DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

BREXIT

A New Era?

Contents

Background

1. The British referendum to exit the EU was unexpected by most quarters and the immediate **reaction** was **negative**, seemingly driven by sentiment.
2. The biggest negative effect was felt on the **currency markets** with the Pound Sterling plummeting 11% against the US Dollar.
3. **Policy makers** in the UK have taken a more **pragmatic approach** to stabilize the markets and prepare for a likely hit to the future growth of the UK economy:
4. The **Bank of England** has **eased its monetary policy** and is likely to do more in the coming days to reduce the collateral damage
5. The **UK Government** could go for a **more liberal fiscal policy** to counter the effects of a slowing economy
6. Still, the true impact of Brexit will take months, if not years to become apparent and will largely depend upon the nature of the relationship UK crafts with the EU going forward.

Road Ahead

DEZAN SHIRA & ASSOCIATES
Your Partner for Growth in Asia

Models

Five distinct models are set out below which are presently being used.
The UK may, on the other hand, negotiate an entirely different relationship with the EU which meets its aspirations. Naturally there will be trade-offs. Gains on the economic front could be off-set by losses on the political front. Or vice versa. This is the Brexit paradox.

Model	Explanation
Norwegian-style EEA agreement	The UK joins the European Economic Area and maintains full access to the single market, but must adopt EU standards and regulations with little influence over these. The UK still makes a substantial contribution to the EU budget and is unable to impose immigration restrictions.
Swiss-style bilateral accords	The UK and the EU agree a set of bilateral accords which govern UK access to the single market in specific sectors. Concern in Brussels about cherry picking may limit the sectors. The UK becomes a follower of regulation in the sectors covered.
MFN-based approach	No need to agree on common standards and regulations, but at the expense of facing the EU's common external tariff, which damages UK trade with the EU in goods as well as services. Non-tariff barriers may emerge over time to damage trade in services in particular.

Models

Model	Explanation
FTA-based approach	The UK is free to agree FTAs independently with other trading partners including EU. Tariff barriers are unlikely, but as with all FTAs the UK will need to trade off depth –which means agreeing common standards and regulation –with independence.
Turkish-style customs union	Internal tariff barriers are avoided, with the UK adopting many EU product market regulations, but sector coverage of the customs union is incomplete. The UK is required to implement EU external tariffs, without influence or guaranteed access to third markets. This model is considered to be unlikely to be adopted since it is commonly believed Turkey compromised its sovereignty by giving supervening powers to the EU who forced Turkey not to enter into any treaties with any non-EU country without the knowledge of EU. Otherwise, EU had the right to intervene and annul that treaty.

Implications of Models

	EEA	BIL	MFN	FTA	CUS
Nearly no tariff barriers on trade in goods	✓	✓	✗	✓	✓
Dynamic agreement	✓	✓	✗	✗	✓
Rules of origin requirements avoided	✓	✗	✗	✗	✓
Single set of regulations for exporting firms	✓	✓	✗	✗	✗
Full single market access retained	✓	✗	✗	✗	✗
Passporting of banks from the UK possible		✗	✗	✗	✗
Influence over EU regulations retained	?	✗	✗	✗	✗
Able to adopt own approach to regulation	✗	?	?	✓	?

Implications of Models

	EEA	BIL	MFN	FTA	CUS
Freedom to pursue trade deals independently	✘	✓	✓	✓	✘
No Contribution to the EU budget	✘	✘	✓	✓	✓
Freedom to impose immigration controls	✘	?	✓	✓	✓

Impact on India: Models

DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

Possible Impact of Various Models on India

The Norwegian Model – Joining the European Economic Area (EEA)

1. For UK to become a member of the EEA, it could possibly be advantageous for India in terms of trade
2. UK would have the liberty to negotiate trade treaties with countries outside the EU.
3. Independent trade deals between the UK and India could provide for huge potential for improvement and closer collaboration in terms of trade
4. Since UK will have access to the single market, India would still be able to export to all Members of the EU through UK.
5. However, in order to avail duty free exports to EU region, EEA members are required to meet ‘rules of origin’ requirements.

The Swiss Model: Bilateral Ties

1. The Swiss model of bilateral treaties is in some way more restrictive than the EEA model.
2. Since UK and EU will negotiate and settle bilateral treaties based on mutual national interest, India’s access to the EU through the UK will be limited to the areas in which the bilateral agreements are entered.

