VISTRA

International Expansion

A Guide to Setting up Operations

Contents

Getting Started

If you're considering expanding internationally for the first time, or if you already have a presence abroad and are considering operating in a new country, it's critical to understand that virtually every expansion is unique. Many factors will dictate your compliance obligations, risks, and budget. These include home- and host-country laws, the nature of your activities, and your goals and risk tolerances.

Despite differences in local laws and other factors, there are certain basic concepts related to international expansion that apply in most situations. Any business considering international expansion should be familiar with these concepts, and we address them here.

That said, it's important to grasp that laws governing corporate and indirect tax, immigration, employer obligations, and more are constantly evolving. What may have been widely accepted ten or even five years ago as a rule of thumb may no longer apply. Permanent establishment laws, for example, are changing rapidly to account for the digital economy and to stem the tide of base erosion and profit shifting.

This introductory guide is not intended to be comprehensive, but it will give you an idea of what's involved in setting up operations. Most importantly, it will help you ask the right questions so you can set realistic budgets, timelines, and expectations before you make the leap.

Building an International Expansion Team

The time looks right for overseas expansion — you may already have your eye on a few countries. You just need to craft a plan, get it approved, and then get the ball rolling. Seems everyone is doing it today — sourcing, servicing, or selling overseas. If your peers can pull it off without a hitch, you can too, right? As the CFO or COO of a growing company, you may be planning to handle this yourself; if too busy, you may be thinking of delegating it to someone you can trust to run with it.

The process is more complex, risky, detail-oriented, and time consuming than you may imagine. We've been helping companies do this for more than two decades, and we can tell you, it takes more than one individual — regardless of brains, drive, and experience — to do this right.

A team will help in other important ways — you'll get different perspectives early in the process, which will better shape your plans, and you'll be much more likely to get buy-in from key stakeholders.

It's More Work Than You Think

Consider these issues that might come up, regardless of countries you may expand to, and what type of operation you open:

- HR issues that may be unlike anything you've faced in your domestic market, like national health, work visas, employment contracts, data privacy, and risks of unfair dismissal claims
- Accounting considerations, such as reconciling general ledger entries, local (statutory) accounting requirements, and other compliance matters (for example, ensuring your records are available for inspection at any time by local authorities)
- Regulatory compliance of every sort, from currency controls, to import/export restrictions, and even environmental matters
- Tax considerations, risks, and liabilities, along with complex filing requirements
- Working with different languages, time zones, customs, and cultures

Doing the necessary homework on these issues — and more — will take much more than a few extra hours a week — they could take weeks, if not months of full-time work. Assuming, of course, that you know what to look for, as well as what questions need to be asked and answered. If you've never done this before, a helpful rule of thumb is that it will take twice as long as your current estimate.

Start With a Small, Dedicated Team

So, you need more than an individual; you need a team. Not necessarily a committee representing every single department in your company, but three, maybe four self-starters from the parts of the business who will be most impacted by the project, who can investigate, evaluate, make decisions, and then take action. Unless you work in a resource-challenged start-up, it would be best to appoint one leader of the team who is not tasked with actually completing any specific tasks — ideally let others on the team do the work — leaving the individual best placed as the team leader more free to focus on the day job of running domestic operations. The leader can then jump in to resolve issues and make key decisions. You'll want strong representatives from three areas — Finance, HR, and Legal — as the lion's share of issues in any international expansion will be found there.

You'll also want team members representing any of the departments expecting to hire personnel in the overseas office. Depending on the nature of the overseas operation (selling, servicing, or sourcing), this could include Sales and Marketing, Customer Service, etc. While some departments may not expect to have any overseas employees, the operation of a new office may require their participation (for example, Logistics). You may not need everyone to be full members of the team,

but identifying them early on as resources the team can turn to when needed, will be very helpful.

Pick Proven Team Players

When choosing team members, subject matter expertise is obviously critical, but make sure you pick good team players as well. Their goal is to open a new, completely functioning operation, not deal solely with departmental issues. Working together as a team will be critical to your success, because almost every decision they will make will cut across departments. Some representatives will have opposite perspectives on what is needed, so the ability to negotiate and compromise is critical. Something as simple as the choice between hiring local staff or sending over expats can have surprising, cross-departmental implications. What about tax liability — theirs and yours — in both countries? Will they be subject to "home or host" HR regulations? Will they need new equipment — mobile and office phones, laptops? Can they access domestic databases? Will they need local sources? Local software? If so, how will these interact with domestic systems? Will they need cars and housing?

Give Them Ownership

Your team will be tasked with more than planning. They'll do all of the upfront work that will help you make big decisions — choice of country or countries, type of entity, scope of business — and they'll set up operations — find space, acquire equipment and supplies, hire staff, engage local partners.

It's important that team members be given as much ownership of the process as possible. Take their advice on strategic issues, and let them make all of the detailed decisions. Hold them accountable for the success of the new venture — give them oversight of initial operations; set clear benchmarks and incentives for the office and for them. And when it works, give them public credit — success in your first country is a most likely indicator for further expansion. A happy, empowered, and experienced team will often tackle new countries for you in half the time of the first.

Add a Ringer to the Team

No matter how strong your internal team will be, there's a very good chance that some or all of them will have not done this before, not done it in a while, or not done anything in the countries you're considering. Bringing in a specialist in international expansion to help lead the team will assure they know what questions to ask and where to turn for answers.

If you think you've nailed the choice of country early on, you might be tempted to find a resource there to join your team, such as a local accounting or law firm. Think again. They might know their own country's laws and customs, but they won't typically know yours. Your team needs an advisor who understands both. Given the tax and regulatory issues you can face on both sides, you need someone who can help you weigh options from both perspectives, and find those that will be right for you. And if you're thinking of expanding beyond one beachhead country, you'll need an advisor who understands issues around the world.

Our experience with leaving too many critical decisions in the hands of local providers is that the needs and requirements of the HQ part of the business are often ignored. For example, a local provider will often seek to pursue an in-country banking relationship with a leading local bank that they know and have worked with before. However, this local bank may not be a great fit within the global cash management structure where your corporate account must play a leading role.

Budget Considerations

Preparing for Surprises

If you're considering opening operations in a new country, getting a handle on how much this is all going to cost is likely at the very top of your to-do list. Reliable estimates will help you justify international expansion, compare investment and return in different countries, and when your plans are approved, set P&L goals for your new overseas operations.

It's an important step in the planning process. Often, we hear executives approach it like this: "Let's start with domestic expenses using our standard list of costs — salaries, benefits, real estate, equipment, and supplies — then make adjustments from there."

This is a reasonable tack to take if you haven't budgeted for international expansion before. Unfortunately, the task is rarely that simple. Even basics like staffing, office space, and services will vary significantly from country to country. Then there are tax issues and regulatory compliance requirements that will impact your bottom line. Toss in a host of hidden costs that you hadn't expected, with painful penalties for doing things wrong, and it becomes clear that the process will be more involved than it seemed.

That's usually the first unpleasant surprise of the budgeting process. The second comes when all the costs are totaled. Execs often expect to have lower overhead in developing countries, but you're going to pay more for an overseas office virtually anywhere you go. If you're expanding into another developed country, setting up and running an office could be two to three times your domestic costs.

The good news is that budgeting, when done properly, doesn't itself create success or failure. Rather, it eliminates the menace of surprise. It's important to go into the budgeting process armed with all of the right questions, because no one likes budget surprises.

To help you avoid the unknown, we're going to help you attend to those details. At the end of the chapter, we'll offer an extensive checklist of questions that will assist you in preparing an accurate budget for international expansion. But first, to help you understand what you'll face, we'll show you how much costs can vary around the world by comparing popular countries for overseas expansion in Europe, Latin America, and Asia. (Note that the tax rates and other information described here were accurate at the time of drafting, but are subject to change. The descriptions are intended to give you an idea of real-life budget considerations in certain popular expansion countries.)

Europe

United Kingdom

Let's start with the United Kingdom — one of our clients' most popular expansion countries, and for US companies selling overseas, often their first step abroad. While relatively business-friendly, the UK has a host of personnel-related costs to consider. For starters, employers pay 13.8% of salary towards social security, with no cap. This compares to the US, where the employer FICA of 6.2% and Medicare contribution rate of 1.45% are substantially lower in total, and the FICA contribution is capped at the first $127,200 of annual salary. Pensions in the UK are mandatory, and companies must contribute at least 3% effective October 2018. Add to this $1,000 – 4,000

for employer's liability, plus health and safety obligations if you employ five or more in your UK office.

Thinking of sending in expats? A good rule of thumb for the UK is three times their base salary. Hiring locals can be considerably cheaper, but you'll need to consider recruitment costs. And make sure you hire the right people — termination expenses can be high, and if there is any sign of discrimination or failure to follow proper guidelines, you may end up with unfair dismissal costs that could run you upwards of $125,000.

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Corporate income tax is lower than in the US, with a current main rate of 19%. If you bring goods into the UK to sell, you'll pay customs duties, which can range from 0.5% to 10%, along with an import value added tax (VAT) of 20%. Import VAT is set up to be a temporary tax liability that will be reversed when the goods are sold onward to customers. However, in our experience it's quite common to have situations where UK customs clearing rules are not properly followed, and the "temporary" VAT liability becomes permanent.

Then there's real estate. If you have to be in London, expect to pay about 20% more than you would for equivalent space in a large US city. Secondary business centers — Birmingham, Bristol, Glasgow, Manchester — will be similar to their US peers. On top of the overall rental rates, however, there are significantly more expenses and taxes added that would not typically be seen in the US.

