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Power Up: UK inward investment

Key drivers of foreign investment and its value to the UK economy

Acknowledgement
We would like to acknowledge the significant contributions that shaped this report from featured contributors and subject matter experts.

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About the methodology
The foreign investment data used in this report was automatically created by fDi Markets sourced from The Financial Times Ltd. All investment project data and information is based on public information on company investment announcements. Jobs data and capital investment data are not recorded for all projects and may include estimates and intentions.

The Fortune Global 500 is an annual ranking of the top 500 corporations which is compiled and published annually by Fortune magazine. As of January 2019, the 2018 Fortune Global 500 ranking is the current list. The Top 250 companies are the largest 250 companies in the 2018 rankings of the Fortune Global 500.

For each company a web-based search was carried out to establish the location of their European headquarters. The comparisons with the 2013 data are based on research carried out for our report: London Futures.

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Foreword

Power Up
This is the fifth in a series of insight reports that explore the critical challenges and opportunities facing UK businesses, government and wider society.

Inward investment makes a significant contribution to the UK economy – from job creation and wages through to productivity gains, and research and development. The uncertainty surrounding the future UK-EU relationship is a concern for global businesses with existing operations in the UK and is weighing on investment decisions. This report uses data and interviews with business leaders to explore the key drivers influencing the UK's continued attractiveness to global businesses.

Sharon Thorne
Deputy CEO & Managing Partner, Global & Strategy, Deloitte North West Europe

World trade has been a key driver of global economic growth over the last ten years, both for developed and emerging economies. Rapid advances in technology and globalisation mean today's largest businesses operate in a very different world than they did prior to the financial crisis.

We see this reflected in the changing make-up and investment decisions of the world's largest organisations. In this research we examine the UK's position in the global economy – its attractiveness to global businesses as a place to invest capital and set up headquarters.

Amidst rapid change, the world's largest businesses strive to access the best talent and to collaborate across borders to extend their reach and impact.

At Deloitte, we work with many individuals and foreign businesses who are attracted by the UK's reputation as one of the most open economies in the world and a country that boasts a stable, pro-business environment. We recognise the appetite in our own organisation to access global opportunities and experience and learn from different cultures.

The findings in this report highlight the UK's attractiveness to global businesses over the last ten years, and its resilience in the period following the UK's EU referendum. We explore the value this foreign investment brings to the UK economy and the key drivers of this investment, from the UK's stable and transparent tax, regulatory and judiciary systems to access to talent and the digital and physical infrastructure.

We are sure that the UK will retain its status as a global hub for investment if UK business and government invest in safeguarding our fundamental strengths. This will set a course for future growth in the UK; one that can weather the uncertainty of Brexit; slowdown in growth in emerging markets; increasing protectionism and potential trade challenges.

We would like to thank the business leaders we spoke to in compiling this research and hope that it provides valuable insight into the factors influencing global investment decisions.

Why the UK has been so attractive to global businesses

To understand what the UK can do to continue to attract global businesses and investment, we conducted in-depth interviews with senior executives at a range of multinational companies with investments in the UK.

Combined, these organisations employ over 80,000 people in the UK. Some have been in the UK for over a century, others arrived in recent years. The purpose of the interviews was to understand what drove their UK investment decisions, how Brexit might affect future investment and what the UK could do to ensure continued success.

A number of key factors influencing investment decisions emerged from our discussions with business leaders.

Gateway to Europe

The English language and the UK's position in a time zone between the Americas and Asia were cited as key reasons as to why international investors had set up business operations here. The UK is perceived as a good entry point for businesses looking to expand into Europe.

The scale of the UK's domestic market is also seen as a big attraction in its own right. Firms that are successful enough to expand overseas clearly have ambitions to grow, and the UK is seen as an avenue to do that.

> "No other country in the world has made their market as open to investors."

Stable, pro-business environment

Many of the leaders we spoke to talked about the perception of the UK as pro-business environment, one with a transparent regulatory and tax system, a flexible labour market and a stable social and political system.

While these factors are sensitive to future UK policy choices, there was a general perception that UK would continue to retain these attributes in the longer term. As one interviewee commented: "we need an environment in which we can have trust and confidence; that is supportive of business in the long term."

Several components of the World Economic Forum's Global Competitiveness Ranking reflect the importance of a stable, pro-business environment. The components include 'Checks and balances', 'Public sector performance' and 'Corporate governance', including audit and reporting standards.

> "A driver of the free market."

Lifestyle and education

For some of our interviewees, the UK is seen as a "second home market", with familiarities and cultural ties that render it favourable to other European markets as a place to do business. This is in part due to the world-class education system, which students from around the globe come to experience. As one interviewee responded: "people want to live here and educate their children here". There is evidence which shows that if you are educated in the UK you are more likely to return in the future. There has also been some research into the benefits for the UK and for international students in their future careers. Most international students obtaining a work visa move into a STEM (science, technology, engineering or mathematics) related job.[1] Former students help to foster future trade links with the UK, enhance the 'soft power' of the UK or use their UK education to further the economic and social development of the country where they live.

They can also become informal ambassadors for the UK, based on an emotional bond developed during their UK higher education study. They promoted a point of view of the UK as a desirable partner in potential trade and diplomatic or developmental relationships.

A number of business leaders we spoke to talked about the attractive lifestyle the UK offers; citing its rich cultural heritage as a strength.

> "People want to live here and educate their children here."

Talent pool

The depth of the talent pool in the UK provides flexibility that is a key differentiator. Interviewees stressed that the UK should focus on a ready supply of the skills that domestic and foreign businesses need. Flexibility on visa requirements was seen as critical for a number of foreign-owned business, particularly those from outside the EU. The UK's capabilities in specialised technological areas, such as high-performance computing, was also seen as important.

> "Companies come to hire talent (and lots of it)."

