

# COSTS UP, PRICES UP

BREXIT'S IMPACT ON CONSUMER  
BUSINESSES AND THEIR CUSTOMERS



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# INTRODUCTION

Brexit outcomes remain uncertain because a variety of future trading relationships between the European Union (EU) and the United Kingdom (UK) are still possible. We have investigated how different Brexit scenarios will affect UK consumer companies and their customers, with the aim of helping shoppers and businesses understand what each Brexit outcome will mean for them. This report looks at five of the most frequently-discussed Brexit outcomes, each of which has different levels of tariffs, red tape, and labour costs (see Exhibit 1).

Tariffs and red tape on imports and labour costs all contribute to the price paid for a product or service. All three of these may change after Brexit and our work measures the complex interactions between them. To give an accurate and highly detailed assessment of how consumer businesses and their customers will be affected under each Brexit scenario, our analysis factors in how cost increases can be passed on between businesses, eventually leading to higher prices for the shopper (as illustrated in Exhibit 2).

In our work, non-tariff barriers to trade in goods (the “red tape” costs) are estimated at a granular level by considering both behind-the-border costs (for example, dual certification of electronics or chemicals, pre-shipment inspections of chemicals, and protection of geographical indicators) and at-the-border costs (such as time delays, cost of import or export declarations, and administrative burdens).

This report provides an overview of some of the key findings, explains the drivers behind them, and discusses what mitigating actions might be possible.

In Part 1, we quantify how each scenario will affect household bills and consumer costs, both with and without free trade deals. We also show examples of these costs broken down by sector (food shopping and utilities, among others) under each scenario and by different household income.

In Part 2, we give examples of how and why consumer sectors such as grocery, general merchandise retail, restaurants, and utilities will each be affected differently under any Brexit scenario. We illustrate businesses’ options for putting up prices and the knock-on effects this is likely to have on sales, volumes, and revenues.

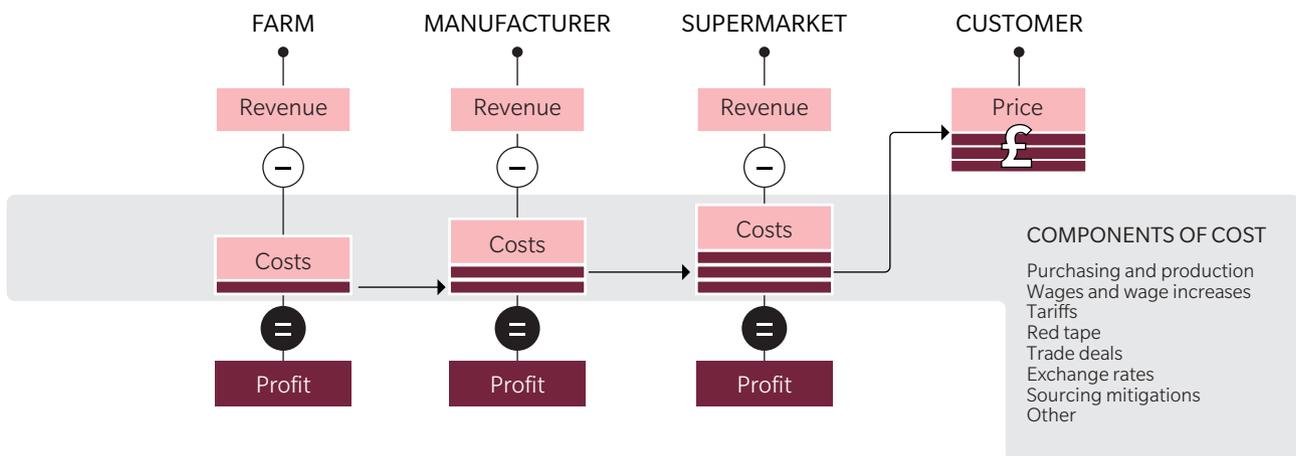
Exhibit 1: Characteristics of the five Brexit scenarios explored in this research

