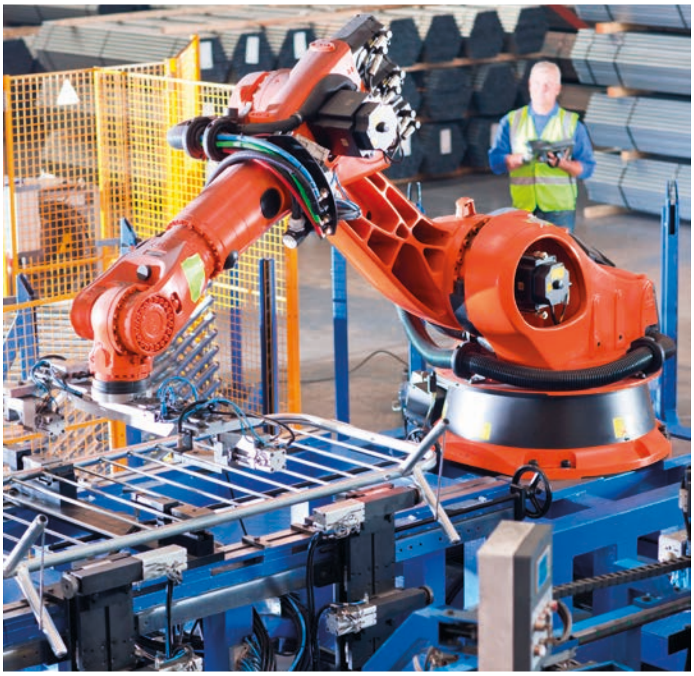
Deloitte.

Brexit Industry Insights

September 2019

Manufacturing

With the UK's default to leave the EU without a deal, there are a number of steps manufacturers can take to prepare. The sector is faced with simultaneously navigating unprecedented technical change and global trade tensions, whilst mitigating the impacts of Brexit – including supply chain disruption, restrictions on skilled EU workers, and trade barriers. The winners over the longer term will be those in the sector prepared for change and alive to the opportunities in the post-Brexit trade and regulatory landscape.



Brexit and the manufacturing sector

The UK's manufacturing industry was valued at £390 billion in 2018 with most areas of manufacturing enjoying growth on the previous year[2]. The sector accounts for 10% of total UK economic output[3]. Make UK estimates this to be 11% of Gross Value Added, and notes production industries employ 8% of the UK's total workforce, account for 45% of total exports (£275 billion), represent 69% of research and development (R&D) and provide 13% of business investment[4].

April 2019 saw output fall by 3.9%, the largest fall since 2002[5], with motor vehicles (and other transport equipment) contributing heavily to the downward change in value, in part due to rescheduled factory shutdowns. As a result of weakening domestic and international demand, coupled with firms mitigating Brexit risks by stockpiling in early 2019, the IHS Markit Purchasing Managers' Index (PMI), which measures economic trends in manufacturing, was 47.4 in August, the lowest level since October 2012. The PMI has fallen in five of the last seven months[6] (below 50 signals contraction).

Manufacturing investment, e.g. building a production line for a new product, re-tooling a factory to take advantage of technological innovation, happens in cycles, so businesses need to plan over the medium to long term. Investment by manufacturing companies is being postponed in light of Brexit uncertainty, and a British Chambers of Commerce survey in Q1 2019 found investment intentions in the manufacturing and services sectors at their lowest for eight years[7]. This has resulted in delays to new technology and systems being implemented. For multinational businesses with global operations, Brexit is one of a number of risk factors they are considering as they make decisions about where to invest in future.

What does this mean for business?

Some of the key implications for businesses operating in the sector are:

Supply Chain resilience

A no-deal Brexit would put the resilience of supply chains under strain as a result of border delays, increased tariffs and the cost of complying with customs procedures.

Visibility of supply chain: limited visibility of multi-tier supply chains and indirect suppliers could cause hidden risks and costs. Understanding the supply chain, from reliance on specialist suppliers where it may not be possible to source substitutes to outsourced service providers, is the first step in mitigating potential sources of supply chain disruption.

Border delays: supply chains could become more complex as the introduction of customs inspections and regulatory requirements increases the time it takes to move goods from one country to another. Transitional Simplified Procedures (TSP) may help to reduce border delays for goods entering the UK, but there are no equivalent simplified procedures for goods leaving the UK bound for the EU. The risk of border delays would particularly impact companies with just-in-time manufacturing and supply chains where parts cross the UK/EU border multiple times during the production process. A recent Chartered Institute of Procurement & Supply (CIPS)[8] survey indicated in the event of border delays, "one in five EU businesses will expect a discount from UK suppliers if border delays persist for just one day".

