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**Original scientific paper**

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## **ENTREPRENEURIAL OPPORTUNITIES FROM OFFSHORING**

### **Abstract**

This paper focuses on the impact which offshoring has on entrepreneurial activities and how specific factors influence certain individuals to follow their incentives and build international business model throughout offshore operations. What is the meaning of offshore financial centers? Which are the steps that entrepreneurs should undertake? Together with advantages and disadvantages of this kind of investment, these are the main topics elaborated in this paper. Outsourcing is an important part in this international venture as well, so they play a huge role in moving capital and human labor from one point of the world to another.

Offshore financial centers along with outsourcing activities offer a variety of services and products, which can be beneficial for today's entrepreneurs. Entrepreneurial start-ups based on this kind of business models can gain competitive advantages, penetrate new markets, reach new customers and ultimately increase profits.

Today, offshoring and outsourcing operations have deep impact on strategic decisions made by the management of the companies; they can influence whole economies and regions, improve corporate profits and decrease risk operations. According to most recent research, offshore financial centers have vast amount of money on their balances – they are very attractive to the majority of investors, and also to entrepreneurs as a way for starting a new venture.

**Keywords:** entrepreneurship, offshoring, offshore finance centers, outsourcing, investments

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## Introduction

Entrepreneurship presents a vital, flexible and dynamic component of the economy and is considered to be the "cradle" of creating new job opportunities. Entrepreneurship has a great impact on the economy and society as a whole, influencing the performances of major companies. It acts as a generator and instigator of reforms. Entrepreneurship and the SME sector can exist and develop only in a specific economic environment and are driven by elements of global trading. One of the most important elements in recent decades concerning the global economy are represented via the offshore operations and outsourcing. The term *offshore finance centers* appeared in the 1980s, being defined as jurisdictions that provide commercial and corporate finance services to non-resident corporations (Andrew and Alex, 2012: 2) and contribute to higher economic activity by improving the profitability of business operations between legal entities. Offshoring and outsourcing forms of financial performance are very similar, but their roles in international operations are drastically different. Outsourcing is the process when it comes to cooperation agreement with an entity outside the company – another company. The company that enters into a contract for outsourcing can be in the same country or abroad. The practice of outsourcing is as old as business itself. What to subcontract is a question of a strategic choice. In the past, outsourcing contracts were made only for a small part of companies' operations. Today, companies keep only the core of their business in-house, and everything that is cheaper and more effective to be done abroad is sent almost anywhere in the world.

Offshoring, however, means moving work and jobs outside the country where a company is based (Bhagwati and Blinder, 2009: 20). For example, if Apple starts its own laboratory in London, instead the one in Palo Alto, that would be offshoring. But if they decide to make an agreement with another company in the US or abroad for their R&D operations, in that case it would be outsourcing.

There are many advantages and disadvantages regarding these kinds of international investments. Entrepreneurs should realize that in order to maintain and increase their business activities, and to become more competitive and achieve higher incomes, they should always be open to considering outsourcing and offshoring as possible ways of starting or expanding their business ventures. Using modern methods of collaboration and continuously investing in human capital are necessary

