# CROSS-BORDER OPERATIONS: **REGAINING MOMENTUM IN 2020 AND BEYOND**

# INTRODUCTION

DESPITE ECONOMIC TURMOIL CREATED BY THE CORONAVIRUS PANDEMIC, recent surveys show a clear trend of CFOs taking a long view when developing their international operations strategies and cross-border M&A plans. They seem intent on looking beyond the present moment towards economic recovery and organizational growth. Moreover, many of their pre-pandemic concerns, such as those related to supply chains, have only intensified during the crisis.

This report draws on two surveys of CFOs, CEOs and other senior finance executives. One survey was conducted in early January 2020, before the coronavirus pandemic was declared, the other was conducted in April, after the declaration. Together, the surveys reveal the compliance and operational challenges that most concern these executives, along with anticipated future challenges. Their concerns include global economic uncertainty, data protection compliance, and cross-border supply chain expenses and management.

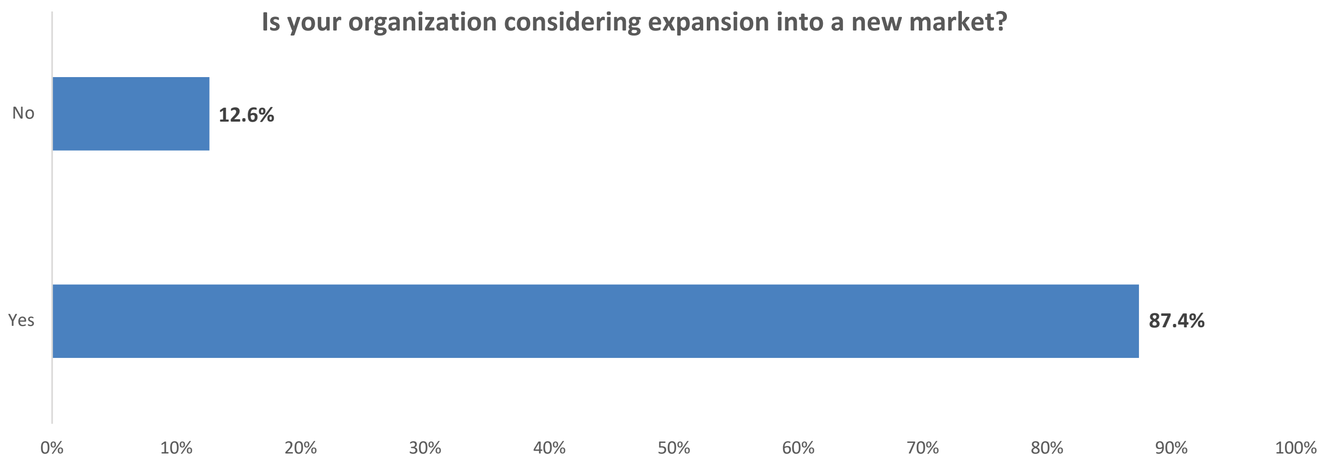
Respondents also shared their views on global expansion target countries, why they engage in M&A, and the solutions they employ to address their most pressing cross-border concerns.

# KEY POINTS

FROM THE JANUARY SURVEY (before the pandemic declaration)

- **Before the coronavirus crisis, nearly 9 in 10 companies were considering expanding into new countries**
- **Most executives said their tax departments were not well-equipped to address cross-border concerns**
- **Six out of 10 companies were considering or engaged in reviews of their legal entity structures**

