

## Reports of the death of shared services offshoring have been greatly exaggerated



**By Mark Klender, Principal and Spencer Schobert, Senior Manager, Deloitte Consulting LLP**

For many companies, offshoring shared services is not only vital to their business, but has become necessary to stay globally competitive. However, growing concerns about over-tapped labor markets, declining labor quality, escalating labor costs, and increased terrorism risk have led many to question the viability and future of offshoring. A new administration in Washington, D.C. that is considering new federal policies regulating trade and offshoring is adding fuel to these concerns.

Questions swirl. Does offshoring still makes sense? Is it still economically viable to do so? How long will the opportunity still hold? Is it the right thing to do? Most fundamentally, has the sun set on offshoring for shared services centers (SSCs)?

In short, the answer is “no.”

While there are many factors to consider before deciding whether to offshore shared services — and it is certainly not for everyone — the growth of offshoring is proceeding at a quickened pace and will continue to hold great promise for companies that do it right. Here, we discuss nine of the most common myths about shared services offshoring that may needlessly discourage companies from pursuing an offshore model.

**Myth 1: Offshoring shared services has not proven to be successful.**

**Our view:**

While offshoring requires a substantial initial investment and may take additional effort to fine-tune, in our experience, companies that have offshored SSCs have enjoyed considerable benefits from doing so.

**Commentary:**

- Offshoring shared services is not a new strategy; it originated more than 20 years ago, with such companies as GE, Procter & Gamble, Shell, and Deutsche Bank pioneering offshoring. If it were unsuccessful, its use would have slowed or died out long before now. Instead, we have seen a significant uptick in global offshoring activity as companies become more comfortable with offshoring and witness others' successes. In fact, one of the significant trends in shared services and offshoring is taking function, scale, complexity, and economic benefit to the next level.<sup>1</sup>
- The evidence for offshoring's continuing vitality is everywhere. One only needs to look at the many locations around the world — such as India, Philippines, Mexico, China, Prague, and Costa Rica, among others — that are vibrant examples of where companies have achieved successes with offshoring.

<sup>1</sup> “Taking shared services to the next level: Towards a portfolio approach for shared services optimization,” Deloitte Development LLC, 2009. Available online at <http://www.deloitte.com/dtt/article/0,1002,sid%253D57841%2526cid%253D249148,00.html>.

- Implementing an offshore SSC has become much easier than in the past as a result of the globalization of markets, customers, and products; the advent of more sophisticated technologies; stronger local infrastructures; more favorable government policies; and the lessons learned from the experiences of others.
- For most organizations, the question now is not “Should we offshore?” but “What processes should we move offshore, where, and when?” The answer should come from careful deliberation, and always must be analyzed in the context of the organization’s strategy, objectives, needs, and comfort level with offshoring.

**Myth 2: Rapidly increasing wages will erode labor cost arbitrage to the point that most offshore locations will offer very little cost advantage.**

**Our view:**

Even though wages in several offshore “hot spots” have risen rapidly, they still offer significant wage arbitrage opportunities relative to the United States and Western Europe. The current global recession has dramatically eased wage pressures in even the “hottest” locations.

**Commentary:**

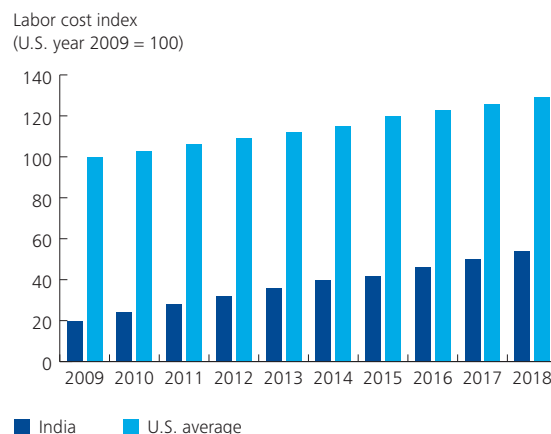
- Prior to the economic downturn, offshoring offered significant wage arbitrage relative to the U.S. and other developed countries, even in markets where wage escalation and attrition were high. With the global

slowing of wage inflation, the anticipated labor cost arbitrage between developed countries and lower-cost offshore options is more positive.

