Baker & McKenzie

Growing pains

Succeeding at business transformation in an increasingly complex world

Change before you have to...

Change is something that philosophers and business leaders have been contemplating for a long time. Centuries ago, Greek philosopher Heraclitus of Ephesus said, "Nothing endures but change." More recently, former General Electric CEO Jack Welch told a roomful of fellow business leaders, "Change before you have to."

Change is the new normal for today's businesses, according to our survey of 350 C-suite executives from around the world. More than 90% of the respondents expect to pursue a business transformation in the next two years, either through internal efforts such as new product development, supply chain restructuring and relocations, or through transactions, such as acquisitions, spinoffs and IPOs.

More strikingly, our survey shows a noticeable rise in business leaders' interest in pursuing partnerships and joint ventures, indicating a greater level of caution following the global economic crisis, as these collaborative arrangements enable companies to share the risk and cost of expansion. In search of lower-risk growth, company leaders are considering a wider range of transformation options, but often not fully considering the obstacles and appropriate external support required before pursuing a direction.

This report, produced in collaboration with Longitude Research, examines the barriers to both business model and transactional restructurings and seeks to identify effective ways companies can overcome these challenges, such as early mapping of legal, regulatory and tax issues that will help business leaders choose business transformations that are more likely to be successful.

Company leaders are considering a wider range options, but often not fully considering the obstacles.

Its key findings include:

- **Companies are pursuing business transformations for growth over cost cutting, but with an eye on managing risk.** Nearly all (99%) respondents expect their companies to change at least one element of their business model in the coming two years, while 91% plan to engage in some kind of transactional transformation. After several years of extensive cost-cutting, few are finding much more to cut and many are finding attractive investments in high-growth markets. Despite this newfound focus on expansion, 33% of our respondents say improving their companies' resilience to risk will be a major priority in the next two years, over twice the number that ranked managing risk a priority in the last two years (16%), evidence that a risk-conscious approach to business transformation will prevail in the near future.
- **Partnerships and joint ventures are the leading types of transactions that companies plan to pursue in the next two years, topping mergers and acquisitions.** More than half (54%) of our respondents say their companies will pursue partnerships and joint ventures to attain their corporate objectives, making them the most widely cited transactional business transformation strategy. Only 23% of respondents said they plan to pursue mergers or acquisitions in their domestic markets and 21% are focusing on cross-border transactions. The heightened interest in JVs and partnerships may reflect a more cautious approach to expansion, but companies need to be aware of the challenges of these arrangements and the risks of close association with another organization.
- **Developing new products and services is the leading business model change that companies plan to pursue to achieve their growth objectives.** More than two-thirds (69%) of respondents plan to develop or launch new products and services in the next two years, making it by far the most common business model change anticipated by executives as they seek new growth avenues. Changing how goods and services are produced and delivered (44%), and supply chain restructuring (43%), are the next biggest priorities.
- **Despite the growing complexity of the legal, regulatory and tax issues associated with business transformations, many business leaders fail to pay sufficient attention.** Legal and regulatory issues are a leading barrier to business model restructuring (cited by 32% of our respondents) and the fourth biggest barrier to transactional transformation. This is largely the result of the proliferation and increased enforcement of antitrust and anti-bribery laws, as well as stricter financial regulations and more aggressive tactics by tax authorities. Despite the rising challenges, however, only 49% of our survey respondents said their companies fully consider the regulatory and legal risks when planning a major change, while only 30% said they devote a high level of attention to the tax risks.
- **Companies that seek legal and tax input early in the business transformation process experience better economic performance.** Many companies fail to take full advantage of legal and tax experts who can help them minimize risk and maximize the benefits of undertaking business transformations. The general counsel is consulted during the early stages of business transformations at only 54% of the companies in our survey, and tax directors at just 27% of organizations. This appears to have a financial impact: Of companies that involved their CEOs, CFOs, general counsel and tax directors in initial business transformation discussions, 57% reported greater success increasing market share. Nearly 40% reported that revenue growth has been well above average, triple the number of respondents (13%) who don't consult their in-house experts early.

What is business transformation?

For the purpose of this report, we define business transformation in two ways:

Transactional restructuring: Changes to the business involving mergers, acquisitions, joint ventures, divestments, spinoffs, carve-outs and IPOs.

Business model restructuring: Changes to how a company organizes itself, such as supply chain restructuring, developing new products and services, changing how goods and services are produced and updating operating models.

Reviving the growth agenda

In recent years, companies have been focused on controlling expenses as they weathered the aftermath of the global financial crisis. But today, expansion, not cost cutting, is once again taking priority. Companies are turning their attention away from survival towards finding new ways to grow, whether through organic development, M&A, margin improvements or diversification.

