

Game changers

EY's Attractiveness Survey
Europe
June 2018



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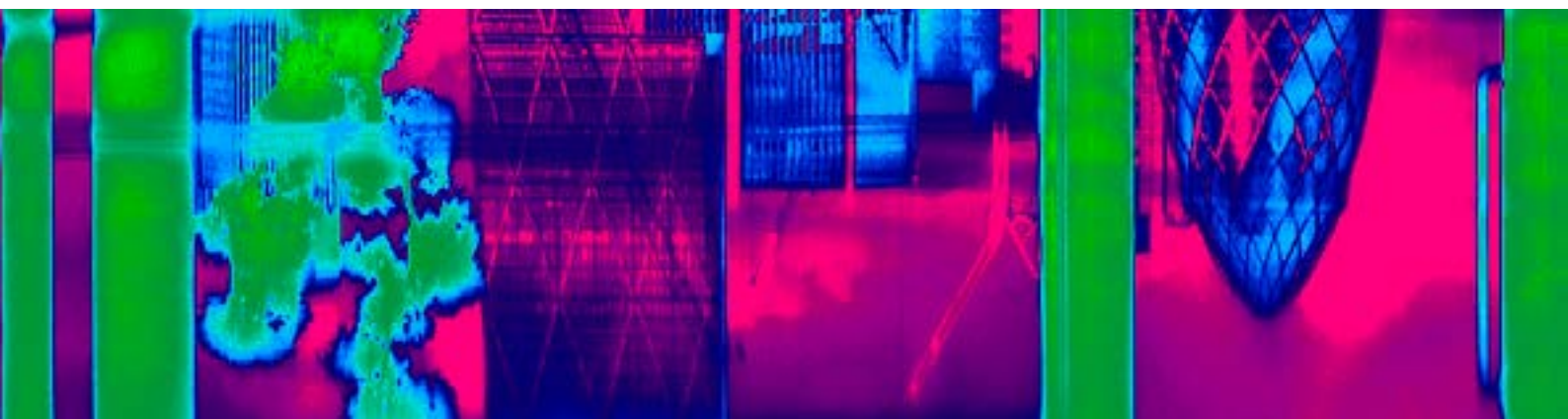
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Game changers

Andy Baldwin
EY EMEIA Area Managing Partner



Foreign direct investment (FDI) is part of Europe's economic lifeblood. In 2017, foreign investors made more than 6,500 decisions to invest in the 50 countries of greater Europe. They made plain their assessment of the region's attractiveness by investing in plants, back-offices, headquarters, R&D centers and other assets across the continent.

Their decisions, become a cartography of confidence. They provide a demonstration of the forces deciding which cities, regions and countries will prosper – and which will stagnate.

EY's *Europe attractiveness survey* has been tracking these investment decisions since 2000. This year it reveals an inflexion in the pace of FDI inflows, influenced by four powerful under-currents of change. We think these are true game changers because sweeping in from different directions, they are remaking the European rulebook on cross-border investment.

First, geopolitical factors are gradually choking investment flows to some countries, redirecting them elsewhere. Nationalism, nativism and isolationism impact investment confidence and affect the way decisions are made.

Second, in Europe, the historic growth of inward investment to the long-standing league champion, the UK, has slowed because of Brexit; and, simultaneously, project outflows by British companies into other European countries have increased.

Third, talent shortages and technological changes are influencing investment decisions. For the past three decades, foreign investors have turned Central and Eastern Europe (CEE) into the continent's workshop and back office. Now, tightening labor markets and surging wages are

making it a suburb of Western Europe, and frontier investment is rolling east and south into the wider region.

Fourth, companies are coping with two competing international responses to the fallout from three decades of rapid globalization and the financial crisis. A coordinated international effort to end tax base erosion and profit-shifting profit shifting (BEPS) by multinational companies is altering incentives, making financial decisions even more complex and uncertain. Overlaid are national and regional tensions over trade, US tax reform and Europe's drive to tax digital multinationals. Result: rethink.

And then there are the challenges of digitalization. Digital activities filter across frontiers as smoothly as digital content. Building Europe into a global tech giant needs a huge step change in education, skills, talent, entrepreneurship, capital markets and infrastructure.

In these days of transformative change, mindsets of corporate executives, advisors and public policymakers – the players, coaches and referees of this deadly serious economic league – are evolving fast.

Our 2018 study, is published at a critical time for the future of Europe. It shows that there is everything to play for. But the winners – corporate and geographical – will be those who learn and understand the new rules, and apply them to best effect.

We would like to thank all of the investors, policymakers, advisors who shared their assessments and insights in this survey. FDI in Europe has very serious long-term consequences for countries and communities. The rules have changed. We hope our study helps to show how and why.

Hanne Jesca Bax
EY EMEIA Managing Partner
Markets & Accounts



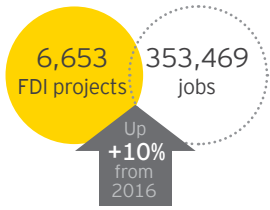
Marc Lhermitte
EY EMEIA Lead, Geostrategic
Business Group



Executive summary

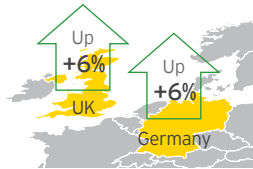
The reality of foreign investment in Europe in 2017

Europe's inward foreign investment changes shape



In 2017, **Europe** secured **6,653** FDI projects up 10% over 2016, creating **353,469** jobs.

Slower FDI inflow growth in 2017 stems from a limited **6% growth** in FDI projects in the **UK** and **Germany**.



CEE countries secured more than **50% of jobs created**.



Increasing inward investment in **Russia**, **Turkey** and **Serbia**.

500+ projects in 2017.

Brexit impacts Europe's FDI dynamics

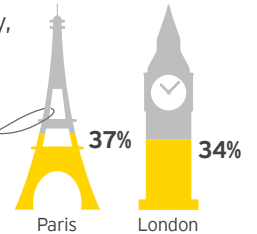
The UK fights to keep its long-standing pole position while a surging France (+31%) is now a fiercer competitor.



Financial services and the **digital industry** saw FDI flow out of the UK (toward the continent, up more than twice on 2016).

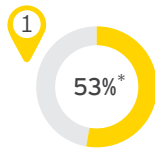
In our perception survey, **Paris** leapfrogs **London** to be seen as

Europe's **most attractive city** for FDI.

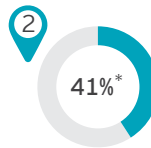


Europe remains an attractive destination for foreign investors

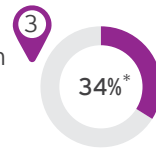
Globally, **Western Europe** is still ranked the **most attractive region**.



CEE comes third, just a whisker behind **China** in investors' affections.



North America's score is **34%**, down from **39%** in our 2017 survey.



*Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

The new shape of FDI in Europe

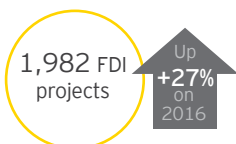
Digitalization and business services are Europe's FDI drivers

Digital and business services accounted for **31%** of all FDI projects and helped create **63,372 jobs**.

The top three countries (**the UK**, **Germany** and **France**) capture more than **60%** of projects.



Manufacturers review their footprint to better address customer demand

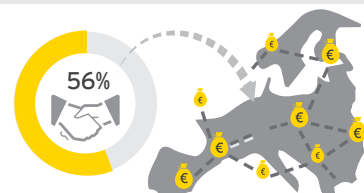


In 2017, European manufacturing attracted **1,982 FDI projects, up 27%** on 2016, fueled by growing European consumer and client demand.¹

FDI source countries: logical moves by US and European companies

Intra-European investment continues to dominate FDI activity, generating **56%** of projects in 2017.

The US remains Europe's leading source of external investment while **Chinese inflows stagnate**.



¹ "Euro zone factories ended 2017 with record high growth: PMI," *Reuters website*, accessed 12 May 2018.

Game changers of 2018

Geopolitical risk is the No. 1 concern

Geopolitical factors were the top concern of **42%** of investors already established in **Europe**, and

26% who have yet to invest there.



For larger companies (€1.5b+ revenues) the score was nearly **50%**.

Brexit: a phased downgrade of the UK is firmly under way

The UK's departure from the EU is only the **fourth-biggest worry**.



Yet **30%** of international investors present in greater Europe said Brexit would have an impact on their business.

Only **8%** of those impacted foresee the relocation of activities to another country.

New location factors change the centers of gravity in Europe

Tight labor markets and fast-rising wages are making **Central Europe** a suburb of Western Europe. Project inflows to Central Europe stall as companies there move up the value chain.



Investment in **labor-intensive projects** shifts east and south to **Serbia, Russia** and **Turkey**.

Superpower rivalry, trade tensions and BEPS tax reform upend investment planning

The **policy fallout** from globalization, the financial crisis and technology disruption creates choppy waters for investors.

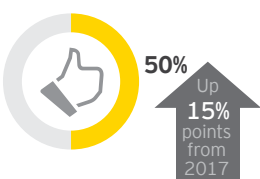


Trade tensions threaten international supply chains and location decisions.

International collaboration to stem tax avoidance coincides with the emergence of new taxes.

Europe's future attractiveness

Investors have plans for future expansion



Although investors are concerned about economic and political instability, **investors' confidence in Europe recovered to 50%** (up from **35%** in 2017).

41% of companies present in Europe, **plan to expand**.

Among international investors not yet present, **12%** are looking to **establish European operations**.

Investors need more ... digitalization, skills and entrepreneurship

34% of investors believe that Europe's economic future will be shaped by the **tidal wave of digitalization**.

26% of international investors highlight the need for Europe to cultivate its **digital economy**. They counsel developing education and skills, and supporting SMEs.

Seven recommendations to make Europe a digital leader

Investors see seven areas of action to improve Europe's competitiveness in the digital age:

- 1 Improve digital infrastructure
- 2 Invest in skills and welcome talent
- 3 Leverage public digitalization
- 4 Encourage investment and investors
- 5 Create a sound business environment
- 6 Support Europe's digital agenda
- 7 Believe in Europe's digital hotspots

The reality of foreign investment in Europe in 2017

- ▶ Europe secured 6,653 FDI projects, up 10%, creating 353,469 jobs.
- ▶ The UK leads though Brexit fears bite, Germany is a close second, and FDI into France surges.
- ▶ FDI into CEE slows, as investors look further south and east.
- ▶ Investors' confidence in Europe remains high.

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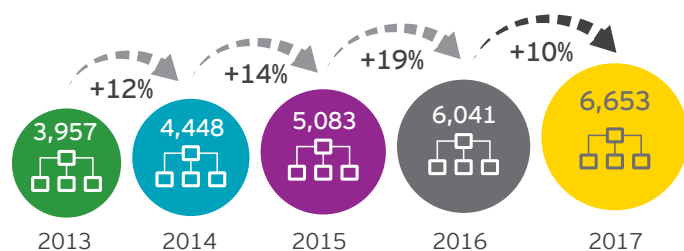
The number of foreign investment projects in Europe increased by 10% in 2017

Foreign investors unveiled 6,653 direct investment projects in Europe during 2017, up 10%. These will create 353,469 jobs.

Economic recovery has lifted demand within Europe, while growth elsewhere has bolstered demand for Europe's exports. FDI has been spurred by tightening capacity and product renewal, and facilitated by low interest rates.

Record year for FDI projects in Europe

FDI projects and jobs created in Europe



Source: analysis based on IBM database, 2017; EY *European Investment Monitor*, 2016.

Europe is resilient against global and regional tensions

The business leaders we surveyed in February 2018 continue to highlight Europe as the world's most attractive region for foreign investment. The European economy has been growing at its fastest rate for a decade, becoming an ever more massive market of consumers and companies. Corporate profits have been beating estimates, and investors already established on the continent, who know it well at first hand, are encouraged.

Spending by European consumers has been resilient despite higher inflation in 2017, underpinned by strong employment growth. Europe's Economic Sentiment Indicator remains above its long-term average, and lending has been growing.

