Going Global – Strategies, Risks and Rewards

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Is Your Strategy Global?

- International (home based) v. global (the world is one market) strategy
- Long term/short term effects: financing, capital investment, personnel (local; expatriate)
- Short term
  - How short; why short term?
  - Fixed supply contract? Cost reduction?
- Long term
  - How long? 10/15/20 years?
  - Will you be exporting from that country?
  - Will the new “foreign” entity become your “regional” global headquarters – e.g., Asia; Europe

Form of Entity: Local Regulatory Approval (Cont'd)

- What are the forms of operating entity available to U.S. companies?
- What are the requirements for local incorporation and foreign ownership – minority; majority
- How long does it take to incorporate? What government approvals are required?
- Minimum capital requirements?
- How is the capital invested? Loans? Over time? What currency – central bank approval?

Form of Entity: Local Regulatory Approval (Cont'd)

- How are profits repatriated?
- What information is required on the parent/subsidiary – this can be time consuming
- Antitrust approvals required?
- Anti-terrorism requirements?
- Rule of thumb – assume process will take at least 50% longer than anticipated

Form of Entity: Operating Entity

- Branch office
  - "Test the water"
  - Generally easier to get local approval
  - Liability/exposure to parent or company operating the branch office – not a separate legal entity
  - Parent /subsidiary could be "doing business" in the foreign country
  - Limitations – can't "trade" in its own right

Form of Entity: Operating Entity (Cont'd)

- Agent/Distributor:
  - Agent: commission based; principal doing business in the country?
  - Distributor: Buy/sell - only doing business in country from products standpoint
  - "Super" Distributors: Need to understand structure
- Licensing Arrangement:
  - Licensed by a parent, subsidiary, third party to operate in the country
  - Royalty fees – can be good but tax implications

Form of Entity: Operating Entity (Cont'd)

- Wholly-owned subsidiary:
  - Separate corporate entity/LLC
  - Limits exposure to the parent
  - Can implement the parent company's global strategy
  - Easier to develop the parent company brand
  - Subsidiary can appoint the board of directors and management team; local knowledge, culture
- Majority-owned subsidiary
  - What % ownership and minority rights?
  - More difficult to operate than wholly owned

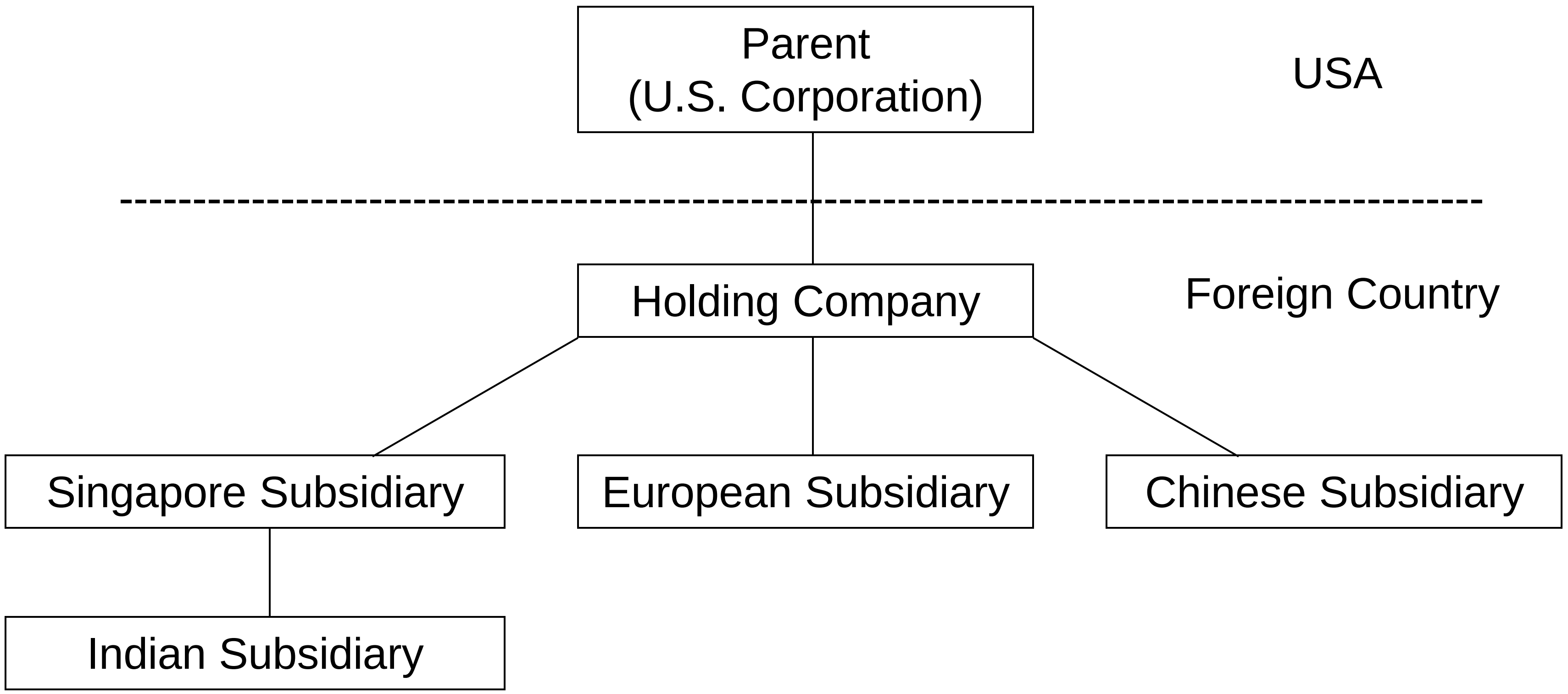
Form of Entity: Operating Entity (Cont'd)

