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Five Board Questions on Brexit

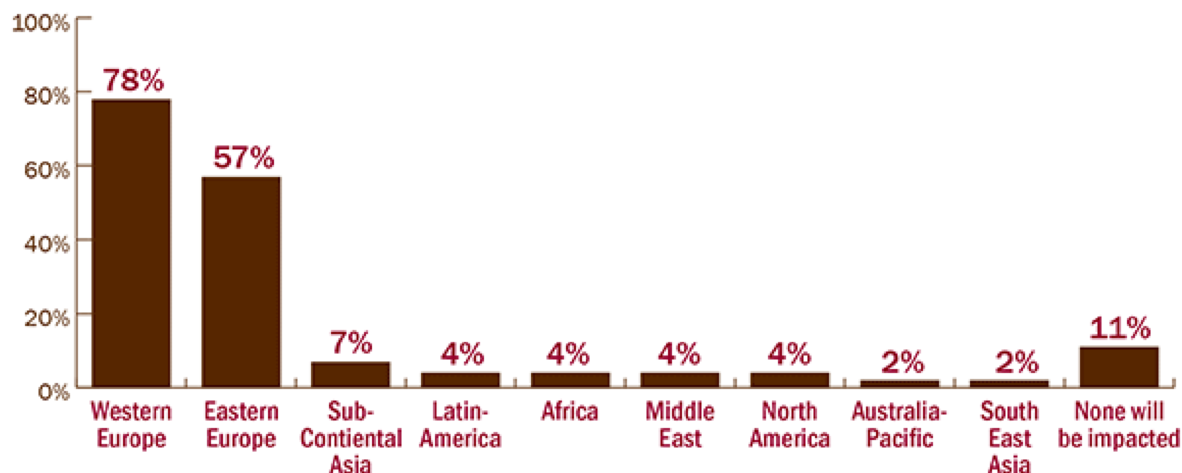
By Melissa J. Anderson July 5, 2016

The U.K.'s referendum vote to leave the European Union shocked markets and political observers who didn't see it coming. Now, boards are being urged to address Brexit risk while also heeding it as an example of how political instability can affect big business.

Global stocks plunged following the Brexit vote on June 23, with the FTSE 250 falling almost 14% in the two days following the vote and the Dow losing 900 points in the same time span. The markets appeared to have regained their losses and stabilized by the time *Agenda* went to press, but both **S&P** and **Fitch** downgraded the U.K.'s credit rating to AA, while **Moody's** cut the U.K.'s credit rating outlook to negative. The U.K. is expected to see a recession by the beginning of 2017, and the financial contagion could spread to the U.S., according to a report published by **Goldman Sachs** last week. In fact, a recent survey by **FTI Consulting** shows that 100 global institutional investors with more than $8 trillion in assets under management believe that Western Europe is the most likely region to experience a recession if Britain leaves the EU (78%) and Eastern Europe would be the next most likely region (57%) to suffer an economic downturn after Brexit.

Regional Impact of Brexit

In which regions would you expect an economic downturn should the UK leave the EU?*



*Base (Global Institutinal Investors) n=100 with more than $8 trillion under management
Source: FTI Consulting

Experts are also anticipating effects on capital investments, currency valuations, human capital, legal agreements, M&A, taxes, trade and more, especially for companies with exposure to the U.K. or EU. It will take at least two years for the details of Brexit to be worked out, so companies can expect continuing uncertainty.

Directors should raise the Brexit issue at their next board meeting, experts say, to ensure their company is positioned to manage expected and unforeseen risks stemming from the U.K.'s pending EU departure.

"Business likes certainty, and businesspeople always complain that political decisions are creating uncertainty. This is the most extreme example," says **Paula Stern**, a former chairwoman of the **U.S. International Trade Commission** who has served on over a dozen public company boards. Stern is currently a member of the advisory board of Zurich-based **LafargeHolcim**.

Boards of companies with significant business or investments in the U.K. should approach Brexit in the same way they considered crisis management following the business effects of the Sept. 11, 2001, terrorist attacks or the supply chain interruption caused by the 2011 tsunami in Japan, she says.

"But this was a self-imposed crisis, not an act of nature nor an act of terrorism," she says. "This was a vote taken on a democratic basis … to go backwards, not forward, economically."

Here, governance and risk management experts share their views with *Agenda* on five key questions that directors and officers should address at their next board meeting to effectively oversee Brexit risk.

1. How will Brexit affect our operations?

Sources have offered a laundry list of potential operational effects Brexit could have — from scuttling tax inversions to hindering talent recruitment. Companies with significant operations or investments in the U.K. should review their operations thoroughly.

