Hogan Lovells

Brexometer

Survey – March 2017

Don’t step back, step forward:

Global businesses looking ahead to Brexit

in collaboration with

OXFORD ECONOMICS

Contents

Foreword 3

Introduction 5

Opportunity knocks. Or does it? Businesses are uncertain and nervous 6

A bearish post-Brexit outlook on corporate profits 7

No pressure then: Negotiation outcomes – best case, worst case 8

UK companies investment decisions 9

Let's get this party started? 10

Businesses, especially in the UK, have little faith in negotiations 12

Fail to plan, plan to fail 13

Brexit: Shaping your future 14

Contacts 15

Foreword

The UK Government has set out a bold vision for a post-Brexit world: The UK as a global pivot; a strategic partnership with the EU; an enduring and perhaps an even more "special" relationship with the U.S.

Before that, on the immediate horizon are years of negotiations and realignment. The implications for businesses – those operating in the UK or whose supply chains rely on the UK – are far from clear.

As advisors to major multinationals around the globe, we wanted to get a sense of business sentiment towards the post-Brexit world. What impact will Brexit have on long term business strategy? On investment decisions? On profitability? And how are global business leaders viewing the impending negotiations – do they really feel the UK is going to get a deal that is right for their businesses?

The Hogan Lovells Brexometer is not trying to predict the future – there are far too many variables to do that with any accuracy. Rather, it is trying to understand the present. Clarity will only emerge as negotiations start and new boundaries and norms are established.

What is clear is that many global businesses are uncertain and nervous ahead of notice being given under Article 50 and the UK's subsequent exit from the EU. But our survey results also tell a story of self-help; that business confidence is built on planning and pro-active engagement. The good news is that there is still time to engage with policymakers and shape the future. Considering the raft of less optimistic expectations expressed in this survey on profits, investment, availability of skilled workers and employment, it would seem a business imperative to do so.

Now is not the time for businesses simply to hope for the best. With negotiations soon beginning in earnest, now is the time for action.

Susan Bright
Leader of the Hogan Lovells Brexit Taskforce

While we found a lot of uncertainty, the survey also revealed clear evidence that active engagement with Brexit creates its own confidence.

Introduction

With the UK about to embark on its Brexit journey, we surveyed global multinationals to understand their views on what lies ahead.

This survey was conducted against the backdrop of UK Prime Minister Theresa May's speech on 17 January. In that speech (and the UK Government's subsequent White Paper), she set out her desire for the UK to set its own immigration rules while securing an ambitious new deal with the EU that will, assuming successful negotiation, provide extensive access to the single market.

So where does that leave the business world? The Hogan Lovells Brexometer sets the stage. Before negotiations formally start, we wanted to find out how large cap multinationals are preparing for Brexit. While we found a lot of uncertainty, the survey also revealed clear evidence that active engagement with Brexit creates its own confidence.

Companies that are **proactive**, **prepared** and have already **started planning** are markedly **more upbeat** than those who have so far faced Brexit more passively.

Other key findings include:

– A large majority expect Brexit to **impact profits negatively**.

– **Uncertainty and nervousness** is likely to play into short-term behavior.

– The outcome of negotiations will have a **significant effect on business investment decisions** in the medium term.

– So far there is **limited confidence in the likely outcome,** particularly on the UK side.

This report summarizes the hopes and fears of major businesses as they look ahead to what is likely to be two years or more of very tense negotiation. We understand that as negotiations progress, and as Brexit fantasies become Brexit realities, business strategies will change and expected (and unexpected) impacts will emerge. This survey does not intend to predict the future; rather it seeks to establish the present.

Opportunity knocks. Or does it? Businesses are uncertain and nervous

At this early stage, before any real negotiation is under way and long before the history books are written, how does business look at Brexit? Sometimes the simplest question is also the most important: Is it a threat or an opportunity?

We found evidence that, faced with uncertainty, business is more focused on the risks than the possible opportunities. For a significant majority, the current uncertainty translates into a concern that Brexit is a threat – to their own businesses, to the UK and even to the EU as a whole. Businesses may be desperately looking for opportunity, but few have so far found it.

Key findings:

Only **7%** of UK-based respondents see Brexit as an opportunity for their business.

