CBI Economics

Where best to invest?

Insights from manufacturing multinationals and the risks of lost investment into the UK

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Foreword CBI Economics

The UK is a great place to do business. But the political and economic headwinds are blowing strong, and other countries are raising their games.

This latest CBI Economics report with Warwick Business School shines a light on this by assessing the factors influencing investment decisions, and how the UK is performing relative to international competitors.

We've interviewed over 40 business leaders of multinational manufacturers. A third of interviewees pointed to lost investment in the UK over the past seven years due to UK-specific factors. Many more warned that the UK will continue to lose out on investment without bold action.

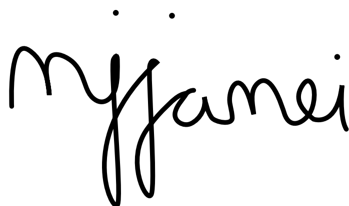
On green growth in particular, the US Inflation Reduction Act and the European Green DEAL have shifted the goalposts The US IRA earmarks some $369bn in subsidies for green technologies, while the EU will look to mobilise over €500bn in public investment.

The UK doesn't need to go toe to toe on subsidies, but we do need to play smart, with market-making and agile regulation. This will boost confidence and encourage investment, enabling us to leverage the huge opportunities that exist for UK businesses from winning in global green markets, including the first-mover advantage we gained from being the first major economy to embrace a legal obligation to achieve net zero carbon emissions by 2050, an advantage we risk losing with further inaction.

The CBI analysis shows that the UK has enduring strengths, with world-leading R&D capability, some of the world's top universities and access to talent and technology. But we need to be more attentive to our chronic labour and skills shortages and a more joined-up approach to driving innovation.

This report also backs up a core CBI message: that businesses need certainty to invest. Short-term policy changes and a lack of detail behind headline policy announcements risk investment heading to competitor countries. In areas like tax, hydrogen and electric vehicles, the government can win investment before spending a single penny, by publishing roadmaps and market-making legislation.

There are major economic prizes up for grabs. Taking bold actions now can avoid a potential decade of low investment and low productivity. The message and findings of this report are clear, act now or the UK will miss out.



Mohammad Jamei
Director of CBI Economics

Foreword
Warwick Business School

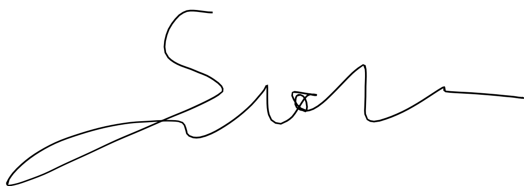
More than ever, in times of extreme uncertainty, the nexus between business and government becomes a core topic of discussion. Together with global challenges such as the COVID-19-induced global supply chain crisis, wars, political unrest and decoupling, both in Europe and between the US and China, BrExit will drive a change in the overall composition of inward UK investment. Changes in the composition of inward investment – particularly, changes in foreign firms' motives to choose the UK market have the potential to significantly alter the UK's value proposition, and over time, the nature of the country's specific advantages. Policies to attract investors - as well as effectively capture the benefits of those investments - should consider the changes in firm strategies and respond to them.

There are still many reasons why investors would select the UK market or, for those already here, why they would choose to stay, for example, the overall size of the UK economy and the nature of its labour markets. Whilst there are still reasons why foreign investors may select the UK market, these reasons may, to an extent, change. This project consisted of 43 interviews with multinational manufacturing firms, ten of which were UK owned. The sample allowed for a better understanding of how investors feel about the UK market, their perceptions of uncertainty and their subsidiaries' evolution plans.

In the report, we discuss why the success of government policies designed to attract investment depends on how quickly and effectively such policies are adapted to the needs and strategies of investors.

This project is one of many projects we started examining the UK market, and the motivations as well as outcomes related to inward foreign investment choices. As a business school, WBS's main goal when working on these projects is to inform policy makers as to how one can better align inward investment policy with the business agenda. The idea is not to simply maximise the magnitude of investment that a country is able to attract, but to maximise the benefits of such investment, in terms of, for example, jobs and productivity. Hence, understanding investors' motivations and future plans is important for policy makers seeking to attract and keep investment, and effectively generate positive externalities. The report offers novel insights that would enable policy to be proactive, rather than reactive.

Notably also, while this report focused on manufacturing sectors, we can extend the research to other sectors. Further research could compare findings for the UK to other countries or look at different locations within the UK. The research could also be repeated in the future to understand changes in investment drivers or sentiment towards the UK following changes in investment policies.



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Executive Summary

Through 43 interviews with business leaders from multinational manufacturers, this report builds a picture of the investment process within foreign-owned and domestic firms and confirms that the UK does compete with other markets for investment funding in most cases.

This report compares the perceived strengths and weaknesses of the UK macroeconomic and political environment, contextualised by findings on the factors that drive investment decisions.

Overall, there was a feeling that the UK remains a good place to do business, but that competitiveness has been slipping away in recent years and continues to do so. For a third of businesses, this has already led to some lost investment, while many others point to the risk that further investment is lost.

Some of the UK's strengths are inherent (such as our language, geography and climate) but some are at risk of fading further over time, such as our world-leading innovation ecosystem. At the same time, Brexit has hurt many firms and continues to play on the mind of decision-makers both at home and abroad, while we also become increasingly uncompetitive in costs.

Based on the findings of this report, the top three things government can do to halt the decline in the UK's competitiveness and attract further investment are:

1. **Government must provide greater political certainty**

   Political certainty strongly influences perceptions of the UK. However, frequent changes in key political personnel, sudden or unexpected policy changes, a lack of decision-making on key infrastructure projects, and a lack of a strategy or policy framework in a certain area can inhibit investment. Government should take action now to provide clarity.

2. **Government must protect the UK's world-beating areas of strength**

   Whilst the UK's world-leading innovation ecosystem attracts investment, global competitiveness is being eroded. Government must take further steps on labour shortages, including support for training and retraining. They should also deliver smarter, more agile and consistent regulation, and clearer policy frameworks for the net zero economy.

3. **Government must provide the support to allow UK-owned firms to flourish**

   UK-owned manufacturers were less likely to point to recent examples of lost investment, with some intimating that UK manufacturing was part of their identity. However, the UK has a scale-up problem related to access to finance. Government must provide more domestic options for firms to grow at pace, by improving finance flows across the economy.

Introduction

Background and context

CBI Economics, the economic consultancy division of the Confederation of British Industry (CBI), in partnership with Warwick Business School (WBS) and the Midlands Regional Productivity Forum. The aim was to carry out a series of business interviews to better understand investment decisions within multinational manufacturing companies. They were particularly interested in understanding:

- **How investment decisions are made within multinationals,** including how subsidiaries and headquarters (HQ) communicate, how investment decisions are signed-off, the most important factors that are considered when deciding where to invest, and how these dynamics have evolved over time.
- **The current state of investment into the UK within multinationals** including recent investment trends, perceptions of the UK's attractiveness as an investment location, and the UK's key competitors in attracting inward investment.
- **What government can do to help,** including how better communication around current and future policy changes can help retain existing investment in the UK as well as attract more investment.

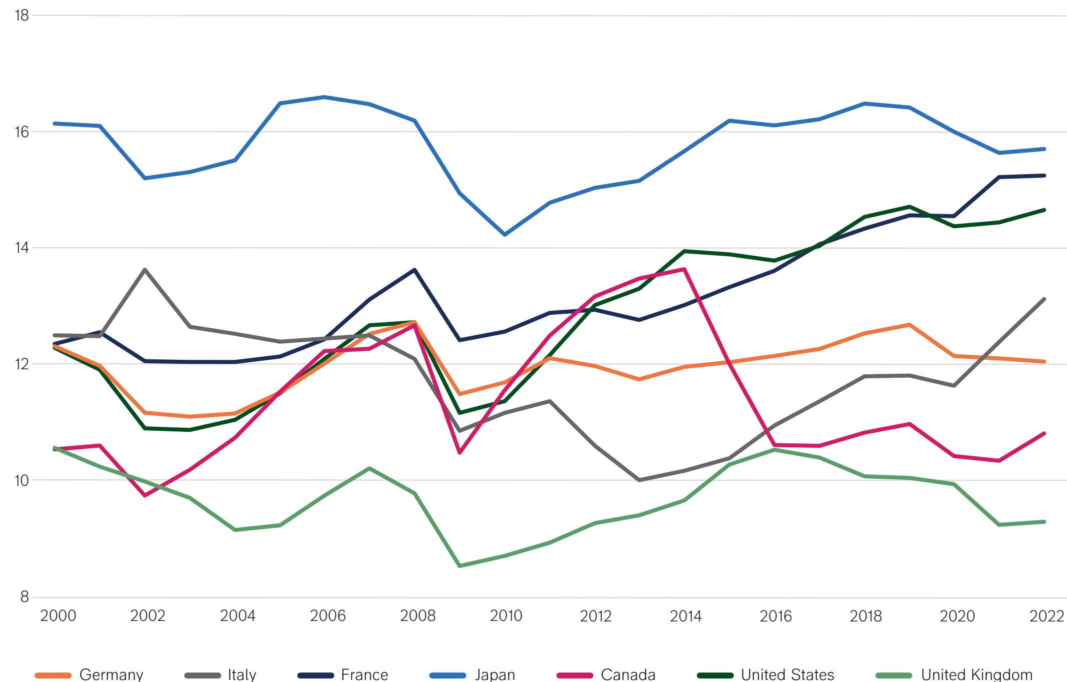
Why this research is needed

There were several motivations for engaging in this research. Firstly, while the literature is clear on the negative impact that uncertainty can have on investment inflows, empirical research has yet to consider specific measures or proxies for different types of uncertainty. Therefore, this may not give the full picture of the importance of certain types of uncertainty relative to others, and to other factors such as economic fundamentals (structural long-term factors representing the strength of an economy, as opposed to short-term/volatility-based factors). Perceptions of uncertainty are generally best uncovered through direct engagement with decision-makers.

