Offshoring and global sourcing
– A client’s guide

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Contents

Executive Summary ................................................................................. 2
1. Introduction .................................................................................. 3
2. Global Sourcing Models ................................................................. 3
3. The Outsourcing Model ................................................................. 3
   3.1 What are the advantages of outsourcing? ................................. 3
   3.2 Is outsourcing right for your business? .................................... 3
4. Making the decision to offshore .................................................... 4
   4.1 Due diligence ........................................................................... 4
   4.2 Communicating the rationale .................................................. 4
   4.3 Potential business impact ......................................................... 4
   4.4 Selecting a country with the best strategic fit ......................... 4
   4.5 Selecting a provider with the best strategic fit ....................... 5
5. The offshoring models examined ................................................. 6
   5.1 The captive operation ............................................................. 6
   5.2 Third party outsourcing .......................................................... 6
   5.3 A joint venture ....................................................................... 6
   5.4 Hybrid models ...................................................................... 7
   5.5 Application Service Providers (ASP) ........................................ 7
   5.6 Build Operate Transfer (BOT) ................................................ 7
   5.7 Multi-client shared services ..................................................... 8
6. Evaluating the options ................................................................ 8
7. Evaluating the captive route ........................................................ 8
8. Evaluating the third party offshore outsourcing route ............... 10
9. Managing risk .............................................................................. 12
10. Contractual governance and controls ........................................ 12
Conclusion ......................................................................................... 12
Biographies ....................................................................................... 13
Executive Summary

Companies face increasing pressures not only to reduce costs, but also to better manage risks and optimise business performance. Taking a strategic approach to these aspects of sourcing can play a key role in achieving these aims.

This practical guide is intended to give any business considering offshoring or global sourcing an indepth view of the options and the processes involved in these areas of sourcing. Covering business models within global sourcing, including: captive offshoring, third party outsourcing, joint ventures and other hybrid models as well as approaches to risk, governance and other contractual controls, this guide should facilitate the decision making for people whose roles are already focused on global sourcing as well as those who may be entering this area of business operations for the first time.

Mark Webber

t +44 (0)118 925 2138
f +44 (0)118 925 2139
Mark.Webber@osborneclarke.com

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1. Introduction

Businesses are constantly being driven to reduce costs and enhance productivity in order to increase shareholder value. Many business models have been pursued to achieve these goals, and for many years outsourcing has been seen as one of the proven solutions. Businesses have also been taking advantage of global sourcing opportunities and nowadays there's nothing new about going offshore. Venturing offshore can offer the opportunity of cost-arbitrage by using equally qualified, but cheaper, employees and lower cost resources and services from offshore locations. A trend led by manufacturing, offshoring is now also a concept readily deployed for service provision in the form of call centres and back office service centres.

Yet offshoring is not necessarily outsourcing. One option is to set-up and manage the business's own offshore operations as a 'captive' organisation. A wide range of business models are available.

Sourcing offshore is not without its risks and disadvantages. For an offshoring project to be successful, it's important for a business to understand its reasons for offshoring as well as why it has selected and how it can manage a certain offshoring model. Offshoring is about more than saving costs. Issues such as control, core competency, provider capability and reputation are also highly relevant.

2. Global sourcing models

In taking a decision to offshore, a business needs to evaluate the various global sourcing models available. Linked to this is an evaluation of the entire strategic sourcing decision. Offshoring strategies vary but, in short, there are three distinct models:

- A business can build (or acquire) its own operations offshore (known as a captive);
- It can buy in the service from a third party provider; or
- It can consider a hybrid solution such as a joint venture, shared services or build operate transfer (BOT) project.

3. The outsourcing model

Outsourcing involves the transfer of a previously internal service to an external service provider. Whilst not all offshoring is outsourcing much of it is, and it would be wrong for any business to dismiss the option without due consideration. As the National Outsourcing Association states in its Offshore Outsourcing Position Statement1.

