Business Across Borders

Licence to travel: how regulation is benefiting business abroad

A series of articles written by The Economist Intelligence Unit

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The business of relationships.

Business across borders

Licence to travel: how regulation is benefiting business abroad

When companies are looking to expand into new markets, regulation is more friend than foe for most, according to a global survey of business leaders carried out by The Economist Intelligence Unit (EIU) on behalf of international law firm Reed Smith. Yet, as senior executives and economists point out, overly burdensome regulation can create barriers to cross-border investment, as does the absence of a clear, transparent regulatory environment.

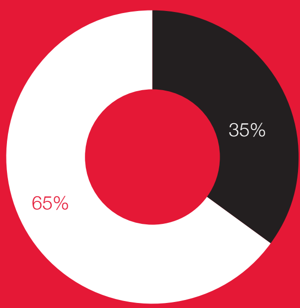
The benefits of regulation

Regulation of business activities for many is a propeller of, and not an obstacle to, international expansion. Nearly two-thirds of respondents (65%) in the EIU survey say that regulatory developments at home have made it easier for their company to expand into new markets. The proportion rises to 78% for respondents from the shipping and transport sector and to 82% for healthcare and life-sciences executives. International regulation too, according to the EIU survey, assists companies' international activities, though not as convincingly as domestic rules. As well as supporting cross-border expansion, regulation encourages investments in innovation, according to three-fifths of survey respondents.

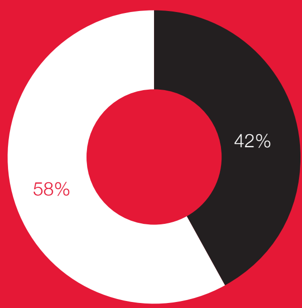
65%

of respondents in the EIU survey say that regulatory developments at home have made it easier for their company to expand into new markets

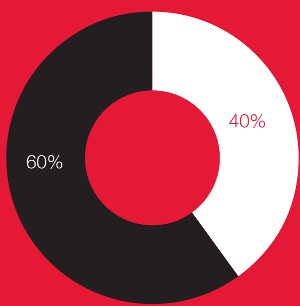
Chart 1:
For each of the following pairs of statements, pick the one statement that is closest to your company's view of regulation.



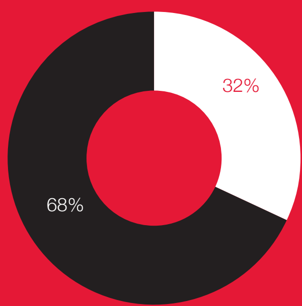
- Regulatory developments in my home market have made it easier for our company to expand into new markets
- Regulatory developments in my home market have made it more difficult for our company to expand into new markets



- International regulatory developments have made it easier to expand into new markets
- International regulatory developments have made it more difficult to expand into new markets



- New regulation has made it more difficult to create new products
- New regulation has spurred our company to invest in and encourage innovation



- The regulatory environment in a market is not a top consideration in our company's decision to invest or not
- The regulatory environment in a market plays a key factor in our company's decision to invest or not

Source: The Economist Intelligent Unit

Regulation is also a key factor in decisions on whether to invest or not in a new market. "If there is regulatory visibility, you can adjust and anticipate, and make investment decisions," says Juan Pablo San Agustin, executive vice-president of strategic planning and new business development at Cemex, a Mexico-based global cement producer. Over two-thirds (68%) of companies in the EIU survey also agree with this, a figure that rises to 76% among respondents from the energy and natural resources sector.

"Regulators are trying to control the behaviour of the financial sector more than any other."

Luis Alvarez de las Asturias, BBVA

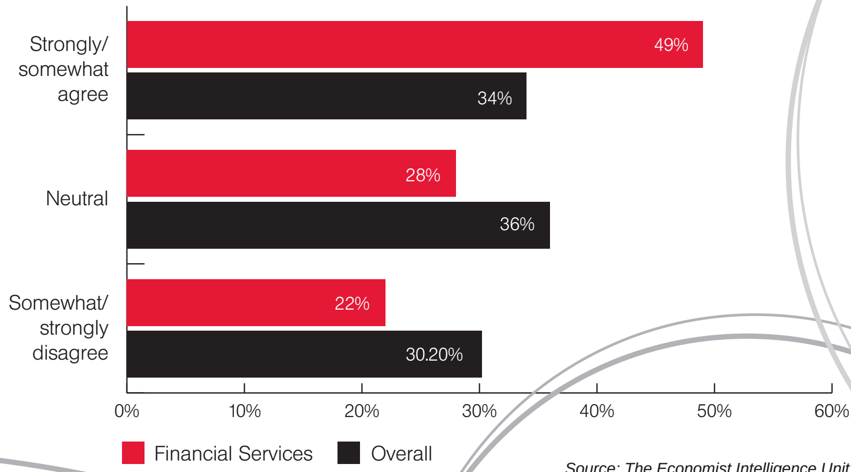
In times of uncertainty markets with clear and well-developed governance and regulation are more appealing to investors than others. In this respect, many see the US as among the best places to do business, says Vishnu Amble, an investment associate with Global Cleantech Capital, a Europe-based private equity firm investing growth capital in clean energy globally. The US "remains an ideal place to establish business because of the transparency, the protections, the clarity of the processes and the understanding of how to work through the system," says Mr Amble, who also highlights Singapore's attractiveness for similar reasons.

