Brexit & UK manufacturing: opportunities and threats

The UK's decision to leave the European Union (EU) raises significant challenges, as well as potential opportunities, for UK manufacturing. *The Manufacturer* and specialist financier Falcon Group hosted a roundtable to look at the key issues facing the industry. Peter Osborne reports on the discussions.

Henry Anson: The UK's manufacturing sector is probably at its most optimistic for many years. But there are challenges ahead, not least the impact of Brexit. What is your view of its likely impact on UK manufacturing?

Andrew Churchill: We operate in the aerospace sector, which is a little bit different – under World Trade Organization (WTO) rules the industry is exempt from tariffs for finished products. However, my main concern relates to non-tariff barriers and the impact on our original equipment manufacturers (OEM).

Global OEMs, to a large extent, look to supply chain manufacturers for an increasing proportion of their output. For instance, an advanced gas-turbine engine would have 60-75% of its content made in the supply chain.

The supply chain in the UK is somewhat different. The UK has a disproportionate number of SME manufacturers. Importantly, these smaller companies are less equipped to deal with non-tariff barriers to trade. Indeed, we are largely unconsciously incompetent at this. It is two generations since our companies had the skills to manage tariffs – let alone non-tariff barriers. Most are unaware that these skills are absent – meaning we'll either have to acquire or buy them in.

As such, there is a real danger that we are steaming towards Brexit without being conscious of what we need to do to be able to trade after Brexit. Personally, I think we will inevitably end up with a period of transition – in fact, I think it is unimaginable not to have one.

Henry Anson: Looking at it from a financial perspective, the drop in the value of the pound has had a beneficial impact on UK exports. What is your position on the movement of sterling?

Emma Clark: In terms of the rate, it is going to be vulnerable – it will likely stay low with the potential to fall even further. At the moment, we are experiencing a short-term boost because the pound is low. The UK, however, is an import-for-export economy, and as the price of imports continues to increase this will have a

The Manufacturer and specialist financier Falcon Group hosted a roundtable to look at the key issues posed by Brexit.

Roundtable participants
(Back)

Paul Marston, Managing Director, Ratesetter

Will Nagle, CEO, Falcon Group

Henry Anson, Moderator, *The Manufacturer*

Geoff Wynne, Head of Trade and Export Finance, Sullivan & Worcester

Andrew Churchill, Managing Director, JJ Churchill

Susan Ross, Director, Aon Credit International

(Front)

Marcus Dolman, Co-Chair BeXa and Assistant VP ECA & Sales Finance, Rolls-Royce plc

Emma Clark, Head of Business Development, Falcon Group

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knock-on effect on both the country's exports and on manufacturer margins. Certainly, these have to be absorbed somewhere, and given that banking lines are typically linked to the falling pound – in turn, impacting the value of these lines – many companies are facing huge cost pressures.

From Falcon's perspective, we see this as a time of opportunity because we can sit on top of what the banks are offering already. Against this backdrop – and given the huge focus on British exports – businesses are going to have to look to alternative sources to secure the funding necessary for growth.

Paul Marston: There is a real opportunity for businesses to win export market share in light of the exchange rate. However, there are a lot of SMEs that are still pricing in sterling rather than considering questions such as: "What is the price overseas?", "What am I competing with?" and "What is the buy-in currency?"

Certainly, there are foreign exchange solutions – such as disaster rates currency options – that can prevent losses when exchange rates move. Yet, a lot of SMEs fail to use these, meaning they do not have a safety net in place. There needs to be more awareness around currency solutions, and traditional banks serving SMEs are not bringing these to the fore.

Andrew Churchill: From an exporter's perspective, there are elements that temper fluctuations. First, on a typical project, approximately 70% of my cost is raw material, which I buy in dollars. The risk for me is purely on the added-value element.

