



Grant Thornton

An instinct for growth™

# Building tomorrow's billion-dollar businesses:

*Playbook for a new tech world*





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# A new global industry

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Almost 20 years since the dot-com era, the Nasdaq is reaching levels last seen during the previous boom. At the same time, we are witnessing business model changes driven by architectural transformations which could disrupt the global technology and media industry.

## **The future's bright**

Tomorrow, we can expect new technologies enabling the internet of things to create opportunities for future fast-growth companies. Some will become industry leaders – the Xiaomis and Ubers of tomorrow. Others will represent an existential challenge to established companies. Many more will fail – either because their offering wasn't differentiated enough, or because their management made the wrong decisions.

## **Today's world**

But as they look to scale, today's fast-growing technology companies are in a radically different position from those in the previous dot-com boom. Their ability to source talent, set up new operations and sell to customers online means they are global from day one. They may not yet be profitable, but they are staying private longer and many of their valuations are more grounded in reality than their forebears'.

The latest IT such as cloud, mobile and internet also reduces the capital costs associated with starting a business. Rather than locking into large infrastructure expenses early on, today's growing tech companies can pay as they go.

## **Location, location, location**

While past companies were largely based in Silicon Valley, Seattle, London or Tel Aviv, technology companies are now anywhere. Emerging markets are particularly important. Baidu and Alibaba originated in China, while India's Flipkart and Snapdeal were among the top venture capital deals recorded worldwide in 2014.

## **Established and emerging**

In this environment, established companies need to use new technologies, explore options like M&A, improve profitability and extend their operations worldwide. Newer, but still established technology companies, need to scale their operations, expand their product lines and extend their customer markets beyond their first domestic market. They must acquire and allocate financing if they are to fund these expansions.

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## **Improving the outcome**

Recognising that there are as many pitfalls as there are opportunities for growth in the new tech world, we explore how tomorrow's businesses are responding – helping you to ask and answer the right questions at the right time.



# The burning tightrope

## *How to rapidly scale operations and teams*

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Scaling a tech businesses is like walking a burning tightrope. The faster you go, the more you risk falling off. But go too slowly and the rope will burn through.

Depending on their level of business maturity, the challenge for tech companies is slightly different – but the principle remains the same: grow or die. To be the next billion-dollar technology brand, CEOs need to figure out how to scale and normalise faster than their rivals – without compromising the DNA of the business.

Tech companies that have passed the first stage of rapid growth must constantly innovate and scale new products and divisions – otherwise their rivals will pass them by. More mature businesses must also make their operations more efficient as they recover from rapid expansion and seek to make their businesses more profitable. And early-stage start-ups must scale fast simply to survive – research suggests that just one in ten companies growing at 20% per annum survive more than a few years<sup>1</sup>.

### **Protecting the core**

The good news is that cloud and on-demand enterprise services are making expansion cheaper and less complex than ever before. Scaling tech companies can use systematising tools like Jira to track issues and manage dispersed software builds. Meanwhile, collaboration tools like Yammer, Skype and Basecamp allow for close teamwork between decentralised teams.

But tech companies cannot grow effectively if they do not also look after their core structure, processes and functions. George Kadifa, managing director, Sumeru Equity Partners, says this is something that growing companies can downplay – only to run into serious difficulties further down the line. “A lot of entrepreneurs are not interested in that side of the business,” he explains. “But the risk of not putting those processes in place is that you will get to a point where the business will suffer.

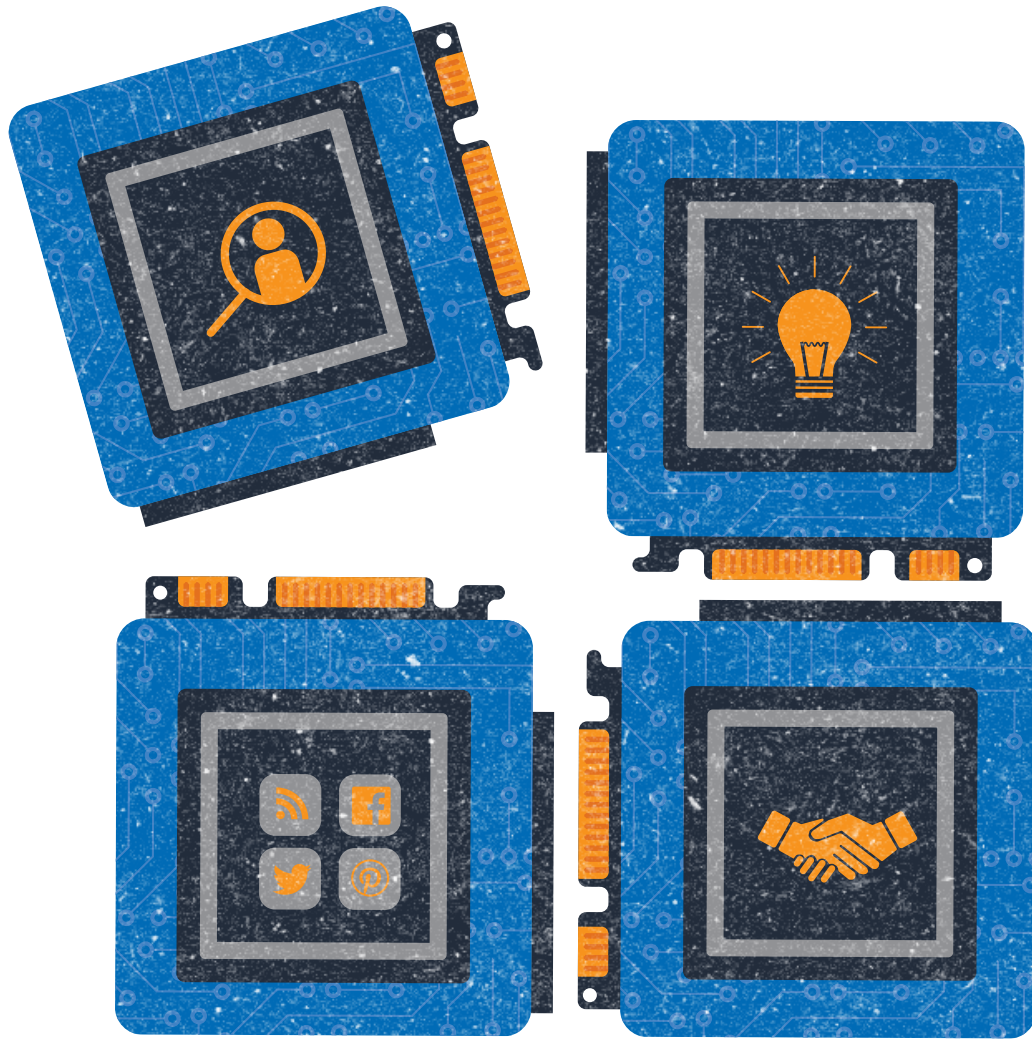
“The head of engineering at a global software company describes some of these CEOs as babies with loaded guns. They’ve all this power but they don’t know what they’re shooting at. You have to get these very smart technical people to the point where they can grow the organisation.”

### **Bob Sutton**

Stanford University, Professor of management science and engineering and author of *Scaling-up Excellence*

<sup>1</sup> ‘Grow fast or die slow,’ McKinsey and Company, April 2014





“The risk of not putting processes in place is that you get to a point where the business will suffer.”

**George Kadifa**

Managing director, Sumeru Equity Partners

In the early nineties, for example, IBM was built in a non-scalable model. Every country had its own structure, capabilities, systems and processes. When the mainframe business slowed down, IBM was close to bankruptcy.”

