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Factors Influencing the Relative Performance of the West Midlands: *Summary Report*

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Foreword

The West Midlands Regional Observatory (WMRO) was appointed by Advantage West Midlands to carry out three pieces of research (termed themes) which form a significant part of the evidence base for the review of the West Midlands Economic Strategy (WMES). The work uses existing data sources to analyse three aspects of the regional economy. The three themes and the aspects they seek to analyse are: Theme 1: Regional Economic Context which looks at projections of the future for the region as a whole. Theme 2: Drivers of Productivity, and Theme 3: Functioning Economic Geography which considers the spatial patterns within the regional economy.

WMRO has chosen to work with academics from the region's universities on each theme in this project. We have done this in part because of their expertise in the fields under investigation and the credibility that they will add, but also because they can take the analysis further than WMRO alone could do under its remit to remain independent and focused solely on data and intelligence.

Theme 2 has the following objectives:

- Examine and summarise regional patterns and variations of the drivers of productivity;
- Examine how and why regional productivity (and value added) is influenced by each driver;
- Identify current and potential resource constraints influencing the potential productivity effect of each driver;
- Summarise the key priorities which policy at a regional level needs to address to maximise the impact of each productivity driver and hence overall regional productivity (and value added).

We have worked with Aston University Business School on this theme with WMRO's primary role being to source and supply raw data as well as help with its presentation and Aston's role being to analyse and comment upon the data as well as review other relevant sources of information.

In addition to commissioning the three themes, WMRO have developed a summary of the outcomes, creating an integrated overview of the important issues raised in the evidence base. We have also reflected comments from regional stakeholder gathered during our consultations on this work. Collectively the output from this work forms the evidence base for the next stage of the WMES review, that of formulating and analysing policy options. It is expected that this next stage will involve the commissioning of additional research possibly to further investigate issues raised during our work

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1 Introduction

1.1 Aims of the research

The fundamental aim of this research is to analyse the available evidence on productivity in the region in order to identify the key issues which regional policy needs to address.

The policy context derives from the Government's Regional Economic Performance PSA (REPPSA) targets, designed to measure the delivery of sustained improvement in economic performance across the English regions. A key element of meeting these targets will be a need for a detailed understanding of the drivers of productivity at the regional level.

The aim of this research is to provide Advantage West Midlands with evidence and a structured examination of the strengths and weaknesses, within the region and in comparison to other regions, associated with each of the drivers of productivity (skills, enterprise, investment, innovation and competition) as well as employment and other potential drivers. The objectives of the research are to:

1. Examine and clearly summarise the regional patterns and variations of the drivers of productivity and employment (with sectoral and sub-regional breakdowns where possible) incorporating past, current and short-term future trends;
2. Examine how and why regional productivity (and value added) is influenced by each driver, by identifying strengths and weaknesses with national and international comparisons (where available);
3. Identify current and potential resource constraints influencing the potential productivity effect of each driver (including sectoral and sub-regional breakdowns wherever possible);
4. Clearly summarise the key priorities which policy at a regional level needs to address to maximise the impact of each productivity driver and hence overall regional productivity (and value added).

1.2 Approach

Our approach to this study draws on the extensive knowledge and experience of the WMRO in combination with the experience of analysing productivity and regional economic trends present within the Aston Business School. We have not undertaken any new primary research. The project has involved desk research using mainly publicly available information, although some new analysis of existing datasets has

been undertaken (notably using the recently completed Community Innovation Survey).

The study comprises three elements:

Phase 1 – Productivity Trends Analysis and Indicator Scoping - involving the analysis of trends in overall levels of productivity and the identification of potential data sources relevant to employment and each of the drivers of productivity, and their limitations.

Phase 2 – Trends and Productivity Analysis – involving the analysis of trends in employment and of each of the individual drivers of productivity, identifying their relationship to productivity and any constraints. This includes:

- Regional trends in the relevant driver since the mid-1990s (or as available), including sectoral analysis where this is feasible;
- Comparisons with relevant comparator regions (bearing in mind the variance in availability, quality and timeliness of data) in order to identify strengths and weaknesses within the West Midlands;
- Sub-regional analysis within West Midlands where feasible.

Phase 3 – Synthesis – involving the synthesis of material from the analysis of each of the individual productivity drivers stressing the strengths and weaknesses of each, and examining any potential synergies or complementary effects.

This final report comprises the output from each Phase of the project, with the exception of the indicator scoping element of Phase 1.

2 Executive Summary

2.1 Scope of the Research

The fundamental aim of this research is to analyse the available evidence on productivity in the region in order to identify the key issues which regional policy needs to address.

