Chapter 14 - International Expansion – Agents, Distributors and Own Operations

Introduction

If a brand enjoys success in Australia, then at some point its ambitions will likely stretch to attempting to tackle other markets. There is our close neighbour New Zealand, with shared aspects of a cultural, political, legal and historical background in common with Australia. There are other close neighbours with very different cultures and legal systems from Australia, such as Indonesia, Vietnam and Singapore. Additionally, there are the large and potentially lucrative markets of North America, Europe and elsewhere.

Broadly speaking, there are three ways to seek to tackle overseas markets:

1. Appoint an established person in that country as your sales agent;
2. Appoint an established person in that country as your distributor; or
3. Establish your own operations in each country.

Key advantages and disadvantages

The key advantage of 1 and 2 is that there is less initial cost and risk to the brand in appointing someone else to seek to develop your brand in other markets. If they have a good reputation and existing relationships with retailers, then the brand may be able to more rapidly establish a reasonable level of sales than if doing so itself. The brand's volume of sales increase, with little incremental effort or risk. The disadvantage is lack of control, less margin and risk that the person selected is ineffective or a rogue. Depending on the country involved and its background laws, and the terms of the appointment, upon termination of the relationship some form of payment upon termination or for goodwill may be required.

Selecting a credible, reliable person with a proven track record is a key to options 1 and 2 (and in selecting employees for option 3). It is important to undertake appropriate investigations and seek references.

Please bear in mind that countries typically require that a person or entity who is "carrying on business" in a country is registered in that country (i.e. either the home country's company is registered as a foreign company there or a local subsidiary is established). This requirement arises principally for two reasons. First, so that there is a person to pay local tax. Second, so that if something goes wrong there is a person present in the country/jurisdiction who can be sued.[1] Australia has such rules.[2] In Australia, the touchstone is whether a person "carries on business in Australia".[3] If they do, they must be registered in Australia. Carrying on business is clearly a broad term. It the ordinary course, having a sales agent of distributor in Australia, selling products to them or their customers and receiving payment would be regarded as carrying on business. However, in Australia, there are two exceptions. A person is not carrying on business in Australia if they either simply "effect a sale through an independent contractor" or "solicits or procures an order that becomes a binding contract only if the order is accepted outside Australia".[4] These exceptions mean

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[1] Corporations Act s601CG requires that a foreign company registered in Australia must appoint a local agent who is "authorised to accept on the foreign company's behalf service of process and notices".
[2] Corporations Act s601CD.
[3] Corporations Act s21.
[4] Corporations Act s21(3)(d) & (e).

that a foreign person who appoints a sales agent or distributor in Australia need not be registered in Australia. So, what are the rules outside Australia (which is more relevant to an Australian brand seeking global expansion)? I am not aware of the equivalent laws of other countries. To my knowledge though, Australian companies do not typically register in countries where they appoint a sales agent or distributor. However, local advice should be sought, not just about the local registration requirement but also the Australian brand's obligations (if any) regarding local tax for sales to its agent's customers or to the distributor (which may include payment of royalties).

Sales Agents

A sales agent is a person who seeks each season to obtain orders for the brand's products from retailers in the agent's appointed country, part of a country or countries. The agent passes these orders to the brand which fulfils them. The brand is responsible for delivering product to the retail customer in the overseas country and bears the risk of default in payment from that customer. That risk can be ameliorated by the brand insisting upon payment before shipping, bank guarantees or letters of credit from the customer.

The brand has a direct relationship with its overseas customers, including a contract for the sale and purchase of products each time an order is placed. Suitable terms of trade with those customers are also essential.

A strong sales agency agreement with terms favourable to the brand is essential. That agreement should address the following topics:

- Who is the agent (is it a company? Get the correct company name and any unique number for that company (equivalent to an A.C.N.));
- Will there be any personal guarantors;
- Territory;
- Duration, including options to renew (typically, if sales targets have been met, it is the Agent's option to extend);
- Rate of commission;
- What products in the brand's range the Agent is authorised to sell;
- The process for sending the Agent samples, whether the Agent pays for them and, if so, at what price;
- When the Agent gets paid. For example, is payment made when the brand delivers an order to the customer, or is payment only made when the brand gets paid by the customer (e.g. who bears risk of default?);
- The currency the Agent is paid in;
- KPIs: That agreement should set strong key performance indicators for each period of the appointment. If the agent fails to reach the KPIs then the brand should have the right to convert the agency to non-exclusive (if exclusive rights were first granted) or terminate the relationship;
- Are there any key personnel of the agent who, if they were to leave, might mean that the brand wished to terminate the relationship;
- Can the agent appoint sub-agents;
- Restrictions on representing other brands, during and after the agency;
- Does the Agent have an interest in retail stores and should the agent receive a commission on sales to those stores;
- Attendance at the brand's global sales conferences (if any); and
- Rights of termination, and consequences for doing so.

