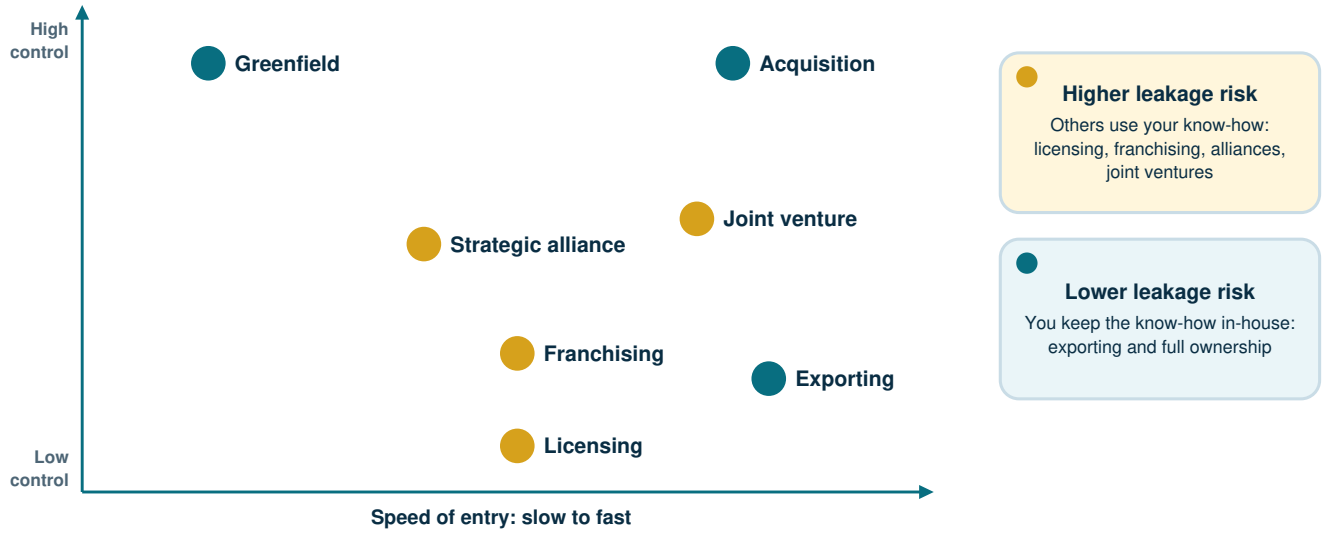
Comparing entry modes and accounting issues

MODULE 4 | 4.6.3 | STUDENT COMPANION

There is **no single best entry mode**. Organisations usually expand in steps, deciding again at each stage how many resources to commit, how much risk to accept, how much control they need and how much profit they could make, often graduating from one mode to the next.

Comparing entry modes: speed and control



Criteria for comparing modes

Criterion	Question to ask
Upfront investment	How much money and management time does it need?
Speed of entry	How quickly does it get us into the market?
Market penetration	How deeply can we reach customers?
Control	How much control, and direct customer knowledge, do we keep?
Political risk	How exposed are we to expropriation or sudden rule changes?
Technology leakage	How likely is our know-how to reach others?
Managerial complexity	How hard is it to run?
Return and payout	What percentage return, and what total dollars, could it earn?

Worked example: return versus payout (imagined)

Return is the percentage earned on the money invested; payout is the total dollar amount.

	Licence	Own subsidiary
Investment	$100,000 to set up the licence	$5,000,000
Annual income	5% royalty on $4m of sales = $200,000	$1,000,000 profit
Return (percentage)	200%	20%
Payout (dollars)	$200,000	$1,000,000 (five times more)

Accounting issues in market expansion

Entering new markets or diversifying brings accounting challenges the organisation hasn't faced before. Their costs must be anticipated and built into the business case and budget, because they can change whether entry makes sense at all. Some surface in the external analysis (tax, governance); others in the internal analysis (can the finance team cope?).

Six accounting issues in market expansion



Where foreign exchange risk comes from

IAS 21 governs the accounting for transactions in foreign currencies and for foreign operations.

Strategy	How the risk shows up
Selling or buying abroad, without a local presence	Gains and losses between the date of a sale or purchase and the date of payment
A wholly owned business abroad	Runs in the local currency; the risk appears when results are translated and consolidated into the parent's accounts, and in costs such as expatriate salaries
New products made overseas	Uncertain production costs that complicate every costing decision

One invoice, two exchange rates

Invoice, payable in ninety days	US$500,000
Rate on the day of the sale	A$1 = US$0.65
Value on the day of the sale	A$769,231
Rate when the money arrives	A$1 = US$0.70
Value when the money arrives	A$714,286
Exchange loss	**A$54,945**

A forward exchange contract could have locked in the rate on the day of the sale

Different financial year ends

Each entity and country usually needs its own accounts, often the basis of its tax return. Different year ends make inter-entity transactions, loans and dividends harder to reconcile; larger foreign entities may need their own audits.

