State of Industry Report

Q1 2023

Executive summary

- The FDF net confidence score gained 17 percentage points in Q1, reaching -30%, reflecting mainly perceptions that market conditions have stabilised in Q1 compared to Q4.
- Business conditions for Q2 are expected to remain the same or improve.
- Labour shortages continued to slow in Q1 to 5.9% from 7.0% in Q4, with vacancies recorded across all skill levels.
- Average pay in the industry increased by 4.1% over the year to March 2023, and over half (56%) of manufacturers awarded bonuses or a one-off cost of living payments to retain their staff.
- Wages are expected to rise by 5.4% over the coming year.
- Consumers have been shielded from the full extent of price increases, as margins have taken a hit. On average, total costs increased by 15.4%, while selling prices rose by 12.5% over the year to March 2023.
- Over the next twelve months, manufacturers expect costs to continue to climb by 5.0% and selling prices by 5.4%, on average.
- Innovation in new products and new manufacturing processes were producers' top priority in Q1 for 61% and 52% of them, respectively.

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Authors

Dr. Liliana Danila
Lead Economist
FDF

Uros Milosevic
Economic Analyst
FDF

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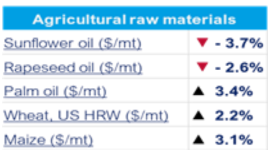
Prices dashboard

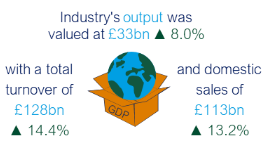


Agricultural raw materials	
Sunflower oil ($/mt)	▼ - 3.7%
Rapeseed oil ($/mt)	▼ - 2.6%
Palm oil ($/mt)	▲ 3.4%
Wheat, US HRW ($/mt)	▲ 2.2%
Maize ($/mt)	▲ 3.1%

Inflation commentary

Trade snapshots

Industry facts and stats



Short-term stability, but longer-term uncertainty continues

Food inflation appears to have peaked and we're expecting it to continue to slow for the remainder of the year. Food inflation fell to 19.1% in April, from 19.2% in March. Sugar and olive oil saw eye-watering price increases and most categories experienced double-digit inflation (Chart 1).

Cost pressures in the industry are subsiding, albeit slowly. Data from the Office for National Statistics (ONS) shows that over the first four months of the year, compared to the first four months of 2022, total input costs for food manufacturers were 16.3% higher, with UK-sourced ingredients up 14.3% and imported ingredients up 27.5%. While costs have plateaued in recent months, they remain significantly higher than a year ago and have not started to decline.

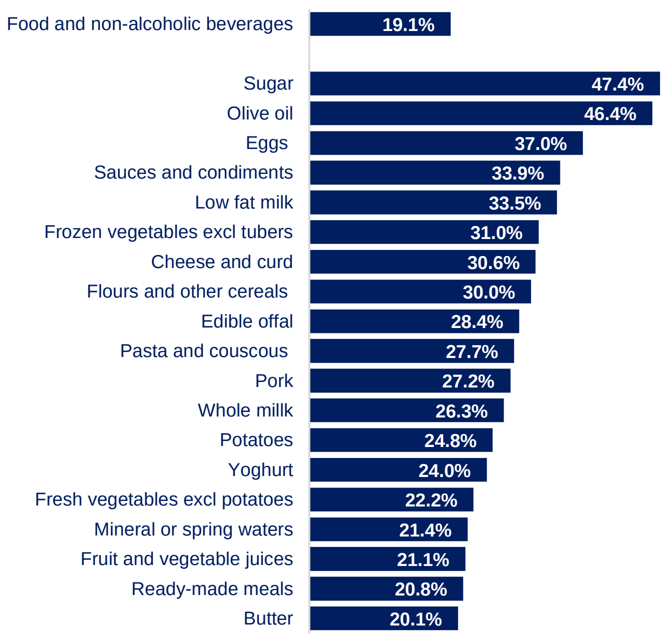
Labour vacancies remain elevated putting upward pressure on wages and while wholesale energy costs are down since December, they remain 15% higher than pre-pandemic levels. Global prices are also on a downward trajectory, now 22% below March 2022 peak levels.

Resilience in the industry has been eroded by the last couple of years of substantial price pressures on all factors of products, from ingredients and packaging to labour, transportation and logistics. On average, in the year to February, 72% of manufacturers absorbed a share of rising costs, compared to 56% of all UK businesses, 53% of retailers and 64% of restaurants and cafes (Chart 2). This illustrates the disproportionate impact of the recent challenges on the industry.

