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A launch pad for growth
How UK big businesses are planning to increase investment

Key points

- Deloitte LLP estimates that businesses based in the UK with a turnover of more than £1 billion will invest around £200 billion by the end of 2015, providing a UK base for international expansion.
- The planned investments could generate £486 billion of new revenue from foreign markets by 2017.
- Major companies in the UK intend to maintain the cash cushions built up mainly since the financial crisis. Only a third plan to use this cash to finance investment strategies.
- Both the Government and businesses should act to maintain this investment momentum. With an election due in 2015, the Government must address the corporate need for macro-stability and sector-specific support. A key priority for business is to re-establish trust with the public by illustrating its significant contribution to domestic wealth creation.

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UKFutures

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Foreword

I am delighted to introduce our latest **UK Futures** report, *A launch pad for growth: How UK big businesses are planning to increase investment*.

Several indicators now point to a recovery in the UK economy. Our recent CFO Survey reported a six-year high in risk appetite levels and our M&A Perspectives report highlighted the growth in cash on corporates' balance sheets. Paradoxically, business investment levels have remained stubbornly static over the last five years: in 2009 they totalled £120 billion and in 2013 the figure was £123 billion.

The purpose of this report is to provide insight on some of the major questions facing business and the Government. Is business investment likely to rise in 2014 and again in 2015? Do major UK corporates plan to use the cash cushion they have built up to fund future investment plans? What should the Government do to sustain business investment?

Major UK businesses are at the core of our country's economic performance. They are equipped with both the scale and long-term aspirations critical for our continued economic revival. Big businesses generated total revenues of £2.4 trillion in 2012. To understand the pace and direction of the economic recovery, Deloitte surveyed senior executives at 132 firms, each with more than £1 billion in turnover, representing nearly 40 per cent of all businesses in this category.

Through our **UK Futures** programme, Deloitte aims to provide invaluable insight to help British businesses truly harness the opportunities available to them. This report provides a strong mandate for action for the Government to refocus its policies around business investment. A clear understanding of how major UK corporates are making investment decisions can help identify how a new era of sustainable growth for the British economy can be supported.

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Introduction

There has been much debate on just how solid the UK's economic recovery is. A well-balanced recovery requires a significant rise in corporate investment and a shift away from consumer-led growth. This report looks beyond the official economic data to determine how big companies intend to make business investments. Specifically, it provides a granular analysis of these investment decisions, and the critical role that foreign markets will play.

First period of sustained business investment since the financial crisis Business investment is set to rise in 2014. Deloitte LLP estimates that businesses based in the UK with a turnover of more than £1 billion (which we call 'big businesses') will invest around £197 billion over 2014 and 2015.[1] Deloitte surveyed senior executives at nearly 40 per cent of all UK big businesses. Our analysis of the survey results shows that big businesses do intend to increase investment. However, the process shaping and defining their investment decisions appears to have changed. Nearly 60 per cent identified returning cash to shareholders (through buybacks and dividends) as their key priority for 2014. In 2015 the key priority for big businesses shifts, with 65 per cent of corporates focused on investing up to £106 billion.

New routes to growth are increasingly international Six years on from the financial crisis, UK big business appears to be building a new launch pad for growth. Not surprisingly UK-based major businesses plan to expand their horizons over the next few years, and not just the FTSE 30 giants. Nearly half of the executives surveyed plan to source between 50 and 74 per cent of revenue from outside the UK in the next three years. If these plans materialise, around £486 billion of new revenue could be generated from foreign markets by 2017. This is not a BRICs story either; major businesses expect to see a balanced growth picture across both mature and new markets. China is considered the highest priority market for revenue growth. Interestingly, the UK and the European Union (EU) are also viewed as having significant revenue potential over the next three years. Crucially, big business intends to execute these investment strategies differently depending on the individual market. In developed markets the preference is for organic investment strategies, while in high-growth markets the preferred method is through M&A deals.

