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MANUFACTURING GROWTH: BUILDING A COMPETITIVE BUSINESS ENVIRONMENT

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CHAPTER 1

MANUFACTURING GROWTH: TAX AND REGULATION

INTRODUCTION

An overwhelming 99% of manufacturers say the UK needs an industrial strategy.

The UK has lacked a long-term vision for manufacturers for far too long. Whilst the last decade or so has seen pockets of growth emerging, industry continues to fall behind our main competitors, in countries like Germany and the US, on key metrics like productivity. Indeed, three quarters of manufacturers highlighted that an industrial strategy would give them a stable business environment.

An industrial strategy comprises of many facets and should stand the test of time, with decision making taking place outside of Government termism. This paper focuses on one of these facets: the tax and regulatory environment, which was highlighted by 36% of manufacturers as being a priority for a future industrial strategy[1]. It encompasses the burdens of the current tax system and what manufacturers want to see included in an industrial strategy.

KEY FINDINGS

44% of manufacturers say the current **TAX AND REGULATORY REGIME** is **unfavourable** for business

Manufacturers believe **THE UK HAS A WORSE SYSTEM** than **Germany**, **France** or **Italy** and even **China**

OVER 1/2 find it **BURDENSOME TO UNDERSTAND AND APPLY** tax reliefs and exemptions

In all cases, **MORE THAN 1/2** manufacturers **INCREASE INVESTMENT** specifically to comply with regulation

OVER 1/2 say **FREQUENT CHANGES TO POLICY INCENTIVES** in the last 3 years made it more difficult to plan investments

55% want **FULL EXPENSING** to be made permanent

62% want **REGULATIONS TO BE SIMPLIFIED**

2/3 would **INCREASE INVESTMENT IN SKILLS** if the tax and regulatory regime was improved

61% would increase investment in innovation

3/4 want **AI** to be subject to **GREATER REGULATION**

[1]Make UK Industrial Strategy Survey 2023

RATING THE TAX AND REGULATORY ENVIRONMENT

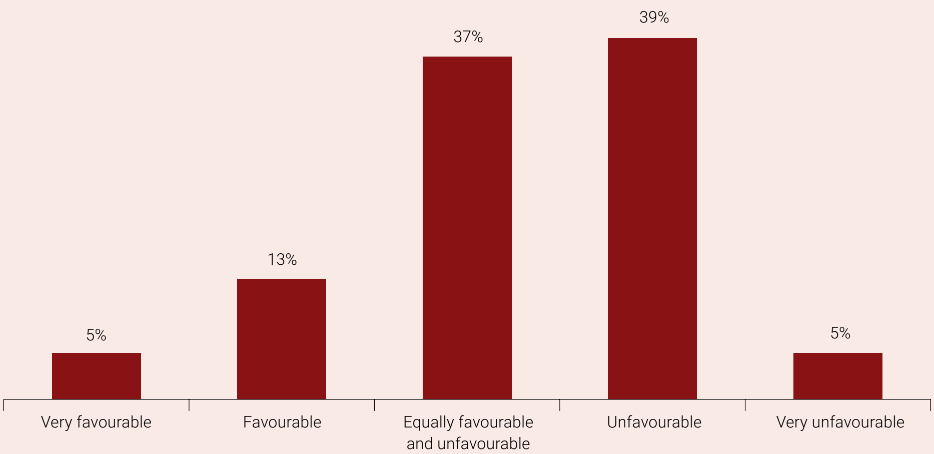
The tax and regulatory regime are critical components in setting up an ideal business environment for companies to thrive. Taxes and regulations can impact investment, employment, and R&D directly but not always in a negative way. Well-designed tax systems and regulations that make doing business fair, without impeding the benefits of competition within the domestic scene, and especially in the international sense, can benefit industry too.

Unfortunately, getting the balance right is challenging and something that policy makers have struggled with, particularly since the UK's exit from the EU. Our attempts to diverge on regulations have resulted in significant costs to businesses trying to meet needs in both the UK and EU markets. Changing markings on products from CA to UKCA and introducing dual testing requirements for the same products no doubt deterred some investment. The UK Government later came to its senses and allowed for indefinite recognition, albeit for a specific list of products only. Nonetheless, despite the last-minute rescue for UK manufacturers, the damage to the UK's reputation is already done and will persist with long memory.

Tax systems and regulations pay for our local services and ensure quality in all things that we use or consume. Most businesses recognise their importance, but long-term certainty plays a big role in investment decision-making, and the latest challenges are already impacting the commercial perception of the UK economy.

Manufacturers find the tax and regulatory environment in the UK more unfavourable than favourable today. According to our latest survey, in total, 44% of manufacturers say the tax and regulatory environment is unfavourable, whilst only 18% say the current regime is favourable).

Chart 1: Manufacturers rate the current tax and regulatory system as 'unfavourable'



Source: Make UK/RSM Business Environment Survey 2023

However, 37% of businesses sit on the fence and say there are elements to the current system that are favourable, whilst some things that are not. It is not surprising that the second largest group of businesses are in the middle, as these regimes can impact different types of businesses in different ways. For example, Governments with pro-net zero initiatives, that offer exemptions to taxes if businesses invest in green technologies, can favour those companies who are able to take advantage. In the UK, for example, the business rates system currently offers temporary relief for businesses that invest in green technologies.

Alternatively, different corporation tax rates apply depending on how much profit you make. In the UK, many businesses continue to pay 19% on their corporation tax, even though the main rate has increased to 25%, as profits below £50,000 benefit from the small profits threshold. Similarly, regulations may apply to a business if they are in a certain industry, like chemical and pharmaceutical manufacturers. However, these regulations are necessary to protect both businesses and consumers.

Whether a tax and regulatory system is favourable or unfavourable is largely down to the experience of the user, and its relative difference to similar systems in other countries. Manufacturers do not find it easy to compare the UK to other nations on this issue, and so, in most cases, businesses did not say whether they think the UK is better or worse than other countries. However, for those that held a view, it is interesting that a moderate share of businesses (28%) thinks the UK tax and regulatory regime is worse than in China.

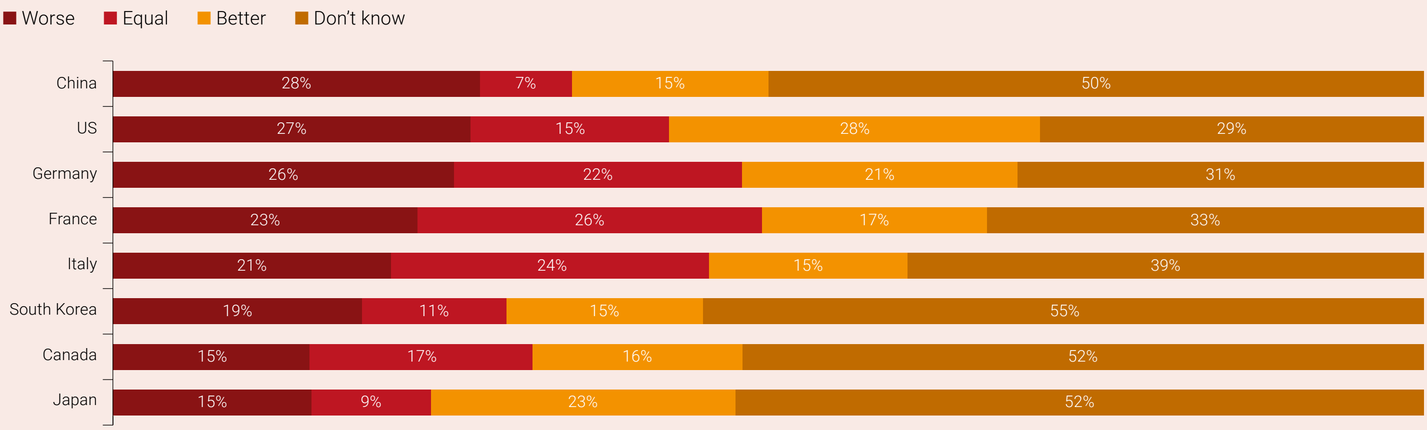
When looking at the countries that manufacturers believe the UK is "worse" than (in terms of tax and regulatory environment), China is followed by the US (27%), Germany (26%) and France (23%). However, slightly more (28%) believe the UK is better than the US on tax and regulations, so the results are an overall mixed bag.

Whilst the latter few countries are expected, the fact that nearly one in three manufacturers think China has a better tax and regulation system than the UK is problematic. It is likely these manufacturers are pointing to the freedom that businesses have to make almost anything in China, whereas, in the UK, complex rules and regulations can deter innovations. However, there are many regulations that exist in the UK, such as standards for safety across employment and products, that ensure there is trust in the system. Manufacturers like to know the inputs that they purchase from international markets meet certain standards to be able to operate their own businesses.

