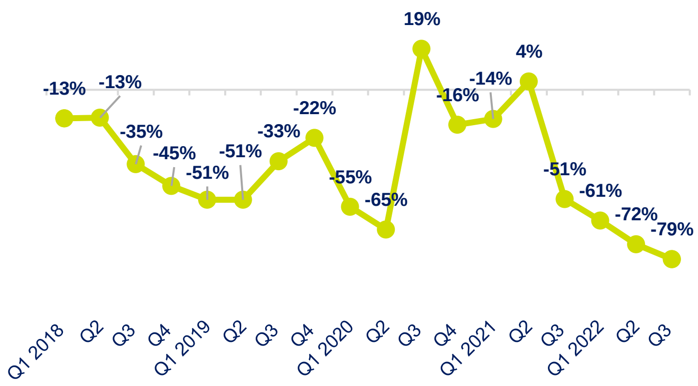
The outlook for Q4 remains pessimistic, with 54% of respondents believing business conditions will deteriorate compared to Q3 and only 8% expecting any improvement. 39% of manufacturers think Q4 conditions will remain similar to those in Q3.

The short-term expectations highlight the inclination of large and mid-sized businesses to have a more negative future outlook (Chart 6). SMEs have been more vulnerable to immediate cost increases and typically felt the brunt of cost rises and market volatility in real time. Large producers are more likely to contract in purchases and hedge against currency shift, mitigating against the worst impacts of rising prices in the short term. However, as contracts have come to an end, they now face paying much higher costs for many key inputs.

Heightened uncertainty persists with no end in sight for the war in Ukraine. Gas prices remain a great concern and are the most volatile cost pressure facing manufacturers right now. While the UK Government's Energy Bill Relief Scheme is welcome in providing respite for businesses, the six-month window is too short to allow for proper planning around future production. Furthermore, the industry bakes, chills, and freezes all year round and industry's energy requirements will not necessarily reduce outside the winter period.

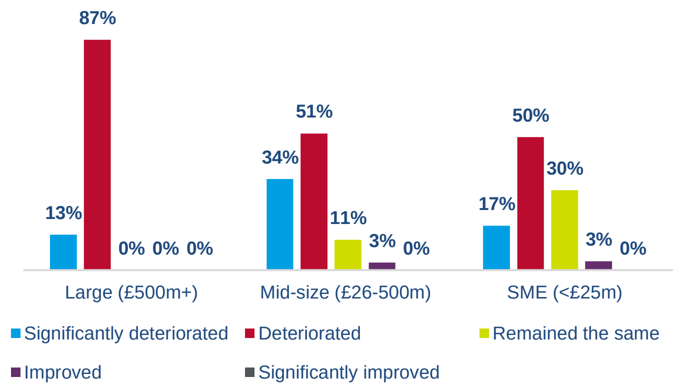
Consumer spend is showing signs of a slowdown as inflation bites and real incomes deteriorate. While food and drink is a necessity, we expect some manufacturers to see a drop in demand and their margins squeezed further, especially those serving the hospitality sector, as households cut back on discretionary spending.

Chart 4: FDF net confidence tracker



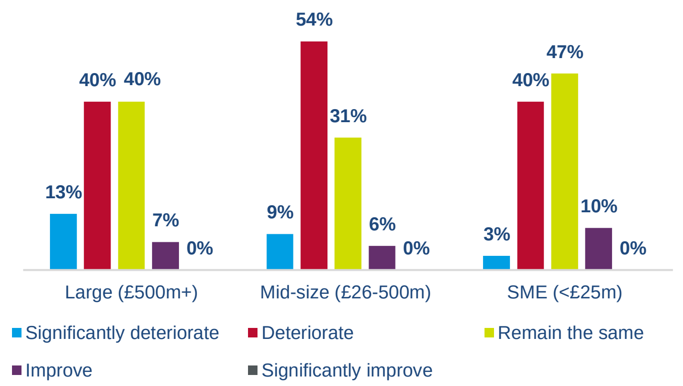
Source: FDF State of Industry Survey

Chart 5: Conditions in Q3 2022 compared to Q2 2022



Source: FDF State of Industry Survey

Chart 6: Expectations for Q4 2022 relative to Q3 2022



Source: FDF State of Industry Survey

Labour shortages continue to trouble industry

Unfilled vacancies remain a significant issue for UK food and drink manufacturers. The reported vacancy rate – the number of vacancies per 100 employees, has increased to 9.1% in Q3, from 6.3% in Q2. Most businesses (76%) are reporting vacancy rates between 0–10% (Chart 7).

