



IMPACT OF BREXIT ON SMALL AND MEDIUM ENTERPRISES IN UK

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ABSTRACT

This paper presents the withdrawal of the United Kingdom from the European Union. This is based on the withdraw agreement according to the Article 50 Of the Treaty of Lisbon with right to any member state to leave the EU. BREXIT- the process to leave the EU was instituted by a referendum held in 2016.

We also summarize how private sector employment in the UK is 60% accounted for by SMEs. The British economy relies heavily on SMEs. Further, because of the exit from the Single Market, the European Union Regulations are no longer relevant to the British SMEs. Britain's decision to depart from the EU created a surge of uncertainty that recorded a 6% reduction in Foreign Direct Investment and around 2% reduction in employment in the first couple of years.

At last we summarize certain policies that have been implemented to ease the risks faced by the SMEs.

INTRODUCTION

BREXIT (portmanteau of "Britain" and "Exit") is the withdrawal of United Kingdom (UK) from the European Union (EU). UK is the only sovereign country to leave the EU. Under the conservative government of Edward Heath, UK had been a member of the European Communities (EC), which is the predecessor of European Union (EU), since 1 January 1973.

Article 50 of the Treaty of Lisbon provides a mechanism for any EU member state to unilaterally withdraw and quit voluntarily and outlines the procedure for doing so. The EU treaties cease to apply to the country in question after 2 years of the notification of withdrawal. It provides the leaving country 2 years to finalize a withdrawal agreement or exit deal.

Three territories of the EU member state withdrew earlier: French Algeria (upon independence in 1962), Greenland (in 1985, following a referendum, after voting to leave in 1982) and Saint Barthelemy (in 2012). The latter two became Overseas Countries and Territories of the European Union (OCT). The main reason for withdrawal was disagreements over Common Fisheries Policy and control of Greenlandic fish resources.

The United Kingdom exited the European Union on January 31, 2020, ending its 47 years long membership. Brexit has been one of the most significant political events of recent times. The process of exiting the European Union was initiated by a referendum held in 2016 where the majority (51.9%) of the voting population were in the favor of Brexit. The voting turnout was 33 million (71.8%). David Cameron, the Prime Minister of United Kingdom at that time resigned over the result. However, he made the following statement at the Prime Minister's office (in Downing Street) on the outcome of the referendum on the UK's membership of the European Union: *"The country has just taken part in a giant democratic exercise — perhaps the biggest in our history. Over 33 million people — from England, Scotland, Wales, Northern Ireland and Gibraltar — have all had their say. We should be proud of the fact that in these islands we trust the people with these big decisions. We not only have a parliamentary democracy, but on questions about the arrangements for how we are governed, there are times when it is right to ask the people themselves, and that is what we have done. The British people have voted to leave the European Union, and their will must be respected."*

On 29 March 2017, the British government officially began the process of withdrawal by invoking Article 50 of the Treaty of Lisbon with permission from Parliament which implied that UK was due to leave the European Union by 11:00 pm on 29 March 2019 when the two-year period for Brexit negotiations were supposed to expire. However, on 20 March, Theresa May (Prime Minister of UK at the time) wrote to the President of the European Union Donald Tusk to ask for an extension until June 30 which led to an agreement of two options:

- 1) The delay of Brexit until 22 May but only if British MPs approve the withdrawal agreement by 29 March 2019.
- 2) Upon rejection, UK will have to present the EU leaders with a way forward or leave with no deal by 12 April.

Even so, the British parliament wanted to further delay Brexit until October. After failing to get the agreement approved, Theresa May resigned as Prime Minister in July and was succeeded by Boris Johnson. Johnson declared that UK would leave the European Union in early 2020. The agreement was ratified by the UK on 23 January and by the EU on 30 January coming into action on 31 January 2020.

One of the most significant concerns of Brexit was its effects on Small and Medium Enterprises (SMEs) in the UK. SMEs are the backbone of the UK's economy, accounting for 99% of all businesses and employing over 16 million people (60% of workforce). SMEs are critical for economic growth and job creation in the UK and any negative impact on these businesses could have significant consequences for the overall economy.

This paper aims to explore the impact of Brexit on SMEs in the UK. The purpose is to identify short-term and long-term effects of Brexit on SMEs and analyze the response and strategies adopted by SMEs to mitigate any negative impacts.

