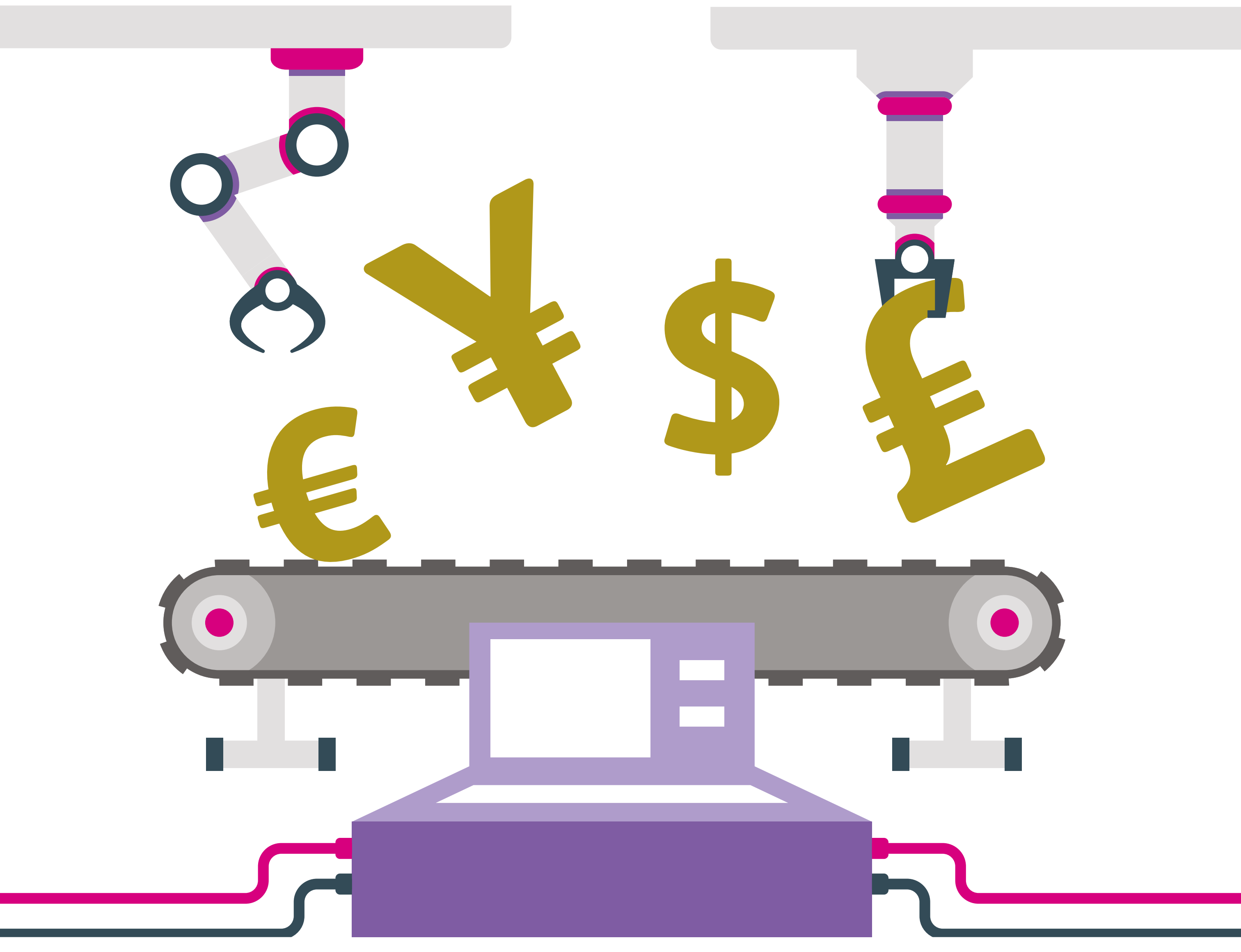
The Manufacturers' Organisation

In partnership with:

Santander Corporate & Commercial

INVESTMENT MONITOR 2018/19



The secret London Arch
Taken by Alfonso Dominguez Lavin at King's Cross Station, shortlisted in the professional category of the EEF Photography Competition 2016.

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1. INTRODUCTION

Welcome to our fifth annual *Investment Monitor*, in partnership with Santander, gauging trends in investment in plant and machinery in the UK manufacturing sector. After a strong showing over the preceding two year period – buoyed by the upturn in the global economy – manufacturing capital spend is expected to tail off in the coming years.

The UK's upcoming departure from the European Union, and the elevated levels of uncertainty which go with it, is clearly a defining factor in this. But there are a number of other risks to the global outlook, including rising trade tensions between the US and China, which could hinder manufacturers' capital expenditure. Our survey delves into these trends, and given the range of uncertainties facing businesses, we look at what the future could hold for manufacturing and investment.

This year we also take a closer look at the relationship between investment and productivity, building on our work from earlier in the year[1], as well as analysing what drives decisions when it comes to making investments in a business.

The summary tables show how this year's results compare with our previous *Monitors*. And here's the 9 things you should know about manufacturing investment in 2018/19:

- In the past two years manufacturers invested 6.9% of turnover in new plant and machinery, up from 6.5% reported a year ago.
- This pick-up didn't come as too much of a surprise, given the strength of growth in industry last year. Moreover an improvement was signalled in our last *Investment Monitor*.
- Looking ahead, however, the balance has tipped with only a third of manufacturers now intending to spend more on plant and machinery in the coming two years, down from half a year ago.
- Order book and political uncertainty are amongst the main drivers behind the weaker investment outlook.
- Linked to this is the shadow of Brexit, with 17% of manufacturers now holding off making new investments until further clarity on the Brexit deal is gained. This is up from 13.5% last year.
- There are some manufacturers bucking this trend, however, investing in order to meet replacement cycles, expand into new areas of activity, and importantly to reduce labour content.
- Yet considering the optimum level of investment, our survey finds that manufacturers are only doing enough to meet their basic requirements, and are falling down when it comes to investing in technology in particular.
- Our survey also finds that financial drivers trump other considerations when making investment decisions.
- This will have implications for the UK's longstanding productivity issue – a topic which has garnered much interest in recent times.

[1]EEF – Unpacking the Puzzle: Getting UK manufacturing productivity growth back on trend (2018)

Investment over the proceeding 2 years picked-up in 2018

Average expenditure in plant and machinery in the proceeding 2 years, as a % of turnover

2014	2015	2016	2017	2018
5.9	7.2	7.5	6.5	6.9

But looking ahead the balance has tipped in favour of holding off more investment

Investment intentions over next 2 years, % of companies

2014		2015		2016		2017		2018	
Same/less	More	Same/less	More	Same/less	More	Same/less	More	Same/less	More
50.6	49.4	53.6	46.3	57.4	42.6	48.8	51.1	65.4	34.4

The need to reduce labour content is a growing reason for those manufacturers increasing investment

% of companies citing factors that encourage increased investment	2015	2016 (Aug)	2017	2018
Need to replace/upgrade equipment	59.8	50.8	63.1	65.0
Expanding into new areas of activity	30.8	35.5	31.9	40.0
Need to reduce labour content	-	26.6	30.0	33.8
Confidence in the export outlook has improved	24.3	19.4	16.9	13.8
Confidence in the domestic demand environment has improved	36.4	18.5	13.8	18.8

Order book and political uncertainty are deterring many from further investment

% of companies citing factors that deter companies from investing	2015	2016	2017	2018
No need for more investment	49.0	35.4	39.9	25.2
We have spare capacity in our business	37.7	29.3	39.9	24.5
Order book uncertainty	20.5	38.4	23.0	36.1
Confidence in the domestic demand environment has worsened	21.3	28.7	17.6	25.2
Political uncertainty	3.3	25.0	16.9	29.9

Source: EEF Investment Monitor Surveys

2. KEY SURVEY FINDINGS
WHAT'S HAPPENED?

Manufacturers' average investment expenditure in plant and machinery, after last year's dip, has picked up again according to our *2018/19 Investment Monitor Survey*. Indeed, as a proportion of turnover, manufacturers have increased their average investment from 6.5% to 6.9%, for the preceding two year period.

