

Business, Energy and Industrial Strategy Committee

Oral evidence: Leaving the EU: implications for the automotive industry, HC 379

Tuesday 14 November 2017

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Watch the meeting

Members present: Rachel Reeves (Chair); Vernon Coaker; Peter Kyle; Mark Pawsey.

Questions 1 – 132

Witnesses

I: Mike Hawes, Chief Executive, Society for Motor Manufacturers and Traders; Patrick Keating, Government Affairs Manager, Honda Motor Europe; Mark Wilson, Chief Financial Officer, Aston Martin.

II: Chris Saunders, Director of Group External Relations, GKN plc; Dermot Sterne, Chief Executive, Applied Component Technology.

Examination of witnesses

Witnesses: Mike Hawes, Patrick Keating and Mark Wilson.

Q1 **Chair:** Thank you very much, all three of you, for coming to give evidence to our Select Committee today. As you know, we are looking at the impact of Brexit on a range of sectors, including the automotive sector. We are very pleased that you can join us and looking forward to hearing your evidence. To start, it would be good if you could introduce yourselves, who you are and where you are from. Then we will open it for questions.

Mark Wilson: I am Mark Wilson, executive vice president, chief financial officer of Aston Martin Lagonda.

Mike Hawes: I am Mike Hawes, chief executive, Society of Motor Manufacturers and Traders.

Patrick Keating: I am Patrick Keating, government affairs manager at Honda Motor Europe.

Q2 **Chair:** Thank you very much. If I could start, I am interested to hear from you the extent to which you see decisions around investment being affected by the current uncertainty arising from Brexit. Would you be able to give any examples of that? Mike, we will start with you, from an industry perspective.

Mike Hawes: In terms of investment, you have to look at the context. Since the recession, the automotive industry has done extraordinarily well. It came out of the recession very quickly and successfully. From 2012 to 2015 we were averaging about £2.5 billion per annum in terms of investment. Last year, 2016, that was down to £1.66 billion. We do not have final numbers, but the indications this year are it is less than £1 billion.

Undoubtedly, part of that is cyclical, because just about every plant in the UK had some form of investment. However, you can match that with what we are hearing anecdotally. We have the suggestion that people are often sitting on their hands, waiting for more clarity about what the trading relationship will be with our biggest market.

Q3 **Chair:** You say they are waiting for clarity. How long can they wait before they have to make decisions?

Mike Hawes: Most companies do not just make an investment at one particular point. There are going to be constant investments. Talking to some of our members, it has been suggested that some investments are overdue. People are waiting as long as possible for that clarity. If we look at the timetable with us leaving the EU, the general view is that companies need more certainty by the turn of the year. Contingency



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arrangements will have to be put in place to give you a good 12 months before you start.

Chair: Mark, you were nodding at that point.

Mark Wilson: I would echo everything Mike says. In particular, for Aston Martin for example, we are on a fast growth trajectory at the moment. That implies that we are investing more heavily than we would in the normal cycle. Our product cycle is typically seven years long. We would therefore expect to be investing at least three years in advance of new product cycles.

About 60% of our supply chain is in the EU, with the balance in the UK. As we go through this ramp-up period now, deciding where we will invest in that supply chain is critical. We have gone through a first phase already. We are going through a second phase again and making decisions. Those decisions are happening every day, and we are waiting to see what will be the outcome. Therefore, clarity is absolutely at a premium for us.

Patrick Keating: In terms of contingency and clarity, I would echo what Mike says, that early clarity is required. In terms of our contingency planning, we are looking at two main areas. One is around what happens to the customs border, whether that is in March 2019 or later. Looking at contingency around that, we are thinking about the need to increase the amount of warehousing and the amount of stock that we would have to hold if friction entered the border at that time. That is a year-long process between deciding we need to invest in additional warehousing and going through zoning, planning and investment into that.

Added to that, you need to take account of the internal decision-making procedures and the need to get clearance from Japan. March 2018 is where we would need clarity at least around transition.

The other piece around contingency is regulation, and particularly type approvals. From what we are picking up from the Commission, there is a real risk that, as the UK leaves the single market, the type approvals issued by the VCA, the UK Vehicle Certification Agency, will either no longer hold validity or not be able to be extended. We need to find a way to bridge that gap. Having clarity around how regulation will be treated over the transition period and under the new arrangements would be very useful.

Q4 **Chair:** Mr Keating, you produce cars in this country, and other vehicles, such as motorcycles, around Europe. Is the authorisation all done in this country, or is it done in different countries?

Patrick Keating: It is done in different countries. The vehicles that are manufactured at our factory here at Swindon are authorised by the VCA in the UK, as well as some small-engined equipment, so marine engines and a few lawnmowers. Other products, such as motorcycles and power



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equipment, which are manufactured in Europe, or items that are imported from Japan, have type approval from the Belgian authorities.

Q5 Chair: If the VCA is not recognised in Europe after we leave the European Union, presumably your cars will have to get a different authorisation at the point of sale or something else. Have you thought about how that might work and the additional costs involved?

Patrick Keating: Yes. There are two issues around that point. One is looking to the future, so new models that would come online. There we would have to find a way to work with the UK Government, to ensure that there is mutual recognition of any approvals issued by the UK Government. Equally, any approvals issued by European authorities should be recognised here. That would allow us to continue to be placing vehicles on both markets with a single authorisation and a single set of testing procedures.

However, if that mutual recognition does not come into place and there is some difficulty in managing that, we would have to look for contingency plans. That could be moving type approval activity, for the vehicles we sell into the EU, to another European member state. However, the key issue is more in the short term: what happens to those vehicles that are already type-approved? There we would hopefully have a transitional period, which would keep the same regulatory conditions as we have now. That would allow us to smoothly continue selling the existing models under the existing type approval into the European market, and equally bring those products from Europe into the UK.

Q6 Chair: Mr Keating, are you saying that, if we left without a deal, cars that people own in European countries that have been authorised by the VCA, would not be authorised any more? It is not your problem perhaps, but would that also apply for cars in this country that had been authorised somewhere else other than the UK?

Patrick Keating: Cars currently on the market would not be affected. It is a question of placing new models on to the market in future.

Mike Hawes: Could I add a bit of clarification to that? The point you are getting at is that you produce a vehicle for sale and it is type-approved for the duration of the life cycle of that vehicle. At the moment, if you were to take the certification out now, we know it is valid at least, for as long as we are in Europe, for the life cycle of that vehicle.

If it got to the situation where the UK VCA certification was no longer valid, you would have to seek an alternative approval. There are two implications for that. You are not allowed to hold simultaneous approvals from two authorities. Effectively, you would have to stop production while you applied for your new certification and then start production again. Secondly, when you reapply under this new authority, you have to meet all the changes to regulation that have evolved from when you first



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got that vehicle certification. It may be the regulation has changed to such an extent that you could not pass that regulatory framework.

Mark Wilson: If I could square the circle, for Aston Martin it is far simpler than it is perhaps for Honda and some of the other larger international players. We are a British company. We produce our cars exclusively in Britain and will continue to do so. Without VCA type approval, it really is quite a stark picture for us. We need to make sure that that type approval carries over, with the validity, recognition and equivalence that it has today. Otherwise, there are significant costs involved for us, not only in resourcing to another type approval, as Mike has indicated, but also the semi-catastrophic effects of having to stop production, because we only produce cars in the UK.

Q7 **Chair:** You say catastrophic. What would it mean in practice? Let us say we get to March 2019 and there is not a deal. I know that all your businesses are now beginning to prepare for that eventuality. You hope that does not happen but of course you have to prepare, as businesses. For your business, Aston Martin, what would that mean in March 2019 if we did not have a deal, in terms of those approvals? What would happen?

Mark Wilson: It is difficult to say exactly. Mike just gave an example of stopping production and recertifying to the new type approval, be that the federal US or Chinese type approval, or even trying to retrospectively apply to use the European type approval. That would mean us stopping our production. I suppose we will not get there. I hope we will not get there, because that is exactly what it means for us. It would mean stopping production.

Q8 **Chair:** We would need to have a deal to avoid that happening.

Mark Wilson: We are encouraged by the transitional talks, so there would be transitional arrangements. Clearly, March 2019 is not the end of the end. We suppose there is a transitional arrangement. During that transition, we would have to look as to how Aston Martins were recertified under a non-VCA approval structure.

Q9 **Chair:** You say that would result in a cost of stopping. How much would it cost you every day that you stopped working? Do you have any idea how expensive it would be to seek a new approval?

Mark Wilson: I am very happy to correspond with you privately on that. As you might imagine, that is quite commercially confidential. I am very happy to give the Committee more information.

Q10 **Peter Kyle:** I have one bit of follow up before I go into the main bulk of my questions. Mark and Patrick, you have both mentioned the transition deal. It is clear that a transition deal is now very important to you. Can I ask you to clarify what you think a transition deal is going to mean or involve? What could it conceivably involve? Today in Parliament, in the Commons, we are about to debate a cliff edge at the end of March 2019.



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At that date, the Government have said that we are leaving the single market, we are leaving the customs union, we are leaving EFTA and we have no oversight from the ECJ anymore. We are leaving all the trading environments we have, including the customs arrangements. What are you expecting us to transition from? What is going to be left to transition from, in your opinion and your hopes?

Mark Wilson: That is a very broad question. It rather depends on how the negotiations proceed and what is agreed within all the frameworks that you have just spoken about. If we are leaving everything, as you described, in March 2019, one assumes there would be something to leave to. The absence of knowing what that looks like today, or even the direction of travel, is the difficult piece for us. If we simply go off a cliff edge, that is a very easy scenario to imagine. That is a difficult scenario for all of us. Tariffs, trade and regulation in that scenario would be very difficult to contemplate. Not knowing the direction of travel at the moment, it is difficult to make an intelligent or informed comment in answer to your question.