A thoughtful approach to business investment Rather than significantly reducing cash cushions, senior executives at UK big businesses intend to leverage finance through a combination of low interest rates and higher revenue growth. In fact, 65 per cent of the executives Deloitte surveyed agreed that access to capital had improved significantly over the past year, and close to 90 per cent believed their revenues would grow by the end of 2014. Only a third anticipate using their cash reserves to fund investments. Moreover, these executives have been on their respective boards at least six years. Having lived through the financial crisis, they appear to be adopting more long-term investment strategies.

A call to action The UK economy has long been driven by consumer spending and it is widely agreed that a shift towards business investment could help create a more balanced recovery. The Government and business should both act to maintain investment momentum. The Government must address the corporate need for macro-stability and micro-sectoral support. A key priority for business is to re-establish trust with the public by illustrating its significant contribution to domestic wealth creation.

UK big business investment behaviour

Understanding what shapes investment behaviour facilitates a deeper insight into future investment trends. The Deloitte survey asked senior executives of UK big businesses how their attitudes had changed towards investment over the past year and how this has affected their investment plans for both 2014 and 2015 – specifically the criteria determining investment decisions and the timeframe.

The change of attitude governing senior executives' investment decisions between 2013 and 2014 shows a significant predisposition towards a willingness to invest (see Figure 1). This marked increase across each of the criteria, which determine investment planning in 2014, demonstrates a clear shift in attitude over the past year.

In 2014 big businesses are planning to increase investments but the desire to strengthen their balance sheets and investor pressures continue to influence their overall decisions.

The priorities for big business in 2014 are shown in Figure 2. In aggregate, 80 per cent plan to invest but this figure masks what lies behind corporate decision-making. With 58 per cent of executives still prioritising shareholders and a further 11 per cent continuing to strengthen their balance sheet, investment hurdles still remain. However, a third are totally focused on investment.

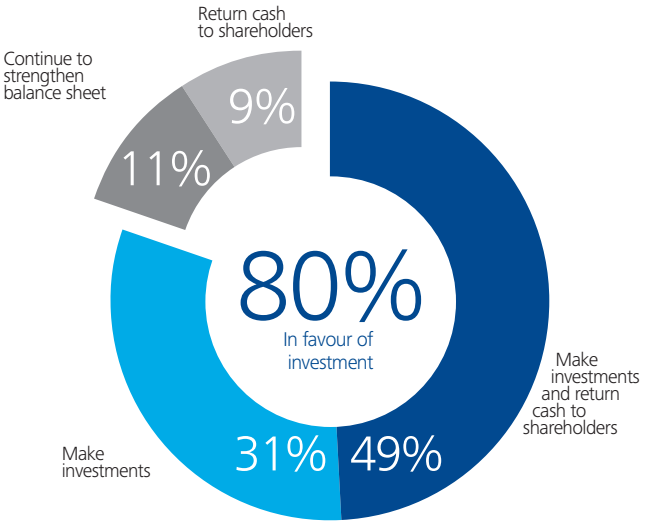
Are big businesses planning to use their widely reported cash cushions to fund these investments? According to Deloitte research the answer is an unequivocal, *no*: just a third of senior executives intend to use existing cash to fund their investment activities.

For example, 31 per cent intend to use their cash for investments in 2014 rather than strengthening their balance sheet. Of the remaining two-thirds, 97 per cent

Figure 1. Big business attitude change to investment planning between 2013 and 2014