Moreover, insolvencies in the industry are rising, with 244 in food and drink manufacturing in 2022 – double the rate of 2019, contrasting starkly with to a rise of 25% in GB as a whole. It's likely there's more to come this year, with 71 insolvencies already recorded in Q1 2023. This amounts to 58% of all 2019 insolvencies in the sector, compared to 38% for GB as a whole.

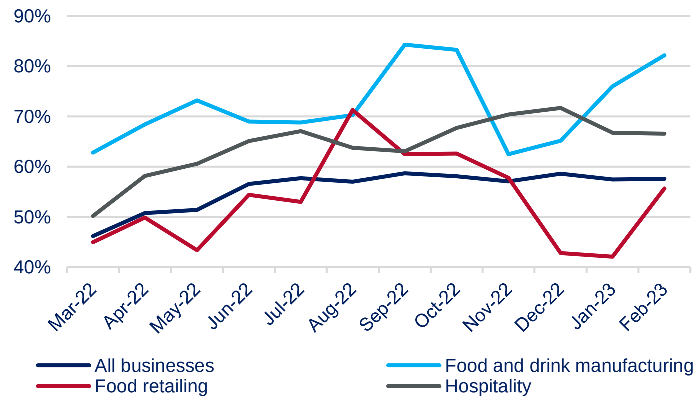
Growth in some subsectors has slowed (Chart 3). In Q1, food manufacturing output was 1.5% smaller than a year ago, with other subsectors also shrinking. As the cost of living crisis hit British households hard, this is not surprising. Worryingly, many people are dealing with the rise in prices by buying less food, with about half of the population reporting lower food purchases over the last year, compared to fewer than 10% in October 2021. The combination of lower demand and an inability to pass on cost increases risks pushing further smaller producers, that are more vulnerable to general market conditions, out of business.

Chart 1: Inflation by category, April 2023



Source: ONS

Chart 2: % of businesses stating they absorbed costs



Source: ONS, Business Insights and Conditions Surveys

Chart 3: Growth by sector, Q1 2023

	Q1 2023 on Q4 2022	Q1 2023 on Q1 2022
Food manufacturing	**0.1%**	**-1.5%**
Meat and meat products	1.0%	2.8%
Fish, fruit and vegetables	1.4%	-1.5%
Vegetable and animal oils and fats	-26.7%	-15.4%
Dairy products	-0.6%	-1.6%
Grain mill and starch products	-1.3%	-4.1%
Bakery and farinaceous products	2.1%	3.0%
Other food products	-2.1%	-7.3%
Non-alcoholic drink manufacturing	**3.6%**	**0.6%**

Source: ONS, GVA, chained volume measures

Market conditions have stabilised

The FDF net confidence score gained 17 percentage points in Q1, reaching -30% (Chart 4). This score is the difference between businesses perceiving improved business conditions in Q1 from Q4, and those believing conditions have deteriorated, with businesses feeling conditions have remained the same being excluded from this calculation. The -30% score in Q1 reflects, in part, this exclusion, as 43% of respondents believed conditions deteriorated, 43% felt that they had remained the same, while 14% felt they had improved.

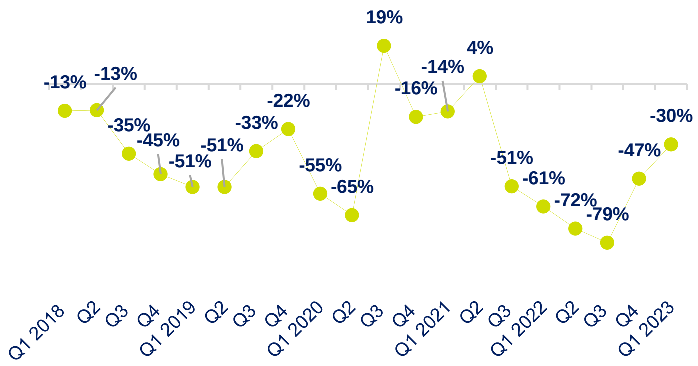
Perceptions of market conditions were to some extent similar across all businesses, regardless of size. Compared with Q4 2022 (Chart 5), 45% of large and small enterprises saw a deterioration in business conditions, and a similar proportion saw the same conditions. Mid-sized companies fared slightly better, with 38% of them had seen conditions worsen and a quarter (25%) felt conditions had improved.

