Ten Success Criteria for Establishing a Thriving U.S. Subsidiary

The United States is the largest economy, and the most important market for many products and services. Growing mid-sized international companies recognize that a presence in the United States is necessary to be recognized as a global competitor. Although many of the success criteria described below apply to global market entries, this paper focuses on the specific opportunities and challenges in establishing a presence in the US. Typical drivers for a US market entry include

- The need to serve their own global customers which includes US distribution and service
- Production volumes needed to achieve a competitive cost structure and amortize R&D investments
- Limited growth opportunities in home markets

Many mid-sized companies enter into international markets without a clear plan and entry strategy. Market entry strategies must be based on the goals of the company. There are no “right” or “wrong” strategies, but a series of trade-offs based on short and long-term objectives. More control, brand name recognition, and higher margins require more investment and a longer term commitment. Market entry strategies with lower investment reduce the potential for long-term market control and margins.

Below are the ten most important considerations for establishing a profitable US operation.

1. A Business Plan with Realistic Expectations

Although this may seem obvious, many mid-sized companies enter the US market recognizing the potential and “need to be there”, but without clear objectives, a business plan, and funding. As a result, money is wasted on half-hearted attempts to slow-roll a market entry. A business plan must answer a few fundamental questions:

- What are your objectives for revenue, market share, and margins?
- How much are you willing to invest?
- When do you expect the US operation to be self-supporting or profitable?

It is essential that the business plan is in line with the long-term objectives and includes the appropriate funding to support the market entry strategy.

2. Adapt to US Culture and Business Customs

In general, most failed market entries – worldwide - are due to a lack of cultural adaptation of the product, business model, or the company culture. An ethnocentric approach assumes that the home culture, products, and business customs are superior, and can be imposed on foreign markets. This is a known challenge for many multi-national US corporations. But it is also often a barrier for European companies where home office executives may feel that European designs, traditions, and ways of doing business are superior to the US. European companies tend to assume a high level of government social programs, not realizing the US dependence on company-provided benefits for healthcare, disability, and retirement savings.

Executives of foreign companies should make an effort to study and comprehend US culture. A good source is Geert Hofstede’s five cultural dimensions[i]. The following dimensions are where the US culture is often significantly different from the home office culture:

- **Individualism (IDV)** – the US has one of the highest IDV scores in the world. This indicates a society with a high degree of self reliance that values individual decision making and achievement over group performance. Example: US compensation plans must be very different from those in an Asian subsidiary or home office.
- **Long-term-orientation (LTO)** – the US score for LTO is low, reflecting the society's belief in meeting long-term obligations, but also a society that tends to value instant gratification and quarterly performance. Example: Be prepared for special incentives from US competitors shortly before quarter and year end.
- **Power-Distance Index (PDI)** – the low US PDI indicates a society that is open, with a relatively high equity between social levels and a cooperative interaction across power levels. Relationships are important, but are less restricted to classes and cultures.
- **Uncertainty Avoidance Index (UAI)** – the good news for a market entry is the relatively low US UAI, indicating a society that is generally willing to accept risk, new products, and new ideas.

By comparing the Hofstede scores for the US culture to the home country, foreign executives will learn to better understand US markets, customers, and employees.

3. Be Prepared to Live up to High Expectations and Tough Competition

US markets are often the most competitive in the world, in terms of delivery expectations, service, quality, and price. International suppliers may be forced to sell products in the US at lower prices and margins than in their home markets. This is especially the case when suppliers cannot pass on the effects of dollar devaluation when they compete with US and other global suppliers.

4. Define your Value Proposition and Differentiation

Market entrants tend to over-estimate the uniqueness of their product or service. International companies often think that their product is unique or superior. If there is a consumer desire or a business need, there is almost always an offering or solution already in the market. Even if you invented cold fusion, you would be competing with other means of generating energy. There is not likely room for one more "me-too" competitor.