Services

The UK's service sector, accounting for over three-quarters of GDP, has been seen as key for driving the economic recovery since the downturn in 2008.[2] The ONS Index of Services shows the increasing economic importance of the services sector to the UK economy and its contribution to the labour market.

> "The depth of talent in the London market is a huge magnet for inward investors."

Our services sector has a huge trade surplus, with TheCityUK calculating that financial and related professional services generate an estimated trade surplus of £80.5 billion.[3] The US remains the single largest market for UK services exports, accounting for almost a quarter of all UK exports.[4]

Innovation and entrepreneurship

The UK is favoured not only for its access to a wide customer base, but also for its network of fast-growing, innovative domestic SMEs that businesses with a presence in the UK can partner with.

According to research by TechNation, London ranks third behind only Silicon Valley and New York in terms of the strength of its tech startup ecosystem.[5] Access to funding and talent are key drivers for London's success, with the government showing its support through the recent Industrial strategy challenger funds. These are aimed at strengthening UK science and business innovation and take on the biggest challenges that society and industries face today.

> "We learn a lot here that we can take back to our home country."

Brexit - what's the impact been to date?

Although the situation is rapidly changing, foreign-owned businesses at the time we spoke to expressed a commitment to the UK and did not intend to change their investment strategy in response to Brexit.

Interviewees see Brexit as a cause of unncessary time, effort and expense. They foresee changes required to supply chains and potentially a divergence of regulatory standards between the UK and EU. This would mean that businesses need more teams on the ground on the continent to set up multiple contracts and consider how regulation is applied across Europe.

The motor industry, closely tied to the EU single market, is among sectors where there is greatest uncertainty. Nissan, Toyota, BMW and PSA have committed to building more cars in the UK since the Brexit vote, but investment across the sector halved from £2.5 billion in 2015 to £1.1 billion in 2017, reflecting how carmakers and suppliers are delaying all but the most essential capital spending.[6] Spending halved again in the first six months of 2018 to £347 million, compared with £647 million for the first half of 2017.[7]

> "Brexit is not the only issue! The speed of change more broadly is driving decision-making."

Many companies are continuing to announce investments. Lidl, the German-owned discount supermarket chain, announced a plan to open more than 50 new stores in 2018.[8] Its rival Aldi, which has 700 stores in the UK, plans to reach 1,000 by 2022.[9]

Amazon has invested significantly in the UK since 2010.[10] It recently opened a new UK head office in London and a development centre in Cambridge and announced plans for fulfilment centres in Bristol, Bolton and Warrington.

Foreign-owned businesses we spoke to said they find it hard to see where in Europe businesses would transfer their investment to. They stressed that their investment decisions are not based on policy ebbs and flows and they think longer term when defining these. Many already had projects ongoing but did voice a reluctance to make further additional investments in the UK – unless incentives were provided.

"To remain Europe's leading financial centre, the UK needs to be willing to transform itself."

Miles Celic, CEO TheCityUK

Historically, the UK has used periods of economic and political difficulty to reinvent itself. Brexit has also brought forward issues that would have to be addressed anyway within the foreseeable future. So, with the right approach, Brexit could provide the opportunity to recast.

This does, however, require a degree of leadership from government and regulators, and significant input from industry. It means taking a long-term view, one which measures policy against its long-term impact and creates the remit to challenge what might be shorter-term political agendas. Creating this space to think longer term is something many developing economies do better than many developed ones.

There is a risk that we've underinvested or not made enough of those areas that have historically differentiated us – our judiciary and legal system, education system and the depth of talent pool. New York, Hong Kong, Singapore provide stiff competition.

Our immigration policy must meet the national need of competing for and retaining talent. It must fully recognise the investment benefits foreign students bring to our economy in the long term – we know that those who study here are much more likely to want to live and do business here in the future.

London is arguably one of only two genuinely international financial centres in the world. The quality of our regulation is critical to maintaining that position. And the UK's decision to leave the EU presents us with different paths that we will need to explore and choose. The US's recent approach on tax and regulation has boosted positive perceptions of New York to, potentially, the detriment of the UK. But do we keep close to European regulation in order to maximise ease of access to the EU despite the risk of losing out on competitiveness on this front to New York? This is just one of many issues TheCityUK will be focused on in our work with regulators, policymakers and industry as we move through Brexit and beyond.

The view from the US

Duncan Edwards, CEO BritishAmerican Business

In financial services, most companies are pretty well prepared for Brexit. They had contingency plans in place and many are triggering them as they have realised that old EU passporting rights will not continue. Companies are beginning to move people, but numbers are small: tens and maybe hundreds in some cases, certainly not thousands. They will move as many people as they need to, but no more. Professional services companies are broadly unaffected.

The position in manufacturing industries, where it is less easy to uproot and move people, is much more complicated. These guys are in a pickle. They are worried about what is going to happen to their supply chain.

They are hoping for a tariff- and friction-free relationship at the EU borders, but these industries are where we hear most concern. If you are a multinational company thinking about where to add capacity, the UK appears less attractive and it is hard for their UK managers to persuade head office to invest.

Post Brexit, the innate advantages of the UK will remain: its workforce, liberal labour market, universities, ecosystem. In terms of what the UK can do to maintain its attractiveness to investors, our membership would appreciate mutual recognition of standards and qualifications.

Our members clearly would not want to see their ability to hire people from the EU restricted – labour mobility is a concern. Freedom of movement of labour between the US and the UK is also an important issue. Our members would like to see it easier than it currently is. Regulatory alignment on data between UK, EU and US would be a big win.

US business is very much on the front foot at the moment. Brexit is important for those businesses affected, but not top of the agenda as far as most American businesses are concerned.

Where the world's largest organisations want to be

One way to measure the UK's success is according to where the world's largest organisations choose to base their headquarters.

We analysed the make-up of the Fortune 500 companies in 2013 and 2018, primarily to understand how many of the world's largest organisations have European headquarters based in the UK, and how that may have changed over the last five years.

