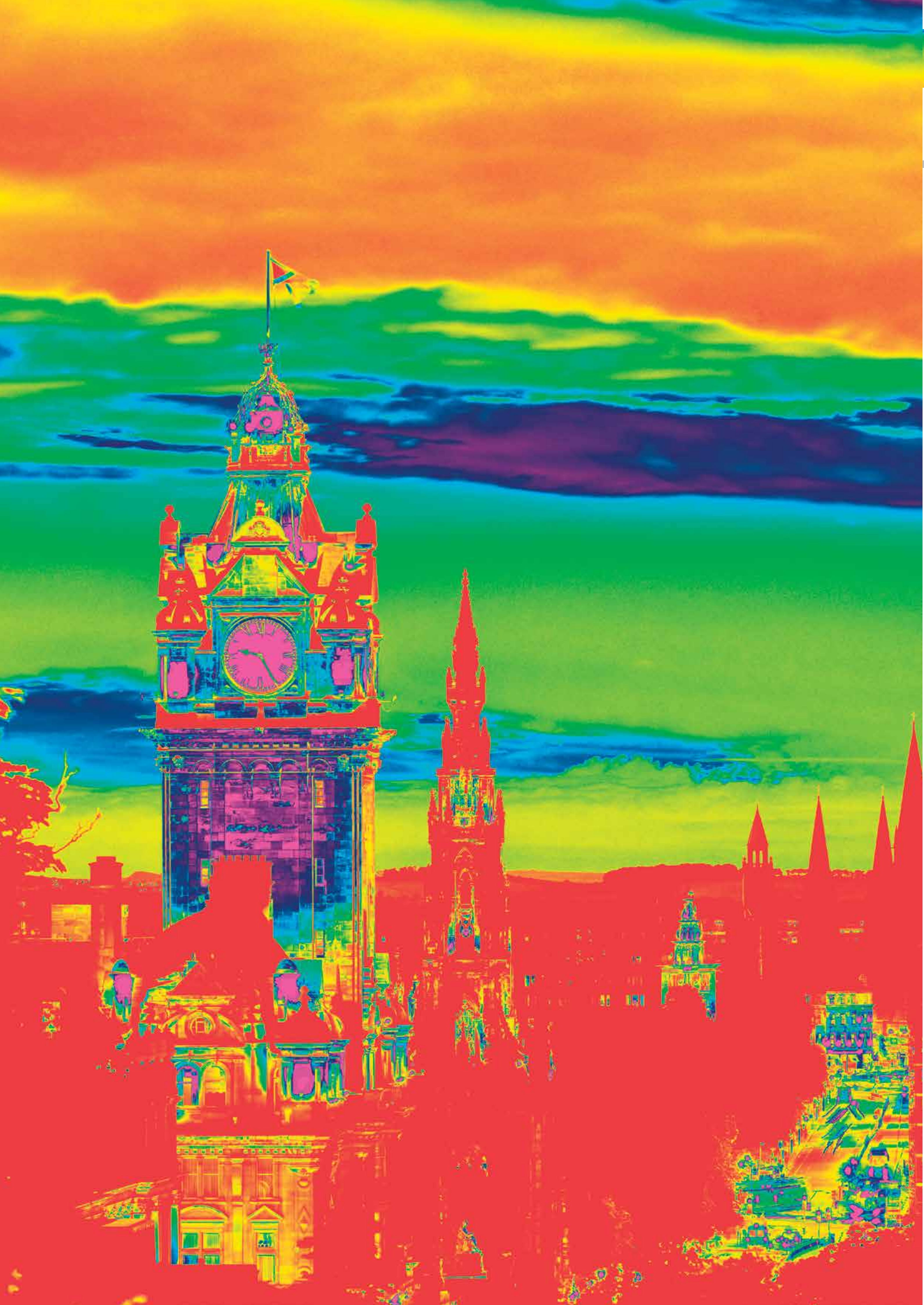
In transition

EY's Attractiveness Survey
UK
June 2018

Building a better working world



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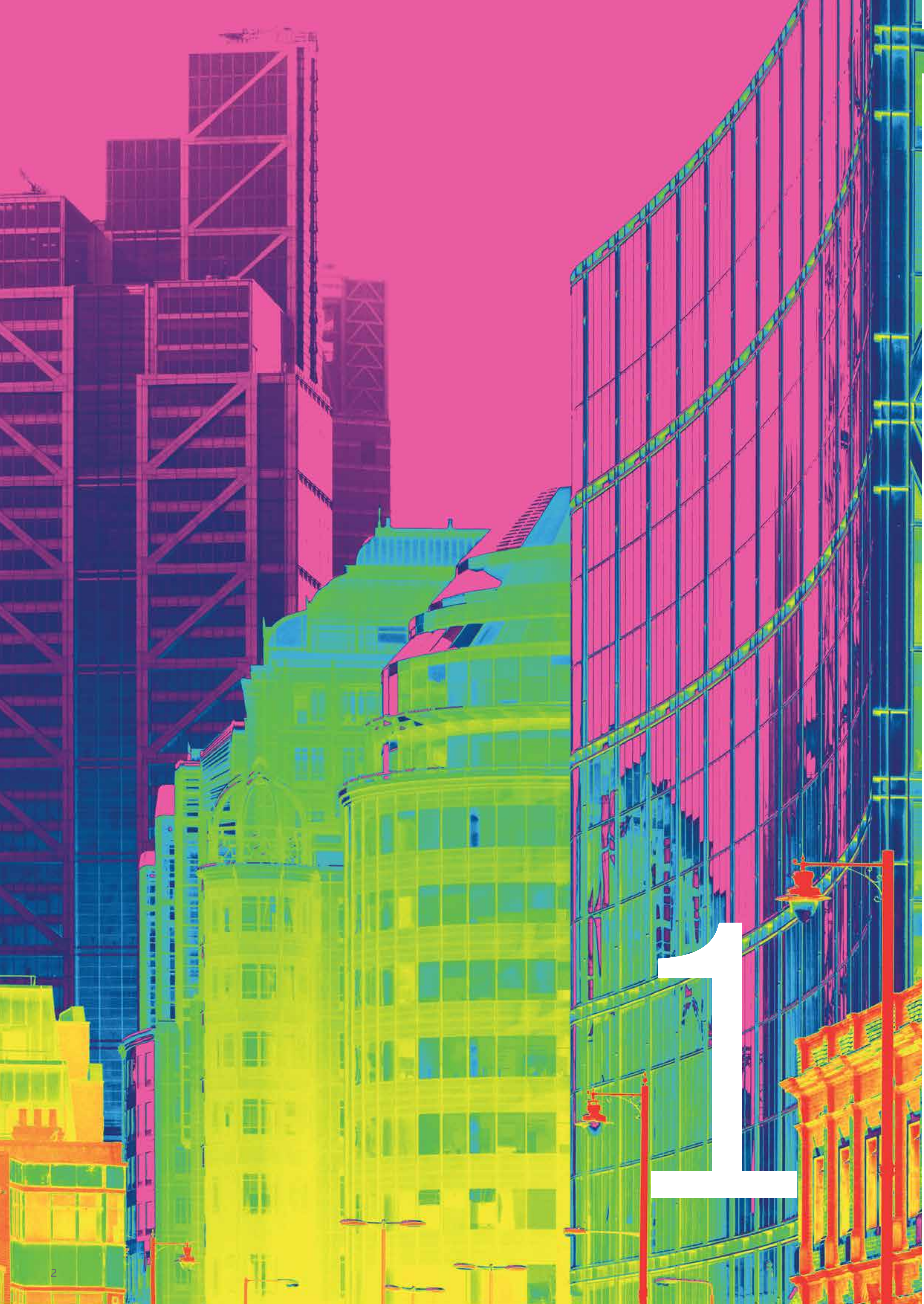


Foreword

STEVE VARLEY
EY UK CHAIRMAN
linkedin.com/in/steve-varley
@SteveVarleyEY

MARK GREGORY
EY UK CHIEF ECONOMIST
linkedin.com/in/markgregoryuk
@MarkGregoryEY

We are delighted to welcome you to EY's 2018 UK Attractiveness Survey, which – as in previous years – examines the evolving performance and perceptions of the UK as a destination for foreign direct investment (FDI). This report continues EY's long history of sponsorship of research into UK trade, including FDI, reflecting our desire to encourage an open dialogue between business leaders, investors and policy-makers on how to maximize the UK's economic performance.

FDI remains a vital source of capability, economic activity and jobs for the UK, and the UK's continued ability to attract it remains under close scrutiny in the run-up to Brexit. The findings of this year's report shed light on the impact of Brexit on FDI to date. Last year, our report presented a mixed picture, with the UK's FDI performance in 2016 continuing to be robust, but with a range of evidence pointing to significant concerns starting to emerge over the UK's medium- to long-term attractiveness. This year, there is no doubt as to the message: the UK is an economy in transition, as the move toward Brexit and the accelerating digital revolution reshape the landscape, and urgent action is required to position the UK for future success.

The UK saw the number of FDI projects it secured in 2017 increase by 6% from the previous year – retaining its position as Europe's leading country for FDI, despite a 31% surge in projects in France.

However, other findings give cause for concern over the longer-term outlook. While the UK achieved a 23% growth in digital projects, this was some way behind European growth of 33%, and investment in both financial and business services, and HQs, in the UK declined. While the proportion of investors intending to invest in the UK in the next 12 months was stable at 24% of respondents, over one-third (36%) of investors globally expect the UK's attractiveness to deteriorate over the coming three years – and the gap between investors with positive and negative views is the worst ever reported in our survey. In addition, 30% of investors say that Brexit may cause them to move assets out of the UK in the future. There is a real risk that the UK's stable performance masks the fact that the UK is missing out on growth opportunities.

That said, only 8% of investors expect to reduce their UK activities in the next three years, indicating that the UK has a window within which to develop responses to ensure its long-term attractiveness. In this report, we suggest a number of policy steps that we believe can help to achieve this. And as our findings make clear, the UK still has remarkable strengths that it can build on, as it shapes its new economic identity on the world stage. We, at EY, look forward to supporting and helping in that process.

> **6%** increase in the number of FDI projects the UK secured in 2017 from the previous year

Executive summary

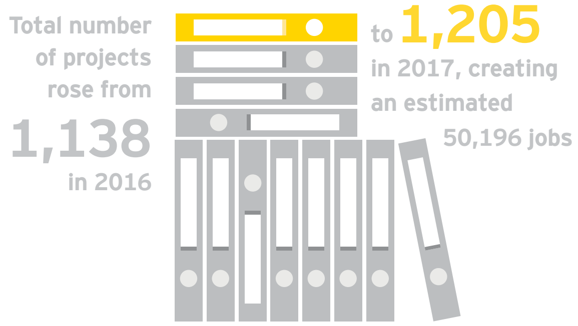
An economy in transition …

A year is a long time in economics. Twelve months ago, faced with mixed messages from our analysis, we found it difficult to reach a firm conclusion on the outlook for FDI into the UK. There is no such problem this year: it is very clear that the nature of FDI into the UK is changing, reflecting an economy in transition being driven by two forces – the move toward Brexit and technological change. The UK can either act now to seize the opportunity or risk missing out on growth.

It is very clear that the nature of FDI into the UK is changing, reflecting an economy in transition being driven by two forces.

… with investment growth in 2017 …

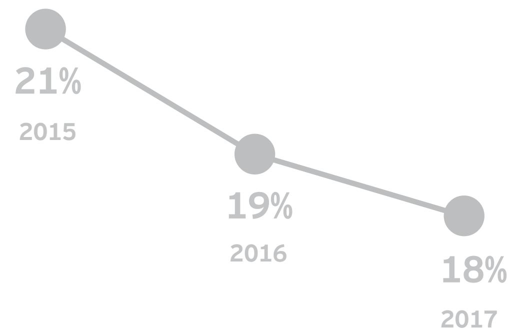
On the surface, the UK's FDI performance in 2017 was solid. The UK attracted 6% more FDI projects compared with 2016, and retained its place as Europe's number one destination, with total projects rising from 1,138 to 1,205.[1] The UK also remained the leading recipient of FDI-related employment in Europe, creating an estimated 50,196 jobs, a 6% increase over 2016 and over 19,000 more than second-placed Germany.



… but a loss of market share …

However, with the European market for FDI growing by 10%, the UK lost ground, with its market share of all FDI projects secured in Europe falling from 19% to 18%, having been at 21% as recently as 2015. Projects into Germany also rose by 6% but this was in part due to the constraints of a tight labor market. The real story was the surge by France. The evidence supports claims of the emergence of the "Macron effect" as projects into France increased by 31% from 779 to 1,019 and France moved above the UK to be ranked second, behind Germany, in investor perceptions of European country attractiveness in our survey of 450 foreign investors.

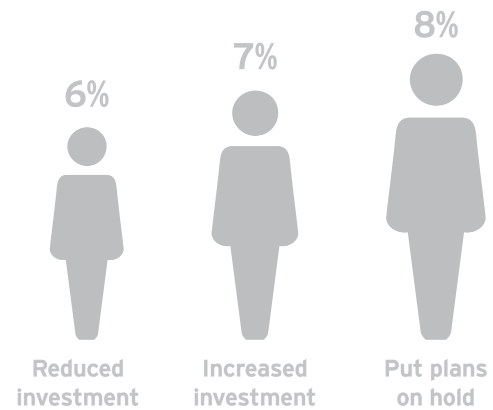
UK market share of European FDI continues to fall



… as Brexit impacts the UK's appeal …

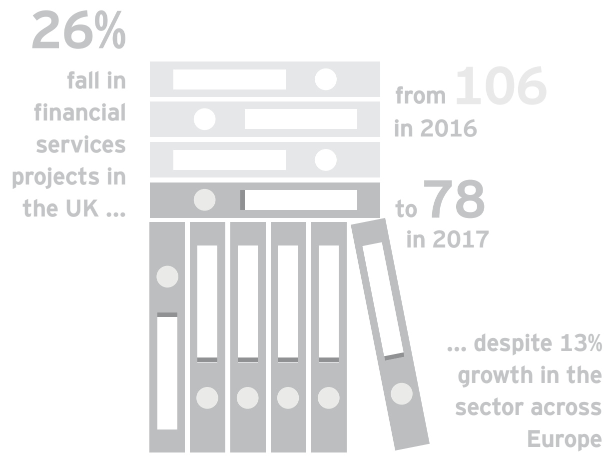
Taking the results of our investor survey together with the analysis of projects flows in Europe, it is clear that FDI into the UK has been impacted by the Brexit vote. When asked how their investment activity in the UK has changed since the referendum on EU membership, 6% of investors said they had reduced their investment, 7% of investors said they had increased their investment, and 8% of investors have put their plans on hold. The overall balance of the replies indicated lower investment, and in a market growing at 10%, these responses begin to help explain the UK's loss of market share in the last two years.

We asked investors how their investment activity in the UK has changed since the EU referendum



1 The project data in this report has been developed in conjunction with IBM. In reconciling this data with our existing EIM database, we have restated the results for 2016 for the UK to reflect more information and to ensure consistency in the analysis across Europe.

The fall in investment in the financial services and business services sectors provides direct evidence of the impact of Brexit. These two sectors generated the most negative responses from investors in our survey and this sentiment was reflected in actual performance. In 2017, the UK experienced a fall of 26% in financial services projects from 106 to 78 despite a 13% growth in this sector across Europe. Investment in business services in the UK, traditionally one of the country's strongest sectors for FDI, fell from 170 to 168 projects in a European market that grew by 12%.



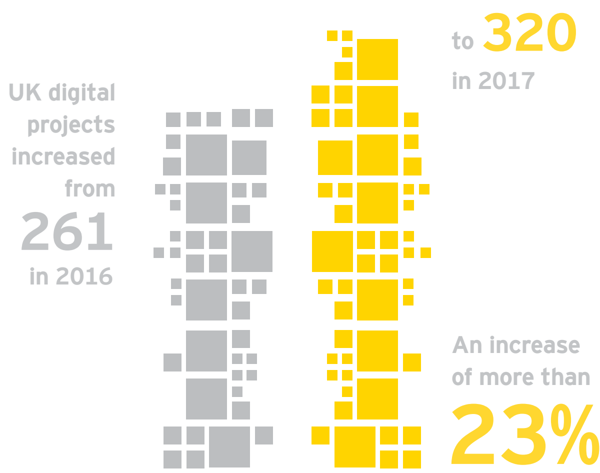
Brexit's impact on UK FDI is also likely to be one of the factors causing the fall in HQ investments in 2017. Projects into the UK were down by 25% in 2017. Surveys and actual activity show that there has been a significant negative shift in investor perceptions of the UK, especially in those sectors for which common regulation across the EU and free movement of people are very important.