Another motivation for engaging in this research, and looking into manufacturing firms specifically, is on account of existing evidence of declining investment into UK manufacturing. The CBI has heard various examples from members about manufacturing companies divesting from the UK, with a glass manufacturer reporting in August 2022 that they have cancelled a planned £1.2m investment into a new manufacturing site because of energy costs, and a household appliance company reporting in July 2022 that they have backed out of previously planned investment and new product development for 2023 due to supply chain issues and components being too expensive. On 17 January 2021, it was confirmed that Britishvolt, a UK startup manufacturer of lithium-ion batteries for the automotive industry, went into administration due to "insufficient equity investment".

Declining investment is also borne out through the data, showing investment within the manufacturing sector falling by 0.3% in the year to Q2 2022. Within manufacturing, investment in buildings fell by 19% in the year to Q2 2022.[1] Recent data from the Society of Motor Manufacturers and Traders (SMMT) shows that annual UK car production fell by to 775,014 units in 2022, down from 1,772,698 in 2016.

Figure 1 Business investment across the G7 (y/y% growth)



Source: Oxford Economics

Another reason for focusing on manufacturing firms was on account of the unique characteristics that make them a particularly interesting case study. The CBI is aware from discussions with its membership body that manufacturers make a wide range of investments, whether it be in machinery, people, or software, and that they tend to have high sunk costs and long lead times. Importantly, manufacturing firms also have considerable potential for technological progress and efficiency gains, making Foreign Direct Investment (FDI) and the transferring of technology particularly important to remain competitive.[2]

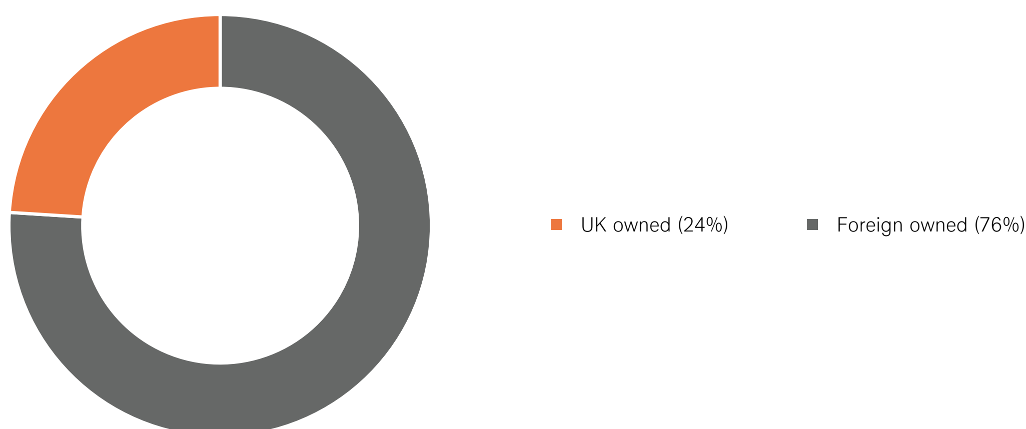
Ultimately, declining inward investment is problematic for economic growth. More investment means a larger capital stock which allows for more goods and services to be produced with the same level of labour and other resources. Greater investment can boost short-run growth, but an economy's rate of investment also has a significant impact on long-run growth, by driving productivity.[3] At a business level, multinational firms bring in better technological and managerial know-how which boosts output in their operations, and FDI can stimulate domestic firms to become more efficient – for example, through stronger supply chains and tougher competition.[4] Given the UK's longstanding productivity puzzle, paired with changes in the macro-environment of firms, research into how policy can be used to enable the UK to attract more Foreign Direct Investment (FDI) is pressing.[5]

Methodology

To conduct this research, CBI Economics interviewed 43 multinational manufacturing firms between November 2022 and February 2023. A range of multinationals were engaged to understand if there are differences across groups, as set out below:

- **Ownership location:** 32 were foreign-owned and ten UK-owned. Interviewees represented multinational firms with parent firms from a range of countries, including the UK (ten businesses), Europe excl. UK (15 businesses including five German and three Swiss), North America (twelve businesses including eleven U.S.), Japan (four businesses), and China (one business)
- **Manufacturing sub-sector:** the interviewees represented a broad range of manufacturing sub-sectors, including chemicals (five businesses), pharmaceuticals and medical (five businesses), defence and aerospace (four businesses), transportation and automotive (four businesses), IT/ Technology/ Electronics (three businesses), and construction and building materials (three businesses).
- **Ownership model:** interviewees represented firms with several ownership models, including publicly listed (26 businesses), family-owned (five businesses), private equity owned (one business), and other privately owned (ten businesses).

Figure 2 Distribution of ownership location for interviewed businesses (% of respondents)



The interview participants were asked broad questions about the macroeconomic and political environments and uncertainty in both, as opposed to questions about the importance of specific factors such as costs of manufacturing or Brexit. This ensured that questions were not leading and that any mention of particularly important factors was made of the interviewees' own free accord.

Analysis of the results included codifications in certain areas. For instance, the interviewer made a qualitative assessment of the transcript and judged the interviewee to have either displayed an overall negative or positive sentiment toward the UK market, focusing particularly on the factors the interviewee judged as important to their investment decisions.

While a binary codification may seem simplistic and will remove a lot of nuance in judgements of the UK market, a higher number of dimensions would be unhelpful in allowing for useful analysis given the sample size achieved. This does provide scope for extending this research to provide a larger sample to increase the number of dimensions by which to codify responses. Linguistic Inquiry and Word Count (LIWC) scores were considered, but the language used by interviewees generally scored poorly for emotive language and highly for analytical language, so this method was deemed inappropriate.

How investment decisions are made

The business interviews included various questions about how investment decisions are made within multinationals, including:

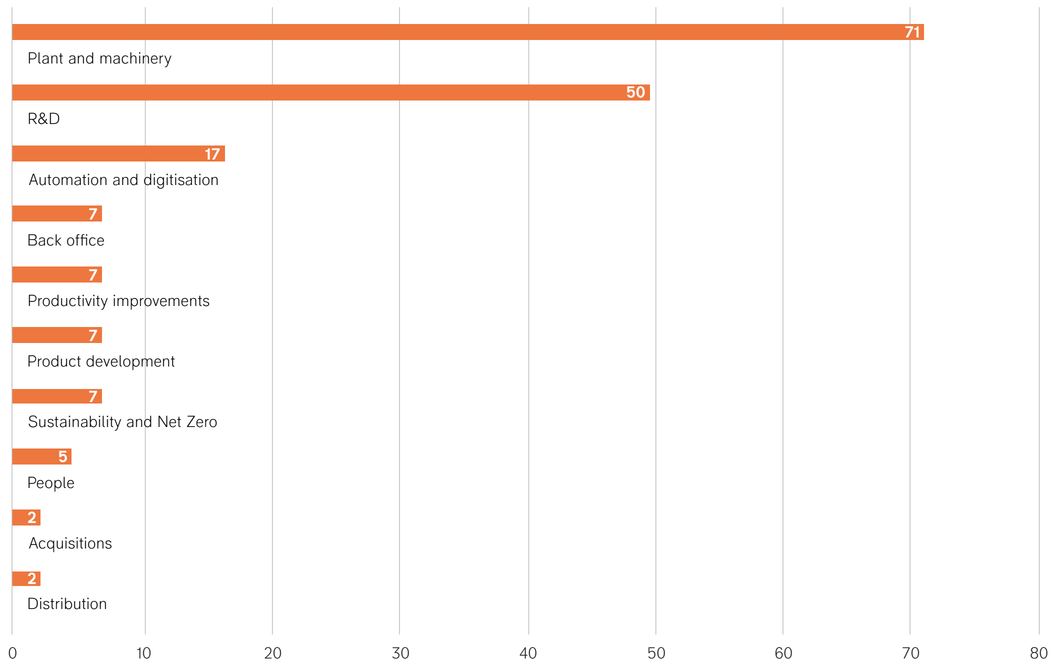
- How subsidiaries and headquarters (HQ) communicate and how investment decisions are signed-off.
- The most important factors that are considered when deciding where to invest, and if these factors have changed over time.

