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The West Midlands' Automotive Industry in the Aftermath of COVID-19: Survival of the Fittest?

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Research by Oxford Economics identifies Birmingham to be hit exceptionally hard by the pandemic because the city, as well as the region, is heavily exposed to manufacturing and local supply chains. The industry is already suffering from Brexit-related issues and a significant decline in sales from China, but coupled with Covid-19, it is forecasted that multiple car plants will close (Inman, 2020). Given the interconnected nature of automotive supply chains in general, and the high concentration of other firms that are highly dependent on the industry, the West Midlands regional economy could shrink by 10.1%. This figure includes the automotive sector itself, which makes up around 6% of the local economy, plus other dependent suppliers and contractors. Factory shutdowns and interruptions to supply chains, alongside a significant decline in demand for new vehicles, means that the sector will take a long time to recover and there are likely to be a growing number of lay-offs and possibly bankruptcies along the way.

Given the UK's pledge to help large businesses via the Coronavirus Large Business Interruption Loan Scheme (CLBILS), in this study, we explore the financial position of the 50 largest (in terms of revenue) automotive firms in the West Midlands. How resilient are they in the face of economic shocks of this scale? Our findings show that 21 firms are at high risk as they have relatively poor current liquidity ratios. These are the firms that will face severe cash flow issues and will need support immediately. Importantly, some of these firms include key Original Equipment Manufacturers (OEMs), thus they inevitably operate at the downstream end of supply chains. Multiplier analyses show that if these firms were to fail, there would be a significant ripple effect with a destructive impact on the industry and the local economy.

Introduction

As attention begins to move from the health-related risks of the Covid-19 crisis to the economic and social impacts, assessments show that English regions outside of London and South-East are amongst the worst affected areas (Inman, 2020). Of these, the West Midlands stands out as vulnerable due both to its demographic structure and its high dependence on manufacturing industries. The automotive industry, already facing significant challenges, sits at the heart of the region and this threat.

The UK Automotive Industry

Although key OEMs in the UK are predominantly foreign owned corporations (Qamar et al., 2019a), the automotive sector is an integral part of the UK economy. The sector accounts for over £82 billion turnover and £18.6 billion in value adding activities (SMMT, 2018), employs around 168,000 people directly in automotive manufacturing and over 823,000 across the wider automotive industry. It also accounts for 14.4% of total UK exports (worth £44 billion), with 80% of vehicles produced in the UK exported to 160 different markets in the world (SMMT, 2018). The industry invests £3.75 billion each year in automotive R&D. More than 30 manufacturers build in excess of 70 models of vehicles in the UK, supported by 2,500 component providers and some of the world's most skilled engineers. In 2019, over 1.3 million cars, 78,270 commercial vehicles and 2.5 million engines were produced in the UK (SMMT, 2020).

The West Midlands is one of the main UK centres for car production and is best known for its OEMs such as Jaguar Land Rover, Aston Martin and Mini. Yet, the West Midlands automotive industry is not only home to large 1st Tier suppliers, it has a large cluster of organisations and component groups including driveline, chassis and body panel, engine components, interior trim, electrical components and design. These manufacturers operate as part of a large cluster in different tiers of the supply chain.

Examining Corporate Resilience and the Impact of Government Financial Support Measures

On April 3rd 2020, the UK government announced that they would be supporting businesses via an initiative known as the Coronavirus Large Business Interruption Loan Scheme (CLBILS). The aim of this scheme was to support large businesses, who achieve an annual turnover of over £45 million, by allowing them to apply for up to £25 million in finance (offered at commercial rates of interest). Firms with a turnover of more than £250 million could apply for up to £50 million in finance. This funding was made available through a series of accredited lenders (listed on the British Business Bank website) and the government has assured lenders that it will provide them with an 80% guarantee on individual loans. This provides banks with the security and confidence to proactively lend to as many businesses as possible to mitigate against the economic impacts of COVID-19.

Overall, the aim of the scheme was to ensure that lenders provide temporary financing to support firms who still have bills to pay but are earning little or no revenue. One-quarter of UK businesses have temporarily closed, others particularly in the travel industry, such as Hertz and Flybe, have closed permanently. Schemes like this provide cash-flow or liquidity to help firms survive until markets pick up again.

The need for these schemes and the value of them to the economy in terms of helping firms survive and reducing redundancies, varies by sector and by firm. This partly depends on: (1) to what degree is this particular crisis impacting their business (e.g. British Airways vs. Netflix), and; (2) how resilient are they, for example do they have assets, savings, a cash surplus sufficient to survive an economic shock? The current economic crisis provides a unique opportunity to analyse corporate resilience. We studied the top-50 automotive firms in the West Midlands, based on revenue, to assess which of these firms required the most support during the economic downturn.

