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THE COST OF DOING BUSINESS IN NORTHERN IRELAND

DETI ANALYTICAL SERVICES UNIT
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CONTENTS

GLOSSARY OF TERMS

ABI	Annual Business Inquiry
APD	Air Passenger Duty
ASHE	Annual Survey of Hours and Earnings
ASU	Analytical Services Unit
BBA	British Bankers Association
BETTA	British Electricity Trading & Transmission Arrangements
CBI	Confederation of British Industry
CC	Competition Commission
CER	Commission for Energy Regulation
CPI	Consumer Price Index
CSO	Central Statistics Office (Ireland)
DECC	Department of Energy and Climate Change
DEL	Department for Employment and Learning
DETI	Department of Enterprise, Trade and Investment
DFP	Department of Finance and Personnel
EAG	Economic Advisory Group
EC	European Commission
ERINI	Economic Research Institute of Northern Ireland
FDI	Foreign Direct Investment
FE	Firmus Energy (Distribution) Ltd
FTA	Freight Transport Association
GB	Great Britain
HGV	Heavy Goods Vehicles
HMRC	Her Majesty's Revenue and Custom
I&C	Industrial & Commercial
ICT	Information, Communication and Technology
INI	Invest Northern Ireland
NAV	Net Asset Value
NI	Northern Ireland
NIA	Northern Ireland Assembly
NIC	National Insurance Contributions
NIIRTA	Northern Ireland Independent Retail Trade Association

NIE	Northern Ireland Electricity
NISRA	Northern Ireland Statistics and Research Agency
OECD	Organisation of Economic Co-operation and Development
OFCOM	Office of Communications
ONS	Office of National Statistics
PMI	Purchasing Managers Index
PNGL	Phoenix Natural Gas Limited
QTR	Quarterly Transparency Reports
ROI	Republic of Ireland
SEM	Single Electricity Market
SIC	Standard Industrial Classification
SOC	Standard Occupational Classification
SSC	Social Security Contributions
UR	Utility Regulator

FIGURES AND TABLES

1 INTRODUCTION

Although there have been significant improvements recently, costs remain one of the biggest issues facing local businesses. This study identifies those cost areas which have placed the most pressure on businesses and carries out benchmarking of Northern Ireland's costs against elsewhere.

1.1 Costs and competitiveness

Competitiveness is core to any successful economy. This is particularly true for Northern Ireland, as a small region with a population of just 1.8million competing for trade and investment in a globalised world of over 7 billion people. The NI Economic Strategy[1] has recognised the importance of competitiveness by making it the overarching goal of all economic initiatives.

Costs are a core part of competitiveness for businesses. Lower costs enable firms to be more price competitive when selling their goods and services in export markets, and make NI a more attractive proposition for attracting inward investment. A firm's cost base can also be the difference between survival and closure. Our overall cost competitiveness should therefore be of key concern to policymakers given its importance for exports, FDI and business growth.

1.2 Cost pressures on businesses

During the downturn, businesses have had to deal with a range of pressures such as rising costs, falling demand, tight cash flow, difficulties in accessing finance and low consumer confidence. Figure 1 shows that the InterTradeIreland Quarterly Business Monitor identified rising costs of other overheads (outside of energy) as the largest issue facing businesses earlier in 2015. Rising energy costs are viewed by local businesses as the third biggest issue.

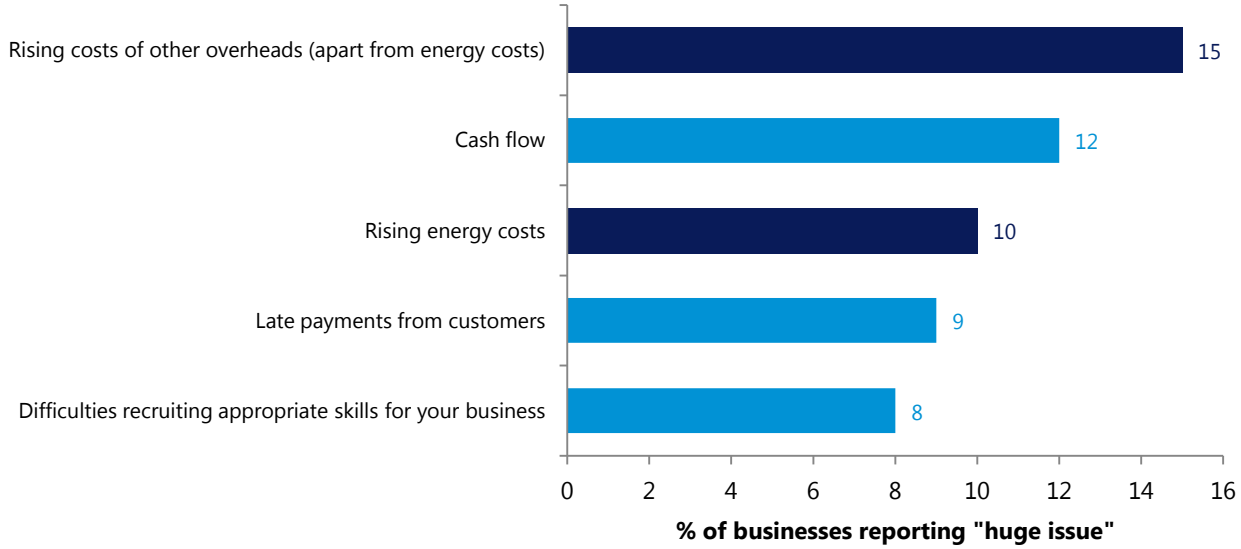
There are clearly still cost pressures facing businesses, although nowhere near to the same extent as a few years earlier. Figure 2 highlights that almost one-half of companies (47%) reported rising energy costs as a huge issue for their business in Q2 2012, which has fallen to just 10% in Q1 2015. Similarly, the proportion of local businesses reporting rising other costs (outside of energy) as a key issue has also fallen from 40% to 15% during this time. This issue of rising costs was widely reported amongst business organisations such as the CBI NI[2], NI Chamber of Commerce[3][4] and Federation of Small Businesses[5].

1.3 The difference between costs and prices

An important distinction needs to be made at the outset between costs and prices. Costs are what businesses pay, but this is determined both by the price charged and their usage. Businesses can therefore have an increase in their cost base which is not down to rising prices. For example, if a business employs

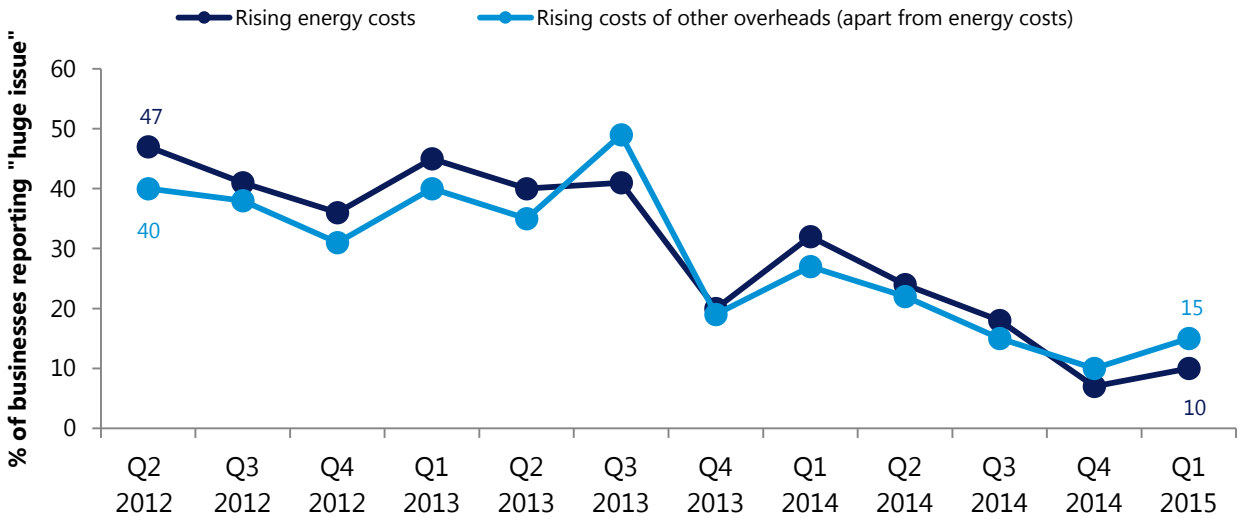
more people its labour costs will rise, even if the salary it is paying the new employees is lower. Similarly, producing more goods or services may require greater energy usage – thus increasing energy costs – even if the price charged by suppliers is unchanged. It is therefore high or rising prices which are of most concern rather than costs. This study will refer to both costs and prices depending on what is being covered.

Figure 1: Top Five NI Business Issues, Q1 2015



Source: InterTradeIreland Quarterly Business Monitor

Figure 2: Cost Issues for NI Firms, 2012-15



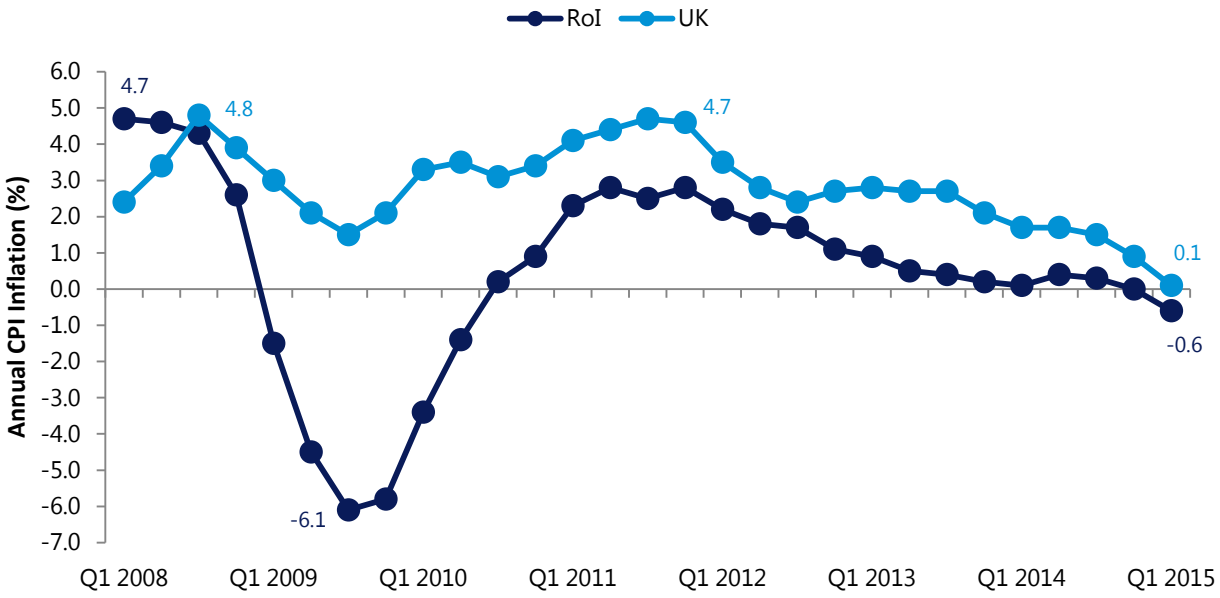
Source: InterTradeIreland Quarterly Business Monitor

1.4 Price inflation during the economic downturn

Information on price inflation is not available at an NI level, so the UK is used as the most appropriate proxy. Although the UK data available is based on consumer price inflation, many of the increases (such as energy

and transport) will also impact significantly on businesses. As shown in Figure 3, price inflation was a key issue during the economic downturn, peaking at almost 5% in 2008 and 2011 in the UK. The ROI, in contrast, faced much lower inflation and even a period of deflation. UK (and NI) businesses are therefore likely to have faced greater pressures in these areas than businesses across the border where inflation was much lower. More recent data shows that these inflationary pressures are no longer evident in the UK[6] or ROI[7].

Figure 3: UK and ROI Inflation, 2008-15



Sources: ONS, CSO

Table 1 presents a breakdown of UK price inflation for some of the main areas which will feed through to business as well. Two defined periods have been chosen – one covering the period of higher inflation (January 2007 to December 2013) and the other looking more recently (January 2014 to March 2015). This highlights that the significant levels of price inflation amongst key business costs during 2007-13 has now eased and, in some cases, there is now deflation for energy and fuels.

Table 1: Breakdown of UK Inflation, 2007-15

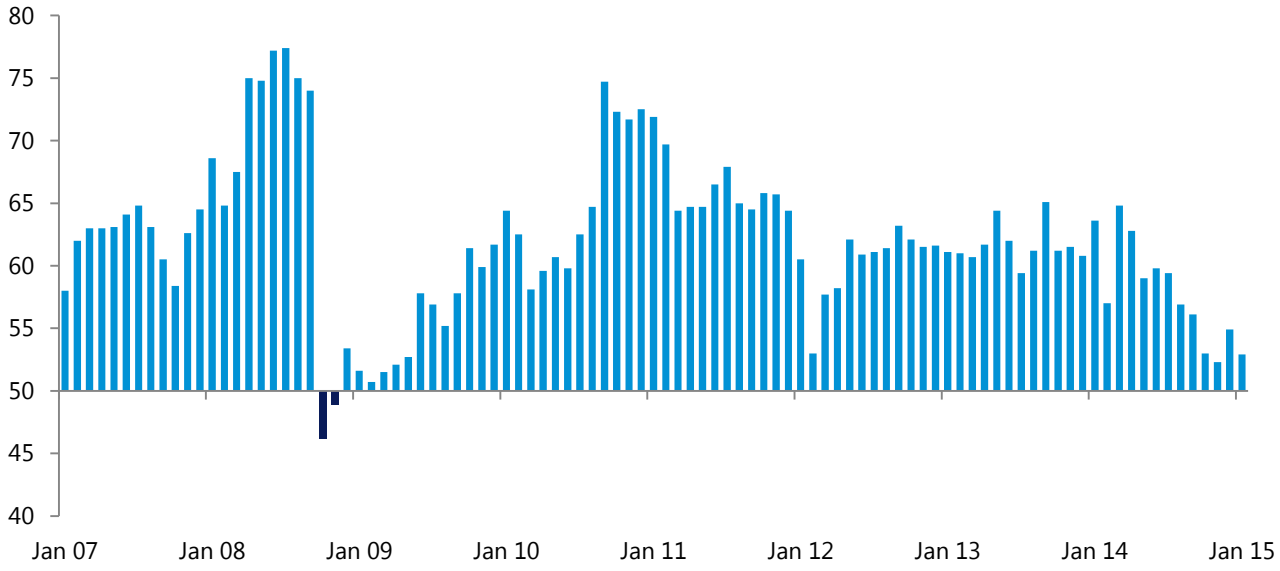
	Change 2007-13	Change 2014-15
Electricity, gas and other fuels	+58%	-3%
Water and sewerage	+37%	+2%
Fuels for personal transport vehicles	+51%	-14%
Passenger transport by air	+96%	+12%
Passenger transport by railway	+41%	+4%

Source: ONS

Given these historic inflation trends, it is unsurprising that businesses have faced rising input costs. The Ulster Bank PMI[8] provides a useful measure of price inflation for businesses; whilst it cannot provide percentage changes, it does show the 'balance' of businesses reporting increases against deceases. Figure 4

demonstrates that many more companies have been reporting cost increases than cost decreases for much of the last seven years. In line with the inflation data, this appears to have been easing more recently.

Figure 4: Change in Input Costs



Source: Ulster Bank PMI

Note: The PMI shows the balance of firms reporting increasing against decreases – values above 50 denote more firms reporting increases than decreases and values below 50 mean more companies are reporting decreases than increases.

1.5 Objectives and methodology

A comprehensive assessment of the local business cost base was last carried out in 2005 by ERINI.[9] This found that energy and insurance costs in NI were higher than in GB, but that lower labour and property costs meant the overall costs were broadly similar. However, a significant amount has changed since then. The overall aim of this study is:

To assess the burden on businesses of rising costs and benchmark how the local cost base compares against elsewhere

To achieve this, the specific objectives of the research are:

- To profile the business cost base across a range of sectors;
- To identify which types of costs in particular have been driving changes;
- To benchmark business costs against elsewhere in GB and other relevant economies;
- To provide an overall assessment of the relative NI cost base; and
- To identify key cost issues which need further investigation going forward.

This research has taken in a wide range of activities to provide a comprehensive assessment of cost competitiveness. Rather than solely being focussed on data analysis, our overall cost assessment also takes in a business survey (carried out as part of the InterTradeIreland Quarterly Business Monitor), case studies and consultations with government representatives.

For a brief overview of the key points from this analysis, please see the **Executive Summary**. This **Main Report** acts as a comprehensive review of the main cost areas. It is supplemented by three appendices which provide much more information on all cost areas and act as standalone reports in their own right:

- **Appendix A** presents the full business survey results;
- **Appendix B** compares the survey findings against other sources; and
- **Appendix C** provides a complete cost benchmarking assessment.

This research is intended to build on the report published back in 2013 on developing an NI Competitiveness Index[10] and to complement the ongoing work by the Economic Advisory Group on competitiveness. Those studies look at the overall competitiveness of an economy, whereas this research is focussed solely on costs. This approach begins to bring NI closer to the approach taken by Forfás with the National Competitiveness Council, who produce separate reports on overall competitiveness[11] and costs[12].

It is important to note at the outset that this study is looking solely at costs and does not cover other areas which will impact on business finances such as taxation. Taxation is an important business issue that determines returns on investment, and is particularly relevant given the potential future devolution of Corporation Tax, but it is outside the scope of this research.

The remainder of this report will consider which cost areas are most important for businesses (Chapter 2), before reviewing these costs in more detail (Chapters 3-7) and bringing together this information to provide a complete cost assessment (Chapter 8). Finally, a summary of key findings and discussion on potential areas to explore in the future is outlined (Chapter 9).

2 BUSINESS COST PROFILES

A survey of 1,000 businesses was carried out to identify how important each cost area was to them. Labour is consistently shown to be the largest cost for companies, with other significant costs reported as being energy, property and transport costs.

2.1 Measuring business costs

Any cost assessment must understand which areas are most important for businesses; a 50% rise in a very small cost will be nowhere near as important as a 5% rise in a very large cost. This requires developing cost profiles, which breakdown overall costs into each relevant area. Costs also needs to be considered at sectoral level to take into account the differences between businesses. Three main options were identified at the outset to provide this information:

1. The **NISRA Annual Business Inquiry**, which was the main data source used to develop cost profiles in the previous ERINI work back in 2005. This has the advantage of being an official government dataset across much of the private sector, but only provides information on a limited range of cost variables;

2. **Case study consultations** with companies, which is the approach used by Forfás to develop cost profiles in their report. This collects tailored information across all cost areas, but is unlikely to be representative given the time limitations in carrying out case studies, meaning only a small number can be carried out; and

3. A **business survey** carried out by InterTradeIreland through their Quarterly Business Monitor. This allows for tailored information to be captured across all cost areas for a wide range of sectors from a survey of 1,000 businesses in NI and ROI via a telephone survey.

All three approaches were pursued by the research team, and a comparison of the results that each produced is presented in Appendix B. The main source used to profile costs in this report is the InterTradeIreland business survey; no other option could provide the scale, coverage and consistency of results across each cost area needed to deliver a comprehensive cost review. All the data presented on the importance of cost areas, cost increases/decreases and steps to reduce costs are therefore taken from the business survey. Headline results have been weighted to be representative and turnover has been used as the common cost denominator to provide consistent measurement across companies of all different sizes.

Appendix B shows that different approaches give different figures. In particular, the business survey tended to produce larger estimates than the others, suggesting that respondents may overstate the importance of costs for their businesses. This is likely down to the method of collecting information (telephone), even though interviews were held with the company Finance Director or the person most knowledgeable about

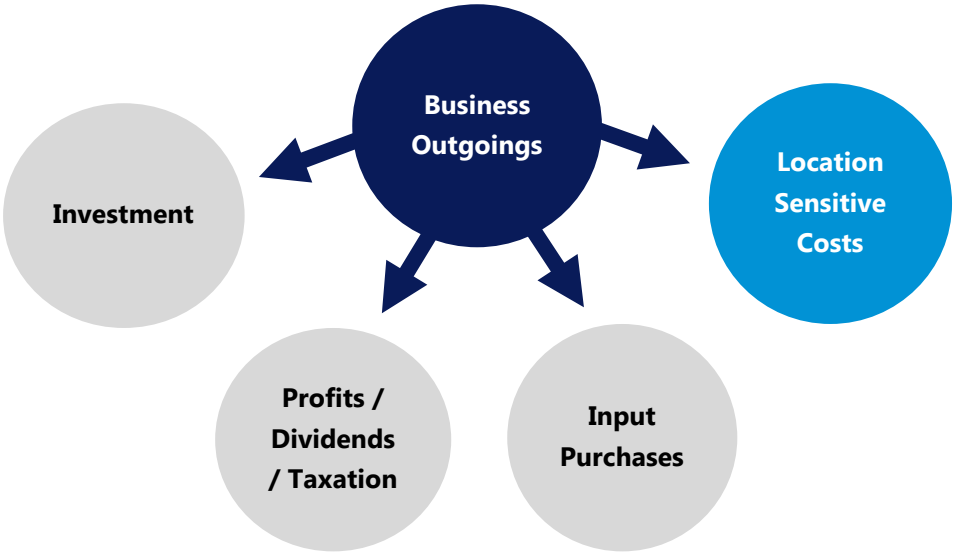
their financial situation. The ideal method of collecting financial information is via postal survey, but unless this is statutory it tends to suffer from poor response rates (as seen in the ERINI work which only received 90 responses and meant the results could not be used to the extent needed). The ABI does provide a statutory postal survey, but the data only covers a limited range of cost areas this study is concerned with.

Although the figures may therefore differ depending on what approach is chosen, the key messages coming out from them are largely the same. Therefore, rather than focusing on each specific individual figure, it is the *relative* importance of cost areas and sectors against one another which are important to note. The figures set out in this main report are taken from the business survey.

2.2 Location-sensitive costs

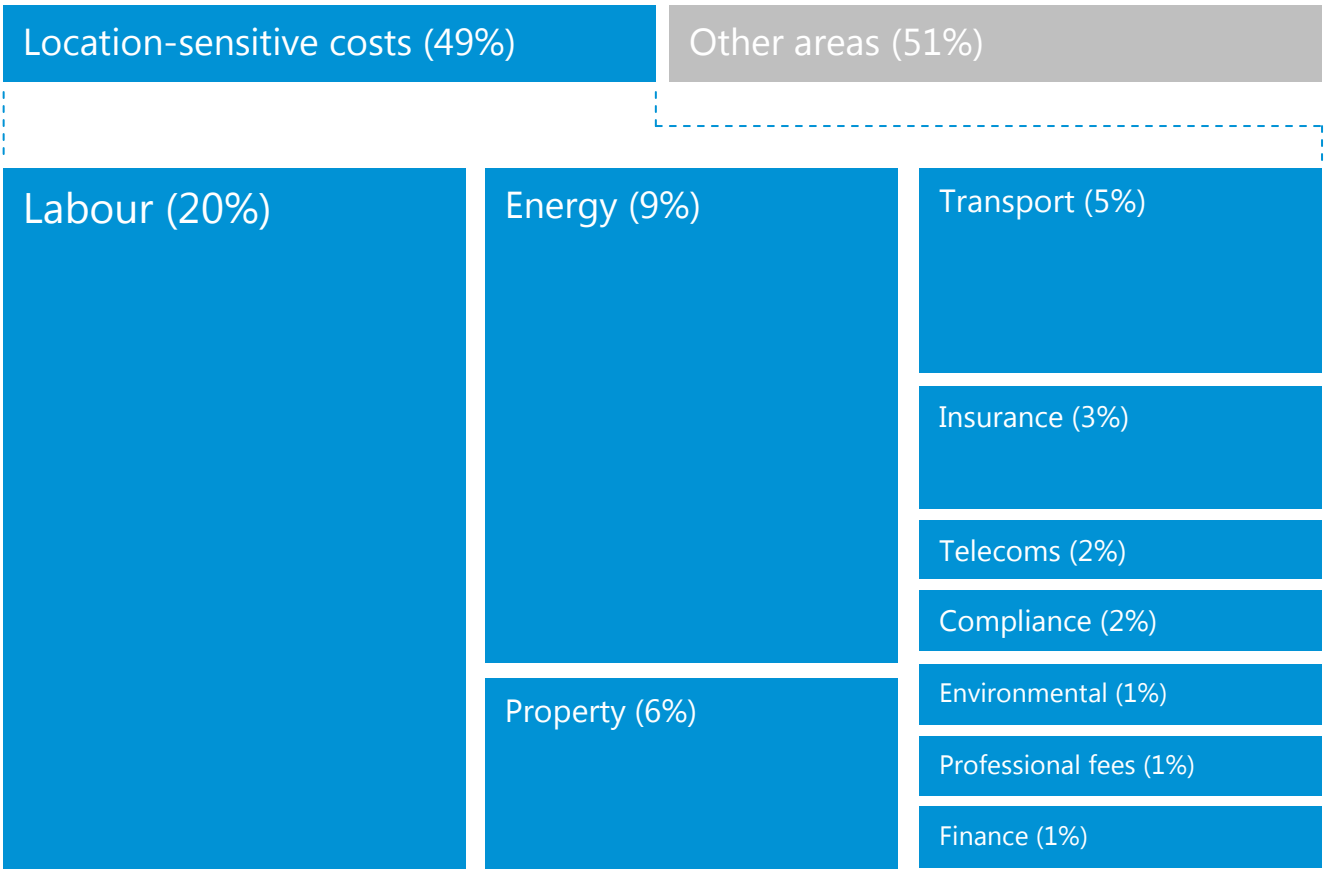
This study is concerned about 'location-sensitive' costs – those areas where companies generally have to chose from suppliers or have costs imposed at a local level – rather than other areas of expenditure which can be more influenced by business decisions (like whether to invest in equipment, retain profits or where to purchase goods/services that are used to produce a product). This is highlighted in Figure 5.

Figure 5: Overview of Business Outgoings



Location-sensitive costs were found to represent almost one half (49%) of turnover for NI companies, with a breakdown of these costs shown in Figure 6. This highlights that labour costs are the largest cost area for businesses, followed by energy, property and transport. These four areas account for over 80% of business costs and are equivalent to 40% of total turnover. The remaining costs are less significant, although there will undoubtedly be individual companies where these areas are much more important (e.g. finance for businesses with large property overhang).

Figure 6: Breakdown of Business Costs, as % of turnover



Source: InterTradeIreland Business Survey

2.3 Sectoral business costs

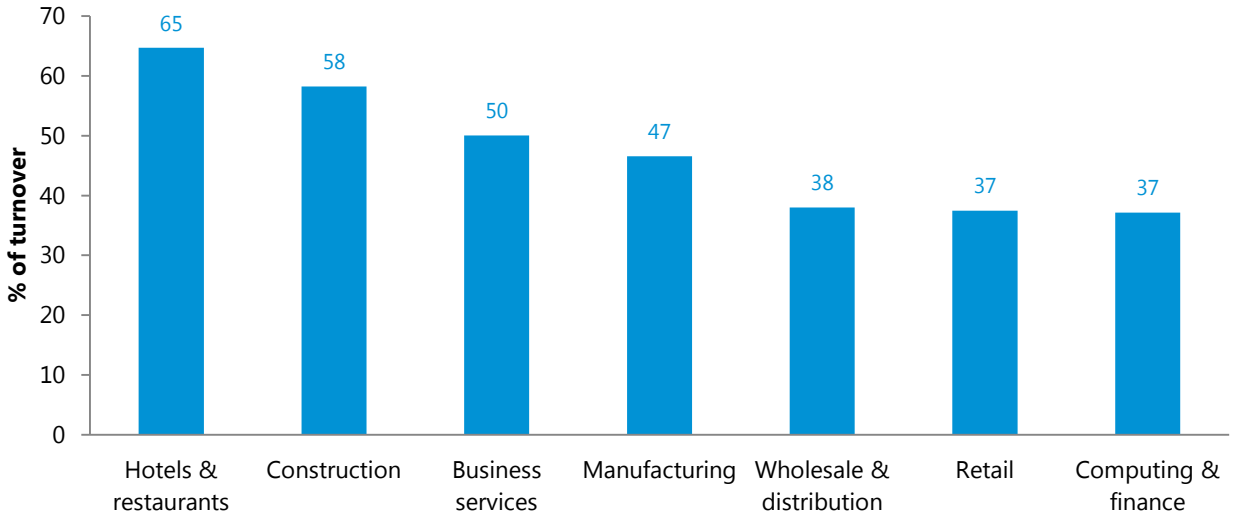
The figures presented above show how important costs are for the 'average' company, and therefore – at a macro level – which are most important for the NI economy. However, in reality costs vary greatly by sector depending on what activities a firm does.

A breakdown of the importance of location-sensitive costs by sector is provided in Figure 7. This highlights that hotels & restaurants and construction have the greater reliance on costs determined by doing business in NI, and are therefore most likely to be impacted by local cost changes. Conversely, wholesale & distribution, retail and computing & finance have the least reliance on location-sensitive costs.

An assessment of the most important business costs by sector is presented in Table 2 (with the full supporting breakdown available in Appendix A). Labour costs are consistently shown to be a key area for businesses, making up the largest percentage of turnover across all sectors. Energy costs are important across sectors, particularly hotels & restaurants, manufacturing and construction. Transport costs are significant in sectors which tend to need to move goods around, whilst property costs are important for a number of sectors but mainly those with large services-based operations. Insurance and compliance costs are somewhat important for a few sectors, but the remaining cost areas all tend to be less important (<3% of turnover).

It is evident that some cost areas are much more important to businesses than others. Over the next four chapters, this report will focus on those cost areas which have the greatest impact on businesses – namely labour, energy, property and transport. Brief consideration is given to the other cost areas in chapter 7, although a fuller cost assessment is provided in Appendix C for every cost type.

