LONDON CHAMBER of COMMERCE AND INDUSTRY

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CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

Q2

2016

ComRes

April – June 2016

LCCI COMMENTARY – THE BUSINESS VIEW

"The second Capital 500 survey of 2016, undertaken before the Referendum was held, suggests a negative business mood among London business leaders. All business indicators declined during Q2 2016, with domestic sales, cashflow and domestic orders all moving into negative territory. Expectations for the year ahead were equally pessimistic. Business confidence indicators declined for the second consecutive quarter, while there are now more Capital 500 businesses who expect the UK economy to decline than to grow.

"There is no doubt that the business mood surveyed, had been affected by uncertainty around the approaching EU referendum held on 23 June. Now, given the result of the referendum, Government must move quickly to maintain confidence and minimise economic uncertainty. As Ministers now contemplate the UK's future outside the EU, London's new mayor, Sadiq Khan, needs to be involved in that planning – to help harness the resources necessary to sustain long-term economic growth.

"Government must look to maintain the capital's position as world-leading place to do business. That means having the pull factors that will attract global companies to invest and locate in London whether that is around business environment, strategic infrastructure or skilled staff. We need to turn the result of the referendum into a time of opportunity for Britain".

Colin Stanbridge, Chief Executive, LCCI

ABOUT 'CAPITAL 500'

For over a decade London Chamber of Commerce and Industry (LCCI) has conducted a Quarterly Economic Survey (QES) of members to gauge business performance and general confidence levels across the capital. This is part of the biggest and longest running national private business survey, conducted by regional chambers of commerce across the UK every quarter.

Since Q2 2014 we have partnered with leading polling company, ComRes, to expand the survey beyond LCCI membership to poll a panel of London businesses that are fully representative of the London economy by business size and broad industry sector. **The LCCI QES is based on responses from over 500 London businesses – the *Capital 500* – that makes it London's largest and most authoritative business survey.**

Since Q1 2016, *Capital 500* has included trend graphs that track the quarterly results for the past two years.

METHODOLOGY

ComRes surveyed a total of 508 London business leaders between 16 May and 6 June 2016. All data has been weighted to be representative of all London businesses by company size and broad industry sector.

ComRes is a member of the British Polling Council and abides by its rules. Full data tables are available at www.comres.co.uk.

The balance figures represent the percentage of firms that reported an increase minus the percentage that reported a decrease. The arrow figures represent the percentage point change in the balance on the previous quarter.

Two categories are used for business size segmentation: micro businesses with fewer than 10 employees (including sole traders), and larger (small, medium and large) businesses with 10 or more employees.

Any data reproduced from the report should be fully referenced.

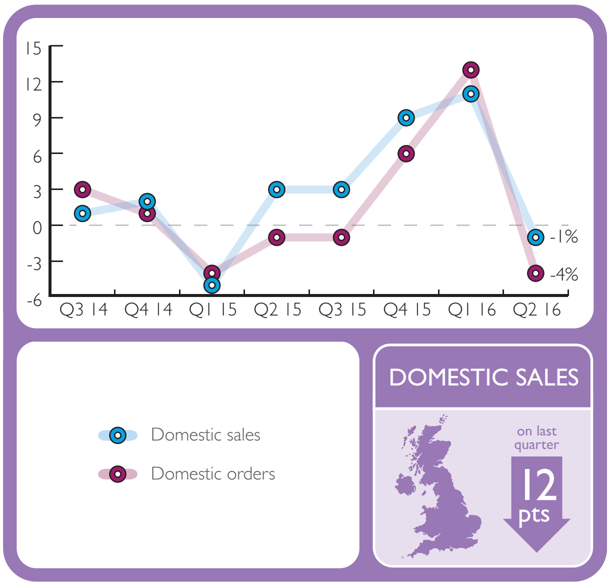
GUEST COMMENTARY – THE ECONOMIST'S VIEW

"The results of the survey certainly chime with what we have seen for the economy as a whole. Business investment fell in the first quarter of 2016 and uncertainty has constrained investment intentions since. UK M&A activity has come to a standstill after a bumper 2015. Second quarter GDP growth is likely to have been subdued.

"The vote to leave in the referendum unsettled markets with both sterling and equities falling sharply. Although a lower sterling may be good for exports it also raises manufacturers' costs and the prices of consumer goods. There is no clarity on what trade deal may be agreed and whether tariffs may be imposed on UK exports. Or whether Scotland remains part of the UK in the longer term. Uncertainty is bad news for growth and for FDI, and the political vacuum created by the Prime Minister's resignation adds to this. Forecasts for 2016 had already been adjusted backwards. More monetary and fiscal support to the economy will be essential to avoid an actual fall into recession."

Vicky Pryce, Centre for Economics and Business Research (Cebr)

DOMESTIC DEMAND



Domestic demand declined considerably during Q2 2016, resulting in a greater proportion of businesses reporting a decrease than an increase in both domestic sales and orders.

There has been a 12 point fall in the balance for domestic sales since last quarter, which is now in negative territory, as on balance, 1% of London businesses reported a decrease in domestic sales. The domestic order balance figure declined by 17 points on last quarter, down from a *Capital 500* record high to the joint lowest level; 4% of London businesses, on balance, reported a decrease in domestic orders.