Surveys and actual activity show that there has been a significant negative shift in investor perceptions of the UK.

Investors in consumer goods and manufacturing indicated they had increased investment in the UK in our survey and this is borne out by the project results for food and electronics, with an increase of around 50% in projects in 2017, and transport manufacturing with investment up by around one-third. The growth in these sectors reflects moves by businesses selling to UK customers to ensure their ability to continue to operate efficiently in the UK after Brexit.

… while digital is driving growth …

2017 was not an ordinary year, as it was the time when the digital revolution hit Europe. Digital FDI projects increased from 881 in 2016 to 1,172 in 2017 across Europe, an increase of 33%, more than three times the rate of overall market growth. UK digital projects increased from 261 in 2016 to 320, a 23% rise, and accounted for almost all of the total growth in UK projects, compensating for declines in other sectors. But this is not just a growth story: digital is changing the shape of FDI, bringing new dynamic businesses to Europe. We estimate that in 2017, around 57% of the digital projects announced in the UK have 10 employees or less with the overwhelming majority of the projects being located in and around cities with world-ranked universities.



In line with the digital surge, the UK performed well in attracting R&D establishments with a rise of 31%, significantly greater than the European growth rate of 26%, reversing the sharp fall in the UK's share in 2016. UK manufacturing sector projects grew by 17%, a creditable performance in a large, relatively high-wage economy in a European market that grew by 27%, but still a loss of share. The UK's move to advanced manufacturing is further evidence of how digital is powering FDI growth. The UK's performance in these two areas shows that when the UK has a competitive offer, it is able to compete effectively for investment.

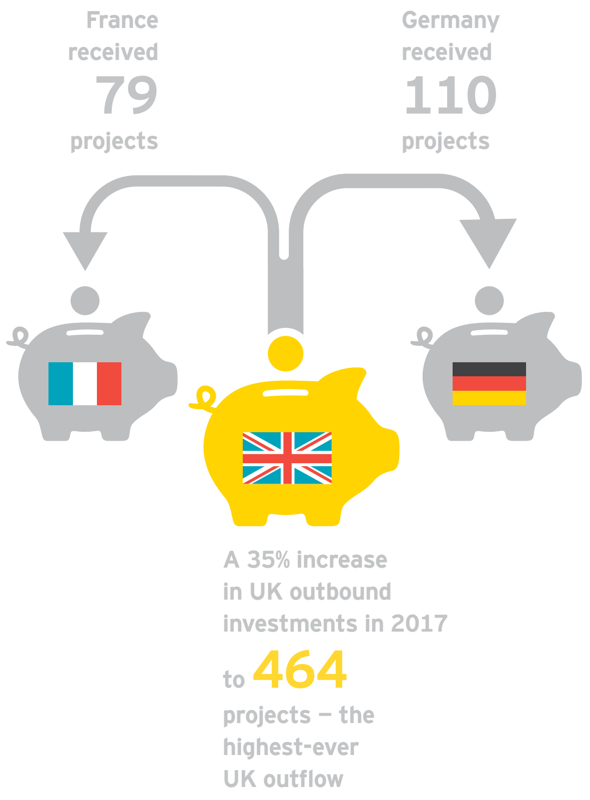
The UK's performance in R&D and manufacturing shows that when the UK has a competitive offer, it is able to compete effectively for investment.

… amid signs of a geographic adjustment …

Of the international regions investing in the UK, Western Europe represented the largest source of projects in 2017. This has been the pattern since 2015, when Western European projects into the UK exceeded North American projects for the first time.

The most interesting geographic shift in UK FDI in 2017 was the increase in UK outbound investment to 464 projects, a growth rate of 35% over 2016, leading to the highest-ever UK outflow. Germany, receiving 110 projects, and France, with 79, were the major recipients as UK businesses appeared to be accelerating their activity to position for the changed environment after Brexit. The number of UK outbound projects from business services, digital, manufacturing and financial services all increased, with digital growing by almost 150% and financial services by 93%.

This shift, together with the shift in projects from the UK to other countries in certain sectors, boosted inflows into other European countries. France attracted 59 HQ investment projects in 2017 compared with 16 in 2016, and Germany went from 33 to 55 in the same period. There were similar shifts in financial services and logistics and a surge in business services inflows from 133 to 226 in Germany, and 109 to 144 in France, between 2016 and 2017.



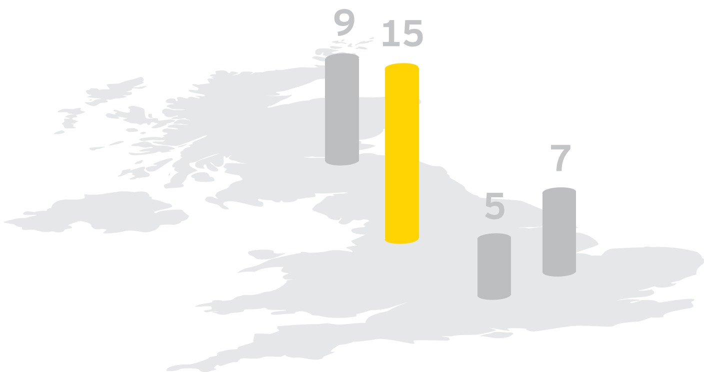
… but less signs of change across the UK's regions

Overall regional performance across the UK was similar to the national picture, with growth rates similar to the UK average. Scotland, the North West, the East and South East all performed strongly in 2017 with a growth in the number of digital projects attracted driving their outturns. Edinburgh (9 digital projects in 2017), Manchester (15), Cambridge (7) and Reading (5) were the cities leading this growth.

The South West was another strong performer with a surge in project numbers from 38 in 2016 to 53 in 2017, but this was not a digital story. The region saw an increase in energy sector investment, reflecting its leadership in clean energy, and a growth in manufacturing led by expansion of existing activity in the food sector and the transport sector, possibly driven by investors wanting to strengthen their UK capability ahead of Brexit.

Our regional analysis shows very clearly that London is where the change in the UK economy is most advanced. The capital has been the jewel in the UK's FDI crown for several years, attracting more projects in 2016 than every country in Europe other than the UK, France and Germany. While FDI projects into London rose slightly from 446 in 2017 to 459 in 2017, this was slightly less than half the UK overall growth rate. The decline in financial services and business services projects and the drop in HQ investments were major factors influencing London's outturn, and London also lost its crown as the most attractive city in investor perceptions to Paris. These shifts have to be balanced against the rise of 34% in digital projects in London, giving the city almost a fifth of the European market and nearly two-thirds of all UK digital projects. The decline in the financial services and business services sectors is being mitigated by the growth of digital.

Number of digital projects attracted in cities outside of London

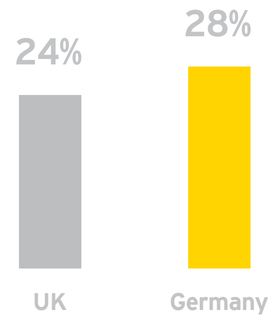


Paris overtakes London in investors' perceptions of the most attractive European city

Although investor perceptions point to no short-term crisis …

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 24% in our 2017 study, in line with the results over the past seven years. Nevertheless this level is below the 28% for Germany and the average across Europe, suggesting the UK is likely to lose more market share over the next 12 months.

Proportion of investors planning to establish or expand operations in the UK and Germany over the coming year

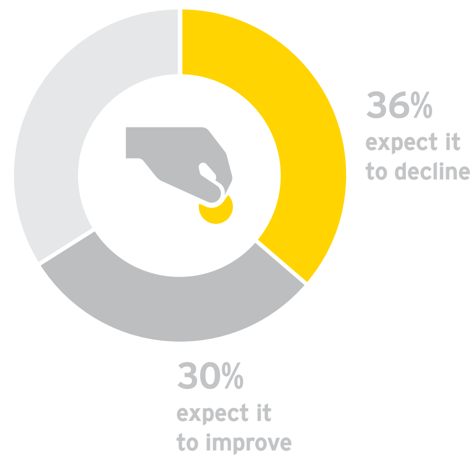


… longer-term perceptions are increasingly negative …

The perception survey responses also contain some worrying indicators for the future attractiveness of the UK for FDI. Our study shows that 36% of investors expect the UK's attractiveness for FDI to decline over the coming three years, while only 30% expect it to improve. The resulting net negative intention of -6% is the worst-ever result in 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.

Looking beyond three years, there are concerns about the UK's long-term attractiveness with 30% of investors surveyed across Europe having said they were likely to move assets out of the UK as a result of Brexit. Taken together with the responses across our survey and the 2017 performance data, there is a real risk that the UK is treading water and most likely losing out on investment that would help drive future growth. It is important therefore not to let the reasonably good results of 2017 allow complacency to develop.

How investors expect the UK's attractiveness for FDI to change over the coming three years



… as the UK's attractiveness ranking has shifted downward …

The UK's FDI performance in 2017 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 our surveys in the immediate post-referendum period, current perceptions are still significantly lower than the pre-referendum levels on all 13 of the attributes we have tracked for at least five years. It is hard to dispute the view that the referendum vote and subsequent statements on proposed Brexit policy have had a major negative impact on how investors perceive the relative attractiveness of the UK.

It is unsurprising that access to the European market and the UK's domestic growth are areas of concern, given the Brexit process, but the decline in the UK's qualitative appeal is also very striking. The fall in perceptions of stability in the social climate, quality of life, diversity and the political environment taken together show how the UK's image has declined dramatically. The contrast to France highlights how feelings can move quickly and significantly in response to perceived shifts in public mood generally, and in attitudes toward enterprise by politicians in particular.

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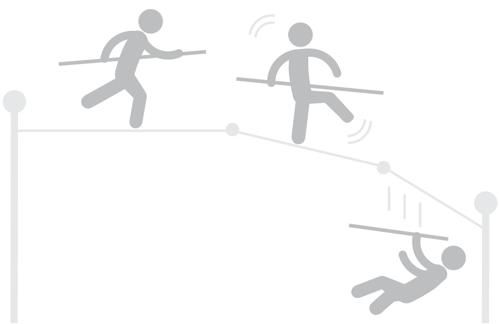


… with transport a particular weakness

The score of 62% for the UK's transport and logistics infrastructure is a long way below its previous high of 80%. This attribute has always been a potential weak spot compared with other European countries but investor perceptions have been falling for four years and are now almost 25% down on the highest-ever result. In part, this ranking may well reflect the failure to address the issue over many years but the message is clear: the time for talking is over and action is required.

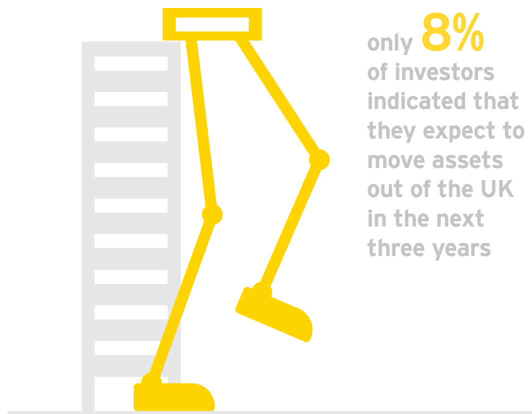
In investors' ranking of the UK's attractiveness across attributes …

… transport and logistics infrastructure received a score of only 62% …

… way below previous high of 80%

There is a narrow window of opportunity to respond in …

The good news is that only 8% 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 financial services and business services companies saying they were likely to move assets, compared with 4% of manufacturers. These results in part reflect the relative ease of moving for businesses in different sectors, and in the case of financial services are being driven to an extent by the need to establish a new base in Europe to meet regulatory requirements. Nevertheless, these moves should serve as a call to action for policy-makers to use the next three years to protect and improve the UK's competitiveness.



only 8% of investors indicated that they expect to move assets out of the UK in the next three years

… with clear priorities both for Brexit …

The responses to our survey serve to identify the key issues that investors are worried about. Future trade and migration policy including access to the European market, the risk of complex customs processes, the possibility of tariffs on European trade, and gaps in skills availability were all raised as significant worries. It is also clear that the UK is seen as a less welcoming place and concerns were raised about the UK's future rate of economic growth when outside of the EU.

… and for the digital age …

According to investors, 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. It appears that investors feel the underlying regulatory and legal frameworks for the digital economy are largely in place, and that the focus should be on expanding the nation's technology and talent bases.

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.

… to ensure a successful transition

The UK's FDI performance shows an economy in transition as a result of the move to Brexit and technological change, with significant shifts in the mix of investment across sectors, project types and size. Investor perceptions confirm this assessment with the UK's attractiveness having fallen from historical highs, and much lower forward-looking intentions to invest.

Digital project growth helped to compensate for a decline in several of the UK's traditionally strong sectors, but even in digital, UK growth lagged the European market growth rate. Manufacturing held up reasonably well but was below the market growth rate while the UK's FDI performance in some of its largest sectors such as business services and financial services was weak. All of the evidence suggests that the UK is starting to miss out on growth, growing more slowly than Europe, losing share in its traditionally strong sectors and slipping back in high-growth sectors such as digital and business services. Project and employment growth in 2017 are not reasons to settle for below-market growth rates – the UK needs to up its game.

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 policy-makers need to engage with businesses and investors to identify the policy responses that will both shape the UK's approach to Brexit, and position the UK for success in attracting digital investment in future. The challenge is to lead the transition and drive toward a successful outcome for the UK.

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Achieving a successful transition

1. Rebuild the UK's reputation

Our survey findings highlight that the UK's appeal on qualitative measures has fallen significantly in the last two years. Investor perceptions of the quality of life, diversity in the UK, the degree of stability in the social climate, and the transparency and predictability of politics and law have all fallen. The UK is seen as less welcoming than it once was and the UK environment is seen as less pro-business.

There is an urgent need for action on two fronts:

- The UK Government must articulate clearly its vision for the UK. This should include explaining how it proposes to drive the future growth of the UK economy and the way in which this will be delivered, emphasizing a pro-business environment characterized by certainty and long-term vision rather than ad hoc tinkering.
- In parallel, there is an urgent need to set out the UK's approach to a range of issues that impact investor and individual perceptions of the UK. These include immigration, provision of public services and the approach to foreign investment. All need to be clearly defined and then communicated to encourage people and businesses to come to the UK.

2. Expand the industrial strategy to services and digital

The impact of Brexit and digital are changing the UK economy, and there is a risk that the UK could miss out on growth opportunities. Manufacturing has performed reasonably well in FDI terms in the last couple of years, and it is important that the UK's industrial strategy is implemented successfully to maintain and increase the sector's appeal. However, it is increasingly clear that both services and digital businesses need support.

The UK is currently perceived by investors as attractive for digital but the UK lost market share in FDI in this sector in 2017. We have previously called for a 'digital drive' to address the early warning signs of a fall in the UK's competitiveness in this sector, suggesting that building on initiatives such as the Made Smarter Review would be a good starting point. There is little sign of progress and our research highlights that a renewed focus on digital skills, broadband infrastructure, support to start-ups and efforts to enable greater diffusion of knowledge is urgently needed.

The fall in FDI projects in both financial services and business services volumes in 2017 should be seen as a wake-up call, given that both are seen by investors as having growth potential. In the case of financial services, this fall in projects is being driven, to an extent, by the need to establish a new base in Europe to meet regulatory requirements and the UK remains the sector's European market leader. Nevertheless, the UK economy is in transition and two of our core sectors are under pressure. Potential restrictions on labor mobility and regulatory uncertainty are concerns for both sectors. The fact that the UK economy is stable should not lead to complacency — there is a need to work with these sectors to shape the future environment to maintain the UK's competitiveness.

