SUBMISSION FROM ADS

1. Background and Importance of the aerospace, defence and security sectors.

ADS is the premier national trade organisation advancing the UK Aerospace, Defence, Security and Space industries. Farnborough International Limited (FIL), which organises the biennial Farnborough International Airshow, is a wholly-owned subsidiary.

Aerospace Sector

The UK Aerospace sector is an economic success story. With a 17 per cent global market share and almost 3,000 companies across all regions of the UK, the sector provides more than 109,000 direct jobs and indirectly supports many thousands more. Since the end of the recession, civil aerospace exports have grown by almost 30 per cent.

ADS Group’s monthly Commercial Aircraft Order and Delivery data highlights the strength of the global market: the aircraft order backlog currently stands at well over 11,000 airframes, equating to nine years’ work in hand for UK industry. The UK Aerospace industry is well-placed to take advantage of significant increases in demand for new aircraft, which are estimated to be worth around US$600 billion to the UK and, since 2011, the sector has grown by 14 per cent.

Defence Sector

The UK Defence Sector is the largest exporter of defence equipment and services in Europe and second globally to the US. Generating annual revenues of more than £22bn and supporting thousands of skilled, high-value jobs, the sector delivers world-leading capability that is vital to protecting UK national security and generating economic prosperity.

The global defence environment is changing: as spending in traditional markets declines, UK companies are positioning to win new business in emerging markets. In 2013, the UK Defence Sector generated exports of £9.8bn, an increase of over 11% on 2012. This report reveals the UK Sector’s continued response to the shifting global picture, with two thirds (67%) expecting further significant growth through the export of our world-class capability overseas.

Security Sector

The Security industry in the UK is vibrant and diverse, made up of many small, medium-sized and large businesses focused on providing the technology and expertise to safe-guard citizens and communities.

Companies working in this sector are responsible for providing solutions to some of the greatest challenges we face today – from detection and protection equipment to supporting those working to contain the spread of the Ebola virus, to tackling the growing business and personal threat posed by cyber-terrorism, to delivering effective security for major events, for which the UK has a global reputation following the success of the London 2012 Olympic and Paralympic Games.
Across this broad industry, we are seeing significant growth, with revenues increasing by a fifth in 2013 alone. Overall, the sector has grown more than five times faster than the rest of the UK economy, and we expect this growth to continue, with the cyber security subsector forecast to double by 2017.

**Scottish Sector**

The latest statistics available for the Scottish sector are for 2013 and estimate that there are a total of 744 businesses active in the Aerospace, Defence and Marine Sector, with the following breakdown

<table>
<thead>
<tr>
<th>Sector</th>
<th>Employment</th>
<th>Turnover (£m)</th>
<th>GVA (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aerospace</td>
<td>8,262</td>
<td>1,649</td>
<td>520</td>
</tr>
<tr>
<td>Defence</td>
<td>4,746</td>
<td>815</td>
<td>257</td>
</tr>
<tr>
<td>Marine</td>
<td>22,450</td>
<td>2,817</td>
<td>889</td>
</tr>
<tr>
<td>Security</td>
<td>2,069</td>
<td>194</td>
<td>61</td>
</tr>
<tr>
<td>Space</td>
<td>242</td>
<td>20</td>
<td>6</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>638</td>
<td>67</td>
<td>21</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>38,408</strong></td>
<td><strong>5,563</strong></td>
<td><strong>1,756</strong></td>
</tr>
</tbody>
</table>

Over a three year period there had been an increase in employment in the sector of 6% and an increase in turnover of 13.6 per cent

2. **Sectors achieving growth through exporting**

ADS surveys of the aerospace, defence and security sectors consistently highlight the importance of exports to the industry, both from current contribution and the potential for further growth.

**For the aerospace sector**

The UK Aerospace sector grew by 9.4% in 2013, with 90% of aerospace turnover being generated by exports. Moreover these aerospace exports grew by 12%, to £24.7bn in 2013. The majority of UK aerospace companies expecting growth greater than 10%, with this growth coming from an expansion of existing business (70%), new export opportunities (68%) and growth of UK opportunities (38%). The prospect for export growth is driven by export opportunities in Middle East, China and Latin America.

**For the Defence sector**
UK Defence companies generated £9.8bn in 2013, a year on year increase of over 11%. Significantly 87% of defence firms generate some revenue from exports; furthermore, almost 40% of goods sold to domestic customers are ultimately used in products or services destined for export. From this strong performance the sector continues to grow and the UK increased defence exports by 11% in 2013 on the previous year. Of this 83% of UK defence export revenue for 2004-2013 was generated through Aerospace sector, 10% from Land and 7% from Maritime. In 2013, 67% of UK Defence exports were to markets in the Middle East; 12% of exports were to North America; 12% to Europe; and 9% to Asia-Pacific. Crucially two-thirds (67%) of companies expect further growth through new export opportunities.