On average, unfilled vacancies accounted for 9.2% of the labour force for large businesses, 8.8% for mid-sized businesses and 8.1% for small businesses.

This performance stands in contrast to developments in the wider economy where vacancies, while still at historically high levels, have started to ease over the last four months (Chart 8).

Shortages were reported across a wide range of roles and skills, including:

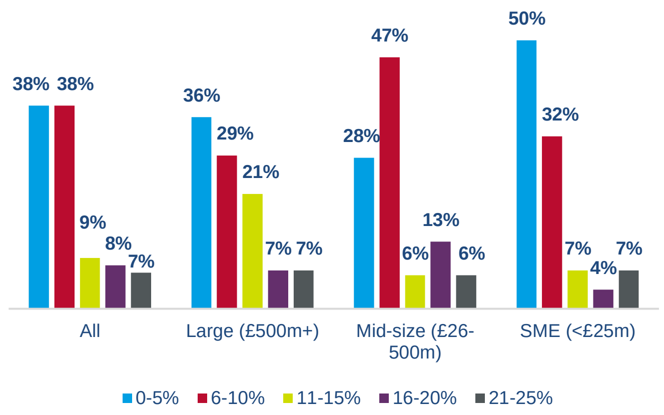
- **High-skilled workers**: engineers (IT/ maintenance/ engineering manager/ chemical engineers), R&D scientists, area supervisors, sales & sales administrator.
- **Technical specialists**: food technologist, packaging technologist.
- **Production operatives**: production and warehouse operators, machine operators, drivers, packers, seasonal workers.

Persistent labour shortages are a major brake on our sector's ability to grow and increase productivity, especially for SMEs that are typically less able to respond to staffing shortages by increasing salaries.

Theoretically, labour shortages should encourage the adoption of automation in the longer-term, where stubborn unfilled vacancies could be tackled through investments in new machinery and more efficient production processes.

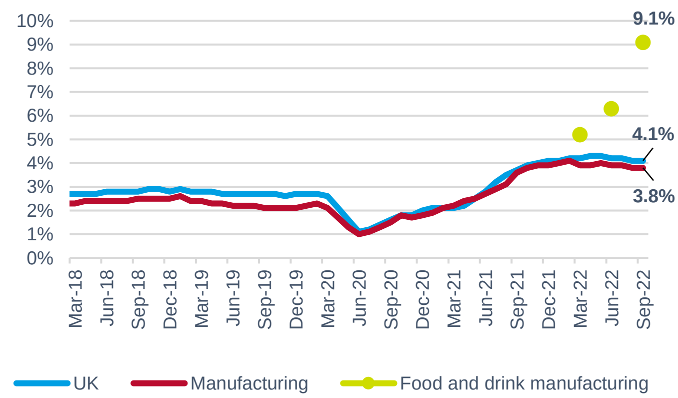
However, the current pressures on margins and cashflow, the cost of borrowing, and uncertain business environment mean that many companies have neither the confidence nor the ability to access finances required to invest in such automation.

Chart 7: Labour vacancies by business size



Source: FDF State of Industry Survey

Chart 8: Vacancy rate in UK, Manufacturing and Food and drink manufacturing
(number of vacancies per 100 employees)



Source: FDF State of Industry Survey

Energy prices shock UK food and drink

Food and drink manufacturers are struggling with unprecedented rises in the cost of energy, with significant impacts right across UK food and drink supply chains.

The energy crisis has intensified challenges for all businesses, particularly major energy users such as the UK's bakers and millers. On average, energy represented 12% of operating costs in Q3 2021, with most businesses reporting energy taking up less than 20% of their operating costs (Chart 9).

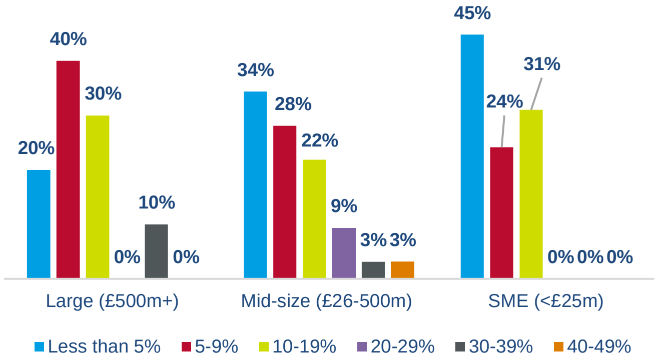
In contrast, energy's share of operating costs shot to 22% in Q3 2022, a 10-percentage point increase on the year. It is noteworthy that 20% of large businesses report energy accounted for 40-49% of their operating costs, compared to just 3% of mid-size businesses and no SMEs (Chart 10).

