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# International Trade

Uncovering opportunities and hidden risks

# Expanding internationally

## How can businesses uncover both the bright opportunities and the hidden risks associated with exporting goods and services to overseas markets?

*By Dinesh Jangra, Partner, Head of Global Mobility Services, Crowe; Sat Khuntia, Head of Corporate Bank FX Sales, Barclays Bank; and Rob Lewtas, Strategic Partnerships Manager, the Department for International Trade*

International expansion gives businesses a platform for tapping new markets and securing additional revenue streams. Thanks to the combination of globalisation and the rise of the internet, there has never been a greater opportunity for British businesses to operate internationally than there is today. World-class British goods and services are in high demand around the world. According to the Office for National Statistics, UK exports rose by 10.4% to £627.6 billion in the 12 months to February 2018[1].

Some companies are effectively 'accidental exporters' that begin to export by chance after receiving an order from an overseas buyer. For others, exporting is a conscious move. While international expansion presents many opportunities, it also presents risks, For example, an audience poll conducted during a recent webinar on international trade, hosted by Barclays, found that the two greatest challenges facing would-be exporters are a lack of market information and knowledge, and worries about securing export licences and documentation. Other concerns were getting paid and having to devote significant amounts of management time to the export process.

So it is important that before companies commit energy and resources to seeking out new export business, they undertake thorough research to assess both the advantages and the disadvantages of entering new markets.

Three key areas where particular due diligence is required are people mobility, foreign exchange (FX), and market selection.

[1] UK Trade: February 2018, Office for National Statistics

## People mobility

A company that expands into a new territory will usually move people, bring in new people specifically to work in that location, hire people from the local market, or possibly do a combination of all three.

Preparation is key to the deployment of people. It will prevent the company from encountering legal difficulties, incurring unexpected costs or having to delay its people from becoming productive Additionally, payroll and tax considerations should be factored into the company's decision as to whether it will hire staff locally or relocate expats instead.

Some of the issues to think about include:

- **Payroll:** If the company is hiring new staff in the country, or moving existing staff, will it be necessary to start a payroll there? Also, will any employment or payroll taxes be due? Is the employer obliged to make pension contributions or social security payments on behalf of its staff? Falling foul of legislation in this area could result in the company having to pay hefty penalties, as well as interest.
- **Tax:** When a company moves UK employees overseas, it could cause those individuals to incur tax-filing obligations in the countries that they move to. Different countries offer different tax breaks to expats so it is important to find out how employees can claim them and the time periods for registration.
- **Permanent establishment risks:** If a company is considered to have permanent establishment in another country, it is generally liable for tax in that jurisdiction. If employees in a foreign market have the capacity to conclude contracts and conduct negotiations, this could result in the UK entity acquiring permanent establishment in that market.
- **Immigration:** UK employees who work in overseas markets need to have appropriate visas. In future, Brexit could present immigration issues for British citizens working in the European Union (EU), and for EU nationals working in the UK.
- **Labour law:** It is a mistake to assume that UK labour law alone applies to UK employees working overseas – local labour laws may also apply to foreign nationals.
- **Employee welfare:** Employees should have access to good healthcare wherever they are based, which means the company might need to provide them with international cover. If they are working in a country that is struck by a natural disaster, terrorist attack or other major event, the company must be able to quickly identify where they are and repatriate them if necessary.

*Dinesh Jangra, Partner, Head of Global Mobility Services, Crowe*

## Foreign Exchange

When a UK company starts to trade internationally, it may become exposed to FX risks. FX risks can be classified as transaction-related risks (the risks associated with paying or being paid in a foreign currency) and translation-related risks (the risks associated with having balance sheet assets and liabilities that are denominated in currencies other than sterling).

Transaction risk is part of international trade. It is possible to manage, or even eliminate, the risk by invoicing in sterling. This may have an adverse impact on sales volumes, however, if customers and suppliers do not wish to transact using sterling.

Translation risk becomes relevant when a company looks to buy, or dispose of, assets in a foreign location. As exchange rates vary, so will the value of those assets, which could make it harder to complete a purchase or a sale. The variance could also impact the balance sheet by giving a distorted view of the company's financial performance. Emerging market currencies, in particular, can be very volatile.

There are four broad practices for managing FX risk:

1. **Doing nothing:** Many companies do not recognise that they are exposed to FX risk all, partly because a lot of their FX exposure is actually embedded deep within their supply chains.

