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State of Industry Report

Q2 2022

Executive summary

- In Q2 2022, food and drink manufacturers' confidence fell to its lowest level since we started tracking it in Q1 2018, with the mood more pessimistic than at the start of the COVID-19 pandemic.
- The outlook for Q3 is bleak, with 45% of respondents expecting the outlook for their business to deteriorate in Q3 compared to Q2, in contrast to only 15% that expect conditions to improve.
- Unfilled vacancies remain a major cause of concern in the sector, with the vacancy rate per 100 employees, increasing to 6.3% in Q2, up from 5.2% in Q1.
- Shortages were reported across a wide range of roles and skills, from high-skilled roles (engineers, HR and legal) to technical specialists (butchers and laboratory technicians) and production operatives.
- Manufacturers are doing what they can to tackle labour and skill shortages, from increasing pay and offering more generous benefits, to increasing flexibility and upskilling their workforce, but it is impacting production levels and cost.
- Most businesses had ongoing investment projects, with only 8% of large companies and 6% of SMEs declaring no current investments. Most investment resources were directed into developing new products and/or processes as a priority.

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More from FDF business insights and economics

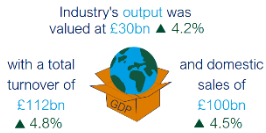
Prices dashboard

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 statistics

Industry facts and stats



Dark clouds on the horizon for UK manufacturers

The sector proved its resilience through Brexit and the pandemic. It successfully adapted to new trading rules with the EU and continued to provide high-quality food at all price points throughout the pandemic. But this flexibility came at a cost. Adjusting and reorganising processes is expensive, and it means foregoing some development. Moreover, since mid-2020, rises in global commodity prices, significant supply chain disruptions and labour shortages have pushed up business costs across the board.

The war in Ukraine hit the industry against this backdrop of intense, prolonged pressures. With most of the UK's sunflower oil imports coming from Ukraine, producers were again quick to adapt their products and processes to use alternative oils. As the war in Ukraine continues, the outlook is bleak. Three successive structural shocks over the past five years have underminded resilience, reducing any slack left in the system, while strong inflationary pressures are not easing and heightened geopolitical uncertainty complicates matters further.

The industry's performance compared to its pre-pandemic period shows diverging trends of solid growth for some subsectors versus noticeable declines for others (Chart 1). The non-alcoholic drink, dairy and bakery sectors are significantly larger than before the pandemic, whereas all other sectors have shrunk since 2019.

Food and non-alcoholic drink inflation jumped to 12.7% in July compared to July 2021, up from 9.8% in June. July 2022 marks a full year of price rises for our sector, and the second highest inflation rate since records started in 1989. Of the 49 food and drink categories reported by the ONS, 38 saw double-digit inflation in July, with the highest price rises recorded for low-fat milk (34.0%), flour (29.7%), butter (27.1%), pasta and couscous (24.4%) and eggs (14.6%) (Chart 2).

Food price rises are likely to continue accelerating as producer prices have sustained their upward pace. July saw higher ingredient prices, with those produced in the UK up 17.5% (up from 15.6% in June) and imported ingredients up 22.4% (down from 23.5% in June). While some global agricultural commodity prices have fallen in recent months, they still remain significantly above 2021 levels. Many are traded in US dollars, so the depreciation of sterling means this partly counteracts the price reduction to UK producers. Meanwhile, gas prices have more than doubled in the past year.

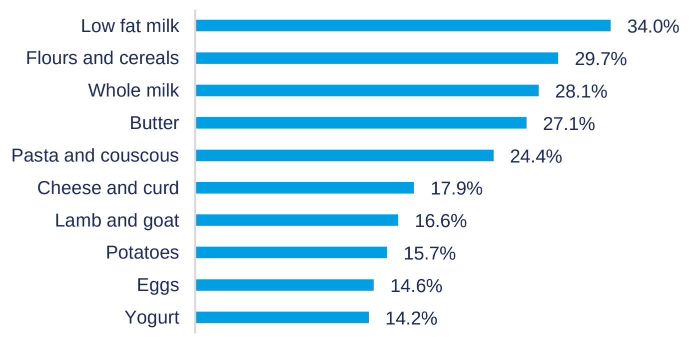
Staff shortages keep cost pressures elevated in the industry as the number of unfilled vacancies increased during Q2 to 6.3 positions for every 100 employees, up from 5.2 in Q1. This is significantly above the figure of 4.3 for the wider UK economy (Chart 3).

