EY's Attractiveness Survey

Portugal 2014

On the move

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Attrac tiveness

EY's attractiveness surveys

EY's attractiveness surveys are widely recognized by our clients, the media and major public stakeholders as a key source of insight on foreign direct investment (FDI). Examining the attractiveness of a particular region or country as an investment destination, the surveys are designed to help businesses to make investment decisions and governments to remove barriers to future growth. A two-step methodology analyzes both the reality and perception of FDI in the respective country or region. Findings are based on the views of representative panels of international and local opinion leaders and decision-makers.

For more information, please visit: www.ey.com/attractiveness.

We would like to extend our gratitude to ...

António Pires de Lima, Minister of Economy; António de Melo Pires, CEO, VW Autoeuropa; Carlos Melo Ribeiro, CEO, Siemens Portugal; José Manuel Fernandes, founder and Chairman, Frezite; Ana Abrunhosa, President, CCDR-Centro; António Portela, CEO, Bial; António de Sousa, co-founder, ECS Capital.

EY's attractiveness survey – Portugal 2014

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Foreword

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The past

In its nine centuries of history, Portugal has seen both highs and lows in its rich economic past. Beginning with the glory days of leading the Age of Discovery, and thereby paving the way for economic globalization 500 years ago, the country was challenged, toward the end of the last century, with a late comeback to the international markets.

Currently, there are over 250 million Portuguese speakers, spread over five continents. This is as much a lingering reminder of Portugal's former status as a global power as is it of our unique cultural and powerful economic bond with several growing economies.

However, faced with political and economic isolation, currency devaluation was used as the key competitiveness driver for a substantial part of the 20th century. As a result, by the time Portugal entered the European Union (EU) in 1986, the country, lacking in infrastructure, had a scarce supply of qualified human resources, a limited pool of capital and insufficient entrepreneurs with the expertise required to successfully engage in international business.

Private and public investment, partially EU funded, rapidly changed this landscape, and the country met the requirements to became one of the founding members of the European single currency in 2002. The sudden access to plentiful funding at historically low cost resulted in high levels of spending by families, companies and the Government, with excessive focus on the internal market, at the expense of international competitiveness.

When the crisis hit toward the end of the first decade of this century, an already anemic GDP began to plunge as a result of reduced internal and external demand. Chronic budget and trade deficits had already generated a massive external debt, only made worse by the international financial and economic crisis.

Doubts over the euro's resilience followed and the markets demanded a risk-adjusted interest rate, effectively making borrowing no longer an option. The request for external financial support, in 2011, was inevitable.

"The results of our survey are very clear in showing the overwhelming confidence of investors in the country's future attractiveness."

The present

The economic impact of the crisis resulted in wide-spread wage stagnation and historically high unemployment levels. The emigration of young talent, at a moment when the country was aligned with the OECD average for university education completion expectations, ensued.

Nevertheless, the crisis has resulted in public policies that promote competitiveness and support businesses. Reforms in competition law, the labor market and the tax system have been put in place and are effectively empowering the private sector to respond to external demand and drive the economic recovery.

Portugal is currently in the enviable position of having world-class infrastructure in place, a highly qualified young work force, a safe environment and high standards of investment protection. All of these allow investors to obtain high levels of productivity while benefiting from competitive costs that, as a result of a relatively high level of unemployment and low inflation expectations, are not likely to increase significantly in the medium term.

Investing in a new location is always a challenging decision. However, the first movers tend to be best positioned to reap most of the benefits. It is important to listen to those who have already invested in the country and, especially, to monitor how often and why they choose to reinvest. Portugal's positive export performance, amid the lackluster growth of its neighboring European markets, confirms its competitiveness as a base from which to manufacture and export to emerging countries. It also demonstrates the capacity of its SMEs and entrepreneurs to reinvent themselves as international players.

The future

The results of our survey are very clear in showing the overwhelming confidence of investors in the country's future attractiveness. These results are especially relevant, as the outlook is considered to be particularly promising by companies already present in this market.

Small and open economies tend to have their future influenced by the performance of their geographic and economical partners. The signs of firm, albeit slow, recovery in the EU ought to have a direct positive impact on the Portuguese economy's performance. This is reinforced by the ongoing effort to diversify international trade partners, which has already resulted in many companies opening up in new markets and in increased export flows to South America, Africa and Asia.

Having been forced to internationalize without adequate capital structures, local SMEs present interesting opportunities for partnerships, alliances or acquisitions, with investors standing to gain immediate access to emerging markets very familiar to Portuguese entrepreneurs, firms and management teams with the skillset required to drive growth in these regions.

Clearly, the country still faces challenges that will require a continued commitment to reform for years to come. However, most of the internal challenges, such as high unemployment and reduced pressure on prices, can translate into opportunities for international investors.

I trust that this publication will demonstrate why we believe that this is the right time to view Portugal as an interesting and promising investment location.

Executive summary

1 Attractiveness perception is at an all-time high

Out of the 200 companies surveyed, 67% think that Portugal's attractiveness for FDI will increase in the next three years (for Europe as a whole, the comparable result is 58%).

Confidence levels are at their highest since 2005, with companies already present in the country reporting a better perception than last year (79% vs. 60% think the country's attractiveness will increase).

Attractiveness will increase over the next three years:

2014	2013
67%	58%

2 Investment intentions are increasing

Investors' confidence is also visible in investment intentions, with 27% of the companies surveyed planning to expand their operations or to make greenfield investments in Portugal in the next year. The percentage of companies that are not present in the country and that have plans to invest in the short term has doubled to 14%, from 7% in 2013.

Resilience is also high, with 85% of decision-makers stating they do not want to relocate operations from Portugal and 9 out 10 projecting to stay in the country during the next 10 years.

Plans to expand operations next year:

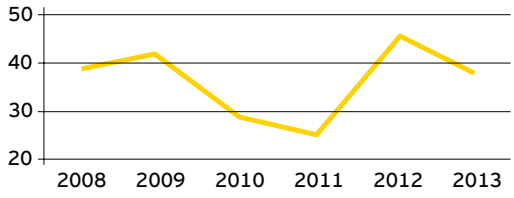
2014	2013
27%	22%

3 Less investments in 2013

EY's European Investment Monitor (EIM) database identified 38 new FDI projects in Portugal, 8 less than in 2012. With 1% of the number of new FDI project identified in Europe, Portugal's market share is still below the 1.1% observed before the crisis (2004 to 2008).

With perceived attractiveness at a record high, continued promotion efforts are required to convert intentions into investments.

Number of new FDI projects:



4 EU leads, but non-EU investors are also active

Germany, Spain and France represent 50% of the total number of projects recorded by EY's EIM.

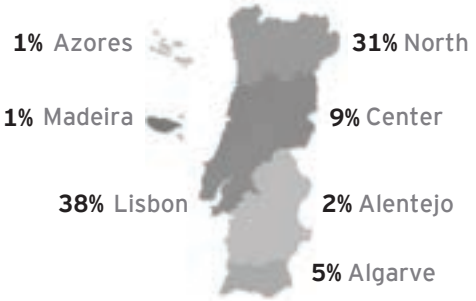
France and Spain were the top investors, with 7 projects each, but French investors created the largest number of jobs, with 487.

Country of origin of FDI projects:

Country of origin	Number of projects	Jobs created
Germany	7	380
Spain	7	161
France	5	487
USA	3	302
United Kingdom	3	156
Brazil	3	250
Other	10	277

5 Lisbon and the north lead attractiveness perception

The Lisbon area is the most attractive region for 38% of the sample. Northern Portugal is the preferred choice for 31% of investors, a value that increases to 43% when only the subset of Spanish companies is considered. Central Portugal nearly doubles its visibility as a region attractive to investment, with 9% (5% in 2013). Algarve (5%), Alentejo (2%) and the autonomous regions of Madeira and Azores are less visible for investors.



6 Access to information can be improved

A little over half of the panel (52%) considers information on regional attractiveness to be available, and two-thirds of these companies confirm access to multiple sources of information. However, 35% of investors still find it difficult to access information on regional attractiveness. This figure rises to 43% in the subset of companies not present in Portugal.

Since 40% of the panel do not receive any information on Portugal's FDI attractiveness, additional effort could be required from national and regional entities to promote attractiveness factors and investment opportunities.

Access to information on regional attractiveness:

Information is available	52%
Access to information is difficult	35%

7 Tourism and R&D will lead growth

The panel identifies tourism as a key driver for growth in the coming years, recognizing the country's location, climate, international access, safety record and heritage as competitive advantages.

The panel highlights R&D, manufacturing and logistics as the business functions that are most likely to attract foreign investment. An increasing number of investors acknowledge the R&D infrastructure and competences, signaling confidence in Portugal's ability to differentiate and add value through innovation.

Key sectors and business functions:

Business sector that will drive growth in Portugal: tourism	45%
Business functions that will attract more investment: R&D	45%

8 Taxation is key to sustain attractiveness

According to 46% of investors, Portugal should concentrate its efforts on reducing taxation in order to remain globally attractive (33% in 2013).

In order to become a leader in innovation, 42% of the companies surveyed, especially the smallest ones (51%), believe the country should reduce bureaucracy.

Decision-makers link competitiveness improvements with reforms that result in a reduction of debt and in the stabilization of the economic environment.

Improving attractiveness:

Where to concentrate efforts to remain attractive for FDI: reduce taxation	46%
Reforms required to become an innovation leader: reduce bureaucracy	42%

Viewpoint

Competitiveness as a driver for attracting investment

The ongoing economic and political reforms are proving effective, as illustrated by the positive evolution of key economic indicators. The results of EY's *Portugal attractiveness survey* are also encouraging and provide further evidence that the path Portugal has chosen is attractive for foreign investors.

Portugal's economic turnaround is noteworthy because we successfully completed the Economic Adjustment Programme while safeguarding the correlation that better health, education, safety and justice have with a more competitive economy. The ongoing adjustment of Portugal's fiscal and external imbalances, combined with successful reforms, has resulted in increased rates of foreign and national investment and in new investment opportunities.

Portugal will implement further reforms to encourage growth, including tax reforms that will further enhance competitiveness, bringing us to a stronger and more sustainable foundation from which to compete and succeed in the complex and challenging economic future of Europe as a whole.

Evidence of increased productivity – which still needs to improve further – and of the growing competitiveness of the Portuguese economy and its companies are found across many sectors. This result stems directly from the efforts of entrepreneurs and companies, including foreign investors already present in the country, with the Portuguese Government acting as a facilitator. Increased international competitiveness, a well-qualified workforce and the strong business acumen of thousands of management teams have all resulted in Portugal gaining export market share for the third consecutive year in 2013. This clearly illustrates the country's potential for manufacturing and services ventures that target foreign markets.

Our efforts to increase competitiveness are driven by the spillover effects that investment and growth will have on employment and on the standard of living of the Portuguese population. Competitiveness is the cornerstone of our reform efforts, which are designed to provide greater stability and predictability for current and future investors, resulting in prosperity for markets and society as a whole.

Since the competitiveness of a country is determined by a multitude of factors, business organizations should also follow government reforms and improve corporate governance, gain competences in national and international markets, and improve management practices from both within and outside of their organizations. Governments and businesses working in tandem will act as a catalyst for better returns on investment and positively influence future growth rates.

As Portugal continues to identify and pursue necessary areas of intervention, our key message to foreign investors is that our ultimate goal is to achieve a more open and competitive economy, with improved efficiency of the public sector and a sustainable government budget. This is the competitive ambition that the Portuguese Government is pursuing, and it should be no surprise that Portugal is already seen, within Europe, as one of the best countries to invest in and to do business with.

António Pires de Lima
Minister of Economy

"Competitiveness is the cornerstone of our reform efforts, which are designed to provide greater stability and predictability for current and future investors, resulting in prosperity for markets and society as a whole."

Investing in Portugal: the reporting framework

"The Directive, which also requires the rotation of audit firms, is a clear step toward better governance and more transparent reporting across Europe, and will likely pave the way for a mandatory application of CMVM's recommendations."

Ricardo Pinheiro
EY Portugal Assurance Leader
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An investor needs to be familiar with financial reporting rules to ensure compliance and also to interpret reports produced by business partners. Investing in a foreign country causes additional investor anxiety: how different is the regulatory environment to the investor's home country? Are there issues of practical application of regulations? To what extent are current rules likely to be subject to change?

The financial reporting framework in Portugal, which follows the standards applied in most EU Member States, was refreshed in recent years with the move to the Sistema de Normalização Contabilística (SNC). The good news is that the resulting rules are largely in line with IFRS, although differences remain relating to recent IFRS rules on valuation of financial instruments. While there are presently few differences, it should be remembered that the SNC was passed into law as a complete set of rules, making its evolution difficult. It is probable that the gap with IFRS will slowly grow as further standards are developed.

Although accounting standards are aligned with international practice, there are a couple of practical reporting issues that foreign investors should be aware of. The Portuguese business community has developed a certain tolerance of qualified auditor's opinions (both disagreements and scope limitations) and also a tacit acceptance of delays in preparing statutory accounts among small and medium-sized non-listed companies. Qualified opinions and delays are often an indicator of poor internal controls and financial condition, but whatever their cause, they provide an investor with useful insight and should not be ignored.

Corporate governance among listed companies in Portugal is based on the "comply or explain" model, and the exceptions explained by listed companies are regularly monitored by the market regulator (CMVM). Although the extent of compliance is high, there may be some questions around the underlying substance of compliance. In particular, the extent of challenge of board chairmen by non-executives and the effectiveness of audit committees could be improved. Increased vigilance by the market and financial sector regulators is putting pressure on companies to improve governance, which is essential in a market where the majority of equity is held by foreign investors.

CMVM has already issued recommendations capping non-audit services at 30% of the audit fee and providing for the rotation of auditors at least every eight or nine years, depending on whether each individual mandate is for three or four years. Maybe because these are only recommendations or maybe because they were only introduced relatively recently, but the extent of visible change remains modest. This is likely to change with the implementation of a recent EU Directive that defines additional services that an auditor may not provide to listed companies, including most tax services, and that fixes a cap on non-audit fees at 70 % of audit fees. The Directive, which also requires the rotation of audit firms, is a clear step toward better governance and more transparent reporting across Europe, and will likely pave the way for a mandatory application of CMVM's recommendations.

My vision for the competitiveness of manufacturing in Portugal

" Investment in education, training and the subsequent promotion and marketing of our current and future professionals as a 'product' of excellence is a key element for a successful vision of the sector."

António de Melo Pires
CEO, VW Autoeuropa

The lack of competitiveness of the Portuguese industry is a recurring topic. However, it is important to consider the problem historically, with particular regard to the delay to the Industrial Revolution in Portugal. In fact, the initial – and feeble, it must be said – policy measures designed to foster industrial development only date from 1806. In the rest of Europe, a sustained industrial growth was visible from 1760, generating wealth, increasing the demand for knowledge and resulting in a greater focus on education. In Portugal, this gap in the education of the people has dragged on for decades, and its effects manifest themselves in low productivity, excessive bureaucracy and the lack of preparation for management roles. It is symptomatic, to this day, that the largest companies in Portugal are not industrial, but operate in distribution and services.

