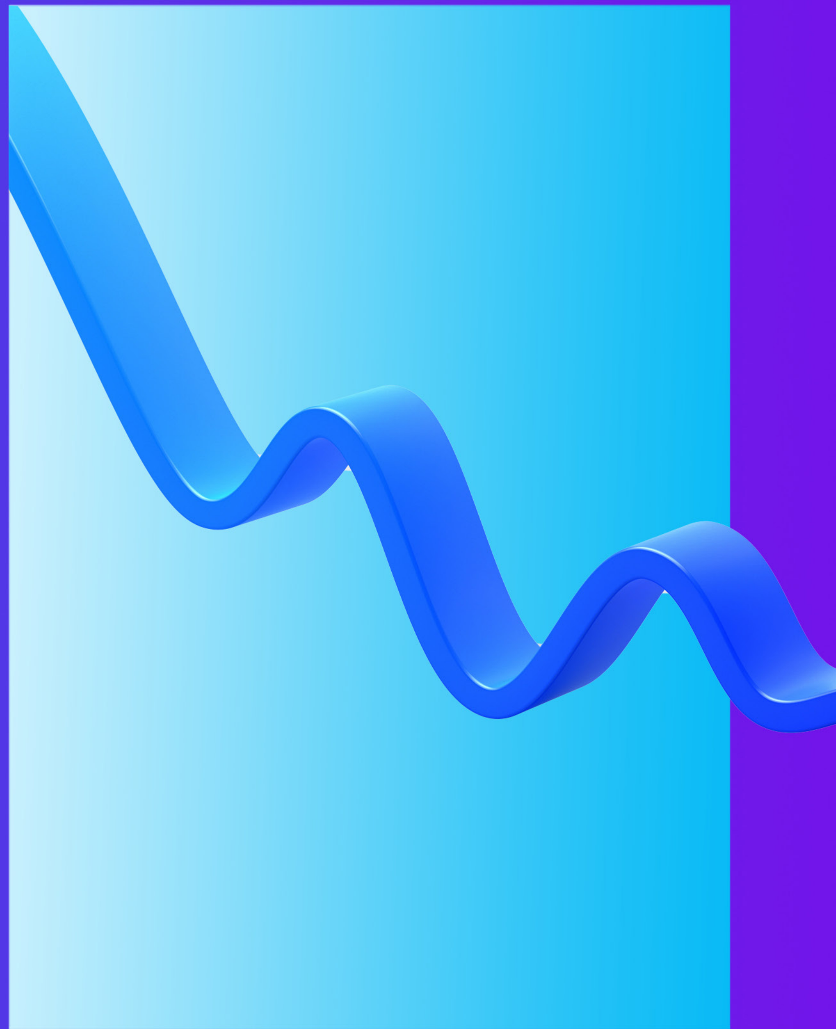
Rethinking global footprint:

Time to exit some markets?



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Introduction

More and more companies are looking to exit from foreign markets. The most notable recent examples were Western multinationals shutting down or suspending operations in Russia after its invasion of Ukraine. In an increasingly complex global environment, companies are reassessing the merits of doing business in certain countries and redefining their priority markets to simplify operations. Even if exiting a country leads to a loss of scale, companies are recognizing that a more targeted approach could improve regional performance and continue to contribute to their overall global success. Leaving foreign markets, however, can be a challenging process. How do you decide if it's time to exit, and what criteria should you use to make an informed decision?

In the past couple of years, KPMG has observed an increase in M&A transactions aimed at extricating companies from foreign markets. The reasons for a country exit vary, but some external triggers include the Russia-Ukraine war, trade conflicts, the COVID-19 pandemic, and global supply-chain issues. And now, with high inflation, rising interest rates, high energy prices, and a potential slowdown ahead—especially in Europe, where the economy may run into a longer and deeper recession—it may be a good time for companies to assess their current global footprint against internal factors and objectives. They may need to take a hard look at which foreign markets are core to their business and decide what to do with the rest—with utmost care and meticulous planning.