for the future of the companies. Therefore, entrepreneurs have obligation and responsibility to decide which of the core activities from the value chain could be best carried out abroad. In recent decades launching hundreds of millions of jobs in developing countries was a direct result of outsourcing and offshoring (Contractor, Kumar, Kundu, Pedersen, 2011: 2). At the same time, many people in developed countries have lost their jobs because companies where they previously worked were able to find cheaper alternatives. Although there are some disadvantages, the benefits offered by offshoring and outsourcing are greater for all parties involved. In countries with a huge supply of cheap labor this provides an opportunity for job creation, which will lead to higher living standard. Thus, companies involved in offshoring and outsourcing will have lower labor costs, and generate higher profits. Moving the businesses from West to East from the very beginnings of this phenomenon has contributed to the loss of jobs in rich countries, especially for the less skilled workers. In the last few years offshoring and outsourcing became one of the most powerful aspects of globalization (Contractor, Kumar, Kundu, Pedersen, 2011: 2). But some new phenomena have been happening in many industries in the world. By the end of 2013, after moving almost entire IT and mobile phones industries in Asia, especially in China, a new production line has been established to make personal computers on America's soil again. But, in this case the new manufacturing facility is built by Lenovo, the Chinese company, not by a company from the US (Wall Street Journal, December 2013). Many companies realized that they move too much work abroad and start to bring some of it back home (such as Google, General Electric, Ford Motors in the last few years), and other companies from emerging countries choose their location for production on European and US soil, thus commencing the process known as "reshoring". These crucial changes that have taken place over the last 5-10 years have opened new opportunities for entrepreneurs to widen their possibilities how to make their startups more competitive and strategically valuable.

### **1. Concept and role of offshore finance centers**

In modern literature offshore finance centers are often identified as "tax heavens" (Hampton and Abbott, 1999; Palan, Murphy and Chavagneux, 2013; Morriss, 2010). In fact they represent jurisdictions

that are separate from the main regulatory bodies (states) and have their own autonomy. This can be a physical separation as a separate territorial unit – an island, or remain within a city like London or New York. Offshore jurisdictions are lands that have a large number of financial institutions engaged in the business of non-residents (Cobb, 2009: 335). However, other institutions classify this offshoring centers as centers for management services with high profits. The most widely accepted term for these centers is "offshore finance center", which is used by global and regional regulatory and supervisory bodies (Maurer, 2007: 155). Offshore finance centers are promoted as places with low taxes, places which protect the anonymity of data, with a wide range of appropriate financial expertise for business and individual assets (Hampton, 2010: 6). According to Henry (2012), a significant fraction of global private financial wealth, at least \$21 to \$32 trillion as of 2010, has been invested virtually tax-free through the world's still-expanding black hole of more than 80 offshore secrecy jurisdictions. And this is just financial wealth. A big share of the real estate, yachts, buildings, properties, jewelry, arts and other non-financial-wealth are also owned via various offshore structures. OECD (1998) characterizes offshore finance centers through a combination of the following parameters:

- Minimal or zero tax
- Preferential tax regimes
- Lack of transparency
- Lack of effective exchange of information.

In fact, offshore finance centers are a symbiosis of all these features. The most typical service performed in these centers are banking operations, but current services also include fund management, insurance, accounting services, tax planning, intellectual property registration, company registration on a yacht, brokerage and consulting services, etc. (Orion, 2014). From the beginning of offshoring and outsourcing, international finance centers became the cradle for establishment of anonymous accounts of wealthy individuals, and therefore there is a general suspicion that they are actually centers typically used for tax evasion. These are attractive locations for investment for the global tycoons, especially for those from the post-socialist transition countries. The mere existence of differences in the manner and form of a national tax policies and practice gives incentive for individuals to reflect on reallocation of their equity. One of the biggest advantages of offshore centers is that they offer lower costs,

higher quality of service, price stability, more potential business partners, and a possible access to a great number of investment funds. On the other hand, certain features, such as tax erosions, banking secrecy and many others are the reasons for which these financial centers are under a high level of monitoring by international institutions, international financial controllers, and international funds. International finance centers in general and offshore finance centers in particular contribute largely to the functioning of the economies in the world. According to Hines (2009: 12-13), their most typical five roles are:

- To stimulate foreign direct investment in countries with high income. Companies are more likely to invest in international finance centers due to the rapid growth of profits in relation to countries that impose high taxes.
- To discipline financial markets. Low tax rates that are offered in international finance centers, limit the extent to which banks and other large institutions can take advantage of local monopolies to the detriment of individuals and businesses.
- To promote good governance and a lot of benefits that can accrue from democratic accountability.
- To have an impact on tax collection and tax competition between major countries. The availability of low taxes allows governments to maintain healthy domestic tax bases without causing tax competition from neighboring countries.
- To influence on the global economy. In the past 25 years they have experienced rapid growth, partly reflecting their growing importance of the financial sector of modern economies. The ability of international finance centers to finance other sectors of the domestic economy adds additional value and economic activity worldwide.

