Offshore Outsourcing – Opportunities and Risks

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Goals

- Introduction
- Is Offshore Really Different?
  - Motivations for Offshore Outsourcing
  - Legal Risks in Offshore Outsourcing
- How to Implement an Offshore Outsourcing Deal
  - Contractual Provisions
  - Planning for Success
  - Negotiation Strategies
- Improving the Implementation of Outsourcing Transactions
Are Offshore Deals Different?
Key Drivers for Outsourcing

Business Drivers

- Reduce Costs
- Flexibility to Add/Reduce Services
- Flexibility to Add/Reduce Staffing
- Focus on Core Competencies
- Establish Local Presence
- Build World-Class Processes
- Improve Overall Competitiveness
Are Offshore Deals Different?
Key Drivers for Outsourcing

IT/BP Drivers

- Backup, Disaster Recovery, Business Continuity
- Improve Service Levels
- Enhance IT/BP Effectiveness
- Supplement IT/BP Resources
- Provide Overnight Coverage
- Shorten Implementation Time
Are Offshore Deals Different?
Key Drivers for Outsourcing

CONCLUSION:

IN MOST RESPECTS, THE MOTIVATION FOR ONSHORE AND OFFSHORE TRANSACTIONS IS THE SAME
Are Offshore Deals Different?
Risks Associated with Offshore Outsourcing

Geo-Political Risks

- Political stability of country
- Civil strife or war in the area of operations
- Political relations with United States
Are Offshore Deals Different?
Risks Associated with Offshore Outsourcing

Workforce Risks

- Education of workforce
- Experience of workforce
- Communication differences based on language differences or usage of the same language
- Cultural customs of population or subsets of population
Are Offshore Deals Different?  
Risks Associated with Offshore Outsourcing

Business Risks

- Tax implications
- Regulatory issues in country and changes to those regulations
- Customs and duties or other licensing requirements that may apply
- Export restrictions on technology
- Limitations or restrictions on import licenses
- Local insurance coverage
Are Offshore Deals Different?
Risks Associated with Offshore Outsourcing

Legal Risks

- Legal framework of country and local authorities relating to the services
- Intellectual property rights and enforcement in country
- Limitations on ownership structures (i.e., are 100% owned subsidiaries permitted?)
- Labor laws in country
Are Offshore Deals Different?
Risks Associated with Offshore Outsourcing

Logistical Risks

- Travel concerns to and within country
- Ability to obtain visas as needed
- Logistics of setting up operations
- Voice and data communication infrastructure, efficiency and capacity
- Power infrastructure and reliability
- Ease of installation or upgrade to infrastructure
- Infrastructure security standards in country
INSERT SYNTEL OVERVIEW SLIDES
Implementing an Offshore Deal - Planning For Success

- Conduct Due Diligence
  - Identify all Assets
  - Identify All Systems/Processes to be Transferred
  - Clearly Define Statement of Work
  - Clearly Define Service Levels
  - Identify Potential Vendors
  - Assess Capabilities of Potential Vendors
  - Investigate Applicable Foreign Laws and Regulations
Implementing an Offshore Deal - Planning For Success

Think Beyond Costs - Provider Must Make Some Profit

Build for Technology Improvement

Retain the Correct Internal Staff

Select Properly Skilled Local Service Managers

Consider Benchmarking (where possible)

Identify Escalation Procedures

Performance Reporting and Meetings with Service Provider
Implementing an Offshore Deal - Planning For Success

- Develop Incentives, Penalties, and Fee-Reductions
- Sharing of Service Cost Reductions From Efficiency Gains
- Focus on All Service Levels, Not Just the Critical Ones
- Develop Contingency Plans for Non-Performance
- Develop Flexible Termination Rights
- Don’t Rely on Penalties and Termination Rights – It’s Better to Choose the Best Service Provider in the First Instance
Implementing an Offshore Deal - Planning For Success