SCENARIO	1	2	3	4	5	
<b>KEY COST COMPONENTS</b>	Significant red tape	Moderate amount of red tape	Moderate amount of red tape and increased labour costs	Global WTO tariffs, significant red tape, and increased labour costs	Unilateral zero tariffs, significant red tape, and increased labour costs	
<b>IMPORT TARIFFS</b>	<b>EU TARIFFS</b>	Zero	Zero	Zero	High	Zero
	<b>TARIFFS FOR TRADE WITH THE REST OF THE WORLD</b>	High	High	High	High	Zero
<b>RED TAPE</b>	Significant	Low	Low	Significant	Significant	
<b>LABOUR IMPACT</b>	No impact	No impact	Model includes an increase in labour costs	Model includes an increase in labour costs	Model includes an increase in labour costs	
<b>PLAUSIBLE BREXIT DEALS THAT COULD CREATE EACH SCENARIO</b>	Out of Customs Union	Bespoke customs deal	Bespoke customs deal	Out of Customs Union	Out of Customs Union	
	In Single Market	Bespoke Single Market deal	Out of the Single Market	Out of the Single Market	Out of the Single Market	

NOTES:

- WTO: World Trade Organization.
- Based on information from the European Free Trade Association, 28 percent of the UK's imports from non-EU countries are covered by existing EU free trade agreements. We assume that these are distributed evenly across all import types.
- For scenarios where a change in labour cost is anticipated, we have modeled the impact as an increase of 16 percent for agricultural and hospitality workers, 8 percent for other unskilled workers, and as zero for skilled workers. This is based on a range of estimates of the potential labour cost increase due to reduced immigration.
- All scenarios assume that businesses will shift some of their sourcing if non-EU sourcing becomes relatively cheaper than EU sourcing.
- The effects of changes in exchange rates have been modeled separately, due to their high magnitude.

Exhibit 2: Cost increases from Brexit will be passed on between businesses as price rises, leading to higher prices for shoppers



SOURCE: Publicly available data, such as annual reports; Oliver Wyman analysis.

## PART ONE: COSTS TO CONSUMERS

Our analysis of the five scenarios reveals costs will increase for consumers after Brexit (Exhibit 3). The increase ranges from £245 per year under Scenario 2, through to £961 per year under Scenario 4.

In addition, a devaluation of the pound will increase costs further. Each 5 percent devaluation in the pound (versus euros and US dollars) increases household costs by £380 per year, equivalent to 1.6 percent.

Exhibit 3: Change in household costs under each Brexit scenario

SCENARIO	KEY COST COMPONENT	CHANGE IN ANNUAL HOUSEHOLD COSTS	CHANGE IN ANNUAL HOUSEHOLD COSTS
1	Significant red tape	£380	+1.6%
2	Moderate amount of red tape	£245	+1.0%
3	Moderate amount of red tape and increased labour costs	£631	+2.6%
4	Global WTO tariffs, significant red tape, and increased labour costs	£961	+4.0%
5	Unilateral zero tariffs, significant red tape, and increased labour costs	£613	+2.5%

SOURCE: Oliver Wyman analysis.

