Engineering and
Machinery Alliance

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
Polymer Machinery Manufacturers and Distributers Association
Printing Industry Confederation
Processing and Packaging Machinery Association
UK Industrial Vision Association

1 March 2012

The Rt Hon George Osborne Esq MP
Chancellor of the Exchequer
HM Treasury
1 Horseguards Road
London SW1A 2HQ

Dear Chancellor

Engineering and Machinery Alliance Budget Submission

The Engineering and Machinery Alliance (EAMA) represents circa 1,700 firms from 12 different trade associations (please see the masthead) mostly SMEs in the mechanical engineering sector with sales of some £8 billion.

They account for a quarter of the UK's mechanical engineering output, and according to 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, printing and food industries) in the form of machinery or packages combining services and products. Some of our members make machines that make machines.

In the UK much but by no means all of this is carried out in small and medium sized niche or specialist firms (SMEs) -- innovative, entrepreneurial companies 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.

From this perspective, we are at one with you in your stated determination to encourage investment and exports as key priorities.

We welcome many of the initiatives introduced over the last year, such as the University Technical Colleges, the reduction in Corporation Tax, the new products launched by UK Export Finance to support exporters' business overseas, the Business Growth Fund, the extension of the short life asset scheme to eight years and the SME enhancements to the R&D Tax Credit.

Current business environment
Although you have created a much better potential environment for UK SME manufacturers their outlook hasn't changed much compared with 12 months ago according to our Business Monitor which tracks monthly changes across a range of measures (orders, jobs, investment and access to finance).

A rocky period from June last year has meant that a big improvement in orders in January has only taken firms back to where they were at the beginning of 2011. But confidence is coming back.

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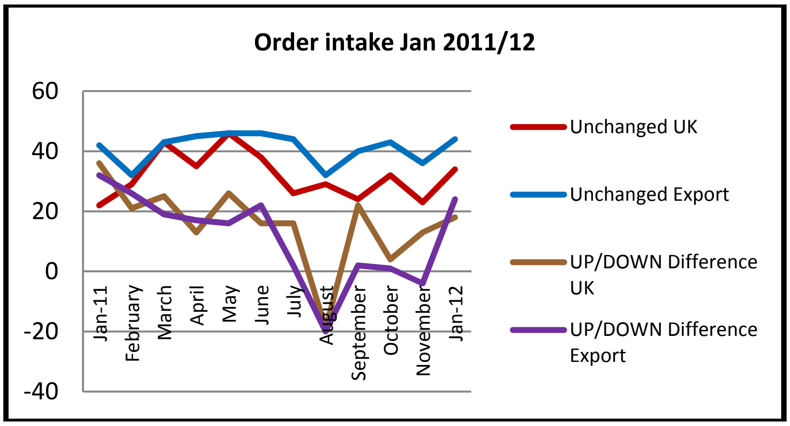
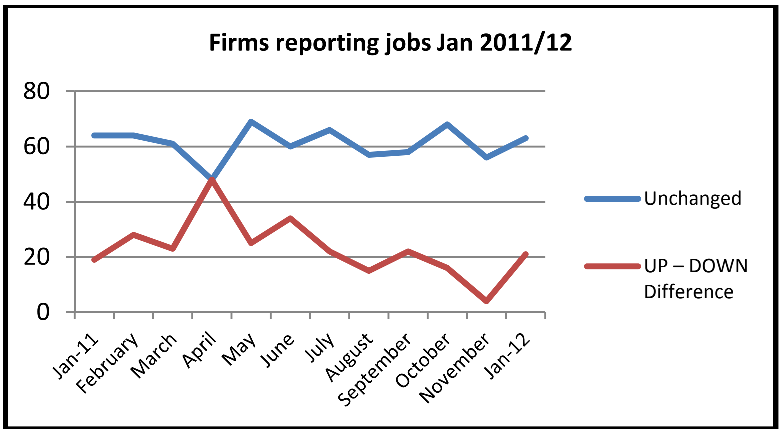
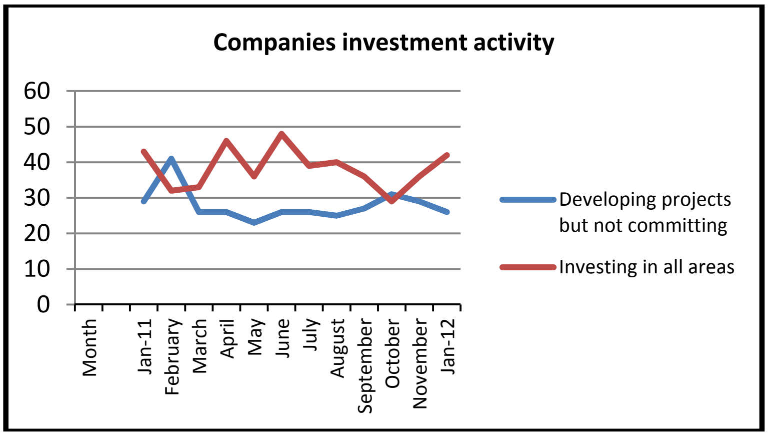


