Running Out of Time

In this special report, IBISWorld assesses the effects of non-tariff barriers on two of the largest manufacturing industries in the United Kingdom, and discusses what businesses throughout the supply chain may do to mitigate the effects of the UK’s exit from the European Union.

The financial implications of tariffs with the UK’s largest and closest export market have been writ large in the year and a half since the referendum. The effects of non-tariff barriers on the complex supply chains of UK manufacturers have received somewhat less attention, but are just as important. Large companies import thousands of products at all stages of the supply chain, and efficiency relies on the smooth movement of goods across borders, with parts regularly hopping across the channel as components come together to roll off production lines across the country. In this special report, IBISWorld analyses two key industries that would heavily by a failure to secure frictionless barriers, and highlights some of the options available to British businesses seeking to pass through the turbulence unscathed. In this regard, UK manufacturers are running out of time to become ‘Authorised Economic Operators’, with waiting times soaring as firms scramble to take advantage of a scheme offering a fast-track through customs, lower risk scores, and much more besides.

Flagship manufacturers
Motor vehicle manufacturing is a highly globalised process, and major UK manufacturers, including Toyota, BMW and General Motors, have stressed the importance of free trade with the European Union to industry growth. The headline figures are startling; IBISWorld estimates that 63.5% of industry revenue is generated from exports, with more than half of these bound for the European Union each year. Should the United Kingdom exit the European Union on WTO rules, without securing a trade agreement, vehicles would face a 10% tariff. Whilst exports have been buoyed by the depreciation of the pound, and are expected to rise by 3.4% in 2017-18, such an outcome would pose a significant barrier to the industry’s long-term success, as well as the performance of companies throughout the motor vehicle supply chain.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Export revenue (£ million)</th>
<th>Exports/Revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor Vehicle Manufacturing</td>
<td>36,836</td>
<td>65.34</td>
</tr>
<tr>
<td>Aircraft, Engine &amp; Parts Manufacturing</td>
<td>27,368</td>
<td>87.48</td>
</tr>
<tr>
<td>Organic Basic Chemical Manufacturing</td>
<td>9,433</td>
<td>76.23</td>
</tr>
<tr>
<td>Measuring, Testing and Navigational Equipment Manufacturing</td>
<td>8,022</td>
<td>87.66</td>
</tr>
<tr>
<td>Engine &amp; Turbine Manufacturing</td>
<td>5,987</td>
<td>57.26</td>
</tr>
</tbody>
</table>

SOURCE: IBISWORLD
More concerning for the industry is the fate of car components. Operators have already been hit by the depreciation of the pound, which has pushed up purchase costs to 75% of revenue in the current year, but it is the way in which inputs are used that poses the most prominent problem. The industry is heavily reliant on the just-in-time manufacturing process, with components arriving from countries across the European Union mere hours before they are required. This streamlined process helps to keep inventory costs down and ensures the competitiveness of the industry on global markets.

In addition to the more apparent effect of tariffs, the cost of non-tariff barriers could be significant, when considering the fine margins and timings just-in-time production requires. The industry has told MPs that every 15 minutes of customs delays could cost some manufacturers up to £850,000 a year, and with more than half of the components that make up modern UK-manufactured vehicles being sourced from abroad, potential customs barriers would severely complicate existing operating processes. Indeed, in a report to the Business, Energy and Industrial Strategy committee, Honda stated that non-tariff barriers are more problematic than potential tariffs, noting the company’s reliance on the frictionless movement of 2 million components through the Port of Dover a day, which allows the company to hold only an hour’s worth of stock.

Similar effects are expected to be felt in the Aircraft, Engine and Parts Manufacturing industry, which generates 87.5% of its revenue from exports, and is similarly reliant on lean, just-in time manufacturing processes. Again, in addition to the headline questions of certification and aviation market rights, manufacturers throughout the aviation supply chain face customs concerns. When reporting to a parliamentary select committee, the aviation industry warned of turbulence, citing the possibility of a £1.5 billion-per-year headwind if customs and regulatory deals are not made. Although wing manufacturing is an area of UK expertise, with approximately half of all large aircraft using British-made wings, the major manufacturers are global, and added costs in the UK supply chain could encourage a shift of focus. Airbus, for
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example, also produces wings in China, and should supply chain costs prove too prohibitive, UK investment and order books could suffer.

