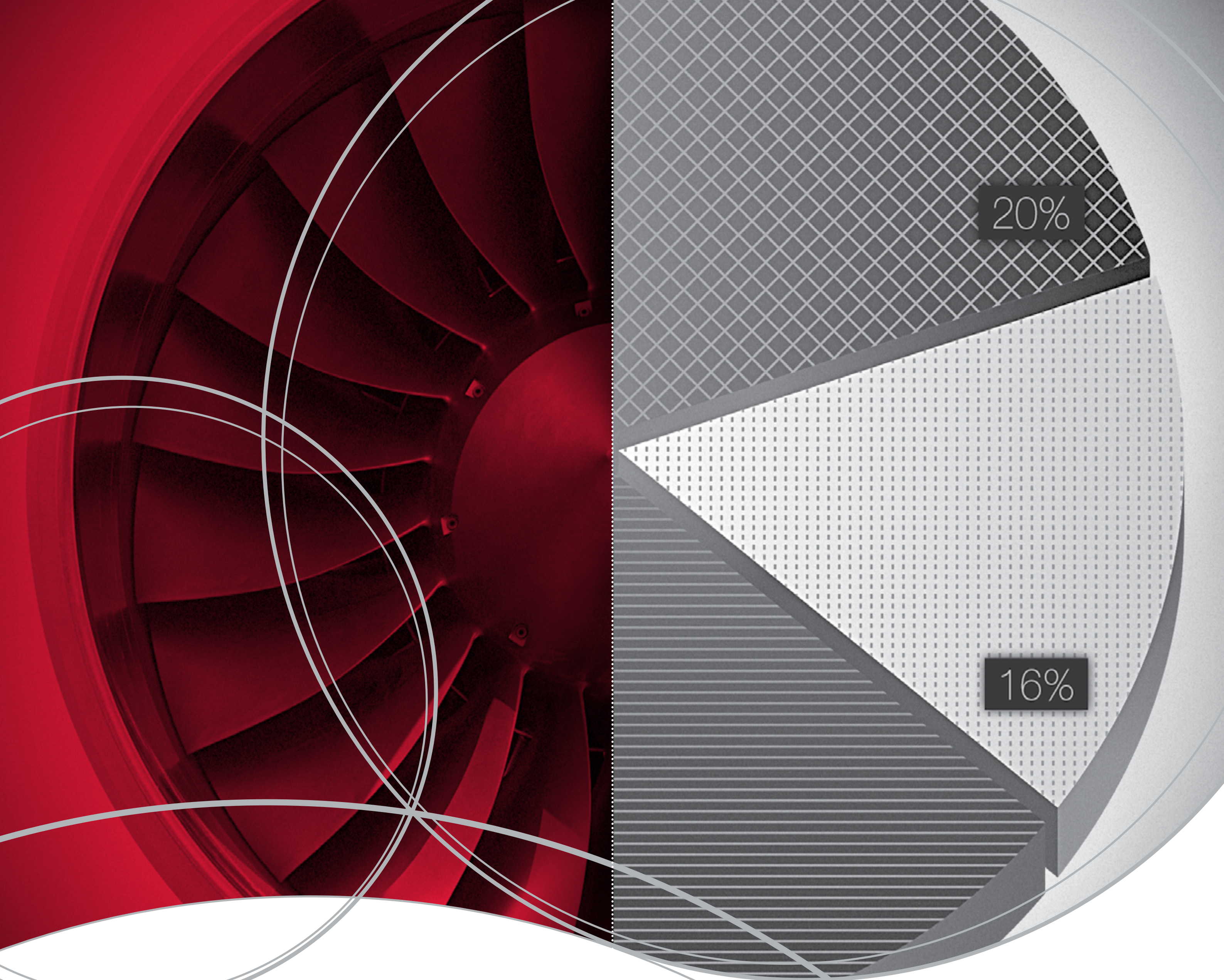


Business Across Borders

Smoothing the path: the challenges of operating internationally

A series of articles written by The Economist Intelligence Unit

ReedSmith

The business of relationships.

Business across borders

Smoothing the path: the challenges of operating internationally

At the outset of the global financial crisis, some predicted a wave of protectionist measures that would cause a slowdown in international business or, at worst, cross-border gridlock. Although extreme protectionist measures have not materialised, continued economic constraints and tightening regulation, combined with administrative and other barriers, still mean that some cross-border business has become more challenging.

