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Brexit's impact on the horizon

What it might mean for CPG companies

Introduction: Another momentous day approaches for the UK

By March 29, 2019, it had been anticipated that the European Union (EU) and United Kingdom (UK) would agree on a Brexit plan for an orderly withdrawal of the UK from the EU. However, this did not come to pass. The UK's Parliament could not find a majority to pass the Brexit deal, or the Withdrawal Agreement, to give it its formal name, which sets out the terms of the UK's withdrawal from the EU and had been agreed between the UK government and the EU. The EU and UK have agreed to further delay Brexit until October 31, 2019. The UK could leave the EU earlier than October 31 if the UK Parliament were to pass the necessary legislation. There continue to be a myriad of unanswered questions on exactly how Brexit will work and what the future relationship between the UK and EU will entail, leaving many companies in an awkward position in preparing for a post-Brexit environment.

Virtually all companies could be affected in one way or another. Overall, it is likely that the implications will vary based on a company's individual situation. To be better prepared for the new and yet-to-be-defined agreements, consumer packaged goods (CPG) companies could benefit from developing strategies using scenario planning to respond to the varied policies that may ensue. This discussion paper will focus on what Brexit may mean for CPG companies, outlining potential implications for consideration.

What it means to be a Member State of the EU

The UK entered the European Economic Community (EEC), which effectively became the EU, in January 1973. The UK's participation in the EU has long been a source of debate in the UK—before joining, while being a member, and now, post referendum. The controversy centers around significant (and sometimes emotionally charged) issues that have been used as justifications for joining and leaving the EU. The following briefly summarizes some of the issues that can also be considered factors in identifying possible implications for CPG companies:

Economics and trade

It was anticipated that joining the EEC would be a boost to the UK economy. In the years between 1958 and 1973, the per capita gross domestic product (GDP) of countries closest in size to the UK—France, West Germany, and Italy—grew by 95 percent, whereas per capita GDP in the UK only grew by 50 percent. After joining the EEC, the UK's economy began catching up. Over the last four decades, the UK's GDP per person has grown faster than in France, Germany, and Italy.[1] One important element fueling this growth has been free trade between the UK and other EU countries, providing unlimited access to new markets and consumers.

However, what may have worked in the '80s and '90s has not been as successful in recent years. The EU has not been able to address the economic problems that began emerging in Europe after the global recession of 2008–09. These issues include the value of the euro and high unemployment in southern Europe.

While the global recession had a detrimental impact on most world economies, its effects were found to be more severe in countries like Spain and Greece that had adopted the euro.[2] The unemployment rate shot up to 20 percent in these countries, triggering a debt crisis. Almost a decade after the 2008–09 recession, the unemployment rates in these countries still hover around 20 percent. Some economists believe that the euro played a major role and that the UK was fortunate not to have opted for a common currency.[3]

Further, an argument in favor of Brexit was that the UK has not been free to implement its own economic remedies while being a part of the EU.[4] Currently, though, the economic outlook for the EU is moderate, with GDP growth in the euro area and EU both slipping to 1.9 percent in 2018, down from 2.4 percent in 2017. The most recent Spring Economic Forecast from the European Commission estimates that this moderate performance will continue in 2019 and 2020. Euro area GDP is now forecast to grow by 1.3 percent in 2019 and 1.6 percent in 2020. The wider EU's GDP growth is forecast to be slightly higher and grow by 1.5 percent in 2019 and 1.7 percent in 2020.[5]

Sovereignty and immigration

A key priority for the EU is to safeguard the EU nationals living, studying, and working in the UK, currently estimated to be around 3.7 million, with workers scattered across all sectors of the UK's labor market. Approximately, 1.8 million UK nationals live in the EU. The Withdrawal Agreement grants rights to existing EU nationals living in the UK and puts reciprocal arrangements in place for UK nationals living in member states across the EU.[6] These rights include:

- Indefinitely securing the status of each EU national who is a resident in the UK (with the exception of those with an offending history);
- Safeguarding the rights of family members;
- Continuing with social security and health benefits arrangements; and,
- The transfer of personal data between the UK and EU.

In a no-deal scenario, EU nationals traveling to the UK for the first time would need to apply for a permit that would allow free entry for up to 3 months and extendable for a further 36 months. This would ensure that firms are able to keep recruiting talent without any rigorous legal processes and compliance requirements.

