The UK's Foreign Investment Position Post Brexit And COVID: Briefing 2

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Highlights

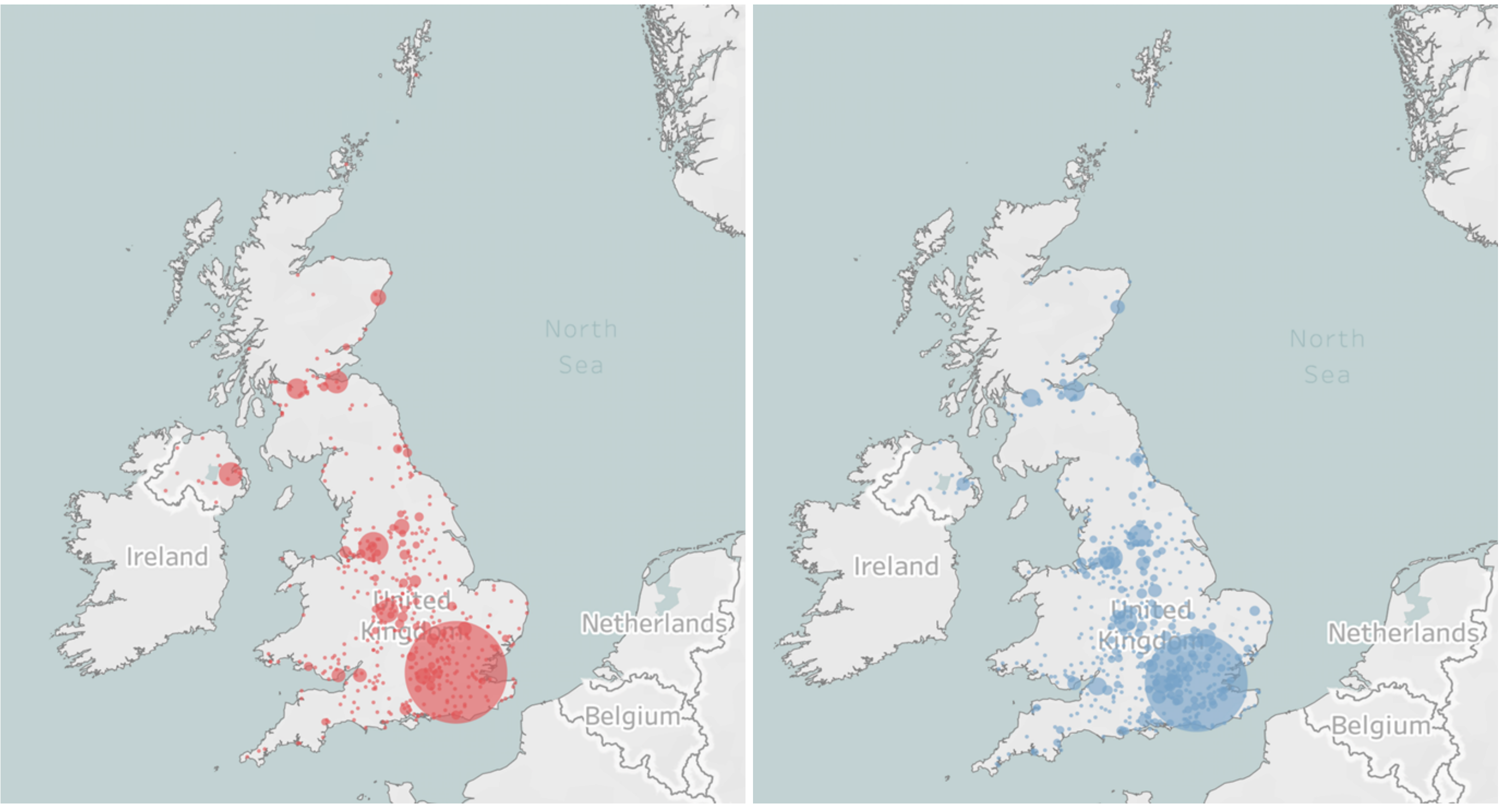
Foreign investment continues to play a substantial role in UK economic growth, productivity, and employment, but its effect varies across the regions. Studying the regional distribution of foreign direct investment (FDI) is crucial for understanding its impacts.

