In association with:

RSM

The Manufacturers' Organisation

125 YEARS BACKING BRITAIN'S MAKERS

CASH, CREDIT & CONTINUANCE:

THE STATE OF LIQUIDITY IN THE MANUFACTURING SECTOR

MakeUK.org

CONTENTS

INTRODUCTION

The manufacturing industry in the UK has endured its worst downturn in over thirty years, since Make UK's modern records began. Almost overnight, manufacturing businesses, along with other sectors in the economy, found their trading cease, their production facilities wind down and their horizons bleak as individuals, businesses and governments were wracked with uncertainty over how long the ordeal would take to pass.

Although one thing was certain, if manufacturers were to survive this yet-unknown period of time, extremely diligent management of their cash and credit would be required. Even with much needed Government support, the right answer was never clear. Remain operational, take out further finance and risk bleak demand in the market? Temporarily cease operations, place staff on job support schemes and hold out on what limited cash reserves there are? In practice, many businesses took a variety of these approaches throughout the pandemic, attempting to make the most of mercurial market conditions that saw confidence rise and fall on an almost monthly basis. From lockdown extensions, travel restrictions and workplace restructuring, navigating the pandemic required businesses to remain nimble and act quickly.

Now, as businesses consider themselves within the recovery phase, it's important that the industry takes stock of the damage, risks and opportunities that have developed. This report, based on a survey of 211 senior financial decision-makers in UK manufacturing businesses, reveals the state of the industry's liquidity, the risks to its financial health, how businesses are taking action to secure their cash flow, and what the future holds for an industry now seeking to make the most of lessons learned in the pandemic.

ASSESSING THE INDUSTRY'S LIQUIDITY

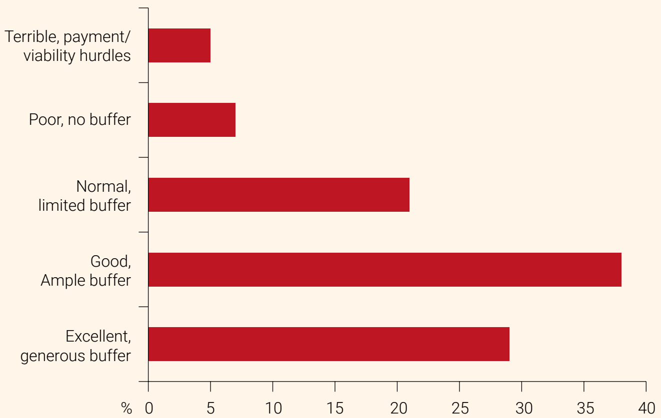
MANUFACTURING LIQUIDITY OVERVIEW

For almost two years now, manufacturers have been forced to place greater reliance on their liquidity reserves as the pandemic held the UK's economy in a stranglehold. Specific pressures have ebbed and flowed during this period, from the first national lockdown near the start of 2020 to soaring confidence at the inception of the vaccine programme. However, unlike sectors such as hospitality and retail, legislature permitted manufacturers to continue operations throughout the crisis. While this was certainly a welcome opportunity from Government to keep the gears of industry turning, too often it was pressure from the market in the form of wavering supply and demand that limited manufacturers' ability to prosper in this period.

At the outset, 12% of industry report that their liquidity position is dissatisfactory, with a further 5% of firms indicating that their liquidity position is dire, entailing business viability concerns.

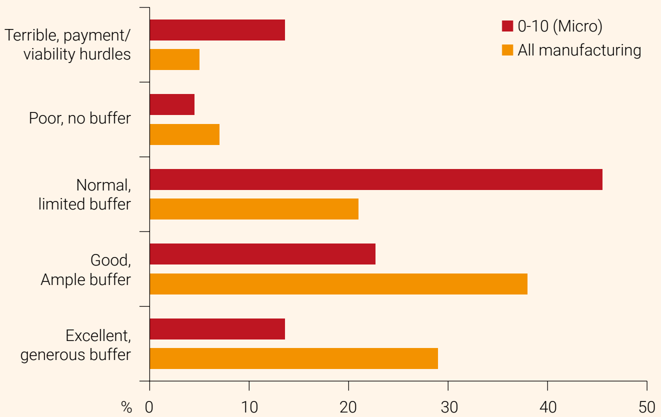
When the data is broken down by business size, based on employee counts, a pessimistic trend emerges as we move from larger firms to smaller ones. Of particular note is the micro-business category (those businesses with a headcount of 10 or fewer employees), which saw 14% of manufacturers reporting terrible liquidity. Similarly, while the overall average of manufacturers reporting a better than normal liquidity situation stands at 67%, within the micro-business category only 36% of businesses report a better than normal circumstance. The increased likelihood of these smaller firms to report poor liquidity now, in the emergence from the pandemic, shows the extra strain these businesses have come under throughout the nation's ordeal. Irregular trading activity, as we saw in the pandemic, harms these businesses more than the rest of

Chart 1: How would you best describe your business' current cash flow?



Source: Make UK & RSM Survey - October 2021

Chart 2: Smaller businesses report worse cash flows than average



Source: Make UK & RSM Survey - October 2021

the field, with small businesses' cash flows being more dependent on regular trading revenue as they are less likely to have significant cash reserves.

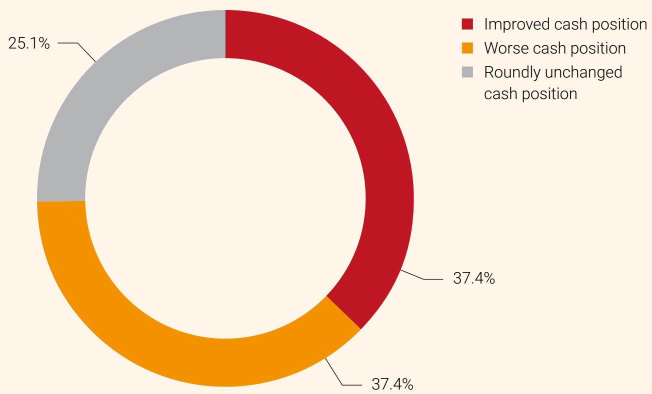
To further our understanding of how manufacturers have arrived at the cash positions they find themselves in, we need to assess how liquidity buffers have evolved since the start of the pandemic. We asked businesses to report whether their cash position was in an improved, unchanged, or worsened state compared to just before the pandemic in the UK, and separately, which period in the last 5 years has placed the greatest strain on their businesses' liquidity stocks.

The results show an interestingly matched split, with 37.4% of manufacturers reporting improved cash positions and worsened cash positions in equal measure, and the remaining 25% of businesses indicating a roughly unchanged circumstance. Given the unrelenting challenges over the past two years, an unchanged circumstance could be considered a success in the face of such headwinds.

Given just over a third of the industry finds itself in a worse liquidity circumstance now compared to pre-pandemic, what separates this group of businesses from the others who find themselves in a preferable position? Some explanation emerges when we look at the toughest periods for businesses' cash flow over the past five years. Most manufacturers (41%) indicated that the early pandemic period (2020 Q2 – 2020 Q4), the period which contained the first 'full lockdown', was the period of greatest strain on their cash. However, if we solely focus on that group that reported a worse cash position now compared to pre-pandemic, businesses within this category indicate that the greatest squeeze on their liquidity reserves came either in the late pandemic period (2021 Q1 – 2021 Q2) or in the current period. 48% of firms that reported a worsened cash position experienced their worst liquidity pressure in either the late pandemic or current period, whereas, with those who reported an improved cash position, only 29% reported the late pandemic or current period to be their worst season for cash pressures.