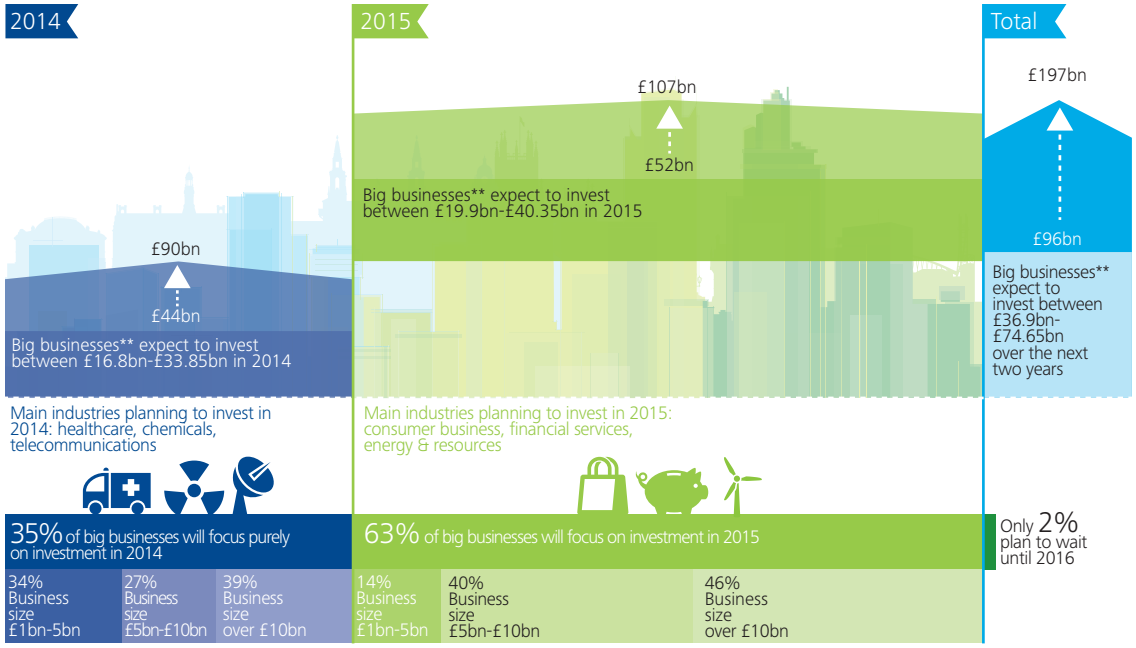
Source: Deloitte analysis, 2014

Figure 2. How big businesses are going to use their cash in 2014



Source: Deloitte analysis, 2014

Figure 3. The investment timeframe, expectation and estimate



*Please note that the totals include a £250-500 million investment projected for 2016
**Investment values shown are the totals for the survey sample size (132)

Source: Deloitte analysis, 2014

plan to prioritise investment in 2015 (see Figure 3). This suggests that corporates are maintaining healthy cash balances and using revenues and financing to fuel growth strategies, as they remain cautious of macro-instability.

Further analysis highlights some important sectoral differences. Driving investment this year are big businesses in the telecommunications, chemicals and healthcare industries. Overall these industries generally place a higher premium on research and development and are likely to have longer investment cycles. In contrast, the consumer business, financial services and energy sectors all plan to boost investment plans in 2015. In part, this is likely to reflect the anticipated rise in personal earnings, incomes and house prices in 2014.

Encouragingly, close to 70 per cent of big businesses intend to invest over £250 million in 2014, reinforcing their commitment. Our analysis identified 347 firms in the UK with revenues over £1 billion making it possible to show the proportion of the proposed investment of the 132 businesses surveyed.[3] This results in a £197 billion investment by 2015. Of the 347 big businesses identified, 171 are listed and 176 are non-listed. The non-listed companies are made up of privately owned UK and foreign businesses in addition to listed international businesses. When asked about investment decisions, different approaches towards investment emerge between the two. In both 2014 and 2015 over 70 per cent of non-listed businesses surveyed indicated that they would invest, while the figure averaged 26 per cent for those listed.

A national launch pad for international expansion

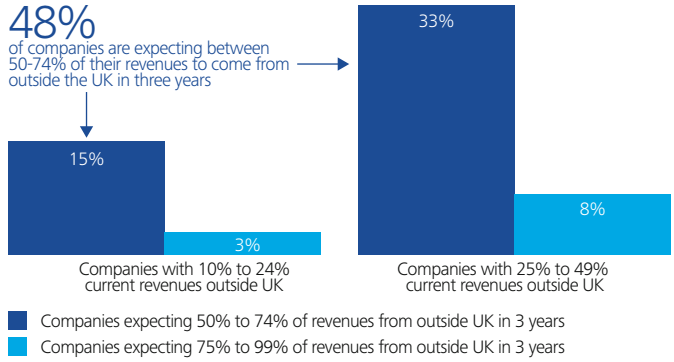
It is widely agreed that sustainable economic recovery is dependent on healthy export growth. The Government has set an aspirational target of £1 trillion of exports by 2020 but the UK is struggling to meet this goal.

