BY
Mark Fielding

Brexit and the Potential Impact on Irish SMEs

Mark Fielding from ISME takes a look at the economic impact of Brexit and provides some key points for small businesses to consider in the wake of the referendum.

Mark has been involved in the SME sector throughout his working life, in the printing, food, biotech, recruitment and property sectors as well as being a senior partner in an accountancy and management consultancy firm specialising in SMEs. He has worked in the UK, France and Ireland and has assisted in the start up of more than 300 companies prior to taking up his current role of CEO at ISME.

Perhaps the most depressing thing was that the Brexit referendum, and an entire country's future, was decided through ignorance. Ignorance led by misinformation and a false sense of identity that failed to grasp that this is 2016, not 1816. The UK population was fed a diet of half-truths and outright lies based on short-termism when the real issues were not just complex but fundamental to their economic and geopolitical future.

The multitude of reasons for which people voted to leave the EU were as irreconcilable as the actual divide between Remain and Leave; people who hated Cameron, racists, eco-warriors, already settled immigrants defending their turf, anti-eurocrats, new age druids. Britain is now left with a fast disappearing economy and a descent into racism and xenophobia, giving rise to hate crimes being committed daily on British streets on anyone without a direct blood line to Boudicca.

After the referendum, on this side of the water, you would think that 'Armageddon and apocalyptic' were the only words that could be used by commentators as they predicted doom, gloom and a plague of locusts! However, as Corporal Jones oft proclaimed, "don't panic, don't panic". I say,

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'keep calm and do the maths'. While Brexit is clearly a significant blow to the EU and a challenging event for the Irish economy, it is time for us Irish to be pragmatic, agile and competitive in our dealings with the UK and the EU.

At governmental level, it is vitally important that Ireland plays a central role in the exit negotiations between the EU and UK, as we will be impacted more than any other country. Our unique economic concerns and interests need to be heard, fully understood and safeguarded in any final agreement. The Irish Government must do all to minimise financial, economic and political instability.

Even with a strong desire from both the UK and EU sides to have as smooth negotiations as possible, it will be long and arduous; much longer than the two year timetable and detailed plans are yet to emerge.

In other words, the challenge today is that we don't even know all the challenges. All 27 member states will be promoting their individual set of interests and the UK will try to guarantee the best possible deal, while undoing 42 years of institutional cooperation, even without additional hostility from the EU side.

Currency and competitiveness

The most significant immediate effect is currency volatility and trying to predict what will happen with sterling over time. However, the world of business and SMEs in particular, are well used to currency volatility. Any decline in sterling against the euro makes Irish exports to the UK more expensive. This could involve a severe deterioration in the competitiveness of Irish goods and services and therefore a slower pace of export growth.

On the other hand, cheaper imports from the UK will give a boost to Irish household purchasing power but will also put pressure on Irish producers competing on the home market.

So, it is imperative that both importers and exporters should be hedging their future transactions to give themselves certainty and a concrete base from which to price their goods and services.

The average Euro/Stg exchange rate for the second half of 2015 was 0.72. In the first half of 2016, this rate increased to 0.78 and a figure of between 0.84 and 0.90 is likely for the second half of 2016. What it will be in 2017 and later is anybody's guess, so hedge, hedge, hedge.

House building

We must also remember to take into account the fact that Ireland's momentum over the past three years is strong enough to carry through 2016 where we will still be the fastest growing economy in the EU for the third year on the trot. Even with the effect of Brexit, 2017 and 2018 estimates will still be twice the expected EU growth.

With that in mind, now add in the positive effect of house building. Currently, the numbers are 17 thousand units shy of the 'normal' requirements. Even with a modest increase, assuming funding, planning and regulatory changes, an additional 15 thousand homes would boost our GDP by a minimum of 1.5%. The recent government housing plan can but add to this positive move.

Foreign Direct Investment

The stock of FDI in the UK stands at well over $1.5 trillion, 50% more than either Germany or France. A good proportion of that investment is focused on the wider European market and is likely to consider relocating after Brexit because of the very considerable uncertainty over the kind of economic relationship Britain will have with the EU, as a non-member.

The major upside to a British departure is that Ireland will become a relatively more attractive place for businesses seeking guaranteed and unfettered access to the EU single market, the largest market in the world with 500 million.

However the ESRI thinks that, if the UK loses out on FDI opportunities, it would be bad for Ireland, as the UK would be a weaker market for Irish goods but it ignores that Ireland might well win the FDI projects in question.

The report states;

"The UK outside the EU would be less attractive to vertical FDI due to uncertainty and the loss of access to the EU single Market. In particular this would affect new investment in industries with large irreversible fixed costs (i.e. heavy manufacturing). This loss of FDI would affect negatively the UK's productivity growth as well as its long-term potential growth. Lower potential growth in the UK is likely to affect negatively economic growth in Ireland via less demand for imports from Ireland."