3. Develop a focused trade strategy

The UK's Department for International Trade has been working hard to identify where FDI creates economic value. This is a very positive development as it offers the opportunity to allocate resources in the most economically beneficial way. The aim should be a focus on key priorities:

- Concentrating resources on high economic value opportunities to reflect current and future value, aligned to the sector strategies highlighted above.
- Investing time in proactive targeting of investors in sectors and with histories of investing that generate high economic value.
- More explicit consideration of the geographic benefits with an increased priority on FDI and trade-related activity that can benefit towns and not just the large cities.

4. Improve the UK's transport infrastructure

Investors are despairing of the quality of the UK's transport infrastructure. Every year, plans are articulated but consistently not delivered. There is an urgent need to prepare a detailed plan for the UK's future infrastructure in a digital world after Brexit and to start to deliver on the promises. Given the importance of transport to investment decisions in the UK regions, the geographic dimension should be a key part of the decision-making on future investment priorities.

2

Reality

The UK's FDI performance in 2017

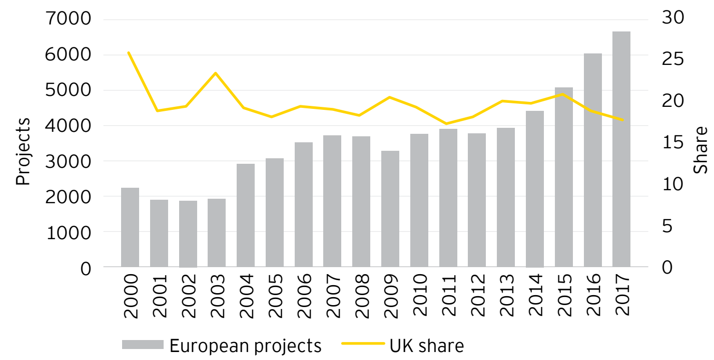
A strong year for Europe ...

2017 represented another record year for cross-border investments into Europe. The total number of FDI projects secured in Europe during the year was up by 10% from 2016, rising from 6,047 to 6,653. To put this into perspective, the low point for annual projects secured in Europe in the past decade was 3,303, in the recessionary year of 2009 — and projects are now running at more than double that year's figure. Also, FDI projects across Europe have now grown for five years in a row. And the total employment estimated to have been created by FDI projects across Europe in 2017 was 353,469, an increase over the estimate of 273,000 jobs in 2016.

... with the UK seeing its projects numbers rise but market share decline ...

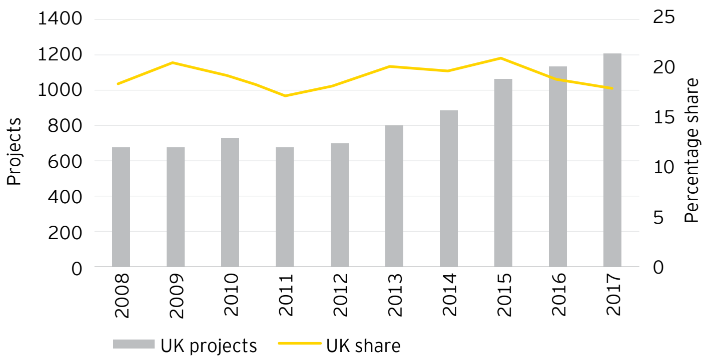
2017 was also the UK's most successful year to date in terms of securing FDI projects. The number of inward investment projects recorded into the UK during the year was 1,205, an increase of 6% from the 1,138 projects secured by the UK in 2016. As well as setting a new all-time high, this performance also means that the number of FDI projects recorded by the UK has now increased for six successive years. However, with the UK's project count growing at a slower rate than for Europe as a whole, the UK's share of all European projects secured during the year fell back from 19% to 18% — the lowest market share for the UK since 2011 and the second successive year of market share loss.

Total number of FDI projects into Europe 2000-17 and UK market share



Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2000-15.

Total number of FDI projects into the UK 2008-17 and UK market share of European projects



Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

The UK is still leading in terms of FDI employment in 2017 with an increase of 6%

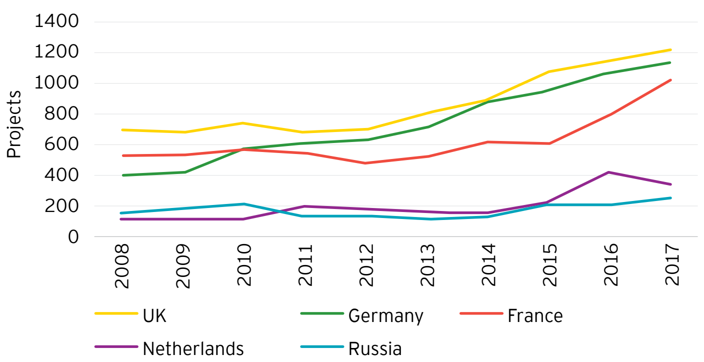
… and while the UK retained its European leadership, ahead of Germany …

The 2017 FDI figures effectively maintained the status quo among Europe's two largest recipients of FDI, with the 6% growth in UK projects being matched by Germany, also up by 6%. In common with every year since the European Investment Monitor (EIM) database was first set up in 1997, the UK recorded the largest number of projects secured by any single country. Meanwhile, the 6% increase recorded by Germany in 2017 took its number of FDI projects to 1,124 – again, a record for that country – and continued an unbroken run of annual increases dating back to 2003. Since that point, Germany has recorded 14 consecutive years of growth, and the number of projects secured by Germany in 2017 was 10 times higher than in 2003.

… France saw a surge in projects

France – which remains in third place behind Germany – also recorded strong growth in projects in 2017, sustaining a recovery that began in 2016. The number of projects recorded by France in 2017 was 1,019, up by 31% from the previous year, representing the highest rate of growth among Europe's largest FDI recipients.

Total number of FDI projects of Europe's leading five recipients, 2008-17

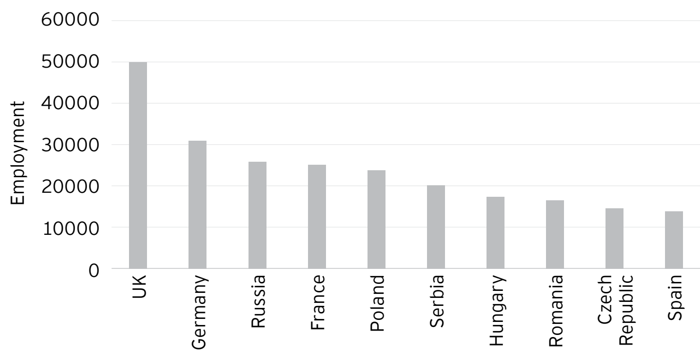


Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

The UK continues to lead on employment creation from FDI

Within the overall increase of 29% in the number of jobs estimated to have been created through FDI across Europe in 2017 to 353,469, the figures suggest that the UK is still leading in terms of FDI employment. Indeed, the distinct mix of projects secured by the UK brings it a significant lead over Germany and France in this regard. In 2017, UK employment from FDI is estimated to have increased by 6%, from 47,000 to 50,000 jobs, while FDI into Germany and France is estimated to have created 31,000 and 25,000 roles respectively.

Employment by country – Europe's top 10 locations, 2017

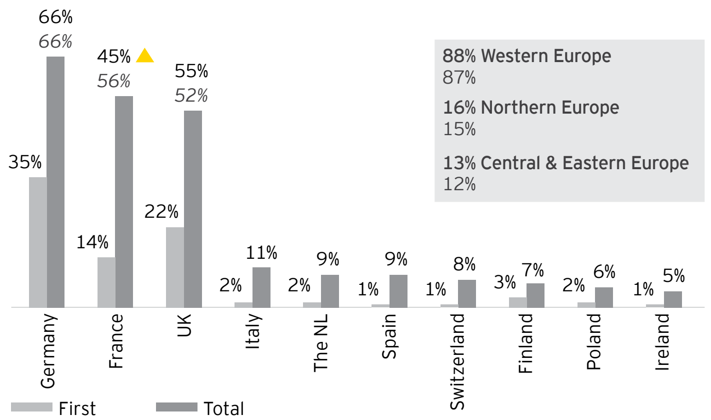


Source: analysis based on IBM database, 2017.

The UK's relative attractiveness is in decline … and signs of a "Macron effect" …

The findings from our 2018 survey of global investors' perceptions of the UK as an FDI location cast an interesting light on the IBM project figures for 2017. Whatever views investors may be taking of specific attributes of the UK – and the UK's continued lead in securing projects suggests those views remain generally positive overall – our research shows that the UK's overall attractiveness is seen as having declined relative to its competitors in Europe. Asked to name their top three countries for FDI in Europe, investors put Germany first on 66%, the same as the previous year. But behind Germany, France gains 11 percentage points to take second place with 56%, while the UK slips to third place, falling by three percentage points to 52%.

According to you, which are the top three countries for FDI in Europe?



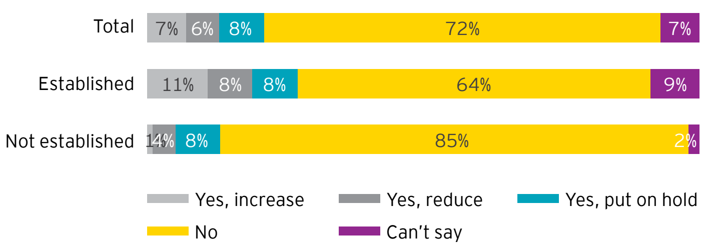
Source: EY's UK Attractiveness Survey 2018, sample (n=443).
Note: open-ended question, three possible answers. Only top 10 countries are shown.

Losing second place in Europe to France on overall perceptions of attractiveness to FDI may be a largely symbolic change for the UK, but it is a worrying one. A particular concern is that the UK's perceived relative attractiveness is declining at a time when its nearest competitor – France – is gaining ground, and when Germany's rating as Europe's most attractive market is holding steady.

... with Brexit appearing to impact perceptions and growth potential ...

As the UK continues its Brexit negotiations with the EU, this year's perception study presents a great opportunity to gauge how the prospect of Brexit has affected global investors' perceptions of the UK as an FDI location. And from the findings, it is hard to deny that Brexit is having an impact on investors' views, as the UK's perceived attractiveness relative to key European competitors slips back. That said, with inward investment projects into the UK reaching another record level in 2017, it is clear that the impact of Brexit on the UK is nuanced. For example, when we asked investors whether they had changed their investment plans for the UK in the wake of the referendum result, their responses varied widely — with some moving in and others moving on.

Following the UK's vote to leave the EU, have you changed your investment plans for the UK in the past 18 months?



Source: EY's UK Attractiveness Survey 2018, sample (n=443).

> "The highest growth in percentage terms was recorded by the East of England, where projects increased by 48%.

The findings on investment intentions show that 21% of investors have changed their UK investment plans since the referendum vote. But within that overall figure, the picture that emerges is a complex one. Seven percent of investors have increased their investment plans in the UK in the past 18 months, 6% have reduced their investment plans, and another 8% have put their plans on hold. So the balance between those increasing and reducing their investment plans is broadly flat. But with the uncertainty and political wrangling over Brexit continuing, the fact that 8% of investors say they are pausing their UK investments is worrying, if not surprising. These findings are consistent with the UK losing share in 2017 and suggest that although the UK attracted an increased number of projects in 2017, its loss of market share and growth below the market rate in its traditionally strong sectors suggest it may be starting to miss out on growth.

... as digital changes the landscape

2017 was not an ordinary year, as it was the time when the digital revolution hit Europe. Digital FDI projects increased from 881 in 2016 to 1,172 in 2017 across Europe, an increase of 33%, more than three times the rate of overall market growth. Digital projects in the UK grew from 261 to 320, accounting for nearly all of the overall increase in UK projects between 2016 and 2017. Yet the increase of 23% achieved by the UK in digital was less than the rate of market growth, which does raise concerns about the future.

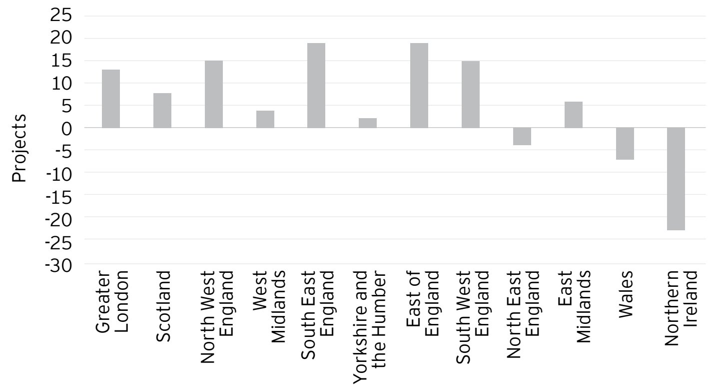
And this is not just a growth story: digital is changing the shape of FDI, bringing new dynamic businesses to Europe. We estimate that in 2017, around 57% of the digital projects announced in the UK have 10 employees or less with the overwhelming majority of the projects being located in and around cities with world-ranked universities.

FDI in the UK regions: generally strong growth — but less so in London ...

At a regional level, the story of FDI into the various parts of the UK in 2017 is generally positive, with 9 of the 12 UK regions increasing their total number of projects secured. Scotland had another good year, sustaining its position as second among the UK regions, with a 7.4% rise in project numbers. This means Scotland has now ranked second behind London in attracting FDI in five of the past six years. Meanwhile, the North West, South East, South West, and East of England all saw significant growth, and Yorkshire and the West Midlands consolidated their strong 2016 performances. The highest growth in percentage terms was recorded by the East of England, where projects increased by 48%.

London maintained its position as the leading location for investment, but only recorded a modest increase of 3% in projects. This relatively poor performance resulted in London's share of UK projects falling to 38%, its lowest for a decade. There is no doubt that the transition in FDI that the UK is experiencing is having the largest initial impact in London.

Actual change in projects numbers per UK region, 2016-17



Source: analysis based on IBM database, 2016-17.

Performance of the UK regions in securing FDI projects, 2016-17

Region	Projects	Change 2016-17
Greater London	459	2.9%
Scotland	116	7.4%
North West England	105	16.7%
West Midlands	97	4.3%
South East England	91	26.4%
Yorkshire and the Humber	82	2.5%
East of England	59	47.5%
South West England	53	39.5%
North East England	48	-7.7%
East Midlands	43	16.2%
Wales	33	-17.5%
Northern Ireland	19	-54.8%

Source: analysis based on IBM database, 2016-17.

… as strong cities help drive UK regions' FDI performance …

Looking across the FDI performance in 2017 from the UK regions outside London, it is clear that cities remain a strong and often vitally important focus and driver for inward investment activity. Looking back over the period since the turn of the millennium, the UK's top five cities (excluding London) have typically exhibited a variable level of performance on a year-by-year basis, and it is sensible to compare results over longer periods than 12 months. All of the top 10 cities in the UK secured more projects in 2017 than their five-year average performance, with the sole exception of Glasgow, which had a slower year in 2017.

Manchester remained the leading city for FDI in the UK outside London. Like London, Manchester achieved only a modest increase in projects, but it still secured 16 more projects than second-placed Edinburgh, despite Edinburgh's projects surging by 45% year on year. The fastest year-on-year growth in 2017 was recorded by Cambridge, which secured double the number of projects it recorded in 2016.

Project numbers and change in the top 10 UK cities for FDI (excluding London), 2017

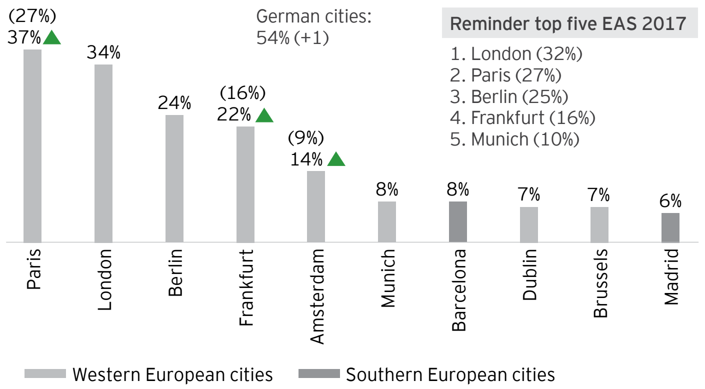
		Projects	Change 2016–17	Five-year average projects
1	Manchester	45	2.3	35.2
2	Edinburgh	29	45.0	24.0
3	Birmingham	21	-34.4	19.8
4	Leeds	19	18.8	16.2
5=	Coventry	16	60.0	10.4
5=	Glasgow	16	-40.7	19.6
7=	Aberdeen	14	-12.5	11.6
7=	Cambridge	14	100.0	8.6
7=	Oxford	14	75.0	6.6
10=	Bristol	13	-7.1	11.6
10=	Newcastle	13	-13.3	8.8

Source: analysis based on IBM database, 2017.

