

# Waking up to the new economy

Ernst & Young's 2010  
European attractiveness survey

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The Ernst & Young's 2010 European attractiveness survey is based on an original two step methodology that reflects first, Europe's real attractiveness for foreign direct investors, based on Ernst & Young's European Investment Monitor (EIM) and second, the "perceived" attractiveness of Europe and its competitors for a representative panel of 814 international decision-makers.

As we present our eighth European attractiveness survey, we would like to thank the hundreds of decision-makers and Ernst & Young professionals who have taken the time to share their thoughts with us.

We would like to extend our gratitude to the selected panel of global observers from the business, political and institutional communities who expressed their

views on the future of Europe: **Michel Barnier** (European Commissioner for the Internal Market and Services), **Lillian Li** (MD/Chief Financial Officer, Huawei Technologies Investment), **Helen Alexander** (President, Confederation of British Industry), **AS Lakshminarayanan** (Vice President & Head of Europe for Tata Consultancy Services), **Wolfgang Flick** (President, UPS Europe), Professor **Örjan Sölvell** (Director, Centre for Strategy & Competitiveness, Stockholm School of Economics and leader of the European Cluster Observatory initiative), **Stephan Kuhn** (EMEIA Tax Leader, Ernst & Young), **Philippe Carli** (President, Siemens France and Vice President, Energy South West Europe) and Dr. **Daniel Vasella** (Chairman of Novartis).

The success of this unique survey is directly attributable to their participation and commitment.

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# Ernst & Young's 2010 European attractiveness survey

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# Editorial: waking up to the new economy

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When the European economy started to contract in 2007, few could have predicted the scale and drama of the events that have followed. Even as the recession ends, economic growth may well be weak for the short term, and it looks certain to be very different and more volatile in the longer run.

Our global economy has turned into a multi-polar world in which China, India, Brazil and the Middle-East have joined the traditional players of North America, Europe and Japan as both the destinations and sources of global investment. Capital is now clearly flowing in multiple directions. New corporate giants are emerging to compete. Opportunities and challenges have grown as a consequence. Old assumptions have been found wanting but the new rules of competitive success have yet to be established.

In this new environment, Europe is still perceived as lacking clarity in direction or the necessary commitment and speed to adapt. Our interviews with 814 of the world's most demanding business leaders, all in search of their next international investment opportunities, indicate that Europe needs a wake-up call if it is not to lose ground to its more dynamic competitors. Ernst & Young's 2010 European attractiveness survey shows that Europe is vulnerable both on its Eastern front (left to rebuild its financial and social systems) and Western front (less cost competitive by the minute and not perceived as a "hot spot" for knowledge-intensive investments).

Foreign investors are setting the alarm clock. They have a vested interest in and a strong influence upon Europe's economies, its industrial champions, banks and regulators. They clearly demonstrate, at the same time, their commitment and sense of urgency with an impressive 3,303 investment decisions in 2009, only 11% fewer than in 2008. Although their projects will be smaller, more selective and more regionally concentrated, they will ride on the demand for technology, services, consumer goods infrastructure and, of course, all things green and renewable. We all have an interest in making sure that the decision makers in Europe hear the alarm.

As in all transitions, the issue is its direction, shape and impact on decisions to create and invest in Europe. In what state will foreign investors find European countries and regions, clusters and industries after two years of recession? How will they perceive Europe's competitive advantages and distinct opportunities in the future? In their global decisions, how will they make choices between the various destinations of our new world order? Which companies truly have long-term confidence in Europe? What will be the substance and size of their future projects? While there is no easy solution to Europe's current situation, finding new ways for the continent to benefit from globalization will be a priority: how can governments and businesses assure Europe's future prosperity?

These issues form the core of Ernst & Young's 2010 European attractiveness survey. We hope you find it interesting and useful in helping to shape the necessary debate.



**Jay D. Nibbe**  
EMEIA Deputy Area Managing Partner  
- Markets  
Ernst & Young



**Marc Lhermitte**  
Partner  
Ernst & Young Advisory

## “Europe: an attractive place to do business”



**Michel Barnier**  
*European Commissioner  
for the Internal Market and Services*

“I don’t want Europe to be a sub-contractor to other great powers. Europe must be at the top table, leading, not lagging behind. Shaping the global economy, not being shaped by it. With the best standards and business conditions in the world.

But we need to make it easier to do business in the EU – for our companies, and Small and Medium Enterprises (SMEs) in particular. We need to keep attracting foreign investment.

Getting the new financial regulatory structure right will be essential. I do not believe in the simplistic opposing of regulation and competitiveness. On the contrary, I firmly believe that the continent which is the first to acquire an intelligent system of regulation and effective supervision will have gained a decisive advantage in attracting future investors.

But it will require much more than that. My belief is that the single market is Europe’s key asset for growth. But it needs new momentum. That’s why I am focusing my energies on full implementation of the Services Directive, which is designed to open up the single market to effective Europe-wide competition in the service industry, which today accounts for the largest part of Europe’s economy. If properly implemented, it could add up to 1.5% to the rate of annual economic growth.

Innovation is also at the heart of growth. But we need to value it more. And that’s not easy when it still costs 10 times more to patent your invention here than it does in the US. How can we be competitive when that’s the case? That’s why we need an urgent final agreement on a regime that will allow innovators to take out a single Europe-wide patent, and provide effective protection for intellectual property.

During these coming five years, I want to work with Europe’s policy-makers, businesses and citizens to build a single market without barriers. A high-performing, wealth-creating single market. A single market that relies on thriving entrepreneurship and responsibility, and a single market that is fair.

In a world where competition is becoming ever more global and intense, the task is imperative, the need urgent. But so is the prize: greater prosperity, and a Europe that is both more competitive, and more attractive to investors.”



# Scorecard and highlights



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## ► Foreign Direct Investment (FDI) 2009 – European slowdown

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**Global foreign direct investment (FDI)** slumped by 39% in 2009,<sup>1</sup> with a 36% slide in FDI inflows into Europe<sup>2</sup> as economic uncertainty caused hesitation among investors. In Europe, the number of FDI projects fell 11%, to 3,303, while FDI job creation maintained a 3-year downtrend, falling another 16% to 124,923.<sup>3</sup>

**Where is the investment going:** FDI created 18% fewer jobs in Western Europe. Almost half of the shortfall was in the service sector, but industry suffered heavily too. Chinese and Indian companies lead a new breed of FDI players in Europe, mostly in Western destinations... for now. In Central and Eastern Europe, the precipitous slide in job creation

1. "Global and Regional FDI Trends in 2009," *The Global Investment Trends Monitor*, UNCTAD, January 2010.

2. Ibid.

3. Ernst & Young European Investment Monitor 2010.

slowed in 2009, as makers of cars, electronics and computers announced a string of new but smaller plants there. Overall, new FDI projects declined 23%, but there were 76,629 new jobs created by FDI, down only 14% on 2008 – outpacing FDI job creation in Western Europe.

**Origins of Investment:** Although a majority of FDI in Europe still comes from traditional sources (the USA, Germany, France and the UK), high growth economies are increasingly making their presence felt. Collectively the BRICs<sup>4</sup> are now the 3rd largest investor in Europe and individually, China ranks 8th in the top 10 largest investors. In job creation, the presence of rapid growth economies is even more noticeable: Chinese FDI is the third largest creator of jobs and Indian FDI is the 8th.

4. Brazil, Russia, India and China.

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## ► Recovery – slower than some

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**Western Europe is still perceived as the second most popular destination for FDI** but in 2010 investors rank China the world's most attractive FDI destination, repeating its 2008 distinction. After a flight to the perceived safety of Europe in 2009, in 2010 investors look at a forecast global growth of 4%, see that only 1%<sup>5</sup> is likely in Europe and turn their eyes to high-growth markets. **China has proved** that political stability, advancing infrastructure and a vast internal market can co-exist with rapid growth, earning it

5. Ernst & Young Eurozone Forecast Spring 2010.

an attractiveness rating of 39%, a point ahead of Western Europe. India, with a score of 22%, equals USA/Canada in attractiveness perceptions, although both trail Eastern Europe by 2 points.

**Geography becomes a relative concept and old illusions about East and West have crumbled.** Sophisticated economic centers, stability and attractive markets are found worldwide, by global corporations originating in both mature economies and fast-growth markets.

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## ► Europe's growth hot spots – entrepreneurs and innovation

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**Executives offer up-beat views on a variety of European business sectors.** Information and communication technologies keep the limelight, followed by energy and utilities, financial services and cleantechs. Technology and innovation, as well as a green commitment, spread across many existing areas of the European industrial and business base, will drive tomorrow's European economy.

**Europe needs policies that remove barriers to its undoubted business and innovation talent,** enabling Europe-based businesses to make the rapidly growing economies and their consumers the purchasers of Europe's products, services and ideas. 85% of investors say that they see Europe as a world class investment destination for innovation and 29% see future European growth coming from SMEs.<sup>6</sup> Europe needs to bring this innovative spirit and small

business potential to the market place, meeting the demand from global consumers, specifically in rapid growth economies.


**Tomorrow's Europe will be created by its entrepreneurs,** not its policy-makers, investors believe. Confusion has given way to clarity, investors say: the best way for states to stimulate future European attractiveness is to support small and medium enterprises (29% of respondents), high-tech industries and innovation (27%), reduce taxation and increase flexibility (22%). The single clear message is: investors expect governments to guarantee security, stability and – in times of economic crisis – to provide aid and growth through public initiatives. After removing the crutch, as conditions gradually normalize, investors remind us that they still believe private business and entrepreneurship are the drivers essential to Europe's economic future.

6. Ernst & Young's 2010 European attractiveness survey.









# The world as it is perceived: the end of geography

In 2009, the global downturn compounded the financial crisis of 2008, provoking a worldwide decline in foreign direct investment (FDI), which fell by 39%.<sup>1</sup> Despite the slump, Europe remained the world's top FDI destination, attracting 36%<sup>2</sup> of total inflows. Yet future potential and investors' perception look set to challenge this leading position. In 2010, world output is expected to rise by 4%.<sup>3</sup> China and India are set to lead the recovery with GDP increases of 10% and 8% respectively, but Europe is expected to grow by a meager 1%.<sup>4</sup> Are growth rates all that interest investors, or are there other elements to the equation?

In terms of future prospects, the main FDI destinations are competing in a global investment race. Investors look for sales volumes and profitability, but also seek value through the best talent and innovation. In this section, we look at the intentions and perceptions of global business leaders. We evaluate Europe's attractiveness relative to its global competitors, and some of the challenges looming in the months and years ahead.

1. "Global and Regional FDI Trends in 2009," *The Global Investment Trends Monitor*, UNCTAD, January 2010.

2. Ibid.

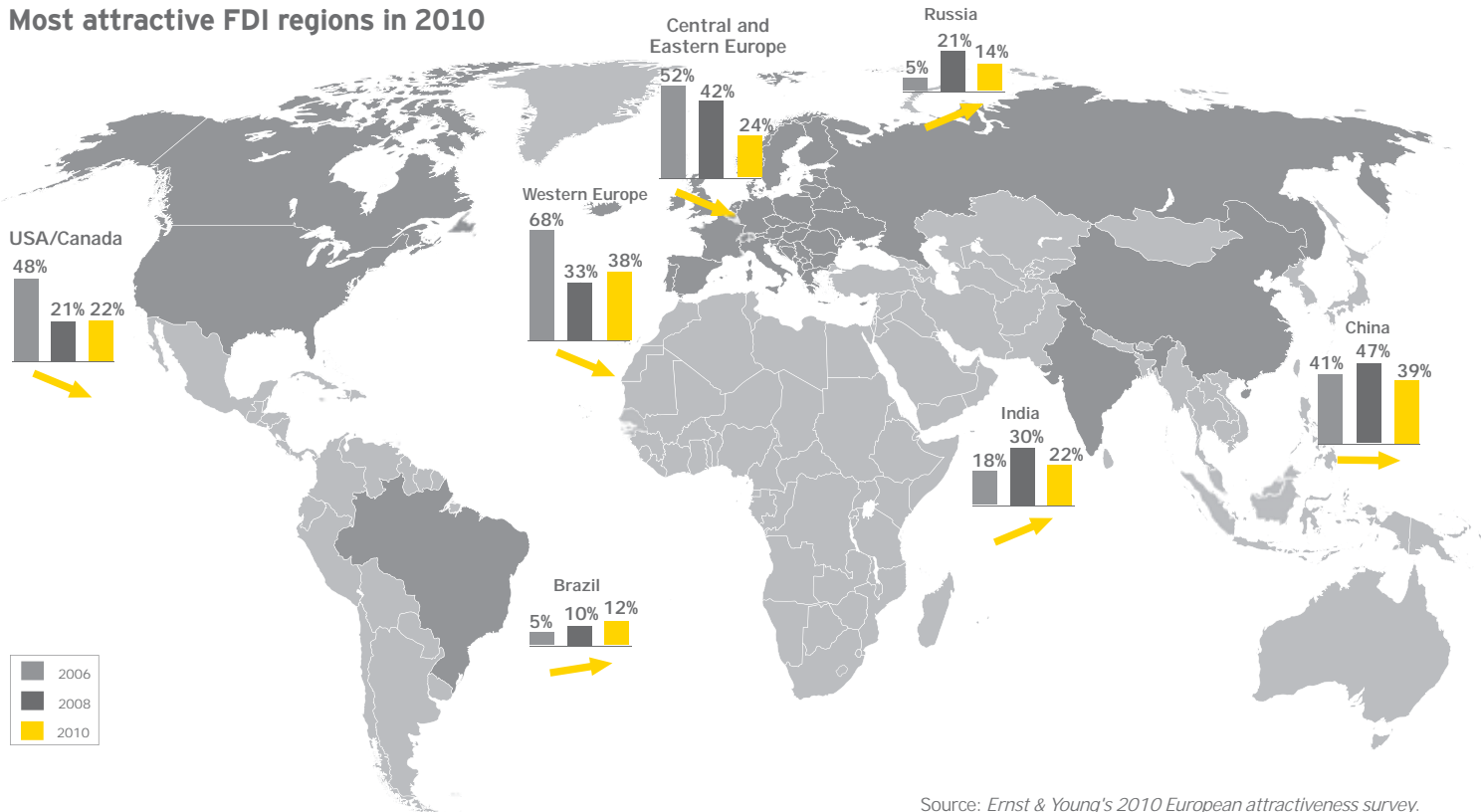
3. *World Economic Outlook Update*, International Monetary Fund, January 2010.

