KPMG

British Chamber of Commerce in Germany 1919–2019

German British Business Outlook 2019

Content

Foreword

Dear reader

Brexit is not only overshadowing the news and companies' strategic plans these days, but it is also a dominant topic in this year's German British Business Outlook (GBBO).

Only weeks before the exit date of 29 March 2019, almost half of the companies that took part in the survey still have not prepared their business for Brexit, since a wide range of scenarios are possible. Forty percent of companies expect Brexit to have a big or very big impact.

Roughly half of the surveyed companies predict new administrative burdens, as well as decreasing sales and service volumes after Brexit. Further, roughly one quarter foresee rising customs and trade expenses and disruptions in their supply chain. Most will react by revising investment and recruitment plans and moving businesses to continental Europe.

As a consequence, a significant 84% of survey respondents see the British economy declining in 2019, 47% of which expect a strong decline. In terms of their own business, 36% of companies surveyed are seeing a decrease in the current business year, while 47% of companies still expect their business to grow.

The main reason for investing in the UK remains customer demand for the goods and services. Another reason, which has been on the rise since last year, is the availability of skilled workers. The 24% of respondents that do undertake R&D in the UK do so in close cooperation with universities and large tech companies. Twenty-five percent of the companies surveyed believe that favourable tax provisions in the UK Taxation (Cross-border Trade) Act 2018 will have a positive influence on their business, whereas 46% of respondents are not aware that the UK administration has any favourable impact.

The main strategies for 2019 among the companies surveyed comprise the focus on existing core competencies, diversification of the business and expansion into new regions. Meanwhile, the challenges linked to data protection and security are also requiring companies to take action.

German businesses in the UK play an important role in the market – as a growth driver for a wide range of industries, ranging from automotive to pharmaceutical. German companies also employ around 412,000 people and invest roughly €118 billion directly in the UK. The UK and continental Europe will certainly remain strong partners after the UK has left the European Union, not only in terms of trade.

We would like to thank the German and British subsidiaries that have taken the time to share their views with us for the German British Business Outlook.

Yours sincerely,

Andreas Glunz
Managing Partner
International Business
KPMG in Germany

Michael Schmidt
President
British Chamber
of Commerce

Executive summary

General observations

84%

A significant 84% of companies surveyed see the British economy declining and 47% of these strongly. However, this bleak outlook stands in contrast to positive business perspectives. Almost half of companies (47%) expect their business to grow and 18% anticipate their business to remain stable.

45%

Almost half of companies plan to focus on their core competencies in 2019. This is followed by a diversification of business (36%) and expansion into new regions (29%).

61%

The majority of companies perceive a number of challenges related to data and data management. Data protection and data security issues account for the main challenges of companies interviewed.

95%

Companies that conduct R&D in the UK collaborate closely with partners, most of which are universities (68%) or large tech companies (27%). However just a quarter of the companies makes use of this.

Brexit-related observations

9%

The attractiveness of the UK as an investment market is affected by Brexit. Perception of relative market stability saw the most significant change, with 20% of companies considering it stable pre-Brexit and only 9% post-Brexit.

47%

Nearly half of the companies surveyed have not conducted a Brexit risk assessment for their business. Those that did, prepare for Brexit by modifying administrative processes and implementing a Brexit task force.

40%

Forty percent of companies surveyed believe that Brexit will have a strong impact on their business. More than half of respondents see a moderate to small impact (53%).

35%

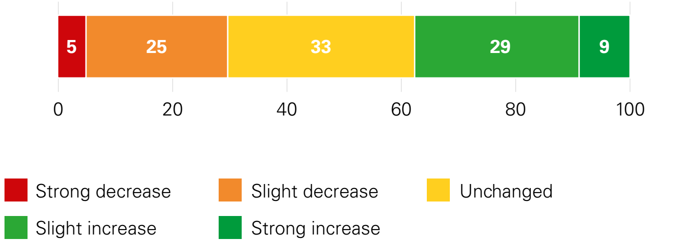
Thirty-five percent of companies will revise their investment plans and another 19% will revise their recruitment plans in the event of a hard Brexit.

