

AUXADI

WHITE PAPER

Spanish Internationalization

A model for
the new normal





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We live in a globalized world. No one doubts that interests, relations, communications, cultural transfers and, in short, everything that defines human beings as social beings knows no borders. This process of globalization, which emerges almost innate to human beings, and which has developed exponentially in recent decades with the boom and democratization of air transport and the development of new technologies, has been threatened by two events in recent history: the (financial) crisis of 2008, and the (health) crisis of 2020.

Interestingly, these two phenomena have their origin in very similar situations because of the unexpected. In the same way that nobody, or few, foresaw the bankruptcy of Lehman Brothers, neither did anybody have in their plans for the decade that began a few months ago the fact that a virus appeared in Wuhan (China) paralyzing the world as a whole. In both cases what came (or will come) after these events is an economic recession.

But it remains to be seen what differences there will be between these two crises. In the face of these events, beyond the humanitarian and personal consequences that are evident and represent the most important drama in this type of situation, companies face challenges that range from guaranteeing the continuity of their activity to taking advantage of competitive opportunities in the future. It is precisely here that the differences between 2008 and 2020 can begin to emerge.

After the situation caused by the financial crisis in 2008, Spanish companies found in internationalization a way to grow and an alternative to the domestic market, thus completing the process started in the 90s. For example, from 2009 to 2017, exports of goods and services as a percentage of nominal GDP continued to grow. Latin America, due to the traditional ties and the existence of a common language; the United States, due to the size of a market that looks with pleasure at everything that has the Spanish stamp; Europe, for obvious reasons as members of the European Union; or Asia and its unstoppable growth in recent years have been regions where Spanish companies have been landing with more or less success.

But this situation has also brought opportunities and a new landscape in which companies can participate. Many sectors are facing the new normality with strength: ecommerce, health, insurance, food, telecommunications, new technologies such as AI or robotization. And those who have been affected by the stop of the activity are responding to the needs and challenges that the situation is posing for them. Therefore, we ask ourselves: What opportunities will Spanish companies face from the point of view of internationalization?

In this new White Paper presented by Auxadi, as an expert professional services firm in international accounting, tax and payroll management with international presence through our 16 subsidiaries and operating in over 50 countries, we will try to answer the questions that define the challenges and opportunities that Spanish companies will face in the future.



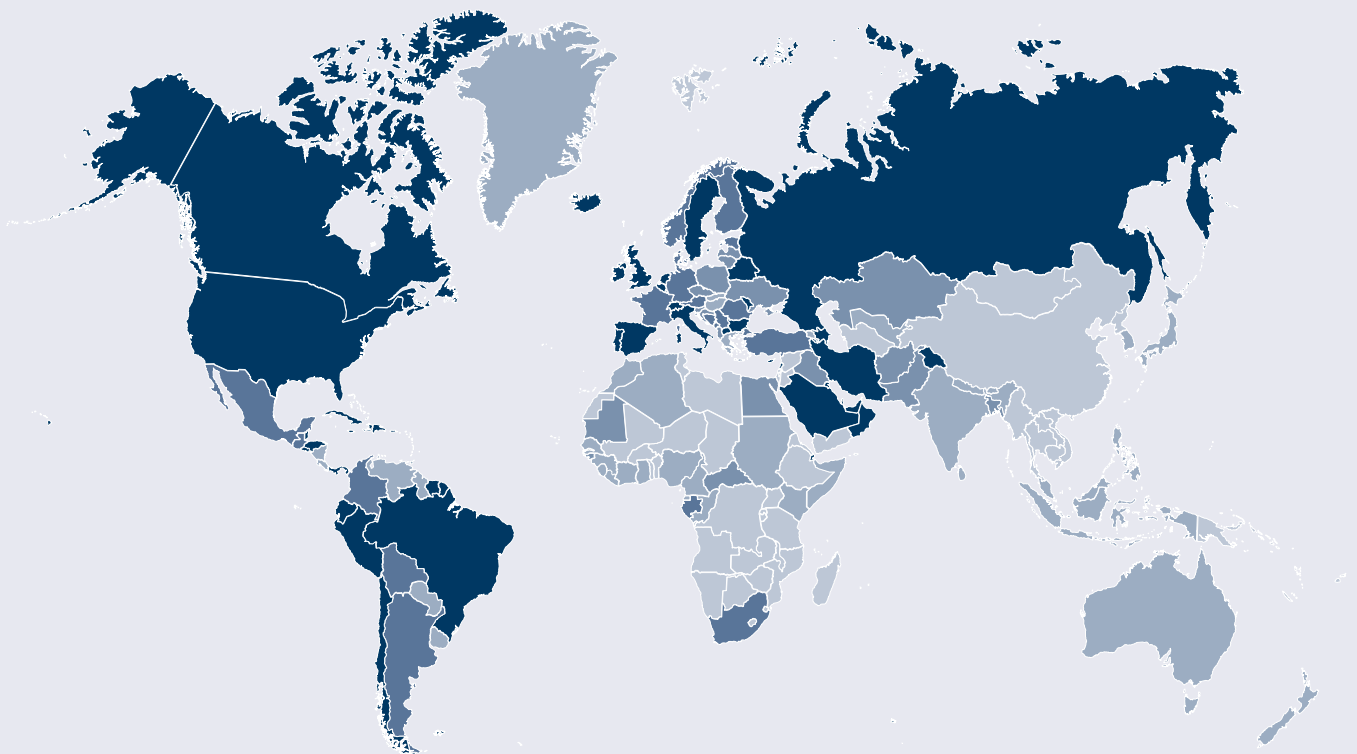
1. Global outlooks and opportunities for the new normality

The first thing to note about the situation caused by the Covid-19 is that each country has reacted differently. Although it may seem that, with the world in quarantine, activity stopped the same way in all parts of the planet, the reality is different. Firstly, because the disease has not been the same in all countries, nor has it developed with the same virulence. The measures implemented by governments have also shown their particularities.

The best evidence of this is that while countries such as Italy or Spain have suffered particularly incidentally from the Coronavirus pandemic, other neighbors such as Portugal have passed this situation in a milder way (measured in

terms of number of infected and dead, at least at the beginning of the pandemic). While on one side of the border the streets looked empty and businesses closed the door, on the other side life continued with a little more normality.

