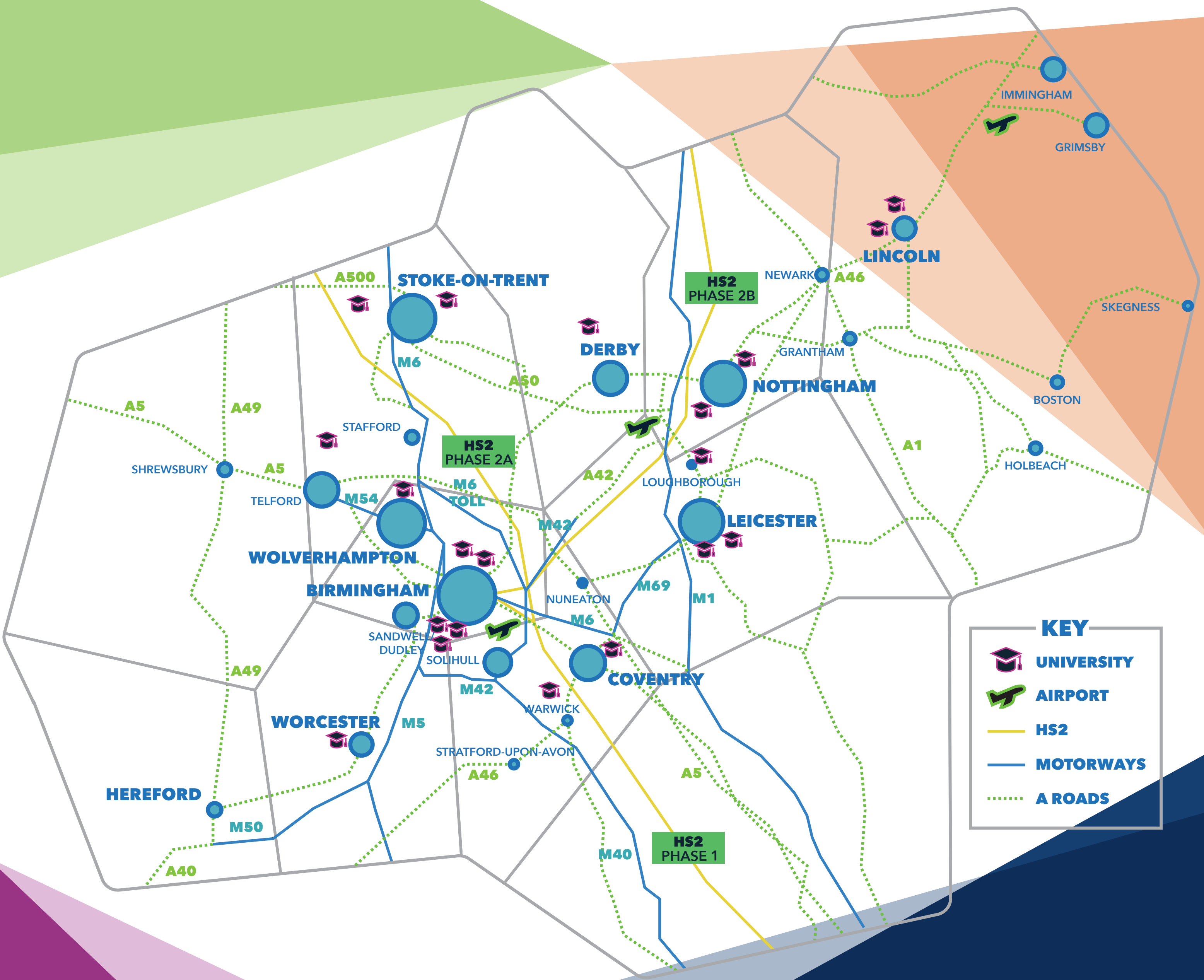
MIDLANDS ENGINE

# MIDLANDS ENGINE
## INDEPENDENT ECONOMIC REVIEW

### EXECUTIVE SUMMARY TO THE MIDLANDS ENGINE PARTNERSHIP

**FEBRUARY 2020**



## Contributors

The Midlands Engine would like to thank the many stakeholders and businesses across the region who provided valuable insight and who supported this project throughout the duration of the IER process.

