Act or react?
Navigating your business through political uncertainty

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Brexit, the triggering of Article 50 and political uncertainty pose familiar dilemmas for businesses: take action now and risk investing resources on an outcome that may or may not materialise? Or wait and risk greater costs and disruption? Prime Minister Theresa May’s decision to call a snap election on 8th June has added another layer of uncertainty.

Unsurprisingly, there has been considerable reluctance in some boardrooms to act immediately, awaiting a stronger signal about where the UK might be heading.

Clarity around Brexit negotiations may not be forthcoming in the near future. Article 50 will trigger a two-year negotiation period to settle the UK’s exit from the EU. Negotiators in Brussels will confirm that any transition period involving complex discussions regarding money and who will police the transition, may be agreed last. Although the route of direction may be evident earlier, waiting until the end of the negotiation period may leave insufficient time to take measured action before rules and trading arrangements change. Doing nothing can in itself be a risk.

So how should businesses balance firm commitments with sufficient flexibility to deal with political uncertainty over, at least, the next two years?
1. Understand and quantify odds and scenarios

The first step is simply to understand and quantify the impact of different outcomes on a business, relative to both probabilities and competitors.

A thorough Brexit diagnostic across the business could isolate the areas or events that are more prone to impact, that in turn warrant further steps or actions. A recent EY diagnostic for an organisation showed surprisingly limited exposure to changed labour mobility rules relative to its competitors, but an equally surprising reliance on EU funding for total R&D spend. No business is ever likely to eradicate uncertainty. However, managing to minimise uncertainty could deliver businesses an edge on their competitors.

2. Assess the impact of the worst-case scenario

A negotiated outcome of a reasonably deep Free Trade Agreement (FTA) is still the most likely scenario. However the prospect of no deal, or a very limited deal between the UK and the EU, is a real political possibility, resulting in the UK falling back on World Trade Organisation (WTO) rules in 2019. The biggest risk to a negotiated outcome is a mismatch in perceptions on both sides, leading to early hostility in negotiations. In Westminster, the WTO outcome is increasingly being ‘normalised’ amongst influential groups; UK Prime Minister Theresa May has explicitly stated that “no deal is better than a bad deal”, whilst in Brussels, the perception is that no trade deal would be a lot worse for the UK than the EU and London would never risk it. In reality, neither side is bluffing.

Businesses that fully assess the impact of this scenario as well as their competitor activity, will be well positioned to make an informed decision as to whether a response requires immediate consideration.

3. Deconstruct Brexit into meaningful parts

For many, “Brexit” is so wide-ranging that it is not a meaningful planning concept. Therefore, a beneficial exercise is to deconstruct it into manageable parts that may be translated into concrete business considerations. This can be areas which directly link to the actual Brexit negotiations, such as workforce, regulation, supply chains and exports. Alternatively, this may be areas linked to drivers associated with the stability and confidence in the wider Brexit environment, such as exchange rates or consumer spending. Or more commonly, a combination of the two. The key is to avoid looking at Brexit as a single issue or in isolation.

4. Spot opportunities to drive change

Once the Brexit impact has been deconstructed, it may offer businesses an opportunity to make changes that may have previously been difficult to drive in isolation or without a clear trigger.

For example, a UK-based global manufacturer that sources supplies from in excess of 20 EU countries is using Article 50 to evaluate its entire supply chain and global customer footprint. This involves mapping the impact against various Brexit outcomes – a deep FTA with minimal friction, a shallow FTA with delays, WTO meaning
In addition they are assessing alternative supplies in light of the position adopted by competitors, potential changes to US trade and tax policy, rising labour cost in East Asia and the potential for automation and robotics. Article 50 was a catalyst to look for ways to retain or improve competitiveness, becoming part of a bigger portfolio of strategic decisions designed to maximise opportunities whilst absorbing further shifts in trade policy, customer trends and technology.

5. Address what you can address now

To mitigate risk and realise opportunities coming from Article 50, there are three steps that companies may consider; no-regrets planning, playing it safe and big investments.

- **No-regrets:** There are measures a company may take to boost competitiveness in all Brexit scenarios. We know, for example, that the UK intends to leave the EU Customs Union, meaning the re-introduction of a UK-EU customs border. Although exact outcomes may range from a very light border to tariffs, businesses with effective customs systems or who understand origins in its supply chain are likely to have an edge. The exact arrangement to replace free movement is unclear, however a business with cost-effective on-boarding systems or recruitment geared towards domestic workers, may be better prepared under all outcomes. A well-known food outlet, whose staff consist of 65 per cent non-UK EU nationals, has launched a recruitment campaign aimed at specifically encouraging more British nationals to apply, offering 16-18 year olds the chance to work across the business. Other businesses are positioning themselves to take advantage of new FTAs once the UK runs its own trade policy.