International transactions will become more difficult, according to nearly one-half (47%) of executives in a global survey carried out by The Economist Intelligence Unit on behalf of international law firm, Reed Smith.

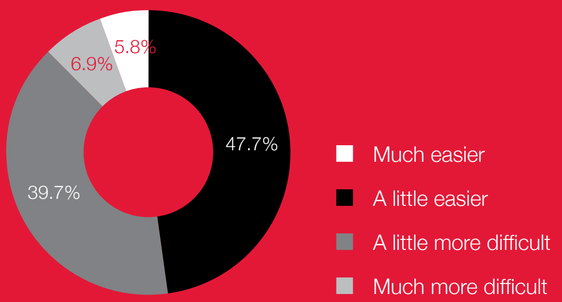
Recent high-profile incidents of resource nationalism and political uncertainty in resource-rich regions have led to the energy and natural resources industry looking more critically at projects. Over one-half (55%) of responses from executives in this sector in the EIU survey think that cross-border deals have become a little or much more difficult. The financial services sector appears to be in a similar boat, with over one-half (54%) of financial services respondents highlighting the challenging international environment – perhaps a result of ever more scrutinising and stringent regulation.

However the greatest proportion of respondents (54%) say that international transactions are likely to become a little or much easier over the next two years. Some parts of the world are more optimistic than others: 61% of North-American respondents think that cross-border activities will become a little or much easier, compared with 50% from Asia-Pacific. Countries in both regions are in the middle of negotiating significant trade deals – a transatlantic free-trade agreement and the Trans-Pacific Partnership (TPP) – which would aid and boost investment.

55%

of responding executives from the energy and natural resources sector in the EIU survey think cross-border deals have become a little or much more difficult.

Chart 1:
Thinking of the situation now, do you think it will become more or less difficult for your company to do business in your most important foreign market over the next two years?



Source: The Economist Intelligence Unit

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Alasdair Ross, global product director at the EIU

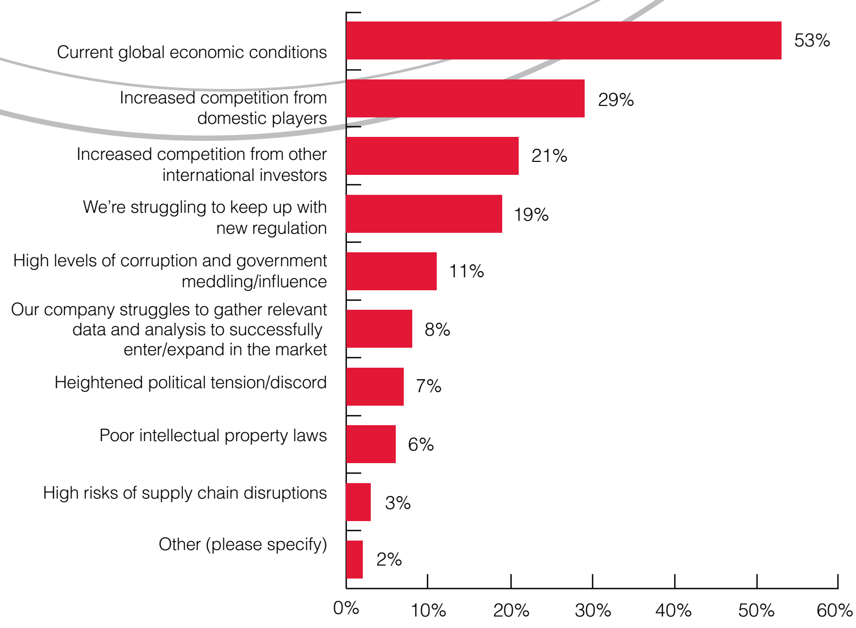
Fretting over the economy

Dominating worries about the ease of doing business globally is the economy. When asked why they think cross-border business has become more difficult, 53% of executives interviewed cite current global economic circumstances, and this proportion rises to 60% among companies from western Europe. Certain industries are more concerned about the economic situation than others. In the media and technology sector, for example, 73% of companies point to the economy as being responsible for the increased difficulty of doing business in their most important foreign market.