The aim of this research is to provide Advantage West Midlands with evidence and a structured examination of the strengths and weaknesses, within the region and in comparison to other regions, associated with each of the drivers of productivity (skills, enterprise, investment, innovation and competition) as well as employment and other potential drivers. The research also aims to summarise the key priorities which policy at a regional level needs to address to maximise the impact of each productivity driver and hence overall regional productivity (and value added).

2.2 Key findings

The key findings arising from the analysis of productivity and its main drivers are as follows:

Productivity

- The West Midlands lags behind the UK average in terms of productivity (i.e. output per head), and there has been some widening of this gap since 1989. However, in terms of output per *hour*, productivity in the region has improved slightly relative to the UK since 1997, but is still below the UK average.
- There are large productivity differences within the region, and the gap between high and low productivity areas is growing. Since 1995, only three parts of the region (Birmingham, Solihull and Warwickshire) have seen productivity increases relative to the UK average.
- Productivity in services lags further behind the UK average than productivity in manufacturing: approximately one-quarter of the ‘productivity gap’ in manufacturing (but very little of that in services) arises from the West Midlands having a distribution of activities skewed towards low productivity sectors. Issues of data aggregation and sectoral classification make a definitive statement on the importance of sectoral composition to productivity difficult.

Investment

- Business investment in the West Midlands is neither particularly strong nor particularly weak.
- There are specific areas of weakness however, including a very sharp fall in manufacturing investment from 1998 to 2003.
- The evidence appears to suggest that recent moderate levels of physical investment derives mainly from relatively low investment by UK rather than foreign-owned businesses.

Innovation

- The West Midlands suffers from low investment in R&D by business, higher education and central government. This has two effects: it lowers knowledge generation within the region, and also lowers the capacity of businesses within the region to absorb knowledge generated with the West Midlands and elsewhere.
- The region also has a relatively low incidence of innovative firms, but this is less marked in manufacturing than in services.
- In terms of innovation outputs (i.e. new products), large firms in the region do well, especially relative to their low R&D base, while small firms in the region perform poorly relative to other UK regions.

Skills and Employment

- Skills levels in the West Midlands are very poor both in terms of formal qualifications and in terms of training.
- There is a direct link between low skills and low productivity: sectors with a relatively large proportion of unskilled workers have low productivity relative to the UK.
- The region has a relatively poor record of graduate retention and demand for graduates, even in manufacturing.
- As the need for unskilled jobs declines, the West Midlands is likely to be in a poor position to deal with this change, both in terms of demand for and supply of skilled jobs/employment.
- Skills gaps are pronounced among West Midlands' employers relative to those in other UK regions. Thus the regions is failing to produce employees with the correct skills *today*, as well as not producing a workforce with the correct skills for employment in the future.

Enterprise

- Overall levels of enterprise activity in the West Midlands closely track those in the UK: the region appears in the middle of the UK regional distribution of enterprise.
- Female involvement with entrepreneurship in the West Midlands is lower than that of males, in common with other regions of the UK.
- Enterprise activity among ethnic minority communities in the region is strong but evidence from GEM does suggest that ethnic communities in the West Midlands are less likely to be involved in enterprise than those in other regions.

- Marked diversity exists within the region in terms of sub-regional patterns of enterprise activity.

Competition/Competitiveness

- Export performance in the West Midlands is slightly below the UK average, and has fallen slightly relative to the UK since 1997.
- However, it seems as likely that productivity growth causes exporting as the reverse, and so the implications of export performance are unclear.

2.3 Implications and challenges

The analysis suggests that the key drivers of productivity interact in a way that leads to productivity levels and ultimately levels of per capita GDP in the region being below the national average. The principal elements of this are the low skills base and low R&D investment in the region which hinder absorptive capacity, innovation and enterprise in the region, especially among SMEs.

Among the key challenges identified for policy by the research are the following:

- Recognising that patterns in issues such as entrepreneurial activity and skills differ markedly between parts of the region, which suggests the need for spatially differentiated support measures.

Skills

- Improving the educational attainment of school leavers entering the workforce.
- Encouraging increased investment in skills training among West Midlands businesses.
- Improving graduate retention in the region and demand for graduate skills in the region.

Innovation

- Improving the business and higher education R&D investment in the region.
- Encouraging product and process innovation, especially among the SME sector.
- Nurturing and improving the absorptive capacity of the region generally, and of SMEs in particular. This will not only ensure that the West Midlands captures much of the benefit of R&D conducted within the region, but can take advantage of ‘knowledge spillovers’ from adjacent regions and elsewhere.

Enterprise

- Encouraging female entrepreneurship in the region
- Nurturing and improving entrepreneurial activity among ethnic minority populations of the region.

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