At first glance, this result may appear counterintuitive, given the uncertainty shrouding the economic climate. However, digging a little deeper into the data, and more pertinently the time period in question (2016-2017), suggests this should not come as too much of a surprise. Manufacturers enjoyed a stellar year in 2017, on the back of a thriving global economy, and an export boost from the weaker level of sterling. This resulted in output growth last year of 2.5%. On the back of this strong demand, and emerging capacity constraints in a number of sectors, it appears manufacturers upped their investment in order to meet their customer demand requirements. This was in spite of looming Brexit clouds.

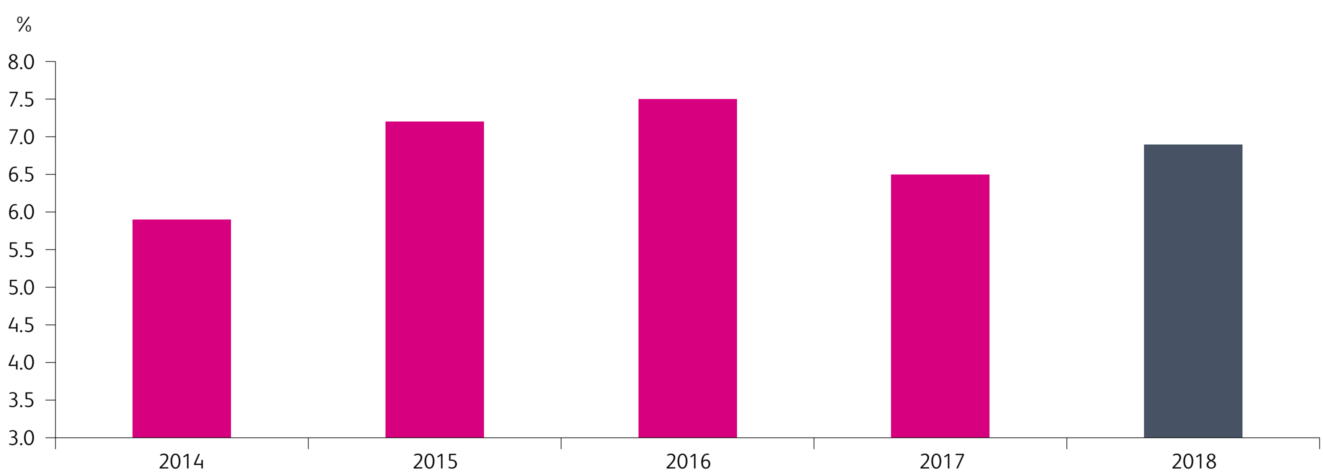
It should also be noted that an increase in investment was forecast in our last *Investment Monitor*, with a majority of manufacturers expecting to spend more on plant and machinery in the next two years. Our survey results are further backed up by official data, which show that manufacturers' investment in machinery and equipment increased by 3.2% in 2017.

Nevertheless, while up on the previous year, manufacturers' average investment remained below their pre-referendum levels. Moreover, given the strength of growth seen in 2017 – the sectors strongest growth since 2014 – we may have expected an even better turnout. It appears, therefore, that while demand was strong, the uncertainties generated from Brexit, as well as other global developments, did hold back some companies from doing more.

This is likely to intensify in the coming years as the cyclical upturn

Chart 1: Investment picks-up in past two years

Average investment in plant and machinery as % of turnover over last 2 years



Source: EEF Investment Monitor 2018/19

eases – already evident in domestic and international data – and Brexit uncertainties reach their peak.
This expectation is supported by manufacturers' forward looking investment intentions, which we will analyse now.

Looking ahead

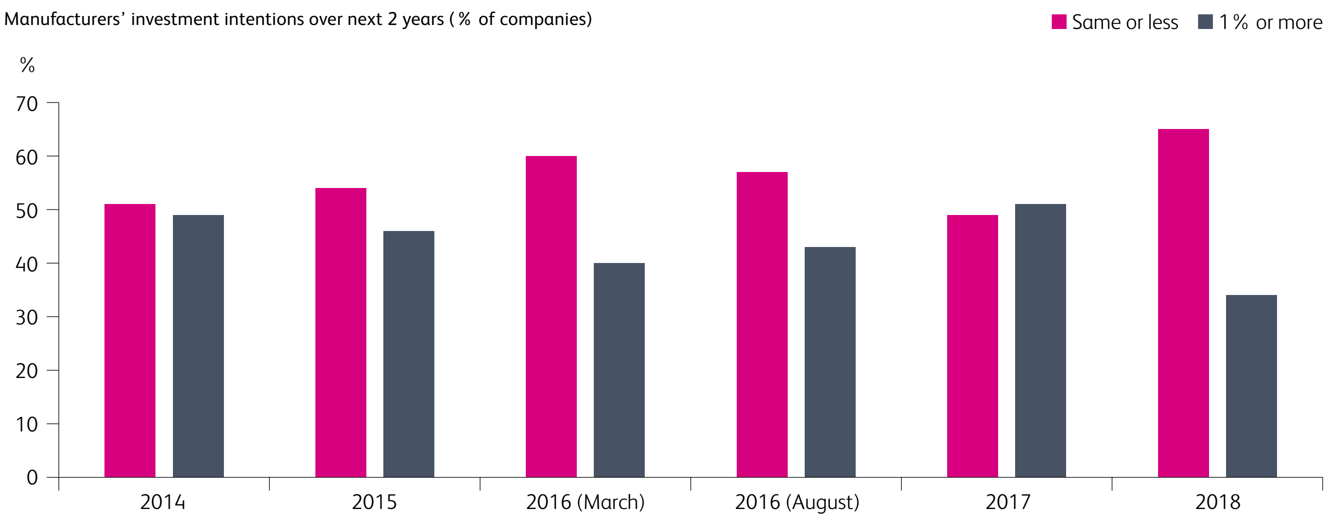
Over the next two years, manufacturers in our survey are planning to significantly pare back their investment in plant and machinery. This contrasts with what we saw in our *2017/18 Investment Monitor*, where there was effectively a 50/50 split between those manufacturers who intended to spend the same or less, and those who intended to spend more. This year we have seen the balance tip quite significantly in favour of the former.

Indeed, the percentage of manufacturers who are planning on spending more in the coming two years fell to 34%, the lowest level in our survey's five year history. The comparisons are even starker when breaking down the results by company size, with three quarters of small and medium sized companies refraining from increasing their investment in the coming years. As ever it appears that these companies, who understandably tend to invest smaller amounts, are taking the brunt of the elevated levels of uncertainty in the economy.

> "The percentage of manufacturers planning on spending more in the coming two years fell to the lowest level in our survey's five year history."

Chart 2: The balance of companies looking to invest more has tipped

Manufacturers' investment intentions over next 2 years (% of companies)



Source: EEF Investment Monitor 2018/19

3. WHAT'S BEHIND THE SLIDE?

With just under two thirds of manufacturers in our survey now intending to refrain from increasing their investment, up from 49% last year, it is clear the economic environment has shifted quite considerably in the last year, impacting investment intentions in particular. This slide is a story of uncertainty, and importantly, not one relating to a lack of ambition.

Compared to our previous editions, the proportion of manufacturers who are not investing as they believe they have no need to has fallen considerably, while only a very small number (2.7%) have no ambition to grow. Manufacturers therefore do not want to hold off making investments, but the economic and political environment means that a majority feel they have no other option. As a result they are instead deciding to do the bare minimum, holding off in the hope that some clarity is gained on the future economic and political landscape soon.

