Business Transactions Solutions § 283:56

Business Transactions Solutions
November 2016 Update
Alan S. Gutterman*
Part XI. Going Global: Building an International Business
E. Foreign Investment Activities
Chapter 283. Establishing Foreign Branches and Subsidiaries
V. Additional Practice Tools
A. Checklists and Questionnaires

§ 283:56. Matters to consider when forming a foreign branch or subsidiary

1. Basic Operational Issues

- Select the legal form to be used for entry into the new foreign market (e.g., wholly-owned subsidiary, agency, or distributor arrangement, etc.).
- If applicable, determine the requirements for having a local investor or agent participate.
- Identify the physical location and determine whether to purchase or lease.
- Establish logistics strategies for procurement of parts and materials and movement of finished products.
- Determine personnel requirements for foreign enterprise including functions and duties.
- Determine best strategy for procurement of services for foreign enterprise (i.e., in-house or outsourcing).
- Understand local methods of doing business including expectations of vendors and customers and potential for corruption/FCPA concerns.

2. Financial Considerations

- Determine capitalization strategy (i.e., debt, equity, or hybrid; internal and/or external sources).
- Select local bank and make appropriate arrangements including accounts and signature authority.
- Evaluate potential impact of foreign exchange controls, if any.
- Determine availability and suitability of investment incentives.
- Determine availability and suitability of Ex-Im Bank guarantees and OPIC financing.
- Determine utility of letters of credit, guarantees and stand-by letters of credit.
- Determine strategies for repatriation of profits.
- Understand local laws and regulations relating to liquidation and dissolution.

3. Legal Considerations

- Determine whether local legal system follows civil or common law.
- Identify applicable domestic and foreign laws.
- Determine any limitations on foreign ownership of companies and/or real property.
- Select competent local attorneys and advisors.
- Establish timetable and create list of steps for establishing branch or subsidiary.
- Understand types of legal entities including governance rules and standards.
- Select management structure, including citizenship and residence requirements.
- Appoint members of governing board and establish board procedures.
- Determine and satisfy local registration and capital requirements.
- Obtain necessary permits, business licenses, and product registrations.
- Enter into contracts with suppliers, transporters, agents, and lessors.
- Consider potential impact of U.S. and local laws relating to competition, corruption, boycotts, etc.

4. Intellectual Property Considerations

- Complete procedures for registration of patents, trademarks, copyrights, and trade names.
- Establish procedures for protection of unregistered intellectual property.

5. Labor and Employment Considerations

- Understand local laws and regulations pertaining to immigration (inbound and outbound).
- Consider impact of local labor laws (e.g., severance, indemnities, unions, participation in management and governing board etc.).
- Understand local laws and regulations pertaining to wage and hour rules, employment contracts, union agreements, hiring and firing, holidays and vacations, bonuses, benefits, leaves, insurances, and other employer responsibilities.

6. Trade and Customs Considerations

- Understand applicable trade and customs laws including classification and valuation of goods and customs duties.
- Understand local import and export procedures including documentation, brokers, licenses, restrictions, and incentives.
- Understand potential impact of trade agreements.
- Understand potential impact of non-tariff barriers such as labeling requirements.

7. Tax and Accounting Considerations

- Determine applicable U.S. and local tax considerations including income, capital gains, franchise, VAT, sales, social security, withholding, etc.
- Identify reporting and filing requirements and establish compliance schedules.
- Understand statutory requirements for bookkeeping and audit of financial statement.
- Appoint local auditors and determine scope of work.
- Determine applicable accounting principles.
- Determine filing and record-keeping requirements.
- Determine transfer pricing issues for products, technology, services, and financing.
- Determine requirements for deductibility of payments (e.g., central bank approval, debt/equity ratio, etc.).
- Analyze permanent establishment exposure.

Footnotes

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§ 283:57. Checklist for managing a global subsidiary governance framework

When companies begin expanding their reach by creating a network of foreign branches and subsidiaries, consideration needs to be given to management of the global subsidiary governance framework that incorporates best practices, attention to the company's overall goals and objectives and respect for local laws and customs. Important steps to be taken include the following:

- Brief members of the board of directors of the parent company on the relevant issues and secure their support for creation of a global subsidiary governance framework.
- Establish uniform policies and procedures for selection of subsidiary board members and procedures to be followed by subsidiary boards; however, provide for exceptions based on local laws and practices.
- If company already has foreign subsidiaries, conduct an audit of their procedures and collect and review relevant documentation.
- Designate a member of the company's legal team (in-house or with company's outside legal counsel) as the responsible person for monitoring activities associated with global subsidiary governance framework, including consultation with local counsel in each of the foreign countries where subsidiaries are organized.
- Develop and implement training programs and communication procedures for members of subsidiary boards and senior management of the subsidiaries.
- Schedule regular audits of subsidiary boards to review composition and effectiveness, directors' service contracts, recordkeeping procedures and compliance with legal entity requirements.
- Create and continuously update policies, statements and procedures that would be applicable across the entire governance framework (i.e., parent and all foreign branches and subsidiaries) on topics such as corruption, ethics, health and safety, human rights, whistleblowing etc.) and make sure they are readily available.
- Regularly conduct training sessions with board members and managers of subsidiaries on the topics of the policies, statements and procedures referred to above.
- Draft and disseminate a handbook or manual that includes guidelines to be followed across the global subsidiary governance framework with respect to issues such as duties of subsidiary board members vis-à-vis their companies, their interaction with the parent, scope of authority of subsidiary directors and officers; reporting and communications procedures; board meeting procedures and conflicts of interest.
- Establish a schedule for regular consultations with subsidiary directors and officers to elicit questions, concerns and advice (consultations should include face-to-face meetings between senior management of parent and their counterparts at the subsidiary level).

