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U.S. Speaker Session 11: Canada and U.S. Approaches - Outsourcing, Offshoring, Nearshoring, Legal Aspects, Possible Conflicts, Economic Impact and Job Effects - U.S. Speaker

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I am going to take a little bit of a different approach. First, I want to give you a perspective on where I am coming from on this, a little different from some of the other speakers you have had today, or over the course of the last couple of days.

This is the wonderful position of being one of the last speakers at a conference. Number one, I am the person standing between you guys and a drink, after two long days of conferences. But the advantages are that I also get a chance to draw in some of the things that I’ve heard over the last day that I’ve been here, and try to tie them together to my presentation so I don’t have to think as hard.

My perspective on this is as a U.S. lawyer, primarily representing U.S. companies when they are doing these kinds of deals on a transactional basis — looking to do outsourcing or offshoring, or however you want to define it. And when I approached this topic, I looked at it from the perspective of a U.S. company and Canada being an outsourcing partner — primarily being a vendor to U.S. companies, which you don’t see a lot of. As Glen showed, there’s a lot of outsourcing from Canada where the U.S. is the vendor, but you do see Canadian vendors coming to the U.S. and pitching and winning business there.
Most of my perspective on outsourcing comes from technology-based outsourcing and business-process outsourcing, although I think a lot of the things that I’m going to talk about would relate as much to manufacturing outsourcing as well. My examples are going to be drawn primarily from the technology perspective, as that’s the area that I have tended to work in.

Interestingly, as I thought about this a little bit, I realized that about ten years ago, I think, was the very first outsourcing transaction that I ever worked on – and it was still sort of in the early days of outsourcing. People were trying to figure out what exactly they were doing. It didn’t occur to me until today that, in fact, in that deal, the vendor was a Canadian company, and the reaction at the time was, “So what?” And I think that that’s largely the reaction that you get today. I think the Canadian companies come in and are treated by Americans – by the U.S. buyers of outsourcing services – as being roughly equivalent to doing business with a U.S. company, and you will see, as we go through this, there are a lot of good reasons for that. But Canadians do have some advantages in competing against U.S. companies for these sorts of deals. However, there also are disadvantages in competing against companies from other countries in these sorts of deals.

To put this in kind of a perspective that maybe will bring you a little closer to home, and try to gain some of the glow from the last presentation on the pharmacy business, which everybody was paying a lot of attention to, it occurred to me during that presentation that you can look at this issue of the internet pharmacies, the Canadian pharmacies selling into the U.S., as a personal kind of outsourcing, where U.S. consumers are effectively outsourcing their pharmacy operations and pharmacy needs to Canadian companies. And when you put it on that basis and think about it on a personal basis instead of on a business basis, a lot of the issues pop out at you in a very different way, and I think these same issues will relate very well to the kinds of approaches that you are seeing in the more complicated business solutions.

So, one of the differences that you will see in the economist talking versus the lawyer talking, is that the economists have the advantage of inventing their words and assuming these things. Lawyers, on the other hand, tend to define their terms, and they may have nothing to do with the English language whatsoever. But what I am going to try and do is sort of a level-set, because I think what you saw in the debates that Jim talked about, as in many political debates, that you had a lot of people that were talking past each other because they were using various definitions of these terms and never bothered to define them because it was not to their advantage to do so.

What is outsourcing? How did it evolve? Where did we get to today? If you start from the very beginning in the technology sector of mainframe processing, where basically there were only a couple of computers around, and everybody had to buy some time on these computers to do their process-
This was before the days of the personal computer, before people – businesses could afford to computerize on a large scale.

They moved up in the mid '90s, when I did that first Canadian outsourcing deal, to looking at high skill on the one hand, but repetitive types of services. IT outsourcing became very big. It is expensive. You need a lot of expertise. You could leverage the expertise of these technology companies, so you’d hire them to do your data processing for you, to run your IT shop, and to do a lot of those kinds of services.