One area where you will save, if expanding from the US, Canada, Australia, or New Zealand, is translation costs. Other than the rare difference in spelling (program/programme, color/colour), there will be no need to pay for translation, however, you may have to reprint business cards and stationary because of different standard print sizes.

France

Budget issues in France are similar to, but even more costly than those in the UK. While France implemented labor-law changes in 2018 to make the country more attractive to foreign enterprises, the country remains notorious for being expensive and time consuming because of statutory employee rights and entitlements. On the personnel side, you'll pay 40-45% of base salary for social security, plus additional insurances, such as medical. These are dictated by federal law and collective bargaining with unions. Unlike the US, both white and blue collar workers are typically unionized. These additional expenses will run at least $3,000- 4,000 per employee per year. Add in extra pay for holidays, over-time and training. A word of caution about bonuses: If you commonly give discretionary bonuses to high performing employees, these may become contractual based on perceived precedent. There's also the pesky matter of the mandatory work week of 35 hours, and the liabilities that can arise when even senior managers are not properly guided to adhere to these limits.

France is one country where you have little or no hope of cutting corners and running a lean ship — in all likelihood, you'll have a work council looking over your shoulder holding you to agreements and pushing hard for worker benefits.

Planning to hire locals? Make sure you're very selective in whom you bring on. Terminating employees in France is difficult, and may cost the equivalent of 12-18 months' severance once they have been on board longer than their probationary period.

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Real estate in France is comparable to that in the UK — you'll pay a 10-20% premium over big-city US real estate to be in or near Paris. Provincial cities, like those in the UK, will cost about the same as second-tier cities in the US.

If you come from an English-speaking country, you will find lots of French businessmen and women who speak English, but if you want an operation that will thrive, you'll need to do business in French, so be sure to budget for translation of everything. Seriously consider hiring a local or an expat with fluent French language skills as soon as possible — this will be especially helpful in all contract negotiations.

Latin America

Mexico

Mexico doesn't have strong private sector unions, so you won't be under pressure to provide expensive benefits, but there are some unique personnel-related costs to plan for. All employers must offer profit sharing, and the minimum is 10% of annual entity profit. You'll also be required to contribute, for each employee, up to $38 per month towards a retirement fund, and up to $64 per month for social security.

Mexico has an excellent public health system, which you don't have to contribute to, but supplemental coverage is becoming a common benefit for employers competing for quality staff. And while Christmas bonuses have been waning in the US, they're often common overseas, including in Mexico, where giving one month's salary at Christmas — the "The 13th Month" — is standard practice. Corporate taxes in Mexico are 30%, and you will pay a standard 16% VAT.

Brazil

Brazil has few government-mandated personnel requirements, but it does have very strong private sector unions that have made rich benefits the rule, not the exception. If you're planning to go with a local staff, recruiting top-notch people will mean playing by union standards for white as well as blue collar workers. Expect to offer unemployment and health care benefits, as well as "reimbursement" allowances for everyday items like restaurant, supermarket, gasoline, cellphone, and parking/transportation expenses. These allowances can add up. Transportation and food per diems, commonly as much as $20 each, will mean more than $10,000 per employee per year. Sending expats? They'll need housing in safe (and expensive) neighborhoods as well as transportation, and may even require personal security.

The issue of safety in Brazil is significant. Sao Paulo, the nation's business center, doesn't get the same bad press as Rio when it comes to urban crime, but it is still a very big issue there. You'll want your offices to be in a safe neighborhood near a highway or public transit, which will mean paying a hefty premium. While space in these neighborhoods may be a little less than Manhattan or London, it will still be in the range of Boston or Chicago. If you want to save money, consider Curitiba or Porto Alegre — two up-and-coming cities an hour or two south of Sao Paulo by plane. You'll find the workforce there more conservative and industrious, and real estate prices closer to 3rd tier US cities. Regardless of where you go, you'll need to pay for both occupancy and health permits — a bargain at around $500 each.

Corporate tax rates are 34% in Brazil. Brazil has a multitude of indirect taxes. The main ones are Federal VAT (IPI), State VAT (ICMS), and Municipal Services Tax (ISS). ISS varies by municipality, with a cap of 5%. ICMS varies by state, averaging 17%. IPI ranges from 0% (essentials like rice) to 365% (luxuries considered superfluous). Given the extraordinarily long list of different taxes, compliance costs are very high even if the tax rates themselves may at times be reasonable.

Asia

Singapore

Singapore is rated one of the most business-friendly nations in the world. It's also one of the most expensive. According to Mercer Consulting, it's the 4th most costly city to live and work in. Expect real estate to be at least 50% higher than in the US or Europe. Thought you'd save on salaries? Top notch professionals will expect compensation packages equal to those in North America and Europe. Want to send in expats? You'll need to provide a hefty housing allowance. They'll insist on living in international neighborhoods, where rents can make Manhattan and Central London look modest.

If you want to use internationals — and there's a sizeable community of global professionals in Singapore — you'll have to set up a local corporation, with all of the attendant costs. On the positive side, Singapore corporate income taxes are only 17%.

China

China is another ball game entirely. It's more expensive than you'd expect, and the procedures are complicated and time-consuming. Think forms and documentation. Think bureaucracy.

For starters, you'll have to set up a WFOE — a Wholly Foreign Owned Enterprise corporation. And you'll have to provide "share capital" of roughly six months of expected operating expenditures. A small three-person office will equate to around $150,000 in share capital you will have to inject into a Chinese bank account to start. Of course you can use the capital, but if your reserves fall below the mark, you'll have to top-off, and that will mean more filings and delays. Setting up a WFOE will take 6-9 months, and will require one staff member in your home office to ride the application process daily. Make sure China is really right for you — shutting down operations there can take longer, and cost more, than the costs for opening up shop.

You'll find that China may not be the bargain you expected. Shanghai is the world's tenth most expensive city; for perspective, New York is 16th. And it's not just real estate that's pricey — staffing costs have been soaring. English-speaking local talent can be hard to find (and often even harder to keep!), and nonlocals will expect global salaries, with hefty accommodation allowances. Then there are contributions to government-run social security, pension, medical, maternity, and housing funds. These can run 5-20% of annual salary each; fortunately, there are salary caps. Unfortunately, they vary by city. You'll need to take this into account as additional branches may be needed to accommodate them if you have staff in more than one locale. It's no wonder Chinese companies have begun to offshore manufacturing to Mexico.

International Expansion Budget Checklist

Staff expenses:		Marketing expenses:	
Salaries		New marketing materials	
Social security		Advertising, PR, lead gen	
Unemployment insurance		New sales materials	
Health insurance		Website translation	
Pension fund			
Profit sharing		**Set-up expenses:**	
Bonuses		Incorporation fees	
Meal allowances		Filings	
Transportation allowances		Legal services	
Handbook translation			
Security services		**Office expenses:**	
Payroll services		Office rental	
Employment contract prep		Rental expenses/taxes	
		Equipment	
Tax expenses:		Computers & software	
Corporate taxes		Phones	
VAT		Communication services	
Import duties		Supplies	
Misc compliance		Health & safety inspections	
Accounting/audit			

Total:

Legal Entity Options

Permanent Establishment

If your organization has determined the time is right for global expansion, and you've decided the location(s) targeted, you will need to consider establishing a legal entity in-country. Deciding whether to set up a legal entity in the host country, and if so what type of entity to set up, will be critical to protecting your organization's bottom line and its reputation.

If you are considering conducting business overseas without registering a legal entity — basically "flying under the radar" — you should probably think again, even if you're simply sending an employee over on what you would consider to be a temporary assignment, or establishing a small promotional office. Any activity that results in revenue being generated, either directly or where the activity contributes to the group entity's revenue, may trigger a taxable presence, or a "permanent establishment" or "PE," in the host country. An organization's physical presence over a sustained period can also be a factor when local authorities make PE determinations.

Tax authorities in all countries are motivated to increase tax revenues, so an organization operating overseas must be particularly cautious of triggering a PE under local laws. Failure to properly register a PE can leave your company exposed to unexpected tax liabilities, but also fines and reputational damage. Before you take on those risks, make sure you answer the following questions:

- Will your employees operate out of a fixed place of business in the host country? (A "fixed place of business" can mean an employee's home office, as well as formal business accommodations.)
- Will your in-country employees be substantially involved in sales or contract negotiations? (They need not have the power to sign contracts to qualify as being involved in contract negotiations.)
- Will your in-country employees have job titles or descriptions that relate to revenue-generation?
- Will your in-country employees receive sales-related compensation, such as commissions or sales performance bonuses?
- Will your in-country employees play a substantial role in product or service delivery?

If you answered "yes" to even one of the above questions, you'll almost certainly be better off registering a legal entity in the host country rather than trying to fly under the radar. While legal entity options vary by country, generally speaking there are three types: representative office, branch, and subsidiary. Case by case elements like your business activities, budget, time constraints, risk tolerance, and other factors will dictate which option is right for you. Let's take a look at each.

Representative Office

A representative office (RO) presumes that the establishing organization will have a minimal presence in the host country and that it will generate no host-country revenue. If employed through an RO, your staff might be involved in brand promotion, customer service, or distributor support, but no one should be directly engaged in sales or contract negotiations. Due to these limitations, ROs (or their equivalents) are relatively quick and easy to establish.

