



Offshoring Services: Which Are the World's Top Locations -- and Why?

Published : May 05, 2004 in [Knowledge@Wharton](#)

Those who have been following the controversy over "offshoring" U.S. service jobs to low-cost markets like India now have new developments to consider: The takeover this month by U.S. business giants -- IBM and Citigroup -- of two major providers of business process outsourcing (BPO) services in India. On April 7, IBM bought Daksh e-services, the country's third largest back-office services firm based in Gurgaon, near New Delhi, for between \$150 million and \$200 million. Five days later, Citigroup consolidated its ownership of e-Serve International, a Mumbai-based company. Citigroup agreed to pay \$126 million for 56% of E-Serve from the latter's promoters; it already owned the other 44% through a subsidiary.



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More such changes are on the way, say experts at Wharton and A.T. Kearney, a management consulting firm headquartered in Chicago. "At this point, the BPO industry is fragmented, and you will see a consolidation in India with 10 to 12 major players emerging in the next two or three years," says Stefan Spohr, vice president of A. T. Kearney's financial institutions practice in New York City. "IBM is acquiring a delivery capability in BPO in India that it has been trying to build organically. It now appears that the company has decided it would be faster to acquire these capabilities than to build them in-house."

[Ravi Aron](#), a professor of information and operations management at Wharton, who has been researching BPO trends for more than two years, offers a different view. He believes that while U.S. companies might acquire Indian BPO providers, many of them are moving towards a hybrid model rather than operating captive offshore centers. "GE, even though it had its own captive center in India, worked with Indian companies like Satyam," he says. According to Aron, the reason why such hybrid arrangements between U.S. and Indian companies will prevail is that captive centers and third-party BPO service providers have different strengths: captive centers are generally better at delivering quality, and BPO providers -- which operate as profit centers -- are better at lowering costs.

IBM's and Citigroup's moves also seem to validate a new Kearney study, released March 30, ranking various offshore locations for back-office work. India emerges on top "by a wide margin" among the 25 countries in Kearney's "Offshore Location Attractiveness Index," which employs 39 criteria to rank the locations. China is ranked second, followed by Malaysia and the Czech Republic. The study was led by Spohr, Andrea Bierce, also a vice president in Kearney's financial institutions' practice, and Paul Laudicina, vice president and managing director of the firm's Global Business Policy Council in Washington, D.C., which spearheaded the study.

Kearney's 2004 index is not comparable with its 2003 rankings, because the parameters and methodology vary significantly. Even so, it is illuminating to see how the pecking order has changed. Last year's rankings had India leading a group of 11 countries: Canada, Brazil, Mexico,

Philippines, Hungary, Ireland, Czech Republic, Australia, Russia and at the very end of that list, China. This year's rankings are in the following order: India, China, Malaysia, Czech Republic, Singapore, Philippines, Brazil, Canada, Chile, Poland, Hungary, and New Zealand.

Spohr says the new study is the most detailed that Kearney has undertaken on BPO trends. "Our study doesn't rely primarily on the experience or opinion of experts as in a lot of other studies, but more on objective criteria," he says. "That is why we have results like Malaysia coming in at third place. Countries like Malaysia, Singapore and Chile are often not mentioned in other such studies."

The 39 criteria are organized under three broad categories with varying weights: cost (40%), people skills and availability (30%) and business environment (30%). Each category is further divided into sub-groups. The "cost" category has three: Total compensation of employees; the cost of infrastructure; and tax and regulatory costs. The "people skills and availability" category has four sub-groups: overall experience and skills in IT and telecommunications; availability of labor and the size of a country's work force; educational levels of the workforce, including language skills and test scores; and the attrition rate in the country's BPO industry. The "business environment" category covers a country's economic and political environment, its infrastructure in telecommunications and IT, cultural adaptability and the security of intellectual property.

The study underscores the fact that countries to which white collar jobs are being offshored offer a range of attractions besides low-cost labor, creating a complex decision-making process for companies selecting offshore locations. Countries such as India and China, with large populations, offer an abundance of educated workers. But at the other end of the spectrum, "small, highly developed economies like Singapore, New Zealand and Ireland offer excellent infrastructure, education systems and business-friendly low-risk environments," the study says.

Singapore's Strengths

Aron has a different perspective on these locations. "I don't know if I'd go with Malaysia at No. 3, and Singapore has been put too low at No. 5," he says. Aron says that labor arbitrage is attractive for call-center operations. In addition, he notes that it holds great appeal for high-end work such as sell-side equity research (buyers, institutional or individual, use outsourced research selectively), bond pricing, supply chain coordination and direct procurement for large industries (the entire process from purchasing enquiries through order placement and tracking to order fulfillment).

