EY
Building a better working world

Investors vote "remain" in Europe

EY's Attractiveness Survey
Europe
May 2017

Contents

We would like to extend our gratitude to …

Arvils Ašeradens, Deputy Prime Minister and Minister of Economics of Latvia; **Ann Mettler**, Director-General, Head of European Political Strategy Centre, European Commission who contributed to this report with their respective viewpoints.

Furthermore, we would like to thank the hundreds of business leaders and EY professionals who have taken the time to share their thoughts and insights with us about the possibilities that await us in Europe in the coming years.

Editorial:
the time remains right for Europe

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Thank you for opening EY's *European Attractiveness Survey 2017*. Every year, this annual study, unique of its kind, provides powerful insights for foreign investors, policymakers, citizens and all who care about the future of Europe. **This year's edition could hardly be more pertinent.**

Today, Europe is profoundly uneasy. Consensus about our common future has broken down, politics has fragmented and many things we took for granted are being called into question. Public debate often seems mired in the received ideas of yesteryear. Yet business executives making hard-nosed business decisions about where, how and when to invest have continued to opt for Europe.

In 2016, we found, international investors launched more projects in Europe than ever before. In pursuing Europe's opportunities, **they are creating a quarter of a million jobs.** Why? What gives them such confidence?

Economic trends and data show that much of Europe has returned to steady, if unspectacular growth. Europe's expanding markets, and gently falling jobless numbers reassure investors that Europe is working, albeit imperfectly, unevenly and unequally.

The outlook is brightening. The European Commission has upgraded its forecast of Eurozone growth this year to 1.7% and is forecasting 1.8% next. Netherlands voters rejected the far right, and France has a new, young president committed to reforming both France and the EU.

Aided by low interest rates, in 2016 companies stepped up their investments in the powerhouse economies of northern Europe – whose companies in turn continued to invest energetically beyond their borders. US companies also remained faithful, while reluctant to pay heavy taxes on repatriated profits.

Investors also returned to southern Europe, encouraged by signs of belated recovery, and especially to Central Europe, where they find an attractive combination of good skills and affordable costs.

Measuring against other regions of the world, where uncertainty has also increased, they find Europe relatively attractive. Though aging, it has a big market, increasingly homogenous in standards, geography and consumer tastes. Its sophisticated industrial, services and transport infrastructure make expanding here relatively easy. They find here the talented, educated, productive employees they need.

New technologies, including artificial intelligence, robotics, and connected objects; in biotechnology, nanotechnology and so on, are creating opportunities to overhaul business models, operations, products and services. That's driving renewal, though productivity benefits seem slow to appear.

Companies have a broad vision of Europe's performance, captured through their order books. They see opportunities and disparities: some countries, cities and people are doing much better than others.

The encouraging news from our study is that amid well-founded concerns, some things are going right. So, **companies, policymakers and citizens must come together, to better understand and recognize Europe's economic success, and to reinforce its foundations.**

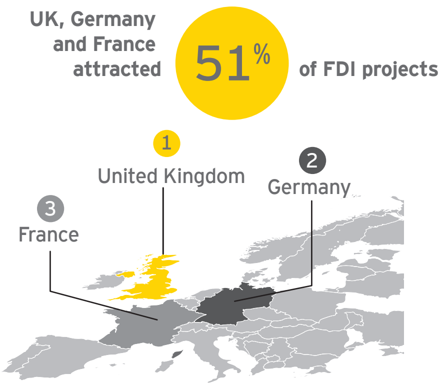
We hope our report will contribute to this process. We would like to thank all those – investors, policymakers and EY member firms' partners, who have given so generously of their time and insights to make it possible.

Executive summary

Europe's attractiveness in 2016: the reality

5,845 FDI projects, up 15% in 2016

With 5,845 new projects in Europe in 2016 (up 15%), foreign direct investment hit a new record and created 259,673 jobs (up 19%): that's twice as many as were being created in the wake of the financial crisis.

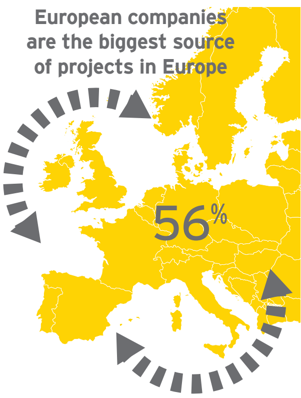


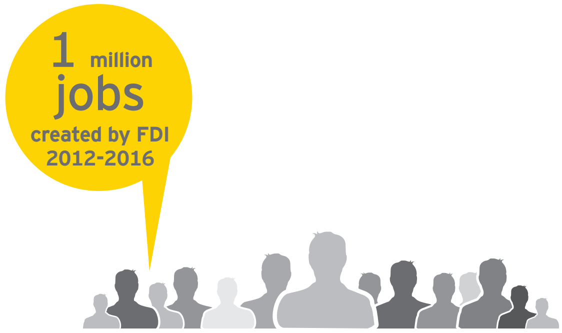
UK, Germany and France top the country rankings

The United Kingdom remained Europe's champion, closely followed by Germany, which is mounting a strong challenge, and a resurgent France.

European investors provide 56% of projects in Europe

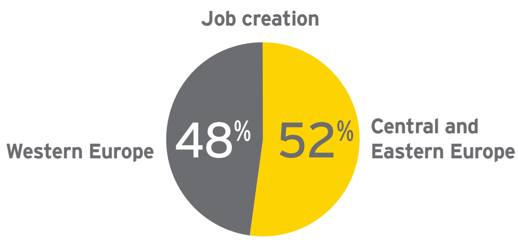
US companies remained Europe's biggest investors, but European companies together are the biggest source of the continent's cross-border flows (56%), with German, British and French companies in the vanguard.





1 million jobs created by FDI between 2012 and 2016

In five years, foreign investors brought almost one million new jobs to the 43 countries of "business Europe", including Russia and Turkey.

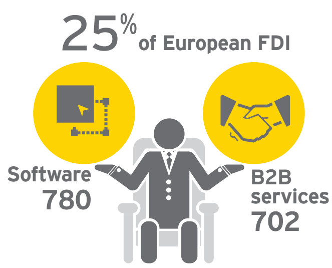


CEE attracted more than half the jobs

CEE remained highly competitive and attractive, capturing 23% of FDI projects but 52% of jobs: Poland leaped to fifth place in the national ranking, while the Czech Republic, Hungary and Slovakia achieved firm gains.

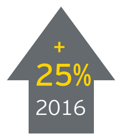
A quarter of FDI goes into software and B2B services

Business services and software underpin Europe's digital transformation. The software sector was the single biggest source of FDI in Europe in 2016, launching 780 projects, up 12%, and business services the next most active (702, +46% in 2016). Together they provide 25% of European FDI.

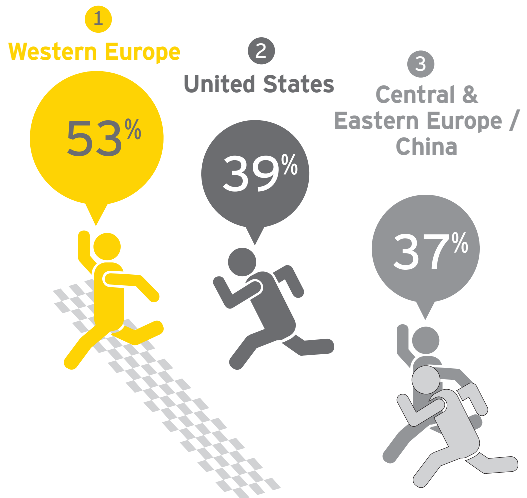


Chinese investors up 25%

Chinese companies launched 297 FDI projects in Europe in 2016, up 25%. But they are cooling on the UK in favor of Germany, France and other continental destinations.



Europe's attractiveness in 2017: changing perceptions



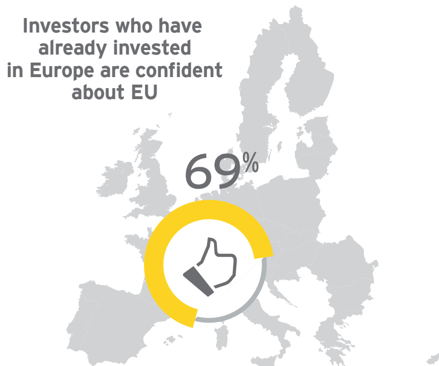
Europe remains one of the world's top regions for executives

Despite major geopolitical events, growth around the world lifts demand for European products and services and gives business decision makers the confidence to expand and invest.

Asked to rank the attractiveness of global regions, investors vote Western Europe first overall (53%). CEE comes third (37%), right after the US (39%). China's vote is 37%, down from 48% in 2007.

Uncertainty is weighing on projects for 2017

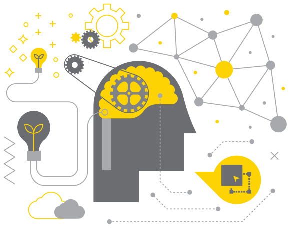
The proportion of decision makers planning to invest in Europe over the next year has eased four points since 2015, to 28%.



Long-term faith in EU's future still strong

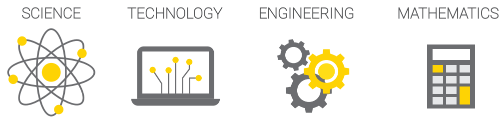
Among our panel of investors, those who have already invested in Europe are markedly more confident about the future of the European Union (EU) (69%) than those who have yet to invest here (45%).

Recommendations for investors and policymakers



Innovation

Policymakers must do more to help develop ecosystems for Europe-born start-ups. Businesses must constantly scan for opportunities and impacts of digital technologies to transform their activities.



Skills

Policymakers need to invest in turning out more people, more able in science, technology, engineering and mathematics at all levels. Companies must take on their share of the responsibility for developing talent.

Brexit

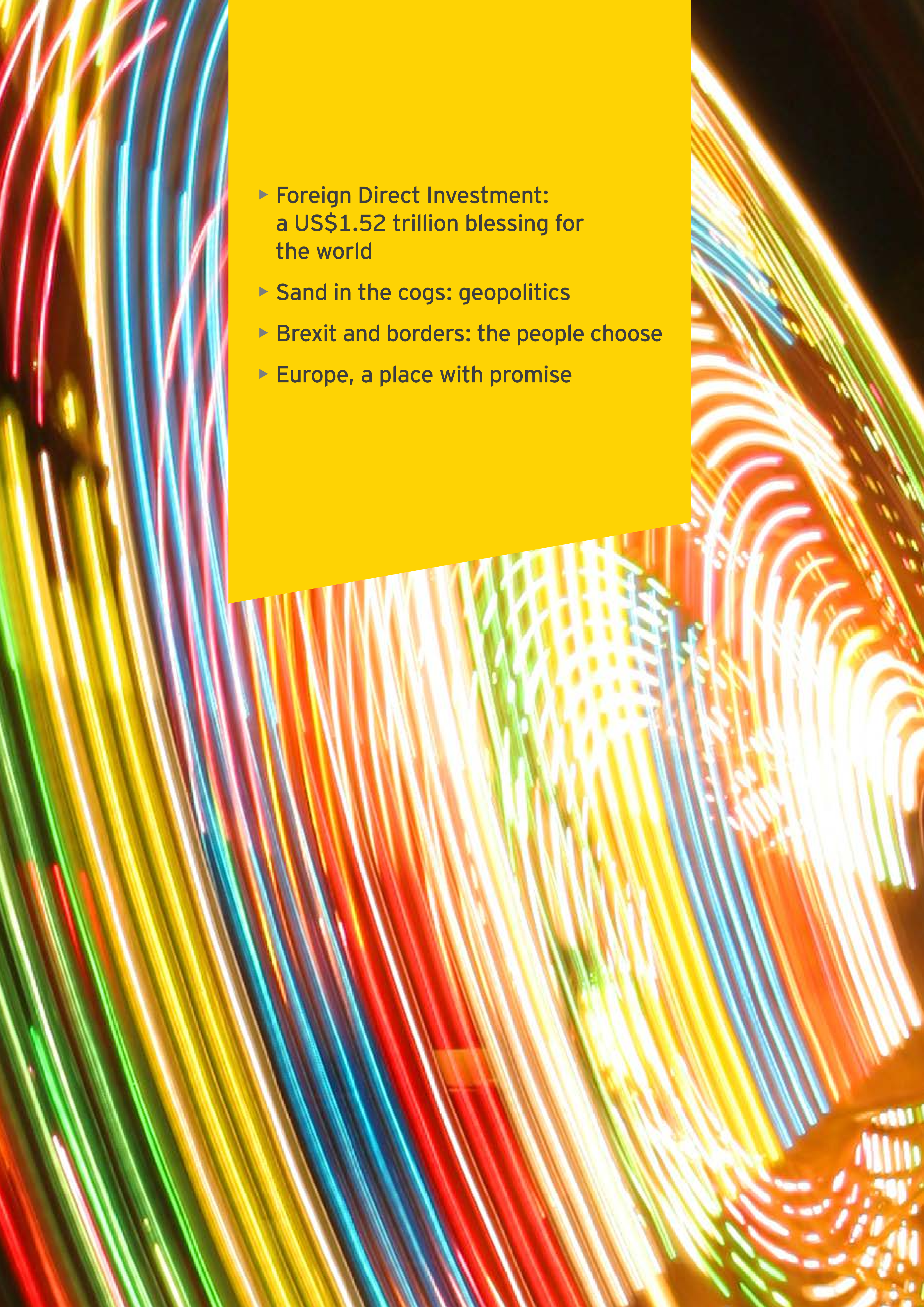
Policymakers need to work on creating clarity. Companies need to think through all the implications of Brexit strategically.

Change

Europe needs to overhaul its national tax regimes in favor of jobs, innovation and the environment. Companies need to provide greater support and speak up.

Chapter 1

The global investment environment: **what world are we living in?**



- Foreign Direct Investment: a US$1.52 trillion blessing for the world
- Sand in the cogs: geopolitics
- Brexit and borders: the people choose
- Europe, a place with promise

1. The global investment environment: **what world are we living in?**

Global cross-border investment supported by strong M&A activity

Globally, international companies made foreign direct investments (FDI) totaling US$1.52 trillion in 2016, according to the United Nations Conference on Trade and Development (UNCTAD). That was down 13% on 2015's total. Over the past decade, cross-border investment in corporate expansion has shown a modest recovery from its slump in the wake of the 2008 financial and economic crisis, but the relative weakness of international trade and investment should be a cause of concern.

Around the world, companies continue to calibrate their investments carefully to the opportunities offered by economic recovery, trade, business expansion, digitization and business model optimization – and continue to create economic progress and jobs.

