Inspiring business

The business end of Brexit

IoD survey on planning & trade

Executive summary

Businesses around the UK have been impacted by the vote to leave the European Union and the uncertainty that surrounds our future trading arrangements. The majority of IoD members trade goods and services internationally and, in this regard, our member surveys are an apt way to gauge the real-world effects of the referendum result on companies. Brexit presents both challenges and opportunities for businesses, and the task now for business leaders and policymakers alike is to ensure UK businesses are able to thrive in a post-Brexit climate.

The post-referendum economic context has produced a mixed bag for IoD members. While exports are gradually rising, the cost of imports has increased. The consequence of the sterling's depreciation has had more of a net negative effect on members' businesses than a net positive, although most report no overall impact. The same is true for exports, where a clear majority say the weak pound has not had any effect on their sales overseas. On investment decisions – an important bellwether in uncertain economic times – there have been few indications of any significant acceleration or deceleration of ongoing plans, although a notable minority report having held off making any new investments.

In terms of business planning for Brexit, firms are roughly divided on their confidence in planning for leaving the EU. Less than 10% have implemented contingency plans already, while most are in the process of drawing them up or plan to shortly. Around one-third of members don't plan on engaging in any contingency planning whatsoever. Notably, those working in financial services feel more able to plan than those in manufacturing.

It is of course little wonder that companies are still uncertain about implementing any sweeping preparations for EU exit given negotiations have yet to address our future economic relationship. An adjustment period will be of critical importance to business certainty, and given we are only 16 months away from leaving the EU without having talked about the future, it is essential that this is agreed early on. Early agreement on this remains among the top priorities for IoD members, alongside maintaining rights and entitlements for EU citizens. While some further clarity on the UK's approach to any financial settlement with the EU may be needed, it is clear we are reaching the limits of what can be tackled in phase one of the negotiations without discussing future relations.

We know more about the kind of future trade relationship the UK does not wish to pursue with the EU than we do about what it actually wants. It is clear that we are leaving the Single Market and the EU's Customs Union formally upon exit, but what replaces it is far from certain. While more proposals will hopefully emerge as we draw closer to phase two of the negotiations, IoD members are clear they would prefer rules governing goods and services to stay aligned to those of the EU's Internal Market rather than diverge. High market access is clearly a top priority for businesses in our negotiations with the EU, and while regulatory control is inevitably coming back to the UK, firms would prefer that we stay close to the Single Market.

Author

Allie Renison
Head of EU and Trade Policy

Allie leads the IoD's work putting forward the members' priorities for Brexit, and explores methods of expanding the UK's global reach in trade and investment.

Trade performance of UK business since EU referendum

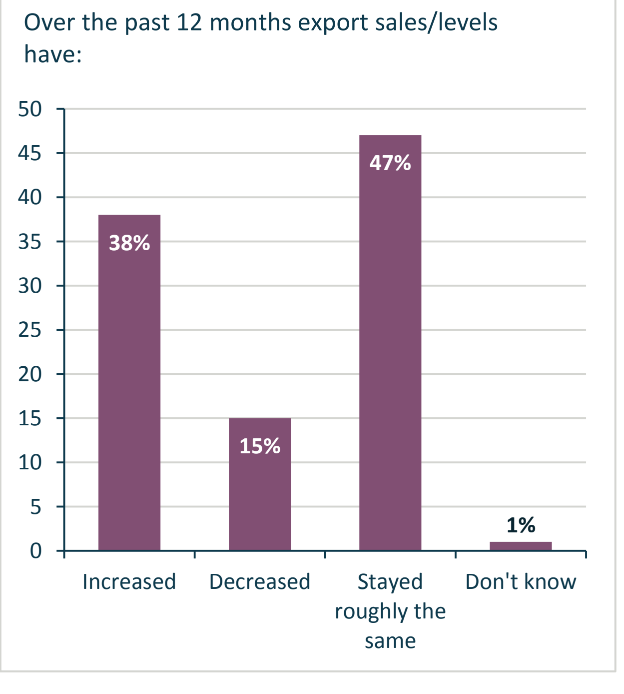
Exports are rising, but the pound isn't the main driver

A sizeable majority of IoD members trade goods and services internationally - 61% export outside the UK and 45% import for use in their business activity. The largest grouping of exporters report no change in their export sales/levels over the past 12 months, but amongst those who have seen some shift, more report an increase than a reduction. This is broadly reflective of wider UK trends, with exports up – although at a lower level (for goods) when excluding commodities that tend to be naturally more volatile.