Chart 1: 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

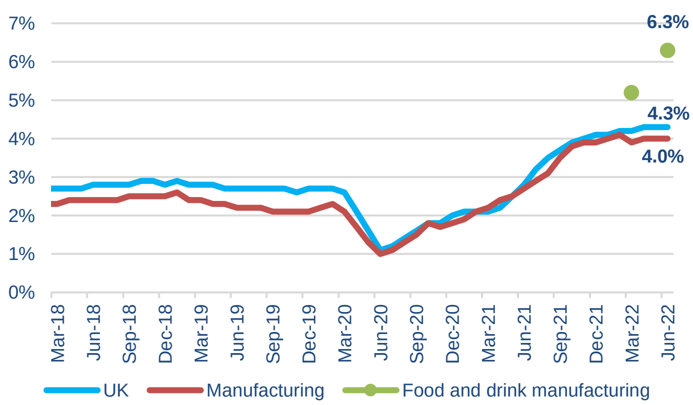
Chart 2: Inflation by category, July 2022, year-on-year



Source: ONS

Chart 3: Vacancy rate in UK, Manufacturing and Food and drink manufacturing sector

(number of vacancies per 100 employees)



Source: ONS and FDF State of Industry Surveys

Industry confidence sinks to its lowest in Q2

Manufacturers' confidence fell in Q2 to its lowest level since FDF started tracking it in Q1 2018, with their mood even more pessimistic than at the start of the COVID-19 pandemic. The FDF's net confidence tracker fell to -72% in Q1 from -61% in the preceding quarter (Chart 4).

The FDF net confidence score is calculated as the difference between those who think that general business conditions have improved in Q2 2022 compared to Q1 2022 and those who believe conditions have deteriorated. In Q2, the share of those who thought conditions have worsened exceeded the share of those who thought conditions have improved by 72%.

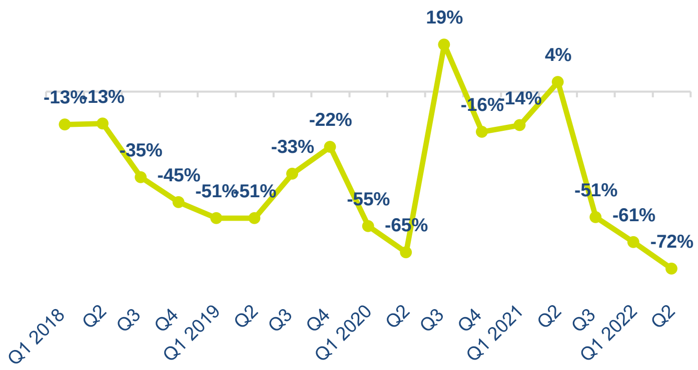
The share of companies believing conditions have worsened in Q2 was roughly the same across businesses of all sizes, although the smaller a business, the more likely it was to perceive that circumstances have deteriorated significantly (Chart 5). This is not surprising, as smaller companies find themselves in an even more challenging position when it comes to negotiating cost price increases. They are also more likely to have less cash and to buy on the spot market, so are typically more vulnerable to market disruption.

The outlook for Q3 is also pessimistic with 45% of respondents thinking that their business' situation will deteriorate in Q3 compared to Q2, in contrast to only 15% that expect conditions would improve. 40% of businesses thought that Q3 conditions would remain similar to those in Q2.

Larger firms were more likely to have a negative view of the short-term than smaller firms (Chart 6). There are several potential explanations for this. Larger businesses are more likely to use forward contracts for ingredient purchases, effectively insulating themselves from the full inflationary force in the market. As forward contracts come to an end, they are facing large cost increases, whereas smaller companies typically have already been more exposed to higher costs.