Figure 7: Location-sensitive Costs by Sector



Source: InterTradeIreland Business Survey

Table 2: Business Costs by Sector

% of turnover	Very important (>10%)	Important (5-10%)	Somewhat important (3-5%)
Manufacturing	Labour	Energy Transport	Property
Construction	Labour	Energy Transport	Property Insurance
Business services	Labour	Property Energy	Transport
Computing & finance	Labour	Energy Property	Transport Compliance
Hotels & restaurants	Labour Energy Property	-	Insurance
Retail	Labour	Property Energy	Transport
Wholesale & distribution	Labour	Energy Transport	Property

Source: InterTradeIreland Business Survey

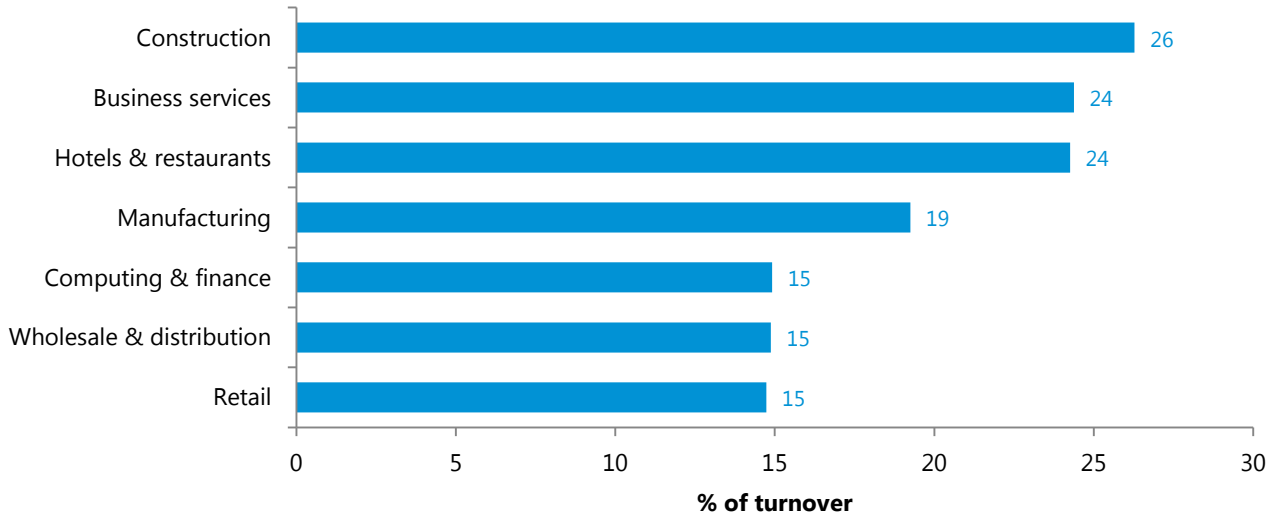
3 LABOUR COSTS

Labour is the largest cost area for businesses, and in general has not been putting significant cost pressures on businesses. This is a key area of competitive cost advantage for Northern Ireland, which has significantly lower private sector wages compared with the UK, Republic of Ireland and further afield.

3.1 The importance of labour costs

Labour is the largest cost area for local businesses, accounting for 20% of turnover on average according to our business survey. Figure 8 highlights a significant degree of variation by sector depending on the activity being carried out, from retail at just 15% to construction at 26% of turnover. A small number of firms – mainly in hotels & restaurants and construction – are very labour intensive and are therefore very sensitive to local labour costs.

Figure 8: Sectoral Labour Costs



Source: InterTradeIreland Business Survey

3.2 Benchmarking labour prices

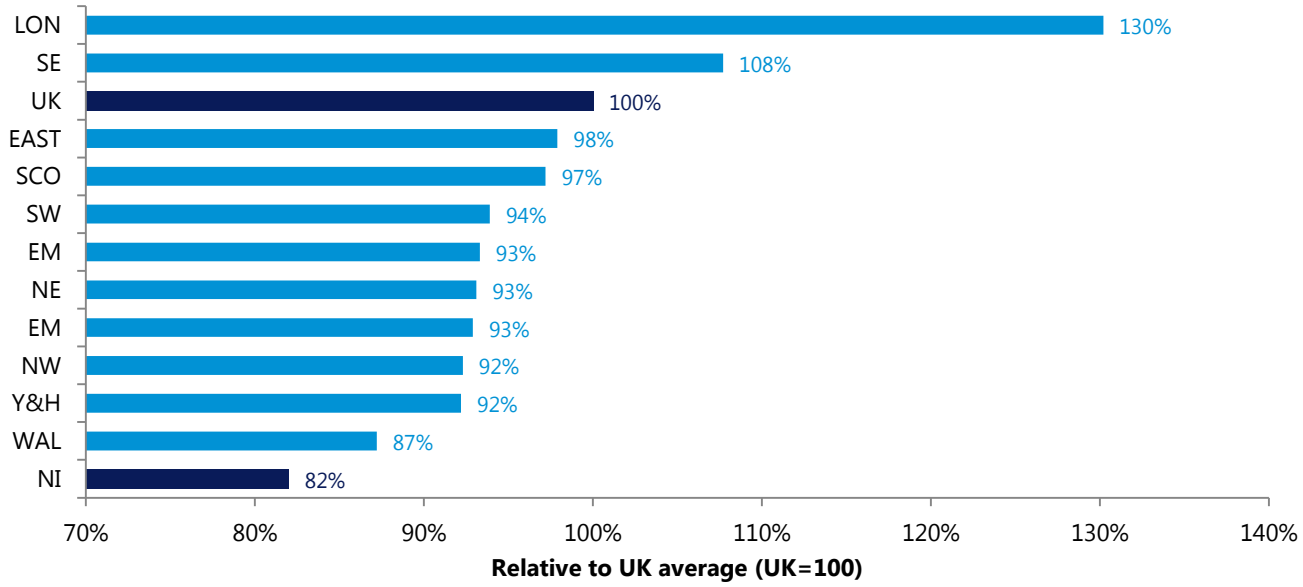
Labour costs are largely determined by the number of people employed by a company and the wages they pay them. Private sector wages are therefore the main area considered in the cost benchmarking, although other factors such as minimum wage rates and national insurance/social security contributions are also reviewed briefly. There is a significant amount of information available in the area of labour costs, which

allows for a robust assessment of NI against elsewhere by occupation and sector. A full cost assessment of NI wages is presented in Appendix B, with the key findings highlighted in this chapter.

Private sector wages within the UK

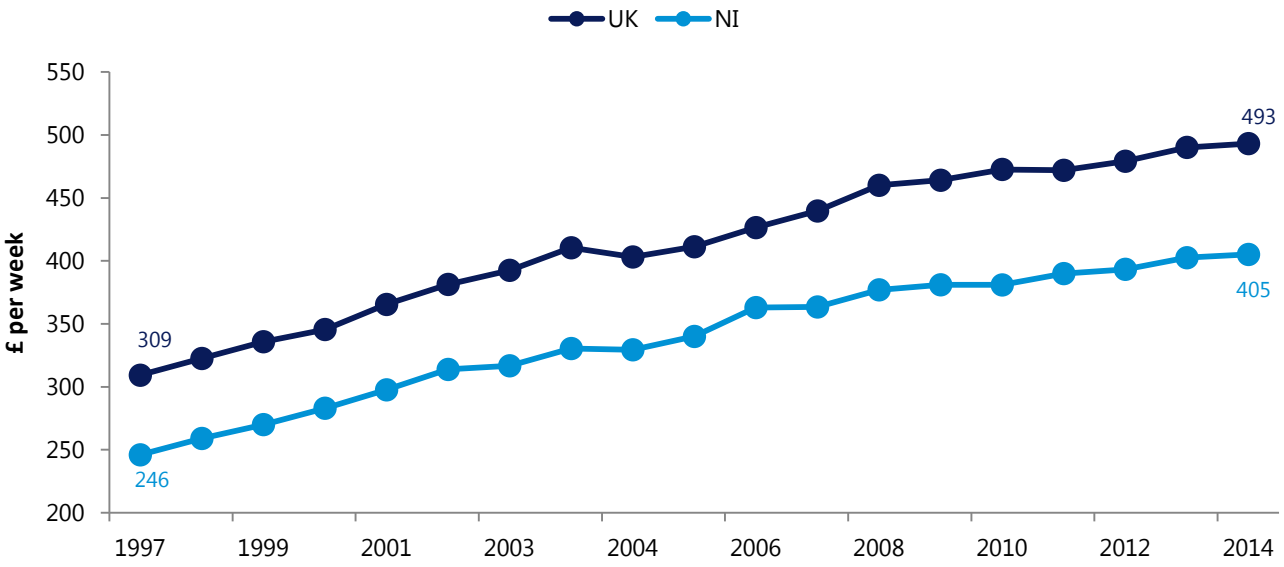
In 2014, the full time NI median wage was £457 per week, which is 88% of the UK average. However, this figure includes the public sector where NI pay is in line with the rest of the UK. Focusing solely on the private sector – which is most relevant for this study – NI earnings of £405 per week are 82% of the UK average and below all regions (see Figure 9). Figure 10 highlights that private sector wages have been significantly lower than the UK for decades, remaining at or just above 80% of the UK average since 1997. The closest NI private sector wages have come to the UK average is 85% in 2006, but the differential has widened again more recently.

Figure 9: UK Full Time Private Sector Wages, 2014



Sources: NISRA and ONS Annual Survey of Hours and Earnings

Figure 10: Private Sector Wages, 1997-2014

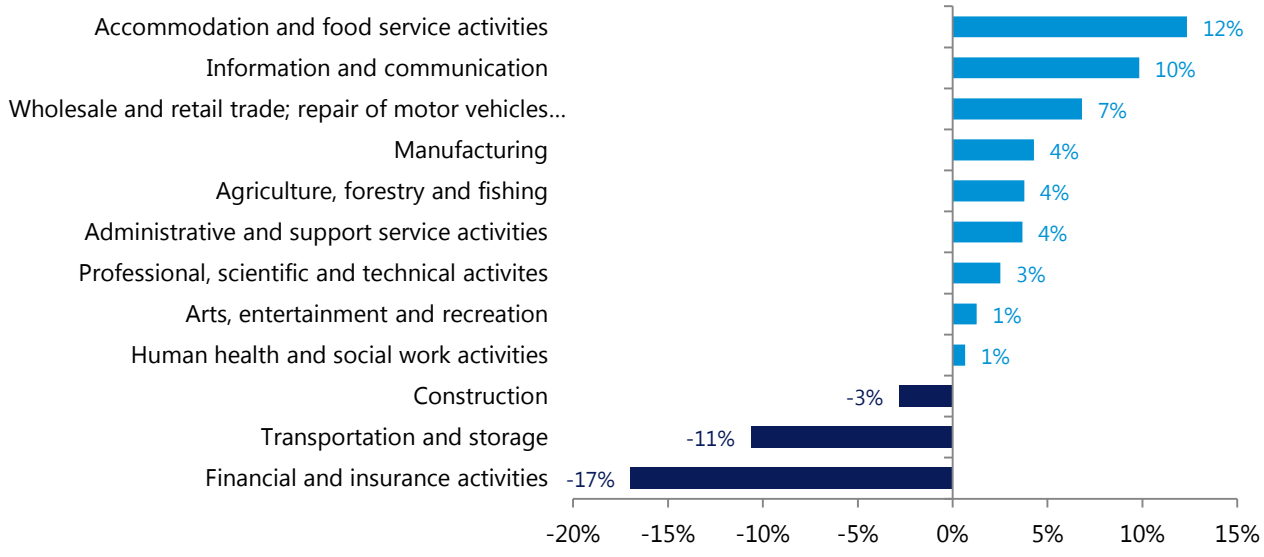


Sources: NISRA and ONS Annual Survey of Hours and Earnings

Sectoral wages

There is a significant degree of variation in wage levels by sector within NI. For example, information and communication has private sector wages 52% above the NI average, whereas accommodation and food services is 31% below. Looking at wage changes by sector, Figure 11 shows that three of the 12 sector groups reported wage decreases during 2011-14, with financial services salaries decreasing by 17% over three years. Of the nine sectors that experienced increases, the largest rises were evident in accommodation & food services (+12%) and information & communication (+10%).

Figure 11: Change in NI Median Private Sector Wages (SIC), 2011-14



Source: NISRA Annual Survey of Hours and Earnings

Relative to elsewhere within the UK, NI remains highly wage competitive largely across the board. Table 3 demonstrates that NI has lower wages across all sectors compared with London, and almost all sectors relative to Scotland, Wales and the North East.

Table 3: NI Private Sector Wages vs UK Comparators, 2014

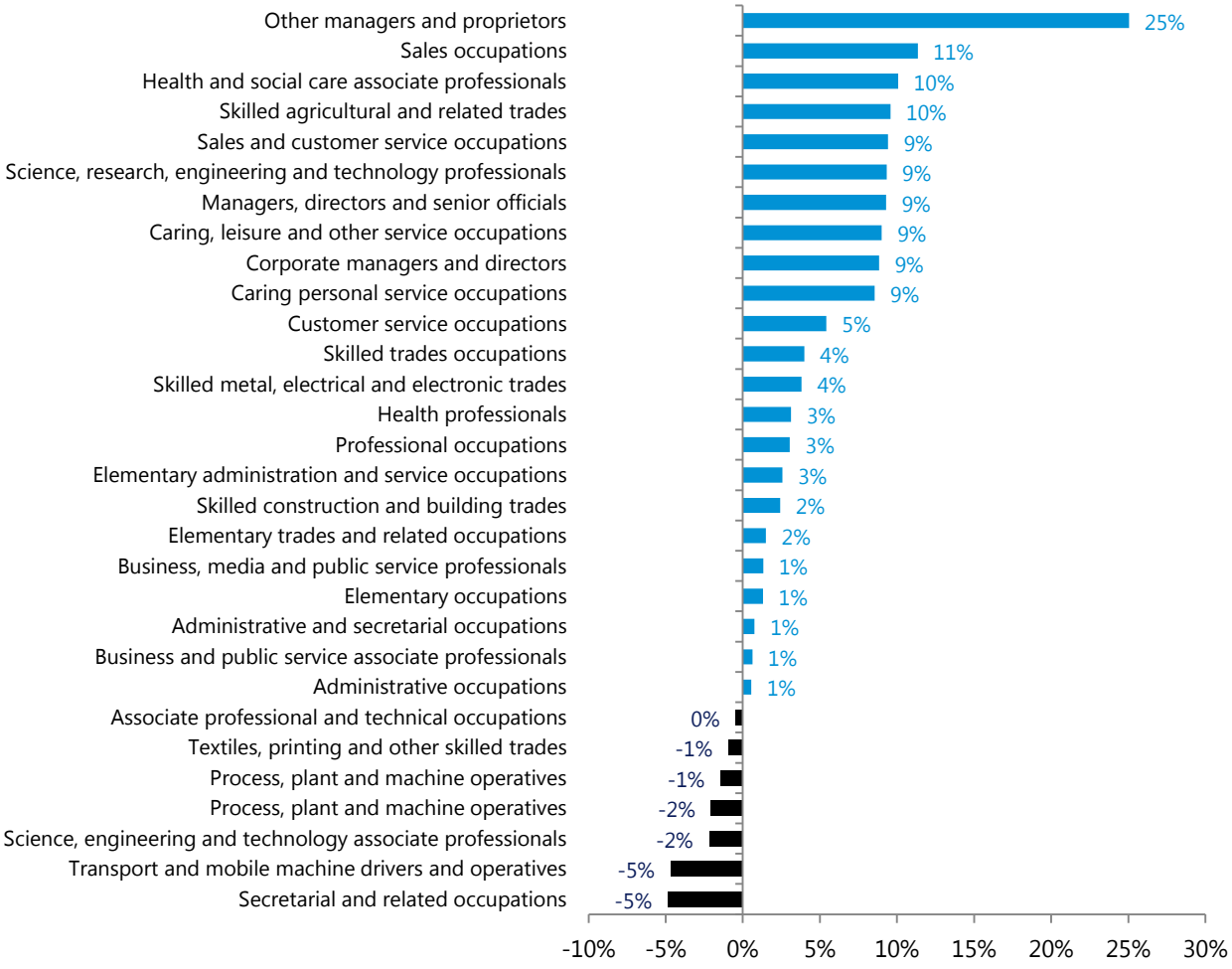
Number of sectors	London	Scotland	Wales	North East
Much lower (more than 10%)	11	9	3	5
A bit lower (between 2% and 10%)	0	1	4	4
Similar (less than 2% either way)	0	0	3	0
A bit higher (between 2% and 10%)	0	1	1	1
Much higher (more than 10%)	0	0	0	1

Sources: NISRA and ONS Annual Survey of Hours and Earnings

Occupational wages

During 2011-14, Figure 12 highlights that most occupations (23) reported wage increases. Other managers and proprietors clearly experienced the greatest pay rise at 25% in three years, followed by sales occupations (11%) and health & social care professionals (10%). Seven occupations reported wage decreases, with the largest falls in secretarial & related occupations and transport & machine drivers (both -5%).

Figure 12: Change in NI Median Private Sector Wages (SOC), 2011-14



Source: NISRA Annual Survey of Hours and Earnings

Compared with selected comparators elsewhere in the UK, NI again remains a highly cost competitive location. Private sector wages are lower across all occupations compared with London and Scotland. Even compared with the North East and Wales – the next lowest wage regions within the UK – most occupations demand lower wages. From a company perspective, this offers significant cost advantages to operating in NI.

Table 4: NI Private Sector Wages vs UK comparators, 2014

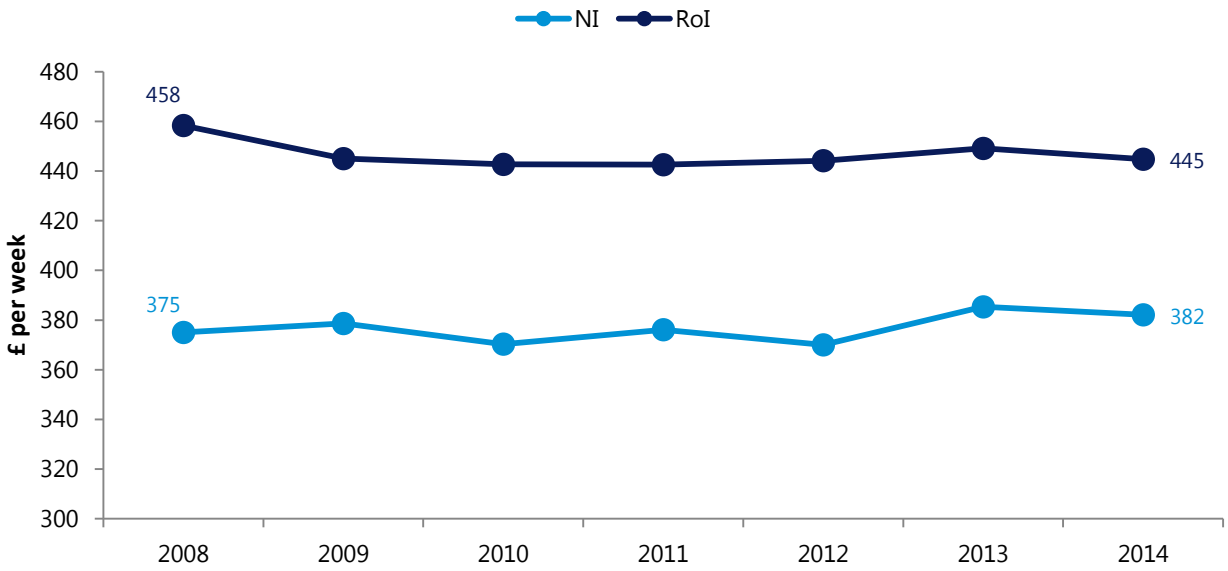
Number of occupations	London	Scotland	Wales	North East
Much lower (more than 10%)	30	21	6	15
A bit lower (between 2% and 10%)	0	8	21	8
Similar (less than 2% either way)	0	1	0	4
A bit higher (between 2% and 10%)	0	0	0	3
Much higher (more than 10%)	0	0	3	0

Sources: NISRA and ONS Annual Survey of Hours and Earnings

Comparisons with Republic of Ireland

Data limitations prevent a full comparison of NI private sector wages (other than at a headline level) with those in the ROI from official sources. Figure 13 compares NI private sector wages with CSO data on average wage levels in ROI[13]; this data is mean wages for all private sector employee jobs (FT and PT) and will not match other NI figures referenced earlier in this report which are for the FT median. This highlights that NI private sector wages in 2014 were 86% of the ROI average – a significant advantage but a closing of the gap since 2008 (when NI wages were just 82% of the ROI).

Figure 13: NI and ROI Private Sector Wages 2008-14



Sources: NISRA Annual Survey of Hours and Earnings; CSO Earnings, Hours and Employment Costs Survey

Note: ROI figures converted at a rate of €1 = £0.72

FDI salary benchmarking

Wages are a key determinant of the location decisions made by foreign investors, and analysis has been carried out to consider NI as an investment location from a business perspective. In order to ensure the benchmarking is relevant, 60 comparator locations have been identified based on where our FDI comes from, whom our main competitors for this FDI are and, finally, where our outward FDI tends to go to. These locations were identified from analysis of historic FDI trends and input from Invest NI and demonstrate where wages are likely to have been a key factor influencing decisions (see in Table 5).

Table 5: List of FDI Comparator Cities and/or Regions

UK & ROI	Europe	North America	Other
Bristol, UK	Brussels, Belgium	Montreal, Canada	Sydney, Australia
Cambridge, UK	Sofia, Bulgaria	Toronto, Canada	Sao Paulo, Brazil
Cardiff, UK	Prague, Czech Republic	California, US	Hong Kong, China
Glasgow, UK	Talinn, Estonia	Colorado, US	Shanghai, China
Leeds, UK	Paris, France	Connecticut, US	Cairo, Egypt

London, UK	Cologne, Germany	Illinois, US	Mumbai, India
Manchester, UK	Budapest, Hungary	Minnesota, US	Bangalore, India
Newcastle, UK	Vilnius, Lithuania	New York, US	Tokyo, Japan
Newport, UK	Amsterdam, Netherlands	North Carolina, US	Casablanca, Morocco
Northern Ireland, UK	Krakow, Poland	Rhode Island, US	Manila, Phillipines
Reading, UK	Warsaw, Poland	Ohio, US	Singapore, Singapore
Cork, ROI	Bucharest, Romania	Pennsylvania, US	Johannesburg, South Africa
Dublin, ROI	Bratislava, Slovakia		Bangkok, Thailand
Galway, ROI	Barcelona, Spain		Ho Chi Minh City, Vietnam
Limerick, ROI	Esbjerg, Sweden		Abu Dhabi, UAE
	Stockholm, Sweden		Dubai, UAE
	Geneva, Switzerland		

To assess how wage competitive NI is for investors, benchmarking data from fDi Intelligence has been gathered across 51 typical FDI roles spanning contact centres, film & television, finance, manufacturing, R&D, shared services and HQ activities and software. An overall average covering each role has been calculated for every location and then benchmarked against NI's average, as shown in Figure 14 overleaf.

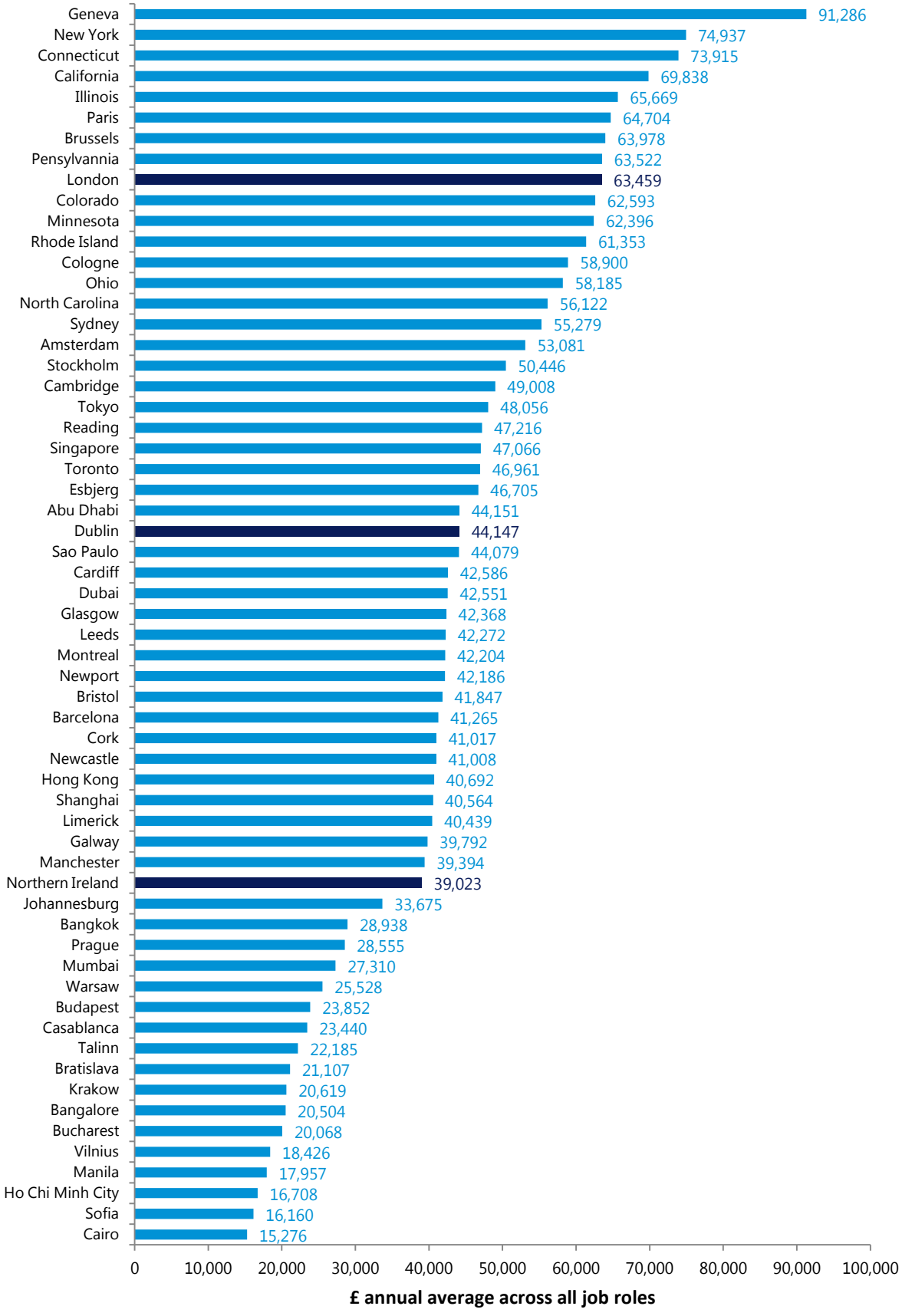
The overall NI average salary cost across 51 typical FDI roles was £39,023. It should be noted that this is the average salary for a broad range of potential job roles which investors may seek, rather than the actual average FDI salary. It is also a mean average across all roles – some of which are senior roles which offer very high salaries – which will skew the average figure upwards. For example, 34 FDI job roles attract salaries below this average, whilst just 17 are above it.

NI was ranked 43 out of 60 locations; this means that 42 locations were more expensive for these job roles and 17 were less expensive. Looking at the data in terms of broad geography:

- **UK and ROI:** NI has lower FDI salaries compared with all 14 benchmarks within the UK and ROI, with the closest cities being Manchester, Galway and Limerick;
- **Europe:** NI offers lower wages than 8 of the 17 comparators, all of which are in Western Europe. 9 of the 17 locations are more wage competitive than NI, all of which are in Central and Eastern Europe;
- **North America:** NI offers significant wage advantages against all 12 of the US and Canadian benchmarks, with the closest being Montreal;
- **Rest of World:** NI has lower FDI wages that 8 of the 16 benchmarks, most of which are in richer developed economies such as Australia and Singapore (although not all). The remaining 8 locations with lower wages than NI are all in developing economies such as Egypt, Vietnam and the Philippines.

The overall outcome of this analysis suggests that NI has competitive labour costs compared with competitors in the UK, ROI, Western Europe and North America. For investors seeking a location with the infrastructure and skills normally found in a developed economy, NI offers a highly competitive location in terms of wages. However, whilst NI *is* competitive it *is not* low cost; as shown by the significantly lower wages in developing countries. Investors seeking more labour intensive and lower skilled labour are therefore unlikely to be as attracted to any developed economy, including NI.

Figure 14: FDI Average Salary Cost for Key Job Roles, 2014



Source: fDi Intelligence

Social security contributions

Comparing and contrasting Social Security Contributions (SSCs) that businesses must pay is complex as every country operates different systems. UK employer National Insurance Contributions vary depending on salary levels and employee status of the individual, with the highest rate of 13.8% paid for many employees with earnings over £153 and all employees that earn £770 and above each week. There is no upper limit to UK National Insurance Contributions (NICs) which are applied equally across all regions, including NI. The ROI has two rates of employers Pay Related Social Insurance of 8.5% for earnings up to €356 and 10.5% above this.

OECD data on the 'tax wedge' of its members[14] demonstrates that 9.8% of UK labour costs are due to employer SSCs, which ranks 12th out of the 34 OECD economies. This is almost identical to the ROI (9.7%) and significantly below countries such as France (29%), Czech Republic and Estonia (both 25%). However, some countries (such as the US and Japan) have progressive rates which get smaller as salaries get bigger, whereas others have maximum contribution limits where employer SSC is no longer payable (such as Canada, Germany and Switzerland). This means that the UK – which does not have a limit on NICs – is less competitive for the highest paid jobs, although at a regional level this is more likely to be an issue for high wage areas such as London rather than for NI.

Minimum wage levels

The latest UK minimum wage rate (age 21 and above) is £6.50[15], which has risen on average by 2.3% annually between 2010 and 2014. In monetary terms, UK monthly minimum wages are the sixth highest in Europe[16], below France, ROI, Netherlands, Belgium and Luxembourg. However, this kind of comparison is not appropriate by itself as average wages vary greatly between countries. OECD data on minimum wages as a percentage of the median wage in each economy[17] places the UK firmly in the middle (14th) of the 27 economies where data is available, marginally lower than the ROI (13th). This suggests that doing business in the UK is not providing any major advantages or disadvantages in terms of minimum wages.

Within the UK, there is no regional variation in minimum wage rates, which means that NI faces the same rate as all other regions. However, there is an argument that the minimum wage is a bigger burden for businesses in NI, where average wages are below all other parts of the UK meaning any increases could impact on a larger proportion of companies.

3.3 Labour costs changes

Labour costs are unlike other cost areas – rather than facing a price imposed by a supplier, it is ultimately the decision of firms as to what wage levels are offered to staff. It is the one cost area where higher prices tend to deliver a better return, with higher salaries tending to attract more experienced or higher skilled staff. However, companies are in a competitive market for both hiring and retaining staff, and the wages that companies have to offer will be driven by both the supply of skilled labour and the demand amongst competitors.

Table 7 highlights that around one-third of local businesses reported rising labour costs during 2013, the fifth highest of all 'location-specific' costs. This compares with just one-fifth (20%) of ROI firms increasing their labour costs. For those local firms with rising labour costs, the large majority reported less than a 10% increase, with only 4% of firms having significant labour cost increases over the year.

A significantly higher proportion of firms that are growing and exporting have been increasing their labour costs, which is unsurprising given that they are much more likely to have been expanding their workforce; this does suggest that increased costs come more from increasing headcount rather than any large rises in wages. Growth firms have had particularly large rises in labour costs during 2013.

