WHERE NEXT?
▶ A NEW ECONOMY

BDO

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A NEW ECONOMY

We are living in a time of unprecedented change. Brexit, emerging markets, technology and regulation are changing the fundamentals of the way we live and do business. But with great change there is also great opportunity. A ‘new economy’ is needed which can help the UK thrive post-Brexit by making the most of its mid-sized entrepreneurial businesses, by balancing growth by sector and by region and by ensuring open and simple access to world markets and global talent.

"Businesses in every corner of the UK are rolling up their sleeves as they prepare for life outside the EU and are committed to making it a success. Leaving the EU will be a highly complex process, and so it is important that as many voices as possible contribute to the debate. Discussions must focus on a 'whole economy' approach so that all areas of the UK are involved in the post-Brexit future."

Carolyn Fairbairn, CBI Director-General

CONTENTS

Foreword from Paul Eagland
Managing Partner, BDO UK LLP

The old adage that 'nothing is permanent except change' has never felt more apt than today. Think back five years. The pace of change is simply incredible.

Rapid developments in technology and regulation, the growth of populist politics, an uncertain relationship with the EU and opportunities for a whole raft of new trade deals across the globe means that many of the boundaries that once shaped the way organisations do business are changing or disappearing altogether.

At the same time, global high-profile scandals have left many people feeling alienated from – and frustrated with – governments and other big institutions. Globalisation has seen many winners but many losers too.

Some have said the vote for Brexit was the first rebellion of a developed country against globalisation. Having been followed by similar electoral sentiment in the US elections, we can expect more surprising news to come in the years ahead.

All these changes pose some interesting questions. For example, how should businesses react in such uncertain times and how can policymakers create the right environment to help them to flourish? In simple terms, what should Britain's post-Brexit economy look like? After all, change brings with it great risk but also great opportunities for those able to capitalise on them.

This report is BDO's contribution to the debate. We believe that a 'new economy' is needed which is not over-reliant on any one sector or region but which makes the most of the UK's talents, skills and entrepreneurial spirit.

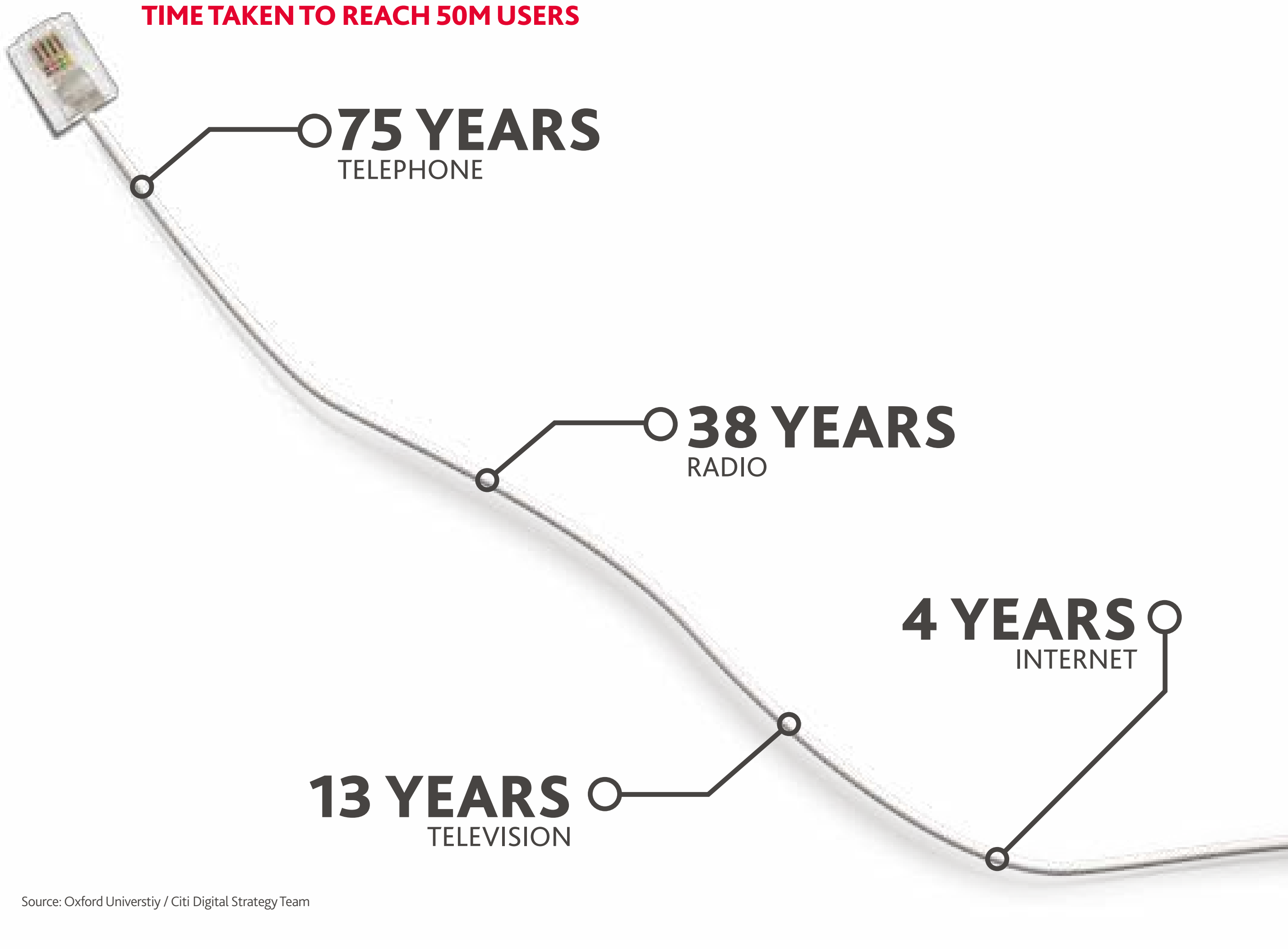
It is an economy which, despite Brexit, is outward-looking and helps its homegrown businesses expand abroad. And it is an economy which puts the UK's high-growth, entrepreneurially spirited, mid-sized businesses at the heart of its thinking; businesses which we feel are overlooked and undervalued by policymakers.

To create a truly sustainable and balanced 'new economy' which works for everyone, there are three pieces of the jigsaw that policymakers must fit together:

1. Encourage the UK's fast-growth mid-sized businesses
2. Create sector and geographic powerhouses
3. Ensure open and simple access to world markets and global talent.

But we don't have all the answers. We want this report to kick-start a conversation. Over the next 18 months we will be talking to our people, industry groups, businesses, policymakers, economists and entrepreneurs to share their ideas and refine our thinking. At the end of that period we will publish a final summary of the policies needed to help the UK succeed and mid-sized businesses thrive. You can read more of our thoughts and contribute to the debate at www.neweconomy.bdo.co.uk

TIME TAKEN TO REACH 50M USERS



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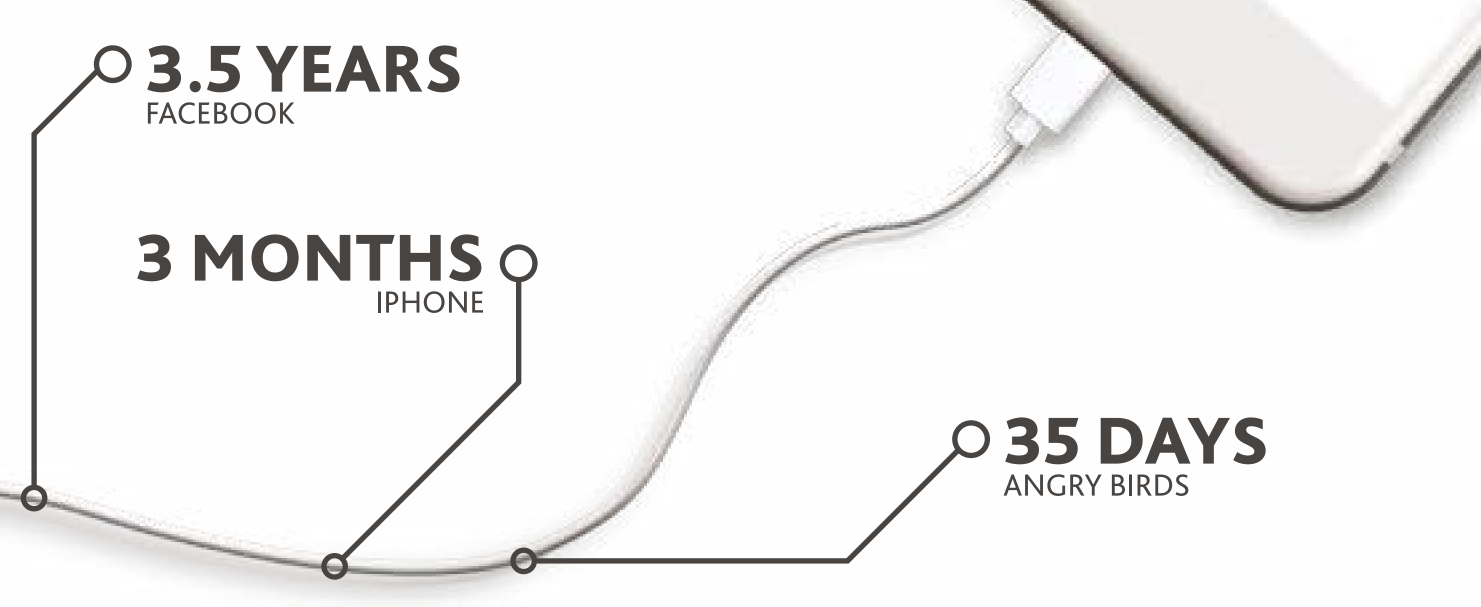

Source: Oxford Universtiy / Citi Digital Strategy Team

Foreword from Scott Corfe

Head of Macroeconomics, Centre for Economic and Business Research (CEBR)

The fundamentals of the UK economy are strong and pessimistic forecasts of an immediate recession following the Brexit vote have been proven very wrong.

The UK continues to have one of the lowest rates of unemployment in Europe, and big names such as Google, Facebook and Jaguar Land Rover have committed to creating new jobs in the country. For now, GDP data show key parts of the economy – consumer spending, business investments and exports – all expanding.

However, 2017 will be a year of uncertainty as rising inflation, driven by the weakness of sterling, pushes up business costs and the prices that households face in the shops. This squeeze on profits and consumer spending power is expected to contribute to a halving in economic growth from about 2% in 2016 to just 1% in 2017 – a huge loss of momentum.

