



ICAEW SCOTLAND RESPONSE TO SCOTTISH PARLIAMENT ECONOMY, ENERGY AND TOURISM COMMITTEE CALL FOR WRITTEN EVIDENCE ON INTERNATIONALISING SCOTTISH BUSINESS

16 JANUARY 2015

INTRODUCTION

1. ICAEW welcomes the opportunity to provide a submission to the Scottish Parliament's Economy, Energy and Tourism Committee call for written evidence on internationalising Scottish business.
2. We would be happy to discuss any aspect of our comments and to take part in further consultations on this area.

WHO WE ARE

3. ICAEW is a professional membership organisation, supporting over 144,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
4. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards, to over 1.5 million businesses. 83% of FTSE 100 companies have an ICAEW member on their board.
5. We believe in acting responsibly, in the best interests of our members and the general public. We act with integrity, creating effective partnerships with organisations and communities worldwide to ensure the highest technical, professional and ethical standards.
6. ICAEW is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
7. ICAEW Scotland serves 1,500 ICAEW members across the private and public sectors in Scotland and represents the views of ICAEW members who work in Scotland for local, national and international organisations.

Keith M Proudfoot
ICAEW Scotland

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Further Contact:

ICAEW Scotland
PO Box 26198
Dunfermline
KY12 8ZD
T +44 (0)131 202 1251
F +44 (0)131 202 1250

E ims@icaew.com

W icaew.com/scotland

8. THE EXPERIENCES AND CHALLENGES FACED BY SCOTTISH EXPORTERS

8a. A WORLD OF OPPORTUNITY

At a UK level ICAEW supports the Westminster Government's aim of boosting UK exports. That approach and support for The Scottish Government is replicated by ICAEW Scotland. ICAEW has conducted research among our chartered accountant members – many of whom are actively engaged in exporting or advising exporters – aimed at identifying the barriers facing businesses and understanding how they might be overcome. Our informal research, based on a series of export round table events, entitled *Outcomes of a series of ICAEW round table discussions on export and barriers to businesses trading overseas 2014*, is attached as an appendix.

9. THE REASONS WHY MANY SCOTTISH FIRMS, PARTICULARLY SMEs, DO NOT EXPORT

TOO MUCH TROUBLE

It is also clear many Scottish businesses lack the ambition, resources and, in some cases, courage to take the substantial risks involved in seeking to open up worldwide markets. It should be noted that the decision to seek out new markets is an entirely commercial one. Companies will export if there is likely to be a profit in it for them. They will not do so if the risks seem to outweigh the rewards, especially when it can take several years to become established in a new market.

It follows that, for many small and medium-sized businesses, there are few tangible incentives to export if they are performing adequately in the domestic market. It is equally true that many SMEs become 'accidental exporters' when foreign customers track them down via the internet.

Despite evidence showing that businesses engaged in export are more efficient, innovative and profitable than those which stay at home, it remains difficult to motivate many SMEs to invest in opening up new markets abroad. Even established exporters have sometimes had their fingers burned. Fear of failure – and fear of losing significant sums – is a constant constraint even on reasonably ambitious companies.

10. THE EFFECTIVENESS OF SDI AND UKTI, AS WELL AS SCOTTISH ENTERPRISE AND HIGHLANDS AND ISLANDS ENTERPRISE, IN HELPING SCOTTISH FIRMS ENTER AND GROW IN INTERNATIONAL MARKETS

10a. LEAP INTO THE UNKNOWN

Despite some criticisms, there is no doubt UKTI, and SDI in particular, has a good reputation among most businesses which use their services.

ICAEW supports the work of UKTI, SDI and UKEF and has been actively engaged in promoting their services to our members. We feel this is especially important as a chartered accountant is likely to be the first port of call for a business which is motivated to export.

However, our research shows there remains a lack of understanding of what these services consist, even among regular exporters. The knowledge of UKTI, SDI and UKEF among those who are not yet exporting is even poorer.