It moved on in the later '90s and turn of the century, into global IT outsourcing, so now it is not just a local IT infrastructure that you are outsourcing, but you are looking at it on a global basis and starting to go into

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what’s called "business process outsourcing," which is a very ill-defined term but goes into other aspects of the business, Human Resources, benefit planning, as an example of that – the call center. The call center outsourcing is a type of business process, so it is taking another business function and has someone else do it; going into more current developments, into what’s called “business transformation outsourcing,” where now you are asking your outsourcing vendor to actually help you change the way you do business. The advantage of that is you get rid of all the old people who are doing it the old way, and you hire somebody new to do it the new way, and you can effect a radical shift in the way the business operates by hiring someone else to do various functions for you.

Development and support services; this is where India and Pakistan are really starting to shine. You get your software development done overseas by another company, which leads us today to the hall of offshore outsourcing, nearshore outsourcing, offshoring, and all these wonderful words everybody has been throwing around.

So what exactly are outsourcing, and offshoring, and nearshoring, and how do you define these terms? People may dispute my definitions of these, but at least for the purposes of understanding my presentation, this is how I would define them. This is exactly the same thing I do in a contract. I define a contract. It doesn’t matter what the word really means in real life; all that matters is for the purposes of this contract, that’s what we are talking about. In outsourcing, you are really talking about using resources outside of your own company to perform functions that were traditionally handled internally. So, that would be a traditional IT outsourcing function. You get rid of a section of your MIS (Management Information Systems) organization. You hire another company to come run your computers for you, and take care of them, and make sure they are working properly.

3 See David Ticoll, Outsourcing Accounting Need Not Be Scary, GLOBE AND MAIL, July 24, 2003, at B9; see also generally Kevin Marron, Outsourcing by the Numbers, GLOBE AND MAIL, September 26, 2003, at 103 (presents business process outsourcing statistics).
4 See generally Editorial: How Outsourcing Helps the Economy, GLOBE AND MAIL, August 3, 2004, at A12 (discusses the types of services generally sent overseas and the limits to services outsourcing).
Offshore outsourcing is effectively the same thing except you are using a company that is located in another country, not necessarily overseas, literally speaking, but in another country. Nearshoring is a relatively new term and refers very specifically in this case to the Canadian-U.S. relationship. When people think of offshore outsourcing, they are thinking about sending jobs to India. What happens when you are doing it with Canada? Well, that's nearshoring; it is a closer country, and it does make a difference as we go along. I would contrast that with offshoring, which is where you are taking a function that is traditionally done locally, but using your own affiliate, subsidiary, branch, or captive company, in another location, to do the work. So it is sort of outsourcing to yourself, but has very different ramifications for how you manage that kind of business.

And then what Glen raised, which I hadn’t thought about, is the Foreign Direct Investment, which again I would define probably a little differently than Glen, where offshoring in my mind refers to having your foreign affiliate doing services that come back to the home office, wherever that may be, and support the sort of local home office business, versus the Foreign Direct Investment, and I would view that as investing in another country to provide services in that market. To put it in more concrete terms, if you’ve got a U.S. company serving a U.S. market, outsourcing would involve setting up their captive company in India to do software development, or whatever it is, to serve the U.S. company and to continue serving the U.S. market, versus doing an investment in China in order to get a toe-hold in serving the Chinese
market with your own affiliate – this is a slightly different view of it and a lot of different strategies would go into this.

The one thing to keep clear on this is that this is all a continuum. Part of the reason why there is no clear definition is that we have been doing outsourcing forever. Basic services agreements are a form of outsourcing. It doesn’t have to be extreme to be this. You know, getting parts from a distributor is a form of outsourcing. It is taking Adam Smith’s pin factory, and now instead of having your own person making the pinhead, you are getting it from somewhere else and pulling it all together that way. And I think that’s part of what comes into the debate and makes it so hard to understand – where do you draw the line between good outsourcing and bad outsourcing, and what’s good for the economy and bad for the economy?

So why do companies outsource? The good reasons to outsource in my mind are the access to expertise, flexibility, scalability, things that another company can provide to you that are hard to generate yourself, and transforming and implementing business changes in the way that you operate.