Investing in a strong core is not just about maintaining operational reliability. It can also open the door to future growth. “Once you have reached a baseline level of stability in your business operations,” says Steven Perkins, global leader of technology, media

and telecommunications at Grant Thornton, “you are in a stronger position to rapidly scale, or to support the next quantum leap to secure additional financing.”

Fortunately, rapid change in the underlying architecture of core enterprise software tools is helping. Whereas companies busy scaling up used to invest in physical mainframes or client-server infrastructure, they can now simply sign up for cloud-based enterprise software services, such as finance and human resources tools like Workday.

### Looking beyond initial markets

After their initial taste of success, tech companies are invariably hungry for more. But frequently there is only so much room to grow in the local market. Moving into new areas quickly becomes an imperative, especially if they are based outside the US. And, if they don't move fast enough, someone else might copy their idea. In Germany, the Samwer brothers have built a successful business based on 'cloning' the ideas of US technology companies<sup>2</sup>.

As they look to new markets, tech companies have several approaches open to them. They can sell direct to overseas customers from their home market, work with established intermediaries or partners with local knowledge, or relocate the business altogether. Selling direct may appear more lucrative at first, but it saddles the company with local compliance, licensing and auditing issues – which could be handled more effectively by a local partner. For others, opening a presence on the ground may seem the best option – but there are several different ways of doing it (see following page and Netcomm case study on page 30).



**“It is very easy to hire ten new people, but it’s extremely hard to hire ten amazing people, and it’s very difficult to fire people.”**

**Noam Schwartz**

Head of innovation, Similarweb

### Innovating the product mix

Technology and innovation are inextricably linked. If tech companies are not prepared to rethink and enhance their existing offering, they are unlikely to reach the next stage of growth. But they also face what appears to be a stark choice. They can continue to add new features to ensure their product remains competitive against their rivals. Or they can focus on providing better performance by making incremental improvements to the product's existing features. As the following case study illustrates, tech companies may also realise rapid growth by expanding their offering far beyond their initial product suite.

### The talent bottleneck

For many growing tech businesses, the biggest obstacle is a shortage of talent. In the US alone, demand for software developers is expected to grow by 20% per annum to 2022<sup>3</sup>. This shortage is not just driven by the tech sector – all sectors are looking for digital skills.

In the UK, Australia and India, tech companies are struggling to recruit talent with backgrounds in science, technology, engineering and mathematics (STEM) subjects – despite government efforts to boost such knowledge. And it isn't just standard issue STEM skills at a premium: there is growing demand for 'smart creatives', who combine bold ideas with technological and commercial knowledge.

New, multifaceted roles are also in high demand. Today's cloud technology specialists are expected to be part technology broker, part cloud integration specialist and part user experience designer.

Making matters worse, there is often significant external pressure to speed up recruitment. “When you're growing there's a lot of pressure from the market and from investors to start ramping up your sales floor,” says Noam Schwartz, head of innovation at Similarweb. “It is very easy to hire ten new people, but it's extremely hard to hire ten amazing people, and it's very difficult to fire people.”

<sup>2</sup> 'Germany's Samwer brothers to become billionaires with rocket internet IPO,' Forbes, July 2014

<sup>3</sup> 'Employment projections program,' U.S. Bureau of Labor Statistics, 2015



# Relocating your tech business: three main options



## IP holding regimes and regional hubs

Through intellectual property (IP) holding regimes, the holding company retains IP rights but gives the trading company a license to use the IP as part of its daily business operations. The trading company pays an up-front license fee and ongoing royalty payments for the duration of the license. Given the importance and value of IP protection, tech companies are considering where best to locate IP assets to ensure protection and manage tax efficiently.



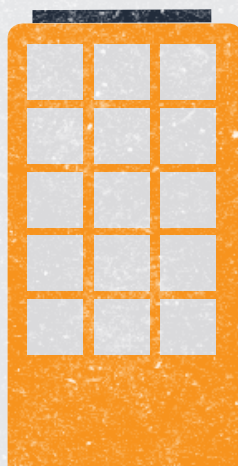
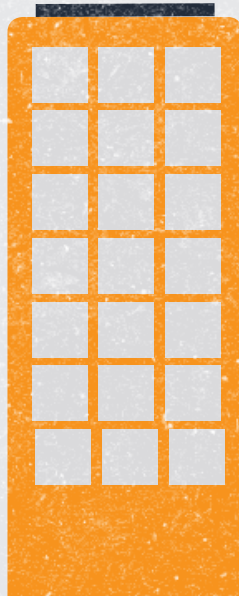
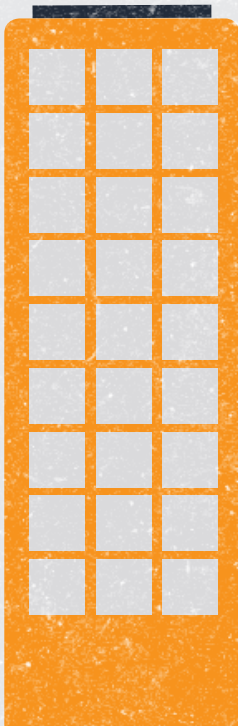
## Offshoring

Offshoring is the overseas relocation of support functions. In recent years, offshoring has been extended to value-add functions, such as R&D and treasury. These centres may be moved to locations where there is a wealth of skilled talent, efficient tax arrangements and incentives to encourage investment.



## Full migration

This involves moving the headquarters or the holding company or both. If you are based in a jurisdiction with a complex tax system, then full migration to a different jurisdiction may prove the most efficient approach. And yet, while the benefits can be significant, there are exit costs to consider. Increasingly, there are also reputational issues to bear in mind. In today's climate of enhanced tax scrutiny (see chapter 3), tax avoidance is an unwelcome brand association.





### To overcome the talent bottleneck, growing tech companies can explore their options:

- Opening shop in talent-rich areas: teams no longer have to sit together – nor do they have to live in the same city, country or continent. Firms can build dispersed ‘virtual teams’ that draw on a new wave of collaboration tools. Growing tech companies may find that opening offices in Asian markets will give them access to skills that are harder to come by in more mature markets.
- Moving to talent-friendly parts of the city: some growing companies are renting office space in different parts of their home cities to be closer to where the most talented developers choose to congregate. They also recognise that talented people tend to choose vibrant, fast-moving and innovative companies. As a result, many CEOs drive active policies to maintain the firm’s founding culture, morale and values.
- Buying teams off the shelf: acquihiring – used extensively by Facebook, Google, Yahoo! and Twitter – is a popular weapon in the war for talent. Growing companies explore M&A around fast-moving start-ups purely so they can bring on board their smart teams and leaders. They have much less interest in the businesses themselves.
- Innovative employee offerings: tech companies should explore carefully how they can develop advanced stock and compensation-based incentives that are more appealing than those offered by their competitors.
- The freelance economy: companies can limit recruitment to a core of critical functions, using freelance workers to fill gaps – a trend supported by marketplaces like Freelancer, Elance, Upwork (formally o-desk) and Airtasker.

## CASE STUDY

### Sláinte Healthcare’s bold path to growth

Sláinte Healthcare is Europe’s fastest growing healthcare technology company, providing software to help hospitals become paperless. The business initially specialised in software for electronic health insurance claims. When the company began gathering momentum, founder and CEO Andrew Murphy started to scale the business by expanding into the electronic medical record (EMR) market.

“Seeing significant usability and adoption gaps in the EMR market we looked at designing something disruptive,” he says. But rather than sell the new product – called Vitro – to existing clients and prospects, the company decided to launch it in a foreign market so it could test the software out first. The company chose the UAE. “It was far enough away that it wouldn’t affect our potential in any other market if we failed,” says Murphy. It was also a convenient market to test Vitro’s international capability, such as its multilingual functions.

