EY’s UK Attractiveness Survey 2017

Time to act: empowering the English regions
Executive summary
A complicated position …
In EY’s UK Attractiveness Survey 2017, we discussed how difficult it is to evaluate the UK’s performance in attracting FDI and maintaining its appeal to investors in 2016. For every positive indicator, we found an equivalent negative development to take into account, making it hard to draw definitive overall conclusions.

As this report will demonstrate, the same is true for the English regions. Performance was good, but challenges are there for all to see as the UK moves into uncharted territory with the Brexit negotiations.

Against this backdrop, we believe it is vital that the UK has a clear strategy for the economy moving forward and, if we are to be able to develop a more inclusive and dynamic economy, this must include a focus on the English regions outside of London. As a contribution to the debate, we have set out our proposals for the appropriate policy response. This draws extensively on the analysis presented in our UK Attractiveness Survey 2017 and the latest forecasts of EY’s region and city economic forecast, which is based on the EY ITEM Club model of the UK economy.

… with the UK posting solid FDI growth ...
The UK’s performance in securing FDI in 2016 was solid. The UK retained its place as Europe’s number one recipient of FDI projects ahead of Germany, with a 7% rise in total projects to 1,144 – the highest number on record. The UK was also the leading recipient of FDI jobs in Europe, recording a rise of 2% in FDI-generated employment to 44,700, more than 20,000 above second-placed Poland.

However, this growth was lower than the 15% increase in project numbers achieved across Europe. Of more concern as we consider the longer-term outlook, the UK also lost share in key areas such as R&D and HQ investments.

On the positive side, the UK had a successful year in some areas, such as logistics in 2016, with the number of projects increasing by nearly 44%. And although UK manufacturing plant projects fell slightly, the overall number of projects by manufacturers across the value chain increased from 355 to 374 projects. Financial services and business services posted strong growth with the UK continuing to lead Europe in these two sectors.

… and although investor perceptions point to short-term stability ...
Against the background of the UK’s solid FDI performance, our survey of perceptions among investors globally reveals a split between their current plans and future expectations. On the positive front, in our 2017 study, the proportion of investors planning to establish or expand operations in the UK over the coming year is 24%, in line with the intention expressed over the past seven years. The UK has also regained second place behind Germany in investors’ ranking of Europe’s top three FDI destinations – a position it briefly lost to France in our post-referendum study in October 2016.

… longer-term perceptions are increasingly negative
However, the perception findings also contain some worrying indicators for the future attractiveness of the UK for FDI. Our study shows that 31% of investors expect it to decline over the coming three years, while 33% expect it to improve. While these figures are a marginal improvement from October 2016, they are significantly worse than both the long-term average and the high point of 2013, when 65% of investors had a positive three-year view of the UK.

Further analysis confirms that investors are worried about future trade and migration policy with the possibility of facing more complex customs processes, the risk of tariffs on European trade, and gaps in skills availability all raised as significant worries. Among investors based in Western Europe, 50% expect the UK to become less attractive for FDI over the next three years.

Regions: the potential is clear
There are also mixed messages to be drawn from the performance of the UK’s regions in 2016. Once again, there was positive news. London’s pre-eminence as the UK’s dominant FDI location continued in 2016, with the UK capital securing 39% of all projects recorded, ahead of Scotland in second place. Looking across the English regional groupings, the Northern Powerhouse and the Midlands Engine are now attracting roughly double the number of projects they secured at the beginning of the last decade, clearly demonstrating the potential of the English regions.
The core strength of England’s Northern and Midlands regions is manufacturing. The continued success in attracting FDI in the manufacturing industries continues to underpin economic activity in large areas of the country. The strong performance of both Yorkshire, and the Humber and the West Midlands in 2016 was built on their manufacturing base. Any future policy has to recognise the importance of manufacturing today and its key role as a driver of medium-term growth for many parts of the UK.