Q11 **Peter Kyle:** Do you think it is realistic to expect to have the same access and privileges from the customs union and single market from the day after the leaving date that has been set by the Government?

Mark Wilson: Honestly, I do not know.

Q12 **Peter Kyle:** You are making commercial decisions that are going to be profoundly impacted by that. How are you, as a company, preparing or even scenario planning what this is going to look like in a year and four months?

Mark Wilson: In order to prepare, we have to understand the direction of travel, which is why it is really important that we get clarity quickly. I think you will hear the three of us emphasise that as we go through this session today and this afternoon. It is very difficult to scenario plan given an extremely wide range of outcomes, some of which are binary opposites to each other. I do not think it is a very good use of time to do that, because you will just come up with a very broad range of answers. What is really important to allow us to scenario plan effectively is to set a direction of travel and give clarity as quickly as possible.

Q13 **Peter Kyle:** Patrick, I know you want to follow up on that. My fundamental point is that a transition implies we are going to smoothly move from where we are now to another destination. On leaving day, we are going to instantly be in a different place, so we are not transitioning to a different place. We are going to instantly be in a different place, and you are saying you then want to transition somewhere else. How are you preparing for this?

Patrick Keating: In terms of transition for us, the key point is that there should be a single point of change for the way we do business. That point of change should be at the back end of any transitional or implementation period. From our point of view, that implementation



period should be long enough to make all the changes that we need to make. We have touched already on customs. Our customs team says there we will need something in the region of 18 months to bring our own internal systems up to speed. That is when we know what HMRC is going to be working to, where CDS is and all those pieces. We are looking for at least two years, potentially a bit longer. As you say, it is hard to say how long we need it to be.

- Q14 **Peter Kyle:** When I hear what you are saying, the two years is fine. You are saying that we have a transition and we want two years to move towards it. I am saying that the first day of the two years is the problem. In that first day, we are going to wake up in a different economy than the one we had the night before. Then we are going to move somewhere else.

Mike Hawes: The Government have made clear to us that business should make one change. I totally agree with you: that has to be from what the status quo is to what the new arrangements are going to be, if you are only going to have one change. If we look at the benefits that we currently enjoy, the single market, the customs union, they are all the things that help make us competitive. We want to try to safeguard as many of those as possible, but if we leave in March 2019 without any sort of agreement we do not know what we are transitioning to. The long period of change would be more than the transition.

- Q15 **Peter Kyle:** Government have said that they understand your concerns over this, so presumably that means Government have been speaking to all of you about this. Do you get a sense that Government have been listening? Is there any evidence that what they have learnt from you has emerged in the approach to negotiations, as we approach the point where trade is discussed?

Mike Hawes: If we look at the various statements and speeches that have been made since the referendum, our thinking on what the future is going to be like has changed. We have had dialogue with Government. Especially since the last general election, it has accelerated. I would like a much more structured nature to it, but we have been very clear from the outset that we need to safeguard those elements that make us competitive. If we are leaving, we need to, as the Prime Minister has said, try to ensure the benefits of single market membership. These accrue particularly well to automotive—

- Q16 **Peter Kyle:** Can I just stop you there? My question is not about what you aspire to get out of negotiations. Are Government listening to you? I want to know whether the dialogue is good, and whether you get a sense that what you say leads to action within Government in this process.

Mike Hawes: They are definitely listening and we have dialogue. Whether that is leading to action is difficult to say because, as Mark said, we still do not know what the exact nature of that future relationship will



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be. If that future relationship can safeguard all those things that we have described, yes, our message has been received. At the moment there is still that uncertainty. Like any other sector, we go with what we read. Equally, they need to safeguard the interests of a number of different sectors.

Q17 Peter Kyle: When you say, "We go by what we read", other people are reading the newspapers. You have the phone numbers of Ministers and have direct conversations with them, so you should not be waiting to read in the newspapers what is coming out of these. Surely, in a functional set of negotiations on behalf of an industry that is so essential for our economy, what you say should lead to demonstrable change with the negotiations. Do you get the sense that what you say makes it to the frontline of negotiations with this Government?

Mike Hawes: We believe, certainly in the last few months, we have had that engagement. It has been clear from Ministers that they understand the challenge that we face. Hopefully, that will inform the aspiration and the outcome, which is the subject of the trade element of the negotiations with the EU.

Mark Wilson: Just to back up what Mike says there, we have not yet started the trade element of negotiations. That is the critical piece here for all of us. It needs to be started quickly, decisively and with a clear direction of travel and a good outcome in mind. There is plenty of conjecture about what happens along the way. We can all speculate, but until we see the shape, colour and direction of travel for those trade agreements it is very difficult to understand whether we are getting through or not.

Q18 Mark Pawsey: I wonder if I might ask some questions about why trading with the EU is important in the first place. Mr Wilson, you just spoke about needing to see the shape and colour of the negotiations. Why is it important? Could I ask Mike Hawes, first of all? Could you talk to us in global numbers in terms of the size of the industry, number of units and value? Then perhaps each of you could tell us about your individual businesses.

Mike Hawes: The automotive industry is export-led. We export just under 80% of the cars that we produce. Those cars are heavily integrated with Europe in terms of the supply chain. If we export 80% of what we build, 56% of that goes to the rest of the EU. That is about four times bigger than our next nearest market, which is the US, albeit the US is growing, as is Europe in terms of total market. It is our primary market.

It is also the primary market for imports. Around 86% of vehicles that are sold in the UK come from abroad. The vast majority, about 70%, come from the rest of the EU. We are totally integrated in the European automotive industry, in terms of markets for import, export and the supply chain.



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Patrick Keating: From our perspective, Europe is important in two key ways. First, 35% of exports from our factory at Swindon are going into the EU 27 market. That is an important export destination for us. Equally, in terms of imports of componentry into the Swindon factory, 40% of the components we use at Swindon are sourced from the EU. Just to give a bit of colour on that, that is about 2 million components a day coming in on 350 trucks through the Eurotunnel. That is why an arrangement around customs is particularly important to us. The third piece in terms of a future relationship is around the people. Something around 14% of our workforce at the factory and around 30% of our workforce at our head office in Bracknell are EU 27 nationals.

Mark Wilson: About 18% of our sales are in Europe, about 25% in the UK and the rest is international. About 60% of our engineering and bill of materials cost, so that is the design and development of the car in engineering terms, is in the European supply base. Concurrently, about 60% of the bill of materials that goes into building the car is sourced from the European supply base.

I have one more point, which is a semi-trade point, about European talent. About 10% of our workforce is European, but it is a very highly skilled workforce. These are top-class engineers, aerodynamicists, vehicle dynamics engineers. The skill level is high and we need to maintain access to that talent as well.

Q19 **Mark Pawsey:** Sticking to numbers of vehicles, this is probably for Mike, looking at it more globally. Europe sells us many more cars than we sell to it. Is it not in its interest that we get a good deal at the end of the day? Are you members not worried unnecessarily because the European manufacturers are going to be pushing their Governments to get this deal done in order to continue to be able to sell their cars in our market?

Mike Hawes: To put it into context, as I said, 56% of our exports go to Europe. Around about 7% of European exports come to the UK.

Q20 **Mark Pawsey:** It is still a bigger number.

Mike Hawes: It is a big number. It is important, and we are the second largest new car market. We have had many discussions with our European counterparts, sister organisations over there, and they are very clear. Yes, the UK is an important market but what matters more is Europe, the European market and the continuation of the prosperity of that market.

Q21 **Mark Pawsey:** Once we have left the European Union, we will be able to go out and negotiate our own trade deals. Until now we have been part of the EU negotiating team. Why can we not go out and attack those emerging markets, increase our sales, and therefore maintain our levels of production by selling more in other overseas markets?

Mike Hawes: Membership of the EU has not been a barrier to that. If you look at the German car industry, it has pursued those markets with



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alacrity. We would like to see freer trade in some of the newer growing markets, but it is about balance. If we are going to put more barriers up to European trade, you will see a depression in that market, so we need to replace it. Where are we going to replace it with? We are very competitive. The UK automotive industry is very productive, but being competitive is also about making the right products for the market.

To give the best example, the bestselling car in the UK is a Ford Fiesta. The bestselling vehicle in the US is also a Ford, but it is an F-150 pickup truck. I cannot envisage us making pickup trucks for the US market, given logistics and so forth. In volume terms, we tend to make for the markets that are close by. We make models that appeal to European tastes in the market.

We have a strong number of premium sports luxury manufacturers that are global. That is one of the real advantages and attributes of the UK automotive industry. It is incredibly diverse, but substituting the large market of the EU with others would be very difficult.

Q22 Mark Pawsey: This is probably one for Aston Martin, then. If we are going to go out and do our own trade deals, what is stopping you selling many more vehicles in markets such as China? Does the fact that we are part of an EU trade delegation mean that we are not achieving our current potential in sectors like that?

Mark Wilson: China is a good market for us. I would say that now, and I would echo Mike's point that being part of the EU has been no barrier to success in China so far. The opportunities that exist for us in the short and medium term are definitely around FTAs, first grandfathering what we have, so piggybacking on the European FTA agreements and making sure that they are secure. Then from there, to take your point, we need to build on those very quickly, swiftly and of benefit to this country.

There is one more point to make in respect of Aston Martin. In terms of global wealth, we sell into a high-net-worth demographic. That is relatively mature, with the exception of China. China would be an excellent market for us to be on the front foot negotiating early trade agreements with, if that were possible.

Q23 Mark Pawsey: Mr Keating, are there any advantages to Honda in selling Swindon-produced products in other parts of the world?

