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EXECUTIVE SURVEY

MANUFACTURERS' EXPECTATIONS FOR THE YEAR AHEAD

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Welding Shower, taken by Andy Newman at Griffon Hoverworks in Southampton.
Winner in the Amateur Next Generation category of the EEF Photography Competition 2018.

MANUFACTURERS' PREDICTIONS FOR 2019

This is the eighth edition of our annual Executive Survey, manufacturers' expectations for the year ahead, in partnership with AIG. Every year we take a look at companies' expectations for growth – in their businesses, across the UK economy and globally – and their headline predictions for opportunities and challenges that lie ahead.

Though trending down from 2018, manufacturers remain mostly positive for 2019. However, our survey provides an early warning of some of the issues that could be behind the downward trend, and difficulties that could make 2019 more challenging than 2018. It's no surprise that for 2019 Brexit is the driving force behind many of the risks and uncertainties that are worrying manufacturers. Whatever the outcome of Brexit, UK manufacturers will have to overcome its challenges and adapt to the UK's post-Brexit trading relationship with the EU.

But 2019 is not all about Brexit, and several other dangers have been highlighted as well. For instance, the impact of cyberattacks continues to be on the radar for many manufacturers; however, since last year's Executive Survey, many have increased their protective measures. A range of financial risks were also identified and manufacturers are focusing on several measures to help mitigate potential impacts of these risks.

As we have seen in previous editions of our survey, UK manufacturers can be responsive and resilient when faced with economic threats, and this survey reveals how they plan to mitigate the possible problems the industry may encounter in the next 12 months.

1. Despite the uncertainty surrounding 2019, manufacturers are planning for improved trading conditions in their industry in the year ahead, which is similar to the expectations from last year.
2. The global outlook remains positive, but the balance has weakened noticeably since last year, in line with the recent performance of the global economy.
3. Overall, manufacturers are expecting both domestic and export sales to increase, though they are less positive about exporting to the EU in 2019 than they were in 2018.
4. Companies are, on balance, still planning for UK economic conditions to deteriorate in 2019. The overall feeling is that there will be more risks than opportunities in 2019, which is unchanged from 2018.
5. Almost three-quarters (72%) of companies agree that Brexit is their main source of uncertainty for 2019.
6. Delays at customs and significant exchange rate movements are highlighted as the most significant risks.
7. If a global slowdown were to happen, manufacturers think this would have a big impact on their business. A slowdown in the UK market is revealed as having the greatest impact of a slowdown in any single market.
8. Manufacturers are not deterred by risk and are taking actions to protect themselves, including measures such as increasing cybersecurity, managing financial risks and stockpiling.
9. Companies identify accounts receivable as one of their main assets and they are taking a number of actions to ensure they maintain cash flow, such as closer control of costs.
10. A positive balance of companies continue to think the UK will be a good location for their manufacturing activities in 2019, but this has contracted since 2018.

MANUFACTURERS' 2019 GROWTH EXPECTATIONS

- The balance for industry conditions remains at the same level as last year.
- Global economic conditions remain supportive but less than a year ago.
- In contrast, manufacturers remain concerned about the UK's economic fortunes, although a little less than a year ago.

After the very good performance of 2017, manufacturers were not able to match it in 2018. The sector achieved another year of positive growth at about 1% (the final 2018 results will be published by ONS in February 2019), a result weaker than the 2.6% achieved a year ago.

Manufacturers' views for the year ahead, in terms of balances for industry conditions and also concerning the global and UK economic situation, remain fairly similar to those registered a year ago. However, a more in-depth analysis points to a clear polarisation in the answers.

Industry conditions for 2019 – great for some, not for all

Executives[1] have reported the same positive balance as last year for industry conditions, at 22.1% – an impressive balance by historical standards. However, this is the result of some very different answers. The question posed has a five-point scale for the answers[2] and, compared to last year, the share of "remain the same" answers dropped from 40.7% to 30.7%. By contrast, "significant improvement" increased by 4.8% and "significant deterioration" increased by 2.9%.

Chart 1: Expectations balances broadly unchanged but answers more spread across the entire spectrum

Growth expectations for the next 12 months, 5 = significant improvement, 1 = significant deterioration

Source: EEF Executive Survey

This polarisation appears to be the same as that which we are seeing in official numbers. In 2017, manufacturing growth was not only very good but also spread amongst sub-sectors, with only pharmaceuticals reporting a significant contraction. Conversely, 2018 was characterised by several contracting sub-sectors and some extremely high growth performers, such as the electronics sector, which reported a double-digit expansion.[3]

Interestingly, there is a diverse mix of companies predicting gloomier industry conditions. There was a slightly negative balance for very small companies (less than £5m turnover) and a tiny positive balance for foreign multinationals operating in the UK.

[1]EEF, Executive Survey 2018
[2]Significant improvement, moderate improvement, remain the same, moderate deterioration, significant deterioration
[3]EEF, Manufacturing Outlook 2018 q4

Global condition still positive, but the best is behind us

The explanation behind the recent period of expansion was an export story, for the most part. The global synchronised growth in 2017 and the related appetite for investment boosted manufacturers' turnover in the UK and around the globe. Both the Eurozone and the US grew by more than 2%, and emerging markets such as China and India continued their expansion. The World Bank reported that only 15 countries (mostly very small economies) out of 188 reported a recession in 2017 and only 11 of them contracted by more than 1%.

2018 was a positive year as well, but not as positive as 2017. In particular, looking at quarterly growth rates, the second half of the year has been much weaker and saw negative growth rates in large markets such as Japan, Germany and Italy. Moreover, even though the US had a very good 2018, even better than the year before, it appears that growth there also peaked between the second and third quarters of 2018.

All of this points to an even weaker 2019 with potential recessions in some important markets.

Our respondents are in line with what is happening around the world. Their vision about global conditions remains in positive territory, but dropping from a balance of 27.6% in last year's Executive Survey to 6.6% in 2018. This year, 2% of the responses pointed to a significant deterioration of global conditions, an option chosen by no one a year ago. Once again, very small companies and foreign multinationals

UK FORECAST

The UK economy demonstrated that it was more resilient than expected in the aftermath of the EU referendum. However, as pointed out earlier, the big expansion experienced by other international partners was not felt on this side of the Channel.

Indeed, all the G7 countries reported a GDP growth substantially higher in 2017 than 2016, with the exception of the UK, which was 0.1% down. 2018 saw a downward trend in Europe and also in the UK, which is set to expand by its lowest rate since the financial crisis.