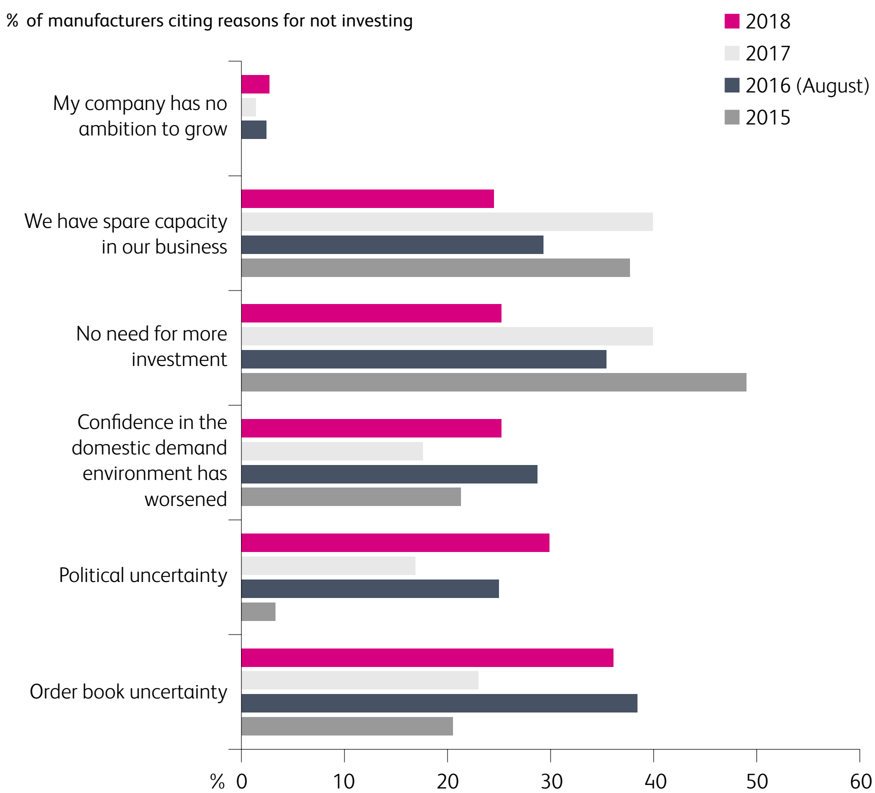
This is illustrated in the fact that order book and political uncertainty are the most cited reasons by manufacturers for not increasing investment, both up significantly from their levels in 2017, and the latter even from its level in our 2016 survey (in the immediate aftermath of the referendum).

It is true that uncertainty has become the new norm, and the buzzword that dominates any economic or political narrative. As a reason for not investing, 30% of manufacturers are citing political uncertainty as a reason, up from 17% this time last year. This likely reflects the growing unrest at the lack of progress and clarity on the final Brexit deal, as well as the prospect of future leadership contests in both main political parties. We will dig into the former in more detail in the next section.

The other major reason for not investing is order book uncertainty, which has risen from 23% to 36%. This pick-up is driven by a number of domestic and international forces.

As mentioned earlier, after an excellent year in 2017, in which order books were well stocked, demand in the manufacturing sector has begun to wane. Much of this is a result of the

Chart 3: Uncertainty driving the decline, not lack of ambition



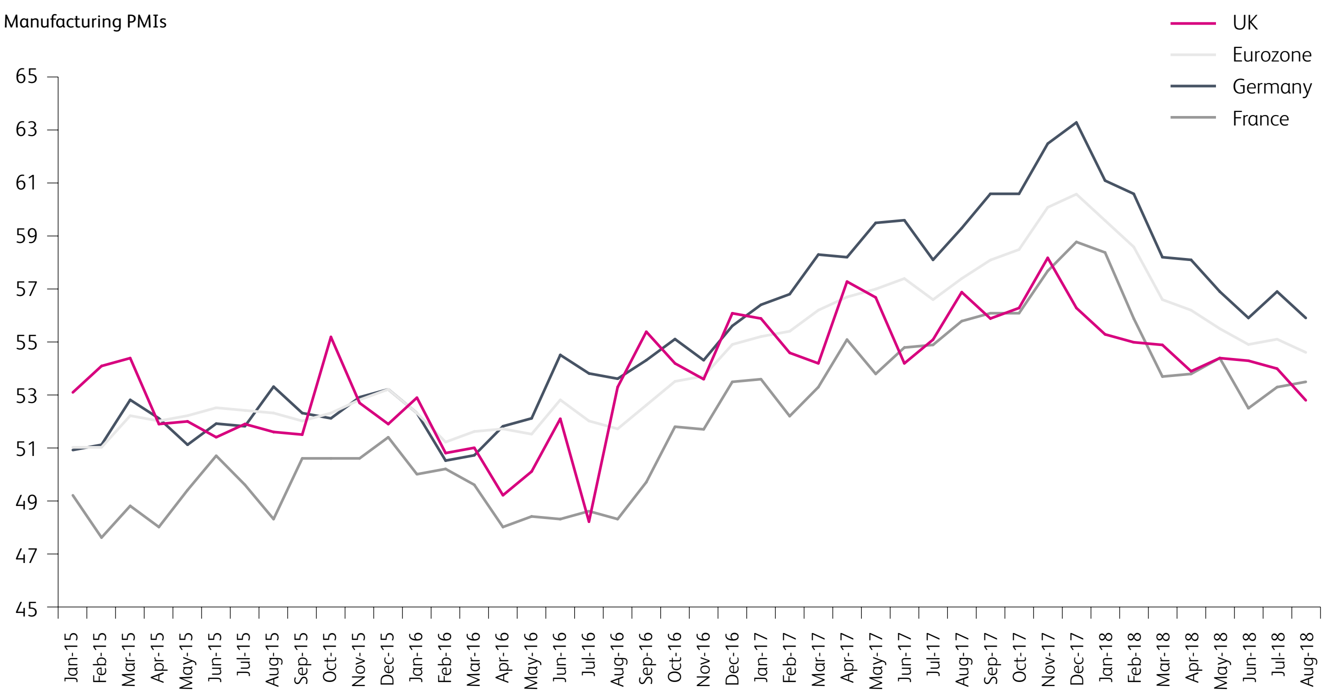
Source: EEF Investment Monitor 2018/19

cyclical upturn, particularly in Europe (the sector's chief export destination), coming to an end. Indeed, growth across the eurozone has slowed over the course of 2018, while other key indicators including manufacturing PMIs and German factory orders have also eased from the heights seen in 2017.

Compounding this unwinding in demand, is the uncertainty generated by rising trade tensions between the US and China, and the implementation of direct tariffs. While the impact to UK manufacturing is likely to have been limited so far, given that these tariffs affect a limited proportion of bilateral trade, the real concern is the prospect of further escalation. The Trump administration has already extended the steel and aluminium tariffs to the EU, and with the export intensive nature of manufacturing, further measures are a worry.

Taken together, these factors will be impacting on manufacturers' order books, in view of the potential disruption to their demand base and supply chains. It is not surprising, therefore, that we have seen an increase in the number of manufacturers holding back investment until they have a better idea of the future state of play.

Chart 4: The cyclical upturn evident last year is coming to an end in Europe



Source: Markit/CIPS (2018)

4. THE BREXIT FACTOR… AND WHAT WE COULD HAVE WON

As posited in the previous section, a driving force behind the order book and political uncertainty holding back investment in this year's *Monitor* is related to the UK's upcoming departure from the European Union.

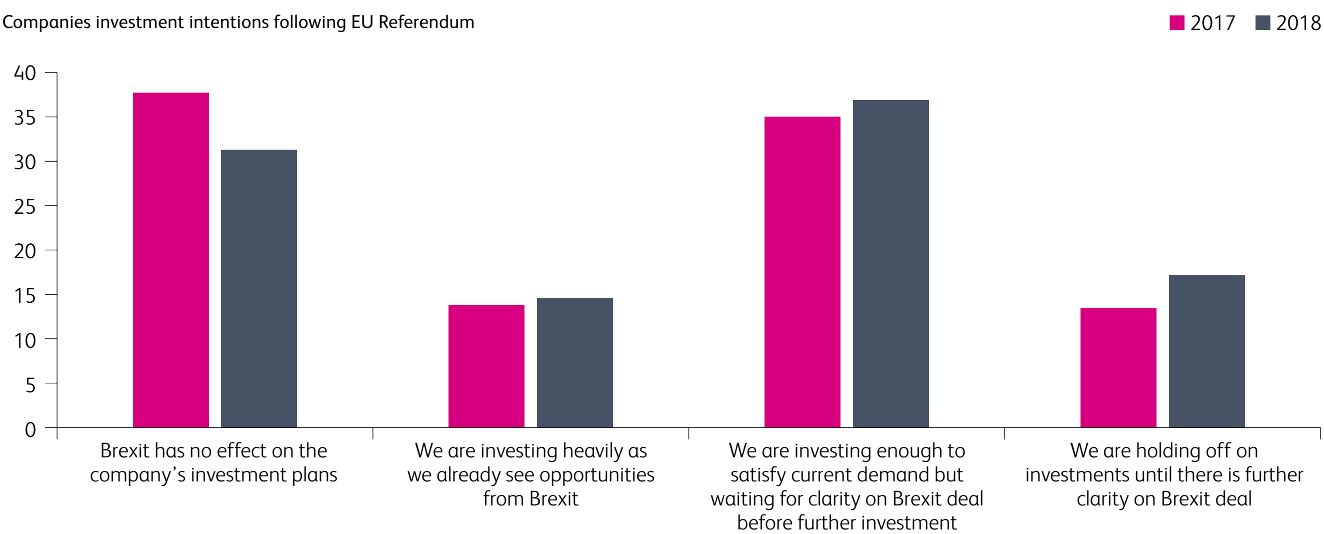
It's now over two years since the UK electorate voted to leave the European Union, and 18 months since Article 50 was triggered. Yet despite this, and with the final deal needing to be ready for ratification at the European Council meeting this Autumn, we are still no clearer (at the time of writing) to gaining a steer on the outcome of some key points of contention.