After experiencing initial success in the UAE, Sláinte next launched Vitro in Australia – a market it thought it could get moving quickly. “We hired someone with credibility across the healthcare system in Australia and won our first site within three months,” says Murphy. Testing and refining the product in the UAE and Australia meant Sláinte could approach bigger markets with a proven product. The company has subsequently launched Vitro in Ireland, the UK and a range of new markets.

Sláinte’s international expansion followed a considered and well-planned process. After Sláinte secured its fifth Vitro client, Murphy continuously sought professional advice on strategy, tax and regulations – while building organisational structures and processes to support a globally expanding business. As he likes to point out, “some people think of entrepreneurs as being risky. But those risks are usually very calculated, with a strong bias to the safe side.”



## Key questions: scaling operations and teams

- If we wait too long, will someone steal our lunch – and how can we stop them?
- What are the big trade-offs we need to make when choosing to scale rapidly?
- How do we preserve and expand our culture as we scale?
- How do we attract, retain and remunerate talent as we expand?
- When is it time to look beyond our initial market – and what should we prioritise when the time comes?
- What approach makes the most sense for our business when it comes to protecting our intellectual assets?

# Bridging the gap

## *Raising the growth capital you need*

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Ongoing access to finance is a key issue for high-growth businesses. Those that lack financial firepower may find their growth constrained. Others may encounter problems with cash flow during day-to-day operations. At the same time, the funding landscape has changed drastically since the financial crisis of 2008 – and continues to evolve.

While expansion and later-stage funding in the US has increased in recent years, the National Venture Capital Association's figures show the highest growth is in early-stage funding – from US\$6.1 billion invested in 1,303 deals in 2010, to \$15.9 billion in over 2,166 deals in 2014. The emphasis on start-up funding often comes at the expense of robust financing options for larger, rapidly scaling companies, where financing options are often far more limited. In India, for example, while deal values in the technology sector totalled \$11.5 billion in 2014 according to Grant Thornton's research<sup>4</sup>, early-stage businesses attracted the lion's share of this investment.

### **Bridging the funding gap**

On average, it took investors around seven years to 'cash out' on the current crop of non-private unicorns in the US<sup>5</sup>. Despite this, there is still high investor appetite for early-stage companies – which represents a stark challenge for more mature enterprises in search of capital to help them grow.

This difficulty is particularly acute outside the US. In North America, investors tend to feel more comfortable with uncertainty. Elsewhere, they are more likely to worry about execution risks – these are significantly amplified during the scaling-up process.

**“In Australia, you're allowed to risk losing all your money in a casino – but you're not allowed to risk losing millions of dollars by investing in a start-up that might help drive growth and create new jobs.”**





The net result is that both start-up businesses and well-established businesses find plenty of support. Companies in the strata in-between face a funding gap.

Public policy interventions have sometimes exaggerated this problem. In the UK, government-backed approaches such as Innovate UK and the Start Up Loans project have boosted many very young companies. But later-stage businesses struggle to attract funding: one recent study found second-stage British companies raise 81% less capital than those in Silicon Valley<sup>4</sup>.

#### **Winning in secondary markets and private IPOs**

The good news for high-growth businesses is there is a growing range of alternative financing options emerging. One possibility is the secondary market, or so-called “private initial public offering”. This was launched to cater for growing companies that wish to offer shares privately, rather than through a full-scale IPO. Often, these include companies not yet ready for the rigors of a full-scale stock market quotation – and consequent regulatory burden and extensive investor relations work. In the US alone, technology companies have raised £20 billion this year through secondary markets, compared to just \$600 million from traditional IPOs<sup>7</sup>.

<sup>4</sup> ‘Grant Thornton – IVCA Technology Dealtracker 2014,’ Grant Thornton India LLP, April 2015

<sup>5</sup> ‘Welcome to the Unicorn Club 2015,’ TechCrunch, July 2015

<sup>6</sup> ‘Internet of things – the soap opera,’ Think Big: the innovation blog, July 2015

<sup>7</sup> ‘Private share trading takes off as tech companies shun IPOs,’ Financial Times, June 2015

This space is maturing, with established exchanges such as SecondMarket joined more recently by new ventures such as Nasdaq's Private Market. The profile of private offerings has also been boosted because well-known tech companies such as Airbnb and Pinterest have opted to raise money this way. This has attracted a growing pool of investors, including institutional investors, such as mutual funds, hedge funds and even sovereign wealth funds<sup>8</sup>. With such high-profile investors interested in secondary markets, growing tech companies must ensure that they are correctly valued before trying to secure finance through this route.

This funding route does not suit everyone: it still involves an additional level of regulatory scrutiny. There is also qualification criteria – Nasdaq Private Market, for example, expects businesses to have raised \$30 million already before listing. Also, investors expect companies to work towards a full-scale IPO, as this offers them the best opportunity to cash out – although it will not suit all companies.

### Securing government support

Another possibility for fast-growth technology companies is to piggy-back on the support that governments offer to investors in such companies. Israel is home to one of the world's most thriving tech clusters, partly because its government has offered generous tax incentives to private equity and venture capital backers of tech businesses. The UK has sought to do something similar with tax incentives such as the enterprise investment scheme.

In some cases, technology businesses are relocating to jurisdictions where the financial and taxation climate is more conducive to their growth plans. This was behind the decision of Australian software company Atlassian to move to the UK last year<sup>9</sup>.

### Traditional IPOs – and M&A deal-making

IPOs remain an important option for fast-growing tech companies. Recent high-profile IPOs – such as Lending Club and GrubHub – demonstrate what successful tech companies can achieve through listing.

**“Global private equity and venture capital investment is flowing into emerging tech companies in Asia, especially in China and India where these rapidly growing companies are focusing on disruptive solutions. Many of these companies are considering cross-border M&A and overseas listings, so building a robust global corporate governance framework early on is very important.”**

**Raja Lahiri**

Partner, Grant Thornton India

<sup>8</sup> 'Data: There are now over 9x more private IPOs than actual tech IPOs,' CB insights, April 2015

<sup>9</sup> 'Too expensive – tech start-ups move overseas,' The Sydney Morning Herald, January 2014

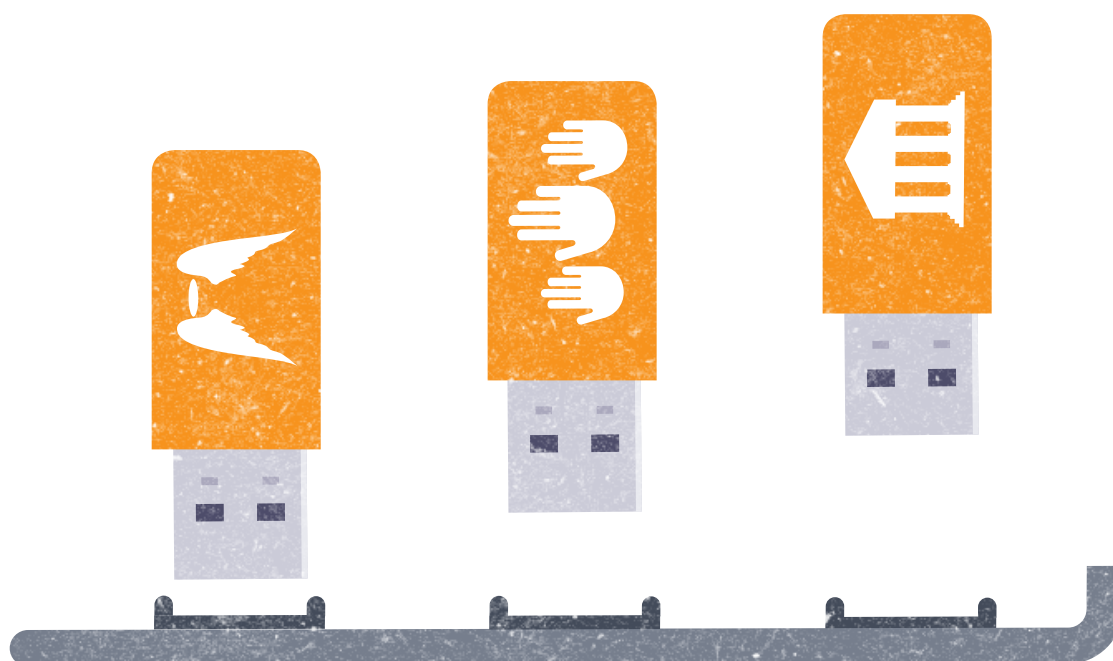
IPOs are becoming especially important outside the US. In Australia, the tech sector has been one of the bright spots on the ASX over the past couple of years, with examples of companies such as Freelancer, MYOB and Ozforex coming to the market<sup>10</sup>. India recently sought to relax requirements for certain companies, to help investors tap into the country's current e-commerce boom – and to avoid tech companies seeking to instead list abroad<sup>11</sup>.

