Many multinational companies (MNCs) have been expanding into new regions either organically or via mergers and acquisitions to ensure sustained revenue and profit growth.

Double digit growth in the Asia-Pacific (APAC) has made it an attractive location for expansion. But with supply chains being increasingly complicated and costly to keep-up, MNCs have ended up with sub-optimal operating models with emphasis on local country operations or multiple stand alone business units within the region.
Case for change

► Country or cluster based operations with missed opportunities for regional and global synergies and leverage
► Duplication of functions in operating companies or across divisions and business units
► Proliferation of legal entities, customer management and invoicing centres leading to complication, high transaction costs and poor customer service
► Operational underperformance due to silo functions, immaturity across geographies and silo key performance metrics
► Poor customer service, high supply chain costs and under utilization of resources due to lack of pan-regional or global supply chain management, planning and control
► Lack of process and organization standardization and harmonization
What is centralization?

Centralization is the process of moving certain business functions into a so called “principal”, which then transacts with, or through local entities that perform domestic operations: the operations and functions that have not been centralized.

Decentralized (country based)
- Point-to-point planning
- Diverging policies and service levels
- Different processes per location
- Different performance measures
- Inconsistent organizational structure
- Roles, structure and locations often result of ‘history’

Centralized (regional or global)
- Single point of accountability for most critical business processes
- One operating model
- Central planning, strategy and policy setting, common T&Cs
- Single set of Key Performance Indicators (KPIs) for performance management
- Consistent and harmonized processes
- Logical location of roles and functions

Centralization of business mgt can bring operational improvements
- Speed and accuracy of operations
- Reduced duplication of business processes
- Improved service, with reduced working capital
- Improved handling of international customers
- Better decision making in ‘constraint’ situations
- Central sourcing cost reduction opportunities

Using certain principles will bring additional benefits
- Increased management control
- Single performance management framework
- Simplified financial reporting
- Indirect tax efficiencies
- Stability / predictability of local tax burdens
- Leveraging operational improvements with lower tax…

Note: Distribution Center (DC)
Which functions to centralize?

- There are many variants of a centralized principal model and the choice of model depends on many factors.
- A careful assessment needs to be conducted to see what are the key challenges to the restructure of the existing supply chain.

Challenges to the value chain

- Redefining strategic relationships with customers and suppliers
- Accelerating pace of globalization
- Permanent Establishment (PE)/M&A activity
- Expanding regulatory, environmental and ethical landscape
- Products transitioning to services
- Rapidly advancing technology

Value chain functions

- Suppliers/Partners: Design, Plan, Source, Operate, Fulfil, Market and sell, Service, Recycle
- Customers: Core product/service capabilities

- In some markets it is not optimal to move the sales and marketing function as the local sales office is a key value driver due to the existing customer relationships and the ability to make sales.
- Likewise, it may not be feasible to perform after sale product support and service from a centralized location, rendering the function to remain country based.
- Other functions such as R&D, manufacturing, procurement, operations and order fulfilment should be considered for centralization.
What does a principal model look like?

The full principal model must take operational and tax reasons into account when choosing where to locate functions.

- **Headquarters**
- **Suppliers**
- **Principal Trading companies**
- **Plant**
- **Sales companies**
- **Customers**

**Functions**
- Business strategy and planning
- Marketing strategy and brand management
- Strategic sourcing
- Supply chain management

**Risks**
- Market risk
- Intangibles
- Inventory

**Returns**
- Residual profit

**Legal title**

**Physical flow**

**Services**

**Functions**
- Production scheduling
- Quality control
- Recruitment and training
- Local sourcing

**Risks**
- Capital investment
- Operating efficiency

**Returns**
- Cost plus

Through moving to a more centralized model, the duplication and inefficiencies are addressed, to drive optimized business returns.

Think global, act local
What benefits can be achieved?

Business change initiatives are bringing operational benefits ...

... tax can add value to the operational benefits by:

- Adding tax savings to the operational savings
- Ensuring operational change does not create tax exposure/incremental cost
- Providing additional funds for reinvestment
- Reducing administration and associated costs

Increasing the after-tax return from the new business model

Think global, act local
What drives the choice of model?

