COMMERCIAL BANKING

Business in Britain: Manufacturing

A survey of key sector opinions, trends and insights.

July 2019

By the side of business

LLOYDS BANK

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Welcome

Scott Barton
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It's an often-repeated myth that the UK doesn't make things anymore.

The reality is that we are still the ninth largest manufacturing nation in the world and the sector plays a vital role as an employer, exporter and innovator.

British-made goods are celebrated and sought-after around the world, with manufacturing accounting for 44% of all the UK's overseas sales.

Manufacturing still contributes 10% of UK Gross Value Added (GVA), represents 70% of all business Research and Development (R&D) spend and directly employs 2.7 million people[1].

However, the sector is also currently facing a diverse range of challenges that might be unprecedented in its history and we wanted to give manufacturers a platform to share their insights, ambitions and anxieties.

We've consulted at the highest level across the industry to produce this report, speaking with hundreds of senior leaders at large manufacturers in order to get under the skin of the sector.

Investing in research like this is all part of our ongoing effort to back British manufacturers.

Year on year, our specialist teams are working to help firms achieve their full potential.

This report will help to inform how Lloyds Bank can continue to effectively support manufacturers, and we hope it will also promote discussion and drive awareness of the issues at the top of the manufacturing industry's agenda.

"...we are still the ninth largest manufacturing nation in the world and the sector plays a vital role as an employer, exporter and an innovator."

AT A GLANCE

93% of respondents are exporters

55% say demand for their products from overseas is growing

47% say the UK leaving the EU threatens turnover growth

1 – House of Commons Library Briefing Paper – Manufacturing: Statistics and Policy, November 2018

Current environment and outlook

> Given ongoing reports that uncertainties, including delays to the UK's exit from the EU, have impacted manufacturing investment, it's encouraging to see that firms are now readying plans to invest.

It's heartening to see that the majority of manufacturers we spoke to have growth on the agenda.

Though they are evenly split on whether the economy will grow (34%) or contract (35%) over the next year, they are far more certain of their own potential, with 79% forecasting that turnover will increase over the next five years, and by an average of 12%.

The same goes for job creation, with 60% predicting their headcount will increase over the next five years, recruiting on average 40 new staff each year.

Firms told us they plan to drive revenue growth primarily through new product development (49%), investment in IT (30%), new equipment (24%) and increasing capacity (22%).

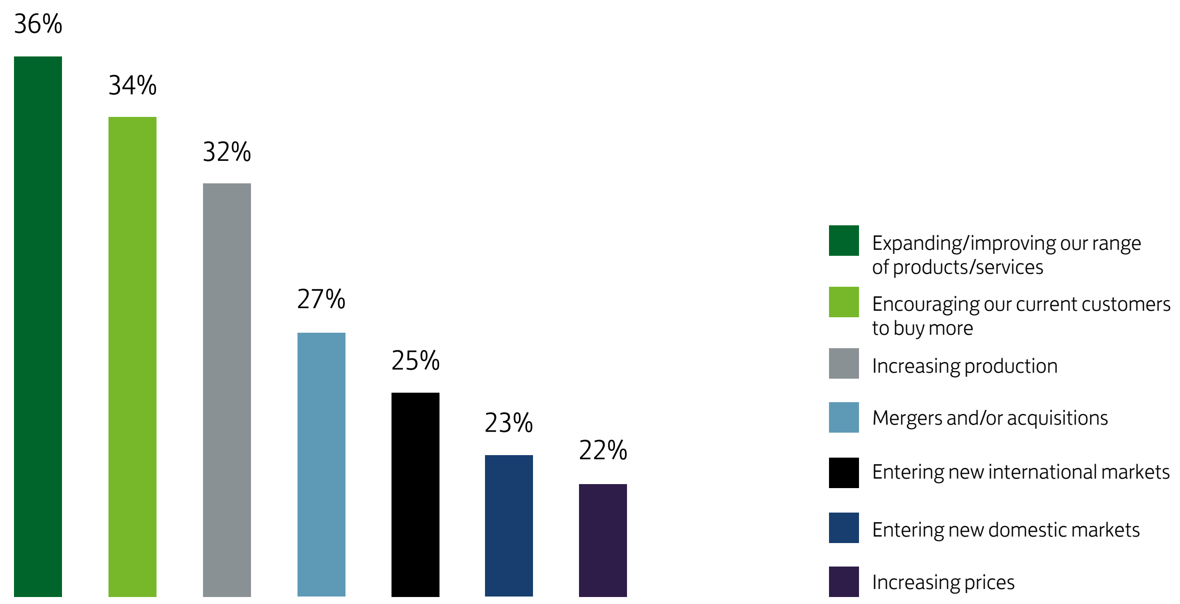
Given ongoing reports that uncertainties, including delays to the UK's exit from the European Union (EU) and global trade disputes have impacted manufacturing investment, it's encouraging to see that firms are now readying plans to invest.

When it comes to spending priorities, as well as developing new products (23%), they're planning more strategic investments to boost their long-term competitiveness in skills (17%), automation (15%), sustainability (11%) and robotics (10%).

However, it is striking that respondents also say their primary concern is to increase turnover (40%), with only half as many prioritising improving productivity (21%).

This is despite the fact that the UK's productivity remains comparatively weak versus other G7 countries[2].

What do you see as the main opportunities to grow your turnover?



2 – ONS: International comparisons of UK productivity, April 2018

Capital ideas

Manufacturing is a capital-intensive sector. We asked manufacturers whether their cash flow cycle – the amount of time it takes them to turn products into cash – had become longer or shorter than it was a year ago.

Half (49%) reported that it had become longer, while just over a third (37%) said their cycle had reduced.

As a result, three in five (61%) have taken steps to shorten their cash flow cycle and improve liquidity within their business.

This should come as no surprise. Firms need resources to draw on in case of unexpected expenses and manufacturers are exposed to an array of global political and economic uncertainties, with 93% of those we spoke to trading internationally.

