An overview for Foreign Companies Entering the US Market

ENTERING THE U.S. MARKET: OPPORTUNITIES AND RISKS

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With a weak dollar and many strong foreign currencies, investors from around the globe (both individuals and institutional) are interested in taking a look at the U.S. market. After all, the U.S. market is still one of the largest and most homogeneous markets in the world. It is composed of an ever consuming public, speaking a single language, and the country has a relatively business friendly legal framework. So why not set up a business venture in the US right away? There are a lot of opportunities: from starting up a branch operation, to joint venturing with US partners and buying existing American companies.

However, the investment opportunities in the United States do not come without risks. As in any business transaction, a favorable financial climate (such as a favorable exchange rate) is only part of the story. Unless one reviews carefully all the aspects of the transaction and all potential risks, what seems like a great opportunity can end up becoming a financial disaster.

This article outlines below 10 key points that a company entering the US market should consider carefully before signing on to such a project. They are not meant to be the only points that one needs to consider. They cover, however, some of the major issues and risks that an investor must assess before starting a US venture.

1. Test the U.S. market: If the purpose of the investment is to bring a new product into the US market, extensive market research is necessary. At times, companies with popular products in Europe, Asia or elsewhere will decide to begin US operations, assuming that their product will be met with the same enthusiasm in America. Soon they realize that the American consumer does not have the same interests as the consumers in the other parts of the world where their product is sold. Their project does not succeed.

On the other hand, there are companies that spend months and often years doing market research before they enter the US market. Sometimes, they modify their products to meet the demands of the American consumers. Other times, they limit their entry to the region of the US where their product is most accepted. Those companies are often met with success of their venture.

Another way to enter the US market is by buying an American company, which has its own products and market share in the US. This move requires a different type of review.

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You need to engage local consultants who can review the company to be acquired and determine its viability as a business. This review should be done simultaneously with the financial review that the accountants will perform, but, probably, before any legal review. Basically, the lawyers should come in after the business persons have determined the viability of the venture. The lawyers will work with the business and accounting team members to structure the transaction.

In summary, an investor will enter the US in one of three ways:

- Starting its own operation in the United States,
- Going into a joint venture with an American company, or
- Acquiring (or merging with) a US company.

Each of those options has its own risks. However, as the balance of this article indicates, some of the risks and concerns are common in all three situations.

2. Forming a Legal Entity: How would a non-US company enter the US market? It can either (a) enter by creating its own branch in the United States, or (b) forming a separate (most probably wholly owned) entity. In most cases, one would choose (b), since opening a branch in the U.S. may subject the entire company’s operations to US tax reporting, as well expose it to liability for actions of the US branch.

In terms of the type of entity one would create when forming a subsidiary, the advice of both legal and accounting/tax professionals should be sought. The decision would depend on the circumstances of the particular venture. Typically, you would select from the following choices:

- Corporation: This is a classic limited liability entity with its own governance structure and tax reporting requirements.
- Limited partnership: It provides partnership benefits with limited liability for its limited partners (one of which can be the foreign investor).
- Limited Liability Company: This is a more recent American entity structure. It permits limited liability to its members (who are the equivalent of shareholders in a corporation) while enjoying the partnership feature of no taxation at the entity level.

3. Forming a Joint Venture: In deciding to go into a joint venture with a US party, the non-US joint venturer should discuss the details of the relationship with its US advisors (legal and accounting). Some of the points to be considered are the following:

- What type of entity is the joint venture going to be? Under US laws there is no specific entity for a “joint venture.” Therefore, it will be either some form of partnership, limited liability company or corporation. Generally, you would want to avoid a general partnership, which would make the general partner liable for the acts of the venture.
- Who will govern the joint venture? The composition of the board of directors and senior management is key to the success of the relationship.
- How are you going to resolve disputes? The advantages and disadvantages of arbitration, mediation or litigation should be discussed in detail.
- Are there going to be restrictions in competition? If there are do they fit with the non-US party’s global marketing plan?
- Who will own intellectual property created by the joint venture?

