

International expansion

A roadmap to successful growth for entrepreneurs





Introduction

Today even very young companies are often international – many entrepreneurial ventures are “born global” in terms of their supply chain or customer base. However, there comes a time when an entrepreneur will decide to make the push into an overseas market in a more formal way, working to establish a presence in that jurisdiction.

In doing so, these businesses are part of a global movement toward internationalization. EY's latest *Capital Confidence Barometer*,¹ published in April 2015, reveals that for 84% of companies, overseas expansion is expected to be the focus of their M&A strategy over the next 12 months.

The rationale for a move into a new market may be one of opportunity – overseas markets may offer exciting new prospects, high growth potential or the chance to better serve existing clients. Alternatively, it may be one of risk – for example, entrepreneurs could be responding to a domestic market that is saturated, slow-growth or too competitive.

Either way, internationalization is a challenging process. “Businesses can’t just follow the herd,” says Bryan Pearce, Global Leader of Entrepreneur Of The Year™ and Venture Capital Group at EY. “Entrepreneurs must analyze the markets they’re interested in and ensure their product or service is appropriately designed and scaled for the unique factors in that market.”

This report outlines some of the key drivers for successful international expansion – the factors to be assessed when entering a new market, the options for doing so, the best routes to success and the pitfalls to avoid.

¹ *Global Capital Confidence Barometer*, EY, April 2015, ey.com/ccb





Eight factors to consider when entering a new market

Choice of market

With almost 200 countries to choose from, entrepreneurs need to think carefully about where to focus their international efforts. The criteria they use to prioritize will include the growth potential of each market, its appetite for the business's products and services and its competitive environment, but the right choice will ultimately depend on each entrepreneur's long-term strategy.

"There aren't straightforward answers to these questions," warns Ralf Osswald, Associate Director in the Global Markets team at EY. "It depends on the type of business: whether it's small or medium-sized, whether it's risk-averse or has appetite for risk; which industry the business is in also makes a big difference – a consumer products company will approach this differently to a mining company or a telecoms company."

The choice of market(s) can often best be accomplished through objective data – this is available from various sources, including EY's Growing Beyond Borders tool, which enables businesses to match their characteristics and objectives to countries that would be a good fit on the basis of the tool's database of information about international markets. Conversations with organizations like government investment agencies and organizations with local presence such as Standard Chartered and EY can also provide valuable input.

Products and services

Some markets will require businesses to adapt existing products and services for sale much more than others. This is the case with food products, for example, where people's tastes differ markedly; the company's offering may have to be adapted to meet the needs of local customers. The entrepreneur must then decide if expansion is worth it, weighing the costs of adaptation against the attractiveness of the market.

"A gap analysis is crucial," says Denise Hummel, Principal in Human Capital at EY. "You have to do an assessment that starts with the entire purpose of the expansion – companies expand for different reasons, so you start with the purpose of the global expansion and then work backward. You figure out, given that objective, what are the potential cultural impediments, and what are the on-the-ground factors that could get in the way?"

Finance

"A well thought-out financing structure is essential as entrepreneurs work out how to fund business expansion," says Anna Marrs, Group Head, Commercial and Private Banking Clients at Standard Chartered. "Factors to consider include whether to fund the expansion from the home country or in the new market, as well as the cost of finance, tax rates, the local legal system and whether any incentives are available from the local government."



“Ideally there will be a combination of locals and expats in a foreign operation. In many countries, there is a significant concern about outsiders, and that concern gets in the way of both the internal brand of the company and its external brand.”

Denise Hummel
Principal, Human Capital, EY

“Many of the entrepreneurs that have had successful IPOs or exits are those that have paid attention to taking advantage of being located in a low-tax jurisdiction.”

James Markham
Global Strategic Growth Tax Leader, EY

Sometimes, the need to access funding may even help determine the choice of market for expansion. Developed economies whose capital markets provide ready access to funding can be very attractive.

However, settling on the right mix of self-funding, debt and equity can be tricky. “Debt finance doesn’t dilute ownership and can be more straightforward to raise, but equity funding can give entrepreneurs more time and flexibility to grow their business,” says Andrew Bainbridge, Standard Chartered’s Global Head, Commercial Clients. “The two are not mutually exclusive: the debt it is possible to service comfortably will also determine the amount of equity required.”

Businesses must also decide which financial institutions can help them expand internationally. An international bank with a presence in many markets may be the best choice for many businesses – especially those rolling out an expansion program – but it needs to offer access to local expertise.

Operating model

International expansion may change how a company needs to be organized and managed. For example, supply chain issues may be to the fore in certain industries. Getting fresh food to market, for example, is challenging if it has to travel long distances in difficult conditions.

