

July 2008

# Considering outsourcing to China?

## What you need to know

### Establishing business process outsourcing in China

There has been a recent change in focus on the opportunity for business process outsourcing away from India to China. Many foreign companies are now looking strategically at China as not only a new market in which to expand their core business but also for their off-shore or part of their global off-shore outsourced services needs and the opportunities to receive these services from Chinese service providers or global service providers who have set up operations in China. All indications are that China is becoming not only an alternative to outsourcing to India but a rival.

Below you shall find a short description of some of the conditions to be found in China that make outsourcing attractive as well as some considerations to be taken into account when contemplating business process outsourcing to China.

#### What are the current conditions?

- China offers an increasingly wide array of business process services that has moved beyond traditional processes such as the manufacturing of products to the outsourcing of IT, human resources, finance and accounting functions and other knowledge process activities such as market analysis and research.

- China offers a relatively sophisticated domestic market that is approximately ten times larger than that of India and arguably a more developed and stable domestic infrastructure upon which is to found the provision of outsourced services.
- China offers lower cost outsourcing that has not yet suffered the spiralling costs being experienced by India where huge demand for experienced Indian outsourcing service providers over the past decade has created competition for resources such as high skilled staff which together with factors such as higher relative inflation has increased the cost of outsourcing

*“ Chinese computer science and technology graduates number approx 350k each year more than double that of India.”*

to India. These pressures have also compelled Indian service providers such as Infosys, Wipro Technologies and Tata Consultancy Services to invest in China to support their International clients together with the traditional providers such as Accenture, IBM, Hewlett Packard and Softech.

- China offers a large talent pool – Chinese computer science and technology graduates number approximately 350,000 each year - more than double that of India.
- In short, the cost in outsourcing certain services in China can be considerably cheaper and in comparison to the US, costs have been said to be between a sixth to an eighth of what they otherwise might be were outsourcing not to take place.

### **What to consider when outsourcing to China?**

There are a number of issues to consider when contemplating an outsourcing:

- Whether to acquire or set up a captive company or engage a trusted outsourcing service provider – this will depend very much upon what type of services you wish to outsource and what the market can offer.
- In considering when or whether to outsource, if companies are already considering China as a market in which they wish to expand their core

business, companies may also wish to strategically consider investigating opportunities to outsource non-core functions which may present an opportunity to add value and assist in creating know-how and expertise in the region.

### **English**

Language is important in any outsourcing and whilst China lags a long way behind India in terms of the number of service providers, beyond the major outsourcing suppliers, who are capable of providing a service with adequate language capability, the importance of being able to deliver services in English in order to attract and retain customers has led to a significant increase in English language skills and cultural awareness among graduates. As an indication, there are now more Chinese people learning English than there are people learning English in the US and there is an expectation that China will have similar English language capability to India within three to five years in this sector, allowing larger scale better service business process outsourcing. When looking at suppliers in a selection process if an English speaking supplier is found, this can be an indication that the supplier is geared to and equipped to provide services to a foreign client.

### **Intellectual Property**

Whilst China's laws meet or exceed the standards set by the principal international IP treaties, implementation and enforcement of existing laws is still worrisome in many industries and intellectual property infringement remains a major concern that needs to be addressed in outsourcing services in this region. That said, the culture in relation to IP protection amongst the serviced providers is changing as many service providers recognise this as a key concern for foreign clients who might not otherwise outsource and have sought to respond by implementing robust procedures and controls in order to attract and retain foreign customers.

Despite these nascent movements, however, any company considering outsourcing to China should take strict measures to address and minimise its risk on this issue, including:

- Identifying outsourcing suppliers with clean IP records.
- Looking at the precautions the outsourcing supplier has taken to protect the customer. Are the outsourcing supplier's employment and IP rights contracts adequate? What are the security measures outsourcing suppliers have in place? Are they adequate? Is more required? Noting that there is never perfect security and it generally becomes a matter of cost and how much security is needed.
- Incorporating effective legal protections into the outsourcing contract to address IP violations – for example enforcement capability in both the company's local jurisdiction and in China.
- If software is being developed under the outsourcing contract, whether to have the entire application developed in China.

### Quality of staff and technical training

It is important for a company to analyse and gain confidence about the quality and ability of the service provider personnel who are to provide the services.

Previously, as China was an emerging market, it was difficult to find employees with long periods of experience in the industry and, in its infancy, to combat this perceived lack and an uncertainty about education standards, China's providers emphasised intelligence and work ethic.

However, as its market and training has matured over time and through significant investment by foreign corporations in educational institutions, so too has the capability of its talent to provide high level service. Nevertheless this remains an important point in selecting any provider.

### Selection and international standards

The selection of a trusted provider that can meet your needs is the critical decision in any outsourcing and Chinese outsourcing suppliers are looking to satisfy international audit and risk control compliance standards for western customers to create this confidence, such as using Capability Maturity Model Integration (CCMI) and International Organisation for Standardisation (ISO) quality accreditations/certifications. By aligning with these standards, the companies in turn achieve better performance. In selecting any provider a company should identify the international standards that may apply to the function to be outsourced and where such standards apply, seek clear evidence from a prospective supplier of its status with regard to those standards.

### Legal Documentation

The contract, choice of law to govern the contracts and means by which risks are addressed and breaches and disputes are resolved are fundamental to any outsourcing agreement. The type and scale of the outsourcing will dictate the level of sophistication and complexity of the contract required and time frames required in order to negotiate the outsourcing agreement. Typically, where the value of the contract is small, the terms and conditions may often be shorter than in large scale outsourcing with the technical schedules left to contain the detail of the services to be performed. However, no matter what the scale of the outsourcing, a company should ensure at a minimum that the services are addressed with sufficient specificity, the agreement contains service levels that promote good performance and that regulatory, confidentiality, security, intellectual property and liability risks are addressed. The company should also give sufficient consideration to governing law and place of arbitration, business interruption and disaster recovery responses and how the company is to receive back or replace the outsourced services on termination or expiry of the agreement. Whilst important in any outsourcing irrespective of the country to which the services are outsourced, if these issues can be adequately addressed in the context of outsourcing in China, then the company should have a robust contract that will assist in creating a good platform to have the services provided at the service levels they require, which is the aim of any successful outsourcing.

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