

The Engine

Issue 5

Keeping You Up To Date With Manufacturing & Engineering Insight
August 2019

Now, for tomorrow





Foreword

Welcome to the fifth edition of The Engine, our Manufacturing & Engineering Newsletter.

At MHA, we're passionate about UK manufacturing and engineering. MHA members act for thousands of businesses across the country, including OEMs, those in the supply chain, as well as engineering companies and tech businesses. As we head towards the post Brexit UK, we think it's more important than ever to champion our sector, which is why we look to share best practice right across our client base. As well as delivering accounts, audit, tax and Wealth Management solutions, we also support skills initiatives, run forums and hold insight events, all aimed at helping our clients in the sector to do better.

Along with others such as Lloyds Bank, Innovate UK, the High Value Manufacturing Catapult and Autodesk, we're a member of the Future of British Manufacturing Initiative (FOBMI).

FOBMI is a collaboration between leading UK industry organisations focused on increasing the competitive advantage of UK Design and Manufacturing companies, by removing the barriers to true productivity and innovation.

What's Inside:

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The Manufacturers' Profitability Puzzle

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Getting the Most from Your 'Top Team'

Thought Leadership

Nationally, we produce an annual Manufacturing & Engineering Survey Report which has become a barometer of how the sector is faring and how it thinks it will do in the future. The report looks at financial considerations, business confidence, innovation, employment, exporting and future considerations and was launched in February 2019:



<https://mha-uk.co.uk/wp-content/uploads/2019/04/Manufacturing-Report-final-web.pdf>

Are Your Back-Office IT Systems Up to Date?

No matter what size your business is, you can't avoid IT. It is the backbone of most businesses and a vital component in the manufacturing and engineering process.

Smaller businesses rely on IT for bookkeeping and payroll, whilst in larger businesses, it could be running some, or your entire production process.

Whatever your level of IT reliance, it is vital that you keep your systems up to date. Cybercrime is a major threat to industry and Forbes recently estimated that over the next five years, global public companies risk losing an estimated £4.1 trillion (\$5.2 trillion) to cybersecurity attacks.

Most respectable IT vendors are working tirelessly to keep their solutions secure, but they are reliant on end users to apply and install the many security patches and updates that get issued daily. Your systems don't even need to be online to be at risk. Even old CNC or moulding machines require programming, and this data is normally saved onto USB drives. If there is a connection between systems, then your data is potentially at risk.

For most vendors, keeping IT systems up to date is a necessary overhead, but as new systems get developed, maintaining the old versions becomes prohibitively expensive. Eventually, vendors will end support for old versions and encourage its customers to update to the latest version. Unless you have a subscription-based licence then this is usually not without cost.

Of course, it is not just the applications, systems and programs that you interact with each day, the operating systems on which they run should also be maintained. You could have the very latest Finance or ERP system, but if it is running on an old operating system then the entire solution could be at risk. This is one of the reasons why solution providers insist that their solutions are only installed on current operating systems.

If your network is part of a certified system, for example PCI DSS, such certifications require that software is supported and patched regularly. Hence, failure to update a device that is attached to a network may be regarded as a control failure leading to the suspension of certifications. Using unsupported systems could also put you in breach of the recent General Data Protection Regulation (GDPR), and in the event of a security breach, subject to large fines from the ICO and public notification that your business is unable to maintain its systems and customer information.

This brings us on to a very important date. In January 2020, Microsoft will be retiring all support for several widely used applications and operating systems. Technically, mainstream support ended some time ago, but Microsoft has continued to provide extended support, which includes security updates. This will eventually end and continued use after January 2020 could put your business at risk.

These applications include:

- **Windows 7** - Although superseded by Windows 8 and 10, it remains a very popular desktop operating system. According to NetMarketShare's June 2018 data, 43.38% of IT users are still using Windows 7, compared to the 32.08% who have moved on to the latest version. Many users disliked the new interface that came with Windows 8 and chose not to upgrade. The release of Windows 10 did a lot to overcome its critics and is now accepted as a reliable and stable desktop operating system.
- **Windows Server 2008 R2** - Like Windows 7, Windows Server 2008 R2 is a very popular operating system. Although this sits in the server room and is usually not seen by end-users, it is a vital IT component for many businesses. The latest version, Windows Server 2019 is worth considering, but this will almost certainly require new hardware to run, so other options should be considered.
- **Exchange 2010** - Exchange 2010 provides the email, calendar and, for some businesses, public and private folders for data storage. The withdrawal of support for Exchange 2010 is perhaps the most challenging aspect of all the products being retired. However, email lends itself to working in a cloud environment so migration to a cloud hosted solution, such as Office 365, should be considered.

