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HOW CAN COMPANIES PREPARE FOR NO DEAL BREXIT?

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SUMMARY
The risk that the United Kingdom (UK) will leave the EU without an agreement on 29 March 2019 is imminent. The Danish government and business organisations have therefore stepped up efforts to inform citizens and companies about how they can prepare for a possible no deal Brexit.

It is important that companies with activities in the UK already now prepare for a no deal scenario. Businesses should as soon as possible mitigate doubts about supply chain issues, existing contracts, obstacles to free movement, IT systems, and personal data management. These are the recommendations of the European Commission, the Danish government, and several business organisations.

If Britain leaves the EU without a deal, companies are faced with tariff and non-tariff barriers over night. There will be no withdrawal treaty or a transition period and a future trade agreement will have long prospects. At the same time, it is expected that agreement on contingency plans can be reached in a few selected areas to mitigate the immediate consequences. This applies in particular to aviation, delivery of medicine to the UK, and bilateral agreements to safeguard the rights of EU citizens in the UK (and vice versa).

MAIN CONCLUSSIONS:

- If Britain leaves the EU without a withdrawal agreement and a transition period, companies will face tariff and non-tariff barriers.
- Studies show that most large companies in a number of EU countries have prepared for different Brexit scenarios. It is more unclear whether small and medium-sized enterprises are as prepared.
- Danish companies should already now take precautions and prepare for a possible no-deal scenario.
- Companies should carefully consider how they will react to fluctuations in the exchange rate, restrictions on the free movement of goods, persons and services, different regulation, and future financing.
- Contracts with British counterparts that run after Brexit should be thoroughly checked. There can already now be clarified regarding the choice of jurisdiction, i.e. which country's laws will apply after Brexit in case of disputes.
- Data and IT systems must be prepared to handle trade barriers, customs, and VAT, particularly for companies that do not currently trade with third countries.

The risk of Britain leaving the EU without a withdrawal agreement or a transition period - a no deal scenario - is imminent. This might happen if a majority in the the British Parliament votes against the withdrawal agreement.[1]

It is, however, hard to imagine a no deal scenario without any contingency plans in place to mitigate the immediate consequences. This applies to, for example, aviation, supplying drugs to Britain and bilateral agreements to ensure resident EU citizens' rights in the UK (and vice versa). However, it is inconceivable that the EU will allow for a replication of most of the aspect in the withdrawal agreement.

The European Commission has for the last six months stepped up its preparation for a possible no deal Brexit and called on EU governments and industry organisations to prepare themselves for a no deal scenario. In Denmark, the government's Brexit preparation follows three tracks. The first concerns citizens' rights; it covers those Danes who choose to stay in Britain after Brexit. Here, it is

[1] Irish border is the decisive Brexit knot, Think Tank EUROPA, September 24, 2018, http://thinkeuropa.dk/politik/irsk-graense-er-den-afgoerende-brexit-knude;
The Brexit fate lies in the hands of the British, Maja Kluger Dionigi, Politiken, 15 September 2018, http://thinkeuropa.dk/politik/brexit-skaebnen-ligger-i-haenderne-paa-briterne.

important to ensure portability, i.e. that Danish social rights such as access to Danish pension will continue to apply after Brexit.

The second aspect covers customs and borders. The Danish Customs Agency is already engaged in preparing for Brexit and has employed 40-50 new employees for customs guidance and control. Their role is primiarly to guide companies with export and import to and from Britain. The government hopes to minimise the negative impact on Danish companies caused by Brexit.[2]

The third aspect concerns preparing companies with activities in Britain for different Brexit scenarios. The Danish government launched a Brexit website in October, which will prepare citizens and businesses for Brexit.[3] The Ministry of Business has recently launched a 'Brexit checklist'-website, where companies can find the information they specifically need. The Conferederation of Danish Industry (DI) launched a 'Brexit toolbox'-website in October 2018 inspired by their Irish sister organisation (Irish Business and Employers Confederation, IBEC). This toolbox advises Danish companies on how to prepare for a possible no deal scenario. This covers questions such as what a no deal Brexit means for supply chains, existing contracts, investments, financing sources, enterprise IT systems, and competitiveness.

