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# Brexit: understanding your tariff exposure

Retailers need to calculate the cost of the UK leaving the Customs Union without a trade deal or transitional agreement

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How much more will we be spending on our weekly grocery shop and other household items if the UK defaults to WTO rules? And what are the additional challenges for retailers? Bob Jones tots up the tally at the ports, while Paul Martin has five tips for retailers.

## What happens to import and export duties if we leave the EU without a trade deal or transitional agreement in place?

Two things: higher prices and a huge spike in red tape at the borders. If the UK leaves the EU without any kind of deal on or before March 2019, we would likely immediately default to WTO rules. That means full declarations on all imports and exports into the UK from the EU and vice versa, with all products needing to be classified, countries of origin determined and duties secured.

Without a free trade agreement with the EU, the full rate of duty for each particular product would also apply. Food and drink products, in particular, would be in the firing line. That would have a major impact on pricing for UK retailers and their customers, given that we currently buy in over half of our food from overseas. Based on its weight, a 1 litre bottle of olive oil originating in Spain, for example would face a tariff of around 30% (effective percentage by value) and a bottle of orange juice produced in Ireland a tariff of around 33.6% (actual percentage by value).

## How will imports from non-EU countries be affected, if Britain is no longer part of the Single Market and Customs Union?

The UK would have to rapidly set about negotiating its own bilateral free trade agreements. It would also need to formalise a unilateral agreement for non-EU countries currently signed up to the Generalised Scheme of Preferences set in place between the EU and certain developing countries, to allow preferential tariffs on their goods imported into the EU.

Otherwise, British importers would face a steep rise in the level of duties, including on kitchen staples, such as tinned tuna imported from Mauritius (which is part of the Economic Partnership Agreement between the Eastern and Southern African States and the EU and its Member States), where the tariff would rise from 0% to 24%. Theoretically, the UK could unilaterally drop all tariffs to zero, but would then have to apply that approach to all its WTO trading partners.

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## Which sectors would be most hit by WTO rules?

It's a very mixed picture, with tariffs the equivalent of over 100% on some products and as little as 0% on others. In terms of tariff hikes, food and drink top the list, followed by clothes and footwear, chemicals, some industrial, automotive, FMCG, toys, aerospace, oil and gas goods. Pharmaceutical products and IT equipment tend to attract zero duty. It's also a varied picture for regulatory requirements - increased admin, licensing and delays at the ports - where the most vulnerable items would probably be pharmaceutical products, food and drink and chemicals.

## Would all this mean a huge additional workload for HMRC?

Absolutely. The scale of these potential changes is unprecedented. We'd be moving from frictionless trade, relating to £290bn of imports and £220bn of exports, to extensive tariff and non-tariff barriers. HMRC's major investment in new technology will help, but questions remain about Customs' capacity to physically process the volume of goods coming into Dover and Folkestone, in particular, especially if ill-prepared businesses are supplying incomplete, inaccurate or late declarations. Customs clearance that now takes a couple of hours could take three days to sign off. There's also a shortage of skills in this area, both in the number of customs officers and more widely in the commercial world.

## If we're in for a period of major disruption, what should importers be doing right now?

The top priority for all businesses is to fully understand their own supply chains: the volumes and values of the goods they ship back and forth and which countries they're importing to and from. That may sound obvious, but many businesses simply don't yet have that degree of insight into their own operations and exposure to risk. We developed our **Brexit Customs Tool**[1] to help clients achieve precisely this kind of visibility about what Brexit could mean for their business in terms of additional customs duty and VAT.

One food sector client of ours, for example, currently ships items from Poland to the UK and then on to Ireland, followed by Northern Ireland. Right now, that process is largely seamless: post-Brexit, it could involve six declarations and three sets of tariffs across three external borders. As a result, they are now looking into all options to simplify the process.

Companies should also consider applying immediately for Authorised Economic Operator (AEO) status, the EU's current quality mark that allows access to simplified customs procedures. Many businesses have held back because they haven't felt the need, but most may require it after Brexit, whatever kind of deal the UK strikes. And the benefits are right there on the bottom line. We calculated that one client faced a bill of £8 million in additional costs from a combination of duties and supply chain changes. With AEO status, simplified procedures and customs warehousing in place, that figure should fall to less than £1 million. It's all about getting the data right: complete, accurate and on time.

## Should importers be considering sourcing from elsewhere?

Some food and drink producers are already looking into sourcing ingredients locally, in order to avoid tariffs. Depending on the product, it may also be worth considering a long-haul solution: whether, for example, it may end up being more cost-effective to import chickens from, say, Brazil rather than the EU, or oranges from Florida rather than Spain. That said, shipping products over longer distances has major implications for the logistics and supply chain, including the need for additional warehousing capacity, either here or overseas. Retailers would need to start laying the groundwork for those kind of decisions now.

An external customs barrier is not just about tax, of course, but also about the regulatory regime, encompassing elements such as the use of pesticides or food safety standards and other health, safety and environmental considerations. Companies need to bear that in mind when considering importing products from new sources overseas.

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### What are the priorities for exporters?

Again, it's all about potentially rethinking the supply chain: working out the best way to get things to the customer and, wherever possible, minimising extra costs. The key is to simplify, reduce, delay or mitigate each customs pinch point as much as you can from point to point.

That, in turn, presents genuine opportunities for streamlining and enhancing the business. We're finding that people are suddenly starting to wake up to this on both sides of the Channel.