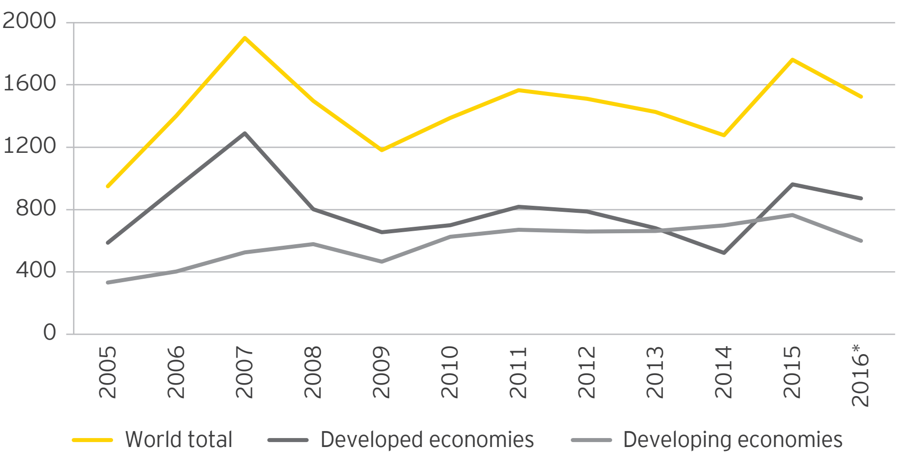
M&A plays a growing investment role as companies reshape

Although EY's series of European Attractiveness Reports concentrate on greenfield foreign direct investment (FDI), in the form of creation and expansion of existing facilities in Europe, it is worth noting that corporate cash and confidence are driving a resurgence of M&A. According to UNCTAD, cross-border M&A in the EU increased by an extraordinary 34% to US$359bn in 2016. This is mixed news. In a world of artificially low interest rates, companies may be encouraged to make unwise acquisitions. UNCTAD says deal values were up more than fourfold in the UK and threefold in Sweden, where small numbers of very big deals skewed the figures. The deal-flow across Europe suggests that companies are consolidating the continent's markets in a host of activities ranging from beer to bicycles.

The April 2017 edition of the EY *Capital Confidence Barometer* surveyed 791 executives at European companies among its global sample. In an environment of ultra-cheap borrowing, it found 56% of firms globally planning to actively pursue acquisitions in the next 12 months. They are confident about the macroeconomic environment – 64% saw the global economy improving – but worry about geopolitics and emerging political risks.

Divestment by companies, particularly of activities deemed peripheral, is part of this ongoing corporate restructuring process. As they bulk-up in one sector or region, companies may shed assets in others. In Europe, investors are navigating an evolving EU regulatory landscape. Commissioner Margrethe Vestager has reinforced EU competition policy and sharpened its teeth, creating constraints for some companies, but opportunities for others. The EY *Global Corporate Divestment Study 2017* found that 43% of decision makers surveyed had plans to shed assets during the next two years.[1]

FDI inflows: global and by group of economies (US$b), 2005–2016



Region	2015	2016	Change
World	1,750	1,525	-13%
Developed economies	963	872	-9%
Developing economies	749	600	-20%

Source: *Global Investment Monitor Trends*, United Nations Conference on Trade and Development (UNCTAD), February 2017.

[1] Global Corporate Divestment Study 2017, EY, 2017.

Supportive macro FDI drivers: better growth and more trade

The continuing massive flow of investment into productive assets around the world comes against a backdrop of global economic recovery. On 18 April the International Monetary Fund lifted its forecast for world growth during 2017 from 3.4% to 3.5%, the first upward revision in six years. It said economic news from Europe, China and Japan was better than expected, and was underpinned by a broad-based recovery in global manufacturing that began in mid-2016, but its forecasts were hedged with caution about geopolitical uncertainties.

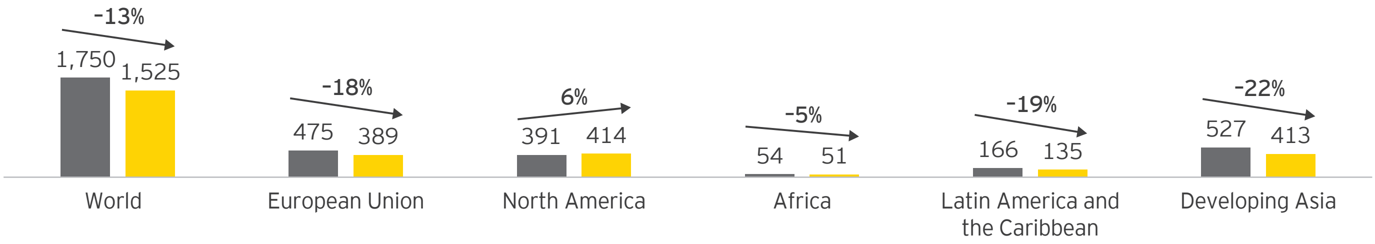
The IMF said that the upturn was supported by accelerating flows of goods and services around the world, and that it expected international trade to expand by almost 4% this year and next – a pick-up from the 2.2% of 2016, but still below the 7.1% a year average in the two decades to 2007.

Real GDP growth (%)

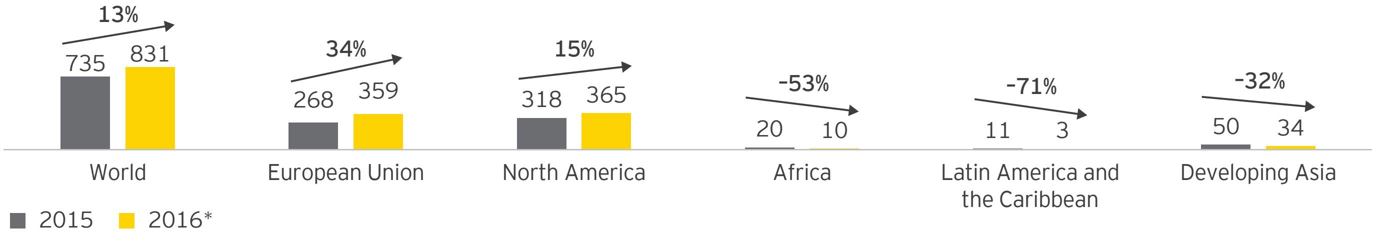
Region	2015	2016	2017E	2018E
World	3.4	3.1	3.5	3.6
Advanced Economies	2.1	1.7	2.0	2.0
US	2.6	1.6	2.3	2.5
Euro Area	2.0	1.7	1.7	1.6
Japan	1.2	1.0	1.2	0.6
Emerging Markets and Developing Economies	4.2	4.1	4.5	4.8
CIS	-2.2	0.3	1.7	2.1
Emerging and Developing Asia	6.7	6.4	6.4	6.4
of which China	6.9	6.7	6.6	6.2
Emerging and Developing Europe	4.7	3.0	3.0	3.3
Latin America and the Caribbean	0.1	-1.0	1.1	2.0
Middle East, North Africa, Afghanistan & Pakistan	2.7	3.9	2.6	3.4
Sub-Saharan Africa	3.4	1.4	2.6	3.5

Source: *World Economic Outlook*, International Monetary Fund (IMF), April 2017.

FDI inflows by region (US$b), 2015–2016



Cross-border M&A by region (US$b), 2015–2016



Source: *Global Investment Monitor Trends*, United Nations Conference on Trade and Development (UNCTAD), February 2017.

Geopolitics have penetrated more boardrooms, more than ever

In 2016, politics had an economic impact everywhere

Cross-border investment flows and trade have hugely increased in recent decades, so geopolitical instability touches many more companies, in more complex ways. The US election campaign, followed by the inauguration of President Donald Trump in January this year, has contributed to a global upsurge in geopolitical – and economic – uncertainty. Investors continue to ponder how US policies are changing, and how they may change further.

In Asia, China is poised to become the world's biggest economy. Yet after more than three decades of breakneck growth, Government continues to prop up expansion. China seeks a massive economic rebalancing toward greater domestic consumption and less reliance upon exports. Skills, science, innovation and services are replacing low-cost labor as the economy's drivers, and the consequences are rippling across the globe.

An economic downturn in Brazil, ongoing conflicts in the Middle East and tensions over North Korea and the South China Sea all contribute to heightened geopolitical uncertainty.

Europe has not been spared

In Europe, continuing economic recovery is accompanied by a widespread and powerful undercurrent of dissatisfaction. Populist parties have garnered significant minority support in many European countries. A Europe-wide schism has opened between those favoring an open trading system and those favoring a return to national borders seen as less permeable to people, goods, and jobs.

The most spectacular of the European shockwaves came from the UK which, after 40 years of rapprochement, voted by 52% to 48% to leave the EU. The 2016 referendum revealed a country deeply divided about the benefits and attractions

EY viewpoint: Negotiating about jobs, growth and trade

The potential for bruising, conflictual negotiations between the UK and the EU about the UK's departure from the EU has been made abundantly clear. Negotiations proper have yet to begin, yet already politics seems to be dominating the agenda.

That said, at least there appears to be calm and unity among the EU27, who have set out some strong and simple negotiating principles.

In view of this, companies need to continue to plan for a variety of Brexit scenarios, including for the possibility of a "hard Brexit" under which many existing arrangements, which facilitate commerce between the UK and the rest of Europe fall away. Whatever happens, it will be some time before final arrangements become clear, particularly if the EU27 stick to their plan of negotiating the terms of the UK's exit before negotiating the terms of a future relationship.

However, recent signals from the EU that transitional arrangements are likely, may help to soften the landing for companies pending completion of talks to define the post-Brexit relationship.

As well as planning for all the possible outcomes, companies need to speak out. As key stakeholders in the societies and economies in which they operate across Europe, they need to become closely involved in conversations with governments.

Companies need, without any hesitation or holding back, to put forward and explain their views on priorities for negotiations, because companies have great insights into the issues which negotiators on either side need to address.

In setting out what they need and why, companies also need to spell out how they contribute to growth, jobs, and a better life for all. Where they have requests, they should take care to express them in trade-friendly language that negotiators can easily adopt and agree.

Andrew Hobbs, EY EMEIA Public Policy Leader of EU membership. On 29 March this year, UK Premier Theresa May formally triggered a two-year period of negotiations for the UK to leave the EU. Parliamentary elections in the UK, to be held on 8 June may reshape continuing uncertainties there.

Populism has surged elsewhere too as European citizens struggle to adapt to economic change. Political parties that favor a return to more national markets have won support, and sentiment has swung against established rulers and parties. However, in France and in the Netherlands, electors earlier this year largely rejected populist insurgents, when other EU countries have swung far to the right. Next, the nature of Germany's vital role as Europe's anchor will be in play in its keynote elections in September.

EU leaders have closed ranks, reasserted the EU's commitment to the free movement of goods, services, capital and people across borders, and agreed a common negotiating position with the UK. At the same time, the imperfection of the EU and its institutions is widely acknowledged, and a frank debate has begun about possible improvements. Europe's place in the world is changing, its relative importance diminishing. Long term, a rethink about the future of the EU might help refresh Europe's attractiveness.

Europe's investment capacity appears intact

Growth is slightly better

After averaging expansion of 1.7% in 2016, ahead of the US (1.6%) the 19 Eurozone countries are expected to achieve GDP growth of 1.7% this year and 1.6% next year.[2] The 11 countries of emerging and developing Europe, on the region's southern and eastern fringe, are expanding almost twice as fast.[3]

Steadier and stronger growth around the world lifts demand for European products and services at home and abroad, raises capacity utilization, and gives business decision makers the confidence to expand and invest. In April 2017 the Eurozone Purchasing Managers Composite Output Index reinforced other signs of strengthening Eurozone growth by reaching 56.8, its highest since April 2011. This measure of future trends showed growth to be strong and accelerating in Germany, France, Spain, Ireland and Italy.[4]

[2] IMF World Economic Outlook, April 2017

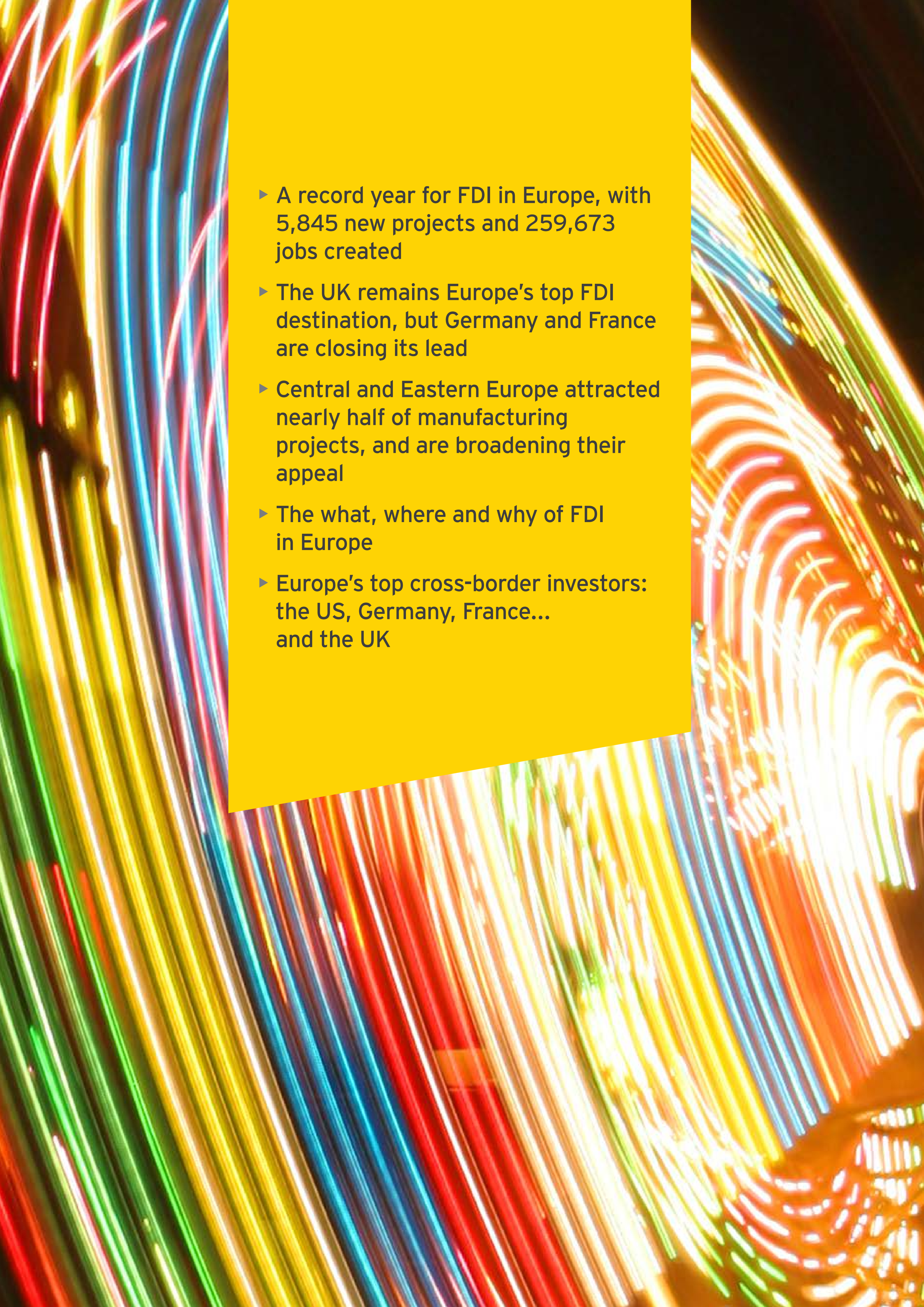
[3] Includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Kosovo, Macedonia, Poland, Romania, Serbia and Turkey

[4] Source: "Markit Eurozone Composite PMI® – final data," IHS Market press release, https://www.markiteconomics.com/Survey/PressRelease.mvc/464e8e1e416c4b08a3e77afe50508228, 4 May 2017

19 Eurozone countries are expected to achieve GDP growth of 1.7% this year and 1.6% next year.

Chapter 2

Foreign direct investment in 2016: **Europe's economy is working, after all**



- A record year for FDI in Europe, with 5,845 new projects and 259,673 jobs created
- The UK remains Europe's top FDI destination, but Germany and France are closing its lead
- Central and Eastern Europe attracted nearly half of manufacturing projects, and are broadening their appeal
- The what, where and why of FDI in Europe
- Europe's top cross-border investors: the US, Germany, France... and the UK

2. Foreign direct investment in 2016: **Europe's economy is working, after all**

FDI in Europe reached new peaks in 2016

In 2016, foreign direct investors announced a record 5,845 new projects in Europe, up 15%. The massive inflow of projects was accompanied by a 19% surge in jobs created, which reached 259,673.

