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Supply Chain: Your Brexit Competitive Advantage

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Planning your post-Brexit supply chain

For over two decades, trade between the UK and the EU has been based on trade agreements that allow free movement of labour, goods, services and capital. You now need to plan for a world where these trade agreements may be very different.

Managing a supply chain between the UK and the EU has been relatively straightforward, however the UK's vote to leave the EU is expected to bring large-scale change, with a range of challenges as well as potential opportunities.

Whatever the outcome of Brexit negotiations, it is wise to start that planning now, to ensure you remain competitive in the changing market. Early and effective scenario planning combined with analysis of the potential consequences of a post-Brexit economy might even improve your position. Many businesses are watching and waiting for signal or policy statements to inform their views on how the relationship between the UK and the EU will work in the future.

Recent speeches from the UK Prime Minister, Theresa May, made clear the UK's intention was a clean break from the European Union's single market – "a Hard Brexit" – with a willingness to leave the single market without a replacement deal in place, if it is better for Britain: "no deal is better than a bad deal".

The specific mechanics of how this separation will work remain unclear. Will people be able to move between the UK and the EU as freely as they do now? Will different regulatory standards apply? Will potential trade tariffs significantly impact the bottom line? Will alternative Free Trade Agreements open new markets?

These are just a few of many significant questions that supply chain professionals need to appreciate and understand. Even though answers to many of these questions are still unknown, it is important that businesses do not wait for concrete answers or policies, but begin to work through potential scenarios and plan their responses now. Then, when required, they will be prepared to change business practices, review their core operating models, switch suppliers, renegotiate contracts or move parts of their supply chain activities into new territories. They will also be able to do it faster because they started thinking and planning sooner.

Aside from free movement of goods, people, services and capital, there are many other aspects of Britain's relationship with the EU that we expect to change as a result of the Brexit negotiations. They include the regulatory, tax and VAT aspects of the relationships between the UK, the EU and other parts of the world.

Normally, business planning is based on hard facts and detailed information, but the Brexit negotiations will create a different situation, meaning business will need to develop plans in the face of many unknowns, using informed speculation and hypothetical scenarios to inform business strategy. These plans can then be adjusted, improved and refined as more information is released through the course of the Brexit negotiations.

What we know

The countdown to Brexit starts when the UK triggers Article 50 of the Lisbon Treaty, which is currently targeted for March 2017. That signals the beginning of up to two years of negotiations that will decide the UK's new relationship with the EU.

Beyond this, much is uncertain, including what form negotiations will take or when and how information will emerge. However, some change is already happening, and it is possible to predict other significant developments that will affect businesses in the near future. We call out several areas we recommend are considered:

1. Foreign exchange – Sudden impact

For businesses importing raw materials to the UK, costs rose overnight when sterling fell by 20% on news of the UK's vote to leave the EU. Yet the same change meant stronger demand for finished goods exported to the EU and beyond. Businesses should be looking at their currency hedges as well as analysing their risks related to raw materials costs.

2. VAT, international trade compliance and customs – Anticipating change

Unless the UK government manages to negotiate an agreement with the EU that it can stay in the EU for free movement of goods, retaining its current VAT and customs duty integration (no other country has this without free movement of people), it is expected that there will be a customs border put in place between the UK and the EU. This is likely to lead to extra paperwork for import and export declarations and charges for goods passing both into and out of the United Kingdom, as well as taxes, duties, tariffs and import VAT. Businesses can start to model the impact on revenue, cash flow, clearance times and margins using the existing known scenarios for the UK's post-Brexit relationship with the EU. It could be complex and time consuming, but it will leave them better equipped to make informed decisions on their post Brexit operating strategies. Also, the basis for UK VAT law will alter, so there could be changes to VAT relating to goods moving between the UK and the EU and for domestic sales.

3. Systems – New data requirements

A new trading relationship with the EU could mean extensive work to reconfigure product master data in ERP systems with information such as revised routings or sourcing information, BOM and cost data, supplier data, invoicing, tax reporting, dispatch note requirements, customs duty and VAT and shipping costs. It is likely that Brexit will call for systems to handle more complexity in terms of information held, and frequency of data submission, for customs declarations. It is important to consider how much systems change each of the Brexit scenarios will need, including short-term fixes, so that you will be able to move more quickly when the situation becomes clearer. If you were considering an upgrade, it might be the time to bring it forward – though not to make a final commitment. If you are in the midst of a systems project, make sure there's plenty of flexibility built in.

4. Contracts – Take care with long-term commitments

Inevitably, Brexit will have an impact on both existing and future supply chain contracts. This means a potentially huge exercise to review existing agreements to understand how Brexit might affect their viability and whether it is possible to change or break them early. For new contracts entered into during Brexit negotiations, it means extra work assessing the likely impact of Brexit (despite all the unknowns) and building in enough flexibility to accommodate uncertainty.