Regulation: a problem child for financial services

Not everyone in the EIU survey agrees on the helpfulness of regulation. Respondents from the financial services sector buck the trend more than once. They are the only group of participants who think that regulatory developments in their home market are more likely to hinder than help international expansion (54% from financial services agree, compared with 35% overall). Over two-fifths (49%) say that international and national regulatory reform makes their company less competitive, compared with just over one-third (34%) of all respondents. Similarly, unlike all other respondents, financial services executives say that regulation hampers investment in innovation. They are also much more worried than their counterparts in other sectors of the potential damage to their reputation from failing to meet regulator standards (69% compared with 51% overall).

Chart 2.1:
Do you agree with the following statements?

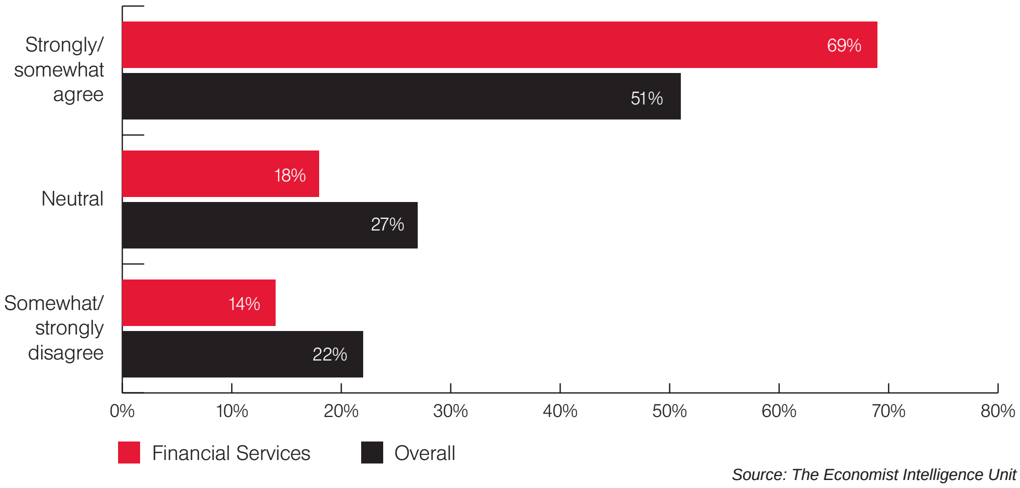
A combination of international and regulatory reforms in the country/region makes our company less competitive.



Source: The Economist Intelligence Unit

Chart 2.2:
Do you agree with the following statements?

One of our biggest concerns in failing to meet regulatory standards is the potential damage to our reputation.



Source: The Economist Intelligence Unit

Regulation of business activities for many is a propeller of, and not an obstacle to, international expansion

Luis Alvarez de las Asturias, head of global clients and cross-border business at BBVA, a Spanish bank, puts the increased financial services regulatory requirements in recent years down to the fallout from the banking scandals. "Regulators are trying to control the behaviour of the financial sector more than any other," he says. This could explain financial services respondents' significantly different attitude to regulation in the EIU survey.

Regulators are aware of the large regulatory burden being offloaded on the financial services sector. During a recent international conference held in Korea, Wayne Byres, secretary-general of the Basel Committee on Banking Supervision, addressed these concerns, saying that "while there have been complaints about the burden of reform, many studies show the cost-benefit trade-offs to be overwhelmingly positive."[1] He also highlighted the importance of pressing ahead with reforms, especially as the sector is beginning to put its newly found inhibitions at risk to pursue improving market opportunities.