Though counting job creation accurately is very difficult, that's more than twice the number of jobs that we believe were created by FDI in the lean years of 2009 and 2010, when Europe was struggling through the immediate aftermath of the financial crisis. What's going on?

Europe is a market too important to shun

The recent upsurge in FDI reflects a long-awaited return to economic growth throughout almost all of Europe, albeit at a much lower level than in earlier decades. International investors have regained some of their confidence in Europe since the worst of the financial crisis. Investors were quick to recognize an emerging economic recovery in Europe, and geared up their capacity to profit from stronger demand, increasing continent-wide market integration, and the improved efficiencies available from new, especially digital, technologies.

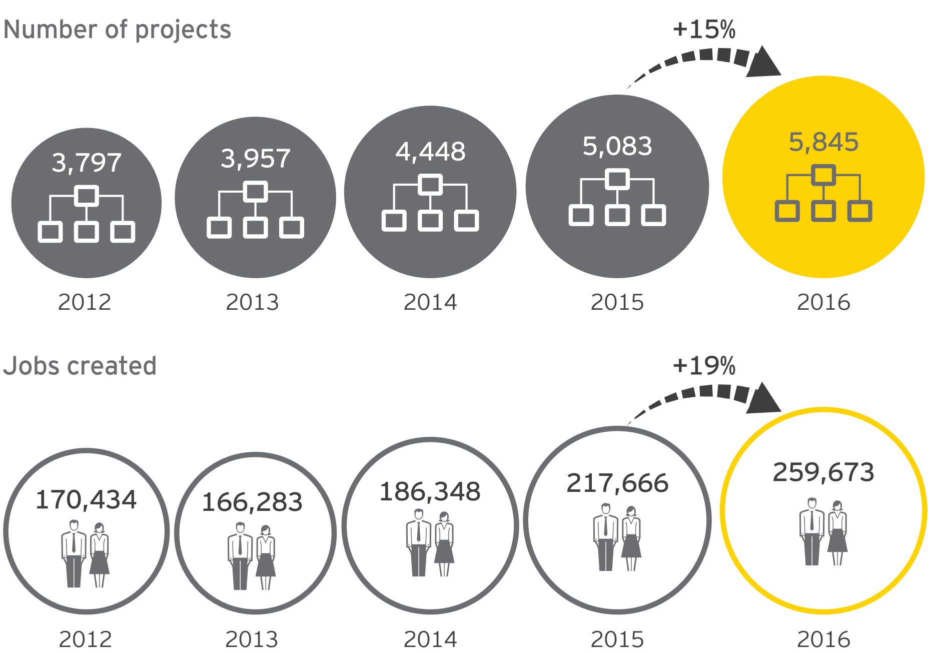
Europe remains a "must be" market for multinational companies, despite its complexity and the uncertainties stalking its politics and institutions. Europe's ability to attract increasing numbers of FDI projects confirms the endurance of its economic environment. Investors remain strongly attracted by and committed to the region, and continue to establish new operations, renew or expand existing facilities, and to create jobs in Europe. Despite question marks over the nature and direction of European integration, the rise of populism, challenges around migration and political uncertainties, investors have accelerated their investments into Europe and signaled their belief in the region's ability to overcome its challenges.

Little wonder that countries and regions make great efforts, so far as European competition rules allow, to clinch investment decisions with advice, financial assistance and tax breaks.

Against the global backdrop of geopolitical and economic instability, the first of many striking messages from EY's *European Attractiveness Survey 2017* is that investors are continuing to bet on better economic trends and opportunities in the EU, as well as its European neighbors, including Russia and Turkey.

Europe remains a "must be" market for multinational companies, despite its complexity and the uncertainties stalking its politics and institutions.

FDI projects and jobs created in Europe



Source: *EY European Investment Monitor (EIM)*, 2017.

Top 20 destination countries by FDI projects

	2015	2016	Percentage Change (2016 vs. 2015)
United Kingdom	1,065	1,144	7%
Germany	946	1,063	12%
France	598	779	30%
Spain	248	308	24%
Poland	211	256	21%
Netherlands	219	207	-5%
Russia	201	205	2%
Belgium	211	200	-5%
Ireland	127	141	11%
Turkey	134	138	3%
Finland	105	133	27%
Romania	98	132	35%
Czech Republic	70	110	57%
Hungary	94	107	14%
Sweden	51	90	76%
Italy	55	89	62%
Switzerland	90	88	-2%
Denmark	63	72	14%
Slovakia	54	70	30%
Portugal	47	59	26%
Others	396	454	15%
Total	**5,083**	**5,845**	**15%**

Top 20 destination countries by FDI job creation

	2015	2016	Percentage Change (2016 vs. 2015)
United Kingdom	42,336	43,165	2%
Poland	19,651	22,074	12%
Germany	17,126	19,961	17%
Romania	12,746	17,545	38%
France	13,639	16,980	24%
Serbia	10,631	16,396	54%
Russia	13,672	15,064	10%
Czech Republic	9,332	14,292	53%
Spain	7,126	12,969	82%
Hungary	11,741	12,450	6%
Ireland	10,772	8,535	-21%
Slovakia	9,564	8,308	-13%
Turkey	2,971	7,179	142%
Austria	1,357	4,759	251%
Ukraine	850	4,547	435%
Bulgaria	3,598	3,959	10%
Switzerland	1,391	3,416	146%
Belgium	3,168	3,309	4%
Moldova	1,000	3,200	220%
Italy	1,383	2,654	92%
Others	23,612	18,911	-20%
Total	**217,666**	**259,673**	**19%**

Source: *EY European Investment Monitor (EIM)*, 2017.

Destinations and country rankings: gains for (almost) everyone

Three Western European countries captured half of European FDI

Europe's appeal to foreign direct investors is diverse: the number of projects increased in every leading destination except the Netherlands, Belgium and Switzerland.

However, Europe's attractiveness is driven by three FDI champions: the UK, Germany and France. Together, these three big, highly-developed economies captured half of European FDI inflows in 2016, almost unchanged from the 51% they secured in 2015.

The UK reinforced its position as Europe's FDI leader in 2016, with 1,144 FDI projects, up 7%. Yet the growth of UK FDI has slowed from the 20% achieved in 2015. UK FDI inflows may have been affected by the country's planned break-away from the EU. Investors seek a stable political and economic environment, so it is likely that the uncertainty that prevailed in 2016 has adversely affected investors' confidence in the UK as an investment destination.

Germany, with 1,063 projects, up 12%, clearly strengthened its challenge to the UK's longstanding European FDI leadership. The rapid growth of FDI into Germany puts it on course to overtake the UK, unless the UK regains its previous rate of growth. With ongoing uncertainty around the terms of any Brexit, that could be a tough challenge.

France achieved a remarkable surge in FDI during 2016, attracting 779 FDI projects last year, up 30%.

The resurgence of interest in France after a decade of declining appeal reflects benefits from modest labor market reforms and a more business-friendly climate. Investors in sectors with high added value are increasingly recognizing the attractions of France's highly skilled, creative, and productive workforce. In addition to manufacturing and logistics, France is attracting R&D and headquarters projects, often linked to the digital transition.

Spain, Belgium and the Netherlands also ranked among the ten most attractive European countries in 2016. In particular, resurgent economic growth and labor market reforms helped Spain attract 308 projects in 2016, up 24% on 2015. With relatively competitive labor costs and a highly skilled labor force, Spain's competitiveness makes it an attractive location for FDI projects.

Central & Eastern Europe: competitive and attractive

FDI in CEE had a strong momentum in 2016. Poland leaped to fifth place in the national ranking, attracting 256 projects, a hefty 21% increase. The Czech Republic secured 110 projects, up 57% and Hungary and Slovakia also achieved firm gains.

The region attracted nearly half of Europe's FDI industrial projects. It has become a favorite among European car-makers, which locate assembly plants in countries such as Slovakia where they find committed, skilled and affordable employees. To ensure just-in-time deliveries and win comparable advantages, many component suppliers also locate new plants in Eastern Europe.

Poland and its neighbors, including the Baltic States, are also attracting a third wave of shared service centers (up 83% for CEE in 2016) and other activities supplying services to companies. Investors are moving up the value chain in Central Europe. An operation that began as a call center may now be broadening out into an IT support function, engaging in sophisticated software development,

Viewpoint: The Baltics' blossoming business appeal

The Baltic States form a natural hub for trans-European trade. They offer a unique business environment, comprising more than six million people who share the North European work ethic and have invaluable experience in conducting business with the East.

Air and sea connections are good, and rail links are being improved. Riga, the capital of Latvia, acts as an air traffic hub for more than 5 million passengers a year, to 89 destinations. It has an ice-free port and the Rail Baltica project, which plans to offer fast passenger and freight trains between all three Baltic capitals and Poland by 2030 is progressing well.

The Baltic States are an attractive location for many companies. For example, Latvia offers the third-best ratio of productivity relative to wages in Europe. The Doing Business 2016 index ranks all three Baltic States among its Top 20 and Latvia at 14, ahead of Germany, Canada, France and Poland.

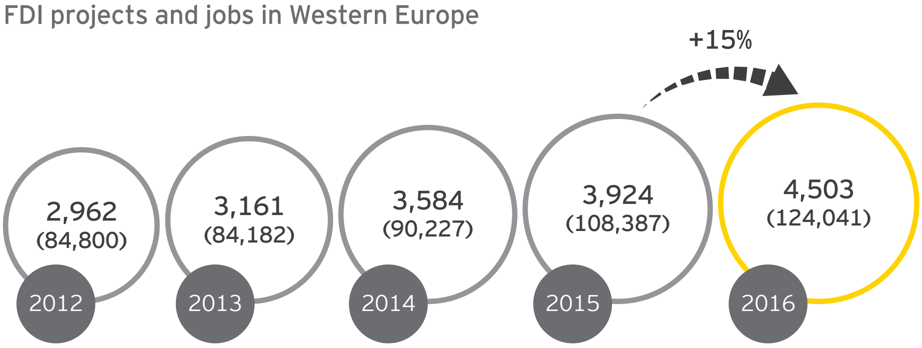
Baltic countries are investing heavily in infrastructure and education, and aim to become an innovation centre. Already, 70% of school-leavers enter higher education; and almost 24% choose to study science and engineering.

Our business environment helps start-ups launch and grow fast. During the past two years we've implemented important steps: in 2017 the Law on Aid for Start-up Companies in Latvia was adopted, and the Government is determined to cut red-tape for start-ups to zero.

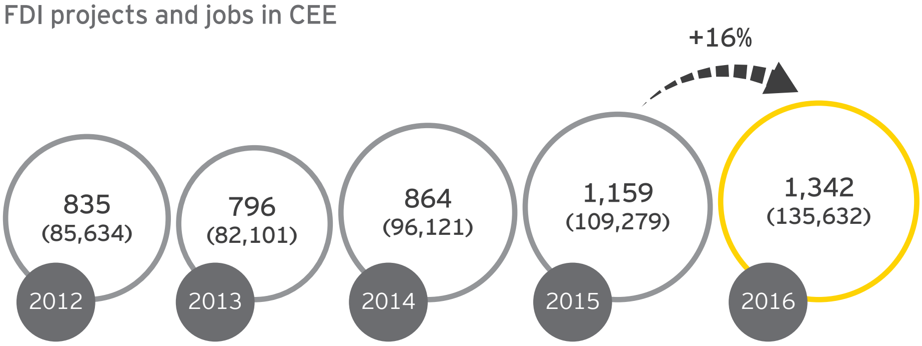
With their relentless focus on digital infrastructure, e-services and IT talent development, the Baltic countries now attract foreign direct investors who value Baltic digital ecosystems over mere cost advantages. Today, technology companies active in FinTech, gaming and 3D design increasingly see the region as first point of entry to the European market and a priority location for their technical development offices.

Arvils Ašeradens, Minister for Economics of the Republic of Latvia and Deputy Prime Minister

FDI projects and jobs in Western Europe



FDI projects and jobs in CEE



Note: Job numbers are in brackets
Source: *EY European Investment Monitor (EIM)*, 2017.

and even adding R&D capabilities. In 2016, the number of R&D projects in CEE surged 36%.

As they look to expand operations, early movers are finding that although high skills and affordable salaries remain strong attractions, tightening labor markets in cities such as Warsaw and Prague push them to expand in second or third-tier cities such as Lodz or Brno. Other investors, chasing their ideal skills and wages combinations, have looked south to non-EU members such as Serbia, while the Baltic States, benefiting from a focus on digital skills together attracted more than 100 projects.

Southern Europe and Turkey: divergent trends

Southern Europe's attractiveness revived strongly in 2016. FDI inflows to Italy, Portugal and Spain surged more than 24% each year-on-year. A plentiful supply of well-qualified and affordable young people, and moderate real estate costs, contributed to the attractiveness of these Southern economies. Italy, long an FDI laggard among Europe's big economies, secured 89 projects, up 62%.

After significant growth of 23% in 2015, however, Turkey's FDI rose just 3% in 2016, to 138 projects. Economic growth slowed last year and the country suffered an attempted military coup and prolonged state of emergency. Combined with a high ratio of US Dollar denominated debt and instability in the neighboring region, including an ongoing conflict in Syria that has displaced many people, these factors will likely affect Turkey's attractiveness for foreign investors.

Investors seek talent in cities, yet often say the skills they need are lacking

In many European countries growth is uneven. The economies of big cities may be growing twice as fast as those of the country overall: metropoles have become key players in a globalized investment map. Greater London, a very global city, netted 454 FDI projects in 2016, up 12%, even as FDI inflows to the UK as a whole increased by 7%. Greater London may have had a catch-up after a poor 2015. Yet with less than 14% of the UK's population, it attracted 40% of its FDI projects. Greater London is so attractive to foreign direct investors that it would rank 4th in the European country ranking, ahead of Spain and Poland. The story is similar in France, where FDI is heavily concentrated in the Paris region. Provincial areas in much of Europe gain less from the prosperity, job creation and business-invigorating benefits that FDI delivers.

