State of Industry Report Q1 2024

Executive summary

- Business confidence rose in Q1 to 20%, its highest level since the FDF began tracking it, showing some growing optimism for 2024.
- 84% of manufacturers are primarily focused on UK sales to grow their business, with new product development as the second highest growth strategy.
- About 50% of manufacturers plan on maintaining similar levels of investment over the coming year, and just over 40% plan on increasing their investment. With industry's investment 30.5% below its 2019 levels, Q1 intentions suggest it will take time before we return to pre-pandemic investment levels.
- Investment was limited by changing business environment (47%), demand uncertainty (43%) and the cost of finance (26%).
- Industry continues to be innovative with 78% of respondents investing in healthier product development in 2023. 85% of respondents develop innovation fully in-house with some collaboration with third parties: retailers (35%), research / innovation organisations (31%) and universities (25%).
- Industry's labour shortages stood at 5.0% compared to 5.2% in Q4, and remained above rates in wider manufacturing (2.7%) and the UK (2.9%). Skills shortages continue to impact different roles and levels, from engineers and managers to technicians and food packers.
- The average pay rise in the industry was 6.0% over the year to March. This was above manufacturers' expectations in Q1 2023 of 5.4% for this period.
- On average, total production costs increased by 9.2% over the year to March, while selling prices rose by 4.3%. For the year to March 2025, manufacturers expect their costs to rise by 2.1% and prices by 1.1%.

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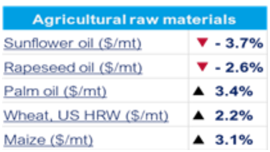
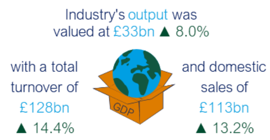


Agricultural raw materials	
Sunflower oil ($/mt)	▼ - 3.7%
Rapeseed oil ($/mt)	▼ - 2.6%
Palm oil ($/mt)	▲ 3.4%
Wheat, US HRW ($/mt)	▲ 2.2%
Maize ($/mt)	▲ 3.1%

Inflation commentary

Trade snapshots

Industry facts and stats



Easing food inflation while demand remains weak

March marked one year of easing food and non-alcoholic inflation, with the inflation rate reaching 4.0%, down from 5.0% in February and its lowest rate since November 2021.

Annual inflation slowed for most of the 49 categories reported by the Office for National Statistics (ONS), with eight in deflationary territory and another 19 categories seeing price rises of 5% or less (Chart 1). But despite an overall fall in annual inflation, monthly prices have continued to climb by 0.2% in March, with a similar increase seen in February.

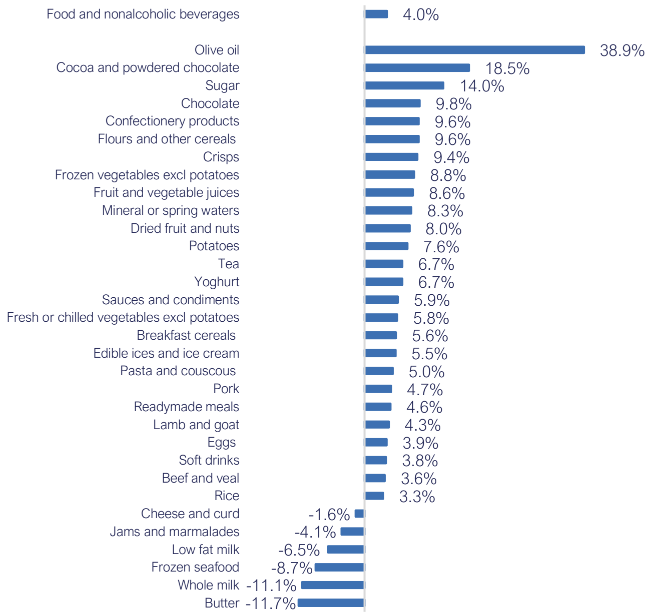
Food price inflation is likely to slow further in the coming months, as cost pressures have been easing. ONS data shows that annual costs of manufacturers fell in March at their fastest annual pace yet of 1.9%, compared to a decline of 1.0% in February. Costs of imported ingredients decreased for the first time since April 2021 by 1.7%, while UK-sourced ingredients were 2.5% cheaper, the steepest decline in the past seven months.

