

Tipping point

EY Attractiveness Survey
UK

June 2019



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Foreword

Welcome to EY's 2019 UK Attractiveness Survey, which — as in previous years — examines the performance and perceptions of the UK as a destination for foreign direct investment (FDI).

This report maintains EY's long track record of sponsoring research into UK trade, including FDI, reflecting our desire to encourage an open exchange of information and insight between business leaders, investors and policymakers on how to enhance the UK's economic performance.

For the UK, in common with other nations, FDI represents a vital source of capability, economic activity and jobs. The UK's continued capacity to attract FDI remains under close scrutiny in the run-up to Brexit as this source of capital offers a unique insight into how foreign investors and businesses view the UK's potential. Last year, our research suggested that the UK was doing reasonably well in managing the challenges posed by Brexit and ongoing technological change. This year, our report shows that the FDI market in Europe has been very challenging and the UK has experienced a reduction in FDI volumes and a decline in investor sentiment. Our analysis shows that Brexit has changed the economic situation in the UK and urgent action is required to chart a new path to achieve success in the future in this new environment.

The FDI figures for 2018 tell their own story. While the UK held onto its longstanding position as Europe's leading recipient of FDI, the number of projects it attracted in 2018 fell by 13% from the previous year, against a backdrop of a 4% decline in FDI projects in Europe as a whole. As a result, the UK's share of all European projects slipped to 17%, its lowest level in the two decades that we have been publishing our attractiveness surveys.

A more detailed look at the findings helps identify the challenges. The UK's recent success in attracting manufacturing FDI came to an abrupt end with a 35% fall in the number of new factory projects in 2018. At the same time, our figures show that the UK managed to remain the leader in attracting digital investments in Europe but the UK's market share of digital investments in Europe declined to 23%.

Our survey of international investors points to reasons for the changes in the UK's performance, with investors voicing the highest level of pessimism over the UK's future attractiveness ever recorded in these studies, and 15% of inward investors in the UK saying they have put their investment plans on hold since the EU referendum.

That said, our perception study finds there's no immediate crisis: only 6% of investors are currently intending to relocate operations to Europe, and the proportion planning further investments in the UK has declined only marginally. The UK still has a window of opportunity in which it can build on its proven strengths by implementing responses aimed at maintaining its long-term attractiveness to FDI. In this report, we suggest a set of policy steps to help to achieve this, as the UK develops its new post-EU economic identity. We at EY look forward to supporting and participating in that renewal.

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Executive summary

The UK attracted 13% less FDI projects in 2018 compared to 2017, with total projects falling from 1,205 to 1,054



A challenging market for FDI ...

Twelve months ago, we identified the dual challenges being posed by the move toward Brexit and technological change for foreign direct investment (FDI) into the UK but also that the country appeared to be coping. A year on, it is very clear that the market has become tougher, and the UK is having to work hard to overcome the changes in perception of the UK's attractiveness. The UK has lost ground in Europe as concerns over the impact of Brexit have reduced the UK's appeal as a destination for FDI. There is time to act, only 6% of investors intend to move assets out of the UK in future but an urgent response is needed to avoid a further weakening of its position in the coming years.

... but the UK remains Europe's leading FDI destination in 2018 ...

The numbers paint a very clear picture. The UK remained the number one destination in Europe for FDI but attracted 13% less FDI projects compared to 2017, with total projects falling from 1,205 to 1,054. While the European market for FDI also fell, shrinking by 4%, as projects into Germany also fell by 13%, largely due to a slump in business services investment, when we exclude Germany and the UK, the European market was flat year-on-year. By contrast, projects into France increased by 1% from 1,019 to 1,027 and so France moved above Germany to be ranked second in Europe for FDI projects.

... but with a loss of market share ...

The UK's much greater decline than the market meant that its market share of all FDI projects secured in Europe fell slightly from 18% to 17%, having been at 21% as recently as 2015. This is the lowest share achieved by the UK in the two decades we have been tracking FDI flows.

... and a similar story in the digital sector ...

Last year we identified the first signs of a challenge to the UK's leadership of the digital sector in Europe, with the UK's 27% growth lagging market growth of 33%. We were right to be concerned: the digital sector in Europe grew by 5% in 2018, despite a declining overall FDI market, but the UK's share fell four points to 23% as project numbers fell 10% from 320 to 288. The UK remains the market leader, but action is required to restore the UK's competitiveness.

... as Brexit impacts the UK's appeal ...

The results of our survey of over 400 investors together with the analysis of project flows in Europe show that FDI into the UK has been impacted by the Brexit process. When asked how their investment activity in the UK has changed since the referendum on EU membership, 5% of investors said they had reduced their investment and 5% of investors said they had increased their investment, but this relative balance does not offset the impact on FDI of the 15% of investors who have put their plans on hold. This represents a near doubling from the 8% of investors last year who told us they had paused activity. This investment is still available to capture but will require engagement with investors to address their concerns.

... with variations across project types ...

The most significant falls in UK FDI in 2018 were in manufacturing (projects down 35% in 2018 against market decline of 6%), HQ projects with a 50% decline to a level one-third of that in 2015, automotive (down 32% in a market that grew by 1%), R&D projects (down 26% against 15% growth) and chemicals (down three times the level of market decline) clearly demonstrating that Brexit is impacting the UK relatively more than Europe. Investors in these sectors are worried about future customs and tariffing arrangements and the availability of skills.

... and within the UK ...

The performance of the UK's regions was very different in 2018 to that of 2017, with much greater variation across the country compared to the national picture. The South East, Wales and the East Midlands all experienced a fall in volumes of only single digit percentages. Northern Ireland bounced back from a weak 2017 with 74% growth and London was almost flat with a 0.2% decline in project numbers.

The rest of the country saw significant declines in project volumes with the weak performance of manufacturing hitting the northern and western most regions of England. While experiencing falls in project numbers, Scotland and the West Midlands had relatively small falls compared to other regions, with the latter performing strongly in the digital sector.

Digital sector in Europe grew by 5% in Europe in 2018 but the UK’s share fell by four points to 23% as project numbers fell 10% from 320 to 288.

The relatively strong performance of London and the South East suggests that attempts to rebalance the UK geographically may be harder to realize if manufacturing FDI remains under pressure. This concern over geographic imbalances becomes greater when we consider the results across the UK’s cities and towns. While Leeds, Glasgow and Reading had strong years, other cities saw project numbers fall, reflecting relative sector strengths in part. However, the most worrying geographic data is that while projects in the UK’s 12 core cities fell by 3% in 2018 and by 10% when we exclude London, the decline in the rest of the country was 23%. FDI is behaving similarly to other forms of investment with lower growth outside of the UK’s major cities.

... as investors from fast-growth regions become nervous ...

The shifts in the sources of the UK’s FDI also merit consideration. While the UK continued to be the leading destination in Europe for investment from the US, it performed relatively poorly with most other major FDI source countries with a 13% fall in investment from the rest of Europe. Most striking was the fall of 65% in projects from China between 2017 and 2018, compared to a 4% fall across Europe, there was a significant albeit lower decline of 24% in Japanese projects, but this was in line with a market decline. The UK also saw a fall to 150 projects from the Commonwealth compared to 192 in 2017.

These results are consistent with the results of our investor survey. Asian investors are nearly three times more likely than US investors to have reduced their investment, and both Asian and West European investors are more than 10% more likely than average to have paused projects since the Brexit referendum vote. It seems clear that the UK is finding it difficult to convince international investors of its potential as uncertainty casts a shadow over decision-making.

... although UK businesses have increased their commitment to Europe.

We highlighted the geographic shift in UK FDI in 2017 with the 35% increase in UK outbound projects over 2016, the highest-ever UK outflow. This trend continued in 2018 with a new record level of 480 outbound investments. Since the referendum in 2016, UK outbound HQ projects have increased almost fourfold, digital, financial services and

research and development (R&D) flows out of the UK have more than doubled, and there were 79 outbound manufacturing projects in 2018 compared to 43 in 2016. With UK business investment falling by 2.5% in 2018, the FDI data shows that UK businesses and investors are reacting to the change in the UK’s relationship with the EU by allocating capital to Europe to future-proof their businesses.

Investor perceptions point to short-term stability ...

Our survey of perceptions among global investors reveals a split between their immediate plans and future expectations. On the positive front, the proportion of investors planning to establish or expand operations in the UK over the coming year is 23% in our 2018 study, the equal lowest score over the last decade but only slightly down on the 24% recorded last year. And, while this level is below the 27% average across Europe, as Europe’s comparable level was 35% last year, declines on this measure right across Europe mean that the UK is relatively closer to the European average ranking suggesting that the UK is unlikely to lose significant market share over the next 12 months.

... but longer-term sentiment remains negative ...

However, the perception survey responses also contain some very potentially worrying indicators for the future attractiveness of the UK for FDI. Our survey found that 42% of investors expect the UK’s attractiveness for FDI to decline over the coming three years, while only 26% expect it to improve. The resulting net negative intention of 16% is the worst-ever result in the decade we have been running our annual survey and is significantly worse than both the long-term average and the high point of 2013 when 65% of investors had a net positive three-year view of the UK.

... as the UK’s attractiveness ranking has shifted downwards.

The UK’s FDI performance in 2018 reflects a changed investor view of the UK’s attractiveness. Sentiment toward the UK weakened after the referendum vote and, while there has been some recovery in investor perceptions of the attractiveness of the UK on a range of attributes since the immediate post-referendum period, current perceptions are still significantly lower than the pre-referendum levels on 12 of the 13 attributes we have tracked for at least five years (the exception is the cost and availability of real estate which is at its 2016 level).



42% of investors expect the UK’s attractiveness for FDI to decline over the coming three years, while only 26% expect it to improve.

In this context, it is unsurprising that access to the European market is nearly a quarter down on its best ranking, but it is worth noting just how far investor perceptions of the stability of the social climate have fallen (from its best-ever rating of 86% positive to 61%), while views on the stability and transparency of the political, legal and regulatory environment have slumped to 53% compared to the high point of 86%. In addition, perceptions of the quality of UK education, infrastructure and labor skills are all at least 10% and often 20% below their best-ever levels, confirming that on both soft and hard attributes, the UK’s attractiveness to investors has fallen dramatically over the last five years.

Businesses remain committed to the UK ...

In this challenging environment, one piece of good news is that only 6% of investors indicated that they expect to move assets out of the UK in the next three years, although the sentiment varied significantly across sectors, with 15% of Asian investors and 8% of manufacturers and chemicals companies indicating that they were likely to move assets. It is welcome news to find that investors in the UK remain relatively committed to their existing operations, but policymakers need to move quickly to ensure that the UK does not continue to lose out on new capital flows into the country.

... but there are clear priorities for economic policy ...

The responses to our survey serve to identify the key issues that investors are worried about. There has been a slight shift in emphasis since 2017. As was the case last year, concern was relatively evenly split between future trade policy (including access to the European market, the risk of complex customs processes, and the possibility of tariffs on European trade), and labor issues (such as skills availability and migration), but this year customs compliance costs and the risks of supply chain disruption have risen sharply in importance for investors. Concern over migration and the impact on skilled and unskilled labor availability also remain significant concerns.

... for the domestic economy ...

The domestic priorities that investors identify are infrastructure and skills. 59% of investors identified some form of transport infrastructure as a priority but social infrastructure, such as housing, health and education, is also seen as important. Additionally, 32% of investors identify improvement in skills in the UK as a priority, the second-highest score. These results also reflect the importance that investors

attribute to skills and infrastructure as drivers for investment in regional locations. There is also scope to appeal to investors with improvements in corporate taxation, support and incentives for foreign investors and reductions in the regulatory burden.

... and for the digital sector ...

According to investors, just as they said in 2018, the UK’s top three digital priorities should be enhancing investments in digital technologies and infrastructure; investing in digital R&D; and enhancing workforce skills. This year public support to foster the digital ecosystem and to guarantee cybersecurity has joined these three priorities. After a year in which the UK saw a decline in its share of digital FDI, it is time to act on these clear and consistent messages from investors.

... to drive the transition to life after Brexit.

The UK’s FDI performance declined in 2018 partly because, unlike in 2017, the digital sector did not provide as much growth as previously and so did not fully compensate for falls in sectors and activity most exposed to the impact of Brexit. This, together with the decline in the FDI flows from countries outside of the EU, shows the UK has more to do to drive the change necessary to ensure that the UK remains an attractive FDI destination after Brexit.

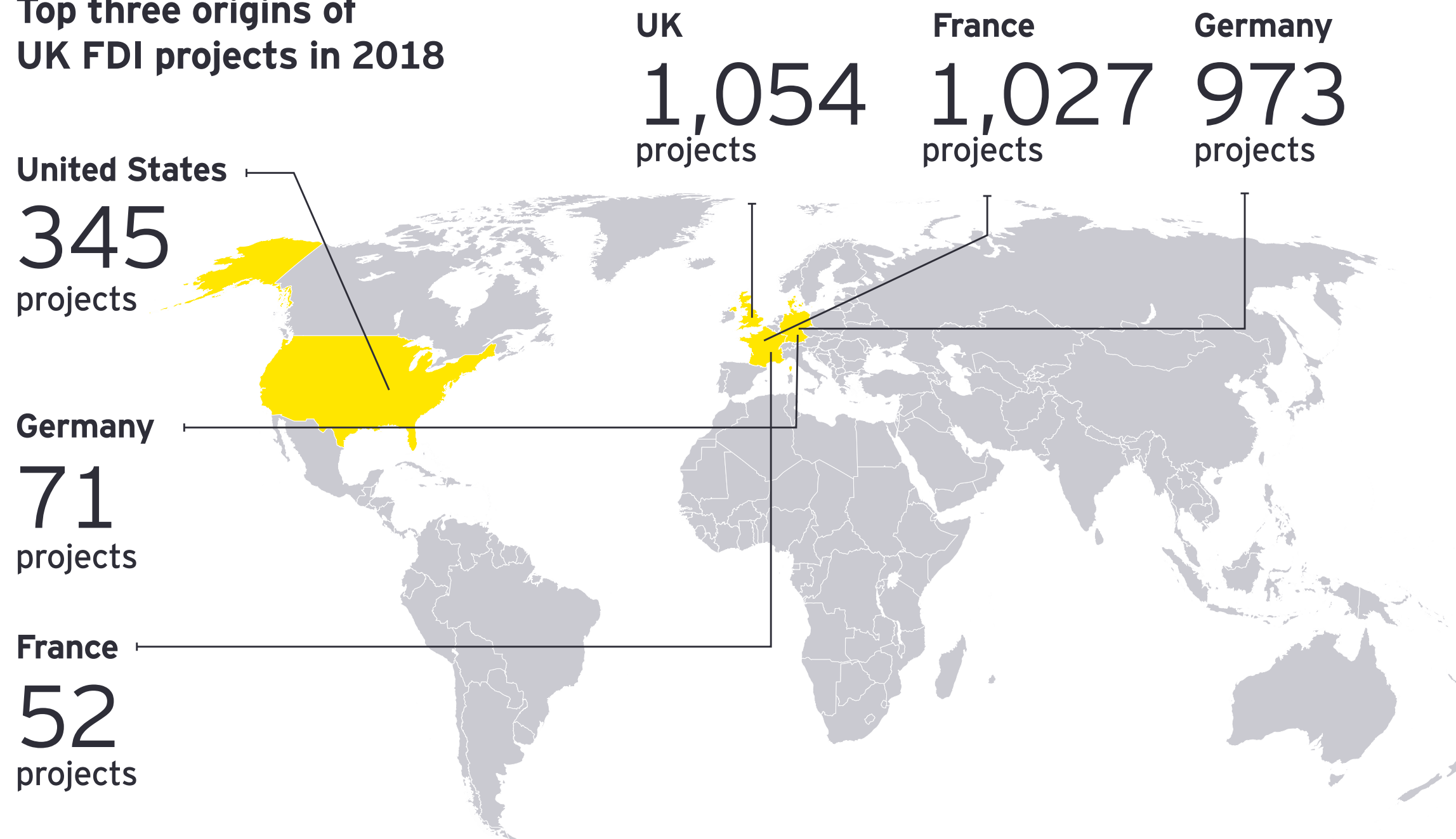
The evidence presented in this report suggests that the UK will risk missing out on growth in the next few years and could grow more slowly than Europe. But the good news is that investors are not rushing to leave the UK but are waiting to see how the situation develops. Our research has demonstrated that investors are clear on which issues need addressing, and policymakers need to engage with businesses and investors to identify the policy responses that will shape the UK’s approach to Brexit, to domestic policy – nationally and by place – and to digital. The challenge is to lead the transformation and drive toward a successful outcome for the UK.

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Executive summary

UK remains Europe's leading FDI destination in 2018 ...

Top three origins of UK FDI projects in 2018



Investors from fast-growth regions are nervous

65% ↓

Fall of 65% in projects from China between 2017 and 2018

4% ↓

compared to a 4% fall across Europe

... with a loss of European market share and a similar story in the digital sector ...

5% ↑

Digital sector in Europe grew by 5% in 2018

4% ↓

The UK's European share in digital fell by four points to 23%

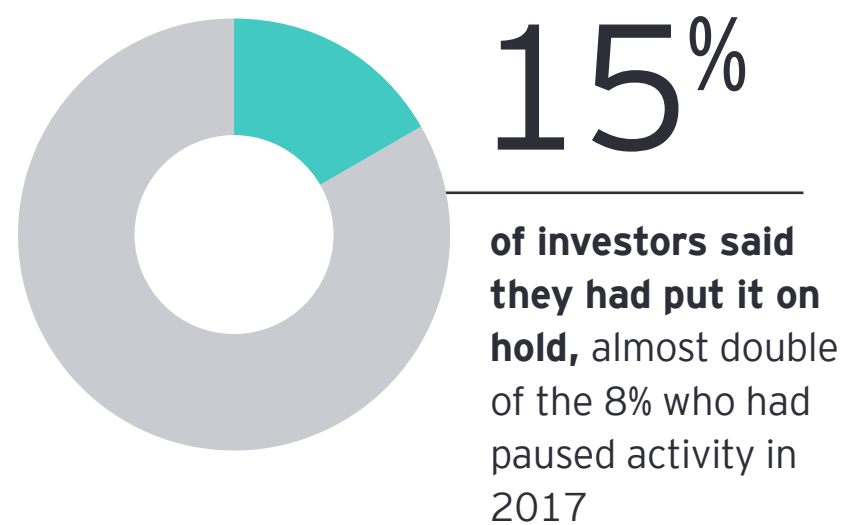
10% ↓

UK digital projects fell 10% from 320 to 288

Executive summary

... as Brexit impacts the UK's appeal with variations across project types ...

When asked how their investment has changed since the referendum,



The fall in UK FDI in areas seen by investors as likely to be negatively impacted by Brexit such as ...

35% ↓

manufacturing (projects down 35% in 2018 against market decline of 6%)

50% ↓

a 50% decline in **HQ** projects to a level one-third of that in 2015

32% ↓

automotive (down 32% in a market that grew by 1%)

17% ↓

R&D projects (down 17% against 15% growth)

3x ↓

and **chemicals** (down three times the level of market decline)

... clearly demonstrate that Brexit is impacting the UK relatively more than Europe

... and within the UK

3% ↓

While projects in the UK's 12 core cities fell by 3% in 2018 and by 10% when we exclude London ...

23% ↓

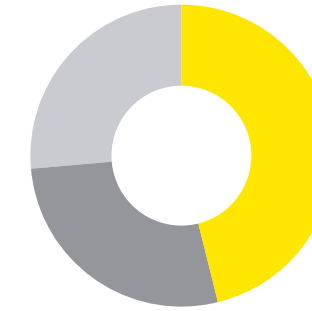
... the decline in the rest of the country was 23%

Top three UK regions for FDI in 2018 (number of projects)



458
Greater London
94
Scotland
89
South East England

Top three UK cities for FDI outside of London in 2018 (number of projects)



37
Manchester
22
Birmingham
21
Leeds

Executive summary

Investor perceptions point to short-term stability but longer-term sentiment remains negative

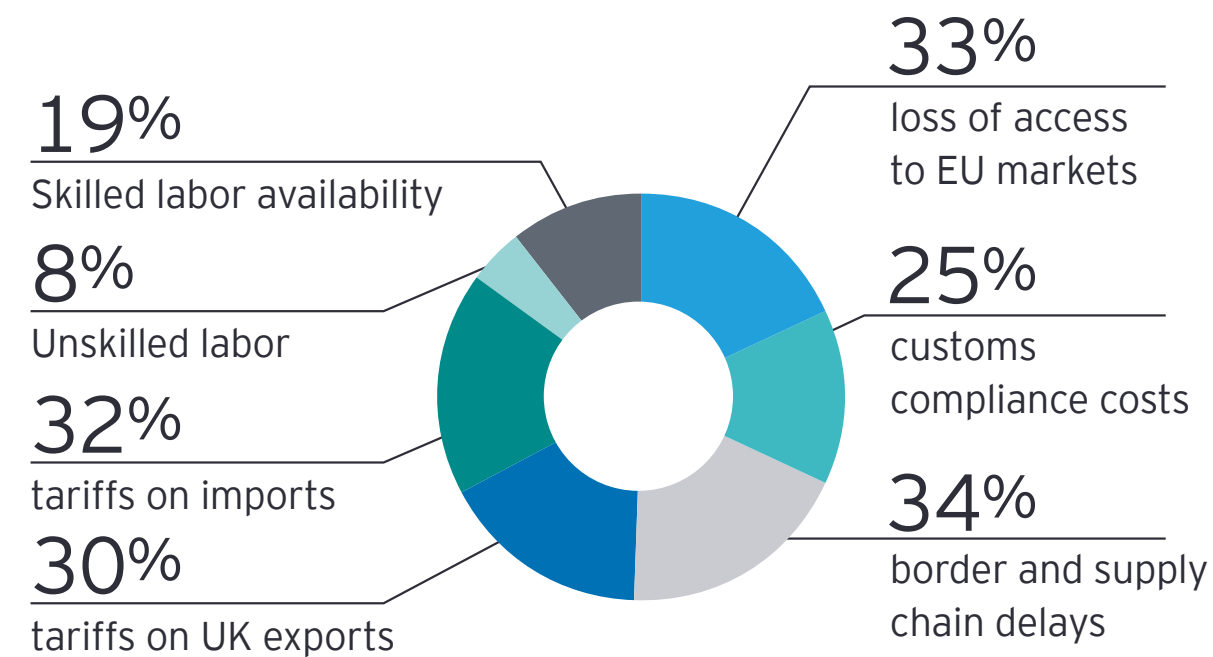


23% of investors plan to establish or expand operations in the UK over the coming year and only 6% of investors in the UK indicated they expect to move assets out of the country in the next three years



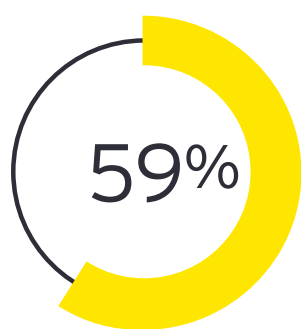
42% of investors expect the UK's attractiveness to decline over the next three years, while only 26% expect it to improve

There are clear priorities for Brexit policy ...