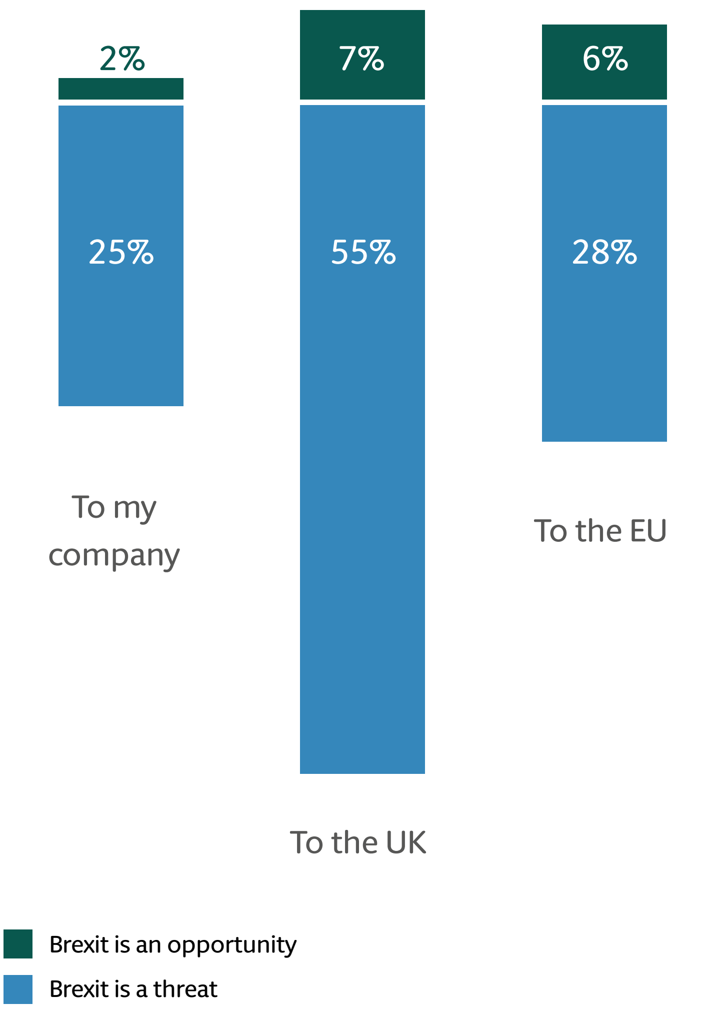
None of our French, German, U.S., or Japanese respondents sees Brexit as an opportunity for their business.

27% of UK businesses see Brexit as a threat to their business.

Largest numbers see Brexit as a threat to the UK as a whole – **60%** of UK respondents, **53%** of German, **73%** of French.

> Brexit will directly hit our research processes in the UK and there is a likelihood that we will shut down our R&D operations. The end result of Brexit would somewhat limit our business growth.
>
> *Japanese Life Sciences Respondent*

Brexit: threat or opportunity?



A bearish post-Brexit outlook on corporate profits

The last five years have been boom time for corporate profits. According to data compiled by *Trading Economics*, 2016 set record corporate profit highs in almost every developed market, including the U.S., the UK, Germany and Japan. It could therefore be argued that Brexit comes at a time when big business has never been stronger, buoyed by record profits and stock valuations to match.

We found that Brexit is expected to bring that run of good form to a halt: most companies we surveyed believe Brexit will negatively impact profits over the next five years.

Perhaps not surprisingly, companies in the UK expect to be worst hit by Brexit.

Key findings:

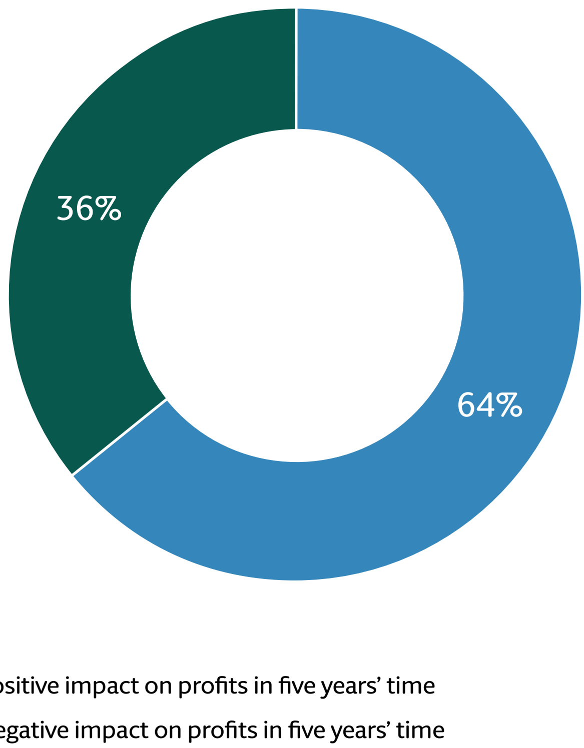
Nearly two-thirds of all companies believe Brexit will create a fall in profits over the next five years, with 14% expecting that reduction to exceed 5%.

