

COMMERCIAL BANKING

# Business in Britain: Services

A survey of key  
sector opinions,  
trends and insights.

October 2019

By the side of business



LLOYDS BANK

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## OUR CONTRIBUTORS



**Scott Barton**

Managing Director,  
Head of Large Corporates,  
Lloyds Bank Commercial Banking



**Chris Sood-Nicholls**

Managing Director,  
Head of Professional Services,  
Large Corporates,  
Lloyds Bank Commercial Banking



**Allan Ramsay**

Managing Director,  
Head of Business Services,  
Large Corporates  
Lloyds Bank Commercial Banking



**Mark Burton**

Managing Director,  
Head of Services & TMT,  
Large Corporates  
Lloyds Bank Commercial Banking

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# Welcome



**Scott Barton**

Managing Director,  
Head of Large Corporates,  
Lloyds Bank Commercial Banking

## **The UK service sector is one of this country's greatest success stories.**

It is viewed as a centre of excellence for outsourcing and an international leader in both business and professional services.

It dominates the UK economy, accounting for approximately 80% of output<sup>1</sup> and employment<sup>2</sup>, and it has been the best performing business sector over the past decade, posting consistent growth<sup>3</sup> during a period characterised by elevated uncertainty.

The sector is as varied as it is vast. The companies we spoke to range from legal and accountancy firms to recruitment, IT/software services, business process outsourcing and support services businesses.

The UK has a trade surplus in services, with the value of exports exceeding the value of imports by more than £80 billion<sup>4</sup>.

And the sector's reputation is unrivalled internationally.

The five law firms known as the Magic Circle are considered among the most prestigious in the world, while three of the big four global

accounting firms are headquartered here in the UK.

We also have a flourishing and diverse business services industry, with world-leading organisations offering facilities management, business process outsourcing, IT/software services and more.

While the service sector is clearly not immune from the uncertainty that has affected so many industries in recent years, its breadth of expertise means it has been able to benefit from certain countercyclical opportunities, advising and supporting businesses as they seek to manage risk.

Lloyds Bank is committed to supporting the sector and sharing the learnings in this research report is just part of that.

Intelligence like this will help inform our approach as well as supporting strategic decision-making at service sector businesses across Britain.

We hope you find it both enlightening and instructive.



The UK service sector is viewed as a centre of excellence for outsourcing and an international leader in both business and professional services.



## AT A GLANCE

55%

expect the service sector to grow over the next two years

67%

plan to adopt or expand their use of disruptive technologies like AI and automation

82%

well protected against cyberattacks

1 - <https://www.ons.gov.uk/economy/economicoutputandproductivity/output/articles/servicessectoruk/2008to2018>

2 - <https://www.ons.gov.uk/economy/economicoutputandproductivity/output/articles/fivefactsabouttheukservicesector/2016-09-29>

3 - <https://www.ons.gov.uk/economy/economicoutputandproductivity/output/articles/servicessectoruk/2008to2018>

4 - <https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/bulletins/internationaltradeinservices/2017>

# Current Environment & Outlook

**While the service sector has proved robust since the global financial crisis 10 years ago and has held up since the UK's vote to leave the EU, there are potential headwinds on the horizon.**

Of course, the industry is far from unique in this regard, though there are particular subsectors, including legal services, that face greater uncertainty than others.

While the nature of UK's exit from the EU will be a key concern for many, there are numerous other disruptive factors at play, from the emergence of potentially transformative

technologies to the increasingly unpredictable nature of global geopolitics.

Weak economic growth in the UK is also an anxiety. Just 25% of service businesses expect the economy to grow in the next 12 months, while 36% anticipate a contraction and 31% predict no growth.

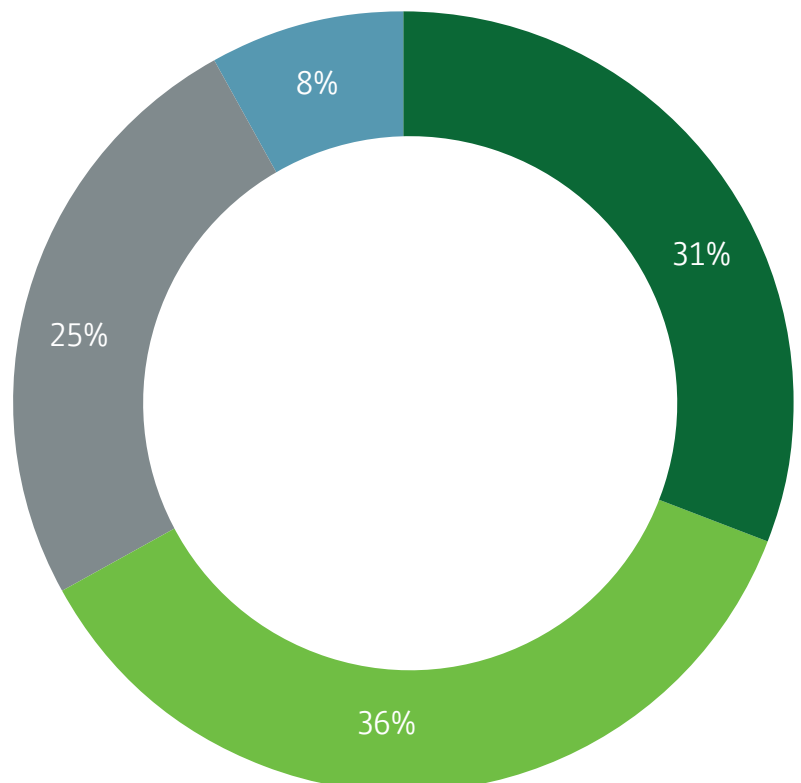
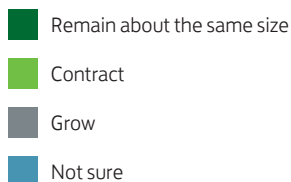
This is somewhat more cautious than the attitudes uncovered in our Business in Britain reports on the retail and manufacturing sectors, where growth was forecast by 30% and 34% respectively.



