The North East LEP Independent Economic Review

Summary of the Expert Paper and Evidence Base

CONTENTS

The Synthesis Report project is part financed by the North East England European Regional Development Fund Programme 2007 to 2013 through Technical Assistance. The Department for Communities and Local Government is the managing authority for the European Regional Development Fund Programme, which is one of the funds established by the European Commission to help local areas stimulate their economic development by investing in projects which will support local businesses and create jobs. For more information visit:
www.gov.uk/browse/business/funding-debt/european-regional-development-funding

EUROPEAN UNION
Investing in Your Future
European Regional
Development Fund 2007-13

THE NORTH EAST LEP INDEPENDENT ECONOMIC REVIEW

The importance of a strong and growing private, public and community sector in the North East has never been greater. The North East Local Enterprise Partnership (NELEP) has established a commission to carry out an Independent Economic Review of the NELEP economy to identify a set of strategic interventions to be implemented over the next five years to stimulate both productivity and employment growth. This Review has the full support of Central Government.

The Review team is led by ***Lord Andrew Adonis,*** formerly Secretary of State for Transport and Minister for Schools, who is joined by expert leaders from finance, industry, public and civil society:

Heidi Mottram, Deputy Chair of the Review team, CEO of Northumbrian Water and member of the CBI's National Infrastructure Panel

Lord Donald Curry, businessman and Chair of NFU Mutual

Will Hutton, Chair of the Big Innovation Centre and Principal of Hertford College, Oxford

Bridget Rosewell, Economist and Chair of Volterra Partners

Jonathan Ruffer, Chairman of Ruffer LLP

The team is supported by a number of international experts who bring significant expertise and knowledge to provide a wider perspective and challenge existing evidence and stakeholder views. In their role as critical friend, the experts have produced a series of think pieces, which reflect their understanding of the key issues facing the NELEP economy and respond to the emerging findings from the initial engagement process.

Economic Review Themes

The Economic Review is being taken forward on a series of broad themes which are:

- The North East in UK and global markets
- Capital markets
- Labour markets and skills
- Private and social enterprise
- Land markets and infrastructure
- Public policy

The broad themes reflect key challenges and areas of interest identified for the North East LEP and act as an overarching framework for the stakeholder engagement process.

Economic Review Process

The Economic Review is being taken forward in a series of stages. To date this has included:

- **Evidence gathering and stakeholder engagement:** This includes a request for written submissions from sectoral, professional and community groups as well as workshops with key stakeholders to gather information.
- **A summary of existing evidence and research:** This has been undertaken by SQW. Undertaken in parallel with the initial stakeholder engagement, this summarises the information prepared through previous research.
- **Production of a series of think pieces:** prepared by members of the Expert Panel supporting the Review Team.

This report **summarises** the evidence that has been submitted (in excess of 1,000 pages), highlighting thematic priorities which have been identified by the Review Team, Expert Panel and local partners and stakeholders. The report will be the basis of discussion at the Review Conference, which is being held on the 15th February 2013, and will inform the recommendations identified by the Review Team. It is structured around the key themes of the review, and includes a number of sub-themes which have emerged during the process, and particularly through the consultation responses.

The recommendations will cover actions that need to be taken forward with partners in the region and across the North of England and Scotland as well as actions that require Central Government intervention. They will be documented in a final report that will be submitted to the Deputy Prime Minister and cabinet colleagues, highlighting the strong explicit backing of central government for the North East LEP Independent Economic Review (NEIER).

Expert Papers

Innovation in North East England: Building Momentum through Specialisation	Chris Pywell
Skills and Labour Market Change	Professor Linda McDowell, Professor of Economic Geography, University of Oxford
The North East (NELEP) Area in the Context of the Global Economy	Professor Philip McCann, University of Groningen, The Netherlands
Transport and Infrastructure	Professor Iain Docherty, Adam Smith Business School, University of Glasgow
NEIER: Land Markets in the North East of England	Professor Henry G. Overman, London School of Economics and Spatial Economics Research Centre
The Regional Advantage: What the Manufacturing Location Calculus Implies for the Economy of the North East	Professor Susan Christopherson, Cornell University
Analysis of the opportunities and barriers to growth in key manufacturing sectors in North East Region	University of Sunderland
Analysis of the North East's Service Industries: Opportunities and Barriers to Growth	Northumbria University
Independent Economic Review of the North East Rural Report	Newcastle Institute for Social Renewal, Centre for Rural Economy, Newcastle University
Social Enterprise in the North East	Charles Seaford, new economics foundation
Financing Business in Slow Growing Regions: Is there a Case for Local Capital Markets?	Professor Ron Martin, Professor of Economic Geography, University of Cambridge
Access to Finance: A thought piece for the North East LEP Independent Economic Review	Professor Colin Mason, Professor of Entrepreneurship, Adam Smith Business School, University of Glasgow

Acknowledgements

The Review Team would like to thank the many organisations and individuals which have contributed to the evidence base and put forward views on future priorities. The various groups are set out below, and are fully referenced in an appendix to this report.

Local Authorities	Transport Providers
Sector groups	Developers and Property Professionals
Business Networks	Universities and Research Centres
Businesses	

Report Structure

The report is structured as follows:

- A brief summary of the TWCR Economic Geography Report which looked at economic performance between 2000 and 2008, the final eight years of the last growth cycle.
- The draft SWQ Consulting Review of Evidence for the Independent Economic Review
- The North East in UK and global markets.
- Innovation, including eco-systems and smart specialisation.
- Capital markets, focusing primarily on public sector capital provision.
- Labour markets and skills, including the recently completed skills plan.
- Land markets and infrastructure, including submission from property professionals and developers.
- Transport, including evidence from the major transport providers.
- Governance, including a paper for the LA7 Leadership Group.
- Advanced manufacturing, including automotive, pharmaceutical, low carbon and energy.
- Low carbon, covering off-shore renewables, low carbon vehicles and micro-generation.
- Service sector, focusing on a number of key sectors including business services, creative and digital, tourism, technology and software.
- Enterprise, including the social economy.
- Rural Economy.

The report concludes with a short section setting out the next steps in the review process.

ECONOMIC PERFORMANCE IN THE 2000-2008 GROWTH PERIOD

The Tyne and Wear City Region Economic Geography, Linkages and the Low Carbon Economy report was the most recent analysis of the last growth cycle, completed in 2010 to inform the City Region's Economic Review. This included large parts of both Northumberland and County Durham. The analysis highlighted the success of TWCR in employment growth when compared to other City regions. At the regional level, the North East went from being the lowest growing region during the 1990s, to one of only two regions (the other being London) to outperform national average between 1999 and 2009.

Employment In City Regions		**(ranked by size)**		
	Employment		**Change**	
	2000	**2008**	**No.**	**%**
Leeds CR	1,214,662	1,283,769	69,107	5.7
Manchester CR	1,128,926	1,170,476	41,550	3.7
Glasgow CR	769,698	848,776	79,078	10.3
Sheffield CR	649,783	710,452	60,669	9.3
Tyne and Wear CR	**636,340**	**693,978**	**57,638**	**9.1**
Liverpool CR	553,886	584,357	30,471	5.5
Bristol CR	484,131	522,342	38,211	7.9
Nottingham CR	354,509	375,026	20,517	5.8
Source: Annual Business Inquiry, 2008				

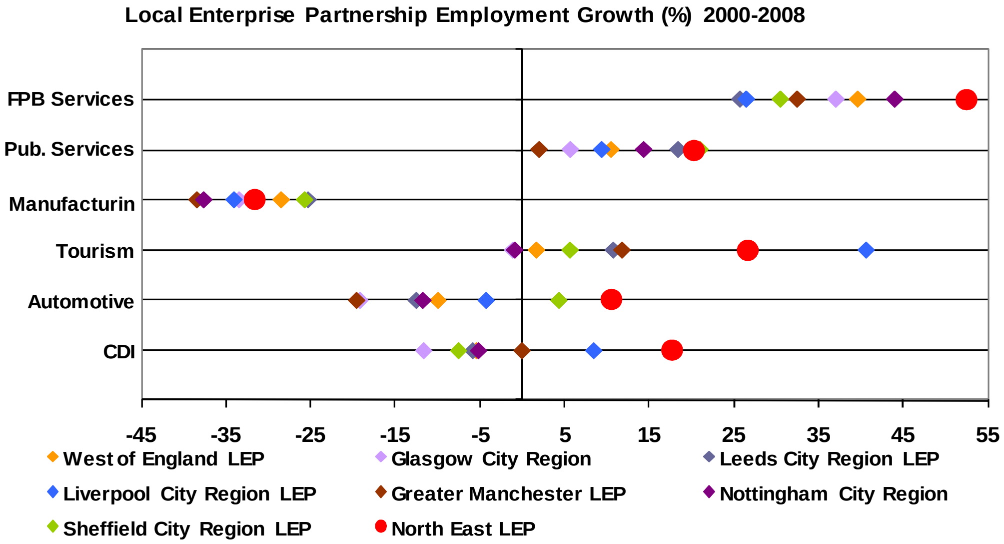
Although Newcastle is by far the largest employment centre a number of the other districts make a substantial contribution to the City Region's total employment base. These include Sunderland, Durham and Gateshead. The parts of the sub region which lie outside of the Tyne and Wear sub region, account for 28% of the City Region employment base.

Employment In Tyne and Wear City Region		**(ranked by size)**		
	2000	**2008**	**Change**	
	No.	**No.**	**No.**	**%**
Newcastle-upon-Tyne	160,766	175,674	14,908	9
Sunderland	107,713	119,287	11,574	11
Durham (parts of)	100,073	111,100	11,027	11
Gateshead	84,874	92,444	7,570	9
Northumberland (parts of)	78,101	84,991	6,890	9
North Tyneside	61,046	68,959	7,913	13
South Tyneside	43,767	41,522	-2,245	-5
Tyne and Wear CR	**636,340**	**693,977**	**57,637**	**9.1**
Source: Annual Business Inquiry, 2008				

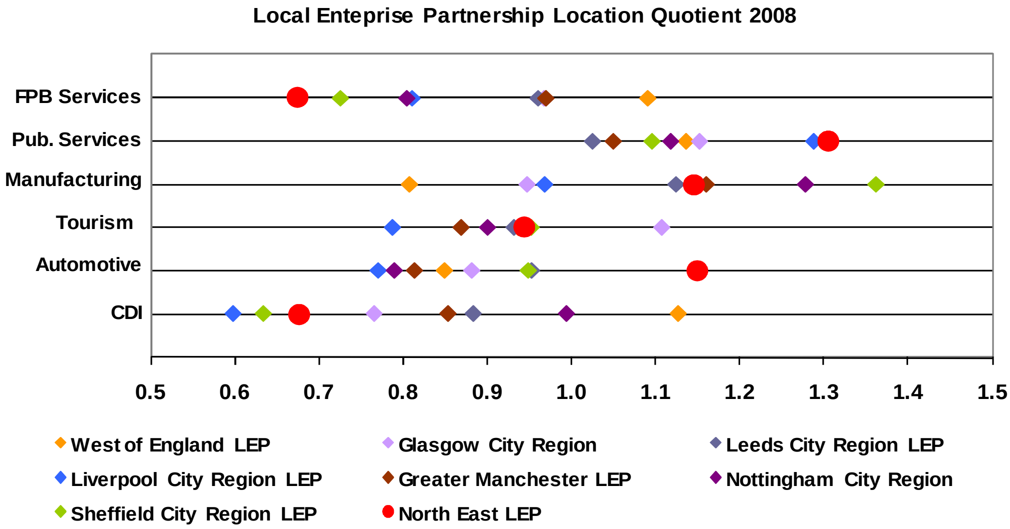
With the exception of South Tyneside, where employment numbers fell by 5%, the other districts grew strongly, notably North Tyneside with a 13% increase in employment. Durham and Sunderland also recorded double digit employment growth in the eight year period. This growth was all the more remarkable given the scale of manufacturing employment lost in the same period. The area benefited from strong employment growth across the sub sectors of financial, professional and business services.

Sub Sectors with a net employment increase of over 2,000 FTEs			
	Employment (FTE)		
	2000	2007	Change
Other Business Services	36,978	51,294	14,316
Public Administration & Defence	53,887	65,038	11,151
Construction	53,082	60,018	6,936
Financial Service	14,526	21,227	6,701
Education	52,902	57,638	4,736
Property	7,052	11,387	4,336
Accountancy, Legal & Consultancy	17,532	21,861	4,329
Health	80,311	84,515	4,203
Computer Services	8,821	12,821	4,000
Other Land Transport	15,742	19,565	3,823
Architectural and Technical Services	10,109	13,087	2,978
Ancillary Transport Services	7,152	9,914	2,762
Total	**358,095**	**428,364**	**70,269**
Source: Annual Business Inquiry, 2008			

Between 2000 and 2008, the NELEP area outperformed its peer group in terms of employment growth in a number of key sectors. In financial, professional and business services employment growth exceeded seven other city region LEPs, including Manchester and Leeds. It also recorded a very strong employment performance compared to other regions in terms of both creative and digital Industries and tourism.



Although the NELEP recorded very strong employment growth in a number of key sectors between 2000-2008 in many cases it was starting from a much lower base than other areas. Even after very strong growth, NELEP has a much lower level of employment in key sectors such as financial, professional and business services and creative and digital industries compared to the majority of competitor city region LEPs. This suggests there is scope for further growth.



While strong employment growth helped NELEP close the gap with other city region LEPs, a large part of the growth was in jobs with lower levels of GVA. This applies to key service sectors and reflects the type of functions being attracted to the region and in some areas, the limited size of local markets.

Several sectors have experienced above average employment and GVA growth (see Groups 1 and 2), although productivity levels vary and the GVA per FTE generated by the majority of these sectors is below 90% of the GB average. This is a particular issue for the larger sectors including financial, professional and business services and public services, which together account for 40% of the City Region's prosperity gap. The public services GVA/FTE variation with GB is not a sign of poor productivity, rather the variation consists of wages and other operating costs differentials.

City Region Strengths	
Group 1: High Productivity, High Growth Above average employment and GVA growth, productivity at least 90% of GB average	Construction; Creative and Digital; Mining and Metals; Research and Development
Group 2: High Growth Above average employment and GVA growth, productivity below 90% of GB average	Financial, Professional and Business Services; Public Services; Process Industries; Aerospace and Defence; Glass Products
Group 3: High Employment Growth Others with employment growth of over 4.5%	Transport; Tourism
Group 4 Others with productivity at least 90% of GB average	Health and Wellbeing; Automotive; Energy; Food and Drink; Timber and Wood; Other Services; Clothes; Other Manufacturing
Source: NEEM ,2007	

Implications and Economic Priorities

The analysis highlights a number of features, which have major implications for economic priorities in the City Region. These are:

- The group of high productivity (relative to the national average) and high growth (GVA or employment) in sectors is very small in terms of employment, and only one has significant employment potential – creative and digital.
- The high growth category is made up of a number of smaller manufacturing sub sectors (where employment has been in decline, although GVA is increasing) and two major components of service sector growth - public sector services, where employment in some sub-sectors has recently declined; and financial, professional and business services, where productivity is significantly below the national average.
- Private services' sector employment has dominated employment growth, and played a major role in off-setting the continued decline in manufacturing employment.
- It is likely that the major contributors to GVA and employment growth during 2000-2008 will also be the major contributors, albeit with some important caveats[1], when the economy enters another cycle of sustained economic growth – financial, professional and business services and creative and digital.

While the performance of the financial, professional and business services has been exceptional, the evidence suggests that the City Region is not capturing the high value added/high skilled employment needed to close the gap with other City Regions and the national economy. The major challenge is to generate and secure higher value added employment in key private sector service sub sectors.

At the time of the Economic Review, it was recommended that the priorities for growth should focus on wealth creation sectors, and not (solely) those sectors that are dependent on local demand. The potential growth sectors can be summarised as:

- **Private Sector Services:** Continuing to grow financial, professional and business services and in particular continuing the strong momentum which has been seen in the recent rapid growth of other business services and financial services. There will also be important opportunities linked to growing the tourism and creative and digital sectors.
- **Public Sector (not dependent on local demand):** Building on the four Universities role as key City Region Assets and developing Regional/National headquarters/service centres.
- **Industrial Base:** Focusing on the automotive sub-sector; the development of advanced manufacturing and process industries; and capitalising on opportunities presented through the development of the Low Carbon Economy. This includes diversifying some aspects of manufacturing operations and the manufacturing skills base.

[1] While there is uncertainty over the scale of future employment growth in financial, professional and business services and the extent to which the scale of employment growth in the 2000-2008 period can be repeated, TWCR is a competitive location for new investment in some sub-sectors and activities.

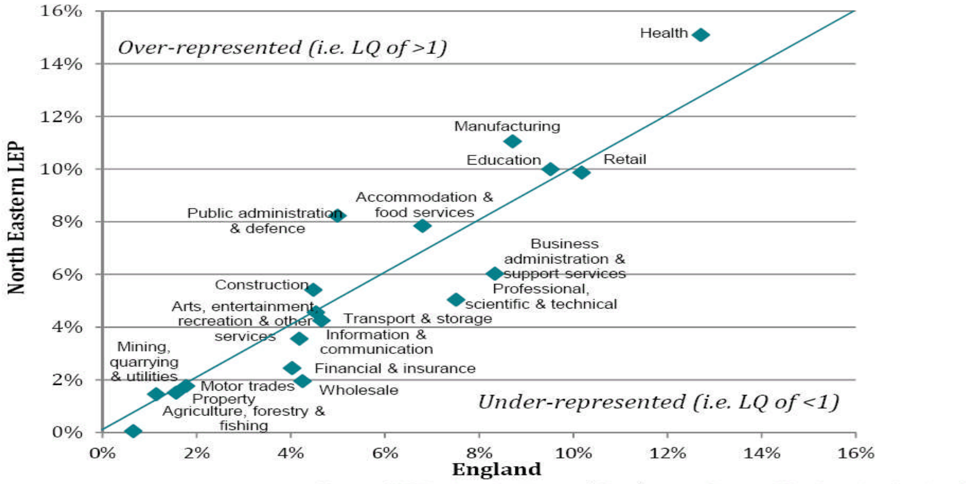
CONTEXT: SQW REVIEW OF CURRENT ECONOMIC PERFOMANCE

SQW were commissioned to review the existing evidence base related to the NELEP economy. The work involved reviewing over 100 documents and reports and was completed at the end of 2012.

The draft report provides an up to date picture of employment trends between 2008 and 2011. This shows that total employment in the LEP area has fallen by 6%, twice the rate of England as a whole. In terms of employees working in the LEP, the number of employees working full-time has fallen by 7% over the same time period, whereas the number working part-time has increased by 1%. The chart below shows the percentage of employees in each sector compared with the national comparator sectors. The NELEP is over-represented in a number of public sectors (such as health and public administration & defence) and also in manufacturing, and under-represented in professional, scientific and technical, and business administration & support services sectors.

Extract from SQW Evidence Base Review:

Figure 2-15: Percentage of all employees by sector (2011) England and North East LEP comparison

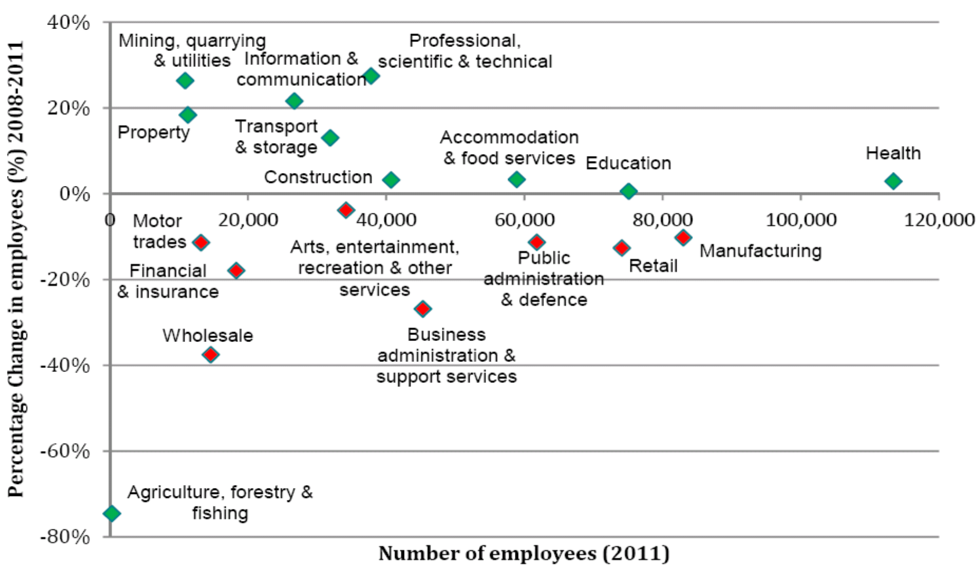


Source: ONS Business Register and Employment Survey. LQ = Location Quotient)

Over the same period, the professional, scientific and technical sector saw the largest increase in employees, rising by 26%. While the manufacturing sector is one of the largest employers in the LEP area, the number of employees fell by 10% between 2008 and 2011.

Extract from SQW Evidence Base Review:

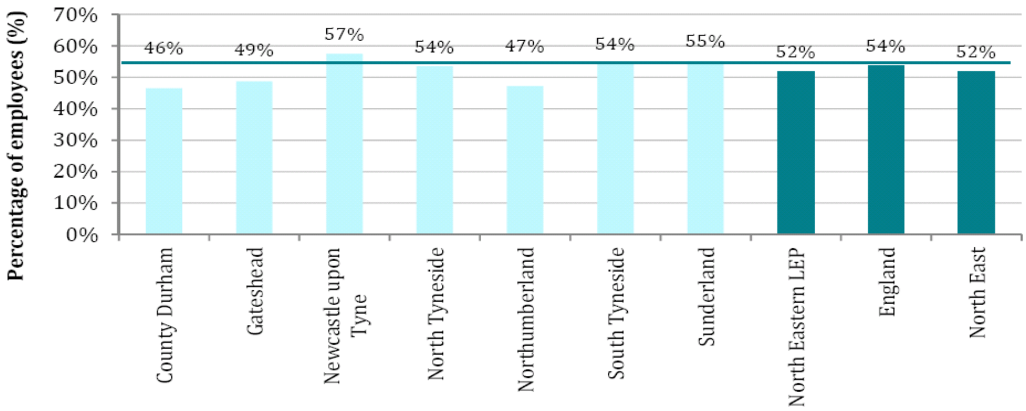
Figure 2-16: Change in employees (%) by sector for the North Eastern LEP area, 2008 - 2011



In terms of the percentage of employees in Knowledge Intensive Businesses (KIBs), the NELEP area average is slightly below the national average, although Newcastle upon Tyne had 57% of all employees working in KIBs compared to the national average of 54%.

Extract from SQW Evidence Base Review:

Figure 2-17: Percentage of employees in Knowledge Intensive Businesses (2011)

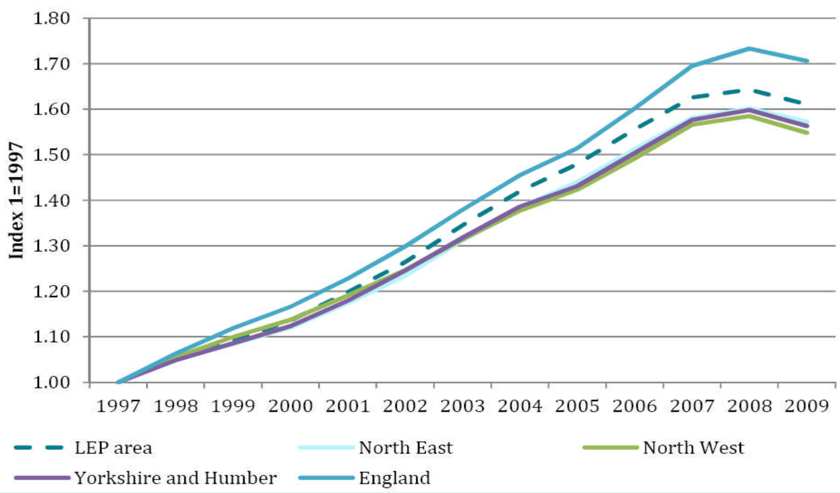


Source: ONS Business Register and Employment Survey

In comparison to the North East and other northern regions, the NELEP area experienced a higher GVA growth rate, although the gap with the national average has widened in recent years.

Extract from SQW Evidence Base Review:

Figure 2-2: GVA growth (1997-2009), Index 1=1997



Source: SQW analysis of ONS data. GVA at current basic prices.
Note: GVA data is only available from ONS at NUTS3 level and so a broad LEP area has been used (Durham CC, Sunderland, Tyneside and Northumberland)

The SQW report summarises the issues which the NELEP areas faces in relation to GVA and productivity. These are:

- The NELEP area lags the England average, and to a lesser extent the other northern regions, on almost all headline economic indicators.
- GVA per head across the LEP area is below the national average and, despite higher growth rate in recent years than the North East region, the gap with the national average is still widening.
- Key drivers of the GVA gap in the NELEP area are low employment rates, a low proportion of residents with high-level skills, and low enterprise rates.
- The productivity of those in work in the NELEP area also acts as a drag on GVA performance, underpinned by structural change from higher productivity manufacturing jobs to lower paid service sector jobs (dominated by public sector employment and low occupation levels).

SWOT

The existing evidence base is summarized in the SWOT analysis set out below:

Table 9-1: Summary SWOT analysis

Strengths	Weaknesses
• Substantial progress evident in improved skills levels: there are high proportions of adults with Level 4+ skills in Newcastle, North Tyneside and Northumberland– but low skills also an issue, both in these areas and elsewhere in the LEP • A relatively high proportion of employees continue to work in manufacturing. Advanced manufacturing, pharmaceuticals, energy/low carbon and environmental industries are important sectors. • There are marked concentrations of KIBs in Newcastle, North and South Tyneside and Sunderland • A strong performance in exports, especially in machinery and transport, has generated a trade surplus, which has held up well during the recession • Relatively strong performance in attracting FDI, and associated jobs • Outstanding natural and built assets, such as the Northumbria National Park and Durham's World Heritage Site • International access via Newcastle International Airport and the ports	• Under-performance in GVA per head, driven in part by issues around low employment rates and the productivity of those in work (especially as employment as shifted from higher value manufacturing activities to lower productivity service jobs) • Pockets of deprivation in both urban and the more rural, ex-mining parts of the LEP. Associated issues around multigenerational worklessness, making it difficult to mobilise the potential workforce. • Issues around connecting those in need of work with areas of employment growth, especially via public transport • The prevalence of employment in lower value activities and occupations, and an under-representation of residents with higher level skills • High dependency on the public sector for employment (including for KIB employment), an under-represented private sector, and under-representation of employees in higher value added services such as business administration, professional and technical sectors • Low levels of innovation intensity • The demand for finance, and the ability of businesses/social enterprises in the North East to develop high quality and viable commercial propositions • Poor broadband connectivity in parts of Northumberland and County Durham • Poor housing stock in some areas, and limited choice of better housing across the LEP area, acting as a barrier to attracting skilled workers • Low enterprise rates and tendency to depend upon large employers and the public sector as a source of investment capital
Opportunities	**Threats/challenges**
• Build on current strengths in exports – and encouraging more of the business base to export – which will help rebalance the economy. • Excellent academic / research / FE and HE institutions – build on innovation assets • Build on high value added/advanced manufacturing sectors, providing an opportunity to raise productivity levels – e.g. in vehicles, offshore energy • The NELEP's Enterprise Zone, provides a major opportunity to attract investment, build further on the area's sectoral strengths and create jobs • Enable and increase homeworking, especially in more rural and remote parts of the LEP • Opportunities to increase the social economy, which could encourage greater entrepreneurial activity • Potential opportunities from the ageing population, particularly given the NELEP's excellence in health research and care.	• Address barriers to inward investment – especially infrastructure • Improve the speed of broadband connectivity in rural parts of the LEP, which could limit future economic growth and access to services/social media for the LEP's businesses and residents respectively • Address the under-representation of private sector business (with the aim of creating a bedrock of growing medium and large companies), and the over-reliance on the public sector, to improve the resilience and diversity of the economy • Raise skills levels – especially in STEM skill – and linking these more effectively with the sectoral strengths in the LEP area • Improve graduate retention (and ensuring graduates are not under-employed), and the ability to attract highly skilled workers to the area (e.g. by improving housing offer, promoting the quality of life advantages effectively) • Risk of long-term unemployment for young adults currently out of the workforce • Address shortage of the right quality/location of commercial property • Vulnerability to business decisions made outside reinforcing a continued sense of being a 'branch plant' economy in some respects • Move away from an over-dependence on the public sector for employment, and stimulate growth of the private sector • Stimulate private sector investment capital and capital markets in general.