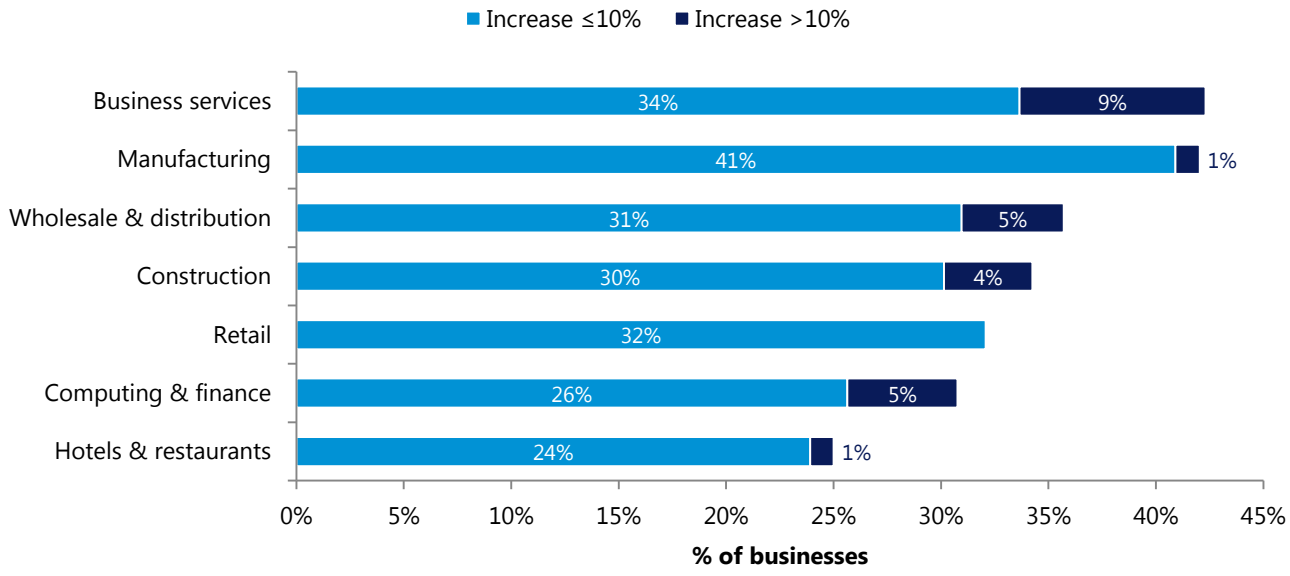
Table 7: Labour Costs Changes, 2013

% of firms	Decrease	Unchanged	Increase	Size of increase	
				≤10%	>10%
All firms	7%	62%	32%	28%	4%
Growth firms	5%	35%	60%	49%	11%
Exporters	3%	40%	57%	52%	5%

Source: InterTradeIreland Business Survey

Figure 15 presents a breakdown of labour cost increases by sector. This highlights that business services and manufacturing firms were most likely to report rising labour costs. Manufacturing increases have tended to be smaller than business services, where 9% of firms had a rise of more than 10% during 2013.

Figure 15: Sectoral Labour Cost Increases, 2013



Source: InterTradeIreland Business Survey

3.4 Reducing labour costs

Reductions to labour costs will largely be determined by the free market based on the decisions of companies (the demand for labour) and individuals (the supply of labour). Government has a role in influencing this, but has limited ability to directly influence these in the short to medium term.

Government approach to wages

Whilst lower wages are good from a business perspective, government's objective is to raise wages in the economy. The NI Executive has a stated aim to raise wealth and prosperity in its Economic Strategy, and Invest NI has a target that at least 75% of new inward investment jobs should pay salaries above the local private sector median[18], which works to raise wage levels in the economy. This does not reduce business competitiveness in the same manner as a tax raise or policy change might, as it is working to create better new jobs rather than artificially force up the wages of those that already exist.

A key issue for NI government is ensuring that companies have access to the skilled labour they need. Skills shortages will lead to wage rises as there is not enough supply of labour to meet the demand. To help avoid this, the Skills Strategy for Northern Ireland - Success through Skills[19] – provides an overarching framework for the development of skills in Northern Ireland. Any future reduction in Corporation Tax, which is expected to create a significant number of new jobs, will require suitable levels of available skilled labour. The Ulster University Economic Policy Centre are currently working on a Skills Barometer for DEL which will help government to understand the future skills needs of the economy, and research being taken forward by DETI, Invest NI and DEL on preparing for a reduction in Corporation Tax will consider the skills implications of this.

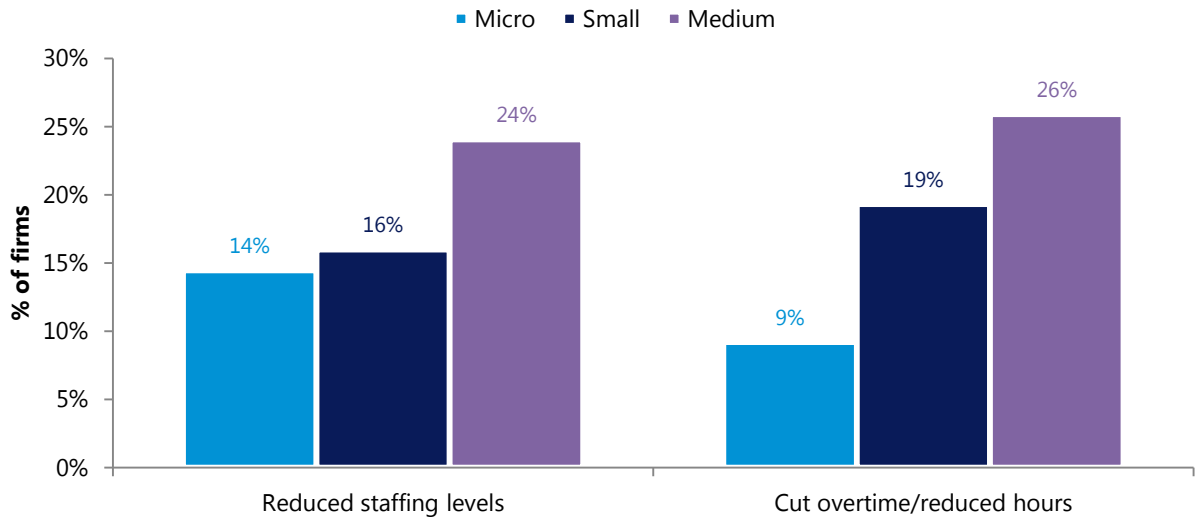
Government policies which impact directly on wage competitiveness are largely reserved matters. The UK government announced in the Summer Budget 2015 that a new "national living wage" will be introduced for those aged over 25 starting at £7.20 per hour in April 2016 and rising to over £9 per hour by 2020[20]. This is effectively a new minimum wage for the over 25s, which represents a substantial increase on the current level. This will benefit employees but, for those businesses that compete on the basis of costs, will reduce their international competitiveness. Given that NI has significantly lower wages than the UK average, it is likely that this new living wage will impact on the competitiveness of proportionately more local companies than elsewhere in the UK. However, it will also increase the attractiveness of younger workers aged below 25, where the new living wage will not apply.

Business steps to reduce labour costs

Despite highly competitive wages in NI, firms still need to manage their labour costs to be as competitive as possible and manage increases that they face. Roughly one-in-five NI companies (21%) took steps to reduce their labour costs during 2013, slightly below the equivalent ROI figure of 25%. The most common step taken was cutting staffing levels (16%), followed by reducing hours (13%). Figure 16 highlights that larger firms (with 50 or more employees) tended to be much more proactive in taking steps to reduce labour costs.

These kinds of measures tend to relate to survival rather than growth, as firms will need to keep (and add to) their workforce to expand into new markets and increase their sales. Our business consultations emphasised that skilled labour was vital both in terms of supporting growth and keeping costs down. This was particularly the case in key FDI sectors such as business services and ICT, where the success of NI in attracting investment has begun to put pressure on local wages for skilled employees. Consultations also highlighted that businesses which have large operations of lower cost/skilled labour are concerned with the minimum wage – which is outside the control of the NI Executive – as increases can have a significant effect on their competitiveness against rivals in low cost economies.

Figure 16: Business Steps to Reduce Labour Costs, 2013



Source: InterTradeIreland Business Survey

3.5 Summary and conclusions

Labour is consistently the most important cost area for businesses, regardless of what sectors they operate in. Wage inflation in NI has been relatively limited in the private sector during the economic downturn which, in general, will not have put significant pressures onto businesses. This came through in the business survey with just one-third of local companies reporting cost increases in 2013, although this figure was much higher amongst growth firms and exporters.

Wages play a major factor in competing for mobile FDI, and a key part of NI's value proposition to potential investors relates to a large pool of skilled labour at competitive wage rates. In terms of salaries, NI represents the most cost effective location to do business in the UK across the large majority of sectors and occupations, and also offers lower salaries than a range of cities benchmarked in the ROI.

Taking an international view, our analysis across 60 different FDI locations spanning 51 job roles in the UK, ROI, Europe and elsewhere ranked NI as having lower salaries than 42 other locations, below all the developed economies. Those economies that offer lower wages are mainly in Central and Eastern Europe, India and parts of Asia (countries in Africa and Central/South America would also be lower, but are not generally viewed as direct competitors to NI and have not been included here). Lower salaries in these countries do, however, have to be set against comparative levels of skills and infrastructure on offer.

Government has limited direct control over wages in an economy, which is particularly true for the NI Executive where minimum wages and NICs are a reserved matter. A key area that government can influence is skills; not just producing and retaining skilled labour but also making NI an attractive place to live and work to attract skilled migrants. Skills were *the* key issue raised in our consultations that impact on labour costs. The greater demand for skilled labour in growth sectors (professional services in particular) needs to be met by the supply-side, otherwise it will lead to further wage inflation and skills shortages, which would become even more of an issue with a big demand-side stimulus such as lower rate of Corporation Tax.

4 ENERGY COSTS

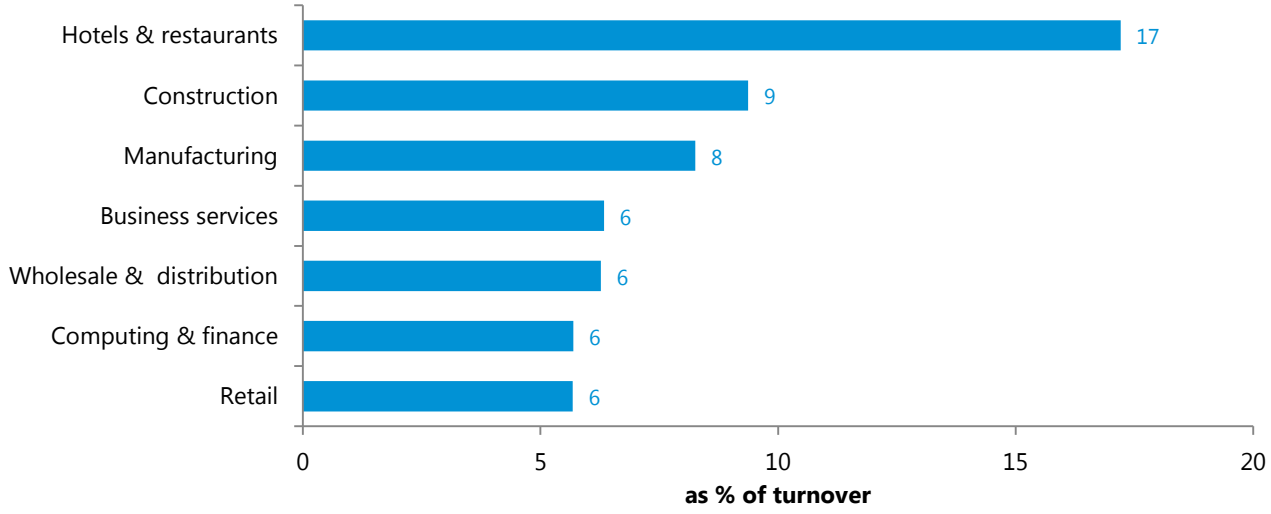
Energy is the second largest cost area looked at in this study. Since mid-2013 electricity prices have been stable for the majority of local businesses, and there have been falling prices more recently due to lower wholesale electricity prices. Most local firms pay similar prices compared with elsewhere in the EU, although prices are reported to be higher for larger users.

4.1 The importance of energy costs

Energy was found to be the second largest cost area for businesses in our business survey, accounting for 9% of turnover on average. As highlighted earlier in this report, we do not include input purchases (such as raw materials) in our analysis, which is why energy is often cited as the third largest cost area by Manufacturing NI in their recent manifesto[21]. By energy, we mean the cost of heating and cooling (usually natural gas and LPG) and power (electricity or gas) but not fuel transport. Although energy prices can sometimes be conflated with electricity prices, in reality it also covers significant usage for heating and transport (which this report looks at separately).

As shown in Figure 17, hotels & restaurants was the most energy intensive sector, followed by construction and manufacturing. We position our analysis in terms of how important energy costs are reported to be for the sector, rather than which sectors consume the most electricity. Larger industrial users taking part in our consultations highlighted that energy costs are key for their competitiveness, whereas smaller users (typically services firms) were typically much more focussed on other areas, which has also been noted by the CBI[22]. Within energy, analysis of ABI data shows that electricity is most important for businesses, followed by gas.

Figure 17: Sectoral Energy Costs



Source: InterTradeIreland Business Survey

4.2 Benchmarking energy prices

Energy price benchmarking will focus mainly on electricity and gas. Electricity has a robust information source from the Utility Regulators (URs) Quarterly Transparency Reports[23] (and the first Annual Transparency Report published in June 2015) which provide a comparison of both domestic and non-domestic electricity prices against elsewhere in Europe. At present, the same level of information does not currently exist for industrial gas prices.

Electricity prices

Available information on electricity is broken down into different user groups depending on their annual consumption. As Table 8 demonstrates, NI non-domestic customers are very heavily grouped in the smallest size band, representing 65% of total Industrial & Commercial (I&C) customers at the end of December 2014 but only 6% of consumption. The majority of consumption is accounted for by a much smaller group of medium and large/very large users. It should be noted that few, if any, of our largest energy users are considered to be energy intensive by international EU or UK standards. Most businesses therefore consume relatively little electricity, but a very small number are heavily reliant on it.

Table 8: NI Non-domestic Market Breakdown

Size of consumer	Annual consumption (MWh)	% of I&C customers	% of I&C consumption
Very small	< 20	65.20%	6%
Small	20 - 499	33.12%	35%
Small/Medium	500 - 1,999	1.24%	16%
Medium	2,000 - 19,999	0.41%	32%
Large/Very Large	> 20,000	0.02%	10%

Source: Utility Regulator Retail Energy Market Monitoring Report, June 2015

Smaller users will typically have to sign up to available tariffs from providers (similar to domestic customers), whereas larger users have more scope to negotiate tailored deals, often with unique terms and conditions (including price), based on their much higher consumption. There is therefore much less transparency over prices for this group given that the outcomes of any negotiations on price are not public. The Utility Regulator has examined this issue and found that, where such customers tender for supply, offers presented were unanimously perceived to be competitive[24]. Appendix 3 provides a full cost benchmarking for all five sizes of consumers, but this main report will focus on those at either end of the spectrum – very small users and large/very large users.

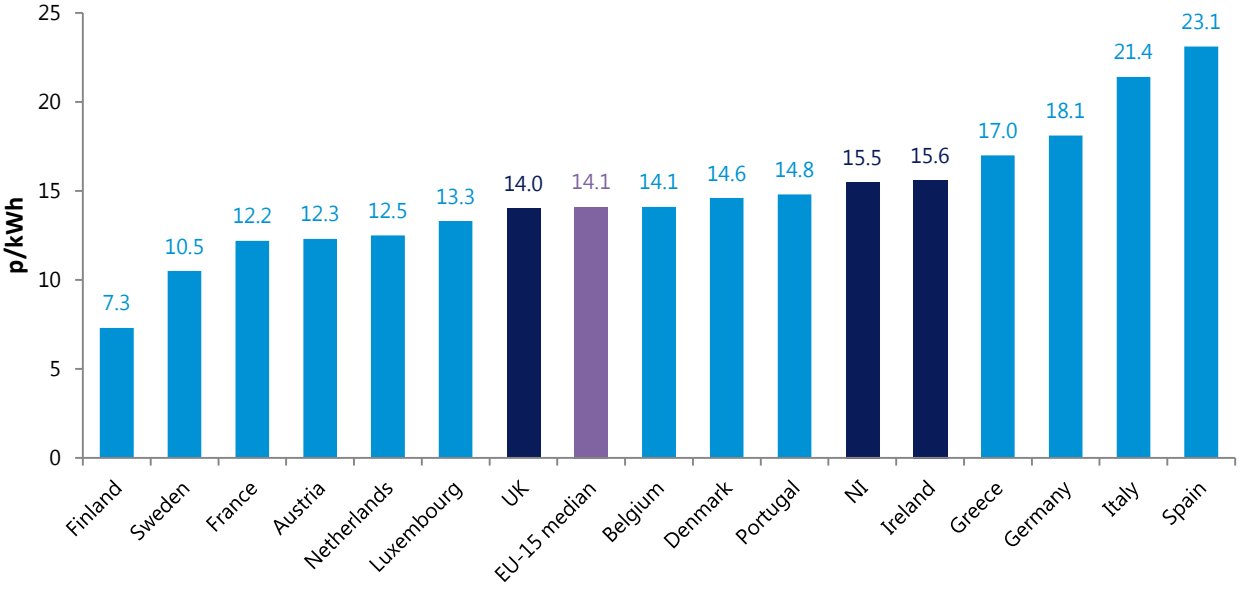
Before looking in detail at prices, it is also worth noting that these prices constantly move. If this analysis had been carried out some time ago it would have reflected a more negative picture. The data used here refers to late 2014 from the latest Utility Regulator report and therefore does not reflect falling tariffs for domestic and SME customers of around 10% in 2015.

Very small electricity users

Figure 18 highlights that average electricity price for very small I&C consumers in NI was 15.5 p/kWh, which is around the median price of 15 EU countries. Although NI ranks at the higher edge of this group in 2014,

this will not take into account the tariff falls previously highlighted. NI therefore ranks as having the sixth highest electricity prices for very small I&C customers in Europe, significantly below Italy and Spain, similar to the ROI and above the UK.

Figure 18: Non-domestic Electricity Prices, Very Small Customers, Jul-Dec 2014



Source: Utility Regulator Retail Energy Market Monitoring Report, June 2015

Table 9: Non-domestic Electricity Price Ranking (out of 16), Very Small Users, 2011-14

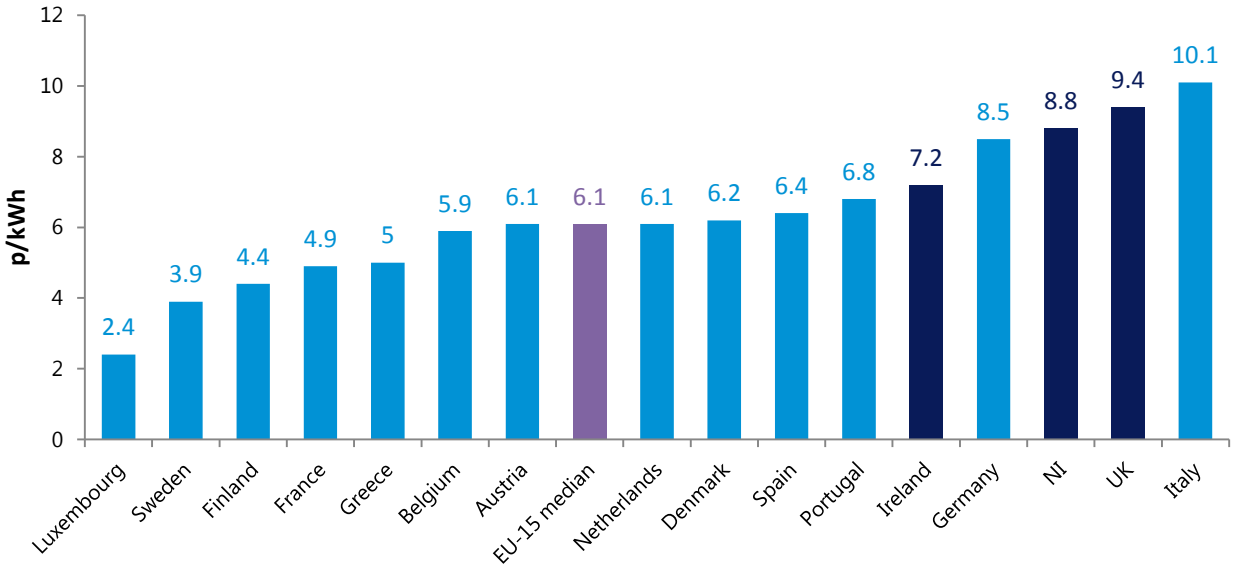
	2011	2012	2013	2014
NI	12	6	9	6
UK	13	12	13	10
ROI	4	5	4	5

Source: Utility Regulator Quarterly Transparency Reports

Large and very large electricity users

Focusing on large & very large users, which comprise 0.02% of customers, Figure 19 highlights that the average electricity price was 8.8 p/kWh. These larger users therefore pay significantly less (43%) per unit than very small users, which will come with the greater bargaining power that these firms have with suppliers (although their overall bills will be significantly larger as they consume much more). Comparing these larger users with elsewhere shows that the NI average price is at the higher end of EU comparators, below Italy and the UK and similar to Germany.

Figure 19: Non-domestic Electricity Prices, Large & Very Large Customers, Jul-Dec 2014



Source: Utility Regulator Retail Energy Market Monitoring Report, June 2015

Table 10: Non-domestic Electricity Price Ranking (out of 16), Large & Very Large Users, 2011-14

	2011	2012	2013	2014
NI	2	2	2	3
UK	6	4	1	2
ROI	9	5	5	5

Source: Utility Regulator Quarterly Transparency Reports

The above comparisons provide an assessment of electricity prices against elsewhere in Europe. However, as highlighted through our consultations, NI's competitors for investment are not limited to the EU and are often in locations much further afield. Analysis using fDi Intelligence data (see Appendix C) highlights that EU electricity prices tend to be considerably higher than locations such as the US, Russia, Asia and the Middle East. The challenges for the EU as a whole have already been examined in detail elsewhere[25].

Understanding electricity price differences

The comparative data above presents a number of different stories depending on size of users and which benchmarks are chosen. The UK, for example, has lower electricity prices for very small users compared with much of the EU, while prices for large/very large users are higher than most member states. There is not a straightforward reason for why this is the case; the starting point for explaining differences in prices is to understand the different components that make up the final price charged.

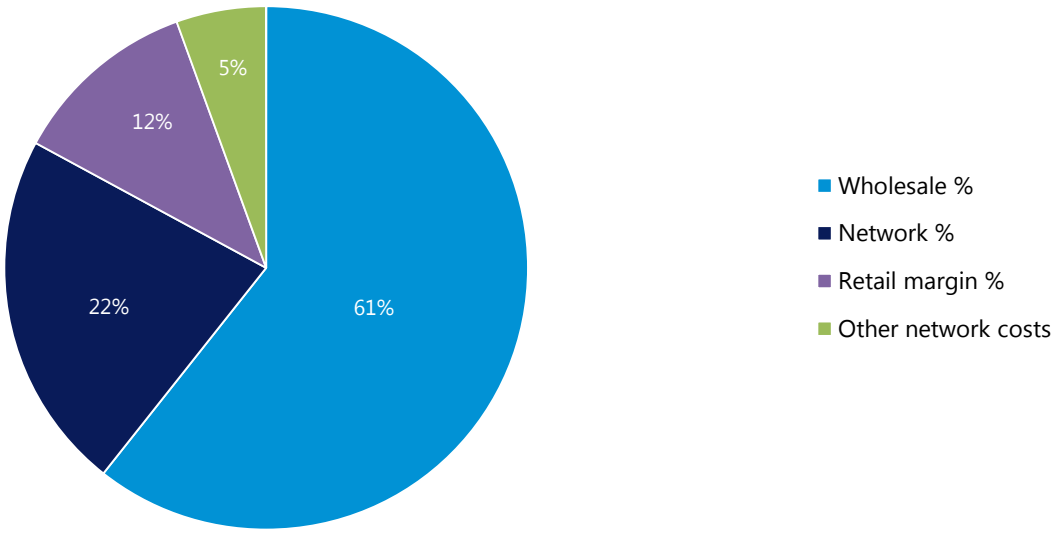
There are four main areas which determine electricity prices – wholesale costs, pure network costs, other network costs and retail margin. Descriptions of each of these costs is given in Table 11, and information from the UR[26] is presented in Figure 20 to outline their relative importance (based on the build up of average charges to Power NI regulated customers).

Table 11: Overview of Electricity Price Components

Cost	Description
Wholesale costs	Wholesale and generation-related costs account for almost two-thirds of the final price. These costs are driven by the global prices of crude oil, coal and natural gas, but can still differ because of structural issues such as a location or economies of scale.
Network costs	**Pure network costs** relate to costs specifically associated with operating the grid. These transmission and distribution costs make up over one-fifth of end user electricity prices in NI.
	Other network costs are those associated with meeting other objectives and policy priorities through, for examples, taxation. They include renewable-support (e.g. RoCs), environmental (e.g. Climate Change Levy) and energy efficiency (e.g. Energy Efficiency Levy) related costs and the Public Service Obligation (PSO).
Retail cost	The retail costs are the cost of supplying electricity to end-users.

Source: Utility Regulator

Figure 20: Components of Average NI End-user Electricity Prices for Power NI Regulated Customers, 2013



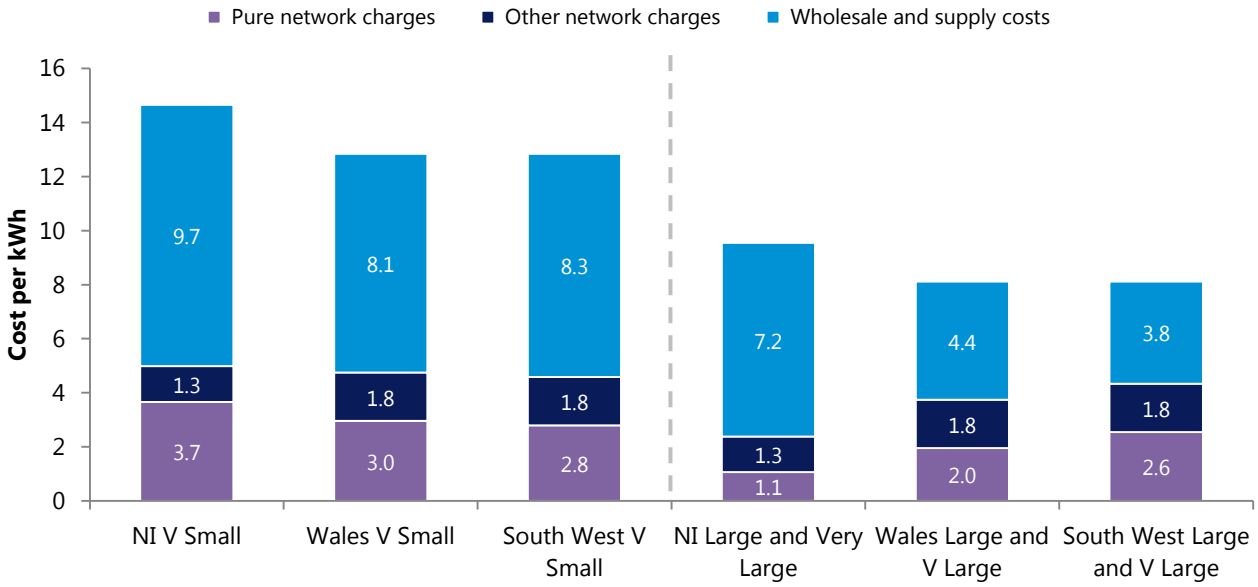
Source: Utility Regulator

Reasons for electricity prices differences with Great Britain

The cost benchmarking has focussed on very small and large/very large users of electricity, and this section continues to look at these two user groups to explain reasons for differences between NI and GB using the cost components outlined above. Focussing on the largest components that make up electricity prices – wholesale costs and network costs – a comparison of how these contribute to overall prices for these two groups of users is presented in Figure 21 (two different GB regions have been used as comparators).

The data used here is for a different time period (2012/13) than that used in the cost benchmarking (2014), and the overall prices may therefore not be consistent. However, it is the relative size of the different components that is important to note in this analysis, not the absolute values. This highlights that prices for large/very large users in both NI and GB are considerably lower than for very small users.

Figure 21: Comparative Charges per Customer Category, NI and GB, 2012/13



Source: Utility Regulator

In terms of comparing the different cost components between NI and GB, the above chart highlights that:

- **Wholesale costs** were considerably higher in NI than for regions in GB. For very small users, the differential was 17% against the South West and 20% compared with Wales. For very large users, the difference was more pronounced at 90% and 64% respectively;
- **Pure network costs** were higher for very small NI users than those in the South West (31%) and Wales (24%). However, the opposite is true for large/very large users. These heavy users benefit from pure network costs that were 58% lower than the South West and 45% lower than Wales as GB network costs are more skewed toward larger users;
- **Other network costs** were lower for both very small and large/very large users in NI relative to GB. Costs for very small users were 26% below both the South West and Wales, whilst large/very large users costs were 27% lower in NI compared to each jurisdiction. This cost differential is partly due to additional GB environmental obligations which are not imposed onto local companies; and
- **Retail costs** (not shown in the chart) comprise a similar proportion of the final bill.

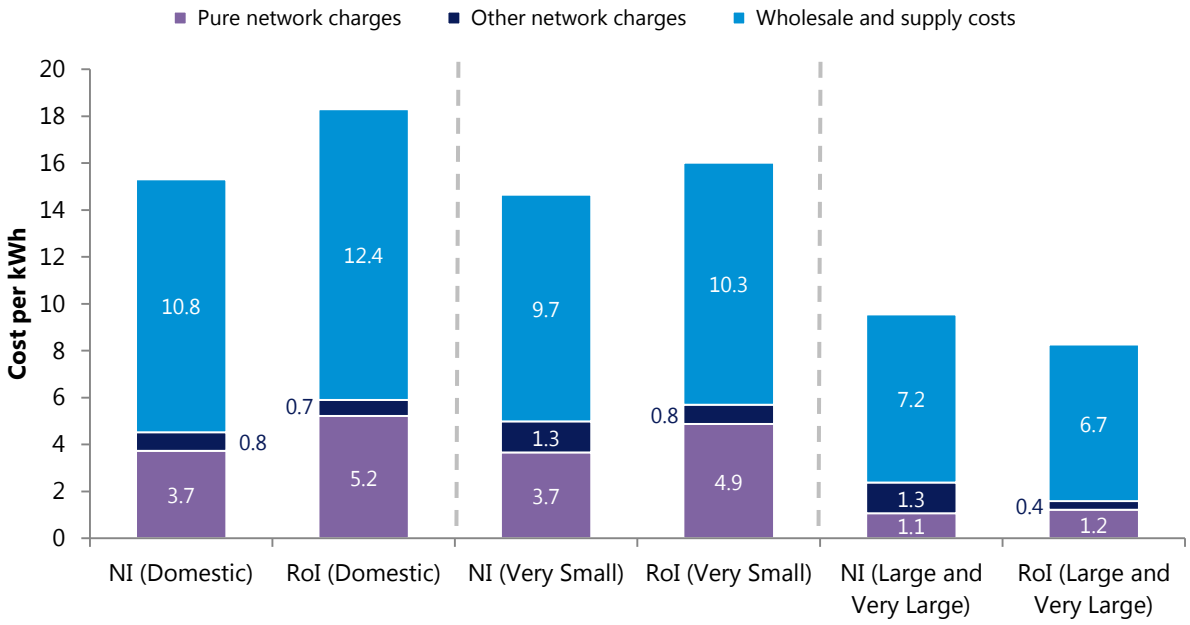
The overall picture here is that significantly higher wholesale and supply costs in NI compared with GB are partly offset by lower network and retail costs[27], but still mean that local firms tend to face higher electricity prices. The Single Electricity Market (SEM) was introduced in 2007[28] to create a single market for the trading of wholesale electricity on the island of Ireland, replacing the two previously separate markets North and South. The SEM was designed to provide at least cost a source of electricity generation to meet customer demand at any one time across the island, while also maximising long-term sustainability and reliability.

