COVID-19

A report into its effects on the
UK IT solutions provider sector

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Economists across the globe are drawing comparisons between the current COVID-19 crisis to that of the Great Recession as well as the years following World War II. Many are wondering how a recession of this possible scale will unfold.

For us in the IT solutions provider sector it is important to think about how this will affect hiring strategies and employment across our market, as well as ramifications and consequences for and from end user clients.

Towards the end of 2007 the US Sub-Prime Mortgage market crashed, resulting in the collapse of the US housing market and so plunging the US economy into a recession that lasted for almost 2 years. This crash created a domino effect on global economies, leading to the collapse of banks worldwide and a credit shortage affectionately known as the ‘Credit Crunch’. The effects of the global recession that followed were far-reaching and lengthy, leading to its positioning as the ‘Great Recession’. The UK economy suffered greatly through this period. But to what end?

Well the UK economy contracted for 5 straight quarters, resulting in a fall in the UK GDP by -6.3% over that period; GDP had grown by 20% in the twenty years previous. We had also not seen an unprecedented drop such as -6.3% since the depression following World War I. It took the UK 5 years to recover its GDP to pre-2008 levels, however there were some significant side-effects:

Real earnings (wages adjusted for inflation) decreased steadily until 2013 and have only recently returned to the level seen in 2007.

UK productivity, or output per hour worked, has remained level since 2007, in stark contrast to the previous 11 years where we saw a rise of 21%.

By the end of 2011, 2.7 million people were out of work and searching for employment. The quarterly unemployment rate reached 8.4%, the highest since 1995. Unemployment returned to pre-2008 levels towards the end of 2015 and has continued to fall since.

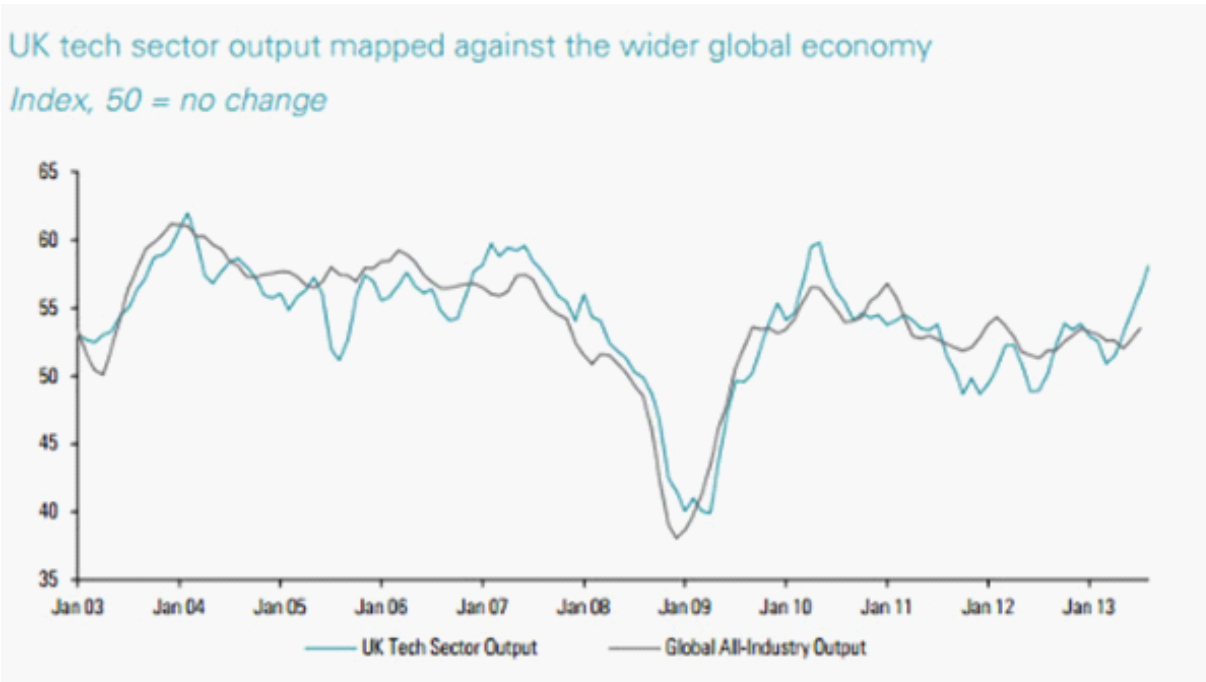
COVID-19

Looking at the years following 2008, it is clear to see a -6% drop in UK GDP will be relatively mild in comparison to the possible ramifications of a post COVID-19 recession.