For the medium term, stubborn labour shortages and shipping disruptions will continue to put upward pressure on prices, while geopolitical and climate events remain significant risks to food prices. Since February, prices of some commodity have risen: Brent oil by 13%, global agricultural commodities by 1.4% and gas by 18%. For now, these are seen to be market fluctuations. Further escalations in the Middle East might lead to additional surges in oil, energy and shipping costs, with unusual weather impacting agricultural yields and prices.

While conditions have stabilised, manufacturers are yet to recover from what has been a challenging, unprecedented few years. The last four years saw their costs rise at a faster pace than retail prices[1] (Chart 2), which means that producers have absorbed a share of the cost rises. Businesses have also postponed or cancelled investment projects and diverted those funds to day-to-day operations. In 2023, the industry's investment was 30.5% lower than in 2019, contrasting with the UK as a whole where investment was 5.4% higher (Chart 3).

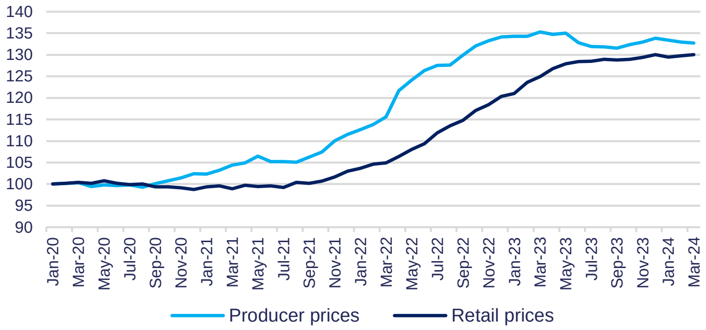
Manufacturers are now seeking to rebuild their margins and cash reserves to be able to invest. To do this, they will need to increase their sales volume at a time when consumers are emerging from the cost of living crisis in a worse financial position than in 2020, in real terms, and with evidence that a third of consumers are attempting to minimise their spend on essentials.

Chart 1: Inflation by category, March 2024



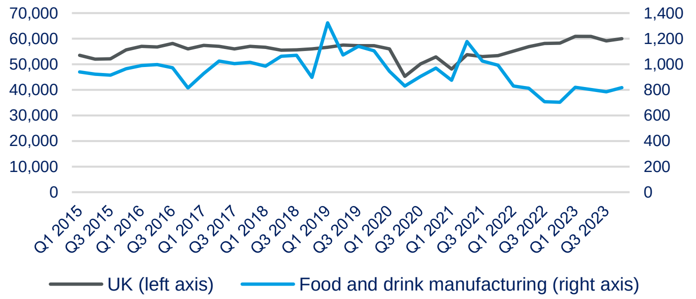
Source: ONS

Chart 2: Manufacturers' costs versus food and non-alcoholic drink retail prices



Source: ONS

Chart 3: Business investment



Source: ONS, Business investment, £ mil, chain volume measures, reference year = 2019

[1] This one-to-one comparison between costs and prices is possible because the indices have been rebased to 100 in January 2020. A similar starting point/ base allows for such comparisons.

Stabilised market conditions: a reason for cautious optimism

The FDF net confidence score increased to 20% in Q1, marking its highest level since FDF began tracking it (Chart 4). This score is calculated as the difference between respondents perceiving improved business conditions in Q1 from Q4 and respondents believing conditions had deteriorated. Businesses that saw conditions unchanged are therefore excluded from this calculation. 54% believed conditions remained the same, with 33% of businesses seeing improved conditions on the quarter, up from 27% in Q4.

Unlike the previous quarter, perceptions of market conditions in Q1 were aligned across all business sizes (Chart 5). 57% of large businesses saw better conditions in Q1 and 14% saw worse conditions. Those figures for SMEs stood at 33% and 17%, respectively. This is in sharp contrast to Q4 when 11% of large businesses and 50% of SMEs had seen a deterioration on the previous quarter. This significant improvement in SME manufacturers' perceptions is the driver of the record-level Q1 FDF confidence score.

