



TRANSCRIPT

LegalMindsTV Exclusive Interview:

"New Developments and Legal Issues in Outsourcing"

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Let's start with a basic questions -- What is "Outsourcing."

Outsourcing is transferring of servicing from a company say in the United States, for example, a help desk or a subset of insurance processing to another company, the company can be overseas or it can be in the United States. Outsourcing today primarily goes overseas. It goes to Asia, it goes to Latin America, and it goes to Eastern Europe; but basically it's transferring of some sort of processing, some sort of internal processing which is not the core competency of a particular company to another company, which is a service provider.

Why are companies outsourcing?

Companies are outsourcing for well, one basic reason, and that's to save money. The second reason is to improve services because if a company say is in the insurance business, that means they know how to sell insurance, they know how to service insurance; but as far as the back office goes, that's not really one of their core competencies. So, they can transfer jobs from the United States overseas at a much lower cost and perhaps and hopefully for their company get better services.

What are some of the commercial developments in outsourcing?

Well, there have been quite a number of acquisitions of outsourcing companies by American companies. For example Hewlett-Packard ([NYSE: HPQ](#)) bought EDS, Dell Computers ([NASDAQ: DELL](#)) bought Perot Systems, Xerox ([NYSE: XRX](#)) now is getting into the outsourcing business with a firm called Affiliated Computer Systems (ACS) which is \$5 billion company, and sometime ago IBM ([NYSE: IBM](#)) bought PricewaterhouseCoopers' consulting division. So, the larger American companies like Hewlett-Packard and Dell are now looking into outsourcing as a way to increase their revenues and increase profitability and making themselves more competitive with other companies.

Would you consider these more financial or strategic investments?

I think they're strategic investments, but obviously these are public companies. Companies like Dell or Hewlett-Packard are public companies so they're looking to increase their profitability. What's happening is that there are a number of Indian companies for example, Wipro ([NYSE: WIT](#)), Cognizant ([NASDAQ: CTSI](#)), Infosys ([NASDAQ: INFY](#)), and Tata Consulting Services ([BOM: 532540](#)); which are becoming extremely competitive. Some of these companies have over 100,000 employees. So, a company like Hewlett-Packard or Xerox to compete with some of these Indian companies must make a strategic acquisition of some smaller outsourcing companies. So, it makes them more competitive, but of course they're looking for economies of scale as well. Some of these larger US companies do have outsourcing businesses so it's a financial decision as well because they can drive that cost and make those companies more profitable.

What are some of the new business models in outsourcing?

Well, the original model of outsourcing was Information Technology and that was computer systems and that was really the basic model. What now is coming into play is business process outsourcing. Business process outsourcing or "BPO" are things like finance and accounting, tax, benefits, human resources, types of back office processing that companies were doing and spending a lot of money on and can now be processed offshore. So for example, benefits for a large company. So, I'm an employee of a large company, I call up my benefits department, I used to get somebody in Chicago that knew about benefits. Now when I call up benefits, I get

somebody perhaps in Argentina or India that knows about benefits and can help me with the benefits and there's less cost there for the company providing those services.

What are some of the political issues that you think are impacting companies outsourcing, or considering outsourcing, right now?

Some of the political issues affecting outsourcing right now are governmental issues, state issues and federal issues. The federal government doesn't want as many jobs going offsite. The federal unions for example and the state unions are pressing their constituencies not to send jobs offshore. And if I could just read – there were two recent reports that came out. One report was given by the Congressional Research Service, what's called the CRS Report for Congress, called "[Outsourcing and Insourcing Jobs in the U.S. Economy: An Overview of Evidence Based on Foreign Investment Data](#)." So, Congress was looking into why jobs were going overseas. There was another report given by the U.S. Government Accountability Office called "[Civilian Agencies Development and Implementation of Insourcing Guidelines](#)." So, the federal government was trying to do a study on why jobs are going overseas and not staying in the United States. So, companies that are doing business with the government are under pressure to keep jobs in the United States and not send jobs offshore to Asia or Latin America or Eastern Europe.

In light of these political pressures, what are some companies' defense and justification for continuing to explore outsourcing?

Well, the justification is that work can be done at a better level and at a much reduced cost. For example, in India there are highly educated people performing call center services. So, you might have somebody with a college degree or an advanced degree in a call center in India whereas it would be difficult to recruit somebody like that in the United States and the salary might be 30% of what it would cost in the United States. So, there are very smart people performing some of these outsourcing services overseas at a very reduced rate.

How does that impact the jobs being done in the United States?