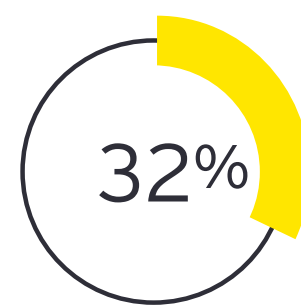


Access to the EU, tariffs and customs are the standout issues for investors whereas concerns over migration and the impact on **skilled and unskilled labor availability** are less-pressing concerns

... for the domestic economy ...



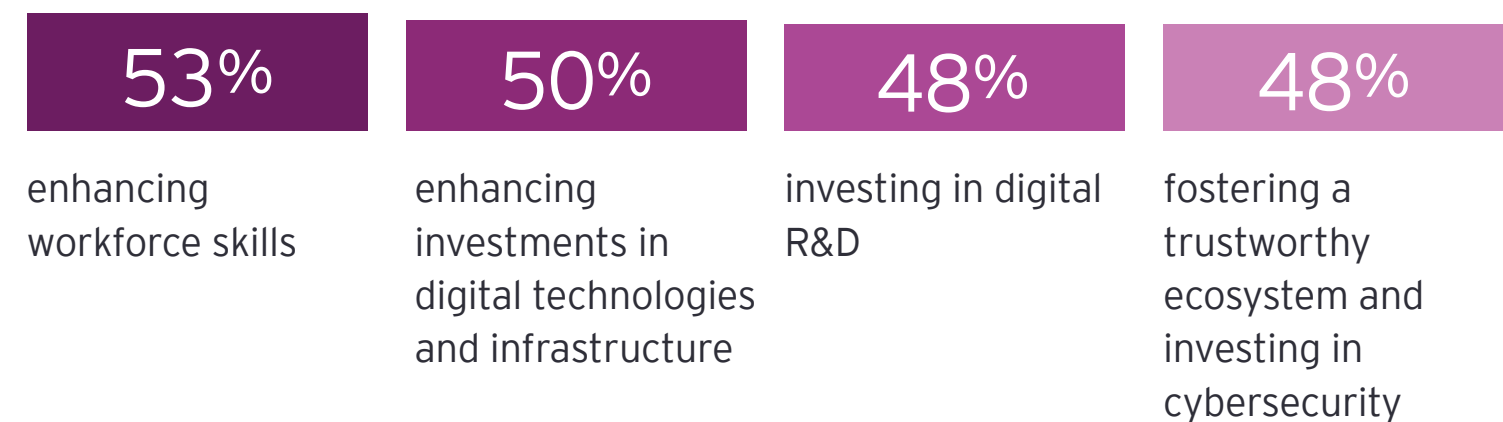
59% of investors identified transport infrastructure as a priority but social infrastructure (housing, health and education) also seen as important



32% of investors identify improvement in skills in the UK as a priority

... and for the digital sector

According to investors, the UK's top digital priorities should be



1

Achieving a successful transformation

Investors are clear that the priorities should be enhancing and broadening digital skills, building better digital infrastructure — both fixed and wireless — improving support for the digital ecosystem and cybersecurity, and providing funding for digital R&D.

1

Rebuild the UK's reputation

In our report last year, we identified the need to rebuild the UK's reputation as a priority action for Government. There has been little progress as yet. Our survey findings highlight that investor perceptions of the degree of stability in the social climate and the transparency and predictability of politics and law have fallen further. There is a need to rebuild investor confidence by demonstrating clear leadership and wider engagement of the whole country in the policy decision-making process while at the same time engaging with investors to articulate a coherent vision for UK economy and society.

2

Define the UK's future trading relationship with the EU

Our analysis identifies that the Brexit process had a negative impact on the UK's FDI performance in 2018. The UK lost market share largely due to poor performance in sectors likely to be impacted by Brexit, and among investors from countries both inside and outside the EU concerned about the impact of Brexit on future trading relationships. The UK must develop and articulate clearly its vision for its future trading relationship with the EU and the plan to implement this. This should include details of the objectives for future customs arrangements, the approach to tariffs and access to the single market. While investors recognize that there will be changes during the negotiations, the current lack of any broad direction is deterring investment.

Transport infrastructure and skills are priority areas for investment and these should be supported by moves to incentivize capital investment, to provide more support to foreign investors and to reduce the regulatory burden on business. In addition, social infrastructure (housing, education, health etc.) is viewed as important and should be incorporated into the plans.

The Industrial Strategy offers the opportunity to balance geographic activity by using knowledge of sectors and places to drive decisions on resource allocation. The key requirement is for a shift to a bottom-up approach and away from the current top-down national and city/region-led plans so as to think about opportunities and needs at a local level and then aggregate these to create regional and then national-level plans to drive the Industrial Strategy.

3

Relaunch the UK Industrial Strategy with place at the core

Brexit and technological developments are changing the UK economy and without a strategic response there is a risk that the UK could miss out on growth opportunities. The UK has set out a strategic intent with four 'Grand Challenges' (life sciences and health, automotive, energy and digital). And this provides the basis for a framework to structure future policy. Investors are clear on the areas requiring improvement and the Industrial Strategy provides the framework to use to allocate resources.

4

Strengthen the UK's digital offer

Alongside the Industrial Strategy there is an opportunity to improve the UK's approach to the digital sector. Investors are clear that the priorities should be enhancing and broadening digital skills, building better digital infrastructure – both fixed and wireless – improving support for the digital ecosystem and cybersecurity, and providing funding for digital R&D. Investors believe there is also an opportunity for Government to use digital technologies to modernize the public sector. The UK starts from a leadership position in the digital sector, and investor responses to our survey highlight the strength of the opportunity. However, the UK lost ground in Europe in 2018 and needs to embrace the requirements of investors in digital across all the areas identified.



Reality



The UK's FDI performance in 2018

Still in the lead ...

During 2018, the UK retained its leadership position in Europe as the number one destination for FDI projects, despite a 13% decline in the number of projects attracted. Meanwhile, France increased its number of projects secured by 1%, enabling it to take second place by moving ahead of Germany, whose projects fell back by 13%, a similar proportion to the UK's.

... in a declining market ...

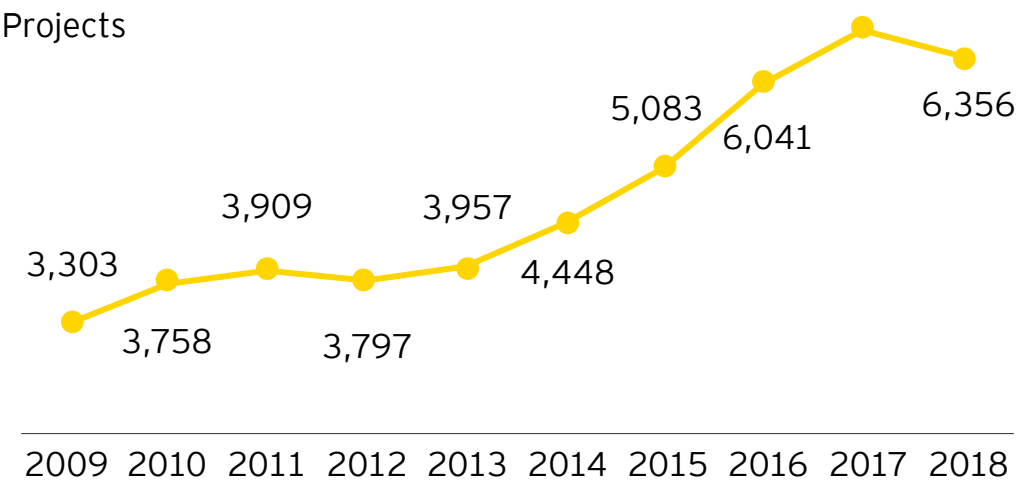
Total European projects also declined in 2018, ending a five-year period during which Europe's annual project numbers increased continuously year-on-year. The fall of 297 projects in Europe in 2018 compared to 2017, represented a drop of 4%, taking the total down to 6,356 projects.

With projects into the UK falling by 13%, and those into Germany down a whisker more, the overall fall in European projects in 2018 was primarily due to the performance of those two countries. When the UK and Germany are taken out, FDI project numbers into Europe were flat year-on-year. France's performance during 2018 mirrored this trend, suggesting specific issues with the appeal of the UK and Germany to investors rather than a Europe wide issue. Of Europe's five largest recipients of FDI in 2018, the remaining two – Spain and Belgium – both increased their numbers of projects recorded. Projects secured by Spain in 2018 rose by 32% to 314, and Belgium increased its projects by 29% to 278. Despite these relatively large increases in project numbers, Spain and Belgium both remained significantly behind the 'big three' of the UK, France and Germany in terms of total projects secured.



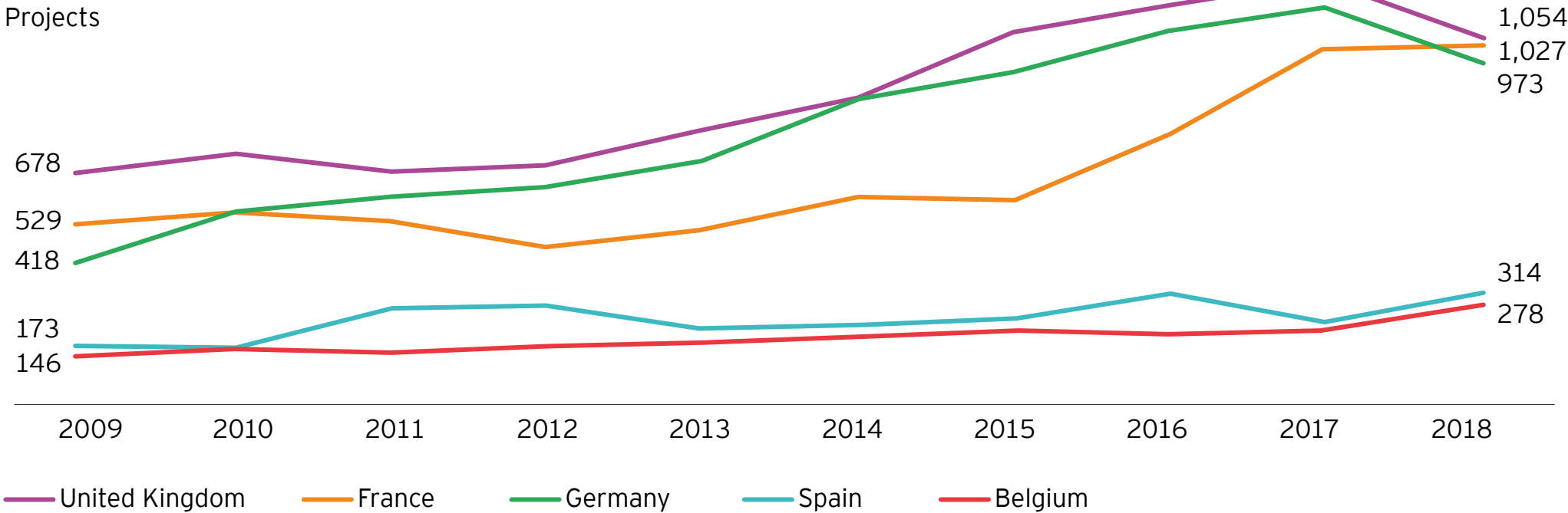
In addition to the strong performances of Spain and Belgium, Poland and Ireland also recorded significant increases in project numbers in 2018. Poland secured 75 more projects than in 2017 (a rise of 38%), while Ireland increased its project tally by 70 projects (a rise of 52%). With a 2% decline in projects secured by countries in Central and Eastern Europe suggesting little change in their attractiveness, the story of 2018 is the significant decline in the number of projects flowing into the UK and Germany, the two countries that have driven the huge growth in FDI coming to Europe over the last decade.

Total number of FDI projects into Europe
1997-2018



Source: EY European Investment Monitor (EIM), 2019

Top five recipients 2009-18 (projects)



Source: EY European Investment Monitor (EIM), 2019

#1 The UK

1,054
FDI projects

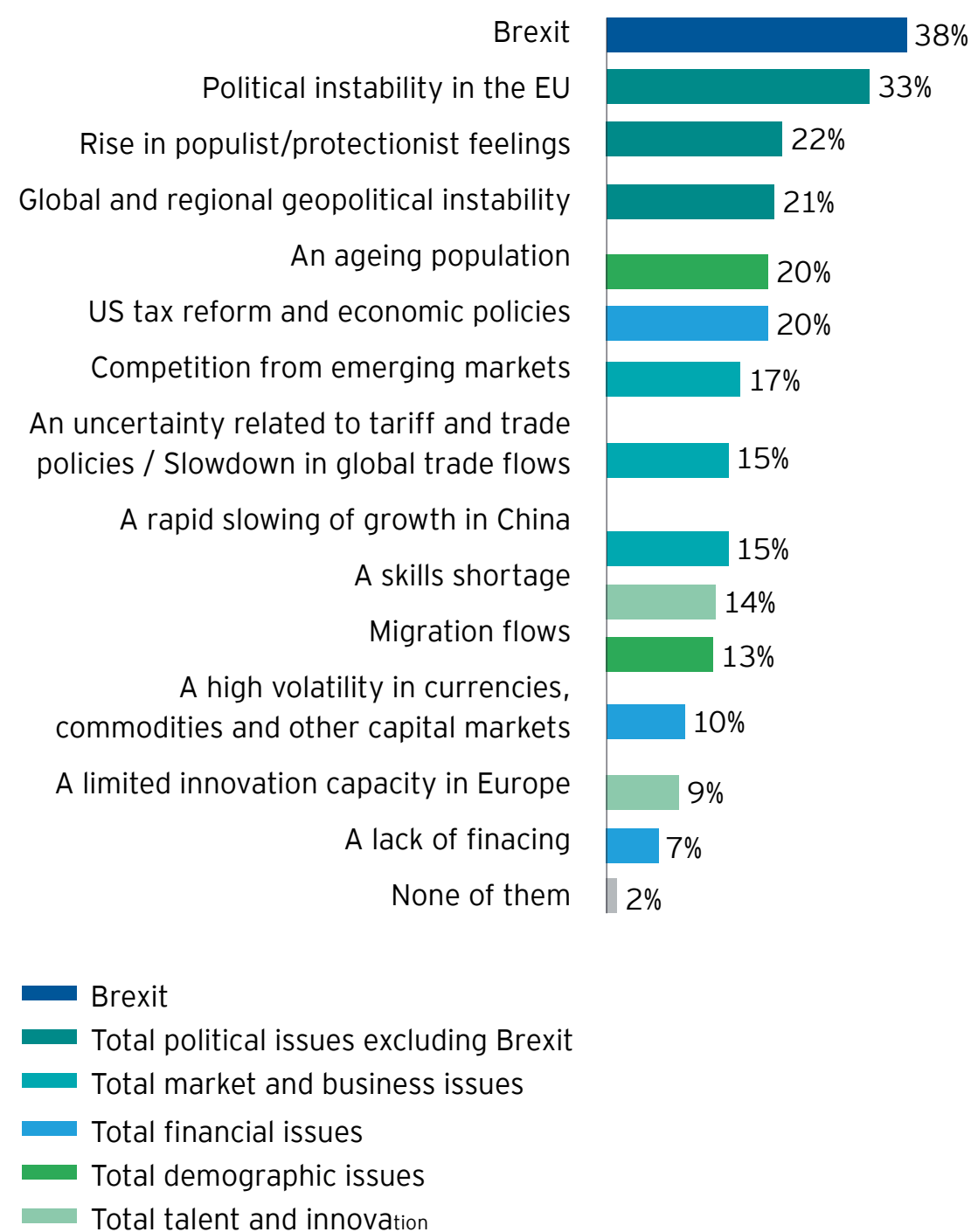
#2 France

1,027
FDI projects

#3 Germany

973
FDI projects

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



Source: EY Attractiveness Survey Europe, June 2019
(total respondents: 506)

... against a backdrop of political uncertainty ...

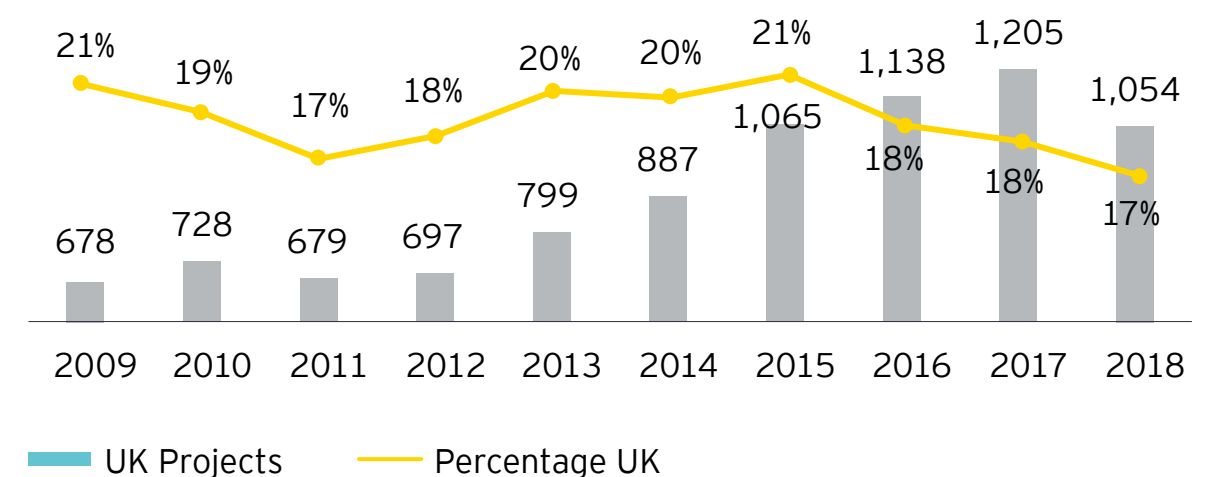
Looking at the wider environment, it is perhaps surprising that FDI project flows into Europe are not under more pressure. The ongoing challenges in the global economy provide an uncertain backdrop, especially when combined with a slowing of European economic growth in 2018 after a couple of good years. At the same time, our Europe wide survey of investors' views in 2019 suggests that the current political uncertainty is worrying investors – with Brexit and political instability in the EU topping their list of risks to Europe's attractiveness in the next three years.

... with the UK's loss of market share continuing ...

As mentioned above, one of the key factors in the decline in total European projects was a sharper decline in the number of projects recorded by the UK. UK projects were down from 1,205 in 2017 to 1,054 in 2018. This decline of 13% was eight percentage points deeper than that experienced across Europe on average resulting in a continuation of the decline in the UK's market share of all European FDI projects secured during the year.

In fact, the market share of 17% of European projects secured by the UK in 2018 represented the lowest market share the UK has achieved over the past two decades. It also means that the UK's share of European projects has now declined for three years in a row from a high point of 21% in 2015. In absolute terms, the number of UK projects secured in 2018 was the lowest since 2014, and the worst-ever UK performance relative to the European market.

UK projects recorded and UK project share 2009-18



Source: EY Attractiveness Survey UK, June 2019

... but declining for different reasons than Germany.

While Germany’s project numbers and European market share also fell in 2018, a closer look shows that there were different reasons for the declines in the UK and Germany. There were signs last year that Germany was hitting capacity constraints, with investors identifying that labor supply shortages were emerging. The German decline in 2018 was driven by a handful of specific sectors, with R&D projects down by 21% and headquarter (HQ) projects down by 16%. By contrast, the UK saw declines in FDI projects across a wider range of areas, with manufacturing plants down 35%, HQs halving from 98 to 48, and R&D projects down by 17%.