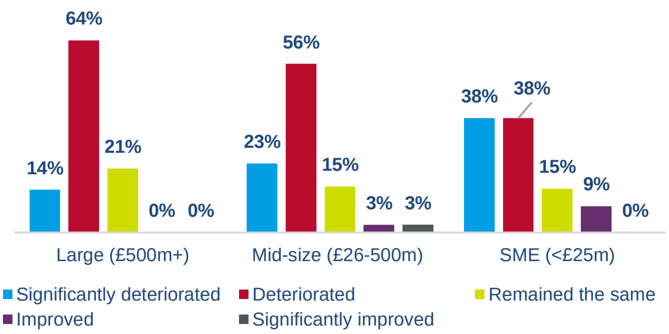
In addition, the ongoing war in Ukraine means significant uncertainty remains, especially regarding the price of gas in the short-term. While the level of concern about the price of gas for all manufacturers cannot be understated, it is likely that the response of larger companies is subject to a lag, compared to smaller companies, where only now business investment is being put on hold, whereas smaller companies are likely to have done that already.

Chart 4: FDF net confidence tracker



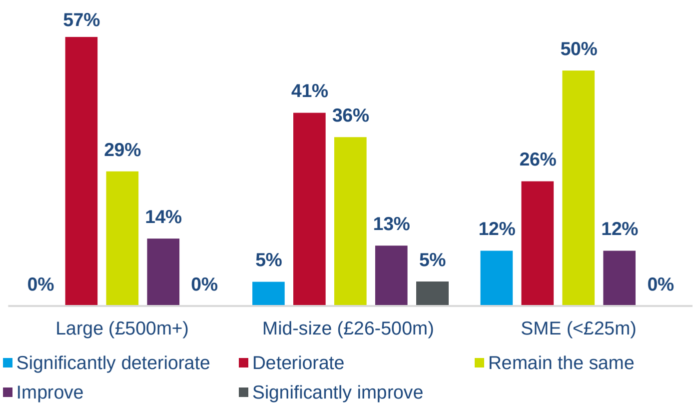
Source: Q2 FDF State of Industry Survey

Chart 5: Conditions in Q2 2022 compared to Q1 2022



Source: Q2 FDF State of Industry Survey

Chart 6: Expectations of Q3 2022 relative to Q2 2022



Source: Q2 FDF State of Industry Survey

Labour shortages are persistently high

Unfilled vacancies are a persistent problem facing our industry. The reported vacancy rate – the number of vacancies per 100 employees, has increased to 6.3% in Q2, from 4.3% in Q1. Nearly half of respondents (47%) report vacancies are running at between 0-5% of their workforce, while for a third of businesses (33%) that figure stands at between 6-10% (Chart 7).

On average, unfilled vacancies were 6.2% of the labour force of large businesses (up from 4.5% in Q1), 6.5% for medium businesses (broadly in line with the Q1 rate of 6.4%) and 6.6% for small businesses (down from 7.4% in Q1).

SMEs are more financially constrained, so they are typically less able to increase wages to retain and/or attract competitive workers, so it is not surprising that SMEs report a higher vacancy rate than larger companies.

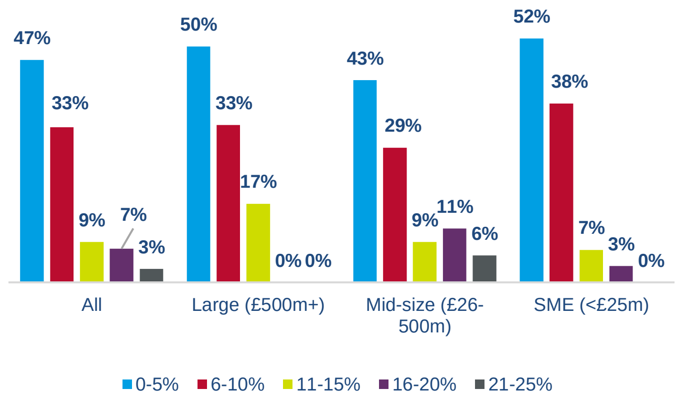
However, reported vacancy rates in Q2 are much closer across all business sizes and this points to staff shortages being a structural issue in the industry. Industry faces significant challenges in the form of sustained supply chain disruption and high price rises affecting all costs and these issues are being exacerbated by serious labour shortages that risk adversely impacting the longer-term growth and productivity trajectory of our industry.