This contention may seem paradoxical when we look at the statistics of educational institutions. In fact, never in its history has Portugal had so many young people with a higher education, and its ratio of PhDs is one of the highest in Europe. But if we look in more detail at the specific needs of Portuguese industry, we find that the training and instruction given is biased in favor of academic subjects as opposed to technical courses. In this sense, it is necessary to rethink the teaching model of universities and polytechnics, in order to keep up with the changing world. Managers of companies in the industrial sector seeking talent in the labor market at the various levels needed for their working structures – graduates, skilled technicians and line workers, among others – face enormous difficulties in finding adequate human resources for their needs. This creates an even stranger situation, given the current reality of the labor market: there are vacancies for well-paid positions that are simply not being filled.

The ATEC – Training Academy, whose promoters are Volkswagen Autoeuropa, Siemens, Bosch and the Portuguese–German Chamber of Commerce and Industry, originated because of the need to bridge a gap in the professional training system, by using a dual system combining academic and practical training.

ATEC was created to train a skilled and certified workforce for the industrial sector. In ATEC's 10 years of activity, there is one indicator that stands out and validates all the work: the employability of graduates stands at 80%. Ît should be noted that these young people are mostly employed by domestic industry and not only by the companies promoting ATEC. However, the merit of the ATEC goes beyond training professionals, as it also promotes the social integration of students unsuited to the traditional school environment, helping them to become responsible and committed citizens.

The negative external forces that affect our industry are well known and are part of an economic geostrategic situation to which the country must adapt. There is no other alternative for Portuguese society – and consequently, for domestic industry – than to qualify its human resources, its most valuable asset. Investment in education, training and the subsequent promotion and marketing of our current and the future professionals as a "product" of excellence is a key element for a successful vision of the sector. Only then will we be able to create a model of sustainable economic and social development, based on productivity, quality and innovation.

Portugal fact sheet

Key infrastructure data

Telecommunication

Portugal was one of the first European countries to invest in a fully digital network. Operators have already deployed 4G and are at an advanced stage with tests for Long Term Evolution (LTE). They are also making significant investments in fiber to the home (FTTH). Overall, telecommunication infrastructure compares very favorably with the European average.

Portugal	Portugal	EU average
Next-generation access coverage	84.4%	61.8%
DSL coverage	99.1%	93.5%
Penetration rate of triple, quadruple and quintuple play services	50%	22.5%
FTTH networks coverage (per 100 habitants)	4.4%	1.8%

Source: *The Communications Sector 2013*, ANACOM

Energy

Nearly half of electricity consumption is produced from renewable sources (EUROSTAT: 47.6% in 2013, vs. 23.5% in the EU). This is mostly from hydro and wind power. The country does not have nuclear energy. The Iberian energy market is liberalized, with Portuguese and Spanish players competing. As grid connections to the EU improve, opportunities for renewable energy exports will increase.

Natural gas is imported by a ship or by a pipeline that is directly connected to Algeria (through Spain and the Mediterranean Sea).

International accessibility

Portugal has three international airports: Lisbon, Porto and Faro. Lisbon is a hub for connections to Africa and Brazil, with more than 1100 direct flights per week to more than 100 destinations. Both Lisbon and Porto have daily connections to most European cities. Faro is mostly used by charter airlines, providing access to the Algarve region, acclaimed for its golf courses and beaches.

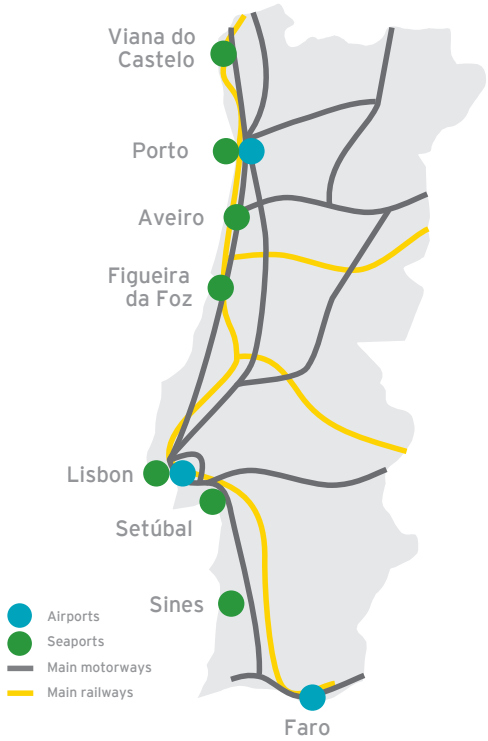
From Lisbon	By air Distance in hours	By road Transit time
Madrid	1	13 hours
Paris	2.4	1 day, 13 hours
Munich	3	2 days, 2 hours

Source: travelmath.com; searates.com

With regular connections to the main harbors in Asia, Africa, and the east and west coasts of the Americas, Portugal is connected, through different operators, to the main sea routes. Sines, Leixões (near Porto) and Lisbon are the best-connected sea ports.

Sea routes

Key economic data



Macroeconomic indicators

Key forecasts from the most recent EY Eurozone Forecast report:

	2014	2015
GDP	0.8%	1.3%
Exports	2.9%	5.5%
Unemployment	14.3%	13.5%

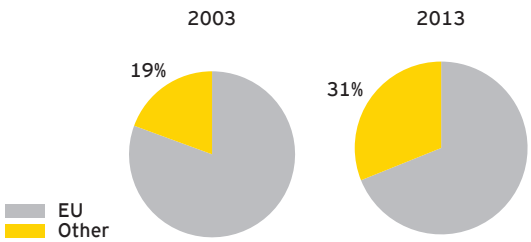
Qualifications

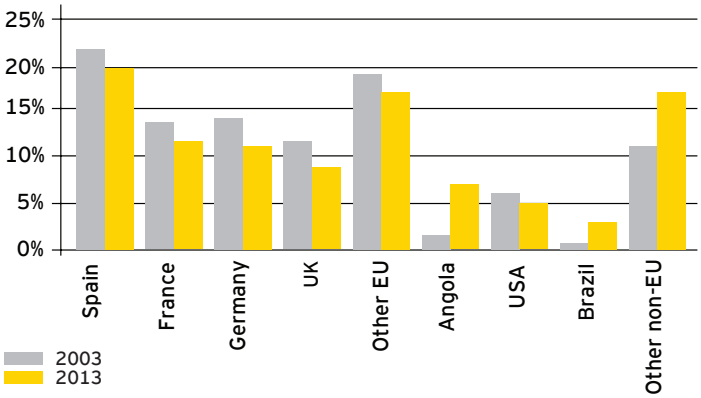
The latest available data from EUROSTAT (2011) indicates a total of 87,000 university graduates, nearly 25% of which are in the science, technology, engineering and mathematics area. The same source indicates nearly 27% of Portuguese aged 25 to 34 speak at least two foreign languages.

International trade

Even though the total volume and value of exports to the EU continues to grow, the evolution of the Portuguese exports of goods and services illustrates an ongoing diversification of markets, as easy access to fast-growing economies in the Lusophone world and in other non-EU markets enables companies to compete.

Exports of goods and services





Source: AICEP; INE

International benchmark

Cost competitiveness

Price stability over recent years is closer to that of France and Germany than to neighboring Spain or the Eastern European countries. This stability is expected to continue, partly due to high unemployment as illustrated by inflation projections over the next 10 years. Price stability, coupled with competitive wage costs, is a good indicator for business models, especially those more sensitive to labor costs.

	PT	ES	CZ	PL	FR	DE
Consumer Price Index Source: *The World Bank* (2005 = 100)	116	119	125	121	112	113
Inflation forecast Source: *Oxford Economics 10 year forecast* (2023)	1.21	1.34	2.24	1.99	1.64	1.74

Financial services

Portugal has a modern financial system that compares well with those of its main competitors for FDI. Integration into the Eurozone enables access to multiple funding options and provides continuous and tightening control over market stability and the solidity of key players.

	PT	ES	CZ	PL	FR	DE
Availability of financial services Source: *Global Competitiveness Report 2014–15, World Economic Forum* (1 = not at all; 7 = extremely well)	4.9	4.9	5.1	4.9	5.3	5.6
Regulation of securities exchanges Source: *Global Competitiveness Report 2014–15, World Economic Forum* (1 = ineffective; 7 = effective)	4.6	4.2	4.4	4.9	5.0	4.8

Quality of life

With good public and private health services, international schools, daily direct flights providing connections to major destinations in Europe, North and South America, Africa and the Middle East, the weather, a heritage resulting from nine centuries of history, the culture and the local gastronomy, Portugal offers many benefits for expatriates and business travelers.

	PT	ES	CZ	PL	FR	DE
Physicians (per 1,000 people) Source: *The World Bank* (WHO, OECD, country data)	3.87	3.96	3.71	2.07	3.38	3.69
Available airline seat km (million/week) Source: *Global Competitiveness Report 2014–15, World Economic Forum*	803	3,756	193	344	3,857	4,925
Global Peace Index rank Source: *Institute for Economics and Peace* (out of 162 countries)	18	26	11	23	48	17

Infrastructure

Extensive public investment in infrastructure, particularly roads, has resulted in above EU average indicators in accessibility. The resulting logistic capabilities enable manufacturing operations to source from and supply to the global market. The telecommunications infrastructure (including 4G and LTE national coverage) supports a buoyant business services sector.

	PT	ES	CZ	PL	FR	DE
Quality of overall infrastructure Source: *Global Competitiveness Report 2014–15, World Economic Forum* (1 = extremely underdeveloped; 7 = extensive and efficient)	6.0	5.9	5.0	4.0	6.1	6.0
Logistics Performance Index - score Source: *The International Bank for Reconstruction and Development; The World Bank*	3.56	3.72	3.49	3.49	3.85	4.12
International internet bandwidth (kb/s) per internet user Source: *Global Competitiveness Report 2014–15, World Economic Forum*	181.1	102.4	112.2	73	141.5	112.4

This set of indicators is normally used for the initial selection of investment locations. The information is compared with some of Portugal's competitors in FDI attraction (Spain - ES; Czech Republic - CZ; and Poland - PL) as well as to core EU countries (France - FR; and Germany - DE).

	PT	ES	CZ	PL	FR	DE
Corporate maximum tax rate (%) Source: *EY's 2013 Worldwide Corporate Tax Guide*	31.5	30.0	19.0	19.0	34.43	30.18
Time to prepare and pay taxes (hours) Source: *Doing Business 2015, Word Bank*	275	167	413	286	137	218
Number of payments Source: *World Bank, Doing Business 2015*	8	8	8	18	8	9

Tax system

One of the immediate impacts of the crisis was an increase in the tax burden in order to reduce the public deficit. The initial signs of recovery have resulted in a tax reform that reduced corporate tax rates in 2014, with additional reductions to be implemented through 2018. Increased utilization of electronic filing has improved the taxpayers' interaction with tax authorities, but there is still room for improvement.

	PT	ES	CZ	PL	FR	DE
Graduates in sciences, mathematics and engineering (%) Source: *EUROSTAT, 2011*	24.6	25.3	21.8	16.5	26.2	26.9
Global Competitiveness Index – availability of scientists and engineers Source: *Global Competitiveness Report 2014-15, World Economic Forum*	5.2	5.2	4.2	4.2	4.8	4.9
Global Competitiveness Index – quality of scientific research institutions Source: *Global Competitiveness Report 2014-15, World Economic Forum*	5.4	4.5	4.5	3.9	5.6	5.8

Innovation and R&D

Human resources for technological or scientific areas are widely available, with the latest EUROSTAT figures indicating 21,000 annual science, technology, engineering and mathematics (STEM) graduates. The local scientific research institutions are highly rated and offer a sound base to support innovation efforts.

	PT	ES	CZ	PL	FR	DE
Days required to enforce a contract Source: *Doing Business 2015, Word Bank*	547	510	611	685	395	394
Procedures required to enforce a contract Source: *Doing Business 2015, Word Bank*	34	40	27	33	29	31
Days required to register property Source: *Doing Business 2015, Word Bank*	1	12	24	33	49	40

Investment protection

The Government has made extensive efforts to improve interaction between itself, citizens and companies within Portugal, with many services being available online. Contract enforcement standards are aligned with most FDI competitors, but there is room to improve to achieve the results of the leading countries.

	PT	ES	CZ	PL	FR	DE
Ease of doing business overall rank Source: *Doing Business 2015, Word Bank*	25	33	44	32	31	14
Days to start a business Source: *Doing Business 2015, Word Bank*	2.5	13	19	30	4.5	14.5
Dealing with construction permits (days) Source: *Doing Business 2015, Word Bank*	113	229	143	212	183	96
Days to get electricity Source: *Doing Business 2015, Word Bank*	64	85	129	161	79	28

Business environment

A decade of reforms has already resulted in above average results in the overall business environment. Procedures have been streamlined, with fewer steps required and fewer entities involved leading to less bureaucracy and costs to comply. Recent competition and labor law reforms have contributed to international competitiveness.

Talent as a driving force for success

" A country that brings together all these characteristics is much more than a privileged place to live – it is also the ideal place to invest and do business."

Carlos Melo Ribeiro
CEO, Siemens Portugal

Portugal's geographical location, historical and cultural legacy and language make the country a point of interconnection with Europe, South America and Africa. We have a good education system, with excellent universities and research centers and, therefore, good researchers and technicians. We also offer a wide and high-quality supply in terms of transport and accessibility and a safe society that is open to the outside world.

A country that brings together all these characteristics is much more than a privileged place to live – it is also the ideal place to invest and do business. If I had to select just one truly distinctive feature of the country, I would emphasize the quality of our human capital. This is also one of the main reasons for Siemens' long history in Portugal. The talent of our people is and has always been the key to our success. During this 109-year history, throughout which we have been an economic actor committed to the development of the country, we have been part of some of the most emblematic national projects, such as the electrification process, the development of rail transport, Expo 98 and three of the four Portuguese combined cycle power plants. These achievements have only been possible because we have always attracted and kept the best talents; people capable of forming teams that are a byword for professionalism, know-how and reliability – characteristics that are inseparable from the Siemens brand.

The success with which we have been implementing this strategy has not gone unnoticed at Siemens' headquarters in Germany – in fact, it was one of the criteria that influenced the decision to locate Global Competence Centers in Portugal. Currently, we export services in the areas of energy, infrastructure, information technology, health and shared services to 200 countries in five continents through 14 Global Operational Centers based in Lisbon.

Of the approximately 2,000 Siemens Group employees in Portugal, more than 700 are working in these centers, 75% of which have degrees in areas as diverse as engineering, accounting, software and human resources. Here, too, diversity is the key, with employees from 35 nations, speaking more than 20 languages.

The excellence of our personnel is also evident in the awards we receive every year, with latest example being the Energy Service Safety Award for the useful life extension project for the Tapada do Outeiro power plant. And this excellence has been moving beyond our national borders for a long time now. In 2013 alone, we had more than 110 employees working on projects as part of delegations in several countries.

