



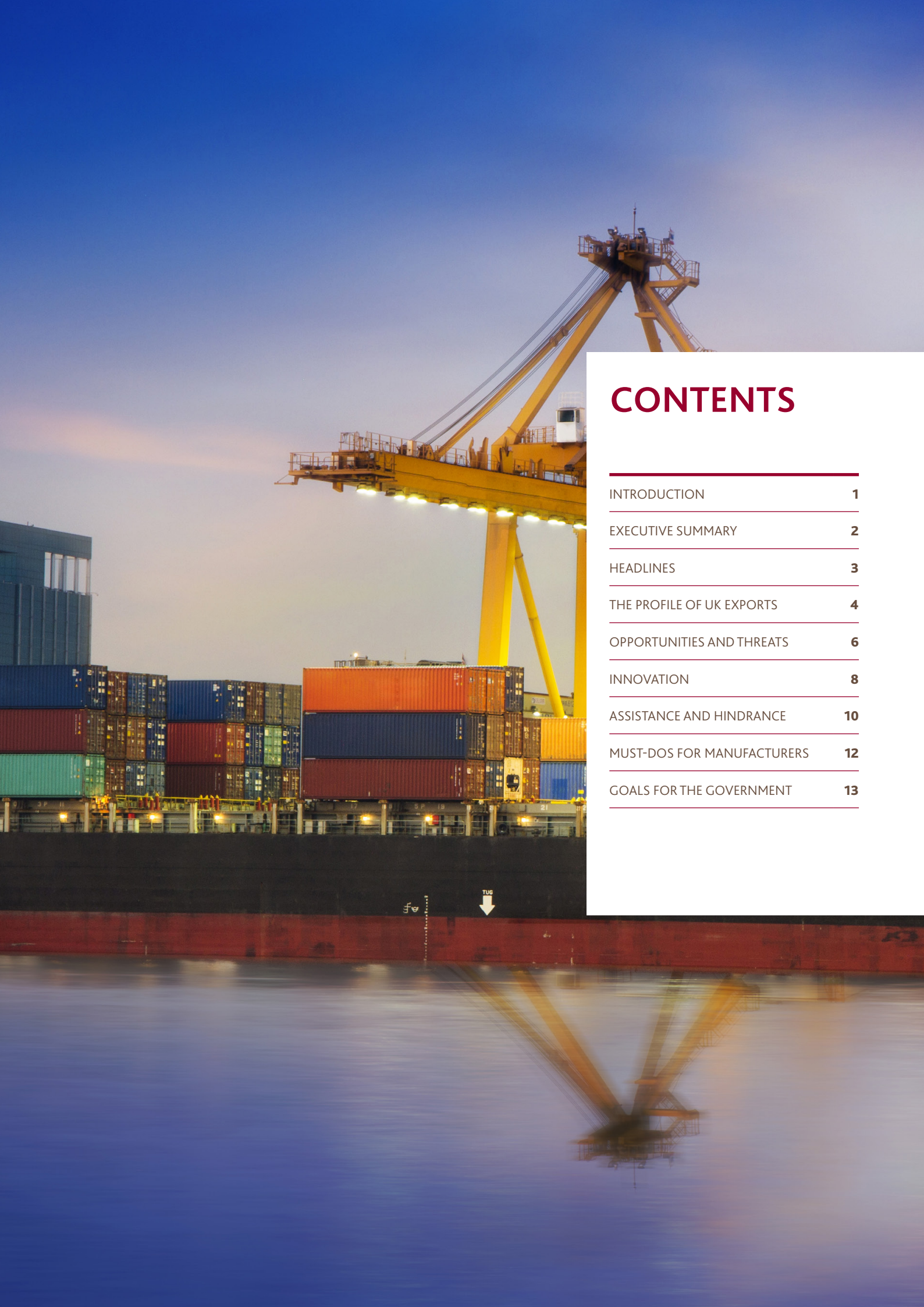
# THE INTERNATIONAL REPORT

2015

Institution of  
**MECHANICAL  
ENGINEERS**

IMechE Services Ltd

**BDO**



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# INTRODUCTION

The UK is the 10th largest goods exporter in the world and there is no question that exports and further internationalisation are fundamental to the future success of UK manufacturing. Recent years have been tricky times for world trade and particularly UK exports. World Bank statistics show a damaging drop in exports in 2009 was followed by a bounce-back in 2010 and 2011; but since then the growth has virtually stalled. Unfavourable sterling exchange rates and the economic weakness in the rest of the EU, which takes around half of all UK exports, are the explanation, though this year has seen a sharp decline in export sales to the US, our single biggest market.