Although the East of England also saw manufacturing contribute to its growth in FDI in 2016, this region and the South East have relative strengths in technology and research. Despite these successes, the overall weaker performance of the UK’s regions in these knowledge intensive areas is an important wake-up call that must not be ignored. The digital economy is becoming a reality, and the UK needs to move quickly to ensure it is investing in the infrastructure and skills that will enable it to exploit future digital opportunities. In addition, as any impact of Brexit on the availability of skills or funding for research becomes clearer, the policy will need to be adjusted.

Time to act
Our research has identified mixed messages. On one hand, the short-term outlook for the UK in respect of FDI is positive but there are clear risks to future performance in the medium to long term. Our survey identified that 9% of investors could leave the UK in the next three years, but the UK still has time to act to secure its future attractiveness in a post-Brexit world, provided it moves quickly.

These findings are consistent with the outlook contained in EY’s region and cities economic forecast. The economy is expected to continue to grow but at a slower rate than in the recent past. While we do expect London to slow significantly, it will remain one of the fastest-growing cities, but the southernmost parts of the UK are likely to grow faster than the rest of England. There will be strong performers outside the south – such as Manchester and Leeds – but little overall rebalancing of the economy geographically. More focus on the English regions and cities is required to both boost their prospects and those of the economy as a whole.

Our perception research among investors provides a clear steer on what business sees as the policy priorities. Nationally, the desire is for a trade agreement with the European Union (EU) but also for deals with the US, China and India. Alongside trade, businesses identify the development of detailed plans for skills, in the light of possible changes to immigration rules, as very important. At the regional level, all of these areas matter but improved infrastructure and high-quality skills are the key drivers of investment. A clear plan of action is required.

A plan for success – empower and support the regions
At the national level, we identified five priority areas for policy to respond to the challenges looming on the horizon:

► Engage with investors on the post-Brexit environment
► Develop a UK trade strategy
► Deliver improved infrastructure
► Improve skills
► Empower and support the regions

If the UK is to succeed in the future, it needs to make the most of all its resources. This means that, as a priority, the UK’s regions and cities have to be empowered to deliver the trade strategy. The signs are that, without more support from the industrial strategy and a sufficient allocation of resources, especially to infrastructure and skills, the more peripheral regions, cities and towns will miss out on the benefits FDI brings.

Brexit may well impact economic performance adversely in the short term if economic activity slows because of increased uncertainty. The English regions are vulnerable in this situation, especially the more peripheral regions that are also relatively more dependent on the public sector as a share of economic activity, both direct spending and welfare payments. Current public spending plans will create greater challenges for these regions and hence plans for the English regions overall must include possible actions to mitigate short-term risks.
Applying a sector lens

As this report shows, the key determinant of performance at the region and city level over the medium term is the existing capability at the sector level as economies can only adjust at a certain rate. It is important, therefore, that the policy proposals developed at the local level are framed through a sector lens. We know from our investor research that individual sectors have their own specific priorities — manufacturers tend to want better roads and ports, while services companies often place a higher value on airports. The same is true of skills – labour markets are local to a significant degree; therefore, investment in developing capability should reflect the ends of local markets and employers. The sector perspective should provide the framework for decision-making in all policy areas, creating the basis for an integrated strategy that brings together the various strands of policy.

A greater emphasis in policy on manufacturing than has been the case in recent years will be important in helping drive future success in the English regions outside London. Significant areas of the UK are still heavily dependent on manufacturing, and Brexit increases the need for a coherent strategy. There are risks that future trading relationships with the EU may be less favourable than the situation today, and if this turns out to be the case, policy should seek to compensate for this. At the same time, policy must support the potential transformation of supply chains in terms of both imports and exports to enable UK business to benefit fully from possible trade deals with other countries outside the EU.

Digital is not the only knowledge-based sector requiring focus. This report shows the English regions generally falling behind in R&D investment, most strikingly when compared with Scotland. The reasons for this are likely to include skills availability, the effectiveness of institutional support for investors, and the links between academia and business.

Streamlining the institutional structure

Finally, there is a need to review the institutional arrangements for supporting the English regions and cities. The success of the Northern Powerhouse and Midlands Engine demonstrates the potential of adopting greater focus on the English regions, and the city and region deals already agreed will provide further impact over time. However, the current structure is both complex and yet far from comprehensive. Investors want an easier to-deal-with framework, and there is a need to develop a more effective, streamlined structure with clear roles and responsibilities.

