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The Engine
Issue 11

Keeping You Up To Date With Manufacturing & Engineering Insight

October 2022

Now, for tomorrow

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In a short poll concluded 15th September 2022 manufacturing companies were asked what they expected their biggest challenge to be over the next 6 months?

52%

52% answered energy costs

23%

logistics or customs issues

21%

parts or labour shortages.

The subject of rising energy costs, caused by a number of factors but heightened by the war in Ukraine, has dominated our recent discussions with clients.

Following the pandemic and unprecedented levels of state support, it was widely proclaimed that the Government wished to wean the country away from this and that increases in taxes were planned in order that monies were repaid to the Exchequer. Political factors have changed this and recent Government announcements have seen a six month business price cap put in place in order to provide some element of support to businesses at this time. Alongside this, the Government, and new Chancellor, Kwasi Kwarteng, has announced significant tax cuts in order to attempt to stimulate business investment and the wider economy.

As I write this, these tax cuts, alongside recent interest rate announcements have caused the Pound to fall on world markets. I am not going to attempt to predict what will happen next, however for this vital sector of our economy to have come through the pandemic to find itself facing another significant obstacle to its trading future is something that needs to be addressed.

The energy market for business, usually without caps, is in need of reform, providing and opportunity for cleaner forms of energy, moving away from oil and gas, are required if the journey to net zero is to be made. My colleague Jose Hopkins picks this up in more detail within his article later in The Engine, however suffice to say that this brings a significant challenge, but also an opportunity to entities of all sizes and across all aspects of their business.

23% of the respondents to our poll highlighted the challenges of logistics or customs issues. In previous surveys that we have conducted, initially 61%, and in the next survey, 49% reported changes within their business as a result of Brexit and highlighted increased paperwork as the most significant impact.

The relief felt, in many parts, with the Brexit deal being completed, soon evaporated as the realities of trying to export goods into and out of the country affected businesses. MHA's Customs and Duties team have worked with many clients helping them to put in place systems which have enabled them to, perhaps change supply chains or advise them on the required paperwork and duties and allow them to continue to work with overseas markets. One of these is highlighted later in The Engine. The position is still changing with, in particular continued uncertainties surrounding the border with Northern Ireland. Some companies have ceased to export. For some that was simply not an option, but this certainly remains a moving target and a further challenge to the sector.

Shortages of parts and labour were highlighted as the most significant challenge over the next 6 months for 21% of respondents. The fact that parts and labour are only 21% is, perhaps more of a reflection of the challenges faced by manufacturers in other areas than the true impact of this challenge.

A shortage of skilled labour is manufacturing's perennial issue and, unfortunately one which has no easy answer. Likewise supply chain issues, already in evidence before, have been heightened by the pandemic and Brexit. A recent discussion with a client stated that… whilst we try to ensure that China does not feature in our supply chains you can never be too certain, and their "Zero COVID" rule can result in a shut port and ever lengthening delays to the delivery of parts. We have then added to this, again the war in Ukraine and the impact not only to supply routes but also essential metals previously provided from that country.

It is clear to say that the manufacturing sector is experiencing significant headwinds and challenging trading conditions. For this innovative group of people this would usually present opportunity to continue to evolve their businesses and it may be that, with the newly announced tax cuts, this could be seen as sufficient stimulus… if, indeed a stimulus were needed. However, I do feel that Government's wish to reduce "state aid" will not come to pass and I suspect that we will, in fact need more of this during this challenging time.

What actions do we recommended manufacturing entities should be taking at this time?

1. Review their pricing model
2. Continue to review their supply chains (including the impact of net zero)
3. Consider the opportunities afforded by technological advancement
4. Collaboration opportunities
5. Lobbying Government – the need for a long term plan for the sector has never been clearer

Chris Barlow
Partner and Head of MHA Manufacturing

Energy costs

It is unsurprising that the current cost of energy is considered the top challenge facing manufacturing companies right now. Russia's invasion of Ukraine and the wider political response has sent gas prices soaring. And because gas plants are frequently the marginal provider in power markets, electricity costs have also increased sharply.

Many SMEs in particular have been hit hard as their fixed price contracts for energy have come to an end and they have faced a doubling or tripling of their energy costs.

As we head into the winter, energy intensive manufacturing companies have been wondering whether they will have to cease 24-hour production and begin to implement shutdowns due to fuel being unavailable or unaffordable. There is also the possibility that the Government will force heavy energy users to shut down at certain periods to ensure the availability of fuel and power to critical facilities like hospitals. If this happens it will be important for the Government to compensate the companies involved.

A new policy announced by the Government has provided some temporary relief for SMEs. The Energy Bill Relief Scheme will provide a discount on electricity and gas bills for all non-domestic consumers. It runs until 31st March and will be reviewed next year. This provides some welcome reassurance for companies, but uncertainty still exists in the longer term. Some analysts predict that high gas prices will persist for months or even years.