In addition to such high-flying industries, customs checks could also affect myriad companies across a range of more mundane sectors. Large wholesalers such as Booker Group, distillers like Diageo and retailers across the country would all be affected by delays to customs checks, and increased supply chain pressure could increase costs for consumers as a result.

What may be done?

In addition to the pitfalls facing the flagship manufacturing industries, retailers, wholesalers and manufacturers of all sizes also benefit from being able to import without having to fill in a customs declaration. Although many firms may feel they lack the clout to affect negotiations, and whilst businesses may only be able to advocate regarding type approval and certification through industry associations and lobby groups, businesses do have recourse to a number of options to mitigate uncertainty, with application for Approved Economic Operator status chief among these.

Although time is running out to apply, AEO status allows businesses to become ‘trusted traders’ and could be one of the most effective means for companies to safeguard their operations. Currently, fewer than a thousand UK firms are AEOs, a significantly smaller number than in Germany, for example, which boasts more than 6,000. Firms may apply for AEO status for customs simplification (AEOC), AEO status for security and safety (AEOS), or both, and the potential benefits are manifold.

Any business involved in the international supply chain may become an AEO provided that it meets criteria regarding compliance record keeping, solvency and professional qualifications or standards of competence (for AEOC) or appropriate safety standards (for AEOS). AEOs may be able to bypass many of the customs problems associated with the United Kingdom leaving the European Union, as AEOC status confers fast application process for customs simplifications, authorisations and reductions or waivers of potential debt guarantees. AEOS status, meanwhile, allows consignments to be fast-tracked through customs control and offers companies lower risk scores, which can reduce the frequency of physical and documentary customs checks. Although most pertinent to businesses with

Aircraft, Engine and Parts Manufacturing products and services segmentation (2017-18)

<table>
<thead>
<tr>
<th>Product</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Space equipment</td>
<td>4%</td>
</tr>
<tr>
<td>Business jets and other planes</td>
<td>4.8%</td>
</tr>
<tr>
<td>Helicopters</td>
<td>4.9%</td>
</tr>
<tr>
<td>Civil aircraft</td>
<td>7.2%</td>
</tr>
<tr>
<td>Defence aircraft</td>
<td>22.1%</td>
</tr>
<tr>
<td>Aircraft engines</td>
<td>28.8%</td>
</tr>
<tr>
<td>Aircraft equipment</td>
<td>24.6%</td>
</tr>
<tr>
<td>Other</td>
<td>3.6%</td>
</tr>
</tbody>
</table>

Total £31.3bn

SOURCE: WWW.IBISWORLD.CO.UK
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particularly lean or just-in-time operating practices, all firms could benefit from AEO status. Firms that wish to take advantage of the scheme must do so soon, however, as the time taken for accreditation is now almost a full year. Delays are likely to continue, regardless of any transitional arrangements, as firms race to secure their position ahead of the UK’s looming exit date.

Many companies may also benefit from reshoring their supply chains where possible. According to the Society of Motor Manufacturers and Traders, 44% of the parts in a UK-manufactured car are sourced from domestic suppliers. Although this is up from the low thirties recorded in the early 2000s, some of the manufacturers supplying these components will also have international supply chains. Nevertheless, many major car companies are seeking to expand the proportion of components they source domestically. Nissan, for example, is opening a new centre next to its Sunderland plant to house local manufacturers, whilst Toyota is also seeking more components for the production of the Auris and the Avensis from the current year. Investment in the domestic supply chain is particularly important for exporters, because firms will have to increase the proportion of components originating in the United Kingdom in order to comply with the rules of origin governing any free-trade deals that the United Kingdom may sign following its exit from the European Union.

Indeed, firms such as Liberty House are seeking to benefit from this through the acquisition of manufacturing sites. The company plans to build a wheel-pressing plant by the aluminium smelter it recently bought in Fort William, as part of a £120 million investment in the site.

Although the form of the UK’s exit from the European Union remains unclear, and whilst individual companies remain beset by uncertainty, there are avenues of advantage, and manufacturers and firms of all sizes have options to smooth out the road ahead.

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**IBISWorld Industry reports used in this special report:**

C29.100 Motor Vehicle Manufacturing in the UK  
C30.300 Aircraft, Engine & Parts Manufacturing in the UK  
C20.140 Organic Basic Chemical Manufacturing in the UK  
C26.510 Measuring, Testing & Navigational Equipment Manufacturing in the UK  
C20.590 Chemical Product Manufacturing in the UK

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