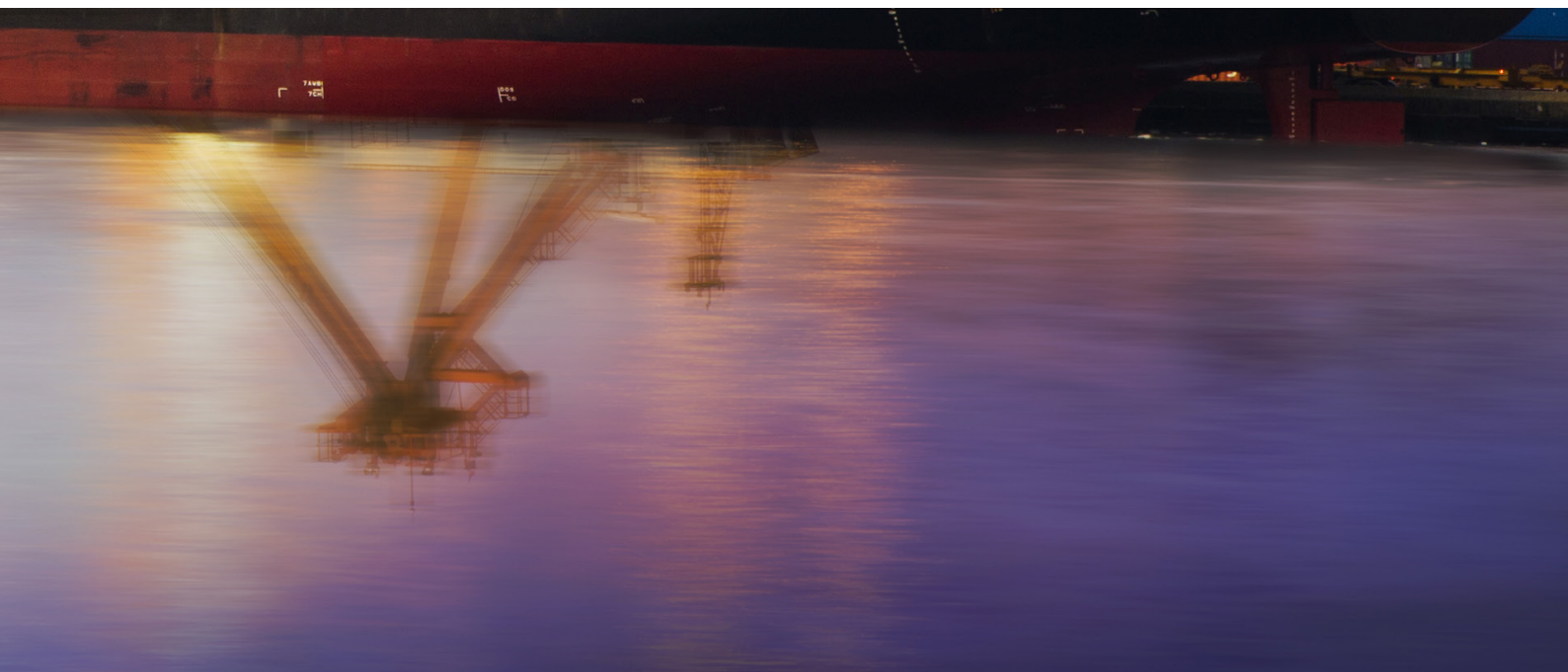
There are signs, however, that in the UK the trade deficit is no longer going to be a forgotten issue. 2014 saw record deficits amounting and between January and March 2015, the UK's deficit on trade in goods and services was estimated to have been £7.5 billion; widening by £1.5 billion from the previous quarter. In response, Labour's economics and industry team commissioned the head of AgustaWestland, Graham Cole, to investigate what might be done to redress the balance and stimulate exports. The Cole Commission on Exports interim report found the 'system' is currently too complex and too fragmented and the Government and businesses in the UK need to give this as much priority and resource as our competition do. The final report, due in early June, is likely to recommend a stronger ministerial "trade" role within government and some realignment between the UK Trade and Investment and export finance bodies. If implemented, this can only serve to support our manufacturing industry.