After responding to political and economic uncertainties, the most common reason for shortening cash flow cycles is to free up cash to invest in new technology (23%), which should improve productivity in the medium term.

As the chart shows, firms are using a range of tools to shorten their cash flow cycle, including leveraging their size – 75% of firms surveyed have turnovers of £101 million or more – to negotiate better terms with their supply chains, as well as working with their customers and suppliers and building new relationships to make their operations more robust and responsive.

Reacting to risk

Another key trend this year has been the stockpiling of raw materials and semi-finished goods.

A majority (62%) of firms told us they had moved to store inventory in the last year, primarily in response to concerns that imports and exports could be complicated by the UK's exit from the EU (69%).

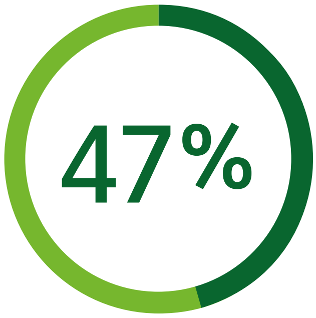
A smaller majority (57%) have asked firms in their supply chain to stockpile, to mitigate the potential impact of the UK leaving the EU.

So, it seems that, while manufacturers have made diverse efforts to increase liquidity in their business, these funds have been deployed to stockpile assets rather than invest in growth.

This could yet prove to be a missed opportunity with long-term implications for the sector, though it is an understandable reaction to the external risks they face.

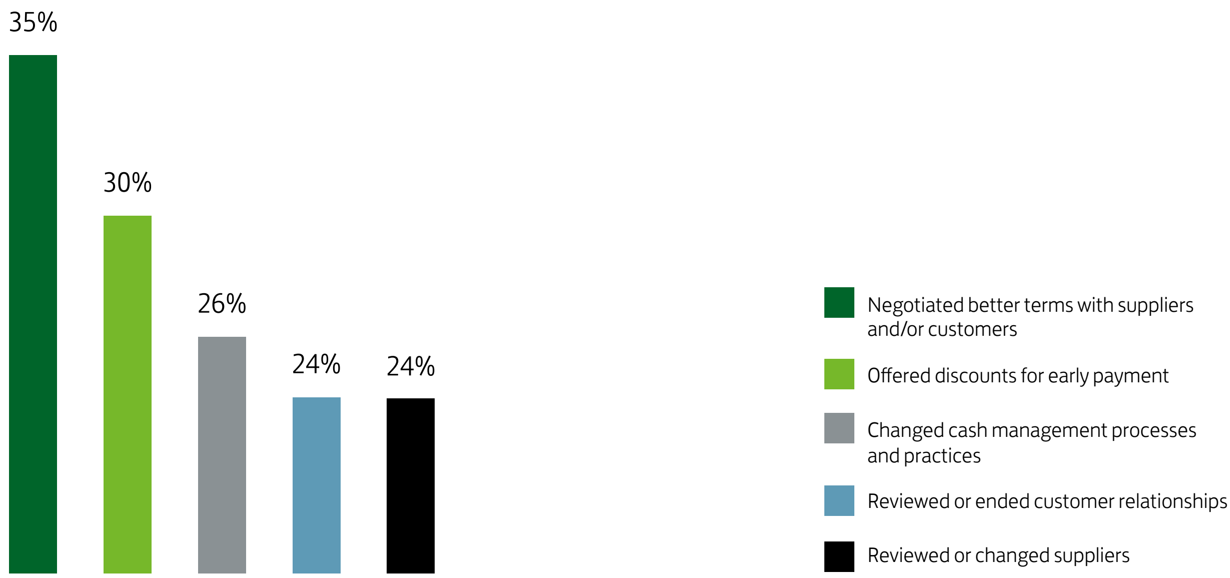
Almost half (47%) of firms say the impact of the UK leaving the EU threatens their growth, with respondents also citing cost pressures (45%), political uncertainty (44%) and weak growth in the UK economy (43%).

But there is one threat that manufacturers seem to feel they have got to grips with - three quarters (74%) say they are now well prepared to face a cybersecurity attack.

