EY's European attractiveness survey
January 2017

Plan B ... for Brexit

A boardroom view on investment and location strategies in Europe

EY
Building a better working world

EY's attractiveness surveys and program around the world

EY's attractiveness surveys are widely recognized by our clients, media and major public stakeholders as a key source of insight into foreign direct investment (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 16-year legacy and has produced in-depth studies for Europe, a large number of European countries, Africa, India, South America and Kazakhstan.

For more information, please visit: **ey.com/attractiveness**
Twitter: **@EY_FDI**

An attractive future

EY UK Attractiveness Survey – Autumn 2016

Our long history of sponsorship of research into UK trade, including foreign direct investment (FDI), stems from our desire to encourage an open dialogue between business leaders, investors and policy makers on how to maximise the UK's economic performance. FDI has been an important source of capability for the UK in recent years especially as investment as a share of gross domestic product (GDP) has lagged the UK's developed country peers.

Our 2016 UK Attractiveness Survey published in May, confirmed another year of strong performance in attracting FDI to the UK. It did however also identify an increased level of uncertainty about the future attractiveness of the UK.

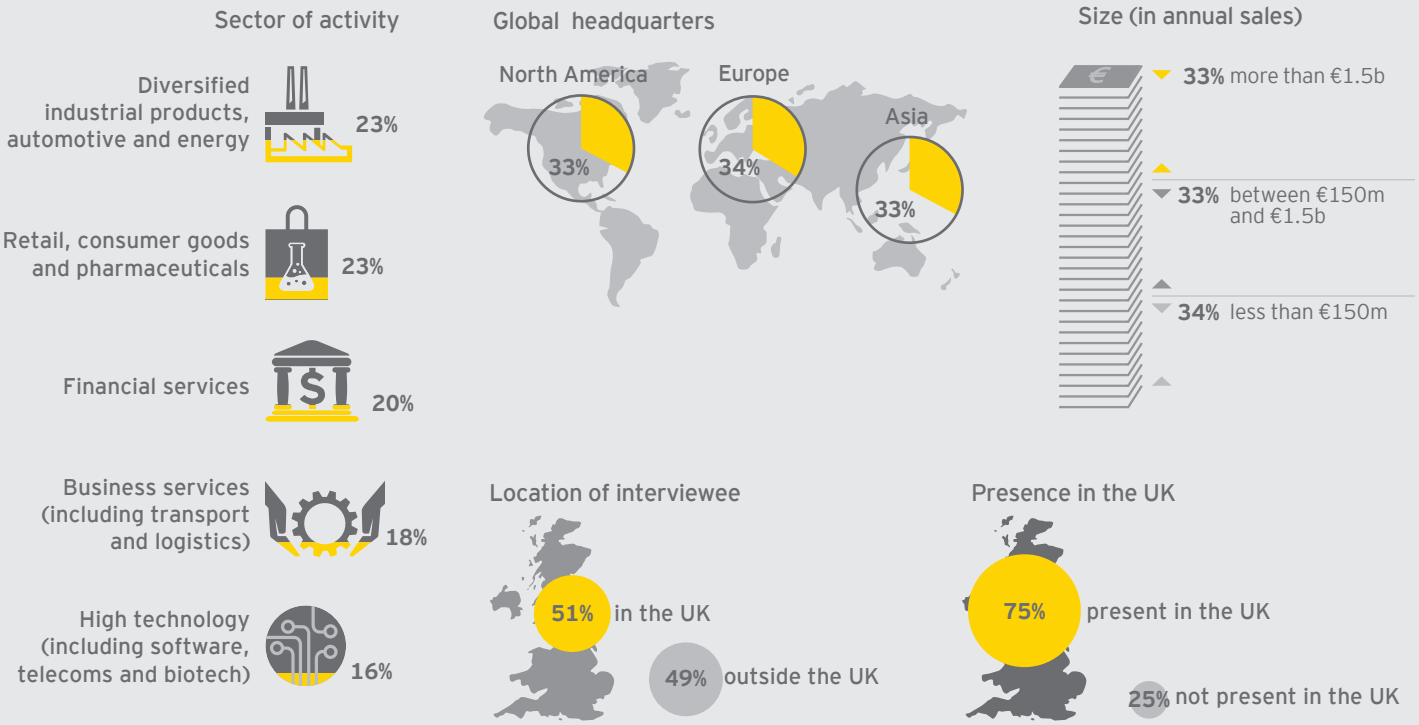
We have updated our investor perceptions survey in the Autumn to compare the mood with that in the Spring 2016. The results of this work together with a detailed analysis of FDI in Europe over the last decade provide the basis for the proposals set out in this report.

For more information, please visit **ey.com/ukas**

How EY designed the research

In November 2016, we interviewed 254 senior business executives representing firms with foreign investments in Europe. We divided our sample group into three groups of approximately equal size, based on whether their companies had their global headquarters in North America, in Asia or in Europe. Our sample group drew from a wide range of sectors. It included foreign investors in diversified Industrial products, automotive, consumer goods, high technology, and the pharmaceutical and chemical industries, as well as investors in business services and financial services. In order to obtain the most direct perspective on Brexit, 128 senior executives were interviewed in the UK. The other 126 were reached in continental Europe, North America or Asia. Within our panel of companies, 67% had annual revenues of less than €1.5b, ensuring a broad spread of perspectives. This proportion is representative of their share of the FDI population in Europe at the time of our survey.

This survey dovetails with the long-running *European attractiveness survey* conducted by EY's Europe, Middle-East, India and Africa (EMEIA) Region, which studies the forces shaping flows of Foreign direct investment (FDI) into Europe. Our European region extends from Gibraltar to Iceland and from Portugal to Russia and Turkey, embracing the 28 states of the European Union (EU28[1]), and their neighbors. To signify the EU minus the United Kingdom, we refer to the EU27.[2]



We also interviewed more than 50 EY professionals who together have in-depth knowledge of many sectors, competencies and geographies. We did not ask them about the politics of post-referendum or pre-Brexit preparation, but rather about the real business implications and the impact on corporate agendas. We asked them to share their experiences and to tell us:

- How companies are managing ongoing uncertainty – not only limited to Brexit, but also relating to instability elsewhere in Europe and to concerns about present and future international growth
- How their clients are reacting to the situation
- What their clients' most pressing concerns are
- How companies are preparing for the emergence of a substantially different relationship between the UK and its continental neighbors.

We want to extend our gratitude to the C-suite executives and EY professionals who shared their insights.

1 EU28 refers to all 28 member states of the European Union i.e., Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

2 EU27 refers to the 27 member states of the European Union excluding the UK.

An EY survey on foreign investment decisions in Europe and the prospect of Brexit

This report is part of a series by EY on the attractiveness of Europe and European countries for cross-border investments. Since 2000, this series has provided information on international location strategies and their impact on countries and cities in Europe.

The global political, economic and investment landscape has entered an exceptional period of transition. In the US, newly appointed President Donald Trump has promised to recast US policies in ways likely to have profound effects both on the US economy and upon investment flows in the US and worldwide.

The tectonic plates of our multi-polar world are shifting. Companies from China, India and other newer markets are continuing to expand on a world stage. Europe is changing too. This year will see elections in the Netherlands, France and Germany which may have far-reaching policy implications. Investors see uncertainty everywhere. As the year advances, EY's *European Attractiveness survey* will aim to capture more outcomes and assess implications.

Our first step, however, is this attempt to look at the impact of the UK's historic decision to leave the European Union upon the European investment landscape within this backdrop of continent-wide change.

On 23 June 2016, the citizens of the UK voted by 51.9% to 48.1% for their country to leave the European Union (EU).[3] The UK Government has said it expects to invoke Article 50 of the EU's Lisbon Treaty and thereby trigger negotiations with the remaining 27 EU member states in March 2017.[4] Michel Barnier, the Chief Negotiator appointed by the European Commission to handle the process, has said that a deal must be struck by October 2018.[5] The transition will coincide with wider changes in the political landscape as President Donald Trump begins to recast US policies.

Implementing Brexit will be extraordinarily complex. On 17 January, Theresa May, the UK Prime Minister, said she hopes to retain partial membership of the customs union, backed by a free trade agreement (FTA) with the EU. But continuing full membership of the single market was not an option. The UK Government wishes to balance the needs of the UK economy with the desire for control of borders and laws expressed by its citizens. EU leaders are clear and consistent that membership of the single market is incompatible with restrictions on the free movement of their citizens. Business leaders must start preparing their analyses and plans for life after Brexit. **To help them in this process, EY commissioned a survey to investigate what impact the referendum and resulting uncertainties are having upon foreign direct investors and their European ambitions.**

Foreign direct investment (FDI) is vital to the economic well-being of the UK and the rest of Europe. The impact of Brexit on investment mobility and location is therefore a critical issue for companies and policy-makers. Last year, foreign investors made 5,083 decisions to set up or expand operations in Europe, building or renewing productive assets and creating 217,666 jobs.[6] Historically, the UK has been Europe's top FDI destination. According to our calculations, the UK secured a record 1,065 FDI projects in 2015 (20.9% of the European total), which created over 40,000 jobs in the country in that year.[7]

There appears to be a growing likelihood that companies located in the UK will lose seamless access to the single market. And it also appears likely that some companies — and not just those in the financial services sector — will reshape, transfer, downsize or transform some of their operations both in the UK and sometimes, in consequence, elsewhere in Europe. However, some business leaders have already said that the current context will not change their plans to invest in the UK.

Andy Baldwin
EY EMEIA Area Managing Partner

Hanne-Jesca Bax
EY EMEIA Managing Partner
Markets & Accounts

Marc Lhermitte
EY Advisory, Global Lead Attractiveness and Competitiveness

3 "EU referendum results and maps," *The Telegraph website*, http://www.telegraph.co.uk/news/2016/06/23/leave-or-remain-eu-referendum-results-and-live-maps/, accessed 1 January 2017.

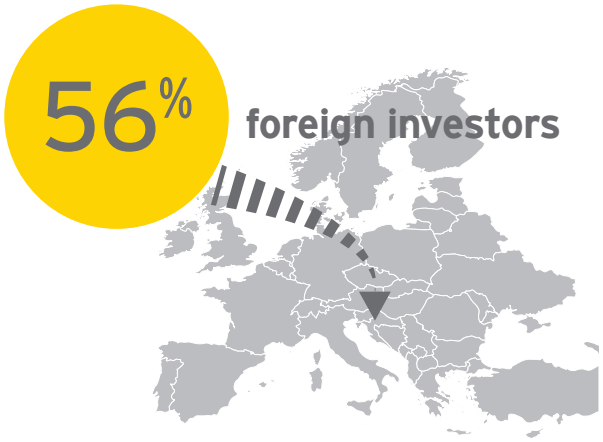
4 "Theresa May to trigger article 50 by end of March 2017," *The Guardian website*, https://www.theguardian.com/politics/2016/oct/01/theresa-may-to-propose-great-repeal-bill-to-unwind-eu-laws, accessed 1 January 2017.

