

MANUFACTURING FOR EXPORT:
MAKE OR BREAK FOR THE BRITISH ECONOMY
JANUARY 2011



British
Chambers of
Commerce

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ABOUT US

The British Chambers of Commerce is the national body for a powerful and influential Network of Accredited Chambers of Commerce across the UK; a Network that directly serves not only its member businesses, but the wider business community.

Representing 100,000 businesses who together employ more than 5 million employees, the British Chambers of Commerce is The Ultimate Business Network. Every Chamber sits at the very heart of its local community working with businesses to grow and develop by sharing opportunities, knowledge and know-how. No other business organisation has the geographical spread across extensive multi-sectoral, multi-sized businesses achieved through local Chambers of Commerce. Lying at the heart of their local community, Chambers reach and serve all businesses, with special emphasis on providing services to their members.

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FOREWORD

BY DAVID FROST



David Frost

Manufacturing is central to our economy. While the media, politicians and general public have often garnered the impression that we 'do not make anything anymore', British manufacturing is alive and well and plays a vital part in securing our future economic growth.

It is now taken-as-read that during the past decade, we have been over-reliant on public sector spending, financial services and consumption for our economic development. Those days are now gone, and we must once again return manufacturing to the heart of the British economy as a driver of growth, exports and wealth creation.

Many commentators have stated that we must export our way out of recession. However, this will not be possible without a renaissance in the part of the economy that actually makes something - our manufacturing industries. However, in 2009 we operated a traded goods deficit of £81bn with the rest of the world. While it is true that during the past

decade we have seen a surplus in traded services, when financial services and insurance are stripped out of this, our competitive advantage in services is negligible. Service exports will also never be able to make up for our enormous deficit in goods gathered through an exponential rise in imports since 2000.

Thus, without resurgence in our manufacturing industries, upon which so many jobs in other sectors depend, we will not see the sustainable recovery that everyone hopes for. At the BCC, we believe that manufacturing must take its proper place in the centre stage of our economy. There is still much to celebrate in British industry today - high productivity, a dedicated workforce and world-beating innovation. But more needs to be done, and the Coalition Government must 'think manufacturing' in everything that it tries to achieve over the course of this Parliament and beyond.

David Frost
Director General
British Chambers of Commerce

FOREWORD

BY PETER IBBETSON



Peter Ibbetson

At the time of writing, certain economic indicators support the view that the manufacturing sector is on track to post respectable rates of growth in the fourth quarter of 2010 which, if realised, would be very welcome news.

As such, we welcome the British Chambers of Commerce report into manufacturing, which adds new insight to the debate about how best to create an environment in which Britain's manufacturing industries can continue to thrive.

There are a number of different issues shaping the manufacturing sector currently - both challenges and opportunities. What is clear is that the sector makes a significant contribution to the UK economy and is well-placed to play an even greater role in a sustained economic recovery.

We at RBS are committed to the sector and to providing finance in support of viable manufacturing companies looking to achieve the growth that will help the sector flourish. We understand that manufacturing companies have different needs to other

British businesses, which is why in 2010 we pledged to make £1 billion of new loans available on competitive, flexible terms to UK manufacturing businesses.

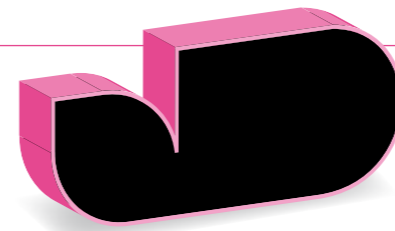
We also recognise the exporting opportunities that exist for manufacturers and recently announced a number of initiatives to make it easier for businesses to increase export activity. These include a new international trade hotline, which gives firms access to expert advice, and free online training courses to help businesses manage risks when trading overseas in new markets. We are also contacting export-ready customers proactively, to offer our assistance in helping them make the most of the opportunities ahead.

With the right support, manufacturing companies will be able to take advantage of the opportunities for growth which we believe lie ahead. At RBS, we want to ensure we are doing everything we can to provide that support.

Peter Ibbetson
Chairman
Small Business Banking
Royal Bank of Scotland plc



EXECUTIVE SUMMARY



Manufacturing firms have been surprisingly resilient during the recession, and many have started to grow again.

MANUFACTURING NOW

- Many in media, politics and the general public assume that Britain has very little manufacturing industry left. However, this does not reflect realities on the ground. While employment in UK manufacturing has consistently fallen during the past thirty years - and now represents a smaller part of GDP - output, productivity and value have risen throughout this time, with an all time high in 2007.
- The UK has developed a strong international position in many higher-value areas such as pharmaceuticals, life sciences, advanced engineering and aerospace - in which the UK is second only to the US. The UK is now also integrated within global supply chains.
- While it is unrealistic to expect UK manufacturing to return to the 24% of GDP it generated in the 1980s, with sterling at a competitive rate and our property and financial services sectors hit particularly hard in the recession, there is real potential for this share to grow.
- Since the 2008 financial crisis and recession, there has been a renewed debate about the need for Government to support UK manufacturing and export growth. The previous Government's September 2008 manufacturing report recommended support for manufacturers who develop products for the low carbon economy, improvements in the skills base, and help for exporters.
- Now that the new Coalition Government has entered office, there has been a noticeable change in tempo on industrial policy and a conscious dismantling of Lord Mandleson's nascent industrial activism, and it has decided that 'picking winners' is not on the agenda.
- Business Secretary Vince Cable has said that the Government will focus on "removing government imposed obstacles to growth: onerous business taxes, red tape which suffocates small firms, and a slow oppressive planning regime".¹ It does however have the desire to encourage certain growth sectors such as the much vaunted 'green economy'.

RESEARCH FINDINGS

THE GENERAL BUSINESS ENVIRONMENT

- Manufacturing firms are far more sensitive to Government policy changes and general business environment than other companies. This is because they encompass a greater part of the whole value-chain and are far more capital intensive than pure service companies.
- Likewise the highs and lows of the economic cycle impact upon manufacturers in a greater way than is felt by other sectors.
- Manufacturing firms have been surprisingly resilient during the recession, and many have started to grow again. Through employing policies such as short-time working, they have been able to avoid losing key skills for the upturn.
- The success of British manufacturers is based upon a relentless focus on quality, speed and precision - as well as on high levels of service quality at all stages of production and sales.

FINANCE, INVESTMENT AND DEVELOPMENT

- Manufacturing firms have much greater financing needs than many other businesses. However, many companies have problems accessing the funding they need to operate day-to-day, and to grow.
- The taxation system and its allowances play a key part in stimulating investment. Changes to Capital and Investment Allowances have the potential to seriously impact on smaller manufacturers' investment in the coming years.
- Research and development is the key to the future success of British manufacturers. R&D Tax Credits are a vital tool for business investment, but are often seen as too prescriptive, bureaucratic and difficult to access.

EXPORTING

- While not enough companies currently export, the majority of successful companies regard international trade as the key to sustainable growth. Businesses themselves must become

more proactive in looking for export markets for their products - especially in high-growth developing areas.

- British goods have the potential to be more competitively priced because of sterling's loss of value, but a lack of global demand, selling into predominantly sluggish markets, and companies bolstering their balance sheets rather than lowering prices, mean that exports haven't grown as predicted.
- UK Trade and Investment offers an important service, but is variable in its delivery.

Receipt of poor quality work can seriously impact on smaller companies' ability to succeed in new markets.

- Trade finance can have an important impact on a company's ability to export, but problems during the recession, coupled with a lack of access to export finance for riskier markets, has left many British exporters in a weak position vis-à-vis their rivals from other major exporting nations who can access state-backed schemes.

1. www.bis.gov.uk/news/topstories/2010/Oct/building-long-term-growth

OUTSOURCING, REGULATION, SKILLS, PROCUREMENT, AND ENERGY

- Many companies have outsourced during the past five years, although the need for high-quality goods and a responsive service means that many companies will continue to produce in the UK. A small number of firms are repatriating their production. Some manufacturing will always need to be undertaken in or near to destination markets.
- The Government must consider the impact on businesses when it implements new regulations, and should take the initiative in helping reduce burdens on exporters.
- Skills are a perennial problem, but successful companies have sought to address their problems in-house with internal training schools offering tailored programmes. However, there is still a gap between what the UK further and higher education system provides, and what manufacturers need.

- Public sector procurement must look at whole value of a product, rather than opting for the lowest price, and must factor in public charges and levies that make British made goods more expensive than foreign counterparts.

RECOMMENDATIONS

BUSINESS AND ECONOMIC POLICY

- We urge the Coalition Government to 'think manufacturing' in everything that it does and to pay special attention to the needs of manufacturers when making policy.

A LONG-TERM MANUFACTURING STRATEGY

- We believe that there needs to be a long-term manufacturing policy which sets out how the sector will be supported by the Government in the coming years. Many of the policy changes explained below would form critical levers of just such a strategy.
- There should be regular evaluations undertaken by businesses within the sector itself, with the formation of a

manufacturing council to hold the Government to account.

RESEARCH, DEVELOPMENT AND INNOVATION

- R&D Tax Credits are an important tool for encouraging business investment and should remain in place.
- The Government should ensure that R&D Tax Credits are as simple to access as possible in order to counter the general business perception that they are too bureaucratic and cumbersome to use.
- To further incentivise manufacturers in the UK, the Government could also set out a roadmap for the broadening of R&D Tax Credits to include additional forms of innovation beyond 2015/16. As the public finances improve, a broader and more generous regime could help improve Britain's SME manufacturing base – and ensure it is focussed on innovative products.
- The Government's proposed Growth Hubs – which must be clarified as a matter of urgency – must

also be equipped to help innovative manufacturers claim R&D Tax Credits.

- Businesses and their professional advisers must become better at recognising where they are able to claim for R&D Tax credits, as many companies are not claiming what they are entitled to.
- Chambers of Commerce could run information sessions on R&D and incentives available in order to further spread the message on innovation to SME manufacturing businesses and help them navigate the system of R&D Tax Credits and grants.

CAPITAL AND INVESTMENT ALLOWANCES

- The Government must be transparent about the impact that the reduction in Capital and Investment Allowances will have on manufacturers, especially those on the Small Profits Rate. If manufacturing businesses on the Small Profits Rate are shown to be worse off under the new tax regime, the Government must take action to mitigate these effects.

- For those on a Small Profit Rate, options could include further reduction or special raised Capital and Investment Allowances.

ACCESS TO FINANCE

- We recommend that banks become more adept at serving the specialised needs of manufacturers. While we recognise that some banks have created manufacturing-specific initiatives in recent years, the evidence from manufacturers in the regions suggests that these services urgently require improvement.
- Banks must also return to a system of relationship management whereby managers within banks understand the needs,

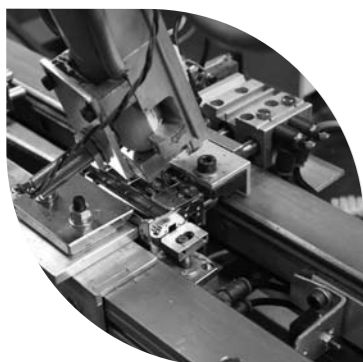
requirements and health of individual companies, and can thereby give better guidance to manufacturers, and show better judgement in their lending decisions.

- We suggest that AIM employ manufacturing specialists in the regions to work with risk-averse companies who wish to attract long-term growth capital investment through the process of selling equity.

EXPORT PROMOTION

- In order to remedy the effects of cut to the UKTO programme budget, the FCO must make good the Prime Minister's announcements that British missions abroad will spend more time and resource on international trade.





- BCC believes that UKTI's targets should be changed to monitor the value of results associated with help given, such as growth in export sales and employment generated, rather than purely on the number of companies assisted.
- There must be greater co-ordination to ensure that manufacturing businesses know where to go for different services, as well as to avoid needless duplication.

EXPORT SPIRIT

- British companies must become more proactive in high-growth markets such as India, China and Brazil, where they are currently under-represented compared to the exporters of other nations.

- A manufacturing and exporting mentoring network should be created and facilitated through UKTI and the Chamber Network.

EXPORT TRADE FINANCE AND INSURANCE

- The BCC believes that the Government should create a state-backed export trade credit insurance scheme run through a private company, who would share the risk and the profits.
- We also believe that the Government needs to remain vigilant to ensure that other countries are not extending support to their exporters that would infringe upon State Aid rules.
- We recommend a trade finance and insurance forum of government, financiers and businesses be placed on an official footing and held at regular intervals to ensure that the Government is receiving a full evidence-base of what is happening in the trade finance market.

INTELLECTUAL PROPERTY RIGHTS

- The UK Government must push for greater intellectual property protection in developing markets for British manufacturers through inter-governmental channels such as the WTO, as well as on a bilateral level.

PUBLIC SECTOR PROCUREMENT

- Public sector procurers must take a smarter 'best value' approach to assessing which products to buy – factoring-in UK Government-imposed costs when comparing the price of British products against their counterparts from lower-cost countries. This would give British manufacturers a fairer chance when bidding for public sector contracts.

SKILLS AND TRAINING

- We are supportive of the Coalition Government's increase in funding for apprenticeships, and believe this will benefit manufacturers in the medium term.

- We believe funding should be put aside to support leadership and management training for SME manufacturers.
- Groups of smaller manufacturers could facilitate their own training centres collectively in order to spread best practice, technical skills and concepts of quality.

ENERGY

- The Government should push for further energy market liberalisation across the EU to ensure that British manufacturers are not placed at competitive disadvantage on energy with our key competitors.
- Energy companies and the Government must actively support manufacturers to lower their energy requirements and become more energy-efficient. The use of smart meters, provided by energy companies should be expanded.
- Business should make better use of existing facilities including assistance from The Carbon Trust - which

includes interest free loans to buy energy efficient products.

THE IMAGE OF MANUFACTURING

- The profile of manufacturing within the UK must be raised. A first step would be to increase knowledge and understanding of manufacturing within the education system, especially among teachers. This could be encouraged by more inset days within manufacturing firms.
- Young Chamber, which goes into schools to establish enterprise programmes, has the potential to help address this problem, as do other outreach and mentoring schemes.
- A campaign highlighting the excellence of British manufacturing could go some way to promoting the strengths and success of British industry to the public.

INTRODUCTION

RESEARCH FINDINGS

▮ This report aims to set out the current state of British manufacturing through the prism of our Chamber of Commerce Network. 🗨️

During the past twenty years, manufacturing has played a more important part in the British economy than many people in the media, politics and the general public have realised. Despite this, the British people see a narrative of post-industrial decline written into their own modern history. While it is certainly true that since 1979 manufacturing's total share in the economy has declined, and that employment in manufacturing industries has consistently fallen, this is true of all modern developed economies, with the notable exceptions of Germany and Japan. Furthermore, as our economy has evolved, many internal service functions of manufacturing companies that would have counted as 'manufacturing jobs', have been out-sourced and are accounted for as part of the service sector now. Although

much high-volume low-cost manufacturing has been lost to lower-cost countries, Britain is still a key producer of high-value goods that are demanded all over the world.

The events of the past two years have thrown the spotlight back onto manufacturing for the first time in a generation. The model of growth premised upon ever-increasing public sector spending, the financial services industry and an unsustainable housing boom have been shown to be unrealistic and damaging to our future economic prospects. Likewise, the burgeoning deficit in traded goods, which stood at £81bn in 2009,² has shown the importance of exporting more of what we already produce and creating innovative goods that the rest of the world wants to buy. If we are to truly rebalance the British economy and create a sustainable place for ourselves in a globalised world, we must create the conditions for a renaissance in modern manufacturing as a matter of priority.

This report aims to set out the current state of British manufacturing through the prism of our Chamber of Commerce Network. We

have visited a broad range of manufacturers from across the country, surveyed 500 companies via telephone, held a manufacturing round-table event with businesses and policy-makers, as well as undertaking an in-depth literature review. We have taken evidence from our Quarterly Economic Survey of business trends. Drawing upon these lessons, we also make recommendations to the new Coalition Government for how it can create a renaissance in British manufacturing, and how this could generate more exports.

We have written this report because we believe that manufacturing in the UK is the key to our economic sustainability in the future. The service sector is important too, but we believe that the rewards of having a successful manufacturing industry demand that special attention be given to ensuring that the needs of manufacturers within the economy are taken into account.



². Source - ONS Pink Book.

MANUFACTURING NOW

THE SIZE AND SCALE OF UK MANUFACTURING - GLASS HALF EMPTY OR GLASS HALF FULL?

Until the recession, the importance of manufacturing to the UK economy has largely been ignored in the national policy debate. However, since the financial crisis, discussion has moved towards the need to rebalance the UK away from a reliance on financial services, public spending and consumption.

British manufacturing has largely been seen as a sector in perpetual decline with little economic future. The idea has taken root both within British public's image of themselves, as well as in the international perception of the British economy. Indeed in 2009, President Sarkozy of France claimed that Britain, unlike France "has no industry".³

The reality of UK manufacturing is actually a much more mixed picture - very few people seem to be aware that the UK is actually the seventh largest manufacturer in the world (see Figure 1), that British manufacturing output reached an all-time high in 2007, and that labour productivity in UK manufacturing doubled between 1997 and 2007.⁴ The picture is further confused by the extent to which manufacturing firms

also deliver services, raising the question of whether a separate definition is even meaningful. Likewise, the outsourcing of many services that were once undertaken in-house by manufacturing firms has changed the structure of British industry.

FIGURE 1. MANUFACTURING OUTPUT IN 2009 MEASURED IN REAL VALUE-ADDED TERMS

1	United States	\$1,717bn
2	China	\$1,608bn
3	Japan	\$827bn
4	Germany	\$581bn
5	Italy	\$381bn
6	France	\$253bn
7	UK	\$227bn
8	South Korea	\$214bn
9	Russia	\$207bn
10	Brazil	\$205bn

Source
IHS Global Consulting

However, although Britain still makes a significant contribution to manufacturing worldwide, there has been a relative decline in its overall global share, which in 2009 was 2.6% of global output, down from 3.6% three years ago and 5.4% in 1980.⁵ Considering the rise of markets in the Far East, Latin America and Eastern Europe, this is hardly surprising; Britain

³. www.ft.com/cms/s/0/a9d059da-7ccb-11df-8b74-00144feabdc0.html

⁴. The Future of UK Manufacturing: Reports of its death are greatly exaggerated, PriceWaterHouseCoopers, April 2009.

⁵. www.ft.com/cms/s/0/a9d059da-7ccb-11df-8b74-00144feabdc0.html

cannot hope to return to being a high-volume producer of low-cost goods.

Likewise, there has been a steady fall in manufacturing as a share of UK GDP for the last 50 years. As a proportion of GDP, manufacturing today constitutes around 12%, compared to 30% in 1970 and 20% in 1997.⁶ However, this decline must be seen in the context of overall economic growth, which has increased at a faster rate than manufacturing during this time. However, in terms of output, manufacturing grew by 28% between 1970 and 2007 and continues to account for half of UK

6. British manufacturing is bigger than you think and its likely to grow, Daily Telegraph, 18 April 2010.

7. <http://www.bloomberg.com/news/2010-08-17/germany-ignores-soros-as-exports-drive-record-growth-at-consumers-expense.html>

8. Innovation and Industry: A Manifesto for Manufacturing, John Willman, Policy Exchange, 2010.

9. www.bloomberg.com/news/2010-08-17/germany-ignores-soros-as-exports-drive-record-growth-at-consumers-expense.html

10. www.bloomberg.com/news/2010-08-17/germany-ignores-soros-as-exports-drive-record-growth-at-consumers-expense.html

export earnings.⁷ The decline in UK manufacturing as a share of GDP actually masks significant increases in production. The smaller share of our economy manufacturing constitutes is comparable with most developed economies; although significantly less than Germany, it is on a similar level to France and actually higher than in the USA.⁸ The general trend witnessed by most developed countries has been that as people become richer, they spend a greater proportion of their income on services, thus increasing that sectors share of the economy exponentially.