Our first briefing explored the aggregate changes in inward FDI in the UK, and the implications for productivity. In our second briefing we focus on the regional variations in these trends and illustrate the uneven spatial distributions of investments across the country. We then proceed to explore the patterns across industrial activities for the different regions, and in turn explore what this means for productivity.

Figure 1. Number of greenfield project investments and Mergers & Acquisition deals by UK destination city, 2014-2021

(A). Greenfield FDI

(B). M&A deals



Source: Orbis Crossborder Investment database and authors' own calculation

This briefing is from a regular series tracking the changing patterns of inward investment in the UK as we emerge from COVID-19. The Productivity Institute is a UK-wide research organisation exploring what productivity means for business, for workers and for communities, with funding from the Economic and Social Research Council.

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Greenfield FDI

Figure 1(A) presents a spatial distribution of greenfield investments across the UK. These investments are concentrated not merely in a few regions, but in a few large cities, with London leading the way. The top 11 destination cities[1] account for almost 62% of all the inward greenfield FDI, with London attracting nearly 72% of the total, followed by Manchester with 6.2%, Belfast with 3.9%, Edinburgh with 3.6%, Birmingham with 3.2%, and Glasgow with 2.9%. Greater London accounted for, on average, 46% of the project counts and 28% of the capital expenditure over the past 8 years.

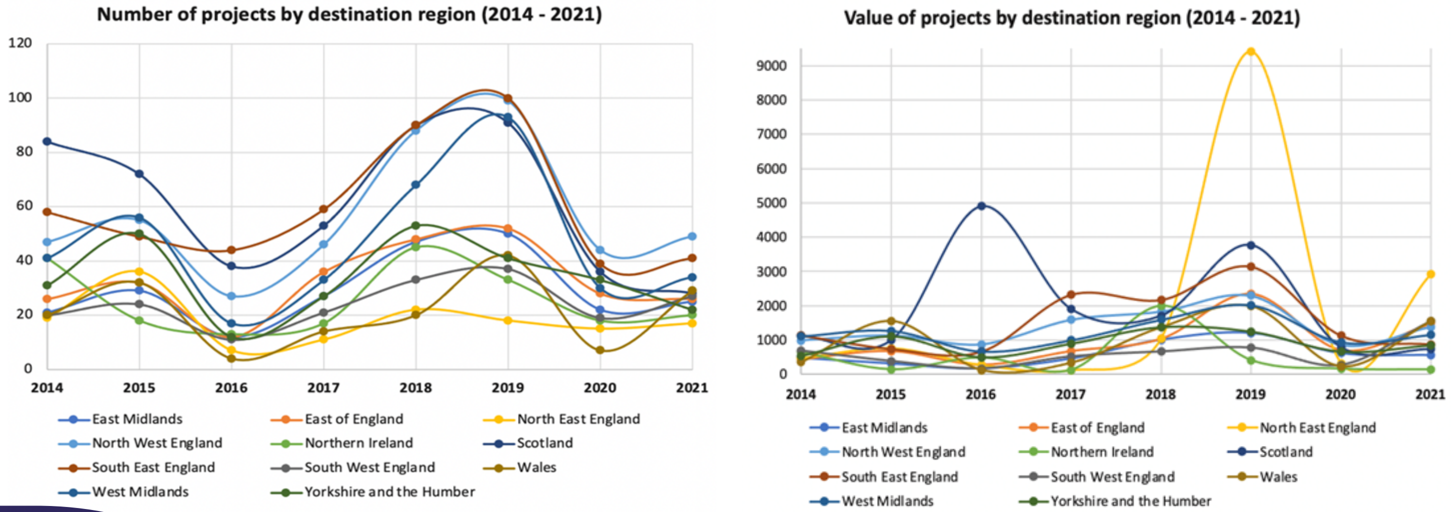
Figure 2 illustrates how UK regions were impacted by the Brexit referendum and COVID-19 crisis. In 2016, Wales and North East England witnessed more than 80% of decline in project number compared with the previous year, and Wales had the biggest value drop of 92%. However, Scotland, Northern Ireland and Greater London reversed this trend, with rising values of capital expenditure. In Scotland this is mainly due to two big investments worth more than 4.3 billion GBP in the mining business function, with Geodis opening an oil & gas warehouse in Aberdeen and Total setting up a gas plant in Shetland.