Footnotes

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B. Client Communications

§ 283:58. Executive summary for clients regarding ways of doing business in foreign markets

§ 1. Introduction

One of the most important decisions when exporting products into a new foreign market is determining the best method or methods for distributing the products to local customers. There are a wide variety of strategies that the company can use to export its goods and the alternatives are generally classified by reference to the level of direct involvement of the exporter in the sales and marketing process. Specifically, the company may elect to:

• Passively collect and fulfill orders from buyers in its home country who then export the goods for their own account into foreign markets. In this case, the company actually has little or no pro-active export strategy and often is unaware that its products are being distributed overseas.

• Passively collect and fulfill orders from customers or end users located in foreign countries. This is often the way that companies first become aware of new opportunities for sales of their products in foreign markets.

• Actively solicit orders from buyers in its home country who act on behalf of customers or end users located in foreign countries. This allows companies to begin generating foreign sales without incurring substantial expense to establish an exporting infrastructure.

• Sell into foreign markets through the services of home country and foreign intermediaries. Probably the most common method of offering products directly to foreign customers in their home country, this method allows companies to tap into the expertise and contacts of experienced intermediaries.

• Sell into foreign markets through local manufacturers or joint ventures. Foreign sales in tandem with local partners typically require a higher level of investment of cash, technical resources and management attention.

• Sell directly to customers or end users located in foreign countries. Direct sales, either through company employees in the home country or employees of a local subsidiary established in the target country, offer the higher potential return yet are accompanied by substantial risks.

While there are numerous exceptions, in general the evolutionary cycle by which most businesses become international traders is reminiscent of the cautious swimmer who eases into the water (i.e., toes first, then the ankles, the knees, the waist, the chest and finally total immersion). In the beginning, a U.S. company may receive an order or two from overseas customers. Such orders might have been met, but by means designed to carefully protect the U.S. party—probably FOB ("free on board") against confirmed irrevocable letters of credit. This stage may continue indefinitely; however, the company should use the interest of foreign customers as an opportunity to consider one or more of the alternative methods that might be used to actively locate and encourage business with other foreign customers or expand trading with some of the initial customers by providing favorable terms of sale, including credit.

Once the threshold decision to expand globally has been made, the company might decide to cautiously move overseas by an indirect investment. By indirect investment, we mean a method that requires no direct involvement of the company in the foreign market. Rather, the company engages an individual or company in the foreign market to assist it in exporting its products to that market. The most common indirect investment other than receipt of orders is the use of a local agent, typically a sales representative, who locates customers and obtains orders that are forwarded to the U.S. company for review and, if acceptable, fulfillment. The agent receives a commission based on sales generated from its activities. Another alternative is a distributorship. Under this arrangement, the U.S. exporter will actually sell its products to the foreign distributor with the intent that the distributor will resell the products to end users or other resellers located in the target market. The distributor assumes the risk of resale of products purchased under the distribution arrangement; however, the distributor will be allowed to retain any spread between the price paid to the U.S. exporter and the consideration received upon resale of the products.

Proper selection and management of indirect investment partners should lead to greater foreign sales and a higher level of comfort with the operational activities necessary in order for products to be prepared for shipment to foreign markets. Moreover, the U.S. company will begin to liberalize its shipment terms to something like C&F ("cost and freight") or CIF ("cost, insurance and freight"), port of entry, shipping documents D/A (documents against acceptance), 90 or 120 days sight. As the company builds up its reserves, and its confidence, it may decide to extend the terms of sale and provide credit terms to its distributors and selected customers identified through its network of foreign sales representatives.

Successful indirect investment will often be followed by some form of direct investment, which means that the company elects to participate directly in the production or sale of goods in the foreign market. There are essentially two means—participation and involvement. Participation is through an economic interest owned wholly or in part by the company. The economic interest can be a permanent establishment, central enterprise or joint venture. A permanent establishment is a part of a company. It can be anything from a department such as a financial office to a single plant. A central enterprise is a complete entity. It includes corporations, partnerships, and the limited liability company. The third type of participation is a joint venture agreement between two independent parties whereby the two parties agree to joint together to achieve a common purpose. To acquire an economic interest for participation in a foreign market, the company might establish a new interest, purchase the assets or stock of an existing one, or merge two existing interests. The extent of participation can be complete ownership (subsidiary), a majority interest less than 100%, or a minority interest.

The other method of direct investment is involvement by agreement or contract. By this we mean the company is involved in foreign manufacturing, and marketing by providing technology, technicians or managers. There are a wide range of strategies that might be used in this type of approach, including licensing agreements, industrial cooperation arrangements, turnkey agreements and employment contracts. Under a licensing agreement, the company permits a foreign company to use its technology in return for a royalty fee. In an industrial cooperation agreement, the company licenses its technology and is paid off by being entitled to a percentage of the products manufactured under the license. A turnkey agreement means that the company agrees to build an entire plant in a foreign country in return for a fee. Under an employment contract, the company provides a foreign enterprise with technicians (i.e., a technical assistance agreement) or managers (i.e., a management contract) in exchange for fees and, in most cases, royalties based on output of products by the foreign enterprise realized through the support that has been provided by the company.