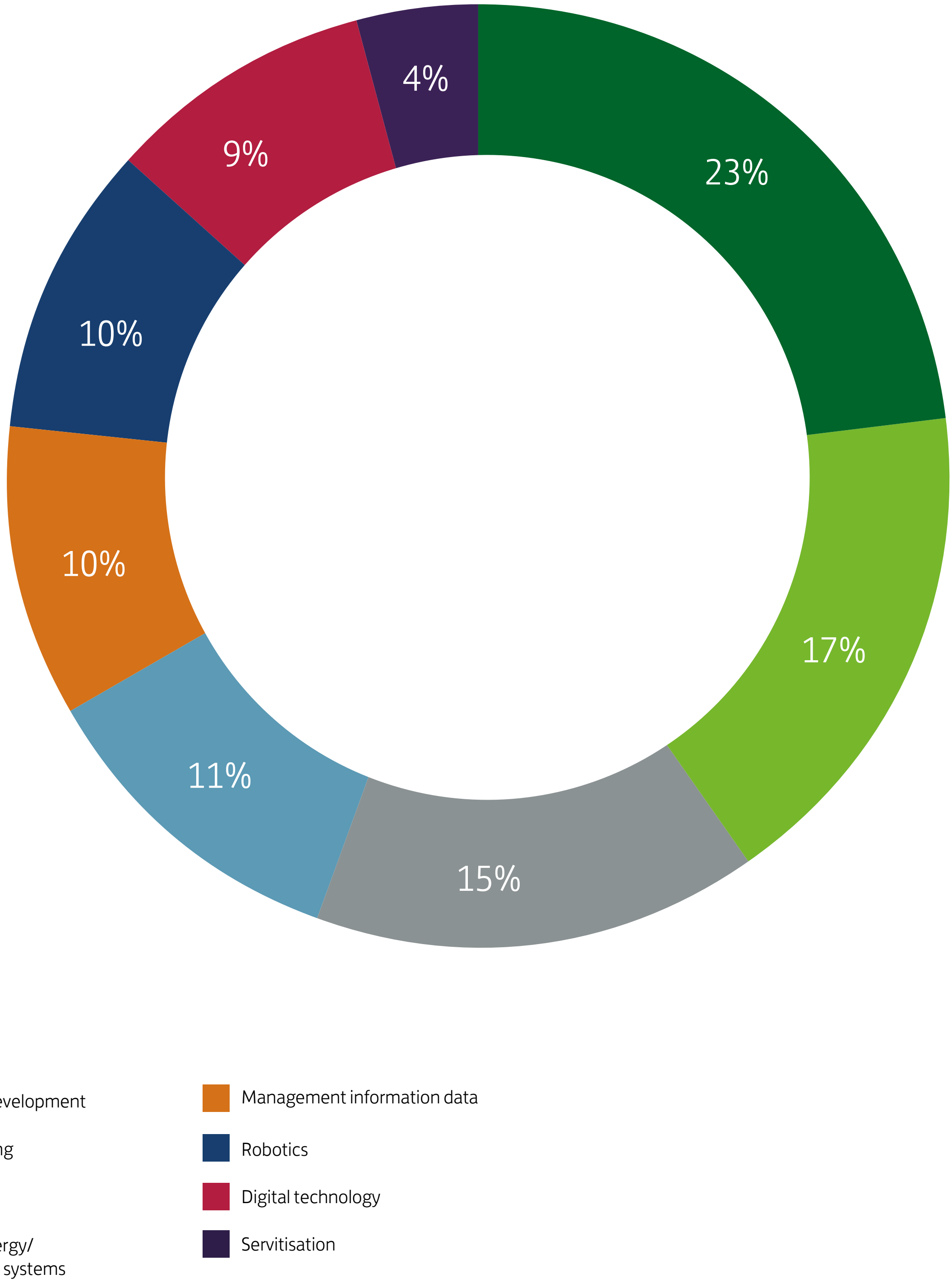


of firms say the impact of the UK leaving the EU threatens their growth

What proactive steps have you taken to reduce your cash flow cycle in the last year?



What is your biggest investment priority for the next two years?



International ambitions

It's hard to understate the impact that UK manufacturers have had on the nation's standing overseas.

Quality brands are ambassadors for the nation and their reputation reflects positively on other business sectors too.

More than nine in ten (93%) of those we spoke to are trading their goods internationally.

Aside from increasing turnover, they're exporting because it gives them access to new, larger markets (55%), boosts profitability (54%) and helps them manage the risk associated with individual national economies (40%).

Brand Britain

When we asked firms about demand for their products from overseas, slightly more than half (55%) said it was growing, while just a sixth (16%) said it was declining.

This result was mirrored in firms' views on the value of the 'Made in Britain' brand, with 56% saying it helps them sell their goods overseas and only 17% saying it was an impediment.

Existing and emerging markets

The EU still accounts for 48% of all exports of UK goods[3].

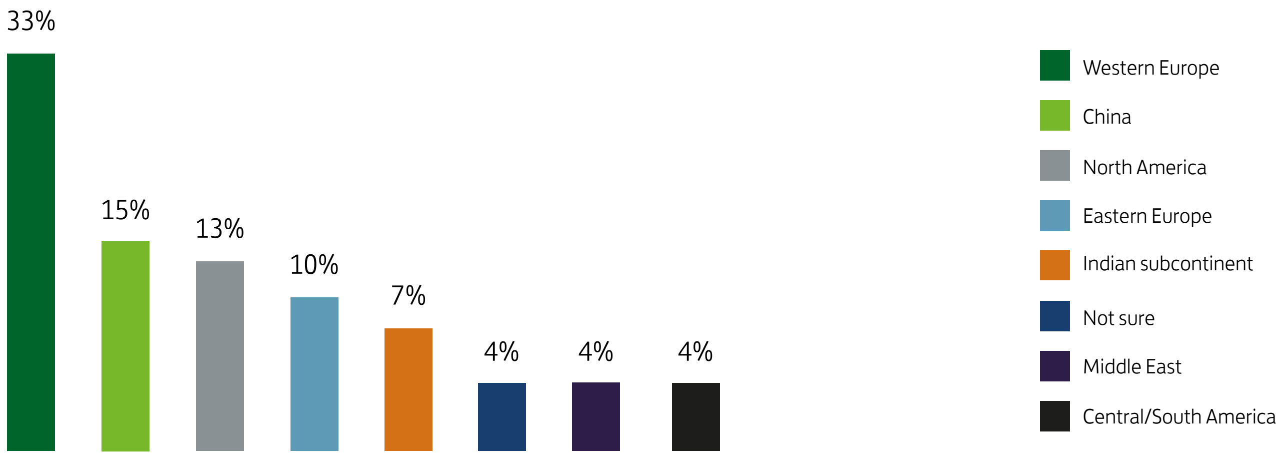
So, given the UK's proposed departure from the Union, it is perhaps unsurprising that a third (33%) of manufacturers told us the EU would remain their most important growth market for the next five years.

The relatively low numbers of firms targeting these geographies may actually reflect a tendency for British firms to set up domestic manufacturing operations when entering these markets.

But should more manufacturers be looking to growth markets like China (15%) and the Indian subcontinent (7%) for opportunities?

of respondents are exporters

Which of these markets will be most important for growing your revenues over the next five years?



3 – House of Commons briefing paper: Statistics on UK-EU trade, January 2019

Reshoring and relocation

More than a third (37%) of firms said they were planning to move manufacturing processes back to the UK that had previously been offshored to territories like Asia and eastern Europe.