These discussions should also consider increasing the scope of responsibility of the local bodies tasked with accelerating economic growth. While there has been good progress on infrastructure through bodies such as Transport for the North, the responsibility for skills development remains primarily national in nature. If skills development is to match the needs of local economies, then at least some of the responsibility and resources should be deployed at the local level to provide the best chance of matching supply and demand.

A focus on digital skills and capability

We have identified the importance of the digital transformation that is already becoming a reality in the economy. The pattern of FDI and the regional economic outlook suggests that there is a digital divide in the UK, with disparities in the level and volume of digital skills that are available. If manufacturing is one key component of the regional industrial strategy, then digital skills and the supporting infrastructure – such as wider availability of higher-speed broadband – is another. Business, policy makers and academics all have a role to play in improving the digital capability of the country.
A solid year for FDI into the English regions with the new economic groupings increasing in significance

The total number of FDI projects secured in the English regions outside of London rose by 5% from 485 in 2015 to 509 in 2016, the highest figure recorded in the past decade. FDI projects in the Northern Powerhouse and the Midlands Engine have almost doubled since 2007, clearly demonstrating the potential of the English regions.

In 2016, the English regions collectively secured 160% more jobs from FDI than London and saw their share of employment generation from FDI reach a decade-long high point of 61% up from 57% in 2015.

Sectors: business services and software important, but manufacturing is critical for many English regions

Manufacturing as a whole is the dominant sector for FDI in the English regions, accounting for 248 of the 509 projects in 2016, 49% of the total.

*UK investment was relatively flat, suggesting that the digital divide between London and the rest of the country may be increasing.
Economic growth in 2016: the South East and East of England step up as London and other parts of the UK falter

Gross value added (GVA) growth in 2016

- East of England: 2.2% — up 0.1% from 2015
- South East: 2.8% — up 0.3% from 2015
- London: 1.9% — down 1.0% from 2015

Employment growth in 2016

- East of England: 1.8% — up 0.4% from 2015
- South East: 2.8% — up 0.3% from 2015
- London: 1.6% — down 1.0% from 2015

Time to act: empower the regions

If the UK is to succeed in future, it needs to make the most of all its resources. As a priority, the UK’s regions and cities have to be empowered to deliver the trade strategy.

In our opinion, the key elements of a regional strategy are:

- A clear sector focus, with support for manufacturing
- Coordination with national efforts on skills and infrastructure
- A plan for digital, addressing the geographic digital divide in the UK
- Development of a simpler, more effective, institutional framework for devolved activity in England
Individual analysis of the UK’s regions

The North West

FDI performance
In 2016, the North West recorded its second most successful year for FDI in the past 10 years. But because the most successful year was in 2015, the year-on-year comparison was down by 11%, with the region recording a total of 90 projects against 101 in 2015. This meant that the North West’s share of UK projects slipped to 7.9%, from a 10-year high of 9.5% in 2015.

Number of projects in the North West and the region’s share of UK projects, 2007–16

However, while the North West secured fewer projects in 2016 than in 2015, the investments that it did secure tended to be larger in terms of job creation. As a result, the region’s reported employment generation of 5,152 jobs from FDI in 2016 represented a rise of 28% on the 2015 total of 4,030. This meant the North West received 11.5% of all employment generated by FDI in the UK in 2016 — its highest proportion since 2012, when it secured 18.4% of the UK’s FDI jobs.

In keeping with all other English regions, the US was the single biggest origin of projects into the North West in 2016, although the number of investments from the US was down on 2015. During the year, the North West secured 25 projects from the US, or 28% of its total investments, compared with 32% for the UK in general. Projects into the region increased from European countries — notably France, Germany and Denmark. The North West also achieved increased project successes from Australia and Israel, although these origins still represent relatively small numbers compared with the region’s leading sources of FDI.

Largest origins of investment into the North West in 2016, compared with 2015

Employment generated from FDI in the North West and the region’s share of total UK FDI jobs, 2007–16
In terms of sectors, the North West’s pattern of investment closely mirrors the national picture, with business services and software accounting for the largest proportion of investments, and machinery and equipment being the third-largest generator of projects.

