



NatWest Sustainable Business Tracker

NatWest

Two-thirds of UK SMEs indicate that rising business costs will hold back their climate action in 2023

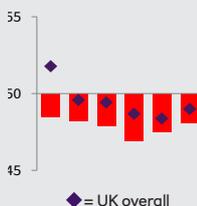
NatWest SME Recovery PMI

48.1

Sep: 47.9

Business Activity Index

Oct '22 - Dec '22



NatWest SME Sustainability PMI

39%

Sep: 39%

Key findings

SMEs cite increased cost inflation as the biggest obstacle to climate action in the next 12 months

Difficulty measuring carbon footprint and staff skills shortages also seen as major constraints

Prioritisation of sustainability at SMEs remains subdued compared to its peak in June 2022

3 in 4 large companies report low carbon energy consumption as a high priority for 2023

Planned investments in solar panels, battery storage and electric vehicles widely reported

The NatWest Sustainable Business Tracker is a quarterly report, designed to monitor business performance and sustainability actions at UK enterprises with 1-249 employees. Results are compiled from responses to S&P Global UK Purchasing Managers' Index[®] (PMI[®]) surveys.

The latest report includes a special feature on obstacles to climate action in 2023.

UK SMEs experienced a challenging end to 2022, with business activity falling for the sixth month running amid shrinking demand and severe pressure on customer budgets from rising inflation. At 48.1 in December, the headline All-Sector Business Activity Index pointed to a modest reduction in output volumes at UK SMEs. The index was up from 47.5 in November, but still below the crucial 50.0 no-change threshold.

SME construction companies experienced a particularly sharp drop in output (index at 45.8) as higher borrowing costs and worsening housing market conditions led to the fastest fall in business activity since May 2020. In contrast, SME manufacturers and service providers pointed to slower reductions in output volumes.

A common theme reported by survey respondents was intense pressure on margins due to higher energy, raw material and staff costs, alongside more subdued pricing power. December data pointed to another steep increase in average cost burdens at UK SMEs, despite the rate of inflation moderating to its lowest since April 2021.

The challenging economic outlook and worries about persistently high inflation continued to hold back sustainability plans among SMEs, according to the latest NatWest Sustainability PMI survey. At 39% in December, the headline index measuring the percentage of SMEs

intending to prioritise climate action over the next 12 months was unchanged since September and the joint-lowest since the survey began in February 2020.

Only two of the five components of the Sustainability PMI picked up in December; cleaner business processes (48%, up from 46%) and the number of SMEs citing sustainable product launches (26%, up from 25%). The biggest fall was the portion of firms citing monitoring supply chain sustainability as a high priority (27%, down from 30%).

There was a mixed picture for low carbon energy consumption plans. SMEs signalled a drop in prioritisation (42%, down from 44%). In contrast, some 77% of large enterprises reported low carbon energy consumption as a high priority for 2023. This index was up from 76% and the highest since the survey began in February 2020. Survey respondents widely commented on planned investments in solar panels and battery storage on site, as well as support for electric vehicle infrastructure.

Finally, we asked UK businesses to report on the major obstacles to action on environmental sustainability over the course of 2023. Around two-thirds of SMEs (68%) cited rising business costs as a constraint on climate action in the next 12 months. Manufacturers were most likely to report hikes in cost burdens as an obstacle (76%). The second-biggest challenge for SMEs was difficulty measuring their carbon footprint (29%), followed by a lack of cost reduction opportunities (24%) and skill shortages (22%). This highlights that a slowdown in global inflationary pressures and easing supply shortages, alongside sustained investments in staff training, could emerge as factors that help to reinvigorate sustainability plans at UK SMEs in 2023.

[Contents](#)

[Foreword](#)

[Sustainability actions](#)

[Obstacles in 2023](#)

[Services recovery](#)

[Manufacturing recovery](#)

[Construction recovery](#)

[Contact](#)

Foreword



It's concerning that businesses are saying that they're experiencing challenges measuring their carbon footprint, and that this is standing in their way to becoming more sustainable. There are a wealth of tools out there to help companies with this, and a lot of them are free.

"At NatWest we have launched our free [Carbon Planner](#) tool which helps businesses measure their carbon output and recommends ways to identify potential cost and carbon savings. All NatWest Business Banking colleagues have also been trained by the Universities of Edinburgh and Cambridge in helping businesses with their carbon reduction. These are just some of the free and easy solutions that NatWest offers companies to become more sustainable.