4. Ibid.

# 2006-2010: a contest among equals

By 2008, investors began to rate rapid-growth markets, especially China, India and Central and Eastern Europe on the same level of attractiveness as established destinations.

## Most attractive FDI regions in 2010



In Ernst & Young's 2010 European attractiveness survey, China (39%) edges out Western Europe (38%) as the most attractive region for FDI and reclaims its 2008 title, gaining six percentage points in its investor attractiveness rating. These top two FDI magnets are followed by Central and Eastern Europe (24%), then India and North America (22% each). With growth in prospect in 2010, investors are returning to their hunt for higher returns, leading to a global FDI competition, which results in the levelling of the playing field.

In the past three years, international investors responded to trends in the global marketplace, recognizing that their return on investment could be as stable – and possibly more profitable – in emerging – or high growth markets, while their risks there could be made manageable. This partly explains why Western Europe's appeal as the most attractive destination for FDI collapsed from 68% of votes in 2006 to 38% in 2010. Enthusiasm for North America fell from 48% to 22% over the same period, while China's attractiveness ranking hovered at 40% and India's grew steadily

during the years 2006-2010.

As noted in the report *Redrawing the map*, featuring insights from the "Globalization Index,"<sup>1</sup> this growing convergence in the appeal of investment destinations increases competition among global regions and countries. Models of stable corporate performance and economic development no longer belong exclusively to North Americans, Western Europeans or the Japanese. The end of geography is neither the end of the West nor the rise of the East in its stead. It is the emergence of a level and interconnected global economy. In this new multi-polar world, every nation, every cluster, every city competes for new investment. In the end, those with the best competitive advantages will win, as investors are able to shop around for growth, talent, technology and productivity. Clearly, international investors are looking for an edge in the increasingly spherical global FDI economy.

1. *Redrawing the map: Globalization and the changing world of business*, an Ernst & Young report, written in co-operation with the Economist Intelligence Unit.

# 2010: investors see warning lights in Central and Eastern Europe

Western Europe may not offer the rapid growth rates and competitive costs of some of its Eastern competitors, but investors continue to see it as a bastion of stable economic power, higher education and dependable infrastructure, with products bearing a global hallmark of quality and reliability.

Central and Eastern Europe (CEE), which ranked second in attractiveness in 2009, just behind Western Europe, sees its attractiveness as an FDI destination collapse by 15 points in 2010.

Previously, international investors perceived CEE's stability as a source of attractiveness for US, Japanese and European investors. The downturn exposed the dangers of a relationship built on rapid growth, competition for talent and easy foreign currency credit. This resulted in production surpluses, financial instability, and consequently, investor alarm.

As the financial crisis developed into a structural economic downturn, banks stopped lending to some EU-12 states, curbing consumption and infrastructure development. At the same time, over-leveraged CEE economies and businesses looked less likely to be able to service their debt and regional banks began to wobble. Industry, faced with slumping demand, began to lay off workers, further reducing demand from Eastern consumers.

Lenders and investors, mainly from the West – 6 out of the top 10 FDI in CEE are from Western Europe, began to pull their money out. Other investors, less familiar with the region, feared contagion between countries despite some remaining economically sound. As worries over potential political instability deepened, the future of the entire region seemed increasingly bleak. In addition, Western multinationals, mired in over-capacity in their historic industrial bases, pulled some of their investments in response to political and public reaction at home.

However, most CEE governments confronted the situation robustly, implementing austerity measures and successfully seeking help from the International Monetary Fund (IMF) and the European Bank for Reconstruction and Development (EBRD) to restore regional financial and economic stability. Although, this near-crisis raised concerns over the stability of CEE, the region's willingness to effectively confront problems should hearten investors. In the

*“Central and Eastern Europe sees its attractiveness as an FDI destination collapse by 15 points in 2010”*

long term, investors will remember that “New Europe” offers emerging market growth combined with ready access to wealthy Western European consumers.

Hit by the economic crisis – hard on its Eastern front and deeply in its high-cost, slow-growth West – Europe's prospects of playing a leading role in a multi-polar world are in doubt if it cannot renew its attractiveness model of a growing east working with and benefiting from a prosperous, if slower growing west.

# 2010: a shift in BRIC dynamics, China and India take the lead

According to business leaders, China is perceived as the most attractive location in the world to establish business operations.

Although approximately 1 in 3 FDI dollars invested worldwide still goes to one of the 27 EU countries<sup>1</sup>, Asian and Latin American locations attracted a higher share of decisions in a difficult year.

The international business community now recognizes a wider spectrum of high-growth markets with countries belonging to different leagues and showing distinct competitive advantages.

Having escaped recession in 2009, China is expected to resume its remarkable trajectory, forecasting 10% GDP growth in 2010.<sup>2</sup> Prized by investors for the potential of its internal market, political stability, low cost of operations and its ease of establishing business, China has benefited from the global downturn, assuming the mantle of emerging economic superpower.

*“In a sense, India and China share parallel location challenges.”*

In 2010, investors see some question marks over India's attractiveness for foreign investment, and clearly differentiate its prospects compared with the “other” high-growth giant. Yet even so, business leaders rank the subcontinent as a Top 5 global destination, with a 22% attractiveness rating. India escaped recession in 2009 and forecasts economic growth of 7.7%<sup>3</sup> in 2010. However, investors appear concerned that the country's success in attracting back-office and technology FDI exceeded expectations and capacity in some states, putting an excessive stress on some labor markets, energy supply and transportation networks.

In a sense, India and China share parallel “location” challenges. Companies have often conducted similar analyses and concluded that urban centers (for instance, on the western seaboard of China) are the most attractive targets, but a “Beijing - Shanghai - Hong Kong” or “Mumbai - Bangalore - Delhi” entry strategy may take them directly into competition with most of their competitors. There are 49 cities in China with population in excess of 1 million, and an estimated 43 in India. Some companies are therefore exploring “tier-two” urban entry strategies to build critical mass before approaching larger markets.

## ▶ 2010: Where else?

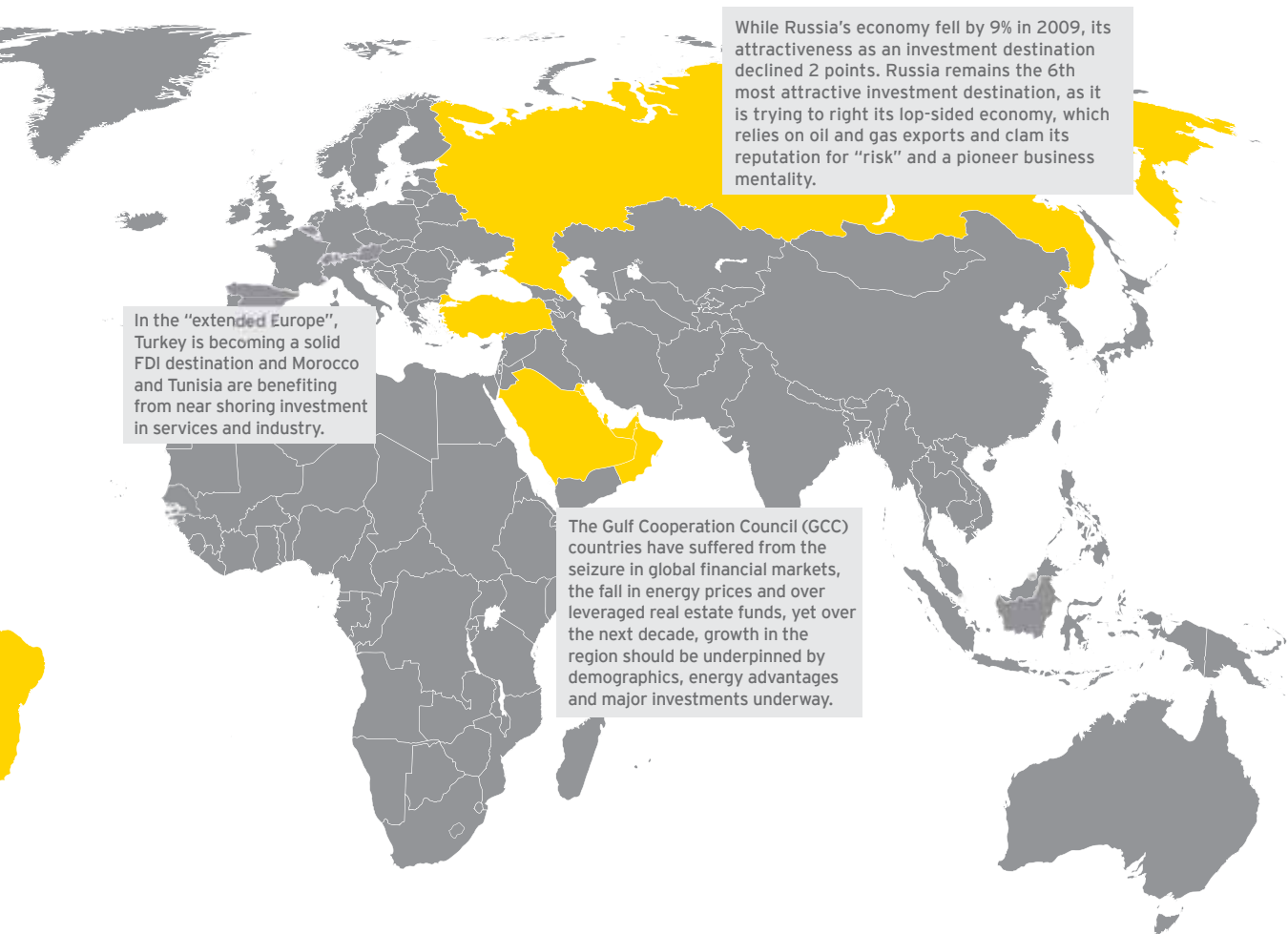


1. “Global and Regional FDI Trends in 2009,” The Global Investment Trends Monitor, UNCTAD, January 2010.

2. *World Economic Outlook Update*, International Monetary Fund, January 2010.

3. *Ibidem*.





Figures in the map from *World Economic Outlook Update*, International Monetary Fund, January 2010.

# Longer term: eastern attraction

There is no doubt investors' confidence – and their willingness to take risks – has returned. Business leaders confirm a general improvement in the economic outlook. All FDI destinations raised their attractiveness rating from 2009 to 2010. Eastern regions are again the hot spots of the three coming years.

For the next three years, investors continue to see China, India, and CEE as their route to future riches. Cities and clusters in these three regions will be the most attractive options for future manufacturing, research and development (R&D) and services projects. Western Europe, which currently ranks as the second most popular destination for FDI, falls to fifth place behind Brazil in our future attractiveness rating.

*“For the next three years, investors continue to see China, India, and CEE as their route to future riches.”*

CEE, which suffered a massive slide in investor confidence in 2009, regains a top-three ranking, implying that investors see the current economic and political problems in the region as temporary. Furthermore, the proactive response to the economic crisis of governments in CEE underscores the region's dedication to creating an attractive future.

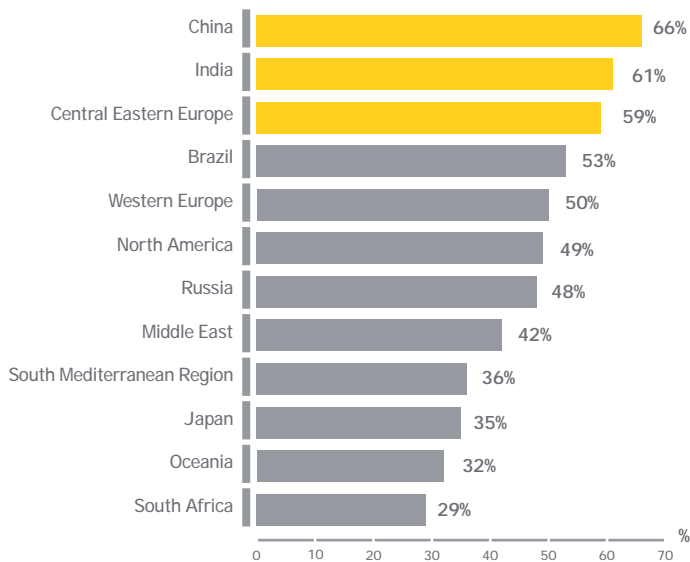
During the economic crisis, investors looked for economies that provided stability, even if they did not offer the highest growth rates or the most exciting opportunities. However, now that the developing world is leading the global recovery, investors see a different future: one that involves a greater role for emerging giants and thus the chance to win bigger returns on their investments.

Overtaken by the developing world in future attractiveness, Western European countries must revitalize. Moving into 2010, they need to carry out reforms – especially those deferred during the crisis years, including the funding of social models – and align corporate business models to the long-term trends shaping the world economy. Emerging markets, which have developed as investment destinations in recent decades, are fast becoming the home of powerful global champions. Investors are looking East and chasing long-term growth and increased returns. Now, Western Europe should aggressively embrace this transfer of global economic power and capitalize on Eastern growth, turning rapidly growing economies into the ultimate purchasers of their products and services alongside Western demand. CEE on the other hand, should seek to leverage its proximity to and relationships with stable Western Europe, while maintaining the raw dynamism of an emerging economy.

Investors clearly see the shift of the world's economic weight eastwards, as they rank China, India and Central and Eastern Europe as the most attractive regions for FDI projects. However the differences in future attractiveness are not so great. Although China may rank number 1, with 66% of the votes selecting it as the most attractive future FDI destination, Western Europe and North America both hover around 50%. This indicates that the world for investors, although favoring the east is in fact multipolar. Traditional investment recipients, who may be lagging in the polls, are only slightly less attractive than the leaders India and China. Furthermore, this reflects the increasingly global nature of business, where companies, employees, capital and customers cross borders in search of the best product and returns.<sup>1</sup> The world is increasingly flat and Europe will have to be the best to keep receiving the lion's share of FDI.