The analysis also provided some interesting insight into how the composition of the Fortune 500 has evolved over the years.

What is perhaps most interesting in the Fortune 500 analysis is the emergence of China in the last five years (see Figure 1). In 2013, there were 85 Chinese organisations in the Fortune 500 (17%). This compares to 106 (21%) in 2018. No other country has experienced such growth. China's growing dominance is also reflected in FDI analysis. Between January 2009 and 2018, our inward investment analysis shows that projects originating in China were approximately two times larger than the average project size across all source countries.

Figure 1. The Fortune 500 by global HQ

Number in the Fortune 500 (global HQ)	2013	2018
US	132	128
China	84	106
Japan	62	52
Germany	30	32
France	31	28
UK	28	22
The Netherlands	12	14
Canada	9	12
India	8	7
Hong Kong	3	5
Other	101	94

Source: Deloitte analysis

US organisations made up a quarter of the organisations in the Fortune 500 in 2018 (128 organisations), down slightly from 132 organisations in 2013.

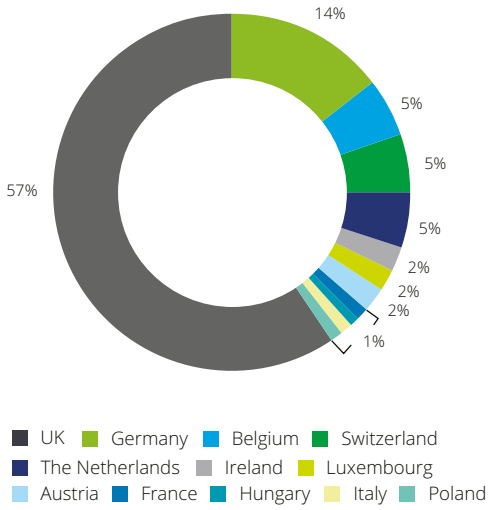
28% of the Fortune 500 are European (139). Germany has the highest number overall with 32 (6%) in 2018, followed by France with 28 (5.6%). The UK comes in third place with 22 (4%). This analysis is interesting when compared with outward investment by country. Between 2013 - 2018, the US was the world's largest outward investor by some way, accounting for a third of projects globally (37,070 and $1.35 billion), with China in seventh position (3,415 and $411,600 million).[11]

European HQs

According to Deloitte analysis, the UK continues to be by far the most popular destination for those organisations with a European HQ. In 2018 over half of those with a European HQ base it in the UK (114 out of 201).

Germany comes second, home to 14% of the European HQs of Fortune 500 companies, Belgium, Switzerland and the Netherlands are joint forth with 5% each (see Figure 2).

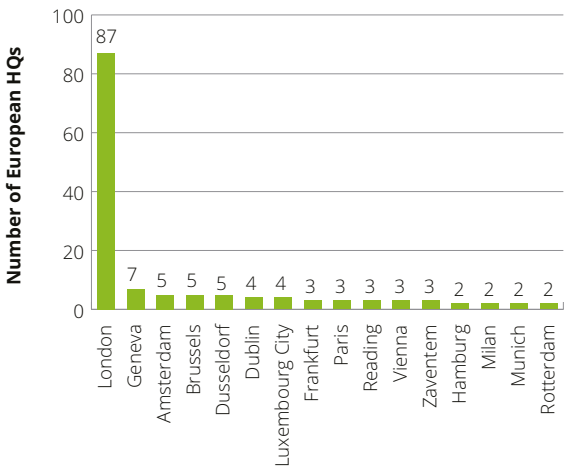
Figure 2. Location of European HQs of Fortune 500 companies in 2018 by country



Source: Deloitte analysis

London's attractiveness as a global city is evident in Figure 3. London is home to 43% of the European headquarters of the Fortune 500 companies in 2018, compared to only 4% in Geneva and 2% in Amsterdam, Brussels and Dusseldorf respectively.

Figure 3. Location of European HQs of Fortune 500 companies in 2018 by city



Source: Deloitte analysis

In 2013, we analysed the Top 250 Fortune 500 companies according to their choice of European headquarter location. There has been a slight decline in the number of European HQs in the UK from the Top 250 Fortune 500 companies over the last five years. In 2013, 72 (64%) were in the UK, compared to 68 (59%) in 2018. Germany has seen an increase from only 7 European HQs from the Top 250 Fortune 500 companies in 2013 to 14 in 2018. The UK remains significantly more popular than other European countries. Austria, Hungary, Poland, Russia and Turkey are now each home to a European HQ, none of which were in 2013.

While the number of European HQs of the Top 250 Fortune 500 companies in the UK and London has declined over the last five years, the number of Euroepan HQs in regional cities has dramatically increased (see Figure 4). Now, a quarter of the Global Fortune 500 European HQs in the UK are based outside of London, spread around various locations, compared to only 4% of the Top 250 in 2013.

The strength of the UK university system – for example Cambridge, Leeds, Manchester and Oxford – creates deep talent pools across the UK. This is combined with a lower cost of operations (premises, staff and running cost) in UK regions compared to London. Manchester's Inward Investment Agency (MIDAS) estimates that it's almost a third cheaper for businesses to operate outside of London.

Easy rail access to London is also helping bolster UK regions. International connectivity is also key for foreign investors. In 2018, the first direct flight from Manchester to India was launched by British Airways, which is predicted to make a significant contribution to driving economic, cultural and academic exchange between the North of England and India.

Figure 4: Location of European HQs based in the UK in 2018

"A global city cannot grow all its own talent."

Jasmine Whitbread, Chief Executive, London First

London has an unparalleled mix of cultural and economic factors that make it the best city in the world to do business – its ecosystem, knowledge bank, infrastructure and talent, to name a few.

Our ethos at London First is not to be complacent. Over the years we've worked on a number of progressive initiatives to safeguard the component parts of London's competitive environment and keep London an open, global city that works for the whole of the UK.