Map of coronavirus disease (COVID-19)



Cases by
1 million people



Source: Google



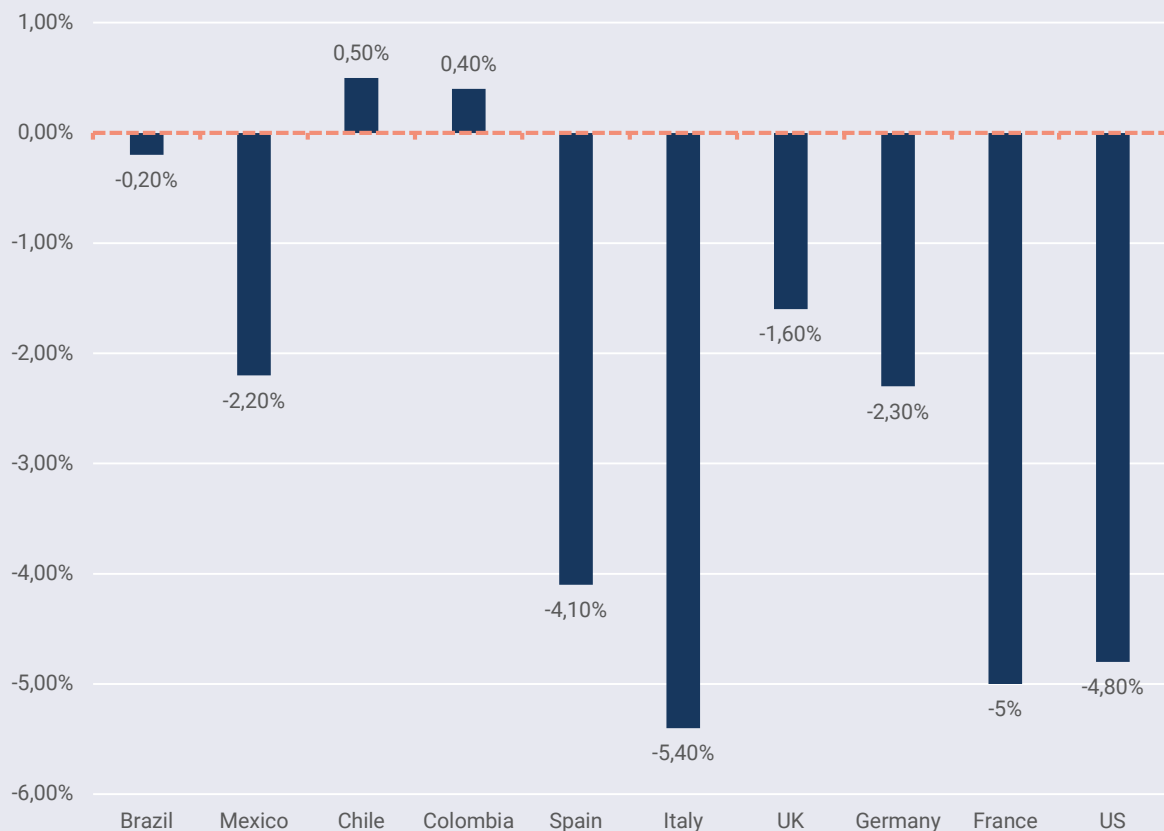
Of course, the pre-crisis management put in place by the various governments also comes into play in this context, as do the decisions taken when the disease was already real. Countries such as the United Kingdom, for example, opted for a strategy that was more focused on maintaining economic activity, at least in the early stages.

Similarly, the Coronavirus crisis has left us examples of excellent management and leadership, as may be the case of Costa Rica. The rapid preparation (materialized through early confinement), the forcefulness in the actions or the tracking of the infections are only some of the reasons that explain the success that the data registered by the country show. A model that is heir to the last ten years and that

have served Costa Rica to be baptized as “the Central American Switzerland”. These praises have not only been in words but also in deeds, since the OECD countries have invited Costa Rica to become the 38th member of the Organization.

In summary: the Coronavirus has not prevented many countries from maintaining a level of activity close to the pre-crisis situation. Thus, as we can see in the following graph, and logically, even the fall in GDP is noticeable during the months of low activity, it does not occur in the same percentage in all countries. Therefore, it is interesting for our companies to bear in mind which countries have managed to keep their GDP afloat, as they are in a strong position to face the recovery and opportunities that the new normality poses.

Percentage change in GDP during the COVID-19 crisis (Q1 2020)



Source: own elaboration



2. Contextual differences between the crises. Socio-Economic context

The first thing the experts agree on is that the two crises (that of 2008, which affected Spain most in 2012, and that of 2020) are different. Although the consequences of periods of this type are usually similar, the truth is that we cannot establish identical solutions for two realities that are not.

Thus, while the 2008 crisis was financial, that of 2020 is health related. In fact, an analysis published by BBVA Research¹ talks about the Great Recession, to refer to the first, and the Great Pandemic, to refer to the second. The proximity of both crises has also given rise to a different context in which families and companies are now characterized by a lower level of debt, to cite one determining variable when facing situations of this type.

Perhaps the most differential aspect in relation to the situation experienced during the last few months, as explained in the same article, is that as a society (as we have previously mentioned in this White Paper) we had not experienced an event of this kind during the last one hundred years. Indeed, the development of the global Welfare State, in the heat of the rise of social democracy, has given rise to an anomaly in the form of welfare and, especially, social tranquility in most of the western world. Thus, in the last seven decades Europe has been generally exempt, generalizing, from great situations of agitation.

This is one of the reasons why, as a group, we are also a different society² from the one that faced the crisis in 2008, which is essential and key to understanding the reality in which companies are going to move in what has come to be called "new normality". In 2008 we were a society that was facing a crisis for the first time in a long time. Not anymore.

Moreover, we must cite the socio-cultural changes that have taken place in the last ten years. From the development of social movements such as feminism or the LGBTQBIQ+ movement, to other currents that have exploded

during the COVID-19 crisis, such as the Black Lives Matter movement and the social debate that has taken place on the issue of racism. Therefore, in 2020 companies must navigate the waters of social change.

In the last seven decades Europe has been generally exempt, generalizing, from great situations of agitation

In this context, the coexistence of generations cannot be forgotten. With the Western world increasingly facing an inverted demographic pyramid, the youngest (millennials and centennials) have been hit by this crisis (in the case of millennials twice over). Thus, companies face a reality with a more polarized society, in which the inequalities between generations are greater and in which the differences are also more significant, having to add to the complex process of understanding the new habits³, the addition of understanding these particularities in a context of new reality.

In any case, there are also similarities in the contexts in how the decade began and in how it ends, from which companies can draw lessons from the 2008-2012 period to apply now in 2020. For example, as a note published by the Atlantic Council⁴ explains, there are three basic economic similarities between these two periods: uncertainty, collapse and reaction. Companies come with the lesson learned because they have already demonstrated in the past their ability, through internationalization, in order to adapt to this new situation.

¹ <https://www.bbva.com/es/de-la-gran-recesion-a-la-gran-pandemia-diferencias-entre-la-tesis-de-2008-y-la-de-2020/>