"We've made no secret of the fact that we think the political instability and uncertainty, and particularly energy and energy policy, is a significant issue for us. The fact that we've had 16 secretaries of state responsible for ensuring the last 22 years is not helpful".

The most common investment types are plant and machinery and R&D

Interviewees raised various types of investment when asked about their recent investment activity. Unsurprisingly, the most common type of investment mentioned was investment into plant and machinery (71% of businesses), including both maintenance of existing capital and new capital. This was closely followed by R&D (50%). After this automation and digitisation was the most common investment type (17%).

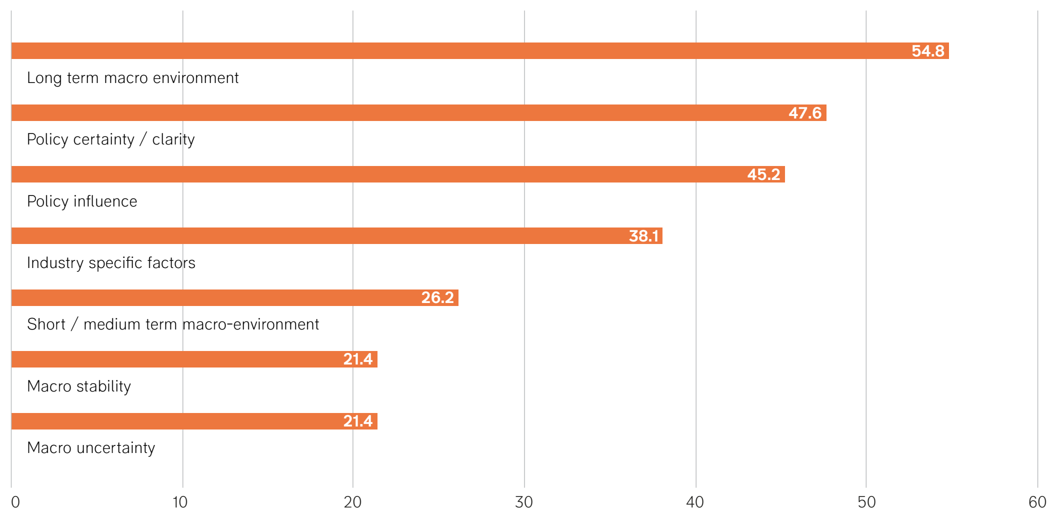
Figure 3 Types of investment mentioned by interviewed businesses (% of respondents)



Manufacturers focus most on long-term macroeconomic fundamentals when investing

Both subsidiary and HQ leaders were questioned about the key factors that are considered when deciding where to invest. **Figure 4** below provides an overview of the most common factors reported by interviewees.

Figure 4 Citations of important issues when making investment decisions (% of interviewees)



The most common external factor that interviewees cited as important in making investment decisions was the long-term macroeconomic environment (55%). Within this, the most commonly-cited macroeconomic fundamentals were a thriving economy that provides strong market demand and an abundance of labour and skills that can be tapped into. An economy that supports technological progress and innovation was also emphasised, as was one with strong infrastructure.

Ultimately, these longer-term fundamentals were generally viewed as being more important than macroeconomic factors such as stability (21% of businesses highlighting) or uncertainty (also 21%). The perception is that strong fundamentals enable businesses to operate profitably and provide a return on investment. This finding also highlights the long-term view that many businesses take towards investment decisions. Businesses in the automotive industry in particular emphasised the need to look beyond short-term economic fluctuations and consider longer-term potential, given the length of their investment cycles.

"If you're in, you're in for the long-term"

"Car manufacturing is a long-term project. We generally look at a ten-year horizon"

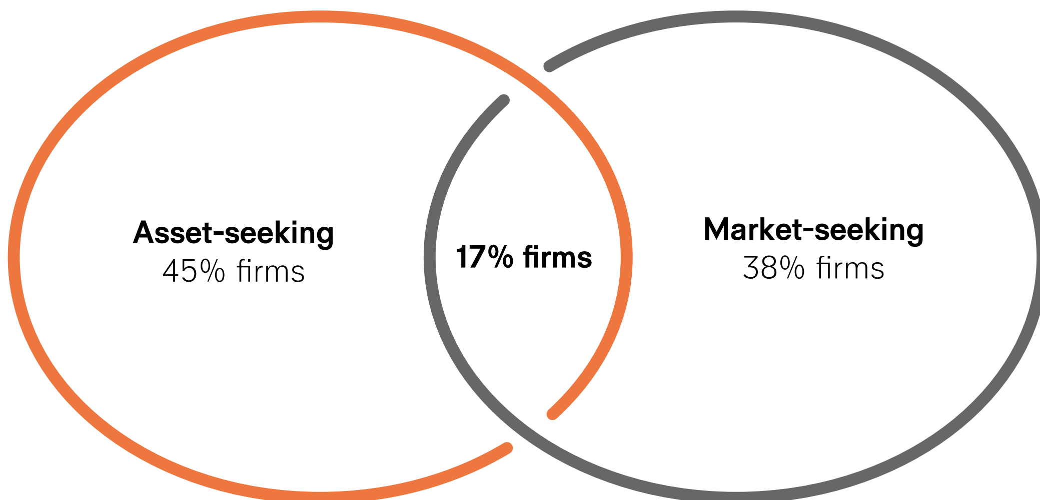
Manufacturers emphasised both a country's assets and market as influencing investment decisions

Amongst the full set of businesses interviewed, it was common to highlight assets that a market possesses as being a reason to have a presence in a particular country, with 45% of firms judged to be 'asset seekers'. Asset seekers were often in more scientific industries such as chemicals and medical devices, emphasising fundamentals such as the availability of skills and low costs.

"Infrastructure is an important consideration and we will always take into account skills, right capabilities and to some degree right mindset."

It was also common to cite demand as an important economic factor, with 38% of businesses judged to be 'market seekers' who invest in markets where the demand for their products exists. These businesses highlighted the importance of having specific growth opportunities in their sector or wider economic growth that can fuel demand. For example, a packaging firm emphasised that they will be attracted to markets that have high population growth and the growth of e-commerce, as these are both closely linked to packaging demand. Otherwise, 17% of firms were judged to be a mix of market and asset-seekers.

Figure 5 The distribution of market and asset-seeking businesses



> *"If consumers have less disposable income, the likelihood is they're going to buy less of our product. So that is a concern globally. Rising inflation and weak economic growth everywhere is something that we watch."*

Industry-specific policy and regulatory issues also influence investment decisions

After the long-term macroeconomic environment and fundamentals, the next most common issues emphasised by interviewees were policy certainty (48%) and policy influence (45%), with a majority of interviewees who raised one of these two topics also raising the other. This provides some evidence that manufacturing multinationals ultimately see macroeconomic factors as more important than political factors, while still seeing both as important.

When policy was emphasised, it was often specific policies or regulations relevant to the industry the interviewee operated in, whether it be the policies themselves or having clarity over future strategy. Around four in ten (38%) said that industry-specific factors were important in making investment decisions, with these firms tending to operate in highly-regulated sectors such as health, defence, infrastructure, and energy. The importance of clarity on energy policy was mentioned frequently, with a paper manufacturing firm highlighting that uncertainty over policies such as the Levy Exemption Certificate (LEC) and windfall taxes has damaged the UK's reputation in the eyes of the European HQ.

> *"the bit that's really probably damaged the UK's reputation in the eyes of the investors in [country] is the uncertainty around windfall taxes"*

With regards to having the ability to influence policy, the majority of UK HQ-ed firms held the view that policy influence is important to making investment decisions (70%), compared to 38% of subsidiaries. This might indicate that UK HQs are more embedded into the UK than UK subsidiaries are, and therefore that they are more likely to have the motivation to engage in policy influencing.

> *"What we try to do is guide civil servants and policymakers around how the market works, giving them that knowledge and intel as to what will work and what won't."*

Regulation and political stability have come to the fore of businesses' minds due to recent changes in the UK's environment

Interviewees did not highlight instances of the intrinsic importance of different factors, when deciding where to invest, changing over time. However, there were examples of certain factors becoming more relevant due to changing external circumstances. For example, regulation and regulatory divergence have become more relevant following the UK's decision to leave the EU, and having a clear view over future policy has become more relevant on account of the high churn of politicians in the UK. The relevance of these factors in affecting inward FDI to the UK is expanded on in the next chapter.