Chartered accountants are one of the key sources of advice to SMEs on export, as on most other aspects of business development. Export agencies could benefit from working more closely with professional bodies and their members to ensure there is a good understanding of the services available.

10b. **SCATTERGUN APPROACH**

One specific observation is that the approach towards encouraging businesses to trade overseas lacks focus. While there is an aim of encouraging medium-sized businesses to export, this appears to treat all sectors, sizes and markets as of equal importance. ICAEW research shows most companies still depend heavily on Europe and the USA for export markets though there is growing understanding of the need to look at less traditional markets in Asia-Pacific and the Middle East.

We are aware of the UK Industrial Strategy, and the eleven sector strategies developed within it. Achieving significant export growth from the Strategy will take time. Within the Strategy, ICAEW believes there needs to be greater recognition that the support required by a medium-sized business is very different from the needs of a small or micro business.

11. **WHETHER THE SCOTTISH GOVERNMENT IS LIKELY TO MEET THE GOVERNMENT'S ECONOMIC STRATEGY TARGET OF INCREASING THE VALUE OF EXPORTS BY 50% BY 2017 (AND THE USEFULNESS OF THIS TARGET)**

Britain is unlikely to meet the 2020 export target of £1 trillion. It looks increasingly likely that the Scottish Government target for 2020 will also be too challenging. There are many reasons for this, including a buoyant domestic economy compared with the lack of growth in our major EU markets.

12. **HOW BUSINESSES CAN BEST BE SUPPORTED**

12a. **OVERCOMING THE HURDLES**

Most of the barriers to export discussed above can be overcome. Some of the actions which could help are:

- Active marketing is necessary as SDI, UKTI and UKEF are not visible or accessible enough. There is a need to raise awareness and encourage the use of their services.
- ICAEW and other professional bodies could work more closely with UKTI, SDI and UKEF to raise awareness of their services among members. To that end, ICAEW is to create an export web resource for members and others and will create a directory of our members offering export advice and services.
- ICAEW has more than 21,000 members in more than 160 countries around the world. From the point of view of export agencies, this is an under-used resource which could be exploited to assist Scottish and UK exporters.
- Clearer strategies are necessary to identify and encourage exporting among different sizes of business, and into different countries/regions of the world.

12b. **A GAME-CHANGER?**

In addition, it is clear the risk-and-reward equation needs to be re-balanced in favour of companies prepared to invest in developing new export markets. This should be limited to small and medium-sized businesses.

Given the time, money and patience involved for many SMEs to establish themselves in a new country, the work amounts to investment in 'research and development'. If it were treated as such for tax purposes there would be much less for a potential exporter to lose and more to gain.

Under R&D credit, the tax relief on allowable R&D costs is 225 per cent – that is, for each £100 of qualifying costs, a company could have the income on which Corporation Tax is paid reduced by an additional £125 on top of the £100 spent. It also includes a payable credit in some circumstances. This incentive might be offered to first time exporters or to businesses which export to particular countries.

The introduction of such an incentive would, at the same time, encourage chartered accountants and other business advisers to advocate exporting to their clients in a far more positive way than at the moment.

APPENDIX:

Outcomes of a series of ICAEW round table discussions on export and barriers to businesses trading overseas, 2014

Government action

- An export credit system, along the lines of the existing research and development tax credit, should be established to encourage SMEs into the export market;
- At the very least, tax and VAT for entertaining foreign customers and travelling on export related activities should be 100 per cent recoverable;
- Remove the requirement to check VAT numbers annually for EU customers.

SDI/UKEF

- SDI should adopt a segmented strategy based on a range of different industry sectors
- SDI and UKEF should work harder to promote their services to SMEs, many of whom remain unaware of what is available
- Work with intermediary advisers, like chartered accountants, to promote an understanding of what is available through SDI and UKEF

ICAEW research

The barriers to export

Many businesses have the same difficulties in developing foreign trade. For example: the difficulty in finding credible local partners with a real presence on the ground and therefore the best route to market.

There is the fear and risk involved in seeking to establish new markets around the world. This requires persistence and, often, deep pockets before an export drive will start to pay off. From our research we know that most businesses under-estimate the amount of time and money it would involve.