Cost savings is always an element of outsourcing, but as we will talk about in a little bit, it is not always the best reason, and very often is not the best reason. If all you are looking for is cost savings, it is the rare outsourcing deal that can deliver cost savings without costs associated with it that are often not understood, or well understood, and often are not factored in properly. Look at risks and outsourcing. The hard risks – which are measurable primarily in dollars, or whatever currency you are working in – how much of your company’s revenue is being exposed in this? How much of your cost structure is being exposed to it? Versus the soft risks and the qualitative costs of offshoring (which are things like goodwill and reputation). People are getting hit now, both politically, in being accused of sending jobs overseas and things like that, and also in customer services aspects. You pick up the phone, you call the help desk, and you are getting somebody in another country that doesn’t speak the language very well, doesn’t understand the nuances, even if they are schooled in English very well, or whatever language you are working in, and it reflects poorly on the customer service of your company as a result. That is a soft cost, and is very difficult to get your arms around, but what we are looking for is that both of those risks have to be considered. But these are some of the questions that companies ask when they are thinking about outsourcing businesses. So let’s look at some of the challenges when you are looking at outsourcing and pushing operations – and again my definition of outsourcing – offshoring: Is it your own company, your own affiliate you are outsourcing to in this place?

You are looking at operational controls. How can you manage that business? The piece that you offshore, it is different. It is in a different country; in a different culture. How much operational control do you have over it? The nice thing is that it is your company. You have a lot of control over that,
but practically, these people are far away, in little bit different time zones, and a little harder to control than keeping it internal.

You’ve got the Foreign Direct Investment issues of currency controls, investment incentives that countries are providing, and things like that. Personnel issues, labor costs, and labor laws – we talked about. You know, things like the Canadian healthcare system is an advantage in some cases, but there are also issues in how do you hire and fire people? What are the rules of service pay? Things like that that factor into those decisions. Language and culture issues are not to be underestimated. Can these people provide the same level of service as a company that is closer to home?

Issues of local infrastructure, particularly in less developed countries: Do you have a steady source of power; communications, and the things that you need in order to continue that operation; tax issues; trade rules, particularly on hard goods; export-import kinds of issues; and political stability? There is a reason why India is being chosen over places like Latin America, which might be closer to home, but Latin American countries have had a less stable political structure and higher risks of expropriation of the businesses and things like that. India is a relatively stable country. Politically, it gives you a little bit more comfort in what’s going to happen to your company over time. When you now look at outsourcing transactions, you get a slightly different set of issues. A lot of outsourcing deals are all about performance expectations. When we negotiate these deals, I would say 75% of the time is spent on determining the performance expectation. But you have a lot of similar issues. Do they have the skill level? Does the company that you are outsourcing to have the availability of the labor, the stability of their personnel? Do they have a lot of turnover issues?

These are the things that are going to affect the quality of the service that you get. Costs obviously are a consideration here and there. You are now outsourcing management control. You have a lot less control over management, which means you have less control over costs and cost savings that may come back to you.

You need to plan in advance for changes in economics, changes in your business, and changes in their business. You are tied together now in a very significant way. And consider changes in legal structures. What we are seeing a lot of right now are issues around data privacy, confidentiality type information, where everybody is looking for it. Everybody knows the law is going to change, but nobody knows exactly how it is going to change. What responsibility are you offshoring or outsourcing to a company that you ultimately have responsibility for legally? Intellectual property rights: When you are going offshore in particular, who owns the software being developed, or the data being developed, or the reports that are being developed? Termination issues and enforceability of contractual provisions – these are all issues that come up in a general outsourcing context.
So now when you add the offshoring element to the outsourcing element, what do you get? Well, you get all of the same issues that you had before, and then some. You now have the reduced management control on two levels: One is that it is a different company. The other is that it is a different country. So now you have your management removed one more step from you. Legal infrastructure issues become very important. Do you have access to the courts if something goes wrong? If your outsourcing vendor is sitting in India — and I can tell from what I have talked to Indian counsel about — it is not easy to get into the Indian courts. It takes a very long time, and they bring the concept of "home-court advantage" to a high art form. So we use arbitration as a way around that.