The optimal strategy for entering a new foreign market or maintaining a presence in the market following entry depends on a variety of factors, including the nature of the goods and competitive conditions in the target foreign market. Companies may use a single export strategy or two or more strategies in combination and different strategies may be used in each of foreign countries that are of interest to the company. For example, companies may adopt fairly aggressive direct sales strategies in neighboring countries while relying on intermediaries to prospect more distant markets until the company is ready to focus on, and invest greater resources in, pursuing market opportunities outside of markets that are in close physical proximity. Changes in strategy are also common as the company learns more about a particular foreign market. For example, initial sales may be pursued through intermediaries, which can provide the company with an opportunity to get its goods known in foreign markets with minimal risk and learn more about how to operate an export business. In fact, commentators have advised that companies entering a foreign market for the first time should test the field by through intermediaries and other indirect sales efforts for at least two years. However, as the volume of business grows and the company develops its own relationships with major customers, consideration may be given to funding the investment necessary to launch a local branch or subsidiary that would engage in direct sales activities.

On balance, a direct approach offers the greatest potential return for the company in most cases; however, it is generally the most difficult of the various alternatives to implement unless and until the company has substantial experience and resources to deal with market research and planning, logistics and collections in foreign markets. However, many small- and medium-sized companies have used direct export strategies with the assistance of governmental agencies and outside consultants and specialists such as international banks and freight forwarders. If the company is unable or unwilling to make the necessary commitment required for direct exporting, serious consideration should be given to engaging qualified intermediaries in the U.S. and/or in the target foreign markets. In that case, the key task is to locate an intermediary that understands the company's needs and is able to effectively and efficiently manage all of the details associated with exporting the company's goods.

§ 2. Passive export sales

Some companies find their goods being used in foreign markets without any active export sales strategy. For example, the company may be approached by a potential customer in a foreign country that has an interest in entering into a contract for the purchase of goods that are otherwise only offered for sale by the company in the U.S. The foreign customer may be interested in the goods solely for use in its own business or may seek the opportunity to promote and sell the goods on the company's behalf in the customer's home market. Such an inquiry may be perceived as a pleasant windfall by the company; however, the company should exercise caution before proceeding to ensure that the transaction complies with applicable legal and regulatory conditions. Moreover, the company should take the time to evaluate how the proposed contract might impact future active export strategies in the foreign market. In particular, the company should be sure that the relationship with the initial customer does not prevent the company from selling to other local customers, selecting another local agent or distributor or perfecting intellectual property rights in the foreign country.

The first order from the initial customer may be followed by others by the same customer and/or others. As management begins to recognize the potential of the foreign market, modest actions may be taken to encourage more orders. For example, the company may offer discounts and other inducements to foreign purchasers and may even begin some type of advertising in the foreign market. There comes a time, however, when the company realizes that the mere receipt of orders is too limiting and that to take full advantage of the potential of the market, strong measures must be adopted. The step taken beyond order receipt is usually toward the establishment of relationships with experienced sales intermediaries in the U.S. and/or in the target foreign country.

Another form of passive export activity is when a company fulfills orders received from U.S. buyers who then turn around and export the goods to customers or end users in foreign countries. From the perspective of the company, the original transaction is no different than a strictly domestic sale and purchase of goods and the company need not concern itself with preparing the goods for export or preparing advertising materials and instructions for the goods that can be used to create and maintain interest in the goods in foreign markets. However, there are significant risks associated with even an isolated transaction of this type and a large volume of this type of business may ultimately harm the strategic alternatives of the company if it decides to pursue an active export approach in the future. For example, if the goods are subject to U.S. export controls, the terms and conditions of sale for those goods to any U.S. buyer should include covenants that restrict the purchaser from re-exporting the goods in a manner that violates U.S. laws.

§ 3. Active solicitation of orders from U.S. buyers that resell to foreign markets

A number of companies attempt to introduce their goods into foreign markets by conducting domestic business with U.S. exporters. While such a strategy can place the company's goods into the hands of foreign customers and end users without the need for the company to gear up to satisfy many of the conditions for exporting, including documentation and packaging requirements, the company does not begin building the goodwill and knowledge necessary to expand its international business. Moreover, while there is no doubt that this approach represents a substantial amount of total U.S. sales of goods to foreign markets, there is no organized marketplace that can bring a company together with interested U.S. exporters. As such, companies must rely on a mix of resources, including industry directories, trade associations and participation in U.S. trade shows.

§ 4. Export sales through U.S. intermediaries

Companies may wish to pursue export sales opportunities without spending the time and expense necessary to select, and develop relationships with, intermediaries and customers in foreign markets. While such a strategy is necessarily limiting in that it deprives the company of the knowledge about foreign markets necessary to adapt its products for export sales, it sometimes makes sense when the company's products are generic and can be sold without customization outside of the U.S. When pursuing this type of strategy, companies may turn to a wide array of U.S. intermediaries for assistance. The intermediaries will gather information regarding the company's products and then attempt to locate buyers in the U.S. acting on behalf of foreign parties or identify customers directly in foreign countries. The advantage to the U.S. company is that all exchanges of information can occur in the U.S., typically at the company's offices, and there is no need for company managers and employees to travel to foreign markets. Ideally, the company will select a U.S. intermediary that can educate the company about exporting activities and begin to build sufficient confidence within the company so that a more direct exporting strategy can be considered at a later date.