Conversely, only 10% of UK respondents and 6% of all respondents believe Brexit will produce profit growth of more than 5%.

> We might have to compromise on profits considering the breakdown of the British economy and its following effects.
>
> *Other EU Insurance Respondent*

> We expect a downfall in the industry as well as our business… unstable currency rates will impact the profitability of the company.
>
> *German Automotive Respondent*

Brexit impact on profits



No pressure then: Negotiation outcomes – best case, worst case

Global business sees success or failure in the negotiation process as a make-or-break proposition for the UK, at least in the short to medium term. The progress – or potential lack of progress – will have a major impact on the economic landscape, in terms of investment decisions, hiring, M&A activity and strategic planning.

We found that the difference between businesses' perceptions of best and worst case outcomes is vast – the latter could mean a collapse in investment, new employment and a total re-assessment of the UK by global businesses.

This only goes to accentuate the challenge facing the negotiators. Before even facing the question "How to secure a good outcome?", they should ask themselves "What would a good outcome look like?" Do all businesses see good outcomes in the same way or are their hopes (and fears) different?

It will be difficult enough to secure an optimal result, but there will be no hope of that if the negotiators have no way of telling what the optimal result for business is. There is only one way for them to find out – businesses need to step forward and articulate clearly what they need to succeed following Brexit.

Key findings:

Outside the UK, the best case / worst case fall in UK investment is steep – best case, **27%** of German companies will invest further, worst case, just **3%**.

32% more respondents expect a decrease in UK employment in a worst case scenario than a best.

84% of all respondents will reassess strategy following a worst case scenario. Least impacted by a worst case outcome is the desire to seek M&A opportunities.

> We think that lots of companies would probably migrate from the UK to other European Union countries.
>
> *German Diversified Industrial Respondent*

> The pharmaceutical industry is a multinational industry… it will cause a big loss to our industry and to the academic and research organizations within the UK.
>
> *U.S. Life Sciences Respondent*

UK Company investment decisions

	Best case scenario	Worst case scenario
UK companies will invest more in the UK	67%	33%
UK companies will invest more in the EU	30%	43%
UK companies will reduce employment in the UK	3%	37%

Let’s get this party started?

Given the uncertainty over the economic implications of Brexit and the fact that very few respondents believe that negotiations will head in the right direction, it would be reasonable to assume that many businesses would support some form of transitional agreement. Such an agreement could delay the full impact of Brexit and mitigate some of that uncertainty.

We found that assumption is generally unsupported. There is little demand for delay. In fact, there is more of a “let’s get on with it” attitude among global businesses. Even in the UK, support for a transitional agreement is not as strong as one might expect, but there are key sectoral exceptions.

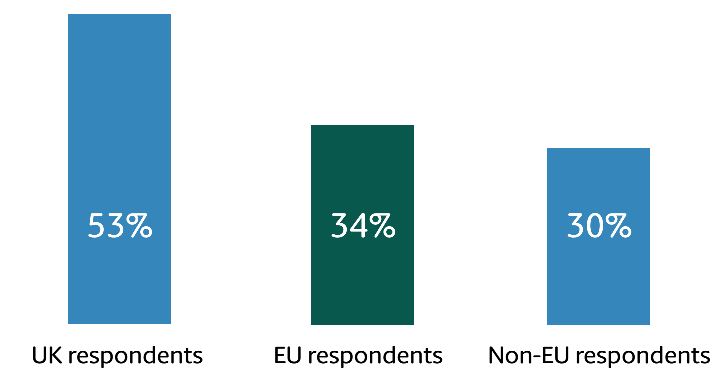
Key findings:

In the UK **53%** of companies would like a transitional agreement.

Though **43%** of Other EU respondents favor a transitional agreement, no other country polled higher than **33%** in favor of a transitional agreement.

However, **75%** of UK Financial Services and Insurance companies would like a transitional agreement.

Support for a transitional agreement



Viewpoint:
Transitional agreement

Rachel Kent
Head of Hogan Lovells Global Financial Institutions Sector

It is not surprising that financial services respondents showed the greatest enthusiasm for transitional arrangements. For financial institutions, the implementation of Brexit is not simply a matter of becoming subject to higher tariffs. If transitional arrangements are not agreed, financial institutions run the risk of being unable to conduct business across a UK/EU border after the date of Brexit unless they obtain local authorisation in the country in which they wish to do business.

