

The future of manufacturing in Europe

A survey conducted by the Economist
Intelligence Unit for European Voice



EuropeanVoice

An Economist Group business

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Introduction

This is an executive summary of an Economist Intelligence Unit (EIU) survey, conducted on behalf of European Voice.

The online survey, which was conducted in October 2008, polled 337 executives from the manufacturing sector to obtain their views on the challenges facing the industry in the EU today. A majority of the respondents were from the chemicals industry (18%), but there was also representation from a number of other manufacturing subsectors, including automotive, building materials, and industrial machinery and equipment (see appendix for full list of industries represented).

The sample contains a mixture of SMEs and large firms. Fully 48% of the companies polled generate annual revenue in excess of \$500m and 19% have annual revenue in excess of \$10bn. Most of the survey respondents hold senior positions at their companies. Nearly one-quarter (23%) of the sample is CEOs, presidents and managing directors; in all, one-third of the sample were from the C-suite.

Our thanks are due to the survey respondents for their time and insights.

It should be noted that this survey is about giving a snapshot of perceptions from the manufacturing industry at a given moment in time. It is intended to take the pulse of industry, and was conducted over a rather short period of time, using non-probabilistic sampling. Furthermore, the survey focused on perceptions and anticipations for the next two to three years.

Background

Although manufacturing has been falling as a share of EU value-add since the 1960s, manufacturing products continue to play an important role in the EU economy, accounting for about 18% of GDP and 75% of extra-EU exports of goods and services.

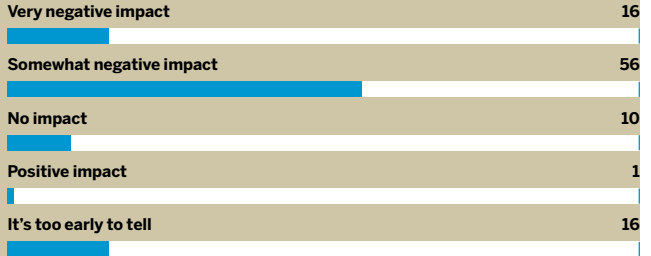
The European free market has done much to allow its manufacturing industry to prosper. Through the recent expansion of the European Union, trade from east to west has boomed, while investment into eastern Europe has thrived as older

Impact of the financial crisis

Although the global financial crisis began as a failure of the banking sector, the fall-out is now much broader and has had a significant impact on a number of other sectors including property, tourism, and retail. Manufacturing, especially automotive, has also been badly affected. At the time of writing this report, European car sales had fallen for six months running. The fall in demand has been blamed on expensive financing and reduced consumer confidence.

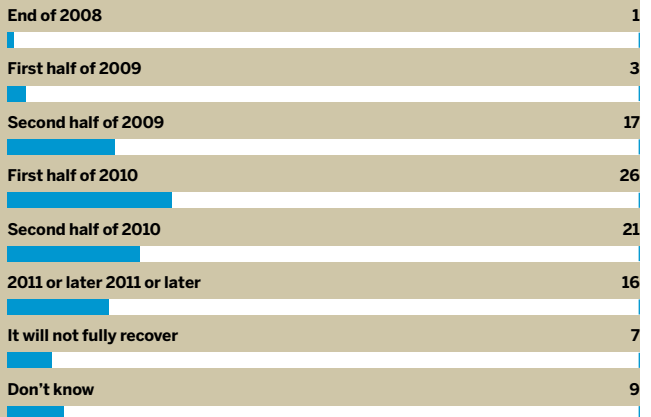
Despite this gloomy picture, only 16% of the survey respondents said the credit crisis has had a very negative impact on their business. Although 56% admitted that it had had a somewhat negative impact. Looking at just the chemicals industry respondents, the figures are roughly similar: 16% state that the financial crisis has had a very negative impact, while a larger proportion than the aggregate (65%) say the impact has been somewhat negative.

What impact has the credit crunch had on your industry?
(% respondents)



Most manufacturers expect an economic recovery in 2010 (26% expect economic recovery in the first half of 2010, while 21% expect recovery in the latter half of 2010). Large firms – those with annual revenue in excess of \$10bn— are more pessimistic. The majority expect the recovery to come later; either the second half of 2010 (26%) or the first half of 2011 (26%).