Germany and Japan are exceptional in the large share of manufacturing within their economies. However, in order to remain competitive and retain their market-share in an increasing globalised world, the real incomes of German and Japanese workers have grown very little. This is because to retain their global share of exports, their manufacturers have surrendered to serious price pressures, which has suppressed pay. Naturally, this has had serious implications for domestic demand – especially in Germany.⁹ While the opposite has taken place within the

UK, France and USA, the real position for the UK is to aim for in one of balance – retaining export markets, developing competitive advantage further, and seeing real incomes of workers rise.

If in comparison to many other developed economies, British manufacturing is not in quite the poor shape many at home and abroad assume, we must question how such a perception came about. One of the most noticeable reasons for this has been because of a major reduction in those employed within the manufacturing industries. While the 2.6m people currently employed in UK manufacturing is far more than the 1m currently working in financial services, it is far less than the 6.9m manufacturing jobs there were in 1978.¹⁰ This reflects a decline in traditional UK strengths in industries such as steel-making and shipbuilding. It also reflects a broader trend across the sector, where companies have increasingly become part of international supply chains and low skill, labour-intensive, mass production work has moved to lower-cost emerging economies. The jobs and competitive advantage for countries like the UK now lies in high-value,

skilled research, design and innovation work rather than traditional production and assembly processes, which employed larger numbers of lower-skilled staff.

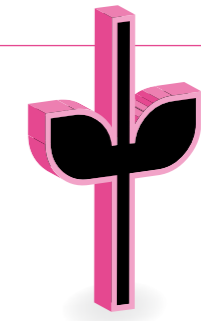
However, there is a debate about the wisdom of lauding hi-tech industries at the expense of less complex or lower skilled manufacturing. This is because even manufacturing normally seen as low-tech is not only remaining in the most developed markets, but also offering important innovation, knowledge and investment benefits to the economy.¹¹ Rather than being an indicator of absolute decline, to a large extent falling UK manufacturing employment numbers can be seen as reflecting some of the broader changes resulting from increased mechanisation and the globalisation of this sector.

Within this context the UK has developed a strong international position in some higher-value areas such as pharmaceuticals, life sciences, advanced engineering and aerospace – in which the UK is second only to the US.¹² There have been significant increases in productivity levels as well as efficiency, with output per

head from manufacturing employees increasing as more skilled and technically proficient employees, as well as more efficient machines, have been brought in.

The perception of manufacturing's decline has been re-enforced by the fact that some of the most visible large-scale UK-based manufacturing is foreign-owned. British manufacturing is characterised by significant foreign investment, with a number of international companies choosing to base aspects of their production in the UK, notably the big three Japanese car manufacturers – Nissan, Toyota and Honda – but also General Motors and General Electric from the USA and Siemens from Germany. However much of this manufacturing is high-value, skilled work which has a positive economic impact for the UK.

Another reason for the perception gap around manufacturing is that while there is a noticeable absence of mass-produced consumer goods made in the UK, a range of hi-tech products are exported by the UK which form part of products assembled in other countries for example silicon chips which go into iPods,



games consoles and mobile telephones. There are also a number of manufacturers, who have developed very successful service offers to clients, and have benefited from being able to offer this additional expertise. Rolls Royce is a perfect example of this, as they derive much profit from the after-sales servicing of its aircraft engines. As a whole, there are a number of strengths in UK manufacturing which can be built upon, particularly if companies can succeed by successfully taking advantage of opportunities in fast-growing emerging markets.

While it is unrealistic to expect UK manufacturing to return to the 24% of GDP it generated in the 1980s, with sterling at a competitive rate and our property and financial services sectors hit particularly hard in the recession, there is real potential for this share to grow. In order to do so it is important for the UK to recognise, celebrate and

11. Manufacturing and the Knowledge Economy, Ian Brinkley, The Work Foundation, January 2009.

12. The Future of UK Manufacturing: Reports of its death are greatly exaggerated, PriceWaterHouseCoopers, April 2009.

▮▮ We need to examine what would be the optimum policies for the UK Government.



promote our successes and comparative advantages in manufacturing. There is however little room for complacency. The UK is not alone in wishing to develop strengths in high-value manufacturing, and competition does not only come from other European and North American rivals, but from emerging economies such as China and India who are equally keen to develop their potential in these areas. If the UK is to fully take advantage of our existing and potential strengths in manufacturing, we need to examine what would be the optimum policies for the UK Government to create the best possible environment for UK manufacturing and for a more thriving export base. This is not however an area where a consistent approach has been adopted in the UK.

UK MANUFACTURING POLICY: A CYCLE OF NON-INTERVENTION AND INTERVENTION

Concern about the continual decline of the manufacturing sector in relation to the size of the UK economy over the last 50 years has been a driver of various policy approaches by governments over this time. Between

1960 and 1979, there was a shared consensus between Conservative and Labour Governments about the need for significant public ownership of, and intervention in, UK industry to try and reverse the UK's declining economic position in the world. Sectors such as shipbuilding, aerospace, steel-making and motor manufacturing were all nationalised at different times by governments of different political hues aiming to turn them into drivers of future UK economic growth. Whilst many of the economic controls put in place during the Second World War were removed by the 1950s, some of these powers, such as over exchange control and bank lending limits, were not removed until the 1980s. Likewise, there were short-lived attempts to move even further in the direction of national economic planning, with the National Economic Development Council (1961), the Department for Economic Affairs (1964) and the National Enterprise Board in the 1970s, engaging in national economic strategies and financial support for particular sectors, such as in information technology. The effectiveness of this approach was heavily criticised, with interventions

around British Leyland, Concorde and Upper Clyde Shipbuilding in particular seen as spending public money to little economic benefit and perceptions of the British Government 'picking winners' in terms of particular companies, with some claims that these were based upon political and electoral considerations.

The election of the Conservative Government under Margaret Thatcher in 1979 witnessed a break from the earlier consensus, with a market-driven philosophy reflected in the privatisation of a range of nationalised industries (including aerospace, shipbuilding, steel and car making) during the subsequent decade and a lifting of controls. This rejection of public intervention also came alongside a recession in the early 1980s, with falling employment, increasing inflation and a strong pound, all contributing to a devastation of the UK's industrial heartlands, which saw the demise of traditional industries such as steel-making and shipbuilding. While some have argued that this process enabled UK manufacturing to restructure and increase its competitiveness and

productivity,¹³ there was no reversal in the fortunes of manufacturers when the economy boomed towards the end of the decade, largely because the boom was in the consumer and housing sectors. While it has been pointed out that the Thatcher government did intervene in certain companies in the early years of the administration,¹⁴ the focus was much more heavily on attracting foreign investment. As we describe below, the continuation of this approach, alongside factors such as access to the European Single Market and the general business environment has resulted in the UK becoming the largest recipient of inward direct investment in the world after the US,¹⁵ including a total of £30bn of foreign direct investment in British manufacturing, with around £430m invested each year from abroad.¹⁶

Throughout the 1990s and 2000s, the relative absence of state involvement in the economy remained constant under both Labour and Conservative administrations, until the current global financial crisis and recession began in 2008. Despite Lord Heseltine's claim as President of the Board of Trade that he would intervene for British

business "before breakfast, dinner and tea".¹⁷ and the impact of the UK's entry and subsequent withdrawal from the European Exchange Rate Mechanism, the focus of UK manufacturing policy remained fundamentally laissez-faire. Despite arguments from some commentators for a more interventionist approach to regulation of the financial markets to encourage longer-term investment,¹⁸ the replacement of a Conservative Government with a Labour administration in 1997 did not lead to a change of policy direction. This was reflected in the Government's 2004 Manufacturing Strategy, which limited interventions to creating a supportive skills, innovation, infrastructure, and regulatory environment.¹⁹

13. Innovation and Industry: A Manifesto for Manufacturing, John Willman, Policy Exchange (2010).

14. Prosperity with Principles, David C. Green, Civitas, April 2010.

15. New Industry, New Jobs - One Year On, HM Government, March 2010.

16. www.lovemanufacturing.co.uk/documents/manufacturingfacts.pdf

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18. The State We're In: Why Britain is in Crisis and How to Overcome it, 1995. Will Hutton, 1995.

19. Manufacturing Strategy (2004) & Knowledge Driven Economy White Paper (1998).

The post-1997 Labour Government did, however, create Regional Development Agencies (RDAs) and gave them responsibility for co-ordinating the delivery of some business support (such as the Manufacturing Advisory Service and Business Link), created R&D Tax Credits and set up a Technology and Strategy Board to try and incentivise companies to invest in product innovation and application. While according to Government, R&D Tax Credits have delivered over £3bn of support for businesses to innovate since 2000,²⁰ UK based businesses continue to invest less in R&D than comparator economies and our strengths in knowledge and research are still not

consistently translated into successful goods and services.²¹ The Enterprise Act 2002 removed the public interest test enabling ministers to intervene in business takeovers, handing this over to the competition authorities, embedding into law what had become common practice since the 1980s.²²

Since the 2008 financial crisis and recession, there has been a renewed debate about the need for Government to support UK manufacturing and export growth. The Government's September 2008 manufacturing report highlighted the trends in modern manufacturing and recommended support for manufacturers developing products for the low carbon economy, improvements in the skills base, and help for exporters.²³ Following the appointment of Lord Mandelson as Business Secretary in 2008, the New Industry, New Jobs White Paper made the case for a new industrial activism to support manufacturing and economic growth. Whilst including measures to improve skills, R&D, infrastructure, and procurement this document went much further in making the case for state intervention

to support sectors where the UK has, or could have, a comparative advantage. Subsequent announcements followed, including Government strategies for a range of sectors and a £750m Strategic Investment Fund (increased by an additional £200m in the 2009 Pre-Budget Report) to support low carbon industries, digital, life sciences and advanced manufacturing. Lord Mandelson also made positive comments about the French Government's support for particular companies and the 2010 Labour Manifesto included a proposal for a public interest test for takeovers of infrastructure and utility companies.

Now that the new Coalition Government has entered office, there has been a noticeable change in tempo on industrial policy and a conscious dismantling of Lord Mandelson's nascent industrial activism. For example, among the new administration's first actions was the cancellation of an £80m loan to Sheffield Forgemasters. The new Government has thus decided that 'picking winners' is not on the agenda, as it has neither the will nor the money to do so. In the absence of direct help for

industry, Business Secretary Vince Cable has said that the Government will focus on "removing government imposed obstacles to growth: onerous business taxes, red tape which suffocates small firms, and a slow oppressive planning regime".²⁴

The Government does however have the desire to encourage certain growth sectors such as the much vaunted 'green economy'. In October 2010, Chancellor George Osborne announced £1bn for a Green Investment Bank, to fund low carbon enterprises and pollution-reducing investments. In the same month, the Prime Minister announced a £200m network of technology innovation centres, linking university researchers with business aiming to address complaints that universities are often hard to work with, and the fact that too much research undertaken in the UK higher education does not find its way into viable British companies.

QUESTIONS FOR THE FUTURE - MANUFACTURING FOR EXPORT?

The overarching picture for UK manufacturing and export remains unclear. The more recent attention given to

manufacturing in the national policy debate is undoubtedly a positive development. However, it is important that this discussion is based upon an understanding of the UK's existing strengths and where its export base can be grown, as much as the challenges it faces. In policy terms, over the last fifty years, UK Government has switched from periods of largely unsuccessful intervention to those of avoiding of public support for any sectors by the state which has not helped UK manufacturing to plan, develop and grow over the long-term. Whilst we would not argue for state involvement to the extent witnessed in some European countries, such as France, we believe that a stable policy environment which seeks to improve general business culture is vital for British manufacturers going forward.

With the new Coalition Government having to rein in public spending in order to reduce the current deficit, whilst at the same time wanting the economy to grow in a more balanced fashion, it is clear that there will be difficult decisions to make. The Government has four levers available to it: incentives (grants, co-investment, or subsidies);

taxation (favouring investment, R&D or particular industries); education (favouring science and technology or manufacturing skills); and, improving regulation.²⁵ In working out the right balance of these to support manufacturing and export, what works will need to be prioritised. Through this report, looking in detail at the experiences of the wide range of manufacturing businesses that make up the Chamber of Commerce network in the UK, we hope to provide a possible future direction.

²⁰. HMRC Corporate Tax: Research and Development Tax Credits, 2009.

²¹. New Industry, New Jobs, HM Government, April 2009.

²². Takeovers: the 'public interest', House of Commons Library Research Paper, April 2010.

²³. Manufacturing: New Challenges, New Opportunities, September 2008, Department for Business Enterprise and Regulatory Reform and Department for Innovation, Universities and Skills, September 2008.

²⁴. www.bis.gov.uk/news/topstories/2010/Oct/building-long-term-growth

²⁵. Rebalancing Act, The Economist, April 10th 2010.

RESEARCH FINDINGS

Our research on manufacturing has focused on working with key businesses from around the Chamber Network. As the voice of local business, we have travelled around the country talking to a range of companies manufacturing a whole variety of products: from luxury chocolates to car components, and high-spec wallpaper to software engineering, and have undertaken 19 in-depth case study interviews (Figure 2). A full report of these case studies can be found on the BCC's website at www.britishchambers.org.uk. During the course of our research we also have run a telephone survey of 500 manufacturing firms to try and gauge a wide base of business experience (see Figure 3 on page 24).

We have likewise taken evidence from the BCC's Quarterly Economic Survey (QES), which is the largest business survey of its kind. The QES looks at key indicators of economic health, which include domestic activity, exporting activity, investment intentions, confidence, and employment. The survey is a highly respected and credible indicator of the overall performance of the

FIGURE 2. COMPANIES INTERVIEWED FOR CASE STUDIES

1 PD Castings	Brake discs for automotive industry
2 Superior Group	Precision rubber seals and mouldings
3 TDSi	Access control
4 Molyslip	Lubricants
5 Hadley	Cold-rolled pressed steel
6 Surface Print	Wallpaper
7 Thomas Dudley	Plastic injection mouldings for bathrooms and foundry
8 PMT Industries	Yankee driers
9 Dynamax	Software
10 Deltex Medical	Medical monitoring equipment
11 Smith of Derby	Clock makers
12 PP Electrical Systems	Electrical systems for machinery
13 Minivator	Lifting equipment for elderly and disabled people
14 MANN+HUMMEL UK	Car components
15 Solutions Group	Wholesalers to TV installers, sound & lighting, and security industries
16 Hotel Chocolat	Luxury chocolate
17 JDR Cables	Subsea cables and umbilical systems
18 H. Weston and Sons	Cider
19 Malvern Instruments	Particle sizing and measuring equipment

Our research shows that manufacturers are far more sensitive to Government policy changes than other businesses within the UK.

TDSI

TDSi is an access control company in the security sector who manufacture entry control systems. Outsourcing the production of its components to a West Midlands firm, the company focuses on its core strengths of product development, research and sales and marketing, and increased sales to the domestic and international security sectors.

It believes that UK manufacturing would benefit from a longer-term approach from Government with fewer short-term initiatives and more tangible delivery, and a much stronger role for trade bodies in shaping and delivering services to meet business needs.

UK economy. Because of the large number of respondents and long time series, it is widely used by policymakers and economists.

To further compliment our research, in July we held a manufacturing roundtable event at the Royal Society for the Encouragement of Arts, Manufactures & Commerce (RSA) in London, which brought together manufacturing businesses, policy decision makers from Westminster and Whitehall, banks, trade associations and Chambers of Commerce from across the country. The aim of the event was to scope out policy proposals to encourage a renaissance

in British manufacturing for the lifetime of this Parliament and beyond. The proceedings of the event can also be found on our website. During the course of our work, we worked in particular with Chambers of Commerce in: The Black Country; East Lancashire; Suffolk; Birmingham; Portsmouth; Northampton; Cambridgeshire; Hereford and Worcester; Derby and Nottingham; Sheffield; Edinburgh; London; the North East; and, GWE Business West in Bristol.

Our research with businesses from across the country has illustrated the continuing depth and breadth of

Britain's manufacturing industries. Despite the economic problems of the past couple of years and a painfully strong currency for over a decade, British manufacturing is still strong, productive, and innovative. We believe that if the new Coalition Government and its successors prescribe the right policies, British manufacturing has a bright future ahead, and a key role in rebalancing our economy away from a reliance on public sector spending, financial services and consumption towards something more sustainable.

FIGURE 3. KEY FINDINGS FROM TELEPHONE SURVEY OF 500 CHAMBER MANUFACTURING MEMBERS

EXPORTING

- 27.2% of companies surveyed did not export.
- 34% exported over half their turnover; 20.3% exported under 20%, and 38.8% exported under 50%.
- 46.5% of those who did not export said it was because they had sufficient business in the UK.
- 16.3% said it was because they had a limited knowledge of exporting.
- 46.4% of exporters said that their export volumes had grown during the past five years, while only 10.5% said they had shrunk. 41.2% said it has stayed the same.

GROWTH AND CONFIDENCE

- 30.5% of respondents said that their overall turnover had gone up during the past five years, while 22.7% said it had gone down. 46.2% said it had gone down.
- 22.9% said that their employment had gone up over the same period, as opposed to 20.9% who said it had gone down. 56% said it had gone down.
- Only one company out of the whole sample had been founded during the past five years.
- 60.5% of companies were confident in their company's ability to grow during the coming five years, compared to only 4.3% who said they were unconfident.
- 68.5% of those who were confident thought that this growth would come from exporting.

COMPETITION

- 46.1% of companies thought that their products compared well with those from

other markets in terms of price, while 21.7% thought that they did not.

- 61.6% thought that their products compared well with those from other markets in terms of price, while only 5.9% thought that they did not.
- 90.0% of respondents said that post-sale servicing formed 5% or less of their turnover.

OUTSOURCING

- 21.7% of respondents said that they had outsourced parts of their supply chain, while 75.8% said that they were considering it.
- Of those that already outsourced, 2% said that it was due to unit costs, while 46.7% said it was also due to employment costs.
- Of those that were considering it, 100% said that it was because of unit costs overall.
- Only 0.9% of those that had outsourced said that they had repatriated production back to the UK, with this being due to skills requirements. Only a further 0.9% said that they were considering it.

PROBLEMS AND SOLUTIONS

- The top five problems respondents cited were: export controls (81.9%); the price of sterling (81.3%); regulation (78.9%); Access to finance (76.9%); and, foreign competition on price (75.9%).
- The top five potential policy changes that respondents thought would be most effective were: continued low interest rates (37.9%); better export support from the Government (32.7%); better access to growth capital (22.2%); more stable energy supply and costs (18.5%); and, a simplified tax system (14.5%).

2.1 BUSINESSES POLICY AND MANUFACTURING

Our research shows that manufacturers are far more sensitive to Government policy changes than other businesses within the UK. This is because by their nature they are involved far greater range of the business value-chain than firms operating entirely within the service sector. A manufacturer of machine tools may well have many functions that are common to service companies, including marketing, accounting and sales, but will also have production facilities and the supply chains that go with them. Manufacturing businesses are thus far more capital intensive than other firms because of the greater amount of plant and machinery involved in delivering manufactured products. They are therefore more impacted by changes to Capital and Investment Allowances or schemes to address access to finance.

