

# Political Risk in the Offshore Outsourcing Service Industry

Navigating Political Risk  
Exposure in Outsourcing  
Location Decisions

# Navigating a Volatile World Series

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## 1 ABSTRACT

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*In an era of changing geo-politics and populist challenges across political establishments, there is an increasing need to understand and navigate the new emerging political environment. Social tensions, labour strikes, and a general reversal of the mechanisms of globalization is impacting on the underlying cost assumptions of the offshoring business model, in both host and buyer countries. In this new and more volatile political environment, this research provides the basis for developing a more relevant and weighted understanding of political risk exposure in offshore service outsourcing, supporting the outsourcing industry in making better risk-informed location decisions.*

### **Key Findings:**

1. **Home Country Risk:** *The analysis highlights that the single largest political risk concern emanates, not from the host country, but from the **Home-country Political Risk** in the form of fallout or **change of home-country regulatory frameworks**, like data privacy legislation, US H1B visas limitations and home land security restrictions, with implications for the offshoring business model.*
2. **Institutional Capacity of Host Country:** *The most profound host country risk is **Institutional Capacity**, with an emphasis on **Host Country Bureaucracy** and to some extent corruption, being the prominent concerns. Bureaucracy directly impacts on processing of host country visa applications, import/export clearances, management of license regimes and other delaying approval processes.*
3. **Legal Predictability:** *Another key risk is **Loss of IP and Contract Enforcement & Legal Transparency risks**. Loss of IP risks is most prominent for KPO engagements and concerns with reverse engineering, changing IP policy framework and the lack of IP legal enforcement. Another key concern is lack of institutional capacity, or political will, to enforce contracts, sovereign immunities and general **Lack of Transparency** in legal frameworks.*
4. **Policy Predictability:** *Another important host country risk is **Policy Predictability**, including change of industry/data management regulatory frameworks and **Predictability of Labor Regulations**. Companies struggle with the disruption and cost implications of changing rules and regulations on for example, regulations on data storage, HR regulations, minimum wages, unstable labour laws and practices.*
5. **Political, Socio-economic and Macro-economic Instability:** *Finally, there are prominent concerns with **Currency Fluctuations** and **Wage Inflation**, plus **Social Unrest** and **Government Stability** in the form of direct or indirect labor strikes, political/parliamentary unrest and implications of elections.*

*The research findings provide the basis for developing better tools to improve identification of emerging risks and determine diversified firm and industry specific political risk impact across global service offshoring. The findings provide differentiated political risk typologies that capture the nuances of external risks in offshoring, allowing for more accurate risk assessment of offshore location decisions.*

Similarly, the research findings provide a guide for governments to develop targeted strategies for attracting offshore investments, by understanding the underlying concerns of the industry, and the potential pull effects of different policy initiatives. The findings further allow for targeting certain types of offshoring, for example some countries are keen on attracting KPO activities, or certain types of ITO and BPO engagements. The granularity of the research findings allows for a more detailed industry hosting strategy that match the development agenda of host countries.

Through proactive risk management outsourcing firms will be able to engage with increased confidence in more complex, yet profitable, offshore outsourcing destinations promoting the expansion of business opportunities into new frontier low-cost countries by developing methodologies that identify and manage political uncertainty. The risk management framework enhances the ability of outsourcing companies to successfully navigate an increasingly volatile world and thereby contribute to the further expansion and deepening of globalization.

## 2 INTRODUCTION

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The past decades have witnessed a revolution in offshore service outsourcing as companies, propelled by globalization, have extended their supplier networks across the world. The emerging trend towards outsourcing, to even lower-cost countries in pursuit of cost savings and higher returns, has expanded traditional risk categories and prompted renewed focus on political risk with the potential to impact the extended supplier networks of outsourcing firms.

The trend has underlined the need to combine offshore outsourcing strategies with proactive risk management methods. The diversification of outsourcing options has introduced the industry to a new level of risk considerations that can represent a direct challenge to extended information networks or represent an opportunity for firms that are able to analyse and manage these new risks effectively.