Policymakers need to ensure that the UK has the right plans in place to lessen economic weakness and uncertainty in 2017 and beyond. In part this means ensuring that the UK gets the best possible deal following Brexit, with businesses able to trade freely with key markets and able to hire the workers they need from overseas to expand and address skills shortages. Policymakers also need to ensure there is an infrastructure programme that makes the UK economy future-proof and a tax regime that helps draw in investment and top talent from across the world.

There is significant potential for the UK economy to internationalise further and achieve solid export-driven growth over the coming years. Already, the depreciation in the pound seen since the referendum appears to be stimulating exports, as UK goods and services have become more price competitive to overseas buyers. Brexit could serve as a catalyst for the UK economy to focus beyond Europe, building trading relations with faster-growing economies in the East, bringing a host of benefits.

More still needs to be done to spread prosperity across the UK, with vast differences in employment and earnings prospects between regions. Economic growth remains heavily driven by London and the South East. As the Chancellor, Phillip Hammond, has acknowledged, in no other major developed country is the gap in economic activity between the capital and other cities so great. As such, plans to allocate £1.8bn from the Local Growth Fund to the English regions are welcome, as are plans to improve road and rail infrastructure in the North of England. These are steps in the right direction, but more can be done.

> "Policymakers need to ensure that the UK has the right plans in place to lessen economic weakness and uncertainty."
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> **Scott Corfe,** Head of Macroeconomics, Centre for Economic and Business Research

IN THE TIME A BRITISH WORKER MAKES £1...

Source: Office of National Statistics

At a glance: Policy picks

Where next for the UK? To build a successful and sustainable 'new economy' which will thrive in the post-Brexit world we have identified three pieces of the jigsaw that the Government must fit together.

Under each area we have suggested policies that will help the UK achieve those ambitions. But we don't have all the answers. Over the next 18 months we will be talking to our people, industry groups, businesses, policymakers, economists and entrepreneurs to share their ideas and refine our thinking.

Let us know what you think by commenting at **www.neweconomy.bdo.co.uk**

1. How do we encourage the UK's fast-growth mid-sized businesses?

POLICY 1:
Align National Insurance and Income Tax to create one simple payroll tax

POLICY 2:
Put in place a moratorium on UK corporate tax changes until 2020 or when Brexit negotiations are finalised (whichever comes first) to give businesses certainty in uncertain times

POLICY 3:
Simplify the rules for the UK economic engine to list on a growth equity market helping them secure quicker access to capital

POLICY 4:
Create Long-Term Lending Trusts to give the UK economic engine greater access to finance

POLICY 5:
Expand the Social Investment Tax Relief once Brexit negotiations are finalised to enable private equity involvement and increase new sources of finance for social enterprises

POLICY 6:
Create tax incentives for technology firms to help boost our growing technology sector once Brexit negotiations are finalised

POLICY 7:
Address the skills gap for high-growth businesses by extending childcare support for one-to four-year-olds

2. How do we create sector and geographic powerhouses?

POLICY 8:
Invest in smart infrastructure to create the right environment for businesses and local communities to flourish

POLICY 9:
Devolve power to local areas in a flexible way and strengthen the role of Local Enterprise Partnerships

POLICY 10:
Create a long-term industrial strategy led by a dedicated Minister of State

POLICY 11:
Increase the annual investment allowance to help increase productivity

POLICY 12:
Encourage innovation and digitisation and provide funding to implement Industry 4.0 processes

POLICY 13:
Cut VAT within the tourism industry

POLICY 14:
Reform business rates for high-street retailers

POLICY 15:
Provide an environment that allows medium-sized housebuilders to play a larger role in delivering much-needed housing

POLICY 16:
Create a centre of excellence for the global oil industry enabling the UK to access oil and gas reserves and be at the forefront of decommissioning technology

3. How do we ensure open and simple access to world markets and global talent?

POLICY 17:
Retain a variant of EU financial services passporting

POLICY 18:
Remove the overseas tax barriers for UK exporters opening a new branch or subsidiary overseas to make it simpler to export

POLICY 19:
Introduce a VAT zero rating of supplies to companies that export once Brexit negotiations are finalised to encourage more firms to trade abroad

POLICY 20:
Negotiate new trade agreements in tandem with EU Brexit negotiations

POLICY 21:
Harness the potential of high-quality apprenticeships to bridge the skills gap especially in manufacturing and technology sectors

POLICY 22:
Reinstate the two-year post-study work visa to help address the manufacturing and tech skills shortage

1. How do we encourage the UK's fast-growth mid-sized businesses?

OVERVIEW

▶ **High-growth mid-sized businesses have been outperforming their larger and smaller counterparts in terms of revenue, profits and job creation, yet they risk being overlooked as the UK prepares to leave the EU. What policies are needed to help this strong segment of the UK economy grow even more and help the UK ride out any economic shockwaves caused by Brexit negotiations?**

The UK's mid-sized, high-growth and entrepreneurial businesses are an essential and dynamic element of the UK economy.

These are the businesses that should be at the heart of the new economy. Innovative, ambitious and at the forefront of developing new technologies, the UK's mid-sized entrepreneurial businesses are engines for growth – thriving through internationalisation and employing millions of people.

Yet these businesses are frequently overlooked and undervalued by policymakers. The sheer scale of the largest PLCs means that they can grab attention due to their individual size and investment capabilities, while the very smallest businesses are seen as the most deserving and dynamic sector.

But the mid-sized companies that largely drive the UK economy remain unknown, and their issues and opportunities are not often aired. Effectively these firms fall into a policy and profile gap: too small to make their voices heard among larger high-profile enterprises but too big to take advantage of the attention lavished on start-ups.

During his time as Business Secretary, Sajid Javid MP, said as much: "For too long, governments have focused on the massive multinationals and the plucky little start-ups, leaving the mid-sized companies to fend for themselves. Mid-sized businesses have traditionally been unsung heroes of the British economy."[1] We agree.

Part of the reason for this relative obscurity is that this segment of business is hard to define. Mid-sized firms cover a broad swathe of the UK economy and encompass family owned businesses, private equity-backed companies and AIM-listed businesses. But despite the variety of shapes, sizes and funding structures, these businesses share some common characteristics. They are entrepreneurial and ambitious, they are high-growth and fast-developing and they are innovative and break the traditional mould within their sectors. At BDO, we refer to these businesses as the **'UK's economic engine'**.

1: Speaking at the Daily Telegraph Festival of Business

IN FOCUS

▶ **WHAT IS THE UK ECONOMIC ENGINE?**

The UK economic engine consists of a huge proportion of British companies. They are the high-growth and entrepreneurial mid-sized businesses whose needs and contribution are frequently overlooked.

We define the economic engine as consisting of three main parts:

1. the UK's mid-market companies (those family and privately owned businesses with revenue of between £10m–£300m)
2. high-growth private equity-owned companies and
3. AIM-listed firms. These businesses make up 1.5% of all companies by number but account for one third of all private sector revenue (£1.2tn) and 45% of private sector employment. Their contribution to the UK economy is simply staggering.

This segment of business has thrived during recent uncertainty. Over the last five years it has grown faster than any other key business segment with revenue growth of 35% double the rate of FTSE350 business growth (13%) and small businesses which have shrunk over the same period (-0.6%).

This growth has created jobs too. These dynamic mid-sized businesses have created more jobs in the last year than large or small businesses combined, with 780,000 new jobs created compared to 320,000 created by the FTSE350 and 135,000 by small businesses.

It's clear that the UK economic engine is a driving force behind the UK economy. But what policies are needed to help it achieve even more?

Promoting the UK economic engine

The Brexit negotiations will be complicated and will naturally dominate the Government's agenda in the years ahead. It is absolutely imperative that this doesn't lead to policymakers losing focus on the domestic business agenda. Growth at home must be given equal priority to negotiations with Europe.

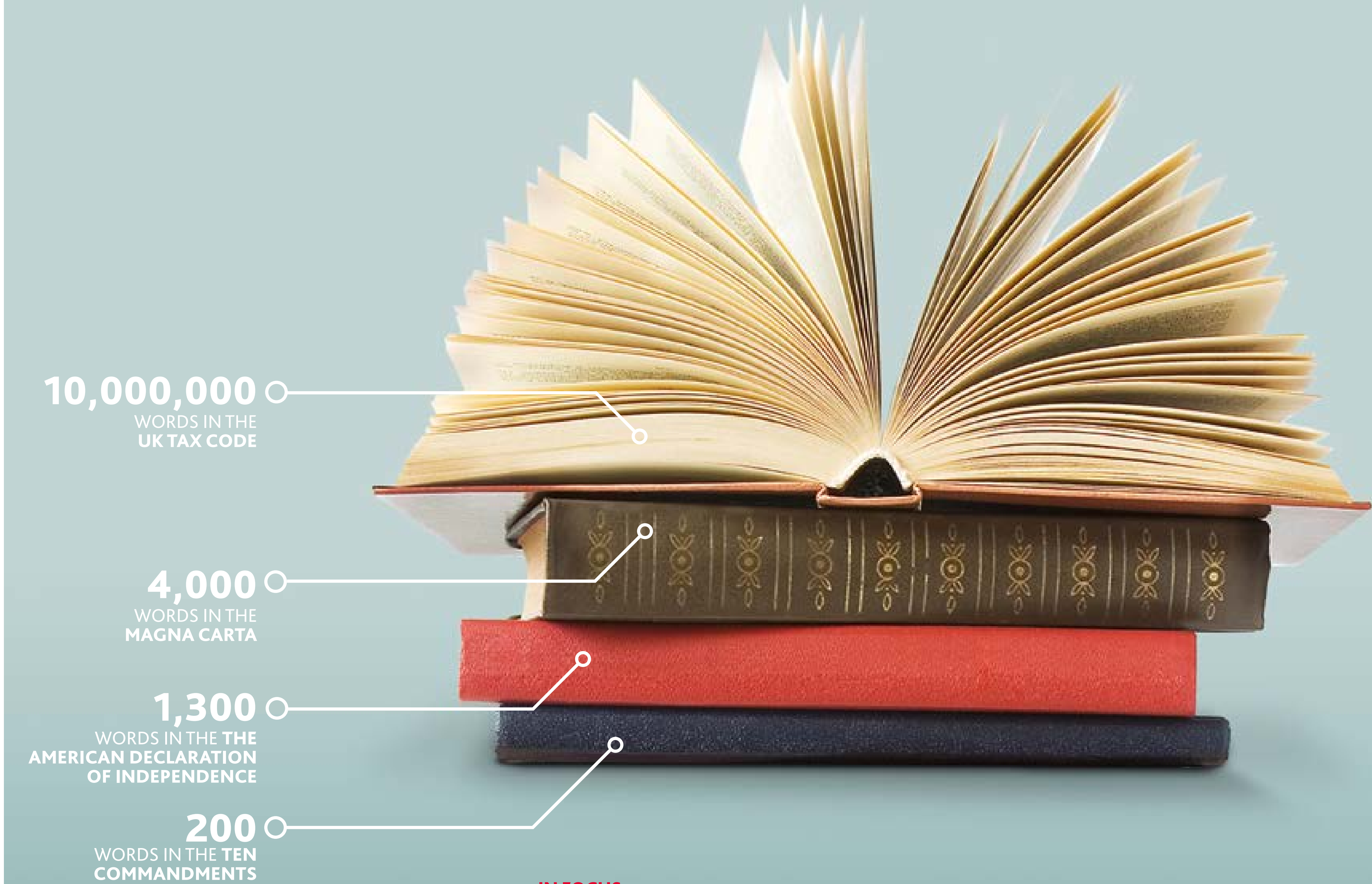
That said, we understand that the Brexit negotiations will cast a long shadow over domestic policy. Policies which only call for subsidies and tax breaks will be difficult to enact, especially if they contravene EU state aid rules and so complicate already difficult Brexit discussions.