Table 1: Top 50 Automotive Firms in the West Midlands Ranked by Current Ratio

Rank	Company name	Latest accounts date	Latest Operating Revenue/ Turnover (Thousands £)	Profit margin (%)	Profit per employee (unit)	Current ratio (X)	Liquidity ratio (X)	Credit score	Likelihood of failure	Latest No of Employees Last avail. yr	Jobs at risk
1	CAB Automotive Ltd.	31/12/2018	27,364	-29.81	-30,662	0.44	0.25	24	11.20	266	HIGH
2	Aston Martin Lagonda Limited	31/12/2018	949,497	4.83	21,121	0.47	0.34	95	0.90	2,173	HIGH
3	Aisin Europe Manufacturing (UK) Ltd.	31/03/2019	27,255	-18.55	-22,775	0.61	0.35	77	2.20	222	HIGH
4	ADV Manufacturing Limited	30/06/2018	27,584	-21.54	-19,805	0.64	0.40	26	11.20	200	HIGH
5	Mahle Filter Systems UK Limited	31/12/2018	28,125	-30.69	-44,495	0.67	0.41	77	2.20	194	HIGH
6	Uk-Nsi CO. Limited	31/03/2019	92,629	2.58	5,685	0.84	0.59	27	11.20	420	HIGH
7	Polytec Car Styling UK Limited	31/12/2018	40,270	-5.33	-4,643	0.85	0.71	86	0.90	462	HIGH
8	Jaguar Land Rover Limited	31/03/2019	20,870,000	-18.55	-117,551	0.86	0.70	86	0.90	32,939	HIGH
9	ZF Automotive UK Limited	31/12/2018	336,380	1.58	2,826	0.86	0.78	89	0.90	1,876	HIGH
10	Faurecia Emissions Control Technologies UK Limited	31/12/2018	54,381	5.84	30,835	0.88	0.73	25	11.20	103	HIGH
11	Grupo Antolin Leamington Limited	31/12/2018	86,092	4.04	15,896	0.89	0.55	88	0.90	219	HIGH
12	Edscha UK Manufacturing Limited	30/06/2007	22,969	8.85	40,642	0.94	0.84	n.s	n.s	50	HIGH
13	TRW Systems Limited	31/12/2018	501,982	-2.63	-11,229	0.98	0.86	40	4.20	1,177	HIGH
14	Rimstock Limited	31/03/2018	18,744	0.10	77	0.98	0.50	92	0.90	235	HIGH
15	Grainger & Worrall Limited	31/05/2019	61,047	6.43	6,624	1.02	0.68	28	11.20	593	HIGH
16	Brose Limited	31/12/2018	263,830	2.62	9,481	1.04	0.83	92	0.90	728	HIGH
17	Antolin Interiors UK Limited	31/12/2018	360,617	0.33	677	1.06	0.42	88	0.90	1,779	HIGH
18	London EV Company Limited	31/12/2018	79,198	n.s	-215,525	1.07	0.89	86	0.90	446	HIGH
19	International Automotive Components Group Limited	31/12/2018	332,502	1.14	3,122	1.10	0.98	89	0.90	1,219	HIGH
20	Tricorn Group PLC	31/03/2019	22,763	4.17	3,125	1.10	0.70	95	0.90	304	HIGH
21	Paintbox Banbury Limited	31/12/2018	24,150	-3.39	-3,916	1.11	0.93	30	11.20	209	HIGH
22	Auto-Sleepers Group Limited	31/08/2018	138,694	5.54	16,710	1.20	0.14	99	0.90	460	MEDIUM
23	Adient Seating UK Ltd	30/09/2018	402,003	-1.29	-3,258	1.23	1.06	81	2.20	1,597	MEDIUM
24	Arlington Engineered Systems Limited	30/03/2018	70,112	4.09	12,630	1.26	1.14	92	0.90	227	MEDIUM
25	MG Motor UK Ltd	31/12/2018	107,420	3.65	103,211	1.33	1.00	85	0.90	38	MEDIUM
26	Sertec Precision Components Limited	31/03/2019	20,243	-6.16	-6,928	1.34	1.13	86	0.90	180	MEDIUM
27	Stadco Limited	31/12/2018	171,054	2.51	5,586	1.35	1.24	92	0.90	768	MEDIUM
28	Rheinmetall BAE Systems Land Limited	31/12/2018	190,000	3.16	8,571	1.51	1.50	86	0.90	700	MEDIUM
29	Don-Bur (Bodies And Trailers) Limited	30/09/2018	51,088	3.87	4,193	1.71	1.19	99	0.90	472	MEDIUM
30	Morgan Motor Company Limited	31/12/2018	33,729	9.38	15,204	1.71	0.90	92	0.90	208	MEDIUM
31	Valeo Engine Cooling UK Limited	31/12/2018	33,419	16.93	70,725	1.75	1.66	99	0.90	80	MEDIUM
32	Bevan Motor Bodies Limited	31/12/2018	23,863	1.46	1,638	1.75	1.36	95	0.90	213	MEDIUM
33	Auto-Sleepers Investments Limited	31/08/2018	138,809	5.73	17,290	1.76	0.22	95	0.90	460	MEDIUM
34	Trak8 Holdings PLC	31/03/2019	19,145	-18.61	-15,292	1.76	1.40	86	0.90	233	MEDIUM
35	Sumitomo Electric Wiring Systems (Europe) Limited	31/03/2019	697,875	0.31	89	1.78	1.01	92	0.90	24,134	MEDIUM
36	Titan Europe Limited	31/12/2018	428,832	2.78	4,726	1.81	0.90	99	0.90	2,522	LOW
37	Bevan Group Ltd	31/12/2018	28,125	3.26	3,013	1.93	1.50	95	0.90	304	LOW
38	DAU Draexlmaier Automotive UK Limited	31/12/2018	45,791	5.36	4,425	1.95	1.95	99	0.90	555	LOW
39	Morgan Motor Company Manufacturing Limited	31/12/2018	28,836	7.34	13,069	1.96	0.43	95	0.90	162	LOW
40	Arcelormittal Tailored Blanks Birmingham Limited	31/12/2018	47,145	2.72	12,232	2.02	1.01	95	0.90	105	LOW
41	GKN Driveline Birmingham Limited	31/12/2018	195,637	-1.96	-4,872	2.04	1.74	81	2.20	786	LOW
42	Walsall Pressings Company Limited	30/06/2018	38,845	3.43	4,687	2.08	1.61	99	0.90	284	LOW
43	Dennis Eagle Limited	31/12/2018	226,383	6.86	18,347	2.11	1.52	95	0.90	847	LOW
44	SAI Automotive Fradley Ltd	31/12/2018	176,010	11.18	37,047	2.14	2.03	92	0.90	531	LOW
45	HUF U.K. Limited	31/12/2018	40,305	5.76	11,540	2.74	2.42	33	11.20	201	LOW
46	Koito Europe Limited	31/12/2018	88,495	10.78	14,385	2.83	2.57	99	0.90	663	LOW
47	Leoni Wiring Systems U.K. Limited	31/12/2018	306,374	4.26	34,168	3.37	3.00	77	2.20	382	LOW
48	Carwood Motor Units Limited	31/08/2018	35,034	12.24	16,689	3.75	3.31	99	0.90	257	LOW
49	Pailton Engineering Limited	31/12/2018	17,772	13.80	14,176	4.41	2.69	99	0.90	173	LOW
50	Brian James Trailers Limited	31/07/2019	25,870	20.69	30,939	5.14	4.22	99	0.90	173	LOW

