Trading Places

A study of UK importers and exporters

January 2024

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Foreword

2024: a changing trading environment

At the end of 2017, we launched our inaugural *Trading Places* report. It was a testing time for SMEs trading overseas, with much uncertainty surrounding the UK's relationship with the EU, and a shifting dynamic in geopolitics following the election of Donald Trump. Without doubt, however, the primary concern for UK importers and exporters was Brexit.

Six years on, the picture is different. Though Brexit continues to pose challenges, a series of disparate yet interwoven significant issues surpass the trials of 2017.

Many SMEs safely navigated their way through the Covid-19 pandemic, others didn't. Those able to survive were left to contend with supply chain disruption not seen on such a scale since WWII and yoyoing consumer demand as a result of a generational shift in buying behaviour.

As businesses were recovering from the pandemic, they were confronted by conflict in Europe, a global cost-of-doing-business crisis, and tightening monetary policy as a result of the latter. In the UK, this resulted in interest rates reaching a 15-year high of 5.25 percent in August 2023, after 14 consecutive rises.

Further challenges emerged amid an already volatile geopolitical picture, namely the Israeli-Palestinian conflict, which has triggered further supply chain disruption, and the Red Sea Crisis, an issue slowing trade flows and driving up the cost of global shipments.

Amid this unpredictable environment for UK firms trading overseas, in December 2023, we spoke with 500 UK-headquartered businesses that import and/or export goods and services overseas.

Despite difficult trading conditions globally, these SMEs remain cautiously optimistic, focusing on opportunities ahead. Half of those who export and a similar proportion of importers (45%) believe sales volumes will increase over the next six months. Further still, 52 percent of exporters are actively seeking partners in new markets. So there are reasons to be positive.

Notwithstanding recent global issues dominating, Brexit has returned to the fore. Almost two-thirds say it has negatively impacted their businesses and 44 percent want to see the UK Government negotiate revised terms with the EU. A fifth want to see the UK return to EU membership.

Alongside increasing costs within the UK - and additional expenses for those trading with the EU - unsurprisingly, currency volatility caused by ongoing market shocks is taking its toll on profitability.

On average, businesses were negatively impacted to the tune of almost £80,000 in 2023 due to currency fluctuations. As well as securing trading partners and customers in new markets, managing exchange rate risk is clearly a top priority to offset rising costs for SMEs.

So, as governments around the world continue to grapple with monetary and fiscal measures to reduce the impact of geopolitical tensions and contagious inflation, businesses trading overseas that are able to take matters into their own hands will be best placed to weather the many storms facing them in 2024 and beyond.

Michael McGowan
Managing Director
Bibby Foreign Exchange
January 2024

in Michael McGowan

Key Insights

Seven years on from our first *Trading Places* report, UK SMEs involved in export and import activities find themselves in quite a different world. A combination of jagged geopolitics, macro-economic uncertainty and the high cost-of-doing-business, means the trading landscape has changed immeasurably.

When we conducted our inaugural survey in 2017 to understand the challenges and opportunities for UK businesses following the Brexit referendum, we uncovered many challenges. The same is true today but, unsurprisingly, the degree of significance and the points of focus have shifted.

Top 10 challenges facing SMEs

(Based on percentage responses)

1. **61%** Inflation / rising costs
2. **55%** Impact of Brexit
3. **45%** Interest rates
4. **40%** Tariffs, customs and trade barriers
5. **32%** Cost of doing business overseas
6. **30%** Supply chain disruption
7. **29%** Global conflicts
8. **27%** Political uncertainty
9. **23%** Currency volatility
10. **21%** Finding reliable suppliers

Executive summary

In 2024, the survey data points to three stand-out challenges for SMEs:

1. Inflation

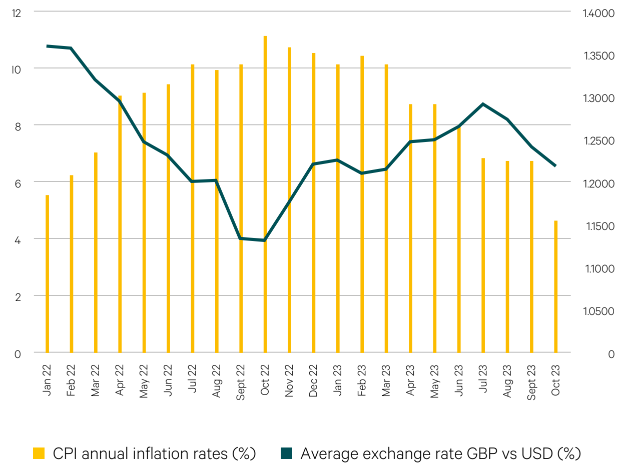
Today, the most significant issue keeping SMEs awake at night is inflation. Figures released in January showed UK shop price inflation continuing to rise at 4%, as price rises on non-food items offset a fall on food prices. In this context, six in ten (61%) UK SMEs see inflation and rising prices as a major challenge.

