

CROSS-BORDER VENTURES

Making the move into U.S. markets

Small companies often underestimate cost of doing business south of the border, or don't prepare for labour, tax and legal issues

BY CHARLES MANDEL

The subprime mortgage crisis in the United States may have helped push that country into a recession, but for one Calgary company the financial fiasco represented a cross-border opportunity.

CBI Group, a real estate investment firm, has launched a fund that aims to raise up to \$12.5-million to buy about 175 single-family homes in Phoenix over the next year. The idea is that Canadians will be able to invest in the United States, profiting from the housing market collapse.

"The opportunities are limitless for CBI," said Jarrett Zielinski, CBI's vice-president of property acquisitions. "For Canadians with a good cash flow, real estate has become so distressed the opportunities are boundless."

CBI, with a staff of 15, is the investment arm of Red Deer-based Diamond Key Homes, which has 40 employees. CBI's principals have invested in rental companies in the Arizona market since the 1980s, but their Arizona Acquisition Fund is their first attempt to raise public money.

For a minimum of \$10,000, investors in the house-buying fund will receive a 6-per-cent bond interest that will be disbursed as the flow of cash permits. They will also share in 60 per cent of the net profits when the Phoenix houses are sold. CBI will keep the other 40 per cent as profit.

The houses CBI is buying used to sell for about \$300,000 (U.S.). Most of the 1,800-square-foot homes are now valued at around \$150,000, but CBI has so far grabbed 20 houses for \$90,000 each in the depressed market. The company hopes the homes will be worth \$175,000 to \$200,000 when it comes time to sell them in a few years.

The owners of the Phoenix houses can remain in their homes as tenants, paying rent to a local property manager retained by CBI. The company aims to sell the houses in



Jarrett Zielinski, of Calgary real estate company CBI Group, sees opportunity in the depressed Phoenix market. CHRIS BÖLIN FOR THE GLOBE AND MAIL

about five years to pay out the fund, and will give the tenants first crack at purchasing their homes.

"What's good for us is, affordability has returned to the Phoenix market," Mr. Zielinski says. "It's something we believe over time will correct itself on an upward direction."

CBI's foray into the U.S. market is just one example of how small Canadian companies are doing business south of the border, even in the tough economic times. According to a recent HSBC Bank Canada survey, the company is not alone in its desire to access the enormous U.S. market.

The survey of 250 small- and medium-sized business owners across Canada, whose firms generated between \$1-million and \$20-million in annual revenues, found that 45 per cent had already expanded into for-

ign markets, including the United States. Another 8 per cent planned to do so.

In many ways the United States is the easiest foreign market for Canadian businesses to jump into because of proximity, the scale of the market and similarities in culture, notes Shahr Guindi, a Montreal-based partner with the law firm of Osler Hoskin & Harcourt LLP.

But Canadian entrepreneurs who want to move into the U.S. market should proceed cautiously, Mr. Guindi said: "Do it with your eyes wide open." He warns that businesses need to be aware of and negotiate a tangle of different legal, tax and employee relation systems.

The biggest hurdle for small companies is they often underestimate the cost of doing business in the United States,

Mr. Guindi says. While the labour costs are often cheaper and commercial real estate may be inexpensive, cross-border tax issues, legal and licensing requirements can all drive up the price of doing business in the United States.

Mr. Guindi says the additional cost burden doesn't prevent companies from crossing the border, but "it certainly adds layers of compliance and complexity that they hadn't initially anticipated."

Beth Wilson, Canadian managing partner with KMPG Enterprise, agrees that the U.S. market is significant because of its sheer size. But companies need to understand precisely why they're entering that market, she said.

"It's really important to understand strategically why you're wanting to go into the U.S., because that then drives a

decision about whether you need a location in the U.S. or whether it's something you can operate from Canada," Ms. Wilson said.

"You don't necessarily need to go and invest in operations and people in the U.S. because your customers are there."

She warns small businesses to watch for hidden costs, such as health care, which can form a large portion of U.S. labour costs. And she cautions that accessing credit can be very difficult.

"If you're looking to borrow in the U.S., it's an even more serious environment than the one we face in Canada."

Jon Hountalas, HSBC Bank Canada's executive vice-president of commercial banking, notes that 20 years ago it was unusual to find small businesses selling to the U.S. market. Today, it's the norm, he said,

Tips for U.S. work

» **Select your location carefully.** Don't assume every American state is the same. Taxes vary and do economic incentives of each state to establish offices and hire locally.

» **Protect your corporate assets.** Set up a layer of U.S. corp holdings and have U.S. lawyers do your marketing and to offer a level of protection against potentially litigious partners.

» **Hire local staff.** Sales and marketing professionals often with them a deep network of contacts. "To arrive cold as a Canadian in a new market is a challenge," said Shahr Guindi, a Montreal-based partner with law firm Osler Hoskin & Harcourt LLP.

» **Be aware of higher costs.** Business is often more expensive in the United States, for example because of the country's rigorous environment.

» **Move staff across the border at good time.** And make sure employees meet all U.S. visa and requirements.

» Charles Mandel

but it is best to enter the market carefully.

"If you try to go in too soon, I think you can hurt your business. It's a different business environment down there and you have to learn to adjust to it slowly," Mr. Hountalas said.

Back in Calgary, Mr. Zielinski said small businesses need to understand the risks of the market when they venture south.

For example, he thinks Canadian exports of high-end goods in the United States might not do well in the current economic climate because consumer demand has dropped off.

"We're investing in how Mr. Zielinski said. "How a vital part of our society it's something people want."

» Special to The Globe and