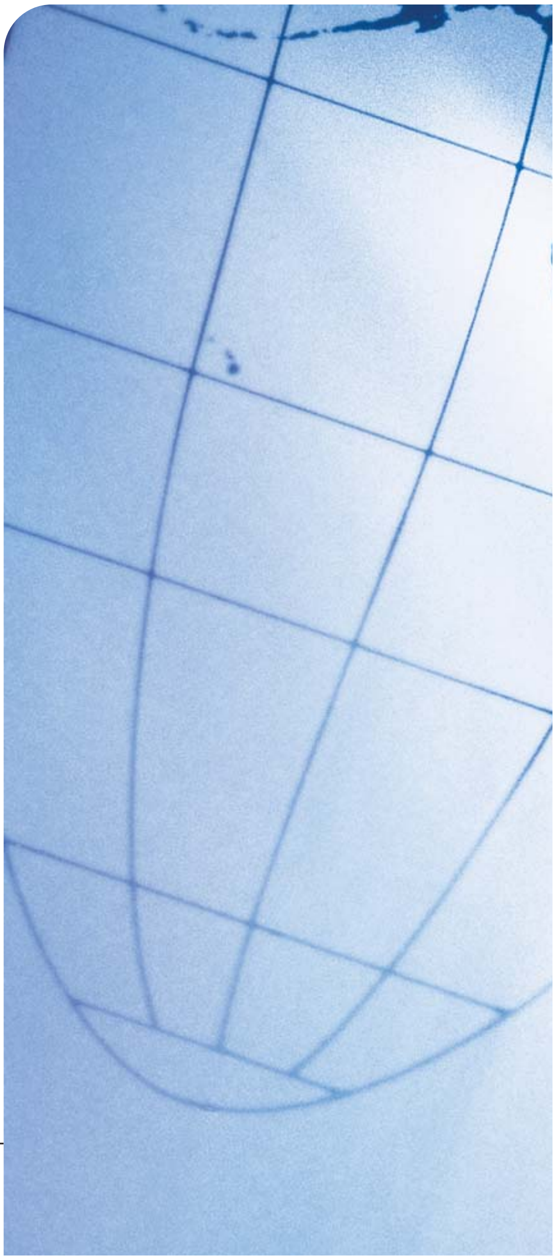
How to Do Business Abroad

A rising number of small and midsize companies go international.

by Sabine Vollmer

Infragistics is a 21st-century pioneer. The midsize New Jersey software developer has built its business by expanding into emerging markets—wherever it could find sales potential and outstanding software development talent. "If there's a strategic business opportunity, if it's kosher, we'll go there," said Chris Rogers, CPA, CFO of Infragistics, which was founded in 1989 and today has about 350 employees on five continents.



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In the not-too-distant past, being a multinational company was synonymous with being a large company. Corporate giants such as Wal-Mart Stores, United Parcel Service, General Electric, and International Paper—multinationals that have tens of thousands of employees; billions in annual revenue; and generations' worth of experience in selling, setting up offices, and establishing production operations overseas—have loomed large among the U.S. companies that own equity in a foreign enterprise.

What has changed, though, is that more small and midsize companies such as Infragistics are venturing abroad in search of talent and leading-edge technology at a lower cost than in advanced economies in North America or Europe and establishing a foothold in markets with developing middle classes.

What they're encountering in Asia, Latin America, the Middle East, and Africa are unfamiliar customs and laws, which, if not handled carefully, can pose significant risks.

"As soon as you move products or services across borders, the game really changes," said Sean Lager, CPA, a partner at Atlanta accounting firm Frazier & Deeter who advises companies interested in getting an international foothold.

Infragistics knows this well. The company started establishing its international footprint about a decade ago. At the time, the company was struggling financially.

Before the Sept. 11, 2001, terrorist attacks, most of Infragistics's cash went into building new technology. When the U.S. economy slowed and the company's business dropped abruptly following 9/11, Infragistics's financial situation deteriorated, leading to a weak balance sheet, Rogers said.

To get back on track, the company restructured and looked abroad.