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Your organization might want to consider establishing an RO under the following circumstances:

- You're exploring market potential (i.e., you want to conduct research, attend trade shows, or have preliminary talks with potential partners, distributors, or customers).

Pros and Cons of Each Entity Option

	Representative Office	Branch Office	Subsidiary
Pros	• No in-country corporate taxes • Less regulatory oversight • Short set-up time	• Can engage in core, sales, and transactional activities • Usually no share capital required • Greater flexibility to enter or leave markets • Relatively short set-up time in most (not all) cases	• Can engage in core, sales, and transactional activities • Limits tax and legal liability of host-country activities • Entity can be marketed as a part of local community
Cons	• Cannot perform core activities, sell, or transact business • Gray-area activities, such as marketing and service activities, may trigger permanent establishment	• Subjects parent company to legal obligations arising from branch activities • Can expose parent company profits to host-country taxes • Set-up and administration costs can be as expensive as a local subsidiary	• Set-up can be a lengthy process, with multiple government registrations • May require minimum capital • May require local directors • Subject to host-country regulatory oversight

- You have customers or distributors that require frequent in-person support.
- You need staff to oversee local or regional brand promotion.

Branch

A branch office is not strictly speaking a separate legal entity, but rather a company's office that has been established to service a specific geographic area. Just as a company headquartered in New York might have an office in San Francisco to serve the California market, that same company might open an office in London to serve the UK.

Branch offices offer no liability protection, so the foreign parent company is subject to any legal obligations that may arise in connection with the branch. Furthermore, branch offices offer no tax protection, so the parent company's profits are exposed to host-country taxes. Your organization must give careful consideration to host-country tax laws and transfer pricing arrangements before making the decision to open a foreign branch office. The decision could significantly affect your company's bottom line.

Despite the drawbacks associated with branch offices, registering one may be appropriate in certain situations. Your organization might want to consider establishing a branch office under the following circumstances:

- Your host-country activities will extend beyond marketing activities where no direct or indirect revenue can be attributed. That is, you have determined that you need staff on the ground to engage in core, sales, and/or transactional activities.
- You have determined that the host country's tax codes will limit parent company liability and have little impact on your bottom line.
- You want to move quickly to capture a market opportunity ahead of the competition, or to support large new clients, and don't want to spend the time required to establish a subsidiary entity type (described in the next section).
- You plan to operate in the host country for a limited time.

Subsidiary

A subsidiary is an entirely separate legal entity, established by a parent company to conduct business in the host country. Subsidiaries provide

a layer of legal protection between the parent company and the activities of the subsidiary. While establishing a subsidiary can be a lengthy and arduous process, and may entail capital investments, the benefits often outweigh both the effort and the expense. Subsidiaries limit tax exposure to activities performed in the host country, shielding the parent company's profits from host-country taxes.

Your organization might want to consider establishing a subsidiary under the following circumstances:

- Your plans call for a long-term presence in the host country.
- Your plans call for extensive operations in the host country, with revenue and profits that will justify the investment needed to set up a subsidiary.
- The host country has tax laws and treaties that would expose the earnings of the parent company to taxation if the parent company opened a branch office or other non-subsidiary entity type.
- Your organization will improve its image and enhance its marketing and sales efforts by operating as a locally registered company.

Ten Questions to Ask Before Choosing an Overseas Legal Entity

1. What types of activities will you perform in the host country, now and longer term?
2. How many employees and/or contractors will you hire in and/or send to the host country?
3. What level of presence will partners have in the host country?
4. How long do you plan to operate in the host country and do you plan to expand there?
5. Will you lease or purchase office space in the host country?
6. How quickly do you need to set up operations in the host country?
7. What will your revenue model be (e.g., cost-plus, buy-sell, etc.)?
8. Are there significant marketing and PR advantages to operating as a local company?
9. What are the tax risks for your parent company in the host country? For example:
   - Are there any discriminatory taxes on particular industries or types of investment?
   - Are there unusual withholding taxes on fund transfers or sales of goods?
10. If considering a subsidiary:
    - What are the initial capital and governance requirements in the host country?
    - Among how many shareholders will you distribute ownership, and who will act as local director?
    - What degree of independence will local management have?

A Real-Life Example of the Consequences of Flying Under the Radar

Triggering a taxable presence in another country is not just a hypothetical problem — it is a real risk. One of our clients, for example, initially approached us because they had unwittingly breached PE laws abroad. The company had placed two employees in Sweden, both in home offices. Since the employees were working from home and not directly generating substantial revenue in Sweden, the company decided to simply complete a payroll registration and forgo registering a full corporate legal entity in Sweden.

One year later, the Swedish tax authorities approached the company to say that it had triggered a taxable presence because one of its employees had the word "sales" in his title. As a result, the company should have more formally registered in-country, which in turn would have resulted in higher employer payroll taxes. In the end, the company owed over $20,000 in employer back taxes and fines. The company took steps to mitigate these damages, but the message is clear: Failure to comply with local PE requirements can have serious negative consequences for businesses like yours.

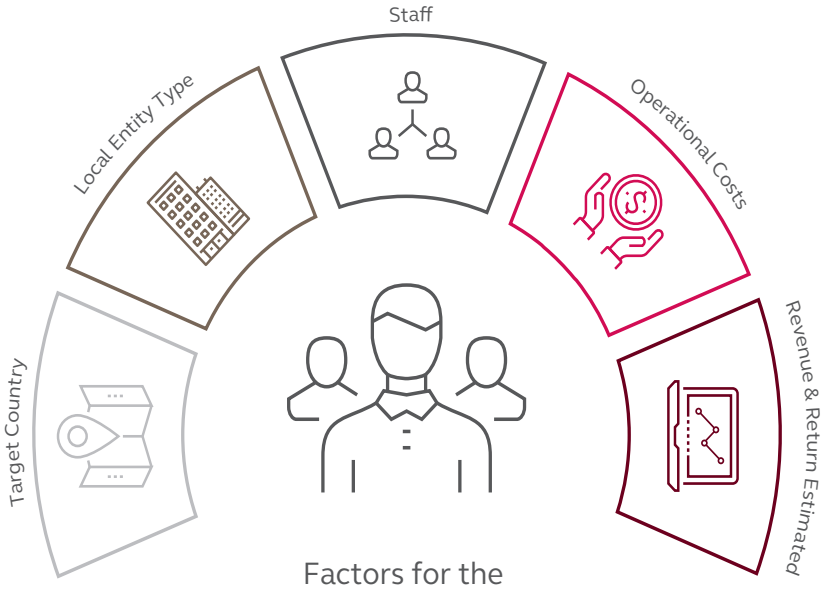
Setting Realistic Timelines

One of the first questions we're asked is, "If we start now, how long will it take until we're operational?" The answer is typically, "It depends…"

That's not the answer anyone is looking for, but there is no standard timeframe for establishing operations in a new country. Set-up time depends on a host of issues, including what type of operation you're looking to set up, the target country, the number and nature of staff (e.g., local nationals and/or expats), and most importantly, what you mean by operational. Do you simply need a legal entity and a bank account that can accept local funds? Or do you need more, such as a physical office space with staff that's ready to work? Do you need an office that's fully integrated into your corporate management structure? Or one that does all of that and has figured out how to do business as effectively in a foreign environment as you do at home? Depending on the answers to these and other questions, your set-up time could run as short as three months to as long as two years.

Let's start with a modest definition of "operational" — commonly, a legal entity set up as a sales and marketing office, focused on opportunities in one country or region, with a barebones staff of three or four individuals, for which you are able to process a locally compliant payroll each month.

> There is no standard timeframe for establishing operations in a new country. Set-up time depends on a host of issues...



Factors for the Planning Team to Identify

Phase 1: Planning

Let's assume you've assembled a small planning team and charged them with developing a business case for international expansion. The team will need to identify the target country (based on market demand, ease of operations in-country, and/or other factors), an appropriate local entity type that will minimize costs and risks, the staff required for the first few years, operational costs (including but not limited to rent and taxes), and a reasonable estimate for revenue and return. Team members should expect to devote at least 10-15 hours a week on the project, over the course of about two months. Add in another month for senior management to review, suggest revisions and ultimately garner the requisite approvals for the plan, and you'll be ready to begin the office set-up process within three months. This is when the tricky parts begin.

Phase 2: Setting Up a New Entity

Establishing a legal entity overseas generally takes between two weeks and six months, depending on the country, the type of legal entity selected, and other factors. Some countries allow foreign businesses to establish an entity without a physical office space or a local bank account — those few are the fast ones. Other countries require a physical office, and in some countries both an office and a bank account are required. The more requirements, the longer the set-up time.

Filing the paperwork for the entity establishment, and garnering the necessary approvals, may itself not take much time. However, preparing the documents that will be filed can often take weeks or even months. One of the first obligatory steps is the Know Your Customer, or "KYC," requirement, which can entail providing detailed information on ownership, legal structure, and details of the officers and directors of the proposed entity. Some countries will demand at least one local national as a director, who in many cases will be held legally responsible for the entity's actions. Not surprisingly, finding a director who will agree to assume this responsibility can take time, and in cases where outsourcing this function makes the most sense, can be expensive. Where the host country requires the opening of a local bank account, the bank will also have to complete the KYC process, and depending on the bank and its internal requirements, their requirements may be even more onerous.

As mentioned, many countries require a physical presence to set up an entity, and some require a presence even to open a bank account. What comes first — entity, directors, bank account, or space — varies considerably by country, and sorting through the requirements of even a single country can be extremely complicated.