The wholesale market in GB is served by British Electricity Trading and Transmission Arrangements (BETTA). Datasets to compare wholesale prices across jurisdictions do exist, though several have data confidentiality restrictions and may depend on a number of assumptions that cloud direct comparability. Although the differential between the SEM and BETTA markets varies over time and different data sets produce various results, a broad estimate indicates that BETTA produces prices that are 20% lower than the SEM[29].

Reasons for electricity price differences with the Republic of Ireland

The underlying drivers of cost differences with the ROI are significantly different than those found with GB. Understanding these reasons again requires focussing on very small and large/very large users and looking at the different cost components which make up electricity prices. The same caveat – that the data used here is for a different time period than the cost benchmarking and so might differ – remains. But again it is the relative size of the different components that is important to note in this analysis, not necessarily the absolute values. Figure 22 presents comparisons between NI and ROI across very small and large/very large electricity users.

Figure 22: Comparative Charges per Customer Category, NI and RoI, 2012/13



Source: Utility Regulator

A key difference in the above chart compared with the GB analysis is that domestic customers have also been included, which will be needed to help explain the reason for differences found in certain components. Focusing solely on I&C users, the analysis again reinforces that large/very large users benefit from lower prices per unit than smaller users. In terms of the different components:

- **Wholesale costs** are the same between NI and ROI because they share the same wholesale market;
- **Pure network costs** tended to be below the ROI in NI for both very small and large/very large users;
- **Other network costs** were significantly higher in NI than in ROI. This is particularly evident for large/very large users where costs are more than double the ROI figure, whereas the difference for very small users was lower (but still significant); and
- **Retail costs** (not shown in the chart) are the small element of end-user prices and are therefore unlikely to be a driver of differences in overall prices.

Unlike with GB, the reason for differences with the ROI is the allocation of network costs amongst customer groups[30]. Total network costs (pure and other) are lower for very small users in NI but much higher for

large/very large users compared with the ROI. This may be explained by Irish Government policy intervention in 2010[31].

Gas prices

The lack of NI data on non-domestic gas prices limits any benchmarking exercise being carried out. Data is only available for domestic customers from the Utility Regulator, which shows that NI domestic gas prices are the second lowest of the EU-15 benchmarks behind only Luxembourg. However, broad international comparisons which might give a sense as to how NI compares are possible.

As with electricity, the gas market in NI is regulated by the UR. There are three distribution licence holders in NI - Phoenix Natural Gas Limited (PNGL), firmus energy (Distribution) Limited (FE) and SGN. PNGL owns and operates the distribution network in the Greater Belfast and Larne areas. FE owns and operates the distribution network commonly referred to as the 'Ten Towns' which runs off the North-West and South-North natural gas transmission pipelines. In February 2015, SGN was awarded a gas conveyance license by the Utility Regulator to develop new gas distribution networks to main towns in the west.

Currently there are ten suppliers holding gas supply licences for supply in the Greater Belfast market and the Ten Towns market, broken down as follows:

- In **Greater Belfast**, two suppliers are active in supplying gas to domestic customers: SSE Airtricity Gas Supply and firmus energy, and another four suppliers are active in supplying gas only to industrial & commercial customers: Electric Ireland, Vayu, LCC Power and Flogas Natural Gas Ltd; and
- In the **Ten Towns**, the large I&C market opened to competition from 1 October 2012 and there are currently two active suppliers in this market: firmus energy and SSE Airtricity Gas Supply. The small I&C and domestic gas market was opened to competition in April 2015, so before then all customers were supplied by firmus energy.

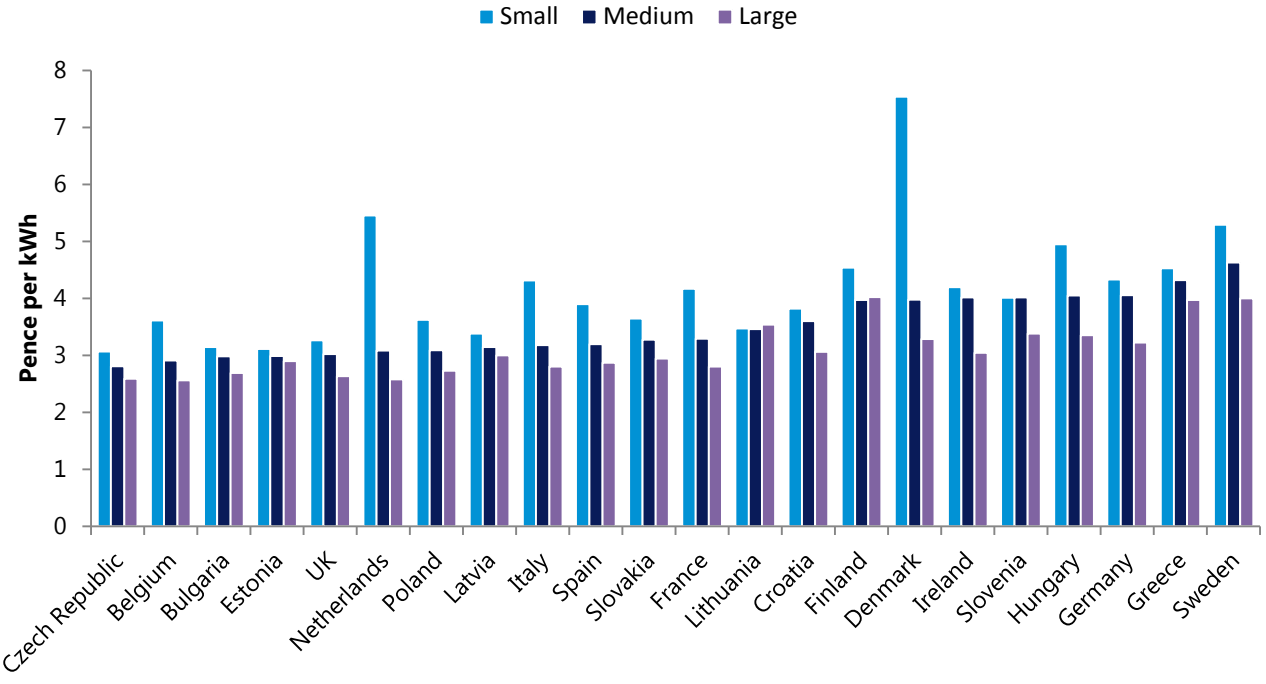
A limited range of information on business tariffs for 2013 from firmus and Airtricity has been gathered in Appendix C. This broadly shows that smaller businesses (consumption up to 73,200 kWh) will pay relatively higher charges for gas compared to medium sized firms (consumption from 73,200 -732,000 kWh). No information was publically available on the price of gas to large businesses; however, Eurostat data does suggest that larger firms will pay a lower price than their small or medium sized counterparts – a reflection of the greater degree of bargaining power that comes with increased size. The data also suggest that gas tariffs tend to be lower in Belfast compared with the 'ten towns' average for Londonderry/Derry, Limavady, Ballymena, Ballymoney, Coleraine, Newry, Craigavon, Antrim, Banbridge and Armagh.

Much like electricity, the final gas price is made up of a number of different components[32]. Published information for the Airtricity regulated tariff for domestic and small I&C customers suggests that wholesale gas costs represent around 50% of the overall tariff and, as the wholesale gas market can be volatile, there is no real control over the wholesale cost. The largest element of the tariff that is regulated is the distribution network costs. Those costs account for 35% of the regulated tariff paid by customers and can have a significant impact on the final gas bill for consumers, therefore active customer involvement is vital during the price control process. Transmission network costs add a further smaller element (estimated to be around 10%) of costs to gas tariffs.

The final component of prices is operating costs and margins. Price controls are set by the UR on the gas distribution licence holders in NI to determine how much they can charge for the use and operation of their networks. These controls are determined for both by assessing an efficient level of operating costs and capital expenditure to run their businesses and continue to promote the development of gas within NI. Price control proposals for 2014-2016 were published in December 2013[33], and work by the Utility Regulator and the gas industry on the next five year (GD7) price control is underway.

Figure 23 presents a wider international comparison of gas prices that does not include NI. This demonstrates that the UK is one of the most competitively priced EU countries in terms of gas prices, compared with the ROI which ranks sixth highest. Whilst lack of data prevents a definitive answer as to where NI sits in this ranking, our case studies and consultations suggest that gas prices in NI were not seen to be materially different than in GB with no competitive disadvantages reported. This is encouraging as gas tariffs in NI include the cost of developing new gas networks since 1996, compared with the long established gas infrastructure in GB which consumers have largely paid for.

Figure 23: Average Industrial Gas Prices in the EU, 2013



Source: Eurostat

4.3 Energy cost changes

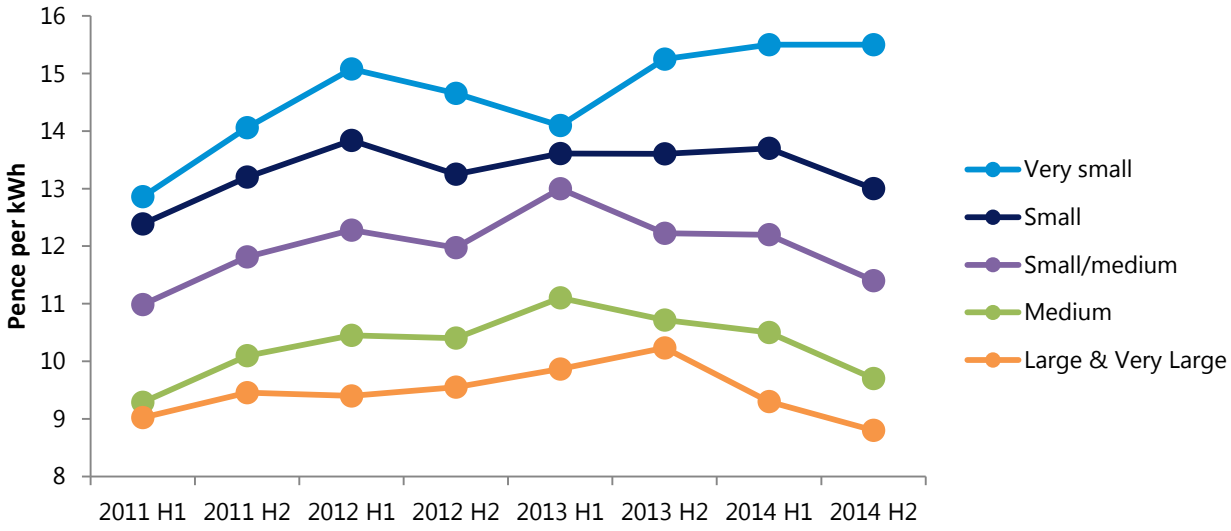
Wholesale energy costs are partly determined by supply and demand on world markets, and high prices from suppliers can be created by a myriad of factors such as unseasonably cold weather, consumer behaviour and the general state of the economy. Prices reflect a cost burden on businesses and, unlike labour costs where an increase in salaries is associated with better quality staff, a unit of energy is the same regardless of price (i.e. it is a homogenous product).

Energy prices can be volatile and subject to large changes, and there has been a significant fall in energy prices most recently. Figure 24 presents electricity prices since 2011 for each customer group. This

highlights that businesses will generally have seen price decreases recently, in particular the larger customers. For example, by the end of 2014, prices for large and very large users had fallen by 14% from the second half of 2013, whilst prices for medium users fell by 13% from the first half of 2013. Only very small customers had not seen price decreases by the end of 2014, although their price had remained flat in nominal terms.

Since then, there have been reductions in regulated retail electricity and gas prices for domestic and SME customers from April 2015. The falls in electricity and gas prices are due to falls in wholesale energy prices on world markets. Gas prices have fallen less than oil prices, which DECC cite[34] have fallen by 53% since their peak in March 2012 and are now around $50 per barrel (July 2015)[35]. However, the gas price reduction has put downward pressure on wholesale electricity prices.

Figure 24: Electricity Prices by Customer Group, 2011-14



Source: Utility Regulator Quarterly Transparency Reports

This data only covers up to the end of 2014, but it is likely that businesses will have seen further falls in prices since. For example, Power NI's customers on the Standard Home Energy tariff will see a 9.2%[36] decrease from 1 April 2015, with SSE Airtricity's electricity tariff falling by 8% and their gas tariff decreasing by 7.8%[37] from that same date. Also, Budget Energy introduced a 5% tariff reduction[38], and SSE Airtricity reduced gas prices for domestic and SME customers by 7.8% from April 2015[39].

Businesses will also be seeing the benefits of falling prices, and the latest InterTradeIreland Business Monitor shows that the percentage of local businesses identifying energy costs as a huge issue has fallen substantially from 32% in Q1 2014 to just 10% in Q1 2015. This is a welcome change from 2013, when our business survey showed that many respondents cited concerns about rising energy prices (see Appendix C for further details).

4.4 Reducing energy costs

In contrast with a cost area such as labour, the energy market is regulated independently of government in Northern Ireland. The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers. This regulation takes place within overarching EU policy. The third European Internal Market for Energy (IME3) package of directives and regulations established a wide

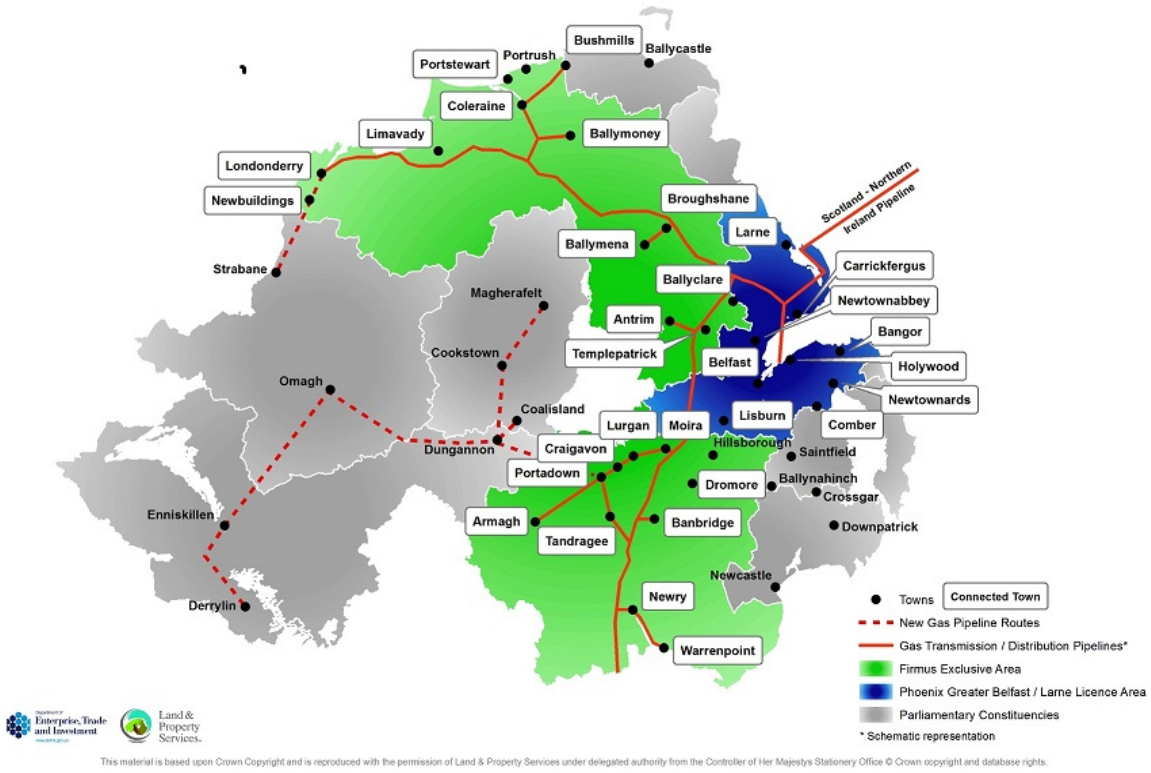
range of measures aimed at achieving greater competition – reinvigoration of market integration, increased independence and powers for national regulators, and harmonisation of their role at a European level via creation of the Agency for Cooperation of Energy Regulators (ACER).

Government approach on energy markets

Wholesale costs represent the largest component of NI electricity costs and, whilst this element of the overall cost is not directly determined within NI, a joint project is currently underway between the UR and the Commission for Energy Regulation (CER) that will result in significant changes to the existing wholesale energy market. This 'Regional Integration' project is driven by European policy with the aim being to create a pan-European energy market. The rationale is to drive competition across the wholesale energy market in Europe and, as a consequence, harmonise prices at the European level. New market arrangements will be implemented by the end of 2017.

As gas prices are considered competitive in NI, the greatest issue raised in our consultations was around the availability of gas supply; firms located in the West of the province are unable to take advantage of natural gas as an energy source as the distribution network has not extended there yet (see Figure 26).

Figure 25: Natural Gas Availability in Northern Ireland



Source: DETI Energy Division

Note: The gas extension lines (dotted) above are simply for illustration and are subject to change once work begins

The lack of gas as an available energy source to date puts businesses in these areas at a competitive disadvantage without access to a lower carbon and more efficient fuel source than oil. Whilst oil is currently

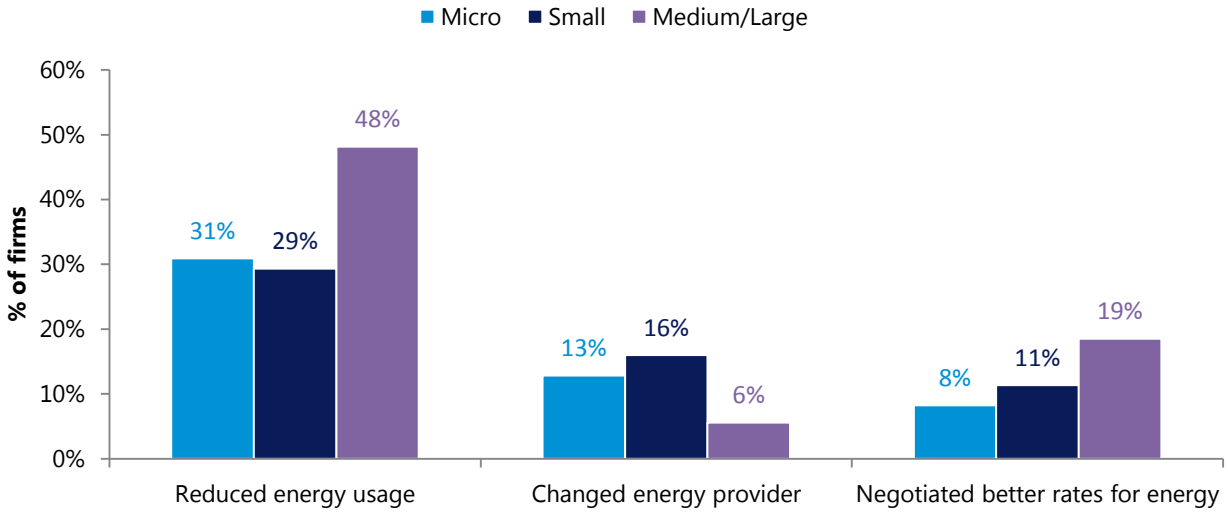
cheaper than gas, it has historically tended to be more costly. Plans are currently underway to extend the natural gas network to the towns of Strabane, Omagh, Enniskillen, Derrylin, Dungannon, Coalisland, Cookstown and Magherafelt via the Gas to the West project, with the aim of connecting around 40,000 energy consumers to gas.

Following a competitive process, on 12 August 2014 the UR announced NIEH (Mutual Energy) and SGN as the ''preferred applicants'' for the Gas to the West project licences. A final determination by the UR was published in November 2014[40] and licence awarded to Mutual Energy and SGN in February 2015[41]. Work on providing gas networks to Strabane is expected to commence later in 2015, with first connections in Autumn 2016. The main gas network development to other towns in the West is expected to be completed by the end of 2017, with local gas distribution networks provided in each connected town over subsequent years.

Businesses steps to reduce costs

Our survey demonstrated that almost half of NI companies (47%) took steps to reduce their energy costs during 2013, on par with the equivalent ROI figure of 46%. The most common step taken was reducing energy usage (32%), followed by changing energy provider (13%) and negotiating better rates on energy (10%). Figure 26 reflects that larger firms (with 50 or more employees) tended to be more proactive in taking steps to reduce energy costs than small and micro businesses.

Figure 26: Business Steps to Reduce Energy Costs, 2013



Source: InterTradeIreland Business Survey

Consultations have reinforced this finding. Larger users (predominantly those in manufacturing) are actively working on strategies to reduce/manage their energy costs. For example, some have retained the services of an energy specialist on site to review usage processes and ensure there is no wastage in manufacturing procedures. Others have recruited energy consultants to source the best energy deal for the company when contracts are up for tender. Some very large energy users are now also turning to their own energy generation for premises in a bid to reduce energy costs.

Whilst this analysis has focussed on costs and prices, businesses also stated that quality and security of supply was vitally important and no issues were raised in relation to this. Indeed, independent analysis

conducted on behalf of the Electricity Association of Ireland ranked the quality of supply on the island of Ireland to be 17th out of 151 countries – above Sweden, Germany, Italy, Spain and the USA[42].

4.5 Summary and conclusions

Energy is an important cost for businesses, particularly for sectors such as manufacturing, construction and hotels & restaurants. These sectors raised electricity prices as a concern during periods of volatility when prices were rising substantially in 2011-13; however, since then prices have been stable or falling, mainly due to falls in the cost of fuel on world markets. Wholesale and generation-related costs account for the most significant part of the final price paid by companies, and global price fluctuations in commodities such as crude oil and natural gas often lead to the volatilities shown in this chapter. Whilst not unique to Northern Ireland, structural issues such as our location and relatively small market size can mean that costs do differ.

Focusing on electricity, most businesses in NI tend to be very small energy users. These NI businesses pay prices that are around the EU-15 average, which is currently above the UK but slightly cheaper than the ROI and significantly lower than those countries with the highest prices. Overall, the energy bill for these companies should generally be small given their low consumption of electricity. The large majority of local firms are therefore not at a significant cost disadvantage from doing business here, and also benefit from advice and support available from Invest NI to help businesses save money in relation to their energy usage and thus bills[43].

Whilst there is more limited information on the prices paid by larger users who tend to negotiate their own tariffs directly, the data that is available shows that a small number of large consumers have comparatively high energy prices. For these users, electricity prices in NI are at the higher end of EU comparator states. Energy costs are one of many costs for large industrial users and, whilst they are at a competitive disadvantage in electricity terms against much of the EU, local prices are currently lower than in GB. This group of companies have benefitted the most from falling electricity prices, with their price having fallen by 14% up to the end of 2014.

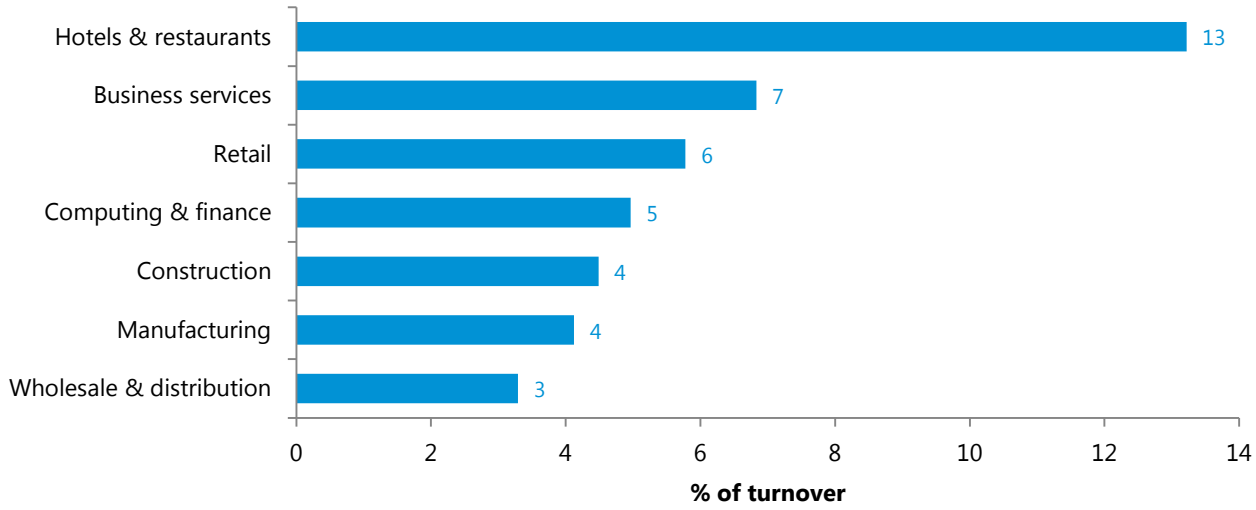
5 PROPERTY COSTS

Property is the third most important cost area for businesses on average. Northern Ireland has highly competitive rental prices for both office and industrial use. Despite these competitive advantages, rising rates bills have still placed a pressure on companies, particularly for retailers.

5.1 The importance of property costs

The business survey suggests that property is the third largest cost area for local businesses, accounting for 6% of turnover on average. Figure 27 highlights that the importance of property is very much dependent on the sector companies operate in. Hotels & restaurants have – by far – the largest share of property costs followed by other services sectors. Manufacturing benefits from lower industrial rates which will explain why property costs are relatively lower than other sectors.

Figure 27: Sectoral Property Costs



Source: InterTradeIreland Business Survey

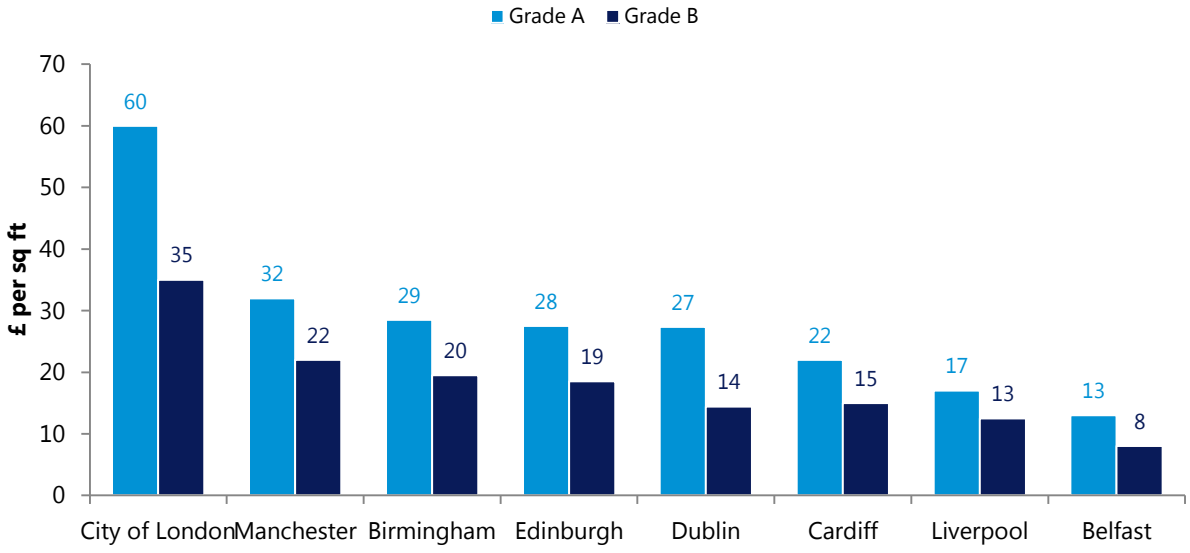
5.2 Benchmarking property prices

The main focus of this analysis to benchmark property prices will be on rental values (both office and industrial units) as well as industrial land values for NI against elsewhere; Colliers provides a comprehensive source of information for this. Business rates will also be a large part of businesses property costs but the 2015 rates revaluation will have led to changes in rates bills for many companies and comparable information on total rates bill with elsewhere is not available to provide a comprehensive review at this time.

Office rents

Figure 28 presents estimates by Colliers[44] of achievable open market rents in prime office locations for Belfast against a range of major UK and ROI cities. Office rents in Belfast for both Grade A and Grade B accommodation are shown to be significantly below these other cities. At £13 per sq ft for Grade A office space, prices in Belfast are less than half of Manchester, Dublin, Birmingham and Edinburgh.