In Europe as elsewhere, clever, well-educated people flock to cities, seeking the symbiotic access to highly-paid skilled jobs, educational and research facilities, cultural and leisure facilities, transport and housing. So investors seek talent and opportunities in these concentrations of people, brainpower and markets.

On a continent where populations are aging, the ongoing availability of the brightest and best talent has become a strategic criterion for FDI success. Yet many European cities acknowledge scarcities in some sectors or skills. Maintaining a good supply of talent is likely to be a key factor for Europe's future attractiveness.

The downside, as our data suggest, is that the massive ongoing re-distribution of talent and prosperity hollows-out old industrial and rural areas, leaving populations struggling amid declining services. Regions that cannot rival cities by offering a concentration of infrastructure, talent and an attractive lifestyle struggle to attract FDI. This has multiple adverse consequences: it causes people to doubt Europe's attractiveness, and it undermines confidence in FDI as a mechanism for economic renewal and growth. And by accentuating economic disparities between successful cities and the rest of the country in which they are found, it contributes to rural-urban migration and to a growing economic and cultural divide between city dwellers and the rest.

Maintaining a good supply of talent is likely to be a key factor for Europe's future attractiveness.

EY viewpoint: A blueprint for a future-facing EU

Europeans may come to remember 2016 as the year of catharsis. The mix of geopolitical instability, terrorism and populism that it brought has given the European Union a unique opportunity to rethink the fundamental reasons for staying together, and hence to recast its long-term goals.

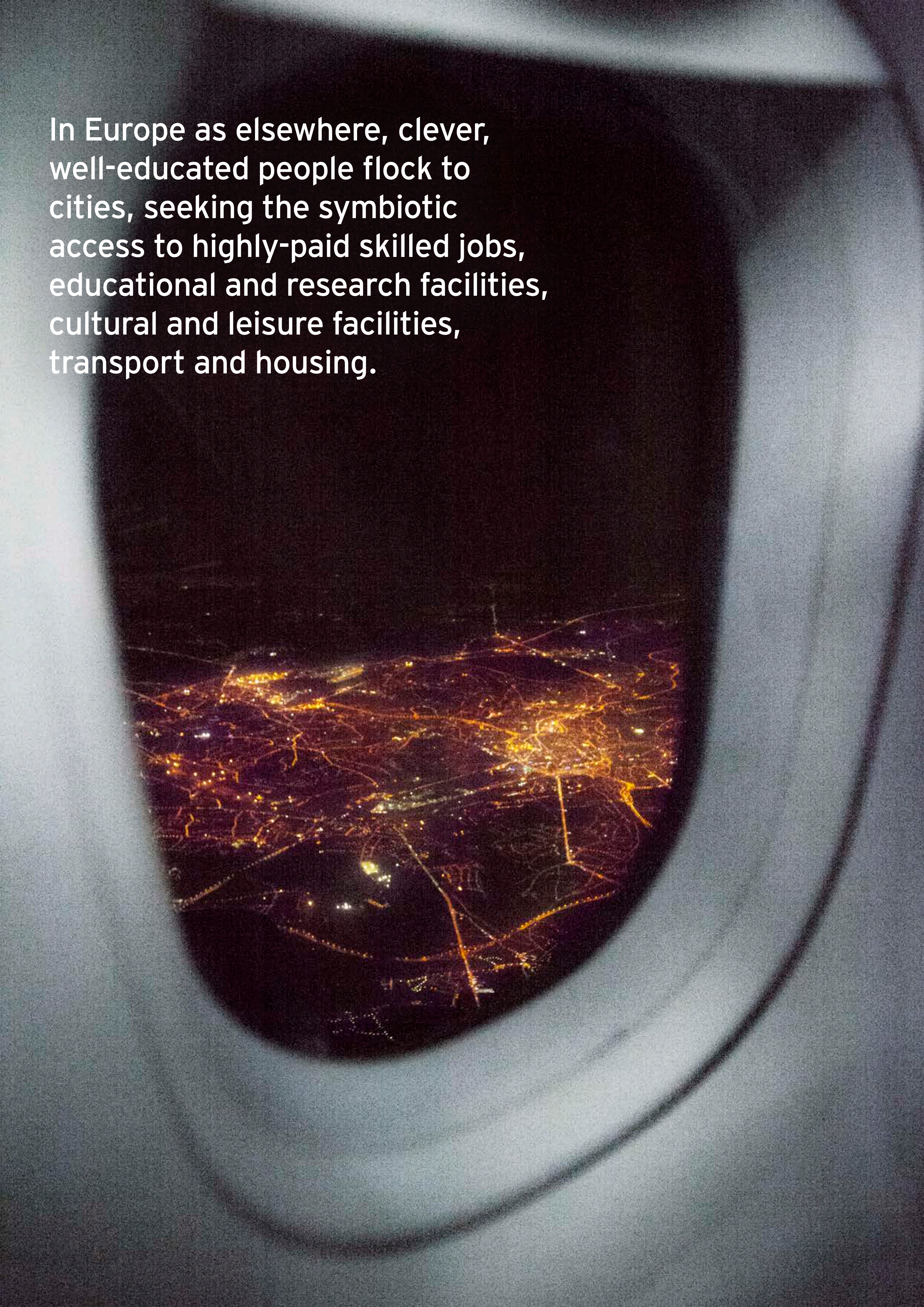
We need a two-fold approach. In the short term, Europe needs to refocus its strategy on delivering higher economic growth, higher productivity and higher employment. But looking longer term, we need to plan for the tremendous effects that will come from demographic and technological change; from a shrinking population and from declining economic power.

My personal agenda for reforming the EU and its priorities would focus on five urgent themes:

- Place stronger emphasis on accelerating institutional reforms in the Member States, in order to improve public finances and reduce public debt
- Overhaul EU Institutions to make them fit for the future
- Complete the Single Market in the domain of services and digital trade, the European Energy Union and the Capital Markets Union – because these are crucial steps to boost innovation and growth
- Invest in education at all levels to prepare the next generation for the work of the future
- Develop a fully-fledged migration policy and a common foreign policy, including for security and defense

Alessandro Cenderello, Managing Partner for EU Institutions, EY

In Europe as elsewhere, clever, well-educated people flock to cities, seeking the symbiotic access to highly-paid skilled jobs, educational and research facilities, cultural and leisure facilities, transport and housing.



FDI by activity, sector and origin: deep dive into the transformation of Europe's cross-border economy

Selling to 500 million consumers and 30 million companies

The nature of projects being undertaken by investors in Europe tells us a lot about what is happening within the European demand-driven economy. Europe's most powerful attraction in the global battle to draw in FDI is the size and wealth of its increasingly dynamic marketplace. In 2016 Europe attracted a record 2,683 sales and marketing offices, up 29% on 2015. Sales and marketing activities made up 46% of all FDI projects in 2016, up from 41% in 2015. But in a digital era, this category almost certainly includes many software and business services companies that are expanding across borders.

Companies originating outside Europe make 45% of FDI investments in sales and marketing projects. But most are cross-border projects by European companies, which increasingly think of the entire continent as their back yard, finding within it the scale and advantages that contribute to their growth, expansion, and innovation.

Digital everything

Europe is in the throes of a digital transformation that is changing the way people live and work, and transforming its economy and businesses. Europe's historic strengths in the manufacture of capital goods and in business services are being reinforced by the development and industrial adoption of robotics, artificial intelligence, the Internet of Things and other business-oriented digital technologies. Every sizeable city now boasts a digital ecosystem, where tech entrepreneurs cluster in incubators and hubs, supported by specialized venture capital firms and lawyers, and increasingly by policy initiatives and fiscal incentives to stimulate innovation.

Measuring this burgeoning business sector is not easy, because bright minds are applying digital technologies

Europe is in the throes of a digital transformation that is changing the way people live and work, and transforming its economy and businesses.

Projects by activity in Europe

Activity	2016 FDI Projects	2016 Evolution	2016 Share
Sales & Marketing	2,683	29%	46%
Manufacturing	1,538	6%	26%
Logistics	508	14%	9%
Research & Development	403	4%	7%
Headquarters	265	-10%	5%
Shared Services Centre	161	55%	3%
Testing & Servicing	104	14%	2%
Contact Centre	70	-26%	1%
Internet Data Centre	70	-16%	1%
Education & Training	43	2%	1%
Grand Total	**5,845**	**15%**	**100%**

Source: *EY European Investment Monitor (EIM)*, 2017.

to every field, from agriculture to vehicles, from shopping to healthcare and social security. Many are captured within the categories of software and business services, which now account for 25% of European FDI. But many more fall within our 'sales and marketing' category. We know that US giants such as Amazon, Alphabet and Facebook are investing hugely in Europe, both in greenfield projects and by acquiring digital innovators. They are surrounded by a growing multitude of European innovators who hope one day to overtake them.

Companies are still completing their European operational integration

Many companies are still completing their European economic integration, or are changing the way they operate to take advantage of deepening integration within the European single market. These adjustments cause them to invest across borders within Europe, and the rising number of FDI projects in recent years is itself a confirmation that companies are adjusting their operating models. When costs matter more than ever, and time-to-market is critical, companies must adjust the nature and location of their operations to remain competitive in markets that are converging. The rise of artificial intelligence, robotics and additive manufacturing are changing the economics of assembly. Though some manufacturing moves east, drawn by lower labor costs, companies are also investing heavily in shared service centers to enhance operational efficiency; and in logistics, to smooth flows of goods, reduce delivery times, and extend their market reach.

EY's *Capital Confidence Barometer* (CCB), a complementary study, has given us valuable insights into the corporate behavior that is driving

EY viewpoint: Building the single market of the future

The creation of a single market in Europe has stimulated economic growth and has provided consumers with greater variety and choice than ever before. The adoption of uniform competition policy and state aid principles has enabled businesses from all EU member states to compete on equal terms and to the benefit of consumers. Liberalization of network services such as telecommunication and energy has initiated competition across providers, fostered innovation and stimulated productivity growth. Free movement of labor and capital has created new perspectives for professional and personal life and thereby inspired integration across European societies.

Today, the need for an integrated Single European Market is stronger than ever, because digitalization has triggered a wave of technological innovations with the potential to fundamentally change existing production processes, business models and even our ways of life. Managing the challenges of digitalization, making best use of the incredible opportunities of this technological revolution, as well as competing successfully on global markets, requires European economies and societies to move together.

However, there is still a long way to go for Europe to provide a high quality digital infrastructure – a necessary basis for digital business models to flourish. For example, several European countries – including Germany – are lagging in terms of broadband provision. Additionally, education systems throughout Europe are highly variable, teaching digital skills and competences on very different levels. Today, a high proportion of the European workforce has poor digital skills or none at all.

Further challenges are ahead: common norms and standards need to be created to enable different systems to interact with each other and to help realize the Internet of Things or automated driving. At the same time, Europe needs to play a strong role in making sure that the free flow of information and data privacy are guaranteed so that the opportunities of digital technologies can be seized – while curbing the risks.

Bernhard Lorentz, Leader, Government and Public Sector Germany Switzerland Austria, EY many FDI decisions. In our latest CCB survey, 73% of respondents said they were reviewing their portfolio of activities more frequently, to help spot areas of growth and accelerate decision making. Companies are increasing their agility in response to increased uncertainty.

In a globalized economy being cost competitive is often about being in the right place – and Europe remains an attractive location for many manufacturers. Cross-border investors launched 1,538 industrial FDI projects in 2016, up 6% on 2015, though they now form a smaller part of the expanding FDI mix. CEE is increasingly becoming the continent's workshop. Last year CEE secured 755 projects, a 15% increase and an overall 49% share of European manufacturing FDI projects - up from 45% in 2015.

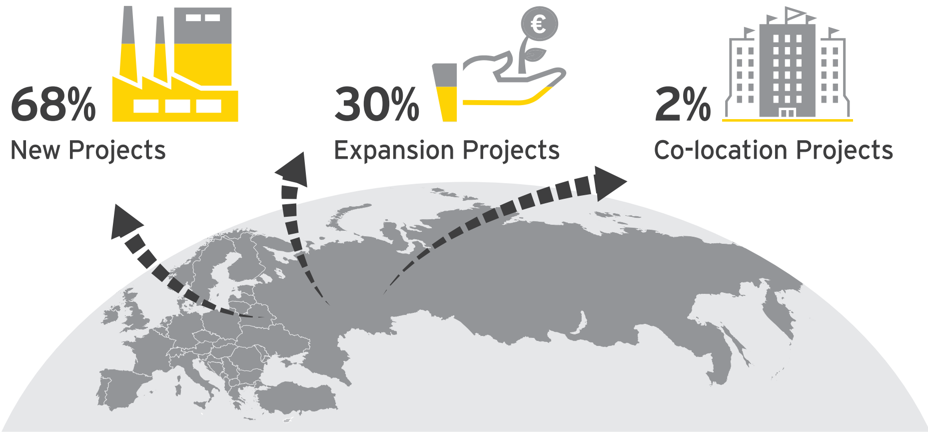
The automotive sector continues to advance. Vehicle makers and their suppliers were among the most active cross-border investors in 2016, launching 345 projects, up 7% year-on-year. Their investments came as the European car market grew for the third year to 14.6 million registrations. European top-end cars continued to win customers in export markets, but with ongoing pressure on profit margins, car-makers have shifted assembly of budget models east, to take advantage of lower labor costs, and component suppliers have followed them.

Blue collar, white collar, black collarless

In 2016, the average European FDI project delivered 44 jobs, compared to 43 in 2015. Manufacturing projects, which typically create more jobs per project, today form a smaller part of the mix. It also appears that on average FDI projects are becoming less capital intensive. As sales and marketing operations become more numerous, the kind of jobs FDI creates is evolving and the lines between activities blurring. Expect fewer blue collar jobs on large industrial sites and more white-collar – or black tee-shirt - jobs in smaller companies.

Meantime, 30% of FDI projects launched in Europe last year involved the expansion of existing operations, up from 27% in 2015. This implies that foreign investors are finding success in Europe. Are they obliged to expand existing activities to satisfy growing demand or market share?
Or are they consolidating their European operations on fewer but bigger sites? It's probably a bit of both.

FDI by project type



Source: *EY European Investment Monitor (EIM)*, 2017.