Likewise, they have much greater research and development costs, and are thus more responsive to policies such as R&D Tax Credits. Even small changes in governmental direction that do not overly impact business as a whole can have far-reaching positive or negative effects on firms that are producing or designing physical goods as opposed to those delivering less tangible services. The Government must therefore always take special consideration of the needs of manufacturers when developing its business and economic policy.

Although manufacturing firms are more sensitive to policies that impact upon the general business environment, such businesses often carry far greater rewards for the British economy. Aside from encompassing larger parts of the value-chain, they also generate a greater level of exports. This means that if the Government implements the right policies and a fertile ground for the physically productive part of the economy, the benefits can be reaped in terms of greater exports, and sustainable private sector-led growth.

However, many businessmen involved in manufacturing's

industries justifiably feel that successive British governments have not taken a significantly long-term view of manufacturing. This needs to change if the sector is to play to its potential in the coming years, although there is evidence that the Coalition Government is starting to understand the importance of manufacturing. Mark Prisk, the Minister for Business and Enterprise, has stated that "manufacturing will be an important component in rebalancing the economy and supporting UK growth in the future", although it is yet to be seen whether this proves to be just rhetoric.²⁶ However, the coming months, and the subsequent importance that the Coalition Government gives to addressing the problems that manufacturing faces, will be the real test going forward.

2.2 MANUFACTURING'S RESPONSIVENESS TO ECONOMIC CONDITIONS

Both statistical and anecdotal evidence suggest that the British manufacturing industries feel the ebb and flow of the economic cycle more acutely than their service-sector counterparts. Figure 4 shows a comparison of performance between the two sectors in terms of

their domestic sales balances taken from the BCC's QES.

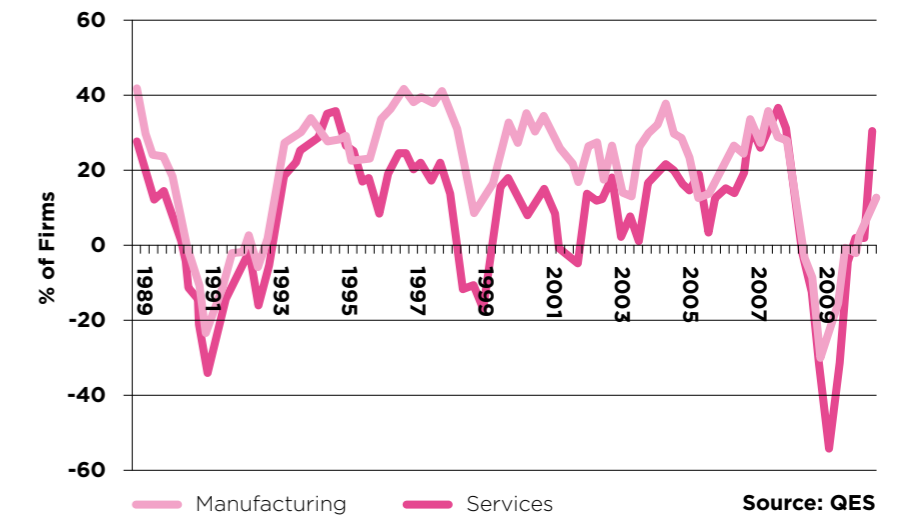
It is evident from looking at the graph that manufacturing firms tend to move closer to contracting sales balances at certain points within the economic cycle. Indeed, manufacturing firms slipped into negative territory in the late nineties and early 2000s, when the service sector continued to expand (albeit at a lesser rate).

The most striking example of sensitivity to economic conditions comes from the most recent recession, when this measure of activity for manufacturers fell substantially. While the service sector dropped to historic lows too, it did not suffer such an extreme reaction to the economic problems.

2.3 THE RECESSION

Manufacturing output collapsed at the start of the recession, falling by 14.5% between early 2008 and the third quarter of 2009, compared to a general GDP slump of 6.4%.²⁷ However, many commentators have been surprised at the resilience of manufacturing since the recovery began, and it has grown by more

FIGURE 4. DOMESTIC SALES MANUFACTURING AND SERVICE SECTOR FIRMS



than 1% in each quarter since the final quarter of 2009, rising to 1.65% in the second quarter of 2010 - well above general GDP growth.²⁸ This is reflected by the QES, which in Figure 4 above illustrates the sharp drop followed by general resurgence of manufacturing after the third quarter of 2009.

The collapse of demand at the end of 2008 and during the first half of 2009, meant that the turnover of a number of companies seriously diminished, such as at PMT Industries (8), which saw its turnover go from £8m in 2008 to £3.7m in 2009. Despite a general fall in demand, the majority of the companies that we spoke to

had seen a recovery by the second quarter of 2010. PMT Industries had a projected turnover of £6m for this financial year, while others, such as wallpaper printer Surface Print (6), described demand as being up by 20% on late 2007's figures.

Companies have dealt with the recession in various ways, but the common features have usually involved a limited number of redundancies and short-time working for the rest

26. Hansard - 8 Sep 2010 : Column 521W: www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100908/text/100908w0001.htm

27. The Economist, September 11 2010, p.32.

28. *ibid.*

of the staff, such as at PMT Industries where staff hours were reduced, and PD Castings (1) who also made redundancies. Businesses reported that Short Time Working meant that lay-offs could be avoided and key skills preserved within the workforce (8, 12).

Management often have commented that they were surprised by the workforce's understanding and general acceptance of the necessary measures to help steer companies through the recession. For example one company's employees even applauded when short-time working and limited redundancies were announced, as they realised it would help the company weather the storm (12). As can be expected during recessions, companies made use of the opportunities offered by the recession to manage production difficulties and make changes that ordinary conditions would not permit. However, the resurgence of many manufacturing companies

29. www.parliament.uk/briefingpapers/commons/lib/research/briefings/snep-01942.pdf

30. *ibid* p.2.

that we spoke to is now such that they have been able to reemploy many of the staff made redundant at the height of the recession, such as at PP Electrical Systems (12).

2.4 BRITAIN'S COMPETITIVE ADVANTAGE

British manufacturers have had a tough thirty years. Employment in manufacturing

has slipped continuously during this period, from 6.9m in 1978 to 2.6m today.²⁹ Likewise, many British manufactured consumer brands have located their production in lower-cost countries, experienced foreign takeovers, or disappeared entirely. As discussed in Chapter 1, despite these indicators, 2007 witnessed the highest

SMITH OF DERBY

Smith of Derby, members of Derbyshire and Nottinghamshire Chamber, is a family-owned manufacturer of clock and timepieces which currently employs 68 people. Established in 1856, the company has a long-standing reputation for maintaining traditional clocks, such as at St Pancras Station and St. Pauls Cathedral. Managing Director Bob Betts is seeking to expand business through designing, making and selling timepieces and artworks for iconic buildings such as new five-star luxury hotels.

By expanding the creative engineering share of the business to produce new high-end automated products, the company is looking to double its existing £5m turnover over the next three to four years. While some parts are bought in and some work contracted out to ensure fixed costs, the high-precision, hands-on skilled work is done by the company's own trained staff. Smith of Derby believe that the skilled workmanship it has is a clear competitive advantage over companies in most other countries, and allied to a long-standing reputation and tradition in clock-making it enables the company to win new business in emerging markets such as China. It recently won a contract to build the world's largest clock for a landmark in Ganzhou, where they saw off Chinese competition to win the bid.

output ever for the British manufacturing industry. Productivity indicators have continuously risen throughout the same period.³⁰ As can be seen in Figure 3, this was further underlined by our survey of 500 companies, which showed that turnover had increased for 30.9% of respondents along with export increases for 46.4% of businesses, while employment had only risen in 22.9% of firms, and had shrunk for 20.9%. This shows that greater turnover and exports have most likely been generated from higher productivity, rather than an increased labour force.

As a result of these trends, Britain's manufacturing industries are now highly efficient, productive, and innovative. Examples in our case studies show that the survivors of the relative decline of manufacturing in the UK and growth in global competition make themselves competitive through offering high quality, high levels of service, and innovative product development. As David Kern, Chief Economist at BCC has commented "after a decade of dealing with sterling's often crippling high value, British manufacturers and exporters are leaner and fitter than

many of their competitors on the continent".³¹

In many markets, British companies still have a strong reputation for quality (3).

own use.³² Such systems are used by other businesses, such as JDR Cables (17), a manufacturer of subsea cables and umbilical hoses for oil, gas, and the renewable

JDR CABLES

JDR Cables manufacture custom-designed subsea power cables, umbilical systems and marine cables for a broad range of uses, varying from oil and gas, to electrical supply transmission. The company is UK-based, but has production facilities in Thailand and The Netherlands, and service facilities in China, Norway and Texas.

RDA funding for JDR has been critical to its ability to become a world leader. For example, a £1.5m grant from the Regional Development Fund was won in 2000 to build new plant. Likewise, a £16,000 technology grant from East of England Development Agency was awarded in 2006 to develop renewable technology, with further £900,000 from One North East for a renewables plant in Hartlepool, as well as £2m from the Department for Energy and Climate Change to develop high voltage cables. As a result of this investment, JDR was one of the only domestic suppliers to the London Array wind farm project. These government investments have enabled JDR Cables to become an undisputed world-leader in its field.

PP Electrical Systems (12), a manufacturer of electrical control systems, has found its competitive advantage in the relentless pursuit of excellence, which the firm have achieved through adapting quality systems such as 'Six Sigma' to its

31. www.rozenbergps.com/books/britain/kern.pdf

32. Six Sigma is a business management strategy originally developed by Motorola in 1981 which seeks to improve the quality of process outputs by identifying and removing the causes of defects and minimizing variability in manufacturing processes.

energy industry. This can also be seen in our survey of 500 manufacturers where 61.6% of respondents thought that their products competed with those of other countries in terms of quality, while only 46.1% thought that they competed well in terms of price. Some businesses commented that their customers even specified British goods because of their reputation for quality. This can be seen at Thomas Dudley (7), which manufactures plumbing fittings, reported that architects in the Middle East demand the use of British products in their plans because of the UK's reputation for high quality.

Thus, despite the trends of globalisation during the past decade, many British goods remain competitive with those from lower cost economies because of the serious differences in quality. PMT Industries (8), which manufactures dryers for tissue paper processing, reported that a Chinese company did attempt to manufacture a comparably sized product, but the quality and safety testing was not to the same standard that PMT Industries would produce to, and thus failed in operation because of the high steam pressures involved.

Businesses which rely on precision work, premium brands, or have a reputation for high quality are far more likely to be successful and retain their production in the UK (4, 11, 12). Clockmaker Smith of Derby (11) has been able to win the commission for the world's largest clock in Ganzhou, China despite significant domestic competition. Likewise, customers now come to PP Electrical Systems (12) from all over the world because of its reputation for quality and precision.

PP ELECTRICAL SYSTEMS

Black Country-based PP Electrical Systems manufacture electrical and electronic assemblies and systems which go into machine tools, aircraft security systems, food packaging and weighing machines. Its turnover having grown from £4m in 1990 to around £20m in 2009, Chairman David Fox chalks up the firm's success to a rigorous training and quality programme which underlines all the work it does.

As the winner of numerous industry awards during the past five years PP Electrical Systems has built its achievement upon quality management and a continuous training programme for staff, all of which is conducted in-house. To further enhance the quality of its products, the company has also invested heavily in hi-tech bespoke machinery which in some instances has reduced production time from 24 minutes to 11 seconds. With such quick machinery, the company is able to remain highly competitive with global competitors who have lower labour costs.

Many companies have used state-of-the-art machines to bolster their competitiveness, which are used to increase quality, precision and speed (2, 6, 12). Other businesses have used their machinery to remain competitive with countries that have lower labour costs in Eastern Europe, South Asia and the Far East (7, 12, 14). This is because labour costs are only a small input into many up-to-date machines, and will therefore cost similar amounts to operate wherever in the world it is located –

FIGURE 5. BUSINESS FUNDING LIFECYCLE

SEED FUNDING

What	Development of ideas before company started.
Volume	Possibly small amounts to scope viability of an idea, but for manufactures might be much greater because could require initial greater R&D to establish product.
Where	Could be sourced from personal funds, grants, or suppliers.

START-UP CAPITAL

What	Capital to create company; buy plant, machinery & inventory; to scope for first business.
Volume	Much greater for manufacturers that other companies because of greater plant, machinery & inventory requirements.
Where	From personal funds, grants, suppliers, or for equity funding for some a limited number of hi-tech enterprises.

WORKING CAPITAL/CASH-FLOW

What	Capital for general working operations, financing orders, paying suppliers, working on export orders.
Volume	As above – often much greater for manufacturers because of supply costs.
Where	Company cash-surplus, bank/ debt finance, structured finance (e.g. invoice discounting).

GROWTH CAPITAL

What	Capital needed to expand – to develop new products, expand production capabilities, scope new markets.
Volume	As above, much greater for manufactures because of plant, machinery, and R&D costs.
Where	Company cash-surplus, bank/ debt finance, structured finance (e.g. invoice discounting), equity.

especially when quality and precision considerations are taken into account. For example, Black Country manufacturer Thomas Dudley (7) invested £2m in a new moulding machine for its foundry. This means that the company can not only compete with the best foundries in Europe, but is now winning business back from China because of delivery and quality issues in dealing with the Far East.

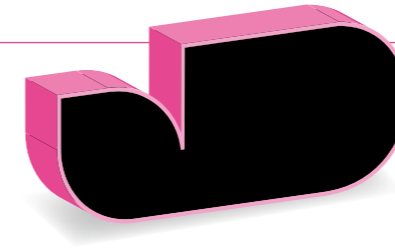
Other companies relentlessly adapt their products to

meet new customer's needs, and often have teams of employees looking for new ways that their products, machinery or in-house expertise can be tailored to find new sources of turnover and profit (2, 5, 12). Indeed, Hadley Group (5), which manufactures cold-rolled pressed steel, has a team of five people researching new uses for their ultra-strong steel, and has recently broken into the wine industry in France through adapting their products to hold vines. British companies also set

themselves apart from competition in developing markets by the high level of service offered to their customers, both in business to business transactions and to consumers. This is illustrated by Minivator (13), a manufacturer and installer of lifting equipment for elderly and disabled people, has distinguished itself in a crowded market by a relentless focus on service standards. Likewise, Malvern Instruments (19), a designer and manufacturer of particle sizing and measuring equipment, consider after-sales service and technical provision a key part of its product and has cornered much of the market as a result.

2.5 ACCESS TO FINANCE

As already discussed in 2.1, manufacturing firms have much greater financing requirements throughout their life-cycle than many other businesses (see Figure 5). The capital costs of setting up and growing a manufacturing business are greater than for a service company, especially given the large amount of plant and machinery that will often be required. Likewise, the initial costs of product design and associated R&D have a high outlay. Innovative products



can take time to become established and accepted into the market, which will have an impact on demands for external working and growth capital. Deltex Medical (10), a hi-tech business which designs and manufactures blood-flow monitors for patients recovering from surgery, is on course to break even for the first time at the end of 2010 after over twenty years of business. This is because it has taken time to establish the efficacy of its product among the medical profession. Many manufacturing firms also have a higher appetite for working capital because of material and component costs. Because cost of producing their products, which can sell for £1m per unit, PMT Industries (8) requires considerable working capital, even given the staged payments that it collects from customers.

Access to working capital and growth funding have been consistent problems for British industry. Indeed, 76.9% of respondents to our survey thought that access to finance was an issue for their business, while 22.2% said that better access to growth capital would benefit their company. These figures tally with the World Economic

Forum's assessment of the British economy, which placed 'Access to Financing' as the main problematic factor for doing business in the UK, with 22.1% of

SURFACE PRINTS

Fourth generation wallpaper maker Surface Print is one of the UK's only printers who add flock, a type of textile, to its wallpaper. It has found its competitive advantage in the use of a specialist technique, and in an unmatched reputation for quality and innovation. Despite a strong reputation and healthy order book, raising finance and maintaining cash-flow has been a problem for the company over the past couple of years because of the banks' conservative attitude towards manufacturers.

respondents citing it as their top issue.³³ This is borne out by the evidence of the Rowlands Growth Capital Review in 2009, which identified a serious growth capital funding-gap of between £2m and £10m for SMEs.³⁴

While British companies had problems accessing finance in more buoyant economic times, especially for growth, manufacturers have experienced exacerbated problems obtaining external funds during the recession and beyond. Even healthy firms with strong order books

PMT INDUSTRIES

PMT Industries manufacture drying cylinders which are an integral part of a papermaking machine; their niche product being the Yankee Dryer which is used in machines manufacturing tissue paper. With the larger dryers selling for in excess of £1m, their Yankee Dryers are used all over the world. It also has a general engineering and casting business in order to fill spare capacity and maintain a constant workflow. A growing part of its business is found in servicing products and helping to maintain and repair not only those manufactured by themselves but also those of its competitors.

Access to working capital has been strained during the past couple of years. Its bank will not offer overdraft facilities unless backed by a guarantee from the parent company's main bank which has left it over-reliant on its parent company. Cash-flow has been further damaged by its suppliers' trade credit insurers who have cut cover to their lines of credit because the British metals industry has been unfairly condemned as too risky.

³³. www.weforum.org/documents/GCRO9/index.html

³⁴. www.berr.gov.uk/files/file53698.pdf p.3

have witnessed such issues over the past couple of years (6, 17), and the majority of firms we spoke to reported that unstructured bank finance had been especially hard to come by. Often, when finance is available, companies commented that it has often been prohibitively priced (6).

These problems are exacerbated by the difficulties associated by businesses perception of banks' conservatism in lending to manufacturers. In order to fund working operations and growth, some manufacturers have turned away from unstructured bank finance and used structured products such as invoice discounting or factoring as a key route to finance operational needs and growth. Deltex Medical (10)

factors its outstanding invoices to its bank in order to free up cash-flow. Family owned company Surface Print (6) used this mechanism to fund a move to larger premises and increase capacity.

Businesses themselves are often unwilling to explore all capital options such as surrendering equity in order to fund growth. This is understandable given that many manufacturing companies, such as Westons Cider (16), Thomas Dudley (7) and Surface Print (6) are family enterprises which have been in business for many generations whose management might feel it inappropriate to alienate shares outside the family. Likewise, entrepreneurs who have set up their companies and worked hard to make

them a success might be unwilling to give up significant equity stakes.

Luxury chocolatier Hotel Chocolat (16) has taken an innovative approach to raising growth funds. Although as a successful growing company it does not have problems raising capital from banks, many of its customer-base wanted to invest in the company. To meet this demand, it issued a 100,000 three year bonds to be repaid in chocolate raising £3.7m in growth capital. This will be used to fund development projects including the development of a cocoa estate, expanding UK manufacturing output, and growing an international commercial presence.

2.6 TAXATION AND ALLOWANCES

Taxation of all forms plays a vital role in encouraging or constraining business growth and investment. It is clearly one of business' main costs, and has the potential to make the UK more or less competitive vis-à-vis its competitors. Britain is actually not in a bad position compared to its chief developed-world rivals on taxation rates; the World Economic Forum's Global

SUPERIOR GROUP

Superior Group designs and manufactures precision rubber seals and mouldings for hi-tech equipment. With a turnover of more than £20m, the third generation family-run business now employs 163 people and produces over a billion 'O' rings and mouldings annually.

Winning the Queen's Award for Enterprise in 2008, the firm invests heavily in cutting-edge research, state-of-the-art automated machinery and a highly-skilled workforce. The businesses management are very concerned about Government changes to capital and investment allowances, and believe conservative attitudes to business lending from the banks are a major problem too.



Competitiveness Report shows that 12.1% of respondents from the UK said tax rates were a top-five issue for business. While this was still the fourth biggest issue, it compared favourably to 14.1% in the US, 14.4% in Germany, and 17.3% in France.