Equally, expansion may deliver operational advantages. “The business may become more cost-effective and enjoy economies of scale,” says Standard Chartered’s Bainbridge. “When you increase your output via international expansion, you can often do so with lower average costs – increasing your margins, offsetting exporting costs with decreased production costs and reducing your prices in your home country.”

International expansion may even deliver new insights to the business back home – about new ways to operate, for example, or new products and services for which demand in one marketplace may be replicated elsewhere.

Sales and marketing

Entrepreneurs will need to decide how to sell their products in a new market – regardless of whether a company decides to sell direct or to establish distribution networks and forge new partnerships, significant resources will be required.

Language and tone will be important when it comes to marketing, adds Standard Chartered’s Marrs. “Translating core marketing and operational materials into the local language may seem simple, but could present difficulties if the concept itself does not translate well,” she says. “Perceptions at the deepest cultural levels may have repercussions on overseas marketing – do product names, slogans and concepts say something meaningful in the target language and culture?”

People

Businesses that have specialist staffing requirements – whether highly skilled workers with specific expertise or unskilled employees for manual tasks – should look for markets (and locations within those markets) where this labor force is available. It may be necessary to invest in training and other support for those staff to help them understand how the business operates, for example, or even communicate with international managers.

Getting the mix right between local and expatriate talent will also be important. Local workers will provide key insights into the new market, while expats will have a clearer view of the overall business and its objectives. “Sometimes, cross-fertilization really gets communication and understanding flowing,” says EY’s Pearce. “Consider moving local people into the home office and expats into the local organization.”

Standard Chartered’s Marrs adds, “Expatriate staff are suited to positions requiring strong organizational knowledge such as products, technology, controls, operations and finance, while local staff are typically better in roles requiring strong market knowledge, local language and established relationships – sales, HR, marketing and public relations are good examples.”

Tax and regulation

“Think about whether a country’s legislation is conducive to the way the business wants to establish itself there,” says Standard Chartered’s Bainbridge. “Tax and customs laws, import restrictions, corporate organization and agency or liability laws may all prove to be stumbling blocks. Technology transfer and foreign investment laws may force a business relationship to be a joint venture.”

The legal system may also be an issue. Businesses will want to know how well-protected they are – how long will it take to resolve disputes with local partners, for example, and how strong are local intellectual property laws?

Still, entrepreneurs should not assume they will only encounter barriers to entry. “Many countries offer different types of tax and other incentives to foreign companies investing in their markets,” points out James Markham, EY’s Global Strategic Growth Tax Leader. “They might be anything from incentives on property tax, income tax or employment tax to exemption from certain types of duty.”

Currency risk is another issue to consider and quantify, according to Standard Chartered’s Marrs, especially if product is being sourced from or sold into a market in another country with a different currency. “Where forex issues are expected to expose the business to undue levels of volatility and risk,” she says, “it may be necessary to employ currency hedging strategies – probably with the assistance of a professional advisor.”

Onward, expansion plans

Very often, entrepreneurs have an ambition to move into a new region, rather than just a single market. In this case, the right market could be the one that works best as a gateway to further expansion. Entrepreneurs should look for business-friendly markets in their chosen regions, as well as markets with good regional links such as established trading patterns and a strong transportation infrastructure.

Choosing the right way to enter a market

How a business enters a market will depend partly on the local regulations and environment, but also on the resources, risk appetite and expertise of the entrepreneur. “The build, buy or partner decision should be a key part of every market-entry decision,” says EY’s Pearce. “Do we hire our own team and build our own business there? Or do we find someone in a similar or complementary business that has much of the infrastructure we need and then acquire or partner with it?” All three options have pros and cons.

- ▶ **Build** – this may require a longer-term investment and represents a bigger leap of faith at the outset, but the company retains total control over its expansion. However, this option may not be possible in some markets, where regulation requires international businesses to have a local partner – and even in markets without such rules, foreign players may be regarded with suspicion.
- ▶ **Buy** – this is a way to accelerate the internationalization process, giving the company access to a ready-made brand

and business. However, M&A deals can be complex, requiring extensive due diligence and strong management to ensure effective integration. It’s crucial to spend time choosing the right target.

- ▶ **Partner** – this enables the business to share risk and reward with a local player with an established presence on the ground. Access to its infrastructure may be attractive, and a partnership should require less capital investment, but developing a clear understanding of how decisions will be made can be difficult. It is crucial to align objectives.

These are not an exhaustive list of considerations. Entrepreneurs venturing into international markets will no doubt be faced with other decisions to make as they seek to establish a sound footing for their foreign operation. The time will then come for action. In the following pages we outline some key steps entrepreneurs will need to take before and during the market-entry phase, along with the most common hazards they will need to avoid in the process.