"International operations have given us access to foreign labor markets at reduced cost while also allowing us to build in zone support for our global customer base," Rogers said.

In December 2011, Infragistics bought a startup with a dozen software developers in Uruguay, an acquisition that helped the company jump-start software development for Apple products. The company also has research and development centers in Japan, Bulgaria, and the United States and sales and marketing offices in Germany, India, and Australia.

With each expansion, the company has confronted new tax laws; repatriation of cash; intellectual property (IP) theft; currency fluctuations; and labor law and regulatory issues.

Among the myriad issues that need to be navigated, three—taxes, fraud, and talent—have come up repeatedly in emerging markets, according to CPAs who work for multinationals and consultants who advise companies doing business internationally. Rogers and several others offered tips and lessons learned on each of the three issues from doing business in emerging markets.

The Talent Search

Finding top accounting, financial, and IT talent in emerging markets can be more difficult than in the United States, said Steve Saah, director of permanent placement services in professional staffing firm Robert Half's Washington office.

The World Economic Forum reported that worldwide an estimated 10 million jobs in manufacturing cannot be filled because of a growing skills gap. The shortage was most acute in Asia Pacific countries last year, according to a Deloitte global poll of more than 350 senior executives at companies with at least $500 million in sales.

U.S. companies doing business overseas for the first time also frequently struggle with the labor laws, business etiquette, and culture they encounter in the new markets, said Tony Cherbak, COO of Resources Global Professionals, Irvine, Calif.-based professional services consultants that help clients recruit employees overseas.

For example, a U.S. company that is used to benefit costs that add 25% to 30% to an employee's pay in the United States

will find that benefit costs double an employee's pay in Brazil, Cherbak said. And firing a Brazilian employee is much more difficult and expensive than letting a U.S. employee go.

Developing a game plan and visiting the country are critical steps to avoid recruitment regrets. When looking into starting operations in Uruguay, Infragistics learned about the intricacies of the country's labor laws.

"It doesn't take long for the lower-cost employee in Uruguay to not be a lower-cost solution," Rogers said. His solution? Hire them as consultants.

"If [the consultant] is a degreed professional, you hire them as a single-member consulting company, and they bill you with VAT that is reclaimed against the government," Rogers said.

Figure out which functions need to be in the emerging market. First, the CFO and his or her team should assess the size of the accounting and finance infrastructure that is needed in the new market and how the overseas functions should report to the U.S. parent company. The talent pool in the country the company plans to expand into and the industry the company is in will influence this assessment.

Also, renting a large office for lots of employees in a particular location can be costlier than expected, Cherbak said. Office space in Brazil, China, and India is not necessarily cheap. "Mumbai is just as expensive as New York City," he said.

Identify skilled local talent. A company should explore all sourcing options and figure out what is most cost-effective—whether that is hiring a recruiter or a temporary staffing firm, holding an open house, or placing ads in the local newspaper, Saah said.

Peers and local vendors can be good resources to vet job candidates, he added.

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Global consulting firm Booz & Co. recommends in a talent management report that companies partner with other companies, even competitors, to custom-build talent through university partnerships; tap nontraditional talent sources, such as crowdsourcing; and embrace local norms, behaviors, mindsets, and commitments in markets abroad.

Avoiding bad hires. Taking time to get to know a candidate in an extensive interview process is a good way to avoid bad hires, Cherbak said.

The job candidate who on paper looked like a good fit for the managing director position of Resources Global Professionals's Shanghai office first had to go through interviews with the firm's employees in China and about two weeks later flew to the U.S. headquarters for a day of interviews with a handful of people in Irvine, Calif., Cherbak said. The candidate was eventually hired and has been with the firm for about two years.

Infragistics also follows a team interview process, Rogers said. "The higher up the chain you go, the more drawn out the process usually is."