We see talent and skills, housing and transport as the three key priorities today.

As a global city, you cannot grow all your own talent.

There's a role for business to play in ensuring that government has a fair and managed immigration system that keeps the door open to the skills business needs. We consulted with over 200 of London's leading businesses, including Deloitte, to shape a post-Brexit immigration proposal that we are putting forward to government on behalf of business.

We know that business has an extraordinary depth of expertise on the skills the UK workforce needs to continue to thrive, but at the moment there's no effective model for business to provide structured support to schools. London also faces a pressing problem in its apprenticeship system.

Business needs to take the lead in upskilling domestic workers of all ages and government needs to ensure the UK's skills strategy is business-led.

"Open economies tend to be more productive."

Ian Stewart, Chief Economist, Deloitte UK

The last 40 years has been a period of rapid globalisation. Trade, cross-border capital flows and migration have seen strong growth. The ownership of assets, from equities to government bonds to prime housing, is becoming ever more international.

Economic 'openness' reflects a host of factors, from tariff and non-tariff barriers to ease of hiring foreign labour and the ability of foreign companies to invest in a country. There is a strong consensus among economists on the gains that can come from free trade and open markets. Trade helps drive living standards in consuming and producing countries. Competition sharpens incentives for domestic businesses to raise their performance. Inward investment introduces new approaches to business and management.

Brexit is naturally a focus of attention for prospective investors in the UK. Yet it is one of many factors that will shape the business environment in the UK over the long term. The scale of the type of investments cited in this report means payback periods for foreign investors often span decades. Such investors seem likely to take a long-term view when considering a nation's competitiveness.

The UK has one of the most competitive economies in the world, ranked eighth out of 140 countries by the World Economic Forum. This ranking testifies to the strength of UK's institution and a pro-business climate. The figures highlighted in this report highlight the UK's success in attracting globally mobile capital. The UK has performed particularly well against its European neighbours, despite being outside the single currency. A pro-growth, open and stable business environment has been at the heart of the UK's success as a destination for foreign investment. It is also the key to maintaining that success.

Where global businesses are investing

The UK has long been one of the world's best performers at attracting foreign direct investment (FDI).

Analysis of data from fDi Markets sourced from The Financial Times Ltd shows that the UK consistently outperforms its nearest European competitors. Between January 2015 and January 2018 the UK recorded a 6.7% share of global FDI, ahead of Germany at 5.7% and France at 3.6%.[12]

Between January 2015 and January 2018, 3,900 FDI projects into the UK were recorded, creating almost 267,000 jobs.

In terms of capital investment, the UK recorded over $140 billion during this time – more than Germany and France combined – with $50 billion in Germany and $43.9 billion in France (see Figure 5).

Key FDI statistics

Over the last ten years, the UK ranks second only to the US globally in terms of number of inward investment projects.[13]

The UK ranks third behind the US and China in terms of FDI by capital investment over the last ten years.

The UK is the clear number one in Europe.

London is the top destination city for FDI globally in terms of number of projects.

Figure 5. FDI projects, jobs created and investment across UK, Germany and France in 2015, 2016 and 2017

Year	Number of projects			Jobs created			Capital investment ($m)		
	UK	Germany	France	UK	Germany	France	UK	Germany	France
2015	1,374	1,233	610	95,992	48,954	24,147	59,729.80	16,492.00	10,547.30
2016	1,280	1,134	624	83,168	51,102	32,690	38,345.80	15,387.70	15,955.20
2017	1,170	888	822	79,704	43,945	38,606	37,440.00	16,058.90	15,705.40
Total	3,900	3,309	2,102	266,826	148,216	98,062	140,356.00	50,074.90	43,999.30

Source: fDi Intelligence from The Financial Times Ltd. January 2009 – August 2018

Over this period, the UK and Germany have both seen a decline in number of projects, total jobs created and total capital investment. This compares to an increase in France in terms of number of projects (from 610 in 2015 to 822 in 2017), total jobs created (from 24,147 in 2015 to 38,606 in 2017) and capital investment (from over $10,000 million in 2015 to over $15,000 million in 2017).

The average number of jobs created and capital investment per project in the UK also outperforms the average per project in Germany and France (see Figure 6). With countries and cities competing fiercely for investment, the UK cannot afford to be complacent. Between January 2015 and 2018, 84% of FDI projects into Germany were recorded as new investments, compared to 72% into the UK (ahead of France at 65%).

Figure 6. Average number of jobs created and capital invested per project in the UK, Germany and France in 2015, 2016 and 2017

Year	Average jobs created			Average capital investment ($m)		
	UK	Germany	France	UK	Germany	France
2015	69	39	39	43.5	13.4	17.3
2016	64	45	52	30	13.6	25.6
2017	68	49	46	32	18.1	19.1
Total	68	44	46	36	15.1	20.9