"Outsourcing is now well recognised worldwide as a business tool enabling corporates to drive business strategies and business benefits in directly measurable, financially efficient, and effective ways"

3.1 What are the advantages of outsourcing?

The key business drivers for adopting an outsourcing model vary. These drivers can include:

- A need to obtain best value and cost savings (which may mean exploiting resources overseas);
- Accessing leading edge technology, processes and skills;
- Ensuring internal focus on core competencies and objectives;
- Accessing flexible, adaptable and scalable solutions;
- Decreasing the product development cycle (use of 'follow the sun'); and
- Remaining competitive in the market.

Reduced costs are regularly cited as a key reason together with focussing on core competencies without the distraction of providing a commodity service internally. There is no doubt these advantages have created the now buoyant offshoring industry in countries like India. However, the advantage of outsourcing is not necessarily just about cost savings or minimising the size of a businesses operation. One key driver can be the speed to the solution – savings are one thing but how quickly can the business outsource and realise benefits and a return on its investment (ROI)?

3.2 Is outsourcing right for your business?

Outsourcing however may not be the panacea a business anticipates. If the existing service function is poorly managed, outsourcing (let alone offshoring) it won’t necessarily improve the
situation. In fact, these problems may well be exacerbated with a move to an external provider.
In order to deliver a successful business process outsourcing (BPO), the business processes need to be stable, understood and under the control of the business. For anyone considering an outsourcing, this should be a priority before handover.

Today businesses devote considerable time and effort to the strategic sourcing of their needs and internal procurement divisions have become more important and influential. As a result, the pricing models and sourcing models deployed are becoming more complex and more creative. This can increase the management requirements during the outsourcing term and inflate the service costs of the provider. It’s important to maintain a balance between innovation and control on the one hand, while at the same time keeping the services simple and leaving the provider to do what it does best.

4. Making the decision to offshore

Before a business can make a full assessment about the sourcing model it wants to pursue, it needs to make a full and frank assessment of the current business and any anticipated impact on the way the sourcing is structured.

4.1 Due diligence

Not all services are suited to offshoring (or indeed outsourcing). However, the offshore industry has in the last few years boomed on BPO for the provision of development services and call centres. The decision to take this route will largely be a commercial one but should also include some legal analysis before a sourcing model is chosen. Technical questions should be asked to understand whether the type of business process or services could influence the sourcing model chosen. These should include:

- Which processes are severable?
- Do the processes require business proximity?
- Can processes be standardised?
- Are the processes of sufficient scale?
- Are there any legal/regulatory restrictions?

In addition the commercial realities of an offshoring or outsourcing should be assessed.

In particular, what do the management and shareholders want from the strategic sourcing programme? Is there a unionised workforce and if so, should the unions be consulted as a part of the decision making process?

4.2 Communicating the rationale

It is essential to communicate the rationale for the sourcing and then identify the objectives and instil them in the project team. Without setting objectives how can the business assess and benchmark the relative success of the project? And how can the key internal sponsors convince other decision makers that it is the optimum strategic route? It is not uncommon for a business embarking on offshoring to select a non-critical project to test a provider or sourcing solution before exporting a business critical operation.

4.3 Potential business impact

An assessment needs to be made about the potential business impact of the offshoring. This should include a consideration of the impact on:

- Existing personnel;
- User/customer perception; and
- Market perception.

The impression of offshoring on external sources should not be underestimated. There are many current examples of UK based businesses trying to distinguish themselves in the marketplace by emphasising the fact they don't offshore. It is increasingly common for 'thou shall not offshore' clauses to be negotiated into agreements. In trying to reach into the service delivery methods of their contractors and prohibit them from utilising offshore services in the delivery or subcontracting of services the user can frustrate real savings. This could be seen as a prudent approach and precaution but perhaps a blanket dismissal of the opportunity is a little naïve.

4.4 Selecting a country with the best strategic fit

Finally, if a decision has been made to go offshore, the location of the offshoring service needs to be carefully considered. Naturally there are many factors to think about: time zones, languages, product localisation needs and synergies with exiting or potential markets or users all need to be considered when making a decision as to location. This may be compounded if multiple locations are to be used.
International locations can vary substantially and all have their advantages and disadvantages. Offshoring doesn’t necessarily mean India, China or the Philippines. US companies like Google and HP have exploited the skilled workforce and tax benefits of Ireland, leveraging the proximity to the major market of Europe. Eastern Europe remains a popular service location for Western European users.