In this report, we summarise the findings of our recent survey on exports and internationalisation and share some thoughts on next steps for UK manufacturers. Produced in collaboration with the Institution of Mechanical Engineers (IMechE) our survey of manufacturers and engineers was conducted in April 2015.

We are thankful to all those who shared their thoughts and experiences – we hope you find this an interesting report.



**TOM LAWTON**  
Head of BDO Manufacturing



## EXECUTIVE SUMMARY

- UK exports of engineering products and services constitute more than 50% of total UK exports and are less susceptible to volatility than some other important export categories.
- The EU and North America are currently the largest markets for engineered goods, accounting for 50% and 13% respectively. Exporters have a very broad range of future target markets, including some parts of the world that have not been important markets in the past: there are still big new opportunities for UK firms.
- Quality and reputation are what sell UK goods and services in export markets. Price, where the UK often struggles to compete with low-cost economies, is less often cited as a leading factor, and there is no particular merit in "Britishness" except in occasional cases.
- Allied to quality and reputation, technology and innovation are very important issues for UK exporters. Support for and investment in R&D in the UK is rated as satisfactory, but more could be done and external statistics indicate that some competitor countries achieve more in this area.
- Nearly a quarter of companies (24%) claim that a lack of finance is holding them back in developing an export strategy, and greater tax relief and direct help on finance would be useful actions UK Government could take in support of exporters.
- Domestic issues can affect the potential for companies to exploit export opportunities, and the UK's skills shortages are of particular concern here.



# HEADLINES



Statistics from our survey respondents

35% HAVE WORKED  
WITH UKTI

79% PICKED OUT  
COMPETITION FROM  
GLOBAL RIVALS AS A WORRY

64% EXPORT MORE  
THAN HALF THEIR OUTPUT

55% THINK THEIR OWN  
COMPANIES ALLOCATE  
ENOUGH SPEND TO R&D

LATIN AMERICA AND INDIA  
KEY FUTURE MARKETS  
FOR UK EXPORTS

70% SAID THAT GREATER  
AND REVISED TAX RELIEF  
FOR EXPORTS IS THE BEST  
GOVERNMENT INCENTIVE

78% SEE QUALITY AS THE KEY  
TO THEIR INTERNATIONAL  
COMPETITIVENESS

24% HAVE ISSUES  
ACCESSING FINANCE FOR  
EXPORTS

## THE PROFILE OF UK EXPORTS

Engineering-based industries account for a high proportion of the UK's export trade. In February 2015's trade figures, mechanical appliances, vehicles and electronics were three of the top five industry sectors for exports to non-EU customers and accounted for 38% of the total; within the EU, the same threesome accounted for 29%.

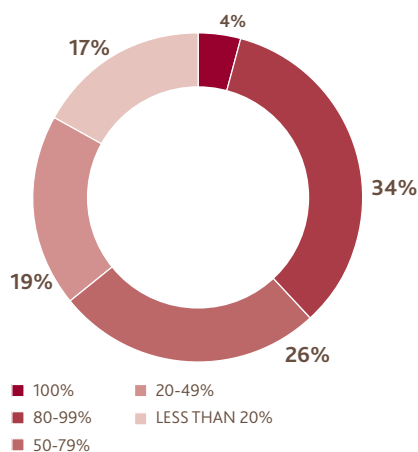
The responses from those surveyed by BDO and the Institution of Mechanical Engineers indicates that the industry remains overwhelmingly international in its outlook.

The nature of the business has, however, changed. Aerospace, automotive, construction and chemicals remain the largest industrial concentrations and account for just under half of the survey respondents. However, 20% are involved in consultancy or service work, academia, government and other sectors where there is no tangible 'product' to export – yet almost all of these people say they are engaged in exporting.