1. *Redrawing the map: Globalization and the changing world of business*, an Ernst & Young report, written in co-operation with the Economist Intelligence Unit.

### Most attractive regions over the next three years



Source: Ernst & Young's 2010 European attractiveness survey.  
Total Respondents: 814. Respondents selected 3 possible answers.

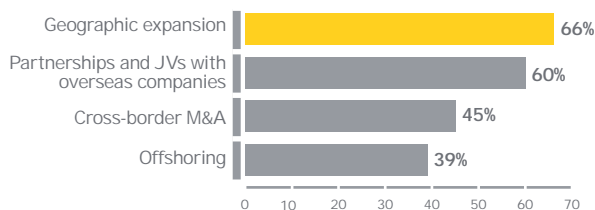
### ► What's next? Redrawing the map.

In "Redrawing the map" (from *The Globalization Index*), Ernst & Young shows that two-thirds of companies will be expanding into international markets over the next 3 years specifically to increase sales, compared with 4 in 10 that say they will conduct more offshoring (see chart) – a surprisingly low figure given the current focus on cost reduction.

Much of the planned international expansion will take the form of direct investment. Despite ongoing credit shortages and the high cost of finance, 45% of firms expect their company to conduct more international transactions over the next three years. This optimism comes in the wake of a general collapse in FDI into Western markets in 2008, duly followed in 2009 by a dramatic drop in previously resilient emerging markets.

Whether this is the start of a trend, or an anomaly which will be reversed once merger and acquisition (M&A) activity – largely a developed market phenomenon – picks up remains to be seen. Emerging market firms may also re-adopt their pre-crisis international acquisition strategies. But obstacles remain, not least the credit shortage and problem of poor due diligence that confounded many deals in the past.<sup>1</sup>

#### Investment activity



Source: *The Globalization Index Survey*, created by the Economist Intelligence Unit.

1. *Redrawing the map: Globalization and the changing world of business*, an Ernst & Young report, written in co-operation with the Economist Intelligence Unit.

# The next generation of international investors

As the world emerges from the crisis and its aftershocks, multinationals and midsize players are reconsidering cross-border investment strategies as they adapt their business models to the global changes.

Emerging giants... have emerged. By 2050, GDP in high-growth markets (Brazil, Russia, India and China, together with Indonesia, Mexico and Turkey) look likely to overtake that of the G-7 countries. Some will develop infrastructure fast enough to keep pace with global investment and some will fall victim to congestion and stagnation. Some will open to investors; others will lag in transparency, fairness and openness to competition.

► **Talent is essential.** The global race for skills, talent and creativity is on, in an environment where competition for specific competencies is fiercer by the week. Some companies will develop protectionist human resources strategies and slow a region's ability to grow through new inward investment. The winners of this race for talent will take a much more holistic, long-term approach to their people and communicate frequently and transparently to both internal and external stakeholders.

► **Risk management** is now at the heart of company location decisions, prompted by the prevailing climate of uncertainty. The current priority is for transparency, stability and clarity in countries chosen for investment projects. Companies are sharpening their focus on the balance of risks and rewards in economies everywhere. Investors are looking at a complex mix of costs, quality and risk factors before selecting business locations.

► **More flexible and focused** investment models: many global companies are looking to optimize costs but are also considering new investment models (near-shoring or re-shoring, co-location options and "open" innovation facilities). The best performers in this next phase will be more innovative in strategy and structure than their competitors, more collaborative with partners and more questioning of themselves and their potential. They will be pursuing and attaining greater speed in making and executing decisions to take advantage of their changing markets.





## “Waking up to China's new role”



**Lilian Li**

*MD/Chief Financial Officer,  
Huawei Technologies Investment Netherlands*

“I recently attended a meeting of executives hosted by a minister in Beijing where we discussed investment by Chinese companies in Europe. All those attending felt positive that Chinese companies continue to find Europe an attractive place to invest, and will increase their investment there in the future, even though the European economy has been through a bad patch.

Two reasons stand out: Europe has very good research and development, and very able managers and advanced management processes with related human resources.

Some companies, like Huawei are attracted to Europe because they find very good technology and management there. I worked for many years in Europe and found that all of the major European telecoms operators have advanced network technology and network innovation. Many are world leaders, for example in fixed-mobile-IP, 3 to 1 convergence. Huawei has the pleasure of collaborating with many of them.

So, for example, we have invested heavily to accompany and collaborate with France Telecom on technology development. By understanding and satisfying the needs of world-leading customers, we can improve our management and provide perfect solutions using vanguard

technologies – a win-win for both sides. That will make our investment in Europe very worthwhile – and by improving our technologies and management helps make our company more competitive.

Another CEO said his business gained a lot from setting up a supply chain business in Europe. A third CEO said his firm will invest in France because they found a very good research institute there.

Asian companies are also attracted by the desire to enlarge market share through win-win mergers: mergers offer a fast opportunity to improve products solutions globally – for example, recently Geely Automobile bought 100% of Volvo Cars in Sweden. Volvo's market share and outstanding reputation give many advantages, and will quickly improve Geely's brand in car markets around the world and provide a platform for further development. Of course, effective cross-cultural management is the key to success, even if it is not easy.

Chinese companies find it easier to invest in Africa than Europe, where regulation and laws are rigorous, especially concerning the workforce, product regulation, accounting and so on. That is why it is important to have very good local advisors to support them.

How could Europe improve its attractiveness further? Today, I think China's open policies for encouraging economic development are very good. State-owned companies are encouraged to invest overseas, and their strong finances offer a sound foundation for strategic integrated development in cooperation with leading European companies.

I think China's rapid development over the past 30 years shows some ways to attract investment. I am sure earlier policies to create some special zones in China, such as Shenzhen and Shanghai with advantages like HR transferring, low taxes in early years, strong support and rapid government decision-making have been very beneficial. This system attracts investment, with a snowball effect.

If Europe can create similar attractions for investors, I think European strengths – its knowledge and technologies, skilled management and workforce and the opportunity for partnerships – provide strong foundations and reasons to invest more in Europe, and Europe as a whole will be the greatest beneficiary.”





# The reality of FDI in Europe: aftershocks

In 2009, Europe was hit by the downturn and its aftershocks, receiving a smaller amount of investment and smaller FDI projects in fewer locations. Five years of sustained inward investment growth effectively came to an end.

How do perceptions of Europe's attractiveness today stack up against the investment decisions cross-border investors actually made last year? Ernst & Young maintains a unique database that tracks the FDI projects which result in new facilities and the creation of jobs, the European Investment Monitor (EIM).

In this section, we describe the changing patterns of FDI in Europe, in sectors and types of investment. We also present, based on Ernst & Young's European Investment Monitor (EIM), the winners and losers in a troubled year.



# Global downturn provokes record FDI slowdown

In 2009, Europe secured 3,303 FDI project announcements, 11% fewer than in 2008.

Evidence from Ernst & Young's European Investment Monitor (EIM) shows that the nature of investments in Europe is changing too, in tune with underlying trends in Europe's economies.

Ernst & Young's EIM records that Europe suffered a 11% drop in the number of FDI projects. Investors were careful in a year of reduced cash, difficult financing and clear over-capacity in some sectors, such as automotive, electronics and industrial equipment.

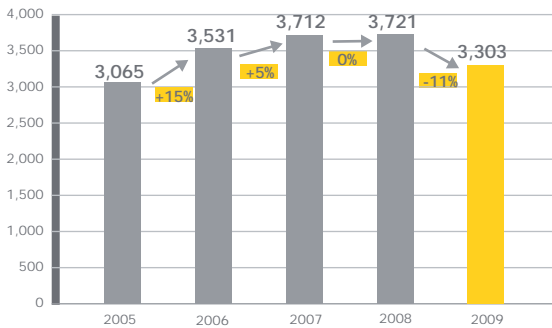
FDI into Europe generated 16% fewer jobs than in 2008 (124,923), a drop of 24,443 jobs, after a high 215,037 in 2006. Projects of international investors continue

*"On average, a new FDI project in Europe creates 69 jobs compared with 101 in 2006."*

to be scaled back, if not postponed or cancelled. This year's European attractiveness survey marks a dramatic turning point. Europe still attracts attention, deals and investments, but these projects clearly have far less employment traction. On average, a new FDI project in Europe creates 69 jobs compared with 101 in 2006.

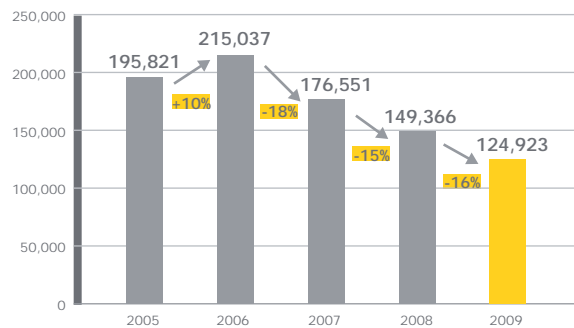
However, FDI began to pick up again in the fourth quarter of 2009, signaling a possible recovery of FDI in 2010.

**FDI projects into Europe**



Source: Ernst & Young European Investment Monitor 2010

**Job creation by FDI in Europe**



Source: Ernst & Young European Investment Monitor 2010



## “Waking up to the new normal”

“I think the economic crisis and recession have forced a return to business fundamentals such as the importance of having the right people and great flexibility in the workforce. Flexible responses from management and workforces, such as unpaid leave, short-time working, closing for a week, or even pay cuts have limited job losses which would otherwise have been far greater.

There has also been a shift around funding, both through a recognition that debt is not going to be available so cheaply in the future, and that both businesses and consumers want less of it.

There is a better recognition of the importance to the economy – and thus to society – of what business can do both in the creation of jobs and income for you and me, and of what the private sector does along the way to generate taxes that government can then devote to schools, health and infrastructure.

In the “new normal,” there is also a greater awareness of risk; and that multiple risk events can happen simultaneously.

A lot of businesses now see the opportunity to reshape in ways that were overdue, to get fit for a changed world. Many have also been forced to look for new markets.

What business needs most now from policy-makers is predictability. We need quick decision-making – which some policy-makers in emerging markets are very good at – but business also needs policy certainty and consistency, and the confidence that taxes, for example, are not going to change without notice. We need an end to uncertainty for individuals and for firms.

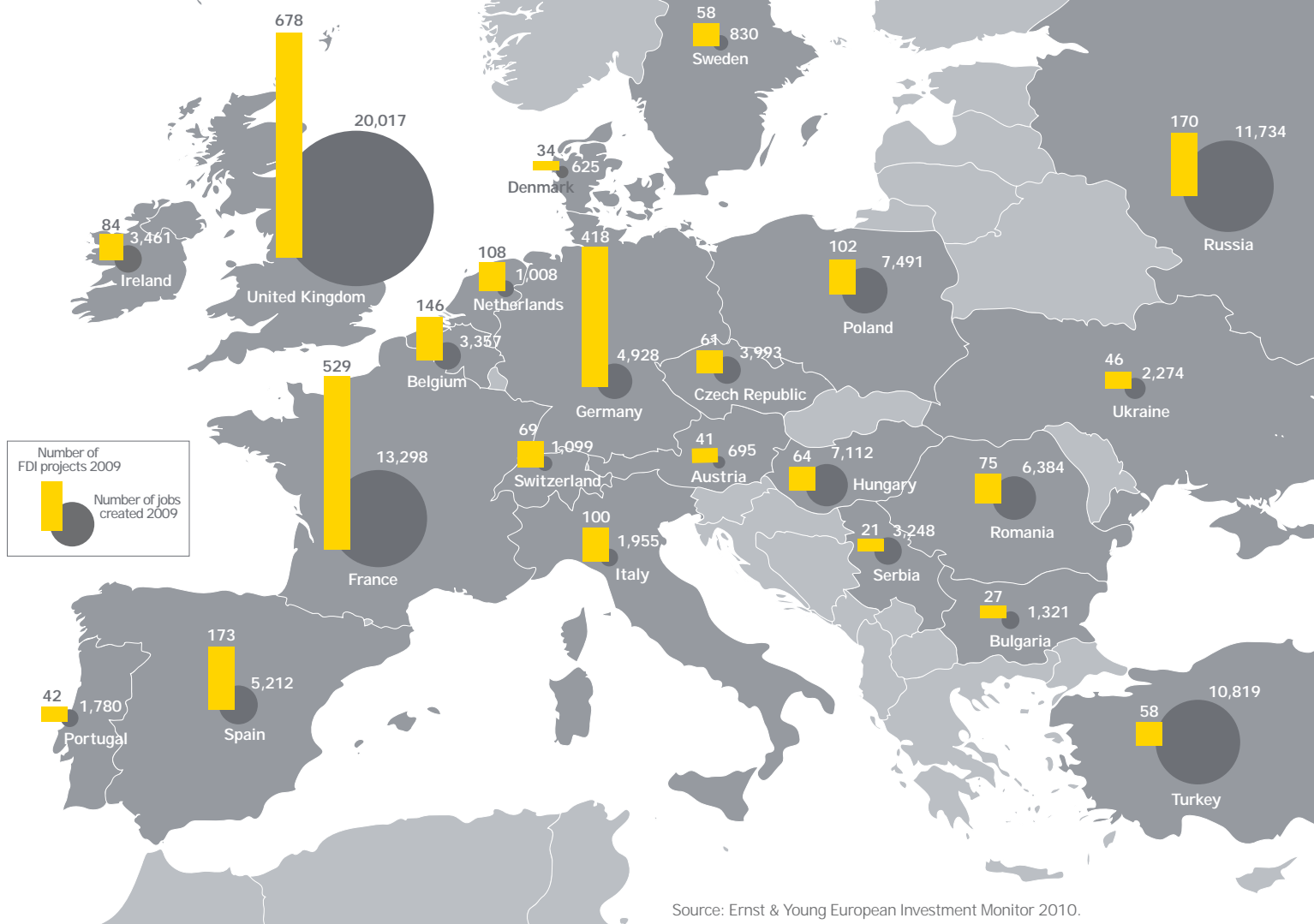
Companies, in the UK at least, have confronted the issue of pensions for their employees. We now need governments to tackle the public sector pension issue, and soon.