One of the world’s most successful hamburger chains suffered a rare failure when it tried to move into Barbados. It failed to appreciate that most Barbadians prefer chicken or fish to beef burgers.



Choosing the right way to enter a market

Seven key actions for successful expansion

- 1 Set the right strategy and priorities**

It can be tough to choose the right markets when there are many potentially attractive options available. Tools such as EY's Growing Beyond Borders can help entrepreneurs make objective assessments of particular markets' potential.
- 2 Develop the skills to evaluate, plan and execute entry into a new market**

Companies expanding overseas, especially for the first time, need to acquire new skills and expertise. "Most companies have a very good understanding of the markets they're operating in, but that may not translate into what's going on in another country," cautions Ryan Burke, Global Strategic Growth Markets Leader in EY's Transaction Advisory Services group.
- 3 Get to grips with cultural, product and regulatory differences**

Improve levels of knowledge of cultural differences in business to help build international competencies and generate a competitive advantage.
- 4 Get the right advice to make appropriate decisions**

Take advice from experts with a granular knowledge of market conditions. Even where good data and information are widely available, look for subjective intelligence.
- 5 Build a strong management team**

The business's management on the ground needs good local knowledge and experience that can drive expansion and ensure linkages with the home market.
- 6 Create a governance structure fit for purpose**

Attempting to micromanage the local operation from afar is unlikely to be successful, but business leaders need to retain oversight. Impose a clear decision-making process that empowers local managers to run day-to-day operations effectively while working toward the strategic vision for the business.
- 7 Be clear about the objectives of expansion and monitor progress**

Set clear objectives for the project at the outset, with measurable performance indicators that can be tracked by both local managers and the head office back home.



An American company launched a new diaper product in Japan, marketing it on the basis that it would need to be changed less frequently. The product launch initially failed because Japanese consumers are particularly focused on cleanliness.

1 Don't bet the farm

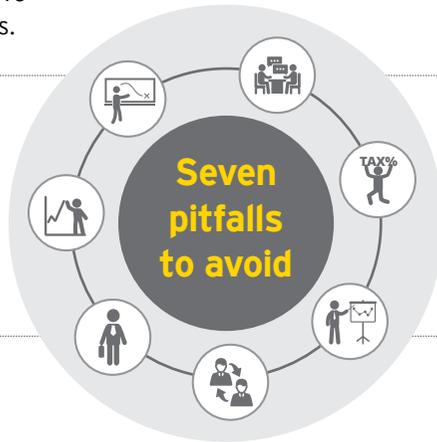
Have a clear Plan B if your expansion plans fail to launch, and ensure you have limited the risk to your overall business.

2 Don't be distracted by non-strategic factors

Choose your market on the basis of what works best strategically for the business, rather than geographical convenience or personal contacts.

3 Don't enter a market without doing the homework

Does the market have the right demographics and growth prospects? Talk to potential customers, as well as inbound investment agencies, about whether your business's product or service will have local appeal.



7 Don't mismanage talent

As well as a strong management team, many entrepreneurs will need a local workforce, but labor markets vary enormously. Get to grips with local issues and have a strategy for recruitment and integration.

4 Don't underestimate cultural nuances

Take counsel from advisors with expertise in the market's cultural norms and nuances.

5 Don't discount tax and regulatory issues

Take into account unique country rules in areas such as reporting, accounting and tax requirements. Also consider the implications for tax treatment back home.

6 Don't be product- or market-myopic

It's dangerous to assume that products and services that are successful in domestic markets will be equally successful elsewhere.

Accept the risk, but do the homework

Internationalization isn't a risk-free exercise. Even the most well-planned overseas projects can and do go wrong. But failing to explore international market opportunities is also a risk, particularly where growth potential in existing markets is beginning to stagnate; competitors that do have the courage to move into new markets often may gain ground.

Moreover, the most successful entrepreneurs know that business setbacks and failures have value in themselves. Many are successful precisely because they have experienced failures in the past and learned from them in order to do better the second time around.

Still, doing the groundwork will pay dividends – understanding what it takes to get into a market and what it will take to get out. “In the long term, the biggest risk for entrepreneurs is failure to take a considered approach to an international investment,” says EY's Pearce. “The key is doing your homework before you make the investment and build the appropriate platform for success.”

Equally, however, don't delay for too long. “Some businesses agonize over how to do things because of their fear of getting things wrong,” says EY's Osswald. “Rather than trying things out, they miss the boat because the local competition has caught up, or other companies have made the first move.”

Getting this balance right is a challenge that most entrepreneurs are very used to confronting. An appreciation of calculated risk is in their DNA. Internationalization is a natural extension to their inherent understanding of risk and reward.



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