As a result of Brexit, a major US-based skin-care manufacturer has proactively engaged with its workforce by investing in and continuously communicating with EU nationals on every aspect of their citizens' rights. The business helped encourage all of its EU workers to apply for settled status, reviewed any cross-border payroll issues and social security impacts, and reviewed the skills levels and value of each EU national to the business. Moreover, given the difficulty of retaining talent in a very competitive environment and limited talent pool, the business now regularly reviews its reward and retention strategy.

EU regulations and their associated costs

If the UK leaves the EU without a deal, businesses would have to remain compliant with EU regulation, and some industries would need to obtain the relevant EU authorizations to supply the EU market (likewise for UK regulations and authorizations in order to access the UK market). Some of the regulatory areas that could be affected include:

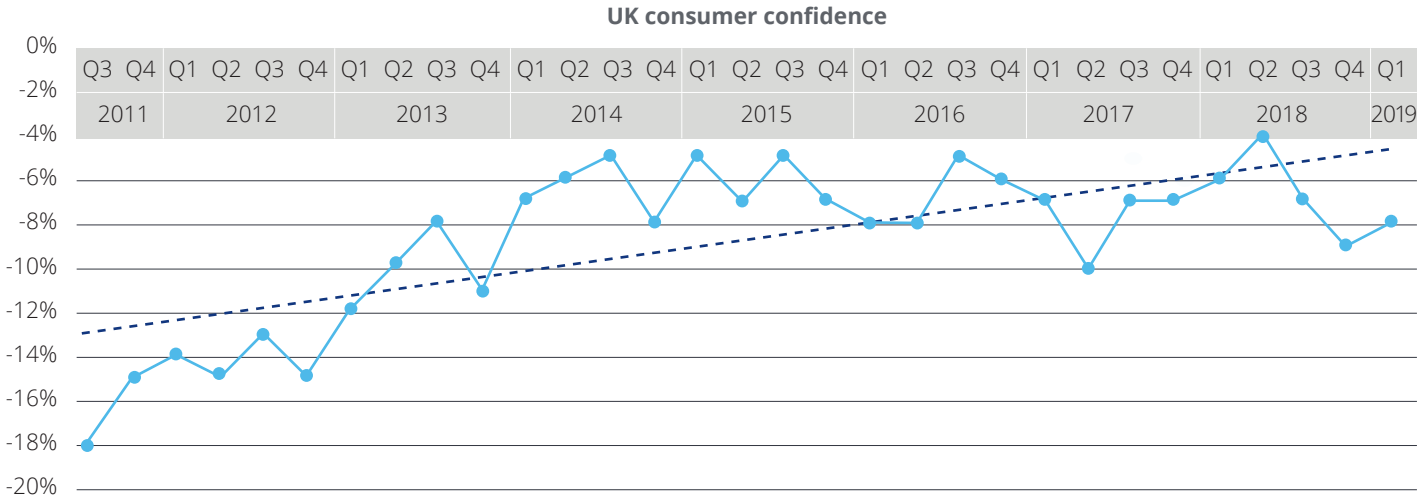
- Requirements for independent conformity assessments;
- Use of EU notified bodies;
- Labeling updates;
- Requirements for dual EU- and UK-registered addresses;
- Additional licenses for goods subject to export controls; and,
- The need for UK exports of "nonharmonized" goods to comply with each individual EU Member State regulation.

Brexit's potential impact on the UK economy remains unclear

An analysis of economic indicators since the Brexit vote suggests most consumers and businesses have yet to feel material impacts, even though shifts have occurred in consumer confidence and retail sales. It is not clear what these shifts foreshadow for the UK economy, but companies would likely benefit from being prepared for any eventuality. Consumer confidence in the UK, as measured by The Deloitte Consumer Tracker,[7] has been in negative territory since 2011 despite recent fluctuations.[8] In the buildup to the referendum, consumer confidence stalled, remaining at minus eight percent in Q2 2016. In the months post referendum, there have been both positive and negative movements, but overall, consumer confidence remains close to its one-and-a-half year low. It is expected to take longer and more certainty to restore back to previous levels.[9] Further, inflation measured by the Consumer Price Index has been on a downward trend since November 2017 and has settled at 1.9 percent in March 2019.[10]

The Brexit vote had little near-term impact on retail sales, which remained buoyant following the referendum. Retail sales (by value), excluding fuel on a non-seasonally-adjusted basis, were exceptionally strong for March 2019, with a rise of 4.4 percent as compared to a year earlier. On a quarterly basis, UK consumers bought 3.9 percent more than in the same period in 2018, according to the Office of National Statistics.[11]

Figure 1. Net percentage of consumers who said their level of confidence has improved in the past three months.