### Do businesses understand the scale of the challenge?

Some do, some don't. It's a mixed picture. Some larger companies have already been preparing for months, particularly if they foresee an impact post-Brexit all the way down their value chain. Others are less advanced, though some sectors and individual companies are far less exposed to border traffic.

Digging deeper into the business model can throw up some surprises. One client realised they faced a potential cost of several million pounds they hadn't been expecting after running their trading data through our Brexit Customs Tool. Sometimes, for example, it is not understood how much a particular classification is worth or a free trade agreement is relied upon.

Equally, some retailers who currently have a next-day – or same-day – delivery offering may well have underestimated the effort involved in fulfilling their side of the bargain. Additional warehousing capacity, here or overseas, may be necessary in order to cope. That storage facility would, in turn, require a fully integrated IT system linked to clients' own systems: and, to complicate matters further, it's highly likely that we'll see a rush on available IT resources as Brexit approaches and many firms play catch-up on what is required. Close working with supply chain partners such as forwarders and agents will also be very important.

### Where do the opportunities lie as retail companies reset their business to prepare for Brexit?

Brexit is just one factor of several now reshaping the retail space, including developments in technology and a drive for innovative new ways of reaching the customer. As those spaces open up, people will move in and grab the opportunities. There will be solutions for the supply chain, because innovators will be out there developing them, looking for the gaps in the market and coming up with creative ways of filling them.

SMEs will have a particular advantage because they are often more agile and responsive to a changing landscape. But the more that larger companies do now to understand and shape their own business, the better prepared they'll also be to capitalise on new openings ahead.

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# Five ways for retailers to be ready

Much of the retail industry could be hit hard by WTO tariffs, with food and drink right at the top of the list. Paul Martin, Head of Retail, KPMG, sets out five priorities to help retailers prepare.

## 1. Make sure you have a granular understanding of where your products come from and how they reach you

If we revert to WTO tariffs come March 2019, the picture will be an extremely complex one for many retailers. There s no 'one size fits all' solution. If you run a grocery business, you could be dealing with thousands of different products across hundreds of different categories, all with different tariff levels applied. Companies need to understand the scale of the issue and the interconnectivity of their supply chain. This will be applicable for both branded and unbranded products sold by the large grocery chains.

Start with the product on your shelf (physical or digital) and trace it – and its constituent ingredients – right back to the start of its journey. What does that tell you about how far and by how much you might be exposed to increased costs twenty months down the line?

In my experience, not enough retailers currently have that kind of deep dive awareness of their and their suppliers business. Hoping all will be well is not knowing. It's only by doing that kind of assessment both internally and externally that you'll fully understand where any vulnerabilities – and future opportunities – lie.

## 2. Join forces with other retailers and suppliers to deliver collaborative solutions

The food and drink sector is a highly interconnected business, at every stage from farm to fork. It makes eminent sense for the industry to adopt a collaborative approach to tackling the challenges that increased costs and customs declarations at the border will entail. Retailers, suppliers and agri-businesses at every point in the supply chain should sit down together to map out solutions. Whether that bundling of resources is done under the auspices of trade bodies or more organically, the key is to start acting now. And, while examples of such cooperation have as yet been relatively limited, the industry is now very much waking up to the enormity of the challenge.

## 3. Consider the possibility of sourcing locally

For some products and some retailers, bringing production closer to home may well be the answer to continuing frictionless trade. Yet there are many products where that will not be a realistic possibility. **British tomato production**[2], for example, currently accounts for about a fifth of the total volume of tomatoes sold in the country through the year. And while we re a nation of wine drinkers, we only produce a fraction of the amount we consume. That's equally true even in the case of some products that could be manufactured in the UK, such as clothing, most of which is currently produced offshore. There are definite opportunities for future growth, but it won t happen overnight. Setting up production facilities and installing the necessary machinery takes time, capital, people and capability.

## 4. Explore your options in terms of pricing and new supply chains

While the tariffs on some products may end up being relatively modest, others face significant additional duties post-Brexit. The judgement is with the retailer as to how willing they are to absorb some of those extra costs and how much they will pass on to the customer: those decisions should all form part of extensive scenario planning, only possible once the company completely understands the twists and turns of its business. If, say, a retailer imports wine from South Africa that currently travels by ship to Calais and then enters the UK via lorry, that will in the future involve two different borders, with two lots of tariffs and two separate, potentially time-consuming, customs declarations. And if a product that has long been widely available all year round is now only offered in limited volumes, that change will have a direct impact on its supermarket price. How much do you absorb those costs and how much extra do you charge the consumer or ask your suppliers to absorb?

## 5. Always stand in the customer's shoes

Lastly, it's always essential to work back from the customer s point of view. Consider what the potential lack of a particular product they enjoy might mean for your relationship with them. What effect might it have from a reputational point of view? Are there alternative products you could source instead to fill in the gap? And how do you deal with the customer expectation of speedy delivery, at the same time as there could be significant delays at the border? The earlier companies have asked themselves these questions and others like them, the sooner they will be able to understand the magnitude of the issues and work toward resolving them.

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## Be prepared: what the KPMG Brexit Customs Tool can tell you about your supply chain

KPMG have designed a tool to help businesses put some real numbers and detail around the potential consequences of leaving the Single Market and Customs Union.

The output of our tool models the potential change to your customs duty and VAT profile post-Brexit, and provides you with concrete insights and metrics on impacted supply chains.

1 https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/01/tis-for-brexit-new.pdf
2 http://www.britishtomatoes.co.uk/tomato-facts/market-info/

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