Some businesses like the appeal of using a 'near-shore' location to avoid hours of international travel; others take a 'far-shore' approach because the cost savings are the more attractive. Weighing up the merits of different locations is as complicated as the reader would imagine.

If you’ve been to Bangalore recently you may be right to question whether it is an optimum place to start a business with the serious lag in infrastructural development. Many businesses are attracted to Bangalore as an important place to be because of the access to existing skills and the leverage of complimentary business experience. If skills and language ability is key, Eastern Europe provides many possible locations (particularly for French and German businesses). China is favoured by the Japanese, and increasingly by others. If the plan is to 'follow-the-sun' in order to facilitate 24-hour research and development activity between international development teams there’s less geographical choice.

In making a decision on location, some of the following factors should be considered:

- The expected role of the country in the global economy in the long-term;
- The talent pool and experience available (including language ability);
- Legal controls and export controls;
- Scalability of operations and potential speed to operations;
- The availability of governmental incentives (eg. Software Technology Parks in India);
- The country’s infrastructure and potential risks; and finally,
- The total costs (including domestic management costs), as opposed to just salary costs.

The geographical and political consequences that an offshore operation may face must also be considered. The availability of infrastructure can also be key – is appropriate technology available? Can this be accessed and if so, how quickly? There are also language and cultural barriers and other issues such as the risk of corruption if some business outcomes can only get made after the 'appropriate' actions are taken. These can all lead to additional commercial, ethical as well as legal debates that compound the decision making process.

Some of the more sophisticated providers (particularly from India) are starting UK-based onshore operations to offer the ability to contract locally for their services or to subcontract internationally. This onshore/offshore approach can aid initial negotiations and maintain local business continuity such that it's much easier to manage the relationship. However, consider the entity you are contracting with - will you have direct contractual redress (is it with the entity providing the services, and if not, is the local entity any more than a corporate shell so that a parent guarantee or performance bond is required)? Are you adding another layer of management and interaction to an already complicated relationship?

4.5 Selecting a provider with the best strategic fit

A suitable service provider also needs to be selected. When potential providers are known, due diligence into their performance record, financial standing and quality process certifications is essential. It will also be important to review the following:

- Size and capability of the provider;
- Whether the provider uses its own employees or subcontractors;
- What processes and operational procedures are deployed to protect confidentiality and intellectual property rights?
- What other customers is the provider supplying? (There could be competitor risks if your business is not a substantial contract relative to others.)

With all offshore operations, delivering a successful operation is harder than it looks – real focus, clear processes and commitment from management is required in order to integrate the work delivered offshore with the onshore internal teams and processes.
5. The offshoring models examined

5.1 The captive operation

A ‘do-it-yourself’ approach – captive operations – is not a new one. Multinationals like General Electric, British Airways and American Express first deployed overseas captives some 12-15 years ago and today captives account for nearly 60% of the offshoring market. Today, Tesco has substantial Indian captive operations for its internal IT operations. NASSCOM, the Indian national software and service companies trade body states that 55% of offshore business in India is captive. The model has by no means gone out of fashion. There is a fine line between offshoring and international expansion.

For the larger operation there is always the option to acquire an overseas business that has the right capabilities and potential to serve an offshore captive operation. This kind of strategy poses all the problems of any international M&A, and the integration path should not be underestimated.

5.2 Third party outsourcing

Third party outsourcing is essentially contracting or subcontracting with a third party to provide services to the business. The main advantage is that a business can move certain activities outside of the confines of the corporate boundary. The third party provider is often engaged for reasons that go beyond pure costs reduction (speed to service, and sheer experience and ability) and may be engaged for discrete projects or long-term service provision.

This is where offshoring is the closest to a procurement strategy. The business is often buying in services on a self-contained project basis and less long-term commitment is required. There are numerous examples of UK businesses using third party outsourcing services providers, these include Thames Water (IT support and maintenance), British Airways (call centre operations), Lloyds TSB and HSBC (both of which source IT services from India).

By handing over to a new third party provider, the user can elect to transfer the existing services wholesale on an 'as-is' basis simply to replicate the service delivery overseas, or, it can opt to 'transform' the services as they are transferred. As a long-term strategy the 'as-is' model can be restricting or lead to stagnation but it does open up the possibility of service improvements deriving from economies of scale and best practice of the provider.