For net UK importers, inflation is a curse, deflating the value of Sterling against other currencies, pushing up the price of goods and services from overseas. It also reduces the purchasing power of UK businesses, wreaking havoc on supply chains.

Net UK exporters have a more nuanced relationship with inflation. For them, higher inflation and stronger Sterling increase prices for overseas customers - a potential positive in terms of higher profit margins. But elevated prices may also encourage overseas customers to seek cheaper alternatives in other markets with a negative impact on revenues for UK businesses.

The reality is that many SMEs trading internationally both import and export - in fact those that do account for over half (56%) of the SMEs we surveyed - so a binary approach to the winners and losers of inflation doesn't hold.

CPI annual inflation rate vs average exchange rate GBP/USD



Source: ONS

Executive summary

2. The ongoing impact of Brexit

While it was too early for most businesses to understand how the withdrawal from the European Union would impact them in 2017 when we released our first Trading Places report, 36 percent of respondents said the effects of the EU referendum had already been bad for their business.

Today, more than half (55%) of the SMEs we surveyed cite Brexit as a key challenge, making it the second most significant issue they face. The extent to which Brexit is affecting Britain's exporters and importers is explored in greater detail later in this report.

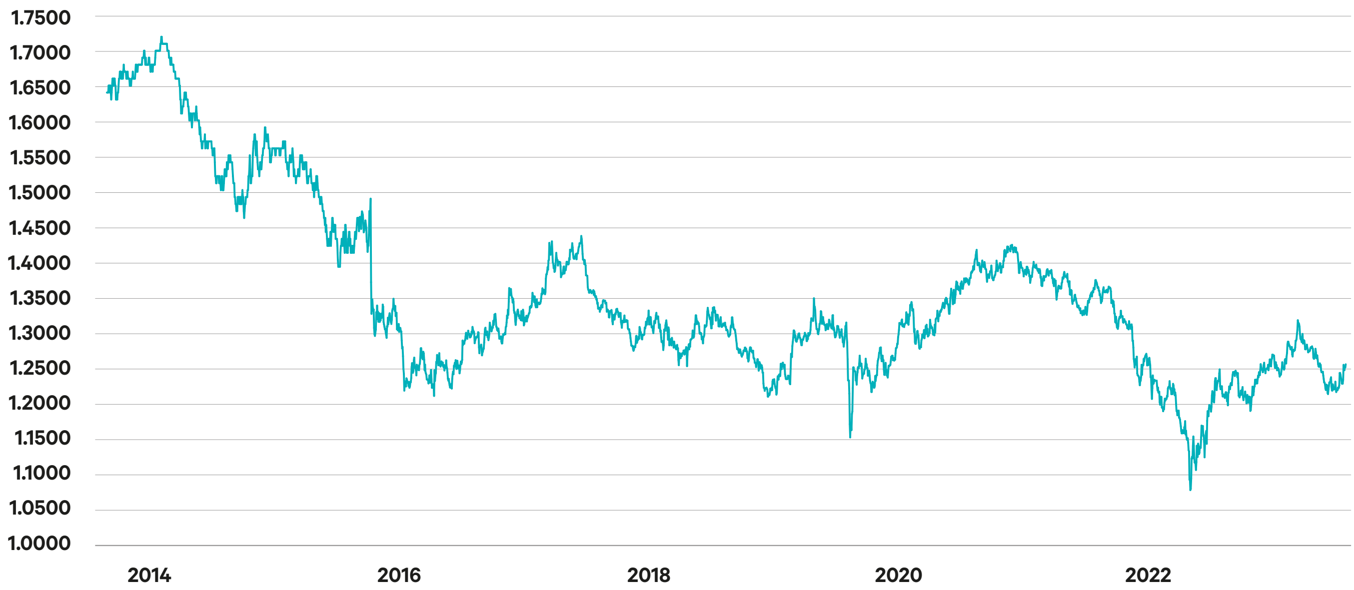
3. Currency volatility and risk

Nearly a quarter (23%) of SMEs see currency volatility as a significant issue, while over half (57%) confirm they've been negatively impacted by fluctuations in foreign exchange rates over the past year.