Possible Impact of Various Models on India

MFN Model

1. Since the UK would have the liberty to set its own MFN tariffs on imports and gain the freedom to choose its own economic policy and regulations, this could potentially be beneficial for India
2. This could ensure that the UK could change existing trade policies with India and further liberalize trade by reducing tariffs under the WTO
3. In this scenario, since the UK would no longer have access to the single market, India would not be able to use the UK as a gateway to the EU in terms of trade as easily as before.
4. Goods exported through the UK to the EU are also obligated to meet various EU standards which is another factor that may make it difficult to trade with the EU through the UK.

Possible Impact of Various Models on India

FTA- based model

1. India and the EU have been unable to reach an agreement on an FTA so far. With UK exiting EU, India can independently enter into an FTA with UK.
2. India's trade with EU through UK will now depend upon the relationship the UK crafts with EU.

The Turkish Model

1. With UK entering into Turkish style model, India's export to EU through UK may be in jeopardy since the model does not allow single market access, however, relaxation from rules of origin would be available.
2. If UK follows the model of entering into the Turkish style of customs union with EU, it shall accept not to do any treaties with any non-EU country without the knowledge of EU. Otherwise, EU shall have the right to intervene and annul that treaty. This would have major impact on India's trade with UK.

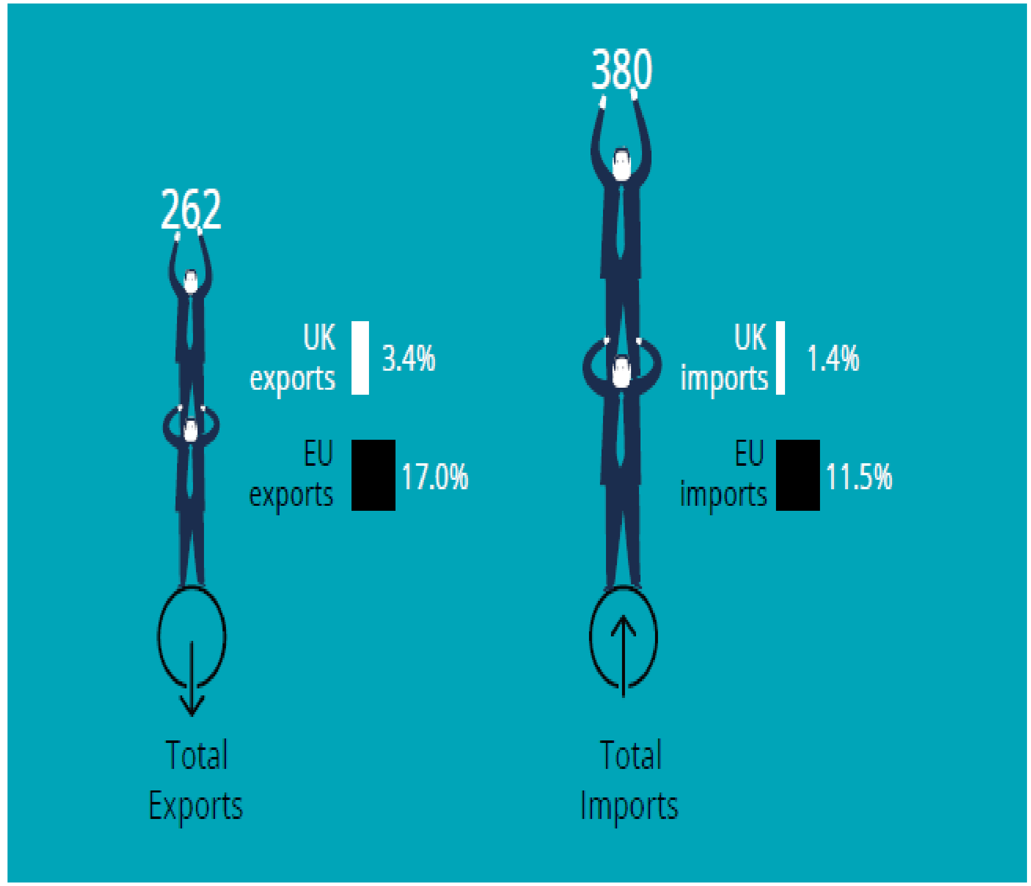
Impact on India: Sectoral Impact

A Look at UK/India Trade

Merchandise Trade

1. For India, both the UK and EU are important trading partners
2. **The UK is one of the seven countries with which India has a trade surplus**
3. Negotiations with the EU are being held regarding Free Trade Agreements (FTAs)
4. **UK-India** bilateral trade was valued at **USD 14.02 billion in FY16**, and, **EU-India** trade (including UK) was valued at **USD 88.56 billion in FY16.**