The business environment running into and during Brexit negotiations will remain fluid. Organisations, and specifically supply chains, will need to retain a greater degree of agility to respond to short term impacts and potentially defer decisions, to allow the business to respond correctly once the trading environment starts to take on greater shape.

What could Brexit look like?

Although the aims of the Brexit negotiations with Europe are currently rather vague, we have created three simplified options that help bring to life what Brexit could look like. Whilst in reality none of the scenarios will be an exact match to how the UK's trading position will conclude, it is important for businesses to understand the likely impacts of each, in order to start to plan effectively in the medium and long term.

	A New EEA	*New FTA*	*WTO*
	The UK keeps almost all its access to the single market, with some limits on free movement of labour.	The UK takes a hard line on free movement of labour and loses substantive access to the single market.	Extended negotiations leave the UK with the same status as any other nation trading with the EU based on World Trade Organisation rules.
What it means for trade	• Preferential access to the single market means trade with the EU carries on much as before, while the UK may also be able to negotiate new deals with non-EU countries once the Article 50 negotiations are over.	• The UK only secures free trade, i.e., no tariffs but still border-controlled movements of goods with the EU. Countries outside the EU can negotiate to open up trade with the UK, but they can't sign new trade deals until the two-year Article 50 negotiations are over.	• The UK leaves the single market. It can negotiate new trade deals with other countries, but delays to the Article 50 negotiations would hold them up resulting in standard WTO tariffs applicable in the meantime. WTO trade deals can take some years to negotiate.
What it means for supply chains	• Limits on free movement mean potential employment issues. • Some changes to tax and legislation. Rises in logistics lead times and costs from import/export duties. • Many EU laws and regulations will still apply.	• An EU customs border means higher costs, more administration and a more complex supply chain. • Stricter immigration controls affect businesses' ability to use EU workers in the UK and vice-versa.	• Uncertainty makes demand volatile and supply chains more complex. • A customs border between the UK and EU adds administration and tariff costs. • Using EU workers in the UK and vice-versa becomes complex.

What will Brexit mean to the supply chain?

The potential impact and opportunities of Brexit extends across many aspects of the supply chain that are central to competitiveness and profitability. These changes will range from redesigning the network to reconfiguring systems. Below are seven possible areas of impact. This list is not exhaustive and the relative impact and importance of each may change as more is known about the outcome of negotiations.

Tariffs: Think through supply chain footprints

Global manufacturers with lucrative UK markets will want to preserve business as usual despite the upheaval of Brexit, and many will have the scale to absorb new tariff costs. But if that barrier becomes too high to be viable, they will need to compensate. In sectors with long product cycles, like Pharmaceuticals and Automotive, it will be difficult for businesses to replace preferred, hard-to-find, potentially validated specialist suppliers. Instead, they might ask critical suppliers to help offset higher costs by moving to locations with, for example, lower trading costs with the UK or lower labour costs to offset the COGS impact. It may also be possible to look to ease logistics costs through government grants and incentives. Also, some industries that have used near-shoring extensively, like fashion, may look to bring some operations back to the UK.

Legal: Be ready for upsides and downsides

Businesses have to be ready to assess a three-way legal impact on contracts, people and intellectual property. How easy is it to renegotiate existing contracts, or leave them if you need to? What safeguards can you build into new contracts to protect against uncertainty?

Prices and costs could fluctuate enough that existing contracts aren't viable any more. So it's vital to know now how flexible those contracts are. This means businesses must review their contracts for risks they could face, and whether they have the option to renegotiate – or even leave – relationships that might not suit them anymore. For any new contracts, businesses should negotiate safeguards against supply chain risks, like changing commodity prices or currency fluctuations. Given the number of contracts requiring review, it may be possible to use artificial intelligence-based capabilities to digitise contracts and 'industrialise' the review to pinpoint risks and opportunities.

How easy will it be for businesses based in the UK to employ workers or use suppliers from the EU– and vice-versa? If you rely on EU citisens employed by a supplier, or employ them yourself, it is important that you have a fall-back plan if free movement of people between the UK and the EU ends. Also, be sure you know which employees or suppliers will be affected by immigration changes and what you may need to do to be sure you can bring in specific high-skilled help when you need it.

It is important to be clear on your Intellectual Property protection, given that some EU rights might not be available to UK-based businesses. For example, the unitary patent will protect inventions in up to 25 EU countries, making administration and enforcement cheaper for businesses. If the unitary patent is not available to UK businesses, innovations in products, services and processes could be more expensive to protect.