FRAUD CAN BE A PITFALL

Common business practices in some countries may collide with U.S. laws, such as the Foreign Corrupt Practices Act (FCPA). Other risks include internet fraud, IP theft, imposters, and even money laundering. Recent research underscores the trend:

- More than one-third of CFOs from around the globe responding to an Ernst & Young poll in 2011 and 2012 reported that bribery and corrupt practices occur frequently in their countries. Corruption seems to be particularly widespread in Brazil, the Czech Republic, Indonesia, Mexico, and Turkey, E&Y found.
- In 2011, 26 enforcement actions were brought against companies under the FCPA, according to an analysis by U.S. law firm WilmerHale. Most involved third-party sales agents or intermediaries. High-risk markets included China, India, Thailand, South Korea, and Mexico.
- Respondents to a recent survey by the Chartered Global Management Accountant (CGMA) joint venture between the AICPA and Chartered Institute of Management Accountants (CIMA) showed regional differences

EXECUTIVE SUMMARY

- **Small and midsize companies are increasingly venturing abroad** in search of skilled talent and leading-edge technology at a lower cost than in advanced economies and a foothold in markets with a developing middle class.
- **The biggest risks of doing business in emerging markets** involve taxes, fraud, and talent recruitment.
- **Becoming familiar with the emerging market, its laws, customs, and culture** is as important as calculating the costs, revenue, and profits of a planned expansion.
- **Internal controls, independent audits, and a whistleblower hotline** are powerful fraud busters, but so is professional skepticism. U.S. companies doing business abroad must also be vigilant about common practices in emerging markets that may collide with the Foreign Corrupt Practices Act.
- **To find local talent in emerging markets,** small and midsize companies can make up for their lack of resources by tapping peers and local vendors, partnering with universities, or crowdsourcing.

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in pressures to act unethically during an economic downturn. More than half of the respondents from India, Malaysia, Pakistan, Sri Lanka, and Zambia said they felt some pressure to compromise their organizations' ethical standards. The United States and the U.K. reported the lowest pressure—18% each.

Protection of IP can be weaker in other countries than in the United States, exposing companies like Infragistics to IP theft. "What we try to do is ensure that the innovation is put to market as fast as possible with quality, so that we can generate profits from the innovation until a competitor 'develops' that feature as well," Rogers said.

Multinational giants usually have established protocols and dedicated resources to ferret out fraud, said David Stulb, global leader for Fraud Investigation & Dispute Services at Ernst & Young. But small and midsize companies tend to be at a disadvantage because they work with smaller budgets and fewer people.

Having senior management with experience in the business and cultural climates of overseas markets is an important asset for small and midsize companies, said Lager at Frazier & Deeter.

Also, a CGMA fraud risk management report recommends, for example, establishing a whistleblower hotline, training employees in procurement and finance to detect warning signs, and introducing fraud and ethics policy statements.

"The likelihood of getting burned in a market you don't know is high," said Nigel Iyer, a fraud expert and former chartered accountant in the U.K. who works with CIMA.

But detecting the early red flags of fraud can be less daunting than it looks.

Turn on your professional skepticism. Iyer recommends companies do their homework. Verify identities, addresses, and phone numbers of potential customers, suppliers, advisers, and partners. Public company registries and telephone books are online in many emerging markets.

With "a healthy cynicism, you're more likely to find red flags," he said. But "attention to details is key."

For example, Iyer said, he recently came across an Indian supplier and business partner with a nice office and a multiyear history on its website. But the actual company had been registered as a business just two months earlier, he said. All it took to find that out was a company registration check on a ministry website, Iyer said. Sometimes, a phone call is required to a regional registry to find a company's name.

An offshore account or company address in a tax haven that does not match a company's location may also be a red flag, he said.

In his investigations, Iyer has come across offshore accounts that were used to provide corporate slush funds for bribes, to pay secret salary bonuses to top managers, and to invoice and overcharge suppliers.

"Don't be fooled by the shortness of the international blacklists you may have heard about," Iyer co-wrote with another fraud expert for the Tax Justice Network. "The international community (and bodies such as the OECD [Organisation for Economic Co-operation and Development]) have understandably focused on aspects like the drugs, dictators, and terrorists but not, in our opinion, on typical frauds."

