Business, Innovation and Skills Committee
House of Commons
London
SW1A 0AA

December 2015

Institute of Directors response to the Inquiry into Exports and the role of UKTI

The IoD welcomes this opportunity to respond to the Committee's Inquiry into 'Exports and the Role of UKTI'. This evidence explores some established and emerging themes around UK exports. In particular we point to the complexity of the discussion and the need to address some of the misguided assumptions that underpin the debate. With 56% IoD members trading internationally, we also explore our recent member data on export trends and how these inform the next steps that the Government should be taking to even approach its ambitious exports target.

About the IoD

Founded in 1903, and granted a Royal Charter in 1906, the IoD is an independent, non-party political organisation of around 35,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. Approximately 92% of FTSE 100 companies have IoD members in management roles, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

It should first be noted that the Government's current exports target is an extremely ambitious one – arguably overly so. It does not necessarily reflect or take properly into account the complexity behind the headline figure of the UK's trade balance.

The UK's trade balance is much more complicated than the overall trade deficit number(s) indicate. This is <u>not</u> to argue that the deficit is of no importance, but it is important to understand the nuance behind the figures. Traditional manufacturing has of course been in decline in Britain for some time. As a result, UK firms are now much more likely to be assemblers of final products, rather than producers of component parts.

In manufacturing, there are a significant number of businesses which import both raw materials and semi-finished goods to assemble and then export. This naturally means that relative to an economy such as Germany, whose industrial structure is very different to the UK's, our trade balance will naturally be more skewed towards high level of imports for value add(ed) activity.

In policy terms, it is imperative that we move away from the established fallacy that imports are a tick in the negative box and exports a tick in the positive one for an economy. As the UK economy began to recover from the post-crash recession in 2007-08, the eventual rise in imports were an important sign that domestic demand and consumption were returning to pre-recession levels.

The issue with treating the trade balance as the official scoreboard is that it reinforces an unhelpful narrative of "us vs them" in respect of international trade. More than ever, though, the reality of complex global supply chains –ones into which British businesses are highly integrated - means identifying national value-add is more difficult for official statistics to capture than ever. They increasingly look at production and selling abroad as a product of some collaboration rather than simply in terms of competition. At the same time, isolating where an export physically happens is particularly difficult for a services-based economy such as the UK's. Many IoD members in services sectors who have set up overseas branches, joint ventures, subsidiaries, etc. have commented that they would not automatically count themselves as a 'traditional' exporter when asked.

Even within manufacturing, where the recession and consequent Eurozone crisis choked off international demand for UK products, changes are happening. These changes mean that the ways in which UK firms export (as well as what they export) is more difficult to capture than it is for Germany, for instance. Germany has been able to maintain its traditional manufacturing base, not least because of the demand for raw materials in emerging and high growth markets over the past decade. This may now start to drop off, however, as these economies mature, and with the current 'slowdown' in the BRICS and elsewhere.

Servitisation:

Originally highlighted by Rolls Royce, servitisation is a developing trend among British firms that is transforming what we traditionally think of as manufacturing. It is broadly defined as the process by which manufacturing firms change their business models to deliver services alongside physical products, developing an integrated offering which expands the life (and sales) cycle of what they sell. Instead of simply producing a car, computer, casing etc, a business will often invest time and resource into R&D in order to be able to offer solutions and contracts care alongside products.

One of the implications of this trend is that identifying value-added activity becomes significantly more difficult than it was when a firm was simply manufacturing and exporting goods. Often this happens towards the end stage of a supply chain in Britain, or through aftermarket services.

Rebalancing the export economy?

The financial crash led to unwarranted speculation that the UK's economy was too dependent on financial services. This narrative eventually gave way to the idea that, in fact, the overall divide between manufacturing and services was too skewed towards the latter and that boosting Britain's manufacturing capacity was needed.

It is vital not to overlook the ways in which global volatility affects countries that rely significantly on manufacturing. The euro's continued weakening in the wake of the European Central Bank's quantitative easing programme, as well as slowdown in markets such as China can also leave a country with a significant manufacturing base precariously exposed.

In fact, there has been a rebalancing in the British economy over the past few years, but it has not come in the traditional form that we might have expected. A rebalancing within the UK's services sector(s) has been taking place, with a trade surplus in services continuing to sit at near record levels. Business services, the accounting/legal professions, transport and travel have been among the main sectors driving the increase in the UK's positive trade balance in services.

A recent IoD survey found that while the overall share of manufacturers involved in exporting and in terms of contribution to turnover still outstripped that of service sector businesses, the level and reach of manufacturers selling to foreign markets has decreased while the latter has increased over the past 3 years – particularly in Asia.

How can the Government meet its targets?

First, the IoD would suggest that they should be considered as objectives rather than hard targets.

The role of Government or any state actor in promoting and facilitating trade should be to reduce cost burdens, barriers, and where possible provide incentives. There are a number of areas where policy action - not directly related to a trade or exports strategy - would have a significant impact.

Our most recent survey data shows the two most widely shared reasons for IoD members (as a whole) beginning to export relate to an overall growth strategy (48%) and realization of market potential to increase profits/turnover (39%). These are followed by business contacts (29%) and unsolicited enquiries from overseas (29%). Unsurprisingly, business contacts are significantly more important for businesses at the much smaller end of the scale –in terms of turnover and employees- exporting as part of an overall growth strategy and (to a lesser extent) realization of foreign market potential is much more relevant for medium to larger sized companies.

Given that lack of time, 'staff and cost resources' are routinely identified as the biggest barrier to export for IoD members. Larger businesses with these resources are more likely to make exporting part of their growth strategy, and are more capable of researching opportunities in foreign markets. Conversely, smaller businesses are more likely to rely on contacts and networking –often by accident rather than on purpose- to identify and pursue export opportunities.