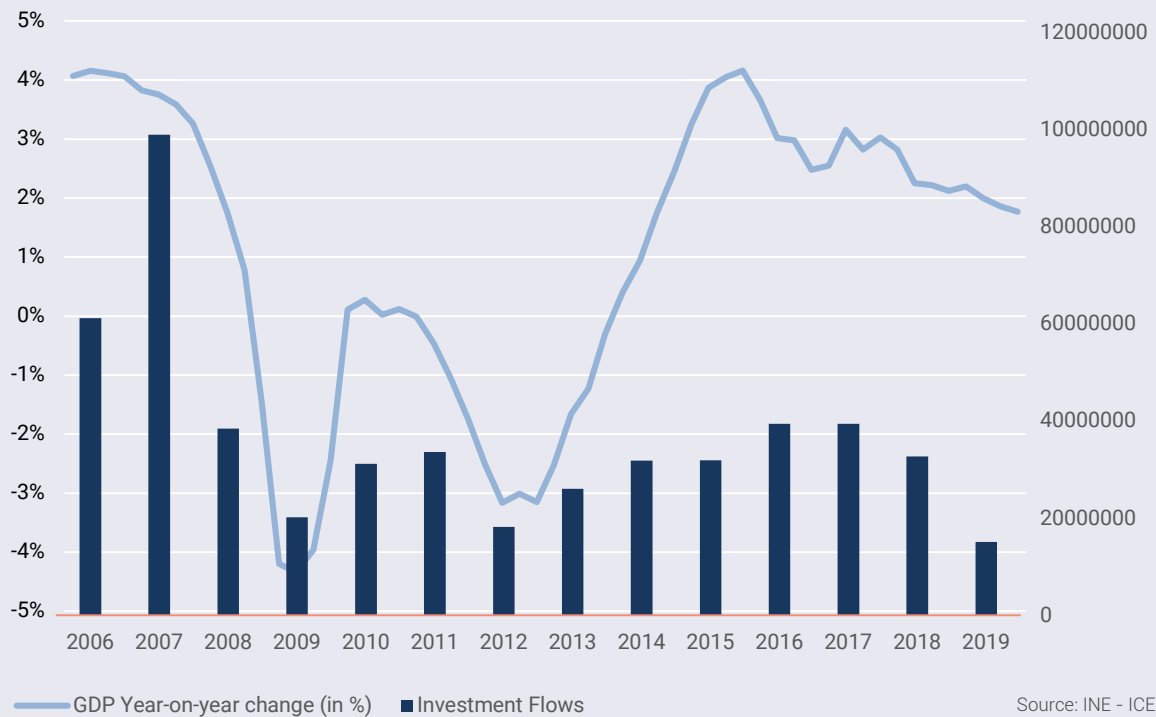
² <https://news.gallup.com/opinion/gallup/265490/major-social-changes-years-woodstock.aspx>

³ <https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/true-gen-generation-z-and-its-implications-for-companies>

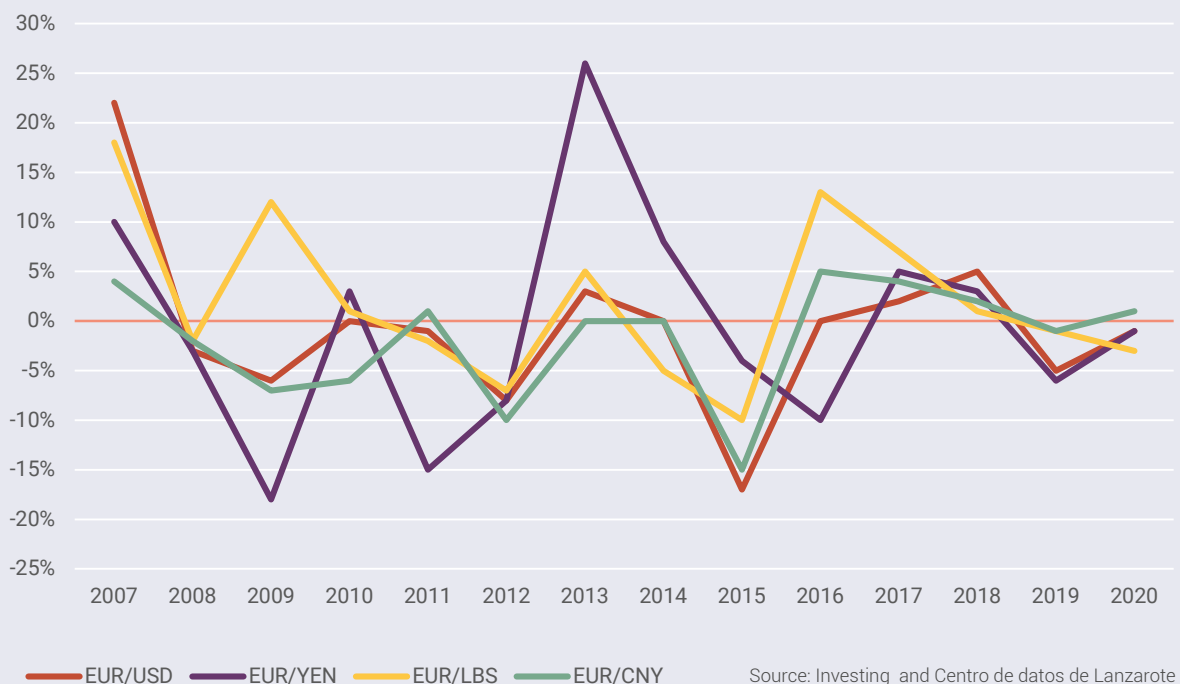
⁴ <https://www.atlanticcouncil.org/blogs/new-atlanticist/can-we-compare-the-covid-19-and-2008-crises/>



Spain's Gross Investment Flows Abroad (Thousands of Euros) - Evolution of Spanish GDP



Evolution of the main currencies (2008-2019)





3. Post Coronavirus provisions

Analyzing the impact that the disease has had in terms of macro and micro data of the economy will provide answers as to how Spanish companies will be able to get out of the Coronavirus crisis.

First of all, the question that probably most concerns all Spanish companies that are on the verge of internationalization is to know the scope of this recession, its duration in time and how we will get out of it. Especially important in this matter is whether the famous V-shaped recovery will come true (as the forecasts of bodies such as the IMF seem to indicate). If the evolution of world GDP finally reaches 6% in 2021, this would undoubtedly mean a more favorable scenario for companies than any of the other alternatives being considered⁵.

If these forecasts come true, one of the first elements to be analyzed is the country of destination of Spanish investment abroad, in order to try to find similarities and differences between these two crises. If we analyze the cumulative figure for 2008-2019, in the list of the fifteen main countries by investment flow we find the United States, the United Kingdom, Brazil, Mexico and the United States in the top five positions (by region, North America, Europe and Latin America are the main preferred markets for Spanish companies when they decide to go abroad).

A look at the geopolitical reality and the management of COVID-19 shows that the situation in 2020 is different from the one lived in 2008, so the reaction of Spanish companies this time could be different. At a time when internationalization can be a path to recovery and growth, it is important to consider certain aspects: The United States is in the midst of a presidential election, while competing with China for the position of the world's leading power. The United Kingdom is immersed in the Brexit process.

This of course does not mean that Spanish companies will not go abroad, but that alternative destinations such as Colombia (which is making significant efforts in terms of receiving foreign investment in fields such as digital-start up) or

Ireland may start to become more relevant in the coming months. If we add to this the data that organizations such as the World Bank offer regarding growth in terms of GDP for countries such as Peru (7% in 2021), Ecuador (4%) or Chile (3%), the options increase.

Almost as important as the destination country for Spanish investment will be the sector of activity. In this sense, it is true that Spain has usually been related to sectors such as the automotive sector (since it represents the first sector by exports, an industry that has been one of the most affected by this situation, as shown by the data on the percentage variation suffered during the first quarter of this year with respect to the figures for 2019). However, if we use this same information, we will see really positive data on other sectors such as the fruit and vegetable, cosmetic, meat and steel industries, which have grown during the first quarter of the year compared to the same period of the previous year.

In addition to these sectors, the pandemic has also been an opportunity for other industries such as everything related to e-commerce, logistics and distribution, health, insurance... these sectors have seen their numbers revitalized in recent months and their prospects for future growth have increased.