Often, manufacturers point to countries like the US and Germany that have comparatively better regimes, not just in tax and regulations. For example, three in four manufacturers cited Germany as having a better environment for manufacturers, whilst 43% said the same for US[2]. Moreover, the US recently introduced the Inflation Reduction Act (IRA), alongside the CHIPS & Science Act, and Bipartisan Infrastructure Law, which represents over $2 trillion worth of investment. This highlights the nations commitment to industry, net zero and skills. If the UK is to compete on the global stage, it must do more, especially if it is to convince businesses to invest in technologies that will dominate the future, such as battery manufacturing and staying relevant in the semiconductor supply-chain. The UK has countered by introducing an insignificant semiconductor strategy, which only commits to invest £1 billion, compared to the US's more than $200 billion investment in chip manufacturing. Manufacturers will, of course, be observing these actions alongside the UK's, drawing the inevitable conclusion that the government has not drawn up a comparable strategy.

While we need not replicate exactly what these countries do we must at least recognise that we are in competition with the rest of the world, and that a long-term plan is needed if we are to ever get ahead.

Chart 2: Over a quarter of manufacturers believe China and Germany have a better business environment for tax and regulations



Source: Make UK/RSM Business Environment Survey 2023

[2]Make UK Industrial Strategy Survey 2023

THE BURDEN OF TAX AND REGULATIONS

The primary objective of tax and regulations are not to make life harder for households and businesses. They play an important role in ensuring the UK economy can serve those that live in it. However, they can also be burdensome to comply with, creating costs for businesses willing to abide by them, and deterring those without the expertise from understanding how to take advantage of exemptions or reliefs.

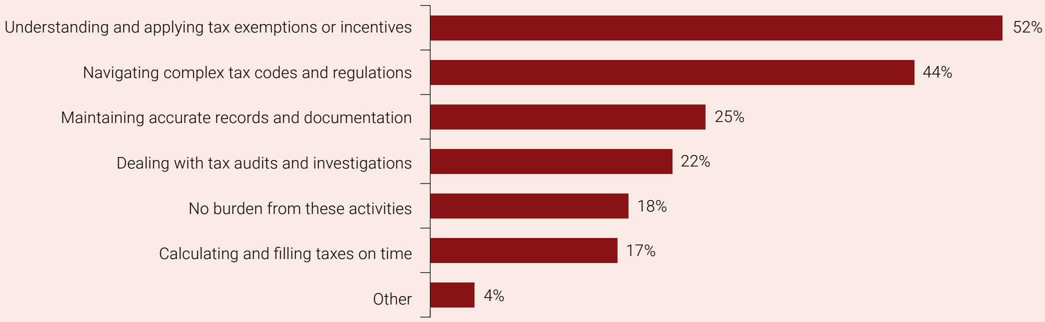
MORE THAN HALF of manufacturers (52%) identified **DIFFICULTIES IN UNDERSTANDING AND APPLYING** tax exemptions or incentives as a burden

This raises an important issue. It is challenging to remove existing taxes, such as Corporation Tax or business rates, because of how important they are to the Treasury's purse to provide the services we use. However, to rebalance the negative impact of these burdens, policy makers often tactically add on exemptions or reliefs that could be used to incentivise certain behaviours amongst businesses or consumers. The use of green exemptions for business rates have already been mentioned.

Other examples include capital allowances that allow businesses to write off the cost of investment in plant and machinery, to reduce their corporation tax bill or R&D tax credits. This is a regime used commonly by manufacturers to incentivise innovation. Recently, the Government even introduced a temporary super-deduction scheme which allowed businesses to claim back up to 130% of the cost of plant and machinery that was heavily favoured by manufacturers, albeit criticised for its two-year window which made it difficult to plan long-term investments.

In some cases, new rules are developed to disincentivise certain activities, such as the associate companies' rules in corporation tax to disincentivise tax avoidance amongst larger businesses. Whilst this rule achieves its objective, it is also viewed by manufacturers as anti-growth, given SMEs could be penalised for growing through mergers and acquisitions. With 52% of manufacturers finding it difficult to make use of existing incentives, it may be that we don't need to re-invent the wheel to get the economy growing again. Rather, we should focus on simplifying what already exists, so it is accessible. We see support for this sentiment, as our research indicates that the second largest burden of the tax system, for manufacturers, is navigating complex tax codes and regulations (44%).

Chart 3: Manufacturers are overburdened by difficulties in understanding tax exemptions and navigating complex tax codes and regulations



Source: Make UK/RSM Business Environment Survey 2023

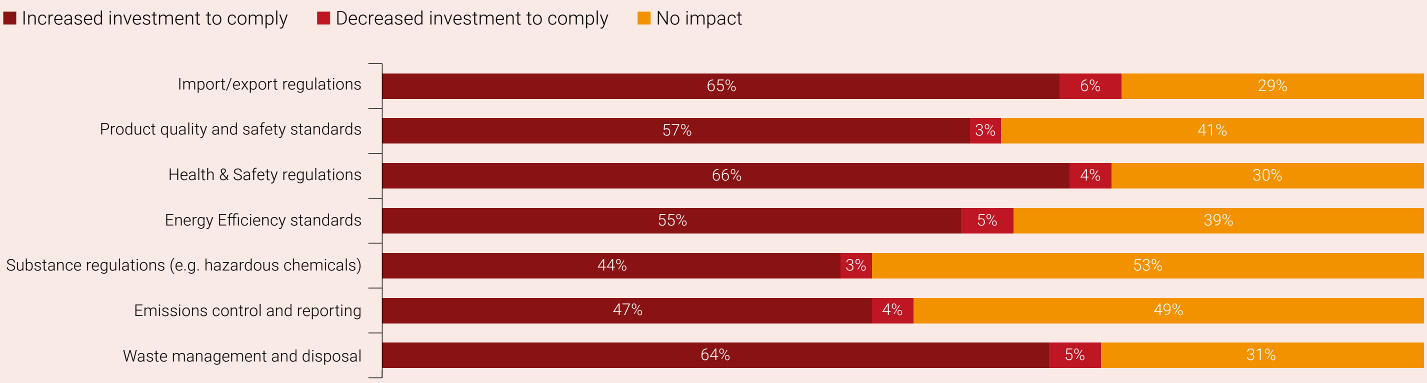
Other burdens reported lower on the hierarchy, although some businesses did face issues due to record keeping, tax audits, and calculating taxes themselves.

52% of manufacturers struggle to understand and apply tax exemptions and incentives

Focusing more on regulations, we find that investment activities can be impacted by these too. For example, 65% of manufacturers increased investment to comply with export and import regulations, likely motivated by the UK's changing trade relationships with the EU as well as other countries (such as Japan and New Zealand). Similarly, the survey found that more than half of manufacturers increased investment in various regulatory subjects as it ensures that they comply with standards. This is good news, particularly for health and safety, to ensure manufacturers continue to provide good jobs. This investment also helps businesses meet Net Zero targets, as emission controls coupled with energy efficient standards reduce their environmental impact. The data shows that regulation can increase investment, but whether that investment is productive remains to be seen.

However, this additional investment could be crowding out investment in other activities, which could be more beneficial to the manufacturer. Nonetheless, to avoid being penalised, businesses must dedicate a significant amount of time and funds to complying with regulations. While this investment in time is often for the greater good, simplification of regulations in these areas can reduce costs for manufacturers too, thereby freeing up capital and time to be used elsewhere.

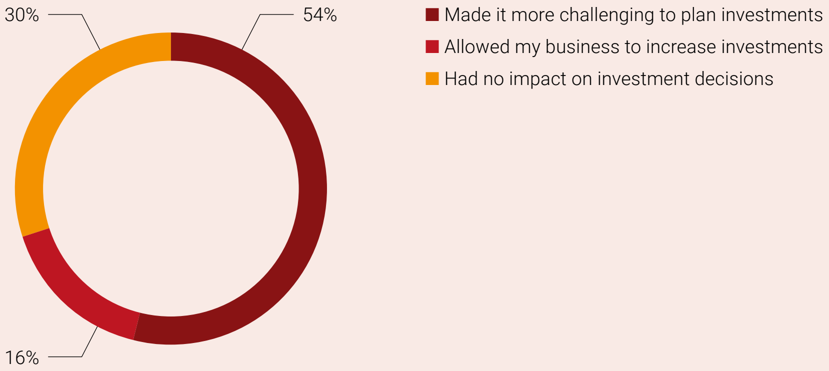
Chart 4: Businesses increase investment to comply with regulations



Source: Make UK/RSM Business Environment Survey 2023

DOES CHANGING POLICY INCENTIVES FREQUENTLY INCREASE OR DECREASE INVESTMENT AND R&D ACTIVITY?

Chart 5: Frequent changes to policy incentives made it more challenging for businesses to plan investments



Source: Make UK/RSM Business Environment Survey 2023

Certainty is a key determinant of investment activity, which manufacturers have repeatedly told us they have been lacking for some time. In the last three years, according to more than half (54%) of manufacturers, the impact of frequent changes to policies and incentives directly made it more difficult to plan investments and R&D. 87% of manufacturers even said an industrial strategy would give their business a long-term vision, which manufacturers yearn for in all aspects of decision making[3].