Source: SQW review of literature

Evidence Base Conclusions

The review concludes on a positive note: "*In summary, the NELEP area is home to some distinctive assets and strengths, which have the potential to generate a real competitive advantage in future – and to realise the Government's ambitions for sustainable economic growth and rebalancing the UK economy. Advanced manufacturing, pharmaceuticals, energy/low carbon and environmental industries are particularly important sectors for NELEP: they offer innovative, highly productive and world-class activities. Many of NELEP's successful businesses hold a prominent position in international market places, with exports for goods such as machinery and transport holding up relatively well. These are strong foundations on which the economy can build".*

A number of challenges are however identified which are linked to the location, economic history and scale of the city region. The report states that while these factors cannot in themselves be changed, recognising the position will help frame actions which can counter their role in limiting economic prosperity. The issues to be addressed include:

- Under-performance in GVA per head and productivity, linked to low skills, under-employment, the nature and type of work mainly on offer (lower value added, service functions), low enterprise rates and a low innovation intensity.
- A high dependency on the public sector for employment (including for higher skilled and KIB employment) and investment capital. An associated need to stimulate more private sector growth.
- Poor infrastructure, such as broadband connectivity in parts of Northumberland and County Durham, poor housing stock in some areas (and a limited range), and inadequate commercial property in some locations.

THE NORTH EAST IN UK AND GLOBAL MARKETS

The **Expert Paper** prepared by **Professor Philip McCann of the University of Groningen**, begins by setting out the rationale for the continuing trend of increasing globalisation, despite international economic events. It also highlights the importance of the NELEP economy making gains with regards to international engagement in the current climate to support the regional economy over the longer-term:

> *"The world is less interconnected than most people assume and in every country most economic activity is related to domestic issues. Yet, in spite of the economic dislocation and falling international connectedness in the aftermath of the 2008 Global Financial Crisis the long run trajectory is still towards increasing globalisation. The reason is that almost all forms of economic internationalisation and multi-nationalism generate greater economic rewards than purely domestic activities.* ***Therefore, the benefits to UK regions of promoting greater international and global connectedness are very significant and will continue to be so."***

> *"This is a timely discussion, because the need to foster greater international economic engagement is urgent. Economic downturns are periods when market competition is greater than ever, and the need for innovation is absolutely paramount in order to compete successfully. At the same time, achieving competitiveness in difficult periods also ensures that firms are best-placed to reap significant benefits when the economy again expands.* ***In the current climate, driving further international engagement for NELEP area firms is therefore critical to build a solid grounding for the long-term future of the regional economy."***

The Changing Role of the UK Economy in the Global Economy

The UK is currently the world's ninth largest manufacturing economy by value-added, down from the fifth ranked nation in 1990, having been subsequently overtaken by China, Italy, Brazil, South Korea and France. Service type activities account for up to half of manufacturing jobs, and their share is correlated with overall skills levels.

For countries such as the UK, most trade and also most cross-border inward and outward foreign direct investment is with neighbouring and nearby countries and also countries which are the most similar in terms of institutional and cultural issues. This is why although the rise of China and other BRICS countries offer important new markets for UK firms, the future of UK trade and international engagement remains largely contingent on the performance of European and other advanced economies.

UK exports to the Republic of Ireland are largely equivalent to the combined sum of all UK exports to China, Brazil and India combined. Europe is increasingly shifting towards medium and high value manufacturing activities and is actually increasing its relative global dominance in these fields, and Germany and The Netherlands have increased their share of activity in all levels of the manufacturing global value-chains.

The relationships between UK and Europe differ very little according to the type of the sector concerned. The typical observation in all sectors is that the EU accounts for something of the order of 43%-45% of all of the UK domestic value-added and employment which is associated with foreign demand, and the EU figures are some 4.35 times the total demand associated with all of the BRICs countries combined.

The characteristics of the international engagement of the NELEP area with the global economy will share many of the features already identified above regarding the evolving features of the UK with the global economy. At the same time, there will be specific features of the NELEP area economy which are rather distinct from those evident at the UK national level.

On the input side and also on the output side, the NELEP area is becoming increasingly more integrated with Europe, both relative to total output and also relative to trade with the rest of the world. Inward FDI projects in the region have tended to be biased towards the production of tangibles (goods) rather than intangibles (services), aimed more at increasing production capacity in situ than in initiating new activities. Over recent years the North East has displayed the lowest share of inward FDI projects with R&D capabilities of any UK region.

Building up knowledge-related capabilities via inward FDI in manufacturing is a priority and offers an opportunity for upgrading the regional production system, because knowledge spillovers in manufacturing are typically distributed more widely across the country than other sectors, and are not confined primarily to particular core regions or to cities in general.

The NELEP Area as a Global Region

The **SQW Review of Existing Evidence** highlights the importance of growth in exports, particularly for manufacturing companies in the North East. Following the recession and subsequent fall in UK consumption, firms have had to become more competitive abroad, particularly outside the EU. The report notes that:

> *"Strong exports are crucial to deliver strong, sustainable and balanced economic growth. Furthermore, it is now widely accepted that exporting companies are: more productive than non-exporters; achieve stronger financial performance; are more resilient and are more likely to stay in business; achieve economies of scale not possible domestically; increase the commercial lifespan of their products and services; and increase the returns on their R&D investments. In short, the evidence is unambiguous in that exporting businesses are becoming increasingly important for UK plc and this also applies for the NELEP economy."*

North East companies are already utilising this thinking; in 2010, it was the only region in the UK to achieve a trade surplus (+£2.5bn). In the year to June 2011, the North East increased its exports 21% (compared to a national average of +15%) on the previous 12 months to a record £12.9bn. This included 20% growth in exports beyond the EU. Goods exports account for a larger proportion of GVA in the North East than any other UK region – this represented 29% of total GVA in 2010.

The profile of the North East as export-intense makes it unique in the UK. Strong export performance is a major regional strength, and this perception is growing with the total value of exports. To increase exports in the North East region, it will be vital to maintain and develop the strong linkages that businesses currently have with international suppliers.

This applies to both the manufacturing and service sectors. As noted in the **Expert Paper**, although 80% of global trade is in goods (with 70% in manufactured goods), 40% of the UK's exports are in services.

The importance and potential of inward investment activities in stimulating growth is also highlighted in a number of responses to the Economic Review. This includes the response from **Bionow**, on behalf of the life sciences sector. It outlines that companies in the sector address a truly global market with an estimated size of $1-1.5 trillion (pharmaceuticals, medical biotechnology and medical devices combined) and with growth rates of 5-10%. The sector is a strong exporter with the North East, along with the North West one of the largest exporters of pharmaceuticals.

It estimates that based on the composition of companies in the region the sector has the potential to add £0.8-1bn turnover (approximate to GVA) organically over the next 10 years and suggests that this economic growth could be significantly increased by inward investment and growth in academies and the NHS. The potential is further highlighted by the region's strong overseas cultural and trade links to clusters that represent good trade and collaboration opportunities in life sciences. Leveraging these ties and looking at innovative models to build "economic bridges" could ensure sustainable growth from these relationships.

The Internationalisation Vision

While the **Expert Paper** recognises the experience and strong positioning of the NELEP area as an exporting region and base for inward investment (particularly in key engineering and energy-related technologies), it also notes that given the major institutional changes in the UK local economic development arena over recent years building a NELEP area vision for enhanced ongoing international engagement is essential.

Three complementary actions are then required to drive the vision:

- **Mentoring those at the early-stage of the exporting process:** Mentoring is a critical element at this stage and local mentors who know both the local as well as the overseas markets are invaluable. Mentors will be able to encourage local SMEs which have been purely domestically-focused to initially target European markets. In these cases, the proximity facilitates the frequent face-to-face contact with customers, agents and distributors which the commencement of exporting activities requires. Once a firm has a successful experience of exporting in geographically closer markets, it is then in a stronger position to target more geographically distant and culturally different markets.
- **Building local public-private partnerships to attract inward foreign investment:** This will ensure that activities (i) exploit the synergies between the local supply-chain requirements of the inward investors and the regional assets to attract investors, and (ii) identify the complementarities and overlaps in the value-chain needs of different inward investors and

target policy towards the strengthening of specific value-chain synergies to enhance the impact of inward investment on the local economy. The former will include ensuring that the local skills provision is appropriate for the needs of inward investors.

- **Increase global engagement in all overseas markets:** Enhancing both regional exporting and foreign investment activities depends on simultaneously exploiting both the European context and also opportunities from further afield such as the USA and BRICs countries. Discussions in some sections of the press often give the impression that UK businesses should target markets in North America, Australasia and emerging markets such as the BRICs and largely forget about Europe. In reality, however, the best globalization strategy is to focus on all overseas market arenas simultaneously, and to target global engagement in general, of which European markets are still a critical element.

Policy Ideas

While creating and taking forward a NELEP area vision will be an important step, the **Expert Paper** also recognises the need to continuously increase the quality of export activities as well as international investment activities to maintain a competitive position globally. This takes account of both the rising demand from advanced and emerging economies for the types of differentiated and high value goods and services in which advanced economies specialise, as well as the competition from competitor countries, namely those same countries with which we share most of our trade and international investment activities. Three key policy ideas emerge:

- Enhancing local-global value chains
- Smart specialisation
- Institutional capacity

Enhancing Local-Global Value-Chains

The evolving international economic landscape, characterised by fragmenting and reconstituting global value-chains, requires that all areas of the value-chain from the low value-adding activities to the very high value-adding activities must be upgraded in order for products and services to compete successfully for the final demand. At the same time, upgrading at all points along the value-chain is also necessary in order to 'anchor' particular activities in a region as far as possible. This is because there is greater competition than ever for foreign direct investment, because such investments link regions to the global economy via the exchange of knowledge, people and resources, and firms operating in global value-chains cannot afford to face bottlenecks or missing links in their operations.

These value-chain arguments do not apply solely to manufacturing or goods trades but to all modes of international engagement. In the case of the UK, it is clear that services not only account for an increasing share of UK exports, but also that service-type activities are both heavily represented in manufacturing industry and that the value-chain effects of foreign demand are also highly favourable to UK service activities.

Over the last two decades NELEP area service industries have been slowly increasing their European presence, as is consistent with UK trends. However, there are also many other high quality and innovation-based sub-sectors where global demand is expected to grow rapidly in response to changes in tastes, demographics and environmental issues, including vehicles, machinery, low carbon technologies and materials, medical and scientific procedures, education, e-learning, healthcare, and infrastructure.

These are also sectors and emerging technological fields where the NELEP area already has many strong and existing capabilities, and helping firms to diversify around these technologies and capabilities in order to gain new export markets could potentially provide a major logic for a local NELEP area policy prioritisation over the coming years. This is not to be understood in terms of a sectoral approach of 'picking winners' but rather in terms of themes around which export-led policy prioritisation logic might be built. One of the cross-cutting areas where the North East already has real experience and expertise is that of the Low Carbon and Environmental Goods and Services (LCEGS) sector.

Smart Specialisation

During the last few years there has arisen a new consensus regarding regional innovation policy in the context of evolving global chains, under the heading *smart specialisation*. This agenda has been closely associated with the reform to EU Cohesion Policy, but has also gained wider interest from various OECD countries.

The *smart specialisation agenda* focuses on the need to develop local innovation-related policies based on a clear *policy-prioritisation framework*, the logic of which is *built explicitly on the basis of the region's* *economic structure and also on the likely emerging technological opportunities consistent with the region's existing industries, skills-profile and knowledge assets*. The aim is to foster entrepreneurship in activities which are well-suited to diversifying the regional economy, but in a way which is closely related to the region's existing structure and capabilities within the context of global value-chains.

The *smart specialisation agenda* is not intended to encourage increased regional sectoral specialisation, but rather, to develop a policy prioritisation logic which *is focused on enabling and encouraging firms and activities which are diversifying around the region's existing skills and knowledge base*. This argument is known as 'related variety', and the logic here is that technological upgrading by means of diversifying into technologies and skills which are closely related to a region's existing technological and skills profile is likely to offer the best long-run growth and innovation prospects.

This approach also implies that policy-prioritisation must be appropriate for a given regional context and tailored to its features, and especially focused on the interactions between technology and skills at all levels of the value-chain. Strong value-chain linkages facilitate the embedding and 'stickiness' (Baldwin and Evenett 2012) of activities in a region (McCann and Ortega-Argilés 2013) and also help to foster future investment.

We have seen that *the NELEP area has a strong public sector knowledge and human capital base in comparison to its competitor regions. Finding ways to link the local higher and further education institutions on a much broader and deeper basis with the local private sector activities would appear to be both an imperative and also an opportunity.* New forms of job placement schemes, revolving skills-based and technology-based internships, re-training schemes and technology-transfer schemes focused on the upgrading of supply-chains are all initiatives required for 21st century development. Moreover, these do not necessarily have to be focused only on manufacturing.

As is clear, European global value-chains have major and positive implications for total employment (Baldwin and Evenett 2012; Timmer et al. 2012b) even when headline manufacturing employment is falling. At the same time, prioritising the development of skills which are tailored to the emerging demands of major exporting employers along with SMEs which comprise the local value chains would also appear to be a priority. Where synergies in these skills can be identified across a range of different firms, this would appear to be even more significant.

Institutional Capacity

Initiating the types of institutional and governance changes required to implement these types of actions requires local leadership (Stimson et al. 2009) because they inherently cut across departmental or institutional boundaries, and require coordination across different actors or agencies. However, medium sized city-regions such as the NELEP area do offer possibilities (Kresl 2012) for building collaborative leadership systems in which decision-making is increasingly shared across all local stakeholders. Collaborative leadership is essential in order to establish the levels of policy continuity required by private sector investors.

OECD (2012a) evidence suggests that amongst the most pressing problems facing non-core and peripheral regions are institutional and governance issues, and getting these issues right appears to be crucial. Those non-core regions experiencing economic growth invariably exhibit good institutional arrangements while those struggling economically invariably exhibit poor levels of institutional alignment.

Many regions internationally have developed novel approaches to upgrading and galvanising their local institutional arrangements so as to foster local economic development, including inward investment.

The Role of the NELEP

The **Expert Paper** is clear in articulating the importance of the role which the NELEP can play in driving international engagement in the area. OECD evidence shows that for regions with 'catching-up potential' such as the NELEP area, having appropriate and well-working institutions is essential. At present many of these activities within England are currently highly centralised, and this is very problematic. The **Expert Paper** notes that:

> *"It is wholly unrealistic to expect that central government decision-makers have either the knowledge or expertise regarding local NELEP area issues - of a technological, skills-related, or institutional nature – in order to make sound judgments appropriate to the context."*

This is echoed in the response from **Bionow,** focusing on the North East's life science sector, which argues that the region currently does not present a coherent image to the global life science community to drive trade and inward investment and that sectoral experts are required to support the process. It sets out that while, inward investment has the potential to significantly enhance sector growth, the centralisation of this process by government severely disadvantages the North East with the sector being highly specialised and technical, primarily B2B, heavily regulated and with complex supply and routes to market.

The positioning of the LEP to engage with the private sector and mobilise local knowledge in international activities is highlighted in the **Expert Paper**. In particular, it suggests that the role for the LEP should entail:

- Acting as the focal point where different local institutions and actors come together to cooperate, coordinate and plan their activities regarding the upgrading of all aspects of the local value-chains.
- Galvanising private-sector engagement in helping to attract new entrants to the region from all regions and countries, working in partnership with UK Trade & Investment (UKTI).
- Encouraging local SMEs to engage in early-stage exporting, and to help small exporters to grow their overseas markets.
- Providing data, evidence and reconnaissance on local skills, training, technologies, market niches, and trade linkages to local investors and also potential interested investors from overseas, who are considering the NELEP area as a place to establish or expand their businesses.

The resources that this role would require are also noted, with the recommendation that the LEP be provided with the appropriate resources and autonomy in order to allow it to successfully undertake these essential and locally-specific roles in partnership with the umbrella role of UKTI, while at the same time also taking responsibility for monitoring of the outcomes of any local policy actions or initiatives.

Support from the Higher Education Sector

Recognising the sectors' involvement in R&D and innovation and the links they are able to generate with potential investors, the response from the **North East Chamber of Commerce** on behalf of the HE sector, recommends that the assets and expertise of the four NELEP universities should be placed at the heart of coordinated inward investment activities. It also suggests that a joint agreement between the universities, LEP and UKTI would ensure that maximum economic benefit can be derived from their overseas activities.

Greater Scottish Autonomy: Opportunities for the North East

The **Association of North East Councils** (ANEC) commissioned the **Universities of Northumbria, St Durham** and **IPPR North** to examine the opportunities for collaboration between the North East of England, Cumbria, and Scotland in the context of greater autonomy for the latter. The research is still in progress although emerging themes from the research that are of relevance to the NEIER Independent Economic Review have been shared (based on the views of the research team rather than the official view of the project sponsors).

The research draws upon detailed interviews with a range of key stakeholders from both sides of the border, presentations to both the North East and Tees Valley LEPs; and the holding of three roundtable events (in Durham, Carlisle and Edinburgh) in late 2012/early 2013. These events included over 40 representatives from local authorities, economic development bodies, private companies, tourist organisations, government departments, and universities from both sides of the border.

The research found a renewed appetite for collaboration between the North East, Cumbria and Scotland, across the Border, between the cities, and amongst the institutions which take the lead in economic development, but there was also a marked uncertainty about who and how this collaboration should take place.

While stakeholders in the region did not underestimate the competition likely to be provided by a stronger Scotland – indeed, some felt that Scotland already had major advantages – many emphasised the positive benefits for the region that stem from the granting of greater economic and fiscal powers to Scotland. There was a general view that in the period leading up to the 2014 referendum, the Scottish Government would be genuinely receptive to new ideas and approaches. The research also found support for the idea that the focus on a more independent Scotland would provide a useful agenda around which to reinvigorate 'East-West co-operation' within the North itself.

It was widely acknowledged that any collaboration would need to be: realistic, both in terms of political feasibility and resource availability; genuinely add value to what is already available; not involve yet more bureaucratic structures; avoid a 'one size fits all approach'; and accept that, invariably, collaboration in a few areas will exist alongside robust competition in others.

Economic sectors where collaboration and joint-working would be beneficial were identified as:

- Transport (including High Speed Rail; Roads; Ports; and Airports);
- Tourism (particularly closer to the Border);
- Rural Development (including super-fast broadband);
- Renewables (particularly off-shore wind);
- Business Development; and
- Education and Skills.

It was also highlighted that a more informed debate about opportunities for collaboration would greatly benefit from an up-to-date and detailed clarification of the economic and business inter-relationships between Scotland, the North East and Cumbria.

The paper on emerging findings recommendations sets out the need for the North East (and Cumbria) to show they wish to support Scotland's future development and growth: that they wish to retain and further develop their links with Scotland and contribute to its resurgence.

Three initial areas for action are listed: (i) activities to establish connections that help create and sustain cross-border relationships, and identify potential synergies that can be the basis for collaborations, (ii) involvement in the devolution/independence debate in Westminster and Whitehall, and (iii) exploring collaborations relating to transport.

The actions suggested include:

- The NELEP, together with NECC and ANEC, could set up a Standing Conference of key stakeholders from Scotland and the North East;
- The NELEP, together with NECC, ANEC and other partners could encourage and facilitate sector-based groups covering areas of the economy that have strong cross-border interests
- Working with ANEC and the individual local authorities, the NELEP could facilitate the development of a Border Network encompassing the four local authorities on both sides of the border. Diversification of the rural economy across Northumberland, Cumbria, Dumfries and Galloway and the Scottish Borders is both a major challenge and opportunity which could benefit from economies of scale to deliver broadband, transport, tourism, and other business environment services.
- The NELEP could open up dialogue with the Treasury on concerns that the area may have about tax changes (including Air Passenger Duty) that could have a serious negative impact on the North's competitive position.
- The NELEP could use the Scottish issue as a lever to press home the case for greater devolution of economic powers to the LEP level, particularly in relation to skills and transport.
- The NELEP, with other partners, could look at ways of improving transport connectivity. This could include joint North East and Scotland campaigns on High Speed Rail; and also exploring collaborations with ScotRail for improving cross-border rail services.

Overall, the paper concludes that the prospect of further autonomy for Scotland has rekindled an appetite for collaboration across the Border. There is considerable opportunity to refresh that collaboration between partners across the North East and Cumbria, in ways that will support the growth of the economy, and improve the quality of life of the citizens who live and work in these communities.

INNOVATION

The SQW Review of Existing Evidence notes that the NELEP area has several national innovation assets including the New and Renewable Energy Centre (NaREC), Newcastle Science City and the North East Technology Park (NETPark).

These assets have expertise spanning a number of key sectors and areas of innovation. In particular, Science City comprises Science Central, the Institute for Ageing and Vitality and the International Centre for Life, while NETPark is home to the Centre for Process Innovation (CPI).

CPI is an internationally leading organisation in printable electronics, industrial biotechnology, smart chemistry, thermal technologies and sustainable engineering, which is recognised by its inclusion in the Government's first High Value Manufacturing Catapult. The catapult is the UK Technology Strategy Board's national programme to support innovation in sectors such as automotive, aerospace, food and drink and energy.

In spite of these assets, the OECD report indicates the North East of England underperforms in relation to basic innovation input and output indicators (such as business and government R&D, patents and high technology employment) compared to the UK and other regions in peer countries.

A recent report by the Northern Economic Futures Commission comments that the north faces a number of challenges in relation to improving its innovation performance. These include:

- Difficulties attracting and retaining high-level skills and graduates.
- Under-developed processes for commercialising technological development (with poor connections between the science base and businesses and a lack of investment capital).
- Inadequate scale and intensity of innovation networking to enable 'open innovation'.

The need to improve innovative activity within the region is identified as a current challenge to the future economic growth of the region.

Innovation in the North East

The **Expert Paper on Innovation** produced by **Chris Pywell** states that:

> *"The North East of England is relatively well placed to benefit from future global developments and growth. The region is the location for a number of strong activities and assets in the areas of innovation that are being most targeted as the sources of future international growth. These include innovations in energy, transportation, robotics, ageing and environmental regeneration*."

The paper also notes that the region has innovation related assets in its universities, specialist development facilities, people and companies and has attracted inward investment in part on the basis of these innovative capabilities.

It then makes the important caveat that many of these innovative assets are at best emerging and often lack scale. However, the future outlook is favourable as the North East structure and strengths are arguably more aligned with future priority growth areas. It suggests the North East is best able to increase its innovative activity by focusing on specific aspects of innovation for certain market applications, where existing specialisations can be built upon in an accelerated and more extensive manner. Essentially success in innovation depends on the extent to which the area's businesses and organisations can adopt and adapt innovations developed elsewhere.

Innovation Opportunities for the North East

The **Expert Paper** identifies three areas that offer opportunities for innovation in the North East. These are:

- **Energy:** The paper cites innovative opportunities arising from energy research in the region's universities and companies, its major testing facilities at NaREC and important development programmes such as having one of the largest smart grid application projects in Europe. The North East's strengths in energy include clean coal, oil and gas, hydrogen, offshore wind and biomass. The region is also involved in manufacturing and servicing energy equipment and has one of the largest 'design' engineering clusters in Europe.
- **Transportation:** The North East leads in the automotive sector and the related supply chain as well as in its application of electric vehicles and other low carbon technologies. The region is also the location of major corporate centres of some of Europe's leading transport operators and is a leader in the application of light rail.

- **Ageing and Vitality:** The region has one of the world's leading centres for ageing and vitality, with further strengths in the NHS, the third sector and a growing group of innovating companies. Newcastle Science City also comprises a Campus for Ageing and Vitality – see below.
- **Other Areas:** It has major strengths in education for fashion, industrial and wider design. There is also expertise and success in environmental regeneration, such as the remediation of industrial pollution in the rivers and coastlines.

The North East has been the beneficiary of substantial inward investment in the above areas. The papers draws attention to a notable shift in the focus of inward investment from access to markets, relatively low cost labour and incentives towards skills, supply chains, innovation chains and innovative capacity.

Sectors Supporting Innovation in the North East: Science and Technology

The 2008 OECD review of regional innovation in the North East highlighted Science Cities as the 'first national programme to link science, innovation and urban regeneration' to 'provide valuable learning for place-based innovation support'. The report also stated that 'the designation of Science City has appeared to have the most catalytic impact in Newcastle'.

The vision for Newcastle Science City (NSC) is to ensure that Newcastle is synonymous with excellence in order to attract investment, talent and growth to the city and the wider region. To achieve this, Newcastle Science City co-ordinates and promotes the Newcastle offer, attracts investment, creates and supports innovative businesses, and engages with the local community and business networks.

The Newcastle Science City vision is articulated around three themes: Ageing and Health, Sustainability and Regenerative Medicine; and manifested in three places in Newcastle: Science Central, the Campus for Ageing and Vitality and the International Centre for Life.

In their response to the Economic Review, **Newcastle Science City** states that it 'is well-placed to provide cross-organisational partnership support between private and public sector institutions in Newcastle, and act as a connective node to emerging multi-scalar innovation policy nationally and in Europe, in order to attract and secure long-term investment in the city region and wider NELEP geography'. The response includes details of the following areas where the organisation is particularly well placed to support innovation:

- **Sustainability:** NSC is very well placed to provide an active forum for working across public and private sectors in the region and supporting the regional agenda on low carbon vehicles. The NSC Board members are working to capture and evaluate the region's wider assets in this field, energise the debate on how the region can capitalise on and grow the assets it has and collectively drive this agenda forward in the future (see Low Carbon Vehicle submission).
- **Ageing and Vitality:** Newcastle's world class research into ageing within the Institute for Ageing and Health (IAH), concentrated predominantly at the Campus for Ageing and Vitality represents a unique model of excellence for research, translational medicine, business collaboration and public engagement.
- **Stem Cell Research:** The International Centre for Life (ICFL) is a world leading facility for stem cell research, business and public engagement.

The response from the **International Centre for Life** (ICFL) draws attention to its UK Maker Faire – the Centre's largest programme with the biggest economic impact. The large scale festival of DIY technology is seen as a catalyst for 'Maker Culture' in the UK, attracting innovators and small-scale manufacturers from across the country (and beyond). The event has also inspired the creation of community workshops (known as 'hackerspaces') across the Country. While ICFL believes that there is potential to increase local capacity for innovation through such events or by targeting niche opportunities, the costs of such activities are also highlighted. It calls for increased support for events and ongoing resources, such as larger community workshops to help realise this potential.

The Role of Higher Education

The contribution of the Higher Education sector, both in relation to research and development and Knowledge Transfer Partnerships (KTPs), is highlighted in the response of the **North East Chamber of Commerce** (on behalf of the four universities). Each of the four universities produces high quality research which is world leading according to RAE 2008 levels and all offer KTPs as means of sharing expertise with businesses looking to innovate or solve a complex problem. However, while there are some excellent examples of successful KTPs, demand from businesses is well below what the universities could handle.

There are opportunities for growth and further innovation by improving links between universities and SMEs. The identification of high growth and innovative SMEs would help universities to target their resources towards such enterprises. The response also recommends that activity to raise awareness of KTPs at the LEP level would also be beneficial.