… with London under pressure …

Any concerns over the relatively slow growth in FDI into London in 2017 may be heightened by the fact that it is no longer the European city perceived by global investors as the most attractive for FDI. EY's 2018 European Attractiveness Survey finds that London now ranks second behind Paris as the European city in which investors would most like to locate their projects. Also, no other UK city makes the European ranking — while Germany, by contrast, has three cities in the top six. Again, this disparity emphasizes London's importance to UK FDI.

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



Source: EY's European Attractiveness Survey 2018, sample (n=502).
Note: open-ended question, three possible answers.

… signaling transition is underway

The positive news from our FDI figures for 2017 is that the UK has seen its project numbers continue to grow, and has sustained its number one position among European recipients of FDI. But, at the same time, the UK's market share has slipped to its lowest since 2011, and perceptions of its future attractiveness are worsening as Brexit looms. The growth in digital projects and the continuing strength of manufacturing and R&D, both strongly influenced by digital, helped to compensate for weaker performance in traditionally strong sectors such as financial services, business services and HQ investments.

The trends in the UK demonstrate that its economy is in transition as a result of the move to Brexit and accelerating technological change, and the signs are that the UK is starting to miss out on growth, growing more slowly than Europe and slipping back in high-growth sectors such as digital and business services. Even the solid performance in manufacturing is below the European growth rate. The way ahead is likely to be challenging.

We'll now move on to a detailed analysis of the drivers behind the UK's FDI performance, to help understand what the policy priority areas should be to ensure the UK can achieve a successful transition.

> "The fastest year-on-year growth in 2017 was recorded by Cambridge, and Manchester remains the leading city for FDI in the UK outside London.

Seizing Europe's tech opportunity

VIEWPOINT

LONDON & PARTNERS
Laura Citron
Chief Executive

As London's official promotional agency, tasked with attracting international investment into the capital, London & Partners welcomes the EY UK Attractiveness Survey as a useful guide to London's FDI landscape in the context of the rest of the UK and Europe.

The most promising development is the ongoing strength of London's tech sector, with an increase of 34% in digital projects from 2016-17, giving London almost a fifth of European market share. This chimes with data from PitchBook, which shows that since the EU Referendum Vote in June 2016, London has remained Europe's number one destination city for venture capital funding, with its tech firms attracting over £4b of investment – ahead of our European neighbours Paris (£1.14b), Berlin (£814m) and Stockholm (£542m).

Of course, this doesn't mean that London should be complacent and we are mindful of the view of foreign investors surveyed by EY who named Paris as the most attractive city to invest in. At London & Partners we are refocusing our efforts on winning foreign investment for London, working in partnership with London's global business community. We're opening new offices in Berlin and Paris to put us at the heart of these exciting tech ecosystems.

I am encouraged by the evidence of a steady rate of FDI projects into London, despite the uncertainty caused by Brexit, and a significant surge in tech investment, indicating that London's unique position as a creative and entrepreneurial city with an unparalleled ecosystem for business – from talent, to regulation, to time zones – remains strong. We will continue to champion these fundamental strengths to help ensure London remains a leading global hub for business and investment.

Analysis

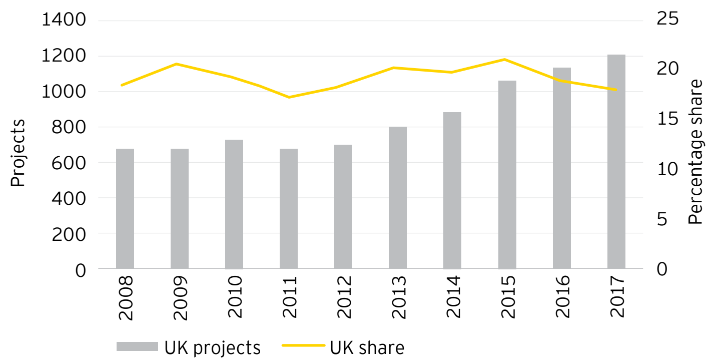
What is driving the UK's FDI performance and perceptions?

The UK economy is in transition, and in this section, we examine the key drivers of the UK's FDI performance and perception among investors globally to help us understand two things: firstly, where the UK currently sits in terms of its current project flows and future attractiveness for FDI; and secondly, the issues that will need to be addressed to give the UK the best chance of continuing its success in attracting FDI and to achieve a successful transition.

New projects: Germany retains its lead, as the UK slips back

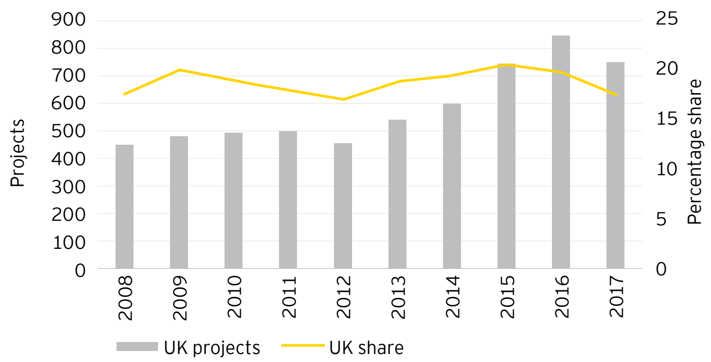
A useful perspective on the UK's FDI performance – and future prospects – can be gained by stripping out follow-on investments by existing projects, and looking specifically at new investments. In 2017, the UK recorded a decline in new FDI projects against the background of a rise in new projects across Europe overall. The number of new projects secured in the UK fell from 842 in 2016 to 753 in 2017 – a fall of 11% – while across Europe as a whole, the number of new projects edged upward by 1%, from 4,276 to 4,314. This meant that the UK's market share of new FDI projects into Europe fell markedly in 2017, slipping to 17% from a 10 year high of just over 20% in 2015.

Total number of FDI projects into the UK 2008-17 and UK market share of European projects



Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

Total new UK projects recorded and UK market share in Europe, 2008-17



Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

The UK's traditional core FDI sectors are exposed to Brexit …

In 2017, the number of projects from what have historically been two of the UK's strongest FDI sectors – financial services and business services – saw declines. Financial services projects fell by 26%, despite growth in this sector's projects across Europe, and business services projects into the UK also declined – in this case by 10% – also against the background of a growing European market. London's strength in FDI in both of these sectors meant these declines had an especially significant impact on London's performance.

However, the FDI figures by sector also reveal some brighter spots for the UK. In particular, the UK is the number one location for the sector generating the largest number of projects – digital. The UK has a 27% market share of digital projects across Europe, and the digital sector remains an area where projects are increasing at a rapid rate.

Top 10 sectors for FDI in Europe 2017 and UK performance

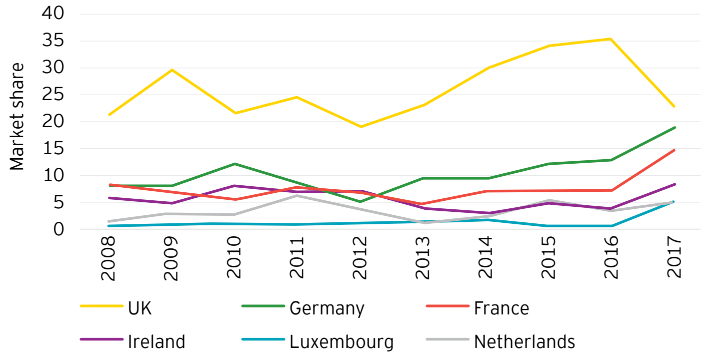
Sector	Projects 2017	Growth	UK projects	UK rank
Digital	1172	33%	320	1
Business services	893	12%	177	2
Transport manufacturing	531	9%	85	2
Chemicals and plastic	404	-7%	37	3
Logistics	396	-2%	48	3
Pharmaceuticals	379	33%	59	2
Agri-food	363	11%	63	1
Financial services	342	13%	78	1
Machinery and equipment	329	-9%	46	3
Electronics and IT	257	13%	42	2

Source: analysis based on IBM database, 2017.

… as Germany and France gain ground in financial and business services FDI

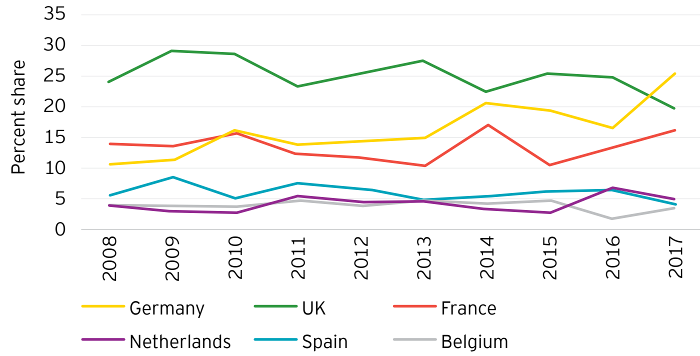
Over many years, the UK has been the leading destination in Europe for service sector projects, holding the lead in business services and financial services FDI in addition to digital projects. In 2017 the UK slipped to second place behind Germany in attracting business services projects, as UK projects from this sector fell back and Germany's increased. UK financial services FDI projects fell back even more sharply than those in business services, while Germany strengthened its performance significantly in that sector as well. In both sectors, France also increased its market share. And while the UK maintained its lead in digital FDI projects, it saw a significant decline in its market share, down from 30% to 27%. A beneficiary of this was France, which registered the biggest increase in market share of digital projects, up from 10% to 15%.

European market share of financial services projects – six largest recipients 2008-17



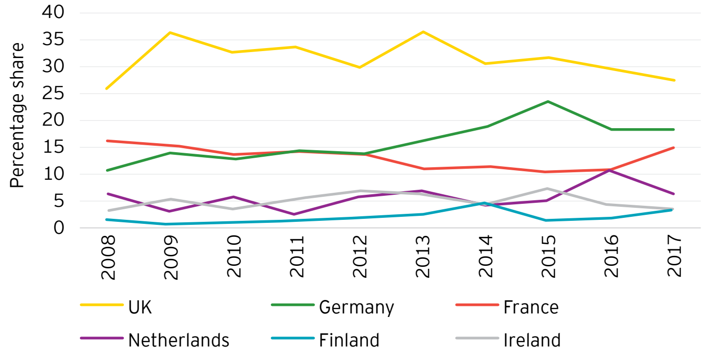
Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

European market share of business services projects – six largest recipients 2008-17



Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

European market share of digital projects – six largest recipients 2008-17



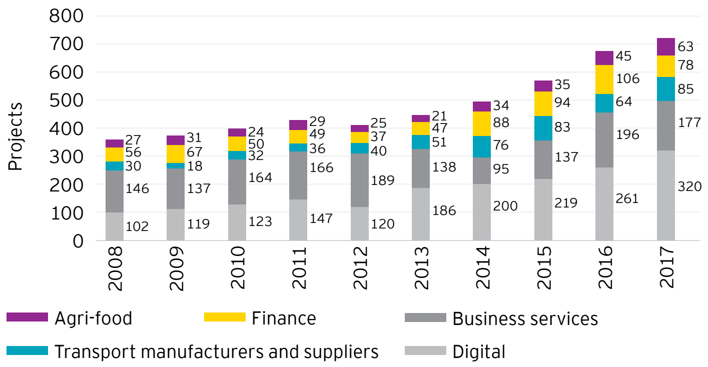
Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

> "The UK has a 27% market share of digital projects across Europe, and the digital sector remains an area where projects are increasing at a rapid rate.

The UK's largest FDI sectors put in varying performances

Looking across the sectors contributing to UK FDI, the 23% rise in digital FDI projects secured by the UK in 2017 means this sector now accounts for more than a quarter of all UK projects. As already noted, financial services and business services projects declined in absolute terms in the UK in 2017. However, transportation manufacturing projects (mainly automotive and aerospace) increased by almost a third in 2017, and food projects also rose — with many of these sectors recording their largest numbers of projects over the past 10 years.

Projects in the UK's largest sectors for FDI, 2008-17



Source: analysis based on IBM database, 2016-17;
EY European Investment Monitor (EIM), 2008-15.

This performance in terms of actual projects secured from different sectors tends to correlate closely with the findings from our investor perceptions survey, which identified significant variations in sentiment between different sectors. For example, an analysis by sector of investors' responses shows that:

- 12% of business services and financial services companies have put investment on hold, the most cautious responses of any sectors.
- Consumer goods companies have been the most active in increasing their investment in the UK, with 13% upping their commitment.
- 11% of hi-tech companies have reduced their investment, but this is almost offset by the 10% who have increased their spending.
- 11% of chemical and pharmaceutical companies have increased their UK spending, but 12% have put activity on hold.

Project types: mixed messages emerge ...

As with sectors, a breakdown of UK FDI in 2017 by project type reveals a varied picture. The best news is a strong rise in R&D projects. These increased by 31%, slightly ahead of the rate of market growth across Europe in an area often portrayed as being at major risk from Brexit. The UK's digital strength was a key factor in this performance. The UK also put in a continued strong showing in sales and marketing, and manufacturing FDI.

Main activities of investment in the UK in 2017, and UK's European market share

	Projects	Market share	Change on 2016
HQ investments	95	26%	-31%
Logistics	75	14%	-29%
Manufacturing	216	11%	17%
R&D	89	17%	31%
Sales and marketing	664	24%	15%
Other back office	66	16%	0%

Source: analysis based on IBM database, 2017.

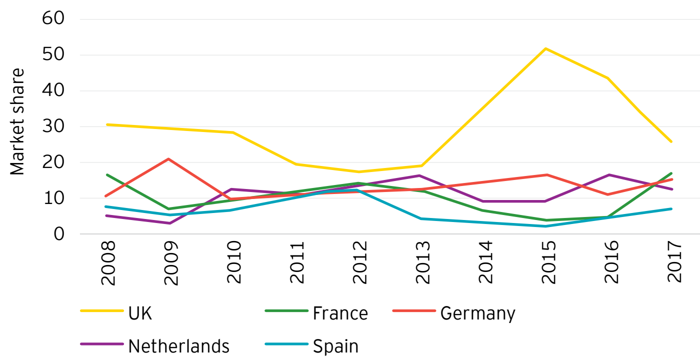
> The best news is a strong rise in R&D projects. These increased by 31%, slightly ahead of the rate of market growth across Europe.

... as the UK's share of HQ projects falls back ...

The decline in UK HQ investment projects in 2017 represents a significant fall in the UK's market share in this type of FDI. 2017 was the second successive year of decline in HQ investments in the UK, a pattern that may reflect Brexit-related concerns over the UK as a suitable location for a European HQ. The UK's market share of 26% of European HQ projects was fully one quarter lower than in 2015.

France and Germany were the major beneficiaries of the decline in UK project numbers. France recorded the largest increase, regaining its position as the number two location in Europe, after the UK, for HQ investments (last secured in 2012), with an increase from 16 HQ projects in 2016 to 59 in 2017. Germany also saw HQ project numbers rise, albeit at a slower pace, from 33 to 55.

Market share of the five largest destinations for HQ projects, 2008-17

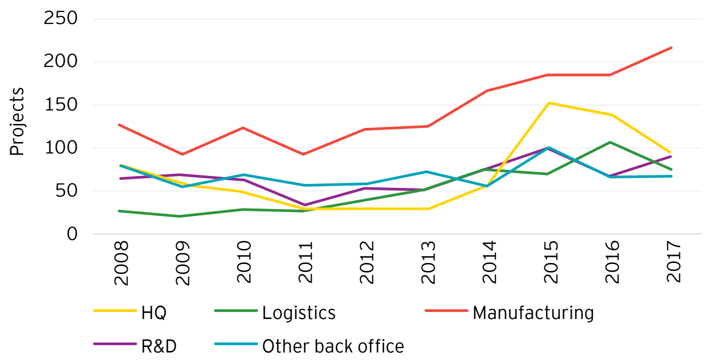


Source: analysis based on IBM database, 2016-17;
EY European Investment Monitor (EIM), 2008-15.

