EY's Attractiveness survey

Europe 2016

How can Europe's investors turn resilience into growth?

Building a better working world

Forward

Despite everything, investors remain committed to Europe

Europe in 2015 remained under tension and mired in several crises: tense geopolitics with Russia and several foreign fronts, historically low confidence in EU institutions, terrorist attacks in France and Belgium, and uncontrolled migration everywhere. Moreover, several economies remained in a dramatic state and on a very difficult recovery path.

"Destination Europe" nevertheless experienced a record year in terms of foreign direct investment (FDI). With 14% more projects, it hosted 5,089 international locations, creating 217,696 new jobs according to EY's European attractiveness survey. And the European FDI story is also reinforced by the dynamics of mergers and acquisitions, up 68% from 2014.

Despite an uncertain business environment and geopolitical risks, investors continue to see Europe as a relatively safe haven, with 82% expecting investment prospects to improve or remain the same over the next three years. Europe's strengths are its digital and logistical infrastructure, skilled labor force, and stable political, legal and regulatory environments. However, inflexible labor markets, high labor costs and complex corporate taxation regimes are relative investment turnoffs.

So what happens next?

Europe is indeed resilient, even in the face of headwinds. However, geopolitical and macroeconomic challenges are denting investor sentiment: our survey of 1,469 executives highlights that only 22% of the respondents have expansion plans for Europe in the immediate future.

Contents

Simplify wherever possible: The general perception by the business community suggests a structure of layered governance and overregulation. To complete the tableau, some countries are in the Eurozone and some are outside; some are members of the European Union and other countries in Europe are not. In other words, the value proposition of Europe evokes a broad range of perceptions and misperceptions, and makes the "selling of Europe" a very daunting task; a task made even more complicated by the fact that individual nations vie with one another for pole position to attract foreign capital and job creation.

Encourage innovation: A third of our respondents see digital industries as the preferred sector for Europe's growth in the coming years. Policy makers need to provide a more dynamic playing field for new market entrants. The role of governments is essential in incubating innovation in the region, investing in education and providing coordinated support for high-potential innovation. As the focus on innovation and digitization increases, businesses may need to alter their business models to encourage innovation. Businesses will also need to adopt multicultural approaches to increase participation and access to the right talent pool.

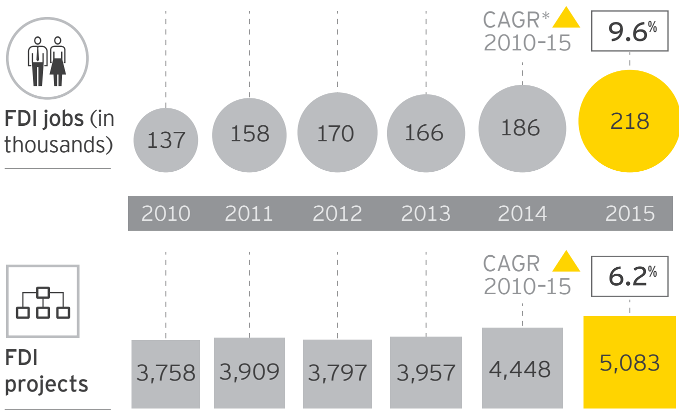
Maintain stability: Local, regional and global conflicts will test the resolve of Europe's governments and businesses to maintain core, stability and community principles. Recent security concerns across Europe highlight the urgent need to collectively and vigorously act to prevent further acts of terrorism at home and abroad. Nevertheless, history has endowed most of modern Europe with strong roots, anchored in a tradition of social justice, education, tolerance and political freedom. Europe's value proposition needs to stay the course to continue to be the object of attention from business, investors and its own citizens.

Marc Lhermitte
EY Advisory,
Global lead Attractiveness and Competitiveness

Europe's recovery continues ...