The last three years have no doubt been challenging, particularly due to the pandemic and our changing trade relationship with the EU. Unfortunately, frequent changes to policies, and subsequent difficulties in business planning, have clearly affected manufacturer's ability to invest, which resulted in underinvestment in the last three years. Whilst we cannot expect the Government to accurately forecast future crises, it can provide the certainty that businesses require - at least, in the way that we develop and apply changes to policy or new incentives. Though it may be the Government's objective to incentivise more productive behaviours, we may end up with the opposite outcome if manufacturers lose faith in the longevity of incentives.

of manufacturers re-invest in plant & machinery every 2-8 years[4]

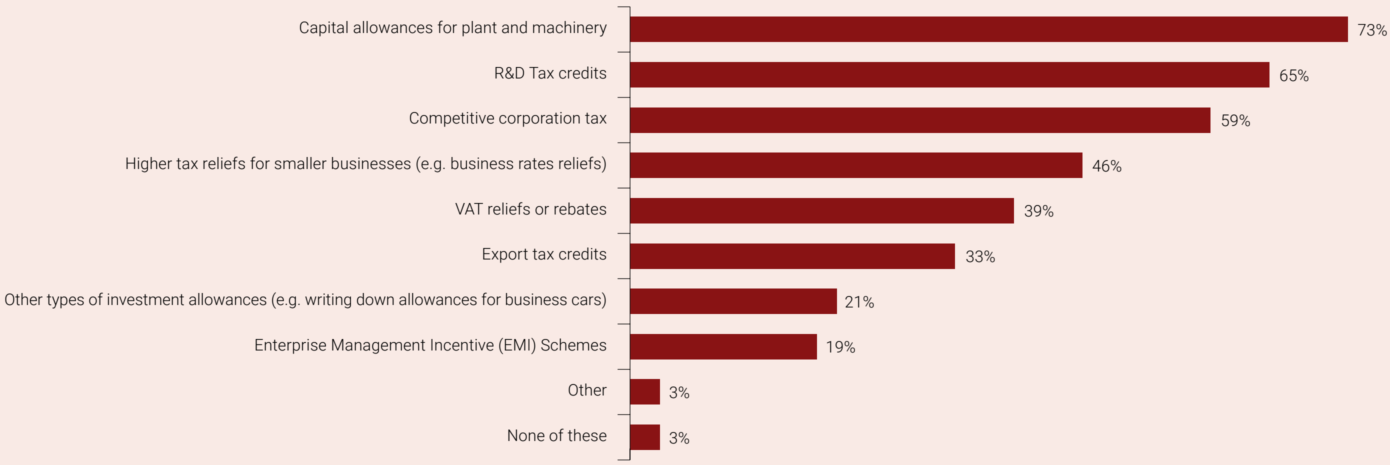
More consistency in policy changes would help investment planning and should form the basis of an industrial strategy.

[3]Make UK Industrial Strategy Survey 2023
[4]Make UK/RSM, Investment Health 2022

WHAT WE WANT TO SEE HAPPEN IN AN INDUSTRIAL STRATEGY

THE MOST USEFUL TOOLS FOR GROWTH

Chart 6: Manufacturers believe in capital allowances, R&D tax credits and a competitive corporation tax system



Source: Make UK/RSM Business Environment Survey 2023

CAPITAL ALLOWANCES

The current tax and regulatory system is not perfect, and whilst a complete overhaul would be ideal, change must be achieved through incremental improvements. Fortunately, manufacturers have a clear idea of what works best for them. Nearly three in four manufacturers said capital allowances for plant and machinery are most effective at helping them achieve their growth ambition. Capital allowances are mostly used by manufacturers due to how capital intensive they are, which allows them to invest more in ensuring they have the latest technologies. A typical manufacturer invests around 7% of their total turnover on plant and machinery on an annual basis, which accounts for a large share of expenditure.

The Government recently introduced 100% capital allowances to replace the relatively more generous super-deduction scheme. Whilst this new scheme is more generous than what has been available historically, it only lasts for 3 years, resulting in a reduction in generosity for an improvement in longevity. Manufacturers will find the policy bittersweet, but we acknowledge the introduction of full expensing capital allowances is a step in the right direction. The next step would be to make this permanent, which is the preferred move for 55% of manufacturers.

RESEARCH & DEVELOPMENT TAX CREDITS

Manufacturers also have a strong preference for R&D tax credits, which help generate innovation in the UK. R&D tax credits have existed since the early 2000s, and manufacturers have grown familiar with the scheme, which has only changed a handful of times. However, in recent years, the Government have been targeting changes to the system to ensure it works more effectively, and introducing features that require additional disclosure of activities. With these actions, the Government risks making R&D tax credits more difficult to access.

In addition, recent changes, such as increasing the general rate for R&D expenditure credit from 13% to 20% and reducing the SME additional deduction from 130% to 86%, indicate that smaller businesses may be being de-prioritised for support. This sends the wrong signals to industry, given 99% manufacturers are SMEs and micro sized, and rely heavily on these tools for growth. Over half (53%) of manufacturers want to see R&D tax credits made more, not less, generous for the typical business.

CORPORATION TAX

The UK maintains one of the lowest tax rates across the G7, but the recent changes made to increase the main rate, to 25% for profits that exceed £250,000, sends negative signals to the international community and has implications for foreign direct investment (FDI). Manufacturers buy and sell goods on the international stage and making the UK as attractive as possible (in the eyes of the rest of the world) can bring benefits to the UK through greater investment and increased trade. For this reason, nearly 60% of manufacturers believe a competitive corporation tax rate is an effective way to promote growth. Fortunately, most businesses will continue to pay 19% on their profits, as most businesses are SMEs, but the headline figure does not make that clear to international parties. This can have a negative implication for how the UK economy is perceived.

of manufacturers believe a competitive corporate tax rate is an effective way to promoting growth

The most important thing manufacturers want to see is the creation of an industrial strategy. This should clarify tax schemes, and simplify and reduce regulations, to make it easier to compete (for 62% of businesses). Though manufacturers see the benefits of regulations, it is clear they have gone too far and no longer meet the needs of businesses today. Therefore, it is imperative that we look back on existing regulations and make them to be easier to understand. Manufacturers are not asking for a bonfire of regulations, but a focus on reducing and simplifying what already exists would go a long way to creating long-term certainty for businesses.

of manufacturers say capital allowances are an effective tool to increase growth

In addition, manufacturers also want longevity in business rate reliefs. Following the revaluation of properties in April 2023, the industry saw a whopping 27% increase in rateable values, resulting in large increases to business rates, even with the Government's transitional relief scheme to shield the worst affected. Changing business rates will not be easy, but, at the same time, simple solutions, such as extending green technology reliefs from 1 year to 3 could bring major benefits. This, for example, would give manufacturers more time to recoup the cost of investing in solar panels or heat pumps, which often take more than 1 year for positive ROIs.

There are several other solutions highlighted by manufacturers, such as making capital allowance more like R&D tax credits, aligning tax and regulation standards to other western economies, and even increasing support to help businesses understand taxes and regulations. The needs of manufacturers are clear, and the ideas put forward here signal what should be put into an industrial strategy.

Chart 7: Prioritise simplification and making incentives long-term and generous

Source: Make UK/RSM Business Environment Survey 2023

CAUSE AND EFFECT – THE OUTCOME OF IMPROVING THE TAX AND REGULATORY ENVIRONMENT

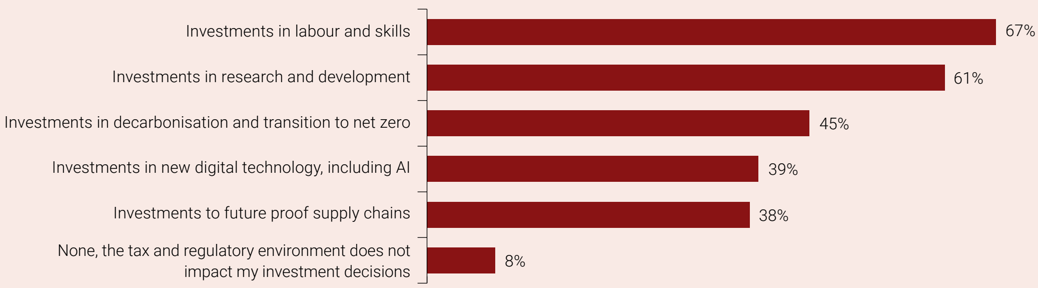
There needs to be a sound case for making all the changes that manufacturers want to see from an industrial strategy. From the Treasury's perspective, value for money needs to be shown to make full expensing permanent, create more generous R&D tax credits, or invest in workstreams to simplify existing tax and regulations. However, we know that the outcomes of achieving our ambitions could lead businesses to increase investment.

Two-thirds of manufacturers say they would increase investments in labour, whilst 61% say they would increase investment in R&D. It is highly encouraging to find that even as the role of AI expands and begins to drive innovation, particularly new generative AI technologies (like ChatGPT, which can generate creative content almost independently) manufacturers still plan to invest more in research and development. This shows that investment in these technologies does not replace essential activities, but accelerates them, allowing businesses to become more efficient and grow. However, as the capabilities of AI grow, so too will calls to regulate to ensure that industry is not negatively impacted. Three out of four manufacturers believe that AI should be subject to greater regulation.