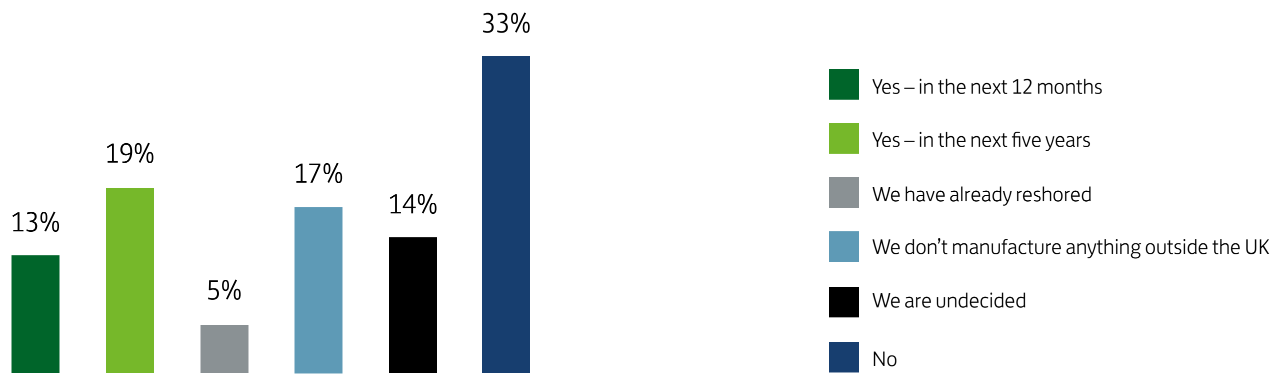
The prime motive for this, cited by 71% of those with these plans, was to improve quality – a telling endorsement of the high standards that British manufacturers and workers uphold, which also has extremely positive implications for UK supply chains.

We also asked manufacturers whether they were considering relocating their head office or main operating site within the UK during the next five years and around a third (34%) said this was a likely development, though almost half (46%) said they were planning to stay put.

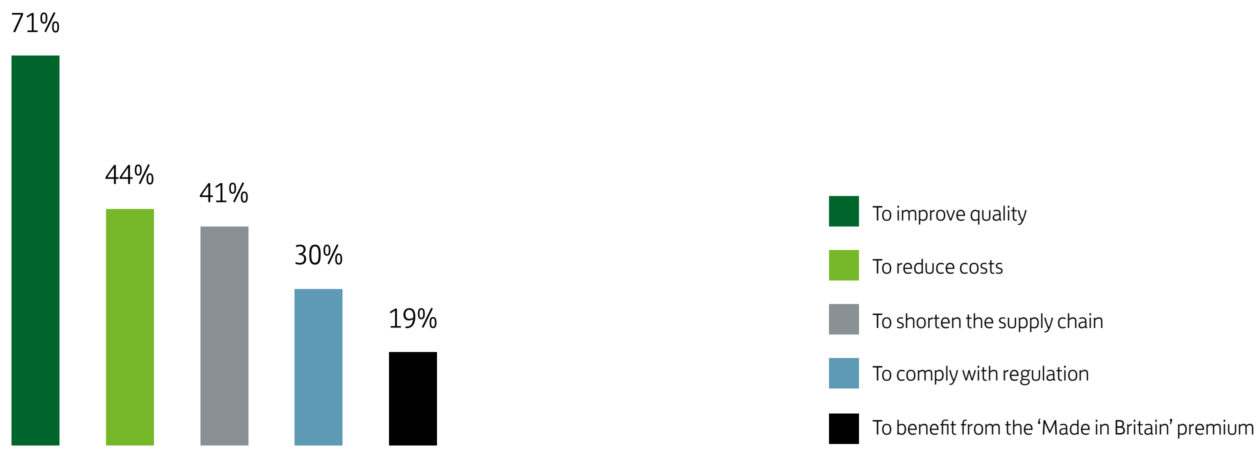
Of those contemplating relocation within the UK, the key motivations were finding cheaper premises (46%), a cheaper area (33%), access to local authority or government incentives (31%) and access to skills (28%).

> Quality brands are ambassadors for the nation and their reputation reflects positively on other business sectors too.

Do you have plans to bring any of your manufacturing processes back to the UK?



You said you plan to move some of your overseas manufacturing back to the UK. What are the reasons for this?



An innovation nation

Telephones, televisions and touch screens – all examples of British innovations that have changed the world.

Today, UK manufacturers are still working hard to create the next new product that can transform their fortunes, and the effort to innovate is being led from the top.

In more than a third of businesses, (35%) a board director takes overall responsibility for innovation, with the chairman or chief executive leading new product development in a further quarter of firms (26%).

We've seen that it's the biggest single investment priority for manufacturers (23%) and that almost half (49%) believe new product development will drive their growth in the next five years.

So, in an environment where investment has been subdued, it is encouraging to see that 60% plan to increase their R&D budgets, and by an average of 13%.

That still leaves almost a third (29%) saying R&D spending will fall, which may be a conceivable reaction to current pressures and uncertainties but could also come with its own risks.

Innovating means investing

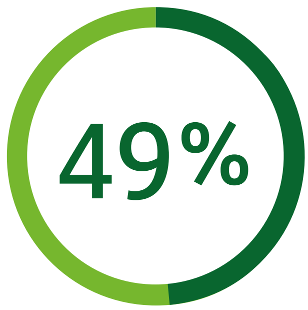
Innovation can be expensive, but businesses can mitigate the risk of committing capital to new product development by accessing support in the form of R&D tax relief or R&D expenditure credit, which is calculated at 12% of a company's qualifying R&D expenditure and is taxable[4].

The government has earmarked around £1.5 billion a year for this kind of relief; claiming is straightforward and it can help overcome the uncertainty of investing in innovation.

So, it was perhaps surprising that only half (50%) of firms said they currently take advantage of R&D tax relief.