... but UK manufacturing FDI continues to strengthen ...

Stripping out the dominant sales and marketing projects, the longer-term trends in terms of types of FDI coming into the UK underline the growth in UK manufacturing projects. These have risen every year since 2011, when manufacturing project numbers were at an all-time low of 92. By contrast, in 2017 there were 216 manufacturing investments recorded in the UK.

UK FDI projects by activity (excluding sales and marketing offices) 2008-17

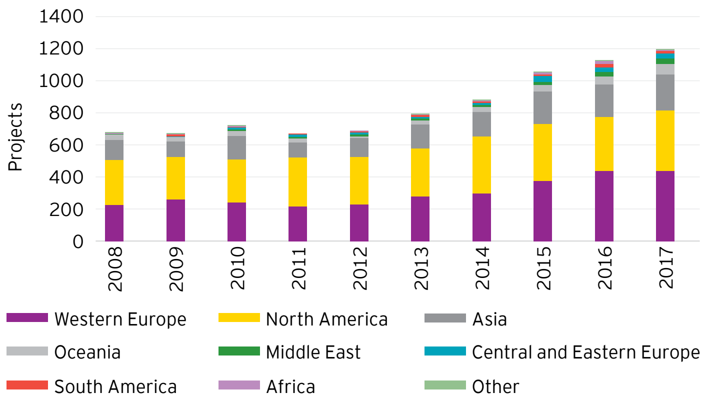


Source: analysis based on IBM database, 2016-17;
EY European Investment Monitor (EIM), 2008-15.

… as the UK wins more projects from outside Western Europe …

In terms of the international regions investing in the UK, Western Europe represented the largest source of projects in 2017. This has been the pattern since 2015, when Western European projects into the UK exceeded North American projects for the first time. However, in 2017 the number of projects from Western Europe into the UK was virtually unchanged, with just two more projects recorded, taking the total to 444. By contrast, projects from North America into the UK increased by 12%, projects from Asia by 10%, and projects from Oceania by 35%.

Origin of UK projects by global region, 2008-17

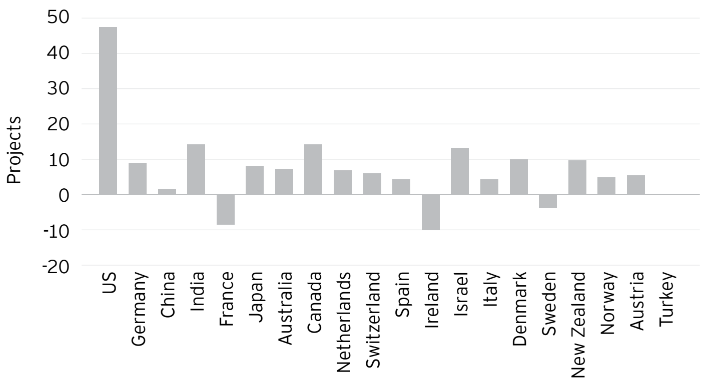


Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

… and the US remains pivotal to the UK's leadership in European FDI …

As in previous years, the 10 leading origins of investment into the UK in 2017 differed from the 10 most important origins of investment into Europe as a whole. The UK's top 10 sources of FDI projects during the year included India, Australia and Canada, replacing the leading European FDI origins of Sweden, Italy and (of course) the UK. Also, investments into the UK from Commonwealth nations increased in general in 2017. In fact, the number of investments from the vast majority of the UK's top 20 origins increased during the year, with the only exceptions being France, Ireland and Sweden. In the case of Ireland and France, these countries' outbound investment projects declined overall. However, Sweden increased its investment projects by 34% — but those projects proved to be less likely to select the UK.

Change in investment into the UK 2016-17 from top 20 origins of investment

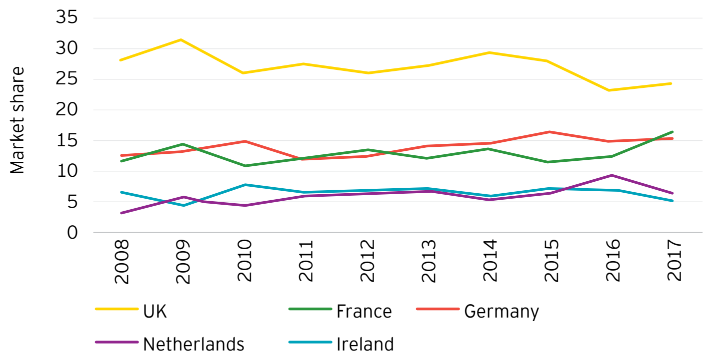


Source: analysis based on IBM database, 2016-17.

> "The increase in projects from the US was a particular feature of the UK's FDI performance in 2017

The increase in projects from the US was a particular feature of the UK's FDI performance in 2017. Indeed, the UK's position as the leading recipient of investment from Europe's largest source of projects is the key reason for its continued status as Europe's largest recipient of FDI. That said, the UK has lost market share of all US projects into Europe over the past decade, from a high point of 31% in 2009 to a low point of 23% in 2016. Against this background, 2017 saw a modest improvement in the UK's European market share of US projects, which recovered slightly to 24%. France also secured an increased share of US investment in 2017 — overtaking Germany to become the second most likely place for US investments in Europe to locate themselves.

Market share of US Investment 2008-17 (top five recipients)



Source: analysis based on IBM database, 2016-17; EY European Investment Monitor (EIM), 2008-15.

… with a surge in UK outward investment

A feature of FDI in 2017 was the significant increase in investment projects by UK-based investors elsewhere into Europe. The concerns over Brexit identified earlier are one contributory factor but another is the relative improvement in the European economy over the last couple of years. Together, these effects contributed to 464 projects out of the UK in 2017, a 35% increase on the 343 projects in 2016. Outbound project numbers have more than doubled from 230 in 2013.

There were increases across a range of sectors with financial services, chemicals, transport manufacturing and food all increasing by significant amounts. Similarly, HQ investments and logistics also grew dramatically as UK-based investors started to position for Brexit and to capture the benefits of faster European growth.

UK outbound investment 2016 and 2017

Sector	Projects 2017	Projects 2016	Change
Business services	125	117	7%
Financial services	54	28	93%
Digital	84	34	147%
Transport manufacturing	29	13	123%
Food	17	12	42%
Logistics	29	17	71%
HQ investments	28	9	211%
Chemicals	28	11	155%

Source: analysis based on IBM database, 2016-17.

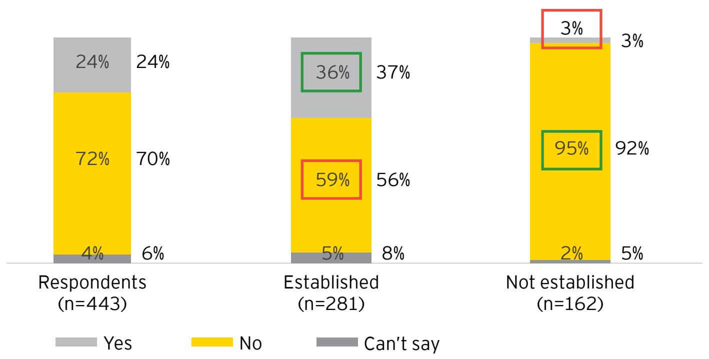
There are benefits from outbound investment both in terms of immediate improvements in business performance and potential gains in influence and soft power, so we should not overreact to these shifts in investment flows. Nevertheless, the changes do illustrate the challenges facing the UK economy and the risk of the country missing out on growth if investment does move elsewhere, especially in the high-growth sectors outlined above.

Outlook: a challenge to retain the lead

No collapse in short-term intentions to invest in the UK, but a relative softening ...

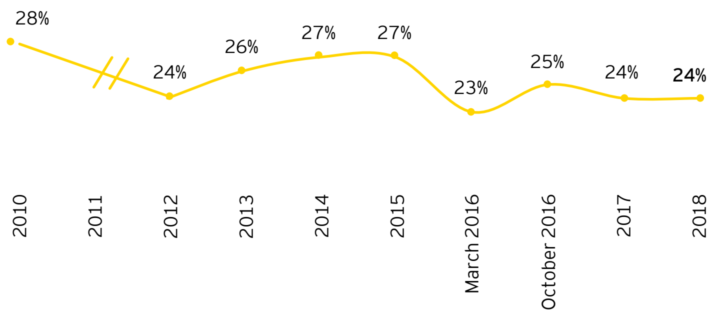
Against the background of our FDI project figures, our 2018 survey of investors' plans shows that short-term sentiment for the next 12 months has not changed significantly. The proportion of investors planning to establish or expand operations in the UK over the coming year is 24%, in line with the previous year's results and within the range seen over the past seven years.

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



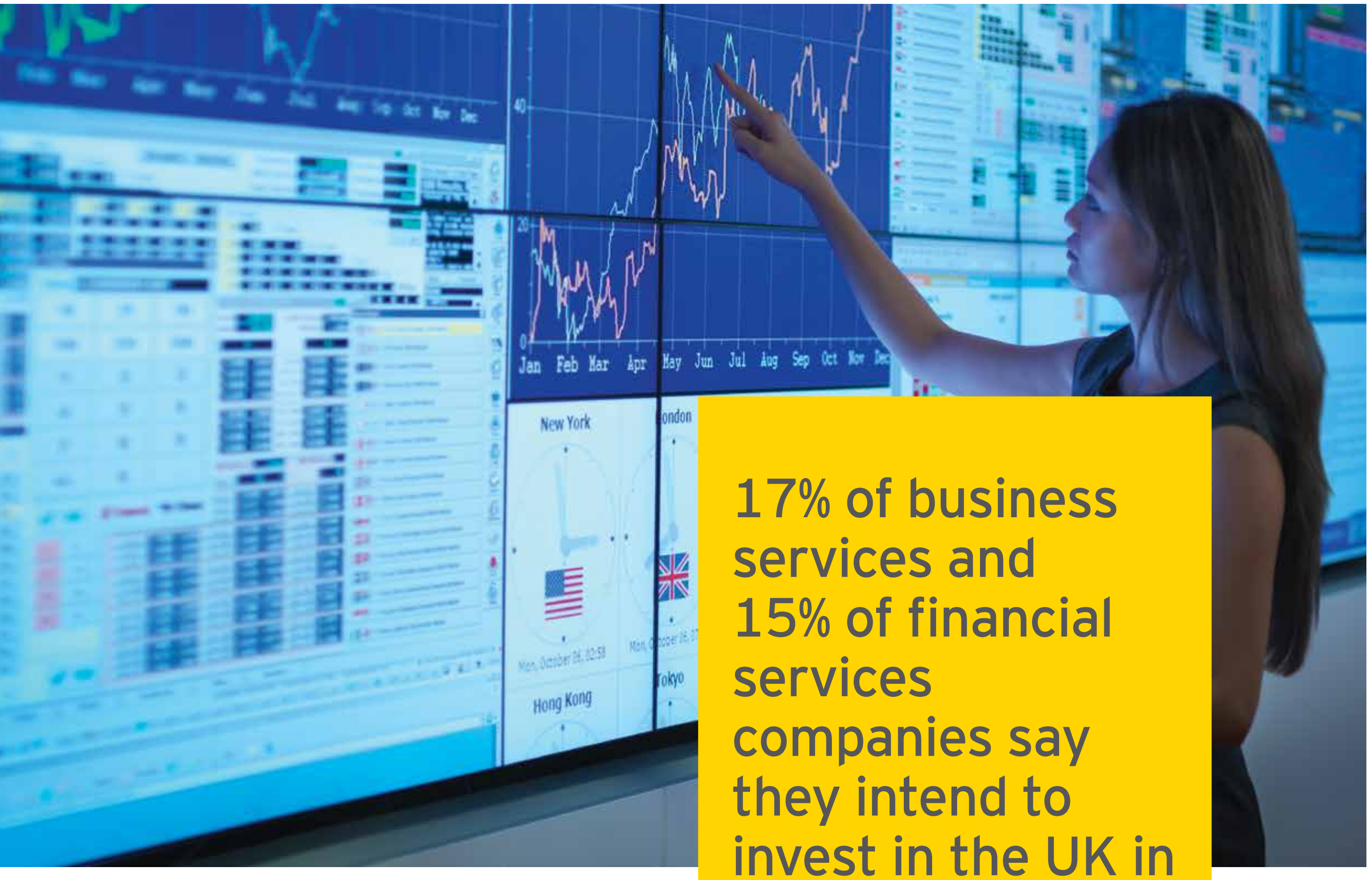
Source: EY's UK Attractiveness Survey 2018, sample (n=443).

Proportion of companies planning to establish or expand operations in the UK over the next year, 2010-18.



Source: EY's UK Attractiveness Survey 2018, sample (n=443).

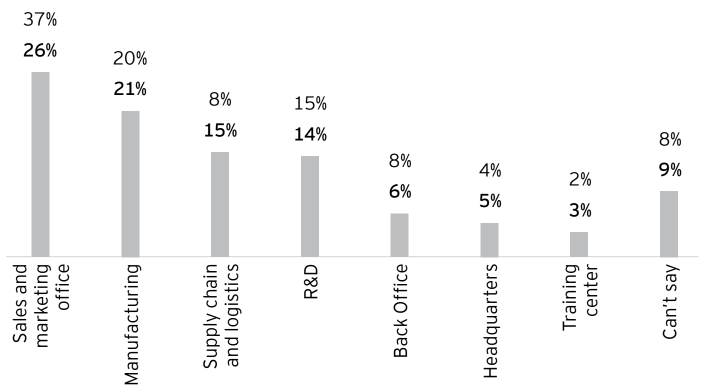
However, it is worrying that this figure of 24% planning to invest in the UK is well below the European average of 35%. A further concern is that this year's study produced improvements in the equivalent figures for Germany, from 24% to 28%, and for France, from 22% to 24%. And a closer look at the UK figures shows that 36% of investors that are already established in the UK plan to invest in the country during the coming 12 months — in line with the 2017 results — against only 3% of those not established in the UK. This suggests that, while the UK may face challenges in attracting new investors, the established base remains secure.



17% of business services and 15% of financial services companies say they intend to invest in the UK in the coming year

Turning to the findings by sector, only 17% of business services and 15% of financial services companies say they intend to invest in the UK in the coming year. More positively, manufacturing businesses are more likely to invest than the average, but logistics is a concern – probably reflecting moves by companies to prepare for the possibility of customs or border changes after Brexit. These findings chime with the UK's project performance in 2017, with services FDI proving disappointing but manufacturing remaining reasonably strong.

Types of investment by companies planning to establish or expand operations in the UK over the next year

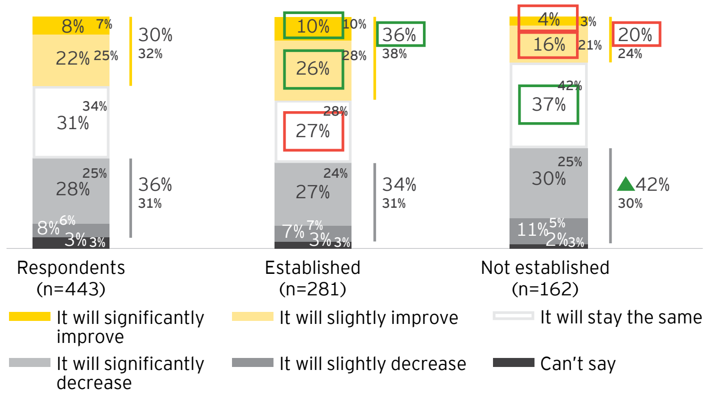


Source: EY's UK Attractiveness Survey 2018, sample (n=107).

... with medium-term views of the UK's attractiveness giving cause for concern.

Taken together, the findings described above suggest that perceptions of the UK's short-term attractiveness among investors have remained relatively stable. However, this relatively rosy picture is darkened by a significant deterioration in investors' longer-term expectations of the UK's future evolution as an FDI location. In our 2018 study, 36% of our respondent investors worldwide say they expect the UK's attractiveness for FDI to decline over the coming three years, while just 30% say they expect it to improve.