For instance, industry is still waiting to find out what our future trading relationship with the EU will look like. How will the Northern Ireland border issue be resolved? Will there be mutual recognition given the host of regulations and standards which are entwined with EU law? These issues are all still to be resolved in an eventual trade deal.

As a result we have seen our Brexit balance tip, with more companies now investing only enough to satisfy current demand, or holding off completely (54%). This is up from 50% last year. Importantly the percentage of companies holding off on investments completely until there is clarity on the Brexit deal rose from 13.5% to 17%. Having consulted with manufacturers on the ground, this does not come as a shock. What incentives do manufacturers have to invest now when the business environment could be materially different in six months' time?

It is clear that while Brexit uncertainty is not the sole factor behind this year's weaker investment outlook, it is having a defining impact.

Chart 5: Brexit uncertainty is hindering some investment



Source: EEF Investment Monitor 2018/19

Given these trends, we wanted to investigate what areas of investment are being held back by Brexit induced uncertainty in particular.

What's being held back by Brexit uncertainty?

Our survey results illustrate that those investment assets most sensitive to Brexit uncertainty are those of the more permanent and expensive nature. Just over half (51%) of survey respondents said investment in plant and machinery had been held back because of Brexit negotiations, and this was followed up by 36% of manufacturers holding off from investing in new/improved buildings.

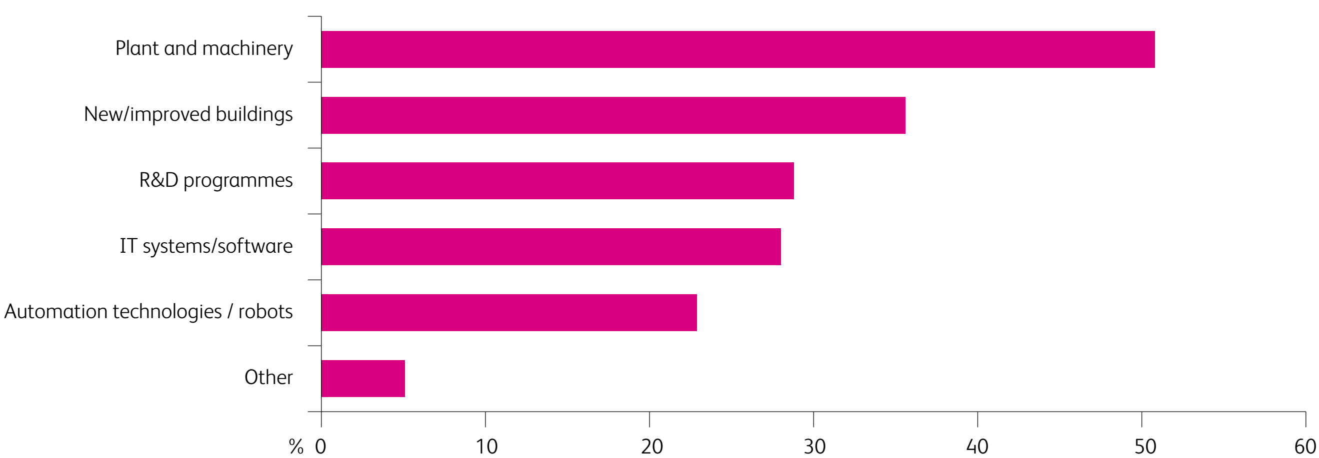
These assets are arguably the most important areas of a manufacturers' core business needs, and it is more concerning given that according to our survey, plant and machinery is the area that almost a third of manufacturers would have prioritised more investment in if they had the opportunity (see section 8).

Therefore while these assets are essential for manufacturers, they are the first to be shelved given their expense and long lead times.

Other areas of investment are not immune from Brexit uncertainty however. In particular a significant portion of R&D programs and IT systems have seen reduced expenditure, possibly a result of manufacturers concerns regarding the status of, and access to, EU wide funding programs such as Horizon 2020.

Chart 6: Permanent and expensive investment assets are first to be shelved

% of companies holding back investment in certain assists due to Brexit negotiations



Source: EEF Investment Monitor 2018/19

5. BUCKING THE TREND

Of course, there are always companies bucking the wider trend. In fact, a still sizeable 34% of manufacturers are intending to increase their investment in the coming two years, indicating that not all companies are being affected by the uncertain climate to the same extent.

Delving into the data we do find some notable trends in the rate of investment however. The proportion of manufacturers looking to increase their expenditure by the higher band levels (i.e. increase their investment by more than 5%) is broadly the same as our previous *Monitors*. Yet the proportion of manufacturers intending to increase expenditure by 1-5% have fallen from 23% to 11%, suggesting heightened uncertainty is preventing those close-call investments getting across the line.

As ever, the need to replace and upgrade equipment is the top most reason cited by manufacturers who are intending to increase their expenditure (65%). These manufacturers will be looking to replace capital equipment which may have become obsolete and out-dated, depending on where they are in their respective investment cycles.

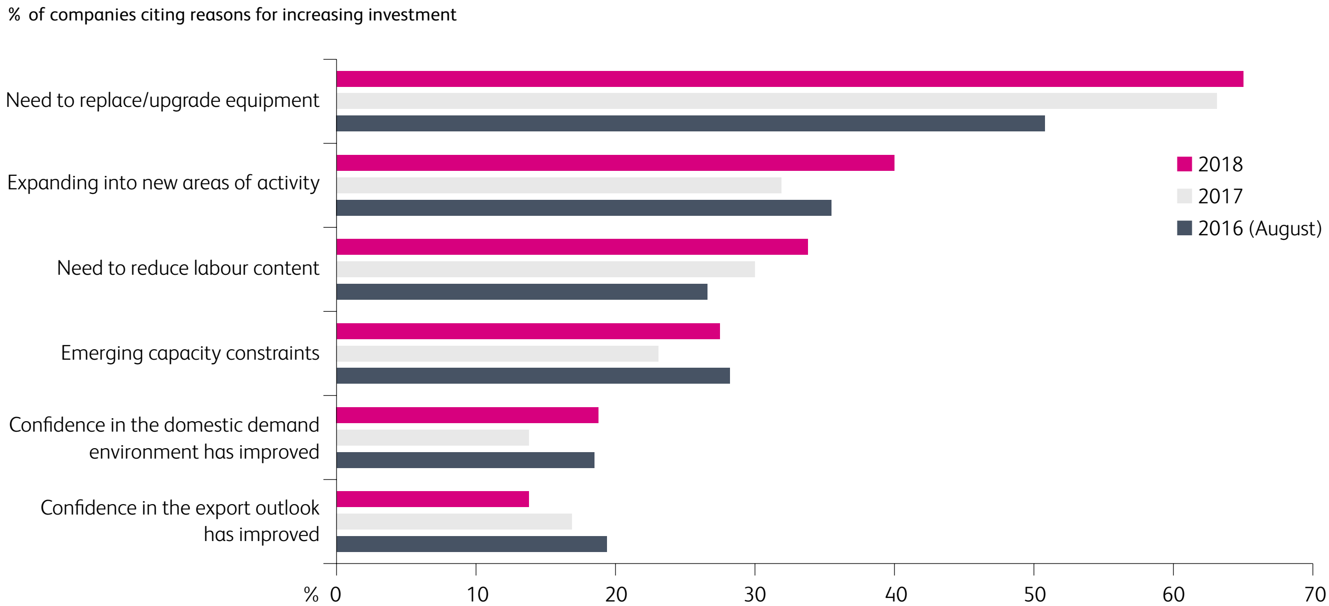
Furthermore, emerging capacity constraints (another one of the top drivers), on the back of healthy demand in 2017, look to be encouraging a portion of manufacturers to increase their investment. This trend was evident in our *Manufacturing Outlook* 2018Q3 survey, where capital equipment sectors such as electronics, as well as the basic metals sector, saw notable upticks in investment in order to meet growing customer demand.

