

The reshoring opportunity

Could Brexit disruption fire up UK factories?

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At a glance

- Opportunity for UK suppliers as customers seek to shorten supply chains to avoid tariffs, delays and forex impact.
- Weaker pound means comparative cost advantage for UK suppliers to domestic economy and for export.
- Companies are mulling reshoring options but generally yet to press the button.
- Firms only have a limited time to prepare for a potential cliff-edge Brexit in 2019.

Theresa May's Lancaster House speech suggests the UK is on course for a 'clean Brexit' – out of both the Single Market and Customs Union as we know it. That has major implications for manufacturers' supply chains. But it also presents a potential opportunity: could Brexit herald the return of manufacturing capacity that left Britain in recent decades?

We are already discussing the idea of reshoring production with clients – both bringing back capacity that had left and also relocating or duplicating plants currently sited on the European mainland. For instance, companies that have been shipping components from the Far East to a plant on the Continent might decide to split that consignment and send some parts directly to the UK. In the short term, that may mean setting up warehousing and increasing inventory to move stocks of finished products closer to customers. But over two or three years, companies may look to move manufacturing facilities as well.

There will be losses in the other direction of course. Any firm with a significant customer base or interconnected supply chain in the EU27 should be asking themselves if relocation to the Continent is the best way to neutralise the risk of tariff and non-tariff barriers. KPMG's *Rethink Manufacturing* survey showed a slight but notable increase in the number of companies considering shifting parts of their supply chain overseas.



Fast fashion

One industry that had already understood the benefits of a UK-centric supply chain is clothing.

Fast fashion label Boohoo now manufactures more than half its clothes in Britain and looks for suppliers nearby to accelerate speed to market¹. Meanwhile Asos has said it expects to double UK production in the next three to four years from 4% today. The online retailer has warned however that hopes of a large-scale return of textile production in the UK were wide of the mark given the UK's cost base and questions over infrastructure and skills in the industry here².



That might seem counter-intuitive at a time when the weaker pound is encouraging greater investment into the UK, but businesses have to plan for the possibility that the UK exits the Customs Union without an EU-UK Free Trade Agreement by March 2019.

Others will use Brexit as a trigger to assess operations more broadly. A third of industrial manufacturers are considering relocating aspects of their plant or operations to another country, the survey found, to boost productivity or reduce costs.

So we need to be realistic. Initiatives such as the UK Government's industrial strategy are important, but will never bring back historical levels of mass manufacturing or allow us to suddenly compete with, say, Vietnam in the volume shoe making business.

Just in time

Yet despite signs of further leakage abroad, I am a growing advocate for companies considering the reshoring option.

For example, one strategy for companies with a global footprint is to go with the prevailing forex and

tariff winds rather than fight them. That means moving UK production of European-bound goods to Europe, but then using the (now-spare) UK capacity to manufacture for the local market and wider global market too (taking advantage of the UK's relative cost-efficiency in US dollar terms).

For companies supplying the vast majority of businesses that will remain in the UK, maintaining – or reshoring – production in the UK should become increasingly attractive for customers. Why? Because manufacturers and other businesses have grown used to responsive and secure supply chains stretching across the Continent.

They will now be seeking to create a far shorter supply chain, given the cost and complication that tariffs and non-tariff barriers might bring. The car industry shows just how big a prize is out there: currently as much as 50% of the value of parts going into a British-built car are imported from the EU, according to a report from KPMG and the Society for Motor Manufacturers and Traders³. I would wager the proportion of EU-sourced components will be a lot lower in a decade's time.

Gaining currency

And then there is the weaker pound. The currency's 16% fall against the dollar since the referendum may have raised input costs, but for those who can localise production and then export abroad there is an opportunity to increase both margins and export volumes, as recent manufacturing data has borne out⁴. Furthermore, some UK subsidiaries of foreign companies can hedge their sterling exposure by continuing to import euro-denominated goods but then invoicing British customers for those goods in euros.

Some of the issues at play in the reshoring decision are neatly captured by a sector like food processing.

On the one hand, I can see a clear opportunity: the UK exports a huge amount of raw ingredients to the EU which then return as finished items and in total runs a 'food trade gap' of over £20 billion⁵. The lower cost of UK production on a global basis, plus the clear brand value of 'Made in Britain', are all encouragements.

Yet set against that are a number of risks.

First, companies need to see Brexit in a broader, global context, not least in the United States where the Trump Administration may attempt to bolster US manufacturing by weakening the attractiveness of foreign-based operations. Could we be entering

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a period of greater protectionism, in which companies may have to localise production to avoid tariff barriers or new taxes on operations abroad?

Second, will companies be able to find the right staff in the UK? More than a quarter of workers in food factories come from EU countries, compared with less than 7 percent in the wider workforce⁶. The numbers are even higher in sub-sectors like fruit picking. In an economy of near-full employment, what that might do to wage-price inflation or continuity of supply?

Dark satanic mills?

Unfortunately businesses don't have long to resolve these questions and

very few have a roadmap of what they need to do and in which order. Yes they need time to analyse the cost implications of weaker sterling and also the wider potential impact of Brexit on things like supply chains. But if they are to make changes, then they will need significant lead time to carry them through before a potential 'cliff edge' Brexit in March 2019. By contrast, setting up a factory can take two or three years and a capital commitment of over 20.

Right now, I wouldn't say businesses are confident enough in the outlook to make a decision – on reshoring or many other Brexit-related strategic questions. Perhaps the triggering of Article 50 will concentrate minds.

If firms are waiting for clear signals from Brexit negotiations this year I fear they will be disappointed.

Each will have a different reason for considering it. It may be the desire to avoid tariffs or maintain speed to market; for others it will be to evade higher import costs or take advantage of the UK's new-found cost advantage. Whatever the reason, companies can use Brexit as the catalyst to undertake a strategic pivot they would otherwise have delayed. The dictum 'never waste a good crisis' has never been more true. ♦

Is reshoring the right option?



Six questions to consider:

1. How dependent are your customers on 'just-in-time' and guaranteed delivery schedules?
2. What tariff levels would your UK customers have to pay – or you absorb – on EU-produced goods if the UK reverted to a WTO regime?
3. What cost, regulatory and other advantages could your firm generate over foreign-based competitors as a result of reshoring?
4. How long would it take you to establish a UK production facility? Could you stock inventory in UK warehouses in the interim to guarantee delivery?
5. By contrast, could a network of European warehouses to hold inventory make UK production more feasible?
6. Stress test your financial models: what would a reversion to the pound's previous strength do to the viability of UK plants? What does that look like after the imposition of WTO-level tariffs?

1 <http://www.telegraph.co.uk/business/2016/12/26/made-britain-will-brexite-spell-march-makers/>

2 <https://www.bloomberg.com/news/articles/2016-12-12/retailer-asos-boosts-u-k-sourcing-after-pound-s-brexite-fall>

3 <https://www.smmmt.co.uk/wp-content/uploads/sites/2/SMMT-KPMG-EU-Report.pdf>

4 <https://www.theguardian.com/business/2017/jan/03/uk-manufacturing-growth-at-a-30-month-high-says-pmi-survey>

5 Defra 2016

6 <http://foodresearch.org.uk/food-and-brexite/>

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