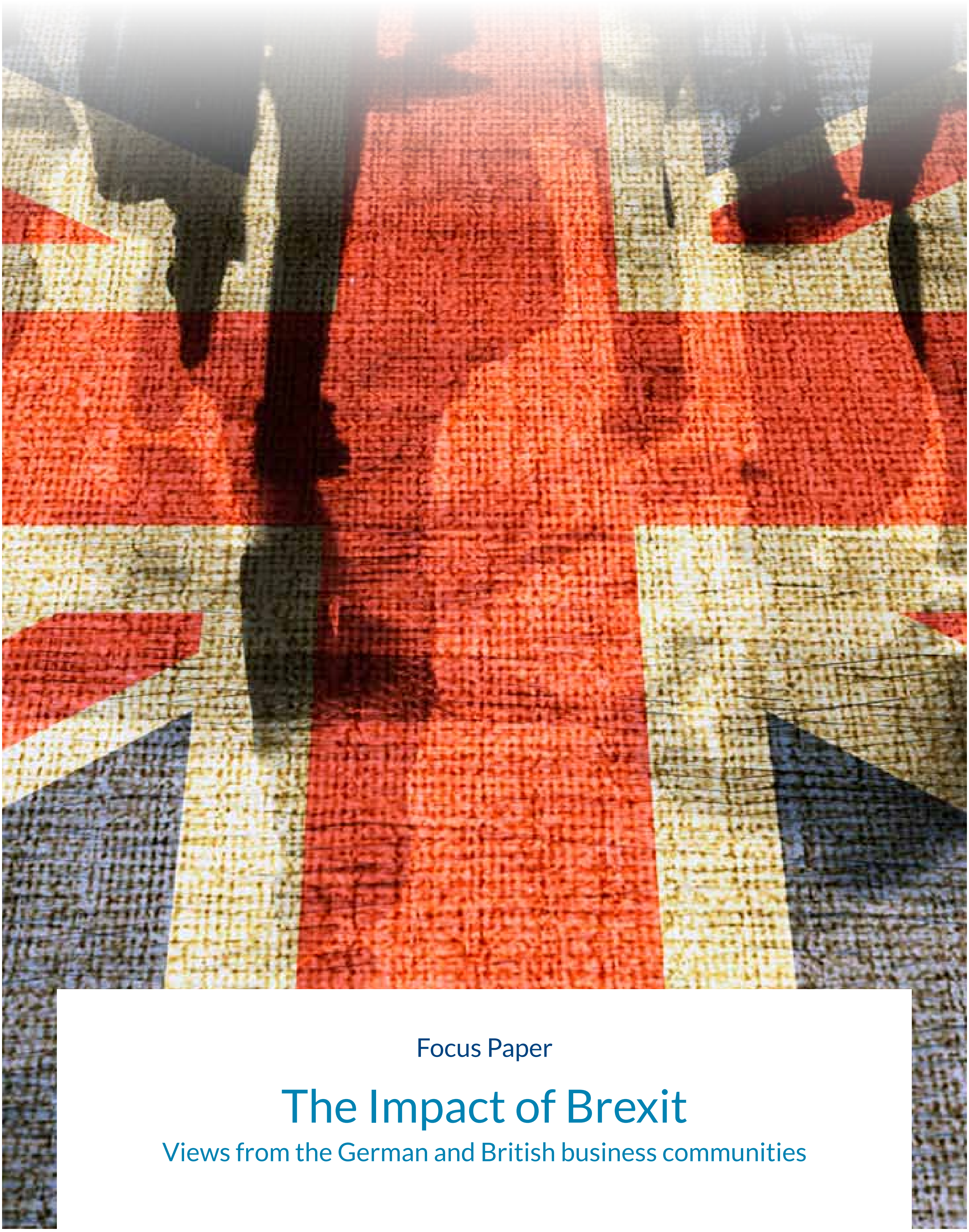
Global Economic Dynamics



Focus Paper

The Impact of Brexit

Views from the German and British business communities

BertelsmannStiftung

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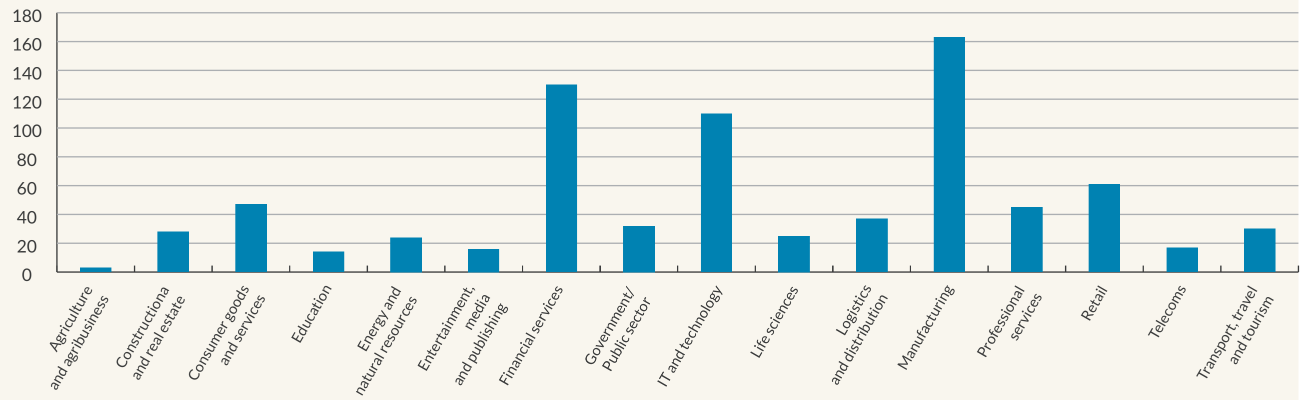
Introduction

As the date of a UK referendum on European Union (EU) membership approaches, the “in” and “out” forces are going into overdrive. Political advocates of Britain staying in the EU have used mainly economic arguments. In particular, they have argued that leaving the EU as a political entity would harm the UK by reducing its trade with EU countries, even if the country retained its access to the single market, an assumption that is by no means guaranteed with a Brexit. The “in” advocates have also argued that the UK would lose its say on matters affecting its trading relationship with EU countries, and that the UK probably would not benefit from future trade deals negotiated by the EU with third countries. Finally, the “in” campaign has argued that a “Brexit”—UK exit from the EU—would make the UK less attractive to inward investors as a place from which to export or distribute to markets across Europe. All those arguments have been supported by economic analyses aiming to prove one point or another. The Bertelsmann Stiftung’s own study “Costs and benefits of a United Kingdom exit from the European Union” found that even under the most positive external circumstances a move to leave the EU would bring more costs than benefits to the UK economy. What has been largely missing from the debate, however, is the view of the business communities in the UK and on the Continent. How do they see the impact of a potential Brexit on their