Four out of ten manufacturers who are planning to increase their investment are also seeing new opportunities abroad. As mentioned, the global economy has slowed from 2017, and there are significant downside risks to the outlook, particularly with regards to rising trade tensions. Yet for the time being, growth is still ticking along, and the US, for all the controversy around the Trump administration's policies, is the driving force behind this. Healthy demand is still emanating from this region, and capital equipment manufacturers in particular look to be taking advantage while they can.

However, the most interesting factor behind those manufacturers looking to increase their investment is the need to reduce labour content. This, as a reason for investing, has picked up over our past three *Investment Monitor* reports, with over a third (34%) citing it as a reason this year. The growing desire to reduce labour content has come into sharp focus recently, given the risk that the UK's upcoming departure from the European Union will stem businesses' access to EU labour. Coupled with the chronic skills shortages across manufacturing as a whole, and the benefits of automation which we highlighted in last year's *Investment Monitor*, this trend looks set to continue.

Having analysed what is expected to happen to manufacturers' investment plans in the coming years, we will now assess what this may mean for one of our favourite topics – the UK's productivity performance.

Chart 7: Some companies are bucking the trend and looking to increase investment



Source: EEF Investment Monitor 2018/19

"Emerging capacity constraints, on the back of healthy demand in 2017, look to be encouraging a portion of manufacturers to increase their investment."

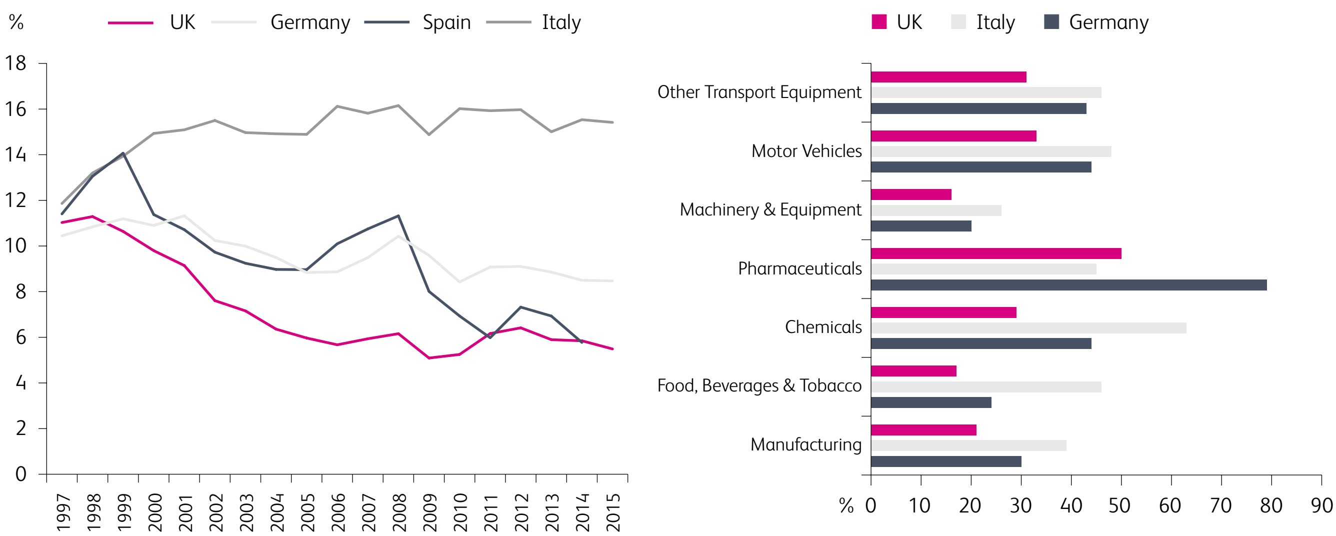
6. INVESTMENT AND PRODUCTIVITY
– ESTABLISHING THE LINK

The topic du jour remains the UK's flat lining productivity performance – economists tell us that in the long-run, productivity growth is almost everything[2]. But at the moment the UK economy is seeing almost none of it. The causes of the UK's relatively weak performance have been extensively debated and, amongst other things, analysis continues to come back to levels of investment in tangible assets by manufacturers in the UK. The longstanding and dominant theory is that UK manufacturing underinvests in capital equipment and, as a result, more hours are worked for the same level of output when compared internationally.

Chart 8a comparing capital investment in manufacturing as a % of output (measured by GVA) across the UK, Spain, Italy and Germany, would give this argument some merit. Moreover, analysis of the balance of capital and labour (shown in chart 8b) in a number of sub-sectors and compared across the same European competitors, again points to something of an historic weakness in investment levels in the UK. Recent research from EEF[3] suggested that the differing structure of business operations across some sub-sectors of manufacturing in the UK may explain some of the difference. For example, sectors such as mechanical equipment tend to derive a higher proportion of their value-add from services such as installation, repair, and maintenance.

Chart 8a and 8b: UK manufacturing investment – still lagging

Investment as % of GVA and consumption of fixed capital/compensation of employees



Source: Eurostat

[2]"Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker." – Paul Krugman, Professor of Economics and International Affairs at Princeton University
[3]EEF – Unpacking the Puzzle: Getting UK manufacturing productivity growth back on trend (2018)

This position in the supply chain may mean there is a reduced requirement for investment in more costly areas of plant and machinery. However, these structural differences do not explain all of the gap, its prevalence in all industry segments, nor its widening with some competitors overtime.

Investment revisited

Manufacturers also recognise the link between their investment and overall productivity and this is one which our *Investment Monitor* has explored before. In 2015, we investigated this relationship with manufacturers and it was clear that a majority saw investment in modern machinery and ICT assets as a means of driving forward productivity improvements within their businesses. Moreover, a majority of companies were planning investment in these areas with the objective of raising their productivity performance. Though workforce skills came a close second with innovation completing the productivity-enhancing investment triad. These are areas which the economic literature would suggest play an important role in driving forward better productivity.

Nevertheless, fast forward and we see that manufacturing output and investment plans have had a bumpy ride, and not all of these plans to invest in order to deliver stronger productivity growth came to fruition. From past wobbles in the global economy, fluctuations in the oil price and now, in the past couple of years, political uncertainty becoming more prominent in the boardroom, there has been plenty in the external environment to hold back investment growth.

The overall consequence is that there is little to suggest that the investment gap will have narrowed significantly, nor does a sea change look in prospect. Therefore, the medium to long-term productivity implications of remaining on this trajectory should be of concern to industry itself and to policy makers.

> “The longstanding and dominant theory is that UK manufacturing underinvests in capital equipment and as a result more hours are worked for the same level of output when compared internationally.”

7. RISK OF FALLING FURTHER BEHIND

As the results presented so far raise questions about the strength of investment growth in the coming two years, it is important to look at these expected outcomes in an international context. The dominance of uncertainty, particularly around potential Brexit outcomes, as a factor weighing on investment plans across UK manufacturing points to UK companies facing a range of constraints that are not in play in other countries.

