BREXIT: Ten Things Manufacturing Companies Should Know

written by Lauri Moon | July 12, 2016
(Manufacturing Leadership Council – Paul Tate: 6-28-16)   When the world woke up last Friday morning, news that the U.K. had voted to leave the European Union after more than 40 years sent shock waves through the world's political elite, global currency and stock markets, and company boardrooms.

Over the last few days the U.K. currency has gone into free fall, at one point hitting a 30-year low against the dollar; stock markets have trembled, not only in London but across Europe, the U.S., and Asia; British Prime Minister David Cameron, who had campaigned to remain in the EU, has resigned; major banking institutions like HSBC have announced potential plans to move thousands of staff out of the U.K. to European locations; Standard & Poor's and Fitch both downgraded their U.K. credit ratings; Moody's has dropped its outlook on U.K. debt to negative; and warnings of protracted economic doom have hit the world's headlines.

As a result, the future for the U.K. economy, and the rest of Europe, now looks highly uncertain. What's more, any sense of real 'certainty' is unlikely to return soon.

Under the EU's Article 50, the process for a member to withdraw will take two years from the moment it is triggered. This may not happen until a new U.K. Prime Minister is appointed in October. However, this process is most likely to cover the general EU governance and regulatory issues only. Some observers believe that sorting out new trade agreements with the 27 remaining EU countries, if that is the chosen way forward, or any new rules governing the ultimate flow of workers across borders, may take much longer.

How, and when, the U.K. formally exits the EU, and under what conditions, is still a mystery. Will the U.K. shed all ties with the 27-nation single market and simply trade as yet another national economy? Or will it cut some kind of deal to remain part of the European single market in a different form, without some of the accompanying controls from Brussels?

One critical element missing from the vote-winning Leave campaign so far, of course, is any clear plan about what to do next. The 'Leavers' appear to be as surprised as the rest of the world that the British public voted for BREXIT at all.

In the midst of all this economic uncertainty and political turmoil, the question now is: What are the possible implications for manufacturing?

Will the BREXIT vote be remembered as an Independence Day for British manufacturers as they seek new, unfettered global markets –– or will it mark a Doomsday for U.K. industry, driving the economy and its manufacturing base to shrink into recession and industrial contraction?

And where does this leave the rest of Europe, and the numerous global manufacturing companies with existing plants and important customer bases in the U.K.?

In an effort to provide some clarity in the midst of the confusion, here are 10 things that manufacturers should know about when trying to assess the future of manufacturing in the U.K., and some of the potential implications of BREXIT on their businesses.

1/ The Current State of U.K. Manufacturing:

The U.K.is the world's fifth largest economy and its manufacturing base is currently the ninth largest in the world, according to a recent report from the U.S. Congressional Research Service.

Manufacturing contributes around $460 billion in gross added value to the U.K.'s GDP each year, says the Confederation of British Industry (CBI), and accounts for around 46% of the U.K.'s total $345 billion of worldwide exports.

Growth in the U.K. manufacturing sector, however, is flat right now, in no small part due to the uncertainty generated by the run up to the BREXIT vote last week. The UK's manufacturing PMI only just crossed the growth threshold of 50 points in May with a figure of 50.1, after dipping into contraction in April for the first time in over three years.

The Eurozone PMI, however, is faring better, with a flash PMI growth projection for June of 52.6, marking a six-month high.

2/ The Downside:

According to some forward economic projections, the impact of BREXIT could hurt the U.K. economy worse than either of last century's two world wars, or the 2008 global banking meltdown.

That may be overly dramatic, but there are already some worrying signs that the U.K. economy now faces a number of significant issues.

A new report from the U.K.'s Institute of Directors reveals that two thirds of the 1,000 members it surveyed over the last few days said the BREXIT vote would have a negative impact on their businesses, a quarter planned to freeze employment, and 5% said they would be cutting jobs. More than a third also intend to reduce their investments plans, and a fifth said they would consider moving some operations out of the country.

Many of the U.K.'s manufacturing industry associations are also deeply concerned and have appealed for clear thinking over the difficult months ahead. "Great care must be taken during the negotiation process to protect manufacturing's interests and we will be working hard in the UK and in Brussels for that outcome. We believe that we can leverage UK manufacturing's reputation for innovation and flexibility to secure the best possible deal for our members outside the EU," James Selka, chief executive of the Coventry-based Manufacturing Technology Association, told the U.K.'s Engineer magazine.