But our commitment to the training and qualifications of our resources goes far beyond our internal recruitment needs. We want to help meet macro challenges, such as the general lack of engineers in Europe. By doing this, we believe we will be supporting the country on its path to economic recovery and increased competitiveness in key areas with great export potential, such as engineering, software and industrial automation.
The signing of the "Engineering Made in Portugal" Protocol, with the Ministry of Education and Science and the Ministry of Economy, which seeks to promote engineering among young students, is an example of these initiatives. Siemens participated in this project by providing free training materials to more than 290 schools, offering a set of tools that have already benefited more than 47,300 students. The project covers the entire educational spectrum – primary, secondary, dual, higher and technical-vocational – with a wide range of initiatives that include internships in Germany. Projects of this nature are designed to increase the potential of our most valuable natural resource – our people, whose talent will always be our best business card.

Portuguese financial system: from resilience to growth

" With the non-financial sector gaining international market share as exports grew even through the crisis, new opportunities are emerging in the financial sector, especially where links to emerging markets can be successfully exploited."

Ana Salcedas
EY Portugal Financial Services Organization Leader
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The Portuguese financial system was severely affected by a succession of events that started with the international financial crisis. The sudden difficulty to access funding in the international markets had an immediate effect on the smaller, less capitalized banks whose deposits' base didn't provide enough liquidity to sustain normal levels of activity. Later, as the sovereign debt crisis emerged, the largest commercial banks were also faced with liquidity issues. Additionally, the banking system faced significant losses, as the economic recession rapidly resulted in an increase in non-performing loans (NPL). As a result, the international assistance program to Portugal included €12 billion earmarked to assist in the capitalization of banks, with a total of €5.6 billion of Contingent Convertible bonds (CoCo's) being used to strengthen the bank's balance sheets. Also, a massive deleveraging effort was imposed, both in non-financial and financial entities.

The evolution of the Eurozone economy, notably with the assistance of ECB's recent adoption of an expansionist monetary policy, has resulted in historical low interest rates on sovereign debt and a return to normality in the access to international funding by the financial system.

With NPLs still high, but having already peaked earlier in 2014, the Portuguese banks have been able to raise capital and some return to profits. This has resulted in more than 70% of the Contingent Convertible bonds (CoCo's) having been refunded until the end of the first semester. At least one Bank has already exited the program, three years beforethe operation's maturity.

The year started with the privatization of an insurance group with a 30% market share. The buyer was the Chinese group Fosun, on a deal reportedly worth €1 billion.

However, despite the initial signs of recovery in the banking system, Portugal ended up being the first country to implement the new ECB's resolution measures, as Banco Espírito Santo (BES) presented record losses at the end of the first semester of 2014. With contamination effects avoided, the markets responded favorably and the financial system is again recovering, with lending conditions to non-financial entities improving.

The steady but slow improvement in the Eurozone's economies coupled with the tightening of supervision efforts from central banks is resulting in increased credibility and new opportunities.

Therefore, after several years without IPOs, a leading health care company kicked off a new phase in the capital markets, raising €150 million in Q1 2014. Within six months, a takeover process had initiated, with multiple international competitors interested in gaining control of the company. The Government and the Bank of Portugal are pushing for a rapid sale of Novo Banco, the bridge bank created under the resolution of BES. With one of the largest retail operations in Portugal, this presents an opportunity to establish a relevant market share rapidly.

Also, with the non-financial sector gaining international market share as exports grew even through the crisis, new opportunities are emerging in the financial sector, especially where links to emerging markets can be successfully exploited. Partnerships or investment strategies should therefore be assessed, as an acceleration of the recovery in Europe could eventually lead to a rapid increase in market valuations.

What it means for investors

Bottom line is the key factor ...

Risk assessment and macroeconomic analysis are important when it comes to investment location decisions, but are not the whole story. When the rule of law and public policies of a country protect the investor regarding physical and intellectual property, risk assessment should be more focused on:

- **Supply chain** – access to raw materials, local suppliers, and inbound and outbound logistics
- **Operations** – logistic infrastructure, access to qualified workers, utilities, availability of adequate industrial or office space, licensing procedures and cost competitiveness
- **Sales** – purchasing power and economic performance of target markets

Macroeconomic indicators, namely around competitiveness, are useful in the definition of public policies that seek to encourage economic development, but should they play a key role in investment decisions? When companies are looking to set up their next investment project, they are not buying a package of the location's qualifications, productivity indices or efficiency indicators. On many occasions, these macro indicators are essentially irrelevant for investment location decisions.

An investor selects his workforce according to the skills required, applies proven technology, implements tested procedures, brings or acquires skilled management and defines and monitors performance metrics. Even for mature sectors, something as simple as creating an adequate scale of operations can result in productivity ratios that far exceed those of neighboring and competing businesses, let alone those of the economy as a whole.

When a short list of potential locations satisfying all the operational criteria has been selected, the key element for a final investment decision is the comparison of business plans adjusted to the costs applicable (and the incentives available) in each location. Normally, it will be the numbers driving the final investment decision.

Globally, benchmark analyses demonstrate that Portugal fares relatively well on most indicators, even when compared with countries with larger internal markets, such as Spain or Poland, or with large core EU countries such as Germany and France.

The business environment rankings indicate an overall pro-business attitude, which has improved in recent years as a result of reforms in competition law, labor law and licensing procedures. All of these are backed by an effective e-government infrastructure that allows most interactions with government entities to that place online, reducing the time required to comply and the corresponding transaction costs.

With interest rates currently at historically low levels and with the government funding for 2014 and part of 2015 already secured, Portugal made a clean exit from the international bailout plan and is having regular access to international financial markets.

After three years of recession, the projected GDP growth for 2014 is 0.8%. As budget deficits narrow and the economy starts to grow, the focus on public policy is changing from austerity to economic growth. Symbolic of that commitment is a tax reform that has resulted in a decrease of the corporate tax rate from 25% to 23% in 2014, with a further decrease to 21% in 2015 already approved. The Government has stated that, depending on the evolution of the economy, the base tax rate could be gradually reduced to as low as 17% in 2018.

The country will have a general election in 2015, with both the Government and the opposition signaling a commitment to implement public policies that support job creation and economic growth. These policies will receive a boost from the already-secured circa €20 billion financial package from the EU, to be used in the 2014 to 2020 period to improve competitiveness. Financial incentives will be available for training, R&D and innovation investment.

With the overall benchmark showing interesting attractiveness factors, investment decisions will be determined mainly by the bottom line. As a result, most of the effort in assessing Portugal as an investment location should be spent on building a business plan that adequately reflects operational and logistic costs, as well as the potential access to local incentives and to rapidly growing markets, notably those of the Lusophone countries, such as Brazil, Angola and Mozambique. Standard financial and tax due diligence precautions should be applied in the final stages of the decision process, but early contacts with established companies from the investor's country of origin are likely to result in positive feedback on key financial, tax, labor or cultural issues to bear in mind.

Investment opportunities

Notwithstanding the importance of assessing each opportunity individually and of securing the same level of specialized advice and due diligence required in developed countries, Portugal offers opportunities in:

- **M&A** – even though a large number of companies have extensive export experience, including an international footprint, many SMEs are currently faced with limited investment capital and difficulty in accessing credit. Targeted partnerships or acquisitions may provide accelerated access to fast-growing markets, including Angola, Brazil and Mozambique. For non-European investors, this may also expedite the learning curve of operating under EU regulations and provide a faster deployment of operations in the region.
- **Business services** – Portugal has been at the forefront of investments in telecommunication infrastructure for the last 20 years, with good broadband coverage (including extensive optical fiber coverage) and 4G already in place. This, coupled with historically high youth unemployment (currently in excess of 30%) results in widely available labor, in a country where the normal school curriculum includes at least two foreign languages (typically, seven years of English and three years of French, Spanish or German).
- **Manufacturing** – after being hit by strong competition in cost from Asian markets, Portugal has emerged in the last five years as a competitive manufacturing platform for companies seeking high-quality and fast time to market. The re-shoring of activities to enable quick response time-to-market changes and to improve client service has resulted in a revival of what were once traditional sectors, such as textiles and footwear, that are now competing in higher-end segments, where quality, service, brand, design and even luxury are the key selling points. For other manufacturing activities where the final weight-volume ratio of the products does not limit the effectiveness of access to markets, the logistics infrastructure supports access to the EU market, and the access to international sea routes enables direct exports to the key global markets.
- **Agriculture** – a public infrastructure project that resulted in the largest artificial lake in Europe enabled the irrigation of 120,000 hectares of land, in an area with a mild climate and sun exposure above the EU average. This secure access to water is generating new opportunities for the intensive production of multiple crops and has already attracted international investors, from neighboring Spain to Japan.
- **Logistics** – as the Panama canal enlargement comes closer to its conclusion, driving additional container traffic, the Portuguese ports in the Atlantic stand to gain from standing in the crossroad of multiple sea routes. Sines, with anchorage depths of up to 28m and over 2,000 ha of industrial land available, could be an interesting platform for manufacturing operations, as well as for oil storage and blending.
- **R&D** – Portugal ranks fifth in the EU in the number of new doctorates in science and technology per 1,000 habitants (aged 20 to 29). With a large number of accredited R&D facilities and growing pressure for universities to generate new revenue streams, Portugal offers competitive costs for R&D activities.

Companies in the core Eurozone countries that currently have offshore operations in Asia could consider near-shoring to the Eurozone periphery. This could be a quick way to rebalance the value chain, gain effectiveness and reduce production costs. In Portugal and Spain, for example, the younger generation is highly qualified, with good language skills, and employment opportunities for them are scarce. This is resulting in migration flows into other EU and non-EU regions. For companies where adequate scale exists, investing in such countries may be more effective than supporting expatriation costs.

LINk
Lusophone Investment Network

International investors recognize the extraordinary potential of markets such as Brazil, Angola and Mozambique, but sometimes fail to adapt their strategy to each country's specific business environment. EY's long-established practices in those markets and our strong international integration enable us to assist clients with in-depth market knowledge and a complete range of professional services.

The Lusophone Investment Network will enhance our capacity to provide tailored services to clients seeking opportunities in the Lusophone countries by:

- Supporting companies from different language and cultural backgrounds in their entry strategies for Lusophone markets
- Linking our clients with investment agencies or other local entities relevant for their investment in Lusophone countries
- Supporting companies from the Lusophone countries to identify and develop business opportunities with external partners

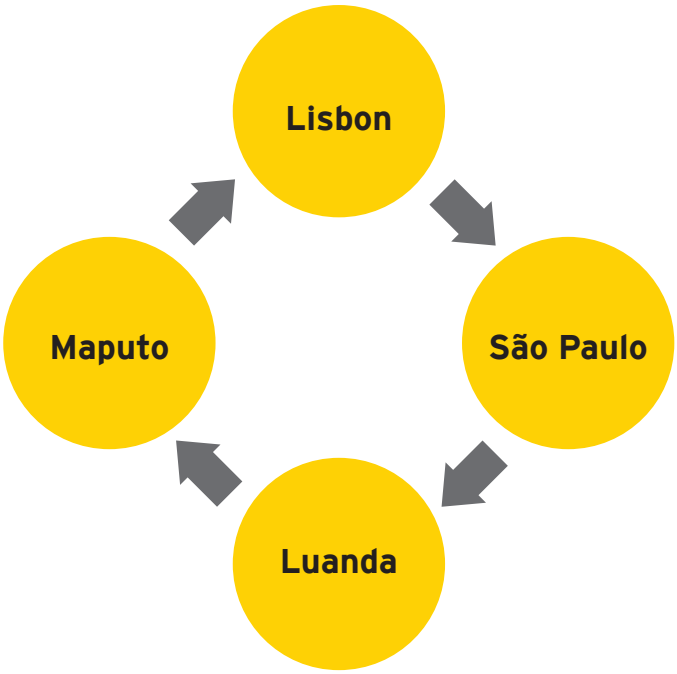
Portuguese language

6th most spoken language

Official language in 9 countries

260 million speakers

Combined GDP of US 2.6t



- Periodic events
- Experts from the four countries available in each location
- Discussion of hot topics
- Information on the business environment
- Access to local entities
- Opportunity to network with local companies and foreign investors
- Opportunity to meet companies with shared business interests

Measuring "real" attractiveness

The EIM

EY knows that monitoring FDI flows is challenging. The most commonly used data are balance of payments' statistics, normally including a significant volume of flows related to purely financial or short term operations. As a result, the evolution of these statistics does not adequately reflect specific FDI projects that will result in a direct economic impact.

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, EY created the EIM in 1997.

As a result, our evaluation of the reality of FDI in Portugal is based on EY's EIM. This database tracks FDI projects that have resulted in new facilities and the creation of new jobs. By excluding portfolio investments and M&A (except where it leads to new investments or job creation), it shows the reality of investment in manufacturing or service operations by foreign companies across the country. 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.

The EIM is a tool frequently used by governments, private sector organizations or corporations wishing to identify trends and significant movements in jobs and industries, business and investment.

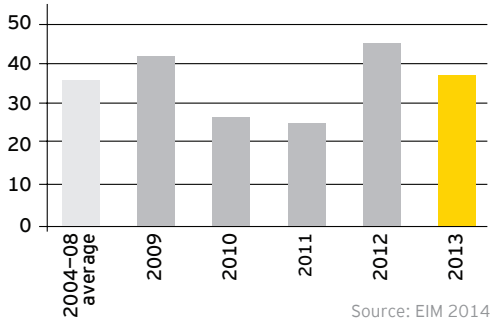
The database focuses on investment announcements, the number of new jobs created and, where identifiable, the associated capital investment. It allows users to monitor trends and movements in jobs and industries, and identify emerging sectors and cluster development. Projects are identified through the daily monitoring and research of more than 28,000 sources. The research team aims to contact 70% of the companies undertaking the investment directly for validation purposes. This process of direct verification with the investing company ensures that real investment data is accurately reflected.

The following categories of investment projects are excluded from EIM:

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

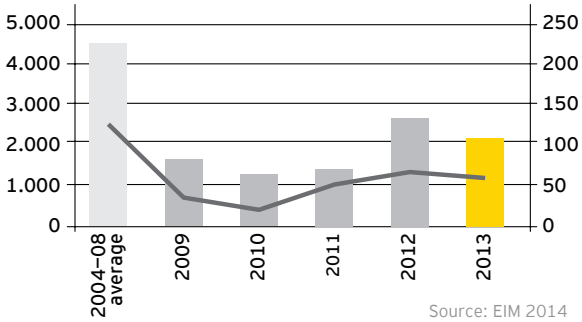
Investment projects in 2013

Number of FDI projects



In 2013, EY's EIM recorded 38 FDI projects in Portugal. This number is slightly above the pre-crisis (2004 to 2008) average of 36 projects per year, but falls below the total of 46 projects recorded in 2012, still the best year on record since EIM started in 1997.