5 "EU sees Oct 2018 Brexit deal," *Reuters website*, http://in.reuters.com/article/britain-eu-barnier-idINKBN13V1DN, accessed 3 January 2017

6 *European attractiveness survey 2016*, EY, 2016

7 *UK attractiveness survey 2016*, EY, 2016.

Ten lessons learned from listening to foreign investors in Europe

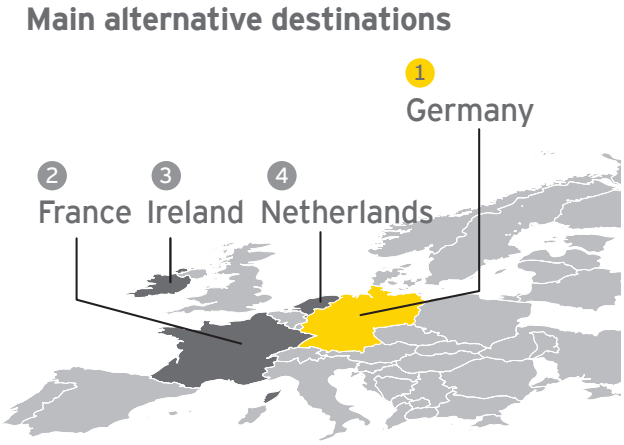


1 **Fifty-six percent of foreign investors plan to invest in Europe in the next three years**, a remarkable sign of investor optimism despite an uncertain political and business climate.

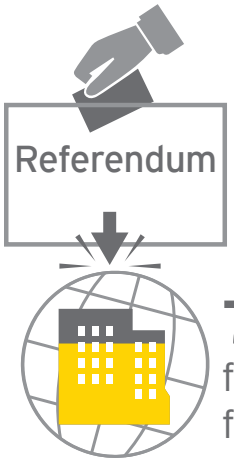
2 **European instability is the boardroom's number-one cause for risk**: Global economic volatility (highlighted by 37% of our respondents) and the fragmentation of Europe (32%) are the biggest worries for the continent's investors.

3 **Brexit is third on the list of concerns** but it's a much bigger worry for foreign companies established in the UK (33%) than for those that are not (15%). For those not established in the UK, geopolitical and wider EU instability and the slowdown in trade flows are more urgent concerns.

4 **Relocation may happen**: 86% of international companies active in the UK say they plan to stay; 14% will transfer some or all of their activities elsewhere. The UK's attractiveness will be affected by Brexit, but its competitive advantages remain strong and may strengthen somewhat if the Government improves incentives in key areas. Yet, we expect an uptick in relocations Europe-wide, driven by diverse deep trends, including technology change and corporate competition.



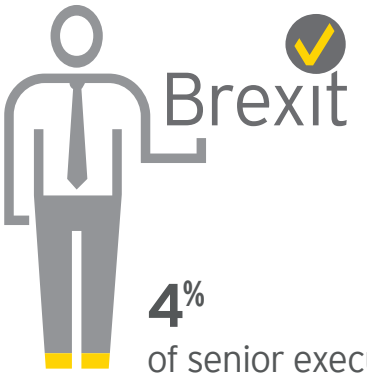
5 **The lines of Europe's FDI map are starting to shift**: Germany is the UK's main challenger for the top spot, while France, Ireland and the Netherlands are more distant competitors. But it is not just a competition between countries: European cities are increasingly competing to attract cross-border investment.



71% of foreign investors felt an impact

6

Seventy-one percent of foreign investors have already felt some impact of the EU referendum results across their European operations on at least one area of their business, most commonly on operating margins, cost of purchases, and sales.



4% of senior executives

8

Just 4% of senior executives said they were well-prepared for Brexit, and 1 in 10 companies have no plans at the moment.

9

If the UK leaves the European single market, foreign investors will need to focus **on the short-term consequences for their supply chains and growth perspectives**.

Sensitive sectors

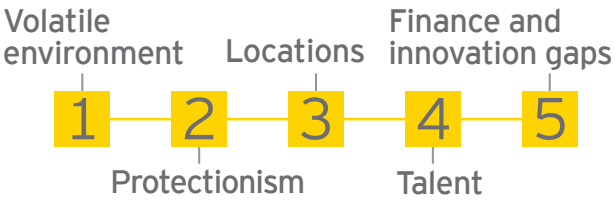
Financial services

High technology

Medium-sized companies

7

The referendum and its potential consequences have a knock-on effect on companies, especially in three business areas that are likely to be vital to the economic future of Europe and of the UK: **financial services, high technology, and medium-sized companies**.



10

Our research suggest that companies and governments in Europe may need to manage their future in an increasingly **volatile environment**, prepare for creeping **protectionism**, redesign their **location** strategies in Europe, tackle the **talent** conundrum and bridge the **finance and innovation gaps**.

1. Foreign investors are keen on Europe, yet cautious

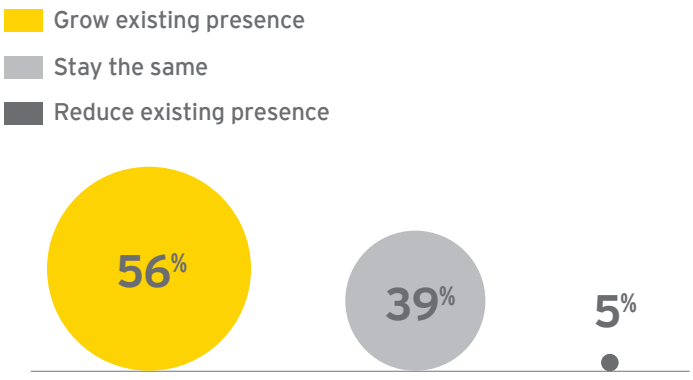
Despite the current climate, appetite to invest in Europe remains strong. When asked about their investment plans over the next three years, **56% of foreign investors say they are planning to grow their presence in Europe.** In this new survey, 21% respondents aim to grow their existing presence significantly. And that proportion is the same both for those established, and those not established in the UK.

These findings differ markedly from those of our *2016 European attractiveness survey*, conducted in May 2016, which found that only 36% of respondents had a positive investment outlook for Europe. It is important to note that the panel and timing of both these surveys are different.

Investors value Europe's talent, innovation capacity, and large, integrated market and production system. They have seen the Eurozone economy overall continue to improve despite recent political events, such as the Brexit referendum and other upcoming political elections in the Netherlands, France, Italy and Germany. The Eurozone's seasonally adjusted Gross Domestic Product (GDP) growth in the quarter to the end of September 2016 was 0.3%, according to Eurostat, which raised its full-year forecast for the zone's growth in 2016 to 1.7%. For instance, Greece is at last showing strong recovery, with a quarterly increase of 0.8%. Spain's resurgence is well established. France also returned to growth (0.2%), matching Germany.[8] Though Europe still has many deep-seated problems, there are signs of improvement. UK GDP confounded commentators by growing 0.5% in the third quarter, according to the UK's Office of National Statistics.[9]

Europe has entered a period of extraordinary upheaval. The investment climate in much of North America also seems likely to change following the inauguration of President Donald Trump in the US – with knock-on effects on the relative attractiveness of locations in Europe and elsewhere. Some sectors will be more affected than others. For example, financial services companies in the UK may be particularly affected by Brexit. Likewise, those in particular innovation-intensive industries, or with complex cross-border supply chains such as automotive. But most companies remain convinced that – despite the uncertainty – trends such as new technologies, geopolitical shifts and demographic change offer opportunities. Some businesses will be rocked by geopolitical shocks such as Brexit. But other, deep-rooted or more nimble businesses will find the strategies they need to succeed in the context of rapid change.

What are your plans for investment in Europe over the next three years?



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

8 "GDP and main aggregates estimate for the third quarter of 2016," Eurostat press release, http://ec.europa.eu/eurostat/documents/2995521/7756312/2-06122016-AP-EN.pdf/2c2866b3-e369-4160-bca4-1238757bd740, 6 December 2016; "ECB extends bond-buying scheme but at slower pace," *BBC website*, http://www.bbc.com/news/business-38252116, accessed 12 December 2016.

9 "Second estimate of GDP: Quarter 3 (July to Sept) 2016," *Office for National Statistics website*, https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/secondestimateofgdp/quarter3julytosept2016, accessed 1 December 2016.

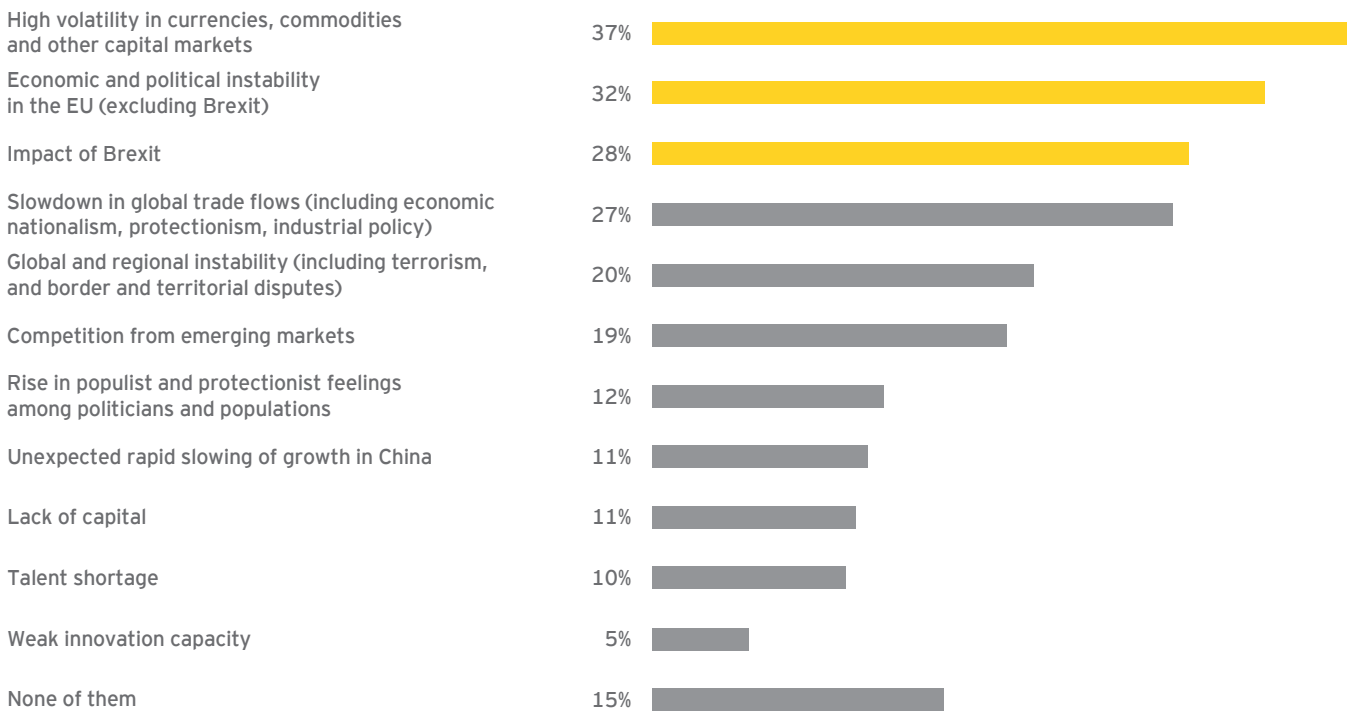
Brexit is high on the list, but global economic volatility and the fragmentation of Europe are the biggest worries for the continent's investors