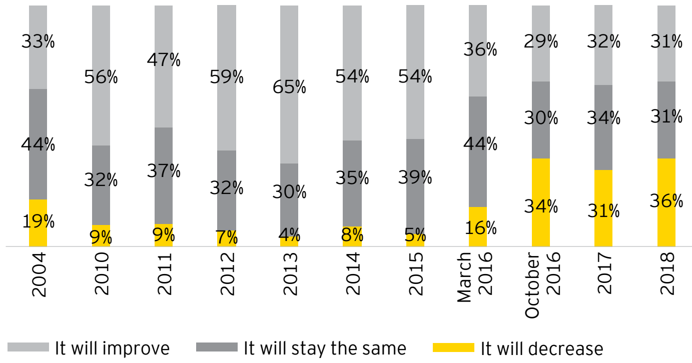
To what degree do you think the UK's attractiveness will evolve over the next three years?



Source: EY's UK Attractiveness Survey 2018, sample (n=443).

Setting aside the post-referendum October 2016 findings as a one off-sample, these are the worst-ever results in our annual survey. Since March 2016, the proportion of investors with a negative view of the UK's medium-term prospects has almost doubled, and the 2018 figure is more than four times higher than the average result from 2010 to 2015. The UK's net score is now minus 6% compared with a peak of 61% in 2012. Equally worryingly, the figure of 30% expecting the UK to improve as an FDI location lags well behind France, whose attractiveness is expected to improve by 55% of investors (up by a massive 28 percentage points from the previous year), and Germany, which 45% expect to improve. The European average is 50%.

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



Source: EY's UK Attractiveness Survey 2018, sample (n=443).

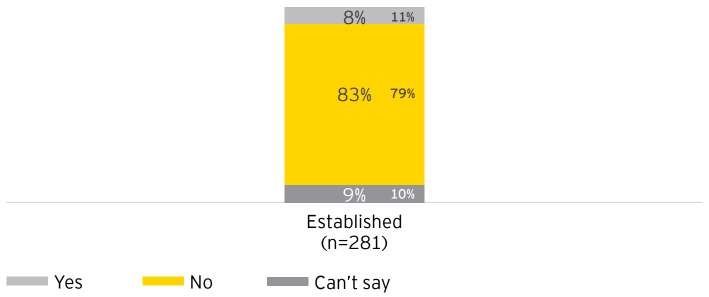
In combination, these results suggest that the Brexit vote and its aftermath may have had a significant impact on longer-term global perceptions of the UK's future attractiveness. As we have seen before in previous attractiveness surveys, it does seem that investors' concerns over the UK tend to be more about future projects than the immediate situation – a tendency that fits in with the long lead times for decisions on FDI projects.

"36% of our respondent investors worldwide say they expect the UK's attractiveness for FDI to decline over the coming three years, while just 30% say they expect it to improve.

A silver lining: investors will not move quickly ...

However, it is not all doom and gloom. A more positive finding from our research is that investors appear to be reluctant to take quick decisions, with only 8% expecting to relocate operations from the UK to Europe within the next three years.

Following the UK's decision to leave the EU, will you relocate operations in the next three years from the UK to Europe?



Source: EY's UK Attractiveness Survey 2018, sample (n=443).

There are, though, wide variations in sentiment by investor nationality, with 25% of Asian investors expecting to move assets, compared with just 1% of Western European investors. Last year, 11% of Western European investors expected to move some operations out of the UK in a three-year horizon, and the decline since then suggests the concerns of this group have eased to some extent.

There is a comparable degree of variation across sectors. Some 16% of chemicals and pharmaceuticals pharma respondents – together with 16% of financial services and 14% of business services companies - expect to move some facilities in the next three years, compared with only 4% of manufacturers and hi-tech companies and 3% of consumer goods producers.

... as sentiment continues to evolve ...

A further factor is that regional variations in perceptions of the UK are continuing to evolve. Japanese investors are typically in the UK – at least in part – to export goods and services, and therefore are more nervous about the consequences of Brexit than businesses that are in the UK to sell to UK customers. This may be why we have seen a hardening of attitudes among Japanese investors in the past year.

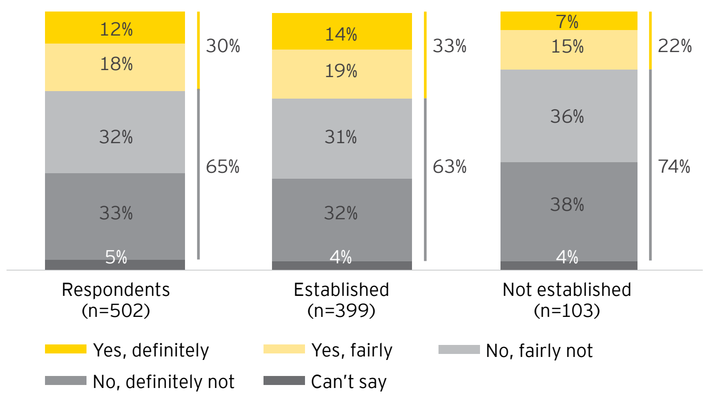
However, this is being offset by the softening of opinion among Western Europeans, probably reflecting a recognition of the importance of geography in shaping economic relations over time, whatever the trading arrangements or agreements might be. There may be challenges for European companies in future, but their relatively high degree of economic integration with the UK will remain – and they will continue to want to operate in the UK market.

Meanwhile, variations in sentiment between different sectors tend to reflect the characteristics of each industry, and how these interact with areas that Brexit is likely to impact. Services companies have more flexible operations, typically with less capital, and so are likely to be earlier movers. By contrast, manufacturers have more complex and asset-heavy businesses, and appear willing to wait before making major decisions.

... but the longer term looks more challenging

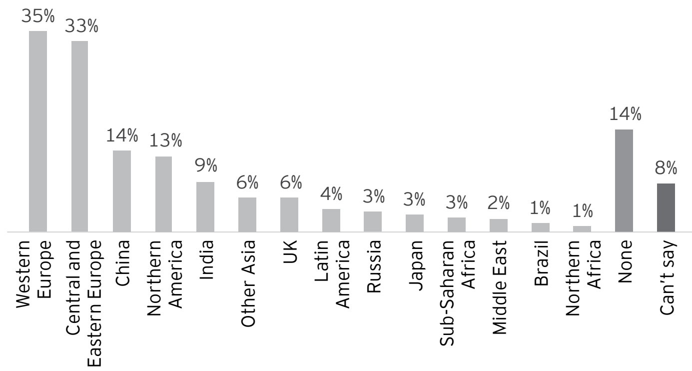
That said, the longer-term outlook beyond the three-year horizon appears more challenging, with our research identifying that over 30% of companies expect Brexit will cause them to move assets out of the UK at some point in future. Moreover, the mood among investors not currently established in the UK is significantly more negative, and this could limit future growth in FDI. For those companies that are impacted by Brexit and are considering relocating operations, Western Europe (excluding the UK) and Central and Eastern Europe are seen as by far the safest bets.

Will Brexit have an impact on your current footprint or activities?



Source: EY's 2018 European Attractiveness Survey, sample (n=502).

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



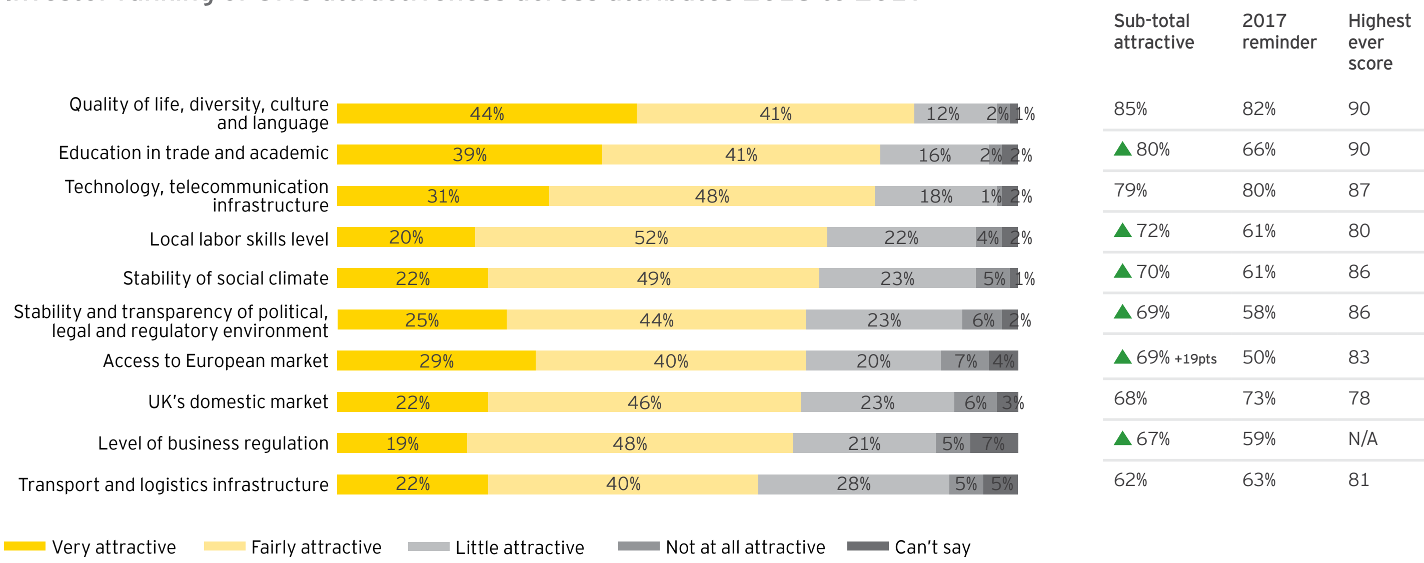
Source: EY's 2018 European Attractiveness Survey, sample (n=154)
Note: three possible answers.

While a short-term decline in FDI may occur, the impact of this would be relatively manageable compared with the risks arising beyond three years out. This means that there is time to respond to ensure the UK remains competitive and attractive, and so reduce the risk of a significant decline in FDI over time. However, it is important to begin the process now. And to do this, the UK needs to understand clearly what investors want.

The UK's rating on several key criteria has improved ...

The UK's FDI performance in 2017 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 our surveys in the immediate post-referendum period, current perceptions are still significantly lower than the pre-referendum levels on all 13 of the attributes we have tracked for at least five years. It is hard to dispute the view that the referendum vote and subsequent statements on proposed Brexit policy have had a major negative impact on how investors perceive the relative attractiveness of the UK.

Investor ranking of UK's attractiveness across attributes 2013 to 2017



Source: EY's UK Attractiveness Survey 2014 to 2018.

It is unsurprising that access to the European market and the UK's domestic growth are areas of concern, given the Brexit process, but the decline in the UK's qualitative appeal is also very striking. The perceptions of stability of the social climate, quality of life and diversity, and the political environment taken together show how the UK's image has declined dramatically. The contrast to France highlights how feelings can move quickly and significantly in response to perceived shifts in attitude toward enterprise by politicians.

The score of 62% for the UK's transport and logistics infrastructure is a long way below its previous high of 80%. This attribute has always been a potential weak spot compared with other European countries, but investor perceptions have been falling for four years and are now almost 25% down on the highest-ever result. In part this ranking may well reflect the failure to address the issue over many years but the message is clear: the time for talking is over and action is required.

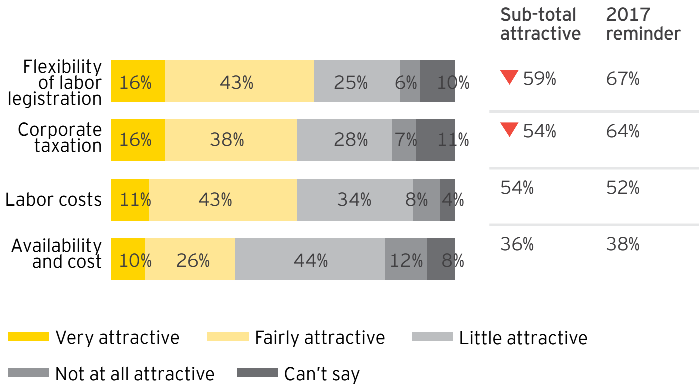
... but weaknesses give cause for concern

These worries are deepened by a look at some of the areas where the UK's attractiveness is weaker or losing ground. In 2018, satisfaction regarding the flexibility of the UK's labor legislation and its corporate taxation regime has declined significantly, while the attractiveness of its labor and real estate costs remain at low levels.

A closer analysis of the 2018 perception findings provides some further interesting insights — and potential causes for concern. Given the critical importance of digital industries to the UK's economic future, it is worrying that technology/telecoms infrastructure is one of the few criteria on which its attractiveness score has fallen, especially among investors from Western Europe.The UK's domestic market has also become less attractive to investors (except those based in North America), perhaps reflecting economic concerns post-Brexit. Also, it may be little surprise that companies from Western Europe regard the stability and transparency of the UK's political, legal and regulatory environment as becoming less attractive, with the proportion of Western European respondents rating the UK as attractive on this criterion declining to 54%, compared with 74% among North American companies and 76% among those from Asia.

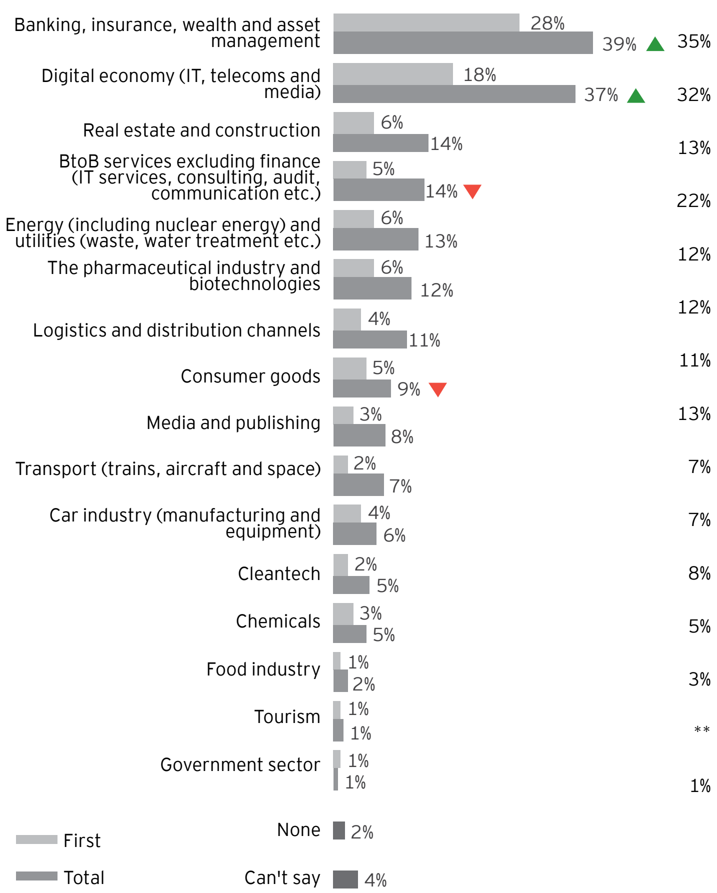
Breaking the respondents down by size, smaller businesses with turnover below €150m are especially unimpressed with the UK's level of business regulation and access to

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



Source: EY's 2018 UK Attractiveness Survey, sample (n=443).

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



Source: EY's 2018 UK Attractiveness Survey, sample (n=443).
Note: two possible answers.

the European market, giving lower scores than last year to the UK's attractiveness on both of these criteria. On some attributes there are some significant differences of opinion between companies of different sizes. For example, the proportion of medium-sized companies (between €150m and €1.5b) rating the UK as attractive for its technology/ telecoms infrastructure has risen to 90%, while the share of large companies (more than €1.5b) saying the same has fallen to 70%.

Future growth drivers: financial services and digital retain their lead in the UK ...

