Manufacturing & Engineering: Cautious optimism for the future
“Although clients in this industry have a cautious outlook towards the future, they still feel very optimistic in relation to generating increased revenues.”
## Contents

1. Executive summary  
2. Key strategies for M&E OMBs  
3. Top risks for the M&E sector  
4. Conclusion
Welcome to the Moore Stephens Manufacturing & Engineering survey. The principle behind this report is simple – to provide a unique insight into the key issues and trends affecting this sector as well as highlighting some solutions and recommendations to overcome these issues.

Owner managed businesses (OMBs) in the manufacturing and engineering (M&E) sector have multiple strategies in play for 2015, but their optimism is tempered by concerns over employee skills shortages.

Just over half of M&E OMBs are confident about the general outlook for 2015, compared to 70% of all OMBs surveyed. Over two-thirds of OMBs in this sector are confident about hitting revenue targets compared to 75% overall, but only 58% are confident about hitting profit targets in 2015, which is relatively low in comparison to the 70% of overall OMBs.
M&E OMBs appear more cautious than OMBs generally in 2015.

Over half of OMBs in this sector expect this year to be better than last year – but a smaller percentage than OMBs overall. Clients in this industry have a more cautious outlook than entrepreneurs in other sectors: 53% say that 2014 was better than expected – a higher proportion than the 45% of OMBs overall whose expectations were surpassed.

However, looking ahead to the next three to five years, clients in this sector seem relatively optimistic about their opportunities, certainly in relation to generating increased revenues.

A large majority (87%) expect turnover to increase over the next three to five years (compared to 80% of OMBs overall).

“Looking ahead to the next three to five years, clients in this sector seem relatively optimistic about their opportunities.”
2. Key strategies for M&E OMBs

Expand customer base
A strong majority of OMBs plan to expand their UK customer base in 2015 compared to 62% of OMBs generally and just under half have a strategy that includes expanding overseas (compared to 20% of OMBs overall). For M&E businesses, this could include setting up operations in locations that have lower costs, a skilled workforce or closer proximity to overseas customers.

Over the next five years, 60% of M&E OMBs expect to increase the proportion of their customer base in Europe, with 31% aiming for proportionately more customers in North America. Around a third (32%) expect the proportion of customers in Asia to increase, 24% in China specifically, and 29% expect to see an increasing proportion of customers coming from South America and also Africa.

Ensure operational cost reduction
M&E businesses are more likely to build cost reduction into their 2015 strategies than other sectors, with 55% planning to do so, compared to 40% overall. Such focus on cost reduction is surprising given the recent recession and the substantial cost-cutting that has already taken place. But M&E businesses face continued cost pressure: 53% of M&E OMBs expect the cost of supplies to increase over the next three to five years, and just 31% anticipate an increase in gross margins, compared to 41% overall. Perhaps as a result of their cost-reduction strategies, 61% of M&E OMBs do expect net profitability to rise over the next three to five years, in line with the expectations of OMBs generally.
Investing in innovation is an integral consideration for businesses in M&E.

**Invest in innovation**
Investment is also in many M&E OMBs minds for 2015: 50% plan to develop new production techniques or other innovation, compared to 27% of OMBs overall, and 47% are investing in new technology or IT systems. Just under half plan to launch new products or services, benefiting from past investments in developmental activity. Most M&E OMBs are funding such activities out of cash and existing finance arrangements. Only one in five expect to increase their use of external finance over the next three to five years.

**Succession planning**
M&E OMBs are also planning for considerable change in their businesses, with 32% undertaking succession planning in 2015, 26% including acquisition in their strategy and the sale of their business.

<table>
<thead>
<tr>
<th>M&amp;E OMB strategies for 2015</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Expanding UK customer base</td>
<td>71%</td>
</tr>
<tr>
<td>Cost reduction</td>
<td>55%</td>
</tr>
<tr>
<td>New production techniques/innovation</td>
<td>50%</td>
</tr>
<tr>
<td>Launching new products or services/diversification</td>
<td>47%</td>
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<tr>
<td>Investment in new technology/IT systems</td>
<td>47%</td>
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<tr>
<td>Expanding overseas</td>
<td>47%</td>
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<tr>
<td>Succession planning</td>
<td>32%</td>
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<tr>
<td>Acquisition</td>
<td>26%</td>
</tr>
<tr>
<td>Sale of business</td>
<td>18%</td>
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<tr>
<td>Supply chain restructuring</td>
<td>13%</td>
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</tbody>
</table>
3. Top risks for the M&E sector

Skills shortage
M&E OMBs are more concerned about employee skills shortages than OMBs overall: 53% of M&E respondents see this as a major risk, compared to 39% of all OMBs surveyed. M&E OMBs’ concerns may be linked to the fact that many are planning to take on more staff over the next few years, with around two-thirds expecting headcount to increase in the next three to five years, compared to 58% overall.