When do you think the European manufacturing market will have fully recovered from the effects of the economic downturn?
(% respondents)



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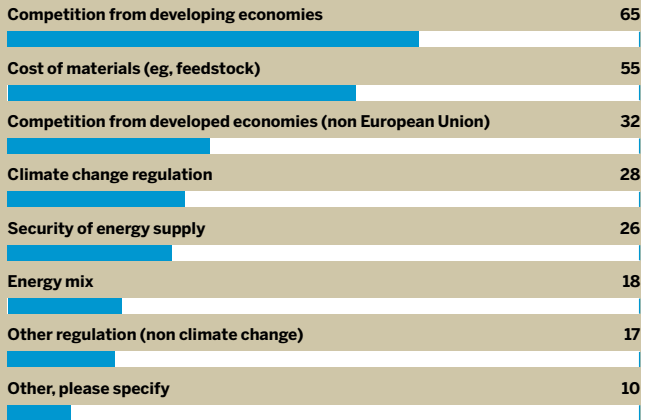
Other challenges facing the European manufacturers

Aside from the financial crisis, the three biggest challenges facing European manufacturers are, in order of significance, competition from developing economies, the cost of feedstocks and competition from developed economies (non-EU). While the challenges for the chemicals industry are the same, the order is different: the cost of feedstocks is the number one challenge, followed by competition from developing economies, with competition from developed economies (non-EU) in distant third place.

Climate change regulation is also a concern, but it only ranks fourth on the list of challenges. Just over a quarter (28%) of the sample cite climate change regulation as a concern for European manufacturers. It is a slightly bigger worry for the chemicals industry, where 30% cite it as a challenge.

What are the main challenges facing Europe's manufacturing industry today?

(% respondents)



Emissions Trading System – blessing or onerous regulation?

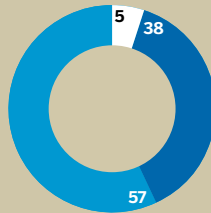
In January 2008, the European Commission set out detailed proposals for meeting its target to cut greenhouse gas emissions by 20% by 2020, including emissions reductions and reforms to the EU's Emissions Trading Scheme (ETS). Under the revised scheme, an EU-wide cap on greenhouse gas emissions will replace individual national allocation plans.

Will the new ETS drive investments in low-carbon technologies, making Europe a leader in the field, as some argue, or will it make Europe uncompetitive? Our survey shows that the majority (63%) of manufacturers believe that the new ETS will not make them any less competitive. However, filtering the data so that just the energy intensive industries remain shows a very different picture. Fully 57% of respondents from energy intensive industries say that ETS will make them uncompetitive. Energy intensive industries are indeed likely to be most directly affected by the new ETS currently under negotiations.

Impact of Emissions Trading Scheme

To what extent will the European Union's Emissions Trading Scheme (ETS) impact your company's competitiveness compared to outside EU competitors?

Energy intensive
(% respondents)

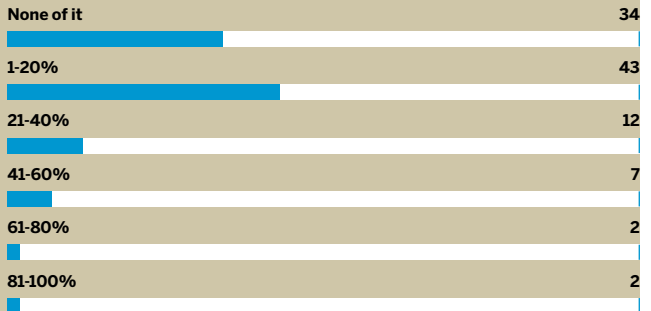


- It will make us more competitive
- It won't change our competitiveness
- It will impact negatively on our competitiveness

Looking at the pharmaceuticals industry, the recent spate of announced closures in European drug manufacturing facilities predates any significant impact on costs from the ETS, and is mirrored by a similar trend of closures in the US. "The shift eastwards for the drugs sector is happening regardless of the ETS, although it is likely to add to the cost differential between Europe and Asia," says Henry Dummett, a healthcare analyst at the EIU. "Cost is just one of the factors determining the location of production facilities."