An industrial strategy that targets improvements in the tax and regulatory environment is necessary to increase investment in not just skills and R&D, but also in net zero, digitalisation and even supply-chains. For only 8% of manufacturers the tax and regulatory environment does not make a difference. These outcomes should give policy makers plenty of reason to act in the best interests of the sector. Manufacturers are already one of the best wage payers in the UK, with average wages exceeding the national average by 9%, as well as one of the most R&D intensive, accounting for two-fifths of all R&D expenditures.

of manufacturers say Ai technologies should be subject to greater regulation in the UK

Chart 8: Manufacturers will invest in skills, innovation and net zero if the tax and regulatory environment improves



Source: Make UK/RSM Business Environment Survey 2023

VIEWPOINT

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TAX AND REGULATION

Tax and regulatory systems can play a vital role in encouraging economic growth. These systems also sit very clearly within government control. Yet, for many years, manufacturers have looked enviously overseas at the regimes of some our international competitors. For an industry that is responsible for 41% of UK R&D and 49% of total exports to feel this way for such an extended period seems foolhardy.

When it comes to tax, the relationship between investment, greater productivity and economic growth is widely identified, and it stands to reason that tax incentives should help to encourage businesses to invest. But more than half of the industry believe it is burdensome to understand and apply tax reliefs and exemptions, while more than half again say that frequent changes to policy incentives over the last three years have made it more difficult to plan investments. Following research we conducted with Make UK in 2022 on investment cycles, none of this should come as a surprise. Together, we produced three principles for government to consider when designing capital investment incentives. They are as follows:

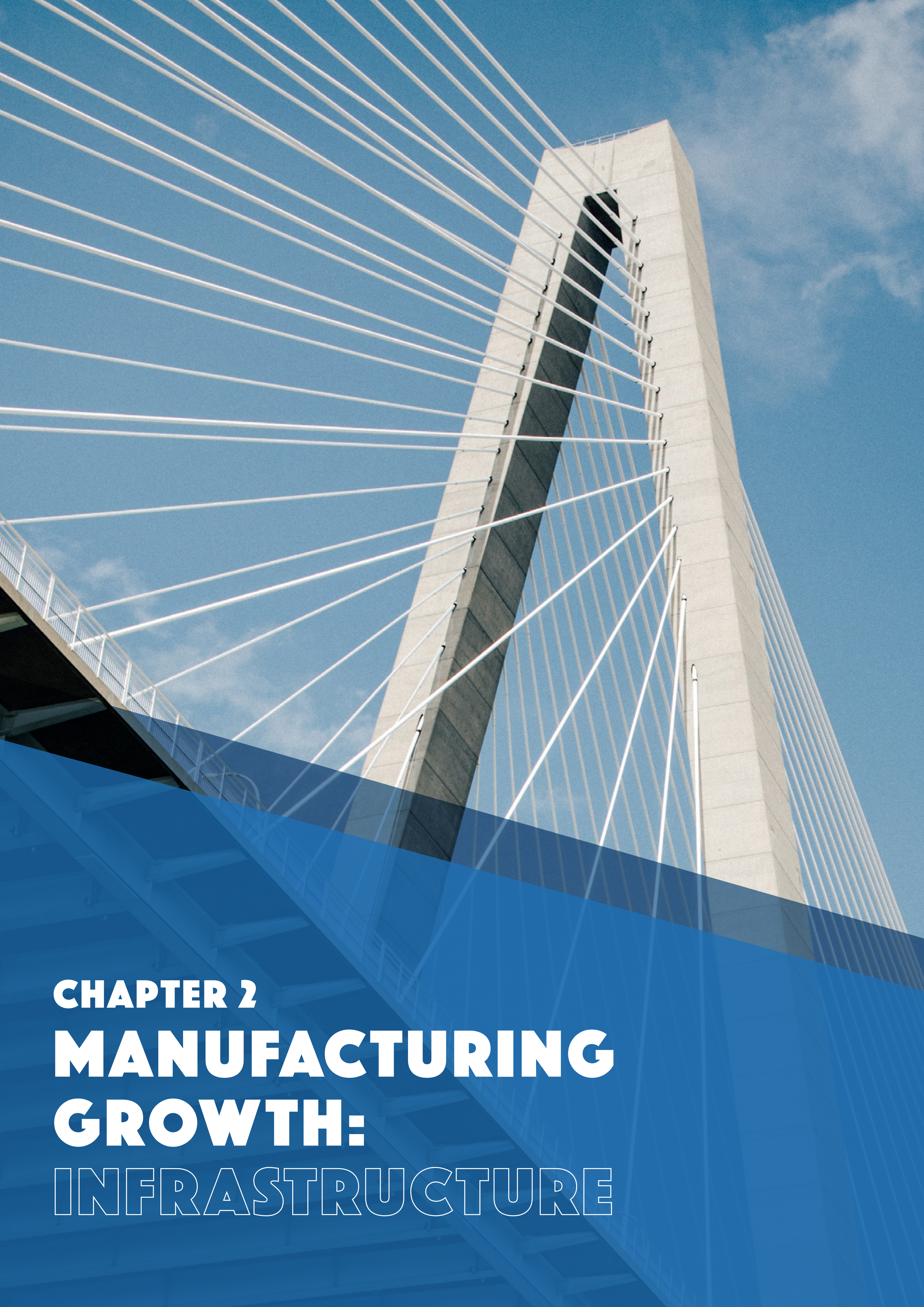
- they focus on ensuring longevity and are therefore not regularly changed;
- they are generous enough to make an impact on cashflow; and
- they are accessible to as many manufacturers as possible.

These principles remain vital if we are to see the significant investment and associated productivity gains that we all want to see.

Meanwhile it is clear that the regulatory environment continues to cause problems too, with 62% of our respondents wanting regulations to be simplified. However, it is also evident that the industry understands the important role regulation plays, with half increasing investments specifically to comply with regulations and 75% believing AI should be subject to greater regulation in future.

As the industry moves forward with net zero plans, manufacturers need an industrial strategy that levels the playing field and provides stability. If government can improve the tax and regulatory environment, then the potential benefits are clear to see, with two thirds of the sector confirming they would increase investment in skills and 61% saying they would increase investment in innovation respectively.

Mike Thornton
Partner, Head of Manufacturing, RSM



CHAPTER 2
MANUFACTURING GROWTH: INFRASTRUCTURE

INTRODUCTION

An effective industrial strategy is necessary for manufacturers to thrive in the UK. A critical part of this plan must focus on infrastructure investment. Only then will the business environment in the UK meet the needs of industry and employees, and rightly connect people and place together.

36% of manufacturers cited the business environment as a key pillar for a modern Industrial Strategy.

A modern industrial strategy must include both physical and digital infrastructure. Physical infrastructure includes the transport network (roads, rails, busses, airports) and energy (electricity, gas, hydrogen, nuclear), while digital infrastructure includes all digital networks (such as 5G or fibre optic). Investing in infrastructure is a commitment to levelling up. More than half (52%) of manufacturers have previously said the Government needs to prioritise upgrading local transport[1].

These remain priorities for manufacturers and this paper takes a closer look at how manufacturers perceive the quality of infrastructure, both locally and nationally. As a result, we make a case for what should be the priority for this or any future Government that chooses to implement an industrial strategy. However, investment in infrastructure only forms part of what is needed and must be coupled with investment in other areas, such as innovation, finance, the tax and regulatory environment and education. Beginning with high quality infrastructure will help the UK get a head start on these challenges.

KEY FINDINGS

NEARLY 1/2 of manufacturers say **THE QUALITY OF RAIL NETWORKS** are **BAD OR VERY BAD**

Most manufacturers think the **QUALITY OF LOCAL AND NATIONAL INFRASTRUCTURE** has **GOT WORSE** in the last 10 years

1/2 say **LACK OF GOOD INFRASTRUCTURE** is a barrier to accessing labour and skills

1/3 say poor quality infrastructure is **SLOWING DOWN DECARBONISATION**

OVER 60% of manufacturers want **GOVERNMENT TO PRIORITISE** investment in 5G and Road infrastructure

OVER 1/2 want responsibility for **INFRASTRUCTURE INVESTMENT** to be held either locally or in partnership with industry

[1] Make UK, Levelling up: bridging the gap between policy and progress

RATING THE QUALITY OF INFRASTRUCTURE

The quality of infrastructure can impact daily life for all, not just businesses. Manufacturers make use of road and rail networks for logistical reasons, such as transporting goods across the UK, or internationally with air and shipping networks. These businesses make use of the energy networks to power the machines that produce the goods we use daily.

Nowadays, the quality of digital infrastructure (internet, telecommunications) plays a vital role in ensuring businesses can operate at maximum efficiency. This is only going to become more important as manufacturers progress on digitalisation and the impact of AI tools turn mainstream. Regions with better digital infrastructure will ultimately find newer technologies more accessible and easier to adopt. This will leave some regions falling behind, given many modern technologies rely on access to the internet or Wi-Fi networks to collect and transfer data.

