The Brexit Breakup Brings New Opportunities

By Lily Fang , INSEAD Associate Professor of Finance

The Brexit referendum result sparked market volatility, upending the status quo, but it is not all doom and gloom.

After taking a dive in the aftermath of the Brexit vote, the global markets have steadied and refocused on other news as businesses assess the damage, and opportunities, ahead. Although US$2 trillion was knocked off the global markets in the aftermath of the referendum, I believe this initial strong reaction was very much due to the shock factor of a voting result not anticipated by most investors. Many big names in the investing world were caught wrong footed, creating a great deal of volatility and downward pressure on international markets.

While globally the focus has moved on to other news, such as the job situation in the U.S., Fed policy, and the U.S. election, British and European firms may feel the instability for some time to come. But this is not all bad news. There will be winners as well as losers.

In the long-run, I think the full impact of Brexit on the market will be more muted than many might expect for two reasons. First, markets are forward looking. The immediate, sharp drop priced in most, if not all, the downsides and subsequent moves should reflect incremental, new information. Even though it will take years for the details of Brexit to be carried out, the financial market will not take that long to figure out the impact and my sense is that this impact has already been priced in.

Second, the Brexit vote could be a crisis as well as an opportunity; in fact, it can be both at the same time – for different firms. Because the pound will weaken, British exporters (Scotch makers among others) will benefit while British importers and those that export to the U.K. – European car makers, for instance – will suffer. Whether Brexit is a long-term plus or minus will be sector-specific.

Taking into account that the pluses are neutralised with the minuses, as well as the fact that there are other major issues weighing on the market such as the resilience of the U.S. recovery and the slowdown in China, the overall impact of Brexit could well be less than many people thought.

Who stands to gain?

As well as the British exporters mentioned above, consumers travelling to the U.K. and those buying British goods will benefit from Brexit as the relative price becomes cheaper. Many emerging markets will be affected by Brexit through the currency markets and trade. China, for instance, will feel the impact on its currency which is linked to a basket of major currencies, including the pound. Some of these effects will be positive and others negative.

More broadly, Brexit in the long term allows Britain to have its own policies and trade arrangements rather than being constrained by the EU, and this may well be a great opportunity. Brexit is an unprecedented event; but unprecedented just means that it changes the status quo. People may feel anxious because we are going into the unknown but, if executed well, Brexit will bring good opportunities alongside the challenges.

What happens to the finance crown?

One industry that has been the subject of much concern is finance. London was the financial centre of Europe, even challenging New York as the financial capital of the world. Brexit could challenge London's position in this respect if firms – banks, hedge funds, private equity firms – move staff and resources away from the U.K. This has many people worried and was something big banks warned of before the referendum. But I think the likelihood of a finance exodus from London is less likely than many people fear, for the simple reason that Continental Europe has no financial centre that can yet compete with London in terms of the depth, liquidity, human capital, and the quality of oversight. Some of the same big banks that had warned of staff movement before the vote have reversed course and are now urging calm.

The fact is, even as many people contemplate moving out of London or the U.K., there are not many compelling places to move into in Europe. New York and Asian financial centres may marginally benefit – mostly for the global business – but London will remain the top financial centre in Europe for European transactions and deals.

In addition, as the pound weakens, global investors will find great opportunities to invest in U.K. assets and M&As, etc. Thus once again, Brexit is creating opportunities as well as challenges.

Long-term advantage

Now that the U.K. does not belong to the single market, it is on its own and smaller, but if British regulators, lawmakers, and dare I say, politicians, seize this opportunity to make London and the U.K. truly competitive and attractive as a financial centre and investment destination, I can see that its advantage can be extended in the long run. This will be especially true if its European counterparts continue to lag behind in reform and innovation.

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