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The Independent Economic Review process was overseen by a Midlands Engine Economic Observatory Project Board, comprising members from the Midlands Engine, representatives from the Ministry of Housing, Communities & Local Government and Department for Business, Energy & Industrial Strategy, Midlands Connect and Greater Lincolnshire Local Enterprise Partnership (on behalf of all nine Midlands Engine LEPs). Feedback on interim outputs was also provided by the Midlands Engine Operating Board.

Midlands Engine Economic Observatory, delivered by:

# FOREWORD

**The Midlands Engine Partnership brings together partners across the Midlands to promote and grow the Midlands Economy. We established the Midlands Engine Economic Observatory (The Observatory) in 2018 to provide essential research capacity and grow contemporary insights into the functioning of our economy.**

The Independent Economic Review is the most significant output of the Observatory since its inception. The review is an extensive investigation of the Midlands economy, at a depth and scale not seen before.

The review was completed prior to the Covid-19 outbreak. Despite the significant changes in context since the completion of the work, we did want it to be made available for our partners to use. Many of the findings will still hold true as we emerge out of the period of economic turbulence caused by the pandemic. Nonetheless, some things will have changed and we will be working with Observatory partners to provide updated findings to this review, during and after the Covid-19 crisis. We will keep all partners informed of this work.

Despite the current economic uncertainty this review remains a foundational piece of work that helps us to understand the drivers, opportunities and barriers facing our economy. It provides our partnership with clear and specific evidence on which to base economic growth interventions in the Midlands. Just as importantly, it provides an evidence base for our ongoing dialogue with Government.

We know the Midlands has a dynamic economy, with enormous assets in its business-base and across our many academic institutions. The review shines a light on these strengths and shows what huge potential we have to build on. However, it also highlights the nature of some of the stubborn barriers to closing the gap in economic prosperity for the Midlands with the rest of the UK, and most acutely with London and the South East.

It highlights key drivers of productivity that we need to improve including transport and connectivity, skills, innovation and enterprise, availability of business finance and trading with the world, post-Brexit. Some of these barriers have been acknowledged previously, the review re-affirms the size of the task at hand, and provides a greater insight into what we need to do next.

The review has already been used in our briefings with Government, and it is therefore no coincidence that the body of evidence produced supports the growing policy agenda of 'levelling up' ambitions across the UK.

The completion of this research is just the first step in the value the Observatory will add. I look forward to working with all partners committed to furthering our efforts together, to grow the economy and prosperity of the Midlands Engine.

**SIR JOHN PEACE**
**CHAIRMAN, MIDLANDS ENGINE**

# EXECUTIVE SUMMARY

## Aims and approach

1. SQW and Cambridge Econometrics (CE), in collaboration with City-REDI at the University of Birmingham, Nottingham Trent University and the Black Country Consortium, were commissioned by the Midlands Engine (ME) to develop the first ever Independent Economic Review (IER) for the Midlands region. This exercise formed part of the wider Midlands Engine Economic Observatory (MEEO) research programme, which was designed to provide an accessible and coherent source of evidence on the Midlands economy as a whole.

2. The primary focus of the IER was on productivity. The research has sought to better understand the key factors driving productivity performance across the Midlands, identifying commonalities and economic linkages across the region. It investigated where a genuinely pan-Midlands approach could potentially add most value in terms of addressing strategic challenges and enabling growth opportunities. The research explored what might be required to improve the Midlands' productivity performance over the next 10 years. As well as strengthening the evidence base and influencing policy, the IER has been designed to stimulate debate and discussion.

3. The IER was developed through two main phases of research:

- First, a review of existing evidence was produced in spring/summer 2019, drawing on data and literature gathered by the Observatory team and through a wider call for evidence across ME stakeholders. Responses to the call for evidence were received from around 40 organisations. In total, c.250 documents were collected, filtered and prioritised,[1] and more than 150 were reviewed in detail.