**Largest sectors generating investments into the North West in 2016**

- Business services: 36%
- Software: 14%
- Machinery and equipment: 12%
- Financial intermediation: 8%
- Land transport: 8%
- Pharmaceuticals: 6%
- Financial intermediation: 6%
- Insurance and pension: 4%
- Publishing: 4%
- Utility supply: 4%
- Other: 6%


The North West benefits from a diversified economy with relative strengths in a number of areas and few gaps in terms of sector coverage. Nevertheless, there is still a need to focus more on the software and knowledge sectors as these will be crucial for future growth. The region has strong universities and the example of Scotland suggests this might be an area that the North West could exploit even more successfully in future.

**Employment structure: North West versus the UK overall (excluding London), 2016**

- Human health and social work
- Wholesale and retail trade
- Accommodation and food service
- Administrative and support service
- Manufacturing
- Real estate activities
- Transportation and storage
- Professional, scientific and technical
- Public administration
- Financial and insurance activities
- Arts, entertainment and recreation
- Information and communication
- Other service activities
- Education
- Utilities, extraction and agriculture
- Construction

Source: EY ITEM Club.

Percentage point difference

Small relative to UK excluding London

Large relative to UK excluding London
Yorkshire and the Humber

FDI performance

The performance of Yorkshire and the Humber in securing FDI continued to improve: in 2016, the region secured 98 projects – which was more in a single year than in the four years of 2010–13 taken together. The region’s number of investments in 2016 was up by 18% from 2015 and represented the largest haul of projects secured in any year during the past decade. As a result, Yorkshire and the Humber’s share of all UK FDI projects increased to 8.6% in 2016 from 7.8% in 2015. By way of comparison, in 2013 Yorkshire and the Humber received just 2.5% of UK FDI projects.

Number of projects in Yorkshire and the Humber and the region’s share of UK projects, 2007–16

The region’s strong performance in attracting FDI was mirrored in terms of FDI jobs. In 2016, employment creation recorded by FDI projects in Yorkshire and the Humber grew by 16% to a total of 3,724 jobs. This was a 10-year high in absolute terms, and meant that Yorkshire and the Humber secured 8.3% of total UK FDI employment. However, this proportion was slightly below the 11% share the region recorded in 2014.

Turning to the origins of FDI projects into Yorkshire and the Humber in 2016, all five of the region’s leading origins of investments increased their numbers of projects between 2015 and 2016. The US was the single most important origin, in keeping with every other English region – and it increased its projects into Yorkshire and the Humber by 30% to 26 investments. Germany, France, Austria and Ireland also saw rises in their numbers of projects in Yorkshire and the Humber.

Largest origins of investment into Yorkshire and the Humber in 2016, compared with 2015

Source: EY’s European Investment Monitor 2016.

Individual analysis of the UK’s regions
The characteristics of investment in Yorkshire and the Humber in 2016 remained more focused on manufacturing than is the trend for the UK as a whole. While the UK overall secures the biggest share of its investments from the software and business services sectors (together generating 25% of all investment), Yorkshire and the Humber secured its biggest proportion from the machinery and equipment sector (accounting for 23% of investments into the region) compared with just 8% from business services. And software is not ranked as a leading sector in Yorkshire and the Humber at all.

**Largest sectors generating investments into Yorkshire and the Humber in 2016**

- Machinery and equipment: 27%
- Fabri acted metals: 13%
- Business services: 10%
- Food: 8%
- Retail: 7%
- Chemicals: 6%
- Land transport: 4%
- Non-metallic mineral products: 4%
- Automotive assembly: 27%
- Electronics: 7%
- Insurance and pension: 4%
- Other: 6%

Source: EY’s European Investment Monitor 2016.

The region’s recent FDI performance shows how Yorkshire and the Humber has successfully continued to develop its manufacturing sector. As a result, there is good sector depth and investment across the region, not just in the major centres. The region also boasts a strong financial services base and back office and logistics capabilities.