**Helen Alexander**  
President,  
Confederation of British Industry



Finally, I think there is now a much greater recognition that infrastructure provision is extremely important to attracting foreign investment, together with having the kind of labor market flexibility that has become a strength of the UK economy.”

## FDI in key countries in 2009



Source: Ernst & Young European Investment Monitor 2010.

### Job creation by FDI into Europe

Rank 2009	Country	Jobs created in 2008	Jobs created in 2009	Market share 2009	Change 08-09
1	United Kingdom	20,210	20,017	16%	-1%
2	France	13,003	13,298	11%	2%
3	Russia	12,900	11,734	9%	-9%
4	Turkey	1,863	10,819	9%	481%
5	Poland	15,512	7,491	6%	-52%
6	Hungary	11,829	7,112	6%	-40%
7	Romania	11,403	6,384	5%	-44%
8	Slovakia	3,660	5,262	4%	44%
9	Spain	5,038	5,212	4%	3%
10	Germany	11,422	4,928	4%	-57%
11	Czech Republic	5,626	3,993	3%	-29%
12	Ireland	6,335	3,461	3%	-45%
13	Belgium	3,406	3,357	3%	-1%
14	Serbia	3,103	3,248	3%	5%
15	Moldova	na	2,508	2%	N/A
16	Ukraine	890	2,274	2%	156%
17	Italy	1,084	1,955	2%	80%
18	Portugal	4,140	1,780	1%	-57%
19	Bulgaria	6,709	1,321	1%	-80%
20	Switzerland	1,996	1,099	1%	-45%

Source: Ernst & Young European Investment Monitor 2010

### Number of FDI projects into Europe

Rank 2009	Country	FDI projects in 2008	FDI projects in 2009	Market share 2009	Change 08-09
1	United Kingdom	686	678	21%	-1%
2	France	523	529	16%	1%
3	Germany	390	418	13%	7%
4	Spain	211	173	5%	-18%
5	Russia	143	170	5%	19%
6	Belgium	142	146	4%	3%
7	Netherlands	116	108	3%	-7%
8	Poland	176	102	3%	-42%
9	Italy	96	100	3%	4%
10	Ireland	108	84	3%	-22%
11	Romania	145	75	2%	-48%
12	Switzerland	125	69	2%	-45%
13	Hungary	100	64	2%	-36%
14	Czech Republic	87	61	2%	-30%
15	Sweden	85	58	2%	-32%
16	Turkey	41	58	2%	41%
17	Ukraine	31	46	1%	48%
18	Portugal	39	42	1%	8%
19	Austria	64	41	1%	-36%
20	Denmark	53	34	1%	-36%

Source: Ernst & Young European Investment Monitor 2010

# Where the FDI projects are going: a contrasted landscape

There were clear winners and losers in the 2009 intra-European FDI market. On the back of the economic downturn, the 2009 rankings provide an unsettled picture and every country was hit in different ways. Each country's ranking is set in a regional frame where FDI projects declined by 11% and FDI job creations by 16%.

## Fair performance

- ▶ Despite suffering a deep and long recession, the **United Kingdom** remains the most attractive destination for FDI into Europe. Job creation only fell by 1% between 2008 and 2009 and the UK attracted 16% of the jobs created by FDI across Europe (20,017). In terms of projects, the UK attracted 21% of new FDI decisions, including 25% of all FDI services projects in Western Europe. The UK's continuing strength in financial services underpinned its receipt of 30% of business services projects, 36% of software projects and 27% of financial services projects in Western Europe. Together, these sectors secured 42% of the jobs created in the UK. The UK attracted 54% of all Indian FDI projects into Europe and Indian investors are the second-ranked FDI provider in the business services, software and financial sectors (9%), behind the US (40%).
- ▶ **Germany** strengthened its 3rd place, attracting 13% of FDI projects to Europe, a 7% increase from 2008. However, the size of the projects falls significantly, from an average 57 jobs per project in 2008 to just 21 in 2009. As a consequence, job creation fell from 11,422 in 2008 to 4,928 in 2009 (-57%), close to its 2007 level (5,972). The upsurge observed in 2008 was caused by investment in regional headquarters for German and Eastern European companies. With the collapse of business services, software and some industrial functions (machinery & equipment and electrical manufacture), job creation in Germany has declined.
- ▶ FDI in **Belgium** remained relatively stable. In 2009, it attracted 1% fewer job creations than in 2008, comprising 3% of the European total. In spite of this decline in job creation, Belgium attracted 3% more FDI projects in 2009 than in 2008, 4% of the European total.
- ▶ **Russia** is climbing the league table, though on the edge of Europe. In 2009 it attracted 11,734 jobs, 9% of the total in Europe, despite being down 9% from 2008. Russia drew 170 projects, a 19% increase from 2008, making it the 5th most attractive destination in Europe for FDI projects. Investors appear to favor Russia's industrial sector, which creates products for the rapidly-expanding Russian middle class. Russia secured 12% of European FDI industrial jobs and its share of industrial projects rose from 7% in 2008 to 9% in 2009. The largest project was in an automotive manufacturing facility that created 3,000 new jobs.

## Vulnerable

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- ▶ FDI project numbers in **Hungary** are down 36% from 2008, reflecting the lack of investor confidence in CEE. Despite only attracting 64 projects, Hungary still managed to draw 7,112 FDI jobs, 6% of the European total. However, job creation from FDI in Hungary fell 40% from 2008, with industrial job creation shrinking from 9% of the European total to 6% in 2009. Investors have been more cautious for investment in Hungary, following fiscal, economic and political problems exposed during the crisis.
- ▶ The **Nordic states**, comprising Denmark, Finland, Norway and Sweden, suffered a steep FDI decline in 2009, attracting only 124 projects in total, down 40% from 2008. Almost three-quarters of FDI projects in the Nordic states were in services, while less than 1% of industrial jobs created by FDI in Europe went to the Nordics. Strikingly, 70% of Nordic FDI projects were in sales and marketing, headquarters and research and development. Investors continue to perceive the Nordic countries as high-quality destinations that are attractive both for their internal markets and their export-oriented services, though this attractiveness may be eroding.
- ▶ **Spain** has suffered a very deep recession and now faces near 20% unemployment. However, FDI created 5,212 jobs, or 4% of the 2009 European FDI total. This increase in employment is mostly felt in the industrial sector, where job creation increased by 63%. Spain's automotive sector received a number of large projects from international investors. But FDI job creation in Spain's service sector collapsed by 70% in 2009, only hiring 724 new employees. Investors are capitalizing on the Spanish economic crisis to establish a foothold in Spanish industry, while avoiding its damaged service sector.
- ▶ **Romania** only attracted 75 FDI projects in 2009, 2% of the total in Europe, but reaped 6,384 jobs, 5% of the European total. Despite both the number of projects and job creation falling by more than 40%, Romania remained highly attractive for industrial services, stable at around 7% of the European total. One large investment in automotive manufacturing created 3,000 jobs. Though wary of perceived instability in CEE, investors continue to choose Romania, especially for industrial projects.

## In transition

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- ▶ **Turkey** has recently become a highly attractive destination for industrial investment. Although it only accounts for 2% of European projects, it secured 9% of the jobs created by FDI. Turkey is the 4th largest recipient of jobs created by FDI, in part due to a large Chinese implantation in the automotive sector that created 5,000 jobs. Turkey's low-cost labor market makes it a highly attractive destination for industrial production. In addition to the Chinese automotive company, a Taiwanese/American computer company created 2,000 jobs and a Chinese/Turkish joint venture created 1,000 jobs manufacturing inflatable equipment. Investors increasingly see Turkey as a bridge between Europe and Asia, offering access to developed European markets but with low labor costs.
- ▶ Unlike other countries in CEE, **Slovakia** continued to attract a large number of FDI jobs in 2009. Job creation there rose 44% to 5,262 in 2009, 4% of total FDI jobs created in Europe. Most were in manufacturing, primarily in the electronics and automotive sectors, where Slovakia is an international leader.
- ▶ The number of FDI projects in the **Netherlands** has declined by 7% since 2008. In 2009, it attracted only 3% of FDI projects in Europe. FDI has stimulated little job creation in the Netherlands, which does not rank among the top 20 European countries for FDI job creation.
- ▶ **Poland** has emerged as the leading economy of CEE. It ranks fifth for attracting jobs in Europe in 2009 (6% of the total). But Polish FDI job creation was down 52%, compared with 2008. The biggest hit was in the industrial sector, which saw its share of FDI jobs fall from 12% to 6% of the European total. The service sector remains more stable, down from 6% to 5% of the total in Europe. The number of FDI projects, meantime, fell to 102, which makes up 3% of the European total and down 42% from 2008. Despite the uncertainty in CEE, investors continue to put their money in Poland's diverse economy, which attracted both a shared service center creating 500 jobs and a logistics center creating 800 jobs.





## ▶ Ernst & Young's Eurozone Forecast Spring 2010<sup>1</sup>

The Eurozone recovery is stuttering but we do not believe it will stall, despite concerns generated by the Greek financial crisis. We expect GDP for the Eurozone as a whole to rise by 1% in 2010 and 1.6% in 2011. Nevertheless, unemployment is set to continue to rise until the first half of 2011 to a peak of more than 17 million across the Eurozone.

The main factors that will underpin renewed growth are the recovery in the global economy – especially in Asia and the US – and continued support from expansionary monetary policy. Growth will also be supported by improved business and consumer confidence as economic and financial conditions gradually normalize.

The Eurozone still faces considerable headwinds, which mean its recovery will be weak. In particular, recent events have highlighted the challenges faced by countries with weak fiscal positions – not only Greece, but also Portugal, Spain, Ireland and, to a lesser degree, Italy.

There will be an opening of a North-South growth-divide, with Germany, France and the BeneLux economies gradually strengthening, while growth in the Eurozone's Mediterranean economies and Ireland will be held back by efforts to reduce their budget deficits. Growth in the Mediterranean economies and Ireland is forecast to average only 0.6% per year over 2010-12, compared with 1.8% per year in Germany, France and BeneLux.

Even the Eurozone's strongest economies will be hampered by:

- ▶ Further rises in unemployment – although a rapid escalation in redundancies is unlikely, the Eurozone economy needs to grow by another 1.5%-2% before productivity returns to pre-crisis levels and employment begins to recover.
- ▶ Weak investment as capacity utilization remains low and banks remain cautious about lending.

The Eurozone governments and the European Central Bank (ECB) continue to face acute challenges. Policy in the short term needs to remain focused on growth and employment. The main risks are to the downside, with a significant chance of a double-dip recession in the Eurozone and deflation in some of the Mediterranean economies. This means that the ECB should defer any increase in interest rates until well into 2011.

A clear and credible exit strategy from the current stimulus policy needs to be put in place. A consequence of the Greek crisis for the Eurozone as a whole is that fiscal tightening will have to happen more quickly than previously intended. Our baseline forecast shows a significant reduction in deficits, from nearly 7% of GDP in 2010, to under 3% of GDP by 2014. This will inevitably weigh on the pace of recovery in the medium term and points to prolonged weakness in the euro.

1. The *Eurozone Forecast* is a quarterly forecast based on the ECB model and co-produced by Ernst & Young and Oxford Economics.

# Where the investment is coming from: Europe's new client portfolio

The advent of a multi-polar global economy upsets the ranking of investor countries in Europe: American, Western European and Japanese companies were far less active than their counterparts from rapid growth regions of the world.

BRIC<sup>1</sup> investors, whose presence in Europe has been increasing slowly, jump to third place in 2009. China alone ranks 8th out of the 10 largest investors and 3rd in terms of job creation.

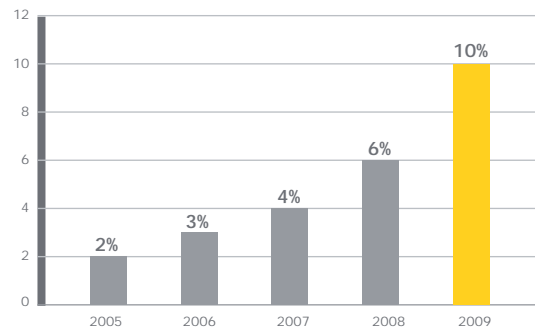
Top ten origin countries of FDI into Europe (job creation)						
Rank 2009	Origin	% of jobs created				
		2005	2006	2007	2008	2009
1	USA	23%	23%	19%	22%	19%
2	Germany	17%	14%	13%	15%	17%
3	China	1%	1%	1%	2%	7%
4	France	8%	3%	7%	6%	5%
5	Switzerland	2%	3%	3%	3%	5%
6	United Kingdom	4%	6%	5%	4%	4%
7	Japan	4%	10%	4%	6%	3%
8	India	1%	2%	3%	4%	3%
9	Italy	3%	2%	4%	4%	3%
10	Sweden	3%	3%	3%	3%	2%

Source: Ernst & Young European Investment Monitor 2010

US corporations (in the IT, automotive and pharmaceutical industries) were hampered by domestic difficulties and careful not to increase employment to levels they could not afford in an uncertain economy. Western European economies shrank, corporate profits were squeezed and liquidity became less available to European industrial champions (especially in Germany, France, and the UK). Increasing European capacity became imprudent, if not dangerous.

## Job creation by BRIC FDI into Europe

(% of total job creation by FDI)



Source: Ernst & Young European Investment Monitor 2010.

Meantime, job creation in Europe by BRIC companies grew by 34% in 2009 to make up 10% of new FDI jobs (from 6% in 2008). As shown by Ernst & Young's Globalization Index, the world is becoming increasingly flat and companies, no matter their country of origin, are becoming industry leaders. In 2000, developing-world companies made up only 10% of the top 1,000 companies globally, but by 2009 the proportion grew to 30%. In the 21st Century, the economic dominance of the West is eroding and being replaced by a new global marketplace in which geography matters less than ideas and innovation.<sup>2</sup> This affects FDI patterns in Europe, where BRIC investors clearly see a manufacturing and service future, based on proximity, increased visibility and the regular transfer of knowledge.