In 2020, Wales, West Midlands, South East England[2] and Scotland suffered the highest decline rates of project number compared with 2019, whereas North East England, Wales and Scotland experienced over 80% of the decreases in capital expenditure in the similar annual comparison. It should be noted that the outlier value of North East England in September 2019 was attributed to a mega project in which Dogger Bank announced the opening of a wind farm worth 9,000 million GBP in South Shields.

The good news is that both the project number and capital expenditure rebounded in 2021, with Wales and South West England leading the number recovery and North East England, Wales and South West England leading the value recovery. Part of the reason might be the fact that the Brexit deal had been completed by then.

1 These include London, Manchester, Belfast, Edinburgh, Birmingham, Glasgow, Aberdeen, Leeds, Reading, Bristol, and Cambridge.
2 South East England does not include Greater London, which is excluded for better focus on the rest of the regions.

Figure 2. Number and capital expenditure of projects by NUTS1 destination region, 2014-2021



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Mergers and Acquisitions

The spatial distribution of M&As presented in Figure 1(B) shows a similar pattern. M&A deals are distributed disproportionately across the target cities. Over 2014 - 2021, approximately 49% of the total M&A deals were captured by the top 10 target cities. Accounting for almost 75% of the total number of the above leading cities, London is substantially overrepresented on the map, far exceeding Manchester (4.0%), Leeds (3.5%), Birmingham (3.3%), and Edinburgh (3.0%).

At the more aggregated NUTS1 level, unsurprisingly, Greater London and South East England accounted for on average 41% and 15% of the total M&A deals, respectively. The value of M&As is even more concentrated in Greater London, with 62% of the total value for the period 2014 - 2021.

In the first briefing, we illustrated that the inflows of cross-border M&A deals remained relatively stable between 2014 and 2019, with a slight fall in late 2016. In 2020, almost all the UK regions experienced various degrees of decline in M&As, but an increase can be detected for both the number and value of deals starting in early 2021.

After disaggregating flows by NUTS1 region over the period, we note that in 2016, numbers of deals declined in seven out of the 12 regions, including Greater London with a 2% decrease. However, Scotland, West Midlands and North West England experienced an increase at the same time. This is not surprising, and illustrates, for example, the complexity in the relationship between inward investment and currency fluctuations. The post-Brexit devaluation of sterling made UK assets cheaper for inward investors, but at the same time devalued short-run returns. By 2020, North East England, West Midlands and South East England had recovered, and by 2021, almost all the other regions followed.

Figure 3 depicts some interesting trends. In contrast to the drop in deal numbers, deal value of East of England and South East England came up to a peak in 2016. The spike in East of England is attributed to two large deals, which are SoftBank acquiring ARM Holdings in Cambridge, worth over 24 billion GBP, and Jazz Pharmaceuticals completing the acquisition of GW Pharmaceuticals in Histon at the cost of nearly 5 billion GBP. At the time the value of sterling was commented on as a significant factor.

The peak of South East England is the result of a transaction in which UK Asset Resolution completed the sale of NRAM to Cerberus at the value of 13 billion GBP.