Political risk concern is mostly associated with Direct Foreign Investment (FDI) or manufacturing outsourcing, on the notion that these engagements represent a more complex investment form, whereas contract-based third-party service outsourcing has less capital at stake and no physical facilities at risk on the ground, and hence less exposed to political events.

With today's extended and interdependent service supplier networks, contracting offshore can lead to detrimental damage in cases of service chain disruption. The dependency on offshore suppliers, often geographically dispersed, has created a situation where companies must now compete on the basis of the performance of each member of their service chain, leading to the claim that global competition is no longer between individual companies, but between the reliability and efficiency of their supplier networks.

Despite the increased awareness of political risks and associated vulnerabilities, research suggests that companies apply limited, if any, political risk analysis when engaging in global sourcing activities. The concern is that today's complex supply and information structures have left companies, and entire industries, vulnerable to political events.

## 2.1 SERVICE OFFSHORE OUTSOURCING STRATEGIES

The term *offshoring strategies* refer to the geographic transfer of a company's operations outside the borders of its home country, fundamentally meaning exposure to a foreign environment. Previous research confirms the importance of analysing extrinsic risks such as political instability and legal infrastructure in host countries, including differences in legislation towards intellectual property rights, labour contracting and employment law (Weiss and Azaran, 2007). Despite the relevance of researching external uncertainties relating to offshoring, limited research has focused on assessing the specific sources and consequences of political risks facing offshoring firms across different business activities and engagement forms, including service offshoring.

While offshoring has traditionally been associated with the manufacturing industry, the offshoring of business services has seen a similar dramatic growth over the years, transforming the way businesses are managing their operations in an increasingly globalized world. The offshore service industry has been driven by technology improvements lifting constraints on geography, time and communication expense, allowing suppliers to easily connect with customers across the globe, giving service offshoring both scale and momentum. As technologies in ICT introduced digitalization, services no longer need to be done *in situ*, it has is possible to separate entire services processes for offshoring. The growth rate of service offshoring underlines the relevance of expanding research towards investigating industry specific risks. Offshore outsourced services are often classified into Information Technology Outsourcing (ITO), Business Process Outsourcing (BPO), and Knowledge Process Outsourcing (KPO).

## 2.2 AN OVERVIEW OF OFFSHORE OUTSOURCING RISK PRACTICES

A review of the literature on political risk in offshoring was applied to map the key political dimensions and their underlying manifestations. Table 1 presents an overview of key political risk dimensions identified through a systematic review of the political risk literature comprising of 115 key papers published during the period 1970–2015. The study includes not only political, but also relevant macro economic variables, as part of a comprehensive political risk framework.

Table 1. Political risk typology dimensions from existing literature.

