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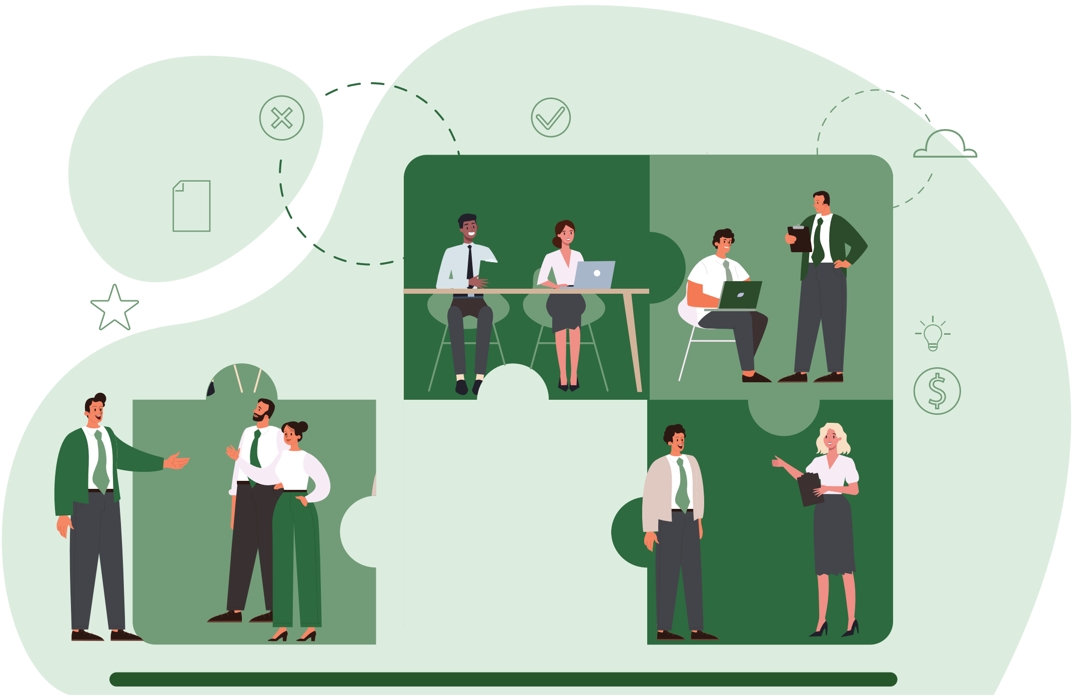
How to deliver successful cross border carve-outs

REPORT



HSP GROUP
Global Expansion Simplified

Carve-outs are taking too much time and money, especially if they involve people and entities

In 2021, M&A deals almost topped the $6 trillion mark – an all-time high, despite the challenges Covid presented. And the first half of 2022 has followed hot on its heels. This presents significant opportunities for both buyers and sellers, if the transaction is executed effectively.

With many companies divesting parts of their portfolios, and so many willing buyers, carving out assets from a company's portfolio has been a successful strategy for many, reaping significant rewards.

However, in today's world, while getting the best bang for your buck is important, the highest bid is not always the winning one.

For many sellers, the need for speed is fast becoming one of the most significant decision-making factors, so they can focus solely on their retained business. And, for buyers, every day adds costs and frustration, particularly if a there is a Transition Services Agreement ('TSA') in place.

Despite this awareness, the time to complete carve-outs is still taking far too much time and, therefore, money – and even more so when the carve-out includes people and/or entities overseas.

HSP Group, a company that specializes in global expansion, and Deel, the leading platform for hiring employees globally, share their insight on ways to execute a successful cross-border carve-out.

Understanding dependencies is critical

Carving out subsidiaries from the parent company can be a seriously complex undertaking. Inconsistent, local regulations and ambiguous, and often convoluted, employment laws make it hard for a non-specialist to make sense of what needs to be done. There are often a significant amount of dependencies, dictated by local compliance, which makes a transaction complicated. Knowing what to prioritize and having the skill set to deliver is challenging.

"Extracting international subsidiaries from their parent companies is fraught with red tape and risk. This is in part due to the inconsistent local regulations and employment laws when human capital is caught up in the transfer. Both the Seller and the Buyer will need to be aware of the legal and operational requirements, and the timelines to achieve them."
states Michele Museyri, Director, HSP Group.