This does, however, give the Government the opportunity to make a virtue out of a necessity and, where possible, choose simplicity over subsidy to support the economy. Simplicity in doing business will give the UK a competitive advantage that does not breach EU rules.

To help simplify the system we are calling for the alignment of National Insurance and Income Tax and a moratorium on all new business tax policies that do not simplify the system until 2020 or until the Brexit negotiations are finished (while understanding the need to support the ongoing efforts of the OECD in their ongoing BEPS – base erosion and profit shifting – programme).

Simplifying the tax system in the UK is a necessity for the short term and a way of ensuring competitiveness. However, there are also a number of tax incentives that can be brought in once the Brexit negotiations are completed, near completion or if there are bumps in the road (while acknowledging that a balance must be struck if the UK is to broker new international trade deals). A new economy will not be built overnight and, once the UK has left the EU, Government policy should be used to create a fiscal environment that rewards innovation and encourages growth.

We would also like to see the issue of financing tackled. Many mid-sized businesses are struggling to find the finance they need to grow – research by the CBI has found that more than half of mid-sized businesses have difficulty in accessing long-term growth capital. To create a 'new economy' this must be addressed by a range of new measures. Private equity must also play a bigger role in the financing mix – it is something that the UK leads the world in and it should be warmly supported by the Government.



IN FOCUS

▶ A TWO-STAGE APPROACH TO HELPING ENTREPRENEURIAL MID-SIZED BUSINESSES IN THE UK

When looking to help businesses or sectors to grow it is tempting for policymakers to reach for tax incentives or subsidies. The Brexit negotiations limit the Government's ability to do this as anything that looks like breaking state aid rules will potentially jeopardise our negotiating position with the EU. Of course, once the UK has left the EU the Government will have greater freedom to enact growth-promoting policies. We therefore suggest a two-stage approach.

1. Simplify tax structure – while the negotiations with the EU are ongoing, the Government should focus on making a virtue out of a necessity and simplifying the UK tax structure by taking a 'simplicity over subsidy' approach.
2. Create a new tax environment that rewards innovation and encourages growth – after 2020 or once the Brexit negotiations are completed (whichever comes first) the Government can then look at a balanced suite of well-targeted incentives and subsidies that reward investment and innovation.

Source: Anton Colella, Institute of Chartered Accountants of Scotland

POLICY 1: ALIGN NATIONAL INSURANCE AND INCOME TAX TO CREATE ONE SIMPLE PAYROLL TAX

National Insurance dates back to 1911 when it was established to help working people insure against illness and unemployment and was later expanded after World War Two to help fund wider social security programmes and the NHS. National Insurance no longer covers the costs of the benefits it was set up to finance and has developed in parallel with Income Tax, yet with a separate set of rules and regulations.

All major economies have a form of social security levy for employers and this would need to be maintained (the UK version is National Insurance) but simplified. Having parallel taxes creates unnecessary bureaucracy and added compliance costs for employers. Aligning both taxes with an ambition to merge both into one payroll tax would remove economic distortions, reduce burdens on business, and improve fairness and transparency. It should be kept in mind that the UK already offers one of the lowest social security costs for employers in the EU.

POLICY 2: PUT IN PLACE A MORATORIUM ON UK CORPORATE TAX CHANGES UNTIL 2020 OR WHEN BREXIT NEGOTIATIONS ARE FINALISED (WHICHEVER COMES FIRST) TO GIVE BUSINESSES CERTAINTY IN UNCERTAIN TIMES

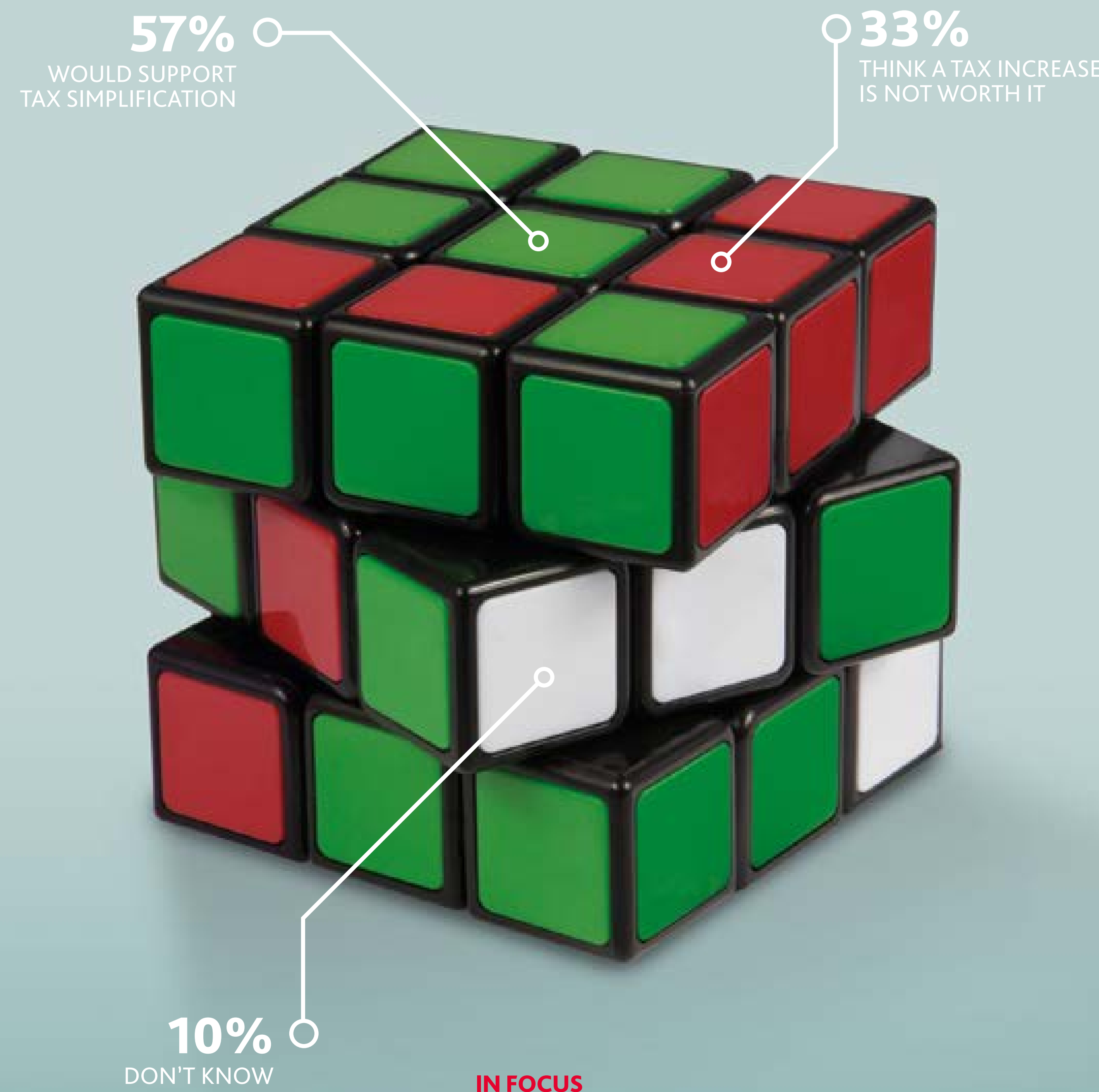
Faced with complicated Brexit negotiations, the UK Government will be wary of introducing any new tax breaks or incentives that could be accused of breaking state aid rules. As highlighted below the Chancellor can make a virtue out of a necessity and focus instead on simplifying our tax code while negotiations are ongoing.

In the last 30 years the UK tax code has increased more than tenfold. A commitment to simplicity would be a clear signal to the world that the UK is a destination where businesses can flourish. We believe the Chancellor should announce a moratorium until 2020 or until Brexit negotiations are completed (whichever happens first) on any changes that do not simplify the tax system. This will allow the Treasury to focus on Brexit and business leaders to focus on strengthening and growing their businesses for the long term.

POLICY 3: SIMPLIFY THE RULES FOR THE UK ECONOMIC ENGINE TO LIST ON A GROWTH EQUITY MARKET HELPING THEM SECURE QUICKER ACCESS TO CAPITAL

Not far from its 25th anniversary, the Alternative Investment Market (AIM) is home to around 1,100 companies from more than 40 sectors around the world. AIM is one of the world's most successful growth markets and a great example of securing investment in mid-sized firms.

The UK's regulatory framework needs to support more effective and cheaper access to capital. We would like to see a simplification of the requirements for companies when they undertake a secondary issuance. This will make it easier for companies already listed to raise extra capital from existing investors without the need to produce a prospectus and would strike a sensible balance between investor protection and access to capital for companies.