- Second, deep dive research was undertaken in late summer/early autumn 2019 to fill some of the gaps identified in the existing evidence base. This included interviews with over 50 businesses/business representative organisations across the Midlands, academic research into the rationale for intervention at a pan-Midlands scale, and a granular analysis of trade flow data. At the same time, Local Area Profiles were developed by CityREDI in collaboration with each LEP, future growth projections and scenarios were developed by Cambridge Econometrics, and an assessment of the potential impact of Brexit on sectors in the Midlands was conducted, alongside an analysis of public spending in the Midlands over recent years.

## Context

4. Geographically, the Midlands lies at the heart of the UK, stretching from the Golden Triangle and Western Gateway in the south up to the Northern Powerhouse, giving it an inherent comparative advantage through its linkages with the wider UK economy. With a population of 10.6m people, 816,000 businesses, 5.3m jobs and an annual economic output of more than £233bn (2017), it forms a significant part of the national economy and therefore, its long-term economic success matters to us all.

5. Historically, the Midlands was at the vanguard of science and industrial innovation. Back in 1771, when Richard Arkwright built the world's first water-powered cotton mill at Cromford, he pioneered a new technology that would drive the industrial revolution and transform production, first in the UK, and then around the world. Shropshire is home to Ironbridge Gorge, which has a legitimate claim to be the "birthplace of the industrial revolution".

[1] On the basis of relevance, quality/robustness and timeliness

6. Since then, the Midlands has become synonymous with globally significant firms and industries operating at the leading edge of advanced technology development and adoption. For example, Toyota and Jaguar Land Rover in automotive, Alliance Medical in medtech, Mondelez in confectionery, Experian in business services, Bombardier and its predecessors in rail engineering, QinetiQ in defence, Rolls-Royce in aerospace, and HSBC in fintech with its new UK HQ in central Birmingham, plus many other household names such as Siemens, 2 Sisters Food Group, Worcester-Bosch, Boots, 3M, Capgemini UK, the Morgan Motor Company, JCB, Young's Seafood and Everards amongst hundreds of others.

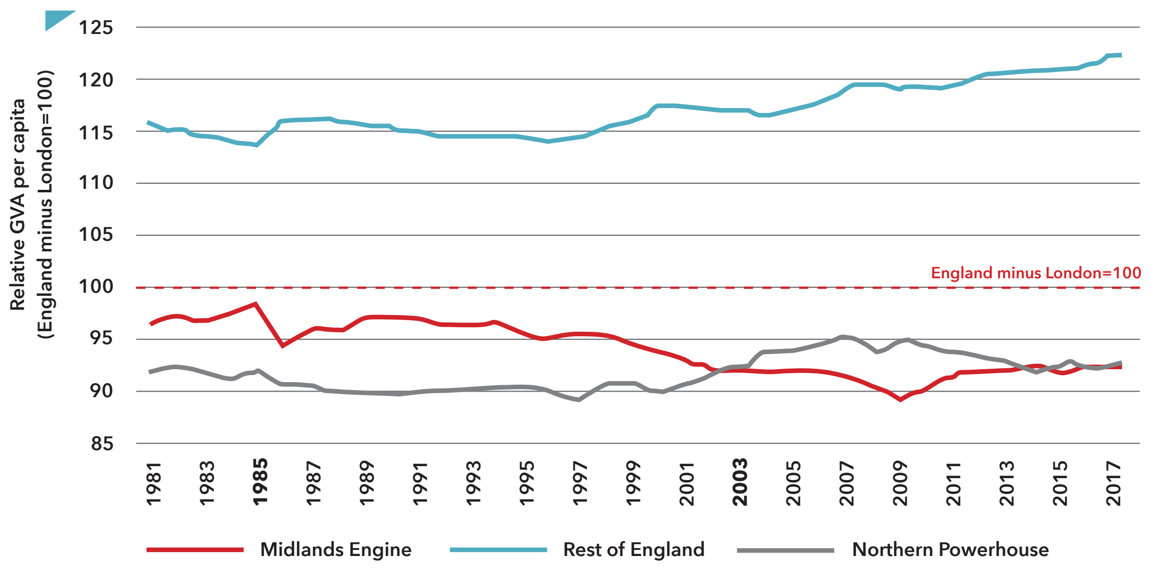
7. However, despite the breadth of the Midlands' business base, its profile globally is arguably most commonly associated with manufacturing excellence – particularly within the automotive sector, which remains a beacon of strength today as Midlands based firms embrace the exciting opportunities presented by industrial digitisation, autonomous vehicles and electrification.

