Brexit

Impact on Automotive Industry

DECISIONPOINT™ by WNS

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AUTOMOTIVE: BREXIT IS A CONCERN FOR VEHICLE MANUFACTURERS

In February 1984, when Nissan and the U.K. government signed an agreement to build a car plant in the U.K., it had been a part of the EU for a decade. The 799-acre greenfield site in Sunderland, Tyne and Wear is now home to one of the biggest manufacturing plants in the U.K., with over half a million unit sales in the EU.[1] Will the result of the U.K. referendum thwart the growth of thriving companies like Nissan?

This section will analyze the impact of Brexit on the U.K. automotive industry and try to answer some of the pressing questions arising from the U.K. referendum.

The result of the referendum on U.K.'s membership can be assessed through the following Issues:

- EU tariffs on U.K. exports
- Cross-sectoral regulatory issues
- Access to EU talent

1. The Society of Motor Manufacturers and Traders (SMMT).

TARIFF-FREE ACCESS TO THE EU SINGLE MARKET

Goods currently traded between the U.K. and the EU 27 enjoy a tariff-free movement. Access to the EU's single market has made the U.K. a formidable competitor as its supply chain companies can do business with other EU automotive companies and the OEMs (Original Equipment Manufacturers) can tap into a lucrative market of over 500 million consumers[2]. If the U.K. leaves the single market without a proper replacement for the current system, it could result in the introduction of automotive tariffs of 10 percent on passenger cars, 10-22 percent on commercial vehicles, and 3-4 percent on average for automotive components.[3]

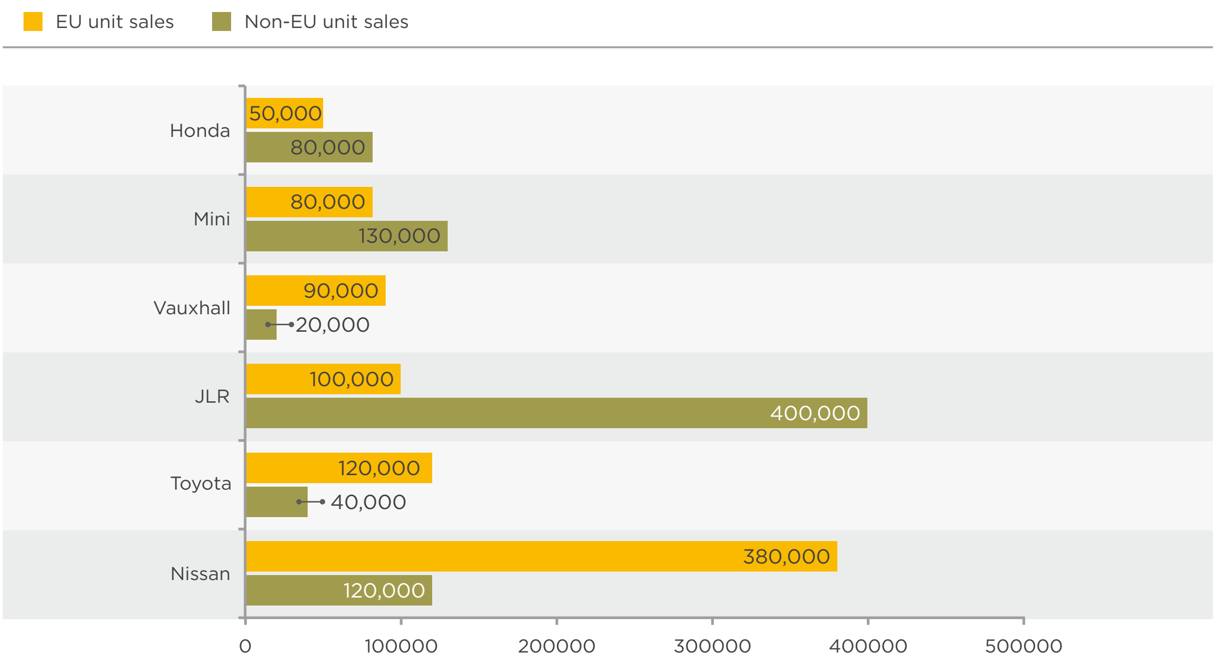
The U.K. produced a total of 1.8 million motor vehicles in 2016, of which more than 900,000 were exported to the EU. The EU represents 81 percent of the U.K. vehicle import volumes (44.7 billion euros) and 52.8 percent of U.K. vehicle export volumes (EUR 14.6 Billion).[4] Many OEMs sell 75 percent of their production within the EU. For engines, this figure stands at 55 percent.