In 2013 KPMG commissioned Markit Economics to collate financial data for the UK technology industry, providing invaluable insights into the sector's employment and output trends.

The subsequent report shows both the good news and the bad news of a possible impending recession.

Looking at the graph below, we see a major dip in the UK technology sector's output around the time of the Credit Crunch and Great Recession, posting an output index decrease of -17 points between January 2008 and January 2009. This sudden drop mirrors that of all global industry output, dropping by around the same amount over that period.



So what can we take from this report? Well firstly, no matter the shape of the recession we can expect as a result of decreased productivity and trade as a consequence of the COVID-19 pandemic, we will almost certainly see a sudden drop in output as end-user clients shelve projects and concentrate capital on solidifying their business' chances of economic survival.

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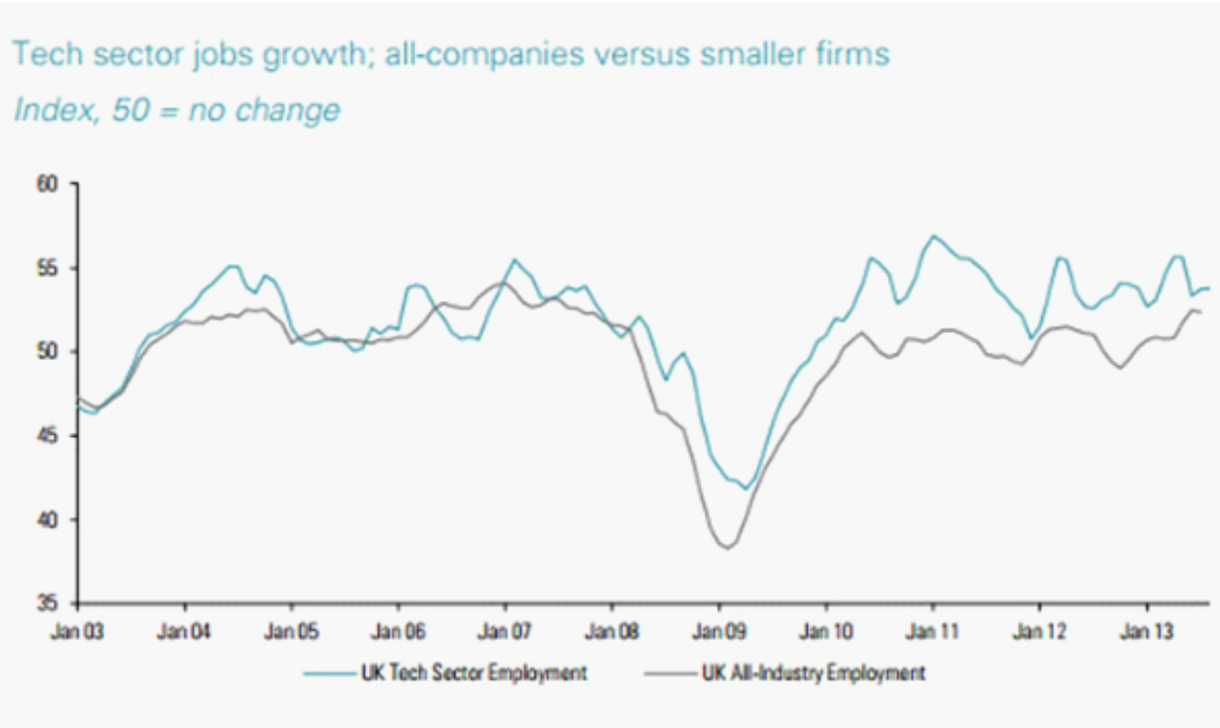
COVID-19

Secondly, however, we can see a bounce back nearly just as sudden as the initial dip. UK technology sector output reached pre-recession levels in early 2010, mirrored once again in a similar rise in global industry output. This speaks to the interconnectivity of industries, and the resilience of the UK technology industry to continue its high output in comparison to other sectors.

This increase in output and activity in the UK technology sector resulted in the growth of employment opportunities and job creation. The graph below shows the growth and decline of jobs in the UK technology sector and that of all UK industry employment. It shows that the UK technology sector's employment growth did not fall as low as the average across all UK industries, as well as recovering faster than the 2010 return of its other UK private-sector counterparts.



There are differences however in the employment trends when looking at the UK technology sector as a whole in comparison to technology businesses with less than 50 staff. The report shows that businesses with over 50 staff returned much faster to pre-recession levels of job creation, however SMEs remained cautious and held on to staff for longer. The most positive takeaway from this is the rising job creation of both large firms and SMEs, which saw employment rise steadily in the years since.