BREXIT AND SMEs IN UK

Brexit is expected to have a major and significant effect on the Small and Medium Enterprises in the UK. SMEs in UK have long enjoyed the benefits of the EU's single market, which allowed them to trade freely across the European Union without any trade barriers or tariffs. After Brexit, UK will no longer have access to the EU's single market which will disrupt its trade. However, since then, UK trade with the EU has been governed by the Trade and Co-Operation Agreement. The UK's exit from the EU is also expected to impact the availability of labor as many SMEs rely on migrant workers from the European Union.

Many SMEs have expressed their concerns regarding the impact of Brexit on their operations. Federation of Small Businesses (FSB) conducted a survey which revealed that two-thirds of SMEs believe that Brexit would impact their businesses negatively and about half convey concerns about new-tariffs and non-tariff barriers. From the same survey, we also found that more than one in three SMEs have already been negatively affected by Brexit.

IMPACT OF BREXIT ON SMEs IN UK

Brexit has created a level of uncertainty for Small and Medium Enterprises in the UK. Its impact is complex and multi-faceted, including:

- 1) **Increased Costs-** One of the most significant impacts of Brexit on SMEs is the increased costs associated with trade. The UK's exit from the EU has generated a new trade regime and the SMEs which traded with the EU have to now deal with new tariffs, customs procedures and regulatory requirements. It has resulted in increased costs and burden on the SMEs that export to the EU or import from it.

Federation of Small Businesses found that around 26% of the SMEs that export/import to the EU reported a significant negative effect of Brexit on their businesses, primarily due to increased costs, administrative burdens and delays at the border.

- 2) **Reduced Investment-** Brexit has also resulted in reduced investment in the Small and Medium Enterprises in the UK. The increased costs and uncertainty associated with Brexit have made it difficult for SMEs to attract investment, both domestically and internationally. It has a potential to impact the growth and competitiveness of SMEs in the UK.

Centre for Economic Performance found that Brexit led to a reduction in Foreign Direct Investment (FDI) by 11% between 2016 and 2018. The study also found that FDI in sectors with a high share of Small and Medium Enterprises, such as manufacturing and services, decreased more than in other sectors.

- 3) **Supply-Chain Disruption-** Brexit has also resulted in Supply Chain disruption for SMEs in the UK. Several SMEs depend upon imports from the EU for raw materials and components and the new trade regime has created delays and additional costs at the border. It has the potential to impact the production and delivery of goods and services.

A study by Chartered Institute of Procurement and Supply found that about 60% of SMEs had experienced supply-chain disruption in the UK after Brexit, with main causes being lack of availability of goods, delays at the border and increased costs.

TRADE IN UK IN 2022

- 1) In 2022, United Kingdom's exports to EU member states was 340 billion pounds of goods and services which is equal to 42% of UK exports.
- 2) The imports from EU in 2022 were worth 432 billion pounds, equal to 48% of UK imports.