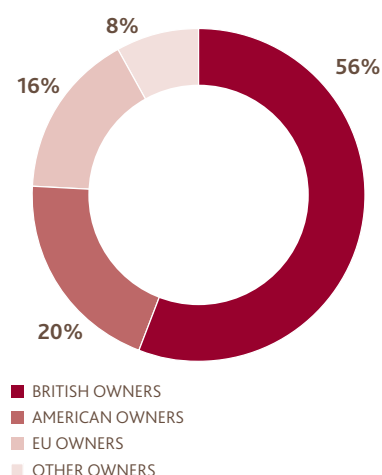
The export of knowledge and know-how rather than – or alongside – physical equipment and goods is now often the way business is done in the globalised world of engineering. That can include research, development and design services at the front end or after-sales and maintenance services during a product's lifetime. In addition, of course, many products such as cars and aircraft are the result of international collaboration where it is difficult to allocate value by geography.

Although this is an international industry, there is still strong UK ownership within the sector, as shown in Figure 2. Of our respondents, 56% work for companies whose ultimate ownership is British; American owners are the second biggest group at 20%, while other EU countries – Germany, France and Italy – own 16%. Among those surveyed, 44% come from companies with an annual turnover of £50 million or less and 35% from groups in the £500-million-plus category.

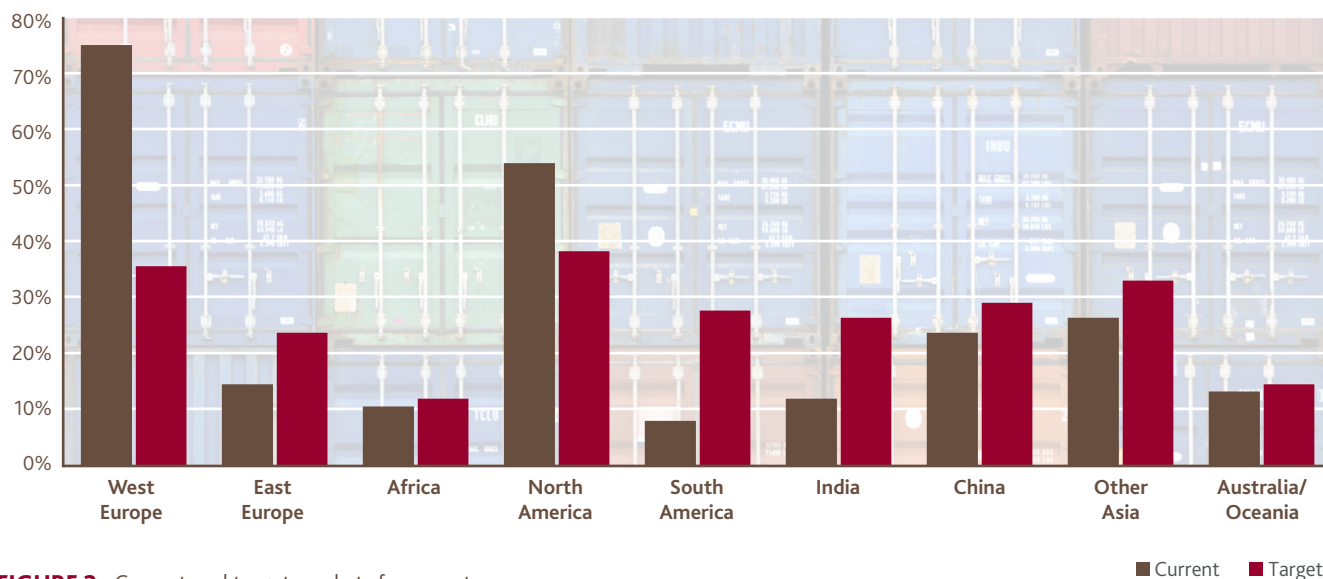
In geographical terms, there is wide dispersion, with every UK region represented in our sample and five English regions – the South East, South West, North West and East and West Midlands – each accounting for between 10% and 16% of respondents.



