THE CHANGING SHAPE OF UK MANUFACTURING

BDO

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Over the past two years we have experienced the deepest recession the country and the developed world economies have seen since the 1930s.

There is little doubt that this recession and its impact on developed economies will have speeded up the transfer of economic power from West to East. It has also had a fundamental and massively detrimental impact on the UK economy – one that is likely to be felt for several years.

But hopefully it might also change the way manufacturing is perceived within the economy of the UK and provide a stronger basis for the idea that helping and supporting a strong and vibrant manufacturing base is fundamental to the health of the British economy.

When discussing 'what happened to create this crisis', most economists and commentators now agree that the economy had become hugely out of balance.

Growth was driven too much by financial services and acquisitions that did not add value, fuelled by booming corporate debt – and consumer spending supported by over-valued housing and increasing personal borrowing – and not enough by strategic investment, manufacturing and exports.

The severity of the downturn and its obvious highlighting of the structural weaknesses in the UK economy have led to serious thoughts about the future economic direction of the country.

Business Secretary Lord Mandelson has admitted that the Government had allowed the country to become 'over dependent on the city' and that it needed a 'renewed politics of production'.

In the New Year the Government released its latest strategy, Going for Growth, which outlines a vision of a future with industry and enterprise at the heart of Britain's recovery.

We believe that a growing and vibrant manufacturing sector is fundamental to the UK economy and although manufacturers can do most of what is needed to be successful, a little more coherent and connected help from government would be useful.

We hope that the exchange rate stays at a level that makes our exports easier to sell and imports more expensive to buy (to encourage UK manufacturing) and we hope that the next government continues what this government has started in its 'Going for Growth' strategy.

In the spirit of 'better late than never', we welcome the overall aims of government strategy that seek to re-emphasise the importance of manufacturing and exports to a well balanced economy.

However, we question the number of separate initiatives introduced by this government, which are not easy to follow and certainly not easy to access (particularly the various well-publicised support to credit/funding initiatives), given the resources available and the complexities involved.

SIX PRIORITIES TO HELP MANUFACTURING

We have identified the following six priorities to help UK manufacturing:

1. **Deal with the deficit:** we believe that the first priority is to announce a realistic and believable plan to deal with the ever expanding deficit and help safeguard the UK's credit rating. Manufacturers and the economy need a stable and consistent platform in which to operate and some level of comfort on foreign exchange rates and longer-term interest rates. The issues connected to Greece, Spain and other debt-burdened economies of the Eurozone need to be avoided in the UK.

2. **Establish an environment that allows business to be competitive:** manufacturers (and probably most of UK industry) need a more supportive business environment. A good start would be to ensure that the promised dismantling of some of the red tape, estimated by the British Chambers of Commerce to be a cumulative £77bn since 1998, actually happens. The government should not forget that its wider strategies have a huge impact on business and manufacturing.

3. **Set a clear strategy with defined and measurable targets:** whilst we support the overall vision and renewed emphasis on what makes a strong economy and the importance of manufacturing within that economy, we are concerned that the flurry of activities and initiatives look too much like political sound bites and not enough like 'let's really make a difference'. We feel that there needs to be a clear overarching strategy that leads into a small number of initiatives that work and can be accessed by manufacturers. Government needs to set clear measurable goals and report back at regular intervals to its shareholders--the taxpayers.

4. **Provide support to the mid market:** mid-tier manufacturers (companies in the £30m to £300m turnover bracket) believe there is an interest/funding gap as government initiatives tend to focus on the small or large companies in the UK. Government-financed R&D is biased in favour of large firms, with those having under 250 employees receiving the lowest share of government-financed R&D in the OECD. However, we believe that these companies are fundamental to the future of UK manufacturing and more emphasis and support needs to be given to the needs of the mid tier.

5. **Create and support investment in emerging technologies:** we agree that the government needs to encourage and support investment in pre-commercial stage R&D in strategic high-tech industries where the country and the manufacturing base have existing strengths. We also like and support the focus on the emerging environmental technologies as one area where the UK can marry its traditional strengths in innovative manufacturing to a sector with huge potential. However, new technologies are expensive to develop and the environmental technologies market is also in its development phase so they will require a framework for investment and support that is available for the longer term.