A more detailed look at the captive and third party models that will help your business make an assessment of the relative advantages and disadvantages of these structural approaches is detailed in sections 7 and 8 of this guide.

5.3 A joint venture

In a joint venture (JV) a new legal entity is created in which each party owns a percentage stake of the entity. A commercial agreement specifies the business objectives and activities of the JV company. Depending on the arrangement, the parties may provide the JV entity with money, management, skilled employees, resources and knowledge and the risk and reward of the venture can be shared. With this model the synergy of mutual goals can be exploited to benefit both parties. Therefore, in an offshoring context, the JV structure can give benefits that cannot be derived from independent action; in particular an enhanced element of control. However, the "outsider" can also gain access to specialist knowledge and cheaper resources and the "local" can access business activity not otherwise demanded locally.

Establishing a JV can be a protracted process and the costs involved can be higher than those of other models. JVs also offer less flexibility and necessitate a longer term commitment from each party. On the plus side, the establishment of such a vehicle can also result in a business entity which can eventually be sold (and thus provide some measurable ROI) or over time, be expanded to deliver services to other users.

A JV is rarely the optimal offshoring vehicle due to the more complicated structural and operational issues involved. However, in some circumstances the JV structure may be the only route available. For example, some countries require JVs as a matter of policy to ensure domestic businesses are involved in particular local markets or sectors. There can also be tax reasons which justify selecting a JV structure for an offshoring venture.

2 Click here for BCS article
JVs tend to work best when each party provides an equal value of skills to the venture. There is plenty of scope for conflict (there may be management, processes or objective clashes) and such clashes can ultimately lead to failure. Stakeholders participating in a JV in purely user/provider roles are not necessarily best suited to the JV approach. In many outsourcings the provider is keen to sell the concept of partnership, but most outsourcings are far from a partnership in the legal sense, because ultimately the user is entitled to demand a right of recourse for non-performance. Such recourse is not so freely available in the JV scenario.

A JV only works if both parties are committed to treating the JV vehicle as a separate entity.

5.4 Hybrid models

It is sometimes preferable to have a mixture of onshore and offshore centres with captive and third party operations engaged in activities in the areas where it makes most sense to deploy effort. This model is popular for software development.

There is a clear trend toward ensuring a diversification in the number of global sources from which services are procured. Avoiding the 'all eggs in one basket' approach gives the additional security many multinationals seek. The use of a hybrid sourcing solution also makes it easier to reverse or transfer an offshore operation if an initiative turns sour. A single source of supply, whilst sometimes easier to manage, may not offer the best service across the board. For some multinationals, (e.g. ABN Amro and Proctor & Gamble) there’s a trend toward deploying sourcing strategies based on 'best of breed'. Where a user requires a diverse range of services it’s becoming common for the larger multi national entity to source from the best vendor for each service line required. An added advantage is the removal of a single point of failure and enhanced redundancy and resilience as services can be moved between providers.

The multi-vendor approach however is not necessarily the optimal solution. Increased internal management resources are required and attention to the inter-relationships between the providers are key to delineate service responsibilities and avoid finger-pointing between providers if things go wrong. This management discipline and internal governance has to be imposed and managed from within the user business. As with any offshoring, clear escalation routes and a governance mechanism to manage disputes both between user and provider, and perhaps even provider to provider, are key.

5.5 Application Service Providers (ASP)

A geographically neutral service provider model is perfectly suited to offshore service provision. The application service provider model (where a provider hosts and supplies services via a remote online connection) is not a new model but it is a means whereby certain service elements can be made available globally from a central (perhaps offshore) location, and if offshore with many of the benefits outlined above. However, there is little scope for customisation, and this service delivery model is only suitable for certain types of services.

The 'software as a service' licensing model pioneered by businesses like Salesforce.com has built increasing interest in this service delivery approach.