Businesses see a diverse range of opportunities to achieve growth, both at home and abroad.



**Over the next 12 months, do you expect the UK economy to...**



### An encouraging outlook

Still, against this backdrop it is encouraging to report that 55% of the decision-makers surveyed expect the service sector to grow over the next two years, while just 14% expect it to contract.

And businesses have even more confidence in their own prospects, with 74% expecting their turnover to increase over the next five years, against just 9% who anticipate a decrease, which is broadly in line with the outlook we also found in the manufacturing and retail sectors.

Despite the growing adoption of automation – a topic that we will explore elsewhere in this report – firm's recruitment intentions are also mostly positive.

Just over half (52%) expect their net headcount to increase over the next five years, though 30% believe they will cut jobs.

### Opportunities and exports

Businesses see a diverse range of opportunities to achieve growth, both at home and abroad.

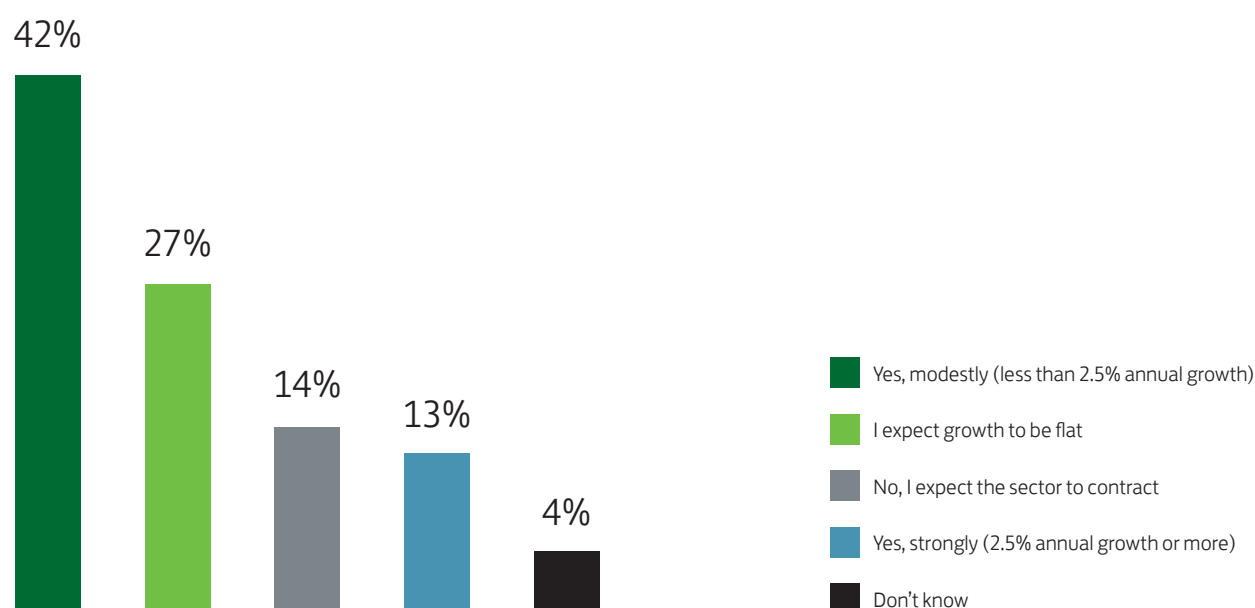
They believe they can adopt new technologies to improve operations and/or reduce costs (41%), achieve improvements in productivity (41%), expand and/or improve their current range of services (36%) and encourage their existing clients to buy more services (34%).

More than a quarter (28%) cited the opportunity to launch their services in new international markets.

Given their relative pessimism over the UK economy, this strategy likely reflects a desire to reduce their reliance on UK earnings.

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### Do you expect the UK services sector to continue to grow over the next two years?

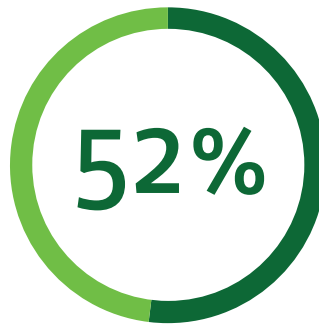


### Hazards and headwinds

Businesses also told us of perceived threats to their business in the next 12 months, the biggest of which was the UK leaving the EU with no deal (48%).