fDi Intelligence from The Financial Times Ltd. January 2009 – August 2018

Figure 7. Top destinations for foreign direct investment over the last ten years

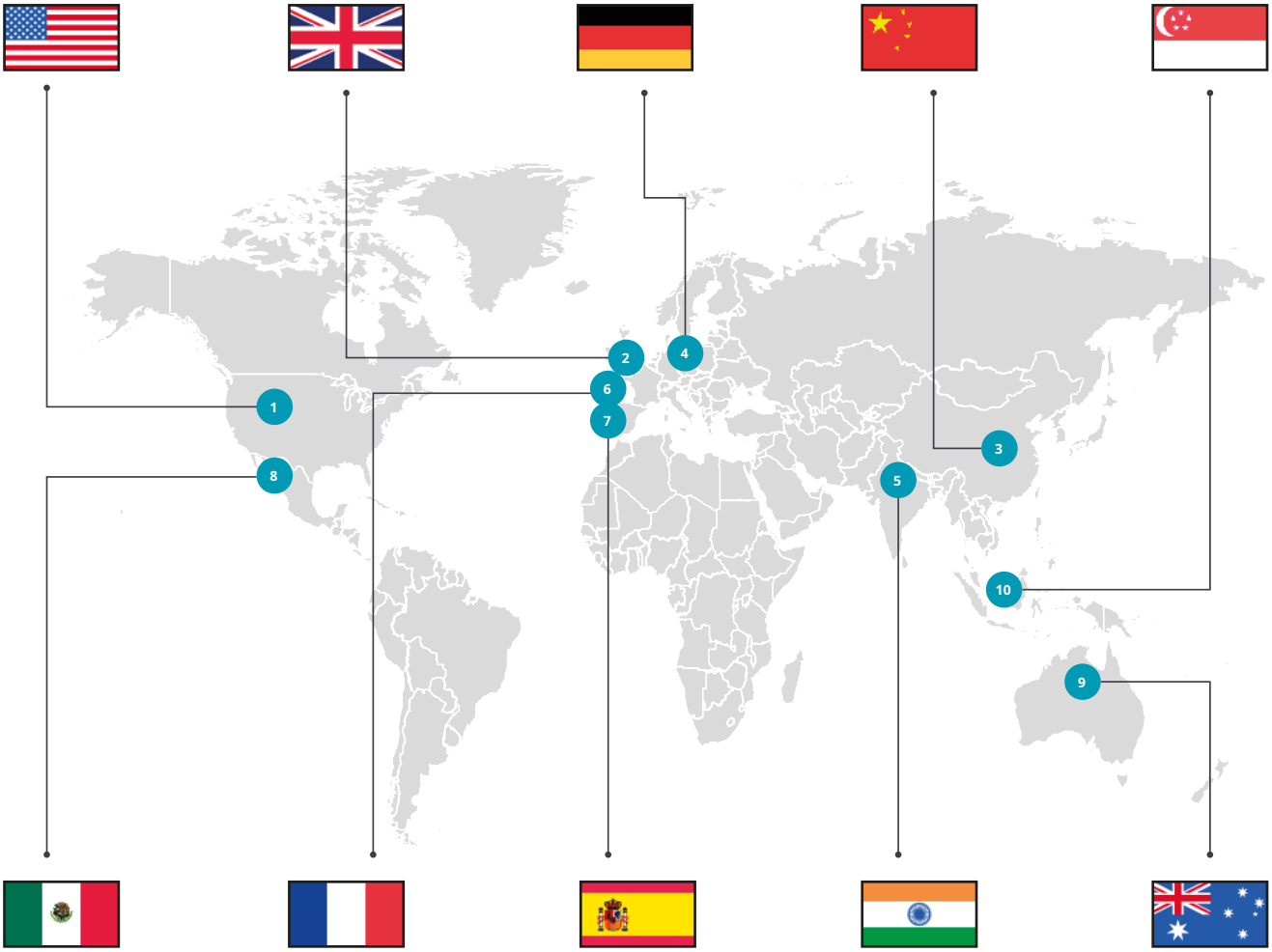
US
No. of projects: 47,557
Jobs created: 4.1m
Capital investment: $1.698bn

UK
No. of projects: 10,965
Jobs created: 788,999
Capital investment: $426,000m

Germany
No. of projects: 9,008
Jobs created: 377,610
Capital investment: $146,000m

China
No. of projects: 10,637
Jobs created: 2.6m
Capital investment: $801,000m

Singapore
No. of projects: 3,832
Jobs created: 302,883
Capital investment: $127,000m



Mexico
No. of projects: 4,022
Jobs created: 1.06m
Capital investment: $250,000m

France
No. of projects: 5,125
Jobs created: 254,242
Capital investment: $115,000m

Spain
No. of projects: 4,477
Jobs created: 378,785
Capital investment: $119,000m

India
No. of projects: 7,437
Jobs created: 1.97m
Capital investment: $405,000m

Australia
No. of projects: 3,892
Jobs created: 345,413
Capital investment: $212,000m

Labels 1-10 are based on number of inward investment projects (1 being the highest).
Source: fDi Intelligence from The Financial Times Ltd. January 2009 – January 2018

London, the unrivalled top destination city for FDI

London continues to be the top city globally for foreign direct investment. Between January 2009 and August 2018, London ranked first in terms of number of projects (with 4,110) ahead of Singapore (second with 3,832), New York (third with 2,854). London received the second highest level of capital investment, at $106,000 million behind Singapore at $126,601 million. London is the clear winner in Europe, with Paris, Dublin, Berlin and Madrid falling notably behind (see Figure 8).

Figure 8. Top destination cities for FDI globally

Destination city	Projects		Companies		Jobs Created	Capital Investment ($m)
	No	%	No	%		
London	4,110	2.23	3,604	5.30	186,959	105,767
Singapore	3,832	2.07	3,275	4.81	302,883	126,601
New York City	2,854	1.55	2,599	3.82	198,029	74,123
Dubai	2,503	1.36	2,282	3.35	151,204	55,869
Shanghai	2,474	1.34	2,123	3.12	327,670	96,316
Hong Kong	2,245	1.22	1,959	2.88	171,115	63,968
Paris	1,852	1.00	1,618	2.38	55,852	31,614
Sydney	1,385	0.75	1,257	1.85	89,291	40,391
Beijing	1,226	0.66	1,119	1.65	159,255	50,805
San Francisco (CA)	1,109	0.60	1,058	1.56	60,445	14,345
Chicago (IL)	1,103	0.60	1,010	1.48	64,488	21,858
Tokyo	1,041	0.56	952	1.40	66,113	19,925
Houston (TX)	1,023	0.55	930	1.37	56,347	21,778
Bangalore	990	0.54	827	1.22	225,921	35,109
Dublin	961	0.52	752	1.11	67,983	25,698
Sao Paulo	954	0.52	898	1.32	68,455	37,718
Los Angeles (CA)	903	0.49	846	1.24	51,634	18,431
Melbourne	840	0.45	744	1.09	83,196	25,079
Madrid	839	0.45	734	1.08	45,345	13,247
Berlin	819	0.44	757	1.11	33,544	11,682
Other destination cities	86,446	46.80	79,477	116.84	11,808,176	3,667,974
Not Specified	36,664	19.85	18,916	27.81	6,849,170	3,276,502
Total	184,707	100.00	68,021	100.00	24,501,490	8,828,179

Source: fDi Intelligence from The Financial Times Ltd. January 2015 – January 2018

The value of FDI beyond the numbers

What are the benefits of FDI beyond the numbers outlined in the previous sections? How have such historically high levels impacted the UK economy?