<b>Political instability</b>	<i>Political instability and turmoil</i> (Brewer, 1983; Coplin and O'Leary, 1983; Goodman and Ramer, 2007; Liuhto et al., 2009; Oetzel, 2005; Robock, 1971; Wade, 2005; Herath and Kishore, 2009; Kobrin, 1981; Kumar and Sosnoski, 2009; Rios-Morales 2009; Ho et al., 2015); <i>election upheaval</i> (Oetzel, 2005) and <i>internal conflict</i> (Busse and Hefeker, 2007); or more broader incorporating the potential <i>instability of neighbor countries</i> (Oetzel, 2005; Tummala and Schoenherr, 2011; Ho, et al. 2015) and <i>external regional threats</i> (Busse and Hefeker, 2007).
<b>Instability of socio-economic environment</b>	<i>Social stability or socio-cultural differences</i> (Leavy, 1984; Ho, et al. 2015); in terms of considering the level of <i>ethnic divide and religious tension</i> (Busse and Hefeker, 2007); the presence of <i>socio-political grievances</i> (Busse and Hefeker, 2007); or in terms of consequence and focusing on <i>social unrest</i> (Liuhto et al., 2009; Sameer Kumar et al., 2009) and <i>law and order</i> (Gholami 2012). More recently research has considered <i>unemployment</i> (Liuhto et al., 2009).
<b>Macro-economic instability</b>	<i>Level of foreign debt</i> (Agarwal and Feils, 2007); <i>currency exchange fluctuations</i> and stability of <i>exchange rates</i> (Agarwal and Feils, 2007; Herath and Kishore, 2009; Liuhto et al., 2009; Oetzel, 2005)
<b>Policy predictability</b>	<i>Regime stability</i> (Busse and Hefeker, 2007; Coplin and O'Leary, 1983); <i>stability of ruling party</i> (Agarwal and Feils, 2007); in combination with <i>predictability and frequent changes of government policy</i> (Brewer, 1993; Oetzel, 2005; Tummala and Schoenherr, 2011; Ho, et al. 2015).
<b>Institutional capacity limitations</b>	<i>Corruption</i> (Busse and Hefeker, 2007; Rios-Morales 2009; Wade, 2005); or <i>corrupt local government</i> (Oetzel, 2005); <i>bureaucracy</i> (Busse and Hefeker, 2007); or <i>quality of bureaucracy</i> (Gholami, 2012; Herath and Kishore, 2009), or degree of <i>red tape</i> ; (Agarwal and Feils, 2007).
<b>Legal unpredictability</b>	<i>Legal predictability</i> (Busse and Hefeker, 2007); <i>accountability</i> (Herath and Kishore, 2009; Gholami, 2012); <i>privacy rules</i> (Gholami, 2012), <i>loss of intellectual property rights</i> - (Ramarapu et al., 1997; Weiss and Azaran, 2007; Sameer Kumar et al., 2009; Herath and Kishore, 2009), <i>compliance risk</i> , relating to local laws and regulations, and their impact on offshoring activities (Narender, 1997; Weiss, 2007; Kumar, et al., 2009).

A number of indices produced by global institutions can support the assessment of business risk including: the Global Competitive Index (GCI), Country Policy and Institutional Assessment (CPIA), The Worldwide Governance Indicators (WGI), Ease of doing business (World Bank), Heritage Foundation's Economic Freedom Index (EFI), Corruption Perception Index (CPI), Bertelsmann's Transformation Status Index (TSI) and Opacity Index, Political Constraint Index.

While these indices can provide a general indication of the level of risk that can affect business operations in a country, none of them drill down into the specific political risk and how they can influence offshoring decisions. This study identifies and categorizes political risk experience in offshoring engagements and determines the level of functional impact on business activities. This research identifies both political risk manifestations and perceived impact on business activities to provide a deeper understanding of political risk dynamics in offshoring service operations.

### 2.3 EXPANDING SOURCES OF RISK

In conjunction with the diversification of political risk dimensions, there is an increasing number of potential sources of risk, including acts by *non-government actors*. Where traditional political risk considerations have emphasized the role of the government, current research is highlighting a wider spectrum of political stakeholders.

Findings also indicates, that in fact national governments are not always the authoritative source of loss problems, meaning that increasingly regional, provincial, state and local governments are dealing with investors directly in ways that the national governments may be unable to control. Other sources of risk could emanate from non-governmental organizations, unions, terrorist groups or transnational crime organizations. This implies a range of declared and un-declared political stakeholders that need to be integrated into the political risk considerations.

Despite these emerging efforts to clarify the nature and sources of political risk, most research remains unspecific about the nature of the political risk concept itself and how best to mitigate its implications. Prevailing research seem unable to distinguish between the relative importance of various political risk variables for a given outsourcing activity and therefore how best to assess and mitigate associated risk effectively.

### 3 DATA COLLECTION

#### 3.1 SAMPLE DISTRIBUTION

For the survey, a series of outsourcing practitioners were interviewed. All participants were in senior positions and involved in outsourcing for minimum 10 years. The regional distribution of the sample cases, presented in Table 2, indicates the global spread of outsourcing destinations. As the the objective was to identify political risk experiences, and corresponding impact perceptions of significance, a qualitative interview approach using a Repertory Grit Technique (RGT) was applied. This technique allowed the identification of underlying risk constructs and impact perceptions across offshoring operations. In total, 25 interviews were conducted analysing almost 100 individual outsourcing cases negatively affected by political risk manifestations.