01 Growth expectations: the outlook for 2019

Sales and services volumes in 2018 demonstrate a homogenous trend in each of the different categories (decrease/unchanged/increase). For one out of every three companies, the respective volume remained unchanged, while for 38%, the percentage of sales volume increased. However, 30% of companies reported a decrease in sales and service volumes.

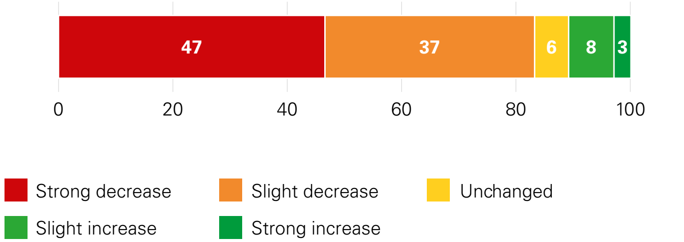
A significant 84% of companies see the British economy declining and 47% of these expect a strong decline. Current political and economic discussions, especially the feeling of uncertainty that Brexit and the different future scenarios are causing, are having an impact on companies' expectations. Only 11% are optimistic about the way in which the British economy will perform this year.

Figure 1:
Sales and services volume development in 2018



Source: KPMG in Germany and BCCG, 2019;
Information in percent

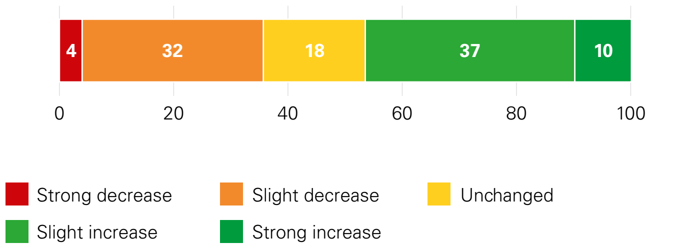
Figure 2:
Expectations for the British economy for 2019



Source: KPMG in Germany and BCCG, 2019;
Information in percent

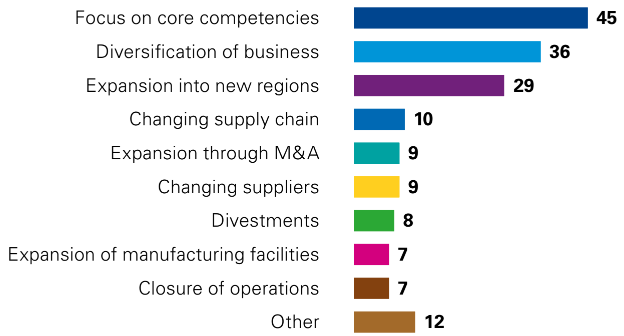
Business expectations for companies' own business are more positive compared to the outlook for the British economy. Almost half of the companies surveyed expect their business to grow (47%) while 18% anticipate a consistent status quo. A remarkable 36% of surveyed companies expect to see a decrease for the current business year.

Figure 3:
General expectations for business 2019



Source: KPMG in Germany and BCCG, 2019; Information in percent

Figure 4:
Strategic actions planned for 2019



Source: KPMG in Germany and BCCG, 2019; Information in percent; Multiple answers possible

There is a certain amount of variation in the **strategies** that companies will be implementing in the 2019 business year. A focus on core competencies is the key strategic direction, on which almost half of the companies are planning to focus.

Other key strategies that companies plan to implement in order to grow their business include diversification of their business and expansion into new regions. A change in the supply chain is likely to have been brought about by companies considering the implications of Brexit and feeling the need to restructure this part of their activity. Expansion using M&A enables companies to exploit market potential by entering new markets in selected locations.