Source: Deloitte Consumer Tracker Q1 2019

The impact of Brexit on CPG companies: A complex issue

Negotiating the terms of Brexit is a highly complex process that is continually evolving and changing as October 2019 approaches. For CPG companies, there are implications related to a calculus of interrelated factors, including:

- The terms of exit and any transitionary arrangements;
- Possible Brexit scenarios, including "a deal" (a deal agreed with the EU on the basis of what has been agreed by the UK and EU) or "no-deal" Brexit;
- Reliance on existing EU trade arrangements with non-EU countries and whether the UK has managed to replicate them;
- Product labeling laws;
- Market access restrictions, including both tariff and non-tariff restrictions;
- Company location—inside or outside the UK;
- Supply chain; and,
- Talent.

Brexit models: "a deal" or "no-deal"

The finer details of the Brexit negotiations are dependent upon the actual Brexit model agreed upon between the EU and UK. There is not an agreed definition of a "no-deal" Brexit, but an effort has been made to describe what it could mean.

Leaving the EU with a deal agreed between the UK and EU: The Brexit deal agreed by Prime Minister Theresa May with the EU has been repeatedly rejected by Britain's Parliament. However, much of the disagreement over the Withdrawal Agreement (the deal) has been split between those critical of the so-called "backstop," which sets out provisions to ensure minimal disruption to the border between the Republic of Ireland and Northern Ireland if the UK and EU are unable to agree to a future economic partnership, and over what the future of the UK's trading relationship with the EU should consist of. Talks between the Conservative and Labour parties failed to bridge these disagreements. Prime Minister Theresa May announced her resignation on June 24, initiating a leadership contest within the Conservative Party, which is expected to last several weeks into the summer period. Many of the leadership contenders have indicated that they would seek to renegotiate the Withdrawal Agreement with the EU; however, the EU and its leaders have said on numerous occasions that the Withdrawal Agreement is not open for renegotiation.

A "no-deal" or "hard" Brexit: Under this model, Britain would give up its membership of the EU single market and no longer be bound by the rules of the EU Single Market or Customs Union. Trade with EU member nations would follow World Trade Organization (WTO) rules. For the purposes of trade from the UK to the EU, the UK would be treated as any other country without any preferential trading arrangements. Under this scenario, highly disruptive changes would be implemented, perhaps within a short period of time.

There are several other possible scenarios that could come into play:

- The UK could hold a **second referendum** on Brexit on whether to accept the Brexit deal on the table.
- An alternative that has emerged recently is a **general election**, which would result if two-thirds of the UK Parliament vote against the government and trigger an election. The rationale being that general elections could determine the populace's preferred view on Brexit and change the parliamentary arithmetic to gain a majority for a way forward.
- The UK can **unilaterally revoke Article 50 to cancel Brexit**. This is an alternative that seems to have a low likelihood since the UK government remains committed to Brexit.[12]

Market access and tariffs

Over time, the EU market has played an important role in the growth and development of the UK's export market: The EU accounts for approximately 44 percent of all UK exports of goods and 40 percent of total exported UK services. The EU accounted for 53 percent of UK imports in 2017.[13]

While part of the EU, the UK enjoys the free movement of goods between the UK and EU without paying any duties or tariffs; access for service providers is considerably smoothed by the removal of many (but not all) nontariff barriers. In addition, there are simplified procedures for trade with EU member nations. Once Brexit is implemented, this is expected to change. However, its exact nature will be dependent on the nature of the ongoing trade relationships as described.

A "no-deal" Brexit scenario, for example, could result in the imposition of an elaborate set of tariffs and trade barriers, potentially resulting in increased costs of tariffs, customs compliance, and logistics delays that may result in a rise in the price of finished goods, which either CPG companies or consumers would likely absorb. Adopting the Withdrawal Agreement would avoid a "no-deal Brexit" and allow for a transition period in which to negotiate the new trading arrangements between the UK and EU. Either scenario, however, will likely result in increased complexity and costs of doing business, which may ultimately impact the bottom line.