Countries across the world compete fiercely for FDI because of the strong correlation between FDI and economic growth – with investment often creating many new jobs and local 'ecosystems' of smaller businesses.

There is an argument that FDI results in technology transfer – with domestic companies learning new technological and managerial practices from inward investors. It can also increase competition, driving improved performance.

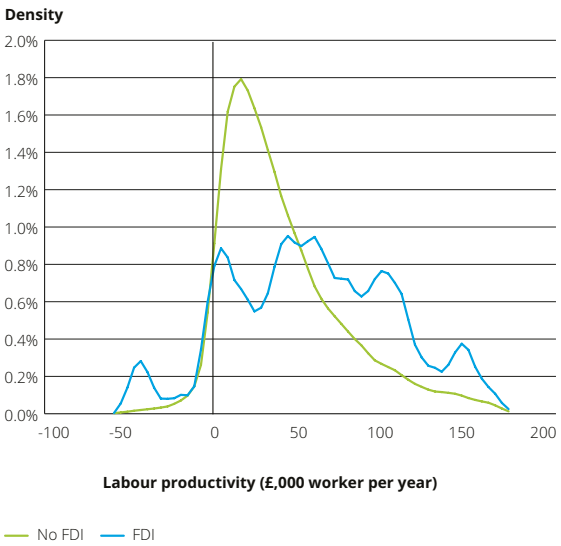
The productivity puzzle

There are strong links between FDI and productivity gains.

Various studies have shown that foreign-owned firms are more productive than their domestic counterparts. Office for National Statistics (ONS) data for around 40,000 UK companies shows that foreign-owned companies in the UK are twice as productive as domestically-owned companies. Part of this is due to the fact that foreign firms tend to export and are larger in size, two characteristics which are associated with higher productivity levels. Once the ONS controls for size, industry, age and region, foreign-owned firms are around 74% more productive than those not involved in FDI, either inward or outward.

Figure 9 illustrates the Gross Value Added (GVA) per worker is higher for foreign-owned businesses in the UK.

Figure 9. Distribution of labour productivity in the UK by engagement in FDI (inward and outward)

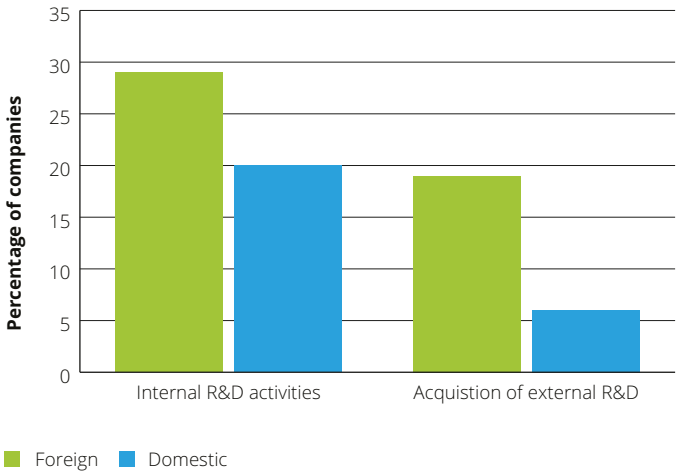


Source: ONS, 2015 data

The spillover effect

There is also data which shows that foreign-owned firms invest more in research and development (R&D) (see Figure 10 from the Bank of England Underground using ONS data*). On average, they spend roughly five times more on R&D than domestic companies and account for 50% of total R&D spending in the UK. Such innovation can often lead to productivity increases.

Figure 10. Proportion of firms engaging in R&D by ownership type spending on R&D per firm by ownership



Source: Bank of England Underground using ONS data

The effect of foreign investment can be multiplied through supply chains and consumer spending in local economies and help boost growth.

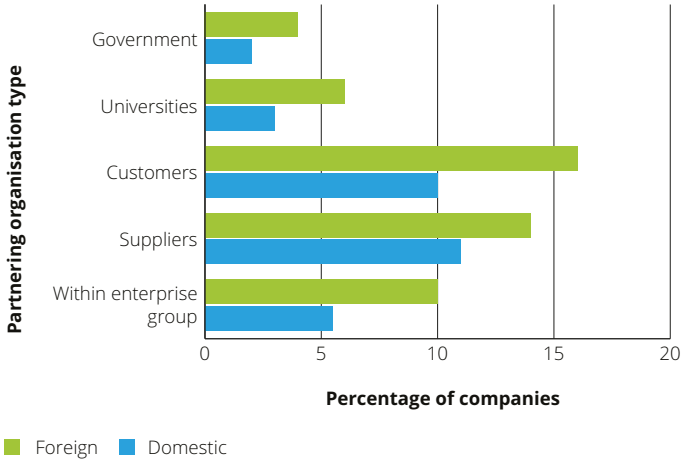
Knowledge diffusion is also an associated benefit of FDI. Figure 11 shows that foreign owned companies tend to be more likely to collaborate with partners, such as government and education institutions.

Collaboration between innovative, high-growth businesses and big business represents an opportunity for both sides. Often, corporates do not have the expertise or structural freedom they need to innovate effectively in-house, so collaboration with entrepreneurs can enable them to innovate in a low cost, low risk way.