In this paper, Think Tank Europa discusses what Danish companies can do now to prepare for a possible no deal scenario. The paper is based on the recommendations given by the European Commission, the Danish government, and business associations (DI and Ibec).[4]

Weakening of the British pound and unstable price development

The fall in the pound sterling against the euro was one of the immediate consequences of the Brexit referendum. It has made Danish goods exported to the

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[2] The Danish Customs Agency manning up for Brexit, Customs Administration, 5 September 2018, https://www.toldst.dk/nyheder/toldstyrelsen-mander-op-til-brexit/

[3] www.um.dk/brexit.

[4] Brexit preparedness, European Commission website, https://ec.europa.eu/info/brexit/brexit-preparedness_en;
Is your business ready for Brexit, Dansk Industri, https://www.danskindustri.dk/di-business/arkiv/nyheder/2018/10/er-din-virksomhed-klar-til-brexit/;
Brexit - a guide for your business, Ibec's website, https://www.ibec.ie/IBEC/DFB.nsf/vPages/Ibec_Europe~Positions_and_publications~brexit---a-guide-for-your-business-29-03-2017?OpenDocument.

UK more expensive than British goods. A no deal scenario will probably lead to a further weakening of the pound[5].

It is important for companies to identify their exposure to short-term fluctuations in the exchange rate. It involves consideration of: (1) when one's business becomes unsustainable in relation to fluctuations in the exchange rate, (2) whether one's contracts allow for price changes as a result of fluctuations, (3) how risk-averse one is, and (4) if companies are willing to hedge to manage short-term currency risks.

It is also necessary to plan how to handle a long-term weakening of the British pound. First, companies can seek new markets to become independent of the UK market. Second, they can reduce their costs through new initiatives. Third, they can explore their possibility of hedging. This involves considerations of whether, or not, it makes sense to (1) move activities to Britain to maintain British customers, (2) use British suppliers paid in pounds to service the British market, and (3) use British ingredients to counter price pressures.

Trade barriers in the supply chain

Today, the internal market secures the smooth running of supply chains between Denmark and the UK (as well as the rest of the EU) through the four freedoms (free movement of goods, services, capital, and persons). The customs union ensures that there is no tariffs and non-tariffs barriers to trade within the EU and a common external tariff on all goods entering the the EU.

In case of a no deal scenario, the World Trade Organization (WTO) rules will apply to all trade between the EU and the UK from 30 March 2019 (the planned Brexit date) until a future trade agreement enters into force. This means that the EU's external tariff towards third countries, without a EU trade agreements, will apply to the UK. In addition, there will also be non-tariff barriers at the border between the EU and the UK, including checks of the compliance with EU technical standards, product labeling, and rules of origin for goods that are entering the EU market. This will result in logistical barriers, delayed trade, and business costs.

Time-sensitive deliveries (such as beverages and food) will be particularly vulnerable to restrictions on the free movement of goods. DI has already urged

[5] Cost of no deal revisited, The UK in a changing Europe, 3 September 2018, http://ukandeu.ac.uk/research-papers/cost-of-no-deal-revisited/.

companies to consider how customs and border control between the EU and the UK may affect their supply chains, costs, and competitiveness. This entails:

1) *A mapping of movements of goods* in and out of the UK to identify potential challenges to supply chains in areas where new costs and work procedures are required.
2) *Expenses*: How does administrative burdens affect customs clearance costs? How does border checks affect delivery times?
3) *Sensitivity*: What impact do trade barriers have on prices and costs? How price sensitive are customers? How are time-sensitive deliveries affected?

Research shows that the introduction of customs and border controls can lead to a two-minute extra waiting time per vehicle and overall result in a fifty-hour waiting time at junctions such as the Calais-Dover crossing.[6] The border control involves customs clearance and related procedures such as rules of origin, product safety check, food safety, and animal and plant health. Goods entering the EU will also be checked for compliance with environmental, and health and safety regulations.

Many manufacturers rely on flexible supply chains for the delivery of product components. They will be challenged by long waiting times at the border. For example, the carmaker Honda relies on deliveries from about 350 trucks every day to its factory in Swindon to provide the parts required to make the cars on a "just in time" basis. Honda estimates that a 15 minute delay at the border due to customs control would cost them tens of millions of pounds in additional tariffs yearly and damage their competitiveness[7].