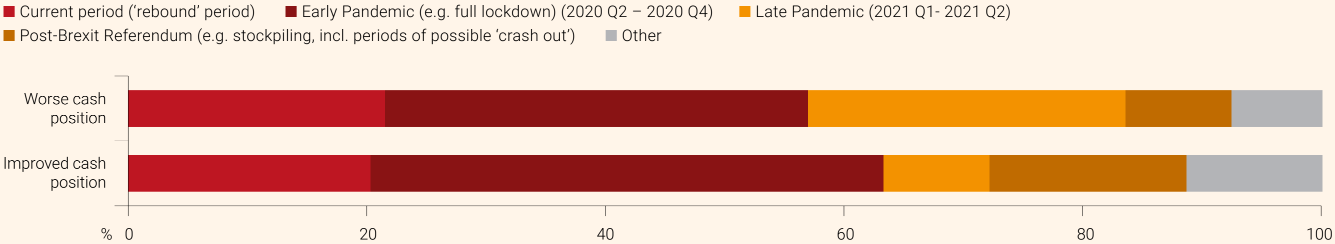
The inference here is clear, those businesses that endured their cash 'crunch' earlier on in the pandemic's trajectory have had more time to recover their cash levels and take greater advantage of government support facilities than those who have faced their cash squeeze in more recent months. As we'll see later in the Debt section of the report, those within industry who report healthy liquidity buffers are often laden with debt liabilities, liabilities which significant proportions of the industry report as unsustainable.

Chart 3: How is your business' current cash position compared to the pre-pandemic circumstance?



Source: Make UK & RSM Survey - October 2021

Chart 4: In what recent period did businesses' cash squeeze come? Broken down by those who report improved and worsened cash positions now



Source: Make UK & RSM Survey - October 2021

GOVERNMENT LIQUIDITY SCHEMES

During the pandemic, the Government announced a variety of support schemes to help businesses through their challenges. Among these were schemes specifically for Government-backed business loans and finance agreements, namely; the Coronavirus Business Interruption Loan Schemes (CBILS and CLBILS), Bounce Back Loan Scheme (BBLS), the Future Fund and Covid Corporate Financing Facility (CCFF). All these schemes have now closed, although there is an additional scheme, the Recovery Loan Scheme (RLS) which remains open at the time of publication.

Overall, £80.43 billion worth of loans were approved across the CBILS, BBLS, CLBILS and Future Fund schemes[1]. The Bounce Back Loan Scheme proved to be the largest scheme in terms of the value of loans issued, accounting for 59% of the total amount loaned from these schemes, excluding the values held within the CCFF, which were designed for large companies only. The manufacturing sector received £6.43 billion of these loans, accounting for 9% of the total value of all coronavirus loans issued. The manufacturing sector was the fourth-largest recipient, in terms of value, of these loans across the entire UK economy spectrum. The manufacturing sector was also only one of four industries that received a loan value in excess of a percentage of its proportion of the total business population (1.8 times the value), indicative of the heightened level of financial support that was required in the manufacturing sector compared to other industries.

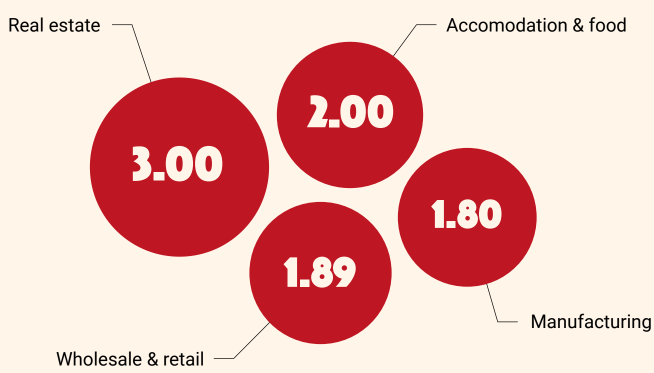
According to analysis carried out by RSM on CBILS funding, the data currently available suggests the manufacturing sector accounts for more than 13 per cent of all businesses that have claimed CBILS support. Based on risk factors such as poor payment performance and credit score, RSM's analysis shows that more than 46 per cent of manufacturers that gained CBIL's support are at a high or higher than average risk of corporate insolvency.

The survey results show that manufacturers' uptake of the Government's liquidity schemes was wide, but far from unanimous, with 64% of firms reporting use of the schemes at some point in the pandemic.

MORE THAN 46% OF MANUFACTURERS THAT GAINED CBIL'S SUPPORT ARE AT A HIGH OR HIGHER THAN AVERAGE OF RISK CORPORATE INSOLVENCY

Source: RSM internal data - October 2021

Chart 5: Loan values received by sector from Government financial support schemes as a ratio to the sector's business population - the four largest ratios from the 16 sector UK economy breakdown



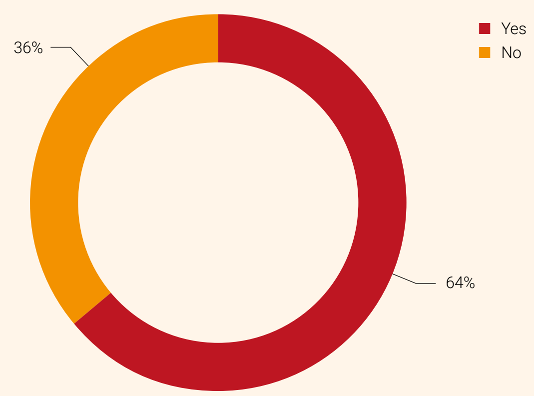
Source: Make UK analysis of British Business Bank data, 6 July 2021

[1] HM Treasury data published in Commons Library Research Briefing, 13 October 2021

HIGHER BORROWING RATES IN THE AUTOMOTIVE AND AEROSPACE SUBSECTORS

However, that figure balloons to 83% and 84% for the Aerospace and Automotive subsectors respectively. The manufacturers within these two subsectors are the most likely to have accessed Government liquidity schemes out of all manufacturing subsectors, at approximately a 20% greater rate than the overall manufacturing average. Exhibiting a negative correlation, these two subsectors also saw the greatest percentage decline in their total Gross Value Added (GVA) in the year 2020, so it is not entirely unexpected that manufacturers from these sectors were more likely to take on Government-backed support.

Chart 6: Has your company accessed any of the Governments liquidity schemes?

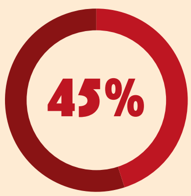


Source: Make UK & RSM Survey - October 2021

Excessive caution exhibited in the face of uncertainty?

Exactly what support was available to manufacturers from the government was not always well understood, particularly within the SME space. When support was available, even though perhaps it was not required at the time, some businesses felt compelled to take on that support given the uncertainty.

Indeed, this was the case for just under half of UK manufacturers who sought out Government liquidity support, with 45% reporting that the liquidity support schemes were applied for just as a precautionary measure.



report that liquidity support was merely a precautionary measure and in practice was not required

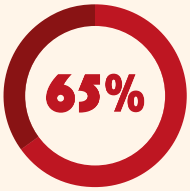
Not ignoring the benefits that this group of manufacturers received by holding a spare cash buffer amongst the pandemic, the debt burden has been increased for those who still hold these loans now in the 'rebound' period.

THE CONSEQUENCE OF LIMITED LIQUIDITY

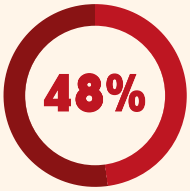
Healthy liquidity is important in every aspect of a manufacturer's business operation, from product development and marketing activity to the payment of both suppliers and employees. Manufacturers need to make difficult decisions about the hierarchy of these operations' importance when they lack sufficient liquidity for normal functioning. When a UK manufacturing business endures pressures on cash flow, where is it in the business' tapestry that the thread begins to unravel?

The most negatively affected aspect arising from a liquidity squeeze for manufacturers is their ambition for business growth, with 65 % of firms reporting that their plans for growth were negatively affected by a cash crunch. Manufacturers throughout the past two years have found themselves repurposing cash that will have been earmarked for investment and business expansion into immediate business continuity. This will have continued implications for the industry well after the pandemic's passing, as firms' plans to innovate will have been set back considerably.

Other negatively affected business functions include the ability to fulfil orders and the purchase of inputs, with 48% and 52% respectively reporting that these functions suffered as a result of limited liquidity.



