

Chapter 4.8

Emerging Legal Challenges in Offshore Outsourcing of IT-Enabled Services

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ABSTRACT

This chapter provides insightful information on the key drivers of offshore outsourcing and highlights the emerging legal challenges for the IT-enabled service industry. This chapter has attempted to collate and exemplify the distinct qualifying processes in the offshore outsourcing landscape exploring and accentuating their legal and management implications where appropriate. Issues relating to risk assessment, selection of service providers, service level agreements, data protection and privacy, intellectual property rights, termination of contract and post-contract governance strategies have been discussed in detail. The primary intention of this chapter is to provide a broader exposure to the compliance management principles and regulatory frameworks which might provide outsourcing firms with vantage points to assess and adopt effective risk mitigation strategies when structuring multi-jurisdictional outsourcing deals.

INTRODUCTION

Outsourcing is defined by Griffiths (2001) as “the strategic use of external resources to perform activities traditionally handled by internal staff and resources”. In its widest sense outsourcing is a strategy by which an organisation contracts out, usually on a long-term basis, non-core business functions to specialized and efficient service providers, which allows the organisation to refocus their scarce finance and technology resources on creative and value-added services. In the 21st century this phenomenon has created a wide range of scenarios that has particularly characterized the growth and evolution of the IT-enabled service industry.

The META Group Inc. predicts that 80% of organisations will outsource at least one information technology function by 2005 (IT facts, 2004). But, the Outsourcing Pricing Guide report warns that 70% of that group will drive a harder bargain when they renew those outsourcing deals, cutting

both the scope and duration of the contract. The META Group (IT facts, 2004) also predicts that the offshore outsourcing market will continue to grow nearly 20% annually through 2008, despite the less-than-favourable light in which it is held in some political quarters, and by 2009, the average enterprise will outsource 60% of application work offshore. META Group also found that application development and maintenance constitutes approximately 30% of the average annual budget for any typical IT organisation and sending work offshore reduces that expense by 30%-60% (IT facts, 2004).

It has been reported in *Financial Times* that the British insurance company, Prudential, had planned to save \$26.2m through the creation of 1,000 customer-service jobs in India (*Financial Times*, 2004). The pharmaceutical giant GlaxoSmithKline had decided to outsource a significant portion of their global IT operations offshore with expected budget savings of around 35% a year (Vnuet, 2002). General Electric saved about \$350m per year through the 18,000 offshore employees in India (*Business Standard*, 2003). Studies suggest that the U.S. banking industry alone saved as much as \$8 billion in the last four years due to outsourcing and estimates on future gains (until 2009) for the overall U.S. industry to be \$390 billion, with \$138 billion in annual cost savings for the world's top 100 financial institutions (*Business Standard*, 2003). British Telecom, Prudential, British Airways, Citibank, Accenture, HSBC, Standard Chartered and P&O Nedllyod's outsourcing contracts has helped push UK's foreign investments to £5 billion. The current outsourcing revenue estimated at \$11.36 billion per year could push upwards to an estimated \$27.06 billion by 2006 (*Hindustan Times*, 2003).

So why do some firms spend a greater portion of their IT budget on IT outsourcing? Is this a long-term trend or a short-term obsession? From an organisational context, outsourcing is fuelled largely by cost cutting imperatives coupled with improved budgetary control, refreshing technol-

ogy and a wish to concentrate on the core functions of the company. Moreover, offshore outsourcing has evolved into an increasingly strategic solution for solving long-term business problems and freeing resources to refocus on core activities.

GLOBAL OUTSOURCING MARKET

Offshore business process outsourcing (BPO) has become synonymous with globalisation and corporate strategy wherein companies are realising the strategic role it can play in maintaining global competitiveness and market dominance. The BPO segment of North America represented 57% of the total BPO market worldwide in 2003 — with market figures of \$69 billion (Gartner Research, 2004). Further, Gartner analysts say that after several years of double-digit growth, delays in contract signings and lower negotiated rates for large BPO deals have led to moderate growth in 2003 and 2004 (Xicom, 2004b). The western European BPO market has grown by 10.9% in 2003, to \$27 billion, according to Gartner Research Inc. (Xicom, 2004b). In Europe, outsourcing of financial services are widely used, however, other industries are growing in respect for different types of BPO. Customer interaction for demand-management BPO is proving popular in the utilities and telecommunications sectors. Supply-management BPO is gaining popularity in local governments, and enterprise services are growing in telecommunications for human resources, finance and accounting. The Asia Pacific BPO market has grown by 7.8% in 2003, to US\$8.7 billion, and it is predicated to achieve double-digit growth in the next few years (Xicom, 2004b). META Group found that nearly all Asia Pacific IT organisations will outsource at least one mission-critical technology operation by 2005. McKinsey's research found that Australia and New Zealand are the most mature economies in terms of acceptance of BPO services, followed by Singapore. In most other countries there is almost

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