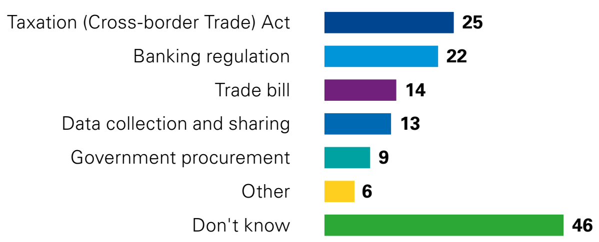
02 Shedding light on the UK administration

The government initiative that has had the most beneficial impact on the business of companies surveyed is the Taxation (Cross-border Trade) Act, followed by the banking regulation. The new taxation, which came into effect on 13 September 2018, imposes and regulates a duty of customs by reference to the importation of goods into the United Kingdom. One out of every four companies benefits from this bill.

Forty-six percent of companies surveyed are unaware of any beneficial impacts that government initiatives have had on their business. The handling of Brexit was the dominant topic in the UK, absorbing all resources of the administration and limiting the chances to drive other initiatives for the economy.

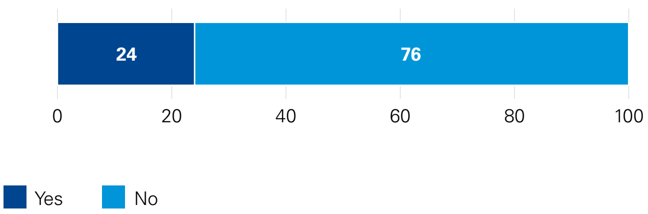
Around three out of four companies are not planning to step up their lobbying with the UK government. Especially in times of political uncertainty, associations and organisations could be used to lobby on a company's behalf to address pressing issues.

Figure 5:
UK government priorities that have favourably impacted business



Source: KPMG in Germany and BCCG, 2019; Information in percent; Multiple answers possible

Figure 6:
Interaction with local governments



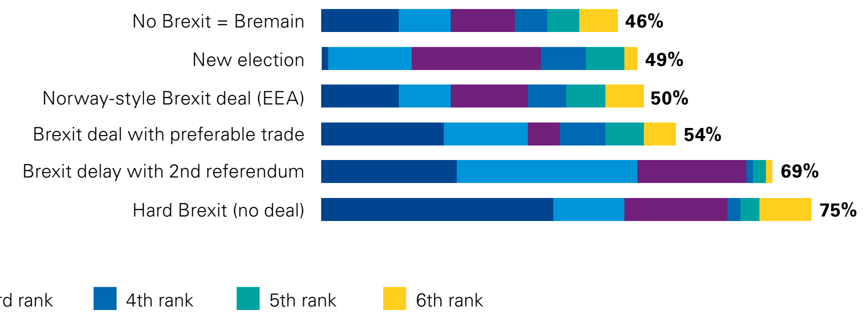
Source: KPMG in Germany and BCCG, 2019; Information in percent

03 Brexit: expectations and precautions

Despite the United Kingdom's partnership with the European Union having grown closer over the past decades, the British have voted to leave the EU. By triggering Article 50, the British government has started the withdrawal process, turning the result of the referendum into reality. However, the precise design of the exit process remains unclear.

Counting only answers by the surveyed companies in the first and second rank of most probable scenarios, it turns out that two scenarios are seen with a reasonable probability of around 50%, which are a Brexit delay with a 2nd referendum and a hard Brexit (no deal) on 29 March 2019. However, there are four other possible scenarios, which just goes to prove the massive uncertainty and imponderability of the current situation. Obviously, this is not the environment to make long-lasting investment or divestment decisions.

Figure 7:
Brexit expectations

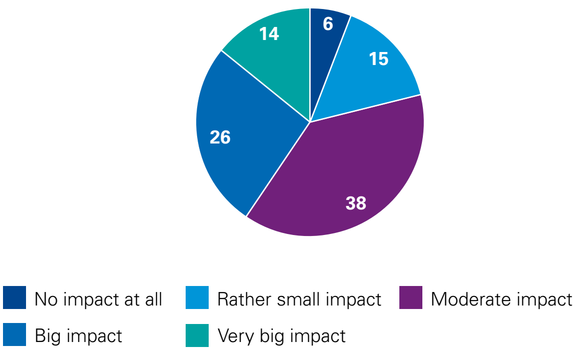


Source: KPMG in Germany and BCCG, 2019;
Information in percent

The effects of leaving the EU are significant for businesses: 40% of companies surveyed expect a big or even very big impact on their business and more than half the companies (53%) predict a moderate to small impact, whereas only 6% predict no impact at all.