Offshore finance centers serve a number of legitimate, and some less than legitimate purposes. In the past their success was characterized by their ability to minimize tax burdens only for the non-resident corporations, but other methods of evaluation have become more useful since offshore finance centers have started providing some other value-added services, as well.

## **2. Distribution and importance of offshore finance centers**

During the 1960s and 1970s in Europe some instruments in the banking sector appeared, which started changing things on global level. The imposition of reserve requirements, higher interest rates, restrictions on financial products, controls over capital flow, and high rates of taxation in many OECD countries were one of the most frequent measures, which were probably the main reasons for change of the financial players on the global stage (Hines, 2009: 33). Attractive services that were offered by offshore finance centers have started to attract international investors. In Europe, Luxembourg began attracting investors from Germany, France and Belgium in the early 1970s of the last century because of introducing low tax-rates. In the Middle East, Bahrain began to serve as a center for collecting excess oil from the region. In the Western Hemisphere, Bahamas and the Cayman Islands were in a similar position. Promoting investment opportunities for the major world economies, which ultimately supported the creation of jobs and increased their economic growth, were one of their major advantages. These offshore finance centers started implementing their development strategies mainly through various tax-exemptions schemes, thus offering a competitive advantage for the entrepreneurs around the world. Because of this, they are often subjected to criticism from international institutions for outstanding issues involving tax evasion, money laundering or financial frauds. There are many examples of funds that originate from the activities involving dealing drugs, prostitution or gambling, which have been invested back into national economies as legal investments through the entrepreneurial activities initiated by the offshore established companies. (Cobb, 2009: 343). But, their real importance is much greater. There is a misunderstanding in the community about their real functions. Burns and McConvill (2012) stress that their importance is particularly evident because they are used for different reasons:

- Joint venture companies. – Offshore companies are often used as a form of joint ventures when investors from different countries are joining together to fund a project.
- Costs and ease of use. – The minimum fees, low costs for establishing a company and ease of use of services are the main reasons why most offshore entities choose to invest offshore.

- Relationship with, and access to regulatory bodies. – A key feature of the leading offshore finance centers is the fact that they are relatively small countries, with little population working together as a close community. This is an attractive feature of financial centers because it means that the regulatory bodies are much more accessible and easier to reach. They are more open-minded and proactive, unlike their colleagues in countries which impose higher taxes.
- Access to financial markets. – If entrepreneurial venture is established in one of the offshore finance centers, there will be many more funding opportunities.
- Equity. – Offshore finance centers are quite significant for investment funds. Investment funds with large assets owned by investors around the world can attract a number of successful businesses in these financial centers.

In the past most of the attractive offshore destinations were mainly on the islands, especially those in the Pacific Ocean. Today, many countries, including developed ones, have realized the power of attracting non-resident entrepreneurs to invest and start their own business on their grounds, under their jurisdiction. Even US has introduced many offshore initiatives in order to attract offshore fund and entrepreneurial ventures especially in industries like: software development, nano-tech, green-tech, e-commerce, web design and web hosting, online consulting and management (Globes America, 2014).

### **3. Establishment and development of offshore companies**

The phenomenon of outsourcing and offshoring gives way to a series of issues which companies must tackle before they begin to focus on this kind of operations (Contractor, Kumar, Kundu, Pedersen, 2011: 37):

- The company needs a diversification into the company's value chain.
- The company should have appropriate interfaces between organizational and spatial features, and
- The company should stay focused on minimizing the outsourcing costs and minimizing the overhead costs of running the company.