IN FOCUS
▶ BUSINESS LEADERS WILL TOLERATE HIGHER TAXES TO CUT COMPLEXITY

BDO research shows that business leaders are willing to see their tax bills rise if it means a less complex and bureaucratic tax system. According to a survey of 500 businesses representing the UK economic engine, 57% of owners would support tax simplification even if it meant marginal tax rises. Half of those who responded specifically called for an alignment of National Insurance and Income Tax to reduce the administrative burden and bring employment taxes into the 21st century.

POLICY 4: CREATE LONG-TERM LENDING TRUSTS TO GIVE THE UK ECONOMIC ENGINE GREATER ACCESS TO FINANCE

We believe that Long-Term Lending Trusts (LTLTs) should be used to encourage investment in mid-sized business.

These would offer income tax relief to savers investing in long-term debt funding for ambitious businesses (as currently exists through the successful Venture Capital Trust scheme) for at least five years. Targeting individual savers, it should offer:

- A tax-preferred return based on yield, not capital gain
- Potential inheritance tax benefits as a further incentive.

The LTLT investment would likely provide good levels of returns in comparison to bond yields or cash deposits, while offering a strong degree of protection as it would be run by regulated investment professionals.

There would also be strict requirements on the type of business that could seek loans from the LTLT, which, according to our Stepping Up report (a joint report written with the CBI), would cost the Government around £310m a year to run and could unlock billions of new long-term loans, while providing better levels of income than currently enjoyed by many retired individuals.

POLICY 5: EXPAND THE SOCIAL INVESTMENT TAX RELIEF ONCE BREXIT NEGOTIATIONS ARE FINALISED TO ENABLE PRIVATE EQUITY INVOLVEMENT AND CREATE NEW SOURCES OF FINANCE FOR SOCIAL ENTERPRISES

Private equity-backed companies continue to be a significant driver of the UK economy and its global competitiveness.

According to the BVCA there are more than 3,000 companies in the UK currently backed by private equity and venture capital, with over £30bn invested. They are geographically spread, with the North West home to the third highest concentration of companies backed by private equity and venture capital, beaten only by London and the South East.

The ability of private equity to drive transformational growth and shareholder value is well understood but its positive social impact far less so.

One area where private equity can have a direct social impact is through the expansion of Social Investment Tax Relief (SITR). SITR is the Government's tax relief for social investment which supports charities and social enterprises by helping them access new sources of repayable finance.

We see an increasing role for social enterprises in the new economy that trade in order to tackle social problems, improve communities, people's life chances and the environment. Government statistics identify 741,000 social enterprises in the UK contributing £55bn to the national economy and employing two million people.

According to Social Enterprise UK, social enterprises are growing quickly with nearly half of all social enterprises five years old or less and 35% three years old or less. Yet 44% sought funding or finance in the last 12 months and 39% believe a lack of access to appropriate funding is a barrier to their sustainability.

We agree with the BVCA, therefore, that SITR needs reform (although we concede that this may need to wait until the conclusion of Brexit negotiations). In particular we would like to see: the size of permitted aggregate investment in a social enterprise increased from £1.5m to £5m. The Chancellor, Phillip Hammond, has made some progress here increasing the permitted size of investment from £200,000 to £1.5m. During his tenure as Chancellor, George Osborne, however, agreed to raise the limits to £5m and apply to the EU to bypass state aid rules. We would like to see Phillip Hammond increase the limits to this level.

This reform would boost the growing social enterprise sector and would also showcase the positive impact of private equity in the UK.

Source: Department for Business, Innovation and Skills

POLICY 6: CREATE TAX INCENTIVES FOR TECHNOLOGY FIRMS TO HELP BOOST OUR GROWING TECHNOLOGY SECTOR ONCE BREXIT NEGOTIATIONS ARE FINALISED

The government is right to be ambitious for the UK's digital economy. The future of advanced economies such as the UK's lies in growing research-intensive, innovative and high-value digital companies.

New industries and new companies need new ways of thinking about the corporate tax incentives currently offered to help companies to grow. Recent years have seen the introduction or improvement of corporate tax incentives for the innovation, development and ownership of intellectual property such as R&D tax credits, the Patent Box and creative sector reliefs.

While these reliefs are commonly accessed by the technology sector, they have not been designed with the sector in mind and the official published guidance does not approach their availability from a perspective that technology businesses will commonly understand without incurring significant professional fees.

We would propose that, given the importance of the technology sector to the economy, a specific innovation credit for technology businesses is introduced which would give an R&D type credit to a wider range of technological innovation than under current rules, together with targeted guidance to assist technology businesses to more easily access and take full advantage of the existing incentives.

POLICY 7: ADDRESS THE SKILLS GAP FOR HIGH-GROWTH BUSINESSES BY EXTENDING CHILDCARE SUPPORT FOR ONE-TO FOUR-YEAR-OLDS

At a time where mid-sized entrepreneurial businesses are finding it tough to recruit people with the right skills into their workforce, it is vitally important to shape an economy that makes the most of its talented people and creates a smooth and supported route into employment. One area where this is absolutely crucial is with parents who want to return to work following an extended period of childcare.

The CBI has called for expanded childcare support to bridge the gap between maternity/paternity leave and school age. This has the triple benefit of reducing skill shortages, improving diversity and helping to reduce the gender pay gap.

At the moment all three-to four-year-olds in England can get 570 hours of free early education or childcare per year. It's usually taken as 15 hours a week for 38 weeks of the year. This current position creates a gap between the end of paid parental leave and the start of financial support with childcare costs. This gap can drive highly talented individuals out of the workforce.

The CBI's plans are projected to cost around £2bn but would create a new pipeline of talent into the economy.

▶ ACCORDING TO A 2016 BRITISH CHAMBERS OF COMMERCE SURVEY, BUSINESS LEADERS ARE SEEING AN IMPACT ON STAFF BECAUSE OF HIGH LEVELS OF CHILDCARE

Source: British Chambers of Commerce

2. How can we create sector and geographic powerhouses?

OVERVIEW

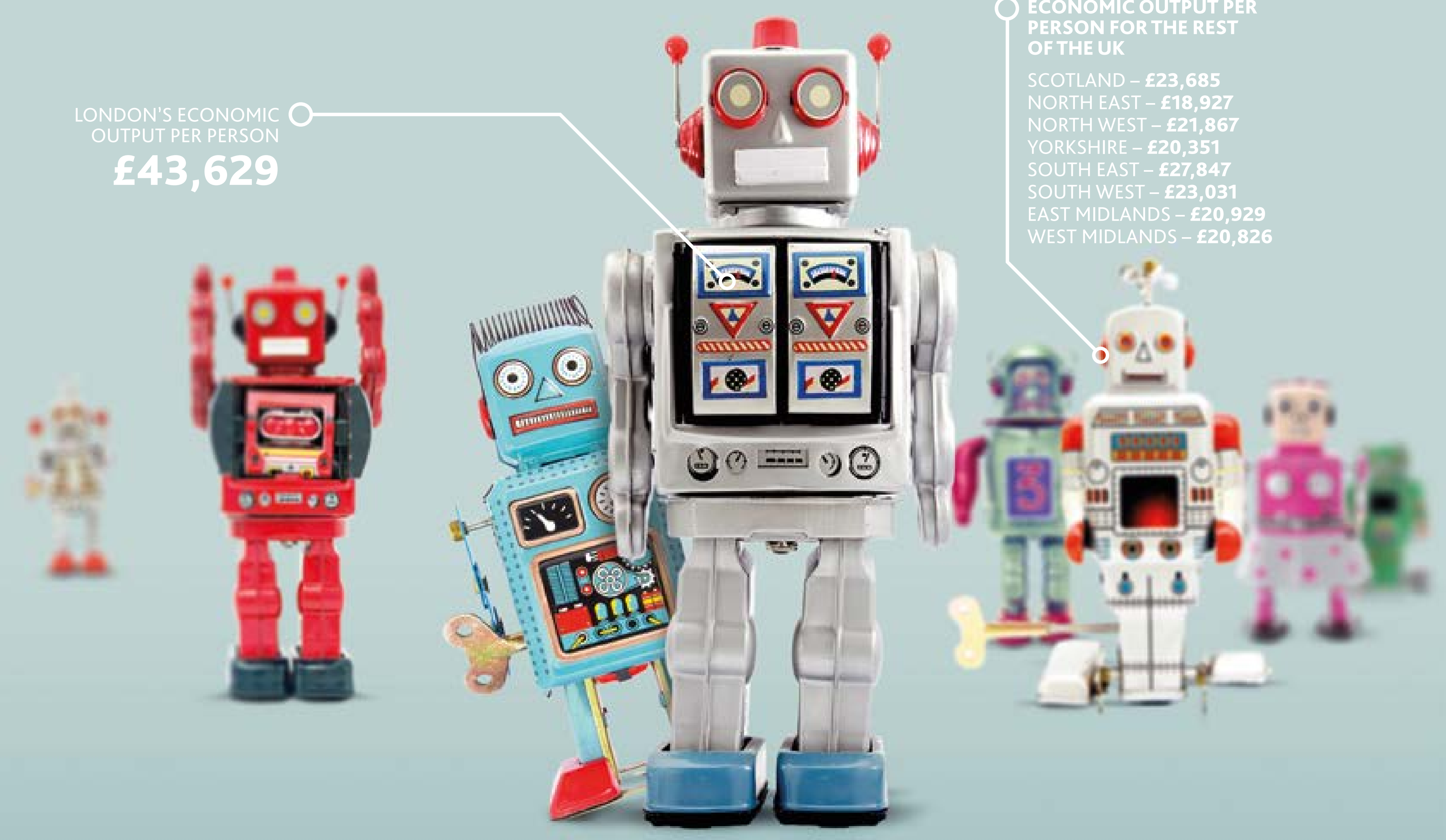
▶ The UK economy is unbalanced with a disproportionate amount of growth coming from the South East and financial services. Our economy in the South East and City of London is an example to the world and is rightly celebrated. To try and bolster the other regions of the UK by denigrating the South East and City of London would be a mistake. But what support is needed for different regions and sectors to help rebalance UK economic success?

Britain's deep pockets of expertise, based all around the country, can power our growth.

From the world-leading tech companies in the M4 corridor to university spin-out companies in Oxford and Cambridge; from manufacturing in the Midlands to energy innovation in Scotland; supporting powerhouses around the UK are fundamental to embedding our economic growth.