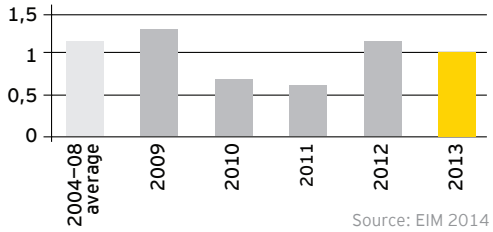
Jobs created (total and average)



The number of jobs created in Portugal by these projects is estimated by the investors to slightly exceed 2,000, a decrease from an above average value in 2013. The impact in job creation is clearly affected by a reduction of the average number of jobs created per project to under half of the pre-crisis period.

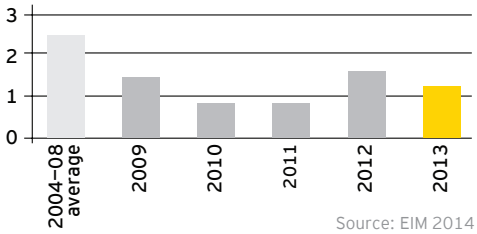
Market share falls below attractiveness perception

FDI projects in Portugal as percentage of total projects in Europe



EIM uses the same methodology to compile information on FDI in the whole of Europe. Therefore, it is possible to assume a market share for Portugal of 1% in 2013, which falls slightly below the pre-crisis average of 1.1%. The positive perception investors have about the country's attractiveness has yet to be reflected in a gain in FDI market share.

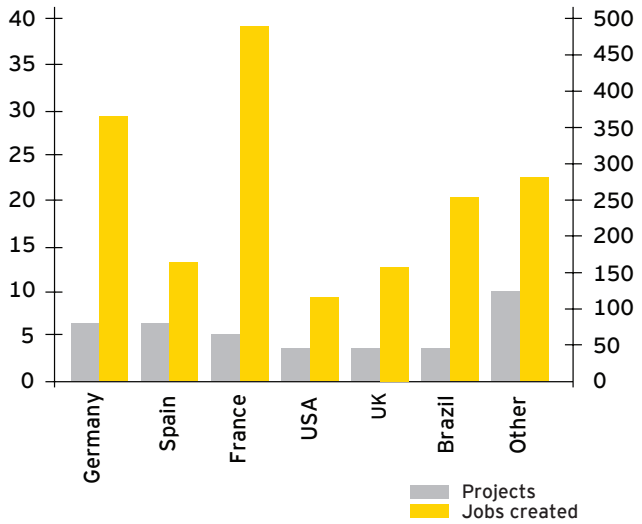
Jobs created by FDI in Portugal as percentage of total jobs created in Europe



The historical trend illustrates that FDI projects in Portugal tend to be above average, in terms of labor intensity, when compared with Europe. The average number of jobs created per project in Europe has declined from 58 in the pre-crisis period to 42 in 2013. The corresponding values for Portugal are 129 jobs per project in the 2004 to 2008 period, and 53 in 2013.

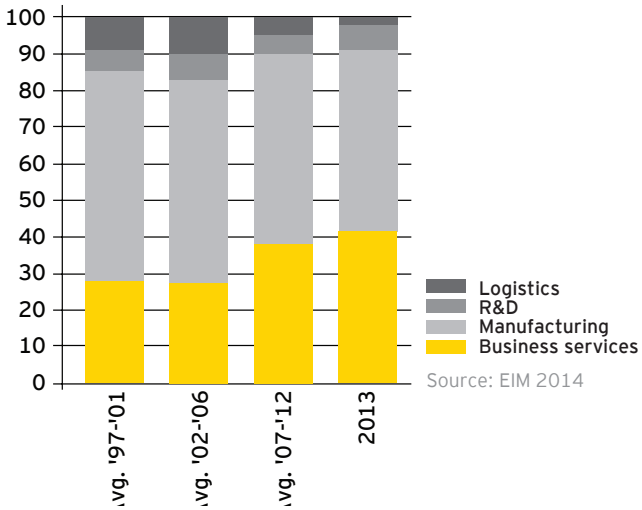
Measuring "real" attractiveness

2013 FDI projects and jobs created, per country of origin



Source: EIM 2014

Percentage of FDI projects, per sector



Source: EIM 2014

Germany and Spain were the top investors in Portugal in 2013, with seven investments each. France led in job creation, with 487 new jobs created, and was second in number of projects, with 5 new investments.

The USA and Brazil are among the top sources of FDI in the country, which illustrates the geographical reach and possibly the logistical potential of Portugal.

German investment, creating a total of 380 jobs, was entirely in manufacturing activities, the majority of which is in the automotive sector. Even though Portugal has OEM operations of VW, PSA, Toyota and Mitsubishi Fuso Trucks, most automotive components manufactured in the country are exported, with the automotive sector representing as much as 14% of total exports.

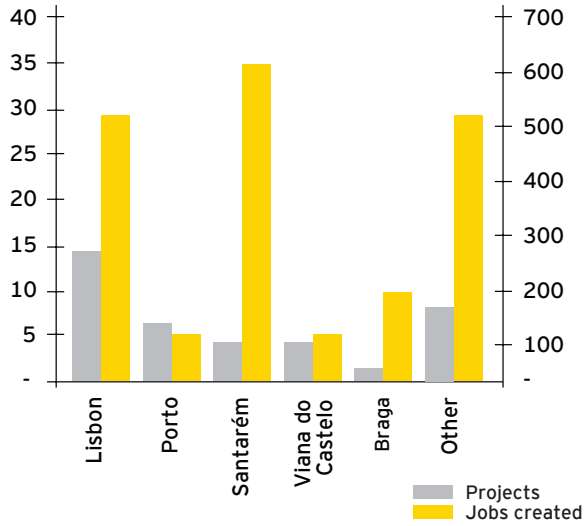
Investments from the USA and the United Kingdom focused essentially on services, including software development. Business services has been one of the sectors with the fastest-growing exports in Portugal.

Manufacturing activities have consistently been the key target for FDI in Portugal recorded by EY's EIM. In 2013, 50% of the projects and 63% of the jobs created were in manufacturing. Considering the relatively small size of the internal market, these projects are essentially focused on the external markets and rely on the country's logistic infrastructure.

However, there is a visible trend of added interest in business services projects, which already accounted for more than 40% of the total in 2013. Services projects include activities such as marketing and sales, shared service centers and contact centers, testing and servicing and headquarters. These normally demand on international accessibility and availability of qualified labor with language skills.

R&D activities continue to generate interest from foreign investors, with two new projects, creating 64 jobs, being recorded in 2013. Portugal's number of new doctorate graduates per thousand population aged 25 to 34 exceeds the European Union average, which results in interesting opportunities for R&D projects.

2013 FDI projects and jobs created, per region



Source: EIM 2014

The Lisbon region was the destination for 14 of the 38 new FDI projects recorded in 2013 (37% of the total), with the city of Lisbon hosting 12 of these projects.

The wider Lisbon area (with Santarém and Setúbal) and the wider Porto area (with Braga and Viana do Castelo) account for more than 75% of the total number of FDI projects.

The city of Porto received four new FDI projects. FDI tends to happen in more developed, more densely populated areas, where infrastructure and qualified resources are more easily available. However, there is a recent trend for services projects to locate in the interior of the country (e.g., Fundão). This results in both the availability of infrastructure and talent and of some municipality's deliberate efforts to create encompassing value propositions that enable investors to accelerate time to market and reduce cost. These locations, with less competition than the larger cities, also tend to offer additional advantages in terms of employee loyalty and reduced attrition rates.

Portugal: the competitiveness agenda

"In the aftermath of the crisis, and as the future pace and sources of growth are still unclear, companies should focus on reassessing and rebalancing their value chain, and Portugal should definitely be in their radar."

Jorge Nunes
EY Portugal Advisory Leader
jorge.nunes@pt.ey.com

Deciding where to locate an investment is a very complex process where multiple selection criteria are considered. Whether assessing a location for industrial activities, an investigation center or a shared services center, companies look for specific attractiveness factors.

The relevant set of factors for a specific project are identified, characterized and appropriately weighted according to their importance. The resulting evaluation matrix enables the comparison of factors across multiple alternatives and the selection of a short list of locations. The process continues with the development of the corresponding business cases, taking into account the specific costs and incentives of each location, as well as with direct contacts with local entities or other stakeholders that may be relevant for the project's future.

Working with investors that seek Portugal as a potential location for their investments, our experience is that the country normally stands out for having differentiating factors that include:

- Availability and qualification of skilled labor, with particular emphasis to the language skills (80% of students attending high school learn English and 63% learn French)
- STEM represents nearly 25% of total university graduates
- Unit labor costs are becoming more competitive, with a recent decrease resulting of the reduction of national holidays, vacation days and the reduction of the hourly rate for overtime
- Flexibility of labor laws regarding dismissal of workers and flexible working hours
- Financial and tax incentives for investment, including support to internships and job creation
- Immediate availability of office spaces at competitive prices
- High quality of road and telecommunication infrastructures

When emotional and subjective criteria influence decisions, investors tend to highlight the sense of security and environmental protection, as well as the availability and quality of health services, international schools and recreational and cultural activities.

There are visible differences in the degree of reforms different European countries have been willing to implement. As a result, we are observing a changing landscape in terms of competitiveness and, as a result, of FDI attractiveness, that seems to be favoring the periphery.

In the aftermath of the crisis, and as the future pace and sources of growth are still unclear, companies should focus on reassessing and rebalancing their value chain, and Portugal should definitely be in their radar.

From subcontracting or outsourcing to companies already present in the market, partnering with local producers or setting up manufacturing or service activities in Portugal, there are plenty of alternative strategies that can unlock value.

A special reference has to be made to the business services area. Over the last 10 years, there has been a nearly silent invasion of shared service centers, with different degrees of complexity, including a good number of projects in the engineering and software development areas. Is Portugal the hot spot for business services (almost) no one knows of?

Portuguese technology, global applications

"Portugal's technological capabilities, supported by its qualified human resources, should be seen as instrumental, as the country can perform as an effective pivotal location for expanding businesses into Africa, Europe, Latin America, Brazil and the US."

José Manuel Fernandes
Founder and Chairman, Frezite

EY's International Entrepreneur of the Year 2014 José Manuel Fernandes led Frezite in a 40-year journey from a small venture selling to international markets into a technology leader in specialized cutting tools with manufacturing facilities in Brazil and Germany.

Ever since joining the EU, Portugal identified the need to enhance its technological infrastructure, enabling it to transfer scientific knowledge and technology effectively to the real economy, i.e., to companies. This was partly achieved, but the country has still not realized the full potential of the expected results. As a result, the Government has implemented a program to reinforce the links between companies and universities, technological institutions and research centers.

Portuguese universities are becoming more effective in the transference of knowledge to the private sector, but are especially successful in the qualifications they offer to a new generation of physicians, engineers and researchers in multiple areas. This output of qualified resources, important for the local economy, is also being recognized by multinational companies who identify in Portugal opportunities to recruit in this pool of qualified talent.

A good indicator for the future is the impact of the number of doctorates that are being concluded in a business environment. The results already achieved by some companies demonstrate that challenges can be effectively transformed, through creativity and innovation, into opportunities that boost competitiveness. And at the core of this new engine of growth is the success in the interaction between universities and companies.

There is a recent increase of foreign investment in Portugal, where a key argument is the availability of qualified human resources. The quality of engineers, managers and scientists is also seen as a key driver for the re-shoring of some activities from Asia back to Portugal. The desirability of local talent is as much the result of the quality of training provided by local universities as of the characteristics these young people. On top of the good academic curricula, they normally demonstrate responsibility, a flexible and adaptable mindset, a goal driven spirit and the capacity to speak a second or even a third language. And the cost factor is also a plus: hiring an engineer in Portugal is already less costly than in China.

The best examples of sectors who invested in our country because of the availability of technological and human resources are automotive, aeronautics and aerospace. And the attractiveness requirements are still there for additional investment projects in these sectors to locate in the country.

When VW set up their plant in Portugal (AutoEuropa), the local supply chain could only deliver 38% of the outsourced components. That capacity currently stands at about 74%. The expansion of the aeronautics and aerospace industries is another example where engineering companies are delivering quality, either in response to local investments or by successfully exporting know-how.

Portugal's technological capabilities, supported by its qualified human resources, should be seen as instrumental, as the country can perform as an effective pivotal location for expanding businesses into Africa, Europe, Latin America, Brazil and the US. As a result, Portugal must be recognized as a partner for the future.

Perceived attractiveness

Measuring investor's perceptions

The attractiveness of a location is a combination of image, investors' confidence and the perception of a country or area's ability to provide future competitive advantages for FDI.

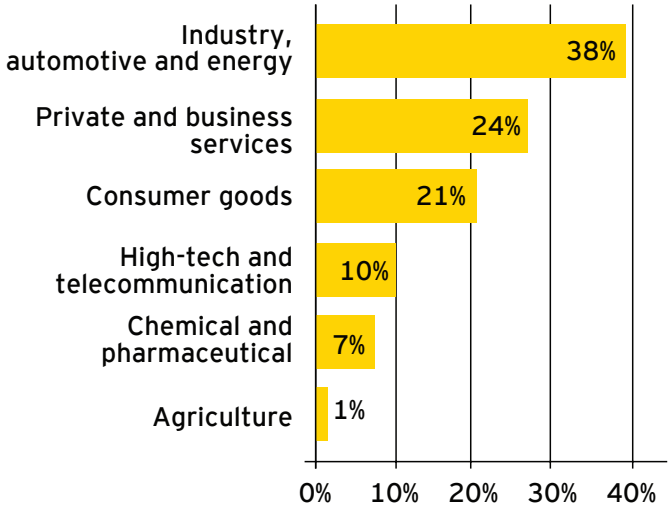
EY's attractiveness surveys have been measuring investors' perceptions of Portugal by using a consistent methodology to assess companies' views on the country.

To ensure the results are as accurate as possible, and that they do not rely exclusively on EY's clients perceptions, the sample selection and field research was conducted independently by the CSA Institute in February 2014. The interviews were conducted in 14 countries in five different languages (Portuguese, German, English, Spanish and French).

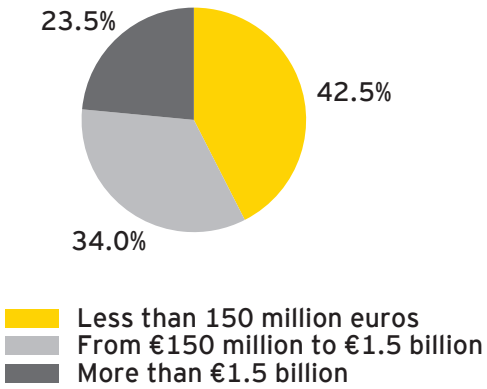
A panel of 200 international decision-makers was interviewed, representing companies that are already present in Portugal (115) and companies that currently do not have operations in the country (85). The sample has a global coverage but is aligned with historical sources of FDI into Portugal, with Germany, Spain and France as key investors. The sample is representative across company size, as measured by total turnover, and by activity sector.

Interviewees are normally board members or directors, with a clear view on the company's investment plans and on location criteria.