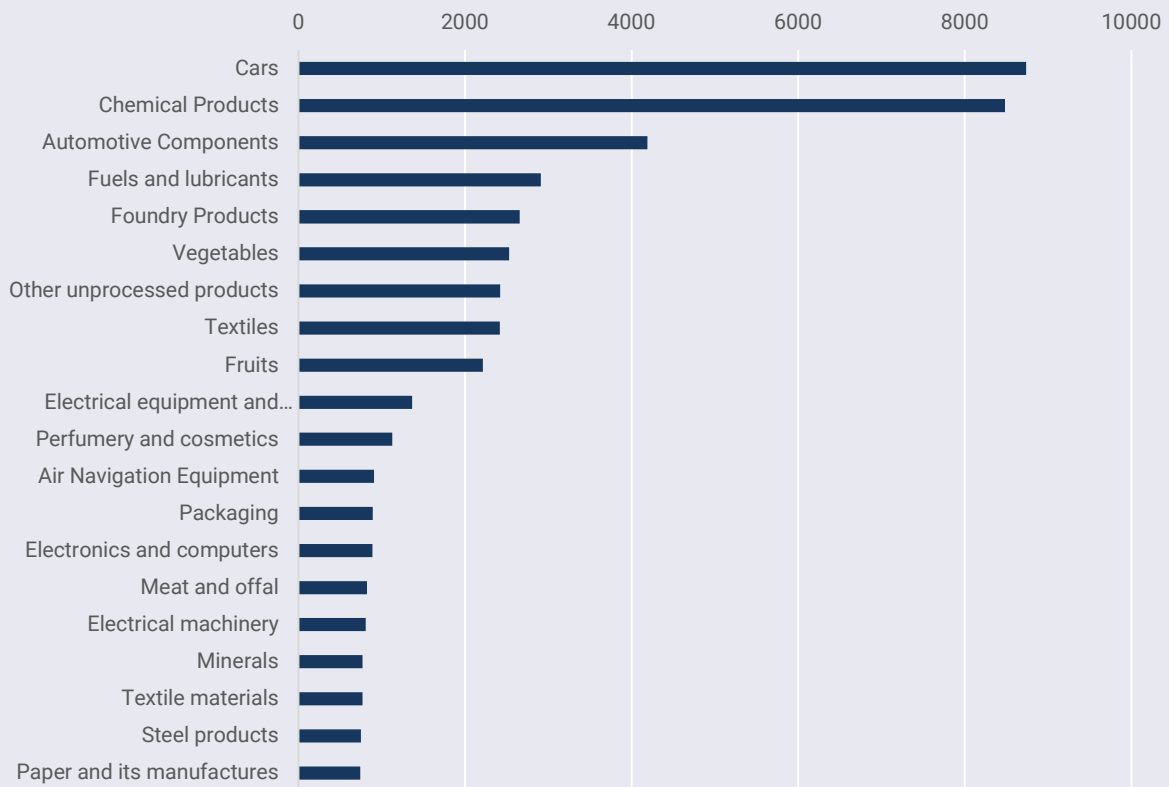
Spanish companies are in a positive position in order to continue growing in terms of internationalization

In summary: with the accumulated experience, their geographical position, or the options that are open both in terms of sectors and new markets to access, Spanish companies are in a positive position in order to continue growing in terms of internationalization. This leads us to try to answer the following question: where should these companies land?

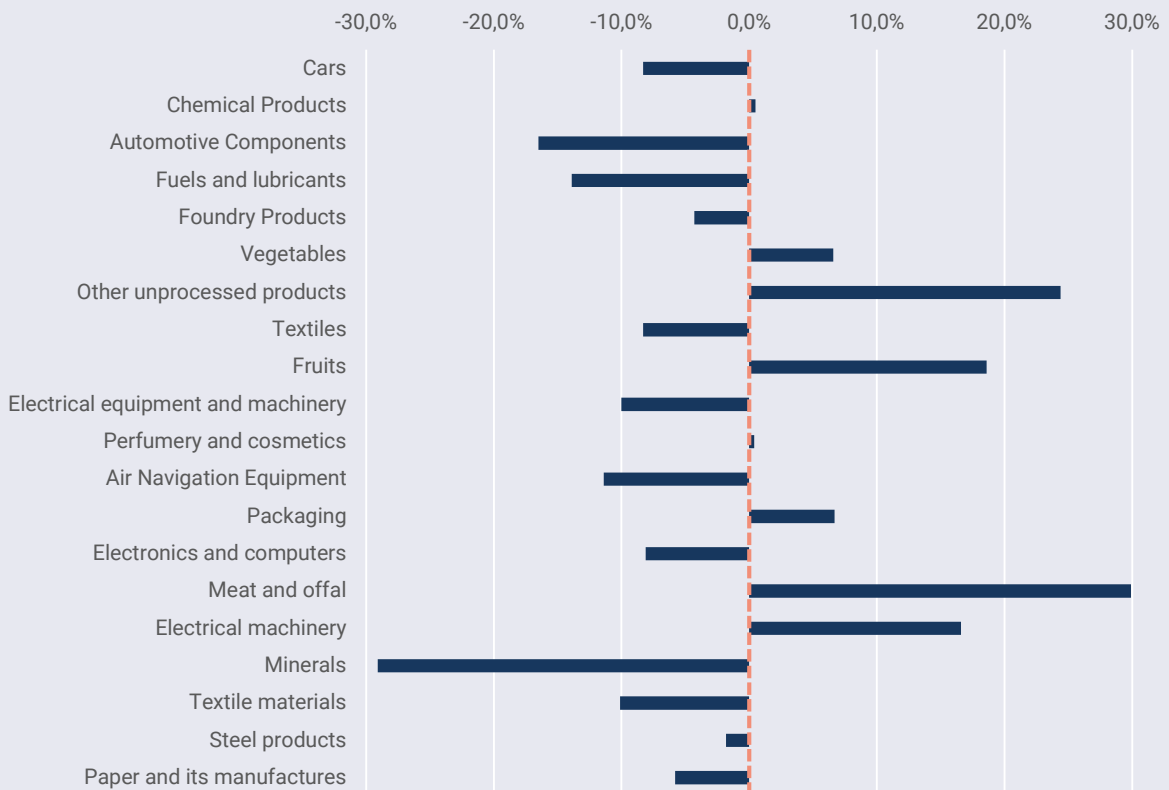
⁵ <https://fortune.com/2020/06/07/economic-recovery-coronavirus-u-shape-check-mark-square-root-swoosh-stock-market-unemployment/>



