ELEMENTS
GLOBAL SERVICES

EMPLOYER OF RECORD SERVICE PROVIDERS:

SPEEDING THE TIME TO GLOBAL MARKETS

RICK HAMMELL, CEO, ELEMENTS GLOBAL SERVICES

INTRODUCTION: INTERNATIONAL EXPANSION TODAY

Year after year, companies of all sizes make the decision to move abroad to improve their potential for expansion and growth. Most recently, Under Armour announced plans to continue its expansions plans in China, Lyft is working with local partners in Southeast Asia and India, Marriott International announced plans to expand its portfolio across Europe, and the list goes on.

The trend of increasing international growth promises to continue. According to the 2017 International Business Indicator, whose results are based on a survey of executives at more than 280 American businesses engaged in international business, 81 percent of U.S. companies expect their international business activity to increase over the next 12 months.

Even with the potential for disruptions in the marketplace from Brexit and uncertainties about the current U.S. administration, respondents to the study indicated that improvements in the global economy and emerging market opportunities contribute to their optimism about the future of international business.

The internet has opened the world to businesses of all sizes as well. While international expansion is still viewed by U.S.-based multinational businesses as a key strategy for achieving their corporate growth objectives, in recent years, new mobile and e-commerce technologies have enabled small and medium businesses (SMBs) to reach new consumers in foreign markets.

As a result, there is growing optimism among SMBs about the potential of international operations. According to an SMB Confidence Indicator survey published by OFX, a foreign exchange company, most (57 percent) of the more than 500 U.S. businesses surveyed are confident about conducting business overseas, with 63 percent reporting positive growth.

Companies decide to expand into international markets for many reasons—to access new customers, diversify operations, and tap into new talents, capabilities, and materials. Today, China and Canada are hot markets for expansion. Largely because of the recent acceleration of its economy, China joined Canada as one of the top choices of respondents to the 2017 International Business Indicator, followed closely by Mexico. Japan, with its late-2016 economic growth, moved to the fourth spot, followed by Germany (Figure 1).

Top Hot Spots for International Expansion

COUNTRY	% OF TOTAL MENTIONS
China	41
Canada	41
Mexico	32
Japan	21
Germany	18

Figure 1. According to the 2017 International Business Indicator, 41 percent of respondents named both China and Canada as key future growth hot spots for their businesses.

American multinational companies are also looking to the emerging markets of South America, while interest is growing in Australia and New Zealand as well. The Asia-Pacific (APAC) region, too, has emerged as an important driver of the global economy and, as such, presents significant opportunities for business growth.

THE CHALLENGES OF INTERNATIONAL EXPANSION

Businesses that follow the traditional process when expanding into a new market, especially in countries that have significant cultural differences from the U.S., face a complex set of challenges. The first, and often most intricate challenge, is the matter of setting up a new legal entity, branch, or foreign subsidiary of the core business, in the new country.

The decision to set up a foreign subsidiary is often made in response to the need to expand brand recognition for the business, to control production costs, or simply to open access to new markets for the product or service. Most often, companies establish a foreign subsidiary with the goal of hiring new talent in that country.

Definition: A foreign subsidiary is a legal entity in a foreign country wholly or partially owned by another company with headquarters in another country (or an international holding company).

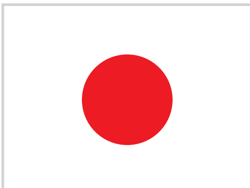
Even though creating a foreign subsidiary may offer advantages for the parent company in terms of taxes and intellectual property, managing the process can demand significant investments of time and money. Setup time, which can be as much as six months or more, can present a serious speed bump to getting an operation up and running. "In China, it can take up to 18 months and even sometimes longer than that," says Rick Hammell, CEO, Elements Global Services (Elements), a global employer of record (EOR) service provider.

While the average cost of initial setup can range from $15,000 to $20,000, amounts vary widely globally. The cost of setting up a Ltd company in the U.K., for example, costs just $5,000. At the other end of the spectrum is Brazil, where the cost to set up a Limitada (LLC) can be as much as $35,000. "For a U.S. company to set up an entity in Brazil, it can sometimes take hundreds of thousands of dollars and a minimum of nine months and you're taxed 30 percent on your investment," says Rick Fazio, Vice President of Business Development at Elements.