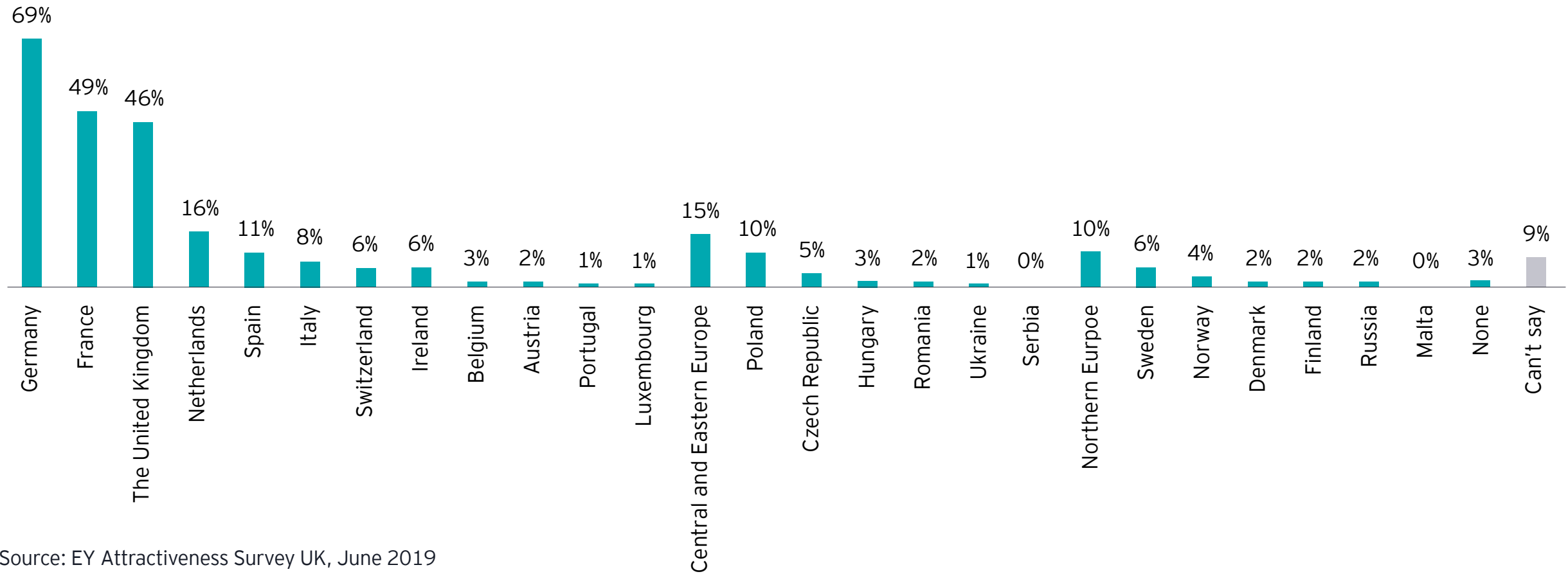
However, with business services FDI projects into Germany slumping by 42% – accounting for 63% of the overall decline in business services investments across Europe – it is clear what the major issue is behind the decline in German FDI in 2018. Investors from the business services

sector were much less positive about Germany than survey respondents overall. Only 17% of investors from business services identified Germany as the number one location for FDI in Europe compared to 34% of investors overall. There were no other significant sector variations which suggests that specific issues with business services are impacting Germany’s FDI performance.

Perceptions of the UK as an FDI location appear to have weakened ...

The relative decline in UK projects in 2018 is consistent with the findings of our 2019 survey of investors’ perceptions. The UK’s overall attractiveness has declined relative to its competitors in Europe. Asked to name their top three countries for FDI in Europe, investors put Germany first at 69%, up by 3% from last year. Behind Germany, France fell seven percentage points to retain second place with 49%, while the UK remained in third place, falling by six percentage points to 46%.

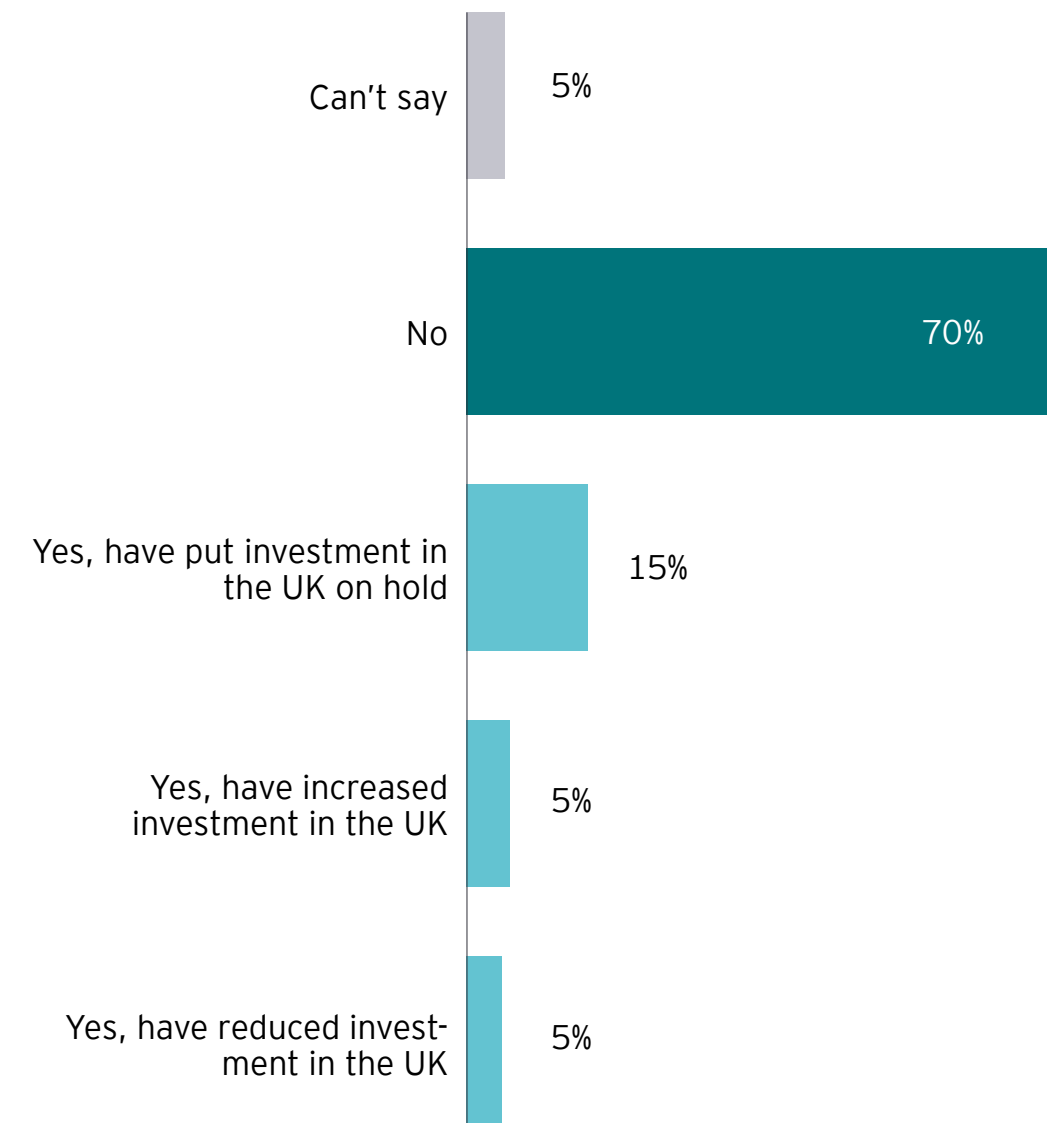
Which is the most attractive country for FDI in Europe?



... and Brexit is a factor ...

It is clear that the move towards Brexit has had an impact on FDI in the UK. Our research shows that 15% of investors say they have paused one or more UK projects due to Brexit, up from 8% last year. Five per cent of investors say they have increased investment in the UK, compared to 7% last year, and 5% have reduced it compared to 6% a year ago. The 15% of investors pausing investment is a key factor explaining the 13% decline in UK projects compared to a flat market across the rest of Europe excluding Germany.

Have you changed your UK investment plans as a result of Brexit?



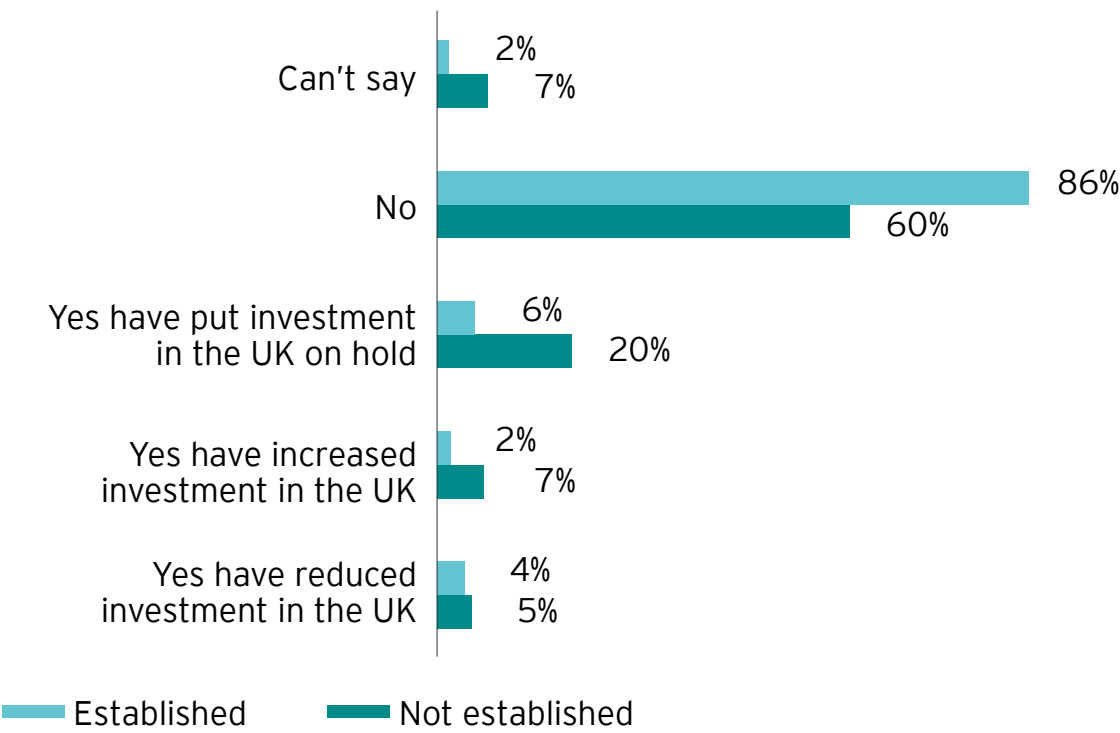
Source: EY Attractiveness Survey UK, June 2019

... triggering pauses in projects – especially from Western Europe and Asia, and in technology.

The higher incidence of paused projects appears to explain the fall in UK FDI activity. There are also some interesting differences in terms of the regional origins and sectors of the companies pausing UK investments. Some 17% of Western European and Asian investors say they have paused a project compared to only 11% of investors from the US. And while 8% of Asian investors say they have reduced investment, only 3% of US investors say the same.

Turning to sectors, 24% of technology investors have put projects on hold. By contrast, only 12% of business services investors have paused activity – while 11% have increased their investment activity and 3% have reduced projects. Among other industries, 9% of manufacturers and 11% of chemicals companies say they have reduced investment. Considered overall, sectors likely to be faced with potential future challenges after Brexit in the movement of people or customs processes or regulatory differences with the EU feature heavily in the list of those experiencing a fall in UK FDI in 2018.

Have you changed your UK investment plans as a result of Brexit?



Source: EY Attractiveness Survey UK, June 2019

#1 Greater London

458
FDI projects

#2 Scotland

94
FDI projects

#3 South East England

89
FDI projects

FDI in the UK regions: a complete reversal of the map from 2017 ...

In terms of the UK's regions, the FDI project figures for 2018 tell a story of wide variations in performance. London, the South East, the East Midlands and Wales held firm, with their project numbers remaining close to flat compared to 2017. But the year also saw significant declines in projects across the rest of England, driven in large part by a fall in manufacturing projects. Meanwhile, Scotland retained its position as second most successful destination after London, a position it has held since 2014, although its project numbers declined to 94 in 2018 from 116 the previous year.

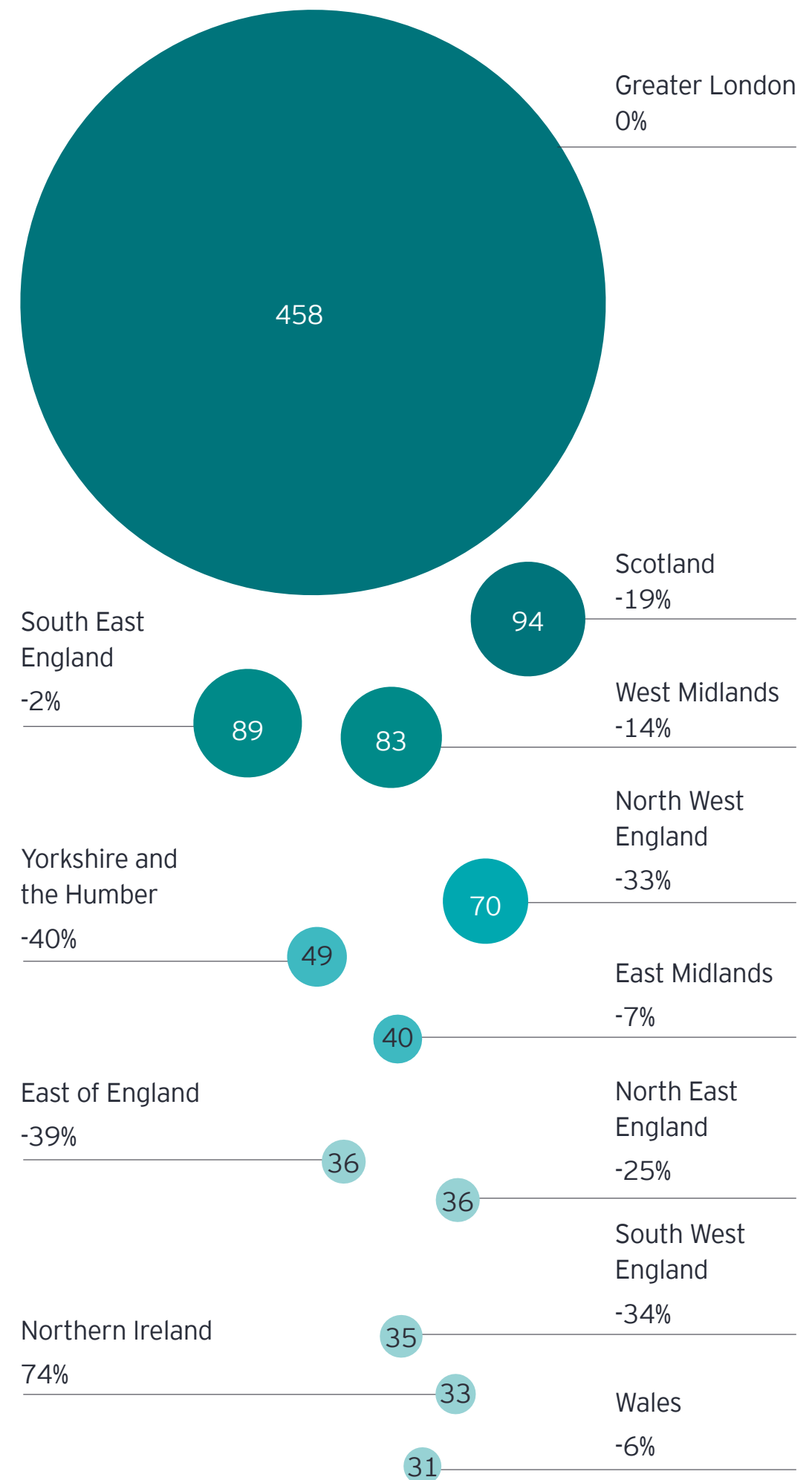
The only UK region to record an increase in FDI projects in 2018 when compared to 2017 was Northern Ireland. Its complement of 33 projects recorded in 2018 represented a 74% year-on-year increase. The surge in FDI projects in Northern Ireland during the year was largely driven by increased numbers of projects from the US and the Republic of Ireland.

Greater London also performed relatively strongly, recording virtually the same number of projects as in 2017. Taken together with the declines in all the other regions apart from Northern Ireland, this flat performance saw London increase its share of all UK projects to 43.5%. London benefitted from its strength in digital and business services FDI.

... as most regions suffer from the decline in manufacturing and expansion projects ...

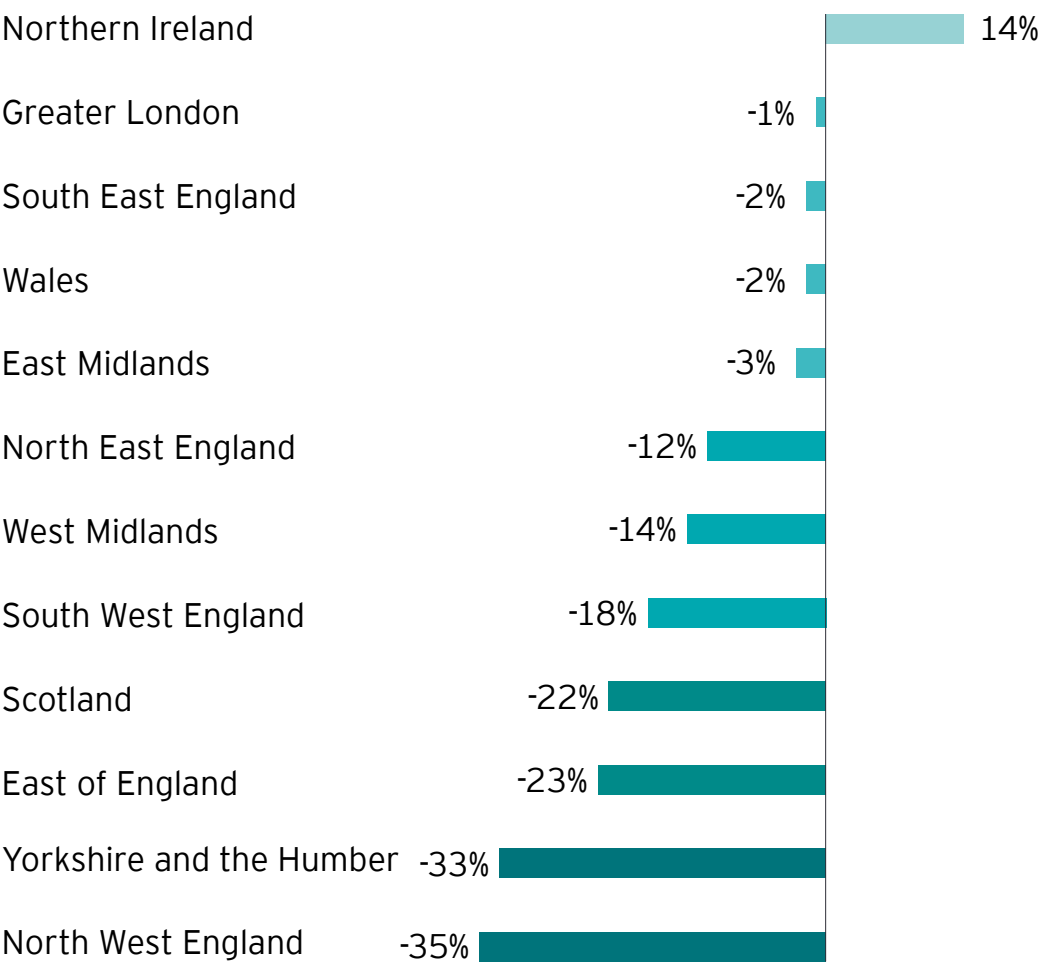
The decline in manufacturing projects in the UK, combined with the fall in reinvestments by existing investors, resulted in 2018 representing a year of reduced FDI activity for the remaining UK regions. Among these declines, the most notable falls included a reduction of 40% in projects in Yorkshire and the Humber – albeit after a strong performance in 2017 and set against an even bigger decline in absolute project numbers in the North West of England. Manufacturing projects in Yorkshire and the Humber were down by 63% from 2017 levels. The East of England also recorded a significant reduction in projects (by 39%), although in this case the decline was largely the result of a 50% reduction in the number of sales and marketing operation projects in the region.

UK FDI projects by region, 2018, and percentage change from 2017



Source: EY European Investment Monitor (EIM), 2019

Annual change in UK projects by region, 2017-18



Source: EY European Investment Monitor (EIM), 2019

... but UK cities fared better ...

Within the UK, it is interesting to look at how the leading FDI cities performed in 2018 compared to historical trends. While it is important not to read too much into one year’s numbers, the general theme that emerges is that cities remain strong and pivotal drivers of FDI activity in their respective regions, and that most put in performances in 2018 at levels close to their five-year average. Looking at the UK’s top 10 FDI cities, Newcastle and Coventry dropped out in 2018 due to the slowdown in manufacturing, as did Oxford due to a weaker flow of R&D and pharmaceuticals projects.

Overall, project numbers in London were flat during the year, while projects in the UK’s core cities were down 3% but, excluding London, projects into the other 11 core cities fell 10%, and the rest of the country was down by 23%. It seems that the hoped-for geographic

rebalancing of UK FDI projects has fallen victim to the general decline in UK projects, as investors appear to have responded to an uncertain outlook by favoring larger population centers.

These dynamics saw the UK’s core FDI cities generally improve their performance in 2018 in terms of securing projects even when the regions in which they are situated performed less strongly. Birmingham, Leeds, Belfast and Glasgow all increased their projects secured when compared to 2017, with – of these – only Belfast located in a region that posted a rise in projects. Manchester, despite recording a decline of 18% in its FDI projects, remained the number one city location for FDI outside London, a status it has now held in each of the past four years. In addition to the decline in projects recorded by Manchester, there were also falls in the projects secured by Edinburgh, Bristol and Cambridge in 2018.

To provide a longer-term context, in the ranking below we have compared the number of projects secured in 2018 to the five-year average for each city. On this measure the only cities – London excluded – performing above their longer-term trend during the year were Leeds, Glasgow, Reading and Cambridge.

Leading city project numbers 2014-18 (excluding London)

		Projects	Change 2017-18 (%)	Five year average projects
1	Manchester	37	-18	40
2	Birmingham	22	5	22
3	Leeds	21	11	20
4=	Belfast	20	100	18
4=	Edinburgh	20	-31	25
6	Glasgow	19	19	19
7	Reading	12	20	8
8=	Bristol	10	-23	11
8=	Cambridge	10	-27	9
10	Aberdeen	9	-36	12

Source: EY European Investment Monitor (EIM), 2019

Viewpoint

... leaving us with a clear message

The message appears to be all too clear. The UK has seen its absolute number of FDI projects fall, its market share of all European FDI shrink, and its future perceptions as an FDI location worsen – all coupled with a reversal of moves to rebalance FDI activity away from London.

While Germany also experienced a difficult year, the reasons behind this were different to those impacting the UK, centering around the business services sector. There is no doubt that the evidence suggests signs of a Brexit effect in the UK. Identifying the best route forward is a challenging undertaking. To map out the way ahead, we'll now move on to a more detailed analysis of the drivers – to understand in detail what has driven the outturn for the UK discussed above, as the basis for establishing what can be done to improve UK economic performance in the future.

Client viewpoint



Roger Marsh
OBE, Chair of the NP11 Board and Leeds City Region Enterprise Partnership (LEP)

The digital revolution in Leeds City Region - accelerating growth and attracting FDI

A digital revolution is underway in Leeds City Region. A fast-growing digital technology sector worth £6.6 billion to our economy, services international businesses and employs over 100,000 people.