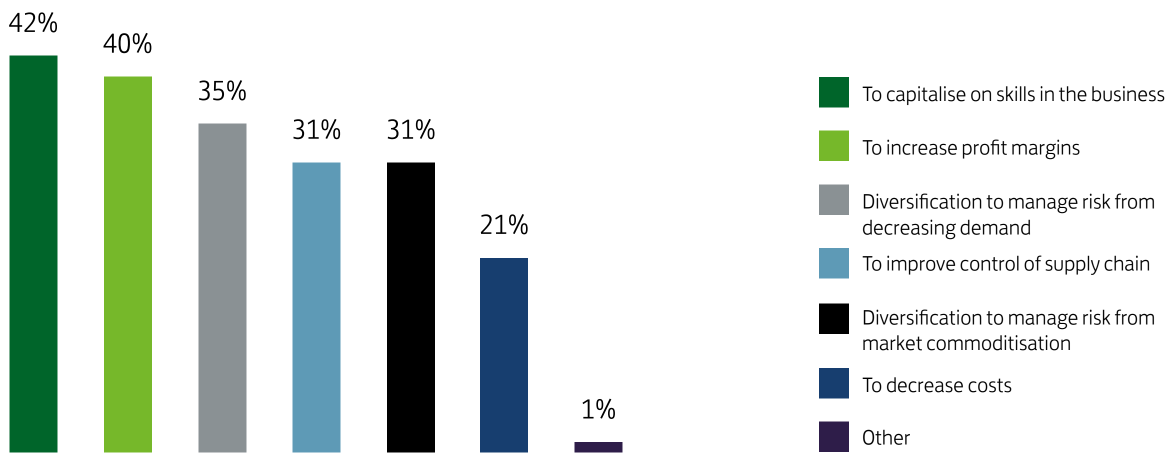
Indeed, the fact that one in 10 (11%) say they'd never heard of it and a similar proportion (13%) say they were aware of the benefit but didn't know how to claim suggests more could be done to raise awareness of the support available.

is the average planned increase in R&D spending



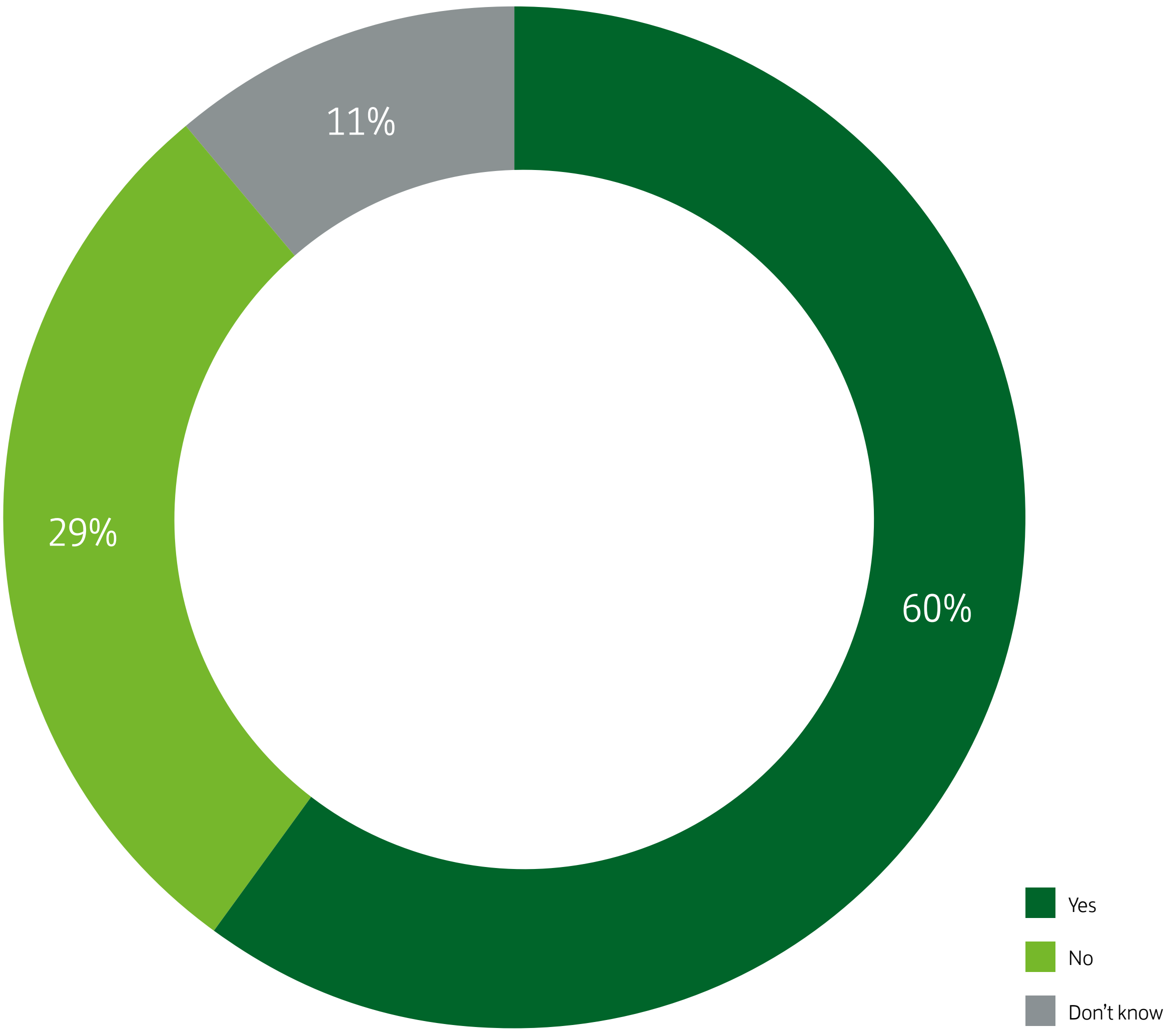
believe new product development will drive their growth in the next five years.

You said you are offering services or planning to. What are the reasons behind this?



4 – Gov.UK guidance: Claim Research and Development (R&D) expenditure credit, June 2019

Are you planning to increase spending on R&D in the next 12 months?



> Today, UK manufacturers are still working hard to create the next new product that can transform their fortunes, and the effort to innovate is being led from the top.

Spotlight on servitisation

Although firms don't seem to see it as a priority for investment - only 4% say it is their primary focus – servitisation is a business model with the potential to help manufacturers boost their bottom line, and it looks to be gaining traction in the UK.