**FIGURE 1:** Percentage of company income from international customers



**FIGURE 2:** Respondents' ownership within the sector



**FIGURE 3:** Current and target markets for exports

The survey asked what percentage of company income came from international customers: the answers are shown in Figure 1. Almost two-thirds of the exporters say that international income accounts for more than half of their business.

The answers to a follow-on question about the potential growth in exports over the next five years are less ambitious. While a few companies are looking to significant export growth of more than 50%, a majority – 64% – expect more realistic growth of between zero and 10%.

Governments of all persuasions for the past 50 years have enjoined UK industry to increase exports and the current Government has set a notably ambitious target of £1trillion a year by 2020.

The survey also explored where the respondents' top export destinations were. There is no great surprise here: as official government figures confirm, Western Europe (55%) and North America (41%) are our biggest trading partners. Less than a quarter of the firms surveyed are exporting to China, though that is still the third biggest concentration.

## OPPORTUNITIES AND THREATS

The survey asked for the respondents' views on what makes for export success, whether they felt confident that their export markets were secure and what the greatest threats might be. There are strong indications here that industry is realistic about its performance and prospects.

The UK exporters' offerings that enable them to be confident about exporting are quality, company reputation and the technology or Intellectual Property (IP) they can bring to the market. Each of these factors were cited by more than 40% of respondents, and quality is by some distance the most important, with 78% seeing it as key to their competitiveness.

By contrast, price is seen as a crucial factor by less than 20% and, in fact, is viewed as a less important factor in export success than after-sales service and future product support. This reflects two important points.

The first is that UK companies have recognised the economic reality, which is that on many, if not most, products they will struggle to compete on price against low-cost countries and that they have instead to win business on other factors. The second, a trend for the future, is a growing realisation that sales of all kinds – not just exports – do not end with the transaction and that there is revenue to be made through after-sales and product lifecycle relationships.

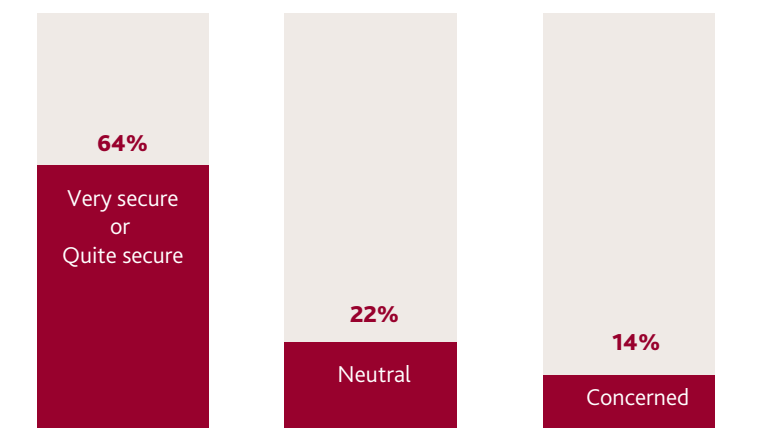
A further point to be made from these responses is the importance of 'Britishness'. Only a handful of respondents felt that a 'Made in Britain' label had useful cachet these days, even fewer said that UK Government initiatives had brought success in target markets, and just one person felt the UK's international reputation or "geopolitical position" was a winning asset. The over-riding impression is that where business is won it is on merit, not through history or sentiment.

That being so, the good news is that a majority of respondents are confident that their export business is stable and not at immediate risk. Asked how secure they felt about their exports, 64% said they felt 'very secure' or 'quite secure' and a further 22% were 'neutral'; just 14% were concerned about potential disruptions, as shown in Figure 4.

The possible disruptions come from a wide range of sources of risk, but the ones that worry UK exporters most are global rather than local concerns. Of those who selected factors that they regarded as threats, 79% picked out competition from global rivals as a worry; less than 10% were bothered by the thought of UK competitors beating them to export business.

Other high-running concerns are also, to a large extent, outside the control of the exporting companies themselves and the influence of the UK Government. Just under half of respondents (49%) are worried by general geopolitical and economic uncertainty, and just under a third (32%) expressed concern about regulations in overseas markets. IP theft is a concern for 23%.

The protection of a company's IP is sometimes overlooked by firms, and the complexity, (and cost) to protect these important invisible assets becomes all the greater when considering international markets.