As a result, a raft of specialists who focus on carve-outs have evolved. These players are experts in compliance tasks, rules and regulations, as well as decreasing the risks associated with cross border transactions. They do it day in and day out, and some do it across all continents, making their knowledge and expertise invaluable.

The key is understanding the implications of both the legal and operational requirements – and importantly the timelines of activities.

Did you know, setting up the entities and registrations is not always simple and can lead to regulatory delays. In addition, deadlines can be significantly impacted by the time taken to obtain the necessary licenses, get bank accounts established and set up payroll. In countries such as India and Singapore, local entities are required to have a resident director. This means the local subsidiary must appoint at least one director who is a resident of the country, i.e. a citizen or a permanent resident. Whereas in France, a fiscal tax representative must be appointed. These individuals are directly liable for the taxpayer's VAT liabilities. Registrations are necessary and the entity must appoint one to two local representatives who speak the language to communicate and coordinate with the local authorities regarding all matters related to tax, compliance, social insurance, etc. In many instances, tax filings become due during the set-up process and companies must be aware of the filing deadlines and prepared to complete and submit them to avoid fines, penalties and reputational damage. These can all happen within days, weeks or even months of the deal being signed.

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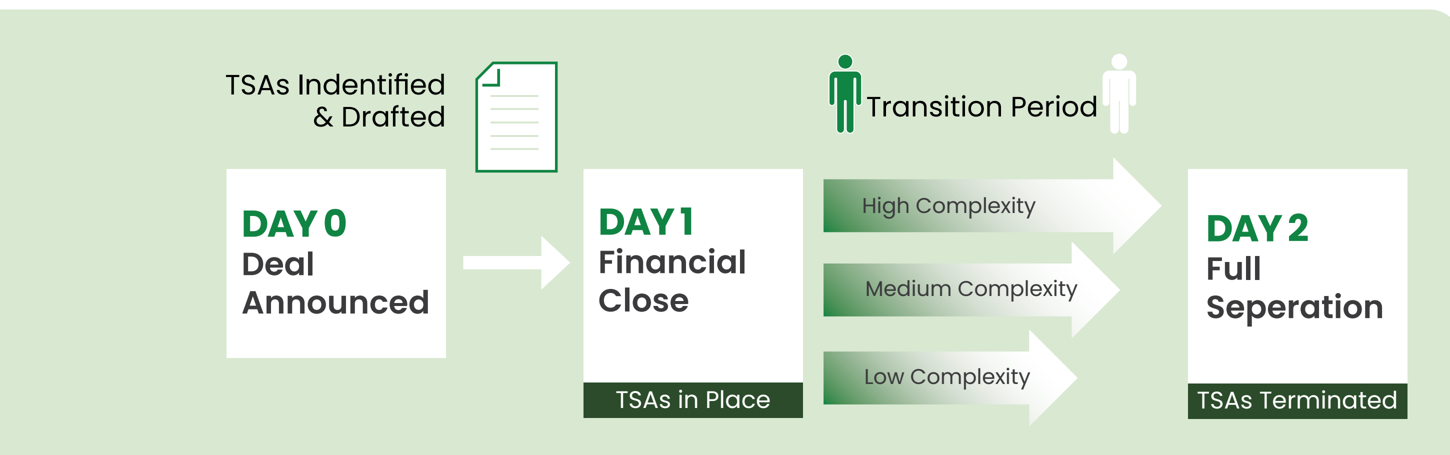
Transition Service Agreements may be the answer

For many buyers, a TSA with the seller smooths the way for a successful migration.

The main objective of a TSA is to maintain business continuity whilst the buyer works through the operational processes and integration challenges that come with bolting on new business. It de-risks the migration and buyers can have confidence that the new business will continue to operate productively while it is transitioned across to their company.

Most TSAs focus on managing HR, payroll, benefits and other mandates, such as IT platforms, for a set period of time after closing. They run from financial close (Day 1) to the full separation (Day 2). On Day 1 the new company owns the carved out business but the seller maintains responsibility for some of the critical support services. By Day 2, the buyer has migrated all works onto their platforms and the seller has severed all ties.



It is, therefore, important for the TSA to be well thought through, realistic and completed within the timeframe stipulated. An ineptly designed, or a poorly delivered or over-running TSA, is often bad news for both parties. The buyer might have to extend the TSA, and remain locked in at considerable cost, and the seller cannot focus solely on their core business.