3/ The Upside:

Not every economist is predicting doom and gloom, however. Oxford Economics has suggested a range of losses could be between as little as 0.1 per cent and 3.9 per cent, and that these may be short-lived as the U.K. will then be free to forge new trade deals with other, faster growing nations around the world.

“We should look ahead to opportunities to trade more freely with the rest of the world, as well as building on existing trading relationships with customers and suppliers in Europe,” commented Lord Anthony Bamford, chairman of the $4 billion British construction equipment maker, JCB. “We have little to fear from leaving the EU.”

In addition, some observers argue that because the falling pound will make British exports cheaper on world markets, and the U.K. a more cost-effective place to manufacture and set up business, any short-term downturn will be mitigated by longer-term gains.

Also, the UK has traditionally had a strong focus on high-value added manufacturing. Coming out of the EU might help UK manufacturers compete better on a global stage, as they will no longer be hindered by highly regulated EU industrial policies.

4/ European Trade:

Based on 2014 statistics, the UK manufacturing sector exported $155bn worth of goods to the EU that year, including over 600,000 vehicles. On the other hand, the EU exported nearly $260bn worth of goods into the UK over the same period.

The ‘Leave’ campaign’s argument was that these figures show the EU needs the U.K. market more than the U.K. needs the EU. As a result, some believe that EU businesses like BMW or French Energy companies will be eager to ensure there are as few trade barriers as possible that could restrict future access to U.K. markets.

Others, however, expect the EU to punish the U.K. by making it as hard as possible to cut new trade deals with the remaining 27 countries in an effort to dissuade other European nations from taking their own exit options in the future. For example, there are already moves in France, The Netherlands, Hungary and Italy to push for similar EU referendums following the U.K. vote.

The problem is that if the U.K. fails to cut a beneficial EU trade deal, manufacturers may then face export tariffs to EU countries of up to 10% on cars, 4.6% on chemicals, 1.7-4.5% on machinery, and around 20% or more on food and beverages.

Potential tariffs, plus low sterling values, could also make imported technology purchases significantly higher in price, and hamper essential investments in future digital solutions across multiple industries, including manufacturing. One suggestion is that BREXIT may wipe out up to $4.6 billion of the value of tech spending in the U.K. this year alone.

5/ Foreign Investment in Manufacturing:

In 2013, FDI from Europe into UK manufacturing activities was estimated to be nearly $150 billion, including nearly $4.6 billion in R&D spending from non U.K.-based companies.

This level of inward foreign investment is now at risk. Foreign companies are expected to put on hold, or perhaps reduce, any plans for investing in U.K. manufacturing concerns until the future relationship with the rest of the EU is clarified. This is unlikely to happen for the next couple of years.

"This is very bad news for the EU, but even worst for Great Britain," commented Industry 4.0 pioneer Dr. Detlef Zühlke, Executive Chairman of Germany's SmartFactory Initiative and a member of the Manufacturing Leadership Council's Board of Governors. "The direct impact will hit GB soon when foreign investors, banks, and companies have to rethink their investments."

6/ Global Manufacturers in the U.K.:

For the time being, trade deals between the EU and the U.K., and the rules governing the free movement of European talent, will remain the same. Foreign companies with plants in the U.K. do not face an overnight crisis – yet.

But they are clearly worried about the future. Airbus, Ford, and BMW have all actively voiced their BREXIT concerns. BMW's head of its Rolls Royce group, for example, wrote to staff warning; "Tariff barriers would mean higher costs and higher prices and we cannot assume that the UK would be granted free trade with Europe from outside the EU … Our employment base could be affected."

Commented Chad Moutray, Chief Economist at the National Association of Manufacturers in the U.S. "It does create some challenges for businesses, particularly those that have a presence in the United Kingdom as a gateway into

Europe. This is especially the case for the financial sector in the United Kingdom, but it is also the case for manufacturers. Those firms will likely watch the upcoming negotiations closely, ensuring that their ability to trade with the continent and others remains unabated."

So a lot will depend on how the U.K. goes about agreeing trade deals with the EU as part of its exit strategy, and when. If the trade barriers are high, foreign companies like Nissan or BMW may well decide the balance between access to UK customers, versus access to the entire EU customer base, is not enough to warrant maintaining production on British shores and so could move existing plants, or focus investments in new plants, onto the European mainland.

7/ Raw Materials:

In the short term at least, if the pound continues to lose ground against international currencies, price rises in imported raw materials for U.K. manufacturers seem inevitable.

In the medium term, if the U.K. decides to ditch, or is not allowed to maintain, the current free trade agreements with EU countries, prices of imported materials from the EU are also likely to be higher than they are today, due to potential import tariffs.