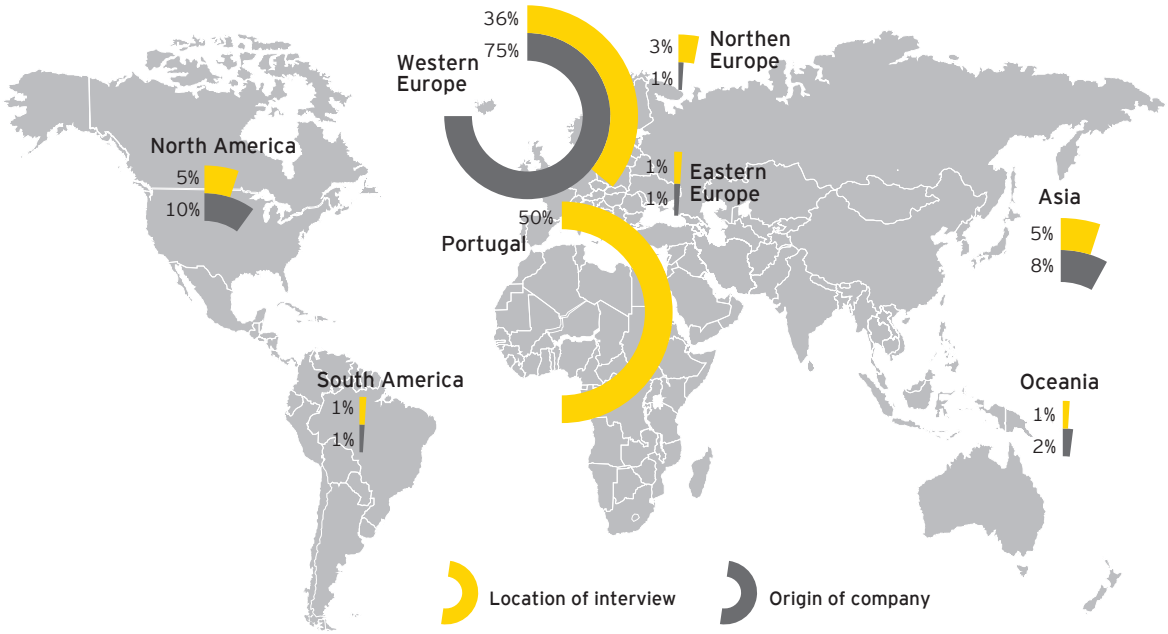
Sectors



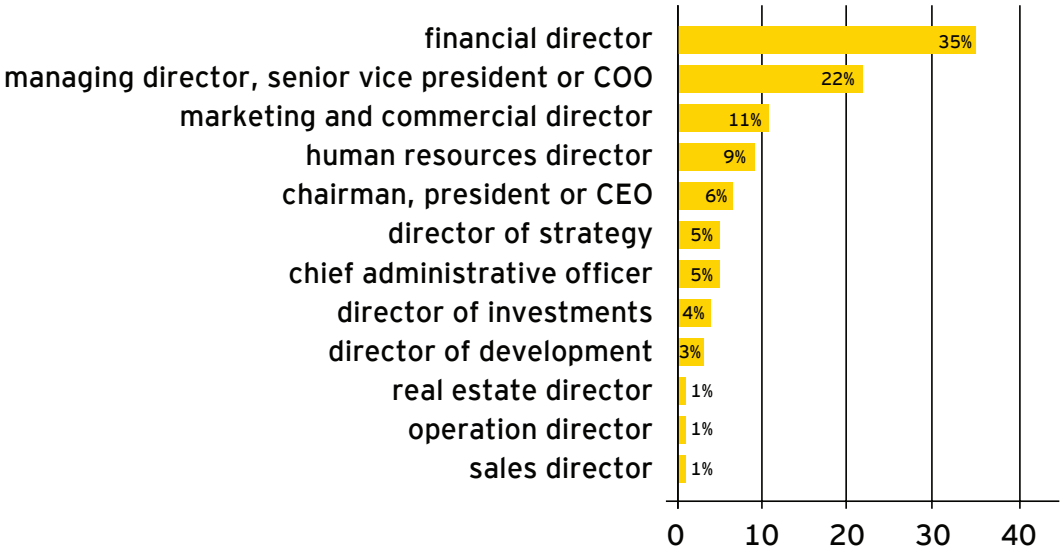
Turnover



Location of interviews



Position of interviewees



Attractiveness factors

What factors matter most when deciding on a location?

The panel was presented with a list of location factors and asked to select the three that are normally more significant to their company when deciding on a new investment location.

"Transport and logistics infrastructure" is the key location factor for 20% of the business leaders interviewed. When the first three choices are considered, 36% of the panel members selected this factor. This result is clearly influenced by the subset of companies already based in Portugal, with 47% of these selecting this factor in their top three, which compares with 20% in the subset of companies that do not have a direct presence in the country.

"Labor cost" is one of the three most relevant factors for 32% of the sample (44% in the industry, automotive and energy sectors), with 29% of the panel members selecting "the country or region's domestic market" and the "stability and transparency of political, legal and regulatory environment" (the latter two factors were selected by 38% of the subsample of companies not established in Portugal).

This year, "R&D and innovation environment" and the "level of protection of intellectual property rights" do not appear in the top 10 of investment location criteria.

The table below illustrates that companies that are not present in Portugal have different priorities in terms of investment location criteria, with a stronger emphasis on the need for stability and transparency of political, legal and regulatory environment, as well as of the size of domestic market.

This view is more aligned with the results of a broader study, conducted with a panel of 808 companies, which resulted in the 2014 *European attractiveness survey*. The report concludes that stability, transparency and the market size are the key location factors, with transport and logistic infrastructure relegated to fifth place.

The gap in the perception of companies already established in Portugal seems to reflect added sensitivity to logistical issues, since their operations normally target external markets.

Key location factors

Ranking of factors that companies take into account when deciding on a location to establish operations

	Total	Established in Portugal		Europe[1]
		Yes	No	
Transport and logistics infrastructure	1	1	7	5
Labor costs	2	2	3	4
Stability and transparency of political, legal and regulatory environment	3	3	1	1
The country or region's domestic market	3	3	1	2
Potential productivity increase for their company	5	5	4	3
Corporate taxation	6	8	5	8
Local labor skill level	6	7	6	6
Telecommunications infrastructure	8	6	7	9
Stability of social climate	9	8	9	7
Flexibility of labor legislation	10	10	10	10

1 – Data from the European Attractiveness Survey 2014 (based on 808 interviews)

Portugal's attractiveness factors

In this year's survey, the cumulative attractiveness score of "stable and predictable business environment" increased by 16% when compared with 2013. This factor was selected as the most important by 30% of surveyed business leaders and is one of the two key features to 50% of the interviewees.

This is a clear signal from investors that, although they recognize the current business environment enables them to continue to operate, they are looking for a continuous improvement in terms of stability and predictability of the legal and regulatory environment to continue to invest in Portugal.

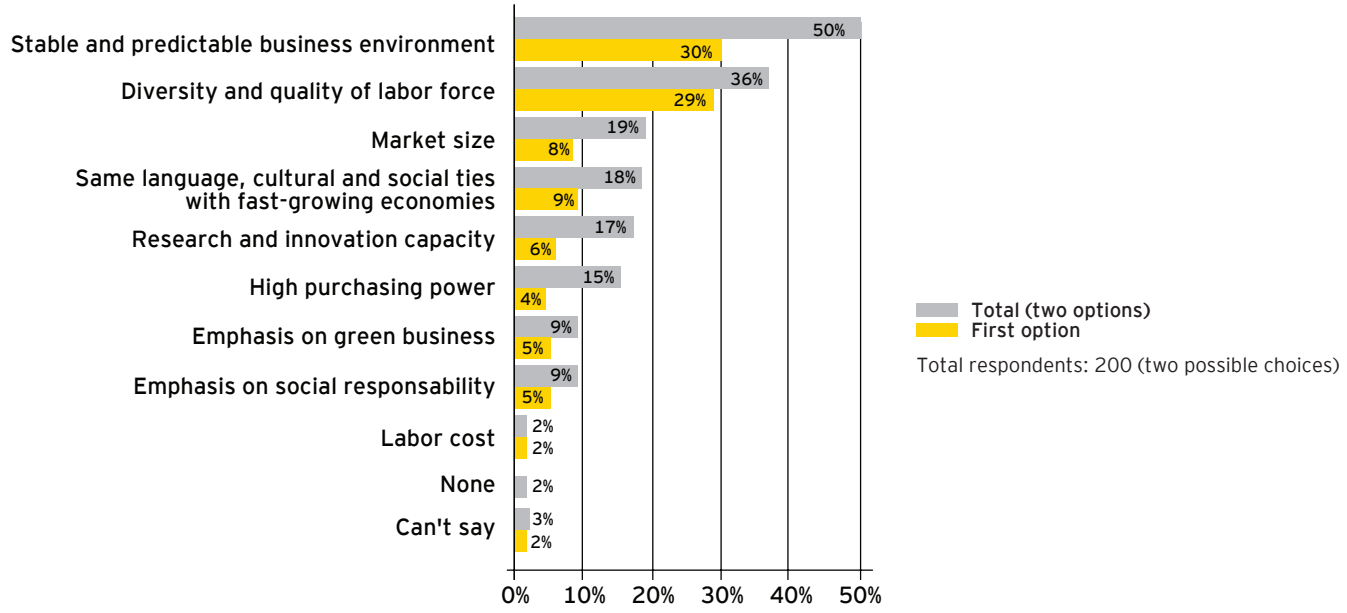
"Diversity and quality of labor force" is selected by 36% of the sample as a key reason for Portugal to remain attractive. Companies are aware that the high level of qualifications of the young workforce, coupled with historically high unemployment rates, presents opportunities. However, aware of the global shortage of talent, companies continue to signal the need for continuous investments in the qualification of the workforce.

"Market size" was selected as the first option by only 8% of the sample, with a total of 19% considering this factor as one of the two most relevant. Surprisingly, "Same language, cultural and social ties with fast-growing economies," essentially linked with a shared language and strong economic connections to Brazil, Angola and Mozambique, experienced a sharp decline as an attractive feature in investors' eyes. In EY's 2013 *Portuguese attractiveness survey*, the latter was considered Portugal's top attractiveness feature, being selected as the most important by 27% of business leaders and one of the two options for 43% of the interviewed investors.
This year, it is considered the fourth most attractive feature of Portugal, being one of the two options selected by just 18% of the interviewed investors.

Nearly one-fifth of the sample identified Portugal's "Research and innovation capacity" as a top attractiveness factor. This recognizes that there is a significant potential for R&D activities and could illustrate a growing realization of Portugal as an origin of innovative goods and services.

Most attractive features to establish operations in Portugal

What are Portugal's world-class features if it wants to remain a major destination for investment?



Regional attractiveness

Portugal's most attractive regions

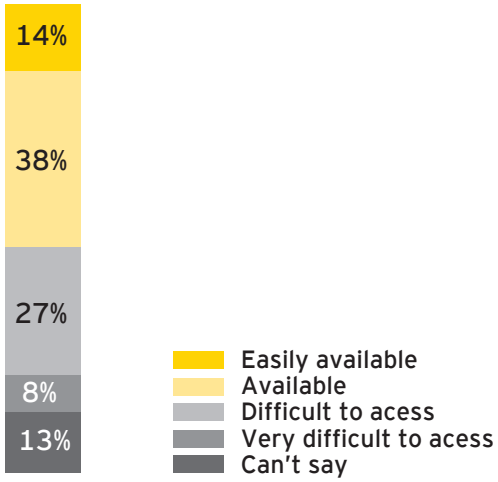
What region in Portugal do you see as the most attractive to establish operations?

The Lisbon area and Northern Portugal continue to be perceived by foreign investors as the most attractive regions for new investments, selected as such by 38% and 31% of respondents, respectively. Compared with 2013, Northern and Central Portugal are perceived as more attractive, registering 31% (vs. 27% in 2013) and 10% (5% in 2013) of preferences, respectively. Alentejo, Algarve, Madeira and Azores continue to be perceived by foreign investors as the least attractive regions.

Lisbon and Porto, the most populous cities in the country and the best served in terms of regular international flights, tend to be more visible to foreign investors. However, there is a significant number of second-tier cities (e.g., Braga, Guimarães, Aveiro, Coimbra, Leiria, Covilhã, Castelo Branco, Évora and Faro) linked by an extensive roadway network and with a good offer of infrastructure and support services (universities, R&D and innovation centers are, industrial and office spaces) that are failing to register in the investors' radars for new potential locations.

Access to information

How do you assess the availability of information on regional attractiveness?



Regarding the availability of information on regional attractiveness, only 14% of investors considered it to be easily available. For 35% of the sample, this type of information is difficult or very difficult to access, which is likely to result in a gap in the recognition of the real attractiveness of the various regions.

On a related question, 52% of investors confirm they regularly or occasionally receive information on the attractiveness of Portugal for foreign investment, but 40% of the sample does not receive such information, including companies already present in Portugal.

Since 25% of the companies who are not already present in the country could not identify a region they consider to be the most attractive, the perception of the attractiveness of the country as a whole could be improved by more widespread dissemination of information.

Corporate tax rate declining and strengthening incentives

"All in all, Portugal is today a less bureaucratic, more flexible, competitive and investment-friendly country".

Carlos Lobo
EY Portugal Tax Leader
carlos.lobo@pt.ey.com

Portugal has undergone significant changes in the last few years as a result of the economic and financial crisis. There is nowadays a clear intention to promote investment, create jobs and boost the economy. In the tax arena, several instruments have been introduced while others have been enhanced.

The non-habitual residents regime, introduced in 2009 to bring highly qualified individuals to Portugal, includes a 20% personal income tax rate on income derived from certain professional activities and tax exemptions on income sourced abroad (upon meeting several conditions). During the last couple of years, many pensioners moved to Portugal, attracted by the perspective of 0% tax on foreign pensions. A special tax regime for expatriates is also expected in the very near future to facilitate the internationalization of Portuguese companies.

Portugal does not have wealth taxes, except for a stamp duty charge on residential real estate valued at more than €1 million. The taxation of inheritances and gifts is low (10%) or even inexistent, inter alia, between parents and children.

As for corporate tax, very significant changes have recently been introduced and are expected. Firstly, there has been a reduction of 2p.p. in the standard corporate tax rate (from 25% to 23%), although the state surcharge has also increased 2pp for major corporations with annual taxable profits exceeding €35 million. Further reductions of the standard corporate tax rate are expected in the next couple of years, which may end up as low as 17%.

Secondly, it is now much easier and efficient to repatriate dividends under the dividend withholding tax exemption that has been extended to tax treaty countries.

Additionally, today's broad participation exemption regime exempts most dividends, capital gains from shares and foreign branch profits.

Foreign tax relief and Controlled Foreign Companies (CFC) rules have also been improved, and exit tax has been changed to conform EU requirements. Portugal can finally aim at being a good location for holding companies, making it an attractive platform for through-bound investments in other countries. Thirdly, tax losses can now be carried forward during 12 years (previously, 5 years), although with a cap of 70% on the annual taxable profit. Fourthly, new regimes for IP have been introduced, which either allow for a tax depreciation over 20 years (e.g., for trademarks and goodwill from business combinations) or a partial income exemption (e.g., for patents) to enhance R&D. The last one, combined with the low (5%) corporate tax rate applicable within the Madeira Free Zone until 2020 (licenses are still available until 31 December 2014), can result in a 2.5% effective tax rate.