Customs: Model the impact on profitability

A new customs border between the UK and the EU means new costs, and businesses can predict these costs now. A Japanese business with a European distribution centre in the UK, for example, could face duties on goods entering the UK, and more duties when those goods move on to continental Europe. Even in a Free Trade Agreement, the duties could still apply. Then there is the cost of making import and export declarations paid to brokers for goods moving to and from the UK to the EU. Businesses need to understand all these transaction costs to see if their supply chains are still viable and the degree of change to maintain a defined cost base.

A UK retailer importing from outside the EU might think there's no issue that arises from Brexit. But their goods would incur costs if first entered into the EU en route; which may be how the supply chain is currently set up. Also, if the goods qualified for lower or nil-rate customs duty based on the EU's trade agreement with a source country, Brexit could force up the customs duty on the imported goods. So, they could need a plan B.

Could some manufacturing come back to the UK? Or could businesses switch their distribution hubs? Businesses can start making informed decisions now if they have the right data to produce accurate models. Much about Brexit is uncertain. But analytics, including our own tool, can help give businesses early insight into duty and customs declarations costs under a range of Brexit scenarios.

VAT: *Be ready for extra costs and administration*

When the UK stops being a member of the EU, sales of goods between the two will become imports and exports for VAT purposes. That means import VAT may be due for payment as goods cross the border travelling either way. As well as systems changes, businesses will have to manage extra administrative and cash flow costs. UK businesses with pan-European supply chains may also miss out on VAT simplification measures that avoid the need for local VAT registrations. So businesses might again face an extra administrative and systems burden.

Also, UK businesses could face a cash-flow hit if it takes longer for them to recover VAT. Non-EU businesses do not automatically benefit from the EU's simplified VAT reclaim mechanism.

Businesses in the EU and the UK will need to review their supply chains to understand the possible knock-on effects of VAT changes on their systems, product costs and how this flows through to product or service profitability.

New duties, VAT and administration costs and fluctuating exchange rates could add up to a cost increase that businesses can only handle by putting up prices. That, in turn, could put a strain on demand and test customer loyalty. So, start thinking now about how you can educate customers on the need for higher prices. At the very least, early work here could help reduce the shock of later price hikes because you have taken the trouble to prepare customers.

Supply chain hubs: *Assess how it affects pan-European business*

Businesses trading across the EU currently have simplicity on their side. For instance, consumer goods businesses often have pan-European supply chain operations, with manufacturing, warehouse and stock locations across the EU designed to minimise costs and maximise service levels. Brexit adds new complexity to their planning. The EU will be one market, the UK another. Businesses now need to plan earlier based on where stock is going, where it needs to be held, and any impact this will have on service and cost.

For example for perishable goods, how do you make deliveries in 24 hours with a border to cross, and an associated cost? Do you hold stock in the UK and Europe to be able to service them both quickly? Do you serve the UK from a European hub? Do you customise stock in the UK so you can hold it at an aggregate level in the EU?

Working through these questions and laying down contingency plans now could put you ahead of your competitors. By the time you decide you need a new UK warehouse, there could be a shortage of infrastructure capacity available to build it. Taking an option on space or land gives you the chance to move quickly.

Lead times: *Work out the impact on planning and margins*

Longer lead times caused by new customs bottlenecks could affect service levels and margins – especially for goods with short shelf lives. Goods in transit are goods that are not on shelves – or in shopping baskets. For example, businesses used to the flexibility of finalising quantities of fresh food, for example, barely hours before dispatch will have to do more planning, further ahead, taking on more risk. No retailer will want to be understocked. That might mean them buying more than they need, leading to the potential need to offer more discounting and suffer greater product waste or obsolescence.

How fast could you start trading with a new supplier? Again, planning for that scenario now could give you an advantage. You may be importing from a country that has a great trade deal with the EU. When that deal stops including the UK, a UK business might need a new supplier. Start talking to possible alternative suppliers now, before your competitors take up all their capacity.

Grants and incentives: *Check for news on how government will fill the funding gap*

Businesses across the EU currently benefit from incentives, from grants to R&D tax breaks. For example, institutions like the European Investment Fund and European Investment Bank currently match investment in

UK biotech research. Their support is vital to bridge academic and clinical research. The UK government has said it will cover the funding gap that is likely to appear. Will grants be available at the same level? Will they attract the top academics? And what will the process be for applying for funding, and what form will it come in? Other industries will have similar questions about grants and incentives for their sectors, which could affect where they base parts of their supply chains. The UK government may see a new chance to stimulate UK manufacturing, but may not have the funding to help every sector.

How could Brexit affect your supply chain?

The impact and severity, be it positive or negative, caused by Brexit will be different for all businesses. It will depend upon their specific situation, from primary trading or sales channels to industry sector, to ownership model and product value and margin. Also, importantly, how each company decides to address the many factors that will impact their operations as outlined in the above section as they position for a post Brexit operating environment.