Country	Usual year end
Australia	30 June (substituted accounting periods are possible)
New Zealand	31 March (standard balance date)
India	31 March
China	31 December

- **Incompatible systems:** add the cost of integrating an acquired business's systems to its price; avoid re-keying figures by hand; moving to one package means licences, upgrades, implementers and training, and puts data integrity at risk.

- **Business conduct standards:** each country's company and consumer laws apply, with heavy penalties. Some home laws reach overseas: US foreign bribery law, and Australia's offence (since 2024) of a company failing to prevent foreign bribery by its associates.
- **Taxation:** income tax rates and rules, and consumption taxes such as GST and VAT (national or state by state), vary widely. Get expert help; favour countries that let start-up losses be carried forward; align year ends where possible.

Case note: Chevron Australia and transfer pricing

Transfer prices, charged between related entities in different countries, must reflect what independent parties would charge. Chevron's Australian business borrowed the Australian-dollar equivalent of US$2.5 billion from a related US company at around 9% interest, while that company raised the money at little more than 1%. The Australian Taxation Office argued the rate was far above an arm's length rate, and in 2017 the Full Federal Court upheld tax assessments of about A$340 million, including penalties and interest, for 2004 to 2008; Chevron then settled with the Tax Office and withdrew its appeal. Transfer pricing isn't a strategy to pursue; it's a risk to manage from the start.

Source: Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62.

Practice questions

MODULE 4 | 4.6.3 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Return or payout?

Calculate the return and the payout for each option, and discuss which suits a company with limited capital and little international experience.

Option for Kookaburra Kitchens (imagined cookware maker) in Korea	Data
Licence a Korean manufacturer	Set-up cost $150,000; licensee sales $6 million a year; royalty 4%
Build its own subsidiary	Investment $8 million; expected profit $1.2 million a year

Question 2 - Exchange gains and losses

Calculate each invoice's value in Australian dollars at both dates, the gain or loss, and how it could have been hedged.

Invoice	Rate at the transaction date	Rate at the payment date
(a) Export sale of EUR 200,000 (receivable)	A$1 = EUR 0.60	A$1 = EUR 0.58
(b) Import purchase of US$150,000 (payable)	A$1 = US$0.66	A$1 = US$0.62

Question 3 - Spot the accounting issues

Imagine **Riverside Group**, an Australian company with a 30 June year end, buys a Singapore engineering firm with a 31 December year end that uses different accounting software and invoices customers in Singapore dollars. Riverside will charge the new subsidiary a management fee for head-office services. Identify the accounting issues Riverside must plan for.

Worked answers

MODULE 4 | 4.6.3 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Kookaburra Kitchens

	Licence	Subsidiary
Annual income	$6m x 4% = $240,000	$1.2m
Return	$240,000 / $150,000 = 160%	$1.2m / $8m = 15%
Payout	$240,000 a year	$1.2m a year (five times more)

With limited capital and little experience, **licensing** suits a first step: a high return, little capital at risk and local know-how from the licensee, though it earns a smaller payout, teaches Kookaburra little about the market and risks technology leakage. A subsidiary could follow once the market is proven.

Question 2 - Exchange rates

Invoice	At transaction	At payment	Result
(a) EUR 200,000 receivable	200,000 / 0.60 = A$333,333	200,000 / 0.58 = A$344,828	Gain A$11,495
(b) US$150,000 payable	150,000 / 0.66 = A$227,273	150,000 / 0.62 = A$241,935	Loss A$14,662

Hedging: forward exchange contracts on the transaction date would have fixed both rates (for (a), a forward sale of euros; for (b), a forward purchase of US dollars), removing the uncertainty at a cost.

Question 3 - Riverside Group

- **Foreign exchange:** SGD revenue and balances must be translated and consolidated; consider hedging.
- **Multiple reports and year ends:** 30 June versus 31 December complicates consolidation, inter-entity balances and dividends; consider aligning the subsidiary's year end; Singapore accounts and audit.
- **Systems:** integrating different accounting software; avoid manual re-keying; protect data integrity.
- **Conduct standards:** Singapore company law; Australian foreign bribery laws apply to dealings in the region.
- **Taxation:** Singapore corporate tax and GST compliance; local tax expertise.
- **Transfer pricing:** the management fee must reflect an arm's length price, with documentation.