**Table 2: Regional distribution of sample cases**

Region	No. cases	(%)	Host countries
South Asia	28	30.8	India, Bangladesh
East Asia	17	18.7	China, Philippines, Vietnam
Europe (EU)	16	17.6	Latvia, Estonia Croatia, Hungary, Poland and Romania, UK, France, Germany
South & Central America	9	9.9	Argentina, Brazil, Costa Rica and Mexico
Europe (Non-EU)	8	8.8	Belarus, Russia and Ukraine
North America	7	7.7	USA (1), Canada
Middle East and North Africa	3	3.3	Egypt, Oman
Sub-Saharan Africa	2	2.2	Kenya, South Africa
Australia	1	1.0	Australia
<b>Total</b>	<b>91</b>	<b>100</b>	

The interviews yielded a total of 91 offshore outsourcing engagements or cases with 32 BPO engagements, 33 ITO engagements and 26 KPO engagements.

**Table 3: Overview of cases**

No. Interviewees	Number of Political Risks Manifestations	Offshoring activity			Total Offshore Engagements
		BPO	ITO	KPO	
25	116	32	33	26	91

The samples were diversified across industries with main segments distributed across pharmaceutical (19.7%), banking and financial services (14.3%), health care industry, software development industry (13.2%), web-based consumer industry (6.6%), telecoms (5.5%), public utilities (5.5%), insurance & re-insurance (4.4%) and the gaming industry (4.4%). In terms of geographical distribution, the samples maintained a spread indicative of the industry sourcing trends.

### 3.2 DATA ANALYSIS

The findings were categorized in accordance with the overall political risk classification established in the literature review. The risk constructs emerging from the interviews were defined according to sub-political categories outlining risk descriptions and associated operational risk implications. The frequency of mention was calculated based on the risk sub-groupings and averaged across the number of respondents.

## 4 DESCRIPTIVE FINDINGS

To present a consolidated overview of the key findings the interview findings were inserted into an overall matrix, presenting the political risk categories with descriptive details, the highlighted operational implications associated with the risk type, and the overall frequency of mention and perceived impact.

Table 4 provides an overview of the identified risk categories, highlighting risk categories mentioned by >12% of respondents. The matrix provides details from the interviews to provide a more in-depth understanding of the business impact.

**Table 4: Political Risk Constructs Classified by Frequency of Mention & Perceived Impact**

No.	Risk Category	Sub Risk Category	Category details	Freq. of mention (%)	Perceived Impact (1-5 scale)
1	Policy Predictability	Home-country risk	<ul style="list-style-type: none"> <li>▪ Client Country - Change in Audit regulations</li> <li>▪ Restrictive immigration laws</li> <li>▪ Client Country - Privacy Rules</li> <li>▪ Client Country changes in security requirements</li> <li>▪ Work visa processing</li> </ul>	48%	3.21
2	Institutional Capacity	Host country bureaucracy	<ul style="list-style-type: none"> <li>▪ Institutional bureaucracy</li> <li>▪ Processing of visa applications</li> <li>▪ License Regime</li> <li>▪ Import/export clearance</li> <li>▪ Under resourced institutions</li> <li>▪ Delayed approval processes</li> </ul>	48%	3.06
3	Policy Predictability	Change of industry/ data management regulatory framework	<ul style="list-style-type: none"> <li>▪ Changing rules and regulations</li> <li>▪ Policy/regulation predictability</li> <li>▪ Regulations on data storage</li> <li>▪ Industry Policy Changes</li> </ul>	40%	2.9
4	Legal Predictability	Loss of IP	<ul style="list-style-type: none"> <li>▪ Loss of IPR - Reverse Engineering</li> <li>▪ Changing IP policy framework</li> <li>▪ IP Legal Enforcement</li> </ul>	40%	2.21
5	Institutional Capacity	Corruption	<ul style="list-style-type: none"> <li>▪ Corruption (risk of management exposure)</li> <li>▪ Business ethics</li> </ul>	40%	2.7
6	Legal Predictability	Contract enforcement & Legal Transparency risks	<ul style="list-style-type: none"> <li>▪ Lack of institutional capacity to enforce contracts</li> <li>▪ Lack of political will or culture to enforce contracts</li> <li>▪ Sovereign immunities</li> <li>▪ Legal Risk Liabilities</li> <li>▪ Transparency in legal framework</li> </ul>	36%	2.54
7	Policy Predictability	Predictability of labour regulations	<ul style="list-style-type: none"> <li>▪ Changing restrictive labour laws</li> <li>▪ Changes in HR regulations</li> <li>▪ Changing minimum wages</li> <li>▪ Unstable Labour Law/Practices</li> <li>▪ Changing safety rules</li> </ul>	32%	3.03
8	Macro-economic	Currency Fluctuations	<ul style="list-style-type: none"> <li>▪ Currency fluctuations</li> <li>▪ Exchange rate fluctuations</li> </ul>	28%	2.19
9	Socio-economic	Organized Labour Strike	<ul style="list-style-type: none"> <li>▪ National/state labour strike</li> <li>▪ National/state transport strikes</li> <li>▪ On-site labour strikes</li> </ul>	24%	3.17
10	Political Instability	Host Government Stability	<ul style="list-style-type: none"> <li>▪ Regime shift (Party change)</li> <li>▪ Regime shift (Systemic Change)</li> <li>▪ Political/parliamentary unrest</li> </ul>	20%	2.42
11	Political Instability	Social unrest	<ul style="list-style-type: none"> <li>▪ Political instability</li> <li>▪ Social tensions</li> <li>▪ Election upheaval</li> </ul>	20%	2.23
12	Socio-economic	Wage Inflation	<ul style="list-style-type: none"> <li>▪ Wage inflation</li> <li>▪ Inflation of cost of living</li> </ul>	20%	3.12