The chart below outlines the sales of the biggest car manufacturers in the U.K. According to these figures published by the Society of Motor Manufacturers and Traders, U.K., the EU unit sales of Nissan and Toyota, the largest vehicle manufacturers in the U.K., was double the number of their non-EU unit sales. Between them, Nissan, Toyota and Honda made half of the 1.7 million cars built in the U.K. in 2016 and employed 16,000 people.[5]

2. Ibid.
3. European Automobile Manufacturers Association, Position Paper Brexit.
4. SMMT.
5. Article by Financial Times, Toyota and Nissan take different roads to Brexit, March 2017.

Exhibit 1

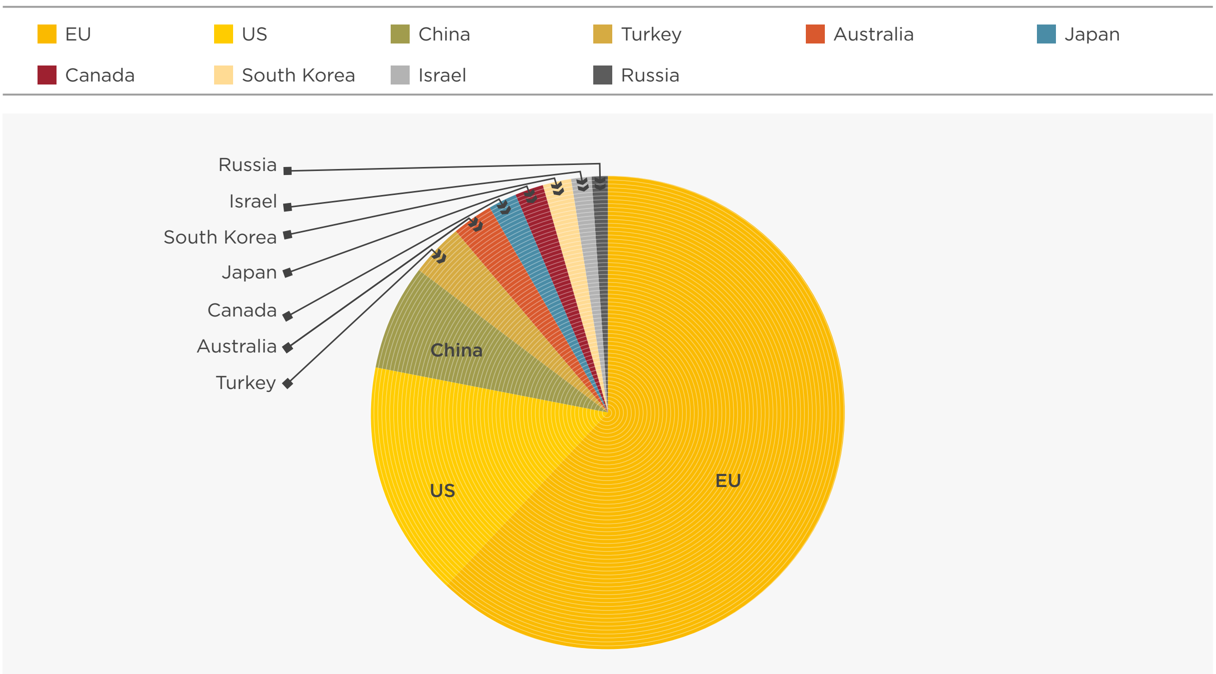
Sales of U.K. Built Cars



Source: Society of Motor Manufacturers and Traders (SMMT)