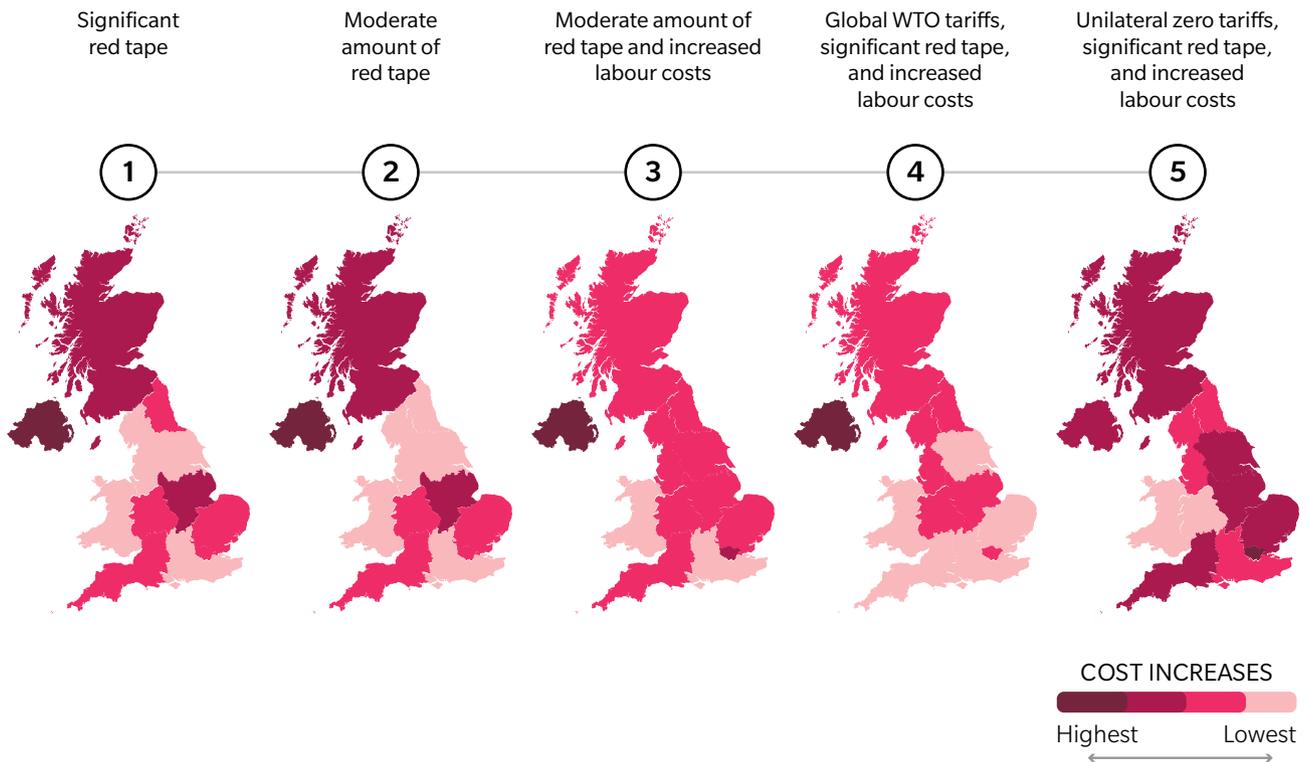
We looked at a range of everyday cost increases for consumers under each scenario. We found that if the UK reverts to WTO most-favoured nation (MFN) import tariffs (Scenario 4), the price of a typical weekly grocery shop would go up by £5.50 (totaling £280 across the year), the price of a family meal for four at a high-street restaurant chain would increase by £9, and a pair of trainers would become £6.75 more expensive.

The effect of rising costs will vary by household. For instance, lower-income households typically spend proportionally more of their income (after housing costs) on groceries, 17 percent compared to 9.4 percent for the highest earners. Should we see the highest increase in grocery costs (7.8 percent under Scenario 4's global WTO tariffs, significant red tape, and increased labour costs), lower-income households will be slightly more affected: Those earning the least will see their overall costs increase by 3 percent more than those earning the most.

In contrast, higher-income households spend more on services, such as entertainment and hospitality, so are more affected by scenarios where labour costs increase, such as Scenario 3 (moderate red tape and increased labour costs). Under this scenario, overall costs for the highest earners will increase by 4 percent more than the lowest earners.

Regionally, we will see a difference in household cost increases after Brexit. This is driven by the differences in spending patterns and income (see Exhibit 4).

Exhibit 4: Regional differences in changes in household costs under each Brexit scenario



SOURCE: Oliver Wyman analysis.

Exhibit 5: Cost changes for different households under Brexit Scenario 4 (Global WTO tariffs, significant red tape, and increased labour costs)

NAME	TOM	AIMEE	MO
LOCATION	BELFAST	LEEDS	LONDON
JOB	Office assistant	Junior doctor	Banker
Monthly outgoings after housing costs	£1,000	£2,000	£3,000
Annual increase in food and drink costs	£165	£280	£398
Annual increase in transport costs	£62	£134	£178
Annual increase in clothing costs	£45	£56	£91
Annual increase in restaurant and hotel costs	£88	£167	£291

SOURCE: Oliver Wyman analysis.

## HOW FREE TRADE DEALS COULD AFFECT CONSUMERS

After Brexit, the UK may be able to sign free trade deals with non-EU countries. In our analysis, we modeled this by reducing import tariffs from non-EU countries to zero. We found that zero tariffs on imports from outside the EU would only mitigate 20–45 percent of any household costs increases from Brexit. Costs will still go up by between £130 and £760 per year (0.6–3.1 percent), shown in Exhibit 6.

Under all likely Brexit scenarios, there will always be a change in the UK's relationship with the EU Customs Union, even with a bespoke deal. As such, red tape costs will rise for imports from the EU. Even if relatively small, this will increase the price of many products imported from the EU.

At the same time, as tariffs fall, imports from the countries now covered by the free trade deal would become cheaper. Consequently, some companies will shift their sourcing away from countries in the EU Customs Union to these other suppliers.

