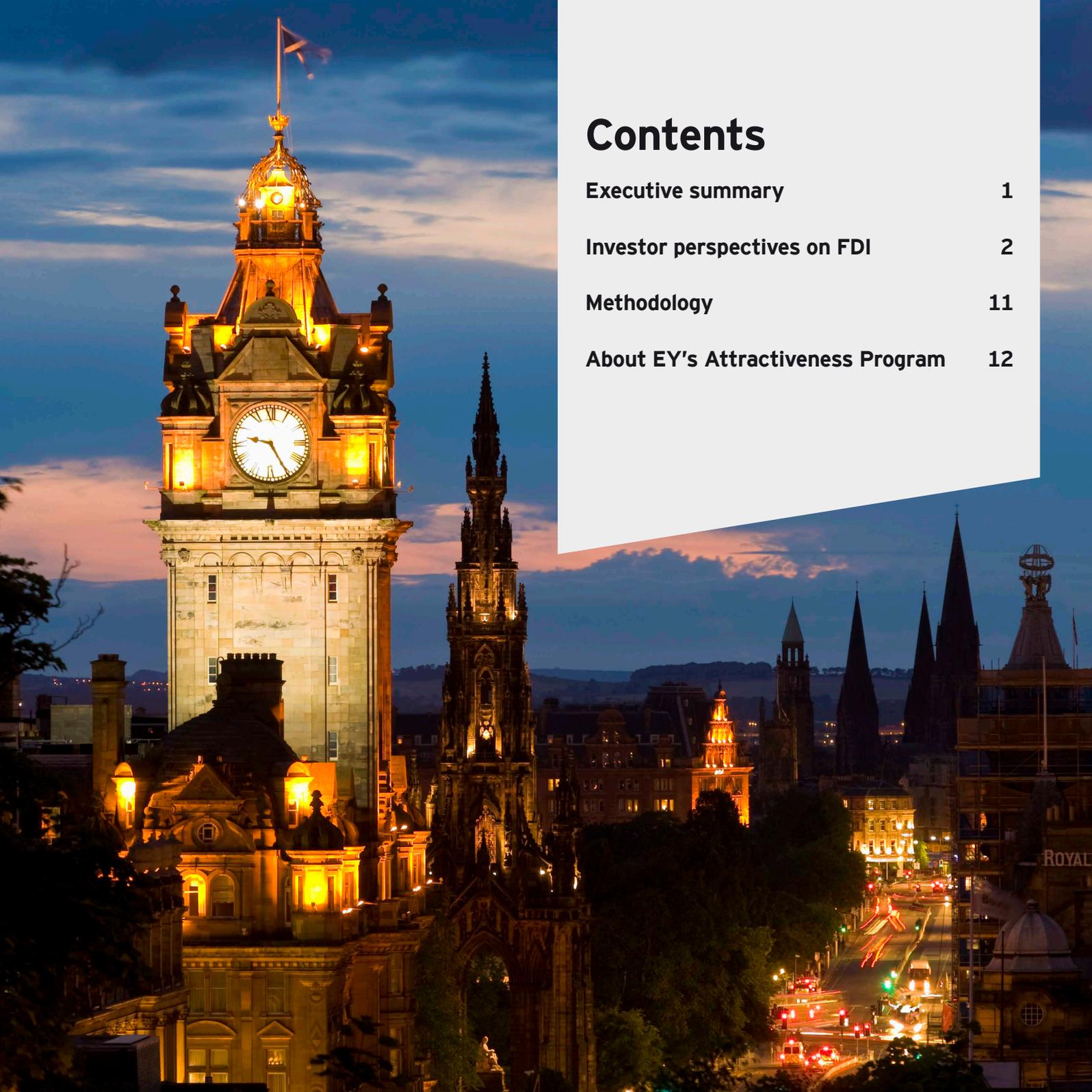


EY's UK Attractiveness
Survey

Inward investment after Brexit

March 2018



A nighttime photograph of the Glasgow City Hall clock tower, illuminated with warm yellow lights. The tower features a large clock face and a flag on top. In the background, other city buildings and a street with traffic are visible under a dark blue sky.

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Executive summary

Inward investment after Brexit – time is of the essence



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Signs of a “Brexit” impact on UK FDI but a small window for a policy response

There has been a significant amount of speculation on the potential impact of Brexit on the UK economy, but conclusive evidence remains elusive. As far as foreign direct investment (FDI) is concerned, EY’s recent survey of 440 foreign investors shows that sentiment toward the UK has not fallen off a cliff as some commentators feared, but there are early signs of a slowing of inbound flows.

