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Taking back control in manufacturing

Challenges & opportunities in manufacturing

The manufacturing industry is undergoing a period of significant change, forced to rapidly innovate in light of the coronavirus pandemic.

Transformative industry practices are not just responses to Covid-19 though, nor Brexit or the US-China trade war. Regulatory and political changes, as well the need for further sustainability to tackle climate change, and modernising technology all look set to alter the landscape of global trade.

Despite numerous challenges in the business landscape, there are opportunities for businesses within the manufacturing sector to deliver growth and compete effectively on the world stage.

The impact of Covid-19

Manufacturing ground to a halt across many industries as a result of the coronavirus pandemic, but the industry also combated Covid-19 and helped the NHS cope in a situation the Prime Minister described as the greatest threat to the UK since WWII.

The South West Manufacturing Advisory Service (SWMAS) and the Manufacturing Growth Programme (MGP) prepared the Manufacturing Barometer report, which shows SME's were confused about the support the government offered during Covid-19. Having asked pubs, restaurants, cafes and gyms to close, the UK prime minister announced a £330 billion package of loans and grants to support businesses affected. The Coronavirus Business Interruption Loan Scheme allows small and medium sized businesses to borrow up to £5m with preferential rates as a 12-month interest-free loan. Large companies can use the Covid Corporate Financing Facility option, provided by the Bank of England.

The government introduced assistance to businesses that had been impacted, with the PM saying he would, "do whatever it takes to support our economy". We have seen the government make additional packages available to support the self-employed, and help protect more UK workers from what is a real uncertain period.

Despite this, the Manufacturing Barometer report which covers 300 UK firms, showed that nine in ten expect sales to drop in the next six months post coronavirus and more than half think they will need to reduce staff, even with the government furlough scheme. Three quarters of respondents were unsure of the help they could access.

Car industry crashes

While London may have taken the initial hit of Covid-19 in terms of confirmed cases and deaths, it seems to be an area that will recover relatively unscathed economically.

KPMG's report analysing the impact on the UK's regions suggests London will contract by 7.3%, compared to other regions, such as the West Midlands, shrinking 10.1% by end the end of the year. The reason for these findings is that London has lots of service industries, such as marketing, advertising, finance, and architecture. These sectors tend to be able to work from home or remotely, while the West Midlands is a manufacturing hub for the country.

The automotive sector makes up 6% of the West Midlands' local economy, is facing a double hit. Factory shutdowns from social distancing and lockdown measures, such as Jaguar Land Rover Automotive, suspended production. However, the company, owned by Tata Motors, returned to work alongside Aston Martin, B&Q and Taylor Wimpey. BMW, Toyota and Honda, who all haveoperations within the UK and globally, also closed. These shutdowns of factories is coupled with a collapse in demand for new cars from consumers meaning the automotive industry could be facing some time to recover.

In the first half of 2020, global production is expected to drop by 13.1% in the automotive industry, compared to 8.4% in textiles and electronics to 7.4% in comparison to Q4 2019. But as demand for many products, including cars and car parts plunged, automotive companies including BMW, Tesla and Ford turned to producing Personal Protective Equipment (PPE) and ventilators to help the pressure on the health services during the pandemic.

Helping the NHS

Many manufacturers diversified their products and switched production lines to aid the NHS in combating the pandemic by producing PPE.

More than 3,000 companies and individuals registered their services to the governments NHS Ventilator Challenge alone. In Cornwall, which is home to 1,100 manufacturing companies, a number of products were made and used for the NHS, including pharmaceuticals, tamper seals for drug vials, catheter clips, water isolation valves and even lights for some of the field hospitals. CHX Products designed tools and produced 5000 PPE face shields per week.

Researchers from the Institute of Manufacturing in Cambridge also worked with medical teams, looking at how the flow of patients could affect day-to-day activities and logistics of managing medical supply chains. The engineers worked on a number of simulations including how nursing shortages could impact the Cambridge University Hospitals. Industrial engineering students also volunteered to study replenishing and filtering the hospitals' oxygen supply.

Supply chains

Manufacturers who have managed to battle through Covid-19 will have adapted to stringent and wide-ranging changes.