According to the April 2018 edition of EY's *Global Capital Confidence Barometer*, Western Europe – along with the US – has become a destination choice for companies looking to acquire innovative assets and more customers, even as they shrug off worries over protectionism and new rules governing cross-border dealmaking.²

Investors' strong enthusiasm for Europe comes against a backdrop of accelerating growth in both developed and emerging markets, and recovering global trade flows. The International Monetary Fund (IMF) says global economic activity firmed in 2017 and will grow 3.9% in 2018 and 2019.³ The World Trade Organization (WTO) expects global merchandise trade to grow at 4.4% in 2018.⁴ The EU's statistics office, Eurostat, says that the EU economy grew by 2.4% in 2017, its highest annual rate since 2007, outpacing the 2.3% expansion of the US.⁵

² *Global Capital Confidence Barometer*, EY, April 2018.

³ *World Economic Outlook, April 2018: Cyclical Upswing, Structural Change*, IMF, April 2018.

⁴ "Strong trade growth in 2018 rests on policy choices," *WTO press release*, 12 April 2018.

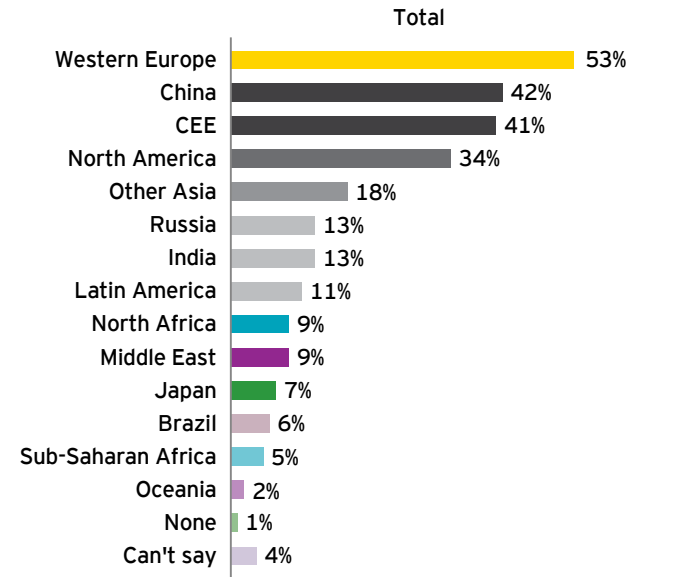
⁵ "GDP up by 0.6% in both euro area and EU28," *Eurostat press release*, 7 March 2018.



China rises, America falters

China edged up four points to take second place overall in our perceptions survey. But North America slipped to fourth position with a 34% score, down from 39% in 2017. Foreign investors there are struggling to distinguish between deeds and rhetoric, and long-term and short-term counter-influences in policies that profoundly affect the US investment attractiveness. They worry about moves toward trade protectionism and limiting access to talent. Yet growth has been strong, and Congress approved far-reaching changes to US corporate taxation at the end of 2017 – paving the way for massive repatriation of US corporate profits held overseas. Some elements of the package appeal; some align the US more closely with emerging global trends that are also reshaping the European corporate tax landscape. In 2018, assessing the attractions of “Destination USA” is unusually difficult.

In general, which of the following regions do you think are currently the top three most attractive regions in which to establish operations?



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

The new pace and regional dynamics of foreign investment within Europe

The accelerating pace of growth in projects recorded over the past three years (averaging annual growth of +15%) has markedly slowed (+10% between 2016 and 2017).

There are reasons to be found for this in the changing dynamics of leading Western European countries – and there are explanations in the experience of foreign investors in some CEE countries.

Brexit and the maturity of Western economies

Western Europe was chosen by foreign companies for the location of 5,032 projects in 2017, more than three-quarters of the total FDI projects into Europe. The increase, 7%, was far below the scorching 20% growth in projects announced during 2016. The recovery of Western economies is now maturing, and growth in sales of durable goods may be slowing to sustainable rates after a catch-up following a cyclical slowdown.

In addition, Europe's top two destinations for foreign investment, the UK and Germany, underperformed in 2017. Together, these two countries attracted 37% of European FDI projects over the past three years.

In the UK, the leading European FDI destination, growth in projects inflows slowed to 6%. The UK's decision to leave the EU has influenced decisions, spurred project outflows and eroded Europe's total.

In Germany, surging growth in project numbers has eased. On average, foreign investment into Germany grew by 14% a year between 2012 and 2016. Last year, it rose just 6%. A long period of political uncertainty in 2017, rising wages and skill shortages may have provided a sense that Germany is entering a period of change.

However, for business leaders interviewed by EY, Western Europe was not only the first choice but was ranked among the top three destinations for investment worldwide by 53%, unchanged from 2017. Back in 2008, on the eve of the financial crisis, Western Europe had fallen to third place in our perceptions survey. It has progressively regained the confidence of investors since 2012 as economic recovery has spread across the continent.

Talent shortage and rising costs in Central Europe

CEE countries still offer the benefit of faster economic growth than Western Europe, under the umbrella of EU membership. Hourly labor costs, at around €10.00, remain less than half the EU 2017 average of €26.80. However, last year, hourly wage costs in Poland surged 8.7%, and in the Czech Republic (where March's unemployment rate had fallen to 2.2%) by 11.3%.⁶

Central European economies are closing the gap with their Western counterparts. They benefit from rising wages, growing consumer markets and more value-added projects, but face increasing shortages of qualified workers. For labor-intensive projects, investors increasingly explore further south and east. This trend is aided by the pull of growing consumer markets in emerging economies on the fringe of Europe. In Russia, Serbia and Turkey investment projects grew by 50% in 2017.

Still, there are no warning signs. The region is in a period of transition to even better growth and development in the years ahead. For executives interviewed in our perception survey, CEE was the second most popular *first-choice* destination for future investments, and was placed *third overall*, its best score for a decade. Their assessment of CEE's future prospects was reflected in their 2017 project decisions. Last year, FDI in Poland created 24,000 jobs, an uptick of 2,000 over 2016.

⁶ "Hourly labour costs," [Eurostat website](#), accessed 18 April 2018.

The European foreign investment map is changing

Germany, France and the UK still grab half of FDI projects in Europe.

Europe's three largest economies, Germany, France and the UK, each secured more than 1,000 projects and, together, 50% of all FDI projects.

The UK is feeling the effect of Brexit. It remains the top destination for FDI in 2017, attracting 1,205 projects. This is only 6% more than it attracted in 2016, a slowdown after very strong growth in earlier years. Many companies may be deferring decisions over future investment choices between the UK and other European locations, pending greater clarity about the nature of future trade relations between the UK and the EU. For now, the UK's appeal for strategic investments in the digital sector, and for investors

from China and India, remains. But there are emerging signs of weakness: it secured 26% fewer FDI projects in the financial sector and 31% fewer projects in headquarters in 2017, for instance.

Germany continues to challenge the UK, but strong growth in project numbers recorded in recent years has slowed. By March 2018, Germany's jobless rate had fallen to just 3.4%, the third-lowest in the EU after the Czech Republic and Malta. Hourly labor costs rose 2.6% in 2017, to €34.10.⁷ Germany continues to attract a diverse range of projects, but a tightening labor market and rising costs drive investors to focus on high productivity and high added value. As with many German companies, international investors tend to locate new labor-intensive projects elsewhere.

France enjoyed surging project numbers (+31%) and has now become a direct competitor to Germany and the UK across the project spectrum, even for the most strategic functions, such as research centers and headquarters (16 headquarters in 2016; 59 in 2017). Investment slowed after the 2008 financial crisis, but France is now in catch-up mode, and a beneficiary of Brexit. The jobless rate remains high at 8.8% for March 2018, and hiring is hampered by hourly labor costs of €36.00 in 2017.⁸ Yet investors are beginning to conclude that France's drive to regain competitiveness, deliver structural reforms and reduce public spending has enhanced its appeal. A more flexible labor market, combined with the growing ability of digital technology to substitute employees, compounds the strong resurgence of investor interest in France.


















7 "Unemployment statistics," [Eurostat website](#), accessed 18 April 2018.

8 "Unemployment statistics," [Eurostat website](#), accessed 18 April 2018; "Hourly labour costs," [Eurostat website](#), accessed 18 April 2018.

A re-shuffle in country rankings show investment shifting further east

Top 15 destination countries by FDI projects

	2016	2017	Change in rank vs. 2016	Share (2017)	% change	Jobs created	Jobs share
 UK	1,138	1,205	-	18%	6%	50,196	14%
 Germany	1,063	1,124	-	17%	6%	31,037	9%
 France	779	1,019	-	15%	31%	25,126	7%
 Netherlands	409	339	-	5%	-17%	8,541	2%
 Russia	205	238	+2	4%	16%	25,788	7%
 Spain	308	237	-1	4%	-23%	13,685	4%
 Turkey	138	229	+3	3%	66%	13,078	4%
 Belgium	200	215	-	3%	8%	5,838	2%
 Poland	256	197*	*	3%	*	24,000	7%
 Finland	133	191	+1	3%	44%	4,300	1%
 Ireland	141	135	-2	2%	-4%	8,961	3%
 Czech Republic	110	134	+1	2%	22%	14,490	4%
 Romania	132	126	-1	2%	-5%	16,490	5%
 Serbia	46	118	+8	2%	157%	20,103	6%
 Hungary	107	116	-1	2%	8%	17,017	5%
Others	876	1,030	-	15%	18%	74,819	21%
Total	6,041	6,653		100%	10%	353,469	100%

*A change in the methodology in the current EAS edition makes it difficult to compare YoY trends for Poland. Assessment of investment activities should also account for other dimensions of this process. In particular, the value of the Polish Investment and Trade Agency (PAIH) projects included in the EAS results for Poland increased in 2017 compared with 2016.

Source: analysis based on IBM database, 2017; EY European Investment Monitor, 2016.

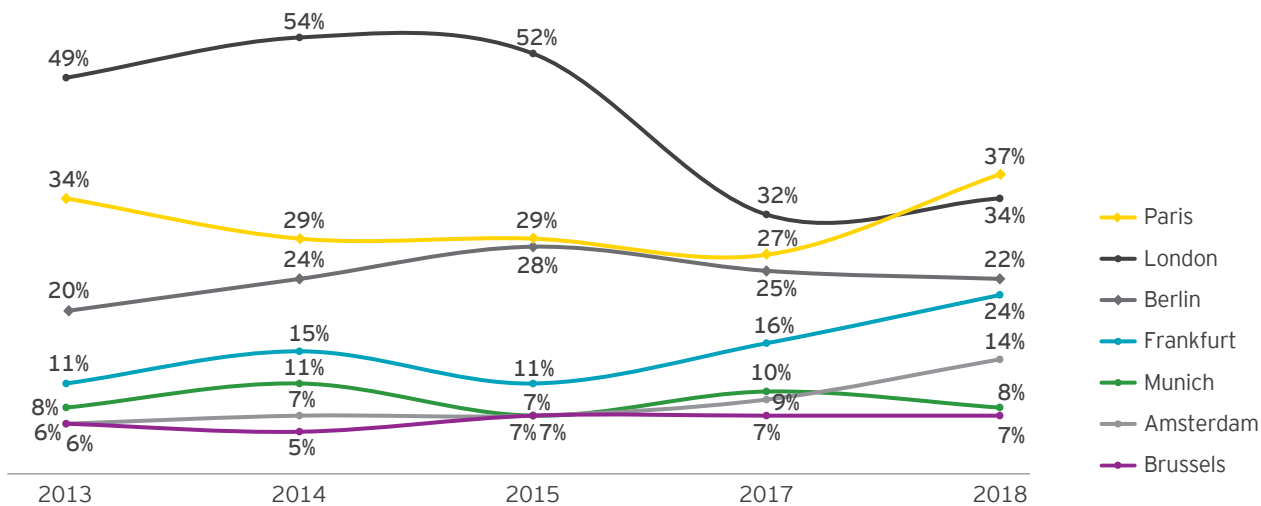
In our perception survey, Paris is ahead of London for the first time

Within Europe, wealth creation is becoming ever more concentrated in leading cities and regions. Yet for the first time since our investor survey began in 2003, **Paris overtakes London to become Europe's most attractive destination for foreign investors** (502 interviewed in February 2018). From its 54% peak in 2014, London's attractiveness has declined to 34% in 2018. Housing shortages and worries about access to talent may be weighing upon London's score. In addition, the effects of Brexit

on Europe's global city extend far beyond the looming departure of institutions such as the European Medicines Agency and the European Banking Authority.

Paris, Frankfurt, Amsterdam and Dublin clearly benefit from rising investor interest as alternative locations to London – particularly for financial services. As other European cities develop, they compete more effectively for projects once drawn to London by the lack of ready alternatives. Germany's federal structure and strong FDI appeal gives it four cities among the 15 most favored by international investors: Berlin, Frankfurt, Munich and Hamburg.