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

- **High-skilled workers**: engineers (IT/ maintenance/ site engineering manager, project engineers), R&D scientists, line leaders and supervisors, sales & sales support, procurement, HR, legal.
- **Technical specialists**: butchers, laboratory technicians.
- **Production operatives**: production and warehouse operators, machine operators, drivers, packers, seasonal workers.

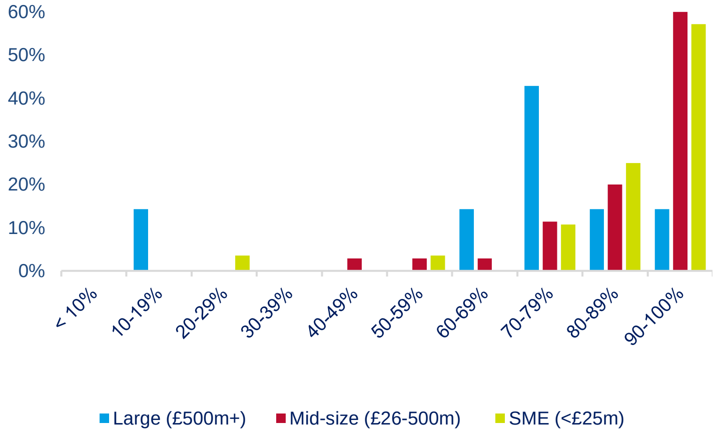
It is worth noting that most employees working in the food and drink manufacturing sector are on full-time contracts (Chart 8).

Chart 7: Labour vacancies by business size



Source: Q2 FDF State of Industry Survey

Chart 8: Share of full-time employees, by business size



Source: Q2 FDF State of Industry Survey

Manufacturers tackling labour shortages

Food and drink manufacturers are tackling the issue of labour and skill shortages via a range of different approaches.

Many have increased pay and enhanced benefits provided to workers while allowing for more flexible working arrangements, including where possible, introducing different shift patterns in factories and working from home for office-based roles.

Higher wages mean higher production costs for producers and this is contributing to inflation. With a myriad of cost increases for over two years now, producers can no longer absorb cost rises, so these will have to be passed on to consumers.

Some companies have also focused on increasing their labour productivity by training and upskilling their existing workers and making use of graduate programmes and apprenticeships.

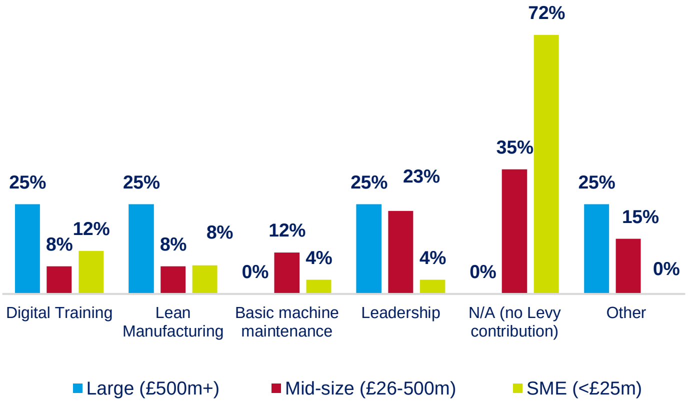
Recruitment practices have been changing as well, with companies reporting that they have reduced their dependency on agency staff and have instead been promoting more frequently within the company or implementing ‘temp to perm’ contracts.

With the removal of Food Technology from the national curriculum, companies are taking steps to tackle the long-term pipeline of candidates available to the industry by expanding their outreach to schools and universities through partnerships, mentorships, workshops and work experience.

One respondent is running a Virtual Work Experience week-long programme for students at the end of summer term 2022. The programme aims to cover the full product development process, including design, consumer science and regulatory affairs.

Over half (54%) of businesses responding contribute to the Apprenticeship Levy. We asked about the types of training needs businesses would address, but are unable to do so due to a lack of available financial resources after paying the Levy. Larger companies reported that digital training, lean manufacturing and leadership were of equal importance (Chart 9). Medium-sized companies report a greater need for leadership training, followed by basic machine maintenance.