Tariffs: the EU's tariff schedule will operate on Most Favoured Nation terms under World Trade Organisation rules. The UK will operate its own tariff schedule, for a limited period of 12 months, in which 87% of imports will enter into the UK at zero tariffs. Finished vehicles moving between the UK and the EU will face a 10% duty or higher. Some raw materials, clothing, and textiles will face tariffs of between 6% and 12% coming into the UK. Agricultural products leaving the UK will face higher tariffs still. Firms in manufacturing, therefore, need to be extra vigilant in looking at the detail of both the UK's tariff schedule and the EU's default position.

Rules of Origin: UK exporters (or EU exporters with UK content) will need to look at third country agreements and assess whether: 1) the agreement has been rolled-over; and 2) they will continue to meet the rules of origin requirements based on the sourcing of their content.

Stockpiling: many businesses have stockpiled raw materials, components and finished goods in anticipation of delays. The PMI saw a high of 55.1 in March 2019, falling to 49.4 in May as businesses unwound stockpiles[9]. Businesses are revisiting plans for similar measures in October.

Product Standards

The regulatory requirements will vary depending on the type of products being manufactured. Some examples are set out below:

- **Conformity assessments:** conducted to ensure compliance with EU product standards and important for manufacturers to consider. Institutions such as the British Standards Institute in the UK, alongside its existing notified body status with the UK government, has been designated a notified body in the Netherlands for assessing a number of product categories. Companies wishing to continue to sell products with a CE marking into the EU or wider European Economic Area will need to ensure their existing CE certificates have been migrated to a new EU-based notified body.

- **Replacing the CE mark:** the UK has proposed to introduce a UK Conformity Assessed (UKCA) marking on its products which will replace the CE markings for the UK's market. CE marked products will have a time-limited period of access in the UK's market. However, once a UKCA is introduced, there is a risk over the longer term of divergence between the two standards and maintaining compliance with both will need to be managed.

In focus: Research & Development

Investment in new technology is often based on strong R&D, with the EU currently administering many of these programs, including the €8 billion available under Horizon 2020. If the Withdrawal Agreement is passed, the UK will continue to receive funding from these programmes until 2020.

The UK will cease to receive EU funding in the event of no deal; although the UK government has guaranteed UK organisations will continue to receive funding in relation to bids successfully made for EU-funded programmes before the end of 2020. This includes the Multiannual Financial Framework allocation for structural and investment funds for the 2014-20 funding period; certain awards from the European Commission whilst the UK was a member of the EU; and successful bids where UK companies are able to participate as a third country from the date of exit until the end of 2020. In the short term, R&D funding under these frameworks should continue to be available for UK organisations. In the longer term, the government has expressed its desire to continue collaboration with the EU on R&D and has invested £725 million in the Industrial Strategy Challenge Fund as part of a range of measures to boost R&D[1].

1. Industrial Strategy - Building a Britain fit for the future, p.58: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/664563/industrial-strategy-white-paper-web-ready-version.pdf
2. ONS, UK manufacturers' sales by product: 2018 provisional results, https://www.ons.gov.uk/businessindustryandtrade/manufacturingandproductionindustry/bulletins/ukmanufacturerssalesbyproductprodcom/2018provisionalresults
3. Parliamentary briefing paper: Manufacturing: statistics and policy https://www.parliament.uk/briefing-papers/sn01942.pdf
4. UK Manufacturing Statistics, The Manufacturer, https://www.themanufacturer.com/uk-manufacturing-statistics/

- **Chemicals:** in the absence of a regulatory alignment between the UK and EU, UK-based firms subject to the EU's Registration, Evaluation, Authorisation & restriction of Chemicals (REACH) will face a regulatory trade barrier, because only a company based in the EU/EEA can register a substance under the REACH regulation. In order to continue doing business in the EU post-Brexit, UK manufacturers will need to appoint an 'only representative' (to manage REACH registrations) or transfer registrations to an EU entity (although transfer of licenses could be a complex process as specific rules apply)[10].

People

The Office of National Statistics estimates 11% of the overall workforce in manufacturing are EU nationals[11]. Under a no deal, free movement of people will end once the UK leaves the EU. EU/EEA citizens resident in the UK before 31 October 2019 will retain their rights to settlement and access to services, and they will need to apply under the EU settlement scheme by 31 December 2020. EU/EEA citizens moving to the UK after 31 October 2019 will for a transitional period be able to move to the UK to live and work as they do now. But those wishing to stay beyond December 2020 will either need to apply for European Temporary Leave to Remain by 31 December 2020 or leave the UK. The UK is expected to introduce a new immigration regime from January 2021 for all EU nationals arriving in the UK after this date.

Multinational manufacturing companies often have a highly mobile international workforce and are reliant on the efficient deployment of individuals around the world including within the EU. Post-Brexit changes will need to be factored into existing processes to avoid delays in putting feet on the ground and/or increased costs. For example, immigration requirements for UK nationals planning to work in the EU will need to be confirmed on a country-by-country basis including expected timelines for completion of the immigration process.

Dual social security liabilities could arise for employers and mobile employees if member states do not agree to reciprocal arrangements with the UK.

