

FRANCE

Cheese Market
in Provence.

The French Paradox

High taxes should deter foreign investors, but labor quality, opportunity and research-friendly policies keep them coming.

By Howard Stock

Famous for having its own way of doing things, France has become considerably more open to foreign investment in recent years. According to French governmental organization Invest in France, inward FDI stock amounted to 42% of GDP in 2012, up from 29% in 2000. “France is now widely open to FDI and that FDI is today not far from being as important as domestic investments,” says Jean-Nicolas Soret, a partner at Altana.

France held onto third place in terms of foreign direct investment (FDI) in Europe last year despite a 12.8% drop in FDI projects to 471, resulting in 19.9% fewer new jobs (although they still amounted to a sizable 10,542, Ernst & Young says). The decline was due in falling investment from France’s European peers, although it remained the destination of choice for new manufacturing projects. FDI projects from the U.S. picked up the slack, with Amazon embarking on a major investment project that created almost 3,000 French jobs and bolstered the country as a logistics destination to rival

Germany. To aid France’s chances this year, French Prime Minister Jean-Marc Ayrault launched at the National Pact for Growth, Competitiveness and Employment. In concert with the government’s efforts to curb spending, early signs are that the measures are starting to enhance employment prospects and French competitiveness.

Indeed, the Banque de France recently noted that more than 46% of the 40 CAC index—the 40 biggest market cap companies on the French stock exchange—is held by non-French residents. “The reality is that the French economy is fueled by foreign investors. Today, 20,000 companies registered in France are currently held by foreign shareholders,” Soret says.

Pierre Descheemaeker, a partner in August & Debouzy’s corporate practice group, says FDI will remain a significant growth factor. “While the current government’s ambiguous policy may have sent mixed messages to foreign investors, the business community nevertheless remains extremely open to FDI,” he says, noting that

Amazon joins a growing list of major U.S. companies investing in France, including General Electric and Microsoft, and new investors from emerging markets China, Brazil, Mexico and Qatar are generating even more.

The door swings both ways, adds Edouard Milhac, a partner at CMS France, pointing out that as many as 30,000 French companies have a presence abroad. It all stems from France's institutional support of FDI. "Invest in France is a body in charge of favoring FDI inflows by foreign companies, but it also supporting FDI outflows by French companies around the world," he says. Invest in France is implemented in 10 European countries, has seven offices in Asia, five in the Americas and two in the Middle East

TAX INCENTIVES

One factor that stands particularly in France's favor is its popular research and development (R&D) tax credit. This scheme allows for a corporate income tax credit up to 30% of R&D expenses incurred by the company, up to €100 million per year.

The French government also recently created the so-called talent passport, which is aimed at encouraging skilled foreign professionals to work in France. In addition, despite "an unfortunate rise in certain taxes rates," Soret says the Hollande government has maintained schemes implemented by the former Sarkozy government, such as the exemption of the most part of capital gains realized by companies subject to corporate income tax.

The National Pact for Growth, Competitiveness and Employment and its key measure, the Tax Credit for Competitiveness and Employment (CICE), should also be an important element for ensuring France remains one of the most popular global destinations for FDI in the next few years. CICE is aimed at refunding businesses from their income tax up to 6% of the salaries paid to their employees.

"The government now has a more business friendly attitude, recognizing the need to overcome the structural difficulties of France and to some extent relax the burden of social charges on companies in France," says Raphaël Mellerio, founding partner of Aramis.

French politicians' reluctance to initiate severe austerity measures has limited the slowdown of the French economy in the past two years compared to many of its neighbors, says Pierre Descheemaeker, a partner in August & Debouzy's corporate practice. "Although the corporate income tax rate remains high and increased again this year, several mechanisms have a significant softening effect, such as the R&D tax credit. Similarly, managers moving to France enjoy for five years a more favorable tax treatment than French tax residents."

French rules also make it fairly easy to conduct business, says Laurent Ségal, a partner at BCW & Associés. "The number of strategic sectors that require an admin-

istrative authorization prior to investing is limited and no restriction applies in terms of buying land or appointing officers originating from an OECD country," he says, adding that "the difficulties do not lie in the regulatory environment regarding investments but rather in the feeling that French labor law is far too complex and protective for employees and social taxes too high."

While the economic downturn took its toll on the entire economy, it revealed certain bright spots for investors, most notably in sectors where intellectual property is strong, either through patents or trademarks. "This is why many investments happen in the high tech, pharmaceutical, biotech and fashion industries," Soret explains. Other investments relate to distressed businesses that foreign investors buy for cheap and turn around with new management, he says.

SOURCES OF FDI

While France attracts investors from the U.K., Germany, the Benelux (a union of states comprising Belgium, the Netherlands and Luxembourg), Italy and, after a

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lull, Japan, the U.S. remains the largest source of FDI.