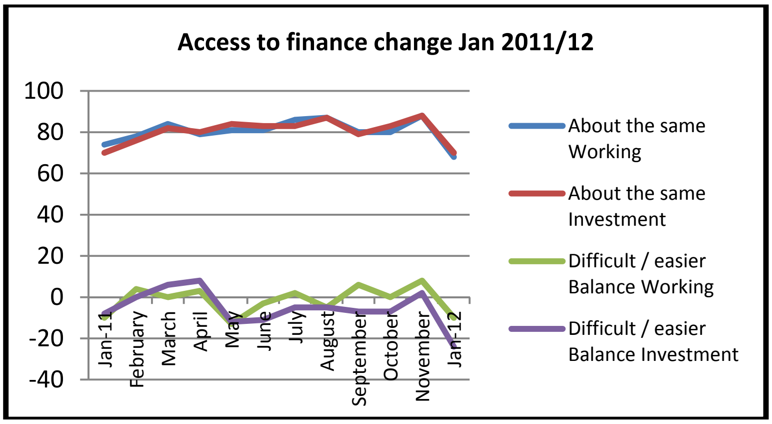
On the jobs front there's even better news. Although the number of firms saying they have jobs to be filled isn't at the levels seen earlier last year, a clear majority (+21%) report they have more jobs than last month. In November the majority (4%) had been the smallest since November 2009, when the overall trend was negative. (Note: This is a company balance not a vacancy measure.)



On finance and investment we have been struck over the year, how respondents to the Monitor have consistently said that they are investing, despite the negative media coverage.



And they are doing this despite the difficulties they encounter with access to finance. Over the last 12 months firms indicated on a couple of occasions that the flow of finance might be easing (as the lines edged above zero in the graph below) but each time the trend evaporated and has now dived much lower. We hope that this may in part reflect a seasonal trend at the start of another year. But we aren't sanguine.



If our competitors were suffering similar financial access blight this wouldn't be so serious.

But they aren't. According to European Central Bank data in the Commission 2012 trends forecast released 22 February 2012, most other countries in Europe are increasing finance, albeit at declining rates *(page 6 EU Commission Interim Forecast February 2012).*

Table 1 Bank lending to non-financial private sector (year on year %)

	December 2010	June 2011	November 2011	December 2011
Germany	-0.1	-0.2	2.3	2.3
Ireland	-20.2	-13.2	-11.0	-7.5
France	6.0	6.9	4.5	3.7
The Netherlands	-2.9	6.6	5.8	3.8
Sweden	21.9	10.2	6.0	No data
UK	4.6	-12.6	-7.2	No data

Source ECB

Of the 27 countries covered, Ireland and the UK show the steepest falls in lending in June and November (UK data not available for December), while others tend to declining increases in availability. Far more worrying from a competitiveness point of view are the inferred developing trends, with the UK yet again falling behind in terms of investment while economies that are our natural competitors in high value added, high and medium technology industries (e.g. Germany, France and Sweden) are able to upgrade their production capabilities and capacity.

Table 2 Manufacturing gross value added comparison constant 2000 € and $ 1998 to 2007

	1998			2007			% change 1998 - 2007		
Country	**Sector billion**	**Nos employed millions**	**Per employee '000**	**Sector billion**	**Nos employed million**	**Per employee '000**	**Sector GVA**	**Nos employed**	**GVA per employee**
Germany €	395.0	8.1	48.8	502.3	7.5	67.0	**27**	**-7**	**37**
Spain €	98.5	2.8	35.2	115.0	3.1	37.1	**17**	**11**	**5**
France €	188.0	3.6	52.2	218.8	3.2	68.4	**16**	**-11**	**31**
USA $	1323.5	20.6	64.3	1813.5	17.2	105.4	**37**	**-17**	**64**