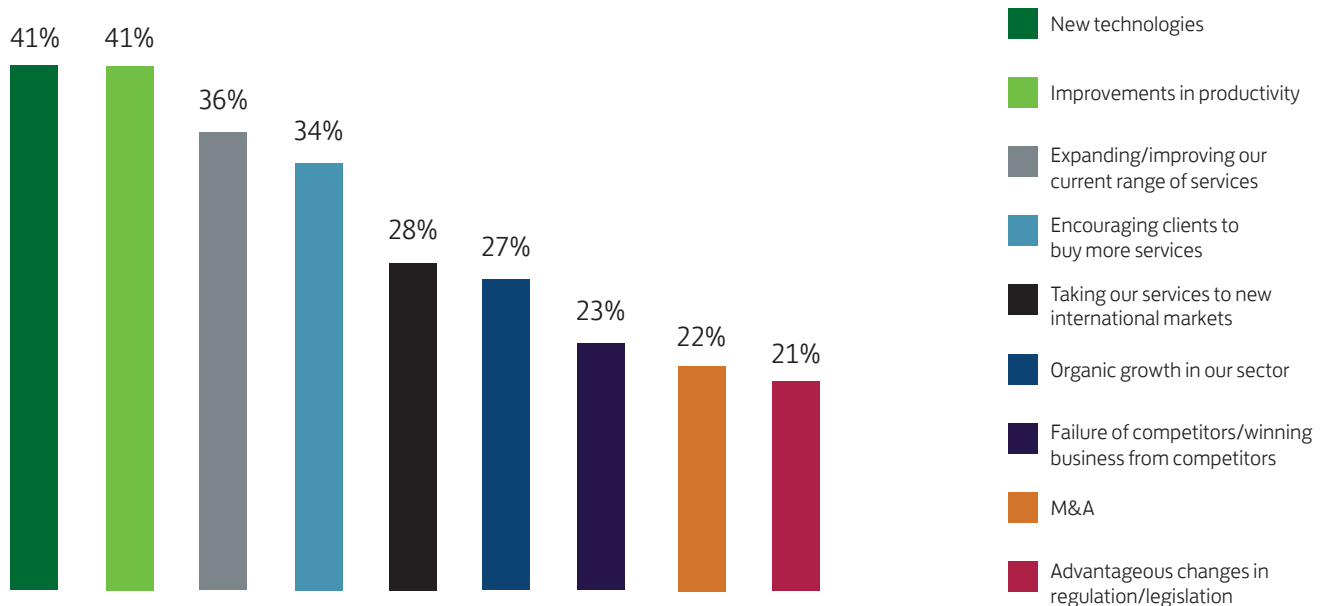
Indeed, close to half (47%) of those surveyed said they had delayed investment decisions because of the ongoing uncertainty around the UK's departure from the EU.

Other threats were largely external and geopolitical, including the prospect of a recession (47%), economic volatility (41%), a general election and/or change to the ruling party in the UK government (38%) and trade disputes between major economies (36%).



expect their net headcount to increase over the next five years

### What do you see as opportunities to grow your turnover in the future?



# Technology & Disruption

**The services industry is one that has already seen significant disruption, fostered by new technologies.**

Disruptive new entrants continue to emerge with the aim of displacing established market-leading businesses and products, with varying degrees of success.

For example, technology has enabled accountancy firms to automate numerous processes that would previously have been conducted manually, bringing cost, accuracy and efficiency benefits.

It's incumbent on businesses to be aware of the threats and opportunities that new technologies present, and this report suggests that service businesses are indeed alert to the potential they offer.

## Driven to invest

We've seen that new technologies are regarded as the biggest opportunity to grow turnover, cited by 41% of respondents.

And businesses report both proactive and reactive drivers for investing in tech.

They told us that they are investing in IT with the expectation of achieving better operational efficiencies by improving the way they use management information (57%), improving the quality of the service they provide (51%) and providing new or superior services (50%).

They are also investing to improve their cybersecurity (54%) – a prudent approach given that many services businesses hold sensitive data about their customers.

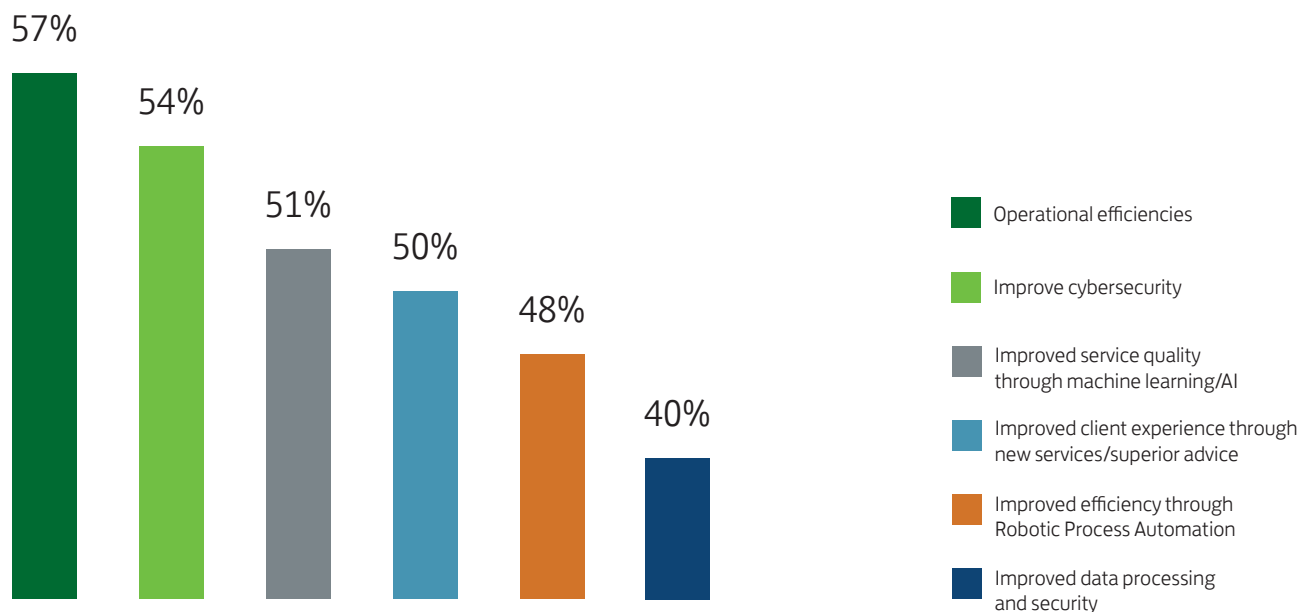
As such, the sector is a common target for cyber criminals. In 2018, UK financial services businesses saw a fivefold rise in data breaches on the year before, for example<sup>5</sup>.