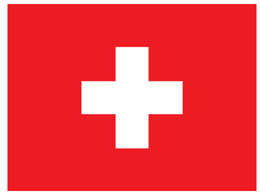
Regulatory compliance is another major challenge that can delay the launch of a foreign operations. Increasingly stringent Know Your Customer (KYC), anti-money laundering (AML), and other international regulations can have potentially dire consequences for a business that does not comply. These regulations vary widely from country to country and, as such, it is a challenge for businesses to keep current and informed. In some cases, signatories for bank accounts are often required to sign documents in person, which can require considerable cost and travel time.

In addition, foreign subsidiaries are required to identify local directors to complete the in-country application. If the business does not have trusted representatives in the new market, this can be a risky proposition.

Tax Compliance Challenges



Japan: Japan has consistent audit policy - 1 out of 4 companies doing cross-border transactions is audited each year.



Switzerland: Certain types of liaison offices do not have to register or pay income tax or VAT, but the rules are different for subsidiary companies.

Capital Investment Challenges

UAE: This is costly location for expansion due to capital investment requirements, licenses, visas, registration and real estate values.

Brazil: Setting up a Limitada can cost $35,000 and the investment is taxed 30%

Employment Law Challenges

Saudi Arabia: There have been measures limiting foreign workers and employment laws regarding termination of workers.

United Kingdom: Statutory maternity leave policy calls for just six weeks of decently paid maternity leave.

Figure 2. Examples of international business expansion challenges.

There are also many potential issues if the company decides to close down the branch or subsidiary—including the need to renegotiate office leases, transfer equipment, secure electronic data, close bank accounts, and pay local vendors and suppliers for products and services that may be covered by a contract.

MARKET ENTRY OPTIONS

Establishment of a foreign subsidiary is not the only strategy for entering a new global market. One option is an international joint venture, which enables a business to establish a presence in a new foreign market with the support of a local partner that can contribute its knowledge about the regulations and norms for doing business in that new market.

A joint venture is a new business entity that is created by two or more parties as a short-term partnership with shared ownership, risks and returns, and governance.

Acquisition of another company in the new market is another option. In this case, the degree of ownership in the foreign operation ranges from wholly owned to partially owned.

The 2015 edition of the International Business Indicator found that nearly half (48 percent) of respondents were planning to set up an in-market subsidiary to handle operations in a foreign market, with another significant portion (36 percent) reporting plans to participate in a joint venture, and 16 percent planning to acquire another company in the new market (Figure 3).

Plans for Entering Foreign Markets

- Subsidiary
- Joint Venture
- Acquisitions

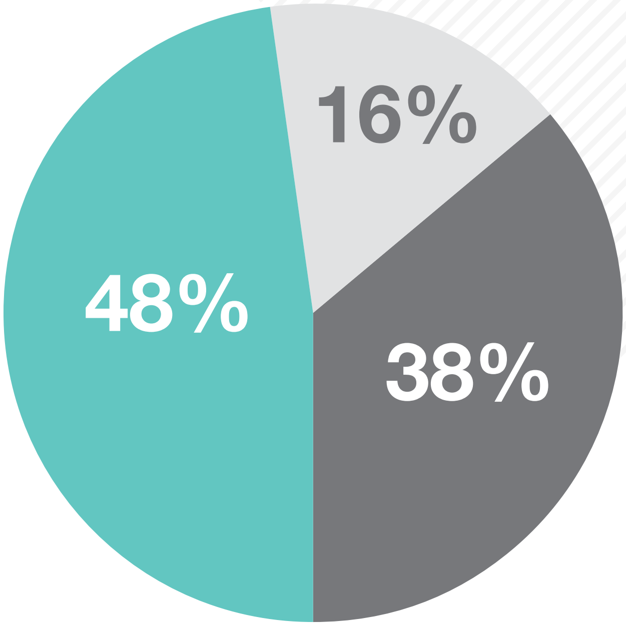


Figure 3. How businesses are entering foreign markets. (Source: Rutgers Online, "Globalization: Challenges of Corporations During Expansion.")

An alternative to forming a new legal entity as an onshore company in a new market is the formation of an offshore company. "Offshore company formation is generally much easier than onshore incorporation because of business-friendly legislation," says Fazio. "You can form your company in as little as a couple of days from payment to your offshore service provider."

With several hundred thousand registered across the globe, international business companies (IBCs) are the most common legal form of offshore companies. The most popular offshore jurisdictions are: Belize, Seychelles, British Virgin Islands (BVI), Panama, Hong Kong, and Mauritius.