In 2015, Europe built on the momentum it established in 2014 and achieved a record level of 5,083 projects (up 14%) and 217,666 jobs (up 17%) created by foreign direct investment (FDI). This was at a time when Europe was facing multiple head winds, such as the migration crisis, sluggish growth and terrorist attacks in France and Belgium. In part, the numbers reflect the share of capital allocated to developed markets over emerging markets, but it also reflects an increased focus by national policy-makers on FDI as a route to economic growth.

FDI projects and jobs in Europe



Source: EY Global Investment Monitor, 2016.
*CAGR is compounded annual growth rate.

Western European destinations maintain the lead, but there was strong growth in Central and Eastern Europe

The top three countries in terms of FDI project numbers – the UK, Germany and France – together account for 51% of all FDI projects and a third of all jobs created. Western Europe (WE) continues to dominate FDI projects with a 77% share (81% in 2014). Other key FDI destinations, such as Spain, the Netherlands, Belgium and Ireland, all posted positive growth in 2015, but countries in Central and Eastern Europe grew almost four times as fast as their counterparts in Western Europe. As far as jobs are concerned, Central and Eastern Europe (CEE) saw the creation of 50% of all FDI jobs in Europe, thanks to the strength of the region in manufacturing, which accounted for 69% of the FDI projects in the region. Poland, Russia and Romania achieved the highest number of jobs created.

Thirty-four percent growth in FDI in CEE compared with 9% in WE

The UK leads the field in both numbers of projects and jobs

Top 10 countries by FDI projects

	2015	2014	Percentage change
UK	1,065	887	20%
Germany	946	870	9%
France	598	608	-2%
Spain	248	232	7%
Netherlands	219	149	47%
Belgium	211	198	7%
Poland	211	132	60%
Russia	201	125	61%
Turkey	134	109	23%
Ireland	127	106	20%
Others	1,123	1,032	9%
Total	**5,083**	**4,448**	**14%**

Top 10 countries by FDI job creation

	2015	2014	Percentage change
UK	42,336	31,344	35%
Poland	19,651	15,485	27%
Germany	17,126	11,890	44%
Russia	13,672	18,248	-25%
France	13,639	12,579	8%
Romania	12,746	10,892	17%
Hungary	11,741	4,868	141%
Ireland	10,772	7,306	47%
Serbia	10,631	5,104	108%
Slovakia	9,564	8,012	19%
Others	55,788	60,620	-8%
Total	**2,17,666**	**1,86,348**	**17%**

Source: EY Global Investment Monitor, 2016.

What our respondents say

Which are the top countries for FDI in Europe?

Germany	69%
UK	43%
France	36%
Netherlands	19%
Poland	15%

Source: EY 2016 European attractiveness survey (total respondents: 738).

European cities: signs of potential change in city attractiveness

Top urban areas for investors in 2015

		FDI projects	Year over year growth
1	Greater London	406	7%
2	Greater Paris	159	0%
3	Dusseldorf	127	-8%

Top urban areas for FDI growth in 2015*

		FDI projects	Year over year growth
1	Oberbayern (Munich)	117	134%
2	Berlin	117	46%
3	Dublin	74	45%

What our respondents say

What are the most attractive European cities?

		Percentage points (change from 2015)
London	57%	+5%
Paris	43%	+14%
Berlin	29%	+1%
Amsterdam	15%	+8%
Barcelona	11%	+5%
Munich	11%	+4%
Frankfurt	10%	-1%
Madrid	7%	+3%
Brussels	7%	0%
Rome	7%	+5%

New entrant: Rome

The top of the list is unchanged, with London once again dominating the FDI perception and reality rankings.

As Europe slowly recovers and regions and cities strive for growth, competition is increasing and investors are being presented with more choices.