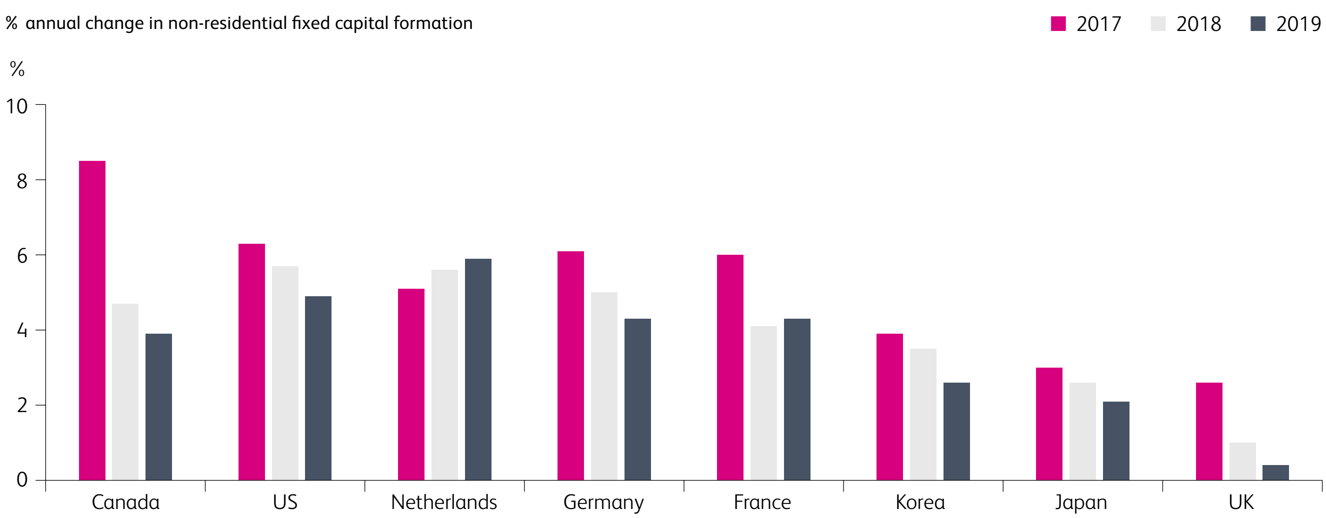
The latest business investment forecasts from the OECD, illustrated in chart 9, confirm this. The UK looks set to languish near the lower end of the developed world league table when it comes to investment growth in the private sector. In addition to the fact that other countries are not expending time dealing with the political and economic complexities of exiting the European Union, there are also signs of more concerted efforts in some jurisdictions to reform tax policy towards a more investment friendly outcome.

The US corporate tax reform programme, which has enacted changes to depreciation allowances and reduced corporation tax rates, looks to encourage companies to expand or return investment to the US at the expense of other locations. On the back of this, the growth picture has firmed up and a boost to private sector investment has contributed to that. And where the US has trod, others are keen to follow; in Canada, for example, there is growing pressure from manufacturers for a similar pro-investment reform package.

Closer to home, policy levers have been targeting investment associated with the fourth industrial revolution. In Italy, for example, generous incentives to invest in new technology and automation are attempting to leapfrog competitors in the 4IR race.

While we've seen some positive policy developments in support of manufacturing and investment in recent years, our *Investment Monitor*

Chart 9: Capital gap set to grow



Source: OECD (2018)

has consistently struck a neutral tone on the extent to which current UK tax policy makes a difference to investment. Nevertheless, we noted last year that companies most advanced on their automation journey felt that the tax environment could be more supportive.

Domestic uncertainty, combined with what feels like a sharper policy focus in other countries, looks set to leave UK business investment growth in the slow lane – for the next couple of years at least. We'll return to some thoughts on how policy makers could start to address this potential growth gap at the end of the report.

> "We have to be extra choosy about investment decisions even with a water-tight business case."

Manufacturer in the automotive supply chain

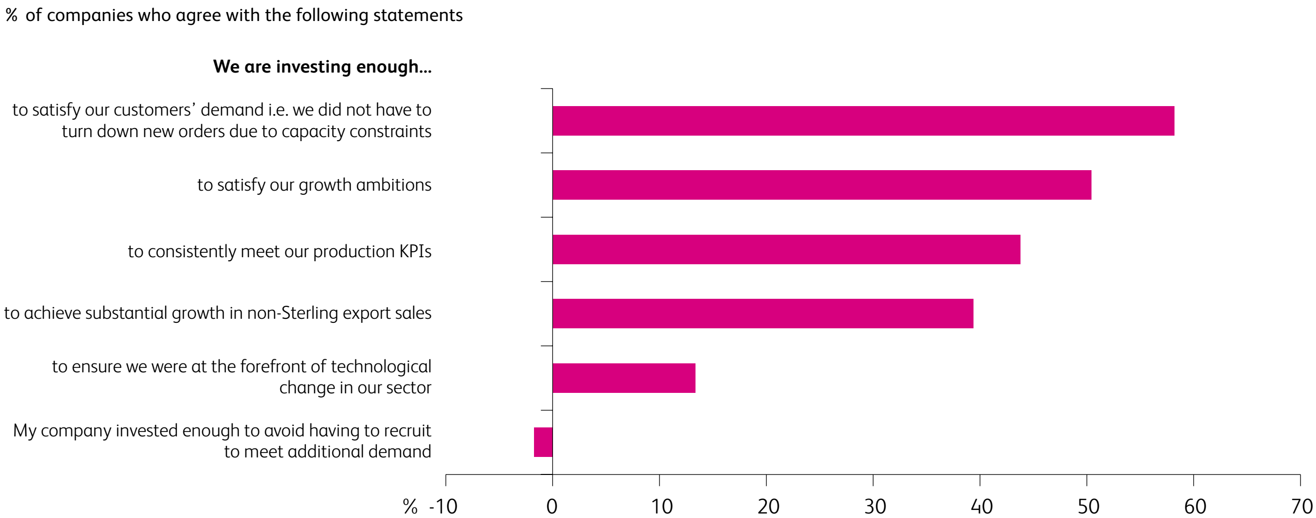
8. INVESTMENT CHALLENGES GO DEEPER THAN UNCERTAINTY

While the economic evidence points to past and likely future shortfalls in UK manufacturers' capital expenditure plans, less analysis has been conducted on firms' perception of this gap. Our *Monitor* tries to address this omission in the evidence base by seeking to ascertain whether manufacturers believe their recent investment levels have been adequate across a range of business indicators. It's a mixed picture – both in terms of companies investing to meet business objectives and also across different size bands within manufacturing.

Starting with where companies are doing well – as indicated earlier, companies are generally avoiding a capacity crunch with a strong balance agreeing that their business is investing enough to fulfil customer requirements. However, whether this is down to just investment is open to argument.

Scoot to the bottom of chart 10 and it is clear that the investment versus recruitment picture to meeting capacity is finely balanced. This is the crux of the productivity debate. Only large companies in our survey have a net balance in agreement that their company has invested enough to avoid additional recruitment, with balances dwindling as you move down the size bands. Over three fifths of companies with less than 100 employees disagree with the statement.

Chart 10: Investment versus recruitment is finely balanced



Source: EEF Investment Monitor 2018/19

This may be a consequence of smaller companies having less visibility of their order books and using recruitment to flex production schedules to meet additional demand. Additionally, discussions with some manufacturers have revealed challenges with space in industrial buildings, meaning there is a necessity to recruit for extra shifts rather than bringing in new capital equipment to meet capacity requirements.

Making the technology leap

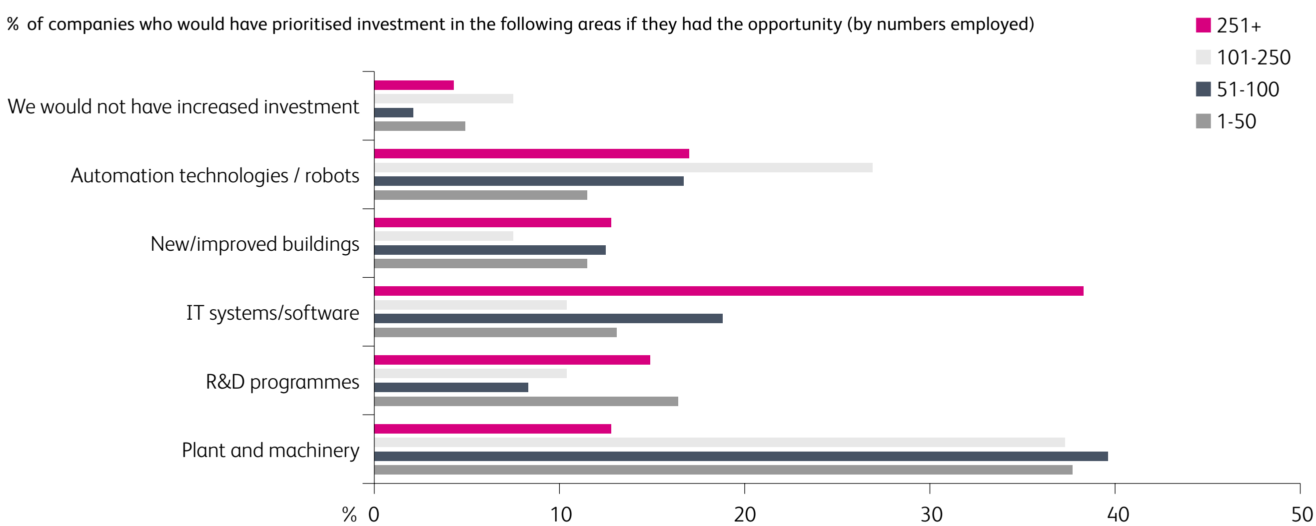
However, this group of smaller manufacturers also feel their companies have not been investing enough to keep at the forefront of technological change. The advent of the fourth industrial revolution brings huge opportunities, in terms of productivity and efficiency gains, but the challenges of implementation on a number of fronts – alignment with business strategy and confidence about returns on the investment and skills for adoption are also significant. This survey confirms our previous research[4] that some companies need more information on how they can implement 4IR investments with confidence.

