THE EU REFERENDUM: WHAT COULD IT MEAN FOR BRITISH BUSINESSES?

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INVESTED INTEREST

The EU Referendum: What Could it Mean for British Businesses?

On Thursday 23 June 2016, Britons will go to the ballot boxes to vote in the EU referendum. Since February, when David Cameron announced the referendum would take place, the evidence has suggested that there is little to separate the 'remain' and 'leave' camps. A poll carried out by ORB at the start of April found that 51% of Britons planned to vote to remain within the EU, with 44% of voters favouring Brexit. A separate Opinium poll saw it differently – it found 43% of people want to leave the EU, against 39% wanting to stay in.

Upon announcing the referendum, the Prime Minister called it "one of the biggest decisions this country will face in our lifetimes". Despite its importance, many people remain in the dark about which way to vote, including those in the private sector. A survey by the Federation of Small Businesses (FSB) earlier this year found that 42% of SMEs did not know which side they favoured, while 38% cited the need for more detail on the administrative burden of complying with EU regulation and 33% argued for the need for more detail on the cost of EU membership.

To help investors and businesses better prepare for 23 June, IW Capital has produced its business-focused EU referendum guide. This impartial document is designed to help the UK's investors and high-growth businesses understand more about the EU, our position within it, and the key business issues that are dividing voters.

What is the EU?

- The European Union is a political and economic community of 28 member states. The Union covers a combined 508 million people, 7.3% of the global population
- In 2014 the EU had a collective GDP of $18.5 trillion, which is approximately 24% of global nominal GDP
- It has its own currency – the euro – which is used by 19 of its member states
- The EU has five main aims:

    1. Promote economic and social progress
    2. Speak for the European Union in an international forum
    3. Introduce European citizenship
    4. Develop Europe as an area of freedom, security and justice
    5. Maintain and build on established EU law

What is the EU referendum?

- On 23 June 2016, British adults will be able to vote on whether they want the UK to 'Remain a member of the European Union' or 'Leave the European Union'
- Brexit supporters are those who are in favour of Britain exiting the EU

How can a country leave the EU?

- Article 50 of the Treaty of Lisbon (2007) makes provision for countries to leave the EU
- To date, no country has left the EU
- The Treaty provides for a two-year exit negotiation, during which time existing EU laws and regulations would still apply to the departing country while the other member states determine what role the departing country will have in connection to the EU after its exit

What Does the EU Referendum Mean for Businesses?

The economic implications of the EU referendum – along with migration – have been held up by voters on both sides as a key factor influencing their decision. Some believe that Britain would flourish without the regulation and red tape imposed by the EU; others believe that losing the support structure and access to the Single Market that come with EU membership would hamper business growth.

From a business perspective, there is a great deal at stake, with the UK's private sector flourishing compared to rival nations; the International Monetary Fund announced in 2015 that Britain's GDP grew faster than any other nation in the G7. Britain's small and medium sized enterprises have been at the heart of this economic recovery, with SMEs accounting for 99% of the private sector, employing 60% of its entire workforce and contributing £1.8 trillion to the nation's economy. Therefore, the outcome of the referendum either way will be of major significance for the future of Britain's growing businesses.

The FSB and British Chambers of Commerce (BCC) have both said that they will neither campaign for Britain to stay in or leave the EU. Instead they have promised to focus on the practical implications of both outcomes. What do these implications include?

Single Market versus Red Tape

Keeping access to an $18 trillion-a-year Single Market consisting of 500 million people is seen as the key benefit of remaining in the EU. According to the Office for National Statistics, in 2014 the EU accounted for more than 44% of all UK exports of goods and services, which have grown on average by 3.6% annually over the past 15 years. The UK imports more from the EU than it exports, and the overall trade deficit has widened, reaching £61 billion in 2014, up from £11 billion in 1999.

Three quarters (74%) of the Confederation of British Industry's (CBI) SME members say that the ability to freely buy and sell products in the EU has had a positive impact on their business. Leaving the EU will mean the UK has to renegotiate free trade agreements (FTAs) with its main trading partners, not just with European countries but also other nations further afield that have trade agreements with the entire EU market.

The Single Market enables trade without tariffs, as well as the freer movement of people. As research by Western Union Business Solutions has found that 76% of UK SMEs export their products or services to Europe, this could prove significant for a proportion of growing businesses. It is also the reason many larger companies – who operate internationally and require an extended talent pool to hire from – are in favour of remaining in the EU. Many SMEs also benefit from access to talent, with 48% of these smaller businesses saying that the ability to recruit and transfer staff from across the EU has been positive for business.

However, despite the positives of the Single Market, membership in the EU also carries restrictions. The Union is able to regulate standards, laws and practices that can prevent companies from operating as they would wish. Just under half (49%) of CBI members say that the pan-EU employment rights, in areas such as working hours, are a negative for business. A vote to leave the EU would free the UK from this red tape, enabling it to become completely autonomous in the laws and regulations that it sets. Moreover, not having to contribute to the EU budget will mean an immediate cost reduction of around €180 per person in the UK.