Overall, 21% of investors have changed their UK investment plans since the referendum vote, but it is striking that 7%, representing one-third of this group, have actually increased their investment in the UK in the last 18 months. However, 6% of investors have reduced their commitment and another 8% have put their plans on hold, and the mood among investors not currently in the UK is much less positive. We expect that, when we finalize our numbers for the last 12 months, we will find a decline in foreign investment into the UK in 2017 compared with 2016’s record performance.

We find a similar picture of a likely gradual rather than dramatic decline when we look three years out. Only 8% of survey respondents expect to move assets out of the UK in the next three years, a slight improvement on the 9% of investors who felt this way when surveyed a year ago. There are, though, wide variations in sentiment by investor nationality: 25% of Asian investors expect to move assets compared with 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, which suggests the concerns of this group have eased to some extent.

There is a similar degree of variation across sectors. 16% of chemical and pharmaceutical, 16% of financial services and 14% of business services companies expect to move facilities in the next three years compared with only 4% of manufacturers.

The longer-term outlook beyond the three-year horizon appears more challenging, with our European research identifying that around 50% of companies currently operating in the UK expect Brexit will cause them to move assets out of the UK at some point in the future. While a short-term decline in FDI looks inevitable, the impact will be manageable compared with the risk beyond three years out. This means that UK policy-makers still have time to respond to ensure that the UK remains competitive and attractive, so reducing the risk of a significant decline in FDI over time, but now is the time to act.

Our survey responses also provide guidance on the potential policy trade-offs. Access to the European market and the risk of tariffs on imports and border delays are the priority issues, as businesses seem to be confident of their ability to adjust and address any changes in labor supply as a result of policy changes around the free movement of people.

These insights can help inform both the UK’s negotiating strategy and the potential domestic and trade policy responses to mitigate any adverse impacts. For example:

- ▶ Gaining favorable access to new markets could reduce the negative impact that many investors fear from reduced access to European markets.
- ▶ The industrial strategy provides a platform for sector initiatives to mitigate any loss of supply chain efficiency – this is a major issue for the consumer goods, industrials and hi-tech sectors.
- ▶ A tailored response for the services sectors is required, given the likelihood that these businesses will move.
- ▶ A concerted effort to understand and reach out to new investors – the group most wary of the UK as a future investment location – is required.

Investor perspectives on FDI

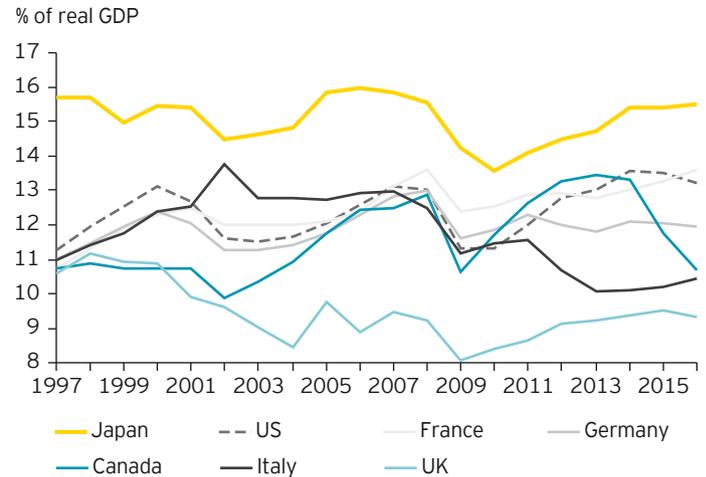
Investment will have a major influence on the impact of Brexit ...

The debate over the potential economic impact of Brexit continues to occupy a significant amount of media attention, but there is no agreed conclusion. UK GDP data has confirmed a slowing of the economy since the referendum vote, primarily due to exchange-rate-driven inflation and a decline in confidence. However, this provides little insight into the long-term consequences, as the final terms of the UK's exit and the policy responses of the UK and other countries will be key influences on the eventual outcome.

In this uncertain environment, business investment is an important forward indicator, as it has a clear potential longer-term effect: a fall in business investment will most likely reduce the UK's long-term productive potential. EY's analysis suggests that FDI has a value equal to around 15% to 20% of UK business investment and hence is an important contributor to the UK's productive potential. As the recent *EY ITEM Club Special report on business investment* demonstrated, the UK lags our developed country peers in this area and, hence, any reduction to current levels would most likely have a negative impact on future UK growth.