Which are the three most attractive European cities for foreign investors?



Source: EY Europe Attractiveness Survey June 2018 (total respondents: 502).

Investors cool on some countries, without alarm

The Netherlands remains a favorite with investors, yet we measured a 17% fall in investment inflows. Strong economic growth there has pared the jobless rate to just 3.9% for April 2018⁹ and driven hourly wage costs up to €34.80 in 2017.¹⁰ Shortages of some skills may be influencing investor decisions. Despite a business-friendly, international outlook and firm attractions, the Netherlands is less successful than some rivals in capturing projects displaced by Brexit.

Spain, despite strong growth, high unemployment and affordable labor, has been politically overshadowed by the attempted breakaway of Catalonia, its leading industrial region. After a rapid recovery of FDI inflows in recent years, shortages of specific skills may also be making investors cautious.

After years of intense activity, FDI in some central European countries appears to have reached a tipping point. The region's twin engines of growth – manufacturing and shared service centers – are now slowing in terms of project numbers (down 40% and 26% respectively) – though still creating more than 18,000 jobs.



⁹ "Unemployment statistics," [Eurostat website](#), accessed 18 April 2018.

¹⁰ "Hourly labour costs," [Eurostat website](#), accessed 18 April 2018.

Which investors are doing what and where?

Incremental changes are reshaping what companies do.

Europe's demand-led recovery is reflected in the strong growth of projects serving consumers and industrial customers.

By activity, we see many more sales and marketing operations, manufacturing, and R&D centers. Strengthening growth in the world economy has also reinforced demand for European manufactured products in overseas markets.

Transportation manufacturers and suppliers were the biggest job creators; but digital remains the biggest business sector by

number of projects, as well as a leading job creator. Business services ranks second. Our data suggests that rising demand is accompanied by a wide-ranging reorganization of the way companies do business. Digitalization is revolutionizing almost every industry, and foreign investors are launching numerous projects to provide digital services to their clients or streamline their own operations.

This operational overhaul is being combined with adaptation to dramatic changes in economic geography arising from Brexit, the convergence of Central European economies and markets with those of Western Europe and an increased ability to tap low-cost labor pools on Europe's fringes.

Some companies appear to be re-engineering their European footprint in response to changes in almost every facet of the European investment landscape. Individually, the changes appear incremental in demand; in hourly wage costs, talent supply and tax regimes; and in technological progress. When combined, they are transforming the logic of what companies choose to do, and where.

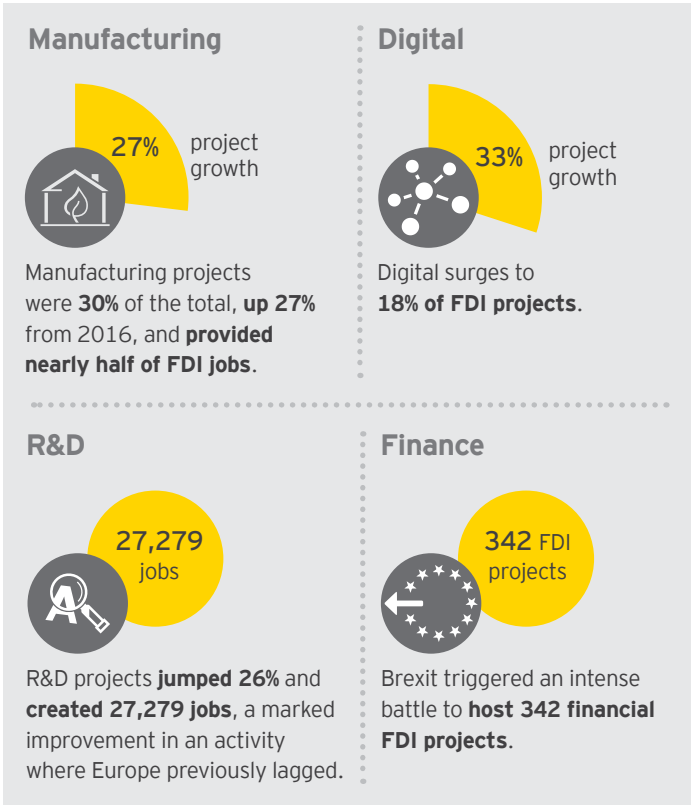
Sales and marketing and manufacturing remained the most prominent activities

FDI projects by activity in Europe

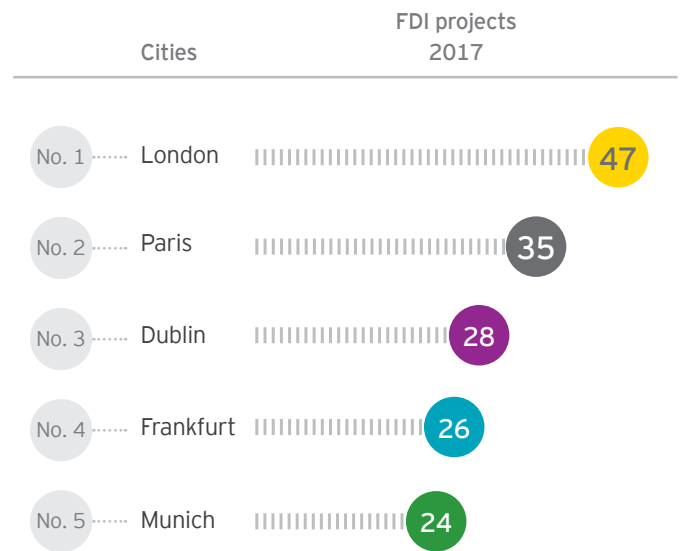
Activity	2017				FDI projects (2016)
	FDI projects	Change (%)	Project share (%)	Job share (%)	
Sales and marketing	2,820	1%	42%	15%	2,787
Manufacturing	1,982	27%	30%	49%	1,562
Logistics	548	1%	8%	13%	541
R&D	523	26%	8%	8%	414
Headquarters	370	15%	6%	4%	323
Shared services center	105	-23%	2%	6%	137
Internet data center	83	20%	1%	0%	69
Contact center	60	-17%	1%	3%	72
Education and training	46	5%	1%	1%	44
Testing and servicing	27	-69%	0%	0%	87

Source: analysis based on IBM database, 2017; EY *European Investment Monitor*, 2016.

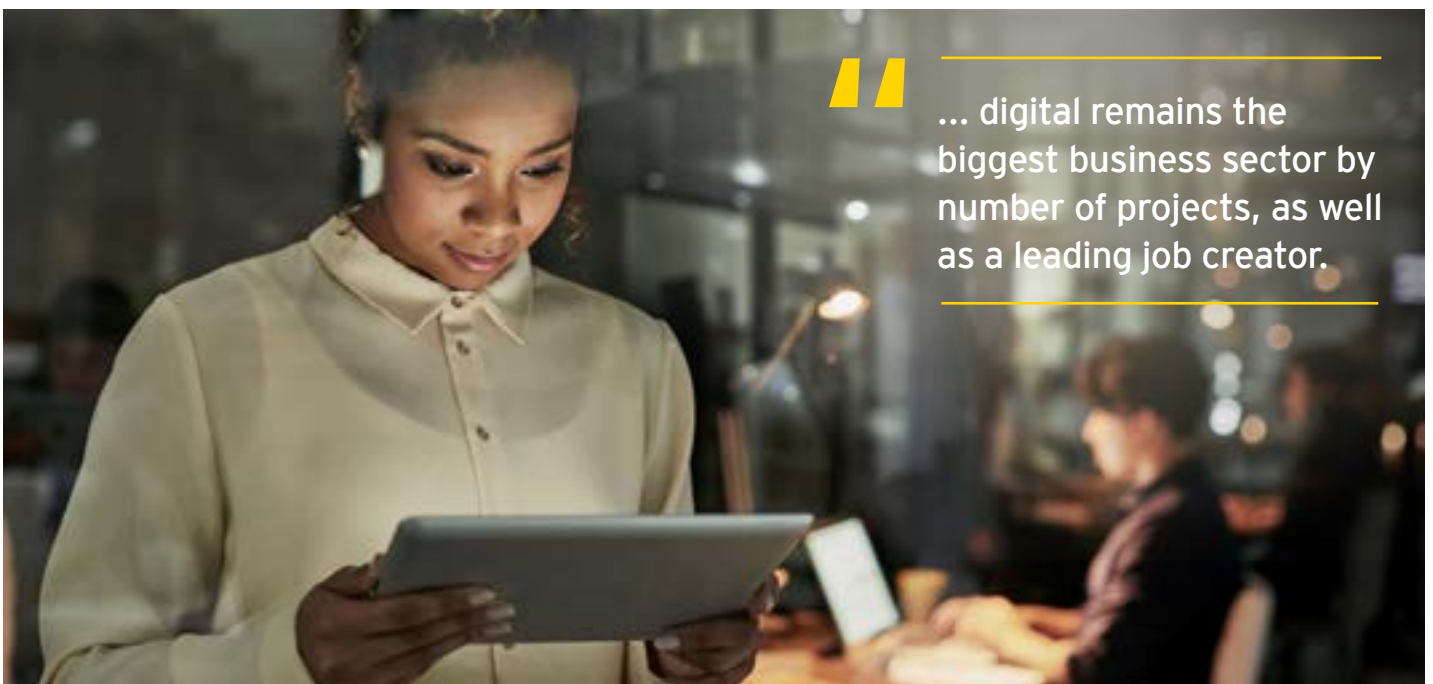
Four noteworthy figures regarding manufacturing, software, research and finance:



FDI projects in Europe in 2017: top five European regions for finance



Source: analysis based on IBM database, 2017; EY European Investment Monitor, 2016.



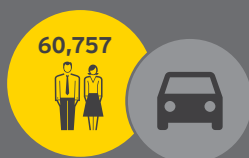
... digital remains the biggest business sector by number of projects, as well as a leading job creator.

Europe's traditional industrial sectors show solid growth

Transportation manufacturers and suppliers

Automotive companies continue to set up and expand operations. Rising employment, higher wages and greater consumer confidence support the automotive sector.

France and the UK were the largest recipients of the FDI projects in the sector, up 81% and 33% respectively.

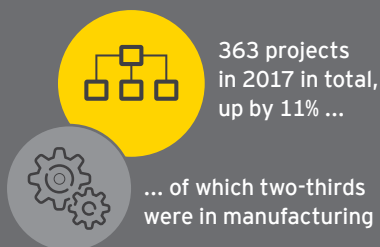


Largest source of FDI jobs in Europe in 2017

Agri-food business

Harmonization of both the EU and international food standards continued to drive more investments in food production.

As food chains become more international, the EU is trying to make the single market in food work better, despite the industry's labor and productivity challenges.



Pharmaceuticals

The sector was the second-fastest growing in 2017, with projects up 78%.

In CEE, project numbers surged 223%, driven by market growth and upgrading of national health care systems.



Source: analysis based on IBM database, 2017; EY European Investment Monitor, 2016.

Top 10 sectors by FDI projects

Sector	2017	Change (%)	Share (%)
Digital	1,172	33%	18%
Business services	893	12%	13%
Transportation manufacturers and suppliers	531	9%	8%
Chemicals and plastic	405	-7%	6%
Transportation and logistics	396	-2%	6%
Pharmaceuticals	379	78%	6%
Agri-food business	363	11%	5%
Finance	342	13%	5%
Machinery and equipment	329	-9%	5%
Electronics and IT	257	13%	4%
Others	1,586	-2%	24%
Total	6,653	10%	100%

Top 10 sectors by FDI jobs

Sector	2017	Share (%)
Transportation manufacturers and suppliers	60,757	17%
Digital	37,113	10%
Wholesale, retail and distribution	28,211	8%
Business services	26,259	7%
Agri-food business	22,114	6%
Transportation and logistics	20,624	6%
Pharmaceuticals	19,291	5%
Chemicals and plastic	18,707	5%
Machinery and equipment	18,642	5%
Electrical products	16,342	5%
Others	85,409	24%
Total	353,469	100%

Source: analysis based on IBM database, 2017; EY European Investment Monitor, 2016.

European companies find cross-border opportunities in their own backyard

Ten of the top 15 investors in Europe, by country, are European. They launched 42% of inbound FDI projects in 2017. Clearly, many mid-sized companies are still developing their presence across Europe's single market.