When manufacturers sell their solutions as a service rather than as individual units, it can help to both differentiate their products and enhance their competitiveness.

Manufacturers seem to believe in its potential, with half (49%) saying selling services will become more important or as important as selling goods over the next five years, though 44% expect selling goods to remain more important than selling services for their business.

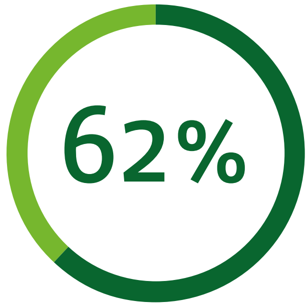
It's something forward-thinking manufacturers are already doing - a quarter (25%) of those we spoke to said they had already begun offering services as well as products, while more than a third (37%) said they were planning to in the next five years.

As the chart on page nine shows, the motivations to servitise are diverse, ranging from capitalising on skills to spreading risk and cutting costs.

It seems likely that the boundaries between manufacturing and service provision will continue to blur as manufacturers seek to compete by integrating products and services.

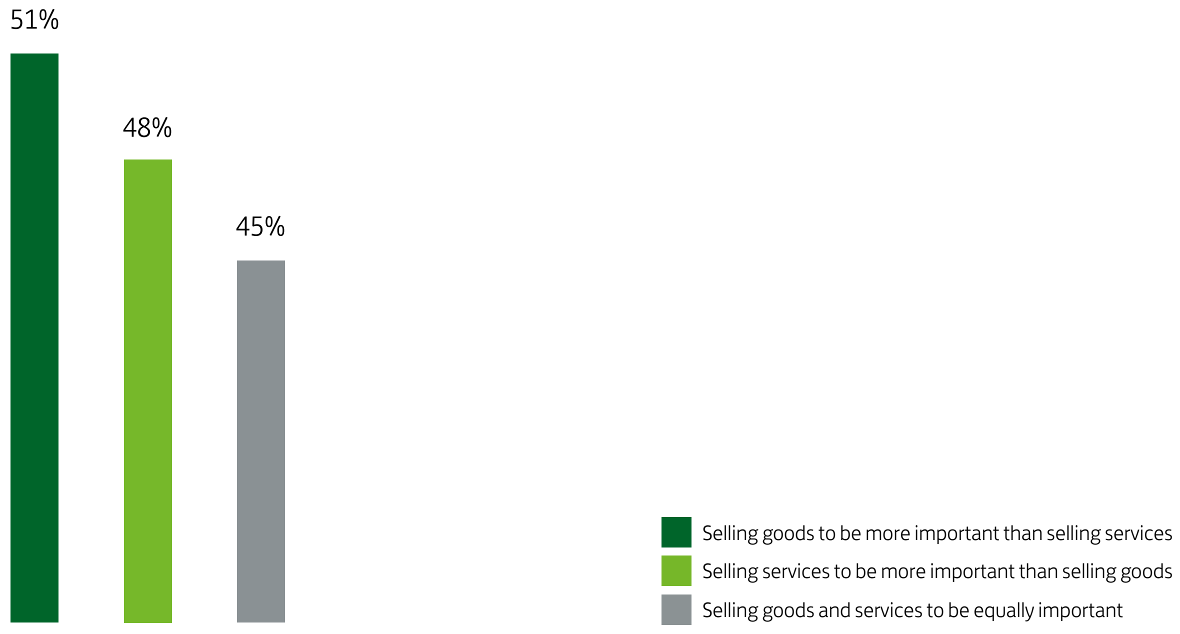
It's a strategy that can help firms differentiate themselves in the marketplace while also creating reliable, long-term customer relationships and revenue streams.

As such, we expect to see more firms exploring opportunities to servitise their offering in years to come.



are already providing services or plan to

To grow our revenues, I expect...



Skills and shortages

The manufacturing skills gap is an enduring issue for the industry.

We've seen concerted efforts to encourage more women and graduates to join the sector, alongside an upturn in apprenticeships and attempts to increase awareness of the opportunities manufacturing can offer.

Despite that, this report still found a net 88% of firms reporting a shortage of skills in their business.

Firms told us that skills and training is their second highest investment priority for the next two years (17%), while over a quarter (28%) are even considering relocating to be in an area with better quality universities and access to graduate talent, or to access a workforce with more relevant skills.

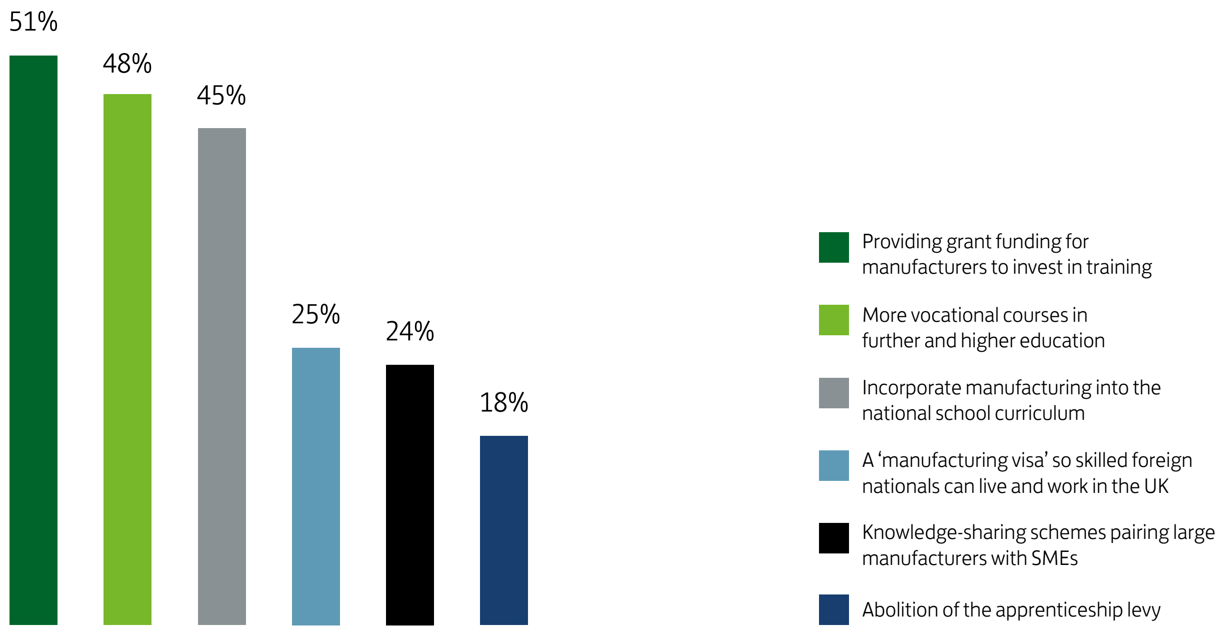
Skills are driving strategy too. Two in five (42%) firms told us that the primary reason for their shift towards servitisation is to capitalise on the skills and expertise in their business.