§ 5. Export sales through foreign intermediaries

Companies that have a serious long-term interest in export sales activities in a specific foreign market often elect to test the water by working with one or more local partners ("intermediaries") to promote, sell, and sometimes even manufacture its products in the target country. Intermediaries serve a number of valuable functions in the distribution process for U.S. companies engaging in export activities:

• By using intermediaries to increase the number of parties contacting potential customers, the company can reduce the number of contacts that it must make to penetrate the market.

• Intermediaries can be used to break large batches of goods up into smaller units that are more suited to the purchasing habits of consumers.

• The use of intermediaries can shift the risk and expense of transportation, storage, and inventory to another party.

• The desire of intermediaries to make a profit will be an incentive for them to generate and maintain market demand for the products, often through their own advertising and promotional activities. This can be particularly important when the exporter has a limited budget for advertising and personal selling activities.

• Intermediaries should be able to provide the company with market information, also a valuable contribution for exporters without their own market research unit or internal sales personnel that could otherwise collect that information.

• Intermediaries can advise the company regarding modifications or enhancements that might kindle interest in the company's products in the country.

Various compensation structures are available, including commissions based on generated sales and discounts to local distributors that actually purchase the products for their own account and earn their compensation based on their ability to resell the products locally at a higher price. While the ability to use intermediaries can greatly expand the market scope for producers, a long distribution channel will increase the difficulty in understanding the needs of consumers and trends in the ultimate marketplace. Accordingly, reliance on intermediaries is often a temporary measure until the company is comfortable enough with the local market to consider more direct sales methods, including formation of a fully operational local subsidiary.

§ 6. Direct export sales strategies

The export strategies described above generally rely on the efforts of U.S. or foreign intermediaries. While there are significant advantages to tapping into the resources of an experienced sales partner, a company with lofty goals and objectives with respect to export sales activities must ultimately consider assuming direct responsibility for locating customers, negotiating and completing sales, and promoting and supporting products in the most attractive foreign markets. Direct sales strategies carry greater risk and expense; however, returns need not be shared with intermediaries and information gained from the direct interaction with local customers can be used to expand the product line and develop goodwill and positive branding in the foreign market. Among the alternative strategies that might be considered are direct sales activities based in the U.S., establishment of a local sales branch or subsidiary, acquisition of an existing local business, and joint venturing with a local partner.

§ 7. —U.S.-based direct sales strategies

The simplest method for entering a new foreign market is to launch a program of direct export sales managed from locations outside of the country. While it is possible to handle all sales efforts remotely through phone, facsimile or even teleconferencing, companies should generally anticipate the need to use one or more export sales representatives to visit potential customers to solicit orders and gather information about the local market to determine whether the firm's products might be suitable. This approach avoids most of the expenses associated with establishing a branch office or acquiring a local firm; however, since this strategy does not involve creation of a permanent presence in the foreign market, customers may be reluctant to commit without regular access to dedicated local sales and support staff. As such, this approach is generally an interim measure at best and indications of interest will ultimately lead to a formal base of operations in the foreign country, such as a subsidiary, local sales office or an agreement with an in-country distributor.

Success with this type of strategy depends on the ability of the company to locate potential foreign customers without establishing a permanent presence in the particular market. This can be accomplished by doing one or more of the following:

• Advertise in trade journals and place a listing in Commercial News USA, which is a print and online catalog disseminated by the DOC;

• Participate in catalog and video/catalog exhibitions organized through U.S. & FCS offices, which creates opportunities for the company's catalogs and product videos to be required by potential purchasers, agents and distributors;

• List the company's products in U.S.-based private sector catalogs that are distributed overseas;

• Actively pursue potential foreign customers through listings of trade leads posted on bulletin boards maintained by the DOC and other governmental agencies and included in various commercial news publications;

• Participate in international trade shows, fairs and exhibits in the U.S. and in foreign markets, many of which are organized/supported by U.S. governmental agencies such as the DOC; and

• Participate in public and private trade missions that are organized by federal, state and local governmental agencies and by trade associations.

In addition, contacts should be made with the chamber of commerce in the foreign country (and any affiliated chapter in the U.S.), the U.S. chamber of commerce in the foreign country; diplomatic or consular representation in the U.S. and in the foreign country; local and foreign banks; and local and foreign associations of trade or industry.

While the listed strategies would apply to most foreign markets, other alternatives should be considered when the company is looking for specific types of export opportunities. For example, many small U.S. businesses have launched their international sales activities by bidding on large infrastructure projects in developing countries. Information on these opportunities can be obtained for the various multilateral development banks, including the World Bank, the African, Asian and Inter-American Development Banks and the European Bank for Reconstruction. These institutions regularly conduct training sessions for U.S. exporters to distribute information on their procurement procedures and requirements.

§ 8. —Formation of new foreign entity

Companies always have the option, subject to local government regulations pertaining to foreign investment, to form a new entity, such as a branch or a local subsidiary, to conduct direct sales activities in a foreign market. A new entity may be used to launch sales activities or may be formed after the company has used a local sales representative or distributor to determine whether its products are marketable in the foreign market. While this strategy allows the company to exercise full management authority without the need to negotiate with other parties, it can be extremely risky unless the company has substantial familiarity with the market or is able to recruit qualified personnel to assist in the venture. In addition, formation of a new entity is an expensive proposition, since the company cannot rely on existing assets contributed by a local partner. Finally, a "go-it-alone" strategy exposes the company to political risks that might be avoided if a local partner was involved in the activity.