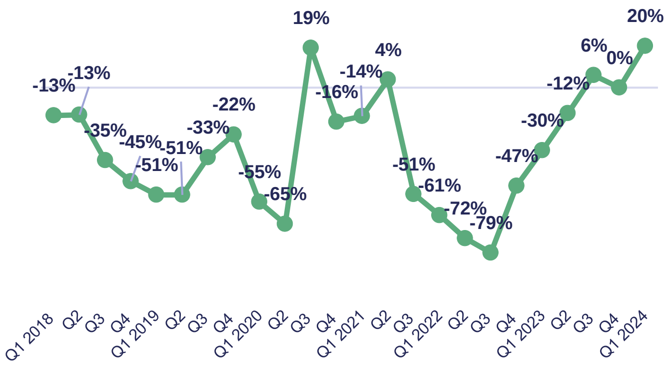
SMEs were able to benefit from stabilising conditions with a lag compared to larger businesses. This is likely due to the fact that they operate on spot markets. Larger businesses use hedging and forward contracts to protect themselves from extreme market volatility.

The outlook confidence score for Q2 2024 is 30%, with 52% of businesses expecting similar conditions in Q2 as in Q1. Smaller companies are more positive, with 50% anticipating improved business conditions, compared to only 26% of mid-sized companies and 43% of large businesses (Chart 6).

The recovery of the industry hinges on its ability to rebuild investment, for which volume recovery is necessary, but not easy to achieve. Retail food sales were 3.6% lower in volume terms in March 2024 compared to January 2020, with household finances significantly affected by the cost of living crisis, especially lower earners. NIESR estimates that households in the lowest 40% of the income distribution will see lower living standards by 7 to 20% in 2024-25 compared with 2019-20.

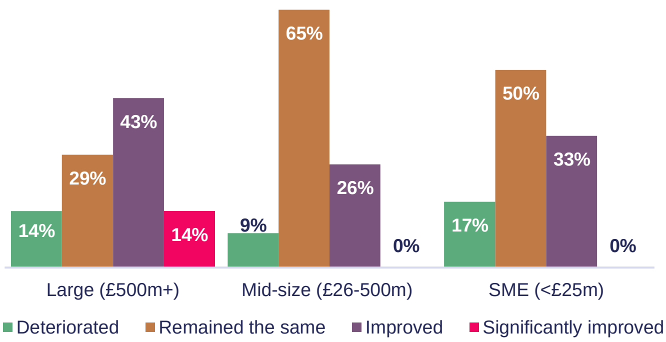
It's not surprising then that ONS surveys found that 36% of consumers in Great Britain were spending less on food and essentials at the beginning of May, and 48% were shopping around more. Similarly, KPMG's Consumer Pulse survey found that 38% of UK consumers bought more own brand or value range items in Q1, 37% bought more promotional or discounted items, while 27% did their shopping at discount grocery retailers.

Chart 4: FDF net confidence score



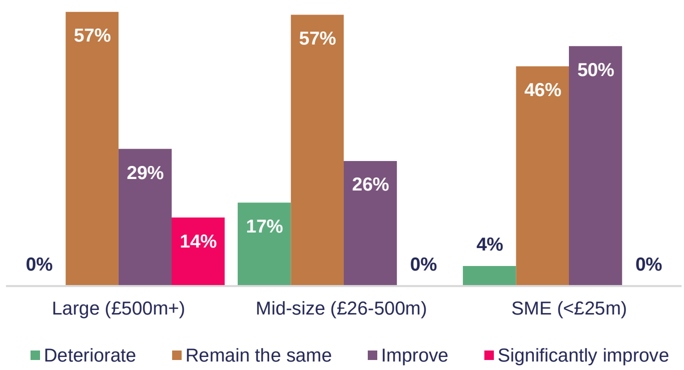
Source: FDF State of Industry Survey

Chart 5: Business conditions in Q1 2024 compared to Q4 2023 by business size



Source: FDF State of Industry Survey
Note: nobody chose 'significantly deteriorated', although this choice was offered.

Chart 6: Expectations about business conditions in Q2 2024 relative to Q1 2024 by business size



Source: FDF State of Industry Survey

Subdued investment intentions for the next twelve months

A considerable share of manufacturers (84%) are primarily focused on growing their UK sales. This is a strong sign of the need to rebuild volumes following the last few challenging years. New product development ranks second in terms of growth priorities for over half (53%) of the industry, indicating an ongoing commitment to innovation and remaining competitive (Chart 7).