- **Small Business Server 2008** - Small Business Server 2008 is not a single product, but an integrated suite of back office applications. These include: Windows Server 2008, Exchange Server 2007 and Windows SharePoint Services 3.0. Premium editions also included SQL Server 2008 Standard Edition. These applications were limited to 15 users and were much cheaper than the full versions.

Upgrading to the latest version of these applications and operating systems might appear to be the obvious choice, but much has changed in the world of IT since their release and there are now many other options to consider. It should also be noted that changing an operating system may require an upgrade to the hardware and any applications that run on it. This could impact other systems and services, so careful migration planning will be required.

If you would like to discuss your IT options and issues, please get in touch with us.



The Manufacturers' Profitability Puzzle

Developing and implementing strategies to maximise profitability is a fundamental challenge facing manufacturers.

To crack this puzzle, companies must carefully plan their strategy and application of resources to identify what investments will have the most impact.

With the Manufacturing PMI falling and much Brexit uncertainty, the intuitive reaction to increase profitability may be to reduce investment that doesn't directly or immediately improve a company's revenue-generating activities. However, areas like R&D, sales, marketing, staffing and recruitment are an essential investment for the future. If companies follow their instincts and cut back, it creates considerable risks for profitability in the long run.

Investing for the Long Term

It is important that companies focus their resources where the full potential has not yet been realised, and there's a real prospect of generating competitive advantages.

Companies should remain forward-looking by focusing their investment on four key areas:

Recent analysis of 1,559 US manufacturing firms published in IJOPM (Strategy, Operations, and Profitability: The Role of Resource Orchestration, International Journal of Operations and Production Management) shows that financing R&D has a significant positive effect on long term profits, as it drives the development of new products to bring to market. Continued upgrades to plants, property and equipment is essential to future proof a manufacturing business, as a lack of investment in these areas ultimately leads to poor performance.

The opportunity to recruit high-skilled technicians and engineers and integrate them into the company, as the agents for future long-term growth, must not be neglected. Incentivisation through investment in pension provisions for example can have long term, positive performance implications, helping to retain your best people.

Although profitability may suffer short term pain as a result of these investment decisions, if executed well they will certainly prove beneficial in the long term.

Maximising Available Tax Reliefs

Industrial strategy released by the UK government in 2018 cited R&D as a key foundation for productivity. Targeting an increase in R&D investment from 1.7% to 2.4% of the GDP by 2027. To support this, the rate of R&D tax credit was increased from 11% to 12%. At a glance, the figures looked promising, with £1.3bn of R&D tax relief being claimed by UK SMEs. Our conversations with manufacturers however show that they are not aware of all the reliefs available to them and may be missing out.

HMRC estimates the manufacturing sector accounts for 28% of R&D claims, with a total tax relief value of over £900m. In addition, lossmaking companies can obtain cash tax refunds of an effective rate of 33% of the R&D spend, while tax-paying companies can claim £19 back for every £100 invested in R&D through corporation tax, as well as a further £24 through the R&D tax credit system.

One of the latest government initiatives developed in line with this strategy is an increase in the Annual Investment Allowance (AIA) to £1m - a considerable boost from the former £200,000 limit.

Manufacturing companies must understand this is a temporary increase due to end in December 2020, and they must therefore make the most of the opportunity as soon as possible. The AIA allows companies to deduct the full value of a qualifying capital item from profits before tax, and most protective equipment also qualifies for the relief. In an environment where unemployment is at record lows and skilled labour can be hard to find, this measure can support investment in areas such as automation, stimulating investment and productivity.

Manufacturing companies face a big challenge in balancing short term profitability with long term growth.

By making the most of tax benefits, maximising existing resources and making new investments, manufacturers will have a far greater chance of enhancing profitability.



R&D



Plant and equipment



Skilled labour recruitment



Reward and investment in staff (e.g. through pension funding).



Grappling with Investment Decisions

It is difficult to ignore the uncertainty that is Brexit, but the positive climate for making bold investment decisions is hard to deny.

Reduction in corporation tax rates to 17% from April 2020, increased Annual Investment Allowance to £1m until December 2020 and the improved availability of cash from banks, all provide a healthy environment for manufacturing and engineering companies to make key decisions about investment, structure, acquisitions and productivity.

With additional cash resources, investment can be made to expand existing manufacturing capacity, improve operational productivity through technology by grasping the digital world and capturing new market opportunities.