Figure 28: Office Rental Values, 2014



Source: Colliers

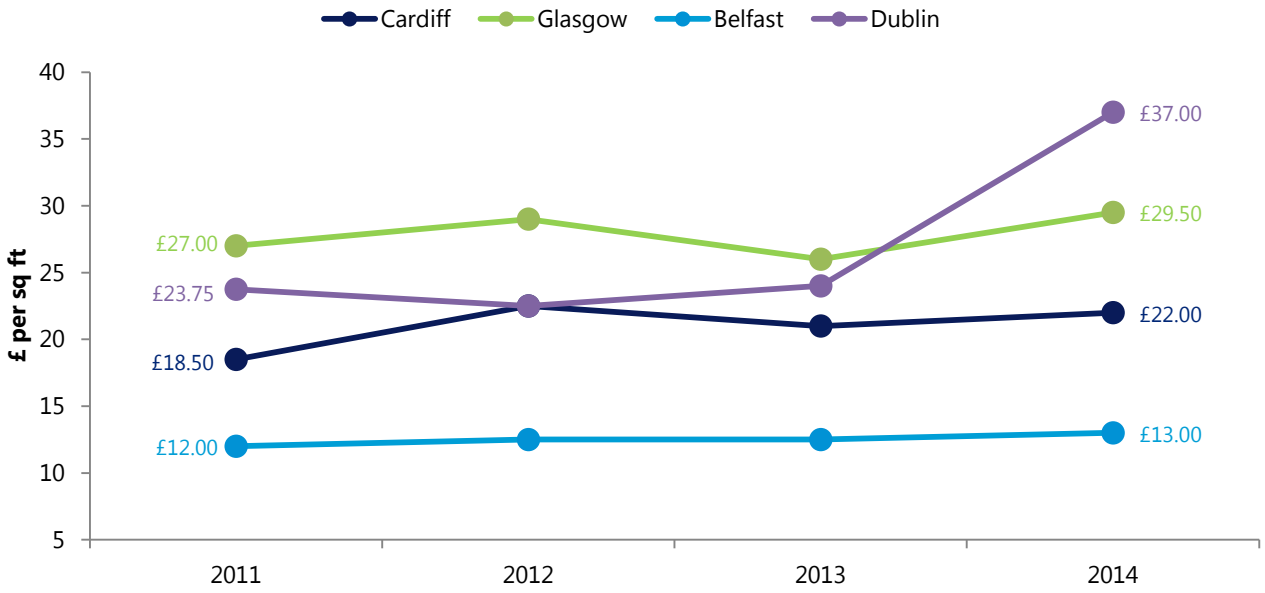
Note: Dublin figures converted at a rate of €1 = £0.72

The above analysis focuses on a selection of major cities, but even widening this further continues to reinforce the competitive advantage that Belfast has in office rentals. Focusing on Grade A office space, the Colliers data highlights that Belfast prices (£13 per sq ft) are lower than Cambridge (£34), Reading (£31), Aberdeen (£30), Glasgow (£27), Leeds (£27), Oxford (£22), Newcastle (£22), Sheffield (£20), Nottingham (£20), Southampton (£19) and Liverpool (£17).

Part of the reason for this price gap is that Belfast has not seen the rises in office rental costs in recent years that other cities have (see Figure 29). Whilst the upturn in the economy has led to rising rental prices elsewhere, Belfast prices have been largely flat over the period. However, the latest outlooks from both Lisney's[45] and the CBRE[46] are highlighting that a shortage of Grade A office space in Belfast city centre is likely to result in rising rents (albeit still keeping Belfast well below other cities).

Perhaps more of a concern than any future price rises is the impact that a lack of available Grade A office space could have in constraining economic growth if there is not enough capacity for new investors and existing expansions. The availability of appropriate office accommodation is an important part of NI's investment proposition, and a recent report by Invest NI has highlighted that there has not been enough development in recent years, thus constraining supply[47]. This was reinforced during our consultations with services companies. Part of the reason for this lack of development relates to our low rental prices, which means that the returns on offer to property developers has been too low to encourage sufficient levels of investment in new property.

Figure 29: Grade A Office Rental Price Changes, 2011-14



Source: Lisney's Office Update 2014

Note: This Lisney's data means that Dublin figures will not match those presented above which are sourced directly from Colliers; likely due to differences in the exchange rates used when converted.

The analysis to date has focussed on Belfast, as this is where the comparable information is available with elsewhere. However, nibusinessinfo.com[48] provides average office rental values across NI towns and cities during July 2014 (see Table 12). These data are an overall average (not split into Grade A and B) and will therefore not match the values identified above.

Table 12: NI Average Office Rental Values, 2014

Value	Location
Over £10 per sq ft	Belfast (city centre), Derry/Londonderry
£8-10 per sq ft	Craigavon, Down, Newry & Mourne, Antrim, North Down, Cookstown, Castlereagh, Belfast (outside city centre), Fermanagh
Under £8 per sq ft	Ards, Lisburn, Ballymoney, Newtownabbey, Coleraine

Source: nibusinessinfo.co.uk

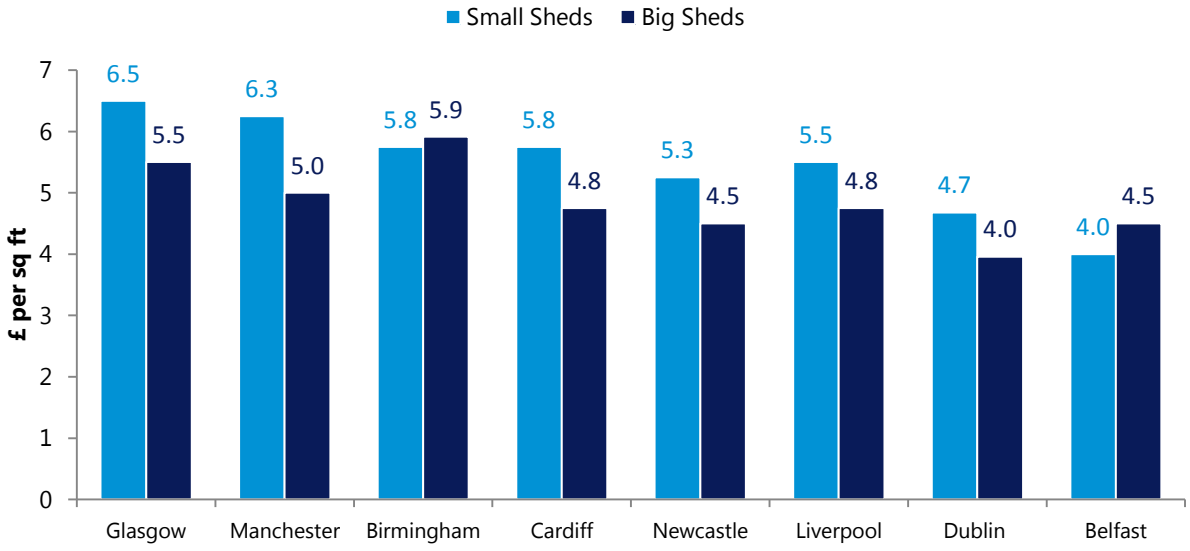
Within NI, office rental rates ranged from a high of £11.19 (Belfast city centre) to a low of £7.38 (Coleraine) per square foot. Given the cost competitive position of Belfast against other UK and ROI cities, this suggests that other parts of NI can offer an even greater cost advantage for office space.

Industrial rents

Figure 30 presents data from Colliers[49] on industrial rents in prime locations for new units in NI compared with selected benchmarks in the UK and ROI. Small sheds refer to units 10,000 - 30,000 sq ft whilst big sheds cover units of 200,000 sq ft upwards. Compared with office space, rental prices for industrial space tend to be much more similar across locations. However, Belfast still remains one of the most competitive cities on

industrial rents, having the lowest prices for small sheds and the second lowest price for big sheds. Dublin has the lowest prices for big sheds and is much more competitive for industrial space than office space.

Figure 30: Prime Industrial Rental Values, 2015



Source: Colliers

Note: Dublin figures converted at a rate of €1 = £0.72

Within NI, there are differences evident in industrial rental prices. As Table 13 highlights (using data from nibusinessinfo.com[50]), the most expensive industrial rents are found in North Down (£5.04) with the least expensive in Newry & Mourne (£2.67). Manufacturers in these areas with lower rental values will be at a cost advantage over local businesses in higher price locations.

Table 13: NI Average Industrial Rental Values, 2014

Value	Location
Over £5 per sq ft	North Down
£4-5 per sq ft	Antrim, Banbridge, Derry/Londonderry, Belfast (outside city centre), Strabane
£3-4 per sq ft	Newtownabbey, Lisburn, Castlereagh, Ards, Magherafely, Craigavon, Fermanagh, Down
Under £3 per sq ft	Cookstown, Newry & Mourne

Source: nibusinessinfo.co.uk

As with office space, there are issues around the availability of industrial properties within NI with a lack of development taking place. Lisney's[51] highlights that although the availability of smaller industrial units (less than 10,000 sq ft) has improved; the options for larger units (particularly over 50,000 sq ft) are extremely limited. Just 1% of available industrial space in NI provides over 50,000 sq ft, meaning that options for inward investment and potential expansion of larger local companies remains limited.

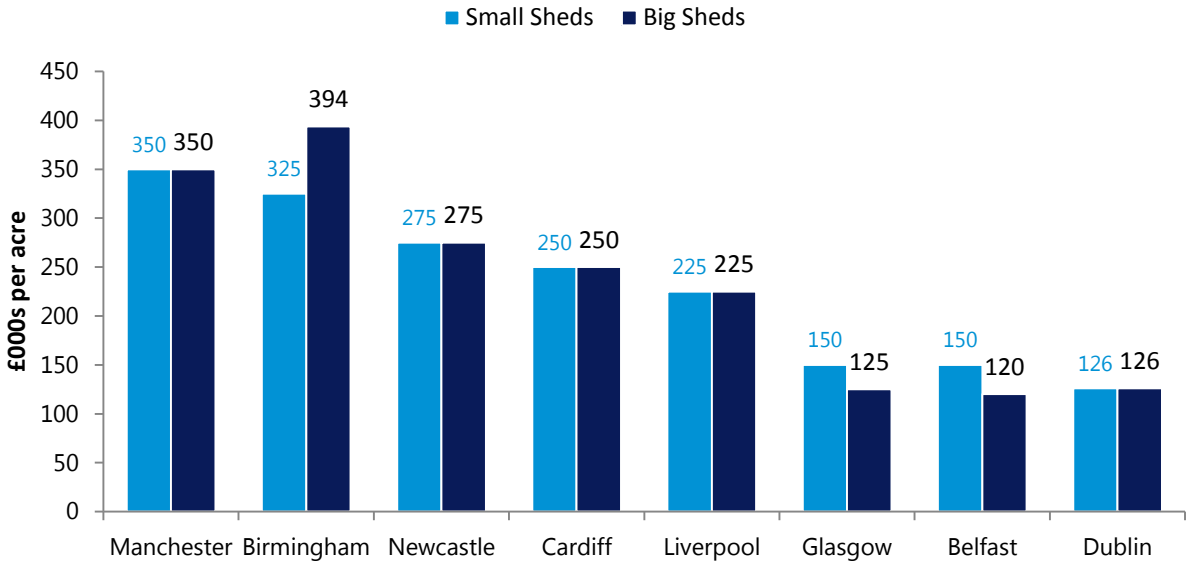
Again, the relatively low prices in NI may be contributing to the lack of industrial development. The CBRE 2015 outlook[52] finds that there is little likelihood of any new speculative industrial accommodation being developed until rental values recover to the extent that justifies new development. Lisney's consider that a

rent in the region of £4.50-5.00 is the minimum needed by developers to support a feasible development. Only North Down had average prices above £4.50 in 2014 (Antrim was next highest at £4.47).

Industrial land values

Many industrial companies will own rather than rent their properties, as was the case with all the manufacturers that took part in our consultations. To compare industrial land values, data has been sourced from Colliers for Belfast against the same comparators used to compare rents. Figure 31 highlights that Belfast is highly competitive for land values, with prices broadly similar to Glasgow and Dublin but much lower than other UK cities.

Figure 31: Industrial Land Values, 2015



Source: Colliers

Note: Dublin figures converted at a rate of €1 = £0.72

Business rates

Non domestic rates are a government charge for the occupation of premises based on their assessed rental value at a particular point in time – they are therefore an inescapable business cost. The UK does not have a single unified non-domestic rates system. Since 1989 in Scotland and 1990 in England and Wales, each of these countries has had its own Uniform Business Rate (UBR) system and has set its own national multiplier or rate poundage. NI has retained its own non-domestic rate system.

Non domestic rate bills are calculated by applying a multiplier (rate poundage) to the value of the property. This value, known as the rateable Net Asset Value or NAV, is an assessment of the annual rental value that a property could reasonably be expected to be let for if it was on the open market. The multiplier applied to this is a combination of two different rates – one set by the NI Executive uniformly across the region (the regional rate) and one set by local councils which differs across districts (the district rate).

Table 14 highlights the current non-domestic rates, both district and regional in NI in 2015[53]. The regional rate set by the Executive was 31 pence, with the district rate ranging from a low of 19.80 pence in Fermanagh

& Omagh to a high of 27.78 pence in Derry & Strabane. This means that the rates multiplier in Derry & Strabane is 15% higher than in Fermanagh & Omagh. The overall NI average rate combined was 55 pence.

Table 14: NI Non-domestic Rates, 2015/16

	District Rate Poundage	Regional Rate Poundage	Total Rate Poundage
Derry & Strabane	0.2778	0.3186	0.60
Mid & East Antrim	0.2769	0.3186	0.60
Belfast	0.2548	0.3186	0.57
Causeway Coast & Glens	0.2448	0.3186	0.56
Antrim and Newtownabbey	0.2433	0.3186	0.56
Armagh, Banbridge & Craigavon	0.2420	0.3186	0.56
Mid Ulster	0.2268	0.3186	0.55
Newry, Mourne & Down	0.2197	0.3186	0.54
North Down & Ards	0.2103	0.3186	0.53
Lisburn & Castlereagh	0.2032	0.3186	0.52
Fermanagh & Omagh	0.1980	0.3186	0.52

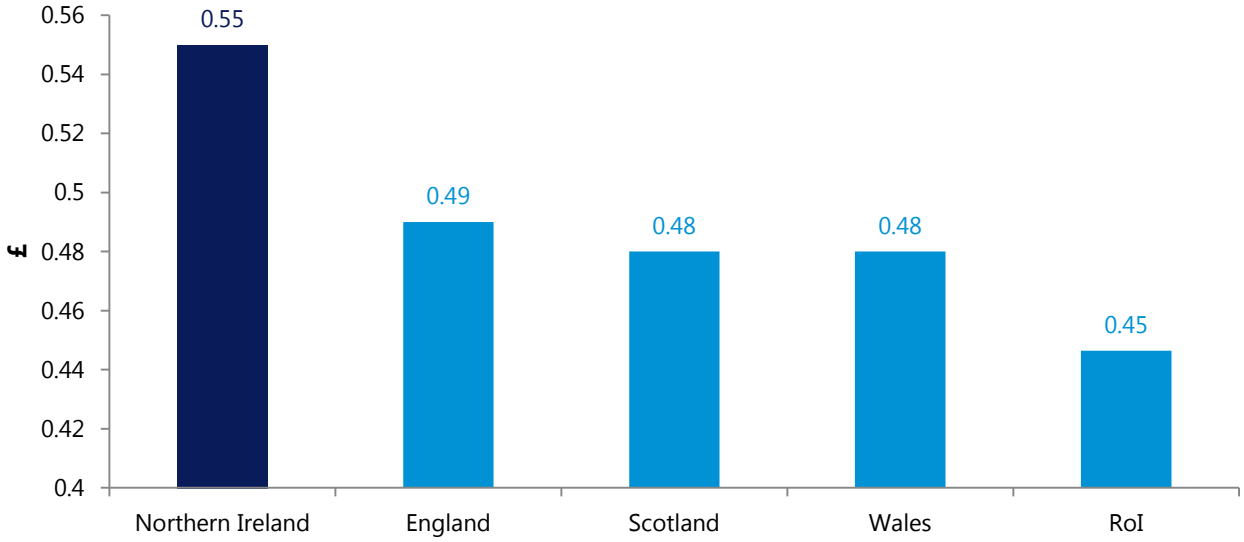
Source: Department of Finance and Personnel

Figure 32 provides a comparison of non-domestic rates multipliers for NI against elsewhere, which shows that the NI average of 55 pence is higher than elsewhere in the UK and ROI. However, this does not mean that rates bills are higher. This is because the multiplier is being applied to a rateable value which may be lower in NI than elsewhere. Indeed, our previous analysis has shown that industrial land values in NI are much lower than many other parts of the UK and, whilst not directly relevant for businesses but still a useful indicator of property values, the latest house price information from ONS[54] shows that NI prices are the lowest of all UK regions at 57% of the UK average. This information would all suggest that the value of similar business properties in NI against elsewhere is likely to be lower, which means that rates bills are likely to be lower even if the rates multiplier is higher.

Calculating total rates bills to benchmark against elsewhere would require data on the values of comparable properties across the UK and ROI, with which the multiplier could be applied. DFP Rating Policy Division were unable to provide information that would demonstrate NI rates bills against elsewhere. Anecdotal information, both from government and business consultations, would suggest that rates bills in NI are not higher relative to elsewhere.

A revaluation of non-domestic properties in NI has recently taken place and, from 1 April 2015, the rateable value of all non-domestic properties have come in line with property values as at 1 April 2013. This exercise aims to restore balance to the rating system, as the last revaluation of non-domestic properties in NI was in 2003 and was based on 1 April 2001 rental values. Property values have shifted considerably since the last revaluation, meaning that ratepayers will not be paying rates in direct proportion to the rental value of the property they occupy. A 2010 rates revaluation had been planned, but was cancelled in light of the continued economic downturn and instability in the property market.

Figure 32: Non-domestic Standard Multipliers, 2015/16



Source: House of Commons Library, Standard Note: SN/PC/06247

Note: ROI figures converted at a rate of €1 = £0.72

The recent revaluation means that some business rate bills will go down and some will go up, whilst others stay the same. In general terms the impact on business ratepayers will depend on the relative changes in local rental values since the last non-domestic revaluation and not just rental changes over the last few years. If the total of all the rateable values (NAVs) in the Valuation List decreases after the revaluation, the rate in the pound to produce the same revenue will have to increase proportionally to maintain the same level of revenue. The implications of this revaluation on the various rating relief systems have been estimated by DFP Rating Policy Division[55].

In the absence of a full comparative analysis on NI non-domestic rating charges, Land and Property Services (LPS) have provided analysis on rates costs in respect of Grade A specification offices in Belfast and industrial space charges in the city. In the usual prime locations, especially the City centre, Lanyon, Gasworks, Clarendon and Titanic Quarter areas, rates costs have been assessed at £7 per square foot. In addition, car parking typically will cost the user a rates charge in the range of £500-£700 per space per annum – although sometimes letting arrangements for car parking are quoted inclusive of rates.

Extending this analysis to industrial space is more difficult due to considerable variation between production/warehouse space; office provision/quality relative to the factory itself; and extent of external marshalling areas, car parking, storage, etc. However, based on the analysis of typical high quality units in prime industrial locations, rates costs have been assessed at around £1.85-1.95/sq ft on the overall internal area of the building(s) in the main prime locations of Mallusk and Dargan. The figure would be slightly higher in the Boucher/Adelaide area of South Belfast at around £2.50-2.60/sq ft, whereas lower quality units or those with limited specification would come in at lower cost.

5.3 Property cost changes

Property experienced the third highest rise of all 'location-specific' costs in our survey, with increases reported by 40% of NI firms. A lower proportion of ROI firms (28%) reported increases in this cost area by

comparison. To analyse the changes in NI, property costs have been split into changes resulting from business rates and those from other property costs such as rent. Note that one firm can report increases in both rates and other costs, meaning the separate figures will not sum to the overall average.

Table 15 highlights that just under one-third (31%) of local businesses reported rising rates costs during 2013, with the majority experiencing an increase of less than 10%. The increase was slightly higher amongst growth firms and exporters.

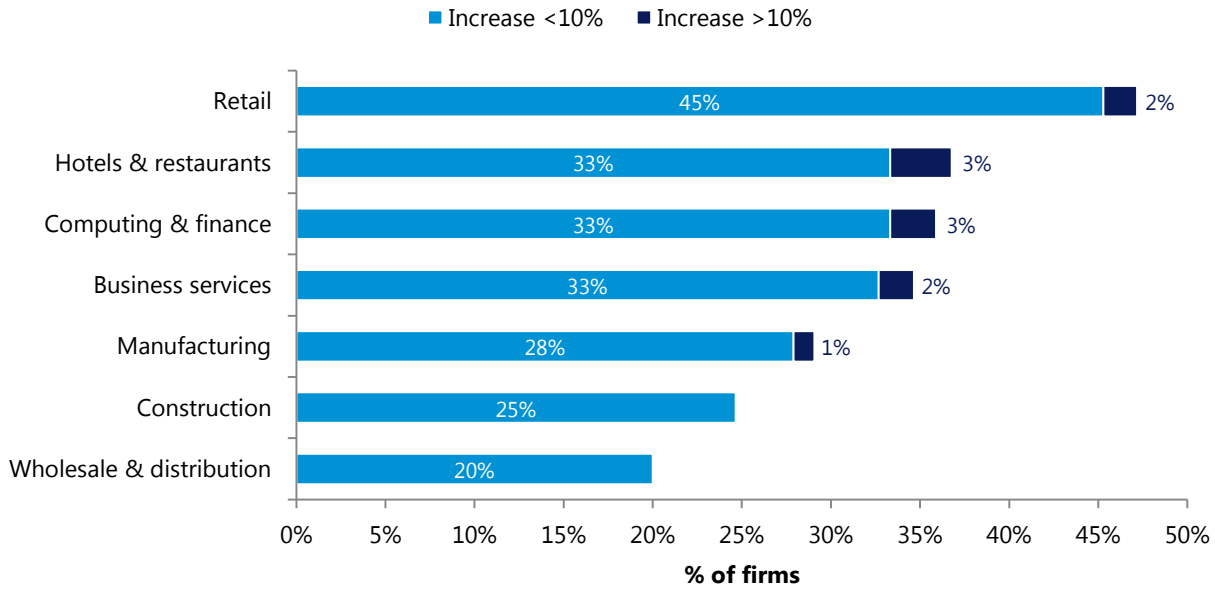
Table 15: Rates Changes, 2013

% of firms	Decrease	Unchanged	Increase	Size of increase	
				≤10%	≥10%
All firms	6%	63%	31%	30%	1%
Growth firms	5%	55%	39%	33%	6%
Exporting firms	7%	54%	39%	34%	5%

Source: InterTradeIreland Business Survey

Figure 33 highlights that, by sector, retailers were most likely to have reported rates increases during 2013, with just under one-half of companies (47%) claiming increases. The Northern Ireland Independent Retail Association (NIIRTA) stated that "business rates is the top priority for NIIRTA in 2015... we face a perfect storm of challenges such as the rates revaluation, long term future of the small business rate relief scheme and rates convergence of the 11 super councils."[56] Although city centre retailers, as noted by CBRE in their 2015 outlook[57], are likely to experience some reduction in their rates bill following a revaluation in April 2015, there will be some exceptions on high streets such as Arthur Street in Belfast – which has seen a vast increase since the last revaluation, primarily due to its proximity to Victoria Square.

Figure 33: Sectoral Rates Changes, 2013



Source: InterTradeIreland Business Survey

Companies did not face the same level of cost increases from other property costs (see Table 16). Whilst 31% of firms reported rates increases in 2013, the figure for other property cost increases was much lower at 18%. There was very little difference between the overall average and those companies that were growing and exporting.

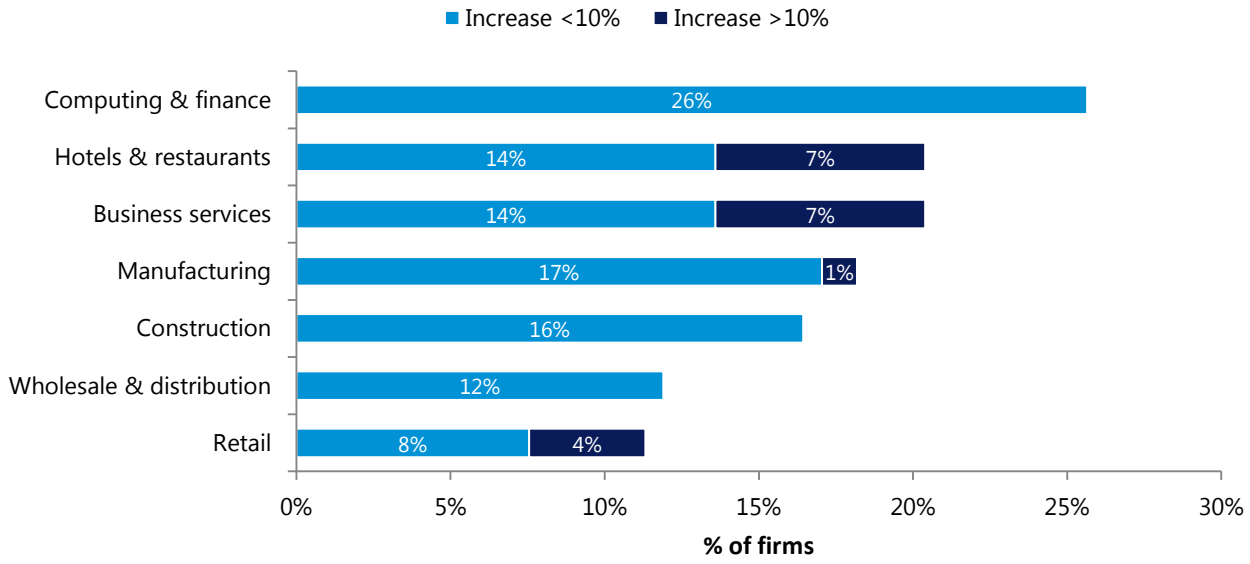
Table 16: Other Property Cost Changes, 2013

% of firms	Decrease	Unchanged	Increase	Size of increase	
				≤10%	>10%
All firms	4%	77%	18%	15%	3%
Growth firms	1%	76%	21%	15%	6%
Exporting firms	5%	76%	19%	13%	6%

Source: InterTradeIreland Business Survey

The sectoral picture for other property cost rises is very different than for rates (see Figure 34). Whereas retail was clearly reporting the most increases in rates, these companies experienced the least increases in other property costs. In contrast, computing & finance businesses had the most companies claiming other property cost increases. A larger proportion of companies within hotels & restaurants and business services reported increases that were significant – at over 10% during 2013.

Figure 34: Sectoral Other Property Cost Increases, 2013



Source: InterTradeIreland Business Survey

5.4 Reducing property costs

Property costs such as rental prices and land values will largely be determined by market forces, meaning that government can only have a limited role in trying to impact on demand or supply which determines these prices. In contrast, rates are set directly by government (both central and local).

Government approach on property

Given how competitive prices are for business rents in NI, government intervention is not seen as a priority to address high prices. However, there is a widely reported issue around the availability of supply of suitable office accommodation. Invest NI has noted that for property developers to provide Grade A office space, and indeed funders to finance them, developments must be viable. The current level of returns on property development, because of our low rental prices, will therefore be hampering this. Invest NI has carried out a comprehensive research report on the current state of the NI property market for businesses which highlights these issues[58].

However, Invest NI has identified recent transactions within Belfast city centre that have completed at more than £15 per sq ft and asking prices continue to increase. Grade A rentals are reported to have increased by 19 per cent in the past year and are now moving towards the £17/18 per sq ft required to make development viable[59]. Invest NI has also announced that it is proposing to offer private sector developers mezzanine or equity funding on commercial terms towards the development costs of new Grade A office accommodation[60].

This type of finance initiative is over and above the existing property interventions that Invest NI already offers to companies. Invest NI owns a range of business parks and industrial land which are available for companies to avail of where appropriate. It also can work with companies to identify suitable properties and provide financial support towards construction costs[61].

Government approach on business rates

NI is the only region in the UK which benefits from industrial de-rating, which allows manufacturers to face lower rates bills. Local manufacturers previously benefitted from 100% rates relief, but the phased removal of industrial de-rating in NI began in April 2005 with a planned gradual increase in liability until industrial properties attract full rates in 2011[62]. However, following a further review of rating policy initiated by the NI Assembly in 2006, it was decided to cap liability at 30%.

Manufacturing businesses occupying qualifying industrial properties can therefore qualify to pay 30% of the normal occupied rates in NI. Consultation feedback from manufacturers has indicated that de-rating is a major advantage in managing their costs, and is viewed as essential to offset the cost disadvantages of higher electricity prices in NI. Companies raised concerns that future public expenditure cuts could put pressure on the NI Executive to consider removing industrial de-rating to raise revenue, which would remove what is seen as a major competitive advantage by manufacturing companies.

Outside of industrial de-rating, the NI Executive implements a wide range of rate reliefs for businesses[63]. A major relief has been the Small Business Rate Relief (SBRR) scheme, which allows businesses to receive up to 50% relief based on the value of their property. It has been in operation since 1 April 2010 and was due to end on 31 March 2015 but has now been extended until April 2016. An evaluation of the SBRR scheme was published in December 2014[64], which highlighted the positive impact on businesses to help improve cash flow, help with survival and reduce the cost of overheads. A decision is still to be taken on the future of the scheme post-April 2016.

In order to help fund the SBRR, a larger retailer levy (representing an average of 15%) was applied to large retail premises with a rateable net annual value (NAV) of £500,000 or more from 1st April 2012. This 'Tesco

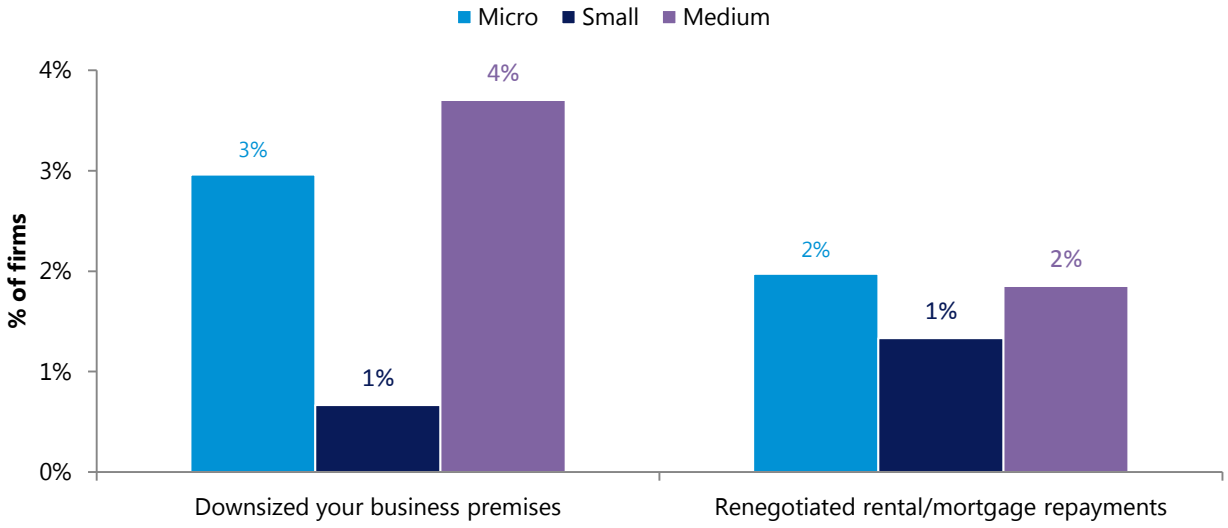
tax' incurred strong opposition from large retailers who maintained that it would limit their ability to invest and eventually cost jobs[65], and the levy ended on 31 March 2015.

The NI Executive has also committed up to £30million for a four year District Rate Convergence Scheme[66]. The move from 26 to 11 District Councils[67] as of April 2015 means that some companies will face higher rates bills due to large differences in the level of rates charged by adjoining Councils. The District Rate Subsidy applies to domestic and non-domestic ratepayers whose rates would otherwise have increased significantly for this reason. It provides a 80% discount in 2015/16 year for this effect and this will be phased out in stages over four years.

