UK growth prospects look uncertain throughout 2012. It is expected that the OBR will revise down its GDP forecast, currently at 0.8% growth, bringing it closer to Cebr’s prediction of a marginal 0.4% expansion. The potential for rising unemployment, stagnant wage growth and reduced spending power may knock business confidence - in particular those close to the consumer pound.

To keep the wheels of the UK economy turning, the Bank of England recently sanctioned a further £50 billion of quantitative easing, taking the total programme to £325 billion. The Deputy Governor of the Bank of England commented “I expect very subdued growth in the first half of the year, followed by a gradual strengthening, reflecting an ease in the squeeze on household incomes as inflation falls, complemented further out by some recovery in investment.” Cebr expect the QE programme to reach £400 billion by the end of 2012.

The UK economy does not operate in a vacuum. Continuing trouble in the eurozone, the UK’s biggest trading partner, also presents a significant downside risk to the economic outlook; a second financial crisis cannot be ruled out entirely if a lasting solution is not found. The impact of persisting risks means that we do not expect to see UK GDP growth exceeding 2% until 2016.

Expanding the picture further afield, positive medium-term signals from the US combined with GDP growth in Asia and South America provide some encouragement to those who can take advantage of it. Excepting only a complete collapse of the eurozone, global GDP could grow by 2.7% in 2012, with China generating 7-8% of growth over the next four years.

Business failure predictions reflect this turbulent two-speed outlook. Following a 6% increase in the total number of insolvencies during 2011, we are predicting another marginal increase in 2012 however these are expected to occur largely in the SME market. In terms of sectors, while Retail and Leisure look set to continue to suffer as households economise, high-tech growth could be good news for Telecom, Media and Technology (TMT). Manufacturing should be comparatively well placed too, benefiting from lower commodity prices and export opportunities driven by global growth.

For more information on any of the data or topics covered in Industry Watch please contact me or your usual BDO contact.

Following a 6% increase in the total number of insolvencies during 2011, we are predicting another marginal increase in 2012 however these are expected to occur largely in the SME market.
MIND THE GAP

A clear division is forming between those businesses able to take advantage of growth opportunities and those that are left behind to fight it out in difficult markets. We look at this trend and consider what businesses can do to Mind the Gap.

One of the dangers of economic forecasting is that, by simply focusing on the big picture, you can miss out on key elements of the story. For example, extreme positives and extreme negatives may cancel each other out to create a false impression of calm. So, looking at the UK economy, while slowing GDP growth and weak domestic demand tends to grab the headlines, it is important to look underneath the surface and see the trends emerging.

To illustrate this two speed performance trend, the beleaguered Retail sector is placed under the spotlight. Barely a week goes by without more dire predictions in the press about the prospects for this sector, but a closer look reveals that as well as challenges, there are opportunities.

Retail
While total UK retail sales values barely beat inflation in 2011, internet sales leapt an impressive 22%. For every struggling Peacocks there appears to be a thriving Burberry and the 'squeezed middle' still appears to have enough in their pockets to keep John Lewis relatively buoyant. On the macroeconomic front, falling inflation should help consumer expenditure to edge higher in real terms in 2012.

Although some towns have nearly one in five high street shops empty, for those retailers with a strong multi-channel offering, the right brand, a differentiated product, quality service and a clear understanding of client demands - growth is still firmly on the agenda. With momentum swelling behind new mobile platforms that can make customer engagement easier and more efficient, the future for those with the ambition and technology to capture it still looks bright.

Technology, Media and Telecoms
Indeed, as technology becomes more and more vital to success in all industries, TMT is the sector most clearly bucking the trend. This is supported by the latest business surveys. A recent ICAEW Confidence monitor shows that IT and Communications was one of only two sectors to record positive confidence in Q1 2012. Similarly the FSB Voice of Small Business Index shows that 'computer and related services' are recording the highest confidence levels of all industries. Here, strong demand for digital solutions – for everything from cloud computing to super fast 4G and mobile platforms – is creating a climate of investment and growth.

IDC, International Data Corporation, estimates 226,000 jobs will be created in the UK between now and 2015 as a result of investment in public and private IT cloud services and also suggests IT innovation created by cloud computing could provide $1.1 billion a year in new business revenues. Whilst this provides
obvious opportunities for cloud computing providers, data centre operators and server manufacturers, it also offers opportunities for businesses across the TMT sector to realise the tremendous cost savings available from the technology. It is important not to get carried away with talk of tech-hubs and creating the new Apple but it does appear that the UK technology sector is doing well. So much so that Cebr forecasts that TMT business failures will fall by over 3% in 2012.