For the Security Sector

The global security sector is expected to continue to grow significantly with a percentage annual growth predicted to accelerate in coming years from 9.3% in 2014 to 10.8% in 2017, with cyber security sub-sector forecast to double by 2017. Also, within this context, two-thirds of the UK Security sector companies themselves expect to grow by 10% or more in the next 12 months.

Indeed, the sector grew by almost 20% in 2013, and by just over 16% on average each year (compound average growth rate) since 2008. Importantly the key drivers of growth in the next 12 months include new export opportunities (70%), expansion of existing business (65%) and growth of UK opportunities (30%).

3. Export impediments

Given the importance of exports to the aerospace, defence and security sectors ADS regularly consults companies to explore which issues are currently causing additional barriers to exporting.

In 2008 the Scottish aerospace, defence and security sectors published for the first time their own strategy with the aim of doubling the Scottish sectors’ annual sales. As part of this strategy, companies considered how they could achieve further exports, and developed the following areas of action:

- Actively pursuing selected export opportunities to help sustain UK industrial base capability;
- More collaboration internationally through sectoral trade associations;
- Greater collaboration and information sharing between UKTI, SDI, Scottish companies and our universities;
- Greater use by Scottish companies of the GlobalScot network;
- Development of a joint public/private sector initiative to promote Scotland as a destination for aerospace, defence, naval and space investment;
• Goods and services will need to be adapted and re-packaged in order to appeal to the new emerging economies in Eastern Europe, Asia, Middle East and Africa where the infrastructure and local support may be less developed;

• Collaboration and information-sharing across those Scottish-based organisations wishing to establish new partnering arrangements and supply sources in other parts of the world (eg Eastern Europe and SE Asia) is urgently required in order to find quicker, cheaper routes to lower-cost labour sources and expanding markets;

• Appropriate forms of service differentiation need to be rapidly developed by MROs in Scotland in order to compete against lower-cost alternatives.

These issues were subsequently taken on board by the Scottish Enterprise Aerospace, Defence and Marine Advisory Group, now the Industry Leadership Group, with a view to making progress.

More recent work to refresh the SE ADM strategy has highlighted the following issues:

• Insufficient visibility of the Scottish supply chain amongst OEMs and Tier 1/2s;
• Pressure to localise supply chain activity within international contracts;
• Explore and address the barriers stopping increased Scottish supply chain engagement;
• Need to increase the ambition and understanding of internationalisation and uptake of support;
• Need to enhance further the Scottish proposition for inward investment.

Furthermore, the ADS International Defence Market Strategy - Barriers to Exports report concluded that for the UK defence sector there were a number of issues currently dampening exports. Many of these issues are out with the scope of this inquiry, including: Export Controls (UK), Export Controls (US), Offset, Local-sourcing Regulation and Proliferation of Unconnected Standards. However, those issues raised of interest to the inquiry include:

**Access to Finance**

Increasingly UK banks and other financial institutions, as well as shippers, have chosen to disinvest from activities in the defence sector. Reports have started to come in from Members that their dealings with their banks, many of whom have been meeting the companies’ financial needs for 20-30 years or more, but are now refusing to provide the financial support that these firms need to facilitate their export activities.
Insurance Cover

UK Export Finance support has widely been perceived within Industry as being uncompetitive in comparison to the degree of support available to our overseas competitors from their own national export credit agencies.

Consistency of Government Support

This spans the gamut from political support to defence export, bi- and multi-lateral trade deals as well as industrial strategies. Defence is a long-lead time industry, with early phase R&D happening many years before mature solutions can be brought to market. A clear and consistent level of support from Government is necessary to allow Industry to make the right investments in people, physical assets and technology to deliver a thriving UK Industry.

Levels of Investment in UK R&D/Capability Development

To remain competitive globally, the UK needs to be at the very cutting edge of technological development in order for it to have a vital commercially competitive edge. Not only could inadequate investment in R&D and capability development jeopardise a thriving indigenous industrial base here in the UK, but in the long-term it may jeopardise the perception of the UK as a valued partner in multinational development programmes. Lower levels of investment in R&D may lead to a perception that the UK has less and less to contribute to potential collaborative partners.

4. Opportunities to develop aerospace, defence and security exports

Recognising the strong export foundations upon which the aerospace, defence and security sectors can further build, the industry has developed a number of areas where further attention could yield greater exporting results. Once again focusing on areas of devolved interest:

Trade missions

There are many organisations that perform a valuable function through reporting, trade missions and presenting to visiting delegations. We recommend coordinating a forward plan of aerospace, defence and security-related trade missions between SDI, ADS, UKTI DSO and others. The current uncoordinated approach, which has resulted in many different missions to the same locations or at the same time, is confusing companies and unnecessarily duplicating effort.

Government, its agencies and trade associations need to provide much clearer and more detailed rationales for visits (i.e. improve the initial market analysis they provide to companies when recommending missions). This would increase levels of interest/participation in missions and make better use of government information relevant to trade.
Commercial understanding

Increased partnership between government and industry in priority markets should be underpinned by efforts to develop commercial understanding and expertise within government.