Manufacturing in the UK is going through a rough patch now, particularly in the automotive sector, with the closure of the Honda plant in Swindon and the Ford engine plant in Bridgend. Time will tell how these regions cope with the flood of labour into the market place and how this cascades down into the supply chain, providing a stern test of will and determination. However, for manufacturing and engineering businesses in these areas, there needs to be opportunities with a skilled workforce becoming available, as production winds down and opportunities emerging for new businesses to replace those that are no longer required.

All this creates an environment where key decision makers in a business are faced with difficult choices about how to respond. Is a focus on modernising equipment, updating IT infrastructure and shifting into more digital manufacturing and supply chain management the right one, or is investing in the workforce to fill the skill gaps priority number one? Additionally, there is looking at expansion through acquisition or merger, or returning wealth to shareholders.

Whatever you choose, it needs to be well thought through and strategic. It is unlikely that any one choice will be successful if made in isolation. Business owners, managing directors, finance directors and operations directors all have overlapping considerations that need to be aligned with strategic longer-term objectives:

- Has the increase in available cash from lower tax rates and investment allowances been quantified?
- What is the ability of the business to raise new finance for investment?
- How should capital investment be prioritised, accelerated or increased?
- Are suppliers, competitors and customers already making moves?
- Is the acquisition of a competitor, or supplier now making more commercial sense, or is there an opportunity to diversify?
- What are the expectations of the business owners and investors?

Key decisions made or avoided now will have a significant impact on what the next five years will look like, and the ability of manufacturing and engineering businesses to compete.

It is best to critically appraise or re-appraise the strategy to ensure the best tax and investment advantage, in order to maximise the benefits going forward.

Getting the Most from Your 'Top Team'

Making a 'top team' function as an effective and cohesive team, one that adds value to performance rather than detracting from it requires collective commitment of time, courage and discipline. It doesn't happen naturally and won't take care of itself.

Anything that effects productivity negatively is bad for any business, in particular manufacturing and engineering businesses, where every minute counts.

How do you know if your top team and those making decisions in the board room are as efficient and cohesive as they could be? It's not about being good enough, it's about achieving your potential.

Start with asking yourself, what is it you're trying to achieve as a business and a team? Make sure you revisit this each year. Do you set clear targets and make sure everyone understands their unique contribution to achieve them?

So, you know where you want to get to... Wouldn't it be great to have your best year yet?

Invest Time in Developing the Team

You've noticed your team is struggling to make important decisions, maybe there is too much or not enough conflict or an inability to reach an agreed way forward. How much time have you put in to building relationships? Are you encouraging the team to build relationships to help them to work better together? You probably need to invest more time than you might think.

I recommend that the average business spends two days a quarter working on improving the effectiveness of the team, whether it's informal time spent getting to know each other, a team building day or time reviewing strategy away from the day job. Getting to know each other properly is more important than you might think. It gives you understanding of each other's personalities, values and the things that really drive us.

Achieving Top Team Potential Starts with the CEO or MD

To lead your team to perform at their best, you must be at your best. Are you working on your own wellbeing? Do you have a coach? Are you working on your physical health and fitness? Do you have effective behaviours and routines? To lead a team, you must be energised and focused on the goals along the way, you can only do this if you take a step back and ensure you are at your best.

Build Trust

In order to develop high trust relationships with your colleagues, you must understand and respect their values, know what motivates them, and take time to really understand what is going on in that person's life. Creating genuine and meaningful relationships that drive productivity and efficiency is often an area that is overlooked.

One Team, No Outsiders

Whether it's private conversations or closed social invites for team nights out, it's easy to make someone feel like they aren't part of a team. Whether male or female, senior or junior, the feeling of not being part of the team can significantly impact how effectively you collaborate, how you react to situations and how much you trust your team mates to be able to delegate or agree strategic direction. Building key behaviours of empathy, courage and curiosity with every team member is key. This isn't necessarily taking on their worries, but offering an ear, being curious as to their issues and concerns and taking the time to help them reach a solution, even if you can't help directly.

