Engineering and Machinery Alliance

Engineering and Machinery Alliance – Evidence for the White Paper on Trade

A Background to the Alliance

The Engineering and Machinery Alliance (EAMA) represents the following trade associations:

- Agricultural Engineers Association
- British Automation and Robot Association
- British Paper Machinery Suppliers Association
- British Plastics Federation
- British Turned Part Manufacturers Association
- Confederation of British Metalforming
- Gauge and Toolmakers Association
- Manufacturing Technologies Association
- Printing, Papermaking and Converting Suppliers Association
- Processing and Packaging Machinery Association
- UK Industrial Vision Association

They represent 1,600 firms in the mechanical engineering sector with sales of £8 billion.

- Based on the Office of National Statistics (ONS) new criteria for the sector they represent a quarter of the UK's mechanical engineering output.
- Using HM Customs' data, sector exports account for about 70% of sector sales.

Typically our companies supply 'enabling technologies' to other sectors (e.g. automotive, aerospace, medical, power and food industries) in the form of machinery or packages combining services and products.

In the UK much, but by no means all, of this is carried out in small and medium sized niche or specialist companies (SMEs). Innovative, entrepreneurial companies are pushing the boundaries of factory performance, extending the envelope of the physically feasible to new levels in terms of speed, precision and migration into novel technologies and materials.

B How these views were assembled

For this submission, EAMA has drawn on members' views, as culled over 2010, for a variety of different documents and submissions where they have touched on exporting and trade.

Context of the recommendations

We have taken the Government's long term objectives to rebalance the economy sectorally and regionally into account. Our recommendations therefore cover propositions for the short, medium and long term, thus recognising current budgetary restrictions while also setting out longer term goals when the finances allow.

C EAMA's views on the key questions raised in the call for evidence

Comparative advantage of the UK

1. In which goods and services is the UK best able to compete internationally?

The mechanical engineering sector must qualify as one of the sectors best able to compete internationally, even though it may be low profile, because it continues to run a positive trade balance for the UK year after year of between three and five billion pounds Sterling according to ONS's Monthly Review of External Trade. The only other UK manufacturing sector to achieve the same sort of record is the chemicals industry.

UK mechanical engineering exports and net balance of trade (£ billion)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Exports	22.1	24.2	22.7	24.2	23.8	25.8	28.22	28.9	32.3	29.4
Balance	4.3	5.6	3.8	5.3	4.1	3.9	5.6	3.2	3.4	5.1

Source: Monthly Review of External Trade July 2010

The Engineering & Machinery Alliance, 62 Bayswater Road, London W2 3PS
Tel: 020 7298 6450 Email: eama@mta.org.uk W: www.eama.info
Company number: 5974924; Company limited by guarantee

2. How will this picture change in the coming years?
The sector is characterised by a large number of niche SMEs and a few large specialist companies. Success for many of these firms is predicated on their ability to develop machines or components that deliver performance to a customer specification that may be unique.

As on-demand manufacturing grows to meet bespoke requirements and UK firms increase their added-value content mechanical engineering firms will play an even bigger role in supporting UK exporting success.

However, this presupposes that Government policy will shift in some significant ways.

3. What domestic factors are preventing us from competing internationally? How can these be addressed?
Of course winning an order is difficult enough. But it is increasingly apparent, despite HMG's intention that exports and manufacturing will play major roles in getting the UK out of the recession, that the problems for the exporter begin back in the UK when it comes to how to supply the order, because the UK is simply uncompetitive when it comes to putting finance in place around export orders.

Using the customer's 30% deposit confirming the export order
In mechanical engineering it is standard practice for a customer to pay a 20-30% deposit to confirm their order. It happens all over Europe and in the USA. In return for the deposit, the customer expects to receive a guarantee, normally from a bank, that they will either receive the machine they have ordered or their money back.

If the company making the machine is any good, this is all very low risk, for which the banks make a charge.

The difference is felt particularly by SMEs: whereas French, German and US governments have bond support facilities that enable banks to provide the guarantee for a small charge, UK banks take the deposit as security or allocate it against the company's overdraft and still charge for the guarantee. The result is that the manufacturer is no better off for having received the deposit in the first place. There's no benefit to company cash flow. Just think of the potential impact if your SME firm builds £million+ machines.