A survey of 1,000 UK SMEs by RSA found that over 80% believe European markets are important to future growth. Those campaigning for Britain to exit say there is no reason why SMEs exporting to the EU market would lose their customers after FTAs were signed with member states. It is also possible that if Britain can remain part of the European Economic Area but not the EU – in the same way as Iceland – it would keep all the key economic benefits of EU membership, such as access to the Single Market, without the restrictions of red tape.

Despite a divide in opinion amongst some SMEs, a key finding from the RSA study revealed that SMEs require further guidance and support; 55% suggested the Government is not offering enough support when it comes to dealing with a potential Brexit, while 66% wanted greater clarity on the UK's future role in Europe.

EIB Funding versus EIS Regulation

The UK's thriving SME community has been supported in no small part by private investment. The country's alternative finance sector, which is expanding at pace, has played a key role in enabling businesses to upscale. In 2015, the alternative finance market grew by 84%, delivering £3.2 billion worth of investments, loans and donations.

The Enterprise Investment Scheme (EIS), one of the few government-back initiatives supporting Britain's growing businesses, has been a particularly important funding programme aiding SMEs. Since its launch in 1994, more than £12.2 billion of funds have been raised through the scheme. In 2013/14 alone, 2,795 companies raised a total of £1.56 billion under the EIS, a notable rise on the year before when 2,470 companies raised £1.03 billion. Both investors and SMEs will need to consider whether private sector funding – and in particular the EIS – would be helped or hindered by Britain leaving the EU.

Currently, the EU – through the European Investment Bank (EIB) – does offer some forms of lending to SMEs, which would no longer be available if the UK left. For example, the EIB lent a record €7 billion in the UK in 2014: an increase of 20% compared to 2013, which itself was a 56% increase on 2012. Furthermore, in September 2015 the EIB revealed that it is preparing to lend £100 million to UK small businesses through the peer-to-peer lender Funding Circle, which followed its announcement earlier in the year that it intended to lend £100 million via Santander.

While studies have suggested that lending from European banks to UK SMEs has a limited impact, there is a pertinent second issue. Without the appeal of being part of the EU – and the world's biggest Single Market by GDP – foreign investors might withdraw from investing in British businesses. For example, Li Ka-shing, Hong Kong's richest man who has £34 billion worth of business interests in the UK, warned in March 2016: "If Brexit really happens, we will surely decrease our investments."

However, as with SMEs' freedom to operate, many have proposed the counter argument that Brexit would free the banking and investment sector from EU regulation. This would primarily help the EIS, along with other government-backed schemes.

The EIS has been subjected to many changes over recent years that have come as a result of its need to comply with EU regulation. The major change – a consequence of EU legislation on State aid – has seen the introduction of a new lifetime cap that limits the total amount of EIS funding a company can receive at £12 million, or £20 million for knowledge intensive companies. As of July 2016, EU regulations will also create more red tape, with companies receiving any form of State aid (including EIS investment) over €500,000 having to report their funding to HMRC.

Leaving the EU returns full control over the future of initiatives such as the EIS back into the hands of British policy makers. As IW Capital's research into the intentions of UK investors revealed that 54% of investors with more than £40,000 worth of investments are considering the EIS in 2016/17, granting greater control over the scheme could be crucial for its longevity. Changes to the EIS to comply with EU legislation risk undermining positive sentiment towards the scheme – they could limit the amount that can be invested or the range of companies eligible for funding.

However, conversely, those campaigning to remain in the EU have stated that even if the UK was to become independent, there is nothing to suggest that the Chancellor would conduct any regulatory changes to reverse legislation in this area.

In Summary

Official campaigning by both 'remain' and 'leave' supporters is already well underway and will continue until the day of the vote. During the coming weeks and months, the referendum will feature prominently in news headlines, with regular polls attempting to predict which way the vote will go.

Supporters of both camps would acknowledge that there will be pros and cons of either outcome. There is also a great deal of uncertainty over what Britain outside of the EU would look like, or if the Government can renegotiate different terms for the UK to remain within a reformed Union.

For SMEs, the key issues will focus on how EU membership – or not – will impact their future growth. On the one hand, access to the Single Market is evidently important even to small businesses that export to the continent. However, red tape and the EU's control over working laws are also seen as hindrances to growth. Furthermore, the impact of leaving the EU on funding options available to SMEs is also a pertinent point; EIB funding and foreign investment would likely decline, but in return the UK would gain greater control over its increasingly important alternative finance sector and, in particular, the EIS.

Thursday 23 June will be a landmark day in Britain's political and economic history – entrepreneurs and investors must assess which outcome better suits their long-term plans in time to cast their vote. Like the FSB and BCC, IW Capital will remain impartial during the build-up to the referendum. Moreover, we will endeavour to inform the investors and high-growth businesses that we work with about pertinent news, research and developments surrounding the Brexit debate to help empower them to make their own decision.

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