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Global considerations for mid-market companies

Finding your fit
Location selection

This article is part of a series devoted to global expansion considerations for US businesses, particularly those in the middle market segment

Whether it's a local office, a regional headquarters, a plant, a data center, or a databank full of intellectual property ("IP"), an overseas expansion of your business almost always includes a decision about where to operate. Choosing the right location is a decision that progresses from large-scale to small — from "what country" to "which side of the street" — and involves a multidimensional array of critical factors. Companies don't always have as much time or flexibility to ponder the variables as they would like, but there are advantages to considering the array of choices.

This article can help identify and address some of the particulars. They'll vary from situation to situation. But one principle generally applies: control. Be mindful of which location criteria you can control and which ones you cannot. Remember that each decision you make today has the potential to preserve or diminish the operating latitude you will have in the future. You will generally have more control at the beginning of the process than you will at the end of the process.

Begin at the top

The region of the world and the country you're considering bring macro issues to the table that definitely belong under the heading "things you can't control." That includes not only the physical terrain and climate, but also the tax and legal environment, the economy, and political stability. Even elements that will eventually be subject to negotiation, such as talent, credits and incentives, take place in the context of an established talent market or government entity whose large-scale characteristics aren't up to you.

Assess these large-scale issues on a dynamic basis, not a static one. Things change — sometimes over the course of a generation, sometimes overnight. How stable is the environment whose characteristics you intend to rely upon?

Just as you would for a discrete, tangible factor like labor costs, you should approach stability with a data-driven eye, not with assumptions. For example: If stability were really the most important factor, might you consider keeping your company in the United States? Perhaps not if you were to learn that in measures of overall political and economic stability, the United States is in the middle of the pack.[1]

[1] *World Economic Forum, The Global Competitiveness Report 2014-2015*

Talent: Parse the populace

A workforce isn't just the number of people in an area, but the number of people who possess the attributes an employer needs. That includes not only technical skills and education, but also factors like sustainability (is there another generation in the pipeline?) and mobility (will everyone move away or change jobs more quickly than you expect?).

Remember that an enterprise needs talent on different levels, from front-line technical or professional to managerial and leadership roles. This is especially important as global organizations have begun to emphasize the use of local leadership instead of the original centralized office model.

If your plan does involve moving key employees across borders, in either direction, it's vital to know the applicable local laws as well as the tax and immigration status of the individuals in question to help them and you comply with local laws and tax regulations. In addition, understanding the tax and immigration rules will help in budgeting for the extra costs related to tax and immigration.

The talent picture meshes with the macro picture because a country's society, economy, and educational system all contribute to the skill development infrastructure that will keep local talent available in the years ahead.

Location, location… etc.

The particulars of site selection vary greatly with the nature of the need: Locating an office, a mine, a distribution center, a retail store, and a manufacturing facility are all very different challenges. Still, there are common factors a company should consider. Business leaders should determine the importance of each of these items.

Knowing the real estate market in multiple potential locations — the availability of real estate, the quality and suitability of pre-existing buildings, and above all the price history — is foundational to any attempt to negotiate. (The local real estate market may exert great influence over any future attempt to divest the site.) Knowing how to approach those negotiations will depend in part on factors like transport, energy, and other surrounding infrastructure and access to key markets, based on business objectives and goals.

Of course, a site's physical attributes matter, whether it's a greenfield (a previously undeveloped location), a brownfield (a location repurposed from previous, often industrial use), or an existing built asset. How do its unique characteristics align with the use you intend? What is its potential for expansion or repurposing?

From the site itself, expand the examination concentrically. What are the relevant environmental sensitivities of the area? Will the expected future growth of the municipality, region, or country correspond to your future strategy, or to your need for market demand? Are the local utilities able to supply the resources the location will need, on permanent terms — not just temporary incentive terms — that are acceptable?

Global location factors

Macro situation | **Talent** | **Site** | **Tax** | **Legal** | **Incentives**

There are several discrete factors — but there aren't several discrete boxes to check. Just one big box that has to pass several tests. Creating an overseas business location is not a decision that allows for silos.