Expectations for 2019 are for another weak expansion. However, a lot is at stake at the moment and Brexit will be the key factor behind 2019's performance. At the moment we are forecasting a 1.3% growth, but our assumptions are for a smooth Brexit with no "cliff-edge" and only marginal disruption after March 2019. If this doesn't happen, 1.3% growth would be an extremely optimistic and probably an impossible result to achieve.

Looking at expenditure components, consumer spending was subdued but stable in 2018 and it should continue to be the key factor in 2019. Despite an inflation rate trending down towards the 2% Bank of England target and real salaries showing some signs of growth, customers appear not to be ready to spend on big ticket items. According to the latest Gfk consumer confidence indicator, consumers are particularly concerned about the UK economic situation and they do not plan to make any major purchases at the moment.[4] This is something we have already seen during the year, in particular in the motor vehicles market, with November 2018 domestic car registrations down almost 7% in the year.[5]

The investment side, as anticipated above, remains the weak link. Indeed, the lack of clarity on the future trade landscape means companies are holding off investment plans, as also reported in our latest *Investment Monitor*.[6] Business investment for 2018 is set to report a negative growth and this is true for both the whole economy and the manufacturing sector. In 2019, a pick-up for investment is expected, but once again this will be related to what Brexit will look like.

[4]Gfk, UK Consumer Confidence – https://www.gfk.com/en-gb/insights/press-release/uk-consumer-confidence-drops-three-points-in-november-to-13/
[5]SMMT car registrations stats – https://www.smmt.co.uk/vehicle-data/car-registrations/
[6]EEF, Investment Monitor 2018

are less confident about another good year for the world economy in 2019.

UK economy continues to be seen as a risky business

Last year saw the UK growing by a meagre rate of around 1.3% (at the time of writing q4 data are still not available). The result was a weak one by historical standards and, compared to what other countries in the developed markets were able to achieve, put the UK close to the bottom of the pack in terms of economic expansion. The country moved from top of GDP growth ranking amongst G7 countries (between first and second position from 2013 to 2016), to the second half of the table in 2017 and 2018 (fifth in 2017 and likely to be fifth or sixth in 2018[7]).

Moreover, 2018 growth was a result of still resilient household consumption, but contracting business investment, which is never great news for investment goods producers. For next year, as we will see in the next chapter, the risk of a hard and disorderly Brexit clearly affected our executives' answers.

Company level indicators – productivity again on top

Despite the situation not being ideal, in particular in terms of the UK economy, companies remain positive about their industry and their future. Indeed, the indicators at the company level are all pointing towards a positive balance.

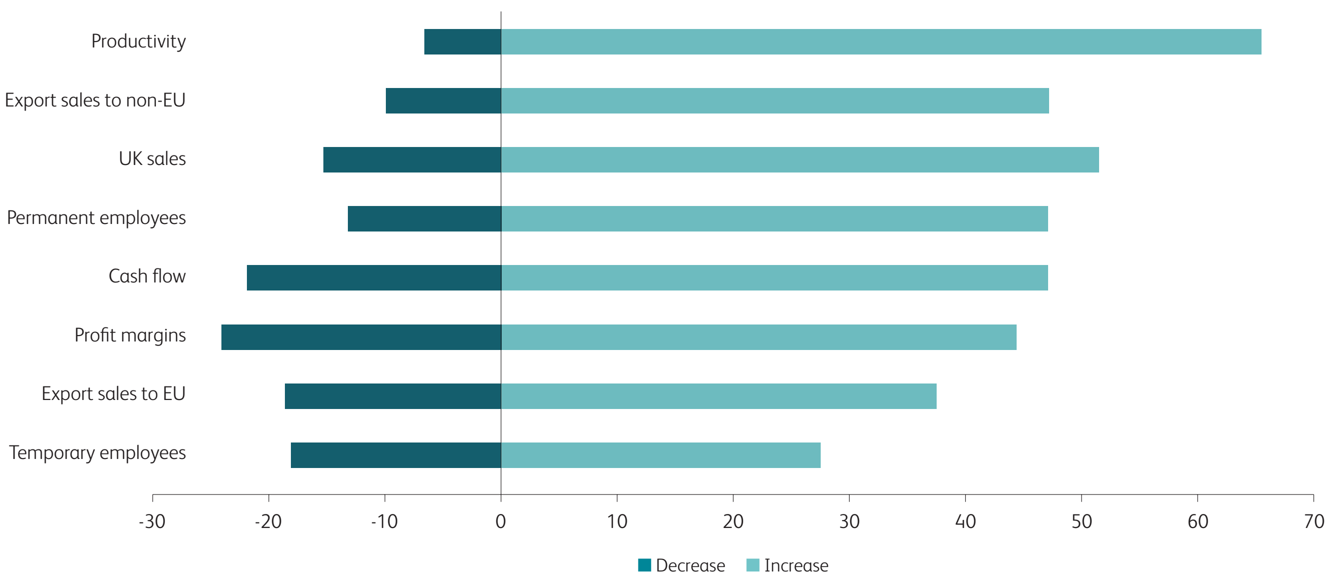
However, even if the numbers are positive, they are less buoyant than a year ago, with balances retracting in all the categories.

When respondents were asked about changes for 2019, productivity improvement remains on top, as it has since we started this publication series. Companies recognise the importance of productivity as the key factor to guarantee long-term prosperity. Moreover, considering the labour shortages we are already seeing owing to a very tight labour market, a drop in EU migrant arrivals and an ageing population, productivity improvement remains the only way to achieve sustainable growth.

Despite being at the top of this chart for the last eight years, the official statistics on productivity results did not

Chart 2: Firm level indicators all positive but less than a year ago

% of companies planning for change in indicators in 2019



Source: EEF Executive Survey

[7]Final data not yet available at the time of writing

show a substantial improvement on a flat-lined growth, which has become a stable feature since the *Great Recession* of 2008.[8]

Executives appear to be a little bit more worried about profit margins than productivity. Even though the balance remains positive, answers are more spread out across the spectrum, with almost a quarter (24%) of respondents reporting a deterioration in margins in 2019. This matches what we are seeing at the moment in official producer price data and our latest *Manufacturing Outlook*.[9] Indeed, input prices are putting significant pressures on costs, which cannot be entirely transferred to customers.