If office space is part of the initial requirement, you'll need to add at least a month or more to the set-up process, as searching for the right location and the right space at the right price, in a market you're not familiar with, can be quite time-consuming. One way to avoid this is to set up shop in a facility that caters to new operations. Flexible office-space providers have turnkey space in some of the best business locations around the world, and those spaces can be ready for occupancy in days versus months.

Setting up the entity is just the first hurdle. Once established, you'll have to pay taxes, set up a locally compliant payroll and in many countries apply to the tax authorities for a social security number before you can hire employees. These additional steps can take as little as a few weeks, or they can add up to several months.

You may be wondering how long it takes to establish an entity in a specific country, which as we've said will require some detailed research. But to take a few popular destinations as examples, it typically takes less time to establish an entity in Singapore, Hong Kong, the UK, Australia, Canada, or Germany than it does in France, China, or most Latin American countries.

Phase 3: Staffing

With an entity in place, your company will be legally compliant, meaning you'll be prepared to accept business, employ staff, and pay taxes. But you're still not "operational" — for that you'll need staff to get your new customers, support existing business in-country, or make or source product — whatever the objective of your local operation is. The fastest way to staff your new operation is to hire competent local nationals. Bringing in expats always takes longer than hiring locals, as they will typically require work permits and visas in advance of being able to work "on the ground." In addition, expats often require complicated tax-equalization arrangements, cost-of-living calculations, and other "localization" services that not only take time, but can add significantly to the cost of getting operational.

Still, there are often sound business reasons for sending expats to run your overseas operations, from increasing the odds that new local staff will be managed in accordance with your company's culture, to ensuring that a known, quality employee is running your operations the way you need them to be run. And some countries are more expat-friendly than others. For example, European Union (EU) citizens from one EU country can by and large effortlessly move between and work in other EU countries. As contrasting examples, it is no sure thing for a non-EU citizen to get a work permit approved in Germany, and obtaining a Brazil visa is notoriously time-consuming and must be completed prior to travel. Be careful of making assumptions; it is often thought that US nationals can relatively easily obtain a work permit in Canada, but this is not necessarily the case despite the close geographical proximity and common language.

> If you hire a completely new staff of local nationals, they'll need to be trained on your systems and practices.

In most countries, once you've identified staffing needs, you'll need to enter into employment contracts, which typically must be written in the local language. Before you begin hiring, you'll also have to agree on and set up a benefits plan. Benefits in your new office will be different from those in your home country due to local labor laws and market expectations. To be on the safe side, think 4-6 weeks to draft a benefits plan that complies with local laws and makes you a competitive, attractive local employer. To avoid delaying your timeline, it's best to begin drafting your benefits plan while you're establishing your entity. The good news however is that for US employers, the list of incremental benefits beyond salary and social taxes is often shorter than it is for US employees, largely because what is provided through the social security safety net is greater.

Assuming some of your staff will be local hires, you'll need to account for recruiting time. Depending on the required skills and talent availability, recruiting could take anywhere from a few weeks to several months. Formal hiring may not be possible until your entity is finalized, but you should consider scouting for talent as soon as possible.

And of course, unless you're going into turnkey office space, your staff will need phones, internet access, furniture, office equipment, and supplies. You may also be required to translate staff materials into the local language. You'll want to resolve these matters before hiring staff, or your operational start date may be pushed out another 4-6 weeks.

Phase 4: Integration

With an entity in place, a bank account set up, real estate secured, and staff on board in a fully-equipped facility, you may be ready for business — but you still won't be fully operational. For that to happen, your new office must be integrated with your corporate operations, but in a manner that properly provides for the differences in marketplace and culture that can often be quite foreign to your home-country business practices. Furthermore, it is necessary to consider how the financial management accounts, revenue model, and corporate tax position of the new host-country operation will fit into the home country's financial and fiscal arrangements.

If you hire a completely new staff of local nationals, they'll need to be trained on your systems and practices. You should count on a few days for the staff to learn the basics, but typically they'll need a month or more before operations are running smoothly. Keep in mind that all of you will need to adjust to different holiday and vacation schedules (and expectations!) when dealing with the head office. More significantly, cultural differences may create unexpected challenges related to staff management, company meetings, and day-to-day communications. Practices that work at home may not work as well in your new country. You'll need to allow time for sales and service feedback, marketing testing, and operational refinements. Time zone differences, which are often daunting, can turn out to be the least of your challenges.

Sending expats to train or be part of the new team can help overcome some of these challenges and speed up office integration. But as we've seen, sending expats poses its own set of problems, costs, and potential delays.

From doors-open to optimal operations will take some time — perhaps 1-2 months for internal integration and 2-4 months for external integration. Proper planning, including recognizing all the factors involved in staffing and beginning operations, can help you set realistic performance expectations and anticipate problems before they arise.

Seven Tips That Can Save You Months

1. Assemble a dedicated planning team and keep the decision-making to a small group of top executives.
2. Look into business-friendly countries that have comparatively simple entity establishment requirements, like Australia, Canada, Germany, Hong Kong, Singapore, and the UK.
3. Take care of staff-related issues (e.g., contracts, benefits, initial recruiting) while establishing the entity.
4. Plan to hire local nationals first, and only consider sending expatriate employees if you have done your homework and understand the obligations and costs associated with expats.
5. Go with a turnkey office space provider where practical.
6. Have an integration plan in place, and work closely with the new office until everyone is fully on board.
7. Be prepared for the new office to do things differently — encourage them to adapt to their local market needs.

Choosing a Location and Office Space

Picking the right location in an unfamiliar place thousands of miles away is not easy. Think about the nuances in your own home market. You need to know where your customers are concentrated, where it is easier to attract and retain the types of employees you'll need, where the best deals are, what your office address says about your business (good and bad), and how quickly real estate market conditions may change. How well would you know these facts if you didn't have personal experience on the ground?

Boston is a good example of a major city where real estate conditions change rapidly, and where outsiders might make the wrong location choices based on out-of-date information. Looking at Boston from afar, you might assume that the most desirable location for a financial services company to set up shop would be downtown, home to some of the area's biggest firms. And if you were a technology company, you might make similar assumptions about an area northwest of Boston known as "Route 128", for years cited with Silicon Valley as a global center of technology innovation. If this were 1995 or even 2005, you'd be right on both counts. But since that time, many of Boston's leading financial services firms have moved out of downtown and into a new neighborhood known as the Seaport. Meanwhile, the region's center of innovation — especially innovation involving biotech, pharmaceutical research, and venture capital firms — has shifted from Route 128 to Cambridge. And downtown, once a bastion of the blue suit crowd, is also now home to a surprising number of tech start-ups and digital marketing companies! When hiring folks in these fields, they will likely expect a location that matches this current reality.

In short, you need accurate, up-to-date information about your target location so you can make a well-informed decision. To assure you make the right location and space choice, you'll need to answer these important questions:

What Is the Purpose of Your New Operation?

The purpose of your new international operation will significantly affect where you set up shop. Sales offices need to be near customers, and depending on how concentrated those customers are in certain locations, you may find that your options are limited to a few defined areas in and around major cities. If your new operation includes R&D, product development, or marketing, you'll need to be within an easy commute of local talent. Urban locations with ready access to public transportation are often a better bet than suburban office parks, where the talent pool may be small and access to transportation limited.

> The purpose of your new international operation will significantly affect where you set up shop.

Manufacturing operations, on the other hand, have different considerations. Real estate costs and access to ports, rail, or air are the key drivers of where to set up shop. With more freedom to choose, manufacturing operations can often take advantage of government location incentives that promote industry in secondary cities and rural areas.

Do You Need to Be Near Customers, and If So, Where Are They?

If your new operation requires staff to be physically close to customers (to sell to or serve them) then you'll need to do some research on where prospective customers are located. If you have a database of customers or prospects, you can plot them geographically, giving you an idea of how concentrated or dispersed they are and what locations would put you near their center.

Real estate professionals can help too, as they have data on business locations by industry. They also have a good idea of where businesses who serve those industries are situated, and which neighborhoods offer the best access to transportation.

If Hiring Staff, Where Will They Be Willing to Work?

Proximity to the right talent pool will be one of the most important drivers of location for businesses planning to hire local staff. Recruiting a few sales professionals might be relatively easy regardless of where you locate your office, since they will be frequently in and out of the office. But if you're planning to operate an office with dozens of employees that work onsite every day and possess specific, in-demand skills — such as R&D, web development, or marketing skills — you'll find it hard to fill positions unless you're in the "right" neighborhood. That is, you'll need a neighborhood that is either home to where the talent resides, or presents a reasonable commute from their homes. Every global center of innovation has neighborhoods like these, whether it's SoMa in San Francisco, Silicon Roundabout (Shoreditch) in London, Block 71 in Singapore, or Zhongguancun in Beijing. You'll pay a premium to locate in these kinds of areas, but you'll find it easier to recruit and retain talented employees as well.

Will you be sending expats to run or help run your new operation? Sending expats typically won't seriously affect your choice of location in most European or Asian countries, although if they have children, proximity to international schools will save your expat staff from long commutes. That said, if you're sending expats to developing countries, the safety of the neighborhood to which you locate can be a very important consideration. In cities like Sao Paulo and Mexico City, business centers adjacent to safe, upscale residential neighborhoods, while expensive, are usually the best choice.

Will Location Help You Qualify for Incentives?

