

# BREXIT: UNDERSTANDING THE IMPACT, PREPARING FOR CHANGE



**Good thinking. Globally.**

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On June 23<sup>rd</sup>, the United Kingdom held a vote on whether or not it should leave the European Union. In a startling result, the referendum passed with the general public voting 52% to 48% in favor of leaving. It immediately triggered a wave of international market turbulence and added to the political friction both domestically in the UK and across the EU. Having strongly urged voters to choose to remain in the EU, British Prime Minister David Cameron suffered an embarrassing defeat and resigned his position. The Conservative Party was forced to select new leadership, which will be responsible for triggering Article 50 of the Lisbon Treaty and initiating the exit. The United Kingdom and the European Union will then have 2 years to negotiate the terms of their political and economic relationship moving forward.

As the fallout continues to unfold, the full impact of this decision is yet to be seen. There are many potential outcomes from the Brexit, all having different implications for international business. Uncertainty looms large. While there is no immediate change, companies must be proactive now to understand their exposure and remain agile enough to adjust course when the time comes.

### How did we get here?

In 2013, when David Cameron was seeking reelection as Prime Minister of Great Britain, he made a campaign pledge to hold a general vote on whether to leave the EU. There had long been a faction of his Conservative Party that represented Great Britain's Euroskeptic opinion. At the time, the pledge was simply a way to appease his backbenchers and resolve internal party politics when the vote inevitably failed. However, since then, anti-EU sentiment had grown and a xenophobic populism movement strengthened, driven in part by the recent terrorist attacks across Europe and the EU's handling of the Syrian migration crisis.

A right wing group called the UK Independence Party (UKIP) used these events as evidence that the EU was wrong for Great Britain. It characterized Brussel's liberal migration policies and its inflexibility on the matter as Europe governing the UK, stoking nationalistic emotions. There was also heavy campaigning by UKIP that highlighted the large sums of money the UK paid into the EU under its

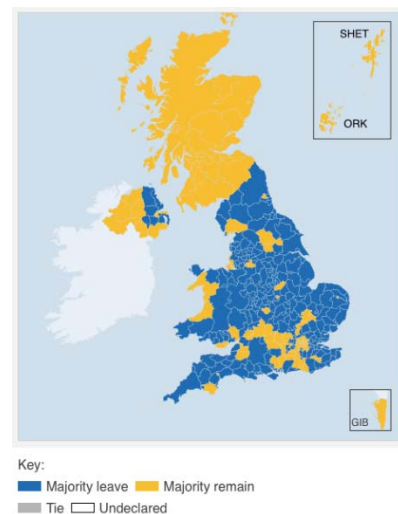
Brexit Quick Facts	
<b>European Union</b>	
• Member states (including UK)	28
• Established	1958 (EEC) 1993 (EU)
<b>Migration</b>	
• EU nationals living in the UK	3.3M
• UK citizens living in EU	1.2M
• Total UK Population	65M
• Total EU Population	510M
<b>Trade</b>	
• UK exports to EU (% of total)	£230B (45%)
• UK imports from EU (% of total)	£289B (53%)
• % of EU exports that go to UK	6.5%
<b>UK Foreign Investment</b>	
• Direct investment from EU	£496B
• % of all foreign investment	~50%
<b>Brexit Referendum (33.5M voters)</b>	
• Leave	52% (17.4M)
• Remain	48% (16.1M)

membership agreement. UKIP claimed that the party could redirect those funds into public programs at home, such as the National Healthcare Service.

## The Fallout

The most visible result of the Brexit vote was the immediate turmoil in global markets. In the first 2 days, the Dow dropped nearly 900 points, the FTSE 250 lost 7%, and other benchmark indexes across Europe fell 2.5% - 3%. Big bank stocks suffered. Some were even halted because of high volume selling. Currencies also fluctuated significantly. The pound dropped 11% against the dollar before leveling off the following week. The euro also dropped against the dollar, as investors flocked to typical safe havens.