In 2017, 34 percent of respondents placed currency fluctuations at the top of their list of major challenges, making it the number one challenge overall. Though it may have slipped down the rankings this year, it's clear that currency volatility remains a persistent and perennial problem.

Overall, this report exposes an international trading landscape awash with interwoven challenges, but also a resounding sense of ambition and optimism among SMEs trading abroad.

Pound Dollar Exchange Rate (GBP USD)



Source: www.macrotrends.net

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Far from over: The ongoing impact of Brexit

Four years on from the implementation of the Brexit withdrawal agreement, UK SMEs are grappling with the realities of doing business with European partners while they are no longer part of the EU trading bloc.

For most, Brexit has been neither positive, nor straightforward. In fact, Brexit was selected as the second most significant challenge in a list of issues making the trading environment more difficult by 55 percent of survey respondents. For businesses with a turnover of between £500,000 and £1million, that percentage jumps to 69 percent, while for SMEs who identified a drop in export sales over the last six months, the figure hit 61 percent.

Measuring the impact of Brexit

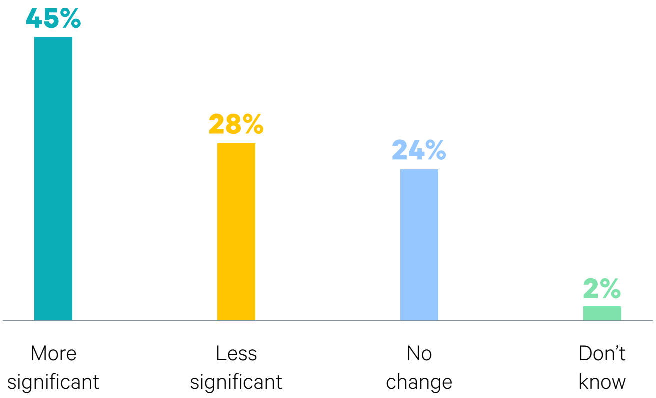
The negative impact of Brexit has increased significantly over time. In 2017, when our first *Trading Places* report was published, 41 percent of net importers and 29 percent of net exporters said Brexit had a negative impact on their business. Today, that perspective is true for 62 percent of net importers and 63 percent of net exporters.

Drilling further down into the impacts of Brexit, 'tariffs, customs and trade barriers' are the fourth biggest challenge facing SMEs overall, with 40 percent of respondents selecting it. It's safe to assume that this is in no small part the result of more punitive tax structures, and increasingly complex and cumbersome bureaucratic processes since the implementation of Brexit.

Tariffs, customs and trade barriers are particularly problematic for businesses with a turnover of more than £5 million, 69 percent of which identified this combination of factors as a key challenge.

Since Brexit, the cost of doing business in Europe is also proving to be of significant concern for UK SMEs. Nearly half (49%) say the cost of trading with companies in the EU has become very expensive and much less profitable, with the figure jumping to 54 percent among net exporters.

Significance of Brexit impact



Far from over: The ongoing impact of Brexit

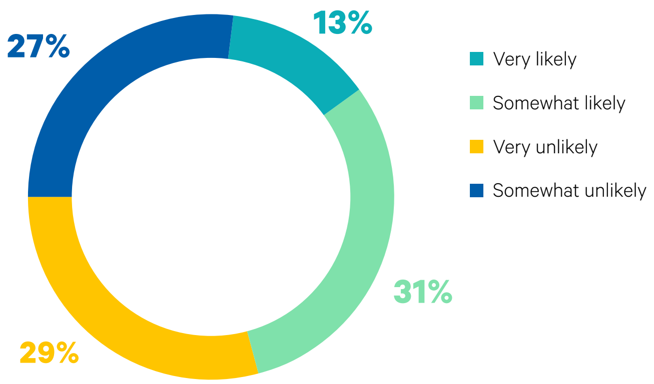
To trade or not to trade with the EU

Despite the myriad post-Brexit challenges, SMEs in the UK are still keen to trade with EU economies. Overall, 61 percent of UK SMEs trade with countries based in the EU. For those with a turnover of between £500,000 and £1 million, that rises to 69 percent.