In the drive to reduce greenhouse gas emissions and get the UK to Net Zero, energy efficiency is often called the 'low hanging fruit'. This is because, in theory, it makes economic sense to invest in it, even in the absence of a subsidy. But for various reasons, many companies do not invest in energy efficiency measures that could save them money.

If any good can come out of this crisis, it may be a greater focus on business energy efficiency, reducing demand, and a more rapid shift to low carbon domestic fuels. But this will not be much comfort to companies struggling to pay their energy bills, and until prices stabilise and come down Government assistance will be required to prevent businesses that would otherwise be viable and successful in the long term from going to the wall.

Matt Rooney

Head of the Engineering Policy Unit
Institution of Mechanical Engineers

Trading into the EU: The Challenges and Top Tips for Smooth Movement of Goods

Since the 1st January 2021, many manufacturers, both UK and EU, have experienced serious issues in relation to their ability to manufacture and supply goods across the English Channel. Depending on the type of goods being transited, the issues vary making it difficult to make a sweeping assessment of the situation since Brexit.

During the recent ICAEW webinar we discussed some of the issues we had identified during discussions with our clients and it was clear that the attendees were majorly concerned about the additional bureaucracy that a customs border imposes. With just the addition of the customs declaration there is a cost and potential risk of delay that was not there prior to 2021. Also, additional paperwork may be required, especially for manufacturers in the Agrifoods sector. This has meant significant investment in extra staffing to manage these new processes, which in turn are required to make the movement of the goods as smooth and timely as possible.

For many UK manufacturers, there are pre-existing supply chains which involve the purchase of parts and components from the EU. Although the UK/EU Trade Agreement attempts to facilitate trade by minimizing the potential for customs duties, this is restricted to 'Originating' goods. Many UK manufacturers will now need to maintain additional records to evidence to HMRC that their goods are 'Originating' and therefore subject to the zero-tariffs.

Depending on the finished product, the evidence required could cause significant administration requirements as these need to be reviewed regularly. Such is the case that we have heard from clients that their suppliers are not willing to invest in the administration required to evidence the origin of their products, resulting in the full rate of customs duty being applicable on importation.

This increases the costs to the manufacturer and potentially creates issues when determining the origin of the finished product. We would recommend that businesses review the impact of customs duty within their supply chain to ensure that any costs are considered as part of determining the price of the finished goods.

Another major issue that manufacturers are experiencing is the continued fluctuations in supply chains due to the imbalance of freight containers caused by the Covid Pandemic.

Businesses should consider managing their stock in different ways to ensure that they can maintain satisfactory levels to minimize the impact of a supply chain collapse. This increases pre-manufacturing costs due to investment in stock that may not be required for up to 12 months.

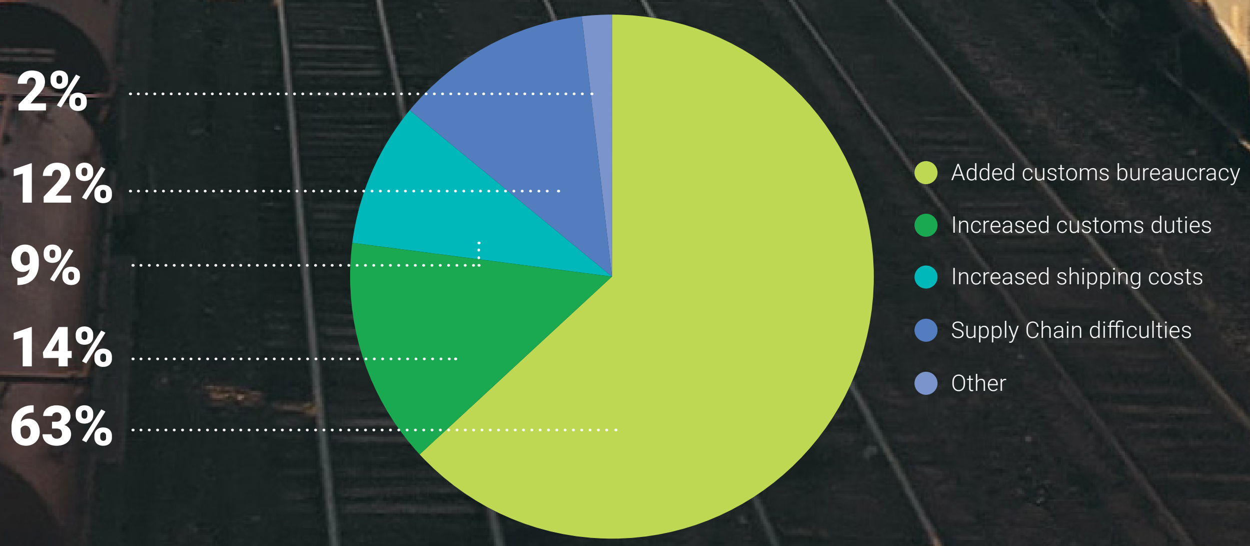
As there is now a customs border, manufacturers who are part of a processing supply chain now should consider the possibility of using Customs Special Procedures to manage their UK duty liabilities. This is especially important for businesses who do not own the parts or raw materials imported for use in the manufacturing process as the UK's policy on the reclaim of import VAT only allows the owner of the goods to make such a claim.