**Aiming for growth**

Just as the gap expands between and within sectors, there is also a widening geographical divide. Globally, it is a familiar story that the West must look East to find growth; with Asia predicted to grow by over 7% in 2012 this certainly holds true. What is less commonly documented is that the US is also looking increasingly strong, a view supported by recent data such as the 243,000 increase in non-farm payrolls in January. Cebr projects that US GDP growth will be 2.5% by 2014, whereas they don’t expect the UK to return to those levels until beyond 2016. The good news here is that UK firms are increasingly taking these international opportunities. The share of our goods exported to non-EU countries has risen from 42% in 2007 to 47% in 2011.

Manufacturing has been one of the first sectors to benefit, with those companies able and willing to adapt products to new overseas markets getting support from a weak pound. This looks set to continue according to the latest CBI Industrial Trends Survey, which expects solid output manufacturing growth over the coming three months, with an improvement in both total and export order books. Many businesses – particularly larger ones – are finding the key to stemming falling domestic revenues is to increase exports, particularly to fast growth BRIC and CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey, South Africa) economies. However, many small businesses remain reluctant to take the plunge and need additional handholding from the government in order to help them take advantage of export opportunities.

It wouldn’t be even handed, however, to talk about geography without looking at Europe, whose slowdown in economic activity is already hitting British exporters. Mind the Gap has plenty of resonance here, as the eurozone’s struggles are due in no small part to the binding together of very different economies under one currency. To illustrate the point, and according to Cebr research, while unit labour costs in Greece rose by a hefty 36% in the decade from 2000, Germany’s rose a mere 6%.

**Bank funding**

If you are an entrepreneur, which side of the gap you are on is likely to have a major impact on your ability to exploit the growth opportunities that arise. This is because, as Basel III and other impending regulations bite, banks are becoming ever more careful about

*There has been a shift in the emphasis of perceived consumer value, placing increased importance on brand and customer perception of branding.*
how they allocate capital. Companies with old-fashioned models in saturated, mature markets may find it harder and harder to access capital. But, on the other side of the divide, well thought out proposals with new approaches to growing markets may find it easier than before to find investment partners.

**Getting on the right side**

The current economic climate does not mean doom or gloom for all. In fact some of the world’s best-known companies, including Apple, Burger King and General Electric, started out during recession. Good quality businesses can and do find market opportunities in difficult trading conditions. The winners will be those who accept the economy is not going to bounce back in the short-term and in the context of this new normal, take action. The key to success in current markets appears to be around the following principles: consumer value, client service, innovation and adaptability.

There has been a shift in the emphasis of perceived consumer value, placing increased importance on brand and customer perception of branding. In the same way, quality of client service, trust and commitment are critical to financial performance as they are intrinsically linked to client-perceived value, competitive advantage, and a target market focus.

Clients are also more likely to favour a unique proposition. Businesses need to focus on differentiating themselves from competitors. This means they must recognise available opportunities and be prepared to take themselves in a completely new direction if necessary.

Growth will be achieved through a combination of innovation and strong financial management – particularly when things are not working so well. Business planning is essential. Businesses looking for growth should have a strategic focus coupled with a robust business plan which is agreed by the management team.

In summary, there are opportunities for businesses across every sector, but the importance of innovation and rigorous management has never been more evident. Tough though it may seem – adapt, evolve or fail is the real challenge facing businesses. For those who Mind the Gap the potential for growth is much greater.

"Good quality businesses can and do find market opportunities in difficult trading conditions."
1. Industry Watch is the first study to make projections of total business failures and the business failure rate in Great Britain by sector, based on data for compulsory liquidations, creditors' voluntary liquidations, administrative receiverships, administration orders and company voluntary arrangements provided by the Department for Business, Innovation and Skills (BIS).

2. The latest quarterly data for Great Britain is Q4 2011. The BIS official company insolvencies by industrial sector are published one quarter in arrears for England, Wales and Scotland. Therefore, the latest sectoral data is Q3 2011.

3. The BIS has changed the industrial classification of its insolvency statistics to adhere to the Standard Industrial Classification 2003 (SIC 2003) as per Q3 2007. Historic insolvency data based on the insolvency trade classification is available up to Q3 2006. There is no official insolvency data by sector available for the period between Q3 2006 and Q3 2007. In order to obtain consistent historic data we converted sectoral insolvency data to the SIC 2003 system using the official insolvency industry data up to Q3 2006.

4. Company liquidations comprise of compulsory liquidations (winding up orders made by the court) and creditors' voluntary liquidations registered at Companies House. The BIS figures do not include members' voluntary liquidations, as this procedure does not involve insolvency.