**FIGURE 4:** How secure respondents felt about their export business

Of 'domestic' issues, the biggest threat to export business is thought to be the UK's skills gap, but only 27% cited it. In keeping with previous answers about the limited importance of price in export competitiveness, cost factors are rated as a significant problem by only a minority: just 20% say labour costs could threaten exports, and costs of materials, energy and transport rate even lower. The UK's own legislation and Government policy is seen as a threat to exports by just 18%.

The strategies that companies deploy to mitigate overseas threats and safeguard their future exports involve continuously improving products, processes and business offerings to ensure their products are more appealing to those of their competitors. Whilst 77% are improving their current products, a massive three-quarters of respondents claim their companies are developing new products demonstrating innovation is now more crucial to winning customers than price competitiveness, which was selected by just a third of respondents. Rather worryingly, 19% said there was no strategy to defend their export business that they knew of leaving them with a degree of vulnerability.

**77%**  
say the strategy is to  
enhance and improve  
existing products

**75%**  
are in the business  
of developing  
new products

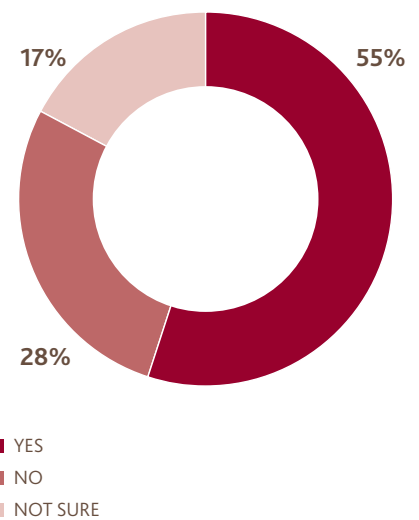
# INNOVATION

Quality of product and service is seen as central to export success. Alongside this, constant innovation and re-invention of the products and services being offered are the prevalent strategies to maintain a competitive edge in the challenging global market. These survey conclusions point to the importance of research and development (R&D) to UK success in world markets, probing whether UK firms are putting enough effort into their R&D.

The survey respondents generally are positive about the corporate commitment in this area. Asked directly whether they felt their own companies allocated enough to R&D, a majority, 55%, said 'Yes'. That compares with the 28% who said 'No'. See Figure 5.

Research spending has been exhaustively analysed in recent years, with the UK's percentage of turnover devoted to R&D compared, not always favourably, with statistics from other industrialised countries. However, the ONS figures show that, although the UK had in the 2012 figures the third highest total expenditure on R&D among the 28 countries of the EU – behind Germany and France – it is still below the EU average as a percentage of GDP. Other EU states such as the Netherlands, Italy and Spain are in a similar position, but most of the others, including the Nordics, appear to do better.

The need for innovation does not go away in a recession, so R&D spending is as vital in bad times as it is in good times. Encouragingly, the Government is trying to help fund research through schemes such as Innovate UK and Horizon 2020, the EU research and innovation funding programme.



**FIGURE 5:** Respondents asked directly whether they felt their own companies allocated enough to R&D

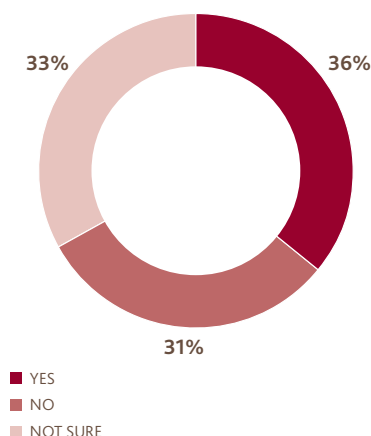


## ASSISTANCE AND HINDRANCE

The Government gets a good rating for its assistance for innovation in exporting industries, whilst other kinds of assistance for exports are less applauded.

Survey recipients were asked whether, overall, they considered that UK Government policy provided a supportive environment for export success, as shown in Figure 6. This question produced a three-way split: 36% said 'Yes,' 31% 'No' and 33% were 'Not sure'. The 'No' contingent were asked for reasons why they were discontent: lack of government understanding of manufacturing industry and particular lack of support for smaller businesses were some of the reasons.