*Bank Underground is a blog for Bank of England staff to share views that challenge - or support - prevailing policy orthodoxies. The views expressed here are those of the authors, and are not necessarily those of the Bank of England or its policy committees.

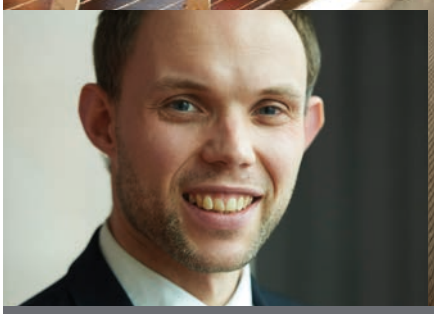
Previous Deloitte research, **Power Up: UK business**, has shown that there is a strong perception among the scaleup community that collaborating with big business is hard work. Breaking down those barriers to collaboration could have mutual benefits. Our community signalled that corporates need to simplify their processes to make it as easy and cheap as possible for young businesses to work with them. More also needs to be done to raise awareness for the various modes of collaboration between corporates, entrepreneurs and aspiring scaleups, as well as the mutual benefits and success stories.

Figure 11. Percentage of companies collaborating



Source: Bank of England Underground using ONS data

In summary, there is a strong argument that the value of foreign investment to the UK economy is not captured in the measurement of capital invested and job creation alone. Foreign investment brings significant benefits for the UK's productivity and competitiveness of domestic companies



"We need to ensure the UK's voice in a global market is not drowned out by Brexit."

Ben Digby, International Investment and Trade Director CBI

When we talk to our members, both UK subsidiaries of foreign owned (increasingly Chinese and Indian businesses) and British parented companies, they cite economic strength and political stability as two of the UK's key strengths. Brexit has put a question mark over these factors.

But, the UK continues to stand out with its transparency around the way business gets conducted, the lack of corruption and limited bureaucracy - providing great certainty for foreign investors making decisions. Overall, the UK's services sector is seen as a real competitive advantage; anything from education services to financial services to creative (design, architecture etc.). Advancing market access for our services sector is critical – and should be considered as such in terms of the Brexit outcomes.

People look to the UK for its deep pool of educated people; it's seen as a great place for people to live and work, particularly due to its arts, culture and heritage, which is a big draw for talent. We also have an openness to new ideas that has created a fast-growing ecosystem of small and medium-sized enterprises (SMEs).

Whatever the terms of the Brexit deal, once we have left, making sure SMEs in the UK understand the opportunities to export in Europe, needs to be a priority. Vice versa, what the UK has to offer to the rest of the world, needs to be clearly communicated. The UK needs to make a clear statement to the world - and ensure that its voice is not drowned out by Brexit.

The Brexit effect

The uncertainty surrounding the future UK-EU relationship is a concern for global businesses with existing operations in the UK and is weighing on investment decisions.

The UK is currently a major European hub for business. A large part of UK's success in attracting in FDI has been because it is perceived as a gateway to the European market. With likely additional barriers to trade with Europe in a post Brexit environment, the question is how significant an impact this could have on FDI.

The challenges Brexit poses for businesses with operations in the UK – supply chain, people, regulatory system and process implications – feature regularly in conversations with business leaders.

Businesses with complex, cross-border supply chains are concerned about the additional costs, administration and potential border delays that could result once the UK leaves the EU. Access to talent too, is a key area of concern. The depth of the UK's diverse and multinational workforce has played a critical role in its success at attracting investment over the years, and there is a fear that this could be impacted by Brexit. Digital interconnection is causing consternation among many businesses as technology underpins and facilitates a significant parts of many companies' operations, which includes the ability to transfer data across borders.

For the financial services sector, there is particular concern regarding how London will be impacted as Europe's dominant centre post Brexit. For the services sector more broadly, which makes up the majority of the UK economy, there has been little detail on what the future UK-EU relationship will look like.

In our report **Power Up: UK workplace**, we explored the potential impacts of Brexit on the views of non-British workers, who make up over 10% of the UK workforce. The research found that despite Brexit, the UK remains attractive to many of these workers, but that a third could leave in the next five years, which is higher than the current average. This could result in a potential skills gap, particularly in sectors heavily reliant on the non-British workers.

Our analysis also found a correlation between sectors with the highest concentration of non-British workers and highest potential for automation. This supports a view that Brexit could be a catalyst for further automation, but businesses would need to be thinking about this now, since new technologies and processes, once identified, often take many years to come to fruition.

So what does the data say?

It's likely that many businesses will be waiting for further clarity before making long-term investment decisions. The data available so far presents a mixed picture, but indicates that there has not been a drastic fall in investment since the UK's decision to leave the EU in 2016, but rather a slight decline.

In 2015, there were 1,374 FDI projects announced in the UK, compared to 1,170 in 2017 – meaning a 16% decline. In terms of UK jobs created - in 2015 there were 95,992 jobs created as a result of FDI, with 79,704 created in 2017.[14] But two years does not represent a long-term trend, given that annual figures can vary significantly depending on just a few major projects.

A global view

Brexit needs to be considered in a global context. Whilst it is hard to avoid the subject in the UK, for businesses with operations across the world, Brexit is one of many geopolitical issues to contend with. Investors will be looking at the longer-term prospects for the UK and whether the it will continue to be a business friendly environment, beyond the current political uncertainty.

What is a universal issue for all organisations, no matter where they currently operate, is the rapid pace of advancing technology and the increasingly global workforce. This means that businesses now have more options than ever before in terms of how and where to operate.

For example, an investment decision which may have previously been based on a lower cost of labour, may be different today, if that particular type of work is something which could be automated. Today's decision might instead be based on the innovation ecosystem in a country, or how well educated the workforce is.

And so while the uncertainty surrounding Brexit is undoubtedly bearing on investment decisions – there are a wide range of factors that need to be considered.

