Independent Review of Economic Policy
(DETI and Invest NI)

Chairman: Professor Richard Barnett

September 2009
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Dear Minister

Thank you for the invitation to undertake the Independent Review into Economic Policy (DETI / Invest NI). The report is published at an important time for the local economy, particularly as you and other colleagues in the Northern Ireland Executive continue to work toward placing the economy on a recovery path to address the ongoing impact of the global recession. As you indicated in your Ministerial statement that launched the Review, the aim of the exercise was to provide recommendations to help position the local economy for the medium to longer term. It is in that context that the report and its recommendations are submitted.

As indicated in the report, the recent achievements in the Northern Ireland economy provide some cause for optimism. For example, the region has achieved a rapid rate of economic growth relative to other parts of the UK, both in terms of output and employment. There are welcome increases in the level of R&D undertaken by SMEs and, within the UK, NI continues to have a strong value proposition to attract investors to the region. Nevertheless, significant challenges lie ahead, some of which are outside the control of the Executive. For example, throughout the report it is recognised that reductions in public expenditure growth and state aid ceilings will inevitably change the way businesses are supported in Northern Ireland. However, as outlined later in the introduction, such challenges are often found to be the necessary catalysts for improving economic performance.

The Executive has already taken the important step of making the economy the top priority in its Programme for Government (PfG), with productivity improvements an overarching policy goal. This has also been reflected in both DETI and Invest NI's Corporate Plans. This is welcomed, although the recession will inevitably raise the importance of creating and maintaining employment in the region. The correct balance will not be easy to achieve and I recognise it will involve a number of hard choices to be made by you and other Executive colleagues. However, it is important not to lose sight of the need for further development of the economy and improvements in productivity. Ultimately it is living standards that matter and it is through productivity improvements that higher wages can be paid and higher living standards can be achieved. Therefore, if Northern Ireland is to make the convergence in productivity and living standards with other parts of the UK (as outlined in the PfG), then there needs to be a much greater emphasis on value added investments, both for indigenous businesses and also as a means of attracting and retaining foreign investors. That is why the report places such a particular emphasis on prioritising Innovation and R&D.

In the report, recommendations are made with regard to both policy development and changes to governance structures. I recognise that the latter can be time consuming and it is because of this that we have kept our recommendations in this regard to a minimum. Also it is important that I recognise that the recommendations for structural change should not be taken as a criticism of individuals who operate within those structures. It is simply that aspects of the current governance structures are serving to inhibit performance.
I am grateful to other members of the Review Panel who have each brought their own areas of expertise to the discussions and analysis that have been invaluable in the production of the report. Further details on the Review Panel are outlined in the introduction. As might be expected, discussions have, at times, been robust, but I am pleased that we have produced a unanimous report. I am also grateful to Dr Graeme Hutchinson, Secretary to the Panel, who has greatly assisted us throughout the Review. I also wish to thank other members of the Secretariat team including Tony Simpson, Thomas Byrne, Karen Wilson, Karen Hastings and Neil McCullough. I am indebted to them all.

I trust that the report and its recommendations will make an effective contribution to the future direction of the Northern Ireland economy.

Yours

Richard Barnett

Vice Chancellor of the University of Ulster and Chairman of the Review Panel
Executive Summary

BACKGROUND

E.1 The Independent Review of Economic Policy (IREP) was commissioned by the Minister of Enterprise, Trade and Investment, Arlene Foster MLA, in December 2008. The Review reflects her desire to achieve the Executive’s priorities for the economy and the Panel were asked to advise on the need to realign existing policies, or to devise new policies, in order to meet the Executive’s goal of halving the private sector productivity gap between Northern Ireland (NI) and the UK excluding the Greater South East of England by 2015.

E.2 Given NI’s favourable record in job creation, the widening productivity gap had been identified by DETI as NI’s main economic challenge. It was recognised that up to 2008 existing policies did not appear to be leading to convergence in productivity. On the contrary, the gap had been widening for a number of years. The aim of the Review has thus been to consider the extent to which DETI / Invest NI policy should change in order to stimulate convergence in productivity and ultimately living standards between NI and the rest of the UK. In addition, the Review was asked to identify issues falling to other departments that might compromise delivery of the productivity goal. A more detailed outline of the Terms of Reference can be accessed in Chapter 1 and on the dedicated IREP website (www.irep.org.uk).

E.3 We recognise that the NI Executive has made a significant step in making the economy the top priority in the Programme for Government (PfG). The Review Panel welcomes this move and our recommendations are designed at enabling the Executive to make more rapid progress in meeting their economic goals. However, we need to note three important caveats. The first is that achieving the productivity target would require productivity gains in a wide range of sectors, including those outside of DETI’s remit. Productivity is, for instance, relatively low in areas such as agriculture, transport, construction and distribution (among other sectors). This Review focuses primarily on the main export sectors within DETI / Invest NI’s remit, and must therefore be considered only as a start in addressing the wider productivity gap. Many other important issues remain to be addressed in other sectors. However, an emphasis on exporting sectors is the logical place to begin a process of reforming economic policy in NI.

E.4 The second caveat is that the economic context has deteriorated sharply in the period since the Review was commissioned. The global recession has led to the loss of thousands of jobs and a doubling in the number of unemployed people. The issue of job creation will undoubtedly raise its importance in the economic policy agenda. Although the Review has been tasked with addressing the productivity gap, and not job creation, we believe that many of our recommendations for increasing economic competitiveness will assist job creation in the longer term. In particular, we consider measures that might be adopted to continue attracting inward investment, as well as growing indigenous firms. We have not, however, addressed the short-term issues of preventing job losses in the recession, or of assisting the rising number of unemployed. These are pressing concerns but are outside the scope of this Review and its Terms of Reference. In addition, we recognise that the NI Executive has already taken steps to address the recession.
Finally, it is important to acknowledge that a number of external factors will influence the degree to which businesses can be supported in NI. For example, public finances will be much more constrained than in the past, and we anticipate that there will be very limited cash terms growth in public expenditure and a decline in capital budgets. While this will be a feature throughout the UK, it is our view that the impact may be disproportionately larger on the NI economy given its over-reliance on public expenditure as a driver of growth. It is therefore inevitable that DETI and Invest NI will face increasing competition from other important public services. The other factor is the changing nature of EU state aid rules which determine the scope to provide financial assistance to industry. As we outline later in the report, the limits for regional aid will be significantly reduced from as early as January 2011. Furthermore, the enlargement of the EU – which has brought in much less prosperous regions than NI – could see these limits reduce further (potentially to zero) when the existing arrangements come to an end in 2013. The recommendations in this report have therefore been framed with these significant challenges in mind.

TERMS OF REFERENCE

The IREP was commissioned in December 2008 and the Panel were asked to make evidence-based recommendations to strengthen the NI economy. The Terms of Reference focus on DETI and Invest NI and the effectiveness of their policies / programmes to deliver on the overarching productivity goal in the Programme for Government (PfG).

The Panel have endeavoured to address the detailed Terms of Reference for the Review, however, given the nature of the exercise some areas have received more treatment than others. It is therefore important that the report and the recommendations are considered in their entirety, rather than individual sections / chapters in isolation.

As we outline in the introduction, the department advised the Panel that Tourism should be considered but only as part of Invest NI’s engagement in the sector. This direction was expected, particularly as other parts of DETI have operational responsibility for this area outside of Invest NI. However, in accepting this direction from the department, we would stress our belief that increased prosperity for NI, particularly its rural areas, could be significantly addressed by building a more vibrant tourism sector, given the region is endowed with large areas of scenic and natural beauty. We anticipate that this will be recognised and outlined in the forthcoming tourism strategy for NI.

STRUCTURE OF THE REPORT

The report has been structured into three sections. In Section I the Panel outline the key challenges facing the NI economy, in particular its comparatively low standard of living compared with the UK average. As we outline in Chapter 2, this is mostly due to the region’s poor performance in terms of raising relative productivity levels and employment rates. This sets the context for DETI and Invest NI which, on behalf of the NI Executive, lead on the policy initiatives aimed at halving the private sector productivity gap with the UK excluding the Greater South East of England by 2015 (as outlined in the PfG). This section therefore reviews the mission of DETI and Invest NI and the various policies and programmes aimed at improving manufacturing and tradable services productivity. The section concludes with our assessment of Invest
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NI’s performance in delivering, on behalf of DETI and the NI Executive, the value added investments and productivity growth in the NI private sector.

E.10 In recognition of the challenges to improve productivity growth in the NI economy, Section II provides recommendations on how a new economic policy for NI could be developed and delivered by DETI / Invest NI. We believe that a reduced rate of Corporation Tax would improve NI’s value proposition, but the Terms of Reference asked for recommendations that are consistent with the existing legislative powers of the NI Executive. Therefore, the Panel have considered alternative policies to increase growth and productivity. The central thrust of the report is the need to prioritise Innovation and R&D investments more aggressively, both for existing businesses in NI and also as a means of attracting potential new investors to the region. We provide definitions on our interpretation of Innovation and R&D, stressing the importance of encouraging Innovation via imitations, adaptations and improvements to existing products and processes, as well as the more traditional forms of R&D. As outlined in Section II of the report, the recommendations have been influenced by a thorough review of the drivers of regional economic growth, and what we consider to be the important elements of global best practice in economic development. This is an important aspect of the Review and one that we believe has received less attention in previous reports on the NI economy.

E.11 In light of the proposed emphasis on Innovation and R&D, which typically represent riskier investments, Section III of the report outlines how the right balance can be made between accountability, risk taking and speed in decision making. Aside from presenting some proposals on strengthening the formulation of economic policy in the NI Civil Service, the Panel consider how the autonomy of Invest NI could be improved to increase the entrepreneurship of the organisation. In addition, given the importance attached to the economy, we consider how the Minister can receive advice from as wide a range of stakeholders as possible. This section concludes with views on those issues falling to other departments that might compromise delivery of the PfG productivity goal.

KEY FINDINGS & RECOMMENDATIONS

E.12 The aim of this Review is to realign existing policies and propose alternative approaches to improve productivity and living standards in the NI economy. To this end, the Panel make recommendations to improve productivity, both for indigenous businesses and also to attract new investors to the region. We recognise that Foreign Direct Investment (FDI) is important if the Executive is to realise its ambition of building a more dynamic and innovative private sector, and one which helps address its wider spatial and social challenges. We also outline recommendations to support local businesses, which will remain the bed-rock of the NI economy. Furthermore, we emphasise the importance of integrating local SMEs into the supply chain of larger companies. In our view, this represents a win-win for the economy: it helps attract larger / value added companies to the region, which typically offer higher wages and productivity levels, but it also makes them more embedded in the region as they locate for access to support and resources that are aligned to the needs of their business, which will include not only assistance for Innovation / R&D, but also access to appropriate facilities, skilled labour and other companies.

E.13 The paragraphs that follow outline, in summary format, the key findings and recommendations from the individual sections / chapters of the report (a full list of the recommendations is included at the end of the Executive Summary). As many of the
proposals are budget neutral, with some even offering potential for savings, we believe they also reflect the reality of the current fiscal environment, which, as we indicate later, is going to be much more constrained than in recent years.

SECTION I: ANALYSIS OF EXISTING POLICIES

E.14 In our review of the economic challenges facing the NI economy (Chapter 2), we highlight the following:

- The economy has achieved a rapid rate of economic growth relative to other parts of the UK, in both output and employment terms. However, NI has been unable to make progress on a convergence of living standards towards the UK average, with relatively poor labour productivity the main factor behind this;

- Invest NI has a relatively attractive value proposition for investors, particularly given the competitive wages, skilled labour and generous incentives on offer;

- Competitive wage levels mean that NI is particularly attractive to labour intensive service sectors. However, the type of firm which chooses locations based on cost tend to be in lower value sectors, vulnerable to cost pressures, and are mobile to relocate internationally; and

- A stronger emphasis needs to be placed on developing Innovation and R&D in NI to attract, develop and retain high value investments, both indigenous and foreign-owned. There also needs to be much greater integration between indigenous SMEs and the supply chains of larger companies.

E.15 In our review of the current policies and programmes operated by DETI / Invest NI (Chapter 3), we outline the following:

- Despite the recent rationalisation of programmes, Invest NI continues to offer a very large and complex number of programmes to businesses in NI;

- Selective Financial Assistance (SFA) is the most significant single programme Invest NI uses to support businesses. However, changes to EU regional aid rules from as early as January 2011 mean that NI will have considerably less scope to support firms using SFA, with aid ceilings expected to reduce further, potentially to zero, post 2013;

- Taken together, the total value of offers to companies for enterprise, Innovation / R&D and trade promotion (the stated aims in Invest NI Corporate Plans) amounted to only one quarter of all offers of financial support over the Review period (2002/03 - 2007/08). In addition, the assistance to attract companies new to NI added a further 10%; and

- Just over 40% of the budget was allocated to business expansion projects already operating in NI, with only 15% directed toward the support of new jobs.

E.16 In our review of the impact of the current policies and programmes (Chapter 4), we observe the following:

- Invest NI has contributed significantly to NI’s economic performance in terms of employment growth. Offers of assistance through SFA were associated with 28,000 new jobs, 15,000 safeguarded jobs and £2.4bn of investment over the period 2002/03 - 2007/08;
• When compared to other UK regions, NI has attracted a higher number of new foreign-owned investment projects and promoted a higher number of jobs per head of population. However, many of these jobs, particularly those in the service sector, offered wages below the private sector average (e.g. contact centres). Furthermore, a significant proportion of support was associated with safeguarding jobs in the manufacturing sector;

• Invest NI has been particularly successful in promoting higher value investments in ICT, although most of these were in expansion projects in firms already located in NI rather than in new firms;

• The projects assisted by Invest NI have been successful in job creation, however, their impact on productivity has been limited;

• The additionality\(^1\) of Invest NI assistance varies by the nature of support offered. Whereas the additionality of SFA supported projects is estimated to be 50% (similar to other UK regions), additionality in projects involving Innovation and R&D is generally higher. Furthermore, the Panel believe that the additionality of SFA supported projects is lowest in those that are associated with the expansion of existing firms (aside from those that involve increased Innovation or R&D); and

• The cost of additional jobs created is high.

SECTION II: TOWARDS A NEW ECONOMIC POLICY

E.17 In our proposals to realign economic policy in NI, we base our recommendations following an in-depth assessment of what drives economic growth in a region such as NI, and also what the key elements are in terms of global best practice in economic development. With regard to the drivers of regional economic growth (Chapter 5), we note:

• HM Treasury's drivers of productivity are a necessary, but insufficient, framework for regional economic growth. They fail to sufficiently prioritise exports and inward investment as the key drivers at the regional level to grow the economy;

• The promotion of Innovation and R&D – including business sophistication and, at the regional level, technology transfer – is the most important long term driver of productivity. This is essential for NI to move up the value chain; and

• Competitiveness varies between places in a region, with cities often offering higher growth and productivity. It is therefore important to allow companies the scope to locate where they can operate most profitably.

E.18 In terms of global best practice in economic development (Chapter 6), we observe the following:

• Leadership comes from the top to promote a shared vision and drive alignment in economic policy;

• Productivity transformation for the economy is recognised as a long term commitment;

• Successful regions place intense focus on attracting, retaining and embedding anchor institutions;

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\(^1\) This refers to how much of the reported benefits from Invest NI support occurred directly as a result of the assistance and how much would have happened regardless.
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- High performing investment agencies have cultures that are responsive, fast-moving and work to overcome bureaucracy. They are outcome, rather than process focused, and they recruit staff that are proactive, solutions-based and are themselves entrepreneurial in outlook; and

- Improved economic performance often has an economic crisis as its catalyst. This is particularly relevant to NI which faces its own ‘crisis’ in terms of tightening public finances and reducing state aid limits.

E.19 The recommendations designed to realign economic policy in NI are outlined in Chapter 7 and some of the key proposals are as follows:

- In light of the reducing regional aid ceilings, grants for business expansion – which tend to have low levels of additionality – should be phased out towards 2013. The resources should be redirected to provide greater levels of support to Innovation and R&D in indigenous and foreign owned companies, and also to attract companies new to NI;

- A new institution for commercially-orientated research should be explored in NI, along the lines pioneered by the successful VTT institute in Finland;

- Given the importance of exports to regional growth, Invest NI should establish a more dedicated and professional approach to supporting and stimulating exports, adopting a similar model to the fee-charging export agencies outlined in the review of global best practice;

- In terms of supporting value added business expansions not involving Innovation and R&D, Invest NI should, where necessary, provide co-financing in the form of equity and / or debt to those companies that have been successful in securing funding from the private sector; and

- DETI should ensure they have a better resourced unit which is dedicated to economic policy development and monitoring / reporting on Invest NI performance.

SECTION III: WIDER ISSUES

E.20 An important aspect of this Review has been to consider not only the nature of the policies and programmes designed to support businesses in NI, but also the governance structures that inevitably influence how they are delivered. This issue is explored in Chapter 8 and some of the key recommendations are as follows:

- The core economic functions (covering existing DETI and DEL areas of responsibility) should be brought under a single ‘Department of the Economy’;

- The FM / dFM and the Executive should establish a permanent sub-committee, chaired by the ETI Minister and comprising Ministers from other relevant departments involved in economic development, to prioritise action on the economy;

- This committee should oversee the development and implementation of an economic strategy, building on the findings of the IREP, as a matter of urgency;
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- Invest NI should be allowed more freedom to operate, with DETI having less involvement in operational matters, to enable the organisation to be more entrepreneurial and responsive to business needs. To assist in this, their delegated authority limits should be simplified and increased; and
- A small business unit should be created within Invest NI to develop supply chain capabilities throughout the NI business base and also co-ordinate policy when the agreed economic development functions are devolved to local authorities.

E.21 In the final part of the Report (Chapter 9), the Panel outline what is required from other areas of government to raise productivity and living standards in NI. The recommendations relate to the important areas of skills, infrastructure and planning and key proposals are outlined below:

- The local education system should prepare now to meet the anticipated increased demand for higher level skills in STEM and other Innovation relevant subjects, arising from the increased prioritisation of Innovation and R&D;
- The Executive should ensure that the third ISNI plan takes a much greater economic focus by committing more investment into projects that will maximise NI's future economic performance; and
- As part of the reform programme, Planning Service should have processing time targets which are competitive and comparable with those countries and regions against which NI is competing for mobile international investment.

CONCLUSIONS

E.22 The current recession highlights the extent to which economic performance is determined by a range of factors which lie outside the control of the NI Executive. The recommendations contained in this report are therefore designed to maximise the competitiveness of the economy and help build a larger export base, and one that promotes and supports the importance of Innovation and R&D.

E.23 The Review Panel believe that the recommendations, particularly the major areas identified previously, should help improve NI's living standards relative to other parts of the UK. In terms of the impact, it is difficult to be definitive on the overall outcome but we believe that the implementation of the IREP recommendations should lead to:

- Greater clarity on the roles and responsibilities of economic policy within the NI public sector, with DETI and Invest NI taking lead responsibility;
- Better co-ordination in the delivery of the key factors influencing economic policy in NI, including more tailored support for businesses in NI;
- Invest NI developing into a more responsive and less compliance-driven business development agency;
- A much greater emphasis on supporting Innovation / R&D and exports for companies throughout NI (indigenous and foreign owned); and
- A smaller and more focused mix of policies and programmes, to help attract and retain a greater level of value added inward investment, with increased integration of SMEs into relevant supply chains.
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FULL LIST OF RECOMMENDATIONS

Policy Development

- As part of the review of structures within DETI (proposed in Chapter 8), the department should ensure that more resources are dedicated to policy development and monitoring.

- DETI should appoint an independent economic advisor (with extensive experience as an economist) to strengthen capacity in economic policy making.

Policy Delivery (Invest NI)

- The concept of Invest NI 'clients' should be removed to allow Invest NI to work throughout the entire business base to raise awareness and provide support for businesses undertaking Innovation, R&D and exports.

- Invest NI should work to significantly reduce the number of its support programmes.

- Most assistance delivered via SFA should be redirected between now and 2013 to provide greater levels of support to Innovation and R&D.

- Grants for business expansions should be phased out towards 2013, after which such grants are unlikely to be available under EU state aid rules.

- Business expansion not involving Innovation and R&D should, where necessary, be supported in the form of co-investment in companies that have already been successful in securing funding from the private sector. Invest NI assistance should be in the form of sub-ordinate debt or equity.

- Invest NI should further reduce its support for company training, and concentrate support mainly to small firms and to projects with a high Innovative content, where retraining is necessary to realise a substantial rise in productivity.

- Invest NI should transfer its budgets relating to tourism accommodation back to DETI to be redistributed to a more appropriate body.

Portfolio of Innovation policies

- A portfolio of new Innovation policies should be developed over time, but should initially include four elements:
  - A new institution for commercially-oriented research should be explored in NI, along the lines pioneered by the successful VTT institute in Finland. The institution should be outside the University system and not subject to the constraints of the Research Excellence Framework (REF). It is envisaged that this would incorporate a number of existing near market research organisations in NI and would be charged with reviewing and taking forward the MATRIX agenda.
  - Additional research in Universities and public sector bodies should be aligned closely with the needs of industry in NI and potential inward investors to NI. Furthermore, the development of specific new research capabilities should be used as an incentive to attract potential investors.
  - Industry-led Innovation communities, as suggested in the MATRIX report, should be developed as a pilot to bring together business, academia and Government and exploit available market opportunities.
FULL LIST OF RECOMMENDATIONS (CONTINUED)

- More should be done to support Innovation in service sector firms beyond software, which we believe is well served. The concept of Innovation in the service sector should include the broad range of areas outlined in the definition of Innovation (presented in Chapter 5)

- Additional support for Innovation and R&D should not involve new public expenditure but instead be financed from savings in grant support for investment by existing firms and in property development

- Invest NI’s export assistance should become more dedicated and professional, adopting a similar model to the fee-charging export agencies identified in Chapter 6, with two tiers of charges depending on whether the company is an SME or large firm

Policy Delivery (DETI)

- As soon as practicable, DETI and other relevant departments should commence work on preparing a case for retaining state aid limits that support the changes outlined in this Review

- Promoting greater energy efficiency / conservation in the private sector should be accorded a higher priority in the 2009 Strategic Energy Framework (reflecting, where appropriate, the current and ongoing work of the Green New Deal for NI)

- DETI and Invest NI should undertake an immediate and focused review of its overall strategic and sectoral approach to capitalise on the benefits of new telecommunications connectivity in NI

Policy Performance

- DETI, as the funding department, should report on the strategic performance of Invest NI, with the co-operation of Invest NI statistical staff

- Relevant policies and accompanying resources should be updated annually to quantifiably demonstrate how individual policies/organisations contribute to the PfG productivity goal

- Wherever data availability / quality allows, ‘impact’ targets for economic development should be expressed in relative terms (to the UK average or appropriate subsection of UK regions) rather than in absolute terms

- When reporting on performance, DETI / Invest NI should include targets specifically for investments new to NI (expressed as a share of equivalent jobs coming into the UK)

- The Invest NI data collection system needs to be developed as a single database, to be maintained by DETI. The IREP database, constructed specifically for the Review, will be transferred to DETI to help facilitate this process

Finance

- Aside from those funds designed to support seed stage projects, Invest NI should disengage its direct involvement with venture capital (VC) funds. Rather than direct participation in the market, Invest NI should act as a facilitator between companies and VCs. In the case of seed stage VC funds, Invest NI should avoid placing restrictions on the market as outlined in Chapter 3
## Full List of Recommendations (Continued)

### Project Appraisal
- Project appraisal rules should be re-assessed to ensure that projects involving investment in Innovation and R&D, which generally present uncertain and wider outcomes, are not placed at an unreasonable disadvantage.

### Further Research
- A study should be undertaken to determine how NI can more rapidly shift the pattern of inward investment towards higher value sectors.
- A study of industrial land provision should be commissioned to determine why there is a perceived need for Invest NI to purchase large amounts of land over the next few years.
- DETI and other relevant departments should undertake a study to establish how the social economy might be further helped to reduce deprivation and increase labour force participation in disadvantaged areas within NI.

### Co-ordination of Economic Policy
- If Northern Ireland is to achieve a step change in economic performance, the economy should remain the top priority of the Executive for many years to come.
- DETI, DEL and Invest NI should work together to more effectively implement their existing liaison arrangements.
- As part of the review of strand one institutions, the core economic functions (covering existing DETI and DEL areas of responsibility) should be brought together under a single “Department of the Economy.”
- The FM / dFM and the Executive should establish a permanent sub-committee to prioritise action on the economy, to be chaired by the Minister for the Economy (in the interim, the Enterprise, Trade and Investment (ETI) Minister).
- The Executive sub-committee should agree an economic strategy, building on the findings of the IREP, as a matter of urgency.

### Governance Arrangements
- DETI should undertake an internal review of its structures to ensure that the allocation of staff is more fully aligned with its policy objectives.
- The core functions of strategic policy development and performance monitoring should be brought together within any revised DETI structures. The department should also provide the necessary support, professional and otherwise, to the Executive sub-committee on the economy.
- Invest NI should consider an internal reorganisation that reflects the differing skill sets required to support FDI, exports, Innovation / R&D and small business support.
- A small business unit should be created within Invest NI, with responsibility for the development and co-ordination of relevant support to SMEs throughout NI.
FULL LIST OF RECOMMENDATIONS (CONTINUED)

- World class training in sales and marketing should be provided for relevant Invest NI staff (particularly those working in international offices). In addition, staff should be recruited with relevant experience to meet the demands of investment decisions that are increasingly based on Innovation and R&D.

- Invest NI should be allowed more freedom to operate, with DETI having less involvement in operational matters, to enable the organisation to be more entrepreneurial and responsive to business needs.

- To help achieve greater autonomy for Invest NI, their delegated authority limits should be both simplified and increased significantly. The current DFP delegated limits for mobile SFA (currently £10m) should also apply to Innovation and R&D projects.

- An NI version of the Central Project Review Group (CPRG) should be established, incorporating Invest NI, DETI and DFP, in order to speed up the decision making process for major industrial assistance cases.

- Given the non-executive composition of the Invest NI Board, it should cease to perform executive functions and focus on providing strategic direction and oversight.

- A senior member of the DETI Departmental Board should be represented on the Invest NI Board.

- High level experience in international business and expertise in economic development should be sought when the Invest NI board is reconstituted.

- Invest NI should be given greater autonomy and flexibility in managing its budgets, including End Year Flexibility (EYF) where required.

- For projects involving financial assistance to industry, ex-post assessments of value for money should be taken on a portfolio basis.

- The DETI / Invest NI Accounting Officer Memorandum should be reviewed in light of the revised governance arrangements implemented as part of the IREP.

- The Management Statement and Financial Memorandum (MSFM) should be reviewed and revised, where appropriate, in light of the recommendations contained in this report.

Advisory Bodies

- The ETI Minister should stand down the Economic Development Forum and establish a small advisory body, comprising expertise on regional economic development (drawn from business and economics) to provide independent advice on the economy.

- Stakeholders involved in economic development should continue to engage with the ETI Minister on a bilateral basis.

Skills

- The local education system should prepare now to meet the anticipated increased demand for higher level skills in STEM and other Innovation relevant subjects arising from the increased prioritisation of Innovation and R&D.
Executive Summary

FULL LIST OF RECOMMENDATIONS (CONTINUED)

• The current focus on technical and professional qualifications, including apprenticeships and vocational training, should be extended to emphasise higher level qualifications at levels 4 and 5

• DEL, DETI and Invest NI should work to significantly develop management and leadership skills in NI and support the proposal for government to sponsor a ‘Management Masterclass’ to identify and develop the best managers from local industry and the public sector

Infrastructure

• The Executive should ensure that the third ISNI plan takes a much greater economic focus by committing more investment into projects that will maximise NI’s future economic performance

Planning

• In the context of reform, the Planning Service should be given processing time targets which are comparable and competitive with those countries and regions against which NI is competing for mobile international investment

• Planning Service should work to ensure that the legislative timetable for reform is met

• The Strategic Projects Team should deal with all applications relating to investment new to NI. In addition, in terms of what constitutes a ‘regionally significant development’, a clear definition and qualifying criteria should be developed and agreed between DoE, DRD, DETI and Invest NI

• The Pre-Application Discussion (PAD) process must be as efficient as possible and the time allocated for PAD should be included when reporting on timings for all applications
Chapter 1

Introduction

Background
1.1 On 1 December 2008 the Minister of Enterprise, Trade and Investment, Arlene Foster MLA, launched the Independent Review of Economic Policy (IREP). A Review Panel was established to undertake the Review and membership is outlined below:

- **Professor Richard Barnett**, Chair of the Panel and Vice Chancellor of the University of Ulster;
- **Professor Brian Ashcroft**, University of Strathclyde Business School and Board Member of the Economic Research Institute of Northern Ireland (ERINI);
- **Dr Graham Gudgin**, Centre for Business Research, University of Cambridge;
- **Professor Michael Moore**, Management School, Queen's University Belfast; and
- **John Wright**, former international banking Director and current Chairman and non-executive director of a number of companies in the UK and overseas.

1.2 The Review Panel also established a consultative group comprising practitioners with experience in deploying economic development policies in the UK and elsewhere. The group was used to discuss the key findings from the Review and the viability of the emerging recommendations. The group comprised the following:

- **Robert Crawford**, South East England Development Agency;
- **Sean Dorgan**, Ulster Bank Group and former CEO of the IDA;
- **Bob Downes**, Openreach Scotland;
- **Katherine James**, Northern Bank;
- **Bro McFerran CBE**, Allstate Northern Ireland; and
- **Paul Rooney**, PricewaterhouseCoopers.

1.3 We wish to place on record our appreciation for the input received from the Practitioners Group. Whereas the Review Panel are solely responsible for the recommendations contained in this report, we have benefited greatly from the discussions and advice received from the Practitioners Group.

Terms of Reference
1.4 In undertaking the Review, the Panel received an extensive Terms of Reference (outlined below), with the overarching aim to determine whether the existing DETI and Invest NI policies, programmes and resources will contribute optimally to the delivery of the productivity goal contained in the Programme for Government (PfG).

1.5 At the outset, it is important to stress that the Review can only offer partial insights into economic policy in NI. This is because DETI and Invest NI represent a significant but only partial coverage of economic development in Northern Ireland (NI). Although we consider the outputs from other areas such as skills, infrastructure and planning, the treatment is limited given the understandable focus on DETI and Invest NI. Furthermore, the Terms of Reference are dominated by productivity issues.
and, as we state in Chapter 5, the Review Panel believe that this remains the correct medium to longer term policy focus for the NI Executive. However, we also recognise that the NI and UK economies continue to face a severe economic recession, which is particularly impacting on the labour market and we expect this to continue for the short to medium term. Therefore, as we outline later in the introduction, it is vital that economic development policy in NI is characterised as being flexible and focused – able to make short-term interventions to assist employment, but equally remains focused on growing the more productive and wealth creating private sector which is at the heart of the PfG.

Aims of the Review

1.6 The Review Panel were asked to consider the following:

- Advise on the extent to which existing strategies, policies, programmes and resource allocations may need to be better aligned to help deliver the productivity goal;
- Identify whether any new policies are necessary, having regard to the existing legislative powers of the NI Executive; and
- Identify whether there are any issues which risk compromising the delivery of the goal, but which fall to other departments, for example DEL and DRD.

1.7 The Review Panel were asked to analyse and, where they deem appropriate, make recommendations in the following areas:

- The current and forecasted performance of the NI economy, relative to other regions with access to similar policy instruments, programmes and resources;
- The current DETI / Invest NI policies and programmes, with an assessment of their effectiveness in stimulating productivity improvements, particularly within manufacturing and private services;
- The policy options to stimulate economic growth / productivity and build a larger and more wealth creating private sector, particularly in financial and value added business services;
- How NI can further attract value added FDI and promote domestic investment;
- Review and advise on the structure and remit of Invest NI and the existing governance arrangements between DETI, DFP and Invest NI;
- Identify any issues which may inhibit the delivery of the productivity goal which fall to other departments in the NI Executive, particularly DEL (in relation to skills) and DRD (in relation to regional planning and infrastructure investment);
- Consider the optimal way by which the Minister of Enterprise, Trade and Investment engages with key stakeholders on economic development issues;
- Consider whether any improvements could be made to DETI and Invest NI’s working links within the NI Executive and on an east/west and north/south basis;
- The sub-regional distribution of inward investment and other support measures to indigenous businesses, and the effectiveness of policy in encouraging the location of investment; and
• Assess the challenging nature of the economic goals / targets contained in the PfG and, where appropriate, recommend any change.

1.8 The Terms of Reference are wide ranging and the Review Panel have endeavoured to address each item as part of the overall work programme. Certain areas have naturally received more detailed analysis than others and, given its structure, it is important that the report is considered in its entirety rather than individual chapters in isolation.

1.9 The Terms of Reference asked the Panel to consider how DETI and Invest NI’s working links could be improved on an east / west and north / south basis. This reflects a point made in Sir David Varney’s report on the competitiveness of the NI economy (referenced later in this report), which called for improved working links between Invest NI and, in particular, the Industrial Development Agency (IDA) in the Republic of Ireland (RoI). While recognising the potential for collaboration between business development agencies, especially in areas such as trade missions, it needs to be recognised that Invest NI and the IDA essentially compete for mobile investment and it is unrealistic to expect them to develop extensive partnerships. The analogy of collaboration between competing firms is relevant in this context – they work together when it makes good business sense, otherwise they directly compete with each other. The same holds for business development agencies, either on a north/south or east/west basis.

1.10 The Panel also asked for clarity on how the sectoral issues relating to the tourism sector should be treated as part of the Review. The reasons were twofold. Firstly, the IREP was asked to focus on DETI and its interaction with Invest NI to achieve the PfG productivity goal. However, we recognise that DETI has also lead responsibility to develop the tourism sector in NI. Secondly, although Invest NI is active in supporting the tourism sector, we recognise that other bodies (such as the NI Tourist Board and Tourism Ireland) have operational responsibility in this area. In response, the department advised the Panel that we should reserve comment on the tourism policies/programmes operated by Invest NI, and form a view on the appropriateness of Invest NI’s engagement in the sector. We have therefore presented some comments and recommendations in this area (in Chapters 3 and 7 of the report). It is, however, important to stress that the Panel believe that increased prosperity for NI, in particular its rural areas, can be significantly addressed by building a more vibrant tourism sector, given the region is endowed with large areas of scenic and natural beauty. We anticipate that this will be recognised and outlined in the forthcoming tourism strategy for NI.

**APPROACH**

1.11 The analysis and recommendations contained in this report have been developed on the basis of the evidence gathered by the Review Panel. In order to ensure that the evidence is both relevant and reliable, we pursued the approach outlined below:

• At the outset of the work programme, the Review Panel issued a public call for evidence in relation to the effectiveness of DETI / Invest NI support on actual and potential beneficiaries. The Panel received a total of forty-five responses and they were subsequently placed on the dedicated IREP website (Annex A outlines a summary of the responses);

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2 Copy of the correspondence from DETI can be accessed on the IREP website at www.irep.org.uk.
3 Of the forty-five responses to the call for evidence, five requested to be treated as confidential.
• Following the call for evidence, the Review Panel undertook an extensive series of evidence gathering interviews with key informants and other stakeholders;

• The Panel engaged with the Invest NI Board and also the Chief Executive and other members of Top / Senior Management. A member of Invest NI’s staff was also seconded to the Review secretariat;

• Representatives from the Review Panel met with the ETI Minister and the ETI Committee in order to report on progress and also assess the views of local politicians on key issues relating to economic development in NI; and

• As part of the review of policies and programmes, a database was constructed using information from Invest NI, which matched data on financial assistance with a range of variables including location, ownership, R&D, exports / external sales, employment and output (further details on the database can be found at Chapter 3 and its accompanying annex (Annex B)).

CONTEXT

1.12 There are a number of important contextual points that have helped influence the overall shape and direction of the report. For instance, in the Ministerial statement accompanying the launch of the Review, it was emphasised that the work of the IREP was to focus on the medium to longer term in order to help position the NI economy for the upturn in the global economy. In short, the Panel were not asked to bring forward recommendations to address the current downturn. In accepting this direction, we recognised that the Executive was already at work in developing its own package of measures to address the downturn. Nevertheless, as we outlined earlier, the severity of the ongoing recession highlights an important policy consideration, namely that financial assistance to industry will vary depending on the economic cycle. For example, the recommendations we make in this report are for the medium to longer term and we believe they are important for future productivity growth in NI. However, the Panel equally recognises that in periods of recession, DETI and Invest NI (and other relevant departments) will need to make certain interventions to support employment and other considerations. Furthermore, if job growth is slower in the medium term future than in the past, then we expect employment considerations to take on more permanent importance.

1.13 The global downturn and the fiscal response initiated by the UK Exchequer have also led to the prospects for public expenditure growth to be much bleaker than in recent years. As Chapter 2 highlights, the Panel anticipate that in the next spending review there will be a significant squeeze on public expenditure in NI. For example, on the basis of the latest HM Treasury projections, there will be limited cash terms growth in expenditure, and capital budgets are also expected to decline. This will have significant implications for the region as a whole, particularly as the public sector has traditionally been an important driver of economic growth in NI. The Review Panel have therefore worked to ensure that the recommendations contained in this report are largely budget neutral, with some even offering the potential for savings.

1.14 The Review Panel are fully cognisant of the imminent changes to the current state aid rules which govern the extent to which DETI and Invest NI can intervene to support companies in NI. These changes are outlined in Chapter 3, however, it is worth...
highlighting that the maximum levels for regional aid are scheduled to decline significantly from the end of next year (December 2010). This will have consequences for economic development programmes in NI, as the majority of assistance is approved under the regional aid framework. However, we are also aware that state aid rules currently offer greater scope for intervention in Innovation and R&D, which reflects the aim of the Lisbon Treaty to boost R&D investment in member states. This is an important aspect of the Review and it has helped influence our recommendations on refocusing government support to industry in NI (outlined in Chapter 7).

STRUCTURE

1.15 The IREP report has been structured into three sections. Section I begins by outlining the Panel’s assessment of the challenges facing the NI economy, particularly if the PfG productivity goal is to be met. The commentary describes the main characteristics of the NI economy, the policies and programmes DETI / Invest NI have in place to support the private sector and also the impact these interventions have had since the establishment of Invest NI in 2002.

1.16 Section II presents our views on developing a new economic policy in NI. At the outset of this section, the Panel outlines what we consider to be the key drivers of regional economic growth, and also what constitutes global best practice in economic development. This material builds on the earlier analysis presented in Section I and is used to frame a series of recommendations which are aimed at better aligning economic policy to improve private sector productivity in NI.

1.17 Section III outlines a number of recommendations designed at improving the degree of autonomy for Invest NI as a business development agency. In part, this follows from our review of global best practice in economic development, where autonomy is viewed as one of a number of important success criteria. In addition, this section considers the wider issues relevant to DETI / Invest NI’s interventions in support of the PfG productivity goal. As one contributor in our key informant interviews remarked, DETI and Invest NI represent the ‘tip-of-the-spear’ when it comes to economic policy in NI, but they need support across the Executive, particularly in terms of skills, infrastructural investment and planning. The Panel therefore offers some views and recommendations in these areas as part of our discussions in Section III.

1.18 As to the individual chapters, they are summarised below:

Section I: Analysis of Existing Policies

- Chapter 2 outlines the current position of the NI economy and reflects on the prospects for growth in the medium to longer term;
- Chapter 3 provides an overview of the policies and programmes run by DETI and Invest NI;
- Chapter 4 provides an assessment of the impact of the policies and programmes outlined in the previous chapter;
Section II: Towards a New Economic Policy

- **Chapter 5** outlines what we consider to be the main drivers of growth in the regional economy, emphasising the need for greater investment in value added FDI, exports and Innovation / R&D;

- **Chapter 6** outlines a summary of global best practice in economic development policy and presents a series of themes aimed at informing economic policy development and delivery in NI;

- **Chapter 7** provides recommendations on how the policies and programmes run by DETI and Invest NI could be better formulated / aligned to help deliver on the PfG productivity goal;

Section III: Wider Issues

- **Chapter 8** outlines a number of recommendations to strengthen the formulation of economic policy in NI and increase the autonomy of Invest NI to deliver on the key economic priorities of the Executive; and

- **Chapter 9** outlines what we consider DETI / Invest NI require in terms of skills, infrastructure and planning. The Panel present a number of recommendations in these areas which are designed at improving the overall performance of economic policy in NI.
Section I

Analysis of Existing Policies
Chapter 2
The Northern Ireland Economy

SUMMARY OF KEY FINDINGS

• The NI economy has achieved a rapid rate of economic growth relative to other parts of the UK, in both output and employment terms

• NI has been unable to make progress on a convergence of living standards towards the UK average, with relatively poor labour productivity the main factor behind this

• Within the UK, Invest NI has an attractive value proposition for investors, particularly given the competitive wages, skilled labour and generous incentives on offer

• Competitive wage levels mean that NI is particularly attractive to labour intensive service sectors. However, the type of firm which chooses locations based on cost tend to be in lower value sectors, vulnerable to cost pressures, and are mobile to relocate internationally

• A stronger emphasis needs to be placed on developing Innovation and R&D in NI to attract, develop and retain high value investments, both indigenous and foreign-owned. There also needs to be much greater integration between indigenous SMEs and the supply chains of larger companies

INTRODUCTION

2.1 Prior to considering the effectiveness of the policies operated by DETI / Invest NI, it is important to initially consider the current position of the Northern Ireland (NI) economy and the prospects for growth in the medium to longer term. In examining the main characteristics and challenges facing the NI economy, we also outline the context for the economic policies that have been developed and delivered by DETI / Invest NI on behalf of the NI Executive.

2.2 In many respects, the performance of the NI economy depends on national and international influences, and hence on factors beyond the control of local policy makers. As a consequence, most of the commentary below on NI’s economic performance is expressed relative to either the UK average or to other UK regions. The aim is therefore to establish how well the economy has performed in comparison with other parts of the UK that share the same, or similar, macroeconomic context.

2.3 In brief, the Review Panel observes that NI has achieved a rapid rate of economic growth relative to other parts of the UK. For example, whether the unit of measure is employment or output, the NI economy has expanded faster than most other UK regions throughout much of the last twenty-five years. As we illustrate later in Chapter 4, we believe that part of this success has been due to Invest NI grant assistance. Furthermore, the success in job creation has been such that, by 2004, many more people were entering NI for work, than were leaving to find employment elsewhere.

5 Other sources of rapid employment growth over the last decade have been investment in retail developments, as major retail companies expand their capacity in NI. Another source has been in construction as the house price bubble developed between 2005 and 2007.
2.4 Despite this comparatively strong performance, NI has been unable to make progress on improving relative living standards. For instance, Gross Value Added (GVA) per capita is a broad measure of living standards and, using this variable, NI has remained around 80% of the UK average since the mid 1990s. The region also sits at the bottom of the UK regional ranking along with the North East of England and Wales. Figure 2.1 disaggregates this gap with the UK average, and highlights that relatively poor labour productivity (three quarters of the gap) and a low employment rate (one quarter) are the key factors behind this. The remainder of this chapter will focus, in turn, on NI’s economic performance in these two areas, before addressing a number of wider drivers of productivity.

![Figure 2.1: Disaggregating NI's Output Gap (2008)](chart.png)

Source: Oxford Economics

**LABOUR PRODUCTIVITY**

2.5 Productivity, as measured by GVA per employee, is a major component of GVA per head, which is the accepted international measure of living standards and economic success. Figure 2.2 presents NI’s position relative to the UK average for both productivity and GVA per head. As already mentioned, living standards in NI have remained around 80% of the UK average. Furthermore, despite the growth in productivity (which has risen on average at a rate close to 1.25% per annum over the period), the long standing ‘productivity gap’ has showed little sign of sustained convergence, even during the period of fast employment growth. If anything, labour productivity has weakened since 1997 and the gap has widened. NI productivity has also lagged behind the UK excluding the Greater South East of England\(^6\), although this gap has not widened over the last decade.

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\(^6\) The Greater South East is defined to include London, the South East and East of England regions.
2.6 Since wages tend to reflect productivity, it is no surprise that average wages in NI are also well below the rest of the UK. This is particularly true for males, where average full-time hourly wages are 82% of the UK average. Since a greater proportion of females in NI are employed in the public sector (which offers higher salaries than the private sector), the gap is smaller and average wages are around 90% of the UK level. In both cases the gap has widened over the last decade.

2.7 The productivity gap reflects both lower individual sectoral productivity compared to the UK average, and also an over-representation in NI of low productivity sectors. For example, recent research has indicated that two-thirds of the productivity gap in 2004 was due to lower individual sectoral productivity, with the remainder due to the sectoral mix of the NI economy⁷.

Individual Sector Productivity

2.8 Table 2.1 sets out the relative productivity across the various sectors in NI, and we have also included the other devolved regions for comparison⁸. Productivity was above the UK average in utilities (where regulated monopolies dominate) and in public administration where a concentration of higher paid senior civil servants and police would appear the most likely explanation. The most significant negative productivity differentials are in financial and business services, agriculture and other personal services. The negative differential for finance is shared across most UK regions and is due to the impact of London’s dominance, though Scotland fares better due to its financial concentrations in Glasgow and Edinburgh. The large health and social services sector in NI has productivity levels well below both the UK average and Scotland / Wales. Although manufacturing productivity remains below the UK average, it has performed better than the majority of service sectors. Despite this, we argue in Chapter 4 that Invest NI support appears to have had limited impact on productivity levels within the manufacturing sector.

Source: Oxford Economics

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7 Oxford Economics (2007) Productivity – Regional Story, Draft Report for the Economic Research Institute for NI (2004 was the latest sub-sectoral GVA data available when the research was carried out).

8 This is taken from the 2006 data, which remains the latest sectoral estimates published, though in most sectors the patterns have been similar for a number of years.
Table 2.1: Relative Productivity 2006 (UK=100 in each sector)

<table>
<thead>
<tr>
<th>Sector</th>
<th>NI</th>
<th>Scotland</th>
<th>Wales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>79</td>
<td>119</td>
<td>47</td>
</tr>
<tr>
<td>Extraction</td>
<td>95</td>
<td>81</td>
<td>112</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>92</td>
<td>113</td>
<td>94</td>
</tr>
<tr>
<td>Utilities</td>
<td>120</td>
<td>99</td>
<td>83</td>
</tr>
<tr>
<td>Construction</td>
<td>92</td>
<td>105</td>
<td>85</td>
</tr>
<tr>
<td>Retail</td>
<td>92</td>
<td>91</td>
<td>80</td>
</tr>
<tr>
<td>Hotels</td>
<td>89</td>
<td>92</td>
<td>87</td>
</tr>
<tr>
<td>Transport &amp; communications</td>
<td>81</td>
<td>99</td>
<td>83</td>
</tr>
<tr>
<td>Financial services</td>
<td>69</td>
<td>90</td>
<td>68</td>
</tr>
<tr>
<td>Business services</td>
<td>80</td>
<td>90</td>
<td>63</td>
</tr>
<tr>
<td>Public administration</td>
<td>110</td>
<td>93</td>
<td>169</td>
</tr>
<tr>
<td>Education</td>
<td>100</td>
<td>109</td>
<td>97</td>
</tr>
<tr>
<td>Health</td>
<td>88</td>
<td>96</td>
<td>97</td>
</tr>
<tr>
<td>Other personal services</td>
<td>79</td>
<td>97</td>
<td>85</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>85</td>
<td>95</td>
<td>83</td>
</tr>
</tbody>
</table>

Source: Oxford Economics, ONS Regional Accounts

Note: Light brown shading indicates productivity above the UK average; green shading represents where productivity is more than 10 percent below UK.

2.9 Table 2.2 highlights the relationship between productivity, wage levels and relative qualifications in individual sectors. Wages are a major component of overall GVA (especially in services and particularly in public services). As can be seen, utilities and education are the only sectors with above UK average wages, and the largest negative differentials are in financial and business services, transport and construction. In particular, the business services sector has markedly low average wages, despite its above average graduate concentration.9

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9 Surprisingly, given the productivity advantage in public administration, the wage data does not record a positive differential. This may reflect sampling variation in the wage data from the Annual Survey of Hours and Earnings (ASHE).
Table 2.2: Comparison of Sectoral Productivity, Wages and Skills (UK=100, 2006/07)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Productivity</th>
<th>Wages</th>
<th>Managers &amp; Professionals</th>
<th>Graduates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>79</td>
<td>80</td>
<td>31</td>
<td>44</td>
</tr>
<tr>
<td>Extraction</td>
<td>95</td>
<td>61</td>
<td>38</td>
<td>0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>92</td>
<td>84</td>
<td>71</td>
<td>85</td>
</tr>
<tr>
<td>Utilities</td>
<td>120</td>
<td>112</td>
<td>82</td>
<td>137</td>
</tr>
<tr>
<td>Construction</td>
<td>92</td>
<td>76</td>
<td>59</td>
<td>73</td>
</tr>
<tr>
<td>Retail</td>
<td>92</td>
<td>89</td>
<td>89</td>
<td>90</td>
</tr>
<tr>
<td>Hotels</td>
<td>89</td>
<td>94</td>
<td>91</td>
<td>43</td>
</tr>
<tr>
<td>Transport &amp; communications</td>
<td>81</td>
<td>79</td>
<td>76</td>
<td>94</td>
</tr>
<tr>
<td>Financial services</td>
<td>69</td>
<td>71</td>
<td>65</td>
<td>84</td>
</tr>
<tr>
<td>Business services</td>
<td>80</td>
<td>82</td>
<td>87</td>
<td>103</td>
</tr>
<tr>
<td>Public administration</td>
<td>110</td>
<td>96</td>
<td>81</td>
<td>102</td>
</tr>
<tr>
<td>Education</td>
<td>100</td>
<td>119</td>
<td>101</td>
<td>100</td>
</tr>
<tr>
<td>Health</td>
<td>88</td>
<td>89</td>
<td>95</td>
<td>105</td>
</tr>
<tr>
<td>Other personal services</td>
<td>79</td>
<td>90</td>
<td>92</td>
<td>91</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>85</strong></td>
<td><strong>87</strong></td>
<td><strong>81</strong></td>
<td><strong>92</strong></td>
</tr>
</tbody>
</table>

Source: Oxford Economics, ONS Labour Force Survey, ONS Annual Survey of Hours and Earnings

Note: Graduates are % of employees with NQF+ qualifications and is a 3 year moving average 2005-07. Wages are weekly gross earnings for full-time employees.

2.10 Table 2.2 also shows that the proportion of employees in NI who are managers and professionals is lower than in the rest of the UK, and this is consistent across almost all sectors. The data are based on a sample and some caution must be exercised in interpreting the results, but there appears to be a correlation between the manager and professional relativities and the observed productivity differentials. The low levels of managers and professionals in construction and agriculture is also striking, as is the 30% negative difference in the manufacturing sector. The positive impact of managerial skills on productivity is further developed in Chapter 9 of the report.

2.11 There are a number of sectors, such as utilities, business services and public services, where NI has proportionately more graduates than the UK average. However, some of these sectors have relatively few managers / professionals and offer lower wages, which indicate that graduates in NI may be taking lower paid, non-professional jobs and are therefore being under-utilised. This issue of graduate underemployment in the NI labour market is also explored in greater detail in Chapter 9.

**Sectoral Mix**

2.12 As already mentioned, the other component of NI’s lower productivity is an unfavourable mix of sectors towards those with lower productivity. Figure 2.3 highlights that, compared with the UK average:

- NI has still a relatively large public sector (education, health and public administration), which accounts for just over one-third of total employment, although productivity levels are not dissimilar than elsewhere in the UK;
- Agriculture, construction, retail and manufacturing are also relatively significant employers;
Despite recent growth, the business services sector remains much smaller than the rest of the UK;

- Transport and communications, other personal services and finance are under-represented in NI; and

- The tourism sector remains much smaller than its potential would suggest and, as a result, the hotels sector is also relatively smaller than the UK average.

Figure 2.3: NI Industrial Structure 2008 (Relative to UK)

<table>
<thead>
<tr>
<th>Industry</th>
<th>% Points Difference with UK Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business services</td>
<td>0.0</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>-0.0</td>
</tr>
<tr>
<td>Other personal services</td>
<td>-1.0</td>
</tr>
<tr>
<td>Financial services</td>
<td>0.0</td>
</tr>
<tr>
<td>Hotels</td>
<td>0.0</td>
</tr>
<tr>
<td>Utilities</td>
<td>-2.0</td>
</tr>
<tr>
<td>Extraction</td>
<td>-3.0</td>
</tr>
<tr>
<td>Education</td>
<td>-4.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-5.0</td>
</tr>
<tr>
<td>Retail</td>
<td>-6.0</td>
</tr>
<tr>
<td>Construction</td>
<td>-7.0</td>
</tr>
<tr>
<td>Public administration</td>
<td>-8.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-9.0</td>
</tr>
<tr>
<td>Health</td>
<td>-10.0</td>
</tr>
</tbody>
</table>

Source: Oxford Economics
Note: Employment is used as the measure of industrial structure.

EMPLOYMENT

2.13 As mentioned earlier, the remainder of NI’s gap in living standards with the UK average is due to a relatively low employment rate. This is despite the economy’s enviable record of job creation prior to 2008 (equivalent to 13,000 additional jobs each year over the last decade). The current recession has led to the region experiencing its first annual fall in overall employment since 1992 and only the second fall since the early 1980s (Figure 2.4). Prior to this, the rate of job growth consistently exceeded the UK average in every year except one since 1990.
NI’s employment growth has been impressive compared to other UK regions and also many international economies. Figure 2.5 highlights that, over the period 1984-2009, NI has had the fastest job growth of any UK region and also compares favourably to countries such as the US and the Eurozone – though the region lies behind the Republic of Ireland (RoI) and fast-growing developing countries including India and China.

The great majority of new jobs created over the last ten years have been in the private service sectors and construction (Table 2.3). Parts of the public sector also expanded but this has only created a minority of the new jobs. Employment in the industrial sectors contracted, especially in manufacturing and agriculture, which mirrored their performance in the UK. However, several sectors grew much faster in NI than in GB. For example, the rapid growth in retailing and construction reflects the extreme bubble in the housing market that was more pronounced in NI than elsewhere in the UK, and also a post-troubles catch-up in retail provision as major retail groups moved into the region.
region. Business services growth has been extremely strong in NI, though as Figure 2.3 showed, it remains a relatively small employer compared with the UK average.

Table 2.3: Sectoral Employment Growth, 1998-2008

<table>
<thead>
<tr>
<th></th>
<th>Northern Ireland</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>000's</td>
<td>%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-13</td>
<td>-29</td>
</tr>
<tr>
<td>Extraction</td>
<td>0</td>
<td>17</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-23</td>
<td>-20</td>
</tr>
<tr>
<td>Utilities</td>
<td>0</td>
<td>-11</td>
</tr>
<tr>
<td>Construction</td>
<td>27</td>
<td>57</td>
</tr>
<tr>
<td>Retail</td>
<td>38</td>
<td>33</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>8</td>
<td>21</td>
</tr>
<tr>
<td>Transport &amp; Communications</td>
<td>7</td>
<td>24</td>
</tr>
<tr>
<td>Financial Services</td>
<td>5</td>
<td>37</td>
</tr>
<tr>
<td>Business Services</td>
<td>48</td>
<td>103</td>
</tr>
<tr>
<td>Public Administration</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Education</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Health</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Other Personal Services</td>
<td>9</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>121</strong></td>
<td><strong>16</strong></td>
</tr>
</tbody>
</table>

*Source: Oxford Economics*

2.16 This impressive level of job creation has helped improve NI's employment rate\(^{10}\), from 65% in the mid 1990s to around 70% between 2005-2008 (Figure 2.6)\(^{11}\). Nevertheless, despite this growth, NI's employment rate has remained well below that in GB.

---

\(^{10}\) The employment rate is the percentage of working-age people who are employed.

\(^{11}\) The 2009 estimate for the employment rate is for a sharp fall, which reflects the impact of the global recession.
With NI’s employment rate below the UK average, it is unsurprising that economic inactivity is also higher than any other UK region (Table 2.4). A particular feature of the NI labour market is that despite achieving significant reductions in unemployment, the region has continued to exhibit high rates of economic inactivity. This is partly due to considerably more incapacity benefit claimants compared with the rest of the UK (9.5% of NI’s working age population is inactive due to sick / disability compared with 5.7% in UK).

Table 2.4: UK Regional Economic Inactivity Rates

<table>
<thead>
<tr>
<th>Region</th>
<th>Q2 2002</th>
<th>Q2 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>South East</td>
<td>17.0</td>
<td>17.4</td>
</tr>
<tr>
<td>London</td>
<td>24.0</td>
<td>23.8</td>
</tr>
<tr>
<td>East</td>
<td>17.7</td>
<td>18.0</td>
</tr>
<tr>
<td>South West</td>
<td>18.1</td>
<td>18.0</td>
</tr>
<tr>
<td>West Midlands</td>
<td>21.4</td>
<td>21.8</td>
</tr>
<tr>
<td>East Midlands</td>
<td>20.0</td>
<td>18.5</td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>22.8</td>
<td>21.2</td>
</tr>
<tr>
<td>North West</td>
<td>23.9</td>
<td>22.1</td>
</tr>
<tr>
<td>North East</td>
<td>26.3</td>
<td>24.2</td>
</tr>
<tr>
<td>Wales</td>
<td>27.1</td>
<td>24.4</td>
</tr>
<tr>
<td>Scotland</td>
<td>21.6</td>
<td>20.1</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>28.3</td>
<td>30.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td><strong>22.4</strong></td>
<td><strong>20.9</strong></td>
</tr>
</tbody>
</table>

Source: ONS Labour Force Survey
2.18 The enlargement of the EU in 2004 has led to an influx of additional labour throughout the UK, including in NI, and this has primarily been from the Accession states (Figure 2.7). This has changed the pattern in NI, from a region traditionally losing population to one gaining significant numbers of additional residents in the period from 2005 onwards. Rising migration is the main reason why the employment rate has levelled off around 70% despite strong net job growth post 2005.

Figure 2.7: Net Migration into Northern Ireland (000s)

Source: Oxford Economics

PRODUCTIVITY DRIVERS

2.19 While NI’s gap in living standards can be explained by labour productivity and the employment rate, there are a number of other drivers of growth at the regional level which underpin these variables. Chapter 5 discusses the relative importance of the productivity drivers, and the remainder of this chapter outlines NI’s recent performance under the HM Treasury’s drivers of growth. It is, however, important to acknowledge the role of the public sector as a driver of regional economic growth in NI. For example, the region has a proportionately larger level of public expenditure than any other UK region, despite contributing relatively less to UK tax receipts. Indeed, the fiscal deficit for NI – the difference between expenditure and tax receipts – was estimated to be £6.7bn in 2006/07 (equivalent to around one quarter of total output in the region). The public sector is therefore an important driver of growth in NI, and much more so than in other parts of the UK.

Investment

2.20 The major long-term component of investment which drives growth in NI is inward investment within export sectors. NI attracted proportionately more jobs in new FDI firms than other UK regions, although this was considerably less than the RoI, where the low corporation tax is an important inducement to incoming firms (Figure 2.8). It is

12 HM Treasury’s productivity drivers are Investment, Enterprise, R&D / Innovation, Skills and Competition. The appropriateness of these for NI are discussed in chapter five of this report.

13 Public Expenditure in NI is 25% higher than the average for England and 44% higher than in London and the South of England (Public Expenditure Statistical Analysis, 2009).
difficult to accurately measure the number of jobs created through inward investment in firms new to NI (this is discussed further in Chapter 4), but a figure of around 1,300 a year is a reasonable estimate. This is equivalent to 10% of all new jobs created annually in NI over the last decade. The Panel have views on the quality of FDI projects that have been attracted into NI in recent years and this is also developed later in Chapter 4.

Figure 2.8: Jobs Promoted in New FDI Projects (per million people) 2002/03 – 2007/08

Source: FDI Intelligence and IDA (Ireland)

Note: UK figures do not include new FDI projects in existing companies (figures for the RoI may not be directly comparable with UK regions and may include FDI projects in existing companies)

Enterprise

2.21 The NI economy is dominated by small firms, with proportionately more small businesses relative to its population size than the average for the rest of the UK (as measured by stock of VAT registered businesses\(^\text{14}\), see Table 2.5). This is due to a larger agriculture sector (with more farmers) and also more small firms than the UK average in construction, retail, transport and extraction. Despite this, NI’s rate of new company formation (measured by VAT registrations in Table 2.5) is below the UK average, and above just two other UK regions (Wales and the West Midlands).

\(^{14}\) The threshold for registering a business for VAT is an annual turnover of £65,000. This includes a number of micro-businesses and self-employed people.
Table 2.5: VAT Registrations and Stock, UK Regions, 2007

<table>
<thead>
<tr>
<th>Region</th>
<th>VAT Stock per 10,000 people of working age</th>
<th>VAT Registrations per 10,000 people of working age</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>625</td>
<td>80</td>
</tr>
<tr>
<td>South East</td>
<td>615</td>
<td>61</td>
</tr>
<tr>
<td>East</td>
<td>580</td>
<td>56</td>
</tr>
<tr>
<td>South West</td>
<td>602</td>
<td>54</td>
</tr>
<tr>
<td>East Midlands</td>
<td>449</td>
<td>48</td>
</tr>
<tr>
<td>North East</td>
<td>499</td>
<td>48</td>
</tr>
<tr>
<td>North West</td>
<td>498</td>
<td>47</td>
</tr>
<tr>
<td>Scotland</td>
<td>431</td>
<td>44</td>
</tr>
<tr>
<td>Yorkshire</td>
<td>441</td>
<td>44</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>594</td>
<td>40</td>
</tr>
<tr>
<td>Wales</td>
<td>475</td>
<td>37</td>
</tr>
<tr>
<td>West Midlands</td>
<td>322</td>
<td>36</td>
</tr>
<tr>
<td>UK</td>
<td>525</td>
<td>53</td>
</tr>
</tbody>
</table>

Source: VAT data via Nomis

2.22 Surveys of attitudes to enterprise also indicate that NI tends to be less enterprising than the UK average and especially when compared with Southern England. However, company formation rates are closer to the UK average in the main export sectors, although they remain behind Southern England (Figure 2.9). This, in turn, may reflect the efforts of the Local Enterprise Agencies in promoting business start-ups, and the support offered by DETI and Invest NI to small firms in export sectors.

Figure 2.9: Business Registrations as % of Previous Year’s Stock in NI (UK=100)

Source: Nomis / Oxford Economics

2.23 This support is also likely to be partly responsible for the low closure rates of small firms in NI (as is the case in other UK regions with significant levels of government support for business). Low closure rates characterise all sectors in NI and mainly reflect lower start-up rates, but closures are particularly low in manufacturing and it may be here that Invest NI support has its main impact. The influence of government support is also noticeable in enhancing the growth of small businesses, especially within manufacturing. This is again a factor in all assisted regions, but NI has the highest proportion of fast growing small firms even if it fails to produce many exceptional high-flying companies

Innovation and R&D

2.24 NI has a particularly poor record on R&D spending by businesses and on Innovation activity and patents. This shortcoming is becoming more important as developed economies are increasingly relying on commercial knowledge as their chief competitive advantage in global trade. As shown in Figure 2.10, Business Expenditure on R&D (BERD) in NI is one of lowest in the UK, although Wales and Scotland have even lower levels. London, which lacks a significant manufacturing sector, also has a lower reported level although it seems likely that much of the Innovation in financial and business services may not be recorded in the statistics.

Figure 2.10: BERD as % of GVA, UK Regions, 2007

Source: ONS and DETI

2.25 In part, R&D spending reflects the location of research-intensive sectors such as pharmaceuticals, but these industries tend to reflect conditions supportive of research, including locations where scientists prefer to live. It is a matter of some concern that levels of BERD in NI manufacturing have lagged further behind the UK average in recent years (Figure 2.11), and also further behind the RoI where levels of BERD have risen substantially. Leading research economies, including Finland and Sweden, now have levels of BERD five to six times higher than in NI. However, levels of service sector BERD are above the UK average, although the sector remains comparatively small.