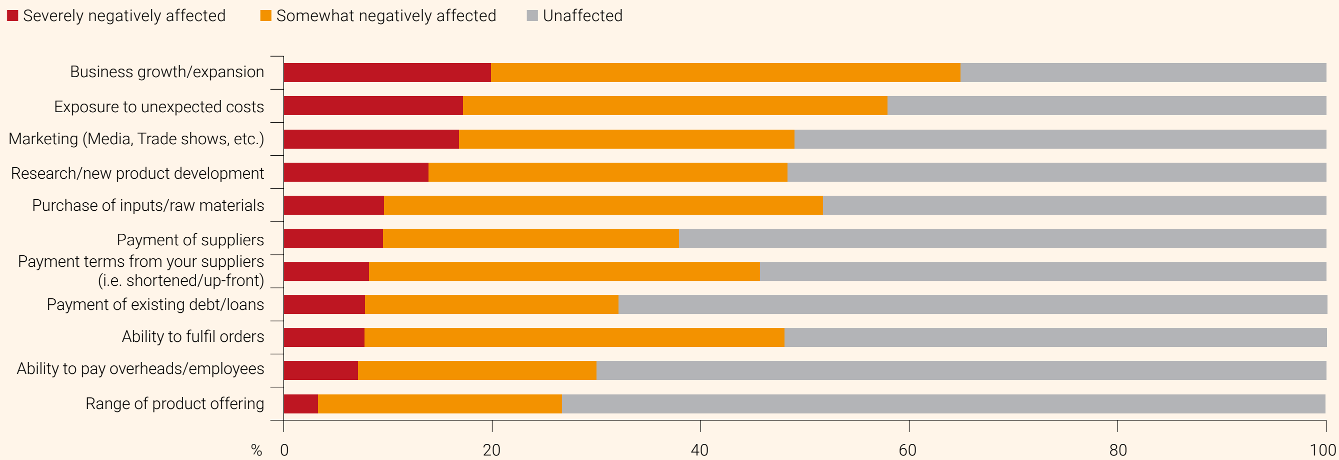
of manufacturers have had their business' growth plans hampered by the pandemic's pressure on firms' cash



of the industry had difficulty fulfilling orders because of limited liquidity

The scarcity of raw materials, which is continuing to plague the sector despite the ebb of Covid-19's grip on the economy, has caused significant challenges for manufacturers over the last two years. Initially brought to a head by the pandemic, subsequent input price increases, further fuelled by troubled logistics, have seen manufacturers struggle to fulfil the orders they hold. This has fed a vicious circle for some manufacturers, who found themselves unable to fulfil what were already suppressed demand streams. This has further weighed on cash flow as customers then left for alternative providers.

Chart 7: The impacts of limited liquidity on business operations



Source: Make UK & RSM Survey - October 2021

RISKS

Risks to a business' liquidity are an enduring feature of the business environment, exacerbated by the market turbulence over the past few years. While firms will endeavour to plan to mitigate the worst of the negative effects should these risks come to pass, in many cases, it is those risks that weren't identified at the outset that leave businesses most vulnerable. As the country's economy grows out of the pandemic induced recession, risks to manufacturers' cash flow remain. Having gone through a recent period where business cash reserves have been pushed to their limit, manufacturers are acutely aware of how important good liquidity management practice is as we move into (and through) 2022.

From assessing the relative impact of the most likely threats to businesses' liquidity to establishing a hierarchy of the most prominent immediate risks to companies' financial safety, we reveal how the liquidity risk landscape will impact manufacturers in the short to medium-term future.

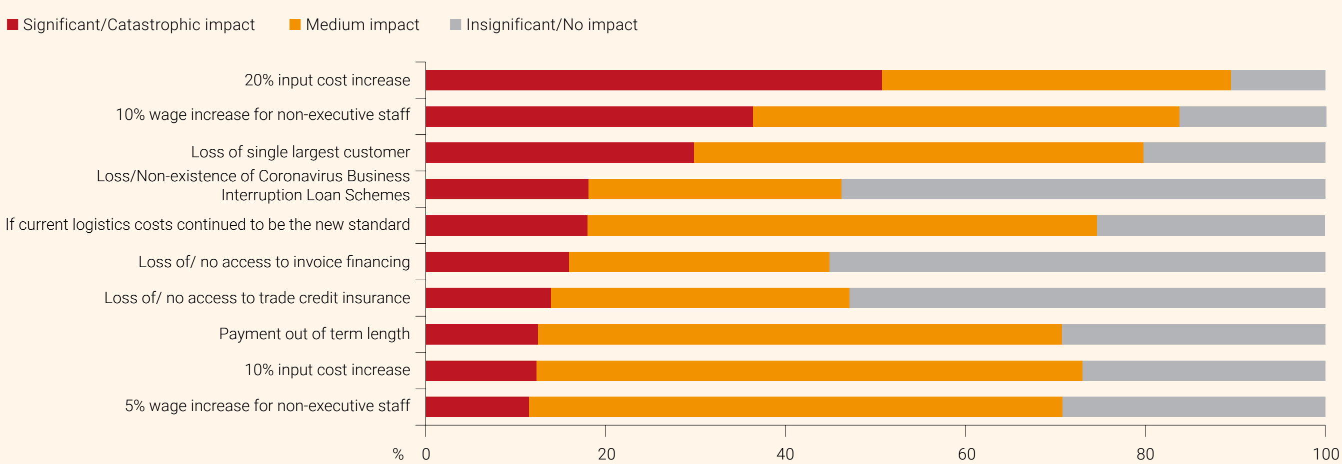
SCENARIO RISK ASSESSMENT

Identifying where manufacturing's greatest post-pandemic vulnerabilities lie will be key for businesses, stakeholders and policymakers alike. In the first instance, understanding the proportional likelihood, and impact, of a certain risk to a business' cash reserves will allow some preparation. Just as in recent history, at the start of the pandemic, the inability to prepare for what transpired to be an extremely sudden slowdown, and cessation in some cases, of industrial activity brought about the worst decline in output figures in Make UK's thirty-year research history.

Secondly, understanding where vulnerabilities lie will afford stakeholders and policymakers a target to which the tools at their disposal can be used to mitigate the industry's exposure to these risks in proportional measure.

> "The inability to prepare for the pandemic brought about the worst decline in manufacturing output figures in 30 years of research history."

Chart 8: Which scenarios pose the greatest threat to business' cash?



Source: Make UK & RSM Survey - October 2021

Rising input costs: a sustained threat

The survey identifies the forerunning risk, and perhaps the most emergent too, to be a 20% increase in input costs. The ramifications of this risk coming to pass are unsurprisingly severe, with 51% of manufacturers indicating that this scenario would have a catastrophic impact on their liquidity, implying that their current business model would not be viable in that circumstance. More widely, 90% say that the same scenario would have an intermediate or worse impact. Just a few years ago, the likelihood of this risk would have been assessed to be considerably slimmer. **Now, with the latest producer price inflation data showing that the headline rate of input prices has increased by 13.0% per cent on the year to October 2021[2], a continued upward creep of input price pressures is an all too plausible risk for manufacturers.**

In comparison, only 12% of manufacturers indicated that a 10% increase in input cost prices would bring about a catastrophic impact on their business. This reveals a viability tipping point for UK manufacturers in the post-pandemic environment concerning the growth of input pricing. Many manufacturers will already be finding themselves paying at least 10% more for inputs than they are typically used to, but the survey indicates that the majority of manufacturers' liquidity constraints would not enable them to absorb a 20% input cost increase, should the input price inflation continue.

The continued pressure being endured by manufacturers on input pricing is being driven chiefly by three factors, which are not mutually exclusive. First, sustained industrial demand as the world began production at pace, with various countries emerging from their own experience with the pandemic, caused a sudden spike in input demand. It was certainly expected there would be a spike in demand following the emergence from the pandemic, but manufacturing activity surged beyond what forecasters had expected in most developed nations, indeed, Make UK's very own forecasts for manufacturing activity in the first half of the year were surpassed.