German companies lead, notably in manufacturing (launching 17% more manufacturing projects in 2017). French companies reined back. But cross-border investments by UK companies surged 35% last year, especially to Germany (110 projects, up 83%) and France (79 projects, up 46%). Cross-border investments in financial services by UK companies increased by 93%, to 54 projects. Some British investors are building their presence elsewhere in the EU ahead of Brexit.

Traditional investors slide; new sources on the horizon

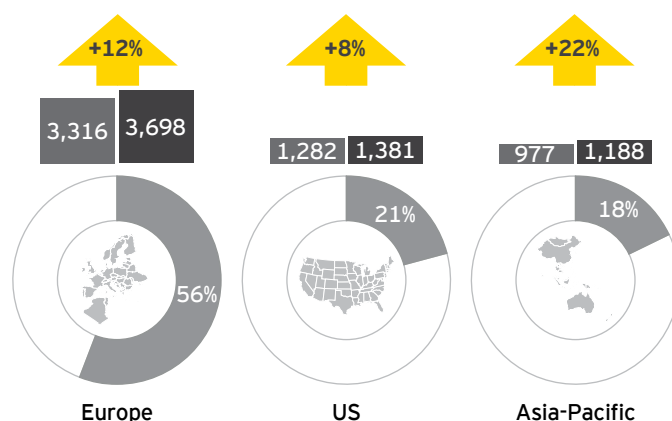
Country	FDI projects 2016	FDI projects 2017	Change 2016 vs. 2017 (%)	Market share 2017 (%)	Jobs created 2017
US	1,282	1,381	8%	21%	79,818
Germany	658	664	1%	10%	55,696
UK	343	464	35%	7%	20,276
China	342	341	0%	5%	17,819
Switzerland	296	327	10%	5%	13,722
Japan	264	327	24%	5%	19,360
France	332	297	-11%	4%	17,720
Netherlands	178	260	46%	4%	10,238
Sweden	160	215	34%	3%	7,634
Italy	193	209	8%	3%	9,420
India	117	170	45%	3%	9,153
Canada	122	146	20%	2%	9,203
Austria	139	140	1%	2%	7,624
Belgium	110	139	26%	2%	4,924
Spain	123	130	6%	2%	5,128

Source: analysis based on IBM database, 2017; EY European Investment Monitor, 2016.

US companies remain Europe's biggest fans. Japan and China provide the continent's keenest Asian investors, and each accounted for more than 320 projects in 2017. While Chinese investment would have been hit by strict capital controls instituted in 2017 by the Chinese Government, Japanese investment surged 24% in 2017 and may be spurred by the new EU-Japan Economic Partnership Agreement. Indian companies are mounting a catch-up, launching 170 projects.

Overall, companies from Asia-Pacific invested in 22% more European FDI projects in 2017. Investment from Asia-Pacific is on an upswing too from Australia (91 projects, up 30%), South Korea (88 projects, up 80%) and Hong Kong (43 projects, up 19%).

Europe maintains leadership, while Asia-Pacific picks up FDI projects by origin



■ Number of FDI projects in 2017 ▲ Change (2017 vs. 2016)
 ■ Number of FDI projects in 2016 ● % share of total FDI projects

Source: analysis based on IBM database, 2017; EY European Investment Monitor, 2016.

Viewpoints

A new France



Client viewpoint

Pascal Cagni

Ambassador for International Investment – France

Investors' perception of France's attractiveness is improving dramatically. France has bounced back as a destination of choice for foreign

investors. As the ambassador for international investment, I see daily this renewed interest and the investment decisions it brings.

After a year rich in changes following the presidential election in France, but also in Europe with the Brexit negotiations, and the new political landscape in Italy and Germany, France is recognized for its dynamism and its economic, political and regulatory stability.

The image of France is improving

France and the Eurozone now show strong economic performances, with growth rates of 2% and 2.4% respectively for 2017. These European dynamics, combined with reforms to the labor market and corporate tax cuts already enacted by the new French Government, create renewed confidence on the part of foreign investors. It is now judged less severely on its traditional weaknesses – the cost of labor and the taxation of companies.

So France recorded a record number of foreign investment decisions in 2017 – its best year ever. France is now seen as the second most attractive European country by foreign executives, behind only Germany. Its position as the No. 1 destination for manufacturing investments has strengthened, and innovation investments are up. Increased competition between countries, and technological changes, create new activities every day – but also raise new questions. Our real challenge is to build coherent labor markets within the Eurozone, while reducing inequalities. At the time of the Fourth Industrial Revolution, Europe must promote the digital industry, embrace robotics and artificial intelligence, promote strategic partnerships and support training for citizens.

Journeying toward higher value-added jobs



EY viewpoint

Marek Rozkrut

Partner, EY Poland Chief Economist, Head of Economic Analysis Team

Poland remains an attractive destination for foreign investors. Over the last few years, Poland has drawn around 3% of FDI inflows to the EU. The

value of the Polish Investment and Trade Agency (PAIH) projects increased in 2017 compared with 2016 and, according to EY's *Europe attractiveness survey*, job creation (24,000 in 2017) by foreign investors has been growing, putting Poland among the top performers in Europe. Meantime, Poland has made huge progress over the past decade in the Ease of Doing Business and Economic Freedom indices.

Skills and productivity ever more important

For many years, Poland's proximity to the largest EU markets and relatively low labor costs attracted companies seeking cost competitiveness advantages and benefits of scale, such as automotive or home appliances manufacturers. But integration of less-developed economies into international value chains is gradually increasing the importance of non-price factors in driving Poland's international competitiveness. Now, it is the well-educated, highly skilled workforce and potential for productivity growth that will play a larger role in keeping Poland attractive to foreign investors. Witness the fast growth of the shared services industry in Poland.

Looking ahead, the attractiveness of CEE as an investment destination will depend on the region's ability to increase labor productivity. This can come from further capital deepening (fixed and intangible investment); from factors stimulating total factor productivity (innovation and skills improvement); or by shifting from less productive sectors, such as agriculture, to more productive ones, such as professional services. An aging population will add to the pressure for such changes. Responses to shortages of labor should also include rapid adoption of automation and robotics.

Game changers for foreign investment in 2018

- ▶ Geopolitical risk is now investors' top concern.
- ▶ Brexit: 30% of Europe's international investors are likely to be impacted.
- ▶ Talent scarcity and technology reshape investment patterns.
- ▶ Changing trade and tax regimes challenge investor planning.

2

Perception

Game changer 1: Geopolitical instability is perceived as the biggest risk

Our survey shows that global and regional geopolitical instability is ranked as the gravest risk by investors as they consider investing in Europe over the next three years. **Geopolitical factors were the top concern of 39% of investors.** In larger companies (€1.5b+ revenues), nearly half of executives worry about geopolitical risks.

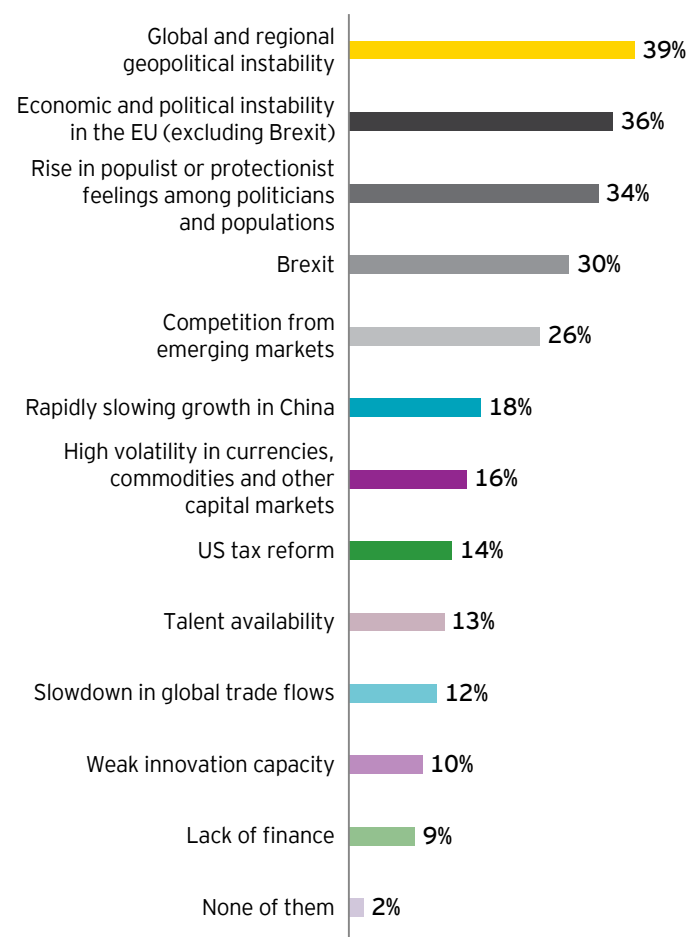
A stronger global economy and upgraded growth forecasts for much of the Eurozone have reassured investors that rising demand will repay their investments in new capacity. Yet recent events have shown companies how easily assumptions about liberal markets, democracy, conflict and international relations can be challenged.

The commitment of some countries to the rules-based multilateralism that has underpinned globalization and the integration of global markets has fractured. US moves to impose tariffs on steel and aluminum imports, and on selected imports from China, have prompted threats of retaliation.

Rising economies are expanding their political and economic influence on the global stage, creating rivalries between emerging powers, and notably, but not only, between China and the US. From the Korean peninsula and the South China Sea to the Middle East and Iran, tensions partly reflect the re-emergence of a jostling for influence between great powers.

While focused on the US, the *Borders vs. Barriers* report, published jointly by EY, Zurich Insurance and the Atlantic Council in May 2018, demonstrates the compelling advantages of Internationalism for wealth creation. It shows convincingly that Isolationism harms economic well-being, and that Atlanticism, based upon common interests between North America and Europe, benefits citizens, communities and corporations alike far less than free trade across open borders.¹¹

What are the three main risks affecting the attractiveness of Europe in the next three years?



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

¹¹ *Borders vs. Barriers. Navigating uncertainty in the U.S. business environment*, EY, May 2018.

It is therefore natural, but worrying, to find instability and populism within Europe were also high among investor concerns. These concerns find an echo in some investment trends we recorded in 2017: investment resurgence in reforming France, and declines in some countries suffering tensions.

Many local communities feel threatened by foreign competition, immigration and technology change. Citizens personally seize the advantages of trade and digital technologies, yet fear losing their jobs and national cultures. Immigration enlarges labor pools and talent supply, yet it is often seen as a threat to employment and to local culture by those who have few options for economic or social progress.

Populism has attracted strong support among some groups, regions and countries, with its mixed messages of anti-globalization, nationalism and the increased role of the state in the economy.

Investors rightly see these forces as threats. Populism and economic nationalism can undermine the rule of law and hinder free competition, movement of labor and even ownership of assets. The resulting unpredictability is a very strong deterrent to investors.

Yet the EU and Member States have been hesitant in response to surging immigration and to the erosion of democracy and institutions in some CEE states. In the absence of firm corrective action, investors are paying increasing attention to the health of democracy in prospective investment locations.



Citizens personally seize the advantages of trade and digital technologies, yet fear losing their jobs and national cultures.



Game changer 2: Brexit will likely impact 30% of foreign investors in Europe

Investors with a pan-European footprint will find that Brexit affects specific parts of their activities: 30% of the international investors we questioned said Brexit would have an impact on their business. Half of those who said yes were interviewed in the UK. Given the flood of FDI into the UK since Margaret Thatcher, then Prime Minister, opened Nissan's Sunderland car factory in 1986, it seems that a huge stock of foreign investment might ultimately be affected.

Slowing growth in new FDI projects in the UK during 2017 reflects more wariness among investors. With a 6% increase in projects between 2016 and 2017, the UK shows resilience, but digging into our database reveals deeper trends in the UK's share of FDI in Europe.

Though UK FDI has continued to grow, elsewhere in Europe it has been growing faster (+10%). As a result, since a peak in 2015, the UK's share of FDI inflows in Europe has declined from 21% to 18%.

Even Greater London's special position is weakening: its share of FDI projects in Europe has fallen from almost 10% in 2013 to less than 7% in 2017. Inflows into the capital in 2017 were up just 3%, half the national rate.

