



**Response from the Forum of Private Business (FPB)
to EGCD Consultation regarding proposed revisions
to non-UK content rules**

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What is the FPB?

The Forum of Private Business (FPB) was formed in 1977 and is a pressure group fighting on behalf of private businesses. The FPB represents approximately 25,000 UK-based businesses, which employ in excess of 600,000 people.

The FPB is active in the European Commission's social dialogue and is a representative, in this country and in the European Union, of small and medium-sized businesses. The FPB has a permanent agent in Brussels, who is supported by an all-party group of MEPs.

The FPB also provides a range of business services aimed at increasing member efficiency and profitability.

Business opinion

All of the FPB's campaigns are based on the views of our members. We talk to our members in various ways. Via surveys, by telephone and face-to-face contact. We also collect data electronically, which enables us to source opinions from hundreds of businesses within a matter of hours.

The FPB works to bring businesses together with their own elected representatives. Members vote in a quarterly Referendum, adding comments for us to send to their MPs, MEPs, MSPs and AMs. Referendum is a tool that business owners have been using since 1977 to make their voices heard.

The FPB has more than 20 years' worth of experience of accredited research into the small business community. We have been using the Quarterly Survey since 1980 to track business growth, and the rise and fall of key issues, working in partnership with the Small Business Research Trust.

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Introduction

The scope for the UK to win large projects needs to be fully supported; both for the benefit of the large global contractors involved, and also for potential spin-off benefits for the wider economy as a whole, and most especially in the context of these comments for SMEs.

That head contractors (and hence contract bidders) are nowadays in many respects project, construction and programme managers rather than full service direct contracting organisations as a consequence of trends in outsourcing and globalisation, and so rely on subcontracting for many elements in project delivery.

Economic benefits to UK plcs thus derive not only from the profit streams of the larger contractors, but from underlying subcontracting patterns and how these support SME business in the UK.

The current foreign content rules do push large companies towards sub contracting from the UK and a significant change in the rules will negatively impact on some SMEs. There will certainly be a further power shift towards the head contractors.

Having said this, exchange rate considerations coupled with regulatory and unit cost burdens can often mean that subcontracted services are substantially cheaper in target markets, especially in the Middle and Far East, so too onerous a regime will negatively impact the ability of UK organisations to win large tenders, and no tender means no work for anyone.

The question is therefore one of balance.

From an SME standpoint there should be three goals for this revised policy:

- To ensure that UK plcs win their share of large projects
- To ensure SME participation in the projects that are obtained
- To adopt simplification measures that minimise compliance costs for all involved

This input is intended as a practical contribution to this debate, accepting that there does need to be a change in the rules and simplification of the administrative procedures, but also proposing that, as such changes will disadvantage SMEs, there needs to be a series of balancing measures that are adopted at the same time and create a win-win opportunity for all concerned.

This Response has been written by an entrepreneur and SME owner for the Forum of Private Business (FPB). The author has extensive practical international experience of a range of diverse sectors.

Response to Detailed Questions

Question 1: Should ECGD change its current policy for supporting foreign content under credit contracts?

Yes - In a rapidly globalising world where prime or head contractors tend to be project managers, the current foreign content rules are an impediment to UK businesses winning the best possible share of large projects.

However, these changes need to be made in a way such that they are not uniquely supportive of large companies, so there will be a need for balancing counter measures focused at supporting SMEs.

Given that due to lower input prices and lower regulatory burdens experience by many foreign content providers it is to be expected that any relaxation in the rules will be followed by a fall in UK content actually purchased.

It is likely that SMEs will suffer disproportionately as they will often be the dominant players in subcontractor activity. SMEs are very important engines of economic activity, innovation and employment so this is likely to lead to a net loss of welfare to society as a whole, as SMEs implicate far more people than will be implicated by the gain in head contractor profits.

Although changing the rules will probably lead to UK-based companies winning more contracts, unless appropriate measures are taken, there will be damage to the SME sector and as this involves more individuals than the profits of large contractors, is likely in the absence of appropriate additional measure to lead to damage to the UK SME sector.

This damage may well affect professional services and consultancies as price pressure in the absence of the foreign content percentage leads to engaging services (such as architectural and engineering support) in markets such as India, where costs are much lower.

Recommendation 1: The current rules do need to change but only if there is a balanced set of measures in place to deal with the negative impact on SMEs.

Question 2: In general, how much foreign content should ECGD be willing to support?

The trouble with prescriptive rules is that there will always be an exception, and so they become an incentive for consultants and others to work out how to present round the rules. Surely the goal of these rules is to make sure that the economic benefit comes to UK businesses?

Is the target then to ensure that the revenue is driven back into the UK economy to create jobs and promote innovation? If so, the critical issue is not the foreign percentage, but rather the mechanism by which the benefits feed back into the UK economy.

As currently structured, the proposed relaxation is one-sided, to the benefit of large companies and to the detriment of many SMEs who perform subcontracting activities. It is unrealistic to expect large companies to subcontract large amounts of work from the UK if the same services are available at a lower price at or near the target market.

