Expectation vs. reality: Expanding your business abroad

International expansion is a highly prized goal for many businesses. Whether it's to access vast new consumer markets or significantly cheaper manufacturing, companies that want to keep growing must ultimately think globally.

Richard Neal, director of Sovereign Trust South Africa

According to Richard Neal, director of Sovereign Trust South Africa, “There are, however, a number of errors that are commonly committed by business owners and decision-makers when seeking to enter foreign markets. And they should all be addressed before setting up a company.

The following outlines five common mistakes that businesses seeking to take advantage of international markets often make:

1. Expecting the foreign market to be the same as the domestic market

Businesses often assume that success in their home country can easily be replicated abroad.

"Any business that is looking to expand overseas would be expected to undertake a thorough study of market and trade conditions, trends, competition and costs, but cultural differences should also be considered. In this context, businesses need to examine variances such as:

- Quality standards/controls in manufacturing and processing;
- Attitudes to work and commitment to business objectives, including average working hours, working conditions and meeting time frames;
- Employee/employer relations;
- Approach to occupational health and safety standards;
- Communication and language issues;
- Business etiquette; and
- Prevalence of corrupt practices.

2. Failure to understand the legal/regulatory environment

How does the legal system work both in principle (common law or civil law systems) and in practice (delays, appeal processes, alternative dispute resolution (ADR) options and expense)? Is there adequate legal recourse to protect commercial activities?

"Attention to regulatory detail is essential. Often companies will set up a company, whether onshore or offshore, in a foreign country and then realise that regulations prevent them from conducting their business in that country in the manner intended. In China, for example, you have to stipulate the precise type of business that you intend to conduct upon establishing the entity," says Neal.

"Any error or omission could lead to the company being prevented from trading."

Similar rules apply in the UAE. It's also important to note the time that it takes to set up a company and to start the process well in advance of when you intend to commence operations.

3. Failure to obtain adequate tax advice

"At Sovereign Trust, we believe that obtaining comprehensive tax advice prior to setting up a company, whether onshore or offshore, in a foreign market should be an essential part of any business strategy," says Neal.

Once a structure is established, it can be difficult and expensive to alter. A common mistake is to focus on the tax payable in the new country while not fully understanding the tax implications it could have in the home country.

Controlled Foreign Company (CFC) rules, for example, could result in a shareholder paying personal income tax on the undistributed profits of a foreign company. The OECD has proposed to strengthen CFC regimes around the world as part of a broader initiative to combat base erosion and profit shifting (BEPS). Some countries, notably the UK and Australia, have already begun to legislate against BEPS.

4. Beware of joint ventures

It can be a very appealing proposition to enter a joint venture(JV) with a local company in order to leverage local knowledge and market exposure.

"However, it is very dangerous to assume that the law in the JV partner's country requires them to honour the contracts and agreements that you enter," adds Neal.

Legal advice in both jurisdictions is crucial to ensure that the JV partner won't simply take your money or "borrow" your ideas. It does happen.

Some JVs could also carry a "political risk". In Zimbabwe, for example, many foreign-owned investments have been taken over by state-driven indigenisation programmes. Broader political risks such as civil unrest, unstable national governments and environmental opposition may also need to be considered.

5. Trying to do it all yourself

Companies expanding overseas will have to comply with rules in respect of tax, employment, administration or immigration (to name but a few) that may differ substantially from those prevailing in their home country. It is extremely difficult, both for small and large business, to comply with all these new rules using internal resources.

It is crucial to have recourse to professional advice and assistance in meeting the many challenges presented by overseas expansion. An outsourcing strategy liberates the business and allows it to focus solely on its commercial objectives.