- Joint Venture:
  - Can (should!) be a separate legal entity
  - Need to decide on percentage shareholding
  - Need to decide on board control and management
- Partnership
  - Seldom advantageous (LLC for tax reasons)
  - Need corporate liability protection
  - Understand what "partnership" means under local law

Corporate Governance

- Having established a separate legal entity to protect the parent, don't then "pierce the corporate veil"
- Upstream (parent) corporate liability must be minimized:

Piercing The Corporate Veil



Piercing The Corporate Veil

- Piercing the corporate veil is governed by "local law" concepts – before setting up in a jurisdiction find out whether the corporate veil can be pierced and, if so, how?
- Commercial operational reality vs. piercing the corporate veil
- Red flags:
  - Wholly-owned subsidiary
  - Common directorships
  - Does parent fund or guarantee obligations of subsidiary
  - Inadequate capitalization

Piercing The Corporate Veil

- Things to watch
  - Are the corporate formalities observed
  - Are goods/services provided by parent to subsidiary at "arm's length?"
  - Is the parent/subsidiary finance function "rolled into one"
  - Is the subsidiary treated as a "division" of the parent?
  - Do internal records show the decisions are really taken by the parent instead of the subsidiary

Choosing Your Partner is Very Important – And Often Underestimated

- Choose your “partner” (agent; distributor; joint venture partner; shareholder) with <u>more</u> care than you would in the U.S.
- Invite partner to U.S.; you visit him/her
- Background searches – U.S. embassy overseas
- Find out who advisors are – but be careful!
- Territorial partners? One partner may not “fit all” particularly if distributor/agent
- U.S. Export Controls

Purpose:

- Protect National Security, Promote Foreign Policy
- May restrict or prohibit:
  - Transfer of Articles, Technical Data, Software or Services from the U.S. or by U.S. persons
    - Items in the U.S. or previously exported from the U.S.
    - Foreign-made items containing U.S. parts, components, materials or technology
  - Transactions involving prohibited countries, end-uses or end-users

- Restrictions may apply to individuals or entities:
  - Company organized under U.S. law
  - U.S. citizen or permanent resident wherever located
  - Non-U.S. company owned or controlled by a U.S. person

NOTE:

It is difficult to comply with all requirements without having a comprehensive, global compliance policy and procedures, and staff to manage the risk