However, for a growing number of Britain's small businesses, there is also a discernible shift in appetite away from the EU. In general, since the implementation of Brexit, 40 percent of SMEs do less trade with companies in the EU and 21 percent are trading more with companies outside the EU.

Despite recent overtures from Germany, in particular, to encourage greater trading rapprochement with the UK, this could reflect the 'needs must' pragmatism of UK businesses thwarted by the Brexit burden.

Will the UK re-join the EU in the next decade?



What SMEs want from government

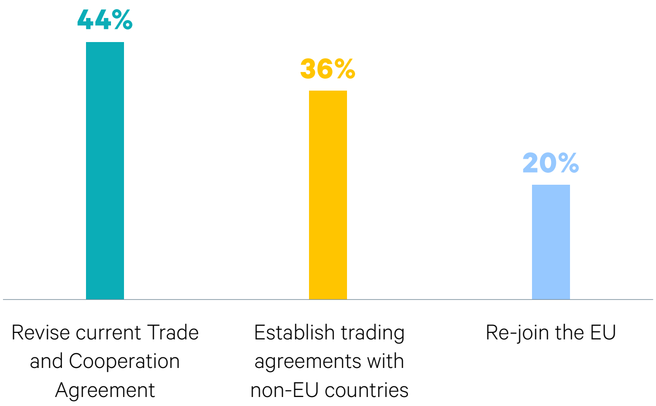
To help get over some of the hurdles presented by Brexit, SMEs in the UK would welcome a fresh approach from politicians.

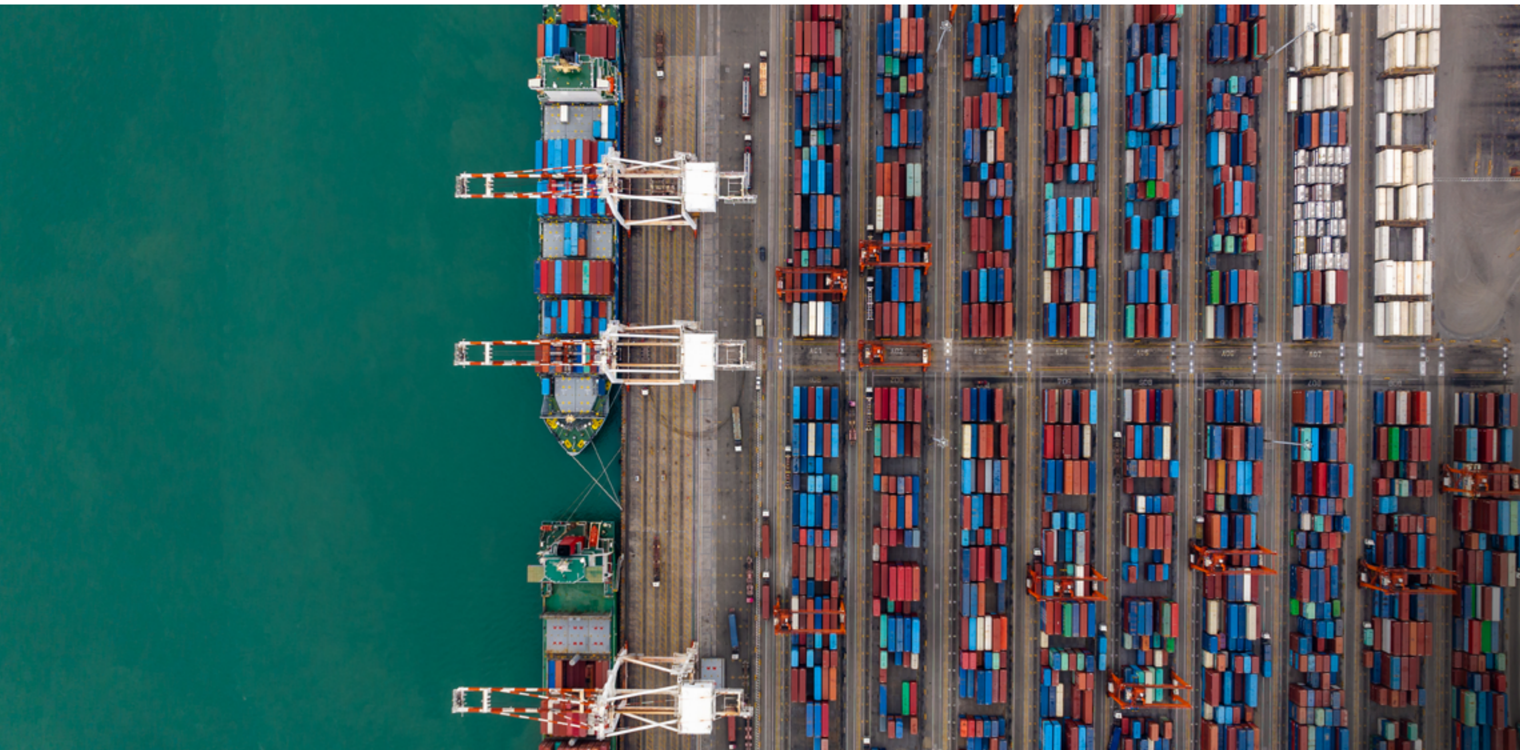
So far as potential 2024 General Election pledges are concerned, a significant majority (44%) say they'd like a new government to revise the current Trade and Cooperation Agreement between the UK and the EU. For net importers that figure is 45 percent, while 43 percent of net exporters are equally keen on this becoming a future policy commitment. But the idea is most popular among businesses with a turnover of between £1 million and £5 million - 58 percent of which support it.