The investment process is generally hierarchical in structure

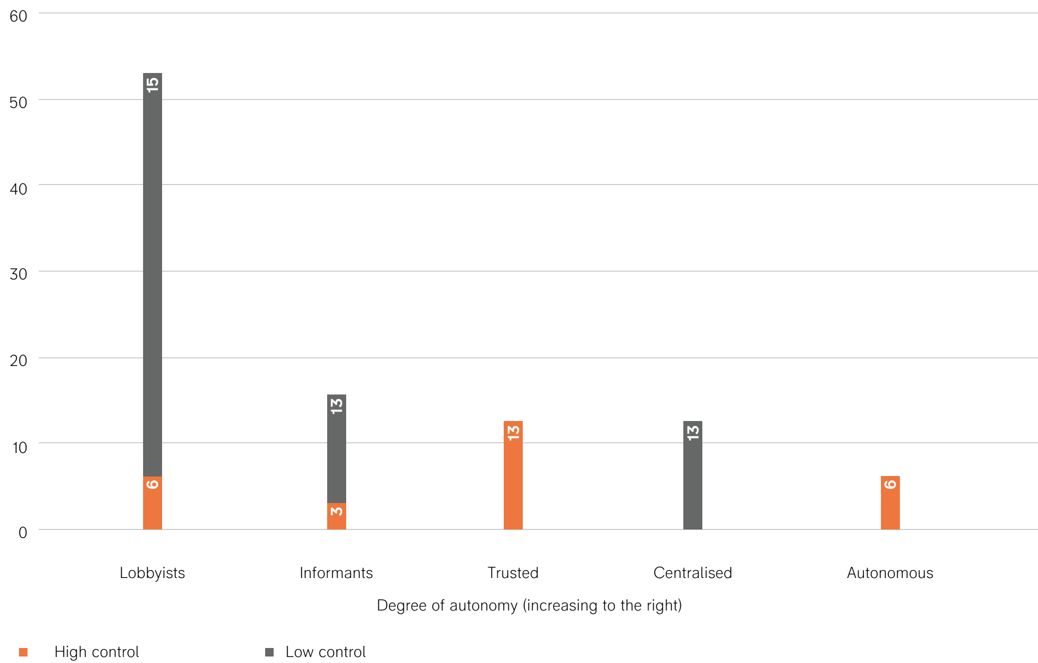
The majority of the subsidiaries (62%) are engaged in a hierarchical process with their HQ when it comes to getting investment decisions signed off. These structures see the subsidiary as having to submit investment requests to an HQ, which acts in a decision-making and sign-off capacity.

Within a hierarchical structure, subsidiaries were further sub-categorised according to the nature of their relationship with the HQ:

- 38% of subsidiaries were classified as 'lobbyists', where the subsidiary would look to influence the HQ to win investment for their market.
- 12% were classified as 'informants', where the subsidiary would look to inform the HQ about the costs and benefits of investing in the UK, rather than influence their decision towards the UK.
- 10% were classified as 'trusted'. These were firms with a hierarchical sign-off process but where the UK subsidiary gets most of the investments they ask for.
- Other subsidiaries were classified as either being autonomous (5%), where the subsidiary could invest as they see fit, or centralised (10%) where the parent or a European entity made most of the decisions.

These findings indicate a clear separation between HQs and subsidiaries, with a formal process for sign-off in which subsidiaries generally have to submit a compelling business case to secure the investment they desire. It was sometimes the case that the formality and length of the sign-off process increased with the size of the investment request. Generally, lower autonomy structures for subsidiaries were more common than higher autonomy structures.

Figure 6 Overview of subsidiaries by type of relationship with HQ (% of subsidiary respondents)



"All [projects] go through a pretty rigorous process and we have hurdles associated with it. Each aspect of it."

"if it's really significant, so you know a major, major investment in the multi-millions, then occasionally it needs to go to the supervisory board who meet once every six months. So that's why huge investments can take a significant amount of time."

Given this, it is perhaps unsurprising that, based on the information provided by the interviewees, most subsidiaries (55%) were classified as having a low level of control over their investment decisions. The nine subsidiaries that were classified as having a high level of control include all six of the 'trusted' and 'autonomous' subsidiaries and just three of the 21 'lobbyist' or 'informant' subsidiaries.

One explanation for the hierarchical structures and overall low level of control of subsidiaries is that most subsidiaries (52%) interviewed have to compete with other markets for investment. This includes companies headquartered in the UK, as most of the UK HQs (17%) compare the UK against other markets when making investment decisions. When interviewees mentioned the markets that the UK competes with, they most commonly answered Europe, followed by the US and Asia. A small number of firms (5%) however clarified that they tend to view investments at a Europe or EMEA level rather than at the country level.

"If you're not in North America, you have to have a battle to get any investment at the moment... It's all about who's got the best specific business case."

Several interviewees mentioned that their firm has a finite amount of capital to invest in any one period and that investment opportunities are prioritised in some way to select where the budgeted capital spend is used.

"We've got a team who's headed up a global vice president who looks after all capital investment [...] so his job is to prioritize the capital needs for any particular financial year. If the Board of Directors approved a certain amount of capital investment, then his job is to try and make everything fit within that envelope. he will use a prioritization model to do that, and they'll assess each investment [request from subsidiaries] in terms of different deliverables."

The current state of investment in the UK

The previous chapter focused on internal and external drivers of investment decisions in multinational corporations and provided insights into the importance of various aspects of the macroeconomic and political environment in the markets where firms look to invest. This chapter sets out the perceptions of the UK as a place for investment, focusing on the following:

- Perceptions of the UK market contextualised by earlier findings around what factors are important for interviewees.
- Current investment trends for the UK economy and how perceptions of the market are driving that.

Manufacturers are broadly downbeat about the UK market

A majority of interviewees (57%) were judged to have displayed negative sentiment about the UK economy (the approach to this judgement is explained further in the methodology section).

The majority (90%) of UK-owned firms displayed negative sentiment compared to less than half of foreign-owned subsidiaries (47%), while North American-owned subsidiaries were more likely (67%) to display negative sentiment than those which are European-owned (47%).

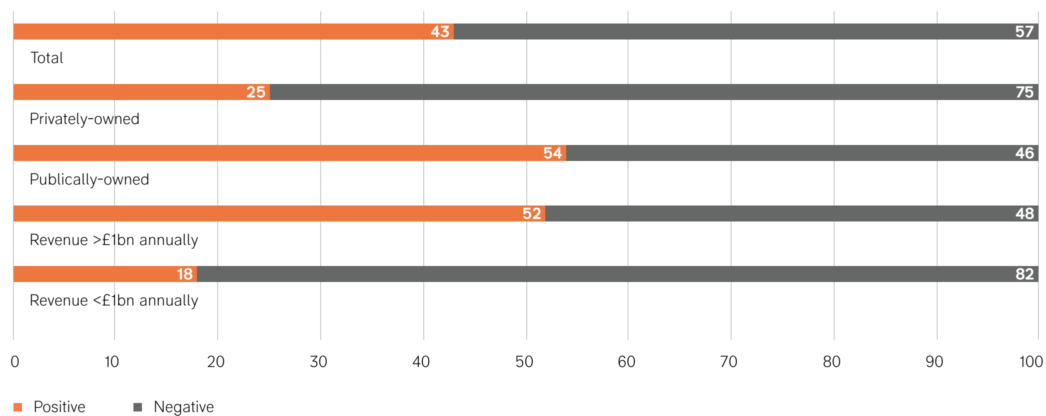
Firms that undertake R&D in the UK were less likely to display negative sentiment (43%) than those that don't undertake R&D in the UK (92%). Some potential reasons for this finding are explored below.

Firms with global revenue below £1bn were more likely (82%) than those with revenues above £1bn (48%) to display negative sentiment. Similarly, the 16 subsidiaries with the highest UK revenues were less likely to display negative sentiment (38%) than the 16 with the lowest revenues (56%).

Privately owned firms were much more likely (75%) to display negative sentiment on the UK market compared to publicly owned firms (46%). This may be linked to the previous finding, as 75% of firms with global revenues less than £1bn are privately owned, compared to 23% of the largest firms.

Despite seeing their role as lobbying for investment in the UK market, 'lobbyist' subsidiaries were roughly as likely to display negative sentiment over the UK market (55%) as the general sample.