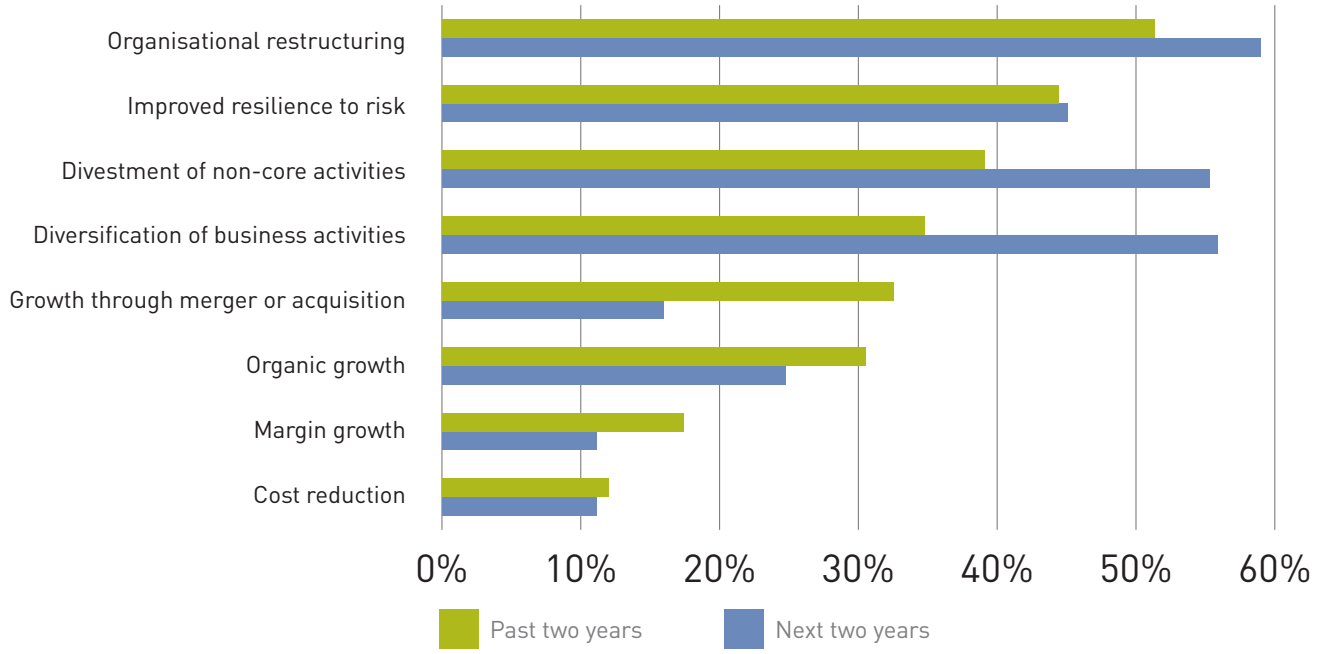
"Cost-cutting initiatives have a limit, whereas top-line growth is something we always need to be striving for," says Juan Pablo Rosas, general counsel at SANLUIS Rassini, a Mexico-based auto parts manufacturer.

After several years in the doldrums, global mergers and acquisitions rose in the first quarter of 2014 at the fastest clip since 2007[1]. Multinational companies have recently announced a number of blockbuster deals, including Comcast's $45 billion bid for Time Warner Cable, and Facebook's $19 billion offer for WhatsApp — Facebook's largest acquisition to date.

[1] Catherine Boyle, "M&A activity set to hit pre-crisis levels," 28 February 2014, CNBC; Alex Sherman "Goldman M&A Head Cites Faith in Acquirers as 2014 Deal Catalyst," 27 March 2014, Bloomberg

Companies are turning their attention away from survival towards finding new ways to grow...

Which of the following best describes your company's main strategic priorities in the past two years and over the next two years?



Source: Baker & McKenzie survey, October-December 2013

Bolstered by stronger balance sheets, ready cash, access to cheap financing and a range of targets with potentially under-priced assets to choose from, many companies are reviving their growth initiatives. In our survey, 43% of respondents reported that their companies are currently engaged in a transaction so substantial that it would have an important impact on the business. In the next two years, 91% expect their companies to take part in at least one such deal.

"In one fell swoop you are expanding your businesses, gaining market share, and getting them at very attractive valuations," says Kaushal Tikku, head of group taxation at Hutchison Whampoa, a Hong Kong-based investment holding company that owns the world's largest port and telecommunication operations.

Despite the renewed optimism about deal making, however, caution remains. Rather than becoming a fading memory, our findings indicate that the global economic crisis has made business leaders more wary about overextending themselves and more strategic about the targets they choose. In our survey, 32% of respondents say that improving their companies' resilience to risk will be a major priority in the next two years, twice as many as the number that ranked managing risk as a priority in the previous two years (16%).

At Tata Chemicals, for example, an Indian company that produces chemicals and fertilizers, the board of directors now insists that company leaders conduct a detailed risk assessment before pursing a major transformation or acquisition. "This has the effect of slowing things down," says PK Ghose, Tata's executive director and CFO. "But in the long run it's much better."

Lower risk options: JVs and Partnerships?

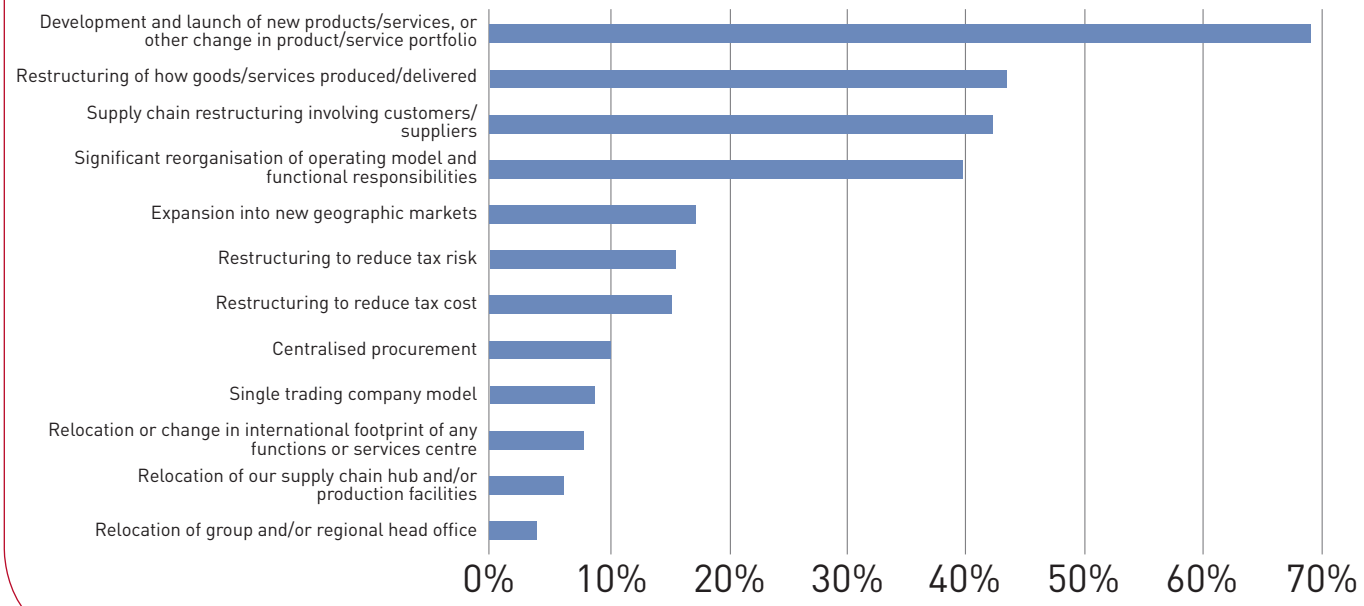
In pursuit of growth, today's business leaders are exploring a wider range of business transformation options. Of those considering a business model change, 69% plan to do so by developing new products and services. Tata Chemicals, for example, is considering creating a pipeline of offerings for the consumer products sector in addition to its industrial chemicals and fertilizers.