According to a benchmarking report produced by the British Exporters Association (BExA), *Export Credit Agencies April 2010*, Australia, Canada, China, France Germany, Italy, the Netherlands Spain and the USA all offer such bond support schemes. In fact within the OECD, the UK is in a very small minority not offering such support.

But that's not all.

Letters of credit
Letters of credit are 'negotiable documents' in other countries. That is, banks will advance proportions of the final sum in the contract at certain stages as work moves towards completion of the contract (e.g. at the start, completion of a specific module, and then when ready to ship). So in other countries the letter of credit is another important route to maintain positive asset-backed and therefore cheap cash flow through the business. But it's not available in the same way here. And foreign banks are catching on to what this means for otherwise successful UK firms.

One SME reports being recently wooed by the Bank of China to put all his firm's letters of credit through the bank's Hong Kong branch to access the funds on more favourable terms there than those offered in the UK.

The attraction was not enough this time. But you can see where it's headed. Once the finance is taken up locally, why not consider moving the production facilities too.

Export Credit Agency
There is a general perception that the UK's Export Credit Guarantee Department does a good job on large scale business, such as the Airbus related business and medium to long term repayment

projects such as power stations and hydro electric type projects. But it's far too complex for simple £250,000 machinery export sales.

BExA's benchmarking study mentioned earlier compared the services offered by 38 export credit agencies around the world, allocating a 'point' for each service provided across ten basic services from short-term export credit insurance through bond support to letters of credit guarantee schemes.

The average score across all 38 organisations was 7.1 with Canada and the USA achieving 10 out of 10. Thirty-three countries scored higher than 5. Five scored 5 or lower. UK's ECGD scored 5.

4. What will the impact be of our ageing engineering workforce and ability of UK to supply skilled workers to meet future demand?

Skills development is one of the two most important issues for companies in the sector. The industry has a problematic skills profile because of the decline in the numbers of new entrants over the last three decades. Government seems to be well seized of this and its significance.

In our sector, the prevailing view is that educational standards have slipped in the last 20 years and that the school leavers the companies see tend to lack the commitment and work ethic found in immigrants from eastern Europe.

Even on the assumption that recent measures being applied rectify the problem, it's still going to take a long time.

Meanwhile, our internationally competitive high-tech companies need top class engineers in their chosen disciplines as well as a raft of supportive technicians.

For example, Germany and Japan lead the world in control systems. Unsurprisingly, those countries also produce the best control engineers. Stopping UK companies recruiting there means that UK companies aren't going to be cutting edge leaders in their chosen field. Hobbling them in this way therefore makes them less competitive and reduces their export potential. The top cryogenics companies worldwide recruit from Russian etc.

It's therefore vital that business is able to recruit from the best worldwide to raise standards in business and ultimately to help raise UK standards in further education and research establishments.

5. Keeping budget constraints in mind, what policy changes would help businesses export for the first time?

6. Keeping budget constraints in mind, what policy changes would help existing exporters export more?

Please see question 3 above. None of those actions need automatically be a drain on HMG's revenues. Quite the contrary. Better financing terms will reduce export risk and help firms grow through export sales ultimately providing additional corporate and personal tax-take both directly from the companies involved and from their suppliers and their employees.

Overall UKTI has done a pretty good job promoting UK exports when allowance is made for its vastly reduced expenditure on support activities such as the Trade Show Access Programme (TAP). Trade Shows remain absolutely central to businesses looking to sell product into capital intensive industries. This pattern is amplified by globalisation which is tending to promote global 'super-shows'. The reduction in TAP support particularly affects smaller companies' interest in and openness to exporting.

There are areas where UKTI could work much more closely with trade associations. For example, some trade associations have their own overseas trade offices to support their members (e.g. in Russia, China, Brazil and the USA). These might be harnessed to strengthen the UK offering. Another possible example, UKTI's regionally dispersed International Trade Advisers in the nine regional offices might work with some trade associations as part of an integrated team promoting export opportunities to new and experienced exporters identified by the trade association concerned.