6. **But do not forget the traditional manufacturer:** it's not all about high-tech innovation. Mid-tier manufacturers think that the recent government strategies do not recognise the innovation that occurs within our traditional industrial base. Ongoing investment is needed to improve machinery, equipment, brands and processes of established manufacturing companies so that they can grow. For example: establishing an export credit guarantee scheme that actually helps exporters, looking at more generous capital allowances and extending the R&D tax credit allowances would bring welcome long-term benefits in productivity and profitability.

We feel that there needs to be a clear overarching strategy that leads into a small number of initiatives that work and can be accessed by manufacturers.

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FINDINGS OF THE BDO LLP SURVEY

During January and February 2010 we asked a number of manufacturers whether they agreed with the government strategy, how important they thought manufacturing was to government and what experience they had of seeking help for their business from government agencies.

75 PER CENT AGREE WITH THE GOVERNMENT'S STRATEGY, ALTHOUGH WITH RESERVATIONS

Three quarters of the manufacturers who responded to the survey were supportive of the Going for Growth strategy but voiced some reservations.

There was concern that the all-important implementation stage would not be followed through, as had happened with previous initiatives.

Manufacturers wanted to see government set goals against which to measure progress. Doubt was also expressed that effort and resources would be too thinly spread between competing initiatives.

Some thought that the initiative was 'too little, too late': the demise of manufacturing had been going on for many years and government had not intervened earlier as key skills disappeared.

Others also expressed a view that the focus was on too narrow a group of industries and neglected traditional manufacturing.

Removing some of the burden of tax and regulation was also mentioned as a good place to start supporting the mid tier.

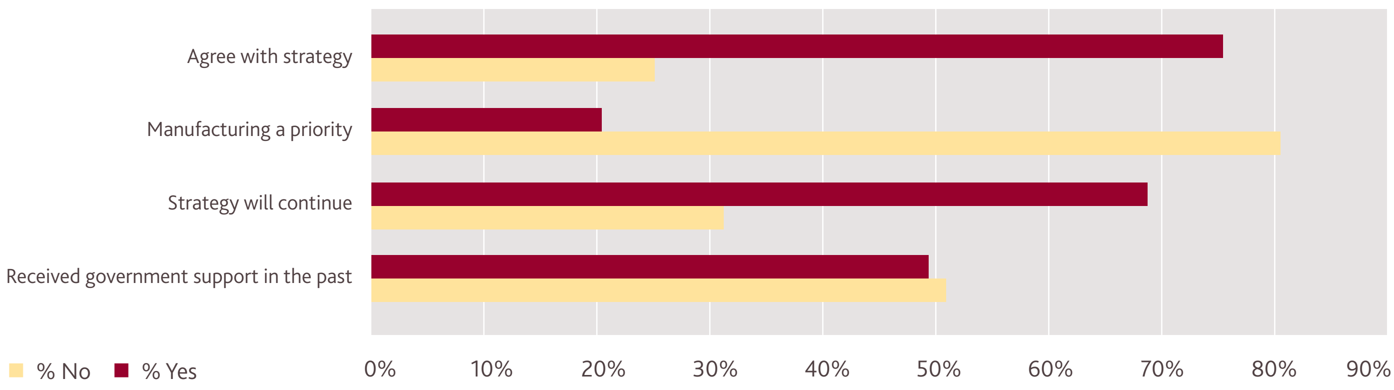
"This is a long-awaited review and the aims of the strategy are good, but they need to be followed through"

Engineering consultancy

"No support for the existing manufacturing base" and "we need support for food and agriculture as well".

Food manufacturer

Manufacturers' thoughts on government strategy



Source: BDO Research

MAJORITY THINK THE STRATEGY WILL CONTINUE AFTER THE GENERAL ELECTION

Whilst the majority (70 per cent) thought the strategy would continue in some form, they make a number of suggestions to government.

Government needs to consult more people who have worked in the manufacturing industry.

Manufacturers feel that government fails to understand the long-term investment decisions that need to be made and the importance of certainty about macro-economic stability.

In particular, the budget deficit would need to be tackled otherwise there 'wouldn't be enough money for such a strategic initiative to be successful.'

Those who thought the initiative unlikely to continue expressed a degree of scepticism about government's real motives, saying that neither party understands manufacturing and that current initiatives were part of a political agenda.

MANUFACTURING IS NOT REALLY A PRIORITY FOR GOVERNMENT

Less than a fifth of participants thought that manufacturing was a priority for government.