Exports by sector



Source: ICEX



Source: ICEX

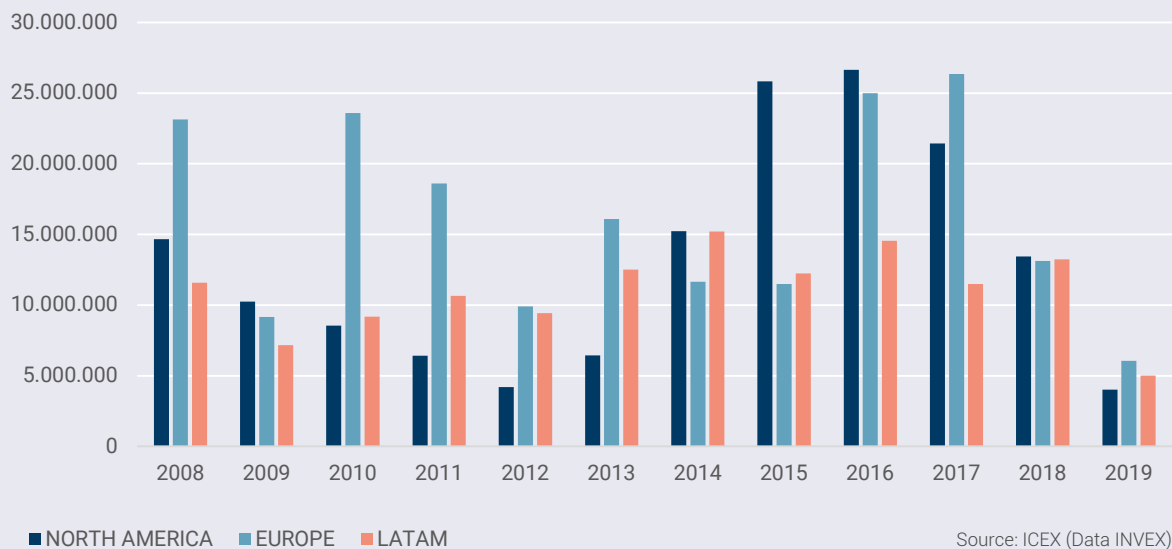




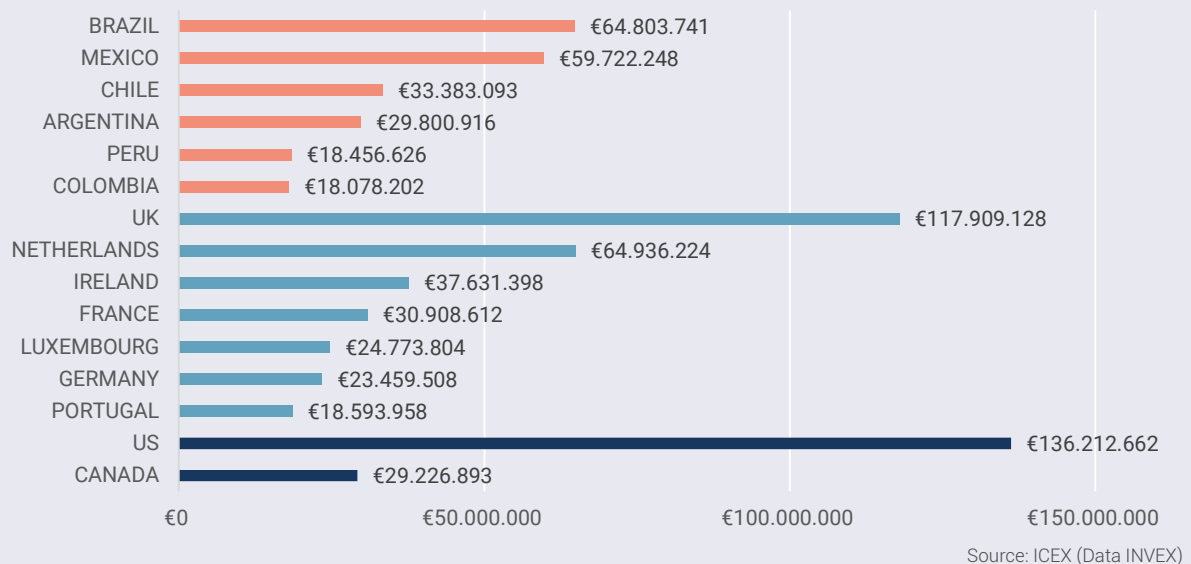
4. Destinations of Spanish companies expanding internationally

The United States, Canada, Latin America, and Europe are the regions that, since the beginning of the last financial crisis in 2008, have collected the highest percentage of Spanish investment abroad. Will the same trend occur after the situation we are experiencing in 2020? To answer this question, it is necessary to analyze the present and future of each of these areas to try to understand where these markets are heading once the new normality has been reached.

Gross Investment Flows Abroad by region



5 countries with most direct investment received (Top 15. Cumulative 2008-2019)

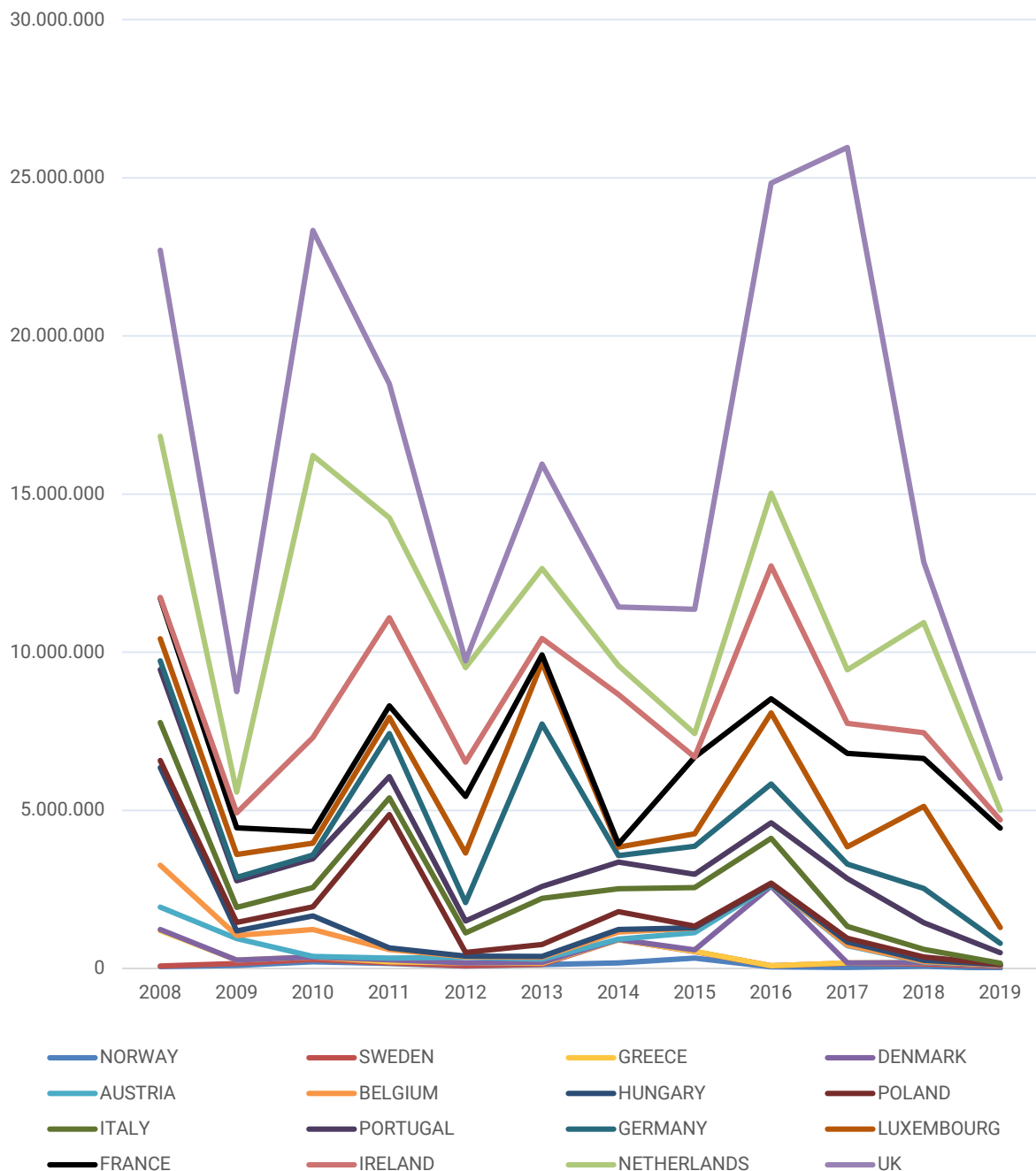




Europe: the commitment to a common market

As the pandemic progressed and the focus shifted to other areas, Europe has once again emerged as a major player on the internationalization game board. Although there are still issues to be resolved in the equation (for example, the disparity of visions for the community model defended by the countries of the north with respect to the countries of the south), these are some of the keys to becoming internationalized in Europe:

Evolution of Spanish Direct Investment in Europe



Source: ICEX (Data INVEX)



UNITY AS A STRENGTH

Regardless of any crisis or contingency, Spanish companies continue to form part of a single market made up of 27 countries, with a single currency in 19 of them and with 446 million potential buyers. All this within the context of legal and institutional security, with the figure of the European Central Bank as the greatest guarantor.

As a result of the above, Europe is also making significant efforts to implement the Digital Single Market. A strategy initiated in 2015 and in which important steps have been taken such as the end of mobile data roaming, new regulations on data protection or joint initiatives such as investment in the European construction of supercomputers.



DIGITAL SINGLE MARKET



PAST LESSONS

We could say that a country is as reliable as its financial and banking structure. In this sense, Europe has emerged even stronger from the 2008 crisis. The supervision by the European Central Bank, as well as the new risk and capital availability regulations are just some examples of the effort made by Europe in this respect. To give an example, in a context marked by the decrease of the indebtedness (by families and companies), the banking institutions have been maintained during the Coronavirus crisis as financial support to the society, unlike the previous crisis

On 23 April, European leaders gave the green light to the recovery plan for Europe, with the commitment to launch an initiative to mitigate the consequences of the COVID-19 crisis. A month later the content of this plan was presented, which includes a budget of 1,100,000 million euros for the period 2021-2027, as well as the 'Next Gen EU' fund, made up of 750,000 million euros⁶.



RECOVERY PLAN



NEW GREEN DEAL

Continuing with the above, and above and beyond promises, Europe is taking important steps towards becoming the first climate-neutral continent, in the form of a roadmap to provide the EU with a sustainable economy. Presented in December last year, progress has been made in recent months, such as the presentation of the Biodiversity Strategy for 2030 and an action plan for the Circular Economy⁷.

Although with particularities and differences between countries, Europe has in many of its countries tax benefits for companies that invest in Research and Development⁸, positioning itself as a region of interest for companies with an interest in international establishment.



TAX BENEFITS FOR R&D

⁶ <https://www.consilium.europa.eu/en/policies/coronavirus/>

⁷ https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_es

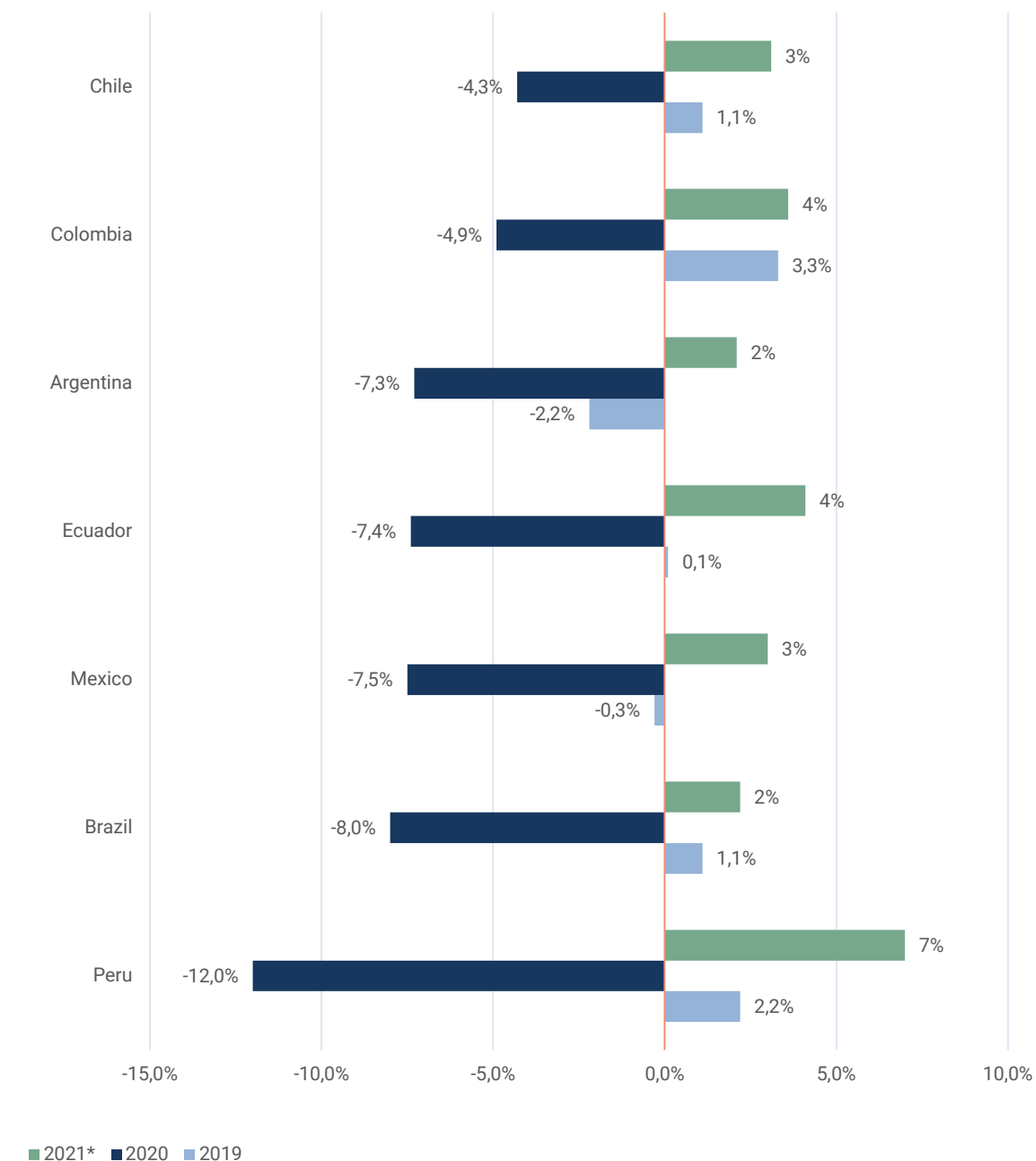
⁸ <https://www.oecd.org/sti/rd-tax-stats-compendium.pdf>



Latin America: a commitment to the future

Before the COVID-19, nobody doubted that Latin America was a very attractive destination as an internationalization scenario, especially for Spanish SMEs. With growth forecasts in terms of GDP reaching 3.5% for some of the main economies⁹, and a business fabric made up of small and medium-sized companies (in countries such as Mexico these companies account for over 75% of the total), the question to be resolved is how the region will respond in the incoming months. These are some of the arguments in favor:

Impact of the pandemic on GDP growth in Latin America



2021: forecast. Source: World Bank

⁹ BBVA Research – Situación Latinoamérica 1T19



SIZE OF THE OPPORTUNITY

Latin America continues to represent a market of more than 650 million inhabitants, made up of more than 20 countries. Despite the notable differences that may exist by region, the existence of a common language and a culture with similar features obviously remains a competitive advantage, especially for Spanish companies. Its presence on the doorstep of the United States and its special connection with the city of Miami as a HUB for American companies with interests in the region, are other factors.