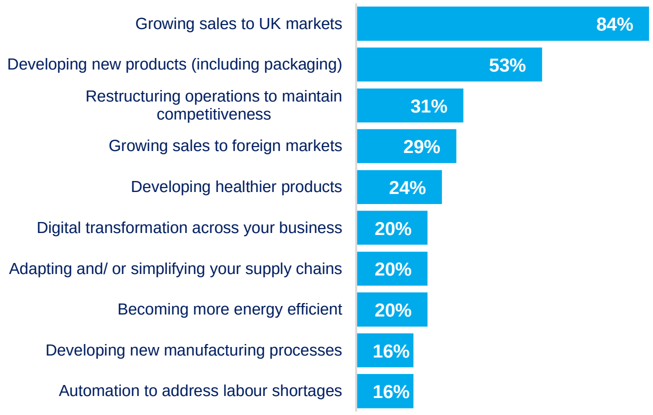
In Q1, restructuring operations emerged high amongst growth priorities for almost a third (31%) of manufacturers. This suggests that hurdles are not in the rear view mirror yet. In past surveys, manufacturers reported they were weathering difficult times by switching suppliers, reducing their marketing and training budgets or postponing investment. Ongoing challenges mean that some businesses feel that a restructuring is needed. By size, 43% of SMEs and 60% of large businesses are restructuring their operations.

At least 40% of respondents are planning to keep their investment expenditure on R&D, plant and machinery, skills and training, and buildings unchanged (Chart 8), and over 40% aim to increase it. On the face of it, these figures might seem encouraging. However, against the backdrop of persistent declines in industry's investment for the past four years, these figures suggest intentions for investment are subdued, and unlikely to return to pre-pandemic levels soon enough.

Moreover, the industry is the worst performer amongst other manufacturing sectors when it comes to investment. Both the UK and manufacturing, when excluding our sector, saw a 5% rise in investment between 2019 and 2023, and all other manufacturing sectors performed better than the food manufacturing sector. The same is true when it comes to the UK food supply chain. Over the same period, investment in agriculture and fisheries rose by 10%, and in hospitality (hotels & restaurants) fell by -21%. This shows that the shocks of the last years impacted our industry disproportionately.

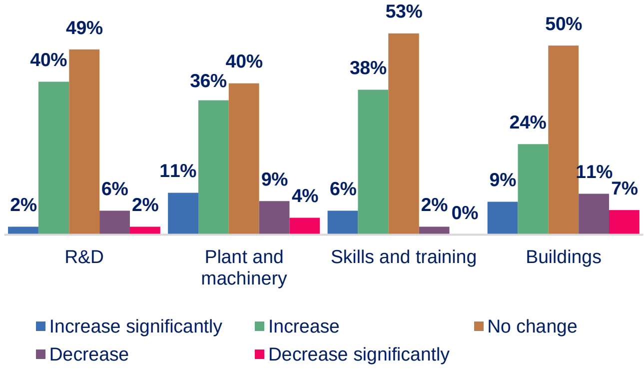
Several factors limited investment in the food and drink manufacturing. Uncertain economic conditions are limiting investment, with 47% of respondents concerned about changes to the business environment reducing the net return of some projects, and 43% limited by demand uncertainty (Chart 9). SMEs are more prone to being limited by the cost of finance, and a shortage of internal finance.

Chart 7: Top three growth priorities



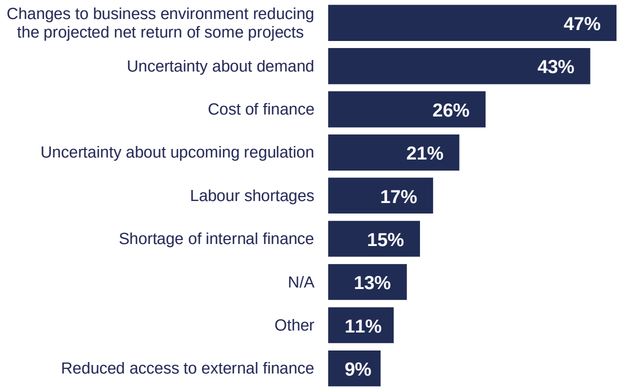
Source: FDF State of Industry Survey

Chart 8: Expectations of planned capital investment expenditure over the next 12 months



Source: FDF State of Industry Survey

Chart 9: Factors limiting investment over the next 12 months



Source: FDF State of Industry Survey

Increased need for collaboration on innovation

Embracing opportunities to significantly advance industry's investment in R&D, innovation and new technologies is key to transforming the food and drink manufacturing sector. The industry is highly innovative and independent in this area with 85% of respondents undertaking innovation in-house (Chart 10) using their own company expertise. Some collaboration with third parties is taking place but there are clear opportunities to foster a more open innovation culture. Creating a formal innovation partnership between food and drink manufacturers, government, UK Research and Innovation (UKRI), universities and catapults will bring together research expertise and UKRI funding to attract further private sector investment. This will deliver long term environmental and health goals and strengthen UK food security.