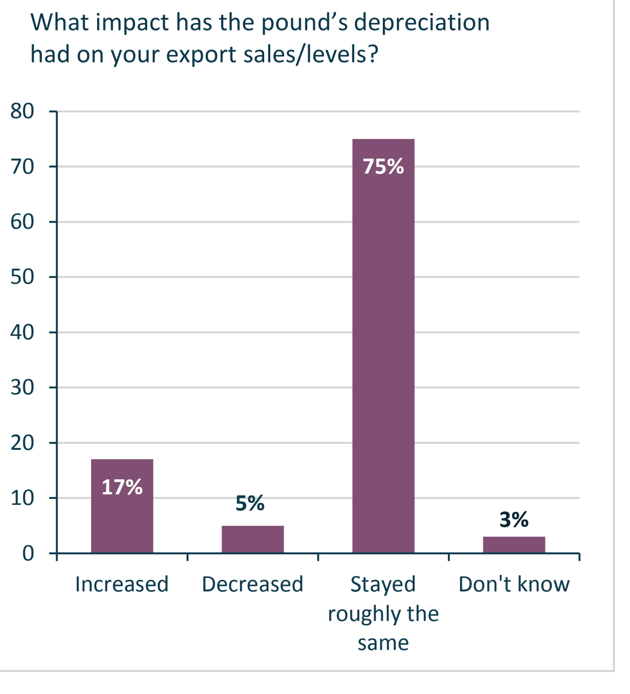
There has been considerable debate about what the impact of sterling's depreciation has had on the UK's international trade since last June. While historical assumptions have linked a weak[ened] currency to a rise in exports - particularly for manufactured goods - recent trends have painted a more complex picture.

The ONS has noted time and again that charting the pass-through effects of the lower pound are harder to pin down for exports than for imports. Amongst IoD exporters, the overwhelming majority report that the falling pound has had no impact on their export sales, with 17% reporting a causal increase. Exports are indeed up somewhat higher for manufacturing businesses (50%) and those selling goods overseas generally (52%) than the average for all exporters (38%) . But even for those exporting goods only, a clear majority (62%) still say sterling's depreciation has had no impact on their export sales relative to those who say it has driven an increase (34%).

Graph 1



Graph 2



Source for Graph 1 & 2: IoD survey conducted between 17 Oct – 20 Oct, 561 & 417 respondents respectively

Imports aren't rising quite as much as exports, but costs have gone up

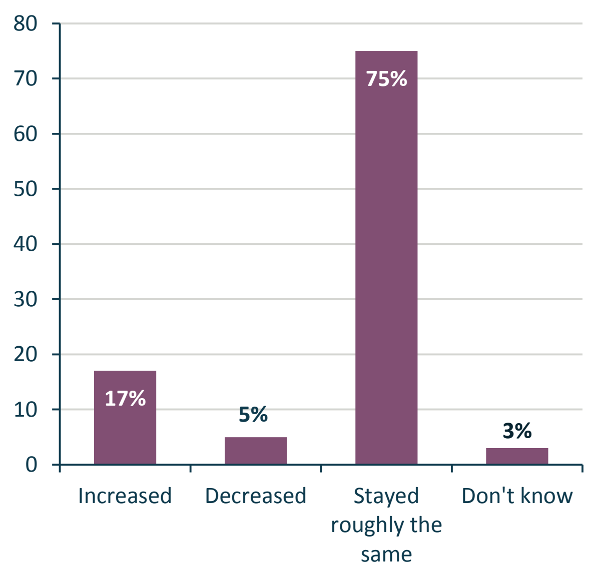
Import levels have remained steadier than exports for IoD members, with 57% reporting no change. Meanwhile, for those who have reported a rise in their imports, it has been slower than the rise in export levels (29% to 38% respectively).