Attracting FDI has been a UK success story for more than a decade and is therefore a potential source of insight into how Brexit might impact

G7: business investment



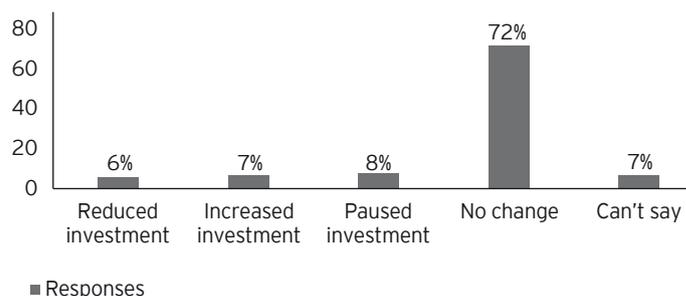
Source: EY ITEM Club and HaverAnalytics.

future UK investment and hence economic performance. EY's 2018 *UK Attractiveness Survey* is due to be published in May and will contain an in-depth analysis of the UK's performance in attracting FDI since the referendum vote up to the end of 2017. Each year, alongside the historic data analysis, we also carry out a perception survey to understand the drivers of investor behavior. This report analyzes the results from our latest survey of 440 foreign investors, carried out in the first quarter of 2018, on their sentiment toward Brexit.

... a slowing of activity but no collapse ...

While many commentators expect Brexit to have a negative impact on FDI, only 6% of foreign investors have reduced their investment in the UK since the referendum and 7% have actually increased their spend, while a further 8% of investors have put their plans on hold. Taking these three groups together, the responses are consistent in aggregate with the relatively sluggish macroeconomic data on UK investment: no dramatic collapse but some decline in activity levels.

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



Source: EY's UK Attractiveness Survey 2018.

However, when we compare the results for investors already in the UK and those yet to commit, we see 11% of existing investors have increased their investment compared with only 1% of potential new investors committing to the UK since the EU referendum. This suggests that the UK's existing base remains stable, but there are potential concerns over future growth in FDI if the UK cannot attract a steady flow of new investors. As new investment typically accounts for 70% of UK FDI projects in a given year, the risks to growth are clear.

... reflecting investor characteristics ...

The overall responses mask significant variations among investor groups:

▶ Asian investors have had the most negative response to the referendum result, with 13% having reduced their investment and 14% having put activity on hold. North American investors have been the most likely to increase investment, with 9% doing so, while Western Europeans have been the least likely to increase expenditure, with only 4% doing so.

▶ Small businesses (worth less than €150m) have responded positively, with 9% increasing their activity. By contrast, medium-sized businesses (worth €150m to €1.5b) have responded more negatively, with 10% reducing, and another 10% pausing, their investment.

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

	Asia	Western Europe	North America	Small	Medium	Large
Reduced investment	13%	6%	5%	4%	10%	5%
Increased investment	8%	4%	9%	9%	7%	4%
Paused investment	14%	8%	6%	8%	10%	5%
No change	59%	76%	72%	74%	66%	77%
Can't say	7%	6%	8%	5%	7%	9%

Source: EY's UK Attractiveness Survey 2018.

In both cases, these responses most likely reflect the fact that both Asian-owned businesses in the UK and medium-sized businesses are more likely to be trade-oriented and hence relatively more exposed to any potential changes in trading relations as a result of Brexit.

“27% of Asian investors have reduced or put investment on hold.”

... across sectors ...

There are also significant variations across sectors:

- ▶ 12% of business services and financial services companies have put investment on hold – the most cautious responses.
- ▶ 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 10% have increased their spend.
- ▶ 11% of chemical and pharmaceutical companies have increased their UK spend but 12% have put activity on hold.

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

	Consumer	Hi-tech	Business services	Financial services	Manufacturing	Chemical and pharmaceutical
Reduced investment	5%	11%	8%	7%	4%	6%
Increased investment	13%	10%	5%	7%	4%	11%
Paused investment	4%	5%	12%	12%	6%	12%
No change	74%	63%	70%	66%	77%	64%
Can't say	4%	11%	5%	8%	9%	7%

Source: EY's UK Attractiveness Survey 2018.