national economies, on their own specific industries, and on their own companies? The “stay” campaigners in politics have assumed that business people, above all, would react to the prospect of a Brexit with dismay and alarm, in keeping with the dire economic predictions concerning the loss of trade benefits and inward investment. But do business people in fact react as predicted?

1. About the survey

FIGURE 1 **Sectoral Allocation**



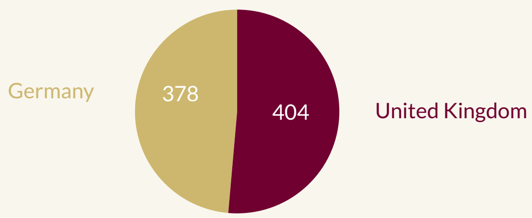
Source: Economist Intelligence Unit | BertelsmannStiftung

To answer this question for us, the Economist Intelligence Unit carried out a survey of companies headquartered in the UK and Germany to gauge their sentiments concerning a potential Brexit. The online survey was carried out in November and December 2015. It focuses on respondents' views of how Brexit would affect their national economies, industries, and individual companies. For purposes of this survey we assumed the best-case scenario for the United Kingdom and defined Brexit as a UK departure from the European Union as a political entity, while remaining within the European free trade zone or single market.

The survey sample has 782 respondents in total, of whom 404 are executives of UK-based companies and 378 are executives of companies headquartered in Germany. The sample is cross-industry but clusters in four industries of particular importance to these two countries: financial services (130 respondents), consumer/retail (108 respondents), IT/technology (110 respondents), and manufacturing (163 respondents. The remaining 271 respondents are spread across 11 other industries, including telecoms, professional services, life sciences, and energy/natural resources.