Well, the concept is that the companies perform in their core competency. So, if you're a bank, you understand the banking business, you don't necessarily understand the back office processing business. If you're a pharmaceutical company, if you're a medical company, if you're a hospital for example, or you service people who are sick; you don't do back office processing, you don't do back office telephone answering, you don't do insurance claims; you would let some other company do something that's not your core competency. And if you're a hospital for example, you would concentrate on having the most advanced techniques in medical care, and the same thing for a bank or an insurance company or an investment bank or a manufacturer for that matter.

What are some of the regulatory hurdles in outsourcing?

Some of the regulatory issues in outsourcing are data privacy and security. For example, the federal government has something called the Gramm-Leach-Bliley Act, which protects individuals' privacy in banking. The medical industry a federal regulation called HIPAA, which is health information security. When companies outsource, this personal information such as social security numbers or medical information goes overseas into India or China or Latin America, there's a loss of control over that data and companies can be very responsible for the data and there can be financial consequences. For example, if data is lost, say 100,000 social security numbers are lost in India, there has to be notification given to those individuals that their information was lost. So, how much does it cost to give notification to 100,000 people, it could cost well into seven figures and the issue is now between customers, the companies, and the outsourcing service providers; a lot of negotiation is who's going to pay for that loss of data.

How do you advise your clients to protect themselves in those situations?

One of the ways we advise our clients to protect themselves in those situations and that's with the customers, say if the customers are negotiating with an outsourcing provider is to put into the contract indemnifications so that if there's a loss of data, there's some financial responsibility on the part of the outsourcing provider to pick up some of the costs of notification and some of the costs for example if there's a class action lawsuit, the question is

who is going to pay for the defense of that class action lawsuit. And frequently there's some kind of a sharing of the liability between the customers and the outsourcing providers.

What are some of the other legal issues in outsourcing?

One of the new legal issues and one of the big legal issues in outsourcing is protection of intellectual property because a customer develops intellectual property, which gives that customer a competitive advantage. An outsourcing provider will be servicing say multiple banks. An outsourcing provider that specializes in banks might have 20 banks it's servicing. But an individual bank doesn't want its own intellectual property that it's developed to be used by the outsourcing provider to service the other 20 banks. So, there's a serious negotiation over who owns an intellectual property and who can use it, whether or not it's just the one bank that gets a competitive advantage or whether the outsourcing provider who may have helped develop that intellectual property can then distribute it to its other customers.

What are some of the other new developments you're finding in the outsourcing business model?

Another new development is pricing models for outsourcing. In the old days, it would just be Information Technology; the number of servers or the number of desktops you would have. Now the pricing model is what's called Full-Time Equivalents ("FTE"s) – how many people are servicing the customer. So, it's more of a "people pricing model" as opposed to an "equipment pricing model."

What are some other trends that you're seeing in terms of the direction of outsourcing business models?

Well, the trends are that outsourcing is really going into the cloud, there's something called "cloud computing" and a lot of the outsourcing companies now are hosting around the world on servers in different locations. So, one of the trends is that a company or a customer may be serviced by servers in all types of different countries; there might be a server in the Philippines, there might be a server in China, there might be a server in Poland; and the

company doesn't really know where its information is and where it's being serviced. So, one of the trends is a global servicing of companies.

What other trends are you're seeing in terms of how companies are utilizing outsourcing?

Another trend is really a result of what's gone on economically here in the United States. There are companies that never thought they would be outsourcing, they just would have everybody working for them as their employees and these companies are really under tremendous economic pressure to reduce costs. So, whereas they used to have all their employees performing the services, they're pressed to outsource which means there's going to be what's called a "reduction in force", that's a "RIF" -- which is a nice name for a layoff. And so companies that have been sort of paternal with their employees now are being pressed to lay off long-time employees so that they can reduce their own costs by outsourcing.

What advise would you give to client's who are exploring entering into outsourcing relationships?

Talking about customer clients, because clearly the outsourcing service providers have a different viewpoint. But the customer clients, these are generally very large transactions. So, the customer clients have to look at them as very large transactions with tremendous risk involved because once a customer transfers his processing and loses control of his processing to a third-party outsource provider, the horse is out of the barn and the customer can't bring that horse back into the barn and he's lost control over processing its own data. The only thing to protect that customer in the future is what's in the four corners of the contract between the customer and the outsourcing provider. So, although there are tremendous economic benefits in outsourcing, there is a very high risk in outsourcing in the event that it does not work and the customer has to somehow scramble around and find a new provider or somehow fix the problem with the outsourcing. So, it's not necessarily a panacea that cures all ills, there's a lot of risk in going forward with outsourcing.

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