To ensure that the contract value flows back into the UK economy as more than just profits for the head contractor, there needs to be a new mechanism to ensure that some proportion of the revenue is spent on UK sourced items.

When defence contractors faced a similar problem when establishing large supply contracts between the UK and the USA, this was solved through the use of offset arrangements. A similar approach should be adopted in this situation. This would work as follows:

1. A series of sector-based guidelines will need to be established that set a norm for SME content that is expected in projects in this sector.
2. Beneficiaries of ECGD support will need to post event demonstrate work valued at the stated percentage of the contract has been contracted with UK SMEs. This work can be on this particular contract or it can be on other contracts, just this value of work needs to be let as UK/SME subcontracts. This value would be over and above the normal proportion (expressed as a proportion of overall cost base in the previous three years) of UK/SME contract work normally let by this company.
3. Next time the company wants EGCD assistance it will need to demonstrate how it fulfilled its UK/SME content commitment to EGCD auditors before the new facility can be approved.
4. Any foreign content percentage should then be set to ensure technical compliance with OECD and other international rules, but there will be no need to re-measure this during the life of the contract as the control on the economic benefits will be post event via an audit of what contracts have actually been placed directly on this business or by means of offset arrangements.

Recommendation 2: That any fixed percentage of foreign content be set to comply with OECD and other international rules

Recommendation 3: That targets be set for the percentage of UK-sourced content (especially SME) for each sector

Recommendation 4: That these targets be fixed in return for any assistance from EGCD

Recommendation 5: That control to confirm these targets have been met post event, and based on auditing actual spending whether directly on the project or indirectly by means of offset arrangements.

Question 3: Should ECGD's policy include the flexibility to support more or less foreign content for a particular credit contract?

The policy should be driven around optimising the benefit to the UK economy, and so by definition it needs to be flexible to each individual specific situation. Rather than focus on a foreign content percentage in the tender or contract, the focus should be on establishing a UK-sourced content percentage that is measured after the event. This percentage can be fulfilled either through the contract itself or by means of offset arrangements that establish incremental work in the UK on other projects.

The offset arrangements should be specifically focused at SMEs as they will be the net losers from increasing the foreign content percentage that can be funded via EGCD. Adopting an offset approach will mean that large companies are free to contract and price as they see fit, without facing artificial constraints on the project itself.

The offset arrangement will then drive a thorough review of purchasing on other projects and look to ensure that domestic economic benefit is driven via additional export or some form of import substitution on other contracts.

Question 4: What factors should govern whether such flexibility is exercised in individual cases?

The flexibility should be driven by the need to comply with international treaty and protocol commitments (for example conforming to EU and OECD policy). Within the UK the process will be:

- Assign a sector to which the contract belongs.
- Identify (probably via a table of standards) the target percentage of UK/SME content in this sector.
- By means of contractual clauses ensure that the beneficiary of the assistance ensures that the agreed target percentage of the contract is contracted in this sector either directly from the contract or by means of offset through other contracts placed by the company benefiting from the assistance.
- Establish post-event monitoring of the discharge of this liability (where spending must be over and above the existing normal UK/SME spend) through an audit prior to approving any further assistance.
- Failure to comply with the contracted percentage would bar the contracting company from future assistance, until the liability is discharged.

Question 5: Should ECGD also simplify its policy? If so, how?

EGCD should stop trying to enforce a limitation for the percentage of foreign content during the life of the contract. The monitoring and re-calculation processes are burdensome and do not add value.

A post-event audit system should be adopted, under which any over-commitment to foreign content must be offset by equivalent additional spending on UK content on other contracts.

By adopting this approach there will only need to be one single reconciliation of actual spend against target spend, saving on administrative activity both in the company benefiting from the assistance and in EGCD itself.

Summary of Recommendations

- *Recommendation 1:* The current rules do need to change but only if there is a balanced set of measures in place to deal with the negative impact on SMEs.
- *Recommendation 2:* That any fixed percentage of foreign content be set to comply with OECD and other international rules
- *Recommendation 3:* That targets be set for the percentage of UK-sourced content (especially SME) for each sector
- *Recommendation 4:* That these targets be fixed in return for any assistance from ECGD
- *Recommendation 5:* That control to confirm these targets have been met be post event, and based on auditing actual spending wither directly on the project or indirectly by means of offset arrangements.

Conclusions

1. UK SMEs will be adversely impacted by the current proposed change in the rules regarding foreign content.
2. This impact is likely to be significant, as input prices and regulatory burdens on SMEs and other subcontractors are much lower in the Far and Middle East, and to some extent in Eastern Europe and the Near East than in the UK.
3. It is better to have no change to the rules than to change them without recognising the damage that will be done to SME interests.
4. A simple way exists by utilising and repurposing the concept of offset to ensure that benefits are driven back into the UK economy based upon a percentage of the contract value being spent directly or indirectly via offset on UK/SME supplies and services.
5. Regulatory burdens can be significantly reduced by adopting a post event audit approach rather than requiring constant updates to ongoing projects as they evolve.

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