The focus of the sample is primarily—but not exclusively—companies that are active across the EU. Of the 782 respondents, 549 represent companies that earn at least 25% of their revenues in EU countries other than their headquarters country. In terms of company size, the sample includes 420 companies whose global annual revenues exceed €500 million, and another 362 companies whose global annual revenues are in the €10 million - €500 million range. (None of the companies has revenues below €10 million.) Of the total respondents, 346 are C-level or above (CEO, CFO, etc., or Board member), and 436 hold titles above department-head level but below C-level.

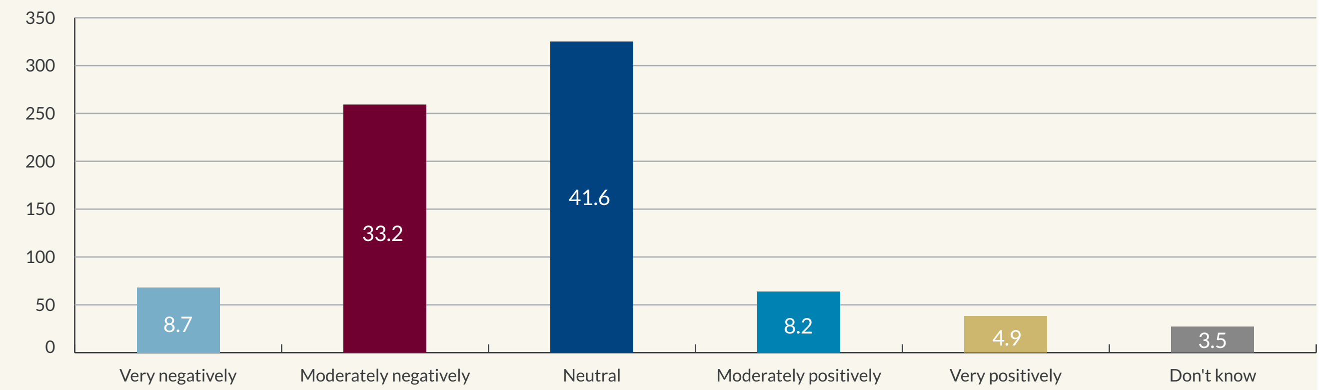
FIGURE 2 **Companies based in:**



Source: Economist Intelligence Unit | BertelsmannStiftung

2. Important findings

FIGURE 3 **In the three years after an exit, how would Brexit affect your country's employment levels? (Percent)**

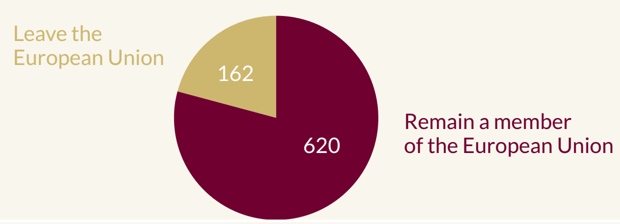


Source: Economist Intelligence Unit | BertelsmannStiftung

A strong call for a united europe

Four-fifths (79%) of respondents say the UK should remain in the EU, with only 21% saying the UK should leave. The German companies seem to be the more committed Europeans. Here 83% speak out in favour of the UK staying, compared to 76% of British companies giving this answer. Among Industries, the strongest advocates of the United Kingdom remaining within the EU are in manufacturing (82%), IT/technology (83%) and consumer/retail (83%).