Anyadike-Danes, M; Bonner, K; Hart, M and Mason, C (2009) Mapping Firm Growth in the UK: the economic impact of High Growth Firms, NESTA: London. The authors have kindly made available additional analysis on manufacturing Industry from this study.
2.26 Innovation is wider than R&D, and the UK Innovation survey for 2004-06 indicates that firms in NI have lower levels of overall Innovation than the UK average by around 10%. Patents data are even more pessimistic, with only 11 patents granted in NI in 2007 – the lowest per capita level relative to any other UK region. There are many ways for firms to innovate other than through their own research or patents, but firms are unlikely to be at the forefront of their sectors without this ability.

Skills

2.27 Despite its strengths in school and higher education, NI has traditionally lacked the types of firm needed to fully retain its well educated workforce. As a result, skills levels within the resident population and workforce have usually been lower than the UK average. However, this position has been changing, and among younger age cohorts the skills levels have been closer to the UK average.

2.28 Table 2.6 indicates that the overall skills gap is now quite small. For example, NI has proportionately fewer people with higher education qualifications but more with A level or equivalent qualifications. The region also has a very high proportion of people with no recorded qualifications, but this may reflect a tendency not to enter pupils for low level qualifications. In addition, NI remains under-represented at the PhD level (4.1 per 1,000 working age persons which is significantly below the UK average (7.5) and half the level of Scotland (8.7)).
Table 2.6: Highest Qualifications, Northern Ireland and the UK, 2008

<table>
<thead>
<tr>
<th>Qualification</th>
<th>NI</th>
<th>UK</th>
<th>NI</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree or equivalent</td>
<td>19%</td>
<td>21%</td>
<td>24%</td>
<td>24%</td>
</tr>
<tr>
<td>Higher Education</td>
<td>8%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
</tr>
<tr>
<td>A-level or equivalent</td>
<td>25%</td>
<td>23%</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>GCSE Grades A-C or equivalent</td>
<td>21%</td>
<td>23%</td>
<td>20%</td>
<td>22%</td>
</tr>
<tr>
<td>Other qualifications</td>
<td>6%</td>
<td>13%</td>
<td>6%</td>
<td>13%</td>
</tr>
<tr>
<td>No qualifications</td>
<td>22%</td>
<td>12%</td>
<td>16%</td>
<td>8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: DETI Labour Force Survey

Note: Figures may not add to 100% due to rounding

Infrastructure

2.29 Infrastructure can be an important factor in economic performance, though some locations remain competitive in spite of congested infrastructure, such as London and the South East of England. Other areas, including the RoI, have also been able to catch up to the highest EU productivity levels despite a generally inadequate infrastructure, particularly in areas such as roads and ports. NI has a commitment to redress deficiencies in certain areas of infrastructure, as set out in the Investment Strategy for NI (ISNI 1 and 2), and this issue is developed further in Chapter 9. However, it is our view that infrastructure is not a major constraint on raising NI’s productivity, nor would a higher level of spending necessarily be expected to have a significant impact in closing the productivity gap.

CONCLUSIONS

2.30 This chapter has highlighted that the two main causes for NI’s low living standards are relatively poor labour productivity and a low employment rate. The Review Panel acknowledge that DETI has already identified the importance of these two issues, and has either taken the lead or supports the relevant Public Service Agreements (PSAs)\(^{17}\) in the latest Programme for Government (PfG):

(i) **PSA 1**: Improve Northern Ireland’s manufacturing and private services productivity; and

(ii) **PSA 3**: Subject to economic conditions, increase employment levels and reduce economic inactivity by addressing the barriers to employment and providing effective careers advice at all levels (DEL is the lead department but DETI has a number of supporting actions).

2.31 In relation to PSA 1, the NI Executive has set a goal which aims ‘to halve the private sector productivity gap with the UK excluding the Greater South East by 2015’. Figure 2.12 highlights that, using this measure, NI’s private sector productivity was estimated to be 94.3% of the UK excluding the Greater South East at the beginning of the PfG period (2008). The corresponding productivity gap is 5.7%, which means that NI would need to improve its relative performance by 2.35 percentage points by 2015 to meet the PfG goal.

\(^{17}\) DETI also leads on PSA 5 relating to tourism.
2.32 These forecasts indicate that NI is expected to improve its relative productivity, although it is not predicted to meet the PfG goal. It should be noted that these forecasts assume a policy neutral base case, where there are no changes to current economic policy over the period, such as those proposed in this report. The Panel believes that the findings of this Review, and its recommendations, will help increase the Executive’s ability to achieve this productivity goal.

2.33 As has been discussed earlier, the current recession is likely to ensure a greater focus is placed on employment as an important policy objective. It is the Panel’s belief that the future for job creation is likely to be considerably more difficult than the past decade. The forecasts for employment in Figure 2.13 suggest that job creation will be slower in the future and employment may not regain its 2008 peak until as late as 2014.
2.34 Lower future growth in construction and retail (now that the major UK retail brands are already located in NI) are expected to remove two important sources of job creation. If economic policy fails to respond effectively to compensate for the future economic challenges, employment growth from 2014/15 onwards may fall to only 5,000 jobs, compared with 13,000 per annum in pre-recession years.

NI’s Value Proposition

2.35 When selling NI to potential investors, there are a number of strengths that Invest NI currently bases its value proposition on:

- A fresh talent pool in one of the youngest populations in the EU;
- A highly educated, English speaking workforce;
- An excellent infrastructure with advanced telecoms and transport networks;
- A competitive cost environment; and
- Generous incentives and ongoing support from Invest NI.

2.36 While the Review Panel consider this to be a relatively attractive business proposition for investors, other UK regions can also offer many of the same advantages. At present, the main differentiating factor between NI and other regions is wages, which is the principal factor behind the competitive cost environment outlined above, although this also extends to other issues such as comparatively low rental costs and other considerations. On average, private sector weekly wages in NI are almost 20% below the UK average, and are lower than every other UK region. In particular, as shown in Table 2.7, NI offers more competitive salaries than many UK and international locations across the full spectrum of jobs in financial and business services (which covers the majority of sectors Invest NI competes in for new FDI).

Table 2.7: Annual Salaries for Jobs in Financial and Business Services (2006)

<table>
<thead>
<tr>
<th>£000s</th>
<th>Junior Accounting Clerk</th>
<th>Junior Developer</th>
<th>Senior Accountant / Supervisor</th>
<th>Customer Service Manager</th>
<th>IT Director / Head of IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belfast</td>
<td>11.2</td>
<td>19.0</td>
<td>29.7</td>
<td>47.6</td>
<td>63.4</td>
</tr>
<tr>
<td>Cardiff</td>
<td>12.2</td>
<td>20.6</td>
<td>32.3</td>
<td>51.7</td>
<td>69.0</td>
</tr>
<tr>
<td>Glasgow</td>
<td>12.4</td>
<td>20.9</td>
<td>32.7</td>
<td>52.4</td>
<td>69.9</td>
</tr>
<tr>
<td>London</td>
<td>15.5</td>
<td>26.1</td>
<td>40.9</td>
<td>65.5</td>
<td>87.4</td>
</tr>
<tr>
<td>Dublin</td>
<td>17.2</td>
<td>27.5</td>
<td>39.9</td>
<td>54.2</td>
<td>66.8</td>
</tr>
<tr>
<td>Paris</td>
<td>16.4</td>
<td>25.3</td>
<td>37.0</td>
<td>52.3</td>
<td>63.1</td>
</tr>
<tr>
<td>San Francisco</td>
<td>19.4</td>
<td>34.9</td>
<td>46.9</td>
<td>74.6</td>
<td>101.7</td>
</tr>
</tbody>
</table>

Source: FDI Intelligence

Note: A common index is applied for the UK regions
These low wages, along with the other selling points outlined above, mean that NI has a relatively strong offering for inward investors, both internationally and compared with elsewhere in the UK. This value proposition is particularly attractive for labour intensive service sectors, such as call centres, which helps explain why NI has been successful in this area. However, the types of firms which choose locations based on cost tend to be in lower value sectors. Moreover, they typically are less embedded in the region, particularly compared to other investments that rely more heavily on value added factors such as access to skilled labour, research / Innovation facilities and infrastructure.

As outlined in Chapter 7, the Panel recognise the need to move from attracting lower value investments in areas such as call centres to higher value added activities. We believe that much greater emphasis should be placed on developing a strong research and Innovation base in NI, and more should be made of the region’s highly-skilled and innovative people (and not solely their comparatively low wages). This shift should help attract and retain quality FDI, and one which moves away from an over-reliance on low costs. There also needs to be much greater integration between SMEs and the supply chains of larger, often inward investment, companies. In summary, the focus of local economic policy needs to differentiate NI from other regions with similar tax regimes, and also help the region compete against other areas with more favourable corporation tax rates. The recommendations contained throughout this report are designed at assisting in this process.
CHAPTER 3
Overview of Current Policies and Spending

SUMMARY OF KEY FINDINGS

- Despite the recent rationalisation of programmes, Invest NI continues to offer a very large and complex number of programmes to businesses in NI.

- Selective Financial Assistance (SFA) is the largest programme Invest NI uses to support businesses. However, changes to EU regional aid rules from as early as January 2011 mean that NI will have considerably less scope to support firms using SFA, with aid ceilings expected to reduce further, potentially to zero, post 2013.

- Taken together, the total value of offers to companies for enterprise, Innovation / R&D and trade promotion (the stated aims in Invest NI Corporate Plans) amounted to only one quarter of all offers of financial support over the Review period. In addition, the assistance to attract companies new to NI added a further 10%.

- Just over 40% of the budget was allocated to business expansion projects already operating in NI, with only 15% directed toward the support of new jobs.

- Almost one-third (30%) of grants offered to companies went to just 10 firms, with almost one half of assistance directed to only 30 companies. Many of these firms have received repeat offers of assistance since 2001.

- In 2008/09, Invest NI increased assistance for priority areas such as Innovation and R&D.

INTRODUCTION

3.1 The previous chapter identified relatively low productivity as one of the main causes of Northern Ireland’s (NI) comparatively low standard of living. It is for this reason that the Executive has made the economy the top priority in its Programme for Government (PfG), and improving private sector productivity is the number one Public Service Agreement (PSA) target. The aim of this chapter is to provide an overview of the policies and programmes operated by DETI and Invest NI to deliver on this objective. We begin, however, by outlining the public expenditure context within which economic development policies are developed.

PUBLIC EXPENDITURE & ECONOMIC DEVELOPMENT

3.2 NI has typically allocated more resources to the economy than elsewhere in the UK. For example, this point is evident when we examine NI’s public expenditure (see Table 3.1). As is apparent, the region has a high level of expenditure per capita on the economy relative to the UK average. Within the broad category of ‘Economic Affairs’, the Enterprise and Economic Development and Science and Technology categories appear to most closely align with the remit of DETI and Invest NI. Spending in NI in the Enterprise and Economic Development category was above the UK average on a per capita basis. Spending on the Science and Technology category was close to the UK average despite the relatively low number of government research institutes in NI.

\[18\] Per capita expenditure on Enterprise and Economic Development was higher than in the English regions but Scotland and Wales spent more on this expenditure category (177% and 185% of the UK average respectively). The Panel, however, considers that these categories may not be consistent between regions, and therefore only benchmarks NI against the UK average. The panel also has doubts about the consistency of PESA programme data between years.
Within the context of the financial resources available to NI, spending on the economy is at the discretion of the Executive. The main resource is the NI ‘block’ which is allocated each year by HM Treasury under the Barnett formula.

Table 3.1: Identifiable expenditure on Economic Affairs in NI (2008/09)

<table>
<thead>
<tr>
<th></th>
<th>Expenditure (£m)</th>
<th>Expenditure per head UK=100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise &amp; Economic Development</td>
<td>305</td>
<td>166</td>
</tr>
<tr>
<td>Science &amp; Technology</td>
<td>67</td>
<td>98</td>
</tr>
<tr>
<td>Employment Policies</td>
<td>196</td>
<td>206</td>
</tr>
<tr>
<td>Agriculture Forestry and Fisheries</td>
<td>539</td>
<td>341</td>
</tr>
<tr>
<td>Transport</td>
<td>543</td>
<td>86</td>
</tr>
<tr>
<td><strong>Total Economic Affairs</strong></td>
<td><strong>1,650</strong></td>
<td><strong>145</strong></td>
</tr>
</tbody>
</table>

Source: Public Expenditure Statistical Analysis 2009 (Table 9.16)

Within the total expenditure on Enterprise and Economic Development, NI has a high level of direct support for private companies. For example, as we discuss later, over half of Invest NI’s assistance to business is provided through the Selective Financial Assistance (SFA) programme to support business investment. In EU terms, this is classified as regional aid. As Figure 3.1 illustrates, NI spends much more than other UK regions on this type of support. However, it is important to recognise that many of the other regions are more restricted in their ability to use SFA given the existing state aid rules (as discussed below).

Figure 3.1: SFA Expenditure by Region (2005/06)

Source: Annual report (2005/06) of the Industrial development Act (1982) and Invest NI

Note: Grants offered and accepted are divided by the total number of employees in NI manufacturing plus NI employees in the financial and business services sectors excluding real estate, renting, labour recruitment, cleaning and security. In NI, grants are SFA and in GB they are grants for business investment (formerly Regional Selective Assistance) plus Enterprise Grants.
3.5 With regard to the other programmes operated by Invest NI, the largest of these relate to Innovation and R&D, training, trade, and starting new / small businesses. These non-SFA programmes are partly, although not wholly, funded by the EU European Regional Development Fund (ERDF) and successive PEACE funds. NI is the second largest recipient of EU funds for economic development under the ERDF programme (after Wales), with over twice the level of support of any other UK region (see Figure 3.2). This also has enabled a relatively high level of spend on non-SFA programmes including R&D, Innovation and training in NI.

Figure 3.2: Projected Annual Spending per Head under the EU ERDF Programme (2007-2013)

Source: Welsh European Funding Office, DCLG, Communities and Local Government, DFP and European Structural Fund Programmes for Lowlands and Uplands Scotland

Note: Northern Ireland includes PEACE III

3.6 Notwithstanding the favourable levels of public resources devoted to the economy in NI, it is clear that the region (along with the rest of the UK) is faced with a tightening public expenditure environment. The Review Panel expects that NI will see very limited cash terms growth in public expenditure, and capital budgets are expected to decline. It is therefore inevitable that DETI and Invest NI will face increasing competition from other important public services, and it is imperative that available funds are allocated effectively in order to maximise the return to investment, jobs and productivity improvements.

EU STATE AID RULES

3.7 In addition to the public expenditure constraint detailed above, there are a number of ‘state aid’ rules imposed by the EU, which limit the extent to which public assistance can be granted to local companies. The rules are designed to avoid any distortion in competition and they set the maximum level of financial support that can be provided to individual projects (as a proportion of total investment or equivalent project costs). State aid to industry is limited to particular sectors and regions with economic problems, and NI traditionally qualified as a less prosperous region. The enlargement

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19 The ERDF is aimed at helping stimulate economic development and regeneration in the least prosperous regions of the EU with funding targeted to three areas: convergence; regional competitiveness and European territorial co-operation. Peace funding (the current programme is PEACE III which runs from 2007 to 2013) is a distinctive EU structural funds programme which is aimed at reinforcing progress toward a peaceful and stable society in NI.
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of the EU to admit a number of much less prosperous states means that NI, as a whole, would no longer qualify. However, the legacy of the ‘troubles’ has led to special treatment, which has extended the period within which regional aid can be offered to companies in NI. Nevertheless, NI is already on a reducing trend with grant ceilings being reduced from as early as the end of next year (see tables below). The current state aid rules apply until 2013, when they will be revised. Uncertainty remains as to what will happen post 2013, although the Panel believe that the scope to provide financial assistance to industry in NI will be greatly reduced. Nevertheless, as outlined in Chapter 7, we recommend that DETI commences work on preparing a case for the treatment and coverage of state aid in NI post 2013, as soon as practicable.

3.8 State aid limits vary depending on the type of aid being offered. Broadly speaking, specific rules are in place for six different categories of aid:

- Regional Aid;
- SMEs;
- R&D&I Aid;
- Risk Capital; and
- Training Aid;
- Temporary Measures.

3.9 The three largest categories of state aids in NI (in 2007) were Regional, R&D&I and Training Aid. They account for the majority of state aid in NI (72%, 10% and 9% respectively), and we therefore limit our discussions to these areas.

3.10 Regional aid is assistance for investment in the setting up of new business, the expansion of an existing business or business diversification into new products. In NI, regional aid is delivered through the SFA scheme. The current and proposed levels of maximum grant intensity for regional aid are shown in Table 3.2. The thresholds are currently above Cyprus, parts of Hungary, and similar to Slovenia and the Border, Midland and Western regions of the Republic of Ireland (RoI). In NI, the grants or loans are usually below the current maximum levels (as we illustrate later), but the reduced ceilings from January 2011 will necessarily result in a reduction in average levels of support. Furthermore, as stated previously, the changing state aid rules post 2013 may see these limits reduced even further, and potentially to zero.

20 Perhaps surprisingly, less than 3% of NI’s state aids come within the EU SME category. This is because maximum aid intensities are higher under the Regional Aid guidelines and they offer greater scope for financial assistance to industry.
### Table 3.2: Regional Aid Intensity Ceilings (% of project gross grant equivalent)

<table>
<thead>
<tr>
<th></th>
<th>Jan 2007 to Dec 2010</th>
<th>Jan 2011 to Dec 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Belfast</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large firms</td>
<td>30</td>
<td>10</td>
</tr>
<tr>
<td>Medium firms</td>
<td>40</td>
<td>20</td>
</tr>
<tr>
<td>Small firms</td>
<td>50</td>
<td>30</td>
</tr>
<tr>
<td><strong>Rest of NI</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large firms</td>
<td>30</td>
<td>15</td>
</tr>
<tr>
<td>Medium firms</td>
<td>40</td>
<td>25</td>
</tr>
<tr>
<td>Small firms</td>
<td>50</td>
<td>35</td>
</tr>
</tbody>
</table>

**Source:** DETI

**Note:** Small firms have less than 50 employees, and medium firms 50-249, and large firms 250+. The Gross Grant Equivalent of the Selective Financial Assistance expressed as a percentage of either: the capital expenditure associated with the project being supported, or the value of two years of the wages and salaries of new jobs created by the project. The Gross Grant Equivalent of any SFA package is the value of grant support plus the value of any subsidies associated with loans or equity investments, discounted to present day value and gross of tax.

3.11 While the reductions in the regional aid ceilings will represent a significant shift in the capacity of DETI / Invest NI to support local businesses, it is important to recognise that the current regime is much more favourable than the majority of other regions in the UK. This is illustrated in Figure 3.3 which presents a high level overview of the limits in place throughout the UK (the precise limits, detailed in Table 3.2, vary by size of firm and location).
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Figure 3.3: Regional aid limits

Source: Department of Business, Innovation and Skills

Note: The GGE of financial assistance is expressed as a percentage of either the capital expenditure associated with the project being supported, or the value of two years of the wages and salaries of new jobs created by the project. The GGE of any SFA package is the value of grant support plus the value of any subsidies associated with loans or equity investments, discounted to present day value and gross of tax.

3.12 An important aspect of regional aid in NI is that it can be offered to firms throughout the region (Figure 3.3). This is not the case in Scotland, Wales or the North East of England, where the location in which firms can be assisted is much more restricted. This is the main reason why the private sector in NI receives more regional aid assistance than other UK regions.

3.13 R&D&I includes all measures and programmes providing aid for R&D and Innovation by, or on behalf of, companies. The financing of non-commercial R&D or Innovation activity is not normally considered to be a state aid, and allowable costs include salaries, equipment and costs of services. Under the state aid rules for 2007-13, a wide range of aid intensities are allowed, depending on the nature of the research, the size of firm and the degree of collaboration between undertakings. A broad outline of the various ceilings is presented in Table 3.3.
Table 3.3: Aid Intensities for R&D Project Aid (% of costs)

<table>
<thead>
<tr>
<th></th>
<th>Through to December 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large firms</td>
<td>25 – 50</td>
</tr>
<tr>
<td>Medium firms</td>
<td>35 – 60</td>
</tr>
<tr>
<td>Small firms</td>
<td>45 – 70</td>
</tr>
</tbody>
</table>

Source: DETI

Note: A collaborative bonus (up to 15%) is also available, which raises the aid ceiling even higher than that shown.

3.14 **Training Aid** accounted for just under 9% of state aid in NI in 2007. State aid is permitted to reduce training costs borne by the firm and, in terms of general training, the maximum aid intensities range from 60-80% of costs – depending on the size of firm. With regard to firm-specific training, the range is much lower at 25-45%.

3.15 The Review Panel are firmly of the view that changing state aid rules will have significant implications for the scale and nature of support that government can offer businesses in NI. In particular, the scope to provide regional aid, currently the main mechanism for providing financial assistance, is likely to be severely restricted over the next few years. However, the limits in place for R&D&I are much more generous, and less likely to be reduced in reforms to state aids, given the objectives of the Lisbon strategy to promote R&D throughout the member states. The prospect that funds are more likely to be available for R&D&I than for other investment projects after 2013, is one reason for the recommendations (presented later in Chapter 7) to realign economic development policy more firmly around Innovation and R&D.

**DETI / INVEST NI POLICIES AND PROGRAMMES**

3.16 The PfG (2008-11) sets out five key priorities for the NI Executive, with ‘growing a dynamic, innovative economy’ as the top priority. The aim is to build a more prosperous society and to address inequality and poverty. DETI takes the lead in this area and has adopted ‘growing a dynamic innovative economy’ as its departmental goal.

3.17 Under this general goal, DETI leads on two priorities for the 2008-11 period and these are included among twenty-three PSAs within the PfG. They are:

- Improving Productivity; and
- Tourism.

3.18 With regard to the broad areas of responsibility, we understand that the department leads on policy development / formulation, whereas delivery is the responsibility of its sponsored NDPBs. This division holds for most areas, although, for the purposes of this Review, it is important to recognise that the department also has policy delivery responsibility in areas such as Energy and Telecommunications. We return to these areas later in this chapter, and we also consider how DETI’s policy development / formulation role could be better delivered in Chapters 7 and 8.

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**Notes:**

21 DETI also makes a significant contribution to PSA 3 (increasing employment) which is led by DEL.

22 It is important to note that overarching telecoms policy is a reserved matter and is the responsibility for the Department for Business, Innovation and Skills.
Overview of Current Policies and Spending

Invest NI

3.19 Invest NI acts under the auspices of DETI and is responsible for the delivery of the policies and strategies in relation to business support in NI. These include encouraging investment (foreign and indigenous), stimulating entrepreneurial activity, increasing exports and trade, promoting R&D / Innovation and providing development support.

3.20 Invest NI was established as a Non-Departmental Public Body (NDPB)\(^{23}\) in 2002 by the Industrial Development Act (NI) 2002\(^{24}\). It was formed following the merger of three existing bodies\(^{25}\) engaged in different aspects of economic development, namely:

- **Industrial Development Board (IDB)** – IDB was responsible for providing, maintaining and safeguarding employment in NI by assisting the establishment and growth of indigenous industry (generally firms employing more than 50 employees), and by encouraging new inward investment to NI;

- **Local Enterprise Development Unit (LEDU)** – LEDU, the Small Business Agency, supported local economic development and promoted the establishment and expansion of small local enterprises (normally employing less than 50 employees); and

- **Industrial Research and Technology Unit (IRTU)** – IRTU was responsible for promoting Innovation, R&D, the use of technology and technology transfer.

3.21 The creation of Invest NI followed a review of economic support structures within the then Department for Economic Development (DED). The report, under the chairmanship of Professor Peter McKie, expressed the view that there was merit in the full integration of support services within a single body offering a fully co-ordinated service\(^{26}\). The team was also of the view that this should only be considered in the context of a wider strategic economic review (Strategy 2010 – referenced in Chapter 5 of this report), and the establishment of devolved government in NI.

3.22 Strategy 2010 was clear on the need to create a single body, stating that ‘bringing all economic services under the direction of one unit would have a number of benefits. It would sharpen the direction and delivery of overall economic development policy, presenting a clearer structure to users and removing the potential for confusion in the marketplace. It would simplify companies’ dealings with the department, and help to ensure that a clear and coherent policy message is presented to potential investors in Northern Ireland’.

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\(^{23}\) An NDPB is defined as: ‘a body which has a role in the processes of government, but is not a government department or part of one. NDPBs accordingly operate at arms length from NI Departments’, *Managing Public Money Northern Ireland*, Department of Finance and Personnel, June 2008.


\(^{25}\) At its formation, Invest NI also incorporated a small element of the NI Tourist Board (NITB).

\(^{26}\) *Review of Structures within DED for delivery of industrial development support services*, Department of Economic Development (DED), April 1998.
3.23 Following devolution, a consultation paper published by DETI\(^\text{27}\) recommended that a single economic development body be created, endorsing the rationale described in Strategy 2010. It was following this process that Invest NI was subsequently established.

**Invest NI’s Mission**

3.24 Invest NI’s mission in its current Corporate Plan\(^\text{28}\) is ‘to increase business productivity, the means by which wealth can be created for the benefit of the whole community’. Since its establishment, the mission statement has evolved over the course of three successive Corporate Plans (see Table 3.4).

**Table 3.4: Evolution of Invest NI’s Mission**

<table>
<thead>
<tr>
<th>Corporate Plan Period</th>
<th>Overall Mission / Aim</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-05</td>
<td>To accelerate economic development in Northern Ireland, applying expertise and resources to encourage innovation and achieve business success, increasing opportunity for all within a renewed culture of enterprise</td>
</tr>
<tr>
<td>2005-08</td>
<td>To deliver expertise and resources to accelerate the creation and growth of businesses committed to, and capable of, being entrepreneurial, innovative and international</td>
</tr>
<tr>
<td>2008-11</td>
<td>To increase business productivity, the means by which wealth can be created for the benefit of the whole community</td>
</tr>
</tbody>
</table>

**Source:** Invest NI

3.25 The emphasis in the 2002-05 Corporate Plan was to encourage firms and / or individuals to become more entrepreneurial, innovative and outward looking. The 2005-08 Corporate Plan continued the same theme, although the mission statement was changed to reflect the need to build capabilities within the NI business base. In addition, the second Corporate Plan introduced a productivity target aimed at reducing the gap with GB, in GVA per hour worked. This goal was consistent with the targets outlined in a policy document which highlighted the ambitions of economic policy more generally in NI (Economic Vision – referenced in Chapter 5).

3.26 Invest NI’s current Corporate Plan describes the means by which the organisation intends contributing toward the PfG productivity goal of halving the gap in GVA per employee with the UK excluding the Greater South East of England by 2015. In order to close this gap, Invest NI has committed to focusing on three priority actions:

- Realising client potential (to promote and embed an Innovation culture within clients firms);
- Shifting the sectoral focus (drive a shift toward higher value economic activity by attracting FDI in target industries, notably financial services, software and ICT. Indigenous firms, whether existing or start-ups, will be ‘boosted’ in high tech

\(^{27}\) *Towards a new structure for economic development support in Northern Ireland*, Department of Enterprise, Trade and Investment (DETI).

\(^{28}\) *Invest NI Corporate Plan 2008-2011*. The document can be accessed at the following link: [http://www.investni.com/index/about/what_invest_ni_does/corporateplan08.htm](http://www.investni.com/index/about/what_invest_ni_does/corporateplan08.htm).
sectors including certain tradable services, niche manufacturing, life sciences and the creative industries); and

- Frontier technologies (this is a longer term aim which draws on the MATRIX Science and Industry panel – outlined later in this chapter – to secure increased commercial outcomes from research, support industrial research within companies and introduce new industry led competence centres).

3.27 The current strategy appears more firmly focused on Innovation than previous Corporate Plans. For example, each of the three priorities focuses on Innovation, high technology and / or R&D. The previous emphasis on entrepreneurship (business start-ups) appears to have been downgraded, although there is reference to the development of a new entrepreneurship strategy, including the social economy. In addition, exporting appears not to receive the explicit priority accorded to it in previous Corporate Plans, despite still being one of three criteria necessary to qualify as an Invest NI client company (further details on the criteria are outlined later in this chapter). The key question, of course, is the extent to which the nature of support offered by Invest NI has changed to reflect the shift in strategic priorities. We offer views and analysis of this issue later in the chapter.

DETI and Invest NI Targets

3.28 In terms of productivity and employment, some of the specific delivery targets within the DETI and Invest NI Corporate Plans are as follows:

- Increase sales outside NI per employee of Invest NI manufacturing clients by an average of 6% per annum in real terms, and tradable-services clients by an average of 4%;
- Increase by 3 percentage points sales outside the UK as a proportion of total sales by Invest NI client companies, excluding the top 25 exporting companies;
- Secure total annual wages and salaries of £345 million from inward investment and locally owned clients. This represents an 8% increase over the three-year period ended 2006/07;
- Promote 6,500 new jobs from inward investment, of which:
  - 5,500 will provide salaries above the Northern Ireland Private Sector Median; and
  - 2,750 will have salaries at least 25% above the Northern Ireland Private Sector Median.
- Increase the business expenditure on R&D by Invest NI client companies with less than 250 employees by an average of 8% per annum in real terms, and client companies with 250 employees or above by an average of 5%;
- Support 45 new start-ups selling outside the UK;
- Support 300 start-up businesses selling to GB;
- 75% of land acquisition (acres) to be in areas of economic disadvantage; and
- 70% of new FDI projects secured to locate within 10 miles of an area of economic disadvantage.

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29 As tourism is outside the remit of this Review, we have not included the targets relating to the tourism PSA priority.
3.29 In their current Corporate Plan, DETI have revised their targets to make them more specific and attainable. The Panel supports this change, which is a move in the direction of more meaningful targets, but feel they should be further improved. One shortcoming is that most of the targets are expressed in absolute terms and hence are affected by national and international economic conditions.

3.30 Detailed targets are better expressed in terms relative to the UK average, as is the case for the Executive's overall goal of halving the private sector productivity gap. Since the NI economy is heavily influenced by national and international policy and events, much that happens is beyond local control. For example, tax, interest and exchange rates are important influences on economic performance but are outside of local control. Policies determined within NI will have a clearer influence on NI's performance relative to the UK average than on the absolute performance. DETI is therefore correct to express its overall aim as reducing the productivity gap with GB excluding the Greater South East of England. This logic, however, should also be followed in most or all of its individual targets, including inward investment (as a share of inward investment coming into the UK) and exports (as a share of UK exports). This will avoid the need to include warning notes in the Corporate Plan about changes in economic conditions. Targets which can be easily impacted by fluctuations in national or international economic conditions are unlikely to be taken seriously by those charged with delivery. In contrast, targets in relative form can be monitored consistently over time, irrespective of national and international economic conditions.

3.31 The Panel believe that Invest NI's presentation of jobs promoted in the category of foreign direct investment (FDI) is not as transparent as it should be. For example, in the Invest NI annual performance reviews, figures for FDI include investment by externally-owned companies that are already operating in NI. This includes new and expansion projects by existing externally-owned firms, as well as investment by firms new to NI. The composition of the ‘new FDI’ category tends to change over time and the current approach is obscuring the difficulty in attracting new firms to NI in economic downturns.

3.32 These observations underlie the recommendations presented later that, wherever data availability and quality allows, ‘impact’ targets for economic development should be expressed in relative terms (i.e. relative to a UK average) and targets for inward investment should include a target for jobs in firms new to NI (expressed as a share of equivalent jobs coming into the UK). The Panel consider this distinction as important because it views investment by firms new to NI as likely to have a higher level of additionality than investment by existing firms.

DETI’s Role in Policy Making

3.33 As outlined earlier, DETI leads on policy development / formulation, whereas delivery is the responsibility of its sponsored NDPBs – Invest NI in the case of business support. Policy development is an ongoing process and, in support of the policy cycle, DETI undertakes economic research and analysis in order to inform policy development. The department also evaluates the effectiveness of policy and its delivery. The findings of

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30 The Panel believes that relative targets are the most appropriate means of measuring the overall economic impact of Invest NI assistance. However, we acknowledge that absolute activity and output targets also have an important role to play in performance management and monitoring.

31 Invest NI have made considerable efforts to obtain comparative data on inward investment relative to other regions, although this does not form part of the performance targets. Invest NI’s comparative performance in FDI was outlined in Chapter 2 and is also considered further in Chapter 4. Our figures differ from those published by Invest NI in that they attempt to exclude investment projects by existing firms within each region.
the evaluations are designed to be fed back into the policy development stage, to refine existing policy and inform new policy development in conjunction with the evidence from the DETI research agenda.

3.34 Given that economic development is now the main priority of the Executive, it is essential that policy development, evaluation and monitoring are adequately staffed in terms of both numbers of staff and requisite ability. Furthermore, the division of labour between DETI and Invest NI, described in the first Invest NI Corporate Plan, has, in our view, never been fully implemented. While DETI takes the lead in setting PSA targets for economic development and in producing some strategy documents, these are set in general terms while much more detailed and active programme design occurs within Invest NI.

3.35 As stated previously, DETI currently has an important lead responsibility for setting PSA targets adopted by the Executive for economic development as part of the PfG. However, the Panel consider that these targets could be better connected, both formally and quantitatively, to the strategies or policies within DETI, Invest NI (or other related departments). While subsidiary strategies or policies are linked to the PSA targets, the mechanisms to ensure and check whether such polices make a significant contribution to achieving the PSA targets could be improved. In this context, the targets become statements of aspiration, indicating a desired direction of travel. We accept that the targets should be signals of intent; however, they also need to be more clearly connected to the policy levers with an indication of the resources and policies that deliver on the targets. As we propose later, DETI should develop a framework which more fully links the overall goal of halving the productivity gap with detailed targets indicating how the latter will contribute to the former.

3.36 An important part of the policy-making process is the monitoring and reporting of performance. This function is split between DETI and Invest NI in unhelpful ways. No organisation should have primary responsibility for reporting on its own performance. Invest NI currently produces its own annual Performance Information reports, however, in our view DETI should assume lead responsibility for reporting on Invest NI’s annual performance with the co-operation of Invest NI statistical staff.

3.37 In terms of policy development, DETI has currently two Divisions that are separately responsible for economic research (Strategic Planning, Economics and Statistics, SPES) and evaluation (Strategic Policy Division, SPD). These Divisions also cover a much wider range of responsibilities, including economic briefing, corporate planning, project appraisal (SPES) and delivery of certain policies relating to telecoms, Innovation and enterprise (SPD). Under the existing structure, DETI has developed a number of economic policies in recent years, including:

- Economic Vision;
- Regional Innovation Strategy;
- Draft Enterprise Strategy;
- Strategic Energy Framework;
- Strategic Framework for Tourism; and
- Social Economy Strategy.
3.38 The Panel acknowledge the extent of policy development which has taken place within DETI. However, we believe that there are too many separate economic strategies for a small region such as NI. Our view is that an overarching economic strategy, proposed later in Chapter 8 and developed by DETI, should be able to sufficiently capture the critical issues relating to areas such as Innovation and enterprise.

3.39 Having reviewed NI’s existing economic policies, the Panel believe that a future strategy should include a much stronger analysis of the issues being addressed and the proposed impact of measures being proposed. This would ensure that policies and strategies are more analytical and less aspirational in nature. For this reason, we are not convinced that the current structure within DETI – with policy analysis and development being separated – represents the best approach to ensure effective economic policy development going forward. Furthermore, the process of analysing and monitoring policy should also be strengthened by the appointment of an independent economic advisor (to work, as necessary, alongside relevant officials and the advisory unit also proposed in Chapter 8). For example, we envisage that this advisor could be called on to provide technical economic advice on evaluation and appraisal methodology, and the interpretation and implementation of findings and recommendations. The Panel are therefore of the view that the strategy function within DETI should be reviewed with the aim of strengthening capacity to develop and monitor economic policy.

Invest NI & Client Companies

3.40 Importantly, the mission and performance targets of Invest NI (and, by extension, DETI) relate only to ‘client companies’. In order to qualify as a client, an enterprise should have or plan to have:

- Total sales of over £100,000 per annum;
- Sales outside NI of at least £250,000 per annum (or 25% of turnover); and
- For companies in the tradable services sector, they must have the potential to sustain salaries above the NI private sector median or show that they can achieve a minimum gross margin of 20%.

3.41 There are currently around 2,500 client companies and they account for 90% of NI’s exports and 95% of business research on R&D. With only 5% of registered businesses in NI forming part of the Invest NI client base, there remains some controversy about eligibility and a view expressed to the Review Panel is that support to a wider range of businesses would be advantageous for the economy.

3.42 At one level, the Panel understand the semi-permanent nature of the client base, as it reflects the importance of establishing and maintaining ongoing relationships with companies receiving support. It is also recognised that companies effectively have a contract with Invest NI during the period which a project is assisted (and monitored). However, we believe that the existing client status – which requires firms to meet the criteria outlined above – limits the ability of Invest NI to support the wider business base in areas where market failure also exists.

3.43 The Panel also believes that the combination of a client-based approach with the general availability of grants, means that firms are able, and indeed expected, to apply repeatedly for government aid. The framing of performance targets to relate solely to client companies also means that there are in-built incentives to devote significant
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resources to the same companies. There is no expectation in the system that firms should be ‘weaned-off’ government aid at any stage. Therefore, as we indicate later, the Review Panel propose that the concept of ‘clients’ is removed and that Invest NI works with the entire business base to raise awareness and provide support for Innovation, R&D and exports. This move will also enable performance targets to be expressed for the NI economy as a whole, and relative to other parts of the UK (as discussed earlier in this chapter).

Invest NI – Policies and Resources

3.44 The majority of business support is administered via programmes operated by Invest NI (Table 3.5). Therefore, in the following paragraphs we focus our discussions on providing an overview of Invest NI’s programmes (alongside the profile of support offered under the separate programmes). The sub-regional distribution of assistance is also discussed later in this chapter. We have also narrowed our focus of DETI’s policy delivery role to the two areas that are directly relevant to the current Review – energy and telecommunications, which are both discussed under ‘economic infrastructure’. It should be noted that the impact of the programmes in terms of investment, employment and productivity is discussed in the next chapter.

Table 3.5: DETI and Invest NI Budget

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<td>DETI</td>
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<td>Invest NI</td>
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<tr>
<td>Grants &amp; Programme Expenditure</td>
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<td>Staff Costs</td>
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<td>Capital Adjustment</td>
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<td>16</td>
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<td>6</td>
</tr>
</tbody>
</table>

Source: DETI and Invest NI

3.45 Invest NI currently operates a suite of fifty-seven programmes aimed at providing assistance to businesses in NI. The Review Panel welcome the rationalisation of programmes that has taken place in recent years. However, there remains a large and complex portfolio of support mechanisms. For example, recipients may receive assistance under more than one programme, at any one time, and packages of assistance are often put together for individual companies. This complexity has inevitably influenced the presentation of key findings in this part of the report.

3.46 Figure 3.4 presents a high level overview of Invest NI’s three main areas of intervention (business formation / expansion; business innovation and capability development and infrastructure). Also presented is the number and nature of the key support programmes available to businesses in NI. We appreciate that this presentation does not fully reflect the cross-cutting nature of Invest NI programmes, but it is included to provide an indication of the main programmes used in each area.
Figure 3.4: Overview of Invest NI Support (2008/09)

Invest NI Programmes

- Business Formation and Expansion
- Business Innovation and Capability Development
- Infrastructure and Energy

Number of programmes by areas:

- Inward Investment: 2 Programmes
- Enterprise: 38 Programmes
- R&D/Innovation: 18 Programmes
- Skills and Trade: 4 Programmes
- Infrastructure and Energy: 4 Programmes

Key programmes:

- Selective Financial Assistance (SFA)
- Small Business Support Programme
- Growth Accelerator Programme
- START
- Complete
- Centres of Excellence
- Knowledge Transfer Partnership
- Business Improvement Training Programme
- Passport to Export
- Carbon Trust
- Property Solutions

Source: IREP Analysis

Note: Some programmes cut across more than one area, therefore the total will add to greater than 57. Programmes do not reflect more recent changes such as the new Grant for R&D programme, which has subsumed START and Compete; Programmes are placed under headings using Invest NI’s categorisations provided to the Panel.

3.47 Table 3.6 indicates that only nine programmes are associated with offers of assistance totalling £5m or greater over the 2002/03 – 2007/08 period, and the analysis presented in this chapter focuses on these programmes (which represent 84% of total programme expenditure). This point also underlines the importance of a recommendation (presented later), namely that despite the recent rationalisation of programmes, the Panel believe that additional steps should be taken to streamline the number of assistance programmes further.
Table 3.6: Programmes Offering in Excess of £5m (2002/03 - 2007/08)

<table>
<thead>
<tr>
<th>Programme</th>
<th>Intervention area</th>
<th>Total Assistance (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selective Financial Assistance</td>
<td>Company Formation &amp; Expansion</td>
<td>418</td>
</tr>
<tr>
<td>Company Development Programme</td>
<td>Innovation &amp; Capability Development</td>
<td>60</td>
</tr>
<tr>
<td>Centres of Excellence</td>
<td>Innovation &amp; Capability Development</td>
<td>44</td>
</tr>
<tr>
<td>Compete</td>
<td>Innovation &amp; Capability Development</td>
<td>33</td>
</tr>
<tr>
<td>START</td>
<td>Innovation &amp; Capability Development</td>
<td>30</td>
</tr>
<tr>
<td>Trade / Passport to Export</td>
<td>Innovation &amp; Capability Development</td>
<td>22</td>
</tr>
<tr>
<td>Knowledge Transfer Partnership</td>
<td>Innovation &amp; Capability Development</td>
<td>11</td>
</tr>
<tr>
<td>Start a Business Programme</td>
<td>Company Formation &amp; Expansion</td>
<td>10</td>
</tr>
<tr>
<td>Proof of Concept Scheme</td>
<td>Innovation &amp; Capability Development</td>
<td>5</td>
</tr>
<tr>
<td><strong>SUB-TOTAL</strong></td>
<td></td>
<td><strong>633</strong></td>
</tr>
<tr>
<td>Assistance provided under all other programmes</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td><strong>TOTAL ASSISTANCE</strong></td>
<td></td>
<td><strong>756</strong></td>
</tr>
</tbody>
</table>

Source: IREP database

Note: Table only includes programmes provided by Invest NI. It excludes funding given to third sector organisations for the provision of programmes (such as Carbon Trust and some support for business start-ups). A number of programmes have recently been re-branded. The Company Development Programme is now the Business Improvement Training Programme; the Start a Business Programme is now Enterprise Development Programmes, Centres of Excellence has been replaced by Competence Centres, and Compete and START have been subsumed within the new Grant for R&D programme. KTP is co-funded by Invest NI and the Technology Strategy Board.

3.48 Selective Financial Assistance (SFA) is clearly the most significant programme Invest NI uses to support businesses in NI – accounting for 55% of Invest NI support during 2002/03 - 07/08. Assistance may be given on a discretionary basis to viable projects to create, expand or sustain productive capacity, or promote development / modernisation and efficiency.

3.49 Legislative authority for SFA (given under section seven of the Industrial Development (NI) Order 1982) describes how assistance can be given to projects likely to provide, maintain or safeguard employment in any part of NI. This focus on employment creation / safeguarding is somewhat inconsistent with Invest NI’s overall aim, which is to stimulate wealth creation via productivity improvements, rather than job creation / protection. Employment objectives are important, particularly in the context of the ongoing recession, however, there is an obvious inconsistency between Invest NI’s stated mission (improving productivity), and the legislative authority of its main mechanism for delivering on this. However, the Panel recognise that, in practice, projects are also assessed on wealth creation and productivity parameters in addition to job creation / protection metrics.

3.50 An important aspect of the legislation is the stipulation that projects must be additional to what would have occurred in the absence of assistance. Companies must be able to ‘demonstrate convincingly that without assistance the project would either not go ahead at all in NI, or would go ahead on a smaller scale or within a longer timeframe’. The general rule is that SFA is provided as assistance of last resort, however, as we discuss in Chapter 4, identifying ex-ante whether a project is truly additional in practice is extremely challenging.
Similarly, projects which create over-capacity or displace jobs elsewhere in the UK are ineligible for SFA assistance. In practice, this means that only firms with potential to export from the UK are eligible to become clients and receive assistance. Broadly speaking, investments eligible for support under SFA include capital expenditure on fixed assets (property, machinery, patents etc) and jobs related to investments involving the:

- Setting up of a new, or expansion of an existing, establishment;
- Starting up of an activity involving a fundamental change in a product or process, through rationalisation, diversification or modernisation; and
- Purchase of an establishment which would otherwise have been closed.

Table 3.7 presents an overview of the aims and objectives of the remaining major programmes provided by Invest NI. The paragraphs that follow provide a description of the profile of assistance offered by these programmes. Furthermore, as stated previously, Annex B provides a more detailed analysis of the remit and impact of the Invest NI programmes.

### Table 3.7: The Aims of Significant Invest NI Programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Aim</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selective Financial Assistance</td>
<td>Support investment and employment related projects to increase business productivity in Northern Ireland</td>
</tr>
<tr>
<td>Company Development Programme</td>
<td>Assist companies to improve competitiveness and performance through the workforce development of both managers and employees</td>
</tr>
<tr>
<td>Centres of Excellence</td>
<td>Stimulate leading edge, commercially focussed research in order to improve the competitiveness of Northern Ireland industry and enhance the market driven capability within local Universities</td>
</tr>
<tr>
<td>Compete</td>
<td>Stimulate manufacturing businesses to develop innovative and high technology products and processes, and to increase the level and quality of near market research and development</td>
</tr>
<tr>
<td>START</td>
<td>Increase the level of industrially relevant applied research undertaken by locally based companies either on their own or in partnership with Universities</td>
</tr>
<tr>
<td>Passport to Export</td>
<td>Helps businesses to access new customers and compete successfully in export markets by developing effective export strategies</td>
</tr>
<tr>
<td>Knowledge Transfer Partnership</td>
<td>Help businesses improve their competitiveness through better use of the knowledge technology and skills that resides within higher education institutions and further education colleges</td>
</tr>
<tr>
<td>Start a Business Programme</td>
<td>Provide a structure of training, advice and financial support to increase the stock and viability of small businesses in Northern Ireland</td>
</tr>
<tr>
<td>Proof of Concept</td>
<td>Supports the pre-commercialisation of leading edge research emerging from the two Universities</td>
</tr>
</tbody>
</table>

Source: Invest NI

---

See Annex C (on economic appraisal for projects involving financial assistance to industry) which provides a critique on the concept of crowding out.
Profile of Assistance Offered

3.53 As outlined in Chapter 1, the Review Panel constructed a database of information on the assistance offered to businesses by Invest NI during the period 2002/03 – 2007/08. This was necessary to inform the assessment of the impact of the policies and programmes, as the information was not contained within a single database. The Review Panel are grateful for the support provided by Invest NI in the construction of the database, although the absence of a single unique company reference meant that this remained a considerable exercise. Furthermore the lack of a matched dataset containing information on both the support offered / drawn down represents a significant shortcoming of the Invest NI Management Information System (MIS). Invest NI have informed the Panel that steps have, and are being taken to improve data collation going forward and the Panel welcome this initiative.

3.54 In total, the IREP database contains the details of more than 32,000 offers, which were subsequently matched to the monitoring information (held by Invest NI) on the firms to which support was offered. This information was also merged and matched with a range of DETI surveys (covering performance indicators such as R&D, Exports / External Sales, Employment and Output) to produce the bespoke IREP database that has been used to base our current analysis and, where relevant, recommendations.

Given the size and nature of the database, the figures presented in this report may not always reconcile precisely with published data. However, these differences are only marginal and importantly they do not alter the conclusions drawn from the analysis of the IREP database. We have also presented a specific recommendation in Chapter 7 on how the information we have gathered could be used to monitor and report on Invest NI performance going forward.

3.55 The Invest NI information on the IREP database reveals that, over the six year period, Invest NI made offers of assistance of over £750m on grants and programme-related expenditure, at an average of £126m of support per annum. Table 3.8 provides a summary of the value of Invest NI offers of assistance during the period 2002/03 – 2007/08, disaggregated by support for business formation; expansion of existing companies and R&D, exports and training support. Furthermore, the Review Panel have worked to distinguish the assistance offered to locally owned and externally owned companies.
Table 3.8: Summary of Invest NI Offers of Assistance 2002/3 – 2007/8 (£m)

<table>
<thead>
<tr>
<th>BUSINESS FORMATION</th>
<th>Locally Owned</th>
<th>Externally Owned</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Inward Investment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First time NI</td>
<td></td>
<td>73</td>
<td>73</td>
</tr>
<tr>
<td>Pre-existing Companies</td>
<td></td>
<td>29</td>
<td>29</td>
</tr>
<tr>
<td>New Small firms</td>
<td>52</td>
<td></td>
<td>52</td>
</tr>
<tr>
<td>EXPANSION OF EXISTING COMPANIES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Involving New Jobs</td>
<td>61</td>
<td>50</td>
<td>110</td>
</tr>
<tr>
<td>Involving Safeguarded Jobs</td>
<td>12</td>
<td>102</td>
<td>114</td>
</tr>
<tr>
<td>Classified as Non Job related</td>
<td>93</td>
<td></td>
<td>93</td>
</tr>
<tr>
<td>R&amp;D, EXPORTS, TRAINING</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D</td>
<td>93</td>
<td>35</td>
<td>128</td>
</tr>
<tr>
<td>Training</td>
<td>24</td>
<td>36</td>
<td>60</td>
</tr>
<tr>
<td>Trade</td>
<td>12</td>
<td>10</td>
<td>22</td>
</tr>
<tr>
<td>Other</td>
<td>63</td>
<td>13</td>
<td>76</td>
</tr>
<tr>
<td>TOTAL</td>
<td>409</td>
<td>347</td>
<td>756</td>
</tr>
</tbody>
</table>

Source: IREP database

Note: Figures refer to assistance given to companies, Universities and third sector organisations.

3.56 Of the total assistance offered, the vast majority was in the form of grants (95%), whereas loans and equity assistance accounted for only 2% and 3% respectively. Furthermore, Table 3.9 reveals that much of this grant support has been concentrated on a small number of firms in NI.

Table 3.9: Total Grants 2002/3 – 2007/8

<table>
<thead>
<tr>
<th>Rank of Companies</th>
<th>Total grants offered (£m)</th>
<th>Grants per Firm (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 10</td>
<td>186.9</td>
<td>18.7</td>
</tr>
<tr>
<td>10 - 20</td>
<td>60.1</td>
<td>6.0</td>
</tr>
<tr>
<td>20 - 30</td>
<td>39.3</td>
<td>3.9</td>
</tr>
<tr>
<td>30 - 50</td>
<td>51.8</td>
<td>2.6</td>
</tr>
<tr>
<td>50 - 100</td>
<td>65.1</td>
<td>1.3</td>
</tr>
<tr>
<td>Total top 100</td>
<td>403.3</td>
<td>4.0</td>
</tr>
<tr>
<td>100 - 250</td>
<td>73.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Total Top 250</td>
<td>477.0</td>
<td>1.9</td>
</tr>
<tr>
<td>All Companies</td>
<td>614.4</td>
<td>0.04</td>
</tr>
</tbody>
</table>

Source: IREP database

Note: This table only includes offers to companies, and excludes £131m of assistance to Higher Education and other organisations over the period of the Review. It also excludes aid to new small start-ups through the Start a Business programme which is delivered through enterprise agencies.

3.57 Before commenting on the profiles presented in Tables 3.8 and 3.9, it is important to be clear on the information that is being described. The IREP database, and consequently the analysis presented throughout this chapter and Annex B, relate to the offers of assistance made by Invest NI to businesses. Not all of the assistance offered is actually drawn down by the businesses in question. Similarly, when jobs data are presented, this only relates to the number of jobs that Invest NI has agreed to promote or safeguard, if the offer of assistance is fully taken by the business seeking support. In
Overview of Current Policies and Spending

practice, a few projects fail to materialise, and others create / safeguard fewer jobs than anticipated at the time of offer.

3.58 The Review Panel would have preferred to analyse information relating to actual assistance provided, and the actual number of jobs created / protected. Unfortunately, as discussed above, Invest NI’s MIS does not hold this historical information in a format that would enable it to be collated and analysed by the Review Panel. The absence of this information constrains the analysis that can be undertaken, although we believe that the conclusions drawn on the basis of the offer data remain valid.

3.59 It is important to be clear that the actual output of Invest NI support in terms of the investment levered, or jobs promoted by projects, is not the same as the economic impact of this support. In assessing the economic impact, the Panel have sought to identify (from recent evaluations and other analysis) the additional activity that Invest NI support has been able to lever over and above what would have happened in the absence of assistance. This evidence is presented in the next chapter. The points below provide a number of important observations on the profile of support offered, and its intended outputs:

• Slightly more than half of the total grant and programme offers were accounted for by locally owned organisations. If the R&D grants to the Universities are subtracted from the locally-owned total, then locally-owned and externally owned companies received similar amounts, i.e. around £350m for each group over the period;

• Surprisingly little of the total aid offered (slightly less than 10%) was spent on attracting 70 new first-time externally-owned companies to NI, almost all in the service sectors. An additional 4% of the finances offered went to 19 new projects by externally owned companies already located within NI;

• Only 7% of the finance offered was for new locally-owned start-ups. Half of this was spent on offers to 1,127 companies identified as having the potential to grow and export, while the other half was offered to 18,249 new and generally very small start-ups across a wide range of locally oriented sectors. These were mostly handled through the network of enterprise agencies, but 119 firms were started with assistance from social organisations including the Prince’s Trust;

• Just over 40% of assistance offered went towards expansion projects of companies already in NI. This includes:
  – 15% supported new jobs (in 484 locally owned and 47 externally-owned firms). While the new jobs in externally owned firms were mainly in the service sectors, the new jobs in locally owned companies were mostly in manufacturing firms;
  – A further 15% supported safeguarded jobs, mainly in 22 externally owned manufacturing firms; and
  – The final 12% were in support of expansion projects in locally-owned companies for which no job promotions were recorded.

• The remainder of the assistance offered (38%) went to companies for R&D, trade, training and other business development. Part of the assistance was directed to Universities to finance business-related research, but the significant majority went to companies, and predominantly to locally owned firms:
– 13% of the total finance offered went to companies for R&D projects through the Centres of Excellence, Start, Compete, Proof of Concept and Knowledge Partnership programmes, with the remaining 4% of R&D spend going to Universities;

– 8% of the total finance offered was for workforce training through the Business Improvement Training Programme (formerly the Company Development Programme); and

– Surprisingly, given the importance of exporting to economic development (as outlined in Chapter 5), only 3% of finance offered was for projects directly promoting trade. It is, however, acknowledged that a wide range of new and expansion projects are likely to have led to higher levels of exports from NI.

- Taken together, the value of offers to companies for enterprise, R&D&I and trade promotion amounted to around one quarter of all offers of financial support. In addition, the assistance to attract companies new to NI added a further 10%. We accept that other areas will contribute to the aims outlined in the Invest NI Corporate Plans, however, it is surprising that these categories attracted such a low proportion of total funding; and

- 30% of all grants offered to companies in the period 2002/3 – 2007/8 went to only ten companies\textsuperscript{33}. These companies received on average almost £19 million each, or just over £3 million (on a per annum basis). The firms employed 14,500 people in 2007, or 10% of NI’s employment in manufacturing and tradable services. In addition, almost half of the £614 million offered to companies in this period went to only thirty companies. Many of these firms received repeat offers of assistance over the course of the six year period. We reflect further on the issue of repeat assistance when the recommendations for change are outlined later in the report.

3.60 Finally, in terms of profiling the assistance offered, the Panel have presented the results from an analysis of the sub-regional distribution of support (in line with our Terms of Reference). Figures 3.5 and 3.6 provide information on the number and value of offers of assistance provided to businesses in each of NI’s District Councils. It is evident that support is significantly skewed towards the urban areas of Belfast, and to a lesser extent Londonderry/Derry.

\textsuperscript{33} In order of grants offered, the companies were Seagate, Bombardier, Citibank, Randox, Firstsource, F G Wilson, Northbrook, Almac, Nacco and Coca-Cola Bottlers.
3.61 It is also important to assess the sub-regional assistance on a per head basis and the profile is understandably less marked. For example, the highest level of assistance per head of population was directed to Belfast and followed by Larne, Londonderry/Derry, Craigavon and Antrim (see Figure 3.7). In each of these areas, firms received offers of assistance over the six year period equivalent to more than £500 per head of population. The areas with the lowest levels of assistance tended to be districts within easy commuting range of Belfast. These areas all received less than £200 per head of population.
3.62 Because a large proportion of assistance was offered to existing companies, especially manufacturing firms, the pattern of assistance within NI tends to reflect the concentration of such companies in the main towns and cities especially in Larne, Londonderry/Derry, Craigavon and Antrim. The fact that almost a third of assistance went to only ten companies also means that the location of these companies heavily influences the geographical distribution of assistance. Furthermore, as much of the inward investment in recent years has been in contact centres, which seek large pools of labour, this means that many of the new companies have located in large urban areas (Belfast and Londonderry/Derry in particular).

3.63 In light of the sub-regional distribution of support to business throughout NI, Chapter 5 stresses the importance of government policy not seeking to unduly influence the location of FDI within NI. It is important to allow companies the scope to locate where they can operate most profitably. However, Chapter 8 highlights the urgency of developing an economic strategy which co-ordinates business and transport policy to efficiently connect people and jobs to their given location preference. With the relatively small size of NI, the Panel are of the view that cities should be recognised as the catalyst for growth, but there should also be a strong emphasis linking places where firms are best located to where workers wish to live.

VENTURE CAPITAL & ECONOMIC INFRASTRUCTURE

3.64 DETI and Invest NI also have a role to play in relation to venture capital and economic infrastructure and this is outlined below.

Venture Capital

3.65 We provide an overview of Venture Capital (VC) in NI, and in particular, the nature and extent of Invest NI’s involvement in the local VC market. Specifically, the Panel identifies the very low levels of VC activity in NI and we probe the extent to which this is due to market and / or government failure.

3.66 There is a significant body of evidence that access to private equity can have considerable benefits for individual companies and an economy in general.\[34\]

\[34\] For further discussion, see the British Private Equity and Venture Capital Association (BVCA) report, The Economic Impact of Private Equity in the UK.
However, while data on the scale of activity in the local VC market is limited, what is available highlights the small size of the market in NI. For example, information published by BVCA indicates that in 2007, £26 million of private equity was deployed in NI by its members, representing only 0.2% of total investment (see Table 3.10). This compares unfavourably with £393 million in Scotland and £128 million in Wales (nearly £12 billion was deployed across the UK in total).

Table 3.10: Investment by BVCA members in 2007

<table>
<thead>
<tr>
<th>Region</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>South East</td>
<td>20.8%</td>
</tr>
<tr>
<td>London</td>
<td>47.9%</td>
</tr>
<tr>
<td>South West</td>
<td>1.7%</td>
</tr>
<tr>
<td>East of England</td>
<td>4.4%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>3.5%</td>
</tr>
<tr>
<td>East Midlands</td>
<td>6.7%</td>
</tr>
<tr>
<td>Yorkshire and the Humber</td>
<td>4.2%</td>
</tr>
<tr>
<td>North West</td>
<td>5.0%</td>
</tr>
<tr>
<td>North East</td>
<td>1.3%</td>
</tr>
<tr>
<td>Scotland</td>
<td>3.3%</td>
</tr>
<tr>
<td>Wales</td>
<td>1.1%</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

Source: BVCA

In addition, over the period 2005 to 2007, only five Management Buy Out / Management Buy In deals were completed in NI by BVCA members, compared with forty and thirty-two in Scotland and Wales respectively (see Figure 3.8). Furthermore, a study for the BVCA on the economic impact of private equity in the UK regions in 2006/07 did not include NI because of a reported insufficient level of activity to register.

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35 A management buyout (MBO) is a form of acquisition where a company's existing managers acquire a large part or all of the company. A management buyin (MBI) occurs when a manager or a management team from outside the company buys it, and becomes the company’s new management.

3.68 With the exception of Enterprise Equity, all VC funds in NI, past and present, have, at their core, public sector funding. The Government funding has been invested through both DETI and Invest NI to encourage and leverage private sector investors (see Box 3.1). It plays a subordinate role to the private sector funding. This is designed to enable private investors to be the first recipients of a revenue stream realised on successful projects, and therefore reducing the risk involved in VC activity for private investors. However, the subordination has the effect of turning the public contribution into state aid for the companies that are invested in by the VC fund.

3.69 In addition to the VC funds, Invest NI supports the Higher Education sector through the QUBIS and UUtech. The University Challenge Fund (UCF) is also a national initiative (a joint bid by QUB and UU secured £2.75m from a UK-wide competition for funding for NI). Invest NI also runs the Proof of Concept Universities scheme\(^{37}\), which provides grants up to £100k and contributes to the funds for NITech, which is managed by Clarendon Fund Managers. From early July 2009, Invest NI has set up a new VC fund called NISPO and further details on Invest NI activity in the VC market is detailed in Box 3.1.

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\(^{37}\) There is also a £3 million Proof of Concept non-Universities scheme for SMEs, which is managed by e synergy.
### BOX 3.1: INVEST NI / DETI ACTIVITY IN THE VC MARKET

- **NISPO** – £10 million of which £7 million for new equity investment in seed and early stage businesses; £50k to £250k:
  - £5 million equity – Invest Growth Fund – early stage, £50k to £250k – number of deals per annum, five year investment period
  - £2 million equity – £1m each for QUB and UU – seed, £125k – number of deals per annum, four year investment period
  - £3 million Proof of Concept grants, non university sector and complements university POC scheme currently in place
  - Intellectual Property Exploitation Unit – carry out SME IPEU activity
  - Investment Readiness and Showcasing events

- **Crescent Capital I** – started in 1995, this £14m fund received 50% of its monies from Invest NI. It is fully invested and closed in 2007;

- **Crescent Capital II** – £22.5 million fund; set up in 2004, Invest NI is a 33% investor in the fund on a subordinated basis. It has a six year investment period with less than eighteen months left to run. It is the successor to CCI with 50% subordination and almost meeting return to private investors; £250k to £1.5 million;

- **NITech 1** – launched as a £3m pilot by the Industrial Research and Technology Unit in 2003 to provide deal flows typically of between £5k-£250k. This is fully invested, with the exception of some limited follow on investment in selected projects;

- **Invest Growth Fund** – launched in April 2009 and managed by E-Synergy. It can invest from £50k to £250k;

- **Viridian Growth Fund** – this £10m fund (of which DETI was a 50% investor) is fully invested. There are some funds available for follow on investment in selected projects; and

- **Halo** – Northern Ireland business angel network which Invest NI and IntertradeIreland will support for the next two years.

In addition to the current activity, Invest NI has a number of proposals for VC going forward, including:

- **Co-investment**: fund available on a deal for deal basis over £250k;

- **Fund model**: matched public sector intervention at fund level with private sector, where public monies would play a subordinated role. This would create a development fund offering investments of between £500k to £1.2 million, which is in line with the EU State Aid requirement of €1.5 million upper limit; and

- **Use of Young Innovative Enterprise scheme and funding**: offers access to €1.25 million from EU, used to provide equity from NISPO and R&D grant from Invest NI.
3.71 The key issue for the Review Panel have been the extent to which the limited VC activity results from low levels of demand for VC services and / or gaps in their supply. The Varney Review into the competitiveness of NI assessed the local VC market and found that little evidence existed in terms of particular market failures, which might lead to greater difficulties in financing businesses compared with elsewhere in the UK. For example, the report stated that ‘evidence that this [NI] small private equity market reflects particular or heightened market failures (as opposed to the ‘equity gap’ seen across the UK) is inconclusive’. Furthermore, the report argued that NI is well served by a number of funds which were set up or supported by the public sector, including the NITech fund, Viridian and Crescent Capital II, in which Invest NI acts as a partner. As a result, the report concluded that limited demand for VC was the main reason for low levels of activity.