Export support schemes

Government, principally through SDI and UKTI, offers a number of schemes to support companies seeking to export. ADS would recommend that we need a formal mechanism with SDI and UKTI to engage companies in reviewing the value and performance of export support schemes and to consider the results of the survey, to develop proposals for reform. Also we should develop a programme of bespoke, in-person briefings to sectors about available support schemes. This should involve not only briefings from SDI and UKTI, but briefings from companies with first-hand experience of using different schemes.

Strategic campaigns and importance of government as a domestic customer

The export success of the UK and Scottish defence and security sectors is predicated, among other factors, on the world-class reputation of our armed forces, security and intelligence agencies, police forces, etc. This reflects the embedded value of the government’s past investments. Future success will be dependent on government and industry recognising the importance of the UK as the domestic customer for its indigenous industry’s products and services, and taking this into account in future procurement decisions. Companies find it more difficult to export products that are not in use by UK departments, forces or agencies or derived from such capability. Furthermore, companies would find it helpful to have end-users included in the marketing teams on a temporary basis (e.g. for exhibitions, providing testimonials during visits). The importance of the UK MoD and other agencies as a domestic customer is increased in the context of heightened international competition in export markets. UK defence and security companies are ultimately seeking proper strategic campaigns and sustained engagement at senior and political levels to ensure a level-playing field with key competitors in export markets.

Commercial priority countries

Some countries represent significant markets from a commercial perspective, in terms of market size and export potential. For Scotland and the UK to be competitive in these markets there should be greater investment in medium/long-term market analysis, more consortia building, and the development of proper campaign plans between Government and industry. To enable attractive UK packages to overseas customers, commercial and financing help from Government to exporters is required. UK Export Finance has a key role in ensuring that the UK remains competitive against the offers of major competitors, which are often underpinned by their respective export credit agencies and other arms of government.

Maximising the economic and technological benefit of exports to the UK

The Government should aim, through its policies and work with Trade Associations, to foster an environment in which companies want to lead their export campaigns
from the UK and investment and generate IP in the UK for export purposes. As the government and industry do more to identify long-term, major export opportunities, the government should also create a space in which companies can collectively decide whether and how to formulate a collaborative “offer” for these opportunities. Companies may decide to enter into consortia arrangements or develop supply chains for this purpose, as it is unlikely that major opportunities will fully be met by a single company. This will help export opportunities flow throughout sectors and down supply chains.

Support to early stage R&D and investment in high value skills

ADS Group strongly supports Government’s investment in early stage research and development. This drives significant innovation in our industrial base and contributes higher-than-average Gross Value Added. Skills are the lifeblood our sectors. ADS Members are significant contributors to the number of apprentices and graduates employed in engineering and related trades. Investment in science, technology, engineering and mathematics is critical to creating an appropriately educated workforce that can then work in key areas of the aerospace and defence industry. The same education system can also enable the training of customer nations to satisfy their technology transfer or offset aspirations.

Inter Government Working

In his recent report Lord Smith said “Throughout the course of the Commission, the issue of weak inter-governmental working was repeatedly raised as a problem. That current situation coupled with what will be a stronger Scottish Parliament and a more complex devolution settlement means the problem needs to be fixed. Both Governments need to work together to create a more productive, robust, visible and transparent relationship.”

As many of the issues already discussed have shown for companies operating within the aerospace, defence and security sectors in Scotland, this observation rings true and the UK Government remains enormously important in their exporting efforts. As our companies continue to operate within a UK regulatory and support environment so must the UK and Scottish Governments collaborate and work together. Indeed recent years have seen increasing complexity and lack of clarity in respect of a number of initiatives, such as the Aerospace Growth Partnership, the Defence Growth Partnership, the Security and Resilience Growth Partnership, etc.

The DGP is the UK’s response to growing global competition; a partnership between government and industry, the DGP is designed to align resources to strengthen the UK Defence Sector’s global competitiveness and deliver security, growth and prosperity for our nation. Specifically the core objectives of the DGP include “Grow the UK’s global market share through increased exports”. In the case of the AGP, the Government worked with the UK aerospace industry to establish a partnership in 2010 as a way to tackle barriers to growth, boost exports and grow the number of high value jobs in the UK.

Some companies in Scotland feel Scottish involvement and exploitation of these initiatives has been a missed opportunity, and Scottish Enterprise, SDI, the ADM ILG
and ADS should, in conjunction with companies, explore how we collectively react to, engage with and maximise the opportunity from such ground-breaking UK initiatives.

5. Summary

The UK aerospace, defence and security sector has shown itself to be enormously successful with exporting being fundamental. While past success provides a strong foundation, it does not guarantee future growth and for the UK sector to maintain and build upon its global presence we must ensure we do all we can to support companies.

Therefore, ADS welcomes this inquiry by the Enterprise, Energy and Tourism Committee in Internationalising Scottish Business and the opportunity it allows to benchmark our current provision of support.

As the global market evolves, so must our support, our sectors more than many have developed a vital partnership with Government to support exports and together we continue to develop the offer. This submission outlines our current suggestions for future developments and we hope the Committee will find it useful in its deliberations.

January 2015