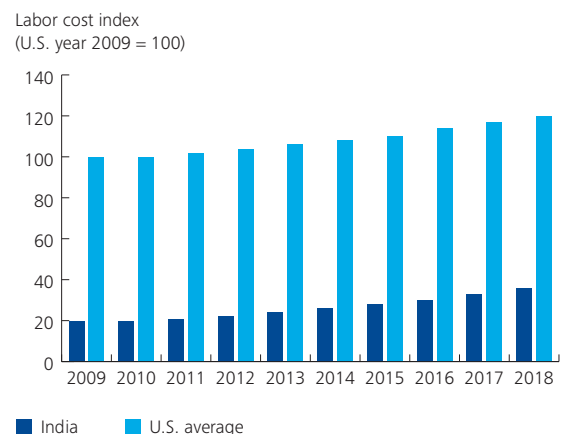
- Many point to India, whose remarkable growth has driven annual wage increases of over 20 percent in some of the larger cities, as the prime example of eroding labor cost arbitrage. But like most of the rest of the world, India has been affected by the global economic slowdown. Its labor market has loosened up tremendously, and our recent research activities indicate that most salary increases this year will be flat to even declining in most markets. We expect last year’s double-digit wage inflation to give way to a low-single-digit level for at least the next few years. (Figure 1 is a representation of potential paths for India labor costs.)
- In today’s chaotic global business environment, three to five years is considered “long term” for SSCs, and many companies build shared service business cases and plans on such a timeframe. Changes in a company’s global markets, business strategies, market presence, operating structures, and service delivery models affect what processes will be in shared services and how specific operations and locations will play out over the long term. Indeed, we find that successful shared services organizations are adopting strategies that plan for ongoing transitions in shared services operations, including growth in functions, processes, and business served — and, with changing operating needs and maturity, the relocation of operations and outsourcing.

**Figure 1. Potential pre- and post-downturn wage escalation paths in India and the U.S.**

Potential wage escalations in India vs. the U.S. (before downturn)



Revised potential wage escalations in India vs. the U.S. (after downturn)



*The labor arbitrage opportunities from offshoring remain significant.*

**Myth 3: Offshore labor pools have been exhausted — the talent has already been taken. If you can find it, you'll just lose it to someone else.**

**Our view:**

While labor availability and quality were becoming an issue in some of the traditional “hot spots,” many viable alternatives exist. As with labor cost, the economic recession has eased the pressure on labor availability and quality in even the “hottest” spots.

**Commentary:**

- We have witnessed a substantial growth in shared services offshoring in the past decade, particularly within the last three years. Because a number of locations have seen rapid growth in shared services operations (see Myth 4 below), the resulting pressure on the local labor markets sometimes reached a point where the markets were becoming untenable. However, even though the growth in offshoring drove considerable competition for labor in several locations, many markets still worked well and did not pose insurmountable challenges even while the global economy was growing.
- We have seen a dramatic change in the labor situation in markets across the globe since the economic downturn took hold, including markets that had the tightest pre-downturn labor environments. Indeed,

many locations have now become a buyer’s market for talent. Governments and employers have driven student populations up in core SSC locations; many companies have reduced their overseas workforces as part of global cost-cutting initiatives; and workers that have returned home from the U.S. and major European centers are having difficulty finding jobs. This combination of factors is producing a large and growing wave of qualified, inexpensive talent looking for stable jobs.

- Returning to India as a case in point, the economic slowdown has substantially reduced demand for talent, especially in the (historically highly offshored) financial services sector. We are seeing job-hopping and attrition, formerly rampant, now rapidly declining — job security is far more valuable.
- One key step in finding stable, skilled labor for an offshore SSC is to match the right labor market to a company’s needs, both in selecting the optimal metropolitan area and the right submarket within it. Proper screening and due diligence are a must, as are steps to mitigate risks during implementation (Figure 2). Competitive HR strategies that address compensation and benefits, culture, and facilities are also crucial. These must be customized to the local culture and labor market — you can’t deploy a U.S. HR model in China.