In the context of depressed investment in the industry, innovation is crucial. Evidence shows that technological progress (or innovation) is the main driver of long-term growth.

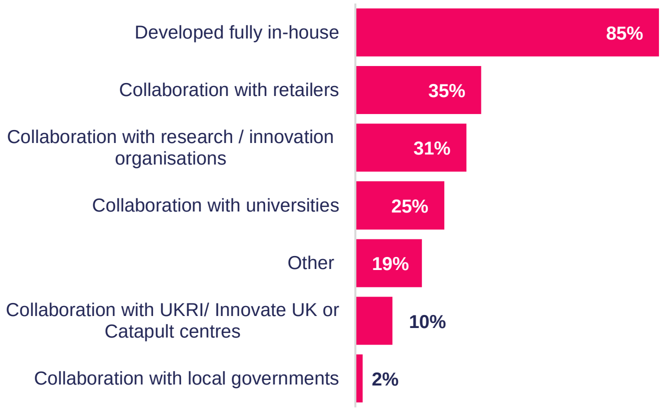
Besides developing innovation projects in house, manufacturers also collaborate with retailers (35%) or with research/ innovation organisations (31%). Answers in the 'Other' category include collaborations with customers, other research organisations or the NHS.

Large companies are most likely to collaborate with research organisations, while smaller businesses are more likely to partner with universities (Chart 11).

Investment in healthier products was undertaken by 78% of respondents in 2023 (Chart 12). Unsurprisingly, given financial possibilities and products in scope, SMEs were more likely to invest less than £100,000 in such projects and large companies were the most likely to invest in projects surpassing £1m.

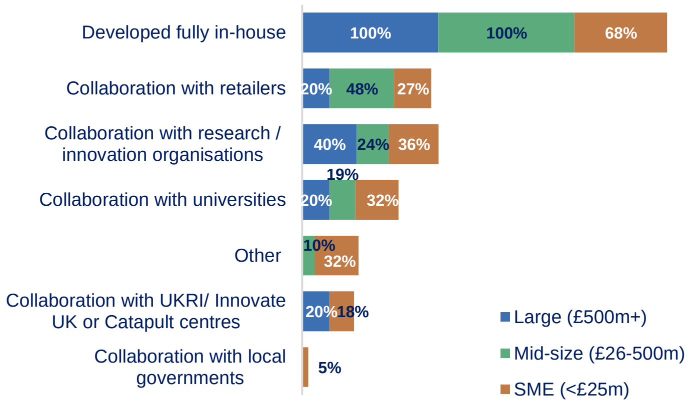
Extending the Reformulation for Health Programme would provide vital seed funding for SMEs to invest in innovation to make their products healthier, when the costs of doing so can be prohibitive. Government and the industry have a working model for this in Scotland, where government funding has driven exemplary SME reformulation.

Chart 10: How innovation takes place



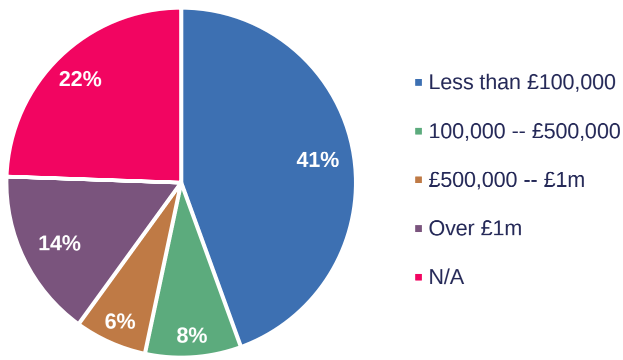
Source: FDF State of Industry Survey

Chart 11: Innovation, by company size



Source: FDF State of Industry Survey

Chart 12: Investment in healthier product innovation in 2023



Source: FDF State of Industry Survey

Stubborn labour shortages

Industry's labour shortages in Q1 were broadly unchanged from Q4. Q1 vacancy rates stood at 5.0% compared to 5.2% in Q4 (Chart 13). Labour shortages remain higher than those in wider manufacturing and the UK, at 2.7% and 2.9% respectively.