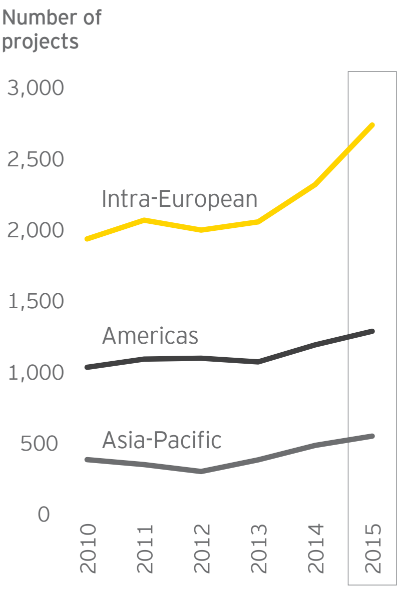
Source: EY Global Investment Monitor, 2016.
EY 2016 European attractiveness survey (total respondents: 1,469).
*From the cities with projects greater than 50.

FDI origin: intra-European investment dominates

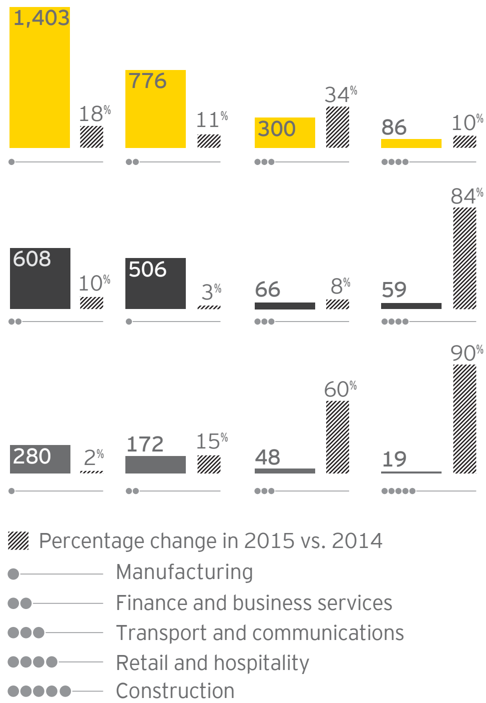
Intra-European projects continue to dominate FDI activity (54% of all projects). The US continued to favor the region, with finance and business services making up the bulk of its FDI activity. The retail and hospitality sector saw a big jump in FDI from the US (54 projects, up 80%). Asia is also increasing its FDI flows: China invested in 238 projects (up 2% on 2015) primarily in the UK and Germany, and created 8,917 jobs (down 25%). India's FDI was also noteworthy, with 37% more projects than last year. India was among the top three non-European investing countries in the finance and business services sector (55 projects, up 22%).