We asked decision-makers to identify the three biggest risks that would shape their next investment strategy in Europe. High volatility in currencies, commodities and capital markets were the biggest sources of concern, highlighted by 37% of respondents. Economic and political instability within the EU was the next-biggest worry (32%). The impact of Brexit was in third place, selected by 28% of respondents, and it was only slightly ahead of a basket of trade-related concerns, including the slowdown in trade flows and the rise of economic nationalism, protectionism and sector-specific industrial policies.

The election and inauguration of Donald Trump as President of the world's most powerful economy has focused much investor attention on the likely implications of his pledge to protect investment and jobs in the US. Is the great post-war era of market-opening over?

The political shift of the UK referendum is a big worry for many. Some argue that **the world has entered a period of hyper-uncertainty**. For European boardrooms, Brexit is merely one of the most recent and visible among the many tectonic changes shaking-up the business landscape. It has to be considered alongside a slew of consequences arising from the 2008 financial crisis and the subsequent Eurozone crisis. Aftershocks from economic upheavals — unrelated to Brexit — are sweeping other European economies too, masked, magnified or simply overlaid by digital disruption whose consequences people everywhere are struggling to comprehend. These aftershocks include migrations into and within Europe, an upsurge in populism that is influencing economic and social policies, a changing relationship between the US and Europe, and inconsistent investment policies by Chinese and Middle Eastern interests.

Among all the risks affecting investment, which three will have the biggest impact on your next investment decisions in Europe?



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

EY point of view

Negotiations ahead

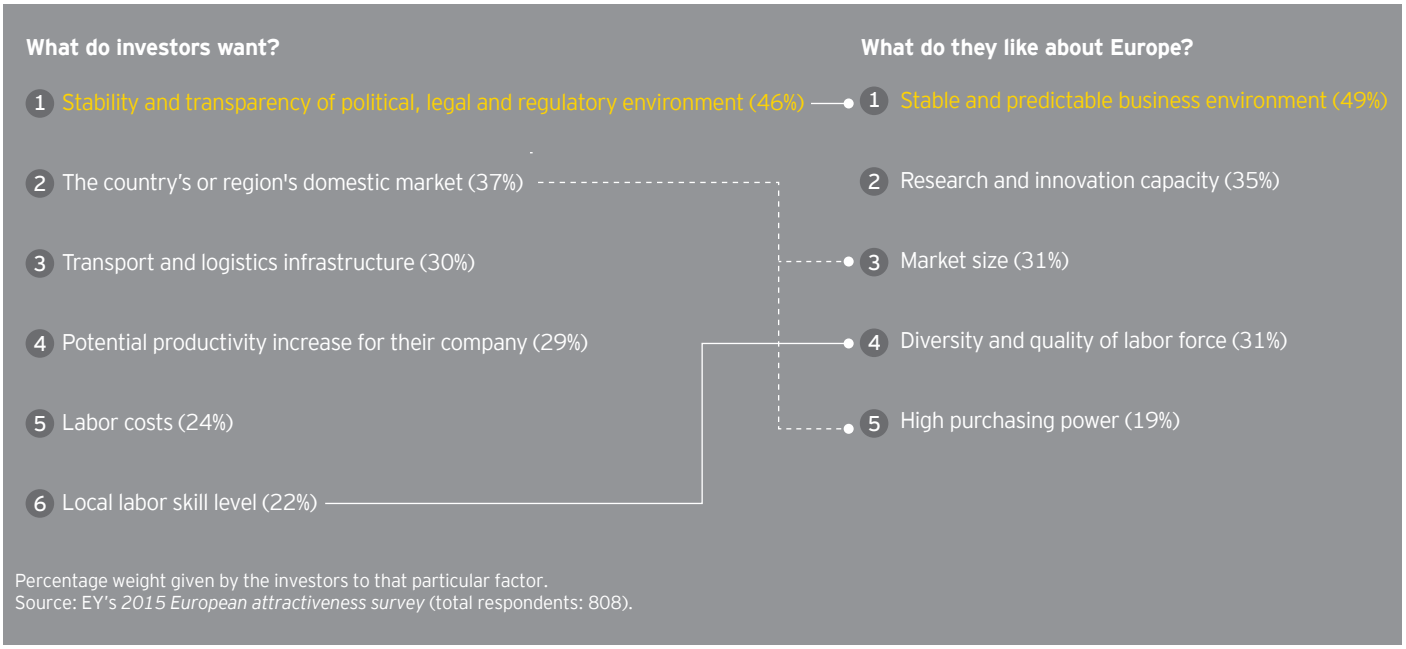
UK companies need to have realistic expectations for the Exit Treaty negotiations. The process will be intensely political. UK Prime Minister Theresa May will seek outcomes that achieve her objectives. Yet the goals of EU negotiators will be to achieve what they believe best for the EU. That includes ensuring that club membership remains attractive. They must avoid a crisis for the EU itself, so the European Commission's goal will be to keep the 27 member states aligned. But for purely domestic reasons, the member states are likely to have divergent priorities. Given the UK red line on regaining control over its borders, continuing UK access to the EU Internal Market, as it stands today, is looking far from certain. Companies need to plan accordingly.

Jeremy Jennings
EY EMEIA Regulatory and Public Policy Leader

Since then, however, investors have lost much of their confidence in Europe's ability to weather post-crisis storms. Amid an upsurge of populism, investors have noted Italy's rejection of political reforms, and the presidential and parliamentary elections looming in 2017 in France, the Netherlands, Italy and Germany. Events in Poland, Hungary and Austria have also caused unease. The possibility of other dramatic policy changes, in a region hitherto regarded as a bastion of stability, transparency and good governance, is deeply unsettling for investors.

Today, the EU could be weakening its biggest competitive advantage in the global contest to secure foreign investment (5,083 decisions by foreign investors to invest in Europe in 2015 alone[10]). In EY's *2015 European attractiveness survey*, decision-makers made clear that stability and predictability are the most critical factors underpinning their investment decisions, and they singled out Europe's stable and predictable business environment as its strongest attractiveness feature.

Flashback to 2015: key criteria for investors to select a location and Europe's features they valued the most



Percentage weight given by the investors to that particular factor.
Source: EY's *2015 European attractiveness survey* (total respondents: 808).

10 *EY's European attractiveness survey 2016.*

EY point of view

Make the EU relevant again

Brexit is a national democratic choice. From now on, the actions of the UK authorities and the EU member states need to be developed with a strict respect for the popular will. The Brexit process needs to be framed within a clear and positive plan of action in the context of representative democracy. From a European perspective, despite growing Euro-skepticism, we must guard against the idea that Brexit is the start of an unraveling of the EU. Brexit is primarily an additional political challenge for the EU, alongside the migration crisis, the Eurozone troubles, unemployment, among others. National and European authorities need to focus more than ever on these pressing challenges, by stressing why we are stronger together.

What are the priority EU policies needed to enhance the attractiveness of EU member states in the next three to five years?

- Improving the investment climate, expanding the existing "Juncker Plan"
- Securing banking and capital market union
- Creating a digital single market
- Enhancing common migration, security and defense policies

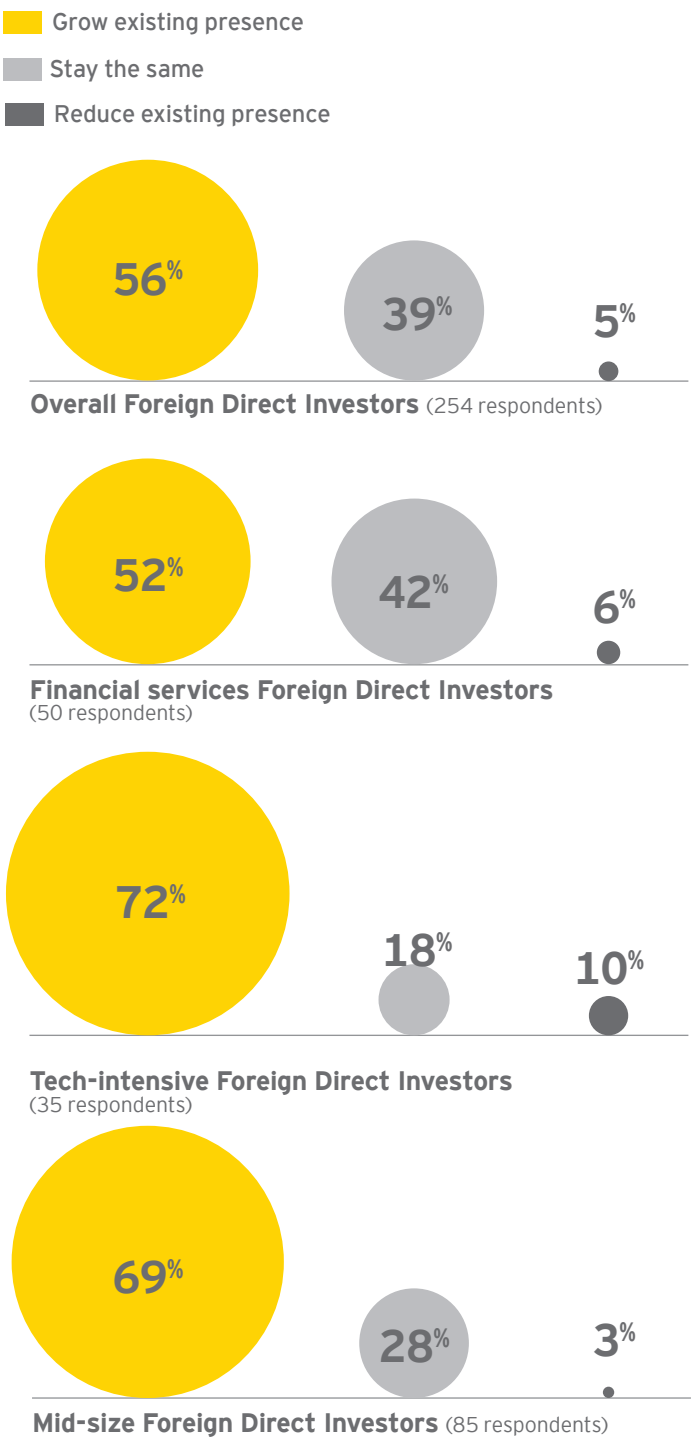
Even without the UK, the EU will be home to 6% of the world's population. European leaders and institutions need to move away from their current fire-fighting mode to better respond to their citizens' and businesses' needs and to stay relevant in this globalized world.