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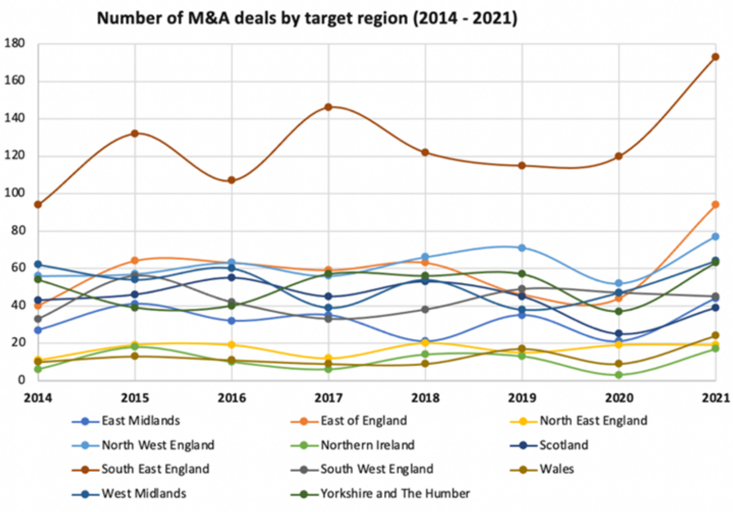
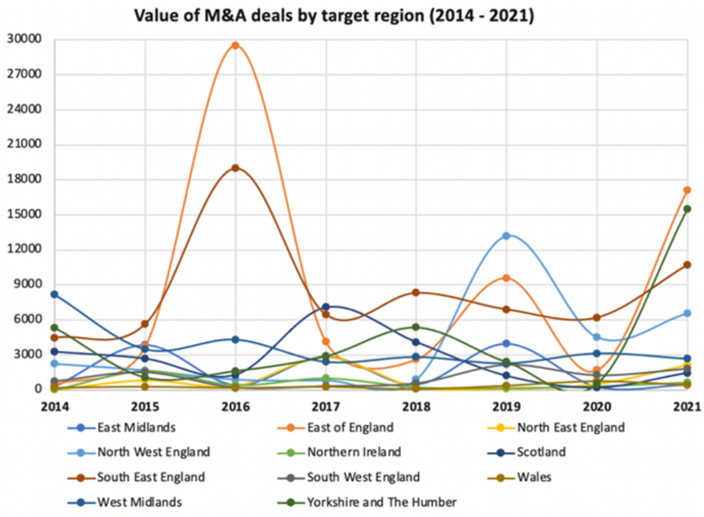
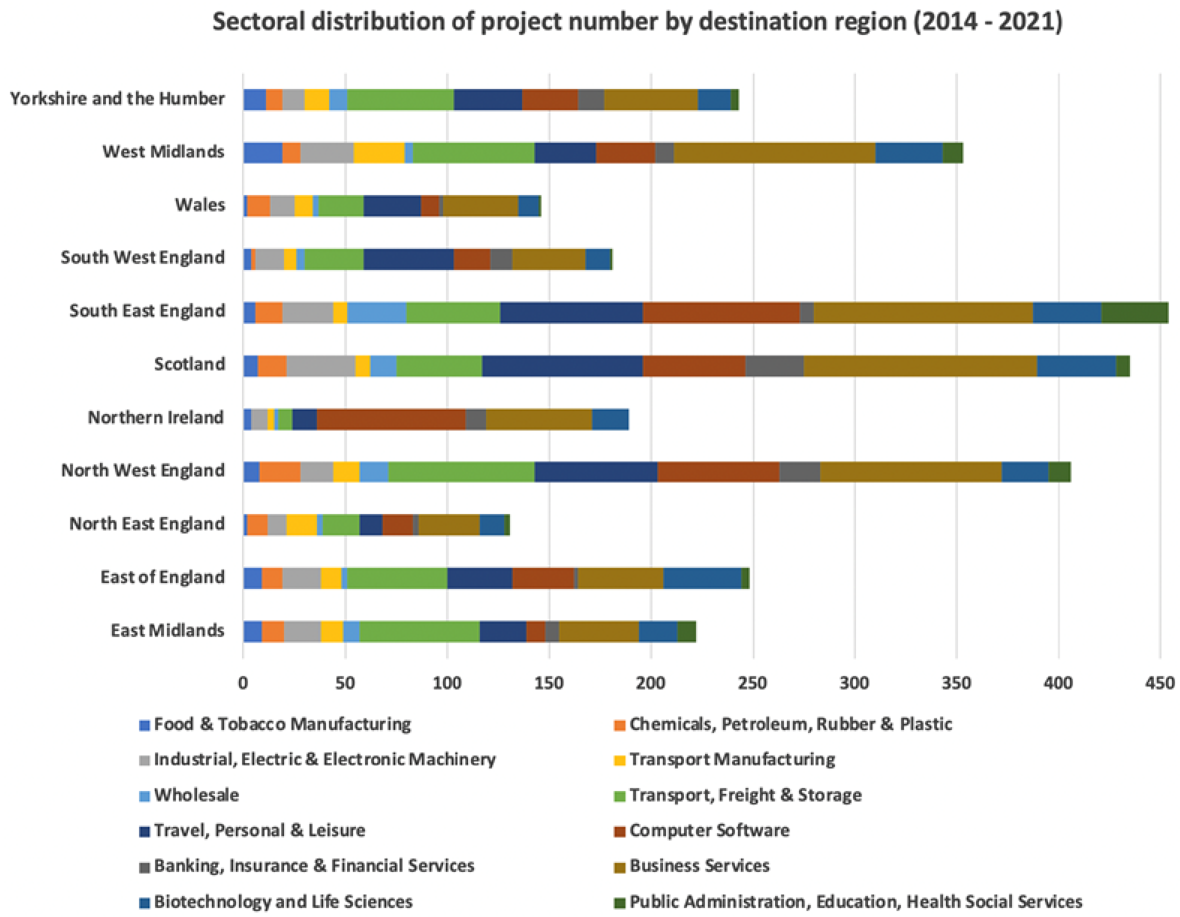
Figure 3. Number and value of M&A deals by NUTS1 target region, 2014-2021