Secondly, widespread material shortages, from plastics to semiconductors, continue to limit the supply of input viability at the source, hampering access and raising prices. Finally, a global logistics market in atypical disarray, from the infamous lack of UK HGV drivers, to the backlog of shipping containers held in the far east and the skyrocketing prices of logistic services themselves, all translating into a greater final input cost for manufacturers. Further exacerbating logistics disruption, businesses on both sides of the Channel have had to deal with new trading regulations following the UK's exit from the EU. Before the UK's exit, many manufacturers that were sourcing inputs from the EU had no prior experience with the formal technicalities of international trade, so conforming to this new requirement caused further delays in the supply chain, particularly where improper paperwork was accompanying shipments.

The second most impactful risk scenario, as identified by manufacturers, is a 10% wage increase for non-executive staff. Just over 36% of manufacturers indicated that this scenario would have catastrophic implications for their business. Again, not dissimilar to the plausibility of continued input cost increases, rapidly rising labour costs are already being endured by manufacturers. With the latest UK-wide ONS labour wage data[3] showing that the year-on-year three-month average wage increase stood at 7.2% in August, and 5.8% in September, a 10% scenario is worryingly close. Wages have been tracking upward since June of 2020.

[2]ONS Producer Price Inflation, November 2021
[3]ONS Whole Economy Year on Year Three Month Average Wage Growth, November 2021

The scenario with the third most significant effect on cash flow is that of the loss of the business' single largest customer. Just under a third of manufacturers says that the loss of their single largest customer would have catastrophic impacts on their business' liquidity. This data also reveals how much of the UK's manufacturing sector is exposed to this risk, as the inference can be readily made that approximately 30% of the UK's manufacturing base is business-reliant on a single customer.

of the UK's manufacturing base is business-reliant on a single customer

IMMEDIATE RISKS

The fast-moving nature of the industry's post-pandemic recovery brings with it rapidly evolving risks. What manufacturers may know to be a poignant risk to liquidity security in the coming years may be very different to the risks that will emerge in only the coming months. While the industry has now developed a degree of experience in coping with uncertainty over the past few years, given just how mercurial the business environment has been in that time, it remains challenging to build specific resilience against an unknown risk.

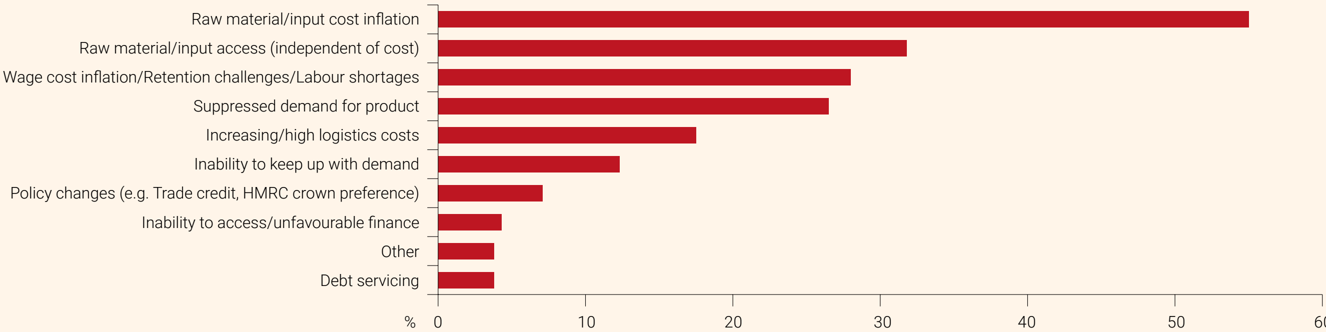
Cost inflation is by far the most prominent risk to manufacturers' liquidity as we approach the end of the year. The majority of manufacturers, 55%, selected this option as one of the two they could make. In a similar vein, the second most prominent risk in the immediate term was the explicit *access* to those raw inputs, independent of cost. 32% of manufacturers, approximately a third of the industry, indicated that even a blank cheque wouldn't resolve their current and incoming challenges with regard to acquiring raw input.

Combined, both input cost inflation and input material access make up for 87% of manufacturers' most pressing risk selections, detailing the overwhelming severity of the issue of sourcing inputs within the industry at present, and in the months to come. In addition, manufacturers must also grapple with the challenges that proper goods marking poses considering diverging regulation following the UK's exit from the EU. Uncertainty around CE/UKCA marking extensions and applicability further exacerbate the challenges businesses face in accessing goods.

Labour force is certainly considered an input in manufacturers' production processes, and in turn, brings about associated costs. The third most prominent immediate risk highlighted by firms is wage cost inflation and hiring challenges. 28% of respondents selected this option as one of their two most pressing risks to their liquidity in the coming months. The dual effects of a sudden spike in both global and domestic orders, combined with the novel difficulty in hiring skilled labour from the European Union has exacerbated a skills gap in the manufacturing industry that pre-existed before the pandemic's inception. At both ends of the spectrum, manufacturers are struggling to recruit talented young staff, whilst also struggling to retain experienced staff as they prove to be an elusive and in-demand commodity across the entire market.

However, the experience of booming demand in which firms cannot keep pace is not the story for all UK manufacturers. 27% of businesses reported that it was in fact a suppression in the demand for their product that was posing the greatest immediate risk to their business' liquidity.

Chart 9: Manufacturers' select the two most pressing risks to their business' cashflow just focussing on the pre-2022 period



Source: Make UK & RSM Survey - October 2021

GAINING FINANCIAL SECURITY

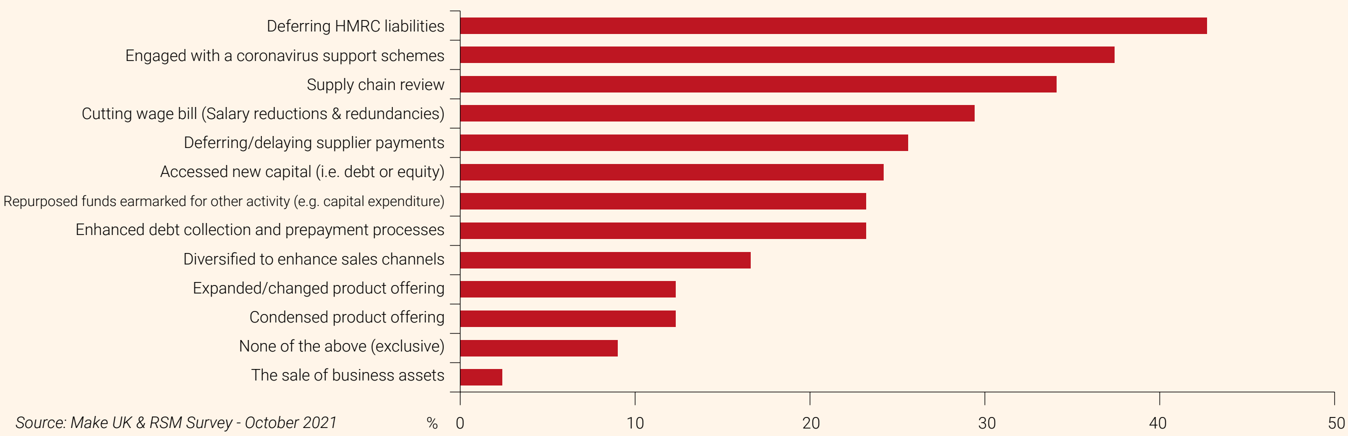
BUSINESS ACTION

As the economy shifted into a panic state in March of 2020, businesses needed to take action to safeguard their cash reserves, ensuring they had as suitably laden pockets as possible to face the uncertainties before them. At this early juncture, little did the industry know just how pervasive this event would transpire to be, which in turn would lead to a myriad of strategies that businesses undertook with regards to their liquidity in order to secure their future.