**Figure 2. Ways to mitigate offshore talent risks**

	Issues				
	Cultural integration	Start-up	Recruiting, brand development	Employee retention	Time zone, access
Leverage external resources (advisory, other global companies in area, government) to address planning, incentives/tax, permitting/licensing, facilities, regulatory, etc.	●	●	●	●	
Hire local leadership and HR management early before start-up; tailor training of standardized processes to local culture	●	●	●	●	
Recruit HR team locally; work with local recruitment firms and government agencies	●	●	●	●	
Communicate value of the corporate brand and culture	●	●	●	●	
Work directly with local universities to develop talent pipeline		●	●		
Moderate ramp-up timing to accommodate lack of experience and presence		●	●		
Locate in optimal area relative to labor shed (safety, access to public transit, reasonable commute, etc.)		●	●	●	
Customize HR and facility strategy based on the local culture (family culture, fitness and recreation, cafeteria, allowances, etc.) to become an employer of choice	●		●	●	
Develop clear career path for incoming employees, including opportunities for job rotation, title subdivisions, skills and language training, travel opportunities, etc.			●	●	
Plan for night shift and orient HR policy to accommodate (sleep rooms, shift differential, late-night transit, etc.)			●	●	●

*Planning for and taking appropriate steps to mitigate talent risks can dramatically improve results.*

**Myth 4: Only a few select locations (the “usual suspects”) offer the best operating environment for shared services. Therefore, these locations should be the primary candidates for an offshore SSC.**

**Our view:**

As companies’ needs and strategies evolve and as labor market dynamics change, the list of viable locations for shared services is growing every year. For a growing number of companies, pioneering locations may actually be more suitable than long-standing offshoring destinations.

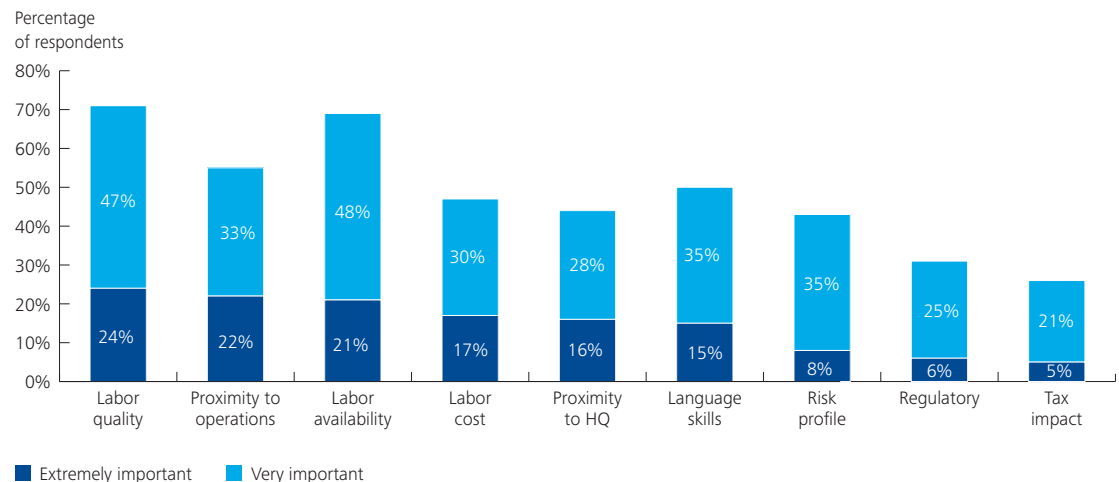
**Commentary:**

- The decision of where to put an SSC is ultimately about metropolitan areas and the labor catchment areas within them, not about countries. In our experience, the variance among cities in the same country can be greater than that among countries. This is where many published studies fail when describing the general viability of a location: Most focus on country-level information without considering the differences among cities within countries.
- Beware the bandwagon syndrome. We have witnessed many companies that “followed the herd” to cities that were commonly held as “the place to be” — such as Dalian (China), and before that, Dublin (Ireland) and San Jose (Costa Rica) — with unfavorable results as the labor markets turned: saturated labor markets, sharply

increasing wages and attrition, and, ultimately, an unsustainable operating environment and cost structure. Even though the recession has made arbitrage and attrition less problematic, these issues still tend to be greater in highly popular locations.

- Every company must determine its own global enterprise strategy for both shared services as a whole and for each center’s operations (functions, processes, skills, and scale). A company should clearly define the decision criteria for evaluating possible locations for an offshore SSC (Figure 3), then conduct careful screening and due diligence against these criteria to develop an informed evaluation of the options. With this underpinning in place, the company can then proceed to make a sound business case for a shared services location that supports the company’s unique objectives.
- Depending on an organization’s priorities and penchant for risk, a company may decide to offshore shared services to either a more established location or a pioneering location (or to a place somewhere in the middle of the established-pioneering continuum). Pioneering locations are generally more risky, as they lack a proven history of success; however, they may also offer greater cost savings and the opportunity to establish a beachhead in an untapped labor market. In general, captive centers, especially for organizations new to offshoring, tend to choose larger, more proven locations, while outsourcers are the first to test new markets.