## NEARLY 90% OF RESPONDENTS INDICATED THEY ARE CONSIDERING EXPANSIONS INTO NEW MARKETS (January survey)

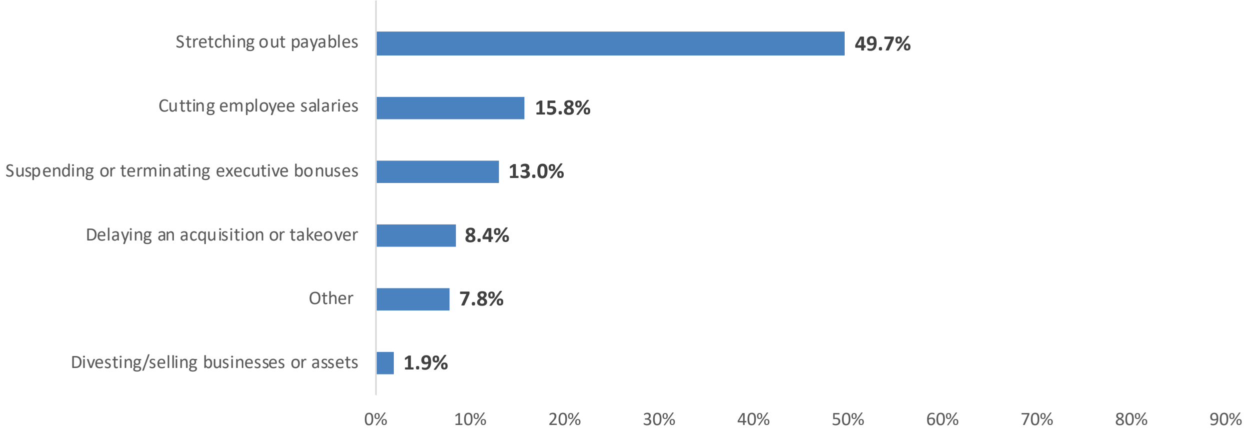


# KEY POINTS

FROM THE APRIL SURVEY (after the pandemic declaration)

- **Supply chain issues continue to be a top concern after the pandemic declaration**
- **Pre-pandemic momentum for cross-border M&A activity also seems to be continuing**
- **Only one in five of the surveyed executives say they're shutting down business lines during the pandemic**
- **Only 2% of the executives' companies are selling businesses or assets to raise cash**

## EXECUTIVES REPORT THEIR COMPANIES ARE PROCEEDING WITH M&A PLANS (April survey)




This question is from a survey by CFO Research to over 300 senior finance executives, gauging their response to the COVID19 crisis.

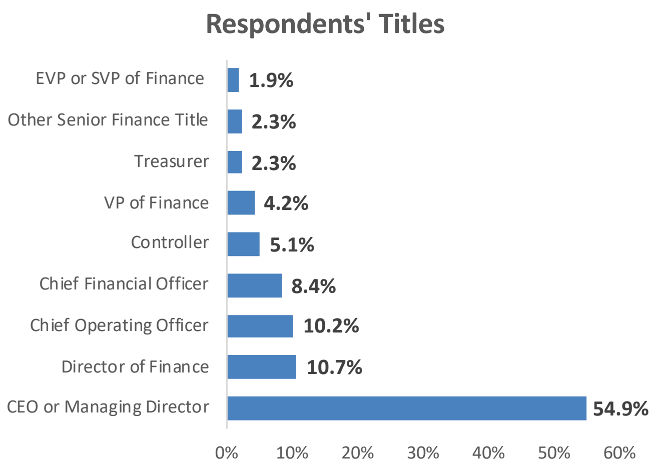
These results were collected from late March to early April.

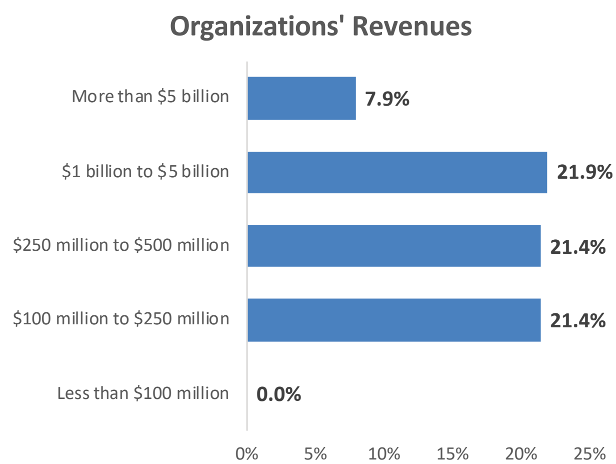
# MAINTAINING MOMENTUM FOR GLOBAL OPERATIONS IN A POST-PANDEMIC WORLD

The two 2020 surveys of CEOs, CFOs and senior finance executives show that as companies grapple with the coronavirus crisis, their executives are taking a long-term approach to managing their global operations. These executives are also focused on many of the same global operational challenges they were concerned about before the pandemic.