An overwhelming 91% of manufacturers indicated they had taken either one or more of the liquidity guarding steps detailed in the survey. On average manufacturers took three of the detailed steps in response to the crisis. So, which of these steps did manufacturers take, and which were the most prolific?

Perhaps the most simple, immediate and effective step to easing firms' cash flow pressures at the height of the pandemic by Government was the announcement of businesses being able to defer HMRC liabilities. Value Added Tax (VAT) deferral, and other tax deferrals, such as corporation tax, could be made under request to HMRC. In most cases where these other deferrals were requested, a three-month extension was given. Just over 4 in 10 manufacturers report having deferred an HMRC liability over the pandemic's period, indicative of the wide uptake that this policy had. Albeit a short-term policy, with many calling for its extension, it can roundly be considered a success, as it enabled those cash-strapped businesses much needed breathing room. Indeed, Make UK itself campaigned for the policy's introduction in the first half of 2020, as a policy option at the government's disposal with

Chart 10: New strategies undertaken during the pandemic to safeguard businesses' cash flow



Source: Make UK & RSM Survey - October 2021

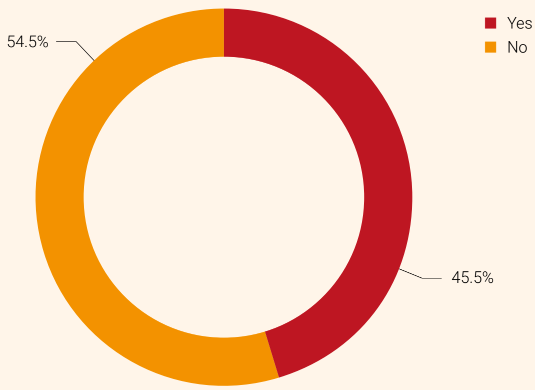
a relatively small administrative burden compared to more complex schemes, heightening its eventual likelihood of adoption.

The pandemic, for better or worse, shone a light on just how fragile many manufacturers' supply chains were. In many instances, businesses didn't have end-to-end sight of their supply chain, leaving them ill-informed of any potential knock-on effects if a supplier of one of their inputs were to have difficulty in delivering, as they too often found out the hard way. Excluding the utilisation of Government schemes, undertaking supply chain reviews transpired to be the most prolific business-led action that manufacturers took to safeguard their business' cash flow. A sudden stoppage in the flow of production inputs can be catastrophic if a firm has no alternatives in place, so building in resilience to a business model by understanding and rectifying the vulnerabilities in the supply chain proved to be of paramount importance.

Two liquidity-guarding actions were similarly used by the industry, but are interestingly juxtaposed in their nature. 27% of manufacturers reported deferring or delaying payments to their supplier as a means of regulating their cash reserves, but in the same fell swoop, 23% of manufacturers also reported enhanced debt collection and prepayment processes. These opposed actions highlight the increased importance manufacturers placed on the liquid cash they held while trading through the pandemic, with relatively equal quantities taking these 'offensive' and 'defensive' measures concerning their intra-industry payments.

As would have been an unfavourable resort for all businesses, it's good news for the sector that so few manufacturers were forced into the sale of business assets to maintain liquidity, with only 2% of businesses reporting taking such a step in response to the pandemic.

Chart 11.1: Respondents indicating whether they have changed their approach regarding payment terms in the last year



Source: Make UK & RSM Survey - October 2021

PAYMENT TERMS

As we highlighted earlier, the issue of payment terms has been thrust into the limelight by the crisis, as firms on both sides of the transaction seek to maximise the time with which they hold liquidity. In most cases, the concern around payment terms does not stem from a belief in a party's malevolent intention to never pay, rather, the intentional staggering of payments to the benefit of the payer and detriment of the payee.

On average, across the manufacturing industry, 46% of manufacturers have indicated that they have changed their approach to payment terms over the last year. However, what's of even more interest is when we look at those changes in payment terms that have been distributed throughout the industry when we take firms by their size.

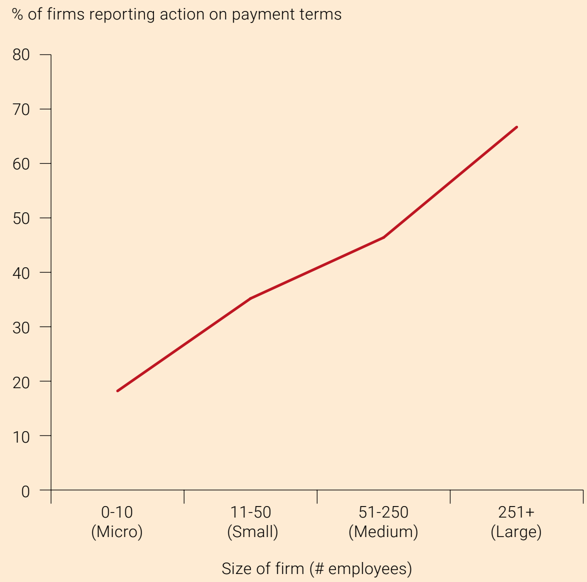
Larger companies are quicker to act on payment policy

A strong correlation emerges between the size of businesses, and their likelihood to have changed company policy on payment terms. The survey's analysis reveals that the largest businesses were almost 50% more likely to have changed their payment term policies than that of their smallest counterparts. This correlation is observed throughout the sizing indices, from micro, small, medium to large businesses.

Smaller companies typically have less ability to dictate terms to their customers, especially if they are selling up into a supply chain, as they must grapple with the pitfalls of the oligopsony (few buyers, many sellers) structure they find themselves in. Their customers may well have many alternatives to source a given input, but a small business may have very few alternatives to whom they can sell their product – leaving them at the behest of those larger companies' payment policies with little power to demand change.

Focusing on supply chains, larger companies will have more power to dictate payment terms to customers, by virtue of their likelihood to be in an oligopolistic (few sellers, many buyers) position in contrast to those smaller companies. Customers of their product are more likely to have fewer alternatives in the market, and so the compelling force to comply with the larger companies' payment policies will be strong.

Chart 11.2: Likelihood of action on payment terms in the last year increases with company size



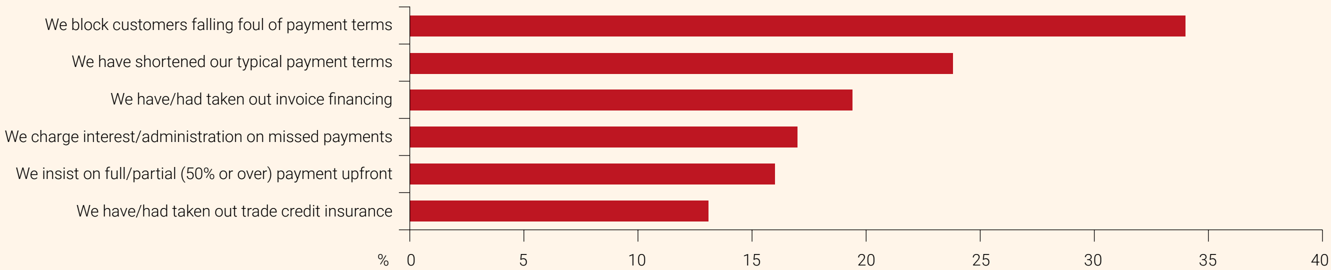
Source: Make UK & RSM Survey - October 2021

The survey results show just how many manufacturers have changed their payment policies in the last year, but how are they being changed? By far the most common novel action taken is the blocking of customers falling foul of their business' payment policy. Just over a third of respondents (34%) indicated that they had started blocking customers and just under a quarter (24%) have shortened their typical payment terms.

The blocking of customers being the prolific action in regard to payment terms reveals just how much of an emphasis manufacturers have placed on the preservation of their liquidity levels during the pandemic. This indicates that manufacturers are willing to sacrifice the potential of future businesses from a given customer in exchange for greater immediate liquidity certainty, a phenomenon you'd be unlikely to see prior to the pandemic's strike so widely.