In addition to the market impact, there are a number of political implications at work. A contagion effect of anti-EU sentiment is something Brussels is very eager to contain. A similar nationalistic movement appears to be taking shape in France. Italy is facing a banking crisis similar to 2008, with officials calling for a recapitalization from the ECB, which is a difficult undertaking both practically and politically. In the opposite direction, Northern Ireland and Scotland both voted heavily to stay within the EU, so many wonder if it is just a matter of time before those regions reconsider staying in the United Kingdom.



**Figure 1: Brexit voting by area**  
(Source: BBC)

The global selloff was partially a correction for recent market rallies that had occurred as investors bet against the exit result. The initial market shock had seemed to pass by the middle of July, and most market indices had actually returned to or surpassed the pre-vote levels. However, the high volatility is a symptom of an uncertain and increasingly charged political climate. The European economy never fully bounced back from the 2008 recession, so it is highly susceptible to additional shocks as it becomes more apparent how the Brexit will play out.

## Implications for international business

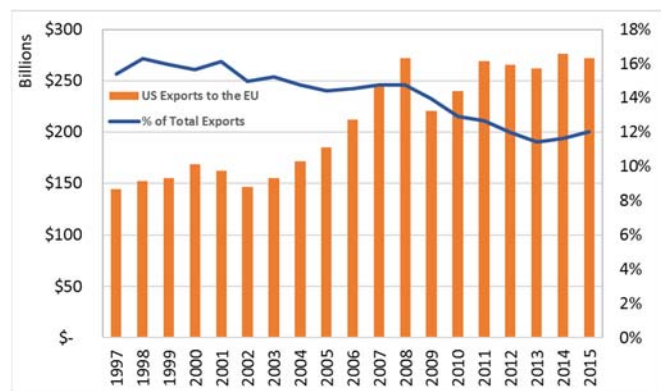
There has been a flurry of corporate press statements regarding the Brexit. The general reaction is a very cautious wait-and-see stance, and nearly all comments have encouraged a speedy resolution to minimize the period of uncertainty. In the near term, high market volatility will likely drive investors to typical safe havens, such as gold and silver. The movement from the initial shock will subside, but similar volatility is likely to occur repeatedly as details of the exit become known. The upward pressure on commodity prices could spur mining investment, benefiting mine operators and manufacturers of mining equipment.



**Figure 2: Gold prices have climbed from the pre-Brexit high**

(Source: Bloomberg)

Beyond the initial shock, the pound and the euro will likely remain weak, especially against the dollar. The effect might be less for the euro, as dollar exchange rates have already been near recent historic lows. But the general strengthening of the dollar will have a negative effect on US exports as the buying power of the UK and EU will decrease. This is significant – the EU economy is roughly the same size as the US and China, and US exports to Europe total about \$270B<sup>1</sup> (12% of all US exports<sup>9</sup>) each year.



**Figure 3: US Exports to the EU**

(Source: US Census Bureau)

Emerging markets are also likely to feel a squeeze from the Brexit through exchange rate volatility. Investors are fleeing many foreign currencies for the safety of the dollar, and emerging markets hold over \$3T in dollar-

denominated debt. As the dollar strengthens, the effective debt burden increases, making the interest payments much costlier. This could also spill onto sovereign treasuries as there are a high number of state-owned enterprises (SOEs) with debt guaranteed by the state in emerging market countries.<sup>4</sup>

For operations within the UK, many changes are on the horizon. Britain will negotiate to maintain its access to the single market but is unlikely to succeed. The EU is very disinclined to allow

Britain to cherry pick the benefits of membership, for fear that other member states will try to leave on similar terms. Some form of partial access is the likely outcome, through lengthy negotiations, but it is unclear how strong of a stance the new UK government will take and what they will be willing to concede.

So the question companies are scrambling to answer is: How will operations be impacted by the UK losing access to the single market and the concessions made by the UK?