Understand The Goals Of the Other Party

- **Provider Goals:**
  - Make money
  - Minimize Risk
  - Clearly Defined Scope of Service
  - Reduce Initial Cash Outlay
  - Leverage Existing Infrastructure
  - Client Reference
  - Grow Contract and Relationship

- **Service Recipient Goals:**
  - Reduce Costs
  - Improve Quality of Service/Business Process Delivery
  - Increased Flexibility
  - Transfer Risk to Provider
  - Focus on Core-Competencies
  - Competitive Pricing Over Contract Term
Implementing an Offshore Deal - Key Contractual Provisions

Termination Conditions

- Breach or Default
- Persistent Service Level Failure
- Specific Service Level Failures
- Convenience
- Bankruptcy (Difficult to Enforce – See Alternative Below)

Disentanglement Obligations

- Post-Termination Assistance
Implementing an Offshore Deal - Key Contractual Provisions

- Remedies For Service Provider Deteriorating Financial Condition
  - Avoid Pitfalls of Bankruptcy Terminations
  - Couple with Strong Audit Provision
  - Remedies Include Replicating Services Internally or Cooperation with Third-Party Service Provider

- Relationship Management
  - Meetings
  - Performance Reporting
  - Key Employees
  - Control of Project Staffing
Implementing an Offshore Deal - Key Contractual Provisions

- Dispute Resolution
  - Escalating Procedure
  - Identify Forum for Dispute Resolution
  - Identify Choice of Law
  - Avoid Unfamiliar Courts
  - Avoid Potentially Hostile Forum
  - Avoid Applying Different Laws Based on Jurisdiction
  - Consider Arbitration for Dispute Resolution
  - Streamlined Discovery and Timeline
  - Award May be Enforceable in Multiple Jurisdictions
Implementing an Offshore Deal - Key Contractual Provisions

- Tax Considerations
  - VAT Applicability
  - Impact of Types of Services
  - Impact of Entity Providing Services
  - IP Ownership Effects
  - Structuring Licenses Versus Assignments
  - Location of Invoicing and Payment
  - Description of Invoiced Amounts

- Structure of Customer Can Improve Tax Consequences
Implementing an Offshore Deal - Key Contractual Provisions

- Record Keeping and Audit Rights
  - Financial Institutions May Have Stringent Requirements
  - Duration of Records Retention
  - Financial Audits
  - Performance Audits

- Benchmarking
  - Does it Make Sense for Your Transaction
  - Defining a Comparable Market
Implementing an Offshore Deal - Key Contractual Provisions

- Invoicing and Currency Requirements
  - Local or Global Invoicing
  - Choice of Currency
  - Currency Exchange Rate Fluctuation
  - Remedy for Late Payment (Suspension of Service/Termination)
  - Inflation and Interest Rate Changes

- Intellectual Property
  - Not Applicable in Some Outsourcing Deals
  - Ownership of Developed Work Product
  - Ownership of Data
  - License Rights to Work Product
  - Use of Work Product After Termination
  - Software Escrow Agreements
Implementing an Offshore Deal - Key Contractual Provisions

- Data Protection
  - What Law Applies
  - Location of Data – Maintaining Backups
  - Jurisdictions Have Different Standards
  - Europe: “Privacy is a Fundamental Human Right” - U.S.: GLB/HIPAA
  - Develop Detailed Plan For Each Service Country
  - Use Appropriate Contractual Provisions
  - Use Appropriate Technical and Organizational Measures
  - Beware of Additional Liabilities
  - Potential of Foreign Forum to Resolve Disputes
  - Firewalls and Encryption Standards
  - Physical Security Standards
  - Monitoring Password Procedures, Data Transfers, Data Storage and Workforce
Implementing an Offshore Deal - Key Contractual Provisions

- Business Continuity and Disaster Recovery
  - Develop Detailed Plan for Each Service Location
  - Require Transfer of Data Upon Instability or Disaster
  - Transfer Key Employees for Continuity
  - Test and Practice Procedures
  - Seek Priority Over Other Customers
  - Retain Right to Trigger Plan
Implementing an Offshore Deal - Key Contractual Provisions