Patrick Keating: Currently 50% of our production from Swindon goes to the rest of the world. That is something like 44% to the US and about 6% to Japan. That has started to pick up over the last few months, so there are potential advantages to reducing the level of tariffs on trade into the US.

The key point to make around a future trade agreement is that there needs to be an EU-UK agreement as a bedrock to any future trading that we do with third countries. That is particularly when it comes to the supply of components I was just mentioning a few moments ago, but



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around rules of origin as well. Any free trade agreement will have a threshold of about 50-60% of local content to be in your vehicle before you can benefit from those preferential or zero tariffs. One of the challenges we face in the UK is reaching that threshold without being able to count European content as local. The first stage in developing that free trade agreement network is to make sure we have a very good EU-UK agreement in place.

Q24 **Chair:** I wonder what impact WTO tariffs would have on your businesses.

Patrick Keating: The level of WTO tariffs on completed cars is 10% and on components is around 4.5%. If we saw WTO tariffs coming in, there would obviously be an impact on the cost of production, with increased costs on componentry sourced from Europe. The cost of our vehicles exported to the EU would be equally impacted.

I am not really in a situation at the moment to talk about specific numbers, but I am happy to follow up with you in writing afterwards about the direct tariff impact on our products. In general, you would see impacts in a number of ways. One is an impact on our competitiveness.

Q25 **Chair:** Could I ask you what proportion of the components that go into one of your cars that you make in Swindon comes from mainland Europe?

Patrick Keating: 40%.

Q26 **Chair:** What is the average cost of one of your cars made at Swindon?

Patrick Keating: That starts to get into area where I would be happy to follow up with you afterwards.

Q27 **Chair:** What is the average price in the shop of one of the cars that you make?

Patrick Keating: It depends which model you would want to buy. A new Civic will retail you for something in the region of £30,000.

Q28 **Chair:** A bargain.

Patrick Keating: A bargain. I highly recommend you look into it.

Q29 **Chair:** 40% of what goes into—

Patrick Keating: Yes, is sourced from the EU. As I was saying, 35% of the vehicles produced at Swindon are then exported into the EU. The other point to make is that we have some manufacturing footprint in Europe for motorcycles and power equipment. Around 12% of those products are imported into the UK market. Those attract a slightly lower tariff rate. Motorcycles are 8% and power equipment, which is lawnmowers and marine engines, is a 2% tariff. The point to make around tariffs is that they would certainly add cost and have an impact on our business planning.

Q30 **Chair:** The tariff would be something in the order of £2,000 or £2,500



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possibly.

Mike Hawes: We have done some calculations. Across the UK market the imposition of the 10% tariff would result in a sticker price rise of about £1,500 per vehicle. Remember that 86% of the vehicles that come into the UK come from abroad. All of a sudden, they will be facing that 10% tariff. Given the market position, that is likely to be passed through to consumers.

Q31 **Chair:** Mike Hawes, perhaps you could also give us an idea about the average proportion of components that come from mainland Europe.

Mike Hawes: This is where it gets a bit difficult. On average a UK car purchases about 44% of its parts from a UK-based supplier. For the purposes of rules of origin, it is not so much where you purchase that tier one from, but, going upstream, what proportion of that UK componentry actually comes from the UK.

Q32 **Chair:** We will come on to the FTA, rules of origin and cumulation in a bit. Patrick Keating is saying 40% of the components for a Honda made in Swindon come from mainland Europe. Is that about average for the industry?

Mike Hawes: On average, 56% come from abroad.

Q33 **Chair:** Is it right that 56% of the components of cars made in this country are purchased from abroad?

Mike Hawes: Yes.

Q34 **Chair:** The tariffs on those are 4.5%, Mr Hawes. What would that mean in terms of the increased cost? You said £1,500 on average on a tariff for exporting the car.

Mike Hawes: That is on the finished vehicle imported.

Q35 **Chair:** Yes. What about for the increased cost of the imports?

Mike Hawes: That is an extraordinarily difficult thing to calculate, because there are certain mitigation measures you can take. However, it is not so much about the tariffs on parts; it is the complexity about shifting parts around.

Q36 **Chair:** Is it perhaps about £300 for the cost of the components?

Mike Hawes: Yes, potentially.

Q37 **Chair:** You are talking about the cost of that car going up by about £1,800.

Mike Hawes: The £1,500 was an average, on the vehicle.

Q38 **Chair:** £1,500 is the tariff for exporting it, but then there is also the increased cost—



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Mike Hawes: No, that is the tariff for importing it. That will be the effect on the showroom price, as it were.

Q39 **Chair:** I understand that, but also to make the car itself is more expensive because the cost of what is going into it is now more expensive by about £300.

Mike Hawes: Correct. Exporting you would have to absorb the tariff on the finished vehicle and any tariffs that were due on the parts.

Q40 **Chair:** The impact of WTO rules would be about £1,800 per vehicle.

Mike Hawes: It would be significant, yes.

Q41 **Chair:** You were going on to talk about the rules of origin, and we will come on to that later. I expect that Honda and Aston Martin would not want to say this, but, Mr Hawes, on average what would be the profit margin on a UK car being exported?

Mike Hawes: Manufacturing is a low-margin business. It is generally understood that manufacturing plants aim for 2% to 4% return on investment.

Q42 **Chair:** If they are exporting a car that is £15,000—

Mike Hawes: You are pretty quickly into negative numbers.

Q43 **Chair:** You are talking about a couple of hundred pounds' profit per car, on average.

Mike Hawes: On the manufacturing, yes.

Q44 **Chair:** Yes, and then you are talking about the additional costs now of £1,500 to £1,800.

Mike Hawes: You would have to try to absorb those within your manufacturing costs, and offset that to maintain your competitiveness.

Q45 **Chair:** It is fair to say that if we went on to WTO tariffs—

Mike Hawes: It would be an incredible challenge, yes.

Q46 **Chair:** It would not be cost effective to produce cars, on average.

Mike Hawes: You would have to try to absorb those costs as best you could. That is where manufacturers will be looking at measures, as they continually are, to try to maintain that competitiveness. Hopefully we do not arrive in a situation where we have that full WTO.

Q47 **Chair:** No, absolutely. That is the worst-case scenario.

Mike Hawes: Most companies will be looking at a range of scenarios, and that is the worst case.

Q48 **Chair:** We will also come a bit later to the non-tariff barriers, but I have a final question before we move on to Vernon. On the other side, you



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have the sharp depreciation of sterling since the referendum and the further depreciation in the last few weeks. To what extent might that offset the higher costs of doing business here?

Mark Wilson: For us, as a high on 80% net exporter, a weak sterling in the short term has been a fillip against any volatility we might see out of changes in sales volumes or inflationary costs coming through. Over the long term, a weak sterling will ultimately catch up with you. We might all be able to sit here and say, "Yes, it has helped".

There are many of us who have also had treasury programmes in place during this period, which mean we have not necessarily been able to take advantage of a weaker sterling. Any negative impacts have been felt without the benefit of that. I do not think we ought to be looking to rely on weak sterling as a way of feeling good about WTO. Put it that way. It helps, but the two are not linked. It could equally be we have WTO and strong sterling. At that point, it is a real problem.

Q49 **Chair:** At some point your hedging will wind out.

Mark Wilson: It is unwinding now.

Q50 **Chair:** Yes, and then you will presumably see some higher margins on the cars you export.

Mark Wilson: Yes. Just to be clear, to Mike's point, we will get that in the short term. Of course we will, but in the event that there are tariffs we have to use that short-term windfall to offset competitiveness in the future. It will not simply be possible, particularly in the segment of the industry we operate in, to stuff it on price. That simply does not work.

Patrick Keating: We have seen some currency fluctuations have a short-term impact on business profitability. The point to make is, while a weak sterling supports exports, equally we have to take account of the fact that we are importing that large proportion of components in euros, dollars and yen. In the final analysis, it is still too early to tell what the impact of currency fluctuations has been on our business.

Q51 **Chair:** I have realised that I did not give Mark Wilson an opportunity to say what proportion of the components that go into an Aston Martin would be sourced from other European Union countries.

Mark Wilson: It is around about 60%. It is a little higher. All the points that my other two colleagues have made already apply to Aston Martin. They just apply on a slightly larger scale because our economics, in terms of transaction price and cost of car, are a little higher. They are quite a lot higher.

Q52 **Chair:** I could not get an Aston Martin for £30,000.

Mark Wilson: You could get a portion of an Aston Martin for £30,000, but not a whole one.

Chair: I will bear it in mind.



- Q53 Vernon Coaker:** I was fascinated by some evidence that came in, which talked about the changing automotive world and the emerging markets outlook. That is going back in answer to the Chair and Mark Pawsey earlier on. It said emerging markets outlook is the key to growth. There is limited potential in mature markets. It points out that, from 2015 to 2023, the projected growth in mature markets is minus 1%, China is plus 32% and the emerging markets are plus 44%, which is quite an astonishing figure.

Building on what the Chair has just been saying, clearly the automotive industry getting into those markets is crucial to their own growth, whatever happens with respect to the EU. I think Aston Martin just did a deal with Japan for £500 million. Others will be doing different arrangements. Rules of origin will be crucial to that, will it not, or does it not matter? Aston Martin did the deal with Japan for £500 million. There was no free trade agreement there necessarily.

The proportion of cars at the moment is supposed to be 60%, for the purposes of determining rules of origin at the moment. That is an average percentage for UK cars. Is that right? How is this going to change?

Mike Hawes: The average car made in the UK purchases 44% of its components from UK suppliers, in other words 56% from abroad. For the purposes of free trade agreements, we look at something called originating content. That means, of that 44% that you are buying from your UK suppliers, how much actually comes from the UK, bearing in mind the supply chain, tier two, will still be buying from Europe, Asia and elsewhere. We are doing some work on that figure at the moment, and it is somewhere between 20% and 25%, which is a long way from the 55% to 60% threshold you would need to qualify for any free trade agreement.