Intra-European FDI projects continue to surge; Americas at distant second

Top investing regions into Europe

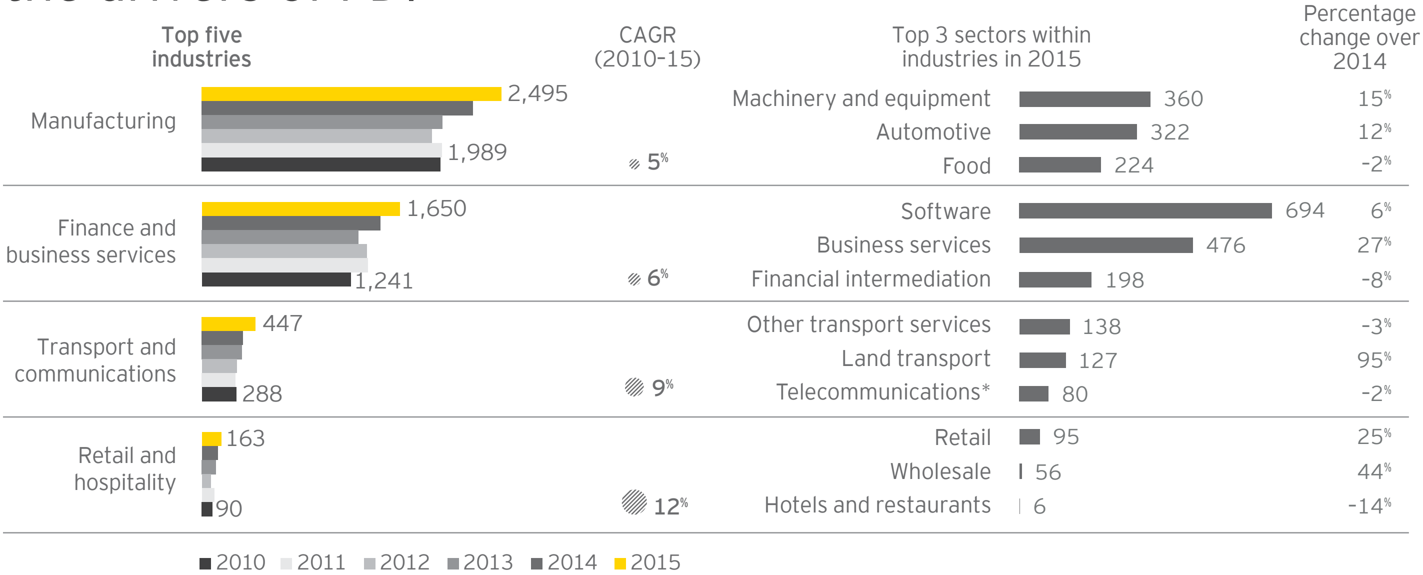


Top industries (based on 2015 projects)



Source: EY Global Investment Monitor, 2016.

Manufacturing, and finance and business services remain the drivers of FDI



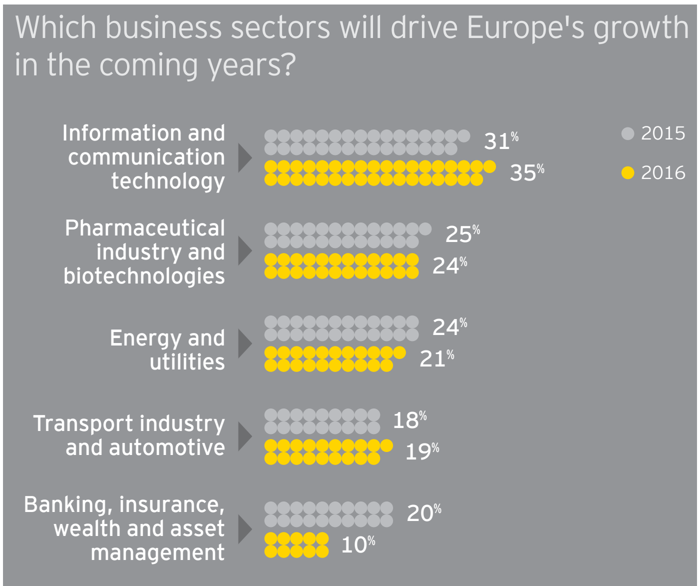
Source: EY Global Investment Monitor, 2016.
*Telecommunications and post.

Favorable exchange rates and cheaper oil added to Europe's industrial competitiveness. However, Germany, the UK and France saw little change in industrial activity, with growth focused in the CEE region. Hungary (69 projects, up 103%), Poland (117 projects, up 34%), Turkey (105 projects, up 52%), Serbia (51 projects, up 76%) and Romania (51 projects, up 21%) drove FDI in manufacturing facilities.

The automotive sector drove manufacturing growth in Hungary and Poland, while machinery and equipment dominated in Turkey, Serbia and Romania.

The UK extended its dominance in the finance and business services sector (496 projects, up 22%). But Germany overtook the UK as the most attractive destination for transportation and communications projects (81 projects, up 72%), while the UK supplanted Germany as the number one destination for retail and hospitality projects (43 projects, up 26%).

Investors increasingly focus on technology intensive investments



Source: EY 2016 European attractiveness survey (total respondents: 731).
EY 2015 European attractiveness survey (total respondents: 808).