1/3 OF **MANUFACTURERS** HAVE **STARTED BLOCKING CUSTOMERS FALLING FOUL** OF THEIR **PAYMENT TERMS**

Chart 12: Manufacturers indicating what steps they have taken in the past year regarding payment terms

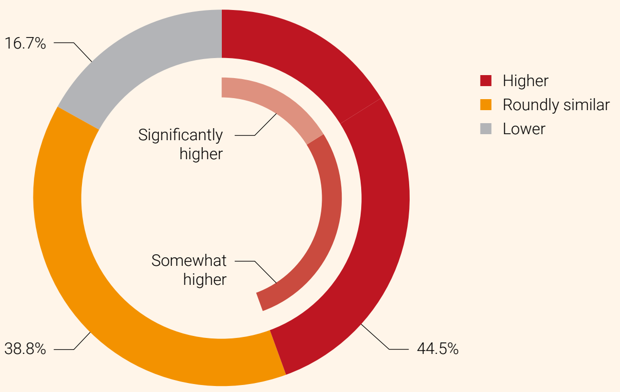


Source: Make UK & RSM Survey - October 2021

DEBT

From the widespread uptake in Government backed loan schemes at the start of the pandemic, it's unsurprising that the amount of debt UK manufacturers took on during the pandemic had increased. For many businesses, particularly SMEs, this would have been the, or one of the, first times their business had taken on debt of this nature. While finance and more complex debt products are more common for larger, more established businesses, with the capacity to manage and make maximal use of these financial products, many businesses on the smaller end of the scale – of which make up the majority of UK manufacturers – opt not to take on debt if avoidable, preferring to finance from past profits. Of course, the business environment over the past two years has limited those businesses' ability to use those profits to keep the business well-financed, or even afloat.

Chart 13: Percentage of manufacturers reporting what their current debt levels are like now, compared to the start of 2020



Source: Make UK & RSM Survey - October 2021

This research seeks to establish just where the UK manufacturing sector stands regarding its total levels of debt, approximately two years after the inception of the pandemic, what plans manufacturers have for their debt going forward, and just where the industry's first port of call is when considering debt solutions.

The survey's results show that just under half (45%) of businesses in the manufacturing industry are holding higher levels of debt now compared to the start of 2020, i.e. just prior to the pandemic in the UK. Apart from those that report similar levels of debt now, only 17% of businesses indicate that they hold less debt than they did.

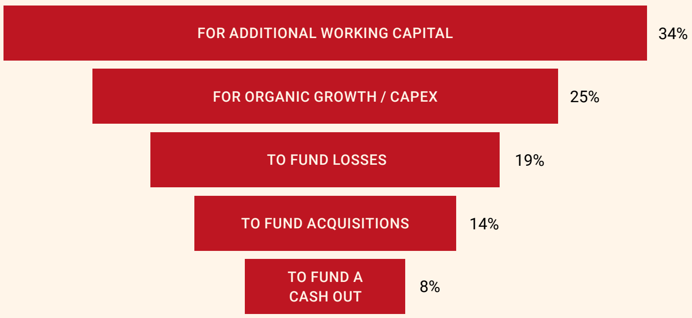
These results show the overall industry is considerably more debt-laden now, in the so-called 'recovery' period, than at the start of 2020, which was a turbulent time for the industry even prior to Covid-19's introduction, with the UK just having left the European Union in earnest following years of both political and market uncertainty.

Despite the already increased levels of debt, the majority of businesses indicated that they have ambitions to take on further debt, albeit for a variety of reasons, with 6 in 10 manufacturers saying they are planning to take on more debt for at least one reason.

The most cited reason for the requirement for further debt is simply the need for additional working capital, in other words, cash needed for the normal running of business operations. Of those who plan to take out further debt in some capacity, 34% indicated it was for extra cash for the normal running of the business. Breaking down the data by sub-sector reveals the extra need for working capital within the Food & Drink industry, with 54% of businesses within this group reporting that extra debt is to be taken on for working capital – which is at a rate approximately 20% greater than the average. The subsector is particularly exposed to increasing labour costs, as accessing foreign labour is now more difficult and costly following the UK's exit from the EU. As the economy goes through its post-pandemic recovery, this quantity of manufacturers requiring more debt for general working capital highlights the fact that while the most worrying of the health effects of Covid-19 may be passing, the effects on businesses' trading outlook continue to be pressing.

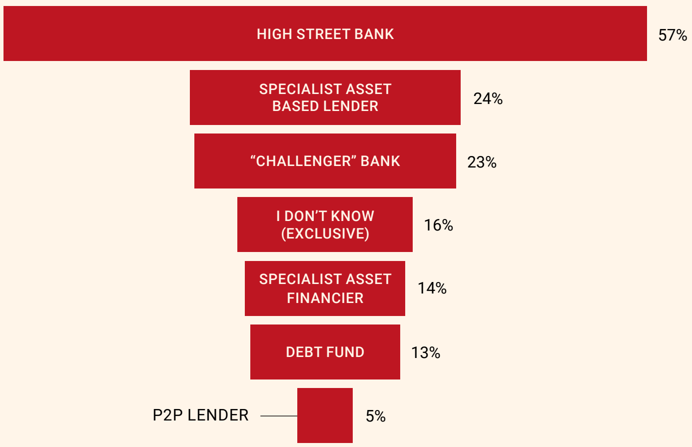
However, more encouragingly for the industry, a quarter of businesses indicate that they are taking on this extra debt to fund investment and growth. Within this group, sub-sectoral differences emerge most significantly within the Chemicals & Pharmaceuticals industry, and the Automotive industry. In the Chemicals & Pharmaceuticals industry, an above average 38% report this extra debt is for investment and growth, while in the Automotive industry, only a below average 16% report the same.

Chart 14: Manufacturers reveal why they want to take on more debt



Source: Make UK & RSM Survey - October 2021

Chart 15: Where do manufacturers consider appropriate for debt solutions?



Source: Make UK & RSM Survey - October 2021

What about where manufacturing businesses go when they are considering taking on debt? The majority consider high street banks as the first port of call, with 57% saying that when considering lenders, the high street banks are on their list.

Albeit under half as popular, specialist asset-based lenders are considered the second most appropriate source for debt solutions, with just under a quarter of businesses saying they'd consider this option. In plain terms, an asset-based lender would typically offer a business a loan using a company's balance sheet assets (such as investments or inventory) as a security to borrow money.

Peer-to-peer lending is seen as the least appropriate of the given options, with only 5% of manufacturers indicating they would consider using it. While the concept of cutting out the 'middleman' in finance arrangements is gaining wider popularity, for example in the case of crowdfunding – a form of peer-to-peer lending, it will be the lack of credence and certainty that will be likely driving manufacturers to shun this form of lending as a preferred option. With such a large proportion of manufacturers considering borrowing more, lesser-known options should be explored by industry as these may be able to provide appropriate finance options that could otherwise be unavailable or too costly at the outset.

CONTINUANCE

The industry was blindsided by the economic shocks brought to pass in the past two years, in which there were many hard-learned lessons. Nevertheless, it was these experiences that now equips the industry with a greater understanding of the importance of liquidity management to their businesses' survival, and prosperity. Firms are now more acutely aware of the most vulnerable facets of their business, having been so recently tested. While there is relatively strong business confidence in the industry now, compared to any period in the past year or so, the financial security of the industry is still far from being out of the woods just yet. Indeed, some of the most prominent challenges industry is facing at present, such as material input shortages, is partially a symptom of that increased confidence and businesses activity arising from an accelerated global return to production.