However, under any deal, even with zero tariffs and companies switching their sourcing to the lowest-priced suppliers, the additional costs from the new red tape on imports from the EU Customs Union outweigh the benefit of removing tariffs.

Exhibit 6: How introducing zero tariffs with non-EU countries will affect household costs under each Brexit deal

SCENARIO	KEY COST COMPONENT	CHANGE IN ANNUAL HOUSEHOLD COSTS	CHANGE IN ANNUAL HOUSEHOLD COSTS
1	Significant red tape	£380	+1.6%
	Significant red tape <b>plus zero tariffs on imports from outside the EU</b>	<b>£255</b>	<b>+1.0%</b>
2	Moderate amount of red tape	£245	+1.0%
	Moderate amount of red tape <b>plus zero tariffs on imports from outside the EU</b>	<b>£134</b>	<b>+0.6%</b>
3	Moderate amount of red tape and increased labour costs	£631	+2.6%
	Moderate amount of red tape and increased labour costs <b>plus zero tariffs on imports from outside the EU</b>	<b>£493</b>	<b>+2.0%</b>
4	Global WTO tariffs, significant red tape, and increased labour costs	£961	+4.0%
	Significant red tape and increased labour costs <b>plus zero tariffs on imports from outside the EU</b>	<b>£758</b>	<b>+3.1%</b>
5	Unilateral zero tariffs, significant red tape, and increased labour costs	£613	+2.5%

SOURCE: Oliver Wyman analysis.

## HOW CONSUMERS COULD MITIGATE THE COST OF BREXIT

Consumers will have little choice but to absorb price rises. As a result, we expect they will look to reduce or remove less essential purchases, for example taking shorter or cheaper holidays, or not travelling at all.

On essential purchases like food, consumers will become more price sensitive and will shop around for the best prices. It will be particularly important for those on lower incomes to seek out the best prices for groceries, since these make up a major part of their household bills.

## PART TWO: COSTS TO CONSUMER BUSINESSES

Without passing costs on to consumers, the average change in earnings before interest, taxes, depreciation, and amortization (EBITDA) for consumer-facing businesses under the different Brexit scenarios would be between -1.1 points for Scenario 2 and -4.2 points for Scenario 4 (as shown in Exhibit 7).

Exhibit 7: Change in EBITDA for consumer businesses under each Brexit scenario

SCENARIO	KEY COST COMPONENT	MEAN CHANGE IN EBITDA (PERCENTAGE POINTS)
1	Significant red tape	-1.6
2	Moderate amount of red tape	-1.1
3	Moderate amount of red tape and increased labour costs	-2.7
4	Global WTO tariffs, significant red tape, and increased labour costs	-4.2
5	Unilateral zero tariffs, significant red tape, and increased labour costs	-2.8

**NOTE:** All scenarios assume that businesses will switch purchasing away from the EU if non-EU prices become cheaper (see Exhibit 8) and that businesses do not pass increased costs on to consumers.

**SOURCE:** Oliver Wyman analysis.

Given how significant these decreases in EBITDA are, many businesses will maintain their profit margins by increasing their prices. As consumers have finite resources, we expect to see overall spending drop in more discretionary sectors. For example, because of the necessity of food and drink, people will continue to buy groceries even if prices rise, but they may choose cheaper alternatives. In contrast, we're more likely to see people cut back on holidays and eating out, which will affect the earnings of travel operators, restaurants, and the hospitality sector. Exhibit 8 illustrates how businesses could pass the cost increases on to customers. It also shows how these price rises will affect their sales volumes and revenues.

## Exhibit 8: Selected business outcomes under each scenario

SCENARIO 1: SIGNIFICANT RED TAPE			
SECTOR	PROFIT DROP	PRICE RISE REQUIRED TO MAINTAIN PRE-BREXIT PROFIT	RESULTING VOLUME DECLINE
Restaurant	-6%	1.1%	-2%
General merchandise retailer	-37%	3.6%	-5%
Food retailer	-55%	3.3%	-2%

SCENARIO 2: MODERATE AMOUNT OF RED TAPE			
SECTOR	PROFIT DROP	PRICE RISE REQUIRED TO MAINTAIN PRE-BREXIT PROFIT	RESULTING VOLUME DECLINE
Restaurant	-4%	0.7%	-1%
General merchandise retailer	-23%	2.2%	-3%
Food retailer	-37%	2.3%	-1%