The strength of this sector helps to attract new investment and opportunities to the region. International law firm, Reed Smith, is capitalizing on our digital strengths and adapting to future needs by locating their new tech hub in Leeds. Fintech is a significant strength and a growing opportunity in Leeds City Region - home to three of the five largest building societies who are looking to collaborate with scale ups.

This confidence from investors supports the region's reputation as the digital heartland of the UK.

Andrew Jenkinson, Partner at Reed Smith, said: "Leeds has a fantastic story to tell. It has the economic growth, job prospects, location, HS2, universities and the higher education establishments." "We want to create the next generation of lawyers and so we are focusing on tech and digital transformation and Leeds' reputation made it a very easy location choice for us."

Investor confidence is evident across the Leeds City Region. PWC recently opened a new office in Bradford city center and leading technology solutions business AND Digital opened a new operation in Halifax.

Highly successful Tech Hubs like Platform, continue to attract and support the expansion of digital technology businesses with

continued growth by Australian fintech, Sandstone Technology, the arrival of Estonian fintech scale up Fitek and US sports analytics business Hudl making Leeds their home - recognized as having the highest concentration of scale ups outside London.

Outside of foreign direct investment, Leeds City Region is still attracting high profile UK businesses. Channel 4 has confirmed that Leeds City Region will be the home to its new national HQ, enhancing an already powerful hub for screen, creative and digital talent. The already thriving creative and digital sector will benefit however the impact will be felt far wider, across our towns and cities, in infrastructure developments, skills and career opportunities. Our region's universities play a crucial role in producing almost 40,000 graduates annual and investing in the future of innovation and knowledge-based research.

Investment from North America continues to dominate and Leeds City Region is bucking the national trend in terms of FDI in the industrial and manufacturing sector. US company Avnet - owner of the electrical components business Premier Farnell - has shown renewed commitment to its operations in Leeds by taking the largest ever pre-let industrial development in the city at Logic Leeds at 326,000 square foot unit.

Leeds has the largest volume of office floorspace under construction recorded since 2007 with development now commencing on the South Bank - one of the largest regeneration schemes in Europe.

Bradford, the UK's sixth largest city is developing exciting plans to bring forward new grade A commercial office space at the heart of the center and York has ambitious plans for a mixed-use scheme connected to the station and East Coast mainline at York Central. It is clear that the thriving digital sector is a catalyst for delivering economic growth and a strong foundation on which to attract new investment, which in turn accelerates the digital revolution already underway.

3 Analysis

What is driving the UK's FDI performance and perceptions?

The UK's FDI performance deteriorated in 2018. In this section we analyze both the key drivers of the UK's FDI performance and perceptions among investors, with two aims in mind.

Firstly, to help us understand where the UK currently sits in terms of its attractiveness. And secondly, to enable us to identify the issues that will need to be addressed to give the UK the best chance of achieving continuing success in attracting FDI. We analyze FDI performance across sectors, types of project and the origins of FDI to create a comprehensive picture.

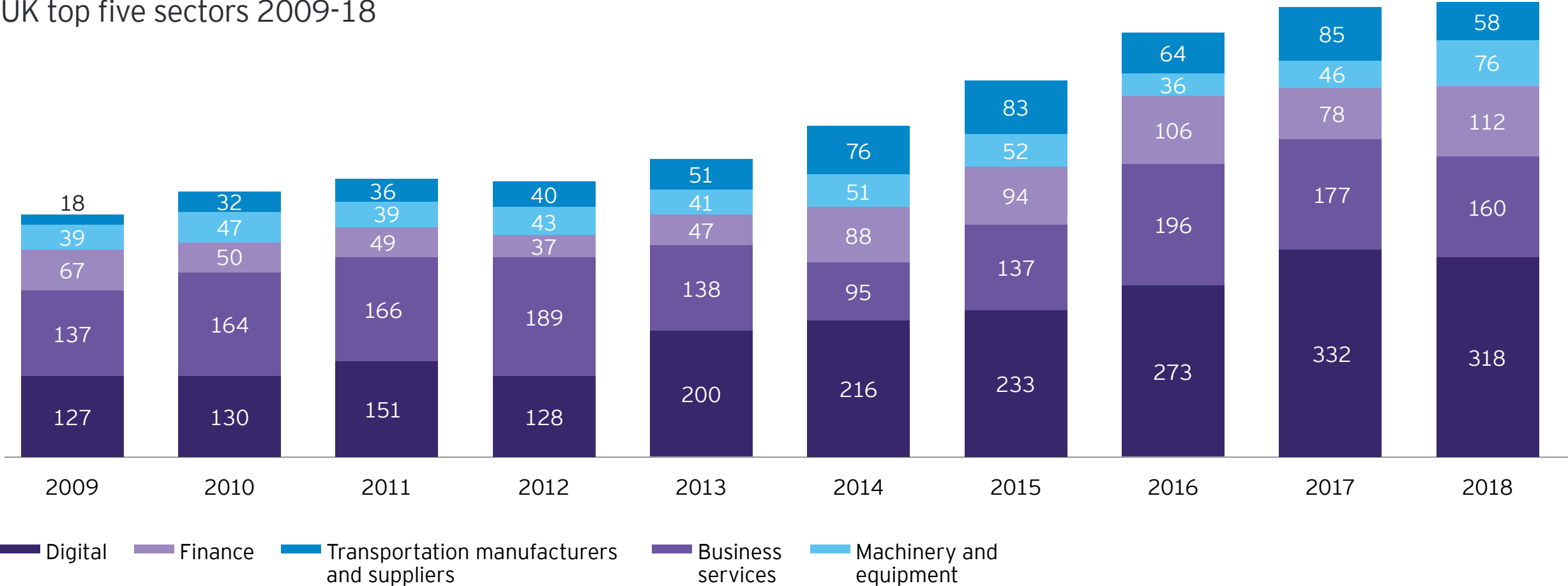
Wide variations in sector performance ...

A breakdown of FDI by sector in the UK in 2018 reveals that the sector generating the largest number of projects in the UK during the year was digital. This sector has held the leading position in the UK for the past six years, starting in 2013. In 2018, the number of digital FDI projects recorded in the UK fell by 4% to 318, partially reversing a rise of 23% in 2017. But despite this decline, digital projects still outstripped the second-placed sector – business services – by a wide margin, recording almost double the total number of projects contributed by business services. Business services projects also declined in 2018, falling by 10% to 160 projects recorded.

Finance projects represented the third-largest sector generating UK FDI in 2018. This meant that, in common with four of the past five years, the UK's three largest FDI sectors in 2018 were the service industry sectors of digital, business services and finance.

The other sector generating the largest increases in project numbers in 2018 was machinery and equipment, rising by 30 projects, representing an increase of 65% over 2017. The automotive sector took a big hit with project numbers falling from 85 to 58, a 32% decline.

UK top five sectors 2009-18



Source: EY European Investment Monitor (EIM), 2019

... as the UK loses ground in Europe ...

Turning to the top 10 sectors generating FDI projects across Europe, digital and business services remain the two leading sectors generating the largest number of projects, as in the UK. But finance – which ranks third in the UK – generates only the fifth largest number of projects at a European level. Transport equipment and machinery and equipment are the third and fourth largest FDI sectors, respectively, across Europe.

The UK is the leading country in securing FDI projects in the digital (24% share), business services (22% share) and finance (27% share) sectors. But for the remaining seven sectors in the top 10, the principle recipient is either France (five sectors) or Germany (two sectors). In those sectors where the UK is not the leading recipient, its lowest ranking among the destinations securing investment is in chemicals and plastic, where the UK is placed fourth behind France, Germany and Turkey.

Sector performance for leading sectors across Europe

	Leading sectors 2018	All European projects	Growth 2017-18 %	Leading country 2018	Market share	UK #
1	Digital	1,341	9	UK	24%	
2	Business services	741	-17	UK	22%	
3	Transportation manufacturers and suppliers	536	1	France	15%	3rd
4	Machinery and equipment	455	38	Germany	20%	2nd
5	Finance	416	22	UK	27%	
6	Agri-food business	399	10	France	18%	2nd
7	Transportation and logistics	385	-3	France	13%	3rd
8	Chemicals and plastic	351	-13	France	21%	4th
9	Electronics and IT	303	18	Germany	20%	2nd
10	Utility supply	180	-15	France	19%	2nd

Source: EY European Investment Monitor (EIM), 2019

A comparison with 2017 shows that the UK regained the lead in European business services FDI in 2018, but slipped down the rankings in pharmaceuticals (from second to third), automotive (also second to third), food (first to second), and chemicals (third to fourth).

... with possible concerns over digital ...

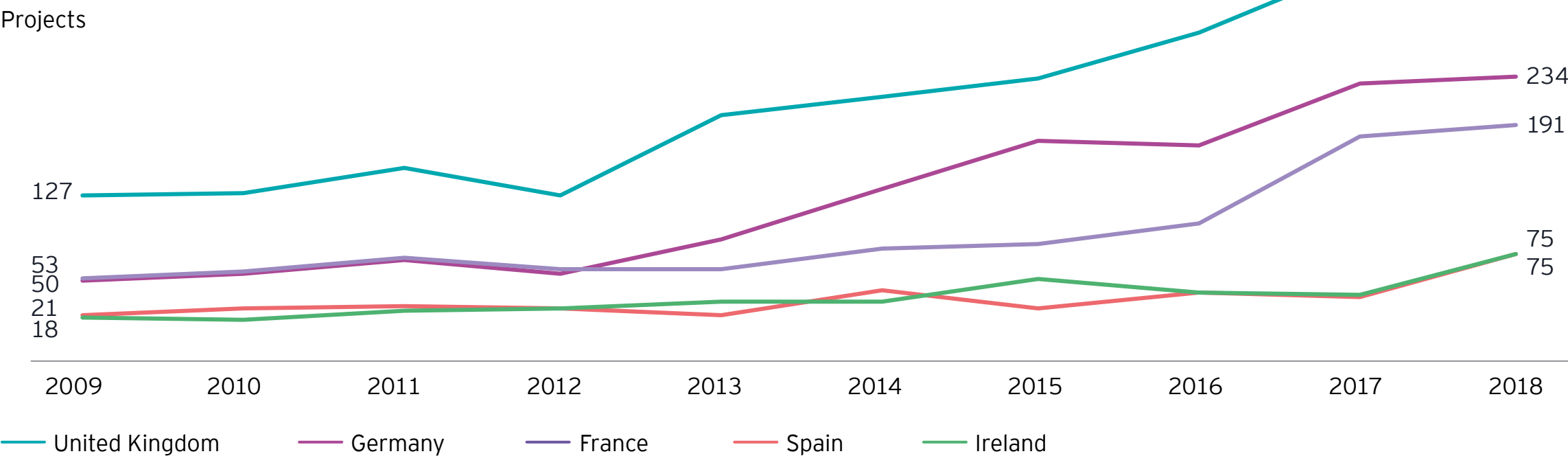
In terms of digital projects, Europe's largest FDI sector, there were 9% more projects recorded across Europe overall in 2018 than in 2017. The UK remained significantly ahead of Germany in terms of digital projects secured, but the gap narrowed slightly from 105 projects in 2017 to 84 in 2018. Worryingly, while the UK still leads Europe in attracting digital projects, it suffered falls in both project numbers and European market share in 2018. The 4% decline in the UK's digital projects in 2018 saw its market share of all European digital projects fall from 27% to 24% of the market, as digital projects across Europe grew by 8.9%. Significantly, this sector's projects increased in the other four largest destinations – Germany (up 3%), France (up 6%), Spain (up 108%), and Ireland (up 97%).



Despite a 10% decline in business services, the UK regained its position as the leading recipient by overtaking Germany which recorded a 42% decline in projects

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Destination of digital projects 2009-18 – Europe's leading five recipients

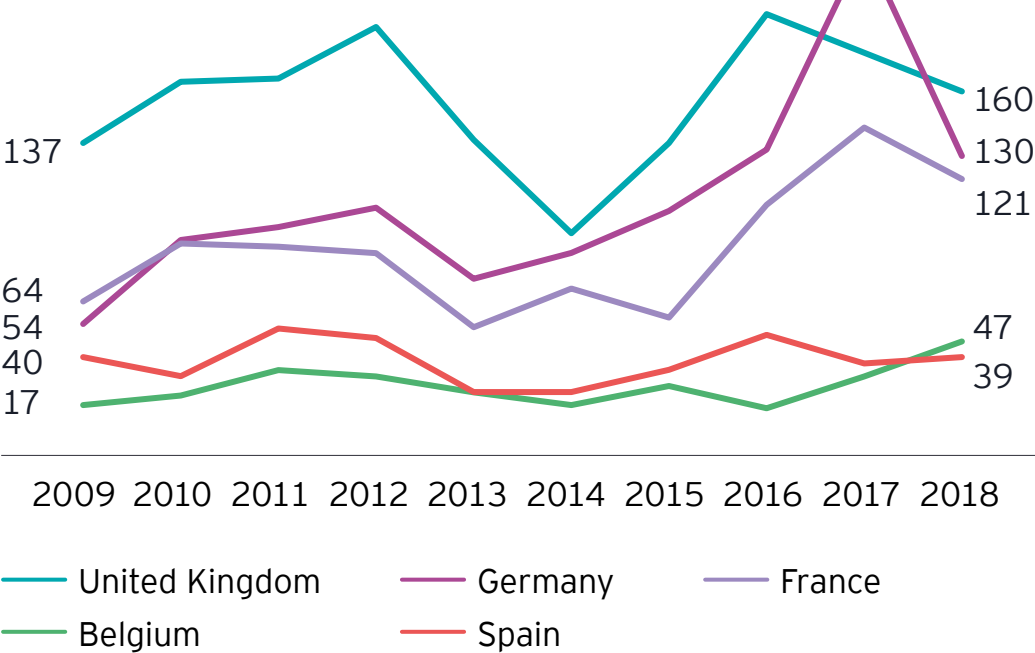


Source: EY European Investment Monitor (EIM), 2019

... pressure on business services ...

Investment in business services over 2017 and 2018 has also changed significantly, with overall projects across Europe declining by 17%. Within this European total, business services projects declined sharply in Germany, falling by 42%. And despite the UK also recording a decline in business services projects (of 10%), the UK regained its position as the leading recipient by overtaking Germany – which in 2017 had been the top European destination for business services projects for the first time in the past decade. Nevertheless, the number of business services investments in the UK has now declined for two years in succession, taking it from a high point of 196 projects in 2016 to 160 projects in 2018.

Destination of business services projects 2009-18 – Europe's leading five recipients



Source: EY European Investment Monitor (EIM), 2019

... and the emergence of a slowdown in manufacturing ...

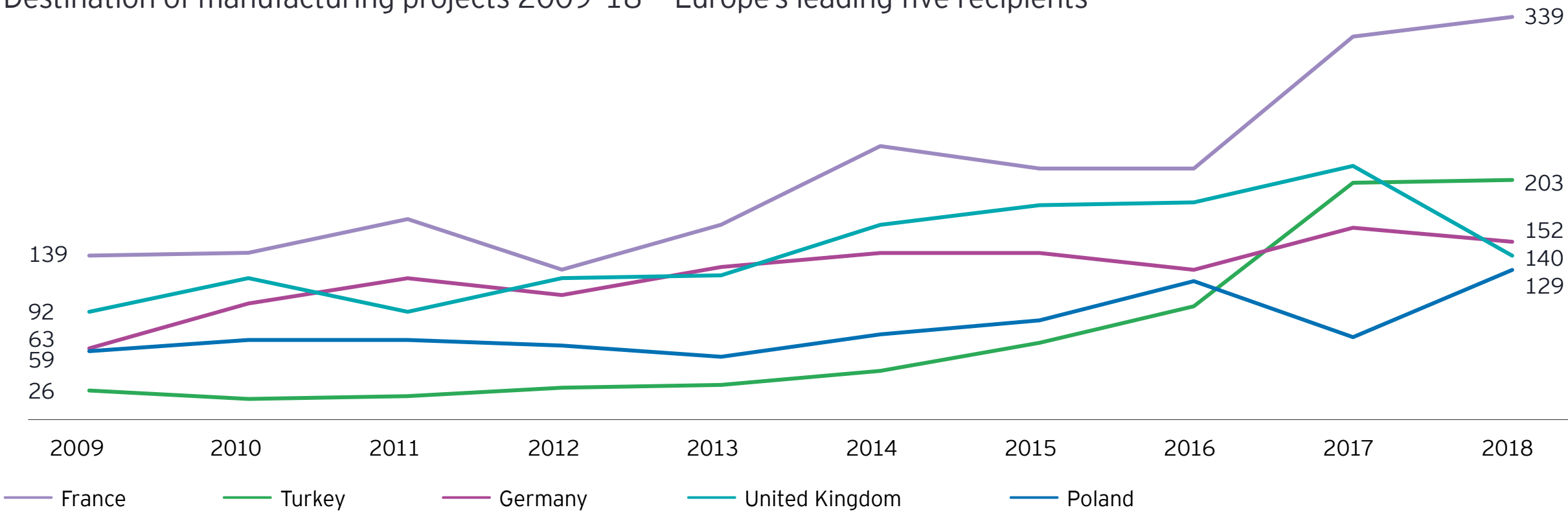
Looking at manufacturing FDI activity on the same basis, the UK is ranked as the fourth-largest recipient of projects across Europe, behind France, Turkey and Germany. Overall, manufacturing projects across Europe declined by 6%, from 1,982 projects recorded in 2017 to 1,869 in 2018. The manufacturing subsectors of food, automotive, pharmaceuticals, metals, and chemicals all saw declines, with machinery and equipment the only strong performer.

2018 was a poor year for UK manufacturing with a 35% decline in the number of investments in manufacturing facilities, breaking a six-year

run of increasing annual numbers of FDI projects attracted by the UK. The continuous year-on-year increases between 2012 and 2017 saw UK manufacturing projects rise from 120 to 216 projects, but the total of 140 projects secured in 2018 was the lowest number recorded since 2013.

The drop from 85 to 58 projects in automotive was the most concerning given its relative importance in the UK economy. The UK did secure 194 non-factory projects by manufacturers – up from 191 in 2017 – but the sector overall had a difficult year casting doubts on the potential ability of the UK’s Industrial Strategy to offset the impact of Brexit.

Destination of manufacturing projects 2009-18 – Europe’s leading five recipients



Source: EY European Investment Monitor (EIM), 2019

... reflecting differences identified in our survey of investors’ perceptions of the UK

The actual performances of the UK’s various FDI sectors in 2018 were consistent with the responses in our investor survey, which identified significant variations in sentiment between sectors. For example, we found that 24% of tech investors in the UK have put projects on hold,

as reflected by the decline in digital projects in 2018. By contrast, only 12% of UK business services investors have paused activity, while 11% have increased activity and 3% have reduced projects. Also, 9% of manufacturers and 11% of chemicals companies said they have reduced their investments.

UK FDI in HQ projects in 2018 fell from 95 projects to 48, a decline of almost 50%



A continuing decline in HQ investments ...

Turning to the types of FDI projects coming into the UK, the 2018 figures reveal a fall in UK FDI in headquarters (HQ) projects in 2018 from 95 projects to 48, a decline of almost 50% – much worse than the fall of 20% seen in the European market overall, from 370 projects to 296. HQ projects have now declined in the UK for three consecutive years. At 48 projects in 2018, the number is now less than one-third of that recorded at the high point of the past decade in 2015, when the UK secured 150 HQ projects. This 2015 figure for the UK represented more than 50% of all HQ projects recorded in Europe in that year. In 2018 the UK’s share was 16%.

... and a worrying downward trend in R&D FDI market share

While not as dramatic as the decline in HQ projects, the UK also reported a fall in its number of R&D projects secured in 2018. The UK’s R&D projects have declined from a high point of 100 projects in 2015 to 74 in 2018. This fall has not been continued every year in absolute terms, as R&D projects into the UK rose in 2017. But the erosion of the UK’s performance in securing R&D projects is clearly illustrated by its loss of market share. In 2015, the UK secured 26% of all European R&D projects. In 2018 this figure had declined to 12%.

As the UK’s performance in securing R&D projects has been declining, France’s has been increasing rapidly. France secured 144 R&D projects in 2018 and was Europe’s leading R&D FDI destination, with the UK in a fairly distant second place. The French total in 2018 represented a 220% increase over 2015 – and France has increased its number of R&D projects secured every year since 2014.

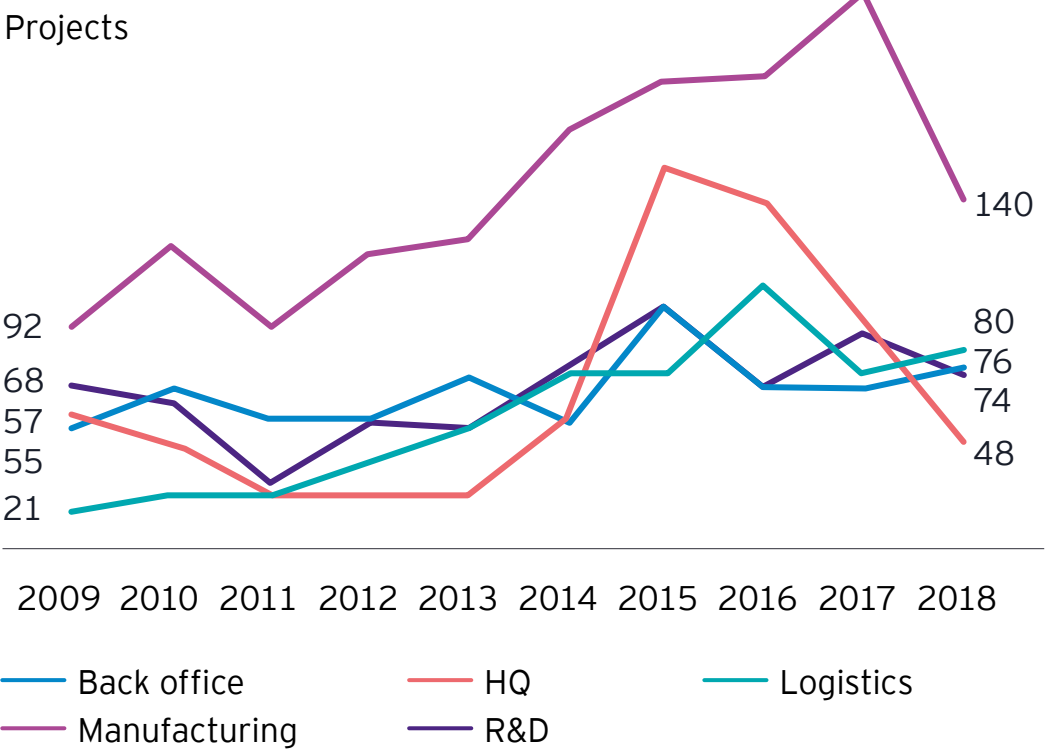
Among other types of project, UK logistics projects rose slightly, in line with the European market as a whole. And sales and marketing projects were down less than the European market, possibly reflecting the effects of companies establishing sales offices in the UK in preparation for Brexit. Overall, the statistics on types of project reinforce the story from the sector figures: that there are some significant challenges to UK FDI, with manufacturers worried about supply chains, R&D investors about access to skills and EU funding, and HQ investors about the change in the UK’s relationship with the EU.