It'll come as no surprise that UK SMEs experienced a difficult end to 2022, with business activity falling for the last sixth months amid shrinking demand and severe pressure on customer budgets from rising inflation.

What may be surprising is the finding that 29% of SMEs said that they found it difficult to measure their carbon footprint. This was also an issue for large businesses (28% of respondents). Many firms commented on a lack of information about carbon emissions across their international supply chain, especially in relation to basic materials sourced from abroad. It is well known that what cannot be measured cannot be managed, so it rests with industry, Government and environment charities to step up to help these businesses, including publicising the huge range of support out there already to help companies measure and reduce their carbon emissions.

Overall, the challenging economic outlook and worries about persistently

high inflation continued to hold back sustainability plans among SMEs. The percentage of SMEs (39%) intending to prioritise climate action over the next 12 months was unchanged since September and the joint-lowest since the survey began in February 2020.

Only two of the five components of the Sustainability PMI picked up in December; cleaner business processes (48%, up from 46%) and the number of SMEs citing sustainable product launches (26%, up from 25%). The biggest fall was the portion of firms citing monitoring supply chain sustainability as a high priority (27%, down from 30%).

A common theme reported by survey respondents was intense pressure on margins due to higher energy, raw material and staff costs, alongside more subdued pricing power. Around two-thirds of SMEs (68%) cited rising business costs as a constraint on climate action in the next 12 months. This means there is a strong demand for businesses to be supported in prioritising sustainability and recognising its growth potential.

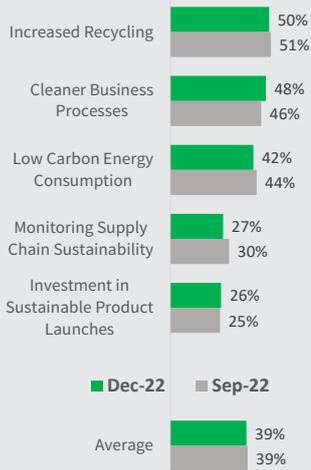
As the UK's largest business bank, to help support SMEs to take advantage of the growth opportunity that lies ahead, we've committed to lending £100 billion of Climate and Sustainable Funding and Financing by the end of 2025. We'll also continue to focus on advice, education, coaching and products that can help SMEs contribute to cutting the UK's carbon emissions by half; and we encourage SMEs and business leaders who need support and guidance to go greener to speak to one of our Relationship Managers or visit natwest.com to discover how we can help.

Andrew Harrison
 Head of Business Banking
 NatWest

SME Sustainability PMI: Actions in the next 12 months

Which of the following actions, if any, is your company prioritising to improve environmental sustainability in the next 12 months?

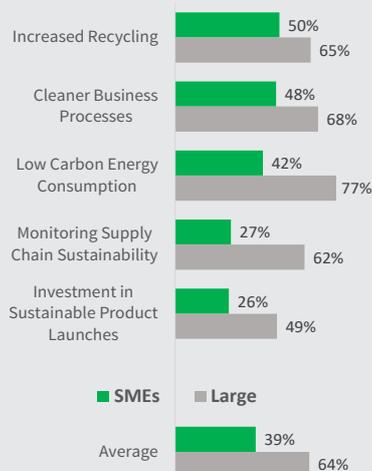
UK SME Sustainability PMI: Actions
Percent reporting 'high priority'



Top changes in percent of SMEs reporting 'high priority' (figures rounded)



SMEs vs. Large Companies (Dec-22)
Percent reporting 'high priority'



Sustainability plans remain subdued amid challenging economic conditions

In this section we look at the actions on sustainability that UK SMEs are prioritising during the year ahead. The headline NatWest Sustainability PMI reading was unchanged from September's record-low, revealing plans by SMEs to prioritise sustainable goals remained the most muted since the survey began in February 2020.

The percentage of small and medium-sized enterprises (SMEs) planning to prioritise sustainability action for the next 12 months was unchanged from September's record-low of 39%. While again, larger companies were more inclined to prioritise sustainability actions (64%, up from 63% in September).

Across SMEs, sectoral difference ebbed during December to the smallest on record. Manufacturing SMEs were only slightly more inclined than their service sector counterparts to prioritise sustainability plans in the coming year.

Challenging economic conditions, including high inflation, energy market turmoil, and rising borrowing costs, were widely reported as constraints on sustainability action in 2023.