5. We also include receiverships, administrations and company voluntary arrangements (CVA). Administrative Receivership involves the appointment of an administrative receiver over a company for the purposes of maximising the return to the appointer. Administration orders are court orders which place an insolvent company under the control of an administrator who puts forward proposals to deal with the company's financial difficulties. CVAs are procedures which allow debtors to put forward a plan of debt reorganisation to creditors and shareholders.

6. The BDO Industry Watch model uses a range of key economic variables which have been shown to be related to business failures for each sector.
## SECTOR SUMMARIES

### WHAT WILL HAPPEN TO BUSINESS IN 2012?

<table>
<thead>
<tr>
<th>Sector</th>
<th>Expect business failures* in 2012 to:</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>STABLE</td>
<td>The Manufacturing sector suffered a significant 32% rise in business failures in 2009 at the height of the global economic downturn. It has subsequently bounced-back encouragingly and failure rates are expected to have been below their 2008 level in 2011. The annual number of manufacturing failures is expected to be roughly similar in 2011 and 2012, and to fall thereafter. The ongoing weakness of Sterling is expected to improve the sector's international competitiveness, facilitating export-led, if lacklustre, growth.</td>
</tr>
<tr>
<td>Retail and wholesale</td>
<td>INCREASE</td>
<td>Retail prospects look bleak for the coming year as consumers, chastened by joblessness, austerity and the eurozone’s troubles, tighten their belts. Several high profile retailers went into administration in January 2012 and more may be on the way.</td>
</tr>
<tr>
<td>Business services</td>
<td>INCREASE</td>
<td>The Business Services sector’s 2010 decline in failures, while encouraging at the time, has not proved persistent. Although the annual number of failures is expected to peak in 2012, it will be 2014 before notable declines in failures take hold.</td>
</tr>
<tr>
<td>Property and construction</td>
<td>INCREASE</td>
<td>Failures in the Property and Construction sector will increase in 2012 and are expected to be roughly 60% higher than their 2006 level. Housing market fragility and reduced public sector demand will keep failure rates high going forward.</td>
</tr>
<tr>
<td>Technology, media and telecoms</td>
<td>EDGE DOWN</td>
<td>Cebr predicts a moderate decline in TMT business failures in 2012. Failures are expected to decline significantly going forward as domestic high-tech firms drive sectoral growth, leading to declining failure numbers.</td>
</tr>
<tr>
<td>Personal services</td>
<td>EDGE UP</td>
<td>Personal Services can expect to see failures rising marginally in 2012 before beginning to decline. Over 2011 to 2013, annual sectoral failure numbers are projected to remain largely stable. Personal Services can expect a somewhat challenging 2012 trading environment as consumers face rising joblessness.</td>
</tr>
<tr>
<td>Leisure</td>
<td>INCREASE</td>
<td>Consumer spending on leisure goods and activities will be under strong pressure in 2012 due to households deleveraging their debts and facing increased unemployment rates. The Leisure sector relies on selling consumers comparatively discretionary goods. Difficult conditions for consumers going forward means leisure provider failures are expected to increase in 2012 and thereafter.</td>
</tr>
<tr>
<td>Transport</td>
<td>EDGE UP</td>
<td>Transport sector performance is highly correlated with GDP growth, but we do not expect this years’ weak 0.4% expected GDP growth to be enough to keep transport failures from rising slightly. However, as the economy returns to more robust growth in and after 2013, we expect transport failures to decline.</td>
</tr>
</tbody>
</table>

We have compared forecasts for business failures compared to the previous year. ‘Decline’ indicates business failures will fall, ‘edge up’ indicates business failures will increase by one to ten per cent, ‘edge down’ indicates business failures will decrease by one to ten per cent, ‘increase’ indicates that business failures will rise by more than ten per cent and ‘stable’ indicates that business failures will rise or fall by less than one per cent.
## OVERVIEW OF INDICATORS