3.72 As part of our evidence gathering phase, the Panel undertook an extensive series of consultations with the private VC companies and the Varney conclusions were reaffirmed. For example, the view was expressed that, rather than there being limited supply, NI suffers instead from an insufficient deal flow, and that the lack of continuity of deals for VC companies restricted growth. In addition, there was a perception that there are not enough high quality deals to attract the Pan-European investors. However, the Panel have a number of concerns about the restrictions that the public sector places on the VC funds in which they are involved. These include the following:

(a) funds are limited to activities that come within the remit of Invest NI;

(b) funds are not permitted to be invested outside of NI, which limit business and growth opportunities for the fund;

(c) they are limited to certain deal sizes; and

(d) Invest NI is typically represented on the VC board.

3.73 Furthermore, Varney expressed the view that the availability of public funds (both equity and debt) may have had a number of unintended consequences. For example, it may limit the attractiveness of NI as a market for private investors, who see smaller potential returns to investment as they are effectively competing with Government. Varney concludes that: ‘one of the key issues for NI is the extent to which the various sources of public funding interact and, potentially, conflict. It is possible that the level of public financing crowds out private or quasi-private investment to some extent. It might also distort competitive pressure’.

3.74 The Review Panel concur with this view, and believes that public finance, and particularly the significant grant aid on offer, is crowding out private finance. However, it is also important to acknowledge the nature of firms in NI, which tend to be small and, in many instances, family owned (where entrepreneurs may be less willing to dilute family ownership by releasing equity), also plays a role in limiting demand for VC locally.

3.75 As part of our analysis, the Review Panel were provided with a draft summary report, commissioned by InterTradeIreland, which includes an assessment of VC activity in Ireland. The report indicated that a gap did exist in the supply of equity finance geared towards seed and early stage seed projects. The report attributed this to a number of factors:
Overview of Current Policies and Spending

- A migration of venture capitalists from early stage investments. In particular, VCs tend not to support high technology or R&D deals at an early stage due to the high risks associated with these deals;
- The decline in the private investor market in Ireland due to liquidity issues and a diminished appetite for risk-based investment opportunities – in so far as it relates to seed and early stage investment; and
- The business angels networks in Ireland are less developed than other European countries where approximately half of their investment is in seed stage projects.

This therefore suggests a role for Government in supporting the provision of equity finance in seed stage projects. However, the overview of Invest NI / DETI activity in the VC market (provided in Box 3.1), highlights that Government is involved in supporting VC in both seed and later stage projects. In addition, given the restrictions outlined previously, the Panel is not satisfied that Invest NI / DETI has been managing its involvement in the venture capital industry in a manner that is most supportive of the growth of the industry.

Economic Infrastructure

DETI / Invest NI play an important role in supporting the development of economic infrastructure in relation to property, tourism, energy, and telecommunications. Interventions in these areas are discussed below.

Property

Invest NI has a landholding of 2,775 acres, the bulk of which are leased to Invest NI client companies on controlling 999 year leases. They also possess nineteen buildings which are largely occupied by client companies. As part of the Review, the Panel were informed that Invest NI has currently a modest level of remaining land which is available solely to Invest NI clients (760 acres). In a normal year, Invest NI leases circa 60 to 70 acres per year to client companies for their projects. As a result of this and the continued demonstration of what Invest NI considers to be a market failure in the provision of serviced sites for sale, Invest NI are engaged in a program of acquisition and development involving planned expenditure of £65 million up to 2011.

As a result of an independent review of property intervention and organisation in 2004, Invest NI has a tight focus in its property purchases. The Invest NI Board reviewed and approved the need for continued intervention in the provision of serviced sites in April 2009, and agreed the following activities (where market failure can be demonstrated):

- Sell serviced sites to Clients for their builds;
- Support Clients with grant and advice to build assets;
- Match clients to private sector property provision;
- Help planning to protect and zone land for industry; and
- Provide property advice to clients.
3.80 The Review Panel understand that Invest NI does not intervene in areas where there is no perceived market failure (this includes the office rental market and the general rental market). In addition, Invest NI does not:

- Build buildings to rent or sell (small stock of legacy buildings largely rented to existing clients);
- Engage in the small unit market (DSD / DARD / LEA / councils and the private sector provide in this area); and
- Provide retail and warehousing.

3.81 Invest NI’s current programme of land acquisition appears to be largely aimed at the provision of industrial land (since it is not involved in either the office rental market or the provision of retail / warehouse facilities). It is not obvious to the Review Panel why this particular land market should be uniquely subject to market failures and hence require intervention from Invest NI. Few industrial inward investments have been attracted to NI in recent years and hence the majority of site provision must be anticipated to be for existing companies in the manufacturing sector. If there is a failure of the market to provide sufficient land for industrial development, the Panel would question the nature of the perceived failure. One possibility is that the Planning System fails to zone enough land for industrial expansion or, alternatively, the expectation of Invest NI intervention deters private developers from developing land for industrial development. In light of these concerns, the Panel later recommend that DETI should commission a fundamental review of industrial land provision to determine why there is a perceived need for Invest NI to purchase large amounts of land over the next few years. This should go beyond the scope of the planned evaluation of the programme in 2009/10.

Tourism

3.82 As outlined in Chapter 1, the Review Panel have been asked to consider the tourism policies / programmes operated by Invest NI, and also form a view on the appropriateness of Invest NI’s engagement in the sector. Over the Review period, Invest NI offered a total of £12m to tourism related projects in NI. The majority of assistance has been delivered via SFA, although the assisted projects include the development of new hotels and the expansion of existing hotels, with funding given to build new bedrooms, leisure complexes (in particular, the development of spa facilities) and conference amenities.

3.83 The Review Panel have two major concerns with these types of tourism investments made by Invest NI. Firstly, the nature of the projects appears to sit uncomfortably with the stated mission of Invest NI, which is to boost business productivity in the NI economy (wages in the Tourism sector are typically very low\(^\text{38}\)). Secondly, there are other bodies funded by DETI which have a more clearly defined objective to develop the Tourism sector in NI (for example, the NI Tourist Board and, in part, Tourism Ireland). The Review Panel are firmly of the view that Invest NI should remove itself from supporting tourism projects in NI and that this area of responsibility should be picked up by other bodies that have an exclusive policy objective in the Tourism sector. A specific recommendation reflecting this point is included in Chapter 7.

\(^{38}\) The median full-time gross weekly earnings in Hotels and Restaurants (used as a proxy for the Tourism sector) were 41% lower than the NI private sector median wage in 2008.
Overview of Current Policies and Spending

Energy Policy

3.84 Energy policy is the responsibility of DETI and a new Strategic Energy Framework (SEF) was issued for consultation in July 2009. The document updates the 2004 SEF to reflect the many recent and substantial changes within the energy markets. Since the last SEF, a single electricity market (SEM) has been introduced (in November 2007), and climate change concerns and the importance of renewables have risen greatly. The focus in the new SEF is on improving competitiveness, ensuring greater security of energy supply, the targeting of a more sustainable energy system, with greater efficient energy use and a higher dependency on renewables. Generation prices are also to be as competitively priced as possible.

3.85 The NI economy, with few domestic energy resources, has traditionally been considered a high energy-cost economy. The dependence on fossil fuels for electricity generation and space heating has been highlighted recently as fuel prices have fluctuated widely. Although energy accounts for only around 1-2% of turnover in manufacturing and tradable services, costs can be much higher in certain industrial activities and high energy users are deterred from investing in an area with above average costs. The Panel understand that the SEM has created the potential to reduce NI's electricity cost disadvantage with GB by introducing greater efficiency, competition and wholesale price transparency. For larger firms, where prices are linked to the wholesale pool price in the SEM, there is now a much more immediate and direct link to underlying world fuel prices. At the same time, market opening and greater competition at the retail level has made electricity prices harder to identify and compare due to the existence of confidential contracts between electricity suppliers and larger companies.

3.86 Current estimates are that the electricity cost disadvantage for SMEs has been reduced from its traditional level of 30-50% above the UK average to a level closer to 20%. For larger companies, the comparison is more complex. As part of our evidence gathering phase, the Panel noted that electricity pool prices movements under the SEM are in line with those in GB. However wholesale prices, which account for around 70% to 80% of the final retail price, remain higher than GB and this reflects primarily differences in fuel / plant mix, the potential in GB for greater economies of scale in generation as well as differences in market design and in particular how generation capacity is rewarded. In the SEM, capacity is explicitly rewarded with a long-term capacity payment equivalent to around 15% of the wholesale cost. In GB, there is no explicit capacity payment and reward for capacity is reflected in the wholesale price which is likely to be more volatile, peaking at times of generation capacity shortage and below the long-term average when there is generation capacity surplus.

3.87 There is a broad consensus that GB is moving from a capacity surplus to a capacity shortage, though this may have been mitigated by the sharp reduction in demand in the current recession. The NI energy regulator believes that the pricing approach to capacity in the SEM allows for more stable pricing, lower risk and hence lower cost of capital for generation and greater security of supply - which favours local users in the long-term. In addition, NI prices (at the retail level) include a Public Service Obligation (PSO) cost, adding around 5% to prices, as a result of the high prices paid to local electricity generators resulting from long-term contracts negotiated at the time of privatisation. We understand the contracts underlying the PSO can be renegotiated from 2010 and that the regulator will make determinations which maximise the benefit.

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to consumers. The conclusion the Review Panel have reached is that electricity prices remain somewhat higher than GB, but the gap is less than in the past and may diminish further as the SEM widens and matures; the long-term contracts are reviewed and inter-connection with the GB market is optimised in a way which benefits consumers.

3.88 Under the EU Renewable Energy Directive, the UK including NI, is required to produce 20% of its energy from renewable sources by 2020 to help minimise climate change and to increase security of energy supply. This equates to 35-40% of electricity generation, and the UK has one of the most generous subsidy regimes in Europe for renewable energy with subsidies generally halving generators costs. Large scale renewable energy generation in the UK is supported by a trading mechanism to allow it to compete with fossil fuel generation – the Renewables Obligation. Northern Ireland has its own Obligation (set at a lower level than in GB to minimise the impact on its smaller customer base) – the NI Renewables Obligation. The cheapest, most available renewable energy resource in NI will come from onshore wind.

3.89 However, since the majority of wind capacity is in the west, transmission power lines will need to be strengthened both to transmit power to the population centres in the east and to cope with power surges. The estimated costs would amount to £1 billion over a decade.

3.90 The Review supports the current SEF but considers that more attention should be given to energy efficiency which has been downplayed in the SEF. Furthermore, various respondents to our call for evidence and key informant interviews indicated that significant opportunities exist for further investment in energy conservation with short payback periods. For example, the Green New Deal, a cross-sectoral initiative led by the Confederation of British Industry (NI), the Irish Congress of Trade Unions, the NI Council for Voluntary Action, the Ulster Farmers Union and Friends of the Earth, supports an approach focussed on energy conservation schemes. Furthermore, a recent research project undertaken by DETI \(^{40}\) highlighted that firms believed they could achieve a 10-20% reduction in energy usage without seriously affecting their business. This research also identified a number of policy options which could deliver carbon emissions reductions in the range of 21/2% – 131/4% by 2020. In light of this, the Panel makes a specific recommendation which calls for energy efficiency / conservation to be given a higher priority in the 2009 SEF.

3.91 At the same time the Panel note that DETI / Invest NI does not have the policy lead across all the strands of energy policy. For example, the diverse policy responsibilities (including statutory obligations) for energy across government include:

- **DARD:** bioenergy and rural regeneration issues;
- **DFP:** energy efficiency in the public sector, government as an exemplar including responsibility for central procurement Building Regulations;
- **DSD:** energy efficiency in the social housing sector;
- **DOE:** climate change policy and carbon emissions, energy from municipal waste, energy planning and environmental consent issues; and
- **OFMDFM:** sustainable development strategy.

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3.92 In addition, the independent energy regulator (NIAUR) shares some statutory functions with DETI, as well as exercising consenting / licensing and enforcement duties for the electricity and gas sectors.

3.93 The cross cutting nature of energy policy with its close links to not only economic development but also social and environmental policy, makes it difficult to secure holistic and co-ordinated policies. This is particularly the case around energy efficiency, renewable transport and bioenergy, as well as ensuring that job creation and Innovation opportunities are maximised. The Panel note that in GB, the former DTI (and part of DEFRA) was re-organised into BIS (the Department for Business, Innovation and Skills) and DECC, (the Department for Energy and Climate Change), as a means of giving clear focus and leadership to the range of energy policy activities, as a separate and distinct government priority. Similar restructuring in NI may be needed to ensure that sufficient emphasis and impetus is delivered here.

Telecoms

3.94 Telecoms is a reserved matter – with the overarching policy direction continuing to reside in the Department of Business Innovation and Skills (BIS) – which is also regulated, on a UK-wide basis, by the national regulator OFCOM. However, under the provisions of the Communications Act 2003, DETI has discretionary powers to spend public money to support the development of regional telecommunications services in NI.

3.95 During the period 2006 to 2010, the department’s stated aim has been to further develop telecommunications infrastructure and services in NI in conjunction with the Regulator and the private sector. The overarching approach has been outlined in the Telecommunications Action Plan 2006-10, and developed in the Programme for Government and the Infrastructure Strategy for NI (ISNI2).

3.96 The importance of ensuring that NI retains a modern, efficient telecommunications infrastructure cannot be under-estimated. The small size of NI and its peripheral location means quality telecommunications access is vital in support of balanced economic (and social) development across the region.

3.97 The Panel welcomes the work undertaken to make NI the first region in Europe to have 100% geographical coverage of broadband. This has presented significant advantages, especially for businesses, and it will be important that these are capitalised on in the next three to five years. Research supplied to the Review Panel provides top-down estimates suggesting that transforming the connectivity in an economy can help lever a 0.5% increase in GDP$^{41}$, although it is recognised that this is likely to overstate the true impact. This could translate into an increase in Gross Valued Added (GVA) of the order of £8-£11 million per annum in NI.

3.98 It is in that context that DETI’s telecoms activities are positioned in support of the Public Service Agreement (PSA) in relation to improving productivity (PSA 1). We understand that there are three key strands of the ongoing work in this area: in relation to the range of broadband stimulation activities to encourage the take-up and innovative use of telecommunications; the development of NI’s next generation network and the establishment of a direct international communications link to the US and Europe.

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$^{41}$ DETI (2009), Economic Appraisal of Next Generation Access.
3.99 The Panel encourages DETI to continue to deliver in these areas, and on the commitments made in the PfG. However, the Panel would also like to stress the importance of ensuring that telecoms infrastructure is ‘future-proofed’, particularly in terms of speed but also with regard to connectivity.

3.100 The Panel endorse the plans to fully evaluate the overall impact of the Strategic Action Plan. In doing so, the department should supplement this with the new work of the MATRIX Panel, with consideration being given to undertaking an horizon scanning exercise to allow industry to input views and ideas on developments and opportunities in the telecoms market over the short to medium term.

3.101 In relation to the work due for completion in 2009/10 to provide NI with direct international connectivity, it is important that DETI and Invest NI maximise the impact of this infrastructure, and the benefits it can have for businesses in NI, both indigenous and foreign owned. In terms of FDI, Invest NI needs to ensure that potential investors are fully informed of what NI can offer in telecoms. We later outline a recommendation for DETI and Invest NI to undertake a review of how to capitalise on the benefits of improved connectivity. For example, from an FDI perspective, there are significant opportunities in relation to security and reliability which could attract companies in the financial, ICT and business continuity sectors, as well as medical research, data mining and cloud computing initiatives. The review should also consider the opportunities for indigenous companies in NI.
Chapter 4
Impact of Current Policies

SUMMARY OF KEY FINDINGS

• Invest NI has contributed significantly to NI’s economic performance in terms of employment growth. Offers of assistance through SFA were associated with 28,000 new jobs, 15,000 safeguarded jobs and £2.4bn of investment over the period 2002/03-2007/08.

• When compared to other UK regions, NI has attracted a higher number of new foreign-owned investment projects and promoted a higher number of jobs per head of population.

• Many jobs promoted by Invest NI, particularly those in the service sector, offered wages below the private sector average. Furthermore, a significant proportion of support was associated with safeguarding jobs in the manufacturing sector.

• Invest NI has been particularly successful in promoting higher value investments in ICT, although most of these were in expansion projects in firms already located in NI rather than in new firms.

• The projects assisted by Invest NI have been successful in job creation, however, their impact on productivity has been limited.

• The additionality of Invest NI assistance varies by the nature of support offered. Whereas the additionality of SFA supported projects is estimated to be 50% (similar to other UK regions), additionality in projects involving Innovation and R&D is generally higher.

• The additionality of SFA is lowest in those projects that are associated with the expansion of existing firms (aside from those that involve increased Innovation or R&D).

INTRODUCTION

4.1 In previous chapters, we outlined the shift in DETI and Invest NI’s policy towards improving private sector productivity in Northern Ireland (NI). The aim of this chapter is to outline the effectiveness of the various policies and programmes delivered by Invest NI to deliver on this policy objective. The focus is on Invest NI given its role as the delivery body for economic policy on behalf of DETI and the NI Executive. Furthermore, the assessment is in relation to two areas covering the period 2002/03-2007/08: (i) business formation and expansion (ii) business Innovation and capability development. A brief assessment is also included of 2008/09, the first year of its current Corporate Plan where there is an explicit focus on productivity improvements. It is also important to recognise that the Panel are seeking to outline the additionality of Invest NI assistance on variables such as employment, productivity and investment (as outlined previously, this refers to how much of the reported benefits occurred directly as a result of Invest NI support and how much would have happened regardless).
BUSINESS FORMATION & EXPANSION

4.2 Selective Financial Assistance (SFA) is the main programme used to support business formation and expansion. The programme annex provides a full breakdown of activities under SFA, but in this chapter our analysis is detailed as follows:

i. Overview of jobs promoted / safeguarded and associated investment;
ii. Job and investment outputs, specifically from externally-owned projects;
iii. Job and investment outputs, specifically from locally-owned projects; and
iv. Evaluation evidence on the overall impact of assistance for business formation and expansion.

Overview of Jobs Promoted/Safeguarded and Associated Investment

4.3 Invest NI offers of assistance were associated with £2.4bn of investment over the period 2002/03 – 2007/08 (see Table 4.1). Support was also linked to the promotion of over 28,000 new jobs and the safeguarding of more than 15,000 jobs. Chapter 2 previously outlined the strong employment growth in NI over the past decade and the Panel recognise that Invest NI has contributed significantly to this performance. The precise contribution depends on how many of the jobs promoted were actually created and, of these, how many can be regarded as being unlikely to have been created in the absence of assistance.

<table>
<thead>
<tr>
<th>Number of Offers</th>
<th>New Jobs</th>
<th>Safeguarded Jobs</th>
<th>Assistance (£m)</th>
<th>Investment (£m)</th>
<th>Assistance as % of Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>External Owned</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Formation</strong></td>
<td>188</td>
<td>15,942</td>
<td>11,957</td>
<td>252.9</td>
<td>1,318.7</td>
</tr>
<tr>
<td><strong>Expansion</strong></td>
<td>87</td>
<td>9,969</td>
<td>489</td>
<td>101.5</td>
<td>518.7</td>
</tr>
<tr>
<td><strong>Locally Owned</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Formation</strong></td>
<td>1,115</td>
<td>12,065</td>
<td>3,112</td>
<td>160.8</td>
<td>1,086.6</td>
</tr>
<tr>
<td><strong>Expansion</strong></td>
<td>512</td>
<td>2,462</td>
<td>18</td>
<td>20.7</td>
<td>131.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,303</td>
<td>28,007</td>
<td>15,069</td>
<td>413.7</td>
<td>2,405.3</td>
</tr>
</tbody>
</table>

Source: IREP database

Note: Invest NI’s assistance database holds limited information on jobs promoted and safeguarded during 2002/03 - 2004/05 within local firms. The Panel have estimated the additional jobs that were not recorded on the basis of historic trends. This adds 4,540 new jobs and 800 safeguarded jobs. Invest NI has also directed £4.2m of SFA support for business innovation, which gives total SFA expenditure of £417.9m over the period.

4.4 The analysis conducted by the Review Panel indicates that the average cost of a new job promoted within externally-owned companies was just under £10,000 for formation projects and £8,000 for expansions (see Table 4.2). Safeguarding has much more prominence within externally-owned firms, and this has an associated cost per job of £8,000 for safeguarding-only projects, rising to £10,000 for projects which both safeguard and promote jobs. This has tended to vary over time, depending on the

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42 Further information on SFA is provided in the programme annex (Annex B). All figures in this section relate solely to SFA support, which contributed 98% of new jobs and 100% of safeguarded jobs.

43 Other programmes, such as the Start a Business programme, also contribute to business formation and they are considered separately in the programme annex.
nature of the projects being supported, and it raises some issues, which we return to later, about the cost effectiveness of such assistance.

**Table 4.2: Cost per New Jobs Promoted and Safeguarded Jobs (2002/03 – 2007/08)**

<table>
<thead>
<tr>
<th></th>
<th>Cost per Job (£000s)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Local</td>
</tr>
<tr>
<td><strong>Business Formation</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>10.5</td>
</tr>
<tr>
<td><strong>Business Expansion</strong></td>
<td></td>
</tr>
<tr>
<td>New Jobs</td>
<td>10.1</td>
</tr>
<tr>
<td>Safeguarded Jobs</td>
<td>1.7</td>
</tr>
<tr>
<td>Mixed Jobs</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Source: IREP database

**Note:** The mixed category arises where both new and safeguarded jobs are associated with a project. As it is not possible to distinguish between the two from the information available, both are included in the cost per job calculation.

4.5 Despite supported projects having a positive impact in terms of investment and employment, the Review Panel have a number of concerns. Firstly, the level of assistance offered to many of these projects would be above the new state aid limits which are scheduled to come into effect by the end of next year (the overall assistance offered – £414m – represents around 17% of total investment and this would be above the large firm limits that will apply to regional aid projects locating in NI from January 2011). Secondly, the Panel have concerns over job quality. As we indicate later, many of the new jobs promoted have been in call centres, some of which offer low wages and have contributed little to Invest NI’s mission to boost business productivity.

**Job and Investment Outputs Specifically from Externally-Owned Projects**

4.6 Invest NI has provided £253m of assistance to externally-owned projects over the period 2002/03 – 2007/08, representing 61% of total SFA support for investment in formation and expansion projects. Table 4.3 presents an overview of assistance for external projects by year.

**Table 4.3: Offers of Assistance to Externally-Owned Companies by Year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Offers</th>
<th>New Jobs</th>
<th>Safeguarded Jobs</th>
<th>Assistance (£m)</th>
<th>Investment (£m)</th>
<th>Assistance as % of Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002/03</td>
<td>19</td>
<td>1,033</td>
<td>3,015</td>
<td>28.1</td>
<td>166.7</td>
<td>16.9%</td>
</tr>
<tr>
<td>2003/04</td>
<td>35</td>
<td>2,153</td>
<td>2,670</td>
<td>33.5</td>
<td>149.4</td>
<td>22.4%</td>
</tr>
<tr>
<td>2004/05</td>
<td>43</td>
<td>3,467</td>
<td>1,312</td>
<td>46.4</td>
<td>209.6</td>
<td>22.1%</td>
</tr>
<tr>
<td>2005/06</td>
<td>30</td>
<td>3,100</td>
<td>3,281</td>
<td>71.4</td>
<td>361.9</td>
<td>19.7%</td>
</tr>
<tr>
<td>2006/07</td>
<td>26</td>
<td>3,451</td>
<td>204</td>
<td>35.9</td>
<td>174.9</td>
<td>20.5%</td>
</tr>
<tr>
<td>2007/08</td>
<td>35</td>
<td>2,738</td>
<td>1,475</td>
<td>37.6</td>
<td>256.1</td>
<td>14.7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>188</strong></td>
<td><strong>15,942</strong></td>
<td><strong>11,957</strong></td>
<td><strong>252.9</strong></td>
<td><strong>1,318.7</strong></td>
<td><strong>19.2%</strong></td>
</tr>
</tbody>
</table>

Source: IREP database
4.7 A large proportion of new jobs promoted through SFA in formation and expansion projects have been in externally-owned companies, and over four-fifths of safeguarded jobs have also been in externally-owned firms. However, as shown in Figure 4.1, more support has been directed toward expansions of existing externally-owned companies, rather than attracting investments new to NI.

Figure 4.1: Externally-Owned Projects by Type of Investment (2002/03 – 2007/08)

Source: IREP database

Note: Invest NI classify both Companies New to NI and New Projects in Existing Firms as Business Formation. Annex B provides full breakdowns of all classifications used.

4.8 The majority of assistance given for expansion projects has been given to safeguard large numbers of jobs in externally-owned companies, almost exclusively in the manufacturing sector. While assistance for investments new to NI has promoted additional jobs, as we indicated previously, these have mainly been in call centres.

4.9 When considered against other UK regions and the RoI, NI has attracted a higher number of new foreign-owned investment projects and promoted a higher number of jobs as a proportion of the population. Although NI’s ability to attract new companies was only one third of that in the RoI (as highlighted earlier in Chapter 2), the Panel take the view that is largely due to the low rate of corporation tax which NI is currently unable to match.

4.10 Inward investment responds to a range of factors including production costs, accessibility to markets as well as grants and tax rates. As a result, parts of the UK and especially the South East of England, are able to attract large numbers of inward investment projects with few, if any, financial incentives. Nevertheless, grant assistance remains an important attraction, and NI’s ability to offer higher levels of assistance in all parts of the region (in contrast with other UK regions as outlined previously) helps to maintain a leading position in the volume of inward investment attracted. For example, NI attracts more projects per million pounds of SFA than either Scotland or Wales, although the number of jobs promoted is similar to these two regions (see Table 4.4).
Table 4.4: New FDI Projects and Jobs in relation to Expenditure on SFA 2002/3 – 2007/8

<table>
<thead>
<tr>
<th>Region</th>
<th>No. of projects per £m SFA/RSA</th>
<th>No. of Jobs per £m SFA/RSA</th>
</tr>
</thead>
<tbody>
<tr>
<td>South East</td>
<td>59.4</td>
<td>6864</td>
</tr>
<tr>
<td>East Anglia</td>
<td>3.5</td>
<td>870</td>
</tr>
<tr>
<td>East Midlands</td>
<td>3.2</td>
<td>1014</td>
</tr>
<tr>
<td>West Midlands</td>
<td>2.2</td>
<td>499</td>
</tr>
<tr>
<td>North West</td>
<td>2.1</td>
<td>368</td>
</tr>
<tr>
<td>South West</td>
<td>1.2</td>
<td>229</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>1.0</td>
<td>123</td>
</tr>
<tr>
<td>North</td>
<td>0.7</td>
<td>87</td>
</tr>
<tr>
<td>Wales</td>
<td>0.6</td>
<td>135</td>
</tr>
<tr>
<td>Scotland</td>
<td>0.5</td>
<td>143</td>
</tr>
<tr>
<td>Yorkshire &amp; Humberside</td>
<td>0.5</td>
<td>66</td>
</tr>
<tr>
<td>Total</td>
<td>2.3</td>
<td>336</td>
</tr>
</tbody>
</table>

Source: FDI Intelligence and BIS

Note: About half of the projects recorded by FDI Intelligence had job forecasts attached. For the rest, FDI Intelligence use a formula to estimate jobs. The formula is based on average relationships between jobs and project characteristics. The figures in this table include the estimated jobs. The figures are for firms new to the UK and FDI Intelligence has attempted to exclude projects within externally-owned firms already located in the region.

4.11 NI’s success rate in attracting firms new to NI is highest in technical support centres, shared service centres and ICT (see Figure 4.2). In each case, NI attracts a third or more of the firms entering the UK excluding London and the South East of England.

Figure 4.2: Percentage of New Inward Investment Projects attracted into NI 2002/3 - 2007/8 (UK excl GSE = 100)

Source: FDI Intelligence

Note: UK excluding London and SE England

4.12 As indicated previously, it is the quality of the jobs promoted that is of particular concern to the Review Panel (Table 4.5 presents data on the average salary of supported FDI projects). The median wage in the supported projects was, on average, only 10% above the NI Private Sector Median Wage (PSM), although this varies significantly by year. The figures are also skewed by the inclusion of a large number
of safeguarded jobs in manufacturing, where the median wage was close to double the NI PSM wage. Among new jobs, most of which were in the service sector, only half offered salaries above the NI average. It is also important to remember that the Invest NI benchmark of supporting employment above the NI PSM is low (for example, in 2007/08, the annual NI PSM wage was £17,628).

Table 4.5: Median Weekly Salaries of Invest NI Supported Inward Investment Projects compared with NI Private Sector Median (PSM)

<table>
<thead>
<tr>
<th>Year</th>
<th>NI Private Sector Median (weekly)</th>
<th>Invest NI Median</th>
<th>Invest NI relative to NI PSM</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002/03</td>
<td>283</td>
<td>317</td>
<td>+ 12%</td>
</tr>
<tr>
<td>2003/04</td>
<td>300</td>
<td>346</td>
<td>+ 16%</td>
</tr>
<tr>
<td>2004/05</td>
<td>308</td>
<td>274</td>
<td>- 11%</td>
</tr>
<tr>
<td>2005/06</td>
<td>327</td>
<td>468</td>
<td>+ 43%</td>
</tr>
<tr>
<td>2006/07</td>
<td>326</td>
<td>289</td>
<td>- 12%</td>
</tr>
<tr>
<td>2007/08</td>
<td>339</td>
<td>385</td>
<td>+ 13%</td>
</tr>
</tbody>
</table>

Source: Invest NI Performance Information report 2002/3 -2007/8; NI PSM data from ASHE

4.13 Table 4.6 reveals that, in total, more than half of the promoted new and safeguarded jobs in the service sector did not offer salaries above the private sector average. This is mainly due to contact centres (the largest sector in terms of job promotion), where only one-third of new jobs offered higher wages. This indicates that new inward investment in the service sector has not been raising the median wage in the NI private sector and, in some cases, may have actually brought the average down. As wages comprise the majority of GVA, productivity is also unlikely to have been raised by attracting new firms to NI. We would, however, recognise that Invest NI has been successful in promoting well paying jobs in certain sectors, particularly within ICT and engineering, although most of these were in expansion projects in firms already located in NI rather than in new firms.

Table 4.6: Average Salary of New and Expansion Projects in Externally Owned Firms (2002/03 – 2007/08)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Projects</th>
<th>% Above NI Private Sector Median</th>
<th>% Above NI Private Sector Median</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>New Jobs</td>
<td>Safeguarded</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>90</td>
<td>67</td>
<td>86</td>
</tr>
<tr>
<td>Food &amp; Drink</td>
<td>19</td>
<td>33</td>
<td>33</td>
</tr>
<tr>
<td>Electrical &amp; Electronics</td>
<td>17</td>
<td>93</td>
<td>99</td>
</tr>
<tr>
<td>General Manufacturing</td>
<td>13</td>
<td>33</td>
<td>79</td>
</tr>
<tr>
<td>Transport</td>
<td>12</td>
<td>64</td>
<td>0</td>
</tr>
<tr>
<td>Life Sciences</td>
<td>5</td>
<td>27</td>
<td>0</td>
</tr>
<tr>
<td>Services</td>
<td>83</td>
<td>46</td>
<td>100</td>
</tr>
<tr>
<td>ICT</td>
<td>41</td>
<td>93</td>
<td>81</td>
</tr>
<tr>
<td>Contact Centres</td>
<td>35</td>
<td>33</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>173</td>
<td>50</td>
<td>87</td>
</tr>
</tbody>
</table>

Source: Invest NI

Note: Sub-sectors are placed under broad sector headings purely for illustrative purposes and will not sum to sector totals due to the method Invest NI use for defining sub-sectors.

While it is possible that profits in new firms were above the UK average, the profits are likely to have been repatriated and thus are unlikely to have helped the NI economy, at least in the short term.
Impact of Current Policies

Job and Investment Outputs Specifically from Locally-Owned Projects

4.14 Over the period 2002/03 – 2007/08, Invest NI offered £161m of assistance through SFA to locally-owned companies for formation and expansion projects. (Table 4.7 provides a breakdown of the support).

Table 4.7: Offers of Assistance to Locally-Owned Companies by Year

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Offers</th>
<th>New Jobs</th>
<th>Safeguarded Jobs</th>
<th>Assistance (£m)</th>
<th>Investment (£m)</th>
<th>Assistance as % of Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002/03</td>
<td>389</td>
<td>2,011</td>
<td>1,100</td>
<td>42.3</td>
<td>264.4</td>
<td>16.0%</td>
</tr>
<tr>
<td>2003/04</td>
<td>437</td>
<td>2,080</td>
<td>400</td>
<td>26.1</td>
<td>128.5</td>
<td>20.3%</td>
</tr>
<tr>
<td>2004/05</td>
<td>477</td>
<td>2,080</td>
<td>404</td>
<td>34.5</td>
<td>152.3</td>
<td>22.7%</td>
</tr>
<tr>
<td>2005/06</td>
<td>289</td>
<td>1,897</td>
<td>442</td>
<td>20.8</td>
<td>123.7</td>
<td>16.8%</td>
</tr>
<tr>
<td>2006/07</td>
<td>340</td>
<td>1,995</td>
<td>43</td>
<td>16.0</td>
<td>149.4</td>
<td>10.7%</td>
</tr>
<tr>
<td>2007/08</td>
<td>183</td>
<td>2,002</td>
<td>723</td>
<td>21.1</td>
<td>268.2</td>
<td>7.9%</td>
</tr>
<tr>
<td>Total</td>
<td>2,115</td>
<td>12,065</td>
<td>3,112</td>
<td>160.8</td>
<td>1,086.6</td>
<td>14.8%</td>
</tr>
</tbody>
</table>

Source: IREP database

Note: Invest NI’s assistance database holds limited information on jobs promoted and safeguarded during 2002/03 - 2004/05 within local firms. The Panel have estimated the additional jobs that were not recorded on the basis of historic trends. This adds 4,540 new jobs and 800 safeguarded jobs.

4.15 Almost all of the SFA support directed to locally-owned firms has been for expansions rather than start-ups (see Figure 4.3). This is unsurprising given that start-up support is also provided by other programmes and local start-ups are likely to be very small in size and would not require large amounts of assistance.

Figure 4.3: Locally-Owned SFA Projects by Type of Investment

Source: IREP database

Note: Figures relate only to SFA projects and exclude support provided through other programmes such as Start a Business Programme.
4.16 This support for local firms has promoted over 7,300 new jobs, mostly through business expansions. While less safeguarding of jobs has occurred in locally-owned companies than in externally-owned firms, this has still been substantial at almost 2,300 jobs over the Review period. Most of both new jobs in expansion projects and the safeguarded jobs have been in the manufacturing sector, as was the case with externally-owned firms. The relatively few jobs in new local firms were split more evenly between manufacturing and services.

4.17 Assistance for local business start-ups is also provided through other programmes such as the Start a Business Programme (SABp). In addition to the new jobs already outlined under SFA, the evaluation of SABp estimated that between 1,286 and 2,037 additional new jobs had been created within over 18,000 supported start-ups. However, most of these jobs were in sectors serving local demand rather than in the export sectors which are the focus of Invest NI activity. As indicated previously, this programme has since been re-launched under a different name (Enterprise Development Programmes) but still covers a much wider range of sectors than Invest NI. There is no way of estimating how many additional jobs were created in the export sectors.

4.18 The impact of assistance for company formation in NI must be assessed in the context of observed rates of formation as measured through new company registrations for VAT. The analysis presented earlier in Chapter 2 suggested that the Entrepreneurship Strategy may have been impacting on company formation levels, as the levels in both manufacturing and tradable services were rising between 2004 and 2006. However, the sharp fall in 2007 puts this conclusion in doubt and more time will be needed to see whether a sustained increase has been achieved. Furthermore, the figures show no general improving trend, but rather a cycle that may have been influenced by the property price boom in NI. It may be, of course, that the figures would have been lower without Invest NI interventions, but what can be said is that policy has not yet achieved a sustained rise in company formation rates to levels above the UK average. This is unsurprising since formation rates are notoriously difficult to influence.

4.19 However, NI has a good record of company formation and survival compared with UK regions outside southern England (Figure 4.4). This is likely to reflect a range of factors, which may include the policy towards new firm formation in NI. For example, compared with other peripheral regions in the UK, NI stands out as a success in the formation of new businesses within the tradable services sector. In addition, the difference between NI’s registration rate for manufacturing businesses and that in the North East of England is equivalent to 75 extra firms each year, or a third of NI’s annual registrations.

4.20 What is clear is that closure rates (as measured by VAT de-registrations) are much lower in NI than the UK average. The same is true for other assisted regions. This partly reflects lower rates of company formation, but also seems to be related to government assistance. The net result of lower formation and closure rates is that the stock of businesses (as measured by VAT registrations) rose more rapidly than the UK average throughout the period from 2002-2007. How much this has to do with policy is difficult to say, but it should be noted that the outcome on company registrations is relatively favourable in light of the generally negative attitudes to entrepreneurship in NI.
4.21 The 2009 annual Global Entrepreneurship Monitor (GEM) survey of attitudes to business indicates that NI respondents continue to express less favourable attitudes to entrepreneurship than elsewhere. The gap may have closed for younger people, although it is of concern that graduates still appear to be less entrepreneurial. The main findings of the survey include:

- NI is among the lowest of all the UK regions in early stage entrepreneurial activity in 2008, although the gap has narrowed and is no longer statistically significant;
- People in NI in 2008 are significantly more likely to state that ‘fear of failure’ would prevent them from starting their own business;
- For the first time since 2002 young adults (25-34 year olds) in NI have above UK average levels of entrepreneurial activity (7.9%). However, those aged 55 years and over in NI and females are significantly less likely to be engaged in early stage entrepreneurial activity than their counterparts elsewhere in the UK; and
- Graduates in NI are less likely than all but two other regions in the UK (i.e. Scotland and the North West) to be involved in early-stage entrepreneurial activity.

Figure 4.4: Business Registrations per Thousand Employees in Manufacturing (Average for 2002-07)

![Business Registrations per Thousand Employees in Manufacturing](image)

Source: Revenue & Customs VAT Registrations via NOMIS

4.22 A frequently held belief about small firms in NI is that new and small firms tend not to grow rapidly once formed. It is true that few new firms grow to become very large and this view is supported by results from the Sunday Times Tech Track 100 index of the fastest growing profitable small firms, in which NI rarely records more than one out of the 100 fastest growing firms. However, a wider view of company growth suggests that NI’s record in smaller companies is good, and the likelihood is that this reflects Invest NI’s small firm growth programmes. An ongoing study indicates that NI has more fast
Impact of Current Policies

growing small firms than any other UK region. The same study shows that a large proportion of high growth firms are a characteristic of assisted regions and this is likely to be due to the greater availability of government support.

Further to the above, Invest NI’s work with local businesses extends to supporting start-ups and expansions in social enterprises. The Panel recognise the importance of social enterprises generally, and to the NI economy in particular. For example, as part of our work programme we reviewed a DETI-led survey which outlined the activity of social economy enterprises (SEEs) in NI. The main findings were as follows:

- Almost 400 SEEs were surveyed and just over half were classified as community businesses, with credit unions the second largest category (25%);
- The total number of paid employees in the surveyed SEEs was 6,683, with the majority (71%) having less than 10 employees;
- In addition to paid employees, SEEs are highly dependent on the work of volunteers and the survey indicated that they had just under 5,000 volunteers working in their organisations, equating to an average of 13 volunteers per SEE;
- Turnover figures from the survey indicated a total of just over £355 million (the median turnover was £222k, with one-third having a turnover of less than £100k); and
- In terms of the goals of SEEs, the majority (63%) indicated that their main target group to help was the ‘local community in general’.

We recognise that the above represents only a proportion of overall economic activity undertaken by the social economy network in NI. Also, as indicated later in Chapter 8, we are aware that government support for these functions (and for small businesses generally) is due to transfer to district councils as part of the Review of Public Administration. The Panel endorse this move, as we believe the important interests of the social economy will be better met when delivery is taken forward at the local level. Furthermore, in terms of the proposal to establish a small business unit within Invest NI (outlined in Chapter 7), it should provide generic policy advice on entrepreneurship that could, potentially, be of importance to the social economy network. Finally, and more as an immediate step, the Panel later recommend that a study should be undertaken to establish how the social economy might be further helped to reduce deprivation and increase labour force participation in disadvantaged areas within NI.

Evaluation Evidence on the Overall Impact of Assistance for Business Formation and Expansion

As shown previously, virtually all assistance for business formation and expansion, particularly for external companies, has been via SFA. Given its importance, a major

---

45 Using the OECD definition of fast growing firms (more than 20% per annum growth for three successive years with an initial employment of at least 10 employees), NI had a slightly better record than the UK in the 2002-05 period, and both the UK and NI had more fast growth companies than other OECD countries over the same period (NI’s record compared to the UK was reversed in the 2005-08 period).


evaluation of SFA was recently carried out on behalf of DETI\textsuperscript{48} and the Panel have used the findings to inform its own assessment of the impact of SFA.

4.26 The study involved a self-assessment telephone and follow-up survey of over four hundred companies receiving assistance from Invest NI; a survey of Invest NI client executives and managers; and an econometric analysis comparing employment growth and productivity between recipients and non-recipients of assistance. The impact period was 2004-06 but this was extended to 2002-06 for sensitivity purposes and the results remained the same. The evaluation recognised that the timeframe may have underestimated the impact of SFA, and the Panel undertook its own analysis (presented later) to compare our findings with the earlier evaluation, and this tends to reach similar conclusions.

4.27 As we have already outlined, an important aspect of economic development support is the extent to which the assistance has been able to lever activity that is genuinely additional in the sense that the activity would not have occurred in the absence of assistance. It is therefore important to consider the impact of the Invest NI assistance in the context of additionality. Figure 4.5 presents an overview of results from the survey on additionality, which asked firms whether the project would have gone ahead without assistance.

Figure 4.5: Regional Comparison of SFA Additionality


4.28 From the SFA evaluation, almost 10\% of companies said the project would have proceeded in much the same form, while 25\% said they probably or definitely could not have generated similar outcomes in the absence of assistance. Most firms said that assistance either brought forward the project (37\%) or enabled the project to be larger (23\%). The chart above indicates that self-reported levels of additionality were significantly lower in NI compared with similar schemes in GB. For instance, 46\%
of respondents in NI would have gone ahead with their project immediately or later, compared with 23% in Scotland and 26% in England.

4.29 On the basis of the results from the SFA evaluation, the Panel estimate that almost 70% of projects would have gone ahead either completely, sometime later, or in part, irrespective of whether assistance was received. Taking into account partial additionality in some of these categories, the Review Panel estimate additionality to be around 50%. A recent evaluation of expenditure by the English Regional Development Agencies (RDAs) estimated that broadly similar levels of additionality (on average 50%) were associated with economic development and regeneration projects.

4.30 Within NI, 27% of externally-owned SFA beneficiaries said that alternative viable sources of finance were available for the project at the time of applying for SFA. The figure for the (generally smaller) locally-owned businesses was 22%. Presumably some firms anticipated that other finance would have become available for the project at a later date, but this was not clear from the survey.

4.31 The aim of the econometric evaluation was to isolate the impact of assistance by comparing the growth experience of assisted and non-assisted firms (while making allowance for other relevant factors). This is a useful approach, although it can be argued that the technique is not able to definitively tell us whether the assisted firms would have gone ahead with their projects, in the absence of assistance. Nevertheless, the key results from the study were as follows:

- An offer of SFA assistance was associated with a large boost in employment (around 25% per annum) for both locally and externally owned companies;
- An analysis of beneficiary firms alone suggested that the size of grant per employee offered (or received) affected employment growth only for locally-owned firms (these were generally small) and that a doubling of the size of grant was associated with a 4% rise in the annual rate of the company’s employment;
- No similar association between size of grants and employment growth was observed for externally owned firms;
- The estimated cost of SFA grant paid per job created was £11,200;
- Estimated number of jobs created due to SFA was 1,400 - 3,300 a year; and
- Productivity growth may be retarded by offers of SFA for locally-owned (and hence small) firms. For externally-owned firms no relationship was observed between size of grant and growth in sales revenue.

4.32 Our assessment of these results is that firms offered SFA grew much faster than non-assisted firms, even when allowance was made for company characteristics and

49 The figure of 50% is obtained by adding the first two columns for NI in Figure 4.5 plus a quarter of the third column. All of the second column (created but not as quickly) is included since all of the jobs would eventually have been created without assistance.


51 However, the Panel recognises that SFA is often used as an incentive to attract external companies and mobile projects.

52 The average company with 26 employees in 2004 received SFA grant offers totalling £44,370 between 1998 and 2004. The equation suggests that doubling the grant offers to £88,740 would generate a further 4% of employment, i.e. 1 job per annum. Over four years this would generate 4 jobs and give a cost per job of £11,000.
the likelihood of firms applying for SFA (a measure of company dynamism). Although
an attempt was made to control for company dynamism, this is difficult to do and is
inevitably somewhat arbitrary. What can be said, with confidence, is that assisted firms
have a better growth record than non-assisted firms.

4.33 The estimate of 1,400 to 3,300 jobs created each year, compared with what would
have happened in the absence of assistance, accords reasonably well with our own
estimates (presented later). The cost per job created at £11,000 is slightly higher than
our estimates, and this may be because the SFA evaluation estimates are derived for
locally-owned, and hence small, firms only.\footnote{The study makes two estimates of cost per job using different methods and the value quoted here is from the Review Panel's preferred approach} No attempt was made in the econometric
study to differentiate the impact of new jobs promoted from safeguarded jobs.

4.34 One clear result is that there was no evidence from the study that SFA grants were
associated with favourable growth in productivity. This result also accords with the
findings of the Panel's own analysis (presented later).

BUSINESS INNOVATION & CAPABILITY DEVELOPMENT

R&D and Innovation Schemes

4.35 Although Business Expenditure on R&D (BERD) has been growing in recent years, it
remains low in NI at close to 0.5% of GVA, compared with 1.3% in the UK as a whole,
1.2% in the RoI and over 2% in several EU countries including Sweden at 3% and
Finland at 2.6%.\footnote{Comparison of R&D in the Nordic Countries, R Nilsson and I Pettersson (Vinnova and Statistics, Sweden) (undated but probably 2007). Chapter 6 of this report also presents data for Finland and Sweden for total R&D expenditure (% of GDP).} There is, however, evidence that BERD has increased rapidly in small
firms in NI and they now contribute a higher percentage of overall BERD than almost
anywhere else in the UK or indeed in the EU. At the same time, BERD in larger firms has
been falling and this is partly due to the reduction in the already small number of BERD
intensive companies in NI.\footnote{The level of BERD undertaken by large firms in NI fell by 39% between 2001 and 2007; the corresponding figure for SMEs (employment below 250) represented growth of 170%.}

4.36 Invest NI has offered a large number of support programmes for Innovation and R&D
aimed at improving the competitiveness of local firms. Offers of financial assistance for
these programmes rose by around 20% in real terms (between 2002/03 and 2007/08).
A number of new schemes have also been introduced over the last year, including
Innovation vouchers to induce companies to collaborate with University researchers;
Innovation advisors to stimulate activity in R&D&I, and a single R&D programme
(incorporating previous R&D assistance programmes) which has helped rationalise the
overall number of Invest NI support packages available to businesses in NI.

4.37 Instead of job creation, the aim of the Innovation and R&D programmes is to increase
BERD, support collaboration and technology and improve performance on other
measures such as patents and high-tech start-ups. Table 4.8 highlights some of the
benefits associated with Invest NI’s main Innovation and R&D programmes.
Impact of Current Policies

Table 4.8: Benefits from Key Invest NI Innovation Programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Period</th>
<th>R&amp;D Expenditure</th>
<th>Jobs</th>
<th>Patent Applications</th>
<th>Patents Granted</th>
<th>Spin-Outs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Centres of Excellence</td>
<td>2002-2007</td>
<td>£114m</td>
<td>309</td>
<td>51</td>
<td>7</td>
<td>Yes</td>
</tr>
<tr>
<td>Compete</td>
<td>1998-2004</td>
<td>£62m</td>
<td>154</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>START</td>
<td>2000-2006</td>
<td>£62m</td>
<td>n/a</td>
<td>-</td>
<td>25</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: DETI / Invest NI evaluations

Note: Information only relates to the period covered in the evaluations and does not reflect the full period the programmes have been in operation

4.38 Due to the nature of several programmes, benefits are less easily quantified that those in the table above. For example, other benefits of support have included:

- **Proof of Concept**: supports the pre-commercialisation of leading-edge research from the two Universities. Benefits include spin-outs companies and licensing deals;

- **NITECH**: a venture capital fund designed to finance the commercialisation of research and technology within high-tech start-ups and existing firms and to attract follow-on investment from Venture Capitalists and private investors;

- **HEIF (Higher Education Innovation Fund)**: aims to foster research, development and technology transfer within academia and encourage and assist the two Universities to respond to the needs of business.

4.39 Nearly all of these programmes have been recently evaluated and estimates for additionality have been developed (shown in Table 4.9). This highlights that additionality in Innovation and R&D programmes is generally higher, and in certain cases much higher, than other support programmes such as SFA. More information on each of Invest NI’s main Innovation and R&D programmes is available in the programme annex.

Table 4.9: Additionality of Invest NI Innovation / R&D Programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Full Additionality</th>
<th>No Additionality</th>
<th>Overall Additionality</th>
</tr>
</thead>
<tbody>
<tr>
<td>START*</td>
<td>87%</td>
<td>13%</td>
<td>n/a</td>
</tr>
<tr>
<td>NITECH</td>
<td>50%</td>
<td>25%</td>
<td>n/a</td>
</tr>
<tr>
<td>Proof of Concept</td>
<td>38%</td>
<td>31%</td>
<td>n/a</td>
</tr>
<tr>
<td>Compete**</td>
<td>34%</td>
<td>3%</td>
<td>58%</td>
</tr>
<tr>
<td>Centres of Excellence</td>
<td>27%</td>
<td>6%</td>
<td>73%</td>
</tr>
</tbody>
</table>

Source: DETI Evaluations

Note: Overall additionality takes into account partial additionality to give a headline figure

* No assessment was made of partial additionality (to separate from full additionality)

** Figures for Phase 1 & 2 projects

4.40 Although Invest NI has been active in supporting Innovation and R&D, it is clear that NI still lags significantly behind not only the rest of the UK – which itself is a lagging performer in terms of R&D – but also much of the rest of Europe. In contrast, the Scandinavian economies, in particular Finland, have been able to display an impressive performance on Innovation and R&D. For example, as we outline later in Chapter 6,
Finland has been identified as a best practice region in terms of economic development and much of this was due to their commitment to Innovation and, in particular, the capabilities of relevant delivery organisations.

4.41 While Tekes is the most well known of Finland’s Innovation institutions, the Review Panel were very interested in the model adopted by Technical Research Institute of Finland, or VTT (expanded upon later in Chapter 6). We recognise that Invest NI already provides funding similar to Tekes, but we believe there is a gap in NI for an organisation such as VTT, which carries out research itself and provides a strong, more commercially-focussed, R&D expertise outside the Universities. Much of VTT’s research is collaborative with companies and Universities, and this significantly helps knowledge and technology transfer within the economy. The establishment of a similar organisation in NI could, potentially, bring about significant benefits to NI in terms of increasing Innovation and R&D, building research capability and also help address the region’s historic weak levels of absorptive capacity56.

4.42 Further to the Invest NI support programmes, the NI Science and Industry Panel (MATRIX) reported recently on a significant body of work to understand NI’s existing technology strengths and identify potential market opportunities which could be further exploited57. Opportunities within five sectors58 have been identified:

- Life and health sciences;
- ICT;
- Agri-food;
- Advanced materials; and
- Advanced engineering.

4.43 A key recommendation arising from MATRIX is the need to develop industry-led Innovation communities to engage business, academia and government, and address market opportunities through exploiting the science and technology base. We understand that an implementation group is currently working to take this forward.

Assistance for Trade

4.44 Invest NI’s main support programme for trade is Passport to Export. Firms have received £22m of trade assistance over the period 2002/03 – 2007/08, split relatively evenly between locally and externally-owned companies, with the largest share of support going on trade missions / market visits (as shown in Figure 4.6).

56 DETI, in conjunction with a number of other government departments in NI and ERINI, carried out research on R&D tax credits. One feature of the NI business base was its incapacity to undertake R&D and /or buy-in R&D from elsewhere (referred to as absorptive capacity). R Harris, Q C Li and M Trainor, Assessing the case for a Higher Rate of R&D tax credit in NI, January 2006.

57 The MATRIX reports can be found at http://www.matrix-ni.org/.

58 A sixth sector, yet to be fully developed at the time of writing, has also been identified in the form of sustainable energy and consumption.
The Review Panel understand that Invest NI has yet to carry out an evaluation of the programme, and we found this surprising as it not only represents one of Invest NI’s largest programmes, but it is also the main channel for supporting exporters in NI. Following our discussions with relevant officials, we understand that Invest NI is scheduled to carry out an evaluation in 2010/11. Further information on trade assistance can be accessed in the programme annex.

Although no Invest NI evaluations have been carried out to date, the Panel have reviewed a number of academic articles which evaluate the provision of export support in NI. For example, a recent study undertook an evaluation of export marketing schemes for small businesses in 2007. Although the reference period was 1994-98, the results were positive, highlighting a strong impact on export growth in small businesses. Their inference was that export assistance should be targeted on firms that are in a position to take advantage of support.

In addition, another study reported in 2006 that small firms (but not large firms) were underperforming in exports relative to similar sectors in the RoI, concluding that a lack of R&D activity was a key reason for this. This link between exports and Innovation / R&D was also identified by DETI’s research into Innovation in tradable services, which highlighted that exports and Innovation / R&D are both necessary to achieve productivity growth. This all points to the importance of working to encourage companies to enter export markets, not least as this can often expose them to the importance of engaging in Innovation and R&D as a means of strengthening competitiveness.

In our review of global best practice in economic development (Chapter 6), the Panel note the dedicated and intensive support given to exporting companies. We further note the tendency for exports growth to be positively correlated with R&D and overall productivity improvements. There is also an increasing tendency for the dedicated

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export agencies to charge for their services (both in terms of becoming affiliated members and also to receive a range of services including market information / research, trade missions and other customised services). In Chapter 8 we propose that the internal structures of Invest NI should be more clearly aligned to the differing skill sets required to support FDI, Innovation / R&D, Small Business and Exports. Further to this governance recommendation, and in light of the importance of exports as a driver of regional economic growth (see Chapter 5), the Panel believe there is considerable scope for Invest NI to further strengthen its capacity to support export performance. We return to this point later in the recommendations chapter.

**Assistance for Training**

4.49 Assistance for training within companies is permitted within the EU state aid rules, and in NI it is delivered within the Business Improvement Training Programme (BITP was formerly known as the Company Development Programme or CDP). The CDP has long been regarded as a low additionality scheme, and in the past as a virtual employment subsidy. The evaluations highlighted that levels of expenditure of the CDP have been falling and this is welcomed, particularly as the evaluations confirm the low levels of additionality (for example, 63% of firms in receipt of assistance reported that in the absence of CDP the training they would have undertaken themselves would have covered the same content). We note, however, that the budget for the new BITP has been recently increased. A more detailed breakdown of the CDP is available in the programme annex.

**REVIEW PANEL ANALYSIS ON OVERALL IMPACT 2002/03 – 2007/08**

4.50 The analysis in this report has highlighted a view that, although Invest NI supported projects have been successful in job creation, their impact on other measures such as living standards and productivity has been small in many respects. Even with respect to job creation, we have already touched upon the issue of whether this activity was fully additional or whether some part of it would have taken place anyway. The Review Panel have conducted its own analysis to help determine this.

4.51 It is recognised that Invest NI's task in assessing the merits of applications for assistance from firms is a difficult one. Externally owned companies are usually in a position to claim that projects will be located elsewhere unless financial assistance is forthcoming. Similarly, locally owned companies can argue that projects would be delayed or would go ahead on a smaller scale. The Panel acknowledge the difficulty that Invest NI has in identifying ex-ante whether a project is truly additional.

4.52 The large scale of assistance actually offered is perhaps consistent with a view, held by Invest NI and others that few projects would go ahead in NI without government assistance. Paradoxically, this is tantamount to saying that without government support, NI would be an unfavourable place to do business. In our view, this is an overly pessimistic position to adopt. An alternative view is that firms in NI would expand at a rate which reflects prevailing UK macro-economic conditions and company competitiveness, given similar economic and structural conditions.

4.53 Whereas NI may be an inappropriate location for some activities with high transport costs, the region should, in our view, be regarded as a competitive location for much of manufacturing and services. Most new inward investment in recent years has, for instance, been in contact centre, finance or IT sectors. Here, services can be transmitted electronically with no cost penalty for an NI location and travel costs to
meetings are now much lower. Prior to 1998 a higher risk of disruption of services due to ‘the troubles’ deterred most contact centres from locating in NI but such considerations are no longer relevant.

4.54 To measure the impact of Invest NI assistance, we first have to estimate how companies would have performed in the absence of assistance. To do this the Panel have adopted the view that, in the absence of financial assistance, firms would have expanded at a rate close to the average for their sector in the UK as a whole. This view is based on the fact, outlined earlier, that NI shares common exchange rates, interest rates, tax rates and social security system with the rest of the UK. While transport and energy costs are higher these are offset by lower labour costs.

4.55 We have calculated an ‘expected’ growth of employment, based on UK average growth in each sub-sector, to compare with the actual employment in NI. The difference between the actual and expected employment can be taken as an indicator of the impact of financial assistance in NI, over and above that received by firms in GB. This exercise is easiest to do for manufacturing where sub-sectors are well defined. It is less straightforward for the service sectors because many services depend more on local demand and because call centres tend to be allocated in different sectors depending on the precise nature of their activity. We thus focus initially on manufacturing but return to the service sectors later.

Impact on Employment

4.56 Since 1992, employment in NI manufacturing has declined by much less than expected on the basis of similar sectors in the UK as a whole. NI has retained jobs, and output, which would have been lost if growth had been closer to UK average rates. Our assumption is that these extra jobs reflect the assistance given by Invest NI to most manufacturing firms in NI. Over the period since 2002, our estimate is that over 10,400 jobs were added to NI’s manufacturing sector as a direct result of higher levels of financial assistance in NI (see Table 4.10). This implies an addition of around 1,700 jobs each year.

| Table 4.10: Difference between Actual and ‘Expected’ Employment in NI Manufacturing |
|---------------------------------|--------|--------|--------|--------|
|                                  | 2001   | 2003   | 2005   | 2007   |
| Actual                          | 100,186| 91,884 | 87,697 | 87,651 |
| Expected                        | 100,186| 88,416 | 80,930 | 77,229 |
| Difference                      | 0      | 3,468  | 6,767  | 10,422 |

Source: Review Panel calculations using Census of Employment data from DETI and ONS

4.57 Invest NI reported over 11,000 new jobs created and 14,000 safeguarded jobs associated with offers to manufacturing firms over the period 2002/3 - 2007/8, or 25,000 in total. Over the same period, the actual-expected calculation indicated an extra 10,400 jobs in total⁶². In other words, our estimate is that only 41% of the jobs promoted or safeguarded during the 2002/3-2007/8 period were actually added

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⁶² The detailed calculation in Table 4.10 refers to the period 2001/02 - 2007/08. This was conducted at 3 digit level covering 150 individual sub-sectors. A calculation with less sectoral detail at 2 digit level (14 sub-sectors) for 2002/03 - 2007/08 gave an actual less expected difference of 10,200.
to manufacturing employment between 2002 and 2008, over and above changes expected at UK rates of change.

4.58 We recognise this comparison is not precise, since there are potential lags in the creation of promoted jobs. Some of the jobs promoted in this period may have been created after the end of the period. Also, some jobs promoted prior to 2002 may have been created within this period. These are however offsetting effects although they may not completely offset one-another. In addition, as we stated previously, not all promoted jobs are actually created. A few projects fail to materialise at all and others for various reasons created fewer jobs than anticipated at the time of offer. In some cases part of the grant is reclaimed to reflect this under-performance. Invest NI’s Performance Information Report states that between 2002/03 and 2004/05, 82% of financial offers to new FDI projects were paid within 2-4 years and 82% of jobs promoted were actually created.

4.59 Applying the 82% job creation rate to the 11,000 new jobs, we might perhaps expect 9,000 jobs to be created during the 2002/03–07/08 period. It would be expected that all of the 14,000 safeguarded jobs should be included since these actually existed at the time of offer even if some were later lost. Taking the 9,000 promoted jobs and the 14,000 safeguarded jobs gives 23,000 assisted jobs, compared with the 10,400 we judge to have been created over and above what would have happened in the absence of assistance.

4.60 We conclude that under half of the jobs promoted and safeguarded in manufacturing were actually added to NI’s manufacturing total over and above what would have happened in the absence of any assistance at levels greater than the UK average. In other words, around half of the jobs created or safeguarded are likely to have been realised in NI in the absence of assistance over that in the rest of the UK. Importantly, this finding on additionality is broadly consistent with the SFA evaluation that we outlined previously. Although Invest NI have some reservations on the evidence from the SFA evaluation, the Panel take the view that a range of measures, both in NI and GB, find that additionality of regional aid is generally around 50%, and hence accepts this as a reasonable approximation.

4.61 A similar exercise can be undertaken for the service sectors although not at the same level of sectoral detail. Figure 4.7 shows that employment in the financial and tradable business services sectors had been growing at close to the UK rate until the cease-fires of 1995-96. Thereafter, employment in NI grew much faster. We ascribe this change in trend primarily to the ability of Invest NI to attract call centres and similar activities to NI, following the cessation of the ‘troubles’.

63 The sectors include financial and business services excluding labour recruitment, industrial cleaning, security and real estate.
Impact of Current Policies

Figure 4.7: Actual and Expected Employment in the Financial and Tradable Business Services sectors

Source: Data from ABI and previous employment surveys and censuses for NI and UK.

Note: The sectors include financial and business services (excluding labour recruitment, industrial cleaning, security and real estate). Expected is NI employment in 1971 multiplied by the cumulative growth rate for the same sectors in the UK as a whole.

4.62 The gap between the two lines in Figure 4.7 suggests that NI attracted an extra 3-4,000 jobs between 2001 and 2008. Over the period 2002-08, around 17,000 new service sector jobs were promoted and 1,000 safeguarded in NI, of which 5,700 were in firms new to NI. If 80% of the 5,700 jobs were actually created, the 4,500 would still be more than the 3-4,000 jobs estimated above as being additional to the NI economy, but is of a similar magnitude. It may be that perhaps 10-30% of the firms new to NI would have been attracted without the assistance available from Invest NI, perhaps due to the available labour at relatively low wage levels. In addition, the majority of the 9,000 jobs promoted or safeguarded in expansion projects should also be regarded as non-additional. In this case, the Panel’s view is that firms already located in NI’s low labour cost environment could be expected to grow at UK rates for their sector. Our conclusion is that additionality in the service sectors is once again below 50%, and again consistent with the findings from the SFA evaluation.

Impact on Productivity

4.63 As NI’s record on job creation has improved, the focus of economic development policy has shifted towards raising the generally low level of labour productivity. Productivity, conventionally defined as GVA per employee, is a measure of the income generated from production divided by the number of employees. It is influenced both by physical productivity (i.e. the volume produced per employee) and the average price received from selling products net of costs. As the economy shifts from manufacturing to services, physical productivity has become harder to measure and GVA per employee is the most useful measure. The impact of Invest NI policy on productivity is best observed for manufacturing since most sub-sectors qualify for assistance. Figure 4.8

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64 The exact number depends on whether allowance is made for the faster growth of population in NI after 2004 and hence higher local demand for financial and business services.

65 A further 1,500 service sector jobs in firms new to NI were outside the financial and business services sectors being analysed here. Most of these were in call centre activities classified to the telecommunications sector.
shows NI’s manufacturing productivity relative to the UK average, compared with expected productivity if NI had followed the UK pattern.