Figure 7 Sentiment on the UK market, by ownership type and firm size (% of respondents)

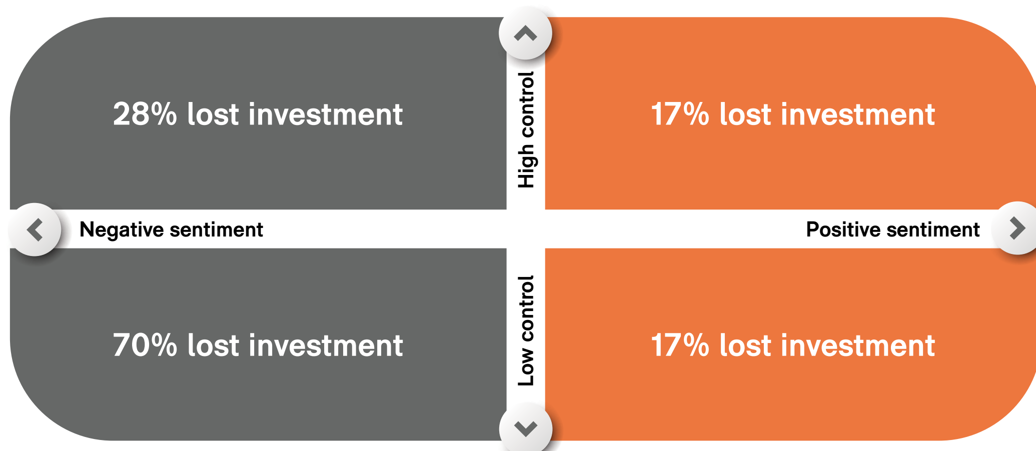


UK-specific conditions are leading to lost investment

A third (33%) of firms pointed to a specific example where an investment was lost or a divestment was made in recent years due to UK market-specific factors. As **Figure 8** shows below, this was more likely when an interviewee displayed negative sentiment on UK market conditions, and/or the UK subsidiary had a low degree of control over the investment decision.

For some of these firms, there was a mixture of UK-specific factors which led to this lost investment. However, a majority of those with lost investments pointed to policy-related factors, with four of these primarily blaming Brexit. Around half blamed high or rising costs as the reason behind lost investment.

Figure 8 Percentage of firms with recent example of lost UK investment, by level of control and sentiment[6]



Unsurprisingly, firms that displayed negative sentiment were more likely to have pointed to an example of lost investment over the past seven years (44%) than those that displayed overall positive sentiment (17%). For the latter group, it did not matter if the subsidiary had a higher or lower level of control over the final decision to invest in the UK or not.

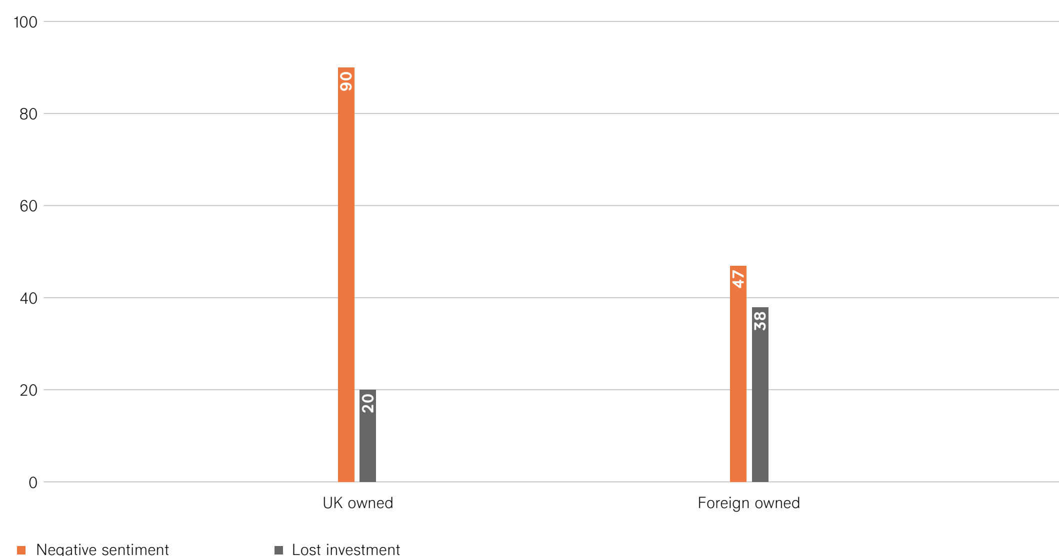
For those firms with negative sentiment about the UK market, the level of control the subsidiary has over investment decisions made a big impact on if there was lost investment in the past seven years. Around a quarter (27%) of those with a high level of control point to investment being lost, this compares to 70% of those with low control.

This is partly driven by the fact that UK-owned firms mostly held a negative view of the UK economy (and were all deemed to have a high level of control over the decision to invest in the UK or not), but only 20% of UK HQs gave an example of lost investment in the UK. However, when removing HQs, a similar figure of a third of subsidiaries in the 'high control, negative sentiment' quadrant also pointed to lost investment.

For firms that are headquartered in the UK, while the majority say that the UK competes with other markets for funding, there seems to be a desire for many of them to focus on the UK. For instance, one components firm sees technology development often localised in a parent company's country and expressed a desire to build a UK footprint for their industry. A very large manufacturer was 'encouraged' by their UK supply chain. One firm said they see a choice between investing in the UK or overseas, and felt they had to become less UK-centric to broaden their horizons. Another firm, which is generally UK-centric, had to move some production to the far east due to labour shortages in the UK.

> *"Our heart is here in the UK, it's where we were born and we're very much British by brand as well as a company. So developing and innovating here, the UK is actually a very important part of who we are."*

Figure 9 Sentiment and lost investment examples by country of ownership (% of respondents)



The firms who provided an example of lost investment were more likely than the general population to be asset seekers (64%) than market seekers (29%), and one (7%) was a mixture of the two). This may simply reflect the fact that asset seekers were more likely than market seekers to say that the UK market competes with other markets for funding (84% vs 63% respectively).

There are a couple of potential reasons why asset seekers might have been more likely to lose investment in recent years compared to market seekers. It may be that recent developments such as Brexit or political instability have had a greater impact on the perceived value or availability of the assets in question, more so than they affected the outlook for the UK as a market. It could also be that asset seekers are more sensitive to changes in the macroeconomic and/or political environment.

When looking at UK subsidiaries, North American-owned firms (50%) were more likely than European-owned firms (27%) to provide an example of lost investment, which may stem from the previous finding that they were more likely to display negative sentiment about the UK economy, while being equally likely to give a low level of control over investment decisions to their UK subsidiaries (75% vs 77% respectively).

Those firms who undertook R&D in the UK were less likely (30%) than firms who did not (50%) to provide an example of lost investment. This builds on the result that UK R&D firms were much less likely to display negative sentiment than non-R&D firms.

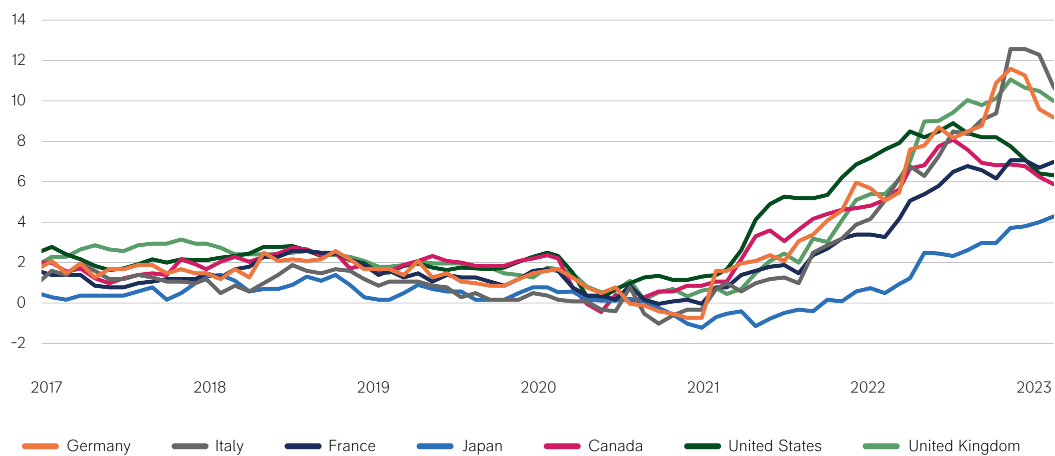
Operating in the UK is an increasingly costly business

The main reason given for lost investment into the UK was high costs. The UK has long been recognized as a country where the cost of doing business is relatively high. According to ILOSTAT data, labour costs in the UK are high, but lower than in Scandinavian countries and many mainland European countries, such as Germany, France and Italy.[7]

Some of our panel, however, suggested that the UK is not cost-competitive even compared to the aforementioned mainland countries. One firm said that investing in a new site in the UK is overall around 25-30% more expensive than in Germany. A couple of interviewees mentioned Poland as being a more cost-competitive country to undertake production.

So the UK is structurally high cost but is also dealing with particularly strong growth in cost pressures. **Figure 10** shows that inflation in the UK was one of the highest across the G7 as of February 2023. This was also picked up as an issue for some of our panel, although opinions were mixed on if the situation was worse for the UK compared to other markets (one firm mentioned Poland in particular as one market they operate in which is experiencing higher price growth).