Setting up entities can take time

For many carve-outs, setting up new entities is the norm.

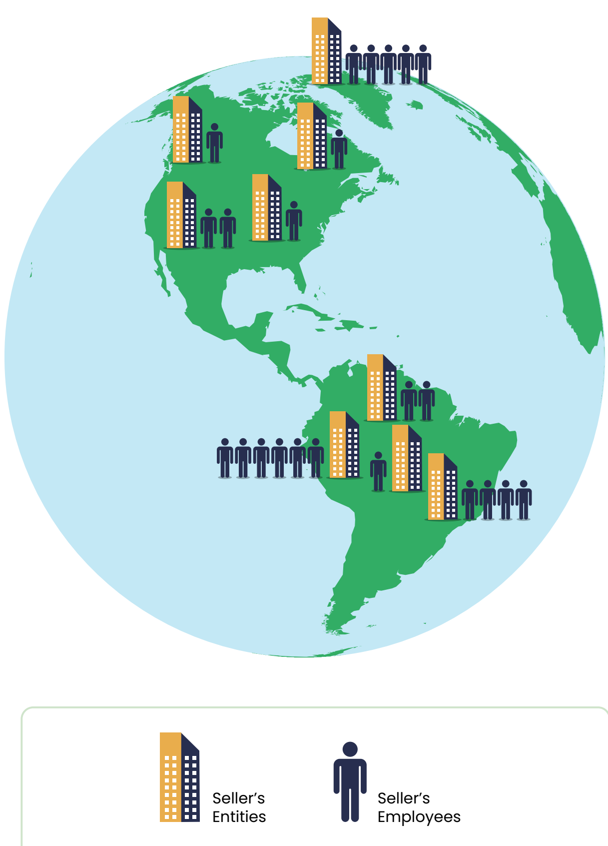
This is often for compliance reasons, with the buyer needing to set up an entity in an existing or new country. There can be challenges around timelines with this, as setting up an entity can take weeks or months, depending on which jurisdictions are involved. **Knowing what you can do and how to do it swiftly is advantageous.**

On top of this, in many countries, sorting out banking can take longer than expected, particularly with increasing Know Your Customer (KYC) laws across the globe. And, in some cases, without a bank account, establishing an entity is impossible, creating further delays.

After incorporation, tax liabilities, payroll administration, HR management, statutory bookkeeping and other administrative tasks will need to take place.

Having the systems and knowledge to administer this immediately and accurately will make the difference between moving ahead smoothly or falling into a whole raft of legal and compliance headaches.

Pre-Transaction



Post-Transaction

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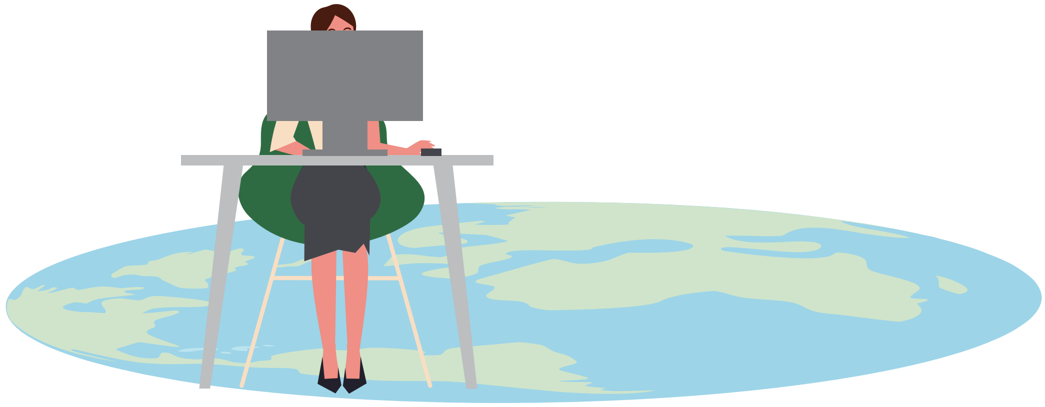
Employer of Record could be a strategic solution for countries with low employee headcounts

It may be that some locations have just a few employees and no real revenue generating activity. In these cases, buyers may want to consider an EoR. This can be a short term or long term solution depending on the location, number of employees and the company's strategy.