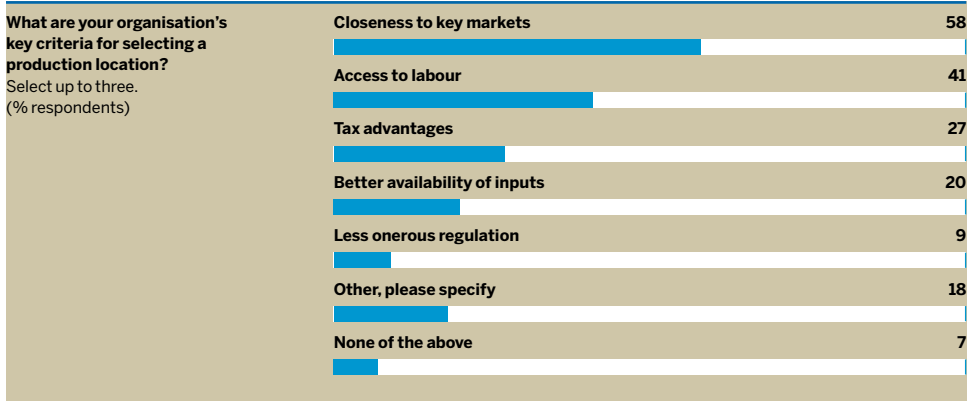
Over the next two to three years, 66% of firms will move some of their production facilities outside the EU's borders. However, only 9% will move because of more onerous regulation. The most common reason for moving production abroad is to get closer to key markets (58%), followed by "access to labour" (41%) and then "tax advantages" (27%). Onerous regulation, including the revised ETS, is not driving European manufacturers abroad.

Approximately what proportion of your company's production (by value) is being moved outside of the European Union over the next 2 to 3 years?
(% respondents)



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Easing the burden

When we asked the panel "what policies or actions could be implemented by national governments or the European Commission to make European manufacturers more competitive?", the majority (57%) said "provide more funding and incentives for research and development". While the EU has the highest levels of R&D investment in the world, if manufacturers are to remain competitive, they must continue to invest heavily in R&D. Production of basic goods will continue to shift eastwards. For example, European pharmaceuticals firms will find it increasingly difficult to compete with generic drug makers in India and PET (polyethylene terephthalate) producers in Europe will find it harder to compete with manufacturers in the Middle East. European manufacturers have to focus on innovative, high-end products, such as biotech and complex composites.



The survey respondents are also keen to see an increase in the availability of high-quality employees. This would be achieved by "strengthening incentives and mechanisms for workers and employers to invest in continuous training". While the war for talent is a global phenomenon, it is going to be particularly acute in Europe with its ageing population and falling birth rates. In Germany, for example, the population is decreasing at a rate of 100,000 people per year. The panel would also like to see more public-private cooperation on education to create an "innovative, relevant workforce for Europe".

Conclusion

The manufacturing sector in Europe faces challenging times over the next two to three years. Germany and Italy are in recession and other economies are likely to follow. And, as our research shows, most executives do not expect a recovery until 2010. To compound the problem, oil prices are extremely volatile. In 2008, the crude oil prices went from about \$100 per barrel to \$147 per barrel in July, and it is now hovering at \$50 per barrel. The EIU projects that prices will average \$65 in 2009 and \$68 in 2010.

For the chemicals industry, organic feedstock prices are likely to remain high as OPEC cuts production. Commodity chemicals will be particularly hard hit, with UBS forecasting a decline in demand of between 10-20% and a price decrease of up to 30%.

One silver lining to come out of the gloomy economic picture is that many people are now questioning the wisdom of putting too much faith in the services industry (especially the financial services industry). Fully two-thirds of the panel agree or strongly agree that, as a result of the failure of the financial service sector, we can expect to see renewed focus and investment in manufacturing in the future.

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Appendix

Which of the following best describes the change in the number of orders for your company's products over the past 12 months?

(% respondents)

Increased significantly (Over 20% change)	11
Increased somewhat	29
Remained the same	24
Decreased somewhat	27
Decreased significantly (Over 20% change)	9

Has your organisation moved towards a business model based on sustainable production?

(% respondents)

Yes, adopted in the past year	5
Yes, adopted in the past 5 years	21
Yes, adopted in the past 10 years	11
No, but we plan to move towards sustainable production in the near future	35
No, and we have no plans to move towards sustainable production	29

In which region are you personally based?