Similarly, 36 percent of SMEs would like a new government to establish more trading agreements with countries outside the EU, such as the recent deal with Switzerland. This rises to 47 percent for businesses with a turnover of between £500,000 and £1million.

Twenty percent of small businesses say they would be in favour of a new government taking steps to re-join the EU, to help improve trading conditions with the bloc. But views on the likelihood of the UK re-joining the EU within the next decade vary considerably. Forty one percent think reintegration with the EU is likely, while 52 percent do not. Perhaps this is evidence of lingering divisions on the vexed question of EU membership.

SMEs' wishlist for a new UK government





Two perspectives: Importers vs exporters

The UK generally runs a trade deficit, importing more than it exports. In 2022, the UK's exports of goods and services totalled £838 billion and imports totalled £906 billion, resulting in a trade deficit of £68 billion.[1]

This gap has widened since we released our first *Trading Places* report in 2017. That year, the UK exported £615.9 billion of goods and services and imported £641.8 billion, which led to a trade deficit of £25.9 billion. This is reflected in our own data, which shows that SMEs attribute less of their turnover to exports now compared to 2017.

Looking to some of the most recent ONS UK trade data available for 2023, it's clear that the current business environment is a difficult one for UK businesses trading overseas, with Q1, Q2 and Q3 2023 seeing successive drops in total trade of goods and services, compared to the previous quarter.

The exporting landscape

Selling goods and services overseas plays a pivotal role in business's ability to grow, and the UK saw an increase of total exports, from £676 billion in 2021 to £838 billion in 2022.

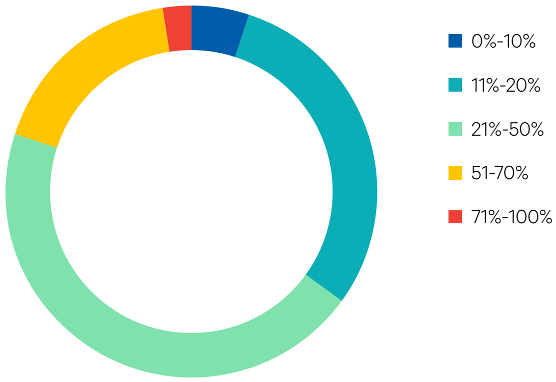
On the surface, these numbers appear to show a broadly positive picture. However, the past few years have presented many challenges that have restricted appetite to trade internationally amongst SMEs - from Brexit, to the Covid-19 pandemic.

Indeed, whilst our research finds that amongst businesses that export, on average this export activity contributes to 32 percent of their annual turnover, this is down from 37 percent in 2017. The manufacturing sector has seen a slowdown in export sales for nearly two years, with the manufacturing PMI for December 2023 reporting a further drop as poor demand from key trading partners weighed on exports.

When looking at overseas trading activities over the course of the last six months, the data shows a mixed picture. Thirty eight percent of SMEs say export sales have increased, while a similar number (36%) say exports have decreased, and 25 percent report no change.

Exporting businesses are more optimistic about the coming six months. Nearly half (47%) of SMEs predict that export volumes will increase, against a quarter (26%) that anticipate a decrease.

Proportion of export related turnover



EU markets top the list of most valuable export destinations

Our research reveals that whilst the US is the most popular exporting destination for UK SMEs, it's not the most valuable - and European neighbours remain important trading partners post Brexit.