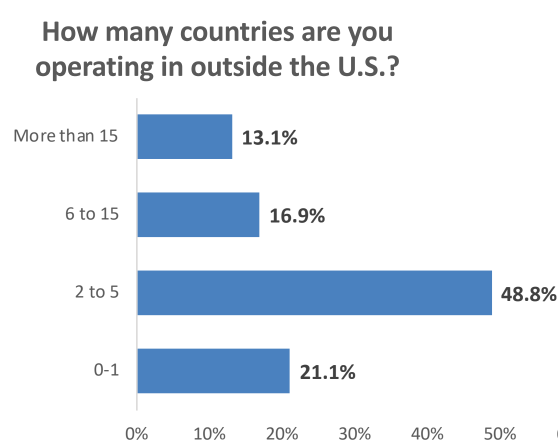
In early January 2020, before the pandemic had been declared, CFO Research and Vistra surveyed 215 executives at $100-million-plus companies, almost all of which are U.S.-based. In April, CFO Research conducted another survey of 333 executives about their response to the coronavirus crisis.

## JANUARY SURVEY DEMOGRAPHICS







The April survey found that a strong percentage of the executives, 31%, considered supply chain disruption to be a major concern. That finding dovetails with the early 2020 survey, which reflected a similar preoccupation with supply chain management. In that earlier survey, maintaining supply chains was the number one cross-border expense expected to increase the most dramatically in three to five years, as cited by 35% of the CFOs and other senior executives. And 22% of the respondents said they would update their supply chains in the next three to five years to address concerns about global expansion and operations.

On the subject of M&A, only 8% of the respondents in the April survey said they were delaying acquisitions or takeovers. That result aligns with pre-pandemic survey results, which showed that nearly nine out of 10 executives were considering expanding into new markets, and 97% of their companies were engaged in cross-border mergers and acquisitions.

While it remains to be seen if M&A will be a key driver of global expansion in the future, momentum had been building prior to the coronavirus crisis. Cross-border M&A played a prominent role in the strategies of multinational companies, and it was a nearly universal practice, with only 3% of the executives reporting that they didn't engage in it. The primary reason for cross-border M&A was to expand to new markets, as cited by six out of 10 executives in the early 2020 survey. A quarter of the survey respondents said their primary reason was to acquire new intellectual property and technologies.

The most important factor considered when selecting a target region for M&A was economic stability, said 36% of the executives in the January survey. This suggests the global economic uncertainty created by the pandemic could potentially slow cross-border M&A momentum worldwide, at least in the short term. Number two on the list of important M&A target-region factors was political stability, cited by 27% of the respondents, followed by labor costs, cited by 24%.

# A CAREFUL, PROACTIVE **APPROACH TO GROWTH**

The April survey asked executives about the short-term steps they were taking to survive the revenue and profit impacts from the coronavirus outbreak. The number one response—from half of the respondents—indicated that companies were delaying investments, showing they are more inclined to slightly alter their strategies than to abandon them altogether.

Only 20% of the April survey respondents said they were shutting down some operations or idling business lines. This may be evidence of finance leaders wanting to maintain their global operations where possible. That finding was reinforced by the fact that only 2% of the executives reported their companies selling businesses or assets to raise cash.

The relative lack of appetite for shutting down operations as reflected in the April survey also supports findings from the January survey, with most companies taking a careful and proactive approach to winding down or consolidating certain operations, rather than a hasty or reactive approach.