Most manufacturers (61%) reported vacancies in the range of 0 to 5%. We estimate the vacancy rate of SMEs at 6.3% on average, higher than that of large businesses (5.7%) or mid-size businesses (3.7%).

Unfilled vacancies continue to affect a wide range of roles and skills, including:

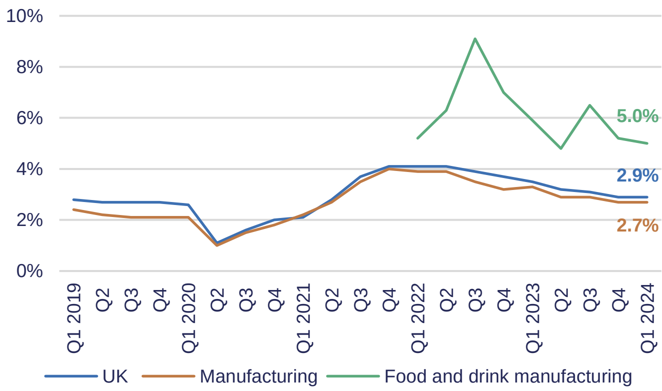
- **High-skilled workers:** agronomists, software development, automation, first line managers, and engineering.
- **Technical specialists:** engineering technicians, sales, electrical maintenance technicians.
- **Production operatives:** packers and food handlers, warehouse and factory operatives, hygiene, and cleaning roles.

Labour shortages put upward pressures on wages. We estimate that the average pay rise in the industry was 6.0% over the year to March. This was above the expectation held a year ago, when manufacturers were anticipating average rises of 5.4% for this period.

42% of businesses offered pay rises in the range of 4.1 to 6%, and 23% in the 2.1 to 4% range (Chart 14). Over the coming year, industry expects pay to increase by another 4.7%.

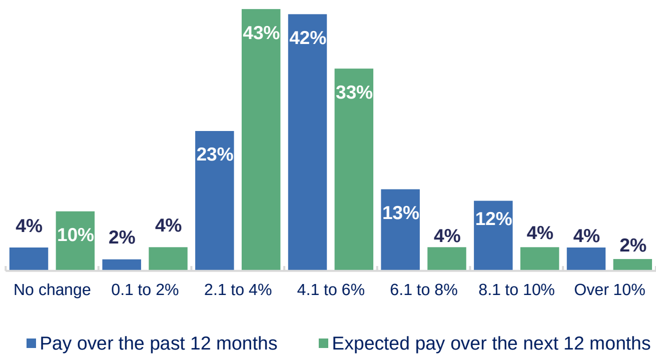
The National Living Wage rose by record levels of 9.8% in April 2024 and 9.7% in April 2023. Food and drink manufacturers usually pay above minimum rates, so they're not directly impacted by these rises. However, indirectly, a rise in the minimum rates pushes all other wage rates up. To the extent that employers will not be able to increase all rates at the same pace, unintended consequences can occur. The most likely impacts are squeezed pay differentials (reported by 56% of respondents), increase uptake of automation to replace labour (36%) or increasing higher pay bands (36%) (Chart 15).

Chart 13: Vacancy rate in UK, manufacturing and food and drink manufacturing *(vacancies per 100 employees)*



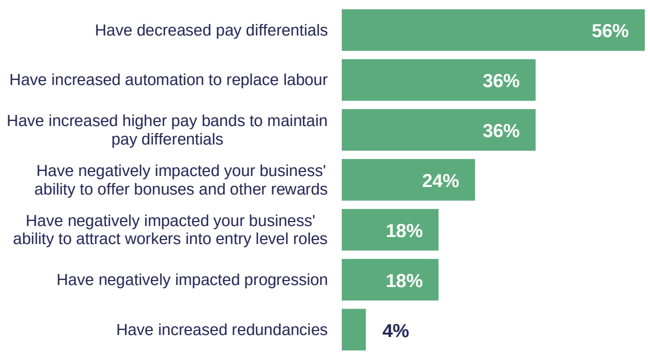
Source: FDF State of Industry Surveys and ONS