Recycling remains key priority for half of all SMEs

Since survey began in February 2020, SMEs continue to strongly prioritise increased recycling over the course of 2023. Surveyed businesses cited plans to reduce single use plastics and packaging, as well as develop products using recyclable materials. That said, the proportion of SMEs citing recycling as a high priority action shrunk from 51% in September, to 50% in December, signalling a fresh record-low.

Similarly, the percentage of larger firms planning to prioritise recycling in the next 12 months also dropped to 65% in December from 66% in September. While the change was minimal, the latest reading edged closer to the record-low

registered in September 2021.

Only two of the five sustainability categories showed improvement in December

Of the five sustainability categories, only cleaner business processes and investment in sustainable product launches registered a rise in prioritisation among SMEs during December. Ticking up to 48% in December from September's record-low of 46%, cleaner business processes remained the second-highest priority for SMEs.

An improvement - albeit smaller - was also noted in plans to invest in sustainable product launches during 2023. More than a quarter (26%) of SMEs had plans to prioritise. While the reading was the highest since the survey began in February 2020, investment in sustainable product launches was still the least cited action of the five broad categories.

A rise in supply chain monitoring expected by larger firms

While SMEs reported a slight downgrade in plans to monitor supply chain sustainability during December (at 27%, down from 30% in September), plans to prioritise across larger firms rose from 56% to 62%. Moreover, strong gains were seen across both large manufacturers and service providers. The rise in prioritisation may reflect an ongoing easing of global supply chain pressures.

Large firms lead the way in terms of low carbon energy plans

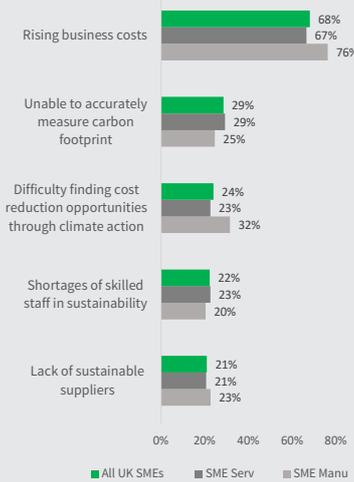
Amid the ongoing European energy crises, the proportion of SMEs planning to prioritise low carbon consumption was 42% in December, much lower than the record-high last June (52%). Many firms nonetheless commented on planned investments in solar panels and battery storage. Large enterprises were especially upbeat about the transition to low carbon energy consumption, with 77% citing this as a high priority for 2023 (a new record high).

Special Question: Sustainability obstacles in 2023

Which of the following are the largest obstacles to your business in becoming more sustainable in 2023? (Select all that apply)

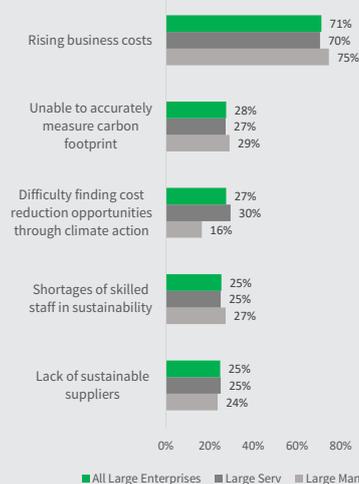
UK SMEs

Top five obstacles



Large UK enterprises

Top five obstacles



Rising business costs seen as greatest obstacle to increased sustainability at UK SMEs in 2023

In this section, we examine the obstacles to becoming more sustainable faced by UK SMEs.

Of the challenges surveyed, firms identified rising business costs as most harmful to their aims of becoming more sustainable. Around 68% of all UK SMEs highlighted that greater operating expenses are likely to stymie progress towards sustainability in 2023.

Higher cost burdens were more likely to be reported as a constraint on sustainability goals at manufacturing SMEs than service providers.

The latest edition of the NatWest Sustainable Business Tracker included a special question about obstacles to progress on sustainability.

We asked UK businesses to select their biggest challenges to becoming more environmentally sustainable in 2023.

Cost inflation set to put pressure on sustainability goals

Over two-thirds of UK SMEs (68%) highlighted that greater operating expenses are likely to prove an obstacle to becoming more sustainable in their business activities in 2023, according to December data.

Concerns about business expenses were broad-based by sector. Moreover, firms of all company sizes noted rising cost burdens as the biggest factor that could hamper sustainability plans for the year ahead.

Hikes in energy and material prices were especially pertinent factors for SME manufacturers, with 76% highlighting higher costs. SME manufacturing firms were also especially likely to report difficulty finding cost reduction opportunities through climate action (32%) and falling customer demand (29%) as obstacles to sustainability

initiatives.

