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White Paper

Brexit: Preparing for a no deal at the end of the transition period

Updated October 2020

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Executive summary

The United Kingdom left the European Union on 31 January 2020 bringing to an end 47 years of British membership of the EU and the institutions that preceded it. As an extension to the current transition period has been ruled out, come 1 January 2021 the UK will no longer be part of the EU's Single Market and Customs Union, and, subject to an agreement, all legal aspects of Britain's membership of the bloc will cease to apply. Without an accord the UK will thereafter be legally considered a "third" country by the EU, creating significant barriers to trade and other aspects of life. Both sides' red lines have raised fears that no deal may be reached, potentially creating an abrupt "cliff-edge" at the end of 2020.

With the transition period expiring at the end of 2020 and with negotiations for a trade deal between the UK and EU remaining ongoing, the date of completion - previously considered a red line - has become a more flexible deadline. However, most commentators are indicating that whilst goodwill is in place there are real stumbling blocks yet to be resolved without significant compromise from both sides. These include ensuring a level playing field for trade; an open, frictionless border in Ireland; access to UK fishing waters; and commitments in respect to aligning government support to business sectors matching that of the EU.

Less than 52% of UK businesses have started to implement Brexit contingency plans.

The current threat of a no-deal scenario is very much alive, and therefore, as a UK-based manufacturing business, your production line and access to stock and industrial supplies remains at risk if you do not take proactive measures to minimise the impact in the short term. The British Chambers of Commerce recently conducted a survey suggesting 52% of businesses are yet to implement Brexit contingency plans.

Consequently, large parts of the British economy are not ready for such an outcome. Even at this late stage many manufacturing organisations are struggling to create a clear plan of what they need to do to minimise the impact of Brexit and maintain production output levels to satisfy customer demands.

Rubix UK are preparing for the eventuality of no trade deal being agreed with the EU as a worst-case scenario with regard to the effect on product supply chains. In 2019, prior to the final negotiations on the transition plan when a hard Brexit looked likely, we questioned all our key suppliers whose stock we carry to understand their plans for continuity of supply. We have now contacted all of them again to get an update on any additional contingencies that they are putting in place to secure product availability after 31 December 2020 when the UK's transition arrangement will end.

The seven biggest risks of Brexit

- Economic and financial risk
- Supply chain
- Customs compliance
- New routes to market
- Tariffs
- Services not covered
- Continuity of production

The potential threats to production line continuity you need to consider

The current confusion surrounding the likely impacts of leaving the transition agreement at the end of this year without a deal struck between the UK and the EU have only been magnified by the impact of Covid-19. The spread of the novel coronavirus has caused many companies to take their eye off Brexit preparations. Should the UK exit the EU with no agreement on the future of our trading relationship, the UK will revert to World Trade Organisation (WTO) rules.[1]

The consequent risks to the continuity of your production line would be huge. First of all, customs agreements existing between the UK and the EU will no longer be valid. Instead, the UK would be forced to follow the same customs checks and tariffs as other WTO countries such as Australia and Argentina with grave uncertainty as to how the UK would process both imports and exports.

But secondly, this extends way beyond trading with the EU. The UK would need to establish its own global trade agreements, as all existing agreements negotiated with the EU and applying only to EU members will no longer apply to the UK and would immediately be invalid. With these deals taking years to establish, the increased rigour in border checks would represent a significant challenge to those manufacturers reliant on importing materials to service their production lines.

> *Hard borders will see a backlog of late goods required to maintain your production line and customer commitments.*

As a result of this scenario, we will see a backlog of deliveries, preventing your production line from running efficiently. Inefficiency means an increase in unplanned downtime, costs and customer complaints, which in turn could lose you future orders, especially if an EU-based competitor who does not have to deal with WTO issues is able to fulfil an order when you can't.

Economically, the British pound will almost certainly become a risk currency for a period of time, causing it to fluctuate in value amidst the uncertainty. Investment from outside the UK will continue to decrease or even stop altogether, alongside the risk of depletion in investors' assets. Transactions involving the British pound will see an increase in the cost of raw materials and industrial supplies to compensate for this depreciation and to pay for any tariffs involved. Inevitably this will result in detrimental impacts on the economy and trade, with additional customs checks and border controls also bringing further disruption to major manufacturers.