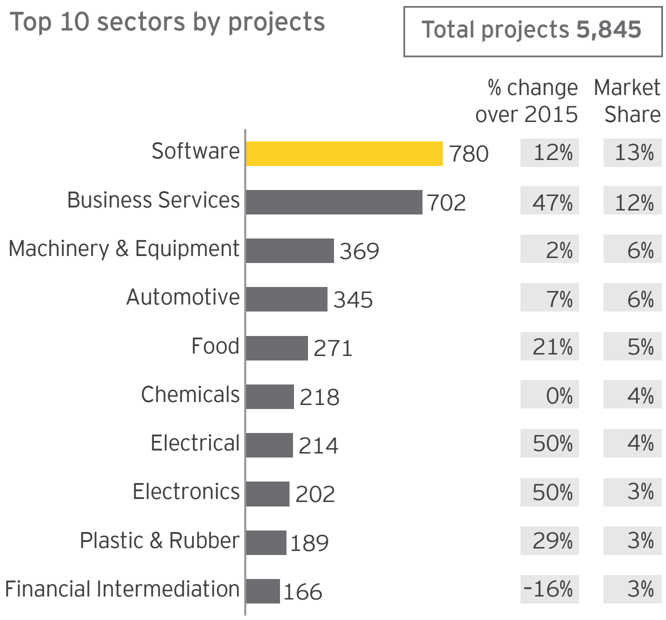
B2B and IT services underpin Europe's sector transformation

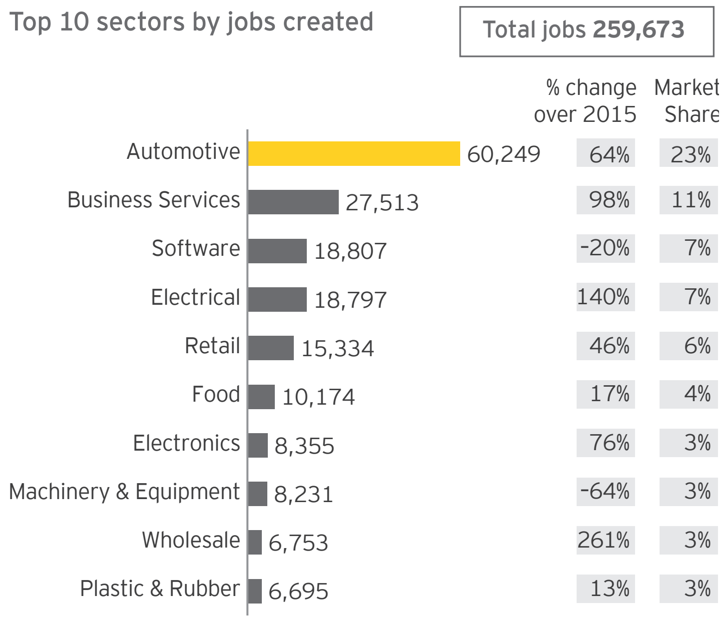
FDI trends provide valuable insights into companies' strategies for the future, and the way they are adjusting to current economic and technology trends. Europe's two leading FDI sectors show the scale and breadth of Europe's ongoing digital transformation. The software sector was the single biggest source of FDI in Europe in 2016, launching 780 projects, up 12%.

Business services, which includes many companies facilitating the digital transition, was the next most active sector for FDI: the number of projects soared 46% in 2016. Together software and business services account for 25% of European FDI.

Financial services firms and insurers, which have much to gain from digital technologies, continued to make cross-border investments. In 2016, overall numbers were up just 5% at 291 projects. In most countries banks have made progress rebuilding their balance sheets in recent years, but with low interest rates, lending margins are slim and financial engineering remains unfashionable. Improvements in financial technologies will provide opportunities to invest.

Growth in pharmaceutical projects stalled, but with 163 new investments, the industry remains significant in cross-border investment. Some industry leaders are shifting more of their research effort from in-house laboratories to collaborations with external partners, including university-based institutions.





Source: *EY European Investment Monitor (EIM)*, 2017.

EY viewpoint: Europe's changing tax landscape

The tax landscape for multinational companies in the European Union is about to change dramatically. In 2015, the OECD published its Action Plan on Base Erosion and Profit Shifting (BEPS), altering the landscape for multinational companies (MNCs). Much of the BEPS plan will enter force as mandatory rules in European Union countries by 2019.

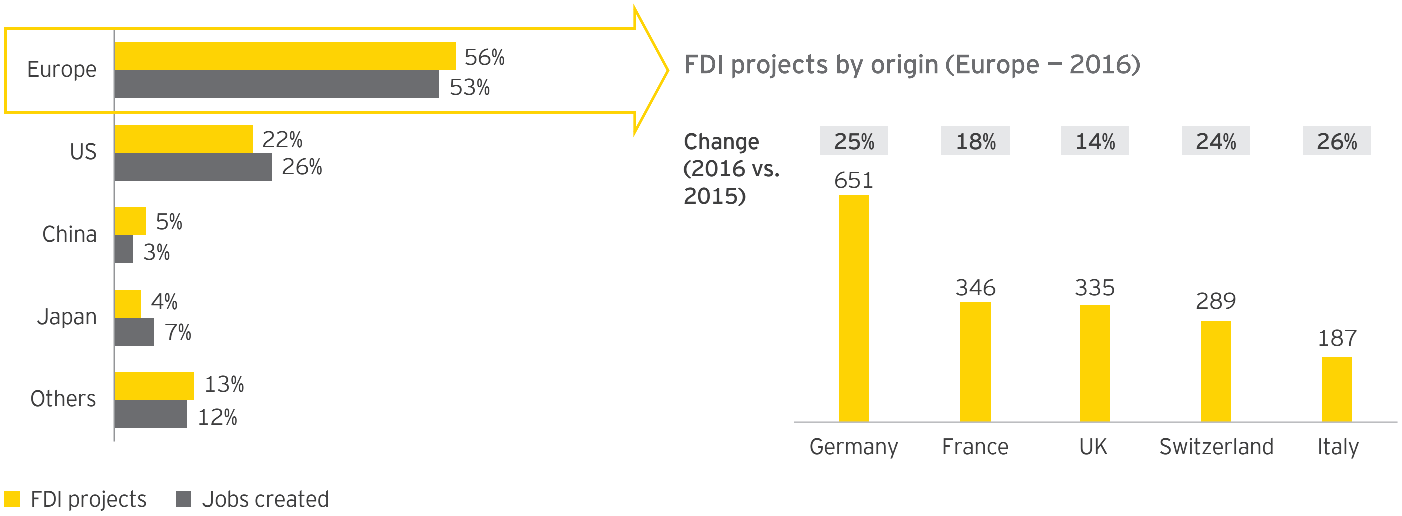
In Europe, the new, more or less universal rules, will leave MNCs with major tax inefficiencies associated with cross border investments (withholding tax, often non-creditable), geographic restrictions on loss compensation, non-deductible expenses, etc. and risks of much higher effective tax rates. The solution in many cases is tax-driven operating model and supply chain planning.

Another major consequence is the uncertainty created by BEPS Action 6, dealing with perceived inappropriate use of tax treaties. Action 6 introduces a potentially very restrictive new Principal Purpose Test. The economic impact of these rules is to create uncertainty that is unhelpful to the investment climate in Europe, and that is likely to raise the possiblity of litigation risks and costs for investors. Others may simply opt to invest in more friendly climates. These rules will be phased-in from 2018 onwards.

Finally, EU Value-added Tax and Customs rules continue to provide an incentive for EU groups to keep their manufacturing operations for products destined for EU customers within the EU. Many British exporters will soon discover that there are inconveniences in exporting to the EU, instead of within the EU. So, they may well adapt their supply chains to benefit from the easiest points of entry into the EU market.

Helmar Klink, Partner, International Tax Services, Ernst & Young LLP (The Netherlands)

FDI projects and jobs created by source, % share



Source: *EY European Investment Monitor (EIM)*, 2017.

Consumer products companies are struggling to adapt their operations to a generation of fickle consumers, and to use digital technologies to connect more effectively with a generation that pays less attention to big brands. Young and innovative consumer brands, meantime, are using the Internet to rapidly extend the success of new products across Europe, backed by small, agile, sales and marketing operations.

The origin of FDI: US and European investors still dominate

As the world's biggest economy, and a leader in the digital transition, it is unsurprising that the US was the single biggest source country for FDI in Europe. However, it is striking that with 1,310 new FDI projects, up 10%, US investors have signaled their continued faith in Europe as a valuable market and a good place to do business. US companies accounted for 22% of all FDI projects launched in Europe in 2016.

However, the majority of FDI in Europe arises from intra-European FDI flows. European companies know their neighboring markets increasingly well, and are busy transforming themselves from national into pan-European or global champions.

For instance, German companies are Europe's leading home-grown cross-border investors, launching 651 projects last year, up 25%. Overall, 38% of German outbound FDI still goes into manufacturing, led by automotive assembly (90 projects), often in countries where costs are lower. Companies from the UK stepped up their investments into other European countries in 2016, launching 335 projects, up 14%. Many of these decisions would have been taken before the UK decided to withdraw from the EU. French companies announced 346 cross-border projects in Europe in 2016. France has a significant group of companies that each rank among global leaders in their field. As these reinforce their European footprint, they draw their trusted suppliers of components, services and advice in their wake, helping other French firms develop across the continent too.

China's bulls shop

Asian investors continue to flag their confidence in Europe. Chinese companies launched 297 FDI projects in Europe in 2016, up 25%. Two-third of these were sales and marketing projects, though Chinese investors also announced 52 manufacturing projects, making up 18% of total Chinese projects, and 22 R&D investments, an increase of 10% on 2015. Chinese companies invest across a very diverse range of sectors, but machinery and electronics are in the vanguard.

Chinese investors are turning away from the UK to Germany and France. In 2015 the UK secured 68 Chinese FDI projects, only six fewer than Germany. But in 2016, Chinese investors launched 118 projects in Germany, up 59% and 21 in France, a 50% rise, whilst unveiling 59 projects in the UK, down 13%. Elsewhere in Europe, their projects are widely scattered, but include a handful in Russia and six in Belarus.

European companies know their neighboring markets increasingly well, and are busy transforming themselves from national into pan-European or global champions.

Chapter 3

Looking ahead:
will it pass or will it last?

- Investors rank Western Europe their top destination in 2017, ahead of the US, as emerging markets fall from favor
- Brexit and Europe: reading the clues
- Uncertainty: Europe's year of elections
- Changing for the better… eventually

3. Looking ahead: **will it pass or will it last?**

In 2017, global decision makers put Europe first

In a mixed field of competitors, Europe doesn't look too bad

During March 2017, we surveyed decision makers in a representative sample of 505 foreign companies in Europe and beyond about how they see Europe's attractiveness as an investment destination.

Their answers show unequivocally that for its typical investors (we survey a representative sample of those who invest in Europe), Europe remains the world's most attractive destination for cross-border investment. When we asked for their top three picks, Western Europe scored 53%, up from 50% in 2015. North America ranked second, with an unchanged score of 39%, and Central and Eastern Europe came third, surging from 28% in 2015 to 37% in 2017 - where it is now level-pegging with China as an investment choice.

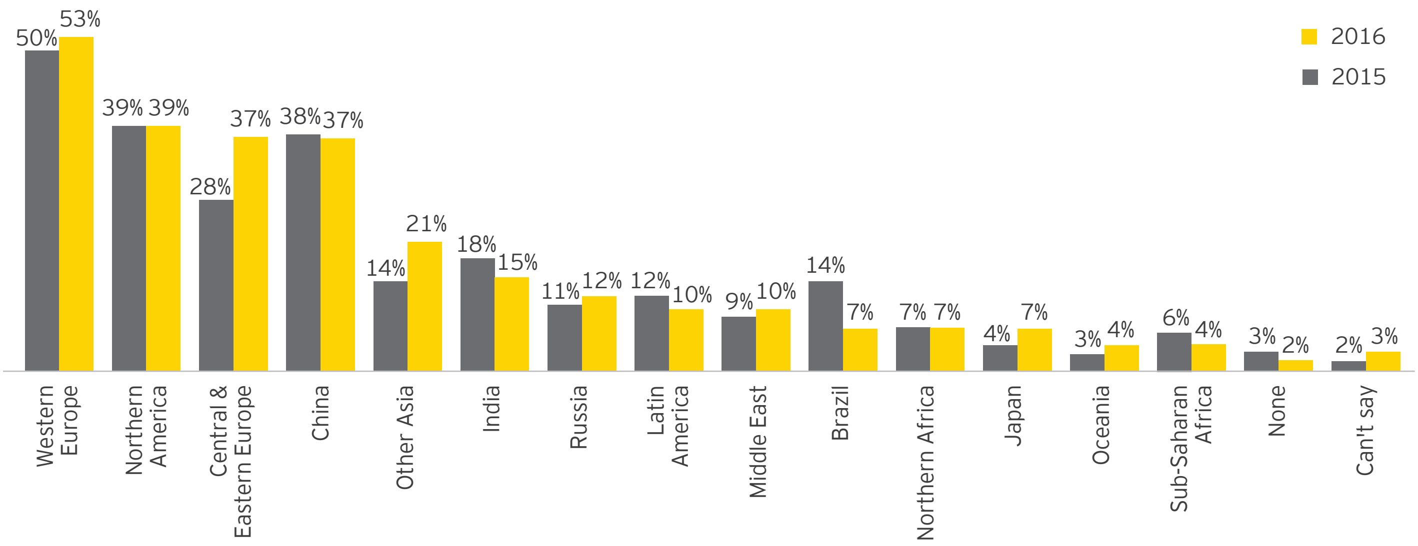
China, and others, lose ground

Executives say that even as Europe is gaining attractiveness, and North America levels off, China's appeal continues to fade. It is now down to 37% from a peak of 48% in 2007. Despite ground-breaking economic reforms and strong growth India's appeal has also weakened, though it is Brazil, down to 7% from 26% in 2013, that risks falling off investors' radar. Russia, meantime, now attracts less attention from foreign investors, who struggle to understand the investment outlook there.

Executives say that even as Europe is gaining attractiveness, and North America levels off, China's appeal continues to fade. It is now down to 37% from a peak of 48% in 2007.

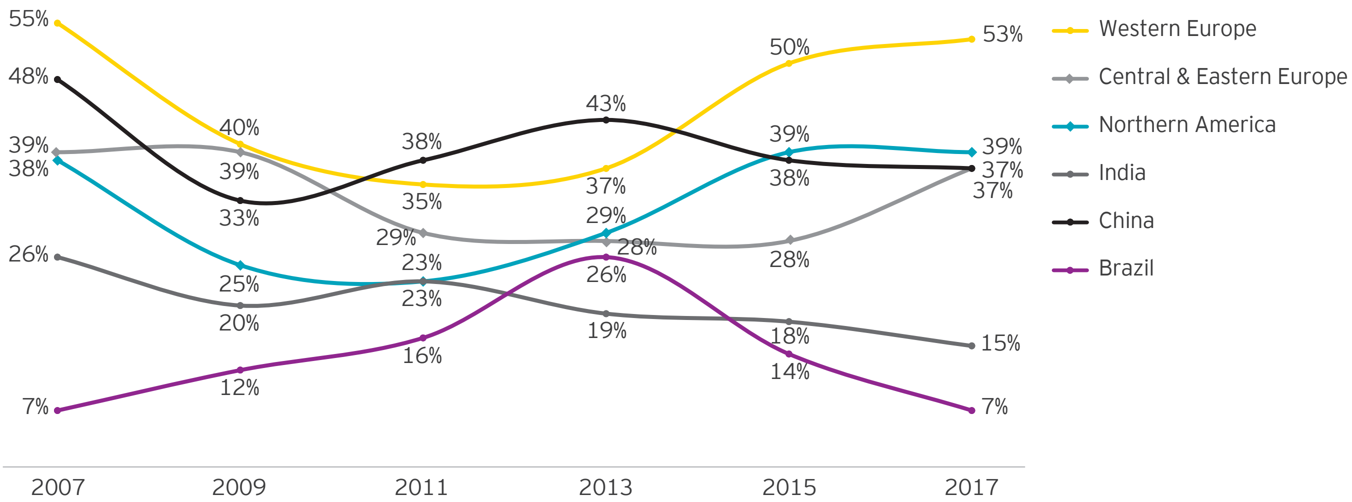
In a world of relatively weak growth and heightened uncertainty, investors seem inclined to focus their projects in regions where stability is deep-rooted, and above all in Europe, where growth is perking up.