Certainly the markets you have identified are growth areas and you would want UK companies and manufacturers to try to take advantage of that. You have to remember that the UK automotive industry is largely foreign-owned. Often they are multinationals, so they will already have plants in China, Vietnam or anywhere else where this big growth is coming. The general rule of manufacturing is to build close to where you sell. It makes absolute sense, because you reduce your logistics costs.

- Q54 Vernon Coaker:** Should the threshold for the rules of origin be lowered to enable UK manufacturers to do bilateral deals with others?

Mike Hawes: We would look for the idea of cumulation with Europe. In other words, European parts would count as UK and vice versa. That will be the easiest and quickest way to meet those thresholds. To move from where we currently are—let us say 20% to 25% originating content—to 60% will take many years. There is not necessarily the capability here in the UK.

- Q55 Vernon Coaker:** So EU content should be categorised as UK content for



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the purposes of rules of origin, in terms of the negotiation we would have with other countries.

Mike Hawes: We would have to agree that with the EU first. That would be part of your trade deal, but equally, when you have those deals with third countries, they would have to recognise that. There are precedents in international trade agreements for that.

Q56 **Vernon Coaker:** Do you think this is likely? I suppose that is crystal ball gazing.

Mike Hawes: It is a possibility. It is known and there are examples whereby what we would say is non-EU, for instance Morocco and Israel, count as European content for those purposes. There are precedents there.

Q57 **Chair:** If we came out of the European Union without a deal, obviously that would not apply. Mark Wilson made the point earlier that we would want the grandfathering of FTAs. If we were to come out of the European Union without a deal, there would not be any grandfathering and presumably it would be quite hard to have the cumulation rules that Mike Hawes is talking about.

Mark Wilson: It would appear to be very difficult if that were the situation.

Q58 **Chair:** How damaging would that be for your business models? Mark Wilson, you export a lot outside of the European Union.

Mark Wilson: It would be pretty damaging. In fact, we know it would be pretty damaging. As Mike has said, 45% is a headline figure. The reality is closer to the 20s, and the same would be true of us, although it is very difficult to chase it back up the line. For us to somehow swap 60% of our European supply base into a UK supply base, which is strong but does not exist to the same depth today, within two years, is an extraordinary ask. It is really important that we get the rights grandfathered across and that origination is recognised as a major issue and dealt with on the cumulation basis.

Q59 **Vernon Coaker:** Is it possible to increase that local content so it counts as UK content? Is there the ability to supply that to you?

Mark Wilson: There is a very strong supply chain in the UK already at tier one and tier two level, but it is not of the scale of the European supply chain. The idea of us developing a supply chain now, without significant investment, time and effort, both from the Government and from business, in time for us to exit such that we can have origination rules of pure UK content, is a very difficult thing to envisage happening.

Q60 **Vernon Coaker:** The idea might be put that this would be a great opportunity for UK companies, because they could expand, develop and take advantage of the new freedoms.

Mark Wilson: That would be another way of putting it, yes.



Mike Hawes: That would be ambitious, for a couple of reasons. First of all, if you look at the current capability of the UK supply chain, it is very good in certain products and components, less good in others and not at all present in some areas. I am sure you can quiz people on that in your later panels.

What would attract a supplier into the UK? Primarily, it is a strong and growing vehicle manufacturing base. If that is not there, or if there is uncertainty that it is growing, why would you invest in that? Remember when you look at the supply chain across Europe, to a certain extent it is counterintuitive: parts begin their life in one country, move to another to turn into a component, into an engine, into a car. You would look at that and say, "That does not make any economic sense", but it does because it is driven by cost and quality. That would not happen if it did not make economic sense to do so.

Q61 **Chair:** Mike Hawes, you touched earlier on the issue of customs. I think Patrick Keating, in Honda's evidence to this Select Committee, suggested that the non-tariff barriers might be even more serious than the tariff barriers. Patrick Keating, perhaps you could start by explaining what impact customs controls would have on your business and ease of doing business.

Patrick Keating: It touches on the fact that we operate to just-in-time manufacturing, which is the most efficient way to run a plant. You order only what you need. It arrives when you need it. This reduces both waste and cost. As I was saying before, 40% of our componentry is sourced from the EU. On daily terms that is about 2 million components coming in from the EU on 350 trucks through Eurotunnel and through the Port of Dover.

Lineside we hold about one hour's worth of stock as part of that just-in-time production model. As we leave the customs union, we are keen to see a system put in place to ensure that excessive friction does not come into place at the port. That is about ensuring that the people, the infrastructure and the systems are in place early and well tested, so that as we leave the customs union on day one there is not a huge amount of friction and blockage at the port.

Internally, we see a period of about 18 months for us to be in a position to have the IT, personnel and systems in place to manage the increased volume of customs work we are going to have to do. I know HMRC has calculated that it is seeing an increase of 50 million to 250 million transactions a year. We are having conversations with HMRC to understand what it is going to put in place and giving feedback on the customs partnership paper.

When it comes to that, we are very happy that it has recognised that there is a need for transition, both from our side as businesses, to put in place the countermeasures we need, but equally for Governments on



both sides of the channel to make the investments in people and systems that are required.

- Q62 **Chair:** In the evidence that you gave to us, Honda suggested that, if custom controls added an extra 15 minutes, that would create costs of about £850,000 to your business.

Patrick Keating: Yes. That is a calculation we have done in partnership with our freight companies, looking at the hourly cost per truck. That is extrapolated out to that figure on an annual basis. That is not a scientific figure, but it gives us a sense of the scale of the cost. It also indicates the fact that, when it comes to calculating Brexit-related costs, it is not just tariffs. There are a lot of other little areas that can build up over time and we need to take account of those.

- Q63 **Chair:** Do you import any of your components from Japan, for example?

Patrick Keating: Yes. 20% of our sourcing is from outside the EU. Most of that is Japan.

- Q64 **Chair:** If it comes in from Japan, how long do the customs checks take?

Patrick Keating: On componentry we source from Japan, we operate a slightly less just-in-time system. We stock onsite about two to three weeks' worth of componentry, just because you have potential delays in the shipping. Those components are coming by vessel from Japan, so there are delays built in there. When clearing things through customs, you are looking more in the two to three days area, rather than minutes, through the Port of Dover.

- Q65 **Chair:** There is some technology involved in the Japanese system. Is it called CHIEF or something?

Patrick Keating: CHIEF is the customs system that HMRC currently uses to handle customs transactions from third countries.

- Q66 **Chair:** You experience that at the moment with imports from Japan. How long does it take?

Patrick Keating: It can take two to three days.

- Q67 **Chair:** You give that cost of £850,000 for a 15-minute delay. Have you modelled what impact it would have if there was a two or three-day delay in bringing in components from the European Union?

Patrick Keating: No, we have not got to that part of our calculation. We are still at the beginning of the scenario planning and costing, so we have not managed to calculate that degree of figure.

- Q68 **Chair:** If it was, say, one hour rather than 15 minutes, could we extrapolate that £850,000 times four is £3.4 million, or would it be wrong to do that?

Patrick Keating: That may be a rather unscientific way to approach it. The costs would build up. We would have to speak with the freight



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handlers and the trucking companies to understand how they would be managing and mitigating the costs as well. That £850,000 is quite a back of an envelope calculation, just to give us a sense of the additional cost we would be looking at. We would be looking with our partners and our truckers to try to mitigate those costs as much as possible.

Q69 **Chair:** If you had to wait for a few hours at Dover, Ashford or wherever else things come in, you are talking of potentially millions of pounds.

Patrick Keating: Yes, potentially. At that point, it would be looking at what other mitigations could be put in place. When it comes to at least the short term around the border, in terms of contingency planning we are looking at the potential to invest in warehousing and holding stock on site. That obviously moves away from just-in-time and is not the preferred option to take, because capital is then tied up in unproductive purposes. That is something you could look at to help mitigate, at least in the short term as new customs procedures were bedded in.

Q70 **Chair:** Can your frictionless model of integrated supply chains function if you do not have those frictionless borders? Can your just-in-time model of production work?

Patrick Keating: Yes. We are looking to make sure that that can continue to happen. We are having discussions with Government about what we can do to at least mitigate the friction. We have to admit that outside of the customs union there is no such thing as a frictionless border, but we can try to find ways to reduce that friction. That could be through things like looking for economic operator status or introducing technology to the border. We are still at a very early point in those discussions.

Q71 **Chair:** If there was not a deal between the UK and the rest of the European Union, at least for that time of no deal, that just-in-time model would not work. You would have to build additional warehousing.

Patrick Keating: I would not say it would not work, but it would certainly be very challenging. There we would have to be looking into warehousing and other ways to mitigate that risk around friction at the border.

Q72 **Chair:** Do you have any estimates of how much warehouse space, for example, you might need if the delay was one day or any other period of time?

Patrick Keating: We have not calculated to that level of granularity. That is something that we are working on internally as we move towards that March 2019 period, just to understand that and have plans in place to know how much warehousing we will need, where it will be and what sort of stock we need to have in those warehouses.

Q73 **Chair:** Mark Wilson, what would the customs controls mean for your business?



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Mark Wilson: Our issues are not quite as acute as those of Honda, because we do not, by all accounts, use just-in-time purchasing. Ours are more bespoke, handcrafted cars, and there is a longer production time. We hold about a month's worth of stock on average, although that is not uniform across the base. Some of the components we buy are in large batches, so it is a much wider spread of goods holding. While there would undoubtedly be costs involved for us—bureaucratic costs, goods holding costs, costs of inefficiency, which would knock on to manufacturing—they are probably not as large as Honda.