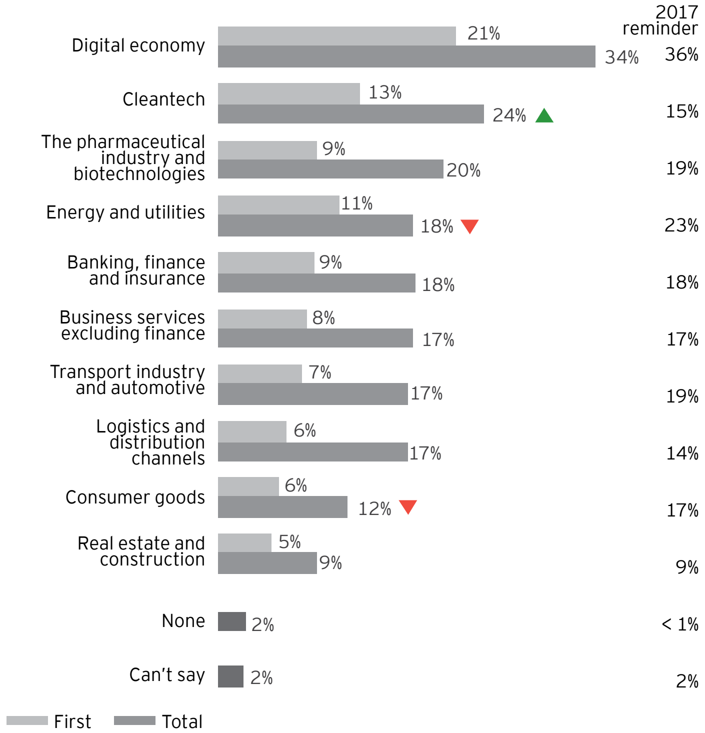
When investors are asked which business sectors they think will drive the UK's growth in the coming years, financial services and the digital economy come out as the most important by a wide margin, extending the already substantial lead they held last year. With the perceived importance of real estate and construction holding steady, the biggest falls since last year are in B2B services excluding financial services, down from 22% to 14%, and consumer goods, falling from 14% to 9%. The perceived decline in the importance of services to the UK's growth is consistent with findings and analysis earlier in this report — including the fact that 12% of business services and financial services companies have put investment on hold in the past 18 months, and that asset-light services operations are generally easier to relocate.

Respondents' views on which sectors are most important to the UK's future growth diverge sharply depending on whether or not they are already established in the UK. Existing investors attach much lower importance to financial services than those who are yet to invest do (34% versus 47%), and the same applies to digital (32% versus 45%). By contrast, 19% of existing investors think real estate and construction will be a key growth driver, compared with only 7% of prospective investors. Meanwhile, in terms of investors' geographical origins, respondents from North America are much more likely than those from Asia and Western Europe to believe that the digital economy will drive the UK's future growth, while investors from Asia are the most likely to cite real estate and construction.

... while Europe's growth drivers are more evenly balanced ...

The contrast with the sectors highlighted in our 2018 European Attractiveness Survey as driving future growth in Europe is stark. Compared with 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 study, the digital economy maintains its lead as the top growth driver, but the scores attributed to other sectors are much more evenly distributed than in the UK, suggesting a broader and more equal balance of economic growth between them. That said, the UK — as highlighted earlier — is the European leader in actually attracting digital projects.

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

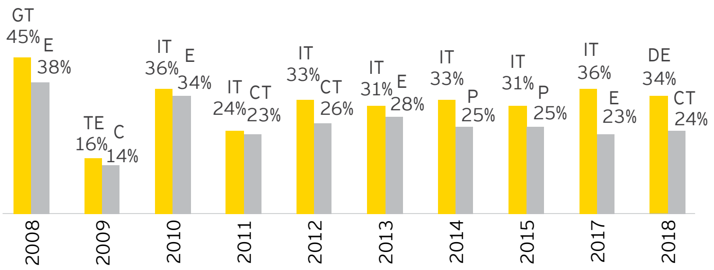


Source: EY's 2018 European Attractiveness Survey, sample (n=502).
Note: two possible answers.

However, a shift that may be particularly significant is the rising perception of clean tech as a growth driver in Europe, up from 15% to 24%, while in the UK this sector remained unchanged, with a score of just 5%. Interestingly, investors based in Western Europe are much more likely than those in Northern Europe, North America or Asia to cite both the digital economy (41%) and clean tech (29%) as drivers of future European growth.

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 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 three years – pharmaceuticals and biotech, energy and utilities, and then clean tech this year. This again points to the relatively even balance between sectors in Europe as drivers of overall economic growth.

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



First sector
Second sector

DE: Digital economy *
TE: Telecommunication equipment
E: Energy and utilities
GT: Green technology

C: Consumer goods
CT: Clean techs
P: Pharmaceutical industry and biotechnologies

* Before 2018 : "Information and communication technologies, IT"

Source: EY's European Attractiveness Survey 2018, sample (n=502).

... but the UK is failing the "Google test," as London's standing as a global tech hub declines ...

With London having experienced slower growth in project numbers than the rest of the UK in 2017, our 2018 survey of investor perceptions also shows that investors think London is losing ground as a global center for technology innovation – a clear signal that digital needs more attention in the UK. Asked to name the cities across the world that they believe are most likely to produce the next Google, investors place London in fifth place with a score of 13% – down from 17% in 2017, when it ranked third equal with Shanghai. This year, Shanghai has leapt to second place with 24%, and London has been overtaken by New York, up from 15% to 21%.

> "Investors placed London in fifth place, when asked to name the cities across the world that they believe are most likely to produce the next Google

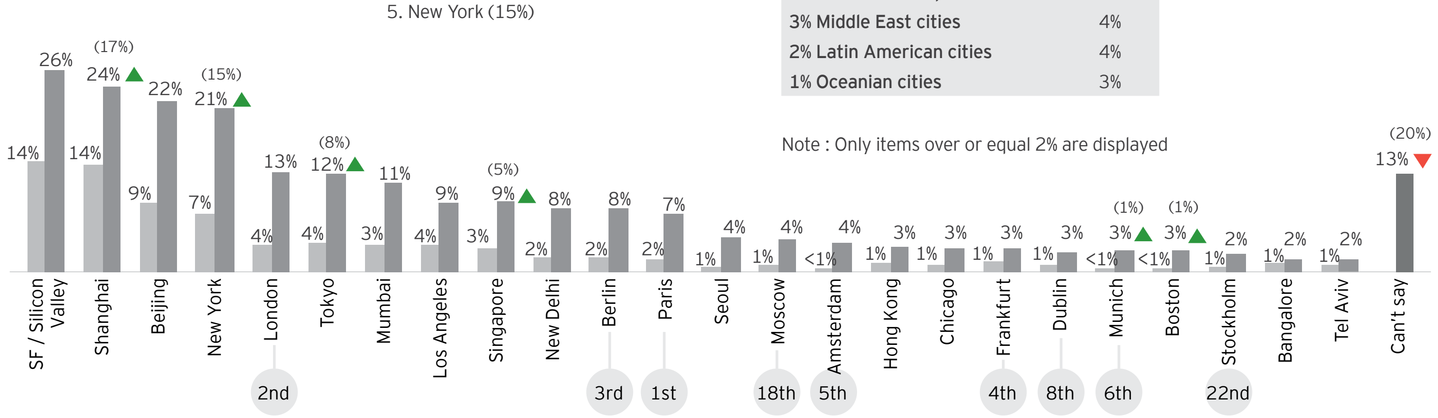
Which three cities in the world offer the best chance of producing the next Google?

Reminder top five EAS 2017 (total of quotations)

1. San Francisco / Silicon Valley (24%)
2. Beijing (18%)
3. Shanghai (17%)
4. London (17%)
5. New York (15%)

	2017
61% Asian cities	53%
50% Northern American cities	45%
37% Western European cities	38%
8% Central & Eastern Europe cities	9%
5% Northern Europe cities	4%
3% Middle East cities	4%
2% Latin American cities	4%
1% Oceanian cities	3%

Note : Only items over or equal 2% are displayed

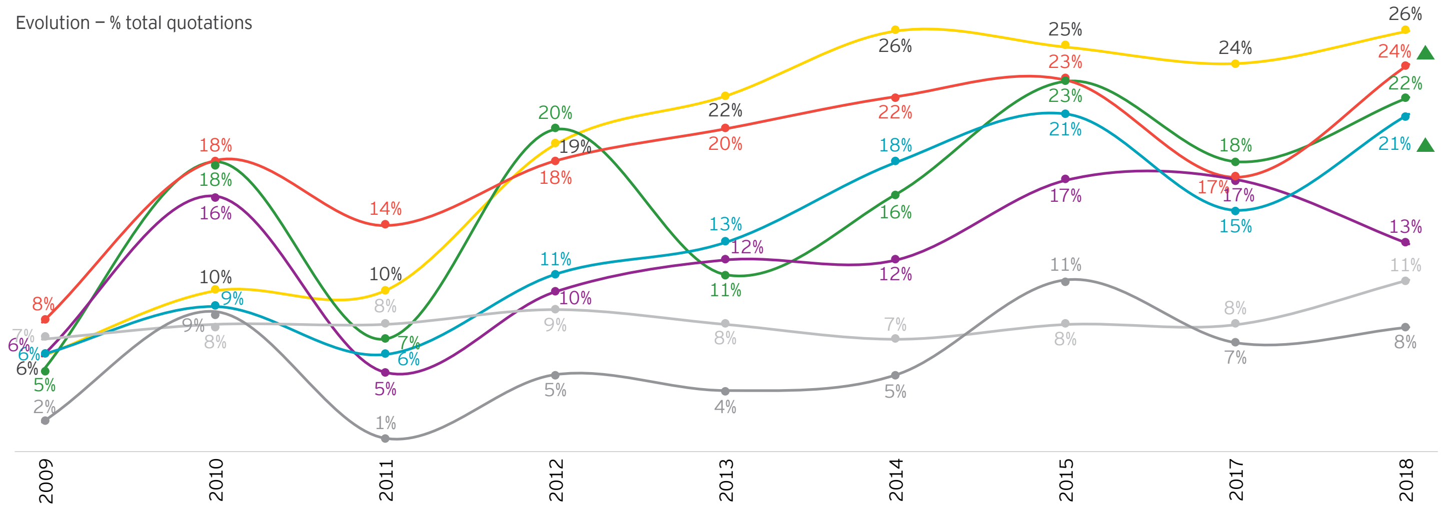


First Total European ranking in terms of attractiveness

Source: EY's European Attractiveness Survey 2018, sample (n=502).
Note: open-ended question, three possible answers.

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

Evolution – % total quotations



SF / Silicon Valley Beijing Shanghai London New York Mumbai Berlin

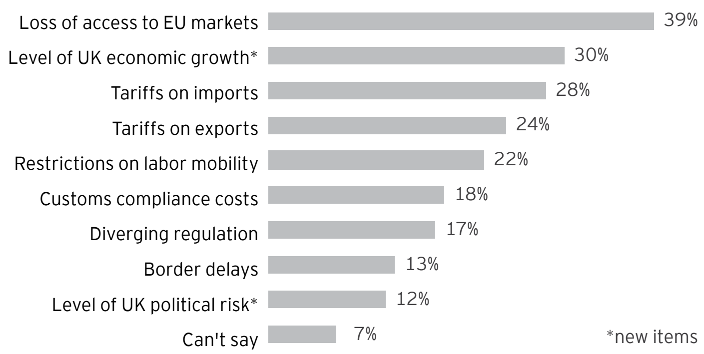
Source: EY's 2018 European Attractiveness Survey, sample (n=502).
Note: open-ended question, three possible answers.

From a regional perspective, the most striking trend is the rise of Asian cities, whose collective score has risen from 53% in 2017 to 61% in 2018. This trend shines through when we map out the development of investors' responses to the "Google test" over the past nine years. Since 2009, London's score has slightly more than doubled, from 6% to 13% — while Shanghai's has trebled from 8% to 24%.

... with clear priorities both for Brexit ...

The responses to our survey serve to identify the key issues that investors are worried about. Future trade and migration policy including access to the European market, the risk of complex customs processes, the possibility of tariffs on European trade, and gaps in skills availability were all raised as significant worries. It is also clear that the UK is seen as a less welcoming place, and concerns were raised about the UK's future rate of economic growth when outside of the EU.

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

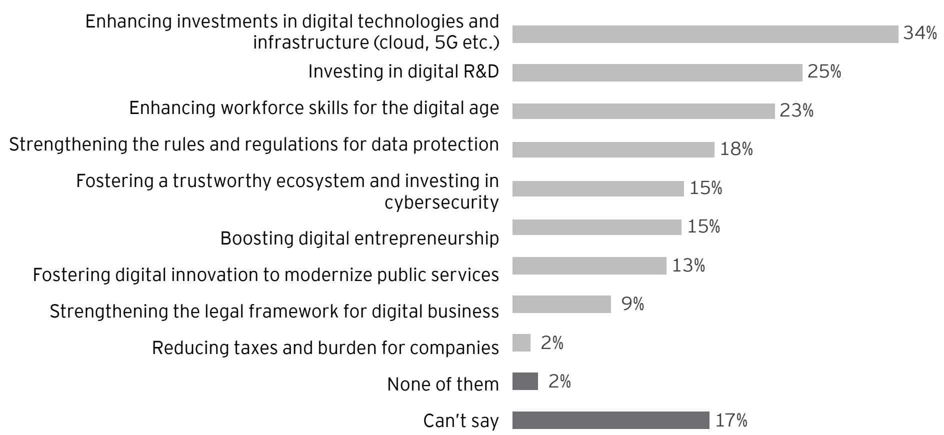


Source: EY's 2018 UK Attractiveness Survey, sample (n=443).

... and the UK's priorities for the digital age: infrastructure, R&D and talent ...

So, in an increasingly digital world, what does the UK need to do to accelerate and maximize its transformation into a digital economy? According to investors, the UK's top three priorities should be enhancing investments in digital technologies and infrastructure; investing in digital R&D; and enhancing workforce skills. It appears that investors feel the underlying regulatory and legal frameworks for the digital economy are largely in place, and that the focus should be on expanding the nation's technology and talent bases. Modernizing public services is also a relatively low priority, suggesting that investors believe this is already in hand.

Where should the UK Government concentrate its efforts to best support the UK's transformation to a digital economy?



Source: EY's 2018 UK Attractiveness Survey, sample (n=443).
Note: several answers possible.

... to ensure a successful transition

The UK's FDI performance shows an economy in transition as a result of the move to Brexit and technological change, with significant shifts in the mix of investment across sectors, project types and size. Investor perceptions confirm this assessment with the UK's attractiveness having fallen from historical highs, and much lower forward-looking intentions to invest.

Digital project growth helped to compensate for a decline in several of the UK's traditionally strong sectors, but even for digital, UK growth lagged the European market growth rate. Manufacturing held up reasonably well but was below the market growth rate, while the UK's FDI performance in Services was weak. All of the evidence suggests that the UK is starting to miss out on growth, growing more slowly than Europe, losing share in its traditionally strong sectors and slipping back in high-growth sectors such as digital and business services. Project and employment growth in 2017 are not reasons to settle for below-market growth rates — the UK needs to up its game.

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 policy-makers need to engage with businesses and investors to identify the policy responses that will both shape the UK's approach to Brexit, and position the UK for success in attracting digital investment in future. The challenge is to lead the transition and drive toward a successful outcome for the UK.