There is a sense of grievance that the government had done 'more harm to UK manufacturing than any other' and of scepticism that manufacturing is only a priority as long as government thinks it is a vote winner.

Some manufacturers also felt the government seems to think traditional manufacturing is 'too old and dirty'.

They understood the importance of investing in new emerging industries but also thought that traditional manufacturing continues to have an important role to play in the economy – and this should be recognised.

ONLY 50 PER CENT HAVE EVER RECEIVED GOVERNMENT SUPPORT

Of the manufacturers who had received government support, the majority (70 per cent) said they found the process complex and bureaucratic.

A major challenge was to know which grants were available. Government departments varied in the extent to which employees were willing and able to help.

Companies in the £30 million-to-£300 million turnover size band seem to fall between SME's and very large companies, and so are not eligible for funding.

This is also the case where a business is part of a larger group.

There was also a sense of frustration at the lack of flexibility regarding funding for skills training--and the lack of a level regional playing field. Some respondents which have secured skills training found it to be of poor quality.

"We have the momentum now and any government should appreciate that this is a way to increase GDP"

Engineering consultancy

"Not since Maggie Thatcher wished for a nation of shopkeepers"

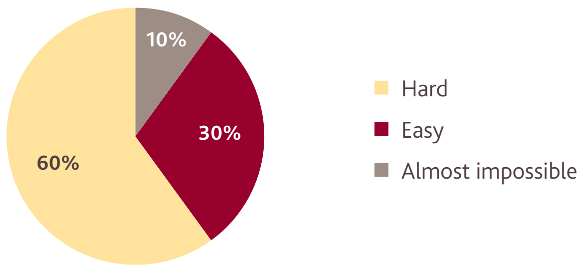
Engineering and metal business

"We have done very well over the years on funding. The accessibility of it depends on where it is coming from; which government department"

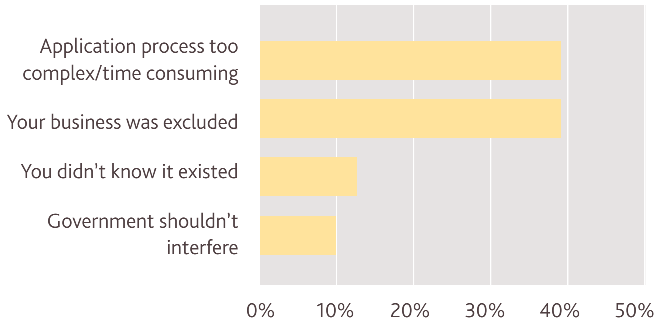
Technology and electronics

"Too much red tape and dealing with disinterested people who don't know how to guide and help."

Ease of getting government support



Reasons why government support not received



Source: BDO Research 2010

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DOES THE GOVERNMENT MATTER?

We believe that government has a crucial role to play in creating a supportive environment for business. A stable, well-managed macro-economic policy will mean favourable interest and exchange rates, which helps investment planning.

Businesses also need a modern road, rail, ICT and energy infrastructure and a highly skilled, flexible workforce supplied by the education system.

Government can also improve the international competitiveness and profitability of UK companies through its management of the tax and regulatory systems. Regulations introduced since 1998 have imposed a cumulative cost of £77 bn on UK businesses.

Further measures are due to come into force by 2014. The additional burden will hit mid-tier manufacturers hard and we would like the government to keep its promise of a one-in, one-out approach to regulation.

Below is a simple international comparison of some indicators that illustrate the way government policy can make conditions more favourable for both manufacturing and the economy as a whole. It compares the UK with France, Germany, Japan and the United States.

The table is not intended to show a direct cause-and-effect relationship across the rows.

Inputs

1. Global ranking out of 133 countries for higher education in science and maths as assessed by the business community[1].
2. Global ranking for extent and effect of taxation[1]. This is one measure of the efficiency of the goods market in which competitiveness can be hindered by burdensome taxes.
3. Regulatory burden[1] as above.
4. R&D intensity[2]: value of expenditure on R&D as a percentage of GDP.
5. Patents per million head of population[2].