A large number of companies also expect to change how their goods or services are produced and to restructure their supply chains, particularly companies in the industrial, manufacturing, retail and consumer goods sectors. Forty percent expect to reorganize their operating models and functional responsibilities.

On the transactional side, joint ventures and partnerships are attracting significant interest, with more than half of our respondents reporting that their companies plan to purse these types of arrangements in the next two years, followed by mergers and acquisitions, IPOs and spinoffs or divestments.

"These structures can be more flexible and allow parties to maximize the value each can bring..."

To attain your main corporate priorities, does your company intend to engage in any of the following business model-related activities in the next two years?



Source: Baker & McKenzie survey, October-December 2013

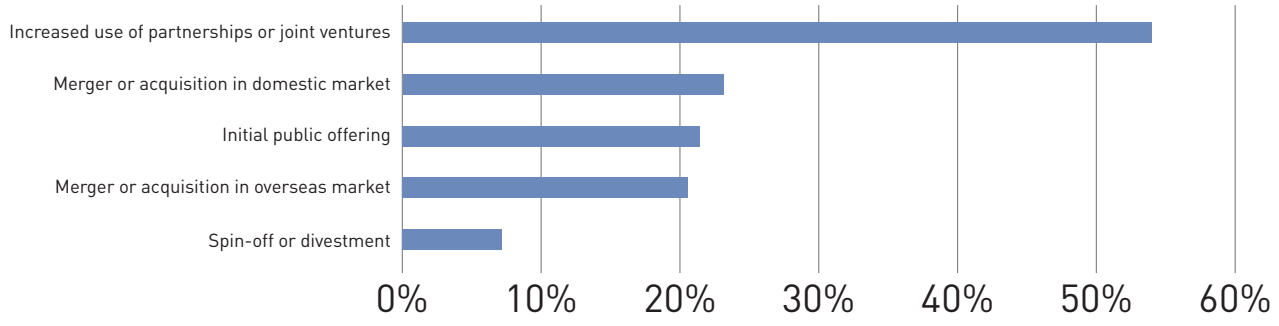
One of the reasons for the increasing popularity of collaboration seems to be the perception that there is now a larger pool of attractive partners, as 74% of our respondents report improvement in the number of opportunities to form partnerships and joint ventures. It's also a reflection of the caution many business leaders have exhibited since the global economic crisis, as these collaborative arrangements enable companies to share the risks of expansion.

"The higher the risks, the more need there is for JV partners to share them and to complement each other," says Navin Jain, tax director at Cairn Energy, an Indian oil and gas company.

Companies may also lack all of the cash they need to pursue an outright takeover, or be concerned about tying up too much capital in an acquisition. Partnerships can also have greater tax benefits, particularly for transfer pricing. If structured properly, payments by the partners to the joint venture are likely to be considered arm's length transactions, something that is harder to demonstrate with a wholly-owned subsidiary.

"Businesses are realizing that sometimes JVs and other modes of cooperation are better than M&A deals," says Deborah Majoras, Chief Legal Officer at Procter & Gamble. "These structures can be more flexible and allow parties to really maximize the value that each can bring to a combination." In many industries, such as the oil and gas sector, partnerships and joint ventures are very common. But for companies without a lot of experience with these arrangements, partnerships and joint ventures can seem less risky than acquisitions, yet actually turn out to be more challenging than they expected.

To attain your main corporate priorities, does your company intend to engage in any of the following transactional-based activities in the next two years?



Source: Baker & McKenzie survey, October-December 2013

Joint ventures: Lower cost, but not always lower risk

A recent survey of 20 S&P100 companies by McKinsey & Company found that 40% to 60% of these companies' joint ventures underperform or fail outright . This is consistent with research going back nearly a decade showing that 30% to 60% of such deals don't achieve their financial goals or business objectives.

[2] Avoiding blind spots in your next venture", McKinsey & Co., January 2014

The first hurdle is navigating the different rules for setting up these partnerships, rules that are often stricter and more onerous than those for M&A transactions. "Quite a long list of additional tax and business ramifications arise from structuring a transactional arrangement as a joint venture or partnership," says Alex Chadwick, a tax partner based in Baker & McKenzie's London office.

Another major concern is not having total control over the shared venture or project, which can lead to disputes and mismanagement. In emerging markets, multinationals can also find themselves vulnerable to being taken advantage of by local partners, particularly when weak legal protections in those jurisdictions make it difficult for them to walk away from the arrangement.

To lay the groundwork for a productive relationship, companies need to work on building trust with their partners, beginning with negotiations. But even when partners work well together, the close association can bring risks. "They're in the public eye, you're in the public eye," says Procter & Gamble Chief Legal Officer Deborah Majoras. "You may not have total control over the joint venture, and yet your name and reputation will now be associated with it."

That's why it's so important for business leaders to understand the risks and potential barriers to executing successful joint ventures and partnerships during the early planning stages. This is also true of any type of business transformation companies plan to pursue, as organizational, legal, regulatory and tax issues can quickly erode the financial value and operational benefits of an initiative that looked so good on paper.

Barriers to transformation

Organizational complexity

For companies planning to engage in business model change, organizational complexity is considered the biggest barrier to success (cited by 43% of our respondents). This is also the second biggest impediment for transaction-related transformation (36%).