SCENARIO 3: MODERATE AMOUNT OF RED TAPE AND INCREASED LABOUR COSTS			
SECTOR	PROFIT DROP	PRICE RISE REQUIRED TO MAINTAIN PRE-BREXIT PROFIT	RESULTING VOLUME DECLINE
Restaurant	-32%	5.7%	-10%
General merchandise retailer	-42%	4.1%	-5%
Food retailer	-71%	4.3%	-2%

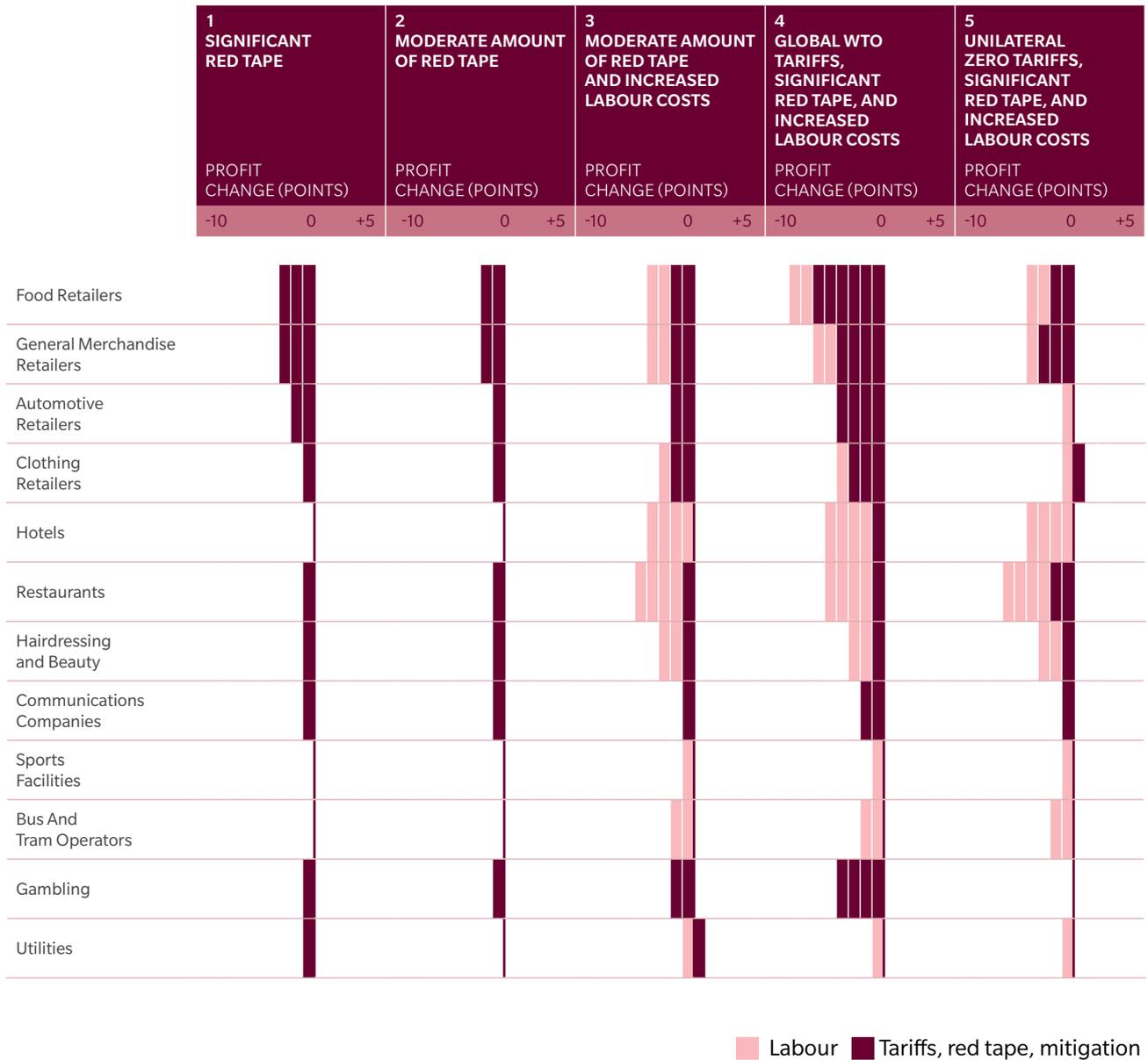
SCENARIO 4: GLOBAL WTO TARIFFS, SIGNIFICANT RED TAPE, AND INCREASED LABOUR COSTS			
SECTOR	PROFIT DROP	PRICE RISE REQUIRED TO MAINTAIN PRE-BREXIT PROFIT	RESULTING VOLUME DECLINE
Restaurant	-38%	6.6%	-12%
General merchandise retailer	-64%	6.1%	-8%
Food retailer	-128%	7.8%	-4%