France attracts only limited investments from emerging countries compared to the U.K. and Germany, Mellerio says, with only relatively small investments by Chinese and Indian companies in the healthcare and digital sectors, partly due to the fact that French companies don't have much visibility in emerging countries compared to U.K. and German groups. "For instance, the tender offer made jointly by China Fosun and AXA Private Equity on Club Med is due to the fact that the target has significant presence in Asia," he says. This project is currently suspended as several minority shareholders have instigated court actions on the ground that the bid price was too low.

In terms of individual transactions, Europe leads the way with 403 projects in 2012 and is followed by North America with 179 projects. The BRIC countries are increasing their investments with 8% of the projects compared to 1.5% in 2003, Milhac says.

With a partial shift in global wealth from West to East, however, BRICS—for Brazil, Russia, India and China—may start accounting for a greater piece of the pie. "Although it's not yet a massive trend, we have seen investments and transactions made by Chinese investors in the wine, technology and leisure businesses, as well as Indian investments in the metal business and investment from Middle Eastern countries in hotels and sports," Soret notes. "For example, we advise Korean group Samsung on a regular basis. We have

also represented the Indian group Tata International, as well as a Chinese investor on an acquisition project.”

In terms of where that money is going, French regions attracting most FDI in volume are Ile-de-France (around Paris), Rhône-Alpes (around Lyon), Midi-Pyrénées (around Toulouse) and Provence Alpes-Côte d’Azur (Nice region). “Rhône-Alpes is a privileged area for the chemical and healthcare industries and Midi-Pyrénées is known for its aeronautics and digital industries,” Mellerio explains, adding that government incentivizes the creation and development of industrial clusters where the reputation of the country is high, such as aeronautics, energy and luxury.

For U.S. investors, France is something of a gateway to Europe, says Soret, whose firm represents a number of clients headquartered in the U.S., including Johnson Controls, Quintiles, Systemax, Idexx Laboratories, Bank of America and Pfizer. “Our experience is that with the recovery of the U.S. economy, our U.S. clients are again active on the French market and the majority

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of them continue seeking opportunities for growth rather than implementing or contemplating downsizing measures,” Soret says.

About 1,200 U.S. entities that have operations in France, Mellerio adds, representing more than 440,000 jobs in the country. “U.S. companies usually praise France for the quality of its transport infrastructures and the productivity of its workforce,” he notes. However, France’s labor legislation is widely seen as too complex and cumbersome, and the tax environment can be volatile.

UNION ACCORD

In March, Brazil announced a 10-year energy plan that France remains far more union-heavy than the U.S., which can lead to disruptions, but mindful of their effects, French unions are proactively addressing challenges before they turn into crises. “A historic agreement was entered into between the main employers’ unions and three employees’ unions in January 2013 to foster social dialogue and prevent as much as possible court actions in the context of labor disputes,” Mellerio says. “It introduces a certain degree of flexibility in relation to mobility of the employees and the implementation of social plans.”

While union negotiations can get complicated, foreign owners are paying for quality. Milhac notes that according to the Conference Board, France is ranked among the top three European countries for hourly labor productivity.



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Add to that France’s excellent infrastructure and culture of industrial and technical innovation, and it’s no surprise so many French startups soon attract foreign investors. This includes the acquisition of the printing specialist Impika by Xerox, the purchase of the ophthalmology company Novagali by Japanese Santen, the sale of human shape automated device manufacturer Aldebaran Robotics by Softbank, and the acquisition of Stallergenes by Swiss Ares Life Science.

Stock markets like NYSE Alternext Paris play an important role in this respect, with the creation of segments dedicated to mid-size companies and by providing a good level of visibility for issuers, as well as detailed and reliable information for investors, Soret says. That being said, many experts agree that FDI could be encouraged through a more steady overall tax environment in France, combined with a more uniformed fiscal policy within Europe.

“The regulatory environment in France continues to be generally seen as a hurdle rather than an encouragement to investment,” Mellerio adds. “France continues to have constraining labor regulations and is characterized by an unstable and extremely complex tax regime. What’s worse is that some recent tax amendments are retroactive.”

The unstable legal and tax environment weighs on FDI, Milhac agrees, but current tax code should attract investment in R&D, augmented by the high standard of education and productivity of the French workforce. France is also a gateway not only to Europe, but also to the Middle East and Africa which should see there FDI increase significantly in the next coming years.

In fact, rather than harping on challenges, France should probably work harder to communicate its strengths, Soret says. For example, according to Eurostat 2012, France is first in Europe in the aerospace and nuclear industries, and second in the chemical industry. While developing countries will probably experience faster growth, “investing in France will remain a wise decision for all investors looking for an access to the European market, a steady environment, a highly skilled workforce, innovative products and people and well-known trademarks,” he says. ■