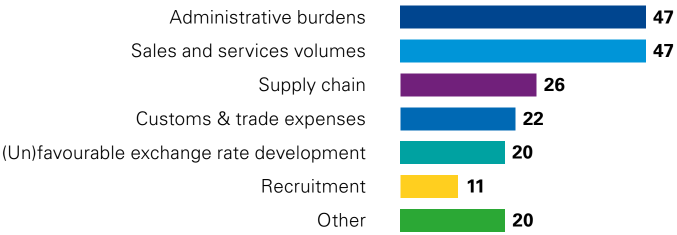
According to an earlier survey, conducted by Forsa, BCCG and KPMG in March 2018, the results were not much different one year ago: 42% of company representatives expected the Brexit to impact their business strongly or very strongly and 41% assumed that their business would be somehow affected.

Figure 8:
Effect of Brexit on business



Source: KPMG in Germany and BCCG, 2019;
Information in percent

Figure 9:
Key areas in which Brexit will have an impact on businesses



Source: KPMG in Germany and BCCG, 2019;
Information in percent; Multiple answers possible

The main areas in which the effects of Brexit on business will be felt include administrative burdens (47%) and sales and services volumes (47%). The impact on the supply chain is considered important by around one in four companies and the effect on customs and trade expenses by slightly more than one in every five companies (22%). Companies will also need to keep an eye on how the exchange rate develops, as this may have a negative impact on business. Other areas mentioned by respondents include intellectual property rights, regulatory issues for clients, workload and country relationship issues.

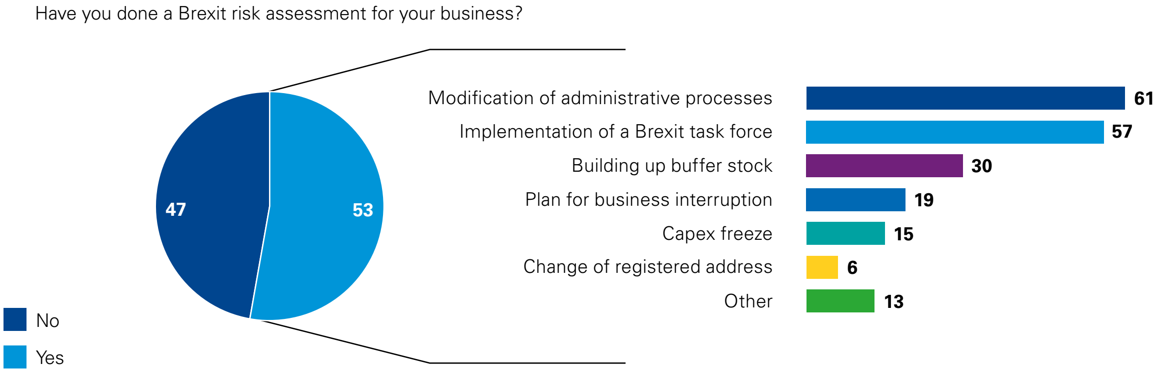
The Bank of England has confirmed its commitment to continue raising interest rates gradually if the economy evolves as expected. The bank has been reluctant to say what it will do in the event of a more negative Brexit outcome, but in theory, it is more likely to keep rates low in order to cushion a blow to demand.

Preparations for Brexit and planned measures

Around half of the companies surveyed (53%) have carried out a Brexit risk assessment for their business.

Most of the companies that have conducted this assessment within their business want to modify administrative processes (61%) or implement a Brexit task force (57%) in preparation. Around one third of companies want to build up a buffer stock as a preliminary strategy and 19% are working for a plan for future interruption to business. Other companies plan to stay informed and, since the outcome is not definite yet, some companies want to 'avoid fretting about the unknown'.