- Financial Terms
  - Performance-Based Fees
  - Service Credits
  - Fee Reductions - Adjust fees down to the level of service being delivered.
  - Incentives: Earn-Backs or Rewards to Service Provider for Efficiency/Cost Savings
  - Most Favored Customer – Always Controversial
  - Taxes
Implementing an Offshore Deal -
Key Contractual Provisions

- Contentious Contract Provisions
  - Service Credits
  - Benchmarking
  - Fee-Reduction
  - Gain Sharing
  - Limitations of Liability
  - Material Breach Events
  - Most Favored Customer
  - Termination for Convenience by SP
  - Liquidated Damages
  - Insurance Requirements
  - Indemnities
Implementing an Offshore Deal - Service Level Agreement

- Requirements – Use as Much Detail as Possible
- Measurement Formula – Objective not Subjective
- Measurement Interval – Make Sure Reports are Delivered
- Data Sources – Consider Low-Level Failures
- Escalation of Disputes
- Readjust Scope to Changing Business Requirements
Implementing an Offshore Deal - Understanding the Provider Market

- Increased Pressure on Bottom-Line Profitability
- Less Investment in the Sales Process and Due Diligence
- Willingness to Terminate Deal with Service Recipient
- Increases Importance on Termination and Disentanglement Language for Service Recipient
- Increased Demands to Share HR risks and costs
- Performance-Based Contracting
- Increased Desire for Transformation Deals
Negotiation Team Must be Complete . . . And Prepared
  – Experienced Attorney
  – Project Manager
  – Financial Expert
  – Consultants and Advisors
  – Specialists – e.g., Tax, Insurance, HR

Negotiation Team Must Have Decision-Making Authority

Prioritize the Most Important Issues

Control Drafting Where Possible

Focus on Goals and Objectives
How to Improve Outsourcing Deals: What is Driving the Deal?

- Look For Motivators Beyond Costs
- Greater Focus on Business Issues
- Create a Win-Win Outsourcing Deal
- More Partnership/Less Adversarial
How to Improve Outsourcing Deals: Who is Driving the Deal?

- Seek Senior Management Buy-in
  - Board/CEO/CFO/CTO are preferable
  - May need to identify motivating factors beyond costs to get management buy-in
  - Focus of deal will switch to motivators beyond costs
  - Deal will progress more quickly
  - Decision-makers will be on board ready to make decisions
How to Improve Outsourcing Deals: The RFP

- Include Important Legal Provisions in the RFP
  - Force Bidders to Respond/Lock in Acceptance of Legal Terms
  - Focus on Important Business Issues
  - Discuss Deal Critical Issues Early

Don’t Wait for the RFP to Discuss Deal Critical Issues
How to Improve Outsourcing Deals: The RFP

- Consider Eliminating the RFP
  - Engage in a “Mutually Beneficial” Design Process with Multiple Vendors
  - Choose the Service Providers with the Best Synergy Early
  - Don’t go Through the Process with Service Providers Unlikely to Win the Project
  - Focus on Vendor Strength
  - Focus on Building a Cooperative Relationship
How to Improve Outsourcing Deals: The Contract

- The Goal is Achieving Flexibility
  - Consider a Shorter Contract Term
  - Focus on Important SLAs

- Focus on Important Remedies
  - Consider a “Dating” Phase
  - Breach
  - Deterioration of Vendor Financial Condition
  - Persistent Low-level Failures
How to Improve Outsourcing Deals: Recommendations

- It’s Not a Litigation – Don’t Approach it as Such
- Structure the Vendor Selection Process to Create a Partnership
- Focus on Pricing, but not to Exclusion of all Else
- Structure the RFP Process to Reduce Adversarial Negotiations
- Build a Flexible Contract with the Remedies You Need
- Be Cautious –
  - Do Not Transition Until the Contract is Signed
  - Don’t Focus on Lost Time/Costs