With this in mind, the Government should prioritise gathering of data in order to encourage SMEs to consider exporting. Data-gathering on live opportunities is a cumbersome task, but one which pays real dividends for firms too busy to gather information across multiple markets or commission multiple speculative OMIS reports. Thankfully the Government have recognised this and made this the central plank of their new Exporting is Great campaign, with a live online platform of international trade opportunities across the world. It is too early at this stage to gauge its effectiveness and take-up by business. Undoubtedly, though, this will rely on sufficient communication to firms, an area in which Government has historically underperformed. However, if this initiative is matched by reliable information about opportunities facing different businesses, this will have been a positive and constructive change in orientation for UKTI.

At the same time, SMEs need practical information about the regulatory and cultural obstacles they are likely to face when trading abroad – particularly for service sector firms where the barriers are much more varied in nature and harder to quantify. Crucially, given that many smaller businesses operate with much smaller profit margins (and where overheads can make a significant difference), knowing the cost of these is vital. 'Surprises along the way' can be priced in and absorbed by larger businesses – for an SME they can be the difference between exporting being worthwhile or a waste of time. UKTI need to provide this information through better in-house commercial expertise, instead of simply referring businesses on to third party services. Business support is as important incentive for first-time exporters – the job is not done once the decision is made. A disastrous experience can make exporting the first time the last time for an SME.

More priority also needs to be given to inbound trade missions. At the moment, outbound trade missions also seem like a box-ticking exercise for smaller firms, geared more towards 'landing the big deals' for bigger players within delegations. Even with subsidised travel as part of outward trade missions (as well as the Tradeshow Access Programme) leaving work for several days to take part in a delegation is a big time commitment for smaller firms.

The commitment and risk is exacerbated by that lack of guarantee that they will actually meet potential clients, specific to their sector. Bringing more delegations to the UK, given the number of countries whose governments' trade promotion budget is still flowing, would both cut down on UKTI expense and provide more opportunities for SMEs.

Thinking closer to home is also key to driving interest in exporting from small business. There has been a tendency within Government to think with macroeconomic blinkers on when it comes to encouraging demand from abroad.

Asia and other far-flung markets do hold significant opportunity for British businesses on account of their growth figures and maturing economies. At the same time, Europe's stalling growth prospects have driven a narrative that non-EU markets are where the real potential for British products and services lie. Yet for the 46% of IoD members who do not currently sell to or trade overseas, the market that most non-exporters would first consider expanding into would be the EU – with 47% indicating it as their first preference. North America and Asia are the next most popular first choice options – but with a comparatively tiny 8% and 4% share, respectively.

Moreover, an earlier survey in February 2015 found that of those IoD members currently exporting, the market which with the most growth for their business over the past 2 years had been the EU (43%). Asia was a distant second, with 26% reporting the region to have brought the biggest increase in their export-generated turnover. Europe is still clearly of vital importance –both in real and prospective terms- to businesses in terms of proximity and expansion of market(s). The Government's tendency to target and prioritise geographic markets further afield does not reflect this reality, and must be better absorbed into its strategic focus in promoting trade opportunities – in particular for SMEs and non-exporters.

UKTI's role and reputation within the business community with regard to effectiveness is a complicated one. Awareness of its services and initiatives naturally affects the uptake of these. The September 2015 survey found that 32% of all respondents and sought or received help from UKTI to grow their business abroad, while 64% had not. The extremely diverse and varied nature of businesses not only across but also within sectors means the experience and relevance of some of UKTI's offerings varies greatly. Understanding of the often cross-sector basis of supply chain management is limited, and so targeting potential partners, distributors, clients/customers etc. in the supply chain beyond the established big players is difficult for UKTI to do. The more niche a product or service, the more complicated bringing it to new markets becomes in terms of knowing where UKTI can step in to make a positive, practical difference – and with market research as well.

The integration of UKTI into UK embassies/consulates overseas has been generally very well received, mainly from companies who have ventured abroad to seek out contacts or who are already present in-country and looking for support in developing their business and navigating hurdles on the ground.

OMIS (Overseas Markets Introduction Service) reports have a very hit-or-miss record with IoD members. Many felt that they could have, in the length and time taken for UKTI to compile the reports, arrived at the same conclusion/analysis and contacts through their own research and for a fraction of the cost, particularly when the findings were shallow. Others consider OMIS to have been effective in assessing whether a market was or –more often not- suitably ready for their business.

UKTI's Tradeshow Access Programme can be helpful but its rigid subsidy structure with regard to travel restricts business choice in what markets they want to go to. While scrutiny of Government expenditure understandably necessitates caution, travel subsidy would perhaps work better to give businesses the option of which tradeshows/exhibitions they wish to attend and allow them to claim back some of the costs incurred.

UKTI's internal structure also needs re-examination. The most positive and practical feedback tends to be about regional trade advisors and regional staff, who are more likely to understand the capacity of local companies' in clustered sectors to internationalise.

Overall, there needs to be a much wider as well as deeper network of commercial expertise within UKTI – which is not to say that this should simply involve more commercialised offerings to businesses. Many have complained that they felt that UKTI acted as a third party in the wrong way – as a middle man to other commercial services- and not in respect of facilitating enough business contacts. Working with established exporters to develop a mentoring network, particularly through events sponsored by or involving UKTI, would be of immense value, although some realism is required about how willing successful exporters will be to help potential competitors in their sector.

We look forward to engaging further with the committee on this issue.

Allie Renison
Head of Europe and Trade Policy
Institute of Directors
T: 020 7451 3366
M: 07894 801870
E: Allie.renison@iod.com