Encouragingly, big business is leading the way, according to our reasearch. First, big firms are using the UK as an export base. But more importantly, they are also using the UK as a hub for controlling their expanding international businesses. The national market is still extremely important for big businesses as 72 per cent of those surveyed currently generate more than half of their revenues from within the UK. By 2017 this figure decreases to 57 per cent, but the majority focus is still UK-centric. This 15 per cent shift means that foreign markets will generate around £486 billion of new revenue in 2017.[4] Given that total revenue in 2012 for these businesses was £2.4 trillion, by 2017, at constant prices, 20 per cent of all revenues would come from outside the UK.

The shift towards international markets is far more evident when looking at the big businesses that currently generate less than 50 per cent of their revenue from international markets. By 2017, nearly half (48 per cent) are expecting to generate between 50-74 per cent of their income from overseas markets.

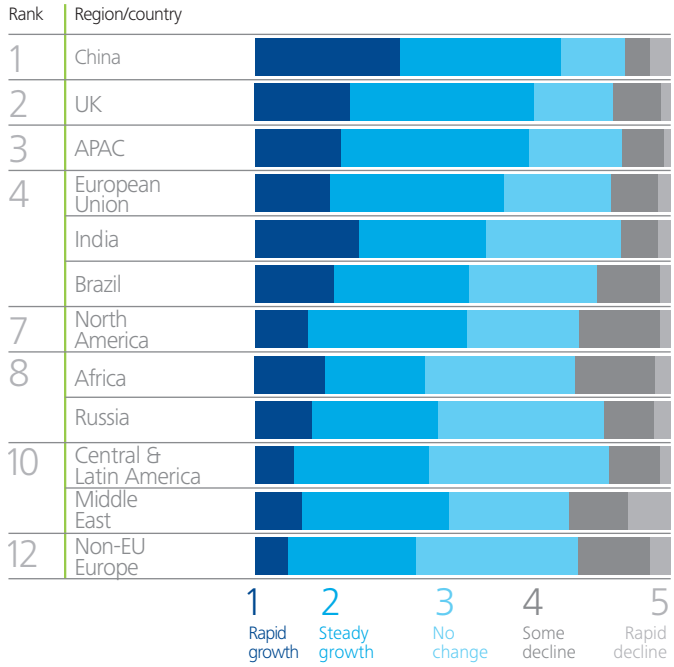
Deloitte research shows that the overall focus of big business is on worldwide growth strategies (see Figure 5). There is also a balance emerging between developed and high-growth markets. Perhaps not surprisingly, China dominates in terms of three-year revenue flow predictions, followed by the Asia Pacific region (excluding China), the EU and the UK. The other regions which make up the BRICs are expected to be a strong, but second-tier source of revenue in the medium term.

Figure 4. Projected international revenue flow for domestically focused firms in 2017



