Setting up an entity abroad: Best practices for startups

Establishing a legal entity abroad is a time-consuming and expensive process and, more than anything, very risky. If business in the new market is bad and the foreign entity needs to be closed again, the financial losses are substantial, which can stifle business growth. Here you will read how startups can minimise their risks and enter new markets with full confidence.

Temps de lecture : minute

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Expanding into new markets is a necessity for businesses to keep growing and remain competitive, and after successfully establishing themselves in their home territory, looking for new business opportunities abroad is also the logical next step for startups.

However, conducting revenue-generating business abroad requires setting up a legal entity, which is an expensive and risky endeavour. With registration fees, capital requirements, fees for legal consultation and administration and real estate costs, businesses must make a significant upfront investment. For instance, organisations planning to set up a limited liability company in Germany will need *at least €30,000 to cover legal fees and capital requirements* alone.

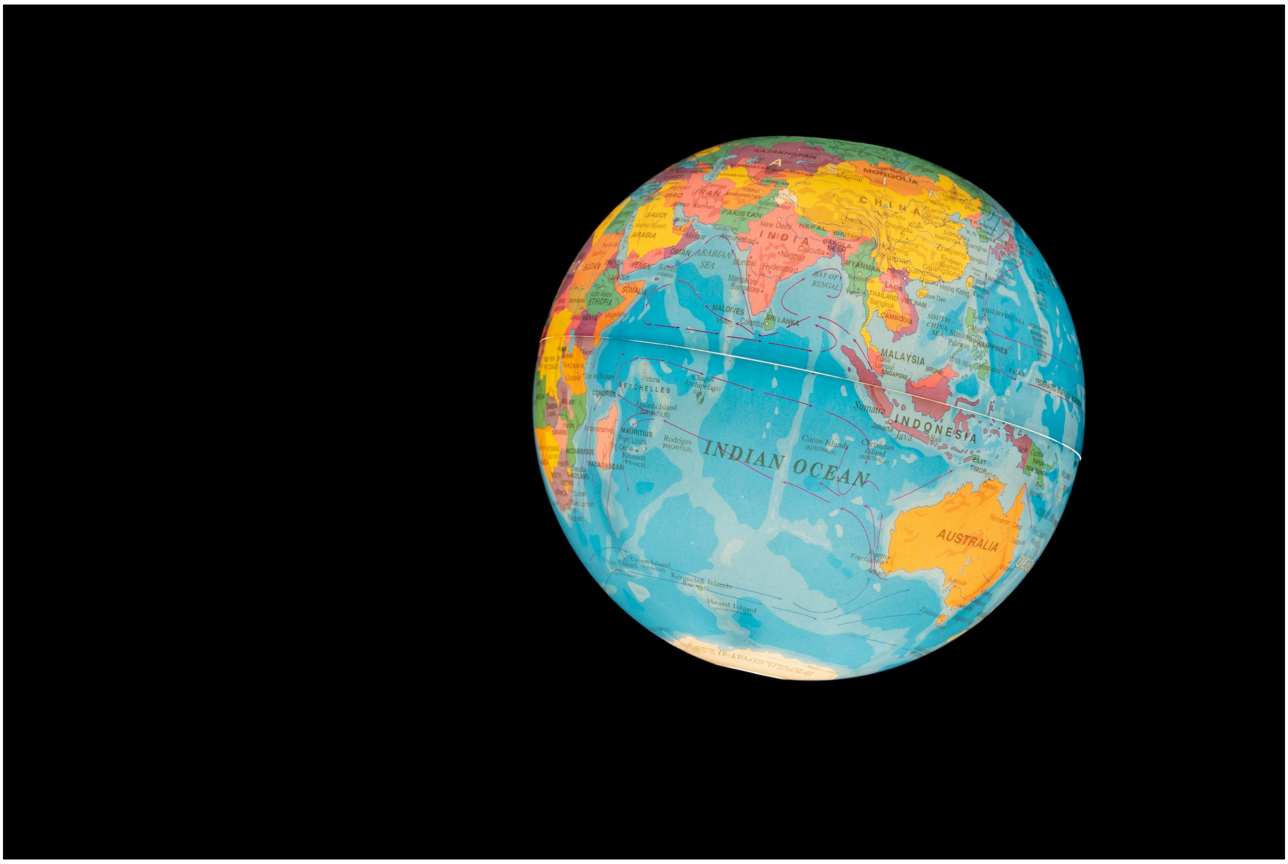
Given that it's difficult to predict with certainty how customers in a foreign market will resonate with a product, making such a heavy upfront investment means taking a substantial financial risk. Instead of jumping in at the deep end, startups should play it safe and establish a local presence in a step-by-step process.