- New regulations on trade with the EU and loss of other trade agreements abroad
- Potential supply chain disruption
- Shifting labor forces as the work status for the 3.3M EU citizens within the UK<sup>3</sup> will change (the overall talent pool will likely shrink)

Short-Term	Mid-Term	Long-Term
<ul style="list-style-type: none"> <li>• Deep slowdown in capital investment, hiring in UK</li> <li>• Market shocks</li> <li>• Currency exposure &amp; risk               <ul style="list-style-type: none"> <li>– Pressure on emerging markets, oil prices</li> </ul> </li> <li>• Depreciating pound, UK buying power</li> <li>• Regulation/compliance questions</li> </ul>	<ul style="list-style-type: none"> <li>• Impacted UK economic growth               <ul style="list-style-type: none"> <li>– Consumer confidence</li> <li>– Asset values</li> </ul> </li> <li>• UK labor policies, worker status</li> <li>• Uncertain future trade terms</li> <li>• Industry loss in UK</li> <li>• Trade options; how to deal with immigrants without stopping trade</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of trade agreements/ time to restructure</li> <li>• Foreign investment in UK               <ul style="list-style-type: none"> <li>– Protectionism</li> </ul> </li> <li>• Shifting UK workforce</li> <li>• Monetary policy</li> <li>• Political               <ul style="list-style-type: none"> <li>– Contagion/EU destabilization</li> <li>– Scotland &amp; N Ireland</li> </ul> </li> </ul>

Figure 4: Brexit implications vary from the short to long term

**How to respond**

While the timeline for this transition is more or less known, the range of potential impact is broad. For now, corporate leaders must closely monitor the situation, as the proper response will vary greatly depending on how events unfold. To overcome the high degree of uncertainty, companies must proactively assess their exposure and strategically plan for many potential scenarios.

- *What is the current UK footprint? What product lines and services are based out of the UK?*
- *Which markets are served out of the UK? How could new tariffs with the EU impact revenue?*
- *What will be the impact of losing access to other trade agreements the EU has with other countries?*
- *What is the demographic breakdown of your labor force in the UK? How reliant are you on EU workers who could lose their work status?*
- *What inventory is held in Britain and Europe? For production facilities in UK, how much of the supply base is in Europe?*

**How CGN can help**

CGN Global is uniquely positioned to address the challenges brought by this transition. CGN transforms organizations worldwide to improve performance, profitability, and global competitiveness. We use our diverse experience and broad knowledge to become a part of our clients’ teams — providing strategic insights, actionable recommendations, and focused execution to drive breakthrough results. Whether it’s developing a strategic operational or competitive shift, optimizing your supply chain, streamlining your internal processes, or improving the quality of your products and services, our work results in innovative ideas that transform your business and differentiates you from your competition. Our services solve a range of management challenges that will accompany this global shift.

Risk & Response	Strategic Transformation Group	Industrial Transformation Group	Digital Transformation Group
<b>Strategy Risk</b> – Reevaluate strategic roadmap to position for competitive advantage following the Brexit	<ul style="list-style-type: none"> <li>• Risk assessment &amp; Mitigation</li> <li>• Business &amp; Scenario Modeling</li> <li>• Disruption Model</li> </ul>		<ul style="list-style-type: none"> <li>• Advanced Analytics &amp; Simulation</li> </ul>
<b>Market Risk</b> – Gain insight into potential customer shifts & competitive positions to inform strategy development	<ul style="list-style-type: none"> <li>• Market Landscaping</li> <li>• Competitive Analysis</li> </ul>		

<p><b>Value Chain Risk</b> – Assess the end-to-end value chain &amp; proactively prevent supply &amp; service disruption</p>		<ul style="list-style-type: none"> <li>• “Lift &amp; Shift” – Facility Moves</li> <li>• Supply Chain Design &amp; Network Modeling</li> <li>• Supplier Resourcing &amp; Rationalization</li> </ul>	<ul style="list-style-type: none"> <li>• Control Towers</li> </ul>
<p><b>Labor Risk</b> – Identify critical competencies, manage transition &amp; create a strategic workforce for the future</p>	<ul style="list-style-type: none"> <li>• Org Capability Assessment &amp; Planning</li> </ul>		

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