Because of the scale of these energy price rises, future energy contract negotiations pose a great concern for all businesses. Three quarters of businesses (73%) highlighted they are feeling very concerned by these negotiations, while only 4% have no concern at all (Chart 11).

Potential outcomes of new energy contract negotiations are a concern across the board, from SMEs to the large companies.

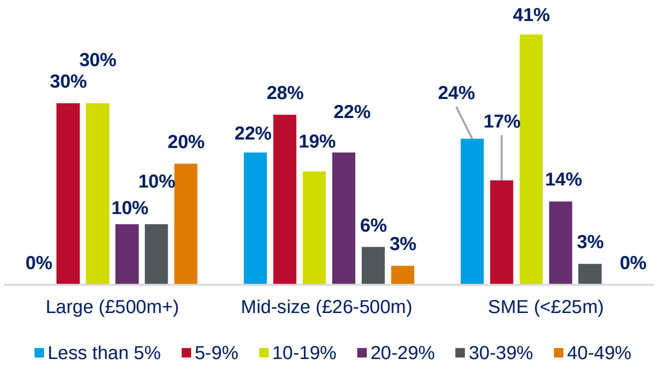
ONS found that 60% of food businesses reported higher energy prices had already impacted production and/or supply back in March 2022, compared to only 38% of all UK businesses. It's not surprising then that energy contract negotiations now present such significant concerns for UK food and drink manufacturers.

Chart 9: Energy as a percentage of operating cost, Q3 2021



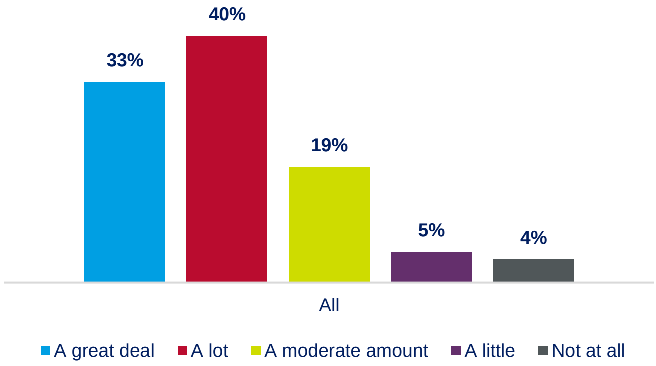
Source: FDF State of Industry Survey

Chart 10: Energy as a percentage of operating cost, Q3 2022



Source: FDF State of Industry Survey

Chart 11: How concerned are you around new energy contract negotiations?



Source: FDF State of Industry Survey

Rising costs continue to squeeze manufacturers

Manufacturers have faced significant increases in production costs over the last year (Q4 2021 – Q3 2022), averaging 21%. The largest share of companies (41%) saw their costs go up by 10 to 19%, while a minority reported rises in excess of 40% (Chart 12).

In the next year, businesses expect further cost increases averaging 21%. 72% of SMEs and 67% of large businesses anticipate increases of between 10 to 19%. Sustained cost pressures mean that margins will continue to be squeezed, while consumer food inflation is likely to remain high throughout 2023.

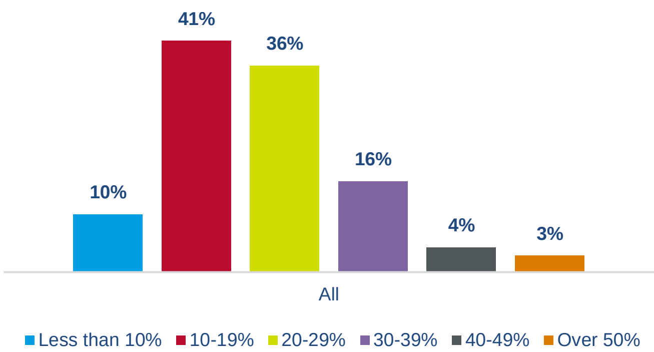
The sterling depreciation against the dollar of 13% since the start of the year has exacerbated challenges faced by many manufacturers, further driving up the cost of essential imported ingredients and raw materials, as a large share of global trade in dollars. Most businesses (57%) stated the depreciation of sterling had impacted them a great deal or a lot.