Fifthly, Portugal will continue to provide financial and tax incentives for the acquisition of fixed assets until 2020, complemented with incentives to R&D that grant significant tax credits and several tax exemptions, as well as with job creation incentives. Start-ups may effectively pay no tax during the first years of activity by offsetting the tax credits derived from investment projects. Small and medium-sized companies also have available notional interest deductions and reinvestment of profits reliefs. These incentives, together with certain other provisions, aim to facilitate the recapitalization of companies.

All in all, Portugal is today a less bureaucratic, more flexible, competitive and investment-friendly country.

Central region of Portugal: promoting innovation, building competitiveness

"CCDRC has more than 2 billion euros available to invest in the region's development through 2020. Nearly half of this will be used to promote private investments that drive competitiveness and internationalization, including FDI."

Prof. Ana Abrunhosa
President, Regional Development Authority of Central Portugal (CCDRC)

Central Portugal exhibits attributes that are essential to the promotion of science and innovation and the building of sustainable competitiveness. Its key attractiveness factors include:

1. Territory – it is marked by a balanced network of cities with excellent quality of life indicators, the existence of two commercial ports (Aveiro and Figueira da Foz), excellent road infrastructure and good rail links to the major urban centers of Lisbon and Porto. The region is also the country's main gateway to Europe, given its accessibility to Spain and therefore the rest of Europe.

2. Qualified and competitive human resources – the region accounts for about 20% of the young population (0 to 14 years) in Portugal, with more than 25% of the population aged 30 to 34 having a university degree. With university campuses in the largest cities, including one of the oldest universities in Europe – Coimbra – and a renowned source of software developers and telecommunication experts – Aveiro – the region produces 17,000 graduates every year (22% of the national total). The areas of business (management, economics and accounting), engineering, mathematics and health account for 43% of these graduates.

3. Excellent scientific and technological infrastructure – featuring a network of universities, polytechnics and advanced research and technology centers, the region provides high-quality services and support to businesses.
It has a very strong heritage in industrial moulds, being the home of leading global companies and of the Portuguese Engineering & Tooling Cluster. CENTIMFE, the technology center for moulds, tooling and plastics, is internationally known. CTCV is the technological center for ceramics and glass, with CTIC playing a similar role for leather industries. Biocant is a dedicated park of biotech-focused science and technology. The availability of industrial sites in modern and well-run business parks completes the business-friendly package of the region.

4. Entrepreneurial drive – this is illustrated by the global success of many of the companies located in the region and built upon by a continuous flow of startups and spinoffs emerging from the universities and nurtured by a strong network of incubators. Pedro Nunes Institute, with an extensive track record in incubating technology companies, is a key reference in this area.

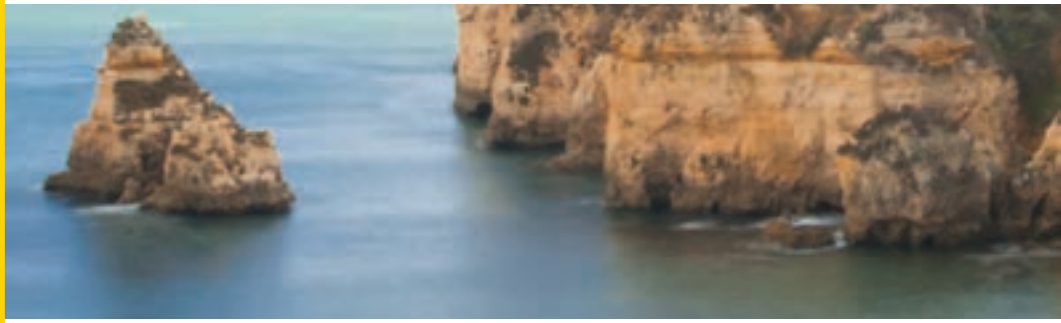
The Regional Development Authority of Central Portugal (CCDRC) is deeply involved in promoting foreign investment into the region, both by attracting new projects and by working with foreign companies already present in the region, monitoring and helping overcome any obstacles to their activities. CCDRC sees FDI as a key driver of technological innovation, strengthening the economic fabric and developing qualified human resources. FDI represents only about 3% of total employment in the central region, but is responsible for a turnover of about 22.5% of regional output, with a decisive impact on regional productivity.

In the next period of application of EU funds during 2014 to 2020, Central Portugal´s Operational Program gives a very clear priority for private investment. CCDRC has more than €2 billion available to invest in the region's development through 2020. Nearly half of this will be used to promote private investments that drive competitiveness and internationalization, including FDI.

Central Portugal offers opportunities to companies looking for business partners in one of our thriving industrial clusters, as well as in agriculture, tourism and business services. We also have the right solutions, from the border with Spain to our Atlantic coastline, for those seeking an investment location that combines the availability of qualified talent with easy access to European and global markets.

With the development of Central Portugal as our key driver, we welcome your challenges.

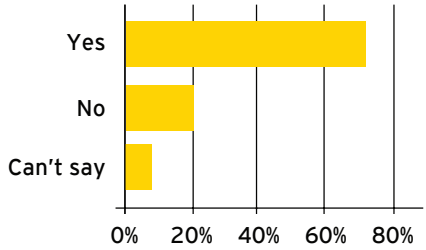
Confidence is back ...

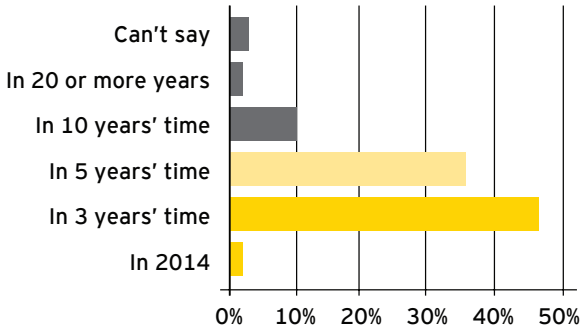


Investors are confident and resilient ...

Overcoming the crisis

Are you confident in Portugal's ability to overcome the crisis? How long will it take?





Total respondents: 200

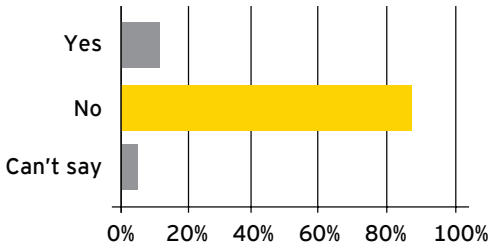
The flow of positive news on the country's implementation of reforms and overall economic performance is driving optimism, with 73% of the panel confident that Portugal will overcome the economic crisis. Those less optimistic about the pace of recovery represent 20% of the panel, a significant reduction from last year's 27%.

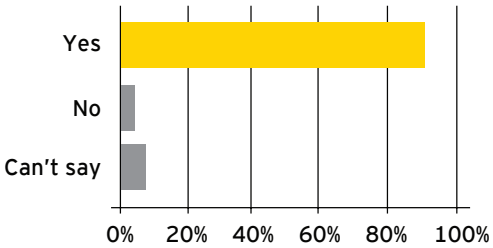
Established investors are far more confident (80%) of the country overcoming the crisis than those who are not present (64%). This could indicate a potential larger uptake in new investments from companies already present in the country.

For 85% of respondents, the effects of the crisis will be overcome in the next five years, with 47% estimating that three years will be sufficient.

Long term resilience

Do you have plans to relocate operations?
In 10 years, will you still manufacture in Portugal?





Total respondents: 115 (companies established in Portugal)

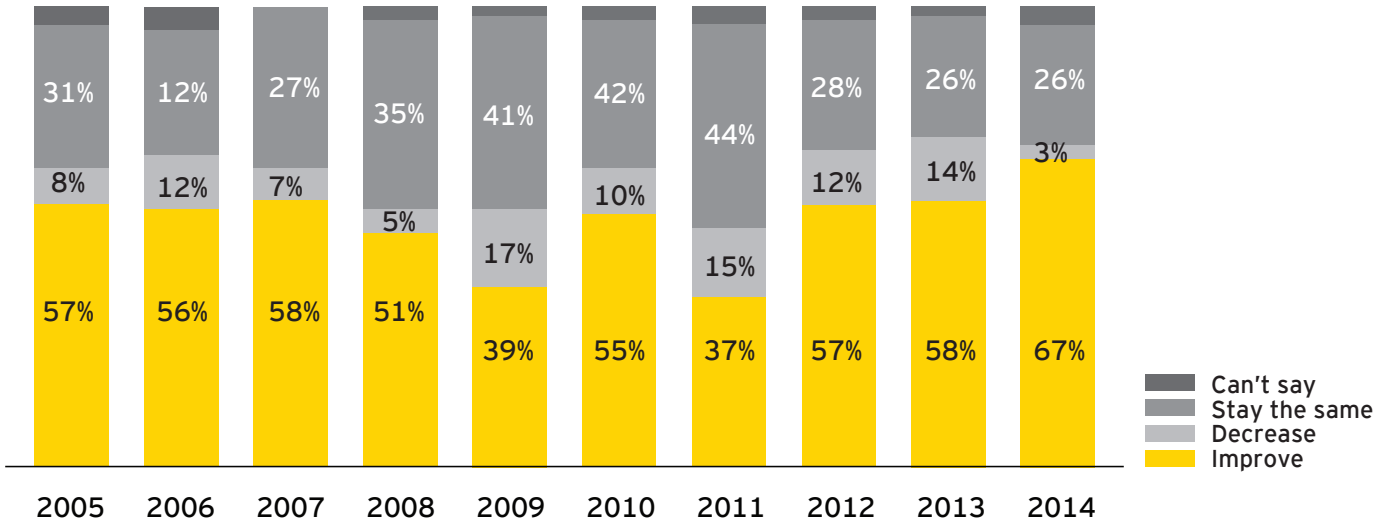
Eleven percent of investors are planning to relocate operations from Portugal, but a strikingly high 91% declare it will still be present in the country within 10 years' time (97% for companies with a turnover of up to €150 million).

This result can be partially explained by the increase of production costs in Asia, while unemployment remains high and labor costs fall in the periphery of Europe. As a result, re-shoring is becoming an attractive option for some businesses, where quality and speed to market are critical success factors. This reduction in the competitiveness gap with Asia, coupled with the advantage of having new product lines designed, manufactured and distributed in a couple of weeks, is already resulting in the relocation of activities to Portugal, both in manufacturing and in services.

... with perceptions of attractiveness at an all-time high

Investors are very positive about future attractiveness

How do you anticipate the evolution of Portugal's attractiveness over the next three years?



Total respondents: 200

For 67% of the panel, Portugal's attractiveness as an investment destination will improve in the next three years. This adds 10 percentage points to 2012's score and represents a solid 30-point improvement from our 2011 report.

With this result, 2014 sets a new record for the forward-looking optimism of investors in the nine editions of the attractiveness survey on Portugal.

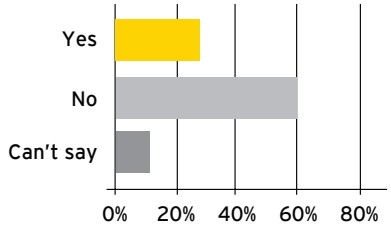
Portugal's score of 67% compares with 54% of positive perceptions as to the evolution of Europe's attractiveness over the next three years.

The subsample of companies already established in Portugal is more optimistic, with 79% of respondents thinking that attractiveness will improve. This is a significant increase from 2013, when the comparable result was of 60%. For non-established companies, this positive perspective is shared by 49% of respondents (53% in 2013).

From perception to decisions

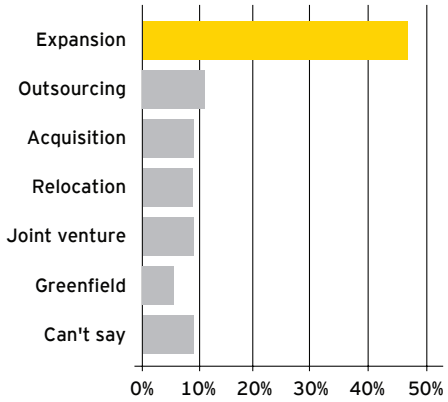
Investment intentions on the rise

Does your company have plans to establish or expand operations over the next year in Portugal? What type of investment? What type of project?



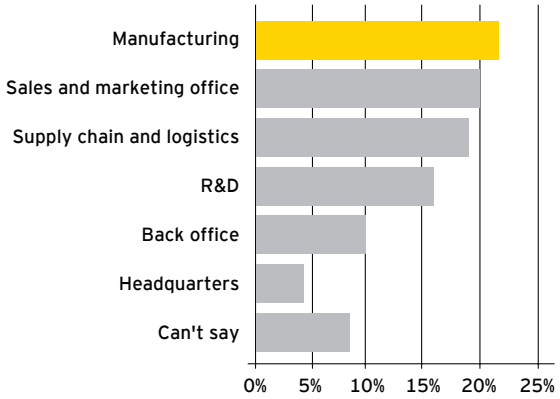
Total respondents: 200

More than perceptions, investors are confirming their plans to invest in Portugal in the short term. Twenty-seven percent of the panel has plans to invest in Portugal in the next year (22% in 2013). These intentions are higher in companies already present in the market, 37% of which signal imminent investments, but the potential greenfield investors are also increasingly confident, with 14% having investment intentions doubling the result of 2013.



Total respondents: 54

In the short term, most of the investment plans are linked to the expansion of existing operations (47%) and, to a lesser extent, to outsourcing (11%). Acquisitions and the relocation of operations into Portugal are both the choice for 9% of the panel.



Total respondents: 49

Manufacturing projects continue to lead investment intentions, but this year's 22% represents a steep decline from last year's 43%.

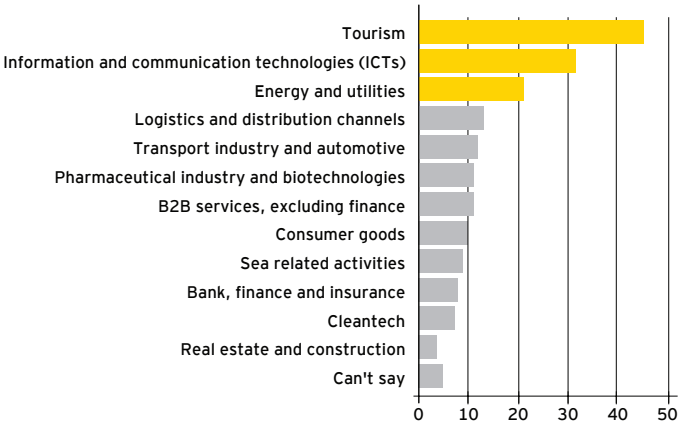
Investment intentions in R&D increase four-fold to 16% from last year's 4%. Coupled with the increase of investment intentions in business services (back-office and headquarters), from 3% to 10%, this indicates a clear movement of investors to tap into the opportunities presented by the existence of a large, qualified but unemployed, young workforce.