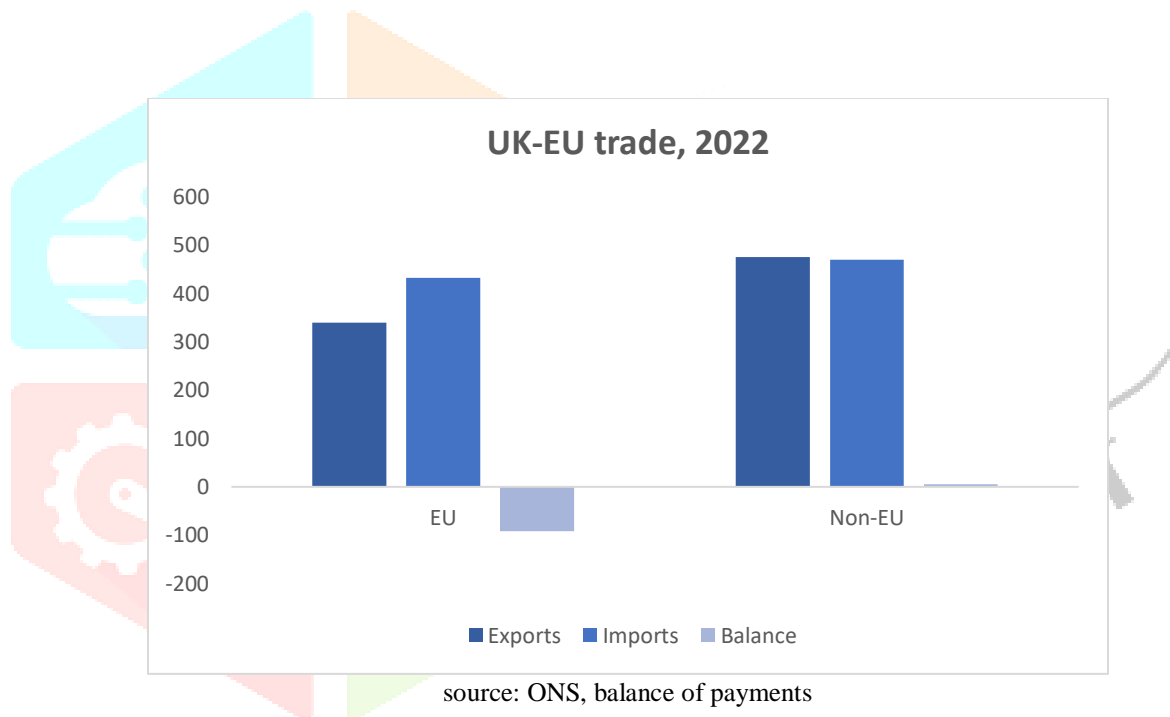
3) There was a deficit of 92 billion pounds with the European Union but a surplus of 5 billion dollars with non-EU countries.

UK Trade with EU and Non-EU Countries, 2022

Goods and Services

	Exports Billion(pounds)	Imports Billion(pounds)	Balance Billion(pounds)
EU	340.1	431.9	-91.9
Non-EU	475.1	469.9	5.2
Total	815.2	901.8	-86.6

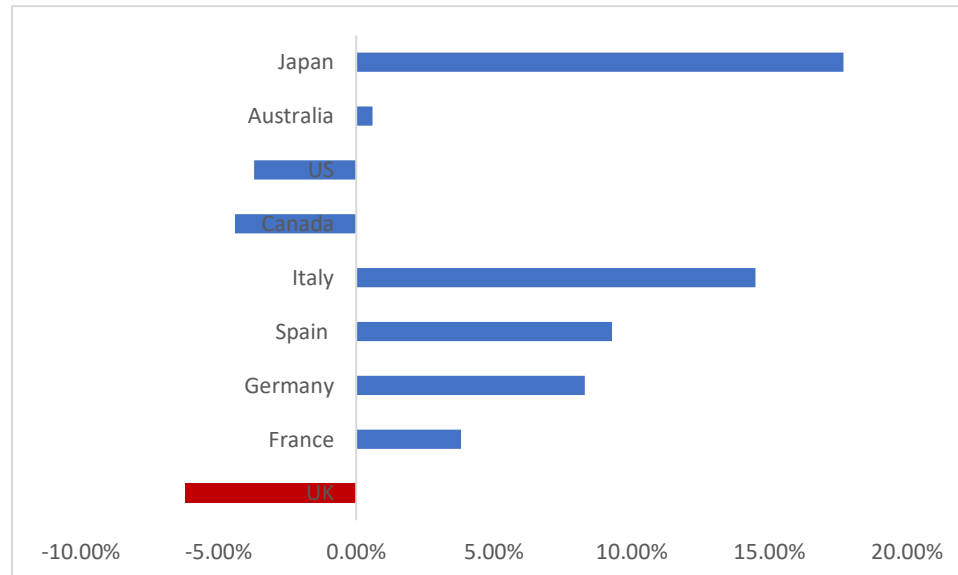
source: ONS, balance of payments



There was a deficit in goods recorded by UK with both the EU and non-EU countries (of 117 billion pounds and 113 billion pounds) but a trade surplus was recorded in services with both the EU and non-EU countries (worth 25 billion pounds and 119 billion pounds).

UK Trade openness has fallen more sharply than other advanced economies since Brexit

Percent change in trade in goods and services as a share of GDP from Q1 2017 to Q4 2021



Source: Organization for Economic Cooperation and Development (OECD), Quarterly National Accounts Database.