Alessandro Cenderello
EY EU Institutions Leader

More active investment strategies in Europe for financial services, high technology and medium-sized companies

The details of Brexit are unclear, but the current economic and political climate may have a strong impact on the investment strategies of financial services and technology-intensive companies, as well as on mid-sized companies which constitute a third of our survey group.

Foreign investment plans in Europe: sector variations on a theme



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

EY point of view: financial services

Preparation time

London is currently the center of financial services in Europe and we expect that to continue in the foreseeable future. However many firms may need a physical EU27 nexus for some of their activities if they are to retain EU clients after a Brexit.

Obtaining regulatory authorizations can be a slow process. Firms with a large EU27 clientele are already exploring possible locations to set up an EU27 subsidiary and are in discussions with regulatory authorities on obtaining the approvals necessary to continue serving clients within the single market.

Recently, the European Commission proposed that banks headquartered in non-EU countries will be required to set up an intermediate holding company for their subsidiaries in the EU. As the UK is expected to become a non-EU country, this has increased the urgency for banks to address the consequences of Brexit.

Many large investment banks fear that Euro clearing operations and derivative transactions worth over US$500 billion may shift from London to other EU countries.

In expectation of the increased investment, EU countries including Ireland, France, Germany and Spain are simplifying regulatory application procedures and wooing London-based financial services firms. Frankfurt is considering relaxing labor laws. The extent of any moves may ultimately depend upon the terms of any exit agreement between the EU and the UK, but companies must plan for the worst and hope for the best.

Marcel Van Loo
EY EMEIA Financial Services, Regional Managing Partner

- **Financial services companies are understandably less optimistic** about their growth prospects in Europe than the sample average. Only 12% expect strong growth, compared with 21% of companies overall, and 6% expect to reduce their existing presence slightly. They are nearly twice as likely as manufacturing firms to identify EU instability (51%) and Brexit (41%) among the top three risks to their growth. For them, volatility is seen as a much less severe risk.

  Their reasons are clear: London is the center of financial services in Europe, and many companies there fear business disruption arising from Brexit. Financial services firms in London face a number of risks, including the potential loss of so-called "passporting rights." These rights allow a financial services firm regulated by one EU state to sell services in the other 27 states without acquiring additional authorizations. If passporting rights are withdrawn, firms may be obliged to relocate some operations to EU27 countries in order to continue trading within the EU.
- **Technology firms are by far the most bullish**. Overall, 72% plan to invest in Europe in the next three years, and of these, 33% expect to grow their presence significantly. That is very good news in a continent that has so far been unable to give rise to a digital technology firm equal to the giants of Silicon Valley.

  Well-established tech firms seem untroubled by instability in Europe, yet the tech firms we surveyed are nearly as worried about Brexit (38%) as those in financial services. They are much less bothered about instability in the EU (24%), but 60% are alarmed at volatility in commodities, currencies and capital markets. One explanation may be that young tech firms rely heavily upon external funding, and fear that their financing ecosystem could be upset by Brexit.

  Despite its poor performance in building consumer-oriented digital champions, Europe is widely seen as a powerhouse in emerging technologies such as artificial intelligence, the internet of things and robotics. The continent, on both sides of the English Channel, has produced many promising young companies in these fields, and hosts powerful ecosystems underpinned by close links between industry and academia.
- **Mid-sized companies will continue to seek growth in Europe**. More than two-thirds expect to grow their presence in Europe, and 26% plan significant expansion. For them, it is volatility in currency and commodity markets that poses the biggest business risk, with the slowdown in trade flows, and Brexit in second and third places.

EY point of view: technology

Digital agility

The digital economy accounts for over 10% of Britain's GDP. And it is growing fast, both in the UK and across the EU. Investment in tech start-ups now tops US$13.6b in the UK and Europe – up fivefold in five years. But since the referendum, financial technology (FinTech) investments have slumped 26% to US$532m in the third quarter of 2016 – running at almost half the pace seen during 2015.

The UK has Europe's strongest start-up ecosystem, centered in the London district of Shoreditch, but spilling out into high-tech centers around the university cities of Oxford and Cambridge. European cities – notably Dublin, Paris and Berlin – see the referendum result as a chance to promote themselves as alternative technology hubs.

Key issues for tech entrepreneurs and investors revolve around talent and mobility, data flow and data privacy regulation, tax and trade rules, and access to finance.

The EU is a leading source of funds for UK research, innovation and SME projects through programs such as Horizon 2020, which aims to achieve nearly €80 billion of investments by 2020. Fears that funding may be harder to obtain may be making venture capital firms more cautious. However, US global technology giants have continued to demonstrate their confidence in London as a digital technology powerhouse.

Jean-Benoit Berty
EY UK Technology, Media and Telecommunications Sector Leader

Source: "UK's digital economy is world leading in terms of proportion of GDP," *TechUK.org website*, https://www.techuk.org/insights/news/item/4075-uk-s-digital-economy-is-world-leading-in-terms-of-proportion-of-gdp, accessed 12 December 2016; "Action is needed now to stem the flow of vital technology talent," *The Times website*, http://www.thetimes.co.uk/article/action-is-needed-now-to-stem-the-flow-of-vital-technology-talent-8dnqbqt5k, accessed 9 December 2016. "Brexit depression casts dark cloud over UK fintech investment," *Finextra website*, https://www.finextra.com/newsarticle/29772/brexit-depression-casts-dark-cloud-over-uk-fintech-investment, accessed 9 December 2016; "European Social Fund 2014-2020," *European Commission website*, http://ec.europa.eu/esf/main.jsp?catId=62, accessed 9 December 2016.

2. A rethink of pan-European investments and activities is looming

Relocation may happen

According to our survey, **86% of foreign investors with a presence in the UK (75% of the sample group) have no plans to change or relocate** European operations in the next three years if the UK leaves the European single market. But 14% of those present in the UK say they will change or relocate some activities if Brexit happens.

Overall, only 11% of the 254 executives we interviewed plan to modify their presence in the UK and consequently, in Europe in the wake of Brexit. The precise consequences of a Brexit remain to be established. But relocation will not be a UK phenomenon alone. Deeper trends arising from technology change and global economic re-balancing are causing many companies to rethink their international investment strategies. The UK referendum also coincided with a rise in protectionist forces more widely, especially following the election of President Donald Trump in the US.

This is a potentially significant trend, considering the importance of FDI in Europe and in the UK. In 2015, the stock of inward FDI into the EU28 exceeded 48% of GDP. This stood at 54.5% of GDP for the UK.[11] For companies in some sectors, it may be necessary to move some operations from the UK to an EU27 country in order to retain access to rights enjoyed only by EU companies. So, fund management companies, insurers and banks may need to set up a new entity regulated by an EU27 member so that they can continue to sell their products throughout the single market.

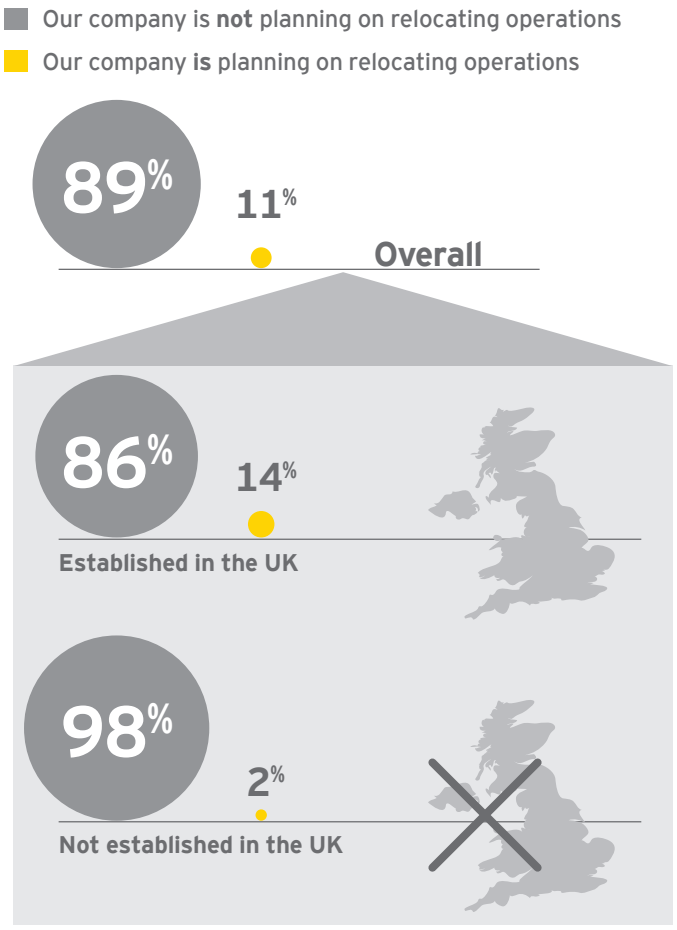
The UK may become a less attractive location for some companies and operations. But for others, its appeal may strengthen. This will depend in part upon the return to stability and the evolution of public policies across Europe. An optimistic view of this survey would note that 9 out of 10 senior executives are not considering either changing or relocating operations.

Yet, what we see now might be a once-in-decades change of location strategies in Europe. Just as Brexit has raised questions of identity for citizens, so it also raises strategic questions for companies. Now is the right time for companies to ask themselves what their overall vision is and what general organization they want in Europe.

Our perception is that the current transition period brings a "strategic allocation agenda" to the table. The Brexit referendum has had a destabilizing effect on companies everywhere. Our sample, though small, suggests that for some firms, back office, logistics, production and headquarters operations may all be areas subject to review in the wake of the vote.

Economic decisions are no longer the primary driver for strategic location decisions. Rather, wider geopolitical events and the impact of resulting changes are becoming increasingly important factors to consider in investment decisions.