Innovation Challenges for the North East

The **Expert Paper** identifies five key challenges that could potentially undermine the growth of the region's innovative activities and capacity. These include:

- **Insufficient capacity:** Many of the region's innovative activities and companies are small scale and lack the critical mass necessary to succeed internationally. These firms are often at an early stage of development and could easily be overtaken by more experienced competitors.
- **Asymmetrical Information:** The region's business support providers, including its nascent professional services sector, may not adequately be aware of or understand the requirements of its innovative opportunities or businesses. Consequently, the region may not be able to achieve it full potential.
- **Low Productivity Sectors:** The North East history of undertaking less competitive activities and low productivity may act as a constraint to the development of new growth areas. Some of these activities are facing global decline and others are at significant risk of its resources shifting away from declining areas into new growth areas, whilst ensuring opportunities and benefits are widespread and fairly distributed across different areas and groups.
- **External Competition:** Unless the North East accelerates its innovation activities it faces the risk of being outpaced by competitors that have achieved stronger market positions sooner. The region is challenged to remove barriers to the development of innovations and growth of its innovative businesses so that it may compete on the global scale.

The paper emphasises the important role of partnership working and collaboration in enabling the region to realise its innovation potential. It points to the need to link further into wider innovation and supply chains, creating new partnerships and new alliances, nationally, in Europe and internationally.

A New Innovation Policy

The **Expert Paper** proposes a number of activities that may be taken forward to support innovation in the North East. These actions if undertaken should assist the region to achieve its potential for innovation and contribute to wider economic success. They are:

1. Adopting an innovation chain approach.
2. Strengthening innovation ecosystems.
3. Establishing Living Laboratories.

Adopting an 'innovation chain' approach

The paper provides an overview of the 'innovation chain' concept and identifies its relevance to the growth of innovation in the North East. It proposes that the innovation chain is a useful framework to manage the development of innovation and identify and obtain necessary resources and organisational engagement. The paper clarifies the role of a 'lead innovator' - a crucial element of the chain that is responsible for taking forward each stage of the innovation. The lead innovator is often a single company working through its various R&D, design and marketing functions. Lead innovators are assisted by a wider 'ecosystem' of supporting resources, services and facilities.

A number of the region's key industries, such as energy and engineering, have particularly complex innovation processes with extensive multiple stages. These stages often require significant funding and major capital facilities, however such facilities have broadly disappeared over time as funding became increasingly concentrated on early research. As a result, many of the region's key industries had arguably lost their capacity to innovate. There is now a growing understanding of the role of innovation chains, which has led to investment at regional and national levels for prototyping, testing and demonstration facilities. The establishment of centres such as NaREC are the result of this change in thinking.

The key point for the North East is that it is unlikely to be able to specialise in many stages of many innovation chains. "***The region is more likely to achieve success by undertaking different stages of a limited number of innovation chains, where there are comparative strengths, including in the associated ecosystems"***.

The paper notes that:

> *"The North East may undertake several stages of energy engineering, from research to market introduction; specialising only in early stage research for bio-medicine for an ageing population, with the later stages, such as clinical trials, being undertaken elsewhere. In contrast to low carbon vehicles where the initial research and development, product design and testing may all be undertaken elsewhere, particularly in Japan, with the final market evaluation and introduction taking place in the North East*. "

Strengthening innovation eco-systems

The paper makes the case for the development of appropriate ecosystems which it regards as being crucial for the innovative success of the region. Currently only some elements of these ecosystems are available in the North East, such as universities, colleges, specialist testing, prototyping and scale-up facilities, specialist accommodation and some venture finance. The paper identifies gaps in the wider areas of business support, skills and infrastructure. It therefore calls for a programme of support to develop networks, resources and institutional capacities that are closely and effectively aligned with the needs of innovators. It suggests strongly that this should be the focus for a future policy for innovation.

The programme of support should assist innovators to engage with innovation ecosystems. Suitable innovators and innovations could be within a start-up company, a research organisation or larger company. The **Expert Paper** suggests that the programme of support could be delivered by individuals within the region's business community. These individuals would be attached to a specific innovator or innovation, working with them over a period. They would identify barriers to an innovation's development and signpost to appropriate support that could overcome these barriers. The paper does not identify potential sources of funding for such a programme, although it recognises that funding is likely to be limited.

Establishing Living Laboratories

The paper proposes a 'Living Laboratory' programme, focused particularly on the area of smart cities. It argues that such a programme could assist in the development of a range of innovation and innovating companies in the region and attract new investment.

The Living Laboratory would enable the testing and trialling of technologies and new business models related to aspects of smart cities, such as low carbon vehicles, logistics, traffic management and related energy networks. It points to the North East as having been the location for a number of trials in smart cities and reports that organisations from the region are now managing trials and development projects elsewhere. The paper suggests that a Living Laboratory would enable organisations already involved in these activities to develop further and also facilitate the emergence of system integration capabilities.

The paper also notes that a Living Laboratory could assist in securing new inward investment by enabling the region to be considered as a potential location to develop innovations and wider innovation capacity in the area of smart cities.

SMART Specialisation

SMART specialisation is a concept being developed and promoted by the European Commission to help focus investment in research, innovation and entrepreneurship in every EU Member State and region. It is based on identifying the unique characteristics and assets of each region, with a view to strengthening regional innovation systems.

SMART specialisation is expected to be one on the major factors influencing ERDF spending in the 2014-2020 period, with an emphasis on moving away from sectors where a region has limited strengths. The Commission Briefing Paper notes that:

> *"The most promising way for a region to promote its knowledge based growth is to diversify into technologies, products and services that are closely related to dominant technologies and the regional skills base. New industries will grow out of the most successful clusters, but only if sectoral boundaries are abandoned. What matters is not diversification per se, but rather specialised technological diversification in emerging activities."*

SMART specialisation is expected to be developed at the regional level, led by business, research centres and universities working together to identify the most promising areas of specialisation.

Prioritisation

In its response to the North East Commission, **CBI North East** presents a series of recommendations around the areas of strategy, structure and capacity, which it regards as central to the future economic growth of the North East. In relation to **strategy**, the CBI makes a case for the development of a strategic industrial policy to drive private sector growth in the North East. It recommends that this policy focuses on those sectors in which the North East already has a core advantage, a reputation for excellence, market access and the supply side factors able to provide critical mass. These sectors should also be strategic industries for the UK with future opportunities for growth and long term sustainable jobs. The paper cites the region's strengths in water resource and energy, its coastline and manufacturing sectors as well as its excellent higher education base as key assets able to support an effective industrial strategy.

CAPITAL MARKETS

The **SQW Review** of the existing evidence base highlights three main drivers for capital markets:

- The operation of capital markets, the scale and type of finance made available to business, the degree of competition among suppliers and the extent to which products meet business demand, are driven for the most part by national and international economic conditions.
- The offer to businesses in an area and the extent to which this is tailored to specific local conditions will be influenced by the potential for scale economies in supply – which will itself largely be determined by the scale, type and dynamism of local business activities.
- The products and services on offer will also be influenced by the broader economic heritage as well as immediate economic conditions. This includes the extent to which there is a tradition of a financial infrastructure providing different types of capital, local control or at least influence on the products and specialist professional networks.

It also sets out four key messages which relate to the operation of capital markets in the NELEP economy:

- **Dependence on public sources of capital:** The distinctive economic geography, scale and heritage of the North East have resulted in a tendency to depend on public sources of capital to a greater degree than other English regions.
- **Competition from other areas:** The restructuring of the NELEP area continues to be work in progress and while repositioning is ongoing in other city regions, in most cases this is from a more advantageous base. The NELEP faces an increasingly challenging environment for securing mobile investment opportunities, and is directly competing with Leeds and Manchester City Regions.
- **Access to finance:** SMEs in the North East are still experiencing difficulties in accessing finance. Barriers include confidence amongst SMEs, a lack of assets available for security, the complex funding landscape, limited access to mentors and investment angels and the extent to which SMEs are investor ready.
- **Confidence in locally controlled institutions:** Although Newcastle saw significant growth in financial services in the years leading to the recession, and the sector continues to be an important source of jobs, confidence in locally-controlled institutions was considerably damaged by the collapse of Northern Rock.

Working with private sector partners and the European Union, the former RDA established a series of funds, which it hoped would develop into private sector mechanisms and institutions. Many of these continue to operate under the ‘Finance for Business North East’ banner, including the £5m North East Micro Loan fund; the £15m North East Proof of Concept Fund, the £20m North East Accelerator Fund, the £25m North East Technology Fund, a £7.5m North East Angel Fund and the £20m North East Growth Plus fund.

Finance for Business manages £125m of funds in total, and has two boards, statutory and advisory, both led by chairs from the private sector. It is backed by the European Investment Bank, the European Regional Development Fund, and the Department for Business, Innovation and Skills through its Capital for Enterprise Programme.

Expert Papers

Two expert papers have been produced relating to capital markets – one by **Ron Martin** of the University of Cambridge which focuses on financing business in slow growing regions and examines the case for local capital markets, and a think piece by **Colin Mason** of the Adam Smith Business School at the University of Glasgow, which focuses on equity (or risk) capital. The two papers cover a number of national and regional issues for consideration in developing a policy response relating to capital markets and access to finance. These include:

- The location of capital markets, and in particular the distance of the North East from London;
- The role of supply side policies in increasing access to finance;
- Smart money and the added value of investors;
- Investment readiness;
- The funding escalator and access to finance at different stages of the business lifecycle.

In addition to the expert papers, responses have been submitted by **FW Capital and NEL Fund Managers**, **North East Access to Finance** (NEA2F) and **North East Enterprise Agencies Ltd** (NEEAL) which draws upon their experience of providing finance in the NELEP area and the region more widely.

The Role of SMEs in Economic Growth

The expert paper produced by **Ron Martin** begins by setting out the role which small firm growth can make to rebalancing the economy and promoting private sector activity, particularly in the north of Britain:

> *"A healthy, vibrant small firms sector has a major contribution to make in supporting high, sustainable economic growth. At a time of slow, hesitant recover from the worst recession since the interwar years, the role of the small firm sector is arguably of central importance as a source of the enterprise, productivity, innovation and jobs needed to cement economic recovery and revival."*

It also presents evidence showing that the North East has consistently had one of the lowest rates of growth in the stock of businesses and that (as with other areas) the main contributor to the increase in stocks during the 1993-1997 boom years was a fall in the business death rate rather than a significant increase in the start up rate.

It argues that the vibrancy of SMEs depends, in part at least, in access to finance capital, both to assist the start up of new firms and to enable existing firms to expand and prosper. The long running contention and debate around supply of finance to small firms is also acknowledged, with the most recent focus on banks restricting lending because of the need to rebuild their capital ratios following the banking crisis.

Demand for Finance

The unmet demand for business finance is highlighted in a large number of responses prepared for the economic review, including the expert papers, sector based responses and the submissions of the local authorities and Northern Group of Labour MPs.

Focusing on the local market, the issue of demand for finance outweighing supply is highlighted in the response from **FW Capital and NEL Fund Managers**:

> *"Demand outstrips supply for finance in the region in general. Banks are less willing to offer term loans and overdrafts to companies, particularly in the SME market, and now favour asset based lending. The banks typically offer facilities on a fully secured basis that are supported by company assets, often in addition to personal guarantees from directors. Whilst the VC Funds in the region and business angels have gone some way to support companies where banks may not be able to, this does not fully satisfy demand."*

The responses from **North East Access to Finance** (NEA2F) and **North East Enterprise Agencies Ltd** (NEEAL) have attempted to quantify the unmet demand for their suite of funds arising from a limited supply of funds, inability to respond to demands due to eligibility, and the products available being unattractive to the applicant. Cases where applications for funding are rejected due to unviable business plans, unrealistic sales targets and case forecasts, and an inability to develop an accurate picture of the existing market and potential market share are also contributing to the unmet demand.

The **NEA2F** response suggests that a further £35m per annum could be invested into viable opportunities. This is based on unmet demand of £15m due to the limited amount of funding available and a further £20m if the public funds were relaxed and there was some change in the product offering.

The response from **NEEAL** focuses on cases where applications are rejected. It is estimated that the value of unmet demand in 2012 was £948,000, which, if converted into viable propositions, could have led to additional turnover estimated at over £2m, creating over 200 jobs.

However, the expert paper produced by **Colin Mason** of the Adam Smith Business School at the University of Glasgow argues that there is not necessarily a large pool of businesses that need access to finance and the argument of unmet demand is overstated.

The paper focuses primarily on equity (or risk) capital and suggests that creating new sources of finance may not result in a significant increase in business start up and growth. This is based on views that, while an issue for some businesses, the extent to which a lack of finance is a serious constraint on business start-up and growth is overstated for the following reasons:

- Only 1.3m of the 4m businesses in the UK have employees. The majority are one person businesses or people who are self employed and work on specific projects for a limited duration.
- The traditional use of bootstrapping techniques to find creative ways of minimizing or eliminating the need for finance by securing resources at little or no cost.
- Some business owners making a deliberate choice to forego or delay raising external finance and equity finance in particular, relying instead on self-funding, family and friends and bootstrapping in order to preserve their equity.
- The costs of starting a business have reduced considerably over the past decade as a result of advances in technology, and in particular software, including cloud based software, web and social media campaigns and e-commerce platforms for independent businesses.
- The development of new methodologies to achieve capital efficient start up such as the Lean Start-Up Approach which is based on an iterative process of market testing, analysis of customer feedback and iteration or pivot. However, critics have argues that significant finance is still required to scale-up a businesses, with such approaches shifting the point at which businesses need to raise finance.

Overall it concludes that the financial needs of many small businesses are now lower than they were in the past, reducing the demand for finance. It does, however, also acknowledge the (perceived or actual) decline in bank lending, which has expanded the pool of discouraged borrowers who do not think it is worthwhile making a loan application. It is also noted that women business owners are over-represented amongst the population of discouraged borrowers.

The Supply and Distribution of Finance

The **expert paper** produced by **Ron Martin** examines the argument that the perceived lack of finance for small and medium sized firms varies across regions, and is notably more acute in slow growing regions, especially those that are at some remove from the main centres of finance in an economy.

The paper concludes that it is not easy to answer questions around whether firms in such regions face particular difficulties in accessing loan and equity capital and/or if distance from the main centres of finance reduces the availability of finance for firms and especially SMEs.

It highlights that in the absence of a perfect market (where it is assumed that there is equal allocation of capital between firms and regions and that all profitable investment projects receive funding irrespective of local supply), various information asymmetries and agency problems and the scale-sensitive nature of these costs work against small investors and small firms participating in centralised financial markets.

Small firms have high death rates, high risk/return ratios, high marginal transaction costs (loan charges, due diligence costs, etc), and are frequently prone to low cash flows (with which to service loans), and insufficient security (in the event of default on loan repayments). Such firms are likely to experience external financial constraints. Banks, for example, may ration the supply and/or increase the costs, of loans in the sector, while capital markets will tend to give priority to large and established firms over small riskier ones.

It is noted that the spatial structure of the financial system may contribute to this problem. If the problems of asymmetric information, agency and uncertainty are a function of the physical distance between firms seeking finance and the institutions providing finance, then whether the financial system is centralised or decentralised may have consequences for the ability of firms to raise loan finance or equity capital.

A spatially-centralised system, with a major centre containing the main financial institutions and capital markets - such as London – could result in funds being biased to those firms within close proximity to the centre, relative to more distant firms, given that information on the former is likely to be greater and more reliable than on the latter. The financial system may not, therefore be spatially neutral and economically lagging regions that are at some remove from the main centres of finance may possibly suffer from a shortfall of funds for firms.

Locational Advantages by Supply Type

Ron Martin's expert paper reviews issues relating to the distance between centres of finance by supply type. This includes banks, venture capital and the stock exchange and also the distribution of recent policy initiatives.

Banks: The banking system in the UK is branch based, with the head offices of most of the major banks based in London. Lending by banks and similar institutions is often characterised as 'relationship' lending, which depends on the accumulation over time of soft information on (local) small firms by (local) banks. Geographical proximity is believed to be important for this type of lending, with evidence from research outside the UK supporting this. This is in contrast to 'transaction' lending, which relies more on hard information on borrowers, such as credit scoring, on asset based lending and leasing and which can be conducted without necessarily requiring geographical proximity between the lending institution and the firm seeking finance.

Obtaining geographically disaggregated data on the distribution of bank lending and loans to small business is particularly difficult in the UK. On this basis it is recommended that there is a need for detailed research to determine:

- Whether and to what extent the main decision centres of the banks being based in London works against small firm lending in regions more distant from the capital such as the North East, or how much lending discretion is devolved to bank branches in the regions; and
- How the reductions in demand and supply linked to the economic recession and uncertain recovery have interacted and impacted across the regions. Overall, it is estimated that the proportion of SMEs refused loan financed increased from 8% in 2007 to 21% in 2010.

Venture Capital: Around 75 percent of venture capital institutions are located in Greater London, with provincial centres, such as Birmingham, Bristol, Manchester, Leeds, Cambridge, Edinburgh and Glasgow, having a relatively small number of offices. This domination of London is largely linked to many venture capital firms spinning out of banks and other financial institutions located in the capital and their ability to access financial related expertise and services concentrated there.

The flow of venture funds into investment has consistently displayed a geographical bias towards London and the South East. In recent years, these two regions have attracted on average around 60 percent of total venture capital investment, twice their share of (VAT-registered) firms, as indicated by their location quotients in the table below. All other regions of the country have attracted less than the share of venture capital investment. The worst performing regions have been the South West, East of England, Wales and Northern Ireland. While the North East region has fared much better, it has nevertheless attracted less venture capital than its business stock would predict.

The Regional Distribution of Venture Capital Investment 2005-2011

	Percent of Total Invested							Location Quotient
	2005	2006	2007	2008	2009	2010	2011	
London	9	18	21	15	35	42	44	2.83
South East	35	42	48	42	27	14	17	2.20
South East and London	44	60	69	57	62	56	62	2.22
South West	7	5	2	2	3	9	3	0.47
East of England	9	6	4	6	3	1	2	0.44
West Midlands	4	3	3	5	8	11	8	0.73
East Midlands	16	4	7	6	3	1	3	0.84
Yorkshire-Humberside	4	12	4	6	4	6	4	0.80
North West	6	6	5	4	4	7	11	0.64
North East	**1**	**2**	**1**	**1**	**4**	**4**	**2**	**0.81**
Scotland	2	2	3	12	9	2	5	0.72
Wales	7	1	1	1	1	-	1	0.40
N. Ireland	-	-	-	-	-	2	-	0.10
UK	100	100	100	100	100	100	100	

Source: British Venture Capital Association. The Location Quotient is calculated by dividing the region's share of the national total venture capital investment by its share of the national (VAT-registered) business stock. A value of greater than 1.0 indicates that a region has attracted more than its predicted share of venture capital investment; and vice versa for a value of less than 1.0

A key issue is whether a true 'equity gap' exists, and whether SMEs in regions such as the North East find it difficult to access venture finance, because of (i) a lack of a local market; (ii) local firms (or firms based elsewhere) regarding local opportunities for investment as too risky or lacking in growth potential;

or (iii) because there is a lack of demand for venture finance by local firms, and hence no equity gap. It is noted in the paper that detecting equity gaps and quantifying their magnitude is not straightforward and would need to take account of differences in economic structure between regions.

Nine Regional Venture Capital Funds (RVCFs) were delivered between 2002 and 2008 to fill regional equity gaps, although performance was mixed and the funds were criticised for being too small, having a restricted remit, lengthy delays in providing finance, and being too dependent on London-based venture capital institutions for their management.

The other issue which the expert paper highlights in relation to venture capital finance is the way in which the funding has been used. Rather than focusing on funding start-ups and small firm expansions, especially in riskier activities (such as high technology ventures), funds have tended to provide equity for management buy-outs (MBOs) and buy-ins (MBIs). The case of the North East region in recent years illustrates this point (see table below) where typically between 60 and 80 percent of investment has gone into these and related funding opportunities. While financing MBOs and MBIs can help save firms that might otherwise go under, SMEs do not seem to be the primary target of this source of finance.

Venture Capital Investment in the North East Region, percentage by Stage

	2007	2008	2009	2010
Start-up/early stage	4.4	14.7	2.7	1.7
Expansion	16.6	23.5	4.3	6.3
Replacement capital	0	1.4	1.0	5.5
MBO/MBI	66.7	60.4	29.0	86.5
Other Stage	12.3	0	63.0	0
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: British Venture Capital Association. Consistent data not available for 2011.

Stock Markets: The expert paper looks at whether there is a case for local or regional sock exchanges and concludes that the case is not easy to make and that the market would have driven their creation if they were required. However, a useful first step might be to derive local indexes of firms listed on the London Exchanges, including AIM and techMark.

An index has been complied for the local Cambridge economy for some years now (www.nwbrown.co.uk/cambridge-index/). It consists of around 25 local companies, mostly high-technology firms, listed on the London exchanges. The Cambridge index provides direct information on the comparative performance of local firms to potential investors. Constructing local and regional indexes of this sort would begin to provide insight into the geography of the public equity markets. The landMARK site on the London Stock Exchange gives regional breakdowns of its listed companies, but does not provide indices for the regions themselves.

Recent Policy Initiatives: The paper states that it is unclear how far recent national policies to stimulate bank lending to SMEs have benefited the business community in the North East. This includes the Enterprise Finance Guarantee (EFG), the Enterprise Capital Funds programme and tax based venture capital schemes as well as a number of other Government interventions designed to increase the supply of bank lending to businesses. None of these are specifically targeted to particular geographical areas or regions, however, and there is little information on how far the schemes have improved the relative position of the SME sector in each region.

Policy Response

Overall it is concluded that detailed research is needed to ascertain whether and to what extent the North East has become locked into a low-demand-low-supply equilibrium with regard to the financing of SMEs. In particular this should focus on:

- How far is the low rate of growth in the population of businesses in the region due to the general lack of economic growth and dynamism in the region over the past 30-40 years?
- How far has this lack of growth and dynamism worked against the emergence and development of a local financial and capital market of sufficient critical mass to stimulate and fund local economic expansion?

In addition, the presence of a sizable financial centre in a region like the North East could contribute significantly to the region's economic development.

There is potentially an important role for public intervention, for example in the establishment of publically underwritten regional investment banks, specifically charged with financing and supporting local SME activity, together with revamped regional venture capital funds. But such measures also need to be deliberately linked to and supported by other policies aimed at renewing and re-orientating the economies of regions like the North East.

Current Barriers to Accessing Finance

A number of factors limiting businesses access to finance are highlighted in the responses from both **NEA2F** and **FW Capital and NEL Fund Managers**. These can be summarised as:

- **High risk investments:** This includes securing finance for new/early stage businesses with little track records of operating in new markets as well as finance for priority areas, including technology, innovation and key sectors where no collateral is available and the risk appears too high. This is especially the case in sectors such as renewable energy, ageing and vitality, nanotech, printable electronics, digital and high end advanced manufacturing and affects established as well as early stage businesses.
- **Eligibility restrictions:** A number of good investment proposals do not get the funding that they require due to the eligibility restrictions of current Finance for Business North East Funds. With regards to European funding, there are also restrictions which prevent some sectors (such as construction, retail, and hospitality), propositions (such as MBOs/MBIs/acquisitions) and businesses in non-assisted areas from accessing funding.
- **More limited options for small scale equity (of up to £2m):** This reflects the preference of venture capitalists for higher value deals because of the high percentage of costs to deal size and greater hands on input at lower deal sizes. Further, while JEREMIE funds advertise themselves as providing up to £2m, ERDF rules again restrict this to a series of transactions with a company; the actual limit for a single investment in any one year is €1.5m. The advent of the Business Growth Fund and to a lesser extent the Santander "mezzanine fund" has addressed the gap above £2m. But both these Funds have rules of their own, their primary focus being medium/large firms that are established (and profitable).
- **Requirement for multiple funding rounds of more than £2m over time:** High growth, high technology, early stage business are renowned for requiring many rounds of funding over long time periods. The restrictions on size of investment (see comments above) and the periods over which follow-on investment can be made, are unhelpful to the SME, and put the fund manager at a great disadvantage with regard to protecting its position against other equity investors.
- Businesses in capital intensive industries (e.g. manufacturing, engineering, utilities) require comparatively larger and more frequent investment than the current per investment, per annum and per business investment limits often allow. Investees in these sectors defer their growth plans to meet the availability of funding. Given that these businesses are often employing larger numbers of skilled employees in long-term sustainable businesses, this deferment of growth to meet the current investment limits is counter-productive to local economic development.
- **Limited job creation outputs:** Local economic benefit should favour high value-add businesses achieved through the development and commercialisation of intellectual property. Unfortunately such businesses require high initial investments but create relatively small numbers of jobs. A key social output for existing funds is always job creation.

Mason attributes some of these barriers to the fact that the design of public sector schemes, especially in the risk capital market, often mimics the private sector. As a consequence, this reinforces funding gaps rather than alleviating them. The common features identified include the size of investments, a focus on new and young businesses and limited life (rather than evergreen) funds.

It is also noted by **Mason** that since the onset of the financial crisis the ability of entrepreneurs to use housing assets as a means of financing their businesses, for example, through equity withdrawal and use as security has been much reduced.

Access to Finance – Not a Magic Bullet

The **expert paper** prepared by **Colin Mason** strongly argues that across the board supply-side policies involving an increase in publicly supported venture capital fund will be ineffective, at least without significant policies to promote entrepreneurial activity operating in parallel.

> *"There is a relationship between access to finance and the quality of management. In most basic terms, putting finance on the hands of poor quality entrepreneurs will not produce economic growth and job creation. Creating new sources of finance is not, by itself, a 'magic bullet'. Arguably the starting point should be to ensure that the resources required to transform the North East into an entrepreneurial economy – of which finance is just one resource – are in place. Increasing the supply of finance will only lead to economic development if it is used effectively."*

The access to finance view assumes that an increase in the supply of capital will be productively used. However, **Mason** sets out that in reality small businesses are not attractive financial propositions on account of either their level of innovative or original ideas or limited industry and management experience, or both. As such increasing the supply of finance might have little or no effect on overall business performance.

This is largely supported by evidence from a NESTA study which compared the performance of firms that had received funding under one or more of six UK government backed venture capital schemes (which included both public and private sector money) and found that they do not yet exhibit significant improvements in performance. The authors of the NESTA study state that *"this suggests that the UK does not possess untapped resource of high potential firms whose (greater) performance will be unleashed by simply making available more equity finance within the 'equity gap'"*.

This conclusion challenges the justification for intervention as a response to 'market failure'. The NESTA report argues that the problem is one of thin markets. A small number of high potential firms co-exist with small numbers of investors with the skills to help them grow. Both parties find it difficult to find one another without unacceptable transaction and/or search costs. Adding more money is not a sufficient policy response. There must also be an increased demand from high potential firms that are, or can be made, investment ready. One of the key attributes of such firms will be the quality and depth of their management team.

Smart Money and the Added Value of Investors

Linked to the above **Colin Mason's expert paper** recommends that sensible entrepreneurs need to ask potential investors what they will get in addition to their money recognising that what is required to build a strong entrepreneurial economy is not money, but the smart money supplied by investors who have the skills, knowledge and contracts to be able to add value to the businesses in which they invest.

The paper draws on evidence which suggests that regionally based venture capital funds, which use public money do not add the same level of added value as independent venture capitalists. A recent pan-European survey shows that 'independent' and 'government' funds make different types of value added contribution, with those of the 'independent' firms giving more support to professionalisation, changing the management team, exit orientation, and also making a greater impact on accelerating growth and providing credibility to other investors. The superior role of independent venture capitalists in enhancing the professionalism of their investee businesses also finds support in other studies.

While added value is a critical question in the case of venture capital, it also applies in other types of investment. Evidence that support provided by mentors who are business professionals leads to business outcomes is also cited in the **expert paper**.

Investment Readiness

The continued issue of many of the businesses which come forward to seek finance being judged by investors as not being investment ready is highlighted in **Colin Mason's expert paper.** Within this group, there are businesses that investors intuitively recognise as having potential but require significant additional work to get to the point where they could attract finance. They comprise, at one extreme, businesses which have presentational failings, typically incomplete information, and at the other extreme businesses that are not investable in their present form, for example because of the skills and composition of their management team, route to market, status of their IP or governance arrangements.