FIGURE 4 **Should the UK leave the European Union?**



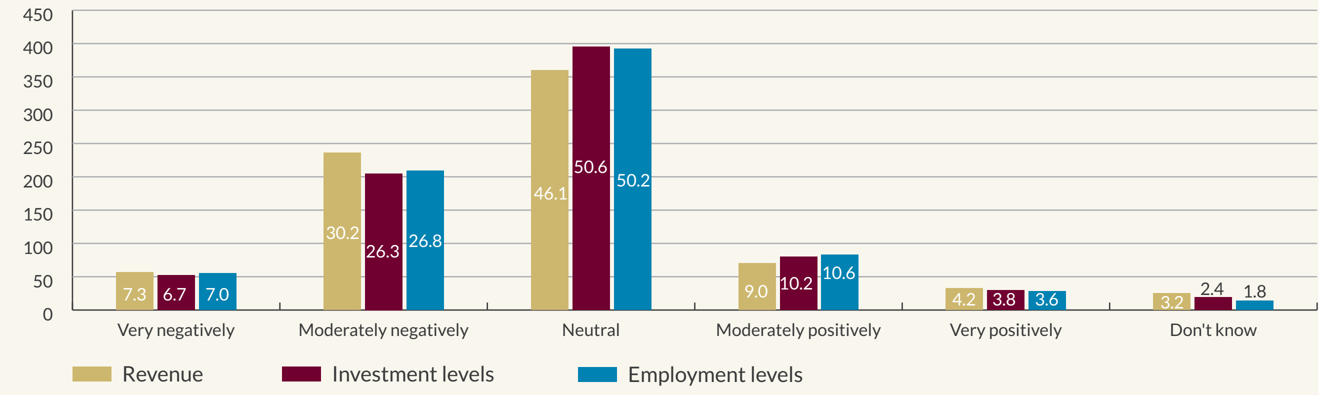
Source: Economist Intelligence Unit | BertelsmannStiftung

The Opinions, however, are more divided on the question of whether the UK will actually end up leaving the EU. In the overall sample, nearly half of the respondents (46%) predict Britain will leave while a similarly sized portion (47%) says the UK will stay. There is no difference in predictions between British and German companies on this question. Companies in IT/technology are most likely (58%) to predict the UK will leave. Conversely, financial services companies were most optimistic, with 53% predicting the UK to stay.

Companies worry about national employment levels

Among all respondents, the negative predictions for the effect of a potential Brexit on their countries' employment levels far outweigh the positive ones. While overall 42% of businesses see a "negative" or "very negative" effect, only 13% think a Brexit could increase national employment numbers. The remaining of respondents either see a neutral effect (42%) or didn't know what effect to expect (3%).

FIGURE 5 **In the three years after an exit, how would Brexit affect your industry's … ? (Percent)**



Source: Economist Intelligence Unit

BertelsmannStiftung

UK companies (44%) are more likely than German ones (39%) to expect a negative effect on employment levels in their country. Slightly less alarmed are manufacturing companies. Among their respondents the largest neutral response (49%) can be found, here too however, the block of negative predictions (36%) is more than three times the size of the positive ones (11%).

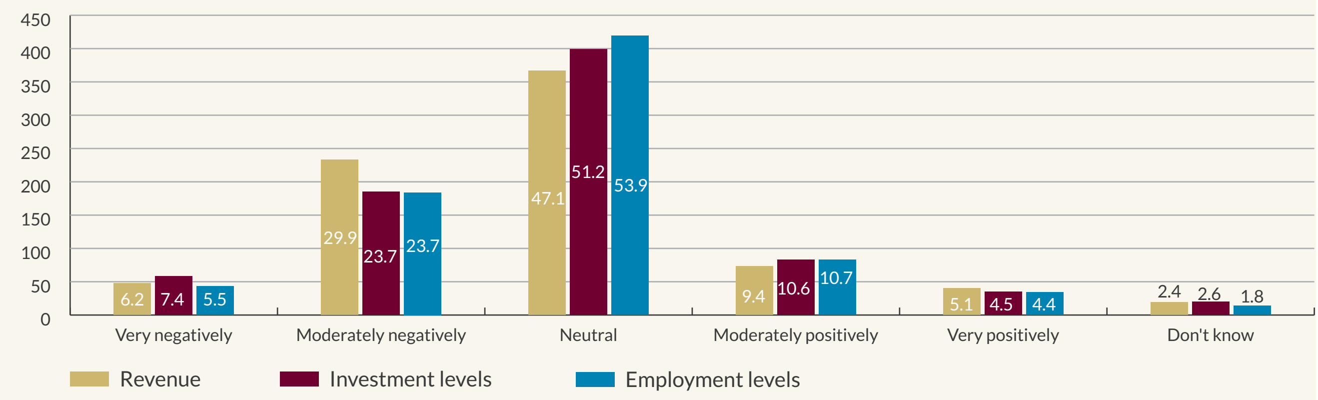
Respondents predict hard times ahead for their industries …

The same tendency towards negative predictions can be observed when asking about respondent's own industries. Of the total sample, roughly three times the number of respondents expected a negative impact on their industries' revenues (38%), than respondents expecting positive changes (13%). The "neutral" sentiment was stronger in Germany than in the United Kingdom, where opinions were more diversified along a spectrum of optimism to pessimism.