Most countries offer employment, tax, and/or R&D incentives for companies entering their market. Staff size, investment in R&D, and location may all factor in to your chances for qualifying for these incentives. Depending on the country, you may have to establish operations in special economic zones to qualify. While such zones won't give you the same immediate access to downtown customers, the incentive value can often outweigh locational drawbacks. Some countries have located these zones near major airports, giving you the best of both worlds — tax incentives and ready access to transportation. Digital Media City, about 45 minutes outside Seoul, South Korea, is a good example.

Many countries offer incentives for establishing operations in secondary cities rather than the capital. Incentives are relatively easy to come by in Ireland, for example. Ireland is a hot market for tech companies looking to establish European operations, and if you're willing to forgo Dublin and Cork and consider smaller cities like Waterford, Dundalk, or Limerick, you may be eligible for incentives.

To learn more about potential incentives, contact the economic development agency in your expansion country. If you want an objective opinion, a global real estate specialist can help you determine if you qualify and help you weigh the trade-offs.

Will Your Address Impact How Your Business is Perceived?

Location — choice of neighborhood or building — can have an impact on your business, especially if you're new to the market, relatively small, and/or selling your image. If you're new to a market, setting up shop in a second-rate building in a marginal neighborhood makes you look like an outsider or a potential bit player. If you want to look like a real player, go to where the real players are — the City of London or Marina Bay in Singapore. Want to look even bigger than you really are? Open an office in a premium location or a landmark building. Even if you've only leased a small office, telling London prospects you're in The Gherkin gives you immediate credibility, if this objective is important.

What Are Your Plans for the Next Three to Five Years?

Very few of the firms we've worked with have opened offices overseas without expecting to make at least some strategic adjustments after their first year of operation. Most planned for growth and achieved or exceeded their goals. A few entered what they knew were situations with unclear prospects and eventually cut back on staff or even pulled out of the market.

Regardless of plan or result, flexibility is key when expanding into a new location. Here's why: Conventional real estate leases overseas typically involve both a more significant commitment and a more sizeable initial capital investment than seen in the US. Conventional leases typically run "5+5" (five years with a five-year option to extend) in London and 3+3 in Singapore. Get an office that's too small to account for growth and you'll have to move — a costly and disruptive undertaking. Get one that's too big, and your office will be a drag on profitability for years to come. And while short-term leases are available, high demand for space in some top cities means landlords will charge you a hefty premium. Then there's the capital outlay for build-out. With quality space running $110 to $165 a square foot to fit out, a starter office (typically 1,000 square feet) in either of these cities will require an investment of at least $110,000. An office that can accommodate 15-20 employees (3,000 square feet) could be almost a half million US dollars. Finally, there is the concept in many countries of "dilapidations" — meaning the tenant pays the cost of bringing the space back into the state it was in before any build-outs.

To avoid the "too small/too big" problem, many of the firms we've worked with have chosen to start with what's called serviced offices or flexible workspace. These office spaces are fully furnished, with reception and office management provided. You can start with one office and share meeting space, or take out your own complete suite with conference room, offices, and kitchen. Want to add offices? Not a problem — you can move to a new location for only a nominal charge. The downside? You'll pay an often hefty premium for this type of space. However in our experience, the premium is quite often worth the flexibility you'll need during the first critical years of your new operation.

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Staffing Options: Expats and Local Hires

The Most Important Asset in Your New Overseas Operation: People

Like most companies at this stage in the international expansion process, you're likely debating whether to send existing home-country staff to launch the office (with the understanding that you may add local talent as needed later), or start fresh with an office staffed by locals.

You've probably heard how expensive expat assignments can be — commonly two to five times more expensive than hiring local talent, even in high labor cost countries — so you may be leaning towards hiring local-national employees. But you may also be thinking about the risks of hiring "complete strangers" to run your new, mission-critical operation. Hiring local employees involves hiring people you and your management team don't know, employees who will be new to your business culture and operations, who could be thousands of miles away and likely in a time zone that makes real-time communication difficult. And all the while, all of this is new to you, and to your colleagues at HQ.

This situation might look like it comes down to a choice between saving money and reducing risk, but it's not quite that simple. Short-term cost savings in staff outlays may not always yield a positive return on investment. In some circumstances, costly expats with defined skills may give you the better business return in the long run. And risk is a two-way street. As we'll see, there may be as much risk in sending someone known to a new country as in hiring a new local employee.

In this chapter we'll walk through the pros and cons of hiring expats versus hiring locals. And we'll help you decide which option, or hybrid, is right for you.

> The rule of thumb for the all-in cost of an expat assignment is generally between two to three times the expat's home-country salary.

Send in the Expats?

Let's begin with when and why you send expats to run your new overseas operation. When the local operation must conform as precisely as possible with standards or processes in your home market, then starting with expats may make the most sense. This is often the case with manufacturing operations, where an expat plant manager sets up operations and hires a mostly local staff.

If you're planning a sales operation in a country that shares your language — say you're a Canadian firm going into Ireland — then starting with an expat sales director who is a proven performer might be a good idea. The expat will know your products and how to sell them, and will be particularly valuable when hiring and training locals.

If you're planning to establish a larger office right out of the gate — say one with twenty or more employees — then an expat functioning as the local GM might also make sense. He or she will be able to set up and maintain operations that mirror those in your domestic offices.

You may also find that your target country has a limited local talent pool for your particular industry, which can make finding qualified staff difficult or prohibitively expensive.

For example, finding qualified workers in the mining, oil, and gas industries is increasingly difficult, as those industries are becoming more reliant on computerized extraction technologies. And bear in mind that fluency in the language used at HQ is simply another vital skill set, which may or may not be easy to find locally.

Now for the cons of hiring expats. First, as we've noted, they are expensive. With additional costs — such as those related to travel, visas, home- and host-country tax differentials, and relocation allowances — you can expect to pay two to five times more than you would when hiring a local national. Put another way, the rule of thumb for

the all-in cost of an expat assignment is generally between two to three times the expat's home-country salary. In addition, sending expats involves all of the obvious productivity challenges that will arise when any individual is entering a foreign country, such as confronting a new language and unfamiliar culture while entering a situation with no social connections. And unless they've spent significant time in your target country, expats just won't know the market as well. This lack of familiarity can pose problems, especially for expats tasked with sales and marketing objectives. Also, while short-term expat leadership may make sense, long-term expat leadership can send negative signals to local staff. They may feel that they're not trusted, or that they will be blocked from being able to rise to the top.

There are personal issues for expats as well. They must adjust to a new country and to being away from family and friends. In cases where an expat brings a spouse and/or children on assignment, the entire family must also adjust to the new culture. There will be attendant obstacles and costs associated with such areas as finding adequate, safe housing and schools, and/or employment for the spouse. These family factors can also be a drag on the expat's productivity, and represent the reason most often cited when there is a request for early repatriation.

Burnout can be a problem, too. Expats located far from home and performing demanding jobs have a very high burnout rate, and as many as 25% are called home early because they've taken on too much and can't handle the stress. And there's the flip side. Some young expats go abroad to build their careers and find they don't want to return to the same old job! Between 20% and 25% of repatriated employees resign within 12 months of returning home, most often for this reason.

Sending expats also poses risks, both for them and your company. For example, if an expat fails to comply with immigration requirements, including visa and work permit obligations,

your company may be fined and/or barred from operating in-country. The expats themselves may also be fined, or, in rare situations, even face imprisonment. (For example, a foreign worker in Thailand who continues to work in-country beyond his or her work permit's expiration date may face imprisonment of up to three months.) An EY study on global mobility noted that 64% of companies surveyed incurred avoidable penalties for non-compliance when sending expats.

When making a decision to send expats to run or help run your new operation, you should consider these related best practices:

- Focus on finding the right employees — those with superior management skills, job expertise, and company knowledge, who work well with limited resources and have the sensitivity to learn and adapt quickly to a new culture.
- Develop realistic, fully-loaded cost estimates that include position- and country-appropriate compensation, benefits, and tax obligations.
- Plan for a complete package of relocation assistance, including moving, housing, and travel, if needed. Structure these packages in the most tax-efficient way for both host and home countries, and make sure you're set up to comply with local tax payment policies.
- Consider the income tax and social security impact on the employee and family — what are the tax consequences (in the home and host country) of taking the assignment overseas, and is the family better or worse off in net terms? The answer to this question will affect the compensation package the expatriate can expect to receive.
- Consider family support programs that help spouses and children find employment, schools, and activities.
- Craft a detailed assignment letter that spells out everything.
- Offer cross-cultural language and technical training that will help expat staff integrate with any local coworkers, and into the local business community.
- Identify who at HQ will manage all the highly complex details that will arise relative to supporting this assignment, and determine how they themselves will be properly supported to manage all of this successfully.

Hire Local Talent?

There are many good reasons to staff an overseas office with local nationals. If you're planning to stay in the target country for many years and grow the office over time, finding a strong local team and letting them build it "the right way" for the market you are in will help you avoid problems associated with management transition and an "us versus them" rivalry that can often arise if you start with an expat leadership team.

In the vast majority of countries, locals are cheaper than expats. Even in high labor cost countries, relocation, allowances, taxes, and travel will double or triple the cost of using expats. In lower cost countries, locals can run you as little as 20% of a fully-loaded expatriate employee.

And with locals, there should be fewer adjustment issues compared with expats. If the details are properly addressed (strong training and orientation programs, visits from HQ to the field, time spent back at HQ, use of videoconferencing technology, etc.), onboarding a new employee or GM should take no more than a few months. For an expat, adapting to a new country, language, and culture may take a year or more.