***“Job creation in Europe by BRIC companies grew by 34% in 2009”***

Chinese FDI outperformed that from other BRIC economies in 2009,

as shown by the 28% increase in projects from 2008 to 2009. Furthermore, the Chinese appear interested in labor-intensive industrial projects, where job creation through Chinese FDI tripled in the past 12 months.

1. BRIC: Brazil, Russia, India and China.

2. *Redrawing the map: Globalization and the changing world of business*, an Ernst & Young report, written in co-operation with the Economist Intelligence Unit.

# Sector highlights in Western Europe: vulnerable business services?

Although the recession was fairly shallow in Western Europe, the persistent economic downturn fostered a climate in which FDI and related job creation declined.

Job creation in Western European<sup>1</sup> locations was already declining in 2008, and it slumped by 18% (13,423 fewer jobs) in 2009. There were 185 fewer FDI project announcements (-7%), reversing a timid 2% gain in 2008.

Many industries were severely hit and there were no significant exceptions to compensate this trend. The slowdown of FDI in Western Europe is especially pronounced in the service industry. Optimizing the availability and deployment of capital has clearly been a key focus for executives in 2009; companies have continued to hoard capital in 2009, waiting for better investment opportunities to arise<sup>2</sup>.

## FDI into Western Europe

	2008	2009	Change 2008-2009
Number of FDI Projects	2,729	2,544	-7%
Job Creation	72,737	59,314	-18%

Source: Ernst & Young European Investment Monitor 2010

Business services have taken a big hit in the global downturn. With corporate profits down, companies have been restraining spending, diminishing demand for new services. Consequently, business service projects have decreased by 15% and job creation has fallen by 35%.

## Western Europe: top 20 FDI sectors (job creation)

Rank 2009	Sector	Jobs created in 2008	Jobs created in 2009	Change 2008-2009	Market Share 2009
1	Automotive	5,865	6,158	293	10%
2	Business Services	10,891	5,695	-5,196	10%
3	Software	5,473	4,324	-1,149	7%
4	Machinery & Equipment	7,674	3,837	-3,837	6%
5	Electronics	3,249	3,711	462	6%
6	Food	2,886	3,549	663	6%
7	Other Transport Services	3,475	3,184	-291	5%
8	Electrical	3,113	2,419	-694	4%
9	Pharmaceuticals	3,429	2,329	-1,100	4%
10	Retail	1,254	2,047	793	3%
11	Financial Intermediation	1,745	1,827	82	3%
12	Chemicals	1,541	1,787	246	3%
13	Other Transport Equipment	2,736	1,775	-961	3%
14	Computers	810	1,465	655	2%
15	Scientific Instruments	1,824	1,438	-386	2%
16	Air Transport	906	1,262	356	2%
17	Insurance & Pension	1,252	1,247	-5	2%
18	Publishing	1,382	1,198	-184	2%
19	Fabricated Metals	1,128	1,196	68	2%
20	Plastic & Rubber	1,054	947	-107	2%
	Other	11,050	7,919	-3,131	13%
	Grand Total	72,737	59,314	-13,423	100%

Source: Ernst & Young European Investment Monitor 2010

1. Western Europe includes the following countries: UK, France, Germany, Spain, Belgium, Sweden, Switzerland, The Netherlands, Ireland, Denmark, Italy, Austria, Portugal, Finland, Greece, Luxembourg, Norway, Malta, Iceland, Monaco and Liechtenstein.

2. Lessons from change: Finding from the market, Ernst & Young, 2009.



**AS Lakshminarayanan**  
Vice President & Head of Europe  
for Tata Consultancy Services (TCS)

## “Waking up to technology”

In the software industry, swift cost cutting and increased flexibility is proving critical to companies' abilities to support their strategic initiatives efficiently. In general, technology companies experienced an average overall drop in demand of 20% to 30% during the downturn. But technology companies expect a fast, strong cyclical upswing, and are positioning themselves to benefit from it.<sup>3</sup>

Although the pharmaceuticals sector created more than a thousand fewer jobs compared with 2008, investors have increased the number of FDI projects into Western Europe (117 FDI projects vs. 98 in 2008). Pharmaceutical firms have focused on improving cash flow and working capital management, increasing their speed to market, catering more for top customers and driving efficiencies throughout their supply chains.<sup>4</sup>

Despite the saturated automotive market in most Western countries, existing players remain confident and active in Europe<sup>5</sup>. Three major international automotive manufacturers decided to expand production in 2009, Volkswagen built a new facility in Spain, while both BMW and TATA expanded existing operations in the UK. Together they created 3,300 jobs. Clearly, major companies see the European market as attractive for sales and European labor as an indispensable element to their investment.

From a business functions perspective, announcements to establish or expand business support services were also modest. Shared services centers in particular provided 1,358 fewer jobs in Western European countries in 2009.

3. *Lessons from change: Weathering the storm in the technology industry*, Ernst & Young, 2009.

4. *Lessons from change: A changing environment in the life sciences industry*, Ernst & Young, 2009.

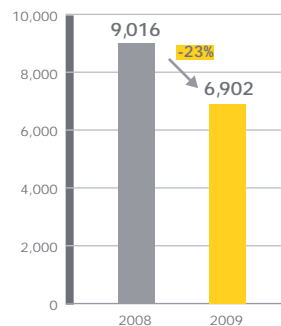
5. *EMEIA European Automotive Survey 2009*, Ernst & Young, 2009.

“While the recent recession has certainly impacted industries across Europe, TCS continues to view Europe as a high-potential market, and therefore an area of strategic investment particularly countries such as Germany and France.

IT is integral to the restoration of global competitiveness for Europe's major industries. Companies need to innovate to transform their customer understanding and focus, to enhance value across the supply chain, improve new product and solutions' time-to-market, to renew business

IT services, software editors, logistics and call center outsourcers continued to suffer from weaker demand. In addition, executives in these companies, where HR management and the retention of the best talent is essential, belatedly followed the downsizing decisions that had been made by their more practiced manufacturing counterparts, as early as 2008.<sup>6</sup>

### Job creation from business support services (shared service and call centers) FDI projects (2008-09)



Source: Ernst & Young European Investment Monitor 2010

The outsourcing industry is being affected by shrinking volumes arising from closure and consolidation among financial services companies, which provide much of their business. Clients may have stalled or reviewed plans, and been waiting for more clarity about the future needs of their own businesses. The search by companies for savings is likely to lead to a slew of new and renegotiated contracts. Providers with capacity and flexibility on pricing may gain market share. But wage inflation and a reduction in staff turnover at middle grades has put pressure on the profitability of many outsourcing providers.<sup>7</sup>

6. *Outsourcing: time to review the value in a recession*, Ernst & Young, 2009.

7. *Ibid.*

and operating models, to ensure internal processes are perpetually analyzed and re-tooled to assure leanness and agility. These are all imperatives for future success and require a collaborative approach to improve productivity whilst addressing climate challenge, to arrive at intelligent IT solutions and services that help customers save money and time as well as create growth solutions for the low-carbon economy.

TCS' Global Networked Delivery Model (GNDMTM) is a key strategic enabler in this process, through its

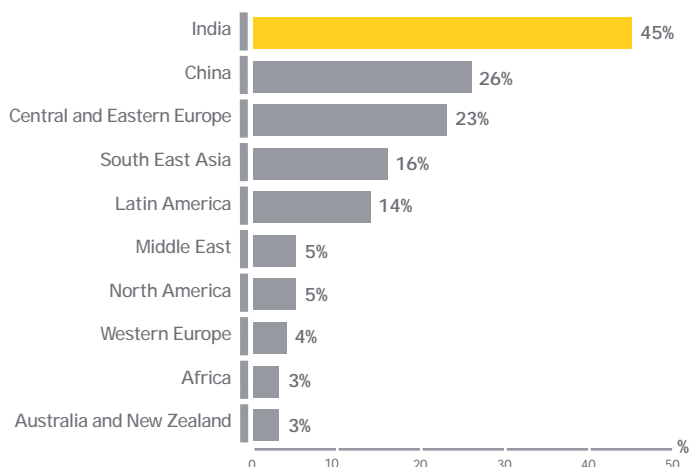
centers in China, Latin America as well as Europe, where we have invested in 8 delivery centers each of which specializes in a particular industry or technology. For example our center in Dusseldorf is helping drive R&D and product engineering services for Nokia Siemens Network, allowing them to compete more effectively in a challenging and highly competitive telecommunications market.

Europe, being a diverse set of individual markets and economies, has displayed varied reactions to the

recession. On the one hand, there is the clear and understandable temptation to retract, to adopt what became a passive protectionism which can only lead to the erosion of competitiveness in the long run. The other, more positive response we have observed is the drive to proactively harness the skills available and use strategic tools such as IT to strengthen the organization's business model. This is what Europe must continue to do in order to be attractive to inward investors and to rebuild its economic and commercial competitiveness."

Despite tighter budgets and increased costs in some destinations, business leaders should remember that outsourcing has a clear and important role to play in helping companies optimize their budgets in the wake of the global economic crisis. The economic instability, which resulted from the financial crisis has led to increased volatility in currency markets, which in turn influences the pricing dynamics of business process outsourcing (BPO), making some destinations more expensive while other regions have become increasingly competitive. Business leaders need to keep abreast of these changes, avoid short-term arbitrage implantations and look instead at the fundamentals of a country for a long-term value solution.

#### Which of the geographic markets do you expect to offer the best off-shoring possibilities for your business



Source: *Opportunities in adversity*, Ernst & Young, January 2009. Respondents selected three possible answers.

In January 2009, Ernst & Young carried out a survey which revealed that 31% of companies polled planned to increase their use of outsourcing or co-outsourcing, while a further 27% planned to integrate shared service centers into their overall strategy<sup>8</sup>. Cash priorities usually drive outsourcing decisions: companies look to outsource when they can afford a long-term investment, which will lower costs. Increasingly investors are looking East for outsourcing opportunities, with India, China and then CEE tempting the most investors, given their labor fundamentals.

2009 was a year of cost cutting. Looking into 2010, business leaders polled by Ernst and Young said they plan to restructure their business processes and particularly the IT function. For many, this means centralizing IT in a shared service center, relocated to another region for better access to low-cost labor and specialized skills. Furthermore, some business leaders are thinking of outsourcing the IT function altogether, to an external provider, often in a low-cost destination so that they can focus on core business functions. Outsourcing or the use of a shared service center allows businesses to optimize and standardize the performance of their IT across multiple geographies, from one central unit.<sup>9</sup>

8. *Opportunities in adversity*, Ernst & Young, January 2009.

9. *Outsourcing: time to review the value in a recession*, Ernst & Young, 2009.



# Sector highlights in Central and Eastern Europe: automotive safety

Investor confidence in CEE collapsed and the number of projects fell by almost a quarter. But industry provided some comfort, with confirmation of high-capacity investments and the long-term potential of markets eager for equipment and infrastructure.

Job creation in CEE<sup>1</sup> declined as the financial crisis developed, although more slowly in 2009 (14% fewer jobs and 23% fewer investment announcements).

FDI into Central and Eastern Europe			
	2008	2009	Change
Number of FDI Projects	992	759	-23%
Job Creation	76,629	65,609	-14%

Source: Ernst & Young European Investment Monitor 2010

The 14% slowdown in job creation is mainly affecting industrial operators in CEE who have slowed near-shore outsourcing and R&D activities in the region.

1. Central and Eastern Europe include the following countries: Poland, Hungary, Russia, Czech Republic, Romania, Slovakia, Bulgaria, Turkey, Serbia, Ukraine, Lithuania, Estonia, Latvia, Croatia, Slovenia, Bosnia and Herzegovina, FYRO Macedonia, Albania, Belarus, Moldova, Cyprus, Montenegro.

***“In 2009, the automotive sector accounted for 41% of FDI jobs created in the region.”***

Demand from CEE’s customers in Western Europe fell, resulting in mass layoffs in the shared service center and call center industry while R&D activities were put on hold.

However, many companies are using the current environment as an opportunity to renegotiate existing outsourcing contracts, to extract additional value; expanding geographic and functional scope in order to further leverage the benefits of outsourcing. Outsourcers located in Eastern Europe, India, the Far East and Latin America are expected to benefit in particular, as developed countries seek further low-cost alternatives.

The automotive sector buoyed the decline in CEE job creation in 2009. Investors have proved that car manufacture in CEE is a fair investment. In 2009, the automotive sector accounted for 41% of FDI jobs created in the region. CEE’s strength in the automotive sector is underscored by the fact that for every 100 jobs created in the European automotive industry, 81 are in the region.

FDI into Central and Eastern Europe by sector (job creation)					
Rank 2009	Sector	Jobs Created in 2008	Jobs Created in 2009	Change 2008-2009	Market Share 2009
1	Automotive	27,266	27,002	-264	41%
2	Food	5,811	5,426	-385	8%
3	Electronics	2,320	4,811	2,491	7%
4	Machinery & Equipment	4,937	3,774	-1,163	6%
5	Computers	1,390	2,800	1,410	4%
6	Non-metallic mineral products	2,209	2,459	250	4%
7	Electrical	3,365	1,997	-1,368	3%
8	Retail	1,555	1,500	-55	2%
9	Furniture & Sports Equipment	1,781	1,398	-383	2%
10	Plastic & Rubber	3,800	1,341	-2,459	2%
11	Wood	1,810	1,265	-545	2%
12	Fabricated Metals	2,394	1,259	-1,135	2%
13	Software	1,891	1,258	-633	2%
14	Chemicals	2,087	1,243	-844	2%
15	Oil & Gas	350	1,025	675	2%
16	Business Services	2,329	1,009	-1,320	2%
17	Other Transport Equipment	2,067	903	-1,164	1%
18	Pharmaceuticals	1,158	850	-308	1%
19	Scientific Instruments	33	783	750	1%
20	Construction		675	675	1%
	Other	8,076	2,831	-5,245	4%
	Grand Total	76,629	65,609	-11,020	100%

Source: Ernst & Young European Investment Monitor 2010

## “Waking up to the new global logistics”



**Wolfgang Flick**  
President, UPS Europe

“UPS arrived in Europe back in 1976, when the first waves of EC expansion were underway, and since then has played an important role in helping to make the smooth flow of goods, funds and information – so central to the European ideal – a reality.