The UK has also attracted high foreign investment since the 1970s, driving higher wage growth, more innovation and technological investment. However, Foreign Direct Investment has retreated since the Brexit referendum. Between 2017 and 2020, average UK FDI inflows plummeted to its lowest level since the 1980s.



source: Macrotrends, UK Foreign Direct Investment 1970-2023

foreign direct investment inflows, 1970-2023

STRATEGIES ADOPTED BY SMEs

In spite of the challenges presented by Brexit, Small and Medium Enterprises in the UK have adopted various strategies to mitigate its potential negative impact. The strategies that SMEs have adopted are as well:

- 1) Expanding into New Markets- A strategy adopted by SMEs is to expand into new markets. SMEs are exploring opportunities in non-EU markets such as the US, Asia, and the middle east, to diversify their customer base and reduce their dependence on the EU market.
- 2) Developing New Products- SMEs also responded to Brexit by developing new products or services that are less dependent on imports from the EU. It involves identifying alternative suppliers or developing new products that require locally sourced materials.
- 3) Investing in technology- SMEs are also investing in technology to streamline their operations and reduce costs. It includes endorsing digital technologies, such as e-commerce platforms, to reach new customers and improve their supply-chain management. A study by Institute of Directors have found that 33% of SMEs have increased their use of automation to reduce costs and increase efficiency.
- 4) Collaborating with other businesses- SMEs also collaborated with other business ventures to share knowledge, resources and reduce costs. It included forming partnerships and tie-ups with other SMEs, joining associations and participating in government-supported initiatives.

GOVERNMENT SUPPORT FOR SMEs

The UK government has implemented various measures to support the Small and Medium Enterprises during the Brexit transition period:

- 1) The SME Brexit Support Fund provides grants of up to 2000 pounds to help with the costs of adapting to new customs procedures.
- 2) The SME Brexit Fund provides loans of up to 10 million pounds to SMEs to help with the cash flow issues related to Brexit.
- 3) The Trade Credit Reinsurance Scheme provides government backing to credit insurance providers to support the supply chain of SMEs.
- 4) The UK Global Tariff provides tariff reductions on import from non-EU countries to encourage SMEs to explore new markets.

CONCLUSION

Brexit has been a significant political event that has had a complex and multi-faceted effect on the Small and Medium Enterprises in the UK. SMEs that trade with EU now face new tariffs, customs procedures and regulatory requirements, which have increased costs and administrative burdens. Brexit has also created uncertainty, disrupted supply-chain management for SMEs and resulted in reduced investments.

UK's Foreign Direct Investment reached at its lowest since the 1980s and a trade deficit of goods was also recorded. In spite of these issues, SMEs in the UK have responded by adopting various strategies to mitigate the potential negative impact of Brexit and it is essential that SMEs in the UK continue to adapt to the new trading environment created by Brexit. Various strategies adopted by SMEs include expansion into new markets, investing in technology, developing new products, collaborating with other SMEs and taking advantage of government support.

In addition to the above outlined strategies, there are other potential avenues that could be explored by SMEs to mitigate the impact of Brexit. A potential approach is to leverage emerging technologies like blockchain to reduce the complexity of customs procedures and improve supply chain transparency.

Blockchain technology has the potential to improve speed and accuracy of customs processes by making a secure and transparent platform available for tracking goods as they move across border. Another potential approach would be to explore international trade outside of EU. The UK has already signed trade agreements with several non-EU countries including Japan and Canada. By diversifying their customer base and exploring new markets, Small and Medium Enterprises in the UK can reduce their reliance on EU trade and minimize the impacts of Brexit.

It is also important to note that impacts of Brexit will continue to evolve over time. As the UK government negotiates new trade agreements and adjusts its regulatory framework, SMEs will have to be responsive to these changes. It may require ongoing investment in training and workforce development to ensure that SMEs have the required skills and knowledge to operate in the post-Brexit environment.

At the same time, it is important to take a note that Brexit is just one of many geopolitical and economic factors that will shape the future of SMEs in UK and around the globe. Ultimately, the success of SMEs in the UK will depend on their ability to adapt to these changing circumstances. By embracing a culture of continuous improvement, innovating and investing in the skills, technology and partnerships needed to succeed in the post-Brexit era, Small and Medium Enterprises in the UK can continue to thrive and contribute to the growth and prosperity of the UK economy.

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