While important indicators for general domestic demand and consumption, imports also serve a vital and often irreplaceable role for many in terms of the day to day running of their business. Previous survey data indicates that a quarter of IoD members import for the express purpose of use in their exports, while 44% reported doing so due to lack of availability in the UK.

The vast majority of IoD members who import both goods and services report that the costs of doing so have gone up since the referendum (72%), with a higher share amongst manufacturing businesses and those importing goods only (84% and 85% respectively).

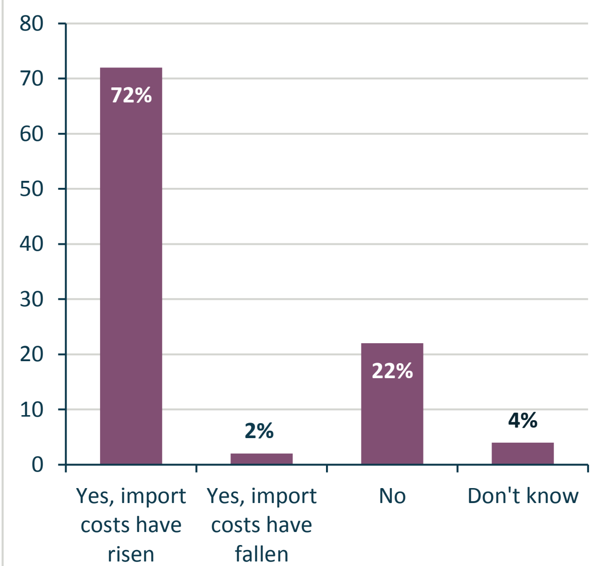
Graph 3

Over the past 12 months, import sales/levels have:



Graph 4

Have the costs of your organisation's imports changed since the referendum?



Source for Graph 3 & 4: IoD survey conducted between 17 Oct – 20 Oct, 417 respondents

More directors overall tend to feel no impact or a negative fallout from the weak pound

Outside of questions about imports and exports, the impact of sterling's depreciation since the referendum has been a mixed bag for business. Sectors like tourism and leisure have received a boost from visitors taking advantage of a beneficial exchange rate, while many companies' overseas investments have also soared.

However, the clear message coming from IoD members is that amongst those that have felt impacted by a change in sterling, it has been felt in a largely negative way. 30% of those who have felt the impact say it has been negative, against 13% who say it has been positive.

A slightly larger share report no real impact (37%), while those in the manufacturing sector indicate a more sizeable impact, with a similar disparity between negatives and positives.

Table 1 What overall impact has the pound's depreciation had on your business since the referendum?

	All sectors	Construction	Financial & insurance activities	Information & communication	Manufact-uring	Professional, scientific & technical activities	Other service activities
Net positive	13%	13%	12%	14%	22%	9%	10%
Net negative	30%	44%	24%	33%	43%	25%	28%
Even balance of positives & negatives	17%	13%	12%	16%	20%	19%	19%
No real impact	37%	28%	51%	36%	13%	45%	35%
Don't know	3%	3%	1%	0%	2%	2%	8%

Source for Table 1: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

On investment decisions – business as usual apart from a substantial minority

Business investment patterns are increasingly treated as an important bellwether for the UK economy as we move towards Brexit – with unsurprising political ramifications as observers wrangle over the data and its interpretation. The Governor of the Bank of England has also laid it down as a marker for Brexit-related uncertainty in holding back UK growth. Yet a slowdown in companies investing is clearly not a substantial enough worry to hold back the Bank's decision to raise interest rates earlier this month.