It's incumbent on businesses to be aware of the threats and opportunities that new technologies present, and this report suggests that services businesses are indeed alert to the potential they offer.



## Thinking about your planned IT spending, what are your top priorities?



<sup>5</sup> - <https://www.ccta.co.uk/cyber-attacks-on-uk-financial-services-sector-rise-fivefold-in-2018/>

### Safe and cybersecure

Reassuringly, four in five (82%) of those we spoke to said that their business is well prepared to protect itself and recover quickly from a cyberattack, though that does leave almost a fifth (18%) who do not feel cybersecure.

This is perhaps concerning given the number of high-profile attacks that have occurred recently, and the severe operational, reputational and financial implications. However, it may also reflect the growing and rapidly-evolving nature of the cyber threat, which is causing businesses to feel vulnerable.

With this in mind, one might conclude that the proportion of respondents who told us they plan to invest in protecting themselves from cybersecurity threats in the next year (70%) should be higher.

### Automation and innovation

At the same time, two thirds (67%) of businesses said they are planning to adopt or expand their use of disruptive technologies like AI and automation.

When we asked whether they thought advancements in these fields were driving innovation, four in five (80%) agreed.

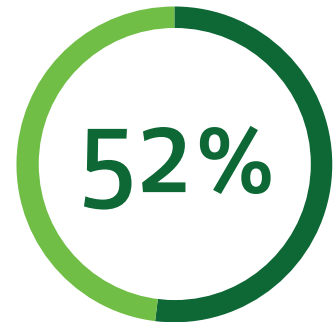
Just over half (52%) said they had already automated some work, while a third (33%) plan to do so within the next five years.

They're doing this to cut costs (67%) and improve client services (60%), but it's also encouraging to see businesses cite a desire to focus their people on higher-value roles (43%) as a driver.

While there is obvious concern about the potential impact of automation on employment, the majority of businesses (52%) who are working to adopt, develop or expand these kind of technologies told this report that they would maintain or grow their workforce, though 43% said they expect to employ fewer people over the next three years.

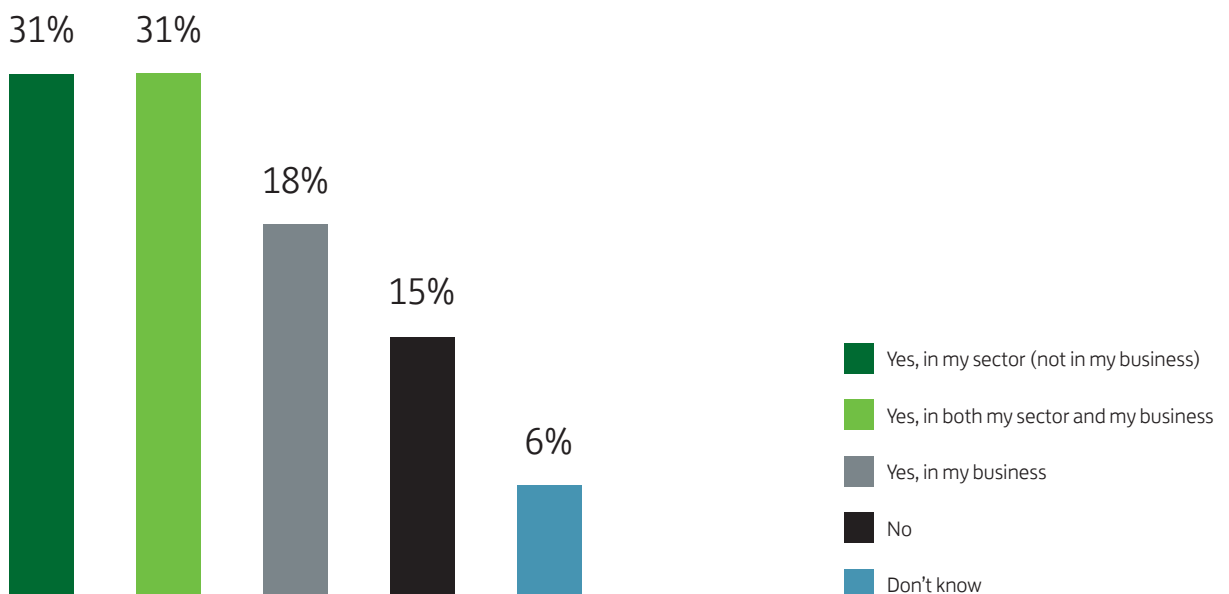
When it comes to technology, businesses aren't looking for off-the-shelf solutions. Some 49% are investing in the development of their own proprietary software with the aim of boosting efficiency (74%), improving staff productivity (54%) and enhancing margins (52%).

Investments like these are helping to support innovation and they have helped the UK become a world leader in emerging fields including fintech and law-tech.



have already begun to automate some processes

### Do you think investments in AI and automation are driving innovation?



## Skills & Recruitment

**More than 26 million people currently work in the UK service sector<sup>6</sup>, but there remains considerable uncertainty around the number and type of jobs it will support in years to come.**

New technologies hold the potential for simple tasks to be automated, like using algorithms to make underwriting decisions and performing these kind of functions more quickly, accurately and efficiently.

We've seen that two thirds (67%) of businesses are exploring the potential of technologies like AI and automation, but businesses don't seem to be adopting automation with the intention of cutting jobs.

Indeed, the balance of businesses surveyed (52%) expect to grow their headcount over the next five years and automation can open the door for the creation of more highly-skilled, strategic roles that command higher wages.