Society as a whole dramatically changed how we work, socialise, communicate, and importantly, consume goods. History shows us that businesses that can keep up with sweeping changes, and in this case adopt far-reaching social distancing measures, have further opportunities for growth in the long-term.

An optimised supply chain is a significant asset in any organisation, but during the coronavirus pandemic, many manufacturing supply chains transformed from a straight line of materials, from factory to market, into an ecosystem considering the social and economic benefits of production. Others struggled, especially if they rely on international goods forming part of their logistics. Not only could this push up costs because of currency fluctuations, but also affect time and productivity.

Coronavirus has truly put supply chains in the spotlight, with chaos ensuing for at least as long as 18 months post pandemic, according to the UK roundtable of the Council of Supply Chain Management. Many businesses coming back to work may find some of their international counterparts may be still in lockdown or facing different measures.

And then there is the issue of closer to home supply chains, with the Road Haulage Association (RHA) warning that transport firms were on the brink of collapse because of coronavirus. In mid-April the RHA found that nearly half of lorries were taken off the road. With many regional and international airports and ports closed, another crucial element to the manufacturing sector, the supply of goods and equipment, had the life squeezed out of it.

The fourth industrial revolution

While the world grapples with post pandemic recovery, manufacturing also needs to remember it's innovations during the crisis and look at how adaptions could be permanent. The trend towards automation and data exchange across manufacturing highlights the importance of technology on the industry, facilitating changes in sustainability models, resourcing and labour. Ultimately manufacturers can look at cybersecurity, cloud computing and AI as opportunities to deliver growth and compete effectively on the world stage.

Data-driven production and IoT

Data-driven production contributes to reducing waste and improving profitability. Data gathered through the Internet of Things (IoT) means that companies have real-time data on production, distribution and sales volumes. Data collected, analysed, stored and transmitted via the cloud allows organisations to increase their efficiency and analyse the global supply chain. Early warning of spikes or declines in demand, growing markets or issues with sourcing or distribution can help companies maintain a lean operation. It often ensures that companies remain agile and outward looking – as one geographic market declines, another may be found, for example.

Blockchain

Blockchain technology is another technology that is transforming manufacturing. For example, in the food and drink industry, blockchain can log everything from the growing, manufacture and retail of goods in a common blockchain, making it easier to identify any potential food contamination. Systems such as IBM Food Trust, already in use within the industry, facilitate greater transparency and traceability. Integrated sensors can even monitor the quality and safety of the food right up to the point of sale.

While food manufacturers are early adopters, there is potential to extend applications across the manufacturing sector. The challenge is the cost of the initial implementation; assuming that the expertise required isn't currently held within the business, additional staff, systems and strategies may be required to leverage the potential of blockchain. It's likely that as the benefits are proven within the industry and the technology gains wider adoption, more companies will be looking for partners and clients to deliver sector-specific solutions which support efficiency and cost-reduction measures.

Skills gap and automation

The promised revolution which sees robots replacing workers has yet to happen. While there have been many improvements in production due to robotics, far from replacing jobs it has created new areas of employment. One of the challenges that the industry is facing relates to the skills gap created by technology advancing at a faster pace than training.

Automation is becoming integral to production and AI-driven robots can support efficiency strategies. However, the programming, analytics and maintenance of these new technologies need to be supported. The manufacturing industry is keen to address this skills gap. The announcement of a government fund to support digital transformation will provide additional support – the £30m fund for the Made Smarter Challenge supports projects relating to data analytics, immersive technologies, connected environments and IoT. In addition, there is an opportunity to gain outside support through partnerships with start-ups and experts across the world.

Cyber security and GDPR

Technological change is transforming the industry for the better, facilitating more cost-effective and sustainable practices and allowing for greater customisation and personalisation to meet market demand. However, alongside these opportunities comes new challenges. Cyber security is a growing concern; major companies are vulnerable to cyber-attacks and the more data are gathered through technologies such as IoT, the more vulnerable manufacturers become as targets. Changes to the GDPR mean that data breaches must be made public; primarily these relate to customer data, but some client data will also apply and as more detail is gathered across the supply chain, the risk has increased.