**Figure 3. What were the key factors in selecting the organization’s SSC location(s)?<sup>2</sup>**



*Labor-related factors dominate the criteria for selecting an offshore location at surveyed companies.*

<sup>2</sup> “Shared services shines in challenging times: Insights from Deloitte’s 2009 global shared services survey,” Deloitte Development LLC, 2009. Available online at [http://www.deloitte.com/view/en\\_US/us/article/c9150b2253903210VgnVCM20000bb42f00aRCRD.htm](http://www.deloitte.com/view/en_US/us/article/c9150b2253903210VgnVCM20000bb42f00aRCRD.htm).

**Myth 5: A successful location for my competitor will be successful for me.**

**Our view:**

Maybe — but don't count on it.

**Commentary:**

- As we discussed earlier (see Myth 4), the bandwagon syndrome can be dangerous. In our experience, a herd mentality, along with careless strategy and implementation planning, underlie many if not most of the problems associated with offshoring.
- This is not to say a company should ignore the actions of its competitors. But decision-makers must also take into consideration how their own company's priorities compare with those of its competitors, and seek to learn from their competitors' experiences rather than blindly copy them. Examine what others have done — and the rationale and detail behind it — to evaluate whether the same approach would be right or wrong for your organization, and consider how your company can use accumulated marketplace knowledge to make a more informed location decision.
- Undertaking offshoring and selecting a location must be done in a purposeful, comprehensive manner that is in tune with the center's current and planned operating needs as well as with global shared services marketplace dynamics. Each company has unique perspectives on what is most important: what markets to prioritize, what investment criteria matter most, how much risk it is willing to incur, and what strategy is right for the

business (Figure 4). Accordingly, each company's shared services and global deployment strategy will need to be tailored to fit its unique priorities and perspectives.

- If a company decides that it is appropriate to offshore, the question of "where" becomes a key factor in achieving the desired results. Choosing the right location requires detailed study and due diligence. Without it, the best-designed center can fail.

**Myth 6: The risks in offshore locations are too high — and the cost savings in less risky locations do not justify the effort.**

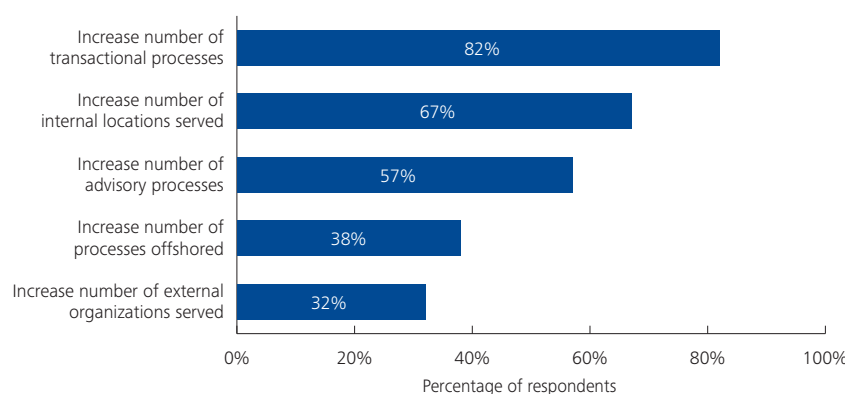
**Our view:**

Many companies and executives have a tendency to overestimate the risks of offshore locations — even when they already have a significant presence in the country of concern. Few companies currently operating in places such as the Philippines and India, two locations that have been cited as "riskier" locations, have moved their operations for fear of risk.

**Commentary:**

- The potential risks of working abroad are certainly real. For example, so-called "express kidnappings" are common in most of the larger Latin American cities; the southwestern Philippines has been experiencing an ongoing insurgency (since the 16th century); and areas in India, particularly Mumbai, Delhi, and Kashmir, have experienced a series of attacks over the years. However, in reporting on offshore locations the media often neglects similar if not greater security risks in the major cities of developed countries, and they, at times, exploit misguided perceptions. For example, many multinational companies have chosen to locate some operations in Manila, even though reports abound that portray the Philippines as a risky country.
- A recent study comparing various risk factors among a long list of potential offshore cities asserted that certain stable cities in India are riskier than one of the riskiest locations in Mexico, and assigns lower risk profiles to a number of higher-risk locations in Colombia, Asia, and Russia. The study, which was based on an online survey that did not include companies from the U.K. or U.S. (the countries that account for the bulk of worldwide offshoring activity), could lead a casual reader to conclusions that are not consistent with the operating realities we have seen for the cities listed.