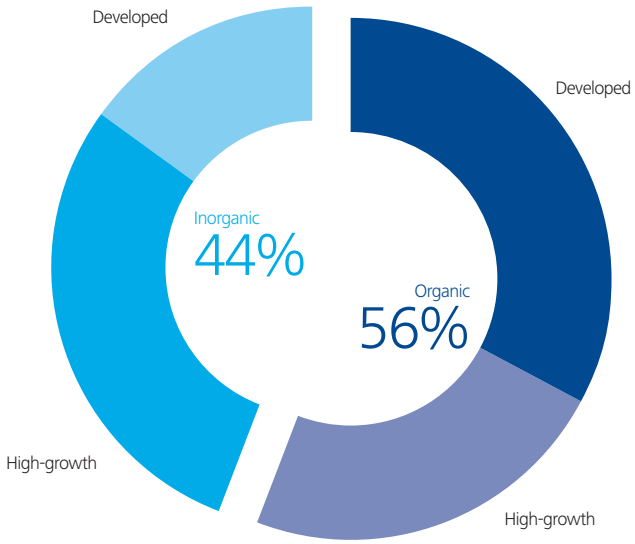
Source: Deloitte analysis, 2014

Figure 5. Ranking of revenue flow expectation in 2017



Source: Deloitte analysis, 2014

Figure 6. UK big business 2014 growth strategy



*N=218, Multiple responses from a single respondent

Source: Deloitte analysis, 2014

There has been a long running debate regarding the rate of return companies received from M&A transactions compared to those for organic growth. Figure 6 shows a slight preference among those surveyed for organic growth, with 56 per cent of respondents identifying it as their favoured strategy for 2014. Between developed and high-growth markets the distinction is far more marked with M&A dominating in riskier environments and organic strategies preferred when conditions are similar to those found domestically. This reflects the overall risk aversion guiding current investment decisions.

The investment equation – a point of view

Looking to the long term, how will the changes in behaviours and priorities impact investment decisions? Clearly, this is a complex area. Our investment equation provides one possible method of interpreting the significance of shifting patterns of investment.

What emerges from our research and our own experience with clients is the complexity of the variables which guide big business investment decisions. The investment cycle of each business is likely to be governed by sector-specific uncertainties. However, we have identified four overarching variables central to the investment decision (see Figure 7).

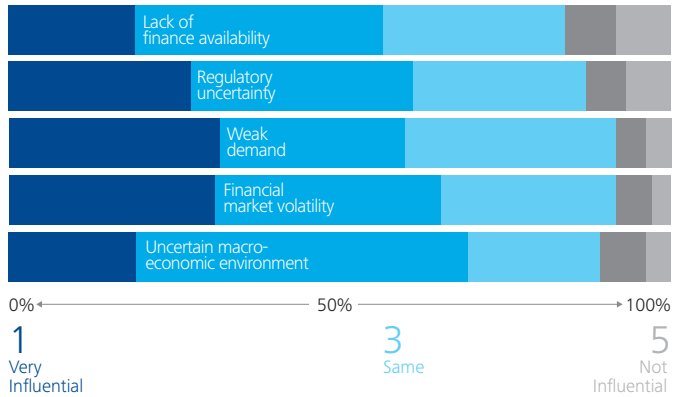
Figure 7. The investment equation

External drivers

The first variable in the investment equation groups all **external drivers**. These include capital accessibility, sentiment in terms of both stability and growth, and regulatory policies that directly impact the balance sheet of the business (see Figure 8).

When asked about each of these drivers 65 per cent of senior executives agreed that access to capital had improved significantly over the past year. Sixty per cent indicated that they expect the UK to maintain or increase its current growth rate over the next two years. In addition, close to 90 per cent believe that their revenues will grow by the end of 2014.

Figure 8. External drivers of big business growth



Source: Deloitte analysis, 2014

Ambition

The second variable is **ambition** and is broadly dependent on the growth strategies and confidence of the executives leading the business. The data collected points to a healthy level of ambition among the UK's big businesses. Sixty-seven per cent of executives felt that current economic conditions are ideal for bolder investment decisions, while 64 per cent consider the diversification of investment opportunities across markets as crucial.

Corporate capabilities

Corporate capabilities make up the third variable in the equation. These include cash surpluses, current balance sheet performance and predicted revenue flows. A positive outlook for each implies a willingness on the part of businesses to invest. Close to half of the firms surveyed indicated that they hold large amounts of cash on their balance sheet and 90 per cent expect their revenues to grow between 2013 and 2014.