With the removal of internal EU borders in 1993, UPS's European transportation network provided the ultimate solution for companies that needed to move goods within the internal market in an efficient and reliable manner. Since then, we have enhanced our services within the Single Market and improved our ability to connect EU businesses with markets in North America, Asia, the Middle East, Latin America and the rest of Europe.

Europe is already an attractive place to do business, and will continue to be so in the future, despite the recent economic crisis and the rising prominence of emerging economies in other regions of the world: European goods are sought after the

world over for their quality, efficacy, and design; imports from elsewhere also continue to play a key role in the region's development.

Companies with foresight have been able to see the opportunities arising from the crisis. Improvements in efficiency and the added attention to detail required to remain competitive in difficult times have positioned the best-prepared businesses to emerge stronger than ever in the upturn.

There is always more to be done. Government needs to go further with legislation that makes it easier to do business within Europe and beyond. Reducing red tape and smoothing the transit of goods through customs will be a vital component in this process. The EU currently predicts that within a couple of years, businesses will be able to throw away all their paper customs forms. At UPS we have been offering a Paperless Invoice solution, allowing our customers to do just this, for over two years.

In addition, economic recovery and growth will require an efficient and sustainable transport infrastructure, offering the right mix of road, air and rail transport for its users.

UPS welcomes the European Commission's efforts to develop the 'Europe 2020' strategy, seeking to create growth and jobs in the EU. We pride ourselves on helping bridge the gap between business and world markets, whether we're serving small- and medium-sized enterprises or major multinationals. As facilitators of global trade, we strongly encourage government to continue on the path of liberalization. By providing businesses, small and large alike, with access to the markets of the world, UPS will continue to do its part to stimulate growth, create jobs and keep Europe firmly at the top table of international commerce.”

Despite the European automotive sector's excess capacity, Chinese manufacturers pushed into the market, establishing a European presence in CEE. Focused on the still-growing entry-level segment with small, inexpensive and fuel-efficient models developed for the Chinese market, these manufacturers see opportunity in investing in Europe. Additionally, they are looking to internationalize their brands, and proximity to the highly competitive Western European market will improve their prestige and their technology development. Chery Automobile, which announced a large plant in Turkey in 2009, is the prime example of this phenomenon.

A few large automotive projects were announced and confirmed (for instance, PSA's car assembly plant in Russia, Ford's expansion in Romania). In electronics, HP, Hon Hai and AU Optronics confirmed longer-term plans in Central and South Eastern Europe, including Turkey.

However, increasing numbers of M&As may lead assemblers and suppliers to reconsider some of their projects and existing operations in the region, and the European automotive sector looks set for several years of slow growth. For the coming years, stabilized local operating conditions, tighter management by central and local governments, and the reservoir of low-cost, productive and highly skilled labor, support CEE's competitive advantage in the top five industries, which still account for 66% of its FDI inflows.<sup>2</sup>

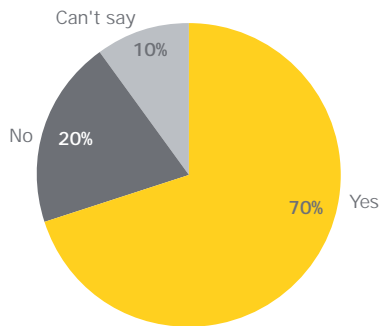
2. *Lessons from change: A roadmap to sustainability for the automotive industry*, Ernst & Young, 2009

# The unbearable lightness of manufacturing

Challenged to predict or contradict the possibility of a de-industrialized Europe, 70% of business leaders say that in 2020 they will still manufacture in Europe.

Among European investors interviewed for Ernst & Young's 2010 European attractiveness survey, the proportion of "would-be" manufacturers is higher, reaching 88% among Northern Europeans. But non-European investors are far more likely to say that they have little intention of manufacturing in Europe 10 years from now. It is striking that 38% of Asian company executives and 37% of North American corporate leaders interviewed predicted that Europe would become an increasingly unattractive manufacturing location in the next 10 years.

**In the next 10 years, will you still manufacture in Europe ?**



Source: *Ernst & Young's 2010 European attractiveness survey*  
Total Respondents: 814. Only one answer possible

The difference in cost and sector specialties between Western and Central and Eastern Europe clearly influences their attractiveness to investors and the types of projects that they receive. CEE countries still enjoy a more competitive cost base than their Western counterparts. Average labor costs in these countries remain approximately 15% to 30% of the European average. However, wage costs have increased significantly faster (95% between 2000 and 2008 in Hungary, 68% in the Czech Republic, and 31% in Poland) than the Eurozone average, which increased of 22% over the same period.<sup>1</sup> Some analysts predict that so-called "labor convergence" will have happened by 2020 at the latest.

Consequently, Western Europe's manufacturing sector is attracting ever fewer FDI projects, primarily due to its higher labor costs, inflexible labor regulations and slow economic growth. Chemicals stagnated while machinery and equipment, food and plastic all saw declining levels of FDI. Coupled to this decline in projects was a fall in FDI job creation across the region. Interestingly the automotive sector remained relatively stable in 2009.

1. *OECD Labour Force Statistics*, "Unit Labour Costs – Annual Indicators – Compensation Per Employee in national currency for the whole economy".

## "Waking up to new clusters"



**Professor Örjan Sölvell**

*Director, Centre for Strategy & Competitiveness, Stockholm School of Economics and leader of the European Cluster Observatory initiative.*

"Europe's industrial clusters are a real source of competitiveness and attractiveness for investment, including FDI. We look at 250 EU regions, and everyone has clusters. Yet across the EU, only a little over 100 qualify as being truly specialised industrial agglomerations. There are probably only around 20 world-class clusters in Europe that ranks alongside Silicon Valley, Hollywood or Boston.

Every region claims to have a biotech or IT cluster. Of course, these are industries of the future, but policy-makers should not try to pick winners. Cluster development aid needs to be long-term, and

# Investment plans from 2009 to 2010: more of the same?

As we move into 2010, the picture is more encouraging, with economic indicators suggesting an incipient recovery. But FDI flows may be slow to grow again in Europe.

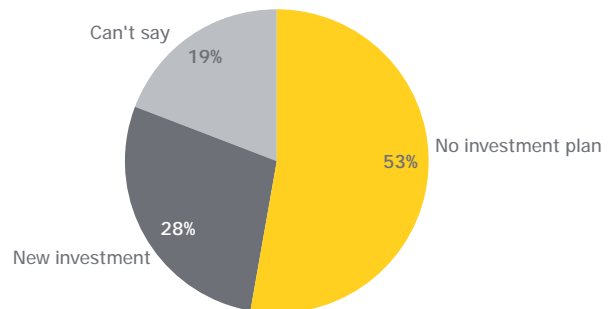
Half of the investors surveyed say they have no plans to invest in Europe, a proportion unchanged from 2009. The majority of business leaders are currently focused on maximizing returns from their existing assets and not on investing in new capacity. The downturn ate into many companies' balance sheets, limiting the amount of capital available for investment. So it is little surprise that businesses might want to defer investment until a return to growth in Europe is assured, rather than pump scarce capital into a potentially stagnant region.

*“Business leaders are currently focused on maximizing returns from their existing assets.”*

Despite the apparent diminishing interest, Europe remains attractive for businesses which know the market and have already invested in the region. Almost one in three leaders polled said that their company does have plans to expand in Europe in 2010 and, of these, 42% intend to expand current facilities – demonstrating that they know Europe as an attractive and worthwhile economy.

These “clients of Europe” may have plans in higher-growth regions, but they also know they will produce and deliver goods and services to affluent consumers. In particular, small and medium-size businesses may prefer the safe grounds of Europe to the complexities and risks of rapid growth economies.

## What are your plans to invest in Europe?



Source: Ernst & Young's 2010 European attractiveness survey  
Total Respondents: 814

companies and universities should have to compete for it.

But we must also accept that you can provide high wages and be innovative and competitive in world markets in any industry, from wine to paper and packaging.

If you put an innovation ‘turbo-charger’ on a traditional industry, by promoting links between companies, academics and small firms, so called cluster initiatives, you can achieve spectacular results through innovation in process, product and business models. Steel, paper, packaging and automotive provide excellent examples of that process in action.

Yet you can kill that by slowing down the integration of the European market or through protectionist trade policies.

I believe policy-makers are beginning to recognize that promoting traditional clusters can deliver the most exciting transformations in Europe. Clusters are best built on heritage and history, where we have people who have knowledge in a particular field and specialized research.

Cluster policy is very close to innovation policy. Innovation takes place first between firms, between firms and University departments, and between firms and other actors.

By breaking down barriers, you can unleash enormous activity.

But in Europe we still don't maximise our opportunities. Research in biotechnology is very advanced in both France and the US. But if you look at the outcomes in terms of patents and IPOs, one unit of investment delivers five times more biotechnology companies in the US and ten times as many IPOs. In Europe, we still have a lot of issues to address.”









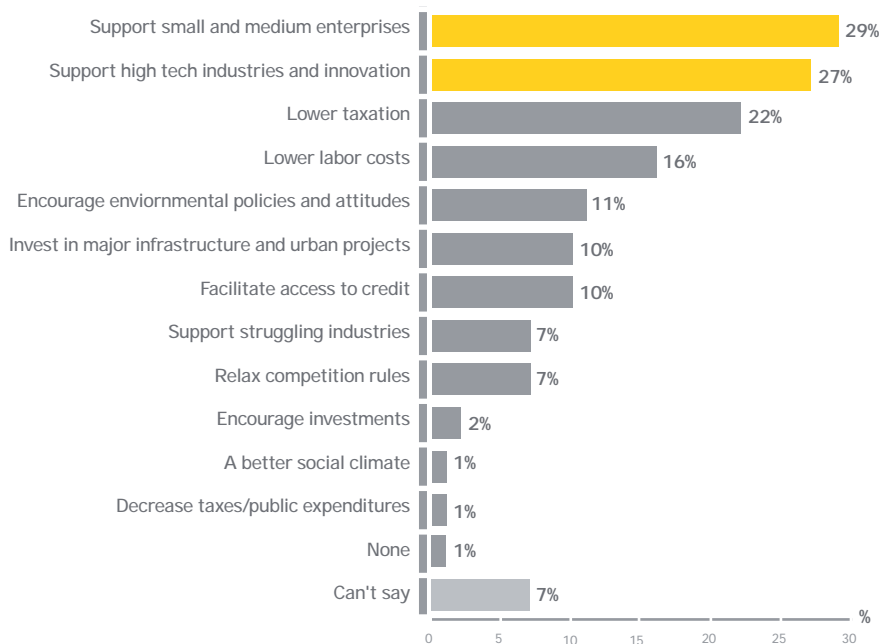
# Europe's new attractiveness model: from words to action

In this section, we look at the European attractiveness model and challenge its future shape. Business leaders outlined a clear set of priorities that are needed if Europe wants to remain relevant in a multi-polar world. These require concerted action by governments, investors and entrepreneurs.

# Action 1: more power to entrepreneurs and innovators

Today, business leaders want Europe to liberalize and let entrepreneurs spur growth and enhance prosperity. Investors have spoken: Europe needs to quickly shed the governmental crutch and let the imagination of its entrepreneurs and enterprises run free.

## What measures should Europe and European countries take to stimulate growth in the next two years?



Source: Ernst & Young's 2010 European attractiveness survey.  
Respondents selected three possible answers. Total Respondents: 814.

In the depths of the global downturn of 2009, international investors were unable to decide on the measures that Europe and European countries should take to stimulate growth. One in three business leaders polled then could not think of a single initiative to boost Europe's competitiveness and attractiveness. Those who responded latched onto the necessity for government action: reform of the financial system, lowering payroll taxes, investment in infrastructure and government support for innovative industries.

One year later, the buds of economic growth have transformed the outlook of the business community, who no longer see the government as the principal source of growth. Rather, 29% of investors think that European countries should increase their support for small and medium enterprise, as the first order of business. They clearly say that Europe's undeniable, most compelling source of growth lies with its entrepreneurs.

To facilitate the restart, 27% of respondents think that governments should support technology and innovation and 22% want to see taxation reduced. Helping cut costs has been relegated to fourth

place. Investors want to see lean and liberated companies emerge from the crisis and capitalize on the new business opportunities of the rebound. Increased government spending does not even enter

***“Europe’s undeniable, most compelling source of growth lies with its entrepreneurs.”***

the top five recommendations from investors – proof of their bullish outlook on global economic prospects.

In 2009, only governments seemed capable of spurring economic growth. But in 2010, investors see opportunity in Europe's entrepreneurial qualities. Instead of deficit spending on state-run projects, investors see the chance for organic growth created through smaller and more innovative companies. Promoting environmental policies is seen as peripheral. Respondents believe growth will originate where it once did in Europe and does today in rapid growth economies: from the ingenuity of entrepreneurs and companies in identifying unmet needs of consumers and differentiating themselves with innovative products, processes and services.

## “Waking up to the new tax competition”

**Stephan Kuhn**  
 EMEA Tax Leader  
 Ernst & Young



“There are four drivers changing the face of tax. They impact companies as well as countries. The first two are globalization and a shift in economic power. Though the trend slowed in recent difficult times, more and more companies are doing business in many different jurisdictions. Asian companies are doing business in Europe, the US and the Middle East, and more European companies are doing business in Asia. Companies can plan to do business in places where taxes are low, and optimize the supply chain, financing and other elements of their business.

Tax administrations are always three steps behind, because they are organized on a national basis. States incurred big deficits, so they have to increase their revenues. Governments are pressuring tax officials to collect revenue now, not later. This need results in the third driver that is now causing tax authorities to collaborate

internationally; for example, by exchanging tax-relevant information automatically. The fourth driver is, and will be, more regulation and legislation around tax and supervision of specific industries, especially in the financial sector.

Governments that want to make their countries attractive places for business to generate additional tax income, can shift their revenues from direct to indirect taxes, and move to increase taxes on immovable assets, such as property, creating scope to provide incentives – say for R&D activities. On the other hand, we will also see governments to use fewer “carrots” in the form of tax incentives for green behavior, but more the “stick” in the form of new taxes for, say, emitting carbon.

