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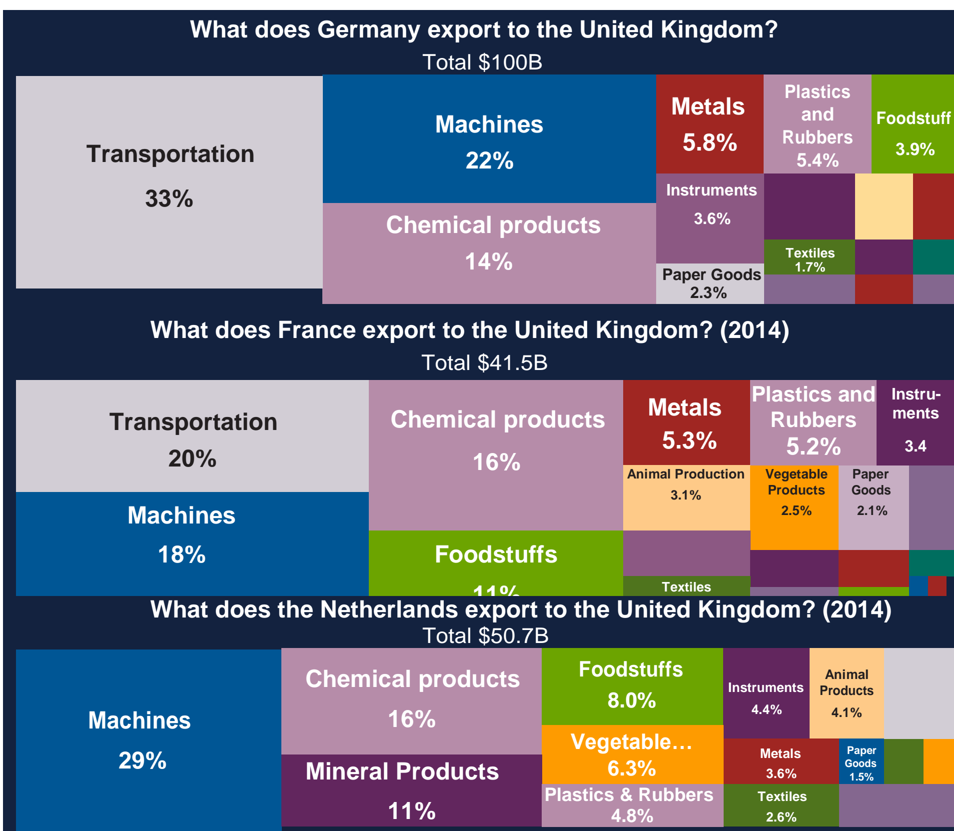
Mayday in London

On Wednesday, 29 March 2017, the British Prime Minister formally initiated the procedure for the United Kingdom to exit the European Union. Controllers eNews asked Paul Moody about the possible impact on European companies, and how they can equip themselves to cope.*

Controller's eNews: *Mr. Moody, what is your assessment of the "hard Brexit" that the British Prime Minister has announced that she will pursue until 2019?*

Paul Moody: Theresa May put it very clearly and succinctly at the end of March: the UK will leave the EU with all the consequences that entails. Also, the United Kingdom wishes to exit the customs union and the European single market. I admit that in light of this, "Mayday" is a rather cynical, but also appropriate, play on words.



Source: http://atlas.media.mit.edu/en/profile/country/gbr

Aside from the direct impact on industry throughout Europe, when it comes to exports to the UK, one should not forget that Great Britain has acted as a kind of bridge between the EU and other countries, as well as offshore locations such as India. Until now, this has made the UK a

highly attractive location for global players in the service industry and for European industrial exports. The impact on the United Kingdom itself is still almost impossible to predict. After all, European imports have always been more important for the UK than British exports have been for Europe. Germany is not the only country to have achieved high trade surpluses over Britain, particularly in the areas of pharmacy, mechanical and systems engineering and cars. In fact, one in five cars exported by German manufacturers have been sold to Britain. Eastern European countries such as Poland, Hungary and Croatia export far more than they import from the UK. The only country with a negative trade balance in 2015 was Serbia.