You have the risk that you are competing with a global competitor. You are teaching your outsourcing vendor an awful lot about your business and how it works. Are they going to turn around and either become a competitor to you, or are they going to turn around and market that new-found expertise to your competitor? And all the time and effort that you put into bringing these guys along suddenly is available to the rest of the marketplace.

Some of the concerns are the same concerns that go up a notch. The same personnel issues are there, but now you have the distance issue involved, the language and cultural issues going up a step again. It is not just a question of can they speak your language, but can they understand the language the way a native speaker does?

Stability issues and so forth are there, and then you have the issues that haven’t really changed. You have more international legal issues. We talked a little bit about that already: antitrust laws and enforceability of various provisions of the contracts. You have got issues of U.S. businesses doing business abroad, so the Foreign Corrupt Practices Act, and things like that from the U.S. perspective, become important.

And compliance, that’s a big issue in the U.S. right now with Sarbanes-Oxley and various other rules and regulations coming in and extending out. They have a geographic reach because the U.S. company is responsible for reporting on them. You’d better make sure that your vendors are all doing what they need to do, and that you’ve got the ability to go in and audit and confirm that they are compliant with these regulations to the degree that you need to be as a business.

So why Canada? Those are all the issues that you look at going into any outsourcing transaction. So, what gives Canada the leg up in all of this? Fun-
damentally, it comes back to comfort. And I think one of the people who was commenting on the pharmaceutical presentation said it as well: “I feel comfortable buying drugs from Canada because, well, it is Canada. We know Canada.”

Canada has been friends with the United States forever, and we have similar cultures, very similar backgrounds, and the language barriers aren’t there. It is a very stable country. It is not a country that we are worried is going to self-destruct and take over all the industries that have been built up there. It is easier to manage an outsourcing vendor in Canada. You’ve got the same time zones, the same language and all of that. It is a legal structure that is understood. The cost structures are understood. The exchange rates are understood. So it is a very trusted trading partner. There is a reason why we trade so much with Canada. Where Canada has the advantage over the United States is primarily on the cost side, and also in some of the skill levels developed in Canada that may not be the same as in the United States. Favorable exchange rates, favorable cost structures, and the ability to outsource our problems with our medical systems by having the Canadian medical structure take care of it, are all benefits to the United States companies looking to use the Canadian outsourcing vendors.

So why not go to Canada for everything? Well, one reason is that Canada is clearly not the low-cost provider. Although lower than the United States in many ways, it can’t compare to the cost of doing some of these functions being done in places like India and China, and so forth. As for the availability of personnel, it was sort of startling to just get a rough number on how many people are available to do this kind of work in India versus Canada, and I realized India has thirty times the number of working-age people than Canada does, and even when you take into account the differences in literacy rates and so forth, it is exponentially different, the number, the volume of business that they can absorb. There are also cost structures embedded in some pro-labor employment laws in Canada that tend to escalate the cost structure a bit, and there is a cultural bias. In some cases, if you want something really transformational, do you really want to go to someone who is

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8 See generally Wolfgang Schürer, A Geo-Political and Geo-Economic Overview: On the Rise of China and India as Two Asian Giants, FLETCHER FORUM OF WORLD AFFAIRS, Summer 2005, at 145 (discussing the cultural, political, and economic differences between China and India, on the one hand, and the Western world, on the other hand).

just like you, or do you want to go to someone who brings a different perspective to the table?

So the advantages are there, and this is where Glen and I do agree: The areas where Canada has an advantage really come in the sort of higher value, lower volume kinds of transactions. The things that are less repetitive, less kind of cut-and-dry kinds of works, things that are closer to the core of the business, more strategic, more high-touch kinds of transactions, customer relationships, and so forth, that are important — and a sense of the customer matters. We trust Canada to maintain our confidences in a way that we may not in other countries, where we may not trust the ability to enforce things when things go wrong. And I think that’s where you are seeing an increase in outsourcing to Canada, as well as U.S. companies starting to put their own operations in Canada to take advantage of those sorts of things.

(Applause.)