To help contribute towards a balanced and sustainable economy, policymakers need to develop two strands of powerhouse support:

1. Geographic powerhouses: First, more must be done to support the geographic powerhouses including areas which already thrive, such as the Thames Valley, and areas with huge potential, including the North of England and the Midlands
2. Sector powerhouses: Second, niche economies in towns and cities – the profitable 'hubs' which power growth around the country, such as Oxford's energy and bio-science sector, must be given the tools to thrive. Alongside these hubs the large pan-regional sectors such as manufacturing and tech must also be supported.



IN FOCUS

▶ A THREE-STEP PROGRAMME TO BOOST OUR SECTORS AND REGIONS

To successfully develop our sectors and regions, three areas of focus are needed:

1. **Creating a new 'regionalism' –** Traditionally Britain's economy has profited from dynamic and entrepreneurial regions and cities. The grand Victorian town halls of major industrial cities like Birmingham and Manchester reflect a time when people looked to their own cities for solutions to problems. Devolved power will help cities and regions take the initiative to generate local growth, be more nimble and focus efforts on their own economies.
2. **Investing in infrastructure –** Businesses in the new economy cannot succeed without infrastructure fit for the future. World-class infrastructure allows businesses to be run from anywhere in the country, linked physically by road and rail and digitally via superfast broadband. But policymakers must look at social and cultural infrastructure too. Schools, healthcare and culture all require investment to make these areas attractive places to live and keep talent evenly spread across the UK. The Government commitment to invest at least 1% of GDP in the UK's infrastructure annually in the 2020s is welcome but these funds must be spent wisely. We believe that smaller 'shovel-ready' projects will provide the quickest 'bang for buck'.
3. **Specific sector support –** There is a growing consensus among Government and business groups that a new 'industrial strategy' is needed. While avoiding the notion of 'picking winners' which was inherent in the policy of British governments in the 1970s, there are some specific sector policy areas that would promote rebalancing within the UK economy.

Source: Office of National Statistics

POLICY 8: INVEST IN SMART INFRASTRUCTURE INVESTMENT TO CREATE THE RIGHT ENVIRONMENT FOR BUSINESSES AND LOCAL COMMUNITIES TO FLOURISH

Better roads and rail links will give the best return if they connect potential powerhouses – helping areas on the cusp of sustainable economic success to cement their position and help their businesses to thrive. In uncertain financial times, Government needs to get the best possible value out of any investment, and some plans will deliver far more value than others.

Much public and political focus has been on the big-ticket infrastructure projects – the so-called three 'Hs' of Heathrow, HS2 and Hinkley Point. Governments will inevitably be drawn to these big projects as a way of leaving a legacy and as a symbol of their vision for the country. We believe that the Government should also focus on smaller 'shovel-ready' projects that can get off the ground quicker and have a more immediate economic impact. To help make this 'smart infrastructure investment' a success we recommend a five-pronged approach:

1. Smaller projects, quicker wins

The first step is to break down 'infrastructure policy' into defined sub-sectors: energy, transport, social infrastructure and so on. Once these have been outlined, we can then see key projects and pipelines for each area. Most importantly, the prioritised projects need to have cross-departmental support to ensure that all areas of Government are committed to moving them forward. Working on smaller and more targeted infrastructure projects would ensure a greater short-term benefit. While HS2 will undoubtedly have significant benefits, it will naturally take time for that benefit to be felt.

2. Local engagement

Our calls for smart 'shovel-ready' infrastructure projects comes at a time when devolution continues to distribute powers away from Westminster. We note that there are currently six large cities and over 30 smaller cities which have devolution deals pending completion – with proposals for infrastructure development plans in each area. Local government must be included in a collaborative discussion about what infrastructure would benefit each location and ensure that smaller, regionally focused infrastructure projects make a real difference to local citizens. This would, in addition, help to dispel the notions that Westminster is too remote or doesn't understand local issues (see policy nine for our thoughts on devolution).

3. Encourage outside investment

The UK continues to enjoy a reputation as a great place to invest. While the UKTI and other promotional bodies are working to ensure that the 'open for business' message continues to resonate post-Brexit, this is a perfect opportunity to attract foreign investors for UK projects. An expected post-Brexit drop in infrastructure funding from the European Investment Bank might not be a disaster. UK banks have more liquidity than over the past few years and global investors from the USA and other countries are keenly competing for deals. The lower British pound and low interest rates make the cost of borrowing much more attractive which promise a long-term return.

Encouraging foreign investment in infrastructure projects is a significant way to work productively with our current EU partners, forge new links with the rest of the world (China, USA, etc) and ensure that the UK remains an attractive place to invest.

4. Encourage pension fund investment in infrastructure

The construction of London's £4.2bn 'super sewer' – the Thames Tideway Tunnel – is being funded, in part, by around 1.7 million people saving for their retirement. We believe that pension funds are natural investors in infrastructure projects and policies that make investment easier will benefit both the country and pension funds – which are struggling in a low-yield environment. A guaranteed return for pension funds making UK infrastructure investments might help to address both investment issues and ease some of the pressure on pension funds in deficit. Although this will add to the Government's long-term liabilities, this may be acceptable under the current Chancellor's more relaxed national deficit reduction plan.

5. Do not overlook social infrastructure

Social infrastructure – leisure, schools, hospitals and housing – is often forgotten in the debate, which tends to focus on large transport projects. Our hospital system is transforming to deal with changing demographics, the regulatory agenda and models of delivering care. We think this means a fundamental re-think of what local communities should look like. Large-scale infrastructure is fine but what happens when the local hospital transforms its estate to integrate more effectively with public transport, reducing costs? Although some of these will, no doubt, be discussed in any local level consultation, before spending money on infrastructure projects we would encourage the Government to consider its role in developing places where people want to live, work and enjoy their lives.

POLICY 9: DEVOLVE POWER TO LOCAL AREAS IN A FLEXIBLE WAY AND STRENGTHEN THE ROLE OF LEPS

It will take time, effort and focus to unlock regional economic potential. The Government recognises this and so suggests that communities should adopt Mayors in exchange for greater powers.

However, there is no one-size-fits-all solution and not all areas will need a Metro Mayor in order to thrive. Instead of imposing a single solution, Westminster should devolve economic power in a flexible way. Greater expertise in local authorities, strengthened LEPs (Local Enterprise Partnerships) or getting local businesses involved in planning for the future may all be models that suit different areas. Our Chambers of Commerce must also have a key role to play in our devolved future.

In particular, we believe the role of LEPs should be strengthened. In 2015, Lord Heseltine – who highlighted the vital role of LEPS in his No Stone Unturned report – described them as "the only serious way of rebalancing the English economy". We agree with Lord Heseltine and feel an enhanced role with additional funding and free from central control will help local economies flourish.

In our view devolution is essential. Local authorities working with local businesses are best placed to drive economic growth and will get best value for each £1 of public money spent.

POLICY 10: CREATE A LONG-TERM INDUSTRIAL STRATEGY LED BY A DEDICATED MINISTER OF STATE

We welcome the Government's approach to developing an industry strategy but we feel that the ownership of the strategy should be held by one dedicated Minister of State and must be focused on the long term.

Take manufacturing as an example. Manufacturing is a long-term game – most businesses in the sector rely on large capital investments which pay off over years or even decades. Businesses need stability and certainty in Government policy if they are to commit to the investment that the country needs to grow.

The Government should match manufacturers' and other sectors' long-term outlook by looking 15 to 20 years ahead to plan an industrial strategy, avoiding the disruptions of the political cycle. This should include setting a formal target for manufacturing growth over the next five, 10 and 20 years to provide the background to a sustainable industrial strategy. The programme must be steered by a dedicated minister, able to focus on firms' needs in a way that will benefit us all.

2: CREATE SECTOR AND GEOGRAPHIC POWERHOUSES (CONTINUED)

POLICY 11: INCREASE THE ANNUAL INVESTMENT ALLOWANCE TO HELP INCREASE PRODUCTIVITY

Productive manufacturing needs investment, and government must encourage this in every way possible. We strongly support the steps taken by the Government in this direction by increasing the annual investment allowance (AIA) to £200,000 (and a temporary increase to £500,000), but this is not yet the game-changer we need to unleash manufacturing might.

Government should take the bold step of increasing the annual investment allowance for expenditure on plant and machinery to £5m for five years.

With the progressive reduction in the rates of capital allowances, many businesses are finding that the reward for investing in new capital assets, such as plant and machinery, is no longer a significant incentive. Increasing the AIA to £5m would provide a significant incentive for mid-sized businesses to invest in the capital assets that will drive future growth, and give businesses the confidence to plan ahead.

POLICY 12: ENCOURAGE INNOVATION AND DIGITISATION AND PROVIDE FUNDING TO IMPLEMENT INDUSTRY 4.0 PROCESSES

The pace of change towards more automation, digitisation and Industry 4.0 (fourth industrial revolution) processes over the next five to 10 years will be rapid and UK manufacturers will need to change how they do business to cope with the new digitised environment. The drive towards automation will require education and investment to keep pace with global competitors and meet the increasing demands of consumers.

Industry 4.0 brings together industrial production and network connectivity with the Internet of Things. Core to embedding Industry 4.0 is a strong infrastructure and reliable internet/broadband connections. The Government's commitment of £1bn investment in full-fibre broadband and trialling 5G networks is a positive start.

Similarly the Government's increase in research and development funding for both universities and businesses for R&D projects provides a platform to allow businesses to innovate and develop new products and processes.

Britain's historic strengths in manufacturing, innovation, design and service, as well as the significant potential that the move to more automated manufacturing offers, should be supported and developed as key foundations for a successful and well-balanced UK economy. The Government should make available a dedicated Industry 4.0 fund to support investment and encourage the adoption of Industry 4.0 processes. The fund would be in the form of grants or loans.

BDO's Industry 4.0 Report found that only 8% of UK manufacturers surveyed have a significant understanding of Industry 4.0 processes despite 59% recognising that the fourth industrial revolution will have a big impact on the sector. Funding for Innovate UK (the executive non-departmental public body sponsored by the Department for Business) and HVM Catapult (a Government announced programme to foster innovation in manufacturing) should be increased to allow sufficient resource to educate and advise manufacturers on how Industry 4.0 is developing and how it's applicable to their business and the benefits this would bring.