VIABILITY

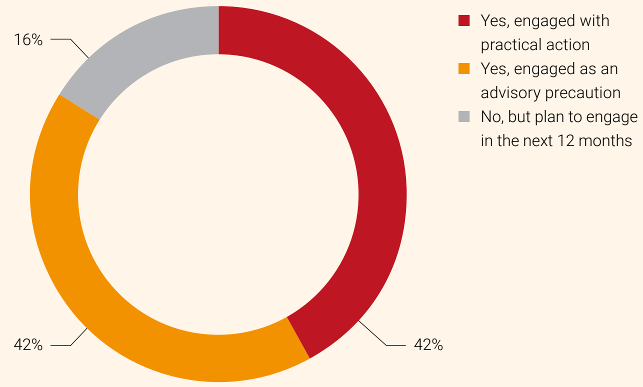
As Government finance schemes -and other business support measures- wind up, manufacturers find themselves moving further away from the safety nets laid down for the economy, with exposure to the risks of the open market and of poor management increasing. The aftermath of the increased debt levels in the industry, with the steady withdrawal of support, heightens the likelihood of business failure in the coming months and years. Indeed, the survey shows that just over a third (34%) of manufacturers foresee their businesses' debt or tax liabilities posing an operational threat to the business in the coming two years.

A 1/3 OF MANUFACTURERS HAVE DEBT OR TAX LIABILITIES THAT WILL POSE AN OPERATIONAL THREAT TO THE BUSINESS IN THE NEXT TWO YEARS

Given the threat posed by these debts, it follows that the industry will have a heightened level of engagement with restructuring, turnaround or insolvency professionals. The survey shows that 38% have either engaged with these professionals or intend to in the next 12 months.

An equal split emerges across the industry, between those businesses that have engaged restructuring/insolvency professionals out of precaution and out of necessity. Interestingly, the category of those that have engaged with these professionals out of a precautionary nature, 42%, is of similar proportion to how many manufacturers reported their taking out of government finance schemes to also be a precautionary step, 44%. This data shows a high adoption of precautionary measures and is indicative of the exceptionally uncertain trading environment the industry currently finds itself in.

Chart 16: Of those businesses who have or plan to engage with restructuring professionals, in what capacity have they done so?



Source: Make UK & RSM Survey - October 2021

In absolute terms, considering the entirety of the manufacturing industry and not just those who indicated that they have engaged with turnaround professionals, the survey indicates that 16% of all manufacturers have taken practical restructuring or turnaround action in the last two years.

of the manufacturing industry has taken practical restructuring or turnaround action in the last two years

2022 & BEYOND

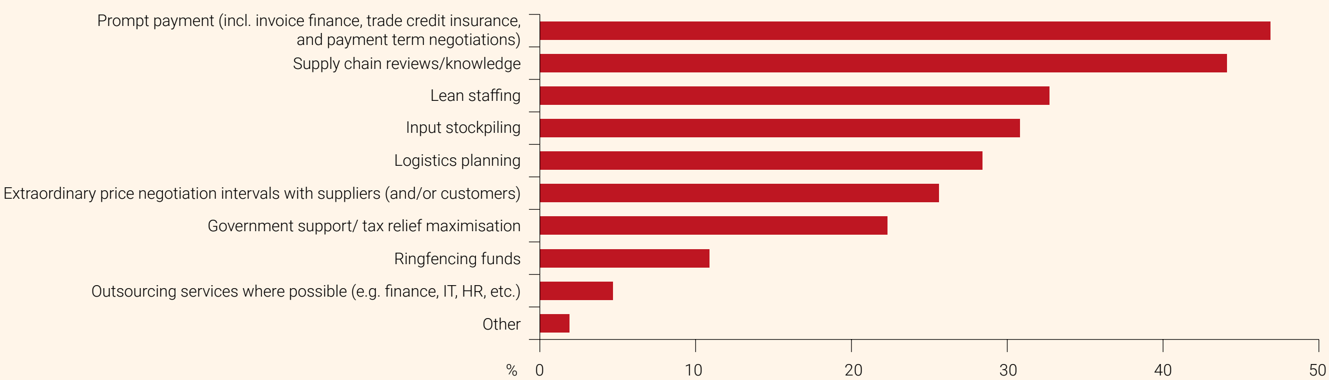
Looking to the future, as manufacturers continue to trade out of the pandemic with greater knowledge of where the most significant vulnerabilities to their liquidity lie, businesses will be targeting specific areas of their operation where further resilience needs to be built in. With this research, it was important to find out how UK manufacturers intend to focus on maintaining a healthy cash flow in 2022 and beyond.

Approximately half of the industry has indicated that they have already taken action on their payment term policies in the last year, and this insight into coming actions in 2022 shows that prompt payment will be the most important component to cash flow management in the coming year. As the survey detailed earlier in the report, there are considerable increases in the number of manufacturers who are experiencing delayed payments as a result of the pandemic, placing their financial health into further jeopardy when work has already been undertaken.

The survey shows that continued supply chain reviews will hold equal importance in manufacturers strategy next year, particularly as material input shortages and inflation are now expected to continue well past the end of this year and deep into next, with some now theorising that these raw materials pressures will persevere into 2023.

> “Manufacturers reveal that securing prompt payment and supply chain reviews will be the two most important cash flow management strategies for their business in 2022.”

Chart 17: Having developed them amongst the pandemic - Manufacturers reveal and rank which new strategies they will continue to use in 2022 & beyond



Source: Make UK & RSM Survey - October 2021

Unfortunately, the industry has endured a wave of redundancies brought about both by a suppression in demand and insufficient liquidity to cover the staff wage bill, even despite the widespread use of the Government's job retention scheme. Nevertheless, it was through these trials that businesses were forced to reconsider how their workforce was best used to maintain production levels as optimally as possible. This survey shows, looking into the next year, that manufacturers are taking the lessons learned through these hardships forward, with lean staffing practices being within the top three strategies being taken into 2022 to safeguard healthy liquidity. However, industry must be cautious with these practices, as there is a long-term skills shortage within the sector, which has only been exacerbated by renewed labour demand in this recovery phase. Permanent skills loss from the economy is a risk manufacturers face, so the benefits of lean staffing practices must be balanced against the risk of long-term skill access concerns.

An analysis of respondents' views on the biggest challenges to their financial stability in 2022 shows an industry with common challenges. By far the most prolific expected challenge comes in the form of continued increases in the cost of raw materials. Staff, logistics and EU-exit issues also come to the fore as challenges the industry still expects to be grappling with in 2022.

Chart 18: Word cloud showing the most frequent keywords in response to "What poses the greatest challenge to your business' financial security in 2022?"

Source: Make UK & RSM Survey - October 2021

SUMMARY & POLICY PRIORITIES

This research shows an industry that has, for the most part, managed to emerge from the pandemic with operational levels of liquidity. However, it also transpires that much of this liquidity has been secured by unprecedented action as manufacturers moved quickly to safeguard their cash flow in the face of rising challenges. It's clear that the challenges are far from over, having revealed that so much of the industry is now significantly more debt-laden than before, with worrying proportions of manufacturers anticipating considerable threats to their businesses' viability as a result of these weighty debt liabilities in the coming years. Nevertheless, we have shown that the industry has developed a myriad of liquidity-securing strategies that have been put to the test over the past two years, strategies that the industry intend to take forward into the future to better safeguard their cash and ensure their future prosperity. However, there remain significant sections of the market that have yet to take action in securing their cash flow. As an immediate remedy for these businesses, this report finds that reviewing both payment term policies and the input supply chain are the two most impactful steps manufacturers can take today to build resilience into their liquidity reserves.

The financial health of the manufacturing industry in the coming months and years will no doubt increasingly lie in firms' own hands, as pandemic-related Government support is withdrawn, placing additional reliance on those tried-and-tested strategies that were forged during the crisis.

The findings of the report identify just where action needs to be taken. Alleviating the debt burden industry holds and enabling a smooth flow of industrial inputs are the two highest priority challenges. There are steps which Government can, and should, take to both address these priorities while also helping to mitigate the worst of the risk to manufacturer's liquidity in the coming year;

Liability holidays: Further payment holidays for those straddled with debt in the coming years, especially within those now slower-recovering subsectors

- The Chancellor's announcement of the Pay as You Grow scheme provided much needed breathing room for those businesses who were struggling with their liabilities having taken on extra debt in the pandemic. The scheme offered a loan term extension at the same fixed interest rate, with options for interest-only payment periods and the option for a single repayment holiday. Our research shows that the loan term extension was a much-used feature by manufacturers. Make UK is calling for additional loan payment holidays to be offered, to help those struggling businesses in the coming years.