Figure 10:
Actions to prepare the business among companies that have conducted a risk assessment



Source: KPMG in Germany and BCCG, 2019;
Information in percent; Multiple answers possible

Figure 11:
Actions in case of a Hard Brexit on 29 March 2019

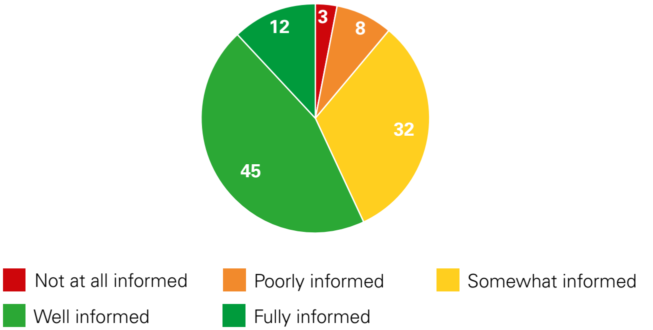
Source: KPMG in Germany and BCCG, 2019;
Information in percent; Multiple answers possible

The measures that companies plan to undertake in the event of a hard Brexit on 29 March 2019 are diverse. Around one third (35%) will revise their investment plans and another 19% will revise their recruitment plans.

Remarkably, none of the companies plan to relocate to the UK (if currently based outside the UK). Indeed, 13% plan to move their business from the UK to Germany or to another country in the EU (10%).

Overall, uncertainty is one of the most prevalent aspects of Brexit, which can be accounted for by media reports and different kinds of news coverage. Forty-three percent of companies claim that they are only informed to a certain (poor) extent. However, 57% admit that they are well or fully informed about Brexit by the media.

Figure 12:
Degree of media information about Brexit



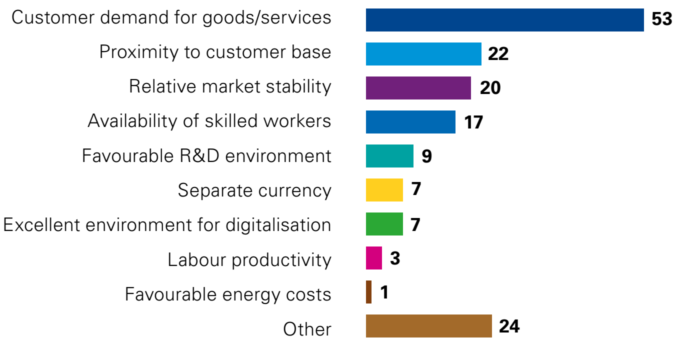
Source: KPMG in Germany and BCCG, 2019;
Information in percent

04 Reasons to invest: pre- and post-Brexit

Business investment is bearing the brunt of Brexit jitters and slumped by 1.4% in the closing quarter of 2018 alone. Investment as a whole is expected to shrink by 0.2% in 2019 with businesses making the choice to delay their investment plans, waiting for clarity. (KPMG UK Economic Outlook, March 2019).

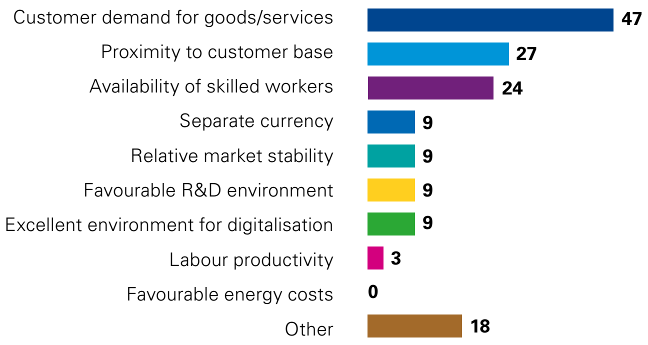
Looking at **past reasons** for investing in the UK, customer-driven factors also shape the picture. For 53% of companies surveyed, it was customer demand that made it attractive, while for 22%, it was proximity to their customers. Market stability accounted for another important reason with 20%.