And skills aren't just an issue on the shop floor, but also in the boardroom.

report a skills shortage

> Businesses across the UK can play an important role in shaping the future workforce, and many are already successfully engaging with the education sector in their area.

Which of these measures do you believe would most benefit your business in terms of identifying and training workers with the right skills?



Boardroom blitz

It's increasingly well understood that suboptimal management skills are one of the key drags on productivity[5].

In particular, practices relating to continuous improvement and employment management – including promotions, performance reviews, training and managing underperformance – have been shown to have a strong correlation with productivity.

Our research found half (49%) of firms had identified a skills shortage among their middle and senior management – more than twice as many as those who felt the need to upskill workers on the shop floor (18%).

While 13% said they are not confident their managers have the skills needed to help the business grow and fulfil its potential, half (50%) said they still have faith in their managers, but believe they need more training and guidance.

Only a third (37%) believe management is fully equipped for the future.

While firms clearly seek support when it comes to funding their own training – citing their desire for training grants (51%) and the abolition of the government's apprenticeship levy (18%) – they also believe more can be done to provide a pipeline of skilled people for them to recruit from.

That includes further and higher education providers providing more vocational courses (48%) and including manufacturing in the school curriculum (45%).

Education and engagement

This presents a fantastic opportunity to invest resources into engaging with UK Catapult Centres, schools, education authorities and more, to ensure more vocational skills can be incorporated into learning programmes.

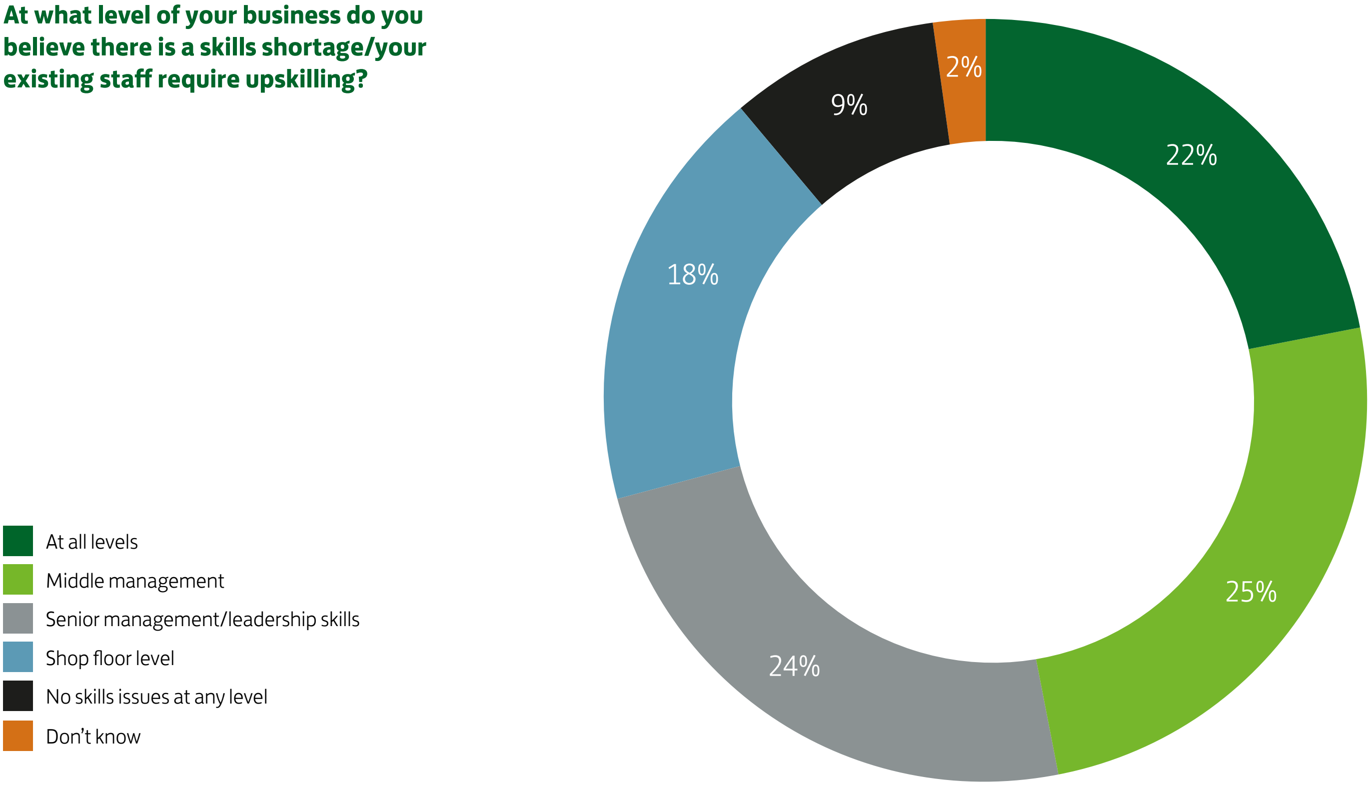
Businesses across the UK can play an important role in shaping the future workforce, and many are already successfully engaging with the education sector in their area.