To me this is like saying "not getting the crumbs from the British Economic table would be bad for Ireland". I would say forget the crumbs, let's get Ireland sitting at the table ourselves and go and win the big prizes.

The subservient and submissive mindset behind this argument reminds me of what Paddy Cosgrave told us last year when he said that the British view was that *the low value back office jobs should be what Ireland should target and let London get the high value front office ones.* I find this mindset to be degrading of Ireland and its capabilities.

With identical systems of operation, language, law, educational standards and geographical proximity and a most attractive corporation tax; the Republic of Ireland is a prime location for these investments.

This is an opportunity that is not on offer from any other member state. Ireland must be prepared to capitalise on the potential opportunities that arise from Brexit.

Based on OECD data and the pattern of FDI flows, it has been estimated that Ireland could attract some "6.5 billion dollars of additional FDI, raising stock of FDI in Ireland by 2%". This would have a very positive impact on the direct creation of jobs and the indirect creation of spinoff industries.

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So what about SMEs?

As a small open economy that depends on the UK for 14% of its exports and 34% of its imports, Ireland's trade is vulnerable. The initial effect of sterling devaluation could severely affect businesses who have not hedged their currency exposure. In the longer medium term, exporters will need to be very careful about their pricing and we know of many SMEs who will insist on pricing and being paid in euros.

For start-ups, Brexit will make it more difficult to start exporting to what has always been our training ground and test-bed for new ventures.

Brexit will definitely pose a major challenge for continued cross-border cooperation and could have a severe negative impact on North-South integration, services and infrastructure in border areas and will also cause serious hardship for cross-border workers.

Strategic plans have been on hold for many of your members prior to Brexit. Now we are hearing of businesses getting on with their plans, although now changed, to take into account the realities. New markets are being investigated.

In this area, the assistance of Enterprise Ireland (EI) will be crucial, for EI clients. For non-EI clients there is a gap in our government assistance structures. This is where there will have to be an expansion in that area to facilitate those exporters.

ISME has called on the Government to create a dedicated unit within the Department of Jobs, Enterprise and Innovation to coordinate the various strands of activity to counter the negative effect of Brexit. In particular the Association called for an immediate implementation of their Plan B in relation to the short-term effect of currency fluctuation for SME exporters.

We should never waste a crisis. Of utmost importance now is the continuing battle for competitiveness and a renewed focus must be placed on government influenced business costs. The Government continuously hides behind the overall inflation rate as evidence that competitiveness is satisfactory but they are not looking beyond the headline figures and analysing how costs are affecting businesses. We must do all we can to reduce our costs. Restoring Irelands cost competitiveness is a prerequisite for enhancing our attractiveness as a place to do business, not just for foreign direct investment but for our own indigenous enterprises.

So many questions will remain unanswered for a very long time. What will the new trade arrangements look like? Will we have new tariffs, new borders? What new customs procedures or administrative burdens will result? How long will it take to negotiate and how long after that will it take for 'normality' to apply? Any prolonged negotiations causes uncertainty for businesses.

Questions such as these are common to business and are part and parcel of the planning process for entrepreneurs. Businesses and SMEs, in particular, who are agile and flexible will find a solution.

Irish SMEs will continue to trade with the UK. We have shown great resilience over the past 8 years since the recession and, with the correct strategy and proper assistance from Government, advisors and representative bodies such as ISME, we will treat this as another challenge and conquer it.

Brexit does not mean that the UK will be closed for business overnight. The doomsday predictions from ESRI, IBEC, Official Ireland et al show GDP reductions of various sizes, as if we Irish were going to sit on our hands and allow this to creep up on us. This ability to "react" is ignored and is a major weakness in their analysis.

So, having said that Brexit will not be Apocalyptic, it is still good business sense to plan around it and spread the risk and exposure. There will be time to take action to overcome any negative consequences to our supply chains.

This of course is where the local trusted advisors, the accountants and auditors, come into their own. Helping the business owner through the 'known unknowns' and warning about the 'unknown unknowns'.

Is your business prepared for Brexit?

Look at your situation vis a vis the UK. It makes sense obviously not to have all your eggs in one basket. Whether you are exporting or importing to or from the UK, remember, there will be a period of uncertainty which will affect Sterling/Euro.

- Are you hedging your currency exposure?
- Are you actively looking for new markets outside the UK?
- If in an existing value chain, are you minding your competitiveness?
- Are you scoping out new suppliers outside of UK?
- Are you using your purchasing muscle to improve trade price and conditions?
- Are you forming new business alliances in the UK and Northern Ireland to facilitate them getting access to the EU through your Irish business?

To quote Winston Churchill, "A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."