5.6 Build Operate Transfer

In the Build Operate Transfer (BOT) model an offshore provider builds an offshore service unit for the user offering its own skills, knowledge and awareness of the local market. Initially the provider owns and controls the new service entity as a group subsidiary. Once the service unit is operational and meeting the relevant performance requirements, the provider relinquishes control and ownership of it to the user, by way of an agreed buy-out plan. With the BOT model the provider can retain an ongoing stake in the business or a right to buy-back the operation in the future.

This model is a popular offshoring route when the user lacks the expertise, time or resources to develop an offshore operation itself. The time needed to achieve full operational status can be much less than for a captive start-up. It is also a popular model for intellectual property development because the user eventually owns and controls the entity responsible for developing its 'crown jewels'. In the case of venture-backed business and others looking to float on a stock market for the first time in the future, this ownership factor can be an important facet.

The BOT model is often structured so that the user business bears none of the initial build and associated infrastructure costs. Only if the offshore entity operates satisfactorily will the user pick up the build costs as the provider transfers ownership and control to it. If there is no successful transfer the provider is left with a
resource and operation it can utilise for alternative users.

Without contractual clarity and defined and measurable operational targets, the transition / transfer process can be difficult to realise. The tax consequences of transition need to be carefully considered; in particular to take account of the transfer pricing issues which are complicated because a BOT is regarded as akin to an international acquisition.

5.7 Multi-client shared services

The multi-client shared services model is another type of hybrid. The popularity of this one-to-many model has grown as it can benefit both smaller and larger business. Smaller users benefit from economies of scale as they can leverage the resources assembled by a provider to serve multiple parties. The business has access to a scale and range of resources and the benefit of investment, which would otherwise be financially prohibitive.

The lower costs and pooled resources for the services mean:

- Greater flexibility for customisation;
- The provider does not inherit legacy processes, infrastructure and people;
- Fast implementation and a commitment-free future; and
- A solution that is very scalable – a service which can by turned off or on.

6. Evaluating the options

There are no hard and fast rules about which model is best for any business. It’s always possible to mix and match and combine the various models depending on internal experience and the user’s risk profile. Whatever the structure selected, it must clearly meet and support the strategic objectives of the user.

As the captive and third party outsourcing models are those that are most frequently adopted, there follows a more detailed assessment of their relative merits.

7. Evaluating the captive route

Initially popular with large multinationals, the captive route gave an alternative offshore solution when local outsourcing providers were scarce and sometimes the quality of their services questionable.

In 1997 General Electric set up GE Capital International Service (GECIS) to provide basic back office, call centre and data centre operations and services in India. Over time this grew to an operation supporting some 1,000 business processes with 17,000 employees. In 2004, GE sold a 60% stake in GECIS to the venture businesses General Atlantic Partners and Oak Hill Capital Partners with the intention that GECIS start to provide services to other international users whilst continuing to serve GE under an outsourcing services contract.

The GECIS approach reflected a trend for the very large multinationals to move from running captives to utilising the services of third party providers. The scale and resources of the current third party providers in India mean the third party route now offers considerably enhanced cost savings. However, some still favour a captive approach for R&D and the development of key intellectual property rights, particularly with concerns over IP infringement and questionable IP enforcement regimes.
The following table assesses the relative advantages and disadvantages of the captive route:

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
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</thead>
<tbody>
<tr>
<td><strong>Control:</strong> The business has direct control over all aspects of the operations. This gives greater flexibility over how the captive's resources are deployed. With a captive it is easier to manage performance and align objectives. Importantly, the business retains corporate 'ownership' of the business processes and methodologies deployed in providing the services.</td>
<td><strong>Time to market:</strong> Captives are slower and sometimes complicated to establish and arguably use more management resource which could be directed elsewhere. In some countries (in certain business environments) a business may be prohibited from setting up a captive and may be forced to form a JV to involve a local enterprise.</td>
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<tr>
<td><strong>Savings:</strong> A captive avoids a provider taking a proportion of the offshore savings in profit. In the longer term real savings can be experienced and realised by the business and are not eaten up by a third party's margin.</td>
<td><strong>Higher investment costs:</strong> A larger up front cost is involved for the business in starting and ramping up captive operations.</td>
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<tr>
<td><strong>Intellectual property issues:</strong> In a captive, IP will vest the captive and therefore within the same group. In addition, a captive operation can implement and monitor compliance with its own procedures for handling and protecting IP and confidential information.</td>
<td><strong>Delayed ROI:</strong> A critical scale of service is required to justify the investment. Additionally, it can be harder to get value from the project in the short-term (e.g. because of a lack of infrastructure readiness). The first year's productivity can be seriously reduced.</td>
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<tr>
<td><strong>Corporate culture:</strong> A captive provides a better environment to immerse the local employees in the business’s culture. This can result in enhanced productivity and benefit staff retention. It can be harder to impose corporate policies and procedures on an external provider.</td>
<td><strong>Red tape:</strong> Export restrictions in the home country (e.g. the UK’s Export Control Act 2002) may prohibit the transfer of certain technologies to certain countries. In addition, customs and red tape may make it difficult to provide the offshore captive with essential equipment and know-how.</td>
</tr>
<tr>
<td><strong>Ongoing cost reduction:</strong> With a service provider it's very difficult to reduce future costs.</td>
<td><strong>Exposure to local risks:</strong> There is a direct exposure to local risk (which may be alien or unpredictable to a UK based parent).</td>
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<tr>
<td><strong>Options for ROI:</strong> Long-term payback is possible if an equity stake / entire business can be sold in the future. Even if sold, the business may still access the captive’s services (services it has helped design and invest in) via an arms-length contract.</td>
<td><strong>Labour availability:</strong> Can the business compete for talent with the local employers? Infosys and Tata know the market and develop it (and have their own formidable in-house ‘universities’ to train their postgraduate recruits further before they are even placed on a project).</td>
</tr>
<tr>
<td><strong>Tax incentives:</strong> It may be possible for a captive operation to take advantage of local tax incentives – such as those on offer in Indian Software Technology Parks and Chinese Development Zones.</td>
<td><strong>Ongoing compliance:</strong> Arranging for and dealing with regular audits, board meetings (do they have to take place in the country?), directors (is there a minimum requirement of one director being a local national?) all takes time and effort and can be a distraction.</td>
</tr>
<tr>
<td><strong>VAT:</strong> If structured properly the captive can remain within the business’ group for VAT purposes.</td>
<td><strong>Lower investment levels:</strong> The investment in service processes, training and infrastructure (and maintaining these) can rarely be matched by a captive operation.</td>
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<tr>
<td><strong>Transparency:</strong> The operations of a captive can be completely transparent without the cost and effort of regular formal external audits. It may be easier to cost projects and realise optimal savings because of such transparency.</td>
<td><strong>Initial and ongoing legal compliance:</strong> What permissions, licences and approvals are required to open a local business? What are the local laws (employment, tax, commercial and IP) that need to be understood to launch and run the operation?</td>
</tr>
<tr>
<td><strong>Economies of scales:</strong> The captive can leverage the existing licensing, service arrangements and procedures of the wider group.</td>
<td><strong>Providing management:</strong> In the early months and years a seasoned manager may need to be relocated to manage and drive the start-up. Relocation of key team members from onshore takes time and can be a substantial cost.</td>
</tr>
</tbody>
</table>
8. Evaluating the third party offshore outsourcing route

Increasingly popular with all sizes of business, the third party outsourcing option now includes the services of substantial and exceptional offshore providers. The flexible working practices, access to qualified and motivated staff and cost savings associated with such providers has meant a real boom in third party offshoring.

TUPE laws (the Transfer of Undertakings (Protection of Employment) Regulations 2006) are relevant because a business function is being transferred to a third party (albeit overseas) and the business will need to give TUPE adequate consideration. With the jobs moving overseas it is unlikely that employees want to transfer to the relevant incoming provider and therefore the main issue will be managing and funding a place of work redundancy. The business will also need to consult in the normal way. If the offshoring model is an onshore to offshore approach, there may be more options for transfer to the incoming provider. It is important to consider the consultation and staff notifications required by TUPE at an early stage and to negotiate how the associated liabilities and redundancy compensation are to be shared between the parties. It is quite rare for an offshore provider to accept any of these liabilities.
The following table assesses the relative advantages and disadvantages of the third party outsourcing route:

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td><strong>Time to solution:</strong> With an ability to exploit existing and tested personnel and infrastructure, a working offshore operation can be operational quickly.</td>
<td><strong>Loss of control:</strong> The user relinquishes substantial control over the services, perhaps losing knowledge of the way in which business critical services are provided and possibly impeding its ability to bring the relevant services back in-house.</td>
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<tr>
<td><strong>Contractual rights:</strong> As opposed to a captive operation, the user can impose its requirements and expectations on a third party, specifying service levels and creating consequences and rights of redress if the services are not adequately provided.</td>
<td><strong>Harder to incentivise:</strong> With the provider outside the corporate boundaries of the user it can be harder to get the provider’s personnel to buy-in to the user’s corporate ethos and drive for the success of the user’s business.</td>
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<td><strong>Service flexibility:</strong> A user need not be tied to (and need not pay for) an ongoing facility that it may not always require. If there is no service requirement in a given period, the user does not need to maintain and support a ‘bench’ operation offshore as it would with a captive.</td>
<td><strong>PR issues:</strong> Extra care needs to be taken to ensure intellectual property rights are fully assigned to the user. There is also a risk that IPRs are contaminated if the provider is engaged simultaneously by a number of users – thorough procedures are essential. The user should also be more careful to be prescriptive about the security measures that should be in place to give adequate protection.</td>
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<td><strong>Options for multiple solutions:</strong> The user has an option to tap into the experience and resources of a number of providers (giving service resilience) and multiple locations (perhaps to ‘follow the sun’ or ‘near shore’ to enable closer management).</td>
<td><strong>TUPE issues:</strong> Moving a domestic service to an offshore location often triggers TUPE consequences. This can have an effect on overall deal costs (Though TUPE technically operates to transfer employees overseas practically they will not want to go. A user must still consult and is faced with the associated place of work redundancy costs).</td>
</tr>
<tr>
<td><strong>Access to experience:</strong> Often the service provider has performed a service or service transformation many times before. The user can access the provider’s knowledge and reap all the benefits of leaving it to the experts.</td>
<td><strong>Financial standing:</strong> The user may encounter problems with the financial standing of the provider. Some providers may contract via ‘shell’ companies or not have the economic substance expected by the user.</td>
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<tr>
<td><strong>Value for money:</strong> The user may easily leverage the economies of scale realised by an offshore provider with multiple customers. An arms-length relationship also enables the user to access creative pricing models (transactional pricing, utility-based pricing, gain share models etc.).</td>
<td><strong>Business risk:</strong> Whenever a service is taken outside the corporate boundary there is an increase in business risk. The user needs to evaluate the track record of the provider and ensure proper contract governance procedures are in place to monitor the provider and the provision of the services.</td>
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<tr>
<td><strong>Outsource local compliance:</strong> By outsourcing the services the user leaves the legal and compliance hurdles associated with the offshore operation to the provider. The provider bares the costs and risks associated with establishing the offshore operation including the hiring of employees and trading issues within the local legal environment.</td>
<td><strong>Enforcement issues:</strong> If a user encounters problems with an offshore provider and requires redress in the local courts these procedures can be complicated and difficult against domestic businesses. It is almost unheard of to enforce a foreign judgment in a Chinese court and equally hard for a foreign business to successfully bring an action against a domestic State owned Enterprise.</td>
</tr>
</tbody>
</table>
9. Managing risk

As discussed above, effective due diligence plays a role in managing and minimising risk in offshoring. It is also essential to understand the issues and obstacles that will be faced by the offshored operation – these can be exacerbated by the geographical distance between the user and the offshore operation. The programme team and provider should work together to maintain a risk register that identifies and documents all potential risks associated with the offshored services and this should be maintained over the term of the operations. Once identified, the risks should be assessed both in terms of likelihood of occurrence, and any resulting impact. Adequate countermeasures or contingencies should be adopted in order to manage and minimise the risks involved. Options for service continuity should also be considered in every case.

10. Contractual governance and controls

No matter what offshoring model is adopted, it is essential for the business to maintain adequate control over the outsourced operations and those providing the services. This can be an issue of internal corporate governance within a captive or, for the third party provider, a well documented and thought-out contract with clear service descriptions, SLAs and service boundaries and contract management procedures. The contractual issues to be considered are not dissimilar to those involved in any outsourcing.