Concerning the impact of Brexit on respondents' industries' investment levels, businesses roughly remained in this ratio with 33% predicting negative changes in investment levels post Brexit and only 14% expecting a rise in investments in their industries. Here, too, the "neutral" sentiment was stronger in Germany than in the UK, whereas the UK response was stronger than the German one at both extreme ends of the sentiment spectrum (ie, stronger UK responses regarding a very negative effect of Brexit, and stronger UK responses regarding a very positive effect of Brexit).

A similar pattern appears in perceptions of the impact of Brexit on industry employment levels. The sample as a whole is far more likely to say the impact would be negative (34%) than to say it would be positive (15%). Again UK companies are more negative in their predictions than German ones. In the UK 41% of companies expect Brexit to result in a "negative" or "very negative" impact on their industries' employment levels. This is more than twice the number of businesses, which expect a positive outcome (19%) and even trumps the "neutral" sentiment with 39%. With all three questions, the block of "neutral" respondents remained large.

FIGURE 6 **In the three years after an exit, how would Brexit affect your company's ... ? (Percent)**



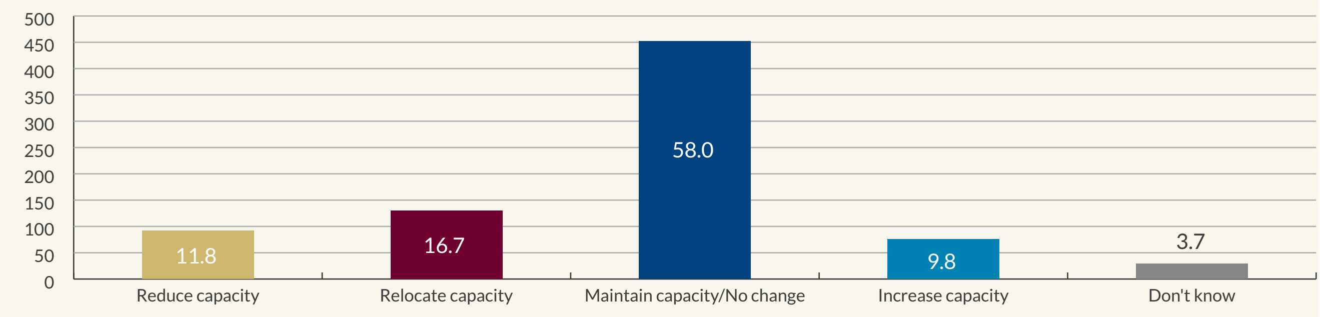
Source: Economist Intelligence Unit | BertelsmannStiftung

... And fear for revenues, investments and jobs in their own companies

The impact at company level is expected equally bleak, in the views of survey participants. When asked about the impact of Brexit on their own companies' revenues three years after the event, 36% of respondents see a negative impact as opposed to only 14% of businesses that hope for an increase in their company's revenue after a Brexit. UK companies (40%) once more are more likely than Germ ones (32%) to predict a negative impact. This makes sense, as British business is far more reliant on the European market, than European businesses are on the UK market. With 19%, UK companies are, however, also about twice as likely as German ones (10%) to predict a positive impact on their companies' revenues. As before, German companies are more likely (55%) than UK ones (39%) to take the view that the impact would be neither positive nor negative.
The views on impact of a potential Brexit on company investment levels follow a similar pattern. Nearly a third (31%) of the total sample say the effect on their companies' investment levels would be "negative" or "very negative". A positive view is only taken by 15% of all respondents.