GDPR rules may only apply across the EU, but companies buying or selling to the EU are subject to those rules. Many other countries are following suit in recognition of the changing importance and value of data as an asset within a business. Any strategy that incorporates digital technology or leverages the opportunities of cloud-based and digital analytics needs to have a firm grasp of the requirements.

Politics & the pandemic

The weakness of the pound since the EU Referendum was initially a significant driver for sales as the decreased value of sterling made UK manufactured products great value overseas. However Covid-19 sent the world into turmoil, and Brexit was on the backburner.

According to data from the Office of National Statistics, UK exports of goods and services increased to a record £647.1bn in the 12 months to May 2019, an increase of 4%. Goods exports accounted for £357.1bn of that total and increased by 4.7%. However, uncertainty over the departure deal, and date, left manufacturers, like the Brexit deal itself, in limbo. According to data from the ONS, the EU currently accounts for just under half of all British exports every year.

For context, the pound lost nearly a fifth of its value since Britain voted to leave the EU. Prior to the Brexit vote, in May 2016, £1 equated to more than €1.27. The pound to euro exchange rate has more recently been hovering around the €1.14/€1.15 mark. GBP/EUR also dropped down to levels of €1.0511 at one point, rates not seen since the global economic crash of 2008.

Understanding the impact of the General Election

The delay of the Brexit deadline until the end of January 2020 led to a General Election in a bid to break the parliamentary deadlock. Boris Johnson led the Conservative Party to its biggest victory since 1987. In the New Year the UK withdrew from the European Union under the terms of a revised withdrawal agreement. Negotiations with the EU were postponed as the world dealt with Covid-19, with chief Brexit negotiator Michel Barnier and Johnson both testing positive for coronavirus, with the latter spending a week in hospital, including a spell in the intensive care unit.

Former MP and close ally of former PM Theresa May David Liddington argued that Covid-19 made extension inevitable because, "There is not enough bandwidth to pay attention to Brexit in Whitehall or the European Commission and the major capitals".

However, the Foreign Office were quick with a firm rebuttal, insisting that 31 December remains the deadline for ending the Brexit transition period, trade deal or no deal.

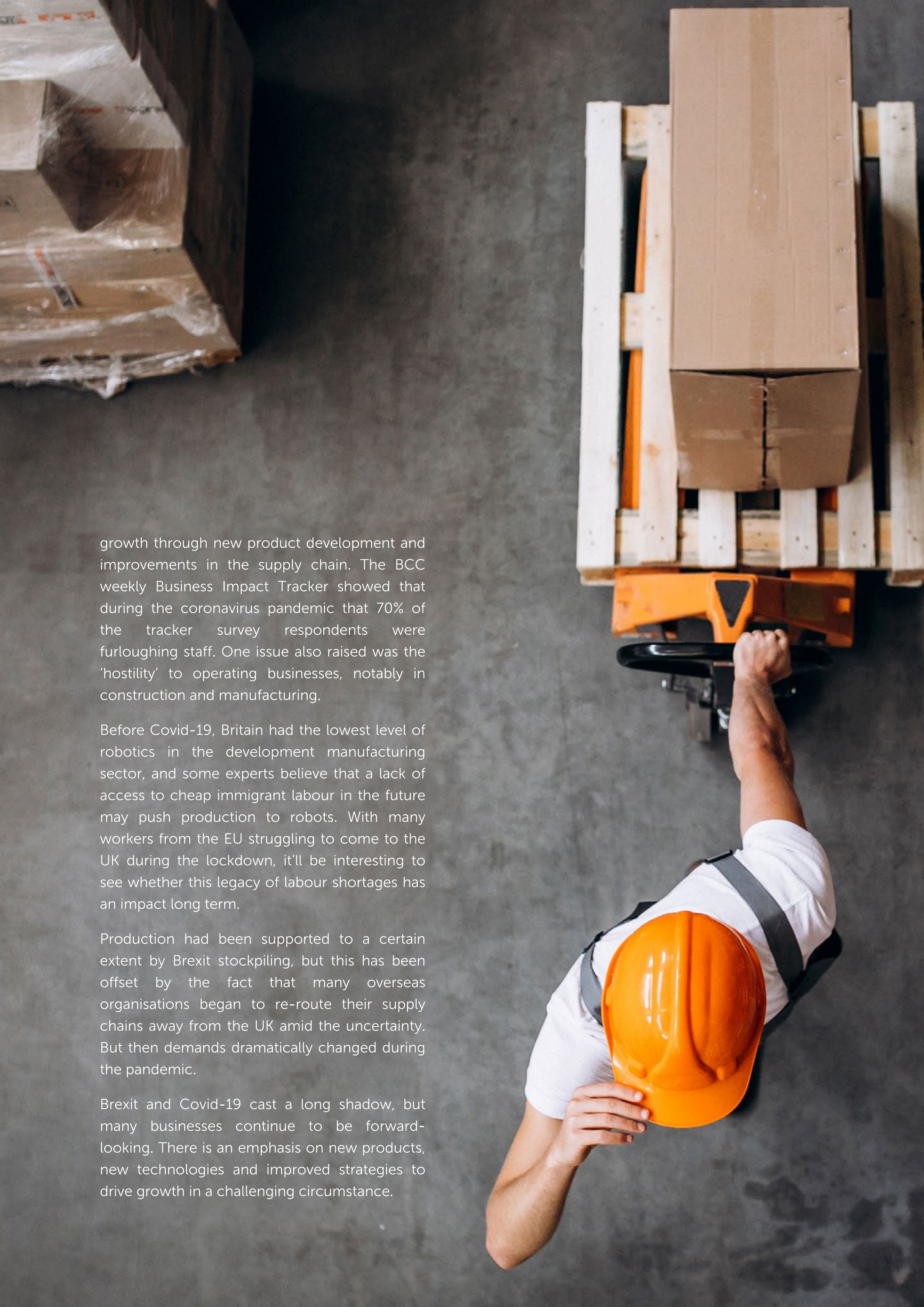
The outcome of the General Election, giving the Conservatives the biggest percentage vote share of any political party since 1979, has shaped the UK's exit of the EU, with the British pound, and in turn the value of British goods, intrinsically tied to developments.