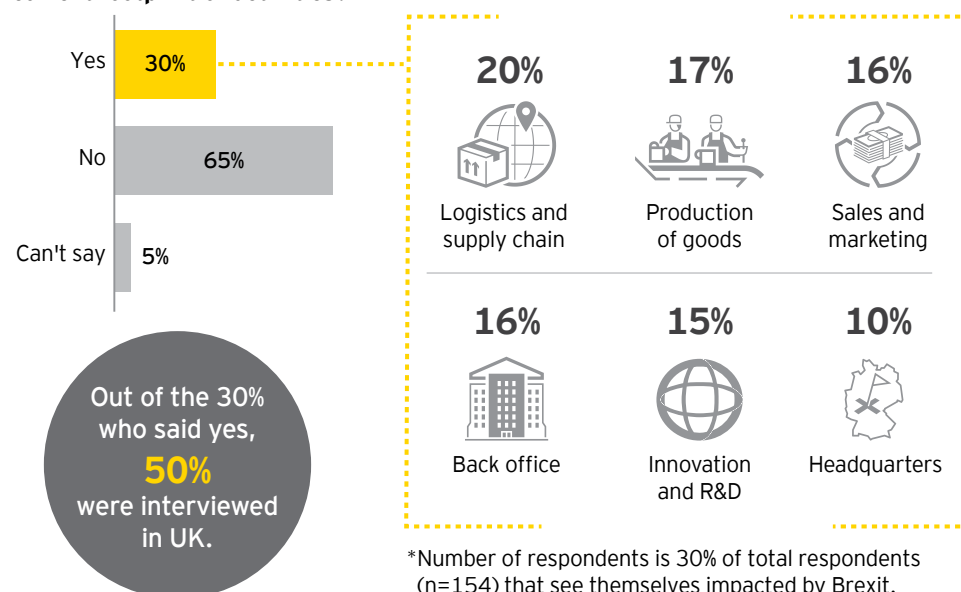
The trends are particularly marked in sectors that shape the future. The UK achieved healthy growth of 23% in the digital sector in 2017, attracting 320 projects. But the country's share of Europe's inbound digital FDI has nonetheless declined to 27% in 2017, from 36% in 2013. Similarly, in the financial sector, the UK attracted 34% of Europe's FDI projects in 2015, but just 23% in 2017.

Brexit-related impacts appear also obvious in some activities where the UK traditionally dominated the European rankings. Its share of headquarters projects almost halved, from 51% in 2015 to 26% in 2017. Over the same period, the UK's share of R&D projects slipped from 26% to 17%.

In our perceptions survey, uncertainty about the future trade relationship between the UK and the EU is the biggest concern: logistics and supply chain activities are expected to be most affected.

But for some investors, a range of other business activities will be affected, from production of goods (17%) to innovation and head-office location.

Will Brexit have an impact on your current footprint or activities? (What operations will you change or relocate?*)



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

Brexit effects ripple far beyond the UK

Trade, customs, supply chain and talent head multiple concerns. In our early 2018 survey, 8% of companies directly impacted by Brexit foresee the transfer of activities to another country. The percentage sounds small – but the UK FDI stock is huge: losing even a few percentage points would have big consequences. For now, however, minimizing disruption is the top priority for executives.

They increasingly perceive 29 March 2019 as a firm and fast-approaching deadline. More than a quarter are working to assess trade and customs impacts; 23% are striving to mitigate the impact of possible increases in import costs, and more than a fifth are reviewing the likely effects on their supply chain. Nearly one in five executives also worry about their future access to talent. Fewer than 1 in 10 said they are well prepared for the fallout from Brexit. One company in five said it was seeking benefits from Brexit. These could be either opportunities to capture new business – or to cut

68% said they would move some of their operations elsewhere in Europe: 35% to Western Europe and 33% to CEE.

costs. Adjustment to Brexit will probably be gradual, but over time it may prove substantial, in the UK, Ireland and continental Europe. Among the small proportion who foresee relocation, 68% said they would move some of their operations elsewhere in Europe: 35% to Western Europe and 33% to CEE. Only 6% planned to relocate operations to the UK.

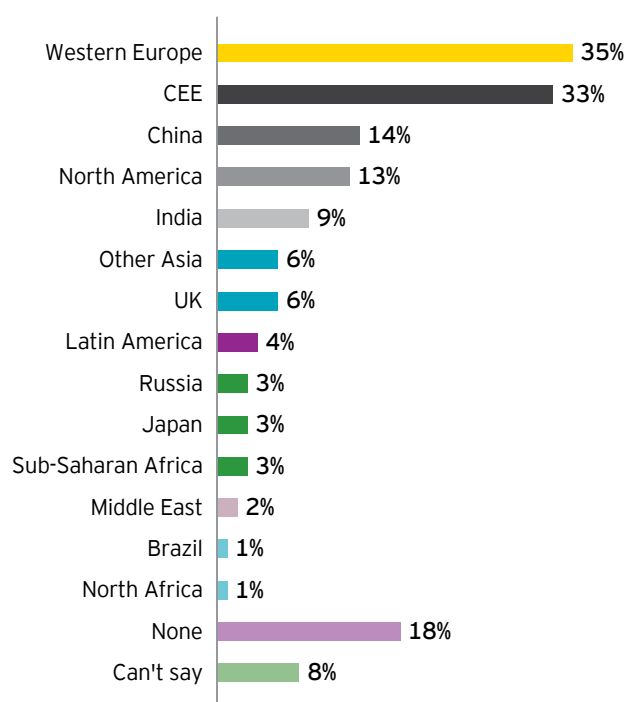
As the UK leaves the European single market, which 3 of the following 11 actions do you see as the most urgent for your business?

		Post-Brexit vote Europe reminder (2016)
Assess trade and customs impacts	28%	26%
Mitigate the impact of possible increases in import costs	23%	32%
Assess impact to my supplier contracts and my supply chain, including outsourcing	21%	27%
Scan for opportunities to capture new business or improve my operating efficiency	20%	26%
Assess customer-related impact	18%	23%
Ensure employee retention and access to talent	18%	20%
Analyze the risk of competitors trying to poach business or disrupt relationships, and make plans to manage this	15%	18%
Assess my investment and M&A plans for the next few years	13%	12%
Plan for securing financing	11%	14%
Reorganize accounting, tax functions, shareholder relations or governance	10%	16%
Relocate operations to another country	8%	10%
I have no plan at the moment	14%	10%
I am well prepared for the uncertainty arising from a changing regulatory and risk environment for my business	9%	4%

Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

For some, the choice was not on which side of the English Channel to relocate operations. Nearly 1 company in 7 would move operations to China, and more than 1 in 10 to North America.

For those operations you may move, which would be your three preferred countries or regions?



Source: EY Attractiveness Survey Europe June 2018 (number of respondents: 30% of the total respondents (n=154) which are impacted by Brexit).

Viewpoint

Adapting to Brexit



EY viewpoint

Mats Persson

Head of International, Trade, Economics and Policy Unit, UK&I

There are four main Brexit-related drivers of change for businesses. First, the uncertainty itself. The precise form of the future relationship

between the UK and the EU is likely to remain unknown for some time, perhaps well into 2019 or even 2020. Secondly, the probable reintroduction of a customs border that is likely to cause friction in cross-border movements, including within integrated supply chains that have evolved across Europe and beyond. Third, potential regulatory divergence between the UK and the EU, particularly impacting companies that currently rely on a single EU authorization to do business across the EU as a whole – notably pharmaceuticals, banks, funds, chemicals and aerospace. Finally, the end of free movement of labor between the UK and the EU, which could – depending on what takes its place – have a significant impact on UK firms that rely heavily on workers from continental Europe – and which, in the end, could inflict the biggest blow to the UK's attractiveness.

Grasping the upsides

So far, companies and investors have tended to see Brexit mostly as a downside risk. But it is important to remember that all these drivers also have potential upsides. A weaker pound has boosted some UK exports; changing regulation means an opportunity to revisit policies that are no longer fit for purpose; less reliance on low-wage labor could be a trigger for productivity-enhancing investment.

While some investment has been diverted away from the UK, so far there is little evidence of a big exodus of assets. Much will depend on the final outcome. For investors and governments alike, there is still much to play for.

Game changer 3: Talent shortages and technological changes are altering investment decisions

There is optimism in Europe, but there is also a sea change in European investment patterns. Europe's centers of gravity are shifting. European FDI has entered a period of transformative change. New dynamics are at work.

Europe's resurgence comes relatively late in a global recovery. Many multinational companies pursue regional investment strategies, locating assets in the Americas to serve that market, in Asia to service Asian consumers, and in Europe, the Middle East and Africa to meet the needs of that region. Having decided to invest in Europe, they survey options to find their preferred national or city location, weighing factors such as market, infrastructure and labor pools.

There is no more certainty in Europe's historic powerhouses for foreign investors. Brexit is a big disruptor of the UK's long-standing leadership, and Germany's tight labor market makes it difficult for new entrants to find the necessary skills at affordable rates for their new facilities.

CEE countries may be victims of their success. Although their appeal is still robust, convergence of the leading Central European economies with their Western European counterparts seems to be making investors more careful. Investors are also responding to signals from political shifts in some countries that are vulnerable to populism.

At the same time, we see some labor-intensive manufacturing moving toward Europe's fringes. The uptick in FDI into Russia and Turkey, two populous growing economies on the fringe of Europe, and Serbia – combined, these three won 200 more projects in 2017 than in 2016 – shows that investors are chasing newer talent pools and markets.

Simultaneously, the continent is exposed to technological forces that are transforming Europe's foreign investment dynamics. Foreign investors seize upon technologies that help them do more, with less.

We believe that digitalization and the industrial efficiency transformation known as Industry 4.0 may be encouraging some companies to invest in existing sites, rather than new cross-border projects. Intelligent automation and robotics can take over low value-added tasks from people in back-office operations. Likewise, 3D printing can produce complex components on site, sparing the need to hire skilled toolmakers, lathe operators and other craftsmen in lower-cost countries.

Amid tumultuous change among so many factors shaping investment decisions, we believe Europe has reached an FDI tipping point. Investors are embarking on a radical re-evaluation of their future options.



Game changer 4: Superpower rivalry, trade tensions and BEPS tax reform upend investment planning

Trade imbalances trigger challenges to trade rules

Decades of globalization have benefited many but have cost some cities and regions their place on the train of economic growth. Widening inequalities provoke new tensions over trade and tax as well as questions over who is benefiting most, and the scale and nature of revisions needed to international rules. Challenges to consensus views on combating climate change, tariffs and terms of trade alert investors that the world order is changing. US President Donald Trump's Administration has revoked some of the country's international agreements and called others into question. Challenges from the anchor economy of the multilateral system have sent shock waves around the world. Though many other countries, and Europe, have rallied to the flag of free trade, investors can no longer be sure the rules will outlive their investments.



Almost 50% of the world's FDI stock will be affected by the US federal tax overhaul launched late in 2017.

BEPS: clamping down on tax avoidance

The global tax landscape has become a battleground. States compete to attract investors, while collaborating – as never before – to close the loopholes that facilitated erosion of their revenues.

The financial crisis of 2008 spurred an international drive, drafted by the OECD, for a global clampdown on corporate tax avoidance. The new rules to combat BEPS are being implemented in the world's first coordinated international corporate tax reform.¹²

In June 2016, EU members agreed the Anti-Tax Avoidance Directive (ATAD 1) scheduled to take effect on 1 January 2019.¹³ This BEPS implementation directive sets minimum standards for interest deduction limitations and exit taxation, and general rules on anti-avoidance and controlled foreign subsidiaries. A second directive, ATAD 2, blocks arrangements designed to exploit differences in the rules between two or more jurisdictions.¹⁴

Digital taxes in Europe: can pay, will pay

The European Commission and the OECD are now respectively drafting proposals for a major overhaul of the way digital businesses are taxed.¹⁵ These follow mounting concern that digital champions can easily supply services or sell advertising across borders, while largely escaping taxation where their services are delivered – giving them an unfair competitive advantage and depriving states of revenue.

Achieving consensus between countries will not be easy. Short term, the Commission is proposing a turnover tax on digital companies in the range of 1%-5% of revenues above a minimum threshold, to be followed by a new concept of a "digital permanent establishment" and revised profit attribution rules. For Europe's digital economy, the consequences could be far-reaching.¹⁶

12 "Base erosion and profit shifting," *Organisation for Economic Co-operation and Development website*, accessed 1 May 2018.

13 "The Anti Tax Avoidance Directive," *European Commission website*, accessed 3 May 2018.