The reasons for this finding vary. Part of the problem may be that the organizational structures of many companies have evolved in response to specific circumstances, establishing a legacy that can make further change difficult. "If you've done serial acquisitions, you can end up with all kinds of structural complexity in your subsidiaries around the world," Procter & Gamble Chief Legal Officer Deborah Majoras says.

Culture can also be a driver of complexity for companies that value a high level of collaboration across business units and regional offices. The need for widespread consultation and consensus often complicates moving forward with decisions to pursue business model restructurings and impedes the execution.

"If you've done serial acquisitions, you can end up with all kinds of structural complexity..."

“If you’ve done serial acquisitions, you can end up with all kinds of structural complexity...”

Globalization is another factor that has made it difficult to maintain simple organizational structures. Today’s multinational companies have thousands of employees, hundreds of business partners and extensive operations throughout the world. Finding the appropriate corporate structure and operating model is an on-going struggle.

“The search for the best way to do business in a global environment — how you work in teams, deliver your services and manufacture your products — is still something that is getting a lot of attention,” says Kirsty Wilson, chair of Baker & McKenzie’s Global Reorganization Practice. “Some organizations seem to have a different operating model or reporting structure every six months.”

Even when organizations try to make changes for the purpose of simplification, such as consolidating a large number of national operations into one global structure, they can end up exchanging one type of complexity for another, given that change often involves installing new protocols, processes and procedures.

“Switching from one complicated structure to another is twice as complicated because your people are used to doing business one way,” Hutchison Whampoa Head of Group Taxation Kaushal Tikku says. “It is very difficult to make that change overnight, so you go through a couple of years of pain, you are very disciplined about it, and the advantages may come through. But quite often, as with some M&A deals, it doesn’t work out.”

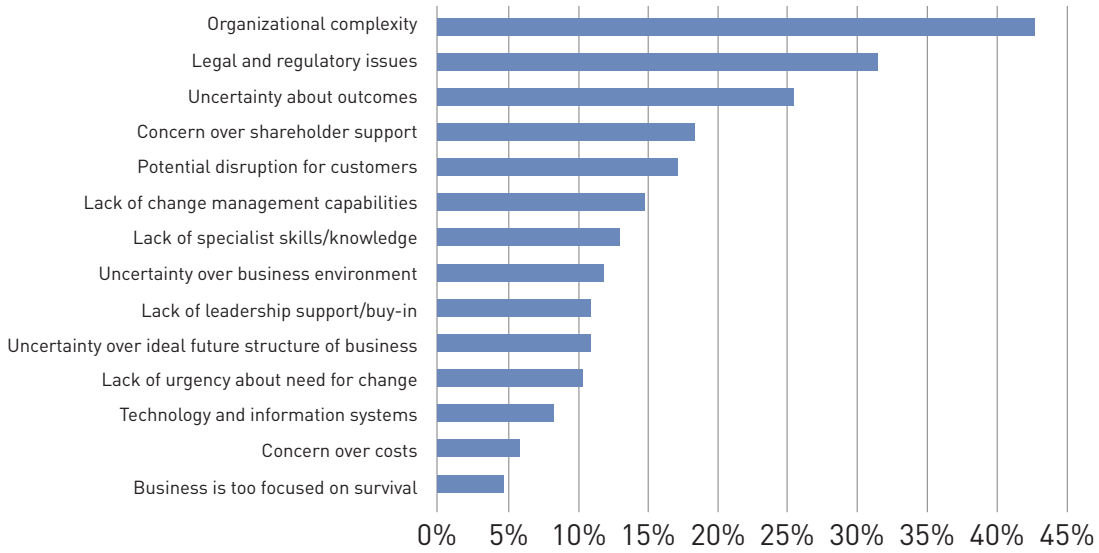
This complexity issue can also be industry-specific. In our study, respondents in the financial services sector (44%) cited organizational complexity as the top barrier to a successful restructuring, followed by legal and regulatory issues (29%), and a lack of change management capability (27%). Organizational complexity was also cited as the top barrier by the manufacturing and telecom, media and technology sectors.

In the financial services industry, this is partly because many banks have struggled to incorporate a wave of new and more stringent regulatory requirements following the global economic crisis. Banks have dedicated more resources to building up their processes to better manage issues like credit and operational risk. But often a lack of planning has led to changes being segmented in separate departments, adding more layers to the organizational structure.

Legal and regulatory barriers

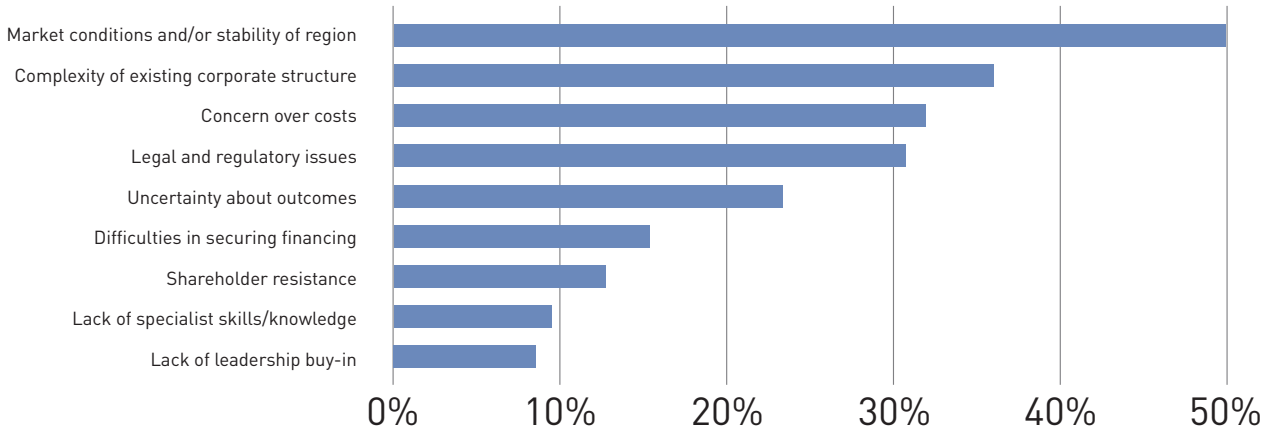
Legal and regulatory issues also pose significant challenges for companies pursuing business transformations. Our survey respondents cited these issues as the second-biggest barrier to business model restructuring (32%) and the fourth-largest hurdle for transactional restructuring (31%).