Once a company has established a local sales subsidiary in a foreign country, consideration is sometimes given to launching other functions in the same facility or elsewhere in the country. The most likely candidates are areas closely related to the sales activities, such as service and warehousing. In some cases, the company may explore opportunities for engaging in product design, manufacturing and research and development activities in the foreign country; however, each of these activities would require substantial investments and management time that may be beyond the resources of the company at that time. For example, while local manufacturing to meet product requirements in the local market can carry certain advantages, including compliance with local content requirements, circumvention of tariffs on imported goods and more effective adaptation of products to satisfy local preferences, many companies lack the resources to effective manage a foreign manufacturing operation. In addition, establishing a manufacturing facility creates additional fixed overhead costs that increases the break-even point for the product on a global basis and reduces funding available for other, and more serious, needs such as new product development and marketing of the products in the foreign market.

§ 9. —-Foreign investments and acquisitions

While uncommon, companies sometimes enter a new foreign market by purchasing a significant equity interest in an existing foreign entity or by purchasing the entity outright. Obviously, this strategy can involve a significant amount of cash and other resources and success may ultimately depend on the company's ability to retain key local employees and continue to capitalize on the reputation and local contacts the local firm developed prior to the acquisition.

§ 10. —Joint ventures

An equity joint venture, involving the formation of a separate business entity jointly controlled by a U.S. company and a local partner, is a commonly used foreign market entry strategy and may be used to sell and promote the products of the U.S. party in the local partner's home market. For example, the company may contribute the right to sell specified products to a new joint venture while the local partner contributes cash, facilities, and equipment to establish stores and other distribution centers for the products. A joint venture structure might also be used when the company is willing to license technology needed to manufacture the products and the local partner elects to provide the manufacturing skills and resources. In that scenario, the joint venture may distribute the finished products on its own and/or license the partners to distribute the products in specified markets in exchange for payment of royalties back to the joint venture (e.g., the company may become the exclusive licensee of the products in the U.S.).

Among the many objectives and potential advantages of forming international joint ventures as part of an internationalization strategy are risk reduction; economies of scale and/or rationalization; technology exchanges; coopting or blocking competition; overcoming government-sanctioned trade and/or investment barriers; facilitating initial international expansion of inexperienced firms; and vertical quasi-integration advantages of linking the complementary contributions of the partners in a "value chain." A joint venture also serves as an opportunity to directly observe the activities of the foreign partner and insulation from some of the risks associated with independently launching activities in a new market. In fact, some governments will not approve foreign investment in certain sectors unless the foreign party is willing to enter into a joint venture with the government or an approved local partner; however, these restrictions are gradually disappearing as developing countries continue to liberalize their foreign investment regimes. On the other hand, however, operation of a joint venture can be time-consuming and the possibility of miscommunication and dispute is very high, particularly if foreign personnel are not totally committed to the joint venture. In addition, the company should be mindful of the risks associated with licensing technology to a joint venture since the foreign partner might use the technology for competitive purposes once the arrangement is terminated.

Footnotes

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§ 1. Introduction

When planning for the formation, organization and operation of foreign branches or subsidiaries, it is important to remember that the branch or subsidiary will ultimately need to perform many of the functional activities associated with any business. The range of activities, as well as the timing for introducing a specific activity, will depend on the strategic purpose of the branch or subsidiary. For example, if a branch is established exclusively to launch direct sales activities in the foreign country, then it is obvious that the initial investment should focus on those areas that support sales—recruitment of sales personnel, development of marketing and advertising campaigns, and customer support. Other functional areas, such as new product development and manufacturing, will continue to be handled at the headquarters level until the decision is made to establish those capabilities in the foreign country. However, even if the activities are limited to a single function, the branch or subsidiary will still need to establish procedures to satisfy accounting and financial requirements; locate suitable facilities and negotiate real property purchase and lease agreements; purchase and lease equipment and other personal property for the business; obtain insurance covering its activities; implement legal compliance programs; and establish management guidelines and human resources policies and procedures to recruit and retain qualified personnel.

Financing the new legal operation is obviously an important issue and many parent companies set up a simple form of loan facility agreement through which the new foreign subsidiary can easily obtain financial support from the parent in order for the subsidiary to conduct various operational activities. See § 283:54. The subsidiary may have been formed and organized by the parent or it may be an established company in the foreign country that was acquired by the parent with the intent that it continue to operate as part of the parent's global network of businesses. While the subsidiary may attempt to obtain a term loan and/or revolving line of credit on its own from a local financial institution it may be easier to set up an inter-company loan facility that the subsidiary can use without having to abide by the restrictive covenants that will inevitably be imposed by outside lenders.

§ 2. Books and records

The applicable statutory scheme for the selected entity form will typically specify the minimum requirements that need to be observed with respect to the various books, reports and records that must be maintained. As a general rule, companies will be expected to establish a system for preparing accounting records and submitting annual reports on its accounts to a governmental agency. In most cases, the statutes and regulations will prescribe the form and content of balance sheets and profit-and-loss accounts and include standardized terminology that must be followed by companies. In general, this means the company must have an accounting system that shows and explains the company's transactions, records all of the company's cash receipts and disbursements, and allows for the generation of profit-and-loss accounts and a balance sheet when required. While all of the directors have statutory responsibilities with respect to the company's accounts and compliance with the accounting requirements, the primary manager in this area is typically a branch controller assisted by other staff accountants. The controller will usually report directly to the chief financial officer of the parent company.