Because headline rates of business taxes have been lowering all over the developed world, the Coalition Government took the decision to lower Corporation Tax in the 2010 budget. In a move broadly welcomed by business, the main rate will drop from 28% to 24% over the next four years, although the small profits rate (for profits under £300,000) is only falling to 20% from 21%. However, Capital and Investment

Allowances have been hard hit in order to pay for the £1.8bn project cost of the tax cut.³⁵ While the rates of Capital and Investment Allowances impact upon all businesses, they are far more important to manufacturers, who have a greater need for plant and machinery, and whose productivity will be affected in a far deeper way by new investment here. As already illustrated in 2.4 above, some companies have found that by installing state-of-the-art equipment they can remain competitive with the Far East, and this behaviour should be encouraged. Indeed, the Impact Assessment for the 2009 Budget stated, "business investment is a key driver of productivity and will

be key to economic recovery",³⁶ although the current Government policy does not necessarily sit well with this.

The lower rates of Capital Allowances will also disproportionately impact upon smaller companies, who ideally should be encouraged to make greater investment in their plant and machinery. Those on the Small Profits Rate will only marginally benefit its lowering, while after April 2012 they will be

MINIVATOR

Minivator manufacture stair lifts, bath lifts and hoists for elderly and the disabled. The company sets itself apart from their competitors by providing a high-quality service to clients. CEO Mike Lord, believes that the greatest problem for small and medium manufacturing firms is in securing access to finance. He believes that if the Government is serious about a renaissance in manufacturing, it must incentivise business investment with lower taxes on capital gains that are re-invested.

³⁵ www.guardian.co.uk/uk/2010/jun/22/budget-2010-corporation-tax-slashed-to-24p

³⁶ www.hm-treasury.gov.uk/d/Budget2009/bud09_impactassessment_1395.pdf p.231

H. WESTON AND SONS

H. Weston and Sons are a premium cider maker based in Herefordshire. The family company has been in business for over 130 years. The last decade has been particularly successful for the company, which has seen nearly threefold growth, mainly due to changing tastes within the UK and increased demand from abroad.

Taking an innovative and adaptive approach to meeting changing consumer tastes, Westons has been particularly adept at developing new products, investing heavily in new products, as well as new capital equipment. It has also invested heavily in skills and employee development.

Managing Director Helen Thomas believes that the greatest threat to growth comes from creeping regulation, which effectively distorts the market. For example, increasingly complex employment regulation and the ever-rising minimum wage mean that fewer jobs are created in rural areas like Herefordshire than otherwise could be.

able to claim far less under Capital Allowances, which are being reduced from 20% to 18% in the main rate, and 10% to 8% on the special rate. The Annual Investment Allowance will likewise be reduced from £100,000 to £25,000 over the same period – another move that will seriously impact on manufacturers, especially smaller firms.³⁷

³⁷. www.hm-treasury.gov.uk/d/junebudget_complete.pdf p.25

³⁸. www.weforum.org/documents/GCR09/index.html

These concerns were reflected by many of the companies that we spoke to, who thought that allowances should be rolled out further with more key capital products on the higher rate of write-off.

While many manufacturing companies appreciate allowances and related schemes levied through taxation, the British tax structure is known to be bureaucratic and difficult to navigate without significant professional advice. This is illustrated by our telephone

survey where 14.5% of respondents said that a simplified tax system would greatly benefit their business. Tax regulations were cited as the third worst issue facing British business by the World Economic Forum.³⁸ The paucity of clear information on business taxes from HMRC websites can only serve to add to the confusion. Businesses we spoke to felt that the British tax system was far too complex, and a number of companies felt concerned about the rules surrounding different allowances. It was also clear from our research that some businesses were not using allowances that they were entitled to because of perceived bureaucracy around claiming.

Tax can also prove to be a disincentive for entrepreneurship. A number of businessmen that we spoke to during our research thought that personal taxation is now set at a rate that discourages entrepreneurs from taking a sufficiently long-term view of their businesses. This is because they seek to sell their businesses in order to make significant money from their hard work, especially now that the top rate of Income Tax is set at 50% (16).

HADLEY

Hadley Group, based in the West Midlands, manufactures highly innovative cold-rolled steel which is used across industry. With a turnover of £90m, it also has factories in Germany, Thailand and Dubai. Placing a high premium on R&D, the company has won the Queen's Award for Innovation for UltraSTEEL® - a stronger, but lighter treated steel.

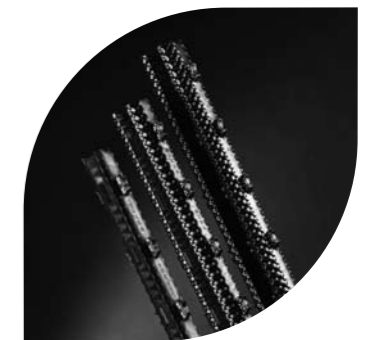
The biggest problem for Hadley is a lack of state-backed export trade credit insurance. The firm has lost valuable business because private insurance companies have withdrawn from the market, and the UK does not have state-backed trade finance products like its European counterparts.

2.7 RESEARCH, DEVELOPMENT AND INNOVATION

Successful manufacturing companies place a high value on research and development. However, despite it being clear that the creation of new products and the improvement of existing products is the lifeblood of industrial growth, British firms continue to invest too little in innovation. The UK has consistently spent 1.8% of GDP on R&D since 1997 compared to an average of 2.29% across all developed economies.³⁹ The necessity of investing in R&D has been highlighted by the OECD, which isolated innovation as a key source of growth, and stated that “cutting back public

investment in support of innovation may provide short-term fiscal relief, but will damage the foundations of long-term growth.”⁴⁰

The importance of investment for individual companies is borne out by our body of successful manufacturer case studies, the majority of whom place a high premium on investment in research. For example, Hadley Group (5), which has won the Queen's Award for Innovation, have over forty employees permanently tasked in development, with a further five looking for new uses for existing products. Likewise, Superior (2), which won the Queen's Award for Enterprise in 2008, invests heavily in cutting-edge research.



As recognised in HMRC's Research Report published in November 2010 Qualitative research into businesses' Research and Development (R&D) decision-making processes,⁴¹ R&D Tax Credits are important for changing the behaviour of British companies and encouraging them to invest more in the development of new products.⁴² However, there

³⁹. OECD Innovation Report 2010.

⁴⁰. *ibid.*

⁴¹. www.hmrc.gov.uk/research/report101.pdf

⁴². Qualitative research into businesses' Research and Development (R&D) decision-making processes. HMRC, August 2010 (published November 2010), p64.

are limited parameters for what may be claimed through R&D Tax Credits. As HMRC states, companies may only claim the credits "if an R&D project seeks to

achieve an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technological uncertainty - and not simply

or developing other non-technological unique selling points) isn't considered as R&D for the purposes of R&D Tax Credits".⁴⁴ While the scheme is generous for qualifying research, many companies are either unaware of what they could claim for, while others are discouraged by the perceived difficulty of access. The lack of clarity leaves many companies wondering if they are able to claim. For example, Surface Print (6) developed innovative new printing machinery, although did not apply for R&D Tax Credits as management did not believe it would qualify. Many businesses also felt that the incentives were too cumbersome and time-consuming to access, even if they had research that could pass the stringent conditions (4, 10).

The overall impact of the scheme is telling. Credits are made available either as a tax deduction based on R&D spending, although in some instances it is possible for certain loss making SMEs to gain a cash payment from HMRC. From August 2008, SMEs have been able to claim 175% of qualifying expenditure, while large companies of over 500 employees can claim 130%. In 2008-09 a total of 6,600 claims were made

by SMEs, costing a total of £260m, of which £80m was from deductions to Corporation Tax and £190m in payable credits. Large companies made 2,190 claims costing a total of £720m, including 450 where research was subcontracted out to SMEs. In total all R&D Tax Credit schemes cost £980m in 2008-09.⁴⁵ Considering that the UK spends 0.5% less of its GDP on R&D than the developed world's average, the gap is not currently being filled by innovation policy in general, or by R&D Tax Credits in particular.

Grants for Research and Development have formed another key plank of R&D policy for the past decade, although they are likely to decline in the coming years. JDR Cables (17) has recently received a £2m grant from the Department for Energy and Climate Change to develop high voltage cables for renewables. Grants such as these have increased the company's chance of entering new innovative high-growth industries and becoming the market leader. Such grants also serve to attract other sources of private funding once they have been awarded.

However, there was also a perception here that schemes

in this area underwent too rapid a change. Deltex Medical (10) spent considerable time and money attempting to access an innovation fund through the advice of a government business adviser, only to find that the scheme had closed by the time it submitted the application, although no warning had been given. Likewise, accessing such grants can also be far too bureaucratic

for many businesses. For example, software engineer Dynamax (9), had to fill in countless forms collecting the same information to access various schemes and grants. Likewise, Minivator (13) has attempted to use various Government research schemes and initiatives such as a Knowledge Transfer Partnership, but found them too slow-moving to be of effective use for a fast-moving business.

DELTEX MEDICAL

Deltex Medical design and manufacture equipment that measure patients flow of blood during operations which has been proven to improve surgical outcome and reduce the length of hospital stay.

The company has previously tried to access grants and R&D Tax Credits to underpin R&D, but the process to do this has been a cumbersome one - and liable to change. For example, in one instance it applied for a grant which required significant time and effort only to find the funding pot had been removed. As a result, it has taken the decision to be very selective about which grants to apply for.

Deltex Medical believes that there is the opportunity now for innovative companies to establish themselves in the UK, but they will need to invest heavily into gaining comprehensive clinical evidence on their product before they will see any significant returns.

an advance in its own state of knowledge or capability".⁴³ However, BIS guidance says this can include "new or improved products, processes and services. However, broader innovation in products, processes and services (e.g. proprietary content, non-technical design

43. www.hmrc.gov.uk/ct/forms-rates/claims/randd.htm#4

44. www.bis.gov.uk/policies/innovation/business-support/rd-tax-credits/about

45. www.hmrc.gov.uk/stats/corporate_tax/randdmenu.htm

FIGURE 6. BALANCE OF TRADE IN GOODS AND SERVICES FROM THE UK 1975-2009

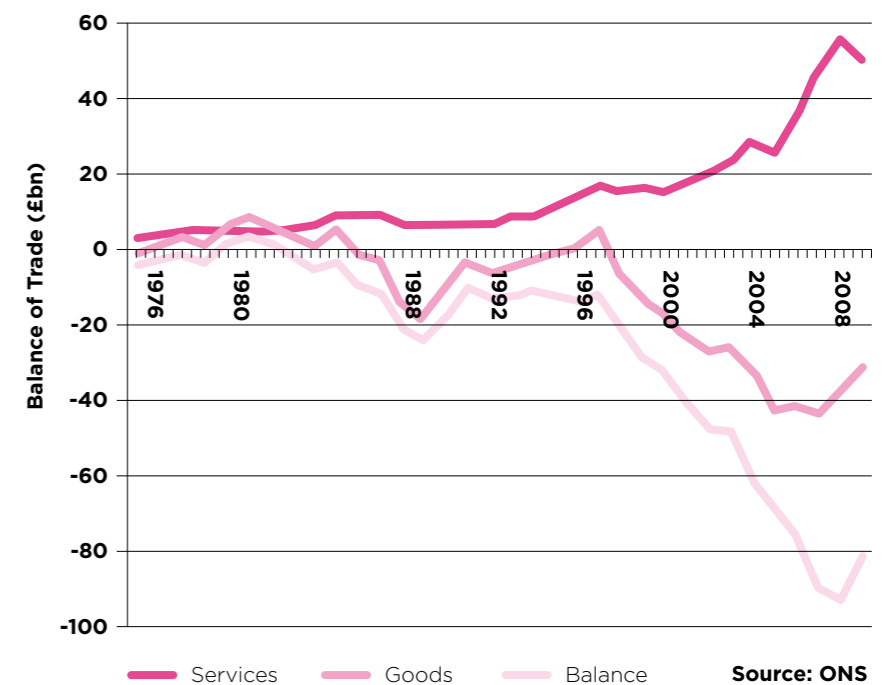
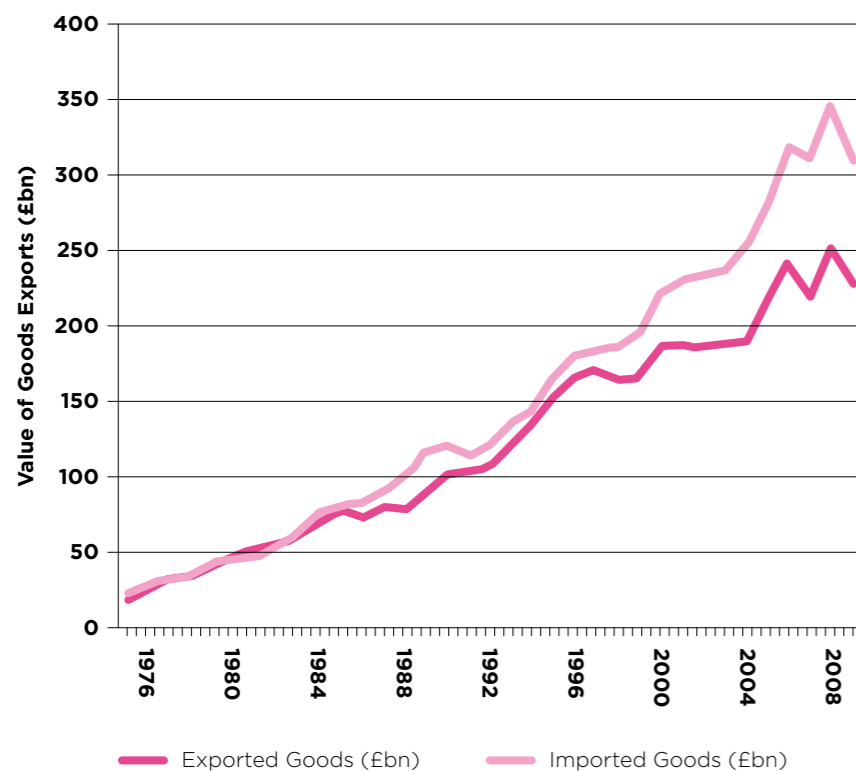


FIGURE 7. TOTAL VALUE OF EXPORTED AND IMPORTED GOODS 1975-2009



Source: ONS

2.8 EXPORTING

Both business and Government are in agreement that exporting more of what the UK manufacturers is the key to creating a successful, sustainable and balanced economic recovery. As global trade demand continues to improve, British manufacturing companies must become more adept at selling their goods abroad – not just within the established markets of Europe and the

developed world, but into the high-growth developing markets of Brazil, Russia, China, India, and the other Asian tiger economies who have experienced only a fraction of the problems experienced by the developed world during the past two years.

Britain still has a mountain to climb in this respect; Britain currently exports more to Ireland than all Brazil, India, Russia and China combined.⁴⁶ As Figure 6 shows, Britain has operated a deficit in traded goods since the early 1980s, while during the past decade a massive rise in imports has fuelled one of the largest trade deficits in the world, which reached £37.8bn in 2008 and £32.0bn in 2009. Likewise, the UK has slipped down the league of exporters, and is now only the tenth largest in the world.⁴⁷

Although these figures have been soothed by Britain's surplus in traded services, the vast majority of which was financial and insurance, the UK's deficit in traded goods reached a peak of £93.1bn in 2008 and £81.9bn in 2009.⁴⁸ However, the situation is more complex than it first seems, because as Figure 7 shows, the value of goods exports have still generally risen over the past 35 years, but have not kept pace with the value

of imports, which have risen exponentially – especially over the past decade.

Exporting is central to many manufacturing businesses, who often find that the home market is too small for sustained growth. Although the vast majority of our case study companies were exporters and considered

international trade to be a key part of their business, not enough British companies currently export their products. In our survey of 500 companies, 27.2% of respondents said that they didn't export at all, while a further 13.8% only made 10% or less of their turnover from international trade. 46.5% of the businesses

who didn't export said that it was because there was sufficient business in the UK for their needs, while 23.2% said that it was because they did not have a suitable export product. This suggests that businesses are not spending enough time and effort on developing new products, adapting existing products for export, or

SOLUTIONS GROUP

Solutions Group, originally wholesalers to the TV and satellite installers, and the multimedia, sound, lighting and security industries, have recently taken production of premium brands in-house and opened a manufacturing facility. The Far East has proven unbeatable for the production of high-volume low-cost goods, but Solutions Group has found that quality is not always reliable, while there is also a genuine risk of IPR theft – especially for their premium range.

Until last year the firm did not manufacture any of its goods in-house. Most of its own products are designed in the UK but manufactured abroad. However, a nearby UK-based Japanese company which produced its premium range withdrew from the UK at the end of 2009 leaving Solutions Group with no one to manufacture its best selling product. It was faced with the choice of either looking for another supplier, or bringing manufacturing in-house for the first time. While it tried to access government grants to help do this, it found the application procedure too slow-moving for real business needs and went forward alone. The new manufacturing business looks like a promising addition to Solutions Group and has employed skilled people who otherwise would have become redundant.



46. www.telegraph.co.uk/finance/china-business/8115991/Vince-Cable-believes-British-companies-can-thrive-in-China-if-they-are-given-the-chance.html

47. stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=GB

48. The Pink Book 2009 ONS.

scoping out possible new markets for their goods.

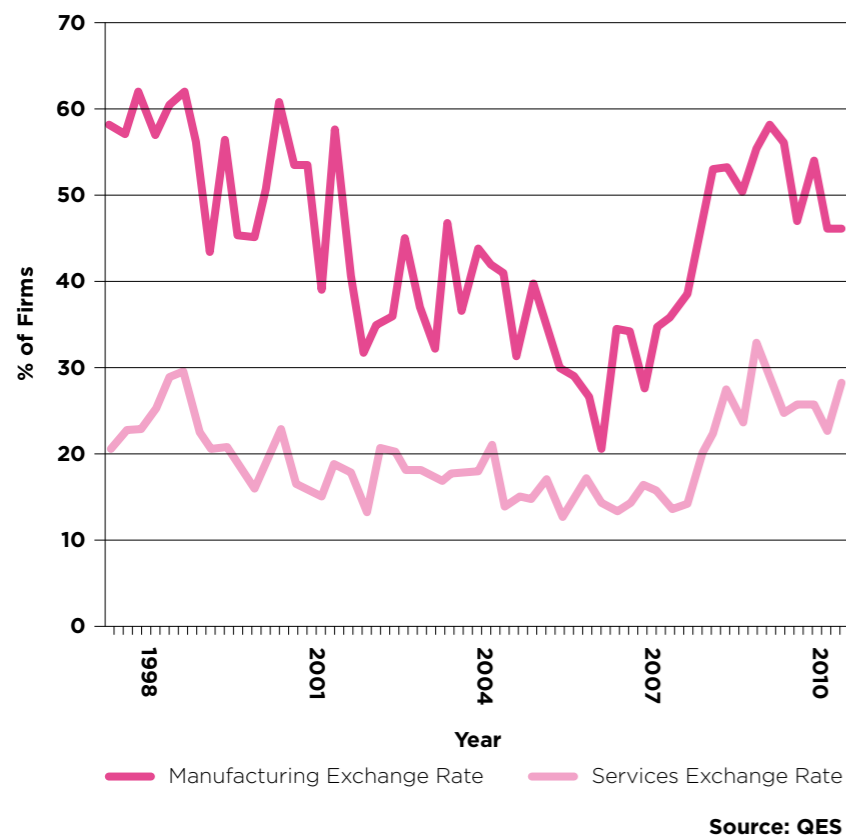
If exports are to help pull the UK into a sustainable recovery, the number of companies who export must increase, while those who already export must increase their volumes and enter new markets. This is illustrated by the 68.5% of respondents to our survey who thought that their growth would come

from exports over the next five years. If this is to be achieved more companies must invest significantly more of their time and money scoping for new business overseas.