Tourism and R&D will lead growth

Sectors and business functions

Tourism and IT seen as drivers of Portugal's growth in the future

Which business sectors will drive Portugal's growth?



Total respondents: 200 (two possible choices)

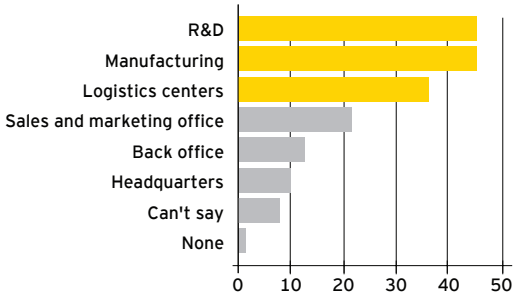
The panel identifies tourism as a key driver for growth in Portugal in the coming years, recognizing the country's competitive advantages, namely its location, climate, international access, safety record and heritage. With more than eight million tourist arrivals in 2013, representing a year on year growth of 8.3%, it's a sector with a good FDI track record and, based on these results, continued potential to grow.

The ICT sector is identified as the second key driver for growth in Portugal in the coming years. Considering the sector is highly dependent on access to qualified resources, this denotes confidence in the ability to attract and retain talent in the market.

The energy and utilities sector ranks third as to its potential to drive growth, with all remaining sectors apparently deemed as potential contributors for growth. This apparent lack of specialization seems to indicate the potential for investment opportunities across the board, in parts of the value chain that can benefit the most from the country's advantages.

R&D, manufacturing and logistics are key functions

Which business functions will attract the most investment?



Total respondents: 200 (three possible choices)

When asked to consider which functions, regardless of sectors, are most likely to attract foreign investment, the panel clearly highlights R&D, manufacturing and logistics as the most appealing.

An increasing number of investors acknowledge that the region's research, innovation and talent are its main strengths. This factor was selected as the business function that will draw the most investments in Portugal by 35% of business leaders and is one of the three options identified by 45% of the interviewed investors. This demonstrates confidence in Portugal's ability to differentiate and create added value with its universities, technological centers and research teams.

Manufacturing was the first choice of 27% of business leaders and is one of the three options to 45% of the interviewed investors. In this year's survey, the cumulative attractiveness score of this business function decreased by 5% in respect to 2013.

Closely related to manufacturing, logistic centers were selected by 37% of the sample, reflecting the potential to use Portugal as a production hub, with easy access to Europe and emerging countries, enhanced by good land, maritime and airport infrastructures.

My vision for the future of R&D in Portugal

"The scientific institutions, the Portuguese companies, such as Bial and HCP, have been building an ecosystem favorable to R&D-focused development, which is strongly open to new partnerships with global players capable of promoting investment and new business opportunities."

António Portela
CEO, Bial

Succeeding his father Luís Portela as the CEO of Bial, António continues the journey of a pharma family business that relies extensively on R&D based in Portugal to sustain growth. Bial has successfully developed and tested an epilepsy and Parkinson's disease treatment, which are already licensed for most major markets. The epilepsy treatment is already being sold in global markets.

In the last 20 years, Portugal has made profound changes to its scientific systems and has achieved great progress in its scientific capabilities, particularly in universities. As a result, the country today has renowned research centers in life sciences, working closely with the universities of Porto, Coimbra and Lisbon. The impact of these changes, which has allowed strong growth in the number of PhDs in science-based production and in the reputation of Portuguese research has also boosted a dynamic transformation in science-based industry, which is visible in a gradual change of companies' investments. Traditionally very focused on production (equipment and facilities), companies now focus more in the areas of knowledge, resulting in a better balance of private and public investment efforts in R&D. These changes resulted in the expansion of product ranges, with higher technology and increased exports due to the greater attractiveness of Portuguese production.

Since the early 90s, Bial has developed an ambitious R&D program that allowed us to contribute to these changes. As a result, we have launched the first Portuguese based medicine – the anti-epileptic Zebinix (Aptiom in the US) – and secured a first license in the Japanese market for a medicine to treat Parkinson's disease. These huge investments have resulted in Bial ranking second among Portuguese companies in investment in R&D.

The increase in life expectancy over the 20th century, extended by 30 years, and the complete turnaround in infant mortality in Portugal since the mid-70s, with the country now ranking in third place among all OECD countries, are examples of how the role of the industry is absolutely relevant in the evolution of societies and collective welfare.

However, as regulatory changes in the EU impose strong budgetary pressures on all Member States, the difficulties and delays in bringing new products to the market are increasing. As a result, there is a risk that, within Europe the role of research in life sciences will be compromised.

The pharmaceutical industry has a prominent place in the global economy. The industry invests more in research than any other, with a share of about 18.1% of the global amount spent on R&D. In Europe, pharma R&D now occupies second place with a relative spend of 17.5%, far from the 22.1% of the industry in the US.

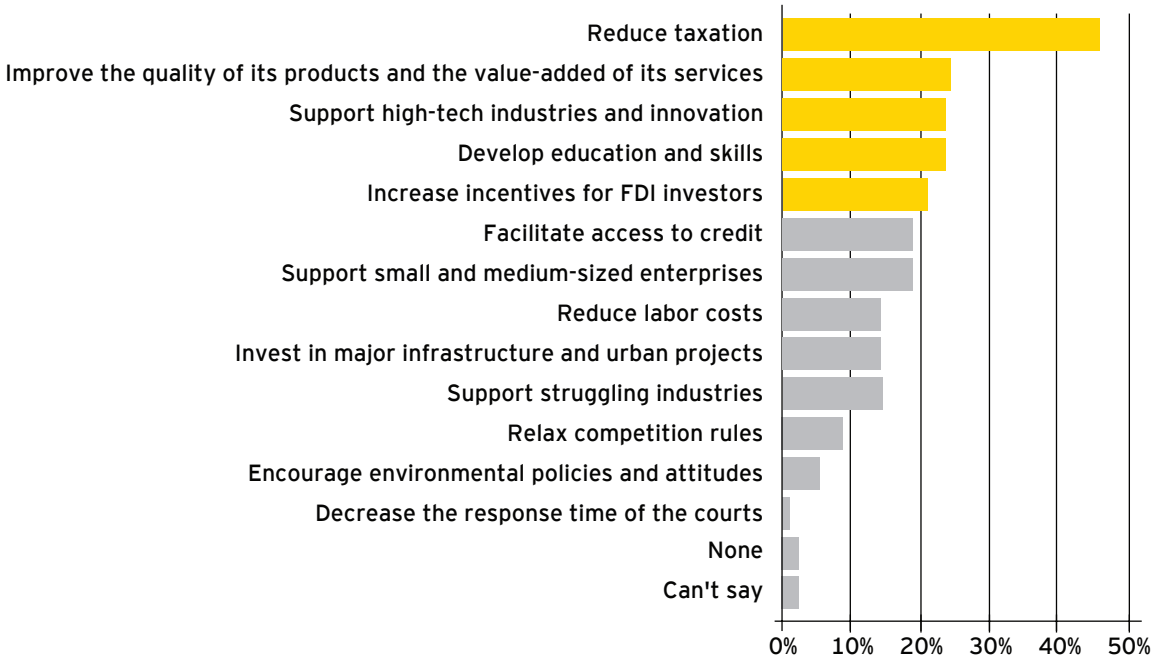
In Portugal, health-related activities are developing strongly, even in the context of the impact of austerity measures on the economy, resulting in positive growth of exports of goods and services. The emergence of new and relevant business knowledge, the development of health tourism, and the consolidation of alliances between scientific research entities all contribute to the leading role of Health Cluster Portugal (HCP) – which consists of more than a 1000 entities.

Given the current budget difficulties in Europe, there is a real challenge for the life sciences industry and the EU Member States to stimulate the quality and cost-effectiveness of health systems, while, at the same time, creating conditions for new investments in R&D in the industry. The scientific institutions, the Portuguese companies, such as Bial and HCP, have been building an ecosystem favorable to R&D-focused development, which is strongly open to new partnerships with global players capable of promoting investment and new business opportunities.

No room for complacency

Portugal must reduce taxation in order to remain attractive

Where should Portugal concentrate its efforts to remain attractive in the global competition?



Total respondents: 200 (three possible options)

The reduction of taxation is identified by 46% of the panel as an important action for Portugal's FDI attractiveness. This represents an increase of 13 percentage points from 2013, when respondents ranked "develop education and skills" as the top priority. Since this year's result was preceded by a tax reform approved in late 2013, which signaled a gradual reduction in the corporate income tax, investors seem to want more, sooner.

The following three factors relate to quality and added value of products and services (24%), support to high-tech industries and innovation (22%), and the development of education and skills (22%). This selection illustrates consistency and an interesting perspective in terms of the way forward, from investors' point of view.

Investors' seem to signal that a continuous production of talent, requiring a modern education system, coupled with an active support to innovation and high-tech activities, will enable companies to increase the quality and added value of their output. The combination of the three factors would result in a faster pace of growth and job creation, with the upside of positioning the country as a source of high-tech and added-value products and services.

Interestingly, labor costs are indicated to be less relevant to investment decisions in Portugal than human capital development and the overall business environment, namely taxation, access to credit, incentives and support to SMEs and innovation.

Research and education are no longer the first priority; investors want further economic reforms

How will Portugal improve its competitiveness in the coming years?

		Competitiveness	Total	Established in Portugal	
				Yes	No
Economic governance	29%	Reduce the deficit and the debt	13%	19%	6%
		Stabilize the economic government	10%	11%	8%
		Set up a common European economic governance	6%	7%	4%
Flexibility	18%	Reduce bureaucracy	9%	15%	2%
		Reduce government intervention	4%	2%	6%
		Relax labor laws	3%	3%	4%
		Reduce business regulation	2%	1%	2%
R&D and education	15%	Focus on R&D, innovation and technology	8%	4%	13%
		Focus on education and training	7%	10%	2%
		Encourage entrepreneurship	7%	6%	8%
Support to enterprises	14%	Focus on industry and manufacturing	4%	2%	6%
		Support SMEs	3%	3%	5%
		Lower labor costs	6%	3%	11%
Competitiveness	14%	Reduce taxation	6%	7%	5%
		Lower manufacturing costs	2%	3%	1%
		Other	5%	5%	1%
		Can't say	5%	1%	4%

To enable the identification of other areas considered important by investors to improve competitiveness, the survey included an open-ended question, asking for guidance on how the country could improve its competitiveness.

Economic governance, both local and at the European level, is the issue most commonly referred to, with a clear bias of already-established companies as to their concern about public deficit and debt.

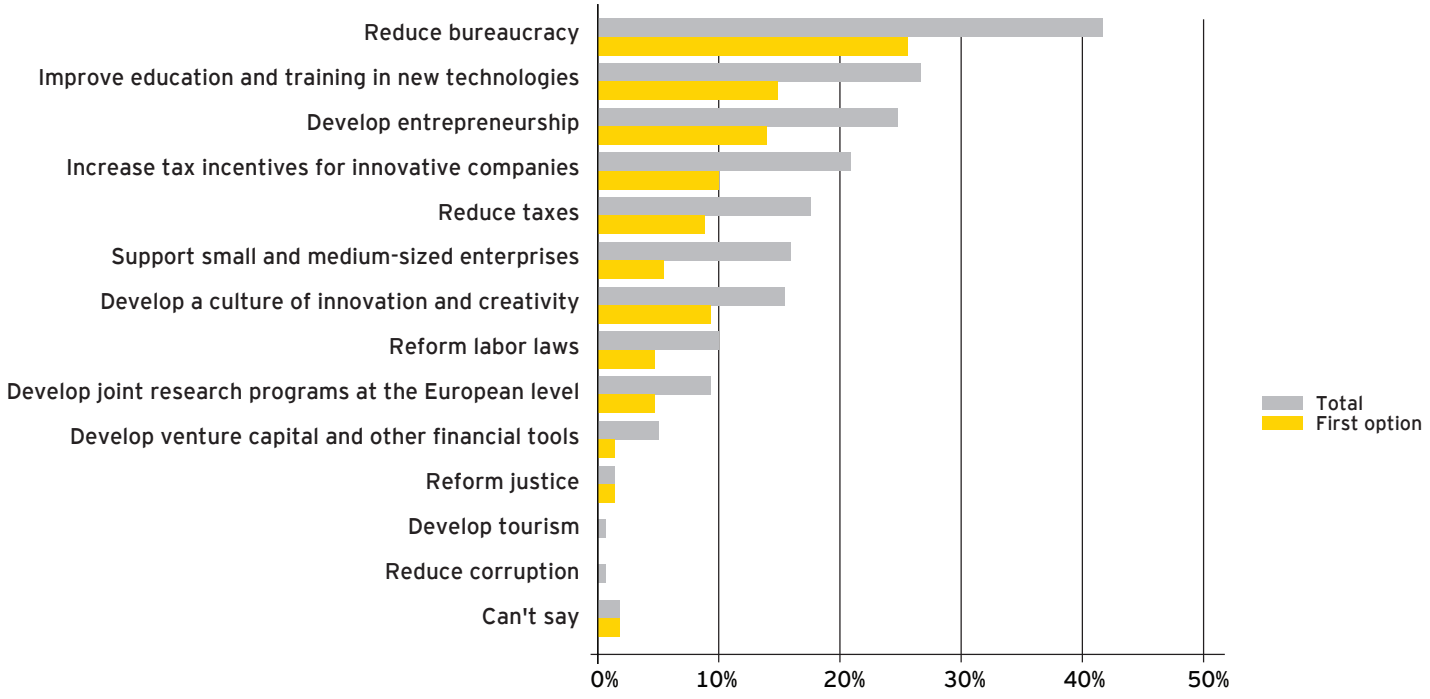
Established companies highlight the reduction of bureaucracy and the need to invest in education and training as key requirements for added competitiveness.

Companies that are not present in the country place a lower weight in those matters, selecting the need for an added focus on R&D, innovation and technology, as well as in lower labor costs.

Investors require continued reform efforts

Key reforms to promote innovation

What reforms should Portugal implement in order to make it a leader in innovation?



Innovation is commonly accepted as a key growth engine for developed economies. When asked about the reforms Portugal needs to make in order to become an innovation leader, 42% of the panel identified the reduction of bureaucracy as the key initiative. It should be noted that this factor was selected by 51% of the companies with a turnover of up to €150 million.

Education and training in new technologies (27%) is the second area where investors believe additional efforts must be made to foster innovation. This area is especially relevant for large companies, with 40% of those with a turnover in excess of €1.5 billion interested in more efforts to generate qualifications in new technologies.

The promotion of entrepreneurship (24%), the support to SMEs (17%) and the development of a culture of innovation and creativity (16%) are identified as key triggers to promote innovation. All of these factors, coupled with the investor's interest in incentives for innovative companies (21%), fall within the priorities announced for the application of the EU funding available throughout 2020.

The impact on public policy

Central Government

Creating, developing and maintaining a country's attractiveness for investment is one of the most challenging and pressing tasks for any government.