Chart 14: % of manufacturers that offered pay increases and expectations of pay rises over the next year



Source: FDF State of Industry Survey

Chart 15: Impacts of the National Living Wage increase



Source: FDF State of Industry Survey

Easing cost pressures amid regulatory challenges

On average, total production costs increased by 9.2% over the year to March, while selling prices rose by 4.3%. Cost rises of over 10% were still experienced by over a quarter of manufacturers (28%), although below last quarter's figure of 45%. In sharp contrast, costs fell for 7% of respondents (Chart 16).

In terms of prices, 9% of respondents stated their prices rose by over 10%, compared to 25% in Q4. Meanwhile, other respondents saw lower selling prices (9%). SMEs saw the smallest increase in their prices (3.8%), an indication of the limited bargaining power small producers have with retailers, as own-label products do not benefit from brand loyalty.

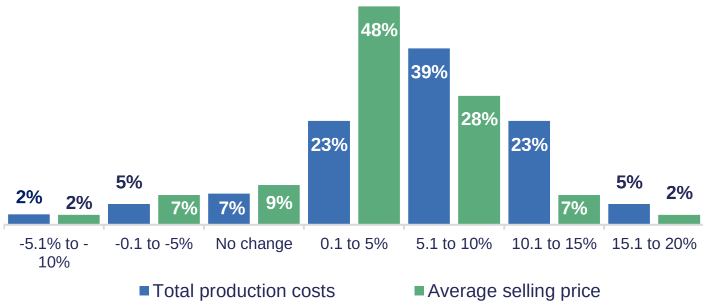
For the year to March 2025, manufacturers expect their costs to rise by 2.1% and prices by 1.1%. Notably, 28% of manufacturers expect production costs to remain the same and 43% expect no change in average prices (Chart 17).

Besides easing cost pressures, good news also came in the form of higher output over the last year for more than half of manufacturers (63%), while almost three quarters (72%) expect higher output over the next year (Chart 18). Unfortunately, this good news is not broadly felt across the industry, with 17% of manufacturers having experienced a contraction in output.

However, poorly designed and / or implemented regulation has the potential to undo some of these gains, hindering growth by rising costs and deterring investment. For instance, the GB-wide 'Not for EU' labelling is an unnecessary policy which would require manufacturers to run separate production lines for EU and UK markets, severely hampering investment, competitiveness and our industry's exports. FDF estimates this could cost the industry £250m per year. Moreover, government's communication is inadequate. Many UK and foreign producers are unaware of the regulation and significant uncertainty remains on the government's plans to mandate it.

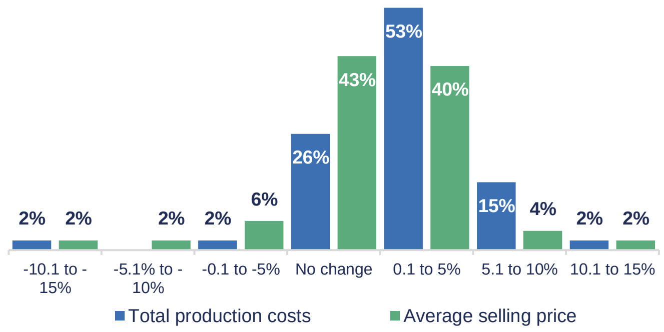
Another example is the second phase of the Border Target Operating Model (BTOM) which came into effect on 30 April 2024, with crucial details on fees being announced only weeks before. SMEs are likely to be disproportionately impacted by these new charges as the government changed its approach from multiple items being included under a single declaration with one charge to charging per item (capped at five), which will significantly increase costs for companies bringing in mixed product loads. Manufacturers have also expressed concerns on delays, the lack of clear government communication and the effectiveness of the phytosanitary inspection service.