Source: AMECO ECFIN revised 29 November 2010

Table 3 UK GVA and investment performance 1998-2007 per employee and per company

Year	**Sector GVA basic prices £bn**	**GVA per employee £000**	**Investment per company £000**	**Investment per employee £000**	**Ratio £GVA to £investment**
1998	150	34	120.4	4.6	7.35
2007	158	51	80.5	3.9	13.17
Change %	5.3	+50	-33	-15%	+79

Source: workings based on ABI 2009

We take it as read that there is no disagreement between us when it comes to the importance of raising UK manufacturing gross value added and total output and how the UK fell behind in the decade post 1997 due to a lack of investment. UK policies drove leaner manufacturing techniques to produce greater GVA per employee but resultant output grew by just 5%, while competitors such as Germany grew theirs by 16 to 37%.

Conclusions

- France, Germany, Spain and the USA all had policies that encouraged investment in manufacturing to a greater degree than the UK.
- The UK's substantial improvement in competitiveness was achieved by paring back on employees and investment (down by a third per company over the period).
- Despite the promising policies that have been introduced, we are in danger of repeating the mistakes of the 'lean' decade.
- Government has to will the means for the long term if UK manufacturers are to achieve the ends that we all want for the UK in raising living standards for all our people whatever their skills.
- The overwhelming priority is therefore to encourage investment for the long term with a manufacturing policy framework that runs as a golden thread through the tapestry of all Government policy, not as standalone short term bright sparks that fade under the weight of the next initiative.
- Our aim in this submission is to suggest some ways that you could do this building on your achievements so far.

Policy recommendations

Investment

Investment allowances

The Annual Investment Allowance cap, currently at £100,000 is due to be reduced to £25,000 in April 2012, when according to the Red Book "it is expected that over 95 per cent of businesses will still have all their annual investment covered by this allowance". That's true, but it's simply because there are far fewer capital intensive businesses in the UK and part of the task of rebalancing the economy must be to grow their role, if manufacturing is to help re-ignite economic growth.

Table 4 Comparing manufacturing and businesses services company investment 2010

	Number of companies	Sector Value Added £ billion	Sector investment £ billion	Investment per company (approx)
Professional, scientific and technical activities	327,836	107	4.3	£13,000
Manufacturing	123,990	143	9.7	£78,000

Source: Annual Business Survey 17 November 2011

Manufacturing investment has to be continuous to improve performance and efficiency. The average per company is currently declining (e.g. by 11% from £88,000 per firm in 2008 to £78,000 in 2010.

We welcome the introduction of 100% first year capital allowances in the Enterprise Zones as a short term measure to encourage inward investors. However, this policy shouldn't be allowed to displace legacy investors in the UK who are here for the long term. Clearly we would much prefer all manufacturers in the UK to be eligible for the allowance. But we recognise that it's expensive. In addition, offering such a prize to foreign companies not previously based here makes the UK competitive with other tax jurisdictions as a potential base for their operations.

Recommendation

1) We therefore recommend the Annual Investment Allowance not be reduced, but rather be maintained at £100,000 until the finances enable you to introduce major increases ultimately up to £500,000.

Research and Development

The R&D Tax Credit is an absolutely invaluable support for high tech or research-based start-ups, not only helping them through the early years when they are loss making with payments that can be used on company operations but then in later years continuing to encourage innovation.

It is a very important lever and without it, it is difficult to see how such companies would be able to make their way in the UK. We welcome the increase in the rate to 200%.

Recommendations

2) We therefore share the views expressed in the Dyson report on the need to:
   a) Focus R&D tax credits on high tech companies, small businesses and new start-ups
   b) Increase the rate to 200% when the public finances allow.
   c) Simplify the claims procedure.
3) To grow its manufacturing base, the UK needs to improve its ability to test and commercialise innovation, not only by the larger companies but also by SMEs.
   a) Make it easier (less expensive) for SMEs to take part in leading innovation-focused organisations such as the Technology Strategy Board (TSB) and the High Value Manufacturing Catapult.
   b) Extend TSB funded projects to cover the pre-production phase so that a proportion of the customers' costs associated with testing and evaluating prototypes or demonstrators supplied by SMEs can be covered (e.g. agricultural machinery for a low carbon future).
   c) The total budget for this would be limited (say to £30 million). Projects would be approved in a twice yearly competition.

Skills

We welcome Government's commitment to apprenticeships, its efforts to raise UK skills levels generally and the introductions of the Talent Retention Solution and University Technical Colleges.