This creates additional supply-chain challenges, where manufacturers in areas of high-quality infrastructure may struggle to do business with those in low quality infrastructure. As time goes on, the gap between areas with good quality infrastructure and bad quality infrastructure will only grow, leading to many of the challenges we see today, such as local areas left behind on economic development.

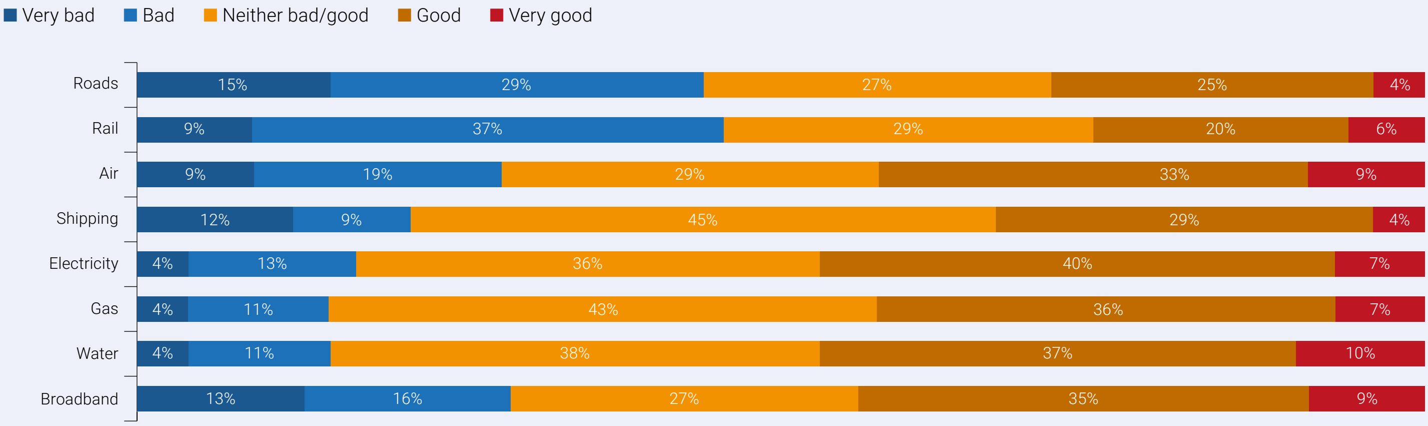
Infrastructure is no doubt vital, and a national issue, but the quality of infrastructure can differ depending on where you are located, and, in many cases, this can determine the choice of location by business. With this context, it makes sense that manufacturers' views on the quality of their infrastructure can differ greatly. Whilst infrastructure is a national project, the perception of quality is dependent on what a person or business uses daily.

Businesses and individuals in Greater London have access to a stronger transport network than what might be available in parts of the North or Midlands. Due to this, manufacturers reported a mixed view of whether the quality of infrastructure was good or bad. Across a selection of different types of infrastructure, some 44% of manufacturers said that the quality of Broadband/5G is good or very good whilst only 29% said it was bad or very bad.

In contrast, the quality of road and rail infrastructure tends to be criticised across the board. For example, almost half (46%) said the quality of rail is bad or very bad. Similarly, over two-fifths (44%) said the same for road infrastructure.

The views for energy, water, shipping, and air are more mixed, but weighted toward the positive side more so than negative. This shows that we continue to progress positively in some areas of infrastructure investment, whilst others do need more work to improve.

Chart 1: The national view



Source: Make UK/RSM Business Environment Survey 2023

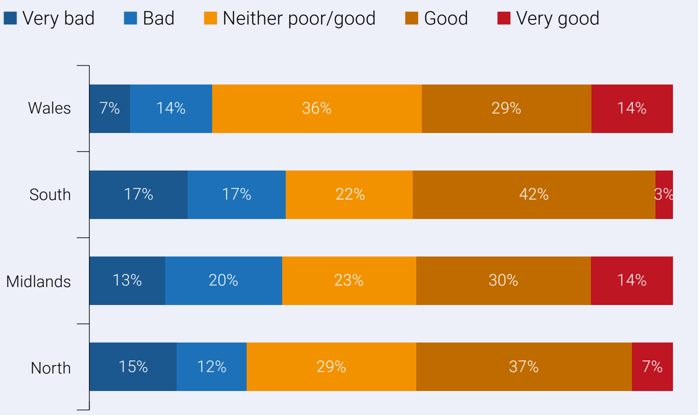
THE EXPERIENCE OF INFRASTRUCTURE CAN DIFFER REGIONALLY

As mentioned previously, the quality of infrastructure can differ based on the location of the business or individual using them. For example, looking specifically at 5G and Broadband for parts of England and Wales, we find that manufacturers are largely consistent in their positive views of digital infrastructure. However, the South and Midlands have a relatively higher share of manufacturers who believe the quality of 5G and broadband is bad or very bad, compared to Wales or the North of England.

In comparison, we have found that more than half (54%) of manufacturers in the North of England believe the quality of rail infrastructure is bad or very bad. Whilst manufacturers in other parts of the UK also hold a negative perception of rail, it is clear the views in the North, where rail transport infrastructure is weakest, supports the finding that businesses would feel it lacks the quality.

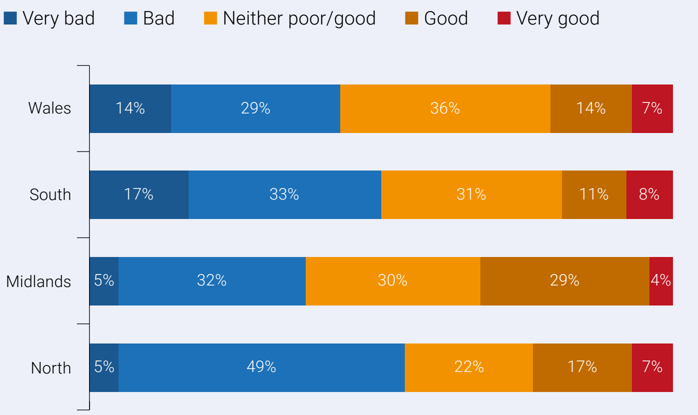
We find similar differences for other types of infrastructure too, which brings challenges to policy makers trying to meet the needs of different groups of businesses. However, understanding where infrastructure is lacking, and the benefits that could be achieved from investing in quality, will enable the UK to spread prosperity more evenly. This strategy should form a part of a wider industrial strategy which would not only support manufacturers but other sectors as well, including services.

Chart 2: Broadband/5G positive views largely consistent across England and Wales[2]



Source: Make UK/RSM Business Environment Survey 2023

Chart 3: Rail differs slightly to 5G with Northern manufacturers believing infrastructure quality is bad



Source: Make UK/RSM Business Environment Survey 2023

[2]English region breakdowns include North (North East, North West, Yorkshire & the Humber), Midlands (East Midlands, West Midlands, East Anglia), South (South East, London, South West)

INFRASTRUCTURE IN THE LAST 10 YEARS

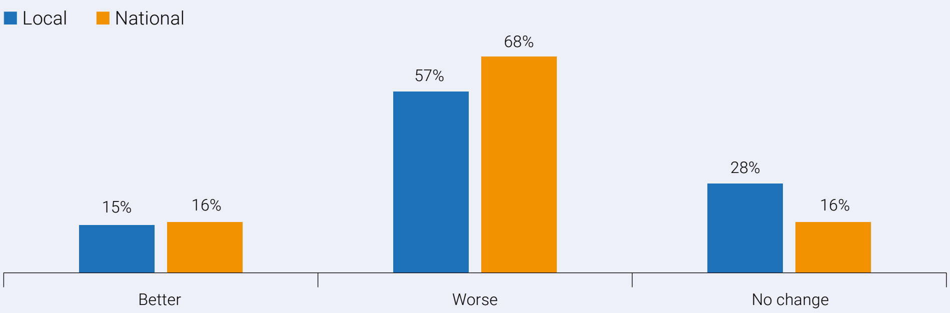
Looking back on the last decade, it is no wonder manufacturers want to see infrastructure prioritised in an industrial strategy.

MORE THAN HALF of manufacturers (57%) said that **LOCAL INFRASTRUCTURE HAS DECLINED** in the last 10 years

7 IN 10 say that infrastructure at the **NATIONAL LEVEL HAS DECLINED** in the last 10 years

This is an unfortunate view, held by the majority of manufacturers, and shows that in the last decade we have not progressed in the right direction, or at least have failed to demonstrate value for the investments in infrastructure we have made. Businesses are aware that the quality of access to the internet, transport, logistics is likely better than 10 years ago, however, manufacturers feel that they are still being held back. For the business environment generally, 29% of manufacturers believe that the lack of an industrial strategy is the primary reason that the industry has not been able to grow in the last decade[3]. The same could be the reason for the lack of infrastructure progress too. Without a formal plan, we risk limiting progress in the next 10 years too.