It is recognised that there have been various attempts to deliver investment readiness in the UK, including schemes in the North East and that their effectiveness is underlined by evidence from the recent Business Angel Investment Activity Reports. These show that those angel networks that offered investment readiness programmes had a higher proportion of businesses which were promoted to investors which successfully raised finance. However, such programmes have relied on public sector funding and have ceased following funding cuts, with the loss of learning by those involved in delivery.

While there is evidence that these schemes have been successful, the expert paper also outlines that they have attracted criticism and would require some elements of re-design if reinstated. In particular, the following criticisms have been raised:

- Their emphasis has been on addressing presentational failings rather than the more fundamental – and much harder to address - investability issues.
- There has often been no follow-up of the businesses to see whether they have implemented the suggestions from the programme or whether they need support in doing so.
- Some are criticised for being delivered by public sector-employed business advisers rather than hands on investors.
- They have been seen as being too soft and failing to incorporate the intensive 'tough love' characteristics of US programmes.
- Investment readiness programmes are targeted at companies raising their first round of finance, typically from angels. However, this is unlikely to be relevant for companies that are seeking to raise £1m plus from venture capital funds.

The paper argues that effective investment readiness programmes need to be able to put entrepreneurs in front of both individuals who have successfully raised finance and grown businesses and also investors. It states that there seems to be a strong case for well-designed and resourced investment readiness programmes that enable entrepreneurs to identify and reach investors and that focus on more than just the early funding stage and to cover follow-on funding rounds and also a stock market listing.

The Funding Escalator

Building upon the point raised by **NEA2F** and **NEL Fund Managers** relating to the requirement for multiple rounds of funding creating a barrier to investment, **Colin Mason** sets out that a major problem in the supply of finance is that the market comprises a series of verticals. Fast growing companies will rarely raise just one round of funding. However, most funders position themselves in a vertical market, only investing a certain amount per company (e.g. less than £250,000, £250,000 to £500,000, less than £1m, £2m-£5m, over £5m) and only in businesses at particular stages in their development (e.g. seed, early growth, development)..

This situation creates a number of negative outcomes:

- **Ongoing efforts:** Entrepreneurs of growing businesses have to engage in new efforts to raise finance every nine to twelve months which takes their attention away from managing the business. It also creates considerable insecurity since an unsuccessful attempt at raising finance might leave the business in a 'living dead' state, generating enough sales to survive but unable to grow, or even to threaten the survival of the business and put at risk investments made by previous investors.
- **Dilution of the founder:** Because each investor is unable to make follow-on investments they are at risk of being diluted in subsequent rounds of investment. Accordingly, one shot investors include terms which protect them from dilution and instead it is that the founders get diluted, risking their motivation and limiting their potential to undertake entrepreneurial recycling on exit. It may also deter future investors from investing.
- **Increased competitions for larger investments:** The supply of risk capital is skewed to sub £1m investments, creating what US commentators are terming 'the Series A crunch' with too many companies that have successfully raised smaller amounts of finance now seeking to raise rounds in excess of £1m. Because the supply of these larger investments is so limited many companies may not secure follow-on funding, which increases the possibility of a low value distress sale.

NELEP: Practical Steps

In light of the issues identified in the current market, a number of suggestions and recommendations are made across the expert papers and other responses received. These relate to the role which the public sector should play in capital markets and the way in which investment is targeted and distributed.

The Creation of New Funds

Based on concerns around the ability of (a) businesses to productively invest significant finance without investor support and (b) public sector funds to add significant value to their investee companies without private sector support, the **expert paper** produced by **Colin Mason** recommends that new funding sources are only appropriate in a small number of situations, notably co-investment schemes alongside business angel groups and larger funds (>£1m) to widen the supply pyramid.

Changes to Funds

The **expert paper** acknowledges that there is a need to rethink the investment focus, eligibility criteria and structure of funds which may be created (such as those outlined above). Practical steps which could be taken relating to fund restrictions and structures are also called for in the responses of **NEA2F** and **FW Capital** and **NEL Fund Managers**. This includes (i) operating funds with fewer restrictions / eligibility issues, to assist more businesses that are currently excluded from Finance for Business North East Funds and (ii) creating larger funds to overcome cases where limits to funds investing up to 10% in an individual company mean that funding is insufficient to achieve the best return.

There is also a suggestion relating to creating a range of funds which each have a different focus, rather than a super fund. This would ensure that leveraged funds where bank debt repayments are required do not lead to a deviation from the original focus of the Fund as Fund Managers change their behaviour. For example, with early stage Funds favouring later stage investments towards the end of the investment phase, and limited equity investments being available if the realisation phase is insufficient to exit.

Facilitating the Expansion of Current Activity

The **expert paper** also recommends that the public sector should focus its efforts on enabling the private sector to invest more effectively. In particular, this should be concentrated on expanding business angel investment activity in the region. Angel networks have been effective in enabling investments to occur but have lacked long term finance support and have closed. It is suggested that the region should look to Scotland to see how angel syndicates can be encouraged and supported.

It states that there should also be support for capacity building in the form of investor training and investment readiness schemes. This requires reinventing previous schemes which only received short term funding from government and are not sustainable without such funding.

A further area of intervention is enhancing the connectivity of the region's entrepreneurial eco-system to external investors by developing networks – or pipelines – to bring in out-of-region investors to make Series B and Series C funding rounds.

Access to Successive Rounds of Investment

The need to enhance the connectivity of the different stages of the market so that businesses can progress seamlessly to future sources of investment is highlighted in the **expert paper** and responses from **NEA2F** and **FW Capital** and **NEL Fund Managers.** Mason suggests that rather than repairing current systems, there is a need to design a funding escalator that can finance growing businesses in a continuous, rather than discontinuous way.

During this process the region's policy makers would need to assess the desirability of a risk based financial system which requires investors to seek an exit, normally in the form of a trade sale involving the acquisition of the young business to an out of region, and often non-UK business. Encouraging and enabling investors to grow some of their investee companies so that they become candidates for an IPO is one approach. Another approach is to investigate the scope for using public sector funds to establish a secondary market.

To address the issues relating to time restrictions on investment and benefit realisation a call is also made for **evergreen funds**[2]**,** which would allow longer term investment decisions to be made, particularly into early stage technology based businesses where multiple rounds may need to be secured.

Targeting of Support

There continues to be questions around whether support should be focused on high-growth businesses or on a broader front. In response to this point, the paper prepared by NEA2F states:

> *"This very much depends on what the economic priorities are for the two sub-regions, the level of new funding that can be found, and the timeframe over which the initiative is being considered."*
> *"With a limited availability of funds, the focus is likely to have to be on supporting businesses with strong growth ambitions led by innovation. High growth is not, of course, a factor of any specific sector."*

[2] Evergreen is the JESSICA ERDF investment fund now operational in the North West of England.

However, the response submitted by FW Capital and NEL Fund Managers, presents the risks associated with focusing on selected parts of the economy. It notes that while investment in lower growth businesses may be less exciting, these businesses form the backbone of the economy and that high growth businesses also tend to be high risk with few big winners and many losers, although these businesses are seen as being more suitable for equity. Overall, it highlights the importance of having a range of funds to support the SME base.

Role of Grant Funding

There are also questions around whether or not there is a role for grant funding, and if so which areas, sector or points of business this would be most appropriate for. While the response from **FW Capital** and **NEL Fund Managers** notes that dependency on grants is not a good thing for the long term sustainability for businesses, it also argues that grant funding can encourage growth and support SME supply chains through larger investment projects. It puts forward the case for grants to support higher risk early stage technology businesses where there is development of IP, which can be very beneficial to the region.

NEA2F have different views on how grants can be used and do not see a role for grants in expansion or capital funding. Instead they argue, grants may be appropriate for early stage companies to access support with investor readiness training, business planning, market assessment studies to improve the applications submitted to existing and any new funds.

This view is supported by NEEAL, who have experienced unmet demand as a result of having to reject applications. They argue that:

> "*The best way of harnessing potential demand is through an investor readiness support package which includes professional business advice….Micro and small businesses are unable or unwilling to pay for this type of support package resulting in a market failure…..Businesses receiving investor ready support are more likely to secure micro loan finance, become more sustainable and grow".*

The response also highlights that this is also the case for third sector organisations and that a tailored business package would enable this sector to take advantage of the opportunities arising from the substantial changes in the public sector, unlocking potential demand for finance.

SKILLS AND LABOUR MARKET

In the **SQW Review of Existing Evidence**, five key issues relating to the skills and labour market in the NELEP area are highlighted:

- **Engagement in the workforce:** While the NELEP has a high share of working age residents, engagement in the workforce is below the national average and (often intergenerational) worklessness remains persistent in some parts.
- **Travel to work patterns:** The Tyne and Wear City Region is an interconnected economic area with links to wider parts of the LEP area, especially in terms of travel to work patterns.
- **Higher level skills:** Although substantial progress has been made in higher level skills, the NELEP continues to under-perform.
- **Lower levels of productivity:** The productivity of those in work lags behind the national average, driven in part by low skills, a high share of jobs in lower level occupations/sectors and barriers to agglomeration.
- **Graduates and highly skilled workers:** There are issues around the under-employment and retention of graduates, and attracting highly skilled workers to the area.

The evidence base for the **North East LEP Skills Action Plan** also shows that while, pre-recession, the area was making progress in closing the gap with the national average on a number of indicators (including NVQ Level 3/4), the gap has begun to re-widen since 2007.

The issue of unemployment and the legacy of ill health and inactivity are highlighted as key weaknesses of the North East in the submission from the **Northern Group of Labour MPs**, which sets out that both the unemployment and inactivity rates of the region are the highest in the UK. Focusing on the sub-region, the NELEP area currently has the sixth highest unemployment rate of all LEP areas across England (based on data to September 2012).

On the demand side, while the gap is closing, labour demand is weaker than average in the NELEP area, with a below average job density. As highlighted in the **Expert Paper** on **Skills and Labour Market Change** produced by **Professor Linda McDowell** of the University of Oxford, there are consequently more people chasing each vacancy than is the case nationally. The **Action Plan Evidence Base** also shows that the gap on job value has widened over the 15 years since 1997.

In terms of the types of jobs available, the **expert paper** cites evidence of the North having a lower proportion of managers, professionals, associate professionals and technical employees when compared to the GB average. It also has a correspondingly higher proportion of employment in caring, leisure and sales (mainly women) and process, plant and machine operators and elementary occupations (mainly men).

The high representation of manufacturing and over dependence on the public sector is also highlighted, noting that the latter, which is a large employment sector for women, increases the area's vulnerability to government cuts. This is echoed in the response from the **Northern Group of Labour MPs** which sets out the scale of the cuts (£2.8bn or 7% of gross output) and the knock on effect to the private sector (estimated to result in a further loss of £1bn based on analysis undertaken by Oxford Economics).

Education Providers

In terms of educational infrastructure, there are 10 colleges in the NELEP area, providing education and training for companies and supporting over 80,000 individuals on Skills Funding Agency (SFA) and Education Funding Agency (EFA) programmes.

The NELEP area benefits from the presence of four universities (Durham, Newcastle, Northumbria and Sunderland). In 2010/11, there were 84,500 HE students in the area, with a further 10,000 students undertaking higher education training at the 10 colleges. Of the students at HE institutions, 81% were from the UK, 4% from other EU counties and 15% originated from outside the EU.

Undergraduates make up 77% of the total student population in the North East. The proportion of undergraduates originating from the North East varies among the universities, with 24% of Newcastle undergraduates coming from the region, compared to 11% of Durham undergraduates. As well as attracting local students, the NELEP universities also attract substantial numbers of international students, with approximately 20% of both Sunderland and Durham's intake consisting of overseas students.

The North East is also home to a large postgraduate population of just over 19,000, of which 43% are overseas students, with the majority originating from outside the EU.

The response from the **North East Chamber of Commerce** highlights that the region has a high percentage of young full-time first degree students remaining in the region to study and the inflow from other UK regions is higher than the outflow to universities outside the north east. All four universities also boast strong figures for securing employment and further study or training for graduates. For the NELEP universities, an average of 90% of first degree leavers progress into employment of further study within six months. Newcastle University's figure was 94% which ranks fifth in the UK among its university peer group.

The Economic Context for Skills

The **Expert Paper** is designed to stimulate discussion and further debate on the topic, rather than provide definitive recommendations. It draws on experiences of the UK labour market and northern Europe to identify key issues which the North East is facing, some of which require national responses over the medium to long term. It highlights issues relating to both the supply of jobs and access to employment and begins by summarising sectoral employment trends, which have implications for labour requirements:

> *"The context is the overall decline in manufacturing employment but the development of industries where new technologies typically imply reduced requirements for labour (especially reasonably well paid but less skilled workers). Correspondingly service sector employment has grown, especially for women. This work tends to be polarised in both skill terms and conditions of employment and at the bottom end is typically low paid, part-time, flexible or contract employment, requiring a different skill set from 'traditional industries', especially in regions like the North East. Interpersonal skills such as customer relations, empathy and caring are often requirements of tough work, whereas the hi-tech work in new manufacturing industries requires sophisticated science-based skills which may need almost continual updating."*

The paper states that the shift in the nature of the economic base of the area has solidified gender inequalities in access to training (especially high quality apprenticeships), employment and a gender gap in wages. This is a cross cutting issue, which is considered in detail in the following sections.

In light of the structural changes, two themes for policy responses are identified: **1) addressing the acquisition of skills by workers**, and **2) improving the number and quality of jobs**, especially in the service sector, to create routes from entry level jobs requiring basic skills into higher quality, more demanding and better paid employment.

Addressing the acquisition of skills by workers includes retraining adults, especially older workers, which is called for by the **Northern Group of Labour MPs,** who highlight the need for skills and retraining for those who are losing jobs in the public sector.

The point relating to the need for higher quality and better paid employment is also highlighted in the response from the **Northern Group of Labour MPs** and the **Northern TUC.** The MPs response sets out that 20% of people in the North East are in relative income poverty competed with the national average of 16%, while the Northern TUC reports that continued prevalence of low pay and in work poverty remains a major concern and could undermine efforts to regenerate the North East economy over the long-term. It argues that in addition to measuring the number of jobs created, the quality and sustainability should be considered.

The North East Skills Action Plan

The **University of Glasgow's Training and Employment Research Unit (TERU)** has been commissioned to provide a robust evidence base and analysis to support the development of the North East Skills Action Plan. The evidence base provides a shared understanding of skills requirements to meet business needs and stimulate growth in new areas. It takes account of demand and supply related issues and identifies emerging priority areas recommended for inclusion on the Action Plan.

The Action Plan will be designed to help drive the NELEP area's economy to a high skills/high value position, with expectations that successful implementation would result in (i) more jobs and more sustainable jobs, (ii) high value jobs with higher earnings, and (iii) reduced unemployment due to a combination of the previous outcomes.

Demand Side Issues

Demand side issues have been identified for growth sectors and the wider business base. The issues for the business base outline a number of barriers which restrict skills investment including:

- The complexity of the skills system with SMEs and micro businesses struggling to engage.
- The difficulties businesses experience in communicating future skills needs.

- The absence of an impartial view on the availability, suitability and quality of training.
- Difficulties in measuring the return on skills investment, which leads to businesses not always being convinced about the value of skills investment.
- Differences between the transferable qualifications that the skills system tends to deliver and the skills (rather than qualifications) than employers want.

There are further issues which relate specifically to growth sectors and the challenges faced in realising current and future opportunities. Some of these challenges relate to the uncertainty of new developments with a lack of confidence in (i) whether opportunities will go ahead, (ii) the timescales over which they will occur, and (iii) the volume of high quality jobs they will deliver. This is combined with the need to replace the ageing workforce either by upskilling existing staff, recruiting a newer/younger workforce and/or retaining/attracting individuals with higher level skills.

The main issues in taking this forward are:

- Recruitment difficulties in some sectors.
- Negative images of some sectors amongst young people and key influencers.
- Concerns around how to ensure the skills system can respond to demand for higher level skills in growth sectors.

The response from the **International Centre for Life** draws attention to their programme of science activities and work with schools, and the importance of overcoming the negative stories associated with engineering and industry. It also argues that there is a need to dispel the widespread belief that science is only accessible for the highest academic achievers and raise awareness of skills in subjects such as STEM, which are needed in most employment sectors in the 21st century.

Supply Side Issues

The supply side issues cut across three main groups – schools, apprenticeships, and colleges and universities. Cutting across the three areas there is also an issue around limited connectivity between local economic development needs and skills prioritisation and funding models which is linked to the perception of a need for greater coordination of skills activity.

For **schools**, the main issues are fragmented IAG, vocational and apprenticeship routes not being pushed strongly enough, and leavers not being prepared for the world of work, linked to a lack of basic skills and core employability skills.

In terms of **apprenticeships**, while there are a high number of Level 2 apprentices, the numbers at Level 3 are more limited and there are views that employers (especially SMEs) find the system complicated. The response from the **Association of Colleges North East (AoC NE)** refers to data which suggests a marked decline in employer interest in taking on advanced apprentices in the 16-18 age group, with employers choosing to recruit form the pool of more mature and experienced unemployed adults.

The response also presents research findings that show many SMEs see little value or opportunity to facilitate the supervisory skills associated with the Level 3 apprenticeship frameworks, but would look more favourably on employing advanced apprentices if the frameworks were more focused on developing technical skills.

For **colleges and universities,** there is an issue around learner/funding-led provision resulting in an over-supply in some courses, with employers also concerned that the offer is not sufficiently tied to labour market needs.

Interaction between the Skills Supply and Demand Side

While touched upon in the previous sections, the overarching issue of the need for increased interaction between those responsible for skills supply and demand is highlighted in a number of responses from stakeholders. It is also a key feature of current policy, with emphasis being placed on ensuring that the skills levels of the current and future labour market meet the needs of local employers.

The response from the **Northern Group of Labour MPs** states: *"the lack of coordination between industry and education is a long standing problem but the advent of free schools, academies, the weakening of local authority education departments and decline of the LSC is fragmenting expertise and making it hard to share information and co-operate".* As set out in the priorities section, there is a strong case for strengthening the employer voice and developing a more coherent IAG offer to ensure that young people are informed of the opportunities available.

Gender Equality

The implications of past and current employment and skills opportunities for gender relations are highlighted in the **Expert Paper,** with it noting that raising women's educational participation, possession of credentials and labour market participation rate (which is currently below average) should be a key aim. The paper states:

> *"One of the key legacies of the traditional male employing industries in the region is low levels of female employment historically and a still evident 'masculinist' public culture (McDowell and Massey 1984). As new high tech industries (cars, IT, software etc) replace older industries, the pattern of male dominance is reproduced. Young women are less likely than young men to take up apprenticeships, to enter employment in the private sector, to work full-time (especially after childbirth) and to earn high wages."*

It goes on to explain the complex and connected reasons for continued gender segregation in the labour market. These relate to a combination of who has the right educational credentials (noting that while girls now do better than boys at GCSEs and with almost equal levels of A level achievement, there is still a subject bias) and who applies for particular types of vacancies. This is combined with the image of different jobs, the workplace cultures and assumptions about gender by selectors, the availability of career paths that do not depend on full-time participation, and so forth.

The paper highlights evidence which has shown that increasing women's participation raises economic performance and productivity, as well as aspirations and household incomes (although child care costs must be considered). It concludes that raising labour market participation rates of both young and older women is key to growth, as well as enhancing men's opportunities in a wider range of sectors and jobs.

NELEP: Priority Areas for Action

The **Expert Paper** produced by **Professor Linda McDowell** argues that "*a two pronged and interconnected approach that is based on raising aspirations and challenging stereotypical images of the region, in association with practical interventions to improve the skills base of the region and to attract and retain suitable economic activities and highly skilled well-qualified employees"* appears essential. It is also noted that policies that may have relatively little payoff in direct employment terms may, nevertheless, be crucial in attracting, educating and retaining highly skilled workers. The paper sets out three overarching policy areas for action based on the strengths and weaknesses of the NELEP area:

1. **Constructing key educational pathways**, linked to the skills needs of the region, with a new focus on transferable skills.
2. **Providing clear pathways into and between employment;** developing new links between employers and training providers at all levels and improving skills in the workplace.
3. **Encouraging and retaining talent** in the region.

These closely align with the 13 priorities for action identified in the Skills Action Plan:

Supply

1. Increase the proportion of working age residents qualified to Level 3 and above.
2. Tackle the skills barriers to sustainable employment for those who are unemployed and have low/no qualifications.
3. Develop high level skills to support growth of key sectors.
4. Address gender imbalances in supply to skilled jobs.

Demand

5. Skills support for creation of more high skills/high value jobs.
6. Increase employer investment in skills.
7. Increase employer engagement with higher level apprenticeships.
8. Skills support for high value replacement demand for labour.

Interconnectivity

9. Develop a more coherent IAG offer – especially at school level.
10. Skills brokerage for employers.
11. Establish employer led process for articulating and communicating skills needs.
12. Greater local autonomy around skills
13. More effective performance and management of skills system to drive more effective skills investment decisions.

The Skills Action Plan is yet to be developed. The sections below set out the detail provided in stakeholder responses which is relevant to each of the priorities.

Increase the proportion of working age residents qualified to Level 3 and above

The need for higher education to be fully included in a 'cradle to career' review of skills provision in the North East is set out in the **North East Chamber of Commerce's** response on behalf of the four universities. It states that "*this would enable the most talented students to access higher education through both academic and vocational routes"*.

Support to tackle the skills barriers of those with low/no qualifications

The responses from stakeholders make the case for supporting those who have low skills and who are either unemployed or in employment. The importance of entry level opportunities and progression routes for those who do not have the skills/opportunities to take advantage of the high growth sectors is identified as a cross cutting issue in the response from **DWP and Jobcentre Plus.** The response from the **Northern Group of Labour MPs** also states that even with the current level of unemployment, there are shortages in the mid-range of technical skills (NVQ 2) – an area which this priority could seek to support.

The response from the **AoC NE** draws attention to the significant expertise and commitment of the colleges directed to the employability agenda. However, it noted that the absence of programmes for unemployed 16-18 years olds and the existence of a pool of experienced unemployed adults expose the group to 'long term scarring'. The response calls for changes which remove the difficulties in referring young people from EFA to SFA funded provision as they find apprenticeship and employment opportunities mid-programme.

The response also calls for all study at Level 2, including second qualifications, to be fully funded. It suggests that there is a need for subsided provision of units and full qualifications for those in low paid employment as well as for those who are unemployed. The AoC NE expresses willingness to work with the NELEP, partners, Central Government and alongside employers to develop pre-apprenticeship programmes with a focus on transferable skills and employability and to review the current provision for 'Preparation for Life and Work' to determine what changes can be made that will gain employer buy in and better meet their needs.

Address gender imbalances in supply to skilled jobs

As outlined in the earlier section, the **expert paper** produced by **Linda McDowell** calls for action to increase the labour market participation rates of both young and older women, as well as enhancing men's opportunities in a wider range of sectors and jobs to tackle gender imbalances. The issue of gender divisions has also been raised by the **NEWomen's Network** and **the Northern Group of Labour MPs.**

The difficulties in challenging regional stereotypes are noted, setting out the need for *"education, cultural changes and policies to attract and retain young women and men in 'non-traditional' sectors and positions"*.

At the same time, policies are necessary to encourage women to have careers and families, especially as the birth rate is falling. The need to acknowledge the argument that public sector spending cuts directed at young families (as in the Autumn statement 2012) discourage women from working is also highlighted. In the UK, the Women's Budget Group is monitoring women leaving the workforce because of high childcare (and transport) costs. The rising costs of childcare and variable quality are noted as areas for national action. In particular, the paper recommends:

- Monitoring the impact of all policies for gendered effects (which include male as well as female disadvantage).
- Exploring ways of resisting downward occupational mobility for women on childbirth and to retain human capital (a great deal of which is developed 'on the job) through flexible re-entry schemes and re-training after maternity leave.
- Linked to the above, developing a strategy for lifelong learning which empowers men and women through occupational mobility.
- Realising women's potential though training courses specifically designed for women.
- Developing high quality apprenticeship schemes for non-traditional entrants (e.g. apprenticeships for women in IT).
- Encouraging men into 'atypical' forms of employment.
- Improving careers advice to overcome gender mainstreaming.

Intervention at an early age is also acknowledged; with suggestions that access to science based courses for girls and arts based courses for boys should be enhanced.

Skills support for creation of more high skill/high value jobs

While the North East has a good record of retaining graduates, the need for further activity to increase retention is highlighted in the **North East Chamber of Commerce's** response on behalf of the four NELEP universities. The universities (supported by business involvement) need to effectively market career opportunities available within the local labour market region to ensure that vital skills are retained within the economy to help drive growth. Business involvement is needed to create gradate level opportunities within the labour market as well as involvement in career and employability services to enable universities to highlight the opportunities available.

In terms of support for specific schemes, the response calls for coordinated support to help identify SMEs who would benefit from university services (and that are often harder to reach) to help strengthen private sector growth. This could feed into activities such as Sunderland University's Graduate Internship Scheme. Tax incentives to stimulate demand for higher level skills and that work for both larger and small companies are also called for in the response by the **AoC NE.**

Increase employer investment in skills

While the current levels of employer investment are similar to those of other LEP areas, there is a question about the potential to stimulate further investment. The **AoC NE** has identified an opportunity to work with the NELEP to raise the profile of the work that colleges do in STEM, digital and other value added sectors as well as the delivery of skills for business and administration and the creative, leisure and care industries. To encourage employers and learners to see the value of investing in learning, the **AoC NE** is also willing to work with the NELEP to develop the capacity to generate a high quality, online prospectus that relates to any sector.

Linked to investment in skills, developing employer understanding of their role in providing opportunities for young people to develop their employability skills, either in partnership with schools or directly for young unemployed people, is identified as a cross cutting issue in the joint response from **Jobcentre Plus** and **DWP.** The response also expresses a commitment to working with partners to encourage employers in Enterprise Zones and across the wider LEP area to engage with DWP for vacancy filling, skills provision and Get Britain Working measures, for example by offering work experience placements.

Increase employer engagement with higher level apprenticeships

Based on the lack of value or opportunities that SMEs identify to facilitate the supervisory skills associated with the Level 3 framework, the response from the **AoC NE** sets out that there is a need for scope to replace supervisory objectives with advanced vocational skills at Level 3.

In terms of post FE progression, the **North East Chamber of Commerce's** response on behalf of the four universities highlights an opportunity for growth in the universities' interactions with FE to provide full career pathways stemming from apprenticeships. While foundation degrees were introduced to bridge the gap between FE and HE, there is greater potential to support progression from apprenticeships through to higher and graduate level apprenticeships.

Establish employer led process for articulating and communicating skills needs

Development and delivery of a joined up employment and skills service that is responsive to the current labour market and future demand is highlighted as a cross cutting issue for **Jobcentre Plus** and **DWP**. There is an opportunity to link to the work of the Jobcentre Plus District Managers (that now have greater autonomy to focus resources on relationships with businesses) in gathering employer views. Similarly, **NCFE** – a national awarding organisation – suggests that their activity and knowledge of working with providers and industry representative agencies nationally can support them in increasing their relationship with the NELEP and meeting the region's skills and economic needs.

In the higher education context, the Government response to the HE White Paper sets out the challenge to make England the global leader for business-university collaboration. It is noted in the **NECC** response that awareness should be raised amongst local partners of the universities leading business engagement activity. The response recommends that employers should be involved in shaping both the curriculum and delivery methods. In particular, focus is placed on gaining greater insight into niche skills gaps to enable universities to use CPD provision as a platform to obtaining a broader qualification, as well as collaborative work with high growth SMEs in the LEP's priority sectors.