In this paper, we look at why companies choose to exit countries and for those considering it, propose a framework for evaluating a potential departure. Profitability by country is a central concern, of course. But options for exiting from countries can vary, from total withdrawal to maintaining an online-only presence. In each case, a company must undertake thorough market and product evaluations and determine if an exit is warranted. Then in executing the exit, it must make detailed plans to minimize disruptions and unintended consequences.

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Reasons for exiting countries

Companies may want to leave a country for all kinds of reasons. But exiting is often related to a rethink in their financial, strategic, and operational positioning, although sometimes it is due to reputational, regulatory, or political concerns. Country exits also can be complete or partial in nature. Complete exits are where a company ceases all operations and leaves a country. Partial exits are where a company relinquishes a majority stake in a joint venture or switches to a distributor operating model. For example, Best Buy completely withdrew from Mexico when it closed all stores after trying to weather the COVID-19 outbreak for several months.[1] Meanwhile, in a partial exit, decreasing sales forced Target to close dozens of stores in Australia, but it also converted some to Kmarts.[2] In either case, these are the key reasons why firms choose to exit countries:

Financial

Operations in some countries may simply be unprofitable, or growth plans may not have played out as expected. This may be due to a decrease in demand, supply-chain/distribution challenges, inflation, tight labor markets, or other unanticipated factors such as the COVID-19 pandemic.

Strategic

A foreign operation may face high competition or may be poorly positioned in the local market—for example, a fast-food chain that offers inferior fare to homegrown alternatives or a do-it-yourself supplier setting up shop in a country with cheap labor. Also, if global headquarters is realigning core businesses/segments/regions, then some foreign operations may no longer be a good strategic fit. Lastly, a company may want to sell foreign operations to raise cash.

Walmart gets more selective

Walmart has exited countries to focus on fewer, more promising markets. The company has moved to free up resources to focus on high-growth regions, but has also tried to keep minor stakes in some countries (i.e., a partial exit), depending on business conditions:

- October 2020: The company sold a majority stake in its grocery business (ASDA) in the U.K. for $8.8 billion as it failed to gain traction as a leader in a highly competitive market.
- November 2020: It disposed of all 92 stores in Argentina, given the challenging economic conditions in the country, which led to low profitability.
- November 2020: In light of stiff local competition and low profitability in Japan, Walmart sold an 85 percent stake in Seiyu to form a joint venture with KKR and Rakuten, aiming to enhance digital operations and offer more products and better services.

Nike redraws the map

Since 2020, sportswear giant Nike has partially or temporarily exited from several countries. The company has either tried to reduce its physical presence or has shifted to a distribution model to be more agile in its customer response. It also took a strong step in Russia after its invasion of Ukraine:

- February 2020: Nike shifted to a distribution model in Brazil with a $212 million strategic partnership deal with SBF Group.
- February 2021: The company terminated sales at around 100 local retailers in Greece as part of its global strategy to reduce the number of sales outlets and focus on direct-to-consumer online sales.
- October 2021: For the same reasons, it terminated sales at partner stores in Israel.
- June 2022: Nike said it intends to permanently leave Russia.

[1] Daina Beth Solomon, "Best Buy will exit Mexico as it scales back during COVID-19 crisis," Reuters, November 24, 2020

[2] Dominic Powell, "Wesfarmers boss criticises international rivals as Target stores close," Sydney Morning Herald, May 22, 2020

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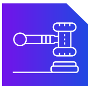
Operating models

A company might decide to retool its operating model in a foreign market to better align the operation to local conditions. This may involve switching from a direct to indirect channel through distribution/licensing agreements, or a blended approach such as switching to ecommerce/online-only sales.

Environmental, social, and governance (ESG)

With customers becoming more aware of ESG issues such as human rights abuses along supply chains, companies may find that it's not worth risking their reputation to continue doing business in certain countries.