In India, tech M&A is also booming – as it is globally. The volume and value of technology deals has risen to pre-crisis levels, as companies seek to deploy record volumes of capital reserves and access cheap debt. The technology sector had the biggest half-year M&A levels on record, according to Dealogic<sup>12</sup>, including the largest proposed tech acquisition on record in Avago Technologies' pending US \$37 billion

takeover for Broadcom<sup>13</sup>. Blockbuster deals like this might grab the headlines, but it is clear that there is significant appetite globally for rapidly scaling tech companies – to capture their IP, their talent and their growth potential.

### Exploring alternative finance

While bank support may be harder to come by today than in the years leading up to the financial crisis, the global alternative finance sector is increasingly stepping into the breach. One recent study<sup>14</sup> suggested that, in Europe alone, the alternative finance sector grew by 144% last year, led by the UK, but with enthusiastic support from providers in countries as far-flung as France and Estonia.



<sup>10</sup> 'How to profit from the IPO boom,' ASX, 2015

<sup>11</sup> 'India eases IPO rules for startups as e-commerce booms,' Bloomberg, June 2015

<sup>12</sup> 'M&A statshot Dealogic,' May 2015

<sup>13</sup> 'Avago to buy broadcom for \$37 billion in biggest tech deal ever,' Bloomberg, May 2015

<sup>14</sup> 'Moving mainstream: The European alternative finance benchmarking report,' University of Cambridge, 2015



## CASE STUDY



### Cloud Imperium breaks crowdfunding records

Cloud Imperium, the US videogame developer, has raised almost \$77 million of funding through a rolling campaign of crowdfunding pitches to investors who believe in the company's commercial prospects – but who are just as excited about playing its flagship product, the space simulator Star Citizen.

Cloud Imperium's founder, Chris Roberts – a former big-name developer who subsequently moved into feature films – saw crowdfunding as a way to reconnect with the gaming audience. That engagement has become a crucial element of the strategy, says Cloud Imperium vice president of publishing John Erskine.

"The money that comes in from crowdfunding is of huge value to a company that's looking to raise finance," he says. "But we believe that equal or maybe greater value comes from the community engagement you get – the proof of the market." For Erskine and his colleagues, Cloud Imperium's campaigns – which have offered investors the chance to try out features of the game as they've been developed – have been an opportunity both to promote the product and to receive continual feedback on its direction.

However, businesses should not underestimate the hard work involved in successful crowdfunding, Erskine says. "The community engagement we have is an everyday activity for our company," he explains. "We produce a staggering amount of content for fans, and that level of engagement is core to who we are as a company."

Alternative finance options for fast-growing companies range from peer-to-peer lending platforms to kickstarter campaigns, depending on the maturity and needs of the business raising funding. And while these platforms were originally best-suited to small-scale ventures and start-ups, our case study demonstrates that this is no longer the case.

In some jurisdictions, alternative finance providers' growth has been limited by legal restrictions – crowdfunding, for example, has been difficult legally in both Canada and Australia. But even in these territories the trend now is towards liberalisation of regulation, potentially creating further opportunities for fast-growing technology companies to raise new funding.

**"When you get past the series A and B rounds, your next round of funding may be coming from somebody who is not a native of your local market. They will be interested in larger projects and will want to see how your product is different in the marketplace. If you can show you are a disruptor, it will give them comfort."**

**Fergus Condon**

Technology sector leader, Grant Thornton Ireland



## Key questions: raising growth capital

- What credit guarantee and insurance measures should we have in place to protect against non-payment?
- How can we prepare our business for success in secondary markets?
- How seriously should we consider crowdfunding and other alternative finance models?
- What happens when we outgrow our local or national funding capacity?
- What investment models should we use to guide our planning?
- What should we do to prepare for IPO?
- How much equity should we give up in order to attract capital? And how do we make choices to protect our ownership rights in the future?

# Navigating tax in a digital world

*Developing a tax strategy that can keep pace with your growth aspirations.*

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When several world-leading tech companies made front-page news for their tax affairs in 2013, nobody in the business world was left in any doubt – tax matters more than ever to today’s ambitious companies.

As global attitudes towards tax change, tech companies need to future-proof their tax practices to stand up to enhanced scrutiny. Any inconsistencies could result in serious damage to reputation, competitiveness or income. One thing is clear – tax matters more than ever to today’s ambitious companies.

The way a growing company markets and sells its services can have a significant impact on its tax bill. Different countries treat different categories of products and services in different ways for tax purposes, making income characterisation a vital consideration.

In some US states, technology firms that specialise in software and services and are classified as selling ‘services’ will not be taxable – yet they will be if they are classified as ‘software providers’. The differences between two income categories can be subtle, and often there are grey areas.

“The language that goes into contracts is often from a technology and marketing perspective,” explains Randy Free, international tax practice leader at Grant Thornton US. “It can bolster your case in defining your services – or it can sink your case.”

Once a tax authority in another state or country is made aware of a technology company’s services being characterised in a particular way elsewhere, it may well seek to reassess its own treatment of the firm’s services.

## Increasing scrutiny

In 2013 when world-class tech companies made the news for their tax decisions, nobody in the business world was left in any doubt – companies that trade across borders need to get their tax affairs in order sooner rather than later.

While the companies under investigation were clearly operating within guidelines, and the majority of governments worldwide recognise that these companies create additional value for their countries – such as by driving job and wealth creation – there are several factors that are likely to keep tech companies firmly within the tax spotlight in years to come:

- tech business value is oriented in IP – which is inherently mobile
- software-oriented tech companies are light on fixed assets
- tech companies regularly source IP through international development centres and M&A, which pulls them into countries around the world
- many firms require little more than a high-speed internet connection to sell services in overseas markets.

Furthermore, as supranational bodies like the OECD, G8, EU and UN continue to make recommendations and amend the international tax landscape, tax planning will become increasingly complex. In this climate, tech companies need to define a strategic approach to tax planning that strikes a balance between upholding reputation and maintaining competitiveness.





“Many technology groups structured themselves to keep the IP located in a low-tax jurisdiction and have minimal people around the ownership of that IP. The new rules will make that increasingly difficult as they’ll create a taxable presence wherever companies do business.”

**Martin Lambert**

Partner, Grant Thornton UK

#### Shift in attitudes

The climate for what is considered acceptable in tax planning has shifted considerably over recent years. For at least a couple decades, the concept of ‘aggressive’ tax planning was considered the norm. Today, it is under scrutiny from the media, politicians, activists and NGOs<sup>15</sup>.