We know these kinds of partnerships can achieve extremely positive outcomes because we have seen it first-hand.

Since 2015, Lloyds Bank has been supporting UK manufacturing skills with our £1million-a-year sponsorship of the Manufacturing Technology Centre in Coventry.

of manufacturers have faith in their managers but believe they need more training

At what level of your business do you believe there is a skills shortage/your existing staff require upskilling?



5 – ONS: Management practices and productivity in British production and services industries, April 2018

A sustainable future

> ...an investment in sustainability can also improve efficiency and profitability.

Awareness of environmental issues is at an all-time high among consumers – and manufacturers too.

The sector is rightly highly-regulated and, for most manufacturers, acting sustainably is a responsibility they feel deeply.

We all have a moral responsibility to do the right thing for the environment and it's an area where manufacturing firms are increasingly under the spotlight from investors and buyers alike.

Customers want to know the goods they buy are manufactured to the highest environmental standards and sustainability is a growing influence on decisions around procurement and supply-chain management.

As such, sustainability must sit at the very heart of every modern manufacturer's strategy.

Efficiency and accountability

This report confirms that is the case for the majority, with two thirds (67%) saying they are planning to invest in sustainability in the next two years, though this does leave almost a quarter (23%) which are not.

It's worth remembering that investment in sustainability can improve efficiency and profitability, future proofing business as well as protecting the environment.

Sustainable energy products and energy efficient systems sit at fourth on firms' lists of investment priorities (11%), behind only new product development (23%), skills (17%) and automation (15%), and they have the potential to reduce operational costs as well as carbon emissions.

As the chart shows, cutting waste and energy use are at the forefront of firm's sustainability strategies.

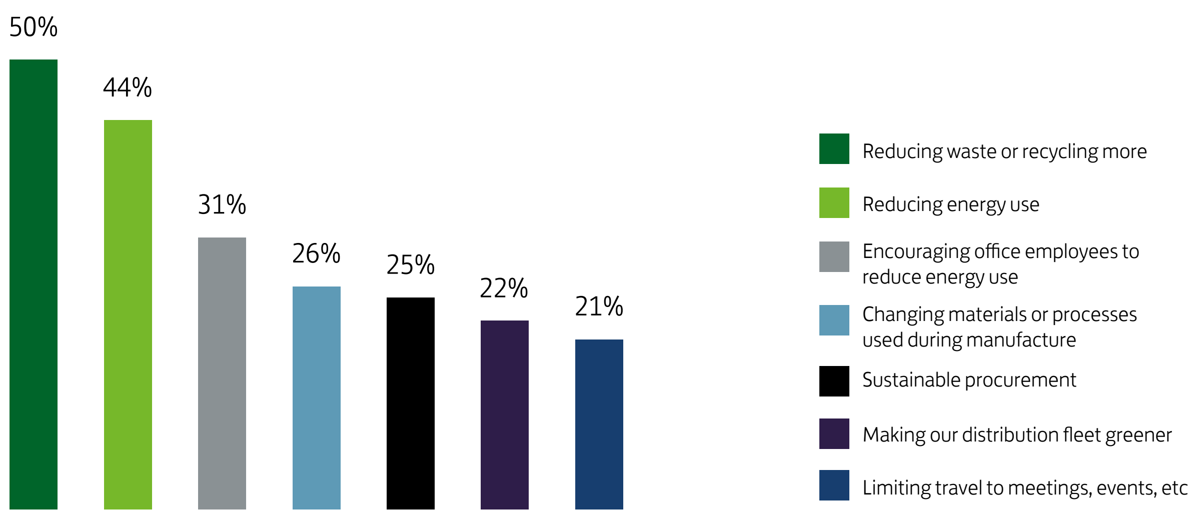
But businesses are also making more fundamental moves, like changing the materials or processes used in the manufacturing process (31%) and reducing or changing manufacturing shift patterns (14%).

Vehicle fleets are another very effective and visible way to reduce carbon emissions by using hybrid and fully-electric vehicles, which was cited by a fifth (22%) of firms surveyed.

Improved charging networks make this an increasingly practical solution, especially if working with a fleet management provider.

Government grants for vehicles that emit 75 g/km of CO2 or less and are capable of zero emission travel are worth up to 35% of the purchase price, while electric vehicle fuel costs are typically around a third as much as with petrol or diesel[6].

In what ways is your business reviewing or implementing ways to reduce its carbon footprint?



6 – Lex Autolease: Cost Savings

Closing statement

Stephen Harris
Managing Director,
Head of Manufacturing,
Large Corporates,
Lloyds Bank Commercial Banking

Much of the news about manufacturing in the media has not made happy reading of late.

We've heard about declining growth, output slowing and order books shrinking.

But, behind the headlines, there's another story that British manufacturers are writing for themselves.

This report shows that they are still showing the kind of resilience, creativity and ambition that they have always been known for.

They are working hard to ensure they will come out of these challenging times stronger than ever before.

They are creating innovative new products with international potential, entering valuable new markets and ensuring they have the world-class skills they need to succeed.

They are investing to ensure they can capitalise on all the opportunities that exist in a modern global economy, and to make themselves robust enough to tackle future challenges.

Of course, like businesses in all sectors, they have been taking action to mitigate against some extraordinary external pressures.

But manufacturers have been particularly proactive in preparing for a new phase of growth when greater certainty inevitably emerges.

Lloyds Bank has been backing British manufacturers for generations.

My message to manufacturers today is that, whether it's assisting with financing growth, improving efficiency or helping enter new markets, we have the resources and expertise you need.

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Calls may be monitored or recorded in case we need to check we have carried out your instructions correctly and to help improve our quality of service. Please note that any data sent by email is not secure and could be read by others.

IMPORTANT INFORMATION

Methodology
To gather representative data, financial decision makers at a cross section of 200 manufacturing businesses with an annual turnover of £50m+ were surveyed in England, Scotland, Wales and Northern Ireland. Online interviews were conducted by BVA BDRC via its business access panel. Fieldwork was conducted 10th to 20th May, 2019.

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