NELEP: Guidelines for Specific Actions

Based on the Evidence Base, initial guidelines for the specific actions that will be set out in the Action Plan were outlined in a presentation delivered by **Professor Alan McGregor** of TERU at Glasgow University. This included:

- Ensuring that any new or freed up resources aligns with (rather than duplicating) existing provision.
- Ensuring that new interventions do not make the skills system more cluttered.
- Potentially focusing early actions around supporting the skills pipeline for existing employers with high value jobs to be filled and starts up with high value potential.
- Developing a skills system which responds quickly and in volume as opportunities emerge on the horizon given that predicting which high value sectors will expand and when is difficult.
- Facilitating more effective matching of skills demand and supply.
- Prioritising certain skills levels.

The need to create a compelling case for central governments and its agencies for significant devolution of skills funding and/or greater flexibility in existing funds is also highlighted – an argument which is echoed in the **expert paper**. It is recommended that this should be based upon clear and strong asks which set out precisely what flexibilities are required and what value this will add for the North East and the UK. This will support the NELEP's influencing role, which needs to be articulated as do the benefits for partners to encourage and drive change.

The presentation also sets out the need for clear lines of responsibility for managing the improvement of the skills systems and sets out that effective management will require (i) greater responsiveness to economic development needs, (ii) more effective measures of systems performance and (iii) making hard decision about 'pruning' ineffective provision. Regular monitoring and review of what has been achieved through the Skills Action Plan is also recommended to support the delivery of change.

LAND AND PREMISES

The **SQW Review** of Existing Evidence provides an overview of premises and land in the NELEP area. The report acknowledges the considerable changes in terms of employment locations over the past twenty years, while highlighting that the tendency towards agglomeration evident in some other city regions is less pronounced as yet in the NELEP area.

The report notes the concentration of office based employment in a number of centres:

> *"Large concentrations of businesses are found at out of town locations and industrial parks as well as the city centres of Newcastle, Sunderland and Durham, with their higher education, tourism, cultural assets and significant concentrations of public administration roles and financial, business and professional services. Office based services are found primarily in central Newcastle, Gateshead, Sunderland, Durham, Cobalt, Doxford International Park, Gosforth Park, Washington, Team Valley, Peterlee (Bracken Hill Business Park), Killingworth and Newburn Riverside."*

The Tyne and Wear City Region economic geography study found that increases in employment were evident across the NELEP area between 2000-2008, and this was in part a reflection of the out of town business parks, many of which were popular with new inward investors. The SQW report also highlighted these locations:

> *"Particularly important business parks include Cobalt Park, Team Valley, Washington, Doxford International Park, Gosforth, Cramlington, Northumberland Business Park and Newburn Riverside; all have available car parking and good access to the strategic road network."*

These newer locations present challenges in terms of access to job opportunities for those dependent on public transport, covered in the skills analysis, and also adds pressure to the strategic road network and its capacity at peak hours, where new investment is linked to avoiding development constraints at key junctions.

Retail is focused in Newcastle, with 439,000m^2, almost twice the level in Gateshead 224,000m^2 in second place (of which 169,000m^2 is the Metro Centre) and much larger than North Tyneside 205,000m^2 and Sunderland 192,000m^2.

There are a considerable number of vacancies in most of the town centres in the NELEP area and the loss of many high street names has led to calls for actions to strengthen town centres and avoid a prevalence of charity shops and food outlets.

There are a number of challenges with regard to retail, including:

- The growth of internet shopping, and the implications for distribution centres and the need for a high street presence.
- The preference for out of town centres for some retailers and consumers (based on ease of access, lower rents/costs and free car parking).
- The longer term role of towns and cities as shopping and leisure centres in the light of changing consumer trends.

These issues have implications for the land and property market as well as transport and employment, and will affect very large centres as well as smaller towns and centres.

Manufacturing is concentrated in a number of historic centres and there is a renewed focus on coastal/port locations which can support new activities in renewable energy. SQW noted the following locations:

> *"Key manufacturing sites in the NELEP area are at Washington, Team Valley, Boldon Business Park, East Gateshead, Peterlee, South Shields, Jarrow Hebburn, Portobello, Blaydon and Cramlington."*

Land Availability

With the exception of South Tyneside all of the local authorities have a large supply of employment land, typically around 200 hectares. This supply includes a large proportion of brownfield land sites and there are issues of remediation and suitable access in a number of local authorities.

Employment Land Availability		
Area	**Date**	**Description**
Northumberland	2011	229 hectares
North Tyneside	2011	222 hectares
Sunderland	2010	195 hectares 19 hectares in central Sunderland for mixed use development
Newcastle	2010	147 hectares 46 hectares at Newcastle Airport
County Durham		103 hectares (gross amount of new B class with extant planning permission)
Gateshead		100 hectares
South Tyneside		46 hectares

Expert Paper on Land Markets in the North East of England

Professor Henry G. Overman (LSE and SERC) produced an **Expert Paper on Land Markets in the North East of England.** The paper notes a number of key points at the outset:

- *The area is characterised by a large number of contaminated ex-industrial sites. At a minimum, these sites require expensive remediation before they might be suitable for alternative uses.*
- *In both the commercial and residential sectors, there are concerns that existing stock tends to be of low quality and limited range.*
- *Weak private sector demand implies low rental values and a subsequent lack of private sector investment in new commercial development (or re-development of existing stock). To some extent, in the recent past, weak private sector demand has been offset by public sector demand. But even before the recent cuts to expenditure, public sector demand only ever partially offset these weaknesses.*
- *Similarly, in the residential sector weak private sector demand is insufficient to generate significant private sector development. More worryingly, despite relatively low residential prices, low income levels and employment rates lead to affordability problems for a large number of households.*

The consultation process indicated that local stakeholders consider that substantial progress had been made pre-recession in terms of improving the built environment and there remains broad public sector support for long term policy objectives in terms of the use of brownfield, encouragement of mixed use mixed tenure developments, although these policy objectives are not as strongly supported by private sector developers and some local policy makers who have a remit to deliver economic growth.

In terms of longer term growth, there appears to be some concern that the larger business sites that are available offer rents that are ‘too low’ and that, although this has helped create employment, this employment has been in low value added activities (such as call centres). A related concern is that existing premises may not be in the right place or of the right quality to attract higher value added activities.

The Enterprise Zone is seen as offering a major opportunity to address these concerns and attract higher value added activities to the NELEP area.

With regard to the housing market there are continued concerns about affordability as declines in income and employment have offset falling prices. Some local stakeholders still worry that the low quality and limited range of residential stock inhibits the attraction and retention of higher skilled workers, although the NELEP has some very attractive rural residential areas.

Market Change

The **Expert Paper** concludes that in the short run there is limited scope for local policy interventions to directly target development values or to have much impact on mortgage availability, even where Planning Officers are actively renegotiating previous section 106 commitments.

Current policy levers are predominantly aimed at boosting development on land with existing development permissions and the Paper suggests as an “*alternative, focusing on granting new permissions on sites that have high development values and lower cost, shifting the planning process to be more market focused and responsive to price signals emerging from land markets. To some extent,* *this appears to be happening, but given its economic growth remit, the LEP may wish to consider ways of reinforcing this change."*

The **Expert Paper** therefore recommends shifting development away from brownfield sites towards more desirable, less costly greenfield sites.

> *"In summary, of all the available policy options, **increasing the supply of market friendly sites would appear to be the only available mechanism for addressing short run land market problems**. Of course, this raises questions about the appropriate balance between environmental, social and economic benefits of development. It is for local policy makers to decide where they feel the correct balance lies but if they wish to increase development rates in the short run, the evidence suggests that plans will need to be more market focused. This highlights the importance of having an up-to-date local plan."*

The **Expert Paper** then proposes that local authorities should put in place market focused local plans and allow the LEP a degree of co-ordination at the regional level:

- *A central priority for the LEP must be to ensure that **all local authorities have in place an up-to-date Local Plan**, developed within the context of the National Planning Policy Framework, which sets planning policies in the area. The LEP should ensure that local plans are more market focused when identifying sites available for development.*
- *To develop effective plans that are more market focused and take account of relative prices across the LEP area, will require careful coordination at regional level in order to control the overall supply response. Legacy documents from the RDA suggest that it was unsuccessful in achieving this, which implies that **the LEP needs to focus on developing coordination mechanisms which are more effective than those implemented by the RDA**. In practice, developing a stronger coordination mechanism may require local authorities to effectively grant the LEP some statutory plan-making powers for the LEP area.*

The paper acknowledges that this raises questions for local policy makers about the appropriate balance between environmental, social and economic benefits of development.

Property Industry Perspective

Developing Consensus, which represents the region's leading property investors, developers and professional advisors and **G9,** which comprises the leading Charted Surveying practices specialising in the commercial property sector put forward the case for a 'city region' approach to be adopted across the LEP area through a Combined Authority united under a single 'Greater Newcastle' brand. This authority should take responsibility for 1) economic development, 2) planning for land use development and infrastructure development, and 3) inward investment.

The change is set out in clear terms in the evidence paper submitted by the two groups:

> *"The present situation is that development activity has stalled, the supply of modern fit for purpose accommodation is diminishing and existing stock is increasingly obsolete.*
>
> *The present situation is that in large part Greater Newcastle competes for occupiers based on occupational costs being below the level that could sustain the capital costs to build the property. This is not sustainable."*

In addition to the proposal for a Combined Authority, the paper puts forward ideas with regard to planning, infrastructure, and inward investment. This includes the need for an economic development plan which deals with the release of strategic sites for development to accommodate growth in all sectors, including land for new housing, and is flexible enough to cope with and respond to changes in market circumstances.

With regard to infrastructure, the suggestion is that the NELEP and the wider region must decide on the key infrastructure projects that will stimulate the most economic growth. This should focus on the following objectives:

- Rail journey times to central London to be no more than two hours by 2030.
- Improved direct connections from Newcastle Airport to key markets, including the US, by 2015.
- Upgrade of the A1 (M) with a priority of increasing capacity of the Newcastle western by-pass, and full three lane motorway connectivity to the south.
- Improve road and rail connectivity to the regions major ports.

Developing Consensus and **G9** put forward the case that inward investment activity must be co-ordinated across the region, and local authorities should consider delegating responsibility for managing and dealing with inward investment enquiries and activities to a single body (part of the Combined Authority) to allow the region to be marketed as an effective whole rather than its constituent parts.

In a section addressing the value gap, a set of targeted initiatives are proposed including:

- Removing onerous planning requirements and restrictions from speculative development activity and key growth areas.
- A focus on enabling land release in high demand locations.
- Speeding up and reducing the costs of planning applications.
- Ways of joint working with the private sector to speed up the development of public land.

Developing Consensus and **G9** also provided the report of a workshop held in the autumn of 2012, attended by developers, surveyors, architects and solicitors. The workshop covered many of the points raised in the submission reported above, and highlighted the Northern Development Company and the Tyne and Wear Development Company as examples of effective regional organisations.

Nathaniel Lichfield & Partners submitted a detailed report on behalf of the **National Housing Federation, the Homebuilders Federation, and the Northern Housing Consortium**. The submission makes the point that the NELEP population is projected to increase by 119,000 over the next 20 years and with trends pointing towards smaller households, the NELEP will need to accommodate some 131,000 households by 2030. The importance of housing to economic growth is highlighted:

> *"Housing supply issues have a fundamental impact on the quality of life of individuals and households in the NELEP and the ability of the local economy to deliver growth. Research has consistently pointed to the importance of new housing in helping to maintain a skilled and talented workforce."*

The paper provides a number of examples of housing cross-subsidising infrastructure and commercial development, including examples such as Greta North Park in Newcastle, the Durham Gate Scheme in Spennymoor, as well as Cramlington and Washington.

> *"Given the limited appetite for speculative development of employment premises and the reduced availability of public sector funding to unlock sites, the cross subsidy offered by residential development remains critically important to the future delivery of jobs in the NELEP."*

With regard to housing finance, the paper proposes two areas for action:

- **Improving mortgage availability:** a range of ideas with a deposit funding pot established from a wide range of sources including HCA, developers, local authorities, and house builders.
- **Rental certainty:** LEP, HCA and Government to consider regional grant differentials to support affordable housing.

With regard to planning, the paper proposes a number of areas for action:

- The rapid adoption of growth focused plans.
- A positive approach to planning applications.
- A sensible approach to value pulling requirements such as public art and energy efficiency.
- A proactive and sensible approach to risk and reward, developer and landowner returns.

Many of the points made with regard to planning reflect the **Developing Consensus** and **G9** submission.

Public Sector Perspective

The **Homes and Communities Agency (HCA)** supports the delivery of affordable housing, market interventions, and land and economic development priorities. It holds significant land and assets in the North East (190 sites and over 900 hectares). The HCA works with the North East Stewardship Committee (made up of the two LEPs and Local Authorities), dealing with assets transferred from One North East. These assets have an approximate value of £150m.

The HCA has a direct role in economic growth through its work in bringing land forward for employment, commercial and leisure uses and is working closely with LEPs and core cities as part of City Deals.

The HCA is seeking to work with other stakeholders as part of a comprehensive investment strategy, including skills and sector development. Recent research and government programmes support a focus on core cities and other cities and places that can deliver growth. The HCA is supporting a focus on public and private sector development in land and infrastructure to bring forward housing development and spatially, this would include:

- Unlocking development opportunities in the Newcastle-Gateshead core through the Accelerated Development Zone, the North Bank of the Tyne Enterprise Zone and the complementary South East Northumberland Enterprise Zone.
- Creating a more competitive central business district in Sunderland City Centre.
- Ensuring the most is made of Durham City Centre and the potential to meet executive housing aspirations set out in the County's Local Plan, something which would benefit the wider LEP area.

The **Homes Group** have produced a short paper looking at the need for and challenges of increasing housing development in the region. The Group's submission proposed the establishment of Housing Enterprise Zones, with Local Authorities given enhanced CPO powers to enable site amalgamation. The Regional Growth Fund could be used to develop infrastructure, with enhanced New Homes Bonus and tax incentives to encourage investment.

The paper suggests the establishment of a round table of industry figures and stakeholders to explore the concept and establishing a dialogue with the Treasury around stimulating the economy though house-building.

The **Local Authorities** provided detailed submission of economic plans and strategies, including spatial priorities for new economic development. These include well established locations, a number of which will require new investment over the next 10 years. The majority of Local Authorities are in regular discussion with both commercial developers and house builders. The table below sets out a short selection of development priorities, a number of which relate to key industrial sectors.

Local Authority	Illustrative List: Selected Spatial Priorities
Northumberland	Ashington, Blyth, Cramlington
Gateshead	Accelerated Development Zone Gateshead Quays, Baltic Business Quarter Team Valley
Durham	Durham City NETPark Peterlee and Newton Aycliffe
Newcastle	City Centre Accelerated Development Zone
Sunderland	City Centre Port of Sunderland
North Tyneside	Cobalt Business Park River Tyne North Bank
South Tyneside	National Advanced Manufacturing Park Low Carbon Enterprise Zone

These locations are only some of the investment and residential development locations which have been prioritised by local authorities.

In terms of development challenges, Local Authorities report a continuing need for infrastructure to unlock sites, some form of gap funding support or equity investment model, while affordable housing and executive housing is proving difficult to deliver in the current market.

Both the public and private sectors have reported difficulties in bringing forward both commercial and residential development under current market conditions. However, there remain structural challenges in the North East property market which are likely to persist even when more normal market conditions return.

TRANSPORT

The **SQW Review of Existing Evidence** notes that the NELEP has substantial infrastructure assets which form key nodes and important channels of communication. These include:

- **Major roads:** including the A1 (M) and the A19 north/south routes and the A69 westwards.
- **The Tyne and Wear Metro system:** which covers five districts.
- **Rail infrastructure:** including the East Coast Main Line and the Newcastle and Carlisle railway/Tyne Valley Line.
- **Newcastle International Airport:** which provides important passenger and freight services; with direct connections to the rest of the UK, Europe and Middle East.
- **The ports:** of Tyne, Sunderland, Blyth and Seaham.
- **Ferry services:** from the international ferry terminal at North Shields.

In spite of these assets, transport and connectivity are regarded as weaknesses with the OECD Report describing infrastructure in the region as 'significantly below national and OECD standards' with a 'low infrastructure density'. Although it is also noted that the sub-region is now only 2hrs 50m from London by rail, 1hr 20m from Leeds, 1hr 25m from Edinburgh and 2hrs 20min from Manchester.

The SQW evidence base highlights that transport – both in perception and reality – is seen as a barrier to increasing economic activity in the NELEP area and in particular to attracting businesses, accommodating growth and connecting workers to employment opportunities. It notes that many commuters have moved outwards from urban centres and the increasingly long-distance commuting patterns have led to congestion, particularly around river crossings.

The need to effectively link unemployed residents to places of employment growth is identified as a future challenge, with areas of persistent deprivation and worklessness being located away from employment centres and having poor accessibility (and public transport links) to areas of employment growth.

The response from the **Northern Group of Labour MPs** acknowledges that the need for better infrastructure is well known and understood in the region. It comprises:

- **Roads –** both within the region and connecting the region with its neighbours;
- **Rail –** especially freight capacity and interconnection with air and sea hubs;
- **Airports;**
- **Ports, and;**
- **Broadband –** with many rural areas lacking broadband (see rural section of report).

Transport Investment Principles

The **Expert Paper** on **Transport and Infrastructure** produced by **Professor Ian Docherty** of the Adam Smith Business School at the University of Glasgow summarised the current transport investment principles:

> *"In the mid 1990s, the UK Government set up the Standing Advisory Committee on Trunk Road Assessment (SACTRA), which was directed to investigate to what extent traditional methods of transport investment appraisal reflected the actual economic impacts of new schemes. The Committee's final report concluded that there were, at the minimum, good and well-founded theoretical reasons to believe transport investment promoted economic growth so long as (a) a certain number of factor conditions were satisfied in terms of the type and location of the investment and (b) infrastructure development was supported by a range of other policy interventions.*
>
> *SACTRA was one of the first organisations to state clearly that transport investment did not necessarily lead to direct economic growth per se. But the report did also set out number of important mechanisms through which transport improvements could, in principle, improve economic performance. These include:*
>
> - *Reorganisation or rationalisation of production, distribution and land use;*
> - *Extension of labour market catchment areas;*
> - *Increases in output resulting from lower costs of production;*
> - *Stimulation of inward investment;*
> - *Unlocking previously inaccessible sites for development;*

- *A 'catalytic' effect whereby triggering growth through the elimination of a significant transport constraint unlocks further growth."*

Given the changing distribution of employment over the past 15 years, the success in terms of inward investment, and the evident extension of labour market catchment areas, evidence suggests that transport investment has contributed to economic growth in the manner described in the SACTRA Report.

Transport Investment: Two New Caveats

The **Expert Paper** on Transport and Infrastructure identified two caveats with regard to transport investment. These are:

- **Two way street:** The conclusion of New Economic Geography (NEG) that reducing the costs (in terms of both money and travel time) by improving transport networks often favours the concentration of economic activity in a small number of places, rather than a more even dispersal across regions and countries. The NEG view that the 'two way street' effect is real and important and improving links to peripheral regions can just as easily take economic activity out of an area.
- **Peak car:** car journeys have been declining for a few years and if this is a societal change, rather than the temporary result of higher costs/lower incomes, it could lead to a greater priority for investment in public transport, rather than road/congestion improvements.

In the case of the two way street, which applies to strengthening cross country links to Leeds and Manchester, the substantial evidence base to support HS2 identified the majority of benefits of improved connectivity as being in the north, not the south. This may, however, assume that supporting policies are in place to capture the full benefits of new transport investment. Nevertheless, the evidence suggests that improved inter-regional connectivity needs strong supporting policies to capitalise on benefits.

The **Expert Paper** also sets out two scenarios for the North East which takes account of the possible conflicting trajectories for transport demand. While there are views that the decreasing traffic levels in the past several years is a short term phenomenon driven largely by an increase in the cost of fuel and insurance, there is also the contrary view that 'peak car' has been reached and that traffic levels will continue to fall. This *could* lead to two very different futures for transport in the North East, which are summarised in the paper as follows:

- Under scenario one, **where car transport continues to be by far the most important element of the wider mobility system,** the region continues to be highly dependant on the car, with public transport playing a supporting role. The region's polycentric nature could become an increased advantage, distributing new development and the consequent demand for transport across the region. This would minimise congestion but further entrench problems of access to services and especially employment for those (often vulnerable) groups without a car.
- Under scenario two, **where demand for car travel continues to decline,** the region's public transport networks would have a larger role in satisfying the demand for travel. The metro would become more important, offering efficient, web-connected travel between the regional centre in Newcastle and other sub-centres. This would imply a shift to a transit-orientated development strategy where employment and key services are directed to a number of fewer, larger concentrations. A strategy for competitiveness based on this type on transport and land use orientation would privilege some locations quite substantially.

The Expert Paper recommends that the LEP should assemble two lists of projects (one for each scenario) to test against bringing productive assets into economic use and maximising the pool of available labour, and favouring projects which contributed to both scenarios. **An accompanying recommendation suggests prioritising transport schemes that could contribute to broader policy goals**, including place making, with schemes such as pedestrian and cycling infrastructure.

The Strategic Road Network

The **Highways Agency**, which manages the Strategic Road Network on behalf of Government, has confirmed that there are high levels of congestion in parts of the network in the morning and evening peak. The A1 Western Bypass is heavily trafficked and together with a number of junctions on the A1 and A19 corridors within Durham are suffering the greatest stress. The issue of congestion is noted in a number of responses, including the submission from **TT2 Limited**, which notes that despite significant improvements prior to the construction of the second Tyne Tunnel, it is vital that the benefits of the New

Tyne Crossing can be maintained and that the potential for the tunnels to actively boost the regeneration of the east coast is not loss as a result of heavily congestion junctions either side of the tunnels.

The Highways Agency is now taking forward a series of improvements including the A1/A19 Seaton Burn junction and the A1/A184 Lobley Hill Improvements. Nevertheless, it is proving difficult for network improvements to keep pace with the levels of congestion and development pressure.

A number of local authorities also made the point about the need to remove road/access/congestion issues in relocation to important employment locations.

The **Highways Agency** is working with Local Authorities to understand development aspirations and have stated that a number of locations would require significant investment before the Agency could fully support development plans. Such restrictions could reduce the location choices for inward investors and companies with expansion plans.

Sustainable Transport

Both the response from **Sustrans** and the **North East Combined Transport Roundtable (NECTAR)** call for sustainable transport solutions as a means for generating economic benefits (including savings) and tackling issues such as congestion.

Sustrans' report draws on the results of the Department for Transport's National Travel Survey which shows that journeys of under five miles comprise over two thirds of all journeys and that more than half of such journeys are made by car (55%), compared with around a third on foot, seven per cent by bus and two per cent by bike. It also notes that a quarter of car journeys are less than two miles, contributing substantially to congestion and unreliability on existing networks in the NELEP area.

Within both of these papers there is an emphasis on focusing infrastructure investment priorities on public transport, walking and cycling. This includes:

- Prioritising schemes to improve connectivity with public transport (e.g. cycling and parking at rail stations) and reduce car use for local trips.
- Implementing and promoting the cycling, smarter choices, behaviour change and sustainable travel initiatives in the recent agreed City Deal.
- Identifying policies which reduce the gap between public and private transport costs.

The **NECTAR** paper also favours an emphasis on transport improvements within the NELEP area stating *"we would advocate region-wide investment in packages of smaller schemes, 'soft' measures such as individualised travel marketing, integrated ticketing and making best use of existing infrastructure through improved management"*.

The ability to influence decisions affecting the rail and bus networks is highlighted as being essential in addressing challenges of connectivity to benefit businesses and residents by the **LA7 Leadership Board.**

Coordinated transport planning to support project delivery

The response from the **Institution of Civil Engineers (ICE)** identified a lack of long term planning and coordination as one of the key transport issues facing the region and the engineering sector. It stated that *"there is no clear body undertaking the planning and prioritisation for transport investment"*.

It also noted that while the economic downturn has intensified challenges for the engineering sector to deliver projects, prior to this, there were further issues linked to the inability of different parties to agree on the prioritisation of schemes and the absence of a clear programme of projects leading to a start/stop nature for projects and funding. Consequently, **ICE** calls for a public and private sector body to plan, coordinate and prioritise multimodal transport projects.

Investment in strategic transport infrastructure and connectivity is highlighted by the **LA7 Leadership Board** as an area for the Review Panel to consider in developing the recommendations. The paper states *"the North East requires a fairer share of national infrastructure investment, greater control in directing such resources, and a greater say in major decisions affecting the wider area, such as rail franchise arrangements".*

The distribution of national investment is also raised by the **ICE** which sets out that infrastructure investment per capita in the North East is estimated at 70% of the national average, and almost half of the levels in the South East even after major schemes, such as Crossrail and Thameslink have been removed.

Air Transport

Newcastle International Airport Ltd has submitted a response to the review, which highlights the importance of the airport to the North East in supporting economic activity, keeping people and businesses moving and linking places that are trading as part of a global economy.

This includes findings of an independent economic impact assessment by York Aviation which shows that the airport supports 7,800 jobs (including direct, indirect and induced jobs) and generates £402.5m in GVA annually. Other benefits generated include tourism impacts (including 1,750 tourism jobs), shorter journey times (estimated to bring net economic benefits of £243.3m in 2012) and export activity (with an estimated value of £173.6m per annum).

The airport provides good connections to cities such as Southampton, Bristol and Exeter which are time consuming to reach by road or rail and a new connection to Dubai has shown the potential for new international routes. Some 500,000 people use the airport to fly to Heathrow, and this number is not expected to reduce substantially even if the rail journey time to central London is reduced. It will therefore, in the view of the airport and many local partners, remain a very valuable infrastructure asset.

The response noted that the airport accommodated 4.4m passengers in 2011, but has terminal capacity that could handle between 7 and 8m and a runway that could accommodate 20m or more. The role and importance was stressed by many local partners including **local authorities** and organisations such as **NewcastleGateshead Initiative**.

The **Expert Paper** highlights the importance of access to long haul air services to key business locations and expresses a concern that increased runway capacity at Heathrow or elsewhere in the South East will not necessarily lead to improved services for regional airports. The **Expert Paper** recommends that the NELEP should work with Government to develop a strategy for increasing the number and range of direct flights to European hubs such as Amsterdam and Frankfurt to increase choice for business users, although it does acknowledge the State Aid and other issues around route development support.

The importance of the airport and further development of direct flights and flights to international hub airports featured in a number of responses from both public and private sector organisations.

Port Activity

Establishing a fully integrated and interconnecting transport system (including road and rail) is highlighted as being key to the ongoing success of the **Port of Tyne** in their response. There are a number of road and rail improvements which have been identified to support this, including those outlined in the **North East Business Transport Priorities document**. The improvements include immediate, short, medium and long term road schemes as well as an increase in rail capacity for cargoes being transported to or from the Port of Tyne to capture market growth and opportunities that already exist. The rail improvements would require major investment at the local, regional and national levels.

There are also opportunities for the Port in the renewable energy sector. The Port is looking to secure additional import volumes of wood pellets in a market that is anticipated to expand rapidly, and also to secure large scale offshore wind turbine manufacturing and increase its presence in the general offshore oil and gas sector. For this to occur, further significant investment is required; estimated to be in excess of £350m in supporting infrastructure.

A number of respondents noted the role of ports in the development of renewable energy investment and in new infrastructure in areas such as biomass.

Business Community Priorities

Transport has been identified by a group of North East businesses and business membership organisations as an area for action to help the private sector economy achieve its growth potential. This has resulted in **North East Transport Priorities document** which has been jointly published by the **CBI North East** and the **North East Chamber of Commerce**. The CBI commented that "*we recognise other valuable issues exist and schemes have been proposed, but through discussion over several months, this lists presents a realistic sector of strategic priorities which we can justifiably call for action on."* The list covers road and rail projects as well as policy changes relating to airports, ports and roads.

The announcement of 'pinch-point' schemes in the Autumn Statement 2012 signalled support for several of these priorities, with the **CBI** emphasising that there is a need to ensure these are now delivered as swiftly as possible.

Strategic Transport Priorities

There are five strategic transport priorities which emerge from the evidence, all of which relate to the infrastructure needed to support a robust and modern economy. The first three priorities relate to improving internal connectivity within the NELEP, while the final two relate to inter-regional and international connections. These are:

1. Reduced congestion within the NELEP area.
2. Better public transport, particularly to employment locations.
3. More local influence/control over transport investment.
4. Faster/better inter regional connections – London, Leeds and Manchester.
5. Improved air services.