Volatility is dissipating, with falling energy and agricultural prices have brought some welcome stability. However, the industry continues to face difficult market conditions. Many manufacturers use long-term purchasing contracts, which means not all of them would be able to take advantage of these favourable market conditions just yet, rather they'll have to wait until their current, higher priced contracts will expire.

The good news is that most companies are not pessimistic about the future. Business conditions in Q2 2023 are largely expected to remain the same or improve. 30% of respondents expect conditions to improve, 51% believe they will remain the same and only 19% believe conditions will deteriorate. The outlook for Q2 2023 is relatively consistent across all business sizes (Chart 6).

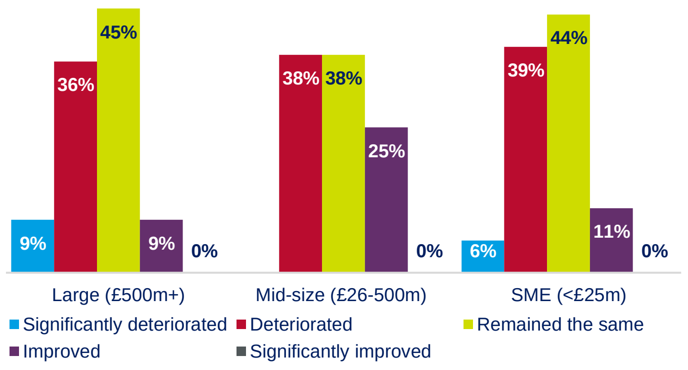
For the short-term outlook for the industry, the most significant challenge is producers' ability to pass on cost increases. Production costs can only be recovered with considerable delays due to the nature of fixed-term contracts, so further cost rises would likely need to be passed on. The decline in real wages over the last year and significant focus on persistent inflation suggests manufacturers will find it increasingly difficult to share necessary cost rises with their customers to rebuild margins and focus on investing to drive future growth.

Chart 4: FDF net confidence score



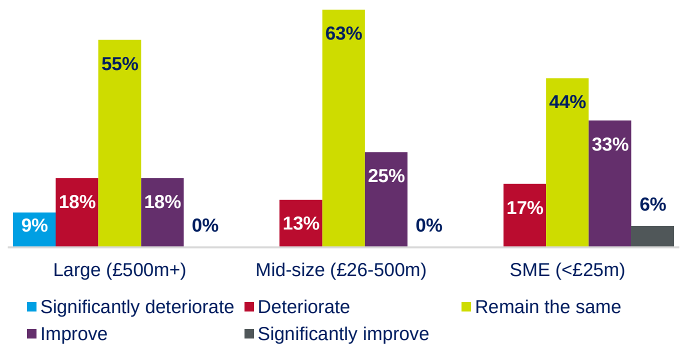
Source: FDF State of Industry Survey

Chart 5: Business conditions in Q1 2023 compared to Q4 2022 by business size



Source: FDF State of Industry Survey

Chart 6: Expectations about business conditions in Q2 2023 relative to Q1 2023 by business size



Source: FDF State of Industry Survey

Labour shortages decline, but still uncomfortably high

Industry's labour vacancies fell to 5.9% in Q1 compared to 7.0% in Q4, the lowest rate since Q1 2022 (5.2%) (Chart 7). However, they remain uncomfortably high at almost double the rate of the whole of UK manufacturing of 3.1% and above the UK's rate of 3.5%.

Vacancies remained widespread across roles and skills, with manufacturers struggling to fill high-skilled positions (R&D specialists, engineers, sales & marketing, IT, finance, HR, and legal), technical roles (bakers or food technologists) and lower-skilled positions (production and machine operatives, drivers, packing operators, maintenance technicians).

Two thirds of respondents reported fewer than 5% vacancies while a quarter had vacancies rates of between 6 and 10%. In a reversal from previous quarters, smaller companies appear the least impacted by labour shortages, with a large majority (83%) recording shortages of below 5%. Against a backdrop of sustained pressures, it's likely that some smaller businesses have restructured their workforce or paused recruitment. Labour shortages continue to hold back growth – with some manufacturers unable to take on new orders due to the lack of available staff and skills.