The issue for us is having a substantial proportion of my outbound balance sheet sat in customs ports around Europe waiting to be ticked through. Every single one of our cars is probably worth 15 to 20 times of the overall price of a Honda, just to give you an example. You can imagine one car sat delayed at Calais has me a lot more exercised than perhaps it does for Patrick with one Honda Civic. Our issue is on the outbound goods and services.

Chair: You should see his face, Mark. I am glad that Mike is sitting between you.

Patrick Keating: We will have words afterwards.

Chair: They are lovely cars, Patrick.

Mark Wilson: They are outstanding cars. Let me put that on record. That is the issue. It is the outbound piece for us, the idea that we cannot collect and therefore cannot take the revenues as quickly as we would like. Aston Martin is doing well at the moment, but cash is always at a premium in a business like ours. The idea of having additional cars sat in ports around Europe waiting to flow through, tying up cash on my balance sheet, is not appealing.

Q74 **Chair:** Have you done any analysis of what sort of costs that might mean and what that might mean for your business?

Mark Wilson: It is more the lost profit opportunity than it is necessarily the building in of the costs, but yes, we have. It is pretty confidential. I would be happy to share that confidentially with you.

Q75 **Chair:** Thank you very much. Mike, is there anything you would like to add?

Mike Hawes: They have encapsulated it well.

Q76 **Chair:** Can I ask one thing about what happens on the Canada-US border? Some people have said that is an example of a border that works very well. Things move back and forth. Do you see anything that we can learn from the US-Canada border?

Mike Hawes: I must admit I am not familiar with that area.

Chair: That is fine. We will move on then.

Q77 **Mark Pawsey:** Can I ask you about regulation and certification, and the



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extent to which the cars we build in the UK are built to a common European standard? If we are out of the EU, does that mean that we can modify a product and sell it in markets where that standard is not important? Does that open any doors or provide us with any fresh opportunities?

Mike Hawes: No.

Q78 Mark Pawsey: In which case, can I then come back and ask you to what extent the UK, as a member of the EU, has been able to influence the regulatory regime? Are there any examples where we might have lobbied, perhaps through your organisation, to effect a benefit to our own industry or to the way we build cars more generally? What concerns do you have if we do not have that in the future?

Mike Hawes: The advantage that all our manufacturers have is they produce a vehicle to one standard and then sell it in 28 member states. Increasingly, the type approval and certification rules are adopted by other countries. For instance, China's emission regulation, although it is not exactly the same, is based on European regulation, as are other countries'. That is the real advantage. You reduce them to a single standard. As soon as you have to build for another standard, and you do for the US and certain other markets, that adds costs. You want to minimise that.

The standards and regulations are set at both a UN level, which we are and will continue to be involved with, and obviously a European level. At the European level, the UK, as a large market and a large manufacturer, has had an influential voice. One of things that we have always been keen to ensure is that the development and implementation of regulation is sympathetic to the diverse nature of the UK automotive industry.

If you look at the nature of the industry, there is a whole stream of small-volume manufacturers like Aston Martin, Morgan and Lotus. They need to meet environmental and safety standards, and so forth, but there is a degree of flexibility on how they meet them, recognising that they are small volume and do not have the wherewithal of a large multinational to do that. That is one example of where the UK has been very influential and supported the industry.

Q79 Mark Pawsey: Are there any general features of cars where we can say, "That was our lobbying within the EU that achieved that"? I am trying to get at whether we have historically been a rule-taker or whether we going to lose out by no longer being part of the rule-maker.

Mike Hawes: We have definitely been a rule-maker. That was just one example I have given. The expertise of the industry here, and the engineering capabilities that can influence and help develop some of those regulations, from the Department for Transport and our own organisation, have helped do that. Once we leave, you are absolutely right: at least 56% of the vehicles that we export will have to meet the



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rules set in Europe without a clear understanding of what our influence will be.

Q80 Mark Pawsey: Just so I understand, for Honda, the cars produced for all markets are to the same standard. There is no element of producing a product for a particular market where standards may be lower. Is that right?

Patrick Keating: That is correct. As I was saying before, 50% or around 50% of what we build at Swindon is exported to the US. That is on a shared platform. The platform that we export to the EU and the US is more or less the same. There are a few tweaks here and there. Achieving that, in order to build a car that met both the European and the American standards, involved a huge amount of R&D effort over a period of time developing that vehicle. It is not something that could easily be done. We would be very keen to avoid divergence between the UK and EU standards and having to make a third set of vehicles for the UK.

Q81 Mark Pawsey: You are currently producing different vehicles for different markets. Where there is regulatory divergence, is it that hard to produce something for a specific market?

Patrick Keating: In a nutshell, yes. We looked to some work that the European Commission did in the context of the TTIP negotiations. It looked to calculate to what extent you would have to diverge a car that was meeting European standards and change components, procedures and testing to make it match the US standard. The calculation was that that would be equivalent to something like a 26% tariff.

There is quite a bit of work to do between the two to make a car that meets both standards. That is why I was making the example that the current Civic, which serves both markets, involved an awful lot of R&D to achieve that.

Q82 Peter Kyle: Patrick, to what extent does Honda utilise freedom of movement to recruit skills from the EU?

Patrick Keating: To a great extent, I would have to say. I will give some numbers around that. In our factory at Swindon, 14% of the workforce are EU 27 nationals. Those are people at all levels of the organisation, although I have to say EU nationals play a significant role on the production line.

Our European head office is based in Bracknell, about 40 miles from here. There, 30% of the team are EU 27 nationals. That is because we are running a European sales and marketing organisation. You need people who understand the dynamics of the market, the language and the way that sales work. We identify high-performing people in those markets and bring them into Bracknell to be part of our leadership team.

The 14% figure at the factory masks a slight trend recently. As we brought the new Civic online last year, we needed to bring on board 600



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additional workers. Of those, 40% were EU 27 nationals. In terms of contractors and people we have hired recently, there is definitely a significant uptick. That is not to say we are not looking to increase the UK-based workforce. Over the last year, we have increased the number of apprenticeships at our Swindon factory by 100%. We do a lot of programmes where we are going into schools and the local community to get kids enthusiastic about STEM and coming to work at the Honda factory.

The other piece is that our Swindon factory is, in effect, a mothership to the other manufacturing plants around Europe. We have a need to move people from that plant—EU nationals, Japanese and UK—easily around Europe, potentially on short-term or last-minute assignments. Going forwards, we are looking for a migration system that is flexible and allows us to attract the talent we need, but equally to move people throughout our organisation.

Peter Kyle: It is good to see you are doing this work on STEM. When the young people see that you care as much for your individual cars as Aston Martin does, they will be inspired by that.

Patrick Keating: Of course we do.

Peter Kyle: Your organisation is going to be in a difficult place if freedom of movement, or what the movement relationship is going to be, does not get resolved quite soon. With this number of people embedded in every part of your organisation, this is surely keeping you awake at night.

Patrick Keating: We have a fair degree of confidence around the ability of UK and EU Governments to agree on the status of current residents and current workforce. We are doing a piece of work to understand what the future requirements around settled status will be and how we ensure we keep the people we need. As you say, going forwards, it could be a challenge, but we will have to find ways to work around that. Again, we are hopeful we will find a migration system that allows that flexible movement.

Mark Wilson: About 10% of our total workforce is from the EU 27 countries. The vast majority of them are based in the UK at our Gaydon headquarters and will be based at our new factory in Wales as well. Our issue is that, compared to Honda, more of our EU 27 employees are based in the higher engineering skills type jobs that I spoke about earlier. Talent is global, so we are a global business and we look to pull the very best engineers, aerodynamicists and individuals we can from around the globe. Limiting our access to the EU 27 would be a bad thing.

There is another opportunity here, though, in that under the tier two system, so non-EU immigration, at the moment we think that is quite slow. It is 12 months. We are bringing people in from Japan and have been over recent years. It is quite a slow process. There is an opportunity there for us, post Brexit, to improve and fast track that to redress the balance.



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Q83 **Peter Kyle:** The difference with people with high skills is that they are making a much more informed choice as to where they come. They have a lot more options as to where they go. I presume the look and feel of Britain and its economy—its openness and so forth—needs to pull people here, rather than just expecting them to arrive because they have a limited choice elsewhere.

Mark Wilson: It has always been one of the strong, compelling benefits of the UK economy. We would like to see that remain.

Mike Hawes: It is particularly challenging in the supply chain. With the likes of Aston Martin, who would not want to work for Aston Martin, the brand alone? Once you are into supply chain, the level of dependency on non-UK nationals goes up. It can be up to about 30%. The anecdotal evidence we are getting at the moment is that increasingly they are struggling to retain people. A lot of them were economic migrants. The economics do not add up as generously as they did before.

Q84 **Peter Kyle:** I have a quick direct question to you, Mike, about R&D. How important have the Horizon 2020 programme and R&D relationships across the EU been?

Mike Hawes: One of the opportunities has been the integration of UK R&D into Europe. Horizon has been one of the mechanisms by which that has been facilitated. We are getting feedback from some universities that the willingness of European partners to engage with UK institutions might be on the wane, because they do not know the eligibility of the UK institutions in the future.

Q85 **Chair:** I wanted to ask two final questions to Mike. We have heard from two UK car manufacturers today, but you represent a much larger number. Are there things that other manufacturers would have told us today that would be different? Particularly, would any of the businesses that you represent see more positive upsides, perhaps some of the other niche car manufacturers? Is there anything positive that they would say or opportunities from Brexit that they would point to?

Mike Hawes: As you will know, this is a fiercely competitive industry, yet this is a subject that is pretty unifying across the industry. We did a survey before the referendum and we had about 10% of our members voting to leave. We have about 700 to 800 members. I have not met any of the members who voted that way, but they exist.

Q86 **Chair:** How many members do you have?