In the long-term, one of the disadvantages of a weak pound is that it could discourage investment in innovative technology and automation. This equipment is largely, although not exclusively, imported and very costly. Yet this expenditure is critical for manufacturers – particularly in the aerospace sector – in order to remain globally competitive. In this respect, one downside of a weak pound is that it is making innovation and investment more expensive.

Geoff Wynne: For many companies, there are a variety of import requirements when it comes to exporting outside of the EU. In fact, most of my work relates to the movement of goods in the emerging markets. Certainly, there are plenty of markets beyond the EU to be explored.

Until now there has been a single standard for those businesses trading in the EU, but this may well change. As such, manufacturers need to start preparing for new trade agreements and the associated compliance around the movement of goods. For instance, businesses that are already exporting or importing – or even considering trading internationally – might want to think about getting a VAT expert.

Henry Anson: Are manufacturers seeing the opportunities of Brexit? Or is the focus still mainly on the challenges?

Susan Ross: At Aon, we have seen a lot of enquiries for what we might call "faraway markets", as exporters start to think about actively sourcing new opportunities abroad.

At the same time, there has been an increased appreciation of risk, more so than we have ever seen before. In my opinion, Brexit has certainly been a catalyst in terms of worries over non-payment, complications with contracts and increased political risk. Added to this are growing concerns over access to finance.

Paul Marston: Brexit has brought to light some fundamental issues both for the government and the wider business community. Given this, one silver lining of Brexit is that it provides an opportunity for reassessment – particularly with respect to our trade position and our economy.

Will Nagle: From a risk perspective, businesses can no longer afford to be complacent. Instead, they need to re-educate themselves and ask necessary questions, such as, "how is this risk assessed?" or, "are we covered in the event of XYZ?" Businesses can no longer afford to be paying huge amounts of money to renew a policy without exploring the finer details and considering all the associated implications.

More broadly, in today's changing landscape, business needs to be proactive. New relationships need to be developed and nurtured in markets worldwide, while businesses that are already operating in established markets must become more adaptive and flexible.

Waiting for the results of the final Brexit deal to become clear will be too late – in fact, there are steps that should be taken much sooner. For instance, redesigning supply chains to take into account barriers to the free movement of products, creating new agreements and contracts, as well as ensuring compliance with new rules.

Marcus Dolman: Brexit has made businesses nervous. One key area of concern for large exporters is around our global supply chains. How might Brexit affect our production and distribution? What impact will it have in terms of moving our products across borders? How many cross-border movements will we have? Will we need to put an extra system in place to assist? Will we need to employ more staff to be able to handle the additional processes? All of this poses a major concern.

Another relates to the impact Brexit will have on our ability to attract skilled people from the EU. The ability to hire the most suitable EU candidate for the role without additional visa implications is very valuable. Large exporters also currently utilise the benefits of free movement to develop their existing people by seamlessly moving them around their various EU facilities. The potential loss of this freedom is of concern to large exporters.

Andrew Churchill: A reduction in the velocity of trade is another issue that needs to be highlighted. Our company's rate of growth is almost entirely controlled – not by technology or the bandwidth of my senior management team – but by cash. Any delay in our products – and the implications of that for payment terms – will have an impact on our ability to grow. More importantly, this will make us less competitive because we are not innovating at the same rate. It is these more subtle implications of non-tariff barriers – and the reduction in the velocity of trade – that I think could be quite damaging, particularly to the supply chain.

Emma Clark: Based on conversations with global manufacturers, many expect that they will have to support their supply chains – both outbound and inbound – by extending finance terms. This is particularly the case when purchasing from smaller businesses. In this respect, some of these major manufacturers will have to become alternative financiers themselves – some of them already are – but even more so now. Of course, this represents its own challenges because they are sales companies, not financiers.

On the SME side, growth will increasingly have to come from exports, and that means exploring new markets such those in the south and further east. But these markets tend to be slower when it comes to payment and they are also higher risk. A large part of boosting British exports must be in getting new companies to export and helping them to do so safely and efficiently. For smaller businesses, cash flow is everything and so ensuring they get paid is the real challenge.