What are the biggest barriers to business model restructuring at your company.



Source: Baker & McKenzie survey, October-December 2013

What are the biggest barriers to transactional restructuring at your company?



Source: Baker & McKenzie survey, October-December 2013

> Failure to abide by new rules brings not just regulatory risk but reputational risk.

Kirsty Wilson
Baker & McKenzie
Global Reorganizations Chair

The regulatory requirements that companies must address when undertaking transformations vary widely by geography. In France, for example, companies undergoing a business model restructuring must pay close attention to local tax and labor laws. Those pursuing a merger or acquisition anywhere in Europe will encounter strict consumer data protection laws. And in many developing countries, domestic ownership requirements in certain sectors, such as mining in Indonesia or auto-making in China, require creating a joint venture. Foreign automakers, for example, can only set up car manufacturing plants in China through 50-50 joint ventures with local partners.

Growing competition within industries is also leading to a proliferation of antitrust laws, and bodies in various jurisdictions are more closely scrutinising international M&A deals. This is particularly true in countries like China and India, where merger control authorities have been paying much greater attention to proposed acquisitions of local companies than in past years and becoming stricter and more unpredictable about approval. In Africa, COMESA, an economic bloc of eastern and southern countries, recently enacted a new multijurisdictional merger control law that established a more onerous approval process and a $500,000 filing fee for foreign transactions — another regulatory development that has caught the attention of C-level executives.

Because of globalization, regulatory changes in one major jurisdiction frequently spread to others, creating a domino effect of greater scrutiny and enforcement for multinational companies everywhere they do business. New US banking regulation in the light of the financial crisis, for example, has led to similar rules in Europe. The US government's heightened enforcement of the Foreign Corrupt Practices Act has prompted countries such as the UK, Brazil, China and Mexico to enact, strengthen or enforce their own anti-bribery laws, raising the stakes even higher.

"Failure to abide by new rules brings not just regulatory risk but reputational risk," Baker & McKenzie's Global Reorganizations Chair Kirsty Wilson says. "That's a high cost for companies because it can lead to a loss of customers and business partners."

Tax risk

International and national tax laws have also grown more complex. Fallout from the global economic crisis has led to growing concerns by cash-strapped governments about whether corporations are paying their fair share of taxes. As a result of pressure from the public, the media and non-governmental organizations, the OECD has developed a global action plan to reform international tax standards, especially those related to transfer pricing.

Compounding the pressure, the US is considering its own anti-base erosion legislation, governments in countries such as the UK and India are implementing anti-abuse tax measures, European tax authorities are raiding more businesses than ever, and an increasing number of multinational companies are being called before US Congress and other Parliamentary committees to defend the purpose and legality of their tax structures.

"There's a raft of anti-avoidance, anti-abuse and international tax law provisions that businesses have to grapple with," Baker & McKenzie Tax Partner Alex Chadwick says. "Companies must make sure they've understood these provisions and properly factored them into a project."

In markets like Brazil, India and China, tax issues have become unpredictable for many foreign investors. In one such example, India's tax authorities claimed that UK telecoms company Vodafone owed more than $2 billion in taxes related to its $11 billion acquisition of Hutchison Essar, the third largest mobile phone operator in India. But because the deal was done offshore, with Vodafone purchasing its ownership stake from Hutchison's Cayman Islands subsidiary, Vodafone claimed it didn't owe any taxes.

In January 2012, the Indian Supreme Court sided with Vodafone and held that the transaction was not taxable in India. The Indian government responded by proposing a retroactive tax on indirect share transfers and introducing General Anti-Avoidance Rules (GAAR), setting off a significant drop in foreign investment.

"The tax risks are getting so huge that they can really upset the valuation and the value that you derive from mergers and acquisitions," Cairn Energy Tax Director Navin Jain says. "It's definitely a significant part of any deal."

IT integration: a major oversight in business transformations

A striking finding from our survey is how few executives considered information technology a major barrier to business model restructuring. Only 8% of our respondents reported that IT is a top concern, a major oversight given that difficulties in integrating IT systems are consistently cited by business consultants, IT experts and legal counsel as a common cause of business transformation failure.

One such example is the 2004 merger of the London Clearing House with Clearnet, its Paris-based counterpart. The plan was for the combined clearing house to replace the 30 legacy systems it had inherited in the merger with a single platform for clearing trades, bringing about significant cost savings. Despite a development program costing tens of millions of pounds, the project was abandoned two years later after it missed a series of internal milestones and one public go-live date. The failure also resulted in the resignation of both the LCH. Clearnet CEO and chairman, major staff cuts and a write-down of £13.9 million against the project.

At the time, business consultants and IT experts attributed the project's failure to the lack of Chief Information Officer involvement in preliminary merger discussions that would have alerted management to the risks and costs of integrating the systems. That oversight is also reflected in our survey results, as the task of IT integration is often assigned to the Chief Information Officer after the deal has closed, creating delays and complications that could have been avoided by early consultation.

The fact that more than one-third of our survey respondents reported difficulty dealing with IT and other back office issues during their last major transformation — more than four times the number that cited IT as a major barrier to transformation — indicates that many business leaders are underestimating the potential financial drain and business disruption of IT integration when considering transactional and business model restructurings.

Overcoming the hurdles

Despite the growing complexity of organizational, regulatory and tax issues, many business leaders admit they do not pay enough attention to these factors in the early stages of business transformation planning. Only 49% of our survey respondents said their companies fully consider the legal and regulatory risks when planning a major change, while only 30% said they devote a high level of attention to the tax risks.