2.9 CURRENCY AND EXCHANGE RATES

Manufacturers are far more sensitive to currency pressures than service companies. This is revealed

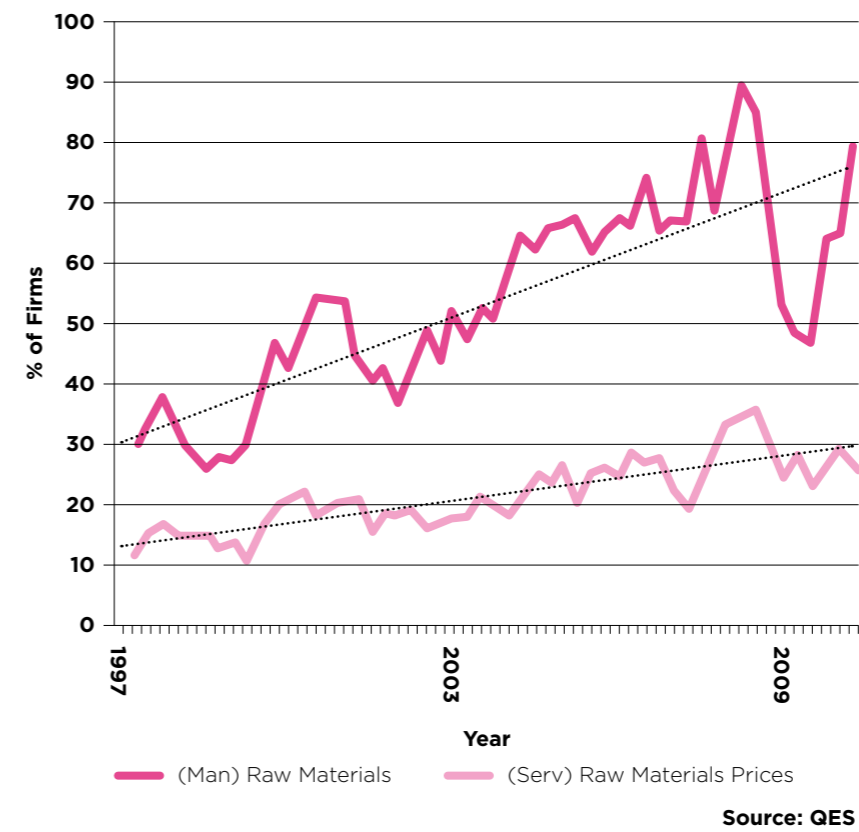
FIGURE 8. FIRMS (%) REPORTING EXCHANGE RATE IS MORE OF A CONCERN THAN THREE MONTHS PREVIOUS



by the BCC's QES, which inquires into which external factors are more of a concern to businesses than three months previously. Although series averages for interest rates, business rates, competition, taxation and, inflation are broadly equivalent since 1998, which for the exchange rate factor in the manufacturing sector is more than double that of the service sector. Furthermore, in absolute average terms it is the biggest external area of concern for manufacturing firms. This is illustrated in Figure 8, which shows the manufacturing and service sector comparison, indicating that the manufacturing sector is much more sensitive to currency fluctuations than the service sector.

Although prior to 2008 sterling was expensive when compared to a basket of other major currencies, it has lost around 25% of its value against the dollar, euro and yen during the past two years. Many commentators predicted that this would increase the volume of exports from the UK, and decrease imports, thus reducing Britain's substantial trade deficit. However, the projected rise in British exports has not materialised

FIGURE 9. FIRMS (%) REPORTING PRICE PRESSURES FROM RAW MATERIAL COSTS



at anything like the extent predicted, and many in both the Government and media have been at a loss to explain why.

In our sample, some companies, most notably suppliers of consumer goods made entirely within the UK, have indeed found that the drop in sterling has correlated with an increase in export orders, such as Surface Print (6) and Westons Cider (18). However, as reflected in Government statistics, many companies

have found that it has made no difference to their volume of export orders.

It must be remembered, that while sterling is still more competitive than it was up until 2007, it has appreciated against both the euro and dollar during the past few months, reaching €1.18 and \$1.60 in November 2010 from lows of €1.02 and \$1.35. This means that many companies are unable to base their business strategies around

currency depreciations, which are usually far more short-term than business cycles. Many companies that we spoke to said that what they really needed was a sustained and stable improvement in the exchange rate for a protracted period if British exporters were really to benefit. (1, 5, 12). Two companies (5, 12) said that a sustainable value for sterling against the euro was £1:€1.30. This was reflected by 81.3% of respondents to our survey who said that the price of sterling was an issue for their business, and 75.7% said that the cost of raw materials was a serious problem - which can only be exacerbated by unstable currency prices.

For many manufacturing businesses, which have inputs to their supply chains from all over the world, raw material costs have increased as the exchange rate has slipped. For example, Thomas Dudley (7) has found that the cost of its raw materials has increased considerably in the past couple of years. Even SMEs maintain supply chains of semi-finished goods and components from all over the world, so a lower value of sterling makes some of their inputs more expensive.

FIGURE 10. VALUE OF EXPORTS BY MONTH FROM JANUARY 2008 TO JUNE 2010



DYNAMAX

Dynamax, based in Blackburn, produces complex software for the scheduling of content on digital signage to customers who include transportation hubs, businesses, education centres and retail outlets.

As a relatively young company, Dynamax has relied on UKTI services to help it export, although this hasn't been without problems. It finds the overlap of UKTI with other Government bodies confusing, while bureaucracy associated with schemes could also be cut down through the use of single customer service managers who act as a front-of-house to all UKTI services. Likewise, the service could be improved through better sectoral knowledge. The company has commissioned a variety of OMIS reports, although these have been of variable quality. The officer responsible for its first report listened to what Dynamax wanted and gathered a number of successful contacts. Unfortunately, the author of the second report did not follow up with the company after the initial commissioning and made no attempt to understand the product or its potential customer-base, resulting in a poor OMIS.

Within the QES, businesses are also asked about the factors that are contributing to pressure to raise prices. As Figure 9 reveals, a key factor for this has been the cost of raw materials. In the manufacturing sector, the upward trend far outstrips that of the service sector, which would also suggest that firms operating in global supply chains would have their increased margins offset, in part at least, by increased input prices as a result of currency depreciation.

Another possible reason for the lack of large scale increase in British exports is that some firms, such as Deltex Medical (10), have used the fall in sterling to increase their profit margins rather than lower their prices in order to gain higher market share. Because of sterling's uncompetitive high value during most of the 2000s, many companies cut their export profits to the bone in order to retain market share internationally, and have since used the opportunity of sterling's fall to shore up their balance sheets during a difficult time.

Globally, it is also clear that while sterling lost value, global demand also dropped

dramatically. Therefore, while British goods did have the potential to be more competitively priced, the markets for them shrunk rapidly. This has been compounded by the fact that British companies still sell predominantly within the Eurozone and developed world, which have seen protracted recession and sluggish growth compared to high-growth developing markets.

Despite the relatively sluggish growth of British exports, there is clear evidence to suggest that trade in goods picked up during the six months from May 2009 to September 2010, as seen in Figure 10 above. Total goods exports by September 2010 reached £22.35bn, up from £17.88 in May 2009 - its lowest point during the recession and collapse in global trade.

2.10 UKTI AND TRADE PROMOTION

Governments across the world provide trade promotion services for their exporters. The British trade promotion agency, UK Trade and Investment (UKTI), performs many vital functions for British companies that wish to engage in trade, such

as organising delegations into different markets, funding tradeshow access and creating British pavilions, providing market research, and running schemes to help SMEs export for the first time. October's spending review has cut UKTI's programme budget by 25% over the next four years, and this will undoubtedly have an impact on the range and quality of services offered.⁴⁹ Further cuts to UKTI's budget could also take place once departmental spending reviews have taken place at the Foreign and Commonwealth Office (FCO), and Department for Business, Innovation and Skills - both of whom provide other parts of the budget for trade promotion.

While many exporting manufacturers that we spoke to had used UKTI and saw its services as vital, they often had mixed views about its effectiveness and efficiency. While some found it useful, especially for its investigative work into new markets (5, 10), the majority felt that it could be further rationalised with a more joined-up service offered, and that its quality could be variable (9, 10).

⁴⁹ Spending Review 2010, HM Treasury p.84.

Our survey showed that 32.7% of businesses responded that they felt better export support from the Government would be one of their top three policy changes to help manufacturers. The number of different Government organisations that attempt to help exporters also added to confusion (9), such as UKTI, ECGD, Chambers of Commerce and RDAs.

UKTI now charges for many of the services that it once offered free of charge. A number of companies commented on this, and also said that they felt UK staff were very keen to sell them charged-for services whenever they came into contact with them (7). Despite these charges, such as for the Overseas Market Introduction Service (OMIS), companies often reported receiving variable quality work (9, 10). One interviewee from an SME technology company commented that a bad OMIS can set a small business's growth back considerably (10). Companies such as these often only have a small marketing budget, which dictates a gradual approach to new market entry; a bad OMIS and in-market service from UKTI has the potential to damage

growth strategies based on exporting for a considerable time period.

It is clear that charges at UKTI will increase after the Spending Review, and that the number of charged-for services will increase. We understand the need to recoup some costs from businesses, both because of the current state of the public finances, and to act as a gate-keeper to make sure companies genuinely have a commitment to exporting. However, fees should be set at a level that encourages and supports new SME exporters without strong cash-flows. Furthermore, UKTI must ensure that the raising of funds through collecting fees for services does not detract from qualitative help for exporters. Businesses also have a right to expect that services they are paying for are of a consistent high quality.

Despite the problems identified by our business case studies, companies thought that UKTI services could often be effective. The UKTI organised British presence at international trade shows was considered a particular success (9, 10). Such events were often made especially effective by the

attendance of a Government minister (10). As such, BCC welcomes the appointment of Stephen Green as Minister for Trade and Investment. We hope that he will play a critical role leading trade delegations and helping to open new markets for sometimes risk-averse UK exporters.

2.11 MARKETS

Well trodden markets within the developed world generally, and the European Union in particular, still form the backbone of UK export markets. While the EU is still not considered as a 'home market', it is certainly an easier market to penetrate than the United States, which is difficult to break into because of size, business culture, and industrial structures which often afford regional monopolies to businesses (4, 9).

There is a strong perception that developing markets are difficult to tap into, with some companies choosing to fill unmet demand in markets closer to home before venturing into riskier business with Asian countries. For example, Surface Print (6) felt that it still had enough potential business in Europe and North America to not

enter riskier high-growth developing markets.

It is clear from the case studies that big companies are far more likely to trade with the Far East than smaller companies, who are more sensitive to the potential problems which are inherent in exporting and exacerbated by trading with developing countries, especially where export finance is unavailable. However, sales to China are growing significantly for some companies.

Malvern Instruments (19), which manufactures particle measuring and sizing equipment, has its main customers in China, and has recently taken over a Chinese competitor. Likewise, Hadley Group (5), and JDR Cables (17) have both opened Thai plants to facilitate trade in the Far East. Hadley also manufactures its special product 'ultra-steel' on licence throughout the world, while JDR Cables manufactures the bulk of their products in the UK, and then assembles them in Thailand for the Asian market.

Some markets are chosen because they have similar technical standards to the UK. For example, Thomas Dudley (7), a manufacturer

of toilet cisterns, has its export destinations dictated by those markets which employ British technical standards, such as in the Middle East or Hong Kong. Conversely, Solutions Group (15), which supplies technical equipment to TV and satellite installers, exports very little because of the different technical specifications in the UK compared to the rest of Europe. Different payment terms across

world markets can prove to be a problem for SMEs, as this can seriously hamper cash-flow. Standard terms in the UK are on average 45 days, while this can lengthen to 60 days in the rest of Europe. Terms in Asia are up to 90 or 120 days. While this is manageable for large companies with strong cash-flows, it can be troublesome for SMEs hoping to enter high-value Asian markets.

HOTEL CHOCOLAT

Luxury chocolate manufacturer Hotel Chocolat has sought to differentiate itself from competitors through a relentless focus on innovative branding and new product development. Premiering a Tasting Club in 1998 to trial new products and build up a loyal customer base of connoisseurs, the company has taken an all-encompassing approach to chocolate-making through the purchase of a cocoa plantation on the Caribbean island St. Lucia in 2006, and is also opening an eco-resort there last year.

Drawing on his business experience, Managing Director Angus Thirlwell believes that in order to stimulate growth, the main aim of the government's business policy should be to provide as simple a business environment as possible. The increasing complexity of the tax regime, regulatory structure and legal environment in which business operates is a major inhibitor of growth. He believes the current personal tax regime also acts as a disincentive to would-be entrepreneurs, and encourages a short-term approach from many business owners, who see selling their business as the only effective way to make a serious return.

2.12 EXPORT TRADE FINANCE

Exporters often rely on export finance because international trade is highly risky for many businesses, especially small and medium sized firms. Many of the problems inherent in domestic trade are also evident when trading abroad, but are harder to predict and much more difficult to resolve once they occur. Export trade finance arrangements, such as trade credit insurance which guarantees open lines of credit, Letters of Credit which guarantee payment on production of the correct documents at a bank, or export working capital, mean that companies can mitigate some of the risk of exporting.

BCC research from March 2010, *Exporting Britain: Trade Finance*, has shown that during the recession, many of the trade finance arrangements that exporters relied upon dried up, while the private market has been

consistently reluctant to cover risk in high-growth developing markets. While this is also the case for other major trading nations, their businesses are able to access state-backed schemes that cover markets private insurers consider too risky.

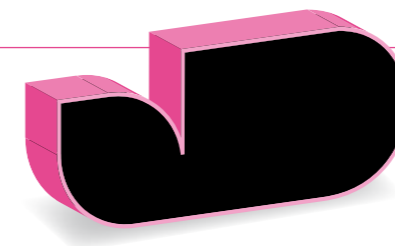
Exporting is often undertaken through an open account basis, which means that companies bear the risk without finance or insurance. In the absence of trade finance arrangements, newer or riskier customers are also forced to pay upfront for goods (4, 7, 10). This can put British companies at a competitive disadvantage to manufacturers from countries which offer better state-backed export trade finance regimes, such as at wallpaper manufacturer Graham and Brown. As a case study in the March 2010 BCC report *Exporting Britain: Trade Finance*, Graham and Brown found that despite its size, it is unable to enter the Russian market, which is the world's largest, and operates on 90 day terms. As a private family business, the firm cannot afford to expose itself to more than €2m aggregate debt, which has limited its sales potential. Regrettably, this places Graham & Brown at a serious disadvantage

against their main German competitors, who use state-backed export credit insurance to leverage much larger sales into the Russian market.⁵⁰

Even cash-rich large companies with healthy order books have experienced serious restrictions on their exports because of a lack of available trade finance. Hadley Group (5) recently lost out on a £2m export order because it could not obtain insurance, and to trade on an uncovered open account basis would have been too great a risk.

Because of this, a significant number of exporters believe that the Government must institute a state-backed short-term export trade credit scheme if it is serious about supporting British exporters (5). Indeed, 12.2% of businesses that we surveyed thought that a state-backed export trade credit insurance scheme would be one of main policy changes that would benefit their company.

Letters of Credit (LCs) are also a commonly used finance facility. However, some companies refuse to use LCs in their transactions, even in risky markets, because they are overly



expensive and bureaucratic (4). Furthermore, banks have become even tighter on enforcing the terms of LCs during the economic crisis, meaning that they are too cumbersome to be used by many companies. While the last Government instituted a Letters of Credit Guarantee

had to be paid for up-front, seriously damaging cash-flow. Another company who was interviewed as part of BCC's trade finance work, Team Leyland, found that it was down-rated by its supplier's export credit insurers, despite being in good financial health.⁵¹

2.13 EXPORTING AND REGULATIONS

Export regulations are often cited as a real issue for manufacturing companies. Businesses accept that some regulations such as those relating to health and safety are necessary, but believe that other requirements, such as those associated with exporting are cumbersome and badly implemented (4, 5). This can be seen in those related to trade with Turkey and other countries that have preferential trade agreements with the EU require burdensome documentation because of European rules. Many SMEs believe that the needs of big business are better taken into account when the Government is creating regulation because they are easier to engage with (4).

Political problems and the associated bureaucracy can often interfere with quite reasonable access to high-value markets such as Iran or Syria. The ever growing list of items under some form of export control impedes genuine business to business contact in those markets (4).

MOLYSLIP

Molyslip, based in Oxfordshire, manufactures specialist lubricants for use across industry in expensive machinery using special compounds to set its products apart from those of larger competitors. Government regulations around exporting are one of the company's main problems.

In some instances, overly zealous export control rules can stand in the way of reasonable trade with countries such as Iran, where there are significant profits to be made. Likewise, the banks also stand in the way of British exporters in these markets. For example, many will not deal directly with Iranian banks, even if the export products themselves do not contravene the terms of the current embargo.

Scheme during the course of the recession, only a handful of LCs have been facilitated in this way.

Export trade insurers have also caused problems by downgrading some British manufacturing firms. For example, PMT Industries (8) was downgraded, which meant that goods have

In line with the experience of businesses that have had lines of finance cut, decisions have usually been based on arbitrary classifications such as which particular industry the firms operate in. This has caused serious cash-flow problems for businesses that now have to pay up-front for their supplies.

50. *Exporting Britain: Trade Finance*, March 2010 p.7.

51. *ibid* p.11.

Banks also often stand in the way of trade with such markets, as they can refuse to deal with companies from

Europe. During the past five years or so, many technical standards have been repealed as they could be considered

water-efficient valve flushes into the UK. When changing technical regulations, the Government should always attempt to understand the impact that this will have on domestic producers.

MANN+HUMMEL UK

MANN+HUMMEL UK are a car components manufacturer. The British subsidiary of a German family company has been based in the UK since 1996, where they opened in Wolverhampton because of the potential of the UK engine market and the Black Country's strong engineering reputation.

The company has found itself to be competitive with many lower-cost countries because of its hi-tech machinery, production quality and a well-motivated workforce. Whenever the UK offers the best conditions, production will take place here.

Neil Davies, Chief Financial Officer in the UK, said that while the UK may never be a low-cost country, it is still a best-cost country because of the whole package of quality, service and productivity offered.

such countries, even if the UK Government permits trade with them, or in certain products.

Changes in domestic regulation can sometimes adversely affect manufacturers especially where they relate to technical standards. For various reasons, British technical standards and regulations are often different from those in Continental

as non-tariff barriers to imports from the EU. When such changes occur, British companies, who have specialised in conforming to British standards, are placed at a disadvantage. For example, Thomas Dudley (7), which manufactures British cistern toilet flushes, found that it has been impacted by the Government changing regulations to allow cheaper but less

2.14 EXPORT TRANSPORTATION COSTS

The costs of physically exporting goods are significantly more expensive for British companies than for their European competitors, especially when trading within the EU. Moving goods from the British Isles to Continental Europe is expensive; although road-haulage costs within the Continent are cheap (5). One company cited the fuel costs involved in transporting their goods as a serious problem, which they have got around through using German hauliers who pay less duty, and who are also not subject to British vehicle taxation (14). Shipping costs have also increased significantly over the past couple of years. While rising fuel costs clearly have an impact, shipping lines are also increasingly sharing cargo in order to reduce the number of freight ships in service to lower completion and increase prices.