ABOUT EMPLOYER OF RECORD SERVICE PROVIDERS

With all of the challenges that business expansion into global markets presents, many businesses opt to engage a professional employer organization (PEO) to help them navigate the process. A PEO takes on the legal responsibility of employees in the new country, as well as all of the time-consuming administrative tasks involved in managing those workers that the business often does not have the knowledge or experience to handle.

Since the 1980s, U.S. businesses have used the services of PEOs to outsource their employee management. Since then, the PEO market has generated $152 billion in gross revenues and reinvented the employee leasing marketplace. Today, the global PEO, or the global employer of record (EOR) platform, serves businesses seeking to set up operations and onboard employees in foreign markets.

Working with an EOR, the client business continues to maintain responsibility for the strategic direction of the company and the core product or services, as well as decisions about hiring, compensation, terminations, and benefits options. The EOR assumes responsibility for risk management, human resources management, benefits administration, payroll, and tax and labor law compliance. Although workers in the new market are employees of the client business, the EOR acts as "employer of record."

An employer of record is a company or organization that serves as the employer, for tax purposes, for employees that work for the client company.

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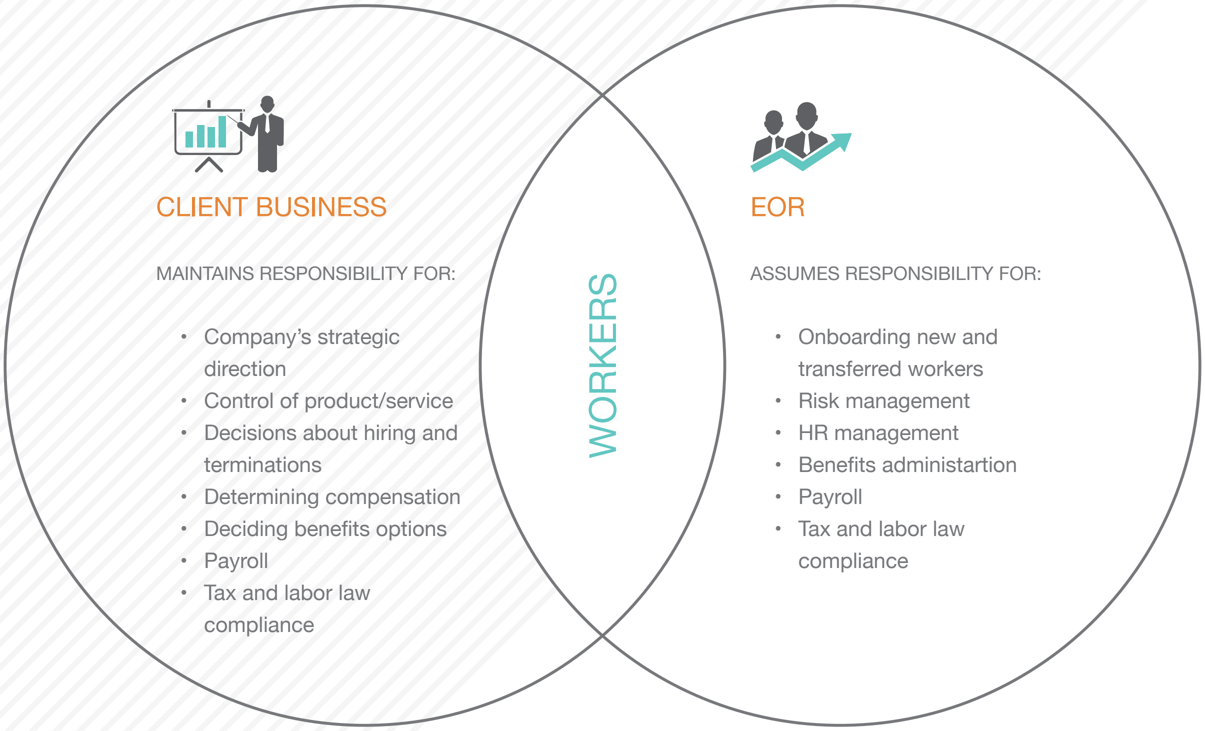

Figure 4. How an EOR works.