Chart 9: If you contribute to the Apprenticeship Levy, is there any training you’d like to undertake, but are unable to due to fewer or no financial resources available after paying the Levy?



Source: Q2 FDF State of Industry Survey

Ongoing investment projects

Business investment is the engine of long-term growth. Given food is a necessity, our sector generally performs well, regardless of wider economic conditions. Prior to the pandemic, investment had been on an upward trend since 2009. In comparison, wider UK business investment rose between 2009 and 2016 but stalled between 2016 and 2019 (Chart 10). This has resulted in the share of food and drink manufacturing investment out of total UK business investment rising in recent years, from 1.6% in 2016 to 2.1% in 2021.

However, unprecedented recent cost pressures have meant that manufacturers had to absorb a significant share of cost increases while at the same time reducing spending in other areas. Given extraordinary ongoing business uncertainty, many planned projects are being put on hold, to preserve financial resources.

However, most food and drink businesses had ongoing business investment projects in Q2 (Chart 11), with only 8% of large companies and 6% of SMEs declaring no current investments. It is likely that these projects predate the current economic downturn.

A third of businesses report that developing new products and/or processes is their priority for investments. Given the high levels of competition in UK food and drink, bringing new products to market or refining existing products is key to maintaining a company's competitive edge.

The second most important area of investment was to address labour shortages, a telling sign of the strain staff shortages are imposing on businesses. As labour issues disproportionately impact SMEs, it isn't a surprise that a larger share of SMEs invest in these areas.

Other investments included restructuring, investments into plant and equipment, cost reduction and improving equipment performance.

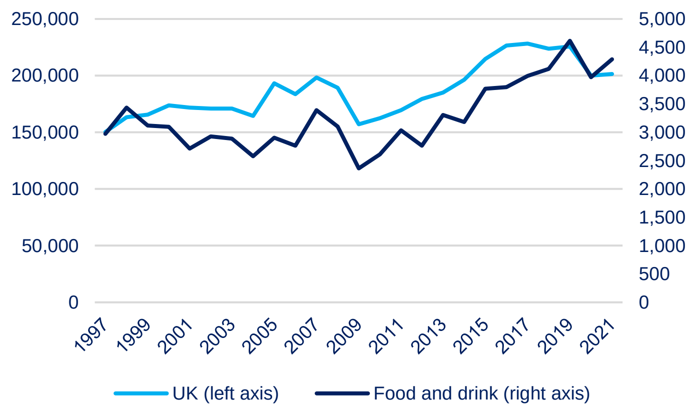
In terms of schemes utilised for investment, R&D tax credits was the most frequently used (Chart 12), with 51% of mid-size businesses and 44% of SMEs having used it or planning to use it and there is strong potential to grow this use further.

16% of all businesses have used or have plans to use the 130% super-deduction and 21% of businesses have made use or have plans to use the 100% annual investment allowance. British Business Bank or government-banked lending is the least favoured option out of all of these, with 41% having no plans to use it.

Businesses have used these schemes to help support investments in new technology and automation, new plant and equipment, energy efficiency or factory improvements.

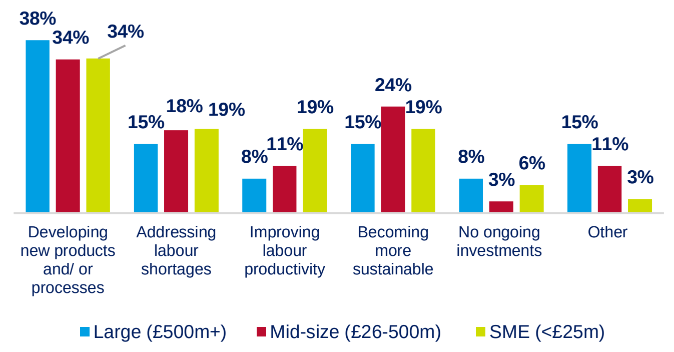
Chart 10: Business investment in the UK and in the food and drink manufacturing