For completeness I should add how disappointed we are the Engineering Diploma has been downgraded despite employers' contribution and commitment to its design and the demanding multi-disciplinary curriculum it covers.

As you know, there are only a limited number of places on UK university engineering courses. A large proportion of graduates from these courses are directly recruited by non-manufacturers (e.g. management consultancies) offering much bigger initial salaries than a typical manufacturer can afford. This displacement undermines UK manufacturers' competitiveness, depriving them of the country's home grown talent.

Recommendation

4) Government to examine pros/cons of introducing a temporary (say five year) counter employment bias into the milk round by forgiving graduates their university loans if they take up employment for a minimum of three years in manufacturing or a closely allied sector (e.g. consulting engineering). Graduates going elsewhere for higher pay will be able to afford the repayments.

Government's push to reduce the number of immigrants working in the UK has directly affected some SMEs' R&D work as well as firms seeking skilled workers.

For example, at a recent meeting with your officials, two of the four firms we brought along had taken on foreigners. They had come to the UK to take their second degrees and having qualified were keen to find a job where they could further develop their now enriched skills.

The Home Office intervened at both companies, reducing the number of permitted licences, fighting appeals and even in one case insisting the salaries of those allowed to remain be increased.

Recommendation

5) Foreigners studying for second degrees here should be encouraged rather than constrained from working here as a rapid way to fill the gaps the UK education system has thrown up in STEM subjects at advanced levels.

Despite all the economic uncertainty, the UK is trying to rebuild its skills base. We believe that now is also the time to look in more detail at how the UK can perform better at retaining the skills in the sector in addition to the Talent Retention Solution.

As you know, German unemployment increased by just over 200,000 in the most recent recession (compared to the UK's approx 1 million since Spring 2008). And as German firms have come out of recession their industry has been able to re-skill immediately thanks to their short time working arrangements. For UK companies that had to let people go in 2008/09 the road back will take much longer and will be more expensive, involving training and/or re-skilling.

Recommendation

6) Government to set the parameters for a potential UK solution, perhaps adapting the framework of the German insurance based scheme and by involving experts from the UK insurance industry, major manufacturers and some supply chain SMEs for a practical solution. (Note: A well designed practical scheme could also have an important impact on young people's career decisions if it helps create a more stable employment environment.) Manufacturers are natural partners for such a scheme given their businesses' asset intensity.

Employment

In the current environment there are two broad employment issues: getting unemployed people back into work and with 'rebalancing' helping people to move from one firm or sector to another. In both cases the candidates concerned will in all likelihood need some training, additional skills development and/or orientation (e.g. on health and safety). In addition, flexible attitudes need to be encouraged amongst both work candidates and employers if some rebalancing from one sector to another is to be achieved.

Government supported apprenticeship schemes understandably focus particularly on the younger workers and school leavers (up to age 24), but we understand there are plans to reduce support for those aged 24+, which is the age group that is going to make up a large proportion of those having to change jobs.

Recommendations:

7) Expand the NIC holiday for start-ups to all SMEs for one additional (long term unemployed or under 24 year-old) worker for two years. The SMEs can then combine this with the support for training to give new employees the wherewithal to make a new career in a new sector.

8) Ensure that Government support for those in 24+ age range encourages SMEs to take them on as trainees for a qualifying period just as much as for young people under 24.

Exporting

UK Export Finance's new products

We welcome UK Export Finance's new products. They are helpful and if indeed the products are made routinely available by the banks they will begin to put UK-based manufacturers on a more equal footing with the export credit support of our international competitors.

For us, the weakness in the scheme is that they are only available through the banks.

Recommendations

9) It is still too early to assess their effectiveness, so we recommend HMT hold off from judging their success or otherwise for some time yet, not to be 'suckered' into dismissing the schemes as not having enough demand to warrant the effort.
10) We need to establish whether or not the banks are promoting the products as actively as they might and suggest Government could help in this as an independent party by working with some trade bodies to arrange 'mystery shopper applications' to test the system directly.

Export licensing

Export licence advice is another area where red tape is causing difficulties for exporters.

As overseas customers become more sophisticated in their dealings around contracts for hi-tech products, they are asking whether the goods they want will receive all the necessary clearances as part of their pre-qualification process before awarding the contract.

Government offers an advisory service to help guide exporters as to whether a particular contract is likely to encounter problems. This service is now taking over six months to respond (making it impossible for firms involved to tender as they don't have the necessary information) and seems to have got worse just as the service issuing export licences has improved its performance.