Competing in the digital age

VIEWPOINT

TECH NATION

MB Christie
COO

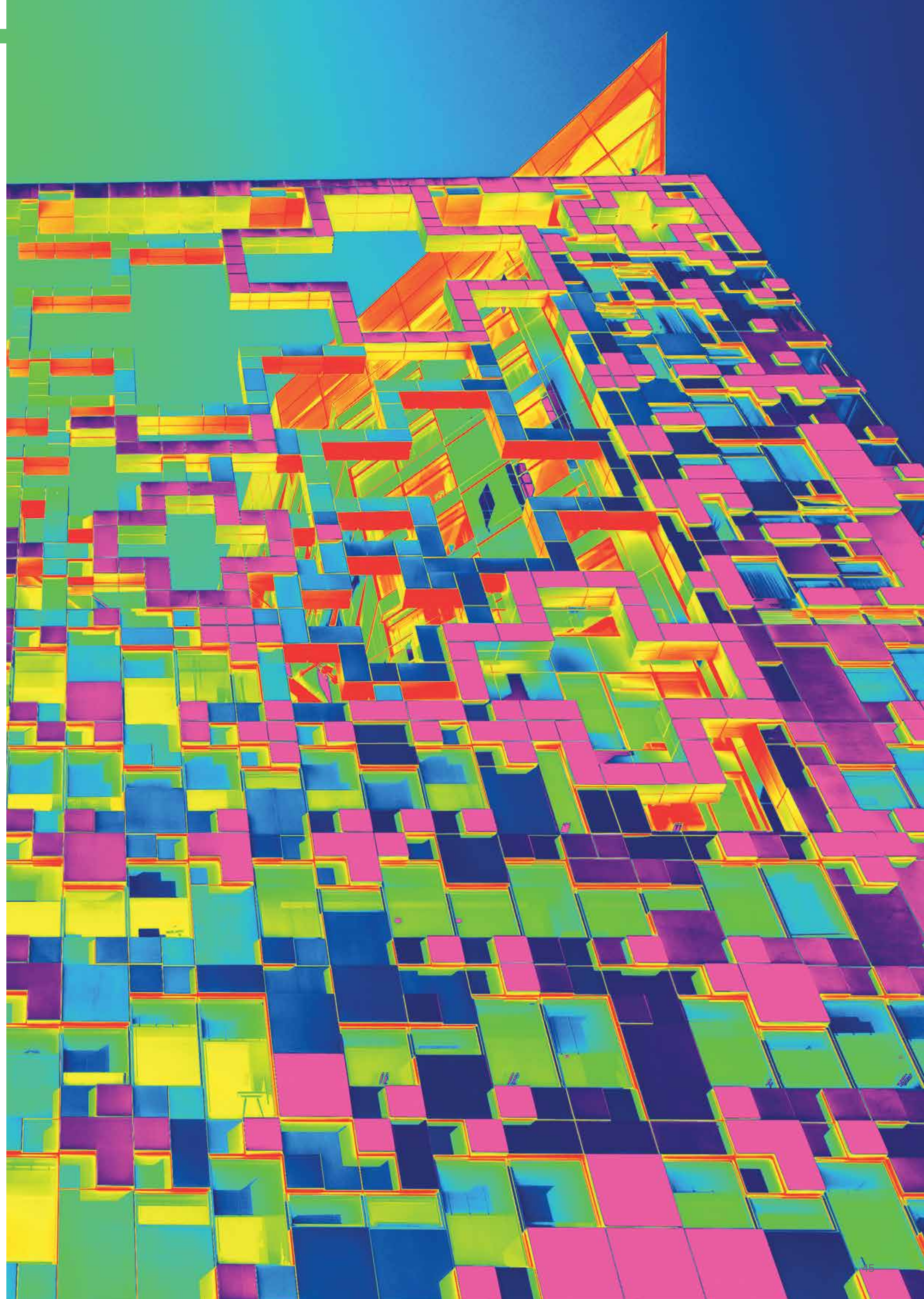
Digital tech is an increasingly important part of the UK economy. Cities like London, Manchester, Edinburgh and Bristol have long been considered tech powerhouses with strong performance internationally. However, burgeoning tech hotspots located in the UK's digital suburbs are breaking new ground and driving local growth. This is evidenced by the findings of EY's UK Attractiveness Survey showing new projects located near the country's world ranked universities account for more than half of the digital FDI projects announced in the UK in 2017.

The EY Attractiveness Survey is a valuable asset in understanding inward investment trends. This year's Survey reinforces the findings of the Tech Nation Report 2018 that global connections are driving domestic success. The findings reveal how the digital tech sector, driven by the global connections of its entrepreneurs, is changing the UK FDI landscape. Digital tech companies in London are the most connected in Europe, second only to Silicon Valley for international connections. These connections extend the UK's market reach, drive innovation, and attract dynamic tech businesses.

Tech Nation supports EY's call for regional digital strategies to fuel what the Survey calls the UK's 'digital revolution'. High growth digital tech firms are engines of UK growth. By helping them thrive beyond major cities, the UK can consolidate its strength as a tech nation and ensure that the benefits of the digital economy are felt by everyone.

Much can be done to facilitate this process. The Tech Nation Report 2018 found that access to talent and investment continue to challenge tech communities across the UK. Investors we surveyed for the 2017 UK Attractiveness report reinforce this. They told us that the UK's top three priorities should be boosting investment in technologies and infrastructure, increasing funding to support digital research and development, and supporting initiatives to grow the country's digital talent base.

Connections and collaboration between ambitious tech entrepreneurs, investors and the tech community can help to bridge these gaps. We found that the UK is highly connected, and tech communities are going from strength to strength across the nation. We must work to ensure that this national network accelerates growth in the UK's digital tech sector.



Methodology

How EY researched the report

The "real" attractiveness of the UK for foreign investors

Our evaluation of the reality of FDI in the UK is based on analysis of the IBM Global Location Trends database, produced in collaboration between EY and IBM-Plant Location International. This database tracks those FDI projects that have resulted in the creation of new facilities and new jobs. By excluding portfolio investments and M&A, it shows the reality of investment in manufacturing and services by foreign companies across the UK.

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

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

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

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

The database focuses on investment announcements, the number of new jobs created and, where identifiable, the associated capital investment. Projects are identified through the daily monitoring of more than 10,000 news sources.

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

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

The "perceived" attractiveness of the UK and its competitors by foreign investors

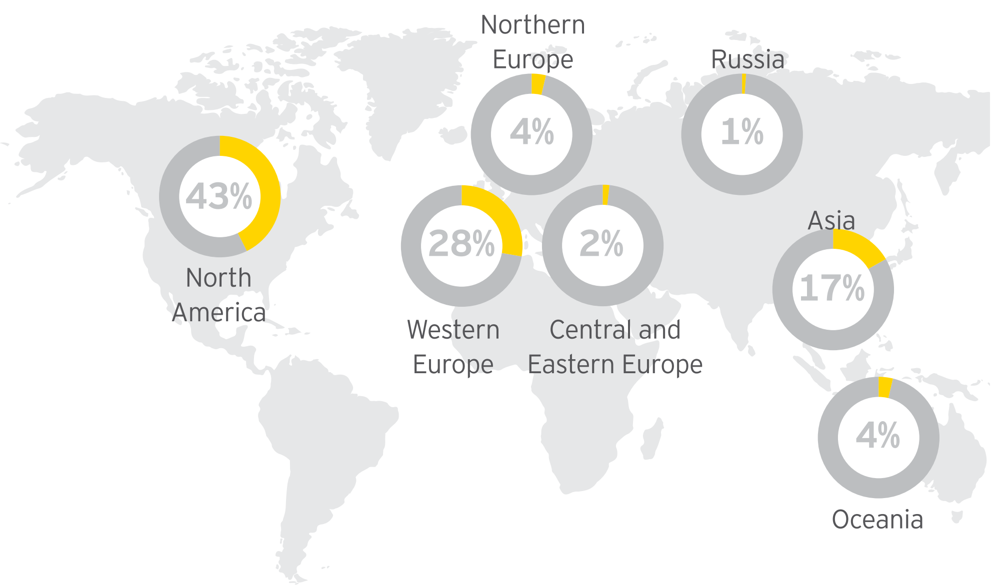
We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country or area's ability to provide the most competitive benefits for FDI. The field research was conducted by the CSA Institute in January and February 2018, via telephone interviews, based on a representative panel of 443 international decision-makers.

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

- North America: 43%
- Western Europe: 28%
- Asia: 17%
- Oceania: 4%
- Northern Europe: 4%
- Central and Eastern Europe: 2%
- Russia: 1%

Overall, 64% of the 443 companies interviewed have a presence in the UK.

Geography



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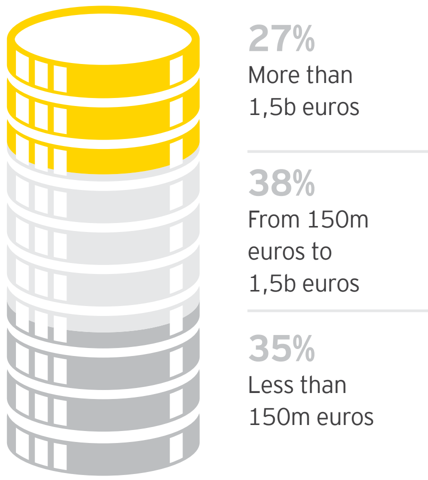
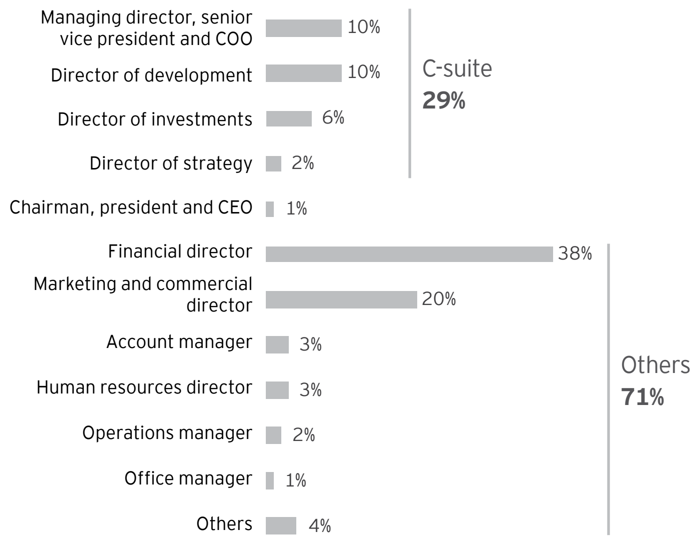
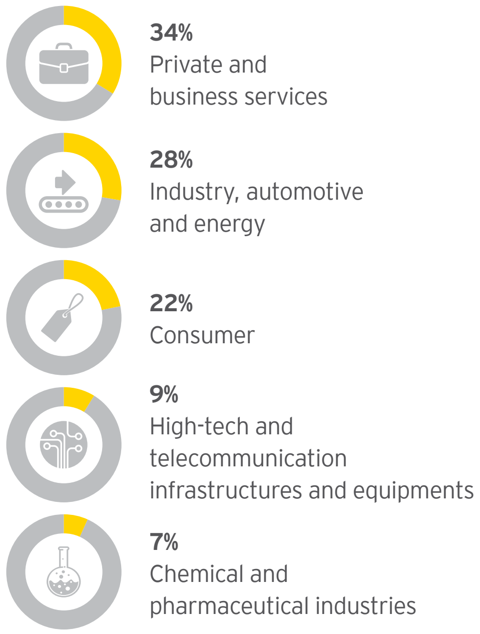


Job title



Sector of activity



About the Attractiveness Program

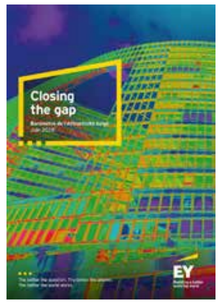
EY's Attractiveness Surveys are widely recognized by our clients, media, governments and major public stakeholders as a key source of insight into FDI. Examining the attractiveness of a particular region or country as an investment destination, the surveys are designed to help businesses make investment decisions and governments remove barriers to growth. A two-step methodology analyzes both the reality and perception of FDI in the country or region. Findings are based on the views of representative panels of international and local opinion leaders and decision-makers.

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

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

EY's Attractiveness country reports in Europe 2018

Belgium (in Dutch)

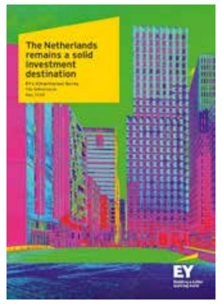


Belgium (in French)

Europe

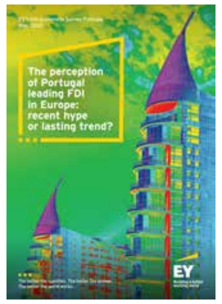
France

Germany



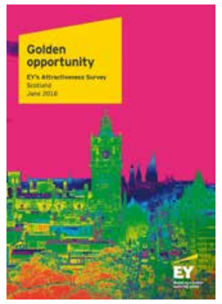
Netherlands

Nordics

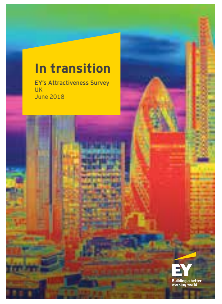


Portugal


Russia

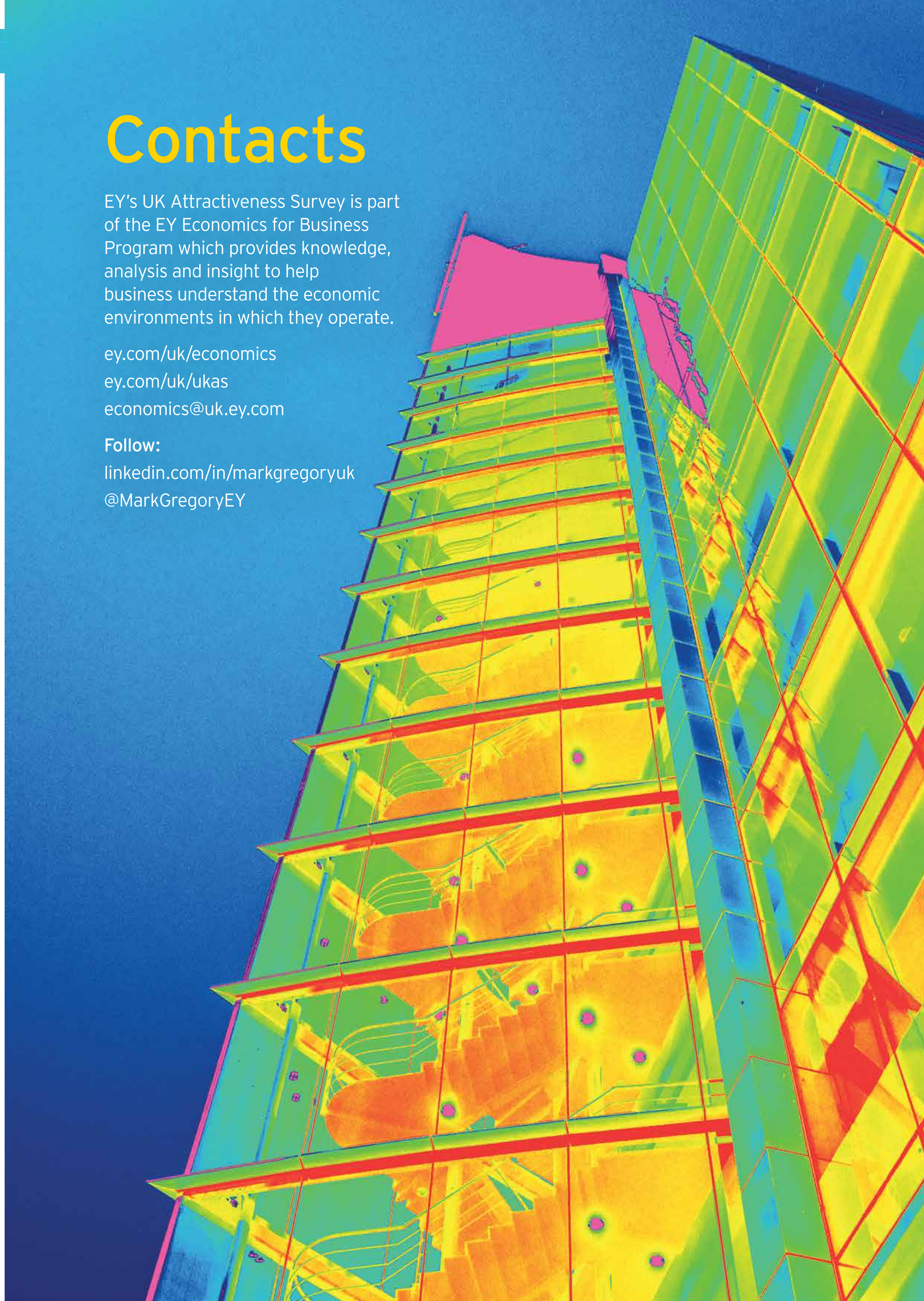


Scotland



United Kingdom

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



Contacts

EY's UK Attractiveness Survey is part of the EY Economics for Business Program which provides knowledge, analysis and insight to help business understand the economic environments in which they operate.

ey.com/uk/economics
ey.com/uk/ukas
economics@uk.ey.com

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linkedin.com/in/markgregoryuk
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