Exhibit 2

U.K. Export Share by Region



Source: SMMT

PRODUCTION OUTLOOK SCENARIOS: HARD BREXIT VS. SOFT BREXIT

Reassuring Nissan, Toyota and the other leading auto manufacturers has been a priority for the U.K. government after the June 2016 referendum to leave the EU. Eight months after the referendum, Nissan and Toyota have signaled their commitment, with Nissan announcing in October 2016 that new versions of its Qashqai and X-Trail would be made in the north-east of England, thereby turning its Sunderland plant into a 600,000 plus production plant.[6] In March 2017, Toyota announced GBP 240 Million worth of investment into its Burnaston site in Derbyshire, with an additional investment of up to GBP 21.3 Million from the government, thereby underlining the company's resolve to continue to manufacture in Britain even if trading conditions were to change.[7]

However, whether the big auto manufacturers continue with their commitment to treat U.K. as a major manufacturing hub depends on how well the U.K. is able to negotiate the terms of Brexit and is able to retain the current structure of its access to the single market. Recent falls in the value of sterling have made U.K. exports cheaper, while the value of sterling against the euro and the dollar is approximately 15 percent below the long-run average. While the lower value of sterling will improve the competitiveness of U.K. exports in the long term, it will also increase the costs of imported components from the EU, which account for nearly 60 percent of components used in U.K. built cars.[8]

The latest figures published by the SMMT on car and commercial vehicle production for the first five months of 2017 suggest that production has slowed down across the U.K. following the referendum and the resulting uncertainty it brought with regard to the U.K.'s position as a strategic manufacturing hub in the EU. British car production fell by 9.7 percent in May 2017 in the wake of a slowing auto market across Europe. Cars produced in the U.K. for export fell by 9 percent to 109,591, while those made for the home market fell by 12.8 percent to 26,528. Production of commercial vehicles also slowed down to hit an all-time low of 6,875 in May 2017, declining by 28.3 percent from May 2016.

6. Article by Guardian, Nissan to review Sunderland plant's competitiveness after Brexit, January 2017.
7. Article by Financial Times, Toyota and Nissan take different roads to Brexit, March 2017.
8. SMMT.

Exhibit 3

Car Manufacturing

	May-16	May-17	% Change	YTD-16	YTD-17	% Change
Total	150,802	136,119	-9.7	738,516	729,755	-1.2
Home	30,431	26,528	-12.8	166,766	153,199	-8.1
Export	120,371	109,591	-9.0	571,750	576,556	0.8
% Export	79.8	80.5	-	77.4	79.0	-

Source: SMMT, May 2017 Release

Exhibit 4

Commercial Vehicle Manufacturing

	May-16	May-17	% Change	YTD-16	YTD-17	% Change
Total	7,748	6,875	-11.3	39,935	36,458	-8.7
Home	3,826	2,503	-34.6	19,062	12,999	-31.8
Export	3,922	4,372	11.5	20,873	23,459	12.4
% Export	50.6	63.6	-	52.3	64.3	-