Recently revised figures for the UK overall show that business investment actually grew after an initial downturn following the EU vote last year, albeit at a sluggish pace. Meanwhile, the share of IoD members reporting an acceleration of ongoing investment plans was marginally higher than the number who have decreased these since the referendum. The majority have made no changes, but just under a quarter of business leaders indicate they have held off making any new investment decisions over the past 16 months. This is perhaps less of a substantive change, but it is no less an important reaction, and could be difference between firms 'growing' and 'booming' to use the Governor's words. Sectoral breakdowns indicate a somewhat more acute slowdown amongst IoD members in construction, with a slight acceleration for the manufacturing sector.

Table 2 How have your primary organisation's investment plans changed since the referendum?

	All sectors	Construction	Financial & insurance activities	Information & communication	Manufact-uring	Professional, scientific & technical activities	Other service activities
We have accelerated ongoing investment plans/decisions	9%	8%	5%	12%	13%	7%	5%
We have decreased ongoing investment plans/decisions	7%	18%	10%	8%	7%	7%	5%
We have held off making any new investment plans/decisions	22%	18%	17%	26%	17%	24%	27%
We have made no changes	61%	56%	69%	54%	63%	62%	58%
Don't know	1%	0%	0%	0%	0%	1%	4%

Source for Table 2: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

Business planning for Brexit

Companies are divided on feeling able to plan for EU exit

No sovereign country has ever left the EU, and few have faced the prospect of a trade agreement that is likely to result in new barriers with a trading partner. While there are undoubtedly potential opportunities further down the track following the UK's exit from the EU, the short-term risks feel like a more imminent challenge for many businesses to manage. Given the uncertainty that inevitably arises from such an unprecedented situation, it is partially encouraging that just over half of IoD members feel able to plan for Brexit. However, with 46% feeling unable to plan, there remain worrying questions over how prepared a sizeable chunk of firms will be to absorb new arrangements when they come into force.

It also highlights the urgent need to agree on a sufficient period for business to adjust to new arrangements once these are known. Interestingly, financial services firms feel somewhat more able to plan than IoD members in manufacturing– despite the prevailing wisdom that those trading in goods have clearer Brexit counterfactuals to work with than those in the services sectors. We do not break these sectors down by those engaged in international trade however, and there are many other variables beyond formal trading rules to consider in Brexit planning.

Segmentation analysis by size also shows that IoD members running larger companies than SMEs feel slightly more able to prepare for Brexit.

Table 3 To what extent does your organisation feel able to plan for Brexit?

	All sectors	Construction	Financial & insurance activities	Information & communication	Manufact-uring	Professional, scientific & technical activities	Other service activities
Very able	20%	21%	30%	24%	13%	23%	17%
Somewhat able	31%	23%	27%	27%	31%	35%	34%
Not very able	29%	38%	24%	31%	32%	25%	30%
Not able at all	16%	15%	15%	14%	24%	17%	14%
Don't know	3%	3%	4%	4%	0%	1%	5%

Source for Table 3: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

A majority of internationally active businesses trade outside as well as within the EU – this may help with firms' Brexit preparations

While the EU as a single trading entity is by far and away the biggest market for IoD members, the clear majority of those who trade internationally do so with both the EU and non-EU markets. 17% of exporting businesses and 19% of IoD members who import do so only with/from the EU. Meanwhile 76% of exporters and 68% of importers within the IoD membership have trading relationships with both the EU and the rest of the world. Unsurprisingly, the share of those who export only to the EU decreases the larger the company – 25% of microbusinesses, 20% of small firms, 17% of medium-sized enterprises and just 3% of large businesses export only to the EU.

There is little room for complacency of course, as those trading solely with the EU are still a sizeable number of businesses in absolute terms – HMRC has estimated the overall number to be around 130,000. The challenge is particularly acute for those trading goods with the EU, who will face customs processes and new barriers such as complying with rules of origin for the first time.

The ratio of EU-vs-non-EU trade amongst those IoD members dealing with both is not known at this stage, so predicting the scale of increasing compliance costs for this majority is difficult.