It is necessary for companies to consider the possibilities of reorganizing their supply chains in terms of customs and border control. It may be necessary to move production in the UK to another EU country to find alternative suppliers in the EU and find new routes for goods that pass Britain on their way to the EU

[6] Cost of no deal revisited, The UK in a changing Europe, 3. september 2018, http://ukandeu.ac.uk/research-papers/cost-of-no-deal-revisited/
[7] Honda UK warns MPs of consequences of leaving EU customs union, The Guardian, 14. november 2017, https://www.theguardian.com/business/2018/sep/18/honda-no-deal-brexit-tariffs-swindon.

Revision or renegotiation of contracts

A no deal Brexit have consequences for companies with commercial contracts with British counterparties that expire after Brexit. Companies can already now review their contracts to check if their contracts, for example, require British membership of the EU, free movement of goods, services and persons, and a joint regulatory authority. Furhermore, it is necessary to check if the contracts allow for price increases due to customs and other trade barriers.

Without a withdrawal agreement and a transitional period, it is uncertain which country's rules apply if disputes arise between two contracting parties. Companies can already enter into a jurisdiction agreement with their British contract party to reach agreement on which country's laws apply in case of disagreement.

Restrictions on freedom movement of workers

Today, EU citizens are entitled to work in the UK without a residence or work permit and get recognition of their professional qualifications from another EU country. Businesses can smoothly station workers to subsidiaries in the UK.

A no deal Brexit leads to restrictions on the free movement of persons and services with consequences for companies relying on free movement of labour between the EU and the UK. Therefore, it is important already now to consider what impact restrictions on freedom of movement for workers will have on business activities and employees in Britain. Visa restrictions and new residence rules will affect staff in the UK. The ability of EU citizens and businesses to provide services in the UK will also be limited.

Britain has the opportunity to change the rules for recognition of qualifications and authorization after Brexit. This might have consequences for the recognition of EU citizens' professional qualifications from EU and their ability to pursue their profession in the UK. In the long run, it may be necessary for companies to adapt to the restrictions on free movement of persons and services by for example relocating.

Upgrading IT systems and data infrastructure

Trade barriers between Britain and the EU after Brexit have consequences for companies' IT systems, especially for companies who are not accustomed to trade with third countries. Businesses can already now ensure that their data and IT systems are geared to deal with trade barriers, customs duties, and VAT.

Brexit may also create restrictions on personal data exchanges between the EU and the UK and on where the data is physically hosted. After Brexit, personal data transferred to the UK will be regarded as the transfer of data to a third country. Companies can already now explore how restrictions on data exchange after Brexit will affect their data infrastructure and personal data management

Different regulation

Common EU rules for goods and services will not necessarily apply to the UK market after Brexit. Britain's current business regulation builds on EU law. There is the long term risk that the UK's rules will diverge from the EU's. This means that companies must change their products and packaging, when trading on the UK market. Companies cannot be sure that mutual recognition of products will be in place after Brexit.

Businesses can already now consider how vulnerable they are to different business regulations in the EU and the UK. For example, is it too expensive to adapt a product to two different markets? In addition, there are a number of other aspects that companies must keep in mind: responsibilities and obligations in the supply chain, EU trademarks and certificates, licenses and authorizations. Companies have different responsibilities depending on where they are located in the supply chain (manufacturer, importer, distributor). Following Brexit, EU27 companies that purchase goods from the UK will be considered importers in relation to EU product law. This gives them other obligations than they have today.

EU trademarks or supplementary protection certificates do not necessarily apply in the UK after Brexit. Certificates, licenses, and authorizations issued in the UK will not automatically be valid in the EU after Brexit. They will have to be transferred to or recertified by similar bodies in the EU for products to be sold in the EU.

Influence on investment plans and sources of funding

Uncertainty after Brexit could have consequences for decisions on Foreign Direct Investment (FDI), access to capital markets, and EU support programs. Businesses can presently consider how their investment plans and funding sources will be affected by Brexit. Is there for example a need to delay or cancel investments when the future is uncertain? Is access to EU funding dependent on British partnerships? Are sources of funding affected by Brexit and the resulting uncertainty in capital markets?

Businesses can already now plan how to secure their future finances and funding after Brexit concerning their budget, alternative partnerships from other EU countries in order to secure future EU funding and access to capital and liquidity.

Business competitiveness

Brexit not only affects the cost and complexity of business activities in the UK. It also impacts on economic growth, consumer behavior, and the competitiveness of Danish companies operating on the UK market. It is, therefore, necessary for companies to consider how they can adapt their business model and/or strategy to increased competition.