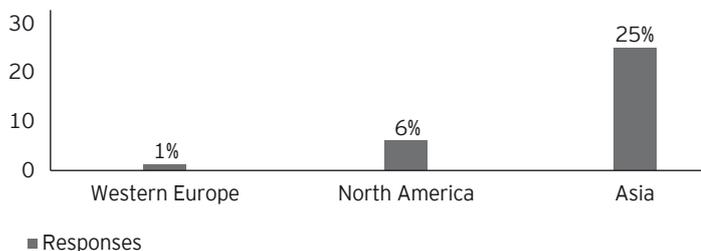
The differences in response can be explained, to a large extent, by the characteristics of individual industries. Services companies can turn investment on and off more easily than other sectors and hence can more easily pause activity. By contrast, manufacturing decisions, requiring long lead times and planning, are much more all-or-nothing decisions and, hence, the strategy appears to be one of waiting as long as possible for maximum clarity before committing resources.

The UK consumer is clearly a valuable asset, and companies appear to be moving to ensure they can continue to access their customers after Brexit, with a good number of both hi-tech and consumer goods companies moving to increase their UK assets. However, the share of hi-tech companies moving investment and the cautious behavior of chemical and pharmaceutical companies shows that, for many businesses, the importance of their integration with the European Union (EU) will influence the level of their future commitment to the UK.

... especially in future ...

The variations in response by country and sector are even more marked when we explore future intentions. Once again, Asian investors are the most likely to react to Brexit. While only 8% of investors overall said they were likely to relocate assets in the next three years, 25% of Asian investors say they intend to move assets out of the UK, compared with 6% of North Americans and 1% of Western Europeans. In the last year, we have seen a hardening of attitudes among Asian investors but a softening by Western Europeans, most probably reflecting the recognition of the importance of geography in shaping economic relations over time, whatever the trading agreements. There may be challenges for European companies in future but, if their degree of economic integration remains, they will continue to want to operate in the UK market.

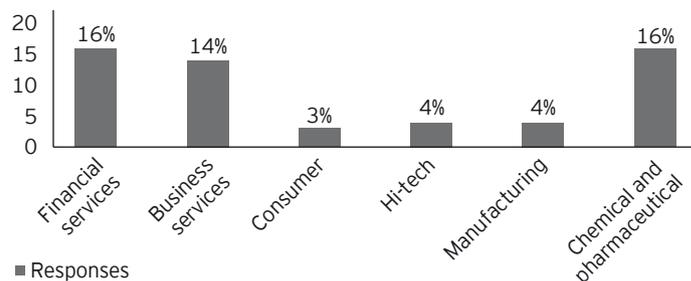
Following the UK's decision to leave the European Union, will you relocate operations in the next three years from the UK to Europe? (Percentage that answered yes)



Source: EY's UK Attractiveness Survey 2018.

Across sectors, 14% of business services companies, 16% of financial services companies and 16% of chemical and pharmaceutical businesses expect to move assets in the next three years. By contrast, only 4% of manufacturers and hi-tech companies and 3% of consumer goods producers expect to do so.

Following the UK's decision to leave the European Union, will you relocate operations in the next three years from the UK to Europe? (Percentage that answered yes)



Source: EY's UK Attractiveness Survey 2018.

These results offer a positive message for UK policy-makers, despite the risks to future investments: with only 8% of businesses expecting to move in the next three years, there is time for the UK to craft its policy response to mitigate any perceived long-term negative effects of Brexit on FDI. Even more positively, investors from the main source countries for UK FDI – the US and EU – and in some key sectors with significant economic impacts, such as manufacturing and consumer goods – appear unlikely to make an early move. This means that the net risk over the next three years is probably less than 8% of the economic value of UK FDI.

However, this is no time to rest on our laurels. There are clear long-term risks to FDI, with significantly more investors likely to consider their positions in the long term than the 8% currently doing so. Research by EY across Europe* suggests up to 50% of businesses currently in the UK might move assets out of the UK in the long term. However, investors do seem to be waiting for a transition agreement and more clarity on the future situation before making major decisions. The UK has a window in which to act and must take this opportunity to develop a tailored strategy that reflects the nuances of differing investor sentiment.

... with clear opportunities to improve the outlook ...

The variations in investor sentiment by geography, company size and sector offer the UK Government clear information on how the trade-offs in the negotiations will differentially impact investment and hence the relative value of alternative outcomes. In addition, the responses and the progress in negotiations will shape the design of the UK's policy to remain competitive.