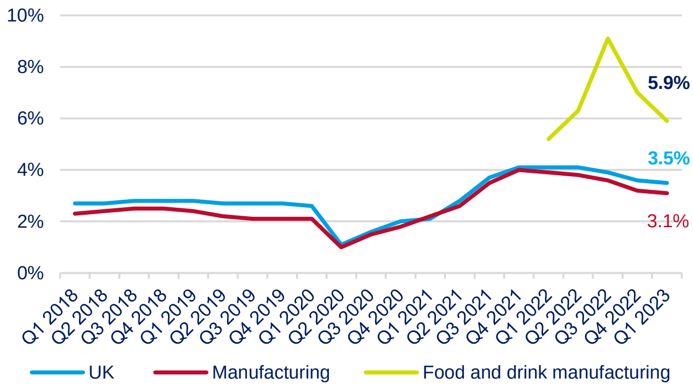
This fall in vacancies aligns with national data that shows declining employment in the industry. Our industry lost 3,000 jobs in Q4, following a decline in employment of 7,000 jobs in the preceding quarter.

When asked about occupations in short supply that are eligible for inclusion on the government's Shortage Occupation List, over half of manufacturers (58%) had difficulties recruiting food and drink process operatives, while a third (33%) experienced shortages of science, engineering and production technicians or large goods vehicle drivers.

Severe, persistent labour shortages have driven up pay. Average pay in the industry increased by 4.1% over the year to March 2023. Half (48%) have offered pay rises ranging from 4-6% (Chart 8), while a tenth (9%) of respondents awarded rises of 8-10%. Industry anticipates higher rises over the coming year. On average, it's expected that wages will rise by 5.4%, with most businesses (33%) projecting rises of 4-6%.

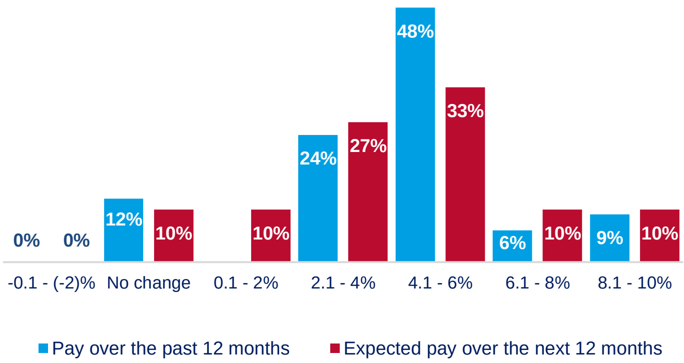
To provide extra support for their employees during the cost of living crisis and to help retain and recruit staff, 56% of businesses surveyed offered bonuses in the year to March 2023 (Chart 9), another 56% made one-off cost of living payments and a quarter (26%) have provided non-monetary compensation (recognition, meals, extra holidays, etc).

Chart 7: Vacancy rate in UK, manufacturing and food and drink manufacturing *(vacancies per 100 employees)*



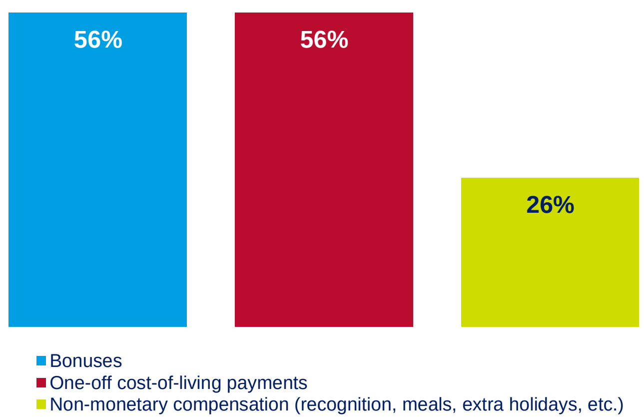
Source: FDF State of Industry Survey and ONS

Chart 8: % of manufacturers that offered pay increases and expectations of pay rises over the next year



Source: FDF State of Industry Survey

Chart 9: % of manufacturers that offered rewards to their employees



Source: FDF State of Industry Survey

Changes in production costs filter into retail prices with a lag

On average, total costs increased 15.4%, while selling prices rose by 12.5% over the year to March 2023. All surveyed businesses reported cost rises, although only 94% reported rises in their average selling price (Chart 10). Over a quarter of respondents (27%) listed cost rises of 10 to 15%, while the most common price rise (for 32% of companies) was of 5-10%.