Those and other points (such as tax, employment and immigration issues) must be discussed in detail before finalizing the venture.

4. Due Diligence when Buying a Company: If the method of entering the US market is purchasing an American company, then there is a whole new set of due diligence questions that must be answered. The purpose of this article is not to go in detail into this subject. There are, however, five basic steps in a purchase (or merger) transaction that the foreign investor must be aware of:

- Execution of a letter of intent (binding or non-binding), which would include confidentiality provisions,
- Due diligence Review,
- Negotiation and execution of Agreement of Sale (or merger),
- Satisfaction of conditions to closing (such as financing and completion of due diligence), and
- Closing of the transaction.

An investor considering to buy a US company must engage US based legal and accounting consultants early in the process so they can assist it in the formulating and executing the due diligence review of the target company.

5. Tax Considerations: One of the most important and often overlooked aspects of entering the US market is the US (and sometimes home country) tax consequences associated with this event. It is important, therefore, to engage early on a good tax advisor (law firm or accounting firm) to review the tax issues and work with the foreign company in structuring the US transaction in a way that makes sense from a tax perspective. For instance, the tax treaty between the US and the country of domicile of the non-US investor may provide special tax consideration for one form of investment over another. The investor should be made aware of the different options of structuring the transaction and what they mean with respect to its tax liability so it can make an informed decision on how to proceed.

6. Real Estate Considerations: In many cases, the investment in the U.S. would involve some type of real estate transaction. Whether it is a lease for space, when starting a branch, or the purchase of real estate assets in the purchase of a company, the investor should familiarize himself with the U.S. real estate practice. Of course, that practice also varies from state to state within the U.S. So, the location of the operations becomes critical in the real estate review.

7. Employment and Immigration: As the decision of investing in a US operation becomes more concrete, the issues of employment and immigration laws should be explored. First, if the non-US investor enters the US market on its own (without a US partner who presumably is familiar with US employment laws), then it must have expert advice on setting up its employment structure in compliance with all US (federal, state and local) regulations. Secondly, if management personnel is expected to come to the US to assist in the management of the new operations, then the US immigration laws should be
investigated early on, so there is no delay resulting from potentially lengthy visa approval procedures. The US immigration laws have changed in the last few years and require a greater amount of investigation of individuals entering the country. Having early competent immigration advice will avoid unnecessary delays at the end of the process.

8. Regulatory Matters: Most industries in the United States are regulated by the federal or state governments. As part of the process of acquiring a US company or entering the US market, the non-US investor must review the relevant regulatory provisions and create a compliance plan.

9. Intellectual Property and Confidentiality: One of the main issues facing companies today is the ownership of intellectually property ("IP") rights. So, when deciding to look at the US market a company must think of how intellectual property issues would affect its efforts. Some of those issues include:

- If the non-US company owns IP which it is contributing to the US venture? If yes, unless the contribution is accomplished through the proper license agreement, the non-US company may lose the rights to the IP anywhere else in the world.
- If the IP is contributed, what is its value?
- What happens to new inventions or improvements to the IP? Who owns them?
- What restrictions will apply in the use of the IP upon termination of the joint venture?

Those and other questions must be reviewed carefully by the investing entity and its legal and business team.

10. Engaging the Right U.S. Management: Finally, the company that decides to enter the US market must assemble a US management team that will reflect its needs. Careful selection of such a team is going to be a major factor in the ongoing success of the US venture.

In summary, the economic benefits of entering the US market can only be realized if the decision is made and executed in a thoughtful and methodical manner. The 10 basic points that are outlined above provide a general framework for beginning to think of that process. They are not the only issues that one must consider. Every business and every fact pattern has its own challenges. To that, we must add the fact that the US is a multi-jurisdictional country, when it comes to legal systems. There is the federal legal framework, but also each state has its own laws. The non-US investor must be aware of that complexity when considering entering the US market.

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