Positive cash flow and sales

This year we introduced a new option in this set of indicators related to cash flow. The majority of executives appear not to be concerned about cash flow, reporting a positive balance at 25%. In contrast, this means that there is a not insignificant share of companies (about 22%) fearful about future flow of cash.

This goes together with a still positive, but contracting, balance for UK and export sales. Balances are down from last year, particularly for exports to EU markets, which was already the weakest balance in the last year's *Executive Survey*.

Employment continues to be positive

The labour market story has been a very positive one for several years, with labour statistics in 2018 reaching their best performance since ONS records began. The employment level is currently close to its historical maximum and unemployment to its minimum. This is a reflection of sustained demand, but also a weak expansion in terms of investment. In particular since the EU referendum, balances in our *Manufacturing Outlook* have clearly shifted, with many more manufacturers relying on an extended labour force rather than on investment to keep the required flexibility to face sharp and sudden changes in demand.

Despite the tight labour market, our respondents still expect to increase their headcounts and, despite the uncertainty, their preference continues to be permanent employees rather than temporary. This is possibly a reflection of the difficulties that HR departments are experiencing finding suitable candidates in a labour market with little room left. The temporary option appears to be disliked particularly by foreign-owned companies, which reported a negative balance at -19% for this indicator.

[8]EEF, Unpacking the puzzle: Getting UK manufacturing productivity growth back on trend
[9]EEF, Manufacturing Outlook 2018 q4

RISKS IN THE YEAR AHEAD

- Consistent with 2018, half of companies see more risks than opportunities in the year ahead, while a quarter think the opposite.
- The three largest risks to manufacturers are all Brexit related, including movements in exchange rates, upward pressure on pay settlements and delays at customs.
- Disruptions as a result of cyberattacks represent the most significant risk to manufacturers that is unrelated to Brexit.

Our survey found that manufacturers will face significant risks in 2019, and as a result 50.7% have identified 'more risks than opportunities' in 2019. Unsurprisingly, Brexit continues to be a key driver of this, with 72% of respondents agreeing that Brexit is the biggest source of uncertainty for their business in 2019.

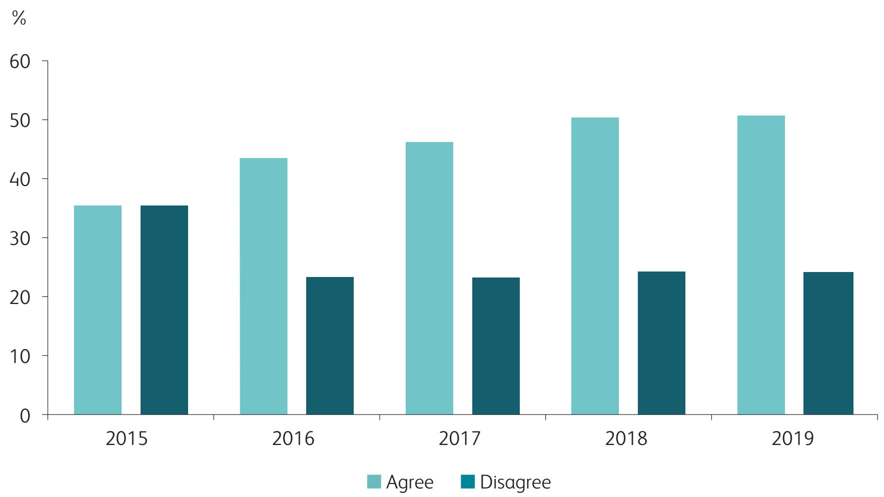
Delays at customs recognised as top risk of 2019

Our survey found that one in three respondents have indicated delays at customs as being the most significant risk to their business, with a total 76% identifying delays as a risk to some extent. As the most significant risk, delays at customs was 21% higher than movements in exchange rates, 13% higher than the most significant risk in the 2018 survey, and is the highest single response in the past five years.

The knock-on effects of customs delays have the potential to significantly impact supply, production and cash flow. Any delays manufacturers face to goods crossing through the Dover–Calais route, in addition to other ports of entry, could spell disaster for just-

Chart 3: More companies observing a risky outlook

% of companies agreeing with statement 'There are more risks than opportunities for my company in year ahead'



Source: EEF Executive Survey

EXCHANGE RATE VOLATILITY

Our survey shows that exchange rate movements top the ranking of risks to manufacturers with just 19% not seeing significant currency movement as a risk in 2019. Of the 81% worried about the value of sterling, three-quarters associate this risk with Brexit, with the possibility of another sharp currency movement, similar to the one immediately after the EU referendum vote.

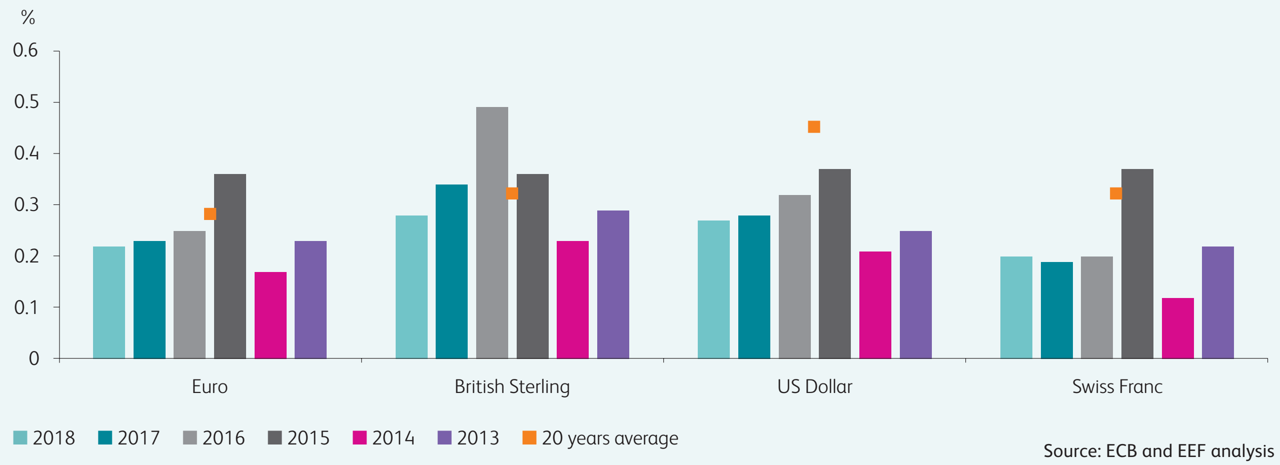
As chart 4 shows,[10] sterling volatility was much higher in the period between 2015 and 2017, compared to other currencies peaking in 2016 as a result of the EU referendum. This volatility continued in 2018, and the pound remains less stable than other currencies such as the euro or the Swiss franc.