By business size, average changes in costs and prices, respectively, are the following: large companies: 15.7% and 13.0%, mid-size companies: 12.8% and 7.2%, while small companies: 10.7% and 4.6%. These differences are explained by the lag between changes in production costs and changes in prices and the fact that many businesses also absorbed a share of cost rises.

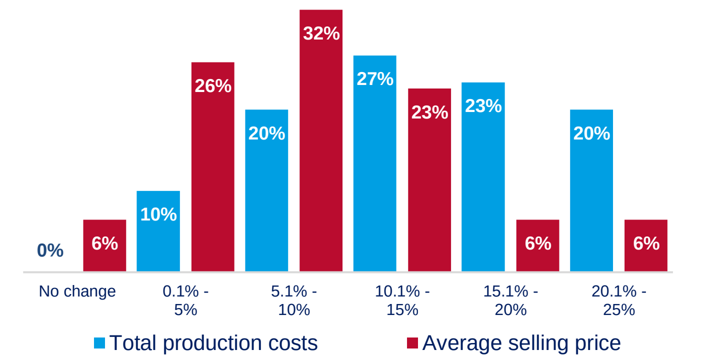
Changes in underlying production costs take between seven to twelve months to filter through to consumer prices. This time lag is the result of the use of fixed-term contracts with suppliers and with customers. Food manufacturers can lock in commodity prices for up to 12 months, long enough to cover a season of bad weather, but short enough for underlying demand changes to feed through. Such contracts are protect both producers and consumers from price volatility and the impacts of seasonality in the short term.

Many companies also absorbed a share of rising costs, with smaller companies typicaly absorbing a larger share than larger companies, because of their reduced negotiating power with supermarkets. Larger producers can also benefit from brand loyalty compared to own-label producers.

The decline in energy costs has helped manufacturers. Wholesale energy prices have fallen significantly since December and rates available to businesses also fell. On average, energy accounted for around 10% of the operating cost base in Q1 2023, in line with figures reported in Q3 2021 (12%) and Q4 2021 (8%) – significantly below Q3 2022 (22%). The energy share of operating costs displays variations within same-size companies and companies of different sizes (Chart 11), suggesting that the main driver of costs is how energy-intensive the sector is in which a manufacturer operates.

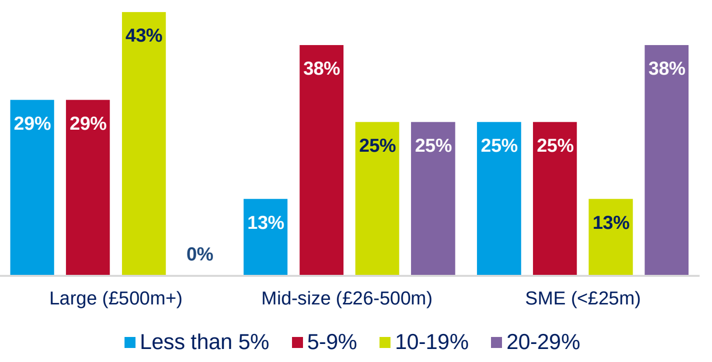
Over the next twelve months, manufacturers expect costs to continue to rise by 5.0%. They also expect average selling prices to rise 5.4% (Chart 12). As above, this difference is explained by the lag between input and sales costs.

Chart 10: Changes in total production costs and average selling price over the year to March 2023



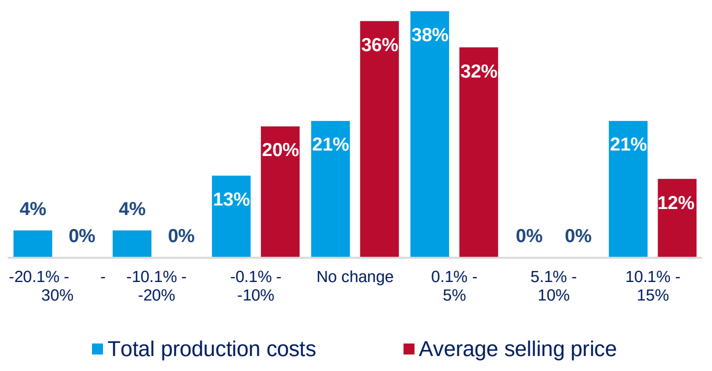
Source: FDF State of Industry Survey

Chart 11: Energy as a percentage of operating cost base



Source: FDF State of Industry Survey

Chart 12: Expected changes in total production costs and average selling price over the next 12 months



Source: FDF State of Industry Survey

Innovation is industry’s top priority

The industry recognises that innovation is key to future competitiveness and growth. Innovation in terms of both new product development and new manufacturing processes were producers’ top priority in Q1 for 61% and 52% of them, respectively (Chart 13).