Preparations include considerations on how vulnerable the company is to changes in consumer behavior in the UK. It is possible that Brexit will lead to a dampening of British private consumption as a result of rising inflation and lower growth. Danish goods, wholly (e.g. Lurpak) or partially produced outside the UK, will become more expensive due to the depreciation of the pound.

Businesses can already now consider potential strategic opportunities to ensure their competitiveness, such as possibilities of expanding into new markets, innovative products to differ from cheaper competitors, and reducing product and service costs

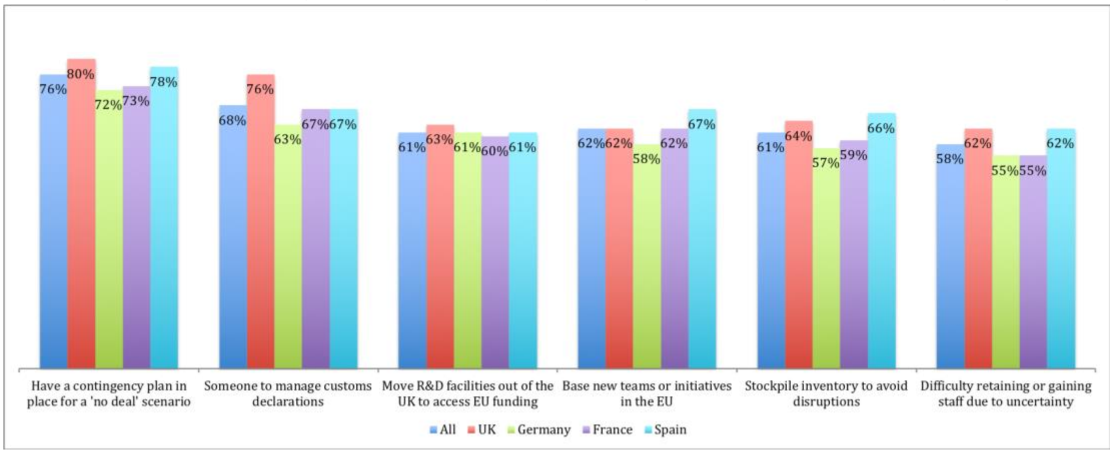
How well prepared are companies for Brexit?

A survey by FTI Consulting from September 2018 among 2,087 managers from large companies in France, Spain, the UK, and Germany[8] shows that 76 pct. of the respondents have emergency plans in place for a no deal scenario. [9] Here, the UK tops the list (80 pct.), followed by Spain (78 pct.), France (73 pct.), and Germany (72 pct.). Figure 1 shows how the surveyed companies have prepared for Brexit in relation to customs declarations, R&D (research and development), new initiatives, inventory, and employee retention.

[8]Country distribution is: France (n = 512), Spain (n = 545), United Kingdom (n = 518), Germany (n = 512).

[9] Brexit in the Boardroom: The View From Business: Autumn 2018 Update, FTI Consulting, 15. oktober 2018, https://www.fticonsulting.com/insights/reports/brexit-boardoom-view-from-business-autumn-2018-update.

Figure 1: Have or are you planning any of the following as a direct result of the expected scenario of the UK leaving the EU? Percentage of respondents that answered 'yes', pct.



Source: Brexit in the Boardroom: The View From Business: Autumn 2018 Update, FTI Consulting, 15 October 2018.

The survey shows that 68 pct. of the companies asked will deploy extra staff to handle any customs declarations. Again, the UK tops the chart (76 pct.). 61 pct. of companies will increase their inventory to avoid disturbances in trade in case of border controls. 58 pct. expects that they will have problems attracting and retaining new employees after Brexit. 63 pct. of UK businesses plan to move their R&D facilities to the EU after Brexit to continue to have access to EU funding. The same holds for 61 pct. of German and Spanish companies and 60 pct. of French companies with activities in the UK. In addition, 62 pct. of all surveyed companies plan to base new teams or initiatives in the EU after Brexit.

The survey suggests that large companies are prepared for Brexit. The question is if that is also the case for those small and medium-sized companies that are not used to trading with third countries. For them new administrative burdens of a 'hard' Brexit are both time consuming and expensive. [10]

[10] DI: A hard brexit weakens corporate competitiveness, Altinget, 5 September 2018, https://www.altinget.dk/eu/artikel/di-et-haardt-brexit-svaekker-virksomhedernes-konkurrenceposition.