The earlier survey found that legal entity rationalizations have been a big concern for multinational companies. Legal entity rationalizations are reviews to determine whether existing legal entities are necessary and to identify potential savings and efficiencies from simplifying legal structures. Executives in the early 2020 survey said that 61% of their companies were considering or engaged in legal entity rationalizations. Cost savings and tax-structure simplification were the primary reasons cited by executives for rationalizations. Companies typically engage in legal entity rationalizations after years of acquisitions have created complex and inefficient legal structures, though companies can also benefit from rationalizations after significant organic growth. Because it is difficult to sell a company with a complex structure, and because simpler structures sell for higher multiples, many companies implement rationalizations a few years before planned M&A activity.

It's reasonable to assume that multinationals will continue to look to legal entity rationalizations to promote efficiencies and cost savings in a post-pandemic global economy, where economic headwinds may persist for some time. Multinationals may even increase these activities to put themselves in a better position to thrive during economic recovery.

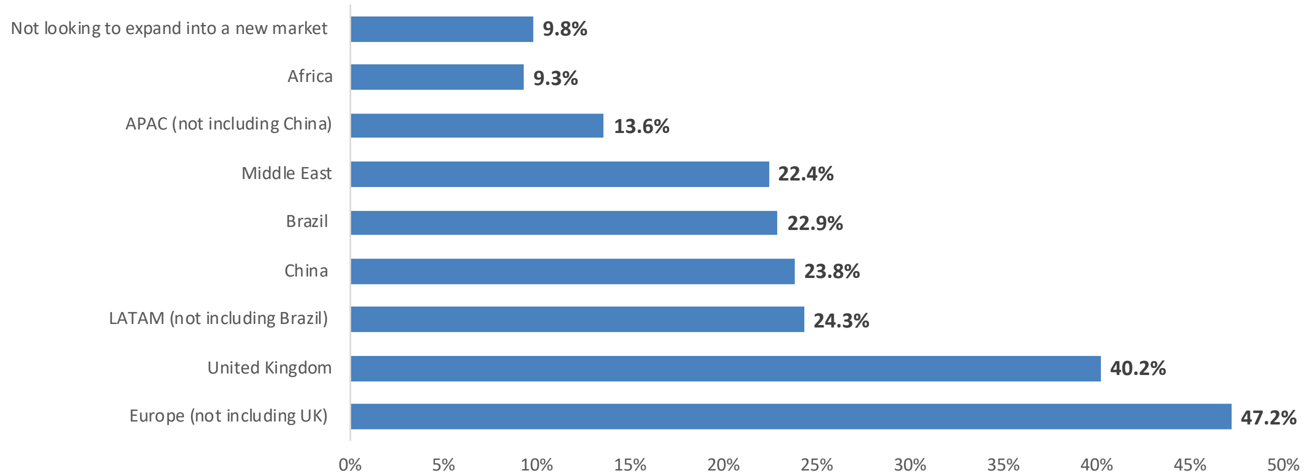
# PRE-PANDEMIC: **A HEALTHY APPETITE FOR GLOBAL EXPANSION**

While it's too early to know how the coronavirus will affect the global business environment, the early 2020 survey of executives pointed to some interesting pre-pandemic trends. The survey showed a healthy appetite both for maintaining global operations and for international expansion. About half of the companies represented by the survey respondents operated in two to five countries outside the U.S., and 30% operated in six or more countries outside the U.S. A whopping 87% were considering expanding into new markets.

The executives' answers about the countries they were targeting for expansion were illuminating. The United Kingdom was a target for 40% of the executives considering expansion; China was for 24%; and Brazil and other Latin American countries were targeted by a combined 47% of the executives. The popularity of these countries as expansion targets indicates that companies had particularly strong, long-view growth strategies that were not going to be disrupted by the newsworthy challenges of the moment, including Brexit and the U.S.-China trade war. Respondents were also undeterred by longstanding economic and regulatory hurdles, such as those traditionally encountered by companies expanding into Latin American countries.