Large firms highlight a lack of sustainable suppliers and skills shortages

The obstacles to becoming more sustainable differed between SMEs and large firms, with the former much more likely to report difficulty navigating government regulation. Manufacturing SMEs were especially concerned about securing investment and funding (25%).

Large firms commonly cited constraints on their sustainability goals from a lack of sustainable suppliers (25%) and staff skills shortages (25%). Devoting greater resources to increasing the skills of current employees, alongside near-shoring supply chains were often suggested as factors likely to combat these obstacles.

Businesses seek guidance on monitoring carbon emissions

SMEs ranked difficulties measuring their carbon footprint (29%) as an important obstacle to future sustainability plans. These challenges were also the second-biggest issue cited by large businesses (28% of respondents). Many firms commented on a lack of information about carbon emissions across their international supply chain, especially in relation to basic materials sourced from abroad.

Survey respondents also reported a range of positive factors set to help reduce their carbon footprint in 2023, including applications for grants for solar panels, increased electric vehicle take-up and hopes of enhanced government support for energy saving schemes.

The full list of obstacles listed by the survey were; rising business costs, lack of sustainable suppliers, shortages of skilled staff in sustainability, unable to accurately measure carbon footprint, falling customer demand, difficulty finding revenue opportunities through climate action, difficulty finding cost reduction opportunities through climate action, lack of availability of investment/funding, government regulation and sustainability is not a priority for my business.

SME Recovery PMI®: Service Sector

Service sector activity decline eases to slowest in four months

SME service providers in the UK (firms with less than 250 employees) signalled a further contraction in business activity at the end of 2022. The respective seasonally adjusted index picked up from 47.7 in November to 48.6 in December, as service sector businesses recorded the slowest decline in output for four months. The slowdown in SME output remained sharper than that at larger firms.

Client demand remained weak, as new orders fell for the seventh successive month at SME service providers. Although the pace of the downturn in new business softened in December, firms often mentioned that lower output and new orders stemmed from postponements or cancellations of customer orders following the pressure of inflation on disposable incomes. Companies noted a move towards essential purchases and spending among clients in an effort to bring down outgoings.

Employment nears stabilisation as growth slows again

UK SME service providers continued to indicate an expansion in workforce numbers during December, despite the rate of job creation slowing for the fourth month running. The pace of employment growth was only marginal and the softest in the current sequence of increase that began in March 2021.

Although some firms noted hiring was in response to staff shortages and plugging skills gaps in workforces, others stated that the non-replacement of voluntary leavers and other cost-cutting initiatives reflected higher operating costs and lower business activity.

Slowest uptick in input costs since August 2021

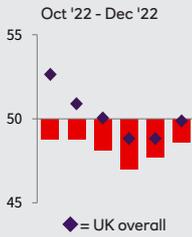
Service sector SMEs in the UK recorded a marked rise in input costs at the end of 2022. Higher wage bills, increased fuel and energy costs, alongside hikes in supplier prices reportedly drove inflation.

Although historically elevated, the rate of cost inflation eased to the slowest since August 2021. Output charges, meanwhile, rose at one of the softest paces for over a year.

Optimism at five-month high

Business confidence among UK service sector SMEs picked up in December, and was the strongest for five months. Output expectations for 2023 were, however, historically subdued as recession and inflation concerns dampened firms' outlook for output over the year ahead. Although greater than at SMEs, economic uncertainty and pressure on customer spending was also reflected at larger firms where optimism was also relatively muted.

Business Activity Index



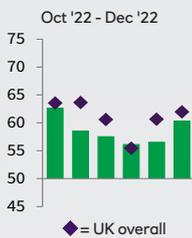
Employment Index



Input Prices Index



Future Activity Index



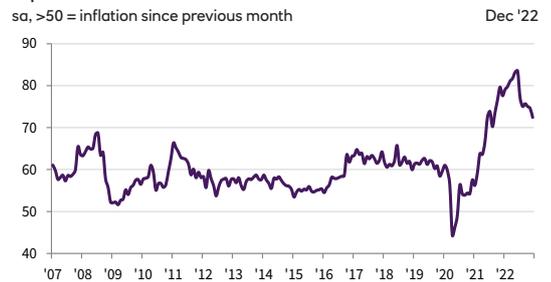
Business Activity Index



Employment Index



Input Prices Index



Future Activity Index



SME Recovery PMI[®]: Manufacturing Sector

Manufacturing downturn continues in December

SME manufacturing firms operating in the UK reported a further decrease in output during December, resulting in the sixth consecutive monthly decline in production. Up from 46.1 in November to 46.8 in December, the latest Business Activity Index reading signalled that the rate of reduction eased at the end of the fourth quarter to the slowest since July. Nonetheless, the decrease in output was strong overall. The latest fall was often linked to shortfalls in demand.

