Brexit can have profound implications for firms on both sides of the Atlantic

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Brexit is a monumental event that is likely to have serious consequences, raising challenges while creating international business and entrepreneurship opportunities for companies around the globe. This effect is likely to be felt acutely by North America, which has historically maintained strong political, cultural and economic relationships with the UK. The June 23, 2016 UK vote to exit the EU gives rise to the question of how Brexit will affect these long standing relationships between North American and the UK companies.

A key source of concern centers on the continuing existence of the UK itself as a political entity, with Scotland signaling its intent to seek independence. Likewise, Northern Ireland is debating its interest in leaving. There is further uncertainty as to whether and if so how the UK will in fact leave the EU. Regardless of the outcomes of these potential moves, Brexit is likely to unleash fundamental changes in the British business environment that will profoundly alter the dynamics of the relationship with the EU, North America and, in fact, the rest of the world.

Our recent paper provides an overview of the international business and entrepreneurship implications of Brexit. Our perspective is preliminary and based on a review of the practitioner, policy, and academic literature over the first month following the Brexit vote. We highlight some of the potentially negative consequences for markets in the UK and around the world that result from barriers to trade and immigration associated with the uncertainty created by Brexit.

North American companies will want to retain their strong and mutually beneficial relationship with the EU, already one the world's biggest markets, with advanced technologies and highly skilled and educated labor force. The future of the relationship between the UK and both the EU and North America is less clear and very hard to predict.

Perhaps a new round of negotiations may lead to a mutually beneficial agreement among these groups. Such an agreement may take time and considerable effort to reach. In the meantime, it is easy to see that Brexit will influence how and where UK companies and entrepreneurs carry out their businesses or even create new companies as well as how incumbent UK companies and new ventures interact with their North American counterparts, traditionally among the most important and valued partners.

In particular, large UK and North American companies are among the world leaders with operations spanning the globe; they are also the source of innovative technologies and marketing and managerial practices. They often set the rules of competition in their industries. These companies thrive on innovation, which is the source of their global advantage.

In recent years, these companies have actively sought innovations from all sources outside their operations but especially from younger entrepreneurial companies. Toward this end, these multinational companies have actively invested in startups using corporate venture funds, developed partnerships with these companies in the form of technology and other types of alliances, and built accelerators that offered startups support in pursuit of rapid expansion and growth. They have also acquired some of the world's most technologically promising, vibrant entrepreneurial companies. Because of this growing and intimate relationship between larger companies and startups and the interconnectedness of the global economy, Brexit can have profound implications for companies on the two sides of the Atlantic.

For decades, UK, Canadian and US companies have been collaborators as well as competitors. The UK is an important partner for US companies, with 9 per cent of foreign affiliate profit derived from the UK since 2010. The picture is somewhat different for Canada where the UK represents only 2.5 per cent of the overall trade volume, and therefore Brexit is expected to have less of a damaging effect at least in the short term. The question now is, how will Brexit change this?

Some see positive changes. For example, North American companies can benefit greatly from Brexit. Specifically, the UK will be free to directly negotiate a set of mutually beneficial conditions for their companies and US and Canada. Costs of operations are also likely to decline because the tariffs, regulations and barriers imposed by the EU will be streamlined or even removed, making the flow of commerce easier and faster.

The declining value of the pound could also encourage international expansion by North American companies, especially through exports. However, the decline of the value of the pound relative to the US dollar can harm global business. This negative effect will most likely be felt by young and smaller companies operating in UK markets or exporting to them. It may delay entry into the UK market in particular by Canadian and US multinationals.

Facing uncertainty, some of these multinationals have already expressed concern about declining profit margins causing them to reconsider the attractiveness of the UK as a place of business. Some are contemplating retrenching their operations, laying people off, discontinuing operations, and keeping expansion plans on hold. Currency and political fluctuations are driving these concerns. Academic evidence recently published in Finance Research Letters (see also this paper and another related paper) finds that Brexit had an overall negative effect on the share price of companies located both in England and in continental Europe, but the UK companies experienced significantly worse performance relative to continental Europe. Abnormal returns of companies in the UK fell by over 10 per cent on average, while abnormal returns of companies in continental Europe only fell by around 1 per cent on average over the 10 days after the Brexit vote.

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Notes:

- *This blog post is based on the authors' paper International business and entrepreneurship implicatons of Brexit, British Journal of Management , Volume 27, Issue 4, October 2016 Pages 687–692*
- *The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*

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