8. This pioneering work has been supported by the growth of centres of learning, scientific research and innovation, as well as technology test-beds that are amongst the very best in the world. It also has a strong and vibrant cultural scene that forms part of an impressive wider quality of life offer, combining urban "buzz" with Areas of Outstanding Natural Beauty and UNESCO World Heritage sites.

9. The Midlands' diverse economy has huge potential, but the region faces a number of challenges including a need to improve its productivity performance and respond effectively to the so-called 'Grand Challenges' of AI and data, an ageing society, clean growth, and the future of mobility. This Independent Economic Review - and the substantial evidence base that underpins it - is designed to support policy-makers, investors and wider stakeholders as they progress the Midlands Engine's important growth agenda – for the benefit of the Midlands' residents and the rest of the UK.

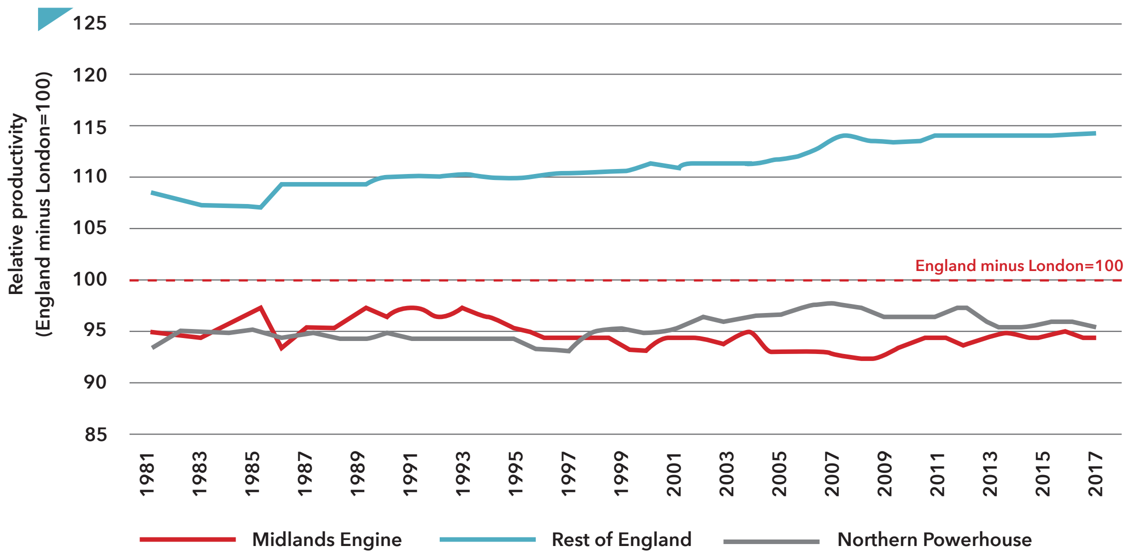
## Economic performance and the key factors driving productivity and growth

10. GVA per capita is a broad measure of economic prosperity. In 2017, GVA per capita in the Midlands was nearly £22,000, which represents 92% of the England minus London average. **If this gap in GVA per capita with the England minus London average was closed, the Midlands economy would generate an extra £20bn each year.** However, if we compare the Midlands with the rest of England (including London), GVA per capita is only 76% of the benchmark. This gives a GVA gap of £76bn.




Source: Cambridge Econometrics calculations, ONS

11. **Productivity[2] is the key factor explaining the GVA per capita gap in the Midlands.** Productivity performance compared to the national average improved slightly post-recession, but has remained relatively static since 2013. **By 2017, productivity in the Midlands was 94% of the England minus London average (or 82% if we compare to the rest of England).** The employment rate also contributes to the GVA per capita gap, but to a lesser degree: in 2017, the Midlands' employment rate was 97% of the England minus London average. The two other drivers of the GVA gap – jobs per worker and working age population – are broadly in line with the England minus London benchmark, and therefore do not explain the gap.