§ 3. Real property

Real property used in the business activities of the branch or subsidiary is one of the most significant investments in a new foreign market. When real property is purchased, it is likely that the purchase price will be substantial in relation to other assets. When facilities are leased, the annual payments for rent and associated services can become a large fixed expense for the company. The issues in this area are further complicated by the need to move operations to larger facilities as the staff requirements increase and the branch or subsidiary takes on additional functional activities. As such, the company must retain the flexibility to move quickly and easily without incurring any substantial penalties.

The choice of the location is extremely important. Apart from the costs of leasing or purchasing a facility, the location can impact the availability and cost of labor, the quality of transportation and distribution networks, relationships with customers and suppliers, and overall quality of life of the human resources involved in the business. A lack of care and analysis in the original location decision can lead to problems as the business develops. For example, local infrastructure problems, such as congestion and traffic, can make access to and distribution from the location more difficult. Environmental quality can also be a problem, particularly for firms that are typically forced to choose locations based on availability of inputs. Of course, the impact of these disadvantages is subject to change as time goes by. For example, if the area surrounding the location grows quickly because of other firms moving in, it is more likely that quality of life and infrastructure problems will crop up.

Most companies do not purchase their facilities when establishing a new branch or subsidiary and instead opt to lease one or more buildings in the selected area. Leasing may make sense for a number of reasons including: temporary need for the land or premises without the desire to expend the resources to purchase land for that time period; rapid growth that means the company will outgrow any purchased facility within a short period; need only for a parcel of limited size (it is more economically sensible to lease a portion of a larger parcel than be required to purchase the entire property); and availability of resources to lease a parcel of property from which to operate its business (without being able to afford the purchase of the land). The disadvantage of leasing, however, is that any increase in the value of the facility goes to the owner, not the lessee. Also, if the company intends to invest considerable sums in improving a facility in the foreign country, it may prefer to own it, particularly if the improvements cannot be relocated.

§ 4. Facilities management

All businesses require equipment and other tangible business assets, including furniture and computers, to operate effectively. While a new office in the U.S. may be equipped with assets transferred from the parent company, formal procedures will be needed to purchase equipment and furniture for foreign branches and subsidiaries. These procedures generally classify procurement transactions by the amount of the proposed purchase or lease. For example, many small acquisitions may be left to the discretion of the local managers, provided the transaction conforms to a pre-established budget and the parent company has not made arrangements for bulk purchases of the class or type of asset from a single distributor throughout the organization. Larger acquisitions, on the other hand, may be subject to tender and bidding requirements and the purchase or lease cannot be completed until bids have been collected, information reviewed and appropriate approvals obtained.

In most cases, the procurement decision involves a choice between outright purchase of the asset and a leasing transaction. By purchasing the asset, the company obtains full title and is generally required to pay all or most of the purchase price at the time that title is transferred. In contrast, a lease can significantly reduce the upfront cost of gaining access to the asset for immediate use in the business. Capital not diverted to payment of the entire purchase price can be used for other purposes; and, in many cases, the lessor is willing to provide the lessee with flexibility to upgrade the leased asset as new enhancements are introduced during the lease period. Another important factor in any procurement decision is the availability of repair and maintenance services, which are provided by the vendor (or an affiliate) for an extra charge.

Almost every business relies on outside vendors to service, maintain and repair the company's valuable business assets. Among the most common types of relationships are those pertaining to repair and maintenance of the company's business equipment (e.g., computers, production machinery, etc.); building maintenance and services, including cleaning and repairs; repair and maintenance of specialized equipment on business premises (e.g., elevators or escalators); and property protection services, including security services and maintenance of alarm systems. Repair and maintenance services are generally provided pursuant to a detailed agreement between the company and the chosen service provider. In many cases, the manufacturer will provide services on its equipment directly. However, it is also common for the manufacturer to delegate repairs and maintenance to trained and qualified outside providers. In any event, the parties should agree on the service provider's specific duties and services and detail them either in the main body of the agreement or as an exhibit or schedule. A number of factors should be considered in determining the scope and content of the services, including any requirements as to the personnel to be provided by the service provider (e.g., the number of workers, experience, work location, etc.), and the facilities, tools or equipment that it must provide.

One of most common scenarios that may occur when a new foreign subsidiary is formed is the transfer of the assets and liabilities of a pre-existing branch office in the country to a new corporation formed under local law. While the transfer is often invisible to the employees working in the branch/subsidiary, it is necessary to have a formal assignment and assumption agreement drafted and signed by representatives of both parties to the transaction (i.e., the parent company on behalf of the "branch" and an authorized officer of the new foreign subsidiary). Preparation of the assignment and assumption agreement provides a good opportunity to conduct a full inventory of the tangible and intangible assets to be assigned as well as to compile a list of all contractual rights and potential obligations. During this process, a determination can be made as to whether a purported assignment of a contract will trigger a right of any outside party to terminate the contract unless and until such party affirmatively consents to the assignment. A condition to that consent may be a requirement that the parent company guarantees the performance of the subsidiary under the contract. This form of agreement also contains language necessary to satisfy taxing authorities that the transfer should be treated as a tax-free reorganization; however, notice should be taken that transfer taxes may be owed under local laws.