13	Policy Predictability	Predictability & transparency of tax regime	<ul style="list-style-type: none"> <li>▪ Changes in Business taxes</li> <li>▪ Lack of transparency of taxation</li> <li>▪ Predictability of taxes</li> </ul>	12%	1.43
14	Political Instability	Geo-political Risk	<ul style="list-style-type: none"> <li>▪ Geo-political Risk</li> <li>▪ Geo-political instability</li> </ul>	12%	3.33
15	Political Instability	Terrorism	<ul style="list-style-type: none"> <li>▪ Terrorism (Hostage)</li> <li>▪ Terrorism (targeting affiliated suppliers)</li> </ul>	12%	2.25
16	Socio- economic	Organized Crime	<ul style="list-style-type: none"> <li>▪ Organized Crime</li> <li>▪ Gang violence</li> </ul>	12%	2.40

The survey results were further stratified in accordance with frequency of mention and associated perceived impact on the offshoring engagement. The following tables capture the stratification of survey results across activity type (ITO, BPO and KPO) (Table 6).

Table 5: Stratification across offshoring typologies		(BPO) Cases (N=32, 12 Grids)		(ITO) – Cases (N=33, 13 Grids)		(KPO) - Cases (N=26, 9 Grids)	
Offshoring (Total) -Frequency and significance of political risk manifestations		<i>Freq.</i>	ASR* (1-5)	<i>Freq.</i>	ASR (1-5)	<i>Freq.</i>	ASR (1-5)
Political Risk Family	Political Risk Event						
Client Country Political Risk	Home-Country Risk	33.3%	2.9	38.5%	3.1	22.2%	2.6
Policy Predictability	Change of data management regulatory framework	41.7%	2.7	23.1%	3.3	44.4%	1.9
Institutional Capacity	Corruption	41.7%	2.4	23.1%	3.4	55.6%	2.7
Legal Predictability	Loss of IP	25.0%	2.6	38.5%	2.4	44.4%	2.9
Political Instability	Host Government Stability	33.3%	1.2	23.1%	3.75	11.1%	3.0
Political Instability	Social unrest	33.3%	2.1	23.1%	2.3	11.1%	3.0
Policy Predictability	Predictability of labor regulations	58.3%	3.4	23.1%	2.5	0	0
Macro-economic	Currency Fluctuations	41.7%	2.3	23.1%	1.5	11.1%	1.0
Legal Predictability	Legal Transparency & Contract enforcement	16.7%	1.8	15.1%	2.0	22.2%	2.9
Policy Predictability	Predictability & transparency of tax regime	16.7%	1.4	15.1%	1.4	0	0
Socio-economic	Wage Inflation	33.3%	3.0	23.1%	3.3	0	0
Socio-economic	Organized labor Strike	41.7%	2.9	38.5%	2.9	0	0
Socio-economic	Organized Crime	16.7%	2.5	23.1%	2.0	0	0
Political Instability	Terrorism	25.0%	2.5	23.1%	2.0	11.1%	2.0
Institutional Capacity	Host country bureaucracy	0	0	38.5%	2.3	55.6%	3.4
Political Instability	Geo-political Risk	25.0%	2.7	15.1%	3.7	0	0
Policy Predictability	Local Audit regulations	8.3%	3.3	23.1%	2.5	0	0