Mike Hawes: About 800, in terms of manufacturers, supply chain and aftermarket. This is an issue that pretty much unifies the industry. There will be some outliers, but all the conversations I have had have reflected these issues that you have discussed today to varying degrees. There is that consistency.

Q87 **Chair:** Lastly, someone who has been slightly lost today is the consumer.



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I wondered what impact Brexit would have on people buying cars, perhaps not Aston Martins, but your normal consumer who buys cars. Car sales have been quite weak in the last few months and you have spoken about that before, Mike Hawes. For somebody buying a car, when we leave the European Union, what impact might they see in terms of prices?

Mike Hawes: There are two major issues. It depends on the deal, if we get a deal and so forth. In the worst-case scenario, prices will go up.

Q88 **Chair:** The number that you gave earlier was £1,500 to £2,000

Mike Hawes: That is on the price of an average vehicle. That is one impact. The second impact, potentially, is on consumer choice. That goes to whatever the regulatory framework is. If there is any sort of divergence, given most of our cars we are sold here are imported, a manufacturer will have to decide, "Do I want to type approve that vehicle to this UK standard? Am I going to get a return on that investment in terms of volume?" There might be a contraction in terms of consumer choice as well. As you rightly say, we are already seeing a drop. We have not left Europe yet, but in terms of consumer and business confidence, we are seeing a drop in demand for vehicle purchases.

Q89 **Chair:** Would you attribute that to the uncertainty about Europe?

Mike Hawes: All the indicators are that consumer confidence is declining, especially the propensity to have a big-ticket purchase. Outside the home, a car is obviously a big-ticket purchase.

Q90 **Chair:** Thank you very much, all three of you, for coming to give evidence today.

Examination of witnesses

Witnesses: Chris Saunders and Dermot Sterne.

Q91 **Chair:** Thank you very much for coming to give evidence to us today. I think you were here for the earlier session when we heard from the SMMT, Honda and Aston Martin. We are keen to get your perspectives now on the topic of our inquiry, the impact of Brexit on the automotive sector. It would be helpful if we could start with both of you introducing who you are and where you are from.

Chris Saunders: I am the director of external relations for GKN.

Dermot Sterne: I am Dermot Sterne. I am CEO of Applied Component Technology. We are a tier two supplier to the industry.

Q92 **Chair:** Thank you very much. I will kick off with the questions. To what extent do you see decisions around investment being affected by the



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current uncertainty around Brexit? What impact is that having on investment in your industry?

Chris Saunders: There are probably two levels of investment that go on. There is day-to-day investment. Our largest automotive plant in the UK is in Birmingham, employing about 800 people. On a day-to-day basis we will have to make capex decisions, in order to make sure that our plant and machinery is up to scratch and continue to deliver to our customers. That has not been affected, because we have to get on with that.

However, when it comes to major capex decisions, there is clearly a delay. As a tier one supplier, we are driven by what our customers want. We will not speculatively go and make a very large investment. We will need to know that there is a contract at the end of that. In those sorts of decisions, there is already a nervousness.

In public I cannot go into details, but with some of our customers, and particularly one of our customers, there is a potentially large investment we would need to make in order to meet that order. That is dragging on and dragging on. These commercial relationships often do, but, putting myself in the position of our customer in that instance, I am sure that they are keen to see the lay of the land before they make their investment, which would lead to us making ours.

Q93 **Chair:** Do you see something similar, Mr Sterne?

Dermot Sterne: Regarding our own business, our main owners are all EU citizens. They are looking in and hoping for some clarity more than anything else. They have been supportive and continue to be supportive, but the level of capital expenditure we have had to make since the referendum has been fairly low. It is a worry, but more so maybe when I look at our tier one and OEM customers.

Q94 **Chair:** What would both of you and your businesses be looking for in terms of a Brexit deal? What would it need to cover to be effective in terms of providing certainty for investment going forward?

Chris Saunders: It is driven by our customers. As you know, although we are a tier one supplier and we are a UK-listed headquartered company, we are a multinational. We produce all over the world, and we attempt to utilise our global knowhow, international supply chains and local delivery. Ultimately, the work we do in the UK is for local customers. To be honest, they have already been here: we have Honda, Toyota, Jaguar Land Rover, Nissan. These are all our customers in the UK.

Although we are delivering locally, we know that they, in turn, are exporting back into the EU 27. For us, for a deal to be worthwhile, it needs to be free from tariffs within our own supply chain, because we often supply ourselves but from elsewhere in the EU. That is also important for our customers in terms of selling back in. In addition to the



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tariff barriers, it is also the non-tariff barriers as well. We know that we have a large volume of supply chain that comes from elsewhere in the EU and we know that the product goes forward. Unless we have zero tariffs and low friction, we know that there are going to be significant problems for our customers. In turn, that makes it more difficult for us to deliver for them.

Q95 **Chair:** Are your customers in both the UK and the rest of the EU?

Chris Saunders: We have customers all over the world, but our customers of our UK plant are overwhelmingly in the UK. 90% of what we do in the UK is because we are selling down the road. If we go back to the just-in-time and logistics principles, we want to make sure that we can deliver to our customers with real rapidity. Going to the Honda example from earlier where it has an hour lineside, we do not want to be the people responsible for it stopping its line, so we deliver locally. We have European customers, but we do that outside of our European plants.

Q96 **Chair:** Is there a possibility that you might get more work after we leave the European Union, in that car manufacturers here will want to source more from domestic suppliers?

Chris Saunders: We are always looking for a business opportunity. I am sure we will get to it later, but this comes into the issues of content, because we are a UK-based tier one supplier, but 70% of our supply chain comes from elsewhere in the EU. That is for reasons of competitiveness, volume and the fact that we are our own supplier. That problem gets pushed down to the next level. There would be just as many pitfalls from that as there are opportunities.

Dermot Sterne: When we look to our tier one customers, as Chris has just said, they often say the balance of buying parts is 70% from the EU and 30% from the UK. I represent a business that supplies from the UK, so part of that 30%. Even at our level, half of what we buy, our raw materials, is sourced from the EU. We have to buy from the EU because those components or raw materials are not available in the UK competitively. Even at tier two level, where we sit, it is a worry.

There are some reshoring opportunities for work coming back, but you can very quickly see those opportunities being diluted because of the rising costs of any tariffs coming in. The weak GBP makes that even worse.

Q97 **Peter Kyle:** Are you getting the same level of engagement with Government at the moment that the manufacturers were? You heard the session earlier on. Are you being listened to? Are they reaching out to you? Do you feel that your concerns are being recognised by Government and are having an impact?

Dermot Sterne: Personally, I am delighted to be here today. If you think of the automotive industry as a large pyramid, you have a couple of guys at the top in the car manufacturers and tier ones, but then tier twos



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are a big chunk at the bottom. It is good news that I am able to give the input from a business like that. I have been invited to give such an input before to various government bodies, but typically you would always have more car manufacturers and tier ones in the room. It is very important to recognise the size of that wedge at the bottom of the pyramid.

Something that worries us a little bit is that we are less mobile by our very nature. If I look back to other chunks of my career, where I have been in a large tier one, you maybe have six plants in Europe and can make decisions where best to place work. We have one plant. It is in Wrexham and it is designed to serve the UK car industry. To that extent, that degree of less mobility is a concern.

Q98 **Peter Kyle:** Obviously Government cannot speak to everybody who is out there, but do you feel that the specific challenges that you and your sector face are recognised by Government?

Dermot Sterne: On that particular point, I am vice chair of the automotive components section of Mike's organisation, the SMMT. We ensured that very point about it being higher risk the further upstream you get was in the paper that got submitted to the BEIS Committee. To a degree, we are making sure the message is there. Is it understood? I cannot say.

Q99 **Peter Kyle:** I must admit, I had not considered the increase in anxiety due to the lack of mobility and options as you go down the supply chain. That is a new one for me. Presumably, the further down the supply chain you get, the smaller and more niche and specialist you are going to be getting in some cases. Therefore, perhaps they will not have the voice that others have.

Dermot Sterne: Yes, although there is an important point that as you get further down sometimes the suppliers are enormous, such as chemical companies supplying raw material to us. Sometimes it can be an uncomfortably lonely place.

Chris Saunders: Dermot's points are very fair. This is probably the counterpoint. GKN is tier one and we are a large company. We have a turnover of £10 billion. 50% of our business is in aerospace, so we have the ability to speak to Government. We have had direct conversations, partly through our trade body and ourselves, with Ministers concerned.

Q100 **Peter Kyle:** You know where I am getting with this, because we went down the same path with the previous session. It is not about whether you can speak. Are they engaging, and do you feel it is having an impact?

Chris Saunders: To be completely candid, straight after the Brexit vote, there were an awful lot of conversations where, every single time we had a conversation, a civil servant or a Minister would say, "We are in listening mode". That is what they would do. You would say your



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concerns and they would walk away. You would be none the wiser as to whether they had heard things or anything.

Post the election, that has changed. There is now a genuine back and forth. I think that they hear our concerns. We say, "We are very concerned about what happens in April 2019 and we really need a one stage process. We need to make sure we have access to the market". The response to that is usually, "We completely understand that". We are sceptical as to whether they can deliver that within the political constraints that they have created for themselves. To go back to your earlier session, they are saying there is going to be one change and we are concerned that one change moment will come in April 2019, not after an implementation period.

Q101 **Peter Kyle:** Are your needs aligned? You heard the previous session. Are your needs for the outcomes that are produced by these negotiations similar to the car manufacturers we heard from before?

Chris Saunders: For us, they are similar. There is a slightly different emphasis. Issues around regulation and type approval for a components manufacturer are not as important. We are all heavily aligned on tariff and non-tariff barriers. The cost of moving things across the border is a primary concern.