Government policy

Excessive or changing government regulations, volatile political situations, sanctions, trade tensions, and wars can all make risks of doing business in a foreign market too high. A stark example of this was the pressure on Western companies to leave Russia after its invasion of Ukraine.

Repercussions of the Russia-Ukraine war

The Russia-Ukraine war has shown how quickly businesses may need to react and adapt to a changing global climate. With the public outcry and U.S.-led sanctions, Western businesses came under tremendous pressure from various stakeholders to leave Russia. And more than 750 companies had suspended or ceased operations within two months of the Russian invasion of Ukraine. As of mid-September 2022, over 300 companies have totally halted Russian engagements or completely exited Russia, and almost 500 have temporarily curtailed operations in the country, according to Yale School of Management.[3] This event has taught companies the importance of being nimble enough to quickly pivot and exit from operations in a foreign market.

[3] "Over 1,000 Companies Have Curtailed Operations in Russia—But Some Remain," Chief Executive Leadership Institute, Yale School of Management, September 14, 2022

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Framework to evaluate country exits

An evaluation for potential country exits consists of four steps: market allocation, product allocation, scenario analysis, and decision.

Market allocation

The first order of business is to determine profitability by market. To reveal the true cost structure (i.e., what the country business would need to operate on its own and minimize potential stranded costs), consider shared costs in addition to direct costs in each market. Allocate shared services costs and corporate overhead costs to the market: for example, information technology (IT) infrastructure and applications, finance and accounting, sales and marketing support, or any other centralized costs such as distribution, research and development (R&D), non-salary-employee compensation (benefits, performance incentives, etc.).

Then, build out pro-forma financial projections based on the anticipated market outlook and demographics. Determine the competitive market positioning, and conduct in-depth commercial opportunity assessment. Assess market share, market outlook, and projections by region and overall trends. Weigh up customer sentiment by region, as well as any changes in regulations, political outlooks, and increases in raw material prices. Consider performing digital footprint analysis to assess the company's online presence in the market.

Product allocation

Equally important is to determine profitability by product line. Do this using the lowest level of data available (i.e., transaction database) to diagnose and understand the underlying challenges and provide a granular view of the business. Consider indirect costs to deliver product in markets (e.g., R&D and engineering, administrative, sales and marketing, shared service costs paid to the parent entity). Then, conduct a bottom-up product profitability or stock-keeping-unit (SKU) analysis, building toward understanding contribution margin by SKU or by region. Lastly, compare data points against internal and external benchmarks, as well as against financial goals of the organization.

Scenario analysis

Once the profitability picture comes into focus, the next step is to determine the impact of the future-state operating models. Key objectives are to set the desired profitability threshold and identify what profitable model works for countries. Consider first optimizing the current model by exploring options that increase revenue (e.g., pricing change) or cost efficiencies (e.g., removing unnecessary overhead) based on profitability analyses. If optimizing the current model does not present any viable path forward, then assess how various alternative operating models—direct presence, indirect presence (i.e., selling through distributors/licensing partners), and blended approach (i.e., outsourcing most operations with or without a sales presence, or switching to an online-only presence)—impact profitability. For each scenario, consider not only run-rate cost impact but also other critical factors such as one-time costs, including capital expenditures, timeline, and risks of switching to an alternate operating model.

Decision

Based on the outcome of the scenario analysis, decide on what to do. If the profitability threshold can be achieved within a specific timeline and is sustainable, continue operations by making shifts identified from the scenario analysis. Otherwise, consider exiting the market.

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Key considerations when exiting countries

Once you get clarity on the best path forward and the decision has been made to leave a country, the actual process of exiting must be executed as smoothly as possible. Exiting a market can be very complex and requires detailed planning and diligent execution to minimize disruptions and unintended consequences. Some key considerations include:

01 Customer contracts and impact to sales/volume

Identify all customer contractual commitments and determine if there are any penalty clauses. Determine if any customers span multiple countries and potential impact to sales in other markets as a result of the exit. Consider meeting customer demand from nearby markets to fulfill commitments until a negotiated contract exit date.