... as European cities improve their perception of being digital leaders

Which cities in the world offer the best chance of producing the next tech giant?

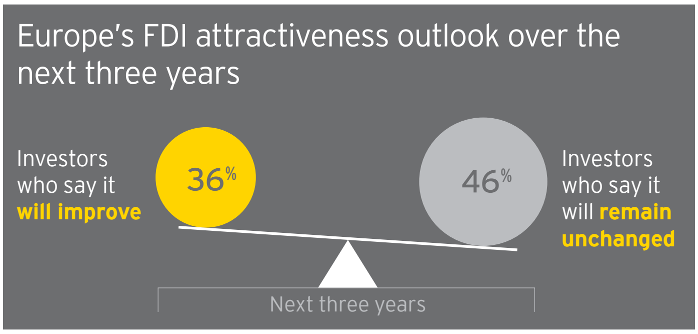
European cities	2016 rank (improvement in ranking from 2015)	2016	Percentage points (change from 2015)
London	2 (+3)	23%	+6%
Berlin	6 (no change)	10%	-1%
Paris	10 (+1)	8%	+1%
Amsterdam	13 (+5)	5%	+3%

Source: EY 2016 European attractiveness survey (total respondents: 1,469).
EY 2015 European attractiveness survey (total respondents: 808).

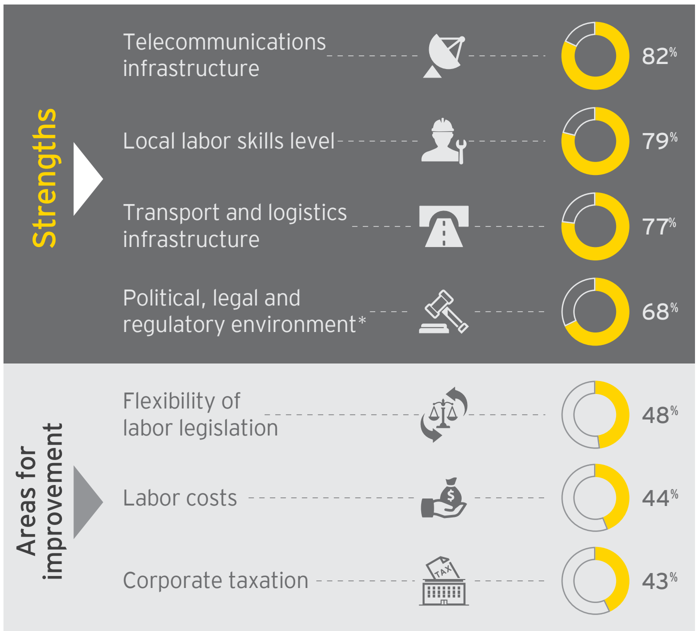
What attracts investors to Europe? ...

Despite an uncertain business environment and a number of geopolitical risks, investors continue to see the region as an attractive destination, with 36% respondents expecting investment prospects to improve over the next three years.

Europe's strengths are its digital and logistics infrastructure, skilled labor force and stable political, legal and regulatory environments. However, inflexible labor markets, high labor costs and complex corporate taxation regimes are relative investment turnoffs.



How attractive are the following features of Europe?

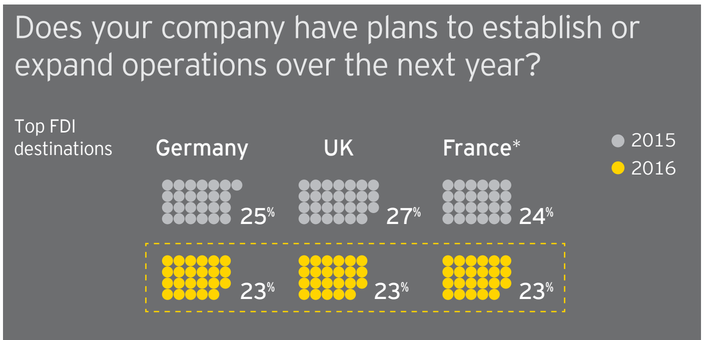


Source: EY 2016 European attractiveness survey (total respondents: 1,469).
*Stability and transparency of political, legal and regulatory environment.