Source: FAME Bureau Van Dijk database

Notes: (1) the latest available accounts were used in this study and vary by firm; see latest accounts column in Table 1 for exact dates; (2) FAME does not provide precise information about the region in which employees are based.

How Resilient are Regional Car Manufacturers?

Table 1 lists the largest 50 automotive manufacturing organisations in the West Midlands region (based upon revenue) and are ranked on their current ratios (ascending order). The current ratio is a liquidity ratio that compares a firm's current assets to its current liabilities and is commonly used to evaluate whether an organisation has enough resources to meet its short-term obligations. We define a firm as being high-risk when its current ratio is below 1.2, medium-risk if current ratios are between 1.20 and 1.80 and low-risk firms if above 1.80. Based upon the latest available accounts in FAME we find that 21 firms (highlighted in grey) have an annual turnover below the £45 million threshold, so they are not eligible to apply for the CLBILS.

In Table 1, firms highlighted in orange are the 21 firms that we define as high-risk. Together they employ 45,814 people, but only 12 of these high-risk firms are eligible for the CLBILS. Out of these 12 firms we find that 4 firms (UK-Nsi CO. Limited, Faurecia Emissions Control Technologies UK Limited, TRW Systems Limited and Grainger & Worrall Limited) have weak credit scores, thus applying for the CLBILS is exceptionally important for these organisations. Critically important, the big OEMs and particularly JLR, but also Aston Martin, are amongst the high-risk firms. JLR is the largest direct employer, but also supports several tiers of supply chain firms and a wide range of dependent contractors and service firms in the region. If either of these firms were to shut down the repercussions for the West Midlands economy would be severe.