Distributors

Distributors operate their own distribution business in the selected country. The distributor buys product from the brand, typically operates a warehouse/distribution centre and makes wholesale sales to retailers. The brand ships product to one place, its distributor's warehouse (and this is typically easier to coordinate with the brand's manufacturers directly).

The brand does not have a direct relationship with retail customers in the designated territory. The distributor is at risk of customers defaulting on payment (although the brand is at risk of the distributor defaulting).

A strong distribution agreement having terms favourable to the brand is essential. That agreement should address the same topics as above for the agency agreement and further stipulate the following matters:

- The procedure and timing of product ordering;
- The brand's obligations and timing to deliver product;
- The price at which sales are made to the distributor. This will typically be something less than wholesale (because the distributor will need to sell at wholesale price to retailers);
- If the distributor has its own retail outlets, whether it should pay an additional amount to the brand for such sales to its own retail outlets;
- Payment terms and currency;
- Alternatively, should the distributor buy products at cost plus a small mark-up and pay a royalty (tax advice is likely required);
- Is the distributor allowed to manufacture the brand's products in the territory or not;
- Can the distributor appoint sub-distributors or agents;
- Can the brand itself or other people it has appointed sell directly to customers in the territory via e-commerce platforms;
- Can the distributor operate its own website featuring the brand's products;
- What is the annual minimum marketing expenditure to be spent by the distributor;
- How often, and what is the content of, reports by the distributor to the brand; and
- Who pays for freight and who bears risk of goods while in transit.

Own Operations

As an alternative to options 1 or 2, or after some time of having an agent or distributor, a brand may decide to set up its own operations in an overseas country. The key advantage is that the brand controls its own overseas operations and there is not margin erosion. However, the brand bears the risk of the success or failure of that overseas business and the risk of foreign exchange currency fluctuations.

A hybrid position is possible, where the brand partners with a local person in that country as part of a joint venture. The obligations of each joint venturer should be spelt out in a joint venture agreement, a partnership agreement or shareholders agreement.

Besides the commercial aspects, a brand will need to consider and address the following legal issues if it decides to establish its own operation:

- A wholly owned subsidiary in that country will need to be established. There may be different types of entities to choose from and an appropriate selection will be required. Incorporation in some countries is not as quick as in Australia (for example, Indonesia typically takes several months to incorporate and apply and be granted the necessary permits);
- Where should that entity sit in your corporate group structure;

- How much money is needed by the new subsidiary and will this be provided by way of equity or loan capital (there are thin capitalisation rules that typically apply;[5] seek advice form an appropriate accounting/tax advisor);
- Will any expatriates be employed in the country, what employment contract is appropriate (it may need to comply with local laws) and what visa is required;
- What local government permits or licences are required legally to carry on business in that country;
- Are there any restrictions under local laws for foreigners undertaking certain businesses (for example, in Indonesia retail operations are reserved for locals);
- What is the tax regime in that country, what rates of tax are payable, and what registrations (equivalent to obtaining an ABN and registering for GST) are required;
- does the country have a strong legal system or is there a greater risk of corruption, and does this influence the brand's decision whether to invest directly into a country. What internal rules and training should be set to deal with anti-corruption laws and anti-money laundering obligations;
- identify and lease (or possibly buy, if permitted) local premises; and
- engage local staff, and understand local legal obligations to staff.

Note of caution – beware some foreign countries

Australia enjoys a stable social, political and legal environment. We have a highly developed legal system with courts that apply the law without fear or favour. That is, courts in Australia do their best to hear evidence and decide cases on their merits, applying the relevant law (this is what lawyers mean when they speak of "rule of law"). There is very little, if any, corruption in our legal system. Unfortunately, this is not so in many less developed countries, including some of our near neighbours. In such countries, a corrupt person can manipulate the criminal and judicial system to produce outcomes desirable to that person, regardless of what the written law may say. As an Australian business, it is a criminal offence under Australian law to bribe a foreign official.[6] If convicted, the guilty person faces penalties of up to 10 years imprisonment and a fine of $1.8 million. Caution must be used when entering these markets, selecting partners, distributors or customers, and even the best care taken over documentation will not necessarily result in decent outcome (but strong documentation with a clever arbitration clause should be used).

[5] These are rules that can limit the debt to equity ratio of a business and disallow deductions for debt expenses over the threshold. For general information see https://www.ato.gov.au/Business/Thin-capitalisation

[6] Criminal Code Act 1995 (Cth) s70.2.