The potential issues and opportunities for these different business types can be predicted. Some examples of these are explained below, alongside recommended actions for businesses in order to minimise impact of potential issues and maximise potential opportunities. This is not an exhaustive list of models, but a framework to help categorise the areas to be investigated and understood given a business specific operating model.

1. Exporting to the UK

Manufacturing and configuring in the EU and the rest of the world. Distributing to the UK market.

Issues

- Higher costs triggered by foreign exchange movement could force up prices and hit demand in the UK.
- New customs costs and longer shipping times could add costs and force up prices.

Opportunities

- New trade deals between the UK and non-EU countries could make links with new suppliers possible.

Actions

- Investigate whether to move manufacturing to the UK.
- Assess the impact of tariffs and customs charges on costs and profitability.
- Talk to suppliers about sharing any increased costs.

2. Multinational

Making or configuring products in the UK with UK raw materials plus imported work in progress and imported raw materials. Distributing to markets in the UK, EU and the rest of the world.

Issues

- Higher costs for importing raw materials from the EU, and exporting goods to the EU and the rest of the world.
- More complex supply chains.
- UK suppliers could suffer if new trading barriers make customers look elsewhere.
- Cash flow could be impacted if trading terms are changed adversely.

Opportunities

- Mapping the supply chain could help spot ways to improve it – for example, by relocating parts of it or renegotiating contracts.
- Relationships between the UK and non-EU markets could become viable once the UK negotiates new trade deals.

Actions

- Assess whether higher demand in the EU could offset lower demand in the UK.
- Investigate whether UK suppliers could take over from EU suppliers to limit costs.
- Explore the potential of other non-EU markets.
- Put contingencies in place for UK suppliers and customers destabilised by Brexit.

3. UK captive

Manufacturing in the UK with raw materials mainly sourced in the UK. Distributing to markets in the UK, EU and the rest of the world.

Issues

- Higher customs costs and longer shipping time to the EU and the rest of the world. The UK currently ships as an EU member, so arrangements may change post-Brexit.

Opportunities

- New UK trade deals could open up more non-EU markets, and suppliers based outside the EU could win new UK clients.

Actions

- Decide whether EU markets are important enough to open new manufacturing facilities there.
- Assess whether new non-EU markets and a weaker pound could offset the higher costs of exporting to the EU.

4. Manufacturing and configuring in the UK for export

Manufacturing and configuring in the UK with imported work in progress. Exporting work in progress to the EU and rest of the world.

Issues

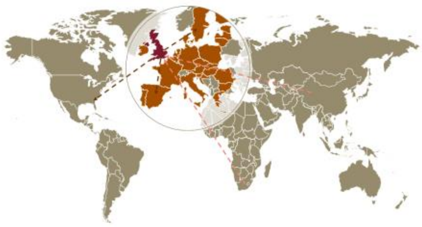
- Higher customs costs and longer shipping times for goods travelling into and out of the EU.
- Less freedom of movement could cause a labour shortage, and higher costs.

Opportunities

- Foreign exchange movement could mean lower prices and so higher demand from the EU.
- Grants could make relocating production to the EU possible.

Actions

- Assess whether it would be worth relocating production to avoid new customs costs and longer lead times, as well as labour shortages.
- Explore potential shipping costs with suppliers.



How do you make the most of the Brexit opportunity?

As the official notification for Brexit gets closer, there are many unknowns for businesses in terms of how changes may affect them as well as many impacts that are becoming clearer. In the face of this uncertainty it is important that businesses take the time to understand the potential impacts of Brexit on all areas of the business.

Some of the potential impacts resulting from the UK's decision to leave the EU might have a perceived immediate, and negative impact; others might have positive longer-term benefits. What is clear, as the trading landscape between the UK and the EU starts to take shape, is that it will be critical for your business to understand all considerations so you can make timely, informed and measured management decisions.

In order to do this, it is important to build a plan capturing all the scenarios and responses available. The plan will change as the situation develops but it is important that it is in place, providing a basis for fast, structured analysis and discussion.

Businesses that are well prepared will be able to adapt effectively in response to the challenges brought about by Brexit, as well as being equipped to capitalise on the opportunities that will arise. Having a list of considerations and scenarios is important, but businesses need to also be aware of how quickly alternative arrangements can be implemented once concrete information does appear. These could provide you with a tangible "first-mover" advantage if your business has the response plans ready and can adapt, switch or remodel at pace.

It is well proven that strong businesses can absorb shocks and recover fast. Some even thrive on unpredictability by seizing the opportunities it presents. Looking at historical disruptions – environmental, economic or political – proves that organisations with robust contingency planning frameworks thrived. Work through the Brexit scenarios to see the potential impact on your business, and become clear on where you need to strengthen. Understand the risks to your business and take action to mitigate them now where you can, as well as seeking advice where required to support your planning.

Who to talk to

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