Reduced congestion within the NELEP area

The issue of congestion was covered in the **Expert Paper** on Transport and Infrastructure and also featured in the responses of several local authorities. **Docherty** identified the influence of the Eddington Report on the prioritisation of transport projects, based on transport's contribution towards a number of processes (including cluster and agglomerations of economic activity, expanding labour market catchment areas, improving job matching, increasing labour market flexibility and facilitating business-to-business interaction) is most significant within large high productivity areas, advocating a re-ordering of infrastructure investment in favour of the major city regions and cautioning against speculative investment to inspire such growth in other areas.

Docherty notes from Eddington's work that:

> *"First, that the cumulative impact of several relatively small improvements to infrastructure networks can often be at least as big as that of the large 'megaprojects' (such as, in the current policy context, high speed rail) that often steal the limelight.*
>
> *Second was the recognition that failure to address key identifiable constraints and bottlenecks, such as poorly-performing road junctions or a lack of capacity in hub railway stations, would seriously constrain the ability of cities to compete against places with less congestion, and better quality public transport.*
>
> *…Policy attention has shifted to the kinds of middle-sized schemes that tackle the kind of specific bottlenecks that Eddington identified as the most important targets for action. The North East has several of these, especially on the road network, such as the pinch points on the A1 Western Bypass and the A19 at Testos. Given this, it would seem that the ideal strategy for the North East would be to accelerate the delivery of these improvements."*

This includes areas such as the A1 Western bypass and the A19 at Testos, where there is a programme of well understood improvements for the road and rail networks which are deliverable over the medium term. The paper states that "*this would increase the efficiency of the networks, reducing congestion and journey times, with improvements to the road network satisfying SACTRA's*[3] *test that such investment should release new productive assets – in this case key sites for new employment – into the economy*".

The feedback from the **Highways Agency** that a number of locations would require significant investment before the Agency could fully support development plans makes transport investment a priority for NELEP and the **LA7 Leadership Board** has stated that investment in the strategic road network will be necessary in managing congestion on key routes and improving links to Scotland and other UK destinations.

Better public transport, particularly to employment locations

The ability to influence decisions affecting the rail and bus networks is highlighted as being essential in addressing challenges of connectivity to benefit businesses and residents by the **LA7 Leadership Board.** This includes both local and national decisions, with the paper outlining that, as essential components of transport infrastructure, the North East needs an equitable say in future Northern rail franchise arrangements and in High Speed 2.

Public transport services in parts of NELEP are very strong, although there is evidence of a disconnect between some population centres (including rural centres) and new employment locations which is echoed in the response of several local authorities. The response from the **Northern Group of Labour MPs** states *"commuting patterns within the region demonstrate that travel between areas which are*

[3] Standing Advisory Committee on Trunk Road Assessment

geographically very close if often extraordinarily low because of poor public transport provision" and that *"bus grant cuts have affected many areas badly".* Other aspects of public transport could also be strengthened, and a number of proposals have been set out in the **SUSTRANS** response.

Priorities include more influence over the quality of bus services throughout the region, a greater influence on the rail franchising in the north of England, and the development of an oyster type card which has proved successful in London.

More Local Influence/Control

The **Institution of Civil Engineers** highlighted the need for a long term plan and decision-making process for engineering projects – this need was also identified by a number of local authorities and the **LA7 Leadership Group**. Given the importance of transport infrastructure to development plans there is a compelling argument for a LEP wide plan for economic development and skills and transport and a dedicated infrastructure fund under local control.

> *"**Investment in strategic transport infrastructure and connectivity** - the North East requires a fairer share of national infrastructure investment, greater control in directing such resources, and a greater say in major decisions affecting the wider area, such as rail franchise arrangements."*

The point above is echoed in the response of the **Northern Group of Labour MPs** which sets out that the North East received 0.03% (£13m) of the £40bn infrastructure plan last year.

There are a number of new developments which are likely to increase local stakeholders' influence over both transport investment and the provision of public transport; particularly bus and rail services. It will be important, particularly in increasing the use of public transport, that services are geared towards the needs of local businesses and residents.

Better Inter Regional Connectivity

Faster connections to London have been a priority for the north of England for some time and are highlighted in a number of responses from **sector representatives**. The **Northern Group of Labour MPs** sets out that *"distance from the capital has been an increasing concern with the London focus on finance and services".*

Over the past five years in particular, the argument has been made that faster connections will result in enhanced economic growth. The case of HS2 has been endorsed by the Government, with all-party support. The most recent announcement will see high speed terminals at Manchester and Leeds, with greatly reduced journey times to London operational in 20 years time.

Until 2033 at least, and possibly beyond, the NELEP fast access to London will be the East Coast rail line. While it is difficult to predict improvements to the East Coast line over this extended time period, or how HS2 will be progressed to Edinburgh, reduced journey times and/or additional services at peak hours from Sunderland and Newcastle would go some way to improving connectivity to London.

Travel times to Leeds and Manchester are time consuming, even allowing for improvements to services, and substantial numbers use Manchester Airport for international flights. As both of these City Regions take forward their own growth plans, many business in NELEP will want to access these markets. It will be important that NELEP is able to influence rail services to and from these City Regions.

Improved Air Services

Improved air services will be challenging to deliver due to the economics of the airline industry. Even much larger airports outside of the South East, with greater catchment areas, have struggled to maintain new scheduled international routes. New services by Emirates and Etihad have, however, been a welcome new development for many regional airports.

The UK's main international gateway will be based in the South East, either through an expanded Heathrow, a greater role for Gatwick or Stansted, or the Mayor of London's proposal for a new airport to the east of the city. It will be important that the NELEP has a good service to the main South East hubs for those connecting internationally.

There is an on-going debate on abolishing Airport Passenger Duty, amending it to favour regional airports or investing some of the monies raised in regional initiatives, such as route development. Newcastle International Airport faces a particular challenge from Edinburgh Airport which is likely to be prioritised by the Devolved Administration in Scotland as a strategic transport asset.

The **Expert Paper** recommendation for the NELEP to work with Government on route development is a useful strategy point for the development of further services.

GOVERNANCE

The abolition of ONE North East and the Government Office for the North East, and the introduction of new geographies which reflect LEP boundaries has led to consideration of how best to manage strategies and actions which support economic growth. The seven Local Authorities within the NELEP area have now established the **LA7 Leadership Board** which is responsible for shaping the strategic direction of Newcastle International Airport and for agreeing local major transport schemes and will have a particular focus on economic growth.

The seven Local Authorities have expressed a commitment to working together and collectively with wider stakeholders for the benefit of the region. Although the current arrangements are relatively new, the formation of the Tyne and Wear City Region established a solid foundation for continued collaborative working across the North East. The Leadership Board has expressed a need for greater devolution in a number of key areas:

> *"It is vital that growth policy is tailored to individual areas as needs and priorities vary widely from other areas in the UK. The seven local authorities are keen to explore opportunities to access greater powers and funding delegated from central government to enable locally devised interventions that are delivered in a coherent and planned way*. "

Greater devolution combined with a closer relationship with Government would provide an opportunity to align funding, such as the 2014-2020 European Structural Funds, as well as national sources such as those from the Technology Strategy Board and the Skills Funding Agency.

The **LA7 Leadership Board** has agreed to explore arrangements aimed at further strengthening joint working between the seven Local Authorities and providing collective leadership across the area through a **Combined Authority Governance Review.** Terms of reference have been agreed for a review into the effectiveness and efficiency of arrangements to promote economic development, regeneration and transport in the North East. The outcome of the review will be reported in April 2013. As the North East includes an established **Integrated Transport Authority** operating between the five Tyne and Wear Authorities, the **LA7 Leadership Board** has agreed to include transport arrangements in the review.

The concept of a Combined Authority has been strongly recommended by the **North East CBI**:

> *"The existing economic development arrangements for the North East are considered cumbersome and confusing, with much institutional debris from previous government initiatives still in place and multiple publicly-funded organisations operating across similar areas. Issues such as transport, planning and even inward investment – considered key to business leaders - are mainly handled by local authorities, yet most issues impacting on economic development cross their boundaries.*
>
> *Now that the North Eastern LEP area has been established, it makes sense that procedures impacting on economic development apply uniformly across it. This would be best achieved by the seven local authorities establishing a new Combined Authority with responsibility for strategic economic development, planning and transport."*

The North East **CBI** suggest that the seven local authorities in the NELEP area should delegate functions to this new, streamlined body, modelled on the Singapore Economic Development Board, providing a 'one-stop shop' for both inward investors as well as existing businesses seeking strategic support for growth and sustainable job creation. It suggests that future and existing City Deals and other such incentives should then be aligned to the LEP geography and a review carried out of all other publicly-funded organisations with economic development functions.

Developing Consensus, which represents the region's leading property investors, developers and professional advisors also strongly endorsed the concept of a Combined Authority:

> *"It is the strongly held view of those within the (property) sector that a 'city region' approach is adopted across the LEP area through a Combined Authority united under a single 'Greater Newcastle' brand. This authority should take responsibility for:*
>
> *1) Economic development;*
>
> *2) Planning for land use development and infrastructure development; and*
>
> *3) Inward investment."*

The National Housing Federation, the Homebuilders Federation and the Northern Housing Consortium also endorsed the idea of a Combined Authority.

There are three other areas where the Local Authorities believe further delegation of responsibility would contribute to economic growth and more effective economic development. These are:

- *"**Investment in strategic transport infrastructure and connectivity –** the North East requires a fairer share of national infrastructure investment, greater control in directing such resources, and a greater say in major decisions affecting the wider area, such as rail franchise arrangements."*

Transport related issues are discussed further in the transport section of this report.

- *"**A comprehensive and area-wide approach to skills** – developing a range of job opportunities at all skill levels and agreeing skills priorities that meet employer needs requires a strategic and joined-up approach across the area. Greater influence over skills funding is required to ensure provision is focused on areas of shortage and future growth. Alongside this we would also wish to see a greater local determination of **employment programmes,** linking them more intrinsically with our own investment programme and understanding of growth areas."*

Greater local control and decision making for skills funding are being developed across England through the City Deal process.

- *"**Access to financial tools –** greater availability and use of financial incentives and other measures including those available through Enterprise Zone status and Tax Increment Financing is essential to unlock economic growth at key business locations".*

Already a feature of a number of new initiatives, including City Deal, local authorities are continuing to look at new ways to finance economic development measures both from capital investment and from revenue activities for sectors such as tourism.

The emphasis on more local control of both resources and policy, with investments decisions based on local priorities, is a consistent theme in many submissions, in addition to the emphasis in the **LA7 Leadership Board** submission. The response of the **Northern Group of Labour MPs** also calls for cooperation between the North East LEPs (and the public and private sector) on major issues ranging from exploiting the potential of the North East's universities, major infrastructure projects and the development of green industries.

MANUFACTURING

The **Tyne and Wear City Region Economic Geography Review** (TWCR, 2011) found that manufacturing was in relatively good health in the North East LEP area. Manufacturing is the third largest employer after the public sector and 'financial, professional and business services', employing some 118,800 people (NEEM, 2007) and was the second largest in terms of GVA contribution (£5.2 bn). Productivity in manufacturing averaged £44,000 per head, but varied substantially by sub-sector. In common with the rest of the UK, manufacturing employment fell substantially in the early 2000's (19% reduction 2000-07) although economic output increased by 12%, outperforming the national figure (9%).

The Review found that the region's manufacturing sector held up well during the recession, with bankruptcies and redundancies lower than anticipated. The Review sought to identify strengths, weaknesses and obstacles to growth in the manufacturing sector overall. Strengths were diversity of manufacturing, well-established supply chain networks, improving business networking, research facilities, cost competitiveness, workforce skills and transport links.

Weaknesses included lack of business-led R&D, gaps in supply chains, high level skills gaps, business attitudes/practices, under-developed business-university links and risks relating to the branch plant economy. Obstacles to growth were identified as access to finance, an ageing male workforce, rising energy costs, difficulties in entering established markets, lack of business management skills, a confusing business support environment and lack of time to plan within SMEs.

The **SQW Review of Existing Evidence** identifies the major manufacturing companies located in Tyne and Wear in February 2011, including:

- Automotive – Nissan and Tanfield Group
- Aviation – British Airways, Easyjet and Jet2
- Engineering – Offshore Group Newcastle, British Engine and Parker Domnick Hunter
- Food and Drink – Longbenton Foods, Nestle and Gregg's
- Mechanical Engineering – Siemens Power Generation and Rolls-Royce plc
- Printing and Publishing – Trinity Mirror and De la Rue

Many of these firms introduce supply chain companies either through creating industrial clusters – i.e. Nissan – or forming part of business concentrations – i.e. pharmaceuticals at Cramlington and Durham. While the majority of the manufacturing currently located in the north east is in traditional sub-sectors, opportunities that exploit the region's strengths and resources are being pursued in high growth and emerging sectors, in particular the low carbon sector, with an emphasis on offshore wind. This sector utilises the North East's accumulated strengths in: engineering, professional services, metal goods, construction, manufactured fuels, higher education and power generation.

The **University of Sunderland** was commissioned to undertake an analysis of opportunities and barriers to growth in key manufacturing sectors in the North East region of the North East Local Enterprise Partnership in October 2012. The brief was to consider the actual and potential contribution of manufacturing industry to the North East Local Enterprise Partnership area, specifically examining three sub-sectors:

- Automotive – i.e. Original Equipment Manufacturers (OEM's) and supply chain for all cars, passenger and commercial vehicles and construction equipment (yellow goods);
- Pharmaceutical Industries – i.e. manufacture of pharmaceutical products and preparations, plus supply chain;
- Low carbon/ energy – manufacturing associated with energy generation, to include wind, wave and tidal energy and supply chain.

The report identified engineering skills and the location of large global companies and their induced supply chains in the region as strengths in manufacturing. The three common issues cited across these three sub-sectors are specific shortages in relation to technical skills and graduates, barriers to finance inhibiting growth in smaller companies and a lack of agility and efficiency in a highly competitive and evolving market.

What the New Manufacturing Location Calculus Implies for the Economy of the North East

Professor Susan Christopherson of the Department of City and Regional Planning was commissioned to prepare an **Expert Paper** on What **the New Manufacturing Location Calculus Implies for the Economy of the North East.** The paper begins with a very positive assessment of the North East's strengths with regard to manufacturing:

> *"Despite its recent reputation as a lagging region, a close look at the evidence about the Northeast presented in the NELEP Evidence Report (2012) and other recent studies on regional manufacturing present a picture with considerable promise. The Northeast, for example, leads UK regions in exports, in part because of continuing positive performance in industrial manufacturing."*

The rationale for the paper's approach is based on recent trends in the strategies of manufacturing companies and the increased opportunity to bring employment closer to market and customers. The report cites a number of sources including:

> *"Advanced manufacturing represents one of the best opportunities for the UK to rebalance the economy. The sector has the potential to drive up levels of value-added in the economy, and make a substantial contribution to export growth. Its global competitiveness is ultimately dependent upon the skills of its workforce.* UK Commission for Employment and Skills 2012".

> *"Manufacturers are beginning to recognise that many of the factors they previously based their off-shoring manufacturing and supply decisions on, such as component price and transportation costs, have dramatically increased over the last few years – and those seemingly initial cost savings are no longer so big*. The Manufacturing Institute 2011".

One reason why increasing manufacturing is important is improving quality of the jobs. A significant proportion of the US and UK manufacturing sector is now in medium-technology industries that provide good jobs for middle skill workers. These are workers who have credentials and training beyond the secondary school level but whose work does not require an advanced degree.

What the evidence on company strategies tells us is that manufacturers are changing their location strategies for complex reasons – to reduce total cost and to find new ways to add value through services. Their reasons for returning to locations closer to their end markets can stimulate expansion and innovation in knowledge-intensive businesses such as manufacturing services as well as in key enabling technologies, including photonics and new materials (European Commission, 2011).

The author concludes that regions such as the North East with already existing specialised industry infrastructure and knowledge are in an unusual position to benefit from these changing business strategies. The challenge is recognizing the dimensions of the regional advantage and finding ways to intersect with firms that are exploring and making investments in forward-looking forms of competition.

What is striking in government and consulting reports is the parallel between the UK's national manufacturing strengths and those identified as strengths in the North East (BIS, 2010). The North East's manufacturing firms are represented in a significant number of the sectors identified as important contributors to current national exports and holding the potential for future technological breakthroughs.

The **Expert Paper** recommends:

1) **Strengthening connections between product and process innovation research centres with North East producers, through the North East universities.** Research on product and process innovation is available in the UK but is divorced from the production regions. Developing North East program branches at the universities would begin to align product and process innovation and engineering education with regionalized industries. One possibility for this type of connection closely tied to industry strengths in the North East is the industrial photonics research centre at Cambridge University: http://www.ifm.eng.cam.ac.uk/research/cip/. This program is collaborating with The University of Sheffield on new magnetic materials and that project could be examined as a model.

2) **Identify "manu-services" present in the supply chains of regional manufacturing firms**, identifying markets for North East suppliers. This type of activity was being fostered by The Marine Design Centre and should be reconstituted in other key industrial groups, such as petro-chemicals and automobile production. Follow the recommendation of *"More than Making Things"* to: *"Ensure that Technology and Innovation Centres engage in non-technological innovation, specifically designed to promote manu-services".*

3) **Make skills development a priority**. Regional higher education institutions need incentives to develop both the technically-skilled workforce and the service workers who have sufficient technical background to understand and provide services to customers for advanced manufacturing products.

Manufacturing Opportunities and Priorities

There are strong linkages and overlap between **Professor Susan Christopherson's Expert Paper** on **What the New Manufacturing Location Calculus Implies for the Economy of the North East,** the **Expert Paper** prepared by **Professor Philip McCann of the University of Groningen** on **Globalisation** and the **Expert Paper on Innovation** produced by Chris Pywell. Both Christopherson and Pywell begin with very positive assessments of the North East's strengths with regard to manufacturing:

"Despite its recent reputation as a lagging region, a close look at the evidence about the Northeast presented in the NELEP Evidence Report (2012) and other recent studies on regional manufacturing present a picture with considerable promise. The Northeast, for example, leads UK regions in exports, in part because of continuing positive performance in industrial manufacturing."

"The North East of England is relatively well placed to benefit from future global developments and growth. The region is the location for a number of strong activities and assets in the areas of innovation that are being most targeted as the sources of future international growth. These include innovations in energy, transportation, robotics, ageing and environmental regeneration".

The **Expert Paper** prepared by **Professor Philip McCann of the University of Groningen**, sets out the rationale for the continuing trend of increasing globalisation and the importance of the NELEP economy making gains with regards to international engagement in the current climate to support the regional economy over the longer-term. The paper also recognises the need to continuously increase the quality of export activities as well as international investment activities to maintain a competitive position globally. It recommends actions with regard to:

- Enhancing local-global value chains.
- Smart specialisation.
- Institutional capacity.

The **Expert Paper on Innovation** produced by **Chris Pywell** states that the region has innovation related assets in its universities, specialist development facilities, people and companies, and has attracted inward investment in part on the basis of these innovative capabilities. The **Expert Paper** proposes the following activities that may be taken forward to support innovation in the North East:

- Adopting an innovation chain approach.
- Strengthening innovation ecosystems.
- Establishing Living Laboratories.

These overlap with **Christopherson's** recommendations, which are:

- Strengthen connections between product and process innovation research centres with North East producers, through the North East universities.
- Identify "manu-services" present in the supply chains of regional manufacturing firms.
- Make skill development a priority.

In its response to the North East Commission, **CBI North East** presents a series of recommendations around the areas of strategy, structure and capacity. In relation to **strategy**, the **CBI** makes a case for the development of a **strategic industrial policy** to drive private sector growth in the North East. It recommends that this policy focuses on those sectors in which the North East already has a core advantage, a reputation for excellence, market access and the supply side factors able to provide critical mass. These sectors should also be strategic industries for the UK with future opportunities for growth and long term sustainable jobs. A similar recommendation – for an active industrial policy (which also covers strengths in service sectors) that builds upon private/public partnerships and working cooperatively with universities and centres of excellence – is presented in the response from the **Group of Northern Labour MPs**.

The **CBI** paper cites the region's strengths in water resource and energy, its coastline and manufacturing sectors, as well as its excellent higher education base as key assets able to support an effective industrial strategy. The themes identified in the **Expert Papers** should help to identify those manufacturing sectors and supply chains which offer the greatest potential to support economic growth.

LOW CARBON ECONOMY

The **TWCR Economic Geography Review** suggests that the North East is well placed to access opportunities arising from the move towards a low carbon economy. The region is in a position to benefit from its locational advantages, and build upon its strong industrial base, existing engineering skills and the strengths of its key companies. The North East's main opportunities relate to the development of electric vehicles and associated infrastructure, and specific opportunities in the offshore wind turbine markets. The main industrial opportunities for electric vehicles are concentrated in and around the south of the NELEP area (South Tyneside, Sunderland, and Easington), while Blyth, Cramlington and the North Bank of the River Tyne are generating new potential around offshore wind turbine blades.

The review identifies some of the region's important and competitive assets including:

- **An emerging and growing offshore renewable sector.** The offshore renewable sector is anticipated to stimulate growth in the oil and gas industry in the medium to longer term. The opportunities for the region are multi-faceted and include the manufacture of components and the assembly and maintenance of full wind turbines, as well as working as part of the associated supply chain.
- **A growing low carbon vehicles sector**. The region is home to the UK's largest car plant and is actively involved in the production of electric vehicles, including the production of the Nissan Leaf. The opportunity will expand to other low carbon vehicle technology, such as hydrogen, and related technology including electrical networks and informatics.
- **Micro-generation.** This technology is likely to become increasingly viable and will create local economic opportunities in the North East - in both manufacturing and project management. There is a need for a lead to be taken in removing barriers, promoting opportunities and market creation.

While other opportunities will gain momentum as new regulations are agreed, e.g. biomass and carbon capture and storage, there are two substantive areas where the NELEP area can realise its potential in the shorter-term. These are the development of low carbon consultancy skills, building on the region's very strong consultancy and technical experts, and the retro fitting of housing, currently being prioritised by the Government, with significant employment creation potential. The latter is likely to be carried out over a five to 10 year programme.

Cross Cutting Opportunities

Responses from the **Northern Group of Labour MPs** and the **NE Process Industry Cluster** (NEPIC) set out additional opportunities for the area linked to the presence of energy intensive businesses and the opportunity to access natural energy resources, which with Carbon Capture and Storage can become a low carbon energy source. The response from the **Northern Group of Labour MPs** states:

> *"The North East is leading the UK in electric vehicle manufacture and is at the centre of sustainable energy innovation. Our location gives us access to Dogger Bank, the largest of the nine Round 3 offshore wind farms. This is happening next to some of the UK's most important yet most energy intensive businesses, creating a special opportunity for the region to be a word leader in the decarbonising industry".*

The need for low cost energy to support the continued development of other sectors is set out in the **NEPIC** responses, which sets out:

> *"The chemical industry in the UK because it is so energy intensive compared to other advanced manufacturing activity needs rapid access to low cost energy resources such as shale gas if it is to remain competitive within the global industry. If not we will see a tidal wave of cheap US chemical exports coming to our shores and the UK's advanced manufacturing industry may be irrevocably damaged".*

It is noted by NEPIC that significant infrastructure investments would be required to access the natural resources.

Low Carbon Vehicles Sector

The North East is home to the UK's largest car plant – Nissan and the associated supply chain in the region is worth close to £1bn. In its response to the economic review, **Zero Carbon Futures**, acting on behalf of the low carbon vehicles sector, observes that the automotive industry is currently undergoing the biggest transformation in its history with the introduction of electric and hybrid vehicles. With established companies such as Sevcon and Smith Electric Vehicles, the North East is regarded as a pioneer in the low carbon vehicles sector. The paper reports that in the last six years more than £300m has been invested in developing world leading expertise and R&D in this technology. It identifies the North East as "*the only area in Europe with such a comprehensive sector geared up to the development of low carbon vehicles comprising of manufacturers, battery development, R&D, skills and training as well as a leading supply chain"*.

A Department for Transport report published in 2011 summarises the growth prospects of the UK's low carbon vehicles sector:

> *"The shift to lower carbon vehicles creates growth opportunities for the automotive sector, supporting the rebalancing of the economy and securing high tech jobs. The Government wants to ensure UK-based businesses are well positioned to seize opportunities in both the early domestic car market, and in the longer term, to position the UK as a major player in the rapidly expanding global market*".

The shift to low carbon vehicles is an important opportunity to position the region as a knowledge–based economy with significant R&D activity, together with manufacturing and commercialisation. The paper identifies one of the positive and unique features of this sector as the opportunity it offers for North East businesses without previous involvement in automotive to become involved in the sector, thereby creating opportunities for a whole new tier of suppliers.

According to the **Zero Carbon Futures** paper there are four existing barriers to the growth of the sector. These are:

- **The need for a co-ordinated body for the sector in the North East**. The paper proposes the establishment of a resources alliance, similar to the North West Automotive Alliance, to coordinate and facilitate the development of the sector as well as attract inward investment opportunities. Whilst Gateshead College, through Zero Carbon Futures, has initiated coordination of the sector, additional support is required – particularly in the areas of economic development and inward investment.
- **Access to funding**. The sector is still relatively embryonic in the region with unproven and to some extent uncertain technologies which makes it difficult to develop a commercial model for its R&D and infrastructure. Therefore attracting private investment is a challenge and public support remains important to stimulate the market.
- **Skills gap**. The paper cites a shortage in engineering and technical skills as a potential barrier to growth in the sector. It emphasises the need to work with universities to promote the sector and attract and retain talent.
- **Support for supply chain**. Funding support to help companies join supply chain initiatives is required to remove barriers to commercialisation. The response argues that distribution of funding for supply chain initiatives has been inconsistent across the UK and opportunities for UK suppliers should identified and supported to market.

The primary challenge for the sector in the North East is how *"to remain the UK leader in this field by attracting inward investment, stimulating research and development, supporting diversification into this field from regional companies and ensuring that the workforce is trained and ready to take advantage of this fast moving sector"*.

The North East has the potential to become the European centre for low carbon vehicle development, building on its strengths in manufacturing, engineering, energy and science. However, **Zero Carbon Futures** believes success is dependent upon the region being promoting and positioned as a leader in the field and subsequently attracting appropriate inward investment.

Energy

NOF Energy reports that a third of its members (140 businesses) are based within the NELEP area, and they have a combined turnover in excess of £1.8bn. North East England is recognised as one of the world's leading subsea centre. There are an estimated 50 businesses in the area engaged in subsea activity, employing circa 10,000 employees and having a combined turnover of over £1.5bn.

The oil and gas sector supports around 440,000 jobs across the UK, with approximately 15% of these within the North East of England. The **Oil and Gas UK 2012 Economic Report** indicated that production boosted the UK's balance of payments by some £40bn, with the supply chain adding another £6bin exports of good and services.

The emerging offshore renewable sector is growing in its economic contribution to the region's economy. Many of the businesses involved in the oil and gas sector are well placed to secure an increasing share of contracts emanating from offshore wind farm projects based in UK territorial water.

In recent months, a number of international businesses have established operations in the region because of its growing importance as a hub for offshore renewable activity.

The long-term outlook for the region's energy sector remains positive although progress on some offshore wind projects has slowed in the last year. The **NOF Energy** response reports that the tangible benefits from offshore renewable will not start to accrue until 2015 at the earliest. Over the next five years, **NOF Energy** expects the oil and gas sector to experience more growth than offshore renewables.

The paper cites a shortage of qualified individuals, particularly in engineering disciplines, as the primary barrier to the future growth of the energy sector. It suggests that a multifaceted approach should be adopted to address this significant barrier. This should include:

- Early engagement with schools;
- Engagement with the military;
- Positive promotion of the energy industry as a route to a lifelong career; and
- Closer collaboration between the industry and higher education institutions.