"Without doubt, the biggest risk facing companies considering overseas expansion is the still-fragile state of the major economies", says Alasdair Ross, the global product director at The Economist Intelligence Unit. Although conditions seem to be improving, Mr Ross says: "It's far too early to suggest we're out of the woods. From the sustainability of China's growth to the tussle over the fiscal position in the US, there's lots of uncertainty over prospects for market demand."

Chart 2:
What are the most important reasons why it has become more difficult to do business in your most significant foreign market?

(% of respondents who say it has become harder to do business in their most significant foreign market.)



Source: The Economist Intelligence Unit

Increased competition from other investors is also a cause for concern. Fears over domestic competition are more marked among executives who reported an interest in investing in China and south-east Asia over the next two years (37% and 45%, respectively, cite domestic competition as a reason why cross-border transactions have become more difficult). Increased domestic competition – and the sophistication of the products and services on offer – is making life harder for international companies seeking expansion in the fast-growing economies of Asia.

“What has been happening in Latin America is a new wave of nationalisation and intervention from central government.”

Juan Pablo San Agustin, executive vice-president of strategic planning and new business development at Cemex

Barriers to trade

Less than perfect global economic conditions since 2008 have encouraged the pursuit of trade restrictive measures to protect fragile domestic economies. More recently there hasn’t been a significant increase in such measures; the problem now is that there is no real movement to strip away old measures, says Eric Richards, the chair of East Asian Initiatives and professor of business law at Indiana University’s Kelly School of Business. In fact, according to a recent report by the World Trade Organisation (WTO), only 21% of all trade restricting measures put in place in the G20 economies since October 2008 have been retracted.

Political uncertainty is another threat to success in cross-border business. “What has been happening in Latin America is a new wave of nationalisation and intervention from central government,” says Juan Pablo San Agustin, the executive vice-president of strategic planning and new business development at Cemex, a Mexico-based cement producer. “The wave of new higher interventions is a real concern,” he says, citing Venezuela, Argentina and Bolivia as examples. “And if you’re investing for the long term and you don’t have clear visibility of who is running the country, that can be a big issue.”

Nonetheless, there are glimmers of hope for cross-border trade. The development of an EU-US free-trade deal and of the TPP has caught the attention of many. “From a commercial perspective, anything that seeks to de-establish barriers to trade is good for business”, says Michael Fertik, the CEO of Repution.com, an online reputation-management company.

“What the US and Europe are looking for is new types of trade and investment deals that will improve market access for them and their companies. But other markets – particularly China, Brazil, India and Russia – have significantly higher protections than in Europe and the US,” says Fredrik Erixon, the director of the European Centre for International Political Economy, a world-economy think tank. “And in the past ten years, many of these economies have played an uncooperative role in opening up world trade.”

Hidden traps

Political and economic barriers are not the only obstacles to cross-border business. Reducing supply chain barriers to trade could increase GDP by nearly 5% and trade by 15%.[1] Dan Brutto, the former president of a US global package company, UPS International, and responsible for the company’s global expansion, cites as promising an agreement between Chile, Colombia, Peru, Panama and Mexico. The company plans to increase trade by breaking down the barriers of border administration (for example, accepting electronic information for border clearance), increasing use of communications technology and investing in port and airport infrastructure.

“The emerging markets that make it easier to do business as far as border administration goes, and the countries that invest in transport and communications infrastructure are going to be successful, even if they do charge some tariffs,” says Mr Brutto.

Non-traditional trade barriers aren’t restricted to emerging markets, however. “Access to Europe, with all the approvals needed, has become more difficult,” says Jacob Tolstrup, the vice-president for corporate business development and strategy at Lundbeck, a Danish life sciences company with products registered in more than 100 countries. “The hurdles are not protectionist – they’re coming out of constraints when it comes to healthcare budgets. That’s what is driving some of the changes.”

[1] World Economic Forum, *Enabling trade: valuing growth opportunities*, 2012.

The value of experience

When it comes to what has made cross-border business easier in their most important overseas market, the largest proportion of companies (41%) cite something less tangible – familiarity. Knowledge and experience is a particularly important driver of success for high-growth and smaller companies, with almost one-half (47%) of the smallest companies (with annual revenue of less than US$250m) pointing to this factor. This compares with 38% of the largest companies (with annual revenue in excess of US$10bn), which see the fact that their market has become friendlier towards investors as equally important as acquiring knowledge and experience of their target markets.