Requirements for trading with the EU as a third country can also be very different to those for trading with other foreign markets. But some level of existing familiarity with trade barriers elsewhere may well prove beneficial to those encountering barriers to the trading with the EU for the first time.

A very small minority of firms have already implemented Brexit contingency plans, but a clear majority are drawing them up

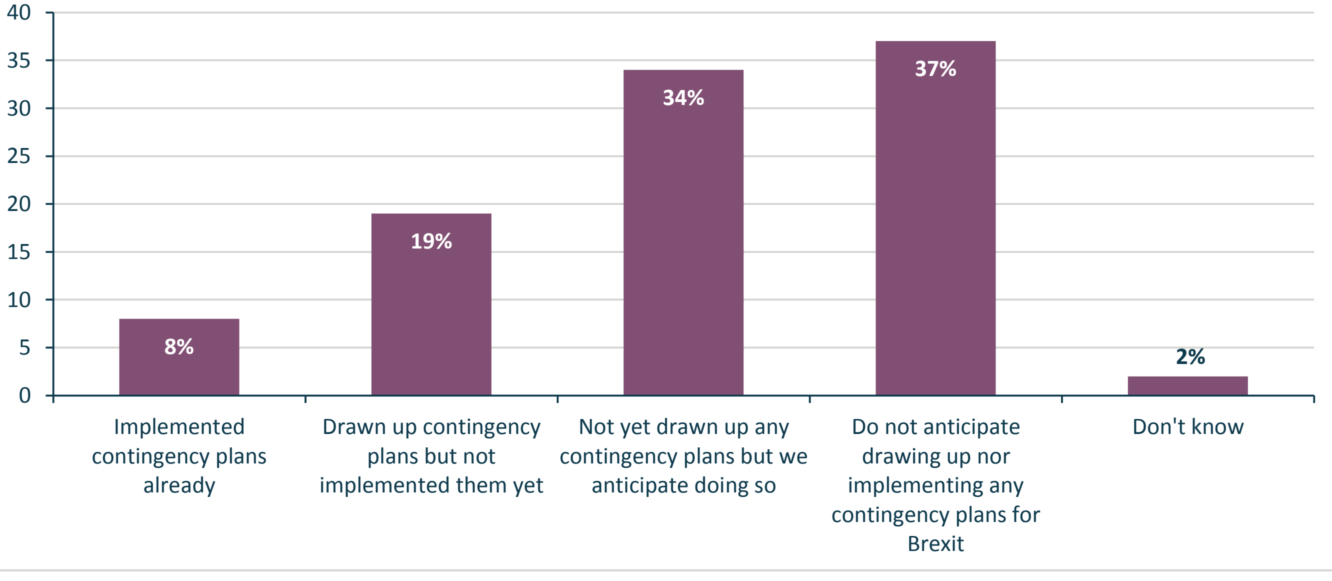
Just over a third of IoD members don't plan to engage in any contingency planning whatsoever, but this should not be taken as an assumption that their companies anticipate no Brexit impact. Of this number, just under half (44%) say this is because they will make any adjustments after the UK's new trade arrangements with the EU are known, while a similar number (48%) do not expect to be affected by the UK's exit.

While there is no variance by firm size among those who have already implemented their plans, larger businesses are more likely to have drawn these up already (30%) than SMEs (18%). They are also less likely to be anticipating no contingency planning (30%) than SMEs (40%).

In terms of sectoral variance from the average, there is a much larger share of IoD members in financial services who don't plan to undertake contingency planning than in manufacturing. The notably larger share of businesses who have not yet drawn up contingency plans but anticipate doing so further underlines the nervousness of many around undertaking changes before the shape of Brexit or transition arrangements are known. A transition period may be a 'diminishing asset' but there will still be many firms who will benefit from it even if agreed next year.

Graph 5

Have you drawn up and/or implemented any contingency plans for Brexit yet?