7. How can the UK make better collective use of resources across Government to pursue trade and investment objectives?

All departments that have an impact on business should understand how they fit in to the whole picture and what the overarching priorities for the country are.

A strategy for rebalancing the economy, of producing jobs and growth through industrial investment (in part) should be shared by all those departments so that the Government's plans are comprehensive and don't produce conflicting outcomes and pressures other than at the policy margin.

Most potential investors coming to the UK will only consider a sales office if they are looking at the UK exclusively as a market. It's only if they want to export competitively from the UK into Europe or elsewhere that they'll consider something more substantial. So actually, the main trade and inward investment considerations for mechanical engineering firms relate to exporting from the UK, the investment environment and the policy pressures and regulations on operations based here.

Many departments of state therefore have an impact on policies that affect UK-based manufacturers' ability to export and the country's attractiveness in inward investor's eyes.

We've already addressed some of the main considerations round export finance.

Investment

Alongside the urgent need to reform the export financing packages available to make the UK a truly competitive base for exporters, there's an equal policy imperative to review and transform the UK's investment framework so that it delivers the objective of rebalancing the economy sectorally and regionally.

For manufacturers, whether they are already based in the UK or are foreign-based firms contemplating setting up here or somewhere in Europe, all want to see the investment intensive nature of their business recognised through reliefs in the tax system.

Simply targeting the lowest possible rate of corporation tax will not encourage entrepreneurs to invest in manufacturing rather than services in the UK.

According to the Office of National Statistics' Annual Business Inquiry, average manufacturing company investment in 2007 was £80,000 while in the service sector the average per company in the fast expanding business services sector was £11,000. The modern manufacturing sector that will compete successfully while based in the UK will be built with a strong focus on investment in productive capacity and capability (plant, the skills of people to design and drive the manufacturing processes and the high knowledge base to research and develop and maintain cutting edge innovation). This virtuous circle will be built here if manufacturers believe the Government is committed across all departments and see it reflected in manufacturing tax reliefs designed specifically to encourage investment in those three areas: plant, skills and R&D.

Regulations

The Government's commitments to better regulation and reducing the burden have been well received.

<u>National standards</u>

But there are areas where policies designed to achieve discrete ends spill over and affect UK-based company competeviness. An example is the Carbon Reduction Commitment, primarily designed to improve performance amongst the large retailers, banks and other non-traded sectors, but the spill-over requirements could have affected UK-based firms uniquely as the scheme only runs in the UK, having been conceived here. As far as non-traded sectors are concerned there would be no loss of competitiveness. They would basically be free to pass the costs on, so there's a level playing field. But in internationally traded sectors it raises costs that can't be recouped without loss of competitiveness.

<u>Implementing international standards</u>

Member firms report UK assessment bodies lacking the flexibility of their German and Italian counterparts, who when it came to introducing the new requirements under the revised Machinery

Directive consulted manufacturers in Germany and Italy about how long they would need so that the schedule didn't disrupt production or customer relations unnecessarily.

8. What are the benefits and costs to the UK from inward and outward investment?
9. How can the UK attract more inward investment and ensure that existing and future investors consider the UK a good place in which to invest?

Inward investors can bring new technology and know-how. Yamazaki Mazak, one of the world's leading producers of machine tools took the decision to locate a plant in the UK, in Worcester in the mid-eighties. One of its suppliers, former Best Factory Award winner Power Panels Limited, puts much of its success down to what it learnt from Mazak, when the Japanese company decided that it would work with its UK supplier-base to raise their standards to international levels of excellence.

But if policies aren't structured right, inward investors can close operations here after acquiring a company, its technology and its client list.

For a manufacturer there are two basic reasons to be here. To make things and then to export most of them.

Companies will be keen to invest in manufacturing operations in the UK if they see that the country is committed to the sector long term, that policies support manufacturing investment in plant, skills and R&D.

The same applies to the UK as an export base. If the UK doesn't at least match other countries' offerings round export financing then UK-based operations must expect to be less favoured when it is time for the parent company to decide whether to invest in the UK in new plant, skills or even R&D.

10. In general, does the world trading system work well? If not, why not?
11. What is the impact for businesses of the 'spaghetti bowl' of free trade agreements that now exist?