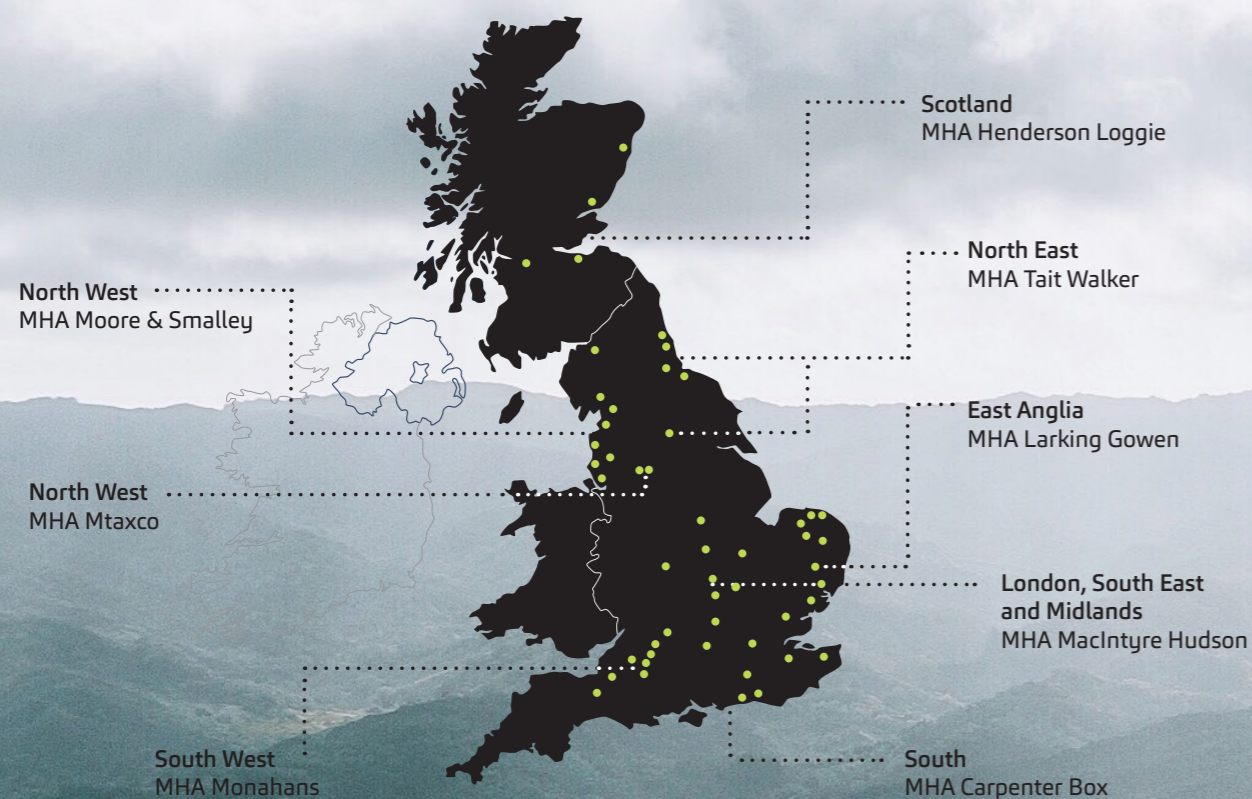
These are just a few things to consider when trying to achieve top team performance and your best year yet.



About MHA

MHA is an association of progressive and respected accountancy and business advisory firms with members across England and Scotland.

Our member firms provide both national expertise and local insight to their clients. MHA members assist clients with their needs wherever they are in the UK, as well as globally through our membership of [Baker Tilly International](#), which has a network of trusted advisors covering 145 territories worldwide.



International Reach

 **145**
Territories

126 
Member firms in
145 territories


34,713
People employed
across the world

National Reach

8 
Independent
accountancy
firms

Combined
turnover of
£143m

UK
Independent
member of Baker
Tilly International

 **50+**
Offices
nationwide

c.179
Partners

c. 2200
Staff

Our Services

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 we are committed to assisting both our clients and the sector as a whole by promoting manufacturing and engineering throughout the UK.

As we head towards the post Brexit UK, we think it's more important than ever to champion our sector, which is why we look to share best practice right across our client base. As well as delivering accounts, audit, tax and Wealth Management solutions, we also support skills initiatives, run forums and hold insight events, all aimed at helping our clients in the sector to do better.

Services

- Compliance: audit compliance, accounting and financial reporting. Our audits reassure stakeholders and identify risk.
- Taxation: particularly around international tax, employment issues, R&D Tax Credits, Patent Box, Capital Allowances and tax mitigation.
- Business planning and support.
- Accessing public and private funding.
- Maximising the efficiency of your supply chain: reducing costs and improving margins.
- Mergers & Acquisitions: We have advised on many engineering transactions, including a number of cleantech investments.
- Due diligence ahead of funding and grant applications.
- Risk management: We advise on both governance issues in order to best attract investment and on minimising fraud and corruption risk.



To view our previous editions of The Engine, please click [here](#)

Contact Us

If you require any further information or advice regarding these topics, then please feel free to contact your local MHA member firm.

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