14 ATAD 2: Hybrid mismatch arrangements, European Commission, November 2016.

15 Digital tax policy disruption: An excerpt from EY's Global Tax Policy and Controversy Briefing, EY, February 2018.

16 "European Commission issues proposals for taxation of digitalized activity," *EY website*, accessed 4 May 2018.

US tax reform: return to sender

According to United Nations Conference on Trade and Development, almost 50% of the world's FDI stock will be affected by the US federal tax overhaul launched late in 2017. Reducing the US federal corporate income tax (CIT) to 21% from 35% is expected to increase US investment attractiveness overall and lead to repatriation of almost US\$2b of assets held overseas by US multinational companies.¹⁷ The new tax rules are still being developed. Tighter rules on royalty payments and transfer pricing could hit many cross-border investors doing business in the US.

What next?

Taxes are also continuing to evolve worldwide. Generally, but not everywhere, corporate income taxes remain on a downtrend. The number of countries offering "patent box" type reliefs to encourage innovation has risen. But European countries are increasingly using excise taxes, for example on sugar or alcohol, to change citizens' behavior.¹⁸ These can reshape markets and oblige companies to modify the composition of their products.



Viewpoint

The breakdown of rules puts geopolitics center-stage



EY viewpoint

Dr. Ferdinand Pavel

Executive Director, Leader Economic Advisory to the Public Sector in GSA, Transaction Advisory Services, EY Germany

During the past three decades, international trade has witness a

drastic structural transformation as rules-based multilateralism has secured market access, freedom from trade discrimination, and limits on conflict. Thus enabled, the pattern of trade has changed from exchange of final goods between countries towards exchange of parts and components along global supply chains, in which the lines between countries and companies are increasingly blurred.

Readjustment looms in global sales and supply chains

The current dispute over US steel tariffs has the potential to be a game changer for this "new world" of global trade. When market access and non-discrimination can no longer be taken for granted, businesses will respond by adjusting global supply chains and sales channels. Geopolitical risks of this type will be increasingly considered as a potential cost in strategic planning. While this will not bring globalization to a halt, it does put much more emphasis on geostrategic considerations. Our survey shows this awareness is now widespread among investors.

¹⁷ "United States tax act could lead to repatriation of \$2 trillion of overseas investment," [UNCTAD press release](#), 5 February 2018.

¹⁸ "Excise tax expands past alcohol, tobacco and fuel," [EY website](#), accessed 5 May 2018.

Viewpoint

Creating an EU ecosystem favoring company growth



EY viewpoint
Alessandro Cenderello
 EY Managing Partner for
 EU Institutions

Evaluating the impact of EU programs and initiatives is often difficult. There is always a political element in decisions about priorities. So the design of the

upcoming post-2020 Multiannual Financial Framework offers the opportunity to realign EU spending with new priorities arising from the changing geopolitical, economic and social context. I think Europe's future competitiveness will rely on our capacity to focus on three domains.

Building up the single European data market

Europe is still very strong in R&D. We've managed to overcome barriers for start-ups. Yet for companies in the next, critical phase of development – fast-growth – Europe is still not the place to be. We need to fix this failing, quickly, because tech giants both make much-needed investments in disruptive technology and define the way the world does business.

Developing the Capital Markets Union

The Capital Markets Union aims to diversify sources of finance for European companies, reducing dependency on bank loans. One of its goals is to mobilize capital into alternative financing, such as venture capital, private placements and crowdfunding. Developing a European market in these domains will aid economies of scale and help companies grow. Meantime, the banking union (with risk reduction and risk sharing) – another catalyst for financial integration – is scheduled for completion by the end of 2018. This will strengthen stability and predictability.

Accelerating structural reforms

We don't want to fight tomorrow's crisis with yesterday's tools. Member States need to work energetically on structural reforms, targeting convergence and a resilient Eurozone. They need to implement their national reforms, in accord with Brussels. This will help companies weather the next economic downturn. For these reasons, negotiating the next EU budget will need a break with the past, and a vital dose of political will.



Europe's attractiveness in the future

- ▶ Europe's attractiveness is set to improve over the coming three years.
- ▶ Digital transformation will be key to Europe's future.
- ▶ Companies need to connect with communities too.

3

Are international investors confident about the attractiveness of Europe?

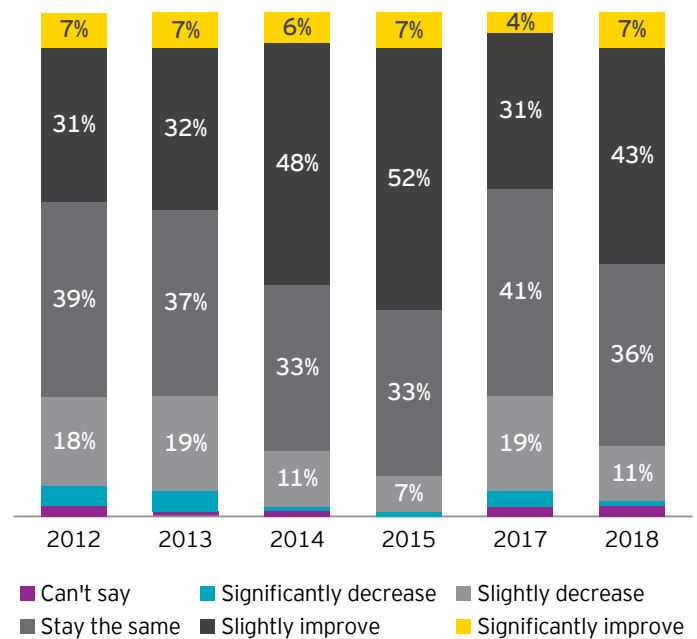
Sunnyside up

After three years of decline, investors' readiness to invest in Europe is recovering. In 2018, 50% of the business leaders we questioned believe Europe's attractiveness will improve over the next year, up from 35% in 2017.

Although investors are concerned about economic and political instability within Europe, when they look around the world they often see greater risks elsewhere. When we asked if they are confident about the future of the EU, 77% said yes, up from 65% last year. Many Europeans concur. A Eurobarometer study published in November 2017 found that 71% of citizens questioned across Member States saw the EU as a place of stability in a troubled world.¹⁹

Meantime, demand in Europe is strengthening, thanks to economic growth and innovation that enable companies to launch new products, or reduce the cost of producing goods and services in Europe.

To what degree do you think Europe's attractiveness will evolve over the next three years?



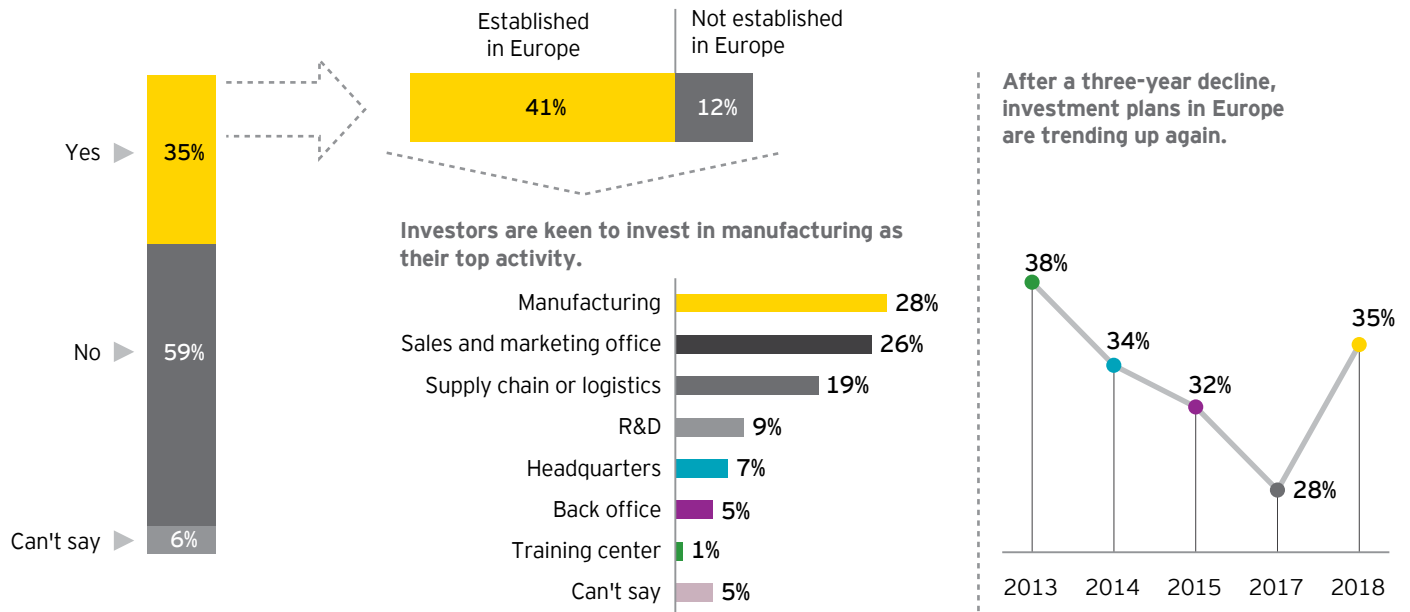
Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

Keener to invest

Rising optimism about Europe is reflected in investment plans. Among companies already present in Europe, 41% plan to expand. But optimism about the continent is also building among international companies not yet present: 12% are looking to establish new European operations in the year ahead, more than twice the proportion (5%) in our 2017 survey.

¹⁹ "Autumn 2017 Standard Eurobarometer: Fixing the roof while the sun is shining." European Commission press release, 19 December 2017.

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



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).



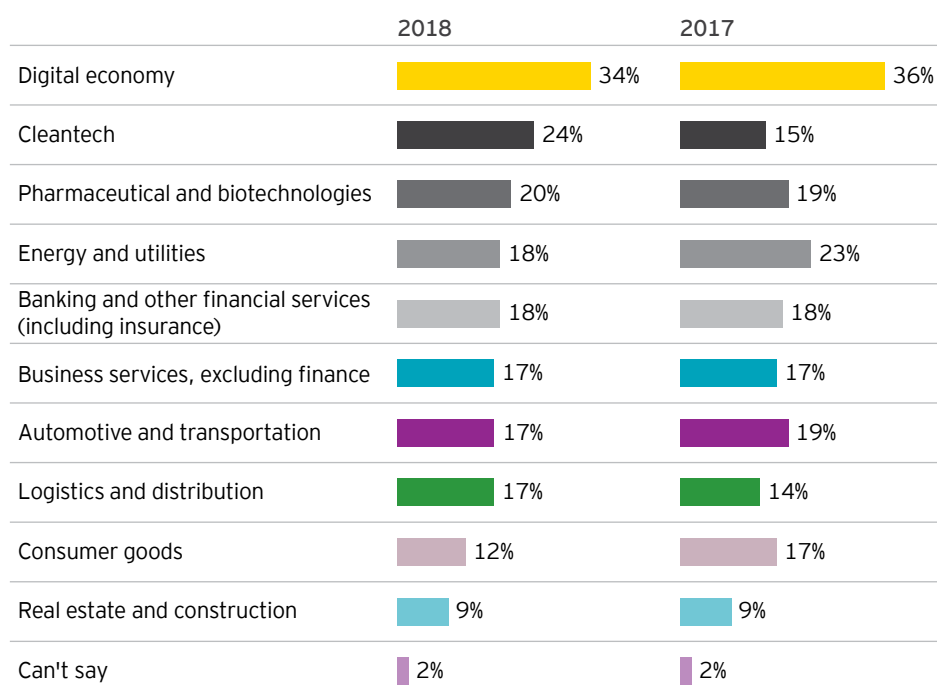
How can Europe compete in the digital age?

Europe's digital potential is obvious to foreign investors

In our survey, business leaders affirm very clearly – and to most, unsurprisingly – that the digital economy will be the dominant driver of Europe's growth in years to come. They believe that Europe's economic future will overwhelmingly be shaped by the tidal wave of digitalization that is transforming the way we live, work and play.

The importance of digital for Europe's future is reflected by matching changes among adjacent or connected industries. Energy is less of a priority in 2018 than in 2017, but the cleantech industry scores nine more percentage points in 2018, and these changes in perception are surely related. Similarly, though consumer goods are less of a priority in 2018, for the rising importance of logistics and distribution, read "e-commerce."

Which business sectors will drive Europe's growth in the coming years?