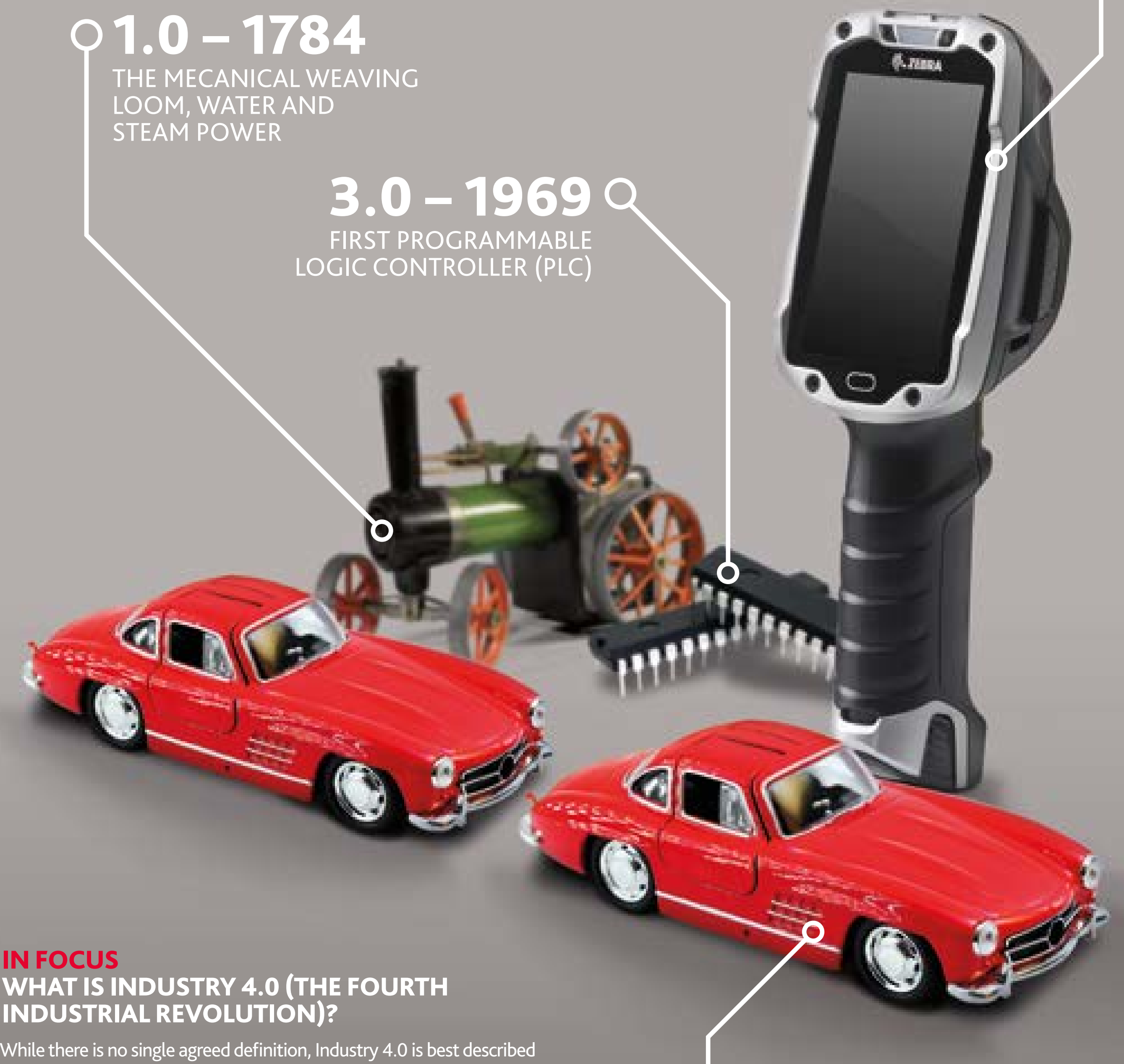


Image: Zebra Technologies (4.0 – TODAY)

IN FOCUS

▶ WHAT IS INDUSTRY 4.0 (THE FOURTH INDUSTRIAL REVOLUTION)?

While there is no single agreed definition, Industry 4.0 is best described as the next phase of digitisation within the manufacturing sector.

The first industrial revolution used water and steam power to mechanise production. The second used electric power to create mass production. The third used electronics and information technology to automate production. And today the manufacturing sector is on the cusp of the fourth industrial revolution driven by a number of technological advances which are blurring the lines between the physical, digital, and biological spheres. These advances include improvements in transferring digital instructions to the physical world through 3D printing, new forms of human-machine interaction (such as touch interfaces and augmented reality) and the huge increase in computing power and data analytics.

Source: Daxue Consulting

POLICY 13: CUT VAT WITHIN THE TOURISM INDUSTRY

Hospitality and leisure is the UK's fourth biggest sector and is one of the largest employers in the UK. However, it does face challenges in the near future. Many of the people it employs are from the EU and the sector is facing increased costs from both the national living wage and the Apprenticeship Levy.

Although a cheaper pound will benefit the tourism industry more should be done to help this crucial sector grow. Alongside the British Hospitality Association we believe the Government should look at cutting VAT to 5% for hotel accommodation and visitor attractions, in line with other EU countries. Professor Adam Blake of Bournemouth University believes that the reduced VAT rate would be largely revenue neutral and boost GDP by £4bn a year, thus generating jobs.[2] As this would simply bring us into line with our fellow EU members this could be achieved immediately.

POLICY 14: REFORM BUSINESS RATES FOR HIGH-STREET RETAILERS

Business rates continue to be a source of controversy. Rates are based on the value of the real estate but also take into account things like the value of machinery and equipment as well as the sector in which the business is operating. After rent and staff costs, rates are frequently the third biggest outgoing for retailers.

We believe the following reforms should be considered:

1. Change the revaluation period to every three years (currently five) ensuring that rates bills reflect changes in the property market and the wider economy
2. Take investments made by businesses out of the calculation for valuing properties rather than improvements adding to rateable values
3. Allow business rates to flex more closely with the economy by removing the link with annual RPI inflation and instead indexing to CPI.

POLICY 15: PROVIDE AN ENVIRONMENT THAT ALLOWS MEDIUM-SIZED HOUSEBUILDERS TO PLAY A LARGER ROLE IN DELIVERING MUCH-NEEDED HOUSING

The eight largest housebuilders currently provide more than 50% of all housing starts in the UK which places the industry in the unhealthy position of relying on a narrow group of developers to deliver the UK's vital housing needs. With a chance that Brexit uncertainty and the challenges of labour access and skills shortages could lead to a fall in the number of homes built over the next few years there is an urgent need to redress the balance.

We welcome the Government's £3bn Home Building Fund to provide development and infrastructure support to this part of the sector and look forward to seeing how this incentive is actively encouraged and implemented by the Homes and Communities Agency (HCA) to ensure this is given priority status.

Significant barriers to entry remain, and many small and medium housebuilders find it difficult to compete with the scale and efficiencies of larger developers. The nature of the current planning system leaves little or no economic headroom for smaller players to access the land market.

The Government has historically not done enough to support the huge untapped market of small and medium-sized developers who can play a vital role in delivering the UK's housing shortage – and with 80% fewer companies of this size in operation than in 1988, we need an environment that fosters this integral part of the economic engine.

POLICY 16: CREATE A CENTRE OF EXCELLENCE FOR THE GLOBAL OIL INDUSTRY ENABLING THE UK TO ACCESS OIL AND GAS RESERVES AND BE AT THE FOREFRONT OF DECOMMISSIONING TECHNOLOGY

The efficient use of energy and the need for renewable sources to form an increasing portion of the UK's energy mix will be a dominant theme of the new economy. However, any new economy will also need to make the most of the sources of energy already available to it and continue to create the new skills and develop technology to access them. The UK, and particularly Scotland, already has a strong international sector reputation but the new economy should harness this and take it to the next level.

The mature North Sea oil fields will require significant and increasing levels of decommissioning in the coming years. The development of this segment of the oil services sector should be accelerated, particularly in Aberdeen which is experiencing the fallout of the lower oil price environment. Aberdeen should become a hub of expertise for decommissioning technologies and delivery requiring (training, tax incentives, collaboration between smaller niche businesses and larger engineers and oil majors). This will position the UK to capitalise on the decommissioning of the North Sea but also create a centre of excellence for the global oil industry with skills that can be exported internationally.

While North Sea oil and gas production is declining, the oil and gas reserves available for commercial production remain significant and there are opportunities to extend the life of fields with additional exploration and investment. However, companies are cash constrained and are struggling to invest counter cyclically in order to support future production rates and the supply chain. We would support Oil and Gas UK's proposal that companies be permitted to trade in historic losses for cashable tax credits that can be used in a restricted manner to fund exploration, drilling and R&D. This would need to be aligned with our vision for a simpler tax system (see policy one and two).

2: The Impact of Reduced VAT Rates on British Visitor Accommodation, Attractions and the Wider Economy 2012

▶ THE RATE OF VAT ON VISITOR ACCOMMODATION AND ADMISSIONS TO CULTURAL SERVICES

Source: The Impact of Reduced VAT Rates on British Visitor Accommodation, Attractions and the Wider Economy 2012

3. How do we ensure open and simple access to world markets and global talent?

OVERVIEW
The UK has a long and proud history as a trading nation. The UK's vote to leave the EU will change the way Britain does business with foreign markets. It is important that UK businesses are given the practical support needed to continue trading abroad regardless of the outcome of Brexit negotiations. The UK must ensure that it retains open and simple access to world markets and global talent but how is this best achieved?

The UK's vote to leave the EU sent shockwaves around the global economy.

Immediately after the referendum result was known, the financial markets were hit hard and sterling fell sharply. Since then markets have started to calm down and volatility is lower. Despite a period of relative calm the Chancellor has been right to warn of the roller-coaster that will accompany the Brexit negotiations (and currency markets are still providing evidence of this). However, focus is now shifting to the impact of long-term growth in the economy and the Government's negotiating strategy.

The Brexit negotiations will be hugely complicated. David Davis, Secretary of State for Exiting the European Union, has called it: "the most complicated negotiation of all time. By comparison, Schleswig-Holstein is an O-level question."

It would, therefore, be wrong for this report to second-guess the nuances of the negotiation and attempt to provide complete answers to a complex situation that will be changing on a monthly basis. Instead, this section highlights broad principles that are desirable to help create a 'new economy' where businesses are able to seize opportunity wherever in the world it arises while acknowledging the realities of the referendum result.

The UK has a long and proud history as a trading nation. According to the FAME database, the UK economic engine has increased its overseas turnover faster than any other segment over the last year and five years.