Overall, Europe (not including the U.K.) was the number one target region for expansion, named by 47% of the executives. More respondents were considering expanding into Latin America (not including Brazil), 24%, than into Asia Pacific (not including China), 14%. (The U.K., Brazil and China were separated from their respective regions in the survey questions due to those countries' popularity as expansion targets.)

## PRE-PANDEMIC TARGET REGIONS CONSIDERED FOR EXPANSION

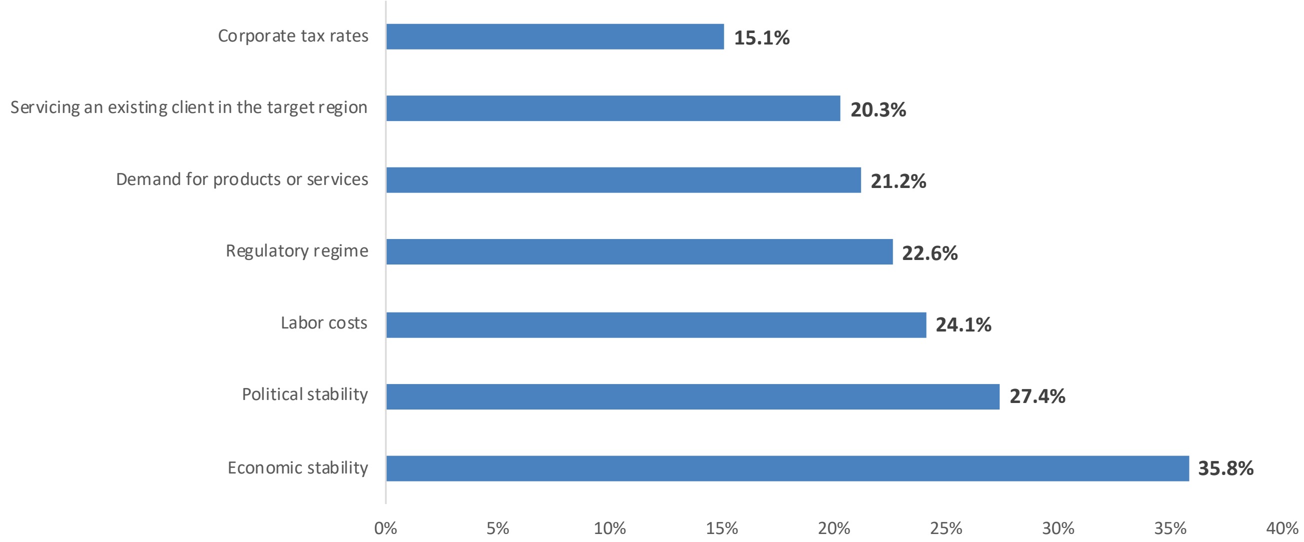


While the survey showed a persistent appetite for international expansion, global political events were certainly affecting corporate strategies. When asked specifically about how U.S.-China trade tensions and tariffs had affected their global expansion and operations strategies, only 25% of the executives said the situation had not affected their strategies. Yet 54% of the executives said they were considering expanding into China, despite the trade tensions and tariffs.

The response was similar for their U.K. strategies in the face of Brexit. When asked how Brexit uncertainties affected their global expansion and operations strategies, only 21% of the executives said the Brexit situation had not affected their strategies. But 55% said they were considering expanding into the U.K.

The early 2020 survey showed that Europe (not including the U.K.) was the most popular region for both past and future M&A, followed by the U.K itself. China edged out Latin America (not including Brazil) for third place for future M&A. The most popular target countries and regions for M&A largely mirrored the countries and regions targeted for traditional expansion.