SCENARIO 5: UNILATERAL ZERO TARIFFS, SIGNIFICANT RED TAPE, AND INCREASED LABOUR COSTS			
SECTOR	PROFIT DROP	PRICE RISE REQUIRED TO MAINTAIN PRE-BREXIT PROFIT	RESULTING VOLUME DECLINE
Restaurant	-32%	5.7%	-11%
General merchandise retailer	-48%	4.6%	-6%
Food retailer	-71%	4.3%	-2%

SOURCE: Oliver Wyman analysis.

Each Brexit scenario affects each business sector differently, depending on the composition of those businesses' cost base. For example, a large proportion of a restaurant's costs are wages, so these businesses will be more exposed in Brexit scenarios that include increased labour costs as a factor. Meanwhile, those selling general merchandise, such as DIY, electronics, and white goods, will be affected more by additional import costs, meaning they will be disproportionately exposed in scenarios where tariffs and red tape increase. Exhibit 9 shows each sector's profit change under the five Brexit scenarios.

Exhibit 9: Impact on consumer business sectors by Brexit outcome



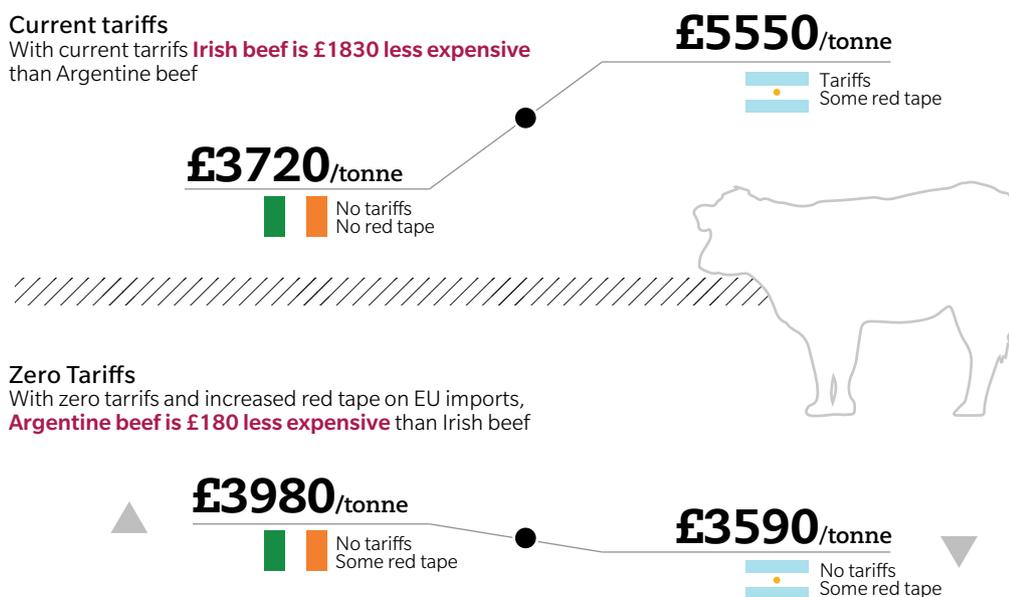
SOURCE: Oliver Wyman analysis.

## HOW CONSUMER BUSINESSES CAN PREPARE FOR BREXIT

Without knowing what the Brexit outcome will be, the first step to mitigating the impact of any scenario is to understand the business' cost base and the major risks it could face, particularly in where its goods are sourced from (UK versus EU versus non-EU) and to what degree it is exposed to labour cost increases.

Where a business is vulnerable to changes in import costs, such as clothing retailers, an agile supply chain will be necessary to enable purchasing to quickly switch between suppliers in different countries as quickly as possible to ensure the best prices. For example, Exhibit 10 shows that under Scenario 5, the cost of beef imported from Ireland – used in mass catering and ready meals – will increase. As such, beef importers will switch to Argentine beef, at least until UK beef farmers can meet the increased demand.