... and what is keeping them away?

Geopolitical and macroeconomic challenges are denting investor sentiment. As per our survey, investment prospects have declined in the top European destinations in the immediate future. In the UK, only 23% investors have plans to establish or expand operations over the next year, down from 27% last year. Similarly, in Germany, only 23% of the investors (down from 25% in 2015) have investment plans. Investment plans in France have taken the worst hit with only 24% investors keen on investing, down from 35% last year.

Europe faces fierce competition from other regions when it comes to attracting foreign investors. Europeans need to convince the investors as to why Europe still deserves the close attention of corporations from around the world. Our conversations with multinationals and entrepreneurs point to some very clear, very urgent — yet very complex — areas of reform, to be tackled together by governments and businesses.



Source: EY 2016 European attractiveness survey (for the UK: 444, Germany: 204, France: 205), EY 2015 European attractiveness survey (for the UK: 406, Germany: 202, France: 206)
*Survey question for France in 2015 – In general, does your group intend to establish or develop its business in France?

Points to ponder for governments and businesses

1 **Europe goes digital**: Less than 1% of our survey respondents feel that digital will drive their business growth in the coming years. This is despite increasing focus of European Commission (EC) on digital. EC will be investing close to €50b over the next five years in its efforts to create a digital single market.

For governments

Europe's focus on creating a digital single market will reduce technology barriers. To capitalize on this, European cities must invest in building their brand, attracting people with the right skills and encouraging inward investment.

How can governments increase their collaboration with business to create an appropriate regulatory framework? How can European cities enhance their brand to increase investor interest? How can governments build a digital ecosystem that will promote innovation?

For businesses

As the focus on digital increases, businesses may need to alter their business models to encourage greater innovation. Businesses will also need to adopt multicultural approaches in order to increase participation and to attract people with the right skills.

How can businesses hire the right people to drive greater innovation? How can businesses partner with governments to provide effective cybersecurity and data protection for everyone? How can businesses identify gaps in their digital strategies? How can businesses speed up their adoption of new technologies?

2 **Increased focus on innovation**: Many of our respondents (35%) expect digital industries to drive Europe's growth in the coming years.

For governments

Policy makers need to provide a level playing field for existing and new market entrants. The role of governments in incubating innovation in the region is essential. Governments need to invest in education and training, and must provide coordinated support for high-potential innovation.

How can we build an ecosystem that encourages entrepreneurship and innovation? How can we lower the barriers to entry for entrepreneurs? How can we lighten the regulatory load? How can governments co-invest? How can we encourage public–private partnership?

For businesses

Developing an innovative product or technology requires the investment of time and money. Europe is home to some of the highest-ranked universities in the world. How can businesses tap that intellectual talent?

Companies need to identify collaboration opportunities, financing options and any government schemes that can help them commercialize their offerings.

How can companies revamp outmoded business models and reach out to new customers? What are the entry and exit options? How can businesses access public and private funding? How can businesses confirm regulatory and tax compliance?

3 **Improve taxation environment**: Forty-four percent of investors consider the European corporate taxation environment to be unattractive.

For governments

Large differences in tax rates among European countries — from tax havens to high-taxing economies — are unhelpful. Moving toward greater tax rate regularization would not only simplify the environment for doing business, but would also help to prevent tax evasion.

What optimal tax structure can the European countries adopt to attract investments? What can European countries learn from their competitors in terms of successful tax measures?

For businesses

Corporate taxation remains a big obstacle for investors. Within Europe, different countries follow different tax regimes, making it difficult for investors to form a single market strategy for Europe.

