Manufacturing in the 21st century

Phillip Inman reveals a mixed picture as British manufacturing companies fight back from the recession

Manufacturers, like farmers, can give the impression that moaning is one of their chief pastimes. One minute they complain that governments are failing to offer enough support and the next they are debating how to get the government’s lumbering bureaucracy out of the way.

In the UK it is easy to see why manufacturers feel ignored and sidelined. The Big Bang in 1986 triggered a boom in the banking sector, captivating ministers and distracting them from putting in place policies to help middle-ranking and smaller industrial companies, traditionally the engine of the economy.

The election in May changed the landscape. Former business secretary Peter Mandelson had championed widespread and well-financed state intervention. During a speech in January 2009 he famously said Britain needed “less financial engineering and more real engineering.” His successor, Vince Cable, agrees with re-balancing the economy towards manufacturing, but has thrown the levers into reverse. Regional development agencies will be scrapped and direct subsidies are, at least in his public statements, history.

**WORLDWIDE SCOPE**

In the report Hidden Heroes: Emerging Retail Markets Beyond China, Deloitte and Planet Retail say China “offers the promise of great riches for the world’s leading retailers and their suppliers.”

“There are other big emerging markets that offer great promise.”

International expansion is very hard for companies to get right - many retailers have tried and retreated. The Internet may make it easier. Next has said it has moved the focus of its international ambitions towards the Internet. But the logistics of delivering to many different countries will be only slightly less hard than working out what goods and retail formats will appeal to consumers in different countries. Those retailers that can unlock the secrets will be able to buy themselves a prosperous future.

Please remember that ongoing stock market conditions and currency exchange rates will affect the value of investments and any income from them. Investors may not get back the amount invested.

Investing in emerging markets is only suitable for those investors prepared to accept a higher level of risk. This is because these markets could go down or up more than the main international markets.

At Baillie Gifford, Monks Investment Trust has recently taken a holding in Renhe Commercial Holdings, which is developing and managing a number of shopping centres in China, while Edinburgh Worldwide Investment Trust has held shares for some time in luxury goods retailer Hermes, reflecting another apparent conundrum: even in a tougher economic climate, the demand for - and supply of - luxury goods remains.

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**MANUFACTURING IN THE 21ST CENTURY**

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Cable subscribes to the argument that governments should focus on creating a landscape conducive for business. He would probably point to initiatives such as the apprenticeship academy set up by truck and digger maker JCB at its Staffordshire base as the kind of private sector investment companies should adopt more widely. On a global level, Cable’s views are in a minority. Most western countries consistently pump more money into technological development and skills than the UK has ever managed, and are carrying on with that policy.

The US and Germany have retained huge manufacturing sectors. German industrial exports are currently soaring and US manufacturers are recovering, largely on the back of massive bailouts, especially to the car industry. Statements by the Chancellor George Osborne have been listened to carefully – more carefully maybe than those of Cable. Osborne has talked tough on cuts and looks set to implement some of the deepest reductions in government spending since the Second World War.

The cuts will bite deep into Whitehall and local government spending from 2011. Just talking about them has made service industries nervous with huge knock-on effects for manufacturers. Figures from the surveys of purchasing managers were buoyant until around June and July of 2010. They have gone downhill across the sector. He says: “Across most other areas of manufacturing, we are seeing a great deal of concern about the prospects for growth.”

Griffiths says that while green technology companies remain insulated, the slowing economy is still something of a worry across the sector. He says: “We need to remember we are recovering from a situation where industrial output declined almost 15 per cent from peak to trough from 2008 to 2009.”

On his list of success stories is Converteam, which supplies power converters for wind farms and more recently solar generation. Rolls-Royce has also weathered the storm well. Despite a sudden seizure in orders from airlines for new planes, and hence the company’s engines, it reported strong underlying profits before tax of £915m in 2009 versus £880m in 2008. Sir John Rose, chief executive, wrote in the Annual Report that sales generated from outside civil aerospace reached 56 per cent of revenues in 2009, adding that the energy sector was one of the firm’s four key markets.

Companies in other areas of manufacturing have also recovered well. Chamberlin, the Walsall based maker of metal castings, has won several export orders helped by the lower exchange rate, says Mr Griffiths. Renishaw, the maker of robots, sensors and lasers, was forced to cut staff during the downturn, making around 500 workers redundant. Its share price, along with much of the market, slumped in March 2009 to 258p. By the autumn of 2010 it had almost quadrupled to 1,020p.

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David Bailey, professor of International Business Strategy and Economics at Coventry University, agrees that the UK recovery remains fragile. “We are seeing expanding areas of activity in India and China, which is great for firms like Land Rover, but not for many other firms which don’t currently export enough to these economies to make a difference,” he explains.

CHALLENGING TIMES

You need to remember we are recovering from a situation where industrial output declined almost 15 per cent from peak to trough from 2008 to 2009. While we have notched up strong growth in 2010, most of it in the first half, we have not yet recovered half of that output gap,” he added. Professor Bailey stresses that Britain continues to maintain a strong manufacturing base, with much of it in high end, specialist engineering. “We are a large producer of premium cars in world terms, but if we are going to maintain that position and specialise in the higher end we need to offer manufacturers more support in the downturn,” he says.

Griffiths says many of the companies he knows have short order books and could be blown off course by a sharp slowdown in the economy. “I wouldn’t say it was hand-to-mouth. It’s better than that. But firms don’t have the long order books they would like,” he adds.

Rolls-Royce has a long list of orders for aero-engines, parts and increasingly, service contracts, but it has one problem that besets much of the sector and that is a substantial final salary pension deficit. Indeed, many of the UK’s manufacturers and engineering groups have been around for 50 years or more and have built up funding shortfalls which are in some cases potentially devastating and have pushed shareholders away.

Shares in engineering firm Babcock International were lifted by its announcement of a groundbreaking pension in 2009, which capped the risk of retirees living longer than expected. The safeguarding operation gave shareholders comfort that pension risks were limited. Within months, Babcock succeeded in buying rival VT Group. Other firms face similar problems and the future seems to hold another challenge for a vital but vulnerable part of our economy.

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