(% respondents)

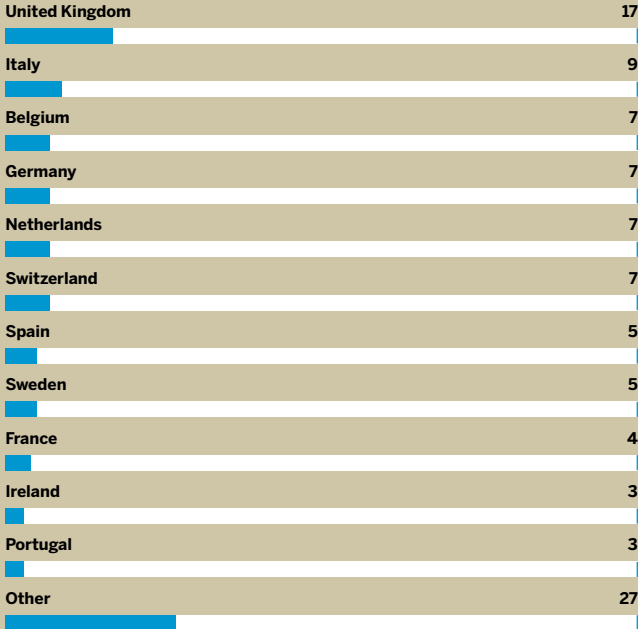
Western Europe	90
Eastern Europe	10

To what extent do you agree with the following statement? The current financial crisis has exposed our over-dependence on the financial services sector. In the future, we can expect to see renewed focus and investment in manufacturing.

(% respondents)

Strongly agree	17
Agree	49
Neither agree nor disagree	17
Disagree	13
Strongly disagree	2
Don't know	3

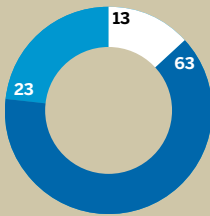
In which country are you personally located?
(% respondents)



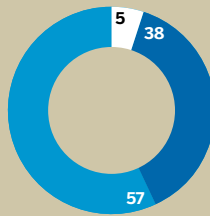
Impact of Emissions Trading Scheme

To what extent will the European Union's Emissions Trading Scheme (ETS) impact your company's competitiveness compared to outside EU competitors?

Aggregate
(% respondents)



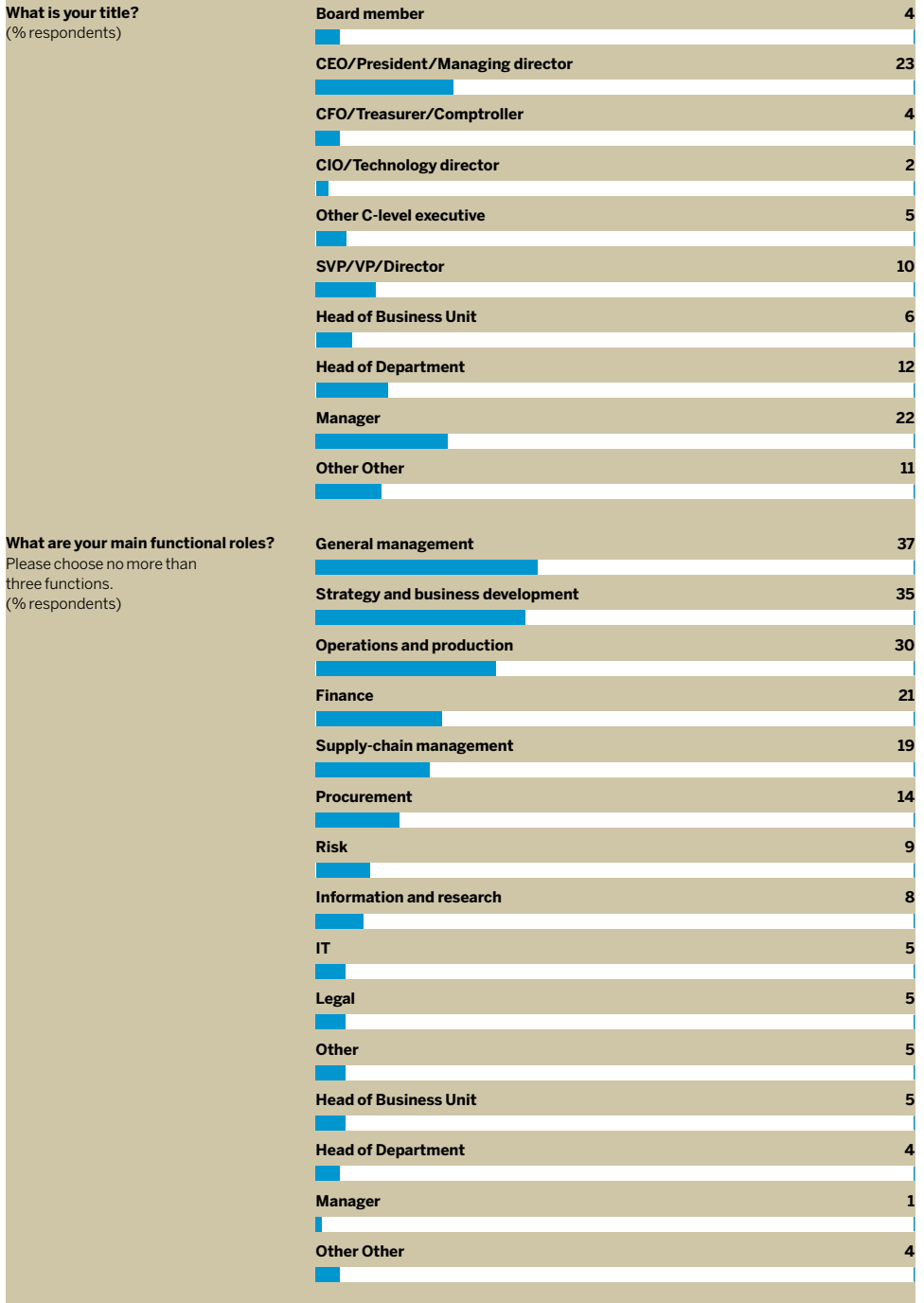
Energy intensive
(% respondents)