Company headquarters—inside or outside the UK

The impact of Brexit on CPG companies will vary based on the extent of a company's exposure and involvement with the UK. While companies fall on a wide spectrum of exposure to the UK, companies headquartered in the UK are likely to be affected to a larger extent compared to global companies headquartered outside the UK. The impact is anticipated to be in terms of market access, nontariff barriers, and tariffs relating to the sourcing of raw materials, the operations, the market for end products, and, ultimately, financial performance.

For those CPG companies trading into or with the UK from outside the EU, there could be improved trading terms and reduced tariffs in the future, depending on the relationship the UK agrees upon with the EU, and what it then negotiates in terms of free-trade agreements around the world.

For the UK-based companies sourcing local materials with local talent for domestic consumption, Brexit may have little impact.[14] In fact, there could be an opportunity for these CPG manufacturers to first aggressively increase their penetration in the market and then drive for an increase in market share relative to imported goods. However, for those CPG companies that operate with a more complex supply chain across borders or employ EU nationals, it could be a different story.[15]

Supply chain considerations

The impact of Brexit on supply chains is another major cause of concern for many CPG companies that do business across borders. Again, the extent of impact on supply chains and the movement of raw materials and finished goods will depend on the Brexit model agreed upon. For those CPG companies with operations limited to the UK, the scale of the impact will likely be low, while for companies that rely on a multicountry supply chain, it will be more complex. For example:

- New tariffs would add more costs to the process of moving goods across borders, affecting profitability;
- Increased cost of complying with new customs procedures that were not present previously;
- IT systems would need to be upgraded to document import/export declarations;
- Longer times for goods to move across the border, which could result in the need for companies to warehouse products in new facilities, resulting in more complexity and costs; and,
- Perishable goods, in particular, could suffer due to the increased time needed to cross borders.

These changes will likely have the greatest impact on CPG companies with more elaborate supply chains, rendering current processes inefficient and costlier, and increasing the time frame for moving goods from the country of origin to the destination.

The impact on talent

A new regulatory framework could be introduced for EU nationals, potentially expanding the existing points-based system, which currently regulates non-EU migrants. These changes could lead to a more restrictive system for sourcing migrants from the EU but could also establish a more streamlined process for recruiting global talent. Employers would therefore have the opportunity to build in a singular HR apparatus that also reduces any monitoring and compliance risks.

The consumer products sector depends heavily on midlevel skilled migrants (equivalent to managers in warehousing, retail, hotels, and restaurants or even lab technicians) and would likely benefit from the proposals outlined in the new system. This could mean that specialist skills that could only be sourced from outside of the EU and restricted by the current immigration system—creating critical gaps—would now be available to sectors that often struggle to fill such gaps.

A number of issues could arise from the proposed overhaul of the immigration system, primarily, the loss of a business's ability to relocate EU nationals to the UK with ease. The new system could mean that EU nationals, along with non-EU workers, would now come at a premium. Employers could potentially pay a skills charge, a health surcharge, and other associated costs. Relocating an EU national and their family members could potentially cost in excess of £15,000, excluding any personal remuneration.

Businesses could also be required to introduce more stringent monitoring processes of their EU workforce, which means a further layer of HR administration and high-risk penalties for noncompliance, including £20,000 fines and imprisonment. Firms are expected to require a robust HR system and highly skilled professionals to ensure that compliance is a low risk.

List of mid-level (level 3 of standard occupational code) jobs that could become unrestricted (consumer specific):

- Warehousing
- Clothing manufacturers
- Retail and wholesale
- Travel agents
- Sales supervisors
- Printers
- Laboratory technicians
- Market researchers
- Pharmaceutical technicians
- Business sales executives
- HR professionals
- Importers and exporters
- Logistical clerks
- Sales administrators

Product labeling and safety

The EU standards for product labeling and safety are among the strictest in the world, requiring complete transparency for consumers. The EU could use these standards as a non-tariff restriction to market access. At present, since the UK and EU follow common standards, product labeling is perceived as a relatively easier issue to address.

The UK government has announced that in a "no-deal" scenario, it would allow goods that are made and assessed against EU regulatory requirements to be sold in the UK, but this is only for an, as yet, unspecified period. Going forward, a new UK conformity marking (replacing the current EU CE marking) would be required to demonstrate compliance with UK regulatory requirements and further guidance would be published on this.

Labeling on products may have to be updated subject to the relevant regulations applying to that product.