Technology firms – especially large multinationals – have suffered their fair share of this criticism<sup>16</sup>. Negative PR can hurt technology giants, but it has an even greater impact on firms still expanding and building their reputations. Even benefit corporations, whose mission is as much about helping society as it is about making a financial profit, have faced heightened scrutiny.

In autumn 2015, for example, Americans for Tax Fairness, a US policy group, publicly criticised online crafts marketplace Etsy for its Irish tax structure. And tech companies are not just risking their reputations when it comes to tax. The OECD’s base erosion and profit shifting (BEPS) project is creating new rules to outlaw and penalise artificial tax avoidance strategies. The project will, for example, aim to address inconsistencies between different jurisdictions in their approach towards transfer pricing. And the first action in its plan is to ‘address the tax challenges of the digital economy’ – including where and how to tax new digitally enabled business models.

<sup>15</sup> ‘David Cameron: Tax avoiding foreign firms like Starbucks and Amazon lack ‘moral scruples’,’ The Telegraph, January 2013

<sup>16</sup> ‘Amazon UK boycott urged after retailer pays just £4.2m in tax,’ The Guardian, May 2014

### Getting ahead of the game in a new tax era

Major international tax reform is inevitable. For high-growth technology firms, the key is to recognise where the rules are heading and plan accordingly.

The issues at hand are clear. Beyond the implementation of the OECD's BEPS measures, G20 countries have agreed an implementation package for country-by-country reporting in 2016<sup>17</sup>. The European Commission has proposed new requirements for EU member states to automatically exchange information on any tax rulings provided to businesses<sup>18</sup>, discouraging companies from shifting profits to member states.

"The days of aggressive tax planning structures are over," asserts Phil Barrett, tax partner at Grant Thornton UK. "Technology firms need to assess where the substance of their business sits in terms of its value creators – the people, the assets, the IP – and align their tax strategy accordingly.

"This is not to say there are not choices to be made to align an efficient tax structure. [There are] and these are centred on thinking about what you do and where you can do it," Barrett explains.

"There are choices, but they're more about where you choose to carry out activities, as opposed to trying to manipulate rules between different countries where you haven't got that substance," Barrett explains. "It's about following where you're doing real activity, trying to keep things as simple as possible and managing your compliance."

### Counting the cost of compliance

In their eagerness to tap new markets, growing tech companies sometimes overlook the compliance costs associated with expansion. The Business Roundtable found that large US businesses were spending an average of \$11 million on tax compliance, and dedicating 43.9 full-time employees to tax compliance activities<sup>19</sup>.

Entering new jurisdictions means creating a distinct set of compliance requirements – not to mention new liabilities. Technology firms must ensure they are fully equipped. "I've seen technology companies wanting to expand very quickly," says Randy Free. "They set up 30 or 40 subsidiaries right away, and suddenly the business doesn't catch up as quickly as they thought and they're carrying the burden of that compliance."

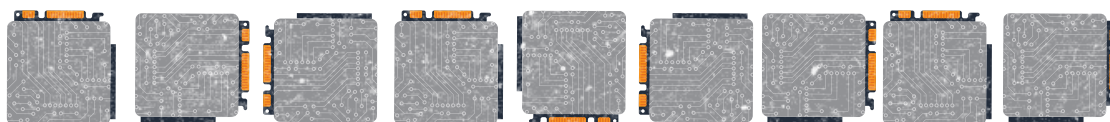
As well as addressing the additional tax liability, companies must ensure their systems have centralised oversight and can communicate in the same language, at the same time, across borders. As complexity grows, they will increasingly rely on automation to bring together financial data from general ledger systems across the organisation.

Sophisticated modelling may also be required to test tax strategies that involve shifting revenues and assets among foreign subsidiaries, or to understand the impact of a potential acquisition. This may mean reverting to outsourcing initially, or centralising the tax compliance function as the resources become available.

**"The key is to ensure that in the countries you chose to operate in you have real business substance and try and keep things as simple as you can!"**

**Phil Barrett**

Partner, Grant Thornton UK



<sup>17</sup> 'Action 13: Country-by-country reporting implementation package,' OECD, 2015

<sup>18</sup> 'Transparency and the fight against tax avoidance,' European Commission, March 2015

<sup>19</sup> 'Total tax contribution – How much do large US companies pay in taxes?' Business Roundtable, 2009

### Incentivising tech companies

Opportunities abound for tech firms. Countries, states and cities are keen to revitalise themselves and be seen as destinations for talented people and cutting edge businesses. For example, in the US, cities such as Austin, Texas have benefitted from a strong campaign to attract technology companies away from traditional bases in California. This has included assisting entrepreneurs with

lower tax rates that incentivise businesses and their people to move and set up, creating new hubs with access to financing and infrastructure.

Likewise governments are taking similar steps to demonstrate their innovation credentials. Patent box regimes in place across Europe encourage investment in R&D through reduced tax rates and deductions for qualifying expenditure.

### Summary of available 'patent box' regimes in different countries worldwide

The following table outlines some of the key incentives that different countries have in place to encourage growth and innovation.

Country	Standard corp. rate in 2015	Patent Box rate in 2015	Fully phased-in Patent Box rate	Qualified IP
France	38.0%	15.0%	15.0%	Patent granted in France, UK or European Patent Office
Ireland (proposed)	12.5%	n/a	5.0% to 6.25%	Patents and property functionally equivalent to patents
Italy	27.5%	19.25%	13.75%	Intellectual property, trademark, designs and models, secret formulas or process connected to industrial, commercial and scientific know-how
Luxembourg	29.22%	5.84%	5.84%	Patents, trademarks, designs, domain names, models and software copyrights
Netherlands	25.0%	5.0%	5.0%	Worldwide patents and IP arising from R&D activities for which the taxpayer has obtained declaration from the Dutch government (trademarks, non-technical design rights and literary copyrights are not included)
Spain	28.0%	11.2%	10.0%	Patents, drawings or models, plans, secret formulas or procedures and rights on information related to industrial, commercial or scientific experiments <sup>20</sup>
United Kingdom	20.0%	12.0%	10.0%	Patents granted by the United Kingdom Intellectual Property Office, European Patent Office and patent rights granted from 13 European Economic Area countries (excludes trademarks, copyright or know how) <sup>21</sup>

20 Additional note from Grant Thornton Spain: The CIT standard rate for 2015 in Spain is 28% and for 2016 onwards is 25%. The Patent Box reduces the taxable base by 60%, resulting 40%. Considering the CIT rates, the patent box rate for 2015 is 11.2%, and for 2016 is 10%. There are no increased or reduced rates regarding fully phased-in.

21 Additional note from Grant Thornton UK: The current UK Patent Box scheme will be closed to new entrants after 30 June 2016 but will continue for five years for companies that have 'elected in' on or before this date. In response to the OECD's concerns and the Forum on Harmful Tax Practices a new Nexus Patent Box scheme will then be available (details to be published later this year) which ensures that only companies that have undertaken R&D to develop the patented technology (the nexus) may claim.



“In Israel, innovation is seen as key to driving economic growth. The government recognises that it needs to encourage technology companies for this to happen, partly through tax incentives for investors backing seed companies. The country has a growing number of unicorns.”

**Mickey Blumenthal**

Managing partner, Grant Thornton Israel



“These companies create high-skilled jobs, they typically don’t have a huge environmental footprint, and they bring in often highly-educated people with lots of disposable income.”