The rewards for achieving and sustaining attractiveness are plenty, as measured through job creation, access to technology and regional development. They also have an implicit political outcome, as the positive impacts on the economy naturally reflect even more positively on those that promoted such policies.

But FDI attraction is a relentless, long-term endeavor, with a long business cycle. The more visible investment decisions in manufacturing can take two to five years to materialize, and then another one to three years to start generating a clear economic impact. Such time frames exceed normal political cycles. Even for services projects, which can be decided and executed in months, building an adequate pool of talent, creating the infrastructure and developing and nurturing an ecosystem of innovation requires an extended time frame of suitable public policies and actions. This requires a coherent, consistent, long-term approach where public policies build upon each other, always presenting to potential investors a clear vision as to the path being followed and a mainstay of stability, periodically combined with the necessary measures to match the competitors' innovations.

FDI attraction is also one of the most competitive global "businesses." As more and more economies enter the global stage, there is increased competition for natural resources, funding and talent. For countries with abundant natural resources, this added competitiveness is their key driver to attract FDI. For the less endowed, such as Portugal, remaining competitive requires the trust of those who have the funds, the capacity to develop and retain talent and the ability to create value around the existing resources, as is the case with renewables and the touristic potential of the country's heritage and geographic diversity.

Competition for FDI is especially fierce In Europe. Since a large number of regions and countries have achieved high levels of development, they can all claim to be effective locations for most investment projects. As a result, communicating a country's attractiveness is essential to build favorable perceptions and, more importantly, to convert intentions into investments.

The survey provides interesting insights into the investor's wish list to improve Portugal's attractiveness, which can be grouped into four major themes.

Taxation

This is clearly a sensitive area, both to investors and the Government, since the pressure to reduce the public deficit is necessary to demonstrate international credibility and does not offer much scope to reduce taxes. But clear efforts should be visible on:

- **Stability** – businesses have enough risk without investors having to take up the additional risk from an uncertain taxation landscape. The recent reform of corporate income taxes was a step in the right direction, but investors need a clear indication that further changes will be limited, directed to further reductions in the tax burden and dependent only on clear, known variables.
- **Certainty** – as much as they want reduced taxes, investors also look for transparency in their relations with tax authorities. Increasing the number and effectiveness of the key account managers for large taxpayers could be complemented with more consistency in the application of regulations and decisions, faster response times to queries and faster decisions from tax authorities.
- **Credibility** – announced budget policy objectives must be attainable and must be met.

The total taxation, the distribution of taxes between corporate and personal income, the balance between direct and indirect taxes and the reduction of public expenditure are central to any discussion on the governance and sustainability of public debt. Even if some of these topics have different priorities for the political parties likely to be involved in any future government in the next decade, there is a broad consensus that businesses should be given conditions to flourish, as private growth is the only avenue for compliance with the public international commitments on fiscal balance and debt. Such consensus should be visible, namely through political commitments that provide investors with clarity on the evolution of key aspects of taxation, even under different Government regimes.

Education

The investors´ focus on the labor market has shifted from cost and regulation to qualifications. When an investment decision is made, time to market is essential. Companies do not have the time to wait for resources to be trained nor the interest to cover the full cost of that training. If either occurs, they are likely to choose a different location. Even though the investors recognize the availability of qualified workers as an attractiveness factor in Portugal, they know that talent is in short supply and that younger generations are more mobile. The education system must be prepared to cope with this, both by attracting foreign talent that promotes international networking of future businesses and by providing the qualifications the market requires, from the shop floor to the R&D departments up to management positions.

Innovation and entrepreneurship

Having successful entrepreneurs develop competitive businesses combines the effects of generating employment, creating value, attracting funding and demonstrating the country's international competitiveness. The ongoing policies to promote innovation and entrepreneurship must be sustained and continuously combined with strategies from the education and tax areas to nurture a risk-taking and business-oriented culture in younger generations.

Investment promotion and retention

As with any business, FDI normally requires less investment to gain client loyalty than to acquire new clients. As such, aftercare activities are essential to identify any difficulties investors are facing before they start thinking of relocation. The same effort should also be put into the identification of opportunities to assist local management teams in attracting expansion or greenfield projects from their parent companies. Even though one-to-one contacts with potential investors are the most effective way to generate leads, the dissemination of fact-based information is essential to overcome the prejudice of investors toward smaller markets, especially when they have become too visible for the wrong reasons. Although central coordination is essential for consistency, regions play a particular role in the definition and promotion of their attractiveness factors and should be pillars of the overall message to investors.

Regions, municipalities and cities

In the competition for FDI, there is not a single formula that can define who the most successful players will be. Different projects have different requirements. Some may become viable simply by having access to a pool of 10 very specialized workers in a small village. Others require massive economies of scale only attainable with access to large markets.

The complexity of competing for FDI does not mean smaller competitors cannot succeed; it simply means they should know when to compete, what their competitors are offering, how to differentiate themselves from their competitors and how to address the requirements of foreign investors.

National public policies should be consistent with the international promotion of the country while enabling stakeholders from different levels to prepare themselves to attract investment. A focused and consistent sector, regional and national message is essential to ensure Portugal's visibility as an attractive destination for investment and will ultimately be beneficial to all players, even if they will sometimes be competing for the same projects.

Public policies should strengthen the capacity of cities, municipalities and regions to map out and promote their attractiveness factors. As smart specialization is a key element in the allocation of EU funding through 2020, it is also important that regions, groups of municipalities and cities clearly identify their strengths, prepare their pitches and learn to cooperate while competing, namely by sharing international networks.

International investors have a positive impression on the overall attractiveness of the country but seem to be relatively unaware of the details of the value proposition being offered to them. As the depth and quality of information improves, as it is more widely distributed and as more teams are prepared to interact professionally with foreign investors, the results are likely to be as positive as the existing investor's perceptions.

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The Portuguese economy and the potential for transactions

"As the recent export performance demonstrates, these companies are being successful at adding value to its products and services. Competitiveness is now driven by a more sophisticated positioning in the respective value chains rather than just on production costs. Differentiation, as a result of technology incorporation and design, is being driven by access to innovation centers and qualified resources."

The global crisis brought the opportunity for a new cycle, especially in economies with structural financial and fiscal imbalances and the will to change.

Since 2011, Portugal followed a strict plan of budget consolidation and structural reforms in areas such as education, health, infrastructures, justice and competition. Targeted at reducing the public deficit and debt, these measures improved competitiveness and enabled a return to the international markets; as important to the financial systems as it is for public debt.

These efforts have already resulted in a return to growth, in job creation and in competitiveness. In early September, the World Economic Forum ranked Portugal as the 36th most competitive economy globally. This represents a significant improvement over the previous year (51th) and places the country ahead of Czech Republic, Poland and Italy, and in line with Spain (35th).

However, firms are still faced with critical challenges, namely regarding their capital structure. Excessive leverage affects solvency and profitability, resulting in difficulties to access bank credit. Limited access to investment capital places increased emphasis on the imbalances of private economic activities,

From a business perspective, this is a key turning point for the Portuguese economy dynamics. In fact, investors are faced with interesting business opportunities: a country with an attractive business environment, an increasingly sustained fiscal and financial public framework and high-potential firms looking for financial resources that can potentiate their growth prospects. Portugal has strong players in a number of traditional sectors – such as textiles, footwear, ceramics and cork – but also in other areas – such as automotive parts and assembly, electrical equipment, engineering and tooling, pulp and paper IT, tourism and business services.

As the recent export performance demonstrates, these companies are being successful at adding value to its products and services. Competitiveness is now driven by a more sophisticated positioning in the respective value chains rather than just on production costs. Differentiation, as a result of technology incorporation and design, is being driven by access to innovation centers and qualified resources.

By investing in Portugal, namely entering the capital structure of existing local and high-potential firms, foreign investors find a fast lane to add capacity in a location with price stability and the logistic flexibility to serve both the European and global markets. Foreign investors also gain access to management teams experienced in other markets, taking advantage of Portugal's privileged positioning as a platform for emerging markets such as Angola, Brazil or Mozambique.

On the other hand, mergers, acquisitions and other types of firm partnerships constitute an opportunity for local firms to access financial resources, balance their capital structure and benefit from new management insights, gaining scale and reinforcing the international potential of their business.

EY Portugal, and the Transaction Advisory Team in particular, have been perceiving this trend and mutual benefits to investors and firms very closely, by supporting clients across a variety of sectors and providing services related to M&A, due diligence and valuation.

Our knowledge of the Portuguese economy and of working with local firms gives us the confidence to expect continued growth in the number of M&A operations in our country and to recommend a close scouting of the existing opportunities for foreign investors.

My vision for M&A opportunities in Portugal

"The return of a more stable and credible macroeconomic environment, combined with the attractive conditions created by historically low asset prices, is creating a growing interest among investors, both national and international, which is feeding this new surge of M&A activity."

António de Sousa
ECS Capital, co-founder

On the rebound from the financial crisis, there are several lessons that we can learn and ought to keep in mind:

- Very easy and cheap money is not, and will not be, available anymore
- Many corporates continue to be over leveraged
- Globalization (offering an enhanced balance of opportunity and risk) is key for success

In Portugal, many companies are clearly at a crossroads in terms of generational change. Moreover, asset prices are still relatively low by international standards.

Therefore, we believe that we are going to see, in Portugal, a significant increase in M&A activity, due to the need for capital investment and to acquire scale so as to be able to participate fully in the forthcoming new wave of international trade and activity. The need to create extensive worldwide networks and marketing abilities, as well as production and logistics far beyond the old export models, requires a financial strength that is not available for most companies that grew based on very limited equity and bank-provided leverage.

The new generation of managers and owners are more inclined to favor combination strategies to tackle the shortcomings of previous approaches based on bank funded leverage; they have seen many marginal companies being bankrupted or becoming easy targets for those pursuing equity-based growth strategies.

The return of a more stable and credible macroeconomic environment, combined with the attractive conditions created by historically low asset prices, is creating a growing interest among investors, both national and international, which is feeding this new surge of M&A activity.

We can see already an increased movement toward alternative capital sources where non-banks play an important role. Private equity will surely play an important role in this movement given the difficulty, mainly due to lack of scale and the disproportionate compliance costs, of accessing directly capital markets and the need to get out of the old mode of depending solely on banking credit.

Private equity with access to funding, the capacity to produce new equity contributing to the deleveraging process, and finally, crucially, the ability to push for more professional and less owner/family centered management, is in a unique position to drive this new stage of economic recovery in Portugal.

How EY can help

Solutions for investors

With offices in Lisbon and Porto, EY Portugal offers the full scope of EY's services in all its service lines: Assurance, Tax, Advisory and Transaction Advisory Services.

Our teams work closely with the financial system, private equities, venture capitalists and privately owned businesses. This in-depth knowledge of the local market enables us to offer a set of services that covers all stages of the investment process:

Identification of acquisition opportunities

- Identification of a list of potential targets, based on the investors' requirements
- Development of initial contacts, with non-disclosure agreements, leading to detailed negotiations with selected targets

Validation of acquisition opportunities

- Financial, tax, commercial, environmental and regulatory due diligence
- Asset valuation
- Business model validation
- Assessment of tax implications

Acquisition and integration support

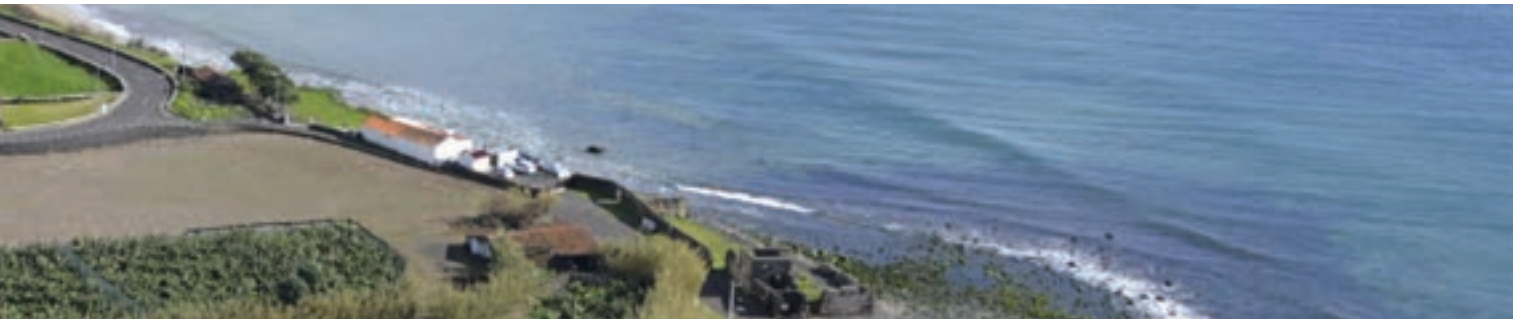
- Technical support to acquisition negotiations
- Identification of local funding opportunities
- Identification of tax and EU-funded financial incentives
- Design and implementation of transformation programs to enable a swift and smooth integration process
- Value chain assessment and identification of logistical and tax improvement opportunities
- Operations assessment and identification of performance improvement opportunities
- Assessment of internal control procedures, including IT
- Assessment of the existing compensation policy and design of compensation packages matching compliance with local regulations and the investor's own policies
- Tax compliance support to expatriates
- Accounting and reporting

Assessment of greenfield opportunities

- Site selection based on location requirements
- Initial business model preparation, reflecting investment, financial and operational costs based on local conditions
- Initial contacts with national and local stakeholders and identification of funding opportunities, including tax and EU-funded financial incentives
- Preparation and assistance to in-site visits and formal contacts with national and local stakeholders
- Identification and selection of local suppliers, based on sourcing requirements

Ongoing support

- Accounting compliance and reporting
- External audit services
- Tax compliance and reporting



Working with the public sector

EY's Investment Location Advisory Services provides our teams with knowledge of the investor's requirements when approaching an investment location decision. This enables us to assist Governments, investment promotion agencies, regions, municipalities and public companies in improving the way they attract, receive and provide aftercare services to foreign investors.

EY can support public entities in FDI-related matters through:

Attractiveness assessment

- Identification of existing attractiveness factors and bottlenecks for FDI and exports promotion
- Assessment of investment locations

Investment promotion

- Identification and validation of targets for FDI promotion
- Compilation of *Doing Business in*... or regional, sector-specific or investor-specific investment brochures
- Preparation of regional business model templates for specific sectors
- Initial setup and definition of procedures for the updating of data sets typically required by investors
- Setting up and facilitation of roadshows and one-to-one meetings with potential investors

Training and governance

- Training of teams on lead generation, handling of requests, meeting preparation, field trip organization and overall management of investment projects
- Advisory on the setting up and management of investor support services (investment decision and aftercare)
- Advisory on the setting up and management of local investment boards, with key stakeholders for FDI-related issues

Investment intentions' assessment

- Validation of business models
- Investor due diligence
- Assessment of regional impacts
- Sustainability assessment

Ongoing support

- Facilitation of focus groups with existing investors to assess satisfaction, identify relocation risks and expansion opportunities
- Facilitation of investment board meetings
- Create investment attractiveness dashboards to measure results

About EY
EY is a global leader in Assurance, Tax, Transaction and Advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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