2.15 SUPPLY CHAINS AND OUTSOURCING

Supply chains for manufacturers now stretch across both the UK and the globe - a trend that has been exacerbated during the past decade. Many firms design in-house, but will outsource production of components to other businesses - often still within the UK (3, 16). This means that they can focus on what they believe are their core strengths - such as product development, research, sales, and marketing (3, 4, 15). Some companies have also separated their manufacturing capabilities from their research, design, sales and marketing functions into wholly owned subsidiaries. This means that they can make products for their competitors and utilise as much capability as possible. Other companies have plants within or close to the export markets, as it is often easier to assemble or manufacture goods closer to their destination markets. JDR Cables (17) has a plant in Thailand, where it assembles electrical and umbilical cables from parts that have been made in the UK, while Malvern Instruments (19) has acquired a business in China to cater for Far Eastern markets.

As well-documented by the media, many companies in developed countries have outsourced much of their production to the developing economies of Eastern Europe and Asia because of the significant cost savings. The value of doing this is well established for some

high-volume low-cost goods (15). In our telephone survey, 21.7% of respondents had outsourced some of their supply chain to outside of the UK, while 2.4% were considering it. The main attraction for outsourcing was overwhelmingly because of lower costs. Respondents

MALVERN INSTRUMENTS

Designing and manufacturing particle measuring and sizing equipment, hi-tech firm Malvern Instruments has been based in the Worcestershire countryside since the 1960s. The company has won numerous awards, including the Queen's Award for Exports in 2006, and the Queen's Award for Technology last year.

The biggest problem that the company faces is finding suitably skilled employees at all levels from administrators and technicians to bachelor and doctorate level engineers, and then attracting them to work in the West Midlands. The difficulties the company has experienced in finding the right skills within the UK means that it will increasingly locate new business areas abroad where such problems are less acute. For example, it now undertakes software development in India and is opening a vision technology centre-of-excellence in the United States.

Financial Director, Rob Prestidge believes that the Government needs to take a more proactive approach in helping to open new markets - especially those in high-growth developing regions. In such places, bureaucracy and non-tariff barriers and high import taxes can make market-entry difficult, and the Government could add real value by more effectively campaigning against such measures, and productivity offered.

cited unit costs overall (69.2%) and employment costs (46.7%) as the main reasons they had outsourced.

A small number of companies are bringing back supply chains to the UK. For example, one company outsourced a component to India because of the projected cost savings. However, the project was hit with quality issues, and a lack of responsiveness to problems. The company is now bringing this back to the

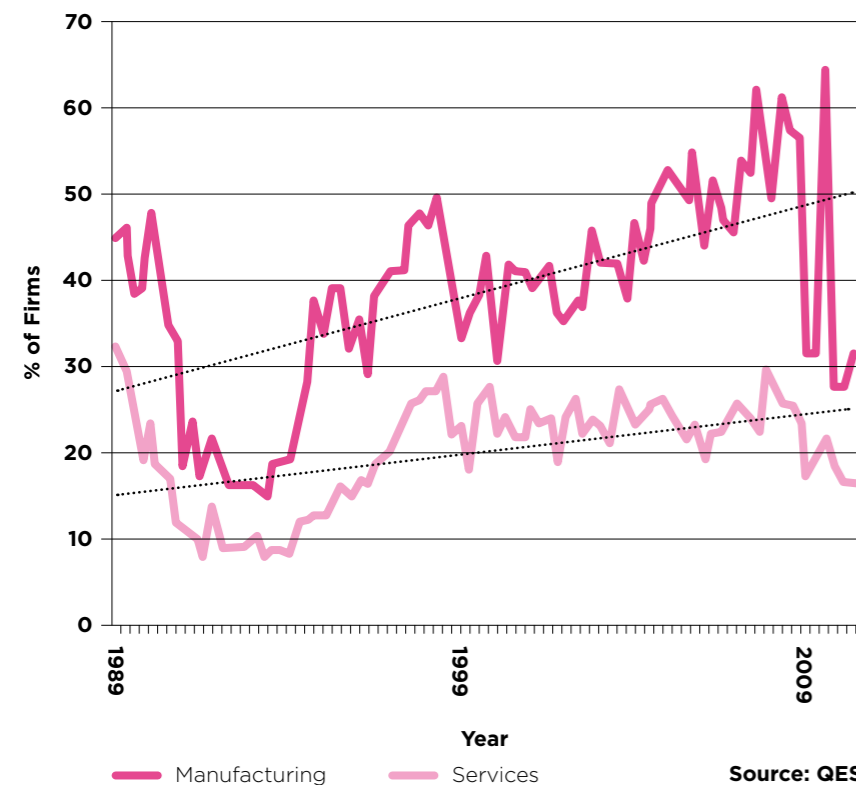
UK for the foreseeable future. Another company, Solutions Group (15) has chosen to take production in-house rather than find alternative suppliers abroad after a UK-based manufacturer of one of their key brands decided to close. However, our telephone survey showed that only 1.8% of respondents who had outsourced production outside of the UK had repatriated production or were considering it, so this trend must not be over-stated.

2.16 EDUCATION AND SKILLS

British businesses have long complained that the UK workforce does not have the right skills to help them grow. While this was reflected by many of our interviewees, many also felt that once the right people had been found, they were usually well educated and productive. Although many companies, such as TDSi (3), thought that ‘softer’ back-office skills in administration, sales, and marketing were easier to recruit for, many companies have found that specialist technical and engineering skills are particularly difficult to source.

This is backed up by the evidence of the QES, which asks whether firms that have tried to recruit in the last three months, have had difficulties finding staff and if so, for which categories they are having the difficulty with. The categories are as follows: Skilled manual/technical; Professional and managerial; Clerical; and Semi/unskilled. For the final three categories, the series average for both sectors is approximately the same. However, as can be seen in Figure 11, for the category of “skilled manual/technical” there is

FIGURE 11. FIRMS (%) REPORTING RECRUITMENT DIFFICULTIES FOR SKILLED MANUAL/TECHNICAL STAFF



a pronounced difference between the sectors, with a consistently higher percentage of manufacturing firms reporting trouble.

Figure 11 also shows trend lines indicating that the prevailing direction of manufacturing firms reporting recruitment difficulties in this category is upward. Furthermore, it is increasing at a much faster rate than the equivalent trend in the service sector. This suggests that left unchecked, manufacturing firms will suffer from worsening skills gaps in vital technical areas in the future.

One of the reasons for a lack of technically skilled

employees in some areas is that British businesses do not generally cluster as intensely as they do in Italy or Germany, which means that in many areas there is not a pool of specialist labour. However, in some cases SMEs have really benefitted from the closure of large plants in their areas which means they have been able to take on redundant staff allowing them to grow significantly (6, 8). Certain areas also have proven attractive for businesses to locate themselves in because of the local skills base. For example, MANN+HUMMEL UK (14), a German car components company, set up its UK manufacturing operation

in the Black Country partly because of the region’s strong engineering tradition.

Successful companies have started to address much of their training needs in-house. Several of the businesses that we visited during the course of our research have developed, or are in the process of establishing, in-house training schools – often with little in the way of funding from the public sector. Hotel Chocolat (16), Westons Cider (18), PP Electrical Systems (12) and Superior (2) all have established training schools, which form part of the backbone of their success. This means they can tailor their courses entirely to their own needs as a company, with clear results in quality and productivity, as well as helping staff retention.

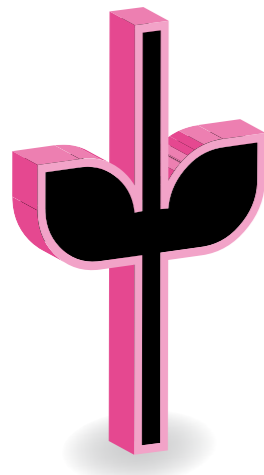
A number of firms also take on apprentices, although there was a mixed experience of such schemes. For example, Smith of Derby (11) felt that there was little financial incentive to develop apprentices, while it was difficult to dismiss students if they did not come up to scratch.

Conforming to a well-known trend, some firms have used

THOMAS DUDLEY

Founded in 1920 and still in family hands, Black Country company Thomas Dudley produces fixtures for bathrooms and products for the construction industry.

Managing Director Martin Dudley is frustrated that Government procurement policies do not take into account the costs of regulations imposed on manufacturers in the UK when making value comparisons with products from lower-cost countries. For example, rather than buying from local businesses, local councils often prefer to buy castings from producers in the Far East who are cheaper because they are not subject to the same regulatory burdens. This means that local economies do not always benefit from public spending.



Some manufacturers are high-volume energy users, and have been seriously impacted by rising power costs.

PD CASTINGS

PD Castings is a privately-owned company who forge, cast and machine brake-discs for the automotive industry. It employs 190 people at its iron foundry in Poole, Dorset, but is part of the larger EURAC group, and has other bases in the West Midlands and the Czech Republic. The business has an annual turnover of £60m making an annual profit of around £3.5m.

As the company melt down hundreds of tonnes of scrap metal in its furnace to produce brake discs, it is a very high volume energy user and is therefore particularly affected by rising energy prices and expensive raw materials.

Asked to identify the factors that would best help manufacturers like PD Castings to grow in the future, Thomas Krosnar, Business Development Director, for EURAC Ltd, says “we need to see much better financing arrangements for manufacturers, a more competitive energy market and a sustained improvement in our exchange rate”.

immigrant labour to fill gaps in their workforce, especially at unskilled and semi-skilled levels. PD Castings (1) have made use of Polish labour, while Solutions Group (15) believes that employees from Eastern Europe often work harder than their British counterparts.

For increasingly globalised manufacturing businesses, other countries with better supplies of labour can prove a big draw. Malvern Instruments (19) has severe difficulty

finding suitably skilled employees at all levels from administrators and technicians, to bachelor and doctorate level engineers, and then attracting them to work in their location in the West Midlands. These difficulties mean that they will increasingly locate new business areas abroad where such problems are less acute. They now already undertake their software development in India and are opening a centre of excellence in vision technology in the United States.

2.17 PUBLIC SECTOR CONTRACTS

Despite the serious cuts in public sector funding that the UK will witness in the coming months, Government at its various levels will continue to be a major customer for many British-based manufacturing businesses. While we would not advocate a ‘Buy British’ attitude within public sector procurement, we would certainly ask that Government-imposed costs such as employment and environmental legislation are taken into account when making comparison judgements about value between British brands and those from elsewhere – especially from India and the Far East.

One company, Thomas Dudley (7), which casts drainage and manhole covers is subject to a number of Government imposed charges such as the Climate Change Levy, that make its products more expensive than those from outside the EU. Local councils, who are a key customer for such products, invariably choose the cheapest products without taking into account domestically imposed levies which non EU countries are not subject to.

2.18 ENERGY

Some manufacturers are high-volume energy users, and have been seriously impacted by rising power costs. PD Castings (1) forge, cast and machine brake discs for the automotive industry from scrap metal which requires a large amount of energy.

Despite making efficiency savings and making use of Government grants, they are unable to compete effectively with European, Chinese or Turkish companies in this field, who enjoy preferential pricing treatment or state-support for their energy use, and describe the situation as ‘prohibitive’. Thomas Dudley (7), which also has a foundry, has observed that its goods are around 30% more expensive than its European competitors, even when accepting low profit margins.

It is likely that this is at least partially due to energy costs. These problems were borne out by 18.5% of businesses in our survey who said that one of their top three policy changes would be a more stable energy supply and lower energy costs. Likewise, 65.6% of businesses said that the price of energy was a serious problem.

The lack of competitiveness in the European energy market in comparison to the UK’s open environment has not served British manufacturers well. In line with the majority of countries, most of Europe still operates a vertically controlled state-led energy system. There is a perception among British manufacturers that this means that these countries offer preferential and subsidised energy prices to their manufacturers. This enables them to lower their costs and therefore places British firms at a serious comparative disadvantage.

RECOMMENDATIONS

1. BUSINESS AND ECONOMIC POLICY

As this report has established, manufacturing firms are more sensitive both to changes in business policy, and to the wider economic environment. Policies made for business in general might not necessarily affect manufacturing companies in the desired way.

FOR THE GOVERNMENT

We therefore urge the Coalition Government to 'think manufacturing' in everything that it does and to pay special attention to the needs of manufacturers when making policy. Government policies, especially around taxation, innovation and skills, have the potential to impact on manufacturers in different ways to other companies. Policymakers must take this into account.

2. A LONG-TERM MANUFACTURING STRATEGY

Drawing on the experiences of the sixties and seventies, Britain has had a shaky experience with manufacturing policy. However, long-term planning and a commitment to manufacturing and export growth have been the hallmarks of successful economies across the world.

FOR THE GOVERNMENT

We believe that there needs to be a long-term manufacturing policy which sets out how the sector will be supported by the Government in the coming years. Many of the policy changes explained in points 3-13 below would form critical levers of just such a strategy.

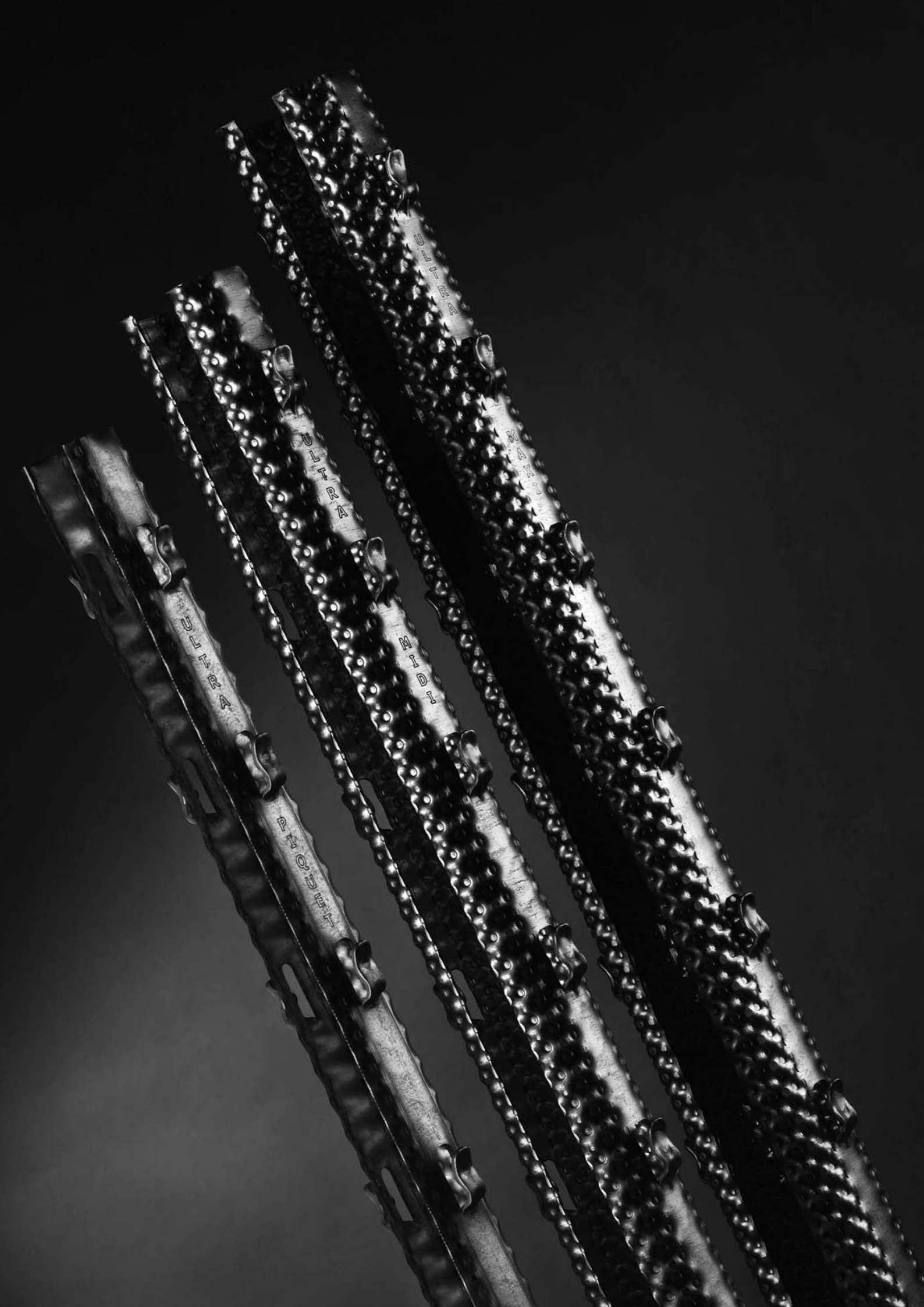
There should be regular evaluations undertaken by businesses within the sector itself. As such, we suggest the formation of a manufacturing council in order to hold the Government to account for such a strategy. This should consist of a range of differently sized businesses from the UK's manufacturing industries.

3. RESEARCH, DEVELOPMENT AND INNOVATION

Innovation represents the life-blood of manufacturing's future. The development of new products and the improvement of existing ones, be they hi-tech industrial products or innovative consumer goods, serves to underpin economic growth in the medium and long-term by ensuring a long term future for British exports. However, as is well established, the UK spends

comparatively little on R&D, not only compared to its key rivals in developed countries, but also to new emerging economies. The funding gap is both at a national level, where direct Government funds sustain research within institutions, and also at a company level where many businesses invest too little in new products. Furthermore, the UK is also poor at translating research into products that are manufactured domestically, as recognised by the 2003 Lambert Review of Business-University Collaboration and other studies.

Considering the extent to which Britain is falling behind its rivals in research and product innovation, we believe that Government has a key part to play in encouraging manufacturers to change their behaviour and invest more in R&D, despite the significant constraints on the public finances. If the UK continues along its current path of under-investment in innovation, then its place as a major manufacturing economy in the medium and long-term will be in question - with implications for future economic growth. This problem must therefore be addressed as a matter of priority.



The tax system represents an ideal way to incentivise and encourage manufacturing firms to invest more in the development of new innovative products. However, the present regime of R&D Tax Credits is not working well enough. Although SMEs can claim credits of 175% and larger companies 130%, the scheme cost £980m in 2008-09, with help to SMEs accounting for just £260m. The UK spends 0.5% less of its GDP on R&D than the developed world's average - accounting for many billions of pounds. The R&D funding gap between the UK and its competitors is therefore not currently being filled by innovation policy in general, or by R&D Tax Credits in particular.

Some of the problems identified through our research show that the qualifications for research covered could be too prescriptive, that they do not cover a wide enough range of research, that access is considered as too bureaucratic, and that many companies who could claim

are unaware of the benefits they could be accruing. Because of these things, R&D Tax Credits do not always have the desired impact on business investment behaviour. These problems have also been recognised by HMRC's Research Report published in November 2010 Qualitative research into businesses' Research and Development (R&D) decision-making processes.⁵²

FOR THE GOVERNMENT

R&D Tax Credits are an important tool for encouraging business investment and should remain in place. However SMEs are not currently benefitting to the extent that was originally intended.

The Government should ensure that R&D Tax Credits are as simple to access as possible in order to counter the general business perception that they are too bureaucratic and cumbersome to use. Questions that need to be resolved include:

- The definition of "improved products";
- The line between "new innovation" and "process improvements";

- A simpler process to claim and justify credits for SMEs.

To further incentivise manufacturers in the UK, the Government could also set out a roadmap for the broadening of R&D Tax Credits to include additional forms of innovation beyond 2015/16. As the public finances improve, a broader and more generous regime could help improve Britain's SME manufacturing base - and ensure it is focussed on innovative products.