Exhibit 10: Supply chains need to be flexible to adapt should import tariffs change



NOTE: Wholesale prices; based on implementing zero import tariffs unilaterally post-Brexit.

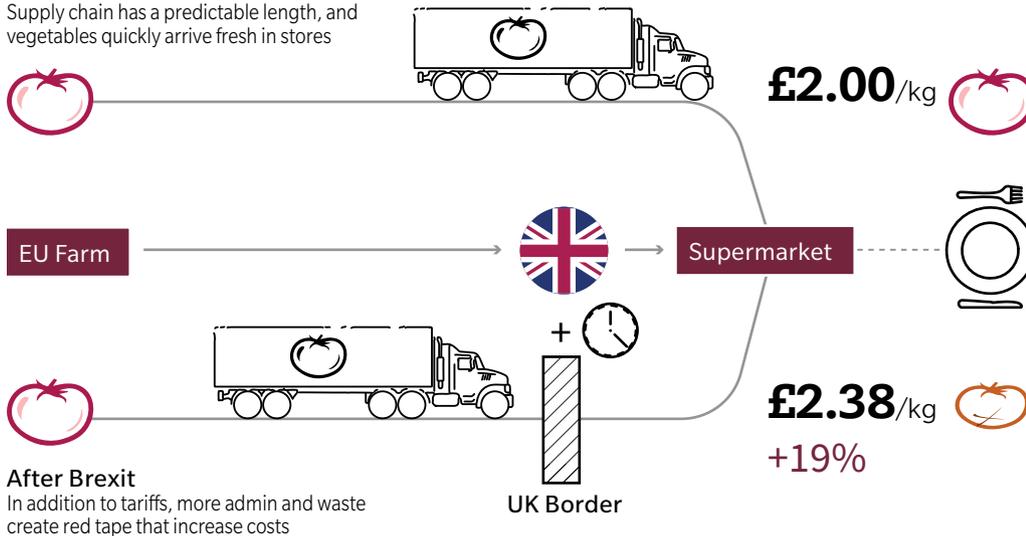
SOURCES: Agriculture and Horticulture Development Board (AHDB) beef prices; Oliver Wyman analysis.

In addition to responding to tariff changes, businesses must consider red tape in their sourcing decisions. For example, businesses reliant on imports of fresh produce will be vulnerable not only to tariff changes and additional costs from border paperwork, but also higher waste and shortages should there be border delays that cause the fresh produce to perish before reaching its destination (see Exhibit 11).

## Exhibit 11: How red tape could add costs to imports

### Current situation

Supply chain has a predictable length, and vegetables quickly arrive fresh in stores



### After Brexit

In addition to tariffs, more admin and waste create red tape that increase costs



SOURCES: WTO Tariffs, Oliver Wyman analysis.

NOTE: Based on the UK being outside the Customs Union post-Brexit. Red tape costs assumed to be 6.9 percent for all geographies outside of the Customs Union.

To minimise exposure to labour costs increases, businesses should ensure employees are spending their time on essential tasks and those valued by customers, and that they complete these tasks with optimum efficiency. For example, many head office tasks currently require manual data processing. These tasks can be automated, reducing labour costs and giving faster, more accurate results.

To remain attractive to customers and maintain demand in an increasingly competitive market, consumer businesses should look to differentiate themselves from the competition. They could entice customers with new, unique products and services, for example: teaching healthy cooking, or how to safely use a power tool they may be interested in buying. Innovative businesses may find ways to combine this with reducing labour costs, for example the novelty and customizability of assembling your own unique pizza, or virtual reality cosmetic testing at home.

It is unlikely that it will be possible to mitigate against all cost increases, so businesses will have to decide how much of the additional costs from Brexit they can afford to pass on to consumers, while staying aware of how their competitors are responding. As consumer costs increase and people in the UK become more price sensitive, even those sectors relatively protected from Brexit cost increases, such as telecoms and utilities (see Exhibit 8), will see consumers easily tempted away by deals that are only slightly better.

## CONCLUDING REMARKS

This research follows on from our report "[The Red Tape Cost of Brexit](#)," published in partnership with Clifford Chance. The report estimated the costs of leaving the EU, the Customs Union, and the Single Market for the UK and EU27 economies. By taking this analysis further and modeling not one but five different Brexit scenarios in more detail, we hope to be able to inform consumers and consumer businesses about their medium-term financial health and help them prepare for the different outcomes of Brexit.

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