Moreover, out of the 9 high-risk firms that *do not* qualify for the CLBILS, 6 of these firms (CAB Automotive Ltd, Aisin Europe Manufacturing (UK) Ltd, ADV Manufacturing Limited, Mahle Filter Systems UK Limited, Polytec Car Styling UK Limited, Paintbox Banbury Limited), also have negative profit margins. These 6 firms have a total workforce of 1,553 individuals and negative profits coupled with poor current ratios makes these jobs vulnerable to redundancies.

Next, there are 14 firms classified as medium-risk, with a total of 29,770 employees. However, out of these firms only 9 firms (highlighted in blue) have an annual turnover greater than £45 million, thus qualify for the CLBILS. Two out of the 5 medium-risk firms that cannot qualify for the CLBILS and have negative profit margins, thus are relatively vulnerable to closures; Sertec Precision Components Limited and Trakm8 Holdings PLC. These two firms employ a total workforce of 413 people.

We identify 15 firms that cumulatively employ 7,945 people with relatively healthy current ratios. Out of these firms, 8 qualify to apply for the CLBILS. The 7 firms, which we deem as low-risk and are not eligible to apply for the CLBILS illustrate relatively healthy and positive profit margins. However, HUF U.K. Limited, which is one of the firms not eligible for the CLBILS, has an exceptionally weak credit score, thus sourcing alternative funding is most certainly required.

What Does this Mean for Management and Policy Makers?

Our analysis shows that the largest 50 automotive manufacturing firms in the West Midlands employ a total of 83,529 individuals and of these, 45,814, 29,770 and 7,945 people are employed in organisations of high-risk, medium-risk and low-risk respectively, using the current ratio as a proxy measure for cash flow or liquidity.

Cash flow is a key measure of resilience in the face of economic shocks, as explained by Dieter Becker (KPMG Partner, Global Head of Automotive), who describes how firms will face a time delay across their supply and demand chains, created by both breaks in component supply and stalled demand. His view is that this could create a double five-month wave effect with fluctuating capacity utilization, in the automotive industry. Becker states, *“While governments and central banks make all efforts to mitigate the virus effects, I am convinced that the automotive industry will not be able to survive a similar second coronavirus wave with the same restrictive lock down consequences”* (Becker, 2020).

Our analysis shows that only 29 out of the top 50 firms have an annual turnover greater than £45 million, and qualify for the CLBILS. The 21 firms that do not qualify for CLBILS will rely heavily on the Coronavirus Job Retention Scheme (CJRS), which is only a temporary measure. This scheme is designed to support firms by allowing them to furlough employees with the government paying cash grants of 80% of their wages up to a maximum of £2,500. The above data should provide a guide for government agencies to target support more precisely where it is needed.

One of the reasons for direct government intervention is the need to limit redundancies. While these reduce costs and can improve resilience for firms, unemployment places the financial burden on the taxpayer via the costs of benefits and welfare support. The significance of the key OEMs in the automotive industry is revealed when we apply appropriate multipliers to account for both direct and indirect unemployment impacts.

A multiplier effect can be defined as *“An increase (or decrease) in income or employment in a local or regional economy triggered by the emergence of a new type of economic activity”* (Domanski and Gwosdz, 2010 p.27). Crucially, multiplier effects result in the formation or loss of a range of additional jobs within the economic system or regional economy, outside of the industry sector affected (Moretti and Thulin, 2013). Local services in particular, including restaurants and many kinds of retailers, rely on consumption and therefore the incomes of those employed in other sectors.

The knock-on effects are expressed as a ratio of direct to indirect jobs and can be as high as 1:5. These provide some important indicators for policy makers looking to mitigate against the risks of redundancies that will have significant direct and indirect impacts on any one region, or promote economic growth and social well-being through employment. In this respect JLR is unusually important for the West Midlands, because it has such a high proportion of global production and employment in this one region.

From a strategic perspective, firms will need to be more 'agile' than ever before. Research by Qamar *et al.* (2018; 2019a; 2019b) into lean (efficient) and agile (flexible and responsive) firms within the West Midlands automotive sector shows why. Across all of their analyses of supply chains they find that downstream firms predominantly adopt a lean strategy and upstream firms an agile strategy. Although this may work within a relatively stable market, Covid-19 and other economic shocks require a more agile approach across all tiers within the automotive supply chain. Even if this requires higher levels of buffer stocks and less just-in-time approaches or at the expense of certain process improvement practices, the ability to respond and react flexibly is more important than ever.

Summary

Overall, in this policy brief our results show that many of the top 50 automotive firms are facing severe cash flow issues, to the degree that some business closures are inevitable. This will impact specific firms and particular regions far more than others and policy makers need to adapt support mechanisms appropriately. Firms need to be agile in response to the current and likely future economic shocks as this will provide resilience in a competitive environment where only the 'fittest' will survive.

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