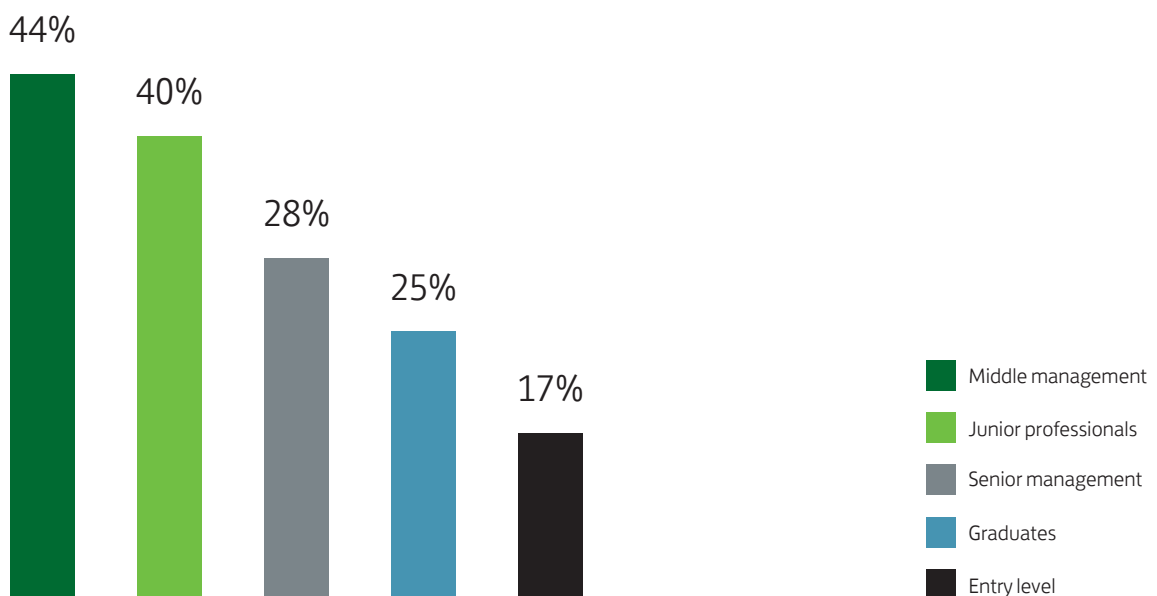
However, this could hold challenges of its own, especially as some businesses in the sector already seem to be experiencing issues when finding staff with the skills they need.



...businesses don't seem to be adopting automation with the intention of cutting jobs.



### At what level of your business do you believe there is a skills shortage?



### Recruiting and retaining

More than a third (39%) said the number of unfilled roles in their business had increased in the past year and only a quarter (24%) said they hadn't experienced any difficulties recruiting.

There was some significant variation among industry subsectors, which we will explore elsewhere in this report.

Unsurprisingly, there is a clear correlation between those roles which have proved most difficult to recruit for in the past year and the roles where businesses now say they have a skills shortage.

Skills gaps were said to be biggest among middle management (44%) and junior professionals (40%), which are also the roles most businesses are struggling to recruit for (30% and 28% respectively).

Difficulties retaining staff were also reported, which were again highest among middle management (31%) and junior professionals (28%).

Just a fifth (22%) reported having no difficulties retaining the skilled staff they need.

### Increasingly agile

Only a minority of businesses said they had sought to bridge this skills gap by employing temporary staff: just 28% had taken on more contract workers while 15% had hired staff on

zero hours contracts.

Rather, businesses are responding with a range of strategies to make themselves more attractive as employers, from offering flexible working practices to benefits in kind and financial incentives.

They reported an average salary increase for someone moving from a junior role to a mid-level role is 12%, while those moving up to a senior role can expect to see their wage packet boosted by an average 14%.

More than three quarters (77%) also believe that offering agile working practices will help to attract and retain talent.

To that end, they see potential in giving staff the option to work from home (68%), work flexible hours (61%) and providing more flexible office spaces (38%), as well as hot-desking (30%), only 14% see unlimited holiday allowance as an attractive perk to offer staff.

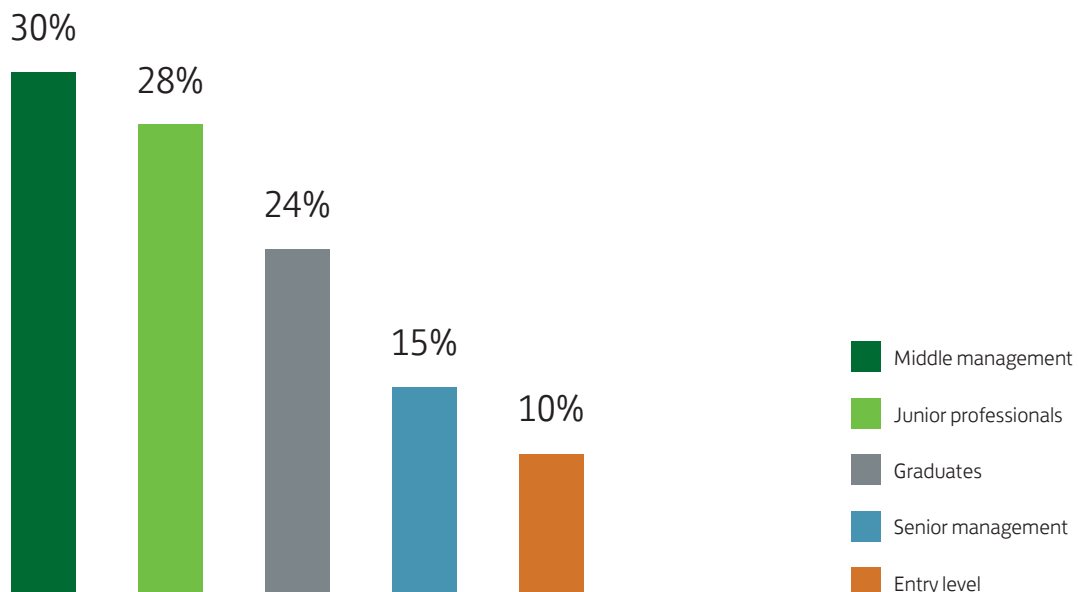
More than half (58%) are offering leave of up to a year for those wanting to take a sabbatical or career break, while over three quarters (77%) offer paternity leave options that exceed the legal minimum of two weeks.