Business steps to reduce costs

Around 10% of NI companies took steps to reduce their property costs during 2013, slightly above the equivalent ROI figure of 8%. The most common step taken to reduce property costs was downsizing business premises (3%) followed by renegotiating rental/mortgage payments (2%). Figure 35 provides a breakdown of companies taking these steps by size.

Figure 35: Business Steps to Reduce Property Costs, 2013



Source: InterTradeIreland Business Survey

5.5 Summary and conclusions

Property is an important cost for businesses, both in terms of the price of renting/owning a property and the rates bills that are charged on this. NI is a highly competitive cost location for both office and industrial space, offering lower rental prices and land values than elsewhere in the UK. There are significant cost advantages from doing business in NI based on these prices. However, these competitive advantages are also having a negative effect, constraining local property development and leading to concerns around the availability of property. This shortage of supply, especially for Grade A office space in Belfast, will constrain the growth of local companies and foreign investors if not addressed.

This would become an even greater issue with a reduction in Corporation Tax expected to attract a large number of new companies and encourage expansions amongst existing companies. Invest NI is considering

a short-term finance scheme to assist property developers which – alongside the wider measures being done to improve access to bank finance in NI – can help to support greater property development than has been the case in recent years.

This study has been unable to provide a comprehensive assessment of rates costs against elsewhere in the UK and ROI. Although the local rates multiplier is higher than elsewhere, the rateable values of properties are likely to be lower meaning overall bills may be lower. A clear competitive advantage from doing business in NI is evident through industrial de-rating, being the only part of the UK to allow manufacturers to benefit from rates bills at 30% of the full value. Other incentives are available, including for small businesses, although retailers in particular continue to face significant challenges with regards their rates bills.

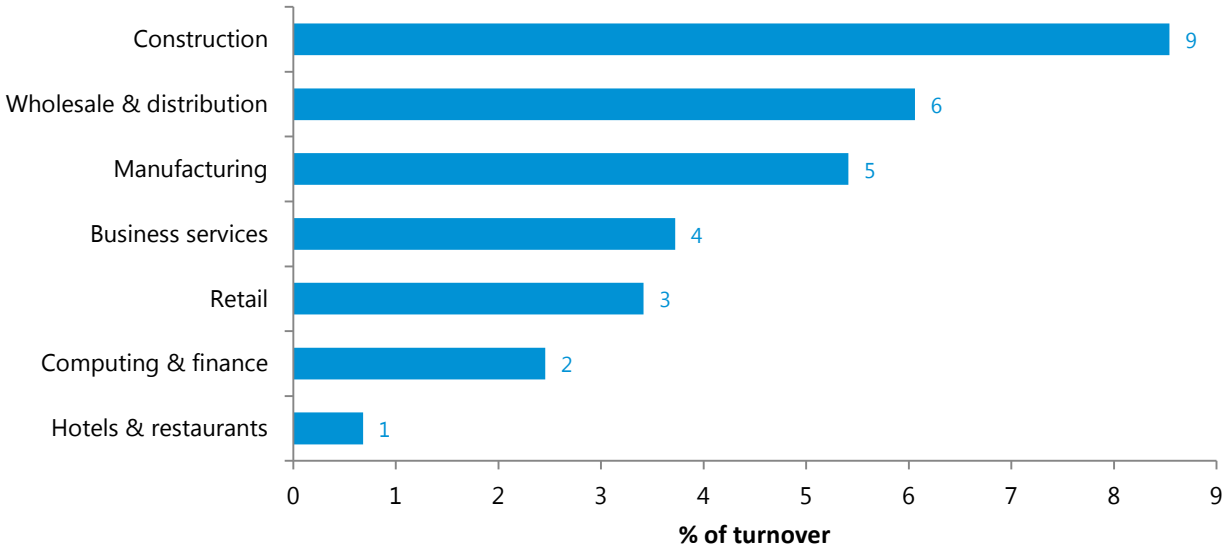
6 TRANSPORT COSTS

Transport is the fourth most important cost area for businesses on average. As a peripheral region, Northern Ireland faces greater transport costs than more central locations. Whilst prices for fuel and air travel are comparable to elsewhere in the UK, the additional travel distance and reliance on air travel will generate additional transport costs for local businesses.

6.1 The importance of transport costs

Transport costs were found to be the fourth largest cost area for businesses, accounting for 5% of turnover on average. As shown in Figure 36, transport is a greater cost burden for sectors that deal with physical products, such as construction, wholesale & distribution and manufacturing. Conversely, transport costs have very little impact on the hotels & restaurants sector.

Figure 36: Sectoral Transport Costs



Source: InterTradeIreland Business Survey

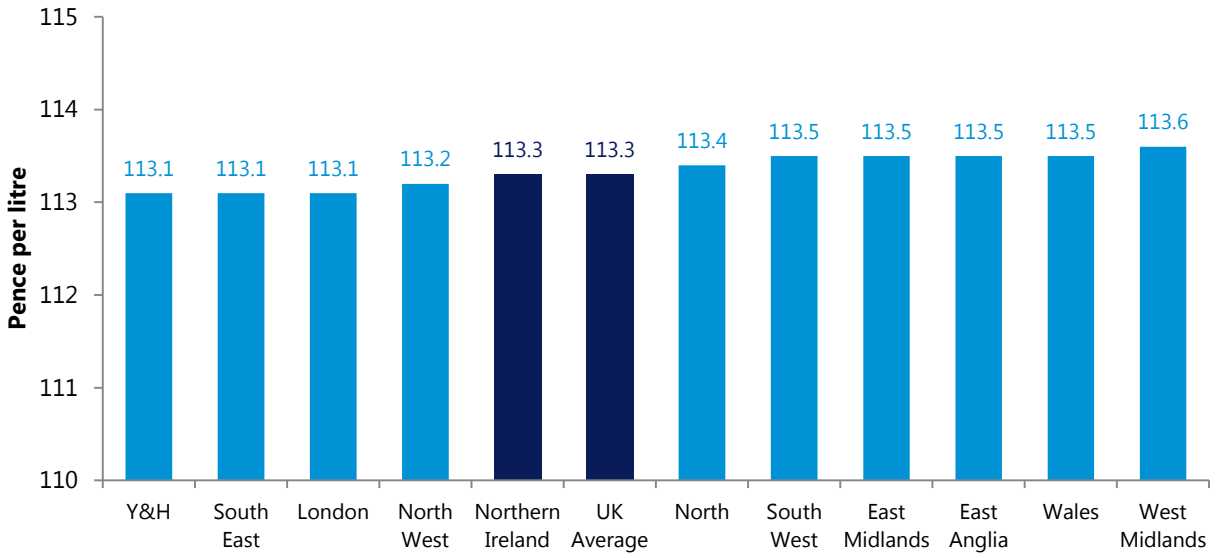
6.2 Benchmarking transport prices

Comparable information was readily available on NI fuel prices versus other UK and EU locations from the AA Fuel Price Reports, whilst analysis at a national level was available for trends in fuel duty, levies, import and export costs. Internal ASU analysis was carried out to determine air travel prices for companies on key business air routes.

Fuel prices

Based on AA data[68], Figure 37 highlights that petrol prices in NI in April 2015 were equivalent to the UK average. Overall, there is very little difference in petrol prices across the UK, with the lowest price region (Yorkshire and the Humber) being just 0.4% lower than the highest priced (West Midlands).

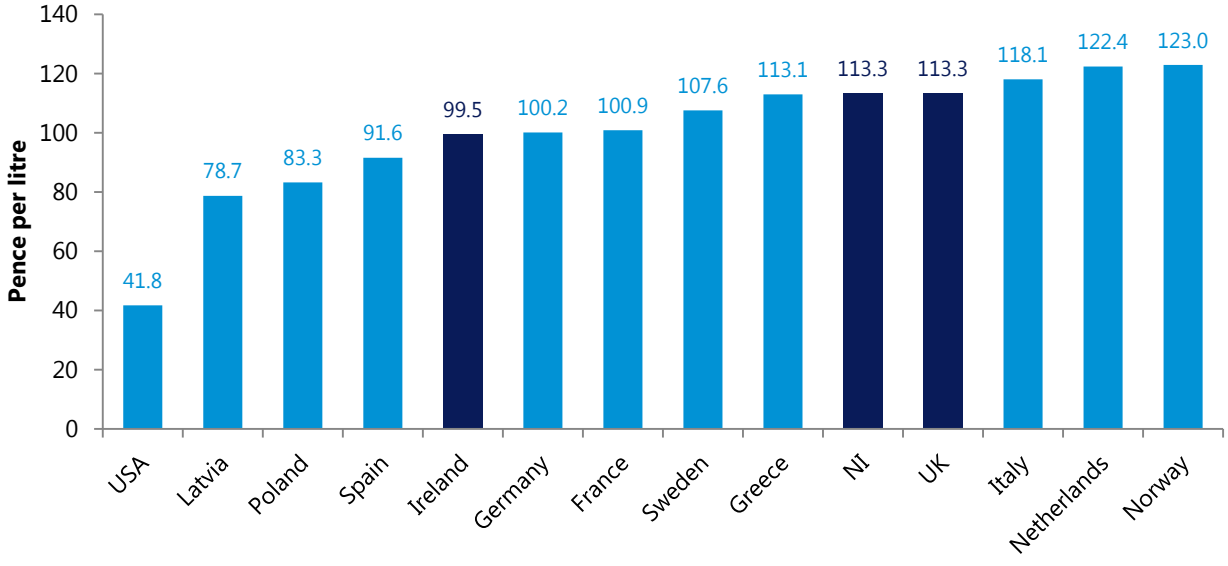
Figure 37: UK Petrol Prices, April 2015



Source: AA Fuel Report

Whilst NI petrol prices are relatively competitive in a UK context, the AA data in Figure 38 demonstrates that UK prices are relatively high compared with elsewhere. Whilst Italy, Netherlands and Norway all have higher prices than the UK and NI, the rest all have lower prices. The US has significantly lower petrol prices than any EU comparator, at almost one-half the price of Latvia (which has the lowest petrol prices in Europe).

Figure 38: International Petrol Prices, April 2015



Source: AA Fuel Report

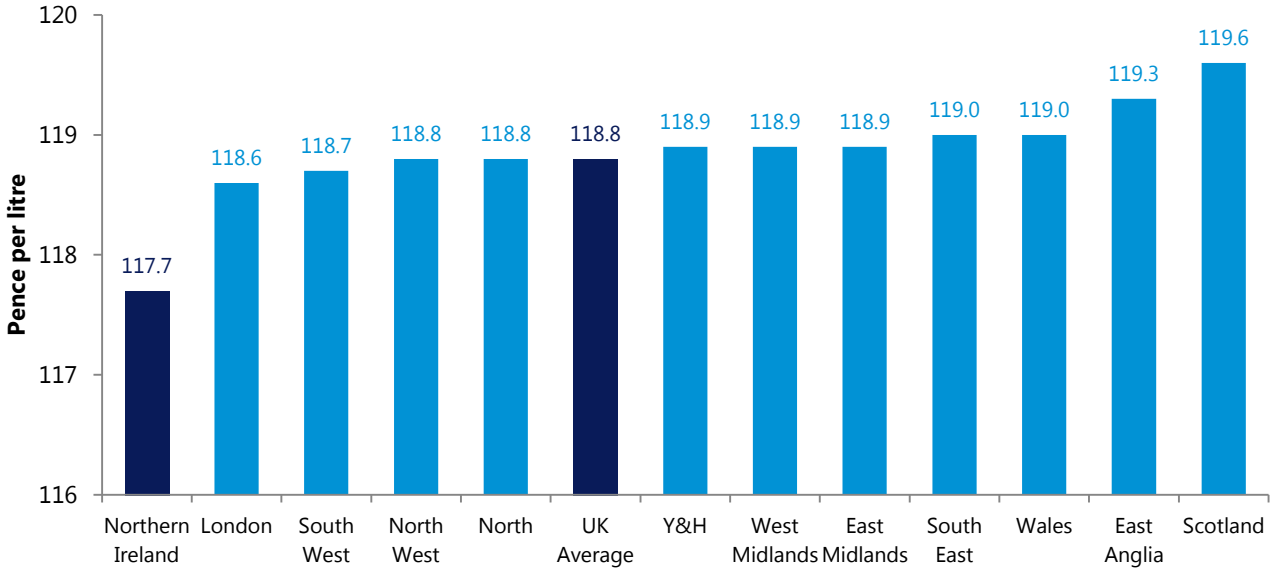
The above chart only covers a selection of international locations. AA fuel price data is available for a total of 29 countries alongside NI and the UK. Widening the analysis to these 29 comparators reveals that 26 have lower prices than NI and the UK, whilst just three have higher prices. The average petrol price across the 28 European countries (excluding the US) is 97.1 pence per litre, meaning the ROI is also above the average albeit to a lesser extent than the UK and NI.

A key reason for this is due to the level of taxation that the UK government imposes on fuel. Information for April 2015 from DECC[69] highlights that 68% of the pump price in the UK is due to tax compared with the EU28 average of 58% and the ROI figure of 62%; no other EU country has such a high burden of taxation on petrol prices. In addition, the recent strength of the Pound against the Euro will also make UK prices seem higher as they have been converted from the local currency.

Diesel prices

Diesel prices in NI are the lowest of all the UK regions (see Figure 39). Compared with petrol, diesel prices are less homogeneous; for example, NI prices are 0.9% lower than the UK average and 1.6% below the highest priced UK region (Scotland).

Figure 39: UK Diesel Prices, April 2015

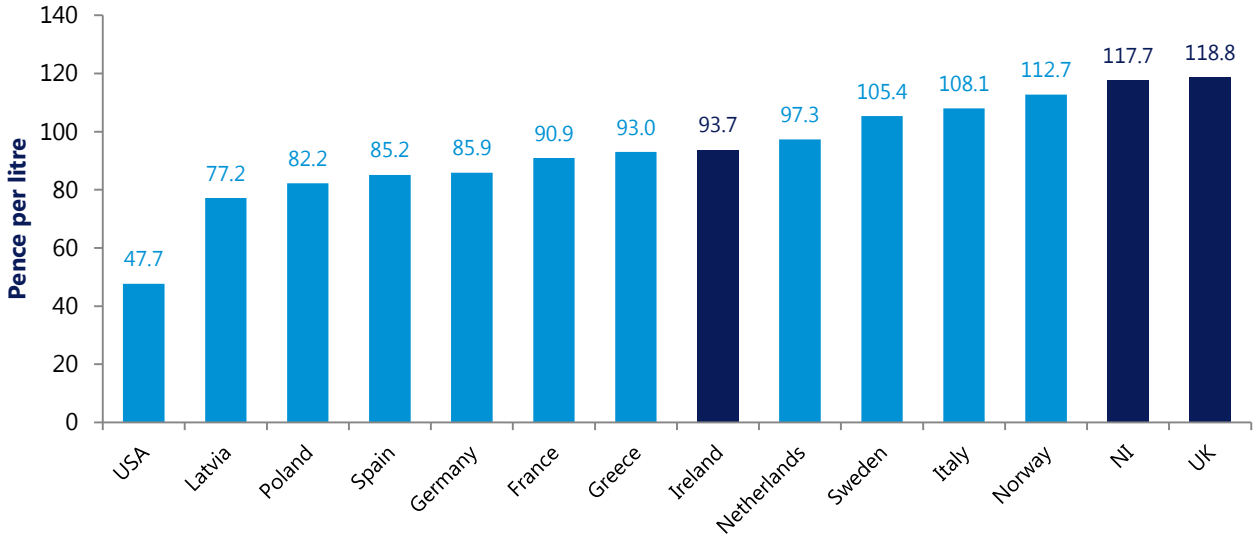


Source: AA Fuel Report

Similar to petrol prices, whilst NI has competitive prices against other UK locations, the wider international picture (Figure 40) highlights that UK diesel prices are highly uncompetitive. All 29 international locations where data was available have significantly lower prices than the UK (and NI). The average price of diesel across the 28 European countries (excluding the US) is 89.7 pence per litre, meaning that the ROI is above the average but again to a much lesser extent than the UK and NI.

A key reason for the price difference is again down to the tax charged on diesel. DECC information for April 2015 highlights that 65% of the total UK diesel pump price is down to taxation, the highest proportion in the EU28 against an average of 53%. The ROI equivalent figure is 57%, also above the average.

Figure 40: International Diesel Prices, April 2015



Source: AA Fuel Report

Import and export costs

Many local companies will use sea travel as a means of importing and exporting goods to and from NI, with a total of £934 million of goods shipped to non-EU countries shipped from Belfast port and a further £1.6 billion of goods imported in 2014[70]. A range of guidance to assist businesses in this process is available from nibusinessinfo.com[71].

To benchmark the cost burden on companies of importing and exporting goods, data from the World Bank[72] is available which measures both the cost and time for a standardised cargo of goods (a full 20 foot container weighing ten tonnes and valued at $20,000) to complete four stages (document preparation, customs clearance & inspections, inland transport & handling and port & terminal handling). Data is only available at a UK national level, but since NI shares a similar regulatory system as the UK the results should broadly reflect where NI is placed in the comparator listings.

An overview of the UK against selected other comparators in the World Bank cost analysis is shown in Table 17 (the full data can be found in Appendix C). Overall the UK compares relatively well in ease of importing and exporting goods, with a lower financial cost and relatively shorter time delay than the ROI, US and the average of 17 EU countries (where data was available).

Table 17: Cost and Time to Import and Export Goods via Sea, 2014

	Export		Import	
	Cost ($)	Time (days)	Cost $	Time (days)
UK	1,005	8	1,050	6
Ireland	1,160	8	1,121	9
EU17 average	1,148	12	1,326	11
US	1,224	6	1,289	5

Source: World Bank

Air travel prices

Air travel is vitally important for exporting companies to win business and serve customers in key markets. Connectivity to markets is therefore essential; it can bring about significant economic benefits to a region or country, including encouraging inward investment, developing exports and providing access for inbound tourists. The British Chamber of Commerce[73] has stressed how important air connectivity is for economic development, and the European Cities Monitor 2010[74] survey indicated that 51% of companies consider connectivity as an essential factor when deciding where to locate a business. This was one of the big four essentials factors in making an investment decision, the others being: easy access to markets, customers or clients, the availability of qualified staff and the quality of telecommunications.

The number of airline destinations available will be driven by the size of the market, which means that smaller economies such as NI will not be able to support as many direct flights as larger economies; for a small peripheral region, it is therefore not just direct flights that are important but also being able to access nearby airports and having direct links with international hubs. Table 18 shows that NI is well connected to GB and, in particular, Heathrow for onward international connectivity. NI's connectivity is significantly enhanced not just from these direct flights to Heathrow's, which serves 75 worldwide destinations that are not serviced by any other UK airport[75], but also the relative ease of access to Dublin airport.

Table 18: NI Connectivity with GB

Departures per week	Winter 12/13	Summer 2013
Heathrow	57	62
Other London	143	132
Other GB Provincial	419	416
Total	**619**	**610**

Source: DETI Economic Impact Assessment of Air Passenger Duty

No existing source of comparative information on prices for air travel currently exists. However, DETI ASU has carried out its own analysis on travel prices to key destinations compared with other UK cities. To inform this analysis, a number of key markets, both within the UK and internationally, have been identified following consultation with Invest NI and DETI Economic Policy Division.

Table 19 outlines the current levels of connectivity with these destinations based on information taken from airlines own website. This highlights that NI has extensive connectivity with all the selected GB markets on a daily basis throughout the day. There is also good connectivity with each of the markets in the EU and beyond, although these mainly rely on indirect travel via Heathrow or Dublin (with the exception of Newark where NI has a direct flight).

Table 19: NI Connectivity with Key Business Markets, 2015

Intra GB	Carriers	Frequency per carrier	Times
Glasgow	Flybe, Easyjet, BA	2/4 flights daily	Early morning through evening
Edinburgh	Flybe, Easyjet, BA	2/4 flights daily	Early morning through evening
Birmingham	Flybe, Easyjet, BA	2/7 flights daily	Early morning through evening
Manchester	Flybe, Easyjet, BA	2/7 flights daily	Early morning through evening
London City	Flybe	3 flights daily	Early morning through evening
London Heathrow	Aer Lingus	3 flights daily	Early morning through evening
EU			
Guernsey	Flybe	Up to 3 flights daily but with stoppages on the way	Not a direct route, possibility of 1-3 stops and mid-morning departures on some dates
Luxembourg	BA	Up to 3 flights daily but only with connection via Heathrow or Dublin	Early morning through evening
Frankfurt	BA	Up to 3 flights daily but only with connection via Heathrow or Dublin	Early morning through evening
International			
New York	United and BA	Daily flights *	Morning and afternoon flight
Toronto	BA	Up to 3 flights daily but only with connection via Heathrow or Dublin	Morning flights and evening returns
Singapore	BA	Up to 3 flights daily but only with connection via Heathrow or Dublin	Evening departures and returns
Chicago	BA	Up to 3 flights daily but only with connection via Heathrow or Dublin	Afternoon departures and evening returns
Hong Kong	BA	Up to 3 flights daily but only with connection via Heathrow or Dublin	Evening departures and returns

Source: DETI Analytical Services Unit

Note: The carriers listed are those used in the price comparison analysis, other carriers are available for the selected routes

** United Airlines temporarily suspended this route between January to March 2015 therefore this is a 10 month service at the time of writing as opposed to a yearly service*

NI travel prices (from both George Best Belfast City Airport and Belfast International Airport) to each of the key markets has been assessed against four other cities across the UK – London, Edinburgh, Manchester and Cardiff. (Whilst City of Derry airport is also available in NI the analysis was restricted on the two airports with the most extensive routes available for domestic and international travel). In addition to air fares, train prices for travel between cities on the UK mainland have also been included as this is an option for business

travellers as well. Searches were carried out on airlines own websites for Monday flights in February, March, April and May 2015 and then averaged over the period, with car parking charges at the departure airport also included to give an overall journey price (not including hotels or other costs in the destination market). Whilst there will always be limitations to using this approach and additional options available to companies that cannot be covered here, the analysis does provide a useful assessment of travel costs on a comparable basis. More information on the methodology and assumptions behind this analysis have been outlined in Appendix C.

A price comparison of travel between markets within the UK is shown in Table 20, with a journey costed for one days travel (leaving in the morning and returning in the evening). Whilst direct flights were available to and from most of the markets, Cardiff proved to be more complex to benchmark due to a lack of direct connectivity which pushed up prices as two flights were having to be made. Train prices are therefore likely to be more relevant for Cardiff, and their inclusion in this benchmarking is solely as a location to travel from rather than a market to travel to. The analysis highlights:

- **London** will be the largest market that companies around the UK need to access, and Belfast compares well here. The cost of flying to London Heathrow from Belfast is more competitive than from both Manchester (-9%) and Edinburgh (-18%). Access to train travel brings down the Edinburgh price in line with Belfast (although requires more than nine hours travelling), wheras Manchester remains more expensive. Belfast is more expensive to fly to London Heathrow when compared with a train journey from Cardiff (+65%);
- **Edinburgh** is an easily accessible and cost competitive destination for flights from Belfast, and it is cheaper to fly there from Belfast than from Manchester (-16%), London (-34%) and Cardiff (-28%). However, using the train brings the price down significantly from both Manchester and London to become cheaper than Belfast. Train travel is likely to be a realistic alternative from Manchester, but the long journey from London may make this less likely even with the lower price; and
- **Manchester** proves to be a relatively cost competitive destination from Belfast. Flight prices from Belfast are lower than from London (-16%) but higher than from Edinburgh (+17%). Train prices make it cheaper to travel from Edinburgh and Cardiff, although this is not true of London.

Table 20: Intra-UK Air and Train Journey Prices

From:	Belfast	Edinburgh		Manchester		London		Cardiff	
To:	**Flight**	**Flight**	**Train**	**Flight**	**Train**	**Flight**	**Train**	**Flight**	**Train**
Belfast	-	£89.72	-	£103.72	-	£156.75	-	£116.97	-
Edinburgh	£113.23	-	-	£134.22	£94.25	£172.00	£80.93	£158.34	£299.95
Manchester	£119.98	£102.47	£90.33	-	-	£142.75	£143.58	£192.95	£67.85
London	£164.73	£201.24	£163.20	£181.24	£227.08	-	-	£215.70	£99.75

Source: DETI Analytical Services Unit

For international destinations, a business trip of three days was costed from each of the key GB cities. Note that Cardiff was excluded from this analysis due to the lack of direct flights to Heathrow which was used as a connection hub by all other cities. Additionally due to incompatible departure and arrival times it proved impossible to cost a three day trip to destinations such as Guernsey and Luxembourg, meaning a trip of five days was required to provide comparability.

A comparison of international air prices is shown in Table 21. This highlights that whilst differences do exist, prices are broadly comparable from most of the UK cities to the key international destinations. A summary of findings relative to Belfast is shown below:

- **London** has higher prices on two of the eight air routes compared with Belfast, and lower prices on the remaining six. London is £270 more expensive to Newark than from Belfast (with the latter benefitting from the removal of long haul APD cost in flights), whereas prices to all the other non-EU destinations (Chicago, Toronto, Singapore, Hong Kong) are all more than £100 cheaper from London than Belfast;
- **Edinburgh** is more expensive on three of the eight destinations than from Belfast, and cheaper on the remaining five. In absolute terms compared with Belfast, Edinburgh is most expensive to Frankfurt (+£60) and least expensive to Toronto (-£159); and
- **Manchester** is higher priced to two of the eight destinations compared with Belfast, and lower priced on the remaining six. Newark has the biggest price disadvantage from Manchester against Belfast (+£211), with the largest advantage being to Chicago (-£187).

Table 21: International Air Journey Prices

From: / To:	Belfast	Edinburgh	Manchester	London
Guernsey	£213.47	£200.98	£180.77	£276.00
Frankfurt	£348.23	£409.32	£333.66	£279.60
Luxembourg	£350.98	£388.99	£333.99	£262.10
Newark	£1,488.38	£1,364.79	£1,699.49	£1,758.03
Toronto	£1,986.48	£1,827.74	£1,844.74	£1,876.60
Singapore	£2,096.48	£2,110.74	£2,114.49	£1,982.27
Chicago	£2,097.98	£1,942.74	£1,919.49	£1,981.78
Hong Kong	£2,293.98	£2,218.66	£2,226.32	£2,184.60

Source: DETI Analytical Services Unit

The results of the analysis did not highlight particular price advantages to doing business from any one city in reaching the overseas destinations, although in practical terms London would generally have the greatest advantage as no connecting flight to Heathrow is needed (unlike from Belfast, Manchester and Edinburgh) which would reduce the journey time both ways.

Overall the analysis has served to highlight that while NI may occupy a peripheral position in the UK, this does not necessarily mean it has worse connectivity (when access to a hub airport such as Heathrow is taken into consideration) or higher prices; indeed, Cardiff would generally appear to have more difficulty in accessing both other UK and particularly international destinations than in NI. However, we are more reliant on air travel than other UK locations as our small population effectively limits the range of direct international air links that can reasonably be maintained, but connectivity with key hub airports such as Heathrow and Dublin mean it is not always necessarily more expensive for NI firms to reach domestic and overseas destinations. In addition, the direct Newark flight offers significant price advantages compared with London and Manchester.

6.3 Transport cost changes

Table 22 highlights that just over half (53%) of local businesses reported rising transport costs during 2013, the second highest of all 'location-specific' costs; this is slightly higher than the ROI equivalent figure of 49% increasing their transport costs. For those local firms with rising transport costs, the majority (two-fifths) reported less than a 10% increase, with 13% having significant transport cost increases over the year. It is likely that the large increases in energy costs during 2013 will also have a significant bearing on transport costs, with the price of oil directly influencing fuel prices and thus also air travel. It would therefore be expected that rising energy prices leads to corresponding rises in transport prices. A significantly higher proportion of exporting firms faced increasing transport costs during 2013, which would not be unsurprising with a greater reliance on travel of goods or people to new markets.

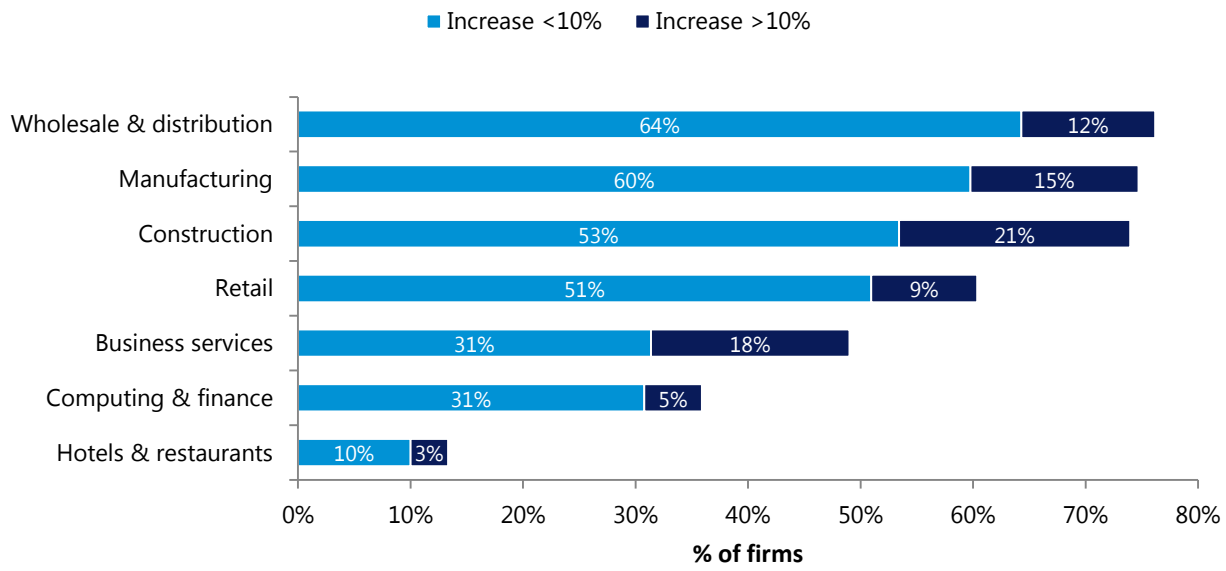
Table 22: Transport Cost Changes, 2013

% of firms	Decrease	Unchanged	Increase	Size of increase	
				≤10%	≥10%
All firms	2%	45%	53%	40%	13%
Growth firms	3%	53%	45%	35%	10%
Exporting firms	0%	32%	68%	54%	13%

Source: InterTradeIreland Business Survey

A sectoral breakdown of increases is shown in Figure 41. This highlights that firms in wholesale & distribution, manufacturing and construction are most likely to have reported rising transport costs. This could be down to a greater reliance on transport to bring raw materials in for production processes in these sectors with cost increases a reflection of higher demand/use.