With cost pressures impacting all factors of production, manufacturers are forced to seek cost price increases from their customers in retail and hospitality, but this isn't simple or straightforward. In the last year (Q4 2021 – Q3 2022), prices facing manufacturers were up 15% on average, while the majority of businesses (88%) have been able to secure price rises (Chart 13). However, almost a third (28%) of SMEs reported receiving increases of less than 5% in the last year, with consequences for their longer-term viability.

With producer margins being steadily eroded, UK food and drink manufacturers will need to recoup costs to stay in business. 57% of businesses report that they would need sales prices to rise over 10-14% over the next year. Just over a third (36%) of large businesses would need increases of 20-24% in response to the overwhelming cost pressures businesses are facing.

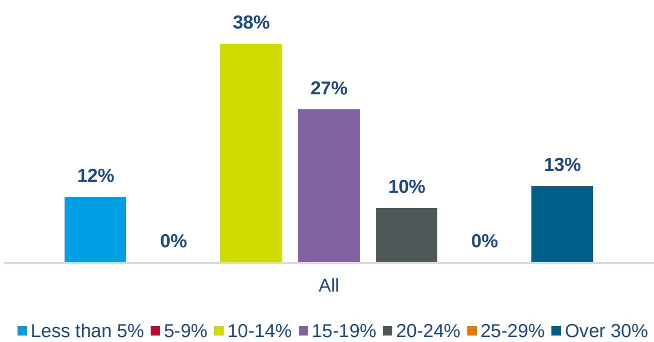
But manufacturers are taking a range of steps to try to minimise the scale of essential price increases. 60% of businesses are prioritising savings through greater energy efficiency in factories, while 50% report changing what and how they procure (Chart 14). 49% have paused or cancelled capital investment projects.

Chart 12: On average, how much have your production costs increased over the last year (Q4 2021 - Q3 2022)?



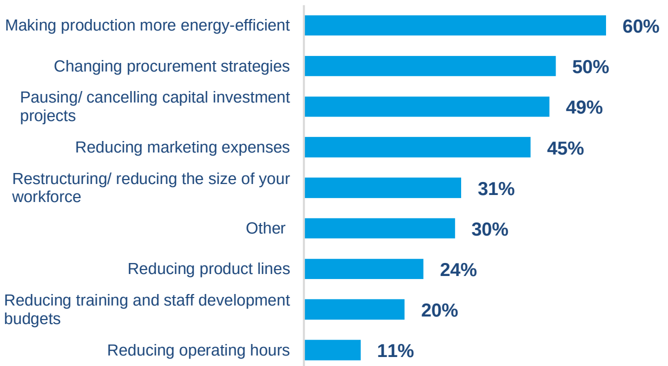
Source: FDF State of Industry Survey

Chart 13: On average, how much have your sales prices increased over the last year (Q4 2021 - Q3 2022)?



Source: FDF State of Industry Survey

Chart 14: How are you managing increased cost pressures?



Source: FDF State of Industry Survey

Business investment priorities

UK food and drink manufacturers are committed to long-term investment. The share of food and drink manufacturing investment out of total UK business investment has been growing in recent years, from 1.6% in 2016 to 2.1% in 2021. This is testament to the industry's resilience over the past five years.

This quarter, businesses noted a variety of priorities for investment. Just over half (53%) listed becoming more energy efficient/ switching fuel as their top priority, with 48% also saying that they are prioritising new product development, including in packaging (Chart 15). The top priorities are clearly focused on reducing cost pressures in the longer term.

Recent unprecedented cost pressures have forced many manufacturers to absorb a large share of cost increases which comes at the cost of reduced spending in other areas, with nearly three quarters (73%) confirming that it is limiting their capital investment (Chart 16). Companies are investing and targeting areas in areas that they hope will alleviate sources of cost pressures on their businesses.

