Lead Left Interview – Stephen Lewis (Part Two)

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This week we conclude our conversation with Stephen Lewis, founder, Cross Border Strategies LLC. His firm provides advice to global middle market companies as they structure transactions internationally and assists those companies in sourcing the necessary financing.

Second of two parts – View part one

The Lead Left: Steve, last week we discussed how it's easier for European companies to do cross-border business there. There's also less ground to cover.**Stephen Lewis**: By definition, expansion in the European middle market includes doing business in someone else's backyard. But because of higher capital requirements and hits to hurdle rates, it's tough to find bank financing.

Due to new regulation post-crises, the availability of Leveraged loans from banks has tightened up.

***TLL:** What about alternative lenders as financing sources?*

SL: Unlike the US, where banks' share of leveraged loans has been around to 20% historically, the reverse has been true in Europe where banks have predominated. That's changing. Alternative lenders there realize they have to lend money cross-border and take security. To do that, they either have to have the regulatory authority to lend cross border or work with someone who does. This process is called "passporting."

***TLL:** What does that involve?*

SL: Prior to the creation of the European Union, it was very difficult for a lending institution in one country to lend in another country. With the European Union and the subsequent implementation of the euro, the landscape changes such that if you had a license to lend in one EU country, you were allowed to "passport" your license to another EU country to serve the needs of your client. What that means for non-bank, non-licensed lenders is that they need to partner with a licensed bank, often referred to as a "clearing bank" . local to lend money in another jurisdiction. Those domestic institutions are happy to assist other firms and grow their fee business.

***TLL:** Steve, could you address the issue of corporate inversions, which seems to be a hot button now.*

SL: What's now called "inversions" has been going on a long time. In the late '90's, the first question any M&A advisor would ask in a merger with a European entity is: Can you create a holdco that lowers the tax rate of the enterprise? Luxembourg-based companies were common, for example.

***TLL:** But not necessarily moving the headquarters out of the US. That's the politically sensitive issue.*

SL: That's why this spate of mergers is attracting attention. Inversion is merely an extension of what's been going on for years. Cross-border M&A always has involved elaborate analysis of the ways to minimize the overall tax rate of the global enterprise. No less a scholar than former Supreme Court Justice Learned Hand once said, "…anyone may arrange his affairs so that his taxes shall be as low as possible." In seeking to move corporate headquarters outside the US, more companies are following that principle.

TLL: *And if the company is public, it will command more attention.*

SL: If it's private, where's the noise? Deals like AstraZeneca and Walgreens are high profile. But if I'm a public shareholder, I'm happy! The value of my shares goes up. That's anti-American? Really?

TLL: *Take an example.*

SL: Let's say Abbott Labs wants to do an inversion. The combined entity pays lower taxes, provides more cash flow, and thus more jobs. Nothing else changes at the US level. The consumer benefits as well.

TLL: *Does the reverse happen? Merged companies moving to the US?*

SL: Of course, but no one pays attention to that. I don't think anyone knows the tax revenue loss, or if it's offset by gains from new jobs, or higher capital gain taxes. It's probably a fraction of what they're worried about. The real problem is the tax code. The focus should be on real growth and eliminating the tax disadvantages US companies face when compared to their competitors based elsewhere.

TLL: *Instead of worried about everyone moving to Switzerland?*

SL: While the goal is to lower the tax rate, there are always complications. If you move to Switzerland, you're subject to Swiss law. All corporate governance laws there now apply. For example, generally speaking US companies can provide cross corporate guarantees to help members of the corporate group obtain financing. You can't do that in Switzerland. There may be other impairments to executing a long-term strategy. And directors may become liable for the debts under certain circumstances if the company becomes or teeters on the brink of insolvency.

TLL: *You mention our tax code. Any chance that gets addressed in our lifetime?*

SL: It's a fundamental problem. And not just for big companies. It trickles down to cash going into the economy, and more jobs. We need to level the playing field with the other major global economies. We're at an unfair disadvantage. Double taxation prevents US corporations from repatriating overseas cash. That's where the tax code is particularly disincentivizing. It makes zero sense!

TLL: *Let's close with our standard final question, Steve. What's been your biggest surprise?*

SL: Not so much a surprise, as an observation. The combined European GDP is about equal to the US GDP, at $17 trillion. We know that middle market companies drive much of the growth here, but smaller companies may actually be bigger contributors to the European economies. With financing options more limited there, it seems to me there's a huge opportunity to provide capital to those companies.

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