The downturn in factory output was accompanied by a sharp and accelerated contraction in new orders, as inflation and higher interest rates stretched client appetite.

Workforce numbers drop further

UK SME manufacturing employment contracted for the third straight month in December. Where a fall was noted, businesses either actively lowered headcounts, or delayed the replacement of voluntary leavers. That said, while the rate of job shedding gathered pace from November, it was marginal overall, with some companies continuing to highlight success in securing workers.

Input price inflation slowest in over two years

UK SME goods producers faced another rapid rise in input prices during December. High energy and material costs exerted an upward push on operating expenses. However, lower demand and reports of easing supply pressures helped to soften the rate of inflation. Although historically elevated, the latest uptick in costs was the weakest since November 2020.

The notable slowdown in average cost burdens was reflected in a further moderation in average prices charged, which rose at the weakest pace since February 2021.

Sentiment improves to six-month high, but remains historically muted

Despite downbeat demand conditions, sentiment across manufacturing SMEs strengthened further from October's recent low, as the Future Activity Index hit a six-month high. Businesses pinned confidence on plans of investment, new customers and greater demand. Nonetheless, the latest reading posted below the historic series average, revealing some caution in respect to growth prospects as firms cited market uncertainty and recession fears.

Business Activity Index
sa, >50 = growth since previous month
46.8
Dec '22



Employment Index
sa, >50 = growth since previous month
49.4
Dec '22



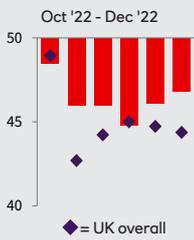
Input Prices Index
sa, >50 = inflation since previous month
64.0
Dec '22



Future Activity Index
>50 = growth expected over next 12 months
65.0
Dec '22



Business Activity Index
Oct '22 - Dec '22



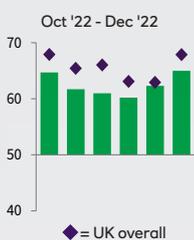
Employment Index
Oct '22 - Dec '22



Input Prices Index
Oct '22 - Dec '22



Future Activity Index
Oct '22 - Dec '22



SME Recovery PMI[®]: Construction Sector

Steepest drop in activity since May 2020

SMEs in the construction sector signalled a decline in business activity for the sixth successive month during December. At 45.8, down from 48.4 in November, the seasonally adjusted Business Activity Index pointed to the fastest pace of contraction since May 2020.

Survey respondents often cited weaker housing market conditions as a factor weighing on construction output at the end of 2022. Subdued customer demand also reflected higher borrowing costs and concerns about the economic outlook.

Employment declines for first time in nearly two years

December data highlighted a reversal of the strong job creation seen among small and medium sized construction companies over the past two years. The latest survey pointed to a marginal fall in employment numbers, with the rate of decline the greatest since January 2021.

Cutbacks to staffing levels reflected weaker order books, fewer pressures on business capacity and uncertainty about the outlook for business activity during the year ahead.

Input cost inflation eases to its lowest since December 2020

Average cost burdens continued to rise sharply in the SME construction sector, as higher energy bills, staff wages and transport costs were passed on by suppliers. However, the worst phase of input cost pressure appears to have passed, as the latest rise in prices paid for construction products and materials was the weakest for two years,

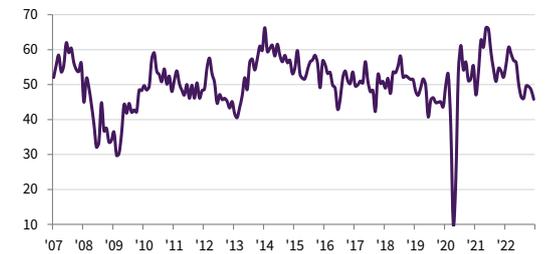
Reports from survey respondents suggested that lower commodity prices and softer underlying demand conditions had helped to alleviate input cost inflation in December.

Business expectations among the weakest for 14 years

The index measuring business expectations for the next 12 months remained in negative territory during December. At 47.3, down from 49.0 in November, the latest reading pointed to the greatest degree of pessimism since May 2020. Moreover, aside from the early stages of the COVID-19 pandemic, the index hit its lowest level since December 2008.