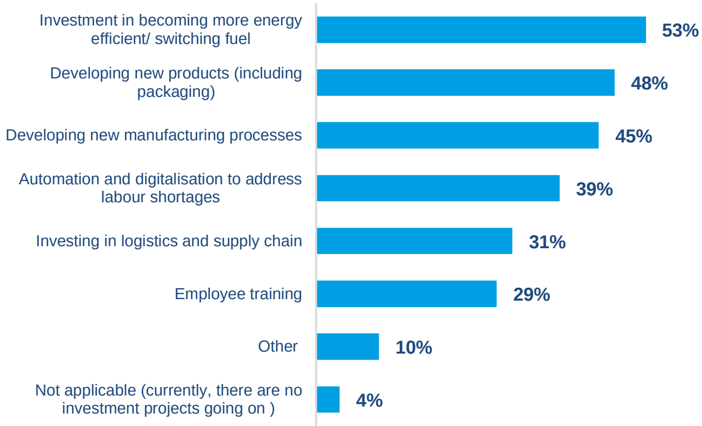
41% are also limited by uncertainty regarding future demand, highlighting the concern of businesses regarding the future economic outlook.

Different sizes of businesses are impacted in different ways. Capital investment for SMEs is restricted by finance-related issues, with 57% noting cash flow issues as a barrier. The difficulty in raising finance, coupled with the challenges they face in increasing sales prices, has meant that investment by SMEs has been hit hardest.

Manufacturers would welcome a range of government initiatives to help grow their businesses over the next five years. Over half (53%) would like to see tax incentives offered for capital investment, while 44% want to see a reduction in the costs and burdens of moving goods between the UK and the EU, through improvements to the implementation of the UK-EU Trade and Cooperation Agreement (Chart 17). There is also strong demand for regulatory reform to reduce the burdens and cost of inefficient and ineffective regulation.

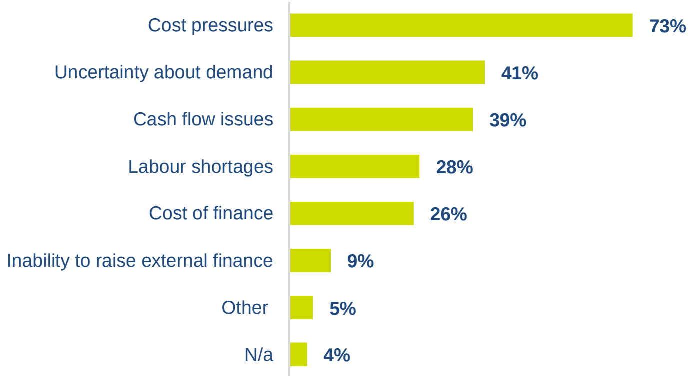
Over half (53%) of SMEs would like to be able to access loans/support to aid their adoption of automation and robotics, highlighting that driving improved productivity is a key aim. Large businesses (47%) are keen for R&D tax credits reform, while 21% of mid-sized businesses urge for increased investment in skills.

Chart 15: If your business is undertaking any investment, which are the priorities?



Source: FDF State of Industry Survey

Chart 16: What factors are likely to limit) your capital investment expenditure over the next twelve months?



Source: FDF State of Industry Survey

Chart 17: What are the top three government initiatives that would help grow your business in the next five years?

Source: FDF State of Industry Survey

Who responded?

Businesses responding to our survey in Q3 represented 21% of our industry by turnover, with respondents representing all turnover bands, all employment sizes and across a wide range of different sub-sectors of the UK's food and drink manufacturing industry.

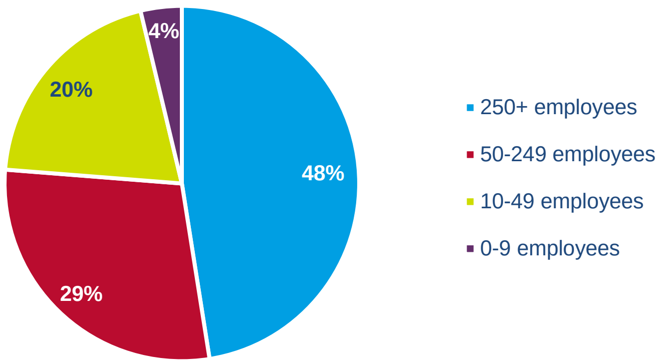
48% of the businesses in the survey are large employers, with more than 250 employees, while 4% of the respondents are micro-businesses with fewer than 10 employees (Chart 18).

Our survey included a good representation of companies of all sizes according to turnover. 18% of respondents were small companies with a turnover of £5m or less, while 11% of respondents have a turnover in excess of £1bn (Chart 19).