[1] 'What If There's No Brexit Deal?', *Parliament UK*

Given the present likelihood of a no-deal Brexit, UK businesses are strongly urged to prepare for the worst-case scenario. There is little to no downside to making such preparations as preparing does not mean implementation. On the other hand, the upside of being prepared would help to ensure the continuity of your production and minimise the impact of such an eventuality on your business.

The seven key risks you need to prepare for

That taken into account then, here are the seven key risks to manufacturers that Brammer Buck & Hickman has identified and is mitigating for a large number of UK businesses already.

1. Economic and financial risk

With Brexit continuing to make the British pound a source of speculation on an international scale, the related currency fluctuations will continue to impact the price of all imports quite dramatically. In the event of the most likely option now, a no-trade-deal Brexit, the costs of raw materials required for manufacturing production will increase. When it comes to parts to keep your lines running, the fact that most of these will be imported from outside the UK will mean their costs will increase too. In some cases, substantially.

From April to June of this year, GDP fell by a record 20.4%, marking the second consecutive quarterly decline and plunging the UK into a recession along with most other countries in the developed world.[2] It was hoped that the Covid-induced recession would be short, a v-shaped dip rather than a prolonged one. However, with the current second wave in full force there is much less chance of that recovery profile. Adding a no-deal Brexit will also almost certainly compound the UK's negative economic situation and risks turning the recession into a prolonged and painful slump.

2. Supply chain

Increased complexity and cross-border duties and regulations will in turn lead to increased costs and inventory management challenges for UK businesses. The amount of work required to manage this is likely to increase significantly due to the additional paperwork required for every customs entry, impacting the supply chain costs (MSS reporting and deferment account management), as well as the time taken to pass between borders.

Companies and customs officials will not only have to deal with a vast scale of change, but also an exponential increase in expected error rates and fines. As these unfamiliar processes are dealt with, increases in delays and errors at customs points of entry will in turn see an increase in delays and costs to your production line.

[2] 'GDP first quarterly estimates, UK: April to June 2020', *The Office for National Statistics*

This will affect your ability to meet your customer demand, with more of your resources required to deal with complaints, in addition to the maintenance of your stock and production line.

One of the latest risk assessments shows a worst-case scenario of there being upwards of 7,000 trucks queuing to cross from Dover to Calais.[3] The Road Haulage Association recently raised formal concerns to the Government over the competence status and testing of the new software system designed to speed up paperwork flow after the transition period.

However, the big question remains would these measures be enough to alleviate the waiting and congestion at these ports and at all ports aside from just those most conveniently situated to the south of England.

3. Customs compliance

This will be particularly challenging as, under WTO rules, the UK will not have a frictionless border with the EU; exporters would have to prove they meet all of the EU's product standards and regulations. Here again, customs compliance may lead to inflated costs, delays to border crossings (elsewhere if even perhaps not in Calais) and an increased head count for companies to complete customs paperwork. All of which will have a dramatic impact on the time taken to fulfil orders. Slower delivery also means more time between your manufacturing and delivery, ultimately delaying invoicing and payment. This will have a considerable impact on working capital.

Customs delays of just 30 minutes could bankrupt one in ten firms, with impacts on firms, large and small.

But again, it is important to note that all existing trade agreements that apply to members of the EU will no longer stand once the UK has left. So WTO rules will apply to both exports and imports from any other country. This will result in increased costs and slower supply of parts as WTO paperwork must be completed.

The economic impact of Covid-19 has placed unprecedented burdens on cash and with it the ability for businesses to maintain artificially high stock levels.

In 2019, a prior Chartered Institute of Procurement and Supply (CIPS) survey found that almost a quarter of 1,300 surveyed firms were stockpiling goods for fear of border delays and shortages. The survey went even further, stating that customs delays of just 30 minutes would bankrupt one in ten firms, regardless of firm size.