Establishing an offshore company is legitimate and legal. Actually, it is a practice of a huge number of entrepreneurs and companies who see their opportunities at offshore destinations. The company management, i.e. the entrepreneur, and the accredited mediation agency should work together in order to determine what is the most ideal place for establishment of the offshore company, in accordance with the laws of the particular jurisdiction. Creation of offshore company is the part where the entrepreneur actually sets the pillars of functioning of the company at an offshore destination. They usually appoint local managers in the country where the offshore company is located, in many cases without any real business role and power, just declaratively to represent the company. One of the many specifics of these financial centers is that the process of establishing an offshore company costs minimal fees, and the incorporation process could contain a big portion of secrecy. If the entrepreneur, the owner of the newly established offshore company wishes to keep his identity secret to the public, then no single authority should be able to trace their involvement into the company's activities. Special intermediary agencies with expertise in offshoring within the particular jurisdiction usually help this process run smoothly and without any legal obstacles. They may provide full support and consulting to ensure effective functioning of the overall operation of the company at a relatively low cost. In recent years, global giants from various industries increasingly use offshoring and outsourcing, even for the most complex work, such as research and development, programming, insurance underwriting, medical prescriptions and more (Contractor, Kumar, Kundu, Pedersen, 2011: 327).

#### **4. Advantages and disadvantages of offshoring**

Offshoring is a possible option even for the already existing businesses; it is not a case only for the entrepreneurial startups. Offshoring certain parts of the company - certain functions of the value chain, meaning reallocating these operations to locations abroad, such as production or handling and distribution. A lot of the companies still retain their core competencies near their corporate headquarters. But, in recent years, companies have even started to reallocate their core competencies, such as design, marketing, research and development and

to shift towards offshoring centers. In fact, more and more functions and activities are considered to bring competitive advantage if they become part of the offshoring or outsourcing process. Depending on the offshore destination, companies benefit from the offshore center's infrastructure, as well as from lower tax rates. Entrepreneurs who invest offshore also gain benefits from using the services of offshore banking. Offshore banking provides greater protection for active investments, along with improved capability in the fund management of the international business. The benefits are significantly greater. Offshore centers generate income from financial activities of their new clients, as well as from the existing ones, which leads to higher economic growth in the offshore country. Economic stability and employment rate growth are factors that also affect the development of a country (the offshore destination). One positive aspect of offshore territories is gaining funds in their state budgets from the payment of minimal fees for the operations of the registered offshore companies, as well as the new company's registration and renewal of licenses. Additional benefits exist for the local workforce due to creating new jobs. Some economies, like the Cayman Islands, Virgin Islands and many others rely exclusively on offshore activities as a major source of government revenue and economic activity. One of the advantages of these small economies is minimum formalities for the establishment of offshore companies. Another advantage is the short distance to major economies, which is often the case and benefit for small offshore jurisdictions.

On the other hand, disadvantages of offshore operations are research topics of international finance institutions, which constantly monitor their development. Restructuring through outsourcing and offshoring of companies from developed countries have a number of negative implications, in which the most explicit are (Bhagwati and Blinder, 2009: 51):

- Slower growth in average productivity - US and other rich countries often shift production to countries like China and India, which increases the growth rates in these economies and in this way, performs the redistribution process of international convergence.
- US vs. Europe. - The constant competition between US and Europe imposed pace of continuous technological innovation, which in some cases gives the advantage to the United States and in other to Europe.

- China or India - US residents and citizens of other English speaking countries in the future should not be concerned by competition from China, which is largely in the manufacturing sector of consumer goods. They should be more focused on competition from India, which is mainly in the service sector. Knowledge of English language is an important source of comparative advantage.
- Inequality in wages and salaries - Differences in financial contributions between educated and uneducated workforce are becoming more prominent around the world. This phenomenon is largely a consequence of technical progress, which will, as it is obvious, continue to grow.
- Job satisfaction – Recently modern economic living imposed alienation and isolation due to excessive professional obligations. It is estimated that the industry of personal services will become dominant in the future, which could lead to an increase of social activities between people and their greater satisfaction with their careers and professional development.