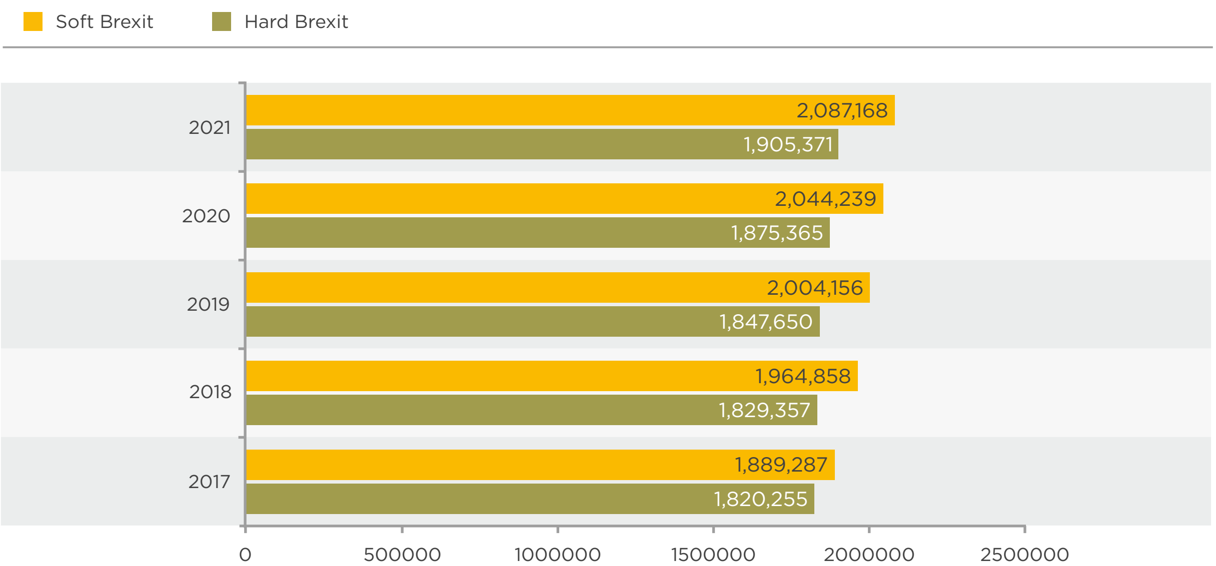
Source: SMMT, May 2017 Release

Cars produced in the U.K. for export fell by 9 percent to 109,591, while those made for the home market fell by 12.8 percent to 26,528

Despite the recent slowdown in auto production, British auto manufacturing industry remains in good health with several new models to go into production over 2017 to 2021 and expansion in investments by leading auto manufacturers. WNS DecisionPoint™ projects an upward trend in auto production over the forecast period. However, this forecast is contingent upon U.K.'s continued access to the EU single market with minimal disruptions to the current trade structure. A hard Brexit scenario without any access to the single market will result in a slowdown in vehicle production from 2018-19, when Brexit negotiations will be underway. But it is expected that 2019-2021 will see some improvement in production, albeit a slow one, owing to finalization of the Brexit agreement.

Exhibit 5

Vehicle Production Forecast



Source: OICA, WNS DecisionPoint™ Analysis

VEHICLE REGISTRATION OUTLOOK: HARD BREXIT VS. SOFT BREXIT

Although the U.K. is a significant consumer market, it is not large enough to support the size of the British auto manufacturing sector. According to the figures published by the Association Auxiliaire de l'Automobile, 2.7 million new passenger cars were registered in the U.K. in 2016, 18.5 percent of the 14.2 million that were registered across the EU and the European Economic Area (EEA) as a whole. The export market will always be vital if the U.K. plans to sustain and expand the existing auto manufacturing sector. The regional nature of the automotive sector is such that that the EU will remain U.K.'s single largest export market, which makes export tariffs critical to the existence of the current sector.

The final sale price of a vehicle is determined by factors other than the costs of manufacturing the vehicle; however, even a 10 percent tariff on automotive components imported from the EU will raise the manufacturing costs significantly.[9] This will be passed on to consumers by manufacturers, thereby curbing the demand for cars and commercial vehicles.

According to the figures published by the SMMT, the year-to-date new passenger cars registered from 2016-17 declined by 0.6 percent to 1,158,357. This slowdown can be attributed to the uncertainty caused by the surprise announcement of a June 2017 election, with buyers holding back until the election outcome. Demand was driven by business purchases, to offset declines from private and fleet buyers.