Figure 13:
Past reasons for investing in the UK



Source: KPMG in Germany and BCCG, 2019; Information in percent; Multiple answers possible

Figure 14:
Post-Brexit reasons for investing in the UK



Source: KPMG in Germany and BCCG, 2019;
Information in percent; Multiple answers possible

Reasons for investing in the UK after Brexit remain relatively similar, albeit with some significant changes. Relative market stability drops to a value of 9%, representing a total decrease of 11% in comparison to pre-Brexit. Companies believe that the market environment will not be as strong as it was pre-Brexit. Customer demand falls to 47% post-Brexit, whereas proximity to customer base rises to 27%.

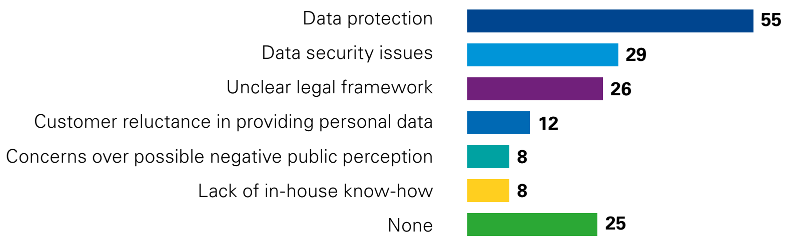
Companies see the availability of skilled workers as a somewhat stronger reason to invest in the UK after Brexit (24% post-Brexit vs. 17% pre-Brexit). Obtaining work visas after Brexit will become more challenging in the EU/Germany. Energy costs and labour productivity are not seen as advantages for investing in the UK.

05 Data-related challenges

Data is a key factor for German subsidiaries in the UK and for UK subsidiaries in Germany. With businesses handling large data sets across various business units, the main concerns for companies are data protection, data security issues and an unclear legal framework. Most significantly, data protection concerns more than half of the companies surveyed (55%).

One in every four companies does not recognise any challenges related to data or data management.

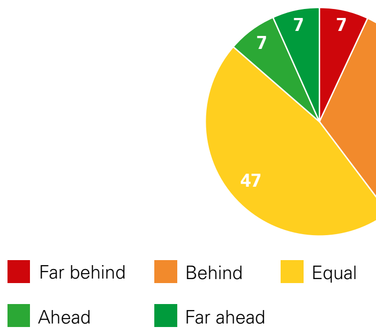
Figure 15:
Challenges with regard to data/data management



Source: KPMG in Germany and BCCG, 2019;
Information in percent; Multiple answers possible

In terms of digitalisation, however, UK and German subsidiaries are relatively equal to their respective counterparts when it comes to applying new digital processes such as big data, machine learning and predictive analytics. Still, 40% consider themselves as behind or far behind their parent company. However, almost half of the firms feel as though they are at an equal level with their parent company due to the fact that digitalisation has been prioritised and widely recognised.

Figure 16:
Comparison of the extent of digitalisation with regard to the parent company



Source: KPMG in Germany and BCCG, 2019;
Information in percent

06 The labour market and joint research initiatives

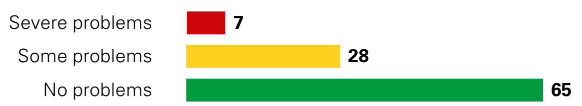
Labour market

Despite continuous developments in the labour market, 35% of companies still find it difficult to attract qualified talent to fill vacancies.

A remarkable 65% of firms surveyed experience no difficulty in finding skilled labour, which speaks in favour of the UK being an attractive talent pool. However, it is uncertain as to whether this situation will remain quite as favourable post-Brexit.

Unemployment rates have improved across most regions year on year, according to the British Economic Outlook (KPMG, December 2018). The latest data shows that in every part of the UK, the unemployment rate is now either at or below 5%. Similarly, the level of employment has increased in most UK regions, with the strongest growth in Wales and the West Midlands. These regions also experienced large falls in the rate of unemployment.