We would recommend that any business who imports goods for processing considers using Inward Processing to mitigate the risk of incurring customs duty and import VAT.

HMRC are responsible for ensuring UK importers maintain a satisfactory level of compliance and there is a risk that businesses will be inspected in the near future. We strongly recommend that, if not in place now, businesses review their procedures for retaining and checking their customs declaration. Failure to do so could result in errors not being identified and render the business liable to customs debts and penalties.

Andrew Thurston
Customs Duty Consultant

What do you consider is your biggest barrier to exporting goods to EU?



Case Study: Interior Products Group

Interior Products Group operates in two business areas: the manufacture and sale of timber-based fit out products including laminated panels, architectural profiles and doors, used in the leisure sector of caravans and holiday homes and the construction sector; and the manufacture and sale throughout the world of commercial wall coverings. Manufacturing of the timber-based products is carried out by Morland, a UK trading division of IPG in the UK. IPG's supply chain is worldwide, importing quality materials from supply partners across the globe, operating an environmental policy that prohibits the use of illegally logged timber and supports sustainable forestry.

The Challenge

In order to relieve EU customers of having to deal with their importation obligations, a separate Dutch subsidiary (Morland BV) was established to which the UK company sold goods and dealt, in house, with both the required export and import declarations. The Dutch company was then able to make sales to EU customers from stock warehoused in the Netherlands. IPG approached MHA with two logistics issues, both of which had tax implications. Firstly, Morland BV were dissatisfied with the service standards at their Dutch warehouse and were considering relocating to Belgium. Secondly, Morland BV were fulfilling orders from customers in the Republic of Ireland from stock held in the UK, rather than from within the EU.

The Solution

MHA provided support by linking IPG with our colleagues in member firms of Baker Tilly International in Belgium and Ireland. Advice in those countries ensured that VAT registrations and compliance were consistent with the movement of product. Belgian warehousing has proved successful using a Belgian VAT registration for invoicing business customers throughout the EU. In Ireland, a retrospective registration was required, but this has been achieved seamlessly and Morland BV are now in the process of collecting Irish VAT from customers in that jurisdiction. In the Netherlands, Morland BV uses its 'one stop shop' registration to account for VAT on B2C sales at the VAT rate which applies in the consumer's country.

Colin Sharp, Finance Director at IPG, commented "The future is bright for IPG. We now have the opportunity to develop our sales model throughout the EU particularly using our recently launched e-commerce platform which is compliant with the VAT requirements in the various EU jurisdictions and is available for B2C and B2B. The reception of the product by EU customers particularly, France, Germany, Portugal and Spain is very exciting as they have expressed how impressed they are with the quality of the product compared to existing alternatives".

ESG in the Supply Chain

Sustainability, the Journey to Net Zero and incremental ESG regulation will prove to be the greatest business challenge of the decade with significant risk and opportunity brought not just by climate change but all environmental, social and governance factors that investors, consumers and customers, capital providers, supply chains, colleagues and competitors will be focusing on in their decision making.

What is the meaning of ESG for the Manufacturing sector?

The "E" of ESG aims to address the impact on the physical environment and the risk of a company and its suppliers derived from climate change. This includes areas such as climate change and GHG emissions reporting, air pollution, water and waste management, circular economy principles and ecosystems rehabilitation.

The "S" of ESG relates to social issues covering the organisation's impact both on internal workers and communities (including the societal impact in sourcing raw materials from locations perceived with lower labour standards when compared to the UK). The "S" also covers the risk associated from societal actions from suppliers, consumers, and communities in which companies operate. The areas included are labour practices, health and safety, community engagement, diversity, and inclusion (including in the supply chain) and community relations.

The" G" of ESG largely relates to a manufacturer's internal governance structure, including how rights and responsibilities are distributed within an organization. The aim of the "G" is o assesses to assess timing and quality of decision making and governance structure with the aim of ensuring a positive societal impact. The areas included are business ethics (including data security), supply chain management, capital allocation and policies (including external disclosures and reporting).

Why do manufacturers need to review this now?

UK will become the first country in the world to make 'Task Force on Climate-related Financial Disclosures' (TCFD) aligned disclosures fully mandatory across the economy by 2025, going beyond the 'comply or explain' approach.