Domestic competition
While 50% of M&E OMBs see domestic competition as a risk, 29% are worried about international competition. The strength of the UK economy is a concern for 42% of M&E OMBs in 2015, while just under a quarter are concerned about the global economy.

The strength of UK economy
Around one in five of M&E OMBs were concerned about the tax environment and, in fact, they were right to be so as following the election, there have been mixed news for the sector:

1. R&D tax credit losses can be surrendered for cash of up to 33% of qualifying spend (up from 25% last year) so this is one piece of good news.
2. From 6 April 2016 further restrictions will be placed on the amount of income tax relief that can be enjoyed by employees earning more than £150,000 and who make pension contributions during the year. This will mean higher-paid employees and directors may need to manage their income more carefully.
3. A consultation has been announced on the effectiveness of Entrepreneur’s Relief in achieving the government’s objectives for the OMB sector in the UK. One can only assume that this relief will become further restricted in its scope. Those who are thinking of selling would do well to take early advice before this relief is either restricted or even withdrawn.
Risks concerning M&E OMBs in 2015

<table>
<thead>
<tr>
<th>Risk</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Employee skills shortages</td>
<td>53%</td>
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<tr>
<td>Domestic competition</td>
<td>50%</td>
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<tr>
<td>Strength of UK economy</td>
<td>42%</td>
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<tr>
<td>International competition</td>
<td>29%</td>
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<tr>
<td>Global economy</td>
<td>24%</td>
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<tr>
<td>Tax environment</td>
<td>21%</td>
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<tr>
<td>Pension auto enrolment</td>
<td>18%</td>
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<tr>
<td>Exchange rate fluctuations</td>
<td>16%</td>
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<tr>
<td>Technological change</td>
<td>11%</td>
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<tr>
<td>Interest rate fluctuations</td>
<td>8%</td>
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“Succession planning, acquisitions and sale of businesses are the main strategies for OMBs in the sector.”
4. Conclusion

This report has captured a sector view of OMBs in the manufacturing and engineering sector in the UK, which provides a clearer understanding of the challenges, threats and hopes for these businesses. The forecast for UK industry is good as the businesses surveyed confirmed, but dark clouds, including skills gap and uncertainty over EU membership, hang over what could be a much brighter future.

We have provided a list of ten tips for success overleaf, which respond to some of these challenges.

Please do not hesitate to contact one of our experts if you would like to discuss this further.

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Top 10 tips for success

1. Make sure you make maximum use of current tax incentives, as appropriate to your business and its lifecycle.

2. If skills shortages are driving up salaries and putting margins under pressure, consider alternative remuneration approaches including share option schemes.

3. Look out for opportunistic acquisitions that could eliminate a competitor, bring in complementary products or services, or give you access to skilled personnel.

4. When seeking bank funding, ask for what you really need, prepare a clear business case and negotiate.

5. Analyse your whole trade cycle to identify any cash pinch points, then look for a finance product to match.

6. Make sure current IT systems and processes are working as efficiently and effectively as possible so that senior staff can focus on value-adding and revenue-generating work.

7. Maximise sales from existing customers by enhancing existing products and services or offering complementary new ones – and make sure you really understand your customers’ needs.

8. Innovate to stay ahead of the competition – continuing to spend on research and development (perhaps funded through grants & R&D tax credits), delivering services in new ways or increasing your staff training budget to enhance in-house skills.

9. Get maximum advice and support when planning to increase overseas sales – in particular, make good use of the government’s UK Trade & Investment services.

10. Plan well ahead of any desired exit from your business, particularly in relation to developing your management team: the business needs to be able to run successfully without you.