

ANALYSIS

With the UK's Brexit vote inevitably impacting retailers, **Nick Hughes** investigates the wide-reaching implications for the global supply chain

THE BREXIT EFFECT

How will global retail supply chains be impacted?



The referendum on Britain's EU membership revealed a nation deeply divided over its future role in Europe. But one point on which all commentators and voters could agree was that a vote for Brexit represented a giant leap into the unknown.

If there was any doubt as to the scale of the challenges facing supply chains that thrive on certainty and stability, the latest CIPS Risk Index for the second quarter of 2016 serves to hammer the point home. Global supply-chain risk climbed to one of the highest levels seen since records began in 1995, reflecting the reverberating effect Brexit is expected to have on supply chains in the region and across the rest of the world.

Although the UK will still have access to the EU's single market for at least two years after it invokes Article 50, the medium-term outlook for retailers with global footprints is less clear, with Brexit set to impact everything from sourcing strategies and trading rules to the release and payment of goods and

shipment costs. Retailers are moving sourcing closer to home to create shorter lead times and a more flexible approach to transportation by using lorries instead of ships.

Supply chain

CIPS director Duncan Brock admits these are very uncertain times for UK retailers, however, he believes most are already planning for a world outside of the EU. "What we are seeing from discussions with retailers is the majority of them are already starting to evaluate their supply chains and how much exposure they have to the European market," he says.

The early evidence suggests the years ahead could herald radical changes in logistics. Almost a third of UK retailers questioned as part of a recent Barclays survey said they are considering changing suppliers as a consequence of Brexit, while 28% are thinking about sourcing from different countries.

Some 32% expect to source more from the UK as result of the referendum, while more

than half expect to source more from India and 43% anticipate buying more from China. Firms also predict they'll be sourcing more from Africa (38%) while 45% expect a drop in how much they buy from Europe.

The survey also highlighted a divergence in retailers' opinions over the implications of Brexit for their own supply chains, with 44% anticipating a negative impact compared with 41% who expect Brexit to have no real effect.

"It's a mixed picture, but there are some encouraging findings," says Barclays head of retail and wholesale Ian Gilmartin. "Retailers are not overly pessimistic about the impact of the vote on their supply chains, and yet they are still thinking carefully about what they need to do now, in particular with regards to which regions they source from and their foreign exchange strategy."

Uncertainties abound

The political and economic fallout from the withdrawal of a member state from the EU is unprecedented. Among the uncertainties highlighted by finnCap analyst Roger Tejwani are the length of time the negotiations for EU withdrawal will take, what the outcome will be, and whether the EU will be willing to agree favourable trade deals with the UK.

For retailers planning their future supply chain strategies there are currently far more questions than answers. "Once the negotiations start and we begin to see the direction of travel, they're going to have quite a serious workload to re-evaluate their suppliers and supply bases," says Brock.

"Retailers are not overly pessimistic about the impact of the vote on their supply chains, and yet they are still thinking carefully about what they need to do now"

Ian Gilmartin, Barclays

Go online to read how driverless vehicles could affect retail logistics
Retail-week.com/Supply-chain-tech



BREXIT IMPACT BY NUMBERS

20% of retailers surveyed plan to increase product prices as a result of the Brexit vote

28% are thinking about sourcing from different countries

32% expect to source more from the UK

Source: Barclays

For pan-European retail businesses, such as Kingfisher, that operate a centralised sourcing strategy, Brock says they will need to know that they can buy and distribute goods easily without having customs controls put in place. He adds that these retailers are likely to view the continued free flow of trade as a desired outcome of negotiations.

Retailers who fulfil EU orders from UK facilities will also be keeping a keen eye on the negotiating process. Next currently has around €200m in sales revenues from EU countries and already has a warehouse and fulfilment operation based in Continental Europe, which it says could be expanded to service most of its continental business in the event that fulfilling sales from the UK becomes less efficient.

On the flip side, UK businesses that are purchasing their goods or materials from EU suppliers may consider relocating production

to the UK or sourcing more from third-world countries. "There could well be a push to do a lot more within the UK," says Brock. "Clearly places like Africa for food could also be a beneficiary, while a lot of sourcing happens out of Asia anyway and we could see more going that way rather than sourcing out of the EU."

In theory, the removal of the EU's control of UK trade policy will allow the UK Government to sign bilateral free-trade agreements with a host of non-EU countries, including the likes of China, India, Australia and the US.

"If the Government is able to get those kinds of preferential trade agreements with a wide range of countries, from a supply chain perspective that gives you the ability to then look for the best value and to be flexible without facing restrictions from customs controls and regulations," says Brock.

Tejwani, however, warns that even though

the UK would not need to get the agreement of 27 other partners to reach a negotiating position with third-world countries, sourcing from non-EU markets such as China could become more expensive without the negotiating muscle of the EU.

Trade directly with the EU, meanwhile, could be subject to tariffs and a separate agreement would need to be implemented with each country the UK trades with, adding both complexity and cost to businesses.

Such talk remains purely speculative as long as formal negotiations are on ice. The priority for retailers is to have clarity over the terms of Britain's EU exit as soon as possible. Then and only then can they plan the future supply chain strategies that will enable them to thrive in a new climate.

Currency volatility

The most immediate short-term impact of Brexit has come in the form of currency devaluation, with the value of sterling falling sharply against the euro and dollar since the day of the vote to leave.

In a recent sector note for Q3 2016, Tejwani warned that currency weakness could prove especially unfavourable for those retailers operating in clothing, furniture and electronics that import a large proportion of their goods from the Far East.

Next has already warned that in the medium term the devaluation of the pound is likely to increase the cost price of its goods by five per cent, despite it partially mitigating the impact by pre-referendum hedging and currency offsets.

In common with Next, more than two thirds of respondents to the Barclays survey said they believe Brexit will have a negative impact on their import costs. Of these, 31% said they plan to respond by increasing product prices; however, more than three quarters plan to streamline supply chains and more than half expect to absorb cost increases themselves. "It's reassuring to note that most retailers don't intend to pass on costs to their customers and will instead look for other ways to tackle supply chain issues," notes Gilmartin.

The building supplies giant Travis Perkins is just one example of a retailer that purchases significant volumes of products that have input costs in foreign currencies but which are denominated in sterling.

The company says it has a number of strategies in place to deal with cost price inflation, including switching to UK-sourced products, increasingly sourcing direct from manufacturers and improving efficiencies, as well as passing genuine cost inflation through to customers where it cannot be avoided.

Such strategies will have been carefully considered and planned for. After all, the risk of currency volatility is nothing new to retailers.