Trade of East European Countries with UK*

Country	Exports UK	Imports UK	Trade Surplus (U.K Leverage)
Poland	$12.9BN	$5.2BN	$7.7BN
Serbia	$201M	$218M	$-17M
Hungary	$3.93BN	$1.66BN	$2.27BN
Croatia	$237M	$237M	$0
Slovenia	$575M	$440M	$126M

*US $ in 2015

Quelle: REL

In the future, customs barriers will close again

What are the changes that European industry anticipates it will need to confront as a result of a hard Brexit?

Paul Moody: In general, trade with the UK will certainly become more complicated, and is highly likely to be restricted in a damaging way. The benefits offered by the European single market and the customs union will fall away. This will affect not only the production industry, but also globally active service providers, and naturally also financial service providers, who also offer their service portfolios for Great Britain, and possibly also generate them there.

The framework conditions will certainly change. Existing contracts have been concluded under the currently valid law; they will in many cases be rendered obsolete by Brexit, or will have to be renegotiated. What will happen exactly depends not least on the negotiating skills of the EU. But one thing is beyond doubt: in the medium term, European industries and service providers will face new and additional organisational, legal and financial burdens when it comes to trading with and in Great Britain.

Who will be particularly strongly affected by Brexit? And what can industry and service providers do about it?

Paul Moody:

The impact will especially be felt by the industrial sectors which are particularly capital-intensive; in other words, by mechanical and systems engineering or the car industry, which require high levels of investment in materials and production. However, the same applies to the chemical and pharmaceutical industries, which need enormous levels of research and development investment, and which also have long and complex approval periods and processes. They will suffer more than others from regressive trading procedures with the UK, and they will have to try to compensate the exports threatened by Brexit through other export flows, in other words, through intensified trade in Europe and elsewhere in the world.

It also remains to be seen which of Trump's trade restrictions really will be imposed in the future. There, too, the feeling has been one of uncertainty. The eastern European countries (see table) will find it particularly hard to increase their exports and develop new markets, since their export volumes and thus their power on the market are relatively low, and to add to their difficulties, many countries outside Europe have a problem with the strong euro.

At any rate, for the industrial companies and service providers of Europe, this will mean that they will need capital in order to expand existing trade flows and develop new international markets.

Where should the money come from?

Paul Moody: Within the companies, Finance and Controlling will have to precisely analyse what the company sells in the UK, which export volumes are at risk, and what additional costs might arise as a result of the new regulations, laws and customs duties – in short, the risks to which the company will be exposed in the future. This process of analysis must be ongoing until fixed Brexit conditions have been agreed between the EU and the UK, probably by 2019.

At the same time, efforts should be systematically strengthened to generate capital and liquidity by improving the circulating assets and reducing the capital commitment duration. In light of the extreme uncertainties that Brexit will bring about in the near future, liquidity must in all cases be given priority over taking on new loans by optimising the working capital performance – despite the current low interest rate. The reason for this is that:

- Liquidity from a company's own resources enables the company to offset the threat of commercial losses, and
- Develop new export channels and strengthen existing exports.

Will that be sufficient as a method to cure all ills?

Paul Moody: No, of course it won't. Optimising working capital performance cannot provide a safeguard against all the possible effects of Brexit. But it can certainly make European companies more resilient. While it does not offer one hundred percent protection against recession, therefore, it will strengthen potential immunity. After all, we shouldn't forget that in this way, liquidity is not just generated at low cost in the companies. An improvement of working capital automatically also leads to an increase in the overall effectiveness of the companies, and makes them generally more competitive on the market.

∗ Paul Moody is Director of REL, an affiliate of the Hackett Group, responsible for project planning in Germany, Austria and Switzerland. Focal areas include working capital management and supply chain optimisation.

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