If the UK leaves the European single market, will you change or relocate the following operations in the next three years?



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

11 "FDI Stocks", *OECD website*, https://data.oecd.org/fdi/fdi-stocks.htm, accessed 29 December 2016.

EY point of view: automotive

Sustaining performance

As we do not know yet when, how and under what conditions a Brexit will be executed, it will remain important to think in scenarios and to build maximum flexibility and agility in any strategic programs. The automotive industry faces significant uncertainty as Brexit unfolds. The UK is the fourth-largest light vehicle manufacturer in Western Europe. In the first half of 2016, UK output was 897,157 cars, up 13% year-on-year. The UK industry is closely integrated with that of the Eurozone both in terms of component supply and sales. EU customers are big buyers of British-made cars, and the UK is a leading market for vehicles imported from Germany, Spain, France, the Czech Republic, and elsewhere. Supplies of components flow back and forth across the Channel.

Now Brexit hangs over a European car industry that already has excess vehicle-manufacturing capacity, and is reshaping itself in search of lower costs and in order to adapt to new technology and changes, such as the spread of electric cars and the emergence of ride-sharing business models.

The devaluation of the sterling has already undermined the margins of car-makers selling into the UK. Several companies have raised prices and begun cost-control measures. Higher prices are likely to cut demand in the UK.

We believe that uncertainty does not mean "wait and see." Companies that fail to act will cede a strategic advantage. We recommend that carmakers increase scenario planning and develop agility.

Jörg Hönemann
EY Germany, Austria and Switzerland (GSA), Automotive team leader

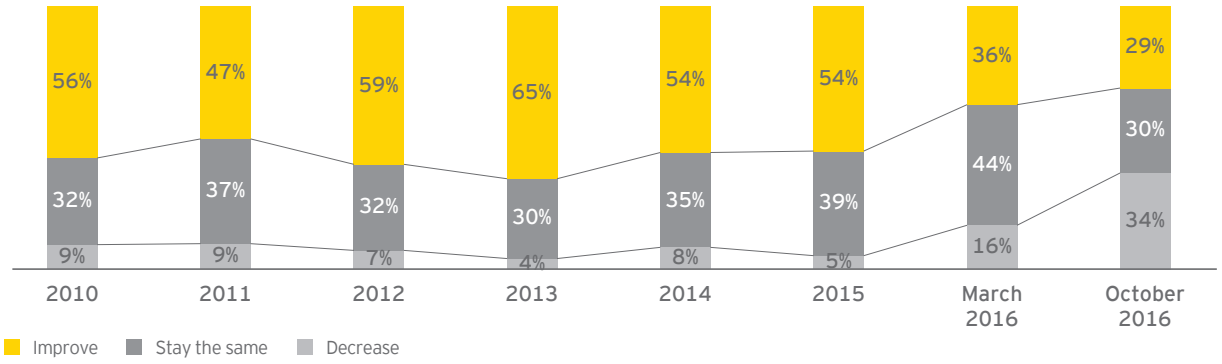
Note: In the following two sections, we draw our analysis from EY's latest UK attractiveness survey Autumn 2016. On the basis of a panel largely made of foreign investors in the UK, this report provides a unique view of the UK's attractiveness to FDI, the competition between countries and cities, and the outlook for foreign investment in the UK.

The UK's attractiveness will be affected

Further evidence that the referendum has impaired the UK's appeal as an FDI destination is provided by ***EY's UK attractiveness survey*** conducted in autumn 2016. Our poll in spring 2016, carried out before the referendum, asked decision-makers how they expected the UK's attractiveness to change over the coming three years. The proportion of respondents expecting an improvement fell to 36% from 54% in 2015.

When we asked the same question in autumn 2016, only 29% predicted an improvement, while **the proportion expecting the UK's attractiveness to decline more than doubled, from 16% to 34%**. This is the most negative perception we have recorded since we began conducting our surveys in 2004.

How do you think the UK's attractiveness for FDI will evolve over the next three years?



Source: *EY's UK attractiveness survey 2012–2016.*

European investors are the most pessimistic on the UK's investment attractiveness outlook. Overall, 43% expect a decline and only 23% an improvement.

Minimizing any damage to the UK's growth potential will require special care. The complex links between the UK and the EU, which have matured over 40 years, may complicate efforts by UK policymakers to change course. Post Brexit, we believe the UK will pursue a vigorous blend of free trade policies backed by targeted interventions.

The UK's attractiveness will be underpinned by long-standing strengths:

- Good governance, light regulation, strong financial markets and business support ecosystems
- Flexible labor markets and a large, diverse, creative skills pool, with low payroll taxes helping the UK present itself as a competitive location
- Outstanding science, research and technology capacity, although Brexit partly puts this at risk since one in four UK academic research publications arise from a European partnership[12]
- Tax competitiveness, with the promise of a corporate income tax (CIT) cut from 20% now to 17%[13]
- London, one of the world's truly global cities with a unique combination of language, low taxes, lifestyle, tech skills – although many of these are imported – and tech-savvy consumers, which appeals strongly to Californian technology companies

12 "EUA Brexit Factsheet: UK – European Research Collaboration and Student Mobility," *European University Association website*, http://www.eua.be/Libraries/publications-homepage-list/eua-brexit-factsheet-research-collaboration-and-student-mobility, accessed 8 December 2016.

13 "Brexit: George Osborne pledges to cut corporation tax," *BBC website*, http://www.bbc.com/news/business-36699642, accessed 20 December 2016. www.ft.com/content/f4b1cd0a-bd68-11e6-8b45-b8b81dd5d080, accessed 19 December 2016.

Companies are taking notice. Since the Brexit referendum, Alphabet has committed to a new headquarters at Kings Cross that will house 7,000 workers, up from 4,000 UK staff today.[14] Apple committed to a new office for 1,400 and more in Battersea.[15] Facebook and Amazon are also expanding in London, where Europe's premier digital start-up cluster and ecosystem has sprung up in the district of Shoreditch.[16]

However, some of the same strengths that underpin the UK's attractiveness are more threatened by Brexit. For example, education, skills and talent may be constrained by restrictions on immigration and by the perception that the UK is less welcoming to foreigners. More than 200,000 students from other European countries study in the UK, 28% of all European mobile students, and far ahead of Germany (17%), Austria (8%) and France (7%).[17] However, Cambridge University has reported that the number of applications it has received from prospective EU students have dropped by 14% since the referendum. And the University's vice-chancellors have warned that immigration restrictions could have "serious repercussions" for UK research.[18]

EY point of view

An attractive future

Our *2016 UK attractiveness survey*, published in May 2016, confirmed another strong year attracting FDI to the UK. It did, however, also identify increased investor nervousness about the UK's future attractiveness, mainly concerning potential changes to its trade relationship with the EU.

In response, we've updated our investor perceptions survey to compare the mood now with that before the referendum. The results of this, together with a detailed analysis of FDI in Europe over the last decade, provide the basis for our updated UK attractiveness report.

The results are mixed. On the plus side, there is no sign of any deterioration in investment intentions over the next 12 months. In fact, there has been an improvement in short-term sentiment since our last survey.

However, the medium-term outlook has worsened across a number of metrics and investors are concerned about how the UK's attractiveness will develop over the next three years. The respite offered by the stable immediate outlook offers the UK Government the chance to implement policies that will maintain and grow the UK's longer-term attractiveness.

A sector strategy is essential for shaping the UK's approach to FDI, and to trade more generally. Once sector priorities have been identified, our discussions with investors indicate that there are five priority action areas for trade, which should form the basis for an integrated UK attractiveness strategy:

1. Developing a comprehensive approach to skills
2. Delivering improved infrastructure
3. Signing trade deals to preserve and grow the UK's market access
4. Introducing incentives to encourage investment
5. The creation of a digital platform

All these initiatives should be developed at both national and city or region levels to ensure trade continues to support UK economic performance and that the benefits of FDI are felt across the whole economy.

This integrated strategy must be communicated to investors as soon as possible, with a focus on making certain they are aware of the UK's vision for the economy beyond 2019.

The current environment is challenging, but there are opportunities as well as threats. The UK has the chance to move decisively and to position itself for an attractive future.

Mark Gregory
Chief Economist, EY UK & Ireland

14 "Google commits to £1bn UK investment plan," *BBC website*, http://www.bbc.com/news/business-37988095, accessed 20 December 2016.

15 "Apple moves UK HQ to Battersea power station boiler room in London," *The Guardian website*, https://www.theguardian.com/uk-news/2016/sep/28/apple-moves-british-hq-into-battersea-power-station-boiler-room, accessed 19 December 2016.

16 "Facebook 'likes' Britain's talent, to add jobs despite Brexit," *Reuters website*, http://www.reuters.com/article/us-facebook-britain-idUSKBN13G0VV, accessed 19 December 2016.

17 "EUA Brexit Factsheet: UK – European Research Collaboration and Student Mobility," *European University Association website*, http://www.eua.be/Libraries/publications-homepage-list/eua-brexit-factsheet-research-collaboration-and-student-mobility, accessed 8 December 2016.

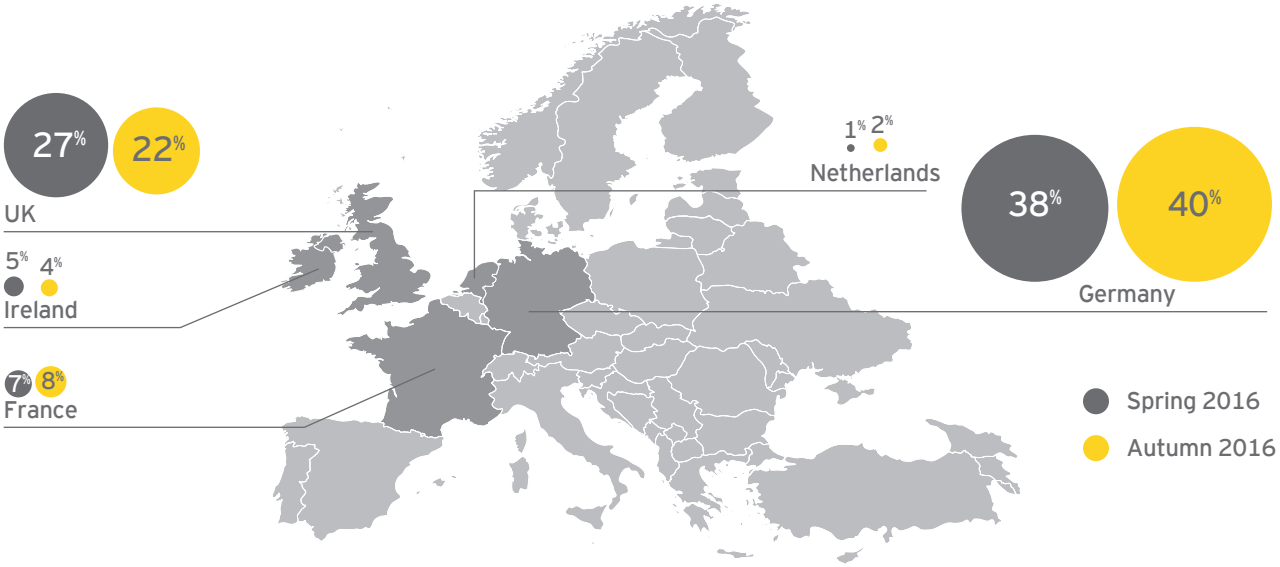
18 "Cambridge warns of Brexit hit on EU student numbers," *Financial Times website*, https:// www.ft.com/content/f4b1cd0a-bd68-11e6-8b45-b8b81dd5d080, accessed 19 December 2016.