Figure 17:
Difficulty in attracting skilled labour in the UK



Source: KPMG in Germany and BCCG, 2019;
Information in percent

Research & development

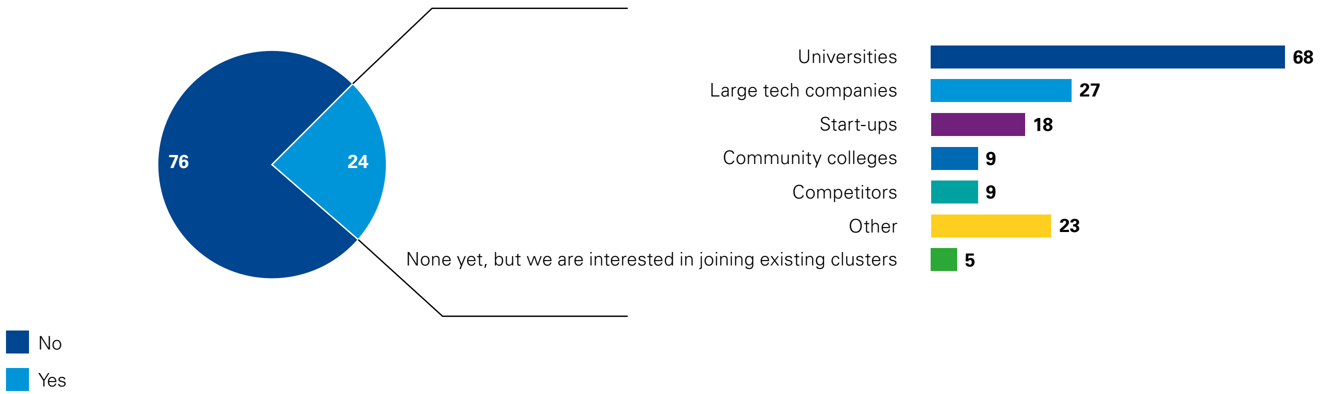
R&D incentives offered by the UK continue to be enhanced and expanded, resulting in a generous package of incentive measures. The incentive regime aims to foster the development of the knowledge economy and to increase UK productivity by 'incentivising' the development of high-tech businesses within the UK.

As from 1 April 2016, large companies can claim an 11% taxable cash credit (previously 10% prior to 1 April 2015), irrespective of the company's tax position. The credit can be used to settle taxes owed to the revenue authority or, if certain criteria are met, can be paid in cash. This has replaced the previous enhanced deduction regime, which will only continue to apply to qualifying expenditure incurred prior to 1 April 2016. Small and medium-sized entities continue to benefit from the enhanced deduction regime, which has been substantially increased over recent years and now provides an additional deduction of 130% of the qualifying expenditure and a 14.5% repayable credit in certain circumstances. (KPMG International EMEA R&D Incentives Guide, February 2017)

Almost one quarter of companies surveyed conduct research and development (R&D) in the UK. It has become increasingly apparent that innovation driven by high-quality R&D is vital to the long-lasting success of almost any business in the region.

Cooperation with external parties provides an additional way of collaborating on innovation and acquiring new technologies. The vast majority of the companies surveyed that conduct R&D in the UK collaborate or intend to collaborate with partners, most of which are universities (68%) or large tech companies (27%). The next category is 'other partners', which includes government agencies and research companies, followed by start-ups. Generally, the UK is widely recognised for its universities.

Figure 18:
Do you conduct R&D in the UK?



Source: KPMG in Germany and BCCG, 2019;
Information in percent

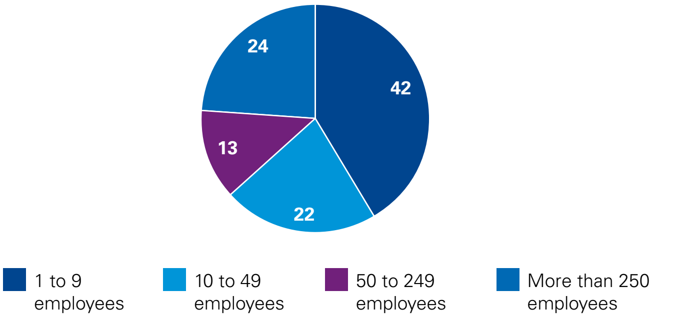
07 Methodology

The British Chamber of Commerce (BCCG) and KPMG in Germany approached German subsidiaries in the UK, and UK subsidiaries in Germany for this survey. The survey was open between 20 December 2018 and 25 January 2019, and a total of 101 companies took part.