However, 2018 was not perceived as stable as 2017. When comparing the sterling against the US dollar, a much more volatile situation would have arisen. Indeed, the volatility against only the US dollar was higher in 2018 than 2017.

Manufacturers recognise that a stable currency is fundamental; indeed, in our *Referendum Survey*[11] only 6% of companies said that a persistently weak sterling would have a positive impact on their business. A devalued currency may give a temporary boost to international competitiveness; however, a stable one is usually estimated as a better option as it helps companies to build a future based on productivity competitiveness gains rather than on exogenous factors.

Chart 4: Effective exchange rate volatility

% Absolute daily percentage change average*



Source: ECB and EEF analysis

*based on average absolute daily percentage changes in the effective exchange rate between the stated currency and a group of 12 major partners plus the eurozone

[10] Data for December 2018 not available at the time of writing
[11] EEF, EU Referendum Survey July 2016

in-time manufacturing and those with supply chains integrated throughout Europe and the rest of the world.

Input costs are increasing

Oil, as a key input for many manufacturers, reached a peak price of $86[12] in October 2018 before dropping off sharply through November. This high price had an impact on manufacturers' margins. In fact, 54% of respondents indicated that if oil prices were to reach $100 per barrel there would be a negative impact on their business. This negative impact is especially felt by small companies' respondents.

Input price pressure was also detected by EEF's latest *Manufacturing Outlook*[13] where margins have been reported to stay flat or to be contracting after the pick-up registered in the previous edition.[14]

Increased pressure on pay

Just over half of the respondents

DISRUPTIONS OWING TO CYBERATTACKS

Disruptions owing to cyberattacks represent the most significant non-Brexit-related risk to manufacturers in 2019. In fact, 6% of respondents identified disruptions owing to cyberattacks as the most significant risk to their business, which is up from 3.2% in 2018.

48% OF MANUFACTURERS HAVE BEEN SUBJECT TO CYBERATTACK

From: EEF, Cyber Security for Manufacturing 2018

As discussed in EEF's *Cyber Security for Manufacturing*[15] report last year, 48% of manufacturers have knowingly experienced their IT infrastructure being targeted by cybercriminals, and half of those businesses suffered some form of financial loss or other business disruption as a result. Most successful attacks on the manufacturing community to date have been indiscriminate, aimed at exploiting businesses whose cybersecurity credentials are poor. Such attacks are commonly motivated by financial gain, and often take the form of 'phishing' exercises that exploit human vulnerabilities to gain system access, or 'ransomware' attacks that target insufficiently protected IT systems, encrypting data until a payment is made.

Whilst the risk of a cyberattack can never be completely eliminated, government-backed schemes such as Cyber Essentials and the standards framework for information security management, ISO 27001, both provide compliant businesses with a much greater degree of

ADOPT/INCREASE AGAINST CYBERATTACK

60% ALREADY put in place

25% WILL take action

15% NOT taking action in the area

confidence in their cybersecurity architecture. As a result, manufacturers are increasingly adopting good practice in line with these frameworks, with more than 50% of the respondents having already put in place some form of proactive measures. However, a worrying 14.5% of manufacturers have not taken any action so far, potentially leaving them exposed. Manufacturers may in response to the risk of cyber-attack need to look to insurance products to mitigate the risks to their businesses which these attacks present.

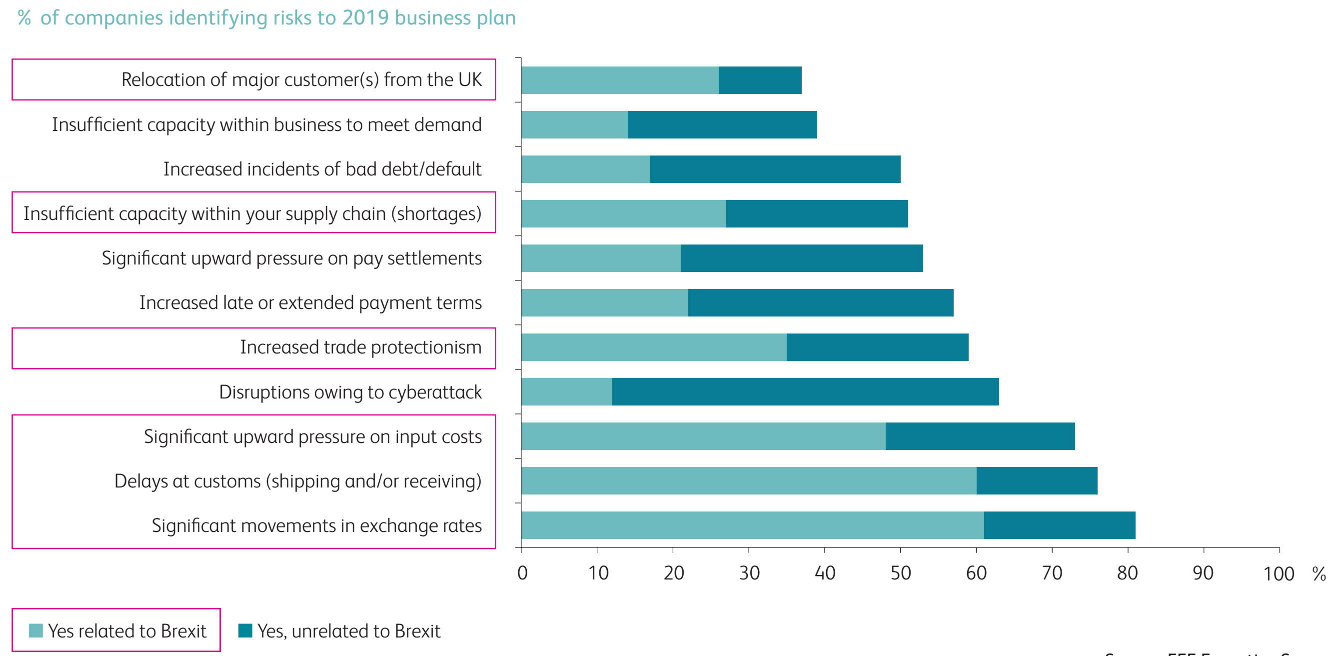
For many manufacturers, their potential vulnerability to a cyberattack is likely to increase as operational technology becomes fully integrated. Therefore, we expect it to be a growing risk in future.