The response also identifies transport links limitations and calls for improved air and rail links to address this barrier.

Power

Northern Powergrid runs the only major electricity distribution network that provides power to customers in the North East, Yorkshire and northern Lincolnshire. The company's latest business plan sets out its 10 priority areas for investment during the 2015 - 2023 planning period. Included among these are specific actions relating to the low carbon economy. The company forecasts undertaking additional investment of £44m per year in response to the growth of low carbon technologies. This would represent 10% of its expenditure in the next regulatory period.

The business plan emphasises that the way electricity is produced and used will change dramatically as the UK attempts to reduce its carbon emissions. Emerging technologies such as solar panels, windfarms, electric vehicles and modern electrical heating are expected to become more commonplace during the 2015 to 2023 period. Therefore, it is important that the powergrid is able to accommodate the transition to these technologies.

The business plan indicates that an additional £25m would be needed annually to accommodate new low carbon technologies. The company has the challenge of ensuring its resources are not wasted on network assets that are either not needed yet or at worst, found to be not needed at all. Northern Powergrid proposes to address the implications of low carbon technologies in the following ways:

- **Innovating to connect low carbon technologies at least cost**. This will accomplish two purposes - help users of emerging technologies to connect easily to the network without causing problems to other users and enable the network to be operated in smarter ways to reduce the number of new assets needing to be built.
- **Connecting renewable generation as required and avoid speculative investment**. Small scale customers (i.e. domestic and light commercial) are able to install low carbon technologies through their existing connections. This approach will continue in the 2015 to 2023 period. The company plans to make small specification changes (such as metering and low voltage boards) as part of standard investments, instead of automatically installing new assets. These are likely to become more useful as low carbon technology develops and will add an extra £8m per year to the cost of the overall investment programme.
- **Implement 'low-regret' smart-grid capability**. This will involve working with installers of low carbon technology to improve understanding of their needs and to streamline service to match. The company is currently leading the Customer-Led Network Revolution project to develop learning in this area.

Constraints on Power Grid System

The **Energy Leadership Council** raises awareness of potential bottlenecks in the North East and North West from power flows from Scotland. It argues that the north-south power flows lead to grid capacity issues in North East England which could hinder the development of new generation. Anticipated increases in renewable power export from Scotland with the completion of the Beauly-Denny Line are likely to cause further capacity problems. This will be further affected by the increase of wind power, the potential loss of the Lynemouth power station, increased biomass generation and the possible commissioning of a large coal-fired power station at Blyth. The response recommends that consideration should be given to the upgrading of the Stella to Harker line from 275Kv to 400Kv to minimise the risk of renewable projects being stymied by these bottlenecks.

Resource Management

Regarding waste management in the North East, the **North East Sustainable Resource Board (NESRB),** reported that there are opportunities for the region to generate greater economic value in this sector. The NESRB's 'Resource Management Plan' paper highlighted that in 2009, 32% of the 8.6m tonnes of waste generated in the North East was sent to landfill. With an estimated combined value of £33m, this represents a significant misuse of resources.

The **NESRB** paper asserts that the waste resource sector has the potential to support growth in the North East economy and also assist in accessing commercial opportunities from low carbon markets. The North East currently undertakes a range of resource management processes, including:

- Improved waste separation for recycling;
- Advanced heat treatment of residual waste;
- Anaerobic digestion, and;
- Waste to energy through bio-fuel creation.

The region is also leading in the UK in areas such as waste to bio-ethanol facility; bacterial breakdown of waste to create fuel; high temperature breakdown of waste pyrolysis; de-polymerisation of plastics; bio-liquids conversion; and cereal grain bio-refineries. The **NESRB's** response calls for a coordinated approach in the NELEP area to ensure the economic impact of the resources management sector in the North East is realised. The paper highlights the importance of networking with other areas, linking companies and public sector waste handlers.

Green Technologies

A paper from **Oled Lighting Thorn** also reiterates the North East's potential to become a global leader and supplier in green technology. The **Oled** paper highlights opportunities in green technology integrated systems, such as renewable power generation, hydro-carbons, CCS, digital networks, printed electronics, solid state lighting, Vdc grids, intelligent transport networks, 20 minute societies, electric vehicles and advanced manufacturing. It cites examples of the TSB Catapults for off-shore energy and advanced manufacturing in Northumberland and Teesside, Newcastle Science City, the universities' research capabilities and the incubator facility at NetPARK as regional institutions offering a world class research base and an exploitation route for green technologies and inward investment.

However the **Oled** paper points to insufficient collaboration among the region's public, private and academic sectors as a potential threat to the growth and development of green technologies. The paper emphasises the need for the region's institutions to work together to exploit opportunities such as TSB £150,000 feasibility studies (a potential useful starting point to bring regional organisations together to explore and develop strategies) and the 'EU Smart Cities' programme which will provide €2bn in funding for integrating systems and networks across cities to demonstrate transferable, scalable low carbon, energy efficient environments.

THE SERVICE SECTOR

The **SQW review of existing evidence** notes the economic change in recent decades, with the NELEP area moving substantially away from its earlier dependence on coal, steel and heavy engineering towards a broader base, more typical of modern city-region economies in its emphasis on services, and in which modern manufacturing also features strongly. Global service firms operate successfully within the NELEP area; some of which have been in the North East for decades and have continued to reinvest, while others are more recent arrivals.

The **Expert Paper** produced by **Northumbria University** analyses the North East's service industries and sets out opportunities and barriers to growth based on a survey of service sector businesses. It summarises the sector's importance to the North East:

> *"The services sector industries represent a major element of the North East economy, in terms of absolute value, Gross Value Added and employment. Importantly, they offer tremendous opportunity for future economic growth for the North East and the rebalancing of the UK economy."*
>
> *"In our analysis of the separate industries and in the information and perspectives shared by businesses and various sector organisations one thread has been consistent: services businesses, individually and collectively, represent tremendous potential for the North East economy and in turn the wider UK."*

The paper covers business services, cultural and creative industries and tourism – sub sectors which have transformed and experienced strong growth in the past 20 years – highlighting that:

- **Business services** account for around £7.2bn of the North East economy, over 13,000 businesses and employ 197,000 people;
- **Cultural and creative industries (incorporating Design and Digital Industries)** contribute over £0.75bn to the North East economy, involve more than 1,250 businesses, excluding non-employing enterprises, with around 35,000 people employed in or working freelance in the sector;
- **Tourism** represents £2.2bn of the economy of the North East LEP area, supports over 54,000 jobs with over 77m tourist days enjoyed in the area.

Separate **responses submitted on behalf of the technology sector** and **Software City** also draw attention to the technology sector (which to some extent will overlap with business services and cultural and creative industries). In terms of scale, the **Software City** response estimates that the NELEP area was home to over 1,070 software businesses in 2009, with the sector employing over 7,400 people in 2008. Further, significant growth is forecast, in terms of businesses, revenues and employees, to 2020.

The quality of life, and in particular the culture, heritage and environment, which the NELEP offers is recognised as a key asset that attracts business in these sectors. The contribution which skills, and the flexibility and availability of the workforce make to the largely positive perception of the North East as a businesses location is also noted.

In terms of the working environment, a supplementary response based on the views of a number of **industry representatives** sets out that the support offered by informal networks fosters cross-sector collaboration and acts as a tangible demonstration of the 'close, tight knit nature' of the North East economy.

These important sub-sectors are, however, less significant to the NELEP area than their counterparts in other regions with London and the South East dominating service sector employment and competitiveness. Given the opportunities for growth which the sectors offer, there is a need to overcome barriers businesses face to realise the area's full potential.

Business Services

Business services are acknowledged as a key sector in local policy and inward investment activity. The paper highlights two issues which the business service sector in the NELEP area faces going forward:

- **Competition for high profile company relocations:** There is a concern, raised by The Law Society, that growth opportunities in the legal sector are being better addressed in other areas. This is demonstrated by the decisions of major international law firm Allen & Overy and London-based Lewis Silkin to open back-office facilities in Belfast and Cardiff respectively, both with financial support from their devolved administrations. There are also concerns that the relocation of the BBC to Manchester will leave a significant void in the North East and detract future opportunities and workforce from the area.

- **Increasing trend for mergers:** In legal services, Deloitte's Quarterly Legal Sector Survey published in December 2012 suggested that slow growth in the fee income of mid-tier firms was manifesting itself in an increasing trend towards mergers. In the same month the North East's largest headquartered legal firm, Dickinson Dees confirmed its merger with Bristol-based counterpart Bond Pearce.

Through the **survey of service sector businesses**, business services organisations cited legislative and regulatory changes, and their organisation's response, as a key factor influencing growth.

Cultural and Creative Industries

The NELEP area's strengths in cultural new media and digital development sectors are highlighted in **the Expert Paper**. Northern Film and Media, Digital Union, Northern Design Centre, Generator and Sunderland Software City are cited as excellent examples of Creative and Cultural Industries space.

The role which arts and culture have played in the economic and creative growth of the North East is also recognised. This includes major capital investment in arts, culture and heritage, to festivals and events such as BALTIC, The Sage Gateshead, The Angel of the North, National Glass Centre, Seven Stories and DanceCity.

The creativity of the CCIs is thought to have influenced the wider economy, with design typically recognised as a crucial driver of innovation. Many parts of the sector are increasingly involved in business to business markets, ranging from the use of games for technology and simulation to 3D visualisation in healthcare.

The paper highlights two sector-specific issues which cultural and creative businesses face:

- **Lack of new resources for cultural and economic growth:** North East leaders have continually lobbied the importance and value of the cultural offer towards enhancing economic and creative growth. However, the report states that *"in the current fiscal and political environment there is a risk that both the social and economic impact of the Creative Industries in the North East may be diminished to such an extent that the value of the previous growth is compromised".*
- **Globalisation and the digital shift:** Digital platforms will become one of the primary means of increasing reach and this is expected to lead to major challenges. The report notes that *"there is great potential to increase the digital capacity of arts organisations in the North East"*.

Focusing on the creative sub sector, the response from **Northern Film and Media** presents a SWOT analysis which echoes the strengths and issues outlined above.

Strengths	Weaknesses
• International reputation in arts, TV, film and video games • Creative industry research and HE teaching credentials • Partnership style working from agencies and cultural institutions • Desirable locations, talented crew an competitive production and cost base • Strong support from the Local Authorities • Historic relationships with key content creators and commissioners • Funding in place for complements production support, business development and talent development activities	• Distance from key markets and decision makers • Talent retention • Creative industry investment experience • Comparatively small direct economic contribution • Perceived riskiness of creative industry investment • Small number of firms makes it challenging to establish a critical mass

Opportunities	Threats
• Scarcity of international finance puts region in a strong position to benefit from investment through high profile projects and companies • Anticipated increase in production arising from planned tax incentives for TV drama, games and animation • Chance to spread economic risk and develop a balanced economy • Desirable job opportunities for North East talent and graduates • Growth of direct economic impact • Ancillary benefits (tourism, quality of life, feel good factor, PR) • Talent retention • Chance to boost competitiveness of region in attracting inward investment	• Mid to long term ROI on equity/loan investments • Job creation volume • Transient nature of production • Wider industry finance and distribution trends (scarcity of finance, business models, disruptive technology) • Other regional funds and tax incentives (UK and overseas)

The response has a strong focus on the issue of access to finance for the sector, outlining that following the abolition of One North East and reorganisation of the UK screen agency network in Creative England, the sector is left with minimal regional sector ringfenced public support.

Northern Film and Media has been successful in attracting modest funding for market access, events and the production services from a coalition of local authorities (Newcastle, Gateshead, Durham and Northumberland), ERDF and national sources such as Creative Skillset and Arts Council England. However, the response outlines that the total amount of funding channelled through Northern Film and Media now represents less than 15% of the total in 2010.

It also highlights that mirroring national trends, creative firms in the North East have a poor track record in securing investment from general public funds, venture capitalists, and angel investors. Often perceived as risky, idiosyncratic and unpredictable, the inability of creative industries to secure access to finance has become a key national issue. This has been highlighted in a number of national studies, including the DCMS' Staying Ahead Review.

The **survey of service sector businesses** highlighted that innovation with new technology, new product development, and the identification of new markets were of particular importance to driving growth in cultural and creative industries.

Technology Sector

A response highlighted on behalf of the **technology sector** outlines that it consists of businesses creating, researching and/or distributing technologically based products to businesses and/or consumers. It should be noted that some technology companies will also be captured within the creative and cultural industries.

There is a growing cluster of technology businesses in Newcastle; supplying software solutions to a wide range of businesses and organisations including banks, engineering companies (including control systems), accountants, GP surgeries, NHS (data investigation), housing associations (management systems) and public sector bodies.

Evidence suggests that despite the current economic climate, these businesses are in growth mode, developing niche markets with some employing over 100 staff. These businesses have the potential to offer great employment opportunities, investment and wider economic development benefits to the region as other businesses are looking to new software solutions to generate savings and access wider markets.

National research suggests that this sector is still in its infancy and is key to supporting the economy out of recession. Currently many businesses in this sector are not reliant on public sector subsidies - the sector has few links with development agencies and is under-represented in regional economic development research.

In recent years the region has seen more new technology company start-ups than any area of the UK outside London. The North East has emerged as one of the world's leading centres for digital games development and start-ups, with a dynamic cluster of firms and university courses acting as a magnet for entrepreneurs and students.

The response highlights a number of sector specific issues which technology businesses and the wider sector faces, including:

- **The need for support to maximise potential inward investment opportunities:** Within the technology sector, there are opportunities to sell the local message to potential relocators. For example, the region is in a position to attract outsourcing from London companies who are reaching a size where locating IT departments in the NE would be a more viable option. The response suggests that links between the LEP, NGI's Business Winning Team, Newcastle Science City and research contacts within the local universities need to be exploited to maximise potential inward investment and indigenous growth opportunities.
- **Local and national skills shortages:** This is linked to growing demand for people with hybrid skills such as technology and design.
- **Cross cutting issues:** Linked to access to training, bandwidth and sector champions to realise growth potential. There is also an opportunity to develop more effective networking to strengthen the sector. A networking group, nominally called Dynamo, has been put together.

Overall, the response concludes that the potential benefits of promoting and supporting the technology sector are significant, both in terms of job creation and economic development of the region. If this agenda is not embraced the region will lose out to other areas of the UK and the local economy will suffer.

Tourism

The **Expert Paper** reports that tourism in the North East LEP area accounted for over £2.2bn of direct expenditure (excluding VAT) in 2011. With indirect expenditure and VAT considered, spend in the area represents over £3.5bn to the North East LEP economy. The importance of the sector is also highlighted in responses from **NewcastleGateshead Initiative (NGI), Visit County Durham, Northumberland Tourism** and Newcastle **Gateshead Cultural Venues** and the role which tourism businesses play in sustainability developments and the promotion of areas as 'green' tourism destinations is noted.

The economic contribution which the area's historic environment and assets make to tourism and the wider economy, by making the area an attractive place to live, is also highlighted in the response from the **North East Historic Environment Forum.**

Opportunities for the tourism sector are set out in the response from **Northumberland Tourism**, which has worked with the county's sector to develop an Area Tourism Management Plan that focuses on high value target audiences. This is based on the premises that attracting higher spending visitors and working with the industry to encourage a greater spend from each visitor during their stay could increase the current economic impact of the sector – in particular, it is estimated that if each visitor spent an additional £5 during their visit this would equate to over £42m a year for the county.

It is also noted that growth could be achieved by encouraging visitors outside of the traditional holiday season, which would have the added benefit of reducing the seasonal nature of tourism employment.

The **expect paper** highlights four issues which the tourism sector faces going forward:

- **Subsidies for tourism organisations facing increasing pressure:** Tourism policy and management has changed and the new architecture consists of Destination Management Organisations (DMOs) - NewcastleGateshead Initiative, Northumberland Tourism and VisitDurham - that work collaboratively with other partners through the Northern Tourism Alliance. These organisations play an important role in marketing the NELEP areas as a tourism destination although the report notes that "*with the pressures facing public finances, subsidies for tourism organisations are facing increasing pressure.*"
- These pressures were also noted in **Visit County Durham** and **Northumberland Tourism's** responses. The latter focused on a lack of marketing funding, stating that this leads to a risk of market failure with only large cities with significant income from larger and more tourism businesses able to promote themselves as holiday destinations. It notes that destinations such as Northumberland which are unable to self-generate significant marketing funding to compete would be overlooked by visitors with a resulting deterioration of the tourism industry.
- Focusing on other organisations, the response from the **North East Historic Environment Forum** also noted that reduced public funding means more limited access to funding for conservation, product development and marketing and that there is a risk that the current economic climate will reduce the number of companies with the specialist skills required to maintain the North East's heritage and tourism offer.

- **Agreeing a consistent marketing strategy:** While there is agreement that additional marketing is required to promote the NELEP area as a tourism destination, there is a debate over whether local delivery partners should be replaced, or report into an overarching regional body responsible for developing and implementing regional strategies.
- NGI suggests that the NELEP should resist the call to create a regional structure and instead build upon existing delivery partners to strengthen collaboration and, where appropriate, develop regional campaigns (for tourism and inward investment) that can be adopted locally. This is reinforced by the **Northern Tourism Alliance,** which believes that visitor promotion must focus on individual destinations, and **Visit County Durham,** which has promoting the Durham brand and its sub brands in the County's growth plan.
- **Competing in the national and international Conference market:** In 2012 there was a reduction in the number of major national and international conferences being held in NewcastleGateshead and this is noted by NGI as 'a potential warning sign'. Other major cities across England and Scotland – including Manchester, Liverpool and Glasgow – have continued to invest in their conference centres which is placing added pressure on the area's ability to compete.

At the business level, other barriers that have been identified include a lack of consistent broadband coverage (for promotion and sales), issues with local transport infrastructure (limited accessibility to some attractions and destinations) and access to funding for product development. The **survey of service sector businesses** highlighted consumer spending as a persistent growth factor for tourism businesses, with VAT, personal taxation and the general economic health of the UK identified as drivers.

NELEP: Priority Areas for Action

There are six main service sector priorities which emerge from the evidence for consideration, all of which link to addressing current barriers to growth. While some of the priorities focus on removing barriers within North East markets, others focus on increasing access to other UK and international markets. These are:

1. Support to access finance for service sector businesses
2. Improved transport infrastructure
3. Improved digital connectivity
4. Increasing international activity within the service sector and learning from other locations
5. Capital investment in facilities for the cultural and creative and tourism sector
6. Case making for the service sectors

Support to access finance for service sector businesses

Businesses are calling for sector specific initiatives that address the need for investment and working capital as set out in the **Expert Paper**. A supplementary response based on the views of a number of **industry representatives**[4] recommends that the North East LEP should acknowledge cultural and creative industries, professional and business services and tourism as strategic sectors to foster future economic growth and that this should be taken account of in the context for future European funding, the prioritisation of Regional Growth Fund investments and other similar public resources. This is echoed in the responses from **Northern Film and Media, Generator, NGI, Visit County Durham, Northumberland Tourism** and **Newcastle Gateshead Cultural Venues** and the need to prioritise the technology sector is also outlined in a response on behalf of the sector.

Proposals for support are outlined in the responses from **Generator** and **Northern Film and Media,** both of which have a track record in managing sector specific funds. The **Generator** response calls for a small, recyclable investment fund which offers businesses a loan of up to 50% for a maximum of five years. It also argues that there is potential to use the fund as a match to lever additional revenue from ERDF to pay for business support mechanisms to help businesses succeed (the need for such support is also acknowledged by **Newcastle Gateshead Cultural Venues**).

The **Northern Film and Media** response calls for the NELEP to allocate funds to the North East Creative Fund to provide a combination of gap and equity funding for projects and companies.

[4] Digital Union, Arts Council, Service Network, The Law Society, Generator, NewcastleGateshead Initiative, Northern Tourism Alliance, Northern Film and Media, Sunderland Software City

Improved transport infrastructure

Improving road, rail and air transport infrastructure to upgrade connections to London and the west of the country and to link businesses in the NELEP area to other UK and overseas destinations is an important priority raised by the sector's businesses. This is echoed in the response from **NGI** and **Visit County Durham.** Public transport is also highlighted as an area for improvement in the submissions from **Visit County Durham** and **Northumberland Tourism.** In particular they highlight the need to better link major visitor attractions and reduce the need for (and environmental impact of) cars.

Business services and CCIs saw the distance to London, where most key policy-makers, press and influential clients are based as a disadvantage. Cultural and creative industries businesses also cited limited connections to Manchester as a growing disadvantage.

It was recognised that while many initiatives would be capital intensive, others such as effective regional lobbying to encourage a direct flight to the United States, would also directly support growth. In particular the NGI and County Durham responses call for investment in new routes into Newcastle and Durham Tees Valley Airports.

Improved digital connectivity

The opportunity that improved IT infrastructure offers to service sector businesses was highlighted in the **Expert Paper** and the responses from **Visit County Durham** and **Northumberland Tourism**. Creative businesses or those located in more rural areas highlighted the need for improved communications. This supports arguments for the rollout of superfast broadband and, in particular, increasing the percentage of the LEP area's businesses benefiting from this.

Increasing international activity within the service sector and learning from other locations

The **Expert Paper** states that *"services organisations have an unrealised potential to exploit international markets and match counterparts in the manufacturing sector in their role in the globalised economy"*. To support this, a major opportunity for partners in the North East to collectively seek to improve the North East's position in international trade (both in terms of exporting and inward investment) is identified. This links to drawing on promotional vehicles used by other successful destinations to market the region's service sector, as well as building upon existing links and partnerships, such as those between the LEP, DMOs, NGI's Business Winning Team, Newcastle Science City and research contacts within the local universities.

Recognising the strengths and competitive advantage which other locations including Manchester, Birmingham, Leeds and London have in the service sector, the need for the NELEP to emulate strategies or participate in these markets is highlighted in the **Expert Paper**. Three main areas for action are identified:

1. Playing a full part in the economic opportunities offered by London which dominates service businesses, and Manchester which is of growing relevance to the cultural and creative industries.
2. Drawing upon the coherent promotional vehicles for professional services firms used by Birmingham and Leeds (such as Advised in Birmingham and Finance Leeds), to develop a model that might serve similar organisations in the North East.
3. Identifying a mechanism for developing alternative propositions to the financial flexibility available for investors in the Devolved Administrations.

In the **Expert Paper**, the voice, perception and visibility of the North East is seen as vital in supporting growth. Its states *"policy-makers, opinion-formers, investors, and potential customers and visitors should be left in no doubt of the assets the area possesses and its potential to support UK growth"*.

Capital investment in facilities for the Cultural and Creative and Tourism sector

Support to help secure essential capital funds for tourism and cultural and creative facilities are highlighted as a priority in the **NGI** and **NewcastleGateshead Cultural Venue** responses. This includes investment for conference facilities, leisure/tourism attractions and business accommodation.

The **NGI** response focuses on a recommendation to secure capital funds for a new conference centre adjacent to The Sage Gateshead and to build a competitive subvention fund, in recognition of the increasing competition which the NELEP area is facing from other UK destinations. This would help to secure and provide much needed exhibition facilities, ensuring that the area is well placed to attract lucrative and influential national and international conferences.

The **NewcastleGateshead Cultural Venue** response is much wider in scope (and also mentions a new conference centre adjacent to The Sage Gateshead). Other potential projects include the Beamish museum expansion, the Live Theatre Quaysides Park, the Northern Stage and Tyne and Wear Museum Production and Rehearsal facilities as well as accommodation for start up and growing cultural businesses.

Alongside capital investment, it will be important to ensure that resources, and the specialist skills required to deploy these resources, are available to conserve the area's historic environment and assets which play an important role in attracting tourists, businesses and skilled workers. This will help to address the concerns raised by the **North East Historic Environment Forum.**

Case making for the service sectors

A supplementary response based on the views of a number of **industry representatives**[5] stated that a new 'case for capital' should be developed that acknowledges the North East's service sector's potential to support UK economic growth.

This was also highlighted as priority in:

- the **NGI** response, with a particular focus on making the case for on-going and sustained investment in the infrastructure, visitor attractions, accommodation offer and cultural assets of the region. It outlined that this should support the long term commitment to rigorous and consistent research and analysis of the contribution and benefit of cultural and creative industries, business services and tourism to the north east.
- **The response on behalf of the technology sector**, which outlined that the sector is considered to still be in its infancy and that a more credible story than is currently captured is needed. It is suggested that this is addressed by the LEP and partners.

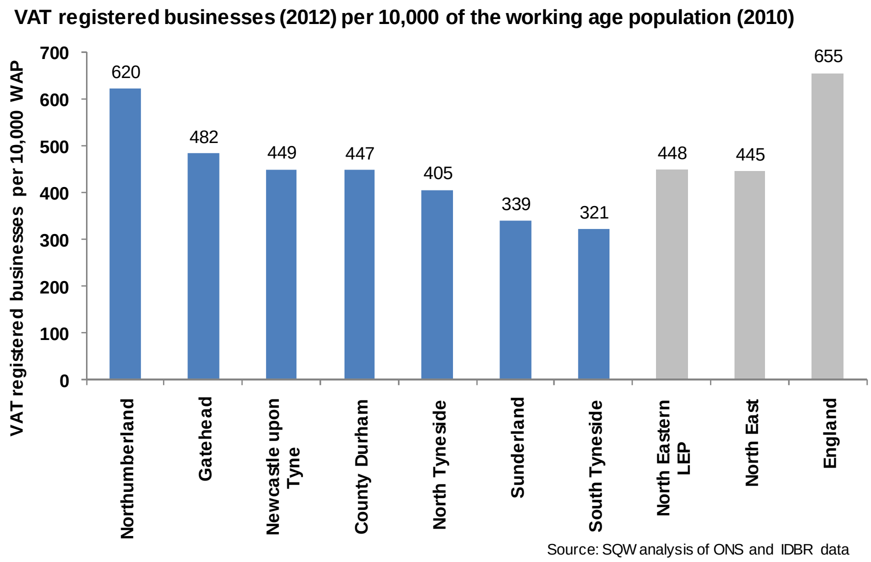
[5] Digital Union, Arts Council, Service Network, The Law Society, Generator, NewcastleGateshead Initiative, Northern Tourism Alliance, Northern Film and Media, Sunderland Software City

PRIVATE AND SOCIAL ENTERPRISE

The **SQW Review of Existing Evidence** provides an up-to-date overview of private enterprise in the NELEP area. Its main findings are that:

- The area's enterprise base, reflected in its business start-up and growth rates, lags behind the national average.
- Employees within NELEP are more likely to work for larger employers. In Gateshead 86% of firms employ less than 20 people, but the percentage of businesses employing over 100 is 2.2%, higher than the 1.5% average nationally. 5% of the businesses in South Tyneside and Sunderland employ between 50 and 249 employees, higher than the 3% national average and 4% regional average.
- Although NELEP has become more diversified, it remains under-represented in some of the UK's high growth/high value activities, such as professional and technical services.
- NELEP is home to a number of successful global manufacturing and service firms, some of which play a significant role in developing industrial clusters.
- Social enterprises are under-represented in the NELEP area, relative to other areas. The **NEWomen's Network** report indicates that the North East has the lowest number of women's voluntary and community organisations in England.

The figure below shows the enterprise rate (number of VAT registered businesses per 10,000 of the working age population) for each of the local enterprise partnership districts compared to the regional and England averages. At 620, Northumberland has the highest enterprise rate in the LEP area, and 84% of its businesses employ less than 10 employees, higher than the national average of 83%. County Durham had the second highest percentage of small enterprises in the LEP area.



In March 2010, there were 313 active enterprises per 10,000 working age population in TWCR, compared to 339 across the North East and 537 for the UK. Between January 2008 and December 2009, there were 30,000 enterprise births in the North East (including Teesside). Northumberland had the highest number of business starts, primarily in 'real estate, renting, computer and other business', followed by 'recreational, personal and community service' businesses. Gateshead had a high proportion of births in 'manufacturing', 'real estate, renting, computer and other business', transport, storage and communication', and 'health and social work'. There were also relatively high proportions of start-ups in Northumberland and County Durham in 'recreational, personal and community service' and in 'agriculture, hunting and forestry'.