Legal

Intellectual Property: EU trade marks (EUTMs) and EU Registered Community Designs (EU RCDs) registered at the EU IPO will be impacted by Brexit. UK government has stated it will clone out equivalent UK rights on exit day so that there is continued protection in the UK. EUTMs and EU RCDs pending on exit day with the EU IPO will have to be refiled as UK national applications and the usual fee will be payable. Copyright will be less impacted by Brexit aside from specific cross-border exceptions, e.g. the country-of-origin copyright clearance specific to broadcasters. In relation to patents, only a few specific areas of UK patent law come from EU legislation and therefore also less impacted. At present the question remains over the UK's future participation in a system for the registration of a unitary patent (UP) covering multiple EU countries. If the Unified Patent Court (UPC) does come into place before exit day, business will need to stay alert to government notices.

Commercial Contracts: contracts may need updating to manage some of the potential risks arising from Brexit or in response to Brexit-related restructuring. Areas of focus include: reviewing risk allocation between parties such as which counterparty bears the risk of border delays and tariff costs; definitions of key terms; changes to pricing structure or frequency of pricing reviews and changes to payment terms and contract enforcement.

What can businesses do to prepare?

- Make sure you know how to complete and submit the necessary customs declaration procedures and forms for both imports and exports.
- Conduct a trade continuity and market access review to understand your exposure to third country trade deals; assess International Commercial Terms (INCOTERMS) for who bears the impact of losing beneficial trade terms.
- Ramp up your operational response capability; take steps to manage disruption as and when it occurs, including accelerating imports/shipments, identifying warehousing space as well as alternative suppliers and/or markets.
- Undertake a regulatory review to understand what the labelling changes and product standards could mean for your products where they are produced and sold.
- Regularly communicate with your EU workforce to encourage status certification as early as possible. Establish a process that monitors member state changes to immigration and social security that could impact UK workers in the EU.
- Keep up to date on UK and EU government, European Commission and regulator announcements in the run up to 31 October and beyond to stay up to date on policy changes.
- Develop a strategy for government engagement on the issues that matter most to the business in order to influence future policy.
- Manage all key stakeholders to understand commitments and expectations. Engage with audit committees and liaise with trade bodies and regulators on preparations.

5. ONS Index of Production, UK: April 2019 https://www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/indexofproduction/april2019
6. Economic Indicators: Manufacturing, House of Commons Library, 2019. https://researchbriefings.files.parliament.uk/documents/SN05206/SN05206.pdf
7. https://www.britishchambers.org.uk/news/2019/04/bcc-quarterly-economic-survey-q1-2019-business-hits-the-brakes
8. https://www.cips.org/en-GB/who-we-are/news/uk-exporters-will-foot-the-bill-for-brexit-border-delays-eu-supply-chain-managers-warn/
9. https://www.markiteconomics.com/Public/Release/PressReleases
10. European Chemicals Agency, EU exit: https://echa.europa.eu/uk-withdrawal-from-the-eu
11. ONS, International immigration and the labour market, UK: 2016, https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/articles/migrationandthelabourmarketuk/2016#what-were-the-employment-characteristics-of-foreign-nationals-in-the-uk

How can Deloitte help?

Deloitte has been supporting multiple businesses across a range of industries to understand the implications of, and prepare for, the UK's withdrawal from the EU. We have supported many clients with their Brexit planning.

Our teams combine Brexit insights, industry knowledge and technical expertise to support our clients with their Brexit readiness planning – from risk assessment to applying the lessons learned to optimise for the future trading environment.

For further information, please contact Deloitte Brexit Support at **brexitsupport@deloitte.co.uk**

Industry contacts

Amanda Tickel
Partner, Global Brexit Lead
Tel: +44 (0)20 7303 3812
Email: ajtickel@deloitte.co.uk

Rob Booth
Director, Supply Chain
Tel: +44 (0)20 7007 6355
Email: robooth@deloitte.co.uk

Ian Washington
Partner, UK Supply Chain & Operations Transformation lead
Tel: +44 (0)115 936 0800
Email: iwashington@deloitte.co.uk

Zoe Hawes
Director, Global Brexit Insights
Tel: +44 (0)20 7007 9033
Email: zhawes@deloitte.co.uk

Further reading

No-deal guidance for manufacturing

UK No-deal Technical Notices:
Placing manufactured goods on the market
Placing manufactured goods on the EU market
Get your business ready to import
Get your business ready to export
HSE no deal guidance

UK Business Preparation Tool:
Prepare your business or organisation for Brexit

European Commission Brexit Preparedness:
Internal Market, Industry, Entrepreneurship and SMEs
Trade/Taxation and Customs Union

Make UK
Brexit Support for UK Manufacturers

This no-deal guidance is not exhaustive. Companies should routinely review the latest official updates and technical guidance as and when they are published by the UK, EU, and individual EU member states.

Designed by CoRe Creative Services. RITM0292071