Taxes

The local tax situation always has the potential to change and is changing with the Global Tax Reset.[2] It may be beneficial to work with people whose local experience gives them insight to the tax environment and knowledge of the nuances. In establishing a new global outpost or entity, an organization should structure in a way that provides tax efficiency while preserving flexibility in case the laws change. In the case of many mid-market companies that might be partnerships or S corporations, it becomes important to decide on which global tax structure to use. Will they will operate in a flow-through structure internationally, or will they operate through regarded corporations? The choice may be influenced by the tax rate that can be sustained internationally and the need for cash back in the United States.

While the lower qualified dividend tax rates remain for individuals and while the individual and corporate income tax rates in the United States remain higher than the corporate tax rates overseas, deferral structures can provide cash tax savings and reduce the global tax rate. For mid-market companies that are regarded C corporations, operating as flow-through entities internationally may not generally be as advisable but there are still very important structural decisions that need to be made in terms of the global tax structure (i.e., use of holding companies, finance companies, intellectual property companies, considering overall treasury policy, etc.) including choice of entity and functions to be performed in a given jurisdiction.

Depending on the jurisdiction and the industry involved, locations can present tax implications that vary in a number of ways for both the employees who are working abroad as well as the companies themselves. Tax benefits may be available based on the type of activity that takes place or the nature of the assets owned in certain jurisdictions. In some locations, an overseas employer may be able to negotiate applicable income taxes or other taxes. Others may have special taxation zones, or different duty rates for some imported products. There may also be treaties or trade agreements in place that affect the way remittances to such jurisdictions are taxed and the local taxes that can apply to entities importing goods from such jurisdictions.

Companies will also need to consider how the organization plans to use the cash the new location generates. Home-country repatriation versus local-company accumulation, or reinvestment in the operation may result in different tax outcomes.

Even if there is no physical location, and a company is merely exporting products or licensing/franchising its intellectual property, there may be implications for the ways tax authorities treat indirect and cross-border income. There may also be opportunities to consider ways to reduce local country withholding taxes and indirect taxes. Furthermore, there may be opportunities to use certain types of entities — such as an IC-DISC (Interest Charge Domestic International Sales Corporation), which provides tax savings to US exporters under qualifying circumstances — when merely exporting property to reduce cash taxes and lower the global tax rate depending on an organization's structure in the United States.

Even if companies are not considering any advance tax planning, an organization should still consider the issue of tax compliance with local laws and regulations.

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[2] *For more information: http://www2.deloitte.com/us/en/pages/tax/articles/global-tax-reset-the-changing-world-of-tax.html*

The legal environment

Every country has a legal system, and like the one in the United States, each legal system is a complex aggregation of many years of tradition and experience. To do business under a different set of laws requires a conscientious effort to move beyond the reflexive use of US-based assumptions.

In each jurisdiction a company considers for expansion, there is likely a body of corporate law. There may be a suite of regulatory requirements, which may extend across multiple areas such as labor, the environment, product safety, and others. There may be a commercial code, and rules around how to account for intellectual property. For each of these facets, your company will need to conform to the local system.

Once you have identified the challenges and opportunities the new location presents in each of those areas, you may have some perspective around what business vehicle is likely to work for your organization from a business and tax perspective — for example an owned subsidiary, a joint venture, a franchise/licensing relationship, or some other structure. How much flexibility and protection do local laws give you in making that choice?

It’s also important to focus on aspects of the local legal and contractual structure that apply most specifically to the operations you intend to move to the local country. One company may prioritize IP protection and data privacy, while another company importing and exporting products may put a premium on complying with import-export regulations. Most companies will have to address more than one such consideration, along with laws that bear directly on “permission to do business,” such as licenses, authorizations, statutory accounting requirements, and public permits.