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

Europe needs to step up its digital and innovation game

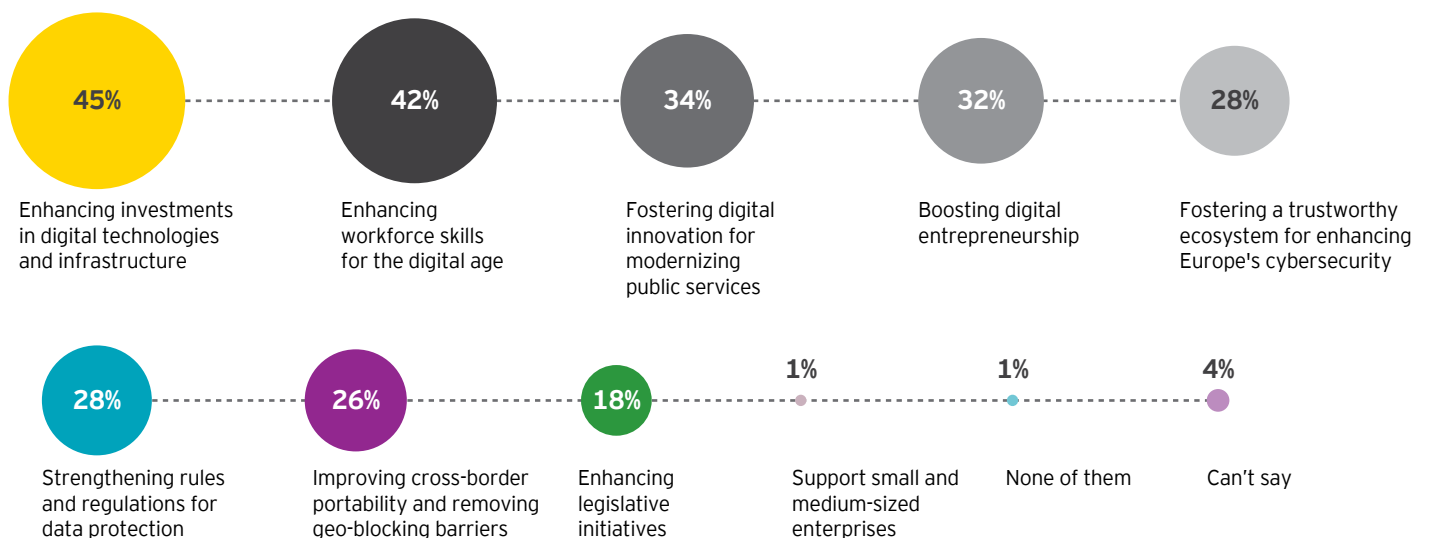
Our survey insists, however, that the European digital scene lacks some key fundamentals to remain a priority destination for entrepreneurs and global tech firms, and to retain talent and capital.

When we asked investors what Europe needs to fix to improve competitiveness and growth, they highlighted areas of weakness where opportunity awaits. These are manifold: from infrastructure to skills and education; from the digitalization of public services to cybersecurity and data protection; to enhancing legal, tax and financial support systems so that they provide the business environment needed for digital entrepreneurship to flourish.



Europe's key priorities in the digital age

The digital agenda for Europe and business in Europe are key priorities to enhance European competitiveness and foster the continent's growth. In your view, where should Europe concentrate its efforts?



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

Seven recommendations for businesses and governments across Europe

So how can Europe improve its chances of delivering growth spurred by innovation, of incubating the next tech giants, and becoming more attractive to entrepreneurs and international tech firms? How can investors overcome these pitfalls to ensure their investments grow in Europe?

1 Ensure innovative companies have access to world-class infrastructure and technologies

This is the top priority for nearly half of executives interviewed for this year's *Europe attractiveness survey*. Clearly, companies think that Europe has some of the world's most advanced technology and infrastructure, in hardware, software, networks and data centers. But they also report that some countries that have recently joined the EU may lack quality, reliability or even simple availability in some key areas. Foreign investors and start-ups need to evaluate carefully the digital infrastructure and key technologies available in proposed locations and how public and private players plan to develop it in the future. Close engagement is needed with present and potential customers and suppliers to ensure their digital infrastructure keeps pace with the global scene.

2 Invest in skills and welcome new talents

Technology companies compete globally for talent. Forty-two percent of companies interviewed say they need more skills for their own digital journey. They need the best engineers, technologists and data scientists. Start-ups also need access to deep talent pools, which means that people must

leave schools and universities with skills that fit the workplace of the future. Europe has some of the best universities and education systems in the world, but studying in Europe needs to be welcoming and attractive to the best talent from abroad, particularly students from emerging markets. A positive attitude to high-skilled immigration could become a real differentiator in the future. Policymakers at the EU and national levels need to address immigration issues, defuse nationalism and find solutions that respect the EU's worthy commitment to human rights and well-being.

Companies need to engage closely with education and training institutions and organizations and play a full part in developing the talent they will need in the future. Community engagement is a double win, enhancing understanding of the benefits business brings, and strengthening the license to operate.

3 Leverage the digitalization of public services

In third place on the radar of investors is the digitalization and modernization of public services. Some of these public services still impose additional costs and delays on business, according to investors we surveyed. Many administrations, however, are progressively adopting digital technologies in every field from tax to driving licenses. Some European countries are still largely dependent on the public sector, which is also a major investor in infrastructure, support programs and, of course, education. A clear record of digital innovation in public services, with a commitment to further digital progress in partnership with companies affected, will enhance competitiveness and investment attractiveness of locations.

Companies should seek out cities where policymakers, universities and the financial community have created effective business ecosystems, and are ready to collaborate more with companies – on contract research, for example – and be a part of the 21st century social and digital transformation.

4 Encourage investment and investors

At the global level, Europe needs to be a firm and forceful advocate for free trade and the rule of law. In doing so, it will create a climate of confidence in its commitment to the rights of individuals and businesses – and distinguish itself from rival regions where investment rules are being undermined. Investors cherish a predictable playing field.

At a more prosaic level, technology funding has historically been one of Europe's challenges. In this field, it still lags the US. According to the European Commission, US venture capital investment was US\$38b in 2016 – six times higher than in Europe (US\$6b).²⁰ While venture capital and private funding are growing, European companies still rely heavily on the traditional banking system. Also, Europe's pool of capital remains fragmented at the country level, and there are fewer private investors prepared to support tech businesses in reaching the next stage of development. With its planned Capital Markets Union – a kind of single market for capital – the EU would provide businesses with a greater choice of funding at lower costs. This could reduce the dependence of tech start-ups on relatively inflexible bank funding. Policymakers also need to think about how they can incentivize private equity firms and private individuals to invest in technology businesses. Big companies can leverage their spare cash, and their procurement, to support fledgling businesses, access innovative ideas, and build their own resilience to unforeseen geopolitical developments.

5 Create the right business environment

We're seeing emerging regulation of privacy, and even proposals for taxing robotics and automation. Although Europe and its businesses need protection from excesses or gaps in regulation, they also need to remain flexible and open to new forms of entrepreneurship. Introducing policies that discourage the development of potentially transformative technology for industries and lives would be a mistake. Socially and politically, European stakeholders have a responsibility to protect businesses and individuals, while recognizing that it would be counterproductive to raise unnecessary barriers or think we can slow the pace of change. Correspondingly, businesses must continue making every effort to meet expectations and act more and more responsibly toward customers and suppliers, shareholders and employees.

6 Support Europe's digital agenda

The EU's Digital Single Market strategy aims to remove barriers and create a single online market, allowing European firms to invest more easily and scale more rapidly. Europe's General Data Protection Regulation has proved remarkably timely. Taking effect in May 2018, it has become a global benchmark. Its privacy protection and related standards are now expected to enhance confidence in Europe's fast-growing online sector, and demonstrate the benefits of effective regulation in enhancing trust and, hence, market efficiency.

Most of our respondents clearly want "more Europe" to underpin digitalization of the economy, rather than less of it. Across Europe, individual countries have historically pursued national digital and technology strategies in the absence of an overarching technology framework. When it comes to digital innovation, people, researchers and companies in different European countries are clearly able to overcome impediments of language, currencies and standards. They are ready to collaborate globally and influence innovation in other parts of the world.

7 Believe in Europe's global hot spots

True, Silicon Valley, Shanghai, Beijing and New York remain the four main hotbeds investors believe most likely to "produce the next Google" – as they have since 2012. The reasons for this leadership can be found in the power of two massive economies, and ecosystems that are geared toward innovation, education and a wealth of domestic and international talent.

But Europe's strength in the digital space is greater than it seems. Our survey shows that international executives place 8 European cities among the 20 worldwide most likely to produce the next global tech giant. Albeit at a slower pace, Europe's digital ecosystem is becoming deeper, and broader.

Strong digital infrastructure and significant pools of digital talent and entrepreneurship are now to be found in many countries and regions. In terms of investment and adoption of advanced technologies such as cloud computing, big data and the internet of things, 10 of the EU28 countries rank among the top 20 worldwide, according to the 2017 Global Connectivity Index.²¹

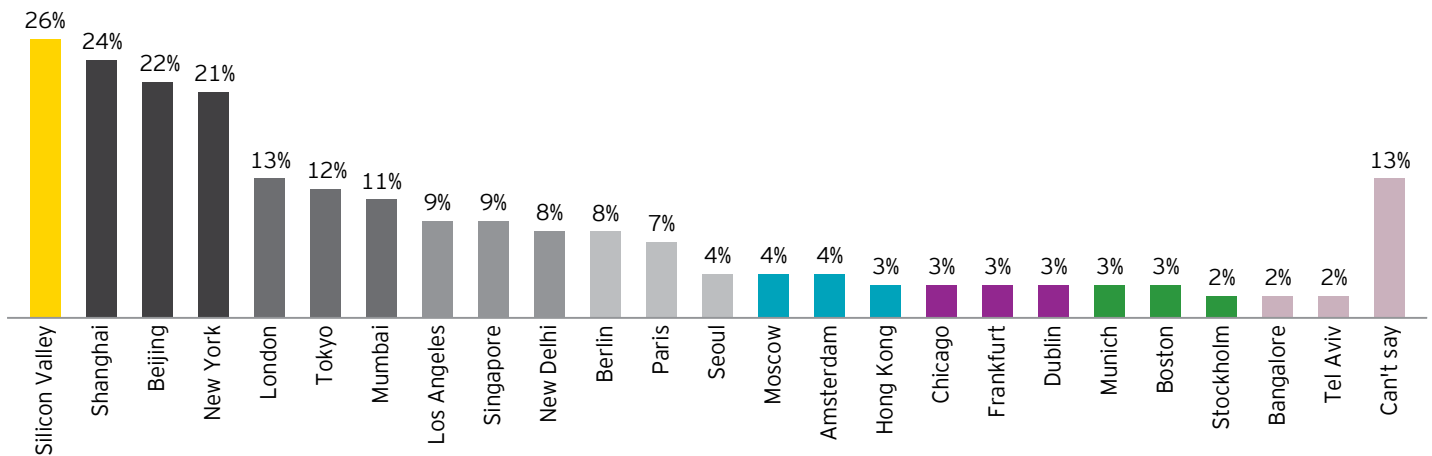


Europe's General Data Protection Regulation has proved remarkably timely.

²⁰ Science, Research and Innovation Performance of the EU 2018, European Commission, February 2018.

²¹ Harnessing the Power of Connectivity: Mapping your transformation into a digital economy with GCI 2017, Huawei, 2017.

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



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

The word “disruption” is surely overused in the corporate world, but the potential to disrupt or be disrupted is a clear and present danger for Europe. Changes that could disrupt Europe’s growth are happening now, so public and private decision-makers need to instill an organizational mindset that helps anticipate and respond to these changes.

None of these recommendations offer quick or simple fixes to the scaling challenges that Europe’s digital economies face. Neither will they guarantee that Europe produces the next technology titan or attracts more innovative companies from around the world.

But if we can do our best to remove both the soft and hard barriers that prevent innovative individuals, start-ups and corporations from operating within the wider European market, the chances of Europe becoming even more attractive will be greatly increased.





Europe can start this renewed innovation race from pole position, given its scientific leadership.

Viewpoint

Laying the foundations for growth through innovation



Client viewpoint
Carlos Moedas
European Commissioner for
Research, Science and Innovation

We are now at a crucial point for Europe's competitiveness. With growth, jobs and investments coming back to levels seen before the crisis,

Europe's "lost decade" is over. We can now turn to laying the foundations for making this growth sustainable.