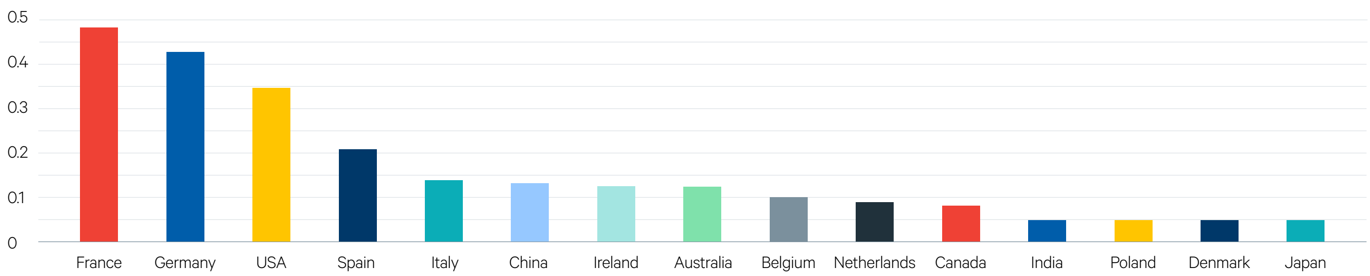
Nineteen percent of SMEs surveyed export to the US, compared to 18 percent to Germany, and 16 percent to France. And, when asked to name the three countries most important to their business in relation to exports, France (49%) and Germany (43%) top the list. The US comes third, with 35 percent of businesses saying this is amongst the top three most important countries they export to. Spain (21%) and Italy (14%) round out the list of the top five export markets.

The data shows there is certainly appetite amongst SMEs to expand relationships beyond their current trading partners - with the US being the one to watch. One in two (52%) of UK SMEs that sell goods or services overseas plan to start export partnerships in new markets in the next 12 months.

Amongst these, 15 percent cite the US as their top target, followed by Germany (9%) and Australia (8%) - demonstrating some appetite to focus on non-EU, English-speaking countries.

Even with its EU membership, Ireland - as a close neighbour and English-speaking country - is an important business partner, ranking 7th amongst the countries that are most important, by export value.

Top 15 export partners, by export value



[1] https://commonslibrary.parliament.uk/research-briefings/sn02815/#:~:text=The%20UK%20generally%20imports%20more,%C2%A368%20billion%20in%202022.

Two perspectives: Importers vs exporters

The importing landscape

On balance, SMEs that import demonstrate relative optimism. When asked about their performance over the last six months, it appears that imports have increased on the whole. Forty one percent of those surveyed say import sales have increased during this timeframe, compared to 30 percent that report a decrease.

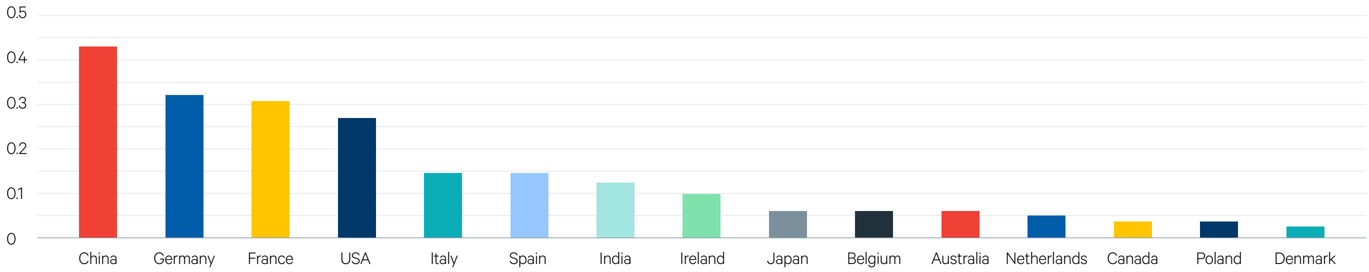
There is clear buoyancy about the next six months as well. Forty five percent of SMEs expect import volumes to increase over the next six months, against 20 percent that expect a decline.

China continues to dominate import partnerships

SMEs that import say they do so from five countries, on average. Looking at the markets that UK SMEs import from, the top three cited are China (30%), US (12%) and Germany (12%).

Similarly, SMEs report that these markets are the most important to their business in terms of import value. China tops the list at 43 percent, followed by Germany (32%), USA (31%), and France (27%). Ireland again punches above its weight in terms of value to UK SMEs, for its relative size as a market. Ireland ranks 8th with respect to its importance by import value.