Benefits case, risk management and change management considerations determine the operating model

Operating and tax model considerations

- Where in the value chain is the opportunity?
- What is the benefit case for change?
- What are the operational and tax risks?
- Is one model suitable in all locations?

Change is manageable

+ Business case for operating model

= Implementable model

Change management considerations

- Is the business ready?
- How will key people be retained?
- Can systems cope?
- What is the legal and contractual position?
- What is the impact on business processes

Decisions:

1. Transactional vs. non-transactional models
2. Scaled vs. fully transformational models
Models for Asia-Pacific
Transactional or non-transactional principal

1. Transactional principal

Global HQ

Product purchases also made from Global HQ

Principal

Purchases product from third party/contract manufacturers, sells to related party limited risk distributors

Third party contract manufacturers

Limited risk distributors (APAC)

Services flow
Invoice flow
Product flow

2. Non transactional principal

Fee generally charged to either manufacturer and/or distributor

Non-transactional principal

Provides routine, non-routine services, intellectual property

Manufacturers (domestic and export)

Limited risk distributors (APAC)

Services flow
Invoice flow
Product flow

Office

Distributors (domestic and import)

Office

Global HQ

Office

Third party contract manufacturers

Office

Think global, act local
The transition to these operating models can be phased, depending on a company’s existing business and organizational model and its readiness for change.
# Case study 1

**Background:**

A leading global manufacturer and distributor of household cleaning supplies and other consumer chemicals with a worldwide sales, research and development and manufacturing presence. The client has complex operations in Asia-Pacific with operations in 14 countries across the region.

**Business challenges:**

- Organization is currently going through a number of organizational changes due to its strategic initiative that is aiming to achieve profit margin growth, decrease functional expense and increase market share
- Challenge to centralize Asia-Pacific activities and executional excellence in alignment with the strategic initiative whilst enabling tax efficiencies
- High volume of domestic-to-domestic transactions (centralization of transactions through hub challenging)

**Features:**

- Asia hub in Kuala Lumpur for Asia-Pacific performing sales and marketing, procurement as well as manufacturing and supply chain functions
- Detailed future state operating model for 14 jurisdictions across Asia-Pacific that is designed in accordance with the relevant tax and regulatory specifics in each jurisdiction
- Centralized buy/sell model (where possible/beneficial) to reduce transaction flows and costs
- Value-added services (VAS) fee approach for domestic-to-domestic transactions
- Favorable tax incentive for Asia hub in Malaysia

**Approach:**

- Various activities to access feasibility of centralized operating model both from a business and from a tax/regulatory perspective
- Further in-depth analysis of the client’s current state operational model covering business and tax aspects
- Incentive negotiations in Malaysia
- Design of future state transactions, processes and roles and responsibilities under the new operating model through collaborative client workshops
- Integration and ongoing management of multiple work streams (direct and indirect tax including local country work streams in all relevant jurisdictions across Asia-Pacific, transfer pricing, legal and organizational)

**Key benefit areas:**

- Saving of US$102m NPV over 10 years in terms of tax savings
- High level of change
- High level of risk
Case study 2

**Background:**
A leading global manufacturer and marketer of ready-to-eat cereal and convenience food with a worldwide sales, research and development and manufacturing presence. The client acquired a major snack business as part of its strategy to expand its snacks business and enhance its global footprint.

**Business challenges:**
- Integrating the new business operations to realize benefits and synergies across the region
- Challenge to centralize Asia Pacific activities and executional excellence in alignment with the strategic initiative whilst enabling tax efficiencies
- Additional expansion through the investment of two new factories worth US$200m

**Features:**
- The buy/sell principal earns residual profits, buying from US/other related parties and APAC contract manufacturers and selling to local distributors
- The model provides flexibility for acquisitions as new entities/functions could easily be integrated
- Favorable tax incentive for Asia hub in Singapore

**Approach:**
- Various activities to access feasibility of centralized operating model both from a business and from a tax/regulatory perspective
- Incentive negotiations in Singapore
- Inclusion of future R&D and IP ownership
- Inclusion of centralized sales and marketing due to the nature of the product/brand not needing to be close to the market

**Key benefit areas:**
- 5% tax rate for 10 years with annual operating expenses spend of US$20m
- High level of change
- High level of risk

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