The most important reason to go with locals is that they're local — they speak the language, they understand host-country business customs, and if you've hired well, they come with strong local networks and personal connections. They're attuned to the local nuances; they know which

restaurants or gifts send the right signals to a prospect, and which don't. They know where to advertise, and which events to attend. They understand local technology and are better at customizing products to meet local needs. They're also street-savvy, and if you're opening a sales and marketing or product development operation, you'll need that if you hope to break in quickly.

Hiring locals is also typically less time-consuming than hiring expats. For one thing, there will be no visas or work permits to apply for. And locals are likely to remain in-market, so you won't have to move them. They will have to learn about your company and products, but once briefed they can hit the ground — their ground — running.

Hiring local leadership sends very powerful signals. When you have locals running your office, selling your products and services, and designing your products, you're sending a message that you're part of the local business community and that you're here to stay.

Many companies start with expats, or expat leadership, but most evolve to operations dominated by local national employees. A survey by PwC reported 70% of US companies with overseas operations planned to hire locals, while only 19% planned to use expats.

> The most important reason to go with locals is that they're local — they speak the language, they understand host-country business customs, and if you've hired well, they come with strong local networks and personal connections. When you have locals running your office, selling your products and services, and designing your products, you're sending a message that you're part of the local business community, and that you're here to stay.

One often overlooked item to consider when hiring local nationals relates to flexibility. If, for whatever reasons (e.g., you're starting small and aren't sure about the potential of your new market), you know from the outset that you may shut down operations in the target country, then hiring locals can be a liability. In some markets — such as France, which has notoriously strict worker-protection laws, and China, where liquidating a WFOE legal entity generally takes eight to twelve months — the time and cost involved in letting staff go, or shutting down operations, may be greater than the time and cost of hiring staff and opening the office.

Is Hybrid Option a Better Fit?

When establishing an overseas operation, you're rarely limited to choosing between all expats or all locals. Most companies end up with a blend. And there are other staffing options that can supplement these alternatives. Here is a list of some of these options.

- **Expats on short-term project assignments.** Expats on short-term assignments will still require visas and work permits, but this option gives you flexibility to bring in specialist talent as needed, with less chance for personal or corporate disruption. Check tax laws in your new country. The "183 day rule" (i.e., if an expat is in-country less than 183 days over either a 12-month, calendar, or fiscal year, then local income taxes may not apply) often obtains, but this must always be verified, as different countries have different rules, and may or may not have appropriate double tax treaties. An expat may trigger local income and social taxes for stays that are much shorter than six months, depending on the country.
- **Global teams.** Your new office may not need as much on-the-ground staff as you think. HR, tech support, and even some marketing may be handled by team members from your domestic offices, warranting only occasional travel.

- **Reverse expat.** Local talent may be sent on short-term assignments to your home country for training and to assist with company-wide special projects. They'll pick up valuable connections and knowledge they can bring back, which can offset the temporary loss of productivity while out of country.
- **Third-country nationals (TCNs or, occasionally, "internationals").** In countries with very tight labor markets, where the right local talent may be hard to find, an alternative may be to hire a national from a nearby country (that is, from a country that is neither your home country nor the target country), or someone from the permanent international community. Hong Kong and Shanghai both have sizeable pools of resident international talent that know local customs, may speak both Mandarin and English, and will cost you much less than sending someone from your domestic staff. (Due diligence must be conducted in these cases related to "right to work.")

It may be that the circumstances of your international expansion pretty clearly dictate which staffing choice — hiring expats, locals, a mix of the two, or some other option — is right for you, even early on in the due diligence process. Still, it should be clear that the decision will necessarily be based on a set of unique, often complex, constantly evolving factors. These factors include, but are not limited to, your industry; company size; budget; and the market, labor force, and laws of the target country. As with all areas of international expansion, make your decision carefully. Base it on research and the advice of outside experts. But be flexible enough to change course if external factors — such as evolving local markets and laws — warrant it.

Common Pitfalls

The old adage, "The devil is in the details," can be painfully true when it comes to international expansion.

Flawlessly handling strategic business decisions — like your choice of country, entity type, location, and staff — is not a guarantee your new operation will launch without a hitch. What may seem like relatively small issues can prove surprisingly problematic down the line, if not taken care of correctly at the outset. For example, the wording of employment agreements and job titles, where you sign contracts, the number of local and foreign board members you recruit, and how you account for sales expenses may all have significant ramifications for your business.

This chapter includes some examples of how seemingly small errors can lead to big problems, and suggests ways you can avoid these pitfalls.

Employment

Hiring temporary contract workers in the US can be an excellent, and in many cases perfectly compliant, approach. However it can be fraught with problems in other jurisdictions, where employment laws more heavily favor the worker over the employer. Take the example experienced by a large US university. Program administrators there thought it would be easier and cheaper to hire a number of local national employees on an independent contractor basis to handle a study abroad program for them in an EU country.

Unfortunately, the program administrators didn't consider the employment regulations of that particular country, which carefully define the nature of employment versus independent contractor relationships. When, after years of service under independent contractor agreements, the host-country workers came forward to claim they were de facto employees under local law and therefore entitled to retroactive benefits, the university refused. The workers sued, and the university was ultimately forced to pay a settlement of more than $500,000 in back taxes and damages for improper worker classification.

Something as seemingly innocuous as where an employment contract is signed can come back to haunt you as well. Take the example of one US company that had been doing work for many years in Switzerland. To meet a short-term need in that country, they brought in a number of UK contract workers. Logically, this wouldn't seem to be a problem, as the company had a registered Swiss subsidiary and followed all Swiss employment laws scrupulously. But the company made one mistake: it had the UK contract workers sign their work agreements in the UK. This effectively meant that the US firm was operating a UK branch, thereby exposing the company to a more than $30 million VAT liability. The company itself discovered the mistake, and approached the UK HMRC about the situation. The company eventually negotiated a favorable settlement. But had it not discovered the error and approached the authorities in good faith, the financial consequences could have been severe.

Terminations

Not all new overseas operations grow. Many firms try out a country, and if sales don't meet targets they downsize their operations. But downsizing can be tricky outside the US, where at-will employment is virtually unheard of. It's essential that you follow the terms of the employment agreement exactly when terminating an employee, and also that you follow related local labor laws governing this area. Noncompliance with termination laws can be very expensive in many countries. We had a client that tried to quickly downsize their operations in China, and found that moving fast had its price. By cutting corners on their employment agreements, and not having the agreements correctly in place from the outset, they faced a fine under Chinese employment law of twice the employees' salaries for every month the company was out of compliance. Ultimately, those fines ran upwards of $300,000.

And doing something to help terminated employees may also have negative ramifications. For example, letting an employee out of a

non-compete agreement may backfire. Take one German employer that wanted to allow certain employees out of their non-compete agreements prior to termination. By not reading the law carefully, the employer failed to understand that waiving a non-compete agreement in Germany requires 12-months' notice. In addition, the employer was unaware that, in Germany, a non-compete entitles an employee to a payment equivalent of 50% of his or her salary for the duration of the non-compete.

Firing someone for cause? Read the fine print carefully. A firm operating in France let an employee go who had made fraudulent expense claims. It appeared to be a watertight case for termination. But the firm missed an obscure clause in French employment law that demands an employer take action within two months of being made aware of a triggering event that may lead to termination. The employer waited a bit longer than two months to let the employee go, and ended up with a claim for $180,000 in damages.

> When repeat visits exceed the maximum allowable stays in a given timeframe (e.g., in a rolling twelve-month period), employees can be denied entry and put on the next flight home.

Immigration

Most businesses know that sending expats overseas can be a complicated and expensive process, including complying with both

home- and host-country tax and immigration laws. What may be less well-known is that bringing expats back to the home country may trigger obligations for the employer and/or the expat. In Singapore, arguably one of the world's most business-friendly countries, employers must file a Form IR21 at least one month prior to an expat employee leaving the country (either for good or for an extended leave). The employer must withhold all wages from the time of filing until the expat employee leaves Singapore, to cover all outstanding taxes. Employers who fail to submit the Form IR21 are subject to fines of up to $1,000. And if the withholding isn't enough, the employee must pay the difference before departure. And yes, we have had clients that have been fined for failure to submit an IR21, and clients whose expat employees have been temporarily barred from leaving the country.

Sending employees to work for multiple short stays in another country can also be a problem. For example, when repeat visits exceed the maximum allowable stays in a given timeframe (e.g., in a rolling twelve-month period), employees can be denied entry and put on the next flight home. It happens more often than you might think.

Getting employees into a new country even once may also prove problematic. We had a US client that thought moving an employee to Canada would be as simple as hiring a moving company to pack up and move her from the US. But because the requisite immigration forms had not been filed with the Canadian government, the employee's entire household belongings were impounded at the border.

Governance

Some countries have very particular laws surrounding the details of governance. India in particular has specific rules regarding the use of local directors and board meeting quorums. Noncompliance can be more than a headache — it can bring your operations to a standstill.

One US firm, for example, thought it would be simple to set up an Indian subsidiary. The company created a three-person board of directors, with one director from their home-country management team and two from their local India staff. The US company assumed it could keep control of the subsidiary by granting each local India national employee director one share, with the remaining 99% of the shares to be owned by the parent company. This model worked until a downturn in business led the parent company to plan a shutdown of the Indian subsidiary. The India national employee directors, not wanting to lose their jobs, blocked the move. With two out of three director seats, the Indian employee directors were able to deny the company a quorum by refusing to attend board meetings. (Indian law demands at least two directors be present at each board meeting). The two employee directors had the company over the proverbial barrel, and the company paid dearly for it.