Indian Merchandise Trade in FY16 (in USD billion)

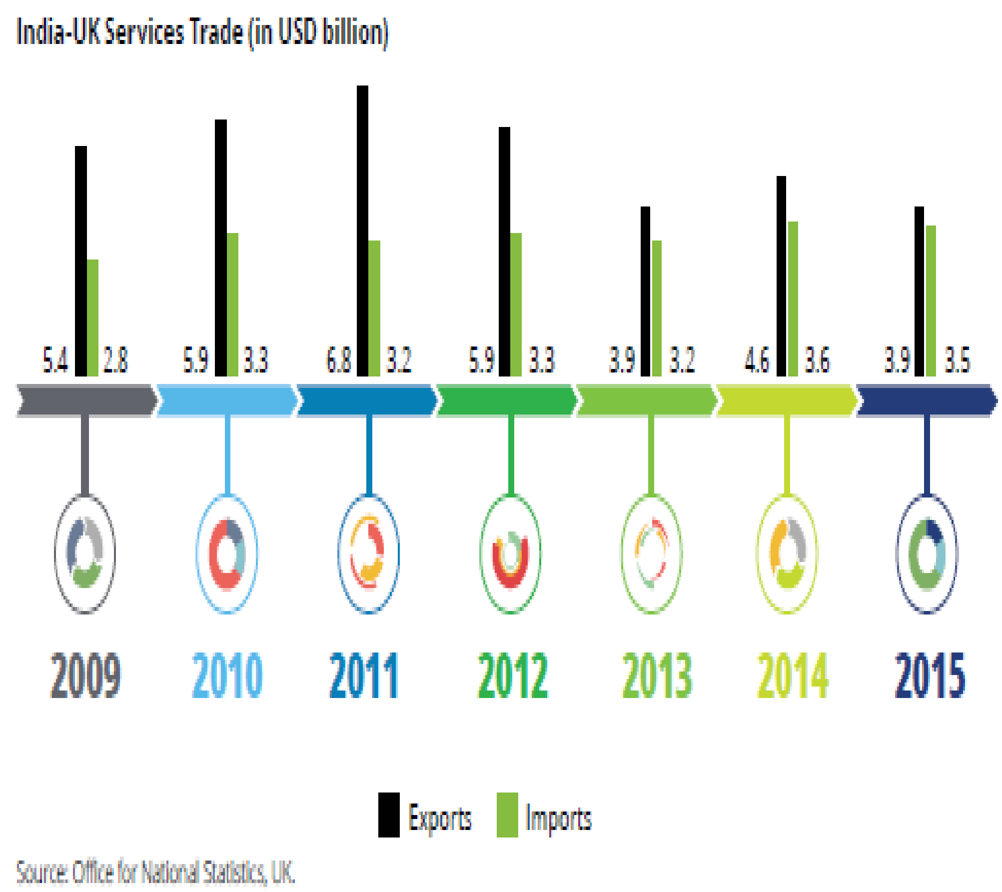


Source: Ministry of Commerce and Industry, India.

A Look at UK/India Trade

Services

1. Though the trade relationship between the UK and India is vastly dominated by goods, services do form an important part of this relationship.
2. Trade in services have declined over the last years as **India exported** around **USD 6.8 Billion** and **imported** around **USD 3.16 in 2011**. However, since then Imports have increased to **USD 3.5 Billion** while exports have declined and stand at **USD 3.9 billion approx. in 2015**



Sectorial Impact

Consumer and Industrial Products

1. This sector is vast and has significant amount of exposure to the UK
2. Following the BREXIT vote, Indian **auto stocks lost almost 10%** of their value as a number of the companies get a major share of their revenue from the UK and EU.
3. The **UK** accounts for **almost 4% of all auto exports** and the **EU accounts for almost 16% of auto exports.**
4. For companies in this sector that have manufacturing units in the UK, the access to the EU single market is important as their products can get artificially uncompetitive if they export directly to EU nations.
5. **These unit's profitability may get affected due to the lower value of the GBP**. While in the near term their products become cheaper, repatriation of funds may fetch lower amounts.
6. Overall, the event is likely to have negative repercussions for this sector as growth in the UK and the EU may both get hit. The problem of slowing sales could get compounded by issues of a weaker currency.