The Government's proposed Growth Hubs - which must be clarified as a matter of urgency - must also be equipped to help innovative manufacturers claim R&D Tax Credits.

FOR MANUFACTURERS

Businesses and their professional advisers must become better at recognising where they are able to claim for R&D Tax credits, as many companies are not claiming what they are entitled to. Chambers of Commerce, and Manufacturing Advisory Service, and many accountants are all able to help.

Chambers of Commerce could run information sessions on R&D and incentives available in order to further spread the

message on innovation to SME manufacturing businesses and help them navigate the system of R&D Tax Credits and grants.

4. CAPITAL AND INVESTMENT ALLOWANCES

The tax system has an important role to play in incentivising business investment and driving change within manufacturing companies. All manufacturing businesses, and especially SMEs, are heavily reliant on Capital and Investment Allowances as a stimulus for spending on fast and efficient plant and machinery. Such investment can allow British companies to remain competitive with those in the Far East and other lower-cost developing economies across the globe.

Business in general supports the reduction of the headline rates of Corporation Tax announced in the June 2010 Budget, and understands the need for fiscal responsibility. However, BCC remains concerned that the reductions in Capital and Investment Allowances that will take place by April 2012 has the potential to negatively impact upon manufacturing businesses in general, and SME manufacturers in particular. SMEs on the

Small Profits Rate will only marginally benefit from its lowering from 21% to 20%, but will still see their Investment and Capital Allowances reduced by the same degree as companies on the Main Rate. Many smaller manufacturers, who often have the greatest potential for growth and future job creation, could be worse off financially under the new arrangements, and deterred from investing in capital equipment which could greatly benefit their business and help them keep manufacturing production within the UK.

FOR THE GOVERNMENT

The Government must be transparent about the impact that the reduction in Capital and Investment Allowances will have on manufacturers, especially those on the Small Profits Rate. If manufacturing businesses on the Small Profits Rate are shown to be worse off under the new tax regime, the Government must take action to mitigate these effects. Options include a further lowering of the Small Profits Rate, or special Capital and Investment Allowances for those on the Small Profits Rate, in order to incentivise further investment in their competitiveness.

5. ACCESS TO FINANCE

Access to finance - working capital, growth capital and export finance - has been strained during the recession, and has hampered the growth of manufacturing companies for a number of years. Our research has shown that at all times in the business lifecycle, manufacturing businesses are far more capital intensive than service businesses, and have thus suffered more serious problems.

Many firms rely on bank finance for both working and growth capital. Therefore, one of the problems comes from within the banks themselves. Some lenders have taken an overly conservative attitude to lending to manufacturing companies. In the regions, there has been a lack of understanding within banks of the particular needs of manufacturers, which has been coupled with a lack of relationship management. This has meant that manufacturing companies have been offered bad advice from their banks about which financial facilities would most suit their needs, and that bad lending decisions have been made by the banks based on an incomplete understanding of the realities facing the UK's manufacturing industries.

⁵² Qualitative research into businesses' Research and Development (R&D) decision-making processes. HMRC, August 2010 (published November 2010).

TO THE BANKS

We recommend that banks become more adept at serving the specialised needs of manufacturers. While we recognise that some banks have created manufacturing-specific initiatives in recent years, the evidence from manufacturers in the regions suggests that these services urgently require improvement.

Banks must also return to a system of relationship management whereby managers within banks understand the needs, requirements and health of individual companies, and can thereby give better guidance to manufacturers, and show better judgement in their lending decisions.

These principles have been at the heart of the BCC's comments in banking reform ever since the credit crunch first began affecting its members.

TO THE EQUITY MARKETS

Equity markets such as AIM have undoubtedly helped match up a number of manufacturing companies who need growth capital with financiers who want to invest in long-term projects. However, many manufacturing

companies who wish to grow are wary of surrendering equity, given the implications that this will have for their business.

We suggest that AIM employ manufacturing specialists in the regions to work with risk-averse companies who wish to attract long-term growth capital investment through the process of selling equity.

6. EXPORT PROMOTION

State-backed trade promotion and export support are vital to the UK's current and future exporters. Governments in all major developed economies provide international trade services to their exporters in order to help them to access new markets. They also exist to offer help and advice on navigating the logistical and bureaucratic requirements of exporting products.

We believe that the current budget of UK Trade and Investment is a small price to pay for the value-added contribution that its services make to the British economy. The cut in the programme budget of 25% over four years announced in October 2010's Spending Review will undoubtedly impact on the service offered, and thence on the export prospects of UK manufacturers.

TO THE GOVERNMENT

In order to remedy the effects of the cuts, the FCO must make good the Prime Minister's announcements that British missions abroad will spend more time and resource on international trade.

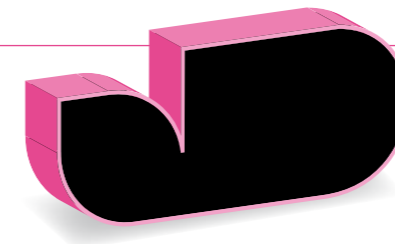
TO UKTI AND THE GOVERNMENT

There are also a number of things that UKTI could do differently. For example, currently it operates under a quantitative, target driven culture, where the number of companies assisted and value of revenue generated to UKTI take precedence over the outcomes of help offered to both new and existing exporting companies.

BCC therefore believes that UKTI's targets should be changed to monitor the value of results associated with help given, such as growth in export sales and employment generated, rather than purely on the number of companies assisted.

TO UKTI, ECGD, THE GOVERNMENT, AND CHAMBER NETWORK

Businesses are confused by the array of different organisations that provide



international trade services. There must be greater co-ordination to ensure that manufacturing businesses know where to go for different services, as well as to avoid needless duplication.

7. EXPORT SPIRIT

Previous research from the BCC has shown that many businesses take an overly passive approach to exporting and international markets.⁵³ The BCC therefore believes that British industry needs to recover its mercantile spirit, and become far more proactive when it comes to exporting. While we are currently the tenth largest exporter of goods in the world we need to work hard to maintain our position.⁵⁴ There is much more that the UK produces of value than is exported currently.

Our survey Exporting Britain in 2009 illustrated that the main reason why businesses export is because they have been approached by their customers (58%), or by an agent/distributor (19%). Nearly half also said they exported because they already had connections in the market into which they were exporting (49%).⁵⁵ This illustrates the lack of tenacity and forwardness in the approach taken by many

British businesses to exporting. We therefore recommend that manufacturing companies themselves become far more proactive in seeking out export markets – especially in the high-growth developing markets.

FOR BRITISH MANUFACTURERS

British companies must become more proactive in high-growth markets such as India, China and Brazil, where they are currently under-represented compared to the exporters of other nations.

FOR UKTI AND THE CHAMBER NETWORK

Many British businesspeople who are already exporting to countries around the globe are very willing to offer advice and guidance to new exporters or those wishing to enter new markets – providing that it does not conflict with their own business interests.⁵⁶ A manufacturing and exporting mentoring network should be created and facilitated through UKTI and the Chamber Network.

8. EXPORT TRADE FINANCE AND INSURANCE

Export trade finance and insurance plays a vital role

in underpinning exports and helping mitigate the substantial risks of international trade. However, access to these sources has been severely curtailed during the recession, while businesses from other major trading nations have access to much greater sources of trade finance and insurance support – especially in developing markets.

The BCC believes that unless the Government intervenes to support SMEs' access to sources of trade finance and insurance, British businesses will not benefit from the predicted rise in global trade flows over the coming year and beyond. There has been a market failure in the industry, especially around short-term export trade credit insurance. The Government must therefore intervene to rectify this by providing a publicly-backed scheme.

⁵³. Exporting Britain, June 2009.

⁵⁴. Source – WTO - <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=GB>

⁵⁵. Exporting Britain 2009 p. 11.

⁵⁶. Supporting UK business: The report of the Business Finance Taskforce October 2010 p.9.

Without such action, it is unlikely that British manufacturers will benefit from the likely rise in demand for consumer goods to BRIC countries and other emerging markets.

While the banks and insurance companies maintain that the problems of the past two years are easing, the Government needs to establish support in this area to ensure that British businesses can access short-term financing for non-capital goods during any subsequent shocks that might disrupt finance flows.

Currently the Government believes that the export credit insurance market is rectifying itself, but our members have not found any greater liquidity within the market and are still being hamstrung by insurance being withdrawn from credit lines both to, and from their companies.

Furthermore, the Government must ensure that British exporters are able to access trade finance for high-growth developing markets in the same manner that all other comparable trading nations provide for their exporters.

FOR THE GOVERNMENT AND ECGD

The BCC believes that the Government should create a state-backed export trade credit insurance scheme run through a private company, who would share the risk and the profits. Both France and Germany have successfully applied this model, with benefits for exporters and their respective exchequers. The application of such a model would mean that exporters would not be dependent on the private market for exporting into emerging markets, or during periods of recession or economic uncertainty.

While in times of economic growth developed markets in the EU, North American and Australasia would not be allowed to be covered by such a scheme under EU State Aid rules, the European Commission relaxed the rules which govern this during the economic crisis.

EU countries that already had such schemes were able to take full and immediate advantage by widening the scope of their cover. The British Government was unable to help its exporters in similar way, but should have a scheme ready to help

exporters both in the short-term and in periods of future market disruption.

FOR THE GOVERNMENT

We also believe that the Government needs to remain vigilant to ensure that other countries are not extending support to their exporters that would infringe upon State Aid rules.

FOR THE BCC AND THE CHAMBER NETWORK

In September 2010, BCC held an SME trade finance roundtable with businesses, banks, insurers and Government officials to thrash out the problems faced by SMEs when accessing export trade finance and insurance.

We recommend that this forum be placed on an official footing and held at regular intervals to ensure that the Government is receiving a full evidence-base of what is happening in the trade finance market.

9. INTELLECTUAL PROPERTY RIGHTS

The UK does not currently export enough to high-growth developing markets compared to other major

trading nations. One of the main issues for this are fears around intellectual property rights. While this has been particularly acutely felt in trade with China and India, it is also an endemic problem across much of the developing world.

FOR THE GOVERNMENT

The UK Government must push for greater intellectual property protection in developing markets for British manufacturers through inter-governmental channels such as the WTO, as well as on a bilateral level.

10. PUBLIC SECTOR PROCUREMENT

Even given the significant cuts in public spending that are expected over the coming years, the public sector will remain a major customer for British manufacturers.

FOR THE GOVERNMENT

Public sector procurers must take a smarter 'best value' approach to assessing which products to buy – factoring-in UK Government-imposed costs when comparing the price of British products against their counterparts from lower-cost countries. This would give British

manufacturers a fairer chance when bidding for public sector contracts.

11. SKILLS AND TRAINING

Skills remain a perennial problem for British businesses, and as the BCC's Quarterly Economic Survey has shown, manufacturers feel skills gaps more acutely than other companies.

FOR THE GOVERNMENT

Despite years of intervention, the publicly funded education and skills system is not always providing manufacturers with what they require – both in terms of school leavers, and in providing work-based training. However, we are supportive of the Coalition Government's increase in funding for apprenticeships, and believe this will benefit manufacturers in the medium term.

While we understand the reallocation of Government funds away from Train to Gain to support apprenticeships, we believe that SME manufacturers have benefitted from funding for short, focussed leadership and management courses, and believe funding put aside to support this has the potential to pay dividends for the manufacturing sector's growth.

FOR THE MANUFACTURERS

One response to the problem should come from within manufacturers themselves. Our research has shown that many successful manufacturers have established their own in-house academies to deliver exactly the training they need to grow their companies.

While this may not be possible for smaller companies, groups of manufacturers could facilitate training centres collectively in order to spread best practice, technical skills and concepts of quality such as those illustrated by some of our case studies.

12. ENERGY

Many manufacturing firms are highly energy intensive. The rising cost of energy is therefore a major issue for many manufacturers.

While hi-tech, efficient and fast machinery can iron out many of the differences in labour and production costs between the UK and less developed economies, the price of energy can add significant costs to UK production.

FOR THE GOVERNMENT

The Government should push for further energy market liberalisation across the EU to ensure that British manufacturers are not placed at competitive disadvantage on energy with our key competitors.

Energy companies and the Government must actively support manufacturers to lower their energy requirements and become more energy-efficient. The use of smart meters, provided by energy companies should be expanded.

FOR THE MANUFACTURERS

Business should make better use of existing facilities including assistance from The Carbon Trust - which includes interest free loans to buy energy efficient products.

13. THE IMAGE OF MANUFACTURING

One of the most striking things that our research has illustrated is the poor image of manufacturing in the UK. Politicians, the media and general public often do not realise the current strength

of British manufacturing and its importance to the economy as a whole.

Furthermore, there is still a negative view of industry in the UK, where wrongly it is often seen as low-skilled and unglamorous work. This contrasts with Germany, where top graduates go into manufacturing.

FOR THE GOVERNMENT AND THE CHAMBER NETWORK

The profile of manufacturing within the UK must be raised. A first step would be to increase knowledge and understanding of manufacturing within the education system, especially among teachers. This could be encouraged by more inset days within manufacturing firms.

Young Chamber, which goes into schools to establish enterprise programmes, has the potential to help address this problem, as do other outreach and mentoring schemes.

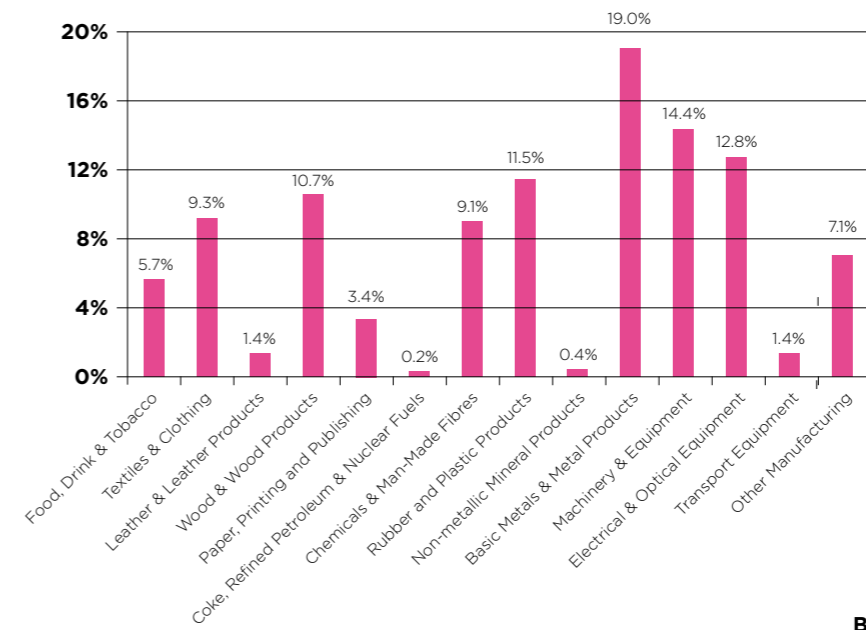
A campaign highlighting the excellence of British manufacturing could go some way to promoting the strengths and success of British industry to the public.



TELEPHONE SURVEY RESULTS

SCOPING QUESTION

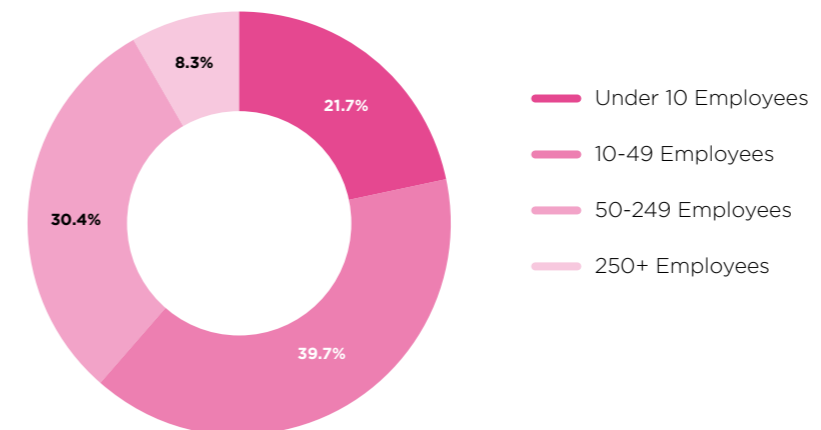
A. INTO WHICH SUB-SECTOR(S) WOULD YOU CATEGORISE YOURSELF?



Base = 494

MAIN SURVEY

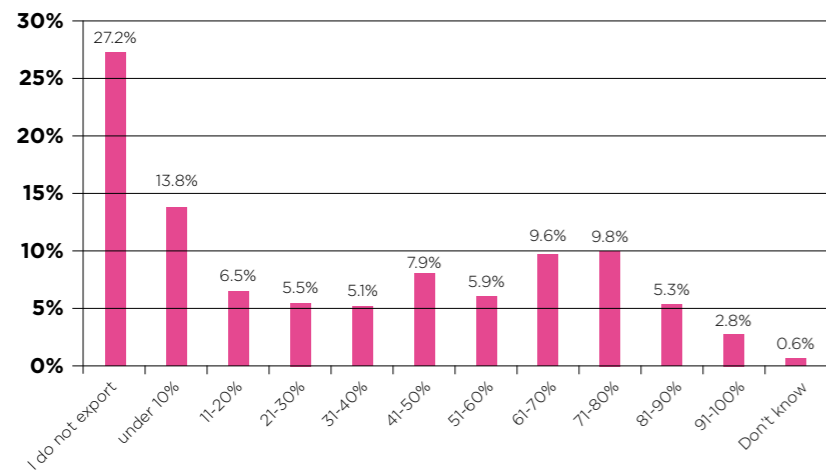
B. WHAT PERCENTAGE OF YOUR TURNOVER IS DERIVED FROM EXPORTING?