If Aron suggests that Singapore should get higher billing, Bierce in fact feels that some industry watchers may be surprised at it getting the fifth place, because it is seen as a more expensive place to do business with its relatively higher wage levels. "But because Singapore's infrastructure is so strong and its business environment is so favorable, it fared very, very well."

Aron finds Singapore is more competitive than India or Malaysia when it comes to high-end requirements. He points to Singapore's superior telecommunications and IT infrastructure, transparent financial markets, clean legal regime, and the availability of a strong pool of middle and senior management personnel. "Singapore also has tremendous risk mitigation management and containing expertise," he says. All of these can substantially offset Singapore's higher wage levels, he feels.

Singapore's strengths have deeply impressed the Kearney team. It says that while Singapore may

not be seen as a low-cost offshore location, it possesses "excellent education and infrastructure, high ratings for economic and political stability, intellectual property protection and aggressive government promotion of the IT and services sectors." These attributes, the study says, continue to reinforce Singapore's position as a favorite location for regional service functions. Aron agrees wholeheartedly, and says Singapore will increasingly emerge as a regional managerial hub for regulatory and accounting compliance, geostrategic risk, auditing and business continuity practices.

India vs. China

The Kearney study offers some interesting insights into the competitiveness between the two biggest players, India and China. China may trail India in BPO experience and qualifications, but its cost advantages and large educated labor pool are big strengths. China also is emerging as a growing offshore destination for Japanese and Korean companies, and it attracts U.S. and other multinationals "because of talented work force," the study says. It notes that since China joined the World Trade Organization in November 2001, Western companies have established more than 130 R& D facilities there.

India too has worked on its competitive strengths. "India has extended a significant lead through its continuing cost advantages and its increasing market maturity," says Spohr. "It has attracted the lion's share of offshore migration activity to date without any impact on cost levels." Spohr clarifies that while wage levels in India have gone up some 10% to 15% year-over-year during the past three years, there are countervailing trends. He points to dramatic reductions in telecommunications costs "that have helped Indian operations maintain or even improve cost levels."

In addition, favorable tax rates and increasingly competitive infrastructure costs have helped India maintain its overall cost advantage. Also, many outsourcing vendors in India are moving to other parts of the country such as B and C class towns, as existing labor markets get saturated. "India has that advantage too," says Spohr. "It has a lot of untapped regions."

Bart Kocha, who heads the Enterprise Services Transformation practice at Kearney, had a first hand exposure to that people strength when he visited his firm's New Delhi offices last year. He came across some call center operations that were adding 500 jobs a month, with the average age of those employees in the early twenties. "I hadn't seen anything like that before," he says.

Wharton's Aron points out that companies that send work to India also need to be aware of certain challenges. He points to India's weaknesses in many of the high end service areas. "The middle class in India is rapidly Americanizing, but it is a country where most middle class people don't have credit cards, mortgage refinance options or access to ATMs," he says. "Much of India is serviced by the public sector which has no accountability. It has completely unaccountable insurance companies, and the biggest banks and insurance companies are public sector organizations. If you have people recruited from Kochi or Trichi and a customer asks for a lower coupon rate, they don't understand, although they can be taught."

Aron, however, clarifies that some companies stand out as exceptions, such as Office Tiger, based in India's southeastern IT hub of Chennai. "Office Tiger has a fantastic way of achieving business affinity," says Aron. "They bring the client's own trainers. It also has an internal tracking system that tracks three times more things than the client tracks. They are trying to bridge the business affinity gap between Madras and Manhattan."

Both China and India score poorly for political and economic risk and weak infrastructure, the study says. "China scores particularly poorly in areas of intellectual property piracy and bureaucratic red tape," it says, adding, "China clearly needs to improve the English language skills of its work force if it wishes to challenge India."

Malaysia is a surprise at No. 3 in the Kearney index. Its population of 22 million people does not allow it to compete with India and China's scale advantages, but there are other factors that work in its favor, the study says. "Low costs, particularly for infrastructure, the most attractive business environment among emerging markets, and high levels of global integration helped Malaysia reach the number three spot in this year's index." Malaysia's government is also promoting the IT and services sector. All that, the authors say, will make Malaysia "one of the strongest competitors to India's BPO dominance in the next five years."