Top 15 most important partners, by import value



When it comes to broadening relationships with new markets to import from, intentions are tempered. Nearly four in ten (38%) of UK SMEs that import plan to start new import partnerships next year, compared to a third (33%) that don't.

Italy (9%) and the US (9%) are cited as the top targets to forge a new import trade partnership with over the next 12 months, followed by France (8%), Germany (7%) and China (7%).

As SMEs plan to increase the volume of both import and export activity with existing and new international trading partners, they will need to prepare for greater exposure to the risks of currency volatility which, as the following section identifies, are already having an impact.

Foreign exchange: Mitigating the risks

Most major economies only narrowly missed sliding into recession in 2023. Global GDP was anaemic, at best, and few businesses escaped the impact of lingering high inflation, and the steep interest rate rises imposed by the majority of central banks to curb it.

As interest rates continued to ebb and flow, so did foreign exchange rates, maintaining currency volatility as a persistent pressure for small businesses trading overseas. Indeed, nearly a quarter (23%) of SMEs highlight this as a key challenge. Furthermore, over half (57%) say they've been negatively impacted by the constant ups and downs of foreign exchange rates over the past 12 months.

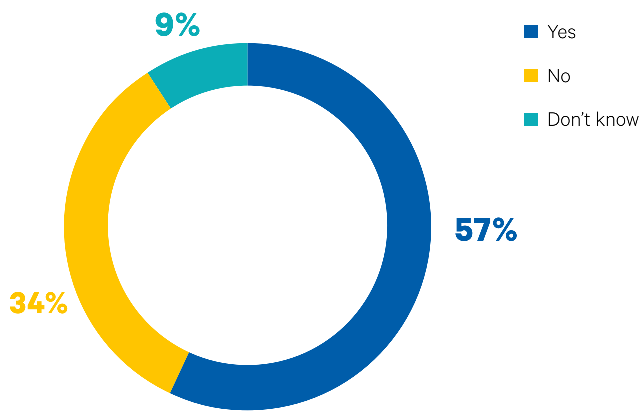
Counting the cost of currency fluctuations

In 2017, when we published our inaugural *Trading Places* report, 67 percent of respondents said they'd suffered the negative consequences of currency volatility. Today, the average value of the repercussion felt by SMEs over a 12-month period from currency volatility is £79,925, up from £69,669 in 2017.

This is a clear indication of the more challenging trading environment within which SMEs are now operating; defined by increased geopolitical tensions and greater macro-economic uncertainty.

Our study shows a significant difference in the financial impact of currency volatility dependent on businesses size. Those SMEs with a turnover of more than £5 million bear the heaviest burden with the average impact reaching a very significant £176,268.

SMEs negatively affected by currency fluctuations in the past 12 months



Foreign exchange: Mitigating the risks

Optimising ways to manage currency risk

Managing the risks associated with currency fluctuations remains a vital, if sometimes tricky, responsibility. In general, 35 percent of UK SMEs engage the support of foreign exchange specialists. However, preference for foreign exchange specialists rises considerably, to 63 percent, for those SMEs whose foreign exchange transactions and usage are extensive.

Overall, more than two thirds (69%) of SMEs turn to banks for the foreign exchange services they require. This edges up to 71 percent for businesses with turnovers of £250,000+.

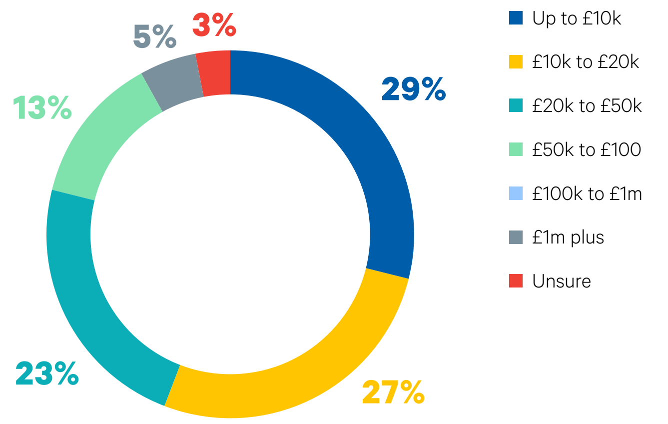
However, the different options open to SMEs for mitigating risk and hedging against currency fluctuations remain as they have always been. Over half (55%) of respondents use spot prices. On average, the typical size of a spot trade is £55,186. This is a substantial uplift from the £39,247 recorded in 2017 and likely reflects higher prices for many foreign currencies, driven by general inflationary pressures which have been exacerbated by recent conflicts around the world.