As one FD said: 'We are experiencing growth of about 30% a year from opening in new markets, but not all markets work for you so it is a big risk and no matter how good your research is there can always be unforeseen issues.'

Finance

Finance is a key issue for exporters. As noted above, moving into new markets can be costly and requires long-term investment. Perhaps not surprisingly many lenders are very reluctant to support expansion into countries with a history of financial and political instability.

It was noted that the finance available from banks is complex and the banks are not really properly advising people on export.

One exporter said: 'Banks don't understand the issues and some covenants don't work. This has had a massive effect on some companies that could have been very successful, but have failed entirely as a business.'

Culture

A hurdle any exporter must overcome is dealing with cultural differences in the target market. One company found it was relatively straightforward to employ people in Spain, for instance, but found it harder in Germany, where staff supposedly do not like working for British companies. Employers also had difficulty persuading their own employees to work abroad.

In another case an adviser said he had a client who went into Russia feeling he had done sufficient research but found it was not adequate to the task. As a result, the client lost £50,000 on a deal. Most members felt there was a need for more market information. One commented: "What you are selling is essential to exports. But language, collateral, import duties, export licensing, freight and logistics, banking restrictions are just some of the things you also have to think about when it comes to exporting."

It was noted that companies sometimes fail to understand the basic issues when either making goods to export or setting up in another country. For example, the quality of the power supply in another country may be significantly different to the UK so electrical equipment may need to be adapted.

Cultural differences cut both ways. On marketing products, one respondent pointed out: 'British companies are far too British. The USA is much brasher. There needs to be more of a just-do-it attitude toward exporting. Government needs to share more success stories with the public, more case studies, and keep the information simple.'

Language

Members were divided over the necessity of learning other languages. In some countries it was expected that business people spoke the local language, though generally, because English was so widely spoken, an inability to speak another language was not considered a serious barrier to export.

However, members thought schools and universities should "emphasise, improve and value language skills; broaden knowledge of the world for students and workforces."

Business issues

It is clear many of the hurdles to be overcome require hard work on the part of the businesses and would not particularly benefit from Government intervention.

Several members admitted to making mistakes in establishing overseas routes to market, particularly in their selection of distributors. As one said, "Going for a distributor or an agent is a big decision and it really depends on the market. If you don't make the right choice it can be a costly mistake."

It was pointed out that products placed with agents were added to a list of dozens of other products. Agents were not allowed to be incentivised to push UK products over other countries' exports.

There are also difficulties over, for instance, bribery and corruption. This was thought to be improving slowly in most countries, but one business indicated their cost base was in some cases double.

As well as problems with recruiting the right partners and agents, many companies had to cope with bad debts, at all stages of a contract, including difficulty with contract terms; heavy costs could be incurred in seeking to recover money owed, especially with enforcement.

And payments were sometimes received net of (sometimes so-called) with-holding tax (eg 12% in India). Some businesses have to wait up to three years before getting paid, in some cases due to interpretation of some contract terms.

There was also a temptation to discount prices for overseas sales – but exporters need to resist this temptation as they could probably actually get a high price for their products, assuming they exercise stringent quality control.

Members also pointed out that the purpose of export was to make a profit. In some cases, exporting made no commercial sense. Increased sales did not always lead to increased profits. Not all markets were good for all exporters.

Tax

Members were painfully aware of what they referred to as the 'very aggressive' VAT regime. VAT on exports to EC countries was excessively complex. It was also pointed out that the requirement to check EU VAT numbers every month was simply impractical for companies with hundreds of customers.

Tax relief for exporters

An idea propounded by members at several of our research meetings was that Britain should introduce a tax incentive for companies thinking of moving into new markets.

It was felt the Government should introduce an Export Tax Credit Scheme along the same lines as the existing Research and Development tax relief scheme.

The argument for this is that it would re-balance the risk-and-reward equation in favour of companies prepared to take the long, slow and expensive step into the unknown that seeking out new export markets actually represents.