**Figure 4.8: GVA per Employee in Manufacturing (UK=100)**

![Graph showing GVA per Employee in Manufacturing](image)

**Source:** ONS Regional accounts, ABI employment data, APS self-employment data

**Note:** Expected GVA per employee is UK GVA per employee in each 2 digit sub-sector weighted by NI employee structure employees include self-employed

4.64 GVA per employee in manufacturing is well below the UK average, but has generally been higher in the current decade than in most of the 1990s. Much of the improvement has occurred in the food processing sector, where world commodity prices are an important influence on GVA. The sharp decline and virtual extinction of the low productivity textiles and clothing sector in recent years has also raised the general level of productivity in the sector. As a result, we take the view that it is most meaningful to examine productivity in the remaining manufacturing sectors (see below).

4.65 The level of GVA per employee (in the manufacturing sector excluding the sectors listed above) has fluctuated in the range 86%-95% of the UK average (see Figure 4.9). The record since 2001 is mixed and data for 2007 is estimated, but the likelihood is that relative productivity was no higher in 2007 than in 2002. Although a number of respondents to our evidence gathering phase stated that productivity in NI manufacturing is converging on the UK average, our view is that the data does not support this assertion. Furthermore, while it is possible that Invest NI support is holding up levels of productivity that would otherwise be even lower, there is little evidence of a trend improvement in manufacturing productivity. The best measure in our view is the ratio of actual to expected GVA per employee in manufacturing excluding food processing, textiles and clothing. This measure suggests that gains were made relative to GB in the run-up to the millennium (chiefly in electronics and transport engineering), but these gains have been partially lost over the current decade.
Impact of Current Policies

Figure 4.9: GVA per Employee in Manufacturing excl Food Processing, Textiles and Clothing (UK=100)

Source of data: ONS Regional accounts, ABI employment data, APS self-employment data

Note: Expected GVA per employee is UK GVA per employee in each sector weighted by NI employee structure. Data for 2007 is estimated based on actual 2007 data for GVA per employee for the whole NI economy, on UK GVA per employee by sector and on employees in NI by sector

4.66 As we indicate, the composition of manufacturing sectors has moved a little in the direction of convergence, as textiles and clothing have declined. However, any improvement across the remaining manufacturing sectors has been slower than in GB. There is also limited evidence that Invest NI intervention has succeeded in either improving the mix of industries within manufacturing, or of raising the productivity within individual sectors by enough to cause a convergence towards UK average levels of productivity.

4.67 In addition, there is little evidence that productivity (GVA per employee) in either manufacturing or financial and tradable business services has converged towards the UK average, either including or excluding the Greater South East of England, since 2002. The fact that policies in force since 2002 have not led to a convergence in productivity suggests that only slightly different programmes to those currently in force will also not be successful. This, in turn, suggests that a major revision of policy will be needed to meet the PfG goal of halving the private sector productivity gap with the UK excluding the Greater South East.

Summary on Impact

4.68 The Review has considered a range of different types of evidence on impact and additionality. All of these consistently point to the following conclusions:

- Additionality in job creation from SFA grants is estimated to be around 50%, even allowing for the fact that not all offers of SFA are fully taken up. We have already indicated that this is in line with the findings of a recent study of expenditure by the English RDAs. This results in an estimate that assistance has resulted in the addition of around 2,500 jobs per annum, over and above what would have occurred in the absence of assistance;
• There is little evidence that SFA has a positive impact on productivity (measured as GVA per employee);

• The evidence from the econometric evaluation of SFA suggests that the size of SFA grants per employee had little if any impact on the growth of either employment or sales revenue in externally-owned firms. This suggests that the level of additionality may be particularly low in these cases, which reflects the fact that most multinational companies have good access to finance for investment; and

• Additionality is usually estimated to be higher than 50% for programmes of Innovation and R&D support. Levels of BERD have risen substantially for SMEs but a major problem remains with larger firms.

OVERVIEW OF INVEST NI 2008/09 PERFORMANCE

4.69 Over the course of the Independent Review, Invest NI released headline performance figures for 2008/0966. Chapter 3 has already outlined Invest NI’s targets for 2008/09, which sets the context for evaluating their performance. The latest financial year is also the first under the current Corporate Plan, and we can thus examine the extent to which broad expenditure patterns have changed to match the altered priorities described in the new Corporate Plan (see Table 4.11)

Table 4.11: Invest NI Offers of Assistance and Plans (£ million)

<table>
<thead>
<tr>
<th></th>
<th>Average Annual Offers</th>
<th>Offers</th>
<th>Plans</th>
<th>Plans</th>
<th>Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002-08</td>
<td>2008-09</td>
<td>2008-09</td>
<td>2009-10</td>
<td>2010-11</td>
</tr>
<tr>
<td>Externally Owned</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Firms</td>
<td>17</td>
<td>41</td>
<td>21</td>
<td>21</td>
<td>22</td>
</tr>
<tr>
<td>Existing Firms</td>
<td>25</td>
<td>13</td>
<td>35</td>
<td>28</td>
<td>22</td>
</tr>
<tr>
<td>Locally Owned</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Firms</td>
<td>9</td>
<td>8</td>
<td>15</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>Existing Firms</td>
<td>28</td>
<td>29</td>
<td>20</td>
<td>21</td>
<td>25</td>
</tr>
<tr>
<td>R&amp;D, Innovation, Training and Trade</td>
<td>48</td>
<td>59</td>
<td>42</td>
<td>50</td>
<td>55</td>
</tr>
<tr>
<td>Property</td>
<td>3</td>
<td>3</td>
<td>11</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>Total</td>
<td>129</td>
<td>150</td>
<td>144</td>
<td>163</td>
<td>166</td>
</tr>
</tbody>
</table>

Source: Invest NI and Corporate Plan

Note: Plans are planned expenditure and hence are not fully comparable with offers

4.70 Planned expenditure for 2008/9 is £15 million higher than the average offers for 2002-0867. Of this, an additional £8 million was planned to be spent on land acquisition, leaving another £7 million for assistance to companies and other organisations. This leaves total planned assistance expenditure at about the same in real terms as the average for offers for the period since Invest NI’s formation in 2002.

4.71 In practice, the amount offered turned out to be higher than planned despite a low spend on property. The change in the actual amounts of assistance offered is shown in columns one and two of the table above. Total assistance offered was £6m greater than that planned (accounted for by one particularly large grant offer for Bombardier).

66 All figures for 2008/09 are provisional and may be subject to change.

67 The Panel recognises that planned expenditure will vary from actual expenditure.
Without this grant, the total offered in 2008/09 was 12% above the average for 2002/8 and hence about the same in real terms. Table 4.12 presents a full breakdown of 2008/09 offers with the average for 2002-08.

Table 4.12: Percentage Change in Value of Offers during 2008/09 from 2002-08

<table>
<thead>
<tr>
<th></th>
<th>Locally Owned (% change)</th>
<th>Externally Owned (% change)</th>
<th>Total (% change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Formation</td>
<td>-12</td>
<td>22</td>
<td>11</td>
</tr>
<tr>
<td>Business Expansion</td>
<td>6</td>
<td>32</td>
<td>19</td>
</tr>
<tr>
<td>Business Innovation</td>
<td>40</td>
<td>-9</td>
<td>24</td>
</tr>
<tr>
<td>R&amp;D / Innovation</td>
<td>42</td>
<td>-6</td>
<td>29</td>
</tr>
<tr>
<td>Training (BITP)</td>
<td>70</td>
<td>-12</td>
<td>21</td>
</tr>
<tr>
<td>Exports</td>
<td>60</td>
<td>68</td>
<td>64</td>
</tr>
<tr>
<td>Business Info &amp; Support</td>
<td>34</td>
<td>-40</td>
<td>24</td>
</tr>
<tr>
<td>Environmental &amp; Other</td>
<td>-6</td>
<td>-100</td>
<td>-23</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>18</strong></td>
<td><strong>19</strong></td>
</tr>
</tbody>
</table>

Source: Invest NI and Corporate Plan

4.72 From the table above, we conclude that:

- Total assistance offered in 2008/9 was similar to the average for earlier years in real terms (this conclusion omits the large grant for Bombardier);
- Offers to locally-owned firms and organisations (including Universities) grew faster in real terms than offers to externally-owned firms;
- Support for new business formation decreased by more than 10% for locally-owned firms;
- For externally-owned firms, there was growth in offers to new FDI projects although most of these offers were to new projects in firms already in NI. Offers for expansion projects increased by almost one-third, but fell by a half if the large Bombardier project is excluded;
- Assistance for Innovation or R&D projects grew by about 20% in real terms. All of this growth was in offers to locally-owned firms and offers to externally-owned firms declined;
- Similarly, support for training grew significantly for locally-owned firms but declined for externally-owned firms;
- The same pattern was also in evidence for business support grants although these had always been small for externally-owned firms; and
- Grants for export promotion grew significantly, but even so remained relatively small for both local and external firms.

4.73 Our interpretation of these changes is that the pattern of offers is slowly moving away from areas likely to involve the lowest levels of additionality, and towards areas generally agreed to be priorities. The limited evidence available suggests that additionality is likely to be higher in smaller, locally-owned firms and spending is now more concentrated on these. Additionality for projects in existing externally-owned firms depends on the argument that such projects would be located outside NI without
government assistance. Although this may be accurate in some cases, it is in firms’ interests to exaggerate the extent of such possibilities, and hence low additionality is at least a possibility.

4.74 There are a number of reasons why Innovation and R&D projects should be increasingly supported and it is encouraging to see that this has been the trend. As we have already displayed, additionality is generally reasonably high and the levels of R&D spend remain very low in NI. The largest increase in R&D support has occurred for locally-owned firms, which may reflect a greater willingness on behalf of small firms to undertake R&D and perhaps also an improving capacity to do so. The main problem, of low R&D spend in externally-owned firms is not, however, being addressed. This may require a new approach and the recommendations chapter presents a portfolio of proposals targeted to this area.

4.75 In terms of actual performance in 2008/09, there have been some positive developments. The total number of jobs promoted and safeguarded has remained at just over 7,000. On the surface, the fact that more of these jobs are classed as new and fewer as safeguarded is a favourable change, especially during a period of recession. There has been a significant fall in the number of jobs from companies new to NI. This would be expected during a recession, but Invest NI’s practice of combining these figures with new jobs in existing external companies hinders what the Review Panel consider to be a transparent assessment of performance. The huge increase in new jobs in business formation by existing externally owned firms includes the large Bombardier project. We are unclear whether consistent definitions have been used between new and expansion projects.

Table 4.13: Invest NI 2008/09 Performance

<table>
<thead>
<tr>
<th>Business Formation</th>
<th>NEW JOBS</th>
<th>SAFEGUARDED JOBS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Firms New to NI</td>
<td>1,317</td>
<td>483</td>
<td>24</td>
</tr>
<tr>
<td>Other New Externally Owned Projects</td>
<td>344</td>
<td>2,031</td>
<td>58</td>
</tr>
<tr>
<td>Locally Owned Start Ups</td>
<td>410</td>
<td>545</td>
<td>18</td>
</tr>
<tr>
<td>Business Expansion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Externally Owned</td>
<td>996</td>
<td>1,541</td>
<td>1,911</td>
</tr>
<tr>
<td>Locally Owned</td>
<td>1,601</td>
<td>1,864</td>
<td>516</td>
</tr>
<tr>
<td>Business Innovation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Externally Owned</td>
<td>8</td>
<td>0</td>
<td>16</td>
</tr>
<tr>
<td>Locally Owned</td>
<td>3</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>4,679</td>
<td>6,464</td>
<td>2,544</td>
</tr>
</tbody>
</table>

Source: IREP database
Earlier in this chapter, the Panel highlighted its concerns over the large numbers of assistance given to safeguarded jobs. There has been a sharp and welcomed fall in safeguarded jobs during 2008/09, with safeguarding in manufacturing falling to a new low. The reasons behind this fall are unclear and have not been sufficiently explained by Invest NI. As we have indicated in previous chapters, it is in times of recession that job protection should take place, rather than in periods of economic growth (which, for NI and the UK generally, was between 2002/03 and 2007/08). One possibility, not ruled out, is that definitional changes have led to fewer safeguarded jobs and more new jobs promoted in expansion projects.
Section II

Towards a New Economic Policy
SUMMARY OF KEY FINDINGS

- Economic growth involves agents from a variety of sectors, but the key agent is the individual company/firm.
- HM Treasury's drivers of productivity are a necessary, but insufficient, framework for regional economic growth. They fail to sufficiently prioritise exports and inward investment as the key drivers at the regional level to grow the economy.
- R&D that promotes innovation and business sophistication—including, at the regional level, technology transfer—is the most important long-term driver of productivity. This is essential for Northern Ireland to move up the value chain.
- Northern Ireland needs to focus on the quality of FDI, not just the volume.
- The contribution of export-intensive FDI to the Northern Ireland economy will be greater if more inputs are purchased from local suppliers, especially SMEs.
- Competitiveness varies between places in a region, with cities often offering higher growth and productivity. It is therefore important to allow companies the scope to locate where they can operate most profitably.

INTRODUCTION

5.1 The analysis presented in Section I indicates that DETI and Invest NI need to strengthen the nature and mix of policies and programmes to deliver on the PfG productivity goal. In that context, the overall aim of this section is to outline the Panel's views on how economic policy could be better targeted in Northern Ireland (NI). Therefore, prior to introducing the Panel's recommendations for change, it is important that we initially outline some analysis on what we consider to be the important drivers of regional economic growth. Furthermore, we also present evidence gathered on global best practice in economic development (Chapter 6). This material is then used to frame the recommendations for change presented in Chapter 7.

5.2 The Independent Review Panel endorse the medium term economic policy goal of the NI Executive, which is to boost private sector productivity relative to other comparable regions of the UK. As outlined in Chapter 2, there is considerable evidence that variations in output per head across the UK are largely explained by differences in labour productivity. However, having a more productive and wealth creating private sector is not the ultimate goal. Instead, the aim is to raise living standards and make every citizen in NI more prosperous, thereby tackling the wider employment, social and spatial objectives of regional economic policy. Therefore, the Review Panel believe that building a more value added private sector economy in NI represents the only viable medium to longer term policy goal for the Executive. However, as we outlined in the introduction, the ongoing global recession is also presenting the Executive with...
important short term goals to protect and generate employment opportunities across the whole economy.

**Productivity**

5.3 The overarching PfG goal seeks to improve labour productivity, but this is only part of the solution to grow a more dynamic and innovative economy, as capital also needs to be made fully productive. This, in turn, raises the necessity of strengthening technological progress and promoting regional spillovers from investment in areas such as Innovation and R&D.

5.4 Whilst the Review Panel agree with the economic goal of the NI Executive, it has found little evidence that a sufficient strategic roadmap exists, which outlines how the goal will be achieved. Indeed, following its assessment of relevant documents such as Strategy 2010, Economic Vision, the draft Regional Economic Strategy and the more recently produced Programme for Government, the Review Panel consider that insufficient attention has been given to the most basic and fundamental question – what drives economic growth in NI? As a consequence, this chapter of the report outlines our view on the key drivers of growth in a small regional economy such as NI. In addition, we make some recommendations (in Chapter 8) on how the NI Executive could develop a more co-ordinated and robust economic strategy for NI.

5.5 The summary box at the introduction outlined the key findings from this chapter of the report. However, before we develop the points, it is worth outlining a number of important outputs from the chapter. For example, it provides an opportunity for the Panel to outline what we consider to be the dominant factors influencing regional economic growth. A key finding is the importance of tailoring economic policy to suit the particular needs of the region, rather than the current approach which seeks to implement economic policy developed by HM Treasury. In addition, we emphasise the critical importance of developing the export base, with Foreign Direct Investment (FDI) taking a leading role, but with increased emphasis on linking foreign owned firms, via supply-chains, to local companies. These factors remain fundamental for economic growth in NI, and are a key component of Invest NI activity. Finally, a key theme running throughout the report is the importance of undertaking a more sustained and focused approach to Innovation, R&D and technology transfer. This chapter defines what we mean by Innovation and R&D and it also provides the economic arguments to explain why they should be considered as the key drivers for productivity growth in NI.

**POLICY & ECONOMIC GROWTH**

**Rationale for Policy Intervention**

5.6 The Review Panel agree with the presumption that the market will generally make more efficient allocation of resources than the public sector. However, in areas such as Innovation, R&D and human capital (skills), the market often results in sub-optimal

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69 Strategy 2010 refers to a report from the NI Economic Development Strategy Steering Group (commissioned in January 1998) which reviewed economic development in NI and developed proposals for the economy through the first decade of the millennium. A full copy of the report can be accessed at the following link: [http://www.detini.gov.uk/cgi-bin/downutildoc?id=222](http://www.detini.gov.uk/cgi-bin/downutildoc?id=222).

70 Economic Vision can be accessed at the following link: [http://www.detini.gov.uk/cgi-bin/downutildoc?id=935](http://www.detini.gov.uk/cgi-bin/downutildoc?id=935).
levels of investment and public policy can, and should, help to mitigate these shortcomings.\(^1\)

5.7 The Panel also acknowledges that, just as markets fail in certain areas, so too can public policy interventions. It is for this reason that strategic reviews of this nature, together with regular appraisal and evaluation programmes, are necessary to ensure that market failures are addressed with the right policy interventions. Central to this is the need for the analysis to be fully objective, and it is important that assessments are carried out by sources independent from those responsible for the expenditure.

Regions and the Nation
5.8 NI is a region of the UK and therefore part of the overall UK economic and monetary union. However, each region of the UK does not exist in isolation and the economic interdependence between\(^2\) and within\(^3\) national economies is well established. For example, in the context of regional economies there are significant labour market linkages through migration and wage bargaining. In addition, there are extensive trade, investment, monetary and fiscal flows between the UK regions. With regard to the latter, the NI economy benefits from a significant fiscal subvention from the UK Government, which enables the local public sector to make a much larger contribution to regional economic growth than elsewhere in the UK.\(^4\)

5.9 It therefore follows that policies designed to enhance productivity and growth within NI will have consequences for other regions and hence the UK as a whole. Equally, the performance of the NI economy will be affected, to some degree, by the productivity and growth policies adopted elsewhere in the UK. This aspect is discussed in greater detail below. Furthermore, it should be remembered that the nature and extent of such policies in the Republic of Ireland (RoI) are likely to also impact on the performance of the NI economy.

UK Productivity
5.10 Over the past decade, there has been a general consensus that to significantly raise UK living standards and strengthen competitiveness, public policy interventions need to be targeted at improving the growth in productivity\(^5\) (largely defined as labour productivity). In response, the HM Treasury devised an intellectual framework that is generally referred to as the ‘productivity drivers’: investment, skills, Innovation, enterprise and competition.\(^6\) For the most part, these areas have been co-opted into regional economic strategies throughout the UK, including NI. For example, the draft Regional Economic Strategy was developed (by the Department of Finance and Personnel) on the basis of these supply-side drivers. In addition, of the twenty-three


\(^{4}\) The latest estimate for the fiscal deficit in NI (produced by DFP for 2006/07) was £6.7bn, which represents 25% of total output. The corresponding figure for Scotland – for the same period – was £10.5bn, representing 11% of total output.


Drivers of Regional Economic Growth

Public Service Agreements outlined in the NI Programme for Government, the first (presumably to reflect the economy as the top priority) is productivity growth which covers exactly the same areas as the UK productivity drivers.

5.11 However, a significant shortcoming of the Treasury framework is that it fails to outline the nature and growth processes linking the drivers; which of the drivers have the greater weight and whether the approach is sufficient at the regional level. Instead, the focus has been to benchmark performance across the productivity drivers to allow for international and/or interregional comparisons. This weakness has also been translated into the regional economic strategy documents that adopt the HM Treasury framework. In this chapter of the report, we set out our own assessment of the productivity drivers and their applicability to NI.

Regional Growth and the Productivity Drivers

5.12 The traditional approach to economic growth, competitiveness and productivity stresses the role of the supply-side. For example, the growth rate of GDP (or GVA at the regional level) depends on the growth of capital, labour and technological process. However, demand is also important and several approaches to growth consider this to be the ultimate driver. Other approaches go further and allow for the interaction between demand and supply, with growth/decline leading to wider spillover benefits/costs.

5.13 However, these views of growth processes only take us so far. They have a macroeconomic focus which ignores other features that may be important to regional growth. Figure 5.1 presents a simple view of economic growth that highlights the role of incentives, change agents – who fundamentally drive the growth of the economy – and demand.

Figure 5.1: A Simple View of the Growth Process

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77 PSA 1 (Productivity Growth) has seven objectives which fall into either enterprise (promote a competitive and outward looking economy & attract/support high quality investment); Innovation (promote higher value-added activity through Innovation/commercial exploitation of R&D and develop and sustain Higher Education research); skills (increase the level of skills to aid productivity improvements in manufacturing and tradable services) and infrastructure (ensure a modern sustainable economic infrastructure to support business and improve the strategic road network by the advancement/completion of a range of major works schemes).
5.14 The HM Treasury approach to the drivers of productivity fails to stress the role of incentives in regional economic growth. Improving regional economic performance requires attention to be paid to the incentives available across the whole spectrum of economic activity. These include incentives to create employment opportunities, to invest in the economy, to start businesses, as well as to increase innovation, R&D and technology transfer. Appropriate incentives are the key ingredient in translating quality science, skills and entrepreneurial flair into flexibility and higher productivity. Such incentives allow a regional economy to capitalise on the opportunities created by openness and are often best secured through the medium of competition, which challenges vested interests and drives efficient economic change. Of course, incentives can also be perverse and may encourage rent seeking and unproductive activity.\(^78\)

5.15 As illustrated in Figure 5.1, it is the nature and behaviour of change agents which are the key medium through which growth occurs. Within this process, the most important agent is the firm, as they seek to recruit and retain skilled labour and make the necessary investments which ultimately drive economic growth. The dynamic entrepreneurial firm is of particular importance, especially the internal processes which encourage innovation and the development of networks and collaborative links with other firms and institutions such as the Further and Higher Education sectors and research Universities.\(^79\) This has important implications, not least that economic development policy in NI should revolve around the needs of businesses.

5.16 Notwithstanding the above, the public sector also needs to be viewed as a key change agent, as both policy and public sector efficiency are important to economic growth.\(^80\) Successful policies require an understanding not only of the processes affecting economic growth, but also the combination of an effective policy process and correct policies. The facts surrounding an economy’s performance are rarely disputed; rather what is contested is the framework of action that guides policy. If the strategic framework is wrong then no amount of hard work can compensate.\(^81\) This is one of the reasons why the Review Panel are recommending (in Chapter 8) the development and implementation of a co-ordinated economic strategy for NI, and one which builds on the findings of this Review. Moreover, an inefficient public sector may waste resources, ‘crowd out’ private sector activity and act as an impediment to private sector initiatives\(^82\). This is a serious matter given the size of the public sector in NI.

5.17 Figure 5.1 also includes demographics as a key change agent. The level and growth of population and its components of change (via birth and death rates and migration) will change the capabilities of the economy and its potential for growth by, for example, affecting the age structure.\(^83\) This is an area where NI currently has some advantages,

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with more than one in five (21.6%) of the population aged under 16 years, which represents the youngest population in the UK\textsuperscript{84}.

Regional versus National Focus

5.18 Figure 5.1 stresses the role of competitiveness and demand. However, at the regional level it is export demand and the creation and retention of a viable, quality export base, well embedded in the local economy that is the key to sustained regional growth. The importance of income from exports was recognised in the report by Sir David Varney into the competitiveness of the NI economy\textsuperscript{85}. A strong export base helps finance imports to the extent that is required at the regional level in a national economy. But, more importantly, a regional export base provides a link to fast growing economies through access to rapid demand growth and also potentially through inward investment and the attraction of skilled migrants\textsuperscript{86}.

5.19 The traditional view of the development of a regional export base was that it should exploit comparative and competitive advantage in a regional specific resource. Natural resources such as harbours, forests, mineral deposits and waste supplies would frequently provide the foundation for the base. However, in recent times the exploitation of man-made resources is more common. A modern regional export base can be based on localisation, agglomeration economies and cluster potential, for example, through a pool of specialised labour skills.

5.20 The export base will more rapidly be created if high value inward investment and highly productive skilled labour (from both indigenous and migrant sources) are attracted. A key influence then on regional productivity (and hence the PfG productivity goal) is the extent to which the economy is attractive to high value added mobile plants and skilled workers, and also the extent to which knowledge based spillovers are facilitated. With regard to the latter, developing the capacity to undertake Innovation and R&D is of particular importance. The globalisation of R&D also means that a region’s capacity to source new technology globally through effective technology transfer is increasingly important. In part, this also requires regions to ensure they are skilled imitators as well as effective innovators.

5.21 Although the export sectors are undoubtedly important for productivity and growth in a regional economy, it must also be recognised that other sectors such as agriculture and construction are also part of the private sector. Therefore, while the measures suggested in this report are designed to increase productivity in the economy, the Panel would again highlight the importance of addressing productivity issues in sectors which are outside the scope of DETI / Invest NI.

5.22 It is clear that the HM Treasury approach requires adaption when the focus shifts to regional productivity, due to the greater openness of regional economies and their sensitivity to inflows and outflows of labour and capital. For example, in a region such as NI, increased supply-side investment may simply result in the under-utilisation of resources and / or leakage out of the region, particularly in terms of skilled labour.

5.23 As a consequence of the above, it is vital that the economy continues to develop its connectivity to international growth hubs, including those proximate to NI such as

\textsuperscript{84} Regional Trends 41, 2009.

\textsuperscript{85} The full report by Sir David Varney can be accessed at the following link: www.hm-treasury.gov.uk/d/varney_review300408.pdf.

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London and Dublin (notwithstanding the impact of the current global recession on these areas). In part, this requires investment in cutting edge communications technology, transportation networks, support to widen the local export base, with stronger supply chain linkages (where new and small firms supply the needs of the regional export base) and the attraction / retention of high value inward investment.

5.24 Despite the importance of demand in the regional economy, the Review Panel would also stress that local supply-side efficiency must not be ignored. It may not be sufficient, by itself, to raise economic growth and productivity in NI but it is clearly a key driver.

Supply-Side Efficiency

5.25 Adopting the HM Treasury productivity drivers not only results in limited analysis of the regional growth process but it also ignores the relative importance of the drivers, their key characteristics and what other ‘drivers’ could, and should, be deployed. These issues are developed further in the remainder of this chapter of the report. The discussion below ranks the Treasury drivers in terms of their relative importance to regional growth (beginning with what we consider to be the key driver – Innovation and R&D).

Key Drivers and Characteristics

5.26 Figure 5.2 adds more detail to Figure 5.1 by specifying further the relationship between drivers, change agents, competiveness, demand and regional growth specifically. The HM Treasury productivity drivers are highlighted (although we separate Innovation as an output from R&D and place it as an input affecting the rates of return influencing company investment). Other key productivity drivers are also identified. Potential interactions between drivers, spillovers and other feedback effects are omitted.

Innovation and R&D

5.27 It is universally recognised that technological progress and Innovation are fundamental to economic growth and productivity. For example, the primary significance of Innovation and R&D is underlined by the World Economic Forum. In their framework which outlines twelve pillars – or drivers – of competitiveness, the Forum argues that almost one-third of the competitive advantage of an advanced economy stems from only two pillars – Innovation and business sophistication. Strengthening performance in Innovation is therefore seen as the major route to achieving greater sustainable economic growth in the EU’s Lisbon agenda.


89 The ‘Lisbon Strategy’ is aimed at making the European Union (EU) the most competitive economy in the world and achieving full employment by 2010. The economic pillar emphasises the need to adapt constantly to changes in the information society and to boost Research and Development.
5.28 Given its relative importance, it is imperative to be clear on the definition, role and impediments to Innovation and R&D. For example, the Review Panel believe it is important to move away from the concept of Innovation as a wholly technological phenomenon, as implied by the emphasis on R&D, toward a view of Innovation as a business and commercial process. Furthermore, a more commercially orientated view would help switch the emphasis from Innovation and newness per se toward the introduction of products and processes new to the region. Hence the encouragement of imitations, adaptations, improvements and adoptions of products and processes into the region would appear to be much more relevant to the promotion of productivity growth in NI than the pursuit of newness per se. As outlined below, we incorporate the HM Treasury definition of R&D (used for the purposes of claiming R&D tax credits\(^{90}\)) and the concept of Innovation adopted by the OECD (and used for the Community Innovation Survey\(^{91}\)):

- **R&D:** takes place when a project seeks to achieve an advance in science or technology. The activities that directly contribute to achieving this advance in science or technology through the resolution of scientific or technological uncertainty are R&D. Certain qualifying indirect activities related to the project are also R&D; and

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\(^{90}\) [www.hmrc.gov.uk/manuals/cirdmanual/CIRD81900.htm](http://www.hmrc.gov.uk/manuals/cirdmanual/CIRD81900.htm).

\(^{91}\) [www.oecd.org/document/10/0,3343,en_2649_33723_40898956_1_1_1_1,00.html](http://www.oecd.org/document/10/0,3343,en_2649_33723_40898956_1_1_1_1,00.html).
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- **Innovation**: incorporates product Innovation (new or significantly improved good and services), process Innovation (new or significantly improved production or delivery method), marketing Innovation (significantly new marketing method) and organisational Innovation (new organisational method).

5.29 There is considerable evidence which demonstrates the strong links between the growth of firms and Innovation. In addition, there is ample evidence that R&D, and business R&D in particular, plays a key role in Innovation. For example, the impact on productivity and the rate of return to R&D appears to be higher for innovative than non-innovative firms, and for firms in sectors defined as net users of Innovations.\(^92\) R&D can also play a major role in technology transfer because it allows companies to learn about leading technological advances\(^93\) and may raise the absorptive capacity of the firm\(^94\). These factors are critical for a region such as NI, which traditionally under-performs in Innovation and R&D due to the relatively small size of firms and poor industrial structure. Therefore, given its importance, a major strand of this Report is to make recommendations to significantly boost Innovation and R&D activity in NI.

**Skills**

5.30 HM Treasury’s report on productivity cites research which indicates that the variation in skills composition across the UK regions is the major factor explaining regional variations in productivity.\(^95\) In addition, this point on the overarching importance of skills on regional growth is at least implicit in the report by Sir David Varney into the competitiveness of the NI economy.

5.31 The Review Panel accept the importance of skills, particularly in terms of supporting Innovation, enterprise and, more generally, the supply potential of a regional economy. It is also an important factor in terms of the value proposition for FDI. In addition, literature assessed by the Review Panel suggests that it is not only Schools, Colleges, Universities and on the job training but also families that are an important source of skill formation.\(^96\) The evidence suggests that cognitive skills are mainly determined by the age of eight while non-cognitive skills can be acquired into the teenage years. In the NI context, this all suggests the need to strengthen the co-ordination of action on skills, particularly between the Department for Employment and Learning (DEL) and the Department of Enterprise, Trade and Investment (DETI), but the Department of Education (DE) has also an important role to play.

5.32 However, the Review Panel believe that while skills availability is a necessary condition for regional productivity growth, it should not be considered as either paramount or sufficient. For example, it is generally recognised that locations containing high productivity firms, offering high wages and varied job opportunities, will attract and retain skilled workers. For example, London has many more graduates employed than studied there. It is therefore critical to stimulate the local demand for graduates and skilled workers, and the recommendations contained in this report are targeted at

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improving the ability of the NI economy to achieve this. Chapter 9 of this report outlines the recent performance of skills provision in NI.

Enterprise

5.33 Enterprise and new firm formation is important, both in terms of investment and Innovation. However, the Review Panel believe that the focus by HM Treasury places undue emphasis on the creation of new firms (business start-ups proxied by VAT registrations is a key indicator in the HM Treasury documentation on productivity) and there are similar problems in the argument that higher business birth rates will necessarily map into higher regional growth.

5.34 Not all new firms enhance regional growth and may indeed be associated with displacement at the local level, given the markets they serve are principally local. As a consequence, there needs to be greater policy focus, recognised by Invest NI and other agencies, on distinguishing between ‘growth starts’ / ‘opportunity entrepreneurs’ and ‘necessity entrepreneurs’ or the ‘volume approach’.

5.35 It is important that, in practice, public policy interventions / resources are increasingly targeted at overcoming the obstacles to business growth, rather than indiscriminately attempting to raise the business birth rate. In addition, ‘opportunity entrepreneurs’ should be increasingly associated with new and small firms that seek to supply the needs of the regional export base (in particular, strengthening the local supply chain throughout key sectors). This approach would help raise the return to NI from inward investment by increasing their overall contribution to value added activity, as such firms become more ‘embedded’ into the regional economy. It also offers the prospect of technological and managerial spillovers to local suppliers through the local supply chain, which will help raise supplier productivity. However, the extent of the spillovers will depend on the absorptive capacity – principally the ability to undertake Innovation and R&D – of the local supplier firms.

Infrastructure / Investment

5.36 Public sector investments are likely to contribute both directly and indirectly to regional productivity: directly through adding to the capital labour ratio in the goods and services produced by the public sector, and indirectly through the economy-wide ‘public good’ consequences of investment in areas such as economic (e.g. transport networks, telecoms) and social (e.g. health, education) infrastructure. Several studies have established a positive link between infrastructure and growth at both the national and regional level. However, the evidence suggests that once a certain provision is reached, the impact on economic performance is much more ambiguous.

That said, the evidence considered by the Review Panel confirms that public infrastructure does have a key role to play in improving the relative attractiveness of locations to mobile firms.

5.37 The HM Treasury framework also identifies investment by sector for UK and foreign owned companies as important factors in raising productivity growth. This distinction is important as foreign-owned companies tend to be more capital intensive, leading-edge activities with higher productivity and greater prospects of knowledge spillovers than their domestic counterparts. An important element of this Review has therefore been to provide an assessment of Invest NI performance, both in terms of the expenditure devoted to attracting new investment to NI and also on the quality of FDI inflows since 2002 (covered in Chapters 3 and 4).

5.38 In addition, a critical part of the regional investment process is the availability and cost of finance. It is frequently assumed that, with national and international banking and capital markets, this should not be an issue, although the ongoing global recession is now seriously challenging this assumption. Furthermore, increased emphasis is being placed on the significance of financial development at the regional and local level, even in an environment where there are no frictions to capital movements. In this connection, the role in NI of venture capital supply is an obvious issue for further consideration and we develop this theme with some recommendations in Chapter 7 of the report.

Other Productivity Drivers

5.39 Aside from competition (which HM Treasury generally dismisses at the regional level), other factors that receive limited, if any, coverage include the role of ‘institutions’ and ‘place competitiveness’. Their role is evident in Figure 5.2 and the following paragraphs explain their impact in more detail.

5.40 Within a regional economy there may be entrenched institutional barriers which impede productivity growth. One commonly cited factor, evident in the public call for evidence for this Review, is the degree of complexity inherent in legal and planning frameworks which often slows investment and other decisions. As part of its work programme, the Panel reviewed the World Bank Doing Business 2009 Report, which ranks the UK sixth from 181 countries in terms of the ‘ease of doing business’ (Singapore is first and is included as part of the global best practice review in the next chapter of the report). Despite this relatively strong performance, the UK ranks sixty-first in dealing with construction permits and twenty-second in the ease of registering property. The index only covers national economies (with no comparable data for the UK regions), however, it is clear that NI policymakers need to consider

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106 The report and the detailed analysis can be accessed at the following link: www.doingbusiness.org/documents/fullreport/2009/Overview.pdf.

107 Defined by the World Bank as ‘procedures, time and cost to obtain construction permits, inspections and utility connections’.

108 Defined as the ‘procedures, time and cost to transfer commercial real estate’.
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carefully the legal and planning barriers to doing business and productivity growth. Chapter 9 offers some views and recommendations in this area.

5.41 In terms of ‘place competitiveness’, the evidence suggests that there is a link between agglomeration and the growth rate of productivity\(^{109}\). For example, urban density and agglomeration offers the opportunity of greater proximity to customers, suppliers, competitors and key institutions such as government. Companies can also benefit from co-locating or clustering together, particularly when they are able to access a pool of skilled labour and other knowledge or technology spillovers. However, the key point is that the evidence points to higher productivity growth for urban / metropolitan areas. In addition, with FDI increasingly stemming from the tradable service sector, it is to be expected that external investors will gravitate toward urban areas where labour supply is more abundant. Government policy should not, in the view of the Review Panel, seek to unduly influence the location of FDI within NI.

5.42 The Review Panel are fully cognisant of the tension between urban / rural policy, particular in a relatively small region such as NI. An economic policy which recognises major centres as the catalyst for growth requires a strong emphasis on the linkage of places where firms are best located to where workers wish to live. It requires co-ordination of policy toward business, housing, the labour market / skill formation, transport, regulation and planning. As outlined earlier, the NI economic strategies assessed by the Review Panel have only partially outlined these linkages. This lack of co-ordination means that the opportunities for growth in NI’s urban areas, and the linkage of these hubs to other parts of the region, may not have been as fully exploited as they could be. Nonetheless, the Panel are aware of the work being undertaken to review the Regional Development Strategy, which proposes strengthening the regional centres of Belfast and Londonderry / Derry, and ensuring that they are better linked to small clusters of towns around NI in order for them to share in greater economic prosperity. We believe this approach is a step in the right direction, although it remains to be seen the extent to which this will fully address existing sub-regional issues within NI.

CONCLUSIONS

5.43 This chapter has examined the role of policy and the drivers of productivity growth in a small regional economy, with special reference to NI. A variety of change agents are viewed as active in contributing to economic growth. For example, both the private and public sectors are important agents, but it is the company / firm which should be viewed as key. This is unsurprising as it is ultimately the companies which make the investments that drive economic growth.

5.44 Another important conclusion from this chapter is that the promotion of supply side productivity drivers, such as those suggested by HM Treasury, are a necessary but insufficient condition for more rapid and sustained growth in NI. Demand is as important as supply and at the regional level it is external or export demand that is of particular importance. Furthermore, a high quality export base will be more rapidly developed if high value inward investment can be attracted. The benefits of a developing export base will also spread more rapidly throughout the region if policy

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encourages and supports inward investors and domestic SMEs to develop supply and purchase linkages with each other.

5.45 Government policy is designed to address market failure, however, the impact of policy will be mediated through the effect on, and nature of, incentives as well as the behaviour of the change agents such as companies, individuals and government. Perverse incentives that encourage rent seeking and unproductive activity must be discouraged by policy.

5.46 The encouragement of more Innovation and R&D is critical to improving productivity growth in NI. In seeking to promote Innovation, not least to improve the competitiveness of the local export base, the regional economy must be prepared to draw on knowledge and best practice from wherever it originates, at home or abroad. Policy should focus on strengthening domestic Innovation and R&D capacity, as this will increase the potential for technology transfer into the region, including spillovers of knowledge from inward investment located in the region.

5.47 The presence of high-level skills is an important productivity driver, however, graduates and other individuals with high skills tend to move to where the best jobs are located. The goal is therefore to raise demand for high-quality jobs within the region and thereby attract and retain key skills. If graduates and skilled labour are attracted to, and retained, within the region (through the availability of the right jobs) then there is also the potential for further growth through knowledge spillovers.

5.48 Evidence reviewed by the Panel suggests that competitiveness varies between places in a region, with cities offering significant agglomeration and spillover benefits. The implication is that firms should be allowed to locate where they generate the highest returns, although this should not be at the expense of where people in NI wish to live. This approach will seek to efficiently connect people and jobs given their location preference, but it demands the full co-ordination of policy toward business, housing, the labour market / skill formation, transport, regulation and planning.
Chapter 6
Global Best Practice in Economic Development

Summary of Best Practice Lessons
• Successful regions have a clear strategy based on rigorous and ongoing diagnosis of existing strengths
• Leadership comes from the top to promote a shared vision and drive alignment in economic policy
• Productivity transformation takes a long time and requires the creation of a competitive and attractive business environment
• Successful regions place intense focus on attracting, retaining and embedding anchor institutions
• High performing investment agencies have cultures that are responsive, fast-moving and work to overcome bureaucracy. They recruit staff that are proactive, solutions-based and are themselves entrepreneurial in outlook
• Promoting Innovation and R&D has been a key driver of economic success, and its impact has been maximised by encouraging co-operation between firms, or between firms and other institutions

Introduction
6.1 Previous strategic reviews of economic development policy in Northern Ireland (NI) have tended to focus on assessing local policies and governance arrangements, with only minimal reference to best practice elsewhere. In contrast, and as commented previously, the Independent Review Panel have sought to identify successful economies throughout the world which offer important public policy insights for NI.

6.2 As this chapter outlines, we have sought to identify key elements of global best practice in economic policy, particularly where there have been significant improvements in productivity performance. In addition, an important element of our work has been to assess the applicability of policies and programmes to the NI economy, having due regard to the existing legislative powers of the NI Executive. It is for this reason that the Review Panel have intentionally avoided the policy debate on securing a lower rate of corporation tax in NI. For, although we believe that a lower corporation tax rate could significantly boost value added FDI flows into NI, it has effectively been ruled out as a viable option by HM Treasury, following the report by Sir David Varney into tax policy in NI.

6.3 As part of this Review, we have also assessed the current DETI research agenda, published in June 2008, which is scheduled to run for the full Programme for Government period (2008/09 – 2010/11). We recognise and welcome the alignment

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110 As part of its evidence gathering phase, the Review Panel were made aware of certain proposals that could lead to NI being designated as an enterprise zone, which may offer the potential to introduce lower rates of corporation tax than elsewhere in the UK.

111 The report can be accessed at: www.hm-treasury.gov.uk/d/varney171207.pdf. This report followed previous analysis by the Economic Research Institute of Northern Ireland (Assessing the Case for a Differential Rate of Corporation Tax in Northern Ireland, Nov 2006).

112 The DETI Research Agenda can be accessed at: http://www.detini.gov.uk/cgi-bin/downutildoc?id=2242.
of the agenda to the Departmental Corporate Plan, where productivity growth is stated as the top priority. In addition, the Review Panel endorse the overarching aim of the agenda which, in part, is designed to identify ‘best practice policy interventions which boost private sector productivity in small open economies in the EU and beyond’.

6.4 In welcoming the agenda, the Review Panel are aware of a number of ongoing research projects which are extremely relevant to the current chapter of this Report. Unfortunately, given the timescales, these projects have not been sufficiently developed to inform this Review. However, the Panel recommend that the output from this assessment of global best practice in economic development is used to inform and influence the direction of the DETI-led research projects.

APPROACH

6.5 In developing relevant case studies to inform the review of global best practice, the Panel initially sought information on the economic context of particular areas, especially with regard to the scale of productivity improvements. In addition, a key aspect of our work has been to understand the institutions, policies and programmes used to drive productivity performance, together with their key success factors, not only in terms of strategy and organisation but also with regard to operational performance. Finally, we sought to apply the evidence base to develop a set of best practice principles that drive productivity growth and which are applicable to NI and DETI / Invest NI in particular.

6.6 In order to address the issues outlined previously, the Panel worked to ensure that country / regional experts were engaged to develop our understanding of global best practice in economic development. In addition, productivity and industrial policy experts were interviewed, as were a number of international and indigenous companies already active within NI. The Panel are grateful for the assistance provided by DETI to enable us to undertake this important aspect of the Review.

6.7 The Panel present a summary of the main findings of the research, which includes the following details – a brief description on the methodology used to select the case studies; an outline of the five major cases that have been examined in detail and an assessment of the key themes and implications that are of relevance to the current Review.

6.8 It is important to recognise that the global economic downturn, referred to in previous chapters, will have inevitable implications for the countries / regions selected as case studies. However, the Review Panel believe that it is short-sighted to discount certain areas solely as a result of the ongoing global recession and its associated impact. It should be remembered that the case studies selected by the Review Panel have been able to secure growth rates in areas such as productivity, exports and FDI that far outstrip performance in the UK / NI economies. It is in this context that we have sought to identify best practice lessons that may help position the NI economy to take advantage of a more favourable global economy.

113 The DETI Corporate Plan can be accessed at: http://www.detini.gov.uk/cgi-bin/downutildoc?id=2242.

114 Building Economic Competitiveness - Lessons from Small Peripheral European States (University of Cambridge, due for completion in April 2010) and Productivity, Innovation and Competitiveness in Small Open Economies (University of Bradford, Manchester Business School and University of Cork, due for completion in April 2010).
SELECTING THE CASE STUDIES

6.9 At the outset of the exercise, the Review Panel worked to identify a small set of countries / regions from which the most relevant lessons could be gleaned for the NI economy. Potential best practice countries / regions were filtered on the basis of:

(i) Relevance – GDP per capita at least 85% of NI; and
(ii) Performance – annual productivity growth of around 2% or higher over the past 10 years.

6.10 This process resulted in twenty-two countries and nineteen regions being considered as potential best practice comparators. Given the limited timescales for the Review, we have focused on five case studies that include Singapore, Finland, Sweden, the Republic of Ireland, and Portland (Oregon, US). Table 6.1 outlines relevant data on the economic performance of these areas and a lower rate of corporation tax is clearly an important factor in certain countries. The analysis also demonstrates the importance of FDI, R&D and exports to the achievement of productivity growth.

6.11 In addition to comparing the relevant economic data, Figure 6.1 also presents a summary of the case studies and the key factors which we believe have driven economic growth in the countries / regions.

Table 6.1: Performance of Five Best Practice Economies (Comparisons with UK and NI)

<table>
<thead>
<tr>
<th></th>
<th>Singapore</th>
<th>Republic of Ireland</th>
<th>Finland</th>
<th>Sweden</th>
<th>Portland, Oregon, US</th>
<th>UK</th>
<th>Northern Ireland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual productivity growth (10 year average)</td>
<td>3.7</td>
<td>2.7</td>
<td>2.0</td>
<td>1.7</td>
<td>3.4</td>
<td>1.7</td>
<td>1.2</td>
</tr>
<tr>
<td>FDI (as % of GDP)</td>
<td>167</td>
<td>86</td>
<td>40</td>
<td>64</td>
<td>n/a</td>
<td>52</td>
<td>n/a</td>
</tr>
<tr>
<td>Exports (as % of GDP)</td>
<td>225</td>
<td>80</td>
<td>45</td>
<td>54</td>
<td>n/a</td>
<td>28</td>
<td>21</td>
</tr>
<tr>
<td>Total R&amp;D spend (as % of GDP)</td>
<td>2.3</td>
<td>1.3</td>
<td>3.5</td>
<td>3.7</td>
<td>2.6</td>
<td>1.8</td>
<td>1.2</td>
</tr>
<tr>
<td>Corporation tax rate (%)</td>
<td>18</td>
<td>12.5</td>
<td>26</td>
<td>28</td>
<td>35</td>
<td>28</td>
<td>28</td>
</tr>
<tr>
<td>Average wages (£ per hour, manufacturing)</td>
<td>4.64</td>
<td>14.07</td>
<td>16.21</td>
<td>17.25</td>
<td>12.93</td>
<td>13.49</td>
<td>11.23</td>
</tr>
<tr>
<td>Use of zonal tax exemptions</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Ease of doing business rank</td>
<td>1</td>
<td>7</td>
<td>14</td>
<td>17</td>
<td>3</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Broadband penetration (%)</td>
<td>42</td>
<td>19</td>
<td>31</td>
<td>32</td>
<td>26</td>
<td>28</td>
<td></td>
</tr>
</tbody>
</table>

Sources: IREP analysis
Note: UK and NI figures presented for comparison; some Portland figures are for Oregon or the US as a whole
Figure 6.1: Major Case Studies on Global Best Practice in Economic Development

- **Singapore**: Success founded in establishing a pro-business environment and aggressively pursuing FDI through a high performance agency.
- **Finland**: Built R&D capacity around Nokia as an anchor and successfully developed R&D and Innovation capabilities.
- **Sweden**: De-regulation and creation of pro-business environment to drive competition and productivity.
- **Portland, US**: Built on anchor tenant firms and proximity to the West Coast to create hot spot for entrepreneurial spinoffs.
- **Rep of Ireland**: Built on low corporation tax rates with a flexible approach to attract FDI and anchor investors to move them up the value chain.

6.12 Each area has clearly different sources of advantage, ranging from different levels of corporation tax and use of zonal tax exemptions, to competitive wage costs and utilisation of broadband. In addition, it is recognised that the case studies will each differ in their cultural and political backgrounds, which may also act as important determinants to the way businesses are supported. As a consequence, it is obvious that no one country or region exactly mirrors the NI economy, nor has it been possible to identify an area with a complete set of transferable lessons for global best practice in economic development. Therefore, the essence of this exercise has been for the Review Panel to select, from the extensive evidence base, a list of factors which we consider to be vital for productivity progress and which offer transferable lessons for NI.

6.13 It should be noted that an additional six cases were developed, albeit in lesser detail than the countries / regions presented above. They include Taiwan, South Korea, North Carolina (US), Estonia and Israel. A key point to emerge from these areas is that they not only offer potentially important lessons for NI policymakers but, in many instances, they reinforce the points emerging from the more detailed case studies.

**IMPLICATIONS FOR NI – KEY THEMES & LESSONS**

6.14 The Review Panel identified a number of themes, summarised at the start of this chapter, which offer important policy lessons for economic development in NI. These themes are also used to inform the remaining chapters of the report. For example, they enable us to form our view and offer recommendations on the current suite of policies and programmes operated by DETI / Invest NI and how they might be refocused (Chapter 7), the existing governance arrangements for Invest NI and how they might be refined (Chapter 8) and the required output from other NI government departments engaged in economic development (Chapter 9).

6.15 On the basis of the available evidence, the key themes are proven to act as catalysts for best practice economic development policy. Although the list is far from exhaustive, we consider them to be the most relevant for the current Review. In addition, we accept that every agency involved in developing their respective economies, including Invest

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115 A full set of slides from our assessment of global best practice can be accessed on the IREP website at [www.irep.org.uk](http://www.irep.org.uk).
NI, will operate these principles to a greater or lesser degree. Nonetheless, our evidence suggests that overall performance will largely depend on the intensity by which these best practice themes are collectively pursued. The themes are developed further in the remaining paragraphs.

(i) **Successful regions have a clear strategy based on rigorous and ongoing diagnosis of existing strengths**

6.16 Given the limited resources of small economies, our research indicates that the most successful productivity improvement interventions are focused on the levers which have the maximum impact on growth companies and sectors. For example, deciding where to target investment is invariably based on a detailed understanding of the competitive position of the area and which kinds of companies have a strong business reason for locating in a specific jurisdiction / location. For example:

- **In Finland**, there was early recognition of the country’s world class education system which, in turn, led to the policy of concentrating R&D around local Universities. In addition, there was a clear understanding of the potential of the telecoms industry in the 1980s, which prompted the Government R&D funding agency (TEKES) to focus on Nokia (the company received around 30% of its total funding between 1981 and 1983). Furthermore, the Government continued to support Nokia, in particular, during the recession of the early 1990s where the R&D support enabled the company to retain its competitive position.

- **In Singapore**, a recognised factor behind its economic performance has been the deployment of an integrated economic strategy (developed by the Ministry of Trade and Industry), where long-term analysis and planning for the direction of economic policy was pursued with relentless energy. At its heart, the strategy develops packages which are aimed at attracting FDI firms and embedding them within the economy. In addition, the economic development agency (Economic Development Board (EDB), Singapore) has a substantial planning unit (approximately ten employees in Strategic Planning and sixty in planning and policies) to bring together market intelligence / trends to identify targeted sectors and to re-allocate resources accordingly.

- **In North Carolina**, the region has worked to deploy a targeted strategy aimed at reducing the ‘brain drain’ of graduates who leave to work elsewhere. For example, policymakers have made an explicit decision to build on its Universities rather than an incumbent firm (as in Finland with Nokia), focusing R&D investments by geography to help support a physical clustering of R&D activity in the Research Park Triangle supported by Chapel Hill, Duke and NC State Universities.

  North Carolina has also identified a clear strategy to have a responsive education system in place to meet the needs of existing businesses and potential investors. Community colleges have at least one committee, made up of business people, to ensure that the skilled labour produced by colleges is consistent with the demands of companies. This has led to the establishment of new, specifically-designed, college courses following interaction with companies, with outdated and unpopular courses removed. A key role of the community colleges is working with other bodies to attract new investors to the state. For example, since the late 1950s, they have made a commitment to train, for free, the workers of a new or expanding industry to the specifications of companies creating employment. The colleges are full partners
with the Department of Commerce and are involved, from the very first meeting, with potential investors or firms expanding. This approach offers a strong incentive for companies to set up in North Carolina and to expand their existing operations. Even for firms not expanding or new to the region, the colleges offer heavily subsidised training that is customised to the needs of the company.

- In the **Republic of Ireland** (RoI), an FDI-led economic strategy, developed by the IDA but supported throughout the Government, was matched with very significant resources and a low rate of corporation tax. The FDI strategy was also maintained despite pressure from other sectors, in particular calls to support indigenous firms. Furthermore, although the strategy to attract FDI has a considerable timeline in the RoI (dating back to the early 1950s), the strategy continues to be reviewed and refined. For example, the Culliton report (published in 1992) encouraged the increased focus on areas raising private sector productivity, but with reduced reliance on public sector grants, and also a bringing together of multiple factors / institutions to co-ordinate economic growth (with a more integrated role for education and infrastructure to improve the country’s attractiveness as a place for business investment). However, as we recognise later, the current global recession is having a particularly strong impact on the RoI economy.

(ii) **Leadership comes from the top to drive alignment**

6.17 In order to effectively deliver economic policy, our research indicates that support stems from the top, with complete clarity on the roles and responsibilities between and within the various government departments and economic development agencies. For example:

- In **Singapore**, the Prime Minister supported the country’s FDI focus by personally meeting with groups of CEOs to show his commitment to serving their business needs and to reassure and / or encourage, where necessary, potential investors.

- In **Finland**, the Science and Technology Council (renamed the Research and Innovation Council from January 2009) is chaired by the Prime Minister, with two co-deputy chairs (the Minister of Economic Affairs and the Minister of Education and Science). The Council drives national policy and publishes reports on the entire ‘national Innovation system’ every two years but it is also responsible for driving policy across a number of important policy areas including industrial support, research, infrastructure and education.

(iii) **Productivity transformation takes a long time and requires the creation of a competitive and attractive business environment**

6.18 A compelling feature from almost every case study (major and otherwise) has been the long term nature of economic development policy. In summary, it is the ability to remain focused on a relatively small set of economic goals despite, at times, very significant pressures that mark the best performers in economic development. In addition, the local business environment is engineered around those factors conducive for investment and growth. For example:

- In **Singapore**, establishing the country as a business friendly environment has remained the top priority for the Government since the 1960s. An important feature has been its ability to exploit crises to further refine its mission and transform its structures. For example, the EDB’s first phase was following independence in the
mid 1960s, when it lost access to raw materials and export markets, and was faced with major unemployment that had the potential to cause social unrest. From this, the EDB reorganised to attract Multinational Corporations (MNCs) that invested in export-oriented labour intensive industries. The recession in the early 1980s showed that foreign investors considered Singapore as an expensive location and that local industries had largely been neglected by government policy. The EDB responded by promoting Singapore as a place where firms could establish their headquarter operations, particularly those seeking to manufacture in neighbouring countries, and it also opened a small enterprise bureau. The bureau encouraged local businesses to integrate into MNC’s supply chains, thereby improving their operations and connecting them to export markets. Growing labour costs and globalisation in the 1990s pushed the EDB to identify new service industries such as Finance and Tourism. More recently, the EDB realised it could exploit Singapore’s unique needs in areas such as urban solutions and health care to provide a test-bed for emerging industries with a global market.

Another relatively recent initiative has been the establishment of a Pro-Enterprise Panel (PEP), which actively encourages feedback on government rules and regulations that hinder businesses and restrict entrepreneurship. The PEP is comprised of business champions from the private sector and senior civil servants, and it takes receipt of suggestions to improve business efficiency (in excess of 1,700 have been made since its inception in 2000 with over 50% accepted for implementation). The EDB also works hard to sustain its rankings as one of the best business environments in the world (Singapore has been top of the World Bank’s ease of doing business rankings in both 2007 and 2008).

- In the RoI, the IDA has been charged with driving forward a long term focus, dating back to the 1950s, which targets anchor investors in key knowledge based sectors. Building on the country’s strength as an EU member with relatively low corporation tax rates, there is a sustained focus on R&D support, and skills have been aligned to meet investor needs, with various institutions creating and / or tailoring courses specifically to meet investors’ skills gaps. The strong pro-business environment is further evidenced by a range of other initiatives, including the country’s National Development Plan which has a very strong focus on economic-related investments\(^\textcolor{red}{116}\) (the current Plan is the largest and most ambitious investment programme introduced in the RoI, although this may come under pressure as the Irish Government seeks to reduce its budget deficit). One outcome of these initiatives is that the RoI was rated as one of most attractive business locations in the world in 2008\(^\textcolor{red}{117}\). This measure takes into account both current and expected economic conditions over the next five years, therefore it is important to recognise that this may be affected by the severe impact of the global downturn on the RoI economy.

- North Carolina’s community colleges are recognised as being heavily business orientated, with each having a Small Business Centre. There are almost sixty small

\(^{116}\) The National Development Plan, 2007-2013, provides €184bn of investment, with over 50% targeted to the economy: €34.6 billion for investment in economic infrastructure; €25.8 billion for human capital (schools, training, higher education etc) and €20 billion for enterprise, science and innovation.

\(^{117}\) The EIU business ranking model examines ten separate criteria, covering the political environment, the macroeconomic environment, market opportunities, policy towards free enterprise and competition, policy towards foreign investment, foreign trade and exchange controls, taxes, financing, the labour market and infrastructure. In the 2008-2012 Business Environment ranking survey, the RoI was 11th globally out of 82 countries.
business centres throughout North Carolina, which are grouped together into a Small Business Centre Network (SBCN). These centres are designed to support small businesses with work-based training and help entrepreneurs start up their companies. Centres are typically staffed by persons formerly of the small business community, who can offer guidance in areas such as refining an idea or product, developing a business plan, getting finance, acquiring accommodation (such as incubators) and problem solving for up to two years. They also provide a valuable challenge function for entrepreneurs, and evaluate ideas to advise on whether the business is sustainable. The majority of services are offered free of charge, with only minimal fees for certain workshops and seminars.

(iv) Successful regions place intense focus on attracting, retaining and embedding anchor institutions

6.19 In order to reap the full benefits from FDI, successful countries / regions have made a concerted effort to embed major investors into the local economy, both to retain them for the longer term, and also to capture the positive spillover impacts for local companies. For example:

- In **Portland, Oregon** (US), an ICT cluster has been developed from two large high-tech companies (Intel and Tektronix). More than half of the 300 high-tech start-ups in the region since 1970 were founded by individuals closely connected to one or two of the ‘anchor’ firms. A number of factors have influenced this pattern of growth. Firstly, the area is situated less than 100 miles from Seattle, a city with a considerable high-tech presence, and Portland was therefore well-positioned to attract ICT workers / researchers and businesses that were looking for the combination of a high quality of life and access to relatively inexpensive labour. Secondly, Tektronix and Intel both have a long standing presence in Portland, with operations dating back to 1946 and 1976 respectively. Thirdly, the anchor firms are in the electronics / computing sectors which are particularly conducive to the development of clusters given the intensity of R&D expenditure and the relatively low barriers to entry in the spin-off software industry. Finally, the area offers a particularly fertile environment for entrepreneurship, offering excellent communications links, tax breaks on capital investments and a sizeable venture capital market which provides the necessary networks and finance for entrepreneurs.

- In **Finland**, Government defence contracts were instrumental in bringing an anchor firm, Nokia, to partner with the University of Oulu to form the hub of a high-tech cluster. In awarding the contract, the Government required Nokia to work closely with the University to encourage collaborative research. As mentioned earlier, Nokia have also been recipients of large amounts of R&D funding, and have worked with VTT on joint R&D projects in the telecoms sector. In the recession of the early 1990s, the Government again supported Nokia with R&D subsidies of up to 40% of their total spend, which is credited with helping the company retain its competitive position. This continued long-term support has enabled the company

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118 Although Portland Oregon experienced strong productivity growth, computing and electronics were the major contributor (two-thirds of the city's productivity growth between 2000 and 2008 came from these sub sectors), demonstrating the importance of the high-tech cluster to the area.

119 VTT is an organisation responsible for providing high-end technology solutions and Innovation services. Further details on the activities of the organisation are provided in the conclusions to this chapter.
to become more embedded in the local economy through developing closer working relationships with Universities and other economic development organisations. In addition, rather than supporting Nokia in isolation, Finland has focused on building a telecommunications industry around the firm. Since the 1990s, long-term partnerships with local suppliers have been developed to provide parts, components and, in some cases, entire processes for Nokia products. More recently, Nokia has begun sub-contracting R&D and co-operating on R&D activities with its network of suppliers. These networks have enabled other local companies to share in Nokia's success, with four out of five estimated to have grown faster than 20% each year. As a result of high levels of co-operation, Finland is now ranked 11th in the world in business cluster development by the World Economic Forum.

- In the RoI, the IDA has not only used the low corporation tax rate to attract FDI, but it has also brought in anchor investors to stimulate activity in important knowledge intensive sectors such as ICT and pharmaceuticals. In order to help embed companies as anchor tenants, the Government has focused on supporting collaborative research projects with local institutions, while colleges have also created new courses to meet the skills needs of investors as they arise. FDI policy has helped to develop sectoral clusters between large international companies, with Intel's initial investment acting as 'magnet' to attract similar firms such as Dell, Google, IBM and HP.

(v) High performing investment agencies have cultures that are responsive, fast-moving and work to overcome bureaucracy. They recruit staff that are proactive, solutions-based and are themselves entrepreneurial in outlook

6.20 From the various case studies, the Review Panel have found that best practice development agencies are themselves entrepreneurial, with a risk-taking mindset, where flexibility and speed to meet investor needs are considered to be paramount. The agencies are staffed with high quality people, active in a range of countries, and they place the business (not internal rules and procedures) at the heart of their ecosystem. Employees are trained to be solutions-focused, with an ability to tailor support packages to the needs of businesses. For example:

- In Singapore, the EDB has a strong customer focus with an extremely high performance culture. Recruits are high potentials (of whom 50% are educated abroad) and they are paid salaries comparable to the private sector, with further incentive packages (bonuses can typically range from 15-50% of salaries). Responsibility for individual clients is delegated to junior staff who have responsibility for ‘making their case’ to superiors and a premium is placed on world class on-the-job training. There is also recognition that given the differing skill sets required to support businesses (FDI, local, export orientated etc), support is best delivered via separate agencies. For example, whereas the EDB is the key government agency in charge of attracting FDI, International Enterprise Singapore, Spring Singapore and the Agency for Science, Technology and Research take forward the separate portfolios of exports, small business and R&D respectively.

The EDB is also a ‘one-stop shop’ for investors, from first contact through to ongoing support. They handle all administration contacts with other agencies, ensuring a fast and flexible response. They also work directly with specific suppliers to ensure key components can be manufactured locally, and they run recruitment
programmes to build a workforce for investors. The ability to make investments happen faster in Singapore than elsewhere, is seen as a key aspect of best practice.

- In the RoI, the IDA has created a high performance organisation, with an ethos that is entrepreneurial rather than compliance driven. In developing its support package around the business, with a proven track record of success, the agency continues to be viewed as the lead body on the economy. This has also helped maximise the level of alignment in the country, political and otherwise, which not only recognises the economy as the top priority but also ensures that the necessary factors are in place to support the pro-business environment. The terms and conditions for its public sector employees are largely based on respect (with limited remuneration incentives), and a premium is placed on seizing opportunities, risk-taking and speed of response. The IDA culture has also resulted in staff being measured on outcomes of work rather than targets. In addition, specialist staff are increasingly recruited to enhance the capabilities of the agency to attract and retain R&D intensive firms.

Finland’s award-winning export agency, FINPRO, has succeeded by focusing on providing firms with practical export support. Recognising that Finland is a relatively small player in the global market, the agency has based its success on being more responsive than larger agencies elsewhere. It has a customer-orientated culture, based on the requirement to provide value for money, with staff offered high salaries to attract the best talent. Although part funded by Government, the organisation is led by the private sector and charges firms for its tailored consultancy-style services. This approach has led users to view the organisation as more professional and customer-focussed, and this element of fee-charging for certain services is becoming increasingly more common in other economic development agencies.\(^\text{120}\)

(vi) Promoting Innovation and R&D has been a key driver of economic success, and its impact has been maximised by encouraging co-operation between firms, or between firms and other institutions.