## RESPONDENTS CITE ECONOMIC STABILITY AS THE TOP FACTOR WHEN SELECTING A TARGET REGION FOR M&A (January survey)



# AREAS **OF CONCERN**

In the pre-pandemic survey, the executives' concerns about global expansion and operations were almost evenly spread across 11 areas. Some of those concerns still resonate in the pandemic business environment, such as those related to economic uncertainty and supply chains.

In the January survey, the top concern about global expansion and operations was in fact global economic uncertainty, acknowledged by 29% of the executives. This seems especially prescient now. The second concern was data protection challenges, cited by 26% of the respondents. Five other areas of concern were named by at least 20% of the executives in the January survey: growing operational costs and challenges; global liquidity concerns; trade wars and tensions; inefficient corporate structuring; and regulatory challenges.

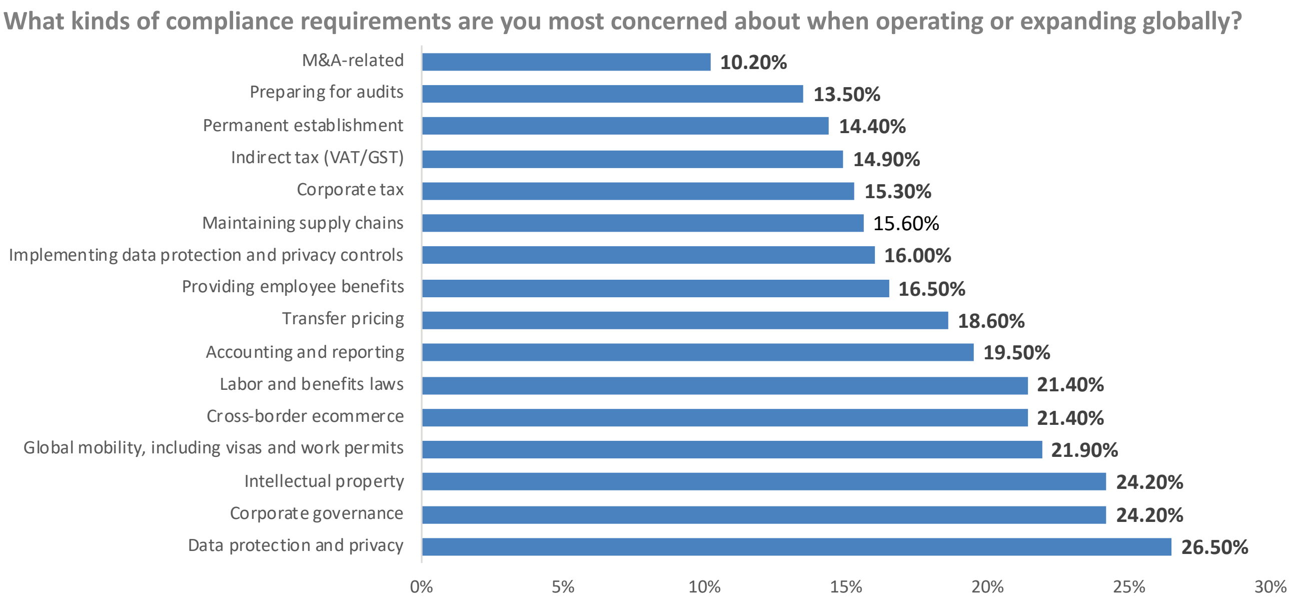
The January 2020 survey showed that the executives' plans for dealing with their concerns about global expansion and operations over the next three to five years were diverse. Remarkably, the top solution was international expansion itself, at 27%. Expanding existing operations was the second-most popular solution, tied with implementing new technologies. Another six solutions were named by at least 20% of the executives: devoting more resources to global operations; mergers and acquisitions; relying more on domestic customers; updating supply chains; introducing new products or services; and winding down operations.

CFOs and other senior finance executives of course face myriad regulatory issues tied to international operations. The January 2020 survey showed that the top three compliance concerns for companies operating or expanding globally were data protection and privacy, corporate governance and intellectual property, all named by about one out of every four executives. The executives' level of concern was spread fairly evenly across nine other compliance areas: global mobility, including visas and work permits; labor and benefits laws; cross-border e-commerce; accounting and reporting; transfer pricing; corporate tax; indirect tax; permanent establishment; and preparing for audits.