Given the time, money and patience involved for many SMEs to establish themselves in a new country, the work amounts to 'research and development' and if it were treated as such for tax purposes there would be much less for a potential exporter to lose and more to gain. It would have the added advantage that it would encourage chartered accountants advising SMEs to recommend exporting to their clients (as they already promote R&D tax credits). It could be confined to smaller businesses to ensure it's not all swallowed up by, say, British Aerospace or whoever.

Foreign exchange

Complications over foreign exchange were regarded by many members as a difficulty facing small businesses looking to export. It was felt there was not enough information available on the subject and, as one adviser commented, 'many clients fall over on this and can get it a real mess here'.

UKTI & SDI and UKEF

Opinion was sought on agency assistance, comments applied to UKTI may or may not be applicable to SDI. UKEF operates under that brand in Scotland.

Views on the services offered by UKTI were mixed. While some members had found their help invaluable, others considered it almost counter-productive.

It was a recurring theme that UKTI and UKEF were not visible or accessible enough. Even some hardened export businesses were wary of involving UKTI while the directors of others were almost entirely unaware of what the organisation could do for them.

One or two members referred to instances where, after an initial contact with UKTI, nothing more was heard from the organisation. It was also difficult for businesses to find the appropriate person to deal with.

One FD said he had found it very hard to convince his fellow directors to use UKTI while another commented: "When UKTI upset someone, they really upset them and I see this number increasing." Of most concern was the fact that UKTI seems unable to deliver on its promises in a timely fashion. At one meeting, two FDs raised this criticism, one saying it jeopardised a significant export contract.

UKTI was thought to have a very low profile – especially in Wales. It was also a regret that its services appeared largely limited to medium-sized businesses.

One exporter with customers in the EU, Nigeria and South America only became aware of UKTI within the last six months and was not aware of UK Export Finance even though financing contracts was a major issue for the company, especially as its customers were international corporations which demanded long payment terms.

The FD of a business with £40 million turnover – 80 per cent for export – expecting double-digit growth this year (for the second year running) said the export environment was changing. His biggest issue was credit risk management. His competitors, parts of larger corporations, were increasingly prepared to take on the risk themselves, but his company was reluctant to do so. They had negotiated an arrangement with UKTI to secure a contract in Nigeria but two months after making the agreement no action had been taken. "There has been progress but it has been very, very slow progress. Given all the advertising and publicity, I have found it incredibly slow going from an initial meeting to something tangible. Maybe it's a learning experience for us and we need to keep the pressure on."

UKEF

As with UKTI, but even more so, it was felt the services available via UKEF were not sufficiently well-known. Many of its products were sold through banks and can be dependent on the relationship a company has with the bank. One FD said: "Banks generally won't tell you about ECGD and therefore the whole system doesn't work."

Another commented: "We nearly lost a contract because it took six months to fill in a form from UKEF. We had to make all sorts of excuses. They are too slow."

However, another FD said UK Export Finance was helping it to agree sales contracts for equipment. "Without UKEF we could not have undertaken a £2.5 million contract with India. There's a lot for exporters to use for financing at the beginning, middle and end of the contract." Funding remains a major issue and growth restrictor. Whilst one well-established and highly profitable business supplying heavy duty, high-end civil engineering projects to developing countries had met 50 or 60 potential financiers, they only managed to borrow from four, with two being tied to equipment finance. They found UKEF 'excellent in every way'.

Conclusions:

As well as the recommendations set out at the start of this report, we have reached the following conclusions affecting UKTI/SDI:

- There are too many export credit schemes and their terms and conditions are too complicated for most SMEs
- Country guides should be reviewed and up-dated to cover a wider range of issues such as the reliability of local power supplies
- Embassies abroad do not appear to be adequate in assisting exporters. Staff must become more commercially-minded
- UKTI and SDI should do more to promote success stories as a source of inspiration to SMEs
- UKTI and SDI could do more to exploit the expertise of chartered accountants at home and based overseas. This is a valuable, largely untapped, resource.