The user should focus on the particular additional risks inherent with offshoring. In particular, thought should be given to covering the following:

- Whether there are any trans-border personal data flows outside the European Union and means of legitimising any data flow;

- What local intellectual property laws impact any rights or vesting of rights resulting from the offshoring? Also are any specific applications or registrations required to perfect such rights?

- Does the local legal regime impact the enforcement or legitimacy of any specific rights built into the offshore agreements? What dispute resolution (for example arbitration or ADR) and jurisdiction clauses should be adopted or considered as a result? It's naive to assume that simply by selecting English Law the offshore contract will work;

- What permits and licences may be required in relation to the operation of the offshored services? and

- Do foreign laws benefit a service provider, excuse a service provider from certain obligations or impact the disaster recovery or continuity planning?

Conclusions

In order to make the decision as to whether to move offshore and if so, what offshore business structure to adopt, a user needs to make a careful assessment of the relative strengths and weaknesses of the potential providers and service solutions available. It also needs to understand its own internal needs and services and be clear about these before an offshore project is commenced. Offshoring can be an emotive decision and corporate values and risk tolerances must also be addressed.

Naturally, the user is dealing with an unfamiliar offshore environment and due diligence should be thorough and considered. Extra attention should be paid to the contractual framework to ensure that objectives and services are clearly documented. In this way the business is more likely to achieve the substantial benefits it seeks as well as minimise the potential risks.

Our commercial lawyers have broad experience of, and a proven track record in, managing the business and legal issues involved in global sourcing, from strategic alliances and partnering to low cost country sourcing, outsourcing and offshoring.
James Mullock Commercial Partner

James specialises in advising on technology and telecoms issues such as technology licensing arrangements, e-commerce business contracts, encryption and data protection issues (in particular data protection audits), technology and telecoms supply, procurement and outsourcing arrangements, establishing MVNOs (Mobile Virtual Network Operators) and telecoms regulatory issues.

He is the co-author of The Data Protection Act Explained (published by the Stationery Office) and is regularly asked to comment on technology issues by trade and national press.

James trained at Osborne Clarke and qualified in September 1996. He became a partner in May 2001, and currently heads Osborne Clarke’s Anglo Nordic team. The Chambers & Partners Guide to the Legal Profession 2002/3 identifies James as one of its three up and coming e-commerce lawyers to watch.

Mark Webber Commercial Senior Associate

Mark is a technology transactions lawyer in the commercial department. Mark’s work focuses on scenarios where intellectual property or technology needs to be leveraged for business success. Mark has considerable experience in strategic sourcing including advising on BPO and ITO outsourcings, IT procurement and offshoring. Other experience includes advising on e-commerce, licensing and development deals, open source software, channel and partner relationships, and wireless ventures.

Mark regularly project manages pan-European legal advice for both European and US technology clients, often acting as de facto European general counsel for venture-backed technology businesses expanding overseas. He also leads the firm’s initiatives in China.

Mark is a regular speaker and has recently presented on offshoring, international privacy, IT security and on effective ecommerce for the ABA in Chicago.

He joined Osborne Clarke in 1997 and worked in London before moving to Silicon Valley in 2001 to head up Osborne Clarke’s technology services. Mark returned to the UK in July 2004.

Mark is registered to practise English law in California.

David Cubitt Employment Partner

David heads up the London employment team at Osborne Clarke. He undertakes all types of employment work, with particular experience in the HR implications of applying organisational change programmes and on the sale and acquisition of businesses, both within the UK and on cross-border transactions. He is very experienced in handling senior level terminations and dealing with discrimination issues. David has a strong reputation for providing pragmatic commercial advice to banks and financial institutions and to the technology and telecoms sectors.

He also has significant experience in advising US businesses on how to comply with employment law legislation and practices throughout Europe.

David is the joint author of the CCH Employment Contracts Manual and frequently speaks on employment law issues. In the Chambers Legal Directory, David is commended as “incredibly fast and thorough”, combining a “direct approach” with an “ability to explain things in layman’s terms.”

He qualified as a solicitor in 1991 and joined Osborne Clarke in March 2000.

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