Attractiveness by region (2017): Europe in top position



Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).

Attractiveness by region (2007–2017): China losing ground



Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).

Viewpoint: Innovation based on progressive trade and a strong Single Market

With great political uncertainty in large parts of the Anglophone world, the EU27 could well be the beacon of stability in coming years. It will remain the world's biggest trade block. It is extending its single market into the digital, energy and capital realms. And the EU is becoming the world's bulwark for open economies with high levels of social protection, the rule of law and freedom of speech and assembly – which have all proven over time to provide the most sustainable growth trajectory for economies.

Amid a drive to re-energise this unique Union of democracies and social market economies, EU27 GDP growth reached 1.9% in 2016, outstripping the 1.6% achieved in the US. The EU27's overall trade surplus of around €564b shows that the world wants to buy 'Made in Europe'.

This outlook is bolstered by rapid advances towards new trade deals with Japan, Mexico and New Zealand – to add to existing EU trade deals with some 50 nations.

Responding to the (electoral) outcry from those displaced by globalisation, new generation bilateral agreements have a clear focus on strengthening the middle class, preserving labour and environmental standards and setting up new multilateral investment tribunals.

Looking ahead, Europe is in pole position in many fields of innovation. The rise of automation and data exchange in manufacturing will certainly play to Europe's unparalleled and highly competitive industrial base and thriving start-up and scale-up scene - cities from Stockholm to Lisbon are now vibrant hubs.

Europe's creative and lifestyle industries, anchored in linguistic and cultural diversity, and our status as the world's top travel destination ensure people around the world associate Europe with superior quality, a sense of style and innovative design. It is this unique combination – one that would be difficult to replicate elsewhere – that will continue to give Europe a competitive edge in the global economy.

Ann Mettler, Head of the European Political Strategy Centre, the European Commission's in-house think tank*

*The views expressed in this article are those of the author alone and not necessarily of the European Commission.

It's about global cities, too

But could it be that the spread of the digital economy is enhancing the capacity of second-tier cities to compete with London, Paris and Berlin? Great coders used to fly to the Silicon Valley honey-pot. Now you can find a start-up ecosystem and talent in almost every big city. When we asked decision makers where the next Google was likely to come from we found a massive shift in the past two years. Silicon Valley, Shanghai, Beijing and New York, previously preeminent, are all on the slide. London holds its own and Berlin's backers back-off.

Current climate does not damage long-term hopes in the European Union

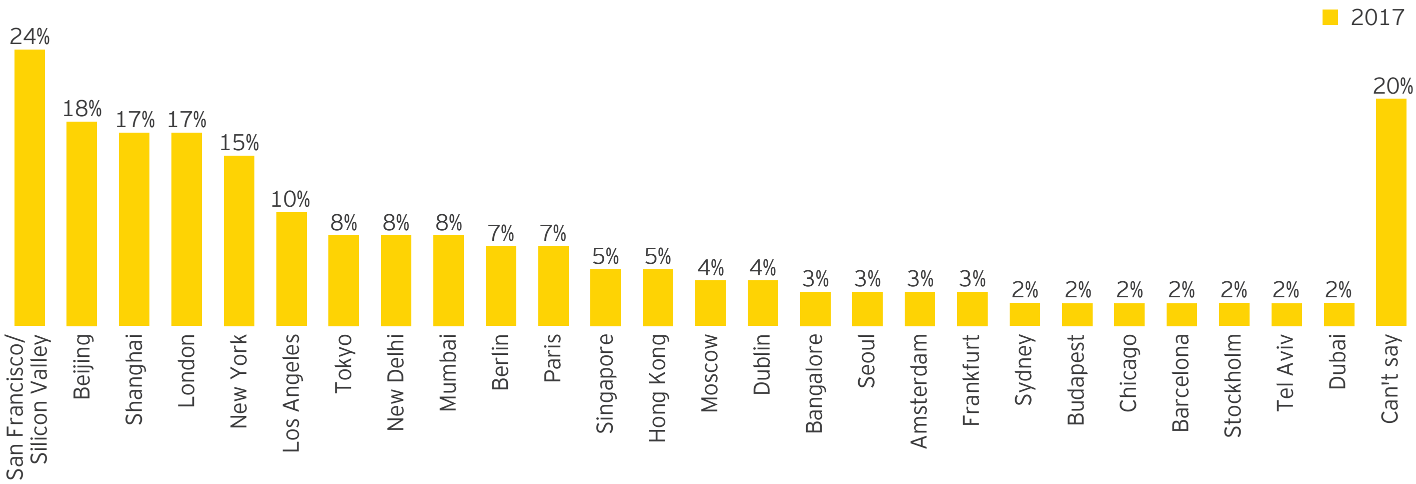
In stark contrast to the ongoing rhetoric of populism and nationalism, our data show that the freedom of movement of goods, services, capital and labor across the EU's 28 states are still providing a fairly attractive environment in which business is thriving, adapting and investing - creating jobs and profits.

Europe's single market of more than 500 million consumers makes investment in new goods and services worthwhile, and enables companies to achieve economies of scale. It also enables them to achieve efficiencies, by locating their activities where they can get the best results at the lowest cost – benefiting their customers and their shareholders.

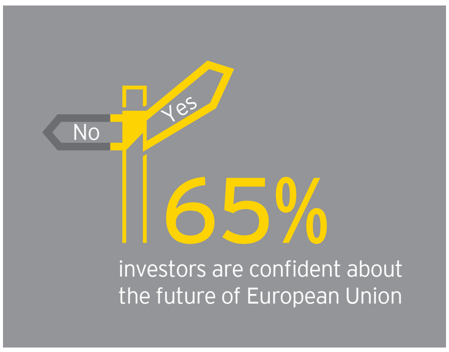
Open borders are facilitating the movement of capital and talent towards modernizing cities and regions in both Western and Central and Eastern Europe. For companies, much of Europe is working reasonably well - at least for the moment.

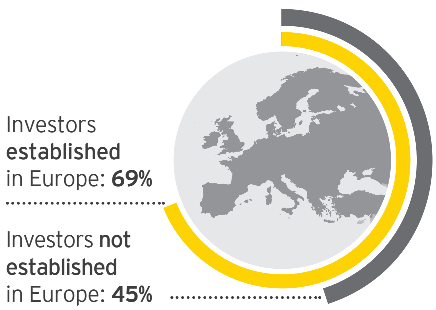
Of course, judgments about investment attractiveness can be shaped by news-flow. Among our panel of investors, those who have already invested in Europe are markedly

Which three cities in the world offer the best chance of producing the next Google?



Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).
Open-ended question, 3 possible answers, results >100% – In first position/in second position/in third position.

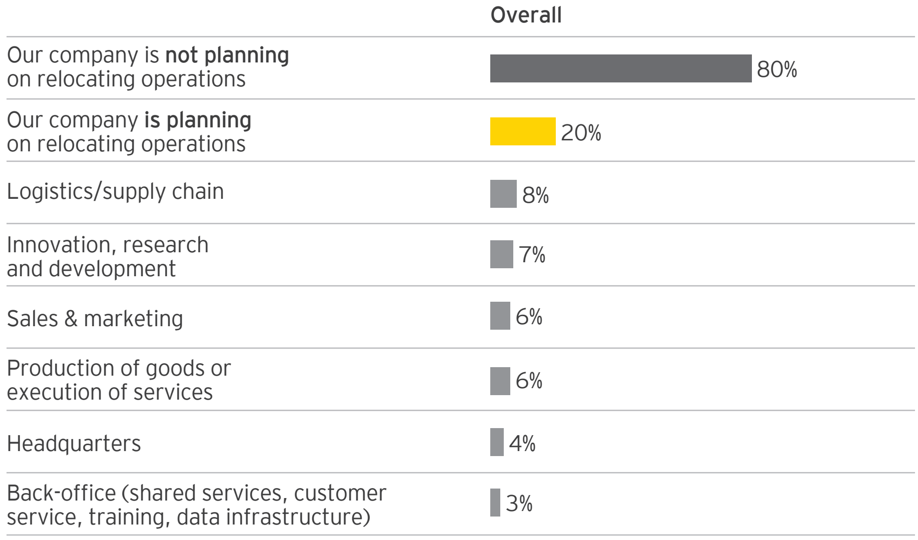




Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).
Investors established in Europe: (total respondents: 407); Investors not established in Europe: (total respondents: 98).

more confident about the future of the European Union (69%) than those who have yet to invest here. North American decision makers – historically Europe's biggest external investors – are notably more skeptical about the outlook for the EU. Only half express confidence in its future, whilst Asian investors are far more positive.

If the UK leaves the European single market, will your company relocate the following operations in the next three years?



Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents established in Europe: 407).

Will Brexit stymie the resilience of Europe?

Brexit and Article 50 will have an impact, but it's just too early to see

We asked investors about the likely impact of a Brexit on their operations. Four out of five say they have no plans to change or relocate operations. But many companies do not yet have a comprehensive view of the tax (VAT pre-financing and exact scope of custom duty), administrative (customs and VAT requirements) and regulatory consequences, and have only just started thinking about the possible consequences. Logistics and supply chain, manufacturing, innovation and R&D activities may well be redrawn as clarity emerges about the detail of the UK's separation from the EU. Some companies will alter their production of goods and services, and even review the location of their headquarters.

The impact of Britain's planned exit from the European Union will probably begin to show in next year's survey. As we write, UK retail spending, which was initially sustained by increased consumer indebtedness, is now slowing, while GDP growth slowed to 0.3% in the first quarter, according to official estimates, down from 0.7% in the final quarter of 2016. The UK has two years, from April 2017, to negotiate its departure terms and ongoing arrangements with the EU's other 27 members. Whilst reviewing their activities, ambitions and opportunities, many investors may hold off taking final decisions about whether to invest in the UK or elsewhere until more information is available. However, in industries such as finance and aviation, where regulatory approvals are critical, companies are likely to soon begin implementing contingency strategies.

With love, from me, to you

For UK-based international companies, adapting to Brexit is likely to prove a two-stage process. In the early days, companies are likely to do whatever is necessary to ensure continued access to markets in the EU27. That could mean setting up a subsidiary, seeking regulatory consents, and moving relatively small numbers of jobs. Later, once the terms of the UK's separation from the EU are clear, they will be able to design optimal ways of servicing their customers, and may relocate activities or recast their future investments.

The EY Brexit Tracker, which monitors public announcements about Brexit intentions from 222 of the largest UK financial services firms, shows that in this sector, at least, companies are already planning ahead. By 8 May, more than 25% of them had announced plans to move some staff or operations out of the UK – up from 18% four months earlier. Moreover, 34% of firms monitored had yet to make any announcement. Many have changed their minds. Among investment banks, 45% now plan some staff or operational moves, along with 27% of insurers and 23% of asset managers.

Yet historically, FDI flows between the UK and continental Europe have been very strong, in both directions. According to EY data, in 2016 the UK remained a leading destination for investors from continental Europe, and UK companies were Europe's third largest group of intra-European investors. The economic development and jobs their investments bring to

Ireland and continental Europe are warmly welcomed. Both the UK and EU27 will surely want that investment relationship to continue.

Is the prospect of Brexit prompting investors to consider alternative locations?

Competition for FDI isn't just between countries. Increasingly it's the attractions of one city or region that investors are weighing against others with some similar features.

In the first half of this decade London became very popular among investors. In just five years, it more than doubled its attractiveness so that by 2015, 52% of investors ranked it Europe's most appealing investment destination. Yet in 2017, though still the leader, its vote slumps to 32%.

Our investors continue to rank Paris second (27%) and Berlin third (25%), yet each has seen a slight decline it its appeal. Meantime Frankfurt, Amsterdam and Munich, long considered also-rans, all gain in attractiveness in the eyes of investors.

Is London's dominance as an investment destination and as Europe's emerging global innovation contender declining? The city and its hinterland, extending as far as the academic and science centers of Oxford and Cambridge, act as a gateway to Europe for investment, technology, science and the development of new ideas. Talent, ideas and innovation are drawn to London from around the world, and radiate from it across Europe. If London's dynamism falters, there may be some benefits to continental Europe, but overall, will Europe gain?

Investors are cautious about immediate uncertainty in Europe

Short-term hesitation

The 2008 financial crisis followed by the Eurozone crisis have cast a long shadow, and have highlighted the vulnerabilities of our financial system. Europe's demographics foretell changing consumer behavior in large parts of Europe, accompanied by strong deflationary forces. Ultra-accommodating central bank policies around the globe have created large pools of excess liquidity and hence inflation in the value of stocks, bonds and real estate, as well as low interest rates - and investments in additional manufacturing capacity. Without a corresponding increase in demand, which is highly unlikely given the demographics of most affluent consumer markets, deflation or low inflation seem likely for years to come, along with slow real GDP growth. Growth rates of the last century were largely driven by demographic trends (baby boomers and women joining the workforce in increasing numbers) and by increasing labor productivity.

Despite impressive technological progress, from digital to biotech, strong labor productivity gains have yet to emerge. Many technologies will need more time to make a real impact. Meantime, many countries face the rising costs of an aging population, declining growth momentum, shifting spending power, and stalled international trade expansion.

In such an environment, it may be tempting for some to blame foreigners and to protect the home market. Ultimately that would lead to lower prosperity, because economic efficiency would be impaired.

Yet, all around us, we see the established order called into question. By 2015, geopolitical factors were beginning to weigh on international investment: in 2017 they still offer a flagrant challenge to investment ambitions, despite Europe's slow recovery. What's especially worrying is that in 2017, the proportion of our decision makers planning to invest in Europe over the next year has eased four points, to 28%.

London maintains its leadership position

What are the three most attractive European cities?