As companies enter a period of renewed focus on growth, however, it's crucial that business leaders gain a greater understanding of these issues and develop strategies to manage the risks. Otherwise they may find it difficult to achieve the desired value and objectives of their business transformations. "If you can't satisfy the regulator, you're either going to get a massive fine or you're going to be put out of business in a particular country," Baker & McKenzie Tax Partner Alex Chadwick says.

Tackling organizational complexity

Given the reality of globalization and fast pace of today's business, there are no quick fixes for simplifying organizational complexity. One thing that can help, however, is to involve your general counsel in the process of identifying useful business transformations. Those in the legal department often have a company-wide perspective that leaders of various business units may not.

"Our beauty care business might not see what our fabric care business is doing in the digital space," Procter & Gamble Chief Legal Officer Deborah Majoras says. "I have a team of expert lawyers who see what both of them are doing and can add value by making sure we are not reinventing."

Consulting general counsel in the early stages of business transformation planning can also provide business leaders with greater insight into what the final structure should look like.

"If 40 companies are going to merge, the general counsel should be there to say why it would be better to create one or ten," says Alexandre Lamoure, general counsel of RICOH France, an imaging and electronics company. "We have to anticipate the issues. If we don't, the merger could take more time than it should or fail altogether. That's why the general counsel should be part of creating the global design, probably more so now than in the past."

Companies that have been effective at managing organizational complexity tend to be more flexible in recognizing that what has worked in the past may not be fitting in their current environment, and that evolution is an on-going process.

"Nobody has a crystal ball but the most successful structures I've seen arose where companies have kept one eye on the future," Baker & McKenzie Reorganization Chair Kirsty Wilson says. "They've given some thought to how their business will change in the next five years and where their industry is going."

Breaking down legal and regulatory barriers

Another reason it's important to involve the general counsel early is to anticipate and account for the legal and regulatory issues that can become the downfall of a business transformation. Business leaders may have unrealistic expectations of what they can accomplish and how soon they can realize results, given local laws on everything from antitrust and data protection to marketing new products and downsizing the workforce.

A growing number of business leaders have begun to view their in-house counsel as key advisors that help drive business strategy, not just the defensive team to bring in when they encounter legal problems. Yet only 54% of our survey respondents reported including general counsel in the early discussion stages of their business transformations.

"At a lot of companies, the perception of lawyers is that these are the people that tell me 'no,'" says Constance Bagley, a professor of legal practice and management at Yale University's School of Management.

Another issue is that many companies don't want to expend the additional resources of involving their general counsel. Those that do, however, are experiencing greater economic success and even increasing their sales and profitability. In our survey, 57% of companies that involved the CEO, CFO, general counsel and tax director in planning business transformation projects reported greater success increasing market share. Nearly 40% reported that revenue growth has been well above average, triple the number of respondents (13%) who don't consult their in-house experts early.

Minimizing tax risk

Another key to executing a successful business transformation is seeking tax advice to determine the most cost effective way to structure initiatives and identify tax risks. Yet only 27% of our survey respondents reported involving their tax directors in early discussions. Most (59%) sought their consultation in the formal planning stage, when important decisions may already be irreversible.

"The tax director should now be a part of the strategic team who works very closely with the business," Cairn Energy Tax Director Navin Jain says.

As media attention on corporate taxes has elevated this issue to a board-level, reputational consideration, the tax director's role has become even more important. His or her first job is to ensure that company leaders understand the organization's tax policy and can articulate why the company uses particular tax structures. Having an enterprise-wide approach to tax risk also helps reduce the chance of disputes with revenue authorities and even litigation.

Nobody has a crystal ball but the most successful structures I've seen arose where companies have kept one eye on the future.

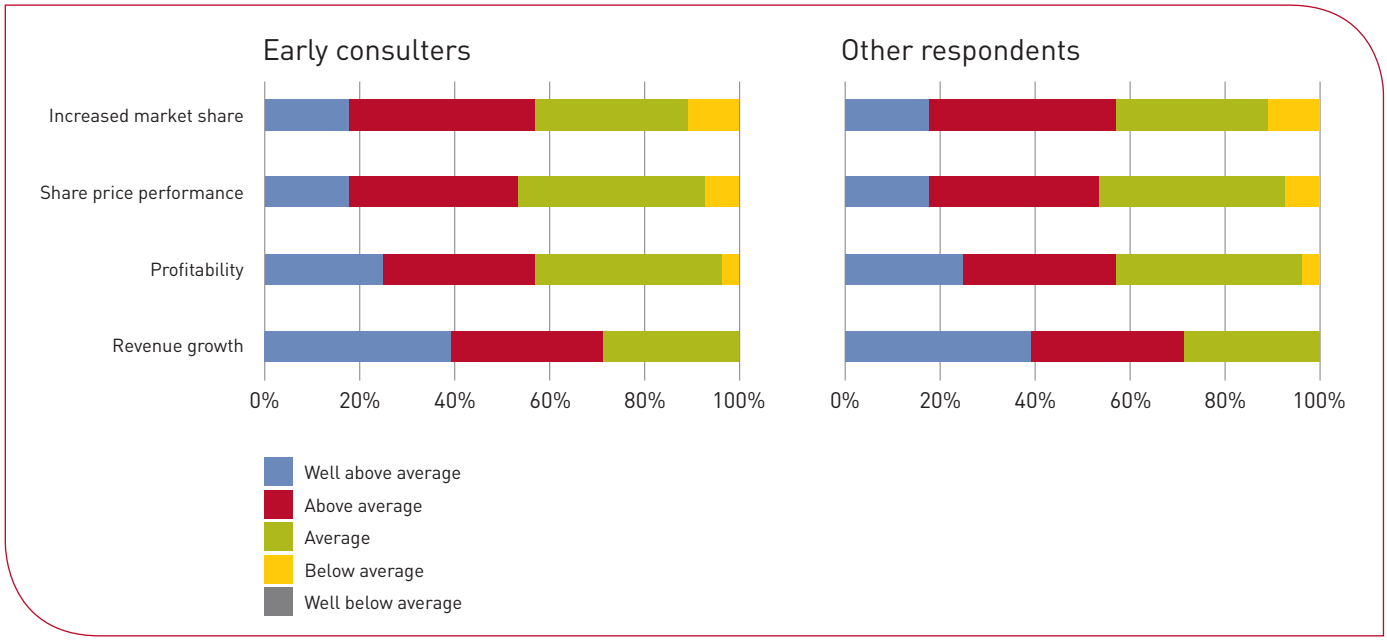
Want better financial performance? Involve in-house legal and tax experts early

Our survey data shows an intriguing link between early general counsel and tax director participation in business transformations and the economic success of the business.