Chart 4: Infrastructure quality has gotten worse for most businesses in the last decade



Source: Make UK/RSM Business Environment Survey 2023

[3]Make UK Industrial Strategy Survey 2023

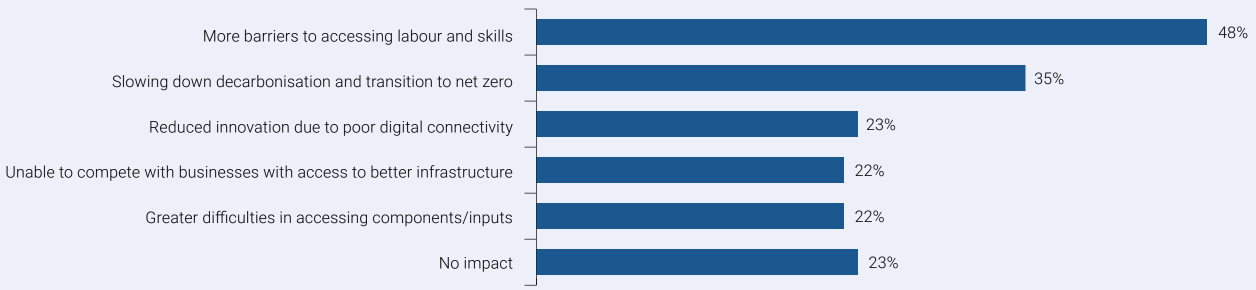
INFRASTRUCTURE MAKES A DIFFERENCE TO DOING BUSINESS

Manufacturers believe that infrastructure changes should be delivered by the state to ensure that the agents of the economy can perform as efficiently as possible. Whether that is for transporting goods/services, communicating with others across the globe, or making sure your employees can travel to work on time.

For nearly half (48%) of manufacturers, low quality infrastructure can create barriers to accessing labour and skills. This is a challenge that is somewhat unique to manufacturers (only faced by similar sectors such as logistics) because these businesses operate from large factories and warehouses away from residential areas. This means that to access labour, it is important that skilled workers can travel to their place of work. In areas that may lack adequate transport links, most workers rely on personal cars or taxis if rail or buses are not available. As a result, manufacturers located in areas with low quality infrastructure will struggle to grow, as the shortage of skills may worsen for these companies. For this reason, 48% of businesses say the biggest drawback of low-quality infrastructure is increasing barriers to accessing labour.

Additionally, 35% of manufacturers say that insufficient infrastructure can slow down the progress to decarbonisation. Achieving net zero and protecting the climate whilst still being able to produce important goods is growing in importance for manufacturers. Indeed, 45% of manufacturers said that the green transition must play an important role in an industrial strategy, not just for energy efficiency but because it is the right thing to do[4]. Similarly, nearly one in four are finding it more difficult to invest in innovation due to poor quality infrastructure. We know that digitalisation can bring significant benefits to productivity and resource management, but given these technologies are often connected to the internet, without adequate digital infrastructure some manufacturers may struggle to compete with those that do have better access. This issue will grow in importance as digital technologies, like AI or Internet of Things, evolve and weave their way into the manufacturing process. This process has already begun for many businesses, and those manufacturers that have access to high quality digital infrastructure (5G or fibre optic broadband) will find it easier to maximise the potential of new AI technologies. Those that do not have equal access will find that any Government incentives designed to promote the adoption of digital technologies will falter, as businesses are not able make use of them, due to unreliable or poor internet connections.

Chart 5: Low quality infrastructure can create barriers to accessing skills and slow the progress of decarbonisation



Source: Make UK/RSM Business Environment Survey 2023

[4]Make UK Industrial Strategy Survey 2023

INDUSTRIAL STRATEGY: THE PRIORITIES FOR INFRASTRUCTURE INVESTMENT

Manufacturers have made it clear that something needs to change for UK infrastructure. Businesses have set their priorities and highlighted where we must focus to ensure industry can thrive.

Of the different types of infrastructure investment, Broadband/5G and Road infrastructure have been identified as high priority by over 60% of manufacturers. Despite the quality of digital infrastructure perceived as already good by most manufacturers, the industry is digitalising faster than ever, resulting in greater demand for existing bandwidth provided by existing wires and cables. If manufacturers are going to rely more on new digital technologies such as AI and robotics, then high speed internet connections will be necessary to help support a smooth transition.

INVESTMENT in road infrastructure has been set at **HIGH PRIORITY** by **60%** of manufacturers

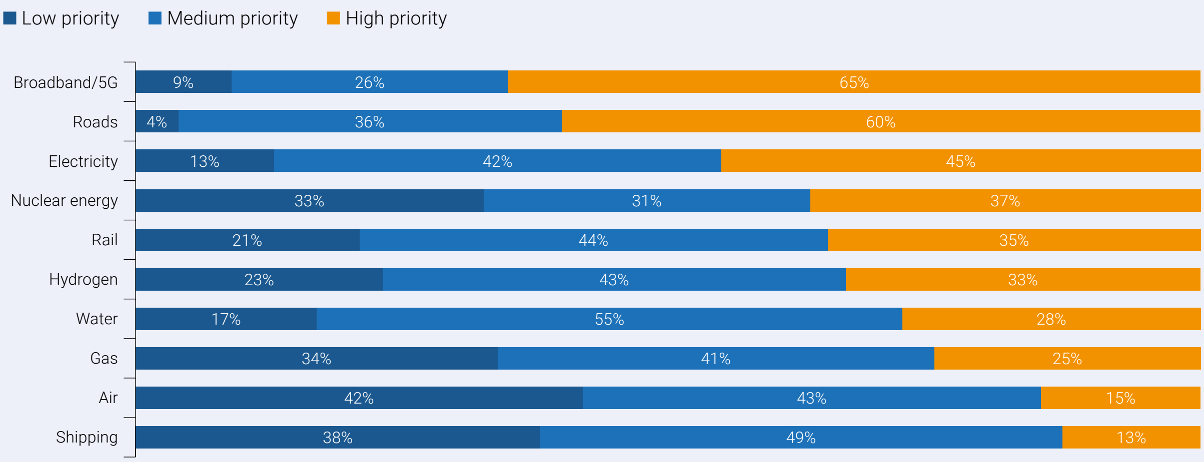
Alongside digital networks, manufacturers are heavily reliant on access to roads for both delivery of goods and services, and for labour mobility. Furthermore, the importance of road networks must be coupled with road regulations, especially in inner city areas, that make it difficult for HGVs to drive through narrower lanes which causes other issues, such as congestion. Free flowing traffic on good quality roads is important for manufacturers to operate at full capacity.

Businesses also want investment in the electricity network, nuclear energy, and rail. The energy crisis exposed how vulnerable industry was to spikes in energy prices, and many businesses found it challenging to deal with the problem directly, due to a lack of connections to the grid. In many cases, manufacturers were investing in self-generating assets, but could not provide energy back to the grid easily due to the lack of infrastructure. Furthermore, though rail has been identified as lower quality by manufacturers, there is less desire for high priority investment here. This may be partly due to the plethora of union strikes that took place over the course of 2022 and 2023, which impacted rail freight logistics and has led manufacturers to become more reliant on roads.

Investment in gas, air and shipping is primarily identified as low priority, whilst there is also a large share of businesses (33%) who believe even nuclear should be low priority.

The evidence presented here shows a clear roadmap of where to begin improving infrastructure. The UK national infrastructure bank can also play a prominent role in setting industry on the right path.

Chart 6: Manufacturers believe investment in digital, roads and electricity infrastructure should be prioritised



Source: Make UK/RSM Business Environment Survey 2023

WHO SHOULD OVERSEE DELIVERING ON THESE PRIORITIES?

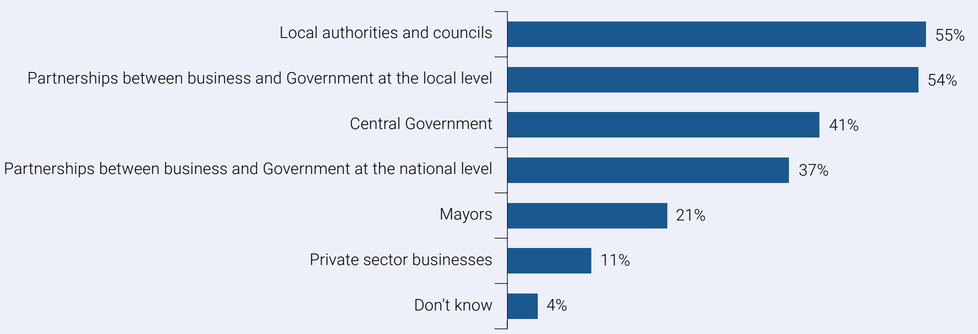
Though funding for investments in infrastructure will originate from central Government, manufacturers want the power of decision making to be local. This aligns with the view that the quality of infrastructure is largely a local issue, based on the experience of the user. The UK infrastructure bank based in Leeds is already working in this way, by offering finance to private sector businesses as well as local authorities.