35% MANUFACTURERS INHIBITED FROM FULLY INVESTING IN DIGITAL OWING TO CYBERSECURITY CONCERNS

From: EEF, Cyber Security for Manufacturing 2018

[12] Brent spot price – https://www.eia.gov/dnav/pet/hist/RCLC1D.htm
[13] EEF, Manufacturing Outlook 2018 q4
[14] EEF, Manufacturing Outlook 2018 q3
[15] EEF, Cyber Security for Manufacturing 2018

Chart 5: Brexit continues to be the main source of risk



Source: EEF Executive Survey

identified pay settlements as a risk. The three-month average for pay settlements has been increasing steadily since 2016.[16] The increase may rise further as EU citizens exit the UK, leaving an even greater skills gap and labour shortages and therefore putting pressure on skills.

Increased trade protectionism

Our survey found that 59% of respondents indicated increased trade protectionism as a risk for 2019. The tariffs imposed by the US have had an adverse impact on UK exports to the US, with exports decreasing by 20% year on year in weight terms – equivalent to a 73,000-tonne reduction. Additionally, US imports of steel have decreased globally, leading to a price glut domestically, making it harder for EU steel companies to be competitive in the market.

Extreme weather

After experiencing extreme weather, including heavy snow and winds in q1 2018, the threat of similar disruptions looms in 2019. Almost half (46%) of respondents agree they are well prepared for extreme weather, while only 10% disagree. Smaller companies, by headcount, are much less prepared than their larger counterparts, ranging from 30% of respondents in the 1–100 range to 80% in the 251+.

EXTREME WEATHER PREPAREDNESS BY HEADCOUNT

1–100 **30%**

101–250 **47%**

251+ **80%**

[16] EEF, Pay Bulletin November 2018

Accounts receivable

Our survey found that 58 % of respondents identified an increase in late or extended payment terms as a risk to their business, and just over half (51 %) identified increased incidents of bad debt/default as a risk. In both cases, respondents see these risks as largely independent of Brexit, with roughly 70 % of respondents who identified those risks indicating they are unrelated to it.

While these risks have been identified by a majority of respondents, 55 % of those respondents indicated that accounts receivable is one of the strongest company assets, while only 6.2 % disagreed with that statement. Even though this means that companies are largely exposed to counterpart/credit risk, the majority of respondents have indicated that they have either already taken steps or will take steps to control costs, review finance agreements, take out insurance to protect against bad debt and improve credit management.

Looking at the near future, finance departments are likely to be tested in the event of border disruptions. These will have a knock-on effect since delayed goods may also delay payments and affect cash flow and credit lines.

A SPOTLIGHT ON EXOGENOUS RISK

In this latest *Executive Survey*, we proposed four different exogenous shocks to respondents to understand what impact they might have on their businesses.

1. **Bank of England increases interest rates to 1.5% by the end of 2019**
   Our survey found that a tighter monetary policy at a rate faster than currently predicted would not have a major impact on companies. Indeed, this was seen as the softest external scenario risk with a 14 % negative balance and 34 % of the answers in the "no impact" area.

2. **Banks introduce more restrictive lending criteria**
   Restrictive lending criteria is also not seen as a major risk, with a balance at -22 %. It would be more harmful for UK domestic companies (balance at -35 %) rather than the UK multinationals (-30 %) and, in particular, foreign-owned multinationals (-13 %) which may be able to access international markets in a much easier way.

3. **Oil price reaches $100 per barrel**
   A sharp increase in oil prices does not rattle manufacturers too much either. The balance is negative at -25 %; however, 30 % of answers are in positive territory. This might be related to some companies in sectors that actually benefit from high oil prices. In particular, those reliant on demand coming from investment – such as the mechanical equipment sector – usually register some pick-up in orders when oil prices are high.

4. **Sharp slowdown in world economy**
   The main risk for manufacturers is a potential sharp slowdown in the world economy. Manufacturers are heavily reliant on foreign demand, and would be at risk if global demand were to fall. Furthermore, some manufacturers are part of complex, integrated supply chains, exposed to fluctuating global demand.

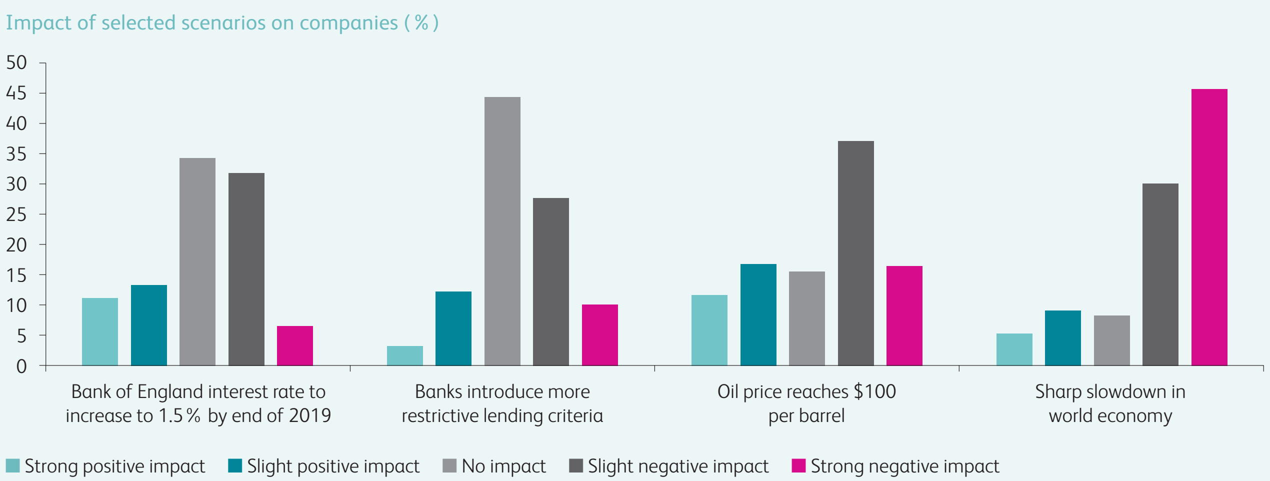
A recession in the world economy is, unsurprisingly, recognised as a very harmful situation for companies, but which markets would pose the biggest risk in the event of a slowdown?