\* Average Significance Rating

## 5 POLITICAL RISK MANIFESTATIONS IN OFFSHORE OUTSOURCING

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The research led to the identification of 16 industry specific political risk constructs, of which 12 constructs are considered key categories  $\geq 20\%$  (Table 4). The analysis indicates that the single largest political risk concern for offshoring companies pertains to home/client-country political fall-out or change of home country regulatory frameworks with implications for the offshoring business model. The home-risk category received the highest frequency score at 0.48 and the highest impact score to match at 3.21 (on a scale from 1-5). This places home-country risk as a dominant political risk concern for the offshore industry.

The risk manifestations elicited from the interviews highlighted negative media or clashes with workers unions with potential for reputational damage or disruption as the main concern. On the other hand, the stricter interpretations of security related requirements i.e. profiling of staff and work locations by home-country regulators, especially within highly regulated sectors like the utility industry, or privacy regulations relating to the banking and health industry. The interviewees expressed less concern with the policies themselves, but more the unpredictability of application and changes, making it difficult to develop and maintain realistic costing models.

On a similar note the risk of changes of data management regulatory frameworks received a frequency score at 0.40 highlighting the impact on businesses *“as new regulations emerge the pricing structure changes due to the new data retention and licenses requirements”* (Interviewee). Again, the risk for businesses are the perceived unpredictability of regulations on data security compliance, which makes it difficult for businesses to maintain price structures.

Furthermore, the notion of data security was not only a regulatory exposure, but also a concern expressed by companies regarding their own proprietary information. As stated, *“there is an increasing concern with data security and data protection”* (Interviewee). This concern relates mainly to the location of server equipment and the policies, or lack of protection, surrounding that location. As stated, *“if you place your information within their reach [private or government hackers], meaning within an infrastructure – you don’t know who enters the data centres with which cables and with which capabilities. Therefore, data protection and security are increasingly a political risk”* (Interviewee).

In addition, host country bureaucracy received the highest frequency score at 0.48 and an impact score

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at 3.06. This finding implies that political risk emanating from local institutions is one of the single highest concerns in the host country environment. The second highest frequency score relates to Loss of Intellectual Property (IP) at 0.40 frequency of mention level. The notion of IP loss was often mentioned in terms of a general breach of confidentiality using external suppliers. However, some interviewees express that *“In fact IP is less a concern because the regulations are pretty clear on that and the clients are protected upfront. The big area is privacy of the client or the client customers. And that is why legislation that exists keeps evolving. I guess the challenging part of that, as regulations*

evolve; the service provider must evolve their practice to be compliant with those legislations” (Interviewee). Other practitioners stressed that loss of IP was a major consideration leading to the necessity of tactics such as service dissection i.e. services being processed at various independent sites, suggesting that concern relating to IP loss be product and service type specific.

The IP loss or infringement issue is also linked to legal predictability and particularly contract enforcement abilities in each offshore setting. With a frequency rating of 0.36 the potential inability to enforce contracts through local institutions, either due to lack of institutional capacity, prolonged processes or simply due to lack of political will. The notion that “*your contract is only as good as your ability to enforce it*” is apparent.

Corruption was mentioned frequently at 0.40, however, it was mainly attributed to low-level operations at destination, rather than perceived as a strategic concern. In fact, one interviewee stated that corruption did not tend to emerge as an issue “*because these clients come from North America and suppliers know it is just not the business culture here*” (Interviewee). The main concern with corruption appeared to revolve more around management exposure and potential reputational risk.