9. SMMT.

Exhibit 6

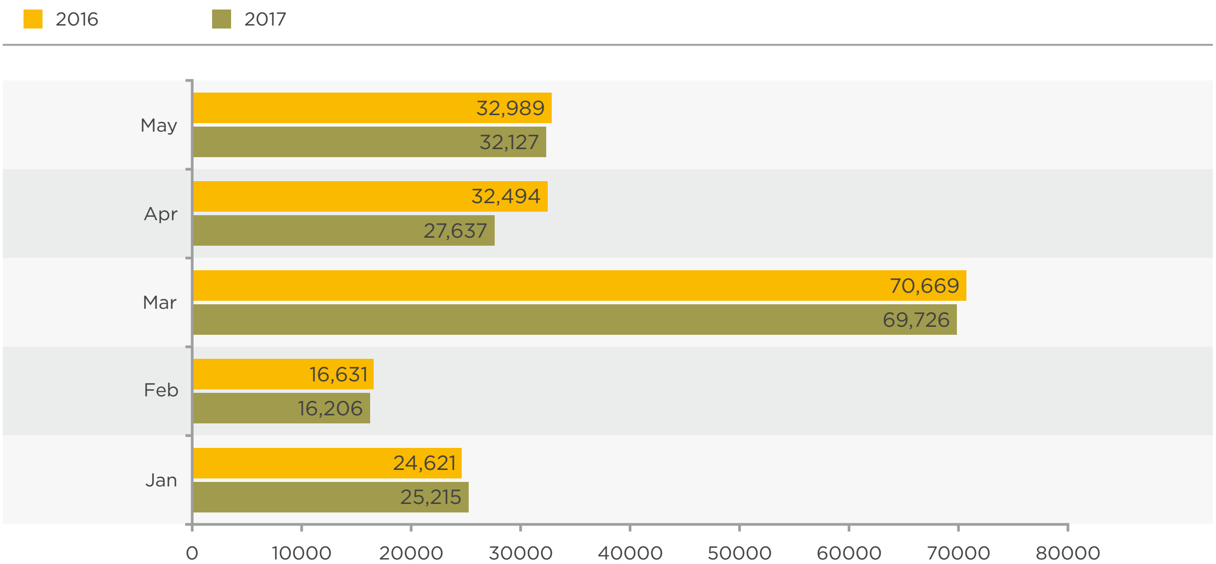
U.K. Passenger Car Registrations – Overview

Year-to-date	Total	Diesel	Petrol	AFV	Private	Fleet	Business
2017	1,158,357	509,817	600,604	47,936	522,877	589,161	46,319
2016	1,164,870	559,269	567,907	37,694	545,674	575,169	44,000
% change	-0.6	-8.8	5.8	27.2	-4.2	2.4	5.3

Source: SMMT, May 2017

Exhibit 7

Commercial Vehicle Registrations



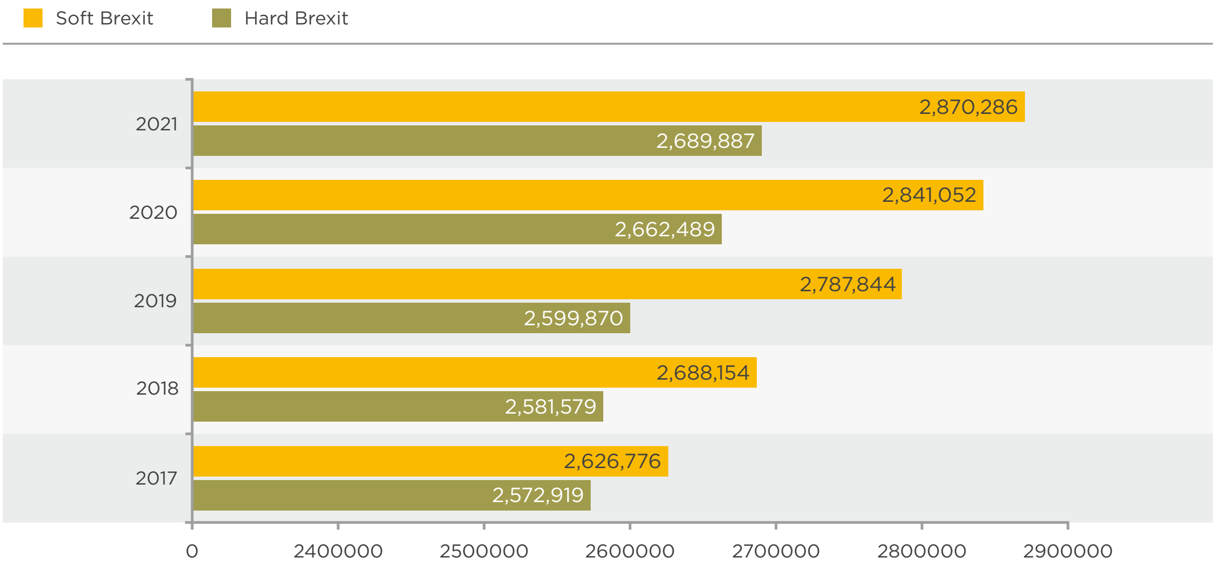
Source: European Automobile Manufacturers Association, June 2017

A comparison between the commercial vehicle registration figures for the first five months of 2016 and 2017 shows a slight decline of 862 units in the registration figures for the month of May, which is lower in comparison to the relatively larger decline of 4857 units for April. The British referendum in June 2016 and the snap election called in the first quarter of 2017 are primary factors leading to the decline, coupled with an ongoing inflationary squeeze on consumer and investment spending brought on by a depreciating sterling.