How can businesses take advantage of the different tax structures across Europe? Europe is working toward an EU-wide floor on corporate taxation: how can businesses prepare for this change? How can businesses work effectively in an ever-changing tax environment?

4 **Europe cannot rest on its laurels**: Only 22% of our survey respondents are looking to expand or set up operations in Europe in the year ahead. This is down from 32% in last year's survey.

For governments

The uncertainties posed by a possible UK exit from the EU, continuing high unemployment in some areas, the migration crisis and slow growth are drags on FDI growth.

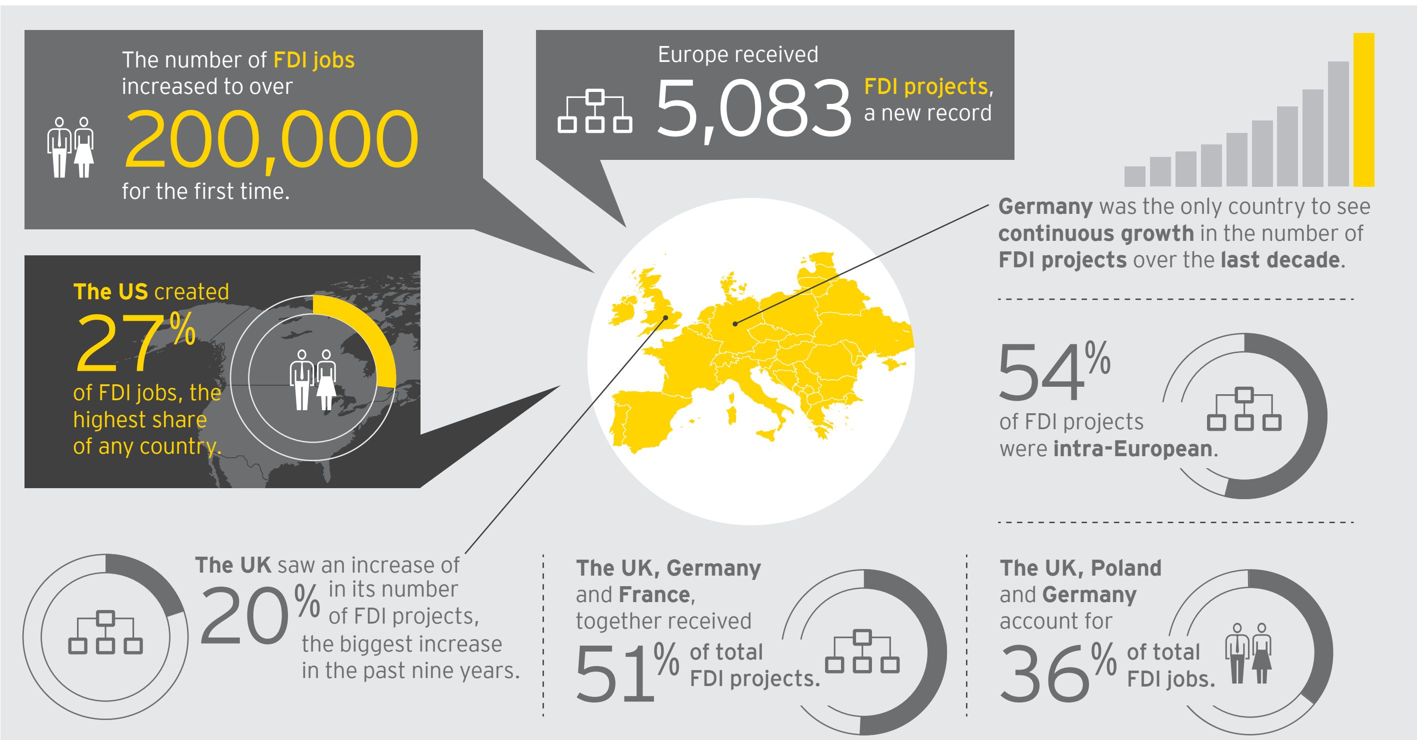
How can Europe show greater unity in tackling some of its regional challenges? How can it help to create greater geopolitical stability? How can it reduce red tape? How can it improve its brand on the global stage, promoting its record on democracy, social justice, free trade and transparency?