There are a wide range of schemes and ideas where the Government could – and often does – provide help for exporters.



**Figure 6:** Recipients were asked whether, overall, they considered that UK government policy provided a supportive environment for export success

We asked which of these would be the most beneficial: the answers are shown in Figure 7. Financial assistance, in the form of tax relief for exports and direct finance for export deals are by far the most popular options. But there is also significant support for the Government to take an active role in extending companies' reach into export markets through relationship building with other countries and for direct help in terms of guidance to individual markets.

Some of the areas where the Government is being asked for assistance augment what the exporting companies themselves already do. The survey asked which out of a range of activities the respondents had participated in, and, as shown in Figure 8, three answers stand out. Exporting companies have mostly attended foreign trade events, set up satellite offices in overseas locations, and actively developed an international sales team, often working also through local distributors. Slightly fewer respondents – (35%) – had used the services of UK Trade and Investment, (UKTI) the Government's export advice service. Barely anyone had used export management companies or export brokers.

Smaller companies sometimes complain that financial support is difficult to obtain for export contracts, but the survey suggests that this is not a major problem for most firms. We asked whether access to funding was a limited factor for international aspirations, and, of those who gave a definite answer, 76% said No. That means there is opportunity there – 24% are having problems.

That impression is reinforced by answers to a question about the degree to which some alternative finance sources have been used to support international business: the answer is not very much at all. Very few respondents had had help from venture capitalists or have raised money through an Initial Price Offering (IPO); but other finance options such as crowdfunding or business angels are barely used, if at all.



**FIGURE 7:** Government checklist of actions helpful to exporters

The final set of questions relate to a theme that crops up as an issue in virtually every industrial discussion: skill shortages. The survey asked whether the UK skills resource was a constraint on international aspirations. For 53% of the respondents it is. This shows the degree to which the UK's skills problems – which are also felt in other competitor countries – are a limiting factor across the range of business opportunity.

The survey asked those who admitted to problems with skills what they were doing to address the issue, and there is a long and impressive list of actions that companies are doing. Two-thirds of the respondents, for example, are actively hiring more graduates and more apprentices; half are engaging with their local schools and a similar number use contract staff. Companies are doing their bit when it comes to tackling skills issues, but the problem is not going away. And it affects the whole business, right the way through to the ability to export.



**FIGURE 8:** Checklist of company actions taken to boost exports

We asked whether access to **funding** was a **limited factor** for international aspirations

**76%** said **no** | **24%** said they are having problems

# MUST-DOS FOR MANUFACTURERS

## UNDERSTAND THE GLOBAL OPPORTUNITY

The old balance of trade is fast changing: developing markets which used to champion their export-led manufacturing industry are now starting to become the world's biggest importers. By 2020, China's import market will be worth over £3tn, with UK exports alone predicted to be as high as £60bn according to the IMF. Having an attractive and quality product proposition will be vital to win on the new world stage.

## TAKE ADVANTAGE OF UKTI AND UKEF

According to our survey, just over a third of engineering companies are using the UKTI and/or the UKEF for advice. Businesses can receive significant help and support from the UKTI's export advice service, whilst the UKEF can provide valuable financial support for exporting, as well as offering financial insurance when entering new markets.

## USE LOCAL REPRESENTATION TO SUPPORT IN NEW MARKETS

Larger businesses may already have a network of contacts within overseas market which they can use for advice and support. However, many smaller businesses lack the network capabilities of their larger peers. The UKTI has an Overseas Market Introduction Service (OMIS) which puts businesses in touch with UKTI staff in over 100 overseas markets, and provides advice on support on entering into new countries. The British Chambers of Commerce also provides help through their Export Britain initiative.

## MAKE THE INVESTMENT TO ATTEND TRADE EXHIBITIONS FOR YOUR INDUSTRY SECTOR

Businesses can access details of trade exhibitions through organisations such as OMIS, Export Britain and industry associations such as IMechE. The UKTI also provides funding through the Tradeshow Access Programme which provides grants for eligible businesses to attend overseas trade shows. The UKTI has a number of targeted events where an accredited Trade Challenge Partner will lead UK businesses' involvement at each event. Trade shows are hugely popular with potential export partners and involvement should always be considered.