Again, UK companies (33%) are more likely than German companies (23%) to foresee a negative impact on company investment, but UK companies (18%) are also more likely than German ones (12%) to see a positive impact. Having less to lose, like before, the strongest sentiment among German companies (63%) is that the impact would be neutral – compared to 40% of UK companies saying this. Concerning the effect of Brexit on respondents' companies' employment levels, respondents are about twice as likely to predict a negative impact (29%) as to say the effect would be "positive" or "very positive" (15%). As with previous scenarios German companies are far more likely to estimate they will be unaffected by a Brexit (66%), whereas in the United Kingdom the extreme ends of the spectrum find more followers. Here 36% foresee a negative development in their companies' employment numbers after Brexit while 20% remain a positive attitude towards the effects of the UK leaving the EU.

FIGURE 7 How, if at all, would your company's production and/or human ressources capacity change in the UK within three years of a Brexit? (Percent)



Source: Economist Intelligence Unit

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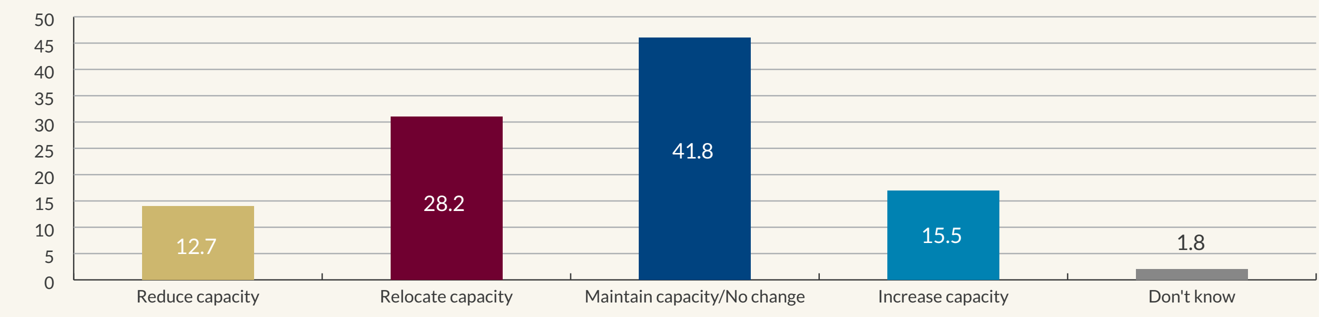
FIGURE 8 How, if at all, would your company's production and/or human ressources capacity change in the UK within three years of a Brexit? ("IT and Technology only") (Percent)



Source: Economist Intelligence Unit

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Nearly a third of all businesses announce to reduce or relocate capacities

Of our complete sample, 29% of all businesses would either reduce capacities in the UK or relocate capacities away from the United Kingdom. Across nationalities, UK companies (28%) and German companies (29%) are about equally likely to reduce or relocate capacity in the UK.

These figures are highest in the IT/technology sector. Here 41% of respondents replied their business would meet a Brexit with a decrease or relocation of capacity in the UK. Equally alarming are also the figures from the crucial finance sector, where 33% see such measures as the likely response of their companies to a Brexit. Manufacturing, with its fixed investments, is least likely to reduce or relocate UK capacity, but even here 26% of respondents tend to this option, dealing another strong blow to the British economy in case its voters decide to leave the European Union.

Retaining unrestricted access to the single market is key

The European project involves a lot of benefits but also costs for businesses. We asked respondents to cite the main benefits as well as the biggest problems for their companies they associate with their country's membership in the European Union.

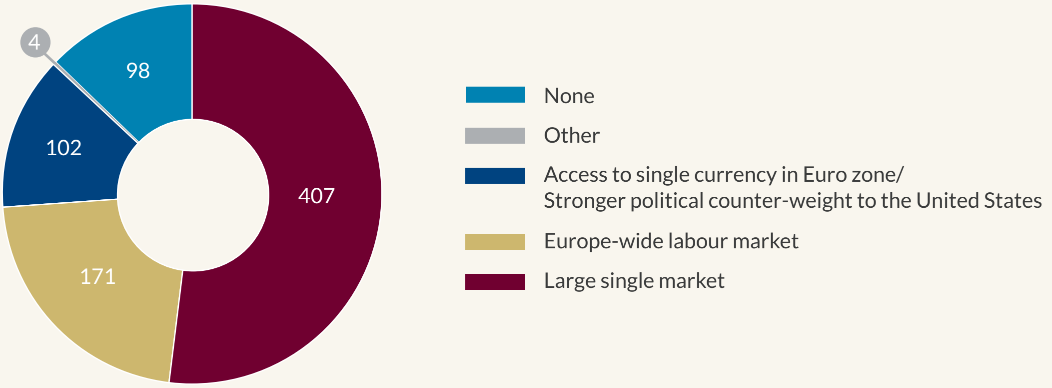
By far the greatest benefit of EU membership, cited by over half (52%) of German and British companies, is access to a large single market.