The survey focused on the economic outlook of German companies in the UK, as well as on the challenges that they face with regard to growth opportunities for their business.

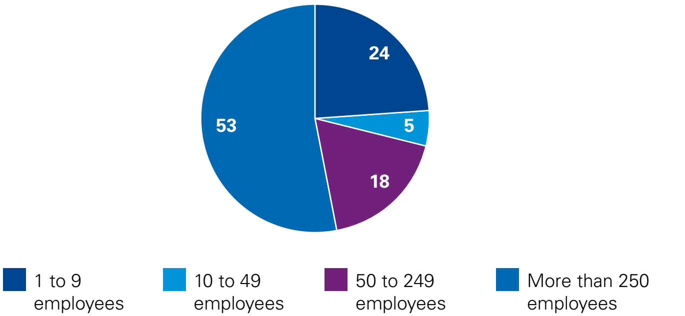
The German-British Business Outlook (GBBO) benchmarks the success and satisfaction of companies in the UK and Germany.

Figure 19:
Participation of German companies



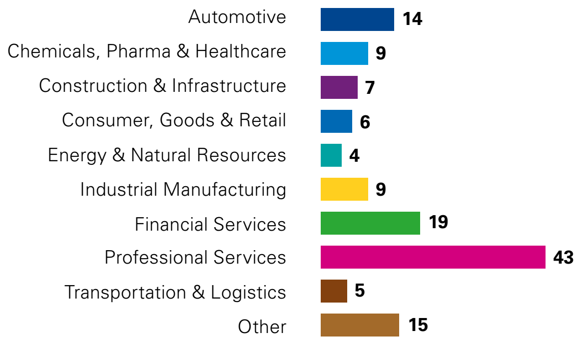
Source: KPMG in Germany and BCCG, 2019; Information in percent

Figure 20:
Participation of UK companies



Source: KPMG in Germany and BCCG, 2019; Information in percent

Figure 21:
Participating companies, by sector



Source: KPMG in Germany and BCCG, 2019;
Information in percent; Companies could select multiple sectors

Note: The answer "N/A" has been removed in the graphic, and the percentage information has been adjusted. Deviations from 100 percent are due to rounding differences.

08 About Us

BCCG

British Chamber of Commerce in Germany e.V. (BCCG) is a privately funded business network with over 600 members and 4000 personal contacts engaged in bilateral trading and business. The British Ambassador to Germany is patron of the BCCG, which was originally established in 1919. In 2019, BCCG celebrates its 100th anniversary as one of the most powerful international business networking forums in Germany and the largest British-German business network in Europe. The BCCG supports bilateral trade and mutual relations, which is even more important now, given Brexit developments.

www.bccg.de

KPMG

KPMG is a network of professional firms with around 207,000 employees in 152 countries. In Germany, KPMG is one of the leading auditing and advisory firms and has around 11,700 employees in 25 locations. Our services comprise Audit, Tax, Consulting and Deal Advisory. Legal services are provided in a separate legal entity.

For all relevant business corridors between Germany and foreign countries/regions, KPMG in Germany has implemented Country Practices. Each Country Practice consists of country experts who know the specifics and regulatory environment of these markets, regularly work in these countries and advise German and international multinationals on a day-to-day basis with their country-/corridor-related demands. The Country Practice UK represents one of the largest Country Practices at KPMG in Germany.

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Contact

KPMG in Germany

Andreas Glunz
Managing Partner International Business
T +49 211 475 7127
aglunz@kpmg.com

Nikolaus Schadeck
Partner, Head of Country Practice UK
T +49 421 33557 7109
nschadeck@kpmg.com

KPMG in the UK

Simon Jonsson
Partner
T +44 121 2323 616
simon.jonsson@kpmg.co.uk

BCCG

Michael Schmidt
President
T +49 206 7080
president@bccg.de

Andreas Meyer-Schwickerath
Director
T +49 206 7080
info@bccg.de

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