Source: Orbis Crossborder Investment database and authors' own calculation

Figure 4. Number of projects of top 12 Bureau van Dijk (BvD) sectors by NUTS1 destination region, 2014-2021



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Variations by Sector

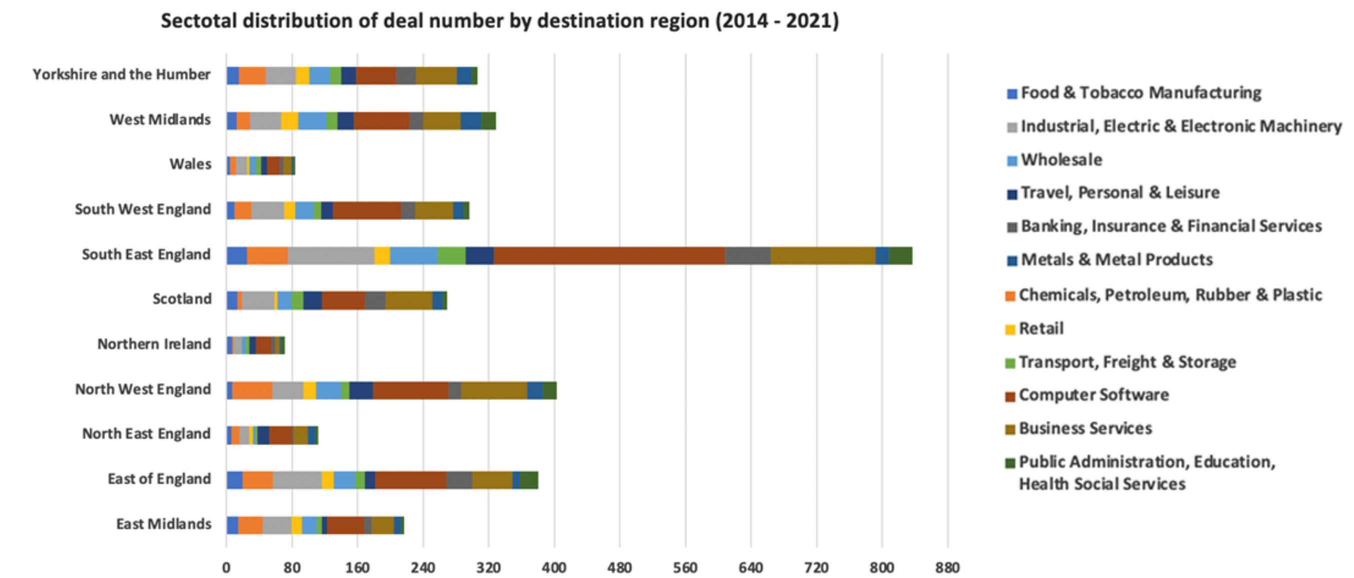
We further explore the patterns of FDI investments in terms of sectoral distribution across different regions. Figure 4 presents the distribution of project number of each NUTS1 region according to the primary code of BvD sector classification provided by the data source. 12 top project BvD sectors of inward greenfield investments are selected. Business Services still attracts most of the greenfield FDI, followed by Computer Software, Travel, Personal & Leisure, and Transport, Freight & Storage. This illustrates the bi-modal nature of the relationship between inward investment and productivity, with these sectors representing two of the highest and two of the lowest productivity sectors in the UK.