The lines of Europe's FDI map are starting to shift

Heightened geographic and political risks across Europe and the UK are prompting 1 in 10 companies present in Europe to review their business location strategies. Across the continent, Brexit is having a ripple effect, both cutting across and combining with more local currents. **Where will companies want to be in 2019?**

Conducted after the referendum, our *UK Attractiveness Survey Autumn 2016* gives some indication of where companies might relocate operations from the UK.

Which are the top three countries for FDI in Europe? (first choice)



Source: *EY's UK attractiveness survey 2016, Autumn 2016.*

When we surveyed companies for this post-Brexit update to our *European attractiveness survey*, we found similar thinking. Only 10% of our respondents gave answers to this question, so the findings are only indicative. But the choices revealed by the 27 responses are broadly in line with trends captured by other EY studies.

Germany was the preferred destination for operations moving from the UK (selected by 54% of respondents who gave an answer), followed by the Netherlands (33%), with France, Italy and Spain among the bigger economies in a distant third place with 8% each. Proximity, language skills, attractive employment, and tax laws and historical ties may explain the strong showing of the Netherlands. France scored low as a potential location for companies currently active in the UK (chosen by only 8%), but much more strongly among those not present in the UK (chosen by 44%). A second cluster of countries in Central and Eastern Europe was also favored by UK companies looking for alternative locations: the Czech Republic was favored by 12%, and Hungary and Poland by 11% each. These countries combine affordable labor with steadily improving skills, investor-friendly policies and increasingly sophisticated business ecosystems.

When companies investigate alternative locations, the business environment they find may differ from what they previously expected, because some European countries have adopted elements of UK strategies — and are closing the attractiveness gap.

Today Europe:

- Has become more business friendly
- Is home to many countries with low corporate tax rates, which are on a downward trend across the EU
- Offers simplified labor codes and more flexible working conditions in many countries
- Has adopted English as the language of business, especially in start-ups and multi-national companies such as ABB, which has declared English its workplace language[19]

Corporate income tax rate across some European countries

Country	2016 tax rate	Country	2016 tax rate	Country	2016 tax rate
Ireland	12.5%	**Finland**	20%	**Spain**	25% (reduced by 10% over 2015)
Cyprus	12.5%	**UK**	20% (to cut to 17% by 2020)	**Luxembourg**	29.2%
Hungary	19% (to cut to 9% next year)	**Denmark**	22% (reduced by 6.3% over 2015)	**Germany**	30%
Poland	19%	**Switzerland**	24%	**Belgium**	33%
Czech Republic	19%	**Netherlands**	25% (to reduce in coming years)	**France**	38%

Source: *EY Global Tax Policy Outlook for 2016.*

EY point of view: tax impact

Doing what makes sense

Does the UK need a FTA with the EU? Arguably not. Three of the biggest economies of the world, the US, China and Japan, do not have an FTA with the EU, yet trade very successfully with the bloc. For the UK, trade with the EU will remain far more important than trade with other economies, with or without an EU FTA. If there is no FTA, UK exporters will review their options. They will look for the least disruptive point of entry into the EU in terms of certainty on custom duties, custom procedures, import quotas and payment of VAT, and route most of their trade through this point (rather than selling directly to the individual countries). UK exporters will deal with this new reality and move on. If they can make changes to their supply chain, to further reduce costs, they will consider their options and do what is necessary.

Non-UK groups that have preferred the UK as their stepping stone into the EU market may reconsider the size and activities of their UK operations. If there is a benefit in moving operations to the continent, they will do what makes most economic sense.

UK-based foreign-owned holding companies with EU headquarters, research centers and other activities will go through a similar process. They will ask themselves whether it continues to make sense to service the EU market from the UK, considering issues including any difficulty in finding and hiring EU talent; availability of relevant financial services; access to EU regulators and government agents; and license to operate issues.

From a tax perspective, all of this creates much uncertainty. Clearly, custom duties and VAT are key issues that are likely to impact UK exporters. Some of the higher costs may be mitigated by changes to the business structure (new EU point of entry). After Brexit, UK companies may face higher withholding taxes on passive income flows (dividends, interest and royalties) from certain EU sources. Whether corporate income tax will end up with a race to the bottom is uncertain, but lower rates and a broader tax base are certainly more than a possibility. We expect tax policy to be high on the political agenda on both sides of the Channel.

Helmar Klink
Partner, International Tax Services, Ernst & Young LLP (The Netherlands)

19 "The English empire," *The Economist website*, http://www.economist.com/news/business/21596538-growing-number-firms-worldwide-are-adopting-english-their-official-language-english, accessed 10 December 2016.

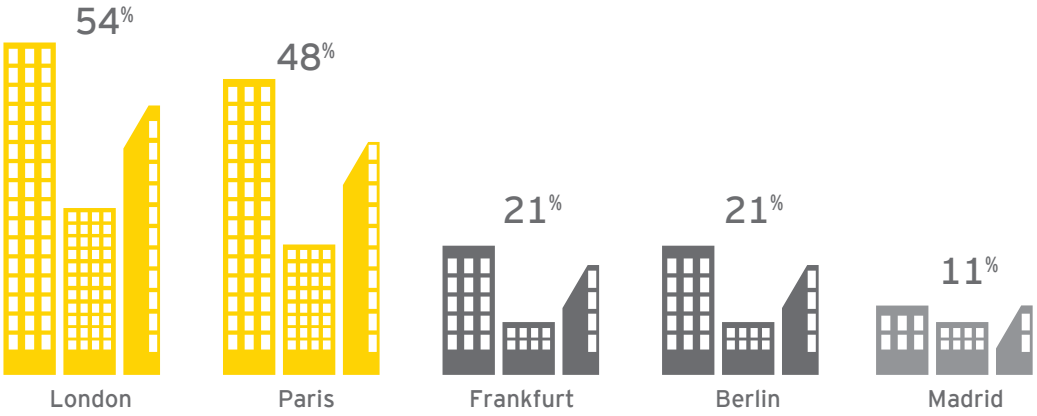
Cities compete for foreign investment, more than ever

The post-referendum *UK attractiveness survey* found that cities are taking steps to retain or attract foreign investment with their own policies, sometimes linked to, and sometimes distinct from the national regulatory and tax grids.

- **London** remains Europe's most attractive city, aided by its business ecosystem, cosmopolitan and capable workforce, and high quality of life.
- **Paris** has narrowed the gap, as enthusiasm for London has reduced, and as investors lean more toward Europe's other truly "global city[20]," with Asian investors showing particular interest.
- **Frankfurt** and **Berlin** divide the votes of those favoring Germany, with the former particularly attractive to financial services companies and the latter to tech companies.
- **Madrid completes the top five**, and is a destination to watch for the future.
- Amsterdam, Munich, Dublin, Brussels and Barcelona, in particular, were mentioned as potential destinations.

All these cities "speak tech" and have developed lively start-up clusters and ecosystems. Increasingly, Europe is becoming a continent of regions and cities with sound infrastructure, cosmopolitan talent pools, 21st-century lifestyles and English as a common language.

Top five of the most attractive European cities for foreign investment



Source: *EY's UK attractiveness survey*, *Autumn 2016* (sample size 259).

20 "Sorry, London: New York Is the World's Most Economically Powerful City," *City Lab website*, http://www.citylab.com/work/2015/03/sorry-london-new-york-is-the-worlds-most-economically-powerful-city/386315/, accessed 12 January 2017

3. Foreign investors in Europe are focused on managing the present – for now

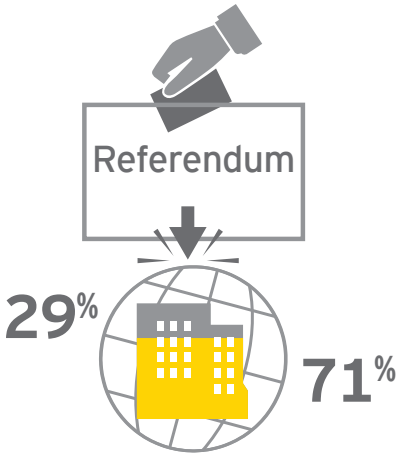
Companies feel the consequences

Since the EU referendum, **71% of foreign investors have already felt some impact of the EU referendum results** across their European operations on a least one area of their business. There is no single "pain point," but the impact is typically felt in one or two areas, especially operating margins, cost of purchases and sales.

This is not surprising, given the uncertainty regarding the future relationship between the UK and the EU. Many companies have reported lower profits in the aftermath of the Brexit referendum, most commonly as a result of the weakening pound or of softer demand. Some companies have raised prices or are considering raising prices in the UK since the Brexit vote.[21]

UK-based companies with extensive overseas operations will benefit from the weaker pound, in so far as it will bolster their profits when reported in sterling. But the companies we surveyed report their results in various currencies, and more respondents reported worsening results than reported an improvement.