For businesses

Businesses are worried that they are operating in a fragile business and consumer environment with deflation weighing on market sentiment.

What unique strengths does Europe offer investors? How can businesses make best use of Europe's advantageous time zones, global financial centers and large consumer market? What can businesses learn from the best practices in other countries? How can businesses get access to better market information? How can businesses better capitalize on opportunities to create value for stakeholders?

European FDI in 2015: what the numbers say



Source: EY Global Investment Monitor, 2016.

Leading industries for FDI investments in Europe

Top industries	FDI projects			FDI jobs			Top sectors within industries			Top destinations for industries		
	2015	2014	Percentage change	2015	2014	Percentage change	Sectors	Projects	Percentage change	Countries	Projects	Percentage change
Manufacturing	2,495	2,259	10%	1,35,202	1,25,210	8%	Machinery and equipment	360	15%	Germany	459	-1%
							Automotive	322	12%	UK	355	7%
							Food	224	-2%	France	333	-6%
							Chemicals	218	12%	Russia	171	80%
							Pharmaceuticals	160	-5%	Belgium	130	2%
Finance and business services	1,650	1,487	11%	48,616	37,550	29%	Software	694	6%	UK	496	22%
							Business services	476	27%	Germany	322	18%
							Financial intermediation	198	-8%	France	161	-9%
							Scientific research	137	20%	Netherlands	83	65%
							Insurance and pension	79	0%	Ireland	73	38%
Transport and communications	447	344	30%	12,636	10,516	20%	Other transport services	138	-3%	Germany	81	72%
							Land transport	127	95%	UK	61	2%
							Telecommunications and post	80	-2%	France	57	36%
							Air transport	56	81%	Netherlands	40	135%
							Water transport	46	92%	Spain	39	11%
Retail and hospitality	163	134	22%	12,418	7,987	55%	Retail	95	25%	UK	43	26%
							Wholesale	56	44%	Germany	30	-19%
							Hotels and restaurants	6	-14%	France	15	88%
							Sale and repair of motor vehicles	6	-50%	Finland	12	500%
										Spain	12	33%
Others	328	224	46%	8,794	5,085	73%						
Total	**5,083**	**4,448**	**14%**	**2,17,666**	**1,86,348**	**17%**						

Source: EY Global Investment Monitor, 2016.

What is the European attractiveness survey?

EY's attractiveness surveys are widely recognized by our clients, media 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. For more information, please visit: **ey.com/attractiveness.**

Methodology

The "real" attractiveness of Europe for foreign investors

Our evaluation of the reality of FDI in Europe is based on EY Global Investment Monitor (GIM). 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 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 being undertaken
- What activities are being invested in
- Where projects are located
- Who is carrying out these projects

The GIM 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 GIM is frequently used by government bodies, private sector organizations and corporations looking to identify significant trends in employment, industry, business and investment.

The GIM 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 GIM:

- 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 from February to April 2016, via telephone interviews with a representative group of 1,469 international decision-makers.

Our sample group included representatives from:

- European businesses — 48%
- North American businesses — 33%
- Asian businesses — 15%
- South American businesses — 1%
- Middle Eastern businesses — 1%
- Businesses from other regions — 2%

Overall, 65% of the 1,469 companies surveyed have a presence in Europe. And of the non-European companies, 30% have established operations in Europe.

*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 centre, this project would qualify for inclusion in the database.

Disclaimer: FDI jobs data is available for 2,600 projects out of 5,083 projects (or 51%) in 2015.

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