Two in five (41%) said they felt that being an equity partner-owned business such as an LLP makes organisations a more attractive place to work.



think agile working practices are important to attract and retain talent

### At what level of your business have you found it difficult to recruit over the past 12 months?



# Diversification & International Expansion

**We've seen that UK services businesses hold robust growth ambitions, but also that they recognise a range of potential headwinds to their future prosperity.**

Diversification is well understood as a means to reducing risk, while also yielding long-term returns.

As such, it should be no surprise that more than three quarters (76%) of businesses told us that they have already moved to diversify into areas outside their main market in the past year or hold plans to do so in the year ahead.

It seems this activity is accelerating, with 45% of those businesses saying their diversification is complete, while 55% said it forms part of their future plans.

Almost half (48%) said they foresee taking their services into any or new international markets in the next 12 months.

Of them, a third (33%) hold ambitions to expand internationally by using strategic mergers and acquisitions to establish a foothold in new territories in the next year, while more than half (54%) have already done so.

## Expansion and ambition

Of those businesses pursuing international expansion via M&A, over half (54%) have already done so in the past year, while a third (33%) plan to in the next year.

This route may partly reflect some businesses' preparations for the UK's departure from the EU, which could impact their access to European markets going forward.

Acquiring a business within the bloc is a way of securing an operational presence that can preserve access to those markets.

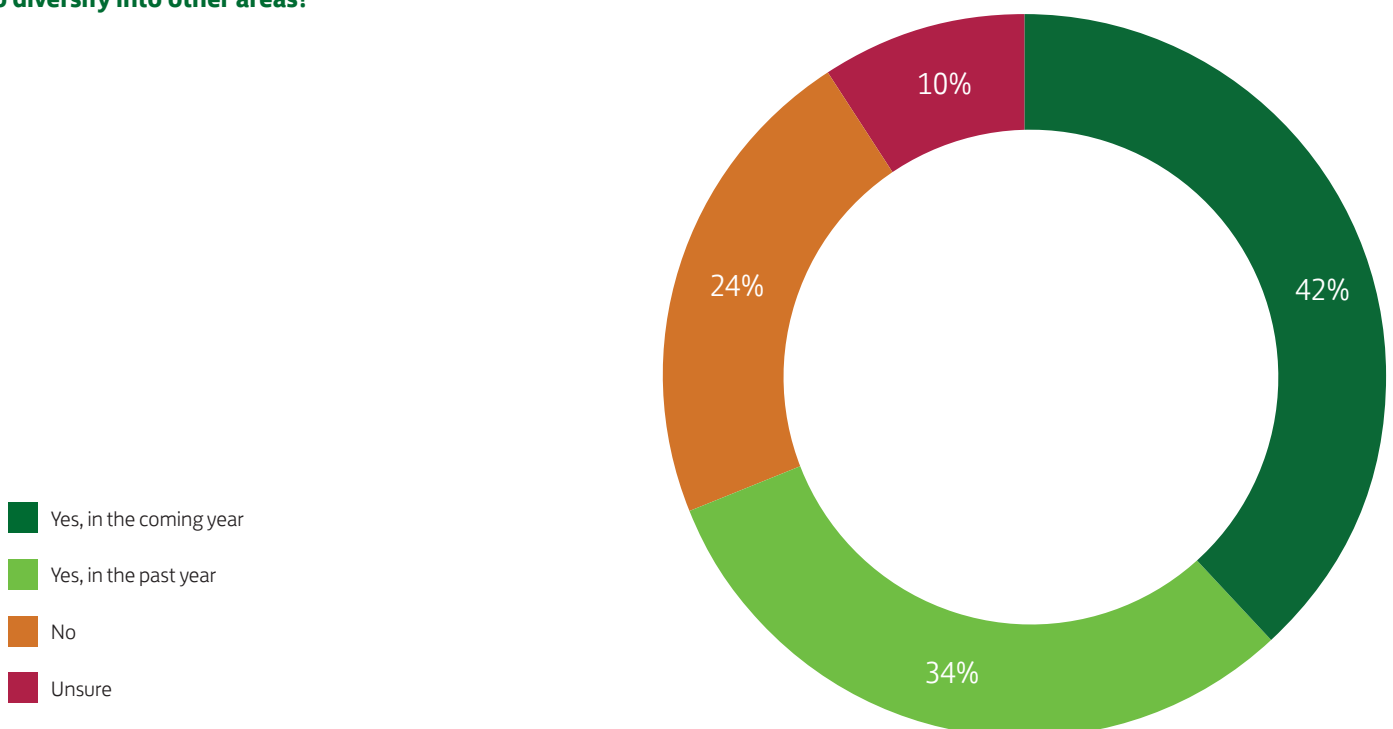
But it also reflects service businesses' overall bullishness, particularly about their own prospects, and their growth ambitions.

Indeed, when we asked businesses why they had chosen the M&A route to international expansion, the top reasons were ready access to new markets (60%), to offer different or better services (54%) and a change in strategy (40%).

Businesses also flagged the prospect of securing new or better talent (35%) and an ambition to grow market share to guard against becoming an M&A target themselves (22%).