Post-Brexit Manufacturing

The second half of 2020 is a tricky one to predict as the world sets into recovery mode from Covid-19. Demand for many products and services slumped as people were instructed by governments globally to stay indoors. This in turn affected imports and exports of certain goods, and the cash flow of many businesses.

Leaving the EU will mean a change in the paperwork required to export goods to the EU, and may cause delays in the supply chain. The disruption could have a significant impact: according to ONS data, a third of UK manufacturers believe that the EU will remain their growth market for the next five years. The next largest geographical segments are China (15%) and North America (13%). However this data report was taken pre-pandemic.

The British Chamber of Commerce (BCC) warned that many businesses are not ready for the "immediate and abrupt" changes that leaving the EU without a deal would bring. The manufacturing industry appears to be looking beyond the specifics of what is in a Brexit deal and focussing instead on R&D and innovation. The ONS report showed that manufacturing leaders were boosting their budgets by an average of 13% in an attempt to accelerate



growth through new product development and improvements in the supply chain. The BCC weekly Business Impact Tracker showed that during the coronavirus pandemic that 70% of the tracker survey respondents were furloughing staff. One issue also raised was the 'hostility' to operating businesses, notably in construction and manufacturing.

Before Covid-19, Britain had the lowest level of robotics in the development manufacturing sector, and some experts believe that a lack of access to cheap immigrant labour in the future may push production to robots. With many workers from the EU struggling to come to the UK during the lockdown, it'll be interesting to see whether this legacy of labour shortages has an impact long term.