Sectorial Impact

India's Energy and Resources: Oil & Gas, Power & Utilities

1. **UK-India bilateral trade** of boilers, machinery, and mechanical appliances was worth **USD 1.4 billion in FY16** and is both the second largest import and export of India with the UK
2. With the impact of Brexit, global demand for crude oil and commodities is also likely to be affected by the UK economy slowing down.
3. A gradual increase in crude oil prices is expected, dependent on demand supply dynamics. This gains importance in the context that with every USD 1 rise in crude prices, India's oil import bill rises by an estimated USD 1 billion. This slower rate of increase in crude oil prices would prove beneficial for downstream Indian industries.
4. A slowdown in global demand means lower commodity prices for a longer duration and given the fact that India's domestic economy will remain a net importer in the foreseeable future, it augurs well for manufacturers and energy companies.

Sectoral Impact

Financial Services

1. Bilateral Financial services, banking, and real estate are among **the largest service sectors** in the UK, which are directly **affected by the currency fluctuations**.
2. These sectors could **endure some negative effects** as businesses could hold up decisions to invest further on account of **ambiguity in trading rules between the UK and the EU**.
3. Depending on which way the negotiations go between the UK and the EU, **London's status as one of the world's largest and most prominent financial hubs may be affected.**
4. This can cause Indian firms to reassess their operations in the UK and move investment and ties someplace else, which in turn could also affect the flow of Indian personnel to the UK.
5. Bilateral Financial Services Trade between the **UK and India in FY 14 was USD 0.40 Billion**

Sectorial Impact

Life Sciences & Health Care

1. India's pharmaceutical sector has significant exposure to the UK, as it exported USD 0.46 billion to the UK and a total of USD 1.51 billion to the EU in FY 16.
2. Mid-to-large tier pharmaceutical companies have exposure to the UK economy and a hit to demand in the UK and the EU is likely to have negative effects on profits and sales.

Technology, Media and Telecommunication

1. India's IT sector has a huge presence in the UK, and therefore is one of the most vulnerable sectors to BREXIT. **Bilateral Trade with the UK in FY 14 was USD 1.13 Billion**
2. Many IT companies have their EU headquarters in the UK and use the country as a gateway for business across the EU.
3. Indian IT firms based in the UK and serving clients in the US, billing them in GBP/Euro will likely witness some **operating-profit margin pressure** as these currencies are likely to weaken against the USD
4. Share prices of numerous key Indian IT players fell following the result of the referendum.

Conclusion

As we look at the impact on various sectors, it is important to understand that these effects will vary with the outcome of negotiations the UK government has with the EU. So, while Britain has decided to exit the EU, the question of how that plays out both politically and economically remains to be seen.

Indian Companies in the UK and Brexit

Views of Indian Companies on Brexit

TATA

- In the run-up to the British referendum, Tata projected that, in a worst-case scenario, its profits could be slashed by almost EUR 1.2 billion by 2020 as a result of Brexit.
- Tata Steel, a Tata group company, which sells a quarter of its British – made steel in the EU, has now reportedly had to halt the sale of its struggling UK assets after several of the shortlisted bidders pulled out.
- "Access to markets and a skilled workforce would remain important considerations for its businesses in Britain" said Tata group.

GP Hinduja

- GP Hinduja described the referendum as an "essential democratic process", which could eventually prove beneficial for Britain's trade with India, and Britain's exit from the European Union as positive for India-UK ties
- "There will be greater focus on India and the emerging markets and among the emerging markets India will be favourites. Trade and investment will eventually grow and in terms of visa norms, which has been stricter because of the EU rules, should also ease up for Indian business" he said.