DIRECT VS. INDIRECT EORS

The indirect or brokerage EOR service model has been the traditional way that businesses work with EORs. With this model, the EOR contracts with local service providers (LSPs) and/or in-country partners (ISPs) in each country in which the business needs support. The outsourcing of these services means local providers manage all logistics and back-office functions instead of the EOR. In the meantime, the EOR, with access to the local providers, serves as the main point of contact for the client business in that country. In this model, there are multiple entities working behind the scenes. "While this model works, it can get complicated if you are operating in multiple countries, working through—and indirectly paying for—multiple LSPs and/or ISPs," says Fazio.

Recently, a direct model has disrupted the EOR industry. With the direct model, the EOR directly owns and manages its own entity in the country in which the business needs support and the EOR partners directly with the business to develop a core solution in which the employees are the employees of the EOR in that country. By cutting out the need for a local provider—the middleman—the direct model offers obvious cost advantages, as well as a more streamlined approach to setting up and managing the foreign operation. "Working with a direct EOR company helps avoid the potential pitfalls of indirectly outsourcing to multiple third-party LSPs and/or ISPs that perform services on behalf of the business, as well as the associated administrative costs," Fazio says.

HOW AN EOR CAN HELP MEET EXPANSION CHALLENGES

As the employer of record for a business entering a new foreign market, an EOR service provider can save the business time and money by taking care of the many issues and challenges involved in setting up the business in another country.

With an in-country presence already in place, the EOR can offer the client business access to a significant network and resources that can streamline the initial steps involved in setting up the new operation. "There are many steps involved—meeting with labor attorneys, setting up employment contracts, pensions, insurance, and more—a number of benefits and services just on the statutory front that, if you've only worked in the U.S., you wouldn't know where to begin," says Mark Rodriguez, Chief Operations Officer at Elements.

Figure 5 compares the average time and cost for a business to directly set up an entity in a new market with the time and cost for an EOR to handle the process. By delegating the entire setup process to knowledgeable EOR staff, a business can save, on average, $70,000, while shaving as much as 12 to 16 weeks or more from the process.

AVERAGE COST & TIME COMPARISON

The time and cost to set-up and manage a company in a new country can be cost prohibitive, require interfacing with various vendors and transition your focus from your core business operations. Working with EGS means you have one partner who can help your business save time and up to 94% in cost.

	Market Cost	EGS
Entity Registration & Set Up	$10,000	....
Statutory & Labor/Employment Registrations	$5,000	....
Entity Tax Compliance & Registrations	$5,000 +	....
Bank Set Up & In-Country Capital Requirements	$20,000	....
Bank Set Up & In-Country Capital Requirements	$10,000 +	....
Bank Set Up & In-Country Capital Requirements	$30,000 +	....
Average Cost To Set Up In A New Country	**$80,000**	**$10,000**

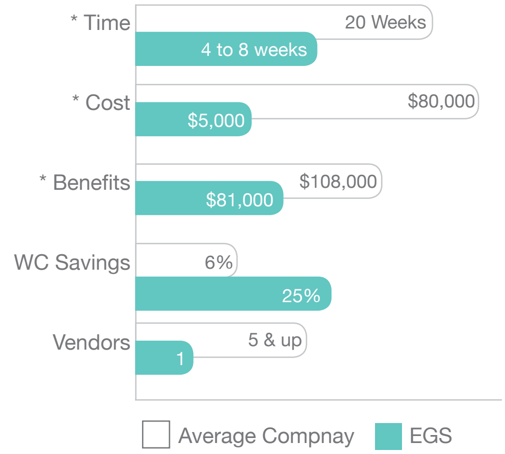

Figure 5. Average cost and time comparison of setting up business in a foreign market: the process handled directly by the client company vs. EOR

HOW EORS CAN MITIGATE THE RISKS AND CHALLENGES OF FOREIGN OPERATIONS

Among the many steps involved in setting up a new foreign operation, those that can be handled and streamlined by an EOR service provider are:

- **In-country registration.** Because governmental agencies do not move quickly, this process can be extremely complicated, take many months, and require significant resources in terms of time and money. With an existing in-country presence, an EOR can help the client get the business off the ground in a fraction of the time and onboard, manage, and pay employees at a fraction of the cost.

- **Compensation.** An EOR company will ensure that payroll compliance is maintained at all times. This includes base pay, as well as many forms of additional allowances that may be customary for a country or an industry. An EOR will also provide insight about compensation practices that might be unique to a particular country (e.g., paying a 13th month bonus or providing a housing, telephone, and/or car allowance).