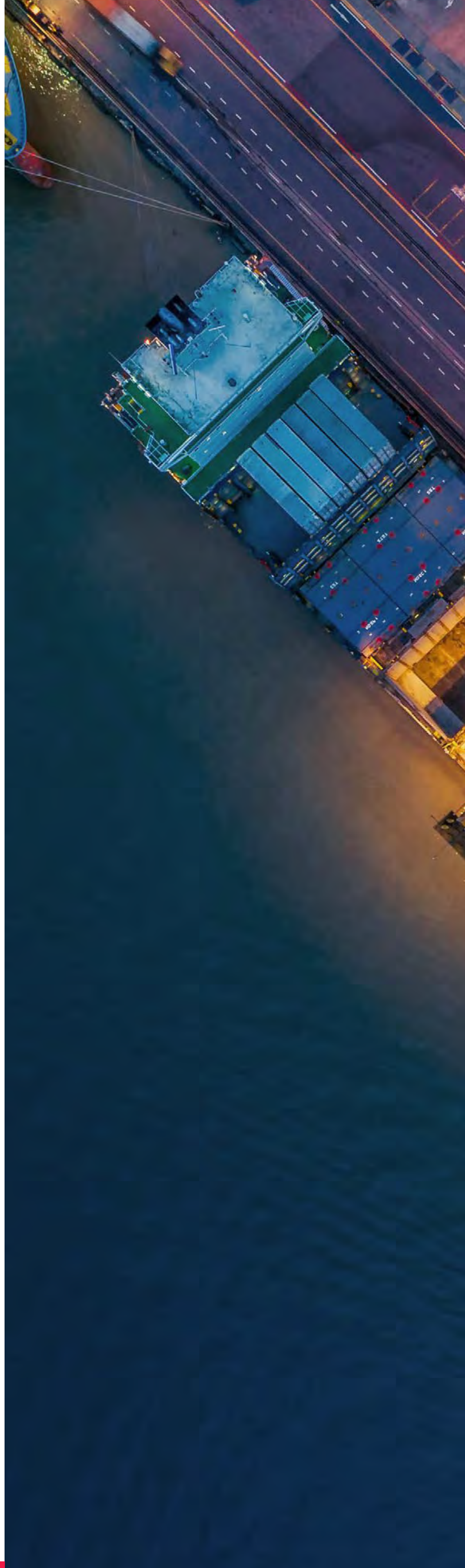
Production had been supported to a certain extent by Brexit stockpiling, but this has been offset by the fact that many overseas organisations began to re-route their supply chains away from the UK amid the uncertainty. But then demands dramatically changed during the pandemic.

Brexit and Covid-19 cast a long shadow, but many businesses continue to be forward-looking. There is an emphasis on new products, new technologies and improved strategies to drive growth in a challenging circumstance.

US-China Trade War

Before coronavirus, the US-China trade war also had repercussions across the world. Commodity-based economies and places on trade routes such as Australia were hardest hit, but the situation adds more unwelcome uncertainty as manufacturers seek to move their business forward.

Escalation of the trade war has had an impact on financial markets and each new round of tariffs brings a wave of selling pressure around the world. It has been a factor in the slowing of growth around the world and many companies are putting investment on pause until the situation has been resolved. There were signs that the trade war was coming to an end; but sentiment changed as the US and China came to loggerheads on handling Covid-19. How each country recovers, and with the US Presidential election around the corner, the optics are very important for both countries.



Price pressures

Many are facing financial difficulties at work and at home post pandemic. While changes in consumer behaviour may lead to more ethical consumption, price pressure is more prominent.

Rising inflation and increased prices mean that many people have less disposable income, leaving producers stuck in the middle, with a need to innovate pushing up costs while falling demand may suggest a need to cut prices. The end result is squeezed margins, and for manufacturers importing components from overseas, this is compounded by currency costs. A weaker pound makes British exports attractive to overseas buyers, which is good news for manufacturers, but it still carries some risk. Currency values fluctuate which can lead to reduced margins or some goods becoming priced out of the market.

Understanding currency fluctuations

There are so many factors that impact a currency – situations such as Covid-19, Brexit and the US-China trade war are major examples, but currencies fluctuate due to economic statistics, political changes and business confidence. As they fluctuate in relation to each other, a major change in another country will have a knock-on effect on other currencies.

The biggest challenge is that given that there are so many factors, and that it includes changeable areas such as politics, the currency market is difficult to predict. This in turn makes it difficult to set prices with overseas partners and clients. In addition, there are some suggestions that the current economic situation may lead to a shift in buying patterns. The overall approach to a company's currency exposure will depend on a number of factors, but here are some key steps to take when planning ahead in uncertain times.