Recommendation

11) It's totally counter-productive if Whitehall cutbacks affect the efficiency of services vital to exporters and result in the country losing out on the sales as a result.

Overseas promotion and representation

As you know firms are being asked to pay an increasing proportion of UKTI's costs in helping firms develop overseas markets. And the pressure on budgets means that financial support for missions and overseas trade fairs is 'grudgingly' low.

Our members understand the reasons but believe the efforts to save the UK public purse have now gone beyond the point where many smaller SME exporters feel it warrants the effort of developing new markets (e.g. a niche manufacturer quite understandably has to educate an overseas post about its business and unique qualities. For an SME this will be resource intensive. And then on top of that and having paid UK taxes etc., the firm will also have to pay for the post's efforts on the firm's behalf).

Recommendations

12) Increase the financial support for attending trade fairs and missions by a sum which is meaningful enough to show that HMG is now committed to helping exporters (e.g. 25%).
13) To save the burden on overseas posts encourage trade associations with offices overseas to take on certain specialist tasks leaving the embassies to manage the higher profile image building agenda.

Cash flow

We welcome the commitment to reduce small rate Corporation Tax.

SME manufacturers' cash flow is still being squeezed.

Recommendations

14) It's therefore important to iron out the unnecessary tax wrinkles, for example a technical amendment to accounting standard FRS 5 so that firms servicing Just-in-Time contracts aren't subject to Corporation Tax liability when work in progress and stocks are grossed up and added to 'forward' sales.
15) Re-introduce the flexibility to delay VAT and other tax payment schedules as soon as possible.
16) Manufacturing start-ups investing in plant using lease financing may well find themselves having to settle a VAT invoice of say £60,000 on a sizeable machine (e.g. being imported) before the company has made anything. The complication here is that the finance house has to pay the VAT. Some form of VAT payment flexibility would be helpful and would ease manufacturing's profile as a route for a start-up entrepreneur.
17) Some large companies have been squeezing their suppliers informing them that they will be delaying payment by an extra 30 days. This is an unequal battle difficult to legislate on as small suppliers aren't going to ruin their future relationship with a large customer if there's any chance of finding a way to keep profitable. But it undermines investment planning. To deal with these hard cultural issues we recommend that payment performance should affect a company's credit rating. If terms are agreed at 30 days and the firm doesn't pay, the penalty for repeated failure should ultimately be a lower credit rating.

SME financing

Although Government wishes to maintain the freedom to impose tougher conditions on the banks than those set out in the Capital Requirement Directive (and we can see how the UK's tougher access to finance environment is playing out competitively refer to Table 1) you may, should you so wish, have some room to help ease Basel III requirements on the banks, through action by the FSA or HM Treasury in the following areas:

18) *SMEs in large company supply chains:* Most large OEMs depend on SMEs in their supply chains. If the OEMs highlighted these suppliers to their banks, the banks would be able to grade them as a lower risk, warranting easier terms and therefore reducing the level of interest that the banks would need to charge.
19) *Premature default:* Strict adherence to the Capital Requirements Directive triggers default "90 days past due". It can do so for relatively paltry sums. It would be more sensible to place more importance on the sums involved and their significance to the company owed the money.
20) *SME loans:* Banks would be able to lower their rates if the losses associated with default could be reduced, e.g. through some insurance scheme or bond as per UK Export Finance.

Reluctantly, we are coming to the view that UK manufacturing SMEs are unlikely to benefit from the sort of supportive relationship with their banks that similar size firms enjoy in Germany and France or the USA. Action on the above will help ensure a more competitive financial partnership for many manufacturers but ultimately maybe only a dedicated I*nfrastructure and Industrial Investment Bank* will make the necessary difference. It would certainly change perceptions of the UK as a place to run a manufacturing business.

Conclusion
Together with BIS you have introduced an important and potentially very significant shift in policy that certainly could help UK manufacturers advance on the road to being the best they possibly can be.

As an alliance of trade associations rooted in the sector our prime aim is to help firms on that journey (e.g. our finance and export event on 27 March http://www.eama.info/EAMA-speed-dating-event.htm)

But we believe despite the positive changes we have seen that there's still one vital element missing – a powerful mechanism that rewards investors in plant so that they can immediately start to make money and create wealth for the UK at large by making things here.

With best wishes

Yours sincerely

(signed electronically 29 February 2012)

Martin Walder
Chairman

cc Mark Prisk MP – Minister of State, BIS
Matthew Little, Jaya Choraria – HMT
Brian Greenwood, Ivan Youd – BIS
Member associations