Base = 494

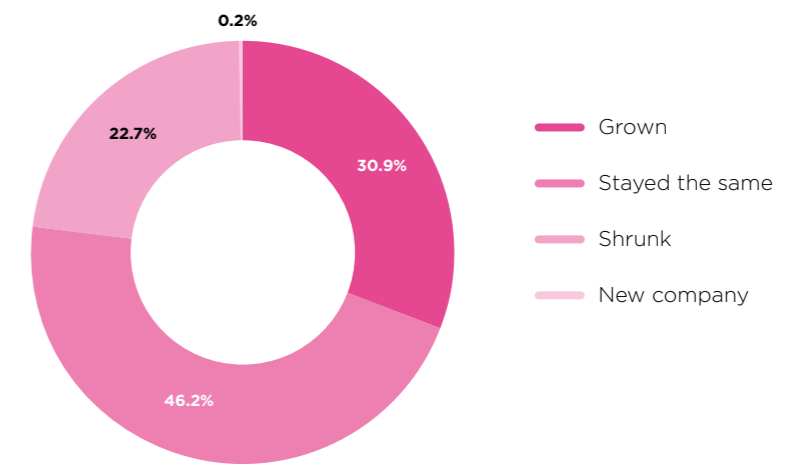


C. IF YOU DO NOT CURRENTLY, IS THIS DUE TO:



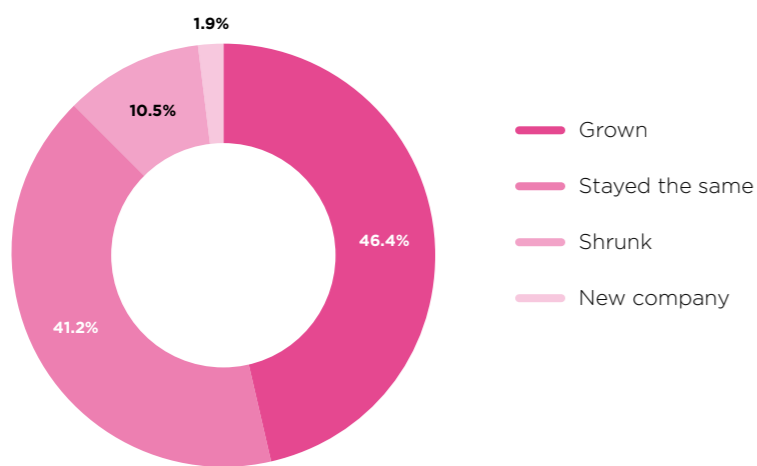
Base = 492

E. HAS YOUR OVERALL TURNOVER GONE UP OR DOWN DURING THE PAST FIVE YEARS?



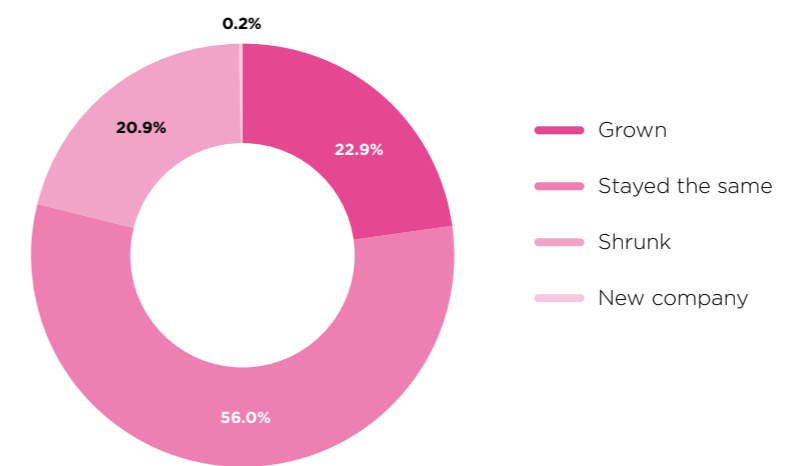
Base = 489

D. HAS YOUR VOLUME OF EXPORTS GROWN OR SHRUNK DURING THE PAST FIVE YEARS?



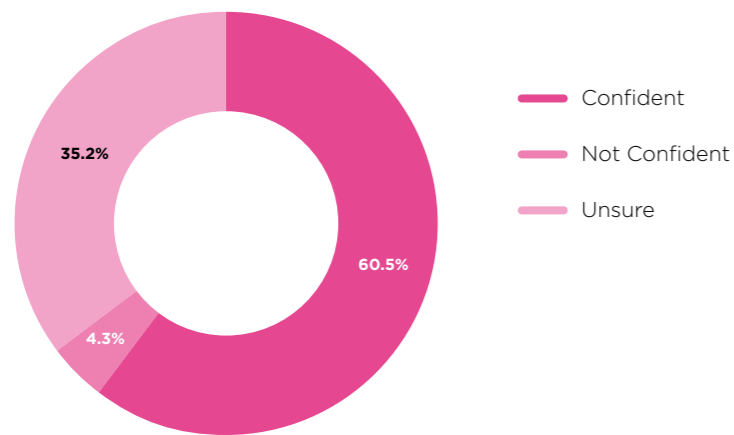
Base = 371

F. HAS YOUR EMPLOYMENT GONE UP OR DOWN DURING THE PAST FIVE YEARS?



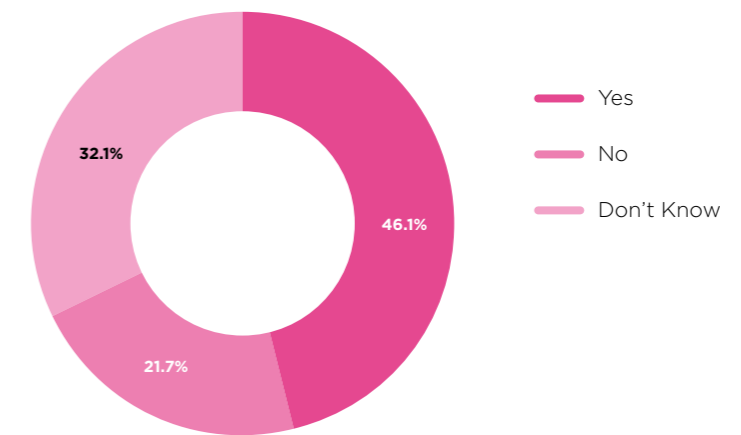
Base = 489

G. ARE YOU CONFIDENT IN THE ABILITY OF YOUR COMPANY TO GROW IN THE NEXT FIVE YEARS?



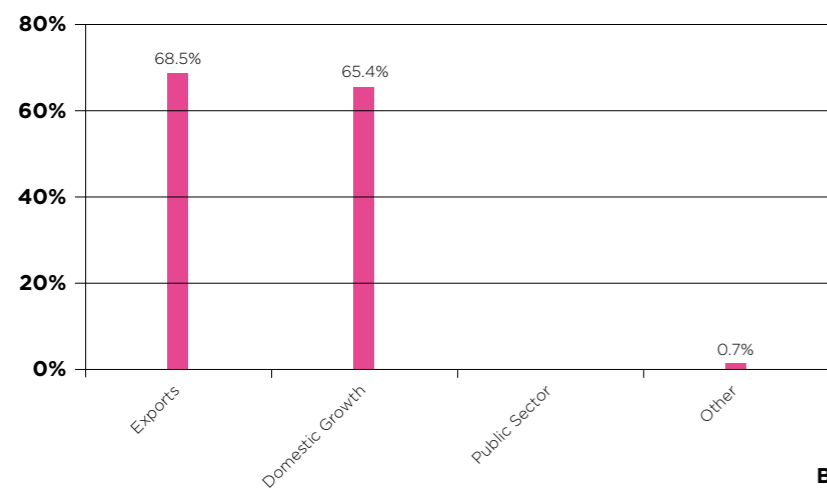
Base = 489

I. DO YOU FEEL THAT YOUR PRODUCTS COMPETE WELL WITH THOSE FROM OTHER COUNTRIES/MARKETS ON PRICE AT PRESENT?



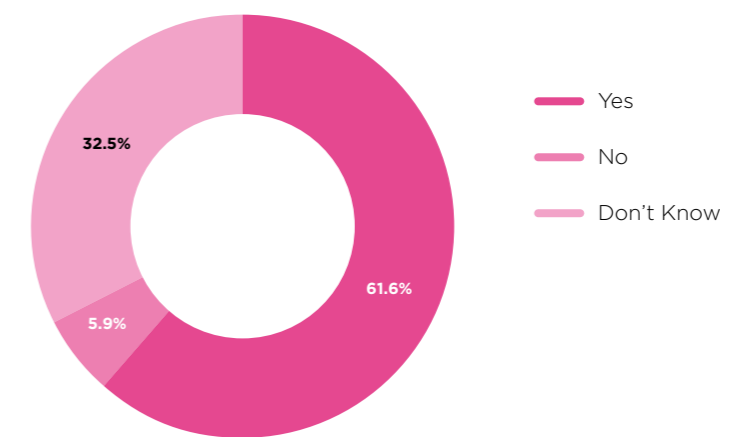
Base = 492

H. IF YES, WHERE DO YOU THINK THIS GROWTH WILL COME FROM?



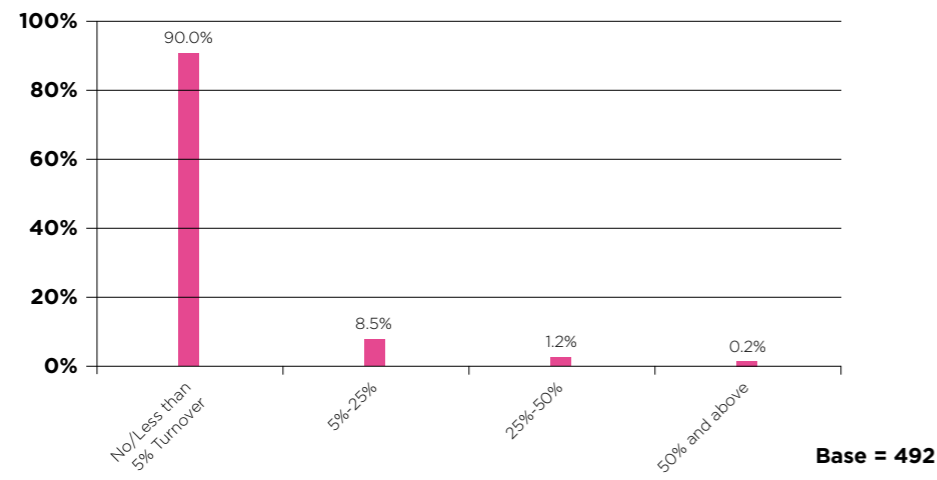
Base = 298

J. DO YOU FEEL THAT YOUR PRODUCTS COMPETE WELL WITH THOSE FROM OTHER COUNTRIES/MARKETS ON QUALITY?

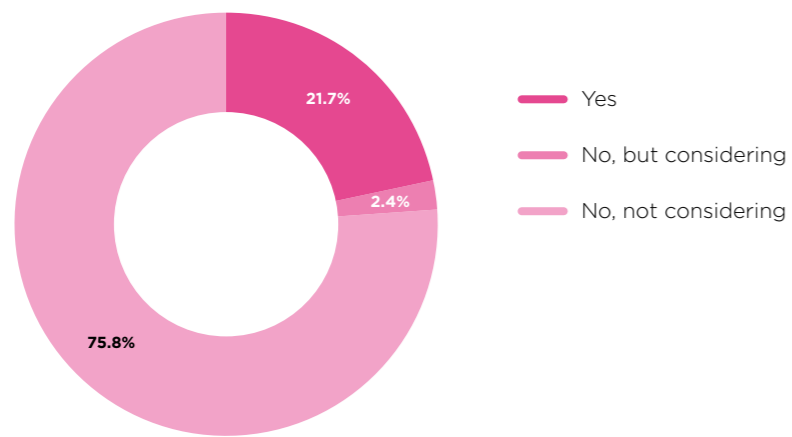


Base = 492

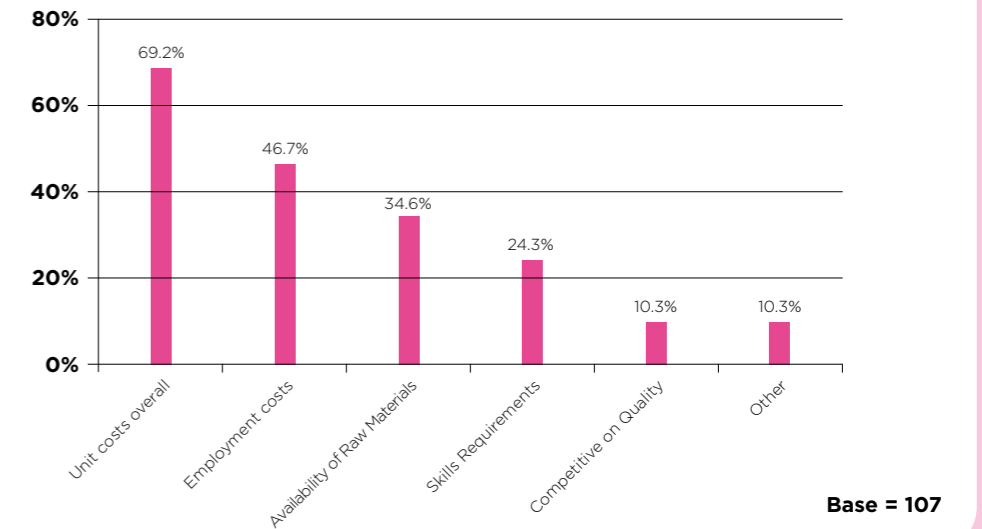
K. IS POST-SALE SERVICING OF YOUR COMPANY'S MANUFACTURED GOODS A SIGNIFICANT PORTION OF YOUR BUSINESS?



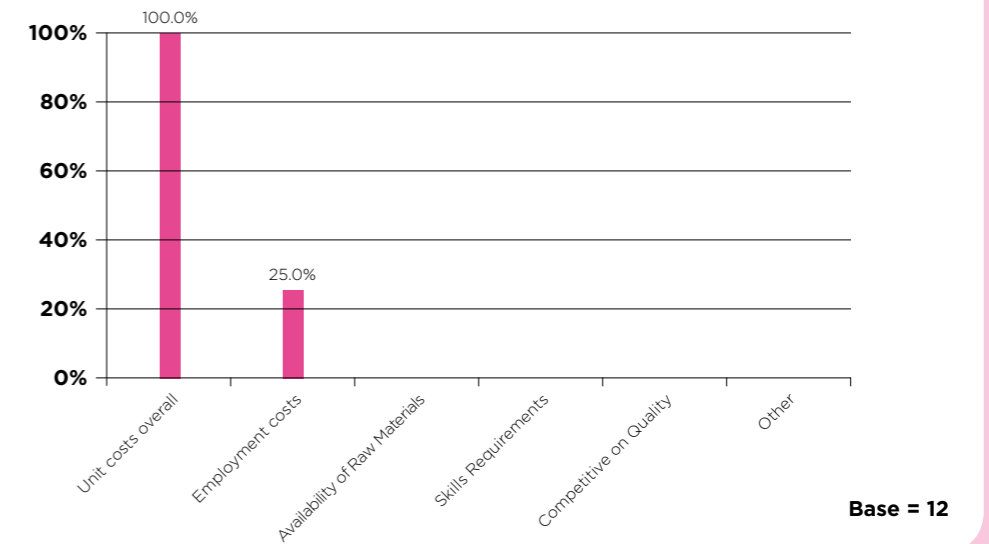
L. HAVE YOU OUTSOURCED PARTS OF YOUR SUPPLY CHAIN TO OTHER COUNTRIES OVER THE PAST FIVE YEARS?



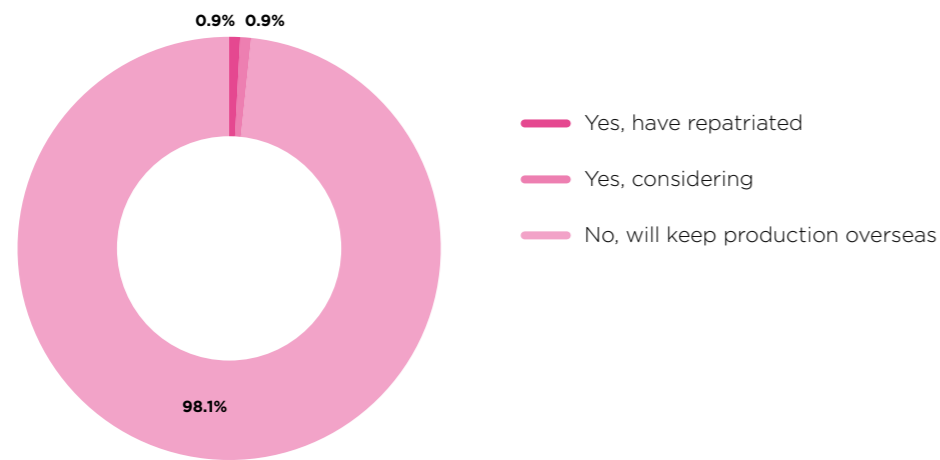
M. IF YES, WAS THIS DUE TO:



N. IF NO, BUT CONSIDERING, WAS THIS DUE TO:

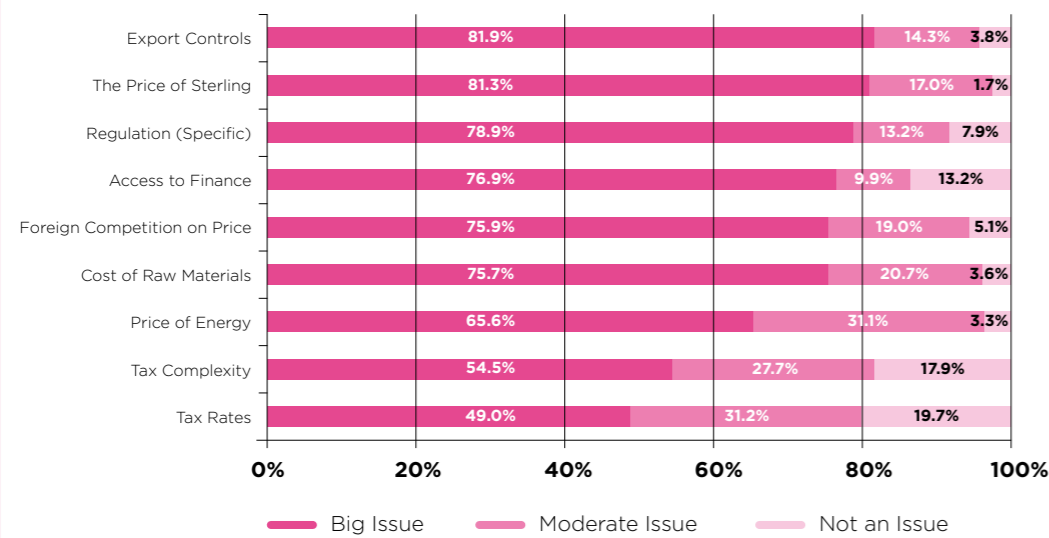


O. HAVE YOU, OR ARE YOU CONSIDERING REPATRIATING ANY PART OF YOUR SUPPLY CHAIN BACK TO THE UK?



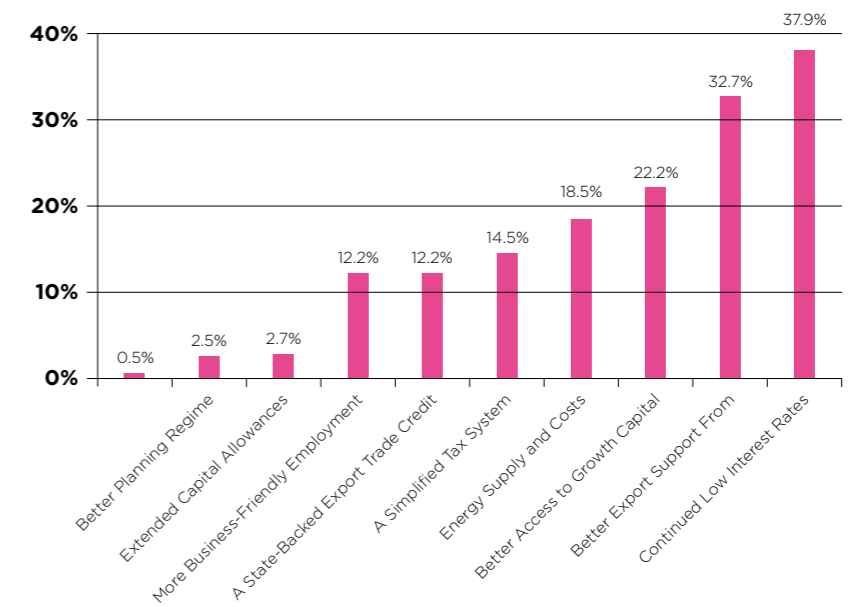
Base = 107

P. PLEASE RATE EACH OF THE FOLLOWING BASED ON WHETHER IT IS AN ISSUE FOR YOUR MANUFACTURING AND EXPORT POTENTIAL (1 = BIG ISSUE - 5 = NOT AN ISSUE)



Base = 383

Q. FROM THE LIST, PLEASE SELECT THREE POLICY CHANGES THAT WOULD HELP YOUR MANUFACTURING AND EXPORTING BUSINESS TO GROW THE MOST.



Base = 401



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