The relatively short timeframes for Brexit under Article 50, and the length of time it is likely to take a financial institution to put alternative arrangements in place (e.g. to establish subsidiaries on the other side of the UK/EU border and get them authorised), means that transitional arrangements should be made as soon as possible. This will minimize unnecessary relocation or restructuring by financial firms and will maintain continuity of service provision to businesses and consumers.

The most desirable arrangement for the transition period would be if the UK and EU could agree that current passporting rights can continue, in both directions, until the longer term arrangements have been agreed and fully implemented.

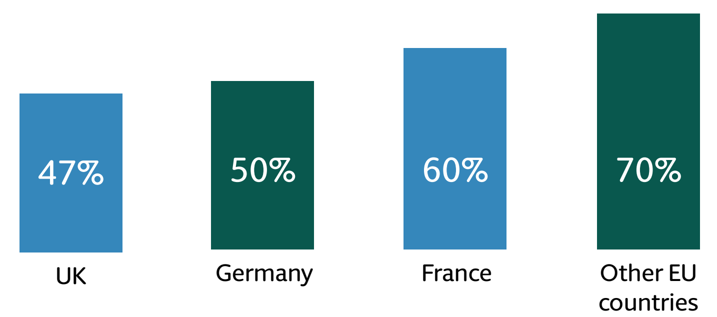
Businesses, especially in the UK, have little faith in negotiations

The UK Government has the unenviable task of attempting to please a disparate group of stakeholders in its Brexit negotiations. In the UK, many political voices are calling for prioritizing immigration control rather than trade and commerce concerns.

We are at a very early stage with little evidence on which to base expectations of the UK's approach to the decisions which really matter. So perhaps it is no wonder that our survey found that businesses are not confident that their voices have been heard.

We found that UK companies have been unimpressed by the indications of the likely approach to negotiations. French and German businesses have more confidence in their own governments' position.

Level of confidence in negotiations



> There are still two years before the final exit of the UK from the EU will happen. Within that time period, we expect extreme uncertainty and risks surrounding exit negotiations.
>
> *Japanese Financial Services Respondent*

The survey also found:

- Only 20% of UK companies believe the approach to the impending negotiations is going in the right direction
- Confidence outside the EU is even lower – only 7% of Japanese and U.S. companies are confident in the direction of negotiations, with only 3% of Chinese companies in agreement that their country's negotiations with the UK will reflect their interests.

Viewpoint:
Negotiations

Charles Brasted
Hogan Lovells Brexit Taskforce

The UK's Article 50 notice will trigger the start of the formal negotiations for the UK's withdrawal from the EU. However, it remains unclear what the scope of those negotiations will be – the EU seems focused entirely on the "divorce terms", while the UK Government is seeking a swift agreement on its future relationship with the EU.

What is clear is that the scope of negotiations is unprecedented: those divorce terms; a future UK/EU trade agreement, potentially including wide-ranging services provisions; transitional arrangements; cooperation on security and justice. That is not to mention the UK's global ambitions, which require new WTO schedules and trade agreements around the world.

Given the scale of the task ahead, and the uncertainty as to how negotiations will proceed, it is little wonder that few businesses are confident about the process or outcome. Much of that sentiment is born from lack of visibility.

Businesses most engaged in the preparations for negotiations are most confident about them. The challenge for every business is to ensure that it understands and is preparing for the issues that it faces, and also that it develops a common understanding with policymakers about how those issues can be addressed.

Proactive engagement now is not just about expressing concerns but also about gathering intelligence and collaborating to develop solutions. All of these will contribute to business confidence, and could bring competitive advantage for those who invest the time now. The good news is that the UK Government, for one, is listening and engaging like never before.

Fail to plan, plan to fail

Our survey found that, whilst many companies are concerned about the impact Brexit may have on their business, some (albeit a minority) have not yet developed plans to manage those impacts. Few have sought external help, and a majority have not considered the possible impact of Brexit beyond their own internal expectations.

However, companies that have dedicated most resources to planning, preparation and proactive engagement with those shaping Brexit have the most confidence, while companies that have not appear most pessimistic.

Almost every company surveyed believes it has a good understanding of how Brexit will impact its business.

Key findings:

93% of UK respondents believe they have a good understanding of how Brexit may impact their business.

