Rathbones
Look forward

Review of the week

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A changing tune

After an austere run for many years, the mood music for global companies seems to have stepped up a beat. Businesses are splashing the cash and investing for a new future.

For much of the 21st century, a few trends have held sway over how businesses view investment, treat their staff and think about supply chains. As we emerge from the pandemic, these trends seem to be unravelling.

Take company investment. Businesses have been encouraged to be restrained with spending on capital expenditure - on building new factories, opening new offices and buying new systems. For many years, investors punished companies that invested too heavily in projects which couldn't show immediate returns (in terms of profits or sales growth). The idea was that investors typically preferred companies to return cash by way of dividends or buying back shares because they felt they could find better returns themselves. They wanted to see 'capital discipline'.

But now capital investment is back in vogue, particularly in the US which tends to set the tone for the rest of the world. Capital expenditure by American companies is growing at about 15% annually. Analysts at investment bank Morgan Stanley expect global investment will be 21% higher than pre-pandemic levels by the end of next year. 'Reshoring' supply chains is the rage, after the fragility of 'just-in-time' production lines spanning multiple nations were highlighted by the pandemic and political shifts. All this extra investment could help boost GDP, productivity and the world's supply levels. Yet it could also weigh on company profitability, if the money that's shelled out doesn't reap the returns expected.

Since the global financial crisis, the buzzword for business and culture in general has been austerity. Parsimony, efficiency, discipline have all been lauded. Of course, the glaring exception to this would seem to be Silicon Valley, which has long prided itself on attempting the impossible and making the crazy the next craze. Yet its products and services are literally in the business of supplying others with efficiency. And the efficiency business has been good. So good these tech companies can burn a bit of cash every now and then and still remain wildly profitable or post soaring growth in sales or users.

Now, after quite a miserable year, fun seems to be back on brand. Throwing money around is actively encouraged, or at least not frowned upon in the same way as it was not all that long ago. The extraordinary stimulus packages rolled out by virtually every major nation no doubt helped break the austere mindset. A lot of people demanded changes and where before companies and governments would have demurred or resisted, now they agreed. After decades of tightly controlled investment, companies virtually overnight and en masse shelled out truckloads of cash to equip their staff with the means to work from anywhere. Governments which had been preoccupied on climbing public debts and unsustainable deficits did an about-face and unleashed the floodgates to support their citizens.

These sorts of things leave traces on our global psyche, on the world's 'Overton window' - the range of things that seem possible in our societies. And when this happens, the world changes, just a bit. This means that the companies operating within that world may need to change too. Because what worked well in the past doesn't necessarily continue forever.

The taxation dragnet

Where many companies have invested a lot of time over the past few decades is in weaving intricate business structures for themselves to lower tax bills. Things like American software companies moving the ownership rights for their products to subsidiaries based in a Caribbean tax haven, then creating byzantine internal business arrangements so that as much money as possible can go through related companies based in lower-tax nations. All legal, this was an easy way to boost profits through lowering expenses (taxes) with few drawbacks. This tactic becomes harder for businesses that are more embedded in the real world, however. It's a breeze to shift the rights to a digital product to the Caymans, not so much for a car factory.

Tax structuring has been causing a bit of geopolitical friction for a few years now. Mostly, the nations that have a lot of large companies anchored in the physical world (Europe) have been getting annoyed with those nations that boast a whole lot of digital business (the US and to a lesser extent Ireland, the low-tax launchpad for the EU operations of American software and pharma enterprises). It also became a brand problem in a world where customers increasingly vote with their wallets.

Here, too, the tide appears to be rolling back. The G7, a policy forum for the world's largest advanced economies, has agreed a global tax reform plan that aims to close the door on this tax arbitrage. The deal has two main parts. The first targets the largest global companies that have profit margins of more than 10%. These businesses will have to apportion 20% of their total profits to paying tax in countries where they have made sales.

The second part mandates a 15% minimum tax rate on companies. This means that an American tech giant using tax havens to lower its global effective tax rate to 10% would have to pay the 5% extra to its headquartered nation (the US) to make the 15% tax rate. To truly embed the new system, it would need to be approved by the G20, which meets in Venice in July.

If you have any questions or comments, or if there's anything you would like to see covered, please get in touch by emailing review@rathbones.com. We'd love to hear from you.

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