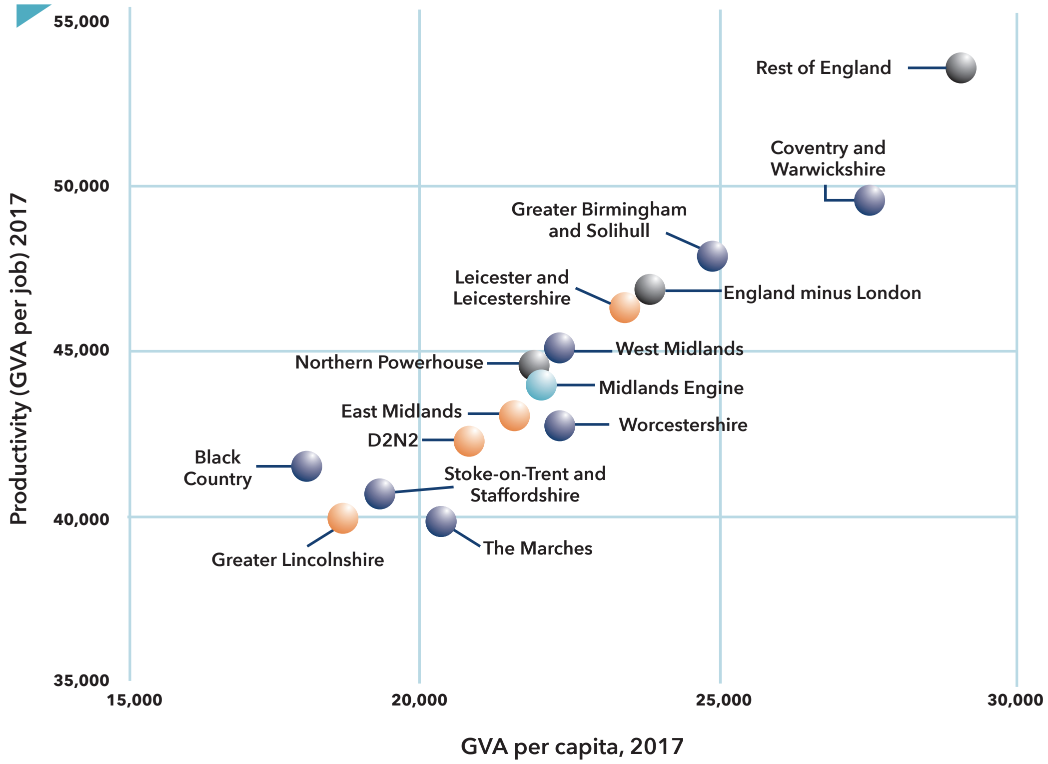



[2] Measured by GVA per job

Source: Cambridge Econometrics calculations, ONS

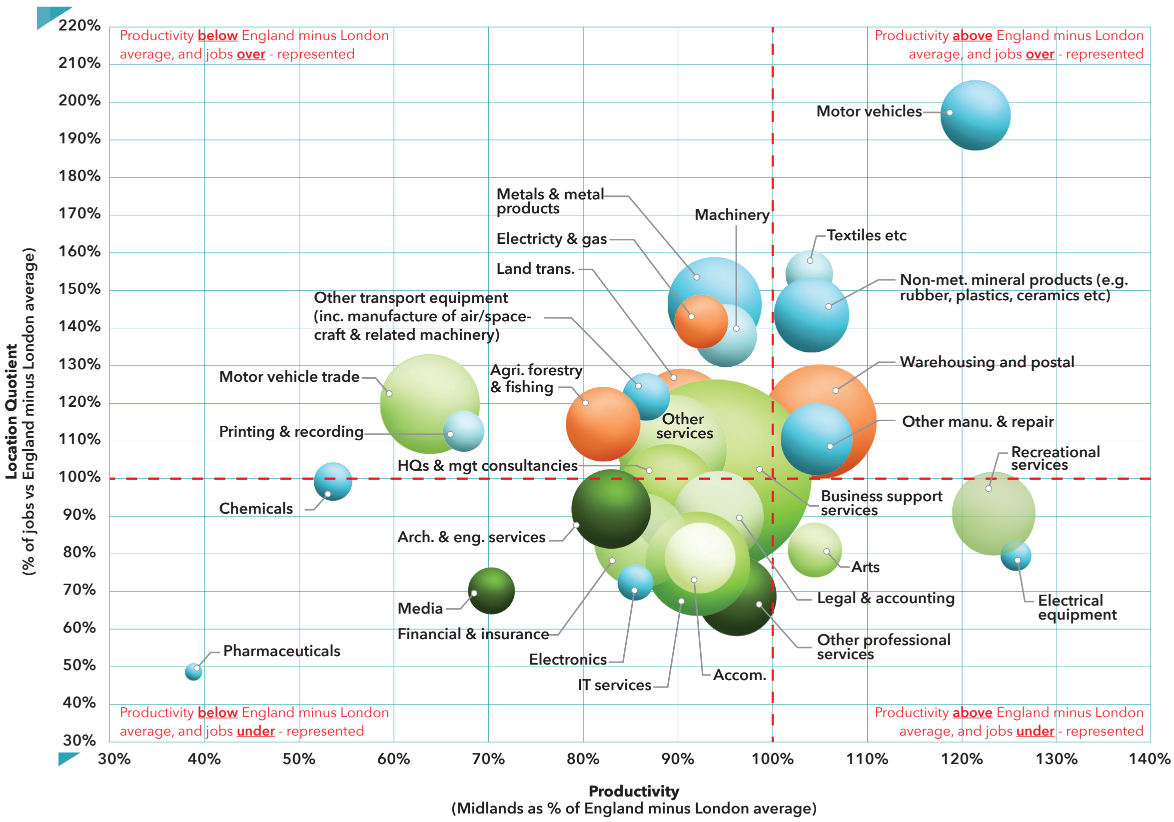
12. **These figures mask variable productivity *within* the Midlands.** Three LEP areas (Coventry and Warwickshire, Greater Birmingham and Solihull, and Leicester and Leicestershire) have higher productivity than the Midlands average and have done so for the last two decades. Productivity is lower in other parts of the Midlands, and the gap has progressively widened in some areas over the last twenty years.

Source: Cambridge Econometrics




13. Over time, shifts in the sectoral structure have influenced productivity in the Midlands, with too few jobs in higher productivity sectors. However, **productivity performance *within* sectors** (driven by tasks, functions, specialisation and markets) **is much more important in explaining the region's productivity gap.** As illustrated below, the performance of the motor vehicles sector excels in the Midlands. However, only 10% of jobs in the region are in sectors where productivity in that sector is above the England minus London average. Productivity is relatively low within some of the region's priority sectors that are in/affiliated to its key strengths, as well as many of the region's business-to-business services.

Source: SQW analysis of Cambridge Econometrics data. Note: data for all sectors is available in Annex B. Note: Midlands sectoral productivity performance, scale and concentration relative to the England minus London average shown for sub-sectors where productivity performance is above or below the benchmark only, 2017. Size of bubble represents Midlands jobs in 2017s, ONS



14. The evidence points towards **challenges in starting and growing a business in the Midlands**, with parts of the region having some of England's lowest incidences of High Growth Firms, **and low in-firm productivity.** Our business interviews for the IER corroborated the data and literature, with **many businesses in the Midlands identifying barriers to growth and challenges in raising their productivity.**

15. According to the evidence gathered for the IER, the most important and common factors holding back productivity and growth across the Midlands are: (i) skills; (ii) infrastructure; (iii) access to growth finance; and (iv) barriers to R&D collaboration, commercialisation and knowledge diffusion/technology adoption. Other issues include premises, utilities, digital connectivity, inadequate business support, and more generally, outdated perceptions of the Midlands, which hamper efforts to attract talent and investment. Some of these challenges are explained in more detail directly below:

    - **Skills:** The Midlands is home to significant centres of excellence and world class expertise. However, in aggregate, the region has too few people with high level qualifications and too many with no/low level qualifications. School performance is very variable, with low early years outcomes in some parts of the region. Apprenticeship starts fell sharply in 2017/18 (as did national figures) but there are recent signs of improvement. There are reported skills gaps and shortages in occupations that are critical to the Midlands' key sectors (and productivity and growth more generally), such as leadership and management (L&M), and digital/data analytics/industrial digitisation and STEM skills. The evidence points to challenges in attracting and retaining talent in the region, both for graduates and more experienced talent (which is linked to perceptions/attractiveness of place, difficulties in commuting, a lack of "depth" in the labour market (i.e. the supply of high quality job options), the quality and choice of housing in the 'right' locations, etc.), and some SMEs experiencing difficulties competing for talent with large multinationals in the Midlands.

    - **Infrastructure and business environment:** Poor road and rail transport is a major and well-documented issue across the region, especially in terms of East-West travel. The Midlands has suffered from relatively low levels of transport investment over a prolonged period of time. It was reported to the IER team that this is acting as a drag on business performance (e.g. for productivity, the size of potential talent pool, access to clients and collaborators, supply chain operations). International airports are an important asset for the Midlands, although concerns were raised regarding road/rail connectivity to airports and insufficient flights to key growth markets. Digital connectivity is very variable across the Midlands, in both rural and urban areas, and is impacting upon home-working, business activities (e.g. communications with overseas clients, productivity). Insufficient water and electricity supply in some parts of the region is hindering business expansion and/or the ability of firms to operate at maximum capacity. In terms of sites and premises, the provision of attractive and flexible grow-on space, large-scale industrial premises and Grade A office space is limited in some locations due to stubborn and persistent land and property market failures.

    - **Finance:** This was raised as a challenge in terms of business investment to grow (and in some cases, having the capacity to secure supply chain opportunities), improve productivity and innovate (especially the second valley of death and pathway to commercialisation). Issues are variable across the Midlands, but on the demand-side, common challenges include a lack of awareness of what finance is available, difficulties navigating the existing offer, L&M skills, investment readiness, and an aversion of external finance. On the supply-side, the existing offer is often perceived as being fragmented, highly competitive, under-resourced and in some instances, unattractive to the entrepreneur commercially.

- **R&D, innovation and technology adoption:** the Midlands is home to nationally significant clusters and major world class assets and "innovation anchors". It has successfully attracted large amounts of FDI in some of the region's high productivity priority sectors. However, R&D activity is variable across the Midlands, and tends to be very concentrated in a small number of highly innovative firms and leading research institutions, contributing to a gap in R&D intensity overall. Moreover, the evidence suggests that some of these high-quality innovation assets are not effectively "joined up", performance in securing public sector innovation funding is variable, and businesses cited difficulties engaging with the research base quickly and efficiently. Diffusion of knowledge/innovation across the wider business base appears to be slow, and there are concerns about absorptive capacity.

16. Concerns were raised regarding competition and the imbalance in governance and leadership (for example, with a Combined Authority in the West, but not the East) across the region, which is perceived by some as hindering progress in terms of economic development and productivity gains. Despite some encouraging signs of progress, a more cohesive strategic agenda, coherent and compelling narrative, and collective identity was seen as being vitally important if the Midlands is to achieve its full potential over the coming years.

## Rationale for a pan-Midlands approach

17. A key question posed for the IER was "What functions or activities does it make sense to discharge at the pan-regional level of the Midlands Engine?", taking into account the principles of subsidiarity[3] and additionality[4], as well as pragmatic considerations (e.g. capacity at different scales) and governance issues (i.e. levers/powers available at each level). Based on academic research, business feedback and the LEP-level profiles, the evidence suggests a rationale for pan-Midlands effort in terms of:

- **Advocacy, identity and promotion,** developing and communicating a coherent, compelling and consistent message/voice – both internally and externally
- **Genuinely strategic and evidence-based** decision-making, case-making and evaluation
- **Science and innovation**, including co-ordination between business/research assets, ensuring agendas are joined-up to maximise synergies, prioritisation and making the case for long-term investment
- **Internationalisation**, including inward investment
- **Infrastructure**, including transport, digital, utilities and energy, in terms of planning, co-ordination and securing the necessary investment
- **Business finance**, including money to "oil the wheels" of growth throughout supply chains
- **Skills** in terms of advocacy (recognising that responsibility for delivery lies elsewhere), for example to help create the conditions to attract/retain young talent and address key shortages/gaps for the Midlands' priority sectors.