Following the well-known "Discipline of Market Leaders" model (Tracy/Wiersma), define one area where your offering will be clearly superior to the competition:

- Customer Centric
- Product Innovation
- Operational Excellence

Setting a goal to beat the competition in all areas would be unrealistic. New market entrant will find it difficult to surpass competitors in the area of customer service and relationships. Any vendor selection based on proven history, relationships, and risk avoidance favors long-term and local competitors.

A more realistic differentiation strategy may be based on product innovation, offering unique features, superior design, high-end quality, or a more elegant design. But the value of the differentiation to the potential buyer has to be clear. European companies tend to overestimate the value of an elegant

design, especially for B2B products. Consumers may base a purchase decision on emotion, but industrial and commercial users are looking primarily for functionality, reliability, and cost of ownership.

Alternatively, a foreign competitor may leverage low-cost development and production to offer a better price-to-value ratio. A key to success is to be clearly superior in the differentiating discipline, but adequate in the other areas. For example, in the long run, technology differentiation or a price advantage cannot overcome poor logistics or customer service.

5. Select your Channel Strategy Carefully

The channel strategy is one of the most critical market entry decisions. Selecting the channel can make or break a market entry. The channel strategy is often very difficult to change later on. This is especially the case with lower investment market entry strategies such as sales through Original Equipment Manufacturers (OEM) or private label retailers that do not create brand equity. A low-cost strategy that relies heavily on sales agents, resellers and systems integrators creates customer loyalty to the sales channel who can often switch customers to a different product.

The table below summarizes common channel strategies, and the trade-off between investment and long-term objectives.

Channel	Invest-ment	Advantages	Disadvantages
Franchising	Low	Franchisees raise capital	Typically more prevalent in out-bound market entry for US companies
Licensing	Low	Royalty revenue with very little investment in sales channels	Licensee service or production quality may impact brand reputation. Risk of theft of Intellectual Property.
OEM and private label sales	Low	Low investment to build a sales channel and infrastructure. May generate sales volume quickly.	Does not build brand equity. Buyer can often switch suppliers easily. Brand owner earns a larger share of the margin.
Joint Ventures	Medium	Local JV partner contributes capital, resources, local market knowledge, and relationships	Long-term viability of JVs is problematic. Sharing of profit with JV partner. Potential for future conflict.
Distributors, Sales Agents, Integrators	Medium	Quickly build market penetration. Local advice, relationships, sales and support infrastructure.	Requires sharing margins with the channel partner. Long-term dependence on partner who “owns” client relationships and may be able to switch suppliers. In some markets, integrators want to be supplier neutral.
Direct Sales	High	Market control, higher margins, direct control over customer relationships.	Requires own sales force, recruiting, training. Much lengthier process that requires investment and patience.

The trade-offs associated with each channel model often result in a hybrid approach that focuses direct sales on certain strategically important target markets, combined with a distribution model for secondary target markets or markets where existing channels exercise a high degree of market control.

6. Recruit Local Talent

International companies may be tempted to staff their US operations with successful foreign nationals. Expatriates may be needed initially to establish the operation, train local staff, and to support more complex products. But success in the US requires knowledge of the markets, business culture, and most importantly a "rolodex" – contacts and established relationships in the target industry. International companies often underestimate the difficulty recruiting local talent with knowledge and industry connections. Candidates from larger companies often lack the entrepreneurial spirit needed to manage a startup, and may be restricted by stifling non-compete agreement with their current employer.