While larger companies reported a positive balance for domestic sales (+19%), micro businesses reported a negative balance (-4%). This is concerning as smaller companies tend to rely on domestic sales rather than exports. On the same measure, businesses based in Inner London fared better (+6%) than businesses in Outer London (-9%).

EXPORT DEMAND

Export demand also declined, but despite falls in both export sales and orders, both balance figures remained in positive territory. On balance, 3% of London businesses reported increased export sales, down 7 points on last quarter, and 5% reported improved export orders, down 4 points on last quarter.

Larger businesses, on balance, reported a much larger drop in export sales since Q1 2016 (down 14 points) than micro businesses (down 6 points), leading to a balance figure of +3% for both groups. Businesses from Inner and Outer London both reported the same balance figure, but as a result of different trends since last quarter. Businesses from Outer London, on balance, increased their export sales by 5 points since Q1 2016, while businesses from Inner London reported a significant decline of 15 points since Q1 2016.

The overall fall in demand is likely caused, at least in part, by deferred investment decisions resulting from increased uncertainty around the EU referendum. The continued pressure on the sterling may help to explain why export demand figures have fared slightly better than domestic demand figures during Q2 2016. At any rate, these figures are a concern, and action is required to better link London businesses to demand overseas.

The new Mayor of London should pursue his pre-election commitment to champion London industry at home and abroad by leading trade missions with London businesses to foster new trade links and attract more global investment to London.

LABOUR MARKET

Following four consecutive quarters of growth, employment levels dropped during Q2 2016, with 2% of London businesses, on balance reporting increased employment over the last three months, down 7 points on last quarter. Expectations for the next quarter were also subdued and dropped by 5 points from +14% in Q1 2016, the highest recorded *Capital 500* level.

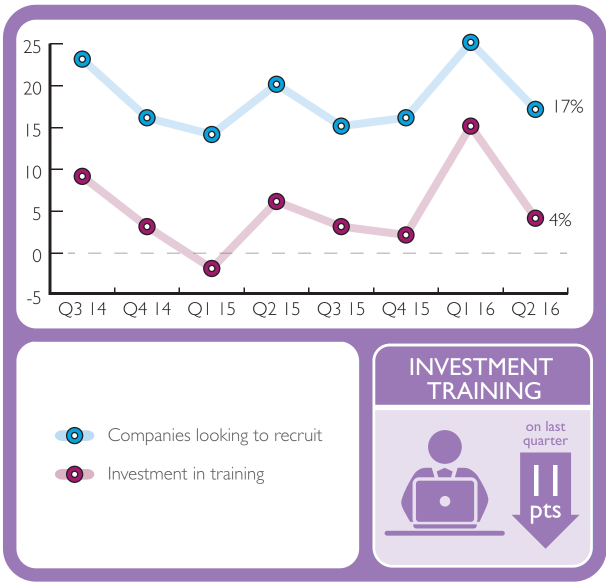
The balance figure for employment in Q2 2016 was lower for micro businesses (0%) than for larger firms (+13%). The latter were also more likely to expect their workforce to increase, on balance, over the next three months (+28%) than micro businesses (+7%).

Businesses in Inner London are more likely to expect their workforce to grow during the next three months, resulting in a balance figure of +13%, compared to +5% in Outer London.

RECRUITMENT AND TRAINING

Both recruitment and investment in training saw considerable declines during Q2 2016. When asked about the methods of acquiring new skills during the last three months, businesses were most likely to mention training existing staff (24%) and employing new staff from the UK workforce (10%) rather than interns (5%), apprentices (4%), EU staff (4%) or non-EU workers (4%).

On balance, 4% of London businesses increased investment in training, down 11 points on last quarter. Nevertheless, some businesses still sought to address their skills requirements through recruitment. A total of 17% (12% of micro businesses and 62% of larger businesses) were looking for new staff during Q2 2016. 58% of companies who sought to recruit did so for full-time positions and 45% for part-time positions. **Of the 17% of companies looking to recruit, a majority (54%) encountered difficulties finding sufficiently skilled candidates.** Of the different types of roles, skilled manual/technical positions remained the most difficult to fill for recruiting *Capital 500* companies.

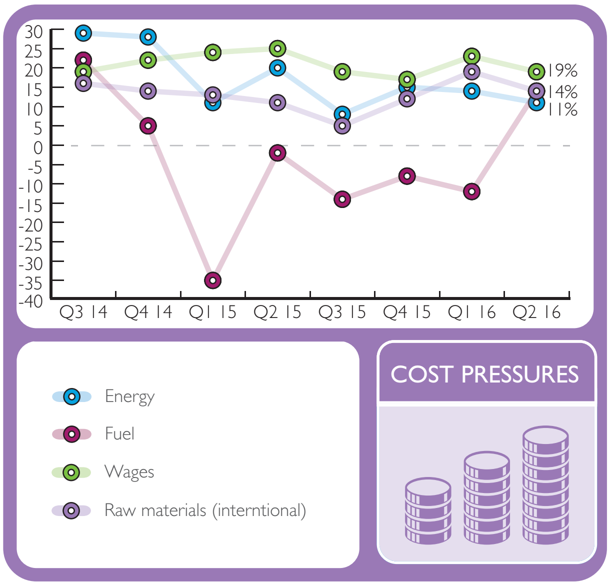


LCCI research has found that London businesses felt that their ability to recruit and retain skilled workers is negatively affected as a result of increased housing costs in the capital.[1] To alleviate the ongoing difficulties in recruiting skilled candidates, it is therefore vital that London's housing supply and affordability crisis is also addressed. There are a number of areas that should be explored in this regard, including enabling and stimulating the development of smaller sites across the capital.