The challenges and risks of setting up a foreign legal entity

Establishing a legal presence in a foreign country comes with *various challenges*, which range from choosing the right legal structure to finding and hiring local talent to complying with foreign laws regarding employment, taxes, social security, payroll and more. Startups that fail to successfully navigate these challenges when opening an entity abroad risk hefty fines for non-compliance – and, in the worst case, *even business suspension or closure*.

Given the multitude of challenges and compliance risks, it's hardly surprising that entering new markets often ends badly. In fact, there are numerous examples of *big corporations that tried to expand into a foreign market, but failed spectacularly*. Home Depot's failure to bring the DIY culture to China and Starbucks's misadventure in the Australian coffee market are just two prominent examples. If big enterprises struggle to successfully establish a presence in foreign markets, *the risk of failure is even greater for startups*, since they have less experience and resources at their disposal.

By the time Starbucks decided to close the majority of its coffeeshops Down Under, the chain had already *accumulated losses of $143M*. While big multinationals can take such a financial blow, the same can't be said for startups. Entering a new market and creating a local legal entity with all the infrastructure that goes with it requires big initial investments. If the startup business then fails to successfully position its products in the foreign market, the impact on business growth can be severe and, if worst comes to worst, it can mean the end of the startup altogether.



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Successfully setting up an entity abroad as a startup: Taking it step by step

Before establishing a legal entity abroad, startups need to gain a deep understanding of the local customer base, verify their market assumptions and evaluate whether expected business profits warrant the financial costs and risks of incorporation. The way to get there is to follow a step-by-step approach which slowly increases the level of commitment to the new market.

Starting with local freelancers and contractors

The best way to “test the waters'', so to say, is to start off by hiring a team of local freelancers and contractors. Their expertise (both in their line of business and with regard to local culture and customer base), flexibility and short-term availability provide ideal conditions for foreign businesses to get to know the new market without making any form of commitment. What's more, startups can use this initial low-commitment phase to start building a local network.

Hiring local employees with an Employer of Record

After a successful test run with a local freelance team, the next step is to hire employees to start building a presence in the foreign market. Instead of creating a legal entity to do so and risking fines for non-compliance with local labour, payroll and tax laws, it's safer to hire local talent through an *Employer of Record* (EOR) who takes on the role of the employee's legal employer and handles all the legal and administrative tasks related to the employment, leaving the client business to manage the employee's tasks and projects.

Establishing a legal entity while the local team is already working

Once all the market assumptions have been validated and business is running smoothly, it's safe to go ahead and start the incorporation process. At this stage, having hired staff through an EOR proves to be a significant advantage because the local team can continue working while incorporation is still underway. By the time all the registration processes are finalised, all that's left to do for the startup is to register as an employer with local authorities, move the EOR hires to its foreign entity and set up local payroll.

Mitigating risks along the way with an all-in-one compliance platform

Gradually transitioning from freelancers and contractors to EOR hires to incorporation is the safest option for startups looking to establish a legal presence in another country. However, safe shouldn't be confused with risk-free. Managing and *paying international contractors* comes with its own set of challenges, and while using an EOR to hire employees abroad mitigates compliance risks, finding the right service provider can be daunting and time-consuming. The same challenges arise when looking for a local payroll partner.

A global compliance platform like *Lano* offers startups a convenient all-in-one solution which addresses all the challenges they encounter in the process, from managing and paying freelancers and contractors to hiring full-time staff through an Employer of Record to setting up local payroll with the help of an experienced payroll partner.

Maddyness, media partner of Lano. A cloud-based compliance and payments platform designed for building and scaling global teams. Through its network of experienced Employer of Record and payroll partners, Lano enables businesses to compliantly hire, onboard and pay employees in over 150 countries.

Article by Maddyness, with Lano