The strength of the UK economy is important to all investors but, beyond this basic requirement, the three most important factors for investors are: access to European markets; tariffs on imports; and customs and border barriers. Mobility is significantly less important on average. However, this high-level view masks significant differences:

- ▶ For Asian investors, access to the European market is 50% more important than average, and this factor is also the most important for existing UK investors, medium-sized businesses, and for financial services, consumer goods and chemical and pharmaceutical companies.
- ▶ The cost of imports is a more significant concern for consumer goods, manufacturing, chemical and pharmaceutical and hi-tech businesses, and for medium-sized businesses.
- ▶ Borders and customs costs matter significantly more, almost 50% so in some cases, to consumer goods and chemical and pharmaceutical companies than the average.
- ▶ Labor mobility is very important for all services companies, manufacturers and chemical and pharmaceutical businesses, and medium-sized businesses.

“... there is time for the UK to craft its policy response to mitigate any perceived long-term negative effects of Brexit on FDI.”

* 502 respondents from multinational companies based in Europe were interviewed for EY's *European Attractiveness Survey 2018* – due out on 31 May 2018

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

	Established in/out			Nationality of the company			Size of the company		
	Total sample	Established in the UK	Not established in the UK	Western Europe	North America	Asia	Less than €150m (less than US\$204m)	From €150m to €1.5b (from \$205m to \$2.04b)	More than €1.5b (more than \$2.04b)
Total sample	443	281	162	125	193	77	155	168	120
Loss of access to EU markets	39%	43%	32%	39%	35%	50%	38%	45%	33%
Level of UK economic growth	30%	32%	25%	31%	27%	32%	29%	27%	33%
Tariffs on imports	28%	32%	22%	37%	26%	24%	22%	37%	23%
Tariffs on exports	24%	24%	24%	26%	29%	19%	22%	28%	21%
Restrictions on labor mobility	22%	21%	23%	29%	17%	21%	20%	28%	15%
Customs compliance costs	18%	17%	19%	20%	19%	15%	18%	17%	18%
Diverging regulation	17%	17%	17%	21%	17%	12%	13%	17%	22%
Border delays	13%	16%	8%	16%	11%	13%	16%	13%	9%
Level of UK political risk	12%	11%	14%	13%	8%	15%	13%	14%	8%
Can't say	7%	6%	9%	3%	9%	11%	9%	7%	7%

Source: EY's UK Attractiveness Survey 2018.

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

	Consumer	Hi-tech	Business services	Financial services	Manufacturing	Chemical and pharmaceutical
Total sample	97	40	151	84	124	124
Loss of access to EU markets	42%	40%	38%	45%	37%	42%
Level of UK economic growth	31%	35%	30%	33%	26%	28%
Tariffs on imports	32%	34%	18%	23%	34%	33%
Tariffs on exports	25%	22%	20%	20%	29%	24%
Restrictions on labor mobility	17%	16%	23%	23%	24%	26%
Customs compliance costs	22%	13%	19%	12%	13%	22%
Diverging regulation	16%	15%	22%	26%	14%	10%
Border delays	17%	11%	9%	7%	13%	24%
Level of UK political risk	10%	4%	13%	9%	12%	26%
Can't say	7%	13%	10%	11%	5%	-

Source: EY's UK Attractiveness Survey 2018.

... with a focused policy response

The size of the UK market and the disruption caused by moving assets means that the UK Government has time to design policy to mitigate any adverse effects of Brexit. This work needs to start in parallel with the negotiations on the UK's future trading relationship. The priority areas identified in our research are:



Identifying the scope to sign trade deals with countries to compensate for any reduced access to the EU

– a sector perspective will help inform value assessments for each geographic market. For example, financial and business services companies are likely to see the US as a major source of opportunity.

Assessing policy initiatives

including investment in infrastructure at ports, road and rail to speed up goods movements, incentives for reshoring of supply chain activities and support for investment in technology to minimize friction in customs. The industrial strategy provides a platform to develop responses to mitigate the effects of any import tariffs or disruptions to customs processes on supply chains.

Developing a tailored offer for business and financial services companies

who view loss of access to the European market, reduced labor mobility and divergent regulation more negatively than other sectors. These are important sectors for the UK economy, and proposals to help them remain competitive, such as incentives for training and support for managing regulatory divergence, will be important.

Reaching out to ensure new investors understand the opportunities in the UK and the potential support on offer

because this group seems the most at risk in the short to medium term, due to the uncertainty over the UK's future trading arrangements. Our research has consistently found that business networks are important to new investors as they seek to learn about new environments.