Country A		**Country B**	
Statutory rate 18%	• Robust incentives • Earnings stripping • Low labor costs	**Statutory rate 15%**	Few incentives
ETR 13%		ETR 14%	

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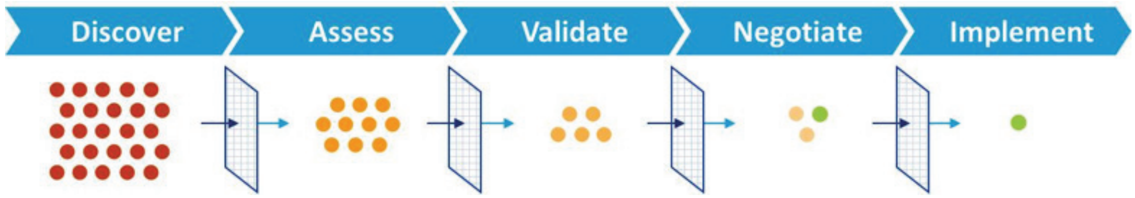
Keeping incentives in perspective

There is a place in overseas location planning for economic development and tax incentives. Such measures may not be permanent, and it's possible other factors will weigh more heavily. But when all else is equal, the terms a location offers may present an opportunity that tilts the scale decisively.

Remember to evaluate incentives in a larger context. Just as a "sale price" for a retail item may mask an unattractive base price, an economic development or incentive in one place may yield a less advantageous tax profile than the standard, unaltered tax system in a different locale. It's important to understand the potential implications on the effective tax rate.

That doesn't mean companies should ignore incentives. They can take many forms depending on the kind of business and the activities it contemplates carrying out: In addition to the familiar form of tax credits, some places may offer cash grants, contracts, applicability of regulations, workforce development programs, or access to physical infrastructure. Note that some incentives may apply not to the business as it operates on day one, but to potential future expansions.

If, after using the other criteria and prioritizing the factors that are most important to the organization, you have narrowed your location search to one or more specific areas, it may be worth the effort to identify and evaluate the incentives, exemptions, or grants available in the candidate location. It's also advisable to make these possibilities a talking point in your negotiations with local government officials. The value your company may bring to a local economy can help give you competitive leverage in the incentive negotiation process. If competing locations have already given your company earnest incentive offers, that may be a source of leverage as well. In fact, you may want to go down a parallel path of considering at least two locations and negotiating for incentives before committing on one.



Learning from those who have made the leap
Choosing the location for an overseas expansion is a process. Like any process, it is subject to refinement.

Other companies' previous efforts have helped to populate a list of common mistakes that a new entrant into the global marketplace can work to avoid.

Don'ts	Dos
• Unprepared site selection team	• Multi-disciplinary team required
• Lack of executive consensus	• Communicate early and often
• Incorrect search area	• Think bigger
• Narrowing the search area too rapidly	• Be conservative
• Failure to consider all issues	• Think broadly and be balanced
• Incomplete labor market analysis	• Consider all factors
• Failure to consider community trends	• Understand the long term
• Poor or absent technical site review	• Do your homework
• Breach of confidentiality	• Discretion is key
• Failure to capture negotiable incentives	• Don't be afraid to ask
• Acceptance of overvalued incentives	• Quality not quantity
• Poor implementation of incentives	• Get what you deserve

A significant mistake is to lose sight of the broad view. Any one of the factors here has the potential to distract a company's attention during the site selection process. Just as importantly, any of the factors that goes into a global location search has the potential to unlock a benefit previously unconsidered. And too much attention in one area may mean too little in several others.

Some of these factors may be more important than others. For each company, based on its needs and circumstances, there may be an order in which to resolve them. But they don't work independently. A company that is going through this process should think not of many boxes it has to check, but instead think of one big box whose checkmark has many interlocking components. •

This article is part of a series devoted to global expansion considerations for US businesses, particularly those in the middle market segment. Future articles will explore related issues in more detail. To learn more, contact one of the Deloitte professionals listed on the next page, or visit www.deloitte.com/us/dges.

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Perspectives

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