Or take the case of another US firm that tried to merge its Indian subsidiary with a local firm. The firm was ready to seal the deal when it found their subsidiary's board meetings had been out of compliance with local law. What might have proven trivial offenses in the US — a few days' delay in meeting times, a missed quarterly meeting, a meeting held by telephone, etc. — triggered a host of Indian noncompliance "compounding" actions that delayed the merger by almost eight months and cost tens of thousands of dollars in legal fees.

Accounting

Companies expanding into overseas markets must remember that engaging in sound accounting practices is essential. Improper accounting practices related to foreign offices may lead not only to problems in the host country, but to the need for a financial restatement in the US.

A Center for Audit Quality report entitled "Financial Restatement Trends in the United States: 2003-2012" indicates that "issues involving accounting for subsidiaries and atypical events, such as acquisitions or reorganizations, were identified in 24% of all restatements." The report goes on to say that subsidiary accounting issues are "most frequent," and that "more than a third of the subsidiaries are foreign."

One US-based company had just such an accounting problem resulting from its overseas activities. Unbeknownst to the company, its global business travelers had created corporate and individual permanent establishments in multiple countries during a particular tax year. This created multiple retroactive tax obligations in many countries — including not only corporate filings but payment of taxes related to expenses that the company had previously assumed were not taxable under host-country laws. This in turn led to quarterly revisions and, ultimately, to financial restatements both at home and abroad.

The ramifications for the company were truly staggering. In order to complete the US restatement, the company hired a Big Four accounting firm, costing them $2 million. In addition, in order to provide support for the Big Four firm in its efforts, the company had to divert hundreds of hours of internal accounting staff time. The company also had to draft a 90-page letter of explanation to the US Securities and Exchange Commission, and that letter had to be reviewed by two pricey law firms. To top it off, the company needed to tap twenty-five staffers to do restatements in three separate EU countries. The message is clear: If you're operating overseas, make sure you know and fulfill your tax obligations in each country of operation so that your financial statements will be accurate.

Sales

If your new overseas operation involves sales, you'll need to be very careful how you get business. In many developing countries, bribes historically were not an unheard of way to persuade prospective customers and government officials to consider doing business with you. The bribes may not necessarily involve cash-filled suitcases, but could entail generous entertainment perks, trips, employment contracts, or promotional allowances. The days of brushing these kinds of practices under the rug are long gone.

The US especially is on the lookout for companies whose behavior runs counter to the Foreign Corrupt Practices Act (FCPA). Some of the world's biggest global firms have been slapped with hefty penalties for using bribes to get business, such as Avon ($135 million), Alcoa ($384 million), and HP ($108 million).

And it's not just the big players that face penalties. The following midsized firms in the medical technology field have been fined for improper payments to doctors and government officials to secure contracts: Bruker Corporation ($2.4 million), Stryker Corporation ($13.2 million), and Biomet ($22 million).

Abiding by your home country's anti-corruption laws may not be enough. If you have subsidiaries in other countries, your parent firm may be expected to follow their regulations as well. Some of these laws can be even stricter than their US counterparts. The UK Bribery Act, for example, bans some facilitation payments and promotional expenses that are allowed under the FCPA.

An Ounce of Prevention

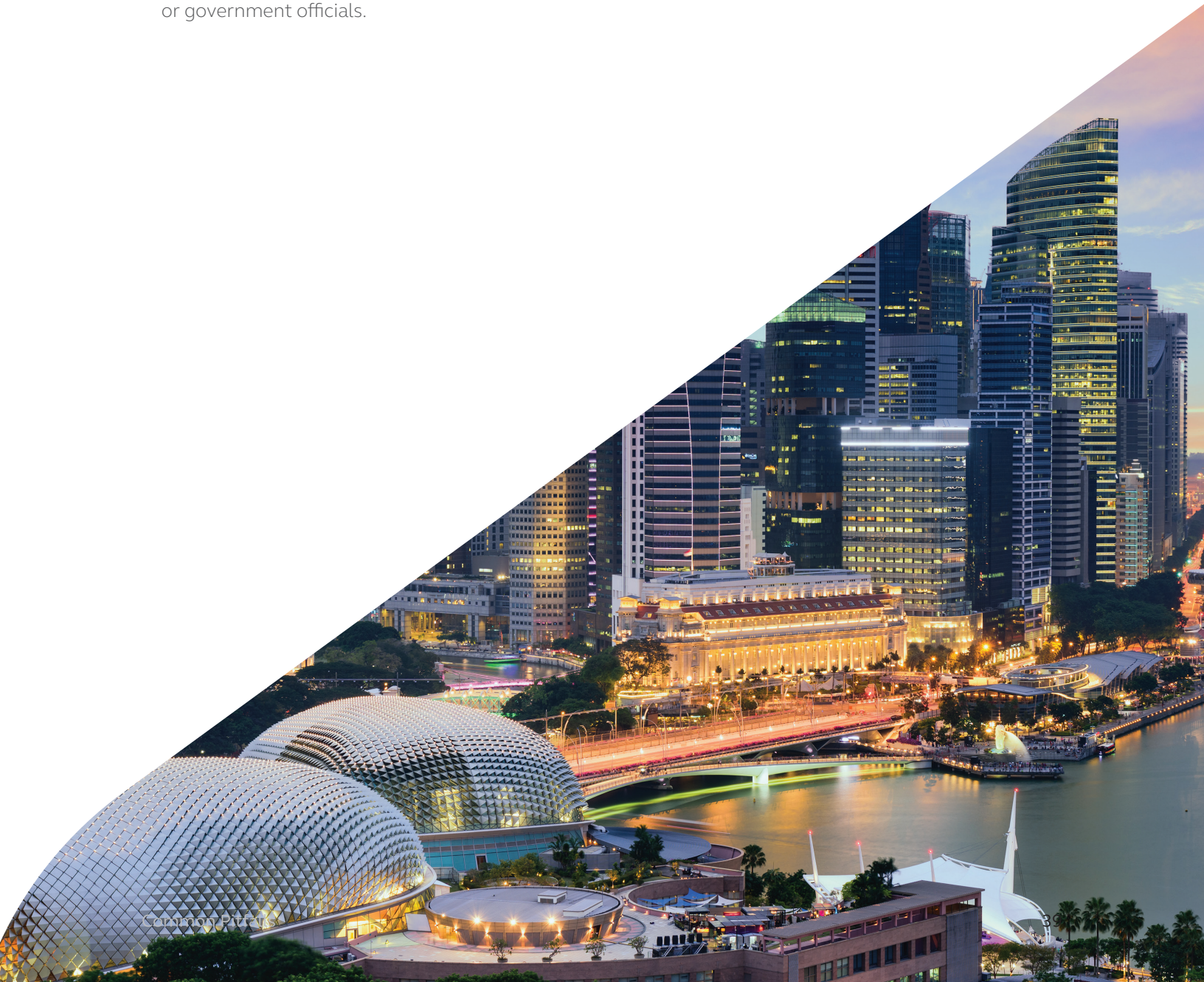
A list of international expansion "surprise" stories could go on for pages, though fines and penalties can be avoided with proper research and planning. And when expanding into a new market, there are five areas you should be especially mindful of. The extra time and cost it takes to tend to these areas will prevent costly, time-consuming mitigation down the line.

- Timeframes related to employees — such as contract terms and lengths; termination notice;

length of stay in-country and number of annual visits.

- Job titles — any title that includes "sales" or "marketing" is a red flag for local authorities, who are always keen to find new taxable income.
- Composition of boards of directors — we recommend at least two non-local (i.e., from the home country) directors to avoid problems associated with local control.
- Board meetings — make sure you're complying with local quorum regulations, along with requirements related to the number of meetings and meeting location.
- Sales, travel, and promotional expenses — be sure that everything claimed is legitimate, and not an attempt to legitimize bribes to prospects or government officials.

Keep in mind that while the above anecdotes speak to some of the harsh consequences that may befall companies that operate internationally, these "horror stories" shouldn't dissuade you and your company from pursuing the opportunities that come with global expansion. We know better than anyone that, for almost any business these days, expanding globally isn't an option but a necessity, not only to generate revenue but to make the business more appealing to investors. The anecdotes in this chapter are meant to be cautionary tales, and (yes) interesting to readers. And there's no reason you have to experience the kinds of pitfalls we've described. With proper planning and due diligence, expanding into new markets can present your company with enormous opportunities.



Developing Systems and Processes

Once Launched, Your New Operation Will Face a World of Change.

Your competition, the economy, and host-country laws governing taxes, HR, data protection, immigration, and more will not remain constant. If you want your operation to grow and become a model for future expansion into other countries, you'll need to minimize the risks that come with change.

The best way to do that is to set up comprehensive systems and processes that will help you monitor all the critical aspects of your new operation, and facilitate your organization's ability to adapt quickly to changing conditions and regulations on the ground. Odds are that if you've stepped outside your home country once, you will be or are already stepping into other locations as well. Accordingly, you'll need to look beyond just your new operation, and put systems and processes in place that will help you keep track of all global activities — even including short-term expat assignments — conducted in other countries, to ensure you don't unknowingly trigger permanent establishment, employer, and other obligations in those places. Finally, you'll want to ensure that any newly proposed international operations are properly vetted before formally approving them.