Europe still has a severe productivity problem that can only be solved by fully embracing emerging innovations and technologies. Yet the nature of innovation is rapidly changing. We are at the cusp of a new wave of innovations where digital technologies will meet the physical world – think, for instance, of automated driving, robotics, artificial intelligence or 3D printing.

Europe can start this renewed innovation race from pole position, given its scientific leadership. But we must also translate this scientific leadership into innovation and entrepreneurial leadership.

To do so, we must tackle some of our most pressing shortcomings. Innovation policy, both at the national and European levels, needs to adapt to changes in the dynamics of innovation.

Helping entrepreneurial innovation

In the next EU program for research and innovation (2021-2027) that we will propose in early June, the Commission is determined to help Europe's many entrepreneurs deliver their full innovation and job creation potential.

We are improving access to funding by boosting private venture capital investment with the launch of VentureEU, a pan-European venture capital fund of funds.

We are reforming insolvency law to make it easier for start-ups to have a second chance without being stigmatized. We are making intellectual property protection more attractive, affordable and efficient.

And we are also ensuring that EU funding for research and innovation is better designed to support breakthrough, market-creating innovation. That is the aim of the European Innovation Council (EIC) that will be part of the next EU research and innovation program.

Viewpoint

Seizing Europe's tech moment



EY viewpoint

Julie Linn Teigland

Regional Managing Partner, EY GSA
(Germany, Switzerland, Austria)

When it comes to tech, the European ecosystem is surrounded by myriad dated myths: the continent is risk-averse and lacks venture capital, and

promising developments are strangled by EU regulations, to list but three.

Yet all over Europe, new Silicon Allees are emerging. Munich, Zurich and Paris are the new kids on the tech block, and smaller European front-runners, such as Estonia, Sweden and Belgium, have outranked the US in overall IT infrastructure and cross-sector internet engagement.

Do differently

So are we there yet? The answer is a clear "No." Talented tech developers are still gravitating toward Silicon Valley, and our large companies are falling short of their agile American peers. What the US tech giants have understood better than anyone

else is the art of self-cannibalization. Too many times, leaders have missed the time to jump and are still paying the price. As management theorist Peter Drucker put it: "If you want something new, you have to stop doing something old" – and that's just it, isn't it?

Our companies have every potential to write their own tech story. New approaches are not only key to answering emerging consumer demands, but to survival. More than ever, it is disrupt, or die.

Last but not least: this profound transformation will only succeed if we mobilize our entire human capital. We cannot afford to leave women out of the equation. Not pushing for digital fluency and literacy today to broaden our digital workforce tomorrow is just bad business.

The tech trends seem to be working in our favor, but Europe must act now, otherwise our countries and companies will be left behind.



Not pushing for digital fluency and literacy today to broaden our digital workforce tomorrow is just bad business.



Methodology: how EY researched this report

The “real” attractiveness of Europe for foreign investors.

Our evaluation of the reality of FDI in Europe is based on analysis of the IBM Global Location Trends database, produced in collaboration between EY and IBM-Plant Location International (IBM-PLI). 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.

An investment in a company is normally included in FDI data if the foreign investor acquires more than 10% of the company's equity. FDI includes equity capital, reinvested earnings and intracompany 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

Global Location Trends is tracking cross-border investment projects across the world. This flagship business information tool was developed by IBM-PLI and, from 2017 onward, has been further maintained in collaboration with EY. It is widely recognized as the most representative source of data on cross-border investment projects and trends. Global Location Trends is frequently used by government bodies, private sector organizations and corporations looking to identify significant trends in employment, industry, business and investment.

The 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.

The following categories of investment projects are excluded from the Global Location Trends database:

- ▶ M&A and joint ventures (unless these result in expansions with new facilities or new jobs being created)
- ▶ Portfolio investments (pensions, insurance and financial funds)
- ▶ License agreements

- ▶ Partnerships for joint business activities without creation of a new business entity
- ▶ Real estate and infrastructure development, generating temporary jobs only
- ▶ Factory and other production replacement investments (e.g., replacing old machinery without creating new employment)
- ▶ Retail centers, restaurants and similar local market-serving operations (unless individual projects are announced to create 100 new jobs or more)
- ▶ Governmental organizations representing individual countries (embassies, consulates and other government bodies representing one single country) with the following exceptions: trade, tourism and investment promotion agencies (new offices of international governmental organizations (coordinated by the UN, EU, World Bank, etc.) are included)

The “perceived” attractiveness of Europe and its competitors by foreign investors

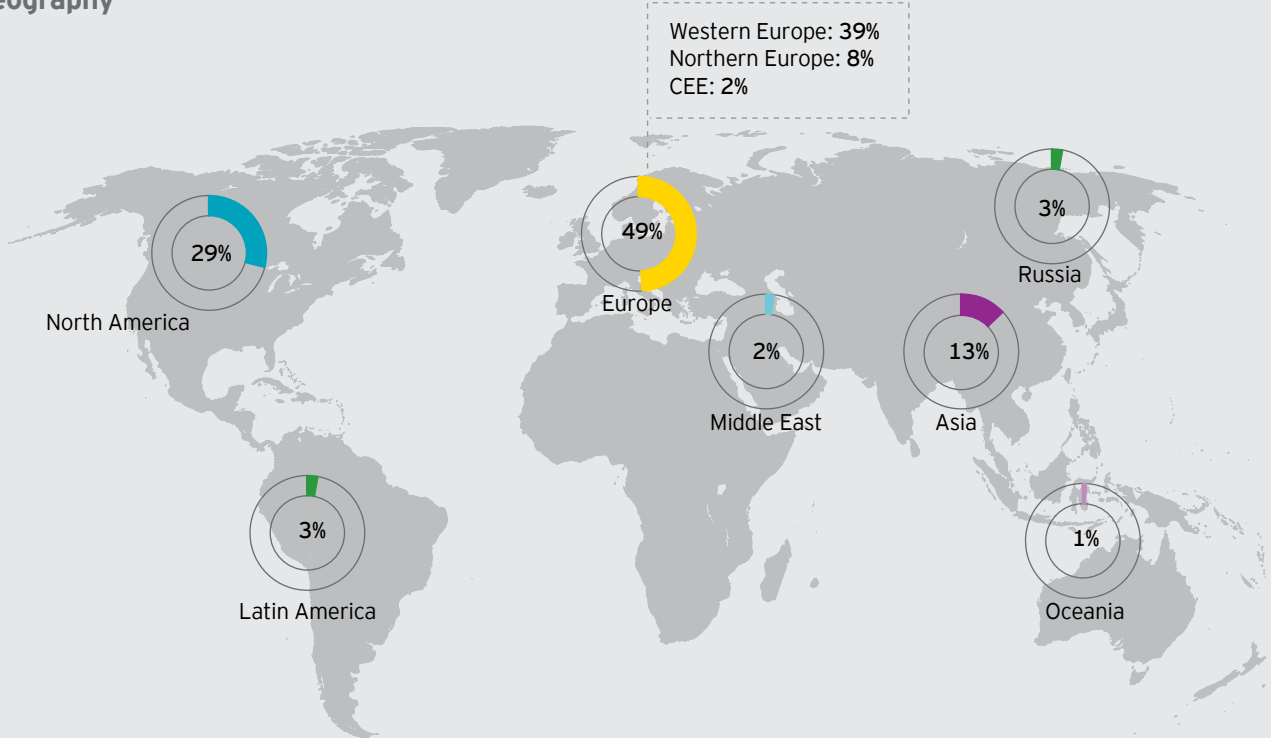
We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country's or area's ability to provide the most competitive benefits for FDI. The field research was conducted by the CSA Institute in January and February 2018, via telephone interviews, based on a representative panel of 502 international decision-makers.

This panel was made up of decision makers of all origins, with clear views and experience of Europe:

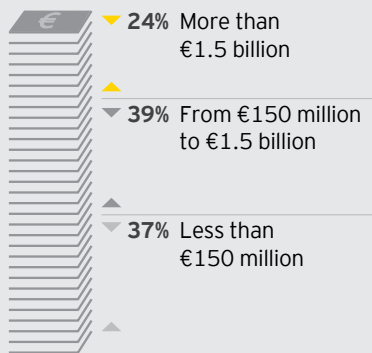
- ▶ Western Europe: 39%
- ▶ North America: 29%
- ▶ Asia: 13%
- ▶ Northern Europe: 8%
- ▶ Latin America: 3%
- ▶ Russia: 3%
- ▶ CEE: 2%
- ▶ Middle East: 2%
- ▶ Oceania: 1%

Overall, 80% of the 502 companies interviewed have a presence in Europe. And of the non-European companies, 30% have established operations in Europe.

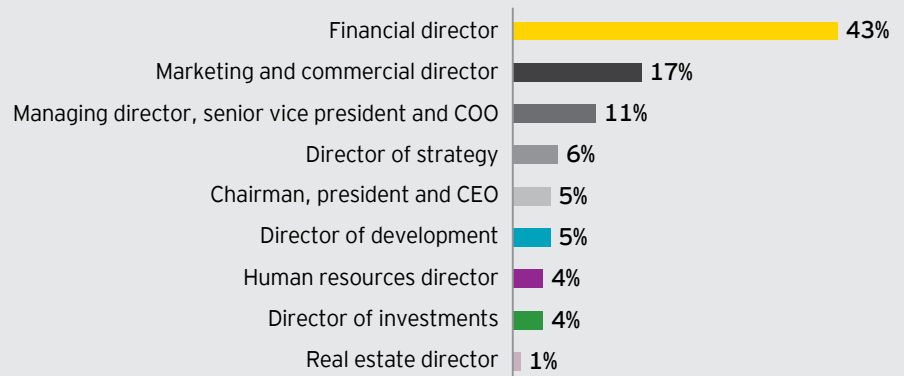
Geography



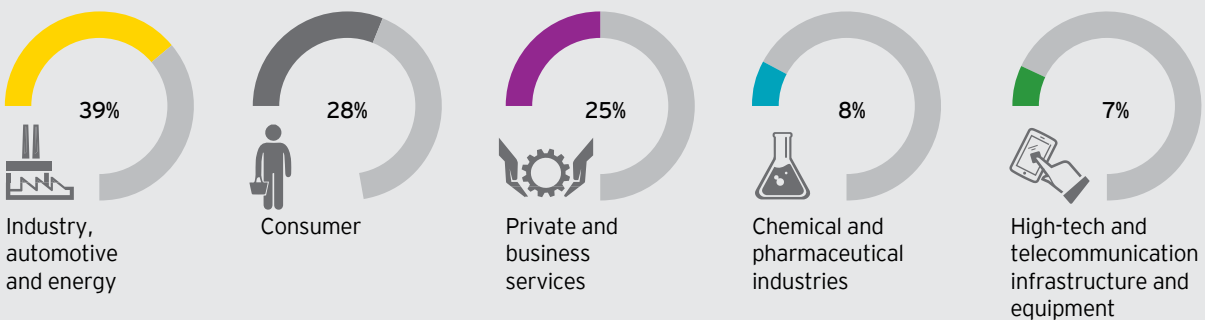
Size



Job title



Sector of activity



Source: EY Attractiveness Survey Europe June 2018 (total respondents: 502).

About the Attractiveness Program

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.

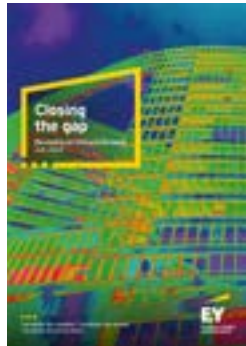
The program has a 17-year legacy and has produced in-depth studies for Europe, a large number of European countries, Africa, the Mediterranean region, India, Japan, South America, Turkey and Kazakhstan.

For more information, please visit:
ey.com/attractiveness
#EYAttract

EY's Attractiveness country reports in Europe 2018



Europe



Belgium (in French)



Belgium (in Dutch)



France



Germany



The Netherlands



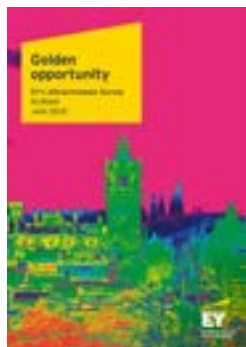
Nordics



Portugal



Russia



Scotland



United Kingdom

Further reports to be launched in EMEIA later this year include Africa, Italy and Malta.



About EY

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