The UK needs to ensure that it continues to be at the forefront of advances in technology and builds a workforce to augment this. The concern around the prolonged uncertainty of Brexit is not only that it may cause investment decisions to be put off. It is also taking up considerable time and resources for both policymakers and businesses. In an constantly changing environment, it is imperative that sufficient attention is also paid to future-proofing the UK economy.

"The UK boasts one of the most professional tax authorities in the world."

Matt Ellis, Managing Partner Tax, Deloitte UK and Deloitte North West Europe

There are a number of UK fundamentals that make it attractive for foreign investment - language, culture and job opportunities. From a tax perspective, the UK has a low statutory rate of corporation tax (having fallen from 30% in 2009 to 19% in 2017) and a tax authority that is easy to work with and transparent.

Clients tell us, and we know from our own experience, that HMRC is one of the most professional tax authorities in the world, but with the additional strain of Brexit and digitisation, funding will be needed to keep current levels of service up.

We shouldn't underestimate the potential burden that Brexit may be on the tax system. Keeping other changes to a minimum is key to ensuring a successful transition.

The UK lags behind other European countries on tax reliefs, and there is more that could be done to boost UK business and incentivise foreign investment, for example tax reliefs on staff training costs. A great success story is how the film and high-end TV tax reliefs have fuelled booms in creative industries. The impact of tax policy decisions on the UK's attractiveness to global businesses should remain top of mind for Government.

"Audit reform must strengthen one of the UK's leading sectors."

David Sproul, Senior Partner and Chief Executive, Deloitte UK and North West Europe

As the UK nears its departure from the EU, there are several major issues that remain beyond the direct control of businesses. Whether that's the ability to access the best talent or safeguard supply chains, such uncertainty is a threat to the UK's status as one of the world's most attractive places for foreign investment. Yet while Brexit will mean change, it's how government and business adapt and respond to this change that will shape the UK's future economic strength and success.

Our research shows that one of the big attractions of the UK to investors is its dependable rule of law and regulatory system. This is reinforced by the World Economic Forum's Global Competitiveness Rankings, which favour those countries with a stable business environment and strong corporate governance – including auditing and reporting standards.

Ensuring a stable regulatory system is especially pertinent given the current debate about the future of the UK audit market. The breakdown in public trust and confidence in business and in audit stemming from corporate failures and executive wrongdoing has sparked a range of regulatory and political reviews of the sector in recent months.

As the Competition and Markets Authority (CMA) consults on how to address concerns relating to independence and audit quality, I'm concerned about the risk of creating a UK audit market that is not fit for purpose and places our capital markets at a huge disadvantage to other major economies, particularly the US as the UK's key competitor as a global financial centre.

We also need to be careful not to reduce the incentive for international networks of professional services firms to invest in centres of excellence and job creation in the UK.

The professional and business services sector accounts for over one-tenth of the UK economy and has accounted for more than one-third of total UK job creation over the past decade.[15] It's no exaggeration to say it is a crown jewel in the UK economy.

Change is needed to restore public trust in the audit profession. But reform must not only improve audit quality, it also needs to be done in such a way that strengthens rather than hampers the future success of one of the UK's leading sectors. The attractiveness of the UK capital markets as a place to do business after Brexit depends on it.

Recommendations for continued UK success

The recommendations set out below are intended to provide practical steps that can be taken now to help shape the UK for future prosperity.

We are committed to supporting policymakers, educators and businesses of all sizes to come together to keep the UK a competitive and attractive place in which to do business.

1. A ready supply of domestic and foreign skills

The focus for the UK should be on a ready supply of skills for domestic and foreign businesses.

Government must assess and reflect skills that the UK needs in its approach to immigration. It should ensure that immigration policy is joined up with the industrial strategy as well as regional economic strategies led by combined authorities in order to realise the benefits of a reformed system.

The education system and learning and development offered by businesses to their workforce need to reflect that roles are being augmented to an ever-increasing extent by technology. According to The Deloitte European Workforce Survey, 54% of the UK workforce think employers should have the primary responsibility for the maintenance and development of workplace skills.[16]

Overall, investors stressed the importance of a broader, more diverse UK economy. They want to see a strategy for inclusive growth for UK-wide cities.

2. World-class digital infrastructure

Foreign investors will welcome the UK Government's ambition to give the majority of the country 5G coverage by 2027, having stressed the importance of digital infrastructure for the UK to compete with other markets. While the UK is a world leader in superfast connectivity, with more than 95% of premises covered, next generation Fibre to the Premises (FTTP) – or 'full fibre' – coverage is only 4%, and lagging behind current world leaders like South Korea (around 99%), and Japan (around 97%).[17]

It is important that transport plans are joined up around regional and national visions, so that the potential of investment is realised.

A 5G network to rival the East?

5G is the next generation of mobile wireless communication which can provide consumers with mobile internet speeds typically around five times faster than currently available on 4G/LTE. The pace at which 5G is adopted in the UK will depend on a number of factors, including network and handset availability. The UK is likely to have its first commercial 5G network within a year, with EE launching first, in August 2019. Vodafone and O2 plan to launch in 2020 .

In 2018, for the first time, Deloitte conducted a **Mobile Readiness for Work** survey, providing the first comprehensive map of the state of mobile readiness among the UK's workforce. It gives an insight into workers in the UK, how they currently use technology and the potential opportunity in using mobile devices and apps to raise workers' productivity.

3. Focus beyond Brexit from government and business

The government's industrial strategy includes pledges to invest in innovation and infrastructure and reach sector deals with companies in key industries. We believe there is more business can do, both feeding into policy development and beyond, to assist in identifying what Britain needs to do to remain competitive. Government needs to swiftly resolve the current political impasse on the nature and form of the EU Exit, and redouble its efforts to provide stability for UK businesses.

If UK business and government invest in safeguarding the key competitive differentiators that have propelled the UK to its current position of strength to date, the UK will continue to be an attractive destination for global businesses and talent.

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