They still see the EU as the market holding the greatest growth potential (44%), followed by the Far East (32%), including Japan and Korea, and China (31%).

**Have you in the last year, or do you plan in the next year, to diversify into other areas?**



### A specialised service

M&A is a well-established route to achieving many of businesses' stated growth strategies, including accessing new technologies to improve operations and/or reduce costs (41%), expanding and/or improving their current range of services (36%) and launching their services in new international markets (28%).

But some businesses are taking an entirely opposite tack, reducing the number of services that they provide in order to specialise.

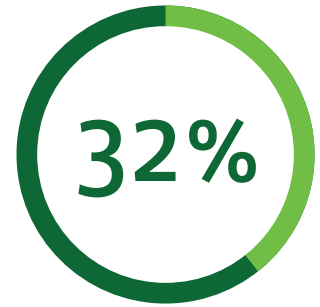
Almost a third (32%) told us that they had either reduced the amount of services they provide in the last year, or plan to in the coming year.

This 'fewer, bigger, better' strategy means focusing on higher value activities and market penetration.

It can pay dividends for service businesses with a well-regarded area of expertise, enabling them to build a loyal customer base and grow market share while ensuring they are not overstretched.

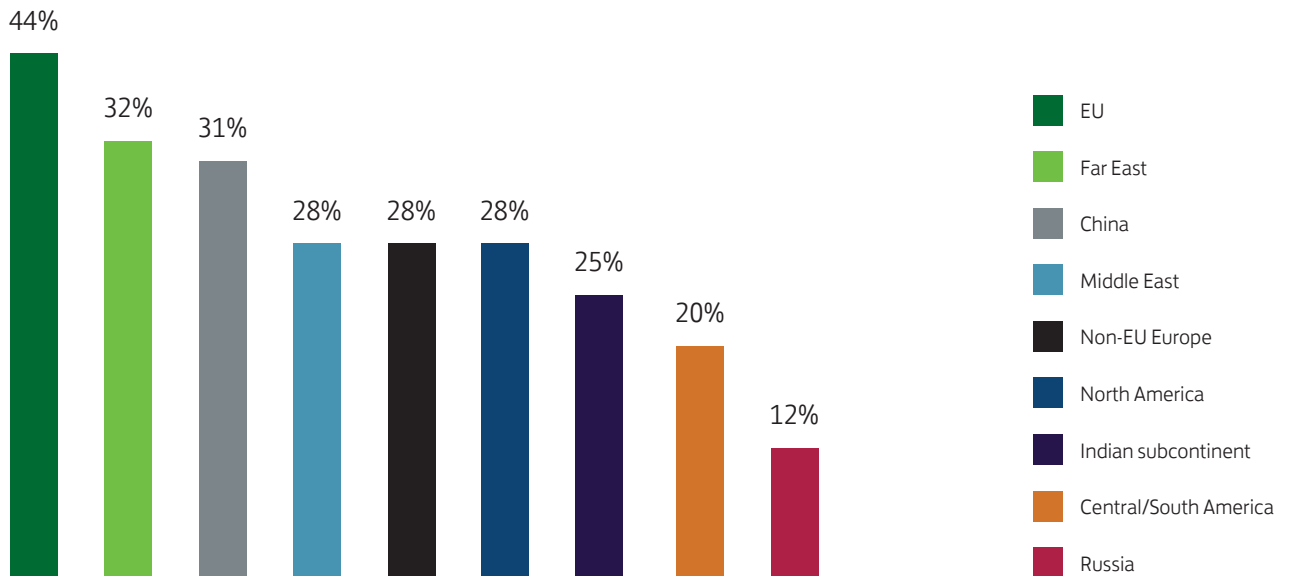


... it should be no surprise that more than three quarters (76%) of businesses told us that they have already moved to diversify into other areas outside their main market in the past year or hold plans to do so in the year ahead.



have reduced or plan to reduce the services they provide

### Which international markets do you think offer the most potential?



# Focus on Professional Services



While they are important drivers of prosperity, they are also facing up to uncertainties over their global position going forward.



**In this report we are choosing to shine a light on one of the most important subsectors of the UK service sector.**

The UK's professional services businesses, including legal, accounting, management consultancy, architecture and more, enjoy a glowing global reputation and generate a substantial trade surplus, as well as being significant employers.

Professional and business services contribute £186 billion to the UK economy every year and support 4.6 million jobs<sup>7</sup>.

While it is an important driver of prosperity, like so many industries, it is also facing uncertainties over its global position going forward.

In particular, some businesses face significant potential disruption to their activities in Europe after the UK leaves the EU.