MORE THAN HALF of manufacturers (55%) want **LOCAL AUTHORITIES AND COUNCILS TO BE RESPONSIBLE** for infrastructure investment

Local governments will likely have a better view of what is and is not working in their areas, with businesses more able to inform decision makers of what they need. It is interesting that a similar share of companies (54%) wants the decision making to be a partnership between business and local Government. It's the users of infrastructure that can attest to its quality so manufacturers believe the responsibility to oversee these changes should be left in the hands of those who have first hand experience of using that infrastructure.

On the other hand, two in five manufacturers believe responsibility should be held in central Government, whilst a similar share (37%) think businesses should be partnered up with Government at the national level. Only one in five believe responsibility should be with Mayors and 11% believe that the responsibility should be with private sector businesses exclusively.

Chart 7: Responsibility should be local and involve businesses in decision making



Source: Make UK/RSM Business Environment Survey 2023

VIEWPOINT

INFRASTRUCTURE

The importance of infrastructure cannot be overstated. Our transport systems, energy networks and digital connections are all enablers to growth. The quality of infrastructure is one of several indicators that businesses use when choosing their base of operation, alongside the tax and regulatory environment and access to skills. With 68 per cent of manufacturers believing our national infrastructure has got worse over the past 10 years, it is clear there is work needed to convince the industry of the value of investments already made and, more importantly, to commit to future investments. Given the challenges and opportunities facing the industry, it is unsurprising to see that more than 60 per cent would like to see enhancements made specifically to both 5G and road infrastructure. Access to appropriate skills remains a problem for the industry and poor road infrastructure can create severe barriers to labour, given the large proportions of manufacturing facilities found outside of residential areas.

Meanwhile, the manufacturing industry continues to become increasingly digitised. The use of digital and data transformations to enhance productivity have long been a priority for many of our clients but with the recent onset of generative AI, we expect a revolution to productivity and operational improvements as well as to the innovation life cycle. Clearly, digital infrastructure is vital to all of this and will only become more important in future. Those currently disadvantaged by poor connectivity will become more so, unless action is taken. Government must ensure digital infrastructure in the UK does not hold back economic growth, and this remains the fear for many, with Britain continuing to lag behind many European nations on the roll out of full fibre broadband.

The findings of this research indicates that manufacturers believe investment in infrastructure has been neglected in the last decade. A focus on expanding the digital infrastructure and improving the quality of roads, electricity and rail will support the engine of our economy. Manufacturers have made their needs clear and infrastructure must be a priority for a long-term industrial strategy.

Mike Thornton
Partner, Head of Manufacturing, RSM

CHAPTER 3
MANUFACTURING GROWTH: PLACE-BASED ECONOMIC INCENTIVES

INTRODUCTION

In 1997, there were 845 different zones with special place-based incentives across 93 markets. By 2018, that increased to around 5000 zones worldwide competing for special investment[1]. These zones include several trade agreements such as NAFTA and the EU single market, which people often do not recognise as areas with special place-based incentives.

From special economic zones (SEZ), freeports to investment zones (IZ), regardless of what they're called, evidence to support their continued use is 'grey' at best. For this paper, these concepts will mainly be referred to as place-based economic incentives (or special economic zones). The advantages and disadvantages to such policies vary widely depending on their purpose and benefits offered to incentivise investment, such as exemptions to taxes or relaxed regulations. However, such policies also have a history of generating illegal commercial activities where actors with bad intentions may take advantage of these relaxed rules.

Nevertheless, well-managed place-based incentives can bring significant economic benefits that many countries have already experienced, particularly in China (Shenzhen). The success story of Shenzhen suggests place-based economic incentives may have a better chance of performing well if decisions about the location of benefits are made strategically (e.g., better access to logistics or an existing skills base/labour force). These success stories have granted the UK Government valuable insight on these incentives, which will now be applied here at a greater capacity.

For example, the incoming UK investment zones are targeting support in eight potential locations to grow specific sectors including digital and technology, life sciences, creative industries, green industries, and advanced manufacturing. How businesses in these sectors are defined exactly is not clear, but with the right support, investment zones could generate new wealth for the areas that benefit from them.

Do these types of policies have a role to play in a long-term industrial strategy? Whether IZs or Freeports are going to be successful is difficult to predict, but this survey will highlight how manufacturers view the use of place-based economic incentives generally, and whether there are any conditions that might convince companies to move to these locations.

KEY FINDINGS

62% of manufacturers **ARE NOT BASED** in any existing or upcoming special economic zone

73% would **NOT CONSIDER** moving to any area with place-based incentives

15% **WOULD CONSIDER** it if the benefits were worth it

43% of manufacturers want **HIGHER TAX RELIEFS** to benefit from Investment Zones

39% want **INCREASED ACCESS TO LABOUR**

35% want **BETTER SUPPORT FOR INNOVATION**

[1]World Bank Data

WHAT DO MANUFACTURERS THINK ABOUT PLACE-BASED ECONOMIC INCENTIVES?

Manufacturers' views vary significantly on place-based economic incentives. We asked manufacturers to select statements that most closely reflected their views and found that nearly one in three (31%) think place-based policy is a good way to generate growth in a specific area.

However, a quarter (25%) said they believed this type of policy can lead to winners and losers, which these types of ideas typically have a history of creating. However, if the benefits may outweigh the costs, then we could expand on policy solutions such as increasing the number of freeports in the UK or introduce the investment zone programme. Policies like these have been used by many countries, such as China and their success with Shenzhen.

But economic growth in one area could mean economic decline in another. For this reason, 25% of manufacturers believe that place-based incentives do not create new growth but move activity from one place to another.

NEARLY 1/10 (9%)
think these policies only benefit big businesses whilst **11%** say they are a good way to attract FDI

There is certainly evidence of increased FDI in regions that benefit from special status. The city Shenzhen for example, which was once a farming village, received $300bn in additional FDI since becoming a special economic zone.

On balance, the views of manufacturers are weighted slightly more to the negative side and suggest that businesses may not be fond of these types of policies, regardless of their benefits.

"Place-based incentives will only benefit big businesses" (9%)

"Place-based incentives are an effective way of generating economic growth in specific areas of a country" (31%)

"This type of policy creates winners and losers that do not lead to overall growth for the UK" (25%)

"Place-based incentives can help attract FDI into special areas that previously lacked investment" (11%)

"Place-based incentives do not create new growth, and only moves activity from one location to another" (25%)

WHAT DID SHENZHEN DO RIGHT?

In 1979, Shenzhen became one of China's first special economic zones (SEZ) and its success propelled the city from a humbling village of 30,000, specialised in fishing, to a mega city of over 17 million people today. The success of Shenzhen as a special economic zone is extraordinary, and debunks arguments against the use of such policies. It is difficult to identify exactly what caused the city's exceptional growth. It is possible, given China was already fast growing due to a manufacturing boom, the Chinese Government capitalised on the inflow of FDI and directed this to special locations to maximise their benefits.

Additionally, there may be special reasons why Shenzhen was a success, while others performed relatively less well in China, and if those reasons are understood properly then the UK Government should consider whether it could attempt to replicate those features into Freeports and Investment Zones.

Examples of what the Shenzhen SEZ included:

- **Tax Incentives:** These included significant tax breaks to businesses operating with the SEZ such as low/zero corporate tax for several years (15% for most), reduced customs duties (such as import duties of critical raw materials), and exemptions to VAT. They even offered lower income tax for workers in some cases to incentivise skilled professionals to move there.
- **Trade Freedom:** Simplified customs procedures and removed trade barriers/reduced paperwork.
- **Foreign Direct Investment promotion:** Encouraging FDI by offering favourable terms to international investors, e.g., by allowing total ownership of companies/industries.
- **Infrastructure investment:** The local Government invested heavily in local transport, energy, communication, and ports to facilitate the mobility of people and goods, making the location more attractive to move to.
- **Legal reforms:** Shenzhen was able to introduce reforms to legal systems, such as increasing IP protection and establishing courts to deal with any disputes.
- **Regulatory flexibility:** Local Government was given powers to change regulations more flexibly when necessary to ensure the business environment was the right one.
- **Skills and Labour:** The city coupled incentives for business by investing in schools and education establishments to create a workforce ready for potential investors.
- **Industrial Clusters/Business Parks:** Within the SEZ, industrial parks almost operate as a more local SEZ to ensure businesses are located near each other and foster collaboration.
- **One-stop shop service:** The city established one-stop shops for businesses to help streamline administrative procedures. This was critical as many new businesses were introduced by foreign investors who potentially were less familiar with Chinese bureaucracy.

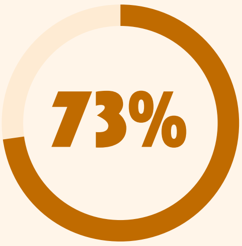
The way in which a SEZ was used in China makes clear that it was not just about incentives for businesses to relocate to Shenzhen. They recognised the importance of the role regulations played, the need for a skilled labour force, the essential investment in infrastructure which was all used to make the SEZ as attractive as possible. Whilst the UK is significantly further ahead on rule of law and regulations, if Freeports and Investment zones are going to work, we must not assume that these zones will work without complementary investment, to ensure they are advantageous to manufacturers.