Figure 10 CPI inflation across the G7 (y/y%)



Source: National Sources

A large driver of the particularly high inflation rate in the UK is down to higher-than-average energy costs, a consequence of an over-reliance on the spot price market for gas linked to a lack of storage capacity[8] as Russia's invasion of Ukraine saw global gas prices balloon. For many manufacturers, energy is a key component of their cost base, so this recent development has had a significant impact on cost competitiveness. One firm said that energy costs have made the UK very uncompetitive in costs against their French sister company. One UK-owned business said energy costs was at the top of their list of investment drivers.

The other primary UK-specific reason for lost investment in the past seven years was government policy. Overall, 10% of firms primarily blamed Brexit for investment being lost, with 31% mentioning that Brexit has led to lost competitiveness.

The dreaded 'B' word continues to bite business

There are three main avenues in which Brexit has impacted UK investment/competitiveness. Firstly, the UK leaving the single market means that some firms no longer see an investment in the UK as an investment in the European market. This, therefore, puts the UK in competition with the EU for investment when for some, the UK was once a 'gateway' into the EU. A chemicals firm said that losing access to the single market was damaging and they have lost three investment decisions since.

Secondly, Brexit has led to a divergence in policy and regulation in several areas. One firm specified that divergence in regulations is a key risk for the medical industry and may mean they have to diversify where they invest more, a car manufacturer said divergence is leading to duplication of costs,

Thirdly, Brexit has hurt the reputation of the UK on a global scale, many subsidiaries point to their HQ continuing to bring up Brexit in discussions. This impact on sentiment is important when considering most UK subsidiaries had little control over investment decisions and a large percentage of firms at least partially used some qualitative assessment of investment opportunities, allowing for sentiment to influence decisions. A few firms believe it is harder to explain to colleagues in HQs why they should invest in the UK due to Brexit, while another said that the UK will not win a mandate to export to another country due to Brexit and the perception that it is harder to move goods around. A pharmaceuticals firm said that their head of global function is still openly critical of Brexit and the UK.

This is not to say that Brexit was a primary influencing factor for all firms. Several interviewees said that it has caused some pain but it is a relatively minor issue, one Northern Ireland-based firm feels they are benefiting from the NI protocol and one firm said that they invest for the long-term rather than make knee-jerk reactions to issues like Brexit.

> *"Brexit has been a disaster. I think for the country, but it's really created issues for us. We're bringing in chemicals from Germany from Poland and trying to get them into the country that documentation requirements have gone through the roof trying to export our chemicals that we manufacture in Warminster and back over to Europe again is a nightmare."*

Policy uncertainty undermines investment plans

Brexit was not the only policy issue that was seen to damage the UK's standing as a place to invest. As mentioned above, policy clarity is one of the most commonly cited external factors that are crucial in investment decisions. However, many firms feel they are not getting that policy certainty. A couple of interviewees cited large-scale publicly funded infrastructure projects such as rail or hospitals as an example of this, where there is not much certainty on the procurement for these projects despite being previously announced as going ahead. A similar issue is mentioned for various aspects of the Net Zero strategy, where there are headline ambitions but not yet the clear details that firms need to invest confidently.

Many of these examples tended to be specific to a firm's industry or operations. Examples include gigafactory strategy, life sciences and aviation.

This issue is exacerbated by policy developments in 2022, where the UK had three Prime Ministers in the space of two months. While some firms dismissed this as mostly "noise," others did point to this having an impact on sentiment. One interviewee called the situation 'pantomime' and said the 'shenanigans' of the past twelve months did put the perceived safety of UK investments in question. Another said that the UK was the 'laughing stock' in global meetings.

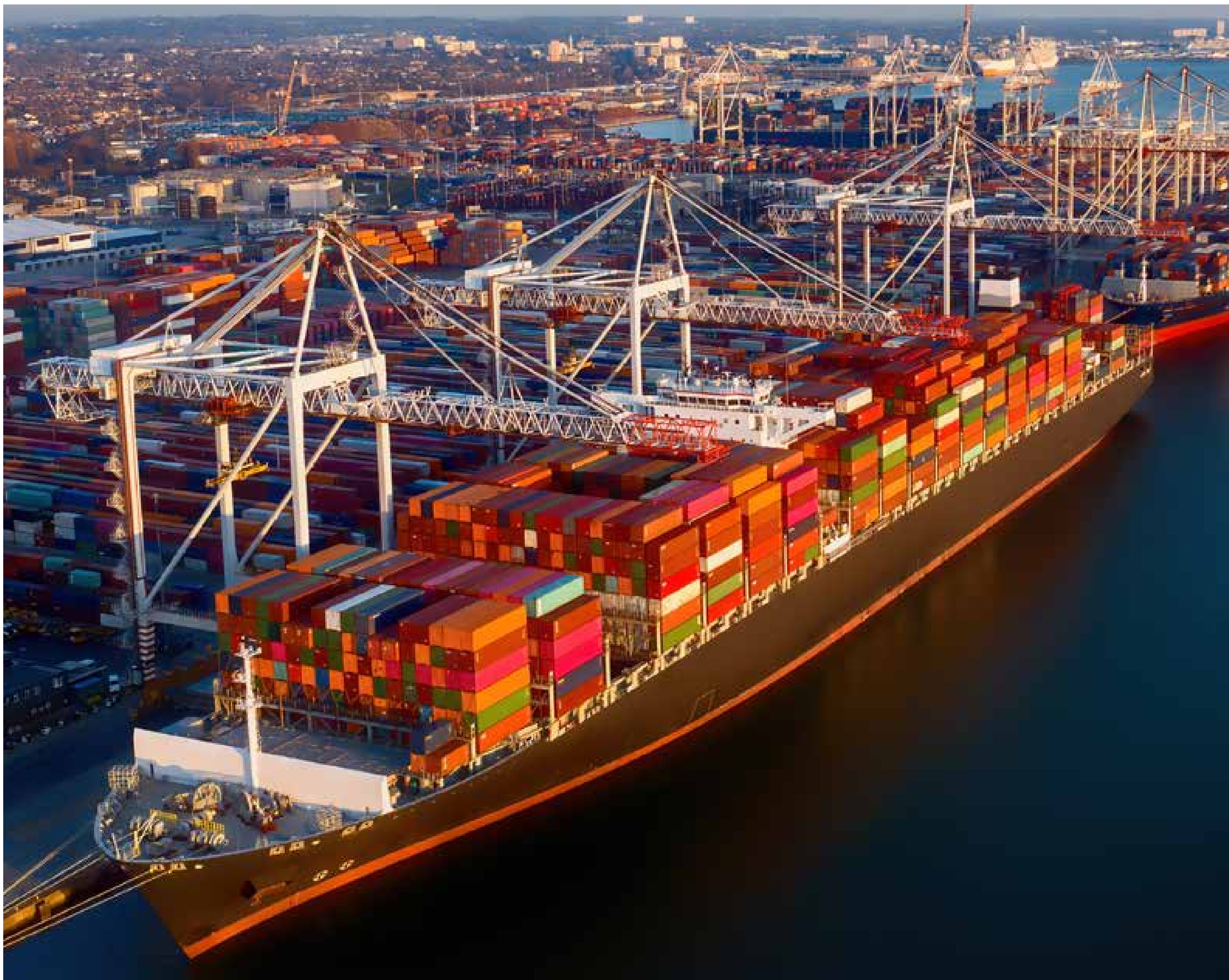
> *"I think very few ministers are drawn from the technology industry really. Detail in parts of policy needs to be made. Clarity there would be hugely helpful to us and hugely helpful and beneficial to the UK if we had clarity of vision, and understood where opportunity was because we would be able to invest."*

UK at risk of losing investment further without intervention

It is clear through the 43 interviews undertaken (and well established elsewhere) that conditions for doing business have worsened notably in the past seven years. The combination of Brexit, rising cost pressures, labour shortages and policy instability have cumulatively led to a loss of competitiveness compared to the markets the UK competes with. This general perception of the UK's competitiveness drifting away was mentioned in several interviews.

The impacts of dwindling competitiveness on investment will only be felt gradually, over a very long period. Therefore, even without further deterioration in conditions, we could expect many more examples of lost investment over the next 20-30 years.