Steve Hoffman of Deel's Strategic Partnerships team, explains:

"Entities are set up for the purposes of employing people on another organization's behalf where they may not have a legal entity of their own in a particular country. They assume the employment liability, guarantees labor law compliance and take care of HR back-office work like payroll, tax reporting, benefits and more. In addition, processes are often automated, shortening the onboarding process in most locations to just a few business days or less."

Regardless of whether the longer term plan is to set up an entity in location, starting with EoR is certainly a quick way to ensure payroll checks are executed successfully to employees worldwide.



Employment legislation can have transfer liabilities

As part of the deal's due diligence process, companies should check if the target country's laws protect employees when a business is transferred.

In Europe, the European Commission's Acquired Rights Directive ('ARD') impacts all EU member states and ensures that any employee engaged in the transaction is transferred to the new business. As a result, it may not be possible to terminate employees following the transfer where an ARD type of legislation applies. This can have serious financial implications for the buyer if this was a route under consideration.

In addition, consideration should be given to other transfer liabilities such as salaries, pensions, accrued vacation, bonuses and other contracted employee benefits, which may need to equal the seller's terms. This is quite an undertaking as the employees' employment related liabilities will need to be reviewed one by one and compared against the one being proposed.

Another obligation could arise if transferred employees are covered by a Collective Bargaining Agreement ('CBA'). Collective bargaining is the process of negotiating the employment terms between an employer and a group of workers. The process takes place between company management and a labor union. It often covers a multitude of subjects including anything that the law requires of the employer, such as salary, overtime, benefits and working conditions.

The employee rights under this agreement will add another layer of employer complexity for the buyer, especially if it is mandatory. And it's often as least a year before any negotiations can take place, and usually only if terms are no less favorable than the original ones.

Finding the right partner is critical

It's clear that while carve-outs can be extremely lucrative, they take a lot of thought and due diligence, as well as a raft of skills and knowledge that often requires external expertise for the buyer. Finding the right combination of solutions to meet goals can be challenging.

As described in this article, when it comes to employment of staff, EoR in certain circumstances, may be an excellent option, particularly if there is a TSA in place with deadlines. In other cases, it will make more sense to set up an entity straight away. Discussing the business strategy and goals with experts will determine the best course of action.

Whichever route is deemed appropriate, bringing in specialists as early as possible can save the new owner money, time and, more importantly, ensure compliance with local rules.

For deals involving different counties, the argument for experts is even stronger. Time zones, as well as multiple rules and regulations with different timelines and expectations, can present huge ramifications for deal completion times and success. Front-line technical expertise and bespoke solutioning is required.

Having access to specific in-country knowledge and skills may be one of the best investments the acquirer can make, as a deep understanding of local laws, local government, local employment practice may make the difference between a successful carve-out and one that eats up management time and budgets.

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We can support your global expansion plans

HSP Group and Deel are experts in the carve-out process. Their in-depth knowledge and expertise, as well as their global reach, make them the perfect partners for M&A transactions.

HSP Group can handle all overseas operating and compliance requirements, and has a specialist consulting practice designed to deliver bespoke services for clients involved in M&A activities. The team is made up of experts with decades of experience in the industry. This, coupled with its proprietary technology platform, **GateWay**, makes entity management and people solutions easy to manage – it helps companies keep track of their operations in one place, with one supplier – in-line with local and global rules and data protection regulations (GDPR) – securely, via one single platform.

HSP Group services include:

- Global People Solutions: global payroll, EoR, HR admin support, global mobility solutions, and technical HR consulting services

- Global Entity Solutions: entity setup, statutory accounting & bookkeeping, tax compliance, legal entity management, import/export assistance and more

Deel helps thousands of companies create locally compliant contracts, pay their global teams in their preferred currency and payment method, and stay compliant in more than 150 countries. All in a few clicks, using one powerful dashboard.

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Services provided by HSP Group & Deel

STAGE 1

Pre-Transaction

- Collective bargaining agreement anaysis
- Employee benefits analysis

STAGE 2

Employment contract

- Employment contract with Deel's local entity
- Benefits registrations
- Payroll and payments processing and reporting

Incorporation & Setup

- Entity incorporation
- Tax registrations

STAGE 3

HR benefits

- Payroll and payments processing
- HR benefits

Compliance

- Nominee Director and local representation
- Bookkeeping
- Tax compliance
- Corporate secretarial

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