**Figure 4. What direction is your organization pursuing in its use of shared services?³**



*Offshoring has its place in shared services strategy – but its role is unique to each company.*

<sup>3</sup> "2009 global shared services survey results: Cost reduction is top of mind – executive summary," Deloitte Development LLC, 2009. Available online at <http://www.deloitte.com/dtt/article/0,1002,sid%253D57841%2526cid%253D254236,00.html>.

- Our perspective on the risks of shared services offshoring is that, while personal safety is an important issue, the more significant offshoring risks are those which could directly disrupt a company's business operations, including the risk of natural disaster, political instability, and economic swings. Most of these risks, however, can be mitigated through redundant operations and business continuity planning.
- The emotional factor in how risks are perceived should not be underestimated. Sound information and local experience can help mitigate fears, especially if the decision team's perceptions are addressed early in the evaluation process. As with all aspects of a location decision, it is critical to perform in-country due diligence to determine the realities of what it will be like to operate in each location.

**Myth 7: Shared services is difficult to manage remotely.**

**Our view:**

Shared services operations are no more difficult to manage remotely than manufacturing, research and development, running a regional headquarters, and many other activities that companies routinely perform out-of-country.

**Commentary:**

- It is true that offshore operations often require a greater initial effort to implement and manage than domestic ones, especially for companies that are new to operating internationally. However, this is true for any type of operation. The challenges are largely a function of factors such as distance, culture, regulations, and legal differences; they are not inherent to shared services operations.
- Companies that properly plan their entry and take a careful approach to operations are more likely to find greater success in offshoring. Examples of effective remotely managed shared services abound around the world. Many potential challenges can be mitigated by performing appropriate due diligence in location selection, leveraging the company's international experience and resources, applying lessons learned from other companies, and putting proper management, governance, and processes in place.
- Our experience shows that most companies that struggle with offshoring simply failed to do proper research to establish that the location was a good fit, did not plan the transition appropriately, or did not effectively

implement the move. Common reasons for failure include labor force mismatch, inexperienced management, poor governance, an inappropriate HR strategy, and ineffective executive support.

- The annual cost savings from offshoring shared services are often so great that a company can usually afford to "beef up" its initial start-up effort by paying for extra management, technology, security, external resources, and other support structures. Even with the additional effort and cost of these extras, the payback period on the total one-time investment cost, as well as the business case's overall net present value, can still be very positive.

**Myth 8: Shared services will eventually be outsourced to third parties, with many companies shedding their captive centers, so why bother to develop a company-operated (captive) offshore SSC?**

**Our view:**

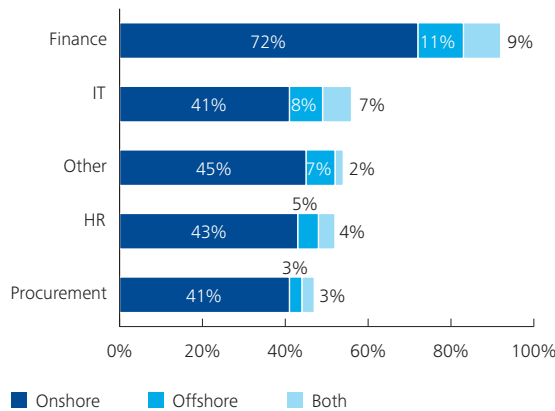
Outsourcing is not the right answer for every company or for every process. Although the use of outsourcing is expected to continue to rise, even companies that outsource extensively often find value in maintaining a captive SSO for certain processes.

**Commentary:**

- Some processes and activities are more appropriate for outsourcing than others (Figure 5). There are many instances where companies prefer captive shared services to outsourcing, as the captive model allows them to maintain full control and to reap the cost savings, productivity, and service level improvements as the operations advance and mature. This is especially true for shared service operations that are more complex and higher-value-added, especially those that involve intellectual property.
- Factors to consider when evaluating a process for potential outsourcing include the strategic importance of the process to the company, the degree to which the company wants to retain control over the process, and the extent to which specific skills or specialized knowledge is needed to carry it out. Other important considerations include whether the outsourcing marketplace offers a match with company needs, the potential impact outsourcing may have on key controls, the company's comfort level with the risks associated with outsourcing, and the possibility of resistance from internal customers.