Respondents represented a wide variety of sectors (Chart 20). The majority (61%) operate within the 'Other food products' sector, which includes manufacturers producing ingredients, confectionery, condiments, and prepared meals. The second best-represented sector was bakery, with 28% of the overall respondents.

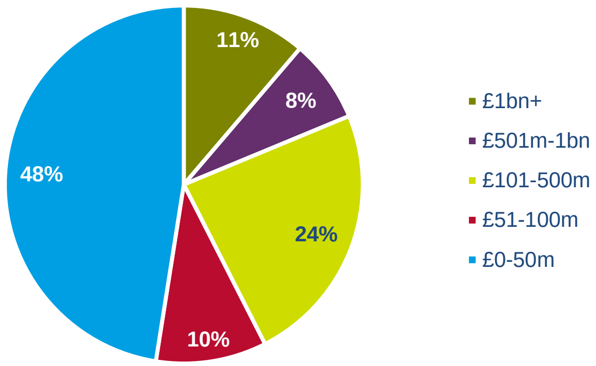
Most of the respondents (84%) operate in England, while 23% have at least one manufacturing site in Scotland and 13% in Wales.

Chart 18: Share of respondents by employment size



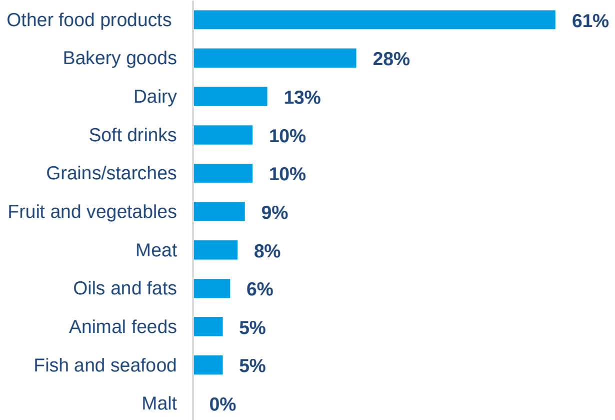
Source: FDF State of Industry Survey

Chart 19: Share of respondents by turnover



Source: FDF State of Industry Survey

Chart 20: Share of respondents by sector



Source: FDF State of Industry Survey

Help for businesses from the FDF

To keep up to date with our policy work, check out our website

FDF Innovation Gateway

The FDF Innovation Gateway can help businesses looking to take their first steps into automation or digital adoption, by connecting businesses with independent experts.

Accessing the independent advice on innovation available through the UK Government-funded Catapult Network couldn't be easier. Businesses can complete the FDF's simple online form or email us. The FDF can then connect them to experts to help identify process improvements, or source the existing technologies that can have a big impact on your business and bottom line.

Toolkit for businesses to understand new rules on food and drink high in fat, salt, and sugar (HFSS)

The FDF has recently launched a new toolkit available here which brings together useful information to help smaller businesses navigate regulations relating to food and drink high in fat, salt, and sugar (HFSS).

The toolkit includes helpful links and resources to support businesses with the new promotion location regulations for HFSS food and drinks in England, which came into force from the 1 October 2022. It also covers upcoming advertising regulations, as well as HFSS policy developments across the devolved nations.

FDF Scotland

Net Zero support for Scotland
FDF Scotland is providing practical support to the Scottish food and drink industry on its journey to net zero. This support is available through the Strategic Net Zero Response Programme on behalf of the Scotland Food & Drink Partnership. Find out more here.

Reformulation support for Scotland
Our Reformulation team is helping small to medium sized food companies to make their products healthier through recipe reformulation. This project is funded by the Scottish Government. Find out more here.

A Future in Food
Our skills programme - A Future in Food – is working with partners to promote career opportunities and the importance of STEM and is gaining insights on the future skills needed by the Scottish food and drink industry. This initiative is funded by Scottish Government through Scotland Food & Drink. Find out more here.

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passionate about food & drink

About the FDF

The FDF is a powerful voice for the UK's vibrant, resilient and diverse food and drink manufacturing industry. For over 100 years, we have successfully contributed to policy making and legislative development, championing our members' views – large and small – on the critical issues of the day.

We bring together business, government and stakeholders to ensure our manufacturers have the right conditions to grow, invest and employ, while continuing to produce high quality, nutritious and affordable food and drink. With more than 1,000 members – from the most recognisable global brands to the most innovative start-ups – we represent the largest manufacturing sector in the country.

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