6.21 An important aspect of global best practice is the emphasis given to incentivising Innovation and R&D activity and, in particular, the need to produce output that is business led and relevant for commercialisation. This reflects a key finding from Chapter 5, namely that Innovation and R&D is the key driver of productivity growth. Furthermore, the intense focus on Innovation and R&D is present in each case study analysed by the Review Panel – below is a summary drawn from the Nordic countries of Finland and Sweden.

- In Finland, our research indicates that significant collaboration exists at a number of strategic and operational levels. Firstly, there are close links between relevant Government departments, in particular the Ministry of Employment and the Economy (covering TEKES, the main public funding body for Innovation and R&D, and VTT) and the Ministry of Education (with linkages to the Universities). Secondly,\(^\text{120}\) FINPRO charges companies a modest fee (£350 per annum) to become affiliated members. A number of their services are then free for members, such as market information, trade fairs / missions, business publications and the export register / business leads service. However, there are additional charges for tailored services which are more time consuming, such as one-on-one consultancy and specific market research. SMEs pay around £600 per day for access to a senior consultant and £350 for a market analyst, while large firms are charged £1,100 and £700 respectively. Singapore also adopts this approach, providing some support for free (use of databases and portals), but requires payment from companies for selected customised services.

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there is ongoing activity between Government, Universities and the business community. For example, through TEKES and VTT, there are significant levels of collaboration with businesses to enhance their international competitiveness and also with Universities to exploit their basic research results. In summary, both TEKES and VTT have a strong focus on promoting co-operation between organisations and they typically make funding contingent on partnership arrangements.

- In Sweden, a key feature of its R&D policy is the extent to which it involves co-operation between institutions. This is largely driven by the requirement of the R&D funding body, VINNOVA, that research grants are matched by support funding from other organisations, including firms and/or Universities. One feature of the country’s success is that the increase in R&D expenditure is driven by non-government R&D (total R&D averages around 4% of GDP, one of the highest in the OECD, whereas government R&D accounts for around 1%). In order to boost ‘need driven’ R&D, Sweden has adopted the ‘triple helix’ model: Public-Private-University partnerships to ensure that there is a strong focus on the practical application of research. One example has been the VINNVÄXT programme, introduced in 2001, which is a competition among the Swedish regions for the development of internationally competitive R&D environments in specific growth fields, with a prize of €14-22m over 10 years, where 50% is provided from VINNOVA and the remainder from the regions. Other examples include the VINN Excellence Centres, which are designed to encourage collaboration between Universities, Industry and Government (each Centre is awarded €2.2m per year, with funds matched by industry) and the Institute Excellence Centres, where top research institutes receive project grants from VINNOVA which are again matched by industry.

CONCLUSIONS

6.22 This chapter of the Review has identified a number of key lessons for best practice in economic development. While no single case study provides the full set of transferable lessons, a range of themes have been developed which act as a benchmark for the Review Panel to assess NI’s economic development performance, and DETI / Invest NI in particular.

6.23 In countries that have been successful in attracting FDI, such as Singapore and the RoI, part of this success has been built on developing a pro-business and high-performing investment agency. Key to this is the ability to maintain low levels of bureaucracy within the organisations, which allows them to be responsive to the needs of investors and gives them the freedom to take risks. In both cases, the agencies responsible for attracting FDI are separate from those focused on growing domestic firms. It is also important to restate the beneficiary role that low corporation tax rates has in attracting value added inward investment, something which NI is currently unable to replicate.
Box 6.1: Further Details on VTT

- VTT Technical Research Centre of Finland is the largest multi-technological applied research organisation in Northern Europe.

- Rather than providing funding, the primary role of VTT is to carry out research and development work, technology transfer and testing. It has close interaction with industry, research institutes, Universities and Government.

- It had a turnover of €245m in 2008 and employed almost 2,700 people, mainly research staff. VTT received 30% of its funding from Government, with the remaining 70% generated from external sources. It has also been successful in exporting its services outside Finland.

- To encourage technology transfer, over half of VTT’s research is in the form of joint projects with Universities, research organisations and companies. In addition, a large proportion of income is generated from commercial activities, which ensures that VTT’s research is market driven / commercially focused.

- VTT has a large number of specific research strengths across nine sectors, including energy, biotechnology & pharmaceuticals, electronics and ICT.

- The organisation served 3,400 domestic firms and 590 foreign companies in 2008. In addition, VTT had 1,000 patent applications at the beginning of 2009, and 2,000 publications during 2008. The organisation also participated in 349 international research projects worth €160m.

6.24 In contrast to an FDI-led growth strategy, both Finland and Sweden have increased productivity by focusing support on R&D, Innovation and exports in domestic firms. These countries have set up dedicated organisations to provide funding for Innovation / R&D and they work alongside companies and Universities in researching and commercialising new ideas. In particular, the Panel were very interested in the model presented by VTT, the Finnish Technical Research Institute (Box 6.1 provides further information on the organisation). The top-down leadership provided by a body such as the Research and Innovation Council, led by Finland’s Prime Minister, has proved to be vital in supporting the country’s Innovation agenda. The agencies set up to promote exports in Finland and Sweden, particularly the fee-charging FINPRO, have also been shown to be highly successful in growing the domestic export base.

6.25 A common theme running through a number of the case studies is the importance of attracting and supporting anchor tenants. Both Portland and the RoI have been able to develop strong ICT sectors based on initial investments by companies such as Intel, which helped increase the number of spin-out companies and attract similar foreign firms to invest. Finland has also adopted the anchor tenant approach by heavily supporting Nokia to ensure that they are embedded in the economy by developing strong links to local Universities and suppliers.

6.26 Given the limited time available for the Review Panel to assess best practice in economic development, it has only been possible to explore a select number of case studies. The DETI research agenda, referred to earlier, should be used to further develop the case studies and also explore other areas of best practice not covered by the Review.
Chapter 7
Recommendations for Change

OVERVIEW OF RECOMMENDATIONS

Policy Development

- As part of the review of structures within DETI (proposed in Chapter 8), the department should ensure that more resources are dedicated to policy development and monitoring.

- DETI should appoint an independent economic advisor (with extensive experience as an economist) to strengthen capacity in economic policy making.

Policy Delivery (Invest NI)

- The concept of Invest NI ‘clients’ should be removed to allow Invest NI to work throughout the entire business base to raise awareness and provide support for businesses undertaking Innovation, R&D and exports.

- Invest NI should work to significantly reduce the number of its support programmes.

- Most assistance delivered via SFA should be redirected between now and 2013 to provide greater levels of support to Innovation and R&D.

- Grants for business expansions should be phased out towards 2013, after which such grants are unlikely to be available under EU state aid rules.

- Business expansion not involving Innovation and R&D should, where necessary, be supported in the form of co-investment in companies that have already been successful in securing funding from the private sector. Invest NI assistance should be in the form of sub-ordinate debt or equity.

- Invest NI should further reduce its support for company training, and concentrate support mainly to small firms and to projects with a high Innovative content, where retraining is necessary to realise a substantial rise in productivity.

- Invest NI should transfer its budgets relating to tourism accommodation back to DETI to be redistributed to a more appropriate body.

Portfolio of Innovation policies

- A portfolio of new Innovation policies should be developed over time, but should initially include four elements:
  
  - A new institution for commercially-oriented research should be explored in NI, along the lines pioneered by the successful VTT institute in Finland. The institution should be outside the University system and not subject to the constraints of the Research Excellence Framework (REF). It is envisaged that this would incorporate a number of existing near market research organisations in NI and would be charged with reviewing and taking forward the MATRIX agenda.
OVERVIEW OF RECOMMENDATIONS (CONTINUED)

- Additional research in Universities and public sector bodies should be aligned closely with the needs of industry in NI and potential inward investors to NI. Furthermore, the development of specific new research capabilities should be used as an incentive to attract potential investors.

- Industry-led Innovation communities, as suggested in the MATRIX report, should be developed as a pilot to bring together business, academia and Government and exploit available market opportunities.

- More should be done to support Innovation in service sector firms beyond software, which we believe is well served. The concept of Innovation in the service sector should include the broad range of areas outlined earlier in the definition of Innovation (presented in Chapter 5).

- Additional support for Innovation and R&D should not involve new public expenditure but instead be financed from savings in grant support for investment by existing firms and in property development.

- Invest NI’s export assistance should become more dedicated and professional, adopting a similar model to the fee-charging export agencies identified in Chapter 6, with two tiers of charges depending on whether the company is an SME or large firm.

Policy Delivery (DETI)

- As soon as practicable, DETI and other relevant departments should commence work on preparing a case for retaining state aid limits that support the changes outlined in this Review.

- Promoting greater energy efficiency / conservation in the private sector should be accorded a higher priority in the 2009 Strategic Energy Framework (reflecting, where appropriate, the current and ongoing work of the Green New Deal for NI).

- DETI and Invest NI should undertake an immediate and focused review of its overall strategic and sectoral approach to capitalise on the benefits of new telecommunications connectivity in NI.

Policy Performance

- DETI, as the funding department, should report on the strategic performance of Invest NI, with the co-operation of Invest NI statistical staff.

- Relevant policies and accompanying resources should be updated annually to quantifiably demonstrate how individual policies/organisations contribute to the PfG productivity goal.

- Wherever data availability / quality allows, ‘impact’ targets for economic development should be expressed in relative terms (to the UK average or appropriate subsection of UK regions) rather than in absolute terms.

- When reporting on performance, DETI / Invest NI should include targets specifically for investments new to NI (expressed as a share of equivalent jobs coming into the UK).

- The Invest NI data collection system needs to be developed as a single database, to be maintained by DETI. The IREP database, constructed specifically for the Review, will be transferred to DETI to help facilitate this process.
OVERVIEW OF RECOMMENDATIONS (CONTINUED)

Finance

• Aside from those funds designed to support seed stage projects, Invest NI should disengage its direct involvement with venture capital (VC) funds. Rather than direct participation in the market, Invest NI should act as a facilitator between companies and VCs. In the case of seed stage VC funds, Invest NI should avoid placing restrictions on the market as outlined in Chapter 3.

Project Appraisal

• Project appraisal rules should be re-assessed to ensure that projects involving investment in Innovation and R&D, which generally present uncertain and wider outcomes, are not placed at an unreasonable disadvantage.

Further Research

• A study should be undertaken to determine how NI can more rapidly shift the pattern of inward investment towards higher value sectors.

• A study of industrial land provision should be commissioned to determine why there is a perceived need for Invest NI to purchase large amounts of land over the next few years.

• DETI and other relevant departments should undertake a study to establish how the social economy might be further helped to reduce deprivation and increase labour force participation in disadvantaged areas within NI.

INTRODUCTION

7.1 As indicated previously, the Panel welcome the commitment by DETI and Invest NI to target private sector productivity improvements in the Northern Ireland (NI) economy. The assessment of policies and programmes, presented in Chapter 4, identified a number of concerns. In light of these, the aim of this chapter is to present a series of recommendations to better align the current policies and programmes to the overarching PfG productivity goal - particularly in the context of the imminent reductions in state aid ceilings. However, we begin by summarising the major issues of concern identified by the Panel.

Why Policy Reform is Required

7.2 The chief concern of the Panel is that, despite the high level of Invest NI support historically, the current portfolio of policies delivered by Invest NI does not appear to be making significant progress towards achieving the PSA goal of halving the private sector productivity gap with the UK excluding the Greater South East. We note that a large number of sectors contribute to the private sector productivity gap and many of these are beyond the reach of the incentives offered by DETI / Invest NI. Closing the productivity gap therefore requires action by a range of departments across many sectors\(^1\). As outlined in Chapter 3, much of Invest NI support has been provided to the manufacturing sector and, to a lesser extent, tradable services. However, Chapter 4

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\(^1\) DARD for example in relation to the significant productivity gap that is evident in agriculture.
showed that there is little evidence of a converging productivity trend in manufacturing or tradable services.\footnote{122}

7.3 The analysis presented in Chapter 2 revealed that NI's relative performance was not improving across a range of measures for the key drivers of productivity. Most notably, while there has been a good record of attracting new companies to NI, some of which will have raised levels of wages and productivity, the overall impact of inward investment on achieving the productivity goal has been limited. Also, the level of Business Expenditure on R&D (BERD) has not converged on the GB average, and remains very low in manufacturing. While the Panel commend efforts to increase R&D spending in smaller companies, the very low levels of BERD in larger and multi-national companies remains a problem. The Panel recognise that Innovation covers a much wider spectrum of activities than R&D, but the evidence is also that innovative activity remains below average.

7.4 It is true that we are only partway through the current Invest NI Corporate Plan in which productivity features as the prime objective, but similar productivity goals have also been prominent in the Invest NI Corporate Plans since 2002. It is also true that Invest NI is adjusting its portfolio of programmes to give greater prominence to Innovation, but the Panel regard these as changes at the margin and hence unlikely, in themselves, to make a substantial difference to NI's relative productivity.

7.5 The Panel recognise that NI's generous grant regime, and the work of Invest NI, has led to increased growth in both output and employment, even if there is limited impact on productivity. This impact appears in the relatively good share of inward investment attracted to NI, a higher level of expansion investment in existing and locally owned firms in manufacturing, and a relatively high number of 'high-growth' SMEs in manufacturing.\footnote{123}. In addition, there was some evidence of an upward trend in the rates of company formation in manufacturing and tradable services (up to 2006), but the latest data are disappointing and more time will be needed to ascertain whether policy is having a positive impact. The Panel's estimate, outlined in Chapter 4, indicated that Invest NI's activity may have been responsible for creating around 2,500 direct jobs each year with perhaps a further 2,000 indirect jobs. The real possibility that these jobs may be at risk after 2013, if EU State aid rules remove most of Invest NI's capacity to give grants, means that it is imperative to move quickly to a regime which can replace the loss of potential jobs. A reduced rate of corporation tax would, in the Panel's view, improve the NI value proposition but we recognise that the current UK government has ruled out such a tax change. Therefore, the Panel have considered alternative policies designed to increase growth and productivity in NI.

Is a Highly Productive NI Economy a Realistic Aim?

7.6 The UK economy has operated for many decades on a basis that several southern regions have high productivity and high wages, while most northern and peripheral regions have much lower productivity and wages. The former then subsidise the latter through the public expenditure system, and private sector firms are assisted in many parts of the low productivity regions. Efforts to raise productivity through excellence in education in NI, and some other regions, have limitations as graduates are highly mobile and can move to high wage regions. Nor do high standards of infrastructure

\footnote{122} The Panel does not regard productivity in financial and business services to be well measured and it is difficult to be precise on relative productivity. However, the regional accounts data on GVA and ASHE data on wages tell a similar story of low productivity with little sign of convergence.

\footnote{123} Using the OECD definition of 'high-growth' SMEs.
Recommendations for Change

appear to make a significant difference beyond a certain level. The NI Executive has taken the view that devolution presents the opportunity to bring about real change. Its vision is of a high productivity and high wage economy. As we have commented above, the Panel welcome this aspiration and we turn below to suggestions for how DETI and Invest NI might change to meet this challenge. However, we have few illusions about how difficult it will be to generate a significant change of course.

7.7 That said, Chapter 6, which outlined the key elements of global best practice in economic policy, provides much encouragement, particularly in relation to those regions / countries where there have been significant improvements in productivity. Most notable among these was the success of Nordic countries, Finland and Sweden in particular, in encouraging high levels of Innovation and R&D. The fact that several remote areas have achieved impressive gains in productivity and competitiveness suggests that such gains should also be possible in NI. At the same time, the relative rarity of outstanding examples of productivity improvements suggests that success in NI will not be easy. What is clear is that a change in policy direction is needed to raise NI's performance above its recent levels.

7.8 The Panel believe that Invest NI policy should be re-oriented in the direction of substantially more vigorous support for Innovation and R&D since this is now central to competing in a globalised economy in which many existing products can be produced at low cost in low wage countries. We are attracted to the Scandinavian concept of an ‘Innovation system' in which many aspects of society are mobilised in support of an economy in which Innovation is a central and embedded characteristic. In the most impressive example of an Innovation system, Finland, it is clear that change is led from the top and pervades many institutions. If NI is to progress down the same path, it is clear that change must be led by the Executive.

POLICIES AND PROGRAMMES

7.9 The Panel believe that the Executive should work to support the development of an Innovation system, with the aim of increasing levels of Innovation and R&D to those of Scandinavia. This should increase the capacity of the public and University sectors to generate commercially-oriented research and should also enhance the capacity of firms, both large and small, to undertake research and to introduce Innovations. Considerable Invest NI expenditure has gone into R&D in Universities through both the Higher Education Innovation Fund and the Centres of Excellence (now Competence Centres). One important imperative is to ensure that research supported by public funds is of direct value to economic competitiveness in NI. This appears to have been only occasionally the case within University Centres of Excellence. For instance, given the pressures on Universities to publish widely in international journals, advantages to the local economy are always likely to be of second-order importance.

7.10 In considering the recommendations outlined below, it is important that they are viewed in conjunction with the recommendations outlined in Chapters 8 and 9 of this report. In particular, the Panel later recommend the development and implementation of an analytical and overarching economic strategy for NI, and one which reflects the findings from this Review. The majority of recommendations outlined in this section should be captured as part of that strategy.
7.11 A portfolio of new Innovation policies should evolve and develop over time, but the Panel recommend that this should initially include the following elements:

- A new institution for commercially-oriented research should be explored in NI, along the lines pioneered by the successful VTT Institute in Finland. The institution should be outside the University system and not subject to the constraints of the Research Excellence Framework (REF). It is envisaged that this would incorporate a number of existing near market research organisations in NI and be charged with reviewing and taking forward the MATRIX agenda;

- Additional research in Universities and public sector bodies should be supported and aligned closely with the needs of industry in NI and potential inward investors. Furthermore, the development of specific new research capabilities should be used as an incentive to attract potential investors;

- Industry-led Innovation communities, as suggested in the MATRIX report, should be developed as a pilot to bring together business, academia and Government and exploit available market opportunities; and

- More should be done to support Innovation in service sector firms beyond software, which we believe is well served. The concept of Innovation in the service sector should include the broad range of areas outlined earlier in the definition of Innovation (presented in Chapter 5).

7.12 It is important to recognise that these recommendations do not exhaust the possibilities for supporting investment in Innovation and R&D. The Panel suggests that further research is undertaken to investigate other potential types of assistance that might lead to higher levels of Innovation and R&D within NI businesses. It is envisaged that this would incorporate the research\(^\text{124}\) that DETI has commissioned to identify new policy measures for supporting Innovation in NI. In addition, the Panel recommend that additional support for Innovation and R&D should not involve new public expenditure but instead be financed from savings in grant support for investment by existing firms and in property development.

7.13 The levels of reported additionality are lower for assistance to business expansion (generally delivered via Selective Financial Assistance) than business Innovation and capability development. The Panel have also expressed concerns on the high levels of repeat assistance which has typically been directed toward business formation and expansion. We have less concern on this issue, provided resources are directed toward building Innovation and R&D capability, as these remain areas where NI economy has consistently underperformed. In this context, and in light of the imminent changes to state aid rules, the Review Panel recommend that most assistance delivered via SFA should be redirected between now and 2013 to provide greater levels of support to Innovation and R&D.

7.14 SFA should remain available for investment new to NI, but in these cases the Panel consider that Invest NI should develop its capacity to understand and attract research-intensive firms, working closely with the Universities and, potentially, with the new commercially-oriented institute. Investment grants for existing firms in NI, whether externally or locally-owned, should become progressively oriented solely towards projects aimed at Innovation and R&D. The Review Panel thus recommend that grants

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\(^{124}\) The Changing Face of Innovation Policy: Complementing R&D Initiatives in Northern Ireland (University of Cambridge, to be published in 2010).
for business expansion should be phased out towards 2013 after which such grants are unlikely to be available under EU state aid rules.

7.15 In terms of the remaining business expansion projects that have typically been assisted by Invest NI, we believe arrangements should be made whereby financial support is sought, in the first instance, from alternative private sources (banks, Venture Capital (VC) companies and other sources of private funding). This type of arrangement may involve a degree of co-funding between the private and public providers of financial assistance to industry. The purpose of requiring pre-approval from private sources would also help limit the problem of deadweight loss associated with public sector support, as the market would provide the initial signal on the value of financial assistance. In this context, the Review Panel recommend that business expansion not involving Innovation and R&D should, where necessary, be supported in the form of co-investment in companies that have already been successful in securing funding from the private sector. Invest NI assistance should be in the form of sub-ordinate debt or equity.

7.16 Given the imminent and significant changes to EU state aid limits (from as early as January 2011, and as outlined in Chapter 3) and the current economic climate, the Panel recognise that other regions will be making special cases for the retention of more generous state aid limits. In this context, it is understandable that NI will wish to do the same. However, we believe that any such efforts must be consistent with the changes in policy outlined in this report. To do otherwise would be counter-productive and serve to put off the changes required. As a consequence, the Review Panel recommend that, as soon as practicable, DETI and other relevant departments commence work on preparing a case for retaining state aid limits that support the changes outlined in this Review.

7.17 The Review Panel have welcomed the rationalisation in the number of programmes Invest NI operates (particularly the recent steps to introduce a single R&D programme). However, we believe there is considerable scope for this to be taken further. For example, our analysis has indicated that 15% of assistance over the Review period has been spread across a very large number of programmes (48 programmes in 2008/09). Consequently, the Review Panel recommend that Invest NI works to significantly reduce the number of its support programmes.

7.18 In addition to the above, the Review Panel recommend that Invest NI should further reduce its support for company training, and concentrate support largely to small firms and to projects with a high Innovative content, where retraining is necessary to realise a substantial rise in productivity.

7.19 The Panel have concerns on the nature and volume of support targeted to improving export performance, particularly within the service sector. We believe there is considerable scope to strengthen the way trade missions are managed and also the type of services provided to actual and potential exporters. In order to improve performance in this critical area, the Review Panel recommend that Invest NI’s export assistance is more dedicated and professional, adopting a similar model to the fee-charging export agency outlined in earlier sections of the report, with two-tiers of charges depending on whether the company is an SME or large firm.

7.20 We are also of the view that the concept of Invest NI client status is disenfranchising a section of businesses in NI. The Panel believe that the aim of economic development should be to provide timely and responsive support to businesses undertaking Innovation and R&D in NI. At any one time, the stock of companies should be kept to
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an absolute minimum, with companies exiting as soon as they receive the necessary support. The Review Panel therefore recommend that the concept of Invest NI ‘clients’ is removed and Invest NI works throughout the entire business base to raise awareness and provide support for businesses undertaking Innovation, R&D and exports. We recognise that the competition for Invest NI support will be increased, but this should be welcomed as a step to improve the nature and speed of assistance, and also help ensure that limited resources are targeted to projects of greatest need.

7.21 In light of the significant expenditure profiled for the area of property, the Review Panel recommend that DETI / Invest NI should urgently commission a review of industrial land provision to determine why there is a perceived need for Invest NI to purchase large amounts of land over the next few years.

7.22 The Panel have also expressed concerns on the engagement of Invest NI in the tourism sector. In our view, activity in terms of tourism accommodation projects is misaligned with the Invest NI mission of increasing business productivity. Furthermore, as other bodies have the policy lead / operational responsibility in this area (DETI / NI Tourist Board and Tourism Ireland), the Review Panel recommend that Invest NI should transfer its budgets relating to tourism accommodation back to DETI to be redistributed to a more appropriate body.

7.23 The Panel have outlined the positive and significant contribution of the social economy to NI. However, given the comparatively small size of the enterprises (in terms of individual employment and turnover), the Panel believe that the important interests of the sector are better served at the local level. We therefore endorse the steps already underway to transfer this (and other enterprise initiatives including the Enterprise Development Programmes) to the district councils under the Review of Public Administration. However, we believe that the small business unit, proposed in Chapter 9, should provide generic policy advice on entrepreneurship, which could benefit the social economy. In addition, the Panel recommend that DETI and other relevant departments should undertake a study to establish how the social economy might be further helped to reduce deprivation and increase labour force participation in disadvantaged areas within NI.

Finance

7.24 The Review Panel recognise that Government funding has played an important role in stimulating and developing the VC market in NI. Our analysis, presented in Chapter 3, suggests a continuing role for Government in supporting the provision of equity finance in seed stage projects. However, aside from seed stage projects, we believe that the small size of the VC market in NI is due primarily to a lack of demand rather than supply. It is clear from the overview of Invest NI / DETI activity in the VC market (provided in Chapter 3), that Government is involved in supporting VC in both seed and later stage projects. The Panel believe that Invest NI’s role, in relation to VC funds in support of later stage projects, should be one of facilitation rather than direct participation. The purpose of Invest NI’s participation should be to promote the development of the VC business itself in NI. It should not be another avenue for providing state aid to the recipients of VC funds.
Recommendations for Change

7.25 Therefore, the Review Panel recommend that, aside from those funds designed to support seed stage projects, Invest NI should disengage its direct involvement with venture capital (VC) funds. Rather than direct participation in the market, Invest NI should act as a facilitator between companies and VCs. In the case of seed stage VC funds, Invest NI should avoid placing restrictions on the market as outlined previously in Chapter 3.

DETI / Invest NI – Project Appraisal

7.26 The Panel recognise that the move toward a greater level of assistance to projects associated with Innovation and R&D presents challenges for conventional economic appraisal. We are also aware of the difficulties associated with assessing the precise level of project add-on, particularly on an ex ante basis. Therefore, as part of the Review, the Panel have assessed the current economic appraisal methodology used to assess financial assistance to industry and we present some views on how this could be further strengthened, over-and-above the steps already taken, to help capture the wider benefits from Innovation and R&D (see Annex C). In general terms the Review Panel recommend that project appraisal rules should be re-assessed to ensure that projects involving investment in Innovation or R&D, which generally present uncertain and wider outcomes, are not placed at an unreasonable disadvantage.

DETI – Policy Development & Analysis

7.27 The Panel believe that policy development in DETI could be strengthened, with a greater link between the research agenda and the development of new or refreshed programmes. Furthermore, the Panel believe that the DETI evaluation programme should develop a more strategic view on the effectiveness of the various programmes to help improve private sector productivity in NI. Therefore, the Review Panel recommend that, as part of the review of structures within DETI (proposed later in Chapter 8), the department should ensure that more resources are dedicated to policy development and monitoring. We would expect that the development of strategy would be undertaken in conjunction with Invest NI staff, but that DETI assumes primary responsibility for ensuring that strategies have the potential to realise PSA targets, and for assessing whether targets are being met.

7.28 In order to strengthen the capacity of DETI to develop economic policy, the Panel also recommend the appointment of an independent economic advisor. This individual should be able to provide strategic advice on the direction of the economy, priority areas for investment and independently validate economic research and evaluations commissioned by DETI and Invest NI. The advisor should have extensive experience of economic development policy, particularly with regard to public policy.

7.29 In terms of performance monitoring, we have indicated that this should be undertaken by the body responsible for setting strategy and not by the organisation charged with delivery. It is our firm view that no organisation should have the responsibility to report on its own performance (as Invest NI currently does in its Performance Information Report). The Review Panel therefore recommend that instead of Invest NI reporting on its strategic performance, this should be led by DETI as the funding department, with the co-operation of Invest NI statistical staff.

7.30 Furthermore, in terms of policy development, the Panel have a specific recommendation that should be taken forward under the auspices of the DETI Research Agenda. We have previously outlined that, in terms of new inward
Recommendations for Change

investment, performance has varied greatly by sector. For example, performance has generally been good in areas such as shared services and technical support centres, whereas the reverse is the case for manufacturing and value added business services. Therefore, the Panel recommend that a study should be undertaken to determine how NI can more rapidly shift the pattern of inward investment towards higher value sectors.

7.31 The Panel have assessed two specific areas of DETI that deliver policy to strengthen business competitiveness and productivity (energy and telecommunications). In relation to these areas, the Review Panel recommend the following:

- Promotion of greater energy efficiency / conservation in the private sector should be accorded a higher priority in the 2009 Strategic Energy Framework (reflecting, where appropriate, the current and ongoing work of the Green New Deal for NI); and
- DETI and Invest NI should undertake an immediate and focused review of its overall strategic and sectoral approach to capitalise on the benefits of new telecommunications connectivity in NI.

7.32 The Panel believe that DETI should also ensure a much clearer link between its interventions (including those of Invest NI) and the overarching PfG productivity goal. The Review Panel recommend the following:

- Relevant policies and accompanying resources should be updated annually to quantifiably demonstrate how individual policies / organisations contribute to the PfG productivity goal;
- Wherever data availability / quality allows, ‘impact’ targets for economic development should be expressed in relative terms (to the UK average or appropriate subsection of UK regions) rather than in absolute terms;
- When reporting on performance, DETI / Invest NI should include targets specifically for investments new to NI (expressed as a share of equivalent jobs coming into the UK); and
- The Invest NI data collection system needs to be developed as a single database, to include offer activity, drawdown and outcome / performance data. The IREP database, constructed specifically for the Review, will be transferred to DETI to help facilitate this process.

CONCLUSION

7.33 In conclusion, the Panel recommend a decisive move in the direction of supporting Innovation and R&D with strong signals being sent from the Executive downwards that NI intends to move in the direction of becoming a more innovative and higher productivity economy. This also means an end to general support for routine investment projects, where we believe that additionality has not been high. Most grant support is likely to be phased out by 2013 under EU state aid rules and the Panel believe that DETI and Invest NI should move rapidly to devise a revised set of policies in anticipation of this new policy regime. The Panel have been especially impressed with the progress made in Finland over the last two decades to develop new sectors and raise its productivity. Consequently, a key recommendation is to emulate Finland’s key institution for undertaking commercial research. The most important change is,
however, to persuade and assist firms to integrate more R&D-based Innovation into their operations. Some firms in NI already do so, with very positive results, but too many do not. In particular, relatively few externally-owned companies have large Innovation / R&D operations in NI. The Panel have thus recommended that support for inward investment is focused on research-intensive firms and that public sector and University research needs to be better aligned with the research needs of industry in NI and potential inward investors. Since the availability of financial support may be greatly restricted after 2013, the Panel believe that speed is essential to realign support around the aims of Innovation rather than investment for expansion. Finally, the Panel recognise that if the PSA productivity target is to be met, productivity must be raised in a wider set of sectors than those supported by DETI and Invest NI.
Section III

Wider Issues
OVERVIEW OF RECOMMENDATIONS

Co-ordination of Economic Policy

- If Northern Ireland is to achieve a step change in economic performance, the economy should remain the top priority of the Executive for many years to come.

- DETI, DEL and Invest NI should work together to more effectively implement their existing liaison arrangements.

- As part of the review of strand one institutions, the core economic functions (covering existing DETI and DEL areas of responsibility) should be brought together under a single ‘Department of the Economy’.

- The FM / dFM and the Executive should establish a permanent sub-committee to prioritise action on the economy, to be chaired by the Minister for the Economy (in the interim, the Enterprise, Trade and Investment (ETI) Minister).

- The Executive sub-committee should agree an economic strategy, building on the findings of the IREP, as a matter of urgency.

Governance Arrangements

- DETI should undertake an internal review of its staffing structures to ensure that the allocation of staff is more fully aligned with its policy objectives.

- The core functions of strategic policy development and performance monitoring should be brought together within any revised DETI structures. The department should also provide the necessary support, professional and otherwise, to the Executive sub-committee on the economy.

- Invest NI should consider an internal reorganisation that reflects the differing skill sets required to support FDI, exports, Innovation / R&D and small business support.

- A small business unit should be created within Invest NI, with responsibility for the development and co-ordination of relevant support to SMEs throughout NI.

- World class training in sales and marketing should be provided for relevant Invest NI staff (particularly those working in international offices). In addition, staff should be recruited with relevant experience to meet the demands of investment decisions that are increasingly based on Innovation and R&D.

- Invest NI should be allowed more freedom to operate, with DETI having less involvement in operational matters, to enable the organisation to be more entrepreneurial and responsive to business needs.

- To help achieve greater autonomy for Invest NI, their delegated authority limits should be both simplified and increased significantly. The current DFP delegated limits for mobile SFA (currently £10m) should also apply to Innovation and R&D projects.
OVERVIEW OF RECOMMENDATIONS (CONTINUED)

- An NI version of the Central Project Review Group (CPRG) should be established, incorporating Invest NI, DETI and DFP, in order to speed up the decision making process for major industrial assistance cases.

- Given the non-executive composition of the Invest NI Board, it should cease to perform executive functions and focus on providing strategic direction and oversight.

- A senior member of the DETI Departmental Board should be represented on the Invest NI Board.

- High level experience in international business and expertise in economic development should be sought when the Invest NI board is reconstituted.

- Invest NI should be given greater autonomy and flexibility in managing its budgets, including End Year Flexibility (EYF) where required.

- For projects involving financial assistance to industry, ex-post assessments of value for money should be taken on a portfolio basis.

- The DETI / Invest NI Accounting Officer Memorandum should be reviewed in light of the revised governance arrangements implemented as part of the IREP.

- The Management Statement and Financial Memorandum (MSFM) should be reviewed and revised, where appropriate, in light of the recommendations contained in this report.

Advisory Bodies

- The ETI Minister should stand down the Economic Development Forum and establish a small advisory body, comprising expertise on regional economic development (drawn from business and economics) to provide independent advice on the economy.

- Stakeholders involved in economic development should continue to engage with the ETI Minister on a bilateral basis.

INTRODUCTION

8.1 Chapter 6 on global best practice outlined the importance of having the right structures and governance arrangements in place to ensure that support to business is both fast and flexible. The Review Panel consider this to be critical, particularly as it impacts on the effectiveness of economic development policies and programmes. Given this context, the aim of this Chapter is threefold. We begin by outlining the range of government departments and agencies involved in economic policy in Northern Ireland (NI), and we offer some recommendations for improvement. Secondly, we outline the organisational structure of DETI and Invest NI, together with their existing governance arrangements, and we present some proposals aimed at improving the degree of autonomy for Invest NI. The proposals also seek to strike the right balance between accountability, risk taking and speed in decision making. This is particularly important in light of our overall findings, namely that Innovation and R&D are the most important long-term drivers of productivity growth and need to be more aggressively prioritised by DETI and Invest NI. Finally, we offer some recommendations on how the economic
advice to the Minister of Enterprise, Trade and Investment could be better delivered than the current arrangements.

ECONOMIC POLICY DEVELOPMENT & DELIVERY IN NORTHERN IRELAND

The Programme for Government and the Economy

8.2 The Review Panel commend the NI Executive for placing the economy as its top priority in the Programme for Government (PfG). However, if NI is to achieve a step change in economic performance, and grow the prosperous and wealth creating private sector envisaged in the PfG, the Review Panel recommend that the economy should remain as the top priority for many years to come. Clearly, there is no ‘quick-fix’ for the Executive, as improving productivity and living standards are longer term goals. It is therefore necessary to continue prioritising the economy and this is also consistent with best practice elsewhere. For example, the case studies reviewed in Chapter 6 illustrated that each have prioritised the economy over the longer term.

8.3 In commending the Executive for its prioritisation of the economy, the Review Panel have also assessed the existing economic development structures to determine if they are appropriate to help deliver the economic goals contained in the PfG. We do this in the context that DETI and Invest NI represent a significant, but only partial, coverage of economic development policy in NI (as we highlighted in Chapter 1). The critical issue is, therefore, the extent to which the structures are optimal and there is clarity in the roles and responsibilities of the various stakeholders involved in economy policy in NI. As the following paragraphs indicate, we believe there is considerable scope to strengthen the existing arrangements.

Dispersal of Economic Policy in NI

8.4 DETI and Invest NI play a central role in economic development policy in NI. For example, they directly interface with the local business community and the majority of financial assistance to industry is channelled through Invest NI. However, following its consultation, the Review Panel consider the formulation and execution of economic strategy within the Northern Ireland Civil Service (NICS) and wider public sector to be less than optimal.

8.5 Interviews conducted with senior officials in the NICS reveal that the majority consider DETI, DEL and DFP as the major players in economic development, with DETI largely regarded as the lead department. However, OFMDFM also has an Economic Policy Unit (EPU) with a stated function of co-ordinating economic policy across departments. The EPU has statutory responsibility to advise NI Ministers on economic policy and evaluate the effectiveness of public spending in achieving the Executive’s economic goals.

8.6 Similarly, DFP plays an integral role in economic policy in NI, in that it has responsibility for the allocation of public expenditure. Furthermore, DFP had lead responsibility for developing NI’s overarching Regional Economic Strategy (RES). We consider this arrangement to be contrary to best practice elsewhere, namely that the formulation of economic strategy should be led by those bodies interfacing directly with business, which, in the case of NI, would be DETI and Invest NI. The Panel understand that the RES remains in abeyance until the findings of this current Review are published.
8.7 The fragmented nature of economic policy in the NICS was a recurring theme from the call for evidence and follow-up interviews. For example, we asked various government departments if they considered themselves to be players in economic development and a large number indicated involvement in a range of areas including support for enterprise, R&D and regeneration through investments in physical infrastructures (in particular, transport and strengthening the image and culture of NI). Although we anticipated this cross-departmental involvement in economic development, it nonetheless confirmed our views that the current structures have contributed to a significant lack of clarity and transparency on who has lead responsibility for economic policy in NI. Furthermore, from our assessment of global best practice, this lack of clarity has hampered the ability of policymakers to execute policies and build an environment that is truly responsive to the needs of business.

8.8 There is evidence of co-operative working links between departments in NI, particularly in the context of the 2008-11 PfG. However, our consultation revealed some issues and barriers to co-ordination. These include reported problems with gaining consensus when a large number of departments are represented, and conflicting priorities when implementing cross-cutting programmes.

8.9 In light of the above, the Review Panel believe that the NICS and other economic development stakeholders are significantly underplaying an important comparative strength for the economy – the relatively small size of the region, with its ability to be flexible and responsive to changing business needs. While previous strategies have acknowledged this, the Panel believe that much more needs to be done to exploit our size advantage. Furthermore, improvements in the co-ordination and execution of economic strategy and policy within the NICS will yield significant benefits for the economy. As a minimum, the Review Panel believe there should be greater clarity and transparency over the roles and responsibilities in relation to economic policy, both within government, and between government and the wider stakeholder community.

8.10 One area where greater co-ordination is particularly critical is in relation to the demand and supply of skills in the economy. For example, it is essential that those responsible for the provision of skills have relevant demand-side information in terms of foreign and indigenous company growth. It is in this context that we have reviewed the existing liaison arrangements between DETI, DEL and Invest NI.

**Liaison Arrangements between DETI, DEL and Invest NI**

8.11 DETI, DEL and Invest NI have established a two-tier liaison structure to facilitate inter-departmental co-operation. Permanent Secretaries from the two departments, the Chief Executive of Invest NI and their top management teams meet, on a quarterly basis, to share information with a view to promoting consistency of approach at both a policy and operational level.

8.12 A second group, at Director Level, meet on a monthly basis to discuss operational issues and individual projects. Further interaction between individual business areas is then reported to flow from this collaborative structure (as illustrated in Figure 8.1).
Evidence provided to the Review Panel indicates that this collaborative approach has led to joint projects in sectors such as ICT (e.g. ICT Action Team, Software Professional Course), Financial Services (e.g. Futures Programme, Citigroup Training), a Future Skills Action Group on Tourism and Hospitality and, more recently, in joint actions to address the specific problems presented by the current economic downturn.

Notwithstanding the above, the Review Panel are of the view that the existing arrangements could be strengthened to better enable the Executive to meet its economic goals contained in the PfG. A number of the recommendations are set out below.

**Improving the Co-Ordination of Policy Development and Delivery (DETI, DEL and Invest NI)**

As an immediate step, the Review Panel recommend that DETI, DEL and Invest NI work together to more effectively implement their existing liaison arrangements. For example, evidence received by the Review Panel outlines important areas where this relationship could be further enhanced. In particular, the Panel believe there should consistently be early participation of DEL and, where appropriate, Higher and Further Education establishments when Invest NI engages directly with external investors. The benefits of such early engagement are recognised in the protocols between DETI, DEL and Invest NI which govern the liaison arrangements detailed above. While the Panel understand that this form of engagement does occur, evidence presented to the Review Panel indicates that these arrangements do not always function optimally. In particular, DEL's early engagement with prospective FDI companies does not appear to be taking place on a consistent basis.
In support of the above, the evidence presented in Chapter 6 outlined how North Carolina operates a responsive education system to meet the needs of existing businesses and potential investors. A key aspect of this is the role played by educational institutions in working with other bodies to attract new investors to the state. In particular, colleges in North Carolina are full partners with the Department of Commerce, and are involved from the very first meeting with potential investors or firms expanding. It is the view of the Review Panel that this should be standard practice and replicated in NI.

Department of the Economy

Notwithstanding the immediate steps required to improve the existing liaison arrangements, this should only be considered as an interim measure, as the Review Panel recommend that, as part of the review of strand one institutions, the core economic functions (covering existing DETI and DEL areas of responsibility) should be brought together under a single ‘Department of the Economy’.

This recommendation, which also reflects the views of contributors to the call for evidence, has a number of important benefits. Firstly, as skills are a critical component of the NI value proposition to potential investors, we need to ensure maximum flexibility and responsiveness to business needs. There is a natural overlap between the two areas – highlighted by the large amounts of assistance that Invest NI currently provides to the two Universities – and it is the considered opinion of the Review Panel that this support would be best delivered within a single department responsible for the attraction and support of external and indigenous investment. Secondly, it is often confusing to the business environment that two separate bodies are responsible for skills provision in NI\(^\text{125}\). A much simpler structure would be the creation of a single department with responsibility for the development of company and individual skills. Thirdly, the amalgamation of two departments would fit with the FM and dFM’s commitment to review the strand one institutions, including the number of departments\(^\text{126}\).

Executive Sub-Committee to Prioritise Co-Ordinated Action on the Economy

In Chapter 6 we outlined that leadership on the economy stems from the very top of government. In that context, we welcome the actions that the First Minister (FM) and deputy First Minister (dFM) have already taken to help attract investments to NI. However, we believe that a further important step should be taken. Specifically, the Review Panel recommend that the FM and dFM and the Executive establish a sub-committee to prioritise action on the economy. We further recommend that this sub-committee is chaired by the Minister of the Economy (in the interim, the Enterprise, Trade and Investment (ETI) Minister).

An important aspect of the sub-committee is clarity on its Terms of Reference and work agenda. Below are a number of specific proposals:

- It should drive forward the development, implementation and periodic review of a co-ordinated economic strategy for NI. Therefore the Review Panel recommend that the Executive sub-committee should agree an economic strategy, building on the findings of the IREP, as a matter of urgency;

\(^{125}\) The Industrial Training Act and the Industrial Development Order both provide legislative cover for the provision of training (by DEL and DETI / Invest NI).

• It is important that the economic strategy produced by the sub-committee has primacy within the NICS. As such, the Executive sub-committee should ensure that all existing strategies are visibly aligned with the overarching economic strategy;

• The Executive sub-committee should include key government departments engaged in economic development. For example, it should include Ministers from DFP (on financial planning); DEL (on skills investment, with their participation prior to the establishment of a Department of the Economy); DRD (on transport infrastructure) and DARD (given the continued importance of agriculture and the rural economy to NI). Other departments should be included when specific issues are under consideration, for example DOE in the context of planning; and

• An effective communications matrix will be an essential part of the Executive sub-committee’s work plan. This should provide clarity in terms of how the various government departments interact with DETI and DEL (subsequently the Department of the Economy), and how the relationship is embedded and reviewed as part of service delivery agreements.

DETI – Structure

8.21 There are two distinct groups within the department, one focusing on policy and the other on management services (Figure 8.2). DETI also has responsibility for four NDPBs, and co-sponsors two North-South bodies set up at the time of the Good Friday Agreement.

Figure 8.2: DETI Organisational Structure
8.22 As part of the work programme, the Review Panel requested a breakdown of staff working in DETI by divisional area (see Table 8.1). This request stemmed from the need to assess the balance of staff between policy formulation / delivery and support. We fully recognise that various divisions have a policy delivery function, however, in the context of this Review, the Panel were surprised to find that only 12% of DETI staff were directly engaged in policy delivery (Energy, Strategic Policy and Tourism) and 14% were engaged in economic analysis (6% if we include professional staff only). That said, we acknowledge that this is distorted by the large number of staff in business regulation and HR support, where much of these activities are mandatory and generally staffed at the lower levels. The Panel believe that additional resources need to be focused in policy delivery areas, and therefore the Review Panel recommend that DETI undertakes an internal review of its staffing structures to ensure that the allocation of staff is more fully aligned with its policy objectives.

Table 8.1: DETI staffing levels

<table>
<thead>
<tr>
<th>Division</th>
<th>Gd5</th>
<th>Gd6</th>
<th>Gd7</th>
<th>DP</th>
<th>SO</th>
<th>EOI</th>
<th>EOII</th>
<th>AO</th>
<th>AA</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Regulation</td>
<td>1</td>
<td>1</td>
<td>6</td>
<td>15</td>
<td>32</td>
<td>31</td>
<td>37</td>
<td>49</td>
<td>24</td>
<td>196</td>
</tr>
<tr>
<td>Tourism, Agency Liaison and Equality</td>
<td>1</td>
<td>-</td>
<td>4</td>
<td>11</td>
<td>6</td>
<td>4</td>
<td>3</td>
<td>7</td>
<td>3</td>
<td>39</td>
</tr>
<tr>
<td>Energy</td>
<td>1</td>
<td>-</td>
<td>5</td>
<td>8</td>
<td>6</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>28</td>
</tr>
<tr>
<td>Strategic Policy</td>
<td>1</td>
<td>-</td>
<td>5</td>
<td>8</td>
<td>7</td>
<td>-</td>
<td>4</td>
<td>2</td>
<td>-</td>
<td>27</td>
</tr>
<tr>
<td>Strategic Planning, Economics and Statistics</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>14</td>
<td>15</td>
<td>4</td>
<td>9</td>
<td>20</td>
<td>10</td>
<td>77</td>
</tr>
<tr>
<td>Finance and EU</td>
<td>1</td>
<td>1</td>
<td>7</td>
<td>15</td>
<td>17</td>
<td>13</td>
<td>16</td>
<td>16</td>
<td>1</td>
<td>87</td>
</tr>
<tr>
<td>HR and Central Support (inc Press Office)</td>
<td>2</td>
<td>-</td>
<td>6</td>
<td>15</td>
<td>16</td>
<td>14</td>
<td>27</td>
<td>25</td>
<td>22</td>
<td>127</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td>8</td>
<td>2</td>
<td>35</td>
<td>78</td>
<td>90</td>
<td>68</td>
<td>99</td>
<td>121</td>
<td>61</td>
<td>562</td>
</tr>
</tbody>
</table>

Source: DETI
Note: Currently 14 staff work in Tourism Policy and Tourism Special Projects

8.23 As indicated in Chapter 1, the Terms of Reference for the IREP are limited to the review of DETI and Invest NI. As such, the policies, programmes and governance arrangements for other sponsored bodies, such as NITB, are outside our remit. However, we have noted that a dedicated branch within DETI has responsibility for overseeing the sponsorship function of arms length bodies to deliver on tourism priorities (NI Tourist Board and Tourism Ireland). We understand that no single division or branch within DETI has overall responsibility for the sponsorship function of Invest NI – which accounted for almost 80% of the department’s budget in 2007/08. We recognise that there are oversight and liaison arrangements in place between the respective senior management teams in DETI and Invest NI (outlined later). However, our view is that these arrangements are primarily designed to support good governance and, although we understand that policy is included as an agenda item at these meetings, they have insufficient scope to facilitate substantive and ongoing policy debate / discussions.
8.24 In addition to the above, the Panel are aware that a number of divisions within DETI are responsible for policy and performance monitoring. However, in our view there remains a lack of clarity on where the overall responsibility for strategic policy development and performance resides. This appears to be spread across a number of divisions within DETI, and Invest NI also seems to have considerable involvement in policy formulation. The Panel acknowledge that it is appropriate for Invest NI to be part of the policy development process as a key stakeholder, but believes that, at present, the agency has too large a role in formulating its own policy. Therefore, as part of the review of divisional structures, the Review Panel recommend that the core functions of strategic policy development and performance monitoring are brought together within any revised DETI structures. The department should also provide the necessary support, professional and otherwise, to the Executive sub-committee on the economy.

Invest NI – Structure

Overview

8.25 Invest NI employs just under 600 people, with an annual budget of close to £150 million a year. It is governed by a Board which is non-executive in composition. The organisation is managed by a Chief Executive, supported by a Top Management Team (TMT), and the organisational structure of Invest NI is illustrated in Figure 8.3.

Figure 8.3: Invest NI Management Structure

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127 The Panel notes the difference between policy development and programme design, and concludes that Invest NI should primarily be involved with the latter as the Department’s main delivery agent.
Organisational Structure, Governance & Advisory Bodies

8.26 Figure 8.3 reveals that Invest NI is structured on the basis of four separate ‘groups’, (each led by a Managing Director that forms part of the TMT). In our assessment of the internal structures, the logic, particularly of the sectoral distribution, is not immediately apparent. An overview of each of the Invest NI Groups is outlined below:

- **Clients Group and Business International** – This Group is specifically responsible for supporting clients in the International ICT, Engineering & Business Services and Transport, Construction & Tourism sectors. As stated previously, the rationale for the mix of client focus in terms of specific sector divisions is unclear, as are some of the sector combinations e.g. engineering and business services. This may be the result of a developing sectoral expertise among particular directorates rather than a deliberate design. The Managing Director of this Group is also responsible for leading Invest NI’s drive to encourage more overseas companies to set up in NI, and utilises a network of Invest NI overseas offices;

- **Clients Group and Entrepreneurship** – This Group has a specific sectoral focus on the Creative & Design based sectors, Life Sciences and Food sectors. The Managing Director of this Group is also responsible for leading Invest NI’s drive to encourage greater entrepreneurship and more business starts, utilising Invest NI’s eight local offices throughout NI;

- **Innovation and Capability Development Group** – This Group manages the delivery of Invest NI’s programmes comprising Research & Development, Training, Trade, Innovation & Strategy, Technical & Process Development and Energy & Environment. Its definition and remit is much clearer than the previous two Divisions; and

- **Corporate Services Group** – This group manages corporate functions such as Human Resources & Information Technology, Finance & Corporate Governance, Strategic Management & Planning, Corporate Finance & Appraisal, Property Solutions and Corporate Communications. Again, as with the Innovation group, the functions of this area are well defined.

8.27 In its consideration of the structure of Invest NI, the Review Panel have raised a number of questions which are discussed below:

- Is the Invest NI organisational structure optimal?
- Is Invest NI a compliance driven organisation?
- What is the necessary skills profile for a successful business development agency such as Invest NI?

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129 Located in Belfast, Ballymena, Newry, Craigavon, Enniskillen, Omagh, Coleraine and Londonderry/Derry.
Is the Invest NI Organisational Structure Optimal?

8.28 We have already indicated that, in our view, the organisational structure within Invest NI is complex and the underpinning business rationale is unclear. The evidence presented on best practice in Chapter 6 suggests that differing skill sets are required to support businesses in terms of FDI, export promotion, R&D / Innovation and small business support. The evidence also revealed that support is often delivered via separate bodies. For example, Singapore has separate agencies taking forward the portfolios of FDI, Exports, Innovation / R&D and Small Business support. Separate agencies have obvious benefits in that they enable a clear focus on the types of business activity being supported. However, the shortcomings of the multi-agency model in the NI context were put forward in both the McKie report and Strategy 2010.

8.29 Given the benefits of the single-agency model, and the significant resource demands associated with institutional change, the Review Panel are not recommending the fragmentation of Invest NI and the move to separate agencies. However, it is our view that the single-agency approach of Invest NI could be combined with a more clearly defined focus on specific business support activities (eg FDI, Export promotion, Innovation / R&D and Small Businesses support). Therefore, the Review Panel recommend that consideration is given to an internal reorganisation of Invest NI and one that reflects the differing skill sets required to support FDI, exports, Innovation / R&D and small business support.

8.30 The Review Panel have made a number of recommendations in Chapter 7 to improve Exports and Innovation / R&D performance, which partly reflect governance and wider policy issues. However, in this Chapter the Review Panel specifically recommend the creation of a small business unit within Invest NI, with responsibility for the development and co-ordination of relevant support to SMEs throughout NI. As with best practice elsewhere, this unit should, inter alia, target supply chain development and work with SMEs to integrate themselves into multinational and local exporting companies. In addition, the co-ordination role will be very important in the context of the roll out of the Review of Public Administration (RPA)130, when responsibility for programmes such as Enterprise Development Programmes (formerly the Start a Business Programme) and Social Entrepreneurship are devolved to the district councils (other economic development functions to be devolved include Enterprise Shows; Youth Entrepreneurship; Investing for Women and Neighbourhood Renewal Funding for Enterprise Initiatives). The Review Panel are of the view that, in rolling out these programmes, it is important that policy is co-ordinated centrally and this is a function that the small business unit within Invest NI should perform. Consideration should also be given to scaling down the regional network of Invest NI, and perhaps using shared facilities with the district councils.

8.31 The Review Panel are therefore not recommending short-term restructuring of the organisation, as this is often to the detriment of service delivery. However, as discussed in Chapter 7, the Panel are recommending a greater shift in the emphasis (toward Innovation and R&D), with the pattern of support offered by Invest NI also changing. In part, the proposed changes are being enforced by State Aid rules, but primarily they are put forward as a means of driving economic growth in NI. It is in this context that the evolution of the organisational structure should be managed to provide greater alignment with core support functions.

130 Further details of the Ministerial statement on the RPA (March 2008) can be accessed at the following link: www.niassembly.gov.uk/record/reports2007/080331.htm.
Is Invest NI a Compliance Driven Organisation?

8.32 Given the tightening public expenditure environment described in Chapter 1, it is increasingly important that Invest NI delivers its services as efficiently as possible. On the basis of the information provided to the Review Panel, it has not been easy to understand the proportion of staff that are fully client facing. However, the proportion of staff / resources in Corporate Services is a useful proxy. On this basis, the proportion of staff working in corporate services has declined from 28% in 2004 to 20% in 2008 (see Table 8.2). Whilst this trend is encouraging, it is clear that one-fifth of Invest NI staff still remain within a non-client facing section.

Table 8.2: Client-Facing & Corporate Services Staff Numbers

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client facing</td>
<td>270 (39.5%)</td>
<td>261 (40.4%)</td>
<td>257 (42.2%)</td>
<td>261 (44.0%)</td>
<td>271 (45.0%)</td>
</tr>
<tr>
<td>Client support</td>
<td>216 (31.6%)</td>
<td>228 (35.0%)</td>
<td>215 (35.3%)</td>
<td>208 (35.9%)</td>
<td>206 (34.0%)</td>
</tr>
<tr>
<td>Corporate Services</td>
<td>198 (28.9%)</td>
<td>162 (24.9%)</td>
<td>138 (22.6%)</td>
<td>125 (21.0%)</td>
<td>124 (20.0%)</td>
</tr>
<tr>
<td>Total</td>
<td>684 (100%)</td>
<td>651 (100%)</td>
<td>610 (100%)</td>
<td>594 (100%)</td>
<td>601 (100%)</td>
</tr>
</tbody>
</table>

Source: Invest NI

8.33 The Review Panel have also undertaken its own analysis to compare the proportion of staff in corporate services across a number of agencies in the UK. On this basis, the research suggests that Invest NI, relative to other development agencies, has a relatively larger proportion of its staff employed in corporate services (see Table 8.3).

Table 8.3: Client Facing and Non Client Facing Staff by Economic Development Body

<table>
<thead>
<tr>
<th></th>
<th>Scottish Enterprise</th>
<th>Scottish Enterprise</th>
<th>Invest NI</th>
<th>Yorkshire Forward</th>
<th>ONE North East (incl. ERDF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client facing % of total</td>
<td>82.2%</td>
<td>65.6%</td>
<td>94.5%</td>
<td>78.7%</td>
<td></td>
</tr>
</tbody>
</table>

Source: IREP analysis

8.34 From the available evidence, it is not possible to draw firm conclusions on the relative efficiency of Invest NI. Firstly, the English Regional Development Agencies (RDAs) and Scottish Enterprise are not directly comparable with Invest NI as they each have differing remits. Secondly, the functions of corporate services may be discharged by other more operational departments / directorates within comparator bodies (rather than a main corporate services department).

8.35 It must be stressed that administrative functions are important for good governance, but striking the correct balance with front-line service delivery is key. In addition, the Review Panel are not making any recommendations on the actual deployment of Invest NI staff, as this is an operational matter for the Chief Executive and the TMT. However, the Panel commend the organisation for the general move to reduce the proportion of staff within Corporate Services and suggests that there is scope for this to be taken further.
What is the Necessary Skills Profile for a Successful Economic Development Body?

8.36 In Chapter 6, we highlighted that economic development bodies prioritise the recruitment of high quality staff. Remuneration and incentive packages are important (as in the case of the EDB in Singapore) although high performance organisations can, at times, reflect the terms and conditions available in the public sector (as with the IDA in the RoI). Furthermore, our research indicated the importance of staff being solutions-based, particularly as they seek to tailor the support packages to the specific needs of businesses.

8.37 In addition to developing generic skills such as sales and marketing (particularly for staff in overseas offices), best practice economic development agencies also ensure that relevant staff are equipped to deal with investment decisions that are increasingly linked to Innovation and R&D. We recognise that Invest NI have taken some steps in this regard. For example, we are aware of the recent recruitment of a small number of Innovation advisors (for global and internal NI work) to help provide specialist advice to clients on Innovation & Technology related areas.

8.38 In light of the above, the Review Panel recommend that world class training in sales and marketing is provided for relevant Invest NI staff (particularly those working in international offices). In addition, staff should be recruited with relevant experience to meet the demands of investment decisions that are increasingly based on Innovation and R&D.

Accountability, Risk-Taking and Speed of Decision-Making

8.39 The emphasis placed on corporate governance in the UK public sector has increased over recent years. Consequently, a significant body of official guidance on good governance has been developed, some examples of which are illustrated in Figure 8.4. In recognition of the importance of corporate governance, DETI and Invest NI have developed a suite of internal and bi-lateral governance and oversight arrangements that are outlined in subsequent paragraphs.
8.40 The DETI / Invest NI Management Statement & Financial Memorandum (MSFM) is the key document which details the respective roles, responsibilities and relationships between DETI and Invest NI. The document also provides the framework for the management of Invest NI and DETI’s sponsorship function. The MSFM sets out the requirements in terms of planning, budgeting procedures and reporting.

8.41 The MSFM, published in May 2002, states that it was to be reviewed by the department ‘at least every fifth year’. A recent NI Audit Office (NIAO) report on good governance also indicates that Arms Length Bodies are normally subject to 5-yearly reviews and that the framework documents such as the MSFM should be revised in this context. The Review Panel are aware that DETI and Invest NI are currently in the process of producing a new MSFM, and have had sight of a working draft of this document. Consequently, the Review Panel recommend that the MSFM should be reviewed and revised in light of the IREP recommendations contained in this report.

8.42 A range of formal accountability and reporting arrangements have been put in place, both within Invest NI, and between DETI and Invest NI, that are in keeping with the governance framework set out above. These arrangements are illustrated in Figure 8.5.
8.43 The recent NIAO report on Good Governance, referred to previously, commended DETI for its accountability arrangements and the measures it had taken to strengthen these. In particular, the report cited the following as key elements of good practice:

- Withdrawal of departmental representation from the Boards of its Arms Length Bodies;
- The co-ordination, at DETI management board level, for dealing with Invest NI across a range of business areas including finance and accountability;
- Quarterly oversight and liaison (O&L) meetings that are held at senior level between DETI and Invest NI to monitor Invest NI performance and to communicate / discuss relevant issues;
- Flowing from the O&L process, the formalised quarterly reporting of performance against targets to the Departmental Board;
- De-briefing meetings between the Chairman and Chief Executive of Invest NI, and the Permanent Secretary and Deputy Secretaries of DETI following each Invest NI Board meeting; and
- Membership of the Deputy Secretary on the Invest NI Audit Committee and corresponding membership of the Chairperson of this Committee on the department’s Audit Committee.
The NIAO specifically commended DETI and Invest NI on the risk management and auditing systems that have been put in place. In addition, we believe that the accountability and reporting arrangements have also been strengthened since the NIAO report was published. For example, a dedicated Strategic Planning Unit has been established (within Strategic Planning, Economics and Statistics Division), which has been tasked with improving the robustness of the challenge function. Further processes have also been put in place whereby the Chief Executive of Invest NI formally writes to the Permanent Secretary to explain where performance is off-target and to detail the remedial action being taken.

The key question here is the extent to which the current governance arrangements strike the correct balance between accountability and risk-taking. Broadly speaking, the Panel believe that Invest NI should be allowed more freedom to operate, with DETI having less involvement in operational matters, to enable the organisation to be more entrepreneurial and responsive to business needs. With regard to this, we provide more detail on the accountability processes, and the role of the key players involved in the decision-making process. The level of authority delegated to Invest NI to make decisions independent of DETI / DFP is used as a proxy for the extent to which the system allows Invest NI to be sufficiently risk taking.

**Invest NI Board**

The Invest NI Board consists of twelve non-executive members, including the Chairman. In terms of the background of the Board, there is a strong input from members with current and prior private sector expertise. Broadly speaking the professional background and experience of the Board members is as follows:

- 12 in the private sector;
- 5 in the public sector;
- 7 in academia; and
- 2 as members of chartered bodies.

The Code of Practice for Invest NI Board Members states that members are responsible collectively for undertaking the following duties:

- Ensuring that Invest NI’s mission, objectives and strategy, as approved by the Minister, are clearly presented and the targets are achieved;
- Assisting the Chief Executive in the development of Invest NI’s Corporate and Operating Plans;
- Exercising decision-making authority in all areas, including expenditure (discussed later in relation to delegated authority);
- Acting as a channel of communication between the department, industry, academia and Invest NI; and
- Engaging with the Minister on the formulation and implementation of economic policy.

The Review Panel are generally content with the Code of Practice and designated responsibilities of the Invest NI Board. However, we have concerns with the
compatibility between its non-executive role and the responsibilities it has in exercising decision-making authority in all areas, including expenditure. We believe that expenditure is the responsibility of the executive team in Invest NI (ultimately the Chief Executive with support from the TMT) and the Board should not be asked to perform its role in approving cases (above £1m – see relevant paragraphs below) that require DETI / DFP approval. Our view is that the Board should perform its remaining responsibilities as outlined in the Code of Practice, in particular to establish the overall strategic direction of the organisation and offer advice on certain policy initiatives. The Board should also ensure that the organisation complies with any statutory or administrative requirements for the use of public funds, and provide assurance to DETI on the management of the organisation. The Board also requires expertise to allow it to evaluate how well Invest NI is meeting its aims and to be able to interface with professionals in DETI and elsewhere with specialist capability to undertake evaluations. The Review Panel therefore recommend that, given the non-executive composition of the Invest NI board, it should cease to perform executive functions and focus on providing strategic direction and oversight. As part of its assurance role, arrangements should also be in place for the Board to note the nature and scale of projects requiring significant expenditures (perhaps on projects in excess of the approval threshold).

8.49 Further to the above, the Review Panel recommend that a senior member of the DETI Departmental Board should be represented on the Invest NI Board. In making this recommendation, we recognise the earlier report by the NIAO which commended DETI for the steps it took to withdraw its representation from the Boards of its Arms Length Bodies. However, in the context of our wider recommendations that seek to provide greater autonomy to Invest NI, and also the proposed revisions to the Code of Practice, we believe there are clear merits in having a senior representative from the sponsoring department on the Invest NI Board. This arrangement is also consistent with experience elsewhere, as we understand similar arrangements are in place in the IDA in the RoI.