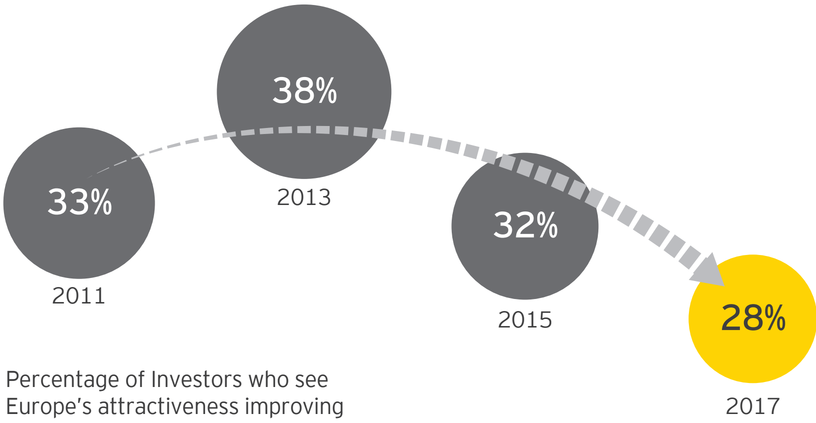
Cities	2017	% points change 2017 vs. 2015
London	32%	-20%
Paris	27%	-2%
Berlin	25%	-3%
Frankfurt	16%	5%
Munich	10%	3%
Amsterdam	9%	2%
Warsaw	8%	5%
Brussels	7%	0%
Madrid	7%	2%

Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).

Uncertainty is the enemy of investors. In this year of elections across the continent, only a handful expect Europe to get back to steady economic growth.

Moreover, the proportion of those planning to invest who see Europe as an attractive location for hard-to-move, long-term manufacturing assets has fallen eight points in two years, to just 23%. Today, investors are more likely to put their money into sales and marketing operations, backed by logistics sites and a modern supply chain, to deliver goods or services produced elsewhere to local customers.

Does your company have plans to establish or expand operations in Europe over the next year?



Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).

EY viewpoint: Mastering Brexit effects

Our research and our conversations with clients have made it abundantly clear that the UK's formal declaration of intent to leave the European Union will have far-reaching effects for foreign direct investors.

Historically, the UK has been Europe's biggest recipient of FDI inflows, with up to 40% of projects flowing to Greater London. So the UK has a huge stock of investments by multinational companies.

In future, investors will have to think about many new considerations in deciding whether to locate in the UK or EU27, but until the UK has negotiated its exit, many of those factors will remain uncertain.

What though, should companies that are already trading between the UK and EU27 do? The 2017 EY *European Attractiveness Survey* found that 20% of them expect to alter their operations in response.

My view is that they need to act now. First, they must deconstruct Brexit into meaningful parts, such as workforce, regulation, supply chains and exports – and avoid looking at them in isolation.

Next, they should map these against possible Brexit outcomes, especially the possible types of future trade agreements. Then, they need to address the possibilities.

What steps must they take now to ensure an adequate future labor supply? How can they ensure continued compliance with appropriate EU regulations? What computer systems should they be installing to handle customs procedures? How must they alter their supply chain? And how can these necessary moves be combined with desirable operational changes, so that where possible they can turn a problem, into an opportunity?

One final thought: companies need to join the conversations, in the UK, in Brussels and in and among its trading partners, to ensure not only that they have up-to-the-minute information about what is being proposed, but can also shape outcomes, where appropriate.

Mats Persson, Head of International Trade EY UK&I

Paradise deferred

Investors seem to see the prospect of strong European economic growth receding further into the future. In 2015, 58% expected Europe's attractiveness to improve within the next three years. In 2017, that proportion is down to 35%. Likewise, in 2015, some 53% predicted an improvement in Europe's growth within five years. By 2017, that proportion had fallen to 42%, whilst the proportion expecting a return to steady economic growth after at least five years has risen to 56%.

In the current social and political climate, the logic of market integration is stronger than ever. But citizens and societies struggle to embrace a European identity, often clinging rather to national and regional icons. They want the benefits of European integration, and the reassurance of local values.

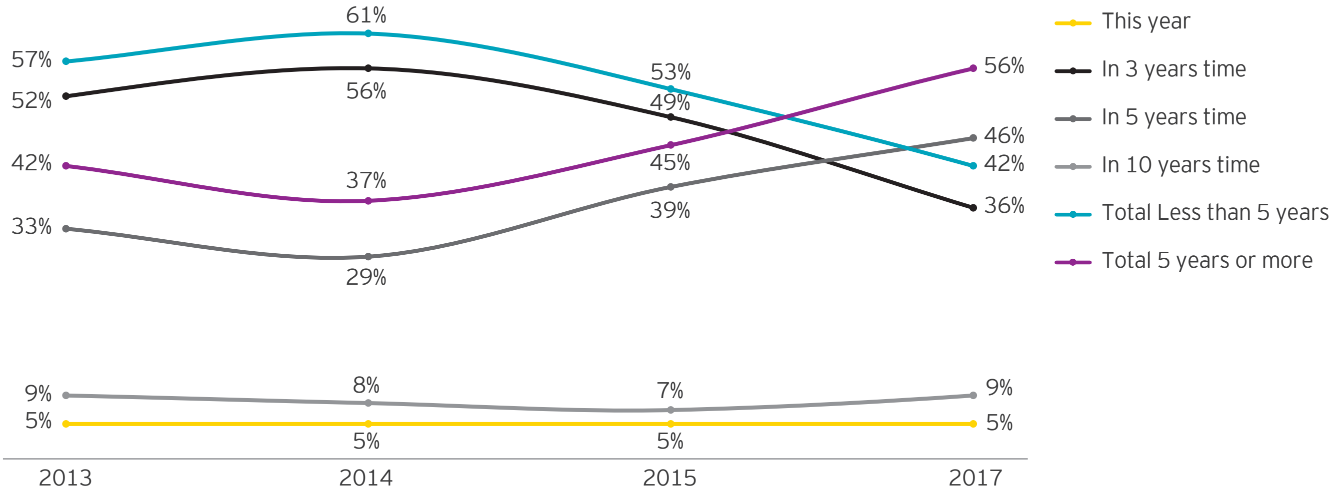
As the world economy gets back on track, growth in some emerging markets has strengthened, and their growing weight is adding to their appeal. International investors now enjoy a wider set of options, in which opportunities in other parts of the world rival those in Europe.

Moreover, many companies are still completing the Europe-wide integration of their operations to serve a single European market that has yet to become a reality in many domains. For example, although many consumer and digital products are essentially identical across Europe, the infrastructure over which they are delivered remains largely in the hands of national players, from railways and trucks to telecom operators.

Though Europe remains one of the world's richest and most sophisticated economies, other economies are playing catch-up. Europe's 500 million citizens, though relatively rich, are today little more than seven per cent of global population, and by 2050 they will be just 4%.

Asian investors continue to flag their confidence in Europe. Chinese companies launched 297 FDI projects in Europe in 2016, up 25%.

In your view, given the current uncertainties in Europe, how long before we see a return to steady economic growth and performance in Europe?



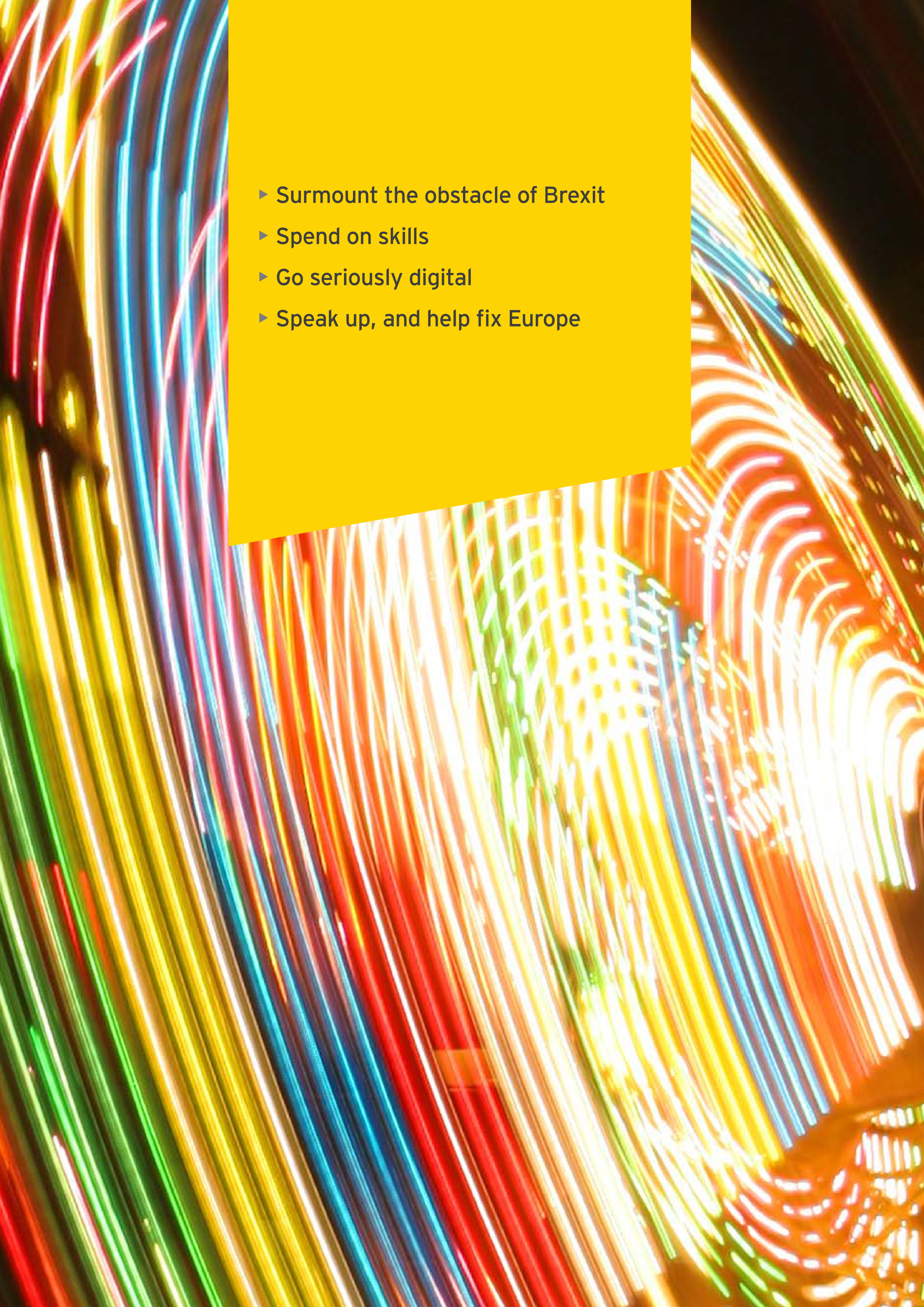
Source: *EY Attractiveness Survey Europe May 2017*, EY, 2017 (total respondents: 505).
Sample: 332 respondents confident in Europe's ability to return to a more dynamic economic growth.

Investors seem to be saying that whatever the near-term bumps, Europe is on its way to more clarity and more sustained economic growth.

Chapter 4

Recommendations for a more attractive Europe

- Surmount the obstacle of Brexit
- Spend on skills
- Go seriously digital
- Speak up, and help fix Europe



4. Recommendations for a more attractive Europe

When they look at the current and future state of Europe, investors ask...

- How can we navigate the longer-term impacts of geopolitical changes and an uncertain economic outlook?
- What are the deep trends that will reshape markets and the economics of servicing them in the future?
- How can we best position our activities to optimize business performance in the long term?
- Are our operations sufficiently insulated against sudden currency and financial market shifts?
- How can I ensure my company has the required skills and capabilities in place to meet the challenges ahead?
- How can I be sure to maintain service delivery through an extended period of uncertainty?
- Is my financing assured, or should I consider new strategies and models for attracting funding and accessing investment?
- Are there any opportunities to take advantage of during this period?

... and policymakers ponder:

- How can Europe be made more attractive to foreign investors?
- What policies will improve Europe's investment environment?
- What can we do to enhance our talent pool?
- How can I woo investors to my country, region, city or town?

We have discussed these issues with many clients and EY teams. Here, for guidance, is a summary of the answers we received.

Some companies have started to re-evaluate supply chains, look at alternative suppliers, and refresh their operating model.

1. Brexit is an obstacle: leap over, leap ahead

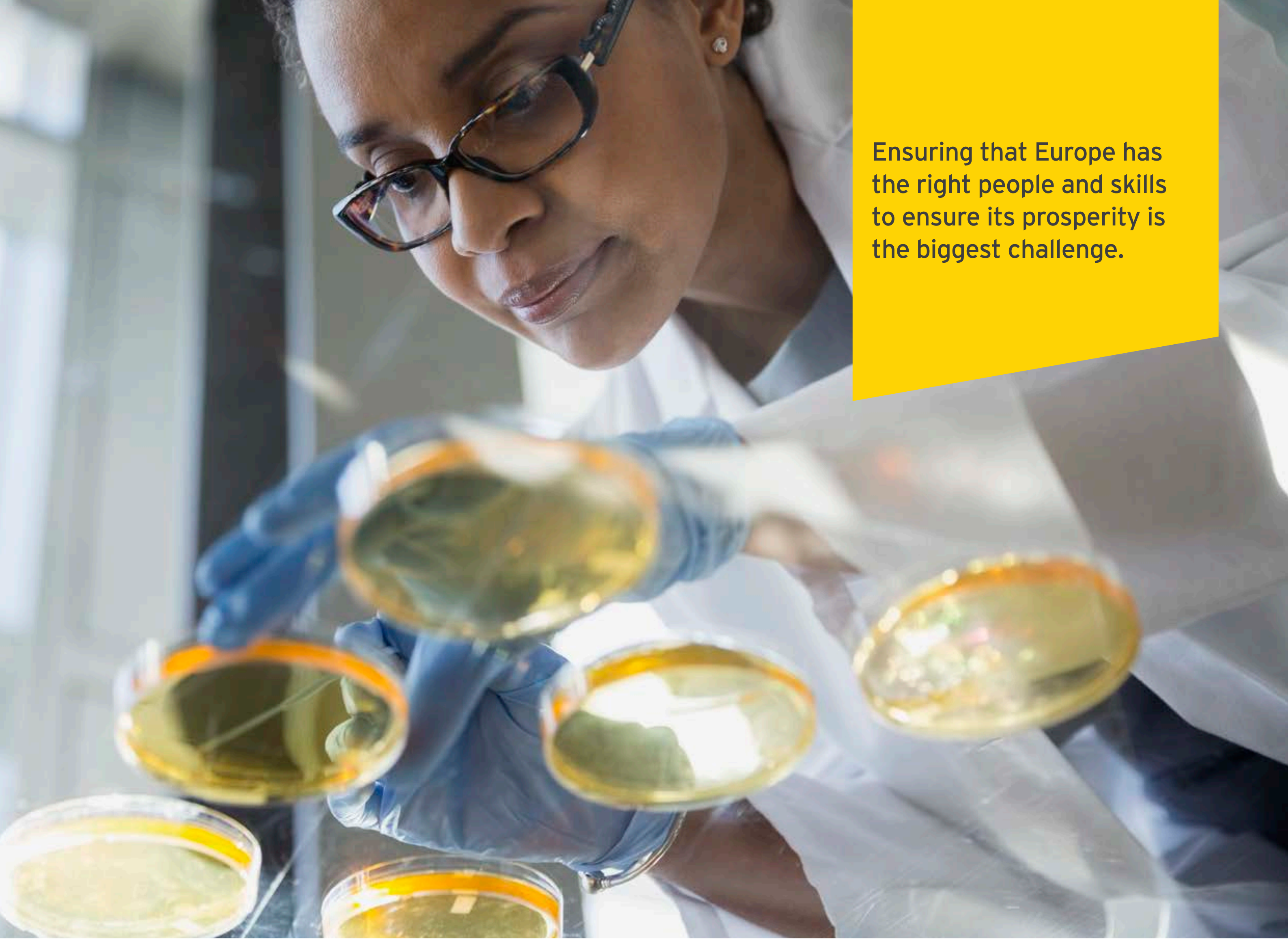
Global trends are disrupting operating models, and will continue to do so because of continuing global economic integration, digitalization and cost pressures. At the same time, the tax and regulatory environment is undergoing unprecedented changes, notably from greater global harmonization and transparency enshrined in the Base Erosion and Profit Shifting initiative (BEPS), and the promised US tax reforms. Any operating model changes must take this wider context into account.