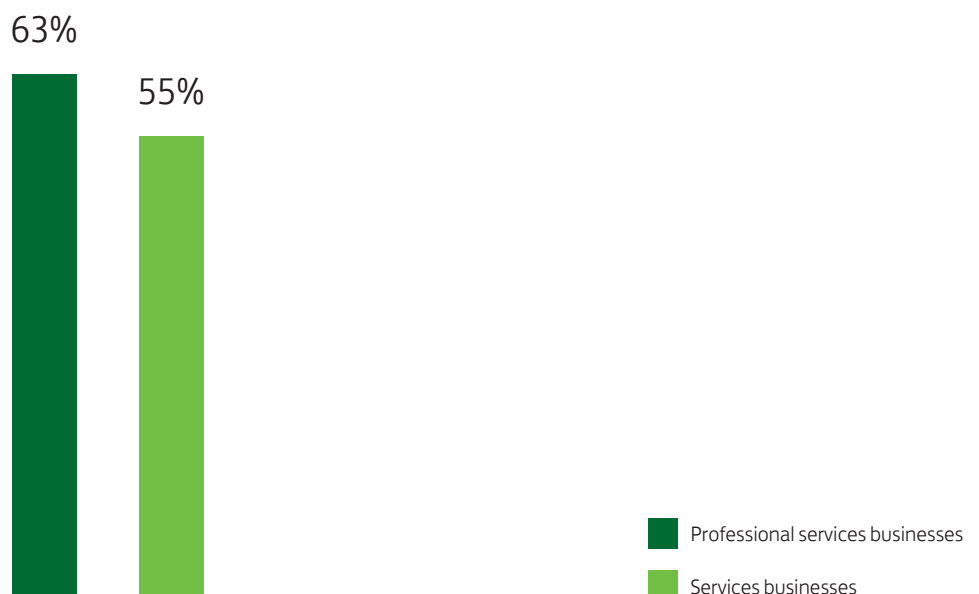
## Positive potential

Despite this, a healthy 63% of professional services businesses expect the UK service sector to keep growing over the next two years, against 55% in the wider service sector.

That was echoed in professional services businesses' outlook for their own growth prospects, with 83% forecasting an increase in turnover over the next five years, against 74% of service businesses generally.

The difference is also apparent in professional service businesses' job creation plans, with 66% expecting headcounts to increase over the next five years, compared with just 52% of all service businesses.

**I expect the UK services sector will continue to grow over the next two years.**



<sup>7</sup> - <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Sectoral%20Analyses/28-Professional-and-Business-Services-Report%20.pdf>

### Prospects and pitfalls

So why is sentiment so robust in the professional services sector?

One potential explanation is businesses feel better prepared for future challenges because far more of them have already moved to de-risk their business by diversifying their service provision.

Two in five (41%) professional services businesses told us they had diversified in the last year, against an average 34% in the wider service sector.

But professional services businesses are finding it harder to recruit skilled staff, with 88% reporting recruiting difficulties in the last year, against 76% of all services providers.

And service businesses foresee greater potential for technology to boost their fortunes, with 41% saying it provides the best opportunity to grow turnover, against a third (34%) of those in professional services.

Given the diverse opportunities and challenges faced by the sector, its future will be watched with great interest around the world.

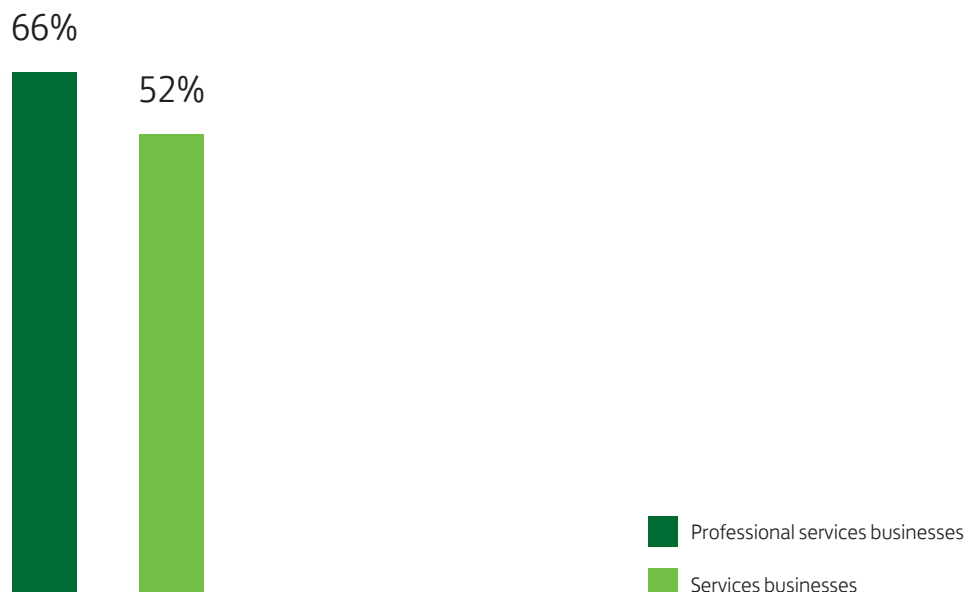


Cybercriminals are becoming ever more adept at targeting vulnerabilities within organisations and the threat is constantly evolving.



of professional services businesses report recruiting difficulties in the last year

### My firm's net headcount will increase over the next five years.



# Closing statement



**Chris Sood-Nicholls**

Managing Director,  
Head of Professional Services,  
Large Corporates,  
Lloyds Bank Commercial Banking



**Allan Ramsay**

Managing Director,  
Head of Business Services,  
Large Corporates  
Lloyds Bank Commercial Banking

## **The services industry is vitally important to the UK's ongoing prosperity.**

While the sector faces a number of external uncertainties, it is far from unique in this and it is reassuring to see that businesses are largely confident that they will keep on surviving and thriving for years to come.

There will, no doubt, be challenges, but this report shows that they are still showing the kind of enterprise, ambition and expertise that they have always been known for.

Businesses are working to ensure they are prepared for whatever the future may bring, recruiting the right people, investing in the best technological solutions and developing the products and services that will drive their success.

They are building robust, resilient businesses with global potential, that will maintain Britain's envied position as a global services hub.

At Lloyds Bank, we are proud of the support we have provided for businesses in the service industry over many decades.

The research we commission is designed to inform how we continue to support the industry as effectively as we can, but we also hope it will help businesses across the country in their strategic decision-making.

The clear message to businesses is that our specialist teams are by your side with the resources and knowledge you need to achieve your full potential.



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### Methodology

To gather representative data, financial decision makers at a cross section of 200 services businesses with an annual turnover of £100m+ were surveyed in England, Scotland and Wales. Online interviews were conducted by BVA BDRC via its business access panel. Fieldwork was conducted 15th July to 24th July 2019.

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