For certain nonharmonized goods, regulations are Member State specific rather than harmonized across the EU. Exports from the UK to the EU would have to comply with the national requirements of the EU Member State it is first being exported into, as they would no longer benefit from the mutual recognition principle. Imports to the UK would have to meet UK national requirements, after the UK leaves the EU.

Potential strategies to mitigate and prepare for Brexit implementation

With October 2019 in sight and still so much to be decided, CPG companies could benefit from scenario planning in which they lay out the scenario of maximum change and identify ways to mitigate any negative impact while maximizing positive outcomes. The potential strategies can vary for each company and circumstance, making this a customized process. What follows are five strategies to consider to address these topics.

1. **Brexit model: "no deal" or "negotiated deal"** – To begin with, companies could benefit by preparing for a "no-deal" Brexit. Continuous monitoring should be undertaken to ensure any updates from either the UK, EU, or relevant regulatory agencies are taken into account. This sets the stage for outlining potential outcomes on all other issues discussed in the following paragraphs.
2. **Product labeling and safety** – UK-based CPG companies will likely have to assess the benefits of continuing to adhere to EU standards for product labeling and safety. On one hand, since EU standards for product labeling and safety are among the strictest in the world, UK companies may want to continue to adhere to EU standards to help ensure continued access to EU markets. However, post Brexit, there could be a gradual dilution in standards for any number of reasons—from lowering product-production costs to changes in marketing communications. CPG companies could benefit from a cost-benefit analysis to assess the costs of making a change and the increased profits resulting from the change.
3. **Market access and tariffs** – In any Brexit scenario, there likely will be an increase in the costs associated with the movement of goods between the UK and EU due to tariffs, which would either be passed on to consumers or negatively have an impact on a company's profitability. CPG companies could benefit by outlining in advance how these additional costs could be dealt with to help ensure that their goods remain competitive in the EU market. As an implication of Brexit, it may no longer be viable for certain companies to manufacture their products in the UK. It may be beneficial to produce products in the EU, or other countries, then sell them back to the UK.
4. **Supply chain** – As noted, UK-based companies with a multicountry supply chain are likely to be affected more than companies that have a simpler and UK-specific supply chain. Brexit could make movement of goods through existing supply chains more complex, costly, slow, and difficult to execute.

   To accommodate this, it may be necessary for companies to invest in surplus storage and warehouse spaces at multiple locations to counter for delays in the movement of goods. Companies that deal in the movement of perishable food items will likely be most affected given their limited shelf life. Finally, the extent and complexity of the changes needed to IT systems to cope with the almost inevitable increase to administration once companies need to make import/export declarations for goods moving between the UK and the EU should not be underestimated.
5. **Talent** – UK nationals could face a more complicated future traveling and working in the EU. Unfortunately, not all EU member states have guaranteed the rights of UK nationals in a no-deal scenario. Countries such as the Czech Republic, Denmark, and Finland, for example, have confirmed that UK nationals can continue living and working in those locations without the need to certify their status, as their existing rights have been confirmed. Others such as France, Germany, and Italy require UK nationals to apply for a new permit to confirm their status. Austria and Croatia are yet to legislate in order to secure the rights of UK nationals.

Each member state in the EU has its own immigration system and separate social security arrangements that fall outside of the EU's legal remit, which is used to regulate non-EU nationals. UK nationals, as newcomers, could be at risk of having to apply through tough immigration systems, such as the current system in France. Existing UK nationals could be at risk of paying double social security contributions and losing health care rights in most EU member states.

Traveling to the EU to carry out specific business-traveler activities should still be possible, although discussions are ongoing around the possibility of introducing visas or a less-stringent system similar to the Electronic System for Travel Authorization (ESTA) in the US. The UK has not, to date, introduced any new restrictive short-term tor business-traveler process.

A number of consumer firms, including major UK and US retailers, French and UK fashion houses, US manufacturers of clothing, skin care, and food and drink, highlighted that there could be significant impacts on short-notice trips, especially on "hand carried" services and critical business and client meetings.

In closing, with roughly five months remaining until the Brexit extension ends, CPG companies should use this time to proactively plan for the UK leaving the EU with or without a deal. The continued uncertainty CPG companies face while waiting for specific policy decisions need not be an impediment to preparation. Through scenario planning, companies can be steps ahead in the planning process and in a stronger position than they otherwise would be at the end of 2019.

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