- **Employment contracts.** Many countries require the signing of employment contracts or some version of an offer letter that provides the employee with a written statement of the terms and conditions of employment. It is also often important to use an in-country format rather than a U.S. contract or employment-at-will-clause. An important tool for managing the business-employee relationship, a well-crafted employment contract can mitigate most potential employment-related issues. An EOR partner like Elements will make sure employment contracts meet statutory requirements and cultural norms, while also protecting the business and the employee.

- **Employment law.** Businesses entering foreign markets must focus on providing employees a work-life balance, with programs that enhance both their professional and personal lives—such as flexible work time, paternity leave, extended holiday time, and on-site child care, some of which are mandated by law in European countries and others. To help client companies avoid violations, Elements keeps client companies advised about requirements like these, as well as any changes in in-country employment laws.

- **Employee onboarding and payroll.** An EOR like Elements, which has a global human resource information system and payroll technology resource, can streamline and manage the process of employee recruitment, onboarding, and payroll from a single centralized system. The payroll function maintains the most current employment and tax regulations for each country to ensure that the client business is always in compliance.

- **Cultural differences.** As businesses expand into the global marketplace, it is more important than ever to understand how cultural differences may impact the conduct of business in the new country. "There are nuances that people don't think about when they enter new markets because they're used to the U.S. way," says Hammell. As businesses expand into new regions, they need to deliver consistent employee messaging internally, while meeting different local language, cultural, and legal requirements in each country. Elements helps organizations deliver effective and meaningful strategic multinational and multilingual communication programs around the world.

- **Tax compliance.** In the area of tax compliance, requirements for employers vary widely. "Every country is different," says Rodriguez. "In some countries, like Costa Rica, it's simple; in other countries, there are significant employer requirements. We keep businesses abreast of the most current tax codes and we take on what they normally pay as a company for taxes." An EOR will collect and remit required payroll taxes and required statutory payments for things such as socialized pension or requirement benefits, medical schemes, and other in-country requirements. An EOR partnership will bond and insure in-country tax payments and liability.

MENSTRUAL LEAVE: A SENSITIVE CULTURAL ISSUE IN SOUTH KOREA

Menstrual leave policy is a culturally accepted practice in some Asian countries. In South Korea, legislation passed in 2001 allows female workers to take one day of menstrual leave per month. Policies in other Asian countries vary. Japanese workers have had menstrual leave as a legal right since 1947, while, throughout China, the issue is still being debated. In Taiwan, legislation passed in 2013 guarantees three days of menstrual leave a year and in Indonesia, women are allowed to take two days a month.

"The reality is that there are menstrual leave policies in those countries and it's important to be aware of them," says Rodriguez. In a recent case, an Elements client had attempted to discipline female employees who had taken time off. The Elements team counseled the client business about what was needed in order to be in compliance with local menstrual leave laws and to be sensitive to the issue. "It was simply a matter of an American company that did not understand the rights and rules of that country," says Rodriguez.

> "Our ability to get companies into a market quickly is important, especially for companies that are looking to test a market to determine whether they will be able to generate business.

ABOUT ELEMENTS GLOBAL SERVICES

Today, there are approximately 15 EOR companies in the world and, of those, only two operate with the direct model outside of the U.S. in Europe and in Asia. Elements Global is the only EOR company operating with the direct model in the United States. This represents a distinct advantage for companies that want to enter a new market and get their business up and running quickly. "Our ability to get companies into a market quickly is important, especially for companies that are looking to test a market to determine whether they will be able to generate business," says Rodriguez. "We enable them to test a market quickly to see if it works for them."

Since launching in 2015, the company has grown exponentially and now serves numerous clients and provides access to over 135 countries. The company works with businesses of all sizes, from startups to Fortune 1000 companies, and manages payroll for thousands of client employees.

The Elements EOR services span a comprehensive spectrum of services—including sponsorship of employee residency visa and work permit requirements, global benefits administration, payroll processing through its proprietary HRIS, access to cutting-edge technology for storing and managing employee data, and in-country tax and labor compliance.

Recognitions

Member
National Association
of Professional Employer
Organizations

Resources

"Under Armour plans to expand its international presence," Market Realist. Find at: http://marketrealist.com/2017/01/armour-plans-expand-international-presence/

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