Q102 **Peter Kyle:** To both of you, on this thing about transition day, when it starts and hard Brexit or not, if this goes wrong—and we know what "goes wrong" looks like—what would the impact be on your sector, your companies, your businesses, the people you represent?

Dermot Sterne: If it all went wrong and we left without a deal, I have tried hard to think of a worse situation but I cannot, if I am honest. WTO rules and not being part of the customs union would have an enormously challenging effect on our business. I can give you examples of parts where profit will disappear due to WTO tariffs, so that is clearly an unsustainable position.

Chris Saunders: On that, in the absence of a clear understanding about what an alternative deal looks like, we have modelled what 2016 would have looked like for GKN, had it been on WTO rules. The answer is for the company as whole the impact is relatively small, because 10% of our business is in the UK and we are a £10 billion company. There are several million in tariffs and an additional several million in non-tariff barrier costs for us, but they fall on a very small number of plants, not just in the UK, so there is an impact. That does not take into account mitigating effects that we could take. Nor does it take into account second-order effects about how that may change demand from our customers. It clearly has a significant impact on a small number of plants for us.

Q103 **Peter Kyle:** Finally, Dermot, are you an authorised economic operator? Will you seek to obtain the status and continue to supply to companies



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that are selling to the EU?

Dermot Sterne: No, we are not, and until the referendum I had never heard of the term.

Peter Kyle: There are lots of terms that we have heard in the last couple of years.

Dermot Sterne: We have never filled out a customs declaration. That is just the way life is. We do buy in some things from China, and usually a freight forwarder would do that for us. The thought of having to do that for most of our trade from the EU or to the EU is a frightening prospect. It would add costs and make us less competitive.

Q104 **Mark Pawsey:** Gentlemen, are we not being a bit negative here? Reshoring has already been taking place recently, as manufacturers found that the length of the supply chain from some overseas markets meant they were not getting their quality. Is this not a big opportunity that you guys are walking away from? We already heard from other manufacturers about quite a substantial amount of EU-produced product going into cars that are made in the UK. Why can we not grasp that opportunity and make some more?

Chris Saunders: The best way to answer that is with an example. In our Birmingham plants, we build side shafts. We build the bit that connects from the engine to the wheel. It sounds simple. It is a surprisingly complex thing. We do that all over the world. We build 150 million side shafts globally each year. We build 45 million across Europe. We build less than 3 million in the UK.

All types of components go into those side shafts, but one of the very obvious ones is it has a forging as a part of it. That heavy forging, which forms part of the side shaft, is created in one of three plants across all of Europe, and that is for 45 million side shafts. They are producing about 15 million forgings a year. The entirety of our business in Birmingham is 3 million. We are not going to put a forge in the UK running at 25% capacity as part of a reshoring activity, particularly if we did not know if we would be able to export back into the EU without tariffs.

There are some opportunities, but the volumes are such that if we want to produce at a low enough price to be competitive for our customers, we do that by specialisation. We do that by integration of a much larger market than just in the UK.

Q105 **Mark Pawsey:** I take the highly specialist component there. Dermot, on your side are some of the more basic bits and pieces. There is a possibility that there is not going to be quite the free movement of goods that we are experiencing right now, and some of them coming in from overseas are going to be a bit delayed. That is a big opportunity for you, is it not? You can go to the manufacturer and say, "I have no problems with meeting your just-in-time requirement, because all I have to do is send it down the motorway".



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Dermot Sterne: There will be some reshoring opportunities. Trust me, we are fighting hard to identify those and to take advantage of them if we can. We entered into a couple of contracts I can think of just before the referendum. You are basically there for the life of a vehicle, so six years. As I have said earlier, 50% of our raw materials come in from the EU. That has suddenly got 8% to 10% more expensive. That offsets the benefits of finding something that you can reshore.

Where reshoring would work is where the raw materials are by and large available in the UK. It is a real struggle to find those. It is the way the automotive industry has grown up, for the reasons Chris has just given, because of scale. We were just looking for something this week for a particular quotation. It was not available in the UK. It was a plastic part we needed. It is a challenge. I am not saying there are no opportunities. There are, but there is more risk at the minute than opportunity.

Q106 **Mark Pawsey:** How about the emerging markets? Perhaps this is more for a tier one supplier. We have seen the depreciation in the pound. We had a discussion about that earlier. There are people putting down plant all around the world. I think JLR is going into a joint venture with one in China. Why can we not seize the opportunity and companies like yours sell more components into these new plants that are coming up?

Chris Saunders: I agree that these emerging markets are incredibly important for us, which is why we go there. We have £1 billion of business that we create in China, because we are a high-volume manufacturer. With the best will in the world, we are never going to be producing side shafts in the UK to export to China. We will do that in China. The American market is a very well-established market for us and is incredibly important. That is why we have several plants in the US.

The nature of the automotive industry—and this is different from the aerospace industry—is very regional. Our business is broadly split a third in the Americas, a third in Europe and a third in Asia. That is not by accident. That is about making sure that we can deliver to our customers on a local basis, because our customers do not want to hear, “Where is your side shaft?” “Do not worry; it is on a boat somewhere in the Atlantic”. They want to know that it is down the road, and that is why we have this process of a regional supply chain with local delivery.

Dermot Sterne: Can I just add to that with a specific example? Absolutely, it is a local business; you need to be close to your customers. We recently looked at a part that we currently sell to the EU. Let us say that cost £20; the additional shipping to ship it to Japan, America or wherever would be 80 pence, so that is 4% gone, just to ship it. As I think was said in the earlier session, automotive is a high-volume, low-margin business.

Q107 **Mark Pawsey:** That does not seem to be stopping people shipping stuff into us. Why can we not turn it on its head?



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Dermot Sterne: We do not buy much from America, in terms of parts coming in.

Chris Saunders: I cannot comment on behalf of other companies, but often, where you see a large portion of a supply chain for a certain company coming from a particular country, it is to do with where that company is headquartered and the relationships that they have built up over a very long period of time.

Q108 **Chair:** I wanted to ask about the impact of WTO rules on your businesses and your costs. Have you done any analysis of what would happen to your costs, Chris Saunders, if WTO rules applied?

Chris Saunders: The answer is yes. We spent the summer going through all our trade flows and looking at what that would be as a tariff, if there is a tariff levied on it. I am happy to provide more detail in a confidential written submission, but it would cost several million pounds to a small number of plants, in direct tariff costs. That could be mitigated, because we know quite a lot is re-exported, through things like inward processing relief.

We also have made some assessments of the non-tariff costs, so the associated customs processes. We use freight forwarders. We have our own freight and logistics business, but we use freight forwarders for things like customs declarations. We know they cost us approximately £35 per declaration, so we know that, for our UK plants, would have a fairly significant impact in terms of costs as well.

Q109 **Chair:** We are going to come on to customs in a minute, but you say it is £35 per customs declaration. How many would you have to make per year?

Chris Saunders: I can give full details, but it is in the thousands.

Q110 **Chair:** What contingency planning are you at GKN doing for this eventuality?

Chris Saunders: Up until the summer, we had been holding, hoping for more clarity. We have not had it, so we are now, on the back of the work we have already done, looking through a number of different steps to make sure that we can mitigate the WTO procedure as much as possible. Some of that is legal; by that, I mean some of that is to do with contract requirements, so, for example, finding out who in a contract has to pay the import tariff, because some contracts are written including taxation; some are written excluding taxation. It is not necessarily clear.

We are looking at administrative processes, so making sure that we apply inward processing relief where we can, and that we achieve authorised economic operator status for the relevant plants.

We are now starting to talk in detail to our customers and suppliers. The risk in 2019 is not just a hard Brexit but a chaotic Brexit, where, for



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example, there are significant hold-ups at ports because of a sudden influx and an awful lot of people who do not know what they are doing. Our suspicion is that our customers will want to build up inventory. That takes a lot of time because, like any efficient business, we run our plants at close to capacity. It is not just a matter of saying, "Can you just run off a few extra thousands of part X, Y or Z?" That is going to take time.

Our first action is about making sure that we are as protected from those tariffs as possible, and that we understand what our customers are going to ask, but that is about as much as we can do.

Q111 **Chair:** As somebody who supplies components, do you think that the just-in-time manufacturing process can work with friction at the borders?

Chris Saunders: Not in the way that it currently does.

Q112 **Chair:** Dermot Sterne, do you want to add something on this issue of WTO tariffs?

Dermot Sterne: Yes, I will just give you an example again of a part that we supply to a UK tier one, and they supply it on to a UK vehicle manufacturer. If that part costs around £20, it could make a nominal profit—I had better be careful what I say, because my customers will be listening—of 6%. That profit, we have calculated, would be halved, to about 3%, with the WTO tariffs. That is done using a 5% tariff. SMMT says the range is 2% to 4.5%. I had a joyous afternoon trying to make sense of EU tariff tables, and I found some raw material chemicals that we would have to buy at 6%. The short answer is that it would have a really serious effect on the profitability.

Q113 **Chair:** But you still would be profitable.

Dermot Sterne: I am answering that question on WTO tariffs alone. If you put the weak GBP on top of that, which is completely related because these parts have to come in from the EU, that is very challenging. At the minute, we try to find ways, through efficiencies, to make ourselves as fit as possible, to give ourselves the best chance. It is frustrating, because the way the industry works is that we are meant to get better every year. That energy and that activity is meant to be lowering our costs every year. It feels very much like we are putting all that energy into trying to mitigate the potential risk.

Q114 **Chair:** Can I ask something about sterling? Sterling has fallen quite sharply since we decided to leave the European Union, and quite sharply in the last few weeks. What effect does that have on your competitiveness?