Manufacturers, both British and global, will need to be vigilant about tracking the impact of price fluctuations of raw materials on their costs of U.K. production, and continually assess the effectiveness of their current sourcing policies and partners, until the BREXIT negotiations deliver more clarity about the future.

8/ Manufacturing Skills:

One of the most fundamental aspects of EU membership is the free flow of talent across borders. This has become a major, and sometimes contentious, issue for many populations in Europe – both in terms of EU citizens moving from poorer economies like Poland and Romania into wealthy ones like the U.K. and France, and the influx of non-EU migrants into the region from other areas of the world.

Irrespective of your point of view, one of the key benefits has been access to a wider pool of talent for manufacturing companies, and the U.K. has benefitted as much as other nations.

While there are currently few suggestions that the existing EU-originating workforce in the U.K. should suddenly, or even eventually, be removed, the U.K. may well lose access to this wider talent pool if it decides not to adopt a reasonable border policy in the future. It may also reduce its attractiveness to talented foreign workers as new border controls are introduced.

With a limited number of skilled next-generation workers coming through the U.K.'s educational system, and a skills gap already having a dampening impact on growth, one of the key issues now facing the U.K. manufacturing sector will be where the next wave of workers it needs to thrive in an increasingly digitally-driven future will come from.

It remains to be seen if a new, non EU-bound, U.K. government can successfully address this critical skills issue before it makes a significant economic difference to Britain's industrial sector.

9/ Product Innovation:

One of the things that the U.K. has a world reputation for is innovation – whether it's for new pharmaceuticals, new production techniques and materials, fashion goods, or leading-edge motor sport design.

Currently the British government maintains a comparatively hands off policy of innovation investment, focusing on programs such as Innovate U.K., with its Catapult and Advanced Manufacturing Center schemes. These, however, are not as coordinated or as powerfully funded as either the network of Manufacturing Innovation Institutes like the DMDII or America Makes in the U.S., or Germany's Fraunhofer Institutes that support German SMEs to continuously upgrade their products and processes by driving technology adoption.

In addition, the UK receives more funding from the European Research Council than any other country in Europe. Disengaging with the EU would mean this research support would be lost. Automotive, aerospace, pharmaceuticals, and chemicals are the verticals that could be most affected in an acrimonious divorce.

If the U.K. is going to maintain its innovative reputation, future British governments may need to review the country's manufacturing and technology innovation support strategy and adopt a far more direct, proactive, and better-funded approach.

10/ The Future of a Single Digital Market

From extended manufacturing supply chains, to common digital platforms for customer support and the delivery of new services, there's a significant global trend underway across many industries today to harmonize as many regulations, laws, systems, policies, and standards as possible to drive out complexity in global networks and keep them secure.

In the past, the EU has launched a number of harmonization initiatives designed to help companies make it easier to do business across the continent, both in physical and digital terms. Inevitably, the U.K.'s departure from the EU now raises questions about whether this move to end-to-end harmonization can progress as swiftly as before if some countries are going to start to make up their own rules, or refuse to abide by others.

As one U.K. supply chain academic warned, if this happens, U.K. manufacturing suppliers may find themselves losing some of their traditional partners. "In a competitive environment where small changes can have significant impact on performance and relationships, switching between supply chains and countries may become an increasingly popular choice," said Dr. Christos Tsinopoulos, Senior Lecturer in Operations & Project Management at Durham University Business School.

As global industries become increasingly digitized, the need to maintain access to a single digital market in Europe may turn out to be one of the most important and complex areas of forward-thinking negotiation between the EU and the U.K. in the BREXIT divorce.

So What's Next?

Unfortunately, the true implications of BREXIT for U.K., European and global manufacturing companies look set to be clouded by continuing uncertainty until the EU and the U.K.'s new government thrash out an acceptable plan of action for both sides – and that could take at least two years.

While the shock waves continue to ripple across the continent, there are now even suggestions that a second referendum may be required detailing the specific exit plans before being signed into U.K. law. Some observers also assert that many British voters are fast moving from the BREXIT camp, to the 'REGREXIT' camp, as they begin to realize just how significant the vote could be for the future of the U.K. economy and industry.

Who knows what the next few months will bring? The future for manufacturing in the U.K. seems as tough to predict as the surprise outcome of last week's vote itself.

Watch this space …

Additional contributions from Frost & Sullivan's Muthukumar Viswanathan in London, and Karthik Sundaram in Frankfurt.

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