Significantly, the Kearney study points out the greater choice of countries that companies now have as they seek to outsource their requirements. Countries like the Czech Republic and Poland hold a lot of interest for U.S. companies that have European operations, as well as European companies that are looking to move to lower cost locations.

"Our study is not exclusively done from a U.S. or a U. K. perspective," says Spohr, adding that a number of countries may not be relevant for a pure U. S. player. "They wouldn't probably go to a Czech Republic or a Poland, but these options are very, very important for European companies," he says. "One aspect of this increasingly complex environment is that people are not looking for one country to go to, but are looking for a range of solutions or options, depending upon their footprint, and depending upon their customer requirements throughout the world."

BPO has worked well for Kearney, too, according to Kocha. He says the firm's revenues from BPO-related projects have risen "from zero to \$100 million" in a practice that didn't even exist a year ago. This year, he expects to double those revenues. The industry is still some distance from achieving its critical mass. "BPO is not yet a mature market," says Kocha. "Our work involves a good deal of hand holding and walking clients through various choices and helping select the right vendors." But the landscape has changed with the availability of several third party providers of BPO services, something that didn't exist a few years ago.

Most of the work now being shipped overseas includes operations such as help-desks or e-mail correspondence where immediate responses are not expected. "When you have work that can be deferred and that can be done several time zones away, costs drop significantly," says James Tuttle, a consultant at Kearney's Atlanta offices. He believes it's unlikely that significant amounts of high-value work will migrate. He says the vast majority of the work now going offshore involves dealing with mass market customers who are, frankly, not very profitable. This includes the work of chasing credit card holders who are late in paying bills, for example. "More high value customer contact will remain at home for most companies," says Tuttle.

Business process outsourcing may have become the buzz word for companies seeking to lower costs, but many have unrealistic expectations, says Andrew Hottell, a Kearney consultant. "They are excited about getting costs down, but lots of them don't understand what is involved,. Few realize that they must already have standardized and digitized their service operations for them to be outsourced. "Many companies don't even have a decent onshore facility," says Hottell.

A Question of Quality

Several companies have expressed concerns about the quality of service rendered by outsourcing vendors. Spohr says this is natural in an emerging marketplace. "People have probably not paid as much attention as they should have on how to structure agreements with vendors, and how to effectively execute offshore initiatives themselves, resulting in service quality issues," he says.

Bierce says some stories of companies being dissatisfied with outsourcing have to be taken with a grain of salt. She knows the background to some of those stories. "There was one financial institution that terminated a piece of work with an Indian company and when we talked to them, they said, 'It was our fault, not the Indian company's fault,'" she recalls. "The institution said, 'We were in too much of a hurry, we didn't properly communicate what this company (the vendor) was going to do for us internally, and we gave them some of our best clients, who complained.' They said that in hindsight they would have done it differently."

Another well-publicized case that Bierce views differently is Dell Computers' reported disenchantment with its Indian outsourcing vendor. "Dell was ramping up from zero to 5,000 people in less than a year," she says. "They did not segment the market as to who would call Dell Computers in Bangalore, and they overestimated [the effectiveness of] the accent neutralization training." Hottell too talks of one particular company which entered into numerous outsourcing deals, only to end up with a mess on its hands. "We know of a company that outsourced bits and pieces of its activities to 18 providers of HR functions," he says.

Bierce doesn't see the public outcry in the U.S. over job losses on account of offshoring as strong enough to stunt or reverse the growth of the BPO industry. "It is an election year and outsourcing is an explosive topic," she says. "It might defer some of the activities for companies that are a little bit more sensitive. But for companies to remain competitive, they have to identify opportunities where they can lower their costs or enhance their skills or expand their global footprint."

Vas Kodali, a Kearney consultant, feels the fallout of the resentment against outsourcing is overstated. "We've spoken to three of the top five banks in the country, and none of them is backing away," he says. "Their future projections are based on costs they plan to take out because of offshoring." In fact, BPO offers attractive options for CFOs in companies to make themselves look good with cost cutting, according to Soeren Dressler, a Kearney consultant. But he notes that CFOs may continue the focus on outsourcing piecemeal operations instead of entire functions. They are unlikely to have the stomach for more flamboyant, high-risk outsourcing exercises. Bierce feels all the talk about protectionism and the bills being proposed to restrict outsourcing will die down after the U.S. Presidential elections. "The issue is not about offshoring or outsourcing, but about productivity gains, which is why we have job losses," she says. "The number of jobs lost to offshoring is less than 300,000 for all of 2003. It's a very, very small piece."

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