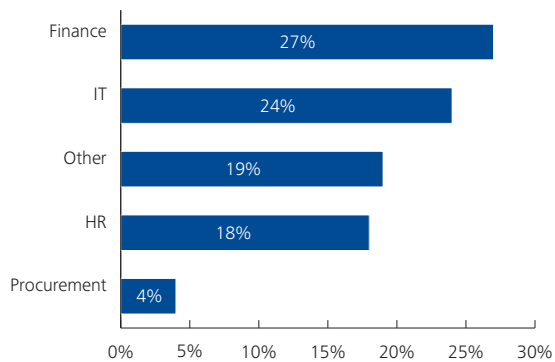
**Figure 5: Outsourcing and offshoring among SSOs<sup>4</sup>**

What processes are in your organization's SSCs?



Note: Percentages in the above chart represent the percent of survey respondents who reported performing at least one process from the indicated function in its SSO.

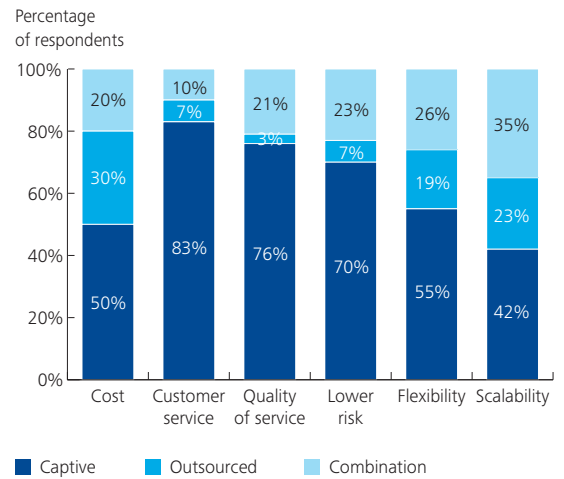
Percentage of respondents that outsource processes in each function



Deloitte's 2009 global shared services survey found that a substantial proportion of surveyed SSOs offshore some of their shared services processes. 34% of the participants offshored at least one process, and 43% of the participants outsourced at least one process.

- We often see an evolutionary model in which companies start shared services with captive operations, and then transition transactional processes to third-party providers. As the outsourcing marketplace matures, and as companies become more comfortable with outsourcing, the transition to outsourcing for these processes can be accelerated.

**Figure 6: Where are you getting the best performance in the following areas – captive operations, outsourced operations, or a combination of both?<sup>5</sup>**



Captive offshore operations more than hold their own with offshore outsourced service providers in many areas among the surveyed companies. We are seeing many companies adopt a "portfolio" approach that combines captive and outsourced service delivery.

- Generally speaking, our experience indicates that a carefully devised combination of captive and outsourced process delivery can greatly improve shared services value (Figure 6). However, it is important for the organization to centrally coordinate the overall service delivery strategy. A coordinated approach can lead to greater cost savings, improved processes and service delivery, and more effective governance of both outsourced and retained services. We believe that this type of "portfolio" approach to shared services provides a greater benefit than the use of either sourcing approach alone.<sup>6</sup>

<sup>4</sup> Ibid.

<sup>5</sup> "Taking shared services to the next level: Towards a portfolio approach for shared services optimization," Deloitte Development LLC, 2009. Available online at <http://www.deloitte.com/dtt/article/0,1002,sid%253D57841%2526cid%253D249148,00.html>.

<sup>6</sup> Ibid.

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**Myth 9: Offshoring shared services is bad for the U.S. economy.**

**Our view:**

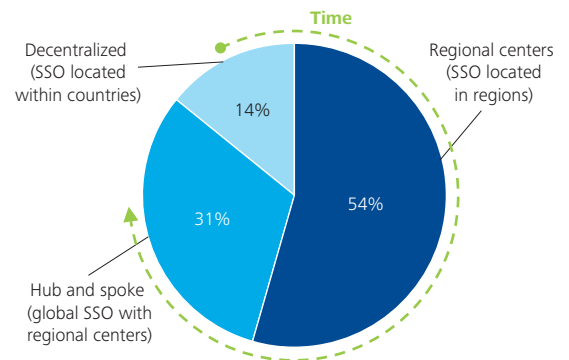
Although there may be some short-term job loss in the originating country, the globalization of the economy requires companies to both expand into new markets and maintain globally competitive operating costs. It is less a question of ethical obligation than one of economic survival: Either maintain globally competitive costs or lose competitive advantage, potentially to the point of losing market share and compromising the success of the business.

**Commentary:**

- The economic tenets of comparative advantage dictate that in a globally competitive economy – holding external influences such as regulation and taxation constant and factoring in acceptable productivity and quality – the production of a good or service will migrate to locations that offer a significant cost advantage. Over time, shifts in production and the law of supply and demand will rebalance resource costs among locations. This has been the case in the movement of manufacturing from developed countries to lower-cost locations; the evolution of shared services has followed a similar path.
- Offshoring is not a black-and-white matter of simply moving positions to another country. Companies design shared services delivery strategies to support expanding markets and operations across the globe. Offshore shared services operations are often ramped up to support growth in the business itself – growth that creates net new jobs across the company, including in the home country.
- Our research suggests that the increased savings and competitiveness from offshoring can actually yield a net increase in U.S. jobs. Beyond maintaining competitive costs to enable the company to compete in the global marketplace for its products and services, the savings from lowering the cost of shared service delivery can help fund other core company investments, initiatives, and operations. These activities can include higher-value-chain activities in which U.S. operations have an advantage and that are associated with higher-paying jobs.

- The decision of where to place a center will depend on a company’s shared services deployment model — that is, what processes it chooses to deliver on a country-specific, regional, and global basis — as well as the maturity of the shared services operation. At most companies, the shared services footprint expands geographically over time (Figure 7). First, services are centralized within each country; then, they are consolidated regionally; and eventually, location-agnostic services may migrate to a global hub with smaller regional centers retained to support region-specific activities and local language needs. As time goes on, more processes tend to move from the local businesses to regional centers — and from the regional centers to a global hub or to external service providers.

**Figure 7: Evolution of shared services deployment models<sup>7</sup>**



*SSOs typically evolve stepwise from in-country service delivery to regionally based service centers to a global hub-and-spoke model.*

*Note: Percentages represent the percent of survey respondents operating under each model.*

- Notwithstanding the above, political debate and governmental barriers have been perennial complications in the offshoring landscape. For protectionist trade policies targeted at offshoring to effectively discourage offshore business activity, the associated reward or penalty would need to be significant enough to offset the often substantial operating cost savings that many offshore locations offer. Policies such as the Troubled Asset Relief Program (TARP) in the U.S., which focuses on financial services companies that are receiving federal bailout funding, are likely to be one-time responses to very extreme circumstances. The full impact of such programs on offshoring is yet to be seen – and, regardless of the outcome, the debate around how companies should run their operations is likely to continue.

<sup>7</sup> Ibid.

## Summary and conclusions

Operating globally to sustain competitive advantage is a business imperative for most companies, and we believe that the trend towards offshoring will continue to accelerate in the years to come. Consequently, location has evolved from being a peripheral consideration to playing a critically important role in the very success of an organization's shared services strategy and operations. Decisions around offshoring and location selection carry considerable complexity and must be carefully planned and strategically implemented — with a clear view of which concerns are valid and which are based on rumors and misconceptions.

To sum up our thoughts on what companies exploring offshoring shared services should consider:

- There is no such thing as the “right” location for all SSCs. Do not assume that published depictions of a location’s viability are an infallible guide to choosing a place that fits your company’s needs.
- Kick the tires. An investigation is not complete until you have experienced the location in person, interviewed local employers and governments, and performed the proper due diligence.
- Learn from the lessons of others, but don’t blindly imitate them.
- Avoid surprises. Educate, involve, and seek buy-in from executives and the steering committee ahead of time and throughout the entire decision process.
- Carefully plan and execute the ramp-up and ongoing operations of your offshore center.
- Be an employer of choice. Implement an HR and operations strategy, tailored to local customs and workforce needs, aimed at becoming a top employer in your chosen location.
- Offshoring is not just about cost; it is usually undertaken as part of a larger long-term business strategy. Effective offshoring and shared services strategies can be invaluable in driving long-term organizational change, transformation, and performance improvement initiatives.

We believe that reports of the death of shared services offshoring are greatly exaggerated. Offshoring shared services is a natural, integral, and vital part of international business growth. Properly planned and implemented, an offshoring strategy for shared services can help drive competitive advantage in an increasingly demanding global economy.

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