The April survey showed that regulatory challenges continue to be a major issue following the pandemic declaration, with 23% of the respondents citing government policy and legislative response to the coronavirus crisis as one of their most pressing concerns.

The January survey revealed that economic substance laws were another significant concern, with 78% of the executives saying that compliance in this area was somewhat burdensome to very burdensome. Economic substance refers to country-specific laws requiring companies and their transactions to have a substantial purpose in the country besides reducing tax liability and an economic effect besides their tax effect. These rules include those recently implemented by countries traditionally considered tax havens (such as the Cayman Islands) to discourage company structures designed to attract profits that do not reflect real economic activity.

## AMONG COMPLIANCE REQUIREMENTS, DATA PROTECTION AND PRIVACY REPRESENT TOP CONCERNS (January survey)




While these economic substance requirements are not, strictly speaking, based on tax law, they did arise largely from concerns over perceived aggressive tax planning. As a result, they are often considered in the context of international tax reforms that promote cross-border tax transparency, such as country-by-country reporting requirements and the EU's DAC6 directive.

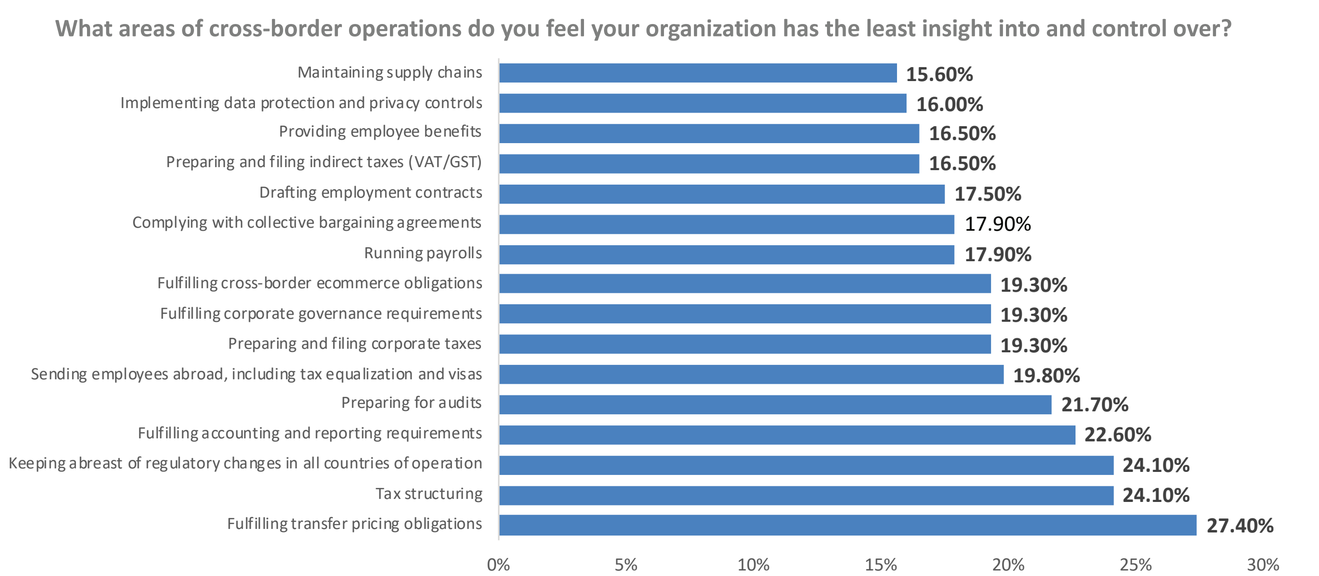
When asked what cross-border operational areas their companies have the most insight into and control over, the executives in the January survey showed the least confidence in drafting employment contracts, running payrolls, and preparing and filing indirect taxes (such as value-added taxes and goods-and-services taxes). And fewer than one in five executives were confident in their companies' cross-border operations in the following areas: fulfilling cross-border e-commerce obligations; implementing data protection and privacy controls; preparing for audits; and fulfilling accounting and reporting requirements.