We expect car and commercial vehicle registrations to grow at a stable rate for the remainder of 2017. This will continue into the first half of 2018, supported by declining oil prices and a depreciating pound which will add to the competitiveness of U.K. auto exports. Our outlook for the period 2019-2021 remains stable, with both car and commercial vehicle registrations forecasted to grow at a steady rate, provided that the U.K. is able to retain its current trade agreement with the EU. A hard Brexit, which implies a shift away from the current system of a single market, will lead to a slide in vehicle registrations in the forecast period, exacerbated by new trade tariffs, thereby aggravating costs of production and final sale prices. A soft Brexit with access to a single market will ensure a rapid increase in registrations from 2019-2021 when the Brexit framework for the British auto industry is finalized.

Exhibit 8

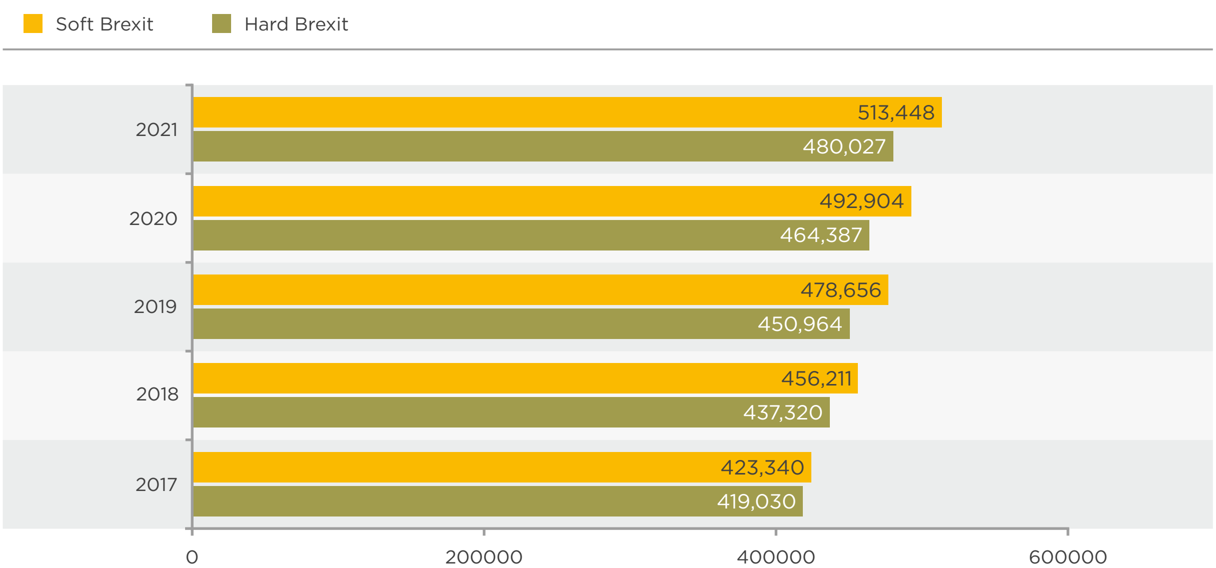
Forecast for Passenger Car Registrations



Source: European Automobile Manufacturers' Association (ACEA), WNS DecisionPoint™ Forecast

Exhibit 9

Forecast for Commercial Vehicle Registrations



Source: International Organization of Motor Vehicle Manufacturers (OICA), WNS DecisionPoint™ Forecast

ACCESS TO EU TALENT ESSENTIAL TO THE SUCCESS OF THE SECTOR

The U.K. automotive industry benefits from access to the skills and experience of the EU and global employees. EU skills and talent are utilized in all aspects of businesses in the U.K. There are three principal reasons for the use of EU migrant labor in U.K. plants. Firstly, U.K. automotive manufacturing has a skill gap of around 5000 people, which is projected to increase. Secondly, with many companies having multiple plants across the EU, employees are moved from one plant to the other for specific engineering or manufacturing needs. Thirdly, many companies choose to move their employees for professional training and development, in order to improve the quality and competitiveness of their business.[10]