Acquiring experience takes time, particularly in some countries. China is one example. "You need to spend a considerable amount of time in the Chinese market," says Mr Tolstrup. "We've been there for some years now and we are patient."

This long-term investment strategy is something companies such as Lundbeck, which develops drugs for central-nervous system disorders, are used to. "In the pharmaceutical industry, because of the long development times, you tend to look further ahead than you would do in some industries," says Mr Tolstrup.

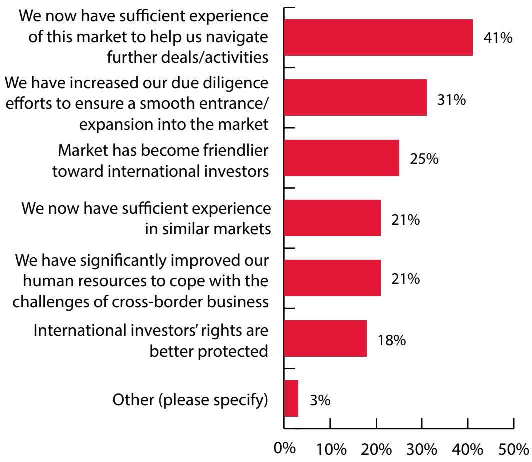
Gaining more experience in Asia is also a strategy pursued by Global Cleantech Capital (GCC), a Europe-based private equity firm investing growth capital in clean energy. Vishnu Amble, an investment principal with GCC, is leading the firm's efforts to build up market knowledge and develop local competencies and on-the-ground relationships. "From our point of view, Asia will continue to grow, so we're in no rush," says Mr. Amble. "So we're taking a more gradual, disciplined approach and focusing on controllable intellectual property or local experience at a smaller scale."

Some industries give more importance to other factors as having eased their cross-border activities. For the shipping and transport, and the energy and natural resources sectors, increased due diligence efforts when entering a new market is what has made international expansion a little easier (46% and 50% of respondents, respectively). Executives from shipping and transport also think international investors' rights are better protected (36% of respondents, compared with 18% overall).

Global economic conditions and the persistence of protectionist and non-tariff barriers all contribute to creating a challenging international business environment. Still, according to the EIU survey, being exposed to the turbulences of the international scene is beneficial. While there are many obstacles, it is clear that with greater knowledge, experience and due diligence, cross-border business can become a smoother ride.

Chart 3:
What are the most important reasons why it has become easier to do business in your most significant foreign market?

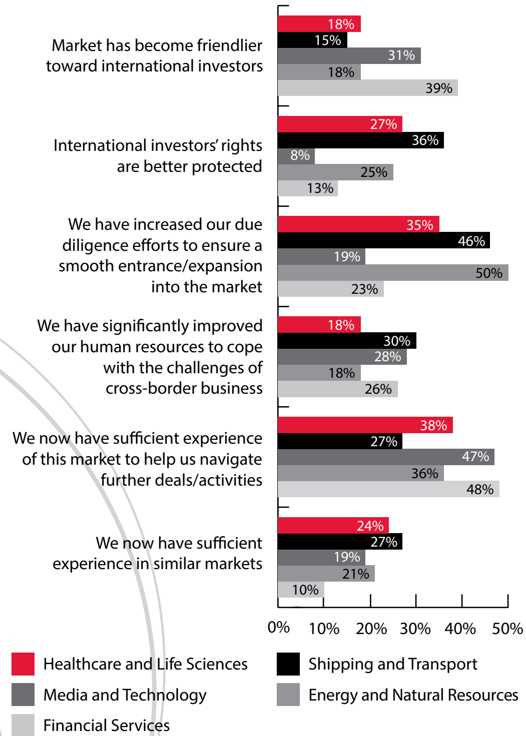
(% of respondents who say it is easier to do business in their more significant foreign market.)



Source: The Economist Intelligence Unit

Chart 4:
What are the most important reasons why it has become easier to do business in your most significant foreign market?

(% of respondents by industry.)



Source: The Economist Intelligence Unit

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.

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