This will increase the pressure to improve transparency across supply chains which will create considerable challenges. Your suppliers may want a carbon strategy, but their own size, budget and capabilities are inherently limited.

Manufacturers are not able to determine their own ESG strategy without including the impact of their suppliers as they represent the largest portion of a manufacturers' carbon footprint (i.e scope 3 is directly related to the reduction in emission from your value chain). Understanding of the various challenges that could affect everything from market access to reputation can assist you in mitigating your risks that may create a material business disruption.

Top 6 Considerations when Performing your ESG Assessment on the Supply Chain?

1. Develop a screening supplier ESG questionnaire to help implement an ESG supplier framework (for example ask your suppliers the timing as to when to expect to report their carbon data to help you measure your carbon footprint).

2. Facilitate training, workshops, and roundtables for the organisations in your supply chain.

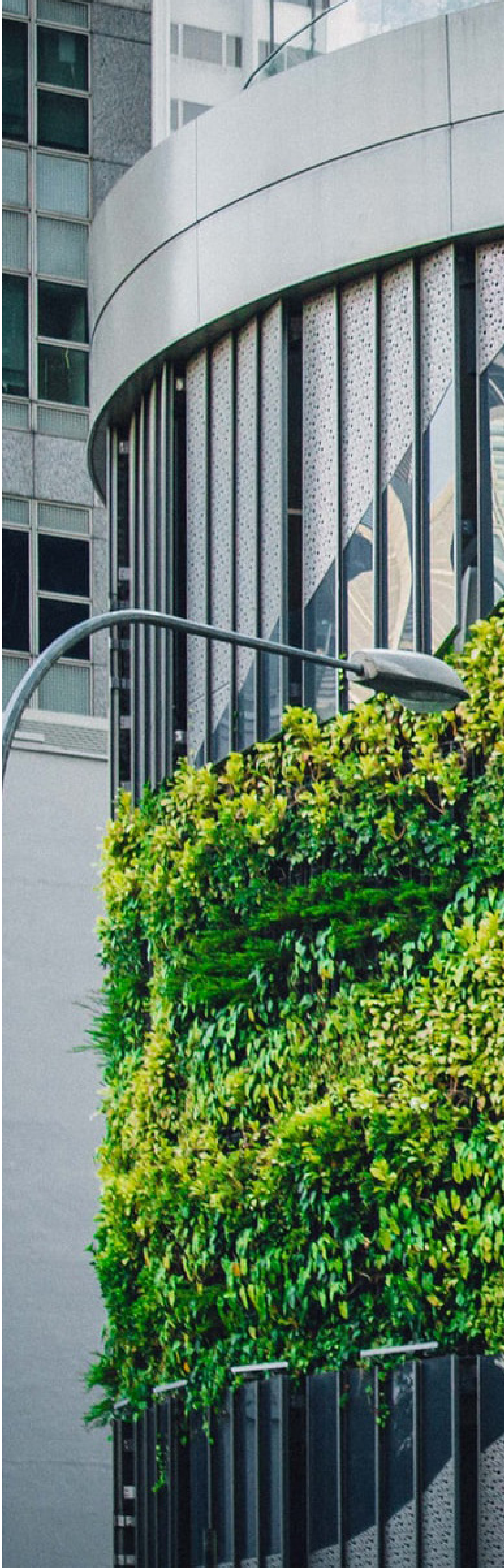
3. Don't forget about the "S" and the "G", do encourage the progress and work with your suppliers to create and promote inclusive environments. Encourage your suppliers to pay the living minimum wage!

4. Draft an ESG supply chain code of conduct and evaluate any assurance to the information submitted by your suppliers.

5. Mapping the impacts of the value chain is key! Gain a detailed understanding of the risks and potential opportunities in your value chain and document a flowchart of your product lifecycle. This will help understand the location of raw materials which can then be mapped to the potential physical risks in these locations (including considerations on how these are transported and distributed).

6. Encourage within your organisation that all your sites and manufacturing plants achieve BES6001 responsible sourcing accreditation.

Jose Hopkins
Sustainability & ESG Technical Director



About MHA

MHA is an network of progressive and respected accountancy and business advisory firms with members across the UK.

Our member firms provide both national expertise and local insight to their clients. As an independent member of Baker Tilly International, a top 10 global advisory network, MHA offers clients unparalleled access to a broad range of in-country international specialists where overseas projects are on the horizon.

Our Sector Approach

MHA allows clients to benefit from in depth sector knowledge in addition to specialist accountancy services and expert business advice. Manufacturing and Engineering is a key sector for MHA, and our industry experts understand the challenges and opportunities within the sector. With MHA's sector experience, and local, national and international knowledge, our team is well placed to provide leading advice.

1076
Professional staff

107
Partners

18
Offices nationwide

£118m
Million turnover

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