**Doreen Griffiths**

Managing partner, California market territory, Grant Thornton US





## **Key questions: developing a tax strategy for growth**

- To what extent should tax planning influence our global growth plans?**
- To protect our business in today's high-litigation climate, how can we ensure we have implemented the right transfer pricing structure and have completed the required studies?**
- How can we strike the right balance between enabling growth, optimising our tax liability, and mitigating the risk of unwanted regulatory scrutiny?**
- How well do our existing structures stand up against the shifting tax landscape?**
- Is our tax function in a position to keep pace with the new tax compliance requirements that will result from our growth rate?**

# The golden rulebook

## *Ensuring compliance and data security in a complex and risky world*

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For tech companies, the regulatory environment is tougher now than ever before. As a way to protect the national interest, governments use compliance to restrict companies that could potentially disrupt established industries. The knock-on effect of this is that the tech industry as a whole is coming under extreme scrutiny and is facing a higher level of financial and reputational damage as a result. Rapidly expanding companies also face a wider range of individual regulations as they expand into new territories. Be it employment law, taxation, product safety or licensing.

Today, many of the most pressing compliance issues come down to data anxiety. As citizens become increasingly uncomfortable about threats to their personal data and privacy, governments are cracking down on the companies responsible for hosting that data and keeping it secure.

Worldwide, regulators have made it clear that they are becoming tougher on tech companies. In the summer of 2015, the US Federal Trade Commission (FTC) said it was investigating Airbnb, Uber and other sharing economy pioneers over their use of data and rating systems<sup>22</sup>. Meanwhile, after several global tech companies were criticised for their data use across the continent, all 28 EU states are now working towards a pan-European data protection framework<sup>23</sup>. Key markets such as Australia<sup>24</sup> are also looking to overhaul and strengthen their data privacy regulation.

### **Taking a positive approach to regulation**

Tech companies must build into their products the functionality and capability to comply with a large and diverse set of sometimes conflicting international standards. They must give their customers a high degree of confidence that their services and products are secure, protect their privacy and support compliance with other standards. And, if that isn't enough, tech companies need to protect their own infrastructure and data as much as – if not more than – any other organisation.

Yet expanding tech companies should also remember something very important: approached correctly, regulation needn't be a problem. It can create competitive advantage.

<sup>22</sup> 'Regulator probes pitfalls of sharing economy,' Financial Times, May 2015

<sup>23</sup> 'EU states agree framework for pan-European data privacy rules,' The Guardian, June 2015

<sup>24</sup> 'Australia's data privacy laws come into force as providers struggle with data management,' Business cloud news, March 2014

<sup>25</sup> 'EU Data Protection Regulation: fines up to 100m proposed,' Computer Weekly, November 2013

<sup>26</sup> '2015 data breach investigations report,' Verizon, 2015





“Regulation is our friend. Governments are saying to telcos, ‘You can’t treat people in rural areas as second-class citizens. You need to give them fixed wireless rural broadband.’ From our point of view, that regulatory overlay is good.”

**Ken Sheridan**  
CEO, Netcomm Wireless

### Preparing for complexity

Ensuring data protection is not just about preventing reputation damage. The EU's proposed rules for data privacy could lead to corporate fines of as much as 5% of global revenue for data security breaches<sup>25</sup>.

And even if regulators were not focusing on data protection, tech companies would still need to ensure coverage. In 2014, for example, the estimated financial loss from 700 million data breaches was \$400 million<sup>26</sup>.

The good news for tech companies is that the actions they need to take to secure data from a regulatory standpoint are about the same as the actions they should have taken to ensure adequate protection anyway. This does, however, require different controls depending on a range of variables (see box). As companies grow and rely on expanded networks and supply chains, the risks become more complex. Hackers breached Target's systems, for example, using network credentials stolen from a third-party vendor<sup>27</sup>.



**All 28 EU states are now working towards a pan-European data protection framework**

### Without transparency, compliance simply isn't possible

As well as demanding stronger data protection, regulators expect tech companies to be transparent about where, how and why they are storing customer data. In particular, regulators are targeting companies that fail to tell customers exactly what they are using their data for.

Snapchat recently settled FTC charges for deceiving 4.6 million consumers about the 'disappearing' nature of their messages. As a result, an 'independent privacy professional' must now monitor the company for the next 20 years<sup>28, 29</sup>. Facebook has also faced criticism over its face-recognition functionality, with some claiming 'astonishment' that they were not consulted before the firm added it to their privacy policy<sup>30</sup>.

Transparency and clear communication is particularly important for companies that provide a B2B service. Bruno De Wolf of BeAligned, a Grant Thornton member firm, thinks many consumers "do not care" where their data is stored. "But in a B2B environment it's completely different," he says. "They are afraid of the cloud, and many IT managers will find any excuse to not put anything on the cloud."

**"But in a B2B environment it's completely different. They are afraid of the cloud, and many IT managers will find any excuse to not put anything on the cloud."**

**Bruno De Wolf**

BeAligned, a Grant Thornton member firm

<sup>27</sup> 'Target hackers broke in via HVAC company,' Krebs on Security, February 2015

<sup>28</sup> 'Snapchat settles FTC charges that promises of disappearing messages were false,' Federal Trade Commission, May 2014

<sup>29</sup> 'FTC finalizes privacy settlement with Snapchat over 'deceived' users,' The Verge, December 2014

<sup>30</sup> 'Facebook's new face recognition policy astonishes German privacy regulator,' PC World, August 2013



## Protecting consumer data: beyond the basics

“Most expanding tech companies have smart, savvy employees who have instinctively taken care of a lot of cyber security basics right away,” says Mike Harris, cyber security partner at Grant Thornton Ireland. “But often they haven’t done so as part of a coherent strategy. Have they considered how they will manage cyber risk in five years’ time? Do they understand the cyber risks that their customers – and customers’ customers – are facing?”

“First, they need to understand the specific threats their business is facing. Each business requires detailed security requirements – and it’s expensive to update these at a later date. There are different threats for B2B or B2C providers, for those with a high dependency on IP, for those who plan to host their app on the cloud.

“Tech companies need to think about this from a strategic perspective because investment will be required. They can then ensure their IT systems are configured correctly and that they have the right operational processes.

But Mike warns that the issue is no longer simply about prevention. “What’s increasingly important is what happens after you have a breach. The instant response is a growing issue. It’s no longer enough to be static in your defences. You need to react quickly. Not only is this more reassuring for customers and the regulator, but it is also essential if you want to stop hackers from breaking their way into the parts of your system that you thought were most secure, such as your IP.”





### Building relationships on the ground

One of the concerns that regulators have about global tech companies is the relative lack of control they have over them. By their nature, tech companies do not have to keep their servers in every country in which they are selling their services.

For regulators, this can lead to a lack of trust. Tech companies that anticipate and respond to this potential distrust from the outset can avoid excessive regulatory scrutiny. By building stronger relationships with regulators, they will likely find it easier to build their presence overseas.

And, as Simon Coulton, partner, Grant Thornton Australia explains, expanding tech companies need to work with local advisers and experts to get a better understanding of issues and concerns on the ground.

“A lot of it comes down to appreciating that the right locals will know how to handle issues better,” he says.

“Regulation matters because it creates market inefficiencies that didn’t exist prior. We’ve got regulation enabling the re-shaping of whole industries.”

**Hussein Kanji**

Partner, Hoxton Ventures

“Some of these organisations may need to be more politically aware as they enter new markets.”

**Nick Watson**

Partner, Grant Thornton UK

## CASE STUDY

### Why Funding Circle welcomes financial services regulation

Funding Circle, which enables peer-to-peer lending between individual savers and small and medium-sized businesses, is one of Europe's fastest growing fintech companies.

Within five years of its launch in summer 2010, Funding Circle had already facilitated around £700 million in loans. In that timescale, however, there was a major upheaval in financial services regulation. “We knew it would be difficult,” says James Meekings, CEO, Funding Circle. “But we were confident that our business was going to change the financial landscape. We believed our growth would be really meaningful.”