- **Foreign Corrupt Practices Act** (Department of Justice)
  - Local bribery acts
  - Prohibits offering anything of value to a foreign government official in an effort to obtain or retain business
- **International Traffic in Arms Regulations (ITAR)** (Directorate of Defense Trade Controls, State Department)
  - Restrictions on the transfer of defense items and services
- **Export Administration Regulations (EAR)** (Bureau of Industry and Security, Commerce Department)
  - Restrictions on the export of commercial/dual-use items

Key U.S. Export Control Statues/Regulations

- **Office of Foreign Assets Control (OFAC)** (Treasury Department)
  - Embargoed destinations/parties
- **Antiboycott Regulations** (Office of Antiboycott Compliance, Commerce Department)
  - Prohibit participation in unsanctioned boycotts (e.g., Arab League boycott of Israel)
- **USA PATRIOT Act**
  - Additional sanctions for violation of the above in relation to terrorist concerns

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Who Is Going To Manage Your Overseas Operations?

- Local manager – knows the "local scene" but may not know your company, culture and products
- Expatriate transplant?
  - Short/long term strategy
  - Transition plan to local manager
- Select the right manager, both culturally and professionally. A good manager in the U.S. may not be a good manager in Japan, India, Saudi Arabia
- If you select an expatriate
  - Think of his/her family
  - They should visit the intended city, accommodation, schools, etc.

What Is Your Exit Strategy?

- Need to consider this at start-up before you begin any negotiations, business planning, etc. Include in the term sheet or LOI
- Need to know local laws as to how a company/venture can be terminated; dissolved; liquidated – and how long it will take?
- In an ideal world,
  - What do you want?
  - Liquidation?
  - Buyout mechanism of partner/shareholder
  - Valuation mechanism of partnership/shareholding
  - Check local estate planning/inheritance laws!

What Is Your Exit Strategy? (Cont'd)

- If the entity is liquidated or you exit the venture what happens to:
  - Assets and plant/machinery
  - Inventory – risk of reverse engineering if abandoned?
  - Your customers – how can they continue to be serviced?
  - Your corporate brand; image; reputation
- If Agent/Distributor
  - What are local termination laws?
  - In many countries, agent/distributor termination laws are very protective of the local agent/distributor.
  - This can effectively "freeze" your company's operations
  - Can affect importation of your goods

Governing Law Of Your Agreements

- This is critical. The tendency is to want U.S. law to govern
- First – you must establish what rights (or otherwise) you have under "local" law
- Second – Is U.S. law even permitted in agreements?
- Third – Where are the principle assets of both companies?
  Eg:
  - U.S. company setting up in India
  - What law governs the agreements?
  - If U.S. law – U.S. law applies; if dispute heard in the U.S. and you lose – Indian company can enforce the judgment in the U.S. against you

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Governing Law Of Your Agreements (Cont'd)

- Indian company may not agree to come over to the U.S. Serious delay
- However, if, Indian law governs – and dispute heard in India and you win, you may be able to enforce the decision against the Indian company and attach Indian company assets
- So – need to consider the pros and cons of which governing law will apply

Dispute Resolution – Litigation vs. Arbitration

- Litigation:
  - Court system; following specific rules and procedures of the court system – common law/civil law/codified system
  - Before one or more judges; not sure of their experience
  - May be in a foreign language
  - May have to manage a case thousands of miles away
  - Unfamiliar process and procedure
  - May take many years – even longer than U.S.!
  - Local counsel/cultural issues

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Dispute Resolution - Litigation vs. Arbitration (Cont'd)

- Arbitration
  - Less formal; less procedure; should be less expensive
  - Can have "neutral" venue – London, Geneva, Paris
  - One or 3 arbitrators – selection procedure is <u>critical</u>
  - Arbitral institution – LCIA, ICDR, ICC, or ad hoc
  - Drafting the arbitration clause is important:
    - Senior level discussions regarding resolution
    - Possible mediation?
    - Time to appoint arbitrator
    - Number of arbitrators
    - Limitation of discovery
    - Issuance and enforceability of Award
  - New York Convention on the Enforcement of Foreign Arbitral Awards

QUESTIONS?