2. **Choosing to do nothing:** Some companies recognise the currency risks involved with their supply chains, but they actively choose not to manage them, believing that the risks are not large enough to warrant intervention. Alternatively, they might apply natural hedging strategies – for example, using costs to offset revenues in a particular currency.

3. **Using simple hedging instruments, such as forward contracts:** Fixed dated forwards provide a guarantee of the sterling amount that will be received on an agreed future date, at an agreed rate, with both being fixed at the outset. Meanwhile, option dated forwards provide a guarantee of the sterling amount that will be received at an agreed rate, across a range of future dates. Exporters can use these kinds of instruments to hedge their receivables in foreign currencies.

4. **Working with multi-currency banks accounts:** Companies have bank accounts in different currencies, which they use to handle payables and receivables in different locations. As result, they only have to manage the FX risk associated with the float.

While the best approach for managing FX risk will vary according to the company's circumstances, it can start by analysing all the supply chain currency exposures that it is exposed to at present.

*Sat Khuntia, Head of Corporate Bank FX Sales, Barclays Bank*

## Market selection

Choosing which market to expand into is probably the biggest decision that a company can make once it has decided to start exporting. Since exporting is innately risky, it is essential that the company makes an informed decision as to where it wants focus its energy and resources.

The World Bank's Doing Business index ranks different economies on their ease of doing business, considering factors such property registration, security credit, trading across borders and insolvency resolution. The highest-ranking economies on the list also tend to be safe destinations, such as New Zealand, Singapore, Denmark, the United States and Norway. Safe does not necessarily mean profitable, however, since some companies become very successful by trading in more challenging markets, where they come up against less competition.

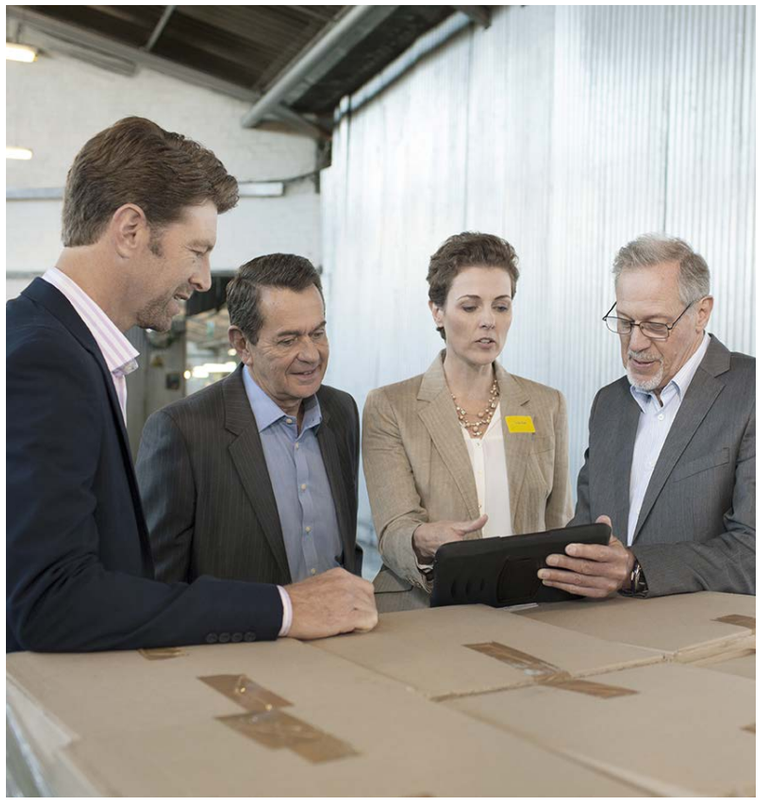
Regardless of whether a company opts to enter a safe market, or a riskier, market, it needs to know what it is going into. This means researching the market in depth and looking at a range of factors, including the size, average age and average income of the population; internet and mobile phone penetration; the scale and sophistication of the banking network; capital controls imposed by central banks; currency volatility; skills availability; the regulatory environment; and whether changing legislation is likely to impact on demand for goods and services. When doing this analysis, it is also critical that the company calculates its true cost of sale.

Finally, companies that are looking to expand into new markets should make full use of the support networks that are available to them, including those provided by banks, business associations and the Department for International Trade.

*Rob Lewtas, Strategic Partnerships Manager, the Department for International Trade*

## Conclusion

Ultimately, the risks associated with people mobility, FX and market selection should not deter a company from expanding internationally. It is important to be aware of all the implications involved with trading internationally, however, and to draw on local knowledge so that the company can take full advantage of all the opportunities that exist.



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