UK projects by activity, 2017-18

Origin	Projects	UK market share (%)	Change on 2017 (%)
HQ	48	16	-50
Logistics	80	14	7
Manufacturing	140	8	-35
R&D	74	12	-17
Sales and marketing	636	26	-4
Other back office	76	15	15

Source: EY European Investment Monitor (EIM), 2019

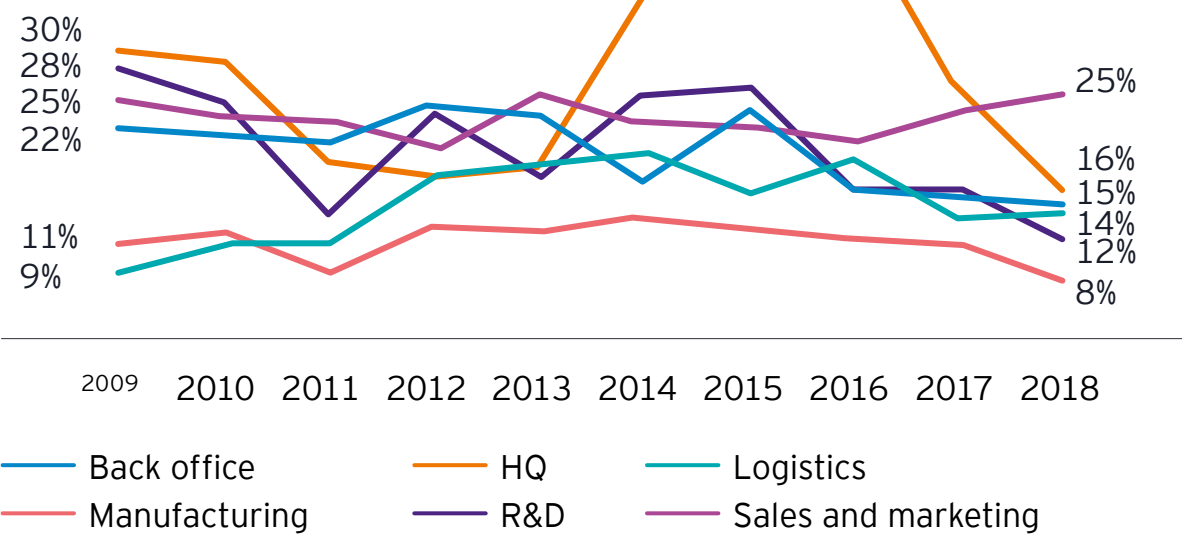
Change in UK projects by activity, 2009-18



Source: EY European Investment Monitor (EIM), 2019

UK market share of all European FDI projects by activity, 2009-18

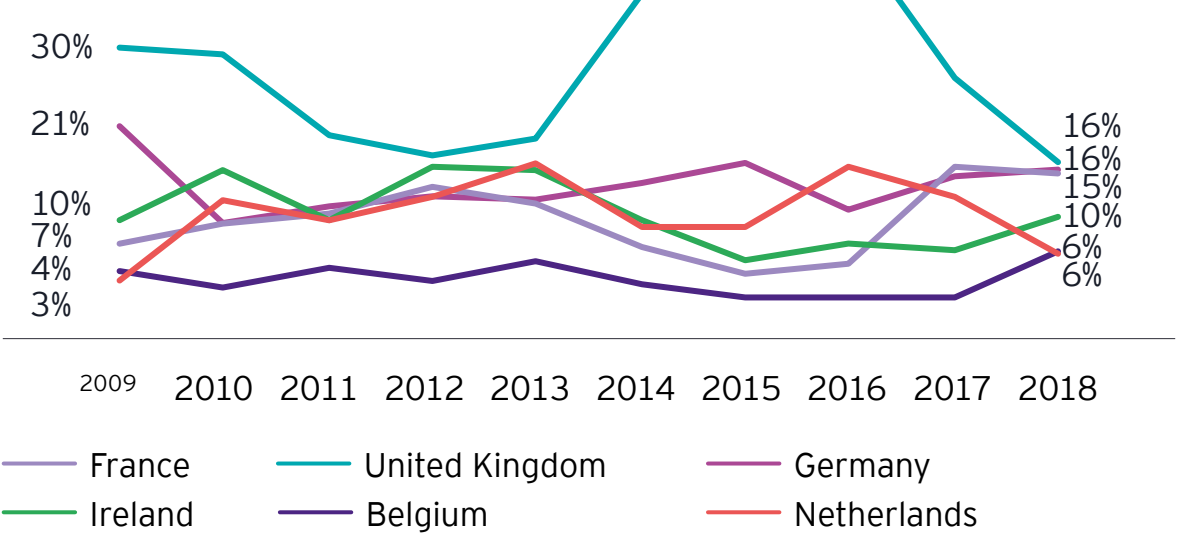
UK Percentage of European FDI



Source: EY European Investment Monitor (EIM), 2019

Destination of European HQ projects, 2009-18

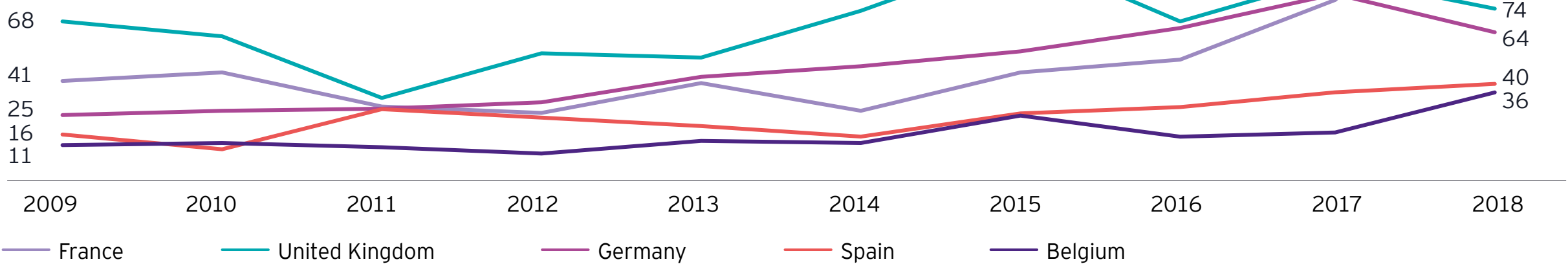
Percentage market share



Source: EY European Investment Monitor (EIM), 2019

Destination of European R&D projects, 2009-18

Projects



Source: EY European Investment Monitor (EIM), 2019

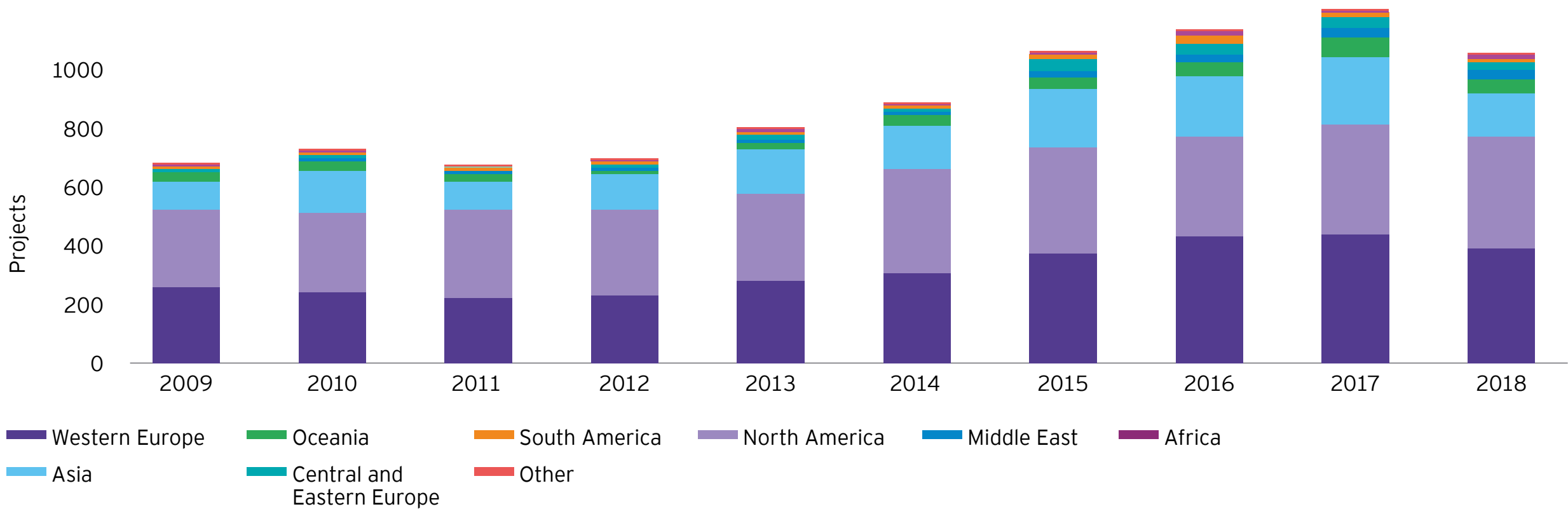


Investor origins: UK loses market share of North American projects ...

The leading origin of FDI into Europe in 2018 was the US. This was hardly surprising: in fact, the US has been the largest origin of investments into Europe in every year since FDI projects were first recorded in 1997. And in 2018, the US was the origin of double the number of projects compared to the next largest origin, Germany.

The number of European investment projects originating from the US in 2018 was 1,418, a rise of 3% over 2017. However, UK projects from the US were largely flat, rising from 336 in 2017 to 345 in 2018. As a result, the UK lost share of US investment in Europe.

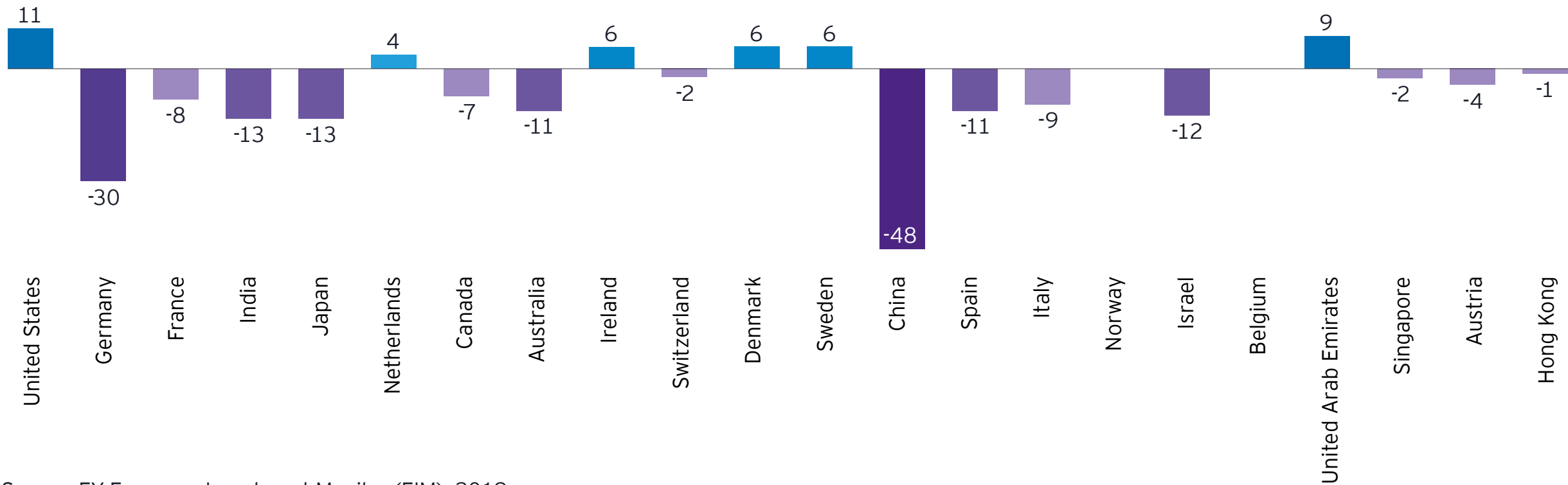
Origins of UK investment by Global region 2009-18



Source: EY European Investment Monitor (EIM), 2019

Change in top 20 origins of UK FDI projects, 2018

Annual change in UK projects



Source: EY European Investment Monitor (EIM), 2019

... and Europe ...

UK projects from a number of Western European origins declined from 2017 levels, including those from Germany, France, Spain, Switzerland and Italy – together accounting for an aggregate reduction of 60 projects. The collective impact of these declines outweighed increases in projects from Ireland, Sweden, Denmark and the Netherlands, which together contributed an increase of 22 projects.

... but a major slump in Asian investment ...

The largest shift in UK FDI project flow from Asia in 2018 was from China. UK projects from China were down from 74 to 26, while France's Chinese projects fell much less sharply, from 39 to 31, and Germany's declined from 75 to 66. So European projects from China were falling everywhere due to policy and economic issues, but much more markedly in the UK. Similarly, UK FDI projects from Japan fell from 55 in 2017 to 42 in 2018, while France's were only down from 54 to 52, and Germany from 57 to 56.

... and no signs of the Commonwealth moving to fill the gap ...

A further trend in 2018 was that, after a strong showing in 2017 in

attracting FDI from Commonwealth countries, from whom the UK secured 192 investment projects during the year, 2018 saw this number fall back, with just 150 projects recorded.

UK FDI projects from India fell from 61 to 48 in 2018, although this compared more favorably in percentage terms with the declines in Indian projects experienced by France (from 19 to 8) and Germany (from 28 to 17). Investments from Australia fell from 49 to 37, and those from Canada were down from 46 to 39.

... underlined by our findings on investors' perceptions ...

Our analysis of the UK's 2018 FDI performance in terms of regions of origin is very much in line with the findings from our survey of global investors' perceptions of the UK as an FDI location. The research shows that Asian investors have exhibited the most negative response to the referendum result, with 13% having reduced their investment and 14% having put activity on hold. North American investors have been the most likely to increase investment, with 9% doing so, while 17% of Western Europeans have paused investment and 6% have cancelled projects since 2016.

An analysis of this year’s attractiveness ratings for different criteria by sector and country reveals few variations. This suggests the factors shaping perceptions are relatively common across the investor community — again pointing to an overarching “Brexit effect”.

... as the ranking of the UK’s attractiveness continues to decline

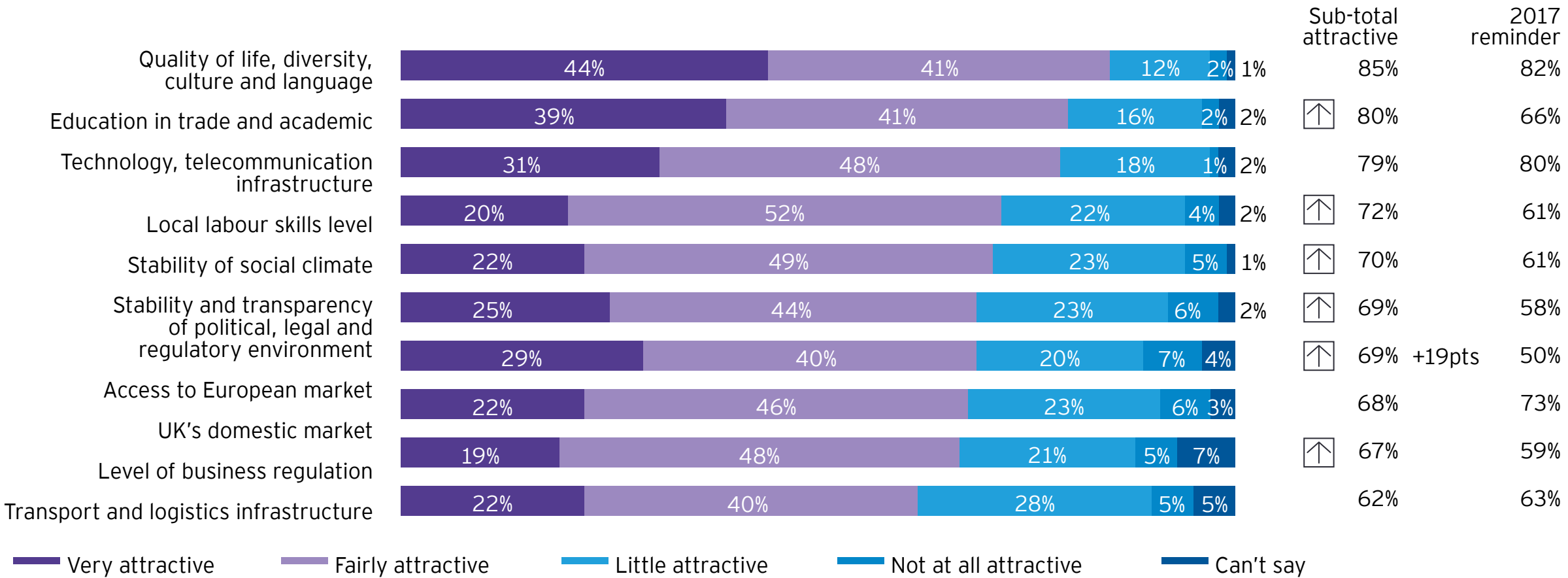
The UK’s perception ratings on factors such as quality of life, educational standards and social stability have been a major source of strength for the UK’s FDI offer over many years, underpinning its broad-based appeal to investors globally based on a wide range of criteria. After recovering in 2018, our research shows that the UK’s ratings on several of these key criteria has slipped back – albeit only marginally in some cases – in 2019, with small declines in investors’ top three criteria of quality of life (down from 85% to 83%), technology/telecoms infrastructure (down from 79% to 78%), and education (down from 80% to 78%).

On most criteria, this year’s findings mean the UK is achieving scores that are below the average for the five years prior to the EU referendum, when it typically scored over 80% on seven or eight criteria. And the falls in the scores for some of the criteria sound particularly loud alarm bells, since they’re factors that are so central to the UK’s global brand.

A case in point is the attractiveness rating given to the stability of the UK’s social climate, which has fallen from 70% last year to 64% this time, reflecting the uncertain outlook. Another unsurprising shift, given the political situation, is that the attractiveness of the UK’s political, legal and regulatory stability has fallen, although the large extent of the decline – from 69% to 53% – is worrying.

On other criteria, the findings represent something of a mixed bag. The attractiveness rating of the UK’s transport infrastructure improves from 62% to 67%, but skills levels, labor costs and the flexibility of labor legislation all decline. And while the UK’s corporate taxation and availability and cost of real estate are seen as having improved in attractiveness, these rises are overshadowed by a sharp decline in the UK’s attractiveness for access to the European market, down from 69% to 60% – again hardly surprising in the context of Brexit-related uncertainty.

How attractive are different aspects of the UK as a location for establishing new FDI activities?



Source: EY Attractiveness Survey UK, June 2019

Viewpoint

EY
viewpoint



Steve Ivermee
EY UK & Ireland
Transaction
Advisory Services
Managing Partner

UK deal appetite hits 10-year high, despite uncertainty

Our latest Global Capital Confidence Barometer (CCB20) has two really striking UK headlines. For the first time in a decade, the UK is named as the most attractive M&A destination by global executives, moving ahead of the US. At the same time, UK executives have also signaled their highest M&A appetite in a decade, with 67% of UK respondents expecting to transact in the next 12 months, compared with just 45% just six months ago.

These findings offer sharp contrast to those in this report, which suggest a decline in the UK's attractiveness to

investors in greenfield FDI. While the obvious uncertainties that still surround the UK's future relationship with the EU are affecting FDI, our CCB20 survey shows companies increasingly using M&A to adapt to technological and geopolitical change, with UK transactions a significant part of that response.

In particular, heightened uncertainties around EU market access have provided a particularly strong imperative for corporate deals to secure supply chains and continuing regulatory alignment. UK respondents listed a "response to regulatory or tariff and trade changes" as their top priority for acquisitions in CCB20.

Meanwhile, technological disruption remains a significant deal driver, with UK companies showing an increasing preference for "buy" over "build" strategies. This may reflect the confidence companies have in their ability to execute M&A compared with the more uncertain environment for new capital investment, which offers longer payback periods.

In terms of inbound acquisitions, UK plc's strong focus on innovation certainly contributed to it becoming the globally preferred M&A destination for the next 12 months. Companies buy for the long, not the short-term and the UK still has a reputation for developing intellectual property, whilst its renowned universities and the strength of its talent endure. The UK has other obvious advantages of geography, in language; in its business-friendly legal system, and in the ease of access to finance.

CCB20 also shows that the UK M&A attractions extend beyond technology. Most companies looking to buy in the UK, are looking at acquisitions in consumer products and retail, industrials and financial services. This may reflect market access, supply chain and regulatory repositioning by global companies, as they prepare for life after Brexit.

The UK still offers a great deal for businesses looking for innovation and resilient growth.