Our overall findings are reasonably positive for the UK and show that, while there may be short-term challenges, there is still a great deal to play for in respect of FDI. What is striking are the differences in response by investor type, with nationality, sector and size all shaping impacts. This does confirm the point we have been making for some time, that a more targeted FDI strategy for the UK, with a focus on quality not quantity, will be essential in helping maintain and grow UK competitiveness.

Methodology

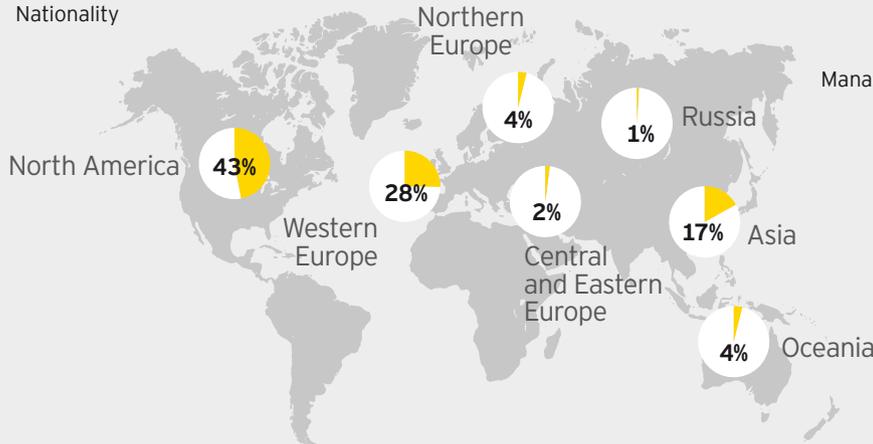
The "perceived" attractiveness of Europe and its competitors for foreign investors

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

This research was conducted by the CSA Institute from January to February 2018, via telephone interviews with a representative group of 443 international decision-makers.

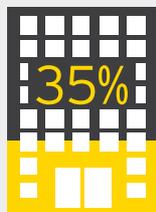
Interviewed companies

Nationality

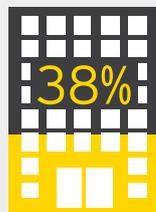


Size of the company

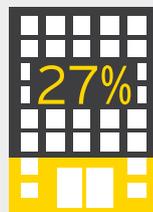
(Sales turnover)



Less than
€150m



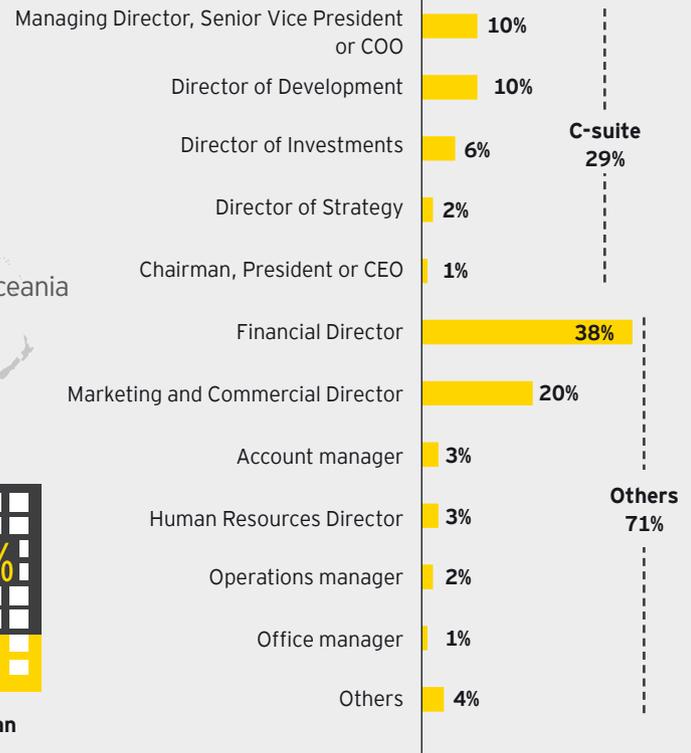
From €150m
to €1.5b



More than
€1,5b

Job title

of the interviewees



About EY's Attractiveness Program

EY's Attractiveness Surveys and Program around the world

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

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

The program has a 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.

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Belgium



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Germany



Italy



Malta



The Netherlands



Nordics



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

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