Going forward, the region will need to engage with policy makers to ensure that plans for investment in infrastructure and skills are in line with the needs of the region. Particular attention is required in the digital arena as this is an area in which the region should aspire to build on its successes to date.

**Employment structure: Yorkshire and the Humber versus the UK overall (excluding London), 2016**

Source: EY ITEM Club.
The North East

FDI performance

After a relatively strong year in 2015, the number of FDI projects secured in the North East fell back by 37% in 2016 to 26 investments. However, this was still the region’s second-largest haul of projects since 2010. That said, aside from the spike in projects in 2015, the general trend for the North East over the past decade has been a steady diminution in its UK market share of FDI projects. In 2007, the region secured 5.9% of all UK projects, but by 2016, this had reached a low point for the decade at 2.3%.

Number of projects in the North East and the region’s share of UK projects, 2007–16

The position is similar in terms of employment from FDI, albeit with the proviso that the employment numbers are more volatile. In 2007, the North East region secured 11.2% of UK FDI employment, a figure that was then bettered in 2009, when the region secured 14% of UK employment. By 2016, its share of UK FDI jobs created during the year had declined to 2.7%, with its total FDI employment recorded falling to just 1,205 jobs – the lowest figure in the past decade and equivalent to just 37% of the 2015 total.

Employment generated from FDI in the North East and the region’s share of total UK FDI jobs, 2007–16

The US remained the leading origin of FDI in the North East in 2016, with projects from the US holding steady at 10 investments in each year. Japanese investment remained the second-largest flow of projects, although its contribution fell back from eight projects in 2015 to five in 2016.

Largest origins of investment into the North East in 2016, compared with 2015

The position is similar in terms of employment from FDI, albeit with the proviso that the employment numbers are more volatile. In 2007, the North East region secured 11.2% of UK FDI employment, a figure that was then bettered in 2009, when the region secured 14% of UK employment. By 2016, its share of UK FDI jobs created during the year had declined to 2.7%, with its total FDI employment recorded falling to just 1,205 jobs – the lowest figure in the past decade and equivalent to just 37% of the 2015 total.

Individual analysis of the UK’s regions
In terms of sectors, the business services sector was the largest single provider of investments in the North East in 2016. Software was also ranked in the region’s top five sectors, and together, these two sectors accounted for 27% of projects, compared with 25% for the UK as a whole. Automotive and food projects were also important to the region.

**Largest sectors generating investments into the North East in 2016**

- Business services: 27%
- Automotive assembly: 15%
- Food: 11%
- Software: 11%
- Chemicals: 11%
- Machinery and equipment: 12%
- Other transport equipment: 8%
- Other: 8%

Source: EY’s European Investment Monitor 2016.

Manufacturing and the public sector are more important to employment in the North East than to the English regions as a whole and this is reflected in the FDI performance of the region. Future policy needs to be designed to provide incentives for continuing investment to ensure that manufacturing remains competitive but also to help to build greater depth in other areas such as software and professional services. This will require a coordinated approach across the cities and towns of the region to ensure that all resources are available and used effectively.

**Employment structure: North East versus the UK overall (excluding London), 2016**

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<tr>
<th>Sector</th>
<th>Percentage Point Difference</th>
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<tbody>
<tr>
<td>Education</td>
<td>-3.0</td>
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<tr>
<td>Human health and social work</td>
<td>-2.0</td>
</tr>
<tr>
<td>Public administration</td>
<td>-1.0</td>
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<tr>
<td>Manufacturing</td>
<td>0.0</td>
</tr>
<tr>
<td>Accommodation and food service</td>
<td>1.0</td>
</tr>
<tr>
<td>Other service activities</td>
<td>2.0</td>
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<tr>
<td>Real estate activities</td>
<td>3.0</td>
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<td>Arts, entertainment and recreation</td>
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<td>Financial and insurance activities</td>
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<td>Information and communication</td>
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<td>Transportation and storage</td>
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<td>Construction</td>
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<td>Professional, scientific and technical</td>
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<td>Administrative and support service</td>
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<td>Utilities, extraction and agriculture</td>
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<td>Wholesale and retail trade</td>
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Source: EY ITEM Club.
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