Additionally, government bail-out investments in companies that suffered in crisis years may be seen

only as a “waste” of money, but rather as an economic model for the future – to generate revenue in another form than taxes.

We have already seen announcements of tax increases in many countries including the UK. There is a real likelihood that the UK’s taxes will drive wealthy individuals and hedge funds into low-tax/low-regulation jurisdictions. And increasing taxes on global profits of US businesses could encourage them to seek takeover by European companies.

In the European Union, we have a code of conduct against aggressive tax competition. But tax competition could be most effective for countries which can reduce spending and lower taxes to attract business.”

### ► Sustainable tax planning

“When it comes to assessing the attractiveness of a region or country, fiscal policy can be crucial. In particular, issues such as low-tax dividend transfer, avoiding double-taxation, and a low-risk tax environment should be critical to investment decisions. Yet too often, investors fail to look beyond corporation tax rates – which varies widely across Europe.

As the Worldwide Tax Competitiveness Survey 2010 unveiled in Paris in January amply showed, the economic crisis has had a big impact on fiscal policies worldwide. We have

seen more widespread use of tax measures to support the economy and a plethora of new international agreements on tax collaboration between states has sprung into being, including the harmonization of VAT collection procedures.

Does that mean tax competition is over? No. We are entering a new era in which investors must analyze taxation levels relative to quality of the services they buy (quality of infrastructure, legal certainty, tax collection modernization, etc...). They’ll also need to take into account the burden of

indirect taxes, from VAT and customs tariffs to environmental taxes. And the trade-off between personal taxes and social benefits.

The new era demands a new approach, in which investors must integrate tax and social issues into their business model ahead of the investment decision. The new benchmark is ‘sustainable tax planning’ - and by this measure Europe could shape-up rather well.”<sup>1</sup>

1. Stephane Baller, Partner, Ernst & Young Tax and Law.

# Action 2: push green business. Really.

Green business is a favorite talking point of politicians and corporate social responsibility gurus. Despite the feeble results of the Copenhagen conference in 2009, European leaders believe they will invent, produce, sell and deliver more “green” in the next few years.

Not only do investors say that green business is real business, they also insist that Europe should and will profit from its development. More than a third of all business leaders polled, and fully half of those from Northern Europe, predicted that in 2020 Europe will be the global leader in green technology and growth. They rank green business as the field in which Europe is best placed to achieve global leadership, and more likely to succeed than in achieving global leadership in education or value added services, and research and development.

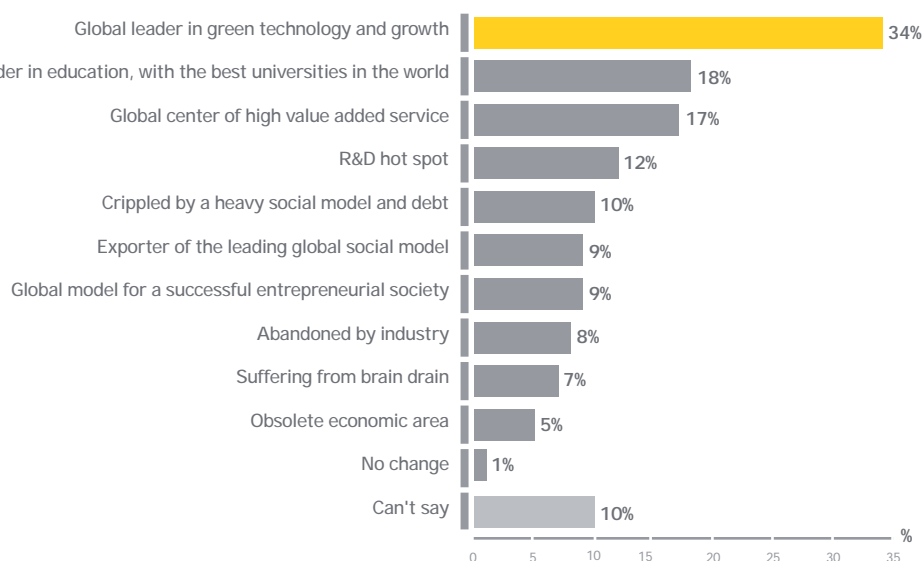
Without calling into question the viability of the green business sector, its limited attractiveness to investors when money is tight surely undermines its capacity to become Europe’s future vanguard growth sector. Increasingly, “green” equates with energy efficiency and minimal waste of

*“6,535 jobs in green business were created in 2009, up almost 10% from 2008.”*

commodities that are becoming more expensive as global demand for them increases. Although currently bolstered by tightening regulatory requirements and government subsidies, green business is surely part of the more fundamental search for business efficiency and not an objective in its own right capable of leading European economic growth. Green business is merely a means by which businesses and entrepreneurs can meet consumer demand, while reducing the environmental impact of their activities. Growth will come from demand, just as it always has.

True to their word, investors have piled money into European green business, projects are up 44% compared to 2008, all the more impressive considering the economic uncertainty during the time period. Furthermore, 6,535 jobs in green business were created in 2009, up almost 10% from 2008. France and the UK attract the most green business investments in Europe at 53 and 36 projects in 2009 respectively.

## How do you see Europe in 2020 ?



Source: Ernst & Young's 2010 European attractiveness survey. Respondents selected three possible answers. Total Respondents: 814.

## “Waking up to the new green”



**Philippe Carli**

*President, Siemens France and Vice President, Energy South West Europe*

“The opportunities for European business in clean energy are real, and enormous. We calculate that already, €23b of Siemens’ turnover, a quarter of the total, comes from green solutions, and that share is growing very rapidly.

Europe, and particularly Germany, took an early lead in recognizing the challenge of developing greener energy and formulating policies to promote its adoption. Europe’s 20-20-20 objectives: to achieve a 20% reduction in CO2 emissions and 20% of power from renewables by 2020 are proof of that commitment.

The economic crisis slowed electricity demand growth in Europe and delayed some renewable projects, but not the trend toward renewable energy, which continues as oil prices recover.

For industries in this sector, there are remarkable opportunities arising

both from rising electricity demand, which in Europe is forecast to grow 44% by 2030, and the focus on energy efficiency and renewables. Solar and wind energy in Europe is already a €30b market growing at 15% a year.

For example, our company is planning an €89m wind turbine plant investment, creating 700 jobs in the UK, to help supply the 1,000 turbines a year that will be needed for Britain’s offshore wind farms over the next decade.

The private sector DESERTEC consortium plans to invest €400b to generate 15% plus of Europe’s electricity needs from the sun in North Africa, while a French government initiative, Transgreen, will provide necessary sub-sea transmission links, using pioneering European continuous current transmission technology.

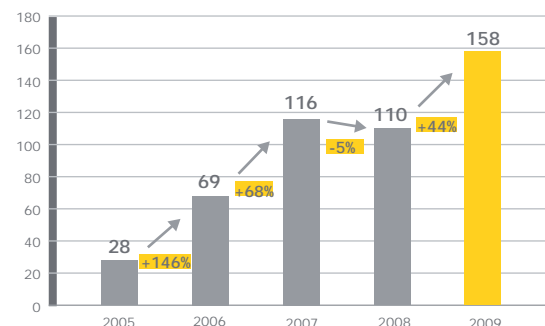
To underpin this transformation in energy generation and distribution, Europe and its governments must provide the necessary legal framework for smart power grids and the smart meters that go with them, as well as tariff transparency and stability.

They can steer the resurgence of nuclear plant construction, and help bring together private sector players; for example, promoting pilot projects for electric vehicles, like those in Italy and France, which draw upon Europe’s advanced battery and electric vehicle technologies. And finally, they can promote the development of innovation clusters involving research centers, universities and business to ensure Europe sustains its technology lead.”

Investor’s perception and their subsequent reactions to the European marketplace reflect European customer perceptions that heavily favor green products. As European customers increasingly demand green products and services, it will be increasingly profitable to sell these products and services in Europe, even in a recession and thus there will be more implantations. Furthermore Europeans will develop specialized skills in the production of these goods and services, facilitating their ability to produce them in Europe and sell them internationally.

Despite the excitement around green business, it is important to remember that it represents just 158 projects out of 3,303 in 2009, or a little less than 5% of the total. Similarly, it represents 6,535 jobs out of 124,923 jobs, or 5% of the total. Clearly, green business is emerging but it will take time to develop. Perhaps investors will see an opportunity to link European leadership in green technology with another strength – the automotive industry – to establish a leading position in the development of “green cars”.

### Green FDI projects into Europe 2005-2009



Source: Ernst & Young European Investment Monitor 2010

Green FDI projects: any investment in the industrial or service sector that includes an emphasis on renewable solutions or clean technology.





**Dr Daniel Vasella**  
*Chairman of Novartis*

## “Waking up to the new European excellence”

“Around the world we have an ageing society, and a rising bill for age-related diseases that are difficult to treat, such as obesity-related ailments, age-related cancers, and so on. But at the same time, in industrialized countries, we are trying to reduce or contain the money we spend on health care overall.

In fast-developing countries, meanwhile, especially in Asia, they are building and investing heavily in health care and insurance systems.

So pharmaceutical companies are continuing to invest in research and development, but the broader focus is more on opportunities in developing economies.

Faced with the problem of aging, the easy option for developed-country health care systems is to cut spending on drugs, by accelerating conversion to generics, by classifying drugs in ways that make them available only to those who can pay, and even by sometimes making it difficult to get approval for new drugs.

Yet in Europe, pharmaceutical drugs are typically only 8%-15% of treatment costs. There is a great tendency to look at the costs of health care systems, rather than the quality of the system and the outcomes it achieves. This needs to change.

The real need is to look at how services are organized, whether treatment is best in hospital, or by ambulatory care, which hospitals achieve the best results, and so on. We commissioned a study which showed, for example, that if you have breast cancer, you would do best to be treated in the US, but that for diabetes, the UK achieves far better results than the US. Policy-makers need granular data and analysis on which better treatment policies can be formulated.

This would be good for the population, for the health care industry, and for the pharmaceutical industry. But the people who would lose from such changes will fight hard to prevent them.

In terms of production and R&D, developed economies are not inherently uncompetitive. We have a plant in the US which is competitive with a similar plant in China, because our US employees really focus on quality and process optimization.

You have to look at the micro-environment. To be competitive, people need to be very dedicated to their work. How can that happen if working hours are very restricted or if people think second best is good enough, not realizing we need peak performance?

When it comes to medical R&D, the UK is strong, Switzerland is quite strong ... but we need to have the courage in Europe to reward excellence, and allow differentiation. The universities that produce the best outcomes should get more funding.

Investment is attracted by high performance: that is what Europe needs to achieve.”

# Action 3: services will be Europe's leading industry

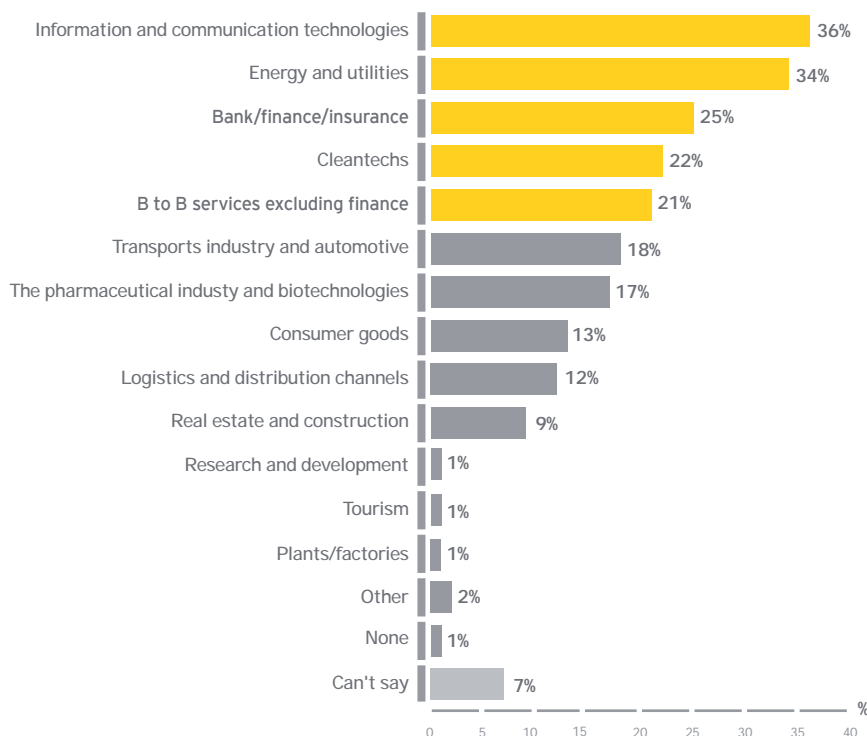
The vote for technology, energy and cleantech businesses is a call for Europe to meet the knowledge and green challenges.

In 2010, information and communication technologies crown the list of industries leading European growth, followed by energy and utilities, financial services and cleantechs.

Investors also understand the enormous needs of services and infrastructure in Europe's growing metropolitan areas, supported by various national and local stimulus investments. Finally, despite the banks' 2008 and 2009 woes and responsibilities, corporate executives are convinced they are vital to Europe's recovery and their own capacity to invest.

Each of these industries is prioritized by different groups of investors. CEE executives overwhelmingly put their faith in Information and Communication Technologies (ICT). Leaders of Chinese and Indian companies favor investing in industrial energy and utilities. All investors think that financial services will support European growth while Western European investors see cleantech as the future.

**Which three of the following business sectors do you perceive as driving Europe's growth in the next two years?**



Source: Ernst & Young's 2010 European attractiveness survey.  
Respondents selected three possible answers. Total Respondents: 814.

# Vision: creativity (and investment in the future) will make the difference for Europe

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Investors indicate that it is not economic conditions or “business as usual” that matter most, but the ability for their companies and employees to create, invent and invest in meaningful communities.

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Our survey indicates that, in addition to its high-quality and predictable business environment, Europe needs to show more creativity, and invest in what will matter for the heavy demographic and environmental changes of the next decades.