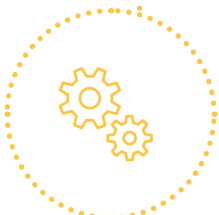
THE GOOD WORK OF SOME COUNTRIES

Although previously mentioned in this report, we must not forget the positive management of the COVID-19 pandemic by many of the countries that make up the Latin American region, as has been the case of Costa Rica, Chile¹⁰, Argentina (with a long confinement ahead of events), Uruguay or Peru (these countries recognized by the presidential approval of their citizens).



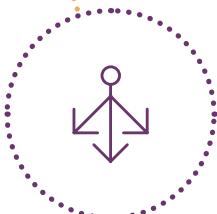
STRUCTURAL REFORM

Progress on the structural reform agenda regarding education, innovation, social issues. Although 2019 was marked by the phenomenon that some have come to call Suraméxit, or the South American Spring¹¹, the debate on the need to make progress on reform and social inclusion is on the table, with issues ranging from gender equality to Agenda 2030¹², to the urgency of preparing the country to prepare for and anticipate the fourth industrial revolution. With most Latin American and Caribbean countries falling into the category of 'Middle Income Countries'¹³, the continent will play a decisive role in the future.



COMPETITIVE ADVANTAGES

Competitive advantages. The countries of the region are also making efforts to attract investment in the field of technology. To this end, countries such as Colombia are offering tax advantages for the IT sector¹⁴; others such as Mexico, Ecuador or Argentina have also legislated new sectors such as digital entertainment platforms.



DEVELOPMENT IN THE FIELD OF NEW TECHNOLOGIES

All of the above is reflected in data such as the 'Annual Review of Tech Investment in Latin America', published by LAVCA¹⁵, which shows how capital investment in technology in Latin America has grown in recent years, doubling annually. Both for the investment in this field, financing rounds, number of 'Unicorn' companies that arise annually... Latin America enjoys the interest of investors. Furthermore, data such as the penetration of e-Commerce or the use of smartphones show a mature market with consumers ready to boost the development of these sectors.



10 <https://www.elindependiente.com/opinion/2020/04/29/chile-un-ejemplo-de-buena-gestion-de-la-crisis/>

11 <http://agendapublica.elpais.com/suramexit-y-desintegracion-latinoamericana/>

12 https://www.fundacioncarolina.es/wp-content/uploads/2020/02/DT_FC_29.pdf

13 <https://www.cepal.org/notas/74/Opinion.html>

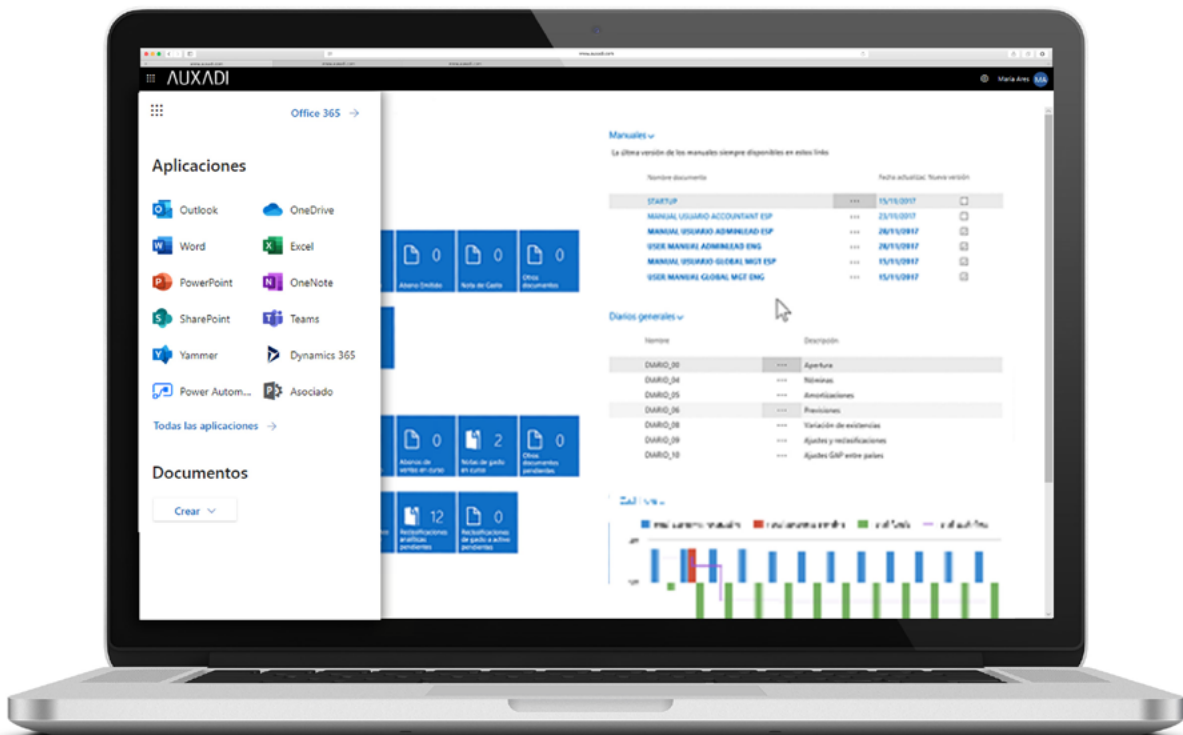
14 <https://www.mintic.gov.co/portal/inicio/Micrositios/Beneficios-Tributarios-para-el-sector-TI/>

15 <https://lavca.org/industry-data/inside-the-4th-consecutive-peak-year-lavcas-annual-review-of-tech-investment-in-latam/>



5. Technology: Key to internationalization

If we talk about internationalization, it is essential to do so also about the impact of new technologies on this process and the opportunity and competitive advantage they represent. Nowadays, nobody can doubt that the key to these processes is the new technologies, and in this respect Spanish companies have gained ground due to the intense penetration of the digital world and, specifically, electronic commerce in this country.



According to data from the IAB Spain eCommerce Yearbook, 71 % of Spanish Internet users claim to buy, which shows the penetration of this sector. In addition, according to another report prepared by Boston Consulting Group, the size of the digital economy in Spain approached 19% of GDP in 2019¹⁶. These are only two figures, but they reflect the importance that the digital world already has in this country and, therefore, for Spanish companies.