Chris Saunders: For the sake of appearance, given that we are a UK public listed company that reports our profits in sterling, unless you spend any time with it, it looks great, because the number looks bigger. Of course, analysts, quite correctly, look through that. The reality is that a lot of our business is done in euros. As I say, 70% of our supply chain



comes from elsewhere in Europe, so the impact of a depreciation is not huge, because it only affects a certain portion of our business. It has had a small impact, but the idea, which we have heard, that we should not worry about a 4% tariff because we are now 20% cheaper is just not an accurate way of describing how our business works.

Q115 **Chair:** But it has some mitigating effect.

Chris Saunders: It has had a small mitigating effect. The only thing that has had any real impact is that you will get the occasional journalist ringing up, saying, "Your profits look excellent". "No, that is just because we are reporting what is overwhelmingly a euro and dollar business back into sterling".

Dermot Sterne: Again, 70% of our turnover is material we buy, half of which is from the EU, so 35%. Directly, a 10% reduction is 3.5%; that is a big number. That is on our current book of business. Looking forward, quoting from new UK programmes, in theory everybody will be in the same boat, but the book of business we have now took a bit of a whack at that time.

Q116 **Vernon Coaker:** The Secretary of State, David Davis, gave evidence to a recent Select Committee where he said the UK will leave both the single market and the customs union, but seek a customs agreement and a deep and special trading relationship with Europe that gives access to the single market. The Government have laid out options for future customs arrangements. What do you think of those options, such as the idea of a highly streamlined customs arrangement between the UK and Europe, or a new customs partnership?

Chris Saunders: Speaking from a business where, in the UK, our core supply is Europe and our core market is Europe and the UK, it is not as good as simply being in the single market and the customs union. However, we accept the result of the referendum, and therefore the more streamlined it can become, and ideally free of all tariffs, the better. The key is to make sure that there is time for that to happen genuinely. We are sceptical that you could deliver that in the next year, which is why an implementation period—

Q117 **Vernon Coaker:** Sceptical that you can deliver a frictionless border?

Chris Saunders: In a very quick period of time. Ultimately, you could deliver that. We are not politicians. We have to make assessments about this, but it would seem that to deliver a highly complex and widespread free trade agreement will take time. That is what we want; we want as little friction as possible, and as little friction as possible administratively, on both sides of the border. We could have the world's best processing system in Dover, but if it is not there in Calais as well, that is a serious problem.

Dermot Sterne: My answer is very similar indeed. The words "seamless" and "frictionless" give us some encouragement, because that



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is clearly something to aspire to, but I do not know what they mean. I would like to see what that is actually going to involve, and how this new customs system will be as free and easy as the one we have today. We have to be encouraged that people are aiming in the right direction, but there does not seem to be any clarity around that at all. It is very worrying when we consider what we hear anecdotally about how long it is taking to implement other new IT systems and the unified customs code in Europe, which apparently took a very long time. I am very nervous when we hear about a short transitional period and then we continue to hear words like, "No deal is better than a bad deal", which adds confusion on top again, because I struggle to tell my EU investors what that all means.

Q118 Vernon Coaker: So a frictionless border, or as close to that as possible, is essential for your industries.

Chris Saunders: Yes.

Dermot Sterne: Absolutely

Q119 Vernon Coaker: What sort of measures are you, the Government or others thinking of, when you discuss this, to mitigate any additional frictions that might occur—for example, in-country inspections, digital inspections, cameras at the border or this idea of pre-assessments? Is there any planning for that? I have heard about it, and clearly there are examples of different borders criss-crossing, where those sorts of arrangements take place.

Dermot Sterne: At our level and our size of business, there is nothing we can do to influence that. We just eagerly await what those systems will be. If they are established, I imagine that they will be managed for us by a freight-forwarding company. That is the most likely situation.

Vernon Coaker: Somebody would do it on your behalf.

Dermot Sterne: Yes, and we would pay for that service, because, in a small company with 60 staff in total, we are not going to suddenly have a customs department. We would almost certainly have to use a contractor.

Q120 Vernon Coaker: That is interesting. We heard from some of the manufacturers this morning, who were talking about having to employ additional staff in case different arrangements happened at the border. They would not have the expertise, necessarily, to deal with that, so they were talking about employing specialist customs officers, almost, within their own business to look at that.

Chris Saunders: It is not just about the specialists; it is about being an informed buyer. Although we have a freight business, that is primarily about the logistics of it. It is about making sure that we are getting as much on to the back of the lorry in as efficient a way as possible. For the actual customs procedures, as they are, we tend to use freight



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forwarders. We will continue to do that, but we will need to become more informed buyers, and with more customs declarations to be done and with potential longer turnarounds, we will probably have to employ additional staff in order to do that purchasing.

We have had some very brief direct conversations with HMRC about what “frictionless” could look like, but, to be honest, our priority at the moment is not what a long-term solution looks like; that is very important, but to get to the long term we have to get through 2019. It is still not clear to us what an implementation period looks like, because it seems to mean different things to different people.

Q121 Vernon Coaker: We are talking about a transition or implementation period of two years. Is that long enough, or does it depend?

Chris Saunders: It depends what it is. From our point of view, a clear preference of an implementation period would be to remain a member of the single market and the customs union until a comprehensive free trade agreement had been signed.

Vernon Coaker: Whenever that is.

Chris Saunders: Whenever that is. We are told that we will be leaving the customs union and the single market but somehow we will manage to maintain all the benefits of the customs union and the single market until a free trade agreement is applied. We do not understand how that is possible.

Q122 Vernon Coaker: It is the “cake and eat it” argument: that we can do all of this and still maintain all the benefits.

Chris Saunders: Yes.

Q123 Vernon Coaker: You do not think that is feasible.

Chris Saunders: They may be better negotiators than we are, but we do not understand how that happens.

Q124 Vernon Coaker: Are there other measures you could take to mitigate any of this? Could you grow your own supply chains with the UK?

Dermot Sterne: Sadly, we are holding some stock.

Q125 Vernon Coaker: So increasing your warehousing.

Dermot Sterne: Yes, which is not something that anybody wants to do because of the impact on cash, especially for a small company. That, I would say, is almost certain, especially for the period where something changes.

Q126 Vernon Coaker: That is a problem for anyone, but a particular problem for smaller companies.

Dermot Sterne: Naturally. For a smaller company, cash flow tends to be king, so you do not want to tie it up in stock. I fail to understand how



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it can be two years when we do not know what we are doing yet. It should be as long as it needs to be. If we do not know what we are doing yet, how can we say it is two years? That is a bit of a concern.

Q127 Vernon Coaker: What about your equivalents in the EU 27? What are they saying to you about what they are saying to their Governments about trying to get a frictionless border, and whatever Mr Davis meant by his "highly streamlined customs arrangements"? What are they saying about their stance with respect to us? Your business is across some of this and you have partners, associates and so on.

Chris Saunders: We are a member of CLEPA, which is an association of European suppliers; I think you met with them last week. Talking to a mixture of our customers and industry colleagues, our concern is that it is just not as high a priority in certain countries. There are some countries within the EU 27, particularly Ireland, that clearly have some significant concerns and are highly engaged, but a lot of companies and countries are not that engaged because for them it is a relatively small part of their business. Also, going into the UK, they are all in the same boat; they do not lose a competitive advantage.

Q128 Vernon Coaker: Mr Sterne will know from Wrightbus, I guess. Just on that, the customs union is interesting. You mentioned Ireland. Is that a really important factor in the negotiations that go around what the customs union is for the UK as a whole, which includes Northern Ireland? There are complications that arise out of ensuring that we do not destabilise anything elsewhere.

Dermot Sterne: Yes.

Q129 Mark Pawsey: Could I just ask you about the regulatory framework? I am assuming, as component suppliers, the regulation comes down from the car manufacturer. Are you concerned about who the regulatory body will be? Should it be Europe? Should we be continuing to play a part in that? Should we be looking at what the US wants to do? How do you see regulation working?

Chris Saunders: You are completely correct. This is driven by our customers. Our products are regulated by going through a type approval process once it is part of a whole vehicle. We will be driven by what our customers want on this. Clearly, given that the largest amount of our products on customers' cars ultimately end up elsewhere in Europe, it would seem natural to want to maintain regulatory alignment with Europe, but that is more of an issue for our customers than it is for us.

Q130 Mark Pawsey: Do you see there being an issue with us being rule-takers rather than rule-makers? Have there been any instances where, perhaps through a manufacturer, you have been able to suggest modifications that would be to the UK industry's or all consumers' advantage, which we now will not have an input into?



Chris Saunders: I am aware of where that has been the case in the past for other companies. I do not have a direct comparison within GKN, but I know that, particularly because of the unusual amount of specialist and high-value manufacturers and automotive makers in the UK, we have, in certain regulations, definitely been able to mould those regulations at an EU level. That will have had some trickle-down effect to GKN, because we also supply the likes of Aston Martin, but I do not have a direct example of where that has benefited GKN in the past.

Q131 **Mark Pawsey:** Presumably, Mr Sterne, if you are a tier down, that works its way through

Dermot Sterne: Yes, it is the same. We do not have an exact example, but there is that disappointment that we will not be at the table as an industry and as a country. We will not be at the table setting the rules anymore; we will just be abiding by them.

We do have some examples currently. For example, if one of our parts is going on a vehicle that is sold in China, often our customers will ask us to do a suite of tests that can get it a specific CCC marking. That cost is passed on to us. Luckily, we do not deal with that very often, but it is several thousand pounds when we do. For that type of thing, if regulation started to diverge to the extent that we had to do that for EU products, that would be disappointing.

Q132 **Mark Pawsey:** That would add a cost to your business.

Dermot Sterne: Yes. Everybody always looks to the man below to pick it up.

Chair: Thank you very much, both of you, for coming to give evidence to us today. It is very helpful and will help inform our views on this issue. Thank you.