As the infographic shows, two out of three companies selected the domestic market as the most important one, followed by the EU and the US, with China only selected by 12 % of respondents.

The domestic market appears to be particularly important to very small domestic companies, with almost 80 % of those selecting this option. A large number within this category also selected the EU, showing once more how important distance is for trade, in particular for companies with limited resources.

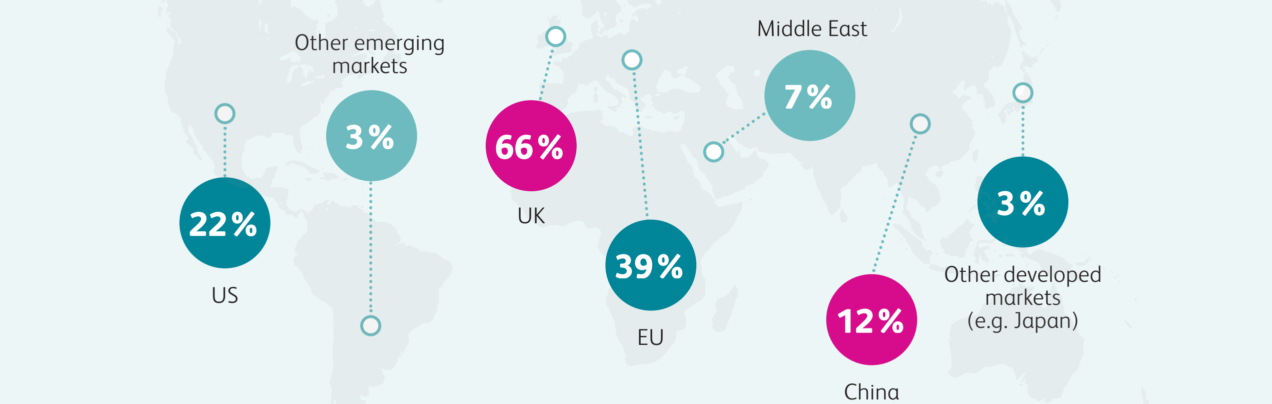
UK and foreign-owned multinationals were also more likely to select the US and China as their most important market compared to domestic companies. However, even for these companies, the UK and the EU remain the top markets.

Chart 6: Global slowdown scenario seen as the worst scenario by far



Source: EEF Executive Survey

A SLOWDOWN IN WHICH OF THE FOLLOWING MARKETS WOULD POSE THE BIGGEST RISK TO YOUR COMPANY IN 2019?*



*respondents were able to select up to two choices so total is higher than 100 %

Industrial capacity does not appear to be a major concern

Even though it appears that some sectors suffered some capacity constraints problems in 2018, 61 % of respondents indicated that they do not expect insufficient capacity within the business to meet demand. This is likely tied in with the overall positive view that productivity will increase in 2019.

2019 then is likely to be another year of uncertainty, with the risks once again outnumbering the opportunities for more than half of companies. Inevitably, some of these risks can be linked back to uncertainties surrounding Brexit. However, there is more than just Brexit to deal with, with wider trade protectionism, cyberattacks, and issues with financial risks.

In the next section we discuss how manufacturers are preparing themselves to mitigate these risks.

PREPARING FOR DISRUPTION AND MITIGATING RISKS

– Actions to improve cybersecurity and mitigate financial risks are the most common steps being taken.
– Although more difficult to plan for, companies are also taking action to reduce the impact of disruption in their supply chain and shortages of input products.
– Although expectations are more subdued, manufacturers continue to expect further growth in 2019 and continue to see the UK as a competitive location.

Manufacturers are positive about the strength of their own industry and, although most are expecting 2019 to be challenging, they expect to see growth overall. With that said, they're conscious that there will be some challenges ahead.

Progress on cybersecurity

This year participants had the opportunity to classify their actions as either those already in place and ready for the challenges of 2019, or those that will be implemented as the year progresses.

In terms of those actions already put in place, adopting or increasing protection against cyberattacks came out on top, with 60 % of companies already adopting or increasing their cyberattack defences, and a further 26 % planning to take action within the next 12 months. Our work on the 4th Industrial Revolution (4IR)[17] has shown that companies are aware that uptake and investment in 4IR technology and the Industrial Internet of Things (IIoT) means that they can collect more data and use these to become more efficient and productive, but they are cognisant of the risks that come with more investment in digital systems.

Foils against financial risk

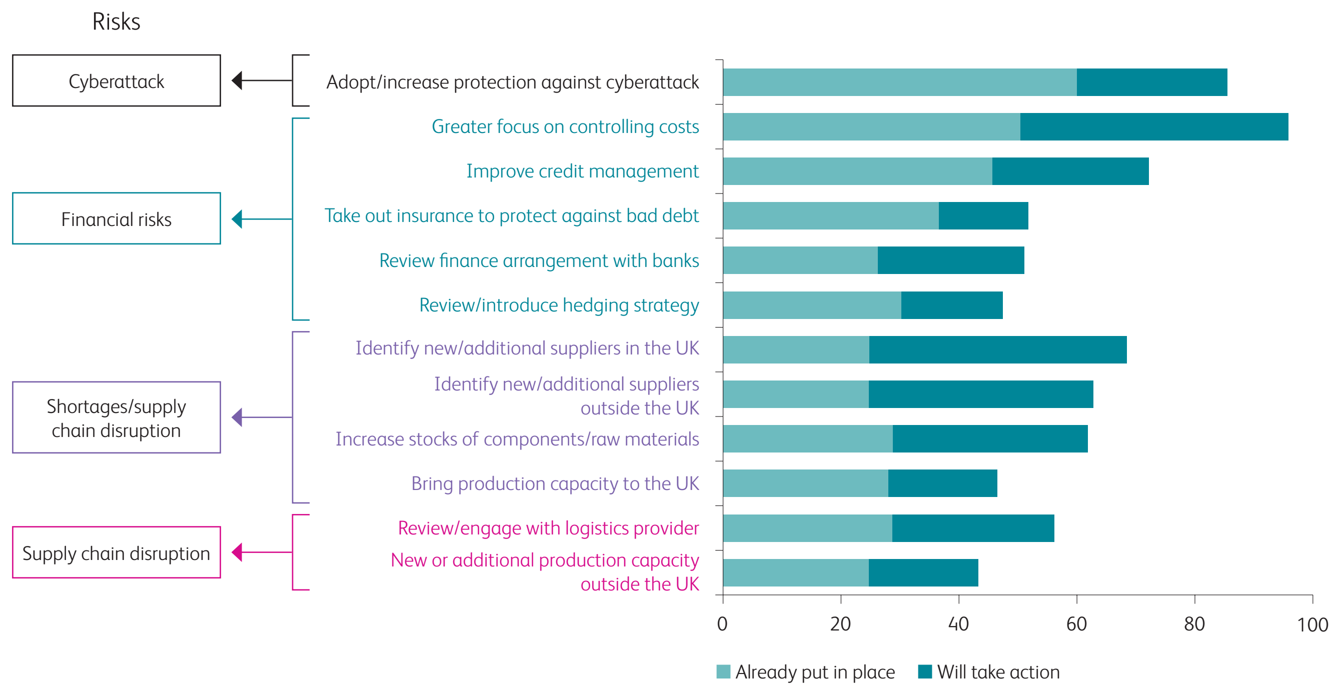
Some of the most popular actions are broadly in response to financial risks. Chart 7 reveals that 'greater focus on controlling costs' and 'improve credit management' were both indicated as steps that most companies are either planning to take in 2019 or have already begun taking. These are most likely reactions to the risks of bad debt and late or extended payment terms as discussed above, but there will be other factors influencing their decisions. Many smaller manufacturers are reliant on a small amount of large customers, with these customers sometimes making up the vast majority of a company's turnover. Being so heavily reliant on one customer clearly has drawbacks.