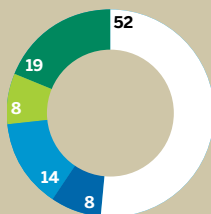
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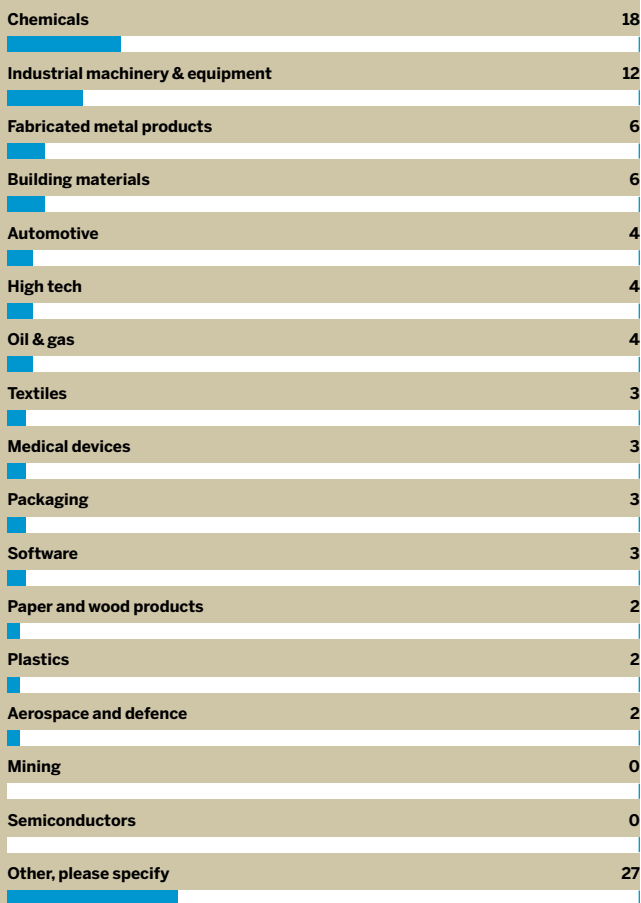


What are your company's global annual revenues in US dollars?
(% respondents)



■ \$500m or less
 ■ \$500m to \$1bn
 ■ \$1bn to \$5bn
 ■ \$5bn to \$10bn
 ■ \$10bn or more

What is your primary industry?
(% respondents)





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