### WHAT WILL AFFECT FAILURES IN 2012?

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Pushing business failures</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross domestic product (GDP)</strong></td>
<td><img src="https://via.placeholder.com/15" alt="UP" /></td>
<td>Economic output in the United Kingdom fell by 0.3% in Q4 2011, down from 0.6% growth in the third quarter of the year and reigniting concerns about a lacklustre and protracted UK recovery. Cebr expects the UK economy to marginally expand by 0.4% in 2012, predominantly due to the weakness of demand for our exports in the eurozone, government austerity and the weakness of domestic consumer demand, in part caused by rising joblessness. Our prediction is noticeably lower than the Office for Budget Responsibility’s (OBR) current forecast of 0.8% growth. Our longer term projections, implying annual growth of 1.1% in 2015, are also less bullish than the OBR’s. The OBR predicts annual growth of 3.0% in 2015.</td>
</tr>
<tr>
<td><strong>Exchange rate</strong></td>
<td><img src="https://via.placeholder.com/15" alt="DOWN" /></td>
<td>The Pound Sterling remains notably weak against the Euro and the Dollar when compared to the pre-recession exchange rate. A weak Sterling, kept weak by low Bank of England interest rates and quantitative easing, will improve the competitiveness of UK exporters and provide a boost to domestic GDP by increasing net exports. Question marks hanging over the eurozone’s stability will place upward pressure on Sterling in 2012 as investors seek security in comparatively safe currencies.</td>
</tr>
<tr>
<td><strong>Interest rates</strong></td>
<td><img src="https://via.placeholder.com/15" alt="DOWN" /></td>
<td>European spillovers, subdued UK GDP growth and declining domestic inflationary pressure going forward all suggest that the BoE will keep interest rates at the current record low of 0.5% in 2012. Cebr predicts rates will be kept on hold until 2016, and will only rise gradually thereafter. The Bank’s quantitative easing programme, recently expanded to £325 billion, is predicted to buy up £400 billion worth of assets by 2013, putting further downward pressure on real interest rates.</td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td><img src="https://via.placeholder.com/15" alt="DOWN" /></td>
<td>Annual inflation was 4.2% for the 12 months to December 2011, a fall from 4.8% for the year to November. The last time there was a sharper decrease in the annual inflation index was between November and December 2008. Reductions in inflation were driven by falls in the prices of petrol and clothing, and gas prices which were unchanged in December 2011. Inflationary pressure is expected to fall off sharply in 2012 and inflation is expected to be below the BoE target by the end of the year.</td>
</tr>
<tr>
<td><strong>Business surveys</strong></td>
<td><img src="https://via.placeholder.com/15" alt="UP" /></td>
<td>In general, business survey results are pointing toward underwhelming levels of business confidence. Several have shown that business confidence has declined significantly since the start of the second half of 2011. Business surveys are often credible leading indicators of GDP growth.</td>
</tr>
<tr>
<td><strong>Consumer spending</strong></td>
<td><img src="https://via.placeholder.com/15" alt="UP" /></td>
<td>Household real net income growth remains subdued as government austerity and rising unemployment take hold. These factors, coupled with debt deleveraging and subdued real wage growth for those who are employed, mean that consumer spending will be underwhelming in 2012.</td>
</tr>
<tr>
<td><strong>Housing market</strong></td>
<td><img src="https://via.placeholder.com/15" alt="UP" /></td>
<td>We predict house prices will rise by 1.6% in 2012, representing a decline in house prices in real terms. This continues the existing trend of weakness in the real estate market.</td>
</tr>
<tr>
<td><strong>Business investment</strong></td>
<td><img src="https://via.placeholder.com/15" alt="UP" /></td>
<td>Credit conditions are expected to remain tight in early 2012 according to the Bank of England’s most recent Credit Conditions Survey. The climate is especially tough for SMEs, who have seen annual percentage decreases in lending to them since mid-2009. This, coupled with weak domestic and Eurozone demand, will keep business investment subdued in 2012.</td>
</tr>
</tbody>
</table>
ACTUAL AND PREDICTED QUARTERLY BUSINESS FAILURES BY SECTOR

Source: BERR Insolvency Statistics; CEBR forecasts
PREDICTED CHANGE IN BUSINESS FAILURES BY SECTOR: 2012 COMPARED WITH 2011

- Transport: -3%
- Business Services: 12%
- Property and Construction: 14%
- Retail and Wholesale: 0%
- Manufacturing: 4%
- Personal Services: 6%
- Telecoms, Media and Technology: 13%
- Leisure: 5%
- Retail and Wholesale: 0%
- Transport: -3%

Source: Cebr calculations based on Cebr forecasts of BERR insolvency data

ACTUAL AND PREDICTED QUARTERLY BUSINESS FAILURES IN GREAT BRITAIN

The Q4 2008 figure includes one holding company with 729 separate managed service companies which were counted as separate entities.

Source: Cebr calculations and forecasts based on BERR insolvency data
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The Centre for Economics and Business Research Ltd (Cebr) is a leading independent commercial specialist economics consultancy. Cebr has particular strengths in all forms of macroeconomics and market forecasting for the UK and European economies and in the use of business survey techniques.

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