This is of particular interest, as such continued access is everything but guaranteed for British companies after a Brexit. While, for the purpose of this survey, we defined Brexit as a UK departure from the European Union as a political entity, while remaining within the European free trade zone or single market, this assumes the most positive outcome possible for the British government and economy. The Bertelsmann Stiftung's earlier study, "Costs and benefits of a United Kingdom exit from the European Union", differentiated between three possible outcomes of a Brexit; a "soft exit" with the UK gaining a status similar to that of Switzerland or Norway, as assumed in this survey, a "deep cut" with the UK losing the non-tariff trade advantages of the single market, and a case of complete "isolation" where the UK loses its access to the EU common market entirely. While the latter surely represents a rather unlikely scenario, a partial restriction to the EU market as in the case of a "deep cut" Brexit, is very much possible. Business reactions to this can be expected to be even more negative than are already captured in this survey.

The Europe-wide labour market is also a major advantage of EU membership, cited by 22% of survey respondents. Depending on negotiations related to a Brexit, here, too, free movement of labour between the UK and continental Europe might be lost in the event of a Brexit.

When asked what they thought was the biggest problems for their companies associated with their country's membership in the EU, respondents answered more diversely. Leading the list are complex regulation (34%) and uncertainty over the future of the euro (22%). "Complex EU regulations" tend to bother UK companies (37%) more than they bother German ones (32%). Uncertainty over the euro is more problematic for German companies (24%) than for UK ones (21%). German firms (21%) are more likely than UK ones (16%) to see no problems with EU membership, suggesting again perhaps that they are the more committed Europeans.

FIGURE 9 **What is the main benefit for your company associated with your country's membership in the European Union? (Percent)**



Source: Economist Intelligence Unit

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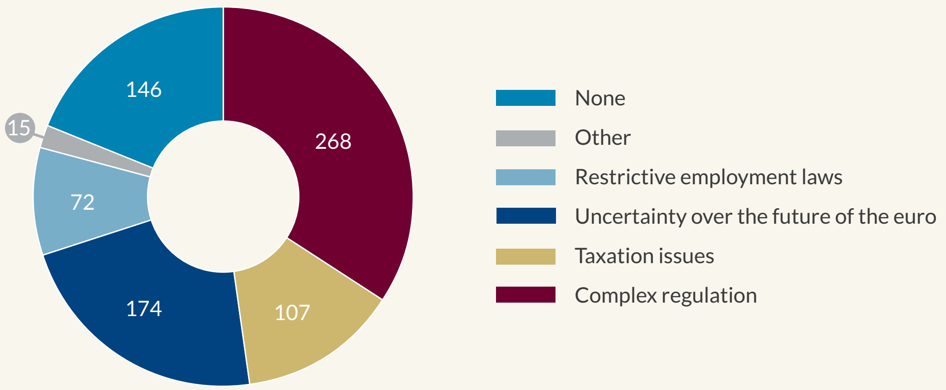
FIGURE 10 **What, if any, is the biggest problem for your company associated with your country's membership in the European Union? (Percent)**