Doing Business in India

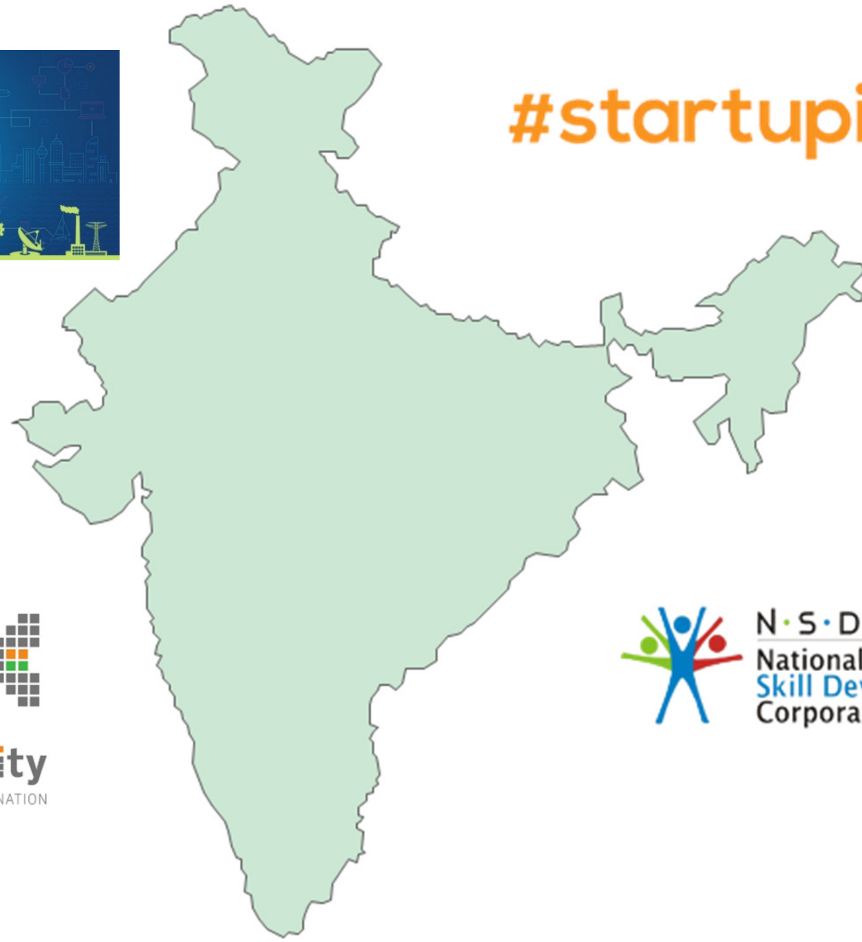
DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

Government Initiatives

MAKE IN INDIA

#startupindia



Digital India
Power To Empower

N·S·D·C
National Skill Development Corporation

Smart City
MISSION TRANSFORM-NATION

Doing Business in India: Brief Introduction

- India is emerging as a major market and investment destination globally. The U.S. Department of Commerce has identified India as one of the world's top ten "big emerging markets". Besides, the economy has also been named as the third most attractive destination for investment in the world in a recent survey conducted by the United Nations Conference on Trade and Development (UNCTAD).

- Outlined below are key facts that make India a favourable business destination worldwide:
  - A growing middle class. A report published by the McKinsey Global Institute estimates that by 2025 the Indian middle class will grow to 583 million earners and consumers.
  - A fluent English speaking population
  - Large pool of skilled manpower
  - Lower labour cost and hence, reduced total cost of manufacturing
  - An abundant supply of raw materials
  - Geographical location, which makes India closer to markets including Middle East, South/South East Asia and Europe
  - Many ports of entry on both coasts: Haldia, Chennai, Kolkata, Vishakhapatnam, Paradip, Tutikorin, Ennore on the east coast and JNPT, Kandla, Kochi, Marmugoa, Mumbai, New Mangalore on the west coast.
  - An extensive and ever expanding rail and road network
  - Major international airports: Chennai, New Delhi, Mumbai, Hyderabad, Kolkata, Bangalore, Goa and Thiruvananthapuram

Dezan Shira
In
India

DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

Services offered by Dezan Shira in India

- Advisory on Market Entry Strategy
- Advisory on appropriate Business Model
- Corporate Establishment
- Business & Operation Advisory
- Legal & Financial Due Diligence
- Location Services International Tax Planning
- Accounting & Reporting
- Tax Compliance
- Audit & Financial Review
- Payroll & Human Resource Administration
- Treasury Administration
- Transfer Pricing

Bibliography

DEZAN SHIRA & ASSOCIATES
Your Partner for Growth in Asia

Bibliography

1. KPMG: The Brexit Strategy - The impact of Brexit on Indian Companies with UK Holdings
2. Deloitte India: Brexit: Focus on India
3. Indian Express: http://indianexpress.com/article/business/companies/brexit-referendum-fears-in-india-inc-with-business-based-in-uk-and-eye-on-eu-market-2874422/
4. Economic Times: Brexit positive for India-UK Ties: GP Hinduja
5. Reuters: http://in.reuters.com/article/britain-eu-tata-sons-brexit-idINKCN0ZA0VL
6. Ministry of Commerce and Industry: http://commerce.nic.in/eidb/Default.asp
7. Report by Global Counsel on Bre-Exit