Fastest-growing industries with relatively high productivity, for example, Biotechnology & Life Sciences, Computer Software, and Business Services, are unequally spread at the subnational level. Undoubtedly, Greater London is the most attractive place for projects related to Business Services, achieving a much greater reach than Scotland, South East England, and West Midlands, whereas the Computer Software sector primarily contributes to the project investments in Greater London, South East England, and Northern Ireland.

Turning to M&A deals, in Figure 5 we again classify the deals in each NUTS1 region based on the primary code of BvD sector of the target firms. Among the top 12 target BvD sectors, Computer Software outstrips the rest, taking up over 22% of the total deals targeting the UK market. Business Services (14%) comes second, chased by Banking, Insurance & Financial Services (9%) and Industrial, Electric & Electronic Machinery (7%).

What is noteworthy in Figure 5 is that South East England greatly outnumbers any other regions in terms of M&A deals, while quite a few regions show the good momentum in attracting projects.

Figure 5. Number of deals of top 12 BvD sectors by NUTS1 destination region, 2014-2021



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What Does This Means For Productivity?

Firstly, the data shows a high degree of co-determinance of FDI and productivity. Those regions that have higher levels of productivity also attract higher levels of inward investment. One needs therefore to consider the mechanisms through which inward investment and productivity are linked. In an earlier paper for The Productivity Institute, we discuss in detail the mechanisms by which inward investment, both new investments and M&As, can improve productivity, covering both the so-called direct and indirect effects. This emphasises the importance of, among other things, the nature of intangible assets possessed by both the inward investors and the host sector, and in turn the ability of the host sector to assimilate and exploit knowledge that the inward investors may generate.

Equally, while there is some evidence that foreign acquisition, in certain settings, leads to the improvement of firm productivity, this is expected in the sectors where there is a marked foreign productivity advantage. This is not expected to be the case in sectors such as computer software or business services, though may be expected in industrial, electric & electronic machinery. However, in general, the motive of much of these acquisitions are what is typically referred to as "knowledge acquisition" and as such productivity gains will be limited to cases where the acquiring firm is able to resolve investment constraints.

Turning now to greenfield FDI, as we remarked in our earlier briefing, there is an increased tendency for the UK to attract FDI that is then focussed on UK markets rather than exports. The regional data also illustrate this, with several regions reporting high levels of investment in transport, freight & storage, in addition to business services. What is also noticeable, as with the M&As data, is that both the more prosperous regions of the UK, such as South East England and East of England, attract investments in similar sectors to Scotland, North West England and West Midlands. These are sectors that facilitate productivity growth in other sectors through the services that they provide, often in conjunction with state infrastructure, such as transport or digital connectivity. Thus, if FDI is to be part of the 'levelling up' agenda in the UK, this places the onus on government to put in place investments to maximise the benefits of this, both along supply chains and into customers of these services.

Upcoming Research

The structure and type of FDI investment offers another two important directions worth exploring. It is imperative to know how the structure of greenfield FDI, in terms of project types, motives, and types of market served, influences local sectors' possibility and ability of benefiting from those foreign investments. To address the above questions, the next note in the series will cover each aspect of the investment structure and further discuss what that means for productivity.

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