While companies are, on balance, investing at sufficient levels to meet their business objectives, as we've seen in previous sections, these ambitions may be tempered by the range of uncertainties they face, from Brexit uncertainties to potential wobbles in domestic or overseas demand. Indeed, few companies say that, given the opportunity, there wouldn't have been other areas of their business that would have benefitted from additional investment.

As shown in chart 11, there are additional areas where investment would have been of value in delivering business outcomes in the past two years. Again, the stand out area of additional opportunity would have been in plant and machinery. This is particularly dominant for the smaller companies in our sample – and those that have been pushing ahead with taking on additional employees to meet capacity requirements.

However, there are some interesting company size differences, with the largest companies identifying new IT systems and software as an area that required additional investment and mid-size companies expressing a stronger appetite for extra investment in new automation technologies and robotics. The next section will consider whether there are aspects of the decision making process within companies that may need to shift in order for these investment opportunities to be taken forward in future.

Chart 11: Investment in plant and machinery is a priority for smaller manufacturers



[4] EEF – How 4IR is transforming manufacturing productivity factcard (2018)

Source: EEF Investment Monitor 2018/19

9. EFFECTIVE DECISION MAKING

The boardroom debate about future investment has become more complex, with management juggling with political uncertainty that has no defined end point, healthy order books in the short term and rapid advances in technology. Making optimal decisions about the level and mix of investment in this backdrop may require a refined set of appraisal techniques and better advice and support from external sources. Our survey points to the dominance of financial metrics in deciding whether investments get the green light, but as we've seen from previous research these may not be keeping pace with the business benefits of new technology.

Larger companies are more likely to see the big picture

In aggregate across our sample, alignment with strategic growth ambitions comes out on top with over four-fifths of companies citing this as the most important factor (30%) or important along with other factors (51%) when approving new investment projects. This confirms what one might expect – with no company likely to buy a new piece of equipment or embark on an R&D investment that is out of synch with the wider objectives of the business. And indeed, there is very little difference across company size bands in this link between investment and growth ambitions.

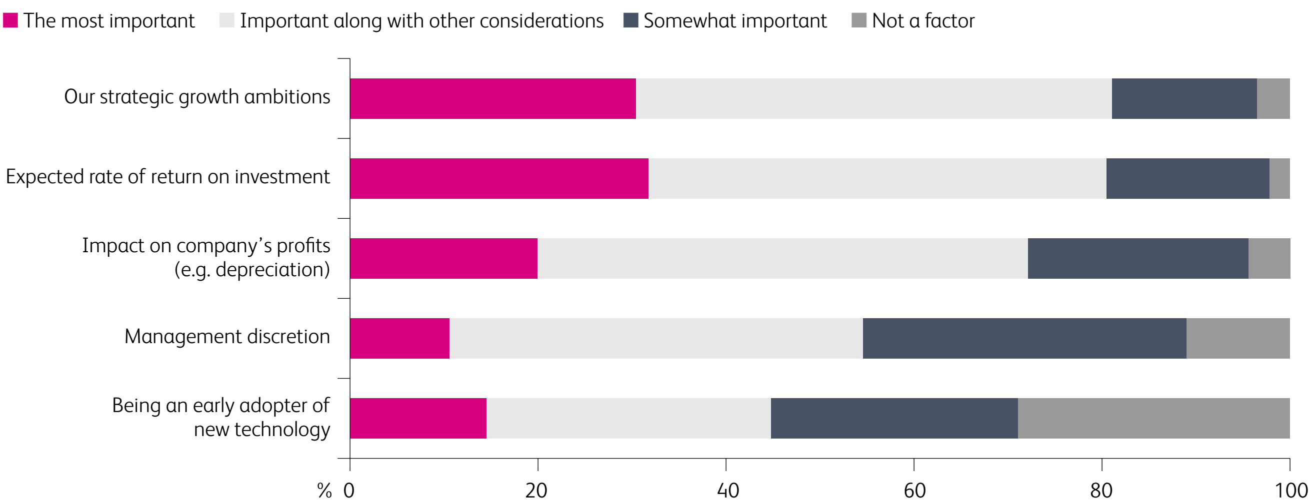
Clearly for foreign-owned firms in our sample there is also an element of discretion or direction from parent companies (not illustrated). For those respondents in our survey for which this is applicable, parent company approval is one factor amongst others, that ultimately drives the decision.

Following closely behind company growth ambitions is an analysis of the rate of return on the investment, again cited by around 80% of companies as being an important factor, and again broadly consistent across all sizes of manufacturer.

Where size differences, in particular,

Chart 12: What factors determine whether an investment gets the green light

% of companies citing importance of factors when it comes to deciding whether an investment project gets approved



Source: EEF Investment Monitor 2018/19

start to emerge is in the use of management discretion on investment projects and the importance attached to being a first mover on new technology adoption. The former is more important at the smallest and largest end of the size spectrum. For example, we see small, nimble manufacturers, perhaps with more visionary leadership, being more speculative in making a new technology investment, to create a niche product or get a step ahead of competitors. Larger companies may also be somewhat better resourced, with management using discretion over some projects as part of a broader portfolio of projects.

But, in the main we continue to see smaller companies taking more tentative steps on their 4IR journey. This may not be a problem if we saw rapid diffusion of technology across manufacturing, but the literature suggests that the gap in uptake of 4IR technology between the frontier and the rest is slow to close. Our survey continues to point to the need for better information on the pay back periods of automation and 4IR technology investments, and greater opportunities for manufacturers through the supply chain to see the potential production benefits first hand. Rather than expecting companies to take the leap, there are a number of agents and policy changes that could more effectively bring about a different approach to investment appraisal, which we'll explore in the next section.

"We see some small, nimble manufacturers, perhaps with more visionary leadership, being more speculative in making a new technology investment, to create a niche product or get a step ahead of competitors."

10. INCREASING INVESTMENT – WHAT CAN BE DONE?

Our latest *Investment Monitor* has some positive news in terms of recent investment developments – capital expenditure plans have held up in line with last year's expectations and manufacturers have invested slightly more as a proportion of turnover in the past couple of years. Good global demand has played an important role in keeping those growth plans on track, despite the backdrop of elevated uncertainty.

The outlook for the next two years is not as positive. Output may have been resilient across many manufacturing sub-sectors, but it is clear that the best of this investment cycle is behind us. Moreover the moderation in investment spending is set to be more rapid than that forecast for many of our competitors.

Heightened levels of uncertainty – primarily about Brexit but consequently feeding a more fragile outlook for domestic demand – are the dominant forces weighing on investment, not a lack of need or opportunity. Boardroom caution around investment has the potential to add to the sector's productivity challenges.

But our survey together with other evidence from international comparisons points to Brexit being one hurdle of many in recent years. Companies, smaller manufacturers especially, have seen their investment fall short of what was needed to avoid turning to more recruitment as a means of meeting extra capacity. We also see companies acknowledge that investment has not been adequate to keep up with technological change. In some cases this is due to the reliance on financial appraisal metrics not being up to the task of assessing the business benefits of 4IR investments.