02 Shared vendors and impact to costs due to loss of purchasing power

If purchasing and negotiations are done at the global organizational level and vendors are shared across multiple countries, then determine if there will be any impact to direct and indirect vendor pricing. Similarly, identify if there are any penalty clauses for early contract termination.

03 Employee impact

Determine employees who will get impacted by the exit, any relevant local labor laws, and severance costs. Identify key employees who would be needed to support the country operations during the wind-down and associated retention costs. If there are pension liabilities, then determine if any funding deficits exist and whether the company will continue to fund the program and retain liability or settle the benefits.

04 Property/facility/infrastructure costs

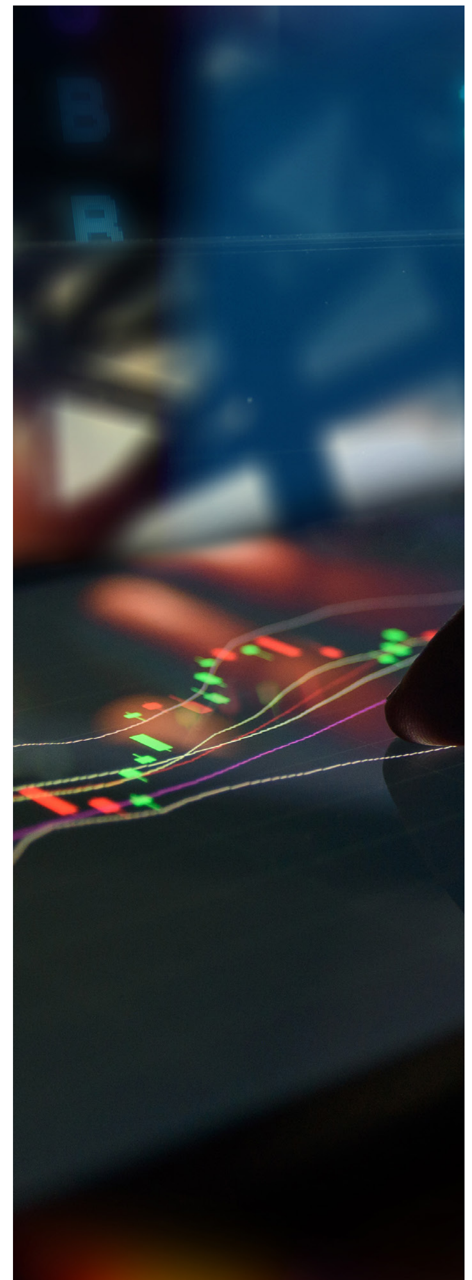
Consider costs to shut down facilities operations and any potential early lease termination penalty charges. Also determine if there are any environmental and regulatory requirements prior to disposing these sites. Determine the costs to dispose of any dedicated in-country IT infrastructure (such as data centers).

05 Stranded costs elimination

Determine what overhead the company will be left with after the exit, and develop an approach to right size the organization and rigorously eliminate these stranded costs. For example, if back-office services in the country were supported through a global shared service center, then consider reduction in personnel and renegotiate vendor contracts for overall reduced support.

06 Legal

Determine a path forward to negotiate and settle any ongoing litigations. Consider also how any intellectual property will be retained and protected after the country exit.



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How KPMG can help

KPMG offers thorough profitability assessments to determine the right-fit operating model for external markets. Based on a decision to exit partially or completely, we help companies craft the appropriate divestiture strategy, develop detailed separation plans, assess and review operational impacts, and guide the execution of the plan with a robust governance program.

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Andrew is a principal with an 18-year track record advising corporate and private equity (PE)-backed companies in buy-side and sell-side transactions and has led a broad range of strategic and operational initiatives. He brings significant experience throughout the M&A lifecycle from diligence to post-close transformation, value capture, and restructuring. Andrew has led large global projects as an external adviser across industries in North America, Europe, South America, and Asia.

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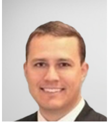

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