Chart 16: Changes in total production costs and average selling price over the year to March 2024



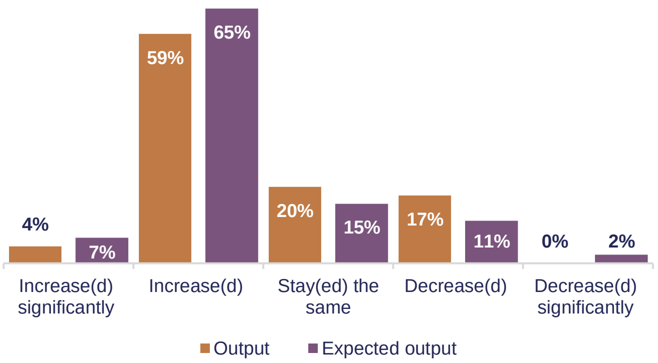
Source: FDF State of Industry Survey

Chart 17: Expected changes in total production costs and average selling price over the year to March 2025



Source: FDF State of Industry Survey

Chart 18: Output changes in the year to March 2024 and expected output changes over the next 12 months



Source: FDF State of Industry Survey

Who responded?

There was strong representation from the industry, with companies from all turnover bands, all employment sizes and from a wide range of industry sub-sectors.

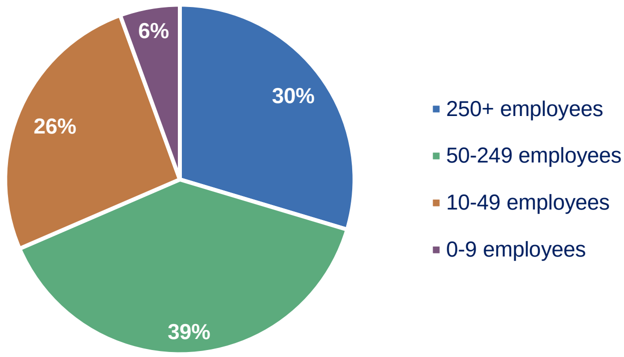
Almost a third (30%) of the businesses surveyed are large employers with more than 250 employees, while 39% are businesses with 50-249 employees, and 26% small businesses with 10 to 49 employees (Chart 19).

By turnover, 19% are small businesses with a turnover of £5m or less, while 11% represent businesses with a turnover exceeding £1bn (Chart 20).

Businesses also represent a wide variety of sectors (Chart 21). Almost a third (28%) manufacture ingredients. The second best-represented sector is bakery goods with 20% of respondents. The 'Other' category covers businesses operating in sectors such as food supplements, sport nutrition, crisps and snacks, and cereals.

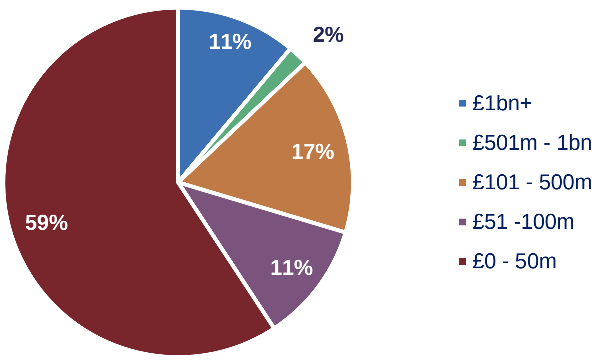
74% of manufacturers operate in England, while 19% have production facilities located in Scotland and 13% in Wales.

Chart 19: Respondents by employment size



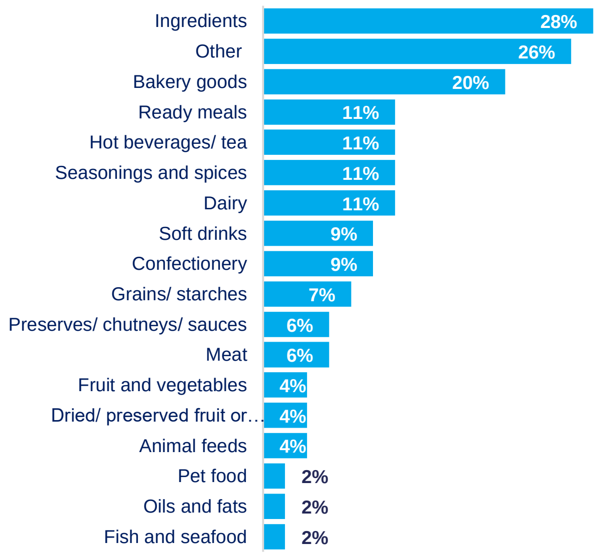
Source: FDF State of Industry Survey

Chart 20: Respondents by turnover



Source: FDF State of Industry Survey

Chart 21: 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.

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