Companies where these in-house experts are on board at the start of discussions appear to have much higher overall financial performance.

In our survey, 28 respondents — 8% of the total — report that they involve the CEO, CFO, general counsel and tax director in planning projects from the beginning. The effect of this practice is striking. Of those early consulters, 57% indicated that they've had greater success increasing market share than their competitors, compared to 29% of the other respondents.

This also had an effect on sales and profitability: 39% of early consulters reported that revenue growth has been well above average, triple the number of other respondents (13%). Similarly, 25% of this group indicate that their companies have much higher profitability than competitors, compared to just 12% of other respondents.



Source: Baker & McKenzie survey, October-December 2013

Involving in-house expertise early does not make legal and tax issues disappear. In fact, early consulters are more likely than other respondents to see high levels of difficulty in business transformations because of legal and regulatory issues (21% versus 6%) and tax considerations (11% versus 5%). But the input of their general counsel and tax directors seems to reduce the impact of these barriers.

Bringing legal and tax advisors into the conversation early on also appears to give many companies the confidence to be more aggressive. Over the next two years, 68% of early consulters plan to make mergers, acquisitions and joint ventures a leading corporate priority, compared to 43% of other respondents. Those that don't consult their experts early report being more focused on risk resilience (34% versus 18%). Based on our survey findings, one way they could become better prepared for risk is to become early consulters.

Five questions to assess your readiness

In today's complex business world, companies must create a new blueprint for how they approach business transformations and their associated tax, legal and regulatory risks. While that approach will vary depending on a company's industry, geography and business model, our survey findings point to five key questions that business leaders should be asking themselves to assess their companies' readiness for change.

1. **Do we understand the complexities of our organization well enough to execute an effective business transformation?**

Companies with complicated corporate and operational structures often have difficulty integrating things like business processes, intellectual property, technology and employees following a transaction or business model restructuring. That's why they should conduct a detailed risk assessment, including of their own operations, and plan for how they will approach these issues in the early stage of pursuing business transformation.

2. **Are our goals best achieved by a business model restructuring, transaction or a combination?**

Mergers and acquisitions can be effective strategies for expanding into new markets, obtaining new products, accessing new customers, realizing synergies and acquiring new talent and technology. But if your company's immediate strategic need is to break down silos between geographies and functions or to become more focused on innovation, it's probably better to pursue a business model transformation. In certain circumstances, a combined business model and transactional change can also be beneficial. For example, in 1999 Roche Pharmaceuticals purchased a significant interest in Genentech not only for the company's assets but so that Genentech's highly innovative culture could strengthen Roche's approach to innovation.

3. **If we decide to pursue growth by doing a transaction, is the best strategy a joint venture, partnership, merger or acquisition?**

Joint ventures and partnerships can provide companies with access to new markets, knowledge and talent without the need for major capital investment. In addition to sharing the cost, you also share the risk, which can be an appealing option for companies that are more cautious about their investments following the global economic crisis. These types of collaborations, however, also have their challenges. Partnerships require sharing control of an area of your business and putting your reputation in the hands of an outside organization. Setting up a joint venture or partnership also involves fulfilling additional and often stricter tax and business requirements. That's why business leaders must carefully evaluate the pros and cons of these arrangements before choosing the most appropriate direction and invest time to make them work.

4 Do we fully understand the legal and tax risks involved in different types of business transformations?

No matter how good a business model restructuring or transaction looks on paper, even the best strategy can suffer in the face of unforeseen legal, regulatory or tax barriers. In some cases, they can stop a deal or reorganization altogether. Legal and tax issues should not be the primary drivers of business transformation, but it is crucial for business leaders to understand their impact during the planning stage to avoid unpleasant surprises.

5 Are we seeking legal and tax advice early enough in the process?

Companies that involve their general counsel and tax directors in business transformation planning are more successful at improving their financial performance, expanding market share and increasing sales and profitability, according to our survey findings. These advisors can add value by helping companies identify opportunities and avoid legal and tax pitfalls. Considering them part of the strategic team that helps drive the direction of the business can lead to better execution of business transformations.

How a legally informed strategy can pay off

Mark Roellig, general counsel at Massachusetts Mutual Life Insurance Company, thinks the leading role of in-house counsel is to be strategic and proactive by "seeing around corners" on behalf of the company.

"Because we know the business, where it's going and what the future legal or regulatory requirements may be, we need to ask what we can do to best advance company strategy," he says.

As an example of how this approach can shape strategy within particular industries is the use of the Social Security Administration's Death Master File by US life insurance companies. The DMF, a public database that tracks the deaths of Americans, has long provided important information to life insurance companies, as the death of an insured can terminate or trigger a variety of liabilities. Many life insurance companies, for example, sell annuities, which cease upon the death of the holder. On the other hand, life insurance policies must be paid out when an insured dies.

Many companies use the DMF asymmetrically, meaning they use its data to stop annuities, but not to inform beneficiaries of payments they are eligible for after an insured died. The insurers justified this by noting that insurance policies typically require beneficiaries to inform insurance companies of a death and request payment.

From the beginning, MassMutual decided to use the DMF to both stop annuities and inform beneficiaries. "We knew the contract said that beneficiaries need to inform the company of a claim but we didn't think that would really do," Roellig says. "We considered the legal and regulatory ramifications, and the public policy implications if people said, 'You're looking to help yourself on one side and on the other side, you're not treating your customers fairly.'