Figure 41: Sectoral Transport Cost Increases, 2013



Source: InterTradeIreland Business Survey

6.4 Reducing transport costs

Transport prices are partly determined by the market (through oil and fuel prices) and partly by government (through taxation). The overall transport costs also brings in usage and - with an increasingly globalised economy and an Economic Strategy that prioritises exports - it would be likely that transport costs will not reduce in the future as companies become increasingly involved in overseas trade.

Government approach on transport

The earlier price benchmarking has shown the large competitive disadvantage that UK fuel duty has on prices compared with elsewhere. Data from the Freight Transport Association (FTA) highlights that UK fuel duty rates increased by 26.5% to 57.95 pence per litre between 7 March 2001 and 23 March 2011[76]. The Chancellor of the Exchequer announced in 2013 that fuel duty would remain at this level until the end of the current parliament in May 2015, and no further increases have been imposed since[77]. As fuel duty is set by the UK government, the NI Executive cannot vary the duty for local businesses. At present, parts of the Scottish Highlands benefit from a five pence per litre fuel discount given to remote locations, which is set to be extended to a further 17 areas, but no areas of NI will benefit from this discount[78].

A key government levy for air travellers is Air Passenger Duty (APD), an excise duty charged on the carriage of passengers from a UK airport. The rates charged depend on the passenger's final destination and the class of travel. Although APD is a tax on airlines, this is largely passed onto passengers. The Finance Act 2012 devolved the power to set APD rates to the Northern Ireland Assembly (NIA) on direct long-haul flights from NI and since 1 January 2013 these devolved rates have been set at £0[79]. However, APD remains £13 per passenger per flight to short-haul destinations (essentially covering the UK and Europe).

DETI has recently completed a study assessing the economic impact of reducing or abolishing APD on short-haul flights in NI[80]. This report highlights the positive benefits that reduced APD could have on business travel, estimating that abolishing APD could deliver an additional £1.1 million from businesses after two years. However, widening this analysis to incorporate both the total benefits (including tourism and multiplier effects) and total costs (imposed by HMT on the NI Executive) suggests that any overall economic benefit would be minimal and, as such, APD would not be a high priority to devolve compared with other higher impact taxes such as Corporation Tax.

Our business consultations highlighted that connectivity is as important, if not more so, than prices. This is particularly true for Northern Ireland, which is more reliant on air travel to reach markets than elsewhere in the UK. The DETI report suggests that a targeted intervention to develop specific air routes may be more appropriate than a widespread reduction in APD, and DETI officials have suggested that any future Air Route Development Fund would be targeted on key markets we do not already serve which have the greatest inbound tourism and business potential[81].

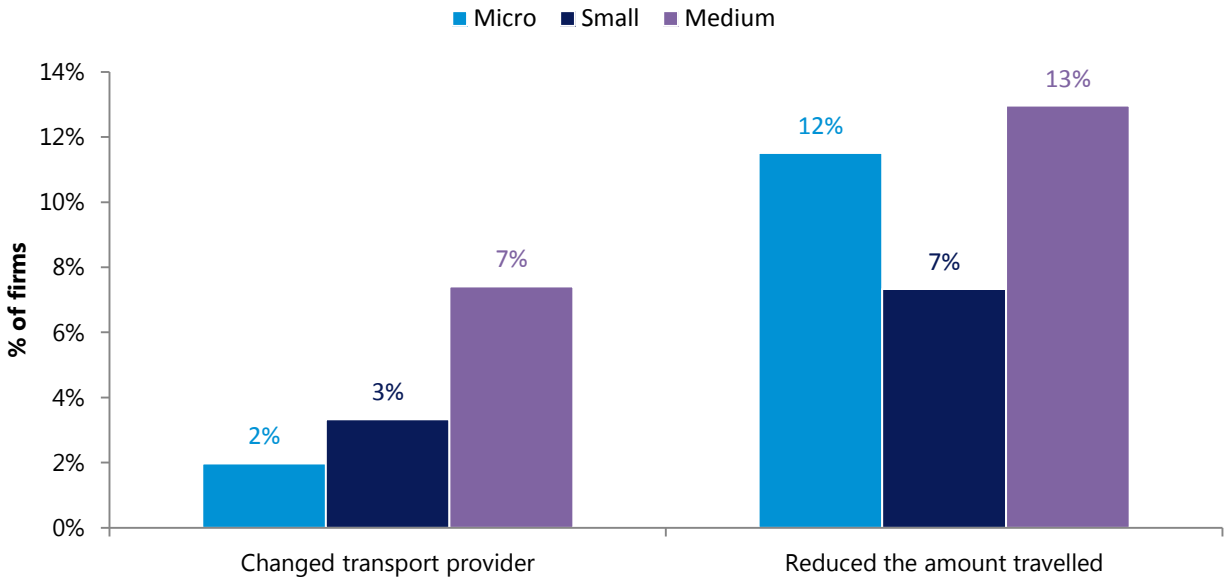
For businesses that rely on the road network to transport goods, a levy on Heavy Goods Vehicles (HGV) of 12 tonnes or more has recently been introduced by the UK government to ensure such vehicles make a contribution to the wear and tear of the UK road network. The levy was introduced by the HGV Road User Levy Act 2013 and began on 1 April 2014. Levy amounts vary according to the vehicle's weight, axle configuration and levy duration.

Whilst the FTA welcomes the Road User Levy, it is concerned that the Irish Government is currently in discussions with the British Government about exempting from the levy on certain cross-border routes on the NI road network. They maintain this is unfair, given that NI operators are required to pay toll charges on many of the main roads in the Republic, including the M1 and the Dublin M50 e-flow orbital route. Toll charges for NI companies using the Republic's road network amount to a minimum of £2,600 per truck per year[82]. The FTA is continuing to call on the government to ensure a level playing for NI freight by not exempting Irish registered goods vehicles using NI roads from the HGV Road User Levy.

Business steps to reduce costs

A similar proportion of businesses in NI took steps to reduce their transport costs (14%) during 2013 compared with those in the ROI (13%). The most common step taken was to reduce the amount travelled (11%) followed by changing transport provider (3%). Figure 42 demonstrates that larger firms (with 50 or more employees) tended to be much more proactive in taking steps to reduce transport costs than small and micro businesses, although micro businesses were more proactive than small firms in reducing the amount they travelled to control costs.

Figure 42: Business Steps to Reduce Transport Costs, 2013



Source: InterTradeIreland Business Survey

6.5 Summary and conclusions

Transport is an important cost for a wide range of companies; manufacturers transport costs may mostly be determined by fuel prices, shipping costs and associated import and export levies, whereas services transport will typically be associated with connectivity, e.g. air travel to meet with clients, visits to key markets etc.

Fuel prices impact on both road and air travel for businesses. Whilst NI is relatively cost competitive on fuel prices within the UK, it is at a disadvantage against other European comparators mainly due to the large tax levy set by the UK government. Whilst business interest groups maintain that more needs to be done to support local business beyond the current suspension of increases in fuel duty, there is a limit on the NI

government's influence in this area as the NI Executive has no influence over either the setting of fuel duty rates or the HGV levy recently introduced by the UK government.

Exporters will also rely on air travel to secure new customers and access key markets for their goods and services. In terms of air travel prices, NI companies are not at a significant cost disadvantage compared with elsewhere in the UK and also benefit from connectivity either directly to markets or via key hub airports. However it should be noted that there is currently no direct access to markets such as Germany and Scandinavia. Although the recent DETI report on APD has recommended that it is not a high priority to devolve and reduce/abolish, it suggests that a targeted Air Route Development Fund should be pursued. An initiative such as this could bring about improved direct access to new markets for business and inbound tourism prospects.

Setting aside comparative prices, the peripheral location of NI will always be at a disadvantage in terms of transport costs. Companies shipping goods to and from NI will have a extra journey from mainland GB ports, although sometimes this may not be apparent as the cost may be 'built into' the total price. Local firms also have no option other than to fly to mainland UK markets, whereas other UK competitors have a greater range of travel options which can reduce costs and offer more convenience.

7 OTHER COSTS

Outside of the four most important cost areas, insurance is the main cost that will impact on companies in general. Costs such as telecoms, compliance, environmental, professional and finance are generally not as significant, but still can place a burden on companies and need to remain competitive to help support the growth of local businesses and attract investment.

7.1 The importance of 'other' costs

This study has looked at six additional business costs over and above the four main ones considered thus far. These costs tend to be less important for companies on average and, therefore, less important for NI's competitiveness (although there will no doubt be companies where some of these costs will be important).

Of the six 'other' costs, Table 23 suggests that insurance is the most important of these for companies across most sectors (other than computing & finance where compliance comes across as most important). Nonetheless, the absolute importance of each of these cost types (as a % of turnover) is generally relatively low compared with the four costs reviewed in the preceding chapters.

Table 23: Sectoral 'Other' Costs

% of turnover	Manufacturing	Construction	Business services	Computing & finance	Hotels & restaurants	Retail	Wholesale & distribution
Insurance	2	3.5	2	2	4.5	2.5	2.0
Telecom	2	1	1.5	2	1.5	1.5	1
Compliance	1.5	2	2	2.5	0.5	1	1.5
Environmental	2	1	1.5	0.5	2	1.5	1
Professional	1	1	1	1	0.5	0.5	1
Finance	1	1	1	1	0.5	1	1

Source: InterTradeIreland Business Survey

Note: each figure has been rounded to the nearest half a per cent for ease of comparison purposes

7.2 Benchmarking 'other' costs

Whereas the four key costs looked at thus far have a relatively comprehensive range of information available to compare with elsewhere, there is generally much less data available for the six 'other' costs. Much of the reason for this is because NI, as a region rather than a country, does not have access to the same level of data and, where there is information, it is not directly comparable. Nonetheless, the following sections provide a brief overview of each area (a more detailed benchmarking is available in Appendix C).

Insurance costs

The main types of business insurance include public liability, employers liability, motor insurance and property insurance. Individual businesses may purchase a number of different types of insurance premium, either separately or in a 'bundle' to meet their needs.

A regular survey of NI insurance premiums was undertaken by the Department of Enterprise, Trade and Investment (DETI) from 2002 to 2007 to establish the cost of premiums to private sector businesses prompted by concerns among the business community that insurance costs were growing increasingly prohibitive. Note that this refers to costs and therefore takes into account level of coverage as well as the actual price. Some of the main findings from the most recent survey were:

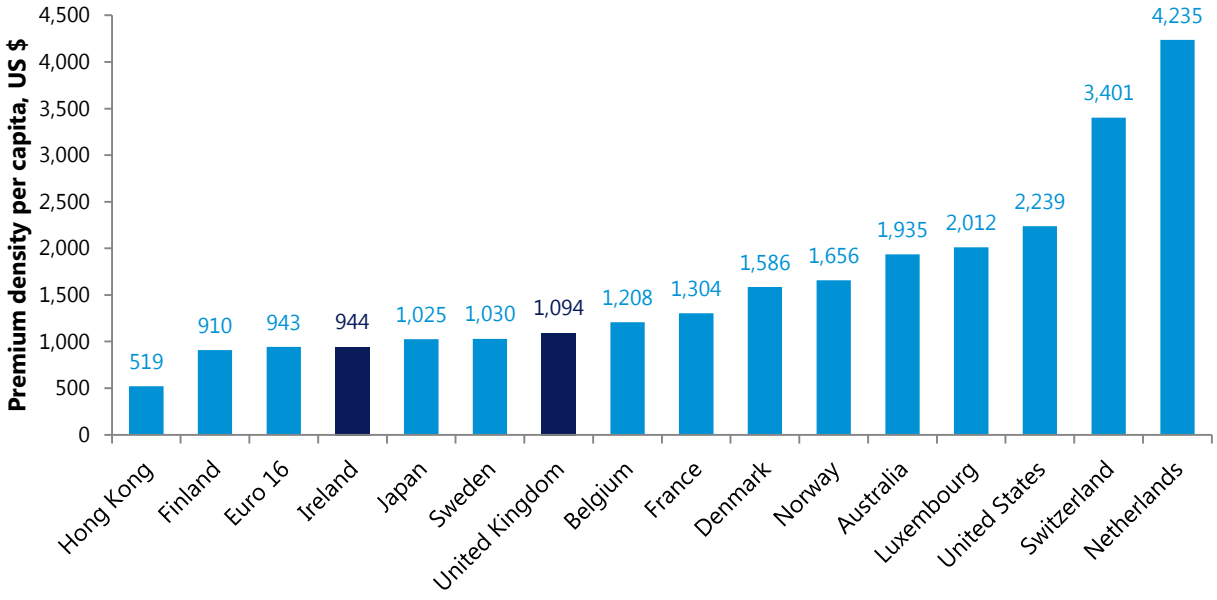
- The overall cost of insurance premiums per business reduced by 4.0% during 2005-06, to an estimated low of £9,821.
- Businesses with 1-9 employees reported the smallest annual decrease (1.1%) in costs during 2005-06 (£4,112 in 2005 compared to £4,068 in 2006), while businesses with 50-249 employees reported the largest decrease of 9.8% to £86,694 in 2006.
- The average cost of premiums per business was marginally highest in the Manufacturing sector during 2006 (£20,175), closely followed by the Transport sector (£19,524).
- Despite a 4.4% rise during 2005-06, service sector businesses continued to have the lowest average total cost of insurance premiums per business in 2006 (£7,897).

Given the greater stability evident in business insurance costs in 2005-06, NISRA proposed not to undertake a survey of business insurance costs thereafter[83]. Consequently there is no recent NI based comparative data analysis. Our consultations did provide useful insights though; insurance is an open and competitive market and NI businesses can take out insurance policies elsewhere in the UK. Local firms were able to make significant savings by broadening their search to GB insurance providers at the time of renewals, therefore companies do not need to be restrained by the local market when choosing premiums.

Although there is no comparable insurance data for NI insurance premiums, comparable information is available at a national level for the UK from Swiss Re[84]. This data covers non-life insurance premiums per capita (referred to as 'density per capita') for a number of countries. Non-life insurance relates to motor, property, employer's liability, public liability, travel and other business insurance. Given that NI firms can use UK insurance policies, this can provide a useful proxy.

High insurance density (premiums per capita) can be a function of both high insurance costs and the requirement for high coverage levels. Figure 43 highlights that the UK ranked in the middle of the comparators for density of non life insurance ($1,094), above Ireland ($944) but well below density rates in the Netherlands at $4,235 per capita. Whilst our consultations suggested that NI insurance costs were higher than those in the UK, the fact that NI businesses can take out UK insurance policies suggests lower premiums can be secured by 'shopping' in GB for policies.

Figure 43: Non-life Insurance Premiums, 2012



Source: Swiss Re

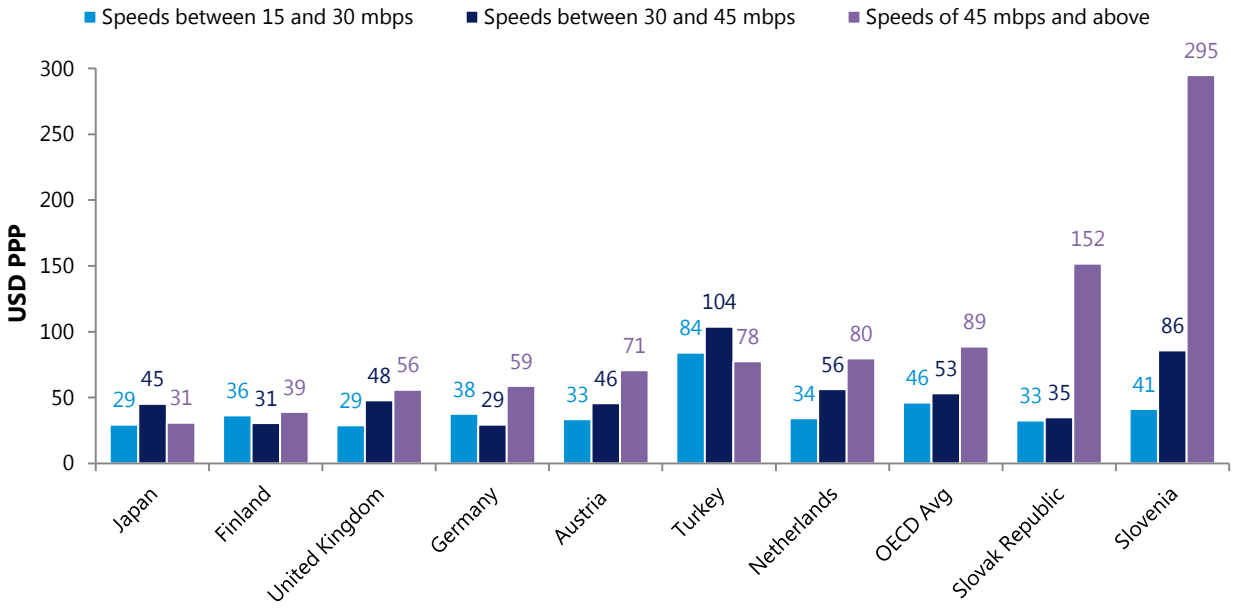
Telecoms costs

The NI telecoms industry is privatised and service providers invest in the region with a view to making a commercial return. There are around 70 operators in the de-regulated market and this should equate to better service and lower costs due to greater competition. There is no available comparative analysis on business telecoms prices in NI, although our consultations did not suggest that NI was particularly different from GB due to having a competitive market in place. The ROI has a has a smaller and less competitive telecoms market than the UK (and NI) which may lead to higher prices.

Our business consultations suggested that the most important issue for telecoms from a competitiveness viewpoint was speed and reliability rather than just prices. NI compared well from this perspective as the first region in Europe to achieve 100 per cent broadband coverage and one of the first to operate high speed, next generation services with a new 40-gigabyte per second transatlantic and terrestrial telecommunications link between NI, North America and Europe. This provides a secure, reliable service and is expected to deliver prices up to 20% below market rates in London, Dublin, Manchester and Glasgow[85]. More recently, a £17million Superfast Rollout Programme has been announced to bring improved speeds to over 38,000 premises[86].

Although there is no quantitative price comparison available for NI, data at a national level from OECD[87] in Figure 44 highlights that the UK performs well in terms of the costs for monthly subscriptions of varying broadband speeds from 2.5 mbps to 45mbps and above. UK prices range from 11% - 60% lower than the OECD average, and if NI is broadly similar to the UK (as our consultations would suggest), this would mean that local businesses may also have a similar competitive advantage internationally.

Figure 44: OECD Broadband Prices, 2011



Source: OECD

Compliance costs

Compliance with Government regulations carries a cost that must be borne by businesses in terms of money and time. There are more than 70 regulatory bodies operating in NI at the moment, around half of which are national bodies with the remainder being local bodies. The local bodies comprise those regulators focussed on environmental health, licensing and building control whereas the national bodies deal with more diverse areas including health and safety, HMRC, OFCOM, Competitions Commission etc.

Estimates of the cost of the administrative burden from regulation in the UK are around 3-4% of GDP, while the policy costs are 7-8% of GDP[88]. A survey by the Forum of Private Business in 2010[89] reported that businesses spent 37 hours on average on compliance issues per month. This equated to average costs for a year of:

- £1,358 for micro businesses
- £3,289 for small businesses
- £5,711 for medium businesses

A regular study by the World Bank[90] provides objective measures of business regulations and their enforcement. The Doing Business indicators are comparable across 189 economies and within the 2015 report the UK was ranked 8th for ease of doing business whilst Ireland was ranked in 13th place.

Whilst there is little comparative data available at an NI level on overall compliance costs, there are figures on the cost of completing statistical surveys - something which all local businesses must do. NISRA regularly reports on the cost to businesses of completing statistical surveys issued by NI departments[91]. In 2012/13, 124 surveys of business were issued by government departments, of which 41 were statutory and 83 were voluntary. The estimated cost to business in NI in 2012/13 of complying with government statistical surveys was almost £1 million, three quarters of which was attributable to statutory surveys. Information provided by

NISRA Corporate Business and Finance Branch (see Table 24) shows that compliance cost per questionnaire for official statistical surveys to businesses in NI compares favourably with England & Wales.

Table 24: Cost to Business of Complying with Official Statistical Surveys

	NI	England & Wales
Compliance Cost	£958,714	£50,593,000
Number of questionnaires returned	103,140	2,700,000
Compliance cost per questionnaire	£9.3	£18.7

Source: NISRA

DETI has recently completed a comprehensive Review of NI Business Red Tape[92] to assess the regulatory landscape and reduce the unnecessary burden imposed by compliance where it may exist for local businesses. Our consultations suggested that a key issue for businesses is identifying what guidance they actually have to comply with as this is a time consuming process (a key finding of an InterTradeIreland study in 2009[93]). The final Red Tape Review has now been published and makes a number of recommendations to improve the regulatory landscape in NI, which should reduce compliance costs for businesses going forward.

Environmental costs

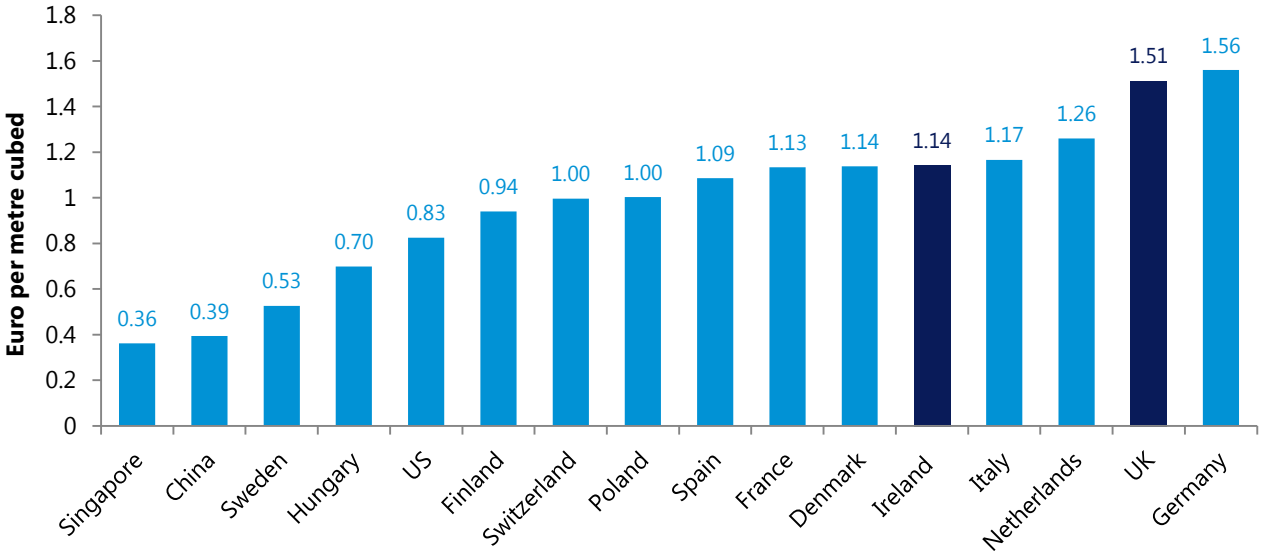
For most firms, environmental charges comprise mainly of water and waste disposal costs. Water and sewerage services used for non-domestic customers are charged annually by NI Water (NI domestic users currently do not pay water charges[94]). Charges will either be applied on a measured basis if a meter has been installed, or unmeasured - based on the Net Annual Value of the property. Measured charges have two elements: a standing charge based on supply pipe size; and a variable charge based on the consumption recorded on the water meter (volume of water used). The tariffs that apply and the allowances available are published by NI Water in an annual Scheme of Charges[95].

From April 2015, NI Water has increased its charges to non domestic customers, its first price rise in three years[96]. While the average increase was estimated at 2.4%, some businesses that do not have water meters would face a higher rise. NI Water estimated that the financial impact of the changes could increase bills on a medium factory by 1.4%, or £45, whereas a small shop or office without a meter would face a 6.4% increase, or £16. Customers using in excess of 100,000m^3 of water per annum and implementing a range of water efficient practices can benefit from a reduced large user tariff ranging from 20-30% depending on usage[97].

Given the variety of pricing structures in place across Europe, it is difficult to get a uniform measure of water pricing. However, as shown in Figure 45, Forfás has provided an estimation of water costs for industrial users across a range of European countries[98], estimating that the UK is the second most expensive country for water charges behind Germany. Ireland is also in the top five most expensive locations benchmarked. However, given the complexities and inconsistencies in how water costs data is collected internationally, caution should be used when drawing inferences from the data.

Feedback from our consultations indicated that water and effluent charges were clearly sector specific, high water users in manufacturing being most concerned. The response from larger water-intensive users has been fairly uniform; they have worked to develop efficiencies in terms of processing to reduce usage and in some cases opened bore holes on site to increase self sufficiency to manage costs in this area.

Figure 45: International Water Charges, 2012/13



Source: Forfás

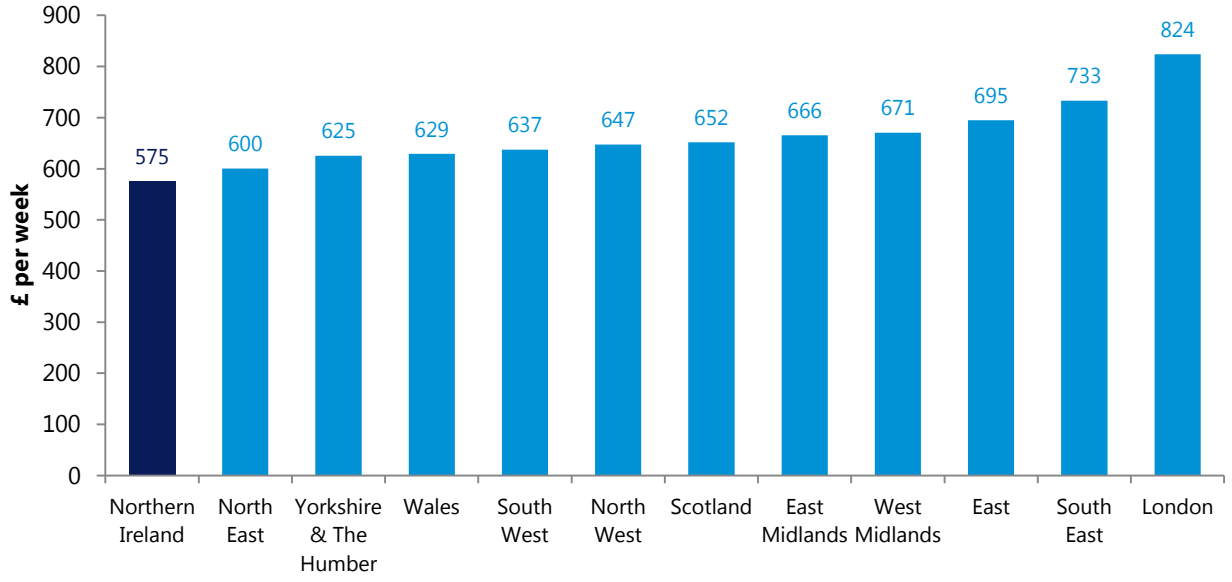
In addition to water, another component of environmental costs will be the cost to dispose of waste. Data from the Confederation of Waste to Energy Plants[99] highlights the differences in landfill taxes and net prices across a range of EU countries. Whilst there is no specific NI data, it is assumed that the UK figure offers a broad proxy. The UK figure (based on the tax element only) is 9% above the EU28 average but well below the most expensive areas like Austria and Denmark. ROI's landfill costs by comparison are just outside of the top five most expensive countries reviewed, with limited waste management infrastructure options meaning a heavy reliance on landfill.

Professional costs

Professional costs relate to businesses having to pay for specialist services the firm may not undertake in-house, for example accounting, marketing and legal counsel. Whilst there is no specific comparative data on NI prices, fees will largely be linked to the earnings professionals providing these services make. It is therefore possible to draw broad conclusions on the differentials across the UK through private sector wage levels using the Annual Survey of Hours and Earnings (ASHE).

The earlier review of wage levels in this report has shown that NI wages are significantly below elsewhere. As a result, it is unsurprising that Figure 46 shows that NI employees working in 'professional' occupations (including accountants, architects, barristers and engineers[100]) receive wages that are between 4% (North East) and 43% (London) lower than in other UK regions. This suggests that local companies can obtain professional services for less than elsewhere in the UK. Of course, many larger firms will have access to professional services in-house and will benefit from these lower wages for professional, or indeed might utilise such services from a head office meaning no cost is borne.

Figure 46: Private Sector Wages for Professional Occupations, 2013



Source: NISRA and ONS Annual Survey of Hours and Earnings

Finance costs

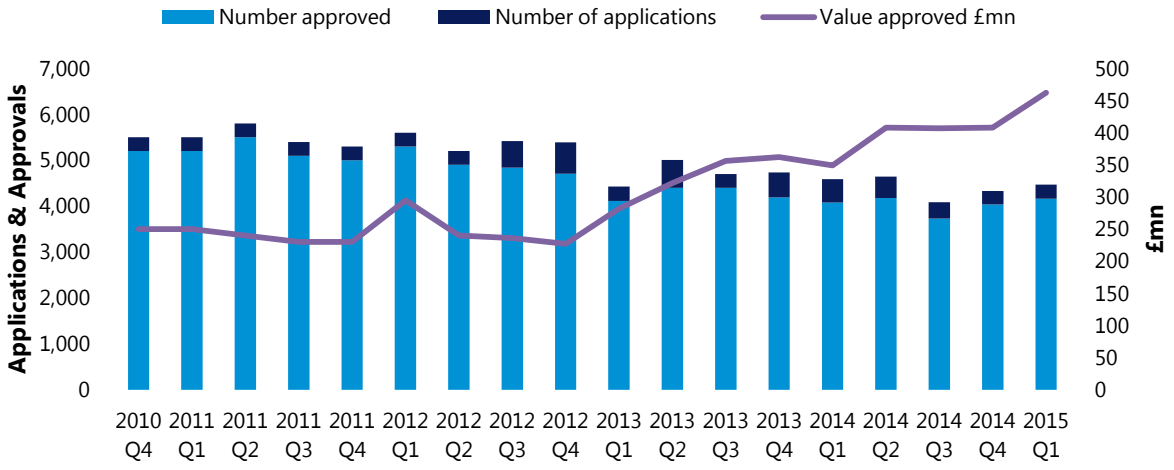
The issue of access to finance in NI in the aftermath of the financial crisis has been explored in great detail in recent years. Following the EAG report in 2012[101], an Access to Finance Implementation panel was established in October 2013 to work with Government, banks and business bodies to progress issues associated with access to finance for local companies and to help implement the recommendations of the report. Research has also been undertaken by InterTradeIreland[102] whilst NISRA have published surveys on access to finance in 2007 and 2010[103] and more recently DETI ASU carried out another survey for 2014[104]. The survey work demonstrated that in NI the success rate for loan applications fell substantially between 2007 and 2010 but has significantly improved in 2014.