4. New routes to market

In order to reduce the impact of some of these threats, the avoidance of logistical "pinch points" may require sourcing from alternative producers, thereby affecting the brand of products used in maintenance, repair and overhaul.

[3] 'UK warns of 7,000-truck queues to cross Channel after January 1', *The Financial Times*

5. Tariffs

The UK Government has already reviewed and put in readiness a new set of tariffs to come into effect after the transition period ends. Working within WTO guidelines every WTO member has a list of tariffs and quotas (limits on the number of goods) that they apply to other countries, otherwise known as their WTO schedules. The changes made by the UK Government are aimed at protecting and supporting certain market sectors.

WTO tariffs can range from 1% to as high as 45%.[4]

On the other hand, the UK Government has negotiated a temporary schedule in the event of a no-deal Brexit, this would see 87% of imports by value benefitting from zero-tariff access, compared to 80% under the current WTO rules. Whilst this might bring some good news (for example, to the automotive industry for the movement of parts but, note, not for finished vehicles), this was agreed back in March and it remains unclear how long these zero-tariff rates will last. There is still a large lack of clarity and confirmation from the Government as to which items will be affected by new tariffs and those that won't.[5]

> *With less than two months to go these tariffs are yet to be confirmed, leaving little time to prepare.*

What trading on WTO rules will mean

Having reached the end of the transition arrangement without any new trade deal, the UK would default to operating under World Trade Organisation (WTO) rules.

Increased border control

Increased administration for the movement of products, goods and services will see increases in costs, time and continuity of production.

Tariffs

WTO tariffs depend on the product or service, varying from 2.6% for non-agricultural goods to 45% for food products, impacting both imports and exports.

Customer compliance

The WTO and EU have varied product and food safety standards, adding extra steps to current processes to accommodate these differences.

Services not covered

The WTO rules focus on the movement of goods with limited, or no, legislation for other services e.g. banking and aviation.

Enforcement of WTO rules

The EU can pick and choose what it allows the UK to sell in the EU, with disputes often difficult to settle.

Trade deals

The UK would need to broker their own deals, which would take time to put in place.

[4] 'World Trade Tariff Profile 2019', *World Trade Organisation*
[5] 'The tariff of the United Kingdom v1.0', *Parliament UK*

With the end of the transition period approaching on 31 December, without a deal, these tariffs are still yet to be confirmed, leaving businesses little time to prepare for increases in costs for imported goods that will either need to be carried by the businesses themselves or passed onto the customer. Volkswagen, for example, have already confirmed that the cost of import duties would be passed onto the customer.[6]

> *The impact of tariffs on production line management would also be severe under such conditions with price increases being passed back to manufacturers directly by parts producers and, through imposed inbound tariffs, indirectly too.*

6. Services not covered

WTO rules barely cover trade within the service industries which means that for those services not covered there is even more uncertainty. For example, trading on only WTO terms would mean there would be no deal on air transport. In order to have access to the EU single aviation market, airline companies (including airline manufacturers) are required to have their headquarters and majority shareholdings in the EU, resulting in the potential for airlines to have to relocate.[7] Airbus, for example, have expressed concern over non-tariff barriers which could result in additional customs procedures and bureaucracy, complicating supply chain processes and increasing costs.[8]

Richard Branson has also noted his concern regarding a no-deal Brexit saying it could be devastating for his businesses and mean relocating outside the UK. "It obviously is going to result in us spending a lot less money in Britain, and just putting all our energies into other countries," he noted.[9]

> *"It is obviously going to result in us spending a lot less money in Britain, and just putting all our energies into other countries."*

The financial services sector is particularly vulnerable, whereby no deal could see businesses lose their "passporting rights" which allow them to serve the EU whilst operating from the UK.[10] This will, in turn, have a knock on impact on the wider economy.

7. Continuity of production

As noted throughout this document, in addition to all of these points – and perhaps also as a result of them – there is a real threat to continuity of production. Your ability to maintain the integrity of your production line and your commitments to your customers is directly impacted by your access to industrial parts. If you can't get those parts as and when you need them, your business will simply grind to a halt.