A Brexit resolution – much as it will help with companies' confidence about investing in the UK – will not overcome all of these issues. There are a number of other actions that could be taken to support manufacturers in their efforts to exploit new opportunities, through this period of (hopefully) short term uncertainty and to change the investment and productivity dynamic in the long-run.

Here are five policy options:

1. The forthcoming autumn budget must bring forward a combination of **grant support and accelerated depreciation** to anchor investment, from companies large and small, in the UK.
2. The new Made Smarter Commission has a role to play in bringing together expertise that better inform **appraisal methodologies** for companies looking to invest in new 4IR technology solutions.
3. Government has a role to play in incentivising the development of **world class management** capabilities across UK companies through more creative use of funds raised through the apprenticeship levy.
4. The private sector and government need to work together on the roll out of demonstrators and tailored support to enable the **diffusion and adoption of new technologies,** which would boost investment across SMEs.
5. While companies remain cautious about large scale investments, the **retail banking sector must maintain engagement with SMEs** and increase their lending appetite when the clouds of uncertainty start to clear.

SANTANDER VIEWPOINT

Santander is delighted to once again be partnering with EEF to publish the Investment Monitor 2018-19. The research provides crucial insight into the views of manufacturers at this delicate moment in the UK's economic cycle. As we look ahead to Brexit and beyond, it is vital that we work together to manage the emerging risks – but also to exploit new opportunities.

This year's research suggests that manufacturers are cautious. As they wait for greater clarity on the shape of the post-Brexit landscape, they are naturally reluctant to commit to long-term investment decisions. Manufacturers haven't stopped investing – indeed the research shows they are spending more on plant and machinery – but they are wary about planning too far ahead. Heightened global tensions, as the US and China continue to impose new tariffs on international trade, have added to the sense of anxiety.

However, there is good news too. Despite the uncertain outlook, more than a third of manufacturers intend to increase the amount they invest over the next two years. And many businesses recognise that while Brexit will pose new challenges, there will continue to be opportunities to increase trade in international markets, both in the European Union and with the rest of the world.

Clearly, there are questions to be resolved. Greater certainty about the final form of Brexit will help manufacturers make more informed decisions. Key issues will include how the UK Government is able to ensure continued access to collaborative innovation and R&D programmes, such as the successor to Horizon 2020 – Horizon Europe.

Nevertheless, at Santander we believe Britain's world-class manufacturers have an exciting future on the global stage. Our challenge is to help these businesses achieve their full potential.

That will mean working closely with manufacturers to identify their investment needs and to provide the most appropriate type of support.
At this key moment, it has never been more crucial for manufacturers to focus on improving their productivity, but there are no one-size-fits-all solutions. For some businesses the route to greater competitiveness will be via investment in technologies such as automation, robotics and artificial intelligence; for others, upskilling the workforce, or the management team, may be the greater priority.

Such investment will help equip manufacturers with the capabilities they need to improve their export performance, breaking into new overseas markets and increasing sales in territories where they already have a place. And our international network enables us to support manufacturers as their global footprint expands.

This will be crucial: our Santander Trade Barometer research shows there is a clear link between export success and business confidence; those manufacturers able to fulfil their international ambitions in the months and years ahead will be much better-placed to drive growth even against challenging headwinds.

The future is bright for the UK's manufacturing sector. At Santander, we're convinced that manufacturers can shine brightly, winning new business and increasing their sales in markets all around the world. We look forward to continuing to work closely with EEF members to help them do exactly that.

Paul Brooks
UK Head of Manufacturing, Santander Corporate & Commercial Banking

UK MANUFACTURING FACTS, 2018/19

2.7 million employees earning on average **£32,467**

10% of **UK output** and the **9th largest** manufacturing nation in the world

45% of UK exports totalling **£275bn**

69% of business R&D

Keeping Britain at the forefront of technological change

Santander Corporate & Commercial

We are fully committed to supporting manufacturers and we appreciate you are looking for something different from your bank. The complex nature of your business requires support from a bank that understands your industry, will deliver on its promises and believes in building long-term relationships.

We will work with you to find a finance package that meets your needs. We have a range of products available to help you manage your day-to-day cash flow, purchase essential equipment, invest for growth and mitigate financial risks when trading in both domestic and international markets.

With business customers worldwide, we have both the expertise and the reach that can help manufacturing businesses with their international expansion.

Products and services are subject to eligibility, status, terms and conditions and availability.

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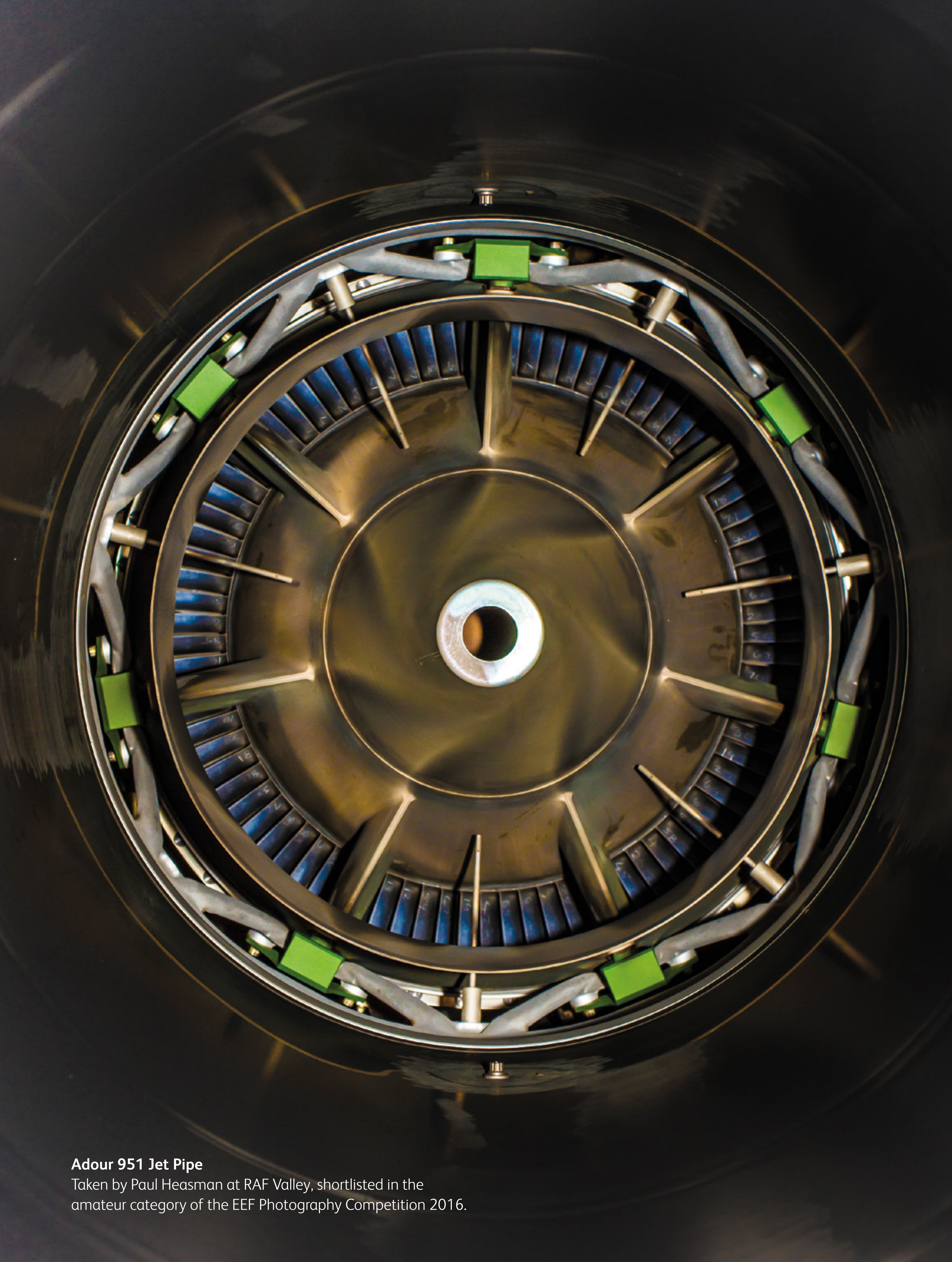

Adour 951 Jet Pipe
Taken by Paul Heasman at RAF Valley, shortlisted in the amateur category of the EEF Photography Competition 2016.

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