Yet the company is a good example of a tech business that has exploited the market inefficiencies caused by regulation. Clampdowns on capital thresholds for banks, via Basel III regulations that make lending to small businesses more expensive, gave Funding Circle an opportunity to grow their business. “We were told, ‘You’re the only financial services business that is asking to be regulated’.”

The company chose to take a positive attitude to regulation and to be proactive in complying. “If billions of pounds go through this marketplace, it is going to be regulated. Is it not better to take it on our terms rather than have it forced upon us when it’s too late? The regulation we are now doing is making our business stronger and more defensible – and protecting customers’ money better. Without it, it would have taken us longer, and customers’ money wouldn’t have been as safe as it will be. We have a growing army of people focused on the regulation process at the moment.”



## **Key questions: ensuring compliance and data security**

- How can we ensure our data – and our customers' data – is secure worldwide?**
- How will local regulations restrict how and where we use data?  
And what other local sensitivities should we be aware of?**
- What operational changes do we need to make to ensure we can respond to compliance?**
- How should we approach our relationship with regulators in each of our markets?**
- What should we do when a breach takes place?**
- How do we keep track of countless regulations across markets – and across different areas of business – many of which are liable to change?**



# Global on day one

## *How modern tech firms tackle international markets*

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Business-minded technologists have always hatched grand plans for global business empires. It used to take decades before they could grow their businesses on the international stage. Today, it can be more or less instantaneous – and this creates a host of new threats and opportunities.

Digital platforms – from Google Play to Salesforce and a host of cloud-based, on-demand services – allow companies to build \$100s of millions in revenue using teams based anywhere in the world. As a result, tech companies are going global from day one. Canva, a web-based graphic design tool, was available internationally from its launch day. It had over 2.5m users within two years<sup>31</sup>. Spotify took a similar approach and amassed 10 million users in the same period<sup>32</sup>.

A new wave of support services is also helping tech firms expand across borders. In order to manage the complexity of operating across borders, tech companies are increasingly outsourcing back office functions. This can include tax, compliance, legal, HR and book keeping. Customers can simply ‘switch on’ a back-office team as they enter new jurisdictions. Language barriers are also falling as cloud-based support services mature.

### **Being first with the right platform**

One reason that tech companies are so keen to grow globally is through fear of coming second. Being first to a tech niche can be critical to success. Often, users will not switch to a late-arriving competitor. Spotify users, for example, create libraries and playlists of their favourite music, which they would lose if they switch. Twitter’s lead over its rivals became unassailable almost the moment it created the micro-blogging niche.

One of the most important considerations at this stage therefore comes down to the platform that the tech company is using. It is worth remembering that, as product and internet services companies expand, they face different adoption models and associated R&D investing decisions.

31 ‘Five reasons why Aussie startups should go global day one,’ Blackbird Ventures, May 2015

32 ‘Spotify hits 10 million users and 10 million tracks,’ Wired, September 2010

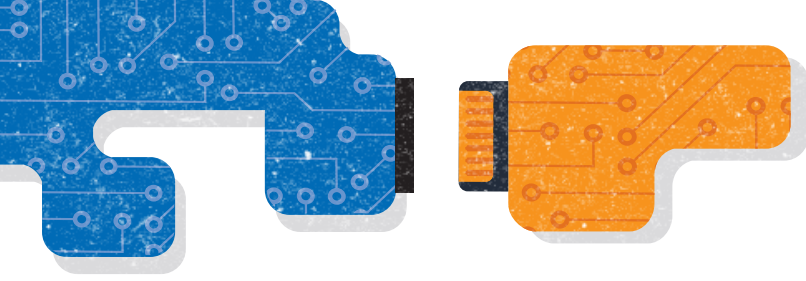




“We have definitely made extensive use of various cloud services. Instead of trying to build everything from scratch, or host everything internally, we’ve leveraged areas available as a service.”

**John Erskine**

Vice president of publishing, Cloud Imperium



# 10,000,000

The number of users Spotify amassed within two years from being internationally available from its launch day

## Age-old entry challenges remain: culture, language and infrastructure

It may be easier to go global than ever before, but significant barriers remain. “In terms of social, cultural, legal and organisational issues, I think nothing has changed,” says Bob Sutton, professor of management science and engineering at Stanford University and author of *Scaling-up Excellence*. “Take Airbnb and Uber – they have needed to tackle significant cultural and legal obstacles.”

Another issue that expanding tech companies face – especially those that are more mature – is the need to rationalise their infrastructure after they have established a presence in a new market. If they do not invest time and resources in making the infrastructure more efficient – eliminating redundancies in processes, systems and the operating structure – they will face significant costs later on.

**“In Asia, the biggest challenges are language and culture, the level of internet penetration and the size of the banked population.”**

**Emiliano Librea**

Head of advisory services, P&A Grant Thornton

## Local knowledge and company knowledge

To tackle these issues, many companies have the same philosophy as Qlik CEO Lars Bjork: “When you enter into a new territory, you always hire a very strong country manager.”

But while a strong local manager may understand the target market, they are often new to the business – or even the industry. Companies that want global consistency must balance local and company knowledge. “This means making sure there’s enough rotation from headquarters into those organisations, or else a very tight coupling with headquarters,” says Hussein Kanji, partner at venture capital firm, Hoxton Ventures.

Google has experienced several failures from getting this balance wrong. Like many tech giants, they keep their real intellectual and creative work centralised, at their Mountain View headquarters in Silicon Valley. “The only international expansion projects that worked were the ones where they had people from Mountain View involved,” says Bob Sutton. “At the same time, they had to understand the local culture. The perfect person was someone who’d spent five years at Mountain View but was also a native of the new country.”

**“When you enter into a new territory, you always hire a very strong country manager.”**

**Lars Bjork**

CEO, Qlik

**“Asian governments provide many different types of so-called ‘free money’. If you set up a new business and employ local people, you can apply for government backed sponsorships and awards.”**

**Manish Chawda**

Partner, Grant Thornton Singapore



## The right structure for the right market

Tech companies need to structure themselves to meet new and traditional challenges. There are four broad approaches to any market, and each involves a balance of control, local market risk and margin protection.

### 1 Local offices

The most traditional option is to set up 'mini me' offices, much like Facebook has done. These can consist of legal, sales and marketing functions, with everything else controlled at head office or development centres. This option takes a lot of time and money, but lowers legal risks and increases the ability to tailor products to local markets. In Asian markets, for example, tech companies can use government incentives to base their businesses locally. "Asian governments provide many different types of so-called 'free money'," says Manish Chawda, partner at Grant Thornton Singapore. "If you set up a new business and employ local people, you can apply for government-backed sponsorships and awards."

### 2 Local partners

Finding a local partner to resell products can be an effective way to move fast. Companies that get this right, such as Apple, access established sales channels, local knowledge, staff, licences, office networks, legal expertise and more. For example, in countries without a branded Apple store the company partners with 'premium resellers' such as Compu B in Ireland and Electronic Things in Argentina. While establishment costs for this approach are low, profit margins are too.

### 3 Virtual presence

For many app developers the option of having a virtual presence is what attracts them to the industry – services can be sold without any local presence or representation at all. It maximises margins, but it also presents risk. "Uber think legislation will adapt to their business model," says Bruno De Wolf, senior consultant at BeAligned, a Grant Thornton member firm. "That is what they hope for but there could realistically be a legal claim against them within the coming months or years."

### 4 Merge or acquire

The M&A route is expensive but gives tech companies an instant local business to build on. In 2014, global tech M&A reached its highest level since 2000 – and cross-border deals were a large component of that<sup>33</sup>. One example is the purchase of Renesas, a Japanese display technology specialist, by Synaptics, a US interface solutions company. The acquisition helped Synaptics instantly expand into Japan, while gaining control over strategically important technology<sup>34</sup>.