SME construction companies mostly commented on concerns about squeezed household budgets and the impact of rising interest rates on customer demand.

Business Activity Index
sa, >50 = growth since previous month
45.8
Dec '22



Employment Index
sa, >50 = growth since previous month
48.9
Dec '22



Input Prices Index
sa, >50 = inflation since previous month
67.0
Dec '22



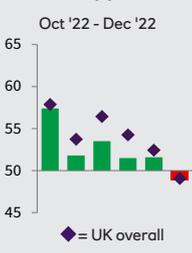
Future Activity Index
>50 = growth expected over next 12 months
47.3
Dec '22



Business Activity Index



Employment Index



Input Prices Index



Future Activity Index



About the NatWest Sustainable Business Tracker

The NatWest Sustainable Business Tracker is a quarterly report designed to monitor business performance and sustainability at enterprises with 1-249 employees.

NatWest Sustainable Business Tracker is based on responses to questionnaires sent to companies with 1-249 employees that participate in monthly UK Purchasing Managers' Index[®] (PMI[®]) surveys compiled by S&P Global.

The panel of around 850 small and medium sized enterprises is stratified by detailed sector, based on contributions to GDP.

SME Recovery PMI[®] survey responses are collected by S&P Global in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of 'higher' responses and half the percentage of 'unchanged' responses.

The SME Recovery PMI[®] indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

Indices are compiled for a range of survey variables, including business

activity, new orders, employment, input costs, prices charged, outstanding business and future activity.

The SME Recovery PMI[®] data for December were collected 6 – 22 December 2022. Historical data are available from January 1998 for the All-Sector SME Business Activity Index.

Manufacturing data are available from January 1992, Services data from July 1996 and Construction data from April 1997.

SME Sustainability PMI[®] data are compiled on a quarterly basis. The latest survey was compiled in December 2022. Companies are asked about the sustainability actions they are looking to prioritise over the next year, and the results are compared against those seen for large companies. The latest survey also monitored obstacles to climate action in 2023.

For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.

Index summary

NatWest SME Recovery PMI[®] data (All-Sector)

sa, 50 = no change over previous month. *50 = no change over next 12 months.

	Activity	New Business	Future Activity	Employment	Outstanding Business	Input Prices	Prices Charged
Jul '22	48.5	48.0	62.8	53.8	48.4	76.4	64.4
Aug '22	48.2	47.6	59.0	54.2	47.4	74.3	63.9
Sep '22	47.9	46.6	57.9	53.1	47.3	74.7	63.0
Oct '22	46.9	45.7	56.2	52.2	48.3	73.9	62.6
Nov '22	47.5	45.7	56.7	51.8	45.4	73.4	60.6
Dec '22	48.1	47.2	59.9	50.4	45.0	70.8	60.3

NatWest SME Recovery PMI[®] data (by sector)

	All-Sector Business Activity	Service Sector Business Activity	Manufacturing Business Activity	Construction Business Activity
Jul '22	48.5	48.8	48.5	46.5
Aug '22	48.2	48.8	46.0	46.0
Sep '22	47.9	48.1	46.0	49.6
Oct '22	46.9	47.0	44.8	49.4
Nov '22	47.5	47.7	46.1	48.4
Dec '22	48.1	48.6	46.8	45.8

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About NatWest

NatWest serves customers in England, Wales and Western Europe, supporting them with their personal, private, and business banking needs. NatWest helps customers from opening student accounts, to buying their first home, setting up a business, and saving for retirement.

Alongside a wide range of banking services, NatWest offers businesses specialist sector knowledge in areas such as manufacturing and technology, as well as access to specialist entrepreneurial support.

NatWest has been running MoneySense, an impartial financial education programme for 5–18 year-olds, for more than 21 years. By the end of 2018, NatWest will help another 1 million young people to understand and take control of their finances.

About S&P Global

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We are widely sought after by many of the world's leading organizations to provide credit ratings, benchmarks, analytics and workflow solutions in the global capital, commodity and automotive markets. With every one of our offerings, we help the world's leading organizations plan for tomorrow, today. www.spglobal.com.

About PMI

Purchasing Managers' Index™ (PMI™) surveys are now available for over 40 countries and also for key regions including the eurozone. They are the most closely watched business surveys in the world, favoured by central banks, financial markets and business decision makers for their ability to provide up-to-date, accurate and often unique monthly indicators of economic trends.

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