Kick the tires a little harder. Due diligence should include an analysis of multiple years of financials and robust interviews of acquisition players and peer groups, Stulb said.

Also, professional organizations, chambers of commerce, and even embassies can help find trusted local partners for U.S. companies.

Train and audit. Once a company is in an emerging market, training and regular audits are critical to keeping fraud at bay.

Stulb recommended at least one annual internal audit visit from somebody independent of the local entity. But audits can be challenging for somebody not familiar with the market, he said. "It's tough for somebody used to U.S. reviews to put him on an airplane to Indonesia."

Hotlines are also considered effective to detect fraud. A 2012 report by the Association of Certified Fraud Examiners found that fraud is most commonly detected through employee tips, and organizations that have antifraud training programs for employees, managers, and executives experience less costly losses and shorter occurrences of fraud.

Respondents from business and industry in an AICPA survey, meanwhile, said they are using general internal controls, screening of new employees, division of responsibilities, appropriate oversight, physical controls, and computer-based controls to prevent fraud.

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At Infragistics, Rogers said he relies on well-functioning internal controls and employees he hires because they are smart and capable. In some locations, he said, he has learned to be creative, to separate duties, and to make nonfinance employees responsible for some finance functions.

Plan for Taxes First

Tax issues, from bilateral tax treaties to indirect taxes, drive how a company's overseas operations should be set up, how a company's products should be priced, and how a company can manage its cash.

The list of tax issues a company needs to address is long—too long to get into all of them here. But some are on the rise internationally, according to a 2012 survey conducted by Taxand, a global organization that advises companies on tax issues. The survey of CFOs of large multinational companies in about 30 countries showed an increase in transfer-pricing disputes and rising value-added taxes (VATs). More than a dozen countries established, increased, or planned to increase VAT rates in 2012, according to data compiled by The TMF Group.

Other tax issues are fundamental:

Plan to get into and out of a new market. Planning the operational structure of an international business expansion should include the possibility that the overseas expansion generates losses, will be transferred in an intercompany restructuring, or will be sold, said Blake Vickers, CPA, CGMA, international tax manager at KBR, a Houston-based global engineering company. Tax treaties between countries make for important ingredients in exit strategies, said Vickers, who also is a member of the AICPA International Tax Technical Resource Panel.

A U.S. company planning a subsidiary in India, for example, may want to invest through a subsidiary in Singapore rather than directly into India, he said. If the subsidiary is sold or transferred in an intercompany restructuring later, the U.S. parent company should owe no capital gains taxes in India because of the current bilateral agreement between India and Singapore and Singapore's lack of a capital gains tax, Vickers said.

In Vickers's scenario, the exit strategy would determine the operational structure of the overseas subsidiary before the subsidiary even opens.

At Infragistics, Rogers said he deals with this by hiring a good local tax firm to prepare a comprehensive tax primer based on Infragistics's business setup.

Understand currency controls. Knowing how to repatriate cash generated by overseas operations is important for a company's cash management. Most emerging countries have some type of transfer-pricing regulation, said Ernesto Perez, managing director at New York-based consultants Alvarez & Marsal Taxand, and U.S. companies interested in doing business in those countries need to understand the rules and the enforcement.

Some countries also have currency controls that further strain a company's cash management. China, for example, limits dividend payments to one a year, Perez said. This can lead to cash being trapped in China and cash management timing issues.

But there are ways around the annually allowed dividend payment, he said. A U.S. company could, for example, charge its Chinese operations royalties or a fee for management services.

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Be aware of the risk of changing tax rule interpretations in emerging markets. While legislation may change tax rules in the United States and Europe, companies can generally rely on tax authorities to enforce the rules in an evenhanded manner, Vickers said.

In emerging countries—especially those with weak or unstable governments—the tax laws themselves may not change, but the interpretation and enforcement often do, Vickers said. For example, paperwork that was not required one year is, without warning, required the following year, or tax assessments may not correctly flow from taxable income, he said. In countries that are unstable or emerging, tax authorities can be arbitrary. ❖

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