Managing currency risk

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STEP ONE: UNDERSTAND THE NATURE OF YOUR CURRENCY EXPOSURE

Take a look at your balance sheet and consider what fraction of overall incoming and outgoing funds is held in currency, because this will indicate your measure of risk. If it's only 10% of your business, you may think you have less to worry about than if it's currently 70% but the issue isn't quite that simple. Of course, a company with higher currency exposure bears more risk due to currency fluctuations, but you may want to look beyond the numbers at your strategic plans. You should consider where the market may be growing or shrinking and where the future opportunities lie. In trying economic times, whatever the percentage of your overall profits and losses are consumed by currency, you should aim to make the most of every penny.

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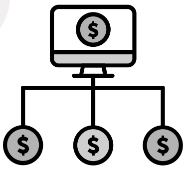


STEP TWO: UNDERSTAND THE CHOICES AVAILABLE

There are a number of currency tools which can help you make the most of your company's resources and still expand into further overseas markets. A forward contract allows you to lock in a prevailing rate of exchange for a set period of time. This can help with forward planning and provide some certainty but it carries its own risk. Currency can go up as well as down, and it depends on what is going to work best for you. In addition, there's the fact that this works best when you have a clear pipeline and this isn't always possible when developing a presence in new geographic markets. If you have definite commitments then a forward contract may be the best approach. However, you can also set up a market order; this allows you to specify your target rate and the funds are transferred if that rate is reached. There are no guarantees with a market order but you can pair this with a stop-loss order which specifies the lowest limit you are willing to accept. This allows you to protect your profit margin while also having the opportunity to take advantage of movements in the market.

Both forward contracts and market orders are longer term strategies that require some planning, but if you operate a more agile business, you may feel like the best approach is to wait and see what the market brings and adapt accordingly. This does carry some risk, but if you work with a specialist who can keep you updated on the latest changes in the market then it could allow you to maximise your profit margin and help protect against too severe losses.

3

STEP THREE: SPEAK TO A SPECIALIST

All of the above products and services are available via a currency specialist but that isn't the only advantage. Currency specialists typically offer better rates and lower fees than high street banks. You also get the benefit of expert guidance from someone who not only understands the foreign exchange market but also works closely with clients in the manufacturing industry. Whether you're just starting to consider your currency exposure or are simply looking to review your current approach, the additional expertise can shed light on the opportunities and risks of different approaches – and you can get all this extra help for free when organising your international payments through a specialist.

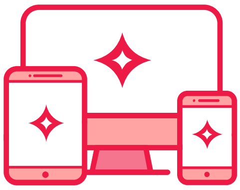
Controlling currency and international payment costs

Fluctuations in the exchange rate have an impact on the cost of international payments, but it isn't the only factor.

Different providers offer different rates of exchange, and even a fraction of a percentage point can make a big difference. In addition, if you're working with multiple partners, perhaps working on innovative new production processes or smart labels, exchange fees can soon add up and can further erode the profit margin. If you're working across multiple markets around the world, then it may be time consuming to set up and deliver the broad range of currency transactions required and to keep track of cash flow when working in multiple currencies.

Managing international payments

Working in partnership with a currency specialist like moneycorp can improve the process of managing international markets and partnerships. As well as expert guidance on the currency market and available currency tools for managing risk, moneycorp provides clients with an online platform for managing international payments. Features of the platform include live statements, progress updates on international payments, the facility to make payments in multiple currencies and management controls. This approach doesn't add too many additional layers of administration or require staff with specialist expertise, but does provide the transparency and checks and balances that allow for the close management of currency costs.



Currency support for the global manufacturing industry

For many organisations, a global approach can help to offset some of the challenges of shrinking domestic markets, political changes such as Brexit and changing consumer tastes and priorities. Wherever the market is expanding, the cost of international transfers and the risk of currency exposure are likely to be a key factor in whether your plans succeed – after all, there is no point in tripling your sales through overseas markets if you find that you didn't make a penny of profit. The corporate foreign exchange service from moneycorp helps companies to manage their foreign exchange risk. Our expert team works directly with the manufacturing industry and provides guidance on the foreign exchange market and insight into currency tools and market developments and how they might impact individual businesses.

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Lee McDarby has over 15 years' experience in foreign exchange and is Managing Director of Corporate Foreign Exchange and International Payments at moneycorp.

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