The Mayor could help facilitate the entry of more smaller builders into the house-building industry by establishing a Small Developers Panel to examine planning red-tape and optimise potential of smaller sites identified by London Land Commission.

[1] LCCI (2014): *Getting our house in order: The impact of housing undersupply on London businesses*, at www.londonchamber.co.uk/research/housingreport

BUSINESS COSTS



More companies saw their business costs increase than decrease during Q2 2016. In comparison to last quarter, however, the pressures of all analysed business costs, except for fuel, decreased on balance. The cost factor that most companies, on balance, reported as having increased was the pressure from employees to increase wages (+19%). Areas in which cost rises were, on balance, reported least often were energy (+11%) and borrowing (+10%).

In Q2 2016, an increase in fuel cost was more likely to be reported than a decrease, for the first time in six quarters, resulting in a balance figure of +14%, up 26 points on last quarter. The balance figures for the cost of raw materials sourced domestically and internationally declined to +18% and +14% respectively.

CASHFLOW AND INVESTMENT

London businesses' cashflow position worsened considerably during Q2 2016. The balance figure for cashflow was down 11 points on last quarter, with 2% of London businesses, on balance, seeing their cashflow decrease. This move into negative territory followed four consecutive quarters of improved cashflow balances and *Capital 500*'s highest recorded balance figure during Q1 2016. The balance figure for investment in plant and equipment also dropped, by 5 points, but remained positive at +5%.

While on balance, businesses in Inner London continued to fare better than businesses in Outer London, they also reported a greater decline compared to last quarter. Inner London businesses saw their cashflow balance decline by 13 points to +3%, and their investments in plant and equipment by 10 points to a balance of +8%; Outer London businesses, in contrast, reported a drop of 6 points (to a balance figure of -6%) for cashflow, and a drop of 1 point (to a balance figure of +2%) for capital investments. While larger businesses reported a better cashflow balance (+11%) than micro businesses (-3%), the balance for capital investment was similar for larger businesses (+6%) and micro businesses (+4%).

With investment figures dropping, more needs to be done to incentivise London businesses to invest in their plants and equipment. As such it is vital that the economic uncertainties that may currently inhibit investment are minimised. For example, the cost of doing business in London is set to rise from 5th April 2017 as business rates, based on 2008 levels, are recalculated using today's rental values which in many parts of London bounced back strongly after the economic downturn.

The Mayor of London should consider what targeted support could help London businesses that will face significant business rates increases in 2017.

BUSINESS CONFIDENCE

Expectations for the next 12 months continued to deteriorate during Q2 2016, although all balances were still in positive territory. On balance, 13% of London businesses expected their overall company prospects to improve, down 4 points on last quarter to a *Capital 500* record low. Profitability expectations also dropped to a new low, with 17% of businesses, on balance, predicting an improvement, down 5 points on last quarter. Turnover expectations remained somewhat higher, as 24% of businesses, on balance, expected an improvement, down 3 points on Q1 2016.

Larger businesses were significantly more optimistic about their prospects than micro businesses. Larger businesses reported balance figures of +25%, +29% and +40% for their company's prospects, profitability expectations and turnover expectations respectively, compared to +11%, +16 and +22% for micro businesses.

ECONOMIC OUTLOOK

Already at their lowest recorded level in the last two years, expectations for both the UK and London economy continued to decline – now for the fourth consecutive quarter. On balance, 5% of London businesses expected UK economic growth to worsen, moving the balance figure into negative territory for the first time and down 7 points on last quarter. Expectations for London's economy remained in positive territory, as 8% of London businesses expected an improvement, down 6 points on last quarter.

Micro businesses continued to be particularly negative about the UK's economic prospects, resulting in a -7% balance figure, compared to +7% for larger businesses. Businesses in Inner London were, on balance, more negative about the UK's economic growth prospects (-8%) than businesses in Outer London (-2%). Similarly, London's economic prospects were, on balance, perceived to be more positive by larger businesses (+21%) than micro businesses (+6%) and less positive by businesses in Inner London (+5%) than Outer London (+10%).

Uncertainty around the EU referendum has undoubtedly had an impact on business confidence and economic outlook during Q2 2016. However, in the aftermath of the referendum, the Government must quickly refocus its attention and boost confidence in the capital by making long-awaited strategic decisions, including on airport expansion.

The lead-up to the EU Referendum effectively saw government 'on-hold' and many big decisions delayed. In the post referendum period the Government should prioritise a final decision on a new runway for the London airports system.

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