While a comprehensive system to promote free trade would be welcomed by British manufacturers, free trade agreements, such as the one the EU recently concluded with South Korea, are useful and seemingly more realistically achievable.

12. Should the WTO take on a larger role in dealing with global issues, such as climate change? What other changes can strengthen the WTO?

In the UK our companies have to comply with a raft of regulations covering health and safety, emissions and environmental norms to meet society's reasonable expectations. Some countries place the very minimum of requirements and their products can enter UK and the EU meeting only the technical specifications for products performance at far lower costs as a result. It could be that the WTO could help in some areas in terms of basic employment rights and global issues such as climate change. But it is more likely that progress will be made in these areas through trade agreements that take them into account and above all by the UK and EU authorities ensuring that the regulatory requirements they impose rest lightly on UK and EU based operations and above all by ensuring that product performance claims for imported products are accurately audited at the EU's borders.

13. What are the key benefits the European Single Market has brought to UK business and citizens?
14. What are the main barriers for businesses trading in the Single Market?
15. What should be the UK's priorities to strengthen the single market?
16. Should the UK's approach be to prioritise Free Trade Agreements (FTAs) with the greatest economic benefits to the UK?
17. Beyond the major emerging powers (i.e. the BRICs or CIVETS Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa), which other emerging countries should we prioritise and why?
18. How can the government support growth in trade and investment with emerging markets?

No comment

19. Should we seek to encourage further integration of global supply chains? Is UK infrastructure capable of supporting further integration of the UK into high technology global supply chains?

Supply chain infrastructure
Our impression is that UK SMEs are integrated into international supply chains both directly and indirectly through their customers (witness the impact of the German and French car scrappage schemes on UK suppliers). Witness the significant export market for car components from the UK.

It is true that many suppliers, SMEs in particular, have closed in the last 20 years. Often this was due to customer OEMs' decisions to source more 'competitively' from Asia. This led to some hollowing out of the supplier base, on which industries like aerospace, medical, pharmaceutical and defence rely. Over those same last 20 years we have not had a coherent and consistent set of policies encouraging investment. Instead changes have been introduced every few years along with technical details at the margin. As a result, UK manufacturing investment has shrunk (approx 40% per company in the ten years to 2007).

If suppliers and their banks see opportunities to grow the business and there's an export-friendly financial environment, businesses will expand their UK activity base and seek new opportunities in global supply chains.

Road infrastructure
The way roadworks are handled in the UK, with every utility able simply to inform local authorities that they need to dig the road up on specific dates leads to prolonged and repetitive road chaos. The system needs to be changed.

According to the AA there are four million holes in UK roads at any one time – one dug every seven seconds (and that estimate predates this and last winter).

The time lost due to the state of the roads is estimated at £4.2 billion in lost business.

20. To what extent do trade finance or trade facilitation problems inhibit UK businesses' ability to trade?
21. How could the EU's trade defence rules be improved?
22. Are there examples of trade promotion support in other countries that you are aware of, that could benefit your company/the UK.

One member points out that both the German Hermes Bank and the US ExIm schemes are much more flexible, easier to apply for, have better commercial risk assessment and are cheaper to apply. In his opinion the current ECGD scheme is making the UK uncompetitive in the world markets.

ECGD sold its short term credit insurance business to Atradius twenty odd years ago and is therefore absent from that business and is virtually unknown to SME exporters.

The closure of SITPRO (Simpler Trade Procedures Board) in the cull of QUANGOs means that the UK is no longer represented on electronic trade documentation in the EU as it once was.

Machinery exporters need to be able to offer customers finance at fixed interest rates as a service that our competitors tend to provide to help clinch the deal, even if clients decide to do the business on floating interest rates. ECGD will be withdrawing this fixed rate export finance offer in March 2011.

23. In which countries/regions of the world do you feel a strengthened economic and political relationship could make a significant difference to your company's prospects? Is it the UK's or (where relevant) the EU's relationship that matters most to you?
24. HMG is keen to learn from the experiences and thinking of other countries. We are already, through the FCO network, looking at a number of other countries but would welcome suggestions.

No comment