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BREXIT SUPPLY CHAIN: KNOWING YOUR TIPPING POINT.

THE IMPLICATIONS OF BREXIT ON SUPPLY CHAIN: DO YOU "KNOW YOUR TIPPING POINT"?

As the UK continues Brexit negotiations, companies across the UK are preparing for a period of economic uncertainty. Whilst the outcome of these negotiations is far from clear, there is little doubt that the "levers" that determine a company's supply chain performance could be significantly disrupted. The challenge for supply chain executives is to prepare their organisations for this change amid so much uncertainty. If they take action now, could they overreact, make the wrong assumptions and arrive at poor decisions? If they do nothing, wait for the Brexit outcome to be determined, could they risk losing out to the competition? In this viewpoint, we'll examine Accenture's number one "no regret action" for the supply chain executive: Knowing Your Tipping Point.

Knowing Your Tipping Point is about recognising when the implications of Brexit could impact your supply chain to a point where the net benefit of "action" is greater than the cost of "inaction". To do this, you'll need to fully understand what drives the performance of your supply chain today, so that you can model potential Brexit scenarios, developing an understanding of what it would take to reach your tipping point.

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SO, TO REALLY KNOW YOUR TIPPING POINT REQUIRES THREE THINGS:

1. A baseline view of your supply chain's performance, expressed in the metrics that matter for your organisation (e.g. cost to serve, working capital consumption, product availability).

2. A clear understanding of the "levers" that are likely to be impacted by Brexit and how they link to your supply chain's performance.

3. An analytical modelling capability that allows you to assess the implications of multiple scenarios, as the Brexit negotiations progress and new outcomes become possible.

LOOKING AT EACH IN MORE DETAIL:

1. Understanding your current baseline performance:

Due to the increasing complexity of supply chains – which have intricate financial models, variable manufacturing staging, differentiated channel segmentation, dynamic supplier and customer collaboration models, extended geographic reach, as just a few examples of complicating factors – very few companies fully understand their supply chain performance. Getting to this baseline view requires detailed analysis of core supply chain value-streams across the organisation, with a rigorous approach to data collection that ensures reliability and repeatability. Given the sheer volume and complexity of baseline data available to supply chain executives, it's important at this initial stage that the foundations of the "to-be" optimisation model are defined – so that no data gaps are left when it comes to running Brexit scenarios through the model. Once the baseline data is established in the model, supported by visual analytics and other techniques, we can start to develop insights on the current performance of the supply chain.

2. Understanding Brexit "levers":

The media is full of speculation and soundbites about the impact of Brexit on companies. Understanding which of these statements are valid and, of them, which are relevant from a supply chain perspective is key to untangling the complexity of Brexit impact analysis. Here we provide only a snap-shot of some Brexit supply chain "lever" considerations.

a. **Foreign exchange rates:** The impact of weakened sterling following the referendum vote has had an immediate and significant impact. With the pound having already fallen in value by ~12% against the euro, supply chain executives need to consider not just the increased cost of imports, but also the positive impact on overseas demand that comes from more favourable export pricing. When mitigating the increased cost of imports with alternative sourcing strategies, it will be important to build additional flexibility into the sourcing process to take account of future FX instability, which is a likely consequence of market uncertainty through and beyond the Brexit negotiations.

b. **Import/export tariffs:** There is a high degree of uncertainty about the tariff arrangements that will be agreed during Brexit negotiations. However, if the UK does not retain access to the single market, the impact could be substantial. Trade law experts – and many others – have argued that the time required to establish a comprehensive post-Brexit tariff structure (for a newly negotiated "free trade agreement") will likely exceed the prescribed two-year window for the EU exit process, which raises questions about potential "interim" arrangements or defaulting to World Trade Organisation (WTO) tariffs. With an average levy of 4%, WTO tariffs vary widely by industry and product type, with some automotive tariffs up to 10% and electronic equipment around 5%. For consumer goods, EU common external tariffs (currently applied by the EU to non-EU countries) vary from 0% on cotton, 11.5% on clothing, 25.6% on sugar and confectionery, to 45% on certain dairy products and 60% on some beef cuts. As well as the potentially negative impact on EU imports (given an increased cost base), supply chain executives will need to consider the potential upside of revised tariff agreements outside of the EU (both "sell-side" and "buy-side").

