

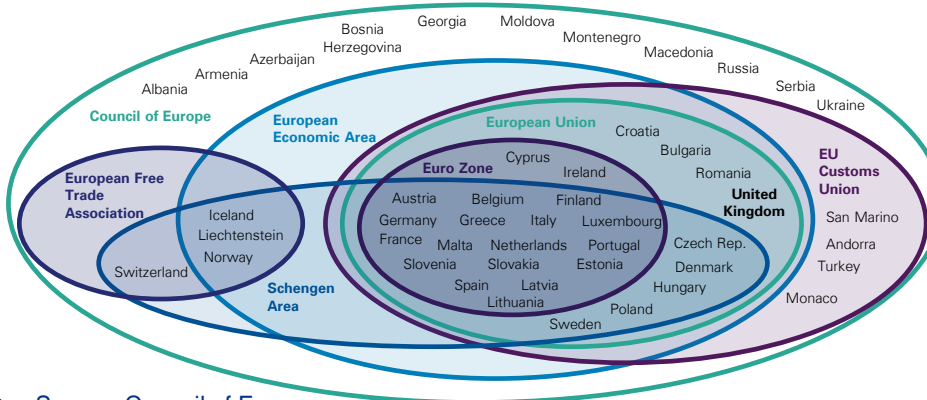
Boardroom Questions

Brexit: geopolitical risk in a VUCA world

KPMG International

What is Brexit and what does it mean for global businesses?

Brexit was a shock to many, but perhaps shouldn't have been. Missing the signals of major change is even more dangerous in an increasingly Volatile, Uncertain, Complex and Ambiguous (VUCA) world.



Source: Council of Europe

'Brexit' means that the UK intends to leave the European Union — and rescind its membership of the EU Single Market and EU Customs Union - and instead is seeking a bespoke deal (FTA) and customs arrangement that, by virtue of its singularity, would move the UK to its own space on the outer rim.

So where does this leave the UK and its relationship with the EU?

Although there are broadly five paths that could be followed (explained below), the UK is seeking to pursue an unprecedented bespoke model. The outcome depends on trading off elements of the Four Freedoms — movement of goods, people, capital, and the establishment and provision of services — to achieve a mutually acceptable arrangement for the UK and all 27 remaining members of the EU.

Norway Model (EEA Member)

- Participation in the EU internal market but no access to EU FTAs
- Member of EFTA
- Free movement of goods, services, people and capital
- Not part of EU VAT area
- Certain principles of EU law apply (e.g. regulation and employment)
- 9% reduction in UK contribution to EU budget

Swiss Model (EFTA Member)

- Participate in EFTA free trade agreements
- Not part of EU VAT area
- Negotiate a bilateral trade agreement with the EU
- 55% reduction in UK contribution to EU budget
- EU concerns about cherry picking

Turkish Model (Customs Union)

- No tariff barriers with EU as UK adopts EU product market regulations
- UK required to implement EU external tariffs
- Not part of EU VAT area
- No contribution to EU budget

Free Trade Agreements

- Negotiate bilateral trade agreements with EU and other major trading partners
- Not part of any customs free trade area or trade association
- Not part of EU VAT area
- UK to be excluded from FTAs agreed by the EU and the EFTA
- No contribution to EU budget

Independent (WTO Member)

- Not part of any customs free trade area or trade association
- Not part of EU VAT area
- Negotiate bilateral trade agreements trading partners
- UK to be excluded from all FTAs agreed by the EU and the EFTA
- No contribution to EU budget

A host of known-knowns, known-unknowns and unknown-unknowns that create the social, political and economic environment for Brexit negotiations

Rise of nationalist sentiment, flows of refugees and migrants, fears and acts of global terrorism, climatic conditions and disasters, performance of the global economy, new US administration, possible second Scottish referendum, pace of technological change, and much more



“ We are switching our thinking on risk maps to a geopolitical lens. We used to think of geopolitics as a separate risk — now it's overshadowing the entire business ”

Global Consumer Markets Company

Uncertainty, uncertainty, uncertainty: when will this all become clear?

Short answer: not anytime soon. **Long answer:** The UK notified the European Council of its decision to leave under Article 50(2) of the Treaty on European Union in March 2017, starting the legal process of the withdrawal. Negotiations are meant to take 2 years, but the need for consensus amongst remaining EU members could mean a more protracted process, particularly in defining the future relationship. And only after the UK officially leaves can trade deals with other countries be signed, which themselves will likely take many months. Complicated, much?

23rd June '16
UK votes to leave the EU

Sep '16
Wave of social, political
& economic change

Q2 - Q4 2017
Trigger of Article 50, key
European elections

Late 2019
Possible conclusion of Article 50
negotiations; UK formally exits EU

Many years
of complex
socio-
economic
changes
leading to
the UK's
referendum
on Europe

New UK PM, Cabinet and Department
for EU negotiations, shock, disbelief
and calls for second referendum,
Eurosceptic parties gaining ground
elsewhere in Europe, political jostling in
various European capitals, other EU
nations wooing global corporate HQs
and non-EU countries laying ground for
UK trade deals

Conservative Party conference
and Labour leadership battle,
key EU summits without the
UK present, trigger of Article 50
(March), Dutch (March),
French (Apr-June) and German
(Sept) elections

2 year (can be extended)
negotiations on terms of
UK's exit from the EU,
definition of future
relationship (possible FTA
and customs agreement),
review, amendment or
acceptance of all EU-
derived law into UK
domestic law

New relationships
between UK and
EU (possible
transitional
period), UK can
officially sign trade
deals with other
countries

Boardroom Questions: Brexit and geopolitical risks



The next best thing to having all the right answers is being able to ask the right questions. Think about your business across the nine Levers of Value, and then ask what strengths and weaknesses do geopolitical shocks — like Brexit — expose in your business and operating models

Financial ambition

What does potential uncertainty mean for availability and cost of capital?

Will investors continue to fund capital investment programs?

Will you update your forecasts in light of new economic scenarios?

Markets

Which alternative markets and new trade routes should be explored?

Will trade between the EU and UK reduce?

Will trade with countries where the EU has FTAs be affected?

Organizational structure, governance and risk

Will your corporate structure need to change to take advantage of opportunities? Or respond to changes in regulation?

If you restructure your organization in the UK or rest of Europe, will you face exit tax costs on transition?

Can you manage your business if you face travel restrictions?

Measures and incentives

Do you have sufficient data to understand how resilient your business is?

How can you improve monitoring to identify any shocks early?

Have you quantified the potential changes to the effective tax rate?

Propositions and brands

Is there an open window of opportunity for foreign brands if British brands face negative sentiment from EU consumers if discussions become tense? What mitigation strategies exist?

Clients and channels

How resilient is your business to the loss of a key customer?

Are your UK or EU customers already developing alternative suppliers?

Will you need to review pricing policy for changes in tax or costs?

Core business processes

Will you need to review your 'go to market' approach?

Does your distribution footprint and network still make sense in light of major geopolitical changes?

Do you have enough visibility over your supply chain to identify threats? Do you have natural hedges?

Operational and technology infrastructure

Will restrictions on cross border activity increase the administration burden for your global operations?

Will IT systems need to be adapted?

Are your systems and processes set up for increased logistics, tax impacts or new pricing structures?

People and culture

How do you manage your global workforce and the restrictions that may come on them?

How will you meet the gap when non-EU immigration is also restricted?

How will your workforce change? Or your staff culture?

How will you deal with employment policies in UK or European operations after Brexit?

Do you have robust policies in place to be able to deal globally and locally with the perceived increase in racism and xenophobia?

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