

Handling Clients' International Expansion

International expansion is more of a survival requirement than an option for many organizations today. With many U.S. companies relying on emerging markets and countries to succeed, the biggest challenge faced by today's finance professional is to effectively support the organization's expansion strategy.



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While there has been an expected decline in both Greenfield Investment and merger/acquisition activity from last year, expansion is continuing. A recent survey of senior executives by *Foreign Direct Investment* magazine confirmed Asia as the leading location for expansion, followed by Europe. When facing expansion, there are three critical areas where finance professionals should have significant input:

- The overall expansion structure and strategy.
- Clearly defining the underlying assumptions complete with planning models that stress test the underlying assumptions regarding labor, technology and development costs.
- Developing an organizational design and infrastructure capable of providing accurate, timely and efficient information to the organization.

There are numerous information sources that focus on due diligence, raising expansion capital and structuring

a transaction for tax advantages. Here, we will focus on refining and understanding the operational and risk drivers that ultimately impact profitability and the efficiencies of back-office processing.

When building models that identify and assist in better understanding associated risks, it's important to examine the local regulations regarding the operations of the business. These are the given constraints to execution and vary by country.

Labor

Labor is typically a significant cost that varies geographically. When examining labor, look at all factors, including how and where future employees will live and commute to work. There is a shift of manufacturing activity from China to third-world Asian countries, like Vietnam, as increasing demand for labor in China has increased its labor costs.

Take the example of what happened in Macau, a special administrative region of China, when the Chinese government allowed foreign investment into the region. Very quickly, large gaming facilities were planned and constructed, driving up the cost of labor and materials. Once they became operational, there was a labor shortage, and the sheer number of employees needed drove up housing costs in the area. This impacted the skilled labor market needed for back-office functions. Further, movement between the mainland and Macau requires travel



through a border crossing, increasing the round-trip commute time, making jobs in Macau less attractive for many qualified mainland residents.

These macroeconomic factors added unanticipated costs plus inefficiencies in operations and should have been considered in the initial planning stages. Finance professionals can add value to the process by asking questions about how development cost overruns will impact the project's overall capital cost and if there are unanticipated operational or skilled labor costs.

Once known, strategies can be developed to address particular areas of concern. For example, back-office operations can be located almost anywhere. In Asia, Indonesia is often considered for shared service centers because there are many college-educated professionals in its workforce. But not all back-office operations need to be located together, and there are benefits for locating some operations in other geographic areas. For example, a retailer recently located its payables operations in Europe, while focusing its reporting center in Asia.

Technology

Another area to examine closely is technology. Technology used in the U.S. may not be widely accepted in the country under consideration. Obviously, most enterprise resource planning (ERP) applications have multi-language capabilities and some have double-byte reporting features for Japan. But others, like payroll and front-line operational applications, are not as widely accepted, creating both short- and long-term training and efficiency issues. These costs

can be significant and are important to consider, especially with employee privacy laws, which can vary by region within a country.

Consideration must also be given to the way in which business intelligence strategies are executed. This includes the design of data warehouses, needed bandwidth and redundant systems, as these costs can be significant.

Local Politics

Expand thinking beyond typical geopolitical risks. Consider the impact of regulation changes on operations. With Macau, the Chinese government placed annual travel restrictions on mainland citizens coming to Macau. That had a significant impact on gaming revenue, and marketing costs have increased as competition for visitors intensified.

Develop the Design

Once a solid understanding of the costs and associated risks has been established, plan and develop the overall organizational design of the finance organization. Balance local requirements, U.S. reporting and regulatory requirements. Understand where, how and by whom local tax or value-added tax requirements will be handled. Identify the processes, controls and reporting structure to manage these requirements, and understand what data needs to be collected in order to effectively comply with the various requirements. Consider forming a center of reporting excellence that is responsible for developing: (1) standard data definitions across geographies; (2) standard external and management reports; and (3) analytical platforms that

link ERP applications with enterprise planning and analytic data marts that support needed business analysis.

COA

Finally, an effective global Chart of Account (COA) can be designed that addresses the needs of the local requirements of the new entity, while obtaining the requirements of the parent entity. Don't force the parent's existing chart on the new entity. Design a COA on a country- or continental-wide basis. While International Financial Reporting Standards may make this easier as a common platform is selected, there are still significant differences to be considered.

To successfully manage a client's international expansion, accounting, finance, legal, operational and human resource colleagues need to collaborate early and often, establish a program management office and thoroughly evaluate plan activities. 🧩

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