UK businesses are committed to Europe

The number of outbound investments from the UK surged in 2017 by more than one-third from 343 to 464 projects, and the figure has increased again in 2018 – albeit more slowly – to 479. From having had historically similar volumes of outbound investment projects to France, the UK now has over one-third more, although it is still well behind Germany's figure of 702.

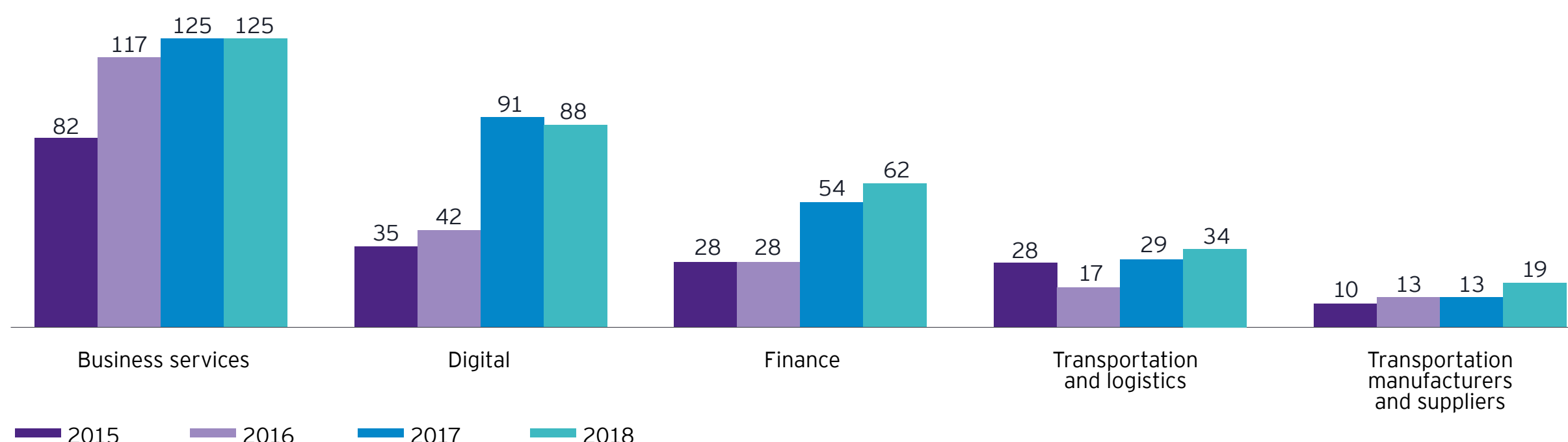
Compared to 2016, the result is that there has been a major shift in UK outbound activity, with significant increases across different sectors and project types: outbound financial services projects up from 28 to 62, digital from 42 to 88, chemicals from 11 to 19, logistics from 27 to 35. The growth in HQs from 9 to 23, R&D from 16 to 36, and factories from 56 to 79 shows how operations are being reshaped ahead of Brexit. A breakdown of outbound projects shows that the UK has more sales and marketing investments than Germany and France, who tend to have more production, research and logistics projects among their outbound investments.

In 2018, outbound projects from the UK increased by 3%, and the UK was the third-largest origin of European FDI projects. UK projects are most likely to go to Germany (the destination for 20% of UK outbound investments in 2018), France (16%) and Ireland (9%).

The chart below illustrates the change in the number of UK outbound investments from the five largest sectors since immediately prior to the Brexit referendum in 2016. In each sector, 2017 and 2018 have represented years when outbound investment was higher than 2015 and 2016. This trend has been most marked in the digital and finance sectors: in each case, outbound investments in 2017 and 2018 have totaled more than double the number of outbound projects recorded in 2015 and 2016. There is no doubt that UK businesses are committed to the European market and are investing ahead of Brexit to ensure they can continue to trade with the most important trading block for UK exports and imports.

Outbound investments by the UK's five largest sectors for outbound FDI, 2015-18

Projects



Source: EY European Investment Monitor (EIM), 2019

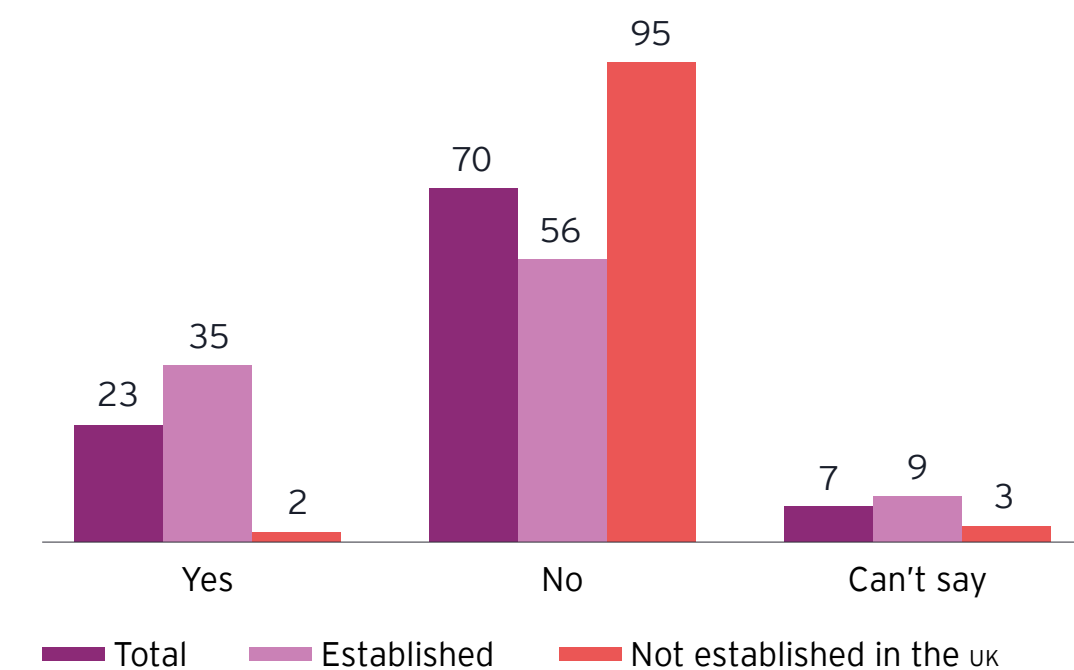
4 Outlook

The challenge of staying ahead

No short-term crisis, as investors' intentions remain stable ...

Our 2019 survey of investors' plans shows that short-term sentiment towards investing in the UK over the coming 12 months has not changed significantly since last year's study. The proportion of investors planning to establish or expand operations in the UK over the coming year is 23%, a slight fall from the figure of 24% in our 2018 research and within – albeit at the lower end of – the range seen over the past seven years. However, it is interesting to note that investors not already established in the UK remain much more nervous about investing in the country, with only 2% (down from 3% last year) planning to do so.

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



Source: EY Attractiveness Survey UK, June 2019

To put the UK findings into context, it is worth highlighting that EY’s European Attractiveness Survey 2019 found that only 27% of international investors were planning to establish or expand operations in Europe this year, down from 35% last year. So, while it may be worrying that the UK figure of 23% planning to invest is well below the European average of 27%, it is actually closer to the European level than last year – when the UK’s 24% was well below Europe’s 35%.

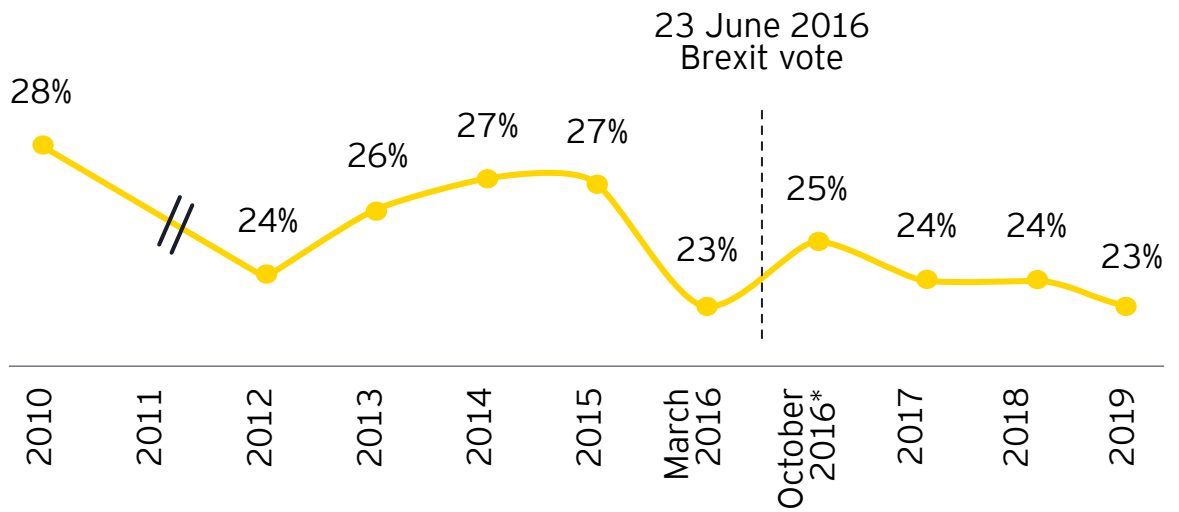
... but expectations of the UK’s FDI attractiveness in the medium-term are deteriorating ...

The findings we described above suggest that perceptions of the UK’s attractiveness to investors over the short term have largely held firm during the past year. However, this apparent stability is in contrast to a significant worsening of investors’ longer-term expectations of how the UK’s future attractiveness as an FDI location will evolve.

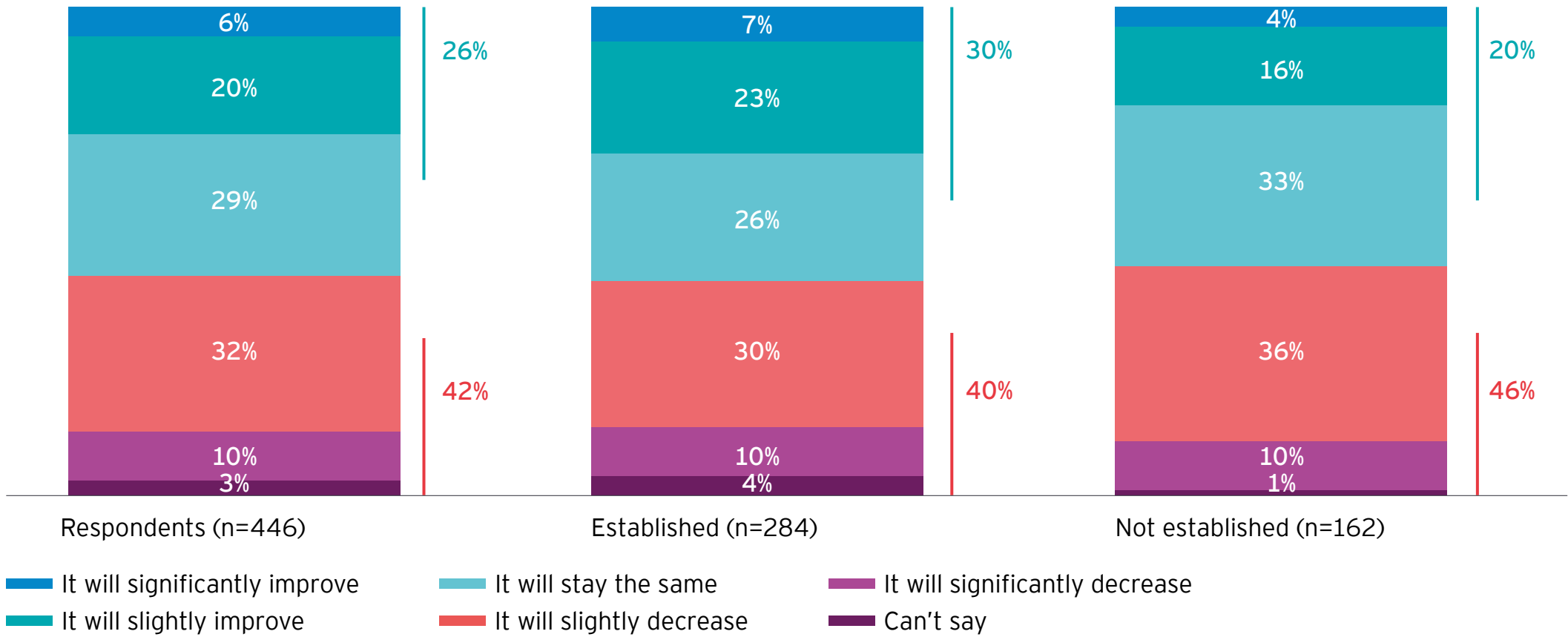
In our 2018 study, 36% of investors worldwide said they expected the UK’s attractiveness for FDI to decline over the coming three years. In 2019, the proportion expecting this deterioration has risen significantly,

to 42% of all respondents. This increased pessimism is mirrored by a decline in optimism: just 26% say they expect the UK’s attractiveness to improve, down from 30% last year.

Proportion of companies planning to establish or expand operations in the UK over the next year, 2009-18



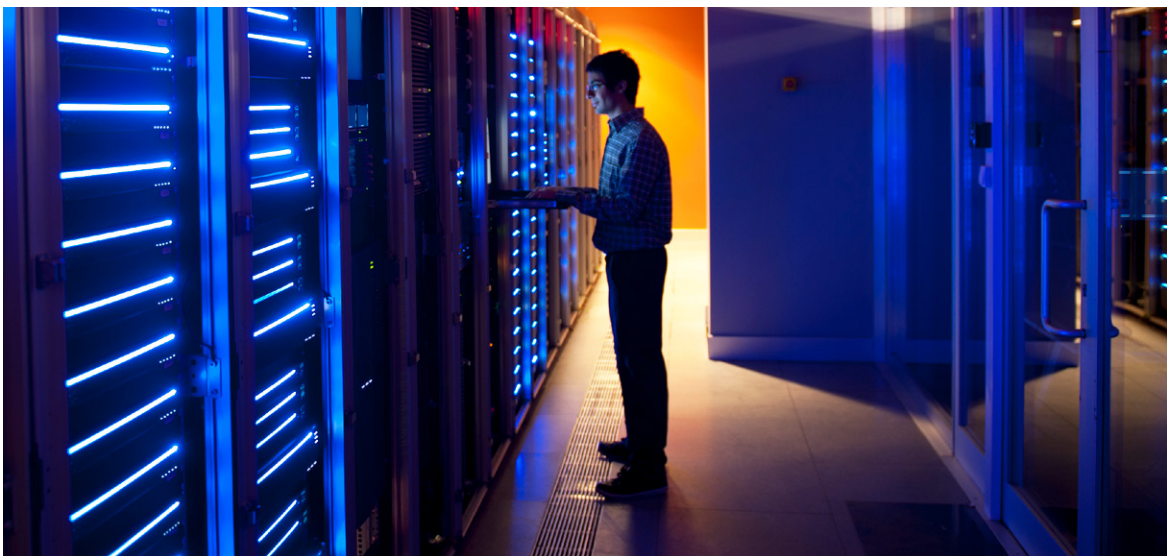
To what degree do you think the UK’s attractiveness will evolve over the next three years?



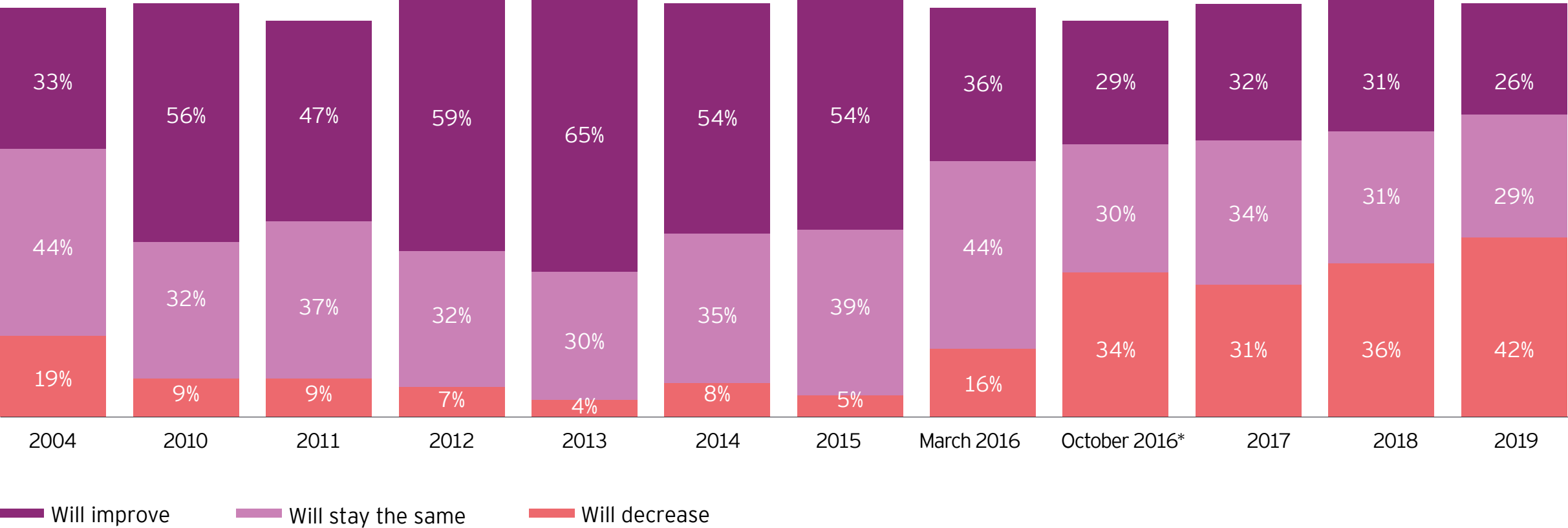
Source: EY Attractiveness Survey UK, June 2019

... and a historical comparison adds further cause for concern

A look at these findings in their historical context gives little comfort. As well as being the worst-ever findings for the UK, these results mean that the proportion of investors with a negative view of the UK's medium-term prospects has almost doubled since March 2016. What is more, the 2019 figure is more than five times higher than the average result from 2010 to 2015. Equally worryingly, the figure of 26% expecting the UK to improve as an FDI location lags well behind the European average of 37%. And the UK's balance of minus 16% between optimists and pessimists is the largest ever found in this annual research, and a far cry from the 61% positive balance that the UK recorded in 2013.



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



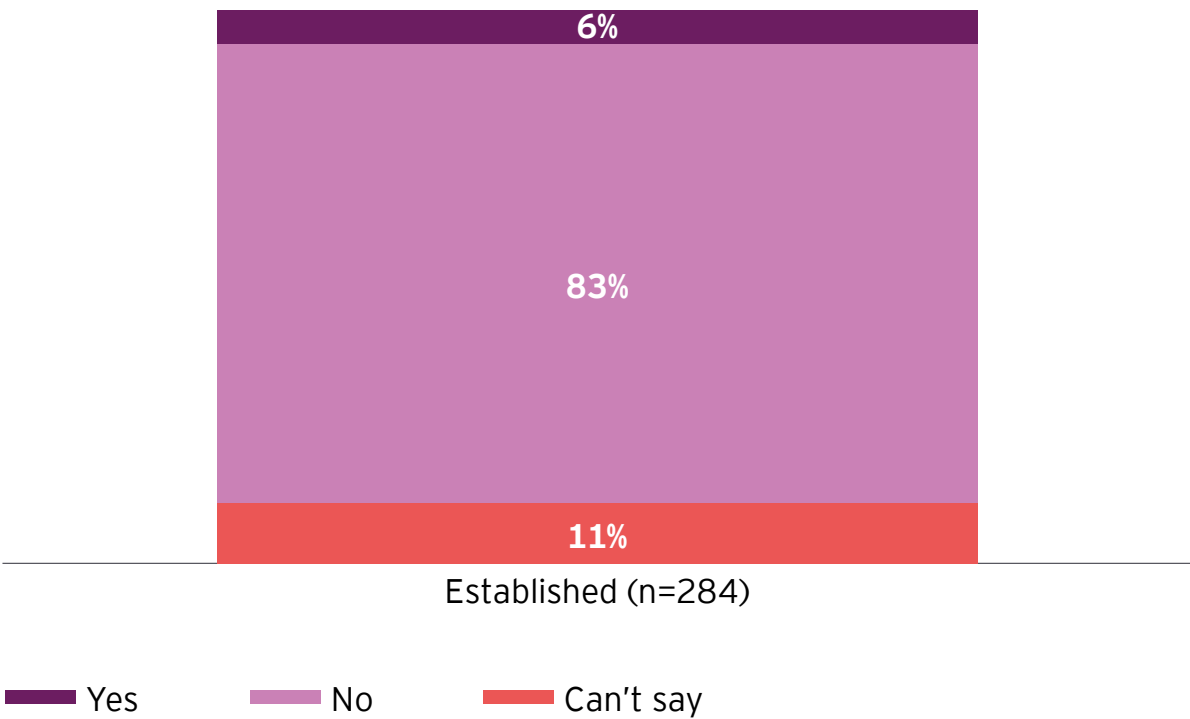
* CSA - EY UK Post-Brexit Attractiveness Survey - sample quite different, trend should be interpreted with care
Source: EY Attractiveness Survey UK, June 2019

22% of companies in the tech/digital sector expect the UK to get worse over next three years and 32% think it will improve

22%

A closer analysis also reveals wide variations between different sectors and regions. For example, 63% of respondent chemicals companies think the UK will become less attractive over the next three years and 15% that it will improve, giving a negative balance of 48%. By contrast, in the tech/digital sector, 22% of companies expect the UK to get worse over next three years and 32% think it will improve – a positive balance of 10%. In terms of regions, 51% of companies based in Western Europe think the UK will get worse over the next three years and 25% that it

Following the UK’s decision to leave the European Union, will you relocate operations in the next three years from the UK to Europe?



Source: EY Attractiveness Survey UK, June 2019

will improve, giving a negative balance of 26%, while among those from the US, 34% think the UK will get worse and 26% that it will improve – a negative balance of ‘only’ 8%.

Looking across all these results, the clear implication is that the Brexit vote and its aftermath may have had a significant impact on longer-term global perceptions of the UK’s future attractiveness. As we have seen before in previous UK Attractiveness Surveys, it does seem that investors’ concerns over the UK are often focused more on future projects than the immediate situation – a tendency that fits in with the long lead times for decisions on FDI projects.