Inevitably, some take a blended approach. "In Asia, the biggest challenges are language and culture, the level of internet penetration and the size of the banked population," says Emiliano Librea, head of advisory services, P&A Grant Thornton. "Smartphone vendor Xiaomi has used different entry models for different Asian countries. In China it uses its own retail e-commerce platform, while in India and the Philippines it uses a combination of third-party online marketplaces and the existing offline retail distribution network for better market penetration in these cash dependent economies."

<sup>33</sup> 'Return of the M&A,' TechCrunch, September 2014

<sup>34</sup> 'Savvy acquisitions may catalyze 30% upside For synaptics,' seeking Alpha, February, 2015



“It becomes a complex business quickly. You have complicated jurisdictional issues around tax, IP, privacy, security and structuring. These are significant challenges and opportunities for both emerging and mature technology companies.”

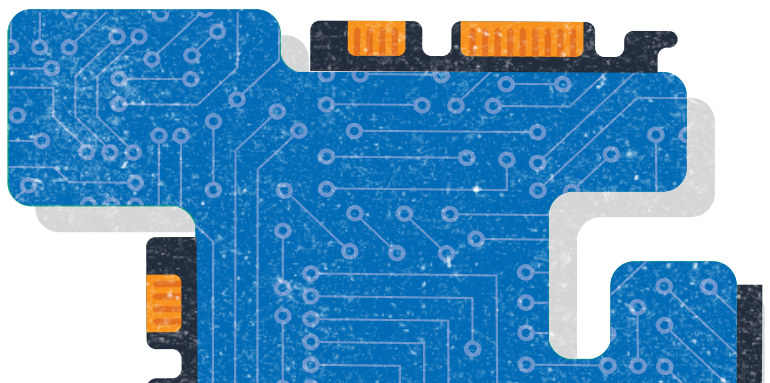
**Steven Perkins**

Global leader – technology, media, telecommunications, Grant Thornton

CASE STUDY

### Netcomm's 'coat-tails' expansion strategy

NetComm Wireless is an Australian communications device manufacturer that allows machines to communicate with each other. Applications include smart meters, contactless payment cards, remote medical monitoring, digital display and countless others in the ever-increasing internet of things. “We’re in full throttle mode,” says CFO and executive director, Ken Sheridan. “We’ve now got operations in the US, Europe, Japan, the Middle East as well as New Zealand and Australia.” NetComm targets big telecommunications carriers, like Vodafone and Verizon, using a low-touch, high-impact strategy. “Our coat-tails strategy sees us linking up with big players, and solving problems for them. It’s a much lower risk strategy than hiring your own teams. You can make it too hard for yourself,” says Ken. Using this approach, NetComm has kept all their engineering expertise back in Australia, limiting staff in new markets to sales and technical support. “We don’t need to replicate that engineering everywhere in the world,” he adds. “You get much better results by centralising here in Australia, where the teams can be collaborative.” Despite favouring developed markets, NetComm is prepared to follow its customers. “We’re happy to go anywhere if a ‘coat-tail partner’ takes us there,” he says, referring to developing countries. “If Ericsson took us, and we’re just supplying them, that’s okay. We want the protection of someone big that knows what they’re doing in that territory. Then we’re insulated.”





## **Key questions: tackling international markets**

- Will our infrastructure let us down at a critical moment of growth?**
- What's the right balance between central control and freedom on the ground?**
- How do we decide on a market entry approach for each market?**
- How do we adapt our operations to the cultural norms of each new market?**
- What kind of new risk mitigation strategies do we need to protect us from litigation, reputational damage, IP theft, cybercrime, local politics and regulatory change?**



# Scaling for tomorrow: supporting you

Grant Thornton's technology industry specialists across the globe can work with you to scale your business. Helping you to plan for growth; adapt your processes and controls for a changing business model; manage risk; meet regulatory requirements and develop growth strategies.

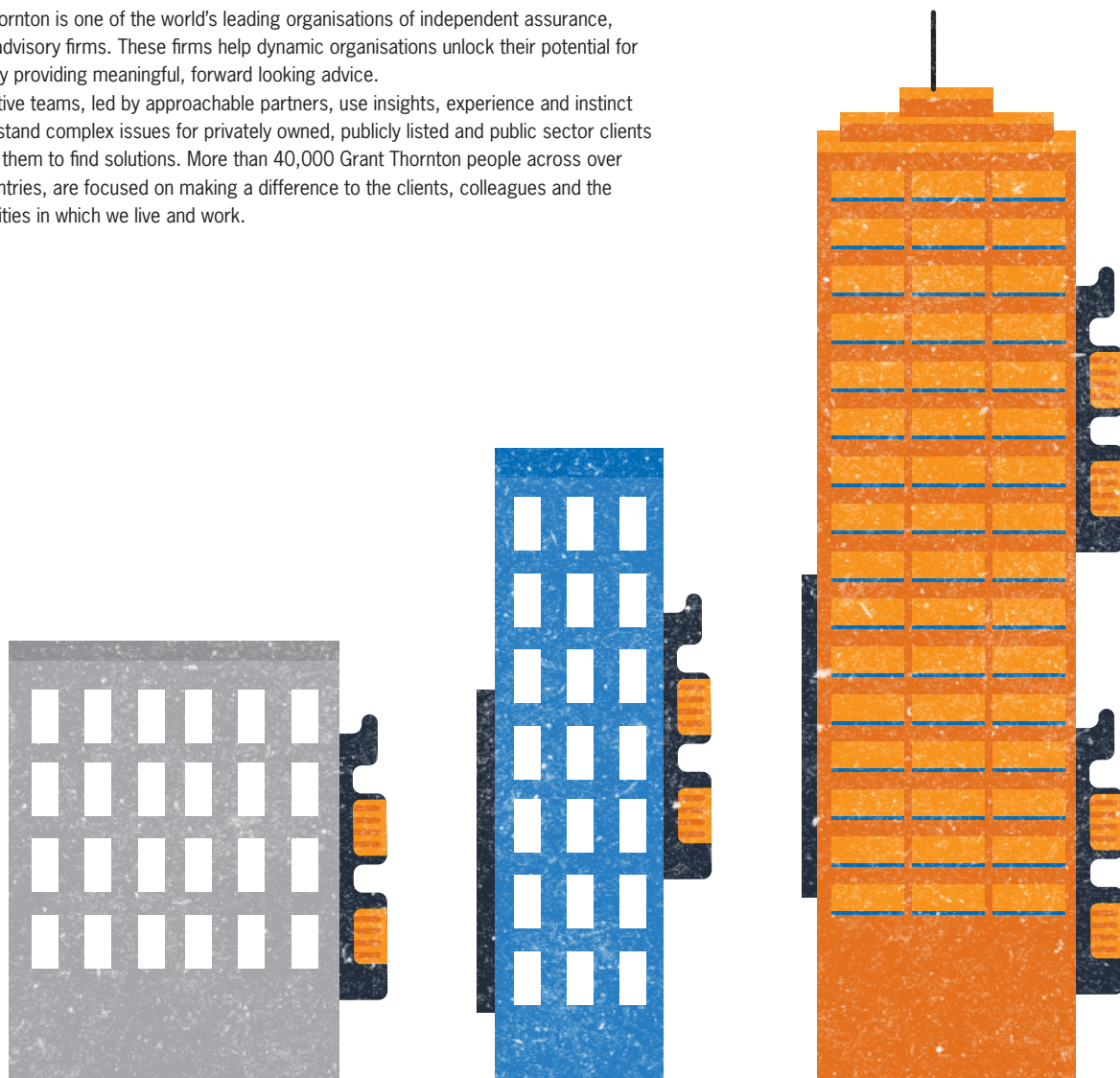
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