8.50 Finally, in the context of the Invest Board, we recognise that the majority of the members currently hold, or have previously held, senior positions in NI businesses. However, evidence from our review of global best practice in economic development indicated that organisations have also benefited from high level international experience. For example, the board of the EDB in Singapore is mostly made up of senior executives from large foreign companies. This allows them to provide strategic guidance to the agency and also offer an external perspective and international industry expertise. The Review Panel recommend that high level experience in international business and expertise in economic development should be sought when the Invest NI board is reconstituted.

131 The Review Panel are aware of the proactive role the Board recently provided in the establishment of the Short Term Aid Scheme to help address the particular pressures arising from the current downturn.

132 In its reports on LEDU (June 2002) and the Northern Ireland Tourist Board (October 2002), the Public Accounts Committee of the NI Assembly recommended that DFP should review and, if necessary, readjust its guidance on the roles and responsibilities of departmental representatives on the boards of NDPBs and other public bodies. DFP subsequently issued guidance in a Finance Directors Memorandum (FD (DFP) 3/05: Departmental Representatives on the Boards of NDPBs and Other Sponsored Bodies). This stated that (in some cases), while the participation of departmental officials on the boards of Arms Length Bodies can be useful and enhance working relationships, it may also create potential for conflicts of interest, blurring of the decision-making process and the potential for embarrassment for departments and Ministers should projects fail to achieve their objectives, or irregularities occur in their business conduct.
Organisational Structure, Governance & Advisory Bodies

Delegated Limits

8.51 DFP exercises administrative control of expenditure on behalf of the NI Assembly to ensure the proper management of tax-payers funds. However, in practice DFP delegates the authority to departments to incur expenditure within defined limits and below these limits, DFP approval is not required. DETI has also delegated authority to Invest NI in respect of expenditure within a second, lower, set of limits.

8.52 Broadly speaking, within Invest NI, approval can be granted for projects of up to £1 million. Above this limit, DETI Ministerial approval is required and, for larger projects, DFP approval is also required. As Table 8.4 reveals, Invest NI’s Executive Casework Committee can typically approve cases of up to the value of £1m. Cases above £1m must first be approved by an Invest NI Board Casework Committee before DETI Ministerial approval is sought.

Table 8.4: Internal Invest NI Approval Limits

<table>
<thead>
<tr>
<th>Invest NI Board Casework Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cases of £1m and over</td>
</tr>
<tr>
<td>• Cases involving ordinary share capital of £500k &amp; over</td>
</tr>
<tr>
<td>• Management buy-out / buy-ins of £250k &amp; over</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Executive Casework Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cases of £750k &amp; over, but under £1m</td>
</tr>
<tr>
<td>• Cases involving secured loans and/or preference share capital of £250k &amp; over</td>
</tr>
<tr>
<td>• Start-up cases of £250k &amp; over</td>
</tr>
<tr>
<td>• Management buy-out/buy-ins under £250k</td>
</tr>
<tr>
<td>• Cases involving ordinary share capital of £250k &amp; over, but under 500k</td>
</tr>
<tr>
<td>• Cases where any element of loan assistance is unsecured</td>
</tr>
<tr>
<td>• Any case requiring DFP (unless being submitted to the Board Casework Committee)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Invest NI officials</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Range of approval levels for Managing Director, Director, Client Manager, &amp; Client Executive</td>
</tr>
</tbody>
</table>

Source: Invest NI Operating Manual

8.53 In addition to the above, DFP has also put in place a relatively complex set of delegated limits (particularly when compared to other economic development bodies). Table 8.5 indicates that these vary by type of assistance offered.

Table 8.5: Thresholds for DFP Approval

<table>
<thead>
<tr>
<th>SFA Projects</th>
<th>Mobile Projects</th>
<th>Non-Mobile Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assistance</td>
<td>Over £10m</td>
<td>Over £6m</td>
</tr>
<tr>
<td>Grant Cost per job</td>
<td>Over £30k</td>
<td>Over £10k</td>
</tr>
<tr>
<td>GGE (Gross Grant Equivalent)</td>
<td>Over 55%</td>
<td>Over 40%</td>
</tr>
<tr>
<td>Capital Grant</td>
<td>Over 30% unless in an NTSN area</td>
<td>Over 30%</td>
</tr>
<tr>
<td>Repeat assistance within 5-year period for same project</td>
<td>No delegation</td>
<td>No delegation</td>
</tr>
</tbody>
</table>
Table 8.5: Thresholds for DFP Approval (continued)

<table>
<thead>
<tr>
<th>Other Mobile/Non-Mobile Projects</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Share acquisition</td>
<td>Over £4m and/or 51% or more of voting rights</td>
</tr>
<tr>
<td>Loans</td>
<td>Interest or capital free period of more than 2 years</td>
</tr>
<tr>
<td>Buying Time/Assistance</td>
<td>Over £1m and/or loan cost per job of over £5k for up to 6 months</td>
</tr>
</tbody>
</table>

Innovation and R&D Projects

| Total Assistance                  | Over £2 million |
| Contribution rate                 | Assistance over £250k where Invest NI’s contribution exceeds 50% of project costs |

Property Assistance

The following delegated limits apply to stand-alone property cases i.e. where property assistance is the only form of assistance to a project. Where property assistance is part of a wider package of assistance, the Project Assistance delegated limits apply.

<table>
<thead>
<tr>
<th>Project type</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Development Agreements</td>
<td>Over £1m</td>
</tr>
<tr>
<td>Land Acquisition</td>
<td>Over £3m</td>
</tr>
<tr>
<td>Estate Development</td>
<td>Over £3m</td>
</tr>
<tr>
<td>Advance Factories</td>
<td>Over £2m</td>
</tr>
<tr>
<td>Bespoke Factories</td>
<td>Over £2m</td>
</tr>
<tr>
<td>Maintenance/minor alterations/repairs to factories</td>
<td>Over £250k per factory on aggregate basis over 3 yrs</td>
</tr>
<tr>
<td>Insurance claims</td>
<td>Over £100k per claim</td>
</tr>
<tr>
<td>Shortfall Guarantee Scheme</td>
<td>Overall contingent liability – over £11.5m</td>
</tr>
<tr>
<td>Individual contingent liability – over £500k</td>
<td></td>
</tr>
</tbody>
</table>

Private Sector Tourism Projects

<table>
<thead>
<tr>
<th>Grant, Loan, Interest Relief Grant or Acquisition of shares</th>
<th>Over 30% of eligible costs or over £0.75m. This may be increased to 50% for areas of high unemployment or key projects subject to departmental agreement.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assistance</td>
<td>Over 30% eligible costs for projects or over £0.75m.</td>
</tr>
</tbody>
</table>

General Programmes Mobile/Non-Mobile Projects

<table>
<thead>
<tr>
<th>General Capital</th>
<th>Over £1 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Grant</td>
<td>3-year package over £250k or over £100k in any of the first 3 yrs</td>
</tr>
</tbody>
</table>

The Aircraft and Shipbuilding Industries NI Order

All payments made under the above Order require DFP approval

Source: Invest NI Operating Manual and DAO (DFP) 06/05

8.54 Table 8.6 provides a high level comparison of delegated limits in Invest NI and other development bodies. It reveals that the arrangements are not only more complex but the level of authority delegated to Invest NI to incur expenditure is also lower than
other comparable bodies. This means that approval is required from DETI and DFP in more instances than would typically be the case in other regions.

Table 8.6: Overview of Delegated Approval Levels within Invest NI & other Economic Development Bodies

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Departmental/Ministerial approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invest NI</td>
<td>Over £1 million</td>
</tr>
<tr>
<td>One North East</td>
<td>CPRG: over £10 million</td>
</tr>
<tr>
<td>Yorkshire Forward</td>
<td>CPRG: over £10 million</td>
</tr>
<tr>
<td>Scottish Enterprise</td>
<td>Over £3 million</td>
</tr>
<tr>
<td>IDA Ireland</td>
<td>Not disclosed</td>
</tr>
<tr>
<td>Enterprise Ireland</td>
<td>Over €4.5m</td>
</tr>
</tbody>
</table>

Source: IREP analysis

Note: Higher delegated limits for the English RDA’s reflect their wider remit in areas such as urban regeneration. CPRG refers to the Central Project Review Group. CPRG is a tripartite committee, made up of representatives from HM Treasury, DBIS (previously BERR) and DCLG. The aim of this group is to add value to the RDA’s own appraisal through their collective knowledge and experience of a wide range of projects in particular in identifying options and alternative ways of delivering project objectives and outcomes, assessing cost effectiveness, the management and mitigation of common types of risk and disseminating best practice.

8.55 On the basis of the current delegated limits, Invest NI had to seek external approval for eighteen cases during 2008/09 (detailed in Figure 8.6), with an average of twenty-one cases being sent for approval each year since 2005/06. The delegated approval limits detailed in Table 8.6 suggests that the other development bodies listed would not have had to seek the same level of approval from their host department in many of these cases.

Figure 8.6: Projects requiring DETI / DFP Approval (2005/06 – 2008/09)

Source: Invest NI
8.56 Our research reveals that Invest NI and the other development bodies in GB and RoI follow a broadly similar internal process in terms of taking cases through from the development of business plans, the economic appraisal and final approval. However, the need to seek approval from DETI and DFP, as outlined above, clearly represents an additional layer of administration in NI, vis-à-vis other comparable bodies (from our understanding this extra layer of accountability can typically extend the approval process by forty-five days\(^{133}\), although it is acknowledged that case-specific factors may contribute to this).

8.57 The Review Panel are aware that some efforts have been made in major projects to introduce an element of parallel processing, which does help to reduce the time taken to gain approval for these projects. However, it appears that when approval is required in Invest NI, DETI, and DFP, it is generally pursued sequentially. This also involves a significant degree of iterative clarification and amendment of casework papers between the three parties. We believe that the current system, and the information required, increases the time taken to approve individual cases, and the administrative resources required for this process. The arrangements are also placing an additional burden on the NI system that is largely absent in other regions that compete with NI for mobile business investment.

8.58 Furthermore, with the exception of an increase in the DFP delegated limits for R&D and Innovation projects (maximum limit increased from £1m to £2m in November 2008), evidence presented to the Panel indicates that the DFP thresholds have not been substantively revised since the first round of devolution in 1998/99. In fact, we understand that the £10m and £6m limits for mobile and non-mobile projects have been in place since the early 1990s.

8.59 In terms of best practice elsewhere, our research suggests that a much better approach to approving major investment projects is the tripartite Central Project Review Group operating in GB. This initiative seeks simultaneous agreement on projects above £10m by key parties including representatives from HM Treasury, the Department for Business Innovation and Skills and the relevant RDA.

8.60 On the basis of the above, the Review Panel recommend that Invest NI delegations should be both simplified and the limits increased significantly. For example, the Review Panel specifically recommend that the current DFP delegated limits for mobile SFA (currently £10m) should also apply to Innovation and R&D projects.

8.61 The Review Panel further recommend the establishment of an NI version of the Central Project Review Group (CPRG), to incorporate Invest NI, DETI and DFP in order to speed up the decision making process for major industrial assistance cases. Any cases above the DFP thresholds should be considered collectively by the Group to minimise the time and duplication of resource necessary to agree on major economic development projects.

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\(^{133}\) DETI has 20 working days to comment on an economic appraisal, while DFP has a further 25. Furthermore, project casework papers often have to be revised and resubmitted, which can require multiple periods of 20 / 25 days to consider.
Organisational Structure, Governance & Advisory Bodies

Casework Processing

8.62 The recommendations outlined previously are designed to provide Invest NI with greater autonomy to undertake investments, particularly in projects involving Innovation and R&D. The proposals should also help quicken processing times but equally maintain the strong accountability mechanisms that DETI and Invest NI have developed since 2002. In making these proposals, the Panel recognise the steps that have already been taken in this area. We have reviewed the casework protocol developed jointly by DETI and Invest NI and consider that this has helped reduce the timelines associated with casework processing, although performance remains inconsistent. For example, the average casework processing time (for projects greater than £1m) was 53 days in 2008/09 compared with 122 days in 2007/08 and 102 days in 2006/07.

Liaison Arrangements – DETI and Invest NI

8.63 The Panel welcome the steps DETI and Invest NI have taken to ensure regular liaison, particularly in areas such as performance and finance. Although our proposals are primarily designed to give Invest NI greater autonomy, we believe the existing arrangements should be maintained, not least to ensure effective communication channels. Indeed, research undertaken by the Panel indicates that this practice of regular communication is a key feature in the RoI. For example, the IDA and its funding department (the Department of Enterprise, Trade and Employment) hold monthly discussions on operational matters.

8.64 As indicated earlier, the revised procedures for performance monitoring within DETI have resulted in the introduction of a challenge function as part of quarterly Oversight and Liaison (O&L) meetings. We recognise that Invest NI will continue to report quarterly on performance to facilitate the current PSA monitoring process. However, the Panel believe that revisions should be made to the way the organisation’s performance is assessed and reported on annually (as discussed below).

8.65 In terms of performance monitoring and reporting, the Panel have concerns on the way important details have been published by Invest NI. For example, in the latest Performance Information Report (covering Invest NI activity between 2002/3 and 2007/8), we believe there is a lack of transparency on important variables. For example:

- The classifications used to define new FDI are extremely broad (as highlighted in Chapters 3 and 4, Invest NI includes some expansion projects in FDI companies already active in NI as new FDI);
- The key metric on job quality is average salaries but the reporting is very limited (Invest NI only report on jobs promoted which offer salaries above or below the private sector median and not the actual salary level); and
- The median casework processing times are reported on broad categories only (offers under £100k and above £100k and total – there is no specific category outlining performance on projects requiring Ministerial approval).

8.66 As recommended in Chapter 7, we believe that DETI – as the funding department – is better positioned to report on Invest NI’s strategic performance. This should be one of the important functions of the enhanced policy development/monitoring role within DETI that Panel recommended previously. The department would report externally (and on an annual basis) on Invest NI performance using a transparent range of variables.
Aside from freeing up valuable resource within Invest NI, the implementation of this recommendation would also strengthen the degree of independence when it comes to reporting on performance.

**Budgetary Control Mechanisms**

8.67 Analysis conducted by the Review Panel suggests that Invest NI has limited budgetary flexibility. By comparison, the English RDAs are entitled to keep / carry over 10% or £20 million at year end whereas Invest NI must surrender all excess resources. Evidence provided to the Panel indicates that Invest NI has a strong track record of performance in terms of budgeting and minimising under / over-spending. For example, over the three years from 2006/07 to 2008/09, Invest NI’s outturn has been, on average, within 3% of its final budget position. Furthermore, the Review Panel obtained a report, commissioned by DFP in 2007\(^{134}\), which recommended that departments demonstrating robust arrangements for financial management should be given greater autonomy to manage their own affairs through End Year Flexibility (EYF)\(^{135}\). Consequently, the Panel recommend that Invest NI should be given greater autonomy in managing its budgets, including End Year Flexibility where required.

**Accounting Officer Memorandum**

8.68 The Panel have also reviewed the Accounting Officer arrangements in place between the DETI Permanent Secretary and the Invest NI Chief Executive. Specifically, the principal Accounting Officer of the department (the Permanent Secretary) is responsible for ensuring that the NDPB has adequate financial systems and procedures in place to promote the efficient and economical conduct of its business and to safeguard financial propriety and regularity. The designated Accounting Officer, in this case the Chief Executive of Invest NI, is responsible to the Invest NI Board and is also accountable to the Assembly for the agency's use of resources in carrying out its functions as set out in the relevant Financial Memorandum. These arrangements are common in NDPBs which have a designated Accounting Officer.

8.69 In light of our recommendations which grant greater autonomy to Invest NI, it is important that any downside risks are fully managed. The Review Panel therefore recommend that the DETI / Invest NI Accounting Officer Memorandum is reviewed in light of the revised governance arrangements implemented as part of this Review.

**Ex Post Assessment of Assistance to Industry**

8.70 Furthermore, it is the Review Panel’s view that there needs to be a change in the approach taken to assess performance and the retrospective attitude taken to risk. Currently, the NI Audit Office and the Public Accounts Committee (of the NI Assembly) assesses Invest NI on a case-by-case basis, focusing on the outcomes of individual projects. We suggest this makes the system inherently risk averse and consideration should be given to adopting a portfolio based approach whereby performance is assessed in aggregate rather than on an individual project basis. Furthermore, where decisions in relation to individual projects are to be audited, it should also be, in part, on the basis of the information that was available at the time of the decision. The Review Panel recommend that the ex post assessment of projects involving financial assistance to industry should be undertaken on a portfolio basis.

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\(^{134}\) Review of Forecasting and Monitoring, PKF, June 2007.

\(^{135}\) End Year Flexibility (EYF) enables the carry over of under-spends to the next financial year.
STAKEHOLDER ENGAGEMENT

8.71 An important aspect of the Review was to consider the optimal way by which the Minister of Enterprise, Trade and Investment engages with key stakeholders on economic development issues. In response, the Review Panel have assessed the current arrangements for stakeholder engagement and we offer a number of proposals for consideration and a specific recommendation on how they could be further strengthened. Our proposals are based on evidence gathered from existing stakeholders and a brief assessment of the approach taken elsewhere.

Current Arrangements

8.72 The main formal mechanism through which DETI engages with stakeholders is via the Economic Development Forum (EDF). The Review Panel are also aware that certain organisations, in particular representative business bodies, routinely seek bilateral discussions with the Minister and / or senior civil servants on ad hoc issues that lie outside the remit or frequency of the EDF meetings. There are also various engagements with the department in response to public consultations on issues such as Corporate Plans, Strategies and Policy Initiatives.

Economic Development Forum (EDF) – Remit & Membership

8.73 The EDF was set up in 1999 to bring together the social partners (in particular, members of the Assembly, the Business organisations and Trade Unions) to agree on the development and implementation of economic development policy in NI. The Forum was designed to provide advice on the recommendations and targets set out in Strategy 2010. Furthermore, the Forum was to have a role in monitoring the economic strategy, with members given an annual report on progress against targets (provided by DETI).

8.74 As outlined previously, the Review Panel are aware that Strategy 2010 was replaced by a shorter document (Economic Vision), which presented a revised framework and targets that broadly reflected the HM Treasury productivity drivers. Despite this change in strategy, EDF was retained although its functions appear to be primarily a vehicle for stakeholder engagement (as outlined below).

8.75 The Forum has an extensive Terms of Reference (summarised in Box 8.1) and they were revised in June 2008 to reflect the current policy framework (with an emphasis on the economic targets outlined in the PfG).

8.76 Membership of the EDF is wide ranging and is outlined in Box 8.2. The Chair remains the Minister of Enterprise, Trade and Investment (deputy Chair is the Permanent Secretary of the department), with additional Ministerial engagement from the DEL and DRD Ministers. Senior government representatives from other departments involved in economic development in NI are also present (DFP and DE).

8.77 One feature of the Forum is that, rather than a representative from the particular stakeholder community attending, there are multiple attendees from each area – as outlined in Box 8.2. We believe this impacts negatively on both the size and function of the Forum and therefore on the ability to harness a single Forum ‘voice’.

8.78 The Review Panel are also aware of the recent initiative by the OFMDFM to establish a Cross Sector Advisory Forum (CSAF). This is an informal group, chaired by the First Minister and deputy First Minister, which is to review the impact of the current economic downturn on local people and business. The Minister of Enterprise, Trade
and Investment is a member of the Forum and co-chairs (along with the Minister of Employment and Learning) a sub-group covering issues relating to business and skills. We understand the CSAF is temporary, however, the Review Panel have concerns on the significant overlap between the CSAF and the EDF.

**BOX 8.1: ECONOMIC DEVELOPMENT FORUM TERMS OF REFERENCE**

**Informing the current position and immediate future growth**
- Provide an effective mechanism for engagement between the social partners and government on matters relating to the NI economy.
- Identify the need for, and commission where agreed by Plenary, economic research and policy advice in the priority areas identified within the current Programme for Government.

**Considering the areas for investment**
- Identify and provide advice on key issues inhibiting or likely to inhibit the competitiveness and productivity of the NI economy.

**Prioritising areas for investment**
- Provide advice on economy-related public expenditure allocations and priorities.

**Informing policy development**
- Provide advice on the evaluation of existing public policies, and development of future policies, relating to the development of the NI economy in accordance with the direction set by the current Programme for Government.
- Advise on ways to balance the objectives of improving competitiveness and productivity, maximising economic growth, achieving sustainable development and promoting social cohesion and inclusion through an equitable distribution of the benefits of economic growth.

**Monitoring the performance of Government**
- Provide advice on the actions/interventions required by the non-government sector to develop a more productive/competitive economy in line with the Programme for Government and monitor progress on the actions/intervention undertaken.
Organisational Structure, Governance & Advisory Bodies

BOX 8.2: ECONOMIC DEVELOPMENT FORUM MEMBERSHIP

- **Chair**: ETI Minister. The Permanent Secretary of DETI is an ex officio member and acts as Chairman of the Forum in the absence of the Minister

- **Business**: Six representatives from the Institute of Directors, the Confederation of British Industry, the NI Chamber of Commerce and Industry, the Federation of Small Businesses, North West Chamber of Commerce and the Centre for Competitiveness.

- **Trade unions**: Four representatives nominated by the NI Committee of the Irish Congress of Trade Unions

- **Community / Voluntary**: Two representatives nominated by the NI Council for Voluntary Action

- **Rural / Farming**: One representative nominated by the Ulster Farmers Union

- **Education**: Two representatives from Higher Education and 1 from Further Education – nominated by Universities and FE sector.

- **Government**: Representatives from the Departments of Enterprise Trade and Investment, Employment and Learning (including Minister), Education, Regional Development (including Minister), Finance and Personnel, Invest NI, the Society of Local Authority Chief Executives and the Employment and Skills Advisor.

Views of EDF Stakeholders / Effectiveness

8.79 The research commissioned by the Review Panel reveals that stakeholders primarily regard the EDF as a vehicle to facilitate a two-way communication channel between government and stakeholders on matters relating to economic policy. The Forum has been involved in the monitoring of economic targets, with a formal sub-group tasked with this responsibility. The Review Panel understand that, as part of the recent review of EDF, the existence and functions of the sub-group have ceased. Certain members expressed the view that this restricts the ability of the Forum to fully discharge its Terms of Reference, particularly in terms of monitoring performance.

8.80 Stakeholders view the EDF as an opportunity to work together with government. Furthermore, stakeholders view the EDF as a vehicle through which they can engage with government rather than DETI in isolation. This is reported as one of the strengths of the Forum, particularly given the fragmented nature of economic policy across government departments (as highlighted earlier in this Chapter). However, while some stakeholders recognise the importance of working in partnership with government, others stressed the need for the Forum to be independent, and thereby able to effectively fulfil its role as a challenge function to government.

8.81 There was a general consensus amongst stakeholders that there are benefits for both government and stakeholders in the breadth of representation on the EDF. Furthermore, it was generally considered by stakeholders that the EDF had helped influence economic policy in a number of areas. For example, the work delivered as part of the sub-group on the economic downturn and, more recently, the sub-groups on manufacturing and exports were viewed as being particularly positive.

8.82 Despite the above, a recurring theme from our analysis is that the current size of the Forum makes it very difficult to facilitate constructive debate and advice to government. Stakeholders considered their bilateral engagements with appropriate...
Ministers to be more focused and productive than EDF plenary meetings. They also expressed reservations on the duplicative role of both the CSAF and the EDF. Maintaining both bodies in parallel was seen to be placing significant pressures on attendees (and the support staff of relevant departments).

Comparable Bodies

8.83 Every UK region has specific challenges and the evidence gathered by the Review Panel indicates that there are also different advisory bodies (varying by number, structure and remit). Nevertheless, by comparing the structures in NI to systems used in Scotland and the RoI, some key messages emerged.

8.84 In the other regions / countries, the remit and functions of the EDF were dispersed across a small number of bodies, rather than lying within one single unit. For example, in Scotland the First Minister receives advice on the economy from a small number of advisors (Council of Economic Advisors136) and engages with the wider stakeholder community on matters of economic policy, through bodies such as the National Economic Forum and the Scottish Council for Development and Industry.

8.85 Membership of individual bodies also tends to be tailored and closely aligned to their role and remit. For example, in Scotland, the Council of Economic Advisors is comprised of academics and private sector representatives to provide expert advice on economic policy. The specialist nature of the advice means that this group may potentially work more effectively as an advisory panel than a body with a diverse membership structure. However, it is recognised that the Council is relatively new, and there has been no formal assessment of its impact within the Scottish system.

8.86 In the RoI, there are a number of economic development advisory bodies, each carrying out a different role. For example, the National Economic and Social Development Office (NESDO) is a management body which facilitates and promotes the work of its constituent bodies, namely the National Economic and Social Council (NESC), which is a strategic advisory body to the Taoiseach; the National Economic and Social Forum (NESF), which advises on the implementation of policies on the ground and the National Centre for Partnership and Performance (NCPP) which advises organisations on workplace change and Innovation.

Proposed Changes

8.87 Following the review of comparable advisory bodies in GB and the RoI, and also the Panel's assessment of the effectiveness of EDF, we outline below a number of options to develop a mechanism whereby the ETI Minister is provided with more focused advice on the economy:

a) Consideration is given to standing down the EDF;

b) Consideration is given to a significant reduction of the EDF membership, with the various stakeholders reducing the number of representatives attending plenary; and

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c) Consideration is given to the establishment of a small advisory body, comprising expertise on regional economic development (drawn from business and economics), to provide independent advice to the Economy Minister (in the interim, the ETI Minister). As well as involving representatives from the local community, this body could draw on international and national expertise, particularly if individuals could be attracted with previous links to NI.

8.88 There are obvious pros and cons regarding the proposals outlined above, however, on balance, the Review Panel favours a combination of options (a) and (c) as we believe this offers the format whereby advice on the economy is offered from as wide a range of sources as possible. Therefore, the Review Panel recommend that the ETI Minister stands down EDF and establishes a small advisory body, comprising expertise on regional economic development (drawn from business and economics) to provide independent advice on the economy. This body should draw on expertise from the local community as well as seek international and national representatives, if possible, with previous links to NI.

8.89 In making this recommendation, the Review Panel proposes that stakeholders involved in economic development should continue to seek engagement with the ETI Minister on a bilateral basis. These arrangements may be ad hoc and / or on a formalised basis. This is something that the Review Panel encourages, particularly as it enables the Minister to receive views from a wide range of local stakeholders. It also reflects an important and positive aspect of devolved government, namely the relative accessibility of local Ministers.
OVERVIEW OF RECOMMENDATIONS

Skills
- The local education system should prepare now to meet the anticipated increased demand for higher level skills in STEM and other Innovation relevant subjects arising from the increased prioritisation of Innovation and R&D
- The current focus on technical and professional qualifications, including apprenticeships and vocational training, should be extended to emphasise higher level qualifications at levels 4 and 5
- DEL, DETI and Invest NI should work to significantly develop management and leadership skills in NI and support the proposal for government to sponsor a ‘Management Masterclass’ to identify and develop the best managers from local industry and the public sector

Infrastructure
- The Executive should ensure that the third ISNI plan takes a much greater economic focus by committing more investment into projects that will maximise NI’s future economic performance

Planning
- In the context of reform, the Planning Service should be given processing time targets which are comparable and competitive with those countries and regions against which NI is competing for mobile international investment
- Planning Service should work to ensure that the legislative timetable for reform is met
- The Strategic Projects Team should deal with all applications relating to investment new to NI. In addition, in terms of what constitutes a ‘regionally significant development’, a clear definition and qualifying criteria should be developed and agreed between DoE, DRD, DETI and Invest NI
- The Pre-Application Discussion (PAD) process must be as efficient as possible and the time allocated for PAD should be included when reporting on timings for all applications
INTRODUCTION
9.1 As outlined in Chapter 3, the mission of DETI and Invest NI is to lead on policy initiatives to help deliver the productivity goal contained in the Programme for Government (PfG). However, the Review Panel recognise that this goal is wider than DETI and incorporates a number of other Government departments. Furthermore, we are also aware that this point has already been reflected in the PfG and supporting Public Service Agreements (PSAs). For example, in terms of PSA1 (increasing manufacturing and private services productivity), the actions (classified as Departmental Strategic Objectives, DSOs) are being taken forward by DETI, in conjunction with DEL and DRD. The non-DETI areas of responsibility are outlined below:

- To develop and maintain a Higher Education research sector that holds a strong position within the UK and beyond, and makes a major contribution to economic and social well-being (DEL);
- Increase the level of skills to aid productivity improvements in manufacturing and tradable services (DEL); and
- Improve the strategic road network by the advancement / completion of a range of major road schemes (DRD).

9.2 Therefore, given the cross-departmental nature of productivity, this chapter seeks to identify issues relating to skills and infrastructure which may inhibit the delivery of the DETI-led PfG productivity goal and supporting PSA. In addition, the Call for Evidence highlighted the importance of planning as a key issue for economic development and performance in this area is also assessed.

SKILLS
9.3 The Review Panel have reviewed the relevant literature which outlines the importance of skills to productivity improvements and also the role that Government should adopt in this area. In particular, we have explored the relationship between skills at level 4 and above (Higher Education level skills) and productivity and the returns to different qualification levels. The Panel have also summarised the current skills profile in NI and the forecast future demand for skills, within both the international and UK context. This chapter also considers the role of apprenticeships in NI and the range of skills required to facilitate the recommendations contained throughout this report, namely the more sustained prioritisation and investment in Innovation and R&D.

Importance of Skills
9.4 As set out in Chapter 5, skills are recognised as an important component of raising productivity and competitiveness. This is outlined in the NI skills strategy - Success through Skills\(^\text{138}\), which highlights the importance of skills to economic development in NI. In addition, the Leitch Review of Skills\(^\text{139}\) asserts that the natural resource of the 21st century is people, and investment in skills is fundamental in unlocking potential. The resulting benefits are higher productivity and wealth creation, with failure to invest sufficiently in skills resulting in declining competitiveness and economic growth.

\(^{137}\) The full Delivery Agreement for PSA 1 can be accessed at the following link: [http://www.detini.gov.uk/cgi-bin/downutildoc?id=2438](http://www.detini.gov.uk/cgi-bin/downutildoc?id=2438).


\(^{139}\) Prosperity for all in the global economy – world class skills, Leitch Review of Skills (Leitch, Lord, S, December 2006).
9.5 With globalisation, the capacity for developed economies to compete on costs has largely been eroded, and the emphasis has switched rapidly toward emphasising the need for value-added investments. With this transition, the development of a strong skills base is all the more important. For example, a recent report on UK competitiveness\(^{140}\) has stressed that the economy must compete globally on skills and knowledge, as they are critical in their contribution to building an economy focussed on Innovation and R&D. Similarly, the recent ‘Digital Britain’ report\(^{141}\) reiterated that skills are crucial to enable the UK to seize the opportunities of the new global economy, specifically in the area of digital technology and communications.

9.6 Further to the above, recent research by Oxford Economics\(^{142}\) illustrated a strong correlation between the percentage of graduates employed in the private sector and the average wages of all employees (the correlation was present for all UK regions and local areas). In addition, a similar relationship exists between graduates and productivity, illustrated in Figure 9.1, but, significantly, no such association exists for graduates working in the public sector.

![Figure 9.1: GVA per Employed Person and Graduate Percentage](image)

Source: Oxford Economics

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\(^{140}\) Building Britain’s Future: New Industry, New Jobs, April 2009 (Department for Business, Enterprise and Regulatory Reform – now Department of Business, Innovation and Skills).

\(^{141}\) Digital Britain, June 2009, Department of Business, Innovation and Skills and Department for Culture, Media and Sport.

\(^{142}\) The Influence of Graduate Qualifications on Average Wages and Productivity across the UK, Oxford Economics, February 2009.
9.7 The report concluded that the concentration of graduates in a local economy leads to higher productivity and wages for all employees, not just the graduates themselves. However, the production of more graduates will not necessarily lead to higher productivity and wages if the graduates move elsewhere. Indeed the report found that graduate concentrations are likely to be determined by the demand for higher level skills, i.e. an appropriate level of higher value added jobs. The important policy message from this is that stimulating the demand for higher level skills (including higher professional and technical skills) remains the key economic challenge for NI (as outlined in Chapter 5 of this report). The Panel believe that regional economic policy in NI should prioritise, to a much greater level than before, the attraction and development of high value private sector businesses with high value added employment potential.

9.8 In support of the above, there is also a strong and accepted body of evidence that qualifications at all levels will lead to greater returns for individuals (in terms of wages). For example, one study found that for the UK, the rate of return to National Qualifications Framework (NQF) Level 1 qualifications was negligible\textsuperscript{143}, while at NQF Level 2 or above, the returns were positive and significant\textsuperscript{144}. For example, the rates of return were around 13-14\% for both NQF Level 2 and Level 3, and rising to 25-33\% for NQF Level 4 and 5 qualifications\textsuperscript{145}. The patterns in the overall rates of return are driven by the returns to academic qualifications, and with the exception of level 5, the returns to academic qualifications are greater than those for vocational qualifications at every level\textsuperscript{146}. The rates of return compared with not having any qualifications by gender, country and qualification level are also shown in Table 9.1.

\begin{itemize}
\item \textsuperscript{143} Although the rates of return were minimal, the study recognised that Level 1 qualifications often act as a passport to obtaining higher level qualifications.
\item \textsuperscript{144} The Distribution and Returns to Qualifications in the four countries of the UK. Research report 21A, February 2008, Skills for Business, Sector Skills Development Agency.
\item \textsuperscript{145} The calculations were on the basis of the former NQF framework.
\item \textsuperscript{146} There is evidence that returns to professional and technical qualifications can be as high as academic qualifications, providing the individual enters a job related to the area.
\end{itemize}
### Table 9.1: Returns to Academic and Vocational Qualifications

<table>
<thead>
<tr>
<th>Male</th>
<th>Academic Qualification Level</th>
<th>Level 1A</th>
<th>Level 2A</th>
<th>Level 3A</th>
<th>Level 4A</th>
<th>Level 5A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>England</td>
<td>0.3%</td>
<td>18.2%</td>
<td>15.8%</td>
<td>24.6%</td>
<td>18.9%</td>
</tr>
<tr>
<td></td>
<td>Wales</td>
<td>3.3%</td>
<td>14.6%</td>
<td>22.4%</td>
<td>19.7%</td>
<td>29.6%</td>
</tr>
<tr>
<td></td>
<td>Scotland</td>
<td>2.7%</td>
<td>12.3%</td>
<td>13.1%</td>
<td>33.6%</td>
<td>20.5%</td>
</tr>
<tr>
<td></td>
<td>Northern Ireland</td>
<td>3.7%</td>
<td>13.1%</td>
<td>12.7%</td>
<td>28.5%</td>
<td>25.5%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Male</th>
<th>Vocational Qualification Level</th>
<th>Level 1V</th>
<th>Level 2V</th>
<th>Level 3V</th>
<th>Level 4V</th>
<th>Level 5V</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>England</td>
<td>-4.8%</td>
<td>-4.0%</td>
<td>4.8%</td>
<td>12.8%</td>
<td>30.5%</td>
</tr>
<tr>
<td></td>
<td>Wales</td>
<td>-3.3%</td>
<td>-3.0%</td>
<td>6.9%</td>
<td>19.3%</td>
<td>26.3%</td>
</tr>
<tr>
<td></td>
<td>Scotland</td>
<td>-3.2%</td>
<td>-0.4%</td>
<td>6.4%</td>
<td>13.3%</td>
<td>37.2%</td>
</tr>
<tr>
<td></td>
<td>Northern Ireland</td>
<td>-4.4%</td>
<td>3.6%</td>
<td>8.9%</td>
<td>22.7%</td>
<td>40.9%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Female</th>
<th>Academic Qualification Level</th>
<th>Level 1A</th>
<th>Level 2A</th>
<th>Level 3A</th>
<th>Level 4A</th>
<th>Level 5A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>England</td>
<td>-1.3%</td>
<td>16.2%</td>
<td>13.8%</td>
<td>24.9%</td>
<td>21.8%</td>
</tr>
<tr>
<td></td>
<td>Wales</td>
<td>-2.4%</td>
<td>11.3%</td>
<td>18.4%</td>
<td>26.1%</td>
<td>14.8%</td>
</tr>
<tr>
<td></td>
<td>Scotland</td>
<td>2.3%</td>
<td>10.4%</td>
<td>18.3%</td>
<td>35.9%</td>
<td>12.7%</td>
</tr>
<tr>
<td></td>
<td>Northern Ireland</td>
<td>-0.6%</td>
<td>18.0%</td>
<td>12.2%</td>
<td>31.1%</td>
<td>19.3%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Female</th>
<th>Vocational Qualification Level</th>
<th>Level 1V</th>
<th>Level 2V</th>
<th>Level 3V</th>
<th>Level 4V</th>
<th>Level 5V</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>England</td>
<td>-4.2%</td>
<td>-5.8%</td>
<td>1.5%</td>
<td>16.9%</td>
<td>22.2%</td>
</tr>
<tr>
<td></td>
<td>Wales</td>
<td>-1.0%</td>
<td>-6.6%</td>
<td>2.0%</td>
<td>28.1%</td>
<td>15.0%</td>
</tr>
<tr>
<td></td>
<td>Scotland</td>
<td>-3.5%</td>
<td>-4.6%</td>
<td>-1.8%</td>
<td>16.3%</td>
<td>30.1%</td>
</tr>
<tr>
<td></td>
<td>Northern Ireland</td>
<td>-1.7%</td>
<td>-6.7%</td>
<td>2.7%</td>
<td>17.7%</td>
<td>15.8%</td>
</tr>
</tbody>
</table>

**Source:** The Distribution and Returns to Qualifications in the four countries of the UK, Sector Skills Development Agency, February 2008

**Note:** A sample of the allocation of qualifications to the National Qualification Framework (NQF) levels used in the study is included below for illustrative purposes. The full list of qualifications and the report can be downloaded from [http://www.ukces.org.uk/pdf/080220%20Research%20Report%2021a.pdf](http://www.ukces.org.uk/pdf/080220%20Research%20Report%2021a.pdf)

Analysis is based on Labour Force Survey data which is a sample based survey. The sample sizes are particularly limiting for NI and the above results should be treated with caution.

<table>
<thead>
<tr>
<th>NQF Level</th>
<th>Academic</th>
<th>Vocational Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Less than 5 GCSE passes</td>
<td>NVQ1</td>
</tr>
<tr>
<td>2</td>
<td>5 GCSE passes; 1 A-Level</td>
<td>NVQ2 Apprenticeship</td>
</tr>
<tr>
<td>3</td>
<td>2+ A-levels</td>
<td>NVQ3</td>
</tr>
<tr>
<td>4</td>
<td>First degree</td>
<td>HNC/HND; Nursing; teaching</td>
</tr>
<tr>
<td>5</td>
<td>Higher Degree</td>
<td>Other degree; Teaching PGCE</td>
</tr>
</tbody>
</table>

For NI, the greatest rate of return for males was associated with moving between Level 4 and Level 5 vocational qualifications, and for females, moving between Level 3 and 4 academic qualifications. This again highlights the importance of higher level skills to productivity growth (wages represent a significant factor influencing productivity improvements).
Facilitators of Growth

9.10 The rationale for Government intervention in skills is equally well established. Investment in human capital may not be at the optimum level for society due to market failures. In terms of skills investment, individuals and employers make training decisions based on their own costs and benefits and typically do not include any assessment of the wider benefits to society in the decision making process. This is further amplified by information asymmetry – where information available to individuals or firms is incomplete, especially in terms of the benefits accruing to skills improvements. These arguments lead to the conclusion that government should intervene to subsidise transferable skills (that is why, for example, there is an emphasis on portable apprenticeships in this report).

Current and Future Skills Performance

9.11 The report by Sir David Varney into NI’s competitiveness, published in 2008, provided a comprehensive assessment of skills investment in NI. The Panel have updated that work with an additional year of data and unsurprisingly it has not significantly changed the overall picture of skills in NI. Furthermore, the Review Panel supports the key findings and messages. The remaining paragraphs revisit a selection of the key points before concluding with some recommendations.

9.12 Both Varney and Leitch define skills as ‘capabilities and expertise in a particular occupation or activity’. Those reports, and the NI skills strategy, broadly defined skills into three separate categories:

- Essential skills - such as literacy, numeracy and ICT;
- Employability skills - including the skills of team working, problem solving and flexibility; and
- Technical skills - which tend to be more specific to a particular sector or occupation.

9.13 The most common measures of skills are qualifications which are valuable to individuals for providing portability in the labour market, and to employers for providing signals when recruiting workers.

9.14 Educational achievement in NI, in terms of GCSE and A Level results, is among the best in the UK, and the region is broadly equivalent to the UK average in terms of the proportion of the working age population with higher level qualifications. However, there is a significant proportion of the population with no, or very low qualifications.
9.15 As illustrated in Figure 9.2, NI could perform better relative to other UK regions, especially in terms of lower level skills. NI’s working age population is characterised by a significant proportion with no qualifications (22.1% compared to the UK average of 12.6% and the highest proportion of any UK region). However, in an international context (Figure 9.3), the evidence suggests that NI’s current stock of skills is reasonable although there is still some room for improvement when compared to major global competitors.

Source: Labour Force Survey, Office for National Statistics (Regional Trends)

Note: Higher education qualifications – below degree level

Figure 9.3: International Comparison of Adult 25 - 64 Qualifications

Source: OECD and Oxford Economics

Note: ISCED refers to International Standard Classification of Education
Facilitators of Growth

9.16 NI’s proportion of the working age population with high level qualifications is in line with that of France and Germany, and only slightly below the UK and RoI. It is at the lower end of the skills spectrum that NI is lagging behind some of the major world economies such as Germany, the US and the UK. However, NI performs better on the proportion with low level qualifications than RoI and France. In terms of performance at the higher end of the skills spectrum, NI is more in line with the UK average. For example, the proportion of the NI working age population with degree or equivalent qualifications is 19.2%, compared to the UK average of 20.3%.

9.17 The flow of skills into the labour market in NI is a key strength, and the number of graduates of working age has increased by 31% (47,000) between Q4 2003 and Q4 2008. However, the working age population only increased by 5% over the same period. As a result, the most recent data indicate that the proportion of the working age population qualified to degree level or above increased from 14% in Q4 2003 to 18% in the same quarter of 2008.

9.18 The educational achievement of NI school leavers is also amongst the best in the UK, with NI’s performance at A-level, and for the top graded GCSEs, the highest in the UK. The proportion of year 12 pupils in NI achieving no GCSEs has declined to 2% in 2007/08 and is only marginally higher than the corresponding performance in England (as outlined in Table 9.2). Therefore, the flow of individuals with no qualifications into the workforce is not significantly different than elsewhere in the UK.

Table 9.2 Percent of School Leavers Achieving no GCSEs

<table>
<thead>
<tr>
<th></th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>NI</td>
<td>4</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>England</td>
<td>4</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Wales</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: DE, DCSF, National Assembly for Wales.

Note: GCSE figures are expressed as a percentage of pupils in year 12 in Northern Ireland, and as a percentage of 15 year olds in England (pre 2004/05) and Wales. From 2004/05 England figures are for pupils at the end of Key Stage 4.

9.19 As the Leitch Review of Skills has emphasised, it is crucial that the education system operates efficiently and ensures that everyone leaves school with basic qualifications as a minimum. The flow of more highly educated young people into the workforce is a positive sign, however, as 70% of the 2020 workforce are already aged over 16, improving school leavers’ qualifications can not entirely improve the stock of skills in NI’s workforce. Up-skilling is also an important process that must take place across the entire workforce.

9.20 We earlier concluded from the evidence on graduates and productivity that the main issue is a lack of private sector businesses with sufficient demand for graduates in NI. This can partly explain why such a significant proportion of graduates in NI (47%) work within the public sector (the public / private wage differential was estimated to be 32% in 2008, compared to 14% for the UK as a whole). Furthermore, a report by DEL also found a lack of private sector graduate employment in NI compared to the UK.

the graduates studied, over half (51.5%) of those who completed their higher education in NI were employed in the public sector, compared to 38.5% of graduates in the UK as a whole. The proportions employed in the private sector were 40.6% and 54.5% for NI and the UK respectively, with the remainder of graduates employed in the ‘not-for-profit’ sector.

9.21 While it is important to increase the demand for higher level skills in NI, it is also necessary to ensure that the supply of skills is better matched to the needs of local businesses. The NI skills strategy outlines the need for an improved understanding of the demand for skills (current and future), and that the education and training system is shaped to address that demand. The Panel recognise the work which has been carried out to date by DEL to address this. For example, DEL – along with DETI – commissioned research to help understand the future demand for skills in NI. In addition, DEL has appointed an NI Advisor on Skills and Employment to act as a champion of employment and skills issues within industry, business and government. The Panel have consulted with the NI Skills Advisor as part of the call for evidence. DEL has also established six Workforce Development Forums (WDFs) to assess and respond to skills demand at a local level.

9.22 The lack of private sector demand for skilled labour in the region partly explains why a proportion of NI graduates migrate to find work; do not return to NI after studying elsewhere; or seek employment in non-graduate occupations locally. For example, IREP analysis of the DEL data indicates that 29% of NI students on undergraduate courses left NI to study outside the region. In 2007/08, 71.0% of NI domiciled students studied at NI institutions, 27.6% at GB institutions (including 5.6% at the Open University) and just over 1% at RoI institutions.

9.23 The data on destinations of graduates show that the majority of those who remain in NI for Higher Education are employed in NI after graduation, with a small proportion entering employment in GB and RoI. However, the majority of those who leave NI for Higher Education appear not to return. For example, DEL estimates that for 2006/07 graduates from NI Higher Education Institutions, 91% were employed in NI, 5% went to GB and 3% went to RoI. Post-graduates from NI Higher Education institutions show a similar pattern of employment. For those domiciled in NI, but studying in GB, 39% of undergraduates returned to NI, 55% remained in GB and 3% went to RoI. The majority of postgraduates studying in GB stayed (67%), with 27% returning to NI and 3% going to RoI.

9.24 Therefore, there is a significant pool of labour, with links to NI, who have studied and worked elsewhere and who might be encouraged to return and deploy their skills and experience locally. The Review Panel recognise the steps that DEL has recently taken to attract talented labour (both locally and from outside NI). However, the most significant catalyst to attract labour from elsewhere is to secure the aspirations

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151 Student Enrolments on Higher Education courses – Northern Ireland 2007/08, Department of Employment and Learning, February 2009.

152 Destinations of Leavers from Higher Education: Northern Ireland 2006/07, Department Employment and Learning, August 2008.

153 For example, the C’Mon Over campaign seeks to highlight the employment opportunities available to those people living outside NI (http://www.delni.gov.uk/cmonover).
Facilitators of Growth

outlined in the PfG, namely a stepped change in economic performance in NI. Furthermore, a sizeable proportion of graduates employed locally are currently under utilised. For example, in a recent report produced by DEL it was shown that approximately 22.7% of the workforce was qualified to a degree level, while the proportion of jobs requiring a degree was lower at 21%\(^{154}\). Similar analysis for the UK showed that while the supply of graduates was broadly the same as NI, demand was lower at 18.7%. The difference may be attributed to the size of the public sector in NI.

9.25 Other studies of recent graduates have found similar underemployment rates for NI and the UK. The Higher Education Statistics Agency (HESA) carried out a longitudinal study of UK 2002/03 graduates, surveying them three and a half years after graduation\(^{155}\). The HESA study found that for the UK graduates employed, only 80% were in ‘graduate occupations’. DEL analysis of the data set found that only 81% of employed graduates from NI Higher Education institutions were employed in ‘graduate’ jobs (three and a half years after graduation). Earlier analysis by DEL included a study of 1999 graduates 4 years on, and this also found a similar proportion employed in non-graduate jobs in NI and the UK (17% and 15% respectively)\(^{156}\).

9.26 There is therefore an active pool of highly skilled labour within the local economy and externally (mainly within the UK and RoI) that could be utilised if there was greater value added growth in the NI economy. As Varney remarked, the challenge at the higher end of the skills spectrum is ensuring there are ‘opportunities and incentives to encourage the most gifted young people to stay’ and also to entice those who have already emigrated to return and bring with them valuable experience gained elsewhere. On the basis of our own analysis, the Review Panel would reiterate the same message – the challenge is to stimulate private sector growth in NI to retain, and attract, the most highly skilled. The recommendations contained throughout this report have been framed with this goal in view.

9.27 Further to the above, the recent report by DEL (referenced earlier) found that under their baseline forecasts for economic growth, the current annual supply of graduates was sufficient to meet future demand (see Table 9.3)\(^{157}\). It is, however, important to acknowledge that there is also a need to upskill the existing labour force, in addition to producing more people with higher level qualifications, to help meet the future demand for skills. This was an important theme in the original Success through Skills, and the current review of the strategy indicates that upskilling and the provision of appropriate routes for progression in skill levels will remain important.

9.28 Currently there is a limited subject specialisation within NI, with a higher concentration of graduates in generalist subject areas such as business and administration and other combined degrees. The DEL report concluded that the degree subject requirement would, however, adjust in line with the changing structure of the economy. For example, degree subject requirements will become more skewed towards physical sciences, mathematical & computer sciences, engineering & technology, law and creative arts & design. As such, the growing sectors of the economy will require an increasing number of Innovation–relevant (including STEM) qualified graduates.

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154 Skills at Work in Northern Ireland 2006, A report prepared by A Felstead (Cardiff University) and F Green (University of Kent, Department of Employment and Learning, June 2008.


157 Forecasting Future Skill Needs in Northern Ireland, Department for Employment and Learning, March 2009.
Table 9.3: Net Requirement from Education and Migration and Comparison with Supply - Degree Subjects (2010-2020 annual average, ‘000s)

<table>
<thead>
<tr>
<th>Subject area</th>
<th>Demand Baseline</th>
<th>Demand Aspiration</th>
<th>HESA NI domiciled graduates from UK HEIs entering employment in NI (2003-07 annual average grossed up)</th>
</tr>
</thead>
<tbody>
<tr>
<td>STEM:</td>
<td>3.5</td>
<td>3.9</td>
<td>3.6</td>
</tr>
<tr>
<td>Medicine &amp; dentistry</td>
<td>0.2</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Subjects allied to medicine</td>
<td>1.1</td>
<td>1.2</td>
<td>1.4</td>
</tr>
<tr>
<td>Biological sciences</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Veterinary science</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Agriculture &amp; related subjects</td>
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<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Physical sciences</td>
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<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Mathematical sciences</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Computer science</td>
<td>0.6</td>
<td>0.8</td>
<td>0.5</td>
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<tr>
<td>Engineering &amp; technology</td>
<td>0.5</td>
<td>0.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Architecture, building &amp; planning</td>
<td>0.3</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>Law</td>
<td>0.3</td>
<td>0.5</td>
<td>0.2</td>
</tr>
<tr>
<td>Business and Administration</td>
<td>1.1</td>
<td>1.2</td>
<td>1.3</td>
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<tr>
<td>Languages</td>
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<td>0.2</td>
<td>0.2</td>
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<tr>
<td>Creative Arts and Design</td>
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<td>0.4</td>
<td>0.3</td>
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<tr>
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<td>0.9</td>
<td>1.5</td>
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<tr>
<td>Combined degree</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Other</td>
<td>0.8</td>
<td>0.8</td>
<td>1.1</td>
</tr>
<tr>
<td>Total</td>
<td>7.2</td>
<td>8.0</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: DEL

9.29 Recent reports by the UK Government also highlight the importance of adapting to the demands from an increasing focus on Innovation-relevant (including STEM) areas. The key actions called for were to increase R&D capability, innovate further in the fields of science and technology and to industrialise this Innovation commercially. Aligned with this, the report called for skills improvements and adaptations to meet these specialist demands of the modern economy.

9.30 The Panel’s recommendations throughout this report are aimed at improving the overall performance of the local economy. In terms of skills, the evidence suggests that the current flow of graduates from the Higher Education sector should be sufficient to meet future demand, and thus the current emphasis on Higher Education should continue. However, the Review Panel believe that, if the proposals in this report are implemented (particularly a greater emphasis on Innovation and R&D), then the probability of achieving the necessary step change in NI’s economic performance should be greatly enhanced. As a consequence, the economy will demand skills aligned with Innovation and R&D, typically considered as STEM qualifications, but also including a wider set of subject areas that are often employed within tradable services. This view is also consistent with the vision in Success through Skills, which outlines a competitive NI economy, based on high value added jobs and supported by entrepreneurial and innovative people, with higher levels of exports and FDI.

Building Britain’s Future: New Industry, New Jobs, April 2009 (Department for Business, Enterprise and Regulatory Reform – now Department of Business, Innovation and Skills).
9.31 In addition, returns to education evidence suggest that STEM and related subjects offer amongst the greatest returns (Figures 9.4 and 9.5) for individuals. For example they have amongst the highest levels of economic activity in the UK. In addition, they also boast some of the highest weekly earnings in the UK.

Figure 9.4: Economic Activity by Degree Subject, 2008

![Graph showing economic activity by degree subject, 2008.](image)

Source: Labour Force Survey

Figure 9.5: Weekly Earnings by Degree Subject, 2008

![Graph showing weekly earnings by degree subject, 2008.](image)

Source: Labour Force Survey
9.32 Current skills policy in NI emphasises the STEM focus, with a key PfG goal to increase the number of students at graduate and postgraduate level studying STEM subjects by 2015. However, a recent report published by the NI Executive raises concerns that the current flow of STEM graduates will not achieve the PfG targets. Within this context, the Panel endorse the commitment of the independent ‘STEM Review’, jointly commissioned by DEL and DE, which seeks to encourage greater take up and build capacity in the local education system to deliver STEM subjects. Furthermore, given that it takes several years to complete a degree course and, as a consequence, Higher Education cannot immediately respond to a changing demand for skills, the Review Panel recommend that the local education system prepares now to meet the anticipated increased demand for higher level skills in STEM and other Innovation relevant subject areas arising from the increased emphasis on Innovation and R&D.

9.33 Focusing at the other end of the skills profile, and as stated earlier, 21.7% of the working age population (just over 236,000 people) have no formal qualifications in NI. In addition, the evidence assessed by the Panel suggests that the rate of return (although negligible at level 1) is positive and significant for people with qualifications at and above level 2. Table 9.4 sets out the number of enrolments in NI FE colleges from 2003/04 to 2006/07. Although enrolments in entry and level 1 have grown, the numbers enrolling at all other levels have fallen during this period, although this still represents significant growth compared to 1998/99 levels. An intake of 52,815 people per year on entry and level 1 courses equates to just over 22% of those with no qualifications. However, the resulting change to the proportion of the working age population with no qualifications – which decreased by around 5% over the period – is likely to be lower as some of these enrolments will already have qualifications and a proportion will not graduate from their course.

### Table 9.4: Enrolments at NI FE Colleges by NQF Level (or Equivalent).

<table>
<thead>
<tr>
<th></th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry and level 1</td>
<td>36,873</td>
<td>43,643</td>
<td>45,562</td>
<td>52,815</td>
</tr>
<tr>
<td>Level 2</td>
<td>47,899</td>
<td>48,158</td>
<td>47,679</td>
<td>45,007</td>
</tr>
<tr>
<td>Level 3</td>
<td>42,442</td>
<td>44,525</td>
<td>42,156</td>
<td>41,839</td>
</tr>
<tr>
<td>HE and Levels 4 &amp; 5</td>
<td>13,330</td>
<td>11,998</td>
<td>12,792</td>
<td>11,625</td>
</tr>
<tr>
<td>Total</td>
<td>140,544</td>
<td>148,324</td>
<td>148,189</td>
<td>151,286</td>
</tr>
</tbody>
</table>

Source: DEL  
Note: Figures include part time enrolments (such as evening classes)

9.34 The trends outlined in Table 9.4, in particular the fall in those enrolling at Levels 2 and above, may be a reflection of the strong economic growth and tight labour market in NI over the period. Employers may have been willing to hire labour that they otherwise would not have, if faced with a larger pool of available labour. Looking forward, with a rising number of people unemployed and slower employment creation in the medium term, the working age population in NI is likely to face more competition for jobs. This will increase the demand for education and training provision.

9.35 The falling enrolment numbers at level 2 and above may therefore reverse over the next few years due to market forces. However, there is scope for Government to try and encourage this further. Indeed, in this context, the Skills Strategy launched by DEL (2006) has led to a change in the training provision in NI, with a greater emphasis on apprenticeship training and a higher target of 10,000 apprentices by 2010. Furthermore, in September 2008, the department re-branded its Training for Success Apprenticeships (TFS) provision to ApprenticeshipsNI. This allows anyone who has attained the minimum school leaving age and who is in full-time paid employment, to gain an industry recognised apprenticeship qualification. The level and content of each apprenticeship qualification is approved by DEL as part of the national apprenticeships framework which is developed by the Sector Skills Councils for each occupational area (apprenticeship qualifications are provided at levels 2 and 3).

9.36 A recent review by the Education and Training Inspectorate (ETI) found that the introduction of ApprenticeshipsNI led to a 68.7% increase in apprenticeship starts, mostly at level 2, including a significant increase (three-fold) in the number of 16/17 year olds recruited. More up to date data for 2008/09, shown in Figure 9.6, indicate that this growth has continued, with the level of enrolments growing by nearly one-third (from 2007/08 to 2008/09).


In addition, the Education and Training Inspectorate (ETI) found that:

- Recruitment is high in the priority skill areas of construction, electrical / electronic & mechanical engineering and hospitality / catering;
- In the remaining areas, recruitment is low, including the priority skill areas of computing and information and communication technology (ICT) and software engineering, where companies tend to require graduate level qualifications;
- Almost all of the apprentices in building and construction, engineering, motor vehicle and in hairdressing and beauty are under 24 years old on entry, compared to the other professional and technical areas where many more are over 25; and
- There is not sufficient strategic collaboration and planning between most Apprenticeships NI level 2 and level 3 suppliers, and the respective employers involved, to fully ensure effective progression from level 2 to level 3 apprenticeships in the same professional and technical area.

Although recent data indicate that Apprenticeship training provision is helping to reverse the falling enrolment numbers at levels 2 and 3, the Review Panel have concerns with the falling enrolments numbers at levels 4 and 5 in FE colleges during 2006/07 (this was also true for Universities). It is important that these institutions continue to provide an alternative route for gaining higher level qualifications other than obtaining a degree. This is also true for promoting other professional and technical qualifications, and the evidence on returns to education, shown earlier, point to the significant benefits that can arise from gaining these higher level skills / qualifications. In support of this, the recent Digital Britain report, referenced earlier, recognises the value of apprenticeships at all levels, but highlighted the importance of developing higher level apprenticeship frameworks (at level 4) in digital technology, as the demand for higher level skills in the digital technology field will continue to grow. Furthermore, the NI skills strategy recognised the need for individuals to have the opportunity to maximise their potential through the provision of skills progression routes or ‘skill ladders’. Therefore, on the basis of the evidence gathered, the Review Panel recommend that the current focus on technical and professional qualifications, including apprenticeships and vocational training, be extended to emphasise higher level qualifications at levels 4 and 5.
9.39 Finally, a key area of concern in NI is that of managerial skills. For example, DEL has highlighted the importance of developing further the management and leadership skills in NI\(^\text{162}\). The Varney Review also emphasised the important contribution that managerial skills can play in how firms innovate and react to competition, and also in their use of physical and human capital. In a recent report produced by DETI, DEL and a range of other partners North and South, there is a significant gap between management practice scores in RoI and NI compared to the best performing countries. For example, both NI and the RoI are below the global average and also below the level in GB. The report found that around half the gap can be explained by structural factors such as firm size, ownership, education and sectoral mix, with the remainder due to specific poorer management practices. The report estimated that improving management practices in NI could lead to an increase in GVA in the region of £150m-300m\(^\text{163}\).

9.40 In light of the above, the Review Panel recommend that DETI, DEL and Invest NI should work to significantly develop management and leadership skills in NI. The Panel also supports the recommendation from a recent sub-group of the Economic Development Forum (EDF) that Government should sponsor a cross-sectoral ‘Management Masterclass’ to identify and develop the best managers from local industry and the public sector.

**INFRASTRUCTURE**

9.41 This report has already highlighted the importance of investment in infrastructure, particularly as it plays a role in improving the relative attractiveness of locations to mobile firms (Chapter 5). Therefore, in the following paragraphs, the Panel discusses the recent and on-going activity of public sector investment in infrastructure, before concluding with a recommendation to better align provision with the needs of the economy.

**Investment in Infrastructure**

9.42 The Investment Strategy for Northern Ireland (ISNI), launched in December 2005, set out a programme of infrastructure investment for ten years. An updated version, ISNI 2, was published in 2008, and since its inception ISNI has embarked on a series of investments such as:

- Road improvements (e.g. A4, A1, and Westlink);
- New public transport (e.g. new trains and Belfast Rapid Transit);
- Enhanced Water and Waste Water treatments;
- Enhanced communications infrastructure (e.g. Project Kelvin, a major fibre optic cable / telecommunications link which directly connects NI with both North America and Europe); and
- Electricity grid strengthening.

\(^{162}\) Leading... to Success, Management and Leadership Development Strategy and Implementation Plan, Department for Employment and Learning, June 2007.

\(^{163}\) Management Matters in Northern Ireland and the Republic of Ireland, March 2009, Department of Enterprise, Trade and Investment; Department of Employment and Learning; Invest NI; InterTradeIreland and Forfas.
In discussions with the Review Panel, the Strategic Investment Board (SIB) anticipates that there will be some £1.7bn of investment delivered over the year to April 2009. In addition, there are a number of future investments plans including:

- Upgrading the strategic roads network (SRN) which includes two major schemes to connect Londonderry/Derry to the Greater Belfast area (via A6) and Dublin (via a new A5); an upgrade to the A8 connection to the Port of Larne; and
- Investment in energy, focusing on greater energy efficiency in buildings; increasing renewal generation capacity and strengthening the electricity grid in the West of the region in connection with wind power generation.

The Department for Regional Development (DRD) is also currently undertaking a Review of the Regional Development Strategy within which they set out future investment requirements. Our discussions with DRD suggest that they share the same views as SIB and their recommendations going forward, under transport, telecommunications and energy will fit with the planned future investment of ISNI. In addition, they also recognise the importance of Belfast as a driver of regional growth, and subsequently the importance of infrastructure to the wider Belfast Metropolitan Area (BMA).

From the perspective of the Review Panel, these aspects are of vital importance. For example, we have already indicated (in Chapter 5) that urban areas, in particular Belfast and Londonderry/Derry, represent the catalysts for economic growth in the region. In addition, in order to ensure the linkage of places where firms are best located to where workers wish to live, this is best delivered via an economic strategy which fully co-ordinates policy toward business, housing, the labour market, planning as well as transport.

In terms of the formulation of the ISNI1, the Panel recognise that it was set up in the absence of the Executive. Although the Executive was re-established in time for ISNI 1 to be published, there was limited scope to influence the strategy given time pressures and the legacy of projects that had already been agreed. Furthermore, ISNI 2 suffered from a similar problem in that it had to include a considerable number of projects that were carried over from pre-ISNI 1 and ISNI 1 itself. Therefore, there was limited scope to focus on delivering those projects that would have maximised economic growth in the region.

Identification of the infrastructural projects in support of the PfG’s top priority (the economy) is an important exercise. Chapter 5 has already provided references outlining the positive link between infrastructure and growth at both the national and regional level. In addition, a relatively recent report provided a high level assessment of infrastructure investment opportunities in NI\textsuperscript{164}. The report highlighted that investment in health, social and the environmental projects have little direct impact on the supply side of the economy. In contrast, investment in skills, networks and the productive sector will increase the potential size of the economy.

\textsuperscript{164} High Level Assessment of Infrastructure Investment Opportunities in Northern Ireland, London Economics and the Economic and Social Research Institute, October 2007.
Facilitators of Growth

9.48 Figure 9.7 presents a comparison on investment allocations between National Development Plans (NDPs) in the Republic of Ireland and the two ISNI plans published to date. This suggests that the NDPs have had a much greater economic focus by allocating significant proportions of investment to transport and the productive sector. This point was also highlighted in the assessment of global best practice in economic development (Chapter 6). In contrast, both ISNI 1 and 2 have tended to have a greater focus on education and health, although there have been some recent increases in the level of resources devoted to the productive sector.