Whether multinationals have headquarters, factories or a major marketing center in the U.K., boards should ask whether the calculations that went into the decision to establish those operations still make sense, Stern says. There are other attractive locations in Europe, she suggests.

"People can say, 'Let's muddle through and see if the politicians can mitigate this disaster,' but business can't wait," she says. Boards have to oversee decisions on the most efficient place to pay taxes, the best places to invest in real estate, and other strategic concerns. The EU and U.K. are considering several different models for their future relationship, and boards should be prepared for any of them, Stern says.

Finally, boards should also be sure to consider changes to trade rules, Stern adds.

"There are potentially all kinds of scenarios," she says. "The rules of the road are now negotiable."

2. Is our board poised to address this risk?

It appears that many large companies were caught off guard by the outcome of the vote. For instance, in April, the *Financial Times* reported that only a quarter of FTSE 250 board chairs or audit committee chairs had discussed the Brexit vote with management. In the U.S., only a handful of companies have filed 8-K disclosures alerting investors to Brexit risk exposure.

"The idea that boards were not discussing the threats and opportunities relating to something so major on a global scale is alarming," says board strategy and governance advisor **Alice Korngold**, author of

The Handbook of Board Governance: A Comprehensive Guide for Public, Private and Not for Profit Board Members.

“How is it that the board is not asking management for scenario planning or contingency planning on something that would have such a significant effect on the company?” she asks.

The answer may lie in the board’s composition, Korngold says.

“With more diverse boards, the group as a whole is better informed about a variety of issues, but also you have a higher likelihood that people will raise questions because they have different backgrounds — they’re not all in the same club,” she says. “The situation really shows the red flags, the hazards, of a lack of board diversity.”

3. Are we overreacting?

Meanwhile, not every company will be directly affected by the Brexit vote, warns **Franklin Miller** principal at the **Scowcroft Group** and a director at **EADS** North America and the **Sandia Corporation**. Even companies in the U.K. and EU have yet to see how the legal details of the U.K.’s exit from and future relationship with the EU will shake out. Since those details won’t become clear for at least two years, it’s important that companies don’t jump the gun and create bigger risks by making rash decisions, Miller says.

“It all depends on how the divorce is negotiated, doesn’t it?” he asks.

Technocrats in the EU seem to be taking a hardline approach to the breakup negotiations, while Miller hopes political leaders like **Angela Merkel** and **Francois Hollande** will offer more amenable terms to the U.K.

“The technocrats are probably on a path to sink the EU, so there needs to be some political horse sense injected into the overall situation,” Miller says.

Similarly, Miller is advising a wait-and-see approach for U.S. companies.

“Domestic boards could make all sorts of assumptions and waste all sorts of time,” he says. “Until we learn how the playing field will lay out — whether it’s soccer or baseball — it doesn’t make a great deal of sense” to make changes now, he says.

4. What are the downsides and upsides?

Boards should request a Brexit report from management on how the new geopolitical situation affects the company’s strategic plan with facts and figures, potential impact and go-forward options, recommends **Andrea Bonime-Blanc**, CEO of **GEC Risk Advisory** and author of *The Reputation Risk Handbook*.

“[C]ompanies need to look on the bright side as well, and in addition to asking about risk impact, it is the responsibility of the board to ask management to find opportunities to take advantage of Brexit from a revenue-enhancing standpoint,” Bonime-Blanc writes in an e-mail.

5. How are we monitoring government relations and geopolitical risk?

Doug Chia, executive director of the **Conference Board** Governance Center, says boards should press management on how they are managing government relations outside the U.S. in recent years.

“There’s a big focus on government relations programs, but I think most U.S.-based companies focus their resources on U.S. government relations and what goes on on Capitol Hill and in certain states,” he says.

“Boards need to understand more about how companies are set up to stay on top of and potentially influence decisions happening in London and Brussels,” Chia says.

Boards should also find out what the company is doing to monitor other geopolitical risk that could affect their company, advises Bonime-Blanc, who was the founding global chief ethics and compliance officer for the global media company **Bertelsmann**.

“[A]nd if it hasn’t done a good job to date [of monitoring geopolitical risk], what is it going to do to factor this potentially strategic risk into its ERM and strategic considerations?” she writes.

Indeed, several sources commented that if the Brexit vote could catch corporate management off guard, perhaps executives are out of touch with similar political forces gathering in the U.S. and other countries.

“[Corporate directors and executives] have to be listening and becoming more cognizant of the kind of anger that is generating some of these really unfortunate political outcries and outcomes,” says Stern.

“There was a time in the U.S., particularly after World War II, when business leaders were the strong proponents of the creation of the EU and the importance of taking down trade barriers, barriers to commerce and barriers to prosperity. They played an incredibly important leadership role, and I think corporate America should step up to that example,” she says.

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