Source for Graph 5: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

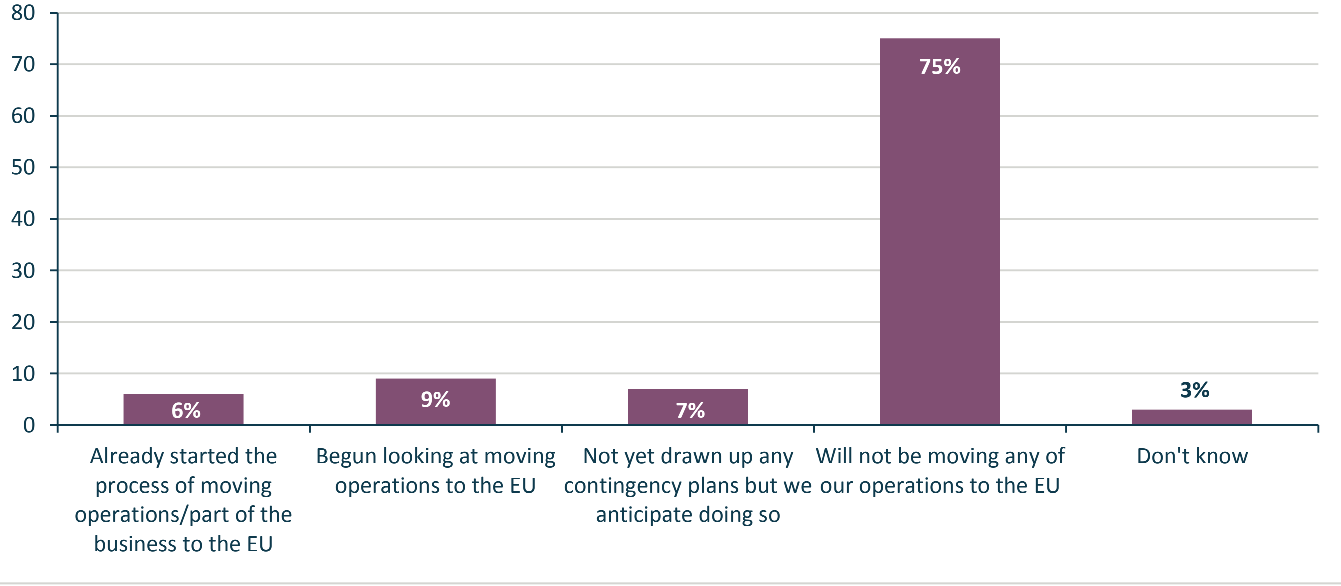
Not all contingency plans involve moving operations to the EU

While shifting business operations from the UK to the EU is amongst the most commonly-referenced mode of contingency planning, our survey data shows not all companies planning for changes are looking at relocation/expansion. While 61% have implemented general contingency plans or intend to do so, just under a quarter of IoD members are either moving parts of their business to the EU or are planning to do so.

It is important - of course - to distinguish between those who press ahead with relocation and those who only contemplate doing so. Hopefully most firms will stay in the ‘contemplation phase’, but that will depend on a ‘standstill’ transition being agreed for cross-border trade between the UK and EU sooner rather than later. However, the number of those actively looking at moving business to Europe remains an important way of tracking business confidence about Brexit.

Graph 6

Since the EU referendum, has your organisation made or considered any of the following changes to the location of its operations to the EU?



Source for Graph 6: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

Business priorities for Brexit negotiations

People and transition matter most for business – urgency is needed on both fronts

Maintaining the rights and entitlements of EU citizens is still the top priority for IoD members - as it was shortly after the election. Avoiding tariffs, early agreement on transition and a reciprocal preferential deal on movement of labour/people all come close behind. It is clear that the most progress to date on any of the withdrawal issues has been made on citizens' rights. Both London and Brussels should be in a position to announce agreement on the content of these rights as soon as possible, even if enforcement remains unclear. 40% of IoD members employ EU nationals. Businesses and workers alike do not want to see people already here before Brexit subjected to any further uncertainty stemming from "nothing is agreed until everything is agreed".