Research evidence suggest that prior to the economic recession, the North East was narrowing the gap with national averages. The ONS Business Demography database shows that in the TWCR the number of active enterprises grew by 11% (adding 4,000 enterprises) between 2004 and 2009, higher than the 8.5% increase experienced in the UK more widely. Until 2008, the five Tyne and Wear districts had a surplus of enterprise births relative to deaths in most years. This may have stalled, as in 2009, there were over 300 more deaths than births and in 2010 this had increased to 1,000 more deaths than births.

The **SQW baseline study** highlights that NELEP has the potential to build on its achievements in a number of core areas. These include:

- investment in electric vehicles and associated infrastructure;
- off-shore energy design and construction;
- strengths in manufacturing;
- reputable skills institutions;
- recent growth in niche activities in financial, professional and business services, also in creative and digital.

Defining Social Enterprise and the Benefits

The expert paper on Social Enterprise in the North East produced by Charles Sleaford of NEF begins by setting out:

> *"Social enterprises are businesses that buy and sell, but where the principal motivation of the owners and managers is not money, but the achievement of a social mission. The majority are small but some, for example the major housing associations, are large. They should not be thought of in the same breath as voluntary organisations dependent on grants; they are above all businesses."*

Strengthening social enterprise is highlighted as one of the ways that the North East can address the risk of economic success failing to reduce relative poverty and inequality, or eliminate pockets of deprivation.

The paper sets out that if social enterprises reach their full potential, they will transmit the benefits of economic success to those that need them most in the three ways set out below. These are also the factors which can be used to describe the contribution which the social economy makes.

- Creating employment and skills development that would not otherwise exist
- Leading social innovation in certain sectors
- Providing affordable goods and services where the market fails.

In addition they can contribute to reducing public expenditure over the longer term and to attracting inward investment.

Social Enterprise in the North East

The **SQW paper** reports there are 4,760 'general purpose' charities and 263 community interest companies operating in the North East. These include organisations such as the North East Social Enterprise Partnership and VONNE (Voluntary Organisations Network North East), which represents the wider community and voluntary sector.

The response from the third sector point to the significant contribution these organisations make to economic growth in the NELEP. These resonate with the benefits outlined in the expert paper and include:

- Providing employment and businesses – the **New Economics Foundation (NEF)** study indicates that 60% of social enterprises are profitable and 16% break-even. The **SQW** study estimates income from third sector organisations in the North East at £1.54bn in 2007/08, with assets valued at £2.7bn.
- Acting as advocates of better service provision and an evidence-based approach to promoting social inclusion and equality.
- Improving the skills, employability and financial acumen of disadvantaged groups.
- Acting as routes to inward investment and attracting sources of funding not available to public or private sectors.

A dedicated loan fund operates in the NELEP area – the Social Enterprise Loan Fund for the North East. FINE – Funding Information for the North East also specialises in finding new sources of funding.

Social Enterprise: Areas for Growth

There are five main areas which the **expert paper** highlights for growth:

- **Residential and non-residential care:** linked to the growing social care market as a result of the ageing population over the long term, and to some extent the increase in personal health budgets over the short term. In the North East, there may also be opportunities to build links with university departments, for example at Newcastle, working on ageing and technologies to deal with ageing. It is noted that branding and scale efficiencies may be needed to make the most of these opportunities and that this branding could be built around social enterprise values.

- **Public service contracts:** Boston Consulting Group predicts that social enterprises can increase their market share from 22% to 32% in 26 public service sub-sectors over the next three years. This is liked to explicit statutory recognition by government of the desirability of directing public service contracts towards organisations that create broader social value, continued spin-outs of public services to employee-owned mutuals, increasing professionalisation of the social sector and a small, but significant, shift in the mix of government contracts towards areas more favourable to social organisations.
- **Supplying large businesses:** Some private sector firms may favour social enterprises where this supports their corporate social responsibility strategy. There is anecdotal evidence that some major corporates in the North East are considering this but the practice appears to be in its infancy.
- **Housing, regeneration and transport:** Housing Associations are large social enterprises, and there is unmet and growing demand for social and private sector housing in the region. They will continue to build social housing, although constrained by restricted HCA grants. The opportunity for growth (and partnership working) lies in developments with significant synergies between different investments, which draw on a range of different government and European funds as well as private money (provided this influx of funds does not simply translate into higher land or property prices).
- There is also potential for social enterprises to compete effectively with profit maximising firms to provide bus and mini-bus services. HCT Group is one of the most successful and best known social enterprises. It wins commercial contracts from transport authorities, and uses its profits to cross subsidise further community transport services, including from other providers.
- **Community services, particularly finance and energy:** Linked to credit unions achieving their growth potential and opportunities for social enterprises and local authorities to work together to do more on energy tariffs and energy efficiency.

Social Enterprise: Challenges

The paper concludes that despite these growth opportunities, the acknowledged potential for social enterprises, and existing support (offered nationally and locally), social enterprise is 'held back' by three primary challenges:

- Capability development, including creating scale where necessary
- Integrating the sector into networks and strategic planning processes
- Optimising private and public sector procurement

These are echoed in the **third sector** input report, prepared by **VONNE** and **Pentagon Partnership**.

Capability development

Attracting the right people into the sector to create the right scale, is highlighted as one of the main challenges in capability development as is providing more business support for established social enterprises with real growth potential, including access to specialised sectoral expertise.

In particular there is a need for people who can build scale and for the support which can help them do so, whether organically or through different forms of combination (replication and franchising, partnerships and consortia, mergers). The median turnover in the sector is now just £240,000, and 90% of those advising the sector believe most social enterprises are too small.

The **expert paper** also notes that scale is important, not just to reach minimum efficient size, but to set standards and provide leadership for the sector.

Integrating the sector

The **expert paper** argues that social enterprises will only achieve their potential if the best companies in the sector are effectively networked with large companies, with the research departments at universities and/or with those planning skills and infrastructure. It sets out the need for joint projects rather than committees to create the relationships of which effective networks consist.

There is also an opportunity for social enterprises to integrate into the planning system. The paper suggests that planning departments for regeneration and transport can take into account the contribution that social enterprise (including transport, energy and finance companies as well as housing) can make to community development and the viability of particular places, and that these departments can also help create the conditions which encourage social enterprise to make this contribution.

Optimising private and public sector procurement

The **expert paper** draws upon the conclusion of a recently published Social Enterprise UK report:

> *"In critically important markets, private sector oligopolies are emerging, where a small number of companies have a large share of the market. Firms with large stakes in multiple public service markets are too big or too complex to fail. Smaller providers, often the social enterprises and charities that successive governments have marked out as ideal providers, are being forced out."*
>
> *"While social enterprises are growing and gaining confidence in consumer and business-to-business markets, our research shows that the ones working mostly in public service markets are drastically low in confidence. Many are making redundancies and turning away from public service markets in order to survive, just when they are needed most. They cite public-sector procurement policy as one of their biggest barriers to sustainability. They often lack the scale, balance sheets or ability to ruthlessly cut short-term costs in order to win out in the current climate."*

It is acknowledged that this problem arises at the local as well as national level, with the argument that a limited choice of providers can also lead to costs increasing. The implication being that the market settles into a far from optimal equilibrium. The paper recommends that local authorities, the LEP and the social enterprise sector need to work together to overcome this equilibrium by working on the demand and supply side but also on the capacity of social enterprise to deliver and compete effectively with large profit maximising companies.

In terms of private sector procurement, the paper sets out that while there is willingness in principle, the barrier appears to be the ability of social enterprises to deliver at the necessary scale. It is recommended that social enterprises and corporate organisations need firstly to identify the opportunities, and then the scale needs to be created to take these opportunities forward. It is suggested that the LEP could facilitate this process.

NELEP: Enterprise Priorities

The responses from **enterprise agencies** and **the third sector** identify three areas of support necessary to stimulate enterprise development within the North East. These relate to:

Supporting mid-sized businesses

Although the North East has a small proportion of small businesses relative to other areas, its mid-sized businesses are regarded as an important but often overlooked asset. The **CBI report** argues that it is these businesses that have the potential to deliver private sector employment and their stability in the North East is an opportunity. Both the **SQW study** and the **CBI report** identify public sector job losses as one of the most significant threats to the NELEP future employment growth. The region's mid-sized businesses have the potential to counter the effects of current and future contraction in public sector employment.

The paper also sets out what the CBI regards as the main challenge to the growth of mid-sized businesses - shortages in certain key skills, specifically mid-level management skills. The **CBI report** cites a lack of decision-making centres in the region around which skills for mid-sized businesses and SMEs can develop as another obstacle to private sector growth.

The **Entrepreneurs Forum** survey identifies four key barriers to enterprise growth and potential opportunities to address these, as shown in the table below.

Key Barriers to Growth	
Barrier	**Opportunity**
Shortage of people with appropriate skills from shop floor through to board level	• Grow your own. • Set up a skills sharing system.
Struggling to find new customers	• Pool knowledge and resources within industry sectors. • Signpost help such as UKTI. • Digital communications champions to share skills and knowledge.
Struggling to obtain finance	• Signpost through regional champions all finance available. • Match business finance needs to the appropriate fund provider. • Ensure all types of funding are readily available: - Proof of concept. - Start-up. - Expansion of established businesses. - Market flotation. - Realistic payback periods and further advances available. • Always have funding with mentoring – the most efficient and effective form of financing.
Price and gross margin pressure	• Regional champions by industry who can share best practise. • Knowledge sharing within industries or types of business entity.
Source: Entrepreneurs Forum Survey	

Targeted and locally relevant enterprise solutions

The **North East Enterprise Agencies Limited (NEEAL)** paper calls for the adoption of targeted and relevant enterprise solutions to meet the current needs of local enterprises. The report notes that while the North East is a strong exporter, its firms face a small local customer base. Therefore it highlights the need to encourage local firms to expand in new markets outside the North East, creating an outward looking regional economy. The **NEEAL** paper calls for the NELEP to support and endorse a private sector led multi-media campaign encouraging businesses to use their links and social media networks to find new customers.

The report also emphasised a need to improve business survivability in the North East, citing recent figures from Deloitte which indicate that business administrations in the North East were up by 9% from 2011. The **CBI** points to a gap in current business support for enterprises experiencing trading difficulties. The **NEEAL** paper also favours a shift in enterprise support from pre-start up to start-up support for businesses.

Growing and supporting social enterprises

The relatively high share of the public sector in the NELEP economy and the pressures to find innovative ways of delivering services at lower cost presents an opportunity for expanding the role of social enterprises and the third sector in the North East.

In spite of its contribution, the sector faces a number of challenges. Research suggests that social enterprises in the North East tend to be smaller than those in other areas, are more dependent on public sources of funding and are under continuing pressure to reduce the scale and breadth of their activities.

The **third sector** input report, prepared by **VONNE** and **Pentagon Partnership**, also cites inappropriate funding mechanisms as a challenge. Lengthy and complex procurement processes, unsustainable client flows, unsophisticated measures of success and a focus on price rather than quality are additional barriers faced by the sector. A lack of skills and expertise in areas such as enterprise, marketing, investment and collaboration were also identified as constraints on the growth of the third sector. These link to the challenges outlined in the **expert paper.**

From the perspective of women's community and voluntary organisations, there appears to be a need for increased commitment to these organisations. The response from the **NEWomen's Network** suggests that investment in the women's sector in the North East has declined over a sustained period from 2009 to 2012.

Three broad priority areas emerge from the third sector responses. These include:

- **Encouraging a more coordinated and proactive approach to joint commissioning by local authorities and other local commissioners**. The third sector should be considered as being integral to the design and delivery of services. The **NEWomen's Network** paper cites opportunities for women and voluntary community groups to sub-contract for Adult Learning contracts with Further Education and other large providers and from emerging structures such as Police and Crime Commissioners and Clinical Commissioning Groups.
- **Encouraging closer working between the third sector and the private sector to facilitate capacity building as well as joint funding bids**. Local businesses and major third sector organisations (e.g. housing associations) could support capacity building in areas such as purchasing, training and enterprise. There is potential for the women's sector to partner with the private sector through apprenticeships, training opportunities, placements and exchanges.
- **On-going engagement between the NELEP and the third sector** to understand the labour market / economic aspirations of the NELEP and its partners, inform the NELEP of the impact of policy on these organisations, and create opportunities for joint initiatives that will increase inward investment.

Overall, the expert paper highlights the need to find the right people, whether in the sector already, attracted to the sector by various LEP initiatives, or in organisations co-opted into the sector. It recommends that action focused projects should be set up which involve relevant individuals from business, education and local authorities and suggests that projects could be set up to:

- Develop a plan for the credit union sector that will build on the current government initiative to maximise the sector's potential.
- Ensure that opportunities for private rented sector improvement, energy management and community transport are maximised in regeneration planning.
- Identify better synergies between grant giving and investment opportunities.
- Identify the scope for social enterprise to contribute to regional skills development, and then integrate this into planning and funding arrangements.
- Ensure social enterprise is equipped to win public sector contracts, addressing the supply and demand side.
- Identify opportunities for social enterprise in supply chains and ensure social enterprise is equipped to take these opportunities.
- Identify innovation opportunities in social care for the elderly and ways of rolling these out.

RURAL

The **Expert Paper** on the potential contribution of the North East rural economy has been produced by the **Centre for Rural Economy** on behalf of the **Newcastle Institute for Social Renewal at Newcastle University**. It summarises the characteristics and current contribution of the rural business base as follows:

- The NE rural economy is a mixed economy, with the public sector the most important in generating GVA.
- The sectoral composition of the rural economy broadly mirrors the breakdown of urban and national economies. Agriculture, which is commonly associated with rural areas, makes only a small contribution to the overall GVA or employment of the total region. However, it is still a significant actor in the local economy of certain parts of the region.
- It has a high proportion of micro businesses (with 0 to 4 FTEs), and about one third of rural businesses are run from home.
- It makes a surprisingly high contribution to the NE economy on a number of indicators: proportion of enterprises, employment and GVA, but the contribution varies between places and sectors.
- Some types of rural businesses are particularly growth oriented: those in the manufacturing sector, businesses with 10 or more FTEs, and newcomer-owned firms.
- Growth aspirations are particularly constrained by the financial climate, lack of finance, regulation, recruitment of skilled staff, space constraints, and broadband speeds.

The forestry sector is a major component of the rural economy in the North East. The recent report on the **Economic Impact of the Forestry Industry to the North East of England** notes that the region's forestry sector is very broad and extensive and includes not only forestry management but also other activities such as primary processing, recreation, tourism, country sports, non-forest products and a range of supporting industries. The North East has the largest and most important softwood resource in England and is one of the main sources of industrial timber. The **Forestry Report** highlights the following contribution of the sector to the overall regional economy:

- Forest management and primary processing businesses support total employment of 1,506 people, 71% of which are directly employed.
- Turnover of £201m is generated by forest management and primary processing, which also provide approximately £40m in GVA per annum.
- The North East's forests attract 11.3m visits per year, of which 1.7m were over three hours and 0.4m were overnight stays. Combined, the four key forests in the region (Kielder, Hamsterley, Chopwell and Guisborough) attract over 710,000 visitors each year.
- Forest based tourism in the region generates expenditure of £150m per annum, including direct expenditure of £95.5m on forest based facilities, accommodation and catering and indirect and induced expenditure of an additional £54m.
- Over 3,500 employers are dependent on forest based tourism and its GVA contribution is estimated at £71.1m per annum.

The sector has several major employers such as Egger at Hexham, which employs 450 people. Since 2008, the sector has received £2.8m of investment in woodfuel related machinery and processing capacity through the Rural Development Programme for England. Alongside this, woodlands and forestry contractors have benefited from an increase in demand for woodfuel, especially firewood, which is anticipated to continue given increases in oil process and concerns over the security of oil supply.

The **Forestry Report** emphasises that the forestry sector *creates economic activity which is an integral and crucial source of employment and income in rural and urban areas where few other opportunities are available*.

Growth Prospects

Drawing upon **One NorthEast's Rural Evidence Base** and the **CRE's North East rural business survey** (which covered almost 1,000 businesses), the paper sets out that although typically small, many rural businesses have entrepreneurial/growth potential:

- The six highest rates of business formation by NE districts are rural.
- Almost half the survey respondents reported that they had introduced some form of innovation in the last five years.

- At the time of an economic downturn (2009), 43% of RBS respondents were looking to expand their business activities in the next two years.

The table below sets out the four sectors with firms most likely to plan growth based on the rural business survey. The manufacturing sector shows the strongest inclination to grow, and also reports the strongest profit growth trend amongst its firms. Its is followed by the Professional, Scientific and Technical sector, which also scores highly on these indicators, as well as having the highest proportion of firms with profit levels at more than 10%.

Sectors Most Likely to Grow in Rural Areas				
	Manufacturing	**Professional, Scientific and Technical**	**Accommodation and Food Services**	**Wholesale and Retail**
Planning expansion in next 2 years (%)	57%	45%	45%	44%
Profit level at more than 10% of turnover (%)	31%	58%	24%	29%
Profit level increasing over last 5 years (%)	49%	46%	38%	32%
Source: CRE's North East Rural Business Survey				

Other differences highlighted by the Rural Business Survey include:

- Aspirations to grow generally increase with size of turnover.
- Small businesses (with 10-49 FTEs) display the highest growth orientation in the short term; medium firms (50 – 249 FTEs) show the highest growth orientation over 10 years.
- Newcomer-owned firms have a 49% growth orientation in the short term (38% for locally-owned firms).

In addition, 34% of firms in the Construction sector anticipated growth in the next 2 years, and 29% in the Agriculture sector.

While these trends are positive, the paper highlights that for these business types to achieve their growth potential, they need a supportive economic context, including: markets where they can sell their goods and buy their supplies; the services of private sector advice and business support companies and local steady state firms; and peer support networks.

Additional evidence in support of rural entrepreneurship is provided by the **Northumberland Uplands Leader Action Group (NULAG**). NULAG has distributed over £2m of grant assistance to businesses and community organisations in the last four years. In total it has supported 79 individual projects with grants resulting in 27 new business start-ups and 46 new jobs being created. NULAG promotes the unique Leader approach to rural development which allows local businesses and individuals to make 'bottom-up' development decisions. The **NULAG** response paper cites the importance of providing capacity building alongside grant funding to support entrepreneurship in the rural economy and business ventures that contribute to local economic development.

Barriers to Growth

Evidence from the rural business survey suggests that there are four main factors currently inhibiting growth. With the exception of broadband speed these are similar to the barriers raised by businesses in the urban economy:

- Anxiety about the current economic climate.
- Increased regulation affecting the business.
- Shortage of finance in the business/high cost of borrowing.
- Broadband speeds that would be inadequate for their business needs in the future.

Businesses in the four sectors with higher growth orientation agreed with the constraints listed above, and also identified the recruitment of skilled staff and space on the businesses current site as barriers to growth. Space was less of an issue for businesses in the Professional, Scientific and Technical sector.

The rural business survey asked businesses what measures would enable them to grow. Overall the most important measures, in descending order, were:

- Better access and adjustment to national and regional business development programmes and grant funding.
- Better access to new IT.
- Better access to private capital.

- Working in collaboration with other business.
- Better access to skills/training programmes.
- Closer relationships with business support agencies.

More generally, the **Expert Paper** and a paper produced on behalf of **ippr** for the Northern Economic Futures Commission also draws attention to a number of wider issues which rural areas face:

- **The role of land use frameworks:** The **Expert Paper** suggests that the land use planning system has contributed to a conceptualisation of rural areas as places to be preserved rather than developed. It reports that this has severely constrained development in some areas, especially in cases where businesses have wanted to expand their premises beyond a size deemed rurally appropriate. Going forward, the paper argues that it will be important for the local planning system to take into account rural issues including the need for affordable housing, developing effective and sustainable transport networks, and encouraging new businesses and homeworking.
- **Maximising innovation in rural areas:** The considerable potential that exists for rural areas to be important sources of innovation in the NE is set out in the **Expert Paper**, although there is a caveat that 'innovation' is typically framed in a narrow sense as a process led by experts in large organisations such as businesses with R & D departments and Universities. While the rural business survey found that many small rural businesses had introduced innovations, and the rural economy would appear well-placed to lead on innovations associated with demographic ageing, renewable energy technologies and the wider 'green' economy, it was also noted that very few rural businesses connect to innovation hubs such as the Newcastle Science City initiative. As such, the paper calls for hubs to actively develop links with rural firms.
- **Incentive structures to support complementary development of economic resources:** the paper prepared for **ippr** highlights that rural areas are net exporters of ecosystem services. While the relative abundance of natural capital is an opportunity for rural areas, including in the development of positive economic relationships with other parts of the economy, there are questions around whether the incentive structures are right to support complementary development of economic resources in rural areas. Further exploration of issues to do with the pricing of these resources, quality of supply and the economic return to rural areas has been suggested as a key area for further work.

NELEP: Priority Areas for Action

The **Expert Paper** identified three priorities for action, which link to maximising the growth potential of the rural economy:

1. Investment in high-speed and robust broadband
2. Giving the potential of the rural economy prominence in the NE Economic Strategy
3. Addressing the skills development needs of rural growth businesses

Investment in high-speed and robust broadband

Increasingly businesses are becoming dependent on high-speed broadband, although there are differences in the reliability and speed accessed in rural and urban areas and this is likely to increase with the introduction of superfast broadband. Investment to close this gap would support the rural economy in meeting its full economic potential.

As noted in the **Expert Paper**, the economic growth potential of superfast broadband (recognised by the government's investment through BDUK) is as essential to rural businesses as to those in the rest of England. However, this public investment will not provide superfast broadband to many rural businesses; nor will the promise of 4G mobile coverage 'everywhere' be realised without a nearby fibre connection. Without high-speed broadband, existing growth oriented firms are unlikely to remain and entrepreneurial incomers and return migrants are likely to be deterred.

The paper states that *"Government plans to ensure that the 'final 10%' of premises nationally (estimated as about half of all rural premises) are given at least 2mbps by 2015 seem woefully inadequate"*. In the case of a particularly sparse county, Northumberland County Council estimates that between 20,000 and 25,000 of premises (13-16% of the total) will be in this category. The Council is also concerned that many rural premises will be connected to 'superfast broadband' (currently defined as at least 24 mbps) with less than state-of-the-art technologies which might not allow upgrades.

Giving the rural economy prominence in the NE Economic Strategy

The need to develop a nuanced understanding of the NE rural economy and ensure that its growth and innovation potential is incorporated and prioritised in sub-regional/regional strategies is included in the **Expert Paper** recommendations. It states:

> "T*he economy of the rural NE is rarely portrayed as dynamic in such strategies; instead urban areas are thought to be the engines of growth with rural areas passively waiting for 'trickle down' effects"*.
>
> *"As a result, growth initiatives such as city-regions, Enterprise Zones, City Deal and Regional Growth Funds are usually urban oriented".*

The paper calls for more effective 'rural proofing' of policies to address the special nature of opportunities and constraints in the rural economy and suggests that a better understanding would be supported by learning from the NE Rural Growth Network, and by developing detailed data gathering and analysis on the NE rural economy.

Specific areas for improved understanding are set out in a paper prepared on behalf of **ippr** for the Northern Economic Futures Commission. These are based on a wider agenda (beyond improving the productivity of rural businesses and developing sustainable futures), which recognises the range of distinctive roles that rural areas in the North play and the opportunities to make more of the range of economic assets and resources through thinking at a wider territorial scale and focusing on linkages and functionality. The main areas for development are:

- Understanding of the future trajectories of existing and emerging assets and sectors in the rural economy and a continuing focus on their performance and new opportunities for diversification.
- Identification of the current and future relationships of rural areas in their wider territorial context, in particular the variety and range of specific urban-rural economic linkages around labour and housing markets.
- Understanding of the contribution that rural areas can make in addressing key infrastructure requirements such as food, energy and water and in addressing environmental and social sustainability through ecosystem services.
- Understanding of the specific barriers to engagement in wider economic systems and ensuring that these are overcome. This includes ICT disadvantages as well as potential issues such as skills alignment, housing supply, the spatial development objectives of key utilities companies within the regulatory framework and the incentives to rural companies for the supply of rural services in the wider economy.
- A specific recognition of the issues and concerns for isolated rural areas and understanding of how marginal economic activities in the area can be supported.

For this to happen, the paper identifies the following requirements (which apply across the North of England):

- Local Authorities, LEPs and Government to develop detailed analysis of the linkages, relationships and interdependencies between different parts of the rural economy and the capacity to design long term strategies which can work with the diversity of total areas and their economic roles and potential.
- Mechanisms for celebrative strategic planning and leverage involving, for example, groups of Local Authorities, LEPs, utilities, businesses and others, to enable the capacity requirements of different parts of the economy to be mediated with supply in key infrastructure areas such as energy, water and food.
- Thought to be given to methods for pricing of 'exports' of ecosystems and other rural assets to incentivise investment and development of these services to achieve complementary economic development in both rural and urban locations.
- Examination of regulation in areas such as spatial planning, water, energy and marine to ensure that decision making can balance economic, environmental and social goals at different scales.

Addressing the skills development needs of rural growth businesses

Ensuring that the approach to skills development in rural areas combines formal training and advice with informal mentoring schemes is highlighted as a priority in the **Expert Paper**. This would help to address barriers which rural businesses face in recruiting skilled staff and accessing formal training for existing workers.

It suggests "*publicly funded schemes to date have generally failed to impact on rural micro businesses'*" and that while formal training and advice has to address the needs of micro businesses, perhaps run from home, in remoter areas; informal mentoring schemes should focus on giving support to local and/or voluntary networks of businesses.

Linked to this, the paper also highlights the need to support the development of rural business networks, their capacity to overcome locally identified growth barriers and the strengthening of their voice within wider economic development circles. The latter being particularly important to ensure that small, and generally voluntarily run local networks have a higher profile amongst public bodies, LEPs and larger business associations, especially given the benefits they can lead to such as allowing critical mass for buying goods, collective marketing with a wider reach, generating savings by sharing premises or back office functions, or joint working to address a local concern or barrier (flooding, for example).

LIST OF RESPONDENTS

Association of Colleges North East (AoC NE)
Beamish
Bionow
Capital Shopping Centres
CBI NE
Civil Engineering Contractors Association
Developing Consensus
Durham County Council
Eldon Square
Energy Leadership Council North East
Entrepreneurs Forum
FW Capital and NEL Fund Managers
G9
Gateshead Council
Generator
Highways Agency
Home Group
Homes and Communities Agency
Institution of Civil Engineers
International Centre for Life Trust
Jobcentre Plus and Department for Work and Pensions
NCFE
NCVO
NE Combined Transport Activists Roundtable (NECTAR)
Newcastle City Council
New Economics Foundation
Newcastle Gateshead Cultural Venues
Newcastle International Airport
Newcastle Science City
NewcastleGateshead Initiative
NEWomen's Network
North East Access to Finance
North East Chamber of Commerce - Response for University Sector
North East Enterprise Agencies Limited
North East Enterprise Agencies Limited
North East Forestry Sector
North East Historic Environment Forum
North East Process Industry Cluster (NEPIC)
North East Sustainable Resources Board
North East Technology Sector
North Tyneside Council
Northern Film and Media
Northern Film and Media and Software Sunderland City
Northern Housing Consortium
Northern TUC
Northumberland County Council
Northumberland Tourism
Northumberland Uplands Local Action Group
Port of Tyne
South Tyneside Council
Sunderland City Council
Sunderland Software City
Supplementary response to service sector report on behalf of Digital Union, Arts Council, Service Network, The Law Society, Generator, NewcastleGateshead Initiative and Northern Tourism Alliance
Sustrans

The Association of North East Councils (based on research conducted by the Universities of Northumbria, St Durham and IPPR North)

The Homebuilders Federation

The National Housing Federation

The Northern Group of Labour MPs

TT2 Limited

University of Durham (Energy Institute and Physics)

Visit County Durham

Vonne and Pentagon Partnership

Yorkshire and North East Forestry Commission