§ 5. Insurance

Business insurance is a critical element of the company's risk management strategy. Without proper insurance, the parent company can lose all the money, time and effort it put into establishing the foreign branch or subsidiary. As with any other product or service the company may purchase, management should consult with various brokers regarding the company's specific needs for protection. The parent company's U.S. broker is a good place to start since the broker will hopefully have affiliates in foreign countries that can provide advice on the available coverage and make recommendations regarding the type and amount of coverage that might be appropriate given the intended operations in the foreign country. Each policy, regardless of the type of risk covered, should be carefully analyzed to determine the scope of protection. Among other things, management should understand the losses and properties covered by the policy; periods covered (i.e., timing of events or actions covered by the policy); persons covered; deductible amounts and maximum dollar amount of coverage; term of coverage; and exclusions. If the standard policy does not provide sufficient coverage, umbrella policies may be purchased to cover losses above and beyond the limits of other policies the company may carry.

§ 6. Legal compliance programs

One of the biggest challenges associated with organizing and operating a foreign branch or subsidiary is complying with the myriad laws and regulations that impact the conduct of business activities in the foreign country. To deal with the demands of legal compliance, companies must establish and maintain a comprehensive legal compliance program that focuses on the local requirements as well as U.S. laws and regulations that might come into play as a result of the activities conducted by the foreign branch or subsidiary (e.g., U.S. Foreign Corrupt Practices Act and/or U.S. export control laws). The program serves many purposes, the most important of which is monitoring the legal health of the branch or subsidiary and identifying problems and opportunities that may develop as the business grows and changes and new laws and regulations are implemented.

Two of the most important practical requirements for an effective legal compliance program are establishment of compliance standards for managers and employees of the branch or subsidiary and the development of communications tools for informing and educating such persons about the program. Codes of conduct, policy and procedure manuals, and training programs are the most commonly used strategies for communicating compliance standards. However, companies should also spread the word through informal discussions of compliance standards or issues between managers and their subordinates, briefings at new employee orientations, posted notices and articles in company publications. As discussed elsewhere in this Library, U.S. companies going global should establish a comprehensive global compliance program, and the managers responsible for that program should be given responsibility for creating localized programs for each branch and subsidiary.

§ 7. Management and human resources

A full discussion of the management issues associated with establishing a foreign branch or subsidiary is beyond the scope of this chapter; however, it is worth noting that the parent company must seriously consider how the new outpost will be managed and determine the relationship between the branch or subsidiary manager and the rest of the organization. Great care should be taken to recruit and select a qualified manager for the branch or subsidiary, and the manager should ideally be someone who is expert at the activities to be conducted and who also understands the local culture and business practices and the way in which things are done within the parent company and the entire global organization. In some cases, the branch or subsidiary manager is given executive authority over all local functions and personnel. At the other extreme, the local manager may act primarily as a representative of the company to local governments, customers and suppliers, and most of the branch or subsidiary personnel will report directly to managers in the appropriate functional or product business unit in the U.S. The role of the local manager will change as the branch or subsidiary evolves and should constantly be reviewed to take into account new circumstances including the early success of the outpost and the opportunity to expand local operations. Some companies enter into management services or consulting agreements with outside parties who agree to provide certain oversight and management services for the subsidiary's activities.

Selection of the local management team is just the first of many human resource ("HR") issues that must be considered when launching a foreign branch or subsidiary. It has been argued that HR may be the most important factor in the success or failure of any company's globalization efforts. While each new branch or subsidiary raises the traditional HR activities and concerns with respect to recruitment, compensation, evaluation, promotion, discipline and termination, the task is complicated by the presence of new laws, regulations, workplace norms and, in many cases, strong involvement of trade unions and governments. Moreover, HR personnel need to play a leading role in making sure the branch or subsidiary is quickly and efficiently integrated into the parent company and the rest of the global organization and, thus, need to facilitate networking and development of personal relationships. A number of strategies can be used, including training programs, rotating branch and subsidiary personnel through temporary assignments in the U.S. (and sending U.S. personnel to the outpost to see operations with their own eyes) and establishing formal teams among managers and employees of the parent company and various foreign branches and subsidiaries to work on common issues (e.g., development of a worldwide brand).

Another important management issue at the parent company level is making sure that the personnel and resources residing within each foreign branch or subsidiary will be properly integrated into the activities of the entire company. The challenges in this area will vary depending on the size and organization of the company. For example, achieving positive integration among functional groups will require more effort and attention when senior managers for each of those functions are widely dispersed throughout different countries. In addition, the stage and level of development of local branches and subsidiaries will also have an impact on communications, particularly if a particular branch or subsidiary has already achieved a high level of operational and marketing independence. As the company grows and specific local markets develop more quickly, it is not uncommon to see the branch office or subsidiary in that country build its own accounting, legal and operational infrastructure. In any event, a number of strategies and procedures can be implemented to facilitate communication and coordination between the parent company and subsidiaries and/or agents in foreign markets, including the following schemes:

• Establishment of permanent cross-functional committees or teams staffed by representatives from both the parent company and the subsidiary as a vehicle for making joint decisions about important technological and marketing issues in the foreign market. The formal structure should be supplemented as necessary by creation of temporary workgroups to brainstorm and resolve specific issues, such as the product design changes that may be necessary in order to satisfy identified local customer requirements.

• Designation of product and project managers with responsibility for overseeing relevant activities across the parent company and each of the relevant foreign markets. The manager may also be assisted by one or more liaisons charged with making sure that there are communications between related functions and departments in the parent company and the various foreign subsidiaries.