In the last year the UK economic engine has grown its overseas turnover by 8% and in the last five years it has grown it by 55%. This compares to an FT350 decline in overseas turnover by 27% last year and a decline of 5% in five years. Small business overseas turnover has declined by 11% in the last year and 25% in five years. In total the UK economic engine accounts for only 1.5% of UK companies but is responsible for one third of the UK's overseas turnover.

The businesses we speak to have two key concerns which stem from the UK's decision to leave the EU. Firstly they are concerned that exports and their business interests abroad will suffer as tariff and non-tariff barriers are imposed. Secondly, businesses are concerned about restrictions in their access to global talent and skills. The policies below are designed to address both concerns.

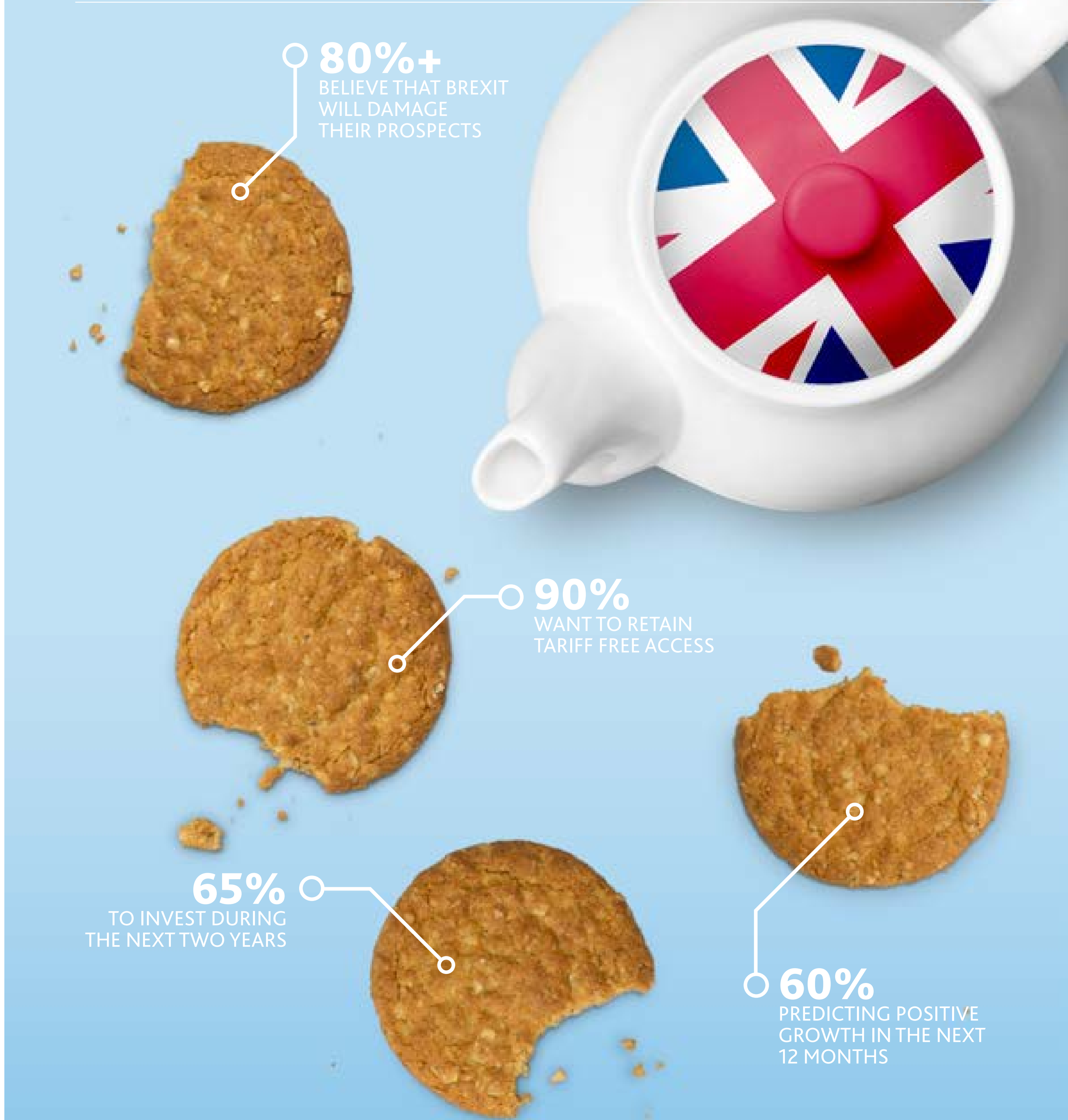
POLICY 17: RETAIN A VARIANT OF EU FINANCIAL SERVICES PASSPORTING

Financial service passports, which were introduced in 1993, give UK banks, insurers and asset managers the right to sell their services freely across the rest of the EU and give firms based in Europe unfettered access to Britain. They have enabled London to develop into a financial hub, with many companies from the US, Asia and elsewhere basing their European operations in the City and relying on passports to access the rest of the EU. According to the Treasury Select Committee nearly 5,500 UK-registered firms depend on passports to do business in the rest of the EU and another 8,000 European companies rely on passports to offer services in Britain.

The alternatives, such as equivalence, will not provide the same access. They only allow a much narrower range of services, more limited rights and can be withdrawn at short notice.

While leaving the EU single market is likely to render it difficult to keep financial passporting (as it currently exists) in place, the UK government must work hard during its negotiations to ensure some variant of passporting can remain. We agree with TheCityUK that it is important for the UK Government to reach a detailed agreement that provides market access to a wide spectrum of financial products and services without the need for businesses to establish a commercial presence in both markets. This would mean the UK and EU 27 agreeing to mutual recognition of regulatory regimes going beyond current equivalence which can only be changed by formal agreement.

London provides a financial eco-system established over many decades which is difficult to replicate elsewhere. Given its importance and its reputation as a trusted and innovative place to do business, we believe that it is in the economic interests of the EU 27 and the UK to reach a bespoke agreement.



IN FOCUS
THE REACTION OF THE UK ECONOMIC ENGINE TO THE EU REFERENDUM

Following the referendum we asked 400 of our clients – all representing high-growth entrepreneurial businesses – for their views on Brexit and the impact upon their business.

Over 80% believe that the UK decision to leave the EU will damage their prospects. There was almost unanimous agreement from the businesses surveyed to retain access to the single market as part of its negotiations.

90% of the firms surveyed want to retain tariff-free access to Europe for their goods and services.

However, there was genuine optimism for the long term, with two thirds (65%) of businesses saying they will continue to invest during the next two years and 60% of respondents still predicting positive growth in the next 12 months, short-term prospects are also looking good.

POLICY 18: REMOVE THE OVERSEAS TAX BARRIERS FOR UK EXPORTERS OPENING A NEW BRANCH OR SUBSIDIARY OVERSEAS TO MAKE IT SIMPLER TO EXPORT

The opportunity to negotiate new and independent trade agreements with foreign markets is a chance to put the internationalisation of mid-sized businesses at the heart of our economic strategy. As and when bi-lateral tax agreements between the UK and other countries are re-negotiated, or a review of the OECD model double tax treaty is undertaken, the UK Government should take the opportunity to agree an exemption for UK businesses when opening a new branch or subsidiary from local taxes up to a de minimis level of economic activity of £1m of total cumulative sales.

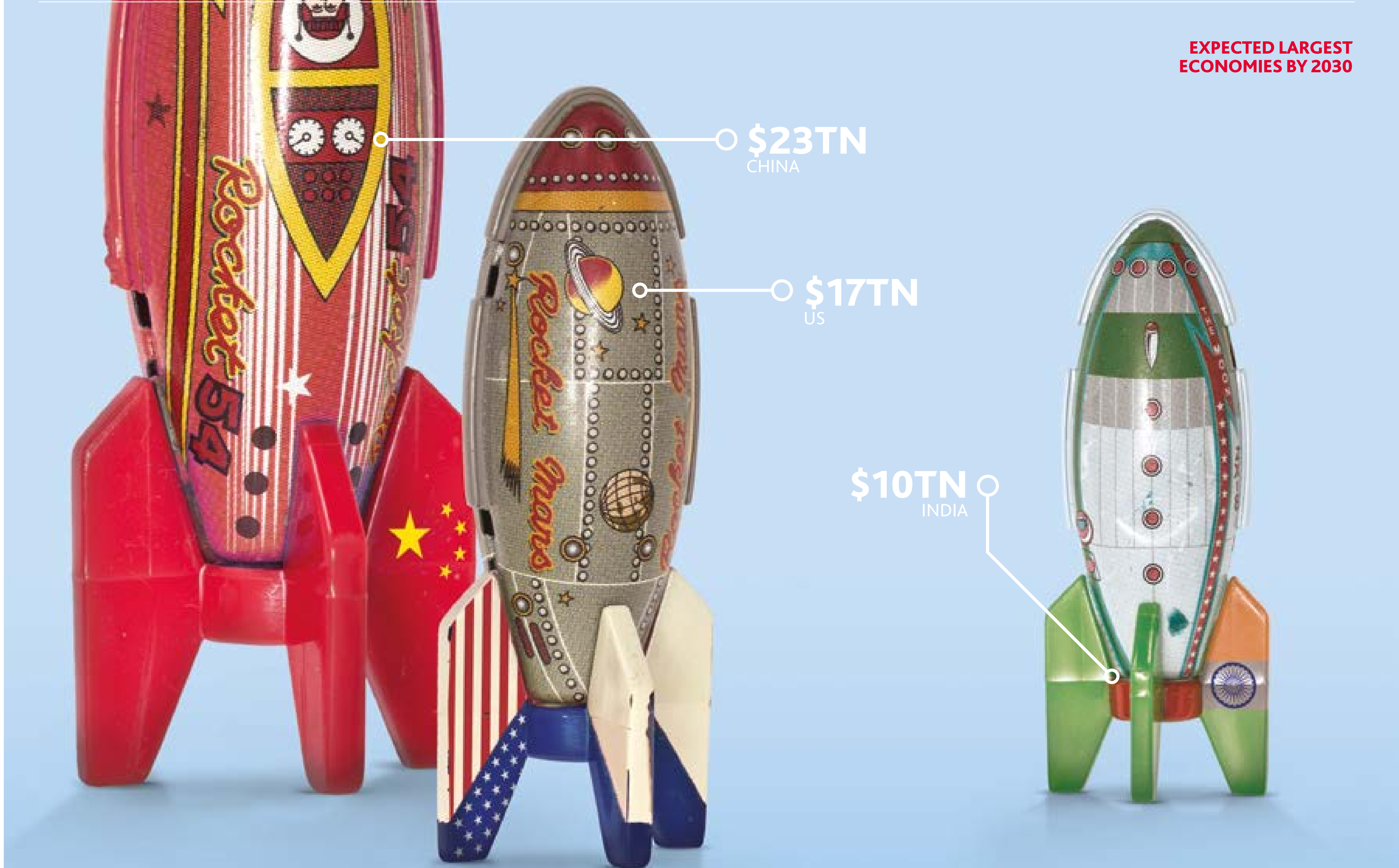
POLICY 19: INTRODUCE A VAT ZERO RATING OF SUPPLIES TO COMPANIES THAT EXPORT TO ENCOURAGE MORE FIRMS TO TRADE ABROAD

The UK currently allows manufacturers to zero rate their exports. However, it is less generous with reliefs for domestic companies that supply to UK exporters. In contrast, Ireland has a more generous relief for regular exporters, where a qualifying exporter is able to inform its suppliers of its export authorisation and those suppliers can then zero rate their supplies to the qualifying exporter. We recommend that the UK introduces a similar relief once EU negotiations are finalised.