According to a survey conducted by the U.K. Automotive Council and the Automotive Industrial Partnership, majority of vacancies in the top 10 current and future priority jobs are engineering positions, with a particular concentration around design and production engineering, accounting for 40 percent of immediate vacancies. However, the potential loss of access to the EU workforce and uncertainty over the status of current EU workers is a challenge for the U.K. automotive industry's plans from a perspective of continued innovation, productivity and output as well as future growth potential.

One of U.K.'s many advantages as a member of the EU is labor market flexibility, which is essential for ensuring that workers are allocated to their most effective use in the economy. High labor flexibility allows easy shifting of workers from one economic activity to another, rapidly and at low cost — and allows for wage fluctuations while minimizing social disruption. It gives companies the confidence to rapidly take on employees to meet market demand. Additional administrative and cost burdens for moving skills, and a reduction in the ease of access to skills will reduce U.K. industry competitiveness and risks creating the perception that the U.K. is not an easy place to do business.

10. SMMT Issue Paper, November 2016.

CROSS-SECTORAL REGULATORY ISSUES

The EU allows financial institutions established within the region to operate a branch network across Member States by virtue of the EU Capital Requirements Directive passport for the provision of banking services, which is crucial to the automotive industry. Motor vehicles are expensive, and hence, dealers need assistance in order to make their purchases. Likewise, motor vehicles are expensive to manufacture, and therefore manufacturers need to be paid quickly for the vehicles that they sell in order to have enough liquidity to fund the manufacture of more vehicles.

To alleviate the cash-flow concerns of both sides to the transaction, a third- party financial institution will finance the sale of the vehicle from the manufacturer to the dealer. In this way, the manufacturer gets paid quickly for the vehicle that has been sold and the dealer is afforded a period of credit for making the payment. Most automotive manufacturers operate in this manner, as this is essential to the maintenance of healthy dealer networks. Many automotive manufacturers set up their own financial institutions created specifically for the purpose of providing wholesale dealer finance, known as 'captives'.

Captive finance companies based in one EU Member State will often operate a branch network to other Member States within the single market. The ability of those companies based in the U.K. to continue to support a branch network once the U.K. leaves the EU may be severely impeded if there is no future provision made for the continuation of the passporting regime. If the U.K. leaves the single market (and sits outside the EEA) and the EU single rulebook on financial services, captive finance firms based in the U.K. would be required to take mitigating action to ensure continuity of service, including relocating their headquarters from the U.K. to another EU Member State.[11]

Uncertainty regarding the application of cross-sectoral regulations following the U.K.'s withdrawal from the EU will negatively impact business operations. The Great Repeal Bill, a new legislation put into place by the U.K. government to ensure an orderly transition from the EU membership and that same rules and laws apply after the U.K. leaves the EU, should provide some certainty. However, clarity is needed regarding the maintenance of regulatory equivalence in areas that are critical to ensuring that the automotive sector can continue to access the single market without any barriers.

11. Ibid.

About DecisionPoint

Making key decisions that improve business performance requires more than simple insights. It takes deep data discovery and a keen problem solving approach to think beyond the obvious. As a business leader, you ought to have access to information most relevant to you that helps you anticipate potential business headwinds and craft strategies which can turn challenges into opportunities finally leading to favorable business outcomes.

WNS DecisionPoint™, a one-of-its kind thought leadership platform tracks industry segments served by WNS and presents thought-provoking original perspectives based on rigorous data analysis and custom research studies. Coupling empirical data analysis with practical ideas around the application of analytics, disruptive technologies, next-gen customer experience, process transformation and business model innovation, WNS aims to arm you with decision support frameworks based on 'points of fact.' Drawing on our experience from working with 200+ clients around the world in key industry verticals, and knowledge collaboration with carefully selected partners including Knowledge@Wharton, each research asset comes up with actionable insights with the goal of bringing the future forward.

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