  The trading environment is still likely to be irregular right the way through to 2023, and manufacturers risk having already used their 'wildcard' holiday in 2021, leaving them exposed to their debt pressure with less recourse. Alleviating debt pressure from those businesses who find themselves still under its weight at the end of 2022 will be critical in ensuring sections of the industry aren't left behind, particularly as the industry's recovery is slower in certain subsectors, such as automotive and aerospace.

Trade credit insurance: Reintroduce government backing to secure confidence and liquidity

- Make UK welcomed the Government's previous backing of Trade Credit Insurance schemes with a £10 billion guarantee. However, with the scheme's winding up in June 2021, the industry has lost the safety net of securing guaranteed trade credit insurance. Now, in a period of recovery where activity levels are high, and trade flows are renewing, Make UK is calling on Government to reintroduce its backing of the scheme. As this research shows, payment terms and non-payment are of paramount importance to manufacturers' cash flow, but for the industry to maximise its recovery potential it needs to be trading globally. Especially where new international customers are concerned, the security provided by trade credit insurance schemes can bolster businesses willingness to seek new trade opportunities, with the knowledge that their liquidity is insured in case of non-payment or non-delivery.

CE/UKCA marking extensions: Further extension for CE marked products to be sold on the UK market for products where the legislation in the UK remains the same as in the EU

- Make UK has worked closely with officials in BEIS to set out the case for the extension of the recognition of CE marking for an additional 12 months, not least because of concerns about international suppliers' readiness. We therefore welcome the Government's decision to do so. Make UK is already working with the business department on raising awareness with both our membership and international partner organisations from the rest of the world as well as Europe. While Make UK is not against regulating differently from the EU particularly in new technologies and cutting edge processes, it's important to recognise that any divergences in legislation have the potential to create a non-tariff barrier without significant benefit.

  It is important therefore for the UK to pursue, where possible, mutual recognition agreements but also to consider from a UK perspective whether legislative changes can be mirrored to ensure that products remain compatible with both market legislations. In the absence of these agreements the UK Government should consider, for manufactured goods, that CE market goods which meet EU rules which are similar or identical to UK market rules should be continued to be accepted on the market. This easement should be extended for as long as required for each product category and certainly until there is a potential divergence between UK and EU rules.

Borders: further easement period from 1 January to the commencement of the UK Border to EU imports

- Make UK has welcomed the continued easement of the SPS control on food imports, addressing concerns about the readiness of both UK firms and international suppliers. However, there has been a mixed response from many large food manufacturing businesses who have already invested significantly to ensure they were ready for the changes and see the extension of the easements on UK import border controls as putting UK firms at a competitive disadvantage to EU firms. UK manufacturers, including food businesses, have faced full import controls with the EU for exports, while EU exporters to the UK have seen a light touch control system.

  While the easements are welcome, we are concerned that the introduction of full controls are likely to impact UK businesses a second time, as while customs and tax obligations are normally borne by the importer, many UK businesses have been forced to internalise the costs for EU customers (importers). It is unlikely however that EU exporters will be willing to do the same as costs increase for import to the UK.

  While we have seen some predictability return to cross border trade with the EU, and a majority of companies no longer see customs and border formalities as a significant concern, many small businesses still see this as a challenge. With the new import controls to be introduced at the end of the year Make UK supports the reintroduction of an SME fund at the least, to assist those smaller businesses in importing & exporting goods.

VIEWPOINT

RSM

Since the pandemic hit, business confidence has fluctuated more rapidly than most can remember. Throughout, we have continued to advise our manufacturing sector clients on many aspects relating to liquidity. But despite the huge resilience demonstrated by the industry, these have been challenging times. It is important that now, as tentative recovery steps are taken, we assess the financial damage and outline the practical actions that can be taken to mitigate future cashflow risks. We are delighted to partner with Make UK in producing this report and believe that as cash flow concerns remain, debt burdens increase, and supply chain challenges continue, government should take steps to safeguard the future of this crucial industry.

The impact on liquidity so far

Many might have expected COVID's impact on liquidity across the manufacturing industry to have been worse than our survey findings suggest, but the impact has been uneven. The recovery within the automotive and aerospace sectors in particular have been hampered to a greater extent than other parts of the sector and inevitably smaller businesses are feeling the pinch before larger businesses. Borrowing levels have sky-rocketed but the issues for many relate to the erosion of cash buffers that were previously earmarked for strategic growth. This is not good timing, particularly with environmental pressures and Net Zero targets in mind. The industry must be able to invest in innovation in 2022 and beyond if it is to address climate change and continue to meet changing consumer demands.

A rocky road ahead

It is no surprise to see a high proportion of manufacturers citing input costs and access to materials and components as primary concerns within the survey. The sector continues to absorb significant additional costs and this is likely to continue to trouble many throughout 2022. While we anticipate that over time, an increasing portion of these costs will be passed throughout the supply chain and onto consumers, this will not be music to the ears of manufacturers struggling with their cashflow position now. The fragility of the manufacturing supply chain has been laid to bare and supply chain reviews must continue to take place across the industry but crucially, they must be a continual process that is focussed on the customer.

Unsurprisingly, sector borrowing levels have significantly risen since the start of the pandemic, and with many manufacturers suggesting they intend on borrowing more, it is vital the industry is aware of all borrowing options at its disposal. While high street banks are sometimes the best option, gone are the days where they are the only port of call. It is encouraging to see how many manufacturers have taken action to safeguard cash reserves, yet 38 per cent of respondents still suggested that they have engaged or plan to engage with restructuring or turnaround professionals. This clearly demonstrates the severity of the cashflow challenges facing the sector.

What next?

The Government must ensure the smooth flow of industrial inputs for UK manufacturers. The sector has enough supply chain related issues to combat without legislation causing further headaches. In addition, further loan payment holidays for those that continue to be severely impacted must be considered.

With this support and the continued resilience the sector possesses, the manufacturing industry can make up for lost time and return strong output levels in 2022.

Mike Thornton
Partner and Head of Manufacturing
RSM

Make UK
The Manufacturers' Organisation

Make UK is backing manufacturing – helping our sector to engineer a digital, global and green future. From the First Industrial Revolution to the emergence of the Fourth, the manufacturing sector has been the UK's economic engine and the world's workshop. The 20,000 manufacturers we represent have created the new technologies of today and are designing the innovations of tomorrow. By investing in their people, they continue to compete on a global stage, providing the solutions to the world's biggest challenges. Together, manufacturing is changing, adapting and transforming to meet the future needs of the UK economy. A forward-thinking, bold and versatile sector, manufacturers are engineering their own future.

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RSM

RSM is a leading provider of audit, tax and consulting services to middle market companies and their owners/managers, globally. With around 3,650 partners and staff in the UK across 32 offices and access to 48,000 people in over 120 countries across the RSM network, we can meet our clients' needs wherever in the world they operate. Manufacturing is a hugely important sector for RSM and our experience in the industry has been built up over many years by serving the needs of our manufacturing clients and providing proactive solutions to their compliance and business advisory requirements. In addition to our knowledge of the manufacturing sector as a whole, we focus on specific sub sectors including food and drink, automotive and aerospace. We regularly run virtual forums, webinars and round table discussions for our clients where they can gain access to an environment that encourages and facilitates the sharing of ideas to combat sector specific issues. Combining our industry knowledge, deep resources and personalised service, we offer solutions to help manufacturers achieve their objectives.

If you would like to receive invitations to our events and to receive our monthly manufacturing industry insight pieces, please visit our preference centre.

www.rsmuk.com

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The Manufacturers' Organisation

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