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We can hypothesise that capital-rich technology firms are able to weather the storm of recessions longer than other industries due to their impact on IT services needed to keep 21st Century businesses running. As other industries return from the output dip of recession they are able to continue and begin IT infrastructure projects, meaning agile and responsive technology firms can be quick off the mark to create new job opportunities to fill the growing demand from end-user clients. But will we see the same again this time around?

Well potentially not well. We hypothesise a Q2 2020 drop in GDP of -14% as a consequence of the COVID-19 Pandemic, which could in fact be far greater dependent on numerous economic and social variables in response to attempts to control the virus' spread. This kind of GDP drop would put us far beyond that of the 2008 Great Recession.

Once the lifting of lock-down restrictions begins, the next point of discussion will be the effect on the population and on businesses, and how long it will take both groups to recover. If the government's depleted national capital reserves cannot financially sustain support for the community and for businesses due to extended lock-down, then we will face catastrophic levels of unemployment and business liquidation, meaning it will take a long period of time for the labour market to recover.

Even with business grants, the furlough scheme and other initiatives, it will not be easy to get businesses back up and running, as they are depending on all links in their supply chain to be operational. This will be far from the case, as many international suppliers are located in different regions with different timeframes on their response to fighting the spread of COVID-19, meaning their ability to supply will be constrained. Consumers will have depleted any savings and increased their reliance on debt, while businesses that survived will have lost profit and have increased their debt burden.

COVID-19

This means that those projects and investments planned before the crisis will be abandoned or postponed. Finally, banks will be more averse to risk and so constrain lending or time to loans.

But how do we see a potential recession playing out in its effect on the UK IT technology sector?

Well on one hand some of the impacts of the COVID-19 Pandemic are in fact benefiting businesses, in particular vendors and resellers. Computacenter and Atea have both reported an enormous jump in demand for PC's such as laptops and notebooks. This stems from the social ramifications of moving office and business activity away from centralised locations and into our new normal of working from home. This rise in sales has been reported by resellers across Europe, as businesses enjoy a 51% year on year increase on notebook sales during the first three weeks of March.

The flip side to this however is made apparent when looking at the months prior. Gartner reported a steep decline in the PC market in the first three months of the year due COVID-19's impact on vendor supply chains, stating a 12.3% decline in shipments to 51.6 million. The pandemic has actively led to a drastic reduction in shipments during the quarter. This is due to factory closures and shortages in labour in China which affects global supply chains.

Opinions on the effects of the COVID-19 Pandemic on the future of resellers differ greatly. IDC predicts that the social consequences and enforced distancing during the Pandemic will lead to a long-term rise in remand for remote working after life returns to 'normal'. Gartner disagrees, predicting a fall in business IT budgets away from PC spending after the Pandemic.

Businesses across the globe are being forced into pivoting their IT and technology strategies to suit our new normal. Companies have been made to implement remote working policies for most of their staff, with no definite end in sight. In order to facilitate this, many have turned to public cloud providers to facilitate the move from office to home. Microsoft has reported constrained capacity in a number of regions on the Azure platform, as is the size of the demand during the Pandemic.

Organisations using on-premise infrastructure as part of their cloud strategy have been turning to the public cloud to maintain business continuity in the short to medium term, due to a combination of product deliveries and on-site access. This has led to a rise in demand for cloud migration as we continue to push toward further remote working. The real question is, however, how will these practices react in an impending recession?

COVID-19

A recent Forrester study of channel partners in the US showed 25% of partners will experience "unrecoverable financial distress" in the most likely of their predicted economic downturn scenarios, that the COVID-19 Pandemic and subsequent recession will last through 2020. They predict that the channel will be disproportionately affected due to its lack of position on fast-growing technologies such as SaaS.

What could this economic downturn mean for hiring? Towards the end of May 2020 Dell announced a freeze on numerous staff benefits such as pay rises, promotions and 401k pension contributions, as well as a freeze in hiring until at least the end of 2020. Previously Dell CEO Michael Dell agreed to forgo his salary until the beginning of 2021, as well as VMware freezing pay rises and promotions. HPE and IBM have already taken steps to preserve business integrity, including laying off staff. We can expect to see a similar picture in the UK as businesses react to the pressures imposed by the COVID-19 pandemic.

So how do businesses in the channel try to safeguard against the most negative consequences?

The first thing to do is to take all the professional advice you can get your hands on. Talk to your bank and your accountant for useful advice and assistance. You can take advantage of numerous government financial schemes launched to ease the pressure of COVID-19 on your business.