Forty percent of SMEs opt for forward contracts, with the average value in the majority (64%) of cases ranging from between £10,000 and £50,000.

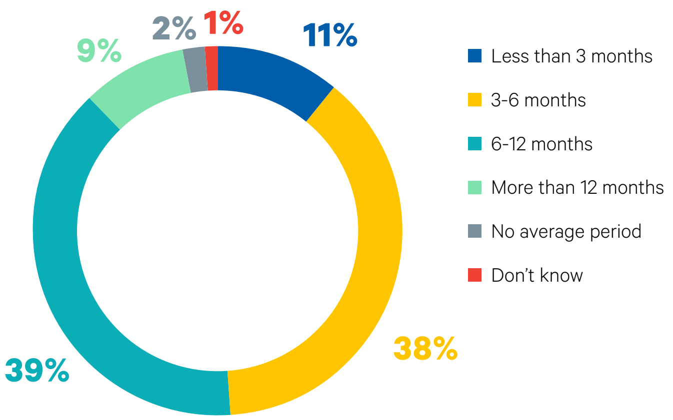
Spot trades tend to be favoured by importers and exporters looking to execute a contract quickly. For those with more time to plan - and particularly businesses looking to hedge against future currency price fluctuations - a forward contract is likely to be the preferred option.

However, there is a worrying eight percent of outliers who are unable to say precisely what method they use to manage their currency risks. The chances are that in many of these cases, SMEs lack a detailed understanding of the different merits of spot trades and forward contracts. The assumption is that, for these businesses, their levels of exposure to currency volatility may be even greater than the average, exacerbating what might already be a vulnerable position. The solution is for them to speak to specialist foreign exchange experts.

Typical size of a spot trade



Length of average forward contract



Taking stock: Recommendations

Recent years' events have transformed the UK's business landscape. The impacts of Brexit and a global pandemic threw international trade - and Europe, if not the world at large - into disarray.

As matters stand today, there are still many challenges facing SMEs trading internationally, and navigating these challenges will be crucial to the UK's growth, productivity and competitiveness.

Based on the findings of this report, we recommend three key takeaways for policy makers, business leaders and the wider international trade sector to ensure Britain's small businesses are prepared to succeed in this volatile environment:

1. Give SMEs a voice on the UK's new trading relationship with the EU

Over seven years on from the Brexit referendum, clarity over the UK's trading relationship with the EU is still lacking. We would urge large corporates, policy makers and the UK's next government, to consider the views of small and medium sized enterprises when taking decisions about the future flow of trade between the UK and the EU. Fail to, and SMEs forced to adopt a 'needs must' mentality may find their relationships with historic trading partners flicker and fade.

2. Seek support from the experts

We believe the private and public sectors should collaborate to educate importers and exporters on how to overcome, or at least mitigate, external challenges such as inflation - the number one challenge for SMEs trading abroad, according to our findings. A sophisticated understanding of both domestic and international economies can help SMEs predict and budget for shocks.

Leading organisations such as the British Chambers of Commerce, the Institute of Export, Open to Export, the British Irish Trading Alliance and the British Exporters Association can champion and deliver such support.

3. Mitigate foreign exchange risk

More can be done to help SMEs protect their businesses against the risk of currency volatility. Industry bodies should provide education on managing foreign exchange risk and encourage SMEs to review their existing arrangements on a regular basis. On a more local level, SMEs should connect with specialist foreign exchange providers to structure a clear plan, budget for exchange rate fluctuations and hedge if they can, to meet and beat the downside risks from the volatility of currency markets.

Methodology

The Trading Places report is a based on a survey of 500 small and medium-sized enterprises (SMEs), headquartered in the UK that import and / or export goods and services overseas. The survey was conducted online by Critical Research between 16 and 21 November 2023.

About Bibby Financial Services

Bibby Financial Services (BFS) is a leading independent financial services partner to over 8,500 businesses worldwide.

We provide specialist and adaptable asset and working capital finance and FX services helping businesses to grow in domestic and international markets.

Formed in 1982, BFS is part of the Bibby Line Group (BLG), a diverse and forward- looking family business delivering personal, responsive and flexible customer solutions for over 200 years.

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