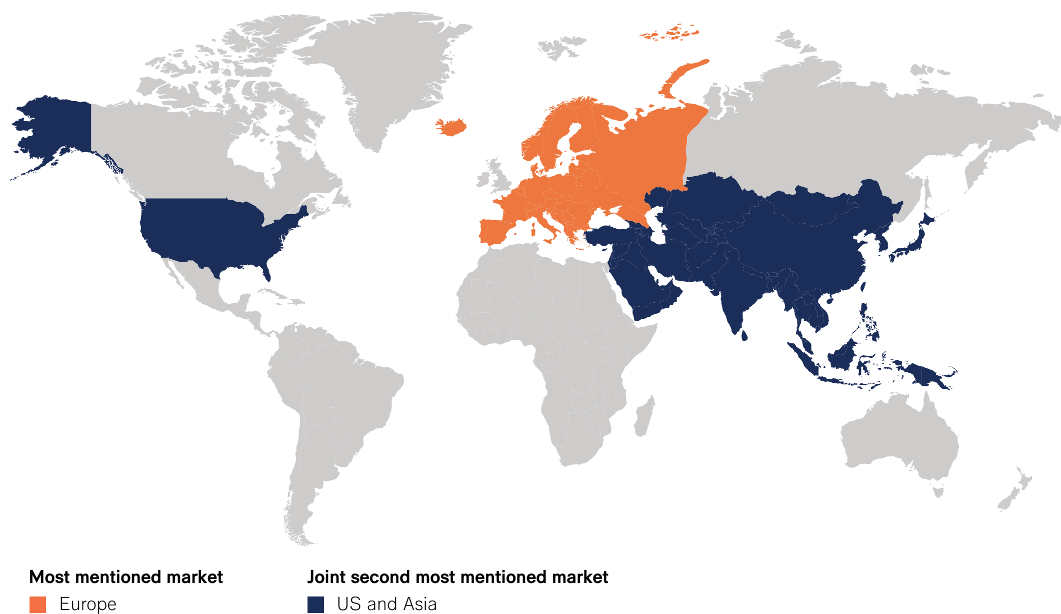
So it is clear that the government is not doing a good enough job to provide firms with the general macroeconomic or political environment they need to feel comfortable investing here. Additionally, the government are also doing a poor job of engaging businesses individually to win investment for the UK.



Several interviewees gave examples of other countries 'rolling out the red carpet' for potential investors. A chemicals firm mentioned when they went to Germany to look at investing in a new building, they saw the Chancellor within two weeks, while you always get great access to government in Belgium. A packaging firm said that the ease of accessing support in Poland and Denmark is much better.

Some firms mentioned that while the government may lobby businesses to invest here, there was no flexibility to offer support to go alongside that. It is an approach that one firm called 'disrespectful.' A health-related firm says if the government are serious about protecting manufacturing capabilities, they should do things to look like they 'give a hoot' and have found it impossible to find people in get anyone to listen. An automotive manufacturer noted that having three prime ministers in such a short time undermined the certainty of regulation.

Figure 11 The markets that the UK competes with most for funding



Most mentioned market
Europe

Joint second most mentioned market
US and Asia

UK continues to compete globally on high-end skills and technology

So the UK is an increasingly uncompetitive place to do business from a cost point of view, struggling with labour shortages and painfully decoupling from the EU. On top of this, it is failing to provide the policy clarity or support that competing markets do.

It is not all doom and gloom, however. The UK continues to display areas of real strength which continue to attract investment. As mentioned in previous chapters, manufacturers who undertake R&D are more likely to display positive sentiment on the UK market and are also less likely to provide an example of lost investment into the UK over the past few years. This indicates where the UK's strengths lie.

"In terms of skills, at the high end the UK compares very well relative to other countries."

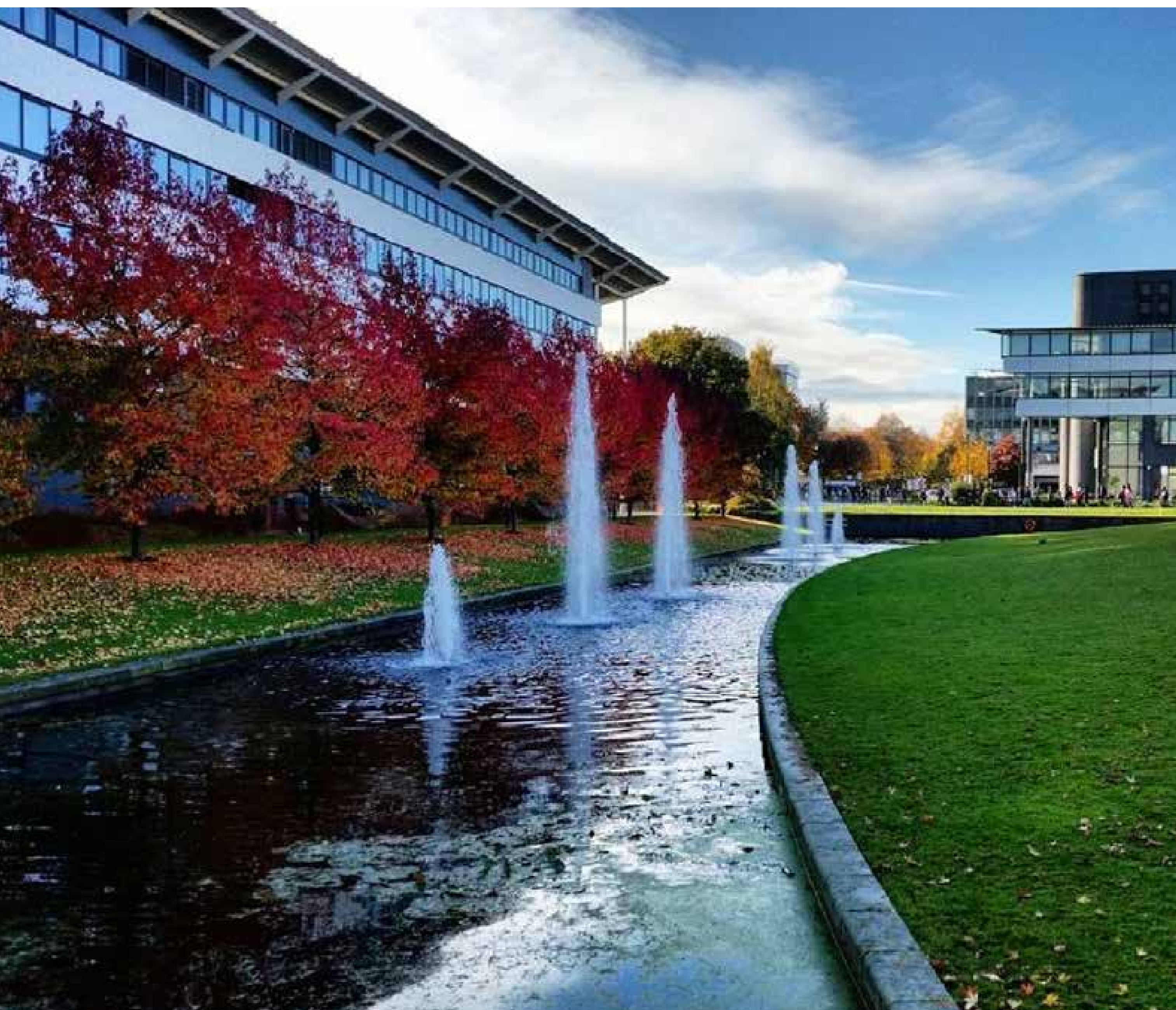
It is well established that the UK punches well above its weight in higher education; four of the top ten global universities are here (according to QS world rankings).[9] This creates world-class talent, which some firms (particularly those in scientific industries) noted. For example, a pharmaceuticals company emphasised that the UK remains the best country to attract and retain high-quality staff, because of the strength of UK academia and attractiveness to global citizens.

Quality of high-end skills is not synonymous with sufficient quantity of labour, however, with the UK (like many other advanced countries) suffering from ongoing labour shortages. A food and beverage manufacturing firm highlighted people as the single biggest issue they face, needing an extra 150 people on top of current staff levels. A packaging firm noted that it has been difficult to get technical skills in the UK for as long as they can remember.

The strength of UK universities also contributes to a globally competitive culture of innovation and consequently, world-class technology. A construction materials manufacturer said that the UK has always been one of the leaders of the pack in innovation. A chemicals firm said the UK has a good track record and reputation in innovation and science, and their only two principal R&D centres are in the UK and the US.

There are also more basic structural factors that work in the UK's favour. An automotive manufacturer noted that the UK is seen as a nice place to live and benefits from having English as a national language. A different automotive company expressed optimism that the UK will rebound from the current slowdown as they view it as a long-term stable option given that it has historically been stable.

Some firms mentioned that they continue to invest because of market-specific opportunities. A packaging company notes that they think the UK can continue to grow above trend due to population growth increasing demand. A machinery and equipment firm notes that, despite recession, they are still investing in the UK as they continue to identify good opportunities, highlighting that poor macroeconomics does not necessarily translate to a poor business case. A motor vehicle parts manufacturing firm highlighted that they think the UK is leading the way in electrification, throwing up several investment opportunities.



Top policy recommendations for government

The interviews highlighted several issues that have either led to lost investment for UK manufacturing subsidiaries or are expected to lead to lost investments. Fortunately, in most cases, there are policy levers available to the government to alleviate these issues. This chapter outlines CBI policy recommendations to the issues outlined throughout this report.

Policy action is particularly urgent given the increasing competitiveness of other countries that may not have previously been considered to be competitors to the UK. Increasingly, our interviews found that countries such as Slovakia, Poland and Germany are attracting investment away from the UK, partly due to having lower costs, while economies such as China have an increasingly attractive domestic market. It is clear that policy action is required to help retain existing investment mandates in the UK, as well as attract further investment.