In this chapter, we'll share best practices related to:

- Setting up an international operations oversight team;
- Establishing policies to guide expansion;
- Establishing a central data repository to house critical information, such as contracts and financial reports; and
- Implementing systems to monitor risk-prone aspects of global operations.

International Expansion Team

If you've set up a team to plan and implement your first expansion — and even if you haven't — you should make such a team a permanent part of your business operations. An ongoing international expansion team can oversee your first operation, and provide the experience and knowledge needed to expand into other countries faster and with less risk. This team should consist of representatives from finance, HR, legal, tax, and, if applicable to your operations, risk management. Your legal team may require outside specialists with experience in potential expansion locations, in order to thoroughly vet any newly proposed international operations.

When you consider new expansion opportunities, your international team will be able to develop plans with a good understanding of what needs to be done in order to be compliant with target-country laws, the processes to follow, and the time it will take to fully establish operations.

An ongoing international team will be well prepared to review your legal entity options — including their respective costs, limitations, and risks — so you can make the right choice about whether to register a branch, subsidiary, or other entity type. In addition, the team will know it must consider specific target-country tax obligations — including corporate taxes, individual income and social taxes, and indirect taxes such as VAT — as well as local employer obligations and customs, including those related to employee benefits, contracts, and terminations.

A knowledgeable, experienced international team will allow your company to thoroughly research and analyze new international proposals and make an informed decision to proceed or not.

Policies

While every new target country will present unique challenges, having company-wide policies and procedures in place will ensure consistent practices globally. Strong policies will not only help mitigate financial and reputational risks, they will make planning for, implementing, and maintaining global operations simpler and faster.

Formal policies help ensure that proposed international offices, partnerships, lease agreements, employment contracts, and other significant obligations are vetted and properly understood prior to entering into contracts, or engaging in activities that might trigger corporate or individual permanent establishment. Furthermore, sound policies and procedures that include steps for regularly monitoring host-country legislation will help ensure that you keep abreast of ongoing changes in all your countries of operation, so you can remain compliant worldwide.

We recommend establishing policies for the following key areas of operations:

- Global Mobility: A global mobility policy puts controls in place so workers are engaged legally in the host country, either as independent contractors or employees, and that their compensation packages (whether contractor payments or employee salaries and benefits) are consistent with host-country norms.

(Note: The next two points are often included in a company's global mobility policy.)

- Immigration: An immigration policy addresses host-country immigration laws; for example, such a policy should reasonably ensure that expats do not work in a country illegally on a tourist visa when a business visa is required.
- Staffing: A staffing policy promotes consistent tax-equalization benefits, housing allowances, and insurance coverages for your expat employees, as well as appropriate salaries and benefits for local host-country employees.
- Banking: A global banking policy ensures that foreign bank accounts are opened and maintained in accordance with related company policies and applicable host-country laws.
- Purchasing and Leasing: Purchasing and leasing policies promote compliance with local regulations in these areas, and with any applicable international laws. (See Export Control policies, below.)
- Export Control: Export control policies ensure compliance with international anti-bribery and export control laws, such as the Foreign Corrupt Practices Act (FCPA) and any Office of Foreign Assets Control (OFAC) sanctions.
- Data Protection: Policies for data protection promote compliance with home- and host-country data security laws.

Central Data Repository

A central data repository is critical to global operations oversight. Your international expansion team must have ready access to the following:

- Partnership agreements
- Lease obligations
- Legal entity documents (e.g., subsidiary documentation from host-country governments)
- Employment contracts
- Other international agreements (such as independent contractor agreements)
- Financial reports (including statutory accounts)
- HR records
- Bank statements
- Tax returns

To turn your first international operation into a model for future expansion, you should include in the data repository all information and documents related to planning your expansion, including:

- Country and location research
- Compliance data
- Alternatives and conclusions
- Business case
- Office launch plans
- International policies

Monitoring Systems and Platform

To give your international expansion team visibility into areas of operational risk, you should set up systems to monitor your employees' global mobility and the changing regulations of all your countries of operation.

Companies with significant international activity should maintain domestic HR/ERP software that has the capability to track an employee's country location, since permanent establishment (PE) is triggered not by where payment is made (e.g., through a home-country payroll in the US), but by where work is conducted (e.g., on a

business trip to France). Ideally, the software will track an individual's time spent in multiple countries against specific host-country permanent establishment laws, so that (where material) the worker can leave a country prior to triggering a PE there.

In addition to an HR/ERP system, you will need a software platform that can house global reports, data, and documents, and provide control over and insight into all your global back-office activities. This platform should cover international accounting, payroll, and HR functions and will:

- Act as a central repository of information for all international documents (e.g., employment contracts, financial reports, and legal-entity documents), assuring your team is audit-ready.
- Provide HQ with insight into global payroll (including income tax and social payments to local authorities) and other activities in all countries of operation.
- Allow payroll, accounting, and expense reporting for all countries of operation, in one system.
- Provide alerts about changes to global tax, HR, and other laws as they occur within your specific countries of operation. (For example, if you're operating in Singapore, and Singapore authorities change transfer pricing laws to require certain documentation, as they did in January 2015, the system will notify you of this change so you can comply by the deadline.)
- Track the number of employees working in any given host country, as the overall number of workers can trigger HR and other laws. (For example, if you have over five workers in a country, you may have to provide certain benefits per host-country laws.)

> You will need a software platform that can house global reports, data, and documents, and provide control over and insight into all your global back-office activities.

Build It Yourself or Find a Partner?

When it comes to setting up an international monitoring and operational system, you have three options: 1) build it yourself; 2) work with local providers to handle each country, and integrate them yourself; 3) use an established international expansion provider that can meet all your needs in all your countries of operation. Let's look at the pros and cons of each.

- **Build it yourself.** Large companies with extensive internal IT and compliance resources sometimes go this route. In most cases, they still need to rely on outside experts to keep them abreast of legal and regulatory changes. This option will still require engaging local law firms to establish legal entities, and hiring locally compliant payroll providers. Other aspects may also require the use of in-country resources per local law, such as accounting services, setting up a bank account, and the use of a local corporate secretary. Pros: Save money by using internal resources; control of integration with existing systems. Cons: A drain on internal resources; need to source and manage external resources in each country; must integrate internal and external resources.
- **Use individual in-country resources.** Some organizations choose this route because they plan to operate in only one or a very small number of countries. Pros: External resource(s) handle most of the work. Cons: Must find and manage a reliable resource in each country, perhaps in a different time zone and in a different language; must integrate external systems and data with internal systems and data; systems may vary by country, with no common view into operations, data, and changes across countries.
- **Use a single international expansion provider.** This can be the best option for organizations that want a turnkey approach that doesn't unduly burden their own internal resources. Pros: Single-provider system does everything;

no need to find and manage multiple resources and keep track of changing international laws; relies on proven experts; provides visibility into all countries at the same time. Cons: Must find a reliable provider that can handle all your countries of operation.

When in Doubt, Consult an Expert

When choosing one of the first two options outlined above — either going it alone as much as possible or using a complicated network of in-country resources — keep in mind that you'll almost certainly have to hire experts, from outside law firms to local payroll providers. And those experts and providers should be thoroughly vetted to ensure you're receiving timely, authoritative advice and locally compliant services. There's no way around it: You'll have to spend a lot of time and effort if you choose one of these routes and still want to remain compliant in your target countries.

On other hand, if you choose the one-stop-shop option of using an established international expansion expert, you will want one that offers a software platform that provides insight, reporting, and control over multiple countries of operation. To keep your international team current, that software should provide updates on the changing laws and regulations of each country you work in. Ideally, the provider can also offer you a complete suite of services to aid in your international expansion, including establishment services (such as setting up bank accounts and legal entities);

recurring services (such as running local payrolls, bookkeeping, and completing corporate tax and statutory filings); as well as consulting advice as needed.

If you've read this far, you're probably well on your way to making responsible decisions about global expansion. It's a subject that we at Vistra are passionate about. For one thing, there's an almost endless amount to learn. Not only are there myriad subject areas — from HR to tax to immigration and much else besides — but those areas and related laws and practices are changing every day. Keeping up with the changes is challenging, but for us it's also deeply rewarding. We like knowing that maintaining our technical edge helps our clients grow and succeed.

All of that said, we recognize that most businesses regard things like maintaining tax compliance in foreign jurisdictions as necessary evils. They want to get on with what they're passionate about — namely, their own businesses. And all the responsibilities of international expansion that we've described in these pages can be overwhelming.

Keep in mind that you're not alone. Not only can we provide services, software, and advice, but there are countless resources like this eBook that are designed to guide you through the process of international expansion. The key to success — which in this case is mitigating your organization's financial and reputational risks when you expand — is knowing the right questions to ask, where to go to get the correct answers, and setting up a companywide infrastructure to support your international operations and ensure they're compliant and cost-effective.

About Vistra

Ranked among the top three corporate service providers globally, Vistra is a versatile group of professionals, providing a uniquely broad range of services and solutions. Our capabilities span across international incorporations to trust, fiduciary, private client services, and fund administration. We employ over 4,000 professionals across 46 jurisdictions throughout the Americas, Europe, Middle East, and Asia Pacific.

As a leading global player with expert industry knowledge and location specialists, Vistra has a deep understanding of the professional worlds of our clients, and a proven track record of offering highly versatile solutions, providing the people, processes, and products that help our clients get the most from their international business.

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