MassMutual's legally-informed approach has proved to be correct. US insurance authorities are now investigating the country's 40 largest life insurers for their use of DMF data. Those found to have used it only to stop annuities are being assessed significant fines; in two cases over $100 million. Not only did MassMutual's policy help it avoid such judgments, but thinking through the ramifications also protected the company's reputation. The New Hampshire Insurance Commissioner who led the MassMutual inquiry publicly stated that the company "used DMF data to serve its customers, not just itself."

The way forward

Esteemed business consultant Peter Drucker once said, "The greatest danger in times of turbulence is not the turbulence. It is to act with yesterday's logic." It's an adage that business leaders should keep in mind as they pursue business transformations, as any type of change inevitably brings some amount of turbulence.

Our surveys shows that business leaders are pursuing a wider range of business restructurings, often with more caution, but not fully considering the obstacles and potential barriers before choosing a direction. In their pursuit of corporate growth, C-suite executives need to be mindful of the increasingly complex legal, regulatory and tax issues that can stand in the way of making successful changes.

Adopting a new approach to business model and transactional restructuring by involving legal and tax advisors early has a demonstrated track record of helping companies achieve their goals of expanding market share, boosting revenue growth and increasing profitability. Early involvement does not automatically make these regulatory and tax issues disappear, but it gives company leaders an opportunity to consider new tactics for transforming their businesses in ways that build a stronger economic future.

Methodology

This report is based on a survey conducted by Longitude Research, a London-based research firm that Baker & McKenzie commissioned. It aims to determine the corporate appetite for business transformations and assess how companies can overcome the increasingly challenging legal, regulatory and tax barriers associated with these business changes. Between October and December 2013, Longitude surveyed 350 CEOs, general counsel, and other C-suite officers to uncover the types of restructurings and transactions they are pursuing, what challenges they have encountered, and which strategies have helped them improve their chances of success.

The survey was global, with roughly one-third of respondents based in North America, Europe and Asia-Pacific. The respondents work for companies in a variety of sizes, with annual revenues ranging from $500 million to more than $5 billion, in a wide range of industries, including manufacturing, financial services and consumer goods. To provide greater context for the issues uncovered by the survey data, Longitude conducted 11 in-depth interviews with corporate leaders and other experts, including:

Constance Bagley, Professor in the Practice of Law and Management, Yale University School of Management

PK Ghose, Executive Director and CFO, Tata Chemicals

Carrie Hightman, EVP and Chief Legal Officer, NiSource Inc.

Navin Jain, Tax Director, Cairn Energy (India)

Alexandre Lamoure, General Counsel, RICOH France

Nancie Lataille, Client Partner, Korn/Ferry International Toronto and member, Korn/Ferry Legal Centre of Expertise

Deborah Majoras, Chief Legal Officer and Company Secretary, Procter & Gamble

Kendra Marion, Manager Assessment Service, Korn/Ferry International

Mark Roellig, EVP and General Counsel, Massachusetts Mutual Insurance Company

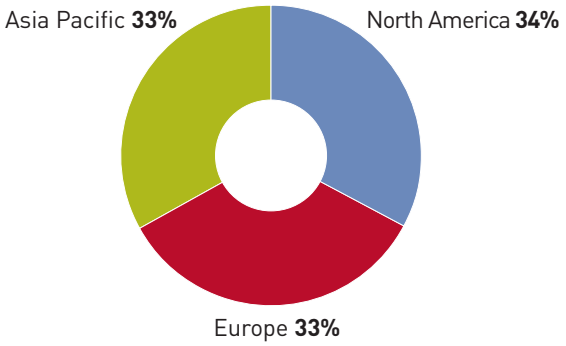
Juan Pablo Rosas, General Counsel, SANLUIS Rassini

Kaushal Tikku, Head of Group Taxation, Hutchison Whampoa

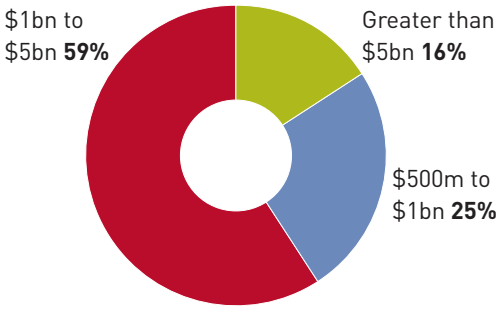
To provide further insight, the report also includes commentary from Baker & McKenzie partners with expertise in the tax, corporate and reorganization issues that arise during business transformations.

Survey demographics

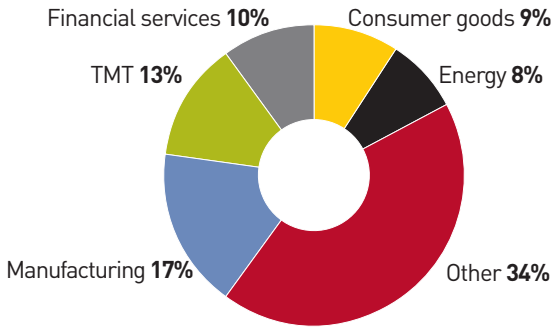
Respondents by region.



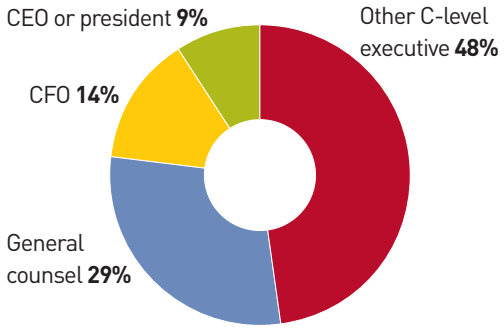
Respondents by company size.



Respondents by industry.



Respondents by title.



www.bakermckenzie.com

Baker & McKenzie has been global since inception. Being global is part of our DNA.

Our difference is the way we think, work and behave – we combine an instinctively global perspective with a genuinely multicultural approach, enabled by collaborative relationships and yielding practical, innovative advice. Serving our clients with more than 4,100 lawyers in over 40 countries, we have a deep understanding of the culture of business the world over and are able to bring the talent and experience needed to navigate complexity across practices and borders with ease.

2834MAR