Interestingly, the January 2020 survey showed that "fulfilling transfer pricing obligations" was one of the areas that companies had both the least and the most insight into and control over. This polarized response suggests that many executives take transfer pricing seriously, but only some are devoting enough resources to achieve compliance. The response was similar for the area labeled "keeping abreast of regulatory changes in all countries of operation." This was another area that the executives had both the most and least confidence in, indicating that keeping informed of regulatory changes is a critical concern that some are prioritizing and others feel anxious about.

Most executives in the January 2020 survey were confident about the ability of their organizations to fulfill regulatory obligations across a range of important areas. The top two regulatory areas of concern were cross-border e-commerce, where 16% of the executives said their companies were not equipped or poorly equipped, and M&A-related areas, with 15% in the not-equipped or poorly equipped categories.

When asked how equipped their tax, finance, human resources and general counsel's offices were to address cross-border concerns, tax was the only department that most executives said was not well-equipped. This was consistent with their responses to other questions of the January survey, where tax structuring and indirect taxes were named as areas of concern. These concerns may spring from the notably complicated, fast-evolving nature of cross-border tax rules. The pandemic has if anything increased the rate of tax-regulatory change in most countries, so these concerns will almost certainly persist for executives and may become even more pressing.

## WITH REGARD TO CROSS-BORDER OPERATIONS, RESPONDENTS REPORTED THEIR COMPANIES HAVE THE LEAST INSIGHT INTO AND CONTROL OVER FULFILLING TRANSFER PRICING OBLIGATIONS (January survey)



# CONCLUSION

The coronavirus crisis has created once-in-a-lifetime business challenges for CFOs and made it all but impossible to make accurate predictions about the future. But the two recent surveys of CEOs, CFOs and other senior finance executives provide some useful insight into their thoughts about global operations and international expansion.

The survey data shows that besides the challenges of the pandemic, global expansion and operations present a long list of concerns executives must effectively manage. Supply chain management issues were a concern of executives before the pandemic, and those concerns remain.

Data protection, corporate governance and intellectual property were atop the list of regulatory concerns in the January survey. Nearly eight out of 10 executives said that compliance with economic substance laws is burdensome. Tax structuring and indirect tax filings were key concerns on the tax front. Executives responding to the April survey placed a similar emphasis on regulations, with about one quarter of respondents citing coronavirus-related legislation and policies as a major concern.

Despite these concerns, the pre-pandemic data indicated that a strong momentum had been building for international expansion and operations, with nearly nine in 10 respondents considering expanding into new markets.

That momentum may be poised to continue following the pandemic. In the April survey, for example, only 1.9% of respondents indicated they were divesting or selling businesses or assets, suggesting that finance leaders want to maintain their global operations even in a time of widespread disruption. Additionally, the April survey revealed that half of the respondents—the top response—were delaying rather than halting investments in response to the revenue effects of the pandemic.

Prior to the pandemic declaration, six out of 10 companies were considering or engaged in legal entity rationalizations, which are often both a result of and precedent to M&A activity. As multinationals look to find efficiencies and cost savings during global economic recovery, this high rate of legal entity rationalizations is likely to continue if not increase in the wake of the declaration.

Robust M&A activity also seems likely to continue, with only 8% of executives delaying acquisitions in the pandemic business environment. This aligns with pre-pandemic findings, which showed 97% of respondents engaging in cross-border M&A.

It goes without saying that corporate strategies are evolving in our current volatile economic landscape. That said, the results from both surveys suggest executives are taking the long view with their companies' global expansion and operations strategies, pausing rather than abandoning plans until economic recovery begins in earnest.