6 'VW Group to pass on costs of no-deal Brexit tariffs to consumers', *MotorFinance*
7 'No deal? Seven reasons why a WTO-only Brexit would be bad for Britain', *The Conversation*
8 'Airbus outlines Brexit risks to UK facilities', *Flight Global*
9 'No-deal Brexit would be devastating for Virgin', *Branson' Travel Weekly*
10 'No-deal Brexit: what would "WTO terms' mean for UK-EU trade"', *EuroNews*

A Brexit scenario that imposes any type of additional tariff and customs barrier means you may not have enough maintenance stock to actually cope. With an estimated 54% of all UK imports in 2018 coming from the EU (a marginal increase from 2017), stock maintenance following Brexit will become critical in planning for likely stock and parts shortages.[11]

Risk assessment & mitigation

If you are to mitigate the risks to your continuity of production, you need to be aware of the impact Brexit could have on your manufacturing line so that you can prepare for those risks by implementing robust, tailor-made solutions.

By way of example, we worked with a UK customer, helping them to understand the impact of Brexit on their business. From their risk assessment they were shocked to find that over 60% of their industrial supplies are currently sourced from the EU.

This means that spare part availability will be reduced, they will not have adequate industrial supplies to cover their needs and they will experience more stock-outs. Stock-outs, in turn, means disrupted manufacturing lines, lower productivity and higher costs.

They concluded that if they don't act, they will see an increase in downtime and, as a consequence, incur additional costs of up to £2m next year. This is before they have even considered overtime costs, recruitment cost for temporary labour, penalties for late deliveries or, in the worst case, lost customers.

It is clear that in this example, as well as in many other cases that we have worked on, the key to mitigating these risks as best as possible is all in the planning. Proper planning provides you with the confidence that, regardless of the outcome of the ongoing trade negotiation issues, your business is prepared, and you do not have to worry about the availability of industrial supplies to maintain production and fulfil your customer obligations.

It's not too late to develop such plans, though time is critically short, and you will need to act very soon.

[11] 'Statistics on UK-EU trade', *Parliament UK*

Brexit and your production – the Brammer Buck & Hickman solution

We are working ever harder with our customers to mitigate these risks and provide bespoke solutions in order to deal with any procurement issues, concerns and challenges in relation to maintaining the integrity of their product lines. We can do this because:

- Of our extensive understanding of the industrial supplies chain
- We are part of the Rubix Group network, who have industrial supplies businesses across the UK and the EU
- Of our stockholding expertise

We have already carried out a detailed Brexit-readiness survey of our suppliers. In each case, the survey clarified:

- Country of origin
- Country of shipment to the UK
- HS codes for the product (The Harmonized Item Description and Coding System)
- Delivery route to the UK
- Inventory risk mitigation

The resulting dataset allows us to make recommendations and plan for the various logistical impacts leaving the transition period without a trade deal will have, together with alternative supply chain options. We can do this for all our customers and for all manufacturers in the UK.

We are ready for Brexit, and we want you to be ready too, but you must act now.

Late as it is, our knowledge and experience means we are equipped to help you immediately, not only as a single source supplier of industrial supplies, but also with a common-sense approach to your own last-minute preparations and any changes you might need to make to your existing plans to take into account this uncertain business landscape.

Our supply chain expertise will help you rapidly identify key risks related to your industrial supplies availability, make recommendations based on your industry sector and, even now, build a robust stock-holding solution to suit your specific needs, whilst minimising your initial outlay.

We are working with a number of large businesses and supporting their Brexit risk assessments.

> *In one instance, we analysed all of our customers' industrial parts data and made recommendations to increase their stock levels to support an additional three months' worth of production capability.*

In addition, we are also able to draw upon the significant stockholdings of the wider Rubix Group businesses to offer alternative product ranges sourced from outside the EU, giving our customers appropriate alternatives and as much peace of mind as possible.

Taking action: there's still time

To get the latest risk assessment of supply chain impact of the EU on products you source from Rubix, please contact your Account Manager for further assistance.

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