7. Empower Your Local Management

A very frequent problem – especially in small to midsize closely held enterprises – is that they establish a subsidiary but manage it as an overseas sales branch. After hiring competent and trustworthy local talent, and potentially a training and transition period managed by home office expatriates, it becomes essential to establish clear rules and approval authorities for the local management team, including

- Authority to hire, manage performance and terminate local employees
- Pricing, discounts, and terms
- Develop and manage compensation plans
- Purchasing, spending, and travel approval
- Day-to-day management of cash flow, P&L, and commissions and bonus payments

Clear rules prevent the micro-management of a subsidiary that invariable hinders nimble local decision making that is essential for the successful execution of a market entry strategy. This does not mean that local management is given a carte blanche, but that authority levels are clearly defined and documented. Home office approval should be required for any transactions that create a risk to the existence of the subsidiary or even the corporation, for example long-term price guarantees, warranties, or purchase/lease commitments, special contract terms and conditions, large expenditures, or transactions that are more likely to result in a legal liability, such as employee terminations.

8. Develop Competitive Compensation Plans

A very common aspect of insufficient cultural adaptation is in compensation plans. European and Asian company plans typically contain a higher element of base salary and benefits, and often fail to adapt compensation – and especially sales commission plans – to the US culture. The US cultural focus on individual achievement and short-term gratification must be reflected in the compensation plans of the subsidiary leadership and sales force. To attract competent sales people to a new market entrant may require some bridge plans (e.g. a draw on future commissions), signing bonuses, or a higher base salary. Another alternative is the creation of intermediate strategic objectives that tie performance to achievements and avoid paying poor performance.

9. Build a Low Overhead Infrastructure

To be a serious contender in the US marketplace requires a local infrastructure. This includes in all cases a local office, a web site, and a legal, marketing, personnel, and finance operation. Depending on the type of business, product and channel strategy, a local service department, stock and the associated warehousing and logistics operation may be needed.

Fortunately, the US offers excellent services to support small businesses and startups. Compared to most countries, it is much easier to obtain regulatory approvals and establish an organization in the US that looks substantial, but with low fixed cost. Successful market entrants take advantage of

- Federal, State, and local support organizations for small business
- Support and funding provided by US state, local and chamber of commerce organizations, and home country organizations chartered with export promotions.
- Low cost web hosting, e-mail, VoIP phone services, and virtual switchboards
- Marketing services firms and free-lance marketing consultants for event management, lead generation, and the adaptation of marketing collateral and websites
- Executive business centers
- Outsourced Human Resource and benefits administration
- Accounting and legal services by companies specializing in the support of international companies
- Fulfillment and logistics services, such as warehousing, packing, shipping and tracking
- Service providers with an established infrastructure to manage parts, warranty and repair

Executive business centers make it easy to establish a professional presence quickly, if necessary in multiple locations, and with the necessary administrative and conference room facilities. Most companies will switch to leased facilities when multiple offices or warehousing space are needed more long-term.

10. Outsource Human Resources, Recruiting, and Benefits

US startup subsidiaries and most small to mid-sized companies require professionally managed payroll, benefits, and government reporting, but should avoid the cost of an in-house HR organization at least during the startup phase. One of the challenges for the subsidiary management is to familiarize the foreign owners with US laws and business customs relating to employees. US employees often rely on company benefits that foreign owners would expect to be government provided, such as health care and disability insurance.

Because of the challenge to provide competitive benefits for a small startup, consider using a co-employment agreement (also called Professional Employer Organization or Employee Leasing). PEOs combine a number of small and mid-sized companies in an employer agreement for the administration of payroll, legal reporting, recruiting, and training. PEOs ensure that local management follows US laws and minimized the risk of lawsuits. PEOs develop an employee handbook, adapted to the company culture and policies, but in line with US laws and regulations, an effort that would otherwise take management time and involve legal expenses. Having an employee handbook sets clear expectations on code of conduct and ethics to reduce legal exposure. Most importantly, PEOs make it easier to establish a benefits package that will be needed to attract the needed talent.

Summary

A successful market entry in any new market, but especially the very competitive US market, requires careful planning, realistic expectations, a strong and well defined value proposition, and – above all – patience. A clear plan with a budget will determine the channel model and the "presence" and visibility of the company. Successful market entries are always based on a respect for the local culture, market demand, and business customs.

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[i] www.geert-hofstede.com