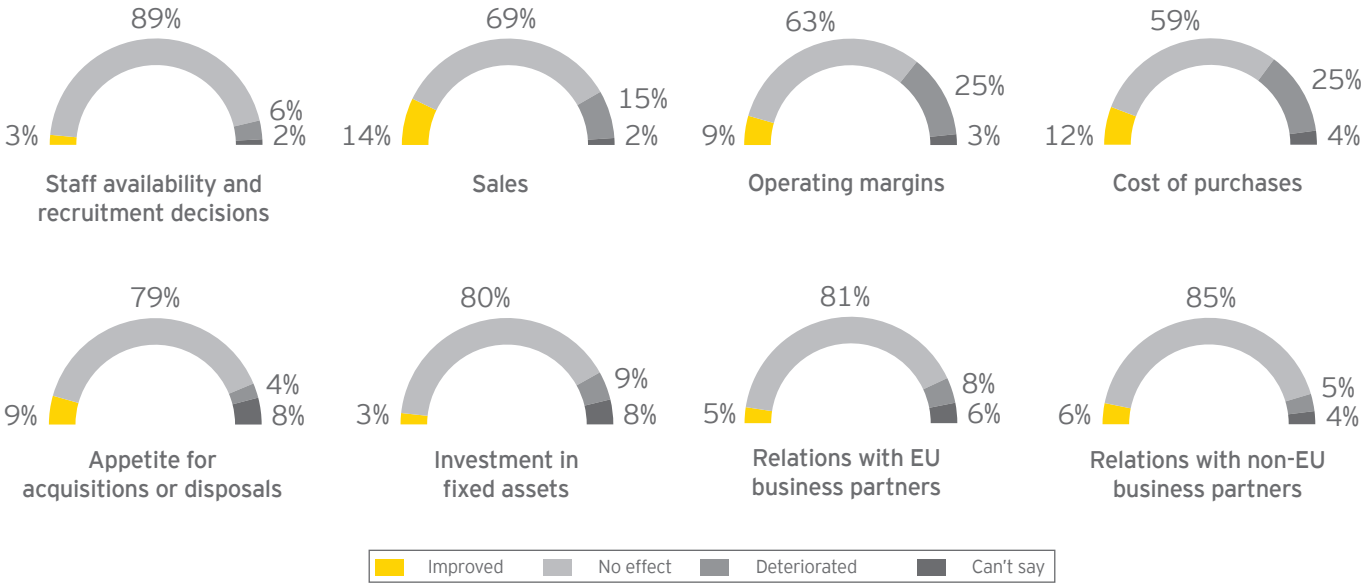
The impact of the Brexit vote



Companies impacted by the referendum on at least one area
Companies not impacted by the referendum

Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

Since the Brexit referendum, what effect have you already seen on your business regarding ... ?



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

21 "Ahead of Brexit Talks, Companies Puzzle Over the Pound," *The Wall Street Journal website*, http://www.wsj.com/articles/ahead-of-brexit-talks-companies-puzzle-over-the-pound-1476142800, accessed 14 December 2016.

A quarter of companies surveyed reported deterioration in their operating margins and a rise in the cost of purchases since the referendum

The big sterling devaluation that followed the referendum has had immediate consequences for many companies. These have been compounded by increased uncertainty for many firms operating in the UK or trading between the UK and the EU27.

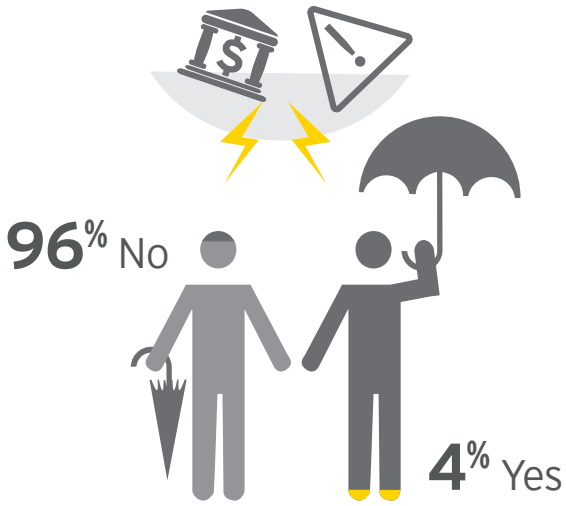
A squeeze on operating margins has affected businesses across our panel, but companies with a strong presence in the UK were hardest hit, with 31% reporting **increasing purchase costs** and the same proportion feeling pressure on their operating margins. However, 9% of companies not in the UK also reported **squeezed margins and higher costs**.

Some companies also said the referendum had hit sales and investment, damaged their relations with business partners in both the EU and beyond, cut their appetite for acquisitions, and impaired staff availability.

A small number of companies have started to plan

A small number of companies have started to plan. **Just 4% of the business leaders we interviewed said they were well-prepared** for the uncertainty arising from a changing regulatory and risk environment. One striking finding from our survey is that many mid-sized cross-border investors, having US$150m to US$1.5b of annual sales, are not planning thoroughly for today's increased geo-political risks. Most companies still have much work to do and this is even more difficult in a context that is constantly and quickly changing. Increased risk is found throughout Europe: in the UK, Western Europe, Southern Europe, and Central and Eastern Europe. Geo-political and related cross-border risks are also high around the planet. In addition, our survey indicates that 10% of foreign investors have no plans in place to modify the way they do business if the UK leaves the single market, a proportion that is significantly higher among companies without a presence in the UK (25%). Yet, given the scale and extent of current geo-political uncertainty across the European landscape, companies would be prudent to ensure in advance that country operations have the stability, agility and local management ingenuity to overcome upsets.

Am I well prepared for any uncertainty arising from a changing regulatory and risk environment for my business?



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

Plans emerge to redesign supply chains and attenuate impact on growth

We asked our survey participants what their three priority actions will be if the UK leaves the single market. The picture that emerges is of a root-to-branch overhaul, with a particular focus on mitigating higher costs and the impacts on the supply chain, as well as updating contracts with customers and looking for new business opportunities.

Assessing and managing the immediate impact of Brexit on costs (largely import-driven) and supply chain is a foremost concern for respondents to our survey. We have already seen a trend for companies to raise prices or reduce the size of units sold to minimize the impact of more expensive imports, and even the (probably temporary) suspension of some products by online stores.

EY point of view: supply chains

Understand and optimize

Given that the nature of any post-Brexit trading structure between the UK and EU is still unclear, it is difficult for companies to fully evaluate the impact Brexit will have on their supply chains. For those with sales or manufacturing operations in the UK, the biggest issue will be potential increases in trade tariffs, changing product regulatory requirements and greater export administration costs and logistics delays — both for raw materials and finished goods. In addition, UK manufacturing cost inflation arising from the declining value of the pound will continue to impact operations. Furthermore, the loss of EU R&D grants and other investment grants, unless replaced by the UK government, will also increase the cost of operating in the UK. However, there are opportunities as well. Companies with centralised supply chain operating models and trading hubs, may see continued advantages to UK locations if the UK government continues to lower corporate tax rates. In addition the devaluation of the pound also brings growth opportunities for companies with exporting operations.

Once the UK begins to negotiate its withdrawal from the EU, companies can start to assess the likely trading model and implications on their operations. It is very unlikely that the UK and EU will be able to conclude a full agreement within the two year exit timeframe envisaged. Understanding any transitional trading agreement will be critical for companies as they evaluate the impact on their supply chains.

In addition to Brexit, other external factors will also influence European supply chains. First is the accelerating adoption of digital and disruptive technologies driving new business models, channels to markets and automation opportunities throughout the supply chain, commonly referred to as Industry 4.0. Global trade volumes and the continued move east will also affect the structure of manufacturing networks. Governments will also influence the use of centralised supply chain operating models designed to optimise tax structures; tariffs may rise as governments become more protectionist; and economic volatility will remain.

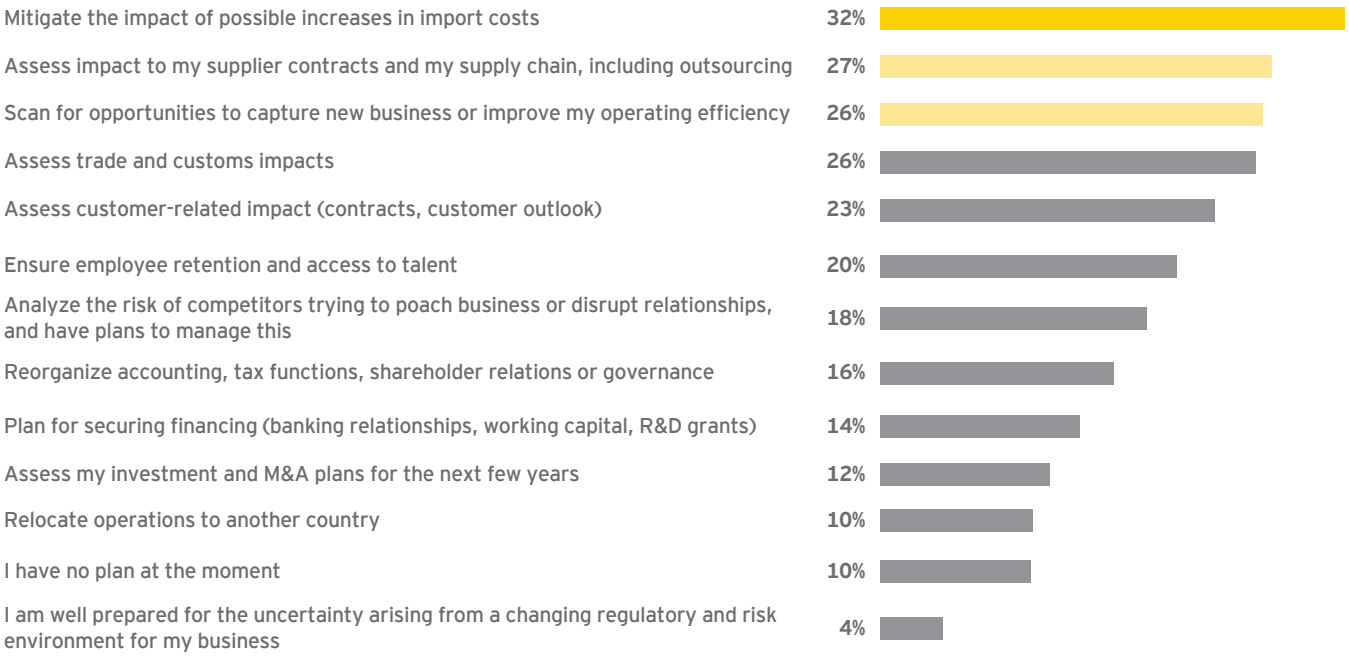
These factors will drive significant changes in European supply chains, so companies need to urgently factor in both Brexit and these other external trends into their European supply chain strategies. Given the lack of clarity on Brexit and some of these other external factors, companies should run likely scenarios to understand how to mitigate risks and future-proof their supply chain designs to continue to drive a competitive advantage from their operations. Those with UK operations should now be modelling the impact of the UK moving to WTO trade tariffs for finished goods and raw materials. This is the worst-case scenario that could be enforced in two years time, when the UK may exit the EU. Hopefully, more favourable trade terms within a transitional agreement will exist.

Andrew Caveney
EY Global Leader Supply Chain & Operations

Six months on, the pound remains well below its previous highs – but not very far off the average rate to the euro over the last decade. Yet, many investors in Europe now have integrated supply chains that span different parts of the continent. With Brexit raising uncertainty over the future trading relationship between the UK and Europe, organizations may need to redesign their sourcing and supply chain to take account of any increase in barriers to trade, such as new administrative procedures, VAT and custom duties, and even quotas.