c. **Customs:** Supply chain executives have become used to near "frictionless" border crossings into and within EU member states. On the occasions when EU border crossings are disrupted, for example during Calais port strike action or heightened security for immigration control, the impact on supply chains has been self-evident, with trucks queuing up the M20 from Folkestone. Transit times could be impacted by customs controls and will need assessment in the context of overall product lead-times, for both the inbound and outbound supply chains. The extent of the impact will be largely dependent on how successful the government is in negotiating a customs agreement with the EU. Longer lead-times would result in an increase in working capital requirements – for industries that rely on Just-in-Time manufacturing, such as the automotive industry, every additional day of stock could increase working capital by as much as 7%. In addition, supply chain executives will need to consider what new tools and capabilities might be required for managing the customs process as efficiently as possible. An example of the potential border implications sits at the Bulgaria/Turkey EU crossing, where trucks face queues of 17km and it can take 30 hours to enter the EU, despite significant investment in modernised border gates and additional truck lanes.

d. **Regulations:** Immediately post-Brexit, UK regulation derived from EU legislation will in most part remain unchanged, mitigating the short-term impact. However, over time, it is anticipated that the UK government will begin to enact changes locally, and the resulting 'regulatory divergence' will inevitably risk impacting supply chains. This would be especially true of regulations that control product standards, which if diverged from EU standards could lead to additional SKU complexity (impacting areas such as packaging, labelling and codification). Additional bodies established to monitor adherence to standards could introduce more supply chain red tape and extended lead times during import/export. Aftermarket or warranty legislation, which defines a product's legal guarantee, will likely impact the reverse logistics supply chain. For example, changes to regulations setting the responsibilities (between OEM and reseller) and service level requirements for returns, repairs and replacements could impact how a company manages its reverse logistics capability.

e. **Tax/Finance:** Changes to the tax regime post-Brexit could have implications on the product cost base, resultant from any change to Import VAT, Withholding Tax and the application (or lack) of EU tax reliefs. Similarly to tariffs, this could affect a supply chain executive's sourcing strategies. Changes to finance could have implications on working capital. An increased cost of finance would drive supply chain executives to focus on inventory optimisation initiatives – attempting to drive stock levels down to reduce the working capital requirement, whilst protecting product availability. This will be especially challenging considering longer lead times resulting from border "friction".

f. **Labour:** The supply chain executive will have two primary considerations here. Firstly, the risk of access to skills in the current supply chain talent pool – where that talent is increasingly scarce and often sourced internationally. Secondly, developing and sourcing new skills that historically have been less important for a supply chain operating predominantly within the EU – namely customs and foreign trade expertise.

The above implications are far reaching, and touch every aspect of the supply chain, from plan to source, make to deliver and return to service. The extent to which each of these levers impacts the supply chain will vary significantly by industry, and even specific product type (in the case of tariffs, as previously noted). From a physical supply network perspective, those industries with a high proportion of EU imports/exports today will be most exposed– this includes manufacturing companies across aerospace and defence, electronics and high tech, consumer goods, automotive and industrial equipment. There will be implications on how a company organises and runs its supply chain (i.e. operating model) in any organisation with a pan-European operation, irrespective of industry.

"Implications are far reaching and touch every aspect of the supply chain."

3. Supply Chain Analytics Modelling:

Given the complexity of the current state performance review and the need to quickly model multifaceted Brexit scenarios, a sophisticated data-led approach using advanced analytics tools is required to reliably inform decision making. It's at this stage where we need to convert our understanding of the Brexit levers into modelling parameter variables. Identifying what to treat as a constant, versus what to treat as a variable, is key to effectively exposing the impact of Brexit against other changes in the supply chain. Also key to establishing the model is deciding how to prioritise the optimisation logic around factors such as cost and service level. This should be done with C-level buy-in, to ensure that what the model is solving for is what the company is most focused on achieving. With the "As-Is" scenario modelled, different potential Brexit "To-Be" scenarios can be developed and rapidly tested for impact (including one "Do Nothing" scenario, which assesses the current supply chain configuration under Brexit conditions). As the Brexit negotiations progress and different outcomes become possible, new scenarios can be reviewed.

In addition to modelling the impact, it is also critical to assess the cost of transitioning from the current supply chain configuration to an alternative optimised configuration. Considerations for the transformation cost span people, process and technology.

Finally, the benefits need to be mapped against the transformation cost in a Return On Investment (ROI) model. When the scenario conditions are such that the model shows a positive ROI, you have reached **Your Tipping Point.**

Accenture is uniquely positioned to help our clients navigate through the implications of Brexit on supply chain, with our deep industry insight, functional supply chain skills and extensive digital analytics modelling capabilities. We work with many of the world's leading companies, not just to advise and optimise supply chains, but also to transform and run them. We have worked with clients undergoing similar trading environment changes elsewhere, for example a global healthcare and pharmaceutical group based in India, where the introduction of a new Goods and Services Tax (GST) regime is significantly impacting the cost of moving inventory between states. **Can we help you find Your Tipping Point?**

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