... but investors are not keen to relocate assets ...

However, some of our findings do point to the UK having time to respond to avoid future declines in FDI. One of these is that investors appear to be reluctant to move activities out of the UK. Only 6% of existing investors expect to relocate operations from the UK to Europe after the UK has left the EU, down from 8% last year.

There are, though, wide variations in sentiment between investors from different regions. Among Asian investors, 15% expect to move assets from the UK to Europe – well above the global average of 6%, but actually a reduction from 25% last year. In contrast, just 4% of Western European investors expect to move some operations out of the UK, although that represents a big increase from the 1% who expected to relocate in our 2018 study.

Unlike last year, there is little variation between different sectors in terms of the level of intention to relocate. Some 8% of chemicals and pharmaceuticals companies say they will move operations – and 8% of manufacturers, up from 4% last year. But these are the only two sectors showing any significant divergence from the average.

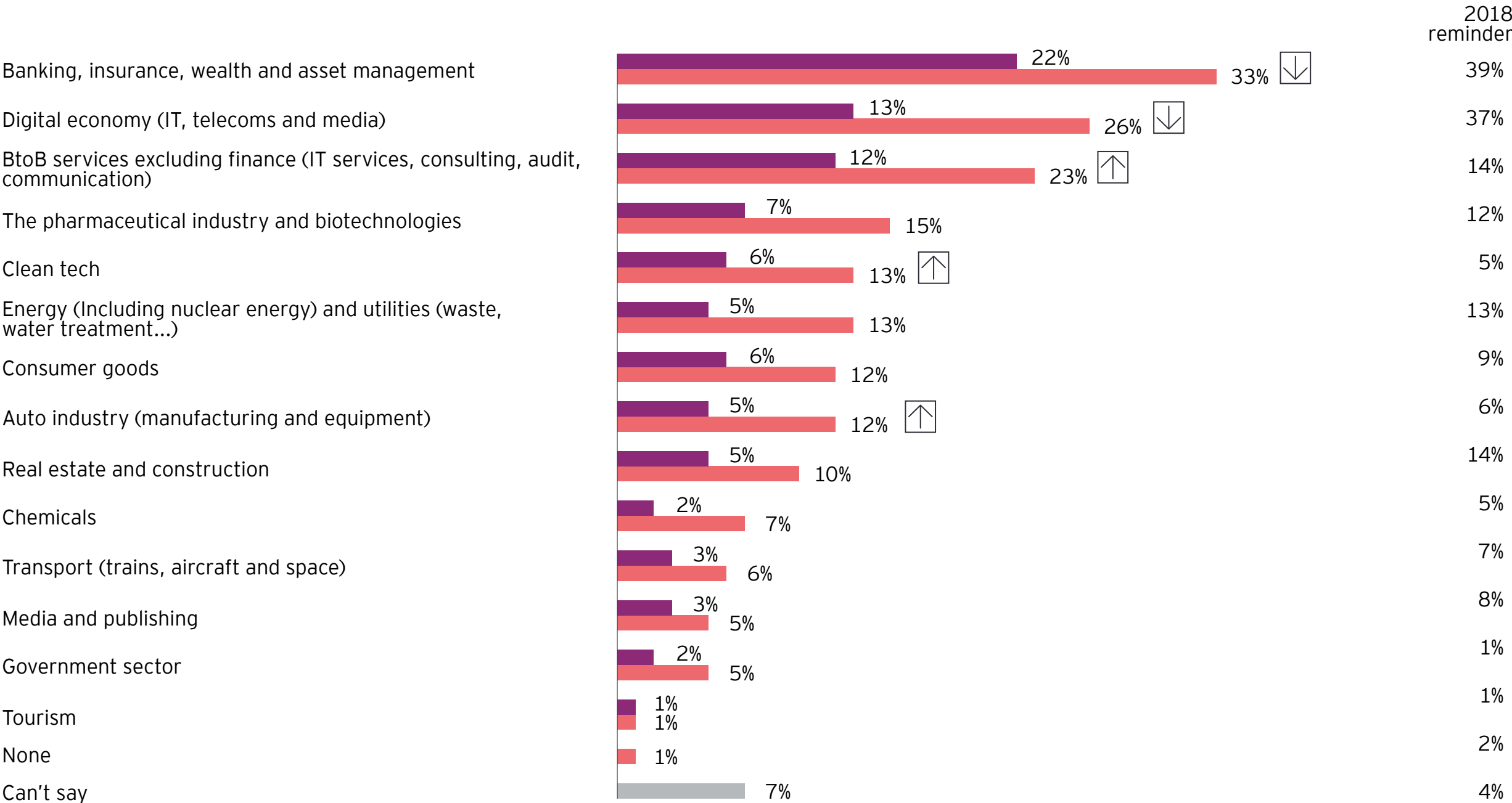
Overall, the message is that it appears there will not be a mass exodus of investment from the UK.

Future growth drivers: financial services and digital lead the UK's future attractiveness ...

When investors are asked which business sectors they think will drive the UK's growth in the coming years, financial services and the digital economy come out as the most important by a wide margin, although both are seen as slightly less important than they were last year. The

digital economy experiences a particularly sharp fall, declining by 11 percentage points to 26%. The slide in the rating of the top two sectors sees several others narrow the gap with significant increases – notably business-to-business services excluding finance (up from 14% to 23%), pharmaceuticals and biotech (12% to 15%), clean tech (5% to 13%) and the auto industry (6% to 12%).

In your opinion, which business sectors will drive the UK's growth in the coming years?



■ First ■ Total

NB: two answers possible
Source: EY Attractiveness Survey UK, June 2019

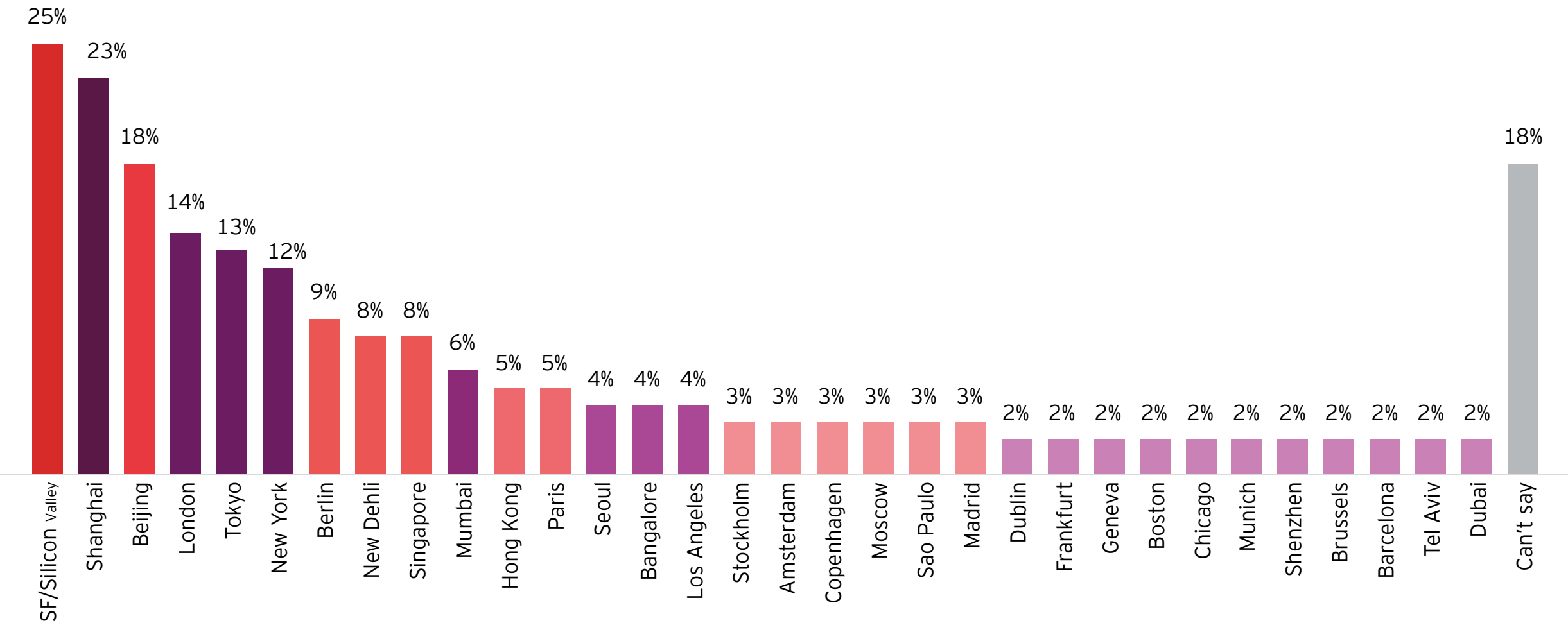
Meanwhile, an analysis of investors’ responses by geographical origin shows that companies from Western Europe are more likely than those from Asia and the US to believe that the digital economy will drive the UK’s future growth, while investors from Asia are the most likely to cite financial services.

... and London is still the digital jewel in the UK’s crown ...

Our 2019 survey of investor perceptions also shows that London has

strengthened its position in investor perceptions of its appeal as a global center for technology innovation. Asked to name the cities across the world that they think are most likely to produce the next technology giant, investors place London in fourth place with a score of 14% – up from 13% in 2018, when it ranked fifth. London’s rise up the ranking is at the expense of New York, which slips from 21% and fourth place last year to 12% and sixth this time.

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



NB: open-ended question, three possible answers
Source: EY Attractiveness Survey Europe, June 2019

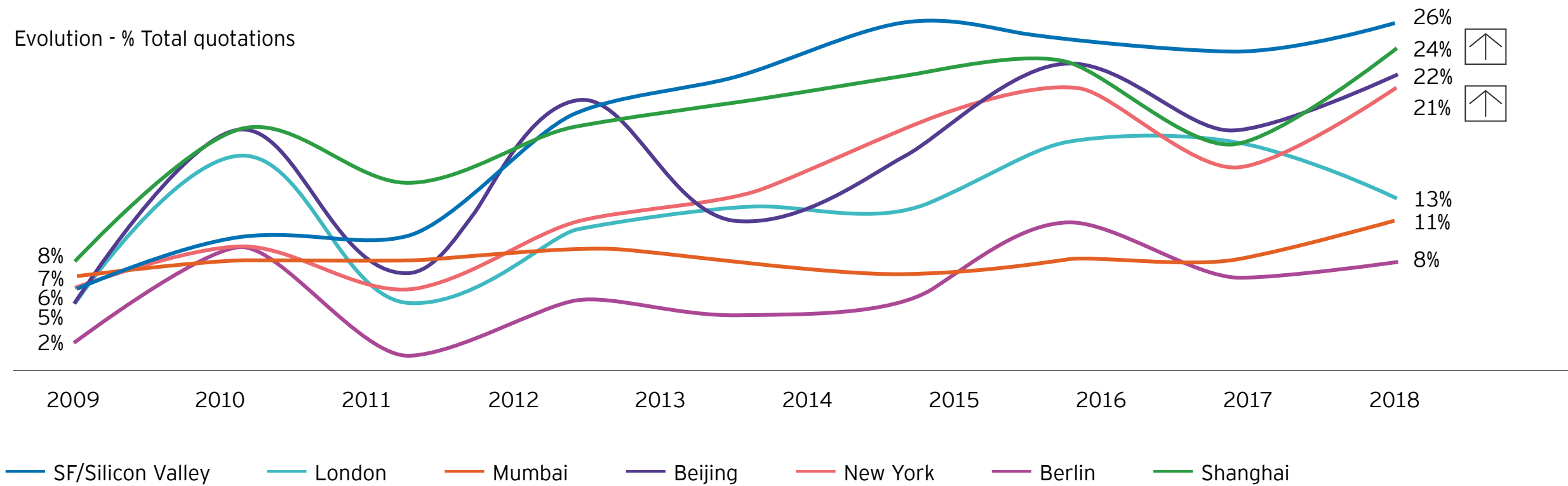
Looking at investors' responses to the technology giant question over the past decade, the most striking overall trend from a regional perspective has been the rise of Asian cities. However the sustained increase in Asian cities' scores has seen something of a correction in the past year, with – for example – Beijing slipping back from 22% to 18% and Mumbai from 11% to 6%.

While London's slightly stronger showing might suggest a shift of perceptions back towards the West, New York's sharp fall this year points the other way, and even San Francisco/Silicon Valley in first place suffered a small decline. Perhaps the overarching message is that more innovation is now emerging from an ever-wider range of cities across the world – and answering the technology giant question is getting harder.



Which three cities in the world offer the best chance of producing the next tech giant Responses 2009-18

Evolution - % Total quotations



NB: open-ended question, three possible answers
Source: EY Attractiveness Survey Europe, June 2019

... while Europe's growth drivers – aside from runaway leader digital – are more evenly balanced

A comparison with the sectors highlighted in our European Attractiveness Survey 2019 as driving future growth in Europe provides some informative insights. Compared to the UK, Europe is perceived as having a relatively more balanced multi-sector economy that continues to be largely driven by digital activities. In this year's European study, the digital economy increases its lead as the top growth driver. But the scores attributed to the other sectors are much more evenly distributed than in the UK, suggesting a broader and more equal balance of economic growth between them – albeit with a huge focus on digital as a common driver. A particularly noteworthy development is the strong and rising perception of clean tech as a growth driver in Europe, up from 24% to 25% after being just 15% as recently as 2017.

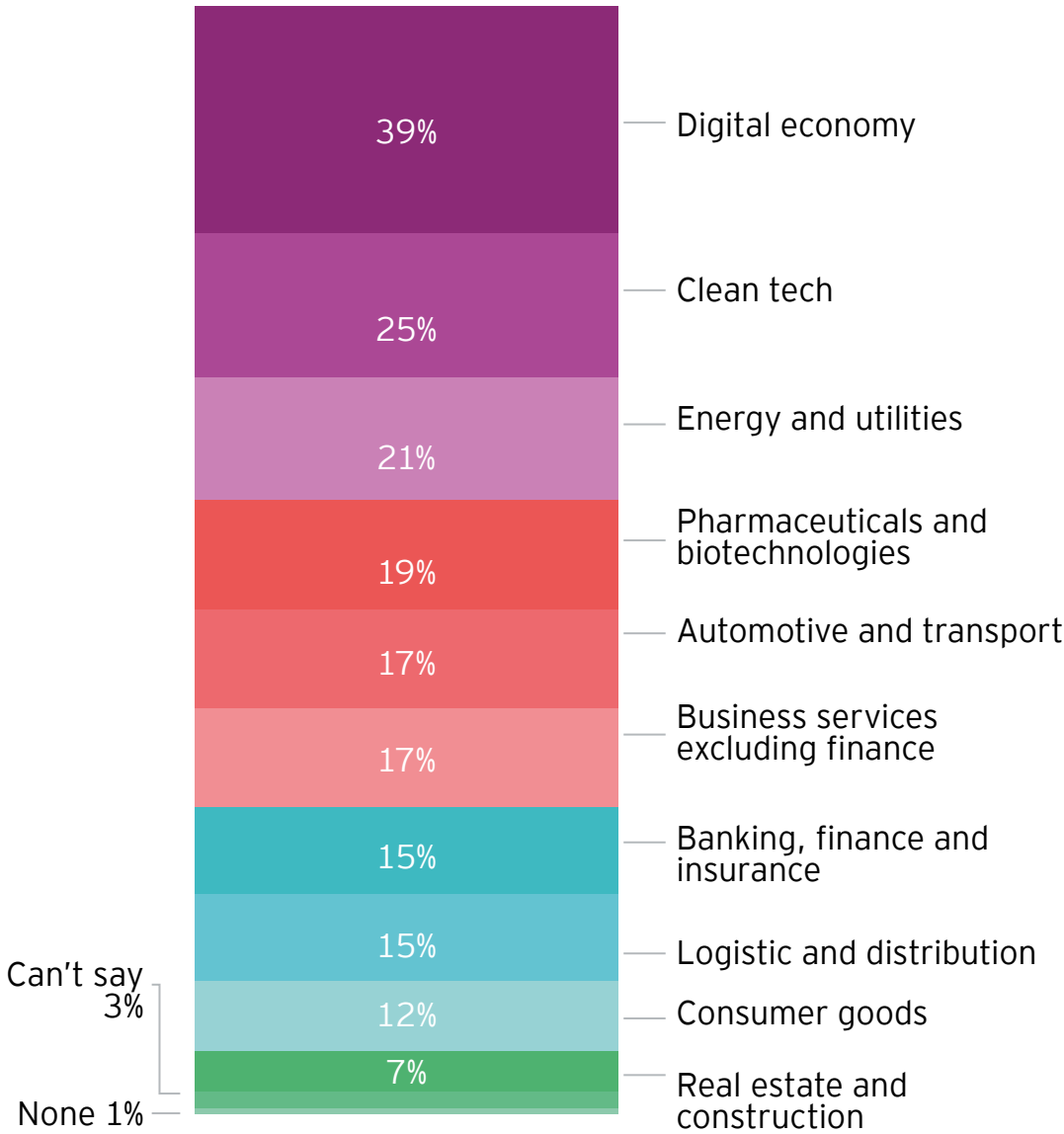
Looking at the findings over time, the digital economy – formerly termed the 'IT sector' in our studies – has held the leading position among Europe's perceived drivers of growth in every year since 2010. Behind it, a variety of other sectors have claimed second place year-on-year, with this position being held by three different sectors over the past four years – pharmaceuticals and biotech, energy and utilities, and then clean tech both this year and the one preceding it. This again points to the relatively even balance between sectors in Europe as drivers of overall economic growth but coupled with the ongoing rise of the 'green' movement.

Towards an action plan for the UK: EU access and the UK economy are still worrying investors ...

Overall, the picture that emerges from the UK's FDI performance in 2018 and our survey of global investors' perceptions in 2019 is of an FDI location that still has significant strengths but is facing significant challenges due to both the decision to leave the UK and the process to get there. The UK has retained its lead in European FDI – albeit with a decline in projects numbers and market share – and there is no immediate crisis, with few investors planning to relocate to Europe. But many of the medium- and longer-term indicators in our perception survey are deeply worrying, as the UK sees the attractiveness of some of its traditionally strongest attributes wither away.

Against this background, what are existing and potential inward investors into the UK most worried about now? On this question our

In your opinion, which business sectors will drive Europe's growth in the coming years?



Source: EY Attractiveness Survey Europe, June 2019

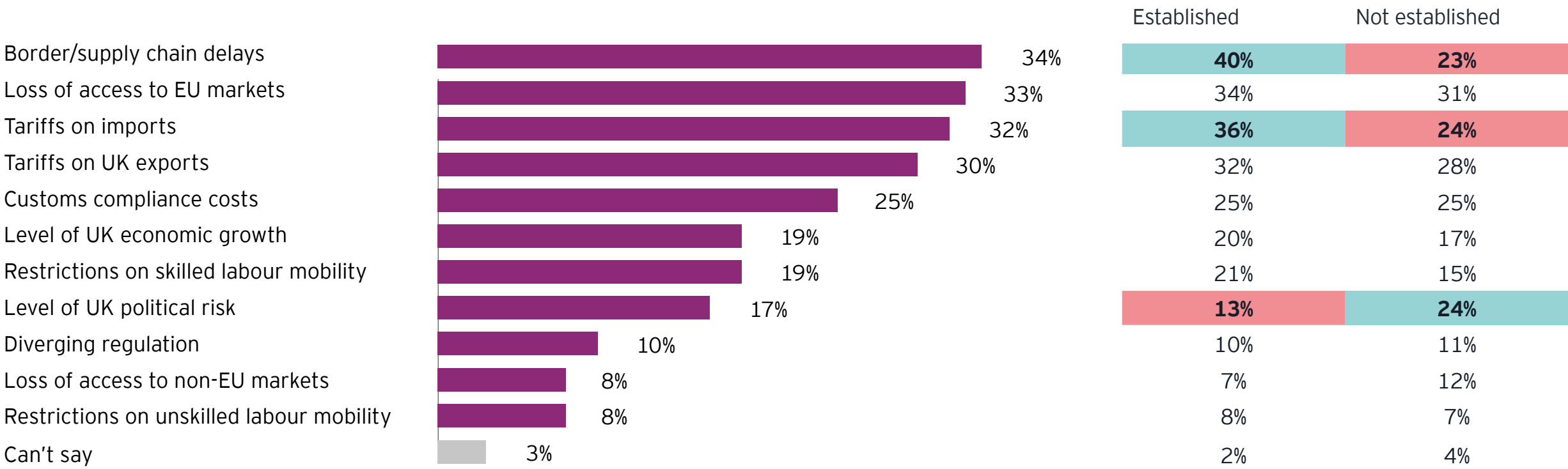
findings reveal some significant shifts from last year. The strategic, longer-term issue of loss of access to EU markets and the level of UK economic growth remain important – with access to EU markets scored at 33% in second place this year, down from 39% and first place last time, and concern over UK economic growth rated at 19% in sixth place, down from 30% and second place in 2018.

... but more immediate border and customs concerns have come to the fore

However, what shines out from the findings is the surge in concern in the past year over more practical and immediate challenges to cross-border trade, with border/supply chain delays rocketing from 13% in 2018 to 34% in 2019 to become investors' number one worry. Concerns over tariffs on both imports and exports have also increased, probably reflecting the very real prospect of a no-deal Brexit at the time the research was conducted. Perhaps unsurprisingly, the top four concerns are all greater among investors established in the UK than in those who have not yet invested here, since it is companies with assets and operations already on the ground who will have to deal with those concerns if and when they arise.



What are the key factors that you are concerned about with the UK after it leaves the European Union?



NB: two answers possible
Source: EY Attractiveness Survey UK, June 2019

Overall, the changes in investors’ concerns may largely reflect rising awareness and knowledge of what Brexit may mean for their businesses in practical terms.