If one major client delays their payments this can seriously dent cash flow, so it's no surprise that we see companies wanting to keep their costs under control and many setting their sights on better credit control as a result. For 55 % of companies, 'accounts receivable' is one of their biggest assets, so good credit control will be particularly important for these companies. In fact, our survey shows that more than half (55 %) of companies with less than £5m annual turnover have already put in place measures to improve their credit management systems, and only 15 % plan to take no action in this area in 2019. Our results also indicate that most companies work with their supply chain on forecasting demand (57 %), which can then help to alleviate any issues with disruption in the supply of input products. However, when it comes to using supply chain finance, less than one in five (17 %) of manufacturers engage with their supply chain.

[17]EEF, How 4IR is transforming productivity: facts and figures 2018

Chart 7: Strategies for risk mitigation

% of companies taking action in area in year ahead and associated reasons why



Source: EEF Executive Survey 2019

55 % OF COMPANIES AGREE THAT ACCOUNTS RECEIVABLE IS ONE OF THEIR BIGGEST ASSETS

In a similar vein, we saw that more than half of companies have decided to, or plan to, take out insurance to protect themselves against bad debt. In this instance, we see that it is the companies with lower turnover levels that are least likely to take out this cover. Potentially, this is because these companies are less likely to approach a bank for funding and instead rely on their own cash reserves, a trend we have seen since the financial crisis. This also chimes with the fact that the smallest companies are least likely to be reviewing their finance arrangements with commercial banks.

The one action that appears as an outlier in terms of actions manufacturers are taking or considering taking to combat financial risk is their hedging strategy. This is clearly linked to a particular risk that many companies identified – significant movements in exchange rates. A substantial 81 % of companies flagged exchange rate movements as a risk in 2019; however, as you can see from Chart 7, only 47 % of companies are reviewing or introducing a hedging strategy to combat this volatility.

Supply chain disruption

A third area where risk mitigation action is being taken by a number of manufacturers is supply chain disruption. Although this is one of the risks that manufacturers are less likely to be active on, we still found that more than half (56 %) of respondents are reviewing or engaging with their logistics provider in direct response to their perceived risks of 2019. Part of this may be related to stockpiling (which we cover in greater depth below), and manufacturers having to use storage in areas that are geographically situated outside their usual locations. It could also be owing to the perceived risks in the domestic environment impacting transport (a risk underlined by the period of severe weather the UK experienced at the start of 2018). With some worries over the reliability of the supply chain, we also see that a smaller proportion (43%) of manufacturers have made efforts to establish additional production capacity outside the UK.

Shortages

As discussed above, the most significant risk in 2019 for manufacturers will be customs delays at the border, with almost one in three manufacturers fearing this. With the UK due to leave the European Union in March and the outcome of the negotiations still unclear after many months, trade barriers and customs changes are likely to be at the forefront of manufacturers' minds until, ultimately, the final deal between the UK and the EU is known.

At the time of writing, the UK government and the EU have reached a draft withdrawal agreement, which needs the agreement of the UK Parliament. Subject to this process being completed successfully, UK manufacturers will have the benefit of a transitional period, lasting until the end of 2020, during which they can continue to trade with the EU on pre-Brexit terms. This would then provide a period of stability for importers and exporters for a time at least. Leaving the EU without this agreement would clearly be damaging for UK manufacturers, with goods stuck at ports and production delayed. The delays at the borders, which many companies have highlighted as one of the biggest threats to their business, will remain a concern until the final, settled, trading relationship with the EU beyond 2020 is confirmed.

Facing the problems

Whatever the eventual outcome of the UK's EU exit, many manufacturers are planning for the worst-case scenario, which is the only outcome they can model. This planning is not just an insurance policy against a hard Brexit in March 2019, but future-proofing, in the event that the UK and the EU fail, in the long term, to find a way of agreeing a light-touch, friction-free trading platform. With almost three-quarters (72%) of surveyed companies labelling Brexit as the biggest source of uncertainty for their business in 2019, this is clearly not a concern which is only short-term or can be easily resolved. It will, in all likelihood, become a long-term business risk which manufacturers will need to grapple with.

Our survey shows that around a quarter of manufacturers are taking actions that include searching for new suppliers (both domestically and internationally), bringing production capacity back to the UK, and stockpiling components/raw materials. All of these are measures to mitigate the impact of a new, potentially unfavourable, trading relationship with the EU, but are neither straightforward nor swift. For some manufacturers, there are no UK suppliers for the goods they need, or the alternative suppliers may be based in the EU.

Diversifying or duplicating suppliers could help manufacturers overcome border delays by having alternative sources for their input products and hedging against the risk that one supplier cannot supply on time, or at all. However, the UK's EU exit date coincides with a more protectionist approach to global trade from the US. Against this more challenging international backdrop, UK manufacturers need a resolution to the UK's EU exit which will not leave them facing barriers and burdens. In contrast, new procedures at customs points of entry will significantly slow down the flow of goods into the UK.