Yes, Europe's political instability and Brexit negotiations are creating volatility and uncertainty in Europe. But paradoxically these factors can have a catalytic effect on companies, prompting thinking and discussion over future business models, market strategies and operational priorities.

Some companies have started to re-evaluate supply chains, look at alternative suppliers, and refresh their operating model. Others are being spurred to accelerate their operational excellence transformation and delve into future international trading opportunities. All in all, companies – whether directly affected or more distantly – must put the UK's planned exit from the EU in context, understand the implications for their business, and get on the front foot for the key battles ahead.

Policymakers need to work on creating clarity. They need to be clear about objectives, realistic about what can be achieved, and pragmatic in finding – and implementing – solutions. The faster uncertainty is removed, the more quickly business can plan and adapt to a changed situation. Policymakers need to devote ample resources to ensure unnecessary business disruption is minimized.

Companies need to think through all the implications of Brexit strategically and avoid falling into the trap of addressing this disruptive shockwave department by department.



Ensuring that Europe has the right people and skills to ensure its prosperity is the biggest challenge.

2. Time to bet on skills

Ensuring that Europe has the right people and skills to ensure its prosperity is the biggest challenge.

The urgency of developing education and skills rings loud and clear from our survey. International investors say this is clearly the most important means (37%, up from 29% in 2015) by which Europe can maintain its position in the global economy.

Moreover, developing education and skills is considered vital by 44% of investors already committed to Europe, against 10% of those not yet present. The clear implication is that Europe's investors find its talent pool wanting, and believe remedial action is pressing.

Policymakers' action needs to begin at the start of the pipeline, where educators must ensure better basic literacy and numeracy for all. They need to invest in turning out more people more able in science, technology, engineering and mathematics (the so-called STEM subjects) at ALL levels, so that there is a place for every disenchanted, unemployed under-25 in the digital economy — and equally — an ample supply of those with doctorates.

Companies that make their home here must assume their share of the responsibility for training and developing talent – and not just focus on scarcities of particular niche skills. To assure their bottom line long-term, their future labor supply – and their license to operate – companies need to hire, educate and train young people, working in close partnership with local bodies and educational organizations. Talent, not geography, will make the difference between success and failure in tomorrow's world.

3. Develop digital Europe

That supporting high-tech industry and innovation (34%) comes in second place in investors' recommendations only confirms their conviction that Europe must do more to underpin its transition to the digital era. Although it lags in consumer IT, Europe is a leader in many emerging digital technologies, including artificial intelligence, robotics and the Internet of Things. Already, the continent has produced thousands of digital start-ups, and even some substantial businesses… developing products and services that companies in Europe need today or will need tomorrow… and that often catch the eye of overseas acquirers.

Policymakers must do much more to enhance the start-up environment. Areas for action include:

- Modernizing laws on copyright
- Overhauling tax regimes: to encourage innovation and not penalize companies that do not turn an early profit, to ensure entrepreneurs are appropriately incentivized, to rationalize VAT rules to avoid unnecessary burdens on small cross-border traders and unequal liabilities between business models offering similar services in different ways
- Overhauling labor codes, to ensure workers have appropriate protections in the gig economy, and bridge the gulf between those with long-term security, and the chronically insecure
- Modernize the regulation of financial institutions to facilitate innovation in funding models, via peer-to-peer lending, venture capital, and traditional grants and lending, so as to ensure appropriate finance is available to develop ideas that can change our society for the better
- Deepen the capital markets union: many start-ups service the needs of big companies, and the funding capacity of big companies is critical to the health of the entire European economy

Companies must learn to constantly scan for opportunities and potential impacts of digital technologies on their activities. They must reorganize their own business models to profit from new ways of working, while adopting intrapreneurship and empowering employees. They must identify and partner with external innovators, and develop an open innovation mindset underpinned by appropriate contractual arrangements that leave scope for the unforeseen.

Europe's complex economy and extensive physical infrastructure offer vast potential for efficiency gains and new services developed on the back of data capture and analysis.

4. Companies should help overhaul Europe and speak up

Economic progress is the most critical issue for Europe's future. Yet people and politicians are focused on yesterday's problems. Progress in the construction of Europe and further expanding the huge range of benefits it delivers has stalled.

For instance, Europe's tax regimes were designed in a bygone age, when companies, assets and people were national and immobile. The attempt to harmonize international corporate taxation through BEPS should stamp out some of the most obvious tax avoidance schemes. But what Europe really needs is a root and branch overhaul of its national tax regimes in favor of jobs, innovation, the environment – and greater equity. Taxation can be used to discourage what is bad, and promote what is good for Europe and its people.

As it hurtles into a period of accelerated change, Europe is abounding with opportunities. Many countries in Central, Eastern and Southern Europe are enjoying rapid economic growth as they progress their transition to open, internationally integrated, market based economies. Educated and connected, their city dwellers are a precious and affordable resource for business.

Meantime in Western Europe, knowledge-based science and industry clusters are developing evermore sophisticated and connected ecosystems. Digital technologies are transforming every sector and business model, from energy and transport to real estate, consumer goods and health care. The diversity of Europe's people, languages, and social and economic models has become an opportunity to experiment alternative solutions in different markets, and quickly transpose those which work best.

Corporate Europe needs to come in and help. Companies and citizens alike benefit enormously from the EU, albeit unequally, and companies have powerful insights into the strengths and shortcomings of the EU. They need to share them, loud and clear, with employees, citizens and policymakers. They need to fight inequality and campaign vigorously for the greater good, including for more support, such as education and training, for those adversely affected by change.

Companies must do more to highlight the success of Europe's single market and open-border policies in improving lives. And they must do more to convince, hire, train and retain the citizens, especially the young, upon whom the future of Europe and its investors depend.

Methodology: **how EY designed the report**

The "real" attractiveness of Europe for foreign investors

Our evaluation of the reality of FDI in Europe is based on the EY European Investment Monitor (EIM), EY's proprietary database, produced in collaboration with Oxford Intelligence. This database tracks those FDI projects that have resulted in the creation of new facilities and new jobs. By excluding portfolio investments and M&A, it shows the reality of investment in manufacturing and services by foreign companies across the continent.

Data is widely available on FDI. An investment in a company is normally included in FDI data if the foreign investor acquires more than 10% of the company's equity and takes a role in its management. FDI includes equity capital, reinvested earnings and intra-company loans.

But our figures also include investments in physical assets, such as plant and equipment. And this data provides valuable insights into:

- How FDI projects are undertaken
- What activities are invested in
- Where projects are located
- Who is carrying out these projects

The EIM is a leading online information provider, tracking inward investment across Europe. This flagship business information tool from EY is the most detailed source of data on cross-border investment projects and trends throughout Europe. The EIM is frequently used by government bodies, private sector organizations and corporations looking to identify significant trends in employment, industry, business and investment.

The EIM database focuses on investment announcements, the number of new jobs created and, where identifiable, the associated capital investment. Projects are identified through the daily monitoring of more than 10,000 news sources. To confirm the accuracy of the data collected, the research team aims to directly contact more than 70% of the companies undertaking these investments.

The following categories of investment projects are excluded from the EIM:

- M&A and joint ventures (unless these result in new facilities or new jobs being created)
- License agreements
- Retail and leisure facilities, hotels and real estate*
- Utilities (including telecommunications networks, airports, ports and other fixed infrastructure)*
- Extraction activities (ores, minerals and fuels)*
- Portfolio investments (pensions, insurance and financial funds)
- Factory and other production replacement investments (e.g., replacing old machinery without creating new employment)
- Not-for-profit organizations (charitable foundations, trade associations and government bodies)

The "perceived" attractiveness of Europe and its competitors for foreign investors

We define the attractiveness of a country or area as the combination of its image, investors' level of confidence in it as an investment destination and the perception of its ability to provide the most competitive benefits for FDI.

The research was conducted by the CSA Institute in March 2017, via telephone interviews with a representative group of 505 international decision makers.

Our sample groups of businesses included representatives from:

- Europe: 53%
- North America: 29%
- Asia: 12%
- Latin America: 3%
- Middle East: 2%
- Other regions: 1%

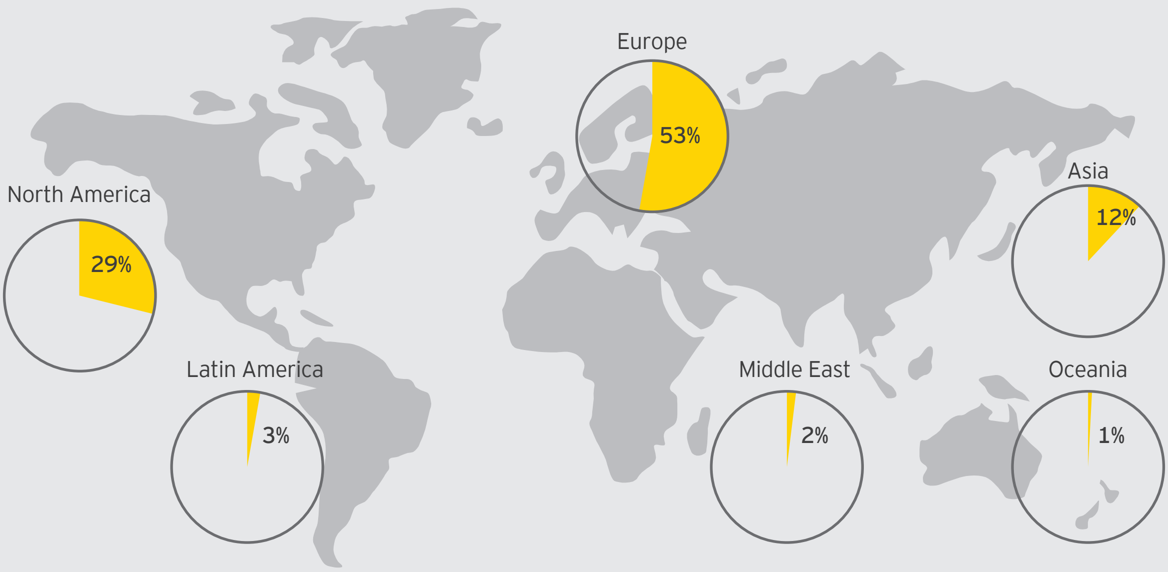
Overall, 81% of the 505 companies surveyed have a presence in Europe. And of the non-European companies, 34% have established operations in Europe.

Finally, the EY Brexit Tracker, referred to on in our commentary on Brexit's impact, tracks the public statements made by 222 of the largest financial services companies with significant operations in the UK across wealth and asset management firms, investment and retail banks, private equity, insurance and FinTech. The tracker captures statements made on key issues across sub-sectors relating to staffing, domicile, financial impact, policy asks, product changes, remuneration and opportunities.

*Investment projects by companies in these categories are included in certain instances e.g., details of a specific new hotel investment or retail outlet would not be recorded, but if the hotel or retail company were to establish a headquarters facility or a distribution center, this project would qualify for inclusion in the database.

Disclaimer: FDI jobs data is available for 3,596 projects out of 5,845 projects (or 61%) in 2016.

Geography



Job title

Financial Director	47%
Marketing and Commercial Director	15%
Managing Director/ Senior Vice President/COO	11%
Director of Investments	5%
Director of Development	5%
Executive Manager	5%
Chairman/President/CEO	4%
Director of Strategy	4%
Human Resources Director	2%
International Business Manager/ Export Manager	1%
Real Estate Director	1%

Size

- 24% More than **€1.5** billion (more than US$2.04 billion)
- 39% From **€150** million to **€1.5** billion (from US$204 million to US$2.04 billion)
- 37% Less than **€150** million (less than US$204 million)

Sector of activity

- 39% Industry, automotive and energy
- 25% Consumer
- 20% Private and business services
- 9% High-tech and telecommunication infrastructures and equipment
- 7% Chemical and pharmaceutical industries

About EY's Attractiveness Program

EY's Attractiveness Surveys and Program around the world

EY's Attractiveness Surveys are widely recognized by our clients, media, governments and major public stakeholders as a key source of insight into FDI.

Examining the attractiveness of a particular region or country as an investment destination, the surveys are designed to help businesses make investment decisions and governments remove barriers to growth. A two-step methodology analyzes both the reality and perception of FDI in the country or region. Findings are based on the views of representative panels of international and local opinion leaders and decision-makers.

The program has a 16-year legacy and has produced in-depth studies for Europe, a large number of European countries, Africa, the Mediterranean region, India, Japan, South America, Turkey and Kazakhstan.

For more information, please visit:
ey.com/attractiveness
Twitter: @EY_FDI and @EYnews
#EYAttract

EY's Attractiveness country reports in Europe 2017

Europe

Austria

Belgium

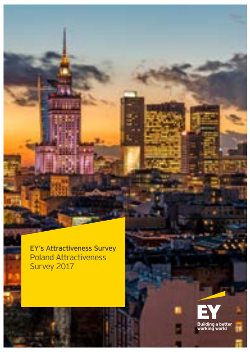
France

Germany

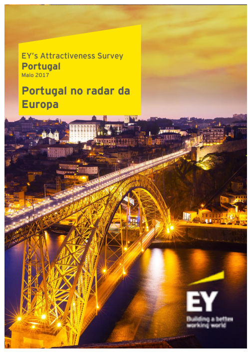
Italy

The Netherlands

Nordics



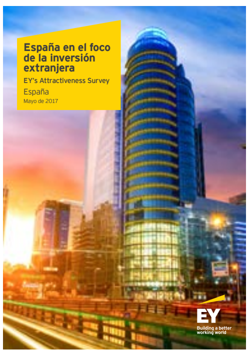
Poland



Portugal

Russia

Scotland



Spain

Switzerland

United Kingdom

Further reports to be launched in EMEIA later this year include Africa, Baltics, Financial Services, India and Malta.

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About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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This survey was carried out by EY, under the direction and leadership of Marc Lhermitte with the participation of Vincent Raufast, Marie-Armelle Benito, Sandra Sasson, Constantina Tseva, Bina Bahia-Basra, Sandeep K Gupta, Gurbaksh Gandhi, Sampada Mittal, Yogender Chibber from EY, and the support of Ilse Blank and Stamatia Zabotto of Melagrana, Ross Tieman of Cayssials Business Communication and Christelle Fumey and Stéphanie Laffargue and the teams of the CSA Institute.