Expectation

The fourth variable is **expectation**, in terms of both the individual business and overall market performance. This variable is different from the other three as it combines the analysis of market data with the individual ambition of the business. While the alignment of the external drivers, ambition and corporate capabilities is needed for investment to occur, expectation will govern whether these three variables are sufficient (see Figure 7). Changes in expectations are determined mostly through the experience of the individual making the investment decisions. Eighty-three per cent of the respondents have been in their current position for more than six years, and 45 per cent for more than ten years, indicating they are highly experienced in the corporate decision-making process.

Together these four variables illustrate the holistic nature of the investment decision. The equation suggests that senior executives are increasingly inclined to wait for each of the variables to be positive to trigger a release of funds. Since the shift in a single variable would affect the decision to, or not to, invest the balance is fragile. This fragility could ultimately diminish the strength of a much needed economic recovery.

A call to action

For the first time in several years, business investment is likely to experience a sustained period of growth. Since the financial crisis, the global economy and geopolitical environment have become more complex to navigate. Any threat to macro-stability could weaken the confidence that has been growing among UK big businesses. This could potentially put a brake on the flow of business investment. Therefore, we are calling on both the Government and business to play a role in ensuring that the investment trajectory continues on an upward path.

Government

Major questions facing the Government is where and how to support business investment plans. Policymakers should increasingly look towards combining both macro and micro types of support. First, with an election due in 2015, maintaining a consistent macro-policy is a key condition for facilitating a rise in investment. Executives of major businesses in the UK need a sense of stability to make long-term decisions. Policymakers can respond to this need for stability by emphasising the benefits of continuity.

Second, as British business has both international aspirations and highly focused investment plans, an emphasis on sector-specific support will be crucial. Three-quarters of the executives Deloitte surveyed identified innovation in products and services over the past three years as significantly contributing to the success of their business. Government bodies such as the Department for Business, Innovation and Skills and UK Trade and Investment need to play an even greater role in providing targeted (international) sector support tailored to the needs of individual firms. This will require policymakers to engage directly with businesses to increase sectoral knowledge and partner with the private sector to support the growth aspirations of UK big business.

Business

Big business in the UK faces a simple paradox. The increase in planned investment identified in our survey is likely to contribute further to the wealth creation process in the UK. However, public trust in business continues to fall and CEOs are viewed as particularly untrustworthy.[6] Clearly, big business needs to articulate better how it is contributing to wealth creation.

Nearly 40 per cent of the executives surveyed consider corporate responsibility as key to business success. For instance just under 90 per cent of our sample is involved in initiatives to support the smaller businesses in their value chain (see Figure 9).

Overall these actions point in the right direction. Big business should consider strengthening its voice in the wealth creation debate – it has much to contribute.

Figure 9. How big businesses are supporting smaller businesses in the value chain

Source: Deloitte analysis, 2014

Notes

1. Please note the ONS figure £125 billion in 2012 is not comparable with the £197 billion estimate by Deloitte LLP. This is because ONS figures are for all business investment in the UK. The Deloitte survey includes both domestic and international investment.

2. The survey interviewed 132 senior executives, including CEOs, in December 2013 and January 2014.

3. UK listed and non-listed businesses with turnover over £1 billion as identified through analysis of Bloomberg data (data was collected on 23 January 2014).

4. This calculation is based on the assumption of a 5 per cent CAGR increase year-on-year.

5. Corporate cash reserves are the highest since the 2008 financial crisis with just the FTSE 100 non-financial companies holding $130 billion in cash reserves in the first half of 2013.

6. "16 key attributes to building trust", Edelman Trust Barometer, 2014. See also: http://www.edelman.com/insights/intellectual-property/2014-edelman-trust-barometer/building-trust/

About the methodology

The survey, conducted by the Longitude Research for Deloitte LLP, interviewed 132 senior executives from board directors to senior business unit leaders in companies with an annual turnover greater than £1 billion in 2012.

These businesses were from 18 different industrial sectors, had a variety of ownership (publicly listed, private and private-equity held) and included both UK HQ (85 per cent) and non-UK HQ businesses.

Survey responses were gathered anonymously between December 2013 and January 2014.

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