Our latest Manufacturing Outlook report showed that manufacturing output was still higher than orders, which could be explained by manufacturers producing more than has been ordered by customers so that they have some surplus supply if there were to be delays in obtaining components at borders.

This suggests that manufacturers, in the lead-up to Brexit, are stockpiling. More than six in ten (62%) companies are looking to do some form of stockpiling, with 29% already increasing stocks and a further 33% planning on doing so in 2019. It's clear from this that companies are expecting serious supply issues to hit them in 2019 and are trying to pre-empt this. Our survey shows that stockpiling is less prevalent in smaller companies, which is likely to be because of their lack of storage space or lack of capital to invest in more storage and stock. Larger companies are not immune from stockpiling issues though, with manufacturers in the automotive sector stating that they are at risk owing to the nature of their just-in-time production and time-sensitive production lines. Other sub-sectors have their own issues that are reducing the capability to stockpile, with those in the food and drink sector unable to stockpile perishable goods, and reports suggesting that much of the chilled storage space in the UK has already been filled.

Risks are surmountable

While the challenges faced by manufacturers cannot be underestimated, on balance, companies are expecting to see increases in sales, profits and productivity in 2019. Though risks and uncertainties are on their radar, UK manufacturers will continue to invest and improve. Despite the risks they have spotted, many of which they have already been preparing for, most expect conditions for their industry to see improvement in 2019 when compared with 2018. Perhaps it is because many have identified the risks ahead, and are already implementing and developing the necessary coping strategies, that 40% of respondents still see the UK as a good location for their manufacturing activities in 2019.

Chart 8: Companies continue to see UK as a good place for manufacturers, but fewer than a year ago

Source: EEF Executive Survey 2019

AIG VIEWPOINT

As manufacturers look ahead the challenges of Brexit and other trade tensions loom large, placing fears of a cashflow squeeze front of mind for some. By strengthening their credit-management and bolstering with trade credit insurance manufacturers can better protect their revenues, unlock trade finance opportunities and navigate new markets.

EEF's Executive Survey shows that risk dominates over opportunity for manufacturers. With a recent focus on the 4th industrial revolution it is noteworthy that disruptions due to cyberattack represent the most significant risk (outside of Brexit) at 63%, with a quarter of manufacturers planning to take action.

However, it is a sustained uncertain economic environment at home, coupled with 51% of manufacturers planning to expand their exports abroad to non-EU countries, which means risks associated with trade become immediate and centre stage.

Dealing with uncertainty

How should manufacturers be responding? With 22% planning for a decrease in cashflow, and 55% regarding their accounts receivable as their most important asset, strengthening credit management must be a priority. Over a quarter (27%) state they will take action this year; we believe this should be focussed around:

1. Pre-vetting of prospective clients by obtaining and maintaining information about their financial health
2. Establishing expected payment behaviour and a well structured collections process
3. Ensuring delayed payments are addressed by issuing automatic, escalating reminders on pre-determined days in the payment cycle
4. Having the right tools at hand to mitigate loss (collections or recoveries agencies, and insurance)

The Executive Survey highlights that 58% expressed concern about the risk of late payments or extended payment terms and 51% of manufacturers' mentioned increased incidence of bad debt as a risk.

Solutions to help confidence

Late payments, as well as impairing cashflow in the short term, can provide an early warning sign that a buyer will default. Trade credit insurance can help mitigate the impact. By insuring their accounts receivable, manufacturers gain confidence that they will still be paid under commercial contracts if their customers default on monies owed. This helps ensure they have enough funds available to continue fulfilling orders and growing their business during potentially volatile times. The Executive Survey states that 37% have this insurance in place already with a further 15% planning to take action.

For companies with good credit management, AIG can offer a different type of solution - non-cancellable trade credit insurance under which there is a commitment to maintain credit coverage for future shipments to buyers, even if the buyer subsequently posts poor operating results. Likewise, coverage remains intact when a country or entire industry sector runs into trouble. For example, the sports equipment manufacturer selling into UK retail and exporting internationally, who had a non-cancellable limit on one of their key buyers. The buyer's risk situation deteriorated, but cover was not pulled and a claim was swiftly settled with the insured following the buyer's insolvency.

AIG are not promoting trade with poor quality risk, but are offering certainty to policy holders that once a credit limit is established it will remain in place for the duration of the policy. It also enables policy-holders to stand by customers, ensuring their customer base remains intact and their sales recover quickly when the business environment improves. Trade credit insurance also helps companies to trade in higher margin, but higher risk and less familiar markets than they would normally be able to.

By enabling firms to better optimise their accounts receivables, trade credit insurance also allows them unlock trade finance.

For more information on trade credit or trade finance solutions please contact Howden, broker partner of EEF.

Andrew Baynes
AIG
Trade Credit

eef The manufacturers' organisation

EEF is dedicated to the future of manufacturing. Everything we do is designed to help manufacturing businesses evolve, innovate and compete in a fast-changing world. With our unique combination of business services, government representation and industry intelligence, no other organisation is better placed to provide the skills, knowledge and networks they need to thrive.

We work with the UK's manufacturers from the largest to the smallest, to help them work better, compete harder and innovate faster. Because we understand manufacturers so well, policy-makers trust our advice and welcome our involvement in their deliberations. We work with them to create policies that are in the best interests of manufacturing, that encourage a high growth industry and boost its ability to make a positive contribution to the UK's real economy.

Our policy work delivers real business value for our members, giving us a unique insight into the way changing legislation will affect their business. This insight, complemented by intelligence gathered through our ongoing member research and networking programmes, informs our broad portfolio of services; services that unlock business potential by creating highly productive workplaces in which innovation, creativity and competitiveness can thrive.

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AIG

American International Group, Inc. (AIG) is a leading global insurance organization. Founded in 1919, today AIG member companies provide a wide range of property casualty insurance, life insurance, retirement products, and other financial services to customers in more than 80 countries and jurisdictions. These diverse offerings include products and services that help businesses and individuals protect their assets, manage risks and provide for retirement security.

Our Manufacturing Industry Group pulls together the strengths and capabilities of AIG together to focus intensely on the current and future needs of the Manufacturing sector. We have a strategic partnership with EEF, the leading Trade Industry Body for the sector to ensure we are at the forefront of the market in providing tailored and distinctive risk and insurance value propositions for a fast moving and developing sector. With the onset of 4IR (Fourth Industrial Revolution) and the evolution of risk within Manufacturing, our Cyber Health Check is an example of our innovative solutions to help our clients understand cyber exposures.

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