18. In order for these pan-regional activities to be effective, clarity and agreement on the functional division of responsibilities will be essential, setting out how the different governance "tiers" will work together effectively so as to maximise impact.

## Looking forward

19. Based on Cambridge Econometrics' "business as usual" projections to 2030, GVA growth in the Midlands (at 1.4% p.a.) is expected to lag slightly behind the national average (of 1.5% p.a. for the UK minus the Midlands) and behind historic trends in the region. In the same projection employment in the Midlands Engine grows by 0.3% p.a. compared to 0.4% p.a. in the rest of the UK. **The result is that productivity in the Midlands is expected to grow at the same rate as the rest of the UK, so the productivity gap will persist.**

20. **In order to fully close the productivity gap** (i.e. match the UK productivity level[5] by 2030), **the Midlands' productivity performance would need to increase at a rate of 2.4% p.a.** (see the "transformational scenario" in the graphic), meaning the region would need to return to (and exceed) productivity growth rates previously seen in the 1980s and 1990s. This is extremely ambitious given how productivity growth has been subdued over the past decade (averaging 0.4% p.a.).

21. The "transformational scenario" has been informed by an analysis of LEP-level growth aspirations and priority sectors (as set out in existing local strategies). However, even if these are successfully delivered through to 2030, further uplift is required across the Midlands as a whole in order to match the UK productivity level by 2030. It should be noted that competitor areas will also be seeking to accelerate their economic growth over the coming years.

[3] i.e. that issues should be dealt with at the most immediate or local level that is consistent with their resolution.
[4] i.e. how working at the pan-regional scale can add most value to activities at finer scales of geographical disaggregation.
[5] UK less the Midlands Engine.

# Policy implications

22. Perhaps as expected given the scale and diversity of the Midlands, a wide range of issues have emerged during the course of this IER process. These issues can be grouped under the following six broad themes:

- Investment in the Midlands' **strategic transport network in order to** strengthen economic relationships (in terms of supply chain links, labour market flows and enhanced access to key science and innovation assets) and in turn, unlock increased agglomeration benefits. Improvements to the region's main East – West transport corridors are key to this.
- The creation of a more **integrated and collaborative science and innovation landscape across the Midlands.** There is scope to better connect key assets and, capabilities, and to facilitate stronger networks between different technology areas and across the Midlands' leading clusters and innovation ecosystems. Innovation within the business services sector and the absorptive capacity of the wider business base should be priorities, alongside continued efforts to strengthen and join-up innovation activity within advanced manufacturing and digital tech areas of the economy.
- Partners across the Midlands should support the region to adopt a leadership position when it comes to embracing the **industrial digitisation agenda**. Linked to this, they should explore opportunities for piloting new approaches designed to tackle the region's **skills deficit.**
- Targeted and tailored support should be made available to the Midlands Engine business base (including service-based firms) to raise awareness of the **international business opportunities** in a post BREXIT world.
- The Midlands should leverage the opportunities presented by the Commonwealth Games, City of Culture and other high-profile events to transform **outdated perceptions/image of the Midlands** and create more of a "buzz" about the region. This will help to attract and retain talent in the Midlands, including graduates.
- There should be a strong focus on improving ***within*** **sector/firm productivity levels, business growth and business formation across the Midlands.** A particular emphasis should be placed on creating more technology-rich High Growth Firms.

In our view, the six themes that have emerged from the evidence, provide a useful framework for any future discussions with Government and partners. These themes are particularly important in relation to devolution, imbalances within the region and the "levelling up" agenda. Governance structures may vary in different localities, but all areas need the strategic capabilities and delivery structures necessary to access devolved powers and resources when Government makes these available. Furthermore, a clear division of responsibility between the authorities involved in these governance structures is imperative if strategic planning and delivery is to be effectively coordinated.

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