However, accompanying the process of internationalisation of companies with a strategy of digitalisation and transformation

will be a key aspect if they want to successfully meet the challenges that the expansion to other countries entails, which could be described as:

- Cultural and language differences
- Physical distance and different time uses
- Existence of multiple technologies throughout the process
- Heterogeneity in the presentation of data, information, reporting, etc.
- Specific legislation in each market
- Number of actors present in the process

Therefore, the CFO, CEO, CTO or any other profile that leads internationalization and technology must consider the following aspects:

¹⁶ <https://www.adigital.org/la-economia-digital-ya-representa-un-19-del-pib-en-espana/>



CULTURAL TRANSFORMATION

• Digitalization processes are more of a cultural change than a digital transformation process. In this respect, organizations that want to successfully face internationalization processes must first be sure that their corporate culture is focused on the digital. And that, in this process, the internal talent is aligned with this objective. For this to happen, the entire organization must look in the same direction and it must be a process that is pushed from the C-level to all levels of the organization.



THE IMPORTANCE OF DATA

• In order to successfully overcome this experience, it is essential to have as much information (in the form of data) as possible in a centralized, immediate and accurate manner. Technology makes it possible to eliminate all barriers in this respect and to guarantee control of these insights, which in turn will facilitate decision-making.



FACILITATE AND UNIFY THE EXPERIENCE

• However, the mere presence of technology is not enough to guarantee that no mismatches of any kind will occur. Both the legislative features, to cite one example, and the existence of multiple technologies throughout the process, as well as the difficulties inherent in the reality of the process (time differences, for example), make the need for a unified user experience almost obligatory. Having a single technological solution that brings together all the necessary information can be a competitive advantage when it comes to leading these strategies.



A MODEL THAT ENHANCES THE PROCESS

• In any case, technology without a model to guide internationalization is a complex initiative with many more obstacles along the way. Therefore, the model must be designed to overcome the challenges we mentioned at the beginning of this section. It must facilitate dialogue processes (which are complex due to the number of actors involved), reduce physical and time distances, guarantee regulatory compliance in each country, etc.



RELIABLE BUSINESS PARTNER

• Internationalization processes take time and require adaptability to overcome the multiple particularities and idiosyncrasies of each one of the markets in which we operate.



6. Relevant Tax Aspects

In a process of internationalization, taxation is typically a key element in being able to properly define both the expected returns and returns on investments, and the ability to properly use and move the cash flow generated in the various locations where groups operate and obtain their income.

At the same time, it is framed within an environment of growing interest and scrutiny by multiple stakeholders, which extends from the most traditional ones, such as the governments and local tax authorities of the various jurisdictions in which they operate, to many others such as public opinion itself, the media, NGOs and other various institutions interested in knowing in detail the tax contribution of companies, in order to be able to assess it with a normally critical view.

In this context, the lack of compliance with tax obligations, apart from the risks and direct costs in the form of economic sanctions that this causes, can lead to a significant loss of reputation that ends up impacting on the Groups' income statements.

It is therefore absolutely essential to have the necessary resources and up-to-date

knowledge of local tax matters so as to be able to control the risks and opportunities in each jurisdiction in which we operate in a centralized manner, but without losing the overall vision that gives meaning to the entire business model.

It is therefore absolutely essential to have the necessary resources and up-to-date knowledge of local tax matters so as to be able to control the risks and opportunities in each jurisdiction

Here, again, technology is the great ally and support in this task of control and monitoring of global tax compliance in the groups.





7. The Future post Covid

After having overcome the worst of the disease (on June 21 the 'State of Alarm' ended throughout the country), and installed in the phase called 'new normality', Spanish companies are facing the great challenge: to continue the trend developed in recent years in terms of internationalization and strengthen its position and growth.

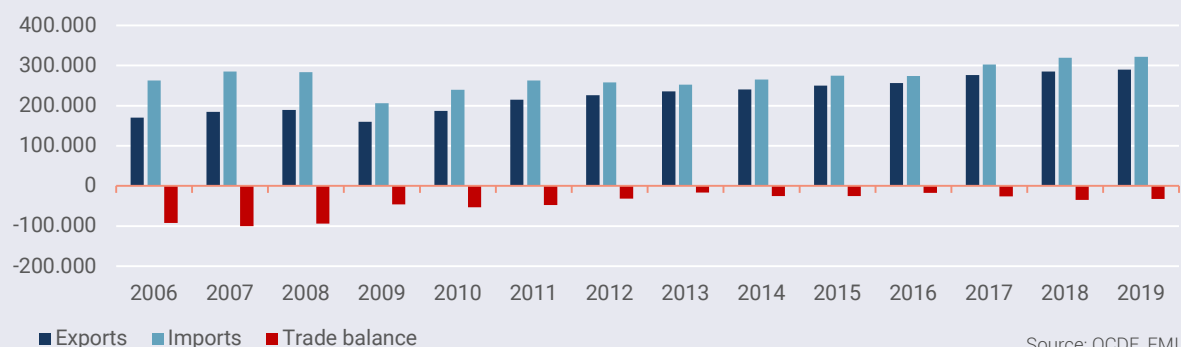
As we have seen throughout this document, the Spanish business fabric has the expertise, talent and know-how necessary to successfully achieve the opportunities that internationalization offers.

Along the way, important challenges remain. From the need to align all levels and stakeholders involved in this process (government, national and supranational organizations, foreign

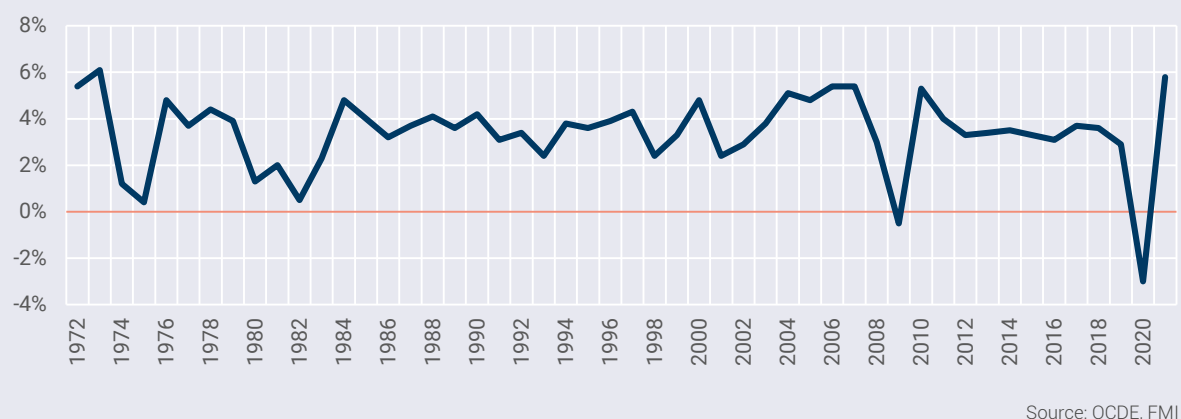
trade, business associations ...), through to achieving consensus and business dialogue necessary for decision making that favors this process, through decisions of equal strategic importance as the commitment to talent within organizations, essential in this kind of process.

On all this, and more, will depend that internationalization is key to the future of Spanish companies.

Trade Balance Spain 2006-2019



World GDP evolution and 2020-201 forecasts





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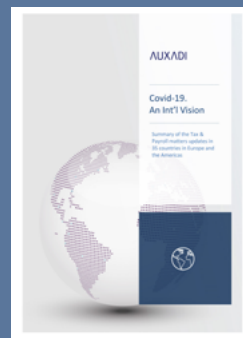


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