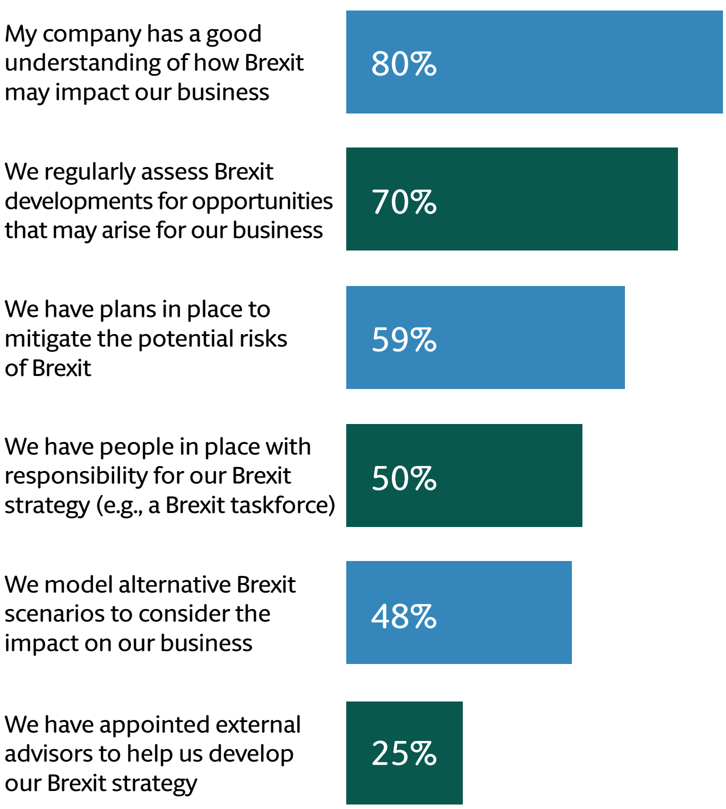
Fewer have plans in place to mitigate the impact of Brexit – **73%** of UK companies, **63%** of German and only **50%** of French.

Only **25%** of all companies have appointed external advisors.

> We could be facing several difficulties as we are clueless about the future prospects of Brexit.
>
> *U.S. Financial Services Respondent*

> We are in the phase of preparing an effective strategy so that Brexit leaves minimal impact on our business.
>
> *German Financial Services Respondent*

Brexit preparedness



Brexit: Shaping your future

Businesses around the world are assessing the potential impact of Brexit on their operations and relationships in the UK, the EU and internationally, and on the commercial and investment opportunities open to them.

For many businesses, making the best of Brexit may be the biggest strategic challenge they face in the next decade.

At stake are not only the terms on which the UK does business with the EU and with the rest of the world, but also how businesses both in the UK and in the EU are regulated.

There are many unknowns. Choices made about policy, trade and regulation in the UK, the EU and beyond will be central to defining the business environment now and in a post-Brexit world.

Understanding the policy and political landscape in which those choices are made, and knowing how to navigate it, will be crucial to shaping it to achieve the best outcome for you.

Having the right team in your corner to interpret the policy and political maneuvers around the world, to develop credible solutions and compelling arguments and to advocate on your behalf, at the right time and in the right places, is critical.

A practical response strategy

Your overall strategy in responding to Brexit should cover the following key elements:

Organize a “Brexit Taskforce” to capture insight from across your business.

Inform your Board and wider business of the possible implications of Brexit and the approach your business is taking to it.

Analyze potential impacts or changes that your business would like to drive.

Capitalize on opportunities generated by uncertainty and change.

Prepare by taking steps to mitigate potential risks and developing a detailed plan to move quickly as clarity emerges.

Monitor developing thinking in London, Brussels and elsewhere.

Engage with government in the UK, EU and beyond, as well as with other key stakeholders.

Further details on this overall practical response strategy are available in our Brexit toolkit at **hoganlovells.com/Brexit**

Methodology

Oxford Economics surveyed 210 senior executives in February 2017, spread evenly across seven geographical markets (the UK, Germany, France, Other EU, U.S., China and Japan) and seven industry sectors (Financial Services, Insurance, Energy, Technology Media and Telecoms (TMT), Life Sciences, Automotive and Diversified Industrials). All companies were over $1 billion in annual turnover, with almost half the sample reporting annual revenues of more than $20 billion. Respondents were asked about how they expected Brexit to impact business performance, the extent of their preparation, their expectations regarding future negotiations and their planned actions in response. Country analysis is based on the location of the respondent, rather than the corporate HQ.

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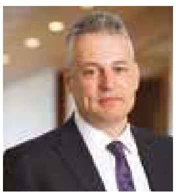

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