There is a pressing need for businesses to see early agreement on a transition period, which will provide certainty and stability to employers and employees alike. Combined with the fact that a number of the items on the withdrawal agenda are inextricably linked to the future, the UK and EU are fast approaching the limits of what can be sufficiently addressed in 'phase one' discussions.

Some further clarity on UK principles regarding the financial settlement is needed, but compromise from both sides is critical in order to avoid letting the ticking clock create too much unnecessary chaos. In order for the UK to provide much-needed answers about enforcement mechanisms and the Irish border, discussions about the future must be able to proceed.

Table 4 **Thinking of your primary organisation, which of the following areas should the Government prioritise in Brexit negotiations?**

Maintaining rights/entitlements for EU citizens in the UK and vice versa	50%
Zero for zero tariffs	38%
Agreement early on regarding transitional arrangements	36%
Reciprocal preferential agreement with the EU on future movement of labour/people	35%
Establishing a joint customs committee between the EU and UK early on to manage customs-related issues	28%
Continuing UK participation in the European Research Area (continued collaboration with the EU on major science, research and technology initiatives)	25%
Maintaining the ability to provide/tender for services across the EU	22%
Coming to an agreement on the Irish border	20%
Agreeing a cut-off date for when the UK will cease to be included in trade deals	12%
Other	6%
Don't know	2%

Source for Table 4: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

Single Market regulatory alignment and EU market access is more important for businesses than domestic divergence

While the UK may be leaving the Single Market upon exit, a more fundamental question about regulatory alignment – particularly in terms of maximising EU market access – has not yet been fully tackled by the Government. Our survey data makes clear that the vast majority of IoD members – more than two to one – think that continued alignment to the rules of the Single Market for goods and services is more important for their business than divergence. This split remains the same no matter what size of business, underlining the point that this is not simply in the interests of large multinationals but also many domestically-focused SMEs. (See table 6)

There is some slight variance amongst those in financial services, which is unsurprising given the discomfort of many in the City - not least UK regulators - about being "rule-takers" in an area where the EU is often prone to more normative rulemaking. However, the gulf widens to three to one in favour of alignment for members in manufacturing, where preferences tend more towards harmonised frameworks for technical regulations. The desire for regulatory alignment with the Single Market is also even higher amongst businesses in professional/science/technical activities and other service sectors. (Table 7)

It is therefore critical that market access remains a very high priority for the Government. Given this fundamentally rests on what regulatory relationship the UK envisions outside of the Single Market, the IoD urges the Government to come forward urgently with these proposals. They are essential to resolving the Irish border question, and will underpin much of our future customs relationship with the EU overall.

Border controls within the EU were not removed by its Customs Union but only finally with the advent of the Single Market. It therefore follows that policy agreement on regulatory issues and non-tariff barriers – even before we get to technology and tools for trade facilitation - will be crucial to keeping trade and business flowing freely between the UK and EU.

Table 5 **What is more important for your organisation?**

Maintaining regulatory alignment with the EU's Single Market to keep our current level of EU market access	**51%**
Departing from Single Market rules to make changes to domestic regulations – even if it reduces the UK's level of access to the EU	**21%**
Neither of those	**23%**
Don't know	**5%**

Source for Table 5: IoD survey conducted between 17 Oct – 20 Oct, 927 respondents

Appendix

Table 6: Breakdown by business size

	All sizes	Small	Medium	Large
UK Reg. Alignment to SM rules	**51%**	51%	52%	59%
Divergence from SM rules	**21%**	22%	18%	18%
Neither	**23%**	23%	23%	17%
Don't know	**5%**	5%	7%	5%

Table 7: Breakdown by sector

	All sectors	Construction	Financial & insurance activities	Information & communication	Manufact-uring	Professional, scientific & technical activities	Other service activities
UK Reg. Alignment to SM rules	**51%**	38%	46%	53%	63%	58%	52%
Divergence from SM rules	**21%**	31%	26%	25%	21%	14%	17%
Neither	**23%**	26%	25%	20%	13%	22%	21%
Don't know	**5%**	38%	46%	53%	63%	58%	52%