![Figure 9.7: Allocations of the NDP and ISNI 1 up to 2010](image)

Source: ESRI “Ex ante evaluation of the investment priorities for the National Development Plan” (2006), and IREP Analysis

9.49 On the basis of the analysis conducted by the Review Panel, we believe there is considerably more scope for ISNI 3 to have a greater economic focus. As part of our consultation, the Panel held discussions with senior representatives from the SIB and they indicated that if 10% of total investments were committed under the Productive Pillar, this would amount to an additional £1bn over the period to 2020.

9.50 On the basis of the above, the Review Panel recommend that the Executive should ensure that the third ISNI plan takes a much greater economic focus by committing more investment into projects that will maximise NI’s future economic performance.

PLANNING

9.51 The importance of planning to regional economic growth was outlined previously in Chapter 5. This has also been recognised by successive devolved Environment Ministers in NI who have made planning system reform a top priority. Furthermore, a range of issues associated with planning, and in particular the speed of the planning process, were also raised by respondents to our public call for evidence. Therefore, in the paragraphs that follow, we discuss the importance of having an efficient land-use planning system for a competitive economy; and provide an overview of the current planning system in NI, and the issues with regard to processing times. We conclude with an outline of the current planning reform and a number of recommendations to strengthen the economic focus of planning in NI.

165 Although it could be argued that the Republic of Ireland was coming from a low base, the scale of investment has also been sustained over successive plans.
Importance of Planning for Productivity & Economic Growth

9.52 The Barker Review of Land Use Planning in England was commissioned to consider the link between productivity and planning. It concluded that the planning system was a ‘vital support to productivity and economic growth’ and noted that planning is regularly one of the top six concerns for inward investors to the UK. Kate Barker outlined more fully the benefits of an efficient planning service, such as ‘providing greater certainty for investors about the likely shape of future development; helping deliver public goods; supporting regeneration; and countering market power where the landowner is in a monopoly position’\(^{166}\). The OECD also produced a report which suggested that ensuring planning takes better account of economic considerations is one of the key micro-economic challenges facing the UK\(^ {167} \).

9.53 In NI, these views have also been confirmed by Professor Greg Lloyd, an independent expert who was appointed to report to then Minister for the Environment (Arlene Foster, MLA) on the planning reform programme in NI.\(^ {168}\) His report affirms the role of planning as ‘an important means of delivering the desired economic, social and environmental changes for NI’\(^ {169}\). Furthermore, in their engagement with the Panel, the Planning Service acknowledged the relationship between the planning system and productivity, noting the ‘major’ contribution that planning makes to economic growth.

9.54 This viewpoint was also reinforced by the Department of the Environment (DOE) Minister, when he made a statement to underline the importance that he attached to ensuring the planning system made its contribution to economic growth. In particular, the Minister indicated that the purpose of his statement was to provide greater certainty in relation to the weight that should be given to the economic aspects of planning applications, especially for projects with significant economic benefits\(^ {170}\). He stated that ‘full account shall be taken of the economic aspects of a planning proposal, including the wider benefits to the regional or local economy, alongside social and environmental aspects’. The Review Panel welcome this statement, firstly, for recognising the link between planning and economic development, and secondly, for the clarity this should provide to both inward investors and local developers. However, our recommendations presented later are designed to strengthen this commitment even further.

9.55 It is also widely acknowledged that a balance must be struck between economic and other factors. Planning Service reiterated this point when they engaged with the Panel, and highlighted that development must be sustainable and take account of competing social, environmental and economic interests. Kate Barker highlighted that planning delivers important environmental and social objectives, while Professor Lloyd’s report highlighted the difficult issues and trade-offs involved in land use planning, such as the ‘elusive relationships between economic development and employment creation versus environmental protection and enhancement’.

\(^{166}\) Barker Review of Land Use Planning, Final Report and Recommendations, December 2006
\(^{168}\) Professor Lloyd was appointed to provide an independent opinion on the medium to long term measures that could be taken to reform the planning system in Northern Ireland. His report included experience of reform of the planning systems in England and Wales, Scotland and Ireland.
\(^{169}\) The document can be accessed at the following link: [http://www.planningni.gov.uk/index/about/about-reform-independent-expert-report.pdf](http://www.planningni.gov.uk/index/about/about-reform-independent-expert-report.pdf)
\(^{170}\) The details of the Ministerial statement can be viewed at the following site: [http://www.planningni.gov.uk/index/policy/policy_publications/policy_other/policy_ministerial/ministerial_statement_on_the_weight_to_be_accorded_to_the-economic_aspects_of_development_proposals_.pdf](http://www.planningni.gov.uk/index/policy/policy_publications/policy_other/policy_ministerial/ministerial_statement_on_the_weight_to_be_accorded_to_the-economic_aspects_of_development_proposals_.pdf)
Facilitators of Growth

9.56 The draft PPS4 on industry acknowledged the need to prioritise the economic development needs of the region in a way consistent with protecting the environment. It notes that environmental considerations in themselves can benefit the economy, such as the economic benefits and employment that may result from promoting areas such as tourism, recreation, agri-food and quality of life attractions. This was reinforced by the Royal Institution of Chartered Surveyors (RICS) submission to the IREP which suggested that a more holistic approach to applications and the principles of sustainable development (economic, social and environmental) should be examined.

Current Planning Performance

9.57 There is a large volume of evidence regarding the planning system in NI. For example, Professor Lloyd’s report noted that the land use planning process was seen to be taking too long and that concerns were expressed regarding the perceived inefficiencies and delays in the system. In addition, the IREP Call for Evidence also received several responses highlighting the view that the planning system in NI is too slow and its lack of responsiveness to business was limiting economic growth. The recent planning reform consultation paper notes that without reform, there would be a risk that the current planning system could have a negative impact on the Executive’s priority objective of growing the economy.

9.58 With the statistical information available, we can draw some conclusions. In an international context, the UK performs relatively poorly compared to some of its global competitors (see Table 9.5). As already noted in Chapter 5, the World Bank Doing Business 2009 Report ranked the UK sixty-first in dealing with construction permits (Singapore was ranked second while Ireland ranked thirtieth). Among the fifteen members of the EU prior to the 2004 enlargement, the UK ranked fourth from bottom.

172 Annex 9 Partial Regulatory Impact Assessment in Reform of the Planning System in Northern Ireland Consultation Paper, July 09
Table 9.5: World Bank Ranking in “Dealing with Construction Permits” for EU-15

<table>
<thead>
<tr>
<th>Economy</th>
<th>Overall World rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>7</td>
</tr>
<tr>
<td>Germany</td>
<td>15</td>
</tr>
<tr>
<td>Sweden</td>
<td>17</td>
</tr>
<tr>
<td>France</td>
<td>18</td>
</tr>
<tr>
<td>Ireland</td>
<td>30</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>40</td>
</tr>
<tr>
<td>Finland</td>
<td>43</td>
</tr>
<tr>
<td>Belgium</td>
<td>44</td>
</tr>
<tr>
<td>Greece</td>
<td>45</td>
</tr>
<tr>
<td>Austria</td>
<td>46</td>
</tr>
<tr>
<td>Spain</td>
<td>51</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>61</td>
</tr>
<tr>
<td>Italy</td>
<td>83</td>
</tr>
<tr>
<td>Netherlands</td>
<td>94</td>
</tr>
<tr>
<td>Portugal</td>
<td>128</td>
</tr>
</tbody>
</table>


Note: Overall rankings are the average of the economy rankings on the procedures, time and cost to comply with formalities to build a warehouse.

9.59 Professor Lloyd also noted that, in the context of UK planning system, there is evidence that current land use planning tends to create delays, uncertainties and costs for the land and property development sectors. The system does not achieve the appropriate balance between economic, social and environmental factors. There is therefore a lack of support and confidence in the land use planning system.

9.60 Within the context of the UK’s poor international performance, the key question for the Review Panel have been the performance of NI relative to GB. As demonstrated by our analysis, the Panel believe that NI is noticeably slower in processing planning applications. For example, Table 9.6 provides data on the targets and actual performance of processing major applications in NI, England and Scotland\textsuperscript{173}. We recognise that the data contained within the table are not directly comparable given the different planning systems with, for example, the current system in NI requiring the Planning Service to consult with local authorities who have no responsibility for the ultimate decision taken. For example, this structural issue can add four weeks to the decision making time in NI. The definition of major applications also varies across jurisdictions. However, the data enables us to make a number of important observations.

\textsuperscript{173} The current key Ministerial targets for the Planning Service, as reflected in the Department of the Environment’s Public Service Agreement (PSA), set the time taken to process major planning applications to decision or withdrawal by 31 March 2011 as follows: 60% of Major planning applications processed in 23 weeks; 70% of Intermediate planning applications processed in 31 Weeks and 80% of Minor planning applications processed in 18 Weeks.
Facilitators of Growth

Table 9.6: Target and Actual Performance of Processing Major Applications

<table>
<thead>
<tr>
<th></th>
<th>Target</th>
<th>Actual performance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weeks</td>
<td>% processed</td>
</tr>
<tr>
<td>Northern Ireland (2008/09)</td>
<td>23</td>
<td>60% 40.5%</td>
</tr>
<tr>
<td>England (2007/08)</td>
<td>13</td>
<td>80% 71%</td>
</tr>
<tr>
<td>Scotland (2007/08)</td>
<td>16</td>
<td>80% 46.5%</td>
</tr>
</tbody>
</table>

Source: Department for Communities and Local Government; Scottish Government’s ‘Planning Performance Statistics 2004-2007’ and NI Planning Service

Note: Major applications are not directly comparable across countries in the UK

9.61 In the context of major applications, NI’s processing targets are substantially less challenging than in England and Scotland. Not only is the target number of weeks processing time significantly above that set in England and Scotland, the target proportion of major applications to be processed is also the lowest. Furthermore, actual performance data indicate that NI lags considerably behind England. This has important implications for NI’s competitive position.

9.62 The existing evidence indicates that NI lags behind the UK in terms of planning responsiveness, while the UK has also scope to improve against its European competitors. Relative performance gives rise to even greater concern when we look at the sub-regional differences within NI. Published data suggest that there are significant differentials in processing times between Planning Divisions (see Table 9.7).

Table 9.7: Average Processing Times (weeks) for Major Projects by Planning Division

<table>
<thead>
<tr>
<th>Divisions</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headquarters</td>
<td>37</td>
<td>45</td>
<td>47</td>
</tr>
<tr>
<td>Ballymena</td>
<td>24</td>
<td>21</td>
<td>25</td>
</tr>
<tr>
<td>Belfast</td>
<td>23</td>
<td>24</td>
<td>30</td>
</tr>
<tr>
<td>Craigavon</td>
<td>40</td>
<td>38</td>
<td>31</td>
</tr>
<tr>
<td>Downpatrick</td>
<td>31</td>
<td>32</td>
<td>39</td>
</tr>
<tr>
<td>Londonderry</td>
<td>35</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>Omagh</td>
<td>31</td>
<td>29</td>
<td>21</td>
</tr>
<tr>
<td>Planning Service</td>
<td>30</td>
<td>29</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: Planning Service

9.63 Overall, performance of the Planning Service has been stable but at a relatively poor level (vis-à-vis the comparisons presented above), although processing times of individual Divisions has been volatile – perhaps reflecting the varying nature of applications being processed at Division level. The Review Panel were given access to a recent report by the Performance and Efficiency Delivery Unit (PEDU), in which it was asserted that a key issue for planning service staff was poor quality applications leading to repeated amendments and slow responses from Agents. It was also viewed as the major issue affecting PSA target performance. Professor Lloyd noted that applications with insufficient preparation introduce delays into the decision making process. However, the Review Panel are not aware of any evidence that either the quality of applications, or the responsiveness of Agents, was lower in NI than in the rest of the UK.
Furthermore, the most recent quarterly statistics (released June 2009), presented in Figure 9.8, show performance against PSA targets for major applications. It suggests that there has been little progress in this regard over the last three years.

Figure 9.8: Planning Service Progress towards achieving PSA Targets (Q1 2006 – Q4 2008)

<table>
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<tr>
<th>Year</th>
<th>Q1</th>
<th>Q2</th>
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<tbody>
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<td>2006</td>
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<td>2008</td>
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Source: The Planning Service quarterly statistics, June 2009

The most recent Annual Planning Statistics show that while progress has been made towards meeting the PSA targets for intermediate and minor applications, performance on major applications increased by just 0.5% from the previous year (to 40.5% against a 60% target). However, Planning Service did present evidence of speedier processing of a number of individual economically significant projects.

Planning Service indicated to the Panel that a number of the short-term reform initiatives were at an early stage and therefore further improvements in performance were expected. The Panel are not aware of any independent evidence which shows that this improvement has impacted on the major projects category (which, given the nature of this Review, is of most interest to the Panel). However it is acknowledged that the nature of some of the short-term reforms which focused on process changes, such as the streamlined consultation process, have impacted on the minor and intermediate applications categories, and that some of the longer term reforms proposed may affect the more economically significant major applications.

Current Reform Process

The current reform programme for Planning was announced in November 2007 and represents the most substantial change proposed to the planning system in over 30 years. The reform agenda in Northern Ireland reflects modernisation of planning systems in England and Wales, Scotland and Ireland, and the proposed changes would bring NI’s planning system into line with other jurisdictions. The aim of the reform programme is to bring forward proposals that would enable the planning system to further play its part in delivering on the PfG priorities and, in particular, by contributing to growing a dynamic, innovative and sustainable economy. The reform programme is designed to take account of and enable the transfer of the majority of planning functions to local government under the Review of Public Administration. The timescale
Facilitators of Growth

of the Reform programme is also approximately the same as that of the RPA process, where the transfer of responsibility to local government is scheduled to take place in 2011\textsuperscript{174}.

9.68 The reform programme has been advanced on two fronts: firstly, short term reforms that can be delivered through current legislation and policy framework, and secondly medium to long-term reforms which will require primary legislation and subordinate legislative changes. The key short term measures include:

- **The creation of Strategic Projects Teams**: Two Strategic Projects Teams (SPTs) were created at planning headquarters to deal with economically significant applications. The teams include staff from the Roads Service and the NI Environment Agency which provides expertise and minimises delay in the consultation process. However, the Review Panel are not aware of any dedicated economics resource in the unit to provide advice on economically significant applications. Although we understand that while the SPTs do not have a dedicated economics resource, they do have ready access to the necessary advice on the economic aspect of applications when required. The SPTs have a target to process applications within six months of application. In 2008/09, the Strategic Projects teams processed twenty-five Article 31 applications\textsuperscript{175}. The teams also work alongside SIB to ensure that capital spend projects flow more smoothly through the planning process. However, in the context of reviewing the current consultation document on the reform of planning, the Panel believe that there remains a lack of transparency with regard to the definition and qualifying criteria for what has been termed ‘regionally significant developments’\textsuperscript{176}. We recommend (later in this chapter) that a clear definition and qualifying criteria should be developed and agreed between DoE, DRD, DETI and Invest NI. Indeed, this aspect should be embedded as part of the work of the proposed Executive sub-committee on the economy (proposed in Chapter 8).

- **Pre-application discussions (PADs)**: The use of PADs was designed to address one of the key reasons for delays in processing applications. For example, the PEDU report on Planning found that a key reason for delays was incomplete information in the application forms. As a result, the PAD process aims to provide the developer / business with support from all public sector stakeholders in completing the forms. This is to ensure the correct information is included resulting in higher quality applications and faster processing times;

\textsuperscript{174} Under the proposed RPA arrangements, local government will have responsibility for key planning functions including local development plans, development control (excluding regionally significant applications) and enforcement. Central government will retain responsibility for a number of areas including regional strategic planning and planning policy, regionally significant applications and performance management.

\textsuperscript{175} Article 31 applications are those which are major in scale and significance. Further information can be accessed from www.planningni.gov.uk/index/advice/advice_leaflets/leaflet08-major-applications.pdf.

\textsuperscript{176} The Review Panel welcome the proposals to introduce a three-tier hierarchy to the planning process which includes: regionally significant developments; major developments and local developments. However, in terms of the former category, the consultation document provides only a high-level assessment on what this may constitute.
The pilot of streamlined Council consultation scheme for processing non-contentious applications: The scheme was successfully piloted by Derry City Council, beginning in December 2007. The scheme reduced average processing times from 89 to 24 days and has now been rolled out across every council. Planning Service believes this scheme should significantly improve performance against the PSA target for processing minor applications and highlight that the greater certainty resulting from the shorter processing times would benefit the local development industry, particularly SMEs, whose proposals mostly fall under the criteria of the scheme. Though this progress is welcome, the Planning Service’s emphasis could better prioritise economic development, particularly with regard to new foreign investment; and

A publication of a good practice guide: This details the roles and responsibilities of Planning Service staff, applicants, agents and consultees.

Several submissions to our consultation process welcomed the good practice guide and noted the commitment for efficiency to be mainstreamed throughout the planning system. In addition, they felt that the PAD system was helping, but planners needed to be more assertive with other Government agencies. With regards to the medium to long-term reforms, these will require primary legislation and a large number of subordinate legislative changes.

The long-term proposals have been set out in the public consultation document, with the exercise scheduled to run until October 2009. However, we believe that the process of consultation has, to date, been unduly drawn out. Consequently, evidence submitted during this review highlighted the frustration felt by local stakeholders at the time taken for the consultation document to receive clearance by the Executive.

The key long term proposals include:

- A development management approach centred on a three tier planning hierarchy: applications would be classified as regionally significant, major and local, and the hierarchy would enable greater resources to be directed at applications with economic and social significance;

- Transfer of key planning functions to district councils in 2011: as discussed earlier, the planning system would operate with planning functions carried out by both district councils and the department. Decisions on major and local applications would be made by District Councils and regionally significant applications would be determined by the department with the Minister making the decision; and

- Development Plan: the provision of an effective, up-to-date development plan system with the intention of providing greater clarity and predictability for developers, the public and other stakeholders.

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177 The types of applications included in the streamlined consultation scheme are: extensions and alterations to a dwelling; new agricultural buildings; advertisements; change of house types; shop fronts; minor alterations and extensions to commercial and industrial premises; as well as minor alterations and extensions to schools; churches; health care and community facilities; and reserved matters following the grant of outline permission.

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9.72 Finally, our consultation process also reported that the Planning Service pays too much attention to single interest consultees who were often very slow to respond. However, we understand that the consultation process has now been formalised by the production of new service level agreements with key consultees in Roads and Environment agencies.

9.73 A more recent Ministerial statement\(^{179}\) has encouraged more efficient processing of applications by removing the tendency to delay decisions on applications while awaiting final Area Plans. Again, we welcome this statement, which should ensure that significant economic development opportunities will not be lost.

Recommendations

9.74 As we have previously outlined, the Panel believe that the current short-term reforms have shown little impact on the processing of major applications. Therefore, the Review Panel recommend that in the context of reform, the Planning Service is given processing time targets which are comparable and competitive with those countries and regions against which NI is competing for mobile international investment.

9.75 With the delays to date in the reform process, the Review Panel recommend that the Planning Service works to ensure that the legislative timetable for reform is met.

9.76 Given the importance of the recently established Strategic Projects Team to economic development in NI, the Review Panel recommend that it should deal with all applications relating to investment new to NI. We also recognise that the Planning Service currently decide on what is economically significant, and how competing claims should be reconciled. As Planning Service recognise, they are not best placed to do this, and are left to take responsibility for what are often highly contentious decisions. Therefore, we also recommend that, in terms of what constitutes a ‘regionally significant development’, a clear definition and qualifying criteria should be developed and agreed between DoE, DRD, DETI and Invest NI.

9.77 The emphasis on the Pre-Application Discussion (PAD) process is welcomed. However, the Review Panel recommend that this process must be as efficient as possible and should be included when reporting on timings for standard applications.

\(^{179}\) The DOE Ministerial Statement can be accessed at the following link:
Annexes
INTRODUCTION

A.1 The IREP Call for Evidence was issued on 30 January 2009, with responses requested by 27 February 2009. In order to maximise awareness, the Review Panel:

- Placed public notices in the main local newspapers;
- Conducted media interviews;
- Placed the Call for Evidence documentation on the dedicated IREP website (www.irep.gov.uk);
- Issued the Call for Evidence documentation directly to a broad range of key stakeholders, including Northern Ireland (NI) government departments, Assembly Committees, political parties, local councils, business representatives, trade unions and academic bodies; and
- Held follow-up evidence sessions with a number of respondents.

A.2 As part of the Call for Evidence, the Review Panel invited interested parties to submit evidence in relation to the issues identified in the Terms of Reference. In particular, the Panel requested evidence on any direct experience respondents might have in relation to:

- How effective DETI / Invest NI support has been to date;
- What factors have prohibited the uptake/ drawdown of support; and
- What further steps DETI / Invest NI could take to further support business growth and productivity improvements in the Northern Ireland private sector.

A.3 While responses were requested under the Terms of Reference headings, respondents were also encouraged to highlight additional issues / information considered appropriate to the Review Panel. Respondents were also advised that, unless they specified otherwise, responses would be posted on the Review Panel's website (www.irep.org.uk).

A.4 Submissions were requested by the closing date of 27 February 2009, either by post to the Review Secretariat's office at Waterfront Plaza, Belfast, or by email to info@irep.org.uk. Where necessary, extensions were granted to this deadline.

A.5 A total of 45 responses were received to the Call for Evidence. The list of these respondents can be accessed on the Review website.
KEY EMERGING THEMES

A.6 Key and recurring themes which have emerged from the responses are summarised as follows, under the separate Terms of Reference:

a) The current and forecasted performance of the Northern Ireland economy, relative to other regions with access to similar policy instruments, programmes and resources

While it was recognised that the Review Panel itself would be considering the performance of the NI economy, a number of respondents provided commentary on current and forecasted performance of the economy. Key points raised included:

• The manufacturing sector has improved in its productivity performance relative to the rest of the UK. However, technology will be of critical importance to all sectors in improving competitiveness and adding more value;

• The NI growth rate will be severely constrained post 2011 as a result of declining public expenditure growth, resulting in an even greater reliance on the relatively small private sector to achieve the Programme for Government (PfG) goals;

• Tighter EU state aid rules are likely to inhibit Invest NI support in the form of Selective Financial Assistance (SFA) to larger companies, particularly post 2010. As such, NI will need to have all the tools at its disposal to attract and retain high value-added FDI and mobile indigenous companies;

• The importance of understanding the relative competitiveness of the NI economy is critical;

• A view was expressed that the impact of the current economic downturn will make achieving the PfG economic goals considerably more difficult; and

• NI’s reliance on the public sector was also identified as a key issue for the economy. It was suggested that, while this imbalance may, in the short term, cushion NI from the worst of the recession, it would not be sustainable in the longer term.

b) Current DETI / Invest NI policies and programmes, with an assessment of their effectiveness in stimulating productivity improvements, particularly within manufacturing and private services

There were a significant number of comments received in relation to the effectiveness of current DETI / Invest NI policies and programmes. On a positive note, many respondents commended DETI / Invest NI on its strong focus on Innovation, R&D, exporting and business improvement. However, a number of respondents, particularly from among the Business Alliance bodies, indicated that DETI / Invest NI could have more ambitious Corporate Plan targets and more clarity in terms of how resources are allocated against its key priorities. Support was also expressed for DETI and Invest NI’s efforts in terms of development of the NI Regional Innovation Strategy, telecoms policy, R&D support and a focus on the social economy.

It was also recognised that Invest NI’s Selective Financial Assistance, and other programmes, have helped to attract inward investment to NI. However, concern was expressed that other international competitors were able to access greater levels of government funding and, as such, there was a real risk that NI companies could not
compete if government funding was reduced or limited in the future. Some respondents suggested that the absence of a focus on assistance for SMEs in both the DETI and Invest NI Corporate Plans appeared to signal an institutional lack of support for SMEs. This was a major concern in the current economic downturn.

Support was also expressed for Invest NI’s Start a Business initiative, particularly from among local councils, which felt that the programme was extremely effective in helping local people to set up business. While the introduction of the new Enterprise Development Programmes was generally welcomed, some respondents felt that the programme needed to be reviewed in terms of its remit and value for money, particularly against the backdrop of the current economic downturn.

A number of local councils raised the issue of DETI’s adherence to the Lisbon Agenda targets in allocating the current round of EU Structural Funds to councils through the Competitiveness Programme. It was felt that these priorities needed to be re-examined in light of the current economic downturn.

In terms of how Invest NI operates, there were a range of experiences reported. Respondents stated that their client liaison was generally good, although experience was largely dependent on the calibre of the client executive. However, there was strong consensus that both DETI and Invest NI were too bureaucratic, highly centralised and frequently inflexible, particularly in terms of extensions to timescales in seeking assistance. For example, it was suggested that the selection criteria for Invest NI’s land and property was too strict and, as a result, significant investment had been lost in several council areas.

While it was noted that the last six months had seen a more sympathetic regime and attitude to client companies, a number of local councils indicated that there had been a lack of engagement with them by INI’s Regional Offices, and a lack of FDI promotion in several council areas.

c) Policy options to stimulate economic growth / productivity and build a larger and more wealth creating private sector, particularly in financial and value added business services

Respondents provided a range of views in relation to options for stimulating economic growth / productivity and to build a larger and more wealth creating private sector. These are summarised as follows:

- High value manufacturing was viewed by many as having a central role to play in the future and should not be overlooked – particularly given NI’s manufacturing success in the last decade which has outperformed the UK. It was also noted that international competition, particularly from low cost countries, necessitates rapid improvements in the effectiveness of NI / GB manufacturing companies and supply chains to ensure industry is agile and responsive to opportunities;

- While there is a need to grow financial services, there may be significantly less growth potential in this sector given the current global financial turmoil. As such, it was suggested that there is a strong case for DETI / Invest NI to try to anticipate future developments, for example in the area of financial regulations;

- There is a need to increase export potential within the tradable services sector, and to both identify barriers to exporting and develop appropriate support mechanisms for this sector;
• There needs to be an enhanced and focused entrepreneurship strategy, with the objectives of changing attitudes and culture, encouraging more business start-ups and offering appropriate support for further business development and growth;

• There is a need for a focus on both Innovation (to ensure it is market driven rather than technology driven) and branding, and to identify best practice in both these areas. Incubation was also identified as a key area for development;

• The adaptability and availability of a skilled workforce was also seen as key to sustainable growth. In particular, leadership and management skills needed to be viewed as high priority for government / Invest NI support and there was also a need for increased export training and assistance;

• The importance of networks and clusters in motivating Innovation was also highlighted, particularly in helping firms to achieve critical mass and economies of scale and to compete in larger, more diverse and competitive markets;

• It was suggested that consideration should be given to the provision of loans and equity to sustain and create new companies in the current economic climate;

• A number of local council respondents highlighted the need for Invest NI to harness the local knowledge and economic development skills of local authorities and to engage more effectively at a local level. Invest NI should also be working with local councils to reach non-INI client businesses and to ensure that there is more effective promotion of the range of business support services for companies;

• The contribution of the independent retail sector to the local economy, both in terms of its role as a significant employer and economic generator, was also flagged by a number of respondents and it was suggested that it should be a priority area for Invest NI in developing local indigenous businesses; and

• A significant number of respondents highlighted the need for a reduction in bureaucracy of support schemes, particularly for larger proposals which require DETI / DFP approval. In addition, it was suggested that more flexibility should be built into budgets to allow money to be allocated where DETI / Invest NI identify a real need, and there should be improvements to public sector procurement procedures to enable local SMEs to compete for public contracts.

d) How NI can further attract value added FDI and promote domestic investment

In terms of how NI can attract further value added FDI and promote domestic investment, it was highlighted that there was a clear need for strong political leadership which recognises the importance of wealth creation and is committed to policies which support enterprise and the development of a more competitive environment. As such, it was suggested that NI needed to be able to provide a competitive package which can attract and retain investors. To do this, Invest NI needed to be resourced adequately to effectively compete for internationally mobile FDI and to enable companies to invest in Innovation and R&D.
Key factors identified in terms of attracting FDI and promoting indigenous investment included:

- the need for support for Innovation and R&D programmes which would be vital in helping companies advance their capabilities, move up the value added chain and compete more effectively internationally. In particular, the MATRIX report was welcomed by a number of respondents, most notably for its identification of a number of sectors in which NI can become world class;
- the need for funding of technology centres to be created to enable the development of new technologies and products across industry sectors;
- the creation of an adequate skills pool across all sectors, building on the work already undertaken in the ICT sector by DEL and the sector trade body Momentum. In particular, improving the quantity of STEM skills was viewed as critical to ensure the transition to a knowledge-based economy; and
- the importance of a suitable transport and telecoms infrastructure, and the need for a reformed planning system (as per section (f) below).

While there was broad agreement that NI needed to be able to compete effectively for FDI, there was a perception, particularly among local council respondents, that the primary focus of Invest NI was on attracting FDI. As such, it was felt that specific strategies were needed to meet local needs and priority of resources should be placed on assisting and developing local entrepreneurship and business development to secure the long term sustainability of the NI economy.

In terms of Invest NI’s remit within tourism, it was proposed that a proactive approach was needed by Invest NI, both in terms of the development of hotel accommodation (specifically in the North West), and in its approach to tourism in general. It was suggested that Invest NI should take a wider role in contributing to the delivery of the PSA 5 targets for tourism, for example by embracing the visitor economy in its overall aim on business productivity and by expanding its current objectives and targets to include tourism targets.

e) Review and advise on the structure and remit of Invest NI and the existing governance arrangements between DETI, DFP and Invest NI

In terms of the structure and remit of Invest NI, several respondents raised the point that Invest NI is viewed as having a risk averse culture, particularly when compared to the IDA. It was suggested that a more outcome focused culture across the organisation remained a challenge and, as such, the introduction of performance related pay, below senior management levels, needed to be seriously considered. Furthermore, while the ethos of Invest NI is that the organisation has a private sector focus, it was unclear whether the accountability mechanisms imposed by government allow this to operate as it should.

A significant number of respondents highlighted a perceived high level of bureaucracy and slow decision-making process, particularly in terms of major project proposals which involve DETI and DFP. This perceived delay in decision-making often impacted adversely on businesses, particularly SMEs. It was also noted that access to senior management was often difficult.
Referring to the structure of the Invest NI Board, it was noted that the new Chairman
and Board were making a difference to Invest NI, with some respondents
experiencing a more responsive organisation and a good strategic direction.
Conversely, concern was raised that the lack of elected representatives on the
Invest NI Board meant that there were no checks and balances in terms of the
economic and social impact of activities undertaken, as opposed to the pursuit of
economic goals only. It was also proposed that, given the critical importance of
skills in improving productivity, there needed to be even closer engagement
between DEL and Invest NI and, as such, consideration should be given to having a
senior management representative from DEL on the Invest NI Board, and similarly
that Invest NI should be represented on the management board of DEL.

In terms of existing governance arrangements, it was noted that a lack of joined up
government, and a perceived duplication of effort at government and delivery level,
caused confusion and inconsistency in the way that economic policy is designed
and applied. Several respondents felt that, while all government departments had a
role to play in contributing to economic growth, the issue of who had ultimate
responsibility for economic policy needed to be resolved, for example by the
creation of a single Department for the Economy encompassing all the core
economic development functions.

The impact of the Review of Public Administration (RPA) was also a recurring theme,
particularly among local council respondents. It was suggested that, while the
Review Panel may have excluded local authorities’ work on economic development
as part of the Review, it should give consideration to their contribution to and role
within the future economic development arena post 2011.

There was also a perception that, while councils played an important role in
supporting the work of DETI / Invest NI, it often felt like councils were left to deal
with those parts of the business sector which were not attractive to DETI / Invest NI
and without sufficient transfer of resources to councils. A number of councils
proposed that there was a strong case, particularly in the light of the RPA, for
councils to be given the necessary resources to assist existing businesses that do
not qualify for Invest NI assistance. Furthermore, it was suggested that there may
be merit in considering whether Invest NI's local office network, if it continues,
should reflect the new council area structures.

f) Identify any issues which may inhibit the delivery of the productivity goal which
fall to other Departments in the NI Executive, particularly DEL (in relation to
skills) and DRD (in relation to regional planning and infrastructure investment)

A number of recurring themes were raised in terms of those issues which may
inhibit the delivery of the productivity goals and which fall to other NI departments.
Comments are summarised as follows:

• Skills/ Education

It was widely recognised that skills and Innovation were central to enhancing
productivity and future prosperity in NI. As such, collaboration across government,
its agencies (most notably between DETI / DEL and Invest NI) and with the private
sector is essential if NI was to achieve productivity improvements. It was also noted
that NI's major attraction is as a knowledge-based economy with a highly educated
and skilled labour force. As such, it was vital to ensure that there are relevantly
skilled personnel available, and that industry is developed in the areas identified by
the MATRIX panel.
Key issues raised included the retention of graduates, particularly in the priority growth sectors of business and financial services, technology and R&D; the continuing high numbers of pupils emerging from the education system with inadequate essential skills; the need to tackle specific skills needs and align qualifications with market demand; and the promotion of vocational education in schools, including more affordable tuition fees for apprenticeships.

- **Energy/ Environment**
  A number of respondents suggested that government needs to take urgent action to address the escalating costs to NI of energy and waste disposal, given their significant impact on competitiveness. For example, over the short term, regulations to protect the environment impose significant financial costs and there is a fear that the costs of national environmental regulations will place NI companies at a global disadvantage. More clarity is also needed on the all-island energy market, in terms of how it will work, and what governance and regulatory bodies will control the new market.

- **Infrastructure**
  A number of respondents, including business representative bodies and industry, highlighted the need for improvements to physical infrastructure. In particular, transport infrastructure was seen as a key factor inhibiting competitiveness. It was suggested that improvements to this infrastructure, or alternatively a financial support scheme to offset the cost of holding inventory, would enable exporters to mitigate the disadvantage of an extended supply chain and improve cash flow for further investment. However, it was noted that delivery of the existing plans for a Strategic Road Network, as set out in the Investment Strategy, could deliver a much enhanced road network and make a significant improvement in internal connectivity within NI.

- **Rates**
  Comments relating to the issue of rates included maintaining or reducing the current rateable valuations to improve the competitive position of companies, as well as consideration of exemption for buildings which carry out R&D or have a low carbon footprint.

- **Planning**
  Planning is seen as a key obstacle to investment and delivery of the productivity goal, and it was noted that proposals were being developed by the Environment Minister. Several respondents highlighted the view that the planning system in NI is too slow and its lack of responsiveness to business was limiting economic growth. There is also a perceived culture within Planning Service which places more weight on environmental considerations than economic factors. It was suggested that close links were required between Invest NI and the Planning Service to ensure that the economic priority is taken into account in planning decisions.
**g) Consider the optimal way by which the Minister of Enterprise, Trade and Investment engages with key stakeholders on economic development issues**

There was general agreement, particularly among the Business Alliance organisations, that the Economic Development Forum (EDF) has some value as a regular arena for engagement on economic issues between government departments and stakeholder groups / social partners.

However, it was also felt that there was no single means by which the Minister should engage with key stakeholders. It was important that the Minister had direct access to companies; ongoing engagement with representative bodies such as the Business Alliance, and access to independent economic analysis / policy advice, to ensure that policy making was not ‘populist’ driven. Reference was also made to a proposal for the establishment of a small group of secondees from the public and private sector with the remit to ensure that government decisions are economy proofed and that all departments keep the economy as a priority.

A number of local councils stressed the importance of the Minister engaging with local authorities on a regular basis to ensure that all parties were working together in the promotion of economic development. In particular, it was felt that engagement was essential for the planning and implementation process required in advance of the transfer of responsibility of economic development programmes to Councils.

**h) Consider whether any improvements could be made to DETI and Invest NI’s working links within the NI Executive and on an east/west and north/south basis**

In terms of DETI and Invest NI’s working links within the NI Executive, it was felt that there needed to be more communication, explanation and open policies developed between experts, the Executive and administrators. For example, it was suggested that links should be strengthened with the Department for Regional Development with regard to the ‘Shaping Our Future’ Regional Development Strategy, which will set out the strategic and long-term perspective on the future direction for NI up to 2025. In addition, there should be greater engagement between DETI and other departments in the NI Assembly to roll out public procurement projects as efficiently and timely as possible. There was also a perceived lack of clarity regarding who had responsibility for economic development within the NICS and this issue needed to be resolved.

It was also highlighted that, as well as the DETI Minister, the First Minister and deputy First Minister should continue to play an important role as ‘ambassadors’ in attracting FDI and helping to improve and promote the NI value proposition abroad.

Referring to cross-border links, it was felt that respective remits of the various economic development organisations needed to be clearly understood in order to optimise the overall economic outcome and value of public spend. For example, while there has been successful co-operation between the main economic development agencies, there was an issue of real or perceived duplication and overlap which needed to be addressed. On an all-island basis, it was also felt that there was potential for further clustering and that this should be encouraged on a sectoral basis. In addition, consideration should be given to the potential for more NI-based companies to tap into the resources of Enterprise Ireland, given its good track record.
While there was only minimal comment received in terms of east / west links, the view was expressed that maximum use should be made of services provided by UK Trade and Investment (UKTI) and, as such, an assessment of the key UKTI services which would be most beneficial to NI businesses would be helpful.

i) The sub-regional distribution of inward investment and other support measures to indigenous businesses, and the effectiveness of policy in encouraging the location of investment

In terms of the sub-regional distribution of inward investment and other support measures, there was a mixed response in terms of the effectiveness of policy. Some respondents highlighted that, while addressing regional imbalance was important, the over-riding priority must be to ensure the location of inward investment is in the long term interests of the company. As such, the policy should be on ensuring people in disadvantaged areas have access to employment (and to training enabling employment), recognising that this may require travel. Consideration needed to be given to relevant factors such as access to skills, telecoms, infrastructure, support services and general access and connectivity issues.

On the other hand, there was strong consensus among a number of respondents that there was insufficient recognition of the sub-regional economic disparities which exist within NI. There were concerns expressed on the deployment of DETI / Invest NI finance, staff, property and land and that it was not reflective of the sub-regions which require most intervention. It was felt that more cognisance needed to be taken of the east-west split and the need for an equitable approach to enable the west to catch up with the rest of NI. In particular, it was noted that the corporate plans of Invest NI and DETI could better set out how they propose to deliver on the NI government’s commitment to balanced regional development as set out in the NI Regional Development Strategy.

In terms of R&D investment, a number of respondents highlighted the announcement of Project Kelvin, which would enhance the telecoms infrastructure across the west of the Province. It was noted that the introduction of advanced telecommunications to the West must be reflected in future programmes and policies, not only to establish equity for businesses in the Western region, but as a key tool to assist them improve their productivity.

j) Assess the challenging nature of the economic goals / targets contained in the Programme for Government and, where appropriate, recommend any change.

A range of views were expressed in terms of the appropriateness of the economic goals / targets contained in the Programme for Government. On the one hand, it was felt that the productivity target was not challenging. Conversely, a number of respondents, particularly from among the Business Alliance, noted that, while the priorities and objectives of the PfG are still valid and should be retained, in light of the current economic downturn, new realistic targets and milestones needed to be established against which progress could be assessed. Furthermore, it was proposed that these new targets should be incorporated into the new proposed Economic Strategy, which should include short-term initiatives to kick-start the economy as well as long-term goals and objectives.

Disappointment was also expressed that, given the important contribution made from SMEs to the local economy, there is only limited mention of SMEs in the PSA objectives.
Summary of the IREP Call for Evidence

CONCLUSION

A.7 The wide-ranging and detailed nature of the contributions received in response to the Call for Evidence have been instrumental in shaping the Review Panel's findings and in ensuring they are evidence-based. The Review Panel wishes to place on record its sincere thanks to all respondents for their valuable contribution to the Review process.
OVERVIEW OF SUPPORT

B.1 Invest NI’s assistance to private companies, Universities and the social economy is administered through a series of programmes. As we indicated in the report, recipients may receive assistance under more than one programme at any one time, and packages of assistance are often put together for individual companies. Companies and organisations are frequently assisted more than once or indeed on an ongoing basis.

B.2 Invest NI had 57 programmes on offer to companies in 2008/09. The majority of these are only open to Invest NI clients, with the exception of programmes such as the Start a Business programme (now Enterprise Development Programmes) and Carbon Trust. Given the large number of programmes on offer from Invest NI, it has not been possible to review each of these. The Panel have therefore focused on assessing the largest programmes in terms of expenditure over the period 2002/03 - 2007/08. Table B.1 sets out the programmes of assistance which have offered £5m or greater during 2002/02 – 2007/08.

Table B.1: Programmes Offering in Excess of £5m (2002/03 - 2007/08)

<table>
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<th>Programme Name</th>
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<td>Selective Financial Assistance</td>
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<tr>
<td>Company Development Programme</td>
<td>60</td>
</tr>
<tr>
<td>Centres of Excellence</td>
<td>44</td>
</tr>
<tr>
<td>Compete</td>
<td>33</td>
</tr>
<tr>
<td>START</td>
<td>30</td>
</tr>
<tr>
<td>Trade Assistance / Passport to Export</td>
<td>22</td>
</tr>
<tr>
<td>Knowledge Transfer Partnership</td>
<td>11</td>
</tr>
<tr>
<td>Start a Business Programme</td>
<td>10</td>
</tr>
<tr>
<td>Proof of Concept Scheme</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Invest NI

Note: Table only includes programmes provided directly by Invest NI and excludes programmes such as the Carbon Trust and elements of the Start a Business Programme. KTP is co-funded by Invest NI and the Technology Strategy Board.

B.3 This annex reviews the performance of the nine programmes outlined above, although a number of additional programmes are also covered in less detail. The analysis has been informed by individual programme evaluations carried out by DETI / Invest NI, and also the IREP database developed specifically for the Review. For each programme, it assesses:

- Objectives and description of support;
- Scale of assistance given;
- Outcomes associated with support; and
- Analysis of additionality / deadweight (where available).
1. SELECTIVE FINANCIAL ASSISTANCE

Overview and Objectives

B.4 The scheme supports investment and employment related projects which are aimed at increasing business productivity in NI. It is the primary method used by Invest NI to support business formation and expansion, and there are two restrictions placed on SFA projects:

- Companies must be an Invest NI client; and
- Projects must involve capital investment and/or the creation or safeguarding of employment.

B.5 SFA provides support in the form of grants (revenue or capital), loans or equity. More detail on these is provided in Table B.2 below.

Table B.2: Information on Types of SFA Assistance

<table>
<thead>
<tr>
<th>Type of Assistance</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue grant</td>
<td>This supports activities that are incremental to a firm’s current cost base and enhances their competitive position. Eligible activities include employing new staff, establishing a new team and introducing new products or undertaking export activities.</td>
</tr>
<tr>
<td>Capital grant</td>
<td>This is suitable where new capital investment offers employment opportunities or where capital expenditure is needed to maintain or enhance a firm’s competitive position.</td>
</tr>
<tr>
<td>Loans</td>
<td>Invest NI generally only provide loans as a support or secondary lender and rarely lend without the presence of primary commercial funds.</td>
</tr>
<tr>
<td>Equity</td>
<td>This form of assistance is given where the private sector is deemed unwilling or unable to provide support. Invest NI may also provide equity in the form of co-investments with private lenders to lever further investment.</td>
</tr>
</tbody>
</table>

B.6 SFA can be used for a wide of new (referred to as business formation) and expansions projects, both for externally-owned firms and locally-owned businesses. Figure B.1 sets out the structure of SFA.

---

180 Externally-owned firms also include those from Great Britain, and therefore the term ‘FDI’ is not used when referring to external projects.
Figure B.1: Overview of SFA

B.7  SFA is a complex programme to evaluate as it provides support to a range of firms for different activities, some of which are very similar to those provided by other Invest NI programmes (such as the Start a Business Programme). For example, SFA provides both multi-million pound support to large inward investors, as well as small scale support for local business start-ups.

B.8  The programme also provides support for business Innovation (not shown in Figure B.1). This only accounts for a small proportion of total SFA expenditure (around £4m over the six year period) and has not been analysed in depth. Invest NI’s main support for Innovation and R&D has been provided through other programmes such as START, Compete and Centres of Excellence, and these are considered later in this annex.

Assistance Offered

B.9  Selective Financial Assistance is the largest programme offered by Invest NI, accounting for 55% of total programme expenditure over the period 2002/03 – 2007/08 (equivalent to roughly £70m each year).

B.10 A breakdown of total Invest NI assistance for the period 2002/03 – 2007/08 under SFA is shown in Table B.3. It highlights that considerably more assistance has gone towards expanding existing businesses rather than growing new companies. The large majority of assistance has been in the form of grants to companies, in particular revenue grants.
Table B.3: Breakdown of Assistance for SFA (2002/03 – 2007/08)

<table>
<thead>
<tr>
<th></th>
<th>Number of Offers</th>
<th>Assistance (£m)</th>
<th>Revenue Grant (£m)</th>
<th>Capital Grant (£m)</th>
<th>Loans (£m)</th>
<th>Shares (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Formation</td>
<td>599</td>
<td>122.2</td>
<td>99.4</td>
<td>17.9</td>
<td>0.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Business Expansion</td>
<td>1,704</td>
<td>291.5</td>
<td>145.2</td>
<td>119.4</td>
<td>12.7</td>
<td>14.3</td>
</tr>
<tr>
<td>SFA (excl Innovation)</td>
<td>2,303</td>
<td>413.7</td>
<td>244.6</td>
<td>137.3</td>
<td>13.2</td>
<td>18.7</td>
</tr>
<tr>
<td>Business Innovation</td>
<td>32</td>
<td>4.2</td>
<td>1.7</td>
<td>2.2</td>
<td>0.0</td>
<td>0.3</td>
</tr>
<tr>
<td>Total SFA</td>
<td>2,335</td>
<td>417.9</td>
<td>246.3</td>
<td>139.5</td>
<td>13.2</td>
<td>19.0</td>
</tr>
</tbody>
</table>

Source: IREP database

Note: Business Innovation is provided purely for illustrative purposes and has been excluded from the remainder of the SFA analysis.

B.11 As shown in Figure B.2, more assistance has been directed towards externally-owned companies under SFA. However, significant support has still been provided to local companies for business formation and expansions at £161m over the period.

Figure B.2: Total SFA Assistance by Ownership (2002/03 – 2007/08)

Source: IREP database

B.12 Assistance provided under business formation has mainly been directed toward externally-owned companies (£102m), rather than local businesses (£21m). In general, this has been focused on the service sector and, in particular, call centres. Section 1A in this annex expands on this further.

B.13 The larger of the two areas, business expansion, has been split much more evenly in terms of ownership. Locally-owned companies looking to expand have been given £140m of assistance compared to £151m for externally-owned businesses. In contrast with business formation, much more assistance has been directed towards the manufacturing sector than in services. Section 1B in this annex provides more detail on this.
Associated Outputs

B.14 The large amounts of assistance given under SFA have been associated with job promotion – both new jobs and safeguarding existing ones – and investment in the local economy. Table B.4 highlights some of the quantifiable benefits from SFA expenditure since 2002/03.

Table B.4: Outputs Associated with SFA Expenditure (2002/03 – 2007/08)

<table>
<thead>
<tr>
<th></th>
<th>New Jobs</th>
<th>Safeguarded Jobs</th>
<th>Investment (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Formation</td>
<td>12,431</td>
<td>507</td>
<td>649.8</td>
</tr>
<tr>
<td>Externally-owned</td>
<td>9,969</td>
<td>489</td>
<td>518.6</td>
</tr>
<tr>
<td>Locally-owned</td>
<td>2,462</td>
<td>18</td>
<td>131.2</td>
</tr>
<tr>
<td>Business Expansion</td>
<td>15,576</td>
<td>14,562</td>
<td>1,755.5</td>
</tr>
<tr>
<td>Externally-owned</td>
<td>5,973</td>
<td>11,468</td>
<td>800.0</td>
</tr>
<tr>
<td>Locally-owned</td>
<td>9,603</td>
<td>3,094</td>
<td>955.4</td>
</tr>
<tr>
<td>Total SFA</td>
<td>28,007</td>
<td>15,069</td>
<td>2,405.3</td>
</tr>
</tbody>
</table>

Source: IREP database

B.15 The table indicates that SFA has been associated with the promotion of a large number of new jobs in the economy (almost one-third of the total increase in employee jobs in the NI economy during this period). At almost 16,000 jobs, around two-thirds of total new jobs promoted through SFA have been in externally-owned firms, with the remaining 12,000 in local firms.

B.16 More new jobs have been promoted through expansions rather than business formation. The majority of jobs created through formation have been in externally-owned companies, mainly through attracting new companies to NI rather than developing new functions within existing firms. Section 1A expands on this further.

B.17 Business expansion has also been associated with the promotion of a large number of jobs, particularly in locally-owned manufacturing firms. However, assistance for expansion has also been extensively used to safeguard existing jobs within companies. This has almost exclusively been to protect jobs in the manufacturing sector rather than in services. Section 1B provides more detail on the impact of assistance for business expansions.

B.18 As referenced in the main report, DETI carried out an evaluation of SFA in NI 1998-2004, which made an estimate of the impact of Selective Financial Assistance. While it highlighted that SFA does have a positive impact on employment growth (related to the initial offer), it also found that many recipient firms subsequently did not grow. Indeed, these firms often grew slower than non-beneficiaries. For the firms that had been seeking to grow and introduce new products, it was seen as unrelated to assistance under SFA. It concluded that there was a group of inward investors for whom the SFA scheme was an incentive to stay in NI rather than to come to the region.

B.19 In total, 2,876 net additional jobs were reported to have been created in local companies. The average lifespan before these jobs begin to have a positive net benefit to GVA was estimated to be between four and five years. It is important to note that externally-owned firms have been the largest recipients of SFA, and they were not covered in the evaluation.
B.20 The report also identified a number of benefits of SFA over and above job creation. GVA per capita in SFA recipient firms was estimated to be 47% higher than the average for the NI economy of £30k, while the total net addition to GVA from support to NI firms was estimated at £126m.

Additionality

B.21 The SFA evaluation included an assessment of additionality, which asked recipients of SFA to choose a statement which best described the impact of support (Figure B.3 shows the main results of this). Just over 9% of cases exhibited full deadweight (i.e. would have occurred anyway), while a similar proportion (8.5%) were fully additional (i.e. would not have occurred at all).

![Figure B.3: Assessment of SFA Additionality](image)


B.22 The majority of cases fall in between the extremes of additionality, with the main impact of assistance being to bring forward investments that would have occurred anyway. While this does constitute additional activity, it is likely that this is the lowest form of additionality, particularly where investments are only being brought forward by a few months. Unfortunately, no information is available on how much time SFA assistance has brought forward investment.

B.23 In terms of ownership, there is very little difference in additionality of projects in local and foreign-owned businesses. However, larger cases (i.e. over £100k) have tended to be associated with higher levels of additionality and lower levels of full deadweight.

B.24 When applying for SFA, over one-fifth of companies reported that they did have access to viable alternative funding sources, rising to over one-quarter for foreign-owned firms. This would indicate that this group of companies were not dependent on SFA to take the projects forward.
B.25 As presented in the main report, Figure B.4 highlights that, in comparison with similar schemes in Scotland (RSA) and England (RSA and SFIE), levels of additionality in NI were considerably lower, with many more cases elsewhere adding new business activities and fewer simply bringing projects forward.

Figure B.4: Regional Comparison of SFA Additionality

![Chart showing regional comparison of SFA additionality](chart.png)


B.26 The SFA Evaluation also asked Client Managers within Invest NI to rate additionality of projects they had been involved in (shown in Table B.5). In comparison with the responses given by companies, their assessment of full deadweight (projects that would have gone ahead in exactly the same format) was almost identical at 8%. However, they tended to overestimate projects being fully additional, at 18% compared with 8.5% of company responses. Client Managers accepted that the majority of projects exhibited partial additionality rather than full additionality.

Table B.5: Client Manager Assessment of SFA Additionality

<table>
<thead>
<tr>
<th>Responses</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gone ahead exactly the same anyway</td>
<td>8%</td>
</tr>
<tr>
<td>Gone ahead but at a smaller scale</td>
<td>25%</td>
</tr>
<tr>
<td>Gone ahead but at a slower rate</td>
<td>27%</td>
</tr>
<tr>
<td>Gone ahead but in a different location in the UK</td>
<td>7%</td>
</tr>
<tr>
<td>Gone ahead but in a different location outside the UK</td>
<td>14%</td>
</tr>
<tr>
<td>Definitely not gone ahead at all</td>
<td>18%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

1A. BUSINESS FORMATION

B.27 The aim of business formation under SFA is to create new businesses and activities in NI, and includes:

- **Investment New to Northern Ireland**: attracting new externally-owned companies to Northern Ireland;
- **New Projects in Existing Companies**: development of new functions within existing externally-owned companies; and
- **Local Formation**: creating new locally-owned businesses.

B.28 Invest NI’s original definition of new FDI combined companies new to NI with those already established in the region. The Review Panel have separated these to allow the analysis to distinguish between such types of investments.

B.29 SFA is not the only programme that provides funding for activities in these areas. In relation to new FDI, Invest NI also operates the NI Screen Commission, which supports foreign and indigenous film, television and digital content companies. This is a relatively new and niche area of inward investment activity for Invest NI and has not been reviewed under SFA.

B.30 In relation to the creation of new local firms, Invest NI provides a large amount of assistance under programmes such as the Start a Business Programme (SABp) and the funding of Third Sector Organisations (TSO) such as Enterprise NI. However, SFA also funds activities in this area under schemes such as the Global and Export Start Schemes. This section focuses solely on SFA related expenditure for business formation, with the SABp reviewed later in the annex.

**Assistance Offered**

B.31 Table B.6 outlines that, in total, 29% of SFA assistance has gone to support business formation in both local and external firms. Although there have been fewer offers to new externally-owned firms, their value has been significantly higher than those to local start-ups, with 83% of total SFA assistance for business formation directed on external companies.

<table>
<thead>
<tr>
<th></th>
<th>Number of Offers</th>
<th>Total Assistance (£m)</th>
<th>Average Value of Offer (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Externally-owned</td>
<td>87</td>
<td>101.5</td>
<td>1.17</td>
</tr>
<tr>
<td>Locally-owned</td>
<td>512</td>
<td>20.7</td>
<td>0.04</td>
</tr>
<tr>
<td>Total</td>
<td>599</td>
<td>122.2</td>
<td>0.20</td>
</tr>
</tbody>
</table>

Source: IREP database

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181 The Export Start Scheme is a mechanism for supporting new starts in the manufacturing and service sectors that have the potential to become export orientated within three years, while the Global Start Scheme is similar but focuses on start-up companies with a more global focus. The programmes offer financial support (loans, grants and equity) and advice / guidance on developing business ideas, market research, management skills and practice assistance on exploiting new market opportunities.
B.32 Figure B.5 presents a breakdown of assistance offered for business formation by local and externally-owned companies since 2002/03. It highlights that the majority of assistance to external companies has been in attracting investment new to NI, with the exception of two years that were dominated by projects in existing externally-owned firms.

**Figure B.5: Breakdown of SFA for Business Formation**

![Chart showing the breakdown of SFA for business formation from 2002/03 to 2007/08.](chart.png)

*Source: IREP database*

**External Business Formation**

B.33 The sectoral mix of Invest NI support for new inward investment has been heavily weighted towards the services sector, in particular business and financial services and software and computer services. Table B.7 provides a full sectoral breakdown of offers of assistance for new inward investment projects.

**Table B.7: Sectoral SFA Offers for New FDI (2002/03 – 2007/08)**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Offers</th>
<th>Total Assistance (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>29</td>
<td>22.2</td>
</tr>
<tr>
<td>Engineering</td>
<td>14</td>
<td>6.5</td>
</tr>
<tr>
<td>Chemicals &amp; Pharmaceuticals</td>
<td>3</td>
<td>3.9</td>
</tr>
<tr>
<td>Food, Drink &amp; Tobacco</td>
<td>5</td>
<td>7.7</td>
</tr>
<tr>
<td>Other Manufacturing</td>
<td>7</td>
<td>4.0</td>
</tr>
<tr>
<td>Services</td>
<td>58</td>
<td>79.3</td>
</tr>
<tr>
<td>Business &amp; Financial Services</td>
<td>23</td>
<td>44.7</td>
</tr>
<tr>
<td>Software &amp; Computer Services</td>
<td>31</td>
<td>30.9</td>
</tr>
<tr>
<td>Construction &amp; Other Services</td>
<td>4</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>87</strong></td>
<td><strong>101.5</strong></td>
</tr>
</tbody>
</table>

*Source: IREP database*

B.34 While the largest sector in terms of offers for new inward investment has been business and financial services, these have been targeted toward attracting call centres which tend to offer lower average salaries (as illustrated in the main report). As Figure B.6 highlights, 39% of offers for new inward investment went to call centres over the period 2002/03 – 2007/08.
Local Business Formation

B.35 As shown in Figure B.7, both the number and value of offers to local companies declined significantly in 2005/06, and have not yet returned to levels close to the beginning of the period. On average, Invest NI has made 85 offers for local business formation under SFA each year, at a cost of almost £3.5m per annum.

B.36 In contrast to offers made to new inward investment companies, which was heavily focused towards services, Table B.8 demonstrates that the sectoral breakdown of local business formation through SFA has been more evenly split between manufacturing and services (although the service sector still receives more financial assistance).
Table B.8: Sectoral Breakdown of SFA Offers for Local Business Formation

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Offers</th>
<th>Total Assistance (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>236</td>
<td>8.1</td>
</tr>
<tr>
<td>Engineering</td>
<td>55</td>
<td>2.4</td>
</tr>
<tr>
<td>Chemicals &amp; Pharmaceuticals</td>
<td>12</td>
<td>0.5</td>
</tr>
<tr>
<td>Food, Drink &amp; Tobacco</td>
<td>34</td>
<td>1.0</td>
</tr>
<tr>
<td>Other Manufacturing</td>
<td>135</td>
<td>4.2</td>
</tr>
<tr>
<td>Services</td>
<td>276</td>
<td>12.6</td>
</tr>
<tr>
<td>Business &amp; Financial Services</td>
<td>88</td>
<td>4.1</td>
</tr>
<tr>
<td>Software &amp; Computer Services</td>
<td>78</td>
<td>4.5</td>
</tr>
<tr>
<td>Construction &amp; Other Services</td>
<td>110</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>512</strong></td>
<td><strong>20.7</strong></td>
</tr>
</tbody>
</table>

Source: IREP database

Associated Outputs

B.37 In total, Invest NI support has been associated with almost 12,500 jobs supporting new inward investment projects and local business start-ups under SFA. The large majority of these jobs (almost 10,000) have been in externally-owned firms, with 7,900 jobs coming from companies new to NI and around 2,100 from new inward investment projects within existing firms. Figure B.8 highlights that the number of new jobs promoted through business formation has been increasing year-on-year, with an annual average of nearly 2,100 new jobs over the period.

Figure B.8: Business Formation New Jobs (2002/03 – 2007/08)

Source: IREP database
B.38 The majority of jobs promoted through business formation have been in the service sector, which contributed 81% of jobs, and particularly within business and financial services. However, as highlighted earlier, the majority of these have been in call centres rather than in other higher value-added services activities. Figure B.9 provides a breakdown of business formation new jobs by sector. New jobs promoted within external companies have been heavily targeted towards the service sector (87% of total), although local start-ups have been more evenly split, with 44% in manufacturing and the remaining 56% in services.

Figure B.9: Business Formation New Jobs by Sector (2002/03 – 2007/08)

Source: IREP database
1B. BUSINESS EXPANSION

B.39 The aim of business expansion under SFA is to grow existing businesses in Northern Ireland, and includes:

- **External expansions**: expanding existing activities within externally-owned companies;
- **Local expansions**: expanding existing activities within locally-owned firms.

Assistance Offered

B.40 The majority of SFA expenditure during 2002/02 – 2007/08 has been targeted towards supporting expansions of existing local and externally-owned companies. Table B.9 shows that significant resources have been put into business expansion projects since 2002/03, accounting for 70% of total SFA assistance. With £292m of assistance being provided for expansions, this is almost three times the amount being targeted towards supporting new inward investment projects.

Table B.9: SFA Assistance for Business Expansion (2002/03 – 2007/08)

<table>
<thead>
<tr>
<th></th>
<th>Number of Offers</th>
<th>Total Assistance (£m)</th>
<th>Average Value of Offer (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Externally-owned</td>
<td>101</td>
<td>151.4</td>
<td>1.50</td>
</tr>
<tr>
<td>Locally-owned</td>
<td>1,603</td>
<td>140.1</td>
<td>0.09</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,704</td>
<td>291.5</td>
<td>0.17</td>
</tr>
</tbody>
</table>

Source: IREP database

B.41 Although many more offers of assistance have gone towards expansions in local firms, Figure B.10 highlights that the value of offers has been relatively evenly split by ownership. This contrasts with the value of offers for business formation, which heavily favoured external projects. In general, assistance given for expansions has fallen in recent years, particularly during 2006/07.

Figure B.10: SFA Offers for Business Expansion

Source: IREP database

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182 This is in contrast to new projects in existing external companies included under Business Formation, which seeks to attract new functions to externally-owned firms in the region rather than simply expand existing activities.
B.42 In terms of sectors, much more assistance for expansions in externally-owned companies has gone to the manufacturing sector compared to the services sector (shown in Table B.10). Engineering received a proportionately large amount of manufacturing assistance (40%), while business & financial services accounted for the majority of assistance in services. With assistance for expansions more heavily concentrated in manufacturing, less assistance has gone towards expansions in call centres than attracting them to NI.

Table B.10: Assistance for External Expansions by Sector (2002/03 – 2007/08)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Offers</th>
<th>Total Assistance (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>68</td>
<td>121.2</td>
</tr>
<tr>
<td>Engineering</td>
<td>27</td>
<td>79.3</td>
</tr>
<tr>
<td>Chemicals &amp; Pharmaceuticals</td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>Food, Drink &amp; Tobacco</td>
<td>15</td>
<td>13.6</td>
</tr>
<tr>
<td>Other Manufacturing</td>
<td>24</td>
<td>25.4</td>
</tr>
<tr>
<td>Services</td>
<td>33</td>
<td>30.2</td>
</tr>
<tr>
<td>Business &amp; Financial Services</td>
<td>17</td>
<td>21.7</td>
</tr>
<tr>
<td>Software &amp; Computer Services</td>
<td>15</td>
<td>8.6</td>
</tr>
<tr>
<td>Construction &amp; Other Services</td>
<td>1</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>101</td>
<td>151.4</td>
</tr>
</tbody>
</table>

Source: IREP database

B.43 As Table B.11 highlights, local expansion projects have also been more heavily focused towards manufacturing, although to a lesser extent than in inward investment expansions.

Table B.11: Assistance for Local Expansions by Sector (2002/03 – 2007/08)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Offers</th>
<th>Total Assistance (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>994</td>
<td>86.3</td>
</tr>
<tr>
<td>Engineering</td>
<td>219</td>
<td>13.3</td>
</tr>
<tr>
<td>Chemicals &amp; Pharmaceuticals</td>
<td>26</td>
<td>22.8</td>
</tr>
<tr>
<td>Food, Drink &amp; Tobacco</td>
<td>182</td>
<td>11.3</td>
</tr>
<tr>
<td>Other Manufacturing</td>
<td>567</td>
<td>38.9</td>
</tr>
<tr>
<td>Services</td>
<td>609</td>
<td>53.8</td>
</tr>
<tr>
<td>Business &amp; Financial Services</td>
<td>148</td>
<td>17.6</td>
</tr>
<tr>
<td>Software &amp; Computer Services</td>
<td>130</td>
<td>4.8</td>
</tr>
<tr>
<td>Construction &amp; Other Services</td>
<td>331</td>
<td>31.4</td>
</tr>
<tr>
<td>Total</td>
<td>1,603</td>
<td>140.1</td>
</tr>
</tbody>
</table>

Source: IREP database
Associated Outputs

B.44 The expansion of existing companies within NI, both locally and externally-owned, has been associated with almost 15,600 new jobs - over 3,000 more than those from business formation. Figure B.11 highlights that more new jobs have been promoted in local firms than external companies each year.