• Establishment of a matrix organizational structure that insures integration of personnel from the parent company and each of the foreign subsidiaries in each functional specialty.

Communication, and a sense of common values and strategy, may also be built and reinforced through a recognized program of regular transfers of managers between the parent company and various foreign subsidiaries. In cases where the company has more than one significant foreign subsidiary, procedures should be implemented to facilitate communications between managers and similar functions at the subsidiary level. This type of interaction can be particularly helpful in assisting local managers in dealing with issues that may arise on customizing product design and marketing strategies to suit their customer base.

In addition, when a U.S. company establishes a new foreign subsidiary, or converts a branch office into a wholly owned subsidiary by forming a new corporation under local law, it must carefully consider how the new subsidiary will perform various administrative services necessary for the subsidiary to fulfill its legal obligations and carry out basic business operations. While the intent of the parent company is usually to expand the personnel and resources of the subsidiary to the point where it is self-sufficient, subject only to the overall direction of the senior management of the parent company, it is usually necessary for the parent to provide certain administrative and management support services to the subsidiary for a limited period of time following formation. The scope of the services, as well as the fees to be paid by the subsidiary to the parent to cover the costs incurred by the parent in providing the services, should be laid out in a services agreement between the parent and the subsidiary.

Other recommendation for managing governance issues relating to foreign subsidiaries include:

• Briefing members of the board of directors of the parent company on the relevant issues and secure their support for creation of a global subsidiary governance framework.

• Establishing uniform policies and procedures for selection of subsidiary board members and procedures to be followed by subsidiary boards; however, provide for exceptions based on local laws and practices.

• Designating a member of the company’s legal team (in-house or with company’s outside legal counsel) as the responsible person for monitoring activities associated with global subsidiary governance framework, including consultation with local counsel in each of the foreign countries where subsidiaries are organized.

• Developing and implementing training programs and communication procedures for members of subsidiary boards and senior management of the subsidiaries.

• Scheduling regular audits of subsidiary boards to review composition and effectiveness, directors' service contracts, recordkeeping procedures and compliance with legal entity requirements.

• Creating and continuously updating policies, statements and procedures that would be applicable across the entire governance framework (i.e., parent and all foreign branches and subsidiaries) on topics such as corruption, ethics, health and safety, human rights, whistleblowing etc.) and make sure they are readily available.

• Regularly conducting training sessions with board members and managers of subsidiaries on the topics of the policies, statements and procedures referred to above.

• Drafting and disseminating a handbook or manual that includes guidelines to be followed across the global subsidiary governance framework with respect to issues such as duties of subsidiary board members vis-à-vis their companies, their interaction with the parent, scope of authority of subsidiary directors and officers; reporting and communications procedures; board meeting procedures and conflicts of interest.

• Establishing a schedule for regular consultations with subsidiary directors and officers to elicit questions, concerns and advice (consultations should include face-to-face meetings between senior management of parent and their counterparts at the subsidiary level).

§ 8. Steps for managing and completing the formation of a foreign branch or subsidiary

Key steps for managing and completing the process of setting us a new foreign branch or subsidiary include the following:

• Develop international business plan and determine purposes and objectives of activities in local market in relation to overall plan.

• Determine the structure for the new operation.

• Establish plans for capitalization and continuous funding of new operations.

• Select qualified U.S. and local professional advisors.

• Analyze intellectual property risks in local market.

• Establish logistics processes in local markets including suppliers and distributors and local agents for customs and export law compliance.

• Understand local legal system including laws and regulations, courts, alternative dispute resolution, contracts, and enforcement infrastructure.

• Understand labor and employment laws and regulations in local market.

• Understand local market requirements for permits, licenses and certifications.

• Understand local laws pertaining to privacy of personal information.

• Develop an exit strategy including repatriation and redemptions.

• Develop an implementation plan for forming and organizing new operations (i.e., formation documents, licenses, permits, visa applications, insurance, government registrations, bank accounts, etc.).

Footnotes

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The Founding Director of the Institute is Alan Gutterman, who is the developer and author of Business Transactions Solution, a Thomson Reuters Legal Solution available through Westlaw Next. Alan is a well-known and widely respected legal and business counselor to entrepreneurs, emerging companies and investors. He received his law degree from Boalt Hall at the University of California in Berkeley and has also earned a PhD from the Faculty of Law at the University of Cambridge, where he was affiliated with the ESRC Centre for Business Research. He has been a partner and senior counsel at internationally recognized law firms where he has specialized in general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property. He has also served as the chief legal officer of a leading international wholesaler in the information technology industry headquartered in Silicon Valley. In addition to his work with the Institute, he is the Founding Director of the Growth-Oriented Sustainable Entrepreneurship Project (gseproject.org), which engages in and promotes research, education and training activities relating to entrepreneurial ventures launched with the aspiration to create sustainable enterprises that achieve significant growth in scale and value creation through the development and commercialization of innovative products or services which form the basis for a successful international business. More information about Alan is available here.

Information on the Institute's publications is available through the Institute's website (businesscounselorinstitute.org) and currently include the popular and innovative online Business Transactions Solution, available exclusively on Westlaw Next; Business Counselor Practice Guides covering legal and regulatory compliance, law firm management, technology management and transactions and strategic alliances; California Transactions Forms for Business Entities and Business Transactions; and Going Global: A Guide to Building an International Business.