£ mill, figures adjusted for inflation



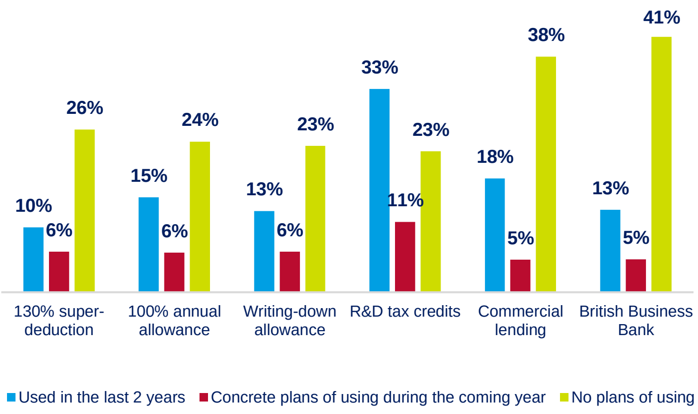
Source: ONS

Chart 11: Prioritised areas of investment in Q2



Source: Q2 FDF State of Industry Survey

Chart 12: Schemes used for investment



Source: Q2 FDF State of Industry Survey
Note: The "Don't know" category has been excluded.

Who responded?

Businesses responding to our survey in Q2 represented 20% 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.

41% of the businesses in the survey are large employers, with more than 250 employees, while 6% of the respondents are micro-businesses with fewer than 10 employees (Chart 13).

Our survey included a good representation of companies of all sizes according to turnover. 20% of respondents were small companies with a turnover of £5m or less, while 8% of respondents have a turnover in excess of £1bn (Chart 14).

Respondents represented a wide variety of sectors (Chart 15). The majority (41%) 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 a third (33%) of the overall respondents.

Most of the respondents (79%) operate in England, while 27% have at least one manufacturing site in Scotland and 11% in Wales.

Chart 13: Share of respondents by employment size

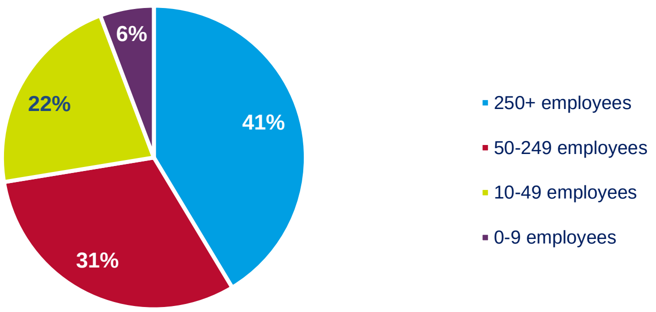


Chart 14: Share of respondents by turnover

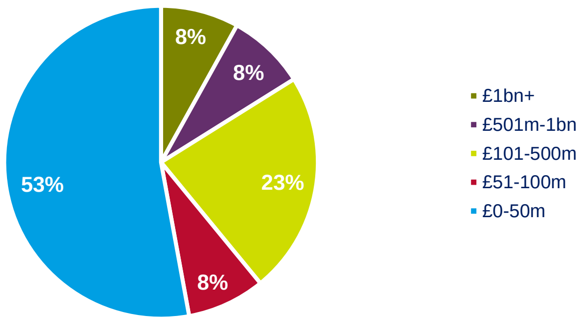
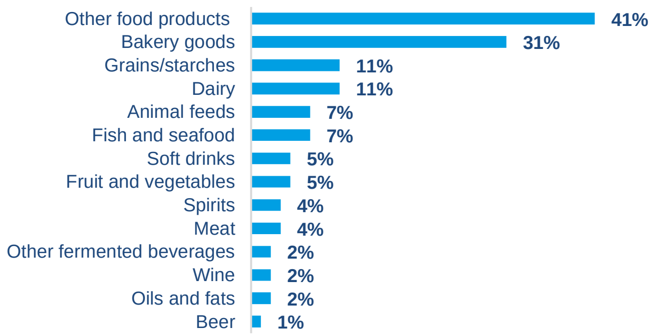


Chart 15: Share of respondents by sector



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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