Outputs

6. Patents per million population[2]
7. Balance of trade in goods[2]
8. Change in manufacturing as a percentage of GDP 1998-2008[3]
9. World competitiveness ranking 2009-2010[1]

	World rank for standard of higher education in science & maths [1]	World rank for extent & effect of tax	World rank regulatory burden 2009	R&D intensity (R&D spend as % GDP)	Patents per million population	Balance of Trade in goods as % GDP	Change in manufacturing % of GDP 1998-2008	World competitive-ness position 2009
France	8	92	127	2.1	41	-3.5%	-3.9%	16
Germany	45	106	84	2.5	75	9.5%	0.5%	7
Japan	25	101	22	34	111	2.1%	-1.3%	9
UK	52	84	86	1.8	27	-8.5%	-5.1%	12
USA	48	59	53	2.7	53	-6.2%	-3.6%	2

Sources: World Competitiveness Report 2009-2010, OECD 2009, United Nations, BDO Research.

[1] World Competitiveness Report 2009-2010, World Economic Forum.
[2] OECD 2009.
[3] United Nations Statistical Office, BDO Research.

SCIENCE AND MATHS EDUCATION

With a world ranking of 52 for quality of higher education in science and maths, the UK is the lowest ranked of the five countries. Furthermore in global ranking terms we have slipped five places since 2008. Finland is the top-ranked European country.

As advanced skills in science and maths are an indicator of future innovativeness in manufacturing, we would like to see Britain at least in the top quartile.

Incidentally, maths is a key skill for the financial services sector, so an improved educational base in maths could improve the competitiveness of both sectors.

BURDEN OF TAX AND REGULATION

The extent and effect of taxation refers to tax burden and evasion for which the UK is in 84th place in the world, having fallen three places since 2008. Europe in general scores less well on tax criteria because of the higher social costs.

The most favourable European countries to do business from a broader tax perspective are Iceland at number 11 and Switzerland at number 12.

The UK ranks 86th in the world in terms of regulation, a steep decline from the country's number four position in 1997. Research from the British Chambers of Commerce estimated that the cumulative additional cost of regulation to British businesses has been £77bn since 1998.

The table shows Britain fares better than France, slightly worse than Germany, but a long way behind Japan. The European countries with the lowest burden of regulation are Switzerland and Finland, ranked 11 and 12 respectively.

R&D INTENSITY

The UK ranks bottom of the five comparison countries with an R&D intensity figure of only 1.8 per cent in 2007. That is just over half the figure for Japan and below the Nordic European country spends of between 2.5 and 3.6 per cent.

UK R&D spending tends to be focused on technology sectors: ICT, bioscience, nanotechnology and environmental technologies. Financing tends to rely on universities, venture capital and funds from overseas.

As a result, UK businesses finance only 47 per cent of R&D expenditure, against an average of 57 per cent for G7 countries.

Mid-tier companies will find that government-financed R&D is biased in favour of large firms, with those having under 250 employees receiving the lowest share of government-financed R&D in the OECD[3].

PATENTS PER MILLION HEAD OF POPULATION

Patents are a rough measure of the commercialisation potential of innovation. The UK's record in the registration of patents is poor, despite its tradition of inventiveness.

The country lies fifth with only 27 patents per head of population recorded in 2006, compared with 111 in Japan and 53 in the United States. However, the UK's share of patents in high technology sectors such as bioscience, nanotechnology, environmental technology and ICT is relatively high.

Regions are significant, with East Anglia second in the OECD for ICT and biotechnology patents and the M4 Corridor ranking fifth.

BALANCE OF TRADES IN GOODS AS A PERCENTAGE OF GDP

The UK's goods trade deficit figure as a percentage of GDP is 8.5 per cent, the highest of the countries we compare. Furthermore, the deficit has multiplied sevenfold since 1997.

In contrast, manufacturing nations Germany and Japan report a positive balance on their goods trading accounts, of 9.5 per cent and 2.1 per cent respectively.

MANUFACTURING AS A PERCENTAGE OF GDP – 1998 AND 2008

Manufacturing's share of GDP has declined from just under 18 per cent of GDP in 1998 to 12 per cent by 2008 as services generated an increasing share of wealth.

Comparator countries have experienced a much lower contraction in manufacturing's contribution to GDP with manufacturing in Germany retaining its 1998 figure of 21 per cent.

RANKING IN WORLD COMPETITIVENESS LEAGUE

The UK ranks 13 in the World Competitive Index, having fallen four places since 2007. The decline was attributed mostly to a weakening assessment of the financial market, declining macroeconomic stability and public sector debt.

United States ranks second in the Index, having been ousted from first place by Switzerland, largely as a result of weakness in the financial markets last year.

HOW WE CAN HELP YOU

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