POLICY 20: NEGOTIATE NEW TRADE AGREEMENTS IN TANDEM WITH EU BREXIT NEGOTIATIONS

As the UK emerges into its post-EU world it's vital that we continue to remain open for business, push our fast-growing entrepreneurial businesses and take advantage of the opportunities that come with change. There is currently some uncertainty as to whether the UK will be able to negotiate new trade agreements while negotiating Brexit (as the UK would technically still be in the EU and bound by its restrictions on negotiating independent free trade agreements). This restriction must urgently be clarified and the UK allowed to negotiate new agreements beyond the EU so that new markets can open up as soon as Brexit is completed. With this in mind, the Government should identify the priority markets and lay the foundations for more detailed negotiations once Article 50 is invoked. A focus on Commonwealth markets – where relationships already exist and where markets like India, Singapore and Malaysia are growing at a rapid pace – could be a good area to start.

EXPECTED LARGEST ECONOMIES BY 2030



IN FOCUS
▶ DOING BUSINESS IN INDIA BY MILIND KOTHARI, MANAGING PARTNER, BDO INDIA

India is one of the fastest-growing major economies in the world. Relationships between the UK and India are already strong. UK/India bilateral trade in goods and services is around £22bn a year. English is widely spoken in India and both countries have a common legal and administrative history.

There are many reasons why businesses are beating a path to India. India has one of the world's largest youth populations and a growing middle-class consumer market. It also has an established network of banks, financial institutions and a successful capital market. With a growth rate of over 7.5%, it is expected to be the third largest economy in the world by 2030.

There are, of course, challenges too. India is a vast country, made up of 29 different states and seven union territories and its infrastructure, logistics and markets vary considerably from place to place and managing diversity may lead to prolonged administrative processes. There are still some barriers to investment and trading as a result of regulation but these are fast dissipating with the announcement of priority economic initiatives like Make in India, Digital India, Smart Cities, and Housing for All giving a fillip to India's development agenda. Relaxation in policy and opening up of investments in several sectors in the past year has led foreign direct investment to grow by over 30% in 2016.

India is rightly seen as a destination of choice for high-growth UK businesses. As well as an exciting destination today, it has huge potential for the future – especially in sectors such as energy, manufacturing and life sciences.

Source: Angus Maddison, Stats of the Ten Largest Economies

POLICY 21: HARNESS THE POTENTIAL OF HIGH-QUALITY APPRENTICESHIPS TO BRIDGE THE SKILLS GAP, ESPECIALLY IN MANUFACTURING AND TECHNOLOGY SECTORS

People and skills are at the heart of the 'new economy'. For the UK to thrive in a post-Brexit world, we need a trained, highly skilled and diverse workforce which can flex with the needs of the economy and the priorities of business. At the same time, skills shortages are consistently cited by the manufacturing and technology sectors. Government and businesses need to work together to fix this. Two crucial developments will impact strongly on employers shortly.

The first is the advent of the apprenticeship levy in April 2017. Employers with a pay bill greater than £3m per annum will pay 0.5% into a levy. This investment will then be used by employers to offer apprenticeship opportunities to both new and existing staff. Employers now have ownership of the skills system and have worked in groups to design new standards that define the knowledge, skills and behaviours required in every new apprenticeship. Employers can use their influence to select quality providers to deliver the training as well as negotiate the price.

The second key factor is the expansion of Higher and Degree apprenticeships – the fastest-growing parts of the apprenticeship programme. Progression will be pivotal for employers – enabling their staff to do training at Levels 3, 4, 5, 6 and 7. Degree apprenticeships are now a credible alternative to university. Enlightened employers need to understand now that apprenticeships can unearth a new talent pool – a potentially lucrative one where there are demonstrable returns in terms of increased business competitiveness and productivity.

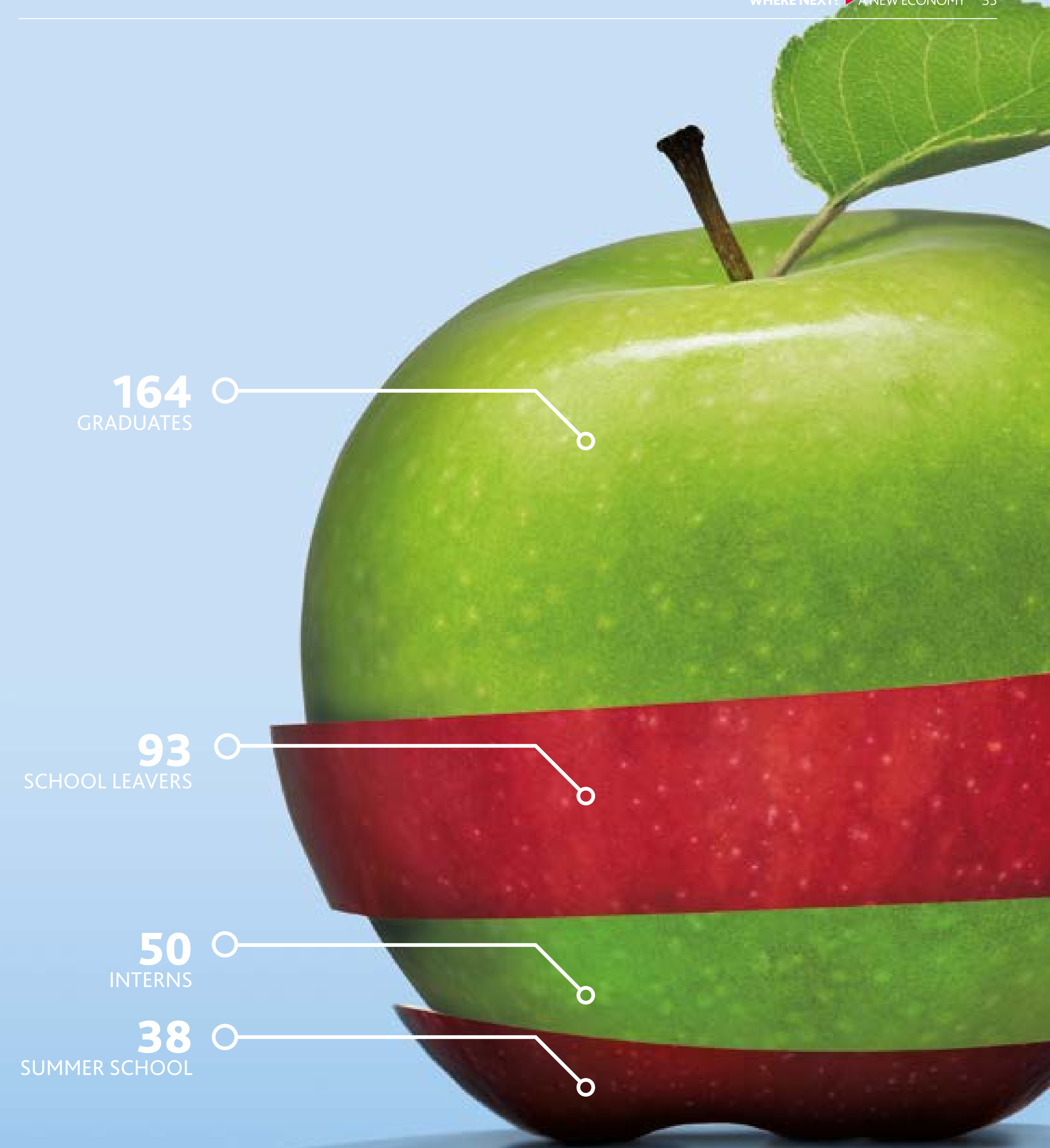
The Government vision is very clear – three million high-quality apprenticeships. With employers in charge, this target can be achieved as long as apprenticeships are synonymous with quality and deliver the skills that employers are calling for. In 2017, a new independent body – the Institute for Apprenticeships – will act as the 'guarantor' of quality. It will be an employer-led body that will also advise on the new Standards.

There are still some additional steps we would like to see taken so that apprenticeships in the UK are improved:

- Reform the Ofsted assessment system for schools to give some weight to the number and quality of apprenticeship places secured by schools. Tracking progress of students to higher-level apprenticeships should sit alongside the numbers of those who have gone onto university
- At the moment the Government target is to have three million people starting apprenticeships, not three million qualified apprentices. The target should be changed so it focuses firmly on outcomes
- Education is a devolved issue but employers are UK-wide. Large employers with branches in England, Wales, Scotland and Northern Ireland will want clarity that the detail of the new apprenticeship standards will be comparable across all four areas (even allowing for some regional fluctuation).

POLICY 22: REINSTATE THE TWO-YEAR POST-STUDY WORK VISA TO HELP ADDRESS THE MANUFACTURING AND TECH SKILLS SHORTAGE

Given the skills shortage in the tech industry, the Government should reinstate the two-year post-study work visas for postgraduates in STEM (science, technology, engineering, maths) subjects.



IN FOCUS
▶ BDO APPRENTICES

In 2017, we announced plans for a further 350 trainees – taking our trainee intake to more than 1,100. Our trainees fit into one of four programmes: graduate, school leaver, summer intern and summer school. Of the 350 places available for 2017, 165 are planned to be graduates, 100 school leavers with the remainder split between the intern programme (six-week placement) and summer school (two weeks).

WHERE NEXT?
▶ A NEW ECONOMY

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