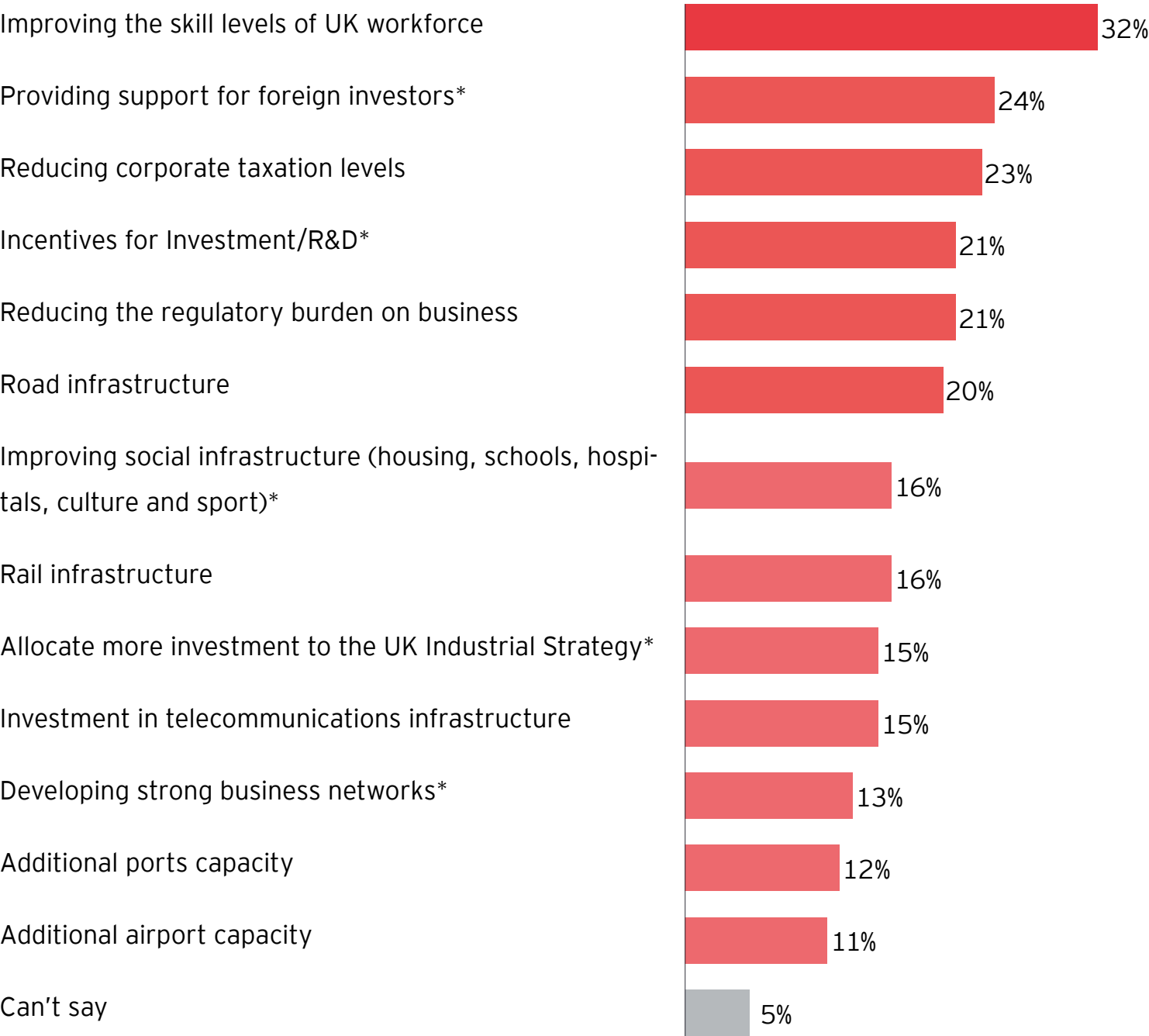
Clear policy messages around skills, infrastructure and incentives ...

The good news is that, against the backdrop of a challenging 2018 and a worsening outlook according to investor perceptions, there is a clear policy agenda for the UK to work on. The importance of investment in both skills and infrastructure is clear in the responses to our survey. Neither should be a surprise given the findings we cited earlier on how the UK’s attractiveness on labor skills, costs and regulation have all deteriorated over time. And on infrastructure, investors are keen to see improvements across all UK’s provision, with a higher share in 2019 compared to last year, identifying road, rail, ports, airports and telecommunications all in need of attention. In addition, we asked for the first time this year about social infrastructure (health, education, housing etc) and investors placed it alongside rail as the joint second most important UK infrastructure priority behind roads.

The potential policy agenda extends beyond the skills and infrastructure areas regularly mentioned in our research. Investors unsurprisingly highlight their desire for investment incentives but also highlight the levels of corporation tax and business regulation as areas for attention.

When we consider how far the UK’s reputation for social stability and political and regulatory predictability and transparency has fallen, it is clear a concerted and integrated response is urgently required to address the decline in the UK’s attractiveness. The UK needs to reconnect with investors and articulate a coherent policy framework for investment.

Which of the following areas should be domestic priorities for the UK Government to improve the UK’s attractiveness in future?

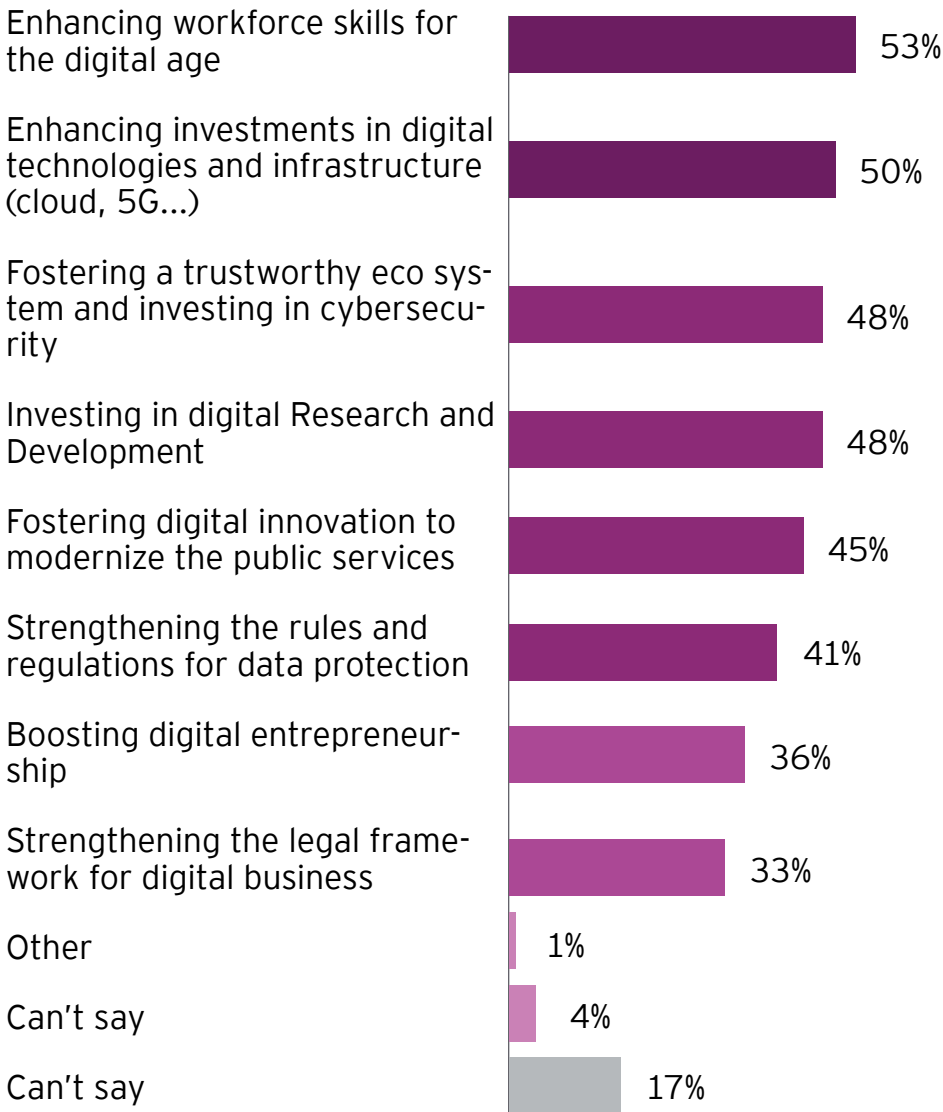


*New items
Source: EY Attractiveness Survey UK, June 2019

... that also resonate in the digital space

The need to invest in skills and infrastructure is reinforced by the importance digital investors place on these two areas. Further work on cyber security, R&D and digital innovation offer additional opportunities for UK policymakers to respond to the emerging challenges to the UK's European leadership in the sector.

Digital transformation is creating opportunities for UK business. In your view, where should the UK Government concentrate its efforts to best support the UK's transformation to a digital economy?



NB: several answers possible
Source: EY Attractiveness Survey UK, June 2019

Viewpoint

EY
viewpoint



Stuart Martin
EY Workforce
Advisory Brexit
Lead

Building a winning workforce for the digital age

In this time of continued uncertainty, combined with the increased pace of socio-political and economic change, the need for substantial investment in workforce skills for the digital age is amplified. We have entered the Fourth Industrial Revolution and have to prepare for the unlimited and exciting opportunities it has to offer.

Since 2016 we have seen an upward trend in job vacancies in many sectors, but more so in the areas of digital and technology skills. When combined with

the decline of immigration from EU countries and an ageing population there is a clear need for priority focus and investment in developing the agile, collaborative workforce of the future.

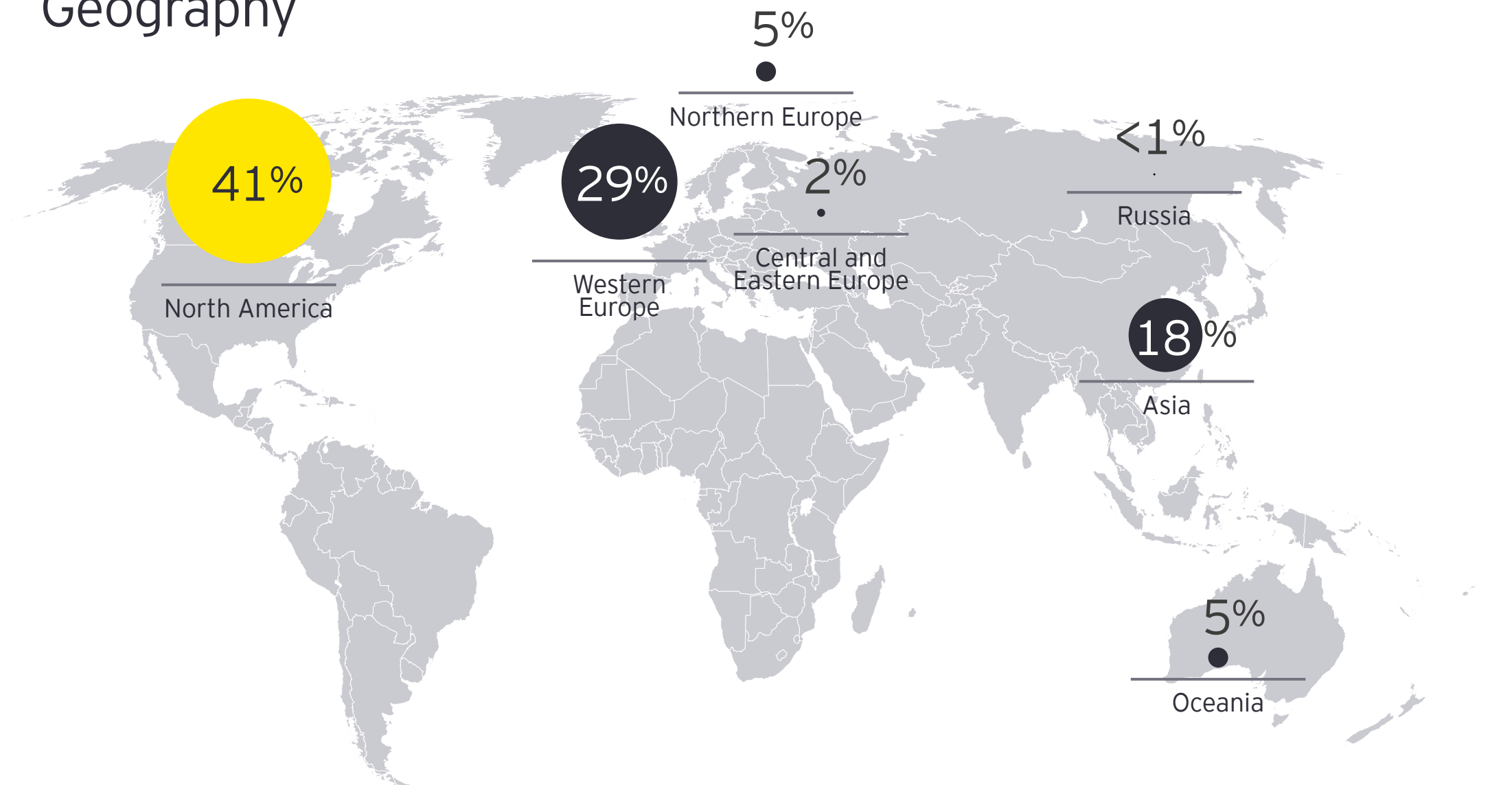
With EY's UK Attractiveness Report 2019 showing investors are concerned about the UK's future appeal, the need for increased and sustained investment in the UK workforce requirements of the future should be one of the most pressing and compelling government priorities.

We need to develop a workforce strategy that creates a truly diverse, international, multi generational and inclusive workforce, comfortable with rapid and constant change and seamless interaction with the digital world.

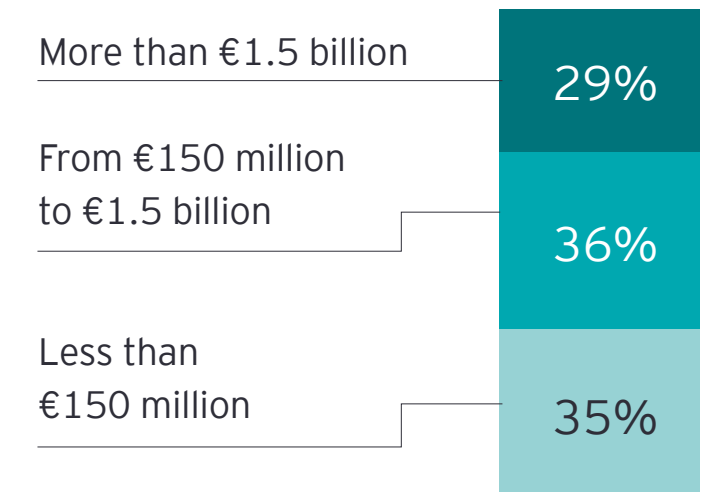
The challenge is immense as the workforce actively seeks not only the right skills, but easy, cost effective access delivered in a multi channel environment, at point of need and as personalised as possible for greatest impact and application. Lifetime learning and reskilling must become the norm and will be key to success in the post Brexit world.

Methodology

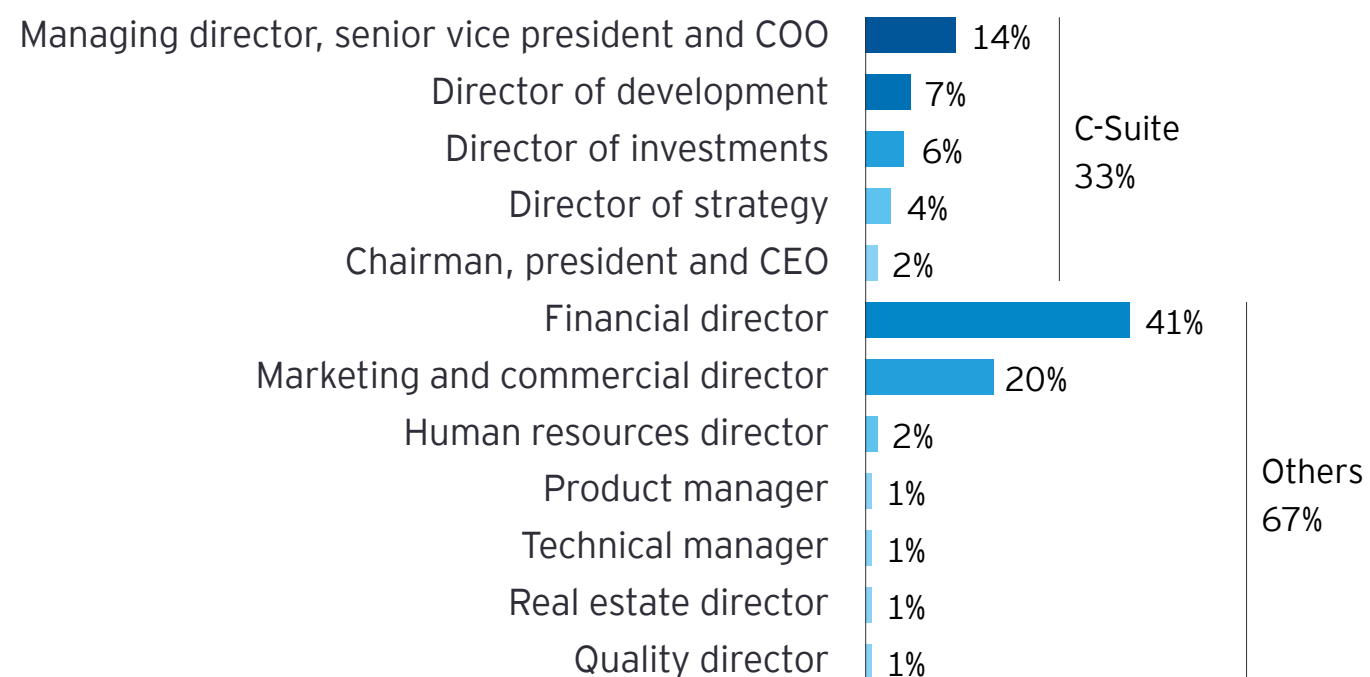
Geography



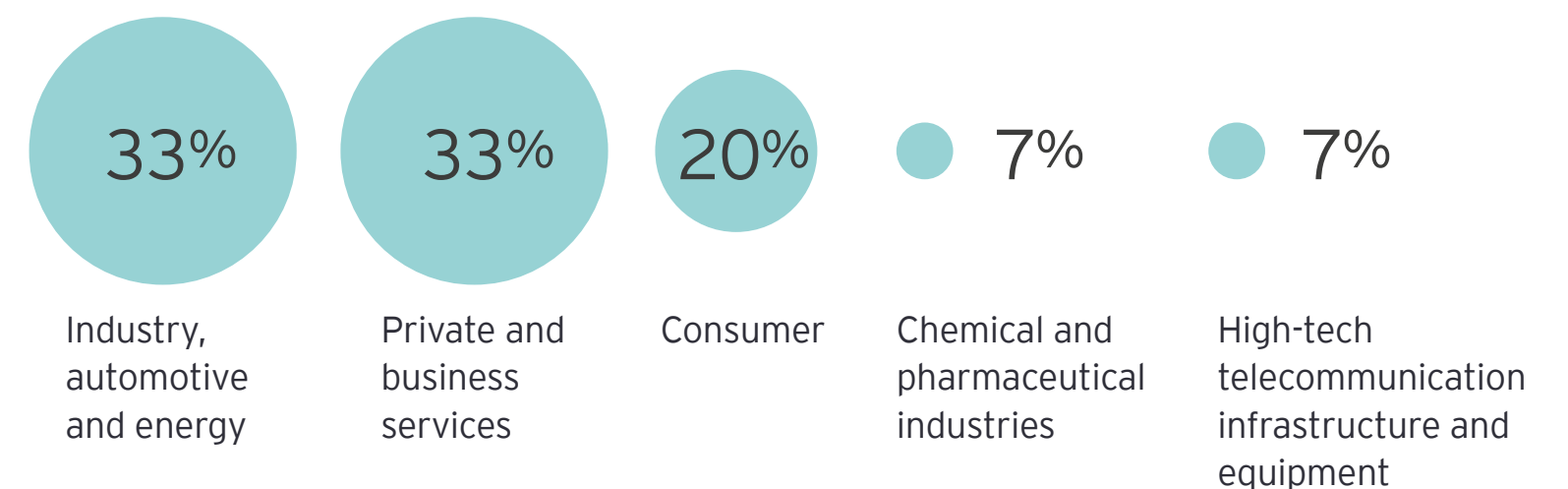
Size



Job title



Sector activity



Source: EY Attractiveness Survey 2019 – Europe

The “real” attractiveness of the UK for foreign investors.

Our evaluation of the reality of FDI in Europe is based on the EY European Investment Monitor (EIM), EY proprietary database, produced in collaboration with OCO. This database tracks the FDI projects that have resulted in the creation of new facilities and 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 on FDI is widely available. 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 undertaken
- ▶ What activities are invested in
- ▶ Where projects are located
- ▶ Who is carrying out these projects

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

significant trends in employment, industry, business and investment.

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

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

- ▶ M&A and joint ventures (unless these result in new facilities or new jobs being created)
- ▶ License agreements
- ▶ Retail and leisure facilities, hotels and real estate*
- ▶ Utilities (including telecommunications networks, airports, ports and other fixed infrastructure)*
- ▶ Extraction activities (ores, minerals and fuels)*
- ▶ Portfolio investments (pensions, insurance and financial funds)
- ▶ Factory and other production replacement investments (e.g., replacing old machinery without creating new employment)
- ▶ Nonprofit organizations (charitable foundations, trade associations and government bodies)

*Investment projects by companies in these categories are included in certain instances: e.g., details of a specific new hotel investment or retail

outlet would not be recorded, but if the hotel or retail company were to establish a headquarters facility or a distribution center, this project would qualify for inclusion in the database.

The perceived attractiveness of the UK 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 April and May 2019 via telephone interviews, based on a representative panel of 446 international decision-makers.

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

- ▶ North America: 41%
- ▶ Western Europe: 29%
- ▶ Asia: 18%
- ▶ Northern Europe: 5%
- ▶ Oceania: 5%
- ▶ Central and Eastern Europe: 2%
- ▶ Russia: <1%

Overall, 64% of the 446 companies interviewed have a presence the UK.

About the EY Attractiveness program

EY Attractiveness Surveys are widely recognized by 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 18-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

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