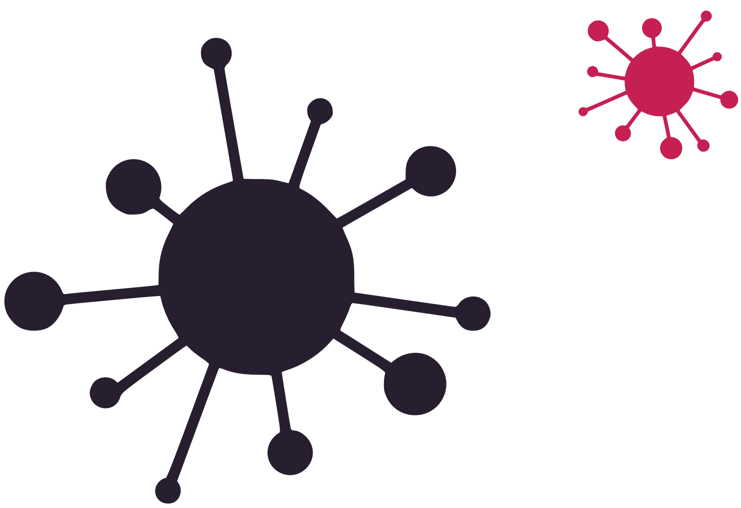
Next think about cost reduction. It makes sense to reduce costs where possible in your business even at the best of times to increase efficiency, however it may appear that the best way to survive the economic effects of the Pandemic is to scrap your strategies across the company. First take a look where you are already saving money. Everyday running costs are reduced at the moment as offices are closed and on-site visits are lowered, meaning lower hotel and travel costs. You may also be able to cut back on events and marketing for the time being, however if you can it would be wise to keep some of these open. Think about your business in the medium term. You want to come out of this with a pipeline of opportunities to work with once we are out of the tunnel.

COVID-19

Then talk to your customers and suppliers. Some customers may owe you money, and you may owe some suppliers. Sorting out this cashflow will help to ease pressure on your business. Of course some customers may find repayments difficult to undertake at the moment, and suppliers will want to know your current state of play, but as we're told endlessly "we're all in this together". People are understanding of others' situation, so easing your cashflow out of the business will pay dividends in the long run.

The best thing you can do in this situation is to keep doing business. Don't just pause and close the doors. There was a huge in rise in business activity when the Work From Home directive was issues. Now businesses are adapting to life in the new normal and adjusting to the levels of activity that are possible in their personal situation. Many customers are taking the opportunity to review and update key parts of their infrastructure. Even for us here at InfraView, including this content and a new website and rebrand, businesses are benefiting from our shift in attention during a dip in hiring. As your customers continue to venture into the world of our new normal, they will uncover different problems. You have an opportunity to strengthen existing relationships and forge new ones as your business helps them in their day-to-day activities, including additional licences and equipment.

In terms of hiring, it will be those businesses that can hold onto key staff which will emerge from this Pandemic strongly, which could lead to them taking significant market share. "The strong companies which have strong financials and are willing to take help from partners like ourselves and governments where appropriate - if you can keep your top people - then you will come out of this and frankly take market share," said Mike Baur of ScanSource.



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Conclusion

So, the question on all of our lips right now; "How will this affect the UK channel?"

The answer is, quite frankly, nobody knows.

We are living in a time of unprecedented uncertainty. Every day there are new scientific discoveries on the nature of the virus, with this in turn influencing measures and restrictions which have major consequences for businesses up and down the country.

We have constructed this report based on all the information we can gather from government reports, business insights and anecdotal evidence. Whilst imperfect we believe this is a steppingstone for conversations to have between businesses on how best to approach whatever the future holds during the Pandemic and afterwards.

There are clearly opportunities for channel partners to continue to add value to their customers during this time, and it is those businesses who are agile and can provide solutions for our new normal who will find their way through this Pandemic the easiest.

Take whatever trusted advice you can, solidify your cashflow and continue to keep the wheels turning on your business. Be ready for opportunities that come your way and continue to communicate and work together as a sector to protect supply chains and maintain business integrity. For hiring, if you can continue to produce job opportunities and hire the best professionals on the market, you will find yourself in a strong position when we emerge into the daylight after the social and economic effects of this Pandemic have lessened.

We'd love to hear your thoughts on how you are reacting to the Pandemic and where you see the situation going in future. Give us a call on 020 3617 1040 or email info@infraview.co.uk.

We'd love to start a conversation.

Stay safe,

Tim Davey,
Co-Founder, InfraView

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