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Manufacturers hit pause, but only for so long

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Sunday 20th will mark 150 days since the EU referendum and UK businesses should have got over the shock by now. That doesn't mean they have adjusted to the new environment. I work with manufacturers in the UK: companies with a heavy physical footprint, but which also have highly-integrated supply chains and important trading links with Europe. In many ways, that makes them the most vulnerable group to a hard Brexit. So while many of them are riding high on the back of sterling weakness, you don't have to probe too deeply to find real worries about life outside the EU.

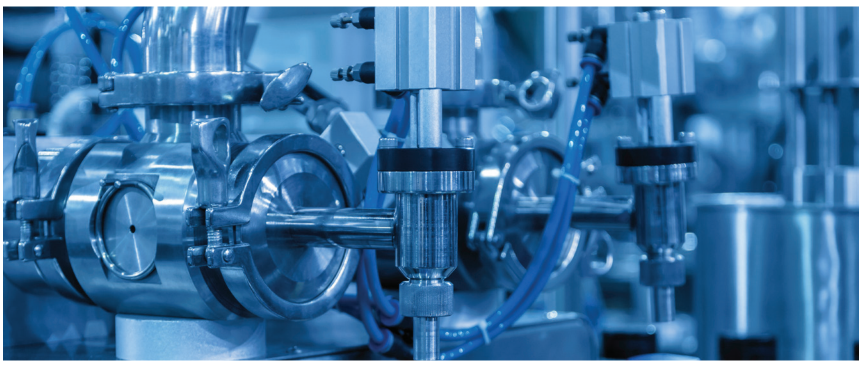
What are companies doing in response to this uncertainty? My general view is that the larger players already have a pretty good idea of what they're doing and what they need to be doing – even if that is just carrying on as usual, completing scenario planning and waiting for more detail on the exit strategy.

Their finance, procurement and strategy teams are examining what tariffs would mean for their suppliers … and the suppliers of those suppliers. They are looking at their dependence on EU-born workers and possible ways around that. And they are starting to get a reasonably good idea of what different negotiated outcomes mean for costs – for example, if the UK reverted to WTO tariffs.

They might be prepared, but they aren't necessarily reassured. Finance teams that have been doing their sums are coming back with some pretty big numbers based on certain scenarios – notably a UK exit from the Customs Union. The costs of tariffs on in- and out-bound goods (together with the hit to cashflow should companies have to change the way they pay and recoup VAT) are placing a strain on financial models.

Wheels keep turning

By contrast, many smaller and foreign-owned operations are only now starting to get to grips



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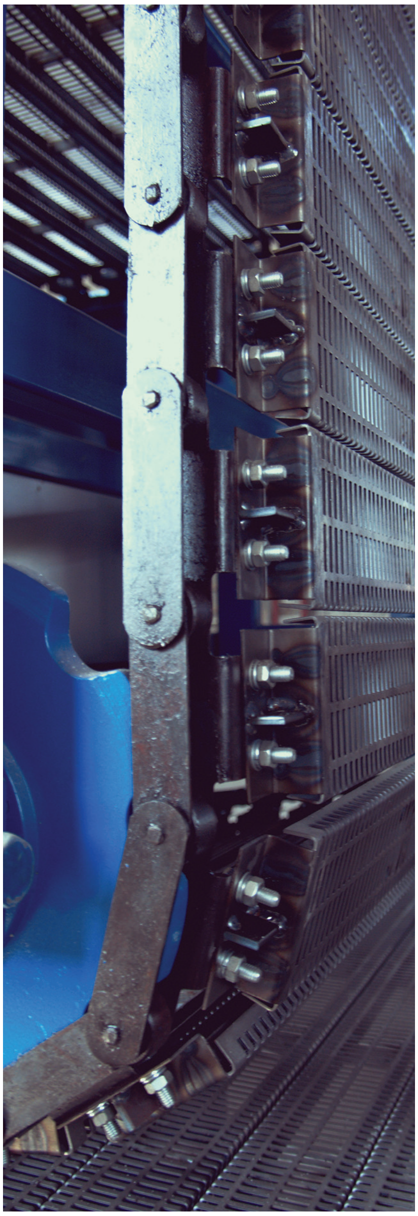

with the reality that Brexit is happening and affects *them*. With that comes the realisation that not only might some of their customers be revising their plans for UK operations, but tariffs could complicate hugely their complex supply chains with Europe.

Despite these anxieties, the general attitude of manufacturers and engineers seems to be one of stoic pragmatism towards Brexit. The day-to-day challenge of staying ahead in this fiercely competitive sector goes on, even as Brexit bubbles away in the background. Questions such as "do I have the right people?", "how do I develop a smart factory?" or "what are the implications of Industry 4.0?". All need answers … and short-term commitments in the form of investment.

And this is perhaps the biggest issue facing manufacturing and the 2.7 million people working within it. Investment decisions are a bigger deal in this sector because fixed assets are such a high proportion of total assets, because investments are physically rooted in one place and because the lead times on capital expenditure are so long. A speedy investment might take three to four years to come to fruition. More typically, it will take six or seven.

Decision time

Companies I speak to are not presenting the issue of investment as a binary choice between uprooting themselves or persevering in the same location. It is more a case of "where do we place our next big investment?". A UK factory may carry on producing, but if the investment goes elsewhere, so will its real, long-term growth potential.

I am definitely sensing a pause in investment decisions. That seems to be backed up in a recent survey, which suggested UK businesses may have delayed or cancelled investments worth 65.5 billion pounds since the referendum[1]. Manufacturers can delay some of these big decisions while they wait to understand the UK's future terms of trade. But only for so long.

While they wait to make that decision, firms need to protect themselves by contingency planning, maintaining efficient operations and giving customers exactly what they want. And they also need to build in natural hedges. First, that means looking at how companies can work with more companies in the UK and 'domesticate' their supply chain – given both the weaker pound,

[1] http://www.bloomberg.com/news/articles/2016-11-14/brexit-costs-u-k-82-billion-in-lost-company-spending-study

the threat of tariffs and also a potential loss of EU workers.

Second, it means looking East and West, and not just across the Channel, for growth. The UK might remain in the Customs Union, but persistent low-growth in the EU does beg the question whether companies shouldn't be looking towards faster growing markets to supplement European business anyway?

Alternatively, the UK may exit the Customs Union, in which case companies will certainly need to move fast to counteract the risk of lost business if tariffs push up the price of British goods. They may have only had 150 days to adjust to the idea of Brexit, but Britain's manufacturers will soon have some big decisions to make.

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