Source: Economist Intelligence Unit

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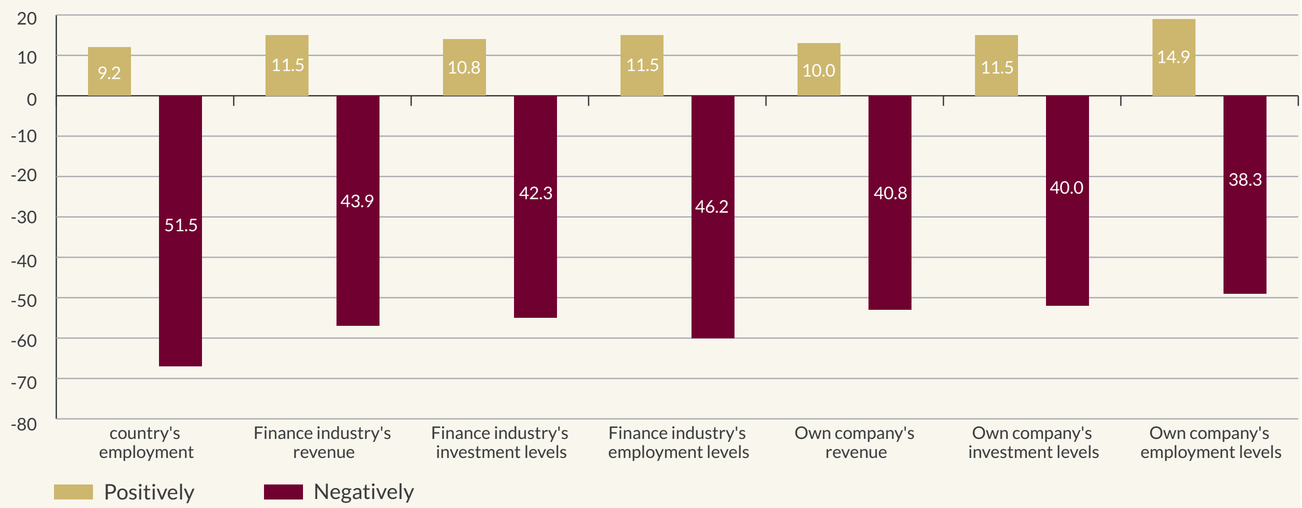
FIGURE 11 **Brexit's effect on various factors as predicted by the Finance Sector (Percent)**



Source: Economist Intelligence Unit

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The finance sector is not amused

Nearly half (46%) of all finance companies in our survey cited "complex regulation" as a major problem for their company associated with their country's membership in the EU. Still, across nearly all questions we asked, respondents from companies in the "financial services" sector also gave the direst predictions for the case of the UK leaving the European Union.

Asked about Brexit's impact on the finance industry's revenue, investment levels and employment levels three years after an exit, the negative predictions outweighed the positive ones by a factor of roughly 4 to 1 every time. The same alarming ratio can be found when looking at the predictions about their own companies' revenues and investment levels.

The predictions about their countries' employment levels three years after a Brexit are even bleaker. Here the voices foreseeing a "negative" or "very negative" outcome (52%) are more than five times as numerous as the optimistic prognoses. Not surprisingly then, a whole third (33%) of surveyed financial services providers would meet a potential Brexit by either reducing their capacity in the UK or even relocating capacity away from the UK. In our survey these numbers are only second to those of the IT and technology sector where even more companies (41%) would answer a Brexit the same way.

Considering the independence of the British financial sector to be an often cited argument by proponents of the Brexit, the threat of losing capacity from one in every three financial services companies in the UK is a mighty blow indeed.

3. Conclusion

Since most arguments cited by the anti-Brexit campaign - and various independent studies - are of an economic nature, we initially assumed that the business community, unlike regular British citizens currently, would be more alarmed about a potential move by the United Kingdom to exit the European Union. Our survey confirms this assumption.

When asking senior executives – whose companies presumably would be directly affected by such an event – the voices predicting a negative impact of Brexit significantly outweighed the positive ones every time. While a large proportion of respondents also always remained neutral in their predictions, this can be explained as we chose to go with the most positive possible Brexit scenario for the UK in this survey, granting the UK a status similar to that of Switzerland should it leave the EU. Our survey showed that access to a large single market was by far the largest benefit for businesses, of their country's EU membership. Should a Brexit involve even a partial loss of access by the UK to the many benefits of the European single market, even more negative predictions, and a significant decrease in neutral ones, can be expected.

The prospect of nearly a third of UK and German businesses in the United Kingdom threatening to reduce or even relocate capacity in the UK should be alarming both to politicians and the general public alike. While our survey showed that four-fifths of respondents from the business community clearly prefer the UK to stay as a member of the EU, they were, however less optimistic about the actual chances of that happening, with predictions about the outcome of the upcoming referendum evenly divided. This survey then should act as a clear sign to everyone involved that a lot of work still needs to be done in order to ensure a positive outcome for everyone.

Imprint

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