This was a shift from the previous two quarters when the main focus was on ensuring improved energy efficiency, which has now dropped down to the third priority to support future growth.

Notably, 35% of respondents are interested in investing in automation to ease labour shortages, whereas a minority are focussed on growing foreign markets, developing healthier products and (listed under “Other”) on growing the UK market or maximising opportunities from the UK’s planned Deposit Return Scheme (DRS).

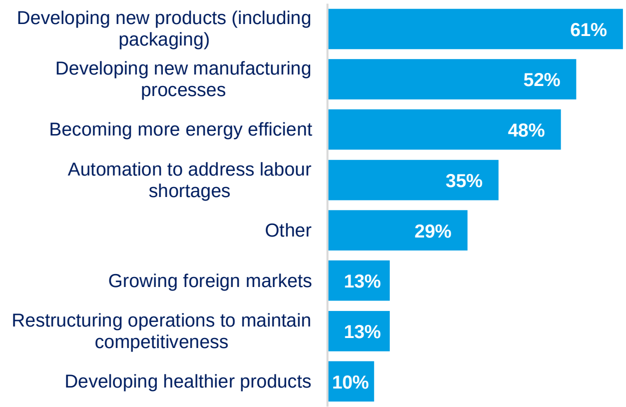
While these priorities offer cause for optimism, the ability of manufacturers to access funds for investment is a concern. National statistics show that business investment in the industry fell between Q3 2021 and Q2 2022 (latest data available). Furthermore, 60% of manufacturers reported in Q3 that they had to pause or cancel investment projects to address ongoing cost pressures.

Against this backdrop, Chart 14 paints a mixed picture in terms of future outlook for investment. 22% of businesses anticipate a decline in investment in the coming year, 42% no change in investment spend, but more than a third (36%) expect this to increase.

More than a third (36%) reported that output has fallen over the year to March 2023, while 44% increased production (Chart 15). Manufacturers are more optimistic about the future. Over half (52%) believe that they’ll be able to grow their business over the next year, and only 16% think that see a reduction.

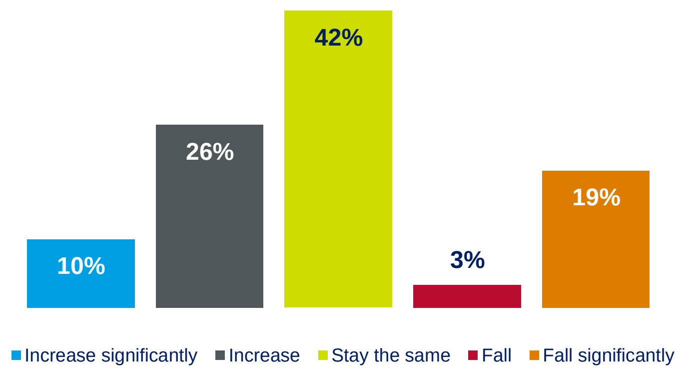
For the medium and longer-term, subdued investment and climate change are the main risks to growth. A slow economic recovery in which consumer spend fails to recover, and poorly designed government regulatory, activities such as existing plans for Extended Producer Responsibility and the introduction of UK-wide ‘not for EU’ product labelling, will further inhibit investment and growth.

Chart 13: Top three growth priorities



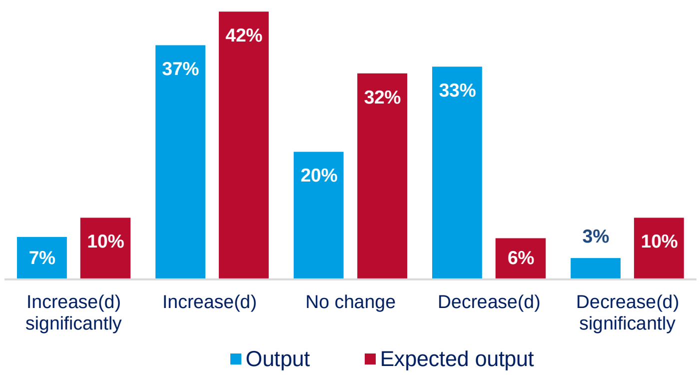
Source: FDF State of Industry Survey

Chart 14: Expectations of planned capital investment expenditure changes over the next 12 months?