## TAKE ADVANTAGE OF THE NETWORK OF YOUR BUSINESS ADVISERS

Business advisers will normally have experience of helping businesses to trade with other countries, or will be able to put you in touch with business advisers within trade destinations. Many advisers will offer a specific unit to help clients with export opportunities.



# GOALS FOR THE GOVERNMENT



## USE FISCAL LEVERS TO INCENTIVISE EXPANSION INTO HIGHER-GROWTH EMERGING MARKET ECONOMIES

Manufacturers would welcome more financial help for exporting: tax credits, subsidies and extra incentives are needed to provide businesses with the security to pursue an export programme. The Government could look to China which provides targeted incentives for growth sectors: Chinese-produced robots, for example, do not attract any export duty.

## ENCOURAGE THE PROVISION OF LONG-TERM CAPITAL

Many smaller businesses are still reporting they are finding it difficult to access long-term capital to support an export programme. However, an initial "no" by a bank should not be viewed as a closed door and businesses should pursue alternative methods of long term funding: The Business Growth Fund prides itself in taking a longer term view for smaller businesses, whilst newer methods such as peer-to-peer lending and capital based crowdfunding should also not be written off.

## REVIEW AND IMPROVE TAX RELIEF FOR EXPORTS

A total review is needed of tax relief policy for exports. Whilst the extending of tax relief to the end of 2015 will help, starting new initiatives such as introducing a more competitive tax rate for profits generating from exports would be an innovative – and almost certainly successful – way of encouraging exports.

## UKTI AND UKEF OFFICES SHOULD SEEK OUT MORE MANUFACTURERS TO SUPPORT

The fact that only just over a third of businesses are using the Government services still suggests a significant amount of ignorance about the capabilities of the organisations. Many manufacturers are asking for more intervention from the organisations. Some companies may feel there is no need to explore international markets given the success of domestic operations. However, the Government has a significant role into introducing businesses to the advantages of trading with international partners.

## SEEK STATE AID APPROVAL FOR THE BUSINESS BANK

The European Commission issued confirmation that the British Business Bank received State Aid approval in October 2014. The Commission has approved that the Mandated Arm may receive up to £6bn of funding from the UK on a non-commercial basis until the end of 2019 and will be an invaluable source of help for SME-sized businesses.

## FOR MORE INFORMATION:

### **TOM LAWTON**

Partner, Head of Manufacturing  
t: 0121 352 6372  
e: tom.lawton@bdo.co.uk

Alternatively, please contact your local BDO business centre:

#### **BIRMINGHAM**

t: 0121 352 6372  
e: tom.lawton@bdo.co.uk

#### **BRISTOL**

t: 0117 930 1549  
e: john.talbot@bdo.co.uk

#### **GATWICK**

t: 01483 408 003  
e: kevin.cook@bdo.co.uk

#### **EAST MIDLANDS**

t: 0115 962 9276  
e: chris.bond@bdo.co.uk

#### **EAST ANGLIA**

t: 01473 320 755  
e: keith.ferguson@bdo.co.uk

#### **LONDON**

t: 020 7893 3159  
e: marc.reinecke@bdo.co.uk

#### **GUILDFORD**

t: 01483 408 003  
e: kevin.cook@bdo.co.uk

#### **LEEDS**

t: 0113 204 1237  
e: jason.whitworth@bdo.co.uk

#### **LIVERPOOL**

t: 0151 817 7562  
e: don.bancroft@bdo.co.uk

#### **MANCHESTER**

t: 0161 817 7562  
e: don.bancroft@bdo.co.uk

#### **READING**

t: 0118 925 4412  
e: chris.pooles@bdo.co.uk

#### **SOUTHAMPTON**

t: 023 8088 1940  
e: arbinder.chatwal@bdo.co.uk

#### **SCOTLAND**

t: 0141 249 5234  
e: neil.craig@bdo.co.uk

#### **CHINA DESK**

t: 020 7893 2218  
e: jingru.liu@bdo.co.uk

#### **INDIA DESK**

t: 023 8088 1940  
e: arbinder.chatwal@bdo.co.uk

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