Leveraging Supply Chain to tackle Brexit: Opportunities and Challenges for Firms and Industrial Strategy

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Brexit has brought about one thing that businesses don't like – uncertainty. Many firms are unprepared for Brexit, which in part reflects the lack of transparency on what the final deal between the UK and the EU is likely to mean in practice for business. Moreover, a recent report revealed three-quarters of UK automotive firms fear a no deal Brexit. The industry imports 80% of its components from the EU, and a no-deal will impose significant costs through new tariffs and customs checks. To mitigate such risks, several firms have begun to relocate operations to the continent. Eisai, a Japanese pharmaceutical company has moved several of its facilities from the UK to Germany. The company is also stockpiling six months of supply (both in the UK and Europe) to ensure availability of its medicines post-Brexit. This has resulted in a twofold increase in its operational costs. Honda[1] and Nestle have both adopted similar costly strategies.

In order to address these concerns, the UK government has advocated businesses start to re-configure their supply and begin to look towards local sourcing. However, in reality the situation is more complex. Implementing a local sourcing strategy will require significant investment in new capital equipment and skills within UK based supply chains, since many UK SMEs – particularly in the regions – suffer from low productivity and are ill-equipped to take a bigger role in domestic procurement. Securing this investment will be challenging, especially since UK SMEs already face significant credit constraints and have weak cash flows exacerbated by late payments from buyers; on average UK SMEs are owed £80,000. Moreover, many UK SMEs benefit indirectly from EU Structural funds, such as the European Regional Development Fund (ERDF) and European Investment Fund(EIF) that support business incubation and entrepreneurship; access to this funding pot will end post 2020.

Rethinking Supply Chain Management

Poor supply chain management practices and a weak bargaining position also add to the difficulties faced by SMEs. Larger firms such as Original Equipment Manufacturers (OEMs) at the apex of supply chains are trying to mitigate the risk of Brexit by increasingly stockpiling large inventories, which inevitably increases the holding cost of their operations. Many of these larger firms are trying to offset these costs by offloading them onto their smaller suppliers, while also using their bargaining position to push down the purchase price of components.   In addition, the falling exchange rate since the Referendum has meant many UK suppliers have faced rising costs of imported materials and, for SMEs, a lack of capacity prevents them from stock-piling at pre-Brexit prices. For example, in the construction industry, SMEs are already dealing with increased prices of Spanish slate (by 22%) and timber (by 20%).

To leverage the capabilities of SMEs in the UK, both businesses and government will have to start addressing some of these issues. First, larger firms must realise SMEs have significant resource constraints and therefore do not have the luxury of a substantial working capital; nor can they hold significant amounts of inventory. Therefore, larger organisations need to consider changing their payment terms so as to facilitate better cash flow.

Second, larger firms need to make their demands and forecasts more transparent throughout the supply chain. Involving SMEs early in this process would ensure they have an estimate of peaks and troughs in the demand forecast. Better communication, trust and collaboration is key here. This would help them in developing strategies to slowly scale up their capabilities according to market demand. It is also important for supply chain managers to regularly visit their suppliers' premises and hold joint-problem solving sessions to address any short- to medium-term issues. In this way, larger organisations can assist their SME supply chain to develop and enhance skills and capabilities. Hinkley Point C, for example, has begun to integrate local SMEs in their supply network by getting them to enter into regional consortia and joint ventures. These are just some of the strategies large organisations should adopt to develop and leverage the strengths of SMEs in their supply chains. One thing is for sure, the short-term, transactional, arm’s-length approach to managing suppliers will not only be ineffective, but will also be counter-productive post-Brexit.

Place-Based Industrial Strategy

Government can play an important role in the process through a place-based industrial strategy. This will mean adopting regionally focused R&D, supply chain and skills policies that build upon existing regional capabilities and specialisms. This is the best route to promoting local growth and addressing the UK’s regional productivity problem. In this regard, it is important for UK policy-makers to stop treating supply chains and regional clusters as separate entities. Clusters comprise local value chains which in most cases are plugged into global value chains through multinational firms. A better understanding of the link between clusters and supply chains for regional development will enable UK industrial strategy to better address issues related to rebuilding supply chains in manufacturing sectors, through for instance, new business formation. This will better enable UK based OEMs to onshore (outsource from suppliers more locally), re-shore or nearshore (change suppliers from overseas to UK or locally).

A local skills policy will be critical in developing regional supply chains. The recent devolution deals have begun to devolve aspects of skills policy to new Combined Authorities, yet much of the UK educational system remains centrally designed and controlled (including further and technical education which is still dominated by national accreditation systems). There is significant scope for local employers to co-develop curricula and training tailored to local demands, especially as most FE students reside locally. Germany offers the best template, whereby local educational institutions, firms and chambers of commerce all cooperate with *Länder* governments to provide education-employment channels. Local areas and regions need to be able to shape training programmes in line with spatially-specific needs and aspirations, as in the case of the Ceramics Skills Academy in Stoke on Trent. Similarly, universities need to be given major incentives to engage with local actors. At present, higher education research and teaching evaluation frameworks offer no such incentives, based as they are on national criteria.

In terms of policy implementation, it remains to be seen whether the emerging devolved structures will be sufficient. The UK has long been one of the most centralised economies, with policy-making dominated by Whitehall and the Treasury. Moreover, regional governance is highly fragmented in terms of the allocation of powers and responsibilities between different bodies. For instance, outside the new Combined Authority areas, local industrial strategy in England will be the responsibility of the Local Economic Partnerships (LEPs). However, LEPs themselves are often too narrowly focused and differ significantly in their available resources and capacity to effectively deal with clusters and supply chain issues. Moreover, supply chains often cut-cross LEP boundaries, yet there remains a lack of appreciation of this spatial dimension and hitherto insufficient co-ordinated policy support for supply chain development. This will need to be addressed if regionally based supply chains are to benefit from the government's new industrial strategy.

References

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