Source: FDF State of Industry Survey

Chart 15: Ouptut changes in the year to March 2023 and expected output changes in the next 12 months



Source: FDF State of Industry Survey

Who responded?

Businesses responding to this survey represented 13% of our industry by turnover. This is a good representation of the industry, as respondents included companies of all turnover bands, all employment sizes and from a wide range of industry's sub-sectors.

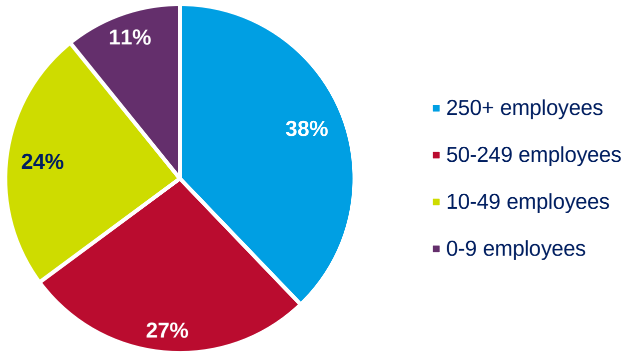
38% of the businesses surveyed are large employers with more than 250 employees, while 11% of the respondents are micro-businesses with fewer than 10 employees (Chart 16).

By turnover, a quarter of respondents (24%) are small companies with a turnover of £5m or less, while 16% have a turnover in excess of £1bn (Chart 17).

Respondent represented a wide variety of sectors (Chart 18). A third (35%) of respondents operate in the bakery goods sector. The second best-represented sector was confectionery, with 22% of the overall respondents.

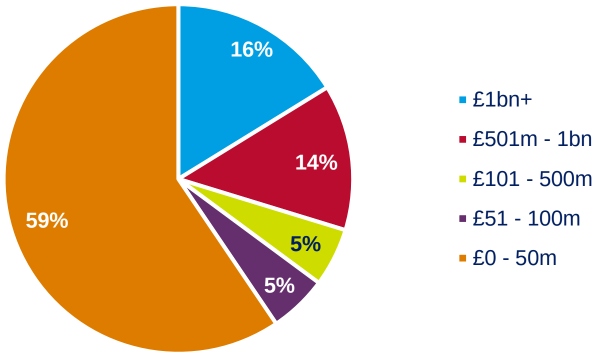
Half of the respondents (50%) operate in England, while 13% manufacture in Scotland and 7% have production facilities located in Wales.

Chart 16: Share of respondents by employment size



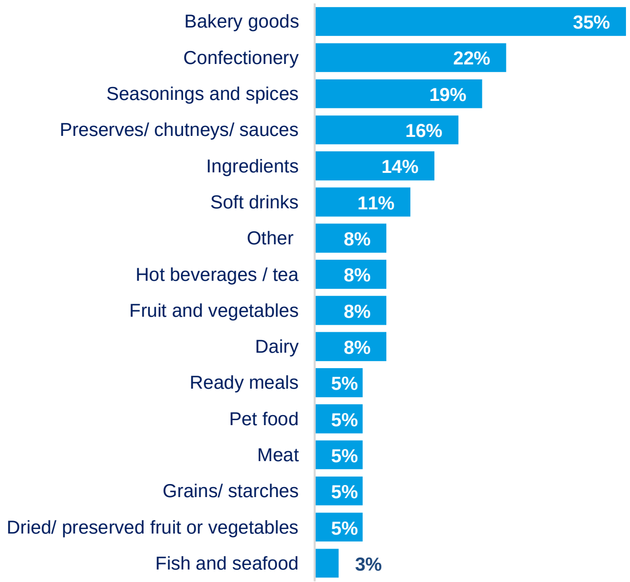
Source: FDF State of Industry Survey

Chart 17: Share of respondents by turnover



Source: FDF State of Industry Survey

Chart 18: Share of respondents by sub-sector



Source: FDF State of Industry Survey

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.

Food and Drink Federation
10 Bloomsbury Way
London
WC1A 2SL

Tel: 020 7836 2460
Email: generalenquiries@fdf.org.uk
Web: fdf.org.uk
Twitter: @Foodanddrinkfed

fdf food & drink federation
passionate about food & drink