Foreign investors are also keeping an eye on their general business outlook, assessing the impact Brexit may have on their customers, their growth and the general business conditions. This "top line" agenda runs in parallel with the immediate and dominating concerns over margins and bottom lines.

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



Source: *EY's European attractiveness survey* January 2017 (total respondents: 254).

EY point of view: retail

Reconsidering strategies[22]

Consumer confidence declined in the UK after the referendum, but is now higher than before the vote and consumer spending has been growing. However, the fall in sterling makes imported products, including those from mainland Europe or that include significant EU-made components more expensive for Britons. It also pushes up inflation, and encourages manufacturers to reduce the size of everyday treats, such as confectionery to avoid raising prices.

In the short term, UK supermarkets will be hit, because they source much of their fresh produce from the EU. For example, much of the butter and cheese sold in UK stores is made from milk produced elsewhere in the Europe. However, as supply chains are readjusted, UK stores may place emphasis on local buying or on procuring supplies from non-EU producers. Outside the framework of the Common Agricultural Policy, retailers may increase purchases from efficient global producers at world market prices. For example, New Zealand farmers may gain market share: EU farmers may lose out, and be forced to either improve efficiency or find new markets for their produce.

Top-end retailers in the UK may draw clear benefits from Brexit. Sterling weakness may encourage customers from China and the Middle East to buy luxury products in the UK, squeezing rival continental retailers as well as EU luxury suppliers.

Sterling devaluation also makes buying online from the UK more attractive. But UK-based online retailers may ultimately face more obstacles in selling to EU27 countries. For retailers, Brexit may prove an opportunity to rethink many supply chain strategies, offering opportunities to expand global sourcing and bring new, more affordable and perhaps innovative brands to the UK market. That will put pressure on existing EU suppliers. So retailers may need to reconsider a range of core strategies, from sourcing and supply chain to digital data management.

Olivier Macard
EY Global Retail Sector Leader

22 "Retailers putting livelihoods at risk by delaying post-Brexit investments warns Worldpay," *World Pay website*, http://www.worldpay.com/us/about/media-center/2016-09/retailers-putting-livelihoods-at-risk-by-delaying-post-brexit, accessed 15 December 2016; "Brexit's Impact on the British FMCG Retail Landscape", *Kantar Retail website*, http://www.kantarretail.com/brexits-impact-on-the-british-fmcg-retail-landscape/, accessed 6 January 2016.

EY point of view: trade and supply chain

Understanding the trade-offs

From a trade and supply chain standpoint, the vote in favor of Brexit involves potential changes for European businesses.

Currently, as part of the EU, the UK enjoys unfettered access to the bloc's single market without tariffs or quotas, and vice versa for EU countries. The EU is a large trade partner for the UK, accounting for 44% of exports and 53% of imports in 2015. The central scenario remains that the UK and EU strikes a Free Trade Agreement of some sort, which would involve no or limited tariffs. However, if the UK leaves the single market without a trade deal with the EU, trade between the UK and the EU would be subject to average most favored nation tariffs applied by the EU on other WTO members. These range from: cars 9.8%, chemicals 4.5%, textiles 6.5%, beverages and tobacco 19.4% and transport equipment 4.3%. Even with an FTA, exporters and importers would still be subject to new rules and customs procedures, such as rules of origin.

From an EU perspective, the UK is an important part of the European supply chain, both for manufacturing goods and services such as finance and media. The Netherlands, Ireland, Belgium, Germany and France are likely to be most impacted in trade terms by a UK departure from the EU. In case of the Netherlands and Belgium, both are major trade hubs with a high degree of exposure to the UK market. For Ireland, the UK is an important export destination.

For European boardrooms, Brexit raises question not just over the future UK-EU trade relationship but also those with other trade partners. Following Brexit, the UK will lose its preferential trade relationships with over 50 countries with which the EU currently has FTAs, though it will almost certainly seek to grandfather many of these. Britain leaving could also trigger calls for compensatory measures from countries with whom the EU currently has FTAs with, given that the EU market will shrink. However, the UK will also be able to run its own trade policy, which offers the chance to strike quicker FTAs with countries such as the US, New Zealand, Australia and emerging economies. This could open up new markets for UK-based businesses.

Mats Persson
EY Executive Director, Performance Improvement

Source: "Beyond Britain: The global implications of Brexit," HSBC Global Research, 24 June 2016, via Thomson Research; *Brexit: What does it mean for Europe?*, Euler Hermes, May 2016; *Economic Analysis – Brexit: Export Opportunities, Not Just Risks*, BMI Research, 18 July 2016; *Brexportgeddon?*, Oxford Economics, March 2016; *World Tariff Profiles 2016*, World Trade Organization, 2016.

4. A longer-term agenda for businesses and governments in Europe

1 Managing investment decisions in an increasingly volatile environment

Investors in Europe are confronted by many uncertainties. Overall, 37% of respondents to our survey are concerned about capital market volatility and its impact on FDI, while 32% consider economic and political instability in the EU a key risk. For them, Brexit is one of many tectonic changes affecting Europe. Only 4% of respondents say they are well-prepared for the changing risk and regulatory environment (including tax).

Issues for businesses: An uncertain business environment remains the top concern for investors — whether that relates to currency or geopolitical risks. Businesses need to consider how to remain agile for this "new normal" of increased volatility and uncertainty. Investing in scenario-based approaches to planning can help businesses prepare for unexpected events, such as Brexit. On the regulatory and tax front, an ability to monitor changing policies and assess their economic and fiscal impact will be essential.

Issues for governments: Brexit is yet another challenge for EU institutions and for European governments, which are already searching for better responses to weak growth, inequality and fiscal imbalances. Governments should look to engage with business leaders to develop new policies that better balance corporate and public interests. But the Brexit decision throws up opportunities too. With 1 in 10 of our respondents now looking to relocate some part of their operations, some national regulatory authorities and city leaders are working with business to highlight attractions of alternative locations.

2 Preparing for creeping protectionism and an uncertain trade environment

The vote in favor of Brexit has unleashed a wave of uncertainty regarding the UK's future trade policies and trading arrangements with the EU. Coupled with an increase in protectionist sentiment, this uncertainty puts trade back on the agenda for European boards. Already, 32% of respondents to our survey are focusing on mitigating higher import costs, and 27% consider assessing impacts on supply chains as a priority.

Issues for businesses: In the short run, organizations may consider revising supply chains to manage currency fluctuations. Post Brexit, companies trading between the UK and EU27 are likely to face higher costs, at the least because of changing import procedures. Businesses (especially those with operations in the UK) must be prepared to review and even redesign their sourcing and supply chain strategies.

Issues for governments: Policymakers need to build a more inclusive, fairer trade system and must counter any negative effects of protectionist and nationalist sentiment in Europe. They also need to respond to the demand of businesses for more clarity on future trade policy. The EU must continue to improve the functioning of the single market and must speed up the completion of free trade deals.

3 Navigating Europe's redrawn attractiveness map

Foreign investors remain rather upbeat about Europe's attractiveness: 56% plan to grow their presence in Europe by 2019. But there's no room for complacency. The continent has lost one of its biggest advantages in the global FDI landscape — the draw of a stable, predictable investment environment. With 1 in 10 respondents to our survey already planning to relocate operations, Europe's FDI map is about to be redrawn.

Issues for businesses: With change in Europe's investment attractiveness map looming, businesses need to assess both apparent and less visible costs, and to consider how they are likely to change in the future. Sound market intelligence and a fact-based, granular approach, balancing short-term pressures and long-term critical success factors (such as turnover, productivity, production or infrastructure bottlenecks, skill shortages and resources) will be vital.

Issues for governments: A changing European FDI landscape may prompt some countries to think more deeply about national attractiveness factors (such as talent or innovation) as well as policies that affect inward investment (including business regulation). At the same time, policymakers in Europe would be well advised to reiterate the enduring nature of the continent's attractiveness features and to take corrective action when and where needed.

4 Tackling the talent conundrum

Brexit has brought the issue of free movement of labor across Europe to the fore. This will change the parameters of competition for talent, and could intensify rivalry to attract the best people in some places. Already, about 20% of respondents consider employee retention and access to talent as priorities if the UK leaves the European single market.

Issues for businesses: There is an increasingly intense race between companies for skills and talent, which is likely to make labor more expensive. Businesses may need to redesign their people strategies, and to rethink their operations and location strategies. And to overcome any restrictions on the free movement of labor, businesses may need to increase their use of automation and digitization and cross-border virtual teams.

Issues for governments: Some European countries may need to revise their employment legislation to make the hiring of people simpler, more affordable and more predictable for employers, and to enhance their national capacity to access and attract high-quality talent. This may require a re-examination of procedures for expatriate workers and students, in particular. Policymakers need to invest in education, training and R&D capacity to enhance skills in the existing talent pool.

5 Bridging the finance and innovation gaps

Perceptions of Europe's capacity for fostering innovation and entrepreneurship are improving according to EY's most recent *European attractiveness surveys*. But foreign investors measure European performance against able and improving competition from the US and Asia.

Issues for businesses: The UK is the most productive country in Europe in terms of scientific output, and one in four UK publications is done in collaboration with a European partner. Twenty percent of projects under the EU's Horizon 2020 program are coordinated by UK institutions. These provide valuable ideas and resources for business, and the UK Government has pledged to replace EU funding and ensure these fruitful partnerships continue.

However, international investors and entrepreneurs need to look carefully at present and future funding availability when choosing where to locate innovation-led businesses, whether these are start-ups or new international operations. Tech start-ups typically rely upon a mix of founder funding, angel investors, venture capital and state lending which evolves as they mature. The UK has a well-developed funding ecosystem. Some European countries have strong national bodies that offer funding, sometimes in exchange for equity, and EU resources underpin some venture lending. Thinking ahead and choosing a location which offers the best funding options within an appropriate ecosystem should be front-of-mind for innovation-driven investors.

Issues for governments: The UK Government has shown it is alert to possible funding challenges arising from Brexit, and has pledged to make good any shortfalls. More widely, access to finance is one of the main challenges for companies in Europe, in particular those that are smaller, younger and more innovative. Studies show that total SME financing gaps for European countries are three to five times bigger than the gap in the US. At the same time, innovative companies face more limited access to business angel capital and venture capital than their US counterparts. Policymakers everywhere in Europe should focus more on services, on people and on places. EU and national efforts to improve innovation and its financing must be sustained and developed further, and any negative consequences arising from a Brexit must be addressed.

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