BREXIT AND THE STRATEGIC CHALLENGE FOR MANAGEMENT

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Brexit certainly poses several strategic challenges for banks. Namely, how best to manage Brexit's complex - and potentially contradicting dynamics and interests - while ensuring alignment to their overall business strategy. In this article, we outline the different options available to banks, and the potential conflicts of interest that the C-suite of an international bank must manage to steer their business through these times of major political and economic uncertainty.

First mover vs. late adopter

Unlike a business' typical large-scale projects, where scope and timeline can be assessed at least to a certain degree (such as regulatory demands), Brexit moves in an unclear speed and direction.

Brexit outcomes can vary from minor change requirements over a longer time-frame (in case of a favorable agreement between UK and EU), to quite extensive organizational changes within a rather short time period (i.e. a no-deal hard Brexit). This situation will demand C-suite executives to weigh up several strategic decisions.

For example, setting up a fully compliant new EU entity that is ready to start business in a hard Brexit environment (with political uncertainties) on 1st April will be no mean feat.

The incentives to delay action, on the other hand, are quite substantial. In case of a cancellation of Brexit or an extensive agreement that only makes minor infrastructural adjustments, waiting would save a lot of costs compared to the 'play it safe' option.

In case of a last-minute Brexit cancellation while already preparing for a no-deal agreement, management would have to justify the significant (unnecessary) investment in time and capital to shareholders.

Furthermore, the setup of additional infrastructure within the EU (including newly created jobs) would become obsolete if there is no business balance or agreements between the UK entity and the newly created EU entity.

Sustainable entity vs interim solution

There is the choice of setting up a self-reliant entity or implementing a dependent business extension of the UK entity. The setup of a new European entity is already in development for most banks, with inside-EU locations such as Frankfurt, Paris, Amsterdam and Dublin being popular choices.

The opening of an additional location brings more decisions to the table and will impact the future work of executives to a profound extent.
Whilst implementing the required minimum infrastructure to a new entity (to be Day 1 compliant) is likely to be the most cost-efficient way forward, it could present some operational inefficiencies from a long-term perspective.

Our experience shows that Day 1 solutions can result in additional effort where complex processes have multiple intersections between different entities and legislations within an organization. The governance issue becomes visible when a lot of steps are outsourced, and supervision and coordination therefore become complicated. In deduction, knowledge and talent should be allocated in the EU entity to an equal extent as in the UK. This is a demanding task, as most know-how and resources usually sit in the UK and the willingness to move operations can be challenging. This increases the necessity of external expertise - not only for successful implementation of sophisticated solutions in a tight time-frame – but also for training staff and to generally bring the organization up to speed for what needs to happen next.

The management dilemma

A further question to consider is: How much responsibility should be transferred to the new entity? If the new EU hub should act independently, proper management structures must be installed, and freedom of choice must be granted. Having a fully operational entity which executes and takes decisions onshore is beneficial, as complex banking business should be holistically managed where its conducted to ensure proper risk management and sound decision-making.

A comprehensive setup of an independently acting entity would be a more efficient long-term solution and serve clients' needs better, in case of Hard Brexit. Nevertheless, this approach would imply major challenges for budget allocation decisions, together with increased short-term costs as well as challenges in controlling decisions. From the UK perspective, the added operational costs require business justification. Furthermore, very specific local regulations may differ from the UK, and as such, stakeholder management will be required to explain why certain decisions are key to having a fully operational and compliant entity.

If a management team is installed in an EU entity and is supervised by UK management, different principal-agent issues can arise. The management team in the new EU entity is motivated to implement state-of-the-art processes and an organizational structure to enable best possible banking operations, while the UK team requires a strong business case to justify the increased costs to Senior Management and explain why this is required despite the very uncertain scenario. This conflict of interest requires extensive experience in Stakeholder Management. Experienced managers are required to conduct a risk-benefit analysis and come to an agreement with both UK and EU senior management.

This leads to the conclusion that, due to uncertainty, UK and EU management may have conflicting opinions in what is best to be ready for Brexit. While management of the legacy business might be in a holding pattern and hope for a soft-Brexit scenario, management of the receiving entity would rather be ready and expect a hard-Brexit so they can manage the business in all eventualities. This conflict of interest does not imply that managers in any of the regions are wrong; from a UK perspective it is challenging to justify the new entity under such risk and uncertainty, and from an EU perspective, this complexity is required to abide with all regulations. After all, Brexit or no Brexit, EU senior management is liable for anything that happens onshore on their entity (regardless of it being legacy or new Brexit business). Notwithstanding this conflict of interest (which is ubiquitous in the corporate world), one thing is certain: UK and EU management are in the same boat and have their firm's interest at heart.

Obligations to be met by the management board can differ a lot between different jurisdictions. For Germany, specifications can be found in the 'Guidance Notice on management board members pursuant to KWG, ZAG and KAGB' issued by BaFin (31.01.2017), especially regarding possible conflicts of interest and personal liability obligations. Making this task a project to develop additional leadership skills to middle level management and (potential) senior executives, or the implementation of an interim management team, are all options to consider.

There is no simple solution for the Brexit dilemma and challenges the C-suite could face. Applying traditional approaches to strategic planning and tactical execution is dangerous when a clear Brexit outcome is still unknown. Indeed, Brexit uncertainty amplifies the importance of making management decisions when the time is right. After all, making critical decisions too early can lead to bad choices, but delayed decisions lead to excessive risks - especially in a Brexit no-deal scenario.

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