Figure B.11: New Jobs through External and Local Expansions

Source: IREP database

B.45 Many of the jobs promoted through business expansions have been in the manufacturing sector (shown in Figure B.12), which accounted for 56% of new expansion jobs. However, this has mainly been because of local firms rather than inward investment companies. The majority of jobs created through externally-owned expansions have been services-based, particularly business and financial services.

Figure B.12: Business Expansion New Jobs by Sector (2002/03 – 2007/08)

Source: IREP database
B.46 In addition to promoting new jobs through expansions, SFA support has also safeguarded a large number of jobs in existing companies (shown in Figure B.13). In total, just under 14,600 jobs have been safeguarded through expansions since 2002/03, with the large majority of these (79%) in externally-owned companies. The number of jobs safeguarded has fallen substantially since 2003/04, although there was a large increase during 2007/08.

Figure B.13: Business Expansion Jobs Safeguarded

Source: IREP database

B.47 The safeguarding of jobs within external companies in NI has almost exclusively been to retain jobs in the manufacturing sector, in particular within engineering. This is also true of local expansions. Figure B.14 presents a broad sectoral breakdown of safeguarded jobs.

Figure B.14: Jobs Safeguarded by Sector (2002/03 – 2007/08)

Source: IREP database
2. COMPANY DEVELOPMENT PROGRAMME

Overview and Objectives
B.48 The Company Development Programme (CDP) was designed to assist companies to improve their competitiveness and performance through the workforce development of both managers and employees. It specifically aimed to promote:

- Planning and structuring of training in line with business objectives;
- Management development;
- Achievement of nationally recognised qualifications and accreditation;
- Improved competitiveness, export-led profitability and growth;
- Attracting FDI and meeting investors skills needs;
- Advice and support for small businesses;
- Addressing social needs, equality and fair treatment; and

B.49 The programme was in existence from 1991, and supported participating firms through providing guidance and financial subsidies. It has been open to all Invest NI client companies in manufacturing and tradable services, with firms generally having to initially complete the Business Health Check (BHC).

B.50 The CDP was re-launched as the Business Improvement Training Programme (BITP) in late 2005.

Assistance Offered
B.51 An evaluation of the programme was carried out in 2004, and covered the period 1995/96 to 2003/04. Although CDP has been the second largest programme supported by Invest NI, expenditure in this area has been falling significantly (shown in Figure B.15). From an annual budget of £18m in 1995/96, this had fallen to £5m by 2003/04. However, the latest 2008/09 budget of its replacement – the Business Improvement Training Programme – has increased to £7m per annum.

183 It is recognised that Invest NI was only in existence for part of this period and inherited the programme from the Training & Employment Agency.
As would be expected, the number of clients supported and particularly the average value of offer have fallen sharply over this period, by around 34% and 42% respectively.

CDP provided a disproportionately large amount of support to manufacturing companies over the nine year period (approximately 65-70%) and considerably less to businesses in the service sector. The evaluation is now five years out-of-date, and it is hoped that Invest NI have made a significant shift to support skills development in the service sector. The Panel understand that an evaluation of BITP is scheduled for 2009/10.

The objectives of the CDP specifically identified targeting small firms for advice and support, yet small firms only received 15-25% of total grants on average, with the large majority of assistance given to medium and larger size companies. It would be expected that firms of this size, particularly larger companies, should be able to provide training for their own employees without resorting to government assistance.

The quantifiable benefits of CDP are less easily identified than other projects, as it does not directly lead to increases in employment, exports, R&D expenditure etc. In relation to skills, 150,000 training units were provided over the period, with 21% relating to management training. In addition, CDP was associated with 7,400 NVQ qualifications, mainly at levels 2 and 3. The programme has been successful in retraining older staff, with the majority of participants having been aged over 25.

The main impact of CDP (identified by 39% of companies) was improved technical skills. This is reinforced by the fact that 56% of firms felt that CDP had made the greatest impression on operational aspects of their firm. While the scheme does appear to have been successful in bringing benefits for the individual firms, it is questionable how transferable these technical skills are to the wider economy, and spillover benefits may therefore be limited.
Additionality

B.57 The evaluation identified high levels of deadweight as a significant issue with the programme. Almost two-thirds (63%) of firms reported that, in the absence of CDP, they would have undertaken training themselves with the same content. Conversely, 8% of recipients (rising to 18% in small firms) claimed that they would not have undertaken any training without the CDP project.

B.58 Although headline deadweight was found to be extremely high, some of this activity was likely to have been partly additional by helping to speed up projects (86% of companies) or provide more breadth to their training (77%) than would otherwise have been the case.

B.59 It is not clear the extent to which the CDP post-2004, or the re-branded Business Improvement Training Programme, has been able to tackle the low levels of additionality found in the evaluation. This will be an important issue for any future evaluations of the programme to address.
3. CENTRES OF EXCELLENCE

Overview and Objectives
B.60 The RTD Centres of Excellence programme was designed to create R&D centres to stimulate leading edge, commercially focussed research in order to improve the competitiveness of NI industry and enhance the market driven capability within local Universities.

B.61 As a general rule, projects were not to be less than 24 months and not more than 36 months. The intention was that each would be given three-year Invest NI funding followed by a three-year period in which the sponsoring organisation was obliged to maintain Centre activity. Each project had specific objectives relating to:

- Income generated (both retainable and non-retainable);
- New staff employed; and
- Industry associated projects and contracts.

B.62 The programme has now been re-launched as Competence Centres.

Assistance Offered
B.63 The programme was established in 2002 and a total of 18 Centres of Excellence (8 University and 10 company) were initially set up. The scheme was evaluated in 2007.

B.64 Table B.12 provides an overview of support, and highlights that the majority of grant assistance was directed towards University projects. Assistance for University projects was limited to 50% of project costs, which all but one project (the largest, which brings down the rate) availed of. Company projects were limited to 35% of total spend, with the grant rate tending to have been between 20-25%.

<table>
<thead>
<tr>
<th></th>
<th>Grant (£m)</th>
<th>Grant Rate (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>University</td>
<td>23.5</td>
<td>34.5</td>
</tr>
<tr>
<td>Company</td>
<td>11.0</td>
<td>24.0</td>
</tr>
<tr>
<td>Total</td>
<td>34.5</td>
<td>30.3</td>
</tr>
</tbody>
</table>

Source: Evaluation of Centres of Excellence

B.65 Figure B.16 provides a sectoral breakdown of the supported projects. The largest amounts of assistance were given to ICT and Health & Life Sciences, with the majority of the projects supported aligned to other DETI / Invest NI priority sectors.
Figure B.16: Sectoral Breakdown of Support

Source: Evaluation of Centres of Excellence

Associated Outputs

B.66 There have been a number of quantifiable benefits from the 18 Centres, including leveraging £114m of R&D expenditure. The programme has also been reasonably successful in terms of job creation, with the Centres creating 309 additional research jobs. These are generally high-skilled, high-wage jobs (in the region of £30k per annum). In terms of knowledge generation and transfer, the University projects generated 4 patents and 1,353 publications.

B.67 The company projects were broadly successful in commercialising their research, generating income of £460m. However, while the University projects reported a number of commercial benefits (such as spin-out, licensing fees and royalty income) they only generated income of £43.5m. The lack of a commercial focus in the University projects was identified as a key issue in the evaluation, and this has led to Invest NI ensuring that all projects in the Competence Centres programme will be industry led, even those in Universities.

Additionality

B.68 As Table B.13 shows, the majority of projects in both companies and Universities tended to have high levels of additionality, either reporting they would not have gone ahead or would have done so on a smaller scale and a later date. Only one of the 18 projects represented full deadweight.
Table B.13: Measurement of Additionality / Deadweight

<table>
<thead>
<tr>
<th>Region Description</th>
<th>Company (%)</th>
<th>University (%)</th>
<th>Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitely would have gone ahead in same form and timescale</td>
<td>10</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>Definitely would have gone ahead but on a smaller scale</td>
<td>10</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>Probably would have gone ahead but on a smaller scale</td>
<td>0</td>
<td>25</td>
<td>11</td>
</tr>
<tr>
<td>Probably would have gone ahead but on a smaller scale and at a later date</td>
<td>60</td>
<td>37.5</td>
<td>50</td>
</tr>
<tr>
<td>Definitely would not have been implemented</td>
<td>20</td>
<td>37.5</td>
<td>27</td>
</tr>
</tbody>
</table>

Source: Evaluation of Centres of Excellence

B.69 Applying deadweight factors, the evaluation concluded that additionality was high at 73%. This varied by type of project, with company projects having lower additionality (64%) compared with University projects (83%).
4. COMPETE

Overview and Objectives

B.70 The Compete programme was initially launched in 1994, aiming to stimulate manufacturing businesses to develop innovative and high technology products and processes, and to increase the level and quality of near market research and development. The specific objectives are:

- To increase the number of well designed and commercially successful NI products in both home and export markets;
- To increase the level and quantity of near-market R&D in NI; and
- To increase the number of businesses involved in R&D.

B.71 Support was available in the form of grants or equity in two phases:

(i) Phase 1 (Project Definition): up to 50% of eligible costs up to a maximum of £15,000 in grant; and
(ii) Phase 2 (Project Development): up to 40% of eligible costs up to a maximum of £250,000 per project for a period of between six and 36 months.

Assistance Offered

B.72 Invest NI carried out an evaluation of the programme in 2004, which covered the period 1998/99 – 2003/04. During this time, there were 946 applications from businesses, of which 527 were funded. Total assistance offered was £21.2m (an average of £3.5m per annum). The budget for 2008/09 was £2.6m.

B.73 SMEs accounted for 90% of Phase 1 and 86% of Phase 2 projects, with a total of 302 companies assisted during the period. Although the programme is open to tradable services companies, the majority of projects have been in the manufacturing sector (shown in Table B.14). This is unsurprising given the R&D focus of the programme, with ICT the only service sector significantly represented in terms of project numbers.

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184 It is recognised that Invest NI was only formed part way through this period, but the programme has been in existence since 1994 and Invest NI have continued to take it forward.
Table B.14: Sectoral Breakdown of Compete Projects (1998/99 – 2003/04)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Projects</th>
<th>Assistance (£k)</th>
<th>Proportion of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICT</td>
<td>114</td>
<td>4,570</td>
<td>22.7%</td>
</tr>
<tr>
<td>Concrete &amp; construction products</td>
<td>16</td>
<td>281</td>
<td>1.4%</td>
</tr>
<tr>
<td>Construction services</td>
<td>12</td>
<td>200</td>
<td>1.0%</td>
</tr>
<tr>
<td>Electrical &amp; electronic equipment manufacture</td>
<td>67</td>
<td>3,716</td>
<td>18.5%</td>
</tr>
<tr>
<td>Manufacture of food and drink</td>
<td>42</td>
<td>1,854</td>
<td>9.2%</td>
</tr>
<tr>
<td>Manufacture of chemicals &amp; pharmaceuticals</td>
<td>31</td>
<td>2,354</td>
<td>11.7%</td>
</tr>
<tr>
<td>Manufacture of machinery and equipment</td>
<td>58</td>
<td>2,154</td>
<td>10.7%</td>
</tr>
<tr>
<td>Manufacture of sheet metal products</td>
<td>59</td>
<td>1,643</td>
<td>8.2%</td>
</tr>
<tr>
<td>Manufacture of textiles/products</td>
<td>34</td>
<td>932</td>
<td>4.6%</td>
</tr>
<tr>
<td>Manufacture of timber, paper, rubber, plastic &amp; resin products</td>
<td>48</td>
<td>1,109</td>
<td>5.5%</td>
</tr>
<tr>
<td>Manufacture of transport equipment</td>
<td>17</td>
<td>697</td>
<td>3.5%</td>
</tr>
<tr>
<td>Other services</td>
<td>25</td>
<td>591</td>
<td>2.9%</td>
</tr>
<tr>
<td>Not Stated</td>
<td>4</td>
<td>14</td>
<td>0.1%</td>
</tr>
<tr>
<td>Total</td>
<td>527</td>
<td>20,116</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Evaluation of Compete

B.74 Compete assistance is eligible for multiple projects, with some companies even using the programme for up to nine projects. While this has helped to stimulate R&D expenditure in the economy, the evaluation recommended that consideration needed to be given to reducing the grant rate with subsequent projects to encourage companies to carry out R&D expenditure without public sector support.

Associated Outputs

B.75 Over the period covered by the evaluation, Compete was associated with £62m of R&D expenditure in NI. At an annual average spend of £10m, this represented 9% of total NI R&D expenditure. The programme was also directed at getting firms to undertake R&D for the first time, with 28% of recipients having never carried out R&D previously.

B.76 In terms of quantitative impacts, firms reported an increase in sales totalling £41m from Compete projects, with prospective sales of £57m in the following two years.

B.77 Although the focus of the programme is not on job creation, firms reported that Compete projects were associated with 154 new jobs, and a further 80 in the following two years. This was a substantial decrease (around 50%) on the number of jobs created from the previous evaluation of Compete.

Additionality

B.78 Levels of additionality were assessed in the evaluation through 100 telephone and 34 face-to-face interviews (results are shown in Table B.15). Around one-third of projects were fully additional, with 10% of Phase 1 and 3% of Phase 2 projects having full deadweight.
Table B.15: Measurement of Additionality / Deadweight

<table>
<thead>
<tr>
<th></th>
<th>Phase 1 (%)</th>
<th>Phases 1 &amp; 2/Phase 2 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Would not have undertaken the project at all</td>
<td>32</td>
<td>34</td>
</tr>
<tr>
<td>Would have undertaken the project but on a smaller scale</td>
<td>24</td>
<td>18</td>
</tr>
<tr>
<td>Would have undertaken the project but it would have been of lower quality</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>Project start would have been delayed</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Project would have taken place at the expense of another project in the firm</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>Project would have taken longer to complete</td>
<td>16</td>
<td>10</td>
</tr>
<tr>
<td>Would have undertaken the project in the same format</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>Multiple responses (Phase 2 only)</td>
<td>-</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: Evaluation of the Compete Programme

B.79 In total, additionality for the programme was estimated at 58% (equivalent to £36m of expenditure). Levels of additionality for Phase 1 projects varied significantly by firm size, with over one-fifth (22%) of small firms reporting that projects were fully additional, compared to 7% of medium firms and no large firms. This scale of variation was not found in Phase 2 projects.

B.80 In order to reduce deadweight, the evaluation recommended reducing or eliminating Phase 1 support for large firms, and ensuring a tougher test of additionality for Phase 2 projects in large firms. The Panel note that an action plan was developed and subsequently implemented, although we are unaware of the extent to which Invest NI actioned the recommendations outlined above. Support for near-market research has now been subsumed within the Grant for R&D programme launched in 2008.
5. START

Overview and Objectives

B.81 The START programme was launched in 1995, following on from the Science and Technology programme. Its overall aim is to increase the level of industrially relevant applied research undertaken by locally based companies either on their own or in partnership with Universities. It is focused at an earlier, pre-competitive stage of the research process than Compete. Specific objectives of the programme are:

- Provide a strong R&D capability within NI companies and Universities in areas relevant to industrial growth;
- Provide an impetus for industrially relevant R&D;
- Accelerate commercial exploitation of local research; and
- Drive forward innovative areas of R&D, which could lead to new industries, and effective transfer of technology from Universities to industry.

B.82 A START project is a planned period of research designed to gain new knowledge used in the development of new or significantly improved products, processes or services. Assistance is provided in the form of discretionary grants, loans or investments, with a maximum rate of 50% of total project costs. Projects generally last from 18 months to three years.

Assistance Offered

B.83 An evaluation of the programme was carried out in 2006 covering the period 2000-06. In total, 30 projects were supported at a cost of £23.1m. Almost all projects were company based (16) or collaborative (13) with only one being a University project. START’s budget for 2008/09 was £3.8m.

B.84 As shown in Table B.16, the large majority of funding went to just three sectors (Health and Life Sciences, ICT and Aerospace). Despite there being almost as many collaborative projects, the 16 company projects received 83% of total assistance.

Table B.16: START Grants Awarded by Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Company (£000s)</th>
<th>Joint (£000s)</th>
<th>University (£000s)</th>
<th>Total (£000s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aerospace</td>
<td>5,458</td>
<td>146</td>
<td>0</td>
<td>5,604</td>
</tr>
<tr>
<td>Agri Food</td>
<td>660</td>
<td>526</td>
<td>0</td>
<td>1,186</td>
</tr>
<tr>
<td>ICT</td>
<td>6,076</td>
<td>410</td>
<td>0</td>
<td>6,485</td>
</tr>
<tr>
<td>Health and Life Sciences</td>
<td>6,516</td>
<td>284</td>
<td>0</td>
<td>6,800</td>
</tr>
<tr>
<td>Nanotechnology</td>
<td>0</td>
<td>0</td>
<td>132</td>
<td>132</td>
</tr>
<tr>
<td>Textiles</td>
<td>0</td>
<td>714</td>
<td>0</td>
<td>714</td>
</tr>
<tr>
<td>Plastic and Packaging</td>
<td>488</td>
<td>1,084</td>
<td>0</td>
<td>1,573</td>
</tr>
<tr>
<td>Electronics and Engineering</td>
<td>0</td>
<td>649</td>
<td>0</td>
<td>649</td>
</tr>
<tr>
<td>Total</td>
<td>19,198</td>
<td>3,812</td>
<td>132</td>
<td>23,142</td>
</tr>
</tbody>
</table>

Source: Evaluation of the START Programme
Associated Outputs

B.85 START projects were associated with a total of £62.3m of R&D expenditure, roughly 16% of all applied BERD investment in NI in 2004.

B.86 Due to the nature of projects (early stage research), the evaluation did not attempt to quantify commercial benefits from START. It did, however, note a number of softer benefits such as increasing technical skills of employees, enhancing company reputation, creating or safeguarding jobs and increasing company revenue.

B.87 Despite the early-stage nature of the projects, some of the benefits reported by companies (such as jobs and revenue) could be easily quantified, and it is therefore surprising that this analysis was not carried out as part of the evaluation to better inform an assessment of impact.

Additionality

B.88 Additionality was only assessed in the evaluation in terms of full deadweight or whether the project was at all additional. It concluded that deadweight was 13%, with significant variation by type of project. Almost one-quarter (24%) of collaborative projects exhibited deadweight, whereas 12% of company projects reported this.

B.89 Overall, the programme was reported to be 87% additional, although given that the analysis did not take into account partial additionality (such as bringing a project forward) it is likely that the figure would be lower. START has now been subsumed within the new Grant for R&D programme.
6. TRADE ASSISTANCE / PASSPORT TO EXPORT

Overview and Objectives

B.90 The Passport to Export programme is a comprehensive suite of services that provide assistance to locally based companies seeking to grow their business in export markets worldwide. It is the main element of Invest NI’s wider trade assistance programmes. It is designed to support all local exporters, but has special provision for first time exporters and more experienced exporters seeking to enter new markets. The programme offers a wide range of support to businesses, shown in Table B.17.

Table B.17: Breakdown of Passport to Export

<table>
<thead>
<tr>
<th>Category</th>
<th>Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capability Development</td>
<td>• Export Skills and Knowledge Workshops</td>
</tr>
<tr>
<td></td>
<td>• Business Information Service</td>
</tr>
<tr>
<td></td>
<td>• Export Advisory and Market Research Services</td>
</tr>
<tr>
<td></td>
<td>• Develop Export Sales</td>
</tr>
<tr>
<td></td>
<td>• Exporting Excellence (E2 Graduate Programme)</td>
</tr>
<tr>
<td>Market Visits</td>
<td>• Trade Missions (Multi-Sectoral and Sectoral)</td>
</tr>
<tr>
<td></td>
<td>• Stands at Trade Exhibitions</td>
</tr>
<tr>
<td></td>
<td>• Solex</td>
</tr>
<tr>
<td></td>
<td>• Partner Organisation Trade Missions</td>
</tr>
<tr>
<td>In-Market Support</td>
<td>• Trade Advisory Service</td>
</tr>
<tr>
<td></td>
<td>• Northern Ireland Trade Development Centres</td>
</tr>
<tr>
<td></td>
<td>• Incubation Units</td>
</tr>
<tr>
<td></td>
<td>• Strategic Business Alliances</td>
</tr>
<tr>
<td></td>
<td>• Going Dutch</td>
</tr>
<tr>
<td></td>
<td>• UK Trade and Investment (UKTI) and Enterprise Ireland</td>
</tr>
<tr>
<td>Special Market and Sectoral Initiatives</td>
<td>• ‘Acumen’ cross border trade programme</td>
</tr>
<tr>
<td></td>
<td>• ‘Doing Business in...’ series of information seminars</td>
</tr>
<tr>
<td></td>
<td>• Tourism Visa programme</td>
</tr>
<tr>
<td></td>
<td>• Olympics 2012 supply opportunities initiative</td>
</tr>
<tr>
<td></td>
<td>• Sales South</td>
</tr>
</tbody>
</table>

Note: E2 is currently suspended awaiting the outcome of a Green Book Appraisal; Tourism Visa finished in June 2009

Assistance Offered

B.91 The programme has provided over £22m of support to companies since 2002/03, with a budget of £5.4m in 2008/09. As shown in Figure B.17, the largest area of expenditure has been on market visits, followed by in-market support and capability development.
Figure B.17: Assistance by Activity Area

<table>
<thead>
<tr>
<th>Activity Area</th>
<th>Assistance (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Visits</td>
<td>10</td>
</tr>
<tr>
<td>In Market Support</td>
<td>8</td>
</tr>
<tr>
<td>Capability Development</td>
<td>6</td>
</tr>
<tr>
<td>Special Market &amp; Sectoral Initiatives</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Invest NI

Associated Outputs

B.92 As indicated in the main report, Invest NI has not carried out an evaluation of the programme to date (elements are being evaluated during 2009, before a full evaluation is carried out in 2010/11). Although no information on past quantifiable benefits is available, the scheme is expected to contribute to relevant export PSA targets (as outlined below):

- Increase sales outside Northern Ireland per employee of Invest NI manufacturing clients by an average of 6% per annum;
- Increase sales outside Northern Ireland per employee of Invest NI tradable services clients by an average of 4% per annum; and
- Increase sales outside the UK as a proportion of total sales by Invest NI client companies (excluding the top 25 exporters) by 3 percentage points.

Additionality

B.93 In the absence of an evaluation, it is not possible to quantify how much deadweight exists in the programmes. However, in the main report, the Review Panel have referenced a number of academic studies on the effectiveness of export assistance and they indicate the importance of this type of programme for NI companies. Furthermore, the proposal in Chapter 7 to introduce a fee-paying element to these support programmes should also help reduce any deadweight (as firms will only be willing to pay for a service which genuinely adds value).
7. KNOWLEDGE TRANSFER PARTNERSHIP

Overview and Objectives
B.94 The Knowledge Transfer Partnership (KTP) is a UK wide programme\textsuperscript{185} that helps businesses improve their competitiveness through better use of the knowledge technology and skills that resides within higher education institution and further education colleges. The criteria for businesses to participate includes:

- The company partner must be regarded as being financially stable based upon their latest annual accounts;
- The proposed project must aim to meet specific needs or solve an identified problem of importance to the company;
- The company partner must be capable of exploiting the knowledge skills or technology to be transferred; and
- There must be a clear need for the knowledge, skills or technology input from the knowledge base to the proposed project.

B.95 Each partnership employs one or more recent graduates for a period of 1-3 years on a project that will transfer knowledge from the Universities and colleges into businesses.

B.96 The programme is funded by 28 sponsors representing research councils, regional development agencies and devolved administrations, led by DTI (now BIS).

Assistance Offered
B.97 Over the period 2002/03 – 2007/08, expenditure on the programme has been £11m\textsuperscript{186} (the 2008/09 budget is £1m). No further information is available on a breakdown of assistance.

Associated Outputs
B.98 As the programme is run on a UK-wide basis, Invest NI has not carried out an evaluation of the programme. A previous evaluation took place in 2001 but, given the time elapse, the findings have not been used as part of this Review. A UK-wide evaluation has recently commenced and it is not expected to report until the beginning of 2010.

\textsuperscript{185} A mini-KTP is also available in NI, which provides similar support but is restricted to SMEs.

\textsuperscript{186} Programme delivered in partnership with Technology Strategy Board.
B.99 In the absence of an evaluation it is not possible to list the quantifiable benefits from assistance for NI\(^{187}\). However, Invest NI anticipate the benefits of the programme the be:

- New knowledge and expertise brought into the business;
- Increased profits;
- Increased skill and knowledge of existing employees;
- Long-term strategic relationships with third-level education sector; and
- A culture of Innovation embedded into the business.

**Additionality**

B.100 Again, as no evaluation was made available it has not been possible to review additionality.

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\(^{187}\) An annual report is produced on a national level and does not specify benefits for NI companies.
8. START A BUSINESS PROGRAMME

Overview and Objectives
B.101 The Start a Business Programme (SABp) was launched in 2001 and was the key programme within NI aimed at providing support for potential entrepreneurs within the local market. It has recently been re-launched as Enterprise Development Programmes (EDP).

B.102 The overall aim of SABp was to provide a structure of training, advice and financial support to increase the stock and viability of small businesses in Northern Ireland. To do this, it offered a core package of support offering assessment, training, business planning support and an initial start-up grant. Specific objectives of the programme were to:

• Contribute towards the overall Accelerating Entrepreneurship Strategy (AES) priority of raising the number and quality of start-ups in NI with a particular emphasis on the locally focused sector;

• Ensure a business survival rate of 70% over three years;

• Assist newly established start-ups become generators of employment and wealth through an emphasis on quality business development support to enhance business survival and growth rates;

• Assist a proportion of the new starts to ‘pull through’ to become Invest NI clients after completing the programme; and

• Contribute towards the creation of a more enterprising society by actions to promote entrepreneurial role models and good practice.

B.103 The new EDP is aimed at supporting business start-ups but it has also introduced new initiatives at both pre and post start-up stages. In addition, it incorporates enhanced provision for under-represented groups such as women, minorities and those from disadvantaged communities.

Assistance Offered
B.104 The SABp has offered a large amount of assistance since 2002/03, but much of this has not been reported by Invest NI in their database, which estimates assistance to be almost £10m over the period. Its replacement, the EDP, currently has an annual budget of £6m. Figure B.18 presents an overview of offers and expenditure under the SABp. In total, over 18,100 offers of assistance were made under the programme.
Figure B.18: Offers and Assistance (2002/03 – 2007/08)

The large majority of offers and expenditure under SABp have gone to the service sector, at 93% of total in both cases. However, these have mainly been directed towards other service sectors outside of the priority sectors of business and financial services (8% of total) and software & computer services (5%).

**Associated Outputs**

The activities already reviewed under local business formation within SFA are similar to those provided by the SABp. However, this programme is not classified by Invest NI as SFA and therefore the activities outlined here are additional to those included under SFA.

An evaluation of the SABp (covering the period 2001-05) was carried in 2006, and this is the main source of evidence for assessing the economic impact of the scheme. The evaluation of SABp calculated a ‘net’ impact figure which adjusted the raw figures to take into account deadweight. Table B.18 summarises the main net benefits of support.

### Table B.18: Net Economic Impact of Assistance

<table>
<thead>
<tr>
<th></th>
<th>Lower Estimate</th>
<th>Higher Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of business start-ups</td>
<td>1,385</td>
<td>2,194</td>
</tr>
<tr>
<td>Number of jobs created</td>
<td>1,286</td>
<td>2,037</td>
</tr>
<tr>
<td>Value of turnover</td>
<td>£71m</td>
<td>£133m</td>
</tr>
<tr>
<td>Profit</td>
<td>£28m</td>
<td>£44m</td>
</tr>
</tbody>
</table>

**Source:** Evaluation of Start a Business Programme

While the gross figures for measures such as job creation are much higher than those presented above (for example, actual average job creation was 6,594), the extremely high levels of deadweight (discussed below) mean that the majority of these jobs would have been created in the absence of the assistance.
Additionality

B.109 The Invest NI evaluation of the Start a Business Programme surveyed 235 participants to identify what statement best describes their view on the contribution that SABP support made on their decision to start a business.

B.110 Table B.19 sets out the analysis of additionality of the SABP. With half of all respondents replying that they would have started up the business anyway, the programme displayed extremely high levels of full deadweight. In total, 91% of entrepreneurs would have started their business at the same scale, either at the same stage or at a later date.

| Would have started up anyway | Total (%) | 50 |
| Would have started up, but not as quickly | 41 |
| Would have started up, but not at the same scale | 2 |
| Probably would not have started up | 5 |
| Definitely would not have started up | 1 |
| None of these | 1 |

Source: Evaluation of Start a Business Programme

B.111 Overall, the programme deadweight was estimated to be between 74% and 84% depending on the deadweight factor applied to the responses. This is consistent with a similar scheme run by Scottish Enterprise, which found similar levels of deadweight (around 80%).

B.112 Despite the high level of deadweight, it was concluded that the rationale for continuing with the programme was the continuing low levels of business start-ups in NI. While no specific market failure was identified, any failure was likely to be associated with lack of information on the benefits of starting a business and the costs associated with the process.

B.113 The evaluation highlighted that the scheme was found to be too rigid, and that the start-up grant was a motivating factor in undertaking the programme but not in starting up a business. As a result, the new EDP has removed the grant element and focused more on aspects that were of greatest benefit to participants (training, mentoring etc). This should help improve additionality going forward, although the comparison with the Scottish Enterprise scheme highlights that start-up programmes are likely to be associated with high levels of deadweight.
9. PROOF OF CONCEPT

Overview and Objectives
B.114 Proof of Concept (PoC) supports the pre-commercialisation of leading edge technologies emerging from local Universities. It was launched in 2003 as a three-year pilot, which offered grants up to £150k.

B.115 Its overall aim is to grow the knowledge economy in NI by improving the level and quality of commercialisation from the two Universities. Proposals for the pilot were expected to achieve a spin-out company, a new technology-based company or a licensing deal for a new technology. Other programme objectives are:

- Increase the commercial awareness of academic staff;
- Attract new skills into Northern Ireland as researchers are recruited to work on projects;
- Development of new research skills and techniques within the Universities through working on the projects;
- Promotion of Innovation backwards in the supply chain;
- Strengthening the technology base within business and creation of opportunities for business-academia links in the future; and
- Enhance the image of a region and contribute to inward investment prospects.

Assistance Offered
B.116 PoC was evaluated at the end of the three-year pilot in 2006. Table B.20 presents an overview of assistance for the four funding rounds, where grants of £5.2m were given to 40 projects. The programme’s 2008/09 budget was £650k, although this is not directly comparable as it relates to the phasing out of the pilot and launch of the new programme.

<table>
<thead>
<tr>
<th></th>
<th>Number of Projects</th>
<th>Total Grant (£m)</th>
<th>UU Share</th>
<th>QUB Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2004</td>
<td>9</td>
<td>1.1</td>
<td>74%</td>
<td>26%</td>
</tr>
<tr>
<td>July 2004</td>
<td>13</td>
<td>1.8</td>
<td>33%</td>
<td>67%</td>
</tr>
<tr>
<td>December 2004</td>
<td>9</td>
<td>1.1</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>June 2005</td>
<td>9</td>
<td>1.1</td>
<td>62%</td>
<td>38%</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>5.2</td>
<td>41%</td>
<td>59%</td>
</tr>
</tbody>
</table>

Source: Evaluation of Proof of Concept Pilot Programme

B.117 In terms of sectors, Figure B.18 highlights that the large majority of projects were in Life Sciences, Engineering and ICT.
Figure B.19: Sector Analysis of Projects

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Sciences</td>
<td>18</td>
</tr>
<tr>
<td>Engineering</td>
<td>10</td>
</tr>
<tr>
<td>ICT</td>
<td>8</td>
</tr>
<tr>
<td>Physics</td>
<td>5</td>
</tr>
<tr>
<td>Nanotechnology</td>
<td>3</td>
</tr>
<tr>
<td>Material Science</td>
<td>2</td>
</tr>
<tr>
<td>Food &amp; Life Sciences</td>
<td>1</td>
</tr>
<tr>
<td>Construction</td>
<td>1</td>
</tr>
<tr>
<td>Chemistry</td>
<td>1</td>
</tr>
<tr>
<td>Biotechnology</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Evaluation of Proof of Concept Pilot Programme

Associated Outputs

B.118 Table B.21 compares the projected performance in the initial business case with the performance projected in the evaluation. The evaluation concluded that both the commercialisation of projects and the number of spinouts would be considerably lower than initially projected, although more licensing deals were projected.

Table B.21: Benefits of Proof of Concept

<table>
<thead>
<tr>
<th></th>
<th>Target</th>
<th>Projected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercialisation success rate</td>
<td>80%</td>
<td>48%</td>
</tr>
<tr>
<td>Licensing</td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>Spin out</td>
<td>60%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: Evaluation of Proof of Concept Pilot Programme

B.119 The evaluation also reported a number of softer benefits from the programme, including better business / commercial skills, identification of potential future projects and increased enthusiasm for commercial activities.

Additionality

B.120 The evaluation found that 38% of projects would not have gone ahead without POC funding, with a further 28% progressing at a slower pace or smaller scale. Almost one-third (31%) of projects would have reshaped themselves into research projects and pursued funding through the Universities. Deadweight was not considered to be an issue.
10. OTHER PROGRAMMES

B.121 This annex has reviewed nine Invest NI programmes with expenditure over £5m between 2002/03 and 2007/08. However, the agency has operated many smaller programmes, which accounted for 14% of Invest NI assistance over this period. This section briefly discusses some of the other support programmes offered to companies in NI.

Business Health Check

B.122 The Business Health Check (BHC) is a diagnostic tool used to review a business and highlight its strengths and areas for improvement. It acts as the gateway for other Invest NI support programmes, and is generally the first way that Invest NI engages with a client company.

B.123 The annual budget for the programme was £500k in 2008/09. It was evaluated in 2007, and received some positive findings, concluding that it offered a more sophisticated offering than similar supports elsewhere in the UK. One issue raised was the deadweight associated with providing a fully subsidised service to large companies that could afford to pay for the services. However, Invest NI rejected the recommendation to charge for the service and it remains free of charge to all firms.

Innovation and R&D

B.124 Although this annex has already reviewed a number of Innovation and R&D programmes, they only form part of Invest NI’s wide range of R&D&I supports on offer. The other programmes in this area are outlined in Table B.22.

Table B.22: Other Innovation and R&D Programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher Education Innovation Fund (HEIF)</td>
<td>• The key objective of HEIF is to support Higher Education Institutions to increase their capability to respond to the needs of businesses. The emphasis is on technology transfer with the private sector</td>
</tr>
<tr>
<td></td>
<td>• Partly funded with DEL, the programme has provided £7.2m of assistance to NI’s two Universities during 2004-07. The budget for 2008/09 was £700k</td>
</tr>
<tr>
<td></td>
<td>• An interim evaluation was carried out in 2007. However, it was unable to conclude on economic benefits of the programme (given the short timescale since launch) or make an assessment of additionality / deadweight</td>
</tr>
<tr>
<td>Northern Ireland Technology Fund (NITECH)</td>
<td>• NITECH was launched in 2003 as a venture capital fund to provide finance for the commercialization of technology within new start or existing small and medium sized businesses</td>
</tr>
<tr>
<td></td>
<td>• The fund was launched with £3m of resources, although only £1.95 was awarded by 2007. The budget for 2008/09 was £400k</td>
</tr>
<tr>
<td></td>
<td>• An evaluation of NITECH, carried out in 2007, concluded that around 25% of expenditure was deadweight, with half of assistance being fully additional and the remaining 25% having partial additionality</td>
</tr>
</tbody>
</table>
Table B.22: Other R&D and Innovation Programmes (continued)

<table>
<thead>
<tr>
<th>Programme</th>
<th>Description</th>
</tr>
</thead>
</table>
| Innovation Advisors                            | • Invest NI has appointed three innovation advisors to address low levels of awareness amongst companies about the availability of R&D support. The budget for 2008/09 was £1.5m, although it also includes a number of innovation promotional activities.  
  • The advisors have a sales background with experience of R&D and Innovation functions, and are targeting both firms that have never used any R&D programmes previously and increasing uptake among those that have.  
  • A Global Innovation Advisor has also been recruited to attract new mobile R&D projects to NI, particularly in the Health and Life Science sector. The advisor works alongside Invest NI’s technical and overseas teams, and the local Universities, to develop NI’s research base and market it overseas. |
| Product / Process Development (PPD)            | • PPD aims to support smaller businesses developing new market-led products and/or more efficient manufacturing or production processes.  
  • Invest NI provides assistance to draw up a project plan, and offers a grant of up to 40% of eligible costs (max £35k). The budget for 2008/09 was £1m. |

B.125 We have previously noted that Invest NI has recently rationalised its R&D and Innovation support into one Grant for R&D programme. This should help reduce confusion with fewer programmes offering similar support to companies. However, as indicated in the recommendations contained in Chapter 7, the Panel believe this process of rationalisation could be extended further.

The Carbon Trust

B.126 Invest NI provides funding to the Carbon Trust (NI) to promote and support sustainable energy projects within the business community (Invest NI does not have overall control of the organisation). While the purpose of funding is to contribute to Invest NI’s corporate objectives and targets, the evaluation found that there is somewhat of a disconnect between these and the Carbon Trust’s remit and purpose, which is much more environmentally focussed.

B.127 An evaluation of Invest NI’s funding for the Carbon Trust was carried out in 2008, which reviewed activity for the period 2003/04 – 2007/08. During this time, £16.2m of assistance was given to the Carbon Trust, including £4.1m put into the Carbon Trust Loan Scheme.

B.128 The activities of the Carbon Trust and the associated loan fund have:

- Identified £106m of energy savings in businesses, of which between £38m and £56m have been implemented;
- Identified carbon savings of 793-886 KtCO2, of which between 322 and 547 KtCO2 savings have been implemented; and
- Provided £4.7m in interest-free loans to 80 projects to use towards the cost of energy saving measures.

188 Although expenditure on the Carbon Trust (NI) has been greater than £5m, it has not been included in Table B.1 as Invest NI does not directly provide any of the activities associated with it.
B.129 Full additionality of the Carbon Trust has been high (at 42%), with around 20% of expenditure being deadweight. However, the loan element has had much higher levels of additionality (almost half of expenditure was fully additional) with just 2% representing full deadweight.

Property Assistance

B.130 Property assistance is Invest NI’s main financial vehicle for supporting client companies to develop property solutions that will increase their capability to compete more successfully in the marketplace. It provides financial assistance within specified limits for eligible projects brought forward by companies.

B.131 The Review Panel have concerns on this type of assistance and has therefore asked for a review to be undertaken to determine why there is a perceived need for large purchases of land over the next few years. The Panel also notes that the scheme is scheduled for evaluation in 2009/10.

Social Economy

B.132 Invest NI currently offers a number of programmes to contribute towards the social economy objectives of DETI. Information on some of these is provided in Table B.23. As outlined in the main report, the Panel are aware that responsibility for the social economy is one of a number of programmes to be transferred to district councils as part of the Review of Public Administration. The Review Panel endorse this decision as delivery of the social economy objectives are viewed as being better delivered at the local level.

Table B.23: Social Economy Programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Entrepreneurship Programme (SEP)</td>
<td>• The SEP supports social economy business start-ups and business development. It focuses on groups that are located in or service disadvantage areas, and had an annual budget of £900k in 2008/09</td>
</tr>
<tr>
<td></td>
<td>• Assistance is available to help develop enquiries and ideas, produce a business plan, provide strategic advice through mentoring and support voluntary and community groups make the transition into a social enterprise model</td>
</tr>
<tr>
<td>Social Economy Fund (SEF)</td>
<td>• The SEF is a specific employability intervention to bring those furthest removed from the labour market into new jobs in both new and existing social enterprises. It is currently running as a pilot with an average annual cost of around £325k</td>
</tr>
<tr>
<td></td>
<td>• The scheme provides an employment grant over a two year placement period, focusing on the long term unemployed in West Belfast and Greater Shankill area. It includes mentoring and training support for individuals to ensure retention and continued development</td>
</tr>
</tbody>
</table>

SFA Tourism

B.133 In contrast to economic development agencies elsewhere, Invest NI is also involved in providing support for the local tourism sector. The Tourism programme provides assistance (via SFA) for the capital development and expansions of tourism related accommodation, and for capability development of accommodation and other non-accommodation projects throughout Northern Ireland.
B.134 The aim of the programme is to provide interventions to establish, develop and grow sustainable tourism businesses. The financial support provided for capability and strategic capital development is intended to improve the quality and competitiveness of the tourism sector.

B.135 Around £5m of expenditure has been committed to the programme since 2006/07. The Review Panel have recommended that responsibility for this function should be transferred back to DETI, to be dispersed to other bodies that have a more specific Tourism responsibility.
C.1 This annex provides an assessment of the current methodology for ex-ante appraisal of financial assistance to industry. We consider the current method used to assess the economic efficiency of proposed projects, outline a number of issues with the current methodology, and consider how the current approach deals with projects relating to Innovation and R&D. Finally, we make recommendations on a potential way forward.

CURRENT ASSESSMENT OF ECONOMIC EFFICIENCY

C.2 The Northern Ireland (NI) Practical Guide to the Green Book (NIPG) is currently the primary guide to Economic Appraisal for NI departments. As per the NIPG, Economic Efficiency is one of four criteria to be satisfied in consideration of assistance to the private, voluntary and community sectors:

1. Economic Efficiency;
2. Addionality;
3. Viability; and

C.3 In order to assess a project’s impact on Economic Efficiency, the method outlined in the then UK Department of Trade and Industry’s (DTI) Economic Efficiency Test (EET) Guide is used by DETI / Invest NI. This includes the following main elements:

1. A Discounted Cash Flow (DCF) Test - this covers the costs and benefits of supporting a project based on the applicant’s financial forecasts. This test is designed to measure the project’s impact upon national income,

2. Appraisal of wider national costs and benefits; and

3. Analysis of regional benefits (where necessary).

C.4 If the project is economically efficient (i.e. benefits are considered to outweigh costs on the basis of the first two elements above), the project is deemed to pass the Economic Efficiency Test. If a project is deemed to be a marginal fail (as defined by the EET guidance) on the basis of the first two elements, assistance can still be given in cases where regional benefits are thought to be substantial enough to justify accepting some national economic loss.

C.5 The DCF test is generally carried out over a period of project initiation plus ten years, or five years (for hi-tech projects). A 10% discount rate is generally used to reflect a commercial rate of return (taken as 8%) plus an allowance for optimism in sales forecasts (2%).
Wider and Regional Benefits are assessed against some of the key elements outlined below:

**Wider Benefits**

a. University linkages with industry;

b. Skills development / training (perform Skills test);

c. Knowledge transfer / collaboration;

d. Encourage Foreign Direct Investment;

e. Entrepreneurship (perform Productivity Test);

**Regional Benefits**

a. Employment quality and longevity (perform Wage test);

b. Reduction of ‘Brain Drain’;

c. Generation of orders from other companies in the Assisted Area;

d. Number of local/regional jobs indirectly dependent on the project;

e. Degree of higher management being injected;

f. Degree of R&D being injected;

g. Innovative nature of the project; and

h. Project located in an area of disadvantage.

**Skills Test**

C.7 As part of the assessment of wider benefits, BERR’s skills test involves calculating the weighted average skills level (as per the Standard Occupational Classification) of jobs created / safeguarded. If the majority of jobs are at skill level 2 and above then the project passes the skills test threshold. If not, the project registers a fail.

**Productivity Test**

C.8 The productivity test is also carried out as part of the assessment of wider benefits. It calculates projected productivity growth for an undertaking plus the planned project, and compares it with average growth observed nationally in the same industry and in the wider economy. The productivity test can also compare the absolute level of productivity with those projects within the same industry and NI.

C.9 The objective of the test is to ensure that projects improve the rate of growth in productivity, both in the region and in the country / region as a whole. If a project is in a sector that is growing above the national average (for either manufacturing or for the whole economy, as relevant), the project is compared with the sectoral average. If a project is in a sector that is performing below the relevant national average, the project is compared with the national average.
Wage Test
C.10 The Wage Test is included in the assessment of regional benefits and looks at the median basic salary of the jobs created / safeguarded by the project. Where this is in excess of the NI private sector median (£17,644 in 2008) (or sectoral average, in sectors that are above the national average) the project passes the Wage Test.

ISSUES WITH CURRENT METHODOLOGY
C.11 From the perspective of the Review Panel, there are a number of issues and inconsistencies with the existing approach, particularly in its assessment of Economic Efficiency. They are as follows:

National / Regional Consideration
C.12 It is likely that there will a greater emphasis on the consideration of economic efficiency from a regional (NI), rather than national (UK), perspective. Amongst other impacts, this may require displacement to be considered primarily in terms of displacement of activity from NI firms. However, it is also likely that there will continue to be a need to take UK displacement into account, where relevant.

C.13 As demonstrated in the overview of current methodology, economic efficiency is currently considered from a national perspective. There may be a requirement in the future for analysis to be carried out separately on both a national and regional basis – where this is relevant and practical. However, the completion of many of the quantitative tests, particularly the DCF and productivity test, on the basis of only regional costs and benefits is likely to be challenging.

100% Crowding Out
C.14 The Green Book position is that if there are no grounds for expecting a proposal to have a supply side effect, any increase in government expenditure would result in a matching decrease in private expenditure. It is not clear that this 100% crowding out holds, either on a national and / or regional basis. The current approach assumes that an increase in government borrowing will lead to an increase in interest rates, thereby causing a reduction in private sector investment across the UK. Alternatively, higher interest rates can lead to an appreciation of the exchange rate, making all UK exports less competitive. However, it is questionable to what extent even the largest of regional investments will influence the exchange rate and crowd out jobs elsewhere in the UK.

C.15 The Panel recognise that there may be some crowding out within the region in cases where the project is competing in the local labour market, or is offering a wage premium. However, assuming the labour market is not at full employment, creation / safeguarding of jobs is likely to have an impact upon aggregate employment by attracting employees from the inactive and unemployed. In cases where employees are drawn from other employment, the secondary effects of job creation are likely to mean a proportion of these posts are likely to be filled by the inactive or unemployed. The 100% crowding out assumption is also weakened in cases of bringing underemployed resources into more productive employment.
There may therefore be a case for disregarding the 100% crowding out assumption and including the impact on regional income of employment effects. This provides some fit with the current strategic context, given that one of the priorities of the NI Executive (Public Service Agreement 3) is to increase employment. However, the possibility of some crowding out remains in the local labour market, whereby a limited pool of skilled labour will lead to displacement of employees from existing activity. We believe that the correct treatment of this issue is important and needs to be resolved.

**Supply Chain Benefits**

Supply chain benefits are considered as regional benefits in the Economic Efficiency Test Guidelines. The current approach considers the incremental value added generated in the regional supply chain, within the assessment of regional benefits.

Given that the current methodology emphasises national benefits, impacts on the supply chain are not generally included in the DCF test. The rationale for not considering impacts on the national supply chain is the assumption of 100% crowding out. However, if this assumption is relaxed then this presents a case for inclusion of supply chain impacts as part of the economic appraisal.

**DCF Test / Quantification of Wider Benefits**

It is generally considered that, in practice, a project is expected to return a positive result on the DCF test. However, in the past most DCF tests have offered minimal allowance for positive or negative spillovers. In the majority of cases, the DCF will reflect principally the incremental profit falling to the organisation carrying out the activity. In FDI projects and projects which promote activities such as Innovation and R&D, there is a case for considering a wider range of benefits.

There is no allowance for multiplier effects. The Green Book defines the net benefit of an intervention as the gross benefits less the benefits that would have occurred in the absence of intervention (the ‘deadweight’) less the negative impacts elsewhere (including ‘displacement’ of activity), plus multiplier effects.

Quantification of wider costs and benefits, where possible, would allow decision makers to take account of the net incremental effect of each proposed project. As many of these impacts are currently considered on a qualitative basis only, and given the weight currently given to quantified costs and benefits, much of this impact is not being considered to the full extent.

**ASSESSMENT OF INNOVATION / R&D PROJECTS**

Given the recommendations presented in the main body of the report call for greater investment in Innovation and R&D, the Panel believe it is important to provide an assessment of whether the current methodology is fit for purpose.

The Innovation and R&D activities of private firms generate widespread benefits for consumers and society at large. The overall economic value to society often exceeds the economic benefits enjoyed by innovating firms as a result of their research efforts. This excess of the *social rate of return over the private rate of return* enjoyed by innovating firms is described as a positive externality or spillover.
C.24 Spillovers flow through a number of distinct channels. Firstly, market spillovers occur when the operation of the market for a new product or process causes some of the benefits, thereby created to flow to market participants other than the innovating firm. It is this “leakage” of benefits through the operation of market forces, rather than the flow of knowledge itself, that distinguishes market spillovers from knowledge spillovers. This occurs when knowledge created by one economic agent can be used by another without compensation, or with compensation less than the value of the knowledge. The spillover beneficiary may use the new knowledge to copy or imitate the commercial products or processes of the innovator, or may use the knowledge as an input to research process leading to other new technologies. Secondly, network spillovers result when the commercial or economic value of a new technology is strongly dependent on the development of a set of related technologies. An example of network spillovers exists among all of the different developers of application software for use with a new operating system platform. If one firm develops a particular application, people will buy it only if many other firms develop other sufficient applications so that the platform itself is attractive and widely used.  

C.25 Further, levels of market and technological uncertainty are usually high when firms invest in innovation and there is the potential for significant information asymmetries / imperfect information to exist. Investors therefore find it difficult to identify good projects and profitable long term investments (over the lifetime of the project) can receive underinvestment.  

C.26 The combination of such factors implies that private firms will invest less than is socially desirable in innovation / R&D, with the result that some desirable projects will not be undertaken, and others will be undertaken more slowly, later, or on a smaller scale than would be socially desirable.  

C.27 The table below provides a summary of the estimates of private and social rates of return to innovation and R&D that have been published in a number of econometric studies. While the scale of the difference between private and social returns varies across these studies, all predict that social returns are higher than private returns.

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Table C.1: Estimated Rates of Return

<table>
<thead>
<tr>
<th>Author</th>
<th>Private Rate of Return (%)</th>
<th>Social Rate of Return (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nadiri (1993)</td>
<td>20-30</td>
<td>50</td>
</tr>
<tr>
<td>Mansfield (1977)</td>
<td>25</td>
<td>56</td>
</tr>
<tr>
<td>Terlecky (1974)</td>
<td>29</td>
<td>48-78</td>
</tr>
<tr>
<td>Sveikauskas (1981)</td>
<td>10-25</td>
<td>50</td>
</tr>
<tr>
<td>Goto-Suzuki (1989)</td>
<td>26</td>
<td>80</td>
</tr>
<tr>
<td>Scherer (1984)</td>
<td>29-43</td>
<td>64-147</td>
</tr>
<tr>
<td>Bernstein &amp; Nadiri (1991)</td>
<td>14-28</td>
<td>20-110</td>
</tr>
</tbody>
</table>


C.28 The existing methodology, as outlined previously, allows projects to pass the EET only if there is a positive result of the DCF analysis, after taking into account the assessment of wider benefits. However, it is considered that Innovation and R&D projects generally offer quality jobs and wider benefits in the form of knowledge spillovers. As demonstrated above, much of the new knowledge created by these projects is likely to be a public good and therefore the benefits of the knowledge cannot be entirely captured by the firm undertaking the research.

C.29 It follows that projects may have an unattractive rate of return from the perspective of the private firm (and therefore return a negative result on the DCF) but, when accounting for the social rate of return, the project may be beneficial to the economy as a whole.

C.30 The Review Panel understand that, in June 2009, the Department of Finance and Personnel (DFP) approved a revision to the approach taken with Innovation and R&D projects, as proposed by DETI and Invest NI. We recognise that the arrangements are for a pilot basis only (to be reviewed after one year).

C.31 The proposals saw the formal inclusion of a previously commissioned InnovationLab model for assessing the wider benefits of Innovation and R&D projects. The Innovation Model primarily focuses on qualitative impacts. The model assesses wider benefits using the following framework:

- Increments to Knowledge (private and social);
- Benefits to future research and research use (private and social);
- Private benefits from commercial exploitation;
- Political and administrative benefits;
- Public benefits (market transactions); and
- Public benefits (knowledge spillovers).

C.32 The revisions also made amendments to the regional benefits (to avoid double counting with the InnovationLab factors) and relegated the DCF analysis to an annex – intended to cause the RCA result to have less prominence on the decision making process, as it is often very difficult to accurately predict future revenue / cost streams for these projects. During the pilot period, additional evidence is to be gathered on the
accuracy of RCA tests by evaluating a random sample of 10 tests from previously
approved cases by 1 June 2010.

C.33 Provided the interim proposals operate successfully and the additional evidence
gathered adds weight to the case for removing the RCA, it was proposed that further
discussions would take place following the pilot. The intention is to consider removing
the RCA from the assessment methodology for Innovation and R&D projects.

C.34 The interim arrangements also give some allowance for the social return to Innovation
and R&D being in excess of the private return. However, the Panel believe there
remains a weakness in this approach, due to the non-monetary approach taken to the
benefits of Innovation and R&D. While progress has been made, we believe the outputs
from the Innovation Lab model are primarily descriptive in nature.

ECONOMIC EFFICIENCY ASSESSMENT – POTENTIAL WAY FORWARD

C.35 Any suggested economic efficiency assessment methodology must provide a clear
framework for assessing the costs and benefits of proposed interventions to the NI
economy, and also be understandable and useable for practitioners.

C.36 The Review Panel have considered two broad alternative approaches to the current
methodology presented earlier:

• To develop a GVA model to produce estimates of the direct, indirect and induced
effects on employment, income and GVA, including a qualitative framework
to provide a structure for the assessment of those impacts that are not easily
quantifiable; and

• To consider an extension to the existing methodology employed by the UK
Department of Business, Innovation and Skills (BIS), which examines the
opportunity cost, rather than accounting cost of projects. As such, this methodology
focuses more on the wider economic impact of proposed investments, rather than
the private benefits.

C.37 Each of the possible approaches is outlined below, followed by a summary of the
proposed way forward:

Continue with the Status Quo

C.38 This would continue to consider projects using the DTI methodology whilst using the
amended approach for Innovation / R&D projects on a pilot basis. Whilst continuing to
use the DTI methodology would ensure continuity for practitioners, it is subject to a
number of drawbacks, as outlined previously.

GVA Model

C.39 Taking account of the previous issues, the Panel believe that the 100% crowding out
assumption is not appropriate on a regional basis. This indicates that any model
should include the impact on regional income of employment. This model therefore
assumes a limiting case where shadow prices are zero for labour, depreciation and
amortisation and also for private project investment costs. This would be reasonable if
there was sufficient spare capacity in the regional economy, and factor markets
adjusted quickly so that all the adjustment is in quantities and none in market prices. It
is also assumed that, for other inputs, the shadow price is equal to the market price.
The direct effects of an intervention are therefore measured via the GVA and
employment impact.
Adjustments for Additionality and Displacement

C.40 Adjustments can be made for levels of additionality and displacement. This will differ on a project-by-project basis and appraisers will be expected to provide the basis for the level of adjustment to be made.

Discounting Future Cashflow

C.41 A discount rate of 10% is used, in line with DTI guidance to discount the GVA impact. Employment is the additional direct employment, adjusted for deadweight and displacement.

Indirect and Induced Effects

C.42 Relaxation of the 100% crowding out assumption may allow the consideration of multiplier effects in assessing the net additional impact. The indirect and induced effect of proposed interventions can be calculated using type 1 and type 2 multipliers that are calculated by sector within national and regional input/output tables. However, we recognise that, at present, there are no input/output tables for NI.

C.43 The indirect effect of a project is the increase in demand for inputs to the final product, i.e. increased demand throughout the supply chain. As a result of the direct and indirect effects, the level of household income throughout the economy will increase as a result of increased employment. A proportion of this increased income will be re-spent on final goods and services (the induced effect).

Cost of Project

C.44 The discounted capital cost of the project needs to be subtracted from the results, both costs to the private and public sector. This represents the cost required to retain the level of GVA created.

Qualitative Impacts

C.45 The qualitative impacts of proposed projects could be illustrated using the following framework, as a narrative in casework papers (based on the framework listed above):

a) Skills development / training (BERR skills test);

b) University linkages with industry;

c) Knowledge transfers / collaboration;

d) Encourage Foreign Direct Investment (Halo effects);

e) Entrepreneurship;

f) Reduction of ‘Brain Drain’;

g) Degree of higher management being injected;

h) Degree of R&D&I being injected;

i) Innovative nature of the project; and

j) Project located in an area of disadvantage.
Extended Methodology

C.46 The Department for Business, Innovation and Skills (BIS) have recently updated their approach to the appraisal of economic projects. This sets out the difference between the private view, which assesses the viability of an investment project from the perspective of the applicant firm, and the public view, which assesses the impact of an investment project on the UK economy as a whole.

C.47 The BIS approach assumes that the default assumption in economic appraisal is that the public analysis should equal the private analysis – only where externalities are shown to exist or where opportunity costs diverge from resource costs should the two perspectives differ.

C.48 The BIS review, known as the Higson Review, looks at how the current appraisal methodology focuses mainly on the level of private benefits, using an accountancy based approach. BIS have developed an extension, which focuses more on the public benefits, i.e. the opportunity cost and wider economic impact. There are three key adjustments which are made in order to arrive at the ‘public’ perspective:

i) remove impact of transfers (e.g. consider revenues/costs gross of tax/subsidy);

ii) adjust accounting costs to reflect opportunity costs (e.g. appropriate shadow price of labour); and

iii) incorporate externalities (e.g. Innovation and R&D, environmental, training spillovers)

C.49 The assessment focuses around a value narrative with eight components. As the value of many of the components is difficult to forecast, a number of values are calculated for each component (low, central and high). The components are then combined into a number of scenarios to give a range of likely net present values for the project. Each component is considered on the basis of activity / benefits additional to those accruing under the counterfactual / without project scenario. The components are:

Discounted Cash Flow

C.50 This involves a discounted cash flow to reflect the private benefits of the project. Three values will be calculated for this component, based on an estimate of the worst case, a central estimate and an estimate of the best case.

Labour

C.51 This is focused on the difference between the labour cost used in the DCF (the accounting cost) and the opportunity cost of labour, based on the shadow price of labour. There are three main elements:

a) Migrant Labour – If a proportion of the jobs created are expected to be filled by migrant labour, the opportunity cost to the economy, and thus the shadow wage, is assumed to be zero. Therefore the salary paid for these posts is included as a benefit;
b) Labour drawn from unemployment/inactive – Similarly, that a proportion of the jobs created will be filled from unemployed or inactive labour resource and this is assumed to have an opportunity cost of zero. The salary paid to these workers is therefore counted as a benefit; and

c) Wage Premium – If any of the jobs to be created / safeguarded involve a wage premium, the benefit of this is counted as a benefit to the economy. The shadow wage is calculated for each post on a low, central and high basis – to reflect the uncertainty regarding the correct shadow wage to be used. Potential candidates might be the regional average for the sector, the national average for the sector or the most likely alternative employment. The premium over the shadow wage is then calculated for each post and three scenarios are calculated based on the sum of the low, central and high estimates for all posts, respectively.

Efficiency Cost of Support

C.52 This is based on the presumption that additional government expenditure (and collecting additional revenue) involves an excess burden. The social cost of government expenditure is therefore likely to include both the opportunity cost of the expenditure plus a deadweight loss as a result of the distortionary effects of revenue collection. The BIS approach assumes that financial support by government should be considered as a transfer of wealth from one part of the economy to another. Therefore, only the deadweight cost is assessed.

C.53 The marginal excess burden of taxation (MET) represents the efficiency cost of raising each additional unit of government revenue. The MET has been calculated in a recent UK study as lying between 18% and 34% (with 80% probability) for tax increases used to finance government transfer spending. Therefore in the assessment, the low scenario assumes an MET of 100%, the central scenario assumes 34% and the high scenario assumes 18%.

Supply Chain

C.54 This component focuses on the additional employment created within the project’s UK supply chain. This is again based on the wage premium over the opportunity cost (shadow wage). Inclusion of this element is only permissible where this employment is not displaced from elsewhere in the economy.

C.55 There is no allowance for the additional value added created within the supply chain. However, it is accepted that there may be some benefit here – provided there is evidence that the supply chain is using resources more efficiently (e.g. economies of scale).

Economic Appraisal of Projects Requiring Financial Assistance to Industry

Innovation & R&D
C.56 The benefit here is based on the social return to Innovation and R&D feeding directly into the benefit stream from the public perspective. The social return is based on evidence, looking specifically at the sector and the firm involved — with low, central and high estimates used. This is then adjusted for leakage outside the UK — using low, central and high estimates of the proportion of the social return which will benefit the UK.

Skills
C.57 Whilst there is evidence on the social return to skill development, there remains a weakness in available data in that it focuses primarily on formal education levels. This component of the value narrative is primarily expressed on a qualitative basis and the focus is primarily on those skills which might be used outside the project. Therefore consideration will be given to whether the skills development involves a nationally or internationally recognised standard or qualification. Anticipated labour turnover is also likely to be a factor. Spend on skills development and the results of the skills test will also feed into this component of the value narrative.

Environment
C.58 This component focuses on any environmental impacts from the project — both positive and negative. It is important to carefully consider the counterfactual in order to identify truly additional environmental gains or losses. Examples might include reductions in carbon emissions, which can be priced using the shadow price of carbon, or detrimental impacts on water quality.

Real Option Value
C.59 This component looks at whether the project is likely to retain capability in the economy which will allow future projects to take place in the UK. It will not always be possible to quantify these benefits but in some cases, the applicant firm may have evidence of future activity which is dependent on the capacity remaining available in the UK. It is important to account for any future government support which might be attracted by potential future activity.

C.60 Following this, the results of the productivity test, skills test and cost per job calculations are presented.

CONCLUSION AND WAY FORWARD
C.61 Each of the approaches above have a number of weaknesses. Remaining with the status quo is, in our view, not a realistic option given the weaknesses we have outlined previously. The GVA model outlined above is based on the assumption that shadow prices are zero for labour, depreciation and amortisation. Whilst this may be a more realistic assumption than the current methodology (that shadow prices equal market prices), both scenarios represent the limiting cases and a realistic interpretation may lie somewhere between these two.

C.62 However, we believe the BIS model suffers from a number of operational difficulties. Primarily, the need to calculate appropriate shadow prices and the need to use suitable premiums for the social return to Innovation and R&D. Also, there may be a tendency for appraisers to demonstrate a lack of consistent approach, with some projects...
considered in a more conservative manner than others. We believe that further work should be carried out to look at these issues and to investigate how the BIS approach could be adopted and applied to NI projects.

C.63 One other possible solution would be to adapt the GVA model by relaxing the assumption of the shadow price equalling zero. The GVA impact can then be adjusted to take account of the direct cost of labour (at an appropriate shadow price). This should take account of the cost (to the economy) of the additional labour – including any displacement. For indirect effects, the positive difference between market and shadow prices can be taken on the benefit side by adopting the input / Output multiplier approach as above. When considering Innovation and R&D projects, the model could be adjusted for the appropriate ratio of the social return to the private return. The appropriate ratio would need to be the subject of further research. However, a key issue with any GVA model would be the lower GVA produced by certain R&D cost centres and transfer-pricing FDI plants – which may, in many cases, have relatively low profits to assign to the project.

C.64 The Review Panel therefore recommend the following:

a. A cross departmental team is established to continue consideration of the most appropriate way forward in developing the methodology for appraising projects requiring financial assistance to industry. This team should include representatives from the key stakeholders – DFP, DETI and Invest NI;

b. The team should commission any required research projects, under the auspices of the DETI research agenda. This will allow the team to consider fully issues such as the social return to Innovation / R&D and also appropriate shadow prices; and

c. The team would also be expected to provide a further assessment of the possible benefits and costs associated with the GVA and BIS / extended methodologies.
Annex D

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