Finally, the political instability risk categories, mostly associated with political risk analysis, were rated at 0.20 in terms of Host Government Stability and Social Unrest respectively. While both were frequently mentioned a review of the perceived impact positions the category below the 2.5 average score threshold.

From the 12 key risk categories  $\geq 20\%$  emerging from the findings, 6 had been previously identified in the literature while another 6 categories appear to be new constructs. The main contribution to existing risk typologies is the concept of *home country risk* and a series of risks relates to regulatory predictability, like change of *data management regulations* and *predictability of labour regulations*, both at the home country level and at the host location. The findings further highlight key risks associated with institutional capacity of host countries, including contract enforcement and legal transparency, IP protection, bureaucracy and the potential for exposure to corrupt practices.

## 6 THE IMPACT OF RISK MANAGEMENT EXPERIENCE

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The qualitative components of the study highlight an apparent contradiction in the sense that political risk within the offshore outsourcing industry remains a relevant concern, and is perceived as something that can be managed, while there is limited evidence of actual proactive risk management taking place.

The concept of political risk and the implications for operations appear to remain elusive. As expressed

**The findings suggest that a narrow conceptualization of the external uncertainty construct of political risk is insufficient to capture the perceived exposure of the offshore service industry and need to be extended with more granularity on the types and nature of risk exposure.**

by one interviewee, the implications of political risk “*could be a protest, or not being able to go to work for a time, or basically not be able to operate locally. It could also be power outages which is not necessarily political but could be politically motivated.*” (Interviewee). From these perceptions the concept of political risk and its implications are difficult to ring fence. The focus seems to be on the

monitoring of traditional risk constructs, like political stability and social unrest indicators, rather than factors like home-country risk pertaining to policy changes, institutional capacity and integrity of legal frameworks.

In terms of active management of political risk, the interviews yielded a high level of variability. Some companies are rather disengaged, as stated: *"...once the relationship is established, we don't monitor. Unless there is something in the press... otherwise we won't notice (Interviewee).*

Conversely, another interviewee stated that *"...it is actually a big piece of our activities in terms of monitoring these things and developing the risk management plans and implementing those plans" (Interviewee).* Others recognized its importance, but with a degree of scepticism, *"Ultimately my sense is that politics does matter, and it is something they are cognizant of and something they work on and actively try to manage. However, I have rarely seen any decision ultimately reversed due to political risk – they slow down, but they don't get reversed (Interviewee).*

The discrepancy in application of risk management approaches could be attributed to firm specific moderators that determine the risk management capacity and risk appetite. The risk appetite, or rather the perceived ability to manage risks, appears to be linked to the experience of the given firm.

As stated, the understanding of risk management varies *"by and large, the larger the client and if they have been exposed 5-10 years, they have a sense of maturity on this. For a new client it is an uphill task and a new thing – and marked by lack of rigor and clarity of how to deal with this (Interviewee).* These suggest that previous experience and exposure to political risk has a significant impact on the risk appetite of the executives and the firm's capacity to manage risks.

## **7 CONCLUSIONS**

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This exploratory study supports the call for re-conceptualizing the political risk definition in the context of offshore outsourcing, to include a broader operationalization of governance characteristics like institutional capacity, policy predictability and legal enforcement capacities, rather than maintaining a narrow focus on political stability indexes.

From a practical perspective this re-conceptualization of political risk allows for a broader scope of monitoring, including an engagement with potential home country specific political fall-out or policy changes. Through proactive risk management outsourcing firms will be able to engage with increased confidence in more complex, yet profitable, offshore outsourcing destinations promoting the expansion of business opportunities into new frontier low-cost countries using methodologies that aim at identifying and managing political uncertainty.

Such a risk management framework enhances the ability of offshore outsourcing companies to successfully navigate an increasingly volatile world and thereby contribute to the further expansion and deepening of globalization.

*This is a first of a series of research pieces on Risk Management in Offshore Outsourcing. Please see the SourcingHaus Location Risk Index at [www.sourcinghaus.com](http://www.sourcinghaus.com).*

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