Investors are identifying the following next class features for Europe:

- ▶ **85%** of survey respondents cite Europe's research and innovation capacity
- ▶ **83%** call for more investment in green business
- ▶ **73%** mention the power of world-class business clusters as a tool to make Europe's innovation both global and profitable

Amid these challenging expectations come three more traditional qualities of Europe's attractiveness: the quality and diversity of its workforce (81%), the emphasis on social responsibility (77%) and the predictable business environment (70%) which cement this new attractiveness construction, while requiring reforms and a reset of priorities.

Innovations and clusters (i.e., the essential triangle of research, entrepreneurship and government support): investors look to Europe for the new and creative solutions provided by its private sector and high-quality labor force. Government incentives and the strategic development of office parks are very low among their priorities. Investors believe that the innovative spirit of Europeans, coupled with their world-renown labor quality, is what will make Europe a world-class investment destination.

The emphasis on green business: respondents are saying that, as the need for low-carbon energy sources and efficiency-improving technologies move to the fore, European governments need to continue their support of cleantech projects, through favorable regulation and co-ordination initiatives. They are also stating that, despite ongoing uncertainty about the global economic situation, spending by the world's biggest companies to develop or acquire cleantech solutions is robust and primed to accelerate.

Before the financial and banking crisis, the world economy could be seen as a huge plane, with a very powerful engine – the US economy, running on credit. When little fuel was left, companies looking for growth and stability found opportunities in alternative or smaller engines: China, India, Brazil, the Middle East ... and Europe. The global economy turned into a multi-polar world, in which European governments were keen on playing a bigger

***“Investors believe that the innovative spirit of Europeans will make Europe a world-class investment destination.”***

role, especially in the financial sector, despite a risk to their balance sheets.

However, following the crisis, the world and investors perception changed, with profound

lessons for the European community of FDI policy-makers. Although important, the historic strengths of Europe are not primary in the new world. In the next decade, Europe will need to emphasize its ingenuity and inventiveness, rather than rely on the traditional incentives that it has provided to investors, including the stimulus packages. Government intervention merely saved Europe's economy from disaster, and helped stave off a collapse in FDI.

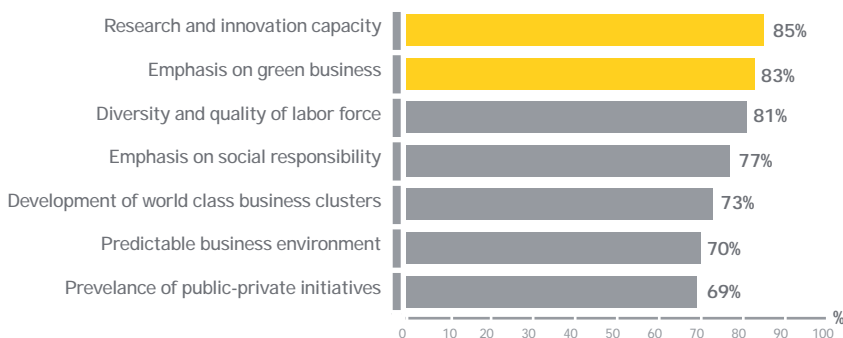


2010 sees some robust improvement in the main economic indicators, which can be attributed to an unprecedented amount of fiscal and monetary stimulus. However, for a sustainable recovery, Europe will also need to boost private sector demand, in the form of consumption, exports and investment, both domestic and foreign. As the world returns to economic growth, the lure of emerging markets for FDI is stronger than ever. The quantity and quality of R&D capacity in emerging countries is improving fast, and the next challenge for Europe will be to produce innovation and deliver it in a commercially viable way to global markets.

Business leaders are now saying that it is private sector entrepreneurship and innovation that will attract investment and create future European prosperity. In tomorrow's even more competitive world, they want governments to assume a narrower role, providing social stability, outstanding education and support for the innovation that business can then leverage in global markets to ensure a place for Europe in a world where creativity will triumph over geography.

Increasingly, emerging economy cities resemble our own, equipped with high-speed trains, modern metro-systems and telecommunications, and sophisticated highways, ports and airports, together with expanding universities and research institutes. Access to fast-growth Eastern markets comes with less risk, more skills and more speed and comfort. Though Western Europe retains excellence in some fields, much else needs renewal.

**In the post-recession economy, what do you see as Europe's world-class features?**



Source: *Ernst & Young, European attractiveness survey 2010.*  
 Respondents selected three possible answers. Total Respondents: 814.

# Methodology

The Ernst & Young's 2010 European attractiveness survey is based on a twofold, original methodology that reflects:

The **"real" attractiveness of Europe** for foreign investors. Our evaluation of the reality of FDI in Europe is based on Ernst & Young's European Investment Monitor (EIM). This unique database tracks FDI projects that have resulted in new facilities and the creation of new jobs. By excluding portfolio investments and M&A, it shows the reality of investment in manufacturing or services operations by foreign companies across the continent.

## The real attractiveness of Europe

Data is widely available on FDI. An investment in a company is normally included if the foreign investor has more than 10% of its equity and a voice in its management. FDI includes equity capital, reinvested earnings and intracompany loans. But many analysts are more interested in evaluating investment in physical assets, such as plant and equipment, in a foreign country. These figures, rarely recorded by institutional sources, provide invaluable insights as to how inward investment projects are undertaken, in which activities, by whom and, of course, where. To map these real investments carried out in Europe, Ernst & Young created the Ernst & Young EIM in 1997. The EIM is a leading online information provider tracking inward investment across Europe. This flagship business information tool from Ernst & Young is the most comprehensive source of information on cross-border investment projects and trends throughout Europe. The EIM is a tool frequently used by government and private sector organizations/corporations wishing to identify trends, significant movements in jobs and industries, and business and investment.

The Ernst & Young European Investment Monitor, researched and powered by Oxford Intelligence, is a highly detailed source of information on cross-border investment projects and trends in Europe, dating back to 1997. The database focuses on investment announcements, the number of new jobs created and, where identifiable, the associated capital investment, thus providing exhaustive data on FDI in Europe. It allows users to monitor trends, movements in jobs and industries, and identify emerging sectors and cluster development. Projects are identified through the daily monitoring and research of more than 10,000 news sources. The research team aims to contact directly 70% of the companies undertaking the investment for direct validation purposes. This process of direct verification with the investing company ensures that real investment data is accurately reflected.

The employment figures collected by the research team reflect the number of new jobs created at the start-up date of operations, as communicated by the companies during our follow-up interview. In some cases, the only

The **"perceived" attractiveness of Europe** and its competitors by foreign investors. We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country or area's ability to provide the most competitive benefits for FDI. The field research was conducted by Institut CSA in January and February 2010, via telephone interviews, based on a representative panel of 814 international decision-makers.

figures that a company can confirm are the total employment numbers over the life of the project. This is carefully noted so that any subsequent job creation from later phases of the project can be cross checked and to avoid double-counting in later years.

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

- ▶ M&A or joint ventures (unless these result in new facilities, new jobs created)
- ▶ License agreements
- ▶ Retail and leisure facilities, hotels and real estate investments
- ▶ Utility facilities including telecommunications networks, airports, ports or other fixed infrastructure investments
- ▶ Extraction activities (ores, minerals or fuels)
- ▶ Portfolio investments (i.e., pensions, insurance and financial funds)
- ▶ Factory/production replacement investments (e.g., a new machine replacing an old one, but not creating any new employment)
- ▶ Not-for-profit organizations (e.g., charitable foundations, trade associations, governmental bodies)

## The perceived attractiveness of Europe and its competitors

An international panel of decision-makers of all origins, with clear views and experience of Europe:

- ▶ 52% European businesses
- ▶ 30% North American businesses
- ▶ 14% Asian and other businesses

Of the non-European companies, 50% have established operations in Europe. As a result, overall 692 of the 814 companies (85%) interviewed have a presence in Europe.

We built a global panel from all business models and sectors to further guarantee a representative opinion on the diversity of international strategies:

- ▶ SMEs (small and medium enterprises)
- ▶ Multinationals
- ▶ Industrial companies as well as service providers
- ▶ Companies from BRIC countries made up 10%

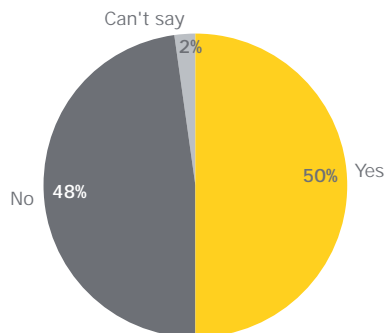
Divided into five main sectors, the businesses surveyed are representative of the key European and global economic sectors:

- ▶ Industry/automotive/energy
- ▶ Business-to-business and business-to-consumer
- ▶ Services
- ▶ Telecoms and hi-tech
- ▶ Consumer goods
- ▶ Real estate and construction

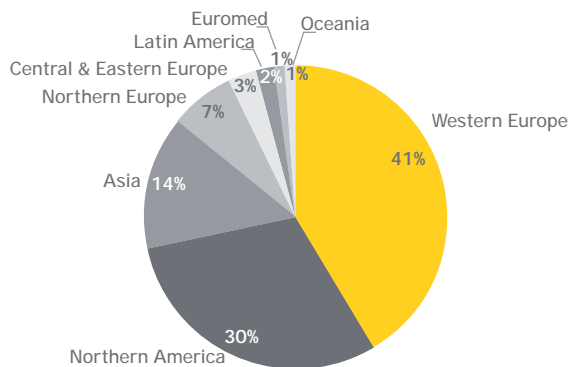


## ▶ Profile of companies surveyed

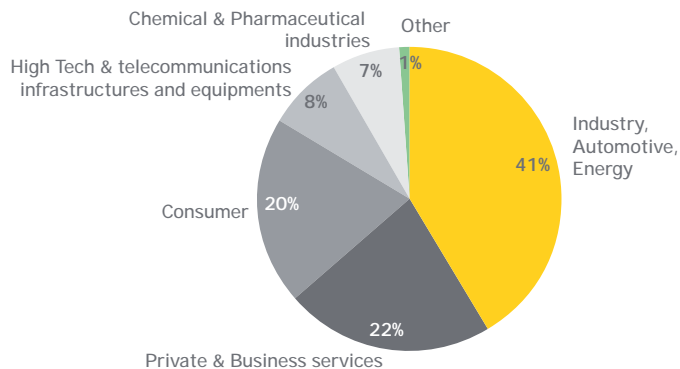
### Companies with operations in Europe



### Nationality of the companies

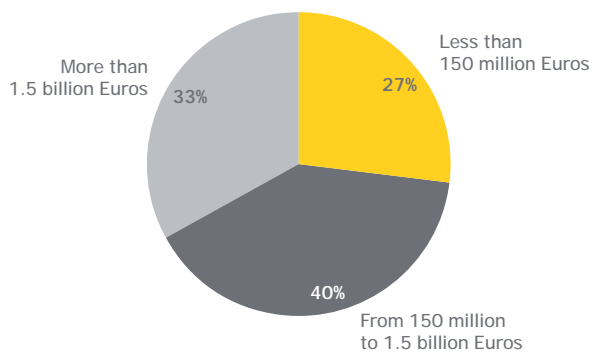


### Sector of activity of the companies

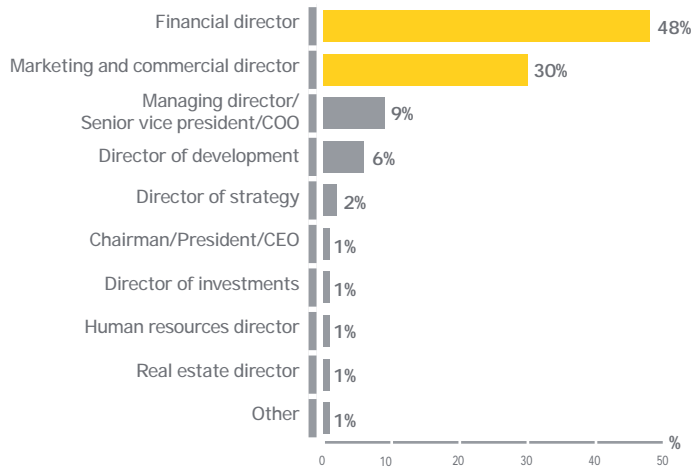


### Size of the companies

(sales turnover)



### Job title of the interviewees



# Ernst & Young building a borderless business

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Shifts in demographics and capital flows are marking the global economy and society as a whole. These trends are also having profound effects on our profession. Our response is to be the most integrated professional services organization in both our mindset and our actions.

We have one strong global leadership team that sets a single global strategy and agenda. To ensure we are efficient and effective, we have organized our legal entities into similarly sized business units in terms of both people and revenues. These business units, almost all of which are purposely not single countries, are grouped into geographic Areas across the Americas, Europe and Asia Pacific. Each business unit's leadership team works directly with their Area and global leaders to ensure flawless execution. This structure is streamlined – it allows us to make decisions quickly, and ensures that we execute our strategy and provide high-quality service wherever in the world our clients do business.

Creating our global mindset and structure are ongoing processes. We've been working with our partners to bring down the barriers to working together seamlessly across borders, and we have succeeded in realigning our previously country-focused organization into a more integrated global one. This organization means our clients get faster response and more tailored services. They get broader, more experienced teams, with deeper industry knowledge. Our people get greater opportunity to pursue the global careers they desire. And our regulators see our structure as helping us deliver consistent, high-quality service across the globe.

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## Contacts

**Marc Lhermitte**  
Partner, Ernst & Young Advisory  
Tel.: + 33 4 78 17 57 13  
E-mail: [marc.lhermitte@fr.ey.com](mailto:marc.lhermitte@fr.ey.com)

**Gregory Gruz**  
Director, EMEIA Marketing  
Tel.: +33 1 46 93 70 39  
E-mail: [gregory.gruz@fr.ey.com](mailto:gregory.gruz@fr.ey.com)

**Melissa Levine**  
Press Relations  
Tel.: +33 1 46 93 81 09  
E-mail: [melissa.levine@fr.ey.com](mailto:melissa.levine@fr.ey.com)

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