Businesses generally emphasised the importance of the UK being seen as a viable long-term investment option, as opposed to the primacy of shorter-term economic fluctuations and uncertainty. They highlighted the importance of macroeconomic fundamentals such as the availability of labour and skills, as well as healthy market demand. In light of this, a clear priority of the government should be to boost confidence in the UK and **incentivise investment for long-term economic growth.**

With this in mind, the following policy solutions should be considered to attract and retain investment in the UK:

- **Take a bigger, bolder approach to tackle acute labour and skills shortages:** Since the interviews took place, the government have taken action to mitigate labour shortages through improved support for childcare, but more action is needed. This could include improving health support provisions to reduce economic inactivity and allowing firms to spend apprenticeship levy funds on a wider variety of accredited training and skills. Such measures can act to increase labour participation amidst a labour market that is expected to remain tight over the coming years.[10] Additionally, supporting businesses to invest in automation and technology will also help to alleviate labour shortages and increase productivity, freeing them up so they can upskill current workers into higher-skilled and paid jobs. Given the emphasis businesses placed on access to labour and skills in the interviews, this should be a clear focus area.

- **Unlock business investment through competitive taxation:** The interviews highlighted that the UK loses investment to other countries on account of greater costs. Since the interviews took place, the government announced full capital expensing which should help, but with investment life cycles often spanning decades and in light of Corporation Tax increasing to 25%, firms will want to know as soon as possible what comes next after this policy ends in 2026. The government should also continue to look at the competitiveness of the UK's R&D Tax Credits scheme, to maintain the UK's strength in innovation. The proposal to merge the large and small companies schemes into one is a real opportunity to simplify and ensure the scheme is world-class by setting the rate/s at least as high as the announced higher Research & Development Expenditure Credit (RDEC) rate, ensuring it is particularly generous for projects that support net zero and decarbonisation.
- **Support firms to enhance their energy efficiency, and reduce bills and emissions:** While the government has taken welcome steps to reduce energy cost pressures for firms through the Energy Bill Discount Scheme, energy costs remain a significant component of business costs, with the need to reduce reliance on imported fuel necessary to reduce bills and improve long-term energy security. This can be done by incentivising home-growth renewable energy solutions and providing frameworks in areas such as hydrogen to attract private investment.
- **Make the UK's funding landscape for manufacturers more streamlined to unlock trapped investment:** The Government should launch a landscape review of funding available for the manufacturing sector following the Manufacturing Prospectus. The review should consider the full and varied policy and funding context within which manufacturing organisations operate, which is complex and challenging for many in the sector to utilise. Streamlining and simplifying the current mechanisms available will help create a more visible and accessible manufacturing landscape, helping to stimulate greater investment in the sector and attract FDI.

All of these focus areas will drive growth, confidence, and ultimately increased demand in the economy, which will in turn attract investment to tap into this demand.

The interviews also highlighted the importance of **industry-specific policy and regulatory certainty.** Highly-regulated industries are not confident in investing in a country where there is a lack of clarity on future policy direction. With this in mind, the government should look to, first and foremost, **remove the 'sunset' associated with the Retained EU Law Bill,** whereby all retained EU law expires end of 2023. Regulatory divergence should only be done where there is genuine opportunity and consensus among policymakers and firms, an approach The Vallance Review exemplifies. A strategic approach such as this will remove policy uncertainty for businesses, and increase confidence in the UK as a place to invest in.

More generally, the UK government should take a **longer-term view of policy,** making sure each industry has a clear perspective on planned policy developments over not just the short-term, but over the medium and long-term where possible. This will require consistent communication and engagement between policymakers and businesses, with a focus on the long-term vision and trajectory of policymaking in specific industries. The government can and should use trade associations as effective vehicles to communicate this vision.

The government should also look to **'roll out the red carpet' more for businesses.** The UK should look to emulate countries like Germany where political leaders are more visible to businesses and more active in engaging with businesses when a large investment is on the cards. This engagement role could be taken on by metro mayors who understand their local area and so can act as a champion in attracting FDI. Some degree of prioritisation will be warranted so that the government can engage as effectively as possible. For example, engagement with businesses with higher control over investment decisions is likely to be warranted, as well as engagement with businesses that have moderate-positive sentiment towards the UK (see figure 8).

Another key finding in this report is that UK-owned firms are much less likely to point to an example of lost investment due to UK-specific factors, while many firms implied that manufacturing in the UK was important to them. Therefore, while the UK is right to position itself as a top destination for foreign direct investment, this must go hand in hand with a **strategy to support UK firms to grow and succeed while remaining domiciled here.**

Britain remains one of the top-performing economies in the world in start-ups,[11] supported by our world-leading innovation ecosystem. However, the UK performs less well in providing the finance they need to grow into global heavyweights, meaning many do not reach their potential.[12] The UK also performs relatively poorly at adapting legal frameworks to new business models.[13]

Government must **support UK scale-ups by improving finance flows across the economy.** Government must also **deliver smarter, more agile regulation** to unlock more innovation by providing clear policy frameworks to attract investment into new technologies more quickly. This will be important to ensure the UK can succeed in capturing opportunities that exist in advanced manufacturing.

Overall, by investing for long-term growth, providing more industry-specific policy and regulatory certainty, and rolling out the red carpet for businesses, the UK government can help retain existing investment in the UK, as well as attract further investment.

Conclusion

This report looked to understand how investment decisions are made in the UK, specifically:

- **How investment decisions are made within multinationals,** including how subsidiaries and headquarters (HQ) communicate, how investment decisions are signed-off, the most important factors that are considered when deciding where to invest, and if these factors have changed over time.
- **The current state of investment into the UK within multinationals,** including recent investment trends, perceptions of the UK as a country to invest in, how this perception has affected investment decisions and the UK's key competitors in attracting inward investment.
- **What government can do to help,** including how policy change can help retain existing investment in the UK as well as attract further investment.

Through 43 interviews with business leaders across the sector, it has been established that there is no one size fits all. Firms make investment decisions in different ways, they have a range of sign-off processes using a range of metrics (or no metrics), involving a range of people.

This reflects the fact that although they are all manufacturers, there are several key differences between them. Their specific industry requires a specific mix of inputs, is subject to specific regulations and interacts with different stakeholders. Therefore, the factors that are important for their investment decisions will change.

Added to that, businesses are made up of people who contain a unique mix of perceptions and sentiments on any given topic. Decision-making in any fora can be biased or influenced by perceptions in an unpredictable way.

Nonetheless, this report did find some key trends. Most UK subsidiaries had a hierarchical sign-off process with their HQ and had a relatively low level of control over investment decisions. Subsidiaries most commonly saw their role as lobbying the HQ for funding, with most manufacturers citing some competition for investment funding between the UK and other markets they operated in.

Long-term macroeconomic conditions were the most frequently mentioned external factor towards making investment decisions, followed by policy certainty and influence. While the UK has historically been seen as strong in both of these metrics, there is a communal sense that competitiveness is falling away over time, exacerbated by recent UK-specific economic and political volatility.

A clear picture emerges of the UK's strengths and weaknesses. While poor in cost competitiveness and labour availability, it continues to excel in technology and high-end skills, making the UK a global leader in R&D and advanced manufacturing.

The easiest, quickest and cheapest thing the government could do to support investment would be to provide policy certainty. Frameworks that clearly define the direction of travel, alongside suitable regulation, can stimulate private investment even before the government spend a single pound. In the current fiscal environment, it would be remiss of the government to not make better efforts to provide this certainty.

However, to compete on a global stage, we must look to compete better on investment incentives. Headline policies such as the super-deduction not only provide financial support but also indicate to business leaders that you are serious about supporting them, often the latter of these can be more important. With the US Inflation Reduction Act and European Green Deal, it is clear that other territories are upping their game to capitalize on global opportunities, and the UK risks getting left behind.

Possible research extensions

This project consisted of 43 interviews with multinational manufacturing firms, ten of which were UK owned. The sample allowed for a binary codification of sentiments and subsidiary control over investment decisions and some analysis according to several other metrics.

One extension to this research could be to interview more manufacturers, to increase the sample and allow for more in-depth research and generalized findings with an even greater degree of confidence underlying them. This could allow for codifications to become more nuanced, or for greater analysis to be done by size, sub-sector, geography of parent etc.

This research could also be extended within interviewed firms, for instance by interviewing both the parent and the subsidiary to understand how perceptions are different between them, or by interviewing different subsidiaries to understand if experiences change between them.

While this report focused on manufacturing, it is possible to extend the research to other sectors. Further research could compare findings for the UK to other countries, or look at different nations within the UK. The research could also be repeated in the future to understand changes in investment drivers or sentiment towards the UK changes over time, or if internal factors change over time.

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