Uncertainty the biggest challenge

Despite improvements in business regulation, lack of certainty on cross-border transaction rules continues to create headaches for companies. Over three-fifths (62%) of respondents in the EIU survey say that regulatory uncertainty is a bigger hindrance to their company than the nature of regulatory reform. "A lack of transparency in the regulatory framework is clearly one of the fundamental factors," says Eric Richards, chair of East Asian Initiatives and professor of business law at Indiana University's Kelly School of Business.

Cemex also takes this view. "If I understand the rules of the game and how much that will cost me as a producer or as a distributor of products, I can make decisions based on that," says Mr San Agustin. "The less developed the regulatory framework is, the higher the risk because you don't know what is coming your way."

Where regulation is insufficiently developed, efforts are being made to establish legislative structures that can facilitate cross-border business. For developed countries, this is the case when it comes to the export of services such as finance, engineering, research and development, and software services. Here, the US in particular is active in bilateral and multilateral negotiations to push its trading partners to open up their industries.

"What's held back the service industry in large part is that we don't have the same international rules that open up markets for services that we have for more basic goods," says Mr Richards. "The developed world is pushing very hard, particularly through the World Trade Organisation, to open up the service sector."

[1] Speech by Wayne Byres, prepared for the BCBS-EMEAP-FSI High-Level Meeting in Seoul, Korea, February 25th-26th 2013.

The absence of intellectual property (IP) laws can also make life difficult for companies in certain sectors. However, businesses are becoming adept at finding ways to secure IP rights in markets where infringement is common. “In the Asian market, we either invest in a player that has secure IP and the right access to growth or we offer products whose core elements are developed outside the market, but can be commercialised in Asia,” Mr Amble explains.

Possibly as a result of such strategies, the infringement of IP rights appears to be becoming less of a worry for companies. In the survey, few (6%) rank lack of IP protection highly among the factors making it difficult to do business in their most important market.

62%

Regulatory uncertainty is a bigger hindrance to their company than the nature of regulatory reform

The perils of over-regulation

The negative impact on business of overly bureaucratic regulation is something tracked in the annual Doing Business report, published by the World Bank’s International Finance Corporation. The latest report stresses the need to standardise regulations across different jurisdictions.

Dan Brutto, president of UPS International and responsible for its global expansion, highlights the pharmaceuticals sector as one that is confronted with a broad range of rules across jurisdictions. “Pharmaceuticals executives tell me that the process from a regulatory standpoint is very cumbersome, because once you have a drug approved in one EU country, you have to go to almost every other one – and it’s similar in the US with the licensing issue,” he explains. “There, you have to be licensed in every state to distribute and move drugs, and they don’t necessarily have the same laws.” The situation in Europe is particularly tough, says Jacob Tolstrup, vice-president for corporate business development and strategy at Lundbeck. “Europe is under pressure because of the financial crisis, and that has an impact on the regulatory environment,” he says. “Getting access to the market with all the approvals needed has become more difficult.”

The challenges of navigating regulatory environments become even greater when doing business across jurisdictions that have different degrees of regulation. For this reason, companies tend to favour regulation as a means of creating a level playing field. Regulatory harmonisation is something that BBVA sees as critical to facilitating international transactions. The bank takes the view that any effective framework for cross-border business requires a convergence of national regimes as well as enhanced co-ordination among institutions, supervisors and resolution authorities.

“The rules of the road are so important,” says Mr Brutto. “If you’re following one set of rules, say, with respect to customs procedures, and competing against someone who doesn’t have the same rule set, it makes it very difficult.” Some argue that this is where a US-European trading agreement could help – spurring greater moves by trading partners such as China to bring their regulations into line with other countries. “That [agreement] could provide the framework for a lot of what goes on around the world,” says Mr Brutto.

“Regulatory uncertainty is clearly one of the fundamental factors”

Eric Richards, Professor of Business Law at Indiana University’s Kelly School of Business

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About the research

In January 2013 The Economist Intelligence Unit conducted a global survey of 451 executives on behalf of Reed Smith. All respondents represented companies that conduct business internationally. Over one-half of respondents (56%) are C-level executives and 53% are from companies with annual revenues in excess of US$500m. Just under one-third of respondents are from Asia-Pacific (30%) and from North-America (30%), and nearly one-third (32%) are from Europe. The remainder of respondents are from the rest of the world, including the Middle East, Africa and Latin America. Respondents represent a range of industries, including: 15% from financial services, 14% from energy and natural resources, 14% from media and technology, 13% from shipping and transport, and 13% from healthcare and life sciences.

In parallel to the survey, The Economist Intelligence Unit also carried out several interviews with senior business leaders and experts.

We would like to thank all survey respondents and interviewees for their time and insight.