Despite all this work, there is little information publically available on the actual costs of finance to firms as loans are negotiated on an individual basis and the interest rates charged and subsequent burden this places on businesses are confidential. The 2012 EAG report referenced that all the evidence "points to higher borrowing costs for businesses" due to the increased risk and return required from the banking sector, with 10% of SMEs reporting an increase in fees charged for their overdraft or loan facilities.

In addition to fees for new loans, a significant finance cost burden for companies who took on a large amount of property-related debt will be servicing these loans. The EAG report estimated that 8% of SMEs purchased property since 2005 that was financed from debt, which has since fallen to 5% in the latest 2014 survey. However, this figure is much higher for medium sized firms at around one-fifth. The cost burden of property debt is likely to be greater for larger firms (i.e. those with 50+ employees).

In the absence of information on fees for bank loans, Figure 47 presents BBA data on the number of applications, approvals and value of bank lending to NI SMEs[105]. These indicate that there was new SME borrowing in Q1 2015 of £462 million which was 33% higher than in Q1 2014. The approval rate for SME loans continues to run at 9 out of every 10 applications.

Figure 47: Bank Lending to SMEs in NI, Q1 2015



Source: British Bankers Association

7.3 'Other' cost changes

A comparison of 'other' cost changes amongst businesses during 2013 is shown in Table 25. For each cost, the majority of companies cost was unchanged during 2013. Insurance is the cost with the greater increases, with around two in five (39%) companies facing rises compared with 29% in the ROI. Only 3% of NI firms experienced significant (>10%) rises over the year. Outside of insurance, telecoms had the next highest proportion of firms with increases, followed by compliance, environmental and professional. Finance costs had the smallest percentage of firms with increases at 13%. Compared with the ROI, more NI firms experienced cost increases for telecoms, compliance and professional fees. Environmental and finance increases were broadly similar on both sides of the border.

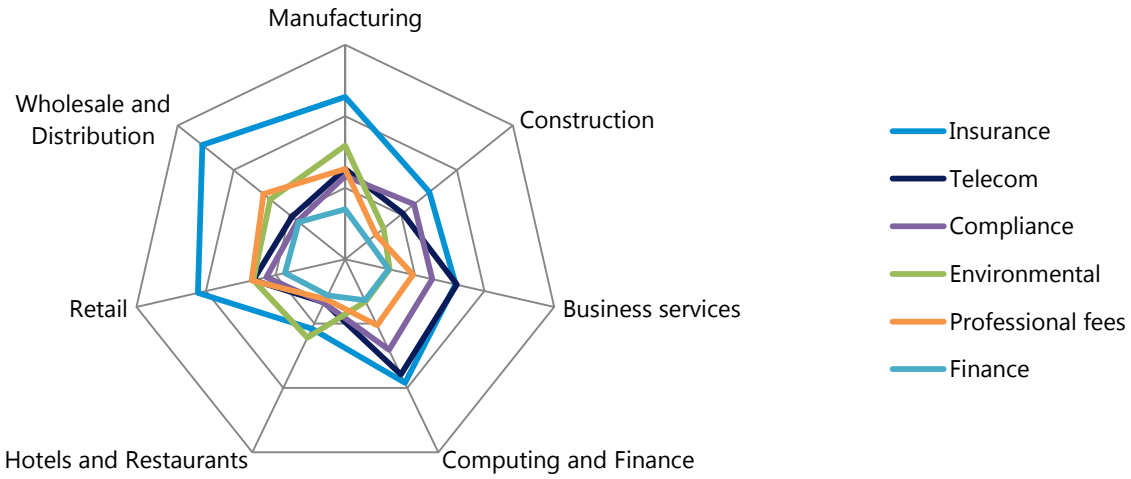
Table 25: 'Other' Cost Changes, 2013

% of firms	Decrease	Unchanged	Increase
Insurance	10%	51%	39%
Telecoms	7%	66%	27%
Compliance	2%	74%	24%
Environmental	5%	73%	23%
Professional	4%	76%	21%
Finance	4%	83%	13%

Source: InterTradeIreland Business Survey

A breakdown of 'other' cost increases during 2013 by sector is shown in Figure 48. This highlights that insurance cost increases have mainly been focussed on wholesale & distribution (51%), manufacturing (46%) and retail (42%) . Relatively large telecoms cost increases have also been more common in the computing & finance (36%) and business services (32%) sectors, although this is likely to be due to their greater reliance on telecoms and the need for access to the fastest broadband connections.

Figure 48: Sectoral 'Other' Cost Increases, 2013



Source: InterTradeIreland Business Survey

Note: each gridline indicates 10% of companies reporting increases

7.4 Reducing 'other' costs

A breakdown of the steps that businesses have taken to reduce their 'other' costs in 2013 is shown in Table 26. This highlights that firms have been most proactive in reducing their telecoms costs followed by insurance costs; this is perhaps unsurprising given that these are both competitive markets where companies will have a range of choices. ROI firms tended to be more proactive in reducing costs across all bar one (environmental) of the 'other' costs.

Table 26: Business Steps to Reduce 'Other' Costs, 2013

% of firms	NI	ROI
Insurance	**11.5%**	**16.6%**
Changed insurance provider	3.0%	5.0%
Negotiated better insurance rates	9.8%	15.3%
Telecom	**19.9%**	**30.0%**
Negotiated better telecom rates	11.8%	17.2%
Changed telecom provider	9.0%	16.6%
Compliance	**1.4%**	**2.0%**
Environmental	**5.1%**	**4.5%**
Reduced waste	9.9%	8.7%
Reduced water usage	5.4%	3.8%
Professional fees	**3.3%**	**5.0%**
Finance	**3.0%**	**4.1%**
Changed bank/credit provider	0.9%	0.6%

Negotiated better finance rates	1.1%	3.3%
Reduced level of credit	0.7%	0.6%

Source: InterTradeIreland Business Survey

7.5 Summary and conclusions

This study has focussed on the four largest costs for business. However, the other six costs - insurance, telecoms, compliance, environmental, professional fees and finance - will also have an impact on businesses cost base and therefore NI's cost competitiveness. The lack of available data to compare against elsewhere in many of these areas limits the ability to carry out cost benchmarking.

Of the 'other' costs, insurance would appear to be the main area that has placed companies under the greatest cost pressure. The previous ERINI cost competitiveness report in 2005 found that NI business insurance costs were higher than in GB but lower than in the ROI. At this time, a good range of information was available from NISRA surveys but these were discontinued in 2007 and it is not possible to assess how NI now compares, although our consultations did suggest premiums remain higher in NI. Nonetheless, local companies can take advantage of policies in GB and therefore 'shopping around' outside of NI insurers may help reduce premiums.

In relation to the remaining five costs, NI would appear to have a competitive telecoms market which helps to keep prices down and benefits from lower wages for professional services, which means in-house professional costs will be lower and external fees correspondingly should also be competitive. Compliance is an area which is likely to have a cost in terms of staff time more so than financial, and the recent launch of the Red Tape Review should help to address this. Local water charges, which are a key part of environmental costs, have been held constant for three years which will have helped businesses during this time, although they are increasing in 2015. Finally, a significant focus has been placed on finance during the downturn and, although there is a lack of information on actual fees and costs, the availability of finance is much improved and it would be expected that fees are in line with this.

8 OVERALL COST ASSESSMENT

Taking into account a wide range of key cost indicators across labour, energy, property and transport, Northern Ireland is shown to be a cost competitive location against both the UK and ROI. This is mainly due to lower labour and property costs, which more than offset higher costs in other areas.

8.1 Relative NI cost assessment

Assessing NI's costs against elsewhere is not straightforward. Firstly, NI is a region rather than a country, and this means that comparable data is harder to find. There are also a broad range of cost areas to be covered, with different measures needing to be looked at within each coming from different sources and with different reference periods. Finally, the available data covers different comparators across measures and also changes between cities, regions and countries depending on the source.

These challenges mean that a 'neat' cost comparison - a cost index which considers the relative position of each cost and weights them to give an overall position- is challenging to develop. In considering relative costs, this chapter will focus on the four main cost areas outlined to date; labour, energy, property and transport. Not only are these the most important cost areas for businesses, they also generally have the best data coverage. Table 27 below considers the availability and comparability of the available data using the sources referenced in each individual chapter.

Table 27: Available NI Cost Information

		Available comparable information for NI			
Area	**Measure**	**UK**	**ROI**	**EU**	**ROW**
Labour	Private sector wages	All regions	National	-	-
Labour	FDI role salaries	10 cities	4 cities	17 cities	28 cities
Energy	Electricity prices (v small users)	National	National	13 countries	-
Energy	Electricity prices (large/v large users)	National	National	13 countries	-
Property	Office rental values (grade a)	6 cities	1 city	-	-
Property	Office rental values (grade b)	6 cities	1 city	-	-
Property	Industrial rental values (prime big sheds)	6 cities	1 city	-	-
Property	Industrial rental values (prime small sheds)	6 cities	1 city	-	-
Property	Industrial land values (big sheds)	6 cities	1 city	-	-
Property	Industrial land values (small sheds)	6 cities	1 city	-	-
Transport	Petrol prices	11 regions	National	12 countries	1 country
Transport	Diesel prices	11 regions	National	12 countries	1 country
Transport	Air travel prices (within UK)	3 cities	-	-	-
Transport	Air travel prices (outside UK)	3 cities	-	-	-

This highlights the complexities of the available data and the differences in approaches across measures. However, it does also suggest that a reasonable overall comparison can be made for NI with the UK and, to a slightly lesser extent, the ROI. Whilst the individual chapters therefore provide cost benchmarking for EU and other international comparators where available, this overall cost assessment will focus solely on UK and ROI from this point forwards.

An overview of NI's relative cost position against the UK and ROI for each indicator is shown in Table 28. Where national or regional data is available, this presents NI's position against the UK and ROI averages. Where only city level data is available, a simple average has been taken across all the data points. This is unlikely to be fully representative of the national average in each case, but will provide a suitable benchmark for considering relative costs for key locations within NI, UK and ROI. For each measure, a value of 100 has been set for the relevant comparator (UK or ROI respectively) and NI indexed against this, which allows us to see what percentage NI costs are either above or below.

Table 28: Relative NI Cost Benchmarking

		Compared with UK		Compared with ROI	
Area	**Measure**	**NI**	**Year**	**NI**	**Year**
Labour	Private sector wages	82%	2014	86%	2014
Labour	FDI role salaries	86%	2014	94%	2014
Energy	Electricity prices (v small users)	111%	2014	99%	2014
Energy	Electricity prices (large/v large users)	94%	2014	122%	2014
Property	Office rental values (grade a)	42%	2014	48%	2014
Property	Office rental values (grade b)	39%	2014	57%	2014
Property	Industrial rental values (prime big sheds)	89%	2015	114%	2015
Property	Industrial rental values (prime small sheds)	69%	2015	85%	2015
Property	Industrial land values (big sheds)	44%	2015	95%	2015
Property	Industrial land values (small sheds)	57%	2015	125%	2015
Transport	Petrol prices	100%	2015	114%	2015
Transport	Diesel prices	99%	2015	126%	2015
Transport	Air travel prices (within UK)	82%	2015	-	-
Transport	Air travel prices (outside UK)	103%	2015	-	-

Sources: See individual chapters

Weighting the data

The above data highlights that NI has lower prices across nine of the 14 available indicators against the UK comparators (not including those within 1-2 percentage points either way which are taken to be broadly similar), and has lower prices for six indicators against ROI comparators (again excluding those which are broadly similar). However, some of these costs areas will be more important than others and weightings need to be given to each indicator to provide an overall assessment of comparative costs.

Chapter 2 of this report has given consideration to the relative importance of each cost area based on three different sources (business survey, case studies and ABI analysis) and further information on this is provided in Appendix B. This highlights that although labour comes out consistently as the most important cost area

for businesses (by some distance), the remaining three cost areas change ranking and importance depending on what source is used. For the purposes of weighting each area to develop a cost index, the largest weight has been given to labour with the remaining weightings shared evenly amongst energy, property and transport (see Table 30).

Table 29: Weighting for Cost Areas

Area	Weighting (as % of four main costs)	Rationale
Labour	55%	Consistently the most important cost area, ranging from 50% in the survey to 83% in the case studies.
Energy	15%	The second largest cost area coming from the survey and case studies (which were heavily focussed on manufacturing) at 23% and 8% respectively, although the ABI would suggest it ranks fourth at 10%.
Property	15%	The third largest cost area in the survey (16%) and fourth largest from the case studies; the ABI only has information on rates costs (8%) but if rental/repayment costs were included here it would likely be the second highest cost area.
Transport	15%	Ranks as fourth highest in the survey (12%) and third from the case studies (7%); however, the ABI has this as the second highest cost area at 12%.
TOTAL	**100%**	**-**

With the overall weights assigned to each cost area, each individual measure needs to be assigned a further weighting within the four groupings to add to the broader totals (shown in Table 31). This is to ensure that each cost area maintains its overall weighting despite differences in the number of indicators available for each, and also to adjust for slight differences between the availability of data for NI against the UK and ROI.

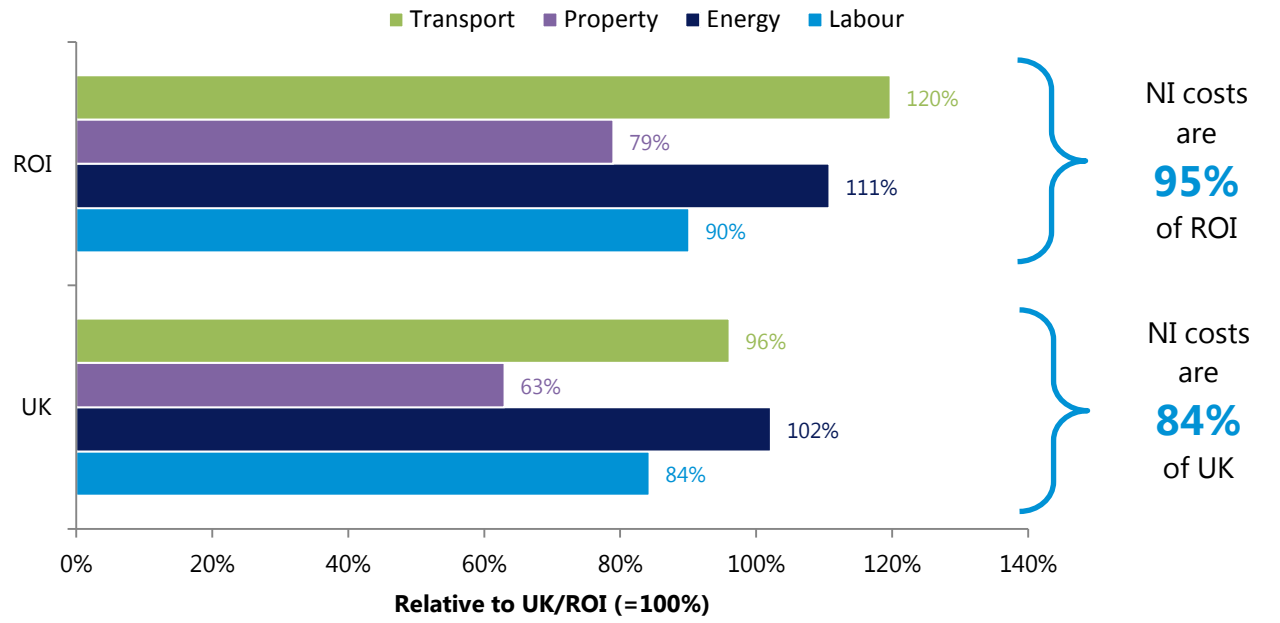
Table 30: Weights for Indicators

Area	Indicator	Weighting (vs UK)	Weighting (vs ROI)
Labour	Private sector wages	27.5%	27.5%
Labour	FDI role salaries	27.5%	27.5%
Energy	Electricity prices (v small users)	7.5%	7.5%
Energy	Electricity prices (large/v large users)	7.5%	7.5%
Property	Office rental values (grade a)	6.0%	6.0%
Property	Office rental values (grade b)	3.0%	3.0%
Property	Industrial rental values (prime big sheds)	1.5%	1.5%
Property	Industrial rental values (prime small sheds)	1.5%	1.5%
Property	Industrial land values (big sheds)	1.5%	1.5%
Property	Industrial land values (small sheds)	1.5%	1.5%
Transport	Petrol prices	3.8%	7.5%
Transport	Diesel prices	3.8%	7.5%
Transport	Travel prices (within UK)	3.8%	-
Transport	Travel prices (outside UK)	3.8%	-
TOTAL		**100%**	**100%**

Overall comparative cost assessment

Applying the above weights to the available data provides an overall cost assessment for NI against the UK and ROI (shown in Figure 49). The cost of doing business in NI is found to be 84% of the UK average and 95% of the ROI. Compared with the UK, NI has slightly lower transport costs (96%) and much lower labour (84%) and property costs (63%) despite having higher energy costs (106%). Compared with the ROI, NI's lower labour (90%) and property costs (79%) more than outweigh higher energy (110%) and transport costs (120%). There are clearly areas where NI can improve its cost competitiveness, but in overall terms, NI is a highly cost competitive location to do business and invest in.

Figure 49: NI Overall Cost Assessment vs UK and ROI



This overall cost assessment has developed a methodology for benchmarking NI costs which could be replicated and refined in the future. These refinements could cover the inclusion of more data sources when available, coverage outside of just four cost areas, benchmarking against international comparators, further analysis to tailor the weightings used and assigning different weights across sectors to accommodate the fact that certain costs will be more or less important for different sectors. But setting these refinements aside, this methodology does allow for an overall quantifiable cost assessment of NI against the UK and ROI. It demonstrates that, even taking into account areas where NI has higher costs, in overall terms NI is a cost competitive location to do businesses.

8.2 Summary and conclusions

This study has developed a new methodology for assessing business costs in NI. This brings together a range of indicators covering the four main cost areas for businesses (labour, energy, property and transport) and weights them based on their relative importance to give an overall score against the UK and ROI. This takes the benchmarking of NI costs one step further than currently available to provide an overall picture of our cost base against elsewhere, whilst still providing the level of detail needed to identify where the key competitive advantages and disadvantages are.

The results of this analysis show that NI has key competitive advantages in both labour and property costs against both the UK and ROI. The overall cost base in NI is found to be much more competitive than the UK (84%) and also lower than the ROI (95%). This analysis is, however, based on available prices indicators and therefore does not include 'intangible' costs – such as time or distance – which may be captured in these but cannot be quantified on their own.

9 SUMMARY AND CONCLUSIONS

This study has carried out a comprehensive assessment of costs facing local businesses and NI's relative competitiveness against elsewhere. Potential further work is outlined which could build on this report and allow for more regular monitoring of our overall cost position going forward.

9.1 The importance of costs

Costs are a key part of an economy's international competitiveness and are central to NI's value proposition. Maintaining a competitive cost base not only helps to make NI a more attractive investment location for FDI, but also ensures that our companies are more competitive in international markets. Costs were *the* key issue raised by local businesses during the economic downturn, mainly driven by external pressures in international commodity markets, although these pressures do now appear to be easing.

This study has sought to provide an overall assessment of NI's comparative cost base against the UK, ROI and beyond, something which has not been available since the previous ERINI report in 2005. It aims to complement the ongoing EAG work into competitiveness, and provide information to assist in tracking the NI Economic Strategy's overarching goal to NI's economic competitiveness. Once a new competitiveness report is completed by EAG, this will – for the first time – bring NI in line with the approach taken in the ROI where both competitiveness and costs are benchmarked annually.

9.2 Understanding businesses cost base

A key issue for this research has been to understand which costs are most important for businesses; the focus has been on 'location-sensitive' costs which are mainly determined from doing business in a particular location. Three approaches have been taken to review business costs – analysis of the NI Annual Business Inquiry, a telephone survey of 1,000 companies from the InterTradeIreland Business Monitor (see Appendix A for full results) and case studies with local companies. Whilst the exact figures from each source are unsurprisingly different, they present a largely consistent message with regards to the most important cost areas (see Appendix B for a comparison of each approach).

Labour is shown to be the main cost for businesses, regardless of what sector they operate in. Energy, property and transport are also shown to be important costs for businesses, although the extent of this differs by sector. Sectors that are involved in producing or moving goods – such as manufacturing, wholesale & distribution and construction – will have a greater reliance on energy and transport than services firms, where property tends to be a relatively more important cost. This report has focussed on these four most important costs, although brief consideration has been given to less important costs such as insurance, telecoms, compliance, environmental, professional fees and finance. A full assessment for each of the 10 cost areas can be found in Appendix C.

9.3 Benchmarking business costs

Availability of consistent and comparable data has been a key challenge for this study to benchmark NI business costs against elsewhere. Much of the data that would be available for a nation does not exist for a region such as NI. However, a comprehensive cost benchmarking has been carried out using a combination of official government statistics, other available data and internal analysis. Focussing on the four main cost areas, the benchmarking shows that:

- **Labour costs** is a key area of competitive advantage for NI. Private sector wages are shown to be 82% of the UK average, with this gap evident across almost all sectors and occupations, and 86% of the ROI. Internal analysis on average salaries for FDI roles shows that NI can offer skilled labour at a lower cost than all its main rivals in Western Europe and North America. However, NI is not a truly 'low cost' location, with many Eastern European and other developing economies offering lower wages, meaning NI is unlikely to be as competitive for lower skilled investments.

- **Energy costs** for businesses differ depending on usage. Very small electricity users, which cover the majority of businesses in NI, pay similar prices to elsewhere in the EU, although face higher prices than in UK. However, large and very large users, which include a small number of large industrial users, have electricity prices that are lower than the UK but higher than the ROI and many other European competitors.

- **Property costs** are another area where NI can offer much lower prices than elsewhere. Rental prices for Grade A office space in Belfast are less than half the price found in other cities such as Manchester, Dublin, Birmingham and Edinburgh. Both industrial rental properties and land are also significantly cheaper in Belfast than elsewhere in the UK, although Dublin has similar prices. It was not possible to make a comparative assessment for business rates.

- **Transport costs** are relatively competitive in a UK context, but not when compared internationally. Fuel and diesel prices in NI are similar or lower than in other parts of the UK, but high UK fuel duties mean that prices are much lower across much of Europe. Our peripheral location requires additional journey time and provides fewer options for travelling and naturally places NI at somewhat of a disadvantage here.

A new methodology for comparing the competitiveness of NI business costs against the UK and ROI has been developed. This involves collecting comparable data for 14 indicators across the four main cost areas, and weighting them based on their broad importance for businesses. This highlights that lower labour and property costs in NI more than make up for less competitive energy and, to a lesser extent, transport costs. It is estimated that the cost of doing business in NI is 84% of the UK average and 95% of the ROI. NI is therefore a highly cost competitive location despite disadvantages in some areas, although this will not include factors such as time and distance which, ultimately, are seen as a cost but cannot be quantified by price indicators.

9.4 Steps to reduce costs

Companies are generally well aware of the need to address rising costs, and the large majority have in place systems to review and manage their cost base. However, businesses in the ROI were generally better at monitoring their cost base than those in NI. In both jurisdictions, there was a clear divide evident when

looking at size of company – significantly fewer micro businesses were 'on top' of their cost base when compared with small and medium-sized businesses. It is likely that micro businesses do not have the same level of resources to dedicate to monitoring costs, which also means that they will be in a worse position when it comes to taking steps to address cost increases.

Given the price rises being faced with rising energy prices in 2013, it is unsurprising that this is the area where most companies took steps to try and address costs. Firms were also generally proactive in reducing their labour and telecoms costs. Looking across the border, NI businesses were more proactive in taking steps to reduce energy, environmental, property and transport costs, with ROI businesses more active in the remaining six cost areas. Again, a clear discrepancy by company size comes through clearly – micro businesses were generally much less active in addressing rising costs than small and, particularly, medium-sized businesses.

In a large competitive market it would be expected that firms can reduce prices by moving to rival suppliers, but NI's small market size appears to hamper this. However, many businesses reported simply reducing their usage to keep costs down in many cost areas, followed by negotiating better rates, before looking to alternative suppliers. This could be down to either a lack of alternative suppliers in the local market, or a lack of knowledge as to what else is out there.

9.5 Other policy implications

The specific prices facing business in each area are generally determined by how the market operates; its size, structure and the role of government involvement. This means that reviewing business costs overlaps in many areas with wider policy decisions which will ultimately impact on the market. A range of observations, taken from our primary consultations and secondary literature/data analysis, are made in relation to other policy implications:

- The supply of skilled labour is vital for businesses. NI's success at attracting investment and jobs in key growth sectors, such as professional services, may start to lead to additional wage pressures for businesses looking to attract skilled individuals in these areas. In particular, whilst a reduction in Corporation Tax is welcomed by businesses, there are some concerns that this will lead to skills shortages and further wage pressures. DETI, DEL and Invest NI will be commissioning research in 2015 to help in preparing for a reduction in Corporation Tax, and a key area within this will be assessing the skills implications to assist with future forecasting work.

- The new UK national living wage for over 25s will deliver an increase in the pay of those earning on or just above the current minimum wage, but may lead to a loss of competitiveness for those businesses which compete internationally on a cost basis – a point that was reinforced in our consultations by some businesses – unless they recruit younger workers who are not subject to this rate. Work is needed to assess the full impact of this announcement on local businesses.

- Some evidence would suggest that NI's lower property prices (i.e. return on investment) are stifling the development of new properties, particularly Grade A office accommodation, which will be key to NI's future success at attracting FDI. However, there are signs that prices are starting to increase, with Colliers reporting a 7% increase in Belfast in the first half of 2015[106]. Invest NI is aiming to help

address this challenge, and has announced a potential short-term loan scheme to help encourage market development.

- The NI Executive has limited control over factors which influence transport costs for local businesses; both fuel duty and APD rates are a reserved matter for Westminster. Recent DETI research has suggested that devolving and reducing or abolishing APD would not provide enough of an economic benefit to justify its cost. Reducing APD is good for local businesses, with exporters paying less for air fares to access markets and local tourism businesses benefitting from increased tourism numbers. However, it brings with it a large cost in terms of a reduction to the NI Executive's spending power at a time when it is facing a difficult public expenditure outlook; the DETI research concludes that a strong case for change in APD rates has not been made and a more targeted air route development fund might be more appropriate.

- Finally, businesses do have concerns around the implications of future reductions in public spending (both from cuts to the block grant from Westminster and funding lower Corporation Tax) on supports and incentives for businesses which would impact on the rate of return on investments.

9.6 Future research

This report marks the first comprehensive assessment of NI's business cost base in a decade and there is additional further work that could be carried out in the future to ensure gaps in the evidence base are addressed:

1. Using the InterTradeIreland Business Monitor to inform this report provided an up-to-date and current assessment of business cost pressures when it was carried out in early 2014. However, merging this survey alongside a cost benchmarking exercise – which is time consuming and requires a lot of data gathering and analysis – means that the results are only being published now in 2015, at which time the cost position for local businesses is very different. A regular assessment of local cost changes, following a similar approach to the survey analysis in this report, could be taken forward in isolation. An existing business survey would be the most appropriate measure of doing this;

2. A comparative cost benchmarking exercise could be taken forward, either annually or bi-annually, to monitor NI's overall cost position against elsewhere. This would mostly be desk-based analysis of key indicators identified used in this report (along with any additional that could be sourced or developed) and could build on the methodology developed to assess NI's overall cost position against the UK and ROI. The ongoing EAG competitiveness work is also considering costs and prices, and may help to deliver on this on a regular basis;

3. The overall cost assessment for NI against the UK and ROI could be developed further to apply different weightings by sector (reflecting the fact that the importance of costs varies by sector) and incorporate additional indicators and more benchmarks;

4. Specific reports on individual cost areas could be carried out to further explore any issues identified in this research. These could look outside of the four main cost areas that this study has focussed on, with insurance (as the fifth most important cost for businesses) or compliance (joint sixth highest and highly topical given the recent Review of Business Red Tape) prime candidates for this; and

5. This study has consistently reinforced how costs will differ significantly by sector and activity. Over and above the suggested high-level cost competitiveness assessments, any future cost reports would benefit from focussing on particular sectors or sub-sectors of key strategic importance for the economy.

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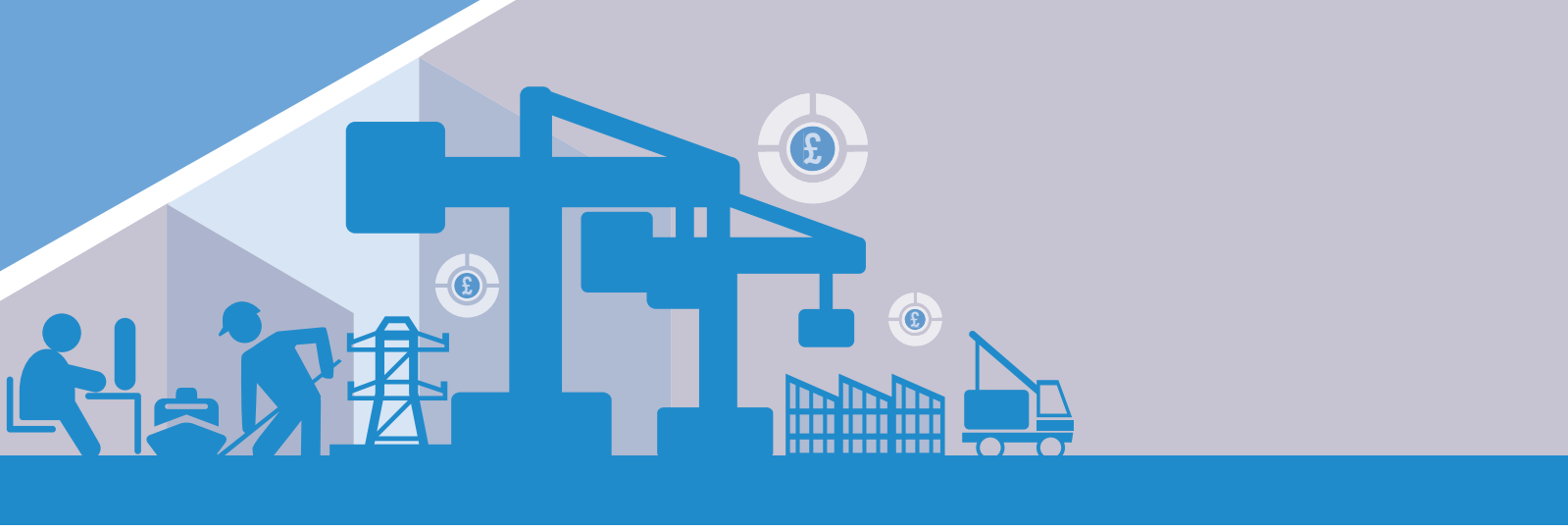

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