ARE MANUFACTURERS LOCATED IN EXISTING OR INCOMING SPECIAL ECONOMIC ZONES?

Most manufacturers (62%) are not located in any type of special economic zones. This is not surprising given there are only a few freeports in the UK (currently 12 although some are not operational yet). Additionally, whilst several locations are being considered for investment zones, they are unlikely to be on the radar of manufacturers until the Government has consulted on exactly which local authorities will become an investment zone.

Given the location of where some special economic zones will be located is not fixed, it is unsurprising that 26% of manufacturers do not know whether they are in one. It is possible these businesses either may be in an area considering becoming an investment zone, or are based in one but do not qualify for the benefits of these zones.

Only 12% of manufacturers are known to be in a special economic zone in the UK. As expected, a small proportion of manufacturers are located in a special zone, which is understandable given they are designed to be exclusive to businesses to motivate them to invest and grow in certain areas.

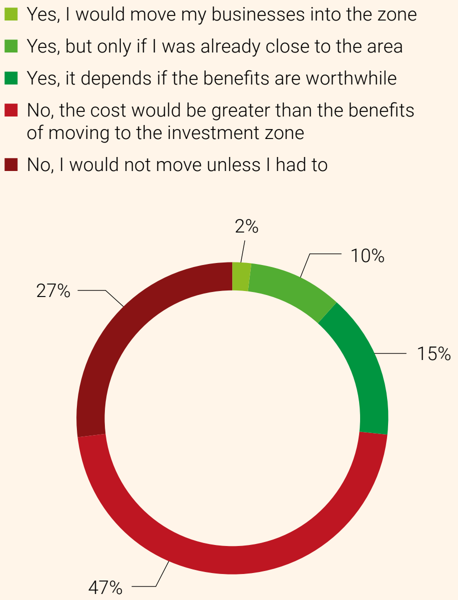


of manufacturers would not move to be in a special economic zone

Chart 1: Most are not located in any special economic zone

Source: Make UK/RSM Business Environment Survey 2023

Chart 2: Most would not move to be in a special economic zone



Source: Make UK/RSM Business Environment Survey 2023

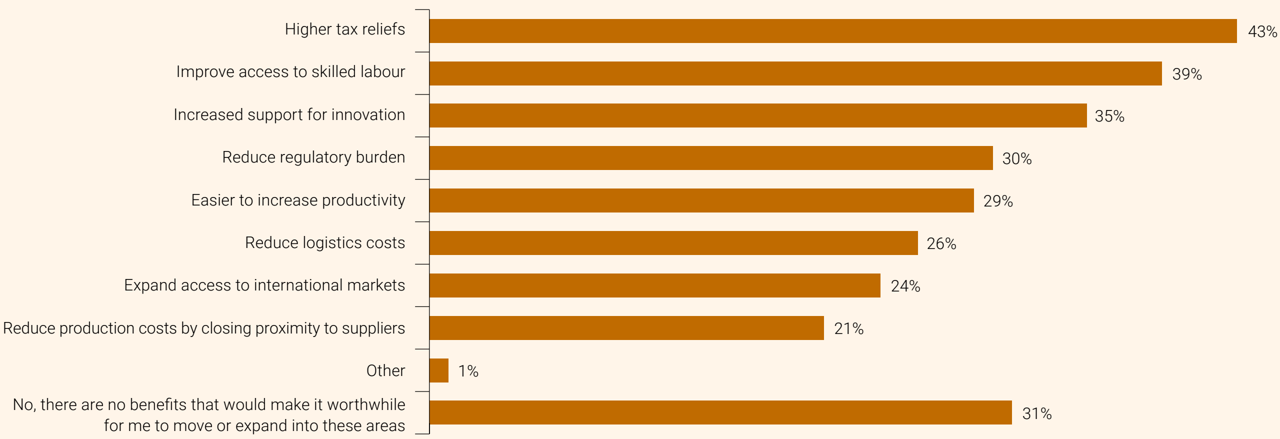
Whilst some manufacturers would consider moving into a special economic zone, like a freeport or investment zone, most of these manufacturers would only do so under certain circumstances. 15% of manufacturers would move if the benefits were worthwhile, whilst 10% would consider it if they were already located near one. This makes sense as manufacturers operate from large facilities that are likely highly expensive, and rely on specialist skills that may be only accessible in a certain area. For a manufacturer to consider moving they must weigh the cost of transporting all their plant and machinery, the ability for their workers to travel to the new location and reorganise their logistics to ensure goods and services can still move efficiently.

This could be achieved successfully under the right conditions, and an investment zone or freeport could even improve efficiencies through the benefits of agglomeration (where many complementary businesses are located near each other). The challenge around access to labour is more difficult to solve and highlights why some businesses would only move if they were already near an investment zone.

Nevertheless, the vast majority of manufacturers (73%) would not move to one of these locations. More than half of this group (47%) believe the costs outweigh the benefits (as highlighted above) whilst the other 26% would not move under any circumstances unless they had to. On balance, most manufacturers are against the idea of place-based economic incentives, even if there are some benefits to them.

WHAT MANUFACTURERS WOULD WANT TO SEE FROM PLACE-BASED INCENTIVE SCHEMES

Chart 3: Businesses want higher tax reliefs, access to skills and support for innovation



Source: Make UK/RSM Business Environment Survey 2023

NEARLY 1/3 believe there are **NO INCENTIVES** that would convince them to move to a **SPECIAL ECONOMIC ZONE**

FOR 31% of manufacturers **THERE IS NOTHING** an investment zone or freeport could do to convince them to move to these areas, which is a strong stance to take

However, for those that have a view, the most preferred benefit is higher tax reliefs for just under half (43%). This is followed by better access to skilled labour (39%) and increased support for innovation (35%). Businesses are also interested in lower regulatory burdens, productivity benefits, lower logistic costs, expanded access to international markets or even cost reductions by closing proximity to suppliers.

It is interesting that manufacturers prefer these benefits given these are almost exactly what most place-based economic incentives do. For example, selected investment zones are expected to receive an envelope of £80m which will allow local authorities to deliver tax incentives flexibly across different measures, these include:

I. Stamp Duty cuts for land bought for commercial use
II. 100% business rates relief (for new or expanding occupancies)
III. Enhanced capital allowances
IV. Enhanced structural and buildings allowances.
V. Employer NIC reliefs

However, these benefits will in most cases apply to new businesses, rather than those that are already located in a zone. Whether manufacturers will view these benefits as worth investing in remains to be seen but the findings of this research indicate that the investment zones may not go far enough to convince potential businesses. If the benefits do not outweigh the costs, then manufacturers will not take investment zones or freeports seriously. The views of manufacturers here indicate that Government must do more to better communicate the benefits of place-based incentive programmes as there is a clear overlap in what businesses want and what the state can offer. In addition, the communication must clarify exactly who will benefit as labelling sectors with modern terms such as "advanced manufacturing" will fall on deaf ears to the business community, if it is unclear to them whether they can take advantage of these opportunities or not.

VIEWPOINT

RSM

PLACE-BASED INCENTIVES

On the face of things, the message from manufacturers to government on place-based incentives is pretty damning. Less than a third of the industry believe them to be an effective way of generating economic growth, only 12 per cent of the sector believe they are already located within a special economic zone and three quarters would not move to gain the benefits of being in one in future. But how much of this narrative stems from the backdrop of constant policy changes, plus a lack of clear information on the benefits of being within an economic zone, who could benefit and by when?

In March 2023, when government announced plans to establish tax incentivised UK investment zones, it may have been welcome news for large parts of the industry that 'advanced manufacturing' featured as one of five priority sectors targeted for support. Other sectors to be prioritised were also industries within which manufacturers play a huge supporting role, such as Life Sciences and Green Industries. Manufacturers across the Midlands and the North of England may have felt even more optimistic, given eight of the potential 12 locations for investment zones were to be scattered across their respective regions. Government were also intending to work with the relevant Mayoral Combined Authority, or other local stakeholders, to ensure incentives were flexible, according to the requirements of each specific region.

Positive investment zone announcements impacting regions with aligned industry strengths have followed, with more still to come. Yet, information on how these sectors have been defined, what the precise benefits of being within an investment zone are and therefore which businesses could potentially benefit from the support, still largely remain a mystery. Could this lack of clarity be partly responsible for the degree of scepticism demonstrated within our findings? Or are manufacturers wary of government decision making not always outlasting political terms? The industry can certainly be excused for struggling to see a defined and coherent plan, with seemingly sporadic announcements reaching them at irregular intervals. Freeports and investment zones being just two recent examples.

What is without question, is that there is work to do to convince manufacturers that place-based incentives are a meaningful method of 'levelling up' and of generating economic growth. An industrial strategy with more ambition is needed.

Mike Thornton
Partner, Head of Manufacturing, RSM

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For further information, please visit the **RSM website**

To speak with RSM about the challenges and opportunities that your manufacturing business is currently facing, please contact:

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The Manufacturers' Organisation

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