- **Playing it safe:** Some companies are putting low-cost structures and hedges into place that allow them the agility to move quickly in the event of a certain outcome. For example, a range of financial services firms have set up de minimis entities in either the EU or the UK in case the financial services passport between the UK and the EU is lost. Anecdotal evidence suggests the expectation is around 45 applications for EU bank licences this year.

A budget airline has announced it is looking to have an Air Operator’s Certificate (AOC) issued in another EU member state to potentially base its HQ there in case of more limited access to the EU’s aviation market. A logistics firm that offers replacement spare parts anywhere in the EU within 24 hours, has a contingency plan if friction at the EU-UK border makes that guarantee unviable.

- **Big investment:** The most difficult step as it involves betting on outcomes. Much publicised examples include Toyota that has announced a £240 million investment in a UK plant and Nissan that decided to manufacture a new model at its Sunderland plant. Considerations for such decisions can include the chance of a tariff-free deal with the EU and domestic policies such as tax incentives for low-emissions vehicles. 14 per cent of businesses with investment in Europe are considering moving investments from the UK, according to a recent EY survey*. 

* EY UK Attractiveness Survey 2016 – insights from understanding growth from a foreign direct investment (FDI) perspective into countries and regions across the globe.
6. Identify trigger points and signposts

Businesses will want to identify signposts that signal a move towards a specific Brexit outcome. These, in turn, can serve as trigger points for taking action or set a plan in motion. Businesses need to tune in to these signals. For example, a manufacturer estimates a new IT system that manages EU customs border will take 18 months to implement. Therefore they can time the initiation accordingly, potentially gaining more clarity from the negotiations in the meantime. A pharmaceutical company has matched its decision timeline for moving the regulatory part of its business from the UK to the EU, with negotiations over the new location of the European Medical Agency. Chemicals firms have considered the lead-time for transferring registrations under the EU’s Registration, Evaluation, Authorisation & Restriction of Chemicals (REACH) regulation to EU entities to ensure compliance in future. Several companies, particularly in the financial services sector, are making use of existing EU law to transfer operations, meaning a firm deadline.

Such an approach may allow businesses to pursue a strategy of multiple potential actions, coupled with constant monitoring and adaptation, with the knowledge of when an action must be initiated to achieve an outcome on Brexit Day 1. The key is to avoid being locked into a single path or plan.

7. Understand the signals and the politics

According to a recent EY survey of businesses with investment in Europe*, political instability is now seen as the second biggest risk to investment whilst global volatility, also linked to political change, is seen as the biggest risk. The result and the nature of the vote in the upcoming French and UK elections are the most obvious signals and political triggers.

Brexit talks will be a complex cocktail of political and economic considerations. The deepest red lines on each side are, however, fundamentally political. Most notably for the UK, control over borders and laws; for the EU, not giving the UK a better deal than it had as an EU member.

Understanding the politics involved in Article 50 and beyond can give businesses an edge on the competition by helping them separating signal from ‘noise’.

There will be much noise over the next two years – leaks, resignations, hostile briefings and sheer speculation. However, only a small part of this will signal a genuine shift in outcome.

Understanding UK and EU politics, and the interaction between the two, will help companies spot which is which. Sterling reacting to Parliament voting on Article 50 is an example of a failing to grasp the politics. Parliament delaying, let alone blocking Brexit, was always very unlikely given parliamentary dynamics in the Conservative Party and Labour Party concerns over pro-Brexit majorities in many of their constituencies.

By understanding the politics – and the social change expressed in the Brexit vote – businesses can also be more effective in shaping government thinking as well as influencing the wider debate.

* EY UK Attractiveness Survey 2016 – insights from understanding growth from a foreign direct investment (FDI) perspective into countries and regions across the globe.
At this time of economic, political, legislative, regulatory and trade change, business decisions are increasingly important and difficult. It is therefore key that businesses are more adaptable, strategic and visionary than ever before and review their methodologies and assumptions. Business leaders must lead more than just business.

Leading through disruption requires access to knowledge and information, collaborative management and decision-making to allow new ideas and business models to come to the fore. Our International Trade, Economics and Policy unit (ITEP) delivers powerful business insights that can help you better understand the changing landscape and identify growth opportunities.

Bringing together a team spanning economics, policy, trade and regulation, ITEP helps businesses, government and industry bodies to answer the most challenging questions and forge a successful future for the UK in the global economy.
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