Governments around the World often express concerns about the negative impact of offshoring destinations on their own economies. The biggest risk detected is tax evasion, which is often said to be the main reason why companies conduct their businesses offshore. According to Hines (2009) there is always a possibility for the income earned in countries with higher taxes to be filed as if earned in offshore destinations for the purposes of smaller taxes. It is a public secret that some of the incentives for offshore operations are inspired by possibilities for dissembling and investments into criminal activities in other countries, including activities related to terrorism and drugs. This type of operations are forbidden in almost all countries in the world and are sanctioned and rigorously controlled by all governments. Financial and economic strength of offshore destinations largely depend on their ability to attract global financial business, thus competition between them is really strong. This competition is beneficial as it contributes to innovations in financial instruments and products and reduces the cost of financial services in the world. However, it can also cause concern if the lower cost of financial services is achieved by reducing the regulatory and supervisory standards. Because of the reason that offshore finance centers provide financial services primarily for non-residents, the

authorities in the countries of their origin are interested in the impact to their national economies caused by the offshore operations. Many renowned economists in the world consider that offshore and outsourcing operations need to have effective consolidated supervision. It would allow national supervisors to have access to information of the modern banking system, which will lead to consolidated supervision that could be effective only when cross-border cooperation and exchange of information is efficient (Darbar, Johnston, Zephirin, 2003). Anonymity of financial transactions in the operation of offshore companies undermines the reputation of these financial centers, which leads to deterrence of potential investors. Even more, certain supervisory standards are inadequate and more comprehensive risk analysis is impossible due to lack of reliable data on activities in offshore finance centers. At policy level there are strong concerns that financial regulatory loopholes could undermine the stability of the global financial system. There is a need for unique solution, by providing conditions in which offshore finance centers would operate under the internationally accepted standards. In that sense there are the recent developments in the European Union, where ministers of finance of the member countries have started negotiation to strengthen cooperation between Member States and certain offshore destinations, thus raising the level of transparency for banking information exchange, which would lead to strengthening the fight against tax evasion (<http://faktor.mk/archives/47612>).

### **Conclusion**

Entrepreneurship is the main generator of new jobs. It is a stimulator of well-being within national economies and provides incentives for new capital investment and continuously sustainable democratic society. New businesses are inspired by new ideas, which are the main instigator of building competitive advantages over other companies. New ideas are not always related to products or services; some of the most innovative people try to extend the range of ideas and have decided to start their businesses offshore. Offshore finance centers represent jurisdictions with special tax and regulatory policies that have specific favorable terms for foreign investment. Despite their size, country of origin or industry, companies often use offshoring and

outsourcing. Going offshore could be an opportunity to pursue an entrepreneurial venture with maximum effective and efficient operations, efficient allocation of resources, which would bring best possible financial results. A large number of limitations in the financial and business sector stemming from the 1970s contributed to the development of this type of offshore finance centers. The establishment of an offshore company in the right jurisdiction effectively protects entrepreneur's investments and offers bigger and wider perspectives and opportunities. The entrepreneur is required to have a vision and information to manage the whole offshoring process. There are benefits from the offshoring and outsourcing process for both the entrepreneurs and the domestic offshore jurisdiction. The economic growth in offshore country, economic stability and employment are beneficiary factors influenced by offshore finance centers. Many of the most attractive offshore destinations keep focus exclusively on offshore activities, which are the main source of government revenue and economic growth and activity.

On the